



ENJOY READING
THESE REPORTS?

Please consider
making a donation
to support the
Budget & Tax Center at
www.ncjustice.org

MISSING THE MARK:

Governor McCrory's Budget Proposal is Hampered by Last Year's Tax Changes and Revenue Shortfalls

BY TAZRA MITCHELL, POLICY ANALYST

Governor McCrory's fiscal year (FY) 2015 budget proposal leaves too many vital public services operating at diminished levels and would take North Carolina further from the path of broadly shared growth and opportunity. While it would make progress in certain areas—such as a small pay raise for teachers and state employees—overall, the spending plan fails to meet the needs of children, working families, and communities.

Further progress is hampered by the substantial revenue shortfall the state is facing in the current budget, as well as the projected revenue shortfall for FY2015. Last year's tax plan, which gave a substantial tax cut to the wealthiest households at the expense of low- and middle-income North Carolinians, will drain \$438 million in FY2015 from resources that could be used to invest in schools, health care, public safety and the other building blocks of a strong economy. Despite scaled-back revenue projections, the Governor chose to move forward with the next phase of tax rate cuts that will go into effect next January, rather than stopping these costly cuts.

As a result, North Carolina would find it more difficult to regain lost ground. In the 2015 fiscal year that begins July 1, the state would invest \$1.6 billion—or 7 percent—less in schools, health care and other public services than it did before the onset of the Great Recession, taking account of inflation (see Figure 1).¹ While the Governor's proposal would take some small steps toward getting North Carolina back to pre-recession levels of spending, it would continue to badly underfund vital public services that North Carolina residents and businesses rely on every day.²

MEDIA CONTACT:

TAZRA MITCHELL

Policy Analyst

919/861-1468

tazra@ncjustice.org

Budget & Tax Center

a project of the

north carolina
JUSTICE CENTER

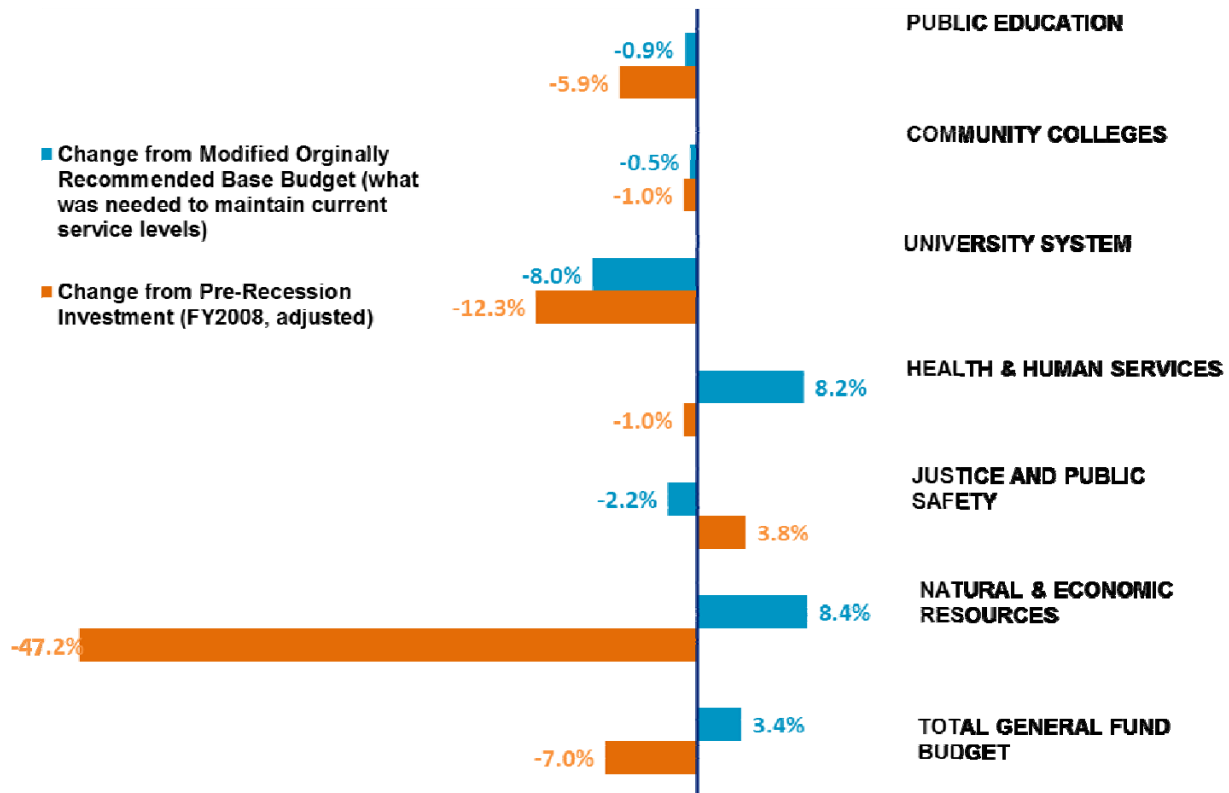
P.O. Box 28068

Raleigh, NC

27611-8068

www.ncjustice.org

FIGURE 1. The Governor’s budget for FY2015 increases spending by 3.4% over the modified base budget, yet investments at every level of education fall short. Overall spending would still be 7% below pre-recession levels.



Source: Budget and Tax Center’s analysis of the Governor’s budget proposal. The author modified the originally recommended base budget for FY2015 that was published last year to reflect the decline in student enrollment in all areas of education and the decline in projected base salaries for K-12 personnel. Also, the Governor provides pay raises to teachers and state employees but places these expansion items in the agency sections of his proposal, rather than in the salaries and reserves section of the budget—breaking from the norm. The author excludes the salary raises from the core areas of the budget and assumes they are in the Salaries and Reserves section of the budget to follow precedent and to avoid artificially inflating spending levels for the core areas of the budget.³

How Does the Governor Pay for his \$20.99 billion budget?

The Governor’s budget is built on the expectation of base tax and non-tax revenues of nearly \$20.96 billion, which is \$191 million short of what the state initially anticipated. The total takes account of the huge cost (\$438 million in FY2015) of the tax plan that lawmakers enacted last year—the benefits of which primarily flow to the wealthy and profitable corporations.⁴ Because those revenues are not enough to cover spending needs, the governor must come up with additional dollars.

The Governor must also deal with a \$445.4 million revenue shortfall for the current fiscal year, which limits the amount of funds that can be carried over into the 2015 fiscal year to help balance that budget. To address the current-year shortfall, the Governor relies heavily on money he anticipates agencies will return to the state from their budgets for this year, some of which results from a directive ordering agencies to curb spending.⁵ He also relies on other one-time dollars.

After addressing the current-year shortfall, the Governor is still able to carry over \$168.3 million in left-over agency funds to help balance his budget for FY2015. He also has an additional \$44 million at his disposal due funds that were forfeited from flexible spending accounts and a settlement reached with an online retailer who voluntarily agreed to start

Budget & Tax Center

a project of the

north carolina
JUSTICE CENTER

P.O. Box 28068
Raleigh, NC
27611-8068

www.ncjustice.org

charging sales tax to North Carolina customers. In the end, the Governor leaves an unspent General Fund balance of \$100.6 million.

It is important to note, however, that the revenue loss from the tax plan could be higher than the state's projected loss. Under an estimate produced for the Budget & Tax Center using the economic incidence model constructed by the Institute on Taxation and Economic Policy, the projected revenue shortfall in FY2015 could reach as high as \$600 million, or more than triple the state's estimate of \$191 million.⁶ Such a revenue shortfall would throw the Governor's budget into disarray, and closing the gap would require agencies to return much more money or the use of substantial amounts of other one-time money.

Funding falls short in key areas

The Governor's \$20.99 billion budget would increase total General Fund spending by \$688.1 million, or 3.4 percent, over what the Office of State Budget and Management determined last year the state would need to maintain current levels of services.⁷ Although this is a step in the right direction, most of the spending increase is targeted to Medicaid and pay raises for teachers and state employees, leaving little for pressing needs in education and other areas of the budget. Overall spending would still be well-below the 45-year average as a share of North Carolina's economy. As such, the Governor's budget would not keep up with growing needs across a number of vital services that directly benefit North Carolina families and the state's economy.

Breaking from the norm, the Governor puts the pay raises for teachers and state employees in the agency sections of his proposal rather than in the Salaries and Reserves section of the budget. To avoid artificially inflating spending levels for core areas of budget and to follow precedent, this report assumes the pay raises are in the Salaries and Reserves section of the budget. The figures below reflect this assumption.

Education: \$11.5 Billion

The Governor's budget falls \$297.1 million short of what is needed for school kids and college students.

K-12: \$7.9 Billion

Spending for K-12 education would fall \$72.6 million short of what is needed. It also would not make up for the deep cuts enacted during and after the economic downturn. Per-pupil spending would still be \$551 less than it was in FY2008, accounting for inflation, when the Great Recession hit. The budget would:

- Save millions in funding for instructional positions and supplies due to the projected decline in student enrollment. Also saves millions due to teacher turnover, which results in savings when veteran teachers leave the classroom and are then replaced by newer, lower-cost teachers.
- Cut \$19.8 million in funding for teacher assistants to freeze funding at current levels.
- Keep the \$10 million appropriation for private school vouchers for K-12 students as part of the Opportunity Scholarship Act that lawmakers approved last year.⁸
- Restore the master's salary supplement only for teachers who hold advanced degrees in the subjects they teach.
- Eliminate all \$3.2 million in funding for the North Carolina Center for the Advancement of Teaching, which provides year-round professional development for teachers. Would eliminate 46 positions.
- Provide roughly \$352,000 to allow teachers of visually and hearing impaired preschoolers to work year-round.
- Provide \$9.7 million in one-time funding for a pilot initiative within eight local school

Budget & Tax Center

a project of the

north carolina
JUSTICE CENTER

**P.O. Box 28068
Raleigh, NC
27611-8068**

www.ncjustice.org

systems to promote retention of the highest quality teachers. Funding is from surplus lottery dollars (not the General Fund).

- Boost funds for textbooks by \$23 million with the use of one-time dollars. In total, funding for textbooks remains well below pre-recession levels. Funding is from surplus lottery dollars (not the General Fund).

Community Colleges: \$1 Billion

Spending for community colleges would fall \$5.4 million short of what is needed. The budget would:

- Increase tuition and fees from \$71.50 to \$72 per credit hour. This is on top of the \$2.50 tuition increase and higher continuation education fee that lawmakers approved last year.
- Provide \$1.9 million to allow recent military veterans who served at a North Carolina military facility and earned an honorable discharge to pay in-state tuition.
- Reinvest \$16.8 million of savings from a decline in enrollment to pay for training programs that support students seeking jobs that pay higher wages but lack enough qualified workers to fill them.
- Shift campus workers' compensation costs to local boards of trustees.
- Keep in place the elimination of the senior citizen tuition waiver that lawmakers approved last year.

Public University System: \$2.5 Billion

Spending for the public university system would fall \$219 million short of what is needed. Per-pupil spending would be \$2,679 less than it was in FY2008, accounting for inflation, when the Great Recession hit. The budget would:

- Save millions in funding due to the projected decline in student enrollment and a change in the enrollment growth formula, which is used to estimate the number of projected student credit hours and the amount of money that universities need to operate.
- Require the system to cut an additional 2 percent, or \$44 million, across all campuses. This is on top of the \$73.6 million in similar cuts that lawmakers already approved for the upcoming school year.
- Underfund need-based scholarships for low- and moderate-income students. It would, however, provide a one-time \$1 million appropriation to the College Foundation of North Carolina, which helps students access federal loan programs.
- Provide \$317,500 in one-time funding to create a pilot internship program for 60 students who attend Historically Black Colleges and Universities.
- Require out-of-state students who receive a "full-ride" scholarship to a North Carolina university to begin paying out-of-state tuition rates, saving the state \$9.3 million. Currently, those students' scholarships are based on lower in-state tuition.
- Provide \$3 million to help translate research and development done on campuses into marketable goods.
- Reduce funding by one-fifth to UNC Centers and Institutes that don't grant degrees or are not central to the educational mission of the university.
- Provide \$5 million in one-time funding for a pilot scholarship program for recent military veterans who served at an NC military facility, earned an honorable discharge, and plan to establish residency in the state. Funding is from surplus lottery dollars (not the General Fund).

Budget & Tax Center

a project of the

north carolina
JUSTICE CENTER

P.O. Box 28068
Raleigh, NC
27611-8068

www.ncjustice.org

Health and Human Services: \$5 Billion

Spending for health and human services would be \$378.5 million above what is needed. But because those funds are largely for Medicaid, the budget would cut key services and rely more on federal funding. The budget would:

- Provide \$123 million to fully fund the projected growth in the number of people eligible for Medicaid and set aside \$1 million for Medicaid reform. Would provide one-time spending increases of \$5.2 million for NC TRACKS and \$4.1 million for NC FAST, which are information management systems for Medicaid and county social services departments.
- Provide \$6.2 million to cover Medicaid provider rates after expected savings failed to materialize last year and save \$6 million by requiring prior authorization for mental health drugs.
- Save \$59.6 million by retaining a portion of the Local Management Entity/Managed Care Organization assessment and another \$15.1 million by retaining a portion of the hospital provider assessment. Provider assessments help finance the state's share of Medicaid costs. Instead of returning those assessments to Medicaid providers, the state would keep a greater share of the fee.
- Allocate \$3.6 million to add roughly 700 student slots to the NC Pre-K program. Total slots would remain below FY2013 levels. Would also eliminate all General Fund support for the program and make it dependent on lottery funding, though the program would also get money for this year only from the federal Temporary Assistance for Needy Families (TANF) block grant.
- Reduce state support for Subsidized Child Care Services by \$13.8 million by relying on the federal TANF block grant. It is unclear if other TANF programs would face a cut as a result.
- Reduce state funding by \$3.8 million on a one-time basis for the AIDS Drug Assistance Program by relying on voluntary drug rebates and additional federal funding.
- Eliminate funding for the Child and Family Support Team program, which identifies and coordinates appropriate community services and supports for children at risk of school failure.
- Boost state oversight of county operations in Child Protective Services, creating 30 positions. And, would provide \$5 million to boost foster care assistance payments.

Justice and Public Safety: \$2.3 Billion Budget

The Governor's budget would spend \$53.5 million short of what is needed in areas key to maintaining an efficient court system and safe communities. The budget would:

- Include no funding to re-establish state-funded drug treatment courts.
- Close a correctional center and make adjustments and modification to other correctional institutions.
- Provide \$3.5 million in one-time dollars to address a shortfall in funding for lawyers to represent indigent defendants.
- Provide \$724,454 in one-time funding to restore funds and 13 positions for Alcohol Law Enforcement that were reduced last year.
- Provide \$1.86 million in FY2015—and only \$689,000 in later years—to expand DNA testing capability in the Western Lab located in Asheville by adding 10 positions and equipment.
- Require the Department of Justice cut an additional \$2.7 million department-wide.

Budget & Tax Center

a project of the

north carolina
JUSTICE CENTER**P.O. Box 28068
Raleigh, NC
27611-8068**www.ncjustice.org

Natural and Economic Resources: \$377.7 Million Budget

While it appears that the Governor's budget would increase spending on natural and economic resources by \$29.4 million compared to what is needed, a portion of the bump reflects a budget gimmick enacted last year whereby lawmakers shifted off-budget trust funds to the General Fund. Some of this "additional" funding is money that was already dedicated to pay for economic development, agricultural services, and environmental regulations. In the end, key services would still get cut, on top of a nearly 50 percent spending cut since FY2008. The budget would:

- Fail to restore funding to community-based economic development that targets lower-income and more disadvantaged communities—such as the Community Development Initiative, the Minority Economic Development Institute, and the NC Association of Community Development Corporations.
- Support privatization of the Department of Commerce by shifting 67 positions into the new nonprofit Public Private Partnership for economic development.
- Restore \$500,000 in funding to the Common Follow-up System, which tracks former participants in the state's education and job training programs, and provide \$500,000 in one-time funds to recapitalize the Main Street Solutions Program, which focuses on downtown economic development to support small businesses and job creation.
- Provide \$2.5 million in non-recurring funding to the One North Carolina Small Business Fund, which supports early-stage funding for small, high-growth, and high-tech businesses across the state. Funding comes from the One North Carolina Program.
- Provide recurring increases of \$1.2 million to the Community Development Block Grant program to support the purchase and installation of new grants management software and provide the state match for federal funds. This program provides financial support for building water/sewer infrastructure and shell buildings to promote economic development in designated distressed census tracts.
- Waive the fee for the apprenticeship program and transfers \$300,000 from the Community College System to the Department of Commerce cover the cost. This program is a federally-administered program that places workers in apprenticeships in certain high-demand occupations.
- Provide \$596,000 in non-recurring funds to DENR for research and monitoring the state's existing coal ash ponds and \$1.2 million in recurring funds to support additional positions and operating expenses associated with the regulation and clean-up of coal ash ponds.
- Provide \$176,000 in recurring funds to support the state's new fracking regulations. And \$3.46 million in recurring funds to continue the clean-up of residential leaking underground storage tanks throughout the state—but pays for it by making cuts to existing programs.

Miscellaneous

The budget also would:

- Boost starting pay for teachers with up to 7 years of experience to \$33,000. More experienced teachers will receive an average pay increase ranging from 2 percent to 4.3 percent. Other school-based personnel receive either a 2 percent pay raise or a \$1,000 salary and benefit increase.
- Provide a flat \$1,000 pay raise for most state employees. Some others receive a step increase. This is the first pay raise since 2010, when a raise of 1.2 percent was awarded.
- Make no additional cuts to the Housing Finance Agency but keep in place the \$900,000 cut that lawmakers approved last year.
- Send \$42 million to the Rainy Day Fund and another \$42 million to the Repair and Renovations savings account, which is used to address deteriorating state facilities.

Budget & Tax Center

a project of the

north carolina
JUSTICE CENTER

P.O. Box 28068
Raleigh, NC
27611-8068

www.ncjustice.org

SOURCES:

- ¹ These figures reflect the comparison of the Governor's proposed \$20.99 billion FY2014-15 budget to the FY2007-08 inflation-adjusted enacted budget of \$22.58 billion (\$20.66 billion, unadjusted).
- ² The current FY2013-14 budget spends 8.3 percent below pre-recession levels, accounting for inflation. Overall, his budget proposal would make slight progress and spend 7 percent below pre-recession levels.
- ³ Teachers and state employees were given a pay raise in the FY2009 and FY2012 budgets. Budget documents for these fiscal years follow precedent and place the pay raises in the Salaries and Reserves section of the budget, not in the major agency sections of the budget. The author's analysis thus follows the precedent of previous budget practices to make a proper comparison to the FY2008 budget.
- ⁴ Johnson, Cedric. "BTC Reports: Final Tax Plan Falls Far Short of True Tax Reform." NC Budget and Tax Center. August 2013.
- ⁵ On March 27, 2014 Governor McCrory issued a memo mandating agencies to curb spending in April 2014. Another memo extended this mandate for the remainder of the fiscal year. These are mandated cuts to state programs.
- ⁶ Special data request to the Institute for Economic and Tax Policy. May 2014.
- ⁷ As noted in Figure 1, the author modified the originally recommended base budget for FY2015 that was published last year to reflect the decline in student enrollment in all areas of education and the decline in projected base salaries for K-12 personnel.
- ⁸ Appropriation actually appears in the UNC System budget, where the NC State Education Assistance Authority was created.

Budget & Tax Center

a project of the

north carolina
JUSTICE CENTER**P.O. Box 28068
Raleigh, NC
27611-8068**www.ncjustice.org