

The State Budget

The ongoing national economic recession spawned unprecedented budget problems across the nation for the 2009-10 fiscal year. North Carolina was among the states that struggled to address a reduction in state revenue by reducing state spending without reducing the quality of state funded services and programs. The following is a summary of the budget process and fiscal provisions of the 2009-11 biennial state budget, and a review of some of the major issues that influenced the 2009-11 biennial state budget process.

The Budget Process

The Fiscal Biennium

The North Carolina state government operates on a fiscal year that begins July 1 and ends June 30 of the following year. During regular sessions held in odd-numbered years, the General Assembly adopts a state budget that makes appropriations for the following two fiscal years (the fiscal biennium). In even-numbered years, the legislature conducts a short session to make adjustments to the state budget for the second year of the fiscal biennium.

In each odd-numbered year, at the beginning of the regular session of the General Assembly, the Governor, director of the budget by virtue of the state constitution, begins the biennial budget process by submitting budget recommendations for the next two fiscal years to the legislature. Those budget recommendations include estimates of the amount of revenues available for appropriations, estimates of the appropriations needed to continue existing programs at current levels, and recommended appropriations for expansion of existing programs, for new programs, and for capital improvements. Governor Beverly Perdue released her recommended budget on March 17, 2009.

Although the House of Representatives (House) and Senate appropriations subcommittees usually meet jointly to review the Governor's budget proposal, the House and the Senate each develop their own respective versions of the state budget. In recent years the House and the Senate have alternated from biennium to biennium the responsibility for initially passing an appropriations bill for continuing operations, expansion, and capital improvements for state departments and agencies. In 2009, the Senate was responsible for taking the lead in preparing the

budget. The Appropriations Act of 2009, S 202, was approved in the Senate on April 9, 2009, and was passed on to the House, where the House passed its version of the budget on June 13, 2009. However, the version of S 202 passed by the House and the version passed by the Senate had technical and substantive differences and the process of negotiating beyond those differences to develop a budget acceptable to both chambers took an additional six weeks.

2008-09 Budget Deficit

The complexities of negotiating the budget were exacerbated by an increasing estimated budget shortfall. In January 2009, the projected revenue shortfall for fiscal year 2008-09 was between \$1.8 billion and \$2.2 billion, according to State Budget Director Charlie Perusse.¹ However, by April 2009, Governor Perdue indicated that the state was facing a \$3 billion deficit for the fiscal year ending on June 30, 2009.²

The governor signed Executive Order No. 11 on April 28, 2009 to address the budget shortfall, mandating a flexible furlough plan for teachers and state employees that reduced their pay by 1/2 %, which was then taken out of paychecks over the remainder of the 2008-09 fiscal year. Other steps taken by Governor Perdue to address the shortfall included ordering state agencies to reduce spending by 7% of their budgets for fiscal year 2008-09, using monies from the state's rainy day fund, and utilizing funds from the federal stimulus package.

In spite of these efforts, on June 13, when the House passed its version of the budget, it had to contend with a projected \$4.6 billion gap³ between tax revenues available for the 2009-10 fiscal year and the General Fund spending that was needed to maintain current services. Among the factors cited as contributing to the deficit was a 10.8% drop in revenue from April 15 tax collections, the largest one-year drop in revenue on record.⁴

2009-10 Budget Negotiations

By the time the budget passed in the House on June 13, 2009, the budget had undergone changes from the version submitted to the House by the Senate. There were 49 amendments proposed to the budget in the House and while they were not all adopted, there were still significant differences between the House and Senate versions of the budget. To reconcile the budget differences, the Senate and the House appointed members in mid June to serve on a conference committee. While there was general agreement on proposed cuts to education and human services, a significant area of contention was on how to raise revenue. During negotiations, the Senate rejected the House's proposal for a ¼ cent sales tax increase and an increase in income taxes on couples earning more than \$200,000 annually and instead advocated for a lower sales tax and the addition of a tax on a range of services such as car repairs, lawn care, and home improvements. Lawmakers also had to address Governor Perdue's urging them to raise \$1 to \$1.6 billion in new taxes to avoid drastic cuts to education.

The conferees worked towards agreeing on a balanced budget by the end of the fiscal year, June 30, 2009, but were unable to do so. In order for government operations and services to continue, a temporary spending plan, the 2009 Continuing Budget Authority (S 311) was enacted

¹ Office of State Budget and Management Memorandum, January 15, 2009, at <http://www.ecu.edu/cs-acad/aa/upload/OSBM-Guidelines-RE-Filling-Vacant-Positions-1-15-09-rtf.pdf>.

² See for example, "Governor Cuts Pay, Calls For Furloughs For State Employees," WRAL.COM, April 28, 2009, at <http://www.wral.com/news/local/story/5037937/>.

³ There continues to be debate as to the exact amount of the budget shortfall, with some insisting that the amount has been exaggerated and others predicting that it has been underestimated and the full impact will be felt in FY 2010-11.

⁴ See for example, Elaine Mejia & Meg Wiehe, "The House Budget: Deteriorating Revenue Picture Forces Tough Decisions," *BTC Reports*, Vol 15 No 6, June 2009, NC Justice Center, at <http://www.ncjustice.org/sites/default/files/btc%20reports%20-%20House%20Budget%20Analysis.pdf>.

on June 30, 2009 as S.L. 2009-215, authorizing the continuation of state expenditures for the operation of government at a level not to exceed 85% of the level at which those operations were authorized in the 2008 Appropriations Act (S.L. 2008-107, as amended). The act was set to expire as of 11:59 pm on July 15, 2009.

With the July 15 deadline approaching and the conferees still unable to agree upon a budget, another continuing budget bill (H 1504) was enacted on July 15, 2009 as S.L. 2009-296. This act amended S.L. 2009-215, reducing the level of state expenditures for the operation of government to no more than 84% of the level at which those operations were authorized in S.L. 2008-107. This act also extended the effective date of S.L. 2009-215 from July 15, 2009, to July 31, 2009.

Both of the Continuing Budget Acts also contained substantive provisions dealing with the allocation and use of funds and setting effective dates and expiration dates for funding allocations.

As negotiations continued, a third Continuing Budget Authority Act (H 102) was enacted on July 31, 2009 as S.L. 2009-399 to further require the Governor as Director of the Budget to implement the budget reductions not in controversy set out in the 3rd edition (final Senate version of the budget) and 6th edition (final House version of the budget) of S 202, the Appropriations Act of 2009. This act also made some substantive changes to provisions in the previous two continuing budget acts and was set to expire when the Appropriations Act of 2009 became law. This final continuing resolution was enacted following Governor Perdue's rejection of what appeared to be a compromise tax plan.

After more than a month of negotiations, budget conferees developed a revenue plan that appeared to be an acceptable compromise. The compromise called for an increase in the sales tax, and an increase in taxes on cigarettes and alcohol (sin tax). However it was the provision for an income tax surcharge on corporate and individual taxes that received the most attention. Governor Perdue chastised the legislature for proposing the income tax surcharge on individual taxes and the newspaper headlines proclaimed that lawmakers were going to have to go back to the drawing board and continue to work on the budget.

Conferees again took up the task of drafting a balanced budget and presented their conference report to both chambers on August 3, 2009. The House and the Senate ratified S 202 on August 5, 2009, and presented it to the governor on the same day. The budget act, as ratified by both chambers, contained provisions for a one-cent sales tax increase, an increase in tax on alcohol and cigarettes, as well as a two-tiered income tax surcharge on individuals earning more than \$60,000 annually (\$100,000 for couples) and a temporary surcharge on corporate taxes. On August 7, 2009, Governor Perdue signed the Appropriations Act of 2009 into law as S.L. 2009-451. Following the enactment of the appropriations act, the General Assembly adopted the 2009 Budget Technical Corrections Act (H 836), making technical corrections, clarifying changes and some substantive changes to the budget. On August 9, the Governor signed the bill into law as S.L. 2009-575.

The Budget

The General Fund

S.L. 2009-451 appropriates approximately \$19 billion from the General Fund for fiscal year (FY) 2009-10 and \$19.6 billion for FY 2010-11. With a few limited exceptions (such as highway maintenance and construction), virtually all functions of state government are funded through the General Fund. This is the fund from which monies are appropriated by the General Assembly through the budget process to support most areas of state government ranging from education to economic development initiatives to health and human services to public safety. Funding comes to the General Fund from three main sources: (1) tax revenues, (2) federal funds (such as block grants and matching funds for certain programs), and (3) receipts (such as tuition, fees paid for certain government services, and investment income). Section 5(3) of Article III of the North Carolina Constitution requires that the state budget be balanced, so the budget as enacted by the

General Assembly cannot appropriate more funds than are projected to be received during the fiscal year.

General Fund Availability

In appropriating the budget for the 2009-10 FY, lawmakers had a beginning unreserved fund balance in the General Fund of approximately \$92 million. In FY 2008-09 that amount was \$506 million, and in FY 2007-08 it was nearly \$1.2 billion. The General Fund availability used in developing the 2009-10 budget also had some \$3 billion less in revenues based on the states' existing tax structure than in FY 2008-09, and more than \$200 million less in nontax revenues.

In FY 2008-09, lawmakers began with an unappropriated balance of \$270,504,098; however the \$21 billion appropriation for 2008-09 left an unappropriated remaining balance of zero dollars for FY 2009-10. Please see Table 1 below to review the General Fund availability used in determining the 2009-10 budget.

Table 1. 2009-10 General Fund Availability⁵

The General Fund availability used in developing the 2009-10 budget is shown below:

	FY 2009-2010
Projected Reversions from FY 2008-2009	91,967,011
Less Earmarkings of Year End Fund Balance	0
Savings Reserve Account	0
Repairs and Renovations	0
Beginning Unreserved Fund Balance	\$91,967,011
Revenues Based on Existing Tax Structure	\$ 16,796,300,000
Nontax Revenues	
Investment Income	\$ 67,300,000
Judicial Fees	200,700,000
Disproportionate Share	100,000,000
Insurance	77,700,000
Other Nontax Revenues	148,300,000
Highway Trust Fund Transfer/Use Tax Reimbursement Transfer	108,500,000
Highway Fund Transfer	17,600,000
Subtotal Nontax Revenues	\$ 720,100,000
Total General Fund Availability	\$ 17,608,367,011
Adjustments to Availability: 2009 Session	
Adjust Transfer from Insurance Regulatory Fund	\$ (1,644,300)
Adjust Transfer from Treasurer's Office	(398,880)
Transfer from Disproportionate Share Reserve	25,000,000
Transfer of Cash Balances from Special Funds	38,318,305
Transfer from Capital and R&R Accounts	24,372,701
Transfer from Health and Wellness Trust Fund	5,000,000
Transfer from Tobacco Trust Fund	5,000,000
Transfer Excess Sales Tax for Wildlife Resources Commission	1,650,000
Transfer Funds for Grape Growers Council	900,000
Department of Revenue Improved Enforcement	60,000,000

⁵ S.L. 2009-451, Section 2.2(a).

Department of Revenue Compliance Initiative	150,000,000
Individual Income Surtax	172,800,000
Corporate Income Surtax	23,100,000
Increase Sales Tax Rate	803,500,000
Digital Products & Click-Throughs	11,800,000
IRC Conformity	(116,300,000)
Adjust Revenue Distributions	22,100,000
Increase Excise Taxes	68,800,000
Suspend Corp Income Tax Earmark-Schools	60,500,000
Increase General Government Fees	7,555,995
Increase Justice and Public Safety Fees	47,090,559
Increase Health Services Regulation Fees	1,093,000
Subtotal Adjustments to Availability: 2009 Session	1,410,237,380
Revised General Fund Availability for 2009-10 Fiscal Year	19,018,604,391
Less: Total General Fund Appropriations for 2009-10 Fiscal Year	(19,008,079,980)
Unappropriated Balance Remaining	10,524,411

Appropriations

The General Assembly made the following appropriations for FY 2009-10:

- Total General Fund \$ 19,003,204,980⁶
- Highway Fund 1,736,590,000
- Highway Trust Fund 881,290,000

For purposes of documenting General Fund appropriations, functions and agencies within state government are grouped into seven main categories:⁷

- Education
- Health and Human Services
- Natural and Economic Resources
- Justice and Public Safety
- General Government
- Statewide Reserves and Debt Service
- Capital Improvements

General Fund Budget Highlights⁸

Public Education

- Provides for additional dropout prevention grants. \$13 million
- Allocates funds to protect K-3 teaching positions. \$139 million
- Preserves 40% of net lottery revenues for school construction. \$147.2 million

Community Colleges

- Funds 8 % increase in community college enrollment. \$58 million

⁶ H 836, Modify Appropriations Act, amended this amount to \$19,010,057,199. This budget technical corrections act made technical, clarifying, and other changes to the Appropriations Act of 2009, including modifying the amounts used in the General Fund Availability statement in developing the 2009-11 biennial budget.

⁷ Because the transportation budget is funded from the Highway Fund and the Highway Trust Fund, which are separate from the General Fund, transportation is not one of the General Fund appropriations categories.

⁸ This list is not intended to be comprehensive.

- Increases nursing, dental, and radiology technology and vocational/technical program. \$9.3 million

University of North Carolina System

- Meets projected enrollment growth at University of North Carolina system campuses. \$44.2 million
- Provides financial aid for UNC System. \$23 million (of which \$12 million is NR⁹)

Health and Human Services

- Provides grant to six regional food banks. \$1 million NR
- Increase allowance for projected Medicaid growth. \$155 million.
- Expands enrollment in the Children's Health Care Program (Health Choice). \$17 million
- Completes last phase of three-year takeover of Medicaid from counties, freeing money for local governments. \$252 million
- Funds 20 additional school health nurses. \$1 million
- Funds competitive grants to community health centers. \$5 million
- Funds rural hospitals. \$1.6 million NR

Natural and Economic Resources

- Funds Farmland Preservation Trust Fund. \$2 million NR
- Provides state matching funds to Drinking Water State Revolving Fund and Clean Water State Revolving Fund. \$6.4 million

Justice and Public Safety

- Funds 18 additional Chief Probation Parole Officer positions. \$1.4 million

General Government

- Provides funds for the North Carolina Symphony. \$2 million NR (with \$1.5 million to leverage matching funds) Funds Justice for Sterilization Victims Foundation \$250,000 NR

Capital Improvements

- Provides funding to the Department of Environment and Natural Resources for the state match for the Water Resources Development Project.¹⁰ \$4.9 million

Budget Cuts

Budget cuts were made across the board, with reductions in funding for many programs and the elimination of others. According to Speaker of the House Joe Hackney, in statements made to the media the 2009-10 budget addresses the \$4.6 billion shortfall by taking 40% in budget cuts, 30% in federal recovery money, 8% in higher fees, and 22% in new taxes.¹¹ For the most part, automatic continuation increases for state agencies and departments were eliminated. An overview of some of the reductions in funding and number of programs eliminated:

- General Government, reduces funding for 80 programs, eliminates two programs;
- Justice and Public Safety, reduces funding for 80 programs, eliminates 10 programs;
- Natural and Economic Resources, reduces funding for 75 programs, eliminates five programs;
- Health and Human Services, reduces funding for 125 programs, eliminates 13 programs; and
- Education, reduces funding for 100 programs, eliminates 23 programs.

The 2009-10 budget also eliminates 2,191 state positions, including 726 that are currently filled.¹² As in previous years, Education, and Health and Human Services received the largest

⁹ NR indicates a non-recurring appropriation.

¹⁰ This is the total capital improvements appropriation from the General Fund. There is an authorization of \$122,782,542 for non-General Fund capital improvements.

¹¹ See for example, "Budget: The deficit debate," *The Raleigh News & Observer*, August 4, 2009, at http://projects.newsobserver.com/under_the_dome/budget_the_deficit_debate.

¹² See for example, North Carolina Budget—Brother, Can You Spare a Dime," *High Country Press*, August 13, 2009 at http://www.highcountrypress.com/weekly/2009/08-13-09/north_carolina_budget.htm; see also,

share of the General Fund operations appropriations, however both experienced cuts in funding for FY 2009-10. Education funding was cut 9.75% (\$789 million) in 2009-10 compared to the adjusted continuation budgets and Health and Human Services had a reduction of 29.5% (\$1.6 billion) in funding. Also missing from the budget are salary increases for teachers and state employees. The following is an overview of some of the budget cuts for 2009-10:¹³

Public Education

- Delays the adoption of math textbooks in grades 6 through 12. (\$48 million)
- Reduces General Fund support for More at Four by 5.8%. (\$5 million)
- Decreases funding for local school systems across the state. (\$225 million)¹⁴
- Eliminates funding for all 200 Literacy Coaches. (\$12 million)
- Reduces funding for public school transportation, which supports salaries of transportation personnel as well as the maintenance of yellow buses. (\$15 million)
- Reduces funding to the following non-public school organizations: Communities in Schools, Schools Attuned, ExplorNet, Teacher Cadet, NC Network, Science Olympiad, Teach for America, NC Math & Science, and Project Enlightenment. (\$4.6 million)
- Reduces staff development by 100%. (\$12.6 million) NR
- Reduces funding for Limited English Proficiency by 2.5% (\$2 million)
- Reduces Small County Supplemental Fund allotment by 4.4% (\$2 million)

Health and Human Services

- Reduces funding for Smart Start. (\$16 million)
- Reduces service funds for supplemental state-funded services provided to CAP/MR-DD patients. State funds are still allowed for room, board, and other services. (\$16 million)
- Reduces funding for state operated services within the Division of Mental Health, Developmental Disabilities, and Substance Abuse Services that are not part of the core mission of DMH, DD, and SAS. (\$4.5 million)
- Reduces funding for community services within the Division of Mental Health, Developmental Disabilities, and Substance Abuse Services that are not part of the core mission of DMH, DD, and SAS. (\$4 million)
- Reduced funds for state-funded services provided through Local Management Entities (LMEs). (\$40 million)
- Reduces Medicaid provider rates. (\$76.4 million)
- Reduces prescription drug expenditures. (\$25 million)
- Reduces appropriation for community support services within the Division of Medical Assistance. (\$65 million)
- Reduces funding for some children's group homes. (\$15.9 million)
- Consolidates case management services throughout the Medicaid program. (\$41 million)

Natural and Economic Resources

- Reduces operating expenses within the Division of Agriculture and Consumer Services. (\$345,873)
- Reduces operating expenses within the Department of Labor. (\$155,877)
- Reduces operating expenses within the Department of Environment and Natural Resources. (\$724,866)
- Reduces operating expenses within the Department of Commerce. (\$333,615)
- Reduces the Clean Water Trust Fund. (\$50 million)

Justice and Public Safety

- Eliminates state funding for the Center for the Prevention of School Violence. (\$481,225)

"N.C. budget: Taxes up, services down," Greensboro News & Record, August 5, 2009, at http://www.news-record.com/cotent/2009/08/04/article/nc_budget_taxes_up_services_down.

¹³ This is not intended to be a comprehensive listing of all budget cuts.

¹⁴ Allows the LEA discretion as to where to make cuts, but prohibits increasing class sizes in grades K-3.

- Reduces state funding Eckerd Wilderness Camp contract, which will close two of the seven camps. The North Carolina Eckerd Wilderness Camps serve boys and girls, ages 10 through 17, with behavioral problems. (\$2.8 million)
- Closes the Samarkand Youth Development Center. (\$2.6 million)
- Plans to close seven prisons, which will be staggered over the course of the 2009-10 fiscal year. (\$8.4 million)
- Freezes the step salary increase for magistrates and clerks. (\$2.3 million)

General Government

- Makes reductions to various operating accounts in eight divisions across the Department of Administration. (\$104,647)
- Reduces various administrative services within the Department of Cultural Resources. (\$193,640)
- Reduces funding for the following expenditures within the Department of Cultural Resources: Tryon Palace, Maritime Museum, the Museum of Art, the Arts Council, State Library Services, the Museum of History, and the Roanoke Island Commission. (\$1.9 million)
- Makes a reduction to the Voter-Owned Elections Fund Balance. (\$1.5 million)
- Reduces funding for the Volunteer Safety Workers' Fund within the Department of Insurance. (\$2.5 million)

Additional Revenue

Federal stimulus funds (\$1.3 billion) offset some of the cuts. For example, the American Reinvestment and Recovery Act of 2009 (ARRA) offsets the reduction in funding to Education with funds in the amount of \$605 million in 2009-10, and the reduction in funding to Health and Human Services with funds in the amount of \$867 million in 2009-10.

The budget act specifically appropriates some of the ARRA funds and directs state government to serve as the facilitator in assisting local government, communities, workers, and other individuals in accessing the 2009 ARRA funds. ARRA funds that are not specifically appropriated in the budget are to be appropriated in the amounts in the notification of award from the federal government or any entity acting on the behalf of the federal government to administer ARRA funds. Budget provisions also direct the Office of State Budget and Management (OSBM) to consult with the Joint Legislative Committee on Government Operations before allocating funds that are not expressly delineated in the budget act, and authorizes the state office of Economic Investment and Recovery to use up to \$1 million during 2009-10 FY for operating expenses.

The budget also includes \$1 billion in additional tax revenues.¹⁵ The largest revenue source is the one-cent increase on the state sales tax, expected to net \$803.5 million.¹⁶ The budget also includes a two-tiered surcharge on income tax for single taxpayers earning over \$60,000 (over \$100,000 for couples). An increase in the so-called "sin" tax, the excise tax on alcohol, cigarettes and tobacco, further adds to increased revenues, as does a new tax on digital products and click-throughs which include Internet downloads of music, publications, computer software, ringtones etc., and the Amazon e-tax on Internet retailers. New fees also add additional revenues to the budget. New Justice and Public Safety fees add an additional \$47 million in revenue, new general government fees will bring in \$7.55 million, and increased health services registration fees add an additional \$1 million to state revenue.¹⁷

¹⁵ Aggregate rounded off to the nearest billion of sales tax increase, individual income tax surtax, and corporate income surtax, S 202, Section 2.2(a).

¹⁶ S 202, Section 2.2(a), Adjustments to Availability: 2009 Session.

¹⁷ Id.

The Highway Fund and the Highway Trust Fund

The Highway Fund provides monies to support highway construction and maintenance, the State Highway Patrol, and the Division of Motor Vehicles. Traditionally, the revenue in the Fund comes from the state gas tax, motor vehicle registration fees, title fees, and federal aid appropriations. The 2009-10 Highway Fund (the Fund) appropriation is \$1.74 billion, a decrease from the \$1.84 billion appropriation for the 2008-09 FY. The Fund increases funding by approximately \$41 million over the previous fiscal year for highway maintenance to prevent further deterioration of the state highway system.¹⁸ The Fund will also provide salaries and benefits for 79 new positions, the majority of which are positions working in the ferry system.¹⁹ The Highway Fund Budget also freezes the step increases for state Trooper salaries for a savings of \$1.7 million.²⁰

Funding for the Highway Trust Fund is provided by highway taxes, the motor fuels tax, and title fees and the funds are used for targeted spending to support specific highways that will be expanded to four-lanes or improved. The total current operations and expansions budget for the Highway Trust Fund in the 2009-10 FY is \$881,290,000, including a transfer to the General Fund of \$108,561,829 and an allocation for debt service of approximately \$83 million.

Capital Projects

Appropriations for capital projects have felt the cuts to the budget. The budget act directs the UNC Board of Governors to identify previously authorized capital improvement projects with unencumbered remaining cash balances and to transfer approximately \$2.5 million to the State Controller to be deposited in the General Fund. Another \$21.9 million in unencumbered cash balances remaining in various capital funds is also to be transferred to the State Controller for deposit into the General Fund. The transferred capital funds are to be used to support General Fund appropriations for the 2009-10 FY.

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¹⁸ Joint Conference Committee Report, August 3, 2009, Section K, Transportation, Highway Fund *see* item # 6 re: reprogramming secondary road improvement funds to statewide maintenance programs, and *see* item # 15 appropriating \$41 million (NR) to maintenance funds for 2009-10 FY.

¹⁹ Joint Conference Committee Report, August 3, 2009, Section K, Transportation, Highway Fund, *see* item # 12.

²⁰ Joint Conference Committee Report, August 3, 2009, Section K, Transportation, Highway Fund, *see* item #25.