BTC Brief

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N.C. Senate Would Have State Stand Still in Face of Uncertainty, Growing Needs

Senate's proposed state budget misses opportunities to build an economy for all.

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The $22.9 billion state budget proposed by the Senate for the upcoming 2018 fiscal year and the $23.4 billion budget for the following year reflects an aggressive pursuit of tax cuts for the wealthy and profitable corporations in spite of increased uncertainty around federal funding to North Carolina and growing unmet needs in communities across the state.

The Senate has been a strong proponent for the flawed limits of arbitrary formulas to guide their budgets. This year, they have continued to use artificial constraints that don't reflect the reality for families, businesses or communities by keeping year over year spending growth to 2.5 percent over last year. These figures fail to reflect the reality of delivering public services; for example, the cost of medical care alone has grown by 3.8 percent over the past year. Moreover, the Senate budget fails to fully address the unanticipated damage from Hurricane Matthew, which is estimated at $2.8 billion, and does not invest in skills training, community economic development and services to poor families, even as communities continue to struggle with mass job loss and high poverty rates.

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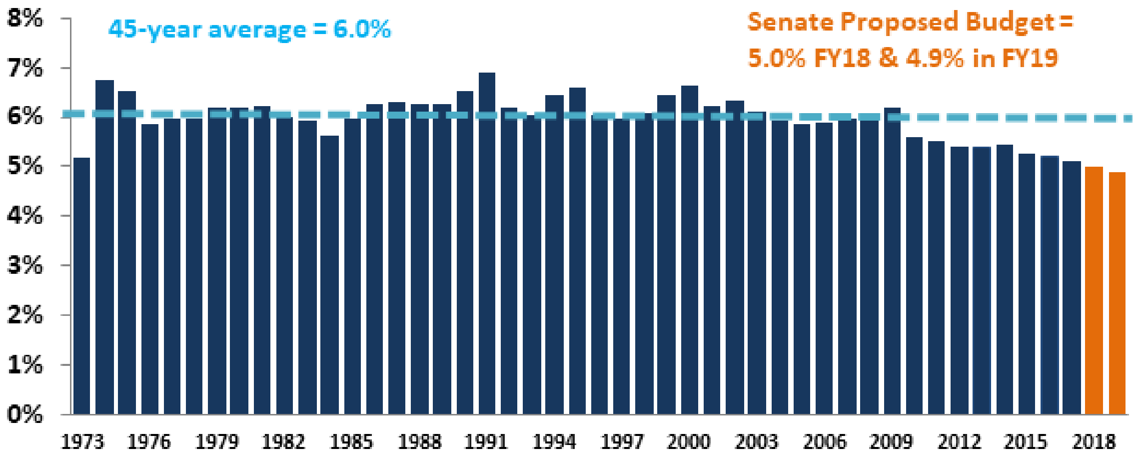
Senate budget proposal would continue the decline in our state commitment to each other

The Senate budget would continue to move away from historic levels of investment relative to the state's economic health. The 45-year average of state investments as a share of the economy is 6 percent, which has allowed North Carolina to sustain the foundations of its economy and make transformative investments in early childhood and career training, for example.

Under the Senate's proposed biennial budget, the level of state investments would remain below that 45-year average: In the first year, investments are 5 percent as a

Figure 1: Senate budget fails to drive economic gains from the national recovery toward a stronger shared foundation



share of the economy, and it drops to 4.9 percent in the second year.

The Senate is constrained by the tax choices made since 2013 that have resulted in $3 billion less in annual revenue than would have been the case under the old tax code.[1] These tax cuts have largely benefited the wealthy and profitable corporations.

The Senate has chosen to add to that loss by continuing to deliver income tax cuts that will primarily benefit the wealthy and profitable corporations in the latest budget proposal. Under their tax plan this year, the personal income tax rate will drop to 5.35 percent on Jan. 1, 2018, and the corporate income tax rate will drop to 2.75 percent by Jan. 1, 2019.

This week will present a compressed timeline for the full review of the budget and will likely mean the full context and implications of investment and policy choices contained in the budget will not be revealed or debated. This stands in direct conflict with how good government should work – making sure that people have the opportunity to engage with the proposals being considered and that the evidence regarding policy choices is presented and debated.

Here are some topline points on how the Senate will pay for its budget and what proposed increased investments mean relative to needs in communities.

The Senate pays for its budget with over-collections, one-time money and reductions to the UNC system, Public Health, Housing Finance and Environment and Natural Resources, among other programmatic cuts.

The state's tax system is expected to raise $23.1 billion in base revenue — an amount that is severely constrained by previously approved tax cuts as noted above. In addition to base revenue, the Senate relies on revenue collections coming in above what officials anticipated ($580 million), money they anticipate agencies will return to the state (known as reversions; estimated at $271 million), and unappropriated dollars from the most recent fiscal year ($208 million). The Senate is required to transfer $100 million of General Fund dollars to the state's Savings Reserve fund, per the special session relief bill passed by state lawmakers in December 2016 to aid communities harmed by Hurricane Matthew, and lawmakers invest an additional $263 million in the fund.

1. Special data request to ITEP, May 2017 of personal income tax structure pre-2013 on current income distribution and levels.

Figure 2

HOW DOES THE SENATE PAY FOR ITS BUDGET?	FY2018	FY2019
Revenue Forecast (Includes Next Round of Corporate Income Tax Cuts)	**$ 23,152,700,000**	**$ 24,135,500,000**
+ Net General Fund Credit Balance	***$ 476,279,046***	***$ 306,975,383***
Unappropriated Balance	*$ 208,607,416*	*$ 306,975,383*
Disaster Recovery Appropriations (S.L. 2016-124)	*$ (200,928,370)*	
Transfer from Savings Reserve	*$ 100,928,370*	
Over Collections FY 2016-17	*$ 580,600,000*	
Reversions FY 2016-17	*$ 271,000,000*	
Replenish Savings Reserve (S.L. 2016-124)	*$ (100,928,370)*	
Savings Reserve	*$ (263,000,000)*	
Repair and Renovations	*$ (120,000,000)*	
+ Recommended Revenue Changes	***$ (422,003,663)***	***$ (900,343,883)***
Tax Law Changes	*$ (323,700,000)*	*$ (709,500,000)*
Diversion of Taxes fro m Short-Term Lease or Rental of Motor Vehicles to Highway Fund	*$ (10,000,000)*	*$ (10,000,000)*
Diversion to Savings Reserve (S.L. 2017-5)	*$ -*	*$ (91,455,000)*
Divert additional MSA funds to Golden Leaf	*$ (10,000,000)*	*$ (10,000,000)*
Transfer from Federal Insurance Contributions Act (FICA)	*$ 1,500,000*	*$ -*
Transfer to Medicaid Transformation Fund	*$ (75,000,000)*	*$ (75,000,000)*
Transfer from Department of Insurance	*$ 660,204*	*$ 1,056,527*
Transfer from the Department of the State Treasurer	*$ (5,463,867)*	*$ (5,445,410)*
Total Revenue Available	**$ 23,206,975,383**	**$ 23,542,131,500**
− Appropriation Requirement	**$ 22,900,000,000**	**$ 23,445,125,555**
REMAINING GENERAL FUND BALANCE	**$ 306,975,383**	**$ 97,005,945**

The second year of the budget proposal is concerning because it does not sustain the progress of the first year. There is just $97 million remaining in the General Fund in the second year after the tax changes reduce state dollars by $709 million, leaving little flexibility for the state to address needs that are likely to arise from the federal budget that will pass in the fall or other state needs that arise. Moreover, the state's Fiscal Research Division has provided legislators with analysis demonstrating that the tax plan will not keep up with the rising cost of public services, creating a projected shortfall in future years as the state's population growth outpaces the state's ability to raise revenue.

The Senate investments fall short of needs and standards

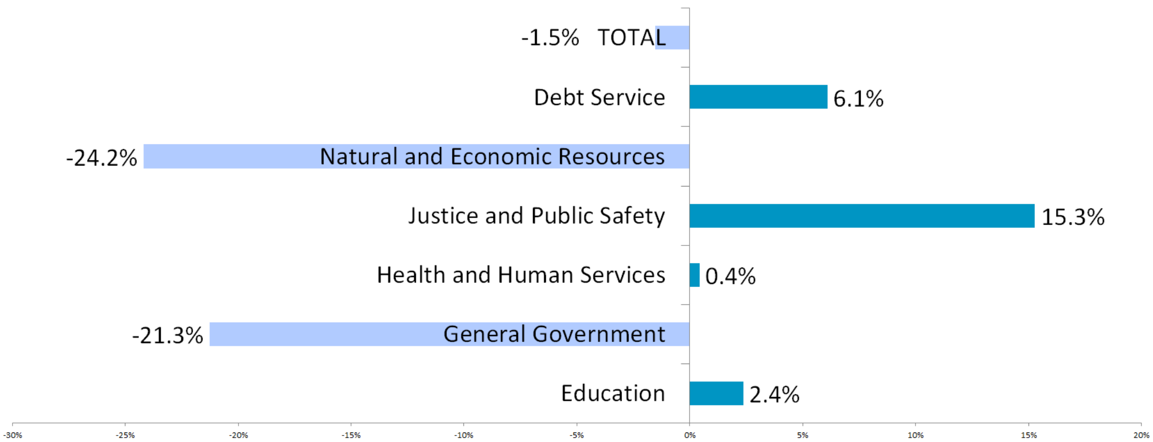
With the release of the Senate budget, Senate leaders highlighted areas where investments were increased year over year. Recognizing some needs in communities and committing public dollars to them will provide some benefits to the broader community and North Carolinians. However, the narrow view of year over year doesn't provide the context to assess whether their investments are actually addressing unmet needs that have persisted since the Recession and despite the economic expansion. Nor do we know whether the investments actually do what is needed to achieve the goals of safe and healthy families, thriving neighborhoods and main streets, and resilient communities.

There are several areas where increased investments fall short of what is needed or recommended. In these areas, it would be possible to make the smart investments needed if the Senate did not continue to cut taxes for the wealthy and profitable corporations.

- The Senate proposes serving an additional 1,150 4 year-olds through NC Pre-K. There are an estimated 67,000 4 year-olds eligible for the program each year. This increase, while progress, still only funds half of the slots in NC Pre-K to fully serve eligible children. To fully meet the need,

Figure 3: Seven years after the Great Recession began, North Carolina still has not increased investments to replace cuts made or meet needs for a thriving state.

Percent change in state funding since Fiscal Year 2007-08, adjusted for inflation



the state would need to make a $191 million investment.

• The Senate proposes increasing funding for textbooks and instructional supplies by $10 million in recurring dollars. This still falls short of pre-Recession spending when there were fewer students in the state's public schools. The State Board of Education requested an increase of $48 million in funding for textbooks and instructional supplies.

• The Senate budget proposes investing $70 million in the rebuilding of Eastern North Carolina communities, businesses and farms and applies an additional $80 million to draw down federal dollars. The estimated cost of the damage is $2.8 billion with just $200.9 million in state dollars provided to date.

There are also significant missed opportunities in the Senate budget. The Senate budget fails to invest in workforce development; provides no funding to support the Raise the Age legislation; reduces investments in affordable housing and fails to target sufficient dollars to community economic development efforts. Even more troubling, the Senate budget allocates federal dollars from the Community Services Block Grant and Community Development Block Grant to critical infrastructure and service investments to connect people and places to economic opportunity, but has left no room to make up those investments if they are cut in the federal budget.