

PERSPECTIVE ON NC BUDGET

Spending is the Problem, Not Lack of Tax Revenue

Summary: North Carolina lawmakers are once again coming to Raleigh to grapple with a projected deficit exceeding \$1 billion. A close examination of the fiscal trends demonstrates that excessive spending, not inadequate revenue, is the cause and that the state budget continues to be bloated with wasteful or low-priority expenditures. Policymakers must show courage, be willing to apply fundamental principles, and target major areas of state spending for savings and reform.

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For the third time in a row, the North Carolina General Assembly will come to Raleigh facing more than a \$1 billion projected deficit in the coming fiscal year. The reason for this is clear. In neither of the previous two years have lawmakers or Gov. Mike Easley chosen to address budget deficits primarily by making significant, permanent reductions in the size and scope of state government. They have not chosen to place the state on a firm path of fiscal responsibility. Instead, they have relied on one-time revenue boosts, on tax hikes, and on nips and tucks around some state programs that really deserved dramatic downsizing or elimination.

North Carolina's budget problems did not develop overnight. They are the result of shortsighted decisions by governors and lawmakers. In essence, new long-term commitments were made by recklessly expanding Medicaid and starting new programs such as Smart Start. This was done during a time when it was clear that revenue growth was extraordinarily high — pumped up by capital-gains realizations and the like — and could not reasonably be counted on in future years. In other words, our state made long-term spending promises with what was clearly short-term money.

For two decades, budget growth has far outpaced inflation, population, and personal income growth. During the 1990s, while personal income in the state grew by a respectable 6.3 percent annual rate, the state budget grew by an average of 7.3 percent. By comparison, the federal budget under President Bill Clinton and a mostly Republican Congress grew at an annual rate of 3.2 percent. The 10-year growth trend was 80 percent in state General Fund spending — even after the “draconian cuts” of the 2001 and 2002 sessions. If the NC budget had expanded only enough to keep up with rising prices and population, the rate of growth would have been nearly halved, and General Fund authorizations for FY 2002-03 would have been \$2.7 billion lower than

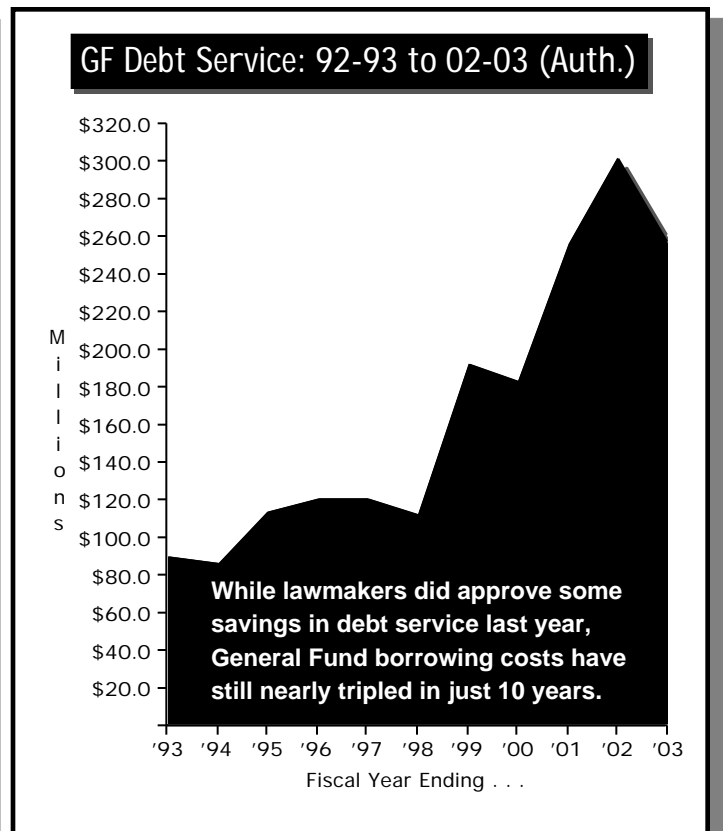
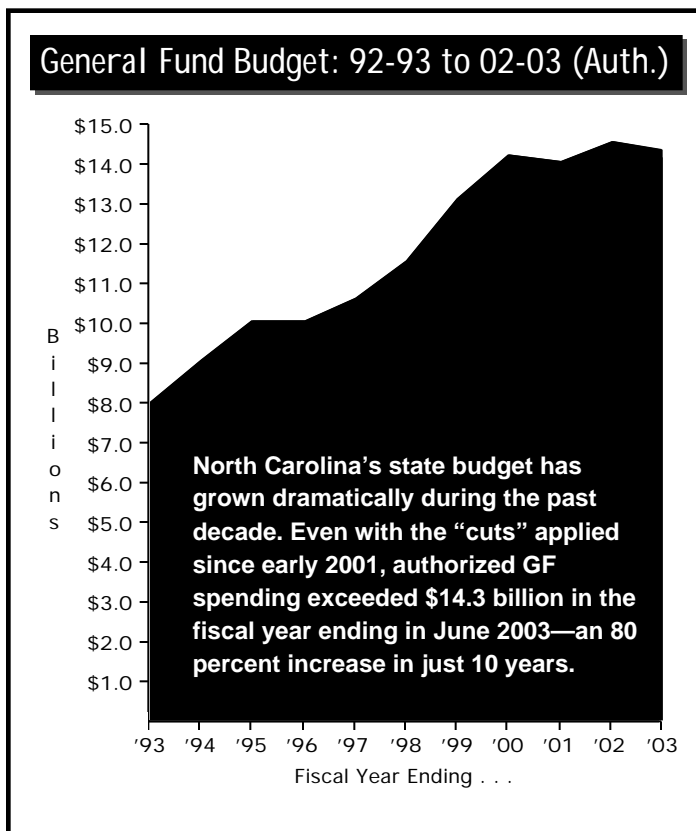
they are. Even allowing for growth in education enrollments and Medicaid eligibles, spending would have grown by only 52 percent, saving more than \$2.2 billion.

Furthermore, in spite of the fact that North Carolina lawmakers enacted tax cuts in 1995, 1996, and 1997, the tax burden is higher than it was 10 years ago due to tax increases in the early 1990s, 2001, and 2002. The real problem is that for every dollar that the tax cuts of the 1990s saved the taxpayers, the state increased spending by \$3. Now, having more than erased the tax-cutting trend of the 1990s, the General Assembly has left North Carolina with a tax burden that as a share of personal income is among the highest in the region, and with marginal tax rates on individual and corporate income that are among the highest in the United States. This is not a recipe for dynamic economic growth or prudent spending restraint.

Courage Needed to Address Budget-Growth Drivers

If the new General Assembly intends to reestablish fiscal responsibility to North Carolina's state budget then there are several major areas that will need serious reexamination. Unfortunately, these are also areas that will take a great deal of political courage to confront — courage that has seemed to be in short supply in recent years.

- **Medicaid** — North Carolina spends far more than comparable states on this program, offering a basic benefits package that has greater coverage than the typical private plan. As the nearby table shows, General Fund authorizations for Medicaid grew by a staggering 224 percent over the past decade, to nearly \$2.2 billion. In spite of this there is no evidence that lower-income North Carolinians are significantly healthier or receive better care than their counterparts in other states.
- **Education** — Again, North Carolina spends more on education than most comparable states do — particularly at the college and university level — without measurable results to show for it. State leaders need to reconsider their allocation of education dollars. This should include a serious reevaluation of Smart Start and other preschool programs, as well as the state's policy of holding community college and university tuition so low that relatively wealthy students benefit at the expense of less-educated taxpayers and are taking too long to graduate, if they ever do.
- **Public employees** — North Carolina has the most state and local employees per capita in the Southeast and exceeds the national average, with real salaries close to regional norms. The best way to pay our valuable state employees more, and improve our retention of them, is to reduce the number of state employees elsewhere in government.
- **Debt burden** —The cost of debt service has nearly tripled in just 10 years. Clearly, political promises made in 1998 and 2000 to fund new debt for water projects and college construction without tax hikes cannot be kept.



Reestablishing Basic Principles for Fiscal Integrity

Over the years, budget-savings proposals published by the John Locke Foundation have been based on a set of constitutional principles regarding the proper role of state government. These include the provision of public safety and education and a sound infrastructure to meet the state's transportation needs. The state's role in other sectors should be considered for either reduction or elimination. And even in those areas where the state has a constitutional role, state activities could be run at lower cost with better results. By applying these principles, we have suggested areas where billions of dollars in General Fund savings could be realized. These include, but are not limited to, the following major recommendations:

- **End corporate socialism.** North Carolina is foolishly attempting central planning of the state's economy by granting subsidies to favored businesses. These subsidies should be abolished, including all business assistance, marketing, and recruitment programs; the recently passed "Stimulus and Job Creation Act"; the Global TransPark; and the Golden LEAF Foundation. The best way to improve North Carolina's economy is to improve basic services and reduce marginal tax rates.

Growth in NC General Fund Spending in Past 10 Years

(Authorization in Current Dollars)

State Department or Agency	FY 1992-93	FY 2002-03	Amount of Change	% Change
Public Schools	\$3,433,952,028	\$5,894,553,493	\$2,460,601,465	71.7%
Community Colleges	\$398,383,365	\$669,281,390	\$270,898,025	68.0%
UNC System	\$1,173,904,861	\$1,768,097,109	\$594,192,248	50.6%
<i>Total Education</i>	\$5,006,240,254	\$8,331,931,992	\$3,325,691,738	66.4%
Medicaid	\$675,014,762	\$2,189,813,795	\$1,514,799,033	224.4%
Social Services	\$169,503,805	\$180,580,506	\$11,076,701	6.5%
Mental Health/DD/Substance Abuse	\$226,813,200	\$573,361,612	\$346,548,412	152.8%
Child Develop. (inc. Smart Start)*	—	\$281,830,361	\$281,830,361	—
Child Health Insur. (Health Choice)	—	\$45,058,178	\$45,058,178	—
Other HHS programs*	\$281,823,929	\$325,784,197	\$43,960,268	15.6%
<i>Total Health & Human Services</i>	\$1,401,944,328	\$3,596,428,649	\$2,194,484,321	156.5%
Correction	\$508,384,381	\$880,054,808	\$371,670,427	73.1%
Crime Control & Public Safety	\$26,648,835	\$27,780,188	\$1,131,353	4.2%
Judicial Department	\$224,023,518	\$371,923,070	\$147,899,552	66.0%
Attorney General	\$50,227,944	\$70,938,193	\$20,710,249	41.2%
Juvenile Justice*	\$48,788,632	\$128,984,633	\$80,196,001	164.4%
<i>Total Public Safety</i>	\$858,073,310	\$1,479,680,892	\$621,607,582	72.4%
Environment & Natural Resources	\$189,865,134	\$215,318,587	\$25,453,453	13.4%
Administration*	\$52,611,415	\$55,943,188	\$3,331,773	6.3%
Commerce	\$55,910,030	\$54,525,583	-\$1,384,447	-2.5%
Agriculture	\$39,916,693	\$50,445,582	\$10,528,889	26.4%
Cultural Resources	\$39,982,473	\$57,525,447	\$17,542,974	43.9%
General Assembly	\$21,546,954	\$36,899,614	\$15,352,660	71.3%
Governor's Office	\$9,427,485	\$13,173,191	\$3,745,706	39.7%
Revenue	\$53,053,677	\$75,571,304	\$22,517,627	42.4%
Debt Service	\$89,020,478	\$255,672,808	\$166,652,330	187.2%
All Other GF Spending	\$155,121,521	\$126,656,820	-\$28,464,701	-18.3%
Total GF Authorization	\$7,972,713,752	\$14,349,773,657	\$6,377,059,905	80.0%
<i>Compared to These Spending-Limit Options:</i>				
Allow only for inflation, population growth	\$7,972,713,752	\$11,637,205,063	\$3,664,491,311	46.0%
Also allow for Medicaid, edu. enrollment	\$7,972,713,752	\$12,088,211,506	\$4,115,497,754	51.6%

* Includes items that have moved between agencies during the period. Sources: NC Office of State Budget, Planning, & Management; NCGA Fiscal Research Division; UNC General Administration; NC Board of Community Colleges; NC Department of Public Instruction.

- **Increase user responsibility.** Require those who use non-entitlement public services to cover a larger share of their cost. Examples include agricultural programs and higher tuition in the UNC and community college systems, where taxpayers subsidize students at a rate much higher than the national average with no discernible difference in quality or outcomes.
- **Prioritize teaching positions.** Reduce or eliminate items in the public schools, community colleges, and universities that do not fund professional classroom instruction. Reducing teacher assistants and support service positions could free up tens of millions for teacher hires and pay hikes.
- **Rethink Medicaid.** North Carolina can realize significant savings through adjustments in services, payment structures, and reimbursements. State Treasurer Richard Moore has called our program the “Cadillac” of Medicaid programs. Hundreds of million of dollars can be saved by bringing our state's program in line with that of its neighbors.
- **Reorganize state government.** Create two new public safety and financial departments to replace six existing ones and merge the Highway Patrol, the State Bureau of Investigation, and other units to form a single police force. The Commonwealth of Virginia provides a comparable array of state services to roughly the same population that the State of North Carolina does, but it does so by employing fewer than half the number of major state agencies and departments.
- **Set firm priorities.** We propose eliminating most state support for arts groups, increasing user fees for cultural and recreational sites run by the state, ending state funding to purely local projects and initiatives, and requiring research activities inside and outside the UNC system to pay more of their own way.
- **Reduce debt service.** We propose suspending issuance of all new state bonds and privatizing state-owned transportation assets, such as the state-owned ports and railroad. The proceeds should be used to buy down existing debt, realizing long-term savings.

Conclusion

The Locke Foundation’s alternative budget that was proposed during last year’s debates and released in May 2002, *Changing Course V*, can be found on the Internet at www.JohnLocke.org. A new alternative budget for the 2003-05 biennium will be published shortly after the governor’s budget recommendations are released. The ongoing state budget crisis in North Carolina presents an opportunity for lawmakers to rethink fundamentals and return to the vision of limited government that is clearly expressed in North Carolina’s constitution. If this is done lawmakers will have no problem avoiding tax increases or local-revenue grabs and indeed will find that substantial tax cuts are possible. As the nearby graphs illustrate, this policy alternative includes among its many virtues the strong support of most North Carolina voters.

— Dr. Roy Cordato, Vice President for Research and Resident Scholar

