

spotlight

No. 459 – August 20, 2014

STATE BUDGET OVERVIEW

Teacher compensation and Medicaid drive the 2014-15 budget

KEY FACTS:

- **For fiscal year 2014-15, North Carolina's General Fund budget rose 2.2 percent to \$21.1 billion.**
- **The budget funded an average teacher salary increase of 7 percent, one of the largest pay raises for North Carolina teachers in a generation.**
- **It added \$840,000 to the state's Opportunity Scholarship Program, enough to fund 400 additional private school scholarships for low-income children.**
- **The legislation removed the 'continuation budget' from the State Budget Act and replaced it with the 'base budget,' which is based upon actual spending levels. This will provide a more accurate starting point for budget officers in future years.**
- **Medicaid spending accounted for 18 percent of the total General Fund and 72 percent of the Health and Human Services' General Fund budget.**
- **A backlog of unpaid claims and enrollment growth caused uncertainty within the Medicaid budget. A Medicaid contingency fund of \$186.4 million was created for any unexpected shortfalls.**

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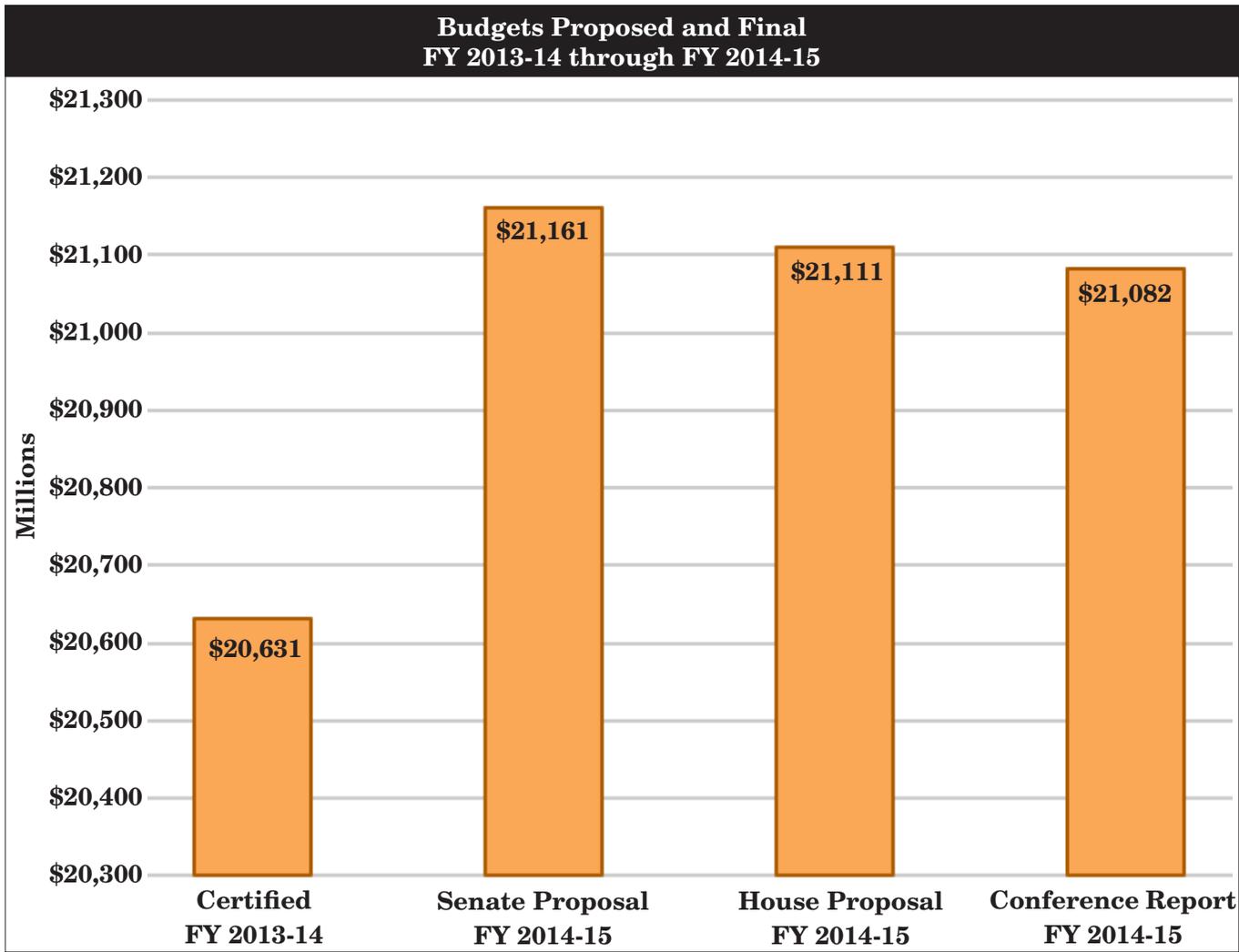
For fiscal year 2014-15, North Carolina's General Fund budget rose 2.2 percent to \$21.1 billion, below the combined rates of population growth and inflation. Although this budget includes a number of key policy changes, spending adjustments compared to last year's budget were relatively small with two exceptions – public school and Medicaid spending. After multiple committee hearings and numerous budget proposals from the Senate and the House, legislators agreed to significant changes to both policy and funding in these two areas, including a \$282 million teacher compensation increase and a \$227 million increase for Medicaid.

Other notable policy changes included transfers of the ABC Commission and State Bureau of Investigation to the Department of Public Safety, as well as the creation of a Medicaid Reserve Fund.

Elementary and Secondary Education

The primary purpose of a state budget is to direct taxpayer dollars to agencies for programs that 1) the state has a constitutional or statutory obligation to fund, or 2) correspond to the policy priorities of the majority party in the N.C. General Assembly. As a result, the budget has both fiscal and policy implications. Nowhere is this more apparent than in the K-12 education portion of the state budget.

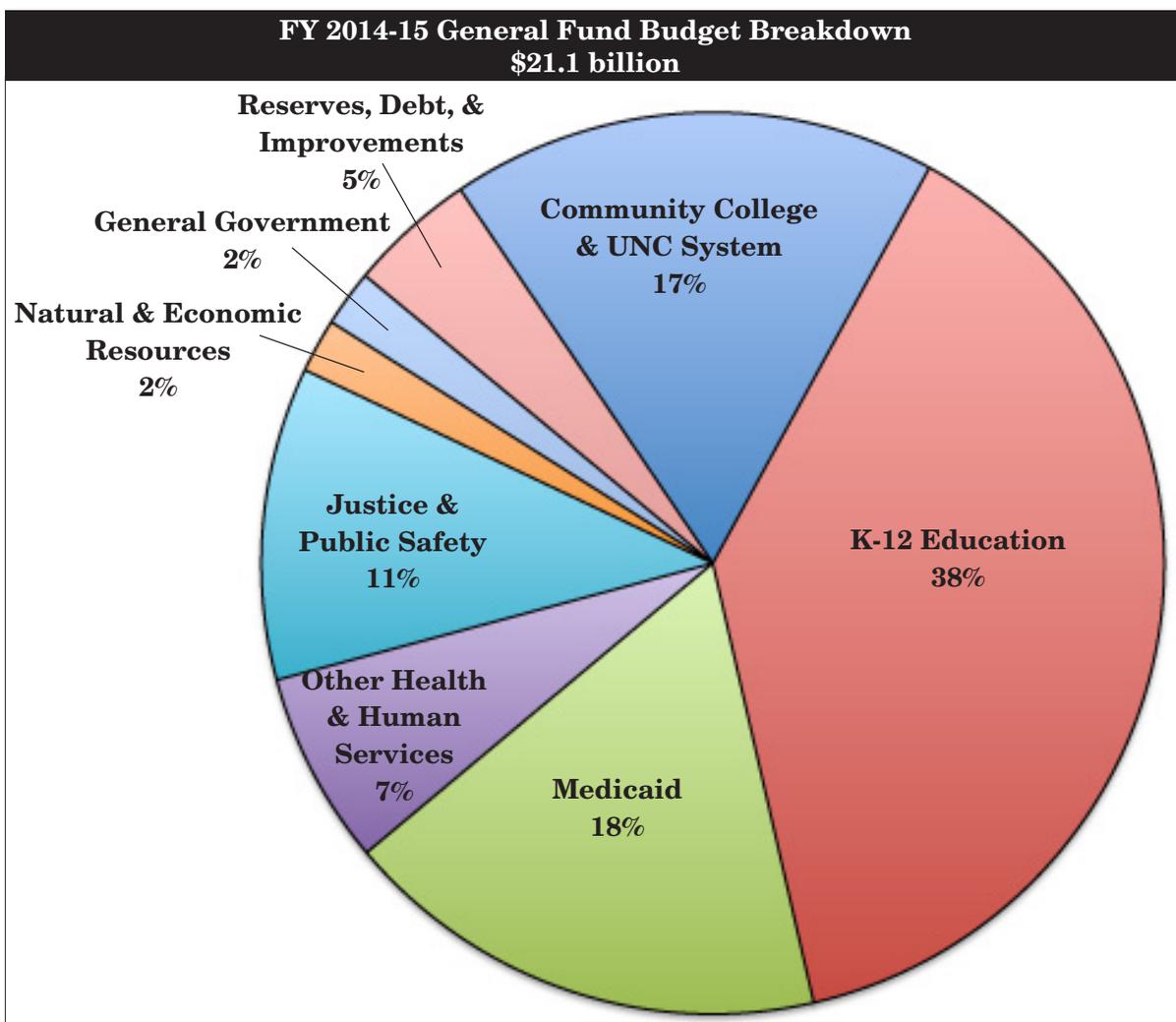
Republican legislators have increased the K-12 education budget in each fiscal year that they have been in the majority. This year, North Carolina's enacted elementary and secondary education budget exceeded \$8.1 billion, an increase of nearly \$240 million, or 3 percent, over last year's education budget.



The additional funding, as well as savings from other areas, combined to provide an average teacher salary increase of 7 percent, making this year's one of the largest pay raises for North Carolina teachers in a generation. Additionally, legislators approved a \$618 salary and benefits increase for full-time school support personnel and a \$1,000 salary and benefit increase for school-based administrators.

Aside from pay increases for the vast majority of public school employees in the state, the legislative leadership also championed practices designed to improve classroom instruction and other innovative policies. Legislators appropriated funds to district and charter schools to pay testing fees for Advanced Placement courses for all students, and directed funds to the North Carolina Advanced Placement Partnership for professional development for teachers of Advanced Placement courses. They also mandated a slight decrease in class sizes in kindergarten and first-grade. Most importantly, the budget included one of the most significant revisions to the structure of North Carolina's teacher salary schedule since the introduction of the system in 1920. Finally, they continued their efforts to develop a much-needed performance and incentive pay program for the state's teachers.

The legislative majority also expanded school choice and alternative learning environments. Legislators authorized the creation of six additional Cooperative and Innovative High Schools, initiated a pilot program that allows two virtual charter schools to begin offering courses to elementary and secondary school students, and directed funding for children who reside in private psychiatric residential treatment facilities. Most notably, they added \$840,000 to



the state's Opportunity Scholarship Program, which is enough to fund 400 additional private school scholarships for low-income children. Unfortunately, this modest funding increase will not accommodate all of the families who would like to send their children to private schools but do not have the means to do so.

To maintain the health and safety of students, legislators now require public schools to have at least two Epinephrine injectors (Epi-pens) to address allergic reactions. They also mandated that school districts provide schematic diagrams and limited emergency access to school buildings to public safety officers. Both measures will improve the way that public agencies respond to emergencies that arise at schools.

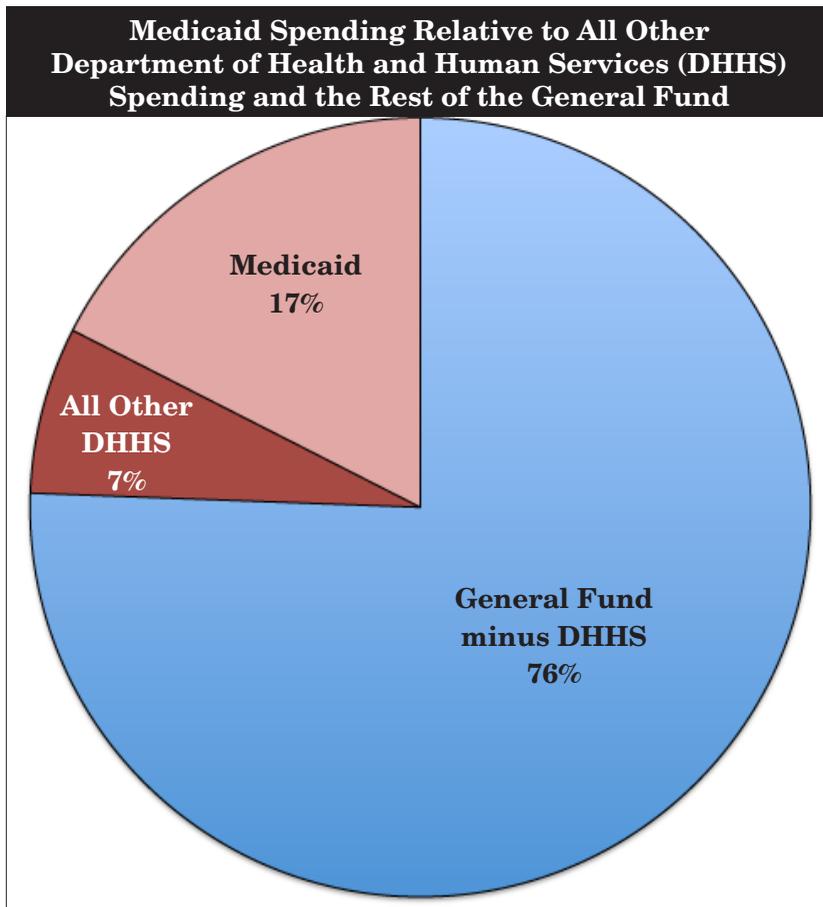
Finally, the state budget includes provisions that protect taxpayers' financial investment in all public schools. The N.C. State Board of Education will now have the option of managing a system of insurance for public charter school property. In addition, charter schools must now maintain an account of at least \$50,000 to ensure payment of expenses related to closure or dissolution of the school.

Of course, state education funding represents only around two-thirds of the total K-12 education budget. When local, federal, and capital funds are included, the total budget for North Carolina's public schools will likely come close to the \$13 billion mark. As impressive as that may sound, it is unlikely that taxpayers' massive investment in public schools will raise student achievement or curb discontent among those who cultivate it for political and financial gain.

Medicaid

Medicaid is one of the largest expenditures in state government. In this year's budget Medicaid accounts for 18 percent of the General Fund and 72 percent of the Health and Human Services budget. A detailed assessment of the Medicaid budget suggested that existing forecasting methods, which were based on previous years' actual spending levels, would not be accurate enough for the upcoming fiscal year. Budget writers found that multiple extenuating factors were affecting the cost of the program, thereby impeding their ability to budget accurately for Medicaid without fear of a shortfall in the upcoming year.

Providers of medical services across North Carolina have submitted claims for reimbursement for the cost of providing health care to Medicaid patients, which has produced a large backlog of unpaid claims. The exact sum of unpaid claims is difficult to estimate. There has also been a large increase in enrollment for Medicaid, with a backlog of applications due to changes to federal regulations and the implementation of the Patient Protection and Affordable Care Act (Obamacare). Shockingly, there is no consensus on the exact cost involved with each enrollee to the program.



Both the backlog of unpaid claims and increase in enrollment have caused uncertainty with the final budget figure for Medicaid. To be cautious, legislators decided to create a Medicaid contingency fund of \$186.4 million for any unexpected shortfalls.

Changes to the Budget Process

In previous years, both Democratic- and Republican-led legislatures conducted their budget negotiations behind closed doors. This year's budget process was more transparent than those in the past. Conference committee meetings were open to the public and exposed tension between the chambers, as budget writers worked on a compromise for the teacher compensation increase and Medicaid figures. The budget negotiations persisted longer than expected, but after seven editions, countless amendments, and lengthy debates, the House and Senate approved the Appropriations Act of 2014 (Senate Bill 744) in early August 2014. Governor McCrory signed the budget into law on August 7.

Policy changes are frequently included in the budget, and this year was no different. One of the more important items was a modification to the way the state budget is created. Historically the state's budget development began with a continuation budget, which is a series of estimates of the amounts necessary to continue the same level of services in the next biennium as provided in the current fiscal year.¹ This figure has caused confusion during the budget process, because some commentators and analysts characterize it as a baseline to show increased or decreased spending for an agency. The continuation budget figure was never an actual spending figure but only a calculation used for the budgeting process. Beginning in the 2015-17 biennium, the starting point for budgets will be the base budget,² a more realistic starting point for budget writers because it represents actual spending figures from the prior year rather than arbitrary calculations and agency wish lists.

This change to the budgeting process should make comparisons from year to year easier and less confusing for budget writers, analysts, and citizens alike. It will also make political manipulation of the budget process more difficult.

Conclusion

As in previous years, Medicaid and K-12 education set the course for budget negotiations. When a budget has a small number of programs that consume a large share of total appropriations, other areas of the budget must fight for the scarce revenue that remains. Consequently, budget writers need to focus on the core, constitutional functions of government. This requires the use of fiscally responsible principles when making budget decisions that support these functions today and for future generations of North Carolinians. Lawmakers must also continue to limit regulation and taxes of private enterprise and find new ways to engage non-profits and community groups to further their legislative goals.

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Endnotes

1. North Carolina General Statute §143C-1-1(d)(7a), ncga.state.nc.us/gascripts/Statutes/StatutesTOC.pl?Chapter=0143C
2. Session Law 2014-100 (Senate Bill 744) amended §143C-1-1(d)(1c). It reads, "Base Budget. - That part of the recommended State budget that provides the baseline for the next biennium. The base budget for each State agency shall be the authorized budget for that agency with adjustments only for the following: (a) Annualization of programs and positions. (b) Reductions to adjust for items funded with nonrecurring funds during the prior fiscal biennium. (c) Increases to adjust for nonrecurring reductions during the prior fiscal biennium. (d) Adjustments for federal payroll tax changes. (e) Rate increases in accordance with the terms of existing leases of real property. (f) Adjustments to receipt projections, made in accordance with G.S. 143C-3-5(b)(2)c. (g) Reconciliation of intergovernmental and intergovernmental transfers."

2014 Conference Budget					
	Certified FY 2013-14	Senate Proposal FY 2014-15	House Proposal FY 2014-15	Conference Report FY 2014-15	Percent Change year-to- year
Education					
Public Instruction	7,865,960,649	8,112,643,423	8,062,541,980	8,104,976,608	3.0%
Community Colleges	1,021,295,467	1,038,638,136	1,042,250,461	1,040,911,271	1.9%
The University System	2,583,048,270	2,617,553,768	2,630,045,501	2,629,382,937	1.8%
Total Education	11,470,304,386	11,768,835,327	11,734,837,942	11,775,270,816	2.7%
Health and Human Services					
Central Management and Support	73,786,129	71,273,073	81,498,151	72,904,800	-1.2%
Aging and Adult Services	54,142,341	53,372,792	54,442,341	53,472,792	-1.2%
Child Development & Early Education	254,314,609	236,282,881	178,467,986	223,636,354	-12.1%
Public Health	144,154,087	131,671,390	136,336,044	136,336,044	-5.4%
Social Services	174,608,432	188,947,789	190,099,941	188,765,287	8.1%
Medicaid	3,461,950,119	3,804,308,059	3,669,166,279	3,688,548,123	6.5%
NC Health Choice	67,949,160	41,933,972	41,997,933	41,933,972	-38.3%
Blind & Deaf / Hard of Hearing Services	8,178,618	8,178,618	8,178,618	8,178,618	0.0%
Mental Health, Devel. Disab., & Subs. Abuse Svcs.	699,535,602	675,153,834	690,938,950	680,063,746	-2.8%
Health Service Regulation	16,396,057	16,123,479	16,123,479	16,123,479	-1.7%
Vocational Rehabilitation	38,773,169	38,197,833	38,197,833	38,197,833	-1.5%
Total Health and Human Services	4,993,788,323	5,265,443,720	5,105,447,555	5,148,161,048	3.1%
Justice and Public Safety					
Public Safety	1,716,893,395	1,750,644,177	1,753,093,634	1,741,198,351	1.4%
Judicial	456,926,252	459,929,240	461,549,584	463,893,072	1.5%
Judicial - Indigent Defense	115,129,423	111,773,820	111,743,301	111,693,231	-3.0%
Justice	79,726,123	34,079,847	50,210,076	49,343,824	-38.1%
Total Justice and Public Safety	2,368,675,193	2,356,427,084	2,376,596,595	2,366,128,478	-0.1%

2014 Conference Budget					
	Certified FY 2013-14	Senate Proposal FY 2014-15	House Proposal FY 2014-15	Conference Report FY 2014-15	Percent Change year-to- year
Natural and Economic Resources					
Agriculture and Consumer Services	115,085,702	116,330,919	115,924,363	117,068,106	1.7%
Commerce	51,228,804	52,541,929	55,841,839	85,788,091	67.5%
Commerce - State Aid	21,723,226	15,896,240	20,630,240	17,454,240	-19.7%
Environment and Natural Resources	154,037,311	166,989,626	159,620,093	159,302,056	3.4%
Wildlife Resources Commission	12,476,588	14,354,606	13,466,068	11,163,269	-10.5%
Labor	16,696,339	16,649,138	16,735,896	16,550,450	-0.9%
Total Natural and Economic Resources	371,247,970	382,762,458	382,218,499	407,326,212	9.7%
General Government					
Administration	67,567,025	65,023,754	55,914,434	65,282,217	-3.4%
Auditor	11,217,468	11,335,806	11,385,623	11,372,267	1.4%
Cultural Resources	63,670,145	62,451,313	63,674,655	63,696,952	0.0%
Cultural Resources - Roanoke Island	450,000	441,000	441,000	441,000	-2.0%
General Assembly	52,087,986	51,590,241	52,511,211	52,097,694	0.0%
Governor's Office	7,170,050	7,121,334	7,408,653	7,217,377	0.7%
Housing Finance Authority	8,411,632	18,241,954	18,241,954	18,241,954	116.9%
Insurance	37,994,004	37,604,496	37,747,138	37,712,322	-0.7%
Lieutenant Governor	681,089	669,460	672,058	671,307	-1.4%
Office of Administrative Hearings	5,241,643	5,051,651	5,069,608	5,064,948	-3.4%
Revenue	80,998,918	81,623,926	79,452,101	79,379,309	-2.0%
Secretary of State	11,575,183	11,552,463	11,612,598	11,600,706	0.2%
State Board of Elections	5,302,373	5,637,834	5,858,467	5,854,059	10.4%
State Budget and Management (OSBM)	7,451,706	7,462,958	7,489,101	7,481,591	0.4%
OSBM-Special Appropriations	4,912,000	1,695,000	1,500,000	1,675,000	-65.9%
Controller's Office	28,710,691	30,311,191	28,587,977	28,508,539	-0.7%
State Treasurer's Office	8,137,890	8,985,833	8,550,088	9,686,236	19.0%
Treasurer - Retirement / Benefits	23,179,042	20,704,546	21,679,206	21,484,274	-7.3%
Total General Government	424,758,845	427,504,760	417,795,872	427,467,752	0.6%
Subtotal Agency Budgets	19,628,774,717	20,200,973,349	20,016,896,463	20,124,354,306	2.5%
Total Capital Improvements	27,939,000	23,233,000	23,033,000	13,560,000	-51.5%
Debt Service	709,197,014	717,096,743	717,946,743	721,591,271	1.7%
Statewide Reserves	264,856,914	219,304,622	353,604,622	222,604,622	-16.0%
Total General Fund Budget	20,630,767,645	21,160,607,714	21,111,480,828	21,082,110,199	2.2%