

spotlight

No. 442 – July 24, 2013

BUDGET BASICS

Sustaining the present, preserving the future

KEY FACTS: • **General Fund spending totals \$20.6 billion for fiscal year 2013-14, only a 2.5 percent increase from the previous year.**

• **Medicaid accounts for the largest increase in spending, almost \$1 billion over the two-year budget.**

• **Tax reform saves taxpayers more than half-a-billion dollars over the two years and makes North Carolina more competitive relative to neighboring states.**

• **Education reforms create new opportunity scholarships for low-income students and end teacher tenure.**

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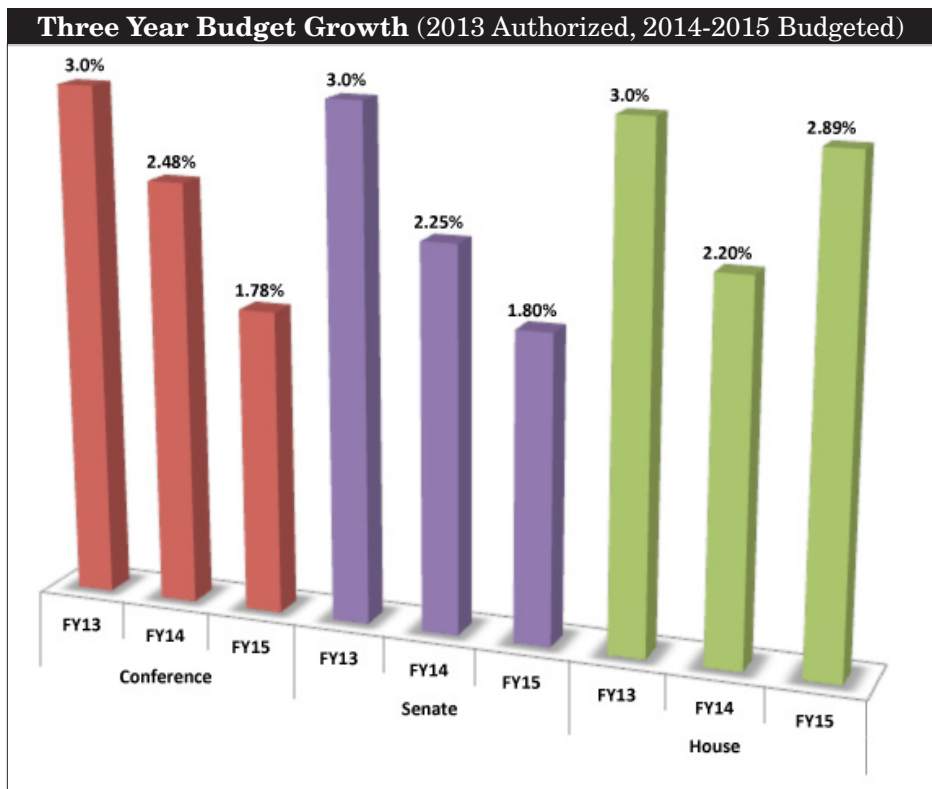
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more >>

State-only funding in the budget climbs 2.5 percent to \$20.6 billion for fiscal year 2013-14 and to \$20.9 billion for FY 2014-2015. Although this budget includes major policy changes, there are no drastic increases in spending as seen in previous years. Legislators saw what would be the driver for this budget early when an audit of the Health and Human Services Department showed Medicaid had been improperly budgeted for many years and had repeatedly overspent its budget. Gov. McCrory addressed the Medicaid shortfall of \$120 million in his budget recommendation, and by the time the Senate released their version the Medicaid shortfall had grown to more than \$300 million.



To account for the growing demand from Health and Human Services, cuts in other areas were required to fund necessary government operations. Lawmakers changed a number of items in the education budget, creating more transparency and allowing parents more choice in the education of their children. Cutbacks were made in a number of departments to create more accountability in how state funds are spent, update the state's outdated information technology infrastructure, and continue to fund the state employees' pension and health plans. Tax reform reduced the funds available, but allowed taxpayers to save money and have tax rates that are more competitive with those of neighboring states.

Education

Education spending makes up 56% of the total General Fund, amounting to more than \$11.4 billion each year of the biennium. That represents a spending increase of \$400 million from 2012-13 to 2013-14. Many sound, research-based policy reforms are included in the budget. If implemented correctly, these reforms are likely to produce positive gains in student achievement.

An idea that has been considered for many years, the opportunity scholarship, has finally been incorporated into this year's budget. This is a private school scholarship program that will provide \$4,200 vouchers on an annual basis to a small number of low-income students. Fiscally will not have a significant impact on the budget, only costing \$10 million in FY 2014-15. It is not expected to have its full budgetary effect for three years. Within the education research community, there is a consensus that school choice raises student achievement for the average participating student.¹ Over time, the incorporation of the opportunity scholarship in North Carolina has the potential to provide better options for low-income students, while spending tax dollars more efficiently.

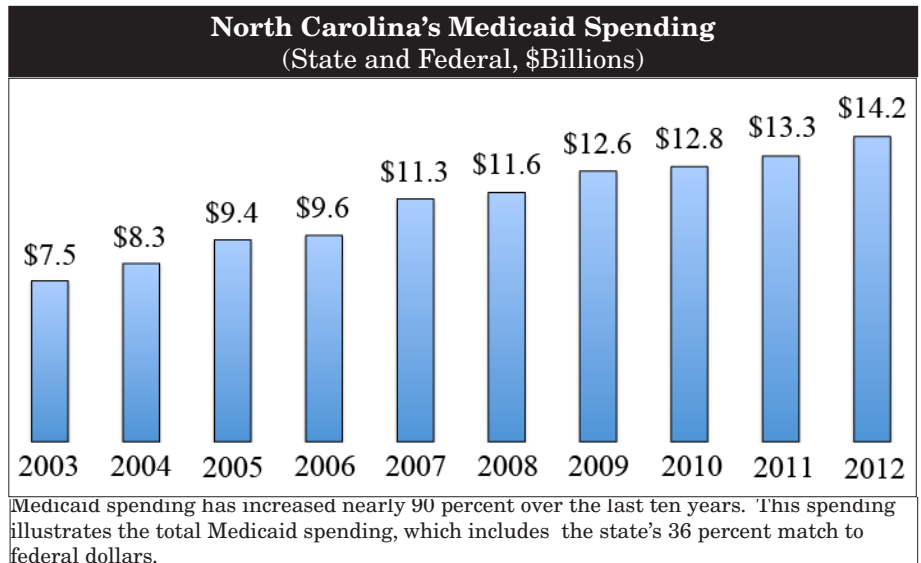
In an effort to raise the quality of instructional personnel, the budget eliminates teacher tenure and lays the groundwork for a performance pay program that will allow superintendents to provide annual pay rises to North

Carolina’s best teachers. This budget also focuses more dollars on recruiting and retaining high quality teachers through an aggressive expansion of Teach for America.*

Before Republicans took control of the state budget process, North Carolina public school districts employed over 26,000 teacher assistants, making them the third largest personnel category in North Carolina public schools.² Funding for teacher assistants is cut by 21% in FY 2013-14 and 19% in FY 2014-15 in grades K-3 only, for a total two-year cut of \$230 million. The decision for this cut was made using over ten years of rigorous peer-reviewed studies conducted on the presence of teacher assistants and other paraprofessionals in the classroom. These studies have demonstrated that additional staff in the classroom do little to increase student achievement.³

Medicaid

Medicaid was created in the 1960s as a program jointly funded by both the state and federal governments to provide medical care for underprivileged citizens. Since then, Medicaid has grown to become the second largest line item in North Carolina’s budget behind public education. Enrollment in North Carolina’s Medicaid program now includes more than 1.5 million people, and spending has grown by nearly 90 percent over the last ten years.⁴



When the budget process for this biennium began, Gov. McCrory was confronted with a Medicaid shortfall of about \$120 million left over from the previous governor’s administration. As the budget process progressed towards the end of the fiscal year, more money was needed to fill the shortfall. It eventually amounted to more than \$330 million. This has become the new normal. Medicaid funding in each of the last four fiscal years has exceeded its appropriated budget by an average of 11 percent.⁵ Between fiscal years 2009 and 2012, Medicaid spending exceeded the approved budget by a combined \$5.4 billion.⁶

Medicaid attracts the largest increase in spending of any item in the General Fund budget. “Medicaid is driving everything in this state budget. These funds coming out are controlling what we do in education, what we do in transportation and highways,” said the Senate Budget Health Subcommittee Chairman⁷ when asked about Medicaid in the budget. Over the two-year period, this spending increase amounts to almost \$1 billion in required funds to keep Medicaid at current operating levels.

Tax Reform

North Carolina’s current tax code was written in the 1930s and is structured around a manufacturing and agricultural economy. Change has been needed for some time, and this budget incorporates the changes the legislature made earlier in the session. The budget adjusts available spending by \$86.6 million in the first year and \$437.8 million in the second, for a two year impact of over half a billion dollars in tax cuts. This was made possible through a small broadening of the sales tax base and cuts to both the personal and corporate income tax rates.

* Teach for America is an organization that places high-achieving recent college graduates and professionals into low-income and rural communities to teach for a two-year commitment.

Legislators and policy advocates alike have been lobbying for a change to the tax code for many years. The code has become inundated with special provisions and loopholes that are not transparent and do not attract new businesses and job growth. North Carolina had both the highest marginal income tax rate in the southeast and the highest corporate income tax rate. Incorporating the changes of the tax reform plan, North Carolina will have a flat 5.75 percent personal income tax rate and a corporate income tax rate of 5 percent by 2015. Over time these rates will make North Carolina more competitive with neighboring states and create an improved business climate, which will promote job growth and economic prosperity.

Conclusion

The General Assembly will accomplish its most important task this year over the next few days, passing a budget that will decrease projected spending and cut taxes. Given the situation inherited from the previous administration, this budget offers the best possible solution to the Medicaid problem while redirecting funds to the most needed areas of state government. Fiscal responsibility was the overwhelming theme of this budget, a refreshing change from budgets in the past.



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Endnotes

1. Terry Stoops, "School Vouchers: From Friedland to the Finish Line," The John Locke Foundation, *Spotlight*, March 11, 2013, page 1, johnlocke.org/research/show/spotlights/280
2. Terry Stoops, "Teacher Assistants and Student Performance: What does the research say?" The John Locke Foundation, April 19th, 2011, johnlocke.org/newsletters/research/2011-04-19-3nug9foam3cuonmodb1up4p2h1-edu-update.html
3. *Ibid.*
4. Katherine Restrepo, "The Partnership for a Healthy North Carolina," The John Locke Foundation, *Spotlight*, pages 4- 5, johnlocke.org/research/show/policy%20reports/253
5. *Ibid.*
6. *Ibid.*
7. Laura Leslie, "Senate Leaders: 'Medicaid is driving' state budget," WRAL News at the NC Capital, May 20, 2013, wral.com/senate-leaders-medicaid-is-driving-state-budget-/12467067/

2013 Conference Budget						
	Senate Budget 2013-14	House Budget 2013-14	Conference Report 2013-14	Senate Budget 2014-15	House Budget 2014-15	Conference Report 2014-15
Education						
Community Colleges	1,026,315,467	1,012,637,467	1,021,295,467	1,014,315,467	1,009,089,167	1,016,487,467
Public Instruction	7,849,691,842	7,905,610,301	7,867,960,649	8,032,588,328	8,044,189,900	8,048,101,622
The University System	2,613,364,593	2,560,018,594	2,583,048,270	2,627,869,160	2,586,827,274	2,599,901,709
Total Education	11,489,371,902	11,478,266,362	11,472,304,386	11,674,772,955	11,640,106,341	11,664,490,798
Health and Human Services						
Central Management and Support	65,069,146	76,923,179	73,786,129	62,655,211	66,509,244	76,301,328
Aging and Adult Services	54,142,341	54,142,341	54,142,341	54,342,341	54,342,341	54,342,341
Blind, Deaf/Hard of Hearing Services	8,178,618	8,178,618	8,178,618	8,178,618	8,178,618	8,178,618
Child Development, Early Education	255,039,269	255,163,458	254,314,609	255,039,269	255,039,269	254,314,609
Health Service Regulation	15,822,840	16,461,992	16,396,057	15,818,506	16,461,992	16,411,479
Medicaid	3,484,745,754	3,480,934,464	3,461,950,119	3,655,086,552	3,686,420,040	3,608,119,091
Mental Health, Developmental Disability, & Substance Abuse Svcs.	675,738,286	704,649,959	699,535,602	678,592,084	710,154,345	704,985,988
NC Health Choice	67,177,341	68,146,401	67,949,160	56,281,405	57,830,737	57,747,933
Public Health	147,178,997	142,616,502	144,154,087	144,980,498	140,616,502	141,941,587
Social Services	172,455,677	174,595,707	174,608,432	172,519,249	174,897,036	176,558,432
Vocational Rehabilitation	38,773,169	38,773,169	38,773,169	38,773,169	38,773,169	38,773,169
Total Health & Human Services	4,984,321,438	5,020,585,790	4,993,788,323	5,142,266,902	5,209,223,293	5,137,674,575
Justice and Public Safety						
Public Safety	1,712,621,317	1,704,408,481	1,716,893,395	1,692,187,988	1,686,128,353	1,690,014,006
Judicial	456,876,742	457,653,356	456,926,252	455,376,742	457,153,356	456,426,252
Judicial - Indigent Defense	114,357,264	116,160,223	115,129,423	109,357,264	112,016,064	111,357,264
Justice	47,476,998	76,774,782	79,726,123	51,365,574	79,663,358	82,308,926
Total Justice and Public Safety	2,331,332,321	2,354,996,842	2,368,675,193	2,308,287,568	2,334,961,131	2,340,106,448
Natural and Economic Resources						
Agriculture and Consumer Services	114,670,702	114,348,472	115,085,702	114,769,902	112,547,672	115,409,902
Commerce	42,661,856	39,979,793	51,228,804	45,692,759	41,316,766	56,733,282
Commerce - State Aid	9,505,810	43,192,758	21,723,226	9,255,810	43,018,126	15,624,767
Environment and Natural Resources	157,890,131	129,455,064	154,037,311	157,385,763	137,092,904	157,767,236
Clean Water Management Trust Fund	0	0	0	0	0	0
Labor	16,696,339	16,696,339	16,696,339	16,696,339	16,696,339	16,696,339
Wildlife Resources Commission	9,476,588	14,476,588	12,476,588	9,476,588	16,476,588	14,476,588
Total Natural & Economic Resources	350,901,426	358,149,014	371,247,970	353,277,161	367,148,395	376,708,114

2013 Conference Budget						
	Senate Budget 2013-14	House Budget 2013-14	Conference Report 2013-14	Senate Budget 2014-15	House Budget 2014-15	Conference Report 2014-15
General Government						
Administration	67,117,185	57,278,879	67,567,025	66,571,237	60,815,588	67,047,033
Auditor	11,217,468	11,013,547	11,217,468	11,217,468	11,013,547	11,217,468
Cultural Resources	62,934,497	63,129,602	63,670,145	61,426,429	62,679,605	63,008,100
Cultural Resources - Roanoke Island	0	450,000	450,000	0	450,000	450,000
General Assembly	51,449,283	52,010,818	52,087,986	51,484,767	51,572,599	51,634,767
Governor	5,120,050	5,170,050	5,170,050	5,122,132	5,172,132	5,172,132
Housing Finance Agency	8,499,464	8,411,632	8,411,632	8,499,464	6,704,921	8,411,632
Insurance	37,994,004	37,994,004	37,994,004	38,003,624	38,003,624	38,003,624
Insurance - Worker's Comp Fund	0	0	0	0	0	0
Lieutenant Governor	681,089	681,089	681,089	675,089	675,089	675,089
Office of Administrative Hearings	4,727,544	4,522,469	5,241,643	4,652,581	4,457,894	5,027,130
Revenue	85,336,745	80,235,417	80,998,918	85,317,085	80,222,072	80,896,458
Secretary of State	11,616,001	11,575,183	11,575,183	11,616,001	11,575,183	11,575,183
State Board of Elections	6,699,032	3,308,273	5,302,373	6,021,532	6,521,644	5,693,244
State Budget & Management	6,837,072	8,397,899	7,451,706	6,919,583	8,480,410	7,534,217
State Budget & Management, Special	1,800,000	3,000,000	4,912,000	1,500,000	1,500,000	1,520,000
State Controller	28,160,691	28,710,691	28,710,691	28,160,691	28,710,691	28,710,691
Treasurer - Operations	8,137,890	8,137,890	8,137,890	7,026,305	7,026,305	7,026,305
Treasurer - Retirement / Benefits	23,179,042	23,179,042	23,179,042	23,179,042	23,179,042	23,179,042
Total General Government	421,507,057	407,206,485	422,758,845	417,393,030	408,760,346	416,782,115
Subtotal Agency Budgets	19,577,434,144	19,619,204,493	19,628,774,717	19,895,997,616	19,960,199,506	19,935,762,050
Debt Service	726,674,176	673,747,014	709,197,014	747,088,218	690,047,935	725,337,659
Statewide Reserves	262,883,228	251,677,414	264,856,914	303,178,499	505,919,499	329,278,499
Total Capital Improvements	17,142,000	27,897,000	27,939,000	8,250,000	10,423,000	8,423,000
Total GF Appropriations	20,849,209,431	20,972,525,921	20,630,767,645	21,054,261,299	21,166,589,940	12751137