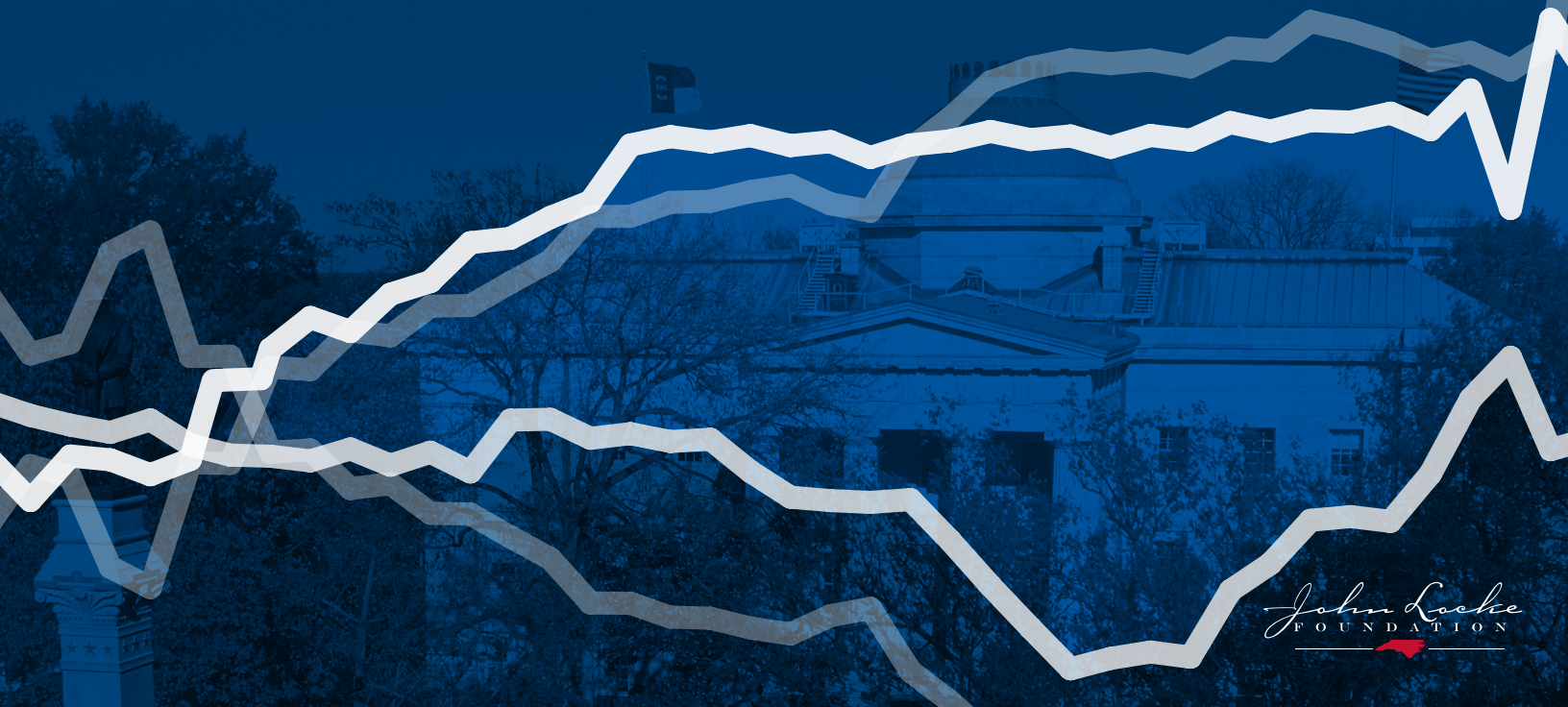


NORTH CAROLINA

# BUDGET IN PICTURES

FY2017-18



NORTH CAROLINA

# BUDGET IN PICTURES

**FY2017-18**



## INTRODUCTION

The state budget is one of the most important bills the North Carolina General Assembly considers each year. For the current fiscal year, which ends June 30, 2018, the budget bill (S.L. 2017-57, S.B. 257) directs \$27 billion in direct appropriations of state taxes and another \$20 billion in funds from the federal government, the North Carolina Education Lottery, community college and university students, and other sources. Changes in the tax system and various policies often are included as provisions in the budget. Legislators usually conclude their legislative session and head home soon after they pass the budget.

Despite its importance, few people give much thought to the full budget picture. We have designed this document to help more people understand the total budget.

We will revise and update these pictures and provide new charts on other budget questions regularly. Please let us know if there is something you would like to see us add.

# ORGANIZATION

## I. OVERVIEW

The first and largest section provides an overview of the state budget. It shows overall tax and spending levels, transportation spending, how federal money is used, contributions from the lottery, and trends over time.

## II. SPENDING

The second section shows how state government uses the taxes and receipts it collects. One of the important things to notice is how much the social services and health programs depend on federal funds. Universities are also indirectly dependent on federal funds through financial aid that students use to pay tuition. As a result of this dependence and strings attached to federal funds, North Carolina actually has little leeway to set its own direction to meet the needs of millions of people.

## III. TAXATION

The third section provides a closer look at the four main taxes state government uses to collect money from its citizens—directly through the individual income tax and the sales and use tax and indirectly through the corporate income tax and franchise tax. Some taxes are more predictable and stable than others, which does not argue for one over another, but is something people involved in policy should bear in mind during the year.

## IV. FUTURE

The final section examines future spending, recent spending reforms, and challenges to the long-term financial sustainability of past promises. It covers current and future employee compensation, state debt, savings, capital investment, and unfunded liabilities.

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NORTH CAROLINA

# BUDGET IN PICTURES

FY2017-18

The word "OVER" is written in large, white, sans-serif capital letters. The background of the entire page is a dark blue color. Overlaid on this background is a light blue line graph that fluctuates across the top and bottom of the page, passing behind the word "OVER".

# OVER

# VIEW

# General Fund Revenues

Individual income tax and sales tax account for 83% of General Fund Revenue.

## GENERAL FUND REVENUES



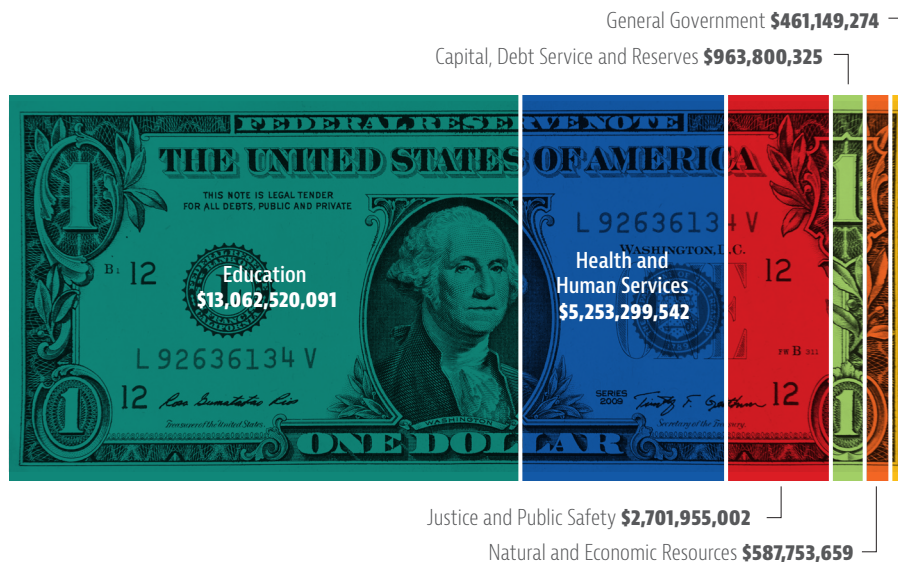
SOURCE: OFFICE OF THE STATE CONTROLLER (FY2017-18)



## General Fund Appropriations

*Most state funding goes to education, followed by Medicaid and other health and human service programs, public safety, and other state government functions besides transportation.*

## GENERAL FUND APPROPRIATIONS AND SOURCES

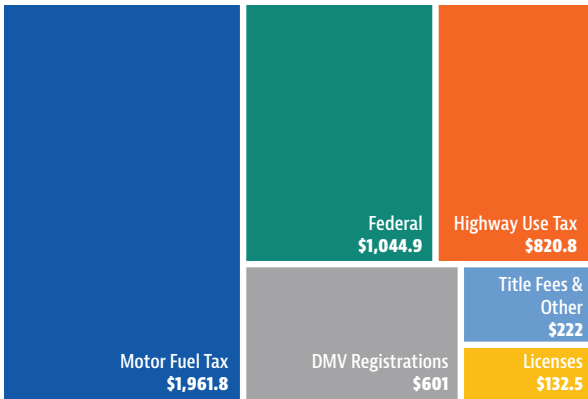


**SOURCE:** OFFICE OF STATE BUDGET & MANAGEMENT (FY2017-18)

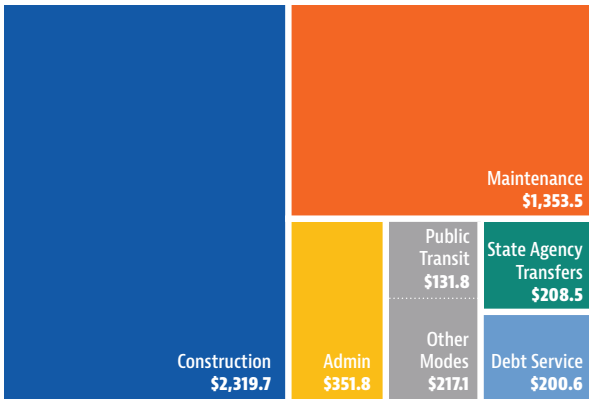
# Transportation Revenue and Spending

North Carolina raises \$3.8 billion in taxes and fees and receives another \$1 billion from the federal government to pay for transportation-related projects and programs. The single biggest source of funds is the motor fuels tax, but continuing improvements in fuel economy and electric vehicle infrastructure present a long-term challenge. Half of the money goes to construction projects identified as strategic transportation investments, and another quarter goes to maintenance of existing infrastructure.

Sources of Transportation Revenue (in Millions)



Transportation Spending (in Millions)

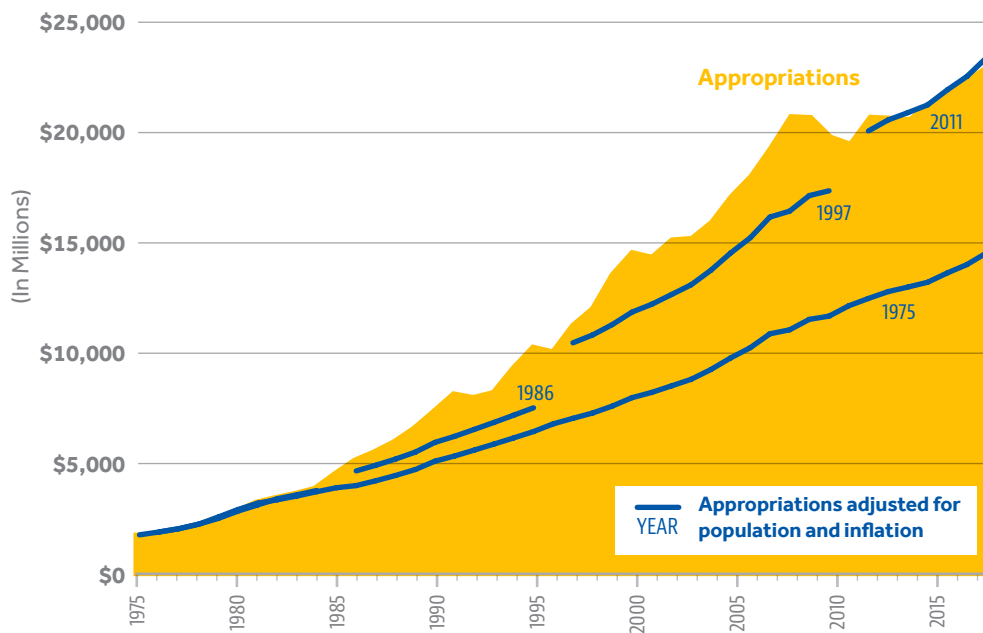


SOURCE: DEPARTMENT OF TRANSPORTATION

## General Fund Growth

*Policymakers kept spending growth consistent with the combined rate of inflation and population growth until the mid- 1980s. Spending then accelerated for two decades, reaching \$20 billion in FY2007, double the population and inflation adjusted level of 1985. With the Great Recession of 2007-09, General Fund spending fell from the start of the recession until FY2011 as federal stimulus spending replaced state tax dollars. Since then, state appropriations have been slightly below the rate of inflation and population growth.*

GENERAL FUND APPROPRIATIONS, FY1974-75 TO FY2017-18

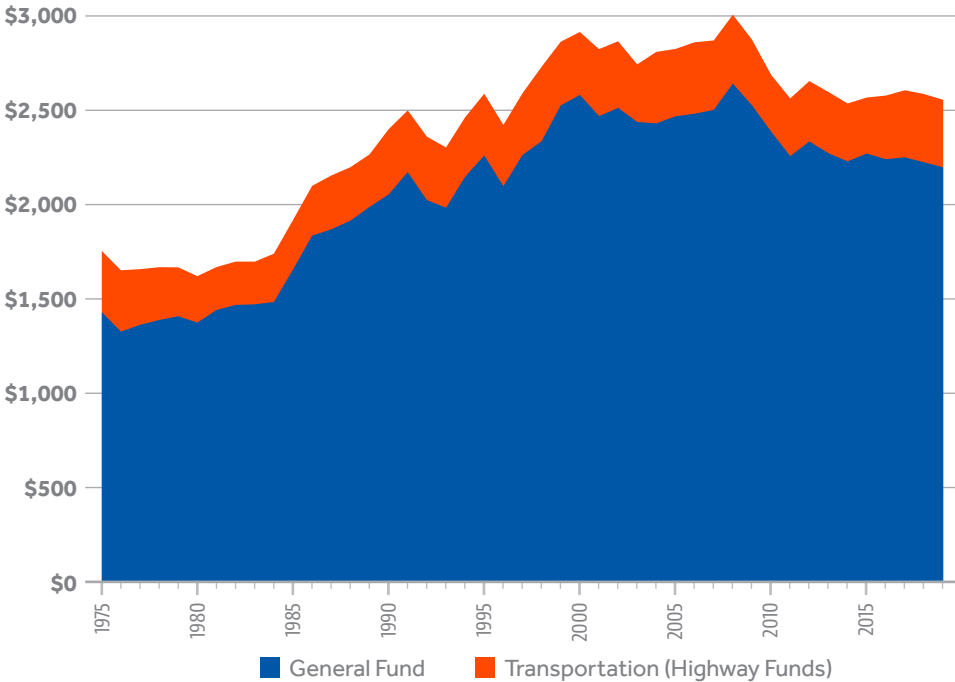


**SOURCES:** OFFICE OF STATE BUDGET AND MANAGEMENT, BUREAU OF LABOR STATISTICS, CENSUS BUREAU

# Appropriations Remain Stable

*Inflation-adjusted appropriations per person have been stable since 2011, roughly comparable to their level in the 1990s, though well above spending before 1985.*

REAL PER-CAPITA SPENDING BY SOURCE: GENERAL FUND + TRANSPORTATION

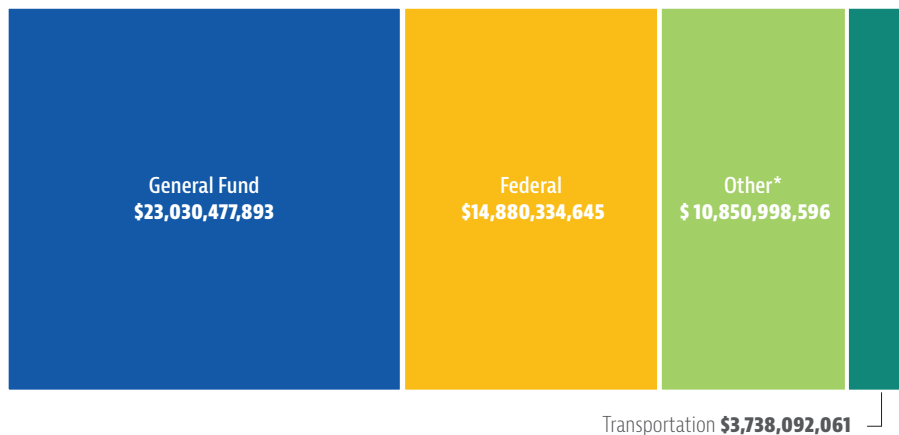


SOURCE: OFFICE OF STATE BUDGET & MANAGEMENT, US BUREAU OF LABOR STATISTICS

## Total Budget Receipts

*The General Fund is only a portion of total state spending. More than \$3.7 billion is dedicated funding from motor vehicles and drivers for transportation needs. Nearly \$15 billion comes directly from the federal government. University tuition payments, unemployment insurance, and state lottery revenue contribute most of the remaining \$11 billion.*

## TOTAL BUDGET



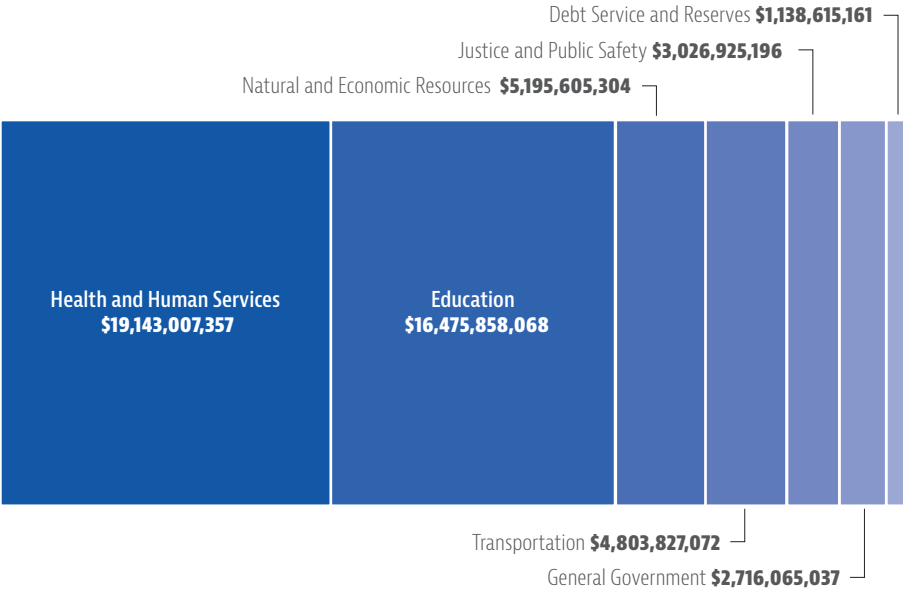
\* Tuition, lottery, unemployment, and other payments

**SOURCE:** OFFICE OF STATE BUDGET & MANAGEMENT (FY2017-18)

# Total Budget Expenses

Combining all sources of revenue, Medicaid is the largest single expenditure for state government. Total spending through the Department of Health and Human Services is \$19 billion. Tuition, lottery, and other receipts lift total expenditures on education to \$16.5 billion. Nearly \$5 billion goes to transportation, including federal funds. Unemployment insurance through the Commerce Department contributes to the \$5 billion in Natural and Economic Resources. Public Safety, General Government, Debt Service, and Reserves account for \$7 billion in state spending.

## TOTAL BUDGET SPENDING

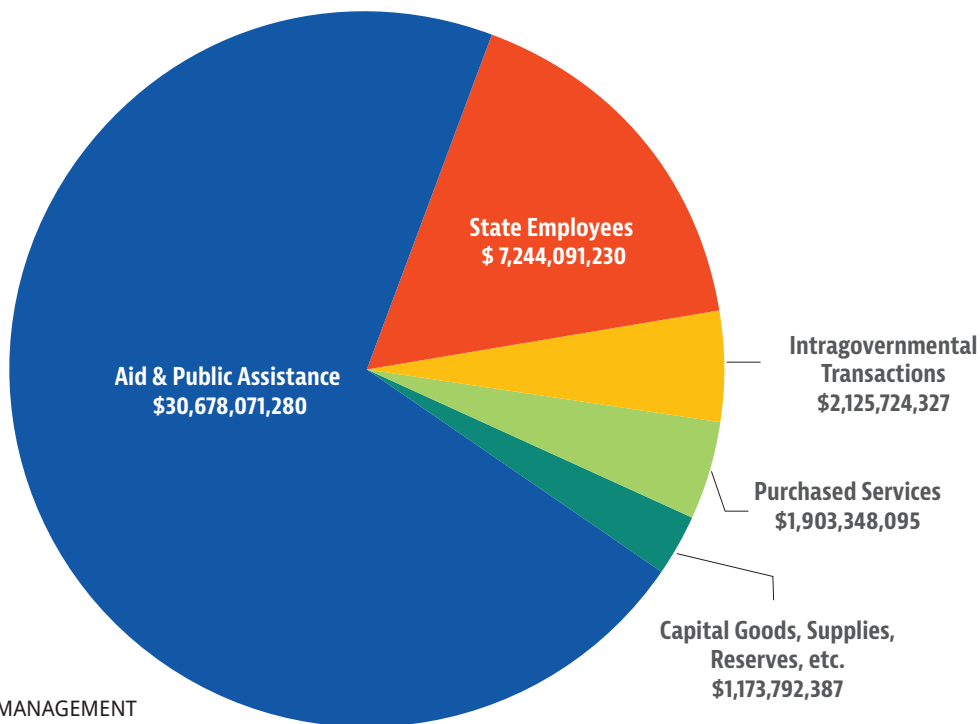


SOURCE: OFFICE OF STATE BUDGET & MANAGEMENT (FY2017-18)

## How Total Funding is Distributed

More than \$30 billion of the \$43 billion in total state spending is in direct payments to people or outside entities for education, Medicaid, and other aid and public assistance programs. State employees receive \$7 billion. Payments from one state government agency to another total \$2 billion. Another \$2 billion goes to outside consultants, temporary employees, and other service providers. The remaining \$1 billion pays for property, plant, equipment, supplies, or goes into reserves.

TOTAL SPENDING BY PURPOSE

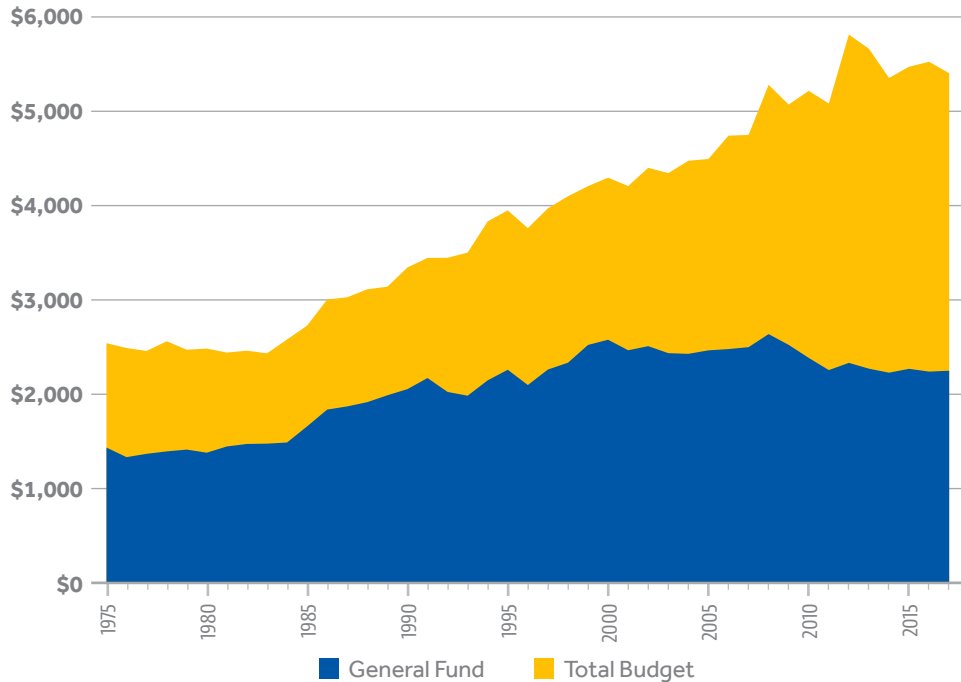


**SOURCE:** OFFICE OF STATE BUDGET & MANAGEMENT

# Spending Continues To Grow

General fund appropriations have stabilized near 1990 levels, but those numbers reflect less than half of total spending, down from 60% as recently as FY2007.

TOTAL REAL PER-CAPITA SPENDING



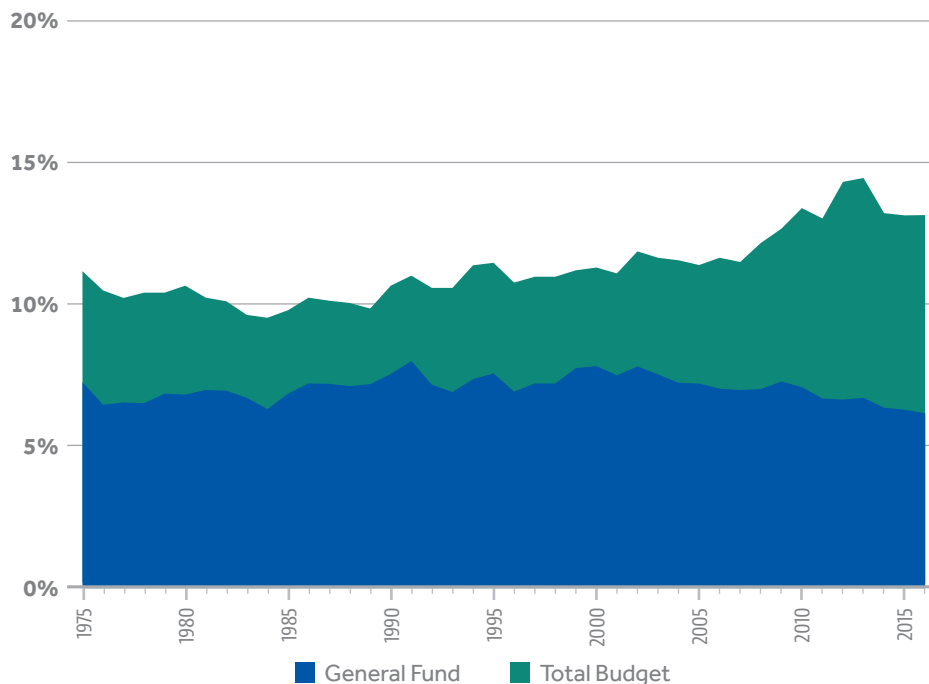
SOURCE: OFFICE OF STATE BUDGET & MANAGEMENT, US BUREAU OF LABOR STATISTICS



## State Government Consumes More Personal Income

*As incomes have grown, state taxes have taken a smaller share of personal income. Total spending from all sources, however, climbed to 13 percent of personal income, up from 10 percent in 1990.*

SPENDING AS A SHARE OF PERSONAL INCOME, FY1974-75 TO FY2015-16

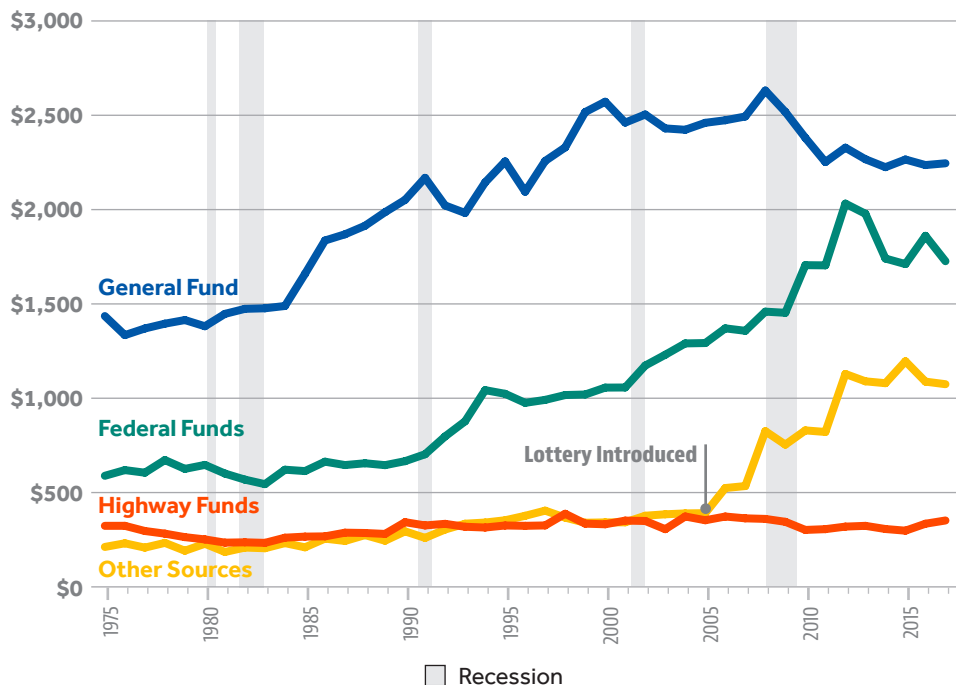


SOURCE: OFFICE OF STATE BUDGET & MANAGEMENT, US BUREAU OF LABOR STATISTICS

## Federal Funds and The Lottery

*Federal funding has ratcheted higher in the wake of recessions since 1990 and has had an upward path since 2000, though it is down from its recent inflation-adjusted high of \$2,000 per person. Among the "other sources," the lottery's contributions to state spending have grown since it was introduced in 2005. Unemployment taxes spiked in 2011 — shown in "other sources."*

REAL PER-CAPITA SPENDING BY SOURCE

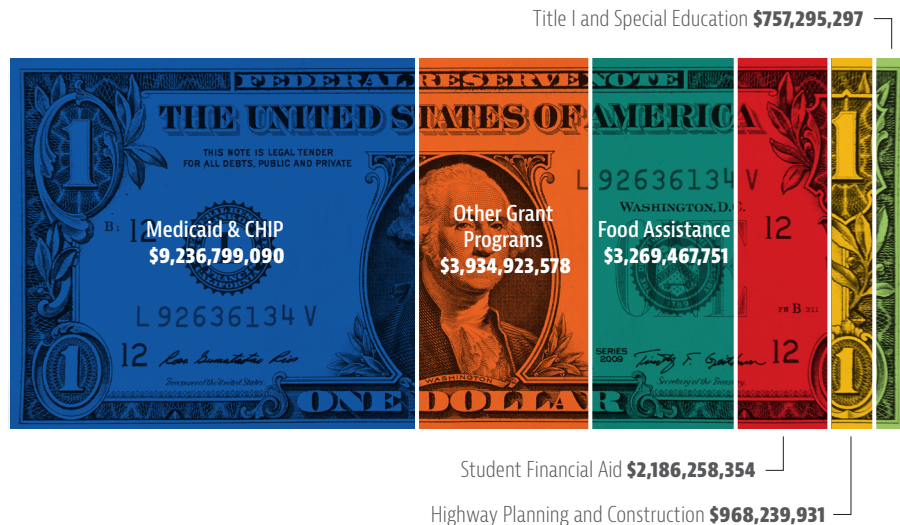


SOURCE: OFFICE OF STATE BUDGET & MANAGEMENT, US BUREAU OF LABOR STATISTICS

## What Do Federal Funds Pay For?

*Federal funds go primarily to medical and food assistance, totaling \$12.6 billion. Financial aid for college and university students and other programs for low-income and special-needs students through 12th grade receive \$2.9 billion per year. Another \$1 billion goes to roads, and the remaining \$3.9 billion is dispersed among more than 700 other grant programs.*

## FEDERAL GRANTS TO NORTH CAROLINA BY PURPOSE

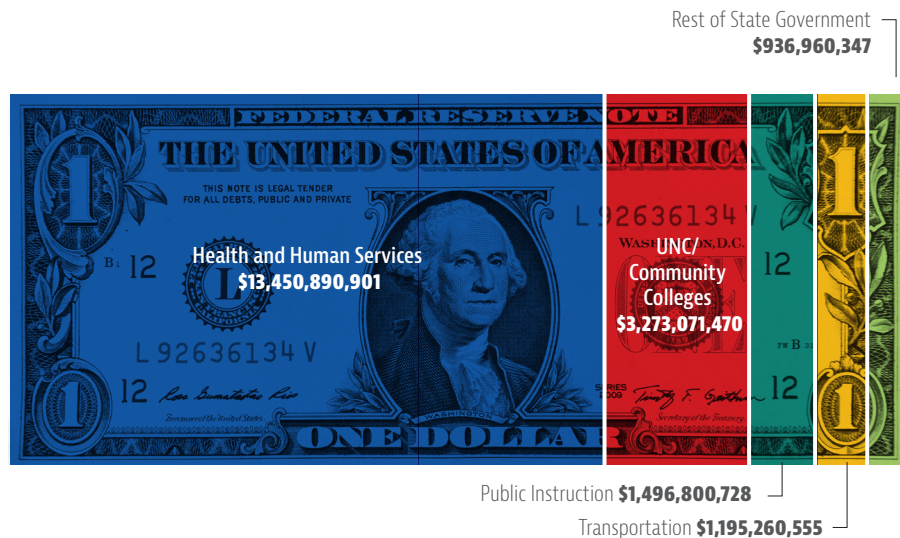


**SOURCE:** OFFICE OF THE STATE CONTROLLER (FY2016-17)

## Where Do Federal Funds Go?

Between Medicaid and other welfare programs, the Department of Health and Human Services receives \$13.5 billion in federal funds, two of every three federal grant dollars to North Carolina. Community colleges and the UNC System receive \$3.3 billion, mainly for financial aid and research grants. Another \$1.5 billion goes to programs in public primary and secondary schools, with \$1.2 billion covering roads and other modes of transportation. Grants to other areas of state government, including public safety and agriculture, account for the final \$900 million.

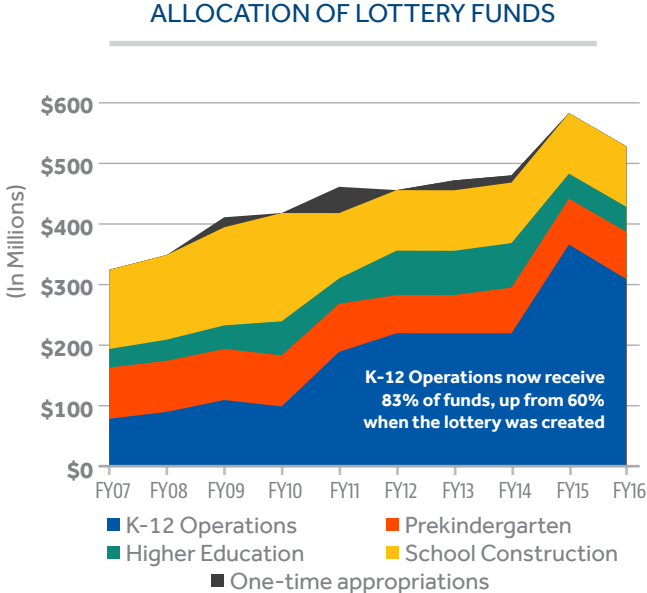
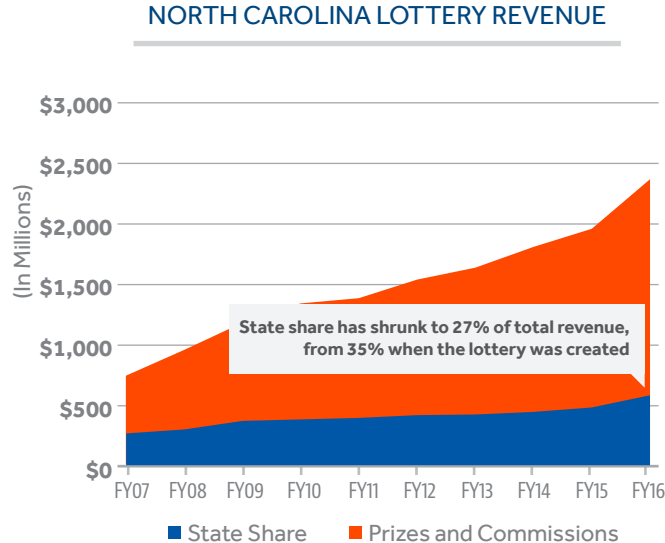
## FEDERAL GRANTS BY RECIPIENT



**SOURCE:** OFFICE OF THE STATE CONTROLLER (FY2016-17)

# State Lottery Funds

Though the state takes a smaller share of lottery revenue than when it was created, total dollars continue to increase, and more of that money pays for K-12 operating expenses.



SOURCE: NORTH CAROLINA EDUCATION LOTTERY



NORTH CAROLINA

# BUDGET IN PICTURES

FY2017-18

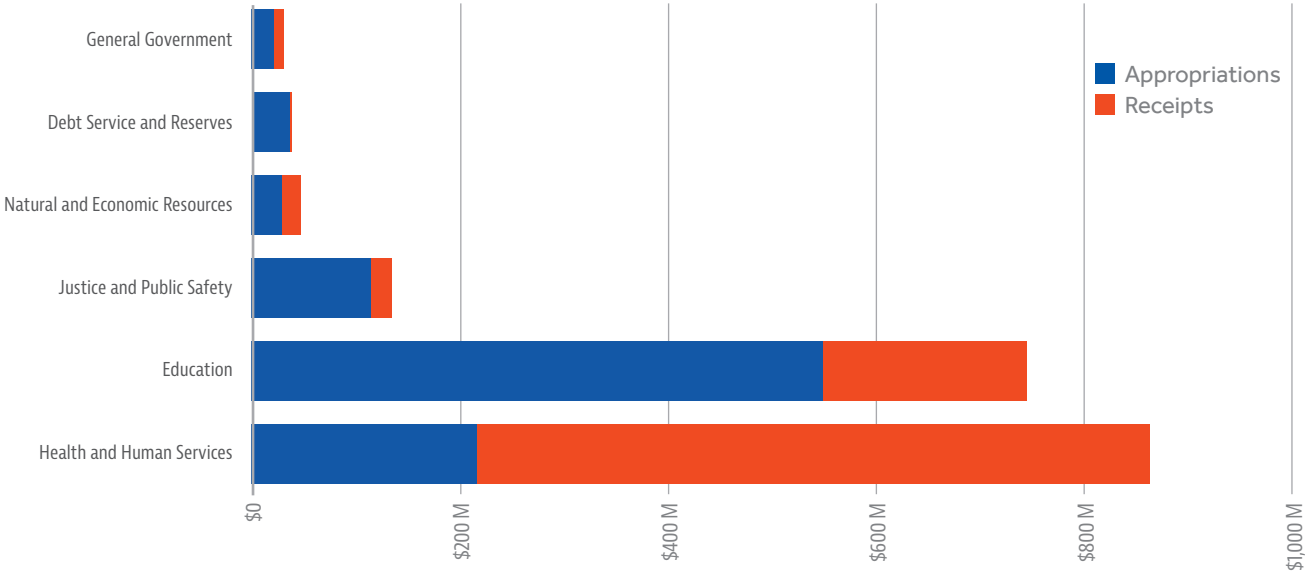
# SPEN

The background features several overlapping, jagged white lines on a dark blue field, resembling a stylized mountain range or a complex data visualization.

# DING

# General Fund Appropriations and Receipts

Government's main purposes, to judge from funding levels, are health, education, and welfare. Education receives the lion's share of state tax dollars. Student tuition and federal funds make up the bulk of receipts. Medicaid's massive federal contribution makes it the largest government program overall. Public safety and other functions receive less funding from all sources.



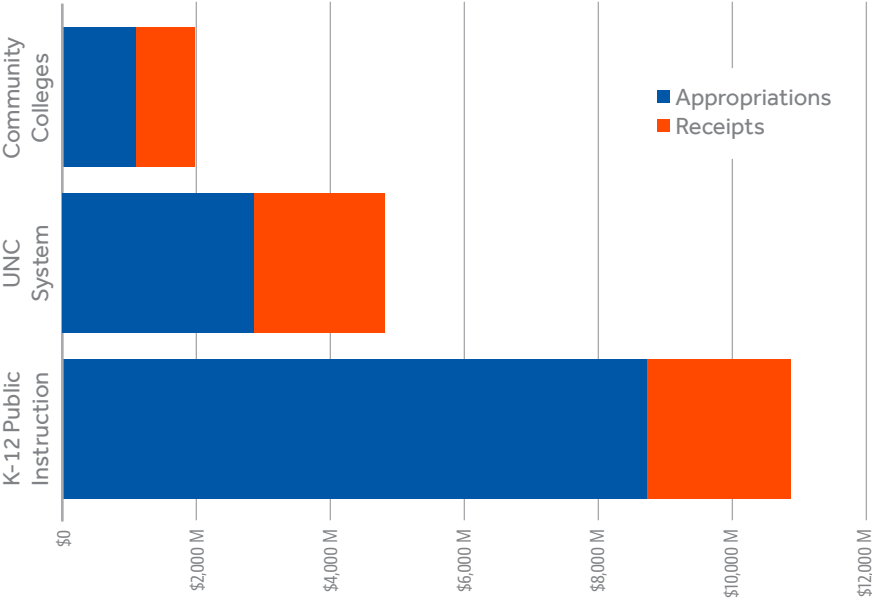
**SOURCE:** OFFICE OF STATE BUDGET & MANAGEMENT (FY2016-17)



# Sources of Education Funding

*K-12 education and community colleges are largely funded with state dollars.*

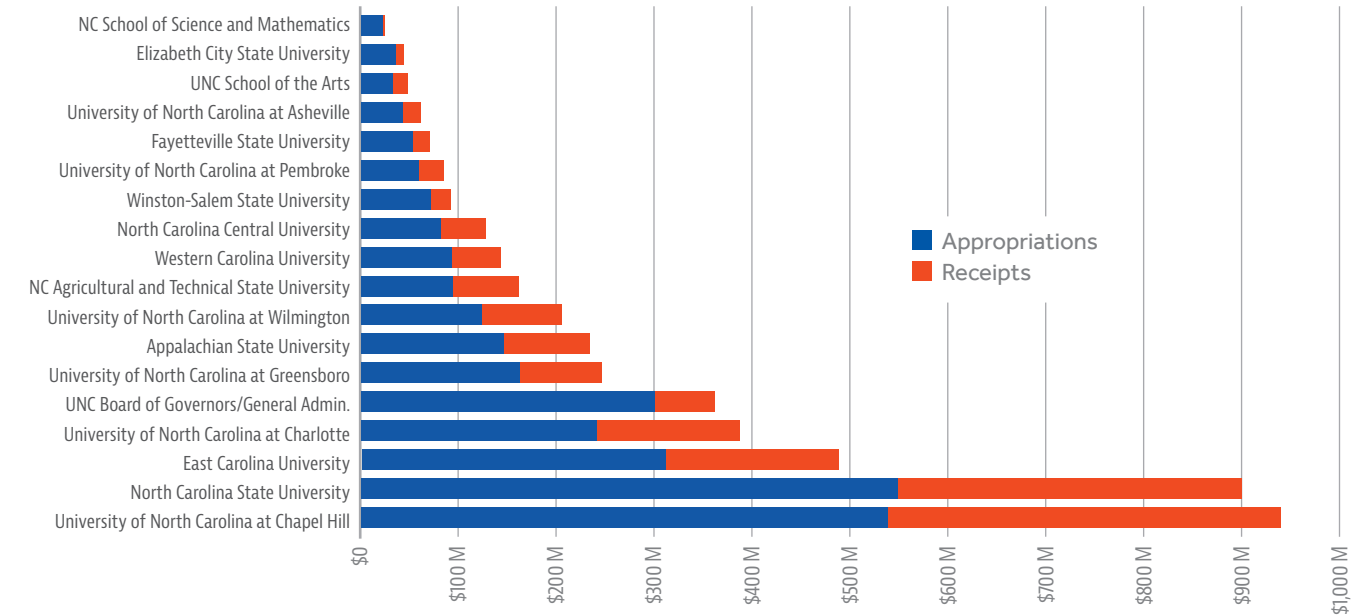
EDUCATION FUNDING SOURCES



SOURCE: OFFICE OF STATE BUDGET & MANAGEMENT (FY2016-17)

# Funding for UNC System schools

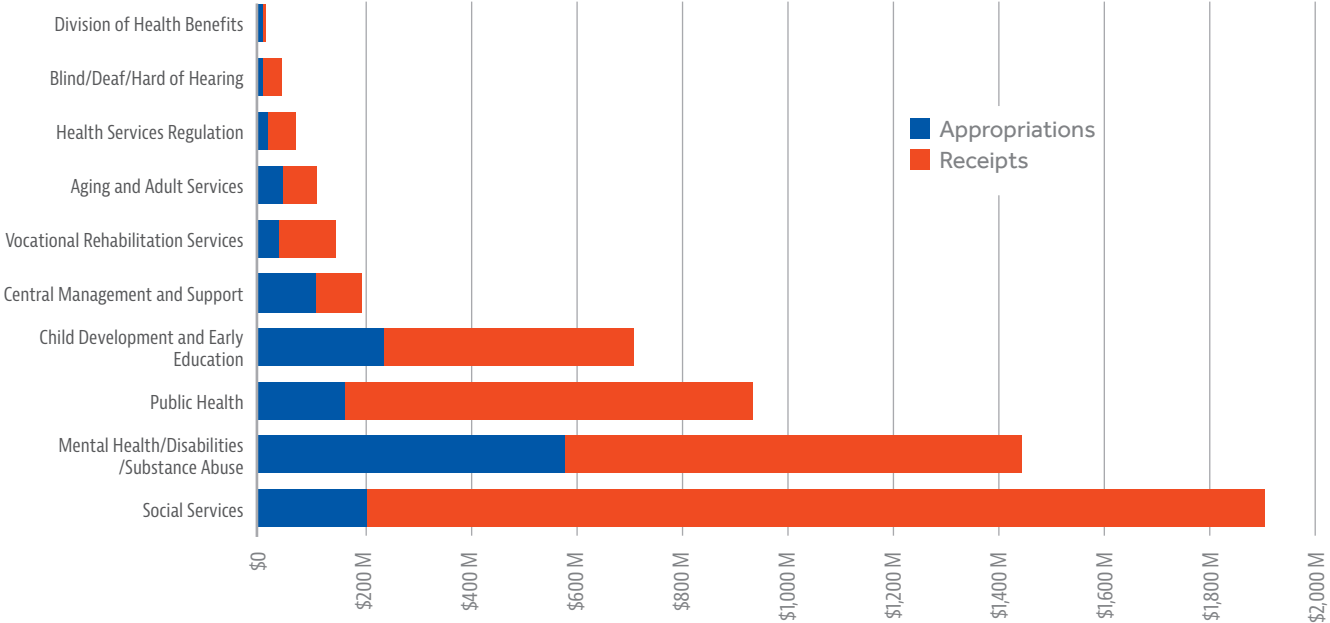
The richest campuses (Chapel Hill, N.C. State, East Carolina, and Charlotte) receive 40 percent or more of their funding from tuition, grants, and other unappropriated receipts. The six poorest campuses rely more on state funding and have budgets under \$100 million each.



**SOURCE:** OFFICE OF STATE BUDGET & MANAGEMENT (FY 2016-17)

# Health & Human Services Funding - Without Medicaid

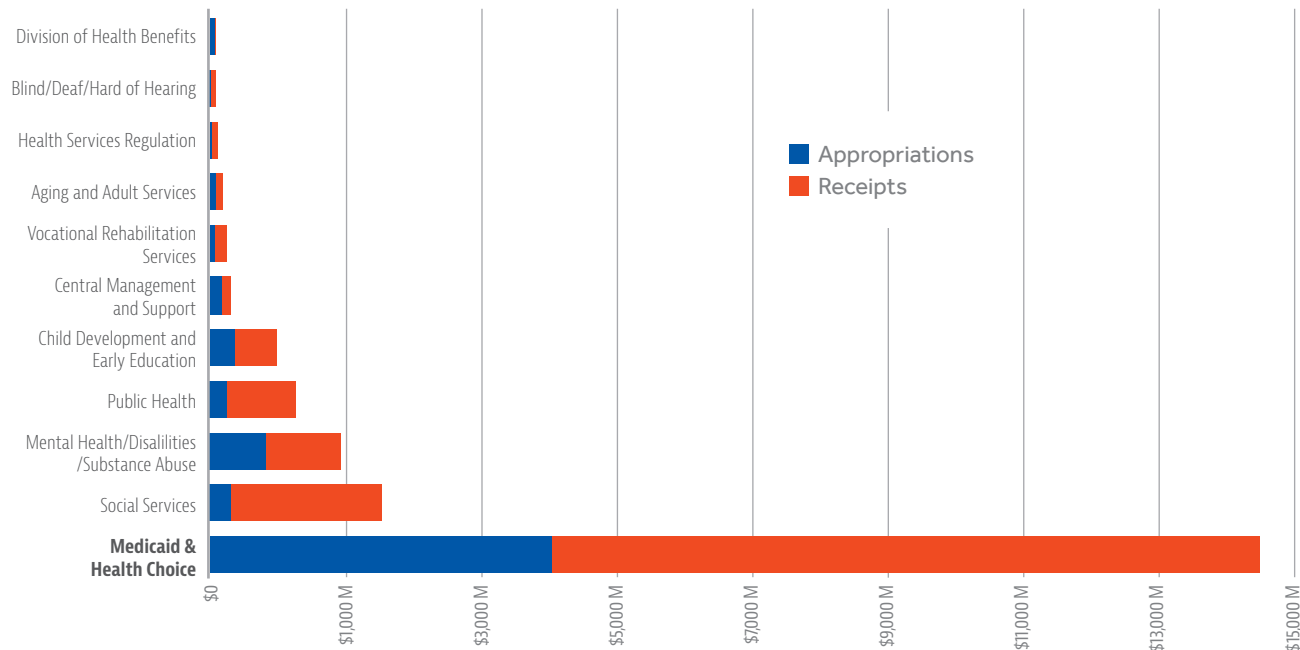
*Receipts, mostly from the federal government, far exceed state appropriations in health and human services.*



**SOURCE:** OFFICE OF STATE BUDGET & MANAGEMENT (FY 2016-17)

# Health & Human Services Funding - With Medicaid

Medicaid dwarfs the rest of the Department of Health and Human Services in spending and funding.

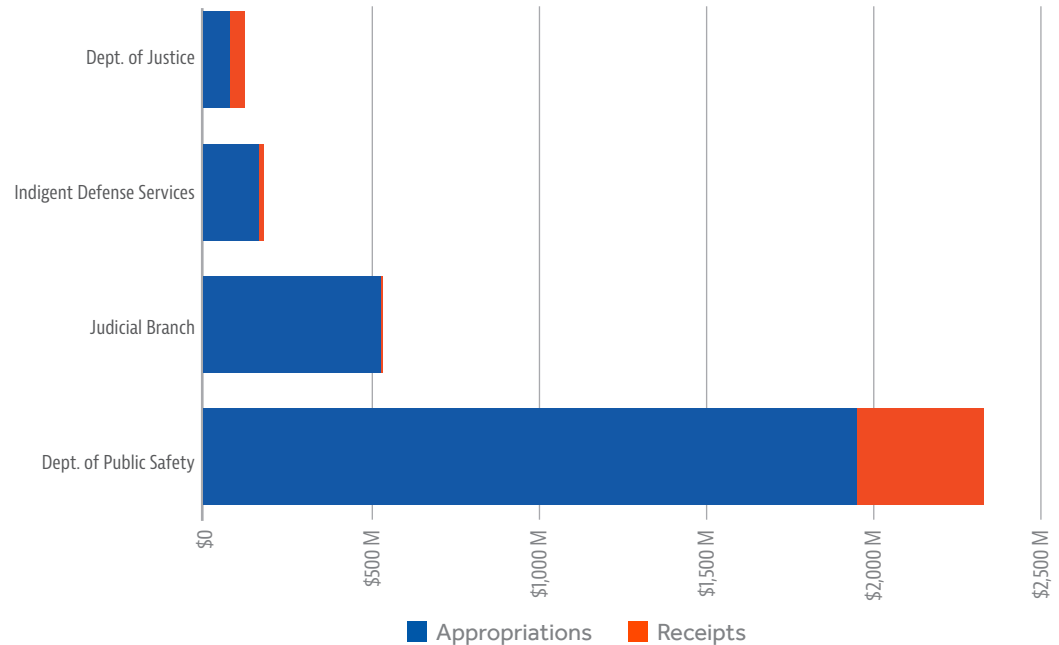


SOURCE: OFFICE OF STATE BUDGET & MANAGEMENT (FY 2016-17)

## Justice and Public Safety Funding

*Justice and Public Safety remain almost entirely state funded.*

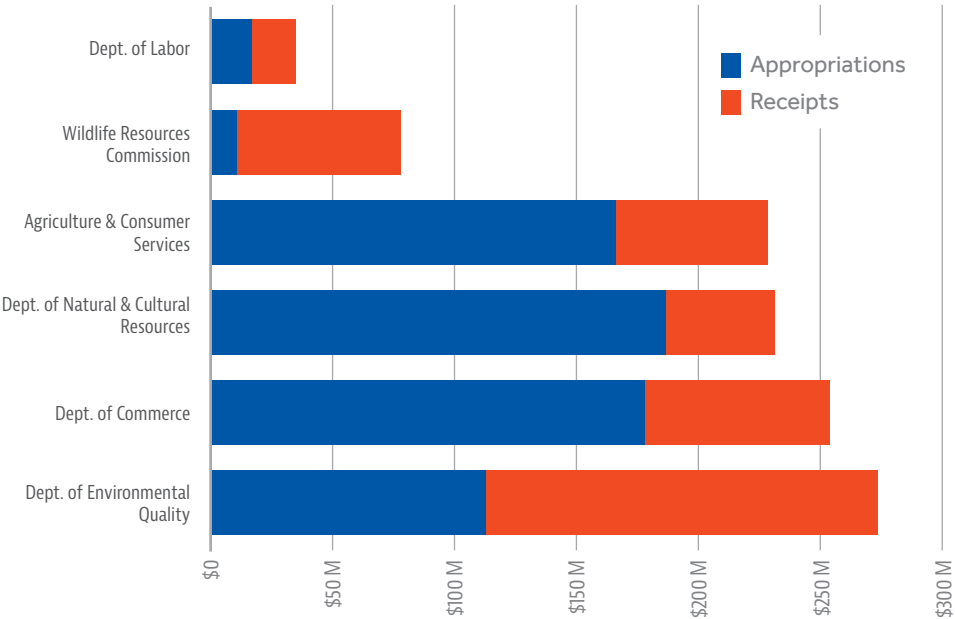
### JUSTICE AND PUBLIC SAFETY AGENCY FUNDS



**SOURCE:** OFFICE OF STATE BUDGET & MANAGEMENT (FY2016-17)

# Natural and Economic Resources Funding

*The Wildlife Resources Commission receives nearly all of its funding from boat registration and titling fees and from hunting, fishing, and trapping licenses, with little in direct appropriations. The Department of Environmental Quality receives most of its money through revolving funds that address specific environmental concerns such as water quality and underground storage tanks. State appropriations are the primary funding source for other agencies.*

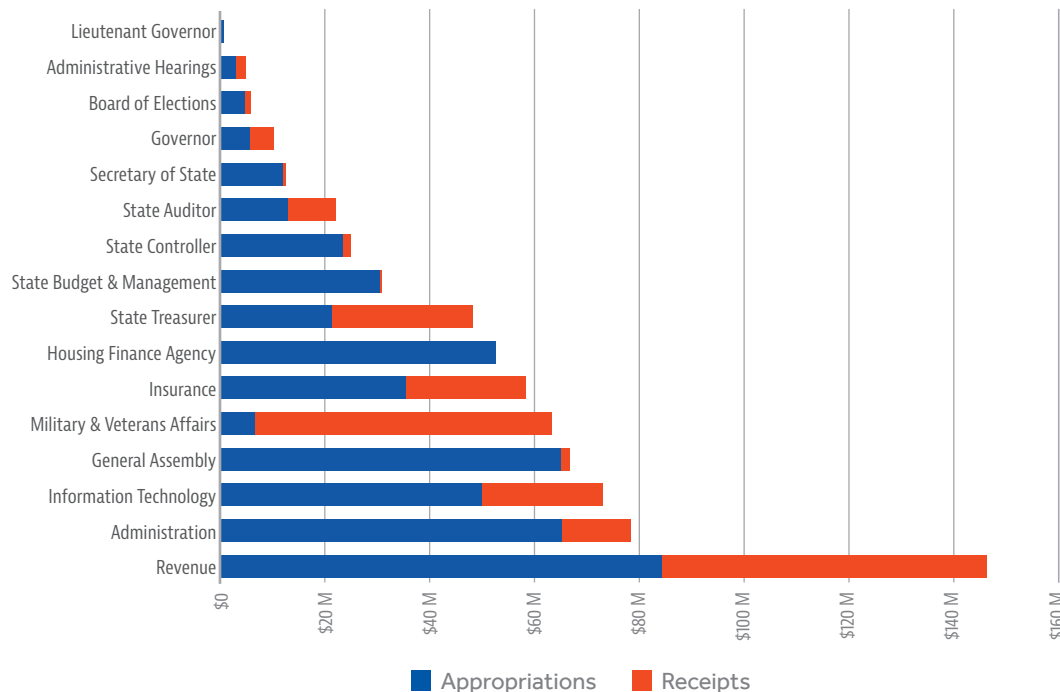


**SOURCE:** OFFICE OF STATE BUDGET & MANAGEMENT (FY2016-17)

## General Government Funding

*Administration, Information Technology, State Treasurer, and State Auditor receive payments for services provided to other agencies. Treasurer and Insurance also make money on investments and fees. Military & Veterans Affairs is mostly federally funded.*

## GENERAL GOVERNMENT AGENCY FUNDS



**SOURCE:** OFFICE OF STATE BUDGET & MANAGEMENT (FY2016-17)



NORTH CAROLINA

# BUDGET IN PICTURES

FY2017-18

# TAXA

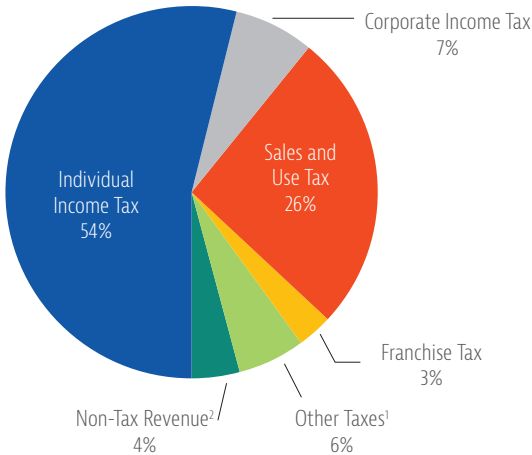


# ATION

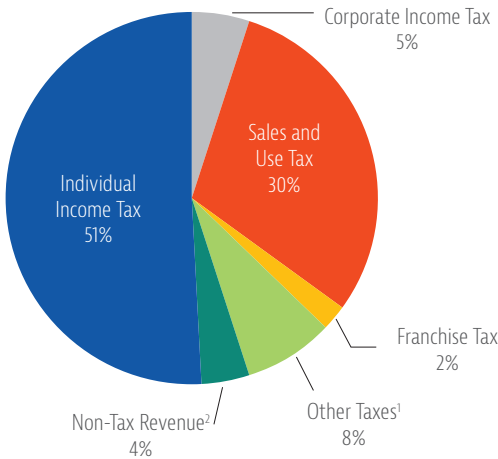
# How the State Collects Money

Tax reform has been shifting the burden from more volatile corporate and personal income taxes to less volatile franchise (business value) and sales and use (personal consumption) taxes.

Sources of State Revenue, 2006-07



Sources of State Revenue, 2016-17



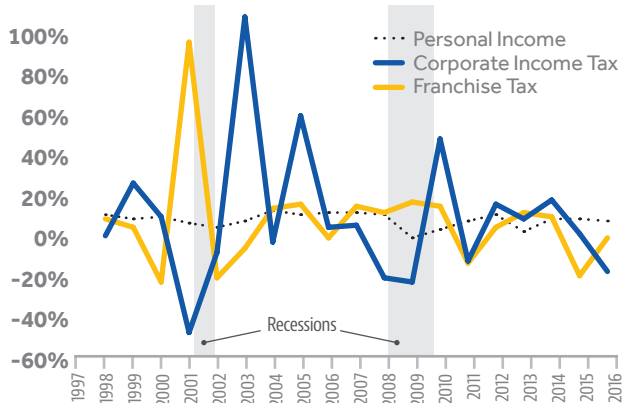
SOURCE: OFFICE OF STATE BUDGET & MANAGEMENT

1.) Taxes on Insurance, Beverages, Tobacco Products, etc.  
2.) Judicial Fees, Disproportionate Share, Master Settlement Agreement, etc.

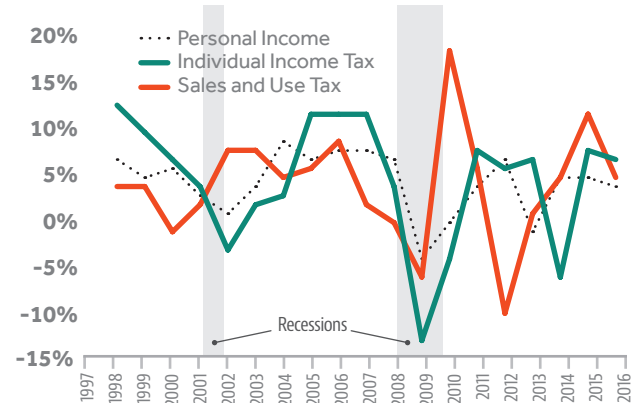
## Why State Government Needs a Savings Reserve, Rainy Day Fund

Tax revenues rise and fall with the economy, but different taxes dampen or amplify broader economic trends as measured in personal income growth. Business taxes are particularly volatile, falling as much as 50 percent in some years and growing more than 100 percent in others. The corporate income tax and franchise tax are entirely business taxes. Much of the volatility in individual income taxes, the state's largest source of revenue, is a result of business earnings and losses. Setting aside surpluses in good years can reduce the need for spending cuts or tax hikes in recessions.

**Revenue Change From Previous Year  
Corporate Income and Franchise Taxes**



**Revenue Change From Previous Year  
Individual Income and Sales Taxes**



**SOURCE:** OFFICE OF THE STATE CONTROLLER, U.S. BUREAU OF LABOR STATISTICS, JOHN LOCKE FOUNDATION

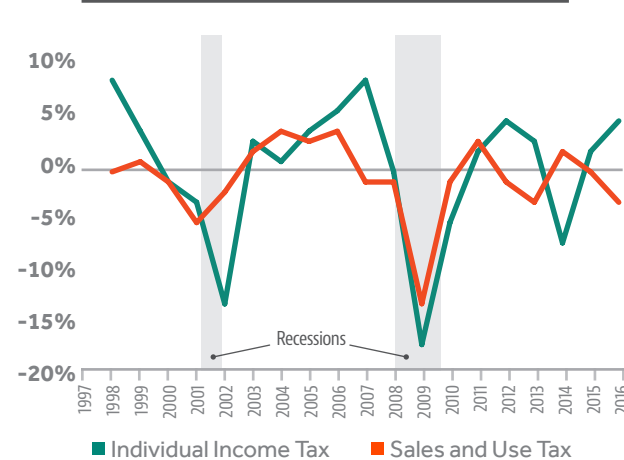
# Forecast vs. Actual Tax Collections

Business income is harder to forecast, which affects both corporate and individual income taxes. Income tax withholding and sales tax collections are more stable, except in the case of economic recessions. The franchise tax on the value of a business is much more stable through all economic conditions. Conservative revenue forecasts keep spending in check and limit risks from missed estimates.

% Difference Between Actual and Forecast Corporate Income and Franchise Taxes



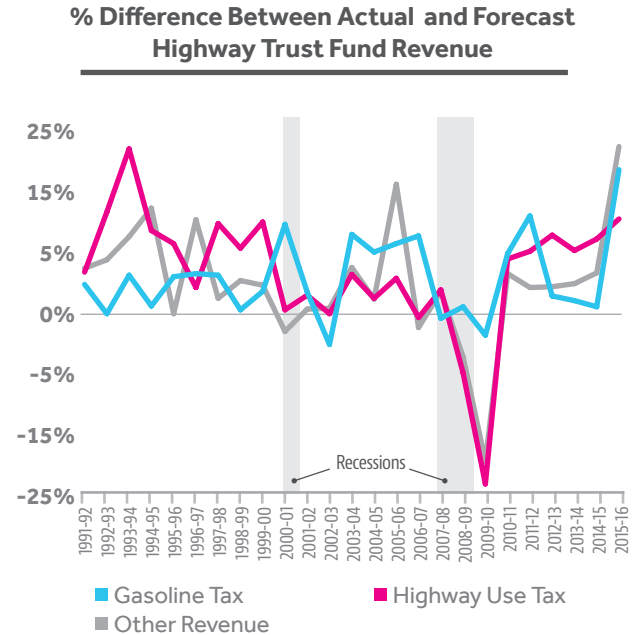
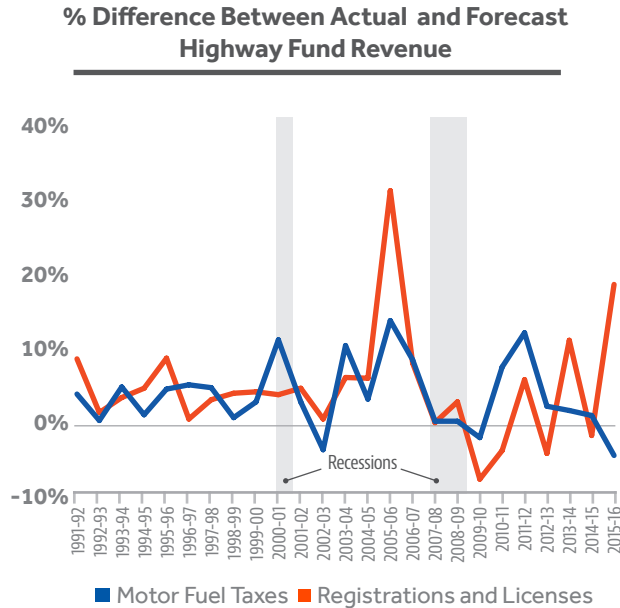
% Difference Between Actual and Forecast Individual Income and Sales Taxes



SOURCE: OFFICE OF THE STATE CONTROLLER

## Volatility of Transportation Taxes

Transportation taxes are less volatile except in response to state or federal policy changes (tax hikes, Cash for Clunkers, etc.).



**SOURCE:** OFFICE OF THE STATE CONTROLLER



NORTH CAROLINA

# BUDGET IN PICTURES

FY2017-18

# FUT

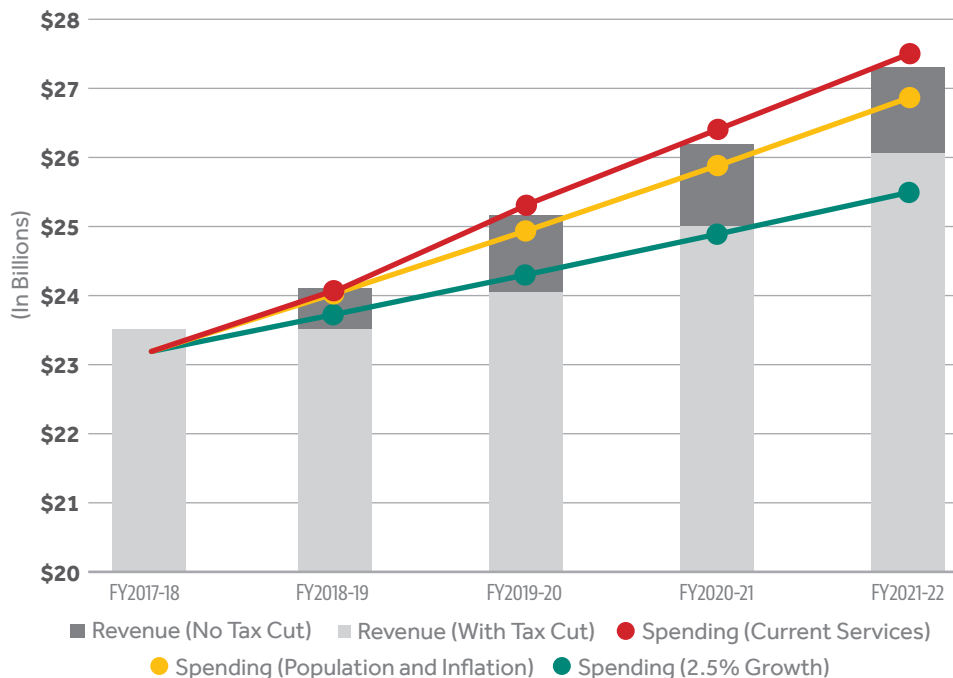
The background of the entire page is a solid dark blue. Overlaid on this are several jagged, white and light blue lines that resemble a stylized mountain range or a complex line graph. These lines are layered, with some appearing in front of others, creating a sense of depth. The word 'FUT' is printed in large, white, bold, sans-serif capital letters, positioned in the lower right quadrant of the image.

# URE

## Reining in Spending Commitments

The Fiscal Research Division provides legislators five-year projections of spending and revenue based on the current budget. This has been a key recommendation of the John Locke Foundation for years and ideally would help inform budget discussions. With no changes from the FY 2017-18 budget in future years, spending would grow faster than projected revenues even without the latest tax reforms. Actual spending growth since 2011 has averaged 2.5 percent per year. Keeping that pace would ensure long-term budget stability with lower taxes.

### REVENUE GROWTH WOULD NOT KEEP UP WITH SPENDING, EVEN WITHOUT TAX CUTS

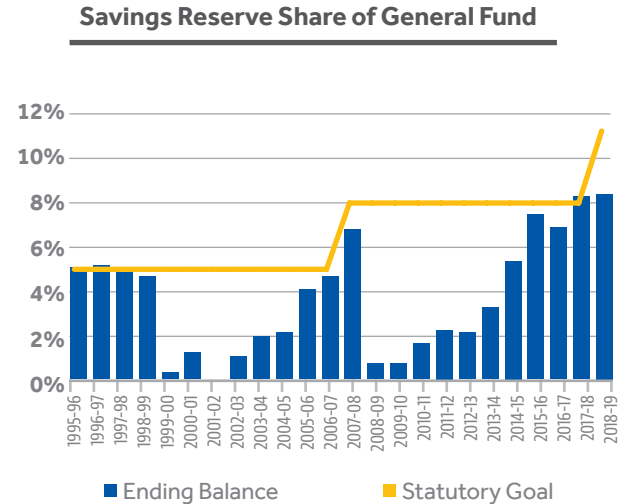
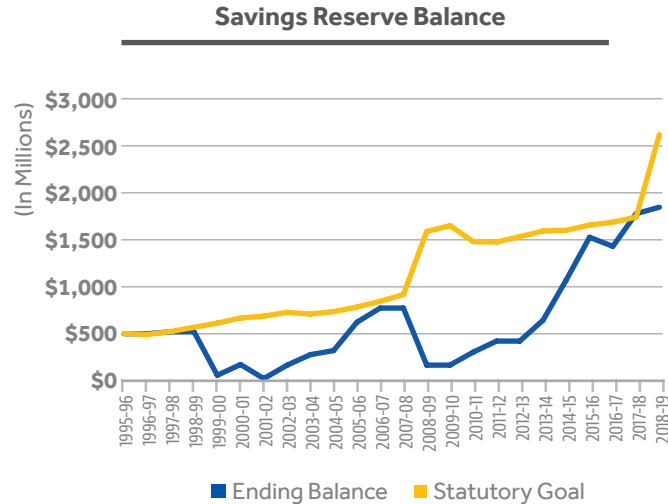


**SOURCE:** NC GENERAL ASSEMBLY FISCAL RESEARCH DIVISION (VIA NEWS ACCOUNTS), JOHN LOCKE FOUNDATION



## Rainy Day Fund

The Savings Reserve (rainy day fund) is at its highest level ever—nearly \$2 billion—and above the 8 percent of General Fund appropriations that has been the goal for the past decade. Legislation passed in 2017 (S.L. 2017-5, H.B. 7) set a new standard for saving based on the amount needed to maintain fiscal health for two years in 90 percent of recessions. Having 11.3 percent of General Fund appropriations set aside in savings, or \$2.6 billion, is the goal to meet that standard.

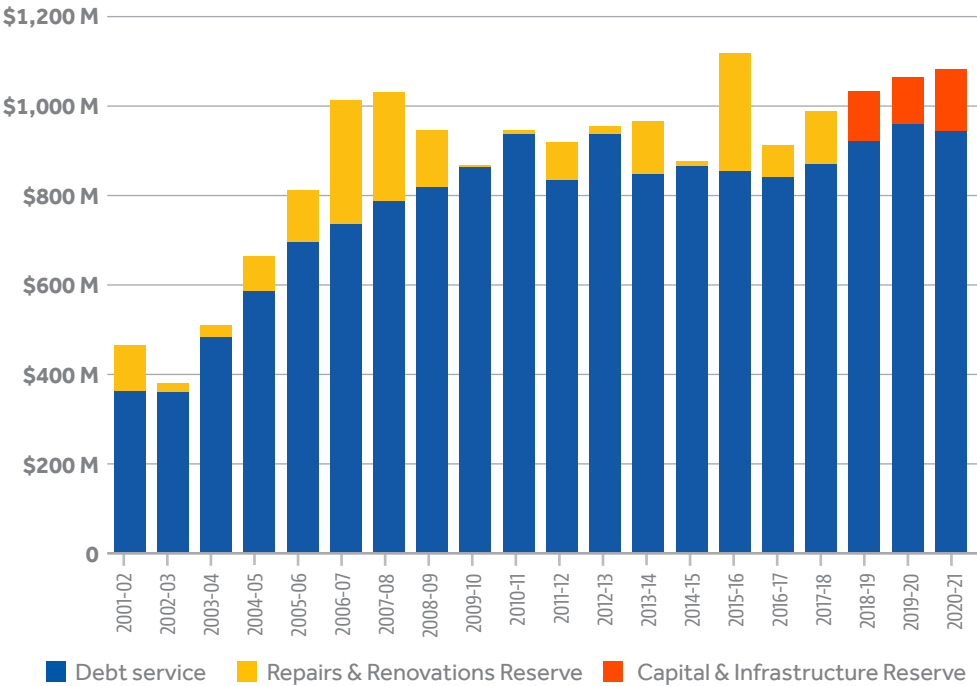


**SOURCE:** OFFICE OF STATE BUDGET AND MANAGEMENT

# Debt, Capital, and Infrastructure

Each year, North Carolina uses a portion of the General Fund to pay down its existing debt, like a household making mortgage and credit card payments. This amount has been capped at 4 percent of General Fund appropriations. In 2017, the General Assembly raised the debt service limit to 4.5 percent and created a new Capital and Infrastructure Reserve, which will use excess debt capacity to pay for repairs, renovations, and capital projects instead of incurring new debt.

DEBT SERVICE AND CAPITAL EXPENDITURES

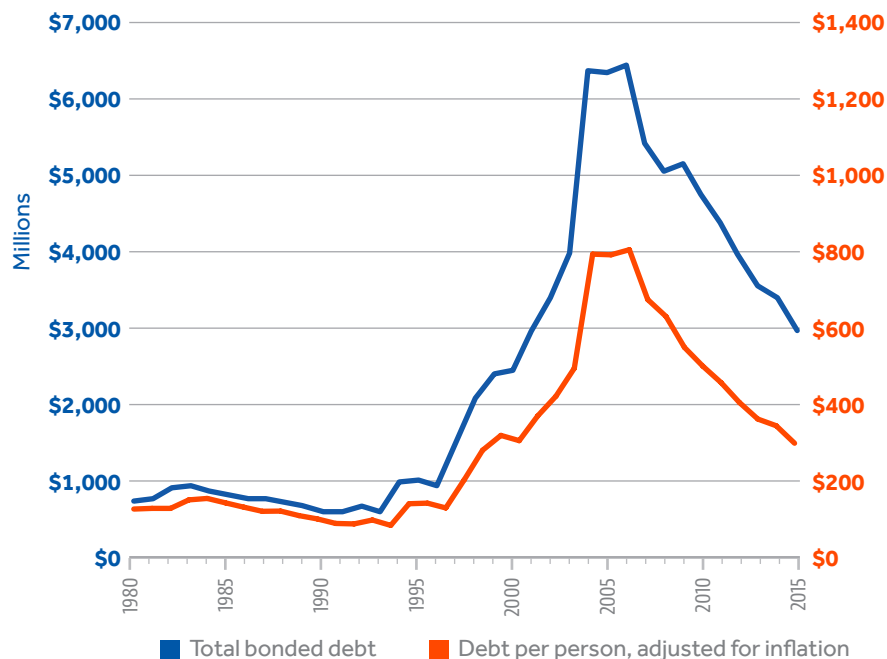


SOURCE: OFFICE OF STATE BUDGET AND MANAGEMENT, JOHN LOCKE FOUNDATION

## State Government Has Less Debt

State debt peaked in FY2007 at \$6.6 billion, more than \$800 per person. Before voters approved \$2 billion for Connect NC bonds in 2016, the last time new debt faced a vote was for community colleges and universities in 2000. But the state continued to issue new "special indebtedness," which climbed from 12 percent of \$5.6 billion in state debt in 2015 to 36 percent of \$5.6 billion in state debt in 2017.

STATE DEBT

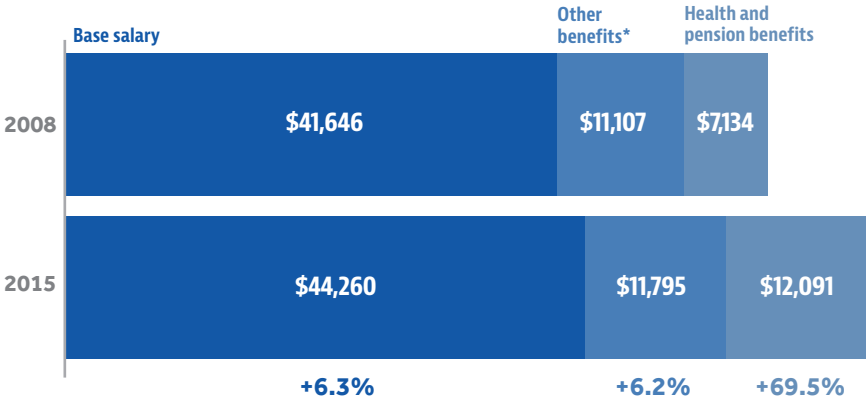


SOURCE: DEPARTMENT OF THE STATE TREASURER

# Health And Pension Benefits Are More Expensive

Health and pension benefits are the fastest-growing component of state employee compensation, up nearly \$5,000 per employee between 2008 and 2015. The 70 percent increase in the cost of these benefits limited the amount available to give pay raises to teachers and state employees. Despite the increased cost to the state as employer, the State Health Plan reduced benefits even as it charged higher premiums to employees and their dependents.

AVERAGE STATE EMPLOYEE COMPENSATION



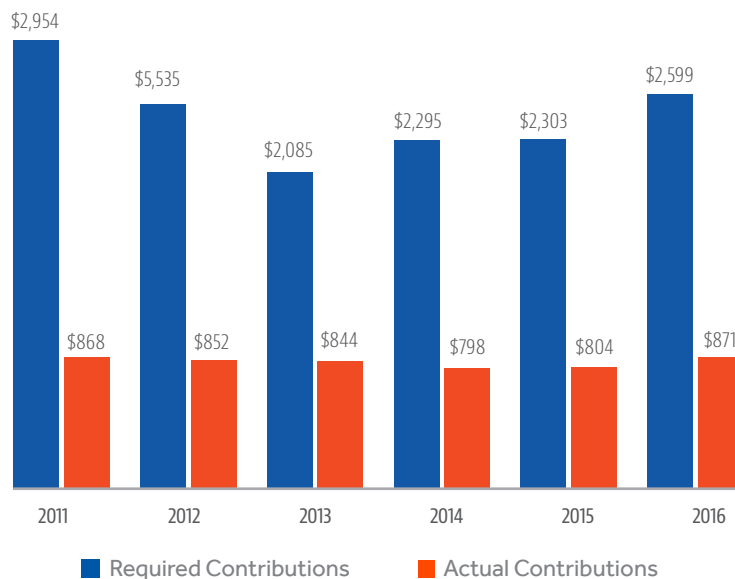
\* Leave, Death Benefits, Longevity Pay

SOURCE: OFFICE OF STATE HUMAN RESOURCES, JOHN LOCKE FOUNDATION

## Retiree Health Benefits Have Never Been Adequately Funded

*State government has never set aside enough money to cover the future cost of health insurance for retired state employees, which has led to a \$32.5 billion unfunded liability for future retiree health benefits. A court ruling in 2017 that the state could not begin charging a premium to those already retired had the potential to increase current and future costs significantly. With few options, the legislature decided to end retiree health coverage for any employee newly hired after Dec. 31, 2020.*

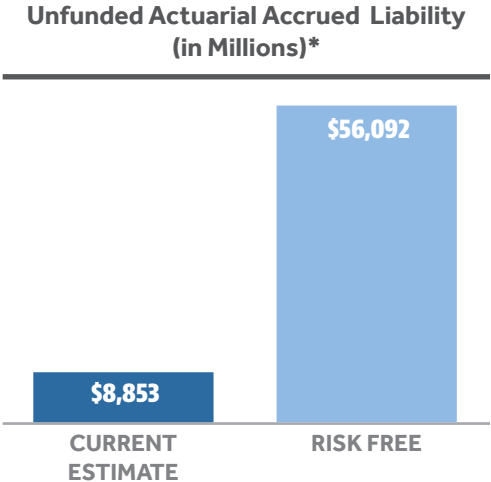
### RETIREE HEALTH BENEFITS: ACTUAL & REQUIRED CONTRIBUTIONS



**SOURCE:** DEPARTMENT OF THE STATE TREASURER

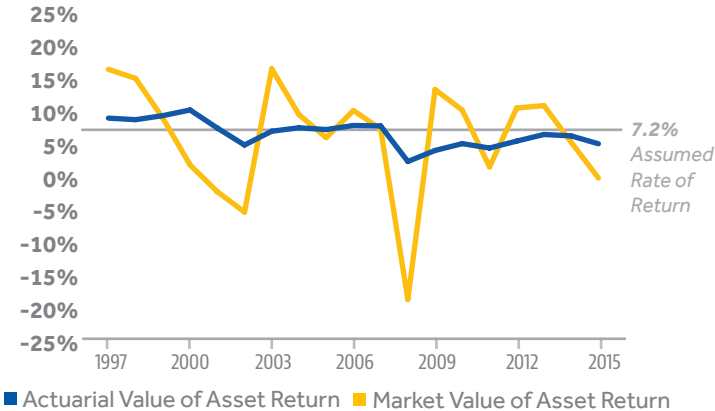
# Pension Obligation May Be Larger Than Acknowledged

Payments into the pension system have been adequate, but investment returns have fallen short, even as former treasurers pursued investments with higher risk. A larger shortfall would compel the state to contribute more and potentially take more from state employees to cover the cost. As it is, the unfunded pension obligation may be significantly more than the \$8.8 billion currently estimated and may be as high as \$56.1 billion to account for the fact that pension benefits are guaranteed to state employees.



\* As of Dec. 31, 2015

**Pension Assets Are Not Growing  
as Fast as Needed**



**SOURCE:** DEPARTMENT OF THE STATE TREASURER





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