



# BTC *Reports*

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## THE FY2012-13 SENATE BUDGET:

Policy-heavy budget continues to short investments in key public structures

BY BRENNER ERFORD BURCH, TAZRA MITCHELL, AND ALLAN FREYER

### EXECUTIVE SUMMARY

- The North Carolina Senate's \$20.1 billion budget proposal for fiscal year 2012-2013 (FY2012-13) would increase total state spending by \$211.9 million, or 1.1 percent, over the \$19.9 billion continuation budget.
- The Senate budget would reduce gross total revenue availability of \$803.2 million by transferring \$178.7 million to state savings accounts, spending \$25.9 million for other adjustments, and paying \$154 million toward North Carolina's \$280.5 million current-year Medicaid shortfall. This leaves the Senate budget with net General Fund availability of \$444.7 million over base tax and non-tax revenues.
- In a notable departure from the House budget, the Senate budget relies less heavily on one-time money, choosing instead to let overall levels of spending in key areas of state investment drop to new historic lows.
- The Senate budget includes 30 pages of special provisions taken directly from Senate Bill 795, Excellent Public Schools Act, and funds first-year implementation of the plan's components at a cost of \$47.4 million. It would eliminate just \$74 million of the \$503 million in recurring cuts to school districts.
- The Senate budget would restore \$168.7 million in recurring funding to Medicaid, which significantly reduces but does not eliminate the program's projected \$243 million shortfall for FY2012-13.
- The Senate budget takes no significant actions to address the state's growing structural budget deficit, and as such it provides neither short- nor long-term relief from growing budget pressures in key areas of state investment, particularly education and human services, which will face sizeable budget gaps going into the FY2013-15 biennium.

## Overview

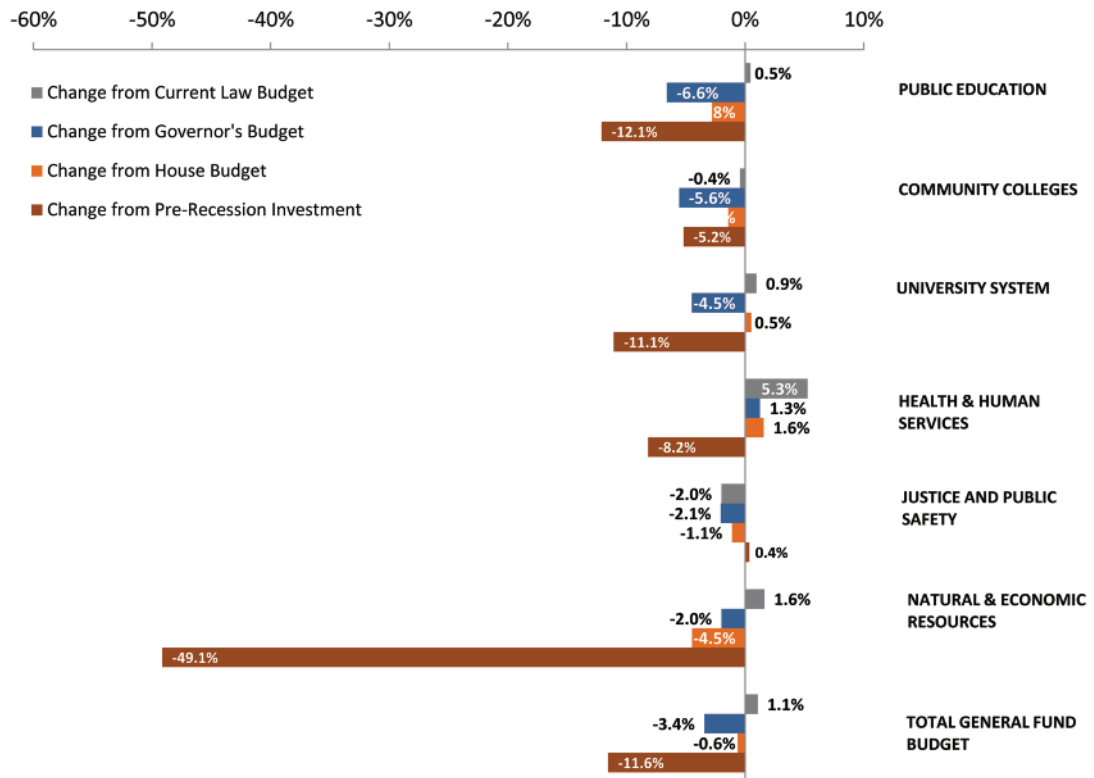
**In terms of overall state spending, the Senate budget is the closest to the \$19.9 billion continuation budget of the three budget proposals, spending \$127 million less than the House budget and \$715 million less than Governor Perdue’s budget. Like the House budget, it raises no new revenue.**

**While the Senate’s adjustment to the continuation budget would increase spending by 1.1 percent over the continuation budget, when compared to state spending before the Great Recession it reflects a tremendously diminished baseline state budget – one that has resulted in fewer teachers in classrooms, aging and out-of-date textbooks, skyrocketing tuition rates for students at public colleges and universities, higher costs for accessing the courts, and widespread disrepair in the state’s transportation infrastructure.**

**The chart below places the Senate budget in context of the continuation budget, the governor’s budget proposal, the House budget, and state spending before the Great Recession (FY2007-08, adjusted for inflation).**

**From an overall fiscal standpoint, the Senate budget continues in the same direction as the one set in the 2011 legislative session. As such, it would continue to significantly underfund the education, well-being, and safety of all North Carolinians.**

**FIGURE 1: Senate Budget Spends 1.1% More than Continuation, 11.6% Less than Pre-Recession**



## How Does the Senate Pay for Its Budget?

The Senate budget is built on the expectation of base revenues of \$18.9 billion – primarily from the state income tax, sales tax, and corporate income tax – and non-tax revenues (excluding transfers from transportation funds) of \$773 million. The Senate budget’s spending side would require \$20.1 billion – approximately \$212 million more than the continuation budget and \$127 million less than the House budget – leaving the Senate with \$444.7 million to “raise” in order to balance its budget.

### ONE-TIME SPENDING IN THE SENATE VERSUS THE HOUSE

Both the House and Senate budgets would make sizeable transfers to the General Fund from non-General Fund sources. Not including transfers from transportation funding sources, the Senate budget has \$66.5 million in non-General Fund balance transfers. This includes \$50 million from the One NC Fund (compared to the House’s \$30 million diversion), \$2.5 million from the E-Commerce Cash Reserve (compared to the House’s \$1.3 million diversion), and \$14 million from the Information Technology Internal Service Fund (compared to the House’s \$4 million diversion). Unlike the House budget, which would have used the entire \$42 million projected education lottery surplus to increase spending on K-12 education, the Senate budget would use the surplus to increase budgeted lottery funding for class-size reduction, early childhood education, and need-based college scholarships.

The Senate budget raises a total of \$803.1 million in General Fund availability. This total includes a \$232.5 million revenue surplus, \$205.5 million in anticipated state agency reversions, \$239.9 million in transfers from the Highway Fund and Highway Trust Fund,<sup>1</sup> \$84.1 million in other fund transfers and adjustments to availability, and \$41.3 million in unappropriated funds from FY2011-12.

The Senate budget would reduce this additional revenue availability by \$358.5 million in total pre-budget expenditures. The budget would spend \$154 million on the current-year Medicaid shortfall,<sup>2</sup>

deposit \$139.3 million in the state’s Rainy Day Fund, deposit \$39.3 million into the Repairs and Renovations Reserve Account, adjust accounting for the non-sale of state assets by \$25 million, and extend the state’s Work Opportunity Tax Credit at a cost of \$800,000. Net of all adjustments to availability, the Senate budget would supplement \$19.7 billion in base tax and non-tax revenues with \$444.7 million in one-time General

Fund availability, raising total General Fund availability to \$20.1 billion.

Under the Senate budget, which includes no new revenue, North Carolina’s growing structural budget deficit would remain unaddressed. 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.<sup>3</sup> Tax and non-tax revenue sources for the General Fund, independent of transfers from the Highway Fund and Highway Trust Fund, are projected to generate \$19.7 billion in FY2012-13—\$444.7 million less than what is needed to fund the Senate budget’s spending target of \$20.1 billion.

**FIGURE 2: The Senate 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>Recurring Adjustments</i>	\$ 165,565,336
<i>Nonrecurring Adjustments</i>	\$ 46,298,406
<b>Total FY 12-13 General Fund Appropriations</b>	<b>\$ 20,149,313,117</b>
% Change from Pre-Recession Budget	-11.6%
% Change from Original Recommended Continuation	-3.2%
% Change from Certified Approved Budget	1.1%

**CREDIT BALANCE  
(ONE-TIME MONEY)**

The Senate budget uses a net current-year credit balance<sup>4</sup> of \$479.2 million, consisting of a \$232.5 million revenue surplus, \$205.5 million in anticipated state agency reversions, and \$41.2 million in unappropriated funds. While this year's modest revenue surplus is fully attributable to stronger-than-expected personal income tax collections, the data necessary to fully understand what drove this surplus is not available at the time of this publication. In keeping with a slow and uneven state economic recovery, state sales tax collections are projected to come in slightly below projections, as are state corporate income taxes.

**ONE-TIME MONEY  
FOR RECURRING  
EXPENSES**

The Senate budget uses the majority of its \$444.7 million in increased General Fund availability to pay for non-recurring expenses, in contrast to the House budget, which relied heavily on non-recurring funding to pay for recurring obligations. Unfortunately, the Senate's decision not to address growing areas of need for state investment, particularly in education and health and human services, will result in no net improvement to the state's fiscal status in the coming year and does not address the funding "cliff" the legislature will confront going into the FY2013-15 biennium.

It is important to note that in fiscal years 2009 through 2012, federal recovery funds were available to supplant a portion of state General Fund appropriations, particularly for K-12 education and Medicaid. While the majority of these funds were drawn down and spent in FY2009-10 and FY2010-11, some portions of federal recovery funding remain in play in the current year, particularly for public schools.

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**The Revenue Plan**

The Senate budget would not raise any new revenue to address North Carolina's myriad and growing budget pressures, including annual enrollment growth in both K-12 and post-secondary schools, the loss of remaining federal recovery dollars currently supported 4,000 to 5,000 classroom jobs in K-12 public schools, and the needs of a growing and rapidly aging state population. There are two tax-related provisions in the Senate budget – an extension of the state's Work Opportunity Tax Credit, which the House also included in its budget, and a special provision creating a tax refund for public and non-public school teachers who purchase educational supplies with their own money.

**WORK OPPORTUNITY TAX  
CREDIT EXTENSION**

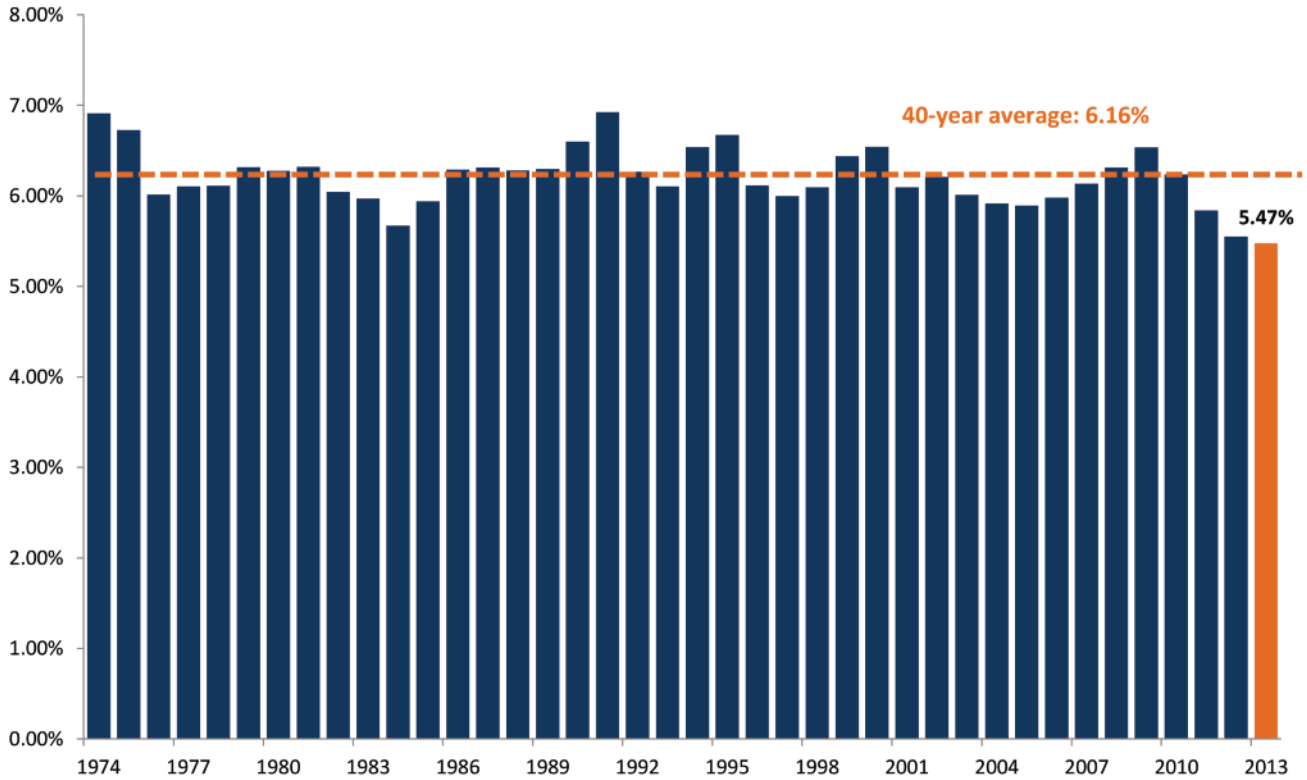
The Senate budget would extend North Carolina's Work Opportunity Tax Credit (WOTC) at an estimated cost of \$800,000 in FY2012-13. The state credit is equal to 6 percent of the federal WOTC, which is available to private, for-profit businesses that hire individuals from "target groups" that have consistently faced significant barriers to employment. Eligible hires include recipients of Temporary Assistance to Needy Families benefits, Supplemental Nutrition Assistance Program (food stamps) recipients, high-risk youth, and veterans who are unemployed and/or have disabilities. The objective of the federal and state tax credits is to enable persons in these target groups to become employed and self-sufficient and to encourage employers to hire from these groups by reducing their federal income tax liability.<sup>5</sup> The state portion of the WOTC is set to expire at the end of 2012,<sup>6</sup> but the Senate budget would extend the credit through tax year 2013. The House budget includes an identical WOTC extension.

**TAX EXEMPTION  
FOR SCHOOL SUPPLIES  
PURCHASED  
BY TEACHERS**

The Senate budget would create a new \$250 income-tax deduction for educational supplies—books, computers, software, and supplementary materials—purchased by teachers at public and non-public schools with their own money. The cost of the deduction is estimated at \$1.8 million annually and would be available for eligible filers starting in tax year 2012.<sup>7</sup> This tax break would be available to individuals teaching in non-public school settings, including home schools. It is noteworthy that the state budget for textbooks and instructional materials for the state's public schools has been cut repeatedly in recent years.

**FIGURE 3: General Fund spending as a share of North Carolina's economy would fall to a new 40-year low under Senate Budget**

*Total General Fund Appropriations as a percent of State Personal Income*



**The Spending Plan**

The Senate budget would increase total General Fund spending by \$211.9 million, or 1.1 percent, over the continuation budget. In contrast to the House budget, the majority of expansion spending in the Senate budget takes place in the Health and Human Services budget, which would increase by \$234.5 million, or 5.3 percent, over the continuation budget.

Over the past 40 years, average General Fund spending as a share of North Carolina's economy has averaged 6.2 percent. The Senate budget would increase state spending as a share of the state's economy by just 0.05% over the continuation budget, to 5.47 percent, which would still make FY2012-13 the year of North Carolina's lowest overall state General Fund spending in four decades.

**PUBLIC EDUCATION**

The Senate proposes a \$34.1 million, or 0.5 percent, increase to the K-12 education budget over the continuation budget. It would eliminate the \$74 million increase in the Local Education Agency (LEA) Flexibility Adjustment, a massive recurring cut to the K-12 public school budget that is set to go from \$429 million to \$503 million under current law. The Senate budget would also appropriate \$47.4 million to implement the first year of changes presented in Senate Bill 795, Excellent Public Schools Act,<sup>8</sup> which is included in its entirety as special provisions in the K-12 education budget.

FIGURE 4: RECOMMENDED EDUCATION APPROPRIATIONS

	FY2012-13 Continuation Budget	FY2012-13 Governor's Recommended	FY2012-13 House Recommended	FY2012-13 Senate Recommended	Change from Continuation Budget	% Change from Continuation
Public Instruction	\$ 7,444,122,100	\$ 8,006,375,540	\$ 7,692,234,560	\$ 7,478,264,218	\$ 34,142,118	0.5%
Community Colleges	\$ 985,000,000	\$ 1,038,504,897	\$ 995,000,000	\$ 980,822,477	\$ (4,177,523)	-0.4%
UNC System	\$ 2,551,672,698	\$ 2,696,757,060	\$ 2,562,230,839	\$ 2,575,718,169	\$ 24,045,471	0.9%
<b>TOTAL</b>	<b>\$ 10,980,794,798</b>	<b>\$ 11,741,637,497</b>	<b>\$ 11,249,465,399</b>	<b>\$ 11,034,804,864</b>	<b>\$ 54,010,066</b>	<b>0.5%</b>

The Senate budget does not address the impending loss of \$259 million in remaining federal EduJobs money in the upcoming year.<sup>9</sup> This money, allocated by Congress through the American Recovery and Reinvestment Act of 2009 (ARRA), reduced the impact of the recession on classrooms by supplanting state General Fund appropriations for public education from FY2008-09 through FY2011-12. This funding currently supports 4,000 to 5,000 public-school jobs, and without financial relief from the state many districts across North Carolina will likely have to cut school jobs. Last year's cuts to the state public education budget resulted in the loss of 915 teacher jobs and 2,042 teacher-assistant jobs,<sup>10</sup> and a state budget that neglects to replace the federal ARRA funding – 92 percent of which was used to support classroom jobs over the course of the Great Recession and recovery to date – is likely to result in further district-level layoffs.<sup>11</sup>

Under the Senate budget, school districts would have to make yet another round of devastating cuts in FY2012-13 because they would lose a significant source of operating support in the form of EduJobs funding. Before accounting for enrollment growth, the state's public education system is likely to face a budget gap in excess of \$688 million going into FY2013-14.

The Senate K-12 budget includes nearly the entirety of Senate Bill 795, Excellent Public Schools Act, an omnibus education bill already passed by the Senate.<sup>12</sup> The budget would make an expansion appropriation of \$47.4 million to implement the act's provisions in FY2012-13. Numerous special provisions under this section in the Senate budget would have a quantifiable state fiscal impact, including the following:

- **Improving K-3 literacy.** Items in this section with a quantifiable fiscal impact include provision of a kindergarten entry reading assessment (\$9.3 million in FY2012-13), formative diagnostic reading assessments for all students in grades K-3 (\$23.6 million in FY2012-13), and retention of students who score at level I or II on the 3rd grade end-of-grade reading tests (\$20.5 million starting in FY2014-15, when the policy would become active). Total state fiscal impact for this section alone is estimated at \$33.9 million in FY2012-13, with the total cost projected to increase to \$59.3 million in FY2013-14 and \$78 million in FY2014-15.
- **Additional instructional days.** The Senate budget would add five instructional days within the existing school calendar for schools that have not requested and received a waiver from the policy passed as part of last year's budget.<sup>13</sup> The fiscal impact of this provision is estimated at \$392,000, the majority of which would go to fund transportation requirements for the additional days.
- **Establish the "North Carolina Teacher Corps."** This program would aim to recruit and place recent college graduates and midcareer professionals as teachers in high-needs public schools and would be comparable in some ways to Teach for America. This provision has no fiscal impact in FY2012-13, because it would be funded through a federal Race to the Top grant, but it would cost the state \$1.9 million in FY2014-15.

## K-12 BUDGET SPECIAL PROVISIONS AND THE “EXCELLENT PUBLIC SCHOOLS ACT”

The Senate K-12 education budget contains numerous non-budgetary special provisions taken from Senate Bill 795, Excellent Public Schools Act. Largely modeled on a series of education policies currently employed in Florida, these policies, if enacted, would significantly change North Carolina’s approach to student

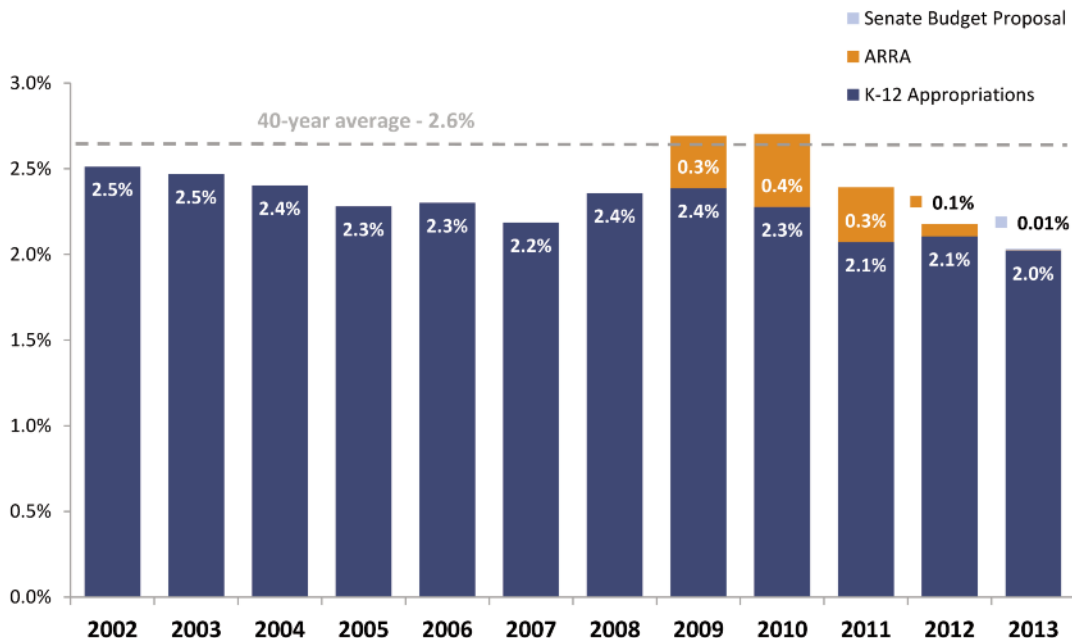
retention, teacher career status, and school performance ranking, among other items.<sup>15</sup>

Under the special provisions, nearly half of North Carolina 3rd graders would be in jeopardy of retention based on a single test score. A separate provision would assign letter grades to schools but

would not provide any additional resources to assist schools with poor grades. Yet another provision would put all new teachers—and even some experienced teachers—on one-year contracts, making both recruitment and retention of skilled educators more difficult.

- **Expand funding for NC Pre-K.** Appropriations to NC Pre-K would increase by \$11.3 million in FY2012-13, which would pay for 2,261 additional slots. This section would also repeal the co-payment requirement for eligible families included in last year’s budget.
- **\$250 tax deduction for educational supplies.** The Senate budget would create a \$250 tax deduction for educational supplies – including books, computers, software, and supplementary materials – purchased by public or non-public school teachers. The cost of the deduction is estimated at \$1.8 million annually and would be available for eligible filers starting in tax year 2012.<sup>14</sup>

**FIGURE 5: K-12 Education Spending as a Percent of State Personal Income**



Over the last 40 years, state spending on K-12 public education has averaged 2.6 percent of state personal income. Under the Senate budget, lawmakers would commit only 2.01 percent of North Carolina personal income to the state’s public schools – an amount 23 percent lower than North Carolina’s historic annual funding commitment to public education.

## COMMUNITY COLLEGES

The Senate budget cuts \$4.2 million, or 0.4 percent, from the continuation budget for North Carolina's community colleges. The Senate budget follows the House budget proposal on community colleges and adopts many of the same special provisions, particularly regarding changes to performance funding measures.

In contrast to the House budget, which would have partially – if temporarily – restored some of the management flexibility reduction to community colleges, the Senate budget uses recurring funds to eliminate the increase in the management flexibility reduction for FY2012-13 only.

## UNIVERSITY OF NORTH CAROLINA SYSTEM

The Senate budget would increase spending on the UNC System by \$24 million, or 0.9 percent, over the continuation budget – approximately twice the increase suggested by the House budget. Nonetheless, state investments in the UNC system would still be 11 percent below pre-recession levels despite the fact that demand for North Carolinians with bachelor's degrees is projected to increase significantly.

The Senate and House budget differ significantly in their treatment of funding for enrollment growth and need-based aid. The Senate would increase funding for enrollment growth by \$1.3 million, which is sufficient to cover the 780 full-time equivalent students projected to increase over last year's estimates. This enrollment growth was not fully funded in the House proposal. The Senate would use lottery funds to restore \$35 million to the UNC need-based grant program. This is an important investment to make at a time when tuition is increasing significantly and families are struggling to make ends meet. The UNC General Administration estimates that 3,700 students at UNC would receive need-based grants if these additional funds were available. However, given that the source of funds is lottery dollars it is unclear if this represents an ongoing commitment to keep university affordable for low-income students.

Also in a departure from the House budget, the Senate budget allocates \$8 million – of which \$6 million is recurring – to building funding reserves which will provide for the operation and maintenance of new or renovated UNC buildings.

A noteworthy special provision in the UNC budget would direct the Fiscal Research Division to perform a study of the tuition surcharge mandated last year and its effect on student's achievement and graduation. The tuition surcharge represents a 50% increase for students who fail or do not drop a course and take more than 110 percent of the credit hours necessary to achieve a baccalaureate degree. Understanding the impact of this financial cost to student completion will be important to determining whether such punitive measures can support students' success.

## HEALTH AND HUMAN SERVICES

The Senate budget increases spending on health and human services by \$234.5 million, or 5.3 percent, from the continuation budget. Multiple agencies under the Department of Health and Human Services would be required to absorb unspecified management flexibility cuts under this budget, with the Division of Central Management Support directed to cut \$34.3 million, or 76.9 percent, of its operating budget under the plan.

### *Child Development*

The Senate budget deepens existing cuts to early care and education programs, in contrast to the House proposal which would have partially restored some cuts. A special provision within the Senate budget section on the Excellent Public Schools Act would direct the Division of Child Development and Early Education to spend \$11.3 million out of its total FY2012-13 appropriation on NC Pre-K, but would not provide any new funds for this expansion. The budget also supplants \$10 million in state funding for Smart Start with federal funding through the Child Care and Development Fund Block Grant.



**FIGURE 6: RECOMMENDED HEALTH AND HUMAN SERVICES APPROPRIATIONS**

	FY2012-13 Continuation Budget	FY2012-13 Governor's Recommended Budget	FY2012-13 House Recommended	FY2012-13 Senate Recommended	Change from Continuation Budget	% Change from Continuation
Central Management & Support	\$ 44,577,987	\$ 57,798,511	\$ 46,085,628	\$ 15,880,642	\$ (28,697,345)	-64.4%
Aging Division	\$ 37,019,667	\$ 41,895,316	\$ 38,519,667	\$ 72,319,667	\$ 35,300,000	95.4%
Child Development	\$ 266,102,933	\$ 309,287,534	\$ 280,602,933	\$ 256,102,933	\$ (10,000,000)	-3.8%
Public Health	\$ 157,538,834	\$ 168,365,609	\$ 178,309,229	\$ 162,616,284	\$ 5,077,450	3.2%
Social Services	\$ 186,183,068	\$ 177,103,952	\$ 177,103,952	\$ 186,183,068	\$ -	0.0%
Medical Assistance	\$ 2,907,276,302	\$ 3,014,833,460	\$ 3,037,547,318	\$ 3,136,851,344	\$ 229,575,042	7.9%
NC Health Choice	\$ 83,717,865	\$ 80,915,808	\$ 81,710,435	\$ 83,717,865	\$ -	0.0%
Services for the Blind	\$ 8,372,886	\$ 8,204,550	\$ 8,204,550	\$ 8,372,886	\$ -	0.0%
Mental Health / DD / SAS	\$ 710,712,232	\$ 717,535,251	\$ 714,295,816	\$ 713,958,186	\$ 3,245,954	0.5%
Health Service Regulation	\$ 16,133,031	\$ 18,025,590	\$ 17,925,590	\$ 16,133,031	\$ -	0.0%
Vocational Rehabilitation	\$ 37,528,128	\$ 37,528,128	\$ 37,528,128	\$ 37,528,128	\$ -	0.0%
<b>TOTAL HHS APPROPRIATIONS</b>	<b>\$ 4,455,162,933</b>	<b>\$ 4,631,493,709</b>	<b>\$ 4,617,833,246</b>	<b>\$ 4,689,664,034</b>	<b>\$ 234,501,101</b>	<b>5.3%</b>

***Aging and Adult Services***

The Senate budget would establish a \$10.3 million reserve fund, called the Transitions to Community Living Fund, within the Division of Aging and Adult Services to facilitate implementation of a plan to transition individuals with severe mental illness to community living arrangements, including establishment of a rental assistance program. The amount of this reserve is the U.S. Department of Justice’s estimate of what will be needed for the first year of a multi-year settlement addressing the department’s findings on North Carolina’s inappropriate housing of mentally ill adults in adult care homes rather than community settings.

A separate \$25 million reserve fund would be established to provide “temporary, short-term assistance” to adult care and group homes as they move toward the state’s Transitions to Community Living Plan. This money would pay stipends to adult care and group homes for residents no longer eligible to receive Medicaid-reimbursable personal care services (PCS) but for whom a community placement has not yet been arranged. This portion of funding for mental health reform may have an institutional bias because it is clearly tied to the organizations that serve mentally ill individuals rather than to the individuals themselves.

***Medicaid***

At the time of the Senate budget’s passage, the current-year funding shortfall for Medicaid was estimated at \$205.5 million, but since passage the shortfall estimate has been revised upward by \$75 million to \$280.5 million.<sup>16</sup> As such, neither the House budget nor the Senate budget – nor, for that matter, already-ratified legislation specifically addressing payment of the shortfall<sup>17</sup> – adequately addresses the program’s entire current-year shortfall. That said, the Senate budget would restore \$168 million in recurring funds to keep pace with projected enrollment growth and service consumption (i.e., the Medicaid rebase). This change would reduce the projected Medicaid shortfall for FY2012-13 but is still short of the full amount needed to bridge the \$243 million gap forecasted for that year.<sup>18</sup>

The Senate budget would also make a major change in eligibility standards for personal care services that could leave as many as 40,000 Medicaid-eligible individuals without the supports they need to live independently in their own communities and homes.<sup>19</sup> Personal care services are provided to Medicaid-eligible individuals who require assistance with Activities of Daily Living (ADLs) such as eating, dressing, bathing, toileting, and mobility. Under current standards, the state will pay for an individual to receive personal care services if he requires assistance with 2 ADLs and requires “extensive assistance” with at least one of those two, or if the individual needs “limited assistance” with 3 ADLs. The Senate budget would eliminate the standard for individuals that need “limited” assistance with 3 ADLs, which is the category under which most Medicaid beneficiaries qualify for personal care services.

<i>Public Health</i>	The Senate budget increases appropriations to the Division of Public Health by \$5.1 million, or 3.2 percent, over continuation. The Senate budget would provide non-recurring funding for several programs formerly operated with support from the Health and Wellness Trust Fund (HWTF), which was eliminated in the 2011 budget, including prescription assistance programs CheckMeds (\$1.7 million) and the Medication Assistance Program (\$1.7 million). The public health budget would also provide \$4.9 million to county health departments to perform a wide array of wellness initiatives, including tobacco prevention and cessation programs that formerly received considerably more financial support from the HWTF. The Senate budget would replace lost federal block grant funding for services to rape victims with \$200,000 in General Fund dollars, and would fund the Each Carolina University High Risk Maternity Clinic with \$375,000 in nonrecurring funds.
<i>Mental Health, Developmental Disabilities, and Substance Abuse</i>	The Senate budget would increase funding for the Division of Mental Health, Developmental Disabilities, and Substance Abuse (MH/DD/SAS) by \$3.2 million, or 0.5 percent, over the continuation budget. That entire increase is attributable to funding for the new Cherry Hospital. Funding to address the inappropriate housing of individuals with mental illness in adult care homes is included and discussed in the Aging and Adult Services section of the Senate budget.
<b>JUSTICE AND PUBLIC SAFETY</b>	The Senate's \$2.3 billion Justice and Public Safety (JPS) budget cuts \$46 million, or 2 percent, from the continuation budget. Compared to the House budget proposal, the Senate budget proposal cuts \$25.6 million more from Justice and Public Safety agencies. Nearly \$40 million of the Senate's cuts would be in the form of management flexibility cuts, which are designed to allow the agencies to determine where the reductions are taken, unlike the House budget, which identified specific cuts. Furthermore, the Senate budget would make no changes to the continuation budget for the Office of Indigent Defense Services.
<i>Public Safety</i>	The Senate budget cuts funding for the Department of Public Safety (DPS) by \$35.4 million, or 2.1 percent, from the continuation budget, of which \$31.4 million would be a management flexibility cut. Like the House proposal, the Senate would divert \$5 million in one-time funds from the Statewide Misdemeanant Confinement Fund to offset a reduction to the Treatment for Effective Community Supervision program, and it would move the Department of Environment and Natural Resources' Geodetic Survey Section to DPS as a Type I transfer.

**FIGURE 7: RECOMMENDED JUSTICE AND PUBLIC SAFETY APPROPRIATIONS**

	<b>FY2012-13 Continuation Budget</b>	<b>FY2012-13 Governor's Recommended</b>	<b>FY2012-13 House Recommended</b>	<b>FY2012-13 Senate Recommended</b>	<b>Change from Continuation Budget</b>	<b>% Change from Continuation</b>
Public Safety	\$ 1,694,715,876	\$ 1,686,139,368	\$ 1,679,193,043	\$ 1,659,278,368	\$ (35,437,508)	-2.1%
Judicial	\$ 435,141,107	\$ 444,034,884	\$ 436,313,762	\$ 430,861,758	\$ (4,279,349)	-1.0%
Judicial - Indigent Defense	\$ 112,748,733	\$ 112,748,733	\$ 112,748,733	\$ 112,748,733	\$ -	0.0%
Justice	\$ 80,864,138	\$ 82,245,859	\$ 74,725,380	\$ 74,489,075	\$ (6,375,063)	-7.9%
<b>TOTAL</b>	<b>\$ 2,323,469,854</b>	<b>\$ 2,325,168,844</b>	<b>\$ 2,302,980,918</b>	<b>\$ 2,277,377,934</b>	<b>\$ (46,091,920)</b>	<b>-2.0%</b>

*Justice* The Senate budget cuts funding for the Department of Justice (DOJ) by \$6.4 million, or 7.9 percent, from the continuation budget. It would make a \$1.6 million management flexibility cut to DOJ and would shift \$3 million of one-time money from DOJ receipts to fund DOJ operations. The Consumer Protection Division in DOJ would lose all state funding and become fully receipt-supported under the Senate and House proposals, affecting 17 positions that would be eliminated unless adequate funding materializes.

*Judicial*

The Senate budget cuts funding for the Administrative Office of the Courts (AOC) by \$4.3 million, or 1 percent, from the continuation budget. The Senate proposal would make a \$6.9 million management flexibility cut to AOC. Like the House proposal, the Senate proposal would use funds from the National Mortgage Settlement to offset a reduction to the Conference of District Attorneys administration budget and would remove the Family Court program from continuation review.

**NATURAL AND ECONOMIC RESOURCES**

The Senate budget would increase total spending on Natural and Economic Resources by \$5.8 million, or 1.6 percent, over the continuation budget. However, this increase obscures the fact that total spending on Natural and Economic Resources (NER) has fallen 49 percent below pre-recession levels. These changes include moving the Division of Soil and Water and the NC Forestry Service to the Department of Agriculture and Consumer Services and moving the Division of Environmental Health to the Department of Health and Human Services.

Cuts and changes in the Senate budget would hit rural North Carolina particularly hard. Funding for the NC Rural Center—a key player in promoting economic development in the state’s rural areas—would receive a 27 percent cut over continuation levels, most of which comes specifically from the line item focused on helping small communities upgrade their industrial infrastructure. Combined with last year’s 90-percent reduction in funding for the Clean Water Management Trust Fund—the single largest resource for financing rural water projects—these cuts to the Rural Center would dramatically reduce the ability of small communities in rural North Carolina to make capital investments in water, sewer, and other industrial infrastructure necessary for industrial development and job creation.

*Agricultural and Consumer Services*

In the Senate budget, the budget and responsibilities of the Department of Agriculture and Consumer Services (DACS) would expansion significantly, increasing by \$62 million, or 74 percent, over the continuation budget. This increase would be the result of shifting two major divisions from the Department of Environment and Natural Resources (DENR) —the NC Forest Service and the Division of Soil and Water

**FIGURE 8: RECOMMENDED NATURAL AND ECONOMIC RESOURCES APPROPRIATIONS**

	<b>FY2012-13 Continuation Budget</b>	<b>FY2012-13 Governor's Recommended</b>	<b>FY2012-13 House Recommended</b>	<b>FY2012-13 Senate Recommended</b>	<b>Change from Continuation Budget</b>	<b>% Change from Continuation</b>
Agriculture and Consumer Services	\$ 62,198,634	\$ 62,504,083	\$ 111,774,658	\$ 107,993,258	\$ 45,794,624	73.6%
Commerce	\$ 33,250,463	\$ 53,351,176	\$ 49,460,665	\$ 45,301,053	\$ 12,050,590	36.2%
Commerce - State Aid	\$ 30,151,984	\$ 33,151,984	\$ 31,785,022	\$ 27,308,944	\$ (2,843,040)	-9.4%
Environment and Natural Resources	\$ 148,148,105	\$ 160,312,552	\$ 103,279,160	\$ 106,254,560	\$ (41,893,545)	-28.3%
Wildlife Resources Commission	\$ 17,221,179	\$ 17,665,000	\$ 17,700,000	\$ 17,655,576	\$ 434,397	2.5%
NC Biotechnology Center	\$ 17,551,710	\$ 18,076,710	\$ 17,551,710	\$ 17,200,676	\$ (351,034)	-2.0%
Rural Economic Development Center	\$ 25,376,729	\$ 45,376,729	\$ 25,376,729	\$ 18,369,194	\$ (7,007,535)	-27.6%
Clean Water Management Trust Fund	\$ 11,250,000	\$ 11,250,000	\$ 11,250,000	\$ 11,250,000	\$ -	0.0%
Labor	\$ 15,836,887	\$ 15,536,887	\$ 15,836,887	\$ 15,520,149	\$ (316,738)	-2.0%
<b>TOTAL</b>	<b>\$ 360,985,691</b>	<b>\$ 417,225,121</b>	<b>\$ 384,014,831</b>	<b>\$ 366,853,410</b>	<b>\$ 5,867,719</b>	<b>1.6%</b>

Conservation—to DACS. These two divisions serve a primarily regulatory function, and it remains an open question whether the primarily consumer-oriented DACS would be able to provide the same level of oversight in these areas as DENR has. Although the House budget also provides for these departmental shifts, the Senate budget spends \$2.9 million less than the House, largely due to the 2 percent flexibility cut and a recurring \$600,000 cut to the appropriation for the Division of Soil and Water.

*Department of Environment and Natural Resources*

Along with the shift of the Soil and Water Division and the Forest Service to DACS, the Senate budget would further dismantle DENR by shifting the Division of Environmental Health—the agency tasked with regulating the health impacts of industrial activity—to

the Department of Health and Human Services' Division of Public Health. The proposal also would shift the Geodetic Survey—the official land, boundary, and geographic survey—to the Division of Emergency Management in the Justice and Public Safety budget. Like the House budget, the Senate version restores the \$16.6 million appropriation for DENR field offices—all of which were eliminated in last year's budget—but shifts those offices and their employees to other agencies. As a result of these changes and the unspecified 2 percent flexibility cut, the Senate budget cuts DENR funding by \$41.9 million (28 percent) from continuation levels.

Additionally, the Senate budget would take \$2 million in recurring expenditures from the Commercial Leaking Underground Storage Tank (LUST) Fund—a special DENR fund tasked with mitigating and cleaning up the environmental damage resulting from leaking underground storage facilities—and shift those funds to the Department of Public Instruction to fund the Driver's Education program. Finally, the Senate proposal would make several policy changes to the Clean Water State Revolving Fund and the Drinking Water State Revolving Fund in an effort to ensure that state dollars are available this year to meet the federal Environmental Protection Agency match for these programs. In doing so, the provision corrects technical timeline-related errors in last year's budget that left the state's matching obligation a full year in arrears.

***Clean Water  
Management  
Trust Fund***

Unlike the House budget, which converted the appropriation for the Clean Water Management Trust Fund to non-recurring basis, the Senate proposal maintains recurring funding for the program at continuation levels (\$11.25 million). However, the Senate budget also continues the \$88.8 million cut to the trust fund in last year's budget—virtually eliminating its ability to finance rural water infrastructure redevelopment projects on the scale originally intended—while keeping the House requirement that the fund prioritize giving its few remaining grants to those projects involving military buffers. Finally, the trust fund is the only agency within the NER budget exempted from the 2 percent flexibility cut.

***Commerce***

The Senate budget increases the appropriation for the Department of Commerce by \$12 million, or 36 percent, from the continuation budget, down from the \$16 million (49 percent) increase proposed by the House budget. The largest portions of this increase come from a \$6 million non-recurring increase to the Jobs Maintenance and Capital incentive program for large-employer investment and a one-time \$6.5 million allotment for the purchase of land for an unspecified economic development project. Other key spending changes included a 2 percent flexibility cut, which would reduce the agency's budget by \$665,000 from the continuation budget, and adoption of the House proposal to increase the agency's appropriation for the restoration of the Commerce Office of Science & Technology. Additionally, the Senate budget authorizes the Employment Security Reserve Fund to spend \$2.5 million on administration costs, \$300,000 less than allowed in the House version, and it appropriates \$1 million from the Worker Training Fund for OpportunityNC, a workforce development program designed to give unemployed workers on-the-job training and hiring preferences at private businesses.

The Senate budget also singles out the OneNC Fund—one of the state's discretionary economic development incentive programs—for significant policy and spending changes, including a shift of \$50 million from the fund's \$60 million balance into the General Fund to help address the Medicaid shortfall. Additionally, the Senate budget would require OneNC to report quarterly on incentive disbursements, would commission a Commerce study to determine the minimum funding level required to implement OneNC, and would strike House language permitting the fund to use \$250,000 of its annual appropriation for administration costs. Finally, the Senate budget maintains House language that would dramatically alter reporting, liability, and compliance requirements for all incentive programs while capping future-year incentive obligations to \$14 million per year.

## SENATE SPENDS TVA SETTLEMENT DOLLARS IN WESTERN NC, BUT SUPPLANTS GENERAL FUNDING FOR BIOFUELS

North Carolina will receive \$11.2 million over the next five years from a Tennessee Valley Authority (TVA) settlement with the U.S. Environmental Protection Agency over Clean Air Act violations at a number of TVA coal-fired power plants in states bordering western North Carolina.<sup>20</sup> The stated intent of these funds in the agreement is to support renewable energy projects in the region most affected by TVA coal-fired plant violations –

namely, western North Carolina.

The Senate budget would use this year's settlement allotment to fund the Biofuels Center of North Carolina, a nonprofit economic development entity located in Oxford that seeks to develop a long-term biofuels industry in the state. However, the Senate would effectively supplant \$2.25 million, or 50 percent, of state appropriations to the Biofuels Center

with settlement money. Although it is within the General Assembly's discretion to fund the center using TVA money in future years, such an action would remove continuing state support for this economic development tool. Since nascent industries need reliable support over the long term in order to expand, thrive, and profit, the Senate budget puts the biofuels industry on an equally uncertain path into the future.<sup>21</sup>

### *Commerce State Aid*

In the Commerce Department's State Aid budget, the Senate proposal reduces state pass-through funding to nonprofits promoting economic development by \$2.8 million, or 9.4 percent. Included in these reductions are \$589,040 in recurring and \$14,000 in non-recurring flexibility cuts across all pass-through funds, including the recurring elimination of \$2.24 million in funding for the Biofuels Center of North Carolina, the nonprofit tasked with developing the state's biofuels industry; that cut is equal to half of the center's budget. However, the Senate budget would replace this cut with \$2.24 million in one-time funds from the state's environmental damage settlement with the Tennessee Valley Authority, in effect placing half of the center's appropriation on a zero-budget basis.

Additionally, the Senate budget would reinstate continuation funding levels for regional economic-development partnerships—unlike the House, which increased funding by \$2.6 million over the continuation budget. At the same time, however, the proposal eliminates the recurring appropriation for the Eastern Regional Partnerships and replaces it with one-time funding provided by interest off Global Transpark Zone loans. The former appropriation to the Eastern Regional Partnership is then redistributed to the other six regional partnerships.

Finally, the Biotech Center would receive a 2 percent spending cut in the Senate budget based on its flex cut, while the Wildlife Resources Commission would see its overall spending increase by 2.5 percent due to the restoration of \$778,000 in funding for the Conservation Education Program, which offsets the agency's 2 percent flex cut.

### *Rural Economic Development Center*

In a major departure from the House budget, the Senate budget cuts the Rural Center's spending by \$7 million, or 27 percent. This is the largest recurring cut to any pass-through and includes \$507,535 in flexibility cuts and \$6.5 million in operating cuts. Of these operating cuts, \$5.8 million is taken from the Infrastructure Program, which helps local governments finance water/sewer infrastructure projects for industrial sites related to economic development recruitment and expansion projects in towns with fewer than 7,500 people. The Senate budget would also reduce the amount of the appropriation that can be used for the Rural Center's administration (a \$105,000 cut) and for pass-throughs to Opportunities Industrialization Centers (\$99,000).

## TRANSPORTATION

The Senate's proposed \$3.1 billion transportation budget constitutes a funding reduction of nearly \$120.5 million, or 3.7 percent, from the continuation budget and a \$26.2 million increase compared to the House budget. The transportation budget is supported by revenue from the Highway Fund and Highway Trust Fund, which are funded by the state's gas tax, highway use tax, and Division of Motor Vehicle fees. The Senate proposal appropriates approximately \$2 billion to the Highway Fund and \$1.1 billion to the Highway Trust Fund. The proposal also includes several policy changes, as outlined below.

The reduction in appropriations stems in part from a revised revenue forecast that estimated a revenue shortfall largely due to declining fuel consumption and in part from the establishment of a 37.5 cents cap on the state's gas tax for FY2012-13. The governor's and House's proposed budgets also instituted a 37.5 cents cap on the state's gas tax. The gas tax is currently 38.9 cents, and because it is adjusted twice a year to reflect changes in the average wholesale price of gas, the gas tax is expected to fall to 37.7 cents by July 2012.<sup>22</sup> Capping the gas tax at 37.5 cents is estimated to cost the transportation budget \$81.6 million in FY2012-13.<sup>23</sup>

### NEW STARTS & REGIONAL CAPITAL GRANT PROGRAM

The Senate budget proposal would eliminate the Public Transportation Division's New Starts & Regional Capital Grant Program and shift its \$29 million fund balance to the Maintenance Reserve. The New Starts Program is a grant program that allocates federal transportation resources for mass transit capital projects, such as light rail and bus rapid transit. The

program requires state and local governments to provide at least 25 percent in public matching funds. The proposal may cause the city of Charlotte, the only city in North Carolina participating in the New Starts Program, to lose out on \$534.6 million in federal funding for the Blue Line Extension if state funds are not available to cover the required match.<sup>24</sup>

The proposed Senate budget cuts funding for Highway Fund programs by \$103.5 million, or 4.9 percent, from the continuation budget and cuts a net total of 22 positions. Compared to the House proposal, the Senate proposal would cut Highway Fund programs by 26.2 million fewer dollars. The Senate proposal would make smaller cuts to the primary and secondary road programs compared to the House proposal—\$59 million versus \$107.4 million. Under the Senate proposal, the construction of secondary roads would be subject to a statewide prioritization plan instead of the existing equity formula.

The cut to state appropriations for public transportation is nearly 11 times larger in the Senate proposal than in the House proposal. The Senate proposal would eliminate the Public Transportation Division's New Starts Program and shift its \$29 million fund balance to the Maintenance Reserve, whereas the House proposal would reduce public transportation grants by \$2.6 million. The Senate proposal would also prohibit public transportation appropriations from the Highway Fund from being expended on any fixed guideway project in

Mecklenburg County. However, fixed guideway projects would be able to compete for Highway Trust Fund appropriations under the existing equity formula. The Senate proposal would levy tolls on all ferries; two ferries are exempt under current state law.

The Senate proposal would remove the Driver License Program from continuation review and restore \$47.7 million in recurring funding. The Senate proposal would no longer charge \$45 to teenagers participating in driver education courses but would instead charge \$45 for limited learner's permits. As such, the Senate proposal would appropriate nearly \$3.2 million in the form of receipts to the Department of Public Instruction (DPI) to help cover the program's costs. DPI would receive an additional \$2.1 million from the Commercial Leaking Petroleum Underground Storage Tank Cleanup Fund, which receives funding from the gas tax.

The Senate proposal cuts funding for Highway Trust Fund programs by nearly \$16.6 million, or 1.5 percent, from the continuation budget. Like the House proposal, the Senate proposal would

provide \$45 million for the Mobility Fund, which was created in 2010 to fund high-priority transportation projects aimed at easing congestion and enhancing connectivity, but the Senate budget would go a step further and appropriate \$32.5 million on a non-recurring basis by eliminating gap funding for other projects. Other notable cuts include a \$9.3 million reduction to the interstate system, a reduction of nearly \$3.8 million for urban loops, and another cut of almost \$1 million to both state aid to municipalities and the secondary road system.

## CONCLUSION

The Senate budget achieves budgetary balance only by falling short of investments needed to ensure that North Carolina can deliver on its obligations to all residents. Senate leaders' decision not to replace expiring federal funds in K-12 public schools would result in further school job eliminations and layoffs, and funding for Medicaid would remain insufficient to meet the needs of North Carolina's most vulnerable residents. These serious and growing budget pressures, in addition to persistent structural weaknesses in the state's revenue system, go unaddressed in the Senate budget. What is clear is that a continued refusal to consider raising revenue to fund core state obligations will continue to artificially constrain budget choices to a series of lose-lose alternatives that undermine North Carolinians' well-being and the state's prospects for economic growth.

- 1 As in the House budget, the Senate budget would transfer \$248 million from funds within the state's transportation budget to increase General Fund availability. While approximately \$188 million of that transfer is to support the State Highway Patrol (which was shifted over to the Justice and Public Safety budget last year), the remaining money would go to other purposes. This practice is contrary to a 2007 General Assembly resolution that budget writers would phase out the use of transportation funds to increase General Fund availability by FY2013-14. While this accounting practice makes this change look like increased General Fund spending, it is offset by a commensurate decrease in the Transportation budget and as such has no net economic impact.
- 2 Both the House and Senate budgets would pay for \$154 million, or 75 percent, of the \$205.5 million current-year Medicaid shortfall with General Fund dollars. S.L. 2012-002 directs the State Controller to pay the remaining \$51.5 million with \$29 million in funds from within the Department of Health and Human Services and \$21 million in unanticipated federal CHIPRA bonus receipts.
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- 4 A state's credit balance is entirely one-time money coming from unforeseen events such as lower-than-authorized state agency spending and revenue over-collections.
- 5 NC Division of Employment Security. Available at <http://www.ncesc1.com/business/savemoney/wotc.asp>
- 6 N.C.G.S. § 105129.16G.
- 7 Detail on cost drivers and estimates are not provided in the money report for House Bill 950, Modify 2011 Appropriations Act, and have been taken from the legislative fiscal note for Senate Bill 795, Excellent Public Schools Act (version 3). Available at <https://docs.google.com/viewer?url=http%3A%2F%2Fncleg.net%2FSessions%2F2011%2FFiscalNotes%2FSenate%2FPDF%2FNF0795v3.pdf>
- 8 See Senate Bill 795, Excellent Public Schools Act. Available at <http://ncleg.net/gascripts/BillLookUp/BillLookUp.pl?Session=2011&BillID=s795&submitButton=Go>
- 9 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.
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- 12 See Part VII-A. Excellent Public Schools Act in House Bill 950, version 5. Available at <http://ncleg.net/Sessions/2011/Bills/House/HTML/H950v5.html>
- 13 All but two LEAs in North Carolina applied for, and received, a waiver from the extended instructional days requirement for FY2012-13.
- 14 Detail on cost drivers and estimates are not provided in the money report for House Bill 950, Modify 2011 Appropriations Act, and have been taken from the legislative fiscal note for Senate Bill 795, Excellent Public Schools Act (version 3). Available at <https://docs.google.com/viewer?url=http%3A%2F%2Fncleg.net%2FSessions%2F2011%2FFiscalNotes%2FSenate%2FPDF%2FNF0795v3.pdf>
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