



Our State, Our Money

A Citizens' Guide to the North Carolina Budget

Prepared by the North Carolina Progress Board as a public service
for the taxpayers and citizens of North Carolina, September 2003

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- 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%

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- Juvenile Justice & Delinquency Prevention



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SOURCE: Fiscal Research Division, NC General Assembly

*2003–2005 distribution based on Session Law (2003-284) as enacted. (See “Highlights” on page 24 and Appendix A on inside back cover.)

Introduction

North Carolina is facing its worst financial crisis since the Great Depression. Grappling with it in a realistic way requires more than just a sea of slogans.

Can we cut taxes? Or should we raise them? Can spending be reduced without affecting key government services like education? A series of questions will guide you through the maze that is the budget process, and help you see how it affects you.

This primer on North Carolina's budget is intended to provide our citizens and taxpayers with straightforward, unbiased information on the state's taxing and spending policies so they can decide for themselves what can—and should—be done.

WHO WE ARE

We are the North Carolina Progress Board. We were created in 1995 by the General Assembly. Our charge is to “...encourage understanding of critical global, national, state, and local...trends that will affect North Carolina in the coming decades...” and further, we are expected to:

- define a long-term vision for the state's future in eight critical “issue areas” (we call them imperatives);
- set measurable goals for attaining that future;
- keep score and report progress to the General Assembly and the people of North Carolina; and
- increase the accountability of government and promote a more active and informed citizenry.

There is a list of current and former board members on the back cover of the guide, and if you'd like to know more about us, please visit our website at www.theprogressboard.org.

We hope you'll find this guide interesting and useful.

WHY WE DID THIS

As far as we know, this is the first-of-a-kind budget guide ever offered to the people of North Carolina.

All sorts of formal, technical documents are available to people in all branches of state government; to the press, lobbyists, legislators, and interested citizens if they care to get on the Web or go to the legislative building in Raleigh and pick up handouts or copies of legislation. The state budget

prepared by the executive branch is issued in several volumes and contains about 20,000 lines of budget information and code. When stacked up, these volumes are about a foot high.

But a non-technical, straightforward, nonpartisan “primer” written for the people who pay the taxes has not been available from the state of North Carolina—or from any other organization, institution or entity. Until now.

MOVING TOWARD ACCOUNTABLE GOVERNMENT, ACTIVE CITIZENSHIP

That's why the North Carolina Progress Board has published this citizens' guide. The Board's statutory authority charges us with addressing issues involving “accountable government and active citizenship.” Many good examples of how this is done can be found in reports and guides printed by cities and counties, public school systems, and so forth. As a matter of fact, this guide is modeled after one developed by the Charlotte-Mecklenburg school system.

Our idea behind this guide is simple, and it is centered on the “accountable government/active citizenship” statutory mandate we just mentioned: North Carolinians can only be “active” about the state budget when they are armed with information about the state budget.

As we began to sketch out how we would put together something about North Carolina's budget, it seemed critical that we avoid assigning blame of any sort to anyone for our current predicament, and that instead we should focus our efforts of crafting a description of how the budget affected us as citizens. Next, we decided to identify where the money comes from and where it goes, and hit the “high spots” of how the budget is put together; what the budget was like several years ago; what was done to build the budget in the recent past; and what is likely to be needed in the years ahead, given population changes.

What has become clear is that our current condition—while severe—is not unique. Our income stream is low, while overall annual budget expense has been driven up. Why? It's not necessarily because state executives and legislators

are spendthrifts, but because our revenues have decreased in this weak economy. At the same time, enrollments in public schools, community colleges, and universities has increased; the state costs for Medicaid have exploded; and salaries for teachers and healthcare costs for all state employees have continued to rise. In other words, it sometimes simply costs more to do the state's business—even in tough times.

State government is big business. The total annual budget of the state of North Carolina is over \$26 billion, when all the money from state and federal funds, receipts, interest income, and so forth are accounted for (see page 22). The business of state government is service—public service.

Coming up with strategies and decisions to provide these services and produce a balanced budget—especially when the economy is weak and money is in short supply—is full of tough choices. The more you know about the state budget, the more you will understand and be able to influence future choices.

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1. How Does the Budget Affect Me?

Note: Unless otherwise noted, Quick Facts refer to FY2001, the latest year for which data is available.

Quick Facts: NC Public Schools (FY 2001–2002)

- Total public school budget: \$5.9 billion
- Public school expenditures distributed to salaries and benefits: \$5.6 billion (94.7%)
- 117 local education administrative units
- 2,230 schools (including 93 charter schools)
- 83,907 teachers (73,290 state-funded; others funded with local, federal, or a combination of funds)
- 27,364 teacher assistants (21,208 state-funded; others funded as above)
- 4,536 principals/assistant principals (3,916 state-funded)
- Public school expenditures distributed to Department of Public Instruction (DPI): Raleigh—\$35 million
- Budget “drivers” in public schools:
 - Average daily membership (ADM) past six years (1997–2003) increased 20,000 per year which translates to \$125 million+ increase per year in public school operating costs
 - Cost of each 1% increase in teachers’ and instructional support personnel salaries: \$37 million

Public Instruction

- 2001–02 First Month Average Daily Membership: 1,295,092 (includes 17,979 in charter schools)
- Projections of state final average daily membership:
 - 2001–02 actual: 1,265,360
 - 2002–03 expected: 1,280,624
 - 2003–04: 1,297,999
 - 2004–05: 1,316,891
 - 2005–06: 1,334,097

Quick Facts: Community College System; University of North Carolina System

Community College System

- 58 community colleges (same number since 1979)
- Funding sources for 2001–02 are as follows:
 - State.....71.3%
 - Local.....13.3%
 - Tuition.....12.2%
 - Federal.....2.5%
 - Other.....0.7%
- 50,137 students enrolled in distance learning courses in 2000–01
- 772,280 students served (unduplicated) in 2000–01 (includes main curriculum students and continuing education)

University of North Carolina System

- 16 campuses
- 141,272 regular-term students

- 10,191 regular-term teaching positions
- The UNC system offers more than 200 degree programs and graduates more than 30,000 students each year. Undergraduates account for more than 80% of UNC’s total enrollment.
- The North Carolina School of the Arts (Winston-Salem) and the North Carolina School of Science and Mathematics (Durham) are part of the UNC university system.
- UNC-TV’s 11 stations cover more than 95% of the state and reach more than 2 million viewers weekly. Nearly 40% of its broadcast schedule is devoted to preparing children for school.
- During the 2000–2001 academic year, the North Carolina State Education Assistance Authority guaranteed more than \$378 million worth of financial aid to approximately 127,500 students.

SOURCE: DPI Annual Report, *A Matter of Facts* (CCS publication 2002)

Every year, the governor, other state officials and the 170 members of the General Assembly wrestle with a spending plan for North Carolina, a budget that has now grown to more than **\$26 billion**. But it is more than size that makes the state budget so critical. The budget expresses *all* our key policy decisions and priorities.

It determines who we tax and how much and how we choose to spend our money for programs and services that range from public schools to repairing highways to a state School of the Arts. Because there is never enough money to do it all, and never will be, the budget reflects the consensus of North Carolina’s elected representatives.

Making decisions about priorities is part of the give and take that drives the state’s annual budget-making process. It is a process that involves the governor, the 120 members of the state House, the 50 members of the state Senate, elected officials, appointed officials, local government representatives, advocates for any number of causes, lobbyists, and average citizens with interests in specific programs or projects.

GENERAL FUND

In all the debate over the budget each year, the main focus is on the General Fund, which amounts to just over half of North Carolina’s total budget. The General Fund, financed almost exclusively from state taxes and fees, pays for all forms of public education, the operations of most state agencies (providing all sorts of services, from economic business development to environmental access and monitoring to adult and juvenile correctional institutions, inspections of rides at carnivals and fairs and housing and maintenance of animals and birds at the NC Zoo), and the state’s share of programs in health and human services, like nursing homes and mental health hospitals.

HIGHWAY FUND

A second major part of the budget, the Highway Fund, pays the state’s share of most transportation programs, including roads, airports, and railways and trains. Highway Fund money comes from transportation-related taxes and fees like the gasoline tax, the annual fee for license plates and

drivers licenses, titles for automobile ownership, and related sources.

FEDERAL FUNDS

A third major section of the budget is comprised of federal funds that are channeled through state agencies as grants for specific services such as community development, worker training and retraining, health and human services, and environmental programs and services.

The General Fund, more than any other

section of the budget, reflects the priorities of state officials for the use of money directly raised in North Carolina. It is the area of the budget that makes North Carolina unique, that reflects what this state's governor and General Assembly consider important.

Every citizen of North Carolina, from the youngest infant to the oldest resident, is affected by the state's budget, either as a contributor through taxes and fees or as a customer of state services. The vast majority of North Carolina's

citizens are both contributors and consumers. You do not have to receive a government check to be a beneficiary of the state budget. Nor do you have to get a paycheck with state income taxes withheld to be a contributor to it.

ESTIMATING REVENUES

The state budget is based on the amount of revenues from taxes, fees, and other sources of funds North Carolina expects to collect in the next budget—or fiscal—year, which runs from

Quick Facts: Crime Control and Public Safety; Department of Transportation; and Department of Environmental & Natural Resources (DENR)

Highway Patrol

- Total charges for violations in 2001: 897,891
- Hours worked: 2.3 million
- Accidents investigated: 98,297

Alcohol Law Enforcement (ALE)

- 2002 arrests: 9,744

Emergency Management Division

- Emergency events responded to in 2001: 3,043
- Search and rescue missions in 2001: 302
- Responses to emergencies involving hazardous materials in 2001: 1,062

Highway System

- 78,350 miles of road constituting the second largest highway system in the nation
- 17,250 bridges spanning 380 miles

DENR—Recreation Only

- 55 state parks
- 168,355 acres in the state park system
- 363,861 acres in state forests

Juvenile Justice

- Court services: processed 41,042 delinquent complaints; 5,285 undisciplined complaints

- Community programs
- Juvenile Crime Prevention Program: 28,660 juveniles
- Eckerd Wilderness Camps: 746 participants
- Multi-purpose juvenile homes: 386
- Governor's One-on-One Program: 1,841
- Support our Students Program: 12,840 students served (after school program)
- Teen Court: 1,643 cases heard resulting in 27,617 hours of community service
- Youth Development Centers: 650 new commitments; average daily population: 885
- Detention centers: 9,138 admissions; average daily population: 269

SOURCES: Statistics from departmental websites of Crime Control, Highway Patrol; ALE, DOT Annual Reports; NC Consolidated Financial Audit Report; Department of Corrections, DJJP website & Annual Report

Quick Facts: Departments of Corrections, Treasurer, Revenue, and Labor

Department of Corrections

- Prison Inmates: 33,465
- Probationers: 115,252
- Parolees: 2,403

State Treasurer

- Total assets under management: \$65.9 billion
- State General Obligation (GO) bonds sold in FY 2000–2001: \$680 million
- Local GO bonds sold: \$1.3 billion
- State GO bonds outstanding: \$3.032 billion

Department of Revenue

- Gross collections: \$18.3 billion
- Average daily deposit: \$70.1 million
- Tax returns processed in 2001: 9,658,531
- Tax payments processed in 2001: 5,619,562
- Number of refunds in 2001 (all tax schedules): 2,673,880
- Number of individual tax refund returns filed electronically in 2001: 1,239,845 (includes personal, business, and corporate)

Department of Labor

- More than 11,000 enrolled in private industry-supported apprenticeship programs
- More than 90,000 boilers and pressure vessels currently on record with the Bureau
- Conducts more than 28,000 annual elevator and amusement device inspections
- Conducts 4,000 occupational safety and health inspections annually
- Provides consulting services to the 180,000 private and public employers under its jurisdiction
- Regulates and supports about 460 private-sector mines, quarries, and sand and gravel pit operations that fall under its jurisdiction

SOURCES: DHHS Medicaid Study; General Assembly Medicaid Study: FY 2001; State Data Center; Department of Corrections website; State Treasurer's website; and Fiscal Research Division, NC General Assembly

1. How Does the Budget Affect Me? *continued*

July 1 to June 30. Those projections are made by economists and financial experts in both the executive and legislative branches of government. In most cases, the governor and members of the General Assembly try to use conservative projections for next year's growth in deciding how much money will be available to include in the budget. In most years, the economy performs better than the conservative estimates, leading to revenue collections that exceed projections. That leaves the state with unbudgeted, one-time funds that can be used for repair and renovation of state facilities,

and a "rainy day fund" for emergencies, clean water projects, construction of new facilities, equipment purchases, or other one-time costs.

But when the economy takes a downturn, as it has in the last few years, revenue collections can fall below even conservative estimates, leaving the state with a shortfall. Unlike the federal government, North Carolina has a *constitutional requirement* that its budget each year be balanced. That means that spending cannot exceed the revenue taken in each year. A "deficit" or "shortfall" in North Carolina means that revenue collections

for the year are running behind projections so that spending, by law, must be reduced to meet the lower revenue amounts.

The governor prepares and submits to the legislature the budget—a balanced plan of expected receipts and proposed expenses.

The legislature adopts the state's final spending plan, but the governor has the constitutional authority to make virtually any spending reductions in that plan as necessary to ensure that the state ends its fiscal year on June 30 with a balanced budget.

YOU CONTRIBUTE TO THE STATE BUDGET EVERY TIME:

- you file and pay your annual income tax
- businesses pay a business license tax or corporate income tax
- you make a purchase and pay sales taxes
- you renew your drivers license
- you buy a gallon of gas or license tag for your car
- you pay an admission charge or buy a souvenir at a state park, museum, or historic site
- you buy any tobacco or alcohol product
- you pay a traffic ticket
- you pay university or community college tuition

YOU BENEFIT FROM THE STATE BUDGET WHEN:

- your children or grandchildren attend school or a licensed daycare center, visit a state park or the state zoo
- you attend a community college or university to upgrade your skills or take a course for personal enrichment
- you visit a state park, museum, or historic site
- you ride on virtually any state highway, built and maintained with state funds and policed by the Highway Patrol
- you attend a North Carolina Symphony concert in your hometown
- state aid to cities and counties offsets pressures to raise local property taxes
- a statewide system of courts administer a uniform justice system in all 100 NC counties
- state agencies respond to fire, flood, or storm emergencies in your community

2. Who Pays for What?

In addition to the state government, which is the focus of this guide, there are several other levels of government that provide services to residents in our communities. Relatively few services are paid for and provided by only one level of government.

LOCAL GOVERNMENT

Cities, towns, and counties do hold the exclusive responsibility for some services, including:

- utilities such as electricity, natural gas, cable television, and sewer services
- jails, police, and sheriffs (but not prisons)
- ambulance services and county hospitals

- fire protection
- cemeteries
- courtroom space (but not officers and staff)

PARTNERSHIPS

A majority of government services are funded through partnerships between local governments, the state government, and the federal government. For these services, the policy decisions, funding arrangements, and actual provision of the services are shared. Often the state and federal governments appropriate money to local governments that oversee the operations of the program or service. This is the case for many social and

human service programs. In a few instances, local governments collect revenues, which they pass on to the state to pay for state services.

OUR STATE, IN CONTEXT

When thinking about the functions and programs of our various government organizations and the relationships between them, it's important to understand how NC compares to other states in the region and the country. The state of North Carolina, from early in the 20th century, has assumed the responsibility for financing and policy making for many of the services that typically are provided and paid for locally in other states.

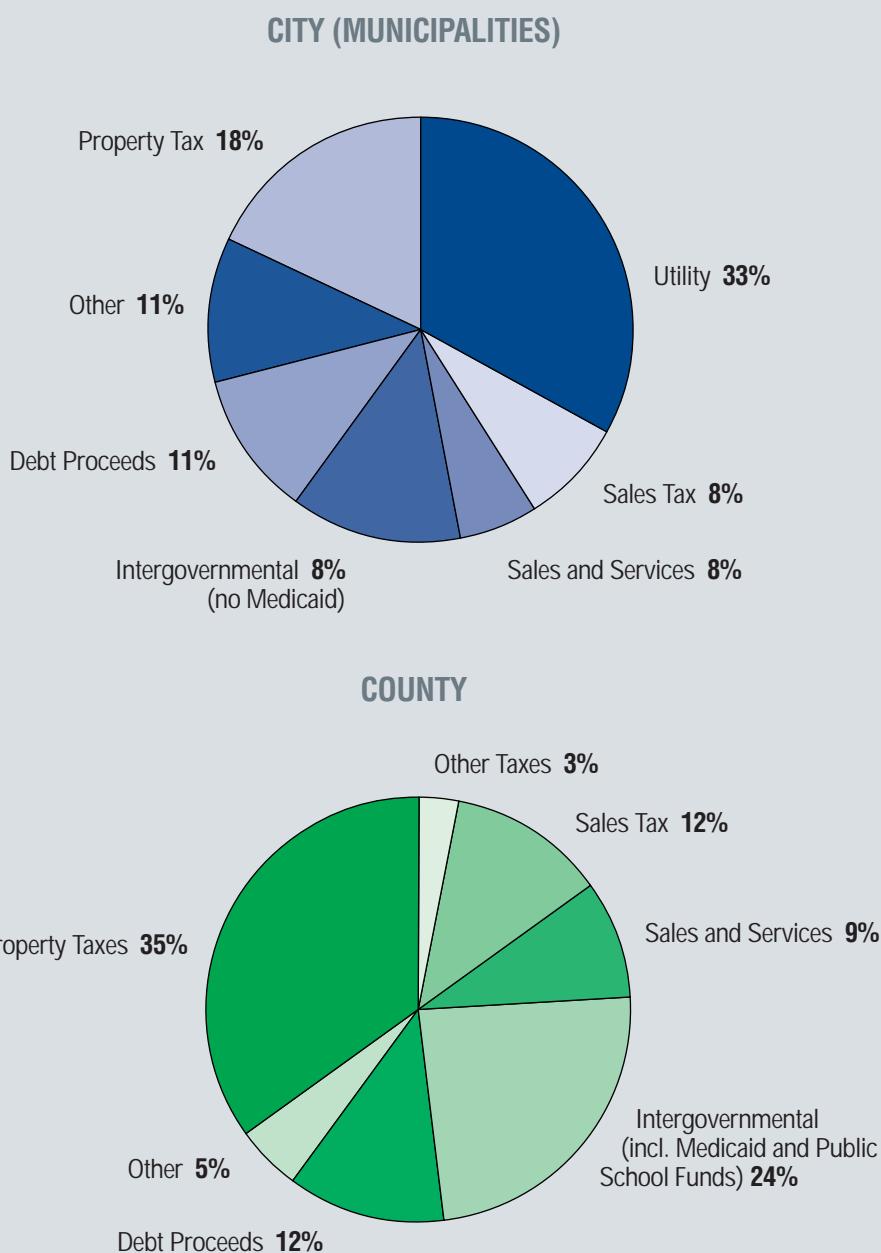
2. Who Pays for What? *continued*

For example, North Carolina was the first state in the country to create and maintain a statewide highway system. In North Carolina, state government is also responsible for all non-municipal roads within county boundaries. Similarly, our state government provides the lion's share of funding for operating most public schools (see Figure 2.6).

North Carolina maintains not only the first state-maintained highway system, but it is the nation's second largest (about 78,000 miles). It is paid for by your gasoline tax and automotive license and title fees, and sales taxes on cars and certain automotive goods such as tires and batteries.

SOURCES OF LOCAL GOVERNMENT REVENUE

Local governments (cities, towns, and counties) are authorized to collect revenues from property taxes, landfill "tipping fees," some court fees, taxes on utilities, and local sales taxes. The amounts and percentages collected for all local governments are shown below.



SOURCE: Fiscal Research Division, NC General Assembly

FIGURE 2.1

LOCAL TAXES AND FEES: PROPERTY TAX

- All taxable property is taxed at the same rate within each local government's boundary
- Both counties and municipalities can levy a property tax
- How the property is used may affect its tax status (farm use, forest conservation, etc.)
- Government and some nonprofit property, like churches, are exempt
- A homestead exemption lowers the tax on low-income, elderly property owners
- Of the eleven most populated states, North Carolina has the lowest property tax burden

PROPERTY TAX: 2002–2003 UNADJUSTED TAX RATES

Region	Regional Average
Coastal	77¢ per \$100 valuation
Mountain	55¢ per \$100 valuation
Piedmont	65¢ per \$100 valuation

SOURCE: Fiscal Research Division, NC General Assembly

FIGURE 2.2

LOCAL TAXES AND FEES: SALES TAX

- Collected from local merchants
- The general rate of tax is 4.5% state, 2.5% local
- Food is exempt from state sales tax but is still subject to a 2% local tax
- The new 1/2 cent of local tax does not apply to food
- Distribution of sales tax revenue to localities is made on both per capita and point-of-sale basis
- Each 1¢ increase in sales tax (in 2002) was estimated to raise \$682 million in state revenue and \$800 million in local revenue (local sales tax revenues are higher due to local tax on food)

STATE AID TO LOCAL UNITS: TAXES SHARED WITH MUNICIPALITIES AND THE STATE

- Gasoline tax: shared through Powell Bill funds (city street repair/construction); restricted use
- Franchise and gross receipts tax on electricity and telephones
- Excise tax on piped natural gas
- Beer and wine tax revenues

2. Who Pays for What? *continued*

STATE AID TO LOCAL UNITS: STATE TAXES SHARED WITH COUNTIES

- Beer and wine tax
 - Shared only for the types of beverages allowed in the county
 - Distribution is based on the type of beverage
- Real estate transfer tax
 - Also known as deed tax
 - County retains 50% + \$1 tax for each \$500 in value transferred

LOCAL TAXES AND FEES: MEALS TAX

- Since 1989, the General Assembly has ratified local bills giving two municipalities and four counties the authority to levy an additional 1% tax on prepared food
 - Municipalities: Charlotte, Hillsborough
 - Counties: Cumberland, Dare, Mecklenburg, and Wake
- The rate is 1% in all jurisdictions.
- Defined as “any food or beverage to which a retailer has added value or has altered its state (other than by cooling alone) by preparing, combining, dividing, heating, or serving in order to make the food or beverage available for immediate human consumption”
- Uses include:
 - Services needed because of tourists
 - Special event centers, museums, and convention centers
 - General tourism development
 - Tourism development authorities

MEALS TAX		
County	Net Collections	Population
Cumberland	3,063,197	299,203
Dare	1,291,003	31,168
Mecklenburg	12,350,272	716,407
Wake	9,370,914	655,642
Hillsborough	159,250	5,525
Total	26,234,636	1,707,945

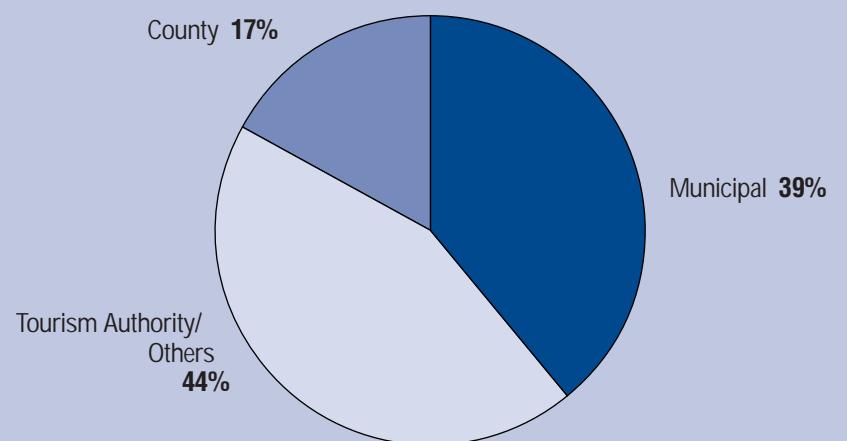
Based on 1999–2000 Collection Data, Department of Revenue

FIGURE 2.3

LOCAL TAXES AND FEES: OCCUPANCY TAX

- 74 counties have the authority to levy an occupancy tax on hotel rooms
- 53 municipalities have their own occupancy tax
- Counties are most likely to give their revenue to municipalities or to a tourism development authority
- Municipalities are most likely to retain their revenue
- Occupancy taxes must be created by the General Assembly

1996–1997 OCCUPANCY TAX DISTRIBUTION



Actual Total Collections: \$56,263,350

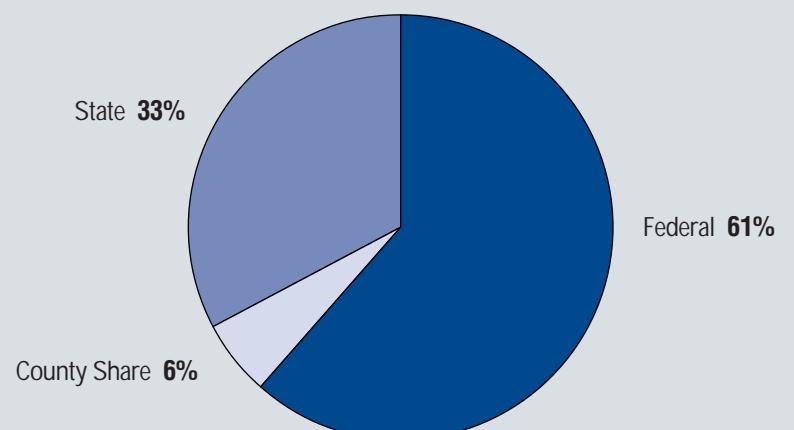
SOURCE: Tax Research, Department of Revenue

FIGURE 2.4

MEDICAID PROGRAM FUNDING

The following chart shows the funding partnership between federal, state, and local governments for two other well-known programs—Medicaid and public schools.

MEDICAID PROGRAM: FINANCIAL PARTICIPATION BY COUNTIES, STATE AND FEDERAL GOVERNMENTS



SOURCE: Fiscal Research Division, NC General Assembly

FIGURE 2.5

Quick Facts: Medicaid

FY 2001

- 1,307,755 recipients of Medicaid services in North Carolina (96.5% of eligibles)

Recipient Make-up in FY 2001

- Special pregnant women and children: 39.4%
- Aliens and refugees: 0.75%
- Aged: 11.9%
- Blind: 18%
- Disabled: 16.4%
- Qualified Medicare Beneficiary: 3%
- AFDC (Aid to Families with Dependent Children) related: 26%

Medicaid Snapshots

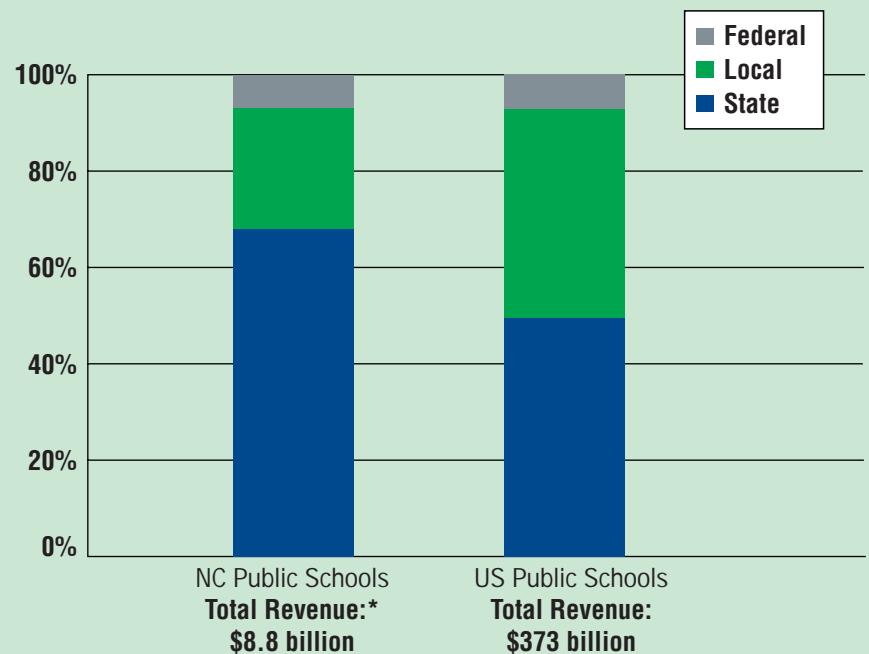
- Covered 1.4 million state residents in FY 2002—17% of the state's population
- Covered over 800,000 children during FY 2002—58% of Medicaid eligible by population
- Covers 45% of the babies born each year
- 31% of Medicaid recipients consume 71.1% of resources—includes elderly, blind, and disabled
- Inpatient care consumes 37% of expenditures for services—includes hospitals, nursing homes, and mental retardation centers
- Expenditures for drugs began to exceed \$1 billion in FY 2002
- 67% of the state's 40,000 nursing home beds are funded through Medicaid
- 14% of NC hospital charges are paid by Medicaid—49% are paid by Medicare (health insurance for the elderly)
- For FY 2003, counties are projected to pay \$388 million for Medicaid services or about 6% of all the expenditures for Medicaid services

LOCAL TAXES AND FEES: OTHER

- Motor vehicle tax: \$5 to \$30 per vehicle; local option
- Land transfer tax: tax on conveyances (some authorized counties)
- Utilities fees: significant for municipalities; includes water, sewer, power, gas, and solid waste
- Privilege license tax: business or occupation based; flexible
- Cable TV franchise tax: up to 5% of gross receipts
- Animal tax
- 911 surcharge
- Other user charges: airports, ambulance, etc. (usually county)
- Register of deeds fees: marriage licenses, oaths, and recording fees
- Regulatory fees: building and environmental permits, etc.

PUBLIC SCHOOLS: REVENUE BY SOURCE OF FUNDS (1999–2000)

Figure 2.6 demonstrates how much more state money in North Carolina (68%) goes to pay for public schools compared to the nation generally (50%).



*including Federal Funds

SOURCE: US Department of Education, National Center for Education Statistics, Common Core of Data (CCD), "National Public Education Financial Survey," 1999–2000

FIGURE 2.6

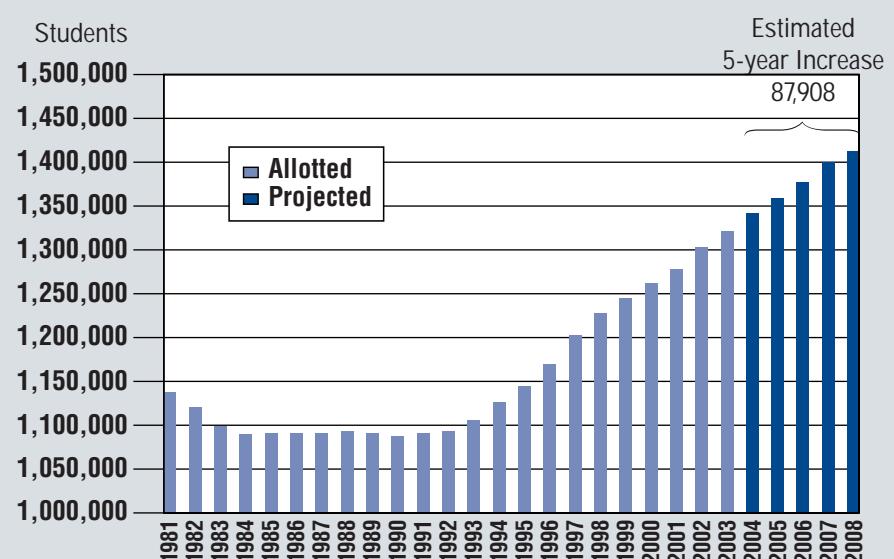
LOCAL TAXES AND FEES: IMPACT FEES

- Also called development or facility fees
- Generally assessed on developers for streets, water lines, sewer, and other infrastructure
- Some municipalities with impact fees include Chapel Hill, Carrboro, and Rolesville
- May be the wave of the future in urban areas

NC PUBLIC SCHOOLS: GROWTH IN AVERAGE DAILY MEMBERSHIP (ADM) 1981–2008

Note that each 20,000 increase in ADM translates into a \$125 million increase in public school operating costs. At this rate, operating increases driven by ADM will amount to over an estimated \$500 million between 2003 and 2008, not

including additional costs for new and remodeled building needs due to increased ADM. Public school enrollments, then, are a major driver of increased budget costs.



SOURCE: Fiscal Research Division, NC General Assembly

FIGURE 2.7

3. Where Does the Money Come From?

State government in North Carolina draws on several sources of revenue to pay for the services that the state provides. Think of a family. A family might have one parent with a full-time, nine-to-five job. Another parent might have a part-time job, or a small side business like delivering newspapers or selling cosmetics. The family also could generate income through an annual yard sale, investments like stocks and bonds, or by borrowing money.

Currently, the state receives about \$26 billion from many sources, including taxes, fees, and funds from the federal government. After taking out the federal dollars, which must be used for specified types of spending, and state taxes that are earmarked for specific items—like gas taxes that are earmarked for road maintenance, or monies set aside for the Clean Water Trust Fund—about \$14 billion remains to fund the state’s “discretionary” spending. This spending is usually what is meant when people refer to the “state budget” or General Fund.

PERSONAL INCOME TAX

It receives most of the attention from lawmakers and the media because it can be spent on just about anything, from public schools to paper clips to elephant food at the state zoo.

For North Carolina’s state government, the personal income tax is like the family’s nine-to-five job. People who earn money in North Carolina pay anywhere from 6% to 8.25% of their income to the state. About 3.6 million individuals and couples file income tax returns in North Carolina each year. Income tax revenue is directly related to the economy—economic growth produces increased earnings, which generate increased tax revenues. On the other side of the coin, an economic downturn can create lower wages and lower capital gains, which can translate into sizeable drops in state tax collections. Personal income taxes account for *over half* of the state’s General Fund revenues.

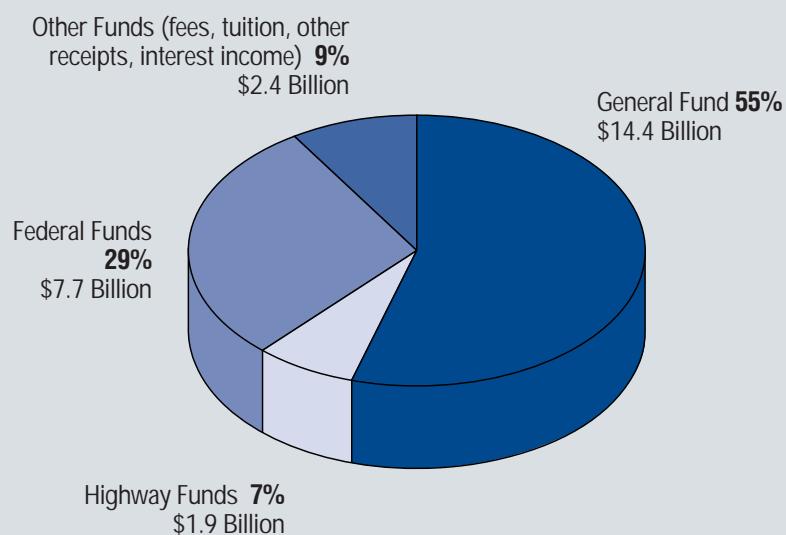
GENERAL SALES TAX

The next largest source of revenue to the state is the 4.5% general sales tax. Consumers pay sales tax when they purchase goods (and a few services) in North Carolina. Sales tax revenue is a more stable source of income for the state than the income tax. Even when people are losing jobs, public assistance programs and personal debt allow people to continue spending money on goods.

Unfortunately for state and local governments, two recent economic shifts are eroding the strength of the sales tax as a source of revenue. The first is increased spending for services, which are virtually untaxed. As the economy grows, people have more money to spend on goods and services. Increased spending on goods brings the state increased sales tax collections, but increased spending on services does not. The second important shift is increased shopping through out-of-state catalogue vendors and on the Internet. If a book club decides to start ordering its books from

TOTAL BUDGET BY FUND SOURCE: FY2002–03

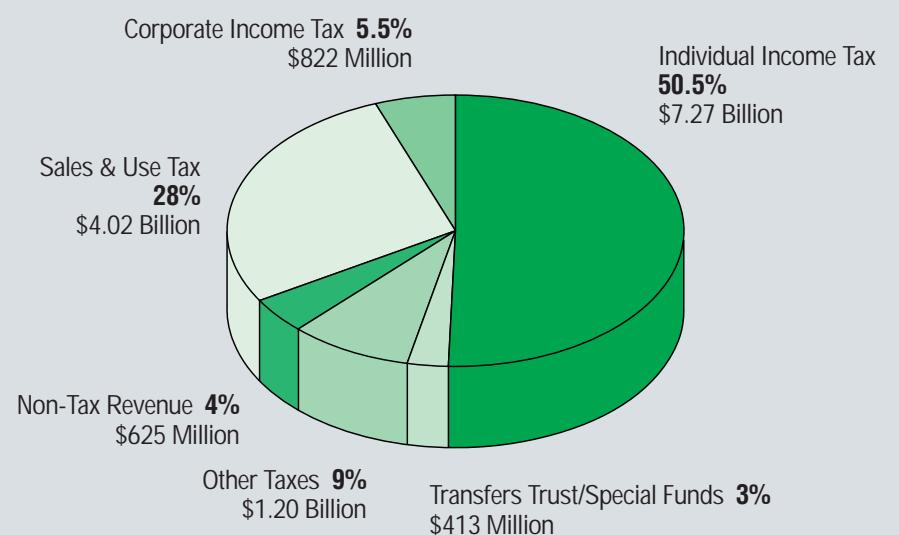
Total Budget: \$26.3 Billion



SOURCE: Fiscal Research Division, NC General Assembly

FIGURE 3.1

GENERAL FUND REVENUES BY FUND SOURCE: FY2002–03



SOURCE: Fiscal Research Division, NC General Assembly

FIGURE 3.2

Quick Facts: Various Taxes

Income Tax

- An increase of ¼ of 1% (0.25%) in all individual income tax rates is estimated to raise \$254 million in revenue each year

Sales Tax

- A 1% increase in sales tax is estimated to generate \$676 million in revenue in 2004–05

Excise Tax

- An increase in excise tax of 1¢ is estimated to raise between \$6–7 million

Corporate Income Tax

- A 1% increase in corporate income tax (from 6.9% to 7.9%) is estimated to raise \$107 million in revenue each year

Amazon.com instead of the local bookstore, the state loses revenue that it once received.

CORPORATE INCOME TAX

A third source of income to North Carolina state government is a 6.9% tax on corporate income. This applies to all corporations which have business operations in our state. In the last fiscal year, corporate income taxes made up about 3% of General Fund revenues and about 6% of total state revenues. Some corporate income tax revenue is earmarked for a building fund for public schools. Revenue from this tax has been declining as a percentage of total collections for the last several decades, mostly due to increased taxes on individuals and changes in corporate structures designed to reduce corporate tax burdens. This source of revenue is particularly sensitive to swings in the economy—generally rising during the boom times and falling during recessions. (It's also important to keep in mind that smaller businesses like partnerships and limited liability companies pay personal income taxes, not corporate income tax.)

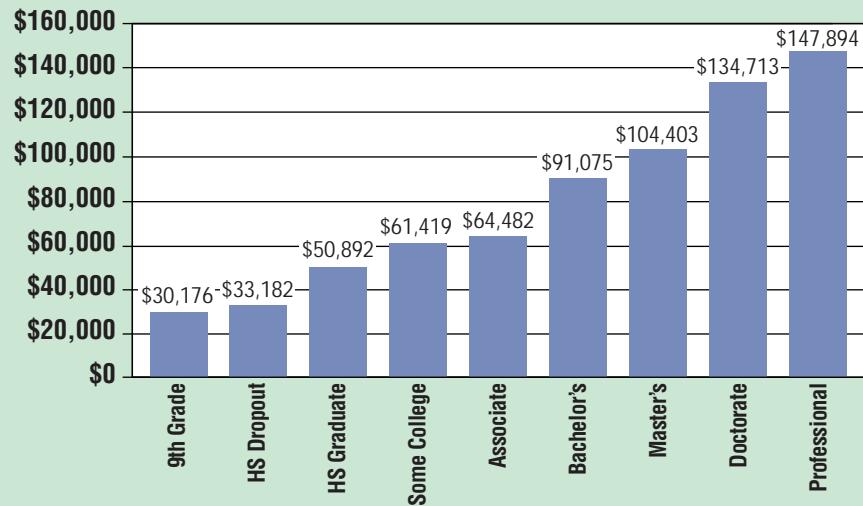
The state also imposes several smaller taxes, such as excise taxes on tobacco and alcohol products, franchise tax paid by certain businesses, estate tax, and a tax on insurance premiums. Even combined, these taxes make up only a small percentage of overall revenue to the state.

NON-TAX REVENUE

The final way that the state raises money is called “non-tax” revenue. Non-tax income to the state includes fees or user charges such as court fees, community college and university tuition and hunting and fishing licenses. Governments charge fees for a variety of reasons. Some charges, like court fees, pay the administrative costs of providing a service. Others, like seat belt fines, are intended to discourage specific behavior. And some, like tuition charges, are intended to account for the private benefit derived from a government service. Other sources of non-tax revenue include things like investment income or transfers from other funds.

Such non-tax revenue makes up about 4.3% of the state's General Fund revenues. The remaining 95% is from state taxes.

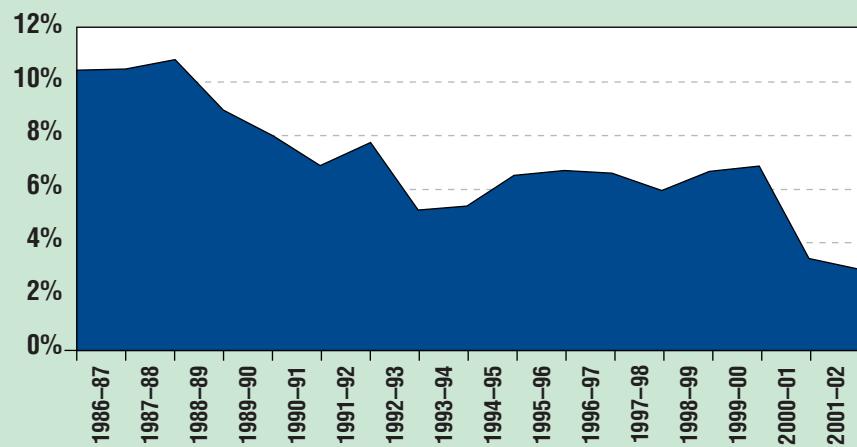
AVERAGE U.S. HEAD OF HOUSEHOLD INCOME BY EDUCATIONAL ATTAINMENT, 1999



SOURCE: Fiscal Research Division, NC General Assembly

FIGURE 3.3

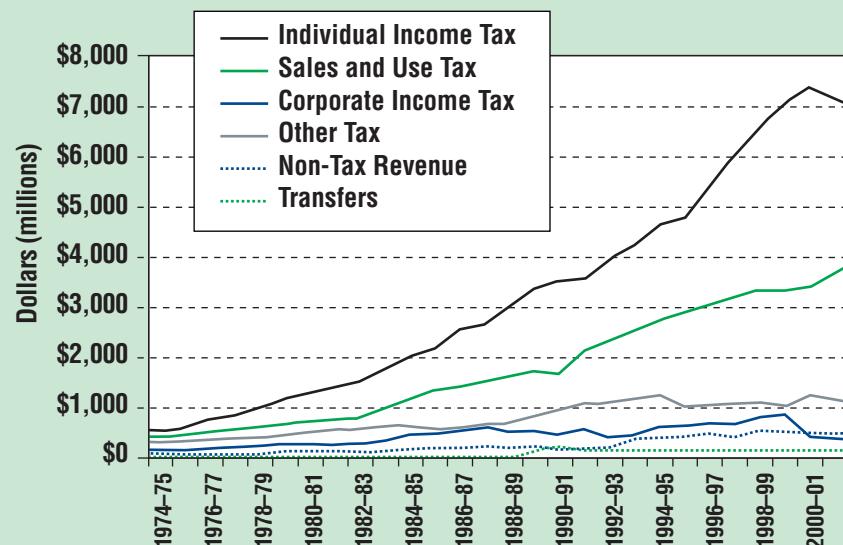
SHARE OF GENERAL FUND REVENUES FROM CORPORATE INCOME TAX



SOURCE: Fiscal Research Division, NC General Assembly

FIGURE 3.4

GENERAL FUND REVENUE



SOURCE: Fiscal Research Division, NC General Assembly

FIGURE 3.5

Quick Facts: Tuition Revenue

- Each 1% increase in resident student tuition generates \$2,564,000
- Each 1% increase in nonresident student tuition generates \$2,462,000
- North Carolina ranks 32nd in resident (in-state) tuition for flagship campuses (NC: \$3,856; national average: \$4,675)
- North Carolina ranks 18th in nonresident (out-of-state) tuition for flagship campuses (NC: \$15,140; national average: \$13,250) [A “flagship” campus is one with large numbers of doctoral programs, i.e., UNC-Chapel Hill and NC State.]

Quick Facts: Aid to Students Attending Private Colleges in North Carolina

- There are two state-funded programs that assist students attending private colleges:
 - Legislative Tuition Grant (LTG): \$1,800 per full-time NC resident attending private college
 - State Contractual Scholarship Fund (SCSF): \$1,100 per FTE NC undergraduate student for need-based aid (FTE or “full-time equivalent” is a special term in higher education used to count actual full-time students. Two half-time students taking half a normal course load equals one full-time equivalent student.)
- The General Fund appropriation for FY2002–03 for the Tuition Grant program is \$47.8 million for approximately 32,160 students. For the Contractual Scholarship Fund, it is \$33.3 million for approximately 30,000 FTE students.

Quick Facts: Portion of Academic Costs Paid by Resident and Nonresident Students at UNC 2002–03

- The General Fund state appropriation for each full-time equivalent (FTE) resident student, on average, is \$9,501 (excludes medical, nursing, and dental school students)
- The General Fund state appropriation for each FTE nonresident student, on average, is \$421 (excludes medical, nursing, and dental school students)
- The percent of academic costs paid by resident students is, on average, 19% (excludes medical, nursing, and dental school students)
- The percent of academic costs paid by nonresident students is, on average, 96% (excludes medical, nursing, and dental school students)

4. Where Does the Money Go?

Before we step off into this patch of fiscal kudzu, we’ll need to set out some key “signposts” about where the money goes. We’re going to first show you the total state budget—all state general funds, federal funds, highway funds, and other income for the state called “non-tax revenue” (like fines, fees, tuition, licenses—other than automobile licenses—and interest income on investments and deposits).

Notice this: General Fund budget amounts are set apart from Highway Fund budget amounts. Federal funds are yet a third fund classification and non-tax revenue is a fourth. This is how the total state budget is set out by source of funds.

Notice another thing: This is the total state budget for FY 2001–2002, covering the period from July 1, 2001, to June 30, 2002. The percentages of general, federal, and highway fund might change slightly—but not markedly.

Now, let’s recap. The total state budget is \$26.3 billion, of which

- \$14.4 billion (55%) comes from the General Fund;
- \$7.7 billion (29%) is funded with federal funds;
- \$2.4 billion (9%) comes from non-tax revenues (other funds); and
- \$1.9 billion (7%) comes from the Highway Fund.

THE GENERAL FUND

In this guide to the budget, we are focusing on the General Fund, because it’s 55% of the total state budget, because it comes mostly from taxes you pay to the state of North Carolina, and because it contains the most options for discretionary spending. That includes income taxes, sales taxes, and excise taxes (cigarettes, liquor, and beer). For businesses, it includes franchise taxes, corporate income taxes, and others. Notice this: *None* of your property taxes go to the state. All property taxes pay for county and city government services.

THE HIGHWAY FUND

Highway Fund money comes from each gallon of gas you buy; from titles and fees for your car, drivers licenses and tags; and sales taxes on automobile products. Some Highway Fund

money is transferred to the General Fund for special uses, but the bulk of it stays with the Department of Transportation to be matched with federal funds for highway construction and maintenance. Additionally, there is a separate Highway Trust Fund that receives a portion of Highway Fund income for specially designated roads and highways.

FEDERAL FUNDS

The best way to think about federal funds is that they supplement and sometimes “match” state funds to offset the total cost of a program. Some federal funds are used for specific grants for specific purposes within a state agency, while others—like funds for the North Carolina Employment Security Commission—pay for the operation in its entirety.

By far the most substantial application of federal funds is to offset costs of North Carolina’s Medicaid program. Medicaid consumes \$4.411 billion (57%) of the total \$7.676 billion in federal aid applied to General Fund costs.

Now that you have a general orientation to the different funds, amounts, and percentages that make up the state budget, let’s wade into the fiscal kudzu patch a bit further!

WHAT DO THESE MONIES PAY FOR?

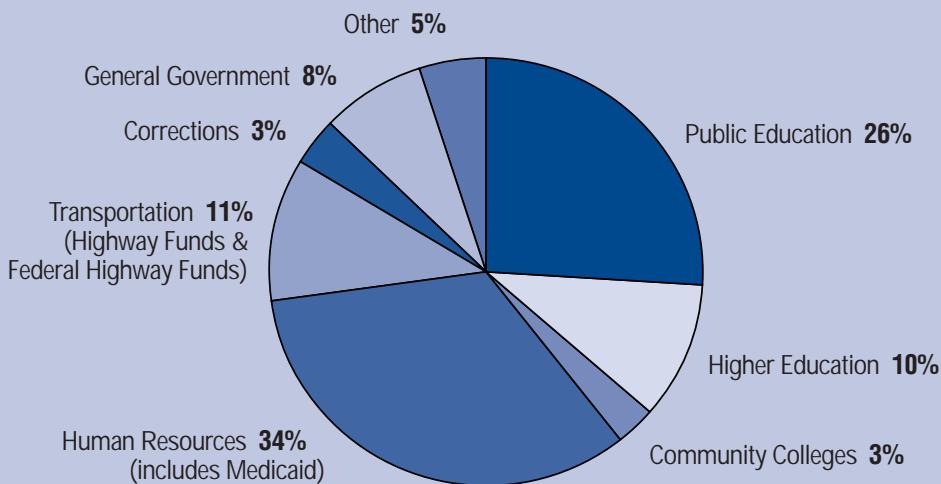
Think about all the state government programs services, and agencies you know about:

- roads
- bridges
- prisons
- public schools
- community colleges
- state universities
- courts
- hospitals at Chapel Hill
- mental health center in your town or county
- State Bureau of Investigation (SBI)
- state parks
- highway patrol
- aquariums
- Medicaid
- elevator inspections
- ferris wheel inspections
- beach access paths
- North Carolina Zoo

Figure 4.1 shows distribution of all funds by general categories. Note a similar graphic, Figure 6.5, on page 22 shows total state budget for a different year, 2000–01.

The overall distribution of percentages has changed little. Figure 4.2 shows uses of all funds that are considered Highway Funds.

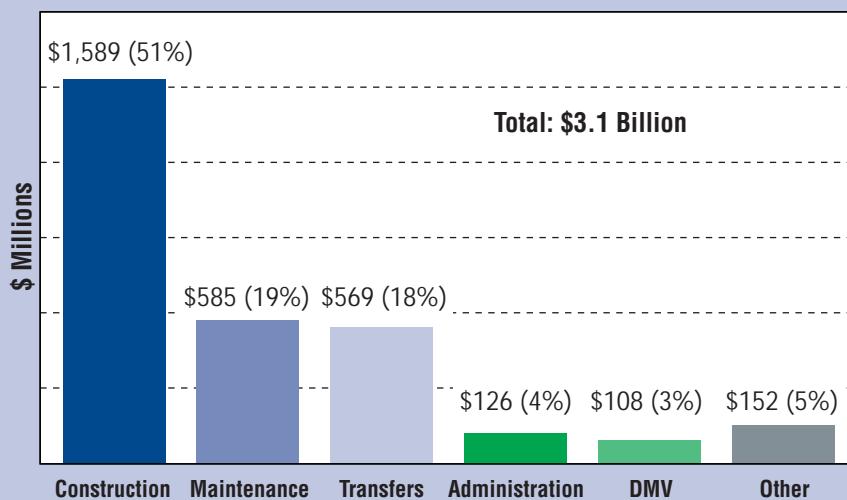
**2001–2002 TOTAL STATE BUDGET
(GENERAL FUND, HIGHWAY FUND, AND FEDERAL FUNDS RECEIPTS)**



SOURCE: Fiscal Research Division, NC General Assembly

FIGURE 4.1

**2002–2003 HIGHWAY (TRANSPORTATION) FUNDING
(STATE/FEDERAL/RECEIPTS)**



SOURCE: Fiscal Research Division, NC General Assembly

FIGURE 4.2

- North Carolina Symphony
- North Carolina School of Science and Mathematics
- North Carolina School of the Arts

The General Fund covers all these services, plus hundreds more, with two exceptions. Roads and bridges, the first two items on the list, are built and maintained with Highway Fund money.

THE BIGGEST DEPARTMENT STORE

One way to get a better fix on the state’s budget is to think about the biggest department store you’ve ever seen. Now, imagine you’ve been to every department in that store, several times, to see what is available to you. After you’ve been there several times, you become familiar, not only with what’s available, but where it is—which department sells what and at what cost.

The state’s budget is like that department store—with one important difference: Instead of a wide variety of manufactured goods, each department offers “services.” Here’s a list of a dozen services state government offers that you help to pay for through the state’s budget:

- education
- prevention
- protection
- prohibiting
- permitting
- informing
- testing
- demonstration
- helping
- healing
- curing
- investigating
- inspecting

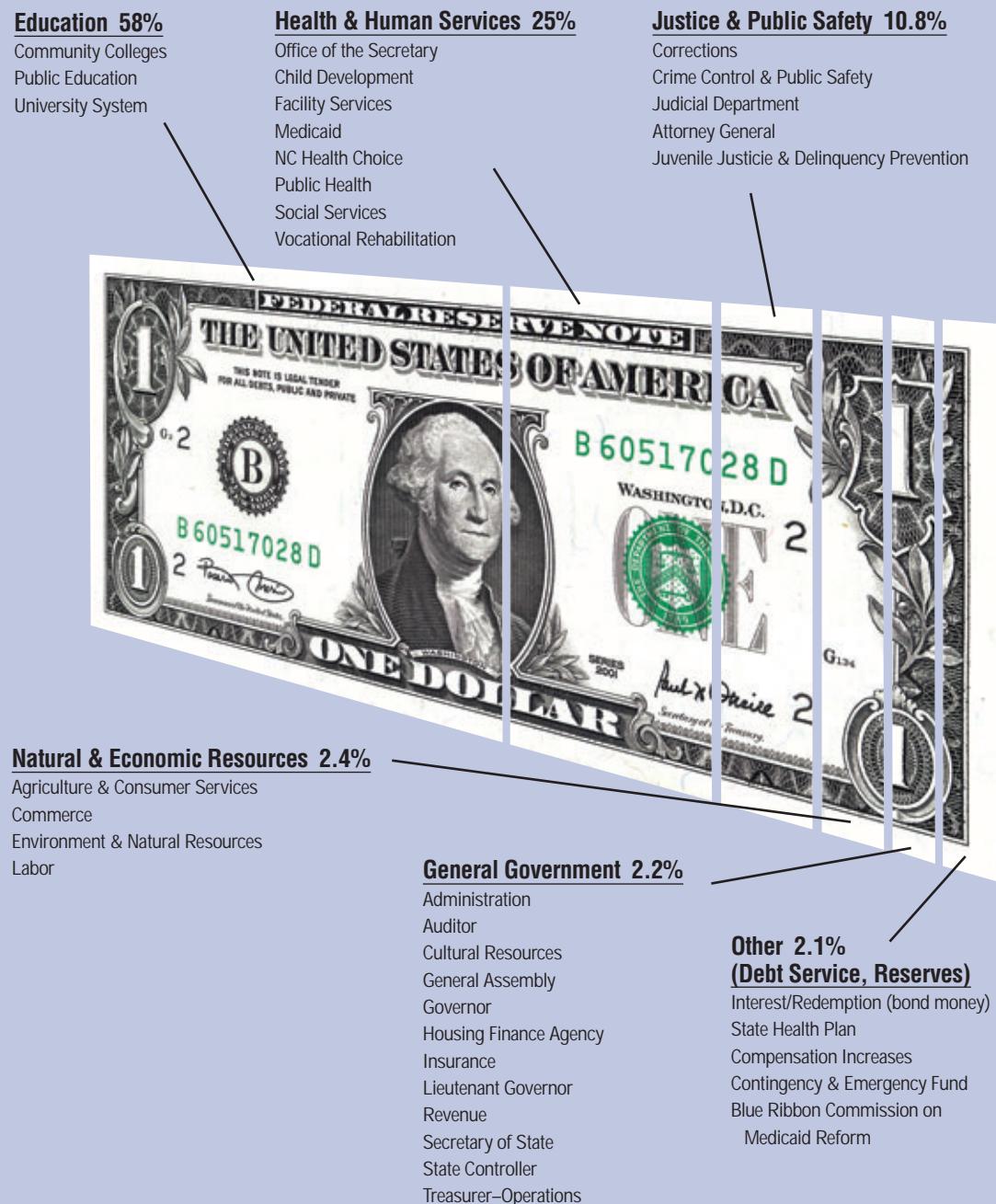
We know you can think of many more. And just like any department store, some departments are much bigger than others and require more money, space, programs, and people to run them. When you look at Figure 4.3 you can see plainly that, as far as North Carolina’s budget is concerned, its biggest “business” is education—and

4. Where Does the Money Go? *continued*

2002–2003 GENERAL FUND EXPENDITURES

North Carolina's \$14 billion General Fund covers most of the operations of state government. Transportation expenses, such as highways, are not included in the General Fund. Education—public schools, universities, and community colleges—take 58% of the General Fund. Health and human services programs, including the state's share of Medicaid, take 25%. Justice and public safety agencies, including the entire court system, prisons, and state law enforcement agencies take 10.8%. Spending for all other state agencies included in the General Fund, such as the

governor's office; the legislature; the Departments of Agriculture, Commerce, and Revenue; the Council of State offices (e.g., the treasurer, auditor, secretary of state, attorney general, etc.); and environmental programs amount to about 6.7%. And some (0.08%) General Fund money is used for grants to state airports. So, when you budget for all education, all health and human services programs, and all courts, corrections, and law enforcement, you have budgeted for about 93.8% of all General Fund expenditures.



it has three major “products lines”(services):

- public schools
- community colleges
- universities

About 58 cents of every state General Fund budget dollar is allocated to education in one of the major “product” areas—schools, community colleges, or universities.

The next most costly area in which state government is involved is health and human services. This “product line” requires 25 cents of every General Fund dollar and covers a wide range of services that can be connected to the list you read earlier: educating, informing, demonstrating, helping, protecting, preventing, healing, curing, permitting, etc.

The largest program within the health and human services arena is Medicaid (slightly more than 15% of the total state budget), funded by money from all three ways you pay taxes: local, state, and federal. Federal money pays for the largest piece of Medicaid costs (66%); the state share is next at 27%; and the local government share is the smallest piece (about 7%).

Health and human services comprise 25% of the total General Fund budget. When federal funds are added to the mix, the percentage rises to 35% of the total state budget. To get a better feel of the various “products” in health services, see the charts and graphs on pages 16–17.

The next largest area of the state's budget is centered around courts, law enforcement, the state's “law firm” (the Office of the Attorney General), the Department of Juvenile Justice, the Department of Corrections (state prisons), and the Department of Crime Control and Public Safety. Together these departments and services comprise 10.3% of the General Fund budget. And, taken together, these services focus on public protection, law enforcement, judicial matters and the courts system, and incarceration of convicted law-breakers. The most common phrase used to group these departments and services into a single category is “justice and public safety.”

When these three categories of state “business”

continued on page 14

SOURCE: Fiscal Research Division, NC General Assembly

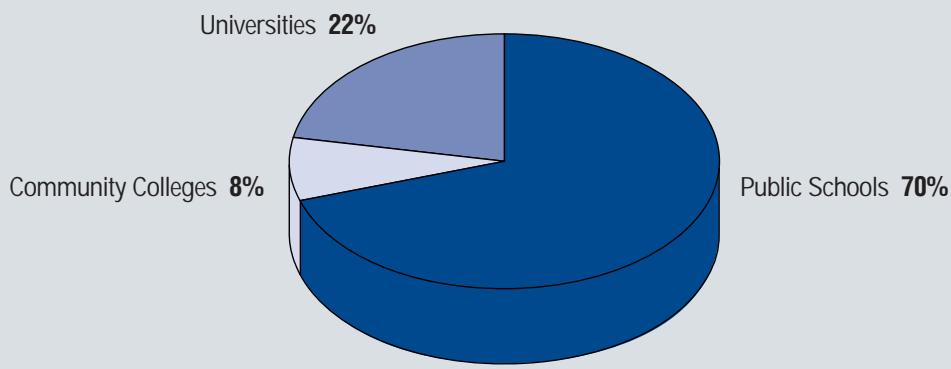
FIGURE 4.3

EDUCATION

North Carolina pays the lion's share of costs for public school operations, including the base salaries for virtually all teachers and administrators; the costs of buses and books; and a share of construction costs for local schools. As a result, public schools take a larger percentage of North

Carolina's budget than they do in most other states. Public schools accounted for 70% of education spending by the state in 2001–2002, while universities took 22% of education funding, and community colleges took 8%.

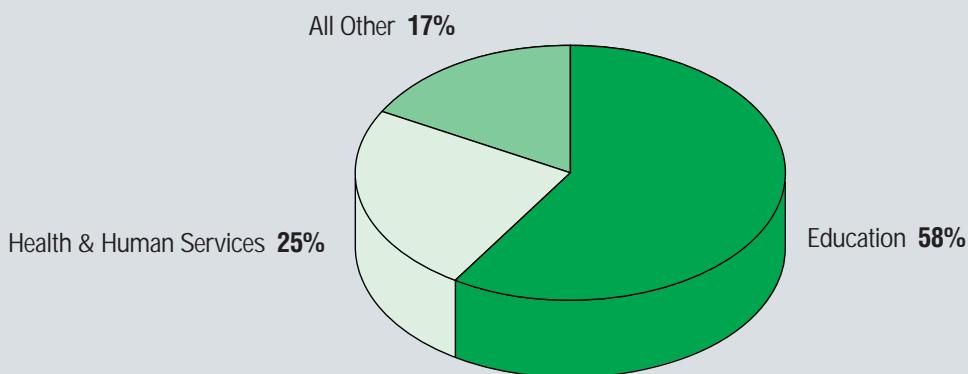
GENERAL FUND APPROPRIATIONS FOR EDUCATION FY 2001–2002



SOURCE: NC General Fund Operating Appropriations, FY 2001–2002

FIGURE 4.4

EDUCATION SHARE OF GENERAL FUND APPROPRIATIONS FY 2001–2002



SOURCE: NC General Fund Operating Appropriations, FY 2001–2002

FIGURE 4.5

Quick Facts: School Transportation

NEW SCHOOL BUSES IN NORTH CAROLINA

- The purchase of the first school bus is the responsibility of the local school district; thereafter, the bus is replaced by the state.
- Each year, the North Carolina General Assembly appropriates funds for the replacement of school buses. The Department of Public Instruction identifies buses, statewide, that are designated for replacement.
- Under current policy, buses are eligible for replacement at 200,000 miles.
- Buses older than 1994 models are eligible at 165,000 miles. No bus will run longer than 20 years, regardless of the mileage.

SCHOOL BUSES AND ACTIVITY BUSES

- Once a school bus is replaced, it becomes a "spare bus," to be used by the school district when a bus is in the shop for maintenance.
- Spare buses are, in turn, sold as surplus property. A list of school buses available for sale can be found at www.ncbussafety.org.
- Transportation to extracurricular activities (such as athletics) that are not part of the instructional program may not be provided on school buses. Most schools use locally owned and operated activity buses for such purposes.
- For 2003–2004 the Durham Public Schools bus fleet will be powered by bio-diesel, a blend of 80% diesel, 20% renewable organic material (e.g. vegetable oils).
- Eight Charlotte-Mecklenburg school buses are powered by Compressed Natural Gas.
- The rest of the school bus fleet uses diesel fuel. The state's school bus fleet consumes over 22 million gallons of fuel each year. (For more school bus transportation facts, see page 23.)

4. Where Does the Money Go? *continued*

continued from page 12

are added together they comprise 93.8% of the total General Fund budget. The remaining 6.4% is dispersed throughout many important—even critical—but less expensive departments such as:

- Office of the Governor
- Office of the Lt. Governor
- General Assembly
- Office of the State Treasurer
- Office of the State Auditor
- Office of the State Controller
- Commissioners of Agriculture, Insurance, and Labor
- Department of Environment and Natural Resources
- Department of Commerce
- Department of Cultural Resources
- Department of Administration
- State Board of Elections

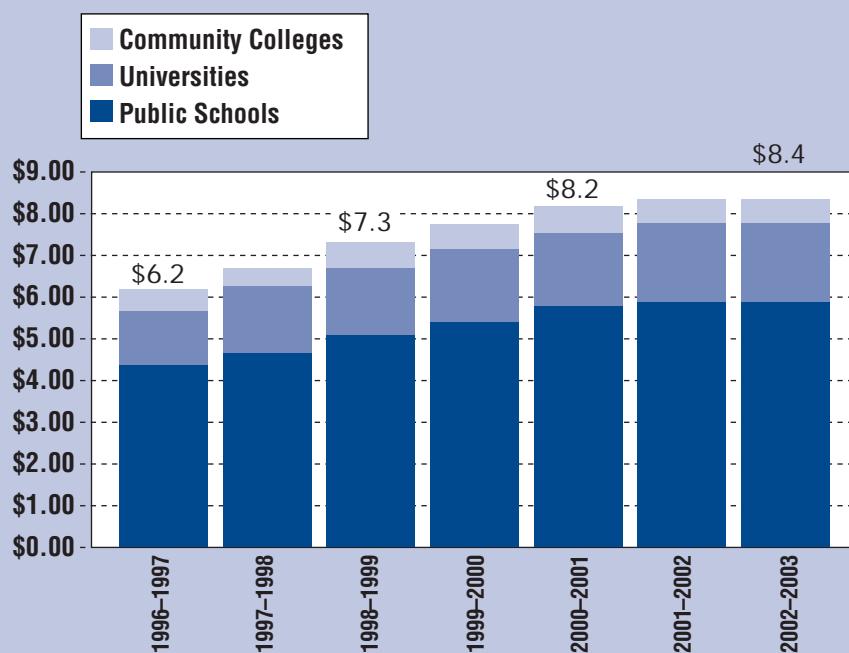
To recap, the General Fund makes up about 55% of the state budget. It is funded almost entirely by you, primarily in the form of income taxes, sales taxes, excise taxes and various business taxes. The vast majority of that money is used to support three important areas: education (58%), health and human services (25%), and justice and public safety (10.8%). The balance of funds available (6.2%) must cover all programs in the area of general government (14 departments, including the governor’s office and the General Assembly; the state controller; and the insurance, treasurer and auditor’s offices) and more departments that deal with programs for the environment, air and water quality, economic development, agriculture, labor, and so forth.

These facts make for tough funding choices when funds are tight like they were in the 2003 legislative session. And as the population increases, driving up enrollments in all educational systems, tending to the “business” of education will become more costly. Similar pressures will occur with human services programs and with programs dealing in public prisons.

The figure below shows that, in total, education is 58.4% of the General Fund. The percentage has not fluctuated significantly over this period. In FY 2002–2003, the percentage of the General

Fund for each education agency is: public schools, 41.4%; community colleges, 4.7%; and universities, 12.4%.

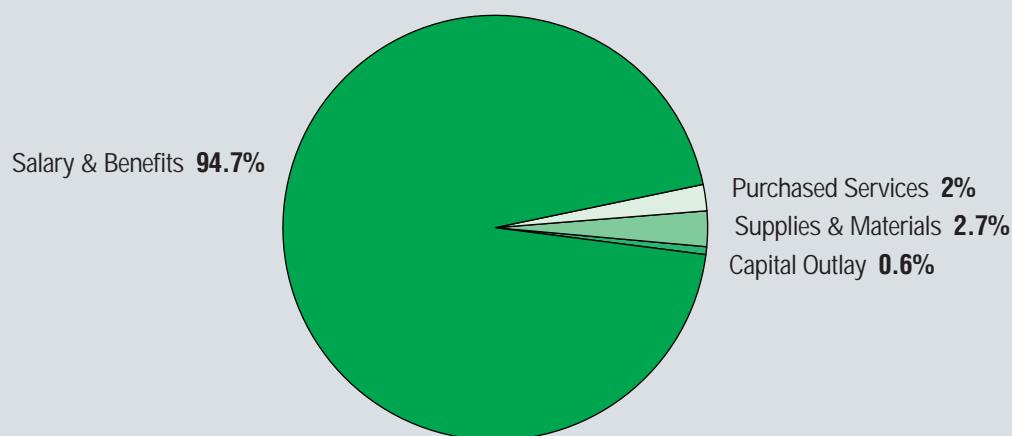
GENERAL FUND OPERATING APPROPRIATIONS FOR EDUCATION: 1996–1997 TO 2002–2003



SOURCE: State Data Center, Office of State Budget and Management

FIGURE 4.6

NC PUBLIC SCHOOL FUND: DISTRIBUTION OF EXPENDITURES BY TYPE, FY 2001–2002



SOURCE: NC Department of Public Instruction, Statewide Expenditures for State Public School Fund, FY 2001–2002

FIGURE 4.7

TEACHER SALARIES: COMPARISON OF NC AND US AVERAGES

	1995–96	1996–97	1997–98	1998–99	1999–00	2000–01	2001–02
North Carolina (% Increase)	\$30,411 -1.24%	\$31,167 2.49%	\$33,129 6.30%	\$36,098 8.96%	\$39,419 9.20%	\$41,496 5.27%	\$41,991 1.19%
US Average (% Increase)	\$37,685 2.20%	\$38,554 2.31%	\$39,454 2.33%	\$40,582 2.86%	\$41,820 3.05%	\$43,339 3.63%	\$44,499 2.68%
NC as % of US	80.7%	80.8%	84.0%	89.0%	94.3%	95.7%	94.4%
NC Rank Among States	43	43	38	29	24	20	21

SOURCE: National Education Association. "Rankings and Estimates of the States 2001 and Estimates of School Statistics 2002," August 2002

FIGURE 4.8

CAPITAL PROJECTS, DESIGN, AND CONSTRUCTION: COMMUNITY COLLEGES, UNIVERSITIES, AND OTHER STATE BUILDING PROJECTS—APRIL 1993

	Projects in Design	Projects in Construction	Projects Overall	Projects in Design Value	Projects in Construction Value	Overall Value
Community College	49	20	69	\$79,626,571	\$27,516,876	\$107,143,447
University	230	89	319	\$539,265,799	\$333,715,481	\$872,981,280
State Bldg Commission	271	103	374	\$132,056,367	\$159,558,096	\$291,614,463
Total	550	212	762	\$750,948,737	\$520,790,453	\$1,271,739,190

SOURCE: Office of State Construction, NC Department of Administration

FIGURE 4.9

CAPITAL PROJECTS, DESIGN, AND CONSTRUCTION: COMMUNITY COLLEGES, UNIVERSITIES, AND OTHER STATE BUILDING PROJECTS—APRIL 2003

	Projects in Design	Projects in Construction	Projects Overall	Projects in Design Value	Construction Value	Overall Value
Community College	93	105	198	\$326,543,767	\$265,714,172	\$592,257,939
University	277	259	536	\$1,849,336,935	\$1,552,946,793	\$3,402,283,728
Other State Buildings	304	324	628	\$1,044,905,421	\$389,105,326	\$1,434,010,747
Total	674	688	1,362	\$3,220,786,123	\$2,207,766,291	\$5,428,552,414

SOURCE: Office of State Construction, NC Department of Administration

FIGURE 4.10

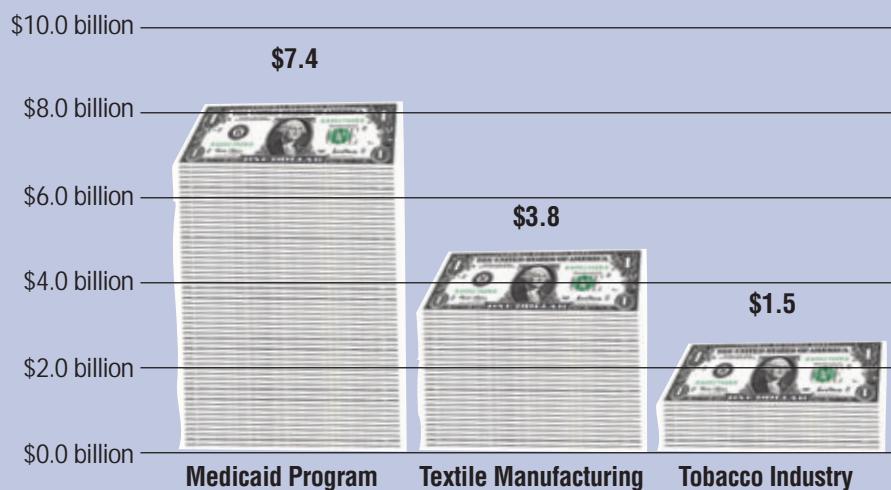
Quick Facts: Selected State-Owned Properties

- Number of state-owned buildings/structures: 12,214
- Current replacement value of these buildings according to the Department of Insurance: approximately \$11.7 billion
- These buildings range in size from a 9-sq.-ft. sentry post at Tryon Palace historic site, to the 451,000-sq.-ft. Brody Medical Science Building at the ECU School of Medicine
- The following is a list of properties that are unique in their function, history or type of construction:
 - Dean Smith Center at UNC-Chapel Hill; total height approximately 20 stories tall
 - SBI Crime Lab in Raleigh; contains high-tech investigative equipment
 - Dorton Arena at the State Fairgrounds in Raleigh; national historic monument
 - *Battleship North Carolina* in Wilmington; famous World War II vessel
 - *Elizabeth II* at Roanoke Island Festival Park; replica of a 16th century sailing vessel
 - State Capitol building in Raleigh; completed in 1840; national historic landmark
 - NC Aquariums located in Fort Fisher, Pine Knoll Shores, and Roanoke Island
 - Mortuary and Temple at Town Creek Indian Mound near Mt. Gilead; built circa 1400
 - Doghouse at Medoc Mountain State Park in Halifax County
 - Museum of Natural Sciences in Raleigh; state-of-the-art museum with the state's only escalator
 - Tryon Palace in New Bern; site of the original state capitol
 - Mount Mitchell Observation Tower, Mount Mitchell State Park; highest point east of the Mississippi River
 - Van der Veer House and Palmer-Marsh House in Historic Bath; built in 1740 and 1744

4. Where Does the Money Go? *continued*

Medicaid, a federal health insurance program for children and the poor, has contributed to North Carolina's budget problems over the last several years as economic declines put more people out of work and health costs soared. While the federal government pays about 66% of the costs of Medicaid, state and county governments are responsible for about 27% and 7% respectively. The costs of Medicaid have been increasing faster than any other section of the state budget over the last several years. The total cost of Medicaid is greater than the estimated economic effects of textile manufacturing and the tobacco industry combined. Medicaid spending in the state hit \$7.4 billion in 2002–2003, while textile manufacturing accounted for only \$3.8 billion and the tobacco industry for only \$1.5 billion. Most Medicaid recipients are children, but about 38% of Medicaid costs are consumed by only eight percent of those eligible for Medicaid, generally the elderly and disabled.

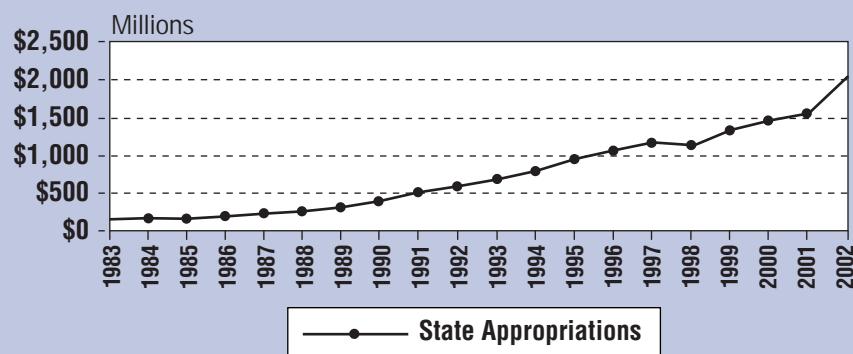
MEDICAID PROGRAM: ROLE IN STATE ECONOMY, FY 2002–2003



SOURCE: Fiscal Research Division, NC General Assembly

FIGURE 4.11

STATE APPROPRIATIONS TO MEDICAID



SOURCE: Fiscal Research Division, NC General Assembly

FIGURE 4.12

MEDICAID PROGRAM HISTORY OF TOTAL EXPENDITURES

Fiscal Year	Total Expenditures
1979–1980	\$410,053,625
1989–1990	\$1,427,672,567
1999–2000	\$5,789,133,085
2001–2002	\$7,366,129,429

SOURCE: Fiscal Research Division, NC General Assembly

FIGURE 4.13

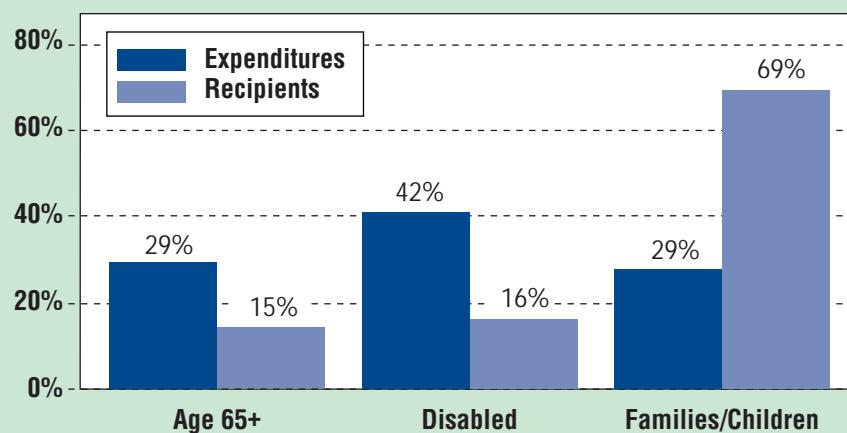
MEDICAID PROGRAM EXPENDITURES AND RECIPIENTS FY 2002

Eligibility Category	Number of Recipients	Expenditures	Annual Cost Per Recipient
Elderly	208,109	\$1,804,543,711	\$8,687
Aged	160,845	\$1,783,081,503	\$10,799
Disabled	223,225	\$2,590,740,655	\$10,645
Families & Children	954,340	\$1,753,986,603	\$1,639

SOURCE: Fiscal Research Division, NC General Assembly

FIGURE 4.14

MEDICAID PROGRAM EXPENDITURES AND RECIPIENTS



SOURCE: Fiscal Research Division, NC General Assembly

FIGURE 4.15

Quick Facts: Selected Department of Transportation Construction Costs, 2003

Selected construction costs for different types of roads and interstates are estimated costs and do not include right-of-way or design costs.

Four-lane Interstate Highways

- Piedmont and coastal plain:
 - Rural = \$6.9 million per mile
 - Urban = \$19.2 million per mile

Mountains:

- Rural = \$26.5 million per mile
- Urban = \$35–40 million per mile

Interstate Highway Interchanges

- Interstate to interstate = \$50–\$70 million each
- Interstate to secondary (diamond or 1/2 clover leaf) = \$4–7 million each
- Interstate to secondary (single point urban) = \$12–14 million each

Secondary Roads

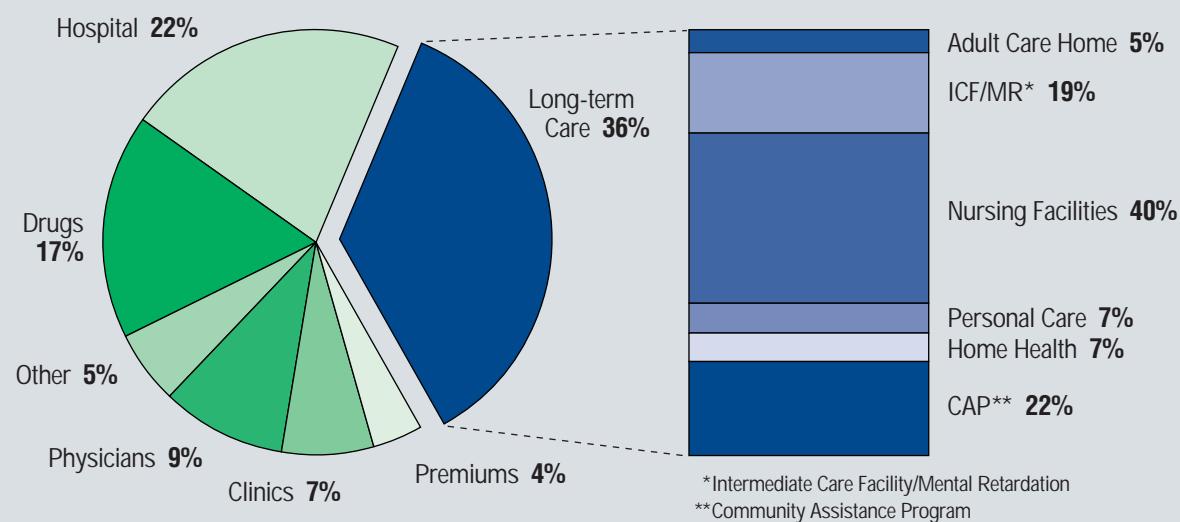
- Piedmont and coastal plain = \$200,000 per mile
- Mountains and foothills = \$318,000 per mile

SOURCE: NC Department of Transportation

MEDICAID PROGRAM: EXPENDITURES FOR SERVICES

Changes in expenditures for services since FY 1995:

- Long-term care expenditures continue to decline—40% to 36%
- In-home services are an increasing share of the long-term care expenditures—19% to 36%
- Hospital expenditures have also declined—27% to 22%
- Drug expenditures have doubled—8% to 17%



SOURCE: Fiscal Research Division, NC General Assembly

FIGURE 4.16

REVENUE GROWTH IN HIGHWAY FUND, HIGHWAY TRUST FUND, FEDERAL AID FOR TRANSPORTATION, AND GENERAL FUND

	Revenues (\$ Millions)		
	1991–92	2001–02	% Change
Highway Fund	\$944	\$1,298	+38%
Highway Trust Fund	537	974	+81%
Federal Aid (budgeted)	341	809	+137%
Total	\$1,822	\$3,081	+69%
General Fund	\$7,638	\$13,157	+72%

SOURCE: Fiscal Research Division, NC General Assembly

FIGURE 4.17

DIFFERENCES BETWEEN HIGHWAY FUND AND HIGHWAY TRUST FUND (RULES OF THUMB)

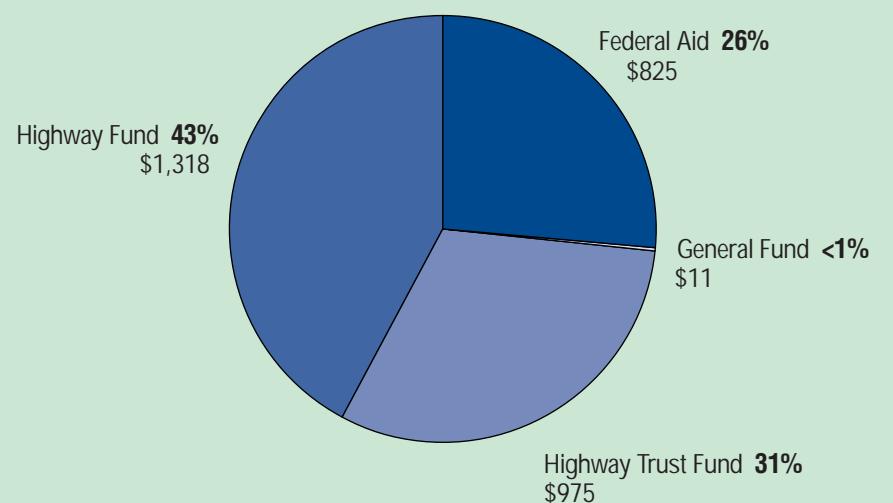
	Highway Fund	Highway Trust Fund
Major State Revenue Source	Motor Fuels Taxes 65%	Highway Use Tax 59%
Biggest Program	Maintenance 52%	Construction 95%
Primary Method of Allocation	Appropriation	Statutory Formulas

SOURCE: Fiscal Research Division, NC General Assembly

FIGURE 4.18

2002–2003 TRANSPORTATION REVENUES (\$ MILLIONS)

Total: \$3.1 billion

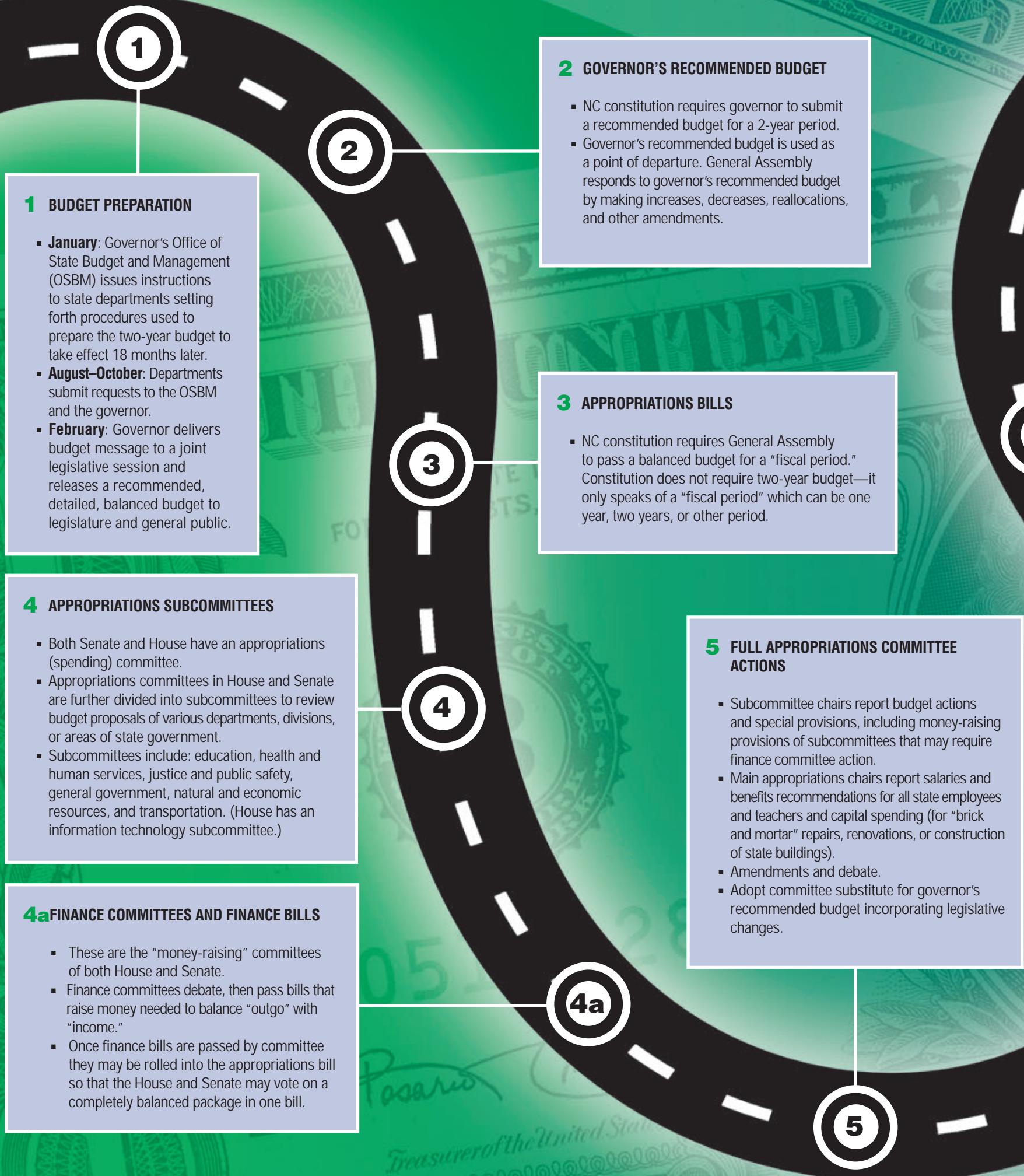


SOURCE: Fiscal Research Division, NC General Assembly

FIGURE 4.19

5. Who Puts the Budget Together and How?

ROADMAP OF THE STATE'S BUDGET PROCESS



8

8 HOUSE AND SENATE VOTE ON CONFERENCE REPORT

- Conference committee report cannot be amended—must be voted “up” or “down” in each house.
- Vote on conference report.

7a HOUSE AND SENATE APPOINT CONFEREES

- Conferees may consider *differences* between the two bills, or formulate special conference committee rules.
- Conferees negotiate differences.
- Develop conference report based on agreements.

7

7 SENT TO OTHER CHAMBER (i.e., if begun by House, it moves on to Senate or vice versa)

- Receiving chamber goes through same process and steps as in 3, 4, 4a, and 5 and sends a bill back to originating chamber.
- Concurrence by originating chamber voted on. (If “Yes”, go to 10; if “No”, go to 7a.)

6

6 HOUSE OR SENATE FLOOR

- Main appropriations chairs and subcommittee chairs explain bill.
- Debate and amendments.
- Vote on second and third readings.

9

9 CONFERENCE REPORT ADOPTED

- *Note:* If not adopted, new conferees may be appointed and the conference committee process and negotiation of the differences is repeated.

10

10 BUDGET BILL ENROLLED, RATIFIED AND SENT TO THE GOVERNOR TO BE SIGNED INTO LAW

- If governor signs the budget bill, the budget is formally enacted. Governorial veto of bill is “all or nothing.” Governor’s veto can be overridden by a 3/5 vote of those present and voting in both House and Senate. If veto is overridden, budget is formally enacted. If governor’s veto is sustained, process begins again at Step 4.

6. Where Have We Been?

During the last 30 years, North Carolina has undergone sweeping changes in its economy, its population, and the services offered by its governments.

MAJOR ECONOMIC SHIFT

Agriculture, textiles, and tobacco production—once the foundation of a vibrant manufacturing and agricultural economy—have faded rapidly over the last three decades. Manufacturing jobs that once offered a route off the farm, or a way to augment a farming income, have moved rapidly to Mexico, South America, China, and other off-shore locations in the last 10 years in search of cheaper labor. The loss of those jobs has been a major factor in the state's economic problems and in the state's slow recovery from the recession. Manufacturing jobs that offered at least the hope of middle-class wages have been replaced with service jobs in tourism or retail that pay only minimum wage or slightly better and often do not offer 40 hours of work a week or benefits. High-tech jobs in computers, biotechnology, and other fields pay high wages, but also require far more education than the manufacturing jobs of the past.

RAPIDLY GROWING POPULATION

The state has seen its population grow rapidly over the last 30 years with “transplants” who moved into the state for new high-tech jobs, retirees who chose North Carolina as a place to spend their golden years, young people attracted by the state's universities who stayed to become entrepreneurs and drivers of a new technology economy, and many others from South America and Mexico.

While dealing with the influx of new residents, the state also has had to deal with the growing numbers of young “baby boomers” who created an increased demand for public school classrooms, universities, community colleges, and teachers and counselors to staff them.

INCREASING DEMANDS FOR SERVICES

A policy that has existed since 1931 that the state would pay for most school operations and local governments would pay for school buildings was

severely eroded by the need for new schools. Poorer counties, unable to levy enough in local taxes to keep pace with school needs, sought help from the state.

The growing numbers of graduates from high schools increased the demand on the university system and community colleges as graduates sought training for new, better-paying jobs.

At the same time, workers left behind by the shifting economy faced difficult times. The

government helped with job training programs, increased Medicaid coverage (especially for children), and other programs to try to shore up the state's stressed regions.

STARK CONTRASTS

The contrast between North Carolina's wealthy piedmont crescent and the regions outside it still exists and grows even starker as the economy continues to stall.

CHANGES IN STATE BUDGET

North Carolina's General Fund has remained virtually constant over the last 25 years as a percentage of the total state budget, while the federal share of the state budget has increased, and the percentage of total spending for the Highway Fund has declined. The General Fund accounted for 56% of the total state budget in 1974–75 and 57% of the 2001–2002 total budget. While the *percentage* was relatively unchanged, the *number* of actual dollars spent has increased dramatically due to inflation, population growth, increases in public school positions, and other departmental employees (especially correctional employees).

The graphs on page 21 show how budgets and program costs have changed over time. In part these changes are driven by the sheer size of the program. But it's plain enough to see in Figure 7.1 on page 23 that if you have more pupils riding more buses more miles every day, year after year, you must have more of everything—from tires and batteries, to drivers, to the salary monies to pay them—not to mention more buses and more maintenance.

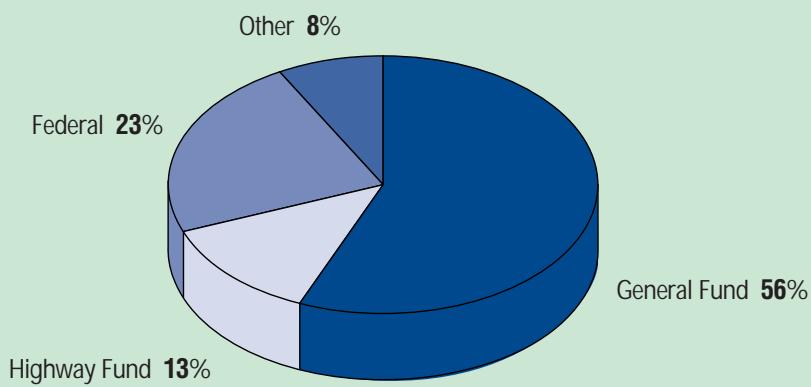
And Medicaid—especially when there is an economic downturn—is the only source of “insurance” for families who do not have jobs and cannot afford private-pay insurance plans. The same is true for older folks on fixed incomes.

The more people eligible for Medicaid, the more the state and local government costs rise. Simply speaking, a faltering economy drives up Medicaid costs. (See Figure 4.16, page 17.)

Over the years, the actual dollars North Carolina has spent on public education have continued to increase, but their *percentage* of the total state budget has *declined* as more dollars were directed to other areas, particularly human resources. In the 1980s, North Carolina increased the percentage of the state budget spent on public schools, universities and community colleges. It also increased the percentage spent on prisons, primarily because of prison construction ordered by federal courts to house increasing numbers of prisoners serving longer sentences.

During the 1990s increasing costs for health care, including Medicaid, led to a dramatic increase in spending for human resources, which grew to 36% of the total state budget. While total dollars spent on education continued to increase, the percentage of the total budget dedicated to education *declined*. Public schools, meanwhile, dropped from 30.2% of the total budget to 26%. Universities dropped from 14.5% of the total budget to 10%. Prison spending continued to increase, from 3.1% to 3.6%.

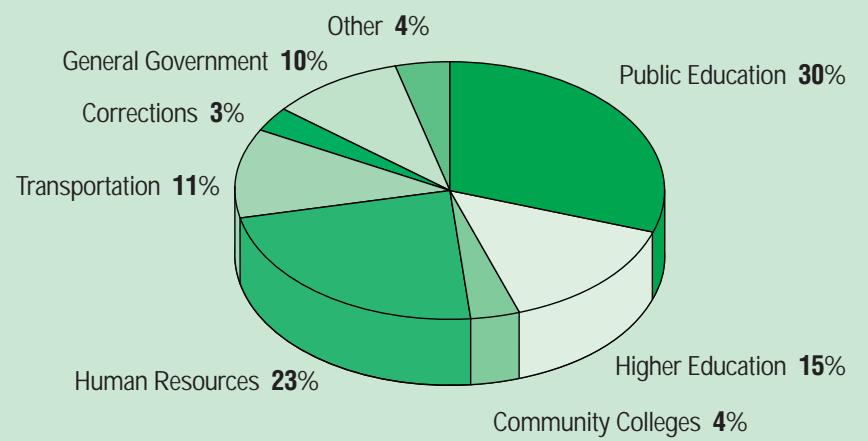
TOTAL STATE BUDGET BY SOURCE, 1974–1975



SOURCE: Appendix Table 5, Post Legislative Budget Summary, 2002–2003, Office of State Budget and Management

FIGURE 6.1

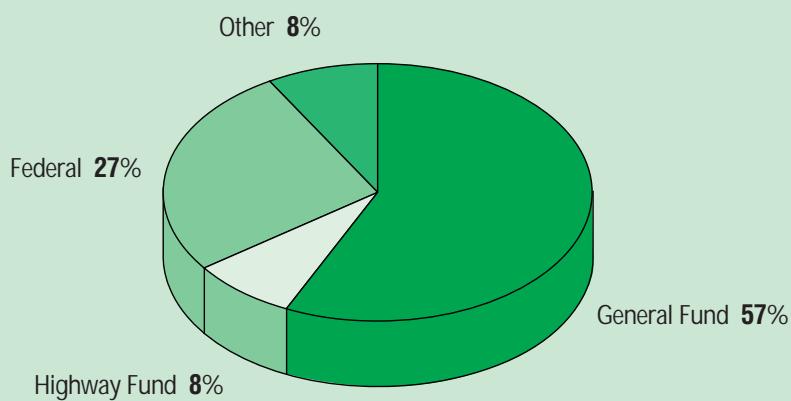
TOTAL STATE BUDGET BY MAJOR PROGRAM AREA, 1987–1988



SOURCE: Office of State Budget and Management

FIGURE 6.2

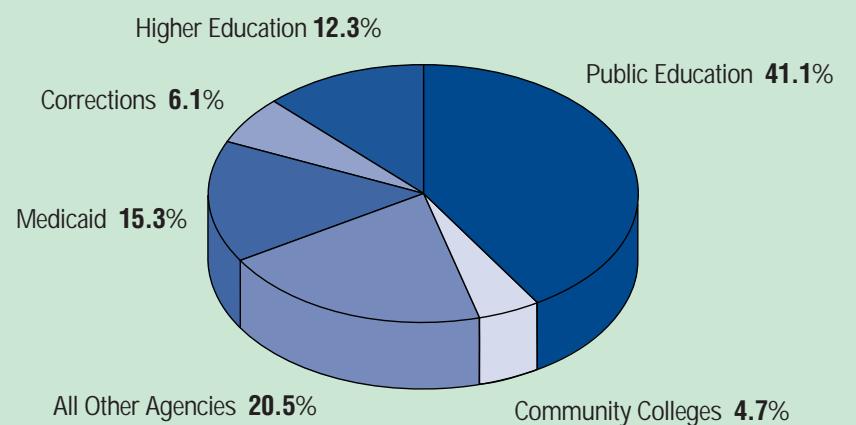
TOTAL STATE BUDGET BY SOURCE, 2001–2002



SOURCE: Appendix Table 5, Post Legislative Budget Summary, 2002–2003, Office of State Budget and Management

FIGURE 6.3

GENERAL FUND EXPENDITURES BY MAJOR PROGRAM AREA, 2001–2002



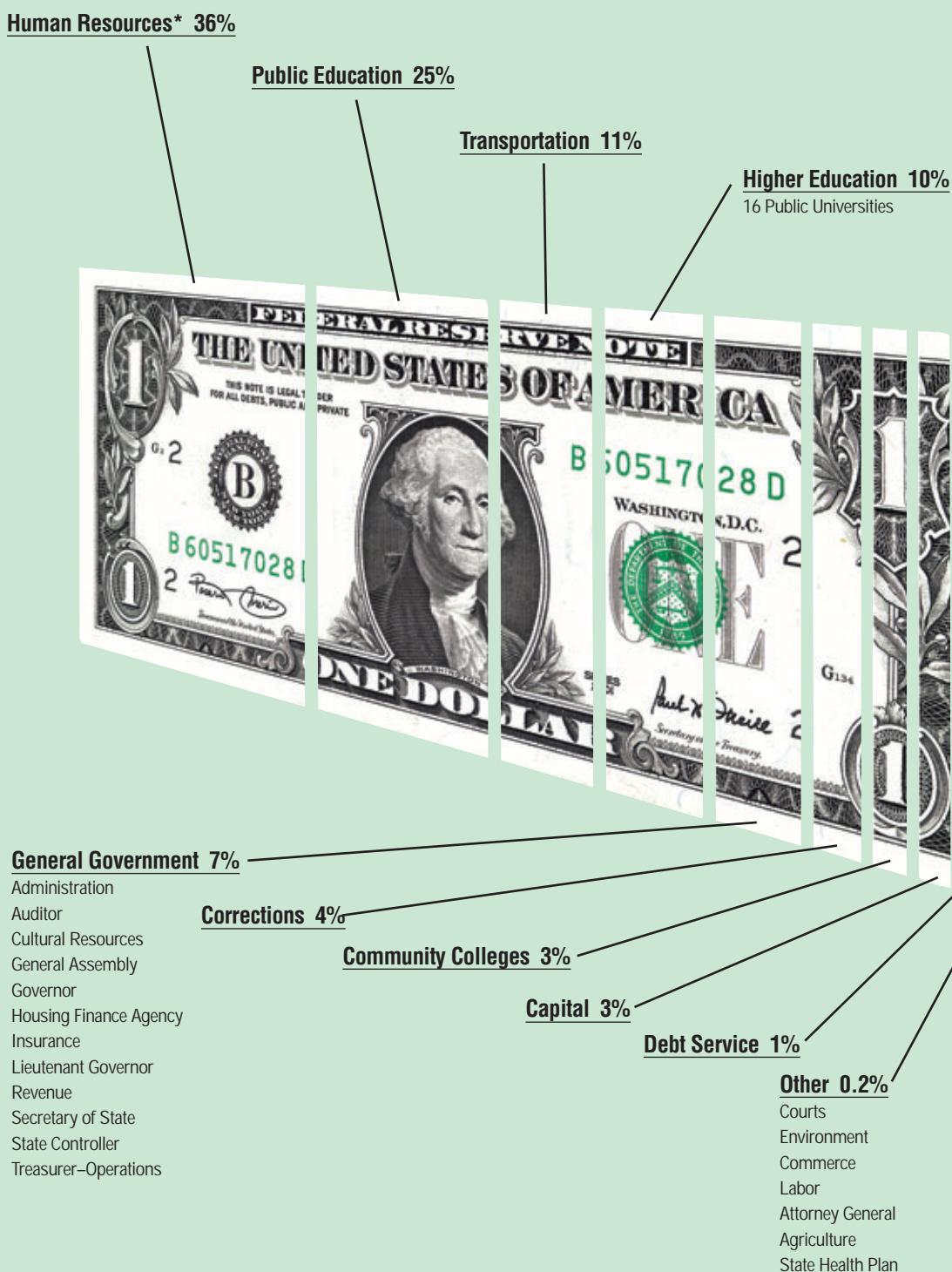
SOURCE: Office of State Budget and Management

FIGURE 6.4

6. Where Have We Been? *continued*

2000–2001 TOTAL STATE BUDGET

When funds from all sources (e.g. federal) are included in the total state budget, human resources comprises a larger percentage share, but education (all levels) still remains the state's chief line of business at 38%.



SOURCE: Office of State Budget and Management

FIGURE 6.5

*By 2000–2001 human resources expenditures began to increase as the economy worsened and more people became eligible for Medicaid programs. Total human resources spending increased to 36% of the total state budget from 33.5% in the 1990s.

7. Where Are We Now?

North 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%

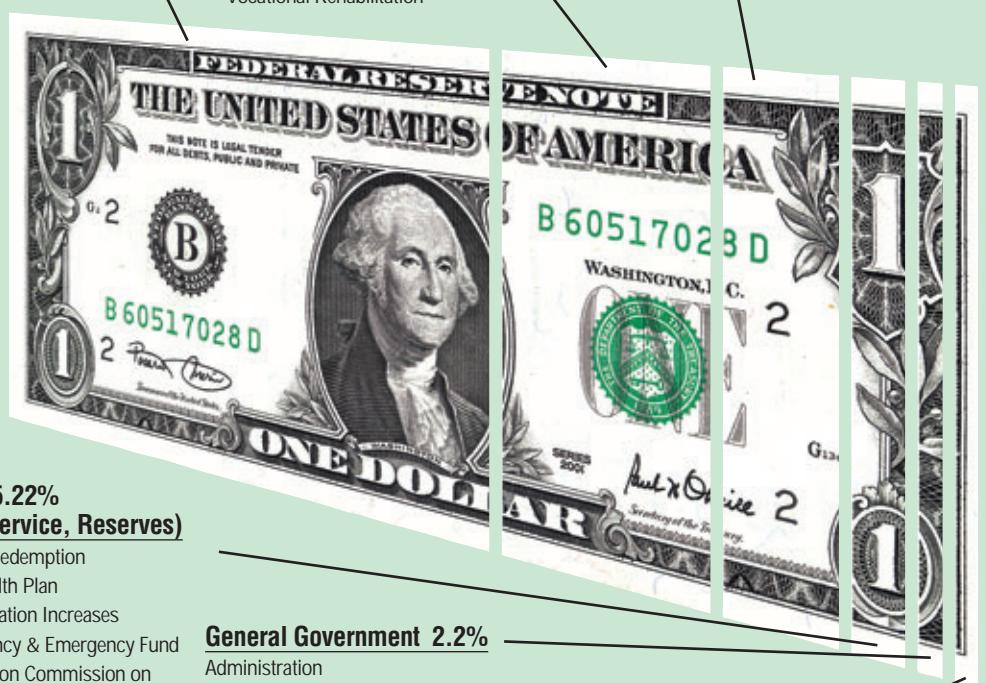
Administration
Auditor
Cultural Resources
General Assembly
Governor
Housing Finance Agency
Insurance
Lieutenant Governor
Revenue
Secretary of State
State Controller
Treasurer—Operations

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

8. Where Are We Going?

North Carolina, like nearly every other state, is in a major fiscal crunch: State operating costs are outrunning state revenues by a substantial margin and will continue to do so for the next several years. This crisis cannot be avoided or waited out. Why? And, more importantly, what can the governor and the General Assembly do to respond?

The state—ours or any other—has service obligations to its people. The cost of providing these services grows with (1) added numbers of

residents, both those born in the state and those who come here to live; (2) program improvements—better services provided to more people in response to rising public expectations of their government; (3) inflation; (4) the transfer of responsibilities by the federal government to state governments without corresponding financial aid; and (5) other largely uncontrollable factors, such as the federal “No Child Left Behind Act” of 2002 and the far-reaching decision of our own state supreme court in the *Leandro* case, which

mandates substantial investment in low-wealth school districts.

Public finance is a matter of supply and demand.

DEMAND CONTINUES TO GO UP

The reasons for the growing money needs of the state include these:

- Our population in 2000 was 8 million. By 2010 it will be almost 9.5 million. We expect to gain roughly 45,000 to 50,000 extra residents

NC POPULATION MAP BY COUNTY 2001

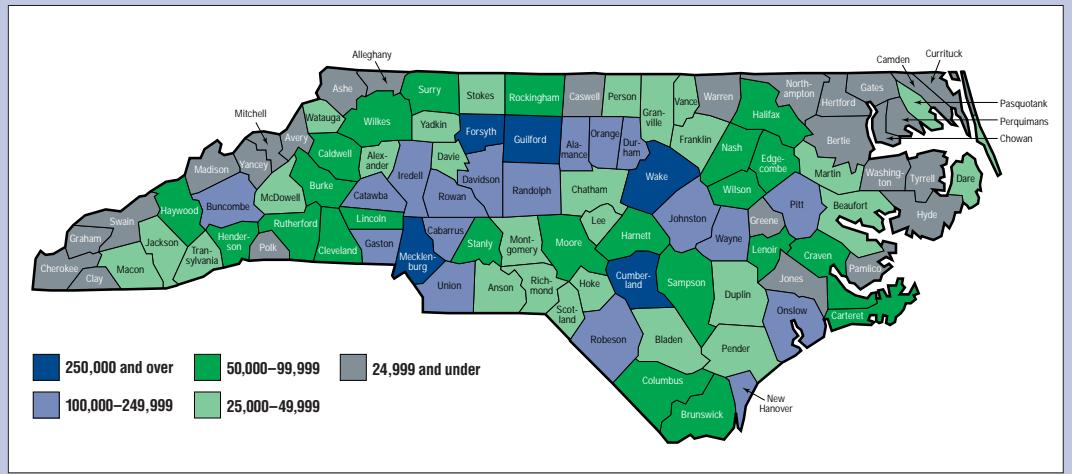


FIGURE 8.1

NC PROJECTED RATE OF POPULATION CHANGE 2000-2030

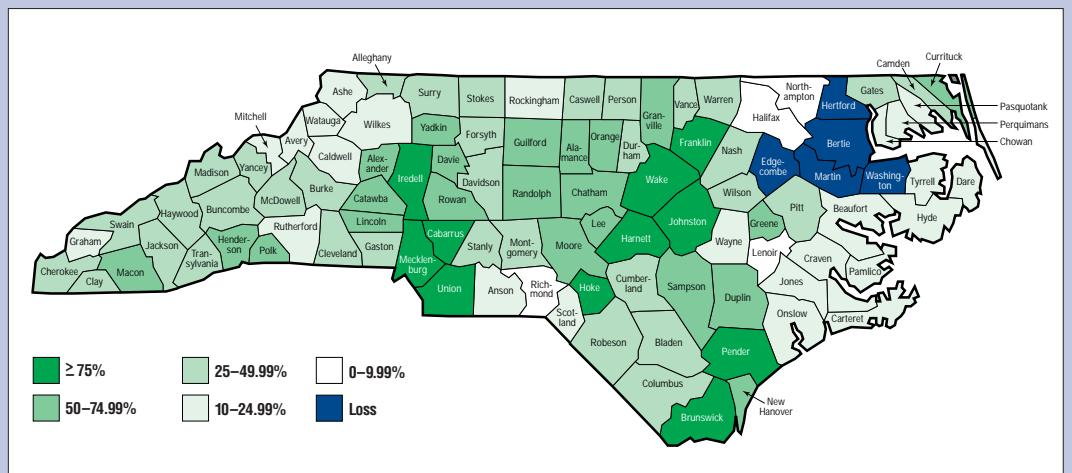


FIGURE 8.2

NC PROJECTED CHANGE IN TOTAL POPULATION 2000-2030

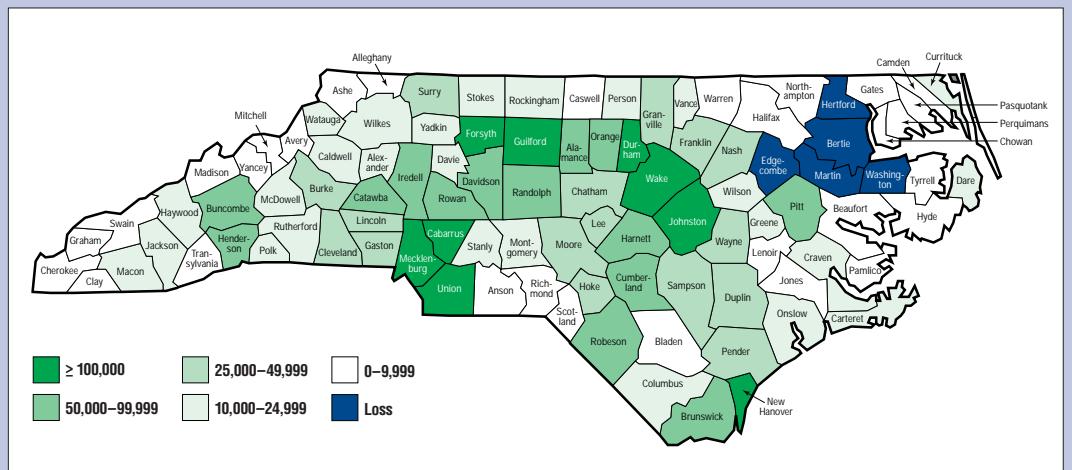


FIGURE 8.3

TOP 10 COUNTIES WITH LARGEST PROJECTED POPULATION INCREASES

COUNTY	PROJECTED INCREASE 2000-2030	RATE OF INCREASE (%)	METRO AREA
Wake	706,254	112.5	RDU
Mecklenburg	622,284	89.5	Charlotte
Guilford	237,216	56.3	Triad
Johnston	146,284	119.9	RDU
Union	138,764	112.2	Charlotte
Forsyth	128,029	41.8	Triad
Cabarrus	115,577	88.2	Charlotte
Durham	105,259	47.1	RDU
New Hanover	103,904	64.8	Wilmington
Iredell	98,711	80.5	Charlotte
TOTAL	2,402,282	81.9	
Rest of NC	1,995,836	39.0	
Total NC	4,398,110	54.6	

PROJECTED TOP 10 FASTEST GROWING COUNTIES

COUNTY	GROWTH RATE 2000-2030 (%)	AREA
Hoke	123.4	Suburban Fayetteville
Johnston	119.9	Suburban Raleigh
Wake	112.5	Raleigh
Union	112.5	Suburban Charlotte
Harnett	90.4	Suburban Fayetteville
Mecklenburg	89.5	Charlotte
Cabarrus	88.2	Suburban Charlotte
Iredell	80.5	Suburban Charlotte
Brunswick	78.7	Suburban Wilmington/beach
Franklin	75.0	Suburban Raleigh
NC	54.6	

FIGURE 8.4

SOURCES: US Census and NC State Demographer

each year through natural causes (births minus deaths) and another 95,000 to 100,000 extra residents each year through the net effect of people moving into and out of the state.

- Our public schools have 1.29 million students this year. By 2011, they will enroll 1.39 million, an increase of 7%. All those students are constitutionally guaranteed a “sound basic education” at the state’s expense.
- Our 59 community colleges, which provide the minimum vocational and technical education our people increasingly need for profitable employment, enrolled approximately 169,000 students in 2002-03; by 2010-11, they will enroll over 237,000, representing a 27% increase.
- Our public universities, which prepare students for a wide range of professional responsibilities, have an enrollment of 177,000 this year. By 2010-11, that enrollment is likely to increase 19% to 218,000 students.
- The share of our population that is 65 or older will grow from 12% of the state’s population in 2002 to 15% in 2010-2020 and 18% in 2030. Older citizens are largely beyond their wage-earning years, and increasingly in need of health and other services that the state must help provide.
- Our job structure is changing with the continuing and long-term decline in employment in agriculture, textile manufacturing, apparel making, and furniture industries. This shift presents an urgent need to create new jobs and to train and retrain people to do them.
- Much of our population, especially of underemployed and unemployed people, tends to be distributed in areas of the state that are not magnets for industrial growth or other forms of economic development.
- Our transportation systems need better maintenance and improvement to serve both public demand and economic growth.
- The state has \$8,182,706,528 invested in buildings and other structures for which appropriated repair and renovation funds have been scanty in recent years. Leaking roofs and rusting plumbing do not disappear during tough economic times, and a delay in treating such problems only magnifies them.

continued on page 27

8. Where Are We Going? *continued*

POPULATION

As shown in Figure 8.5, North Carolina's population is expected to become increasingly gray over the next 25 years as the percentage of people over age 65 continues to grow and the percentage of young people declines. The percentage of the population expected to be over 65 in 2030 is 17.8, more than twice the older population in 1970. Children under age 18 will account for 24% of the state's population in 2030, compared to 36.7% in 1970 during the height of the baby boom. The changing nature of the state's population is virtually guaranteed to lead to changes in state government as citizens demand different services that meet their changing needs.

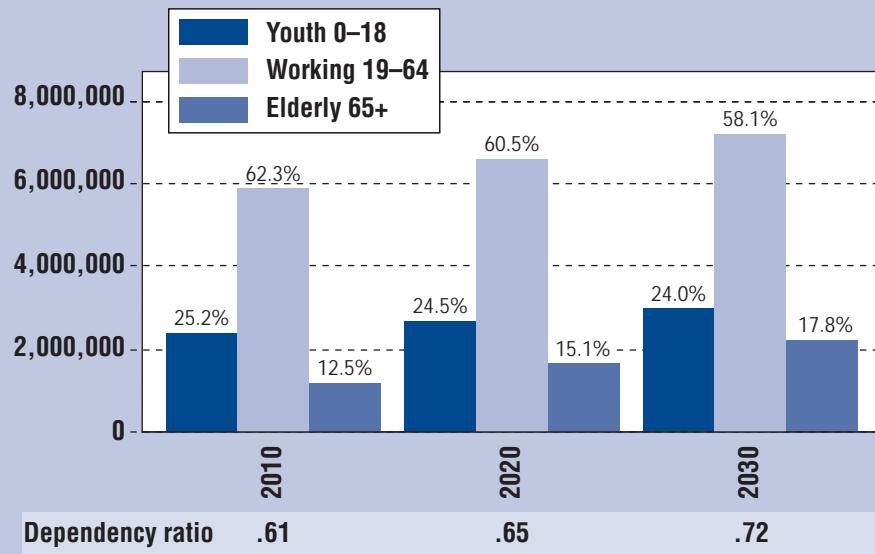
SCHOOL-AGE POPULATION

Figure 8.6 demonstrates the potential impact on demand for increased funding in the public schools' budget, especially during the 2000–2030 period. At the same time, the growth in 18- to 24-year-olds puts relatively fewer people in colleges and the workforce.

UNIVERSITY ENROLLMENTS SINCE 1991

Figure 8.7 shows there has been little over a 13% increase in student head count in the university system between 1991–2002. Yet population projections suggest larger increases in public school populations which, in turn, will place additional pressure on university enrollments.

PERCENTAGE OF POPULATION WORKING (AGES 19–64) 2010, 2020, 2030

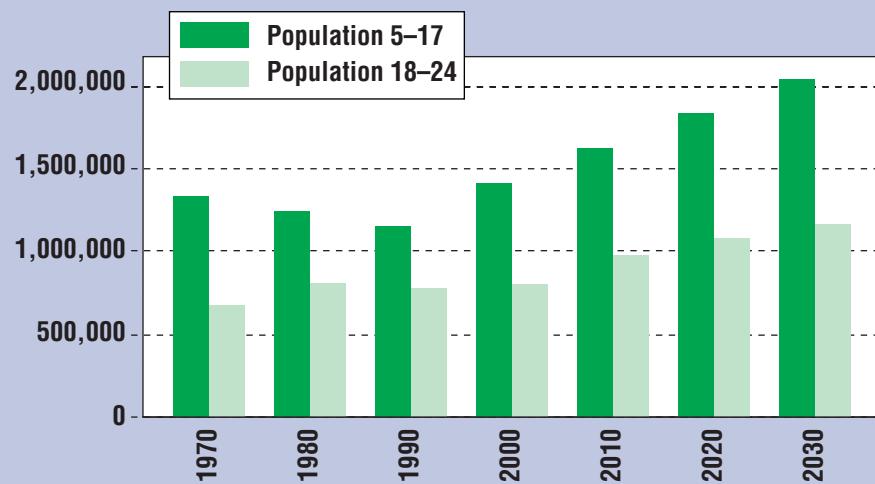


Dependency ratio = (number of elderly + number of youth) / working age population

SOURCES: Office of State Budget and Management and US Bureau of the Census

FIGURE 8.5

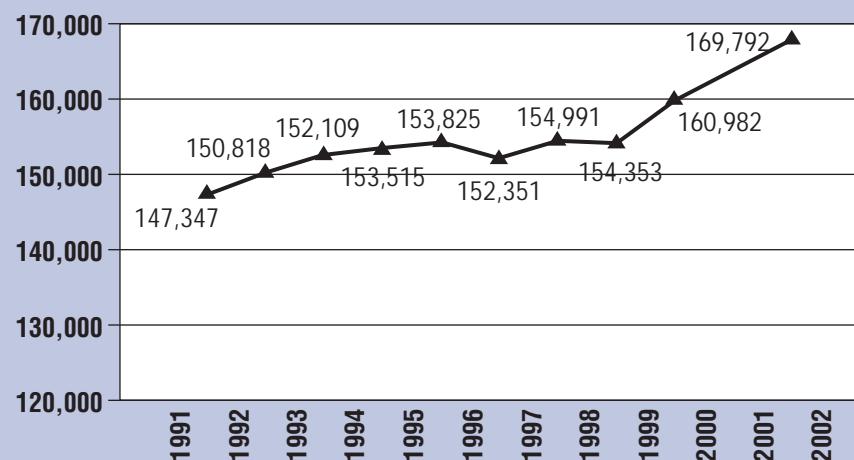
SCHOOL AGE POPULATION (AGES 5–17 & 18–24) 1970–2030



SOURCES: Office of State Budget and Management and US Bureau of the Census

FIGURE 8.6

UNIVERSITY HEAD COUNT SINCE 1991



SOURCE: Office of the President, UNC system

FIGURE 8.7

Quick Facts: Public Education Budget Drivers

Average Daily Membership (ADM)

- Increased by 20,000 per year for the past 6 years
- Translates to \$100 million increase per year

Salaries and Benefits

- \$37 million for a 1% salary increase for teachers and instructional support personnel
- \$9 million for 1% increase for other personnel

Quick Facts: Demographic Trends

- The population will much more than double its 1970 size of 5.1 million to become 12.4 million by 2030.
- The elderly population doubled between 1970 and 1990 and will almost triple its 1970 size by 2030 to reach 2.2 million.
- Age groups needing education (5–24) will steadily increase through 2030, exceeding its current number by over 40%.
- The working age population will shrink by around 4 percentage points (as a percent of the total population) between 2000 and 2030.
- The composition of the population extremes to be supported by the working age group will change dramatically. While increasing in absolute value, the young group will decrease by one or two percentage points as a fraction of the total population. At the same time, the elderly will increase by more than five percentage points as a fraction of the total population.

continued from page 25

SUPPLY IS LIMITED

North Carolina's system of taxes has served it well for seven decades; yet there is an emerging question whether a system developed in the 1930s is adequate for a 21st century economy.

North Carolina continues to rely chiefly on:

- personal income tax, which produces 57.3% of the state's tax collections;
- general sales tax, which generates 29.8%;
- corporate income tax and franchise tax, which account for 6.9%; and
- other taxes, which produce 6.0% of total collections.

The state continues to rely on these forms of taxation because there are no others that could be levied which would yield comparable income to the state.

But some of the taxes as applied have not kept up with the changing economy. The general sales tax, for example, was considered modern and innovative in 1933 when North Carolina was the second state to adopt it. But it is levied almost entirely on merchandise sold, while 60% of today's purchases (in dollars) are not for goods, but services, for which sales taxes are not applied.

In addition, an increasing share of goods are purchased remotely, often across state lines and many such transactions escape taxes.

The nature of North Carolina's economy, together with indications that the state will continue to experience substantial population growth, mean we will likely face economic and budget challenges for years to come.

While North Carolina's budget crisis has ties to the national recession, it also has other causes that are unlikely to improve when the national economy rebounds. Losses caused by dramatic reductions in several traditional industries are likely to be permanent because those industries have fled and will not return.

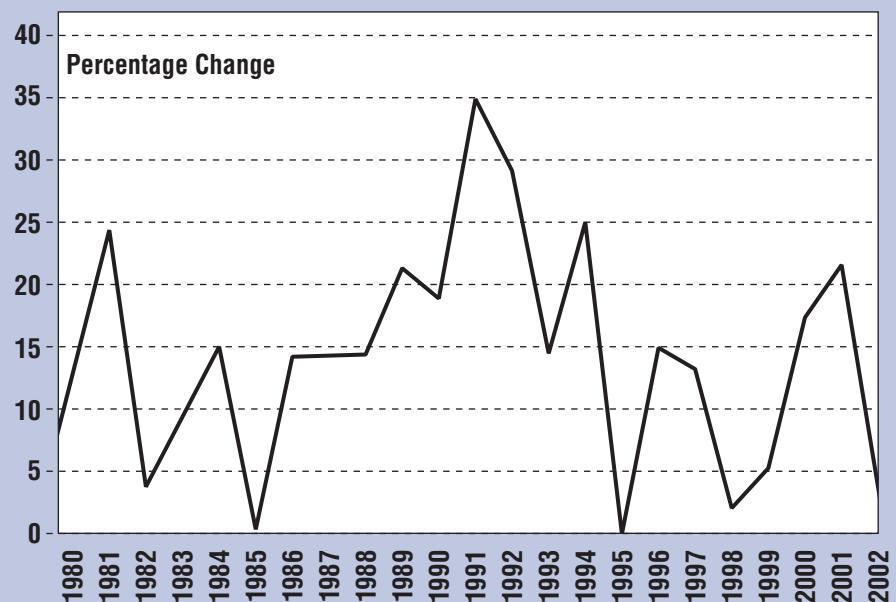
And we have continued to expand programs while simultaneously cutting taxes. The result has been to put the state, not in a fiscal hole, but a fiscal trench that may continue for some time.

MEDICAID PROGRAM RATE OF GROWTH

During the past twenty years, the rate of growth for Medicaid expenditures has varied considerably—ranging from 0 to 35% (see Figure 8.8 below). Yet Figure 8.9 suggests that from 2005–2010 we can expect steady increases in

Medicaid expenditures. Higher rates of growth have occurred during years of economic distress or when major Medicaid expansions have been authorized. Lower rates of growth have occurred during years when the Medicaid population has been stable or declining.

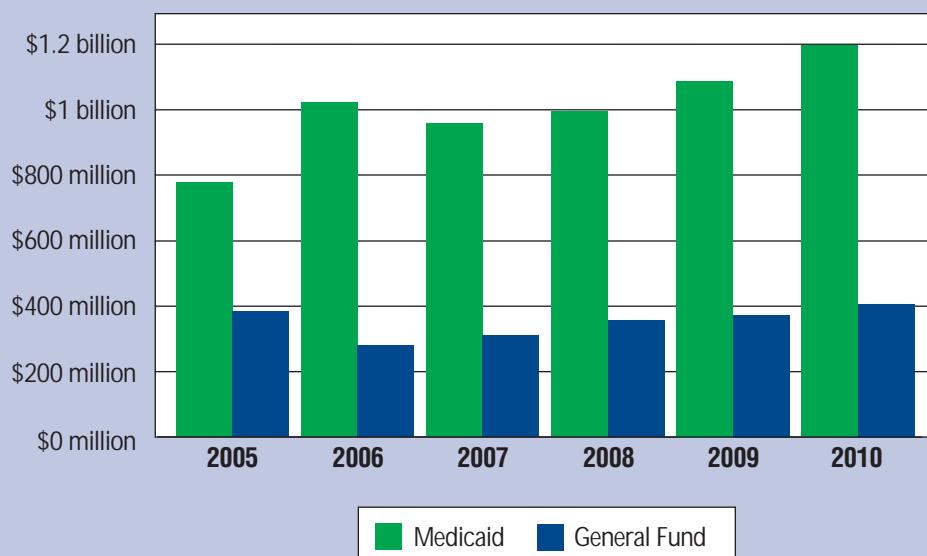
MEDICAID PROGRAM RATE OF GROWTH



SOURCE: Fiscal Research Division, NC General Assembly

FIGURE 8.8

COMPARISON OF ESTIMATED MEDICAID RATE OF GROWTH VS. ESTIMATED GENERAL FUND REVENUE RATE OF GROWTH



SOURCE: Fiscal Research Division, NC General Assembly

FIGURE 8.9

9. Why So Much Change?

North Carolina's budget has seen dramatic growth in the last two decades, due in part to increases in government services, the growth of the state's population, and to the changing nature of that population.

TIGHTENING THE STATE'S "BELT"

When their budgets get tight, individuals or businesses tighten their belts to reduce their spending as much as they can. Families eat out less, reduce their entertainment expenses, or put off trading in their car for another year. In a serious pinch, they may delay medical or dental expenses, or shift at least some of their spending from cash to credit cards.

Businesses may quit offering expensive services that attract customers but eat away at the bottom line. Or they may cease making products or offering services that do not produce enough profits. Large programs or expansions may be delayed or cancelled until the economy improves.

CONSTRAINTS ON THE PUBLIC SECTOR

In some respects, government must operate like families or businesses—managing its money carefully and avoiding, where possible, spending that it ultimately will be unable to afford. But government does not have all of the options available to families or businesses when economic times are hard.

For one thing, tough economic times *increase* the demand for state services. Workers who have lost their old jobs seek training for new ones through the community college system. Medicare costs increase as workers who barely stayed above the poverty line see their jobs lost or their hours reduced. Increased stress and poverty leads to more crime, raising the spending on law enforcement, courts, and prisons. At the same time, revenues from income taxes and sales taxes, the backbone of the state budget, decline.

For another thing, the state simply cannot reduce some services no matter how bad the economy becomes. Take public schools, for instance, which already take nearly half of the state's General Fund. State law requires that children must attend school until they are 16, and the state constitution guarantees that every child will receive a basic education no matter

where they live in the state.

Experts say that because of increasing numbers of children born or moving into North Carolina, teacher retirements, general attrition, and the like, the state will need to hire about 9,000 additional teachers each year for the foreseeable future. At a basic starting salary of \$25,000 a year, that means the state budget will have to increase by at least \$225 million a year. And that will cover only teacher salaries, not the associated costs for additional school buildings, administration, support staff, benefits, school buses, supplies, books, or utilities.

North Carolina, by law, cannot turn away the children that show up at its schoolhouse doors. Nor would it want to, since our economy is rapidly shifting from an agriculture and manufacturing base to a service and knowledge base. A basic education, including at least some college training, is required for virtually every existing job and will become even more critical to jobs created over the next few years.

OUR RESPONSIBILITY

In its *NC 20/20* report, the Progress Board noted that the Census Bureau, the Bureau of Labor Statistics, and the Hudson Institute each reported that well over 60% of 21st century jobs will require 14 not 12 years of schooling—at a minimum. In July 2003 the governor and the superintendent of public instruction reported student test scores in writing skills exceeded national norms. It will be important to continue investments that reinforce that sort of real educational progress.

North Carolina has a proud history of rising to the challenges before us. Just as previous generations made the choices that have resulted in our quality of life, today we now have the responsibility to act on behalf of the generations that follow. We can make choices. Choices that will:

- improve our schools;
- protect the public;
- improve our health;
- stimulate diverse economic development;
- keep our communities clean and safe; and
- construct and sustain a quality of life second to none in this great state we call "Home."

10. How Can You Get Involved?

Wait! Wait! Don't just throw this guide in the trash. At this point, you're probably overwhelmed with numbers, percentages, charts, graphs, and so forth, and wondering what in the world you can do with your new knowledge. Well, here are five easy ways you can become involved in how government raises and spends your money!

You can:

1. Share this guide with friends and family.

This will help others, about whom you care, to understand why government does what it does. This will help them to understand the sometimes-daunting lingo that you read in your local newspapers about taxes and budgets. Help them not to feel funny when they don't know about "appropriations" or "excise taxes."

2. Take a look at the next budget proposal from your local school district, the city, county, or the state. See what the superintendent, town manager, or governor plans to do with *your* money. Consider these questions:

- Did he or she fully explain—so you fully understand—why an increase or a decrease in your taxes is being recommended?
- Do you agree or disagree with their priorities—priorities like a new public health clinic, hiring more police officers, postponing that new park, cutting or raising your property taxes, or spending more money on child day care or on counseling for prison inmates?

3. Tell someone what you think. Once you've studied a budget proposal, tell someone what you think. Elected officials get tired of hearing from the usual suspects like lobbyists, campaign contributors, or agency heads who have a vested interest in more funding. They want to hear from someone who's asked to help pay the bill.

...AND JUST WHEN YOU THOUGHT YOU HAD SEEN ALL THE NUMBERS, PERCENTAGES, CHARTS, AND GRAPHS YOU COULD POSSIBLY STAND...

Fold out the inside back cover for Appendix A, Summary of General Fund Appropriations, (Session Law 2003-284, as enacted), Fiscal Years 2003-05, 2003 Legislative Session.

Acknowledgements

▪ Attend a public hearing and speak up!

And here's a special tip: Elected officials are much more swayed by the carefully-reasoned but forceful argument presented clearly, cleanly—without rancor or anger. Any good politician can dismiss a rabble-rousing loudmouth as "...full of sound and fury...signifying nothing..." Your calm, direct, forceful presentation will travel miles farther.

▪ Write a letter to your representatives and senators at the legislature.

Names and addresses are easily obtained, online [www.ncleg.net], or from a call to the Legislative Services Office at the General Assembly [919 733 7044].

▪ Maybe, even write a letter to the local newspaper.

You'll be surprised how much they appreciate your comments.

4. Attend a debate between candidates for public office.

Ask them a question about the budget.

- Do they seem to know what they're talking about? If they want to cut taxes, do they also tell you *where* they will cut spending? If they want to pay for something new, like reducing class sizes, do they tell you *how* they will pay for it? After reading this guide, you can't be fooled because you know there are at least two sides to the fiscal equation.

5. The most important thing you can do with any information, is share it with a younger generation.

Stoplights, the water from the tap, someone paying for groceries with food stamps, hearing the dump truck pick up the trash, a children's reading group at the local library, keeping the animals at the zoo healthy and happy, taking meals to home-bound seniors—these are all things that government can do because it collects taxes. When kids see that you are struggling to calculate your taxes in April, and when they see that the receipt for their shoes shows an extra few dollars, tell them why. If you don't, who will?

Here's a final bit of wisdom we've discovered: *Information is only powerful if you use it for some purpose beyond yourself.* Stay informed, let others know what you think and then, by example, teach others, especially younger generations, what it means to be an active citizen and to hold government accountable.

Our State, Our Money: A Citizens' Guide to the North Carolina Budget did not spring forth full-blown from the budget muse.

On behalf of the Progress Board, the staff wishes to thank and acknowledge the substantial contributions of a rather large number of people from the executive, legislative, and judicial branches of North Carolina government who thought enough of this effort to lend a hand, critique a section, suggest a format or a "factoid," scour the copy, charts, and graphics for errors of syntax, grammar, fact, addition, subtraction, and punctuation. Most of these folks were volunteers who graciously and willingly took time away from their principal assignments to craft a budget primer for the people of North Carolina. Their contributions stand as a solid testament to the notion that there is a serious commitment among state government managers, analysts, and elected officials to see to it that all citizens and taxpayers learn as much as they will about the budget of the state.

And there were elected officials, too, who commented on our efforts, despite the fact some were up to their "wherewithalls" in real tough budget choices and deliberations at the General Assembly.

While all the folks who made a contribution to this effort are listed below (I hope!), there are a few who deserve to be singled out for their willingness to endure many meetings (many, many meetings!) to hammer out the outline of this guide; to write and read copy, track down and verify data; suggest re-writes, act as editor-in-chief, and so forth. I came to call this group the "Kudzu Coalition" because they set out to unravel and "demystify" that foot-high stack of budget volumes, with 20,000 lines of budget code called the Budget of North Carolina. Please meet them:

- Dennis Patterson, *Audit Publications Coordinator, Office of the State Auditor (our editor)*
- John Sanders, *Former Director, Institute of Government, UNC-Chapel Hill*
- Gwyn Canady, *Chief Deputy Comptroller, Office of the State Controller*
- Francine Stephenson, *Director, State Data Center, Office of State Budget Management (a.k.a. "The Queen of Data")*
- Elaine Mejia, *Senior Fiscal Analyst, Budget and Tax Center, Justice and Community Development Center*
- Elizabeth Jordan, *Policy Analyst, Budget and Tax Center, Justice and Community Development Center*

And while six others were not able to attend all our meetings, they deserve to be cited as members of this coalition:

- Mona Moon, *Principal Fiscal Analyst, Senate Budget Development Team, Fiscal Research Division, NC General Assembly*
- Lynn Muchmore, *Principal Fiscal Analyst, House Budget Development Team, Fiscal Research Division, NC General Assembly*
- Charles Perusse, *Deputy State Budget Officer, Office of State Budget and Management*
- Karl Knapp, *Office of Tax Research, NC Dept. of Revenue*

- Kathy Hart, *Principal, Zubigraphics (a.k.a. "The Queen of Graphics")*

- George Lawrence, *Principal, George Lawrence & Associates*

And there were others without whose patience and help we could not have done what we needed to do to produce this document:

- Honorable Ralph Campbell, *State Auditor*
- Honorable Cherie Berry, *Commissioner of Labor*
- Honorable Michael Ward, *Superintendent of Public Instruction*
- Honorable Norris Tolson, *Secretary of Revenue*
- Honorable Robert Powell, *State Controller*

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- Paul LeSieur, *Director, School of Business Division, NC Department of Public Instruction*

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Special tributes must be given to Ms. Doris Gilbert, administrative assistant to the Progress Board, who has been a steady, solid colleague and friend; John Pearson, our webmaster, who has seen to it that we got our messages online; and Dennis Grissom, who has kept us straight, financially (no small matter!).

And finally, special thanks to the members of the North Carolina Progress Board itself for their willingness to discuss this project and to support it and for their commitment to the work of the Board today and in the future.



—Tom Covington

Appendix A

SUMMARY OF GENERAL FUND APPROPRIATIONS (SESSION LAW 2003-284, AS ENACTED), 2003 LEGISLATIVE SESSION, FY 2003–04

	Governor's Proposed 2003–04 Base Budget	Net Changes	FTE* Changes	Fiscal Year 2003-04 Appropriation	Percentage Change
Education					
Community Colleges	671,476,663	(10,548,944)		660,927,719	-1.57%
Public Education	6,086,682,250	(51,631,948)	(395.68)	6,035,050,302	-0.85%
University System	1,836,352,141	(44,210,480)	518.00	1,792,141,661	-2.41%
Total Education	8,594,511,054	(106,391,372)	122.32	8,488,119,682	-1.24%
Health and Human Services					
Office of the Secretary	99,449,713	(17,281,280)	(0.50)	82,168,433	-17.38%
Aging Division	28,585,838	(900,000)		27,685,838	-3.15%
Blind and Deaf / Hard of Hearing Services	9,533,508	(230,838)	(4.00)	9,302,670	-2.42%
Child Development	267,002,174	(7,985,007)	15.00	259,017,167	-2.99%
Education Services	33,168,936	(1,362,074)	(9.22)	31,806,862	-4.11%
Facility Services	14,442,802	(2,186,010)		12,256,792	-15.14%
Medical Assistance	2,538,978,314	(551,569,228)		1,987,409,086	-21.72%
Mental Health	581,275,947	(3,985,700)		577,290,247	-0.69%
NC Health Choice	37,317,907	12,166,372		49,484,279	32.60%
Public Health	130,648,960	(6,471,485)	(4.45)	124,177,475	-4.95%
Social Services	184,886,538	(5,707,864)		179,178,674	-3.09%
Vocational Rehabilitation	40,645,338	(603,214)		40,042,124	-1.48%
Total Health and Human Services	3,965,935,975	(586,116,328)	(3.17)	3,379,819,647	-14.78%
Justice and Public Safety					
Correction	985,276,327	(45,029,737)	(18.00)	940,246,590	-4.57%
Crime Control & Public Safety	28,706,140	38,186		28,744,326	0.13%
Judicial Department	310,319,781	(5,979,050)	1.00	304,340,731	-1.93%
Judicial—Indigent Defense	75,049,607	(1,784,778)		73,264,829	-2.38%
Justice	73,508,002	(2,466,692)	(5.00)	71,041,310	-3.36%
Juvenile Justice & Delinquency Prevention	135,679,902	(5,366,429)	(21.00)	130,313,473	-3.96%
Total Justice and Public Safety	1,608,539,759	(60,588,500)	(43.00)	1,547,951,259	-3.77%
Natural And Economic Resources					
Agriculture and Consumer Services	51,041,728	(2,546,372)	(24.00)	48,495,356	-4.99%
Commerce	35,569,253	(2,172,711)		33,396,542	-6.11%
Commerce—State Aid	10,266,728	1,005,357		11,272,085	9.79%
Environment and Natural Resources	153,070,901	(5,894,593)	(22.11)	147,176,308	-3.85%
DENR—Clean Water Mgmt. Trust Fund	100,000,000	(38,000,000)		62,000,000	-38.00%
Labor	13,936,595	(671,141)	(4.00)	13,265,454	-4.82%
NC Biotechnology Center	5,883,395	0		5,883,395	0.00%
Rural Economic Development Center	4,658,607	0		4,658,607	0.00%
Total Natural and Economic Resources	374,427,207	(48,279,460)	(50.11)	326,147,747	-12.89%
General Government					
Administration	56,925,133	(4,869,613)	(24.42)	52,055,520	-8.55%
Auditor	10,847,686	(553,885)	(2.00)	10,293,801	-5.11%
Cultural Resources	54,627,586	600,181	(17.35)	55,227,767	1.10%
Cultural Resources—Roanoke Island	1,720,952	(86,047)		1,634,905	-5.00%
General Assembly	42,858,926	(1,297,463)		41,561,463	-3.03%
Governor	5,112,108	(135,605)		4,976,503	-2.65%
Housing Finance Agency	4,750,945	0		4,750,945	0.00%
Insurance	23,364,277	2,942,777	(5.50)	26,307,054	12.60%
Insurance—Workers Compensation Fund	4,500,000	0		4,500,000	0.00%
Lieutenant Governor	633,293	(31,571)		601,722	-4.99%
Office of Administrative Hearings	2,540,719	(131,036)	(2.00)	2,409,683	-5.16%
Revenue	76,720,217	(1,789,451)	17.00	74,930,766	-2.33%
Rules Review Commission	310,454	0		310,454	0.00%
Secretary of State	8,210,304	(153,106)	(3.00)	8,057,198	-1.86%
State Board of Elections	3,123,646	3,714,151		6,837,797	118.90%
State Budget and Management	4,428,558	(216,753)	(3.00)	4,211,805	-4.89%
State Budget and Management—Special	3,080,000	300,000		3,380,000	9.74%
State Controller	10,046,077	(351,613)		9,694,464	-3.50%
Treasurer—Operations	8,063,750	(488,721)		7,575,029	-6.06%
Treasurer—Retirement / Benefits	7,131,179	350,000		7,481,179	4.91%
Total General Government	328,995,810	(2,197,755)	(40.27)	326,798,055	-0.67%
Transportation	12,842,163	(1,412,638)	0.00	11,429,525	-11.00%
Statewide Reserves and Debt Service					
Debt Service:					
Interest / Redemption	430,130,765	(42,344,845)		387,785,920	-9.84%
Federal Reimbursement	1,155,948	0		1,155,948	0.00%
Subtotal Debt Service	431,286,713	(42,344,845)		388,941,868	-9.82%
Statewide Reserves					
State Health Plan	0	113,418,000		113,418,000	
Retiree Health Benefit	0	36,800,000		36,800,000	
Retirement System Contributions	0	26,546,000		26,546,000	
Compensation Increases	0	132,050,000		132,050,000	
Transfer of Various Benefit Plans	0	(55,000,000)		(55,000,000)	
Contingency and Emergency Fund	5,000,000	0		5,000,000	
Salary Adjustment Fund	500,000	4,000,000		4,500,000	
MH/DD/SAS Trust Fund	0	12,500,000		12,500,000	
HIPAA Implementation	0	2,000,000		2,000,000	
State Surplus Real Property System	0	250,000		250,000	
Blue Ribbon Commission on Medicaid Reform	0	250,000		250,000	
Subtotal Statewide Reserves	5,500,000	272,814,000		278,314,000	
Total Reserves and Debt Service	436,786,713	230,469,155		667,255,868	52.76%
Total General Fund for Operations	15,322,038,681	(574,516,898)	(14.23)	14,747,521,783	-3.75%
Other General Fund Expenditures:					
Capital Improvements	0	27,601,000		27,601,000	
Repairs and Renovations	0	0		0	
Total Other General Fund Expenditures	0	27,601,000		27,601,000	
Total General Fund Budget	15,322,038,681	(546,915,898)	(14.23)	14,775,122,783	-3.57%

SUMMARY OF GENERAL FUND APPROPRIATIONS (SESSION LAW 2003-284, AS ENACTED), 2003 LEGISLATIVE SESSION, FY 2004–05

	Governor's Proposed 2004–05 Base Budget	Net Changes	FTE* Changes	Fiscal Year 2004-05 Appropriation	Percentage Change
Education					
Community Colleges	671,285,977	(11,086,755)		660,199,222	-1.65%
Public Education	6,211,172,835	(176,177,652)	(399.68)	6,034,995,183	-2.84%
University System	1,857,413,185	(34,986,528)	518.00	1,822,426,657	-1.88%
Total Education	8,739,871,997	(222,250,935)	118.32	8,517,621,062	-2.54%
Health and Human Services					
Office of the Secretary	100,272,566	(19,304,133)	(0.50)	80,968,433	-19.25%
Aging Division	28,585,838	(900,000)		27,685,838	-3.15%
Blind and Deaf / Hard of Hearing Services	9,617,846	(230,838)	(4.00)	9,387,008	-2.40%
Child Development	267,006,355	(7,795,662)	15.00	259,210,693	-2.92%
Education Services	32,945,950	(1,275,874)	(9.22)	31,670,076	-3.87%
Facility Services	14,443,088	(2,186,296)		12,256,792	-15.14%
Medical Assistance	2,980,706,037	(531,536,074)		2,449,169,963	-17.83%
Mental Health	584,487,605	(4,064,507)		580,423,098	-0.70%
NC Health Choice	37,317,907	18,114,915		55,432,822	48.54%
Public Health	132,441,289	(8,992,394)	(4.45)	123,448,895	-6.79%
Social Services	189,939,178	(909,910)		189,029,268	-0.48%
Vocational Rehabilitation	41,453,587	(618,729)		40,834,858	-1.49%
Total Health and Human Services	4,419,217,246	(559,699,502)	(3.17)	3,859,517,744	-12.67%
Justice and Public Safety					
Corrections	991,226,311	(31,279,029)	(18.00)	959,947,282	-3.16%
Crime Control & Public Safety	28,785,824	(646,814)		28,139,010	-2.25%
Judicial Department	314,116,595	(2,616,901)	1.00	311,499,694	-0.83%
Judicial—Indigent Defense	73,116,571	(2,097,120)		71,019,451	-2.87%
Justice	73,574,376	(2,115,064)	(5.00)	71,459,312	-2.87%
Juvenile Justice & Delinquency Prevention	138,675,409	(8,089,911)	(21.00)	130,585,498	-5.83%
Total Justice and Public Safety	1,619,495,086	(46,844,839)	(43.00)	1,572,650,247	-2.89%
Natural And Economic Resources					
Agriculture and Consumer Services	51,093,029	(2,476,660)	(24.00)	48,616,369	-4.85%
Commerce	34,639,574	(303,273)		34,336,301	-0.88%
Commerce - State Aid	10,266,728	955,357		11,222,085	9.31%
Environment and Natural Resources	157,263,823	(4,465,813)	(30.11)	152,798,010	-2.84%
DENR—Clean Water Mgmt. Trust Fund	100,000,000	(38,000,000)		62,000,000	-38.00%
Labor	13,945,245	((671,141)	(4.00)	13,274,104	-4.81%
NC Biotechnology Center	5,883,395	0		5,883,395	0.00%
Rural Economic Development Center	4,658,607	0		4,658,607	0.00%
Total Natural and Economic Resources	377,750,401	(44,961,530)	(58.11)	332,788,871	-11.90%
General Government					
Administration	57,503,556	(4,919,649)	(24.42)	52,583,907	-8.56%
Auditor	10,857,642	(563,841)	(2.00)	10,293,801	-5.19%
Cultural Resources	54,337,128	(248,530)	(17.35)	54,088,598	-0.46%
Cultural Resources—Roanoke Island	1,722,606	(86,047)		1,636,559	-5.00%
General Assembly	46,268,768	(1,297,463)		44,971,305	-2.80%
Governor	5,112,933	(286,430)		4,826,503	-5.60%
Housing Finance Agency	4,750,945	0		4,750,945	0.00%
Insurance	23,395,414	(2,207,827)	(5.50)	23,187,587	-0.89%
Insurance—Workers Compensation Fund	4,500,000	(1,900,000)		2,600,000	-42.22%
Lieutenant Governor	633,293	(31,571)		601,722	-4.99%
Office of Administrative Hearings	2,542,833	(131,036)	(2.00)	2,411,797	-5.15%
Revenue	77,372,834	(2,198,740)	17.00	75,174,094	-2.84%
Rules Review Commission	310,454	0		310,454	0.00%
Secretary of State	8,179,923	(423,725)	(3.00)	7,756,198	-5.18%
State Board of Elections	3,124,003	1,791,936		4,915,939	57.36%
State Budget and Management	4,432,863	(216,753)	(3.00)	4,216,110	-4.89%
State Budget and Management—Special	3,080,000	50,000		3,130,000	1.62%
State Controller	10,071,064	(351,613)		9,719,451	-3.49%
Treasurer—Operations	8,066,505	(488,721)		7,577,784	-6.06%
Treasurer—Retirement / Benefits	7,131,179	350,000		7,481,179	4.91%
Total General Government	333,393,943	(11,160,010)	(40.27)	322,233,933	-3.35%
Transportation	12,872,739	(1,469,939)	0.00	11,402,800	-11.42%
Statewide Reserves and Debt Service					
Debt Service					
Interest / Redemption	498,993,307	4,689,376		503,682,683	0.94%
Federal Reimbursement	1,155,948	0		1,155,948	0.00%
Subtotal Debt Service	500,149,255	4,689,376	0.00	504,838,631	0.94%
Statewide Reserves					
State Health Plan	0	151,225,000		151,225,000	
Retiree Health Benefit	0	36,800,000		36,800,000	
Retirement System Contributions	0	154,200,000		154,200,000	
Compensation Increases	0	45,550,000		45,550,000	
Transfer of Various Benefit Plans	0	(13,000,000)		(13,000,000)	
Contingency and Emergency Fund	5,000,000	0		5,000,000	
Salary Adjustment Fund	500,000	4,000,000		4,500,000	
MH/DD/SAS Trust Fund	0	0		0	
HIPAA Implementation	0	0		0	
Subtotal Statewide Reserves	5,500,000	378,775,000	0.00	384,275,000	
Total Reserves and Debt Service	505,649,255	383,464,376	0.00	889,113,631	75.84%
Total General Fund for Operations	16,008,250,667	(502,922,379)		15,505,328,288	-3.14%
Other General Fund Expenditures					
Capital Improvements	0	0		0	
Repairs and Renovations	0	0		0	
Total Other General Fund Expenditures	0	0	0.00	0	
Total General Fund Budget	16,008,250,667	(502,922,379)	(26.23)	15,505,328,288	-3.14%

*A technical term for full-time permanent positions and combinations of less than full-time positions that, when combined, create a full-time position

WHO WE ARE

We are the North Carolina Progress Board. We were created in 1995 by the General Assembly. Our charge is to "...encourage understanding of critical global, national, state, and local...trends that will affect North Carolina in the coming decades..." and further, we are expected to:

- define a long-term vision for the state's future in eight critical "issue areas" (we call them imperatives) These imperatives are:
 - Healthy Children and Families
 - Quality Education for All
 - A High Performance Workforce
 - A Prosperous Economy
 - A Sustainable Environment
 - A 21st Century Infrastructure
 - Safe and Vibrant Communities
 - Active Citizenship/Accountable Government
- set measurable goals for attaining that future;
- keep score and report progress to the General Assembly and the people of North Carolina; and
- increase the accountability of government and promote a more active and informed citizenry.

If you'd like to know more about us, please visit our website at www.theprogressboard.org.

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