

spotlight

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START BUILDING A BETTER BUDGET

Seven steps to saner state spending

KEY FACTS: • Proposed spending for FY 2010 is \$20.4 billion, \$775 million more than actual spending FY 2009.

- Gov. Bev Perdue cut \$1.7 billion in spending during fiscal year (FY) 2009 without causing further hardships in the state.
- Actual spending in FY 2009 was \$19.65 billion. The Locke Foundation's Can-Do Budget proposal would have saved another \$610 million for FY2010.
- Proposed spending relies on \$2.7 billion in new taxes and fees over the biennium.
- Proposed spending relies on \$3.2 billion in one-time funds over the biennium.
- Proposed spending for both years of the biennium (FY 2010 and FY 2011) reaches \$41 billion, or \$4,200 per person.
- Seven steps that would make future budgets better include:
 1. Post budget bills online 72 hours before the first vote.
 2. Provide a five-year fiscal note with each budget.
 3. Plan a realistic second year of the biennial budget.
 4. Pass a taxpayer protection amendment.
 5. Expand the state's rainy-day fund to 10 percent of the General Fund and fully fund it.
 6. Create a tax-me-more fund so taxpayers can voluntarily contribute more.
 7. Articulate the purposes of state government and hold activities accountable to those goals.

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Gov. Bev Perdue managed to reduce total spending for fiscal year (FY) 2009 from a budgeted \$21.36 billion to \$19.65 billion,¹ a \$1.6 billion reduction and \$650 million less than anticipated as recently as June 8. That final spending amount is not much more than the \$19 billion Can-Do Budget offered by the John Locke Foundation for FY 2010.² The General Assembly missed a rare opportunity to put government spending on a more sustainable path by instead insisting on higher taxes to pay for three-quarters of a billion dollars in higher spending.

The governor’s ability to remove \$1.7 billion from the FY 2009 budget should have reset spending levels for each agency down instead of working from inflated expectations. Gov. Perdue reduced spending by 8.8 percent from the appropriations bill that passed in 2008. Whatever pain accompanied the cuts did not devastate the state. In fact, per-capita spending adjusted for inflation — \$2,127 in FY 2009 — was only slightly less than the \$2,151 spent in FY 2006 (Figure 1). The General Assembly could have recognize the long-term spending problem, adopted a more realistic spending plan similar to the Can-Do Budget, and avoided tax increases.

Rather than adjust to reality, however, the General Assembly responded by raising taxes and seeking federal government bailout money. Gov. Perdue was complicit in this, even saying she would “drive a pickup truck to South Carolina” if it meant she could collect more of the federal largesse.³ On the spending side, agencies began the budget process as normal and set their sights on appropriations of \$22.1 billion for the first year of the budget.

The final budget for the biennium included \$2.9 billion in new federal money (including \$2.4 billion in bailout money counted as spending cuts), \$2.3 billion in new taxes, \$322 million from a more aggressive Department of Revenue, \$144 million in transfers from reserves and other accounts, \$141 million in new or higher fees (including \$25 million counted as spending cuts), and \$124 million in corporate taxes that had previously been earmarked for schools (Figure 2). All told, the General Assembly added \$5.9 billion in new taxes, fees, and one-time revenue sources to pay for \$41 billion in programs over two years – more than \$4,200 per North Carolina resident.

The state’s spending priorities are as problematic as the overall level of spending. Unproven or failed programs gain while essential services languish.⁴

Fix the process

Whatever flaws there are in the final budget are due in large part to the budget process. Proposed budgets are hidden too long, include unrealistic projections, have no contingencies for future years, and ignore sound research that

Figure 1. State Appropriations Per Person, Adjusted for Inflation, FY1981-2011

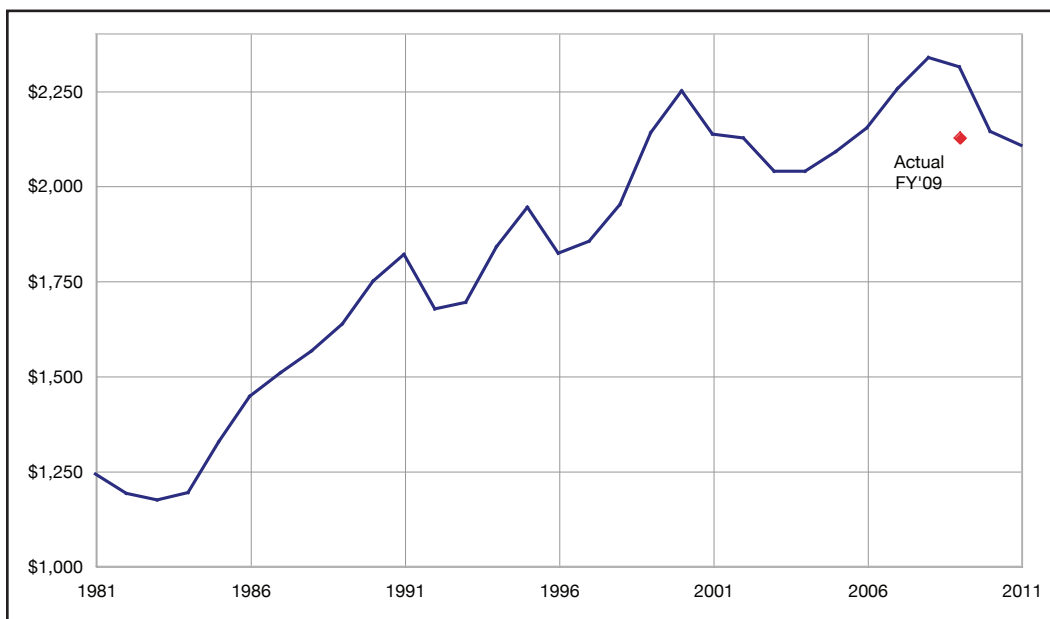


Table 1. Actual Spending FY 2009 vs Budgeted Appropriations FY 2010 and FY 2011

Agency	2008-09		2009-10			2010-11
	Authorized	Actual as of 8/6	House	JLF	SL2009-451	SL2009-451
Public Education	\$8,365,862,894	\$8,141,898,009	\$7,574,324,226	\$7,485,461,732	\$7,835,929,592	\$7,732,114,871
Community Colleges	1,016,658,560	924,402,451	981,477,165	900,764,411	999,833,122	1,012,467,778
University System	2,895,211,623	2,573,878,425	2,761,986,148	2,589,316,062	2,844,650,279	2,800,754,656
Total Education	12,277,733,077	11,640,178,885	11,317,787,539	10,975,542,205	11,680,412,993	11,545,337,305
Total General Government	493,300,083	450,694,524	439,228,307	361,332,133	440,876,661	439,641,878
Medical Assistance	3,182,662,885	2,765,660,559	3,110,705,218	3,076,898,840	3,176,005,666	3,222,762,378
Mental Health/DD/SAS	759,171,026	708,983,994	644,974,271	647,013,102	664,385,884	664,695,955
Other HHS	1,014,753,216	878,634,881	931,565,261	596,506,045	929,911,476	940,750,427
Total Health and Human Services	4,956,587,127	4,353,279,434	4,687,244,750	4,320,417,987	4,770,303,026	4,828,208,760
Correction	1,302,967,489	1,256,095,574	1,251,788,964	1,231,134,490	1,326,741,612	1,339,418,365
Other JPS	919,835,435	862,678,996	843,090,052	695,369,626	870,814,326	851,217,304
Total Justice and Public Safety	2,222,802,924	2,118,774,570	2,094,879,016	1,926,504,116	2,197,555,938	2,190,635,669
Total Natural & Economic Resources	590,021,468	521,211,755	711,121,927	311,173,076	436,985,625	413,026,486
Debt Service, Reserves, Adjustments	706,540,979	545,268,478	757,465,829	1,145,239,023	874,462,978	1,176,309,585
Capital Improvements	129,082,062	23,070,930	7,150,000	-	4,875,000	-
Total General Fund Budget	\$21,376,067,720	\$19,652,478,571	\$20,014,877,368	\$19,040,208,540	\$20,405,472,221	\$20,593,159,683

demonstrates whether programs meet their stated objectives. Seven simple changes could improve the process and create a more stable fiscal future for North Carolina.

1. Post budget bills online 72 hours before the start of voting

Putting a budget bill (or any bill) online for 72 hours before voting would give members, staff, and outside observers time to study the contents of the bills and make informed decisions.

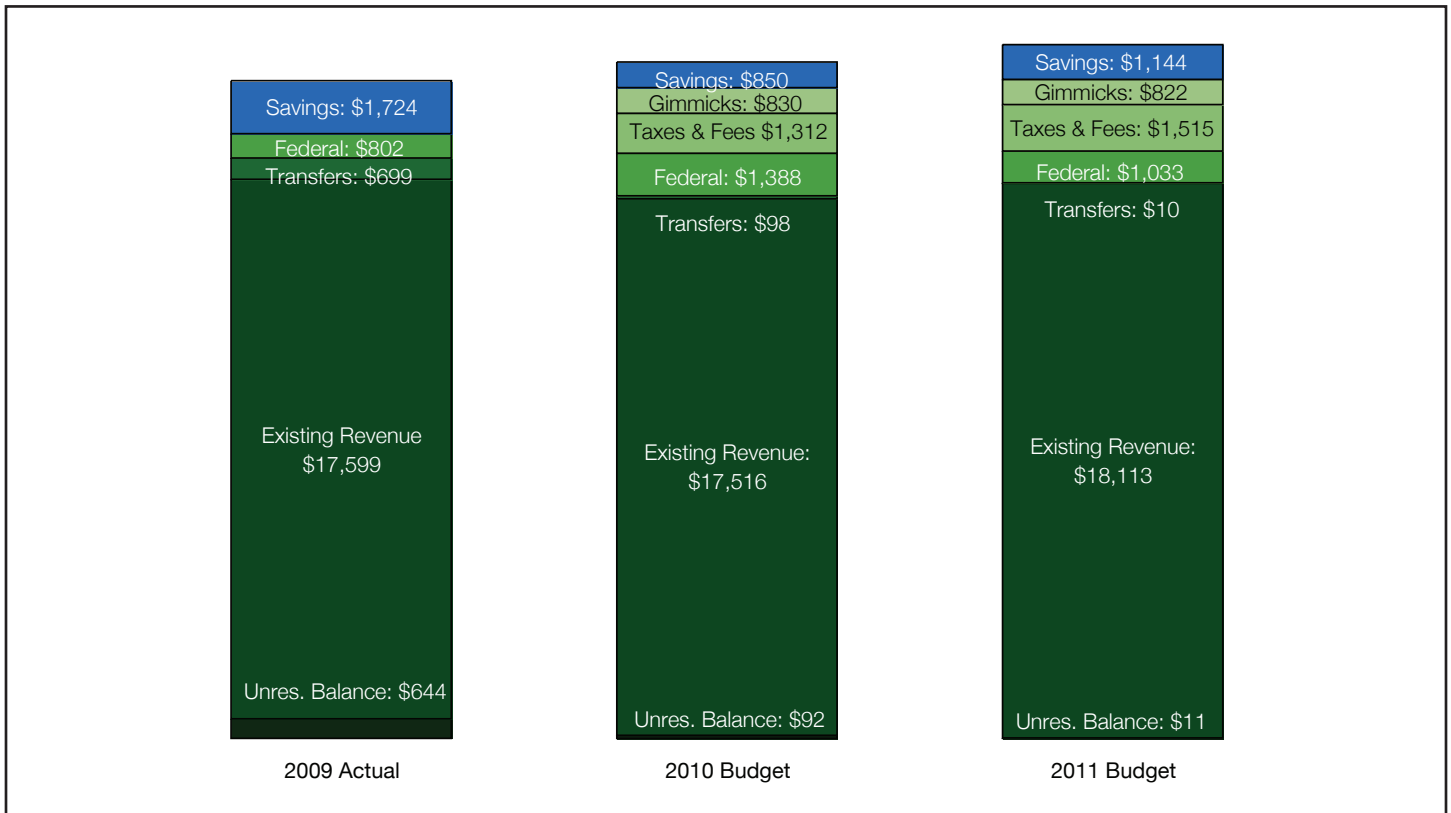
The final conference committee bill was made available to members just 4-1/2 hours before they were to begin discussion and voting. The bill had its final vote less than 48 hours after negotiators reached a final agreement and less than 36 hours after the bill made it online. Gov. Bev Perdue signed it into law just two days later. This timing is relatively common for budget bills, and has led to surprises for journalists, policy analysts, and politicians looking through bills after they passed.

2. Provide a five-year fiscal projection for budget bills

Legislators have asked the fiscal research division staff for five-year estimates of the spending and tax implications of many bills, but there are no similar estimates for budget bills. Budget bills merely show what agencies said they would need to continue doing what they were doing, with adjustments for higher costs and a larger service population. Such an accounting provides no sense of how programs will grow over time, so the budget changes exist in a vacuum.

In the recently passed budget, \$3.7 billion of saving is through temporary cuts or new funds that will disappear by July 1, 2011, including \$2.4 billion from the federal bailout bill. Another half-billion dollars is moved off budget

Figure 2. Budgeting for Higher Spending



and paid with federal funds, \$456 million in FY 2010 alone. It is unrealistic not to acknowledge that, but to claim the budget is fiscally responsible and leave the next session another multi-billion dollar hole.

3. Establish a realistic second-year spending plan

Long-term forecasts depend on realistic projections within the two-year budget plan itself. Too often, the legislature has promised small growth in the second year of a biennium then increased spending when they went returned to Raleigh. The changes are large enough that budgets have practically become annual bills. Most consideration of budget bills – by legislators, the press, and even the John Locke Foundation – reflect this reality and focus on the spending in a given year, instead of over the two-year period.

4. Create a tax-me-more fund

Taxpayers can make voluntary payments to the federal government, county governments, and municipal governments, but they cannot donate to the state government. There is no reason why the state should reject such largesse from willing citizens. Those who want to expand government services or who call for shared sacrifice should have the chance to lead by example. Similar funds in other states and at the federal level have not been inundated with donations, but if residents consider North Carolina’s tax burden too light, a tax-me-more fund would let lawmakers know.

5. Pass a Taxpayer Protection Amendment

Linking taxes and expenditures to population growth and inflation is a proven way to restrain the growth of government. The only way such a policy can limit future legislatures is to enshrine it in the state constitution.

6. Fully fund a larger rainy-day reserve

Any taxpayer protection amendment should not only limit spending, but also set aside excess revenues in a rainy-day fund until it covers at least ten percent of the previous year's general fund appropriations. Current state law caps the amount set aside at just five percent of appropriations. Even this low level is rarely met, which has led legislators to raise taxes. Previous recessions that affected more than one budget year had cumulative shortfalls equal to 33 percent of general fund spending in the last pre-recession year.

7. Explain the goals of state government and seek ways to achieve them, regardless of government involvement in the activity

The main purpose of any government is to protect its citizens' lives and property. Most governments also take as goals having educated, healthy, and prosperous citizens, and the means to transport goods and people quickly and efficiently where they need to go.

As past experience and numerous studies have shown, however, government spending to achieve many of these goals can do more harm than good. Taxpayers in North Carolina have had a poor return on government's investment of their tax dollars. Health, education, transportation, and public safety have not improved as much in North Carolina as in other states compared to the tax burden on citizens.

When evaluating programs, state elected officials need to consider whether government should provide services directly, outsource them, or remove itself entirely from them. These evaluations should include not just the program's cost and ability to produce the desired outcome, but whether the activity is an appropriate role of government in the first place.

Conclusion

The latest budget bill illustrates again the problems with the legislative budget-writing process. Given the cuts Gov. Perdue was able to make in spending since taking office, legislators had no reason to increase spending and raise taxes more than \$1 billion a year. The seven steps outlined here can provide guidance for future legislatures to regain control of the runaway budget.

Joseph Coletti is fiscal policy analyst for the John Locke Foundation.

End Notes

1. "General Fund Monthly Financial Report – June," Office of the State Controller, August 31, 2009.
2. Joseph Coletti, "The Can-Do Budget: The impossible takes a little longer," John Locke Foundation *Spotlight* No. 374, June 12, 2009, www.johnlocke.org/spotlights/display_story.html?id=225.
3. Ryan Teague Beckwith, "Perdue: Stimulus coming this week," Under the Dome blog of *The News & Observer*, February 23, 2009, 1:31 p.m., projects.newsobserver.com/under_the_dome/perdue_stimulus_coming_this_week.
4. These include targeted tax breaks for films (Joseph Coletti and Jacob Burgdorf, "Not the Best of Both Worlds: Tax credit will not save movies but will lose money," John Locke Foundation *Spotlight* No. 376, July 22, 2009, www.johnlocke.org/spotlights/display_story.html?id=227), dropout grants (Terry Stoops, "Dropout Prevention Grants: Legislators need to rethink their approach to the dropout problem," John Locke Foundation *Spotlight* No. 371, March 24, 2009, www.johnlocke.org/spotlights/display_story.html?id=222), and job training programs (Jon Sanders, "Job Training That Works: Public programs stagnate, while private and charitable training excels," John Locke Foundation *Spotlight* No. 344, February 28, 2008, www.johnlocke.org/spotlights/display_story.html?id=194).