

# spotlight

No. 263 – August 10, 2005

## WAITING FOR VETO

*Latest Budget Proposal Could Explode Governor's Spending Cap*

**S U M M A R Y :** Six weeks into fiscal year 2005-06, the General Assembly has a budget proposal from the conference committee. The General Fund budget for 2005-06 includes \$17.2 billion in spending, up 7.9 percent from 2004-05. However the governor interprets it, this spending is well above his spending cap. It also entails over \$700 million in higher taxes and fees in addition to \$681 million in extra collections in fiscal 2004-05. There may be enough pork to ease the bill's passage before a possible veto. This process is too dependent on one person. A constitutional tax and expenditure limit (TEL) provides the best way to insure against permanent tax increases because of reckless spending.

.....

**t**he latest version of the budget is also the largest. At \$17.2 billion,<sup>1</sup> the budget likely includes enough small programs to protect it from defeat in the General Assembly, but should provoke a veto. The 7.9 percent spending increase is well above Gov. Mike Easley's announced 5.6 percent cap,<sup>2</sup> no matter how much the governor or his staff may claim that some General Fund appropriations in the bill should not count toward that cap.

### Higher Revenues, Higher Taxes

Tax collections for fiscal year 2004-05 were \$681.5 million higher than expected. Despite this, the conference committee again did not find a way to allow either the half-cent sales tax increase or the 8.25 percent income tax rate to expire. These taxes were first imposed as temporary increases in 2001 and extended in 2003. All pretense is gone for the sales tax, but the income tax still might revert to the previous rate in January 2008. Combined, these two taxes will add another \$456.9 million to state coffers in 2005-06 (\$552.4 million in 2006-07).

A 25-cent tobacco excise tax will contribute another \$118.8 million in 2005-06 and \$189.4 million in 2006-07. Other changes in the sales tax – such as applying the general rate to candy, cable television, and other goods – will add \$60.5 million (\$103.3 million in 2006-07). And the state will gain \$29.1 million

200 W. Morgan, #200  
Raleigh, NC 27601  
phone: 919-828-3876  
fax: 919-821-5117  
www.johnlocke.org

**The John Locke Foundation** is a 501(c)(3) nonprofit, nonpartisan research institute dedicated to improving public policy debate in North Carolina. Viewpoints expressed by authors do not necessarily reflect those of the staff or board of the Locke Foundation.

## Comparing the Budgets

### Spending and Revenues in Millions, FY2005-06

Spending Category	Governor		Senate		House		Conference Committee	
	YoY %	Change	YoY %	Change	YoY %	Change	YoY %	Change
Public Education	\$6,678.87	8.5%	\$6,686.83	8.6%	\$6,664.81	8.2%	\$6,693.00	8.7%
Community Colleges	763.67	10.4%	792.78	14.6%	775.21	12.1%	787.69	13.9%
UNC System	2,111.36	12.4%	2,072.42	10.3%	2,058.58	9.6%	2,086.05	11.0%
Health & Human Serv.	4,088.21	7.9%	3,958.54	4.5%	4,081.03	7.7%	4,033.24	6.5%
Agriculture	52.49	7.7%	49.83	2.3%	51.02	4.7%	52.04	6.8%
Commerce	67.98	6.6%	55.63	-12.7%	78.74	23.5%	113.56	78.2%
Labor	14.99	9.9%	14.15	3.8%	14.68	7.7%	14.42	5.7%
Environment/Nat. Res.	176.06	14.5%	171.19	11.3%	170.43	10.8%	177.20	15.2%
Correction	1,046.53	10.3%	1,023.19	7.9%	1,029.45	8.5%	1,029.92	8.6%
Crime Control/PS	35.71	11.4%	33.51	4.5%	35.49	10.7%	34.79	8.6%
Courts/Judicial	444.28	11.0%	429.79	7.4%	436.17	9.0%	436.64	9.1%
Juvenile Justice	141.61	7.0%	135.18	2.2%	141.01	6.6%	140.38	6.1%
Justice	78.65	8.9%	76.56	6.0%	78.99	9.4%	77.32	7.1%
Transportation	12.03	7.6%	0.00	-100.0%	0.00	-100.0%	0.20	-98.2%
Other Departments	419.26	2.6%	492.57	20.5%	359.71	-12.0%	480.03	17.4%
Debt Service	486.80	14.0%	491.16	15.0%	491.16	15.0%	491.16	15.0%
Other Items/Reserves	257.78		441.05		611.44		478.20	
Subtotal-Operating	16,876.25	6.3%	16,924.39	6.6%	17,077.93	7.6%	17,125.85	7.9%
Capital/R&R	18.01		26.11		34.32		51.38	
Total-GF Budget	\$16,894.27	6.1%	\$16,950.50	6.5%	\$17,112.25	7.5%	\$17,177.23	7.9%
Current Availability	\$15,972.30	0.3%	\$16,370.91	2.8%	\$16,372.60	2.9%	\$16,665.50	4.7%
Tax and Fee Changes	922.00		827.32		886.04		628.96	
GF Availability	16,894.30	6.1%	17,198.22	8.0%	17,258.65	8.4%	17,294.46	8.6%
Unappropriated Balance	\$0.03		\$247.72		\$146.39		\$117.23	

Source: Office of State Budget and Management, General Assembly Fiscal Research Division reports

in 2005-06 by decoupling the estate tax from the federal rate. That change will add \$115.6 million in 2006-07. These new taxes together take \$665.3 million from taxpayers in the current fiscal year (followed by \$960.7 million in fiscal 2006-07) giving the General Assembly \$1.4 billion more money for special appropriations, other projects, and an unappropriated balance.

### Massive Spending Growth

This additional \$1.4 billion in availability provides more than enough to cover the new spending proposed in the conference committee's General Fund budget. The current legislation includes \$282 million more spending than in Gov. Easley's original proposal.

Spending on public schools in 2005-06 is \$6.7 billion, \$14 million more included than the governor proposed and 8.7 percent higher than in 2004-05. The UNC System and community colleges both receive double digit year-on-year increases, and community colleges gain \$24 million over the governor's proposal for 2005-06. Total education spending reaches \$9.6 billion of the 2005-06 General Fund in the conference committee's bill. It seems difficult to argue that this area is underfunded in this year's budget.

Cultural Resources, with \$75.2 million for 2005-06, gains \$11 million more in this budget than the governor proposed, much of which is itemized in law for the first time in a while. The Commerce Department gets an additional \$9.6 million than the governor's proposed \$55.2 million, even before boosting the North Carolina Biotechnology Center by \$9 million and the Rural Economic Development Center by \$20.5 million. In total, the Commerce Department and its related projects receive a 78 percent increase in appropriations for 2005-06 from fiscal 2004-05. The conference committee's proposal also includes \$3.5 million more in special appropriations through the budget office and \$38 million more for the Clean Water Management Trust Fund.

There are also increases in a number of reserve accounts and trust funds, including \$85 million for the governor to use for teacher salaries if he finds that public school teachers differ from the national average and he can develop a plan to remedy this that meets the approval of House Speaker Jim Black and Senate President Pro Tempore Marc Basnight. Even without this contingency, teachers already receive a 2.24 percent salary increase under the conference proposal instead of the 2.0 percent increase for most other state employees.

## **Constitutional Limits**

Gov. Easley first announced in 2003 his plan to cap state government spending at the average income growth for the previous 10 years. This cap, which relies completely on the governor's willingness to enforce it, faces its greatest test with the current budget. News stories have quoted Speaker Black saying, "he would not let us exceed the cap."<sup>3</sup> If the current proposal passes the General Assembly, as it likely will, fiscal restraint then depends on whether the governor is committed enough to his spending cap to veto the bill.

A constitutional amendment to limit tax and spending increases provides the best safeguard against future rapid spending increases. The General Assembly currently is immune to pressure to act responsibly while members stock the larder with special appropriations. Restraint needs to be institutionalized and made less dependent on personalities. The governor should veto the current budget and begin laying the groundwork for a tax and expenditure limit, such as the proposed Taxpayer Protection Amendment (S274, H424).

*-Joseph Coletti is Fiscal Policy Analyst for the John Locke Foundation*

## **Notes**

- 1 References to the budget rely on the legislation (S622) and the committee report on the legislation as of August 8, both available at <http://www.ncleg.net/homePage.pl>
- 2 "Gov. Easley Announces Plan to Cap State Spending," Governor's Press Office, February 24, 2003
- 3 Gary Robertson, "N.C. legislative Democrats seeking budget agreement," <http://www.freerepublic.com/focus/f-news/1455851/posts>