

spotlight

No. 313 – March 9, 2007

\$20 BILLION

Gov. Easley increases operating budget 7.2 percent for FY2007-08

KEY FACTS:

- **Gov. Mike Easley proposed a \$20 billion operating budget and \$20.1 billion total spending plan for fiscal year (FY) 2007-08.**
- **The operating budget is \$1.3 billion more than in FY 2006-07, a 7.2 percent increase.**
- **Taxes increase a net \$211 million, including another round of extensions for the remaining temporary tax increases first introduced in 2001.**
- **General Fund spending for capital is \$64 million, down from \$206 million in FY 2006-07. But the governor also proposed \$1.6 billion in new debt for capital projects, including \$209 million in certificates of participation.**
- **Teachers and community college faculty receive an average five-percent pay increase. State employees receive a 2.5 percent increase. Total pay increases will cost the \$384.5 million.**
- **Gov. Easley proposes again transferring \$172 million to the General Fund from the Highway Trust Fund.**
- **Results-based information added to the budget proposal is a good idea, but much of the information, if it even measures a result, does not measure the appropriate result.**
- **Corporate and individual welfare payments increase, including \$15 million to the One NC Fund, \$50 million in targeted scholarships, \$28 million in targeted individual tax relief, and \$4.7 million to expand Medicaid to the middle class.**

Gov. Mike Easley has proposed a budget that would increase operating expenditures 7.2 percent to \$20.0 billion, the fourth consecutive year of growth at or above 7.0 percent. The proposed budget has grown a total of 34.9 percent, or \$5.2 billion, over this period.

Looked at another way, proposed General Fund expenditures per capita adjusted for inflation are 6.2 percent higher than the last peak in fiscal year (FY) 2000 and 14.2 percent higher than the last trough in FY 2003.

The General Assembly could push the final budget even higher with new items. One likely addition would be to direct some money to ease Medicaid's burden on counties. Gov. Easley did not include county Medicaid relief in his proposal, but said he hopes members of the State and Local Fiscal Moderniza-

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tion Commission will offer a plan. Currently, the governor's office projects a \$119 million surplus, some or all of which could be redirected to county Medicaid relief.

To pay for all of this, Gov. Easley extends the remaining 0.25 percent temporary state sales tax and top income tax rate increases first imposed in 2001, which combined add \$301 million in revenue for FY 2007-08. Targeted tax relief and other tax changes would return \$90 million to some taxpayers, leaving a net tax increase of \$211 million.

In addition to the operations expenditures, the governor has proposed \$64 million for capital improvements plus \$1.4 billion from general obligation bonds to be voted on this November and \$209 million from certificates of participation (COPs). The debt is about what State Treasurer Richard Moore has said the state can afford.

The Good

Gov. Easley's staff trimmed \$160 million from the base budget. This is less than one percent of the General Fund operating budget, but it is more than zero.

The governor's budget report provides the amount of spending and full-time equivalent positions dedicated to specific activities in FY 2005-06 with measures of their effectiveness. Used properly, this new "results-based information" can lead to fruitful evaluations of programs and policies. At the very least, it should prompt questions about whether the right measures are being tracked. In some cases, however, the measures are clearly not results; in others, the measures are too narrowly defined. For example, Education Management under the Department of Public Instruction has policies to "ensure a uniform, basic education for all students PreK-12." The measures for the fund only provide information about teacher credentials, not students' education.¹

The Bad

Despite growing needs for road construction and maintenance, Gov. Easley resumes the practice of transferring \$170 million to the General Fund from the Highway Trust Fund and continues to transfer \$19 million from the Highway Fund. Only two-thirds of work to be completed through the Highway Trust Fund have been completed and the remaining third is progressing slowly.²

Learn and Earn is one of Gov. Easley's signature programs, providing students the opportunity to get their high school diploma and complete two years of community college coursework in five years, but has not had a positive impact on graduation rates or test scores of students in the program.³ The program would receive \$20 million for 75 schools and an online component. Graduates of the program could qualify for a \$2,000 scholarship for their final two years at a state university. To remain eligible for the scholarships students would need to work 10 hours per week and maintain a 2.0 grade-point average. The Education Access Rewards North Carolina (EARN) scholarships would cost \$50 million the first year and \$100 million a year thereafter.

Parents earning up to \$60,000 for a family of four (median income for a family of four in 2005 was \$59,481)⁴ can now purchase Medicaid coverage for their children. This initiative, called NC Kids' Care, is Gov. Easley's foray into the expanding health care to children movement. Other states, such as Maryland, Pennsylvania, and Illinois have also proposed similar programs. One reason for the popularity of this method of health insurance expansion is that the state is responsible for just \$4.7 million of the \$16.9 million needed in the first year to cover the estimated 11,800 children who would be enrolled. Parents, county governments, and the federal government would pay the rest. This policy will likely result in more parents giving up private health insurance coverage to take advantage of the subsidized program, as happened following the 1999 introduction of NC Health Choice, the State Children's Health Insurance Program.⁵

Revenue and Spending Changes (\$, Millions)	
Tax and Fee Revenue (Existing Law)	\$19,361.6
Baseline Spending	\$18,972.0
Initial Surplus/Deficit	\$389.6
Overcollections and reversions	\$950.1
Net tax increase	\$211.0
Savings Reserve Account	(\$237.5)
Repair and Renovations Reserve	(\$100.0)
Increased Availability	\$823.6
New Spending	\$1,094.3
Final Surplus/Deficit	\$118.8
Source: OSBM	

**Spending by Function Including Salary Increases
FY 2006-07 and FY 2007-08 (\$, Millions)**

	<u>Governor 07-08</u>	<u>Final 06-07</u>	<u>\$ Change</u>	<u>% Change</u>
Public Education	7,923.0	7,406.0	517.0	7.0%
UNC System	2,717.0	2,441.0	276.0	11.3%
Community Colleges	967.0	921.0	46.0	5.0%
Medicaid	2,892.3			
Other Health and Human Services	1,714.7	4,280.0	327.0	7.6%
Correction	1,246.7			
Other Justice and Public Safety	850.3	1,942.0	155.0	8.0%
Environment, Agriculture, Commerce, and Labor	507.1	926.0	16.0	1.7%
General Govt	434.9			
Debt Service	621.4	744.0	5.0	0.7%
Other Reserves	127.6			
Operating Budget	20,002.0	18,660.0	1,342.0	7.2%
Capital Improvements	63.9	206.0	-142.0	-68.9%
TOTAL	20,065.9	18,866.0	1,200.0	6.4%

Expanding spending commitments at a time of expanding revenues has triggered fiscal crises roughly every ten years. The state needs slower growth in government spending and more money set aside for future lean years.

The Verdict

Gov. Easley keeps the remaining temporary sales and income tax increases from 2001. He adds more than \$1 billion in new spending and \$1.6 billion in new debt for the state. Many of his new or expanded programs will make existing problems, such as crowd out in the insurance market or the overselling of higher education, worse. While the governor dedicates more money to the correction system, he directs money to the wrong priorities. New House Speaker Joe Hackney can make a statement for responsible government by rejecting the governor's new spending proposals and higher taxes in favor of putting money towards state needs and preparing for the next dip in state revenues.

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NOTES

1. Office of State Budget and Management, Recommended Operating Budget with Results-Based Information: Education, pp10-11. Online at http://www.osbm.state.nc.us/files/pdf_files/bgt0709v1r.pdf
2. Joseph Coletti, "A Better Bargain: Meeting North Carolina's needs without a \$1 billion tax hike", John Locke Foundation, February 2007, p.11. http://www.johnlocke.org/policy_reports/display_story.html?id=81
3. Terry Stoops, "The Teacher Pay Myth and Other Budget Observations," Carolina Journal Online, May 19, 2006. http://www.carolinajournal.com/jhdailyjournal/display_jhdailyjournal.html?id=3328.
4. U.S. Census Bureau, "Median Family Income in the Past 12 Months by Family Size" 2005 data online at <http://www.census.gov/hhes/www/income/medincsizeandstate.html> accessed March 6, 2007.
5. "Medicaid and Health Choice," John Locke Foundation Agenda 2006. Online at <http://www.johnlocke.org/agenda2006/medicaid.html>