

ANOTHER RICKETY BUDGET

House Plan Follows Senate Lead on Future Tax Hike

Summary: At this writing, the N.C. House is considering a revised General Fund budget of \$14.3 billion, balanced largely by raising state taxes by \$166 million, raiding \$255 million from highway funds and \$156 million from local governments, and achieving net budget savings of \$478 million. Unfortunately, the news for taxpayers is likely to be worse next year, given the use of some \$666 million in one-time money for expenses likely to recur — setting the stage for another tax increase.

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Like the Senate's budget revisions, enacted in June, the House plan for a \$14.3 billion revised General Fund budget includes dozens of excellent ideas for reducing the size and scope of state government. Some of these, including redirection of public school and university dollars and the merging of several divisions and agencies, were included in the John Locke Foundation's alternative budget plan, *Changing Course V*, released earlier this year.

Unfortunately, the House majority has also followed the Senate's lead by tapping hundreds of millions of dollars in nonrecurring savings and fund transfers in order to fund expenditures likely to recur in FY 2003-04. Although less than the Senate's roughly \$800 million, the House's use of approximately \$666 million of such items to balance the FY 2002-03 budget merely delays a fiscal reckoning until the 2003 session, when all indications are that another massive tax increase (perhaps in the guise of a "tax-reform" bill) would be contemplated to cover all or most of this budget gap.

Such ideas as tapping unspent Hurricane Floyd funds (\$120 million) and proceeds from the national tobacco settlement (\$152 million) may be good ideas, but they should have been accompanied with iron-clad changes in spending policy to convert ongoing programs into nonrecurring ones, perhaps as part of a plan to phase the expenditures out over time. As is, the House budget, like its Senate predecessor, includes the equivalent of a promissory note for a costly tax increase in 2003.

Revenue Increases Included for FY 2002-03

Also troubling is how the House plan increases taxes to fund the 2002-03 budget. It includes about \$166 million in net state tax increases, including the repeal of previ-

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ously scheduled tax cuts (\$51.7 million) and new tax burdens on businesses (\$139.2 million). The latter would come in the midst of a painful economic recession in North Carolina, which now has the third-highest unemployment rate in the United States. Although its impact is softened a little by some offsetting tax reductions, primarily to reconcile state taxes to the federal tax code, the package will weaken the state's already shaky economic recovery, reducing job creation and income growth.

Moreover, local governments will lose about \$156 million in scheduled tax reimbursements in 2002-03, after accounting for the swap of a half-cent sales tax in mid-year (\$158 million) and a partial hold-harmless provision for the elimination of the reimbursements (\$333.4 million). Based on published information and interviews with county officials across the state, we estimate that at least \$60 million in local property tax increases in 2002-03 will be attributable to this policy decision, adding another costly layer of taxation in a state that already imposes the second-highest tax burden in the Southeast.

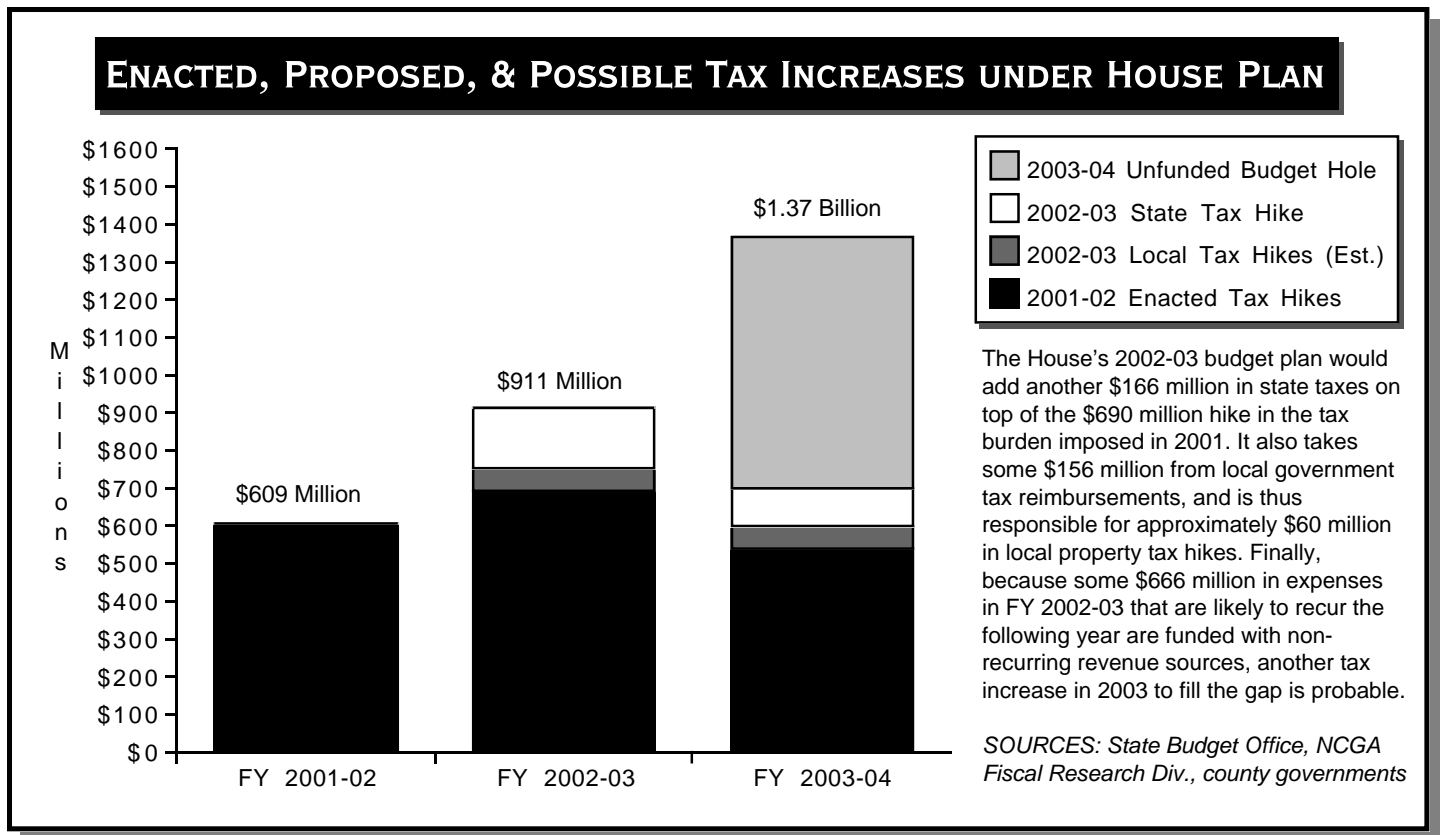
Another move with profound economic consequences will be the House plan's provision to raid \$255 million from the state's highway funds, on top of the more than \$200 million a year already transferred from the taxes and fees paid by highway users to fund non-highway purposes. The condition of North Carolina's highway system deteriorated significantly in recent years, and is only now starting to improve. Congestion is also a major problem in the state's major metropolitan areas. Both transportation problems will hamper economic recovery without attention, and the House budget revisions will go in the opposite — and wrong — direction.

Finally, the House plan relies on an upward revision of \$50 million in expected tax revenues from the current tax structure. The governor's proposed 2002-03 budget and the Senate plan used a lower, more conservative number, and it would seem to be unwise to make optimistic forecasts about tax revenues in the current economic climate.

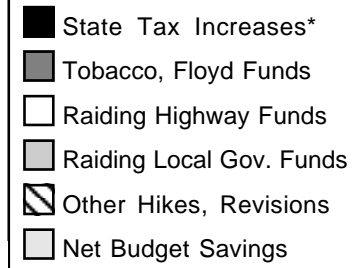
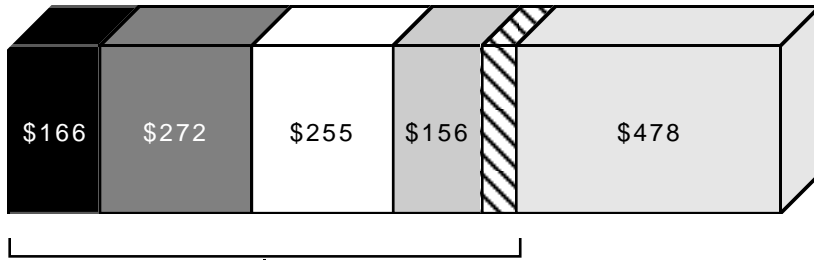
Conclusion

There is much to like about the House plan's identification of real savings in the state budget. But appropriations leaders failed to go far enough in reducing the size and scope of state government, preferring to close most of the expected \$1.4 billion budget deficit in FY 2002-03 largely through tax and revenue increases at the state and local levels. The taxpayers of the state deserve to have their interests considered carefully in the budget deliberations and negotiations to come.

— John Hood, President



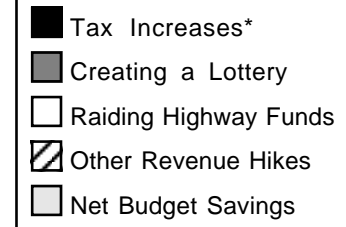
HOW THE HOUSE PLAN CLOSES STATE BUDGET GAP. . .



Total New Gen. Fund Revenue: \$911 million

* Includes business tax hikes and repeal of 2001 tax cuts.
 DATA SOURCE: Fiscal Research Division, N.C. General Assembly

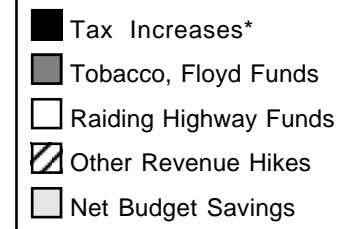
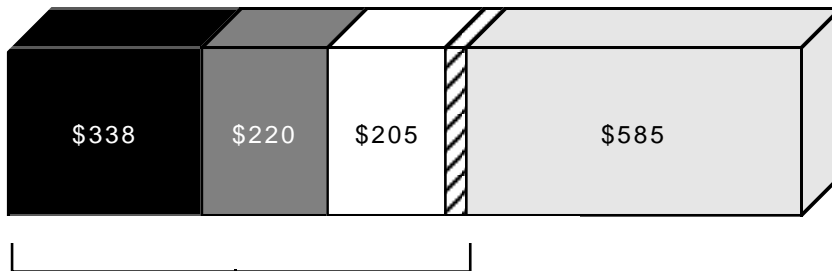
. . . COMPARED TO EASLEY'S PLAN TO CLOSE THE GAP. . .



Total New Gen. Fund Revenue: \$938 million

* Includes "local" sales tax hike and repeal of 2001 tax cuts.
 DATA SOURCE: Office of State Budget, Planning & Management

. . . AND THE SENATE PLAN TO CLOSE THE GAP



Total New GF Revenue: \$800 million

* Includes net from "local" sales tax hike and repeal of tax cuts.
 DATA SOURCE: Fiscal Research Division, N.C. General Assembly