

spotlight

No. 320 – May 15, 2007

SPEND NOW, TAX NOW & LATER

House budget would spend 7.6 percent more in FY2007-08

KEY FACTS:

- House members approved a \$20.3 billion budget for fiscal year (FY) 2007-08, up 7.6 percent from FY 2006-07; 1.5 times the 5.1 percent combined rate of inflation and population growth.
- Proposed spending is \$1.4 billion (\$158 per person or \$632 for a family of four) higher than in FY 2006-07. Nearly all of the increase is in K-12 education, even though dropout rates have been increasing.
- Capital spending is \$36 million lower, but the House added \$450 million in new debt, plus \$300,000 for a November vote on additional general obligation bonds.
- Taxes and fees would climb a net \$207 million, with the “temporary” taxes extended two more years.
- Nearly 95 percent of spending, \$19 billion, goes to continuing programs that rarely get questioned for effectiveness or efficiency.
- The John Locke Foundation’s Freedom Budget 2007 would save more than \$1 billion compared to the House budget, end the transfer from the Highway Trust Fund, and reduce business and personal taxes.
- Senate consideration of the budget will likely begin after Memorial Day. The fiscal year begins July 1.

House members passed a \$20.3 billion General Fund budget just after midnight on May 11. The \$1.4 billion (7.6 percent) spending increase depends on \$1.3 billion in unexpected surplus from fiscal year 2006-07, another transfer of \$172 million from the Highway trust Fund, and \$207 million in net new taxes and fees. All of this translates into roughly \$158 more spending per person, \$632 for a family of four.

Spending

Education is the fastest growing section of the budget, with spending on public schools, community colleges, and the university system up \$1.3 billion (13.3 percent). Despite higher education spending, the dropout rate in 2005-06 was the highest in four years and the percentage of students rated proficient in reading on the 2005 National Assessment of Educational Progress (NAEP) was the lowest since 1998. Health spending climbs \$337 million (8.0 percent) and

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FY 2007-08 Budget Proposals Compared to FY 2006-07 Approved Budget

	Fiscal Year 2007-08						FY2006-07
	Governor	% Change	House	% Change	John Locke Fdn	% Change	Approved
	<u>2/22/2007</u>	<u>vs 2006-07</u>	<u>5/11/2007</u>	<u>vs 2006-07</u>	<u>Freedom Budget</u>	<u>vs 2006-07</u>	<u>Budget</u>
Public Education	\$7,603,028,498	13.1%	\$7,618,008,906	13.4%	\$7,259,401,313	8.0%	\$6,719,751,118
UNC System	2,634,710,710	17.1%	2,561,247,032	13.9%	2,388,380,494	6.2%	2,249,054,978
Community Colleges	915,790,652	10.1%	926,981,160	11.5%	836,419,110	0.6%	831,455,913
Total Education	11,153,529,860	13.8%	11,106,237,098	13.3%	10,484,200,917	7.0%	9,800,262,009
Medicaid	2,882,941,451	9.1%	2,846,030,681	7.7%	2,831,086,340	7.1%	2,643,659,159
Other HHS	1,709,125,955	7.6%	1,723,232,293	8.5%	1,445,244,525	-9.0%	1,588,493,473
Total HHS	4,592,067,406	8.5%	4,569,262,974	8.0%	4,276,330,865	1.0%	4,232,152,632
Correction	1,217,154,018	12.3%	1,213,986,709	12.1%	1,198,155,561	10.6%	1,083,404,206
Other JPS	830,598,469	13.0%	827,009,358	12.5%	807,291,403	9.8%	735,023,228
Total JPS	2,047,752,487	12.6%	2,040,996,067	12.2%	2,005,446,964	10.3%	1,818,427,434
NER	499,174,153	3.4%	536,987,421	11.3%	351,894,193	-27.1%	482,625,289
General Govt	428,162,854	9.2%	428,533,753	9.3%	381,898,285	-2.6%	392,179,564
Debt Service	621,409,384	8.8%	621,409,384	8.8%	512,809,384	-10.2%	570,907,520
Reserves	660,196,566	-51.6%	827,971,232	-39.3%	957,345,931	-29.8%	1,363,062,536
TOTAL Operating	20,002,292,710	7.2%	20,131,397,929	7.9%	18,969,926,539	1.7%	18,659,616,984
Capital Improvements	63,883,409	-69.0%	170,873,741	-17.2%	63,883,409	-69.0%	206,343,300
TOTAL BUDGET	20,066,176,119	6.4%	20,302,271,670	7.6%	19,033,809,948	0.9%	18,865,960,284
COPs	309,600,900		449,207,040				206,343,300
Gen Obligation Bonds	1,388,180,800						
Total Debt	1,697,781,700		449,207,040				206,343,300

spending on corrections, justice, and public safety increases \$223 million (12.2 percent) in the proposed budget. Other areas of growth are corporate welfare, including a new \$1 million fund for green businesses, another \$13 million for the One North Carolina Fund, and more than \$10 million for community development corporations. Overall operating spending is up 7.9 percent.

NC Kids' Care would subsidize purchases of Medicaid coverage for children in middle class families of four earning up to \$60,000. Blue Cross Blue Shield offers similar coverage, with a wider network of providers for a similar monthly premium (\$155 private vs. \$160 Medicaid). Policies with higher deductibles are available for entire families for less than \$300 a month.

Capital spending in the budget is down \$35 million to \$171 million, but the House would also issue \$450 million worth of certificates of participation (COPs) to fund capital projects. COPs are a form of debt that do not require a vote

Recurring/Non-recurring Spending and Revenues	
Originally Forecast Revenue	\$19,403,590,000
Net Tax and Fee Increase	206,521,572
Recurring Revenue	19,610,111,572
Adjusted Continuation Budget	18,967,544,989
New Recurring Appropriations	689,797,622
Recurring Appropriations	19,657,342,611
Surplus / (Deficit)	(47,231,039)
Non-Recurring Revenue	800,150,000
Non-Recurring Appropriations	644,929,059
Final Surplus / (Deficit)	107,989,902
COPS	449,207,040
Gen Obligation Bonds	-
Net New FTE Positions	149.60

by the public and carry a higher interest rate than general obligation bonds. In the budget, however, the House sets aside \$300,000 for a bond vote in November, which indicates more debt will be added to the total.

Taxes

Among the higher taxes in the budget are another two-year extension of the “temporary” quarter-cent sales tax increase and 8.0 percent income tax bracket. Together these two tax law changes generate \$299 million. Some fees also increase. Their impact is mitigated by compliance with federal tax cuts and some targeted tax incentives for businesses and individuals. But even a state Earned Income Tax Credit (EITC), intended to provide tax relief for low-income working families, will provide in FY 2008-09 at most \$17 for a family after they pay \$23 per person in additional sales taxes. A better tax credit in the budget, for purchases of long-term care insurance, can help relieve the state of future Medicaid costs by encouraging individuals to prepare for their own needs.

Conclusion

There are some good ideas in the budget, such as providing \$100 million for one-time relief of counties’ share of Medicaid, redirecting salaries for vacant positions to give non-teacher state employees larger raises, raising tuition at community colleges, and eliminating 188 middle management positions in the university system. Unfortunately, 95 percent of spending is on continuation items that do not receive a second glance, even when the governor’s budget provides information on what the money does.

One alternative for Senators to consider is the John Locke Foundation’s Freedom Budget 2007, which would dedicate more money to mental health, treat all state employees equally, set aside more money for retiree health care liabilities, and begin taking over the county share of Medicaid – all while lowering tax rates for businesses and individuals and saving more than \$1 billion compared to the House budget proposal.

Tax and Fee Changes		
	FY2007-08	FY2008-09
Extend 4.25% Sales Tax Rate for 2 Years	\$258,400,000	\$285,900,000
Extend 8.00% Upper Income Tax Bracket for 2 Years	40,800,000	93,700,000
IRC Conformity	-56,900,000	-49,100,000
Health & Human Services/Facility Services Fees	1,705,501	1,642,407
Secretary of State Corporate Annual Report Fees	563,016	563,016
Earned Income Tax Credit	0	-68,900,000
Long-term Care Insurance Tax	-7,000,000	-7,200,000
Adoption Tax Credit	-3,000,000	-3,000,000
Enhance 529 Plan Deduction (H 1016)	-200,000	-200,000
Privilege Tax on Software Publishers	-3,700,000	-4,000,000
Research & Development Credit Enhancement	-400,000	-800,000
Modify Tax on Property Coverage Contracts	-1,500,000	-3,100,000
Reserve for Manufacturers’ and Farmers Energy Tax Provisions	-14,500,000	-30,100,000
Enhanced Credit for Constructing Renewable Fuels Facilities	0	-2,250,000
Reserve for Military Tax Relief	-4,000,000	-4,000,000
Reserve for Work Opportunity Tax Credit	-6,000,000	-6,000,000
Sales Tax Refund for Aircraft Part Manufacturers	-800,000	-800,000
Adjust Sales Tax Holiday	-600,000	-600,000
Adjust Transfer from Insurance Regulatory Fund	80,274	56,274
Adjust Transfer from Treasurer’s Office	66,638	54,638
Transfer from Closed Capital Account	3,506,143	0
Net Tax and Fee Increase	206,521,572	201,866,335

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