

spotlight

No. 424 – June 28, 2012

ONE WAY STREET FOR SPENDING ADJUSTMENTS

Reverse Logrolling Offers an Alternative

KEY FACTS: • The General Fund portion of North Carolina's \$51.7 billion state budget for 2013 is now \$20.18 billion, as passed by both the House and the Senate. This exceeds planned spending, as passed in 2011, by \$242.2 million, but it does not necessitate a tax increase.¹

- All of this year's General Fund proposals from the House, Senate, and governor have been for more spending than planned. The governor was the most extreme in this regard, proposing a sales tax increase from 4.75 to 5.5 percent and spending increase of \$969.6 million.

- Tax revenues for fiscal year 2012 proved greater than projected by \$232.5 million. The Fiscal Research Division also predicts slightly higher than expected revenues for the coming year, \$21.0 million, for a two-year total of \$253.5 million over previous projections.

- North Carolina's Rainy Day Fund is just 1.6 percent of the General Fund, but legislators have approved spending 95.6 percent of the revenue surplus.

- By taking the lower cost of each General Fund component from the House and Senate proposals — "reverse logrolling" — with a couple of exceptions, one could achieve a General Fund total of \$19.85 billion. That would save \$330 million from the enacted General Fund and \$87 million from last year's plan.

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regardless of whatever debate has occurred over the state's General Fund budget for 2012-2013, all of the latest legislative proposals have been in one direction: more spending than planned.

Prior to this session, the state had a \$19.94 billion General Fund budget in place — approximately equal to the \$19.68 billion of 2011-2012. In nominal terms, it was an increase of 1.2 percent. However, projected inflation of 2.3 percent would convert the value to a 0.9 percent decrease. Either way, this budget would have essentially continued this year's spending levels.

The past year saw more revenues come in than projected, though — \$232.5 million worth. More precisely, revenues from personal and corporate income taxes have been higher than projected and offset lower sales tax revenues.

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When combined with a slightly higher forecast for the coming year, \$253.5 million was on the table when legislators entered the short 2012 session.²

Legislators had a variety of pressing uses for the money, including the state's perilously low Rainy Day Fund (1.6 percent of the General Fund) and the more than \$34 billion of unfunded, state employee health care liabilities.³ Otherwise, they could have held the surplus over to assist with tax reform in next year's long-session.⁴

The response from both sides of the aisle, however, has been a resounding, "Let's spend it!" The General Fund, now passed by both chambers, includes \$20.18 billion of spending — an increase equal to 95.6 percent of the updated tax revenues. This increase came almost exclusively from \$320 million in new spending for education and health and human services, offset by reductions in other areas such as debt servicing and public safety.

Such an increase was not necessary. In the case of education, for example, North Carolina already has one of the world's highest levels of per-student expenditures, and there is no evidence among developed nations that higher per-student spending will improve performance.⁵ In fact, legislators could have saved money on last year's plan. Consider the reverse logrolling approach as an alternative.

"Logrolling" refers to the tendency of legislators to trade support for each other's proposed earmark or favored spending programs, thus ratcheting up support for what might otherwise only appeal to a minority.⁶ Typically logrolling results in increased spending. So, for our purposes, "reverse logrolling" as applied to the General Fund reflects savings from the best of the original House and Senate proposals. In other words, each program with support in both legislative chambers would remain funded, merely with the lower funding level of the two proposals. This approach, had it been enacted, would have saved \$330 million from the now-passed bill and \$87 million from the default plan which passed last year.

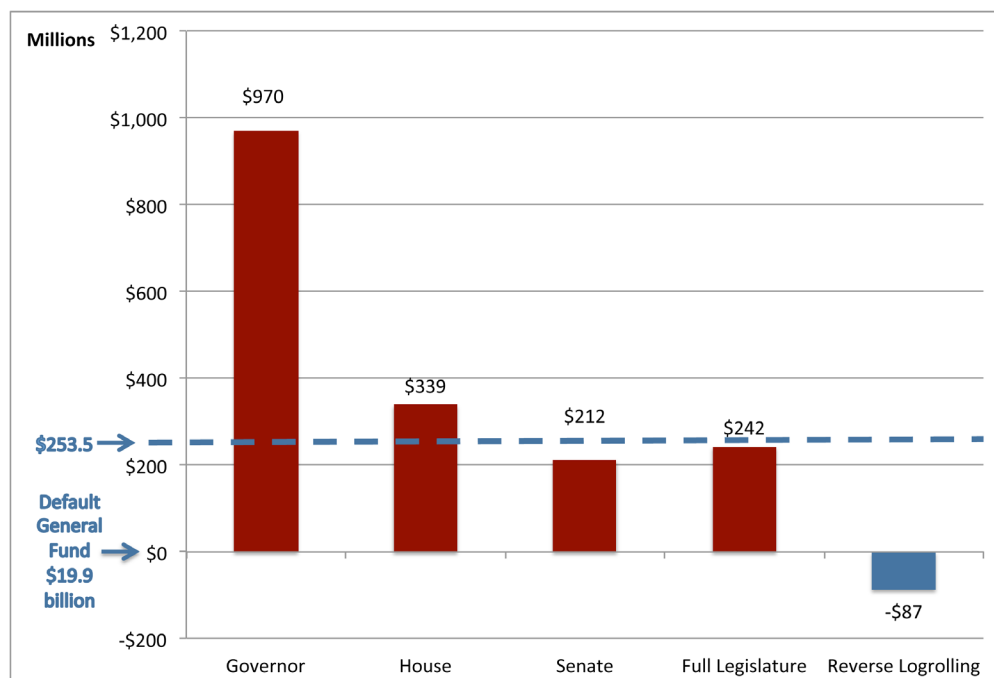
The reverse logrolling's General Fund number of \$19.85 billion, as noted above, also includes two components that might otherwise have been left out of the formula, one being \$11.1 million of compensation for North Carolina's living victims of sterilization.⁷ Additionally, since each chamber's General Fund proposal included a form of compensation bonus for state employees, I have placed one of the two into the reverse logrolling total. That is despite the two bonus plans having different approaches and being labeled differently. Their effectiveness at either attracting new talent

or rewarding high performance remains doubtful.⁸

While the reverse logrolling calculation as presented above is not ideal, it highlights the flexibility that legislators have to work with. The key point is that savings were plausible, even if legislators merely picked the best of each of the North Carolina chambers' proposals.

The rejection of savings and the prevailing General Fund plan will also have tax consequences. North Carolina legislators may not have passed an explicit tax increase this session, but all spending must be paid for, even if deferred. That means there will be less room for

Adjustments for the 2012-2013 General Fund



tax reform, given fewer reserves carried over, and the lack of a substantial rainy day fund may even compel new or higher taxes in the future.

General Fund Budget Proposals for 2012-2013 (\$ millions)⁹

Approved in 2011	Governor	House	Senate	Ratified Budget	Reverse Logrolling	Forgone Savings
\$19,937	\$20,907	\$20,276	\$20,149	\$20,180	\$19,850	\$330

Recommendations:

- The dire condition of the state's finances and record spending levels, both in per capita and percentage-of-income terms, means that all proposed spending increases ought to be met with great scrutiny and avoided where possible.¹⁰
- The consistent tendency for legislators to spend rather than pay off debt with new revenue indicates the need for structural change. Ideally, this would be a Taxpayer Bill of Rights, a set of constitutional constraints requiring all spending increases beyond population and inflation growth to have voter approval.
- The General Fund's declining proportion of total state spending — 38 percent in 2012, down from 59 percent in 2000 — merits cognizance in both reporting and debate.¹¹ A simple addition of total projected spending in the committee reports, as it appears in the post legislative budget summary, would assist in this regard.

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2. Barry Boardman, "General Fund Revenue Report and Economic Outlook," Fiscal Research Division, North Carolina General Assembly, http://www.ncleg.net/fiscalresearch/generalfund_outlook/generalfund_outlook_pdfs/2012_Outlooks/General_Fund_Revenue_Outlook_2012-05-14_May.pdf, accessed June 25, 2012.
3. Op. cit. note 1, p. 5.
4. Richard Bostic, "North Carolina Savings Reserve Account," Fiscal Research Division, North Carolina General Assembly, http://www.ncleg.net/fiscalresearch/frd_reports/issue_briefs/Savings_Reserve_Issue_Brief_2012.pdf, accessed June 25, 2012.
5. Terry Stoops, "North Carolina vs. the World: Comparisons of educational inputs and outcomes," John Locke Foundation, <http://johnlocke.org/research/show/spotlights/270>, accessed June 26, 2012.
6. Paul Johnson, "Logrolling," A Glossary of Political Economy Terms, <http://www.auburn.edu/~johnspm/gloss/logrolling>, accessed June 26, 2012.
7. Jon Sanders, "No compensation this year for North Carolina's forcible sterilization victims," John Locke Foundation, <http://johnlocke.org/newsletters/research/2012-06-21-14i3bu2bui5hasmra7ss3je8r2-regulation-update.html>, accessed June 25, 2012. Daren Bakst, "North Carolina's Forced Sterilization Program: A Case for Compensating Living Victims," John Locke Foundation, <http://www.johnlocke.org/research/show/policy%20reports/233>, accessed June 26, 2012. John Hood, "Missed Opportunity on Eugenics," John Locke Foundation, http://www.carolinajournal.com/jhdailyjournal/display_jhdailyjournal.html?id=9233, accessed June 26, 2012.
8. Joe Coletti, "Compensation Model Cannot Keep Good State Employees," John Locke Foundation, <http://www.johnlocke.org/research/show/spotlights/136>, accessed June 26, 2012.
9. NC General Assembly, Committee Reports on the "Continuation, Expansion and Capital Budgets for House Bill 950," <http://www.ncleg.net/>, accessed June 25, 2012. Beverly Perdue, "Investing in Our Future," Office of State Budget and Management, Office of the Governor, <http://osbm.nc.gov/thebudget>, accessed June 26, 2012.
10. Op. cit. note 1, p. 1.
11. Ibid.

Appendix: Summary of General Fund Appropriations Fiscal Year 2012-2013

	Approved Budget:		Conference
	2011 session	Reverse Logrolling	Committee Proposal
<u>Education</u>			
Community Colleges	985,000,000	980,822,477	990,165,000
Public Education	7,444,122,100	7,478,264,218	7,506,553,067
University System	2,551,672,698	2,562,230,839	2,575,781,169
Total Education	10,980,794,798	11,021,317,534	11,072,499,236
<u>Health and Human Services</u>			
Central Management and Support	44,577,987	15,880,642	45,885,628
Aging and Adult Services	37,019,667	38,519,667	87,019,667
Blind and Deaf/Hard of Hearing Services	8,372,886	8,204,550	8,204,550
Child Development	266,102,933	256,102,933	262,602,933
Health Service Regulation	16,133,031	16,133,031	17,925,590
Medical Assistance	2,907,276,302	3,037,547,318	3,101,448,568
Mental Health, Dev. Disabilities and Sub. Abuse	710,712,232	713,958,186	695,515,251
NC Health Choice	83,717,865	81,710,435	81,710,435
Public Health	157,538,834	162,616,284	168,923,612
Social Services	186,183,068	177,103,952	177,103,952
Vocational Rehabilitation	37,528,128	37,528,128	37,528,128
Total Health and Human Services	4,455,162,933	4,545,305,126	4,683,868,314
<u>Justice and Public Safety</u>			
Public Safety	1,694,715,876	1,659,278,368	1,662,484,741
Judicial Department	435,141,107	430,861,758	432,806,800
Judicial - Indigent Defense	112,748,773	112,748,733	112,748,733
Justice	80,864,138	74,489,075	74,196,634
Total Justice and Public Safety	2,323,469,854	2,277,377,934	2,282,236,908
<u>Natural & Economic Resources</u>			
Agriculture & Consumer Services	62,198,634	107,993,258	109,561,466
Commerce	33,250,463	45,301,053	40,721,825
Commerce-State Aid	30,151,984	27,308,944	28,934,444
Environment and Natural Resources	148,148,105	103,279,160	108,808,817
Clean Water Mgmt. Trust Fund	11,250,000	11,250,000	10,750,000
Labor	15,836,887	15,520,149	15,520,149
NC Biotechnology Center	17,551,710	17,200,676	17,200,676
Rural Economic Development Center	25,376,729	18,369,194	21,619,194
Wildlife Resources Commission	17,221,179	17,655,576	17,655,576
Total Natural and Economic Resources	360,985,691	363,878,010	370,772,147
<u>General Government</u>			
Administration	66,353,073	65,350,406	66,328,212
Auditor	10,676,035	10,462,514	10,462,514
Cultural Resources	61,697,001	60,463,061	61,398,135
Cultural Resources-Roanoke Island	1,203,491	873,491	903,491

General Assembly	50,104,208	51,674,630	51,674,630
Governor	4,741,157	4,646,334	4,646,334
Housing Finance Agency	9,673,051	1,608,417	1,608,417
Insurance	36,393,921	36,320,371	36,852,976
Insurance-Worker's Compensation Fund	2,623,654	2,623,654	2,623,654
Lieutenant Governor	695,324	551,174	551,174
Office of Administrative Hearings	4,142,258	4,059,413	4,142,258
Revenue	78,199,538	76,635,547	76,635,547
Secretary of State	10,654,563	10,441,472	11,421,224
State Board of Elections	5,126,603	5,588,007	5,024,071
State Budget and Management (OSMB)	5,848,663	5,559,751	5,731,690
OSMB-Special Appropriations	440,612	379,000	1,879,000
State Controller	28,368,957	29,148,975	29,949,369
Treasurer-Operations	6,621,750	6,621,750	6,621,750
Treasurer-Fire/Rescue Retirement	17,812,114	17,812,114	17,812,114
Total General Government	401,375,973	390,820,081	396,266,560

Debt Service and Statewide Resources

Debt Service:

Interest/Redemption	759,984,974	707,080,339	707,080,339
Federal Reimbursement	1,616,380	1,616,380	1,616,380
Subtotal Debt Service	761,601,354	708,696,719	708,696,719

Statewide Reserves:

Contingency and Emergency Fund	5,000,000	5,000,000	5,000,000
Information Technology Fund	6,158,142	5,408,142	5,408,142
Job Development Investment Grants	27,400,000	20,900,000	20,900,000
State Retirement System Contributions	336,000,000	273,700,000	336,000,000
Judicial Retirement System Contribution	7,800,000	7,800,000	7,900,000
Firemen and Rescue Squad Workers Pension Fund	5,366,928	5,366,928	5,366,928
State Health Plan	102,151,104	102,151,104	102,151,104
Continuation/Justification Review Reserve	35,576,758	0	0
Compensation Bonus Reserve*	121,105,840	79,086,788	159,984,426
Disability Income Plan of North Carolina**	0	0	-8,688,000
Automated Fraud Detection Development	7,000,000	7,000,000	7,000,000
Controller Fraud Detection Development	500,000	500,000	500,000
One North Carolina Fund	0	0	9,000,000
VIPER Reserve	0	20,000,000	10,000,000
Eugenics Reserve Fund	0	11,050,000	0
Subtotal Statewide Reserves	654,058,772	537,962,962	660,522,600
Total Reserves and Debt Service	1,415,660,126	1,246,659,681	1,369,219,319

Total General Fund for Operations	19,937,449,375	19,845,358,366	20,174,862,484
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Capital Improvements

Water Resources Development Projects	0	5,000,000	5,000,000
Total Capital Improvements	0	5,000,000	5,000,000

Total General Fund Budget	19,937,449,375	19,850,358,366	20,179,862,484
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*Each budget had money available for slightly different bonus plans. I have taken the smaller of the two programs, rather than rule out both of them.

**I did not include the taking of money from the Disability Income Plan as negative spending.