

## 7. Where Are We Now?

**N**orth Carolina, like most other states around the nation, is suffering through a severe fiscal crisis. Revenue growth is stagnant, the cost of services—and the demand—is growing, and lawmakers are struggling to reach consensus on short or long-term solutions.

### **A “PERFECT STORM” PUMMELS THE BUDGET**

Unfortunately for those wishing to assign blame, there is no single reason for the state’s current predicament. In the mid and late 1990s, North Carolina was one of the most aggressive tax-cutting states, enacting permanent tax cuts of approximately 7% of the current revenue stream. Then, starting at the end of the 2000–01 fiscal year, the economy began to falter, causing dramatic job losses and a stock market decline that turned lucrative capital gains into capital losses. As mentioned earlier, a weak economy means less money for state government. In 2001–02, the state’s General Fund actually brought in less revenue than the previous year, an almost unheard of occurrence in North Carolina. During the economic boom period of the 1990s, the state also made some substantial spending decisions. Examples of these new investments include raising teacher pay to the national average, creating the Clean Water Management Fund to pay for water quality improvement projects throughout the state, creating the innovative and now nationally modeled Smart Start Program for very young children, and issuing voter approved bonds for higher education. These three factors—the tax cuts, the economic downturn, and the new investments—combined to create the “perfect storm” in which we now find ourselves.

### **SHORT-TERM BUDGET FIXES**

In 2002, lawmakers balanced the budget primarily with a patchwork of short-term solutions some observers liken to budget duct tape. For example, the state diverted funds slated for other purposes, like highway funds and tobacco settlement receipts, to the General Fund. A third piece of the short-term solution was to postpone the sunset of two tax increases enacted in 2001—an increase on the state sales tax rate and a new top income tax

bracket on high-end earners. Although many lawmakers would like those temporary tax increases to expire, the revenue growth left over is not sufficient to cover the growth in the cost of services—much less to end those tax increases and make any new investments. Another piece of the budget “fix” of 2002 was to end payments to local governments in exchange for allowing them to increase the local sales tax rate by .5¢. Currently, all 100 counties have taken the state up on its offer and increased the local sales tax rate to 2.5¢.

### WHAT HAPPENED THIS YEAR?

The current fiscal year (2003–04) began on July 1, 2003, and will end June 30, 2004. State lawmakers agreed on a two-year budget only hours before state government may have shutdown. Both the General Assembly and the governor were forced to stomach some painful compromises. In all likelihood, there are very few lawmakers or lobbyists who are truly pleased with the budget as it was adopted. Many lawmakers believed that allowing the two tax increases mentioned earlier to continue was tantamount to a tax increase, while other lawmakers considered the nearly \$1 billion in spending cuts too deep in some areas. In the end, lawmakers agreed to continue the 2001 tax increases but not raise other

taxes, despite an effort by the Senate to raise tobacco and alcohol taxes. The final budget essentially holds the line on current state services, although there are significant cuts in some areas, such as Medicaid and summer school courses at community colleges, and some modest increases in government services in other areas, such as lower class size in public schools.

Next year will be equally difficult as expenditures—like kudzu—continue to grow to cover increases in populations who need services.

It is worth noting that the budget adopted on June 30th officially covers the period through June 30th of 2005. In the middle of the two-year cycle, lawmakers may enact adjustments to the second year of the budget. The decisions facing lawmakers in 2004 regarding what changes to make to the second year of the budget are daunting, especially in light of how difficult it was to come to agreement on this year’s budget.

### 2004–05 CHALLENGES

To begin with, some analysts believe that the revenue estimates for the second year are too optimistic. If those estimates are lowered, then the state will be forced to make deeper spending cuts or raise taxes. On top of that, there are several spending items that the legislature typically funds

in the second year of the budget cycle that are considered expansion items (even though they are almost always funded) and there can be significant consequences to not funding those items. Some important examples of these items include covering the growth in higher education enrollment, paying for teacher and employee pay and benefits increases, funding repairs and renovations, and contributing to the rainy day fund.

Most lawmakers agree that these are important spending priorities that should be funded, but the consensus quickly breaks down when it comes to how to pay for them—that is, raising taxes or finding offsetting spending cuts. The strategy in the 1990s—relying on revenue growth fueled by the economy—is unlikely to be a viable solution again for several years. In fact, the General Assembly’s fiscal staff has projected that revenue shortfalls will continue for the next several years. If the legislature does find the money for these items, General Fund budget growth could exceed the governor’s stated goal of not exceeding the growth of the 10-year average in total personal income, making it even more likely that these items will either not be funded or will be funded through deeper spending cuts in other areas.

## NC SCHOOL BUS TRANSPORTATION

They’re big, they’re yellow and over the course of a school year they travel more than 154 million miles on North Carolina’s highways. School bus transportation is big business in the state, with more than 1.2 million students using the public transportation each day. That’s nearly double the number of students who used buses just 10 years ago. The state spends over \$311 a year on each student who rides the bus, a steep increase from the \$185 it spent just 10 years ago.

NC SCHOOL BUS TRANSPORTATION STATISTICS	1990–1991	2000–2001
Miles	124,846,740	154,944,392
Miles per Day	693,593	860,802
Miles per Average Daily Membership (ADM)	116.6	121.6
Buses Operated	13,049	13,127
Miles per Day per Bus	53	97
State Expenditures	\$130,073,101	\$217,865,344
Students Transported	699,907	699,615
ADM per Bus	82	97
State Expenditures per Mile	\$1.04	\$1.41
ADM	1,070,297	1,274,326
Percent ADM Transported	65.4%	54.9%
State Expenditures per Student Transported per Year	\$185.84	\$311.41

SOURCE: NC Department of Public Instruction

FIGURE 7.1

## 7. Where Are We Now? *continued*

### 2003–2005 GENERAL FUND APPROPRIATIONS (SEE DETAIL IN APPENDIX A)

#### **Education 56%**

Community Colleges  
Public Education  
University System

#### **Health & Human Services 24%**

Office of the Secretary  
Child Development  
Facility Services  
Medicaid  
NC Health Choice  
Public Health  
Social Services  
Vocational Rehabilitation

#### **Justice & Public Safety 10%**

Corrections  
Crime Control & Public Safety  
Judicial Department  
Attorney General  
Juvenile Justice & Delinquency Prevention

#### **Other 5.22% (Debt Service, Reserves)**

Interest/Redemption  
State Health Plan  
Compensation Increases  
Contingency & Emergency Fund  
Blue Ribbon Commission on  
Medicaid Reform

#### **General Government 2.2%**

Administration  
Auditor  
Cultural Resources  
General Assembly  
Governor  
Housing Finance Agency  
Insurance  
Lieutenant Governor  
Revenue  
Secretary of State  
State Controller  
Treasurer—Operations

#### **Natural and Economic Resources 2.2%**

Agriculture and Consumer Services  
Commerce  
Environment and Natural Resources  
Labor

#### **Transportation 0.08%**

Grants to airports and related aviation items



SOURCE: Office of State Budget and Management

FIGURE 7.2

### Quick Facts:

#### Highlights of the 2003–05 State Budget

##### Spending

- 1.8% average pay increase for teachers and a one-time \$550 bonus for other state employees plus two weeks of extra vacation
- Provides funding for second grade class-size reduction and More-at-Four kindergarten program expansion to serve 10,000 children
- 5% increase in tuition for in-state and out-of-state students attending public universities
- 3.2% increase in in-state tuition and 8.2% increase in out-of state tuition for students attending community college
- Begins phasing-out of summer school classes at community colleges
- Eliminates funding for Medicaid services for people transitioning from Work-First cash assistance into employment
- Full funding for NC Health Choice children's health insurance program

##### Revenue

- Relies on \$510 million in one-time federal aid for Medicaid and other operating expenses
- Continues 2001 sales and income tax increases
- Relies on economic growth projections of 3.5% in 2003–04 and 5.5% in 2004–05