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THE SENATE'S BUDGET: No big surprises in spending but some major policy shifts proposed

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- On May 20, the North Carolina Senate passed a budget bill that makes changes to the certified budget already in place for fiscal year (FY) 2010-11. The Senate's proposed budget would reduce overall General Fund appropriations by \$544.5 million, or 3%. Compared to the previous year (FY 2009-10), the Senate's proposed budget is \$18 million, or 0.1%, less.
- Like Governor Perdue's proposal, the Senate's revenue plan assumes that baseline state tax revenues will be \$703 million lower next year than was projected when the two-year budget was adopted in 2009. Unlike the governor's budget, however, the Senate's plan includes an additional \$85 million loss in state estate tax. The Senate's revenue plan also reduces the top marginal tax rate for small businesses to 6.9%, resulting in a loss of \$39 million in state revenue.
- The Senate's budget raises \$22 million by increasing several fees, including those for probation supervision, community service, courts, and attorney appointments. It also increases community college tuition.
- The Senate's spending plan includes \$823 million in reductions, the bulk (\$549 million) of which are taken out of the budgets for public schools and Medicaid. It also includes \$278 million in expansion spending. Community colleges, universities, the Division of Mental Health, and the Department of Commerce would all see an increase in state appropriations compared to the certified budget.
- The Senate's budget includes some substantial changes to state policy, particularly in education. The budget bill would give local schools, community colleges and universities the option to furlough staff in order to avoid layoffs and begin spending some lottery proceeds for purposes not included in the original lottery distribution formula.
- The Senate budget, like the governor's, includes a \$20 million increase in the state's contribution to its retirement plan — considerably less than the \$180 million increase the state treasurer has recommended. Unlike the governor's budget, however, the Senate's plan would not reduce the transfer from the Highway Fund to the General Fund in order to create a new Mobility Fund to pay for the Yadkin River bridge overhaul and other transportation projects.

Overview

The North Carolina Senate passed its recommended budget for the 2010-11 fiscal year on May 20. Because North Carolina adopted a two-year budget last year, the Senate's budget bill is a set of proposed changes to the previously adopted budget and a series of policy proposals that would impact state services. The certified General Fund budget currently in place for FY 2010-11 sets total state appropriations at \$19.559 billion. The changes proposed in the Senate's budget would reduce General Fund spending by \$570 million to \$18.989 billion. The Senate's budget includes \$823 million in proposed spending reductions, less than the \$956 million in reductions proposed by Governor Beverly Perdue in her budget. The Senate's plan also includes only \$278 million in expansion spending, far less than the \$560 million the governor proposed. This report from the NC Budget & Tax Center (BTC) examines the Senate's budget, paying close attention to its potential impacts on low- and moderate-income North Carolinians.

FIGURE 1

OVERVIEW OF SENATE'S RECOMMENDED ADJUSTMENTS TO FY10-11 GENERAL FUND BUDGET		
FY10-11 General Fund Appropriations Only		
FY 09-10 Certified Budget	\$19,008,079,980	
FY10-11 Original Continuation Budget	\$22,554,891,906	
FY10-11 Certified General Fund Budget	\$19,559,764,576	
FY10-11 Senate's Recommended Adjusted General Fund Budget	\$18,989,677,325	
<i>Change from FY 09-10 Certified General Fund Budget</i>	<i>\$(18,402,655)</i>	<i>-0.1%</i>
<i>Change from FY 10-11 Certified General Fund Budget</i>	<i>\$(570,087,251)</i>	<i>-2.9%</i>
<i>Change from FY10-11 Continuation Budget</i>	<i>\$(3,565,214,581)</i>	<i>-15.8%</i>
FY10-11 General Fund Appropriations + Federal Recovery Assistance		
FY 09-10 Certified Budget	\$20,405,943,837	
FY10-11 Original Continuation Budget	\$22,554,891,906	
FY10-11 Certified General Fund Budget + Federal Recovery Dollars	\$20,597,354,925	
FY10-11 Senate's Recommended Adjusted General Fund Budget + Federal Recovery Dollars	\$19,577,386,594	
<i>Change from FY 09-10 Certified General Fund Budget</i>	<i>\$(828,557,243)</i>	<i>-4.1%</i>
<i>Change from FY10-11 Certified General Fund Budget</i>	<i>\$(1,019,968,331)</i>	<i>-5.0%</i>
<i>Change from FY10-11 Continuation Budget</i>	<i>\$(2,977,505,312)</i>	<i>-13.2%</i>

The Revenue Plan

The Senate's revenue plan, like the governor's, adjusts the baseline revenue forecast for FY 2010-11 down by \$703 million to account for a more pessimistic economic outlook. The Senate's revenue plan also assumes that 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.

Unlike the governor’s proposal, the Senate plan does not deposit money into the state’s rainy day fund because, unlike the governor, the Senate’s budget does not assume any money will be left over at the end of the current fiscal year that can be dedicated to this fund. Another difference between the Senate’s plan and the governor’s is that it does not reduce the transfer from the Highway Trust Fund to the General Fund in order to create a new Mobility Fund. The governor has proposed creating such a fund, which would be matched with increased transportation-related fees and would pay for high-priority transportation projects such as replacing the Yadkin River Bridge.

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	\$20,000,000
Higher Education Enrollment growth	\$90,678,446
Restoration of Continuation Review Programs	\$20,928,760
Total Budget Pressures	\$562,171,919
= New Recommended Total GF Appropriations	\$20,121,936,495
- Revised Baseline Forecast (\$702 million less than budgeted)	\$18,940,011,278
New FY10-11 Budget Gap	\$(1,181,925,217)

HOW DID THE SENATE CLOSE THE BUDGET GAP?	
FY10-11 General Fund Appropriations Only	
+ Adjustments to Availability	\$54,914,722
Family Owned and Small Business Income Rate Cap	\$(39,700,000)
Department of Revenue Settlement Initiative	\$110,000,000
Loss of Estate Tax Revenue	\$(85,000,000)
Hospital Payments	\$35,000,000
Increased Fees	\$22,214,722
Other Adjustments	\$12,400,000
+ Additional Federal Recovery Dollars (used to offset reduced GF appropriations)	\$587,709,269
FMAP extension for Medicaid	\$482,111,583
FMAP funds for Part D Clawback	\$79,419,834
Emergency TANF Dollars	\$26,177,852
+ Net Spending Reductions	\$544,549,901
Spending Cuts	\$823,014,388
Expansion items other than budget pressures	\$(278,464,487)
Total Available to Close Gap	\$1,187,173,892

The Senate’s revenue plan, like the governor’s, includes an additional \$110 million in anticipated revenues because of the Department of Revenue’s ongoing efforts to more accurately assess corporate tax payments.

The Senate’s revenue plan also includes a proposed tax reduction for small businesses. Currently, small businesses that are not incorporated file taxes as pass-through entities through the personal income tax code — that is, these businesses “pass through” their profits to their owners who file personal income tax claims. The top personal income tax rate in North Carolina is currently 7.5%. The Senate’s budget would lower the top rate for small businesses to 6.9%.

Finally, the Senate’s revenue plan would raise an additional \$22 million from increased fees including court fees, attorney appointment fees, community service fees and probation/parole supervision fees.

FIGURE 3

SIGNIFICANT SPENDING CUTS IN THE SENATE’S RECOMMENDED FY 10-11 BUDGET	
K-12 Cuts	\$(235,459,933)
Average Teacher Salary Adjustment	\$(44,950,676)
Supplant K-12 Appropriations with projected increased Lottery Funds	\$(36,638,646)
More at Four	\$(26,176,036)
Cuts to Schools (Instructional Support, Assistant Principals, Supplies)	\$(15,580,000)
Cuts to Aid for Vulnerable Populations	\$(19,000,000)
Other K-12 Cuts	\$(93,114,575)
Community College Cuts	\$(47,849,369)
Tuition Increase	\$(23,244,836)
Management Flexibility Reductions	\$(13,500,000)
Other Community College Cuts	\$(11,104,533)
University Cuts	\$(55,539,540)
Management Flexibility Reductions	\$(50,000,000)
Other UNC System Cuts	\$(5,539,540)
Medicaid Cuts	\$(223,309,566)
Reform In-Home Personal Care Services	\$(59,805,207)
Savings from Community Care of NC Initiatives	\$(45,000,000)
Reduced Community Support Team Services	\$(41,000,000)
Savings from Increased Fraud Enforcement	\$(36,188,013)
Other Medicaid Cuts	\$(41,316,346)
Other Health and Human Service Cuts	\$(84,440,011)
Smart Start	\$(15,000,000)
Other HHS Cuts	\$(69,440,011)
All Other Cuts	\$(166,582,767)
General Government	\$(21,407,161)
Justice and Public Safety	\$(99,619,629)
Natural and Economic Resources	\$(23,110,592)
Reserves, Adjustments and Debt Service	\$(6,600,000)

FIGURE 4

SUMMARY OF "EXPANSION" SPENDING IN THE SENATE'S RECOMMENDED FY 10-11 BUDGET	
Fund Enrollment Growth (Medicaid + higher education + retirement obligations)	\$562,171,919
Allow Universities to Retain Proceeds from Tuition Increase	\$34,776,301
Restore Continuation Review Programs	\$20,928,760
Restore Mental Health Funds	\$35,000,000
Restore AIDS Drugs Assistance	\$14,177,635
Expansions to Commerce	\$37,400,000
Capital Improvements	\$27,563,778
Other "Expansion"	\$108,618,013
Total	\$840,636,406

The Spending Plan

North Carolina adopts a two-year budget, so technically there is already a budget in place for the fiscal year that begins July 1, though lawmakers always make adjustments to account for changes in revenues and spending estimates. The Senate's proposed changes would reduce spending by \$544 million, or 2.9%, compared to the certified budget already in place for FY 2010-11. Compared to the previous fiscal year's budget, the Senate's proposal would reduce General Fund spending by \$18 million, or 0.1%. The following sections assess the Senate'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 Senate budget would reduce public education funding by \$219.2 million compared to the adjusted continuation budget. Though a reduction, this amount is \$95.5 million higher than the overall spending level in the governor's proposed budget. While the governor's budget would have reduced education spending largely by requiring local schools to enact \$440 million in discretionary reductions, the Senate specifies how funding would be reduced rather than relying on local schools to make budget-cutting decisions. Though more generous to schools than the governor's budget, the Senate still proposes a number of reductions that would impact the education system, particularly as it relates to low-income children. These cuts include reducing funding for the Disadvantaged Student Supplemental fund (\$1.9 million), the More at Four preschool program for disadvantaged students (\$10 million), teacher mentoring (\$9.2 million — funding eliminated), Limited English Proficiency efforts (\$4 million), and dropout prevention grants (\$13 million — funding eliminated). Finally, unlike the governor's budget, the Senate's plan does not include funding for salary step increases for teachers.

In addition to proposing specific reductions, the Senate budget bill would make some significant changes to public school policy. It would allow local school districts to furlough teachers for up to three days per year in order to reduce layoffs. It would also require the anticipated increase in lottery funds to be used for general education purposes as opposed to the earmarked categories to which it was previously limited.

Community Colleges

The Senate's proposed budget for the community college system would increase General Fund spending by \$50 million compared to the adjusted continuation budget. It includes

\$13.5 million in discretionary reductions that would have to be made by the system administrators and campus presidents. The budget also includes a tuition increase of \$5 per credit hour, the proceeds from which would offset a cut in General Fund appropriations, so there would be no net gain to the community college budget. The governor's budget proposed an \$8 per hour tuition increase. Similarly, the 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 Senate'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, yet when offset by spending cuts the net increase to the community college system is only \$50 million, or 5%.

Health and Human Services

The Senate's budget would reduce HHS appropriations by \$405 million, or 9.4%, compared to the certified budget, which is \$21 million less than the governor's proposed budget. Of the proposed reductions, \$349 million would come from the Division of Medical Assistance (i.e., Medicaid). Like the governor's budget, the Senate's spending plan relies on an additional \$482 million in federal assistance for Medicaid in anticipation that Congress will pass legislation continuing that assistance, which was part of the original federal economic recovery package.

Much of the proposed reductions come in the form of anticipated savings from increased efficiency and fraud detection. For example, Medicaid is set to save \$45 million by expanding the Community Care Network, \$5.5 million by changing reimbursement policies for prescriptions, and \$10 million by moving mental health drugs to the Preferred Drug List process.

Some reductions, however, will directly impact services, including reducing the number of hours available for those who are eligible for community support services under mental health. Similarly, funding for the In-Home Personal Care services program would be reduced by \$59.8 million, and the current program would be replaced by a new program under which only adults with the greatest need (i.e., needing assistance with more than three activities daily) would receive assistance. The spending plan also includes a \$15 million reduction in funding for the Smart Start early childhood program.

The Senate's proposed budget also included several noteworthy expansions of services under HHS. The Division of Mental Health would receive \$23 million in increased funding to local management entities to provide community-based services and an additional \$12 million to increase the number of local in-patient beds available. The spending plan also includes \$6.5 million to maintain open enrollment in the State Children's Health Insurance Program, serving an additional 2,750 children, and \$14 million in additional funding for the AIDS Drug Assistance Program to eliminate the waiting list for this program.

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 \$83 million, or 3% compared to the certified budget for FY 2010-11. The Senate proposes increasing several different fees in this area including increasing court costs fees to \$105 per incident and increasing probation and parole supervision fees and indigent court-appointed attorney fees. In addition to fee increases used to offset General Fund spending reductions, the budget includes several noteworthy spending reductions, including funding for community programs such as Harriet's House and Summit House, and cuts to grants made through the Criminal Justice Partnership Program. The largest reductions in dollars are \$39 million in savings from reducing the projected inmate population and \$20 million found through setting prisoner medical care reimbursement rates equivalent to Medicaid rates. Finally, the Senate's budget restores

funding for several programs whose budget was eliminated pending a “continuation review.” These include funding for the Sentencing Services Program and the prisoner education program administered by the community college system.

Conclusion

The budget now heads to the House of Representatives, which, by all accounts, is planning to move swiftly to adopt its proposed budget so that the two chambers can begin negotiating. The Senate’s budget, like the governor’s, provides some additional ideas for savings and targeted reductions to help balance next year’s budget. It also includes some spending reductions that would damage effective programs and the ability of public institutions to fulfill their objectives. Finally, it includes policy changes that may be harmful such as a major tax reduction for small business and allowing public schools, universities and community colleges to furlough employees in order to meet budget savings targets.

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