CIVITAS INSTITUTE PUBLIC POLICY SERIES

UNLOCKING THE STATE BUDGET 1985-2012

JOHN W. POPE CIVITAS INSTITUTE

THE CIVITAS INSTITUTE PUBLIC POLICY SERIES

UNLOCKING THE STATE BUDGET: 1985-2012

A GUIDE TO SPENDING AND TAXATION

JOHN W. POPE CIVITAS INSTITUTE

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ABOUT THE SERIES

The Civitas Institute Public Policy Series

The purpose of the Civitas Institute Public Policy Series is to equip the legislator, as well as the layman, with the tools necessary to understand public policy in North Carolina. Toward this end, each guide does three things: defines basic terms, answers essential questions, and provides a legislative and political history regarding a particular policy area. Thus each guide consists of three distinct sections — Key Terms, Q & A, and a year-by-year timeline — that can be used to easily find specific information on a particular issue or time period. Detailed charts and graphs provide additional data for those readers interested in learning more about select topics. Overall, the guides provide a roadmap for the citizen legislator — and perhaps more important, the average citizen — interested in learning more about essential policy ideas and long-term trends.

While each book in the Civitas series can be read on its own, the current guide on spending and taxation serves as a foundation for the series as a whole. Essentially, this is because the budget process is the annual focal point of the public policy debate in North Carolina. Whether or not this should be the case is a complex question, but the reality remains that the state's priorities are best perceived by looking at how the state spends its – that is, our – money.

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Special thanks to all those who helped make this project a success. Chloe Gossage created many of the charts and contributed to the writing and editing of the guide. Peter Andros compiled and wrote the historical narratives while Chloe, Becki Gray, Sven Larson and Jason Bennett put together the year-by-year tax, healthcare and education boxes. Becki and Sven also helped in the writing of the guide, while Jason wrote several early drafts. Finally, thanks also to Faye Orr for designing the guide and the cover; Dion Terry for assisting with research; and Dennis Parker and Jennifer Taylor for providing editorial and design assistance.

And to preserve [the people's] independence, we must not let our rulers load us with perpetual debt. We must make our election between *economy and liberty,* or *profusion and servitude. . . .*

Private fortunes are destroyed by public as well as by private extravagance. And this is the tendency of all human governments. … And the fore horse of this frightful team is public debt. Taxation follows that, and in its train wretchedness and oppression.

Thomas Jefferson

to Samuel Kercheval (July 12, 1816)

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EXECUTIVE SUMMARY

One would think that a 25-year history of anything, much less the North Carolina budget, would be rather dull. The current guide, however, is anything but boring. Intrigue, deception, corruption, boundless optimism – the state budget has it all. Want high-stakes drama? At $20 billion a year, the stakes don't get much higher. Consider, for example, that over the past two-and-a-half decades:

- Spending has increased by 389 percent
- Tax revenues have increased by 391 percent
- Per capita state debt has risen by more than 700 percent

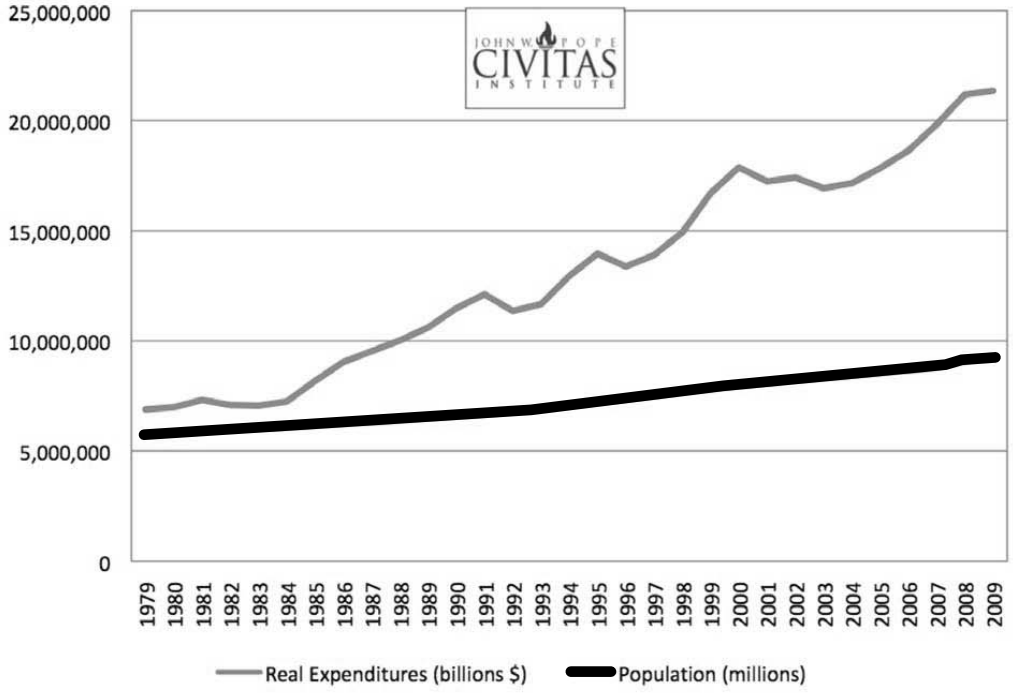
These numbers, however, only tell part of the story. In itself, the budget is simply an itemized estimate of the anticipated revenue and expenditures for each biennium, or two-year legislative session. It is the budget process – the politics of how certain priorities and programs get funded over others – that is the story. With that point in mind, the current guide not only provides a detailed analysis of spending and taxation trends in North Carolina, but also a year-by-year narrative that identifies the people responsible for making these decisions. In the end, the main thing, after all, is not the budget. It is the people behind the budget, and the people of North Carolina that the budget is supposed to serve. That being said, if you want the inside story you'll have to read the book. In this Executive Summary we'll just be looking at the numbers.

Total General Fund Authorizations	
FY1984-1985:	$4.516 billion
FY1989-1990:	$7.360 billion
FY1994-1995:	$10.268 billion
FY1999-2000:	$14.237 billion
FY2004-2005:	$15.918 billion
FY2006-2007:	$18.866 billion

By all accounts, the state is spending more and more, which also explains why the overall tax burden keeps rising. In order to come to grips with the state's current budget crisis – or what really should be termed a spending crisis – we need to take a step back and look at the long-term spending and taxation trends that have shaped North Carolina's economy.

A good start is by examining spending trends for the 30 years leading up to our current recession.

North Carolina's Population vs. Real General Fund Budget Growth 1979-2009



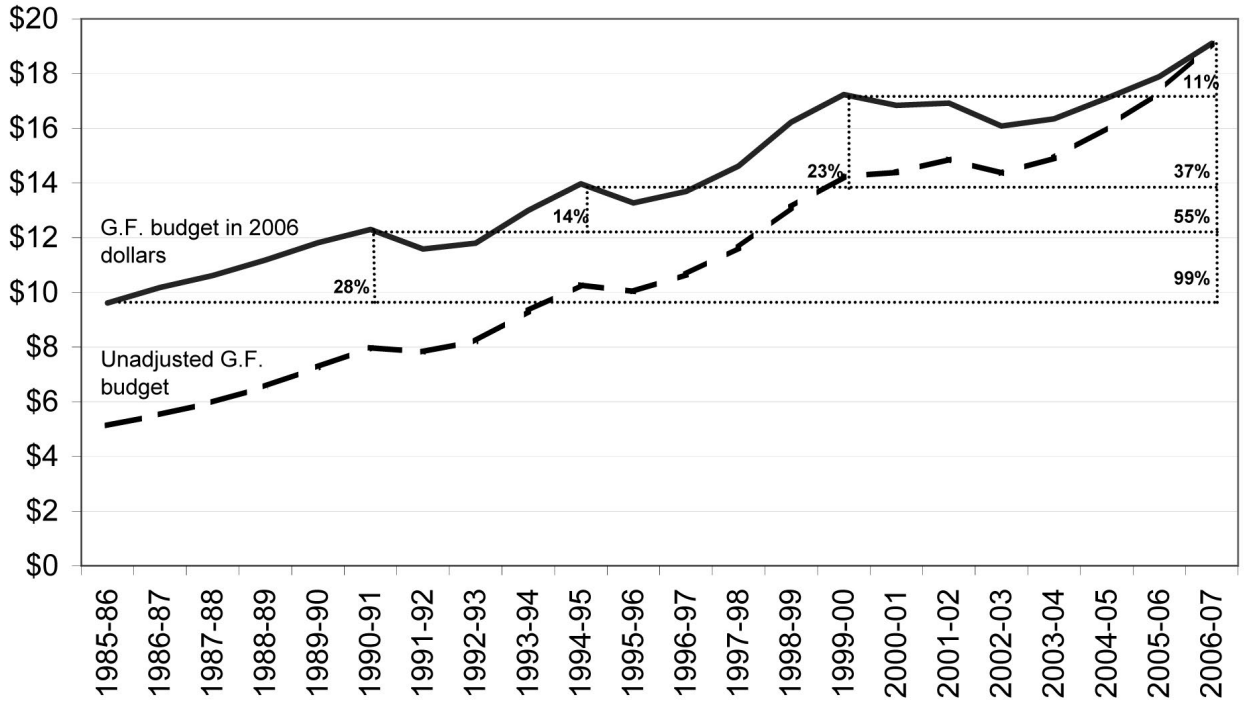
As becomes clear from the above chart, a long-term trend of dramatic spending increases marked the three decades leading up to the current recession. Indeed, even after adjusting for inflation, state spending grew at *three times the pace* of the state's population.

And Figure 1 highlights spending growth trends from FY 1985-86 through FY 2006-07, highlighting some of the shorter-term growth trends within that time frame, even after accounting for inflation.

As for taxes, as a share of personal income, state and local taxes are much higher in North Carolina than in the rest of the Southeast. As Figures 2 and 3 illustrate, from 1985 to 2005, the state/local personal tax burden[1] went from 2.9 percent

Fig. 1. Growth in General Fund Budget

Constant 2006 and Unadjusted Current Dollars
Percent Increase in General Fund Budget in Constant 2006 Dollars



to 3.6 percent. When all taxes, such as sales taxes, are taken into account, North Carolina's state/local tax burden surged from 9.1 percent in 1985 to 10.5 percent in 2006.[2] During the same period, North Carolina's overall state/local tax burden went from 35th to 23rd nationally. (Maine was first, with an overall tax burden of 13.5 percent.) The result has been an overall increase of $2,295 tax dollars per capita.

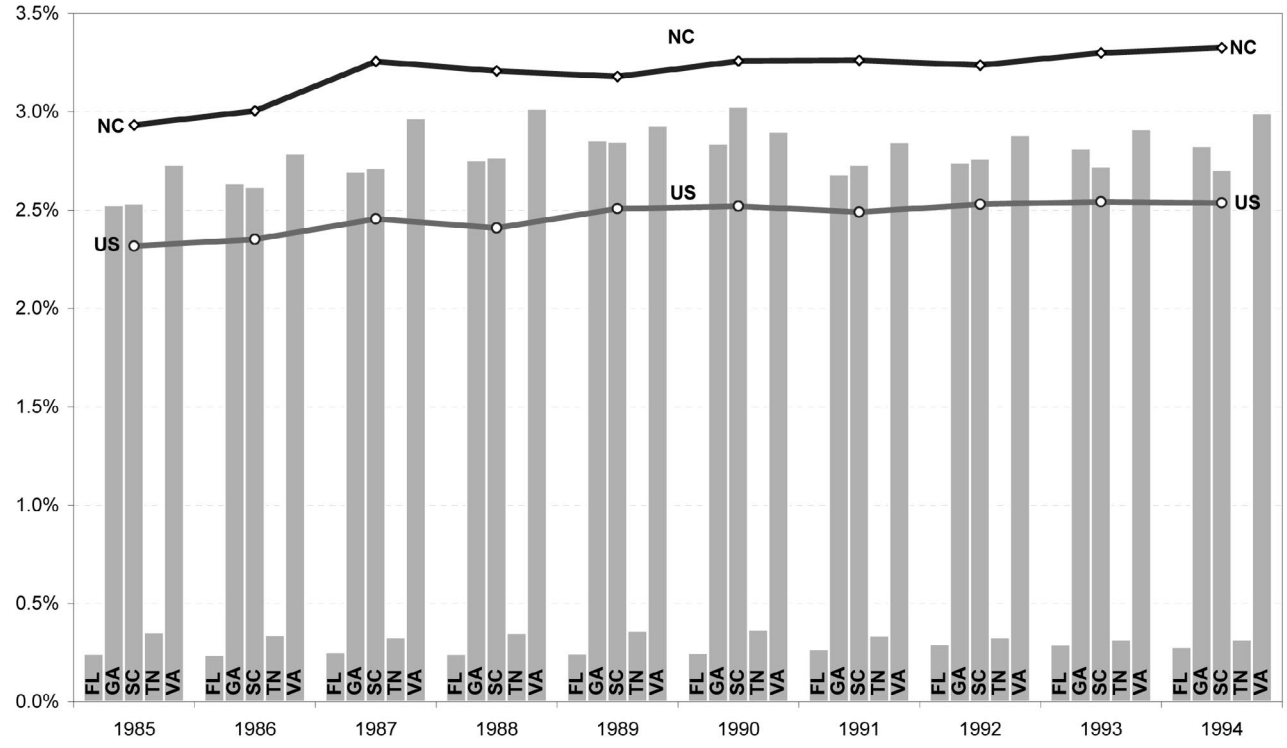
Accounting for an inflation rate of 95 percent, the overall tax burden should have risen by $1,169, which would have translated into $2,400 in 2005. Hence we find that, along with state spending, taxes rose more quickly than inflation – by more than $1,000 per person. As a result, North Carolina's overall state and local tax burden (for 2006) ranked first in the Southeast (N.C., Fla., Ga., S.C., Tenn., Va.).[3]

As bad as this sounds, things were actually worse. Consider that according

[1] This figure does not include sales tax, but is the standard measure used by the Bureau of Economic Analysis for "personal current taxes." As such, it includes income taxes and taxes on personal property.

[2] Using different measures, Dr. Michael Walden of North Carolina State similarly finds that between 1991 and 1999, North Carolina's overall tax burden went from 15.4 percent to 15.8 percent. At the same time, the state went from having the 39th lowest tax burden to the 30th lowest. In particular, notes Walden, "The tax burden ranking rose for income and sales taxes and for fees and charges, fell for motor fuel and vehicle license taxes and other taxes, and was unchanged for the property tax." Michael Walden, "North Carolina's Relative Tax Burden"; available from http://www.ag-econ.ncsu.edu/faculty/walden/nctaxburdenranking.PDF.

Fig. 2. State/Local Taxes as a Share of Personal Income: Southeast States, 1985-1994

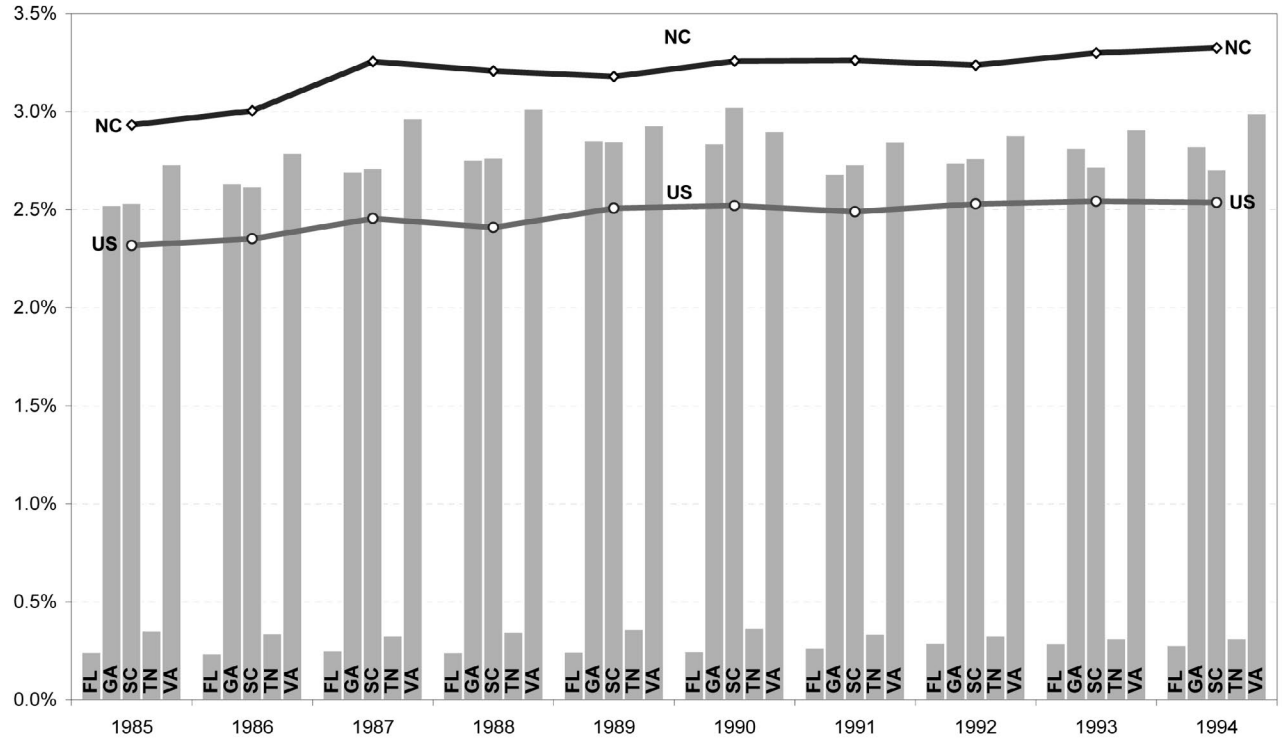


to the Bureau of Economic Analysis, per capita personal income (current dollars) in North Carolina increased from $12,699 in 1985 to $31,029 in 2005. Even once we account for inflation, this increase should have theoretically translated into a decline in the tax rate. This is because the increase in personal income caused an increase in tax revenue, which means that legislators could have lowered taxes and still brought in the same amount of revenue. North Carolina's growing population should have had a similar effect. Indeed, according to the groundbreaking work of late economist Julian Simon, population growth is good for the economy. Because of the dynamic effects of adding new persons to the economy, the increase in population not only broadens the tax base and the debt base, but it also can be correlated to the increase in personal income and productivity. As North Carolina's population grows, we should thus expect a decrease in the tax rate. Instead, the opposite has happened, which means that population growth has helped mask some of the state's long-term budgetary problems.[4]

Finally, let's look at how much debt per capita has increased during that 20-year time span. According to the North Carolina Constitution (Article III, Section 5), the governor and the General Assembly are charged with making necessary

[3] The Tax Foundation, "North Carolina State-Local Tax Burden Compared to U.S. Average (1970-2006)"; available from http://www.taxfoundation.org/files/northcar.swf; also personal correspondence with Tax Foundation, March 15, 2007.

Fig. 3. State/Local Taxes as a Share of Personal Income: Southeast States, 1995-2005



"economies in State expenditures" to balance the budget. Nevertheless, the government is still able to take on debt by issuing general obligation bonds, certificates of participation and other such instruments. As of June 30, 2010, North Carolina's total net indebtedness was $6.1 billion. Of this, $1.3 billion consisted of special indebtedness, an amount that had doubled in just five years. Special indebtedness debt instruments are structured in such a way as to avoid the requirement of voter approval that applies to the more traditional general obligation bonds. Unsurprisingly, the ability to skirt voter accountability over debt spending has proven to be very popular among state legislators. Indeed, the last time North Carolina voters were allowed to vote on the issue of new state debt was 2000.

Since abandoning the bond referenda process in 2000 in favor of special indebtedness, state debt has predictably exploded. Per capita state debt more than doubled in just five years (see Fig.4). Annual debt service payments on the debt tripled in less than a decade (see Fig.5). Moreover, the state has authorized, but not yet issued, another $1.6 billion in debt (as of June 30, 2010).

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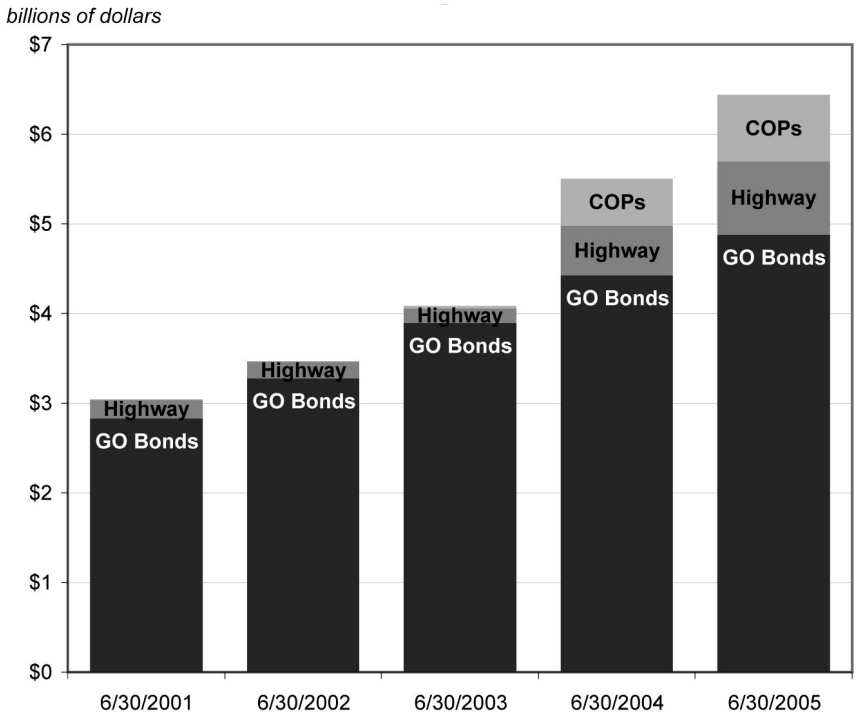
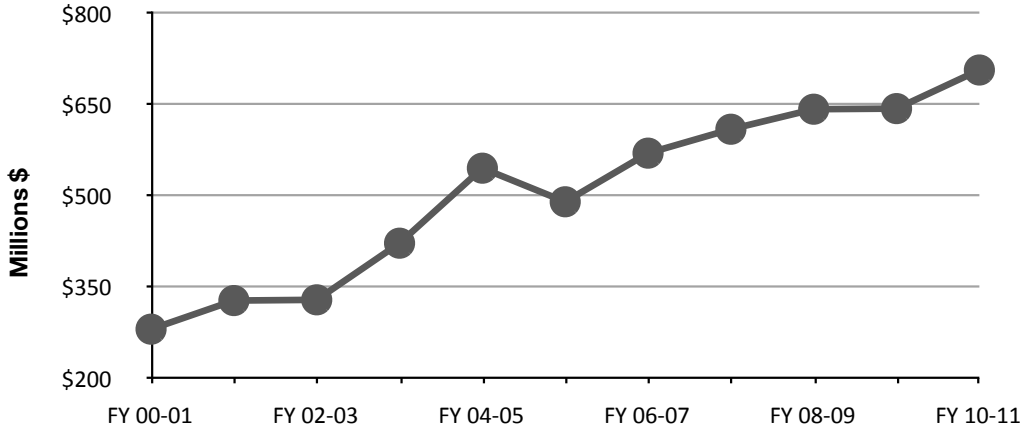
4 Notes Simon: "Economic reforms away from totalitarianism and central economic planning in poor countries probably would have been faster and more widespread if slow growth was not explained by recourse to population growth. … By 1989, the economics profession has turned almost completely away from the previous view that population growth is a crucial negative factor in economic development." Julian L. Simon, "An Unreported Revolution in Population Economics"; available from http://www.juliansimon.com/writings/Articles/REVOLUTI.txt.

Fig. 4. Total Outstanding Debt: 2001-2005



Sources of Debt: Voter-Approved General Obligation Bonds (GO Bonds), Highway Tax-Supported Bonds (Highway), and Appropriation-Supported Certificates of Participation (COPs). (Other debt includes Nontax-Supported (Revenue) Bonds of less than $10 million.)

Fig. 5. Annual Debt Service Payments: 2001-2011



The exclusive reliance on non-voter approved debt has raised concerns in the State Treasurer's Office. According to their Debt Affordability Study of 2011, the growing share of special indebtedness as a portion of total debt poses significant threats to the state's credit rating. Such concerns lead the Study's authors to recommend "that the State consider the authorization of General Obligation (traditional, voter-approved) debt as the preferred method to provide debt financing for its capital needs."

General Bonded/ Obligation Debt Outstanding	
FY1984-1985:	$131.14 per person
FY1989-1990:	$88.66 per person
FY1994-1995:	$142.50 per person
FY1999-2000:	$312.42 per person
FY2004-2005:	$741.51 per person
FY 2010-11:	$774 per person

Moreover, the rapid rise of total outstanding state debt is also cause for concern. The Treasurer's office has also warned in both the 2010 and 2011 Debt Affordability studies that the state has "substantially exhausted" its capacity to issue new debt without threatening its credit rating.

With the state budget having risen by nearly $15 billion over 25 years, it became clear that resolving North Carolina's spending crisis entails more than just eliminating pork barrel appropriations on teapot museums and other such boondoggles. The state is facing long-term budgetary problems that will only be solved by long-term, fundamental reforms. Here, though, we must caution against taking refuge in easy answers. To begin with, even theoretically viable solutions, like a TABOR Amendment, continue to fail to receive a hearing even in today's political climate against growth in government spending. Even more important is recognizing that the majority of voters in North Carolina are unlikely to be swayed by a platform that advances fiscally conservative alternatives at the perceived expense of education and healthcare. Today's voter wants it all. Future attempts at budget reform must be bundled with a confident, forward-looking fiscally conservative philosophy that provides positive alternatives across a wide spectrum of public policy issues.

key terms

Ad Valorem Tax
Tax based on the assessed value of real property, as opposed to personal property.

Appropriation-supported Debt
One of two forms of taxpayer-supported debt issued by the state; the other is general obligation bonds. Unlike general obligation bonds, appropriation-supported debt is not technically guaranteed by the state, but by liens on property or equipment. Hence, such debt can be issued without voter approval. Certificates of Participation (COPs) are the most popular form of appropriation-supported debt. COPs are tax-exempt lease financing agreements that promise investors a share of whatever revenue is derived from the lease (or lease-purchase) of the property or equipment the COP is tied to. As of June 30, 2010, the state owed roughly $1.3 billion in COPs debt.

Authorized Budget
Although the certified budget specifies how much money can be spent on each line item in an agency's budget, the actual expenditures of a fiscal year are documented upon completion of the year and captured on an ongoing basis in the authorized budget. Differences between the certified budget and the authorized budget arise because agencies are allowed to move money between certain line items as needed. For example, an agency can move money from "office supplies" to "office equipment." Each transfer between line items requires authorization from the Governor's Office of State Budget and Management (OSBM).

Base Budget
See Continuation Budget

Baseline Revenue Growth
Increase in the state's revenue, assuming no changes in the tax structure.

Budget Appropriation
Money authorized by the Legislature to be spent on a particular program or line item; an unexpended appropriation is one that could have been spent, but was not; an unappropriated balance refers to cash reserves that have not been allocated for any purpose.

Budget Bill
The session laws that appropriate funds for the next biennium (or fiscal year). In sections called special provisions, the budget bill enumerates the total budget appropriated to each agency, salaries of government officials and other public employees, and the legal language that specifies how agencies and other entities may or may not spend their money and report on their expenditures.
See Special Provisions

Capital Budget
According to the OSBM, a "budget comprised of nonrecurring appropriations for capital improvement projects, such as new state buildings, repairs and renovations of facilities, walks and drives, land purchases, and civil works projects." The capital budget frequently includes appropriations for new or renovated buildings in the UNC system, plus other miscellaneous projects and renovations. The state portion of the funds for water resources projects are contained in the capital budget as well.

DID YOU KNOW?

North Carolina's General Fund budgetary spending increased by 30 percent between FY2002 and FY2007.

Source: N.C. General Assembly Overview: 2006 Legislative Session Fiscal and Budgetary Actions

Carryforward

As defined by the state's Fiscal Research Division, carryforward funds consist of appropriated monies that were unused in the first fiscal year of a biennium with the result that they are "brought forward for expenditure in the second year of the same biennium."

Certificates of Participation (COPs)

See Appropriation-supported Debt

Certified Budget

The total state budget (including federal funds and special funds) as certified by the governor's director of the budget. Although the General Fund budget receives the most attention, the certified budget includes the General Fund, special funds such as the Highway Fund, and other sources, including federal funds. As indicated above (see Authorized Budget), the certified budget does not necessarily reflect actual expenditures for each line item. Monies may be moved among line items within a specific department after the budget has been certified; however, total appropriations for each department must remain unchanged from the certified budget.

Further restrictions exist on how monies allocated in the certified budget can be used. Legislative permission – through the budget bill – is required before an agency can transfer money between personal services (salary and benefits) and other line items. Furthermore, total expenditures on a purpose or program are allowed to be changed under certain circumstances. Primary among these circumstances are: a court or Industrial Commission order; exercise of the Emergency Management Act; extra expenditures required to call out the National Guard; or if an "overexpenditure is required to continue the purpose or programs due to complications or changes in circumstances that could not have been foreseen when the budget for the fiscal year was enacted."

Component Units

Legally separate institutions and entities for which the state is financially responsible. Along with local governments, such "nonprimary government" units receive much of their funding from general bond issues. The largest component units funded by the state are: the University of North Carolina system, the community college system, The Golden LEAF Foundation, The State Education Assistance Authority and the North Carolina Housing Finance Agency. Nonmajor component units are: N.C. Ports Authority, N.C. Agriculture Finance Authority, N.C. Global TransPark Authority, N.C. Partnership for Children, Inc., Regional Economic Development Commissions, North Carolina Railroad Company, N.C. Phase II Tobacco Certification Entity, Inc., and N.C. Turnpike Authority.

Comprehensive Annual Financial Report (CAFR)

By law (G.S. 143-20.1), every state agency is obligated to submit an annual financial statement to the state controller, who combines the statements to create the state's Comprehensive Annual Financial Report (CAFR). The CAFR is

generally divided into two sections: 1) financial statements and analysis; and 2) statistical data on financial, nonfinancial and demographic trends. The CAFR is used by bond rating agencies, such as Moody's and Standard & Poor, to determine the credit risk, and thus interest rates, for bonds issued by the state.

Continuation Budget

Also known as the base budget, this is the budget required to continue existing programs at current levels. The continuation budget grows each year based on increases in inflation rates and population increases affecting institutional and entitlement programs, such as public schools or Medicaid. The budget also annualizes (i.e., provides full annual funding for) new programs and positions, and includes new operational costs of facilities opened in the last year. It does not contain nonrecurring cuts or expansion from the previous year. The biennial continuation budget is organized by department and published in multiple volumes by the governor's office.

Continuing Budget Resolution

Legislation passed to continue critical operations of the state during those sessions when debate over the budget bill extends beyond the end of the fiscal year. In even-numbered years, continuing resolutions are less important because the biennial budget that passed the prior year is still in effect. Resolutions are typically for a short period (one month or less), and more than one resolution may be passed if the budget process remains stalled. Not infrequently, the legislative leadership will use continuing budget resolutions to pass substantive legislation. In 2001, for instance, the Legislature used a continuing budget resolution (S.L. 2001-395) to increase spending for education, in particular, a $20 million initiative to reduce K-3 class sizes. Even more controversial was a 2005 resolution (S.L. 2005-144) that continued the half-cent increase in the sales tax and the half-percent increase in the highest income tax bracket, both of which were scheduled to sunset at the end of the fiscal year.

Even more controversial was a 2005 resolution that continued the half-cent increase in the sales tax and the half-percent increase in the highest income tax bracket.

Deed Stamp Tax

Commonly referred to as the "transfer tax," this is a statewide tax paid by the seller when any real interest in real property is conveyed to another person. The applied rate is 0.02 percent, or $1.00 for every $500.00 paid for the property. The revenue from the tax is shared by North Carolina's local and state governments, with one-half of the proceeds going to the respective county's General Fund and the remaining half, less administrative expenses, going to the state Department of Revenue. Of the funds remitted to the state Department of Revenue, 75 percent is credited to the Parks and Recreation Trust Fund and 25 percent goes to the National Heritage Trust Fund.

Disproportionate Share Reserve

A reserve account established in 1993 (S.L. 1993-321) to hold excess payments, dispersed by the Medicaid Disproportionate Share Hospital (DSH)

program, to hospitals that serve a "disproportionate number of low-income patients with special needs." Throughout the 1990s, federal policymakers expressed concern that many states were taking advantage of the DSH program to decrease their own contributions to Medicaid and subsidize general spending initiatives.

Earmark
A requirement that revenue be spent on a specific project or purpose, therefore intercepting the money before it is pooled with other revenue and appropriated as part of the General Fund. At the federal level, earmarking is often equated with pork spending.

Expansion Budget
Appropriations for new or expanded programs, new positions, increased expenditures above those allowed in the continuation budget, and salary increases.

Fiscal Year (FY)
The 12-month period covered by the state budget: July 1 to June 30.

Gas Tax
The Motor Fuels Excise Tax levied on all fuels (including alternative fuels) sold, distributed or used in the state; the excise tax has a fixed rate of 17.5 cents per gallon plus a variable component rate that is 7 percent of the average wholesale price of motor fuels. The gas tax is computed twice a year in January and July and cannot fall below 3.5 cents per gallon. In January 2006, in the aftermath of Hurricane Katrina and the war in Iraq, the gas tax reached a high of 29.9 cents. The governor and the Legislature capped the rate at this level for the 2006-07 fiscal year, thus preventing a further increase, but providing no additional tax relief at the pump. Just two years later, however, the 29.9 cents per gallon cap was converted to a floor by the 2009 legislature. The intent was to ensure that the gas tax wouldn't drop below that amount due to falling gas prices.

DID YOU KNOW?
North Carolina's top three employers are: the state of North Carolina, the federal government and Wal-Mart. Four of the state's top 10 employers are government entities: the state, the federal government, the Charlotte Board of Education, and the Wake County public school system – with Duke University, Food Lion and the Charlotte Hospital Authority also making the list.

Source: N.C. Comprehensive Annual Financial Report (FY2006)

General Fund
Funds general needs, as opposed to specific or restricted purposes. The General Fund accounts for about half of the state's total budgetary financing and is supplied by revenue from a wide variety of taxes and fees, as well as money from court fees, disproportionate share receipts, investment earnings and bonds, the tobacco settlement, the Highway Fund and the Highway Trust Fund.

General Obligation Bond
A debt, issued in the form of a tax-exempt bond, secured by the taxing power of the state, or what is referred to as "the full faith and credit of the State." North Carolina's Constitution (Art. V, Sec. 3) requires that voters approve all general obligation bond issues. As of June 30, 2010, North Carolina's tax-supported general obligation bond debt was more than $4.4 billion.

Governor's Recommended Adjustments

After releasing the multivolume biennial continuation budget, the governor submits another document detailing recommendations for expansion and reductions to the continuation budget. These recommendations include funding for new programs and the expansion of existing programs, as well as the proposed reduction or elimination of existing line items or programs.

GPAC (Government Performance Audit Committee)

Legislative committee established by the General Assembly in 1991 in order to review the efficiency and efficacy of various state departments and programs. The 1991 GPAC audit resulted in more than 300 recommendations, ranging from broad initiatives, such as establishing a strategic planning process, to agency-specific recommendations, such as closing small, inefficient prisons. The committee was dissolved in 1993 following the final audit report. A new GPAC was established in the 2006 Studies Bill (S.L. 2006-248) and completed its work February of 2008.

Highway Fund

Dedicated to supporting the operations and capital construction needs of the Department of Transportation (DOT) and related services, the Highway Fund is derived from the following sources: 75 percent of fuel tax revenues, various fees collected by the Division of Motor Vehicles and investment income from the existing Highway Fund. The Highway Fund pays for road maintenance and construction, the operations and capital needs of the Division of Motor Vehicles and the State Highway Patrol, and other transportation-related functions. While the Highway Trust Fund is focused on construction, the greatest expenditures from the Highway Fund are for road maintenance. Under the auspices of the Highway Patrol, the Highway Fund was also used to pay for part of the development of the proposed 800 MHz statewide emergency communications network, VOICE. In addition to roadwork, the DOT is directly responsible for various matters related to aviation, ferries, bikeways and walkways, bridges, public transportation and rail.

The Highway Trust Fund (HTF)

Created in 1989 with the goal of rapidly expanding North Carolina's highway/road system for economic development purposes, the HTF is supplied by the following taxes and fees, totaling $1 billion annually: 25 percent of motor fuel and related tax revenues; a special 3 percent highway use tax levied on title transfers; various title and registration fees; and investment income from the existing trust fund. In 1996, voters approved an additional $950 million in general obligation bonds to support the HTF. By law, $170 million was transferred annually from the HTF to the General Fund, but between 2001 and 2005 the governor and the Legislature raided the fund to subsidize

other projects. Beginning with the FY 2008-09 budget, the annual transfer from the HTF was phased down to $71 million over the course of three years. The rest of the traditional transfer to the General Fund will instead be directed to the NC Turnpike Authority and to pay off various highway projects.

Information Technology Budget

Refers to agency requests for expenditures exceeding $500,000 for the state's technical infrastructure, generally included in the expansion budget for each agency. In some years, the General Assembly has appointed a separate Appropriations Information Technology Subcommittee to review large requests of this type. In other years, these requests have been reviewed by the appropriate subject area subcommittees (i.e., Health and Human Services) or by the chairs of the full appropriations committee. All requests for technology expenditures over $500,000 must be approved by the Chief Information Officer (CIO). Passed in 2004, S.L. 2004-129 required a review and evaluation of all major technology projects proposed or being undertaken, gave the state CIO more authority, and created the Information Technology Advisory Board and the Information Technology Fund.

Intangibles Tax

The intangibles tax was enacted in 1937, but was repealed in 1995 after being challenged on the grounds that it violated the Interstate Commerce Clause of the U.S. Constitution. Along with taxing accounts receivable, notes and bonds, and beneficial interests in foreign trusts, the intangibles tax stipulated that all shares of stock owned by either a business or an individual taxpayer be taxed at a rate of 25 cents per $100 of total fair market value of stock, regardless of whether the stock earned a dividend or not (cf. G.S. §105-203). *See Q & A: 12*.

Joint Conference Committee

This committee is comprised of legislative members appointed by the House speaker and the Senate president pro tempore. Typically, the committee is chaired by the Appropriations chairs and includes the Appropriations subcommittee chairs and some of the members of the Appropriations subcommittees. The conference committee is charged with reviewing the approved House and Senate budget proposals and reconciling differences between the two budgets. Conferees are supposed to follow certain self-imposed ground rules when they come together to craft a final budget:

1. Items that are the same in both approved budgets are no longer negotiable: they are to be included as is in the final budget.
2. Items in which the two chambers differ in terms of money can be negotiated to the Senate position,

> The hardest thing in the world to understand is the income tax.
>
> Albert Einstein

the House position, or any point in between. For example, if the Senate appropriated $200,000 for a certain item, and the House appropriated $400,000, the conference committee may appropriate $300,000 – but not $500,000.

3. Only items that are in either budget can be considered by the joint conference committee. No new items may be added to the reconciled budget.

The reconciled budget produced by the joint conference committee is presented to both chambers, each of which must vote for or against the "conference budget" without amendments. Once the conference budget is passed by both bodies, it goes to the governor who can either sign it into law or veto the budget – sending it back to the General Assembly.

Joint Conference Committee Report on the Continuation, Expansion and Capital Budgets

See Money Report

Lapsed Salary

Funds budgeted for positions that are temporarily vacant. Lapsed salary is sometimes used by an agency to hire contractual or temporary employees, but may also be used to fill a negative reserve, or with legislative permission through the budget bill, to pay for other line items. Lapsed salary that has not been obligated by the end of the fiscal year reverts to the General Fund and is carried forward into the next fiscal year. The spending of lapsed salary is one of the most common instances of spending reversions and reduces the General Fund cash balance available in the following year. *See also Reversions*

Long Session

With elections held in November of each even-numbered year, the General Assembly convenes from January to July (but often even longer) of each odd-numbered year for what is called the long session. The biennial budget is crafted and adopted during the long session.

Management Flexibility Reserve

See Negative Reserve

Money Report

Informal name for the Joint Conference Committee Report on the Continuation, Expansion and Capital Budgets. The Money Report contains an itemized account of changes – reductions and expansion – to the continuation budget. It is passed by the General Assembly along with the Budget Bill, and together these two documents direct the executive branch in spending appropriations.

Negative Reserve

Also called a "management flexibility reserve," a negative reserve is a one-time "hole" placed in an agency's budget by the General Assembly in lieu of specific line item cuts. The deficit must be filled over the course of the fiscal year with budget cuts determined by the agency. Negative reserves are frequently filled with lapsed salaries generated by vacant positions (*see Lapsed Salary*). *See also Q & A: 4*

Nonrecurring
Applies to revenue or changes to appropriations – increases and decreases – that are not continued beyond the biennium (and typically not beyond one fiscal year). When nonrecurring revenue or nonrecurring reductions in expenditures are used to fund recurring expenditures, other revenue sources must be found to pay for those expenditures in future years. For example, the 2006 General Assembly added to the FY2006-2007 budget more than $850,000 in new recurring expenditures, using $500,000 in new recurring revenue and $350,000 in new nonrecurring money.

Nontax Revenue
Revenue from a source other than taxes, including Medicaid disproportionate share money, investment income and fees collected by various state agencies that are deposited in the General Fund. These funds cannot be retained and used by the agencies without legislative approval. One of the largest sources of nontax revenue is judicial fees – court costs charged to individuals whose civil or criminal cases are not dismissed. In FY 2009-10, judicial fees brought in approximately $217 million.

Performance-Based Budgeting
A method of budgeting that ties funding to results by reporting on select outcome measures. For instance, the 1999-2001 Justice and Public Safety budget tied funding for district attorney positions to the ability to dispose of all superior court felony cases filed each year. During the 2001 budget crisis, Governor Easley abandoned performance-based budgeting and eliminated the performance planning division of his office. Easley resurrected performance-based budgeting as "Results-Based Budgeting" after the passage of the budget in 2006.

Recommended Budget
Budget the governor submits to the legislature. Includes the continuation budget and the reductions and expansion – including capital – detailed in the Governor's Recommended Adjustments to the Continuation Budget. By law, the governor is charged with preparing a budget that "will promote the more efficient and economical operation and management" of the state (G.S. §143-3).

Recurring
Applies to revenue or changes to appropriations – increases and decreases – that will continue beyond the biennium. Recurring cuts or increases in the budget are built into the base (continuation) budget in the next biennium. If an agency is undertaking a project that will continue for several years, the money for the project is placed in the budget on a recurring basis, and then must be cut when the project is complete.

Reversions
Unspent appropriations from previous years. Unless otherwise authorized, these funds generally return to the fund from which they came. Reversions to the General Fund are included as nonrecurring revenue in the following year's budget. Reversions come from lapsed salary, other unspent funds and any funds the governor may have held back over the course of the year in anticipation of a budget shortfall. *See Lapsed Salary*

Savings Reserve Fund
Also called the "Rainy Day Fund," the Savings Reserve Fund was established in 1991 as a means for setting aside General Fund monies in anticipation of economic fluctuations or fiscal crises (G.S. 143-15.3). Under the law, the Legislature is required to earmark 25 percent of the year-end

credit balance for the Savings Reserve Fund until the account balance equals 5 percent of the prior year's General Fund operating budget. The Fund reached its 5 percent cap in 1995-96 and remained fully funded through 1997-98. During the 1998-99 and 2001-02 bienniums, however, the balance dropped to zero, thanks to withdrawals made for the intangibles tax lawsuit settlement (1998-1999), the Hurricane Floyd recovery effort (1999-2000), and a 2001-02 transfer to the General Fund to cover a revenue shortfall. Subsequently, the balance inched back up, with 2006 funding reaching approximately $636 million, only to be significantly reduced down to $150 million by FY 2008-09 as budget writers dipped into the account to fill the sizeable budget deficit of that year.

Short Session

The legislative session that convenes in even-numbered years. The session meets from May to July (and often longer) in order to make adjustments to the biennial budget adopted during the long session.

Short Snappy

Informal term for the text description that accompanies each budget change – i.e., increase or decrease to the continuation budget – in the Money Report.

Special Indebtedness

See Appropriation-supported Debt

Special Provisions

The provisions that comprise the actual budget bill containing the statutory changes and session laws that delineate how the budget should be implemented. "Substantive" special provisions are often not related to budgetary matters and may be inserted into the budget bill when a legislator wishes to avoid debating a bill on its own merits. The 2005 Budget Bill, for example, contained a substantive special provision (section 10.59F.(g)) mandating eye exams for all kindergartners.

State Budget Act

See G.S. §143c. The State Budget Act recodified and amended the Executive Budget Act. The act applies to the 2007-2009 biennium and every biennium thereafter.

Surtax

A tax "surcharge" (or surtax) essentially amounts to a tax on a tax. A surtax is a rate applied to one's tax liability so that the taxpayer pays an extra amount above and beyond their normal liability. For instance, if there is a surtax of 10 percent on a person who owed $1,000 in taxes for the year, the surtax amounts to $100. In this case, the taxpayer would owe a total of $1,100.

The North Carolina state budget of 2009 (S.L. 2009-451) created a temporary surtax for both individual income and corporate taxes. A surtax of 3 percent was applied to corporations, meaning that they actually owed 103 percent of their tax liability. The corporate tax surtax expired at the beginning of the 2011 tax year. The corporate surtax was estimated to cost corporations an extra $23.1 million in fiscal year 2009-10 and $25.5 million in fiscal year 2010-11.

The individual income surtax targeted higher income earners. A two percent surtax was applied on single filers earning more than $60,000 and married couples earning more than $100,000. The surtax rose to three percent for single filers earning more than $150,000 and married filers earning $250,000 or more. Like the corporate surtax, this tax expired at the beginning of the 2011 tax year. The

individual income surtax was projected to cost taxpayers $172.8 million in 2009-10 and $177.1 million the following year.

Truth in Budgeting

"Truth in budgeting" was a term coined by Gov. Bev Perdue when she released her budget plan for the 2009-10 fiscal year. What Perdue was referring to was the practice by state agencies of including money for positions in annual budget requests when in actuality many positions remain vacant for extended periods of time. Despite the vacancies, agencies receive funding as if the positions are filled the entire year. Agencies then use the unspent payroll money on other obligations.

Perdue's intent in establishing "truth in budgeting" was for agencies to submit budget requests more closely reflecting the actual payroll expenses they expect for the budget year, factoring in positions that become vacant throughout the year through the expected amounts of turnover – as well as positions that are vacant at the time the budget is written and are likely to remain vacant for weeks or months.

Despite estimates that it would save $150 million in 2009-10 alone, Perdue's "truth in budgeting" initiative received mixed reviews. Budget hawks lauded the idea not only for the savings but because it increased transparency. Critics expressed concern about the initiative because state agencies have traditionally relied on the unused payroll money to meet unexpected expenses, and this would leave agencies little wiggle room.

Perdue's truth in budgeting idea quickly and quietly faded into memory as neither the House nor the Senate incorporated the technique in their budget plans for 2009-10. Perdue opted not to include the initiative in her budget plan the following year.

Zero-based Budgeting

Budgeting approach that advocates crafting the budget from the ground up – or a zero base – rather than using the previous year's budget as a starting point. "Modified" zero-based budgeting entails "zeroing out" specific programs or agencies or line items, with the intention of inviting an agency to justify each expenditure. In 2001 and 2005, for example, the appropriations committees chose to examine line items such as travel, cell phone usage, and contracted miscellaneous and personal services across all agencies in an effort to find efficiencies. In previous years, the chairs of the appropriations committees have determined when and how to implement any form of zero-based budgeting.

1 HOW IS IT MADE? The State Budget

North Carolina's budget process is governed by "The State Budget Act," which stipulates that the budget be prepared on a biennial basis.[1] Since the 1975-77 biennium, North Carolina's General Assembly has put the biennial budget together in the odd-numbered year (long session) in anticipation of returning in the even-numbered year (short session) to fine-tune it and make adjustments for changing economic factors.

House & Senate Appropriations Committees

2010 Appropriations Subcommittees:

HOUSE:	SENATE:
• Health & Human Services	• Health & Human Services
• Justice & Public Safety	• Justice & Public Safety
• Natural & Economic Resources	• Natural & Economic Resources
• Transportation	• Transportation
• Education	• Higher Education
• General Government	• Public Instruction
• Capital	• General Government & Information Technology

Issues reserved for the consideration of the full committee chairs in one or both chambers:

- Overall and subcommittee budget totals
- Salaries & Benefits
- Capital
- Information Technology

The budget process begins with the governor submitting his recommended budget to the General Assembly after it convenes in January of each odd-numbered year. The recommended budget contains: (1) predictions regarding available revenue; (2) estimates of appropriations necessary for continuing existing programs at current levels and any recommended reductions (the continuation budget); (3) expansions of existing programs or additional new programs or other expenditures (the expansion budget); and (4) capital improvements (the capital budget).

In both the House and the Senate, the Appropriations Committee and the Finance Committee are responsible for simultaneously crafting separate parts of the budget. The Appropriations Committee determines how much money should be spent in each category while the Finance Committee establishes how much revenue will be available to fund these expenditures. The Appropriations Committee is divided into issue area subcommittees responsible for reviewing the line item continuation budgets of North Carolina's respective state agencies.

[1] Effective July 1, 2007, the Executive Budget Act was repealed and replaced with the State Budget Act (S.L.) 2006-203; G.S. §143C.

The committees also review expansion requests that originate with each agency or with the governor. Each subcommittee receives a spending target it cannot exceed without authority from the chairs of the full committee. The subcommittees recommend their budgets to the full Appropriations Committee, which combines all of the subcommittee budgets, votes on these combined budgets, and passes the resulting budget on to the full chamber for a vote. Amendments to the budget can be offered and votes taken in subcommittee, full committee, and on the chamber floor. Because the budget generally includes changes to taxes or fees, votes must be taken twice on separate days in each chamber – the first vote is called "second reading" and the second vote is called "third reading."

An unlimited power to tax involves, necessarily, a power to destroy.
Daniel Webster

The House and the Senate traditionally take turns initiating the budget process each biennium. The House, for example, will create its own version of the budget, vote on it, and send it to the Senate. The Senate will then create its version – but it may or may not use the House budget as a starting point. The following biennium, the order will be reversed. In the interest of expediting the budget process, House and Senate committee members will sometimes meet jointly towards the beginning of the session to discuss budget matters. Once the House and the Senate approve their respective versions of the budget, members from each chamber are appointed to a conference committee responsible for reconciling the two proposed budgets. Especially when the chambers are divided by political party – as happened during the 1995-1996 and 1997-1998 biennia – the two budgets will be quite different.[2] When its negotiations are complete, the committee will recommend a reconciled version of the budget to both chambers. The full House and Senate must then vote for or against the conference budget without amendments.

After the conference budget passes the House and the Senate, it goes to the governor who may either sign the budget into law or veto the budget, sending it back to the General Assembly. Once the budget is signed by the governor, it goes to the Office of State Budget and Management (OSBM), which must certify the budget. Thereafter, each agency is permitted to begin operating under the new budget.

2 Funding The Budget

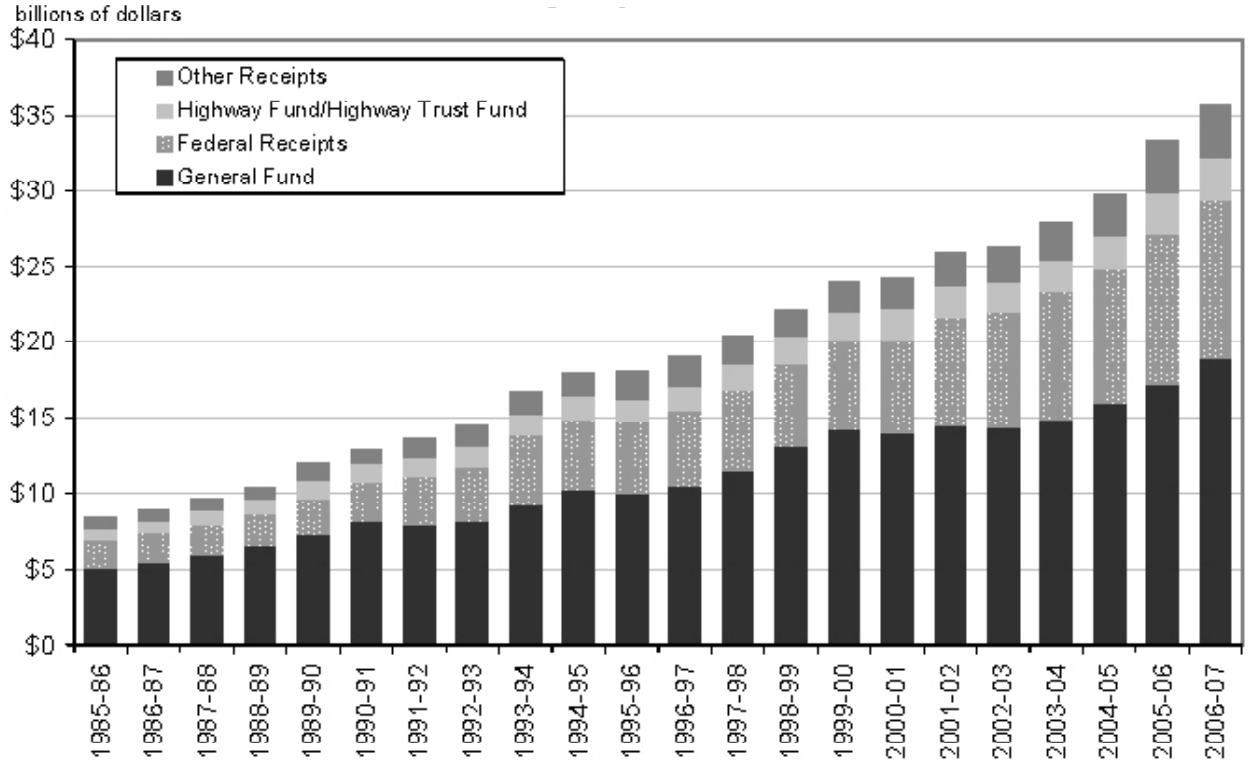
WHERE DOES THE MONEY COME FROM?

In short, your state and federal tax dollars. These taxes go into a number of different funds, the most important of which are the General Fund, the Highway Trust Fund, and the Highway Fund. The General Fund accounts for about half of the state's total budgetary financing and is supplied by revenue from a wide variety of taxes and fees, as well as money from court fees, disproportionate share receipts, investment earnings and bonds, the tobacco

[2] In 1998 the House and the Senate were unable to agree to a final budget until October — well past the technical deadline of June 30. See David W. Owens, "The State Budget," in *North Carolina Legislation 1999,* ed. David W. Owens (Chapel Hill, NC: Institute of Government, 1999), 11-12; available from http://www.sog.unc.edu/pubs/nclegis/nclegis99/pdf/Chfin02.pdf.

settlement, the Highway Fund, and the Highway Trust Fund. Federal tax dollars used to subsidize expenditures in education, healthcare, transportation, and other areas also comprise part of the budget (see Q& A: 8), as does revenue from university tuition fees, prison enterprises, the state fair and a variety of other activities.

Total State Budget by Source of Funds



WHAT IS IT?

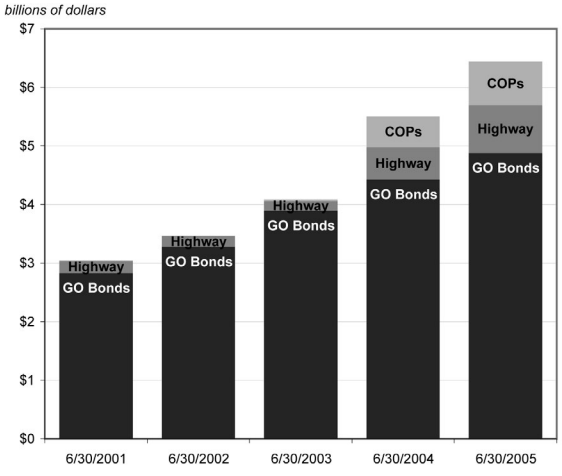
3 The Balanced Budget Amendment

The North Carolina Constitution stipulates that the governor and General Assembly must balance the budget each year. Article III, Section 5 reads: "The total expenditures of the State for the fiscal period covered by the budget shall not exceed the total of receipts during that fiscal period and the surplus remaining in the State Treasury at the beginning of the period." In order to accomplish this end, the executive branch (i.e., the governor) is charged with the following duties: "To insure that the State does not incur a deficit for any fiscal period, the Governor shall continually survey the collection of the revenue and shall affect the

DID YOU KNOW?

North Carolina's annual payments to service the state debt is more than triple what it was ten years ago.

Total Outstanding Debt: 2001-2005



Sources of Debt: Voter-Approved General Obligation Bonds (GO Bonds), Highway Tax-Supported Bonds (Highway and Appropriation-Supported Certificates of Participation (COPs). (Other debt includes Nontax Supported (Revenue) Bonds of less than $10 million.)

necessary economies in State expenditures." The Balanced Budget Amendment was submitted by the General Assembly and ratified by voters in 1977 with the intention of reigning in state spending, as indicated by the fact that the amendment explicitly requires that "economies in State expenditures" be made to balance the budget. At times, however, the amendment has been used as an excuse to raise, or refrain from cutting, taxes. In recent years, in particular, the governor has sought to balance the budget, not by taking "necessary economies," but by illegally taking revenue from reserve funds not intended for general spending.

4 What Is It? Budget Cut

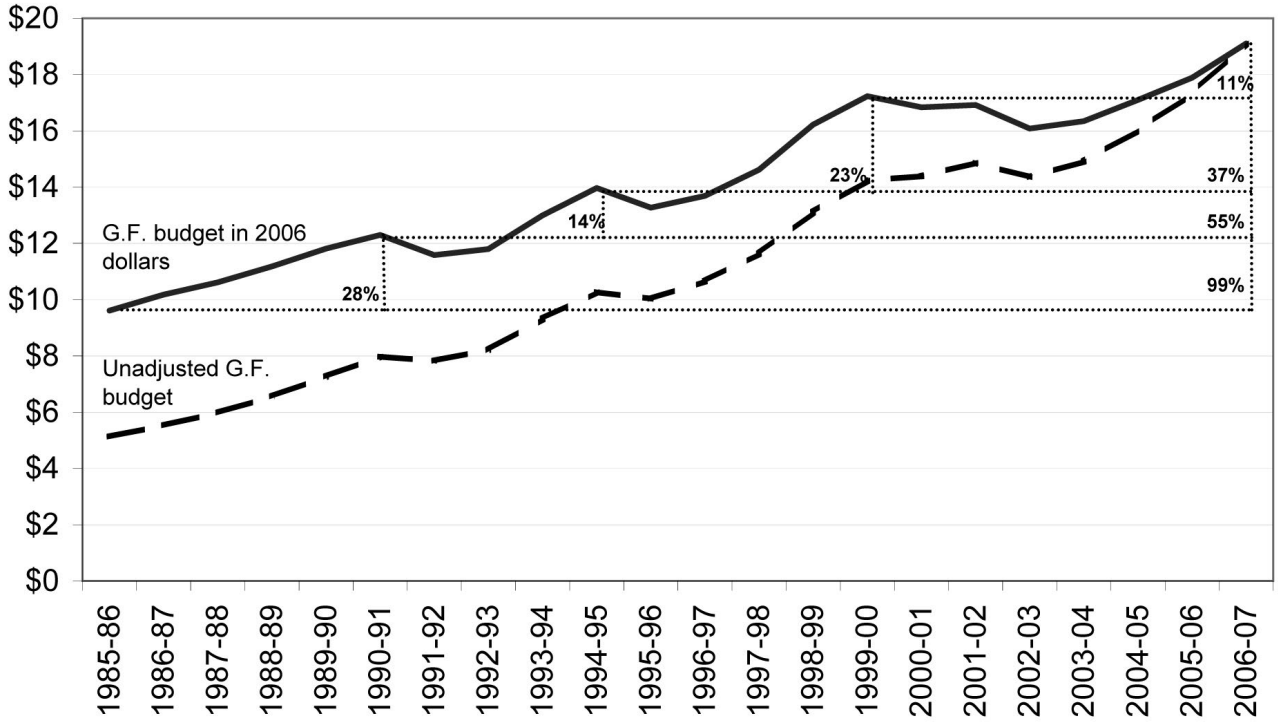
The phrase "budget cut" is used in an equivocal manner when speaking of various budgetary actions and thus lends itself to misinterpretation. For the ordinary voter, a budget cut implies an actual reduction in the amount appropriated for an item or program — an amount that is less than the amount spent in the previous year's budget. The problem here is that there is more than one budget – for instance, the governor's recommended budget as opposed to the legislatively authorized budget. A "budget cut" to the 2007 recommended continuation budget may, in fact, still result in an increase in spending as compared to the 2006 authorized budget. In short, it is politically beneficial to claim credit for cutting the budget (while not cutting spending in certain areas), so the phrase tends to be interpreted in the broadest way possible.

In general, a "budget cut" is used to refer to the following actions:

- Reductions to the continuation budget itself. These are cuts to specific personnel, programs or line items that reduce the budget for those items below the level of the previous year. In 2002, for example, the General Assembly eliminated nearly 70 positions in the Department of Agriculture and Consumer Services. This reduction was an actual budget cut in relation to the year's previous budget and saved the state $2.55 million annually.
- Reductions that slow down the growth in the continuation budget, typically by reducing (but not entirely eliminating) increases recommended by the governor for inflation or population growth. For example, in 2005 the Money Report specified a cut of $1.4 million to the Indigent Persons Attorney Fee Fund. This "cut" was a reduction to a $13 million increase placed in the continuation budget by the

Growth in General Fund Budget

Constant 2006 and Unadjusted Current Dollars
Percent Increase in General Fund Budget in Constant 2006 Dollars



governor due to anticipated claims from attorneys representing indigent clients. Therefore, the budget for the fund actually increased by $11.6 million compared to the previous year. Another example of such a "cut" is the 2002 reduction of $2.3 million for public school classroom materials, supplies, and equipment. This cut was accomplished by reducing the rate of inflation used in the continuation budget from 5 percent to 3 percent. Thus the cut actually increased spending by 3 percent.

- Temporary reductions to the continuation budget. Nonrecurring cuts are temporary reductions to line items in an agency's budget. Such cuts require the agency to make short-term economies that may not be possible on a long-term basis. One common example is a nonrecurring cut to the vehicle replacement line items in criminal justice agencies, requiring that the agencies postpone replacing some vehicles for another year. Another example of a temporary cut is a negative reserve placed in an agency's budget (see Key Terms). Whether the cuts are recurring or nonrecurring, legislators tend to prefer line item cuts to the use of negative reserves because it allows the General Assembly to control which programs or areas are cut. The fear here is that agencies will use the negative reserve to choose to cut a program that legislators – and the public – want to keep. In voters' minds, however, legislators will be blamed for the cut, rather than the agency heads.

- Reductions to the appropriation for an item that will be made up with funds other than the General Fund. For example, in 2005 the appropriation for the community

colleges was reduced by $5.6 million due to an increase in the tuition rate. While the amount expected to be spent did not change, the General Fund appropriation was reduced.

- Reductions to an agency's overall budget. Frequently, budget cuts to specific items or programs are more than balanced by the expansion of other items. In tight budget years, though, some agencies will actually see a reduction in their appropriation as compared to the previous year. For example, in 2002 the General Fund appropriation for the Department of Correction was $51 million below the governor's continuation budget request and $43.9 million less than the amount appropriated by the 2001 General Fund.

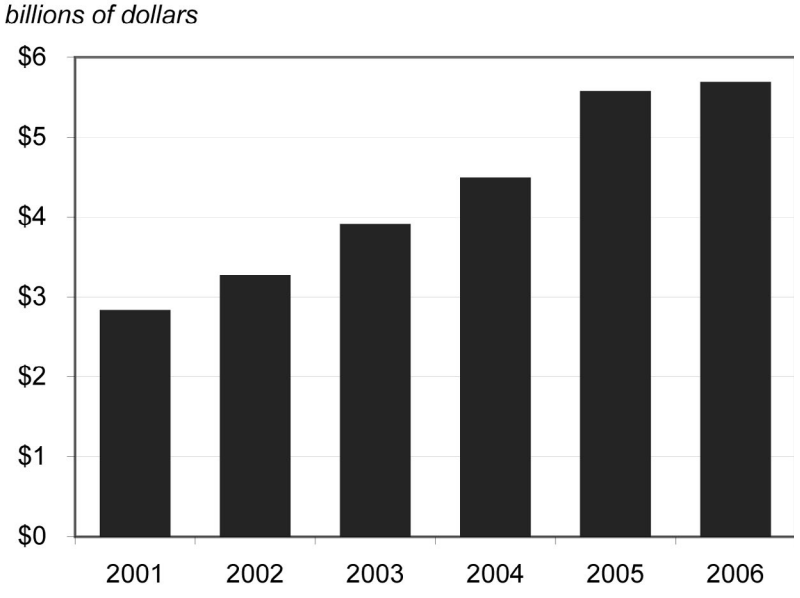
Although every budget passed by the General Assembly has contained numerous "budget cuts," the overall General Fund budget almost always increases from year to year. Even when some agencies receive lower appropriations than in the previous year, these reductions are more than balanced by higher appropriations for other agencies.

5 HOW MUCH IS IT? The State's Debt

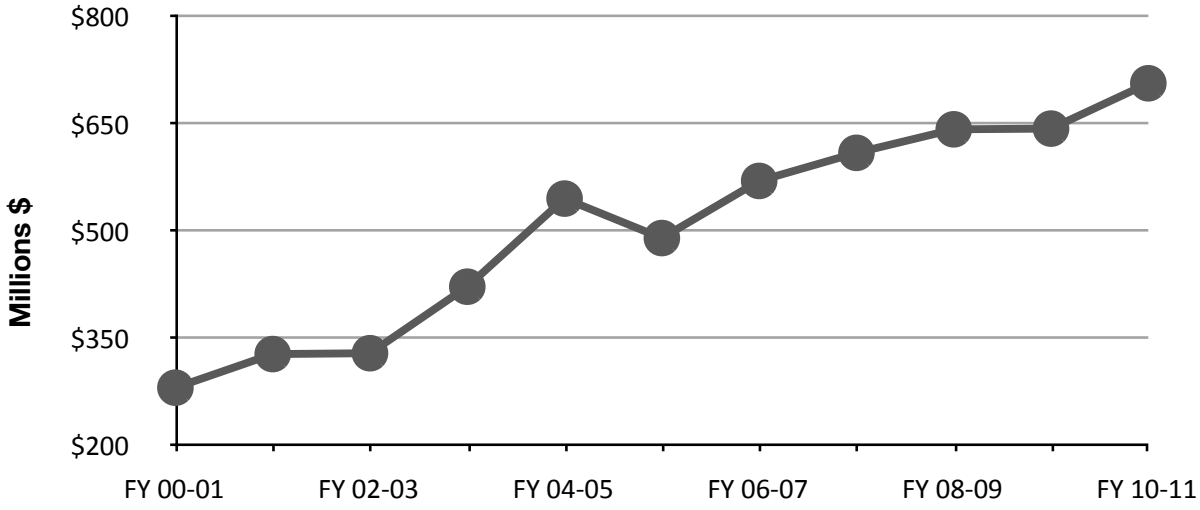
As of the end of FY 2009-10, North Carolina's total principle net indebtedness exceeded $4.4 billion. Adding in scheduled interest payments roughly doubles that debt liability. Of the $4.4 billion, $1.3 billion consists of "special indebtedness" such as Certificates of Participation, that was issued without voter approval. As the following charts show, tax-supported debt grew rapidly earlier this decade in North Carolina, doubling from $2.8 billion in 2001 to $5.7 billion in 2006. As the debt has risen, so has debt service – i.e., those payments on the principal of the debt, plus interest.

According to the 2006 Comprehensive Annual Financial Report, in FY2001 the state's debt service was $281.5 million; as of FY2006 it had risen to $657.7 million. Similarly, debt service as a percentage of noncapital expenditures went from 1.3 percent in 2002 to 2.07 percent in 2006. With the onset of the Great Recession in later part of the decade, state borrowing slowed bit, but the state's debt burden in terms of per capita debt and annual debt service payments continued to climb at a significant pace.

Outstanding Net Tax-Supported Debt: 2001-2006

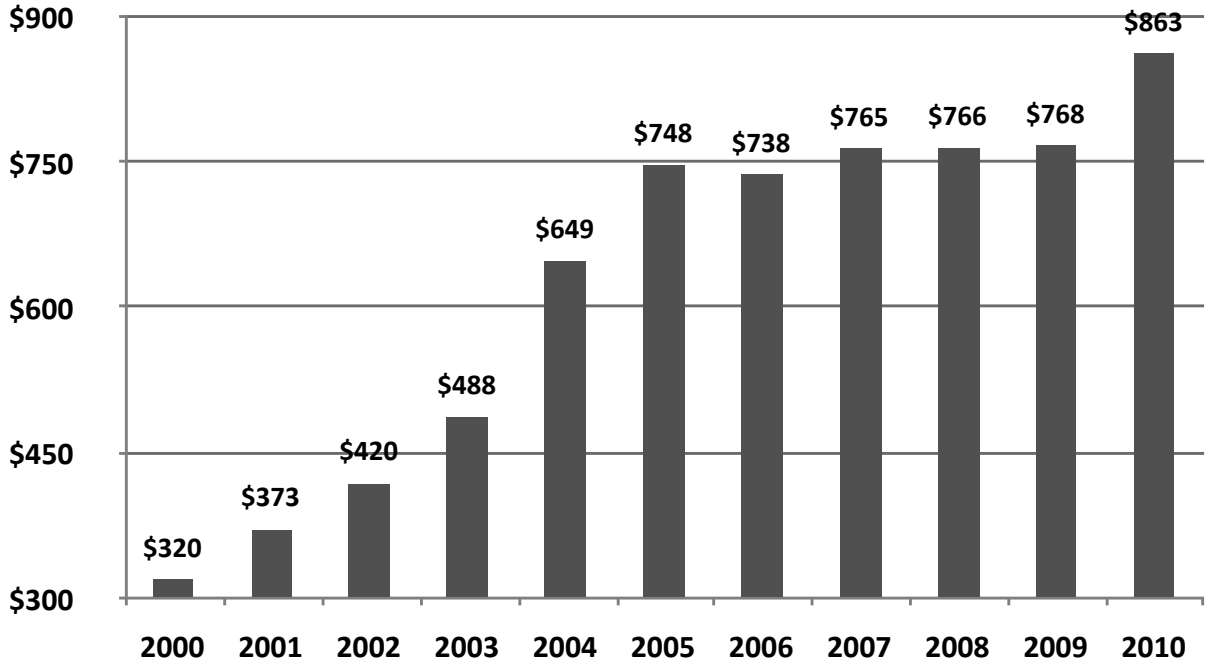


Annual Debt Service Payments: 2001-2011



The annual Debt Affordability Study, usually issued in early February, provides additional information on the state's debt and is often used by policy makers to calculate how much additional debt the state can take on without jeopardizing its bond rating. A copy of the study can be found at www.nctreasurer.com.

Per Capita State Debt: 2000-2010



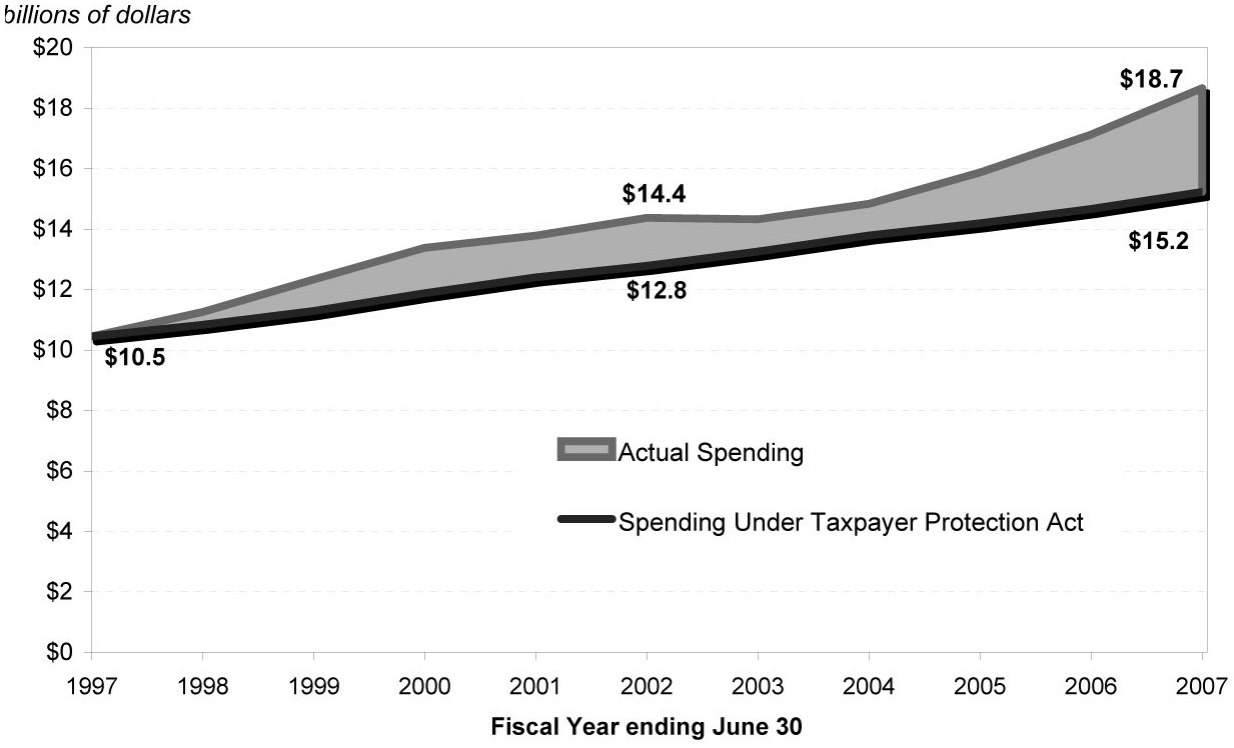
6 WHAT IS IT? TABOR: Taxpayer Bill Of Rights

The **TA**xpayer's **B**ill **O**f **R**ights is a proposed constitutional amendment that would require lawmakers to limit new spending (and thus tax increases) to a rate equal to the state's increase in population, plus inflation. The amendment would also require that surplus tax revenue either be returned to the taxpayers and/or used to fund a "Rainy Day Fund" and a "Budget Stabilization Fund" that would fund budget shortfalls in the event of a major emergency or economic downturn. Surplus revenues could not be spent by the government without specific permission from voters or approval by a legislative supermajority (60 percent, for instance).

TABOR was first implemented in Colorado in 1992. In 2005, however, the state partially suspended its TABOR requirements. In particular, voters decided to shelve for five years TABOR's automatic refund mechanism, thus triggering statewide spending increases. They did, however, keep in place a provision preventing tax increases without voter approval. In the 2006 election, Maine, Nebraska and Oregon held referendums on TABOR-like initiatives that would have capped state spending; none of these proposals passed. Legislators in North Carolina have introduced a TABOR amendment annually over the past ten sessions, but the proposed law has never been permitted to come up for a vote.

Critics claim that TABOR is inflexible and often prevents state revenue from keeping pace with economic growth. Supporters argue that such laws are necessary to limit irresponsible spending and to give voters more control over the budget process – and thus over how their tax dollars are spent. TABOR advocates also note that the problems that led to the suspension of TABOR in Colorado – in particular, the absence of a Budget Stabilization Fund – have been addressed in newer versions of TABOR, such as that drafted by the American Legislative Exchange Council.

TABOR Limit for North Carolina: 1997-2007



TABOR is not to be confused with recent attempts at passing statutory legislation (as opposed to constitutional language) limiting spending, not to mention the "North Carolina Taxpayers' Bill of Rights," which is a promise of courteous service made by the North Carolina Department of Revenue.

7 HOW IMPORTANT ARE THEY? Bond Ratings

Bond sales are used by the state to borrow money from investors. As with any investment, investors look at two key factors when purchasing bonds: the rate of return and the risk of loss. The higher the rate of return, the greater the risk some investors are willing to incur. Conversely, investors will accept a lower rate of return on a safer investment opportunity. For bonds, this means that if it is more likely that a state can repay its debt, the state will obtain a lower interest rate on its bond issues.

In the United States, credit ratings for each state are determined by three private investment houses: Moody's Investors Service, Standard & Poor's Rating Services, and Fitch Ratings. Each house uses similar rating systems: the highest bond rating is AAA for Standard & Poor's and Fitch; Aaa for Moody's.

These credit ratings indicate each state's ability to repay its debt. The higher the rating, the "safer" it is to lend money to that state in the form of a bond. A high bond rating permits the state to repay bonds at a lower interest rate. Lower rates, in turn, enable the state to borrow money at a lower cost and thus entail a more efficient use of public revenue. If a state's ratio of debt to revenue becomes too high, its bond rating may fall, with the result that the state will have to pay more in interest to borrow money.

Although North Carolina has typically enjoyed the highest bond rating possible, Moody's Investor Services downgraded North Carolina's credit rating one level, from Aaa to Aa1 in August 2002. Moody's specifically attributed the downgrade to "the state's continued budget pressure, its reliance on non-recurring revenues, and its weakened balance sheet." The downgrade marked the first time since 1960 that the state did not have an Aaa rating.

As a result of Moody's decision, interest rates on bonds sold by the state increased by an estimated 0.05 percent on the August 2002 bond market. A report issued by the University of North Carolina predicted, "The additional cost in debt service would total $292 per million dollars in bonds per year over the course of the bonds."

According to Jason White of the Pew Research Center's Stateline.org, "Bond ratings are often regarded as a report card on government performance because the analysts who produce them are among the few players in the state budget game who don't have an obvious political axe to grind." At the same time, the threat of a downgrade in bond ratings has been used in the past – for instance, during the 2001 long session – as a justification for raising taxes.

On January 12, 2007, State Treasurer Richard Moore announced that Moody's had upgraded the state's bond rating to Aaa – making North Carolina one of only seven states (Delaware, Georgia, Maryland, Missouri, Utah and Virginia) to enjoy a triple A rating from all three agencies. "The superior ratings from all three agencies are evidence of the confidence the

market has in our state and in our bonds," claimed Moore. " It means that North Carolina can borrow at the best rates possible." According to Moody's, the upgrade was the result of "conservative budgeting, tight expenditure controls, and an improving economy."[4] The Department of the State Treasurer also explained the upgrade by referring to "the state's strong financial performance, relatively moderate debt burden, effective management, healthy financial outlook, replenishment of reserves and recent economic gains" – actions generally thought to embody a "conservative approach" to budget management.[5]

Investment houses use a variety of factors in assessing a state's bond rating. The most basic is the state's ability to take on new debt and manage existing debt as measured, in particular, by the percentage of state revenue dedicated to debt service, i.e. payments on principal and interest. According to Standard & Poor's, most states with a AAA rating also have a "clearly articulated debt management policy."[6] Other factors, such as demographic trends, that affect state debt per capita are also taken into consideration. What is most important, however, is the likelihood of a state balancing its budget. In this respect, spending increases should not outpace revenue. What counts as well is the manner in which the budget is balanced. For instance, using nonrecurring funds to pay for recurring programs is frowned upon. In 1990, for example, North Carolina was placed on Standard & Poor's CreditWatch list over concerns that the state was relying on "one-time solutions" to address "long-term" budget shortfalls. Instead, the agency cautioned, North Carolina needs to address budget shortfalls by enacting "permanent revenue increases or spending reductions."

Contrary to what critics on both sides of the aisle might claim, tax structure seems to have little effect on a state's bond ratings.

Of particular concern, however, is the growing share of non-voter approved debt as a percentage of total outstanding debt. Largely through the use of Certificates of Participation, such non-voter approved debt comprises a much larger share of the state's indebtedness. Specifically, recent Debt Affordability studies from the State Treasurer's office suggest that the exclusive use of "special indebtedness" such as COPs over the last decade could very well lead to a debt downgrade for North Carolina. They conclude that "including all authorized but unissued debt, the percentage of non-GO debt is projected to increase well beyond the medians for 'triple A' states and exceed the median for 'double A' states as well.

In other words, because of the exclusive reliance on special indebtedness over the last decade, North Carolina could be facing a debt downgrade in the near future.

4 See "Moody's restores N.C. bond rating to Triple A," Triangle Business Journal, January 12, 2007; available from http://triangle.bizjournals.com/triangle/stories/2007/01/08/daily36.html?surround=1fn.

5 State of North Carolina, Debt Affordability Advisory Committee, Debt Affordability Study (Raleigh: Department of State Treasurer, 2007); available from http://www.nctreasurer.com/NR/rdonlyres/599BB76E-EA20-4705-9D15-A086DF3EB490/0/2007DAAC_Final.pdf.

6 Ibid, 1.

8 HOW DEPENDENT ARE WE? Federal Funding & North Carolina

Federal influence over state budgets increases almost every year. Today, every state is critically dependent on federal funds just to make ends meet. North Carolina is by no means an exception to this trend. According to the state's FY2006 Comprehensive Annual Financial Report, "The state receives significant financial assistance from the federal government in the form of grants and entitlements, which are generally conditioned upon compliance with terms and conditions of the grant agreements and applicable federal regulations, including the expenditure of the resources for eligible purposes."

Over the past ten years, North Carolina's dependency on federal funds has grown markedly. In FY 1999-2000, federal receipts totaled $5.95 billion. By FY 2009-10, that number had reached $14.2 billion – an increase of roughly 240 percent. For sake of comparison, the state's General Fund increased at a rate of 43 percent during that time.

Put differently: in FY 2000, the state's General Fund expenditures were 2.4 times greater that federal receipts. By FY 2010, that difference had shrunk down to under 1.5.

DID YOU KNOW?

In 2003-04, North Carolina collected more than $400 million in liquor store revenue.

Source: U.S. Census Bureau

The majority of federal dollars go to Medicaid and transportation – always with strings attached. In particular, states that accept federal funds must adhere to federal regulations regarding the use of this money. Take Medicaid, for example. North Carolina pays 39 percent of Medicaid expenditures,[7] with the federal government paying the remaining 61 percent. In return for accepting this money, the state must provide health insurance to the groups that the federal government requires be covered – for example, low-income families that qualify for welfare, as well as elderly and disabled people eligible for Supplemental Security Income. The state must also provide all the services that are specified by federal mandates. The result is a loss of control over who the state can and cannot cover.

Federal funding also hinders states from exercising financial independence by preventing cuts in services that a state no longer wants or can no longer afford. By being forced to subsidize these services, state expenditures become automatic – preparing the way for virtually automatic tax increases. As federal money pays for a larger and larger share of the state budget, voters and taxpayers in North Carolina have less and less say in how to run the state's business. In addition to limiting financial independence, federal dollars are also used to force certain social agendas – for instance, regarding tax-paid health care, abortion, or the environment – on the states.

The chart on page 38 illustrates the long-term impact of federal funding for North Carolina by delineating the relation of state tax revenues to federal dollars in the N.C. state budget. As the history of the founding of the United States suggests, the right to set tax rates is an important part of state sovereignty. At current rates, federal funds will soon replace state tax collections as North Carolina's primary source of revenue. As the chart shows, in 1996 the state took in $2.19 per federal dollar it received; by 2005, this ratio had fallen to $1.56 per federal dollar.

[7] This percentage represents all state and local (county) contributions.

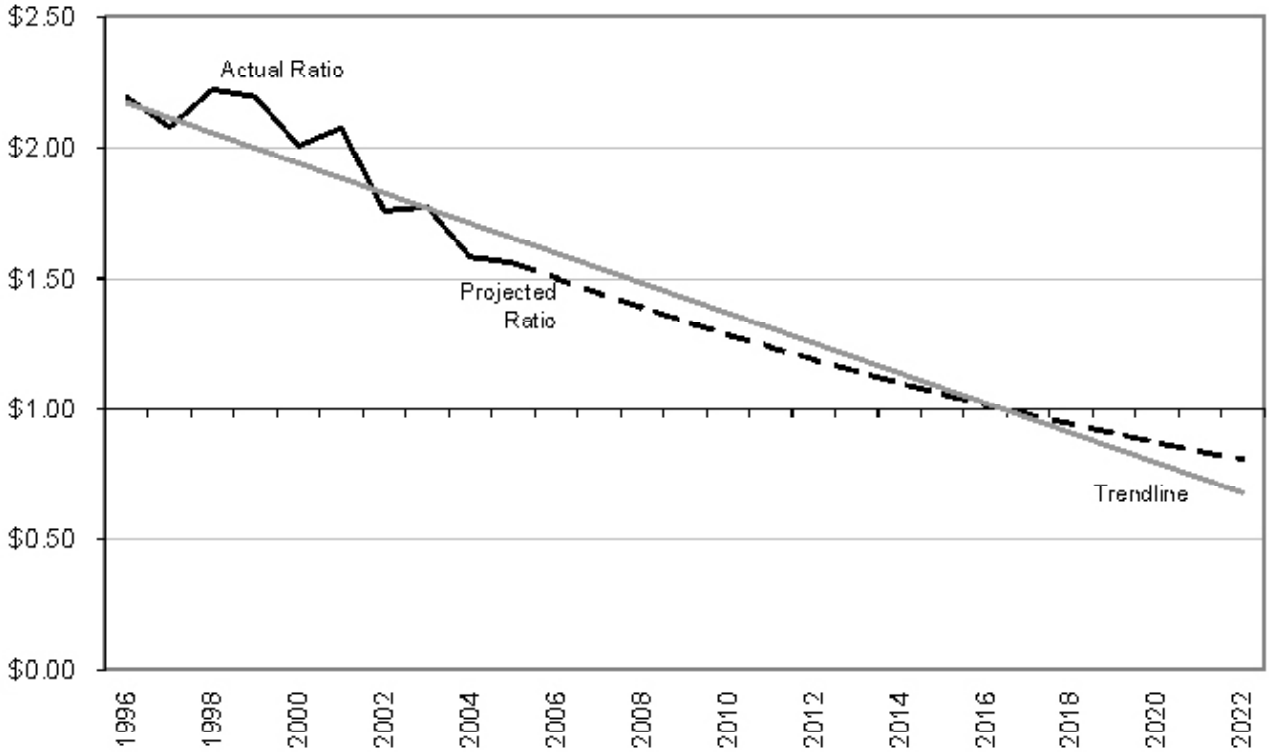
North Carolina
Federal Taxes Paid vs. Federal Spending Received*
1981 to 2005

	Total Dollars ($millions)		Dollars Per Capita				Federal Spending Received Per Dollar of Tax Paid	State Rank (1 is highest)
Year	Federal Taxes Paid to Washington, D.C.	Federal Spending Received	Federal Taxes Paid to Washington, D.C.	State Rank (1 is highest)	Federal Spending Received	State Rank (1 is highest)		
1981	$11,797	$11,189	$1,986	41	$1,884	48	$0.97	31
1982	$12,185	$11,951	$2,030	41	$1,991	48	$0.96	31
1983	$12,155	$12,874	$2,005	40	$2,124	50	$0.90	35
1984	$13,974	$13,626	$2,275	37	$2,218	49	$0.88	42
1985	$15,651	$15,005	$2,512	35	$2,408	50	$0.88	42
1986	$16,685	$15,746	$2,646	34	$2,498	50	$0.86	42
1987	$18,631	$16,598	$2,919	35	$2,600	48	$0.90	40
1988	$20,005	$17,743	$3,096	35	$2,746	47	$0.93	37
1989	$22,243	$19,106	$3,399	32	$2,920	48	$0.91	37
1990	$22,820	$20,573	$3,437	33	$3,099	48	$0.92	36
1991	$23,619	$23,570	$3,497	33	$3,490	47	$0.95	33
1992	$24,889	$26,172	$3,623	34	$3,810	47	$0.95	33
1993	$26,947	$27,352	$3,846	33	$3,904	48	$0.92	37
1994	$29,769	$28,739	$4,163	33	$4,019	47	$0.93	39
1995	$32,224	$30,692	$4,411	33	$4,201	46	$0.95	36
1996	$34,679	$33,370	$4,648	33	$4,472	42	$1.01	29
1997	$38,078	$34,592	$4,999	33	$4,541	39	$1.01	30
1998	$41,642	$35,744	$5,359	31	$4,600	40	$1.01	31
1999	$43,883	$37,482	$5,545	31	$4,736	41	$1.02	31
2000	$47,634	$41,414	$5,920	32	$5,147	37	$1.07	28
2001	$46,843	$44,602	$5,734	33	$5,460	37	$1.07	30
2002	$44,051	$48,180	$5,317	34	$5,815	39	$1.06	28
2003	$42,933	$51,766	$5,117	33	$6,170	38	$1.06	27
2004	$45,854	$55,233	$5,393	33	$6,496	35	$1.06	29
2005	$52,547	$59,162	$6,084	33	$6,850	33	$1.08	27

* During fiscal years in which the federal government runs deficits some spending is financed through borrowing. This creates implicit tax liabilities for states that must be repaid eventually. To incorporate these implicit tax liabilities into the analysis, the following adjustment was made to state tax burdens: First, the total federal tax burden is increased by the size of the federal deficit. Next, this total burden is allocated among states based on each state's proportion of the actual federal tax burden. Finally, adjusted spending-per-dollar-of-tax ratios are calculated by dividing actual expenditures by the adjusted tax figure, effectively making figures deficit neutral.

Source: Tax Foundation Special Report No. 158, "Federal Tax Burdens and Spending by State," and U.S. Census Bureau's Consolidated Federal Funds Report for 2005.

State Taxes Collected per Federal Dollar Received by North Carolina



IS IT FAIR?

9 The Corporate Income Tax

All corporations doing business and chartered in North Carolina pay a flat tax of 6.9 percent of their net taxable income.

Under North Carolina law, a corporation can be a joint stock company or association, an insurance company, a domestic company (organized under state laws), a foreign company (organized under laws other than those of North Carolina), or a limited liability company (LLC).

Not all businesses, however, pay the corporate income tax. Many companies, in particular smaller firms operating as a sole proprietorship, partnership, or S Corporation, pay under the personal income tax provisions. The personal income tax brackets range from 6.0 percent to 7.75 percent, with many smaller firms taxed at the higher rate.

While personal income tax rates have been "temporarily" increased twice in the last decade in North Carolina, the corporate income tax actually declined during the late 1990s:

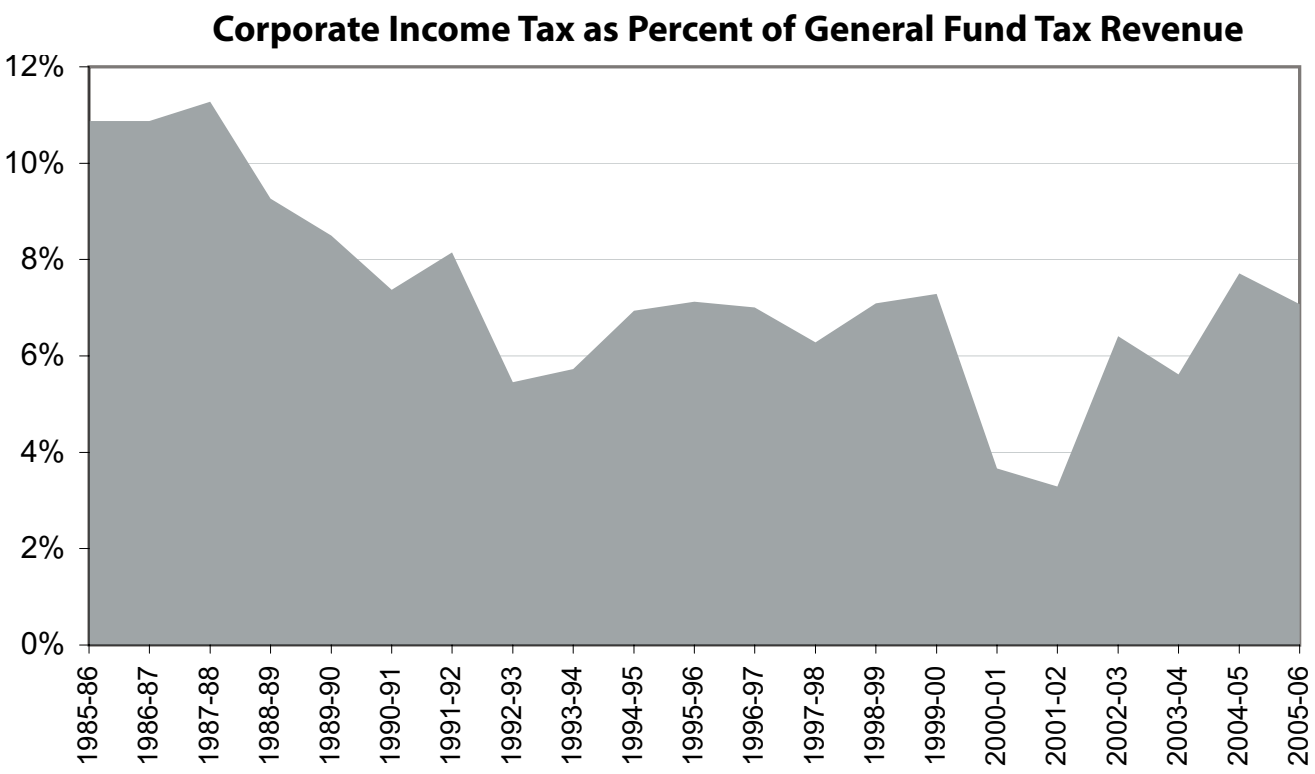
- ➤ 7.50 percent effective for taxable years beginning on or after January 1, 1997
- ➤ 7.25 percent effective for taxable years beginning on or after January 1, 1998
- ➤ 7.00 percent effective for taxable years beginning on or after January 1, 1999
- ➤ 6.90 percent effective for taxable years beginning on or after January 1, 2000

In addition, a variety of exemptions and credits make the effective corporate income tax rate much lower – perhaps by as much as half – than the 6.9 percent rate would indicate. In fact, when measured in proportion to each person's overall tax burden, North Carolina's corporate tax burden is roughly 7 times less than the individual income tax burden. Thus the personal income tax burden, on average, equals 2.8 percent of personal income while the corporate tax burden only represents 0.4 percent of personal income, according to data from 2010. To put these numbers into perspective, consider that in 2010 the state collected about $9.2 billion in individual income taxes, but only $1.3 billion in corporate income taxes.[8]

Still, the corporate income tax remains an important source of revenue for the state. For the past several years, the corporate income tax was the third-highest revenue generator, with only sales and use taxes and individual income taxes generating more revenue. The amount of money derived from the tax, however, fluctuates from year to year, depending upon the economy. For FY2004-05, the corporate income tax accounted for 7.7 percent, or $1.2 billion, of all tax revenue taken in by the state. In 2003-04, the tax accounted for 5.6 percent of total revenue; in 2002-03, 6.4 percent. In 2009-10, the tax accounted for 6.7 percent of state tax collections.

Economists frequently note that high corporate income taxes have an adverse impact on economic growth (cf. Lee & Gordon, 2004). All things being equal, businesses are more likely to relocate to states that have lower corporate tax rates. At the current 6.9 percent rate, North Carolina's high taxes place it at a disadvantage with neighboring states. By comparison, as of 2010, Tennessee's corporate income tax rate is 6.5 percent; Georgia and Virginia charge 6.0 percent; Florida's is 5.5 percent; and South Carolina's is 5.0 percent.

8 "Statistical Abstract of North Carolina Taxes, 2010" North Carolina Department of Revenue, Policy Analysis and Statistics Division



10 How Does The Tax Rate Compare? Large Corporations vs. Small Businesses

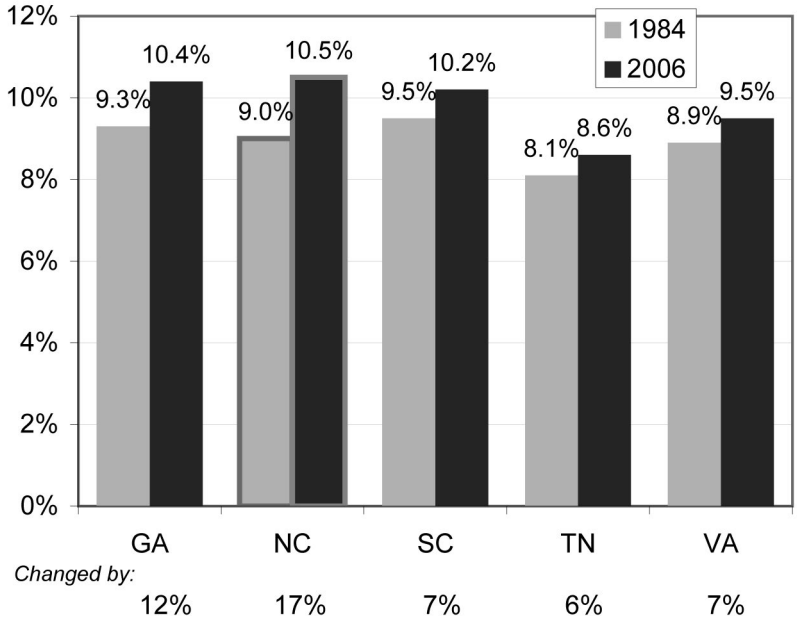
North Carolina's corporate income tax is a flat rate of 6.9 percent. By contrast, many small businesses are taxed at the individual income tax rate of 7.75 percent.

North Carolina's individual income tax applies both to individuals and to many small businesses that operate as sole proprietorships, partnerships, limited liability companies, and S Corporations. The individual income tax rate is based on a sliding scale that taxes persons and businesses with higher incomes at a higher rate. The current tax bracket (as of 2010) ranges from 6 percent for those with the least income to 7.75 percent for those earning more than $60,000 (single filers) or $100,000 for married filing jointly.

Because many small businesses fall into the highest individual tax categories, these businesses must pay the higher individual income tax of 7.75 percent. Thus, many of the businesses that can least afford it are being taxed at a higher rate than their corporate competitors, who pay only 6.9 percent. Yet, according to the U.S. Small Business Administration, small businesses account for half of the private workforce in the United States and between 60 to 80 percent of net new jobs annually. Higher taxes on small businesses translate into fewer jobs for hardworking Americans and lower wages for those that are employed.

At 7.75 percent as of 2010, North Carolina has the highest top marginal tax rate in the southeast, and is 10th highest in the nation. By comparison, South Carolina has a top rate of 7 percent, Georgia 6 percent, and Virginia 5.75 percent. Florida has no state income tax whatsoever, and Tennessee only taxes dividends and interest income, but not earned income. Many critics claim North Carolina's high marginal tax rates make the state regionally uncompetitive, especially for small businesses.

Tax Burden as Share of Personal Income: Southeast States, 1984 and 2006



11 WHAT CAUSED IT? The Budget Crisis of 2001

It is a truism that no single factor can be said to have caused the budget crises of 2001 and 2002. Hurricanes, lawsuits, tax cuts, education spending, a national recession, the September 11 terrorist attack … all these things arguably helped cause or contribute to the budget shortfalls. Democrats, of course, emphasize that the tax cuts pushed through by Republicans between 1995 and 1998 (see "significant tax changes" charts in those years' timeline sections) really caused the crisis – this has something to do with the fact that Democrats attempted to resolve the budget shortfalls by raising taxes. Republicans, on the other hand, tended to blame the crisis on a lack of fiscal discipline and poor financial planning – this has something to do with the fact that the Republicans weren't in the majority or the governor's mansion in 2001 and 2002. At the time, the people of North Carolina tended to find the Republican version of the story slightly more convincing and thus gave the GOP a slim majority in the House in the 2002 election.

Of course, the question of there being a "crisis" at all is a matter of perception (see Q & A: 4). It cannot be denied that baseline sales tax collections dropped sharply in 2001 and 2002 (see chart above) and that corporate income tax revenue also dropped between 2000 and 2002. It also cannot be denied that General Fund revenues decreased in FY2001-2002.

That being said, total General Fund authorizations increased by 1.02 percent for FY2000-2001; by 3.34 percent for FY2001-2002; and then increased again by 3.92 percent in FY2003-2004. Only in FY2002-2003 did authorizations actually decline – by 3.44 percent, or over $500 million. Total authorizations, however, rose from $14.384 billion in FY2000-2001 to $14.914 billion in FY2003-2004. Thus taking FY2000-2001 as a baseline, General Fund authorizations only decreased by $31 million over the course of FY2001 and FY2002.[9]

Even more to the point, in none of these years did the total budget (due to the inclusion of federal dollars) undergo an absolute decline (see Appendix, "Trends in the Total State Budget"). Thus from FY2000-2001 to FY2003-2004, the total budget increased from $24.501 billion to $29.397 billion, with no drop off in between. Moreover, even during the peak of the "crisis" in 2002, the state hired 1,000 new teachers, gave teachers a raise of 1.84 percent, spent $28 million on More at Four, and allocated another $27 million for class-size reduction (see 2002 Timeline). The year before, the state also gave teachers a 2.86 percent raise and state workers a flat $625 raise.

In spite of the economic recession, North Carolina did not cut back spending very much – thanks, in part, no doubt to the tax increases passed in 2001 Even more telling is that the burden of public employees (including federal) per 100 private employees increased between 2001 and 2003 from 18.5 to 19.2. The largest increase in public employment in North Carolina was at the state level. As the private sector was cutting positions, the state increased its number of employees by 4.1 percent. Local governments in North Carolina expanded their employment by 3.3 percent. Meanwhile, private employers cut 163,000 positions – a reduction of 4 percent. Seen from this perspective, the "budget crisis" appears to describe not so much a genuine fiscal crisis as merely a slowing in the rate of growth for the state government.

[9] These numbers reflect adjustments for total current operations. Fiscal Research Division, North Carolina General Assembly Overview: 2006 Legislative Session Fiscal and Budgetary Actions (Revised) (Raleigh: Fiscal Research Division, 2006), Q2-Q3; available from http://www.ncga.state.nc.us/fiscalresearch/frd_reports/frd_reports_pdfs/Overview_2006.pdf.

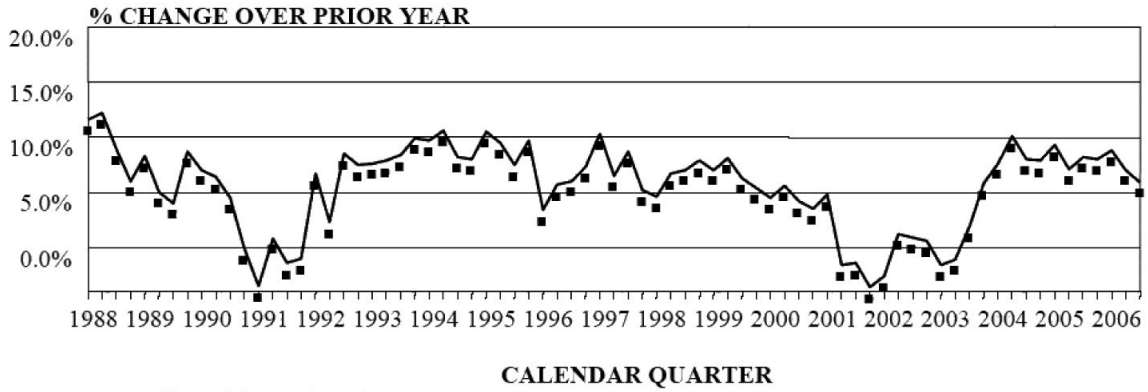
Even granting the existence of a budget crisis, we need at least to mention the impact of those hurricanes and lawsuits. As Figure 1 (below) demonstrates, North Carolina's economy peaked in 1997 and again in 1999. In 1999, however, Hurricanes Dennis, Floyd and Irene hit the state, causing widespread damage. In response, the Legislature met in special session in December and passed the $830 million Hurricane Floyd Recovery Act (S.L. 1999-463es). Similarly, between 1997 and 2000 the state was liable for $596 million in tax refunds stemming from the *Fulton/Smith/Shaver* intangibles tax lawsuits (see Q & A: 12). In 1998 and 1999, the state also paid out $799 million in connection with the *Bailey/Emory/Patton* lawsuits (see Q & A: 13). Each of these settlements likewise resulted in millions of dollars in lost tax revenue.

The box below indicates the decrease in revenue attributable to revenue law changes (including litigation payouts and other factors) made between FY1996 and FY2003:

	Loss	Actual Tax Revenue Collected
FY1995-96	$363.6	$9,428.9
FY1996-97	$454.2	$10,239.1
FY1997-98	$601.5	$11,092.2
FY1998-99	$972.2	$11,965.3
FY1999-00	$1,007.3	$12,423.8
FY2000-01	$1,543.9	$12,572.9
FY2001-02*	$768.5	$13,956.1
FY2002-03*	$770.4	$14,707.8
*Estimated in 2001; includes tax increases		Amounts in millions

The box suggests that as the impact of the tax cuts grew larger, the amount of actual tax revenue increased. This correlation suggests that the tax cuts had a dynamic effect on the economy. In turn, higher rates of economic growth contributed to an increase in overall tax revenue. At the same time that the economy was peaking, the growth of the state government slowed. Thus General Fund authorizations only increased by 1.02 percent for FY2000-2001 – the year in which the impact of the tax cuts reached their zenith and the year before the 2001 tax increases went into effect. The tax cuts thus might be seen, as certainly they were by Republicans, as part of a strategy to force the government to grow in a fiscally responsible manner. What is perhaps even more interesting is that the tax cuts (which in the table on the previous page also include tax refunds and litigation costs arising from *Fulton* and *Bailey*) do not in any way correspond to the FY2003 budget shortfall. Of course, the shortfall was mitigated by the 2001 tax increases, but even accounting for this revenue, it is not as if the cuts match the decline in authorizations dollar for dollar. More

State and Local Sales Tax Revenue Growth



NOTE: Data adjusted for tax law changes.

likely is that the cuts stimulated economic growth, contributing to an increase in overall tax revenue.

Indeed, one could argue that if not for the *Fulton* settlement the FY2003 budget shortfall could have been averted entirely. Likewise, if not for *Bailey*, the Legislature could have set aside additional funds in the Savings Reserve Account, which would have helped the state ride out the 2001 recession. Who knows? If not for Hurricane Floyd, the economic recession might barely have touched North Carolina at all. And if not for the recession …

All of these scenarios highlight the fact that debates about what really caused the 2001 and 2002 budget shortfalls are often misguided. In short, the recession caused the budget shortfall. Recessions, however, will continue to occur as long as the Federal government and central bank continue to orchestrate boom and bust cycles. Unfortunately, North Carolina cannot prevent national recessions from impacting the state, but it can be better financially prepared for these cyclical downturns.

The first question we need to address, then, is whether the state adequately planned for the recession, which it should have known would come, sooner or later. One can argue this issue both ways. On the one hand, we can point to the fact that the Savings Reserve Account was, in fact, fully funded (interestingly enough, by the same people who passed the tax cuts) from FY1995-1996 to FY1997-1998. On the other, we should mention the years – FY1993-1994 and FY1998-1999 – in which the account was barely funded at half its target level. Still, it makes basic economic sense that had the state set aside more money in the so-called Rainy Day Fund it would have had more money to spend when that rainy day came. Let it be granted, then, that fully funding the Savings Reserve Account would have helped the state respond to subsequent budget shortfalls.

So far, though, we haven't really answered the question because we still haven't asked the question as clearly as we might. What many critics really mean when they charge that the tax cuts of the 1990s caused the budget crises of the following decade is that the tax cuts were bad for the economy, bad for the poor, bad for the common good.

Finally, then, here is our question: "Did the tax cuts of the 1990s help or hurt North Carolina's economy?" A necessary corollary to this question is: "Did the tax increases passed in 2001 help or hurt the economy?"

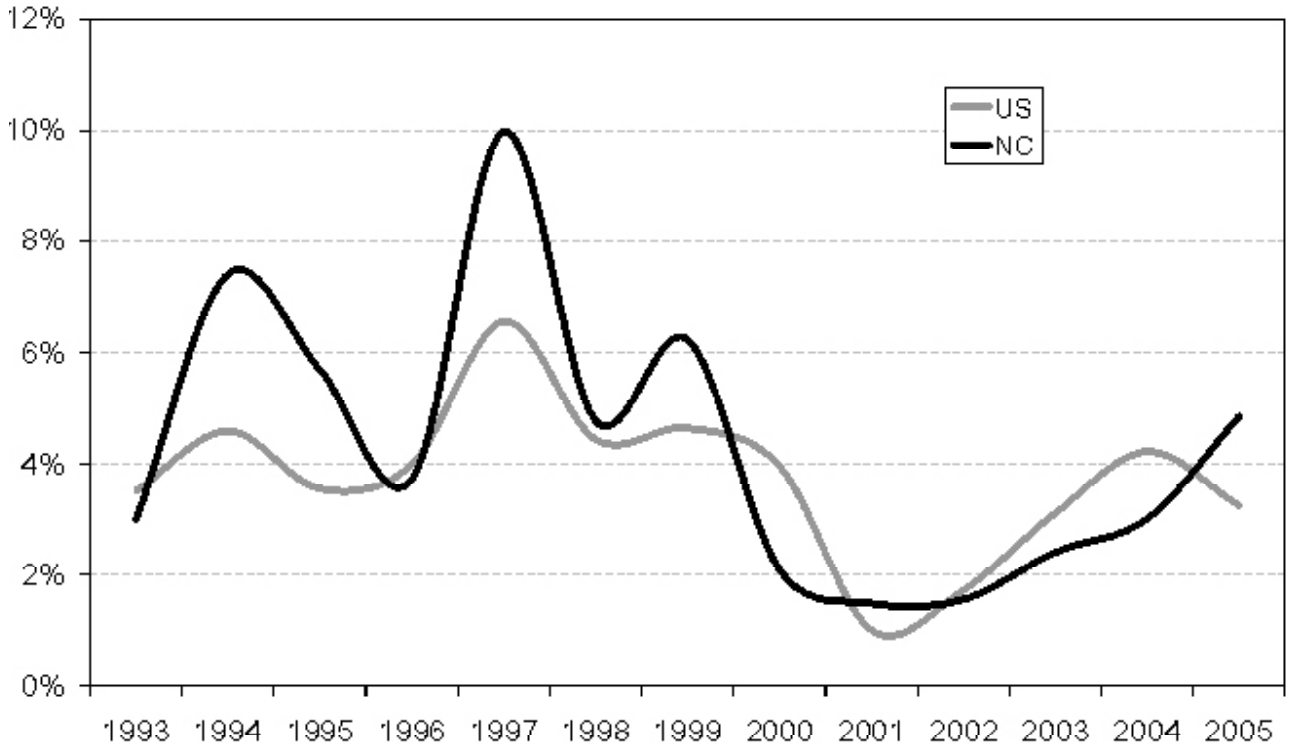
In order to begin to answer these questions we will examine three measures of economic well-being: GDP growth, employment, and tax revenue growth.

During the three-year recession, North Carolina's state GDP remained slightly more stable than the national GDP, with annual average real growth of 1.9 percent from 2000 to 2002. Unlike the national economy, North Carolina's growth never dipped below 1.5 percent per year. As Figure 1 indicates, the 1990s tax cuts correlated with a period of tremendous economic growth in North Carolina. Thus until the start of the recession in late 1999, North Carolina's real economic growth exceeded the national growth rate every year except one. Overall, North Carolina's growth advantage was a healthy 1.6 percent per year.

This is not to say that the tax cuts were solely responsible for North Carolina's strong GDP growth. Still, it is interesting to note that the spike in the state's GDP roughly corresponds with the period following the cuts while the decline in state GDP roughly corresponds with the tax increases. More telling is that in the aftermath of the 2001 tax increases, state GDP did not rebound as in earlier years, but fell behind the U.S. average.

As might be expected, the real impact of the tax increases was not immediately visible. (The "temporary" income tax increase of 0.5 percent went into effect for taxable year beginning January 1, 2001, while the "temporary" sales tax began on October 16, 2001). As the effects of the tax increases trickled down, North Carolina's GDP grew at an average rate of 2.17 percent between 2002 and 2004. During the same period, the U.S. economy grew at an average rate of 2.73 percent per year. By 2003, North Carolina's economic growth rate

Fig. 1. GDP Growth (current prices): North Carolina vs. U.S., 2001 Recession



was only 85 cents to the dollar of U.S. growth. In 2004, the rate of growth had fallen even further behind, slowing to 68 cents per dollar of U.S. growth. In short, it seems as if the 2001 tax increases hindered the state's economic recovery.

By contrast, it seems that the tax cuts actually stimulated North Carolina's economy. Figure 2 shows how North Carolina's employment growth sustained an advantage over the U.S. economy as the tax cuts took effect. Jobs creation was slowing down until the tax cuts kicked in and reenergized the job market.

Job growth started falling only when the national recession began. Unlike the national economy, however, North Carolina's job market took longer to recover. Again, the 2001 tax increases played a role in holding back the recovery: it was not until 2004 that employment in North Carolina actually started to expand again.

While the U.S. economy had recreated by 2003 all the jobs lost during the recession, it took North Carolina another three years to match this achievement. Thus North Carolina did not reach year 2000 employment levels until 2006.

Finally, and perhaps most important for our purposes, is the clear correlation that exists between the tax cuts and a spike in state revenue. Between FY1993-94 and FY1998-99, state budget revenues grew by 32.5 percent. From FY1998-99 to FY2003-04, revenue growth was 26.1 percent.

In sum, it is fair to say that the national recession merely caused a slowdown in the rate of revenue collection. The primary culprit in the budget crisis was escalating state spending commitments leading up to the recession along with a lack of preparedness for the downturn. Tax hikes served to slow the economic recovery.

Savings Reserve as a Percent of the Statutory Cap

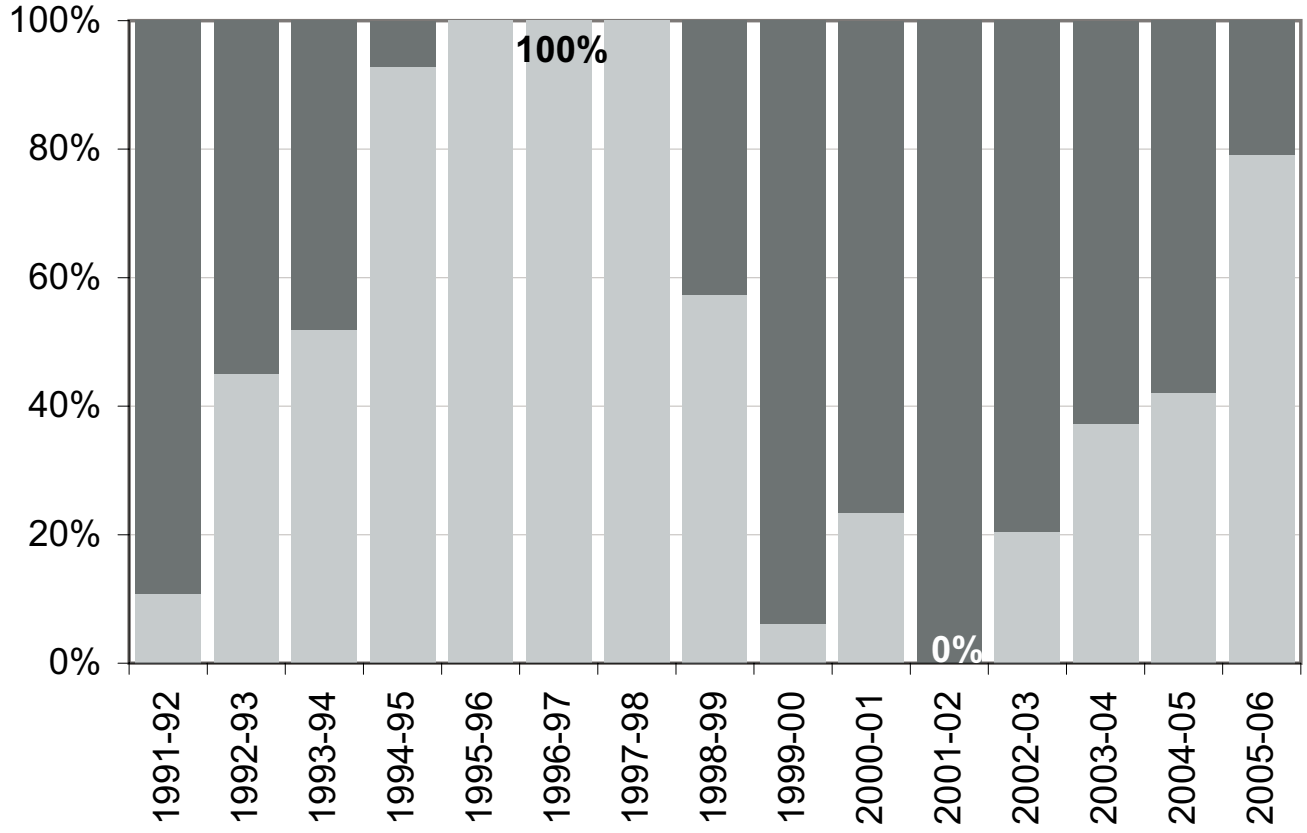
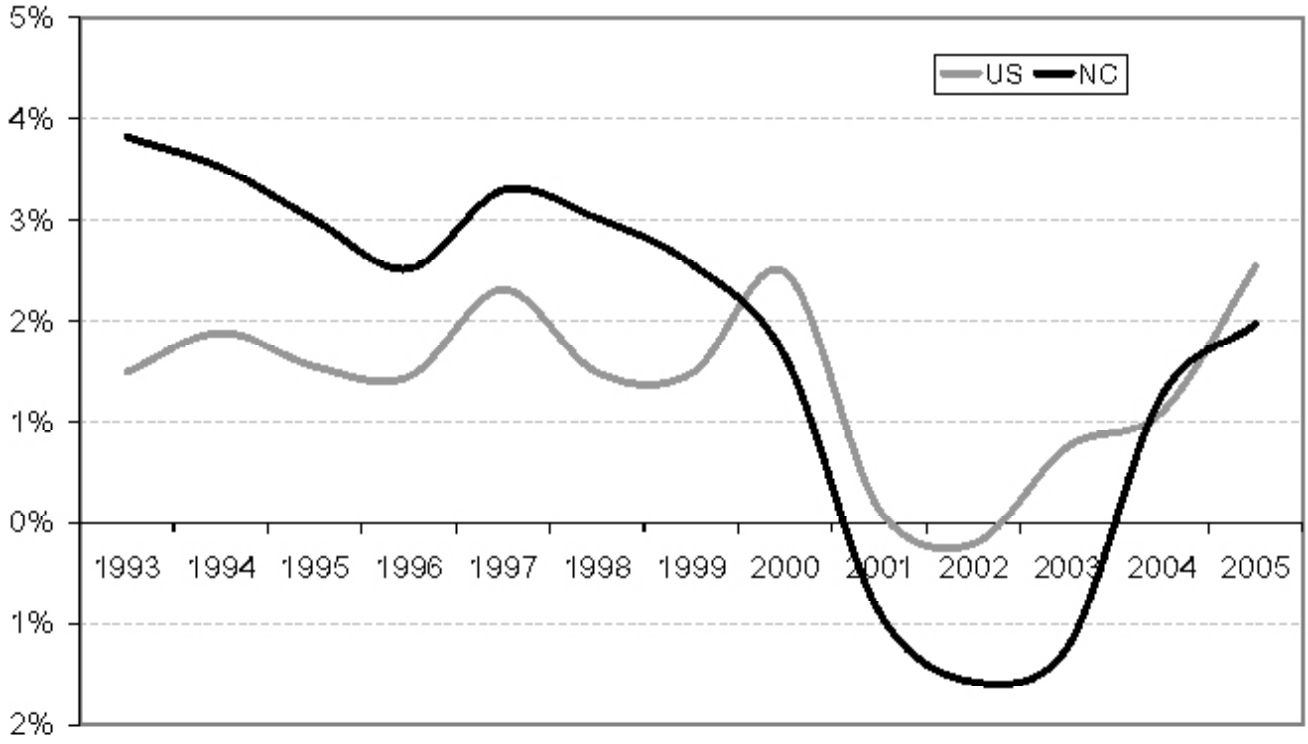
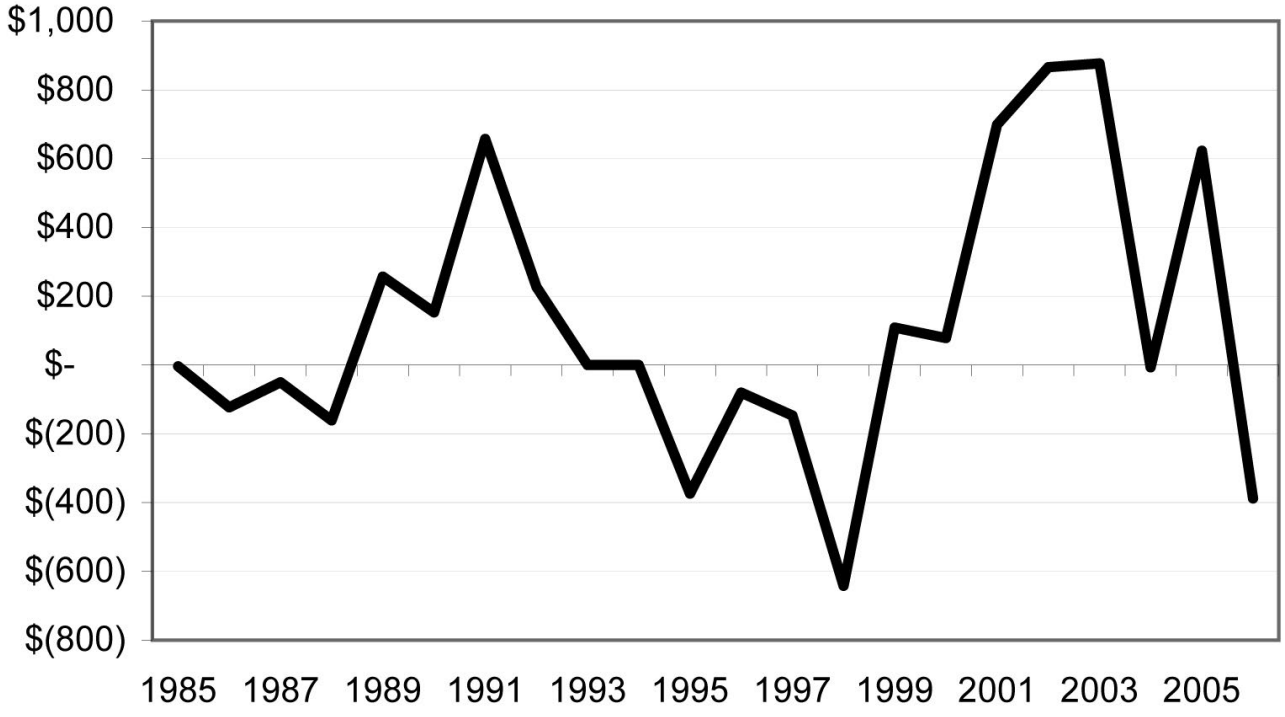


Fig. 2. Private Sector Job Growth: North Carolina vs. U.S., 2001 Recession



Revenue Changes Due to Tax and Fee Changes



12 What is the Intangibles Tax?

WHY WAS IT DECLARED UNCONSTITUTIONAL?

The intangibles tax was enacted in 1937 and remained on the books until its repeal in 1995. Along with taxing accounts receivable, notes and bonds, and beneficial interests in foreign trusts, the intangibles tax stipulated that all shares of stock owned by a business or individual be taxed at a rate of 25 cents per $100 of total fair market value of the stock, regardless of whether the stock earned a dividend or not (cf. G.S. §105-203). The tax, however, did not apply to stock held in any company that paid the state corporate income tax on 100 percent of its income. All other shares of stock were taxed (thanks to a 1939 amendment) at a rate inversely proportional to the amount of corporate income tax paid by the business to North Carolina. As explained in the 1996 U.S. Supreme Court decision, *Fulton Corp. v. Faulkner:*

> Thus, a corporation doing all of its business within the State would pay corporate income tax on 100% of its income, and the taxable percentage deduction allowed to resident owners of that corporation's stock under the intangibles tax would likewise be 100%. Stock in a corporation doing no business in North Carolina, on the other hand, would be taxable on 100% of its value. For the intermediate cases, holders of stock were able to look up the taxable percentage for a large number of corporations as determined and published annually by the North Carolina Secretary of Revenue. In 1990, for example, the Secretary determined the appropriate taxable percentage of IBM stock to be 95%, meaning that IBM did 5% of its business in North Carolina, with its stock held by North Carolina residents being taxable on 95% of its value.

For many years, the business community, in particular, lobbied for the repeal of the intangibles tax. The tax was not eliminated, however, until the Fulton Corporation of Salisbury, N.C., challenged the law on constitutional grounds in a suit filed May 1, 1991. After the North Carolina Supreme Court upheld the tax (*Fulton v. Justus* (1994)), the U.S. Supreme Court heard the case on appeal in October 1995. In a unanimous decision, the high court determined that the law violated the (Interstate) Commerce Clause of the U.S. Constitution because the tax discriminated against corporations in other states "in the hopes of encouraging firms to do business" in North Carolina. Subsequently, the high court remanded the case back to the N.C. Court to determine, in effect, whether the tax should be repealed altogether or be applied equally to all shareholders.

Already, however, North Carolina lawmakers had decided in April 1995 to repeal the entire tax, effective for taxable years beginning January 1, 1995 (S.L. 1995-41). Contrary to media reports that the repeal was a "Grey Poupon bill" aimed at helping the wealthy, the Legislative Research Commission characterized the tax as "unfair" and detrimental to economic development. If the law were rewritten instead of repealed, concluded the commission, the result would be "a tax increase for many taxpayers, particularly individuals who own small, in-state businesses."

Contrary to the General Assembly's clear intentions, the North Carolina Supreme Court decided that the tax should be retroactively applied to stock held in all North Carolina corporations for the years 1990 to 1994 (*Fulton v. Faulkner* (1997)). In response, the General

Assembly passed legislation preventing retroactive collection of the tax (S.L. 1997-17) and also (as prompted by the Wake Country Superior Court) refunded the tax for the years 1990 to 1994 to all those (Class A plaintiffs) who formally protested the tax in accordance with state regulations (S.L. 1997-318). (The tax was refunded only as far back as 1990 due to the five-year statute of limitations regarding refunds). In *Smith v. State* (1998), the North Carolina Supreme Court also granted refunds to a second class of taxpayers (Class B plaintiffs) who had not filed timely protests with the Department of Revenue for taxes paid from 1991 to 1994. Finally, *Shaver v. State* (1998) brought an additional refund for taxes paid in 1990.

While the nullification of the intangibles tax is to be applauded, the elimination of the tax set the stage for even more regressive tax increases in other areas. To begin with, the repeal of the tax resulted in a significant loss of revenue – in particular, for local governments. For six years the state reimbursed local entities (at the 1994 level) for this lost stream of revenue. In 2001, however, the reimbursements stopped and were replaced by a one-half cent increase in the local-option sales tax that was passed with the 2001 Budget Act and went into effect December 1, 2002. Similarly, the refunds arising from the nullification of the tax partially contributed to the so-called budget crisis that precipitated the passage of several other new taxes, including a one-half cent increase in the state sales tax, a one-half percent tax increase for the top income earners, and a 6 percent sales tax on liquor.

All in all, the state was liable for $596 million in tax refunds (including interest) to more than 400,000 taxpayers—the second-largest tax settlement in state history. The first refund of $156 million was paid out in 1997 and taken from the General Fund. The second refund of $200 million was allocated in 1999 and taken from the Savings Reserve Account, which was supposed to have been reimbursed in FY2000-2001, but has never been repaid (cf. S.L. 1999-327). A final refund of $240 million was allocated in 2000 and taken from money devoted to State Aid to Local School Administrative Units, which funds payroll accounts for teachers (S.L. 2000-67). The repeal of the intangibles tax also resulted in the loss of approximately $125 million in annual revenue for the state.

DID YOU KNOW?

As of late 2010, North Carolina had the second highest gas tax rate (30.15 cents per gallon) in the South and the 13th highest in the United States.

Source: API

13 WHAT IS THE *BAILEY/EMORY/PATTON* DECISION?
Taxing Retirement Benefits

The *Bailey/Emory/Patton* decision refers to three lawsuits – *Bailey et al. v. State of North Carolina et al.; Emory et al. v. State of North Carolina et al.;* and *Patton et al. v. State of North Carolina et al.* – that successfully challenged the state's collection of income tax on retirement benefits for certain government employees.

Prior to 1989, benefits received by state and local government retirees were exempt from state and local taxes; by contrast, only a portion of federal retiree benefits were exempt from taxation. In 1989, the U.S. Supreme Court ruled in *Davis v. Michigan* that it was unconstitutional to tax federal retirement benefits differently from state or local benefits. In response, the General Assembly imposed a tax on all government retirement benefits, excluding the first $4,000 (S.L. 1989-792). In 1990, state and local government retirees filed a class action lawsuit representing some 200,000 plaintiffs. Subsequently, state retirees filed a similar lawsuit based on slightly different grounds (*Emory*) while federal retirees also brought suit (*Patton*).

After several years of litigation and five appearances before the state Supreme Court, *Bailey* was finally settled in 1998. In 1991, the N.C. Supreme Court initially ruled against the plaintiffs over matters related to compliance with income tax protest requirements as delineated in N.C.G.S. 105-267. In October 1992, the plaintiffs filed suit again. In September 1995 the Wake County Superior Court ruled in their favor and ordered an income tax refund for those state and local retirees who had filed a timely protest (cf. N.C.G.S. 105-267). The state, represented by then-Attorney General Michael Easley, appealed the decision. Federal retirees also filed suit (*Patton*), claiming that Bailey had not resolved the inequities that existed between state/local retirees and federal retirees because the state had increased the retirement benefits for state retirees at the same time that it had imposed a tax on those benefits, thus reinstating the tax inequalities that existed before *Davis v. Michigan*.

Taking up the three cases in 1998, the N.C. Supreme Court found that the tax on retiree benefits constituted "an unconstitutional impairment of contract and a taking of property without just compensation." As in *Smith v. State*, the court also ruled that refunds could not be limited only to those who had filed a timely protest. *Emory* and *Patton* were likewise settled by the court's ruling, with little comment on the specifics of either case.

In May 1998, the N.C. Supreme Court sent *Bailey/Emory/Patton* back to the trial court with orders regarding who would

> To fix these revenues in a proper manner, regard should be had both to the necessities of the state and to those of the subject. The real wants of the people ought never to give way to the imaginary wants of the state.
>
> Montesquieu

qualify for a refund. But the state settled the cases before the trial court could issue a final ruling. Per legislation passed by the General Assembly that June, the state consented to pay $799 million over two years – FY 1998-99 and FY 1999-2000 – to refund taxes on state, local and federal retiree benefits paid by all vested federal, state, and local government retirees between 1989 and 1997. As a result of the repeal of the unconstitutional tax, the state forfeited approximately $130 million dollars in annual revenue.[10]

14 HOW MANY DOES THE STATE OFFER? Corporate Subsidies

At least 15.

1. **Economic Development Reserve Fund:** Established in 2006 (S.L. 2006-66) with a $10 million appropriation from the General Assembly, the Economic Development Reserve Fund provides funds for grants for site acquisition and economic development projects. The Secretary of the Department of Commerce administers the fund and makes the final decision on grant awards, but the Office of State Budget and Management and the Fiscal Research Division of the General Assembly also keep track of where the funds go and how they are used.

2. **William S. Lee Quality Jobs and Expansion Act:** Repealed, effective January 1, 2007

The Bill Lee Act was replaced in 2006 by (S.L. 2006-252) North Carolina General Statutes, Chapter 105, Article 3J, which created a new tax credit program called "Tax Credits for Growing Businesses." Lee credits are repealed for business activities occurring after January 1, 2007, with Article 3J credits beginning on or after January 1, 2007.

Article 3J provides three types of credits:

- For creating jobs (must create 5-15 jobs with credits ranging from $12,500 to $750 per position);
- For investing in business property (taken over four years, credit is based on a percentage of the cost of capitalized tangible business property that is placed in service during a taxable year);
- For investing in real property in the poorest counties in the state (at least $10 million investment within three years, creating at least 200 jobs in a Tier 1 county gets a credit worth 30 percent of the real estate investment).

The credits can be combined to take up to 50 percent of state income and franchise tax income taxes off of the taxpayer's tax liability. Unused credits in any one year can be carried

[10] For more information, see *Pou Bailey, et al. v. State of North Carolina, et al.*, 53 PA 96 (1998); available from http://caselaw.lp.findlaw.com/scripts/getcase.pl?court=nc&vol=1998/supreme0508/&invol=bailey. See also Statewide Accounting Division, Office of the State Controller, North Carolina Comprehensive Financial Annual Report: For the Fiscal Year Ended June 30, 2000 (Raleigh: North Carolina Office of the State Controller, 2000), 11. Finally, see North Carolina Department of Revenue, "Directive PD-99-1," Personal Taxes Division, March 4, 1999; available from www.dornc.com/practitioner/individual/directives/pd-99-1.html.

over for five additional years. A bonus program for investments in real estate can be carried over for 15 years, with a 20-year carry forward for an investment of at least $150 million over a two-year period.

In order to qualify for the credits, a business must meet certain requirements:

- The credits are offered only to businesses or industries the government has targeted for growth and special treatment. These are as follows: aircraft maintenance and repair firms; air courier services that establish a hub within North Carolina; companies that move their headquarters to North Carolina and create at least 75 new headquarters jobs; customer service call centers; electronic shopping and mail order houses; information technology services; manufacturing; motor sports racing teams; research and development; warehousing; and wholesale trade.
- The average wage for all full-time jobs created under the program must meet or exceed the applicable wage standard of the county where the business is located.
- The business must offer health insurance for all full-time employees and pay at least 50 percent of employee insurance premiums.
- The business must have a clean record (no significant violations) with the North Carolina Department of Environment and Natural Resources for the previous five years.
- The business must have a clean record with OSHA with no serious "willful" or "failure to abate" violations for the previous three years.
- The business cannot have any past taxes due.

Enhanced credits are offered based on designated special needs areas of the state. Counties are divided into tiers based on economic health. The poorer the county, the more generous the credit. Cities with a population of 10,000 or more can designate poorer areas as Urban Progress Zones (UPZ). Counties that have a city with a population of 10,000 or more can designate poverty areas as Agrarian Growth Zones (AGZ). Additional credits are available to businesses willing to expand or locate in UPZ or AGZ.

3. **Industrial Revenue Bonds:** Issued to help new and expanding businesses, Industrial Revenue Bonds (IRBs) provide funds to a manufacturer at a tax exempt interest rate. They are available only to a company engaged in manufacturing and only for land, buildings, and equipment. IRBs are regulated by both state and federal laws.

Three types of IRBs:

- Tax Exempt: $10 million maximum to include the bond amount and capital expenditures over a six-year period that spans three years before and after the baseline date. Federal regulations prohibit any company from issuing more than $40 million nationwide in outstanding tax exempt IRBs at any given period.
- Taxable: Exempt from North Carolina taxes, but not federal taxes. Taxable IRBs cost the borrower more, but can exceed the $10 million tax exempt limit.
- Exempt Facility/Solid Waste Disposal Bond: No restrictions on the amount, and the interest is exempt from both federal and state taxes.

4. **Composite Bonds:** A bond program run by the state that offers tax exempt bonds between $500,000 and $2 million for small to medium-sized manufacturing companies. As with IRBs, the bonds are available only to a company engaged in some type of manufacturing. Proceeds must be used for land, buildings and equipment (fixed assets).

5. **Community Development Block Grants:**

Two types:

➤ Community Development Block Grant (CDBG) funds are available to cities or counties to assist with projects aimed at helping businesses create new jobs or keep jobs in that city or county. Started in 1982, such grants are designed specifically for counties with low to moderate family income levels.

➤ Economic Development Category projects provide assistance to local governments in two areas:

a) Grants for public facilities of up to 75 percent of cost, with the local government providing a 25 percent cash match.

b) Loans through a participating bank to the targeted business for 50 percent or more of the funds needed for construction or to buy machinery, equipment, or property.

6. **The Industrial Development Fund (IDF):** Provides grants, some to local governments and some to businesses, eligible under the Bill Lee Act criteria in the poorer areas of the state — namely, Tiers 1, 2, and 3. Funding depends on the number of new, full-time jobs that are created and can be used for infrastructure needs, equipment or building renovations. Funds from IDF cannot be used to purchase land or buildings or to build new facilities.

There are four categories of funding:

➤ Basic IDF grants or loans to local governments. These grants cannot exceed $5,000 per job created or $500,000 per project and can be used for water, sewer, gas or electrical utility system distribution lines; building renovations; and industrial equipment.

➤ Emergency Economic Development Assistance. These are low interest loans to local governments in areas where 500 or more manufacturing jobs have been lost in the previous 12 months.

➤ Utility Account funds. Available to industries eligible under the Bill Lee Act in Tiers 1, 2, and 3. These funds cannot exceed $500,000 per project and can be used for water, sewer, gas and electrical utility line improvements and construction.

➤ Clean Water Bonds proceeds. Used to provide grants to local governments for clean water projects, such funding must have a favorable impact under the clean water

objectives set out by the state. The money must also be used to benefit industries targeted under the Bill Lee Act that are located in Tier 1, 2, or 3 counties. Projects can include construction or improvements to water and sewer lines, wastewater treatment plants, or water supply systems.

7. **One North Carolina Fund:** The One North Carolina Fund exists to provide cash payments to companies seeking to locate or expand in North Carolina. The fund is under the control of the governor and is dispersed solely at his or her discretion. It is often referred to as the governor's "walking around money." The governor decides which companies receive a subsidy and how much they get. More specifically, the fund is used to close deals for the recruitment, expansion, or retention of new and existing businesses. The money is distributed via local governments that must also provide matching grants.

One North Carolina funds can only be used for the following purposes:

- ➤ Equipment installation or purchase;
- ➤ Repairs or renovations to existing buildings for expansions;
- ➤ Improvements to or construction of new water, sewer, gas or electric utility lines or equipment for existing buildings;
- ➤ Improvements to or construction of new water, sewer, gas or electric utility lines or equipment for new or proposed buildings used for manufacturing or industrial operations;
- ➤ Any other actions deemed appropriate by the General Assembly.

The Department of Commerce is required to file a report at the end of each fiscal quarter on how the money in the One North Carolina Fund has been committed, disbursed and used. Governor Jim Hunt established the fund in 1993 as the Governor's Industrial Recruitment Competitive Fund; Gov. Mike Easley renamed it the One North Carolina Fund in 2004. In 1993, the General Assembly allocated $5 million for Gov. Hunt's special pool of grant monies to help "close deals"; in 2006, they gave Gov. Easley $15 million.

> We might come closer to balancing the Budget if all of us lived closer to the Commandments and the Golden Rule.
>
> Ronald Reagan

8. **Job Development Investment Grant Program (JDIG):** JDIG was passed in 2002 (S.L. 2002-172, s. 2.1(a)) with the aim of providing recurring yearly grants to new and expanding businesses in an effort to stimulate the economy and create new jobs. JDIG gives select employers a tax credit equivalent of anywhere from 10 percent to 75 percent of an employee's withholding tax for eligible positions, with a 12-year maximum on the length

of the grant. Eligibility for the credit requires that the business provide health insurance and pay at least 50 percent of insurance premiums for all full-time employees hired under JDIG. Retail facilities are not eligible to receive JDIG grants.

The JDIG program was effective beginning in January 2003 and is supposed to sunset in January 2008.

9. **One North Carolina Small Business Fund:** Established in 2006 with a nonrecurring $5 million appropriation (S.L. 2006-66), the One North Carolina Small Business Fund provides money to small businesses to encourage them to apply for federal innovation grants.

10. **Industrial Access/Road Access Fund:** Funds offered through the North Carolina Department of Transportation for the construction of roads when needed for access to new or expanding industrial businesses.

11. **Rail Industrial Access Funds:** Funds offered to new or expanding industries to help in financing construction or rebuilding railroad tracks needed for access to a business, with a requirement that the business create a certain number of new jobs or capital investment results.

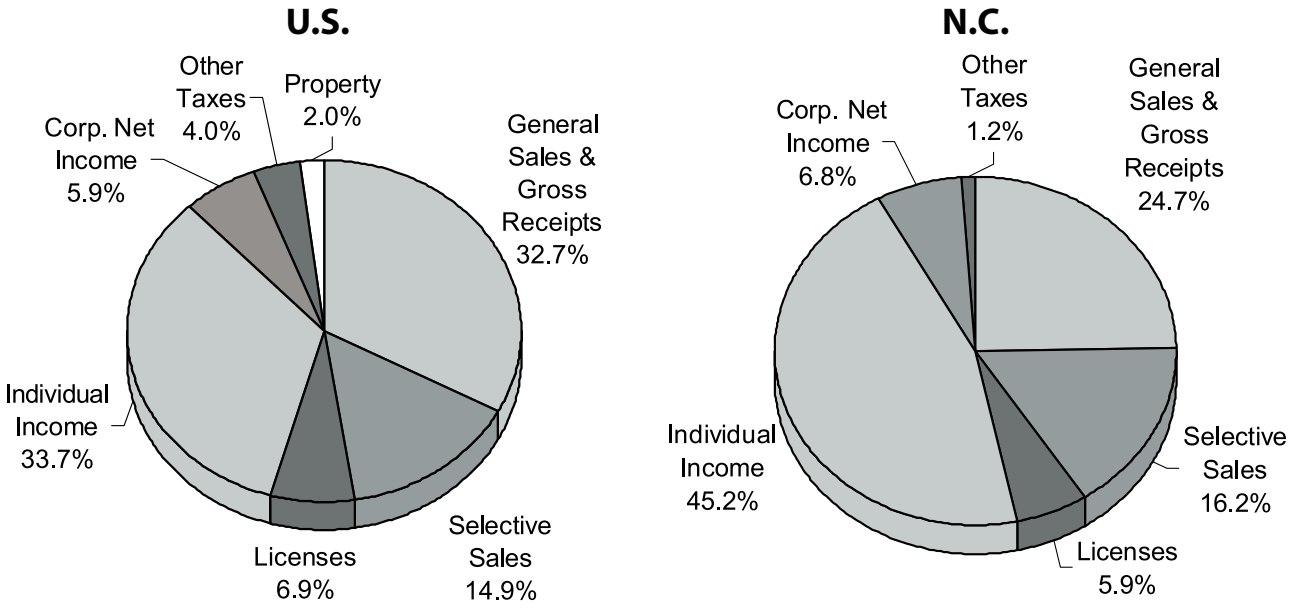
12. **Tax Increment Financing:** Tax increment financing (TIF) is used by local governments to provide incentives to developers and others who presumably would not otherwise choose to invest in certain areas. Such financing often entails providing subsidies for land acquisition and/or for installing or improving infrastructure for water, sewerage, streets, and local services. The financing may even entail giving away or selling land at an attractive price to developers (see Q & A: 15).

13. **County and Local Subsidies:** Counties and cities have recently joined the corporate welfare bandwagon by offering select companies taxpayer subsidies, often in addition to those already offered by the state. In July 2006, the town of Holly Springs, for instance, made news by offering Novartis a $20.8 million package that, according to the *News & Observer*, included providing 167 acres of cleared land, new road, water and sewer service, a new fire truck, and priority snow-plowing service.

14. **The Golden LEAF Foundation:** A non-profit corporation created in 1999 at the urging of then-Attorney General Mike Easley. Golden LEAF uses funds from North Carolina's share of the national tobacco settlement to distribute economic development grants to tobacco-dependent and/or economically distressed counties. The foundation's board is appointed by the governor, the President Pro Tem of the Senate, and the Speaker of the House. By 2025, it is estimated the foundation will have received $2.3 billion (or 50 percent) of North Carolina's share of the tobacco settlement monies. By the end of 2010, Golden LEAF had dispersed more than $450 million in grants to various government entities and non-profits. Critics charge that the foundation operates as little more than a slush fund controlled by Democrat leaders.

15. **Slush Funds:** Pots of money are available to the Speaker of the House and President Pro Tem of the Senate, through the Department of Transportation and the Economic Reserve Fund. These funds are distributed to select companies with little or no accountability or oversight.

Sources of Revenue: U.S. and N.C., 2006



15 What Is It? Tax Increment Financing

Called "Project Development Financing" in North Carolina, tax increment financing (TIF) is used by local governments to provide incentives to developers and others who presumably would not otherwise choose to invest in certain areas. Such financing often entails providing subsidies for land acquisition and/or for installing or improving infrastructure for water, sewerage, streets, and local services. The financing may even entail giving away or selling land at an attractive price to developers.

The TIF concept is based on the idea that development will enhance property values in a particular area and, in turn, bring about an increase in property tax revenue. The projected revenue increase is used to secure bonds or guarantee the repayment of other funds. Municipalities can therefore issue bonds without committing the "full faith and credit" of the government and without voter approval. The incremental increase in property tax revenue from a proscribed area is then used to pay back the bond or borrowed funds. Once the money is repaid, the increased tax revenue goes into the municipality's general fund.

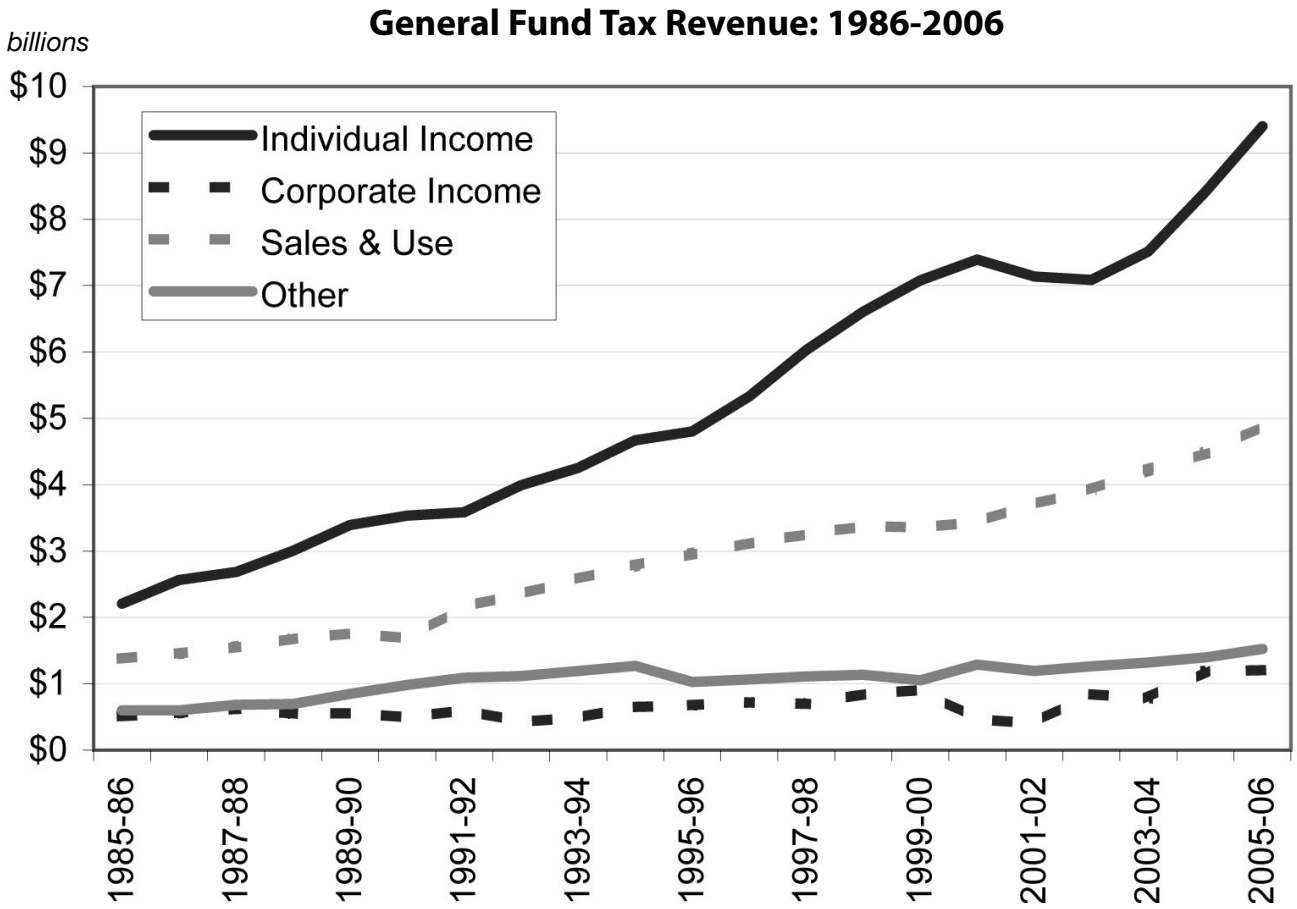
Tax increment financing was first implemented in California in 1952; it has been used for more than 40 years in some states, and for only a few years in others. Only Arizona does not permit its use.[11] In 2004, following the General Assembly's 2003 passage of the Project

[11] Larry Marks, "The Evolving Use of TIF," *REVIEW* 18, no. 1 (2005); available from http://www.development-strategies.com/images_NEW06/evolving_tif.pdf.

Development Financing Act, North Carolina voters narrowly approved a constitutional amendment to allow TIF. Proponents argued that the financing method is needed for blighted areas that are too risky for privately financed development. They claimed the financing would attract jobs and revitalize communities.[12] Opponents argued that in addition to encouraging suburban sprawl, such financing is just another form of corporate welfare that takes voters out of the local decision-making process. Moreover, TIF represents a risk for existing taxpayers who are obligated to repay such loans if new development fails to cause an increase in tax revenue.[13]

[12] Michael Lowery, "Debate About Amendment One Heats Up," *Carolina Journal Online* (September 29, 2004); available from http://www.carolinajournal.com/exclusives/display_exclusive.html?id=1845.

[13] Robin Staudt, "Amendment One, what is it, and what does it mean?" *Freedom Works* (October 12, 2004); available from http://www.freedomworks.org/informed/issues_template.php?issue_id=2107.



16 WHAT ARE THEY? "Temporary" Taxes of 2001

A temporary tax, as opposed to what might be called a "permanent" tax, is supposed to be just that – "temporary." In reality, though, temporary taxes rarely come off the books. Here in North Carolina, two temporary taxes that were first passed in 2001 remained in effect until 2008, with a portion of one of the taxes becoming permanent.

In response to a projected budget shortfall of $791 million – caused by the 2001 recession and exacerbated by the state's refusal to prepare for such an eventual economic downturn – the FY2001-02 budget (S.L. 2001-424) mandated a "temporary" sales tax increase of ½ cent that raised the state sales tax rate from 4.0 percent to 4.5 percent. By law, the tax was to remain in effect from October 16, 2001, to July 1, 2003. Combined with the local sales tax rate of 2 percent, total sales taxes paid by North Carolina consumers reached 6.5 percent (Mecklenburg County levied an additional 0.5 cent in 1998, which is still in place). The budget also included a provision that permitted local entities to permanently raise their own sales tax rate by ½ cent beginning July 1, 2003 (this date was subsequently pushed forward to December 1, 2002).

Along with raising the state and local sales tax by one cent, the FY2001-02 budget also created a new "temporary" income tax bracket of 8.25 percent on annual earnings in excess of $100,000 or $200,000, depending on the manner of filing. The tax bracket increase of 0.50 percentage points (from 7.75 percent to 8.25 percent) was to remain in effect for "taxable years beginning on or after January 1, 2001, and expire for taxable years beginning on or after January 1, 2004."

The so-called temporary taxes proved difficult for lawmakers to part with. More than once, legislators broke their promises to allow these taxes to expire. In 2003 and 2005, legislators voted to extend the temporary taxes. Only in 2006 – just prior to the November elections – did the General Assembly finally allow half (¼ cent) of the temporary sales tax increase to expire. In 2007, legislators permitted the temporary income tax increase to sunset, but then made the other half of the temporary sales tax increase permanent.

Following is a timeline summarizing the life of the 2001 "temporary" taxes:

2001 As part of the FY2001-02 budget, the General Assembly passes both "temporary" taxes. The state sales tax will increase by ½ cent – from 4.0 to 4.5 percent – on October 16, 2001, and is scheduled by law to expire on July 1, 2003. Moreover, the budget contains a local option ½ cent sales tax increase that will go into effect when the statewide temporary sales tax ends. The top marginal income tax rate is increased from 7.75 percent to 8.25 percent, effective January 1, 2001 (so that it applies to the 2001 tax year) and is scheduled to sunset on January 1, 2004.

2002 S.L. 2002-123 accelerates the implementation of the ½ cent local option sales tax rate forward to December 1, 2002 (up from July 1, 2003). No expiration date is included in the bill. The law increases the total sales tax rate in North Carolina to 7 percent (except for MecklenburgCounty, which adds yet another ½ cent to the sales tax).

2003 In the FY2003-04 budget, lawmakers renege on their promise to let the temporary taxes expire. The ½ cent statewide sales tax is extended for another two years – to July 1, 2005. The tax is renewed in spite of the ½ cent local option sales tax increase approved the previous year. Thus, the sales tax rate remains at 7 percent. Likewise, the expiration of the highest marginal income tax rate of 8.25 percent is extended for another two years, to January 1, 2006.

2005 Lawmakers once again break faith with voters by renewing the temporary taxes. The FY 2005-06 budget extends the ½ cent statewide sales tax for another two years, with a new expiration date of July 1, 2007. Similarly, the sunset for the 8.25 percent income tax rate is pushed back to January 1, 2008.

2006 The FY2006-07 budget includes a provision to accelerate the expiration of the "temporary" sales tax. The statewide sales tax is reduced by ¼ cent as of Dec. 1, 2006, lowering the overall sales tax on North Carolina consumers to 6.75 percent. No mention is made of the remaining ¼ cent "temporary" statewide sales tax rate, meaning it is still set to expire on July 1, 2007. The ½ cent local option sales tax increase from 2002, however, remains on the books. The "temporary" individual income tax rate of 8.25 is scheduled

to fall to 8 percent for taxable year beginning Jan. 1, 2007, and then fully sunset taxable year beginning Jan. 1, 2008.

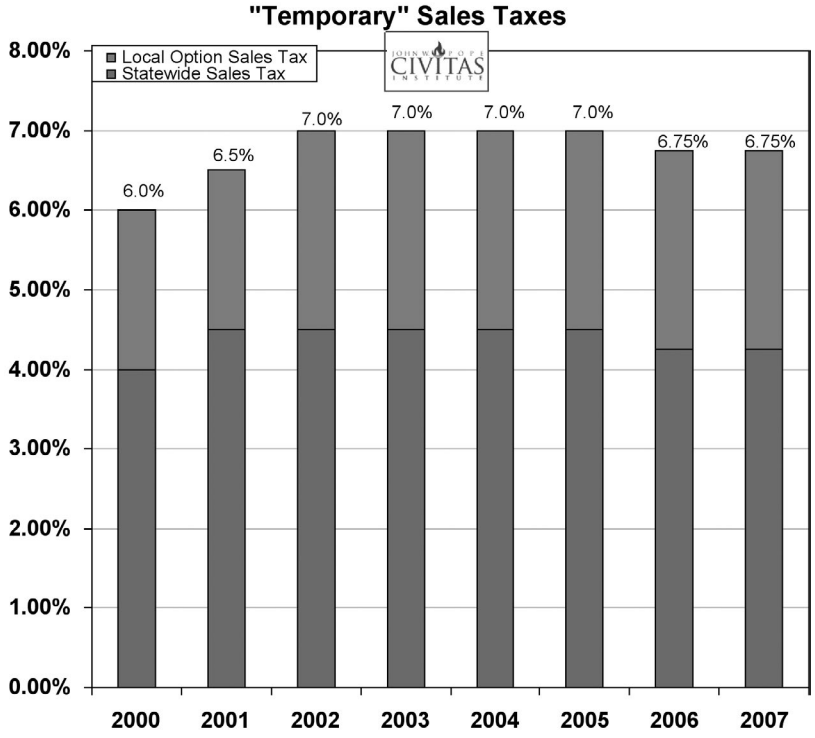
2007 In spite of much debate, the FY2007-09 biennial budget does not reverse last budget's promise regarding the "temporary" income tax rate, meaning it will finally sunset on January 1, 2008 – a full four years after originally promised. The remaining ¼ cent statewide sales tax is made permanent, leaving North Carolina with an overall sales tax rate of 6.75 percent – a 12.5 percent increase in the sales tax rate over the 2000 level.

Using budgetary overview reports issued by the General Assembly, we estimate that the "temporary" sales and income taxes drained more than $2 billion from North Carolina's economy since their originally scheduled sunset date of 2003.

- Since the original sunset date of 2003, taxpayers have paid more than $1.46 billion in extra taxes due to the "temporary" sales tax. Add to this another $258.4 million projected for FY2007-08 and the total comes to $1.72 billion in additional temporary sales taxes over four years.
- Taxpayers paid another $312 million in additional income taxes thanks to the extension of the temporary income tax rate.
- In total, lawmakers taxed North Carolina citizens an extra $2.03 billion by extending the temporary taxes beyond their originally approved sunset dates.

Meanwhile, lawmakers enjoyed a windfall of more than $3.1 billion in total surpluses from FY2003-04 through FY2007-08. If we compare the surplus during this time to the estimated revenue of $2.03 billion generated by extending the "temporary" taxes, it seems the additional taxes were used to finance much of the surplus spending that legislators engaged in once the economy recovered in 2003.

- Spending increased by 39 percent from FY2003-04 through FY2007-08.
- During the same period, the state collected more than $3.1 billion in total surplus revenue.



17 WHAT IS IT? Structural Budget Deficit

A structural deficit occurs when existing budgetary commitments outpace current revenue. Such deficits are often caused by the use of nonrecurring revenue to fund recurring expenses. Nonrecurring revenue is "one-time money" that cannot be expected to be regularly derived from the state's tax structure and anticipated revenue growth. While higher than anticipated revenues will mask a structural deficit, the imbalance will reappear when revenues decline, especially during an economic downturn. In response to such downturns – such as the 2001 recession – legislators will be forced to cut spending, raise taxes, or both.

Structural deficits have been an ongoing problem in North Carolina for the past few years. Consider the following:

- The FY2006-07 budget increased spending by 10 percent. The budget committed the state to $882 million in new recurring expenditures, with only $500 million in new recurring revenue to pay for the ongoing obligations. The new $382 million in permanent obligations paid for with one-time money created a structural deficit going forward.
- The structural deficit created by the FY2006-07 budget was masked by higher-than-anticipated revenue for FY2007-08. In fact, the state enjoyed a budget surplus of $1.4 billion for FY2007-08, allowing lawmakers to continue to postpone tough decisions regarding the state's structural deficit.
- The underlying structural deficit has reared it ugly head in 2008-09, as the state scrambles to fill a budget hole exceeding $2 billion.

18 WHAT IS IT? AND HOW LARGE IS IT?
The Unfunded Liability for Retired State Employee Health Benefits

The state of North Carolina pays 100 percent of the premiums for retired state employees enrolled in the state health plan. This group includes former employees of state agencies, universities, local public schools, and local community colleges. Recent estimates place the state's unfunded liability for these payments at $29 billion.

North Carolina uses a pay-as-you-go method of funding healthcare premiums for retired state workers, meaning that each year the state allocates funds sufficient only to pay for the enrollment premiums of current retirees. To finance the retiree health premiums, each state agency is given General Fund dollars based on a percentage of total payroll for that agency during the fiscal year. For example, the pay contribution rate for FY2005-06 was equal to 3.8 percent of budgeted payroll. Under this method, $477 million was dedicated in FY2005-06 toward funding state retiree health premiums. The pay contribution rate is adjusted annually to reflect the anticipated costs to cover current retirees only.

New reporting standards established in 2005 by the Governmental Accounting Standards Board (GASB) called for states to calculate and disclose the future costs – in today's dollars – of paying for enrollment premiums to future retirees. GASB is a private, nonprofit organization that sets standards for public agencies to meet Generally Accepted Accounting Principles (GAAP). States tend to comply with GASB standards, not because of any legal obligation, but because such unfunded liabilities are used by bond rating agencies to determine the credit risk of state bond obligations.

In 2006 the state of North Carolina hired Aon Consulting of Chicago to calculate the cost of the unfunded retiree health premium benefits accumulated as of December 31, 2005. The report estimated this unfunded liability at $23.79 billion, which was 113 percent of the entire General Fund budget for FY2007-08. By comparison, the state of Texas' liability was only 18 percent of its annual budget.

A new report released in late 2008 calculated the unfunded liability at $29 billion as of Dec. 31, 2007. In other words, the liability grew by $5 billion in just two years.

To better understand the burden this liability will place on the state budget, we can examine the "annual required contribution" (ARC) for the state of North Carolina. The ARC is the amount required to keep up with the future benefit obligations as they are acquired plus paying down the already accrued obligations spread out over the next 30 years. As of December 31, 2007, North Carolina's ARC comes to $2.7 billion annually, an amount sure to grow as the number of state employees continues to multiply.

To date, the state has done virtually nothing to address the nearly $29 billion shortfall it is facing. In FY2003-04, the state created the Retiree Health Benefit Trust Fund (RHBTF) to finance the health plan enrollment premiums for state retirees. The purpose of the RHBTF is to accumulate unused contributions and protect them from being used for any other purpose. Currently, the fund contains $296 million, which reduces the state's unfunded liability accordingly. In 2007, Representative Dale Folwell (R-Forsyth) introduced legislation to increase the payroll contribution rate used to appropriate General Fund

The unfunded liability for state retiree health benefits comes to more than $3,200 for every man, woman and child in North Carolina – or nearly $13,000 for a family of four.

dollars to each state agency in order to better fund the state's future obligations for retiree health benefits. Folwell's bill died in committee.

A major factor contributing to the size of the state's unfunded liability are the generous eligibility criteria established when fully financed retiree health premiums were first implemented in 1978. Only five years of service were required for a state employee to become eligible for fully subsidized health insurance premiums for the duration of their retirement. In an effort to reign in the growth of unfunded retiree health benefit obligations, the General Assembly passed legislation (S.L. 2006-174) in 2006 requiring future retirees to have 20 or more years of "retirement service credit" to be eligible for fully subsidized health insurance premiums. State employees retiring with 10 to 20 years of service will have half of their insurance premiums covered by the state. State workers retiring with 5 to 10 years of service will still be able to enroll in the state health insurance plan, but will be fully responsible for their own premium payments. Employees with less than 5 years of service are not eligible for the state retiree health plan. The new rules apply to state employees first hired on and after October 1, 2006, and members of the General Assembly first taking office on and after February 1, 2007.

19 WHERE DID THE MONEY GO?
American Recovery and Reinvestment Act of 2009

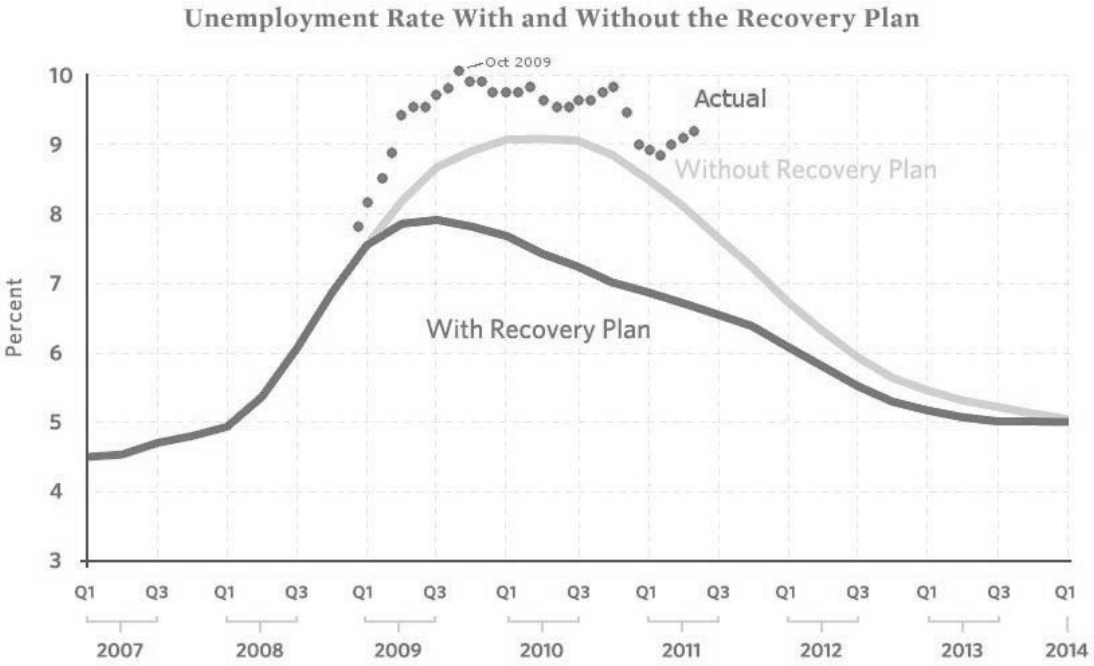
The American Recovery and Reinvestment Act (ARRA), often referred to as the federal stimulus bill, was signed into law on Feb. 17, 2009 by President Barack Obama. In response to the deep and lasting economic recession that began in late 2007, the 1,100 page stimulus bill was a massive federal spending plan passed with the intent of saving or creating 2.5 to 3.5 million jobs. ARRA included $787 billion in total spending – much of it borrowed. Funding in the bill included the following major categories:

- $288 billion in tax incentives for individuals and businesses. Incentives included a temporary payroll tax credit, expansion of the child tax credit, a homebuyer tax credit and a credit to companies investing in renewable energy production.
- $144 billion in aid to state and local governments. This money is allocated mostly to state governments in order to help them balance their budgets. Most of the money was designated for Medicaid programs and public education spending.
- $105 billion for infrastructure improvements. This included highway, bridges, high-speed rail, government building, sewers, parks, broadband and renewable energy investments.

- $81 billion for welfare programs. Most of these funds went toward extending and enhancing unemployment benefits along with an increase of the food stamp program.
- $18 billion for scientific research and other miscellaneous projects. The dubious nature of many of these projects became subject for ridicule. One such project funded with federal stimulus money in North Carolina involved a Wake Forest University research project investigating the effect of cocaine use on monkeys.

In terms of job creation, the stimulus bill falls well short of the Obama administration's predictions. In a now-notorious chart released by White House economists, unemployment is projected to remain below 8 percent – thanks to the stimulus plan – and drop down under 7 percent by mid-2011. Even without the stimulus plan, those same economists predicted that the recession would fade after a couple of years, albeit more slowly. Their projections for unemployment without the stimulus plan had the jobless rate peaking at around 9 percent and dropping below 8 percent by mid-2011.

In reality, national unemployment reached above 10 percent with the stimulus plan and remained much higher than expectations. By mid-2011, when administration economists predicted unemployment would be less than 7 percent, the national unemployment rate stood above 9 percent. (see chart)



North Carolina's share

North Carolina was slated to receive roughly $6.1 billion in federal dollars over the span of two years via the stimulus bill. The largest share – about $2.35 billion – was directed toward subsidizing the state's share of Medicaid expenses. The bill also included $1.2 billion for state public education, largely to avoid teacher and staff layoffs. Also included

was $339 million for high-poverty schools, $334 million for special education, and $17 million for Head Start.

Roughly $2.4 billion of the federal stimulus dollars was used to backfill state General Fund appropriations.

Funding for infrastructure projects in North Carolina included $776 million for highways and bridges, $131 million for mass transit, $66 million for water treatment, $72 million for sewers, and $113 million for "weatherizing" low-income homes.

Gov. Perdue's reaction to the signing of the stimulus bill was extremely upbeat. "I am committed to putting the federal recovery funds to use with a high level of efficiency, transparency and accountability. While the funds won't solve all of the challenges facing North Carolina and the nation, they are critical to getting North Carolina back on track. The funds will help rebuild our infrastructure, grow our economy, stabilize our budget and get North Carolinians back to work" said Perdue.

Her optimism, however, proved to be a bit misplaced. Unemployment in North Carolina in February 2009 – when the stimulus bill was signed – stood at 9.9 percent. Two years, and more than $6 billion later, the state's unemployment rate remained virtually unchanged at 9.8 percent.

You just don't see people running through the streets to have the deficit cut.

M. Kathryn Eickhoff, Chief Economist, OMB

OVERVIEW

1975-1984

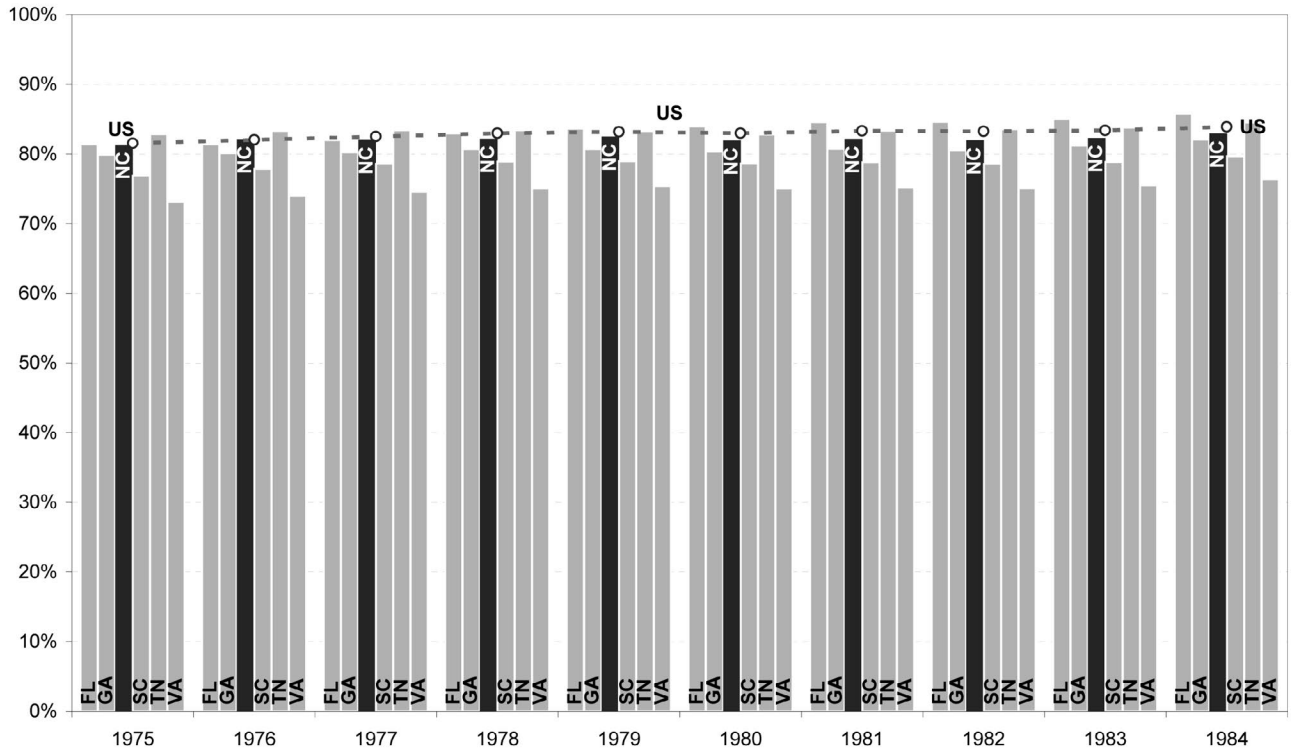
General Economic Trends: 1975-1984

From the mid-1970s to the mid-1980s, the U.S. economy went through two distinctly different phases. The last half of the 1970s was a period marked by a dramatic recession and double-digit inflation, while the first half of the 1980s thrived under the Reagan recovery. The North Carolina economy followed the path of the national economy, although recovery for the state came somewhat later.

In North Carolina, the nature of the recovery is indicated by a shift in two economic indicators: private employment as a share of total nonfarm employment and personal per capita income compared to the national average.

As shown in Figure 1, from 1975 to 1984 North Carolina's private employment share rose marginally, from 81 percent of total nonfarm employment to 83 percent. While the U.S. economy grew more strongly, North Carolina remained one percentage point behind the national average. Virginia, by contrast, experienced stronger growth in private employment, although at much lower levels: from 73 percent of total nonfarm employment to 76.5 percent.

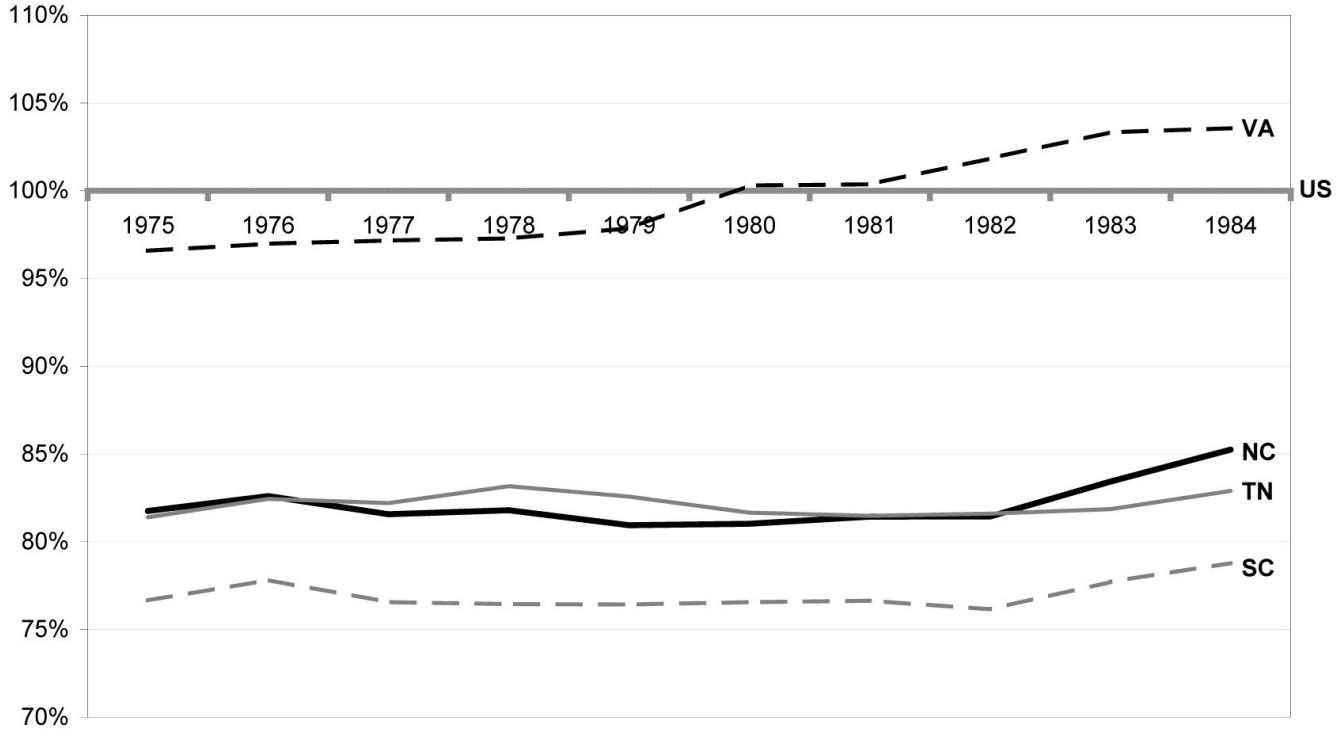
Fig. 1. Private Share of Total Nonfarm Employment: Southeast States, 1975-1984



In neighboring states, such as Virginia, the growth of private sector employment translated into rapidly growing per capita personal income. Compared to the U.S. average, Virginia's per capita personal income grew from 96 cents to $1.03. This means that by 1985, Virginians were making 3 percent more than the national average.

North Carolina, by contrast, trailed the national average for the entire time period, although from 1980 to 1985, the state's per capita personal income rose from 81 cents to 85 cents of the average U.S. per capita personal income.

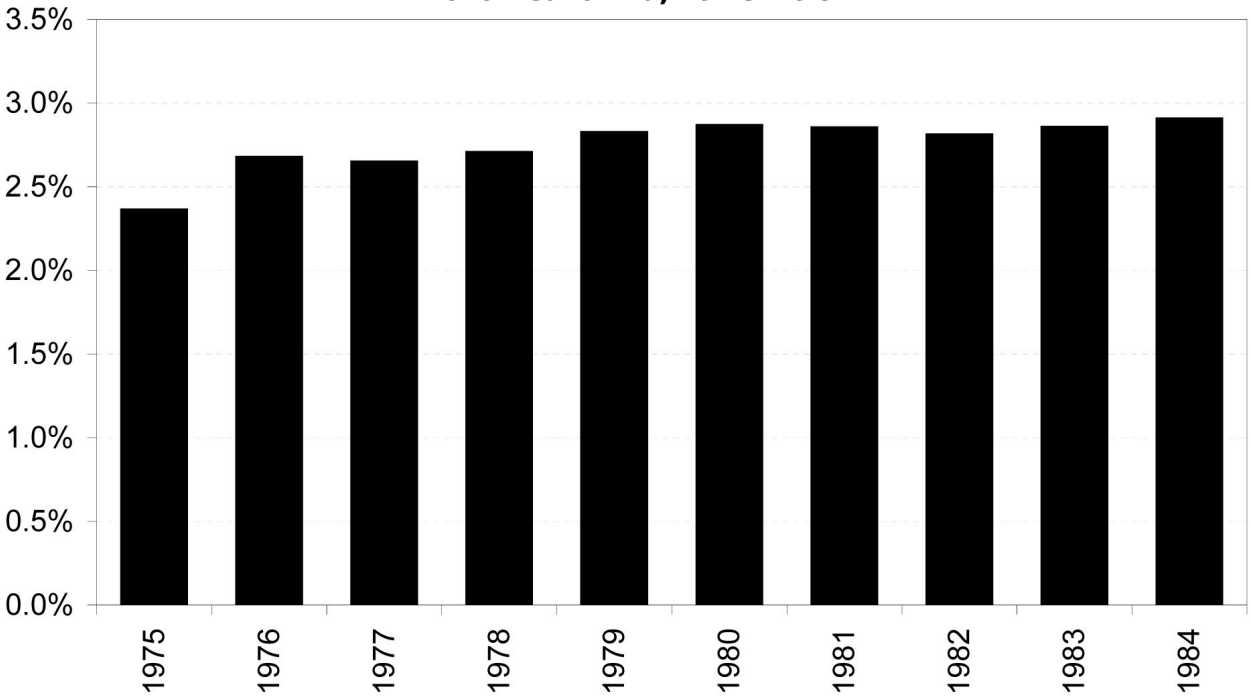
Fig. 2. Per Capita Personal Income: Select Southeast States vs. U.S. Average, 1975-1984



The rebound of the state's economy in the mid-1980s can be attributed to several factors. One was that state and local governments slowed their hiring, which freed up labor for the private market. This may also explain the slight delay in recovery in North Carolina compared to other states. Another explanation could also be that North Carolina increased personal taxes between 1975 and 1980. If the state had taxed personal income from 1976-1980 at the same rate as it did in 1975, the private sector would have kept at least $639 million.[1] By comparison, personal taxes throughout the rest of the country remained relatively stable throughout the period. It seems that the tax increases implemented in North Carolina eroded purchasing power and consumer

[1] The dynamic effect of a lower tax trajectory, however, would have likely contributed to an even greater increase in personal income.

Fig. 3. State/Local Taxes as Share of Personal Income: North Carolina, 1975-1984

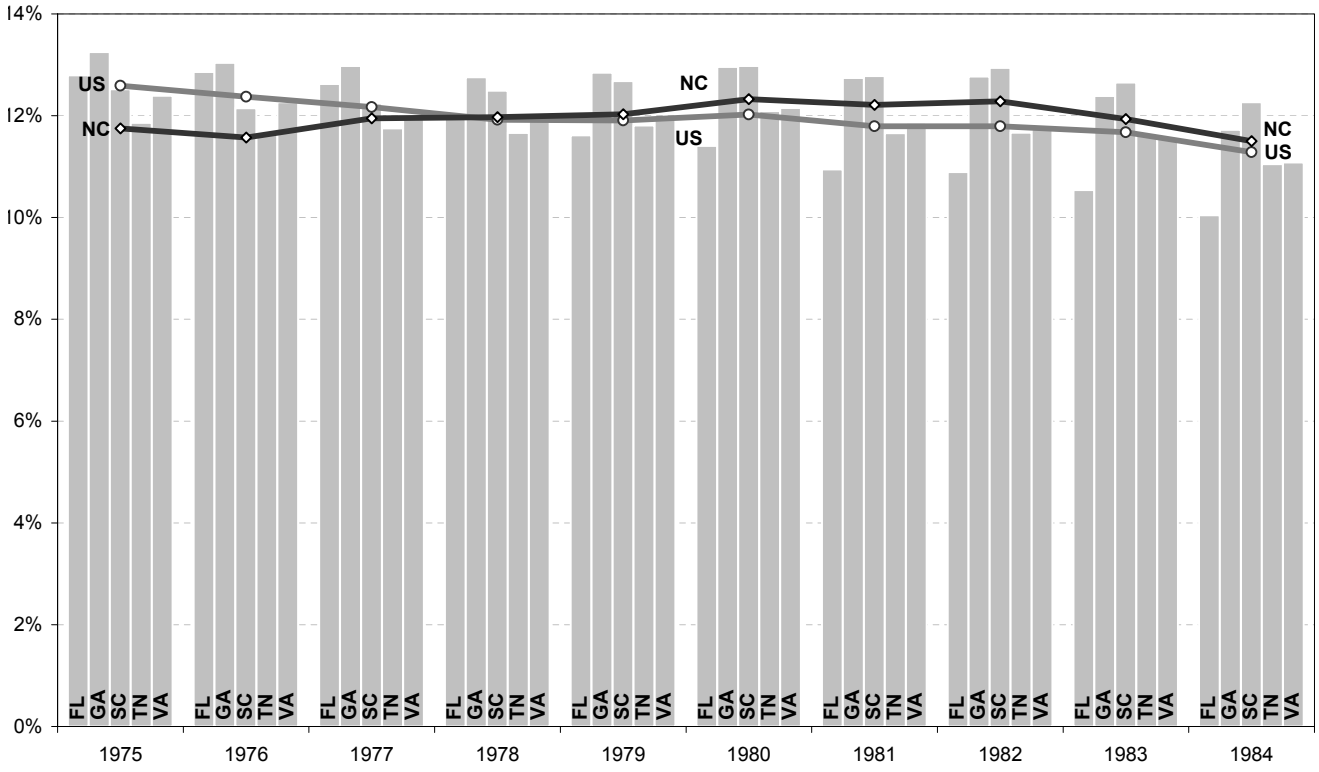


confidence. When taxes stabilized in the early 80s, consumer confidence recovered.

Figure 4 (on the following page) illustrates the state and local share of total employment in North Carolina and three neighboring states. Virginia once again experienced the most dramatic change, with a drop in state and local employment from 12.5 percent of total employment to 11 percent. In North Carolina, South Carolina and Tennessee, the trend was less pronounced, but once the Reagan-era growth period began, the public sector's share of total employment gradually dropped as well.

State and local government employment in North Carolina, however, did not decrease in absolute numbers, which is also to say that the size of the government increased. In fact, the number of employees working for the state and local governments grew by 25 percent between 1975 and 1984. But because private employment grew by 30 percent, the net result was still positive for North Carolina's economy.

Fig. 4. State/Local Government Share of Total Nonfarm Employment: Southeast States, 1975-1984



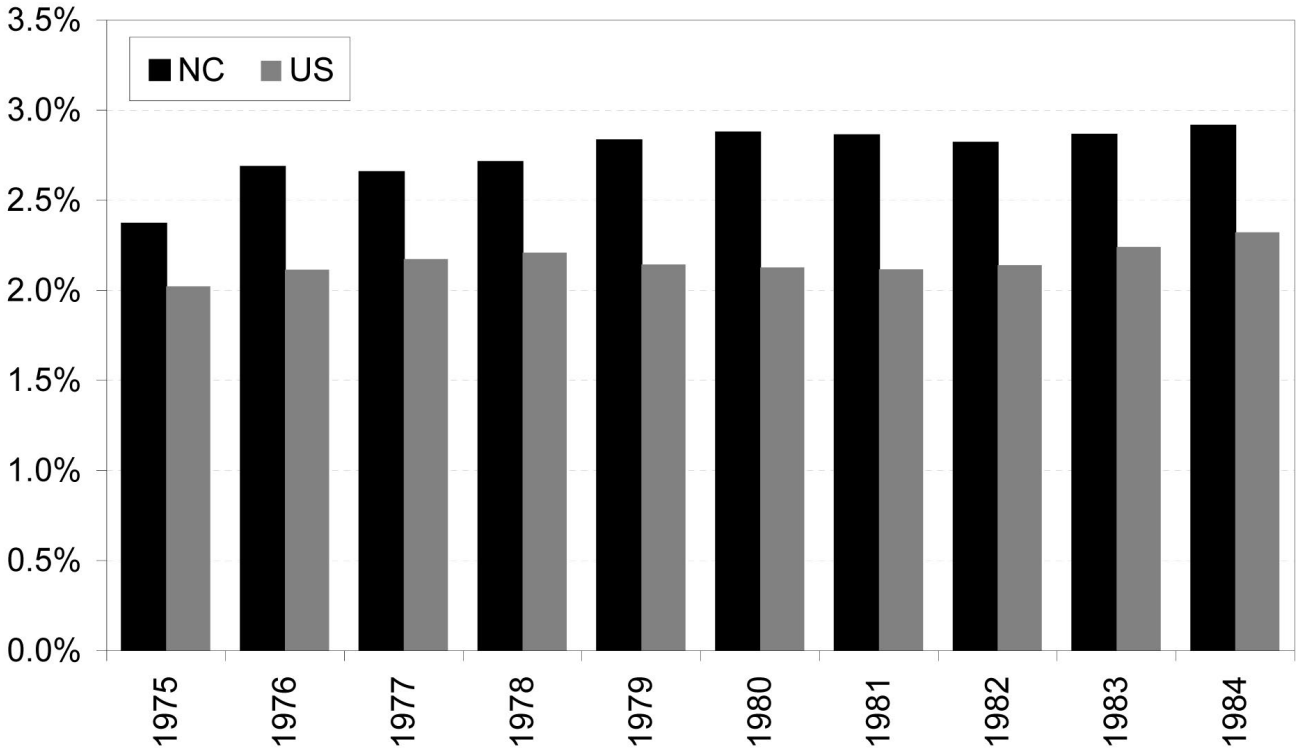
Most of the growth in state and local employment took place in 1976-1979, as Table 1 shows:

Table 1

STATE, LOCAL EMPLOYMENT GROWTH	
1976	2.2%
1977	7.6%
1978	4.4%
1979	3.9%
1980	3.2%
1981	-0.3%
1982	-0.2%
1983	-0.1%
1984	2.2%

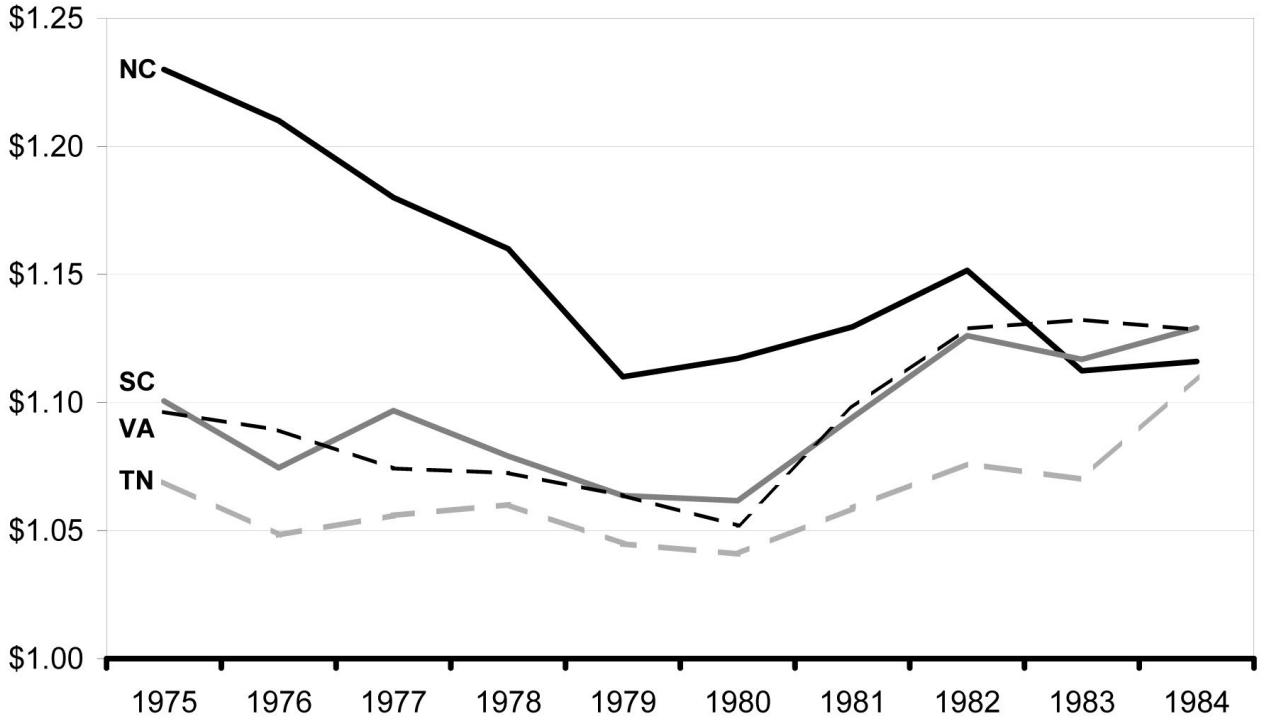
Figure 5 reflects this expansion. It shows how state taxes, especially state income taxes, grew as a share of personal income in North Carolina between 1975 and 1984.

Fig. 5. State/Local Taxes as Share of Personal Income: North Carolina vs. U.S. Average, 1975-1984

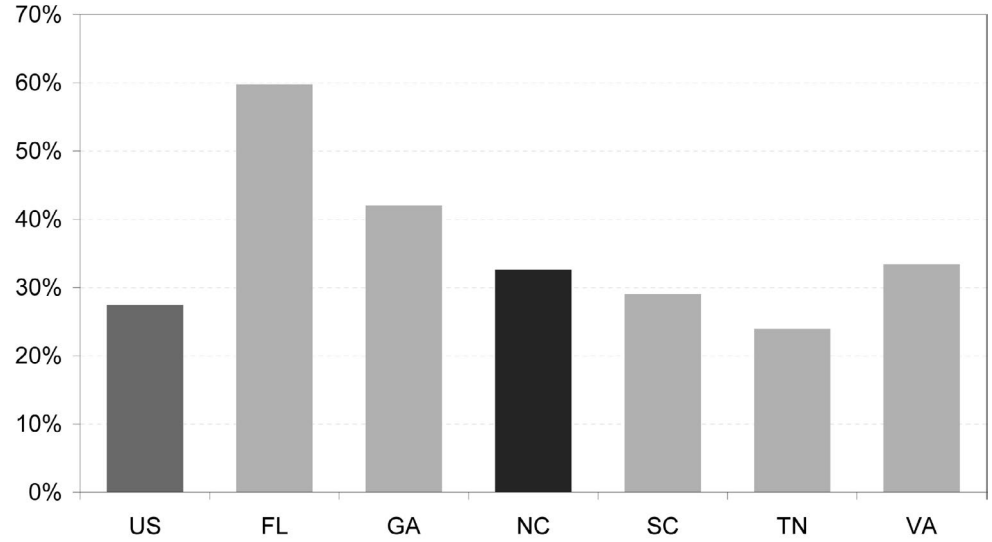


As the number of positions increased throughout the late 1970s, North Carolina also reduced the average salary of its public employees in relation to private sector compensation. In 1975 the total compensation per state or local employee was $1.23 per dollar of employee compensation in the private sector. This was much higher than in neighboring states, such as South Carolina, Tennessee and Virginia, which averaged $1.10-$1.11 in public sector compensation per $1 dollar in private sector compensation. As Figure 6 (on the next page) shows, by 1984 state and local governments in North Carolina had brought their employee compensation down to $1.12 per private sector dollar. This rate was identical to that in South Carolina and Tennessee, and two cents below Virginia.

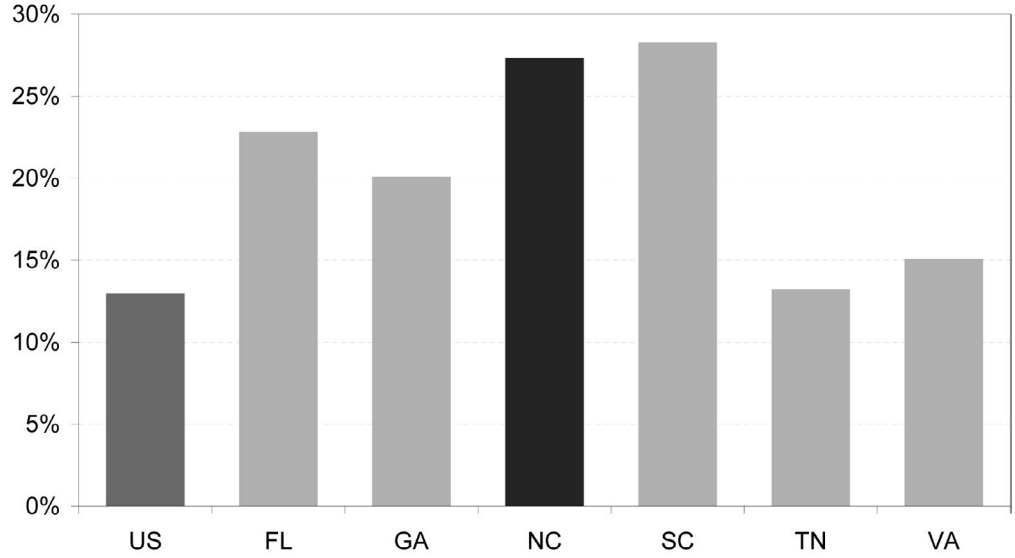
Fig. 6. State/Local Employee Compensation per Dollar of Private Sector Employee Compensation



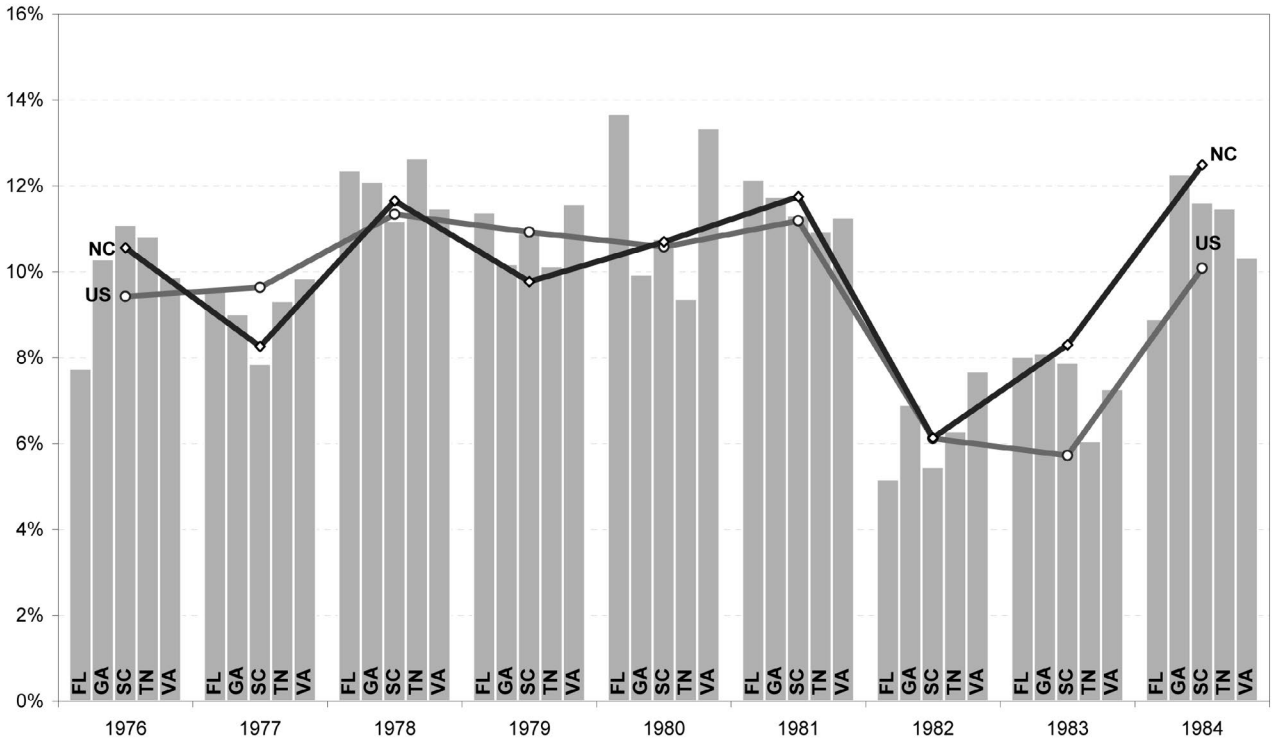
Total Nonfarm Employment Growth: Southeast States, 1975-1985



State/Local Government Employment Growth: Southeast States, 1975-1985



Nominal Per Capita Personal Income Growth: Southeast States, 1976-1984



Note: The use of nominal growth is motivated by the fact that governments collect and project their tax revenues based on nominal, not real, growth in the tax base.

Table 2

STATE TAX ON PERSONS:	U.S	and N.C.
1976	2.68%	2.11%
1977	2.66%	2.17%
1978	2.71%	2.21%
1979	2.83%	2.14%
1980	2.87%	2.13%
1981	2.86%	2.12%
1982	2.82%	2.14%
1983	2.86%	2.24%
1984	2.91%	2.32%

percent of personal income

DID YOU KNOW?

Between FY1990 and FY2001, state tax revenues doubled in North Carolina – increasing 99 percent from $7.87 billion to $15.63 billion. By contrast, population growth, plus inflation, grew by only 67 percent.

Source: Cato Institute

1985 session

1985-1986 BIENNIUM
FY 1986: July 1, 1985 to June 30, 1986

General Assembly:

House Dems:	82	House Reps:	38
Senate Dems:	38	Senate Reps:	12

Governor:
James G. Martin (R)

The 1985 Long Session:
Budget Bill SB1/S.L. 1985-479
Passed Senate: June 25, 1985
Passed House: June 25, 1985
Conference Version Ratified: June 27, 1985
Signed by Governor: June 27, 1985

In 1984, the Republican Party had an exceptional election year in North Carolina. Ronald Reagan won the state by a landslide. Jesse Helms won a third term – defeating two-term Governor James B. Hunt in the most expensive race to date in Senate history (more than $26 million was spent). And James G. Martin, a member of the U.S. House of Representatives, easily won election as governor, taking over the office vacated by Hunt. In spite of vigorous opposition from the Democratic-controlled General Assembly, Martin fought hard to fulfill his campaign promise to cut taxes by $489 million on groceries, business inventories and intangible property. Once the dust cleared, the 1985-1987 budget decreased taxes by $171.5 million.

Not unlike his Democrat predecessor, Martin also ran on an education platform that promised to improve North Carolina schools by implementing a universal curriculum, hiring more teachers, and instituting a merit-based career development salary scale. While Martin succeeded in implementing his Career Development Pilot Program ("Career Ladder") in 16 public school systems, the groundwork had already been laid in 1984 for the Basic Education Program (BEP). In accord with a previous legislative mandate that the state implement a "rigorous academic course of study for the purpose of ensuring a quality education," the 1985 General Assembly launched the eight-year, $799 million Basic Education Program (S.L. 1985-479). The stated purpose of the plan was to improve North Carolina's flagging school system by increasing state education funding by 34 percent and establishing statewide standards for school construction, class sizes, instruction and curriculum. Although the program was ultimately superseded by other initiatives, BEP set the stage for massive and ongoing funding for the state public school system.

January

➤ Jim Martin is sworn in as governor, becoming only the second Republican to hold the office since 1901.

➤ Fulfilling one of his campaign promises, Governor Martin presides over the first Council of State meeting that is open to the public. The Council is comprised of the state's top elected officials and meets to discuss state matters and exchange information.

➤ Speaking before a group of North Carolina Chamber of Commerce executives, Governor Martin attempts to build support for his campaign promise to lower taxes by cutting the business inventory tax, the intangibles tax, and the state sales tax on food.

➤ Martin rejects demands from legislators for a state lottery, calling it a "tax on the weak" that "bleeds money from a lot of people who need it."

➤ In an effort to co-opt Martin's tax break plan, Speaker of the House Liston Ramsey (D-Madison) offers his own proposal; but it only includes partial cuts of the same taxes.

February

➤ Responding to General Assembly inquiries about his supplement to Governor Hunt's transitional budget proposal made in December 1984, Governor Martin says he will outline his own plan in his State of the State address on February 19. The details, promises Martin, will be available by March.

➤ In a move to show the new governor who is boss, the Senate passes a resolution attempting to force Martin to deliver his supplemental budget to the General Assembly by February 28 (Res. 1985-1).

➤ Like Speaker Ramsey, Senate Majority Leader Kenneth Royall (D-Durham) attempts to outmaneuver Governor Martin by filing a bill that repeals the intangibles tax and gives tax credits to low-income earners. Royall's plan also raises the state sales tax one-half cent (SB 3).

1985 HEALTH & HUMAN SERVICES BUDGET

Total Appropriations	**$703 million**
Major Items:	
Medical Assistance (Medicaid):	$203 million
Mental Health:	$105 million
Hospitals & Centers:	$144 million
Health Services:	$72 million
Social Services:	$71 million

➤ Governor Martin and the General Assembly arrive at a compromise in which the governor will outline his budget in the State of the State address on February 28, but then submit the details at a later date, giving the governor time to finalize his recommendations.

➤ In his State of the State address, Martin proposes: repealing the state sales tax on food and nonprescription drugs; repealing the business inventory and intangibles taxes; raising salaries for state workers and teachers by 5 percent; and letting voters decide on whether to give the governor veto power.

March

➤ Democrats assault Martin's address for not being more supportive of education funding. House Speaker Ramsey remarks that the governor "didn't even mention the Basic Education Plan."

➤ Governor Martin releases details of his $9.96 billion budget which includes $328.4 million in tax cuts, $185 million for education and a 10 percent tuition increase for all UNC system students. Lt. Governor Jordan (D) professes his support for the plan and vows that it "will get a fair hearing."

➤ Representative Frank Rhodes (R-Forsyth) introduces a lottery bill in the House (HB 232).

➤ The UNC Board of Governors approves a resolution expressing their concern over the proposed 10 percent tuition increase.

➤ Senator William Redman (R-Iredell) sponsors Governor Martin's tax bill (SB 148), which entails repealing the 3 percent state sales tax on food, repealing the intangible assets tax for individuals and businesses, and reimbursing businesses for the inventory tax paid to counties.

April

➤ North Carolina's Employment Security Commission reports that statewide unemployment fell from 7.1 percent in January to 6.7 percent in February.

➤ Representative James Craven (R-Moore) introduces a gubernatorial veto bill (HB 375).

➤ The Senate approves its version (SB 68) of the Basic Education Program (BEP), which includes an increase in teaching positions and a new "fundamentally complete" statewide curriculum that includes classes in vocational and technical education, the arts, and other nontraditional courses.

➤ With his tax plan stalled in the Senate, Governor Martin asks the House to consider his proposed tax cuts. House Minority Leader Betsy Cochrane (R-Davie) subsequently sponsors the "Tax Relief Act of 1985" (HB 520).

➤ Ignoring the governor's request, House Democrats consider their own tax package, which is nearly identical to Martin's, except that it cuts taxes by only half: $184 million over two years.

➤ Lt. Governor Jordan announces that the General Assembly "will provide a major pay raise for teachers this year."

➤ The House rejects the gubernatorial veto bill.

➤ Governor Martin moves his office out of the state Capitol to the

1985 Other Significant Changes

COMPENSATION

- Salary increase of 9.6% for most state employees and 4.8% to 9.6% for teachers
- 4% cost-of-living increase for state retirees

CAPITAL

- $29 million in capital improvements
- $21 million for community college capital needs

OTHER

- Tax receipts on mixed beverages dedicated to alcohol programs in mental health centers
- $5 million reserve for farmers' markets

more modern Administration Building in order to be closer to his staff.

May

➤ Senate Majority Leader Royall tries to generate support for his lottery bill (SB 532) and calls for 34 percent of the profits to be spent on education. Reiterating a claim that will be heard frequently over the next 20 years, Royall says: "One thing we don't want to cut is education. This will keep education No. 1."

June

➤ Senate Democrats release their $212 million tax cut plan. It includes a partial repeal of the inventory tax, the intangible tax and the food sales tax; a reduction in the inheritance tax; and tax breaks for the elderly, farmers and parents.

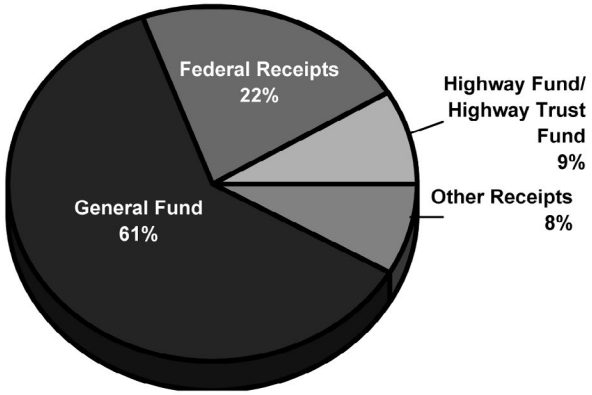
➤ The House Education Committee sends to the House floor their version of the BEP (SB 68).

➤ On June 27, the General Assembly passes an $11.4 billion budget bill (S.L. 1985-479) that includes the $223 million BEP and a 5 percent raise for state employees. The capital budget bill is passed the same day (S.L. 1985-480).

➤ Among other things, the new budget also fulfills Governor Martin's campaign promise to cut the State Abortion Fund. The budget reduces state funding for elective abortions from $1.4 million to $924,500 annually for FY1986 and FY1987 – a 30 percent decrease. The new law also limits funding to cases of rape and incest and fetal deformity and when "the woman's health would be impaired by the pregnancy, as determined in the sole discretion of a physician." The new law brings about a 70 percent decrease in elective abortions performed during the first four months of fiscal year 1985-1986.[1]

➤ The Senate Ways and Means Committee recommends the lottery bill be brought to a vote. Majority Leader Royall is optimistic: "I think it stands a fair chance in the Senate."

Source of Budget Funds: 1985-86



July

➤ An Act to Provide Broad-Based Tax Relief to North Carolina Citizens is ratified on July 9 (S.L. 1985-656). In addition to providing a 20 percent credit on the inventory tax and a partial repeal of the intangibles tax, the law gives a $15 to $25 credit to persons who make less than $15,000 and rescinds the sales tax on food purchased with food stamps.[2]

[1] Katherine White, "State-Paid Abortions Plunge in N.C. After Program Altered," *Charlotte Observer,* December 14, 1985, Main News section.

[2] Luebke, however, notes that federal legislation had already been passed requiring the state to repeal the sales tax on groceries purchased with food stamps. Paul Luebke, *Tar Heel Politics: Myths and Realities* (Chapel Hill, NC: University of North Carolina Press, 1990), 40.

1985 Significant Tax Changes

$171.5 million in tax cuts per the Tax Reduction Act [S.L. 1985-65]:

- ➔ Tax credits to people with low and moderate incomes
- ➔ 20% credit on inventory tax
- ➔ Partial repeal of the intangibles tax
- ➔ Repeal of sales tax on food purchased with food stamps

➤ The lottery referendum bill fails to pass, but is referred to a study committee.

➤ The General Assembly approves $28.7 million in capital improvements to the UNC system (S.L. 1985-661).

August

➤ Governor Martin says he will support a half-percent increase in either the state or local sales tax (bringing it to 5 percent) if the U.S. Congress ends a revenue sharing provision that annually brings in $120 million to North Carolina's cities and counties.

➤ Senator John Jordan (D-Alamance) is sentenced to a two-year suspended sentence with two years probation on charges of bribery solicitation, extortion, conspiracy and misconduct in office. Despite pleading guilty, Jordan maintains his innocence, claiming that he did not "knowingly do anything illegal" but "realize that I was in error, for which I sincerely apologize."

September

➤ In an effort to streamline his staff, Governor Martin moves his office back to its traditional place at the state Capitol building. Also, Martin says he just "like[s] that old office."

➤ Hurricane Gloria strikes the Outer Banks.

October

➤ NCDOT estimates that $5 billion of improvements are needed for North Carolina's roads by 2000.

November

➤ Governor Martin's Urban Transportation Task Force recommends various tax increases

Economic Snapshot: 1985

Population:	6,260,716	Five-Year Population Growth:	6.5%
Civilian Labor Force:	3,031,000	Unemployment Rate:	5.4%
Per Capita Income:	$ 11,685	Pct. of U.S. Per Capita Income:	84%

Top 10 Private Employers (1987)

1. Burlington Industries, Inc.
2. IBM Corporation
3. Fieldcrest Cannon, Inc.
4. Duke University
5. Duke Power Company
6. RJR Nabisco, Inc.
7. Rose's Stores, Inc.
8. AT&T Technologies, Inc.
9. Food Lion, Inc.
10. Piedmont Aviation, Inc.

1985 EDUCATION FUNDING

ENROLLMENT CHANGES

° Public Schools: 3,411 (0.3%) decrease

TUITION & FEE INCREASES

° Average increase of 4% for in-state and 11% for out-of-state UNC students
° No change for community college students

OTHER EDUCATION CHANGES

° New funding for Basic Education Program ($74 million for class-size reduction, dropout prevention, summer school, and science, math, and computer equipment)
° $34 million to reduce class size in grades 7 through 9
° $5 million for remedial summer programs in 1985-86; $10 million in 1986-87
° $14 million for dropout prevention
° $11 million for a pilot Career Development Program
° $14 million for microcomputer labs
° Basic Education Program enacted
° End-of-course testing program begins

Note: Data on UNC enrollment increases begins with 1989; data on community college enrollment increases begins with 1995.

to raise revenue for the Highway Fund. These include a one-cent increase in the gas tax and a new 4.5 cent local and state sales tax on fuel.

➤ Due to concerns that North Carolina's "citizen legislature" is becoming too professional, Lt. Governor Jordan considers shortening the General Assembly's workweek by proposing it not meet on Fridays when in session. (Only in 1995, after the Republicans gained control of the House, was this rule finally instituted.)

December

➤ The Legislature's Fiscal Research Division projects that General Fund collections are above anticipated levels. According to senior fiscal analyst David Crotts, North Carolina's economy "seems to be locked into a stable low-growth, low-inflation pattern" – a trend that bodes well for budget planners who can plan on a steadily increasing stream of revenue.

DID YOU KNOW?

Alabama, Ohio and North Carolina were the only states in the Union to enact significant tax increases during the 2001 recession.

Source: Center on Budget and Policy Priorities

1986 session

1985-1986 BIENNIUM
FY 1987: July 1, 1986 to June 30, 1987

General Assembly:

House Dems:	82	House Reps:	38
Senate Dems:	38	Senate Reps:	12

Governor:
James G. Martin (R)

The 1986 Short Session:
Budget Bill HB2055/S.L. 1986-1014
Passed Senate: July 10, 1986
Passed House: July 11, 1986
Conference Version Ratified: July 15, 1986
Signed by Governor: July 15, 1986

Governor Martin's second year in office would prove less contentious than 1985, although not without controversy. Unlike the previous year's long session, debate over the budget was limited to additional spending for existing programs. The major point of contention between the Republican governor and Democratic General Assembly concerned highway funding – namely, Martin's proposal to increase the gas tax to fund new highway construction in the mountains and a request to shift funding for certain highway programs to the General Fund. Democrat leaders attacked Martin's plan as a thinly veiled attempt to take money from education in order to build roads. Both Democrats and Republicans alike wanted to avoid raising taxes during an election year. Nevertheless, Lt. Governor Jordan, who was preparing for his own 1988 run at the Democrat gubernatorial nomination, took the lead in pushing through a counterproposal that permitted a limited transfer of highway funding (for driver education) to the General Fund and also raised the retail gas tax two cents and the wholesale gas tax by 3 percent. Despite the back and forth of rhetorical barbs, as well as the regressive nature of the gas tax, in general, Jordan's compromise won the day.

In July, both parties left Raleigh to concentrate on the upcoming November elections. Although Governor Martin campaigned hard for fellow Republicans, Democrats picked up two seats in each chamber.

January

- Governor Martin declares his intention to fund his Career Ladder program without raising taxes: "Raising teacher pay ought to be our first priority. … But we should not have to raise taxes to pay for Career Ladder programs if we have our priorities in the right order."
- Martin claims federal reductions in state funding may limit his ability to push through additional tax cuts in 1986.

Despite a surplus in tax revenues for the first half of FY1985-86, collections for December fall below the projected target for the second month in a row.

February

➤ After reviewing the recommendations of his Efficiency Study Commission, Governor Martin decides against privatizing the state's symphony and the North Carolina Museum of Art.

March

➤ With the state Highway Fund in "increasingly desperate" shape and increasing pressure from the business community to build new infrastructure, Governor Martin remains undecided about raising the gas tax and begins looking at other funding alternatives. Martin rules out a state lottery as a means of paying for rising transportation costs.

➤ The Special Committee on Local Government Revenue recommends that the Legislature allow counties to raise their local sales tax one-half cent and implement a hotel occupancy tax of up to 3 percent.

April

➤ Lt. Governor Bob Jordan and House Speaker Liston Ramsey (D-Madison) applaud a proposal by the Public School Forum, a coalition of businessmen, educators and legislators, to recruit more teachers through a "North Carolina Teaching Fellows" program that would cost taxpayers $10 million per year.

1986 EDUCATION FUNDING

ENROLLMENT CHANGES

° Public Schools: 1,765 (0.1%) decrease

TUITION & FEE INCREASES

° Average increase of 4% for in-state and 12% for out-of-state UNC students

° Increase of 26% for in-state and 95% for out-of-state community college students

OTHER EDUCATION CHANGES

° $6 million to reduce the allotment ratio in grade 9, to 1 teacher for every 26 pupils

° $4 million increase for Teacher Effectiveness Program

° $14 million for improvements in UNC accounting systems

° Statewide promotion program implemented

May

➤ Governor Martin submits his revised budget for FY1986-87. The budget includes a plan to raise $134 million for the Highway Fund by increasing the gas tax 2 1/2 cents from 12 1/2 to 15 cents, and shifting funding for driver education to the General Fund. The budget also allocates $51.4 million for a 10-year plan devoted to new prison construction and contains a 3.2 percent pay increase for state workers and teachers. Martin's proposed budget adds $533.6 million to the $8.1 billion budget approved during the 1985 long session.

➤ Spending increases in the governor's recommended budget are to be offset by a 2 3/4 cent increase in the fuel tax, increases in tuition for in-state and out-of-state students, and $329 million in unspent revenue from FY1985-86.

➤ Democratic Lt. Governor Bob Jordan declares that Martin's 3.2 percent raise for state workers is "just not enough."

➤ Likewise, the UNC Board of Governors contests the proposed $10 to $16 increase per student for in-state tuition. Asserts board member John Jordan: "It is not in the tradition of public education in North Carolina. It is a departure of the philosophy we have followed for 200 years." Lt. Governor Jordan and House Speaker Ramsey also oppose the proposed in-state tuition increase.

➤ House Speaker Ramsey states that despite a "need for more money in the Highway Fund," Democrats will not support a tax increase unless Governor Martin also convinces Republicans to do so. "But will we (Democrats) be passing a gas tax over the objections of Republicans?" asks Ramsey. "The answer is no. We weren't born yesterday." Ramsey also opposes transferring General Fund revenue to the Highway Fund.

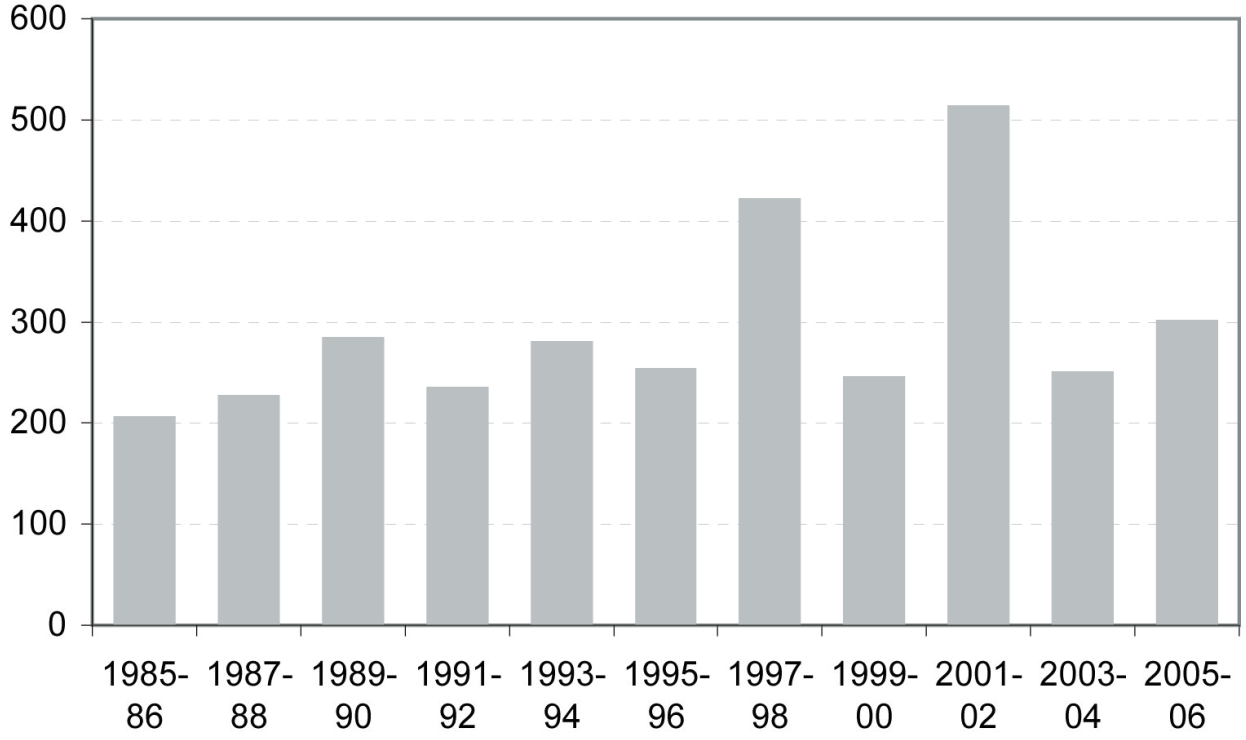
1986 HEALTH & HUMAN SERVICES BUDGET

Total Appropriations	**$729 million**
Major Items:	
Medical Assistance (Medicaid):	$218 million
Mental Health:	$106 million
Hospitals & Centers:	$145 million
Health Services:	$74 million
Social Services:	$71 million

June

➤ Governor Martin states he will still support a gas tax increase even if his highway fund transfer plan is rejected. "I would not personally

Total Days In Session Each Biennium



1986 Significant Tax Changes

⬆	172.2 million in 1986-87 due to "Roads to the Future" Bill [S.L. 1986-982]: ➔ Raise Powell Bill distribution from 1 3/8¢ to 1 3/4¢ ➔ Gas tax increase 2¢ per gallon plus 3% sales tax on the wholesale price ➔ Exempt DOT from state and local sales tax
⬆	Authorize local governments to raise sales tax an additional 0.5% with some restrictions on the use of money; mostly designated for public school capital needs (estimated revenue $198 million) [S.L. 1986-906]
⬇	Restructure insurance premiums tax system with a uniform rate; complete system repeal in 1988 [S.L. 1986-1031]
⬇	Repeal of local government property tax on household personal property [S.L. 1986-982]

turn against that 2 3/4 cent tax," comments Martin.

➤ Following Martin's lead, Lt. Governor Jordan states he will not propose a higher gas tax himself, but will support a tax increase if Governor Martin asks for one. "I really believe if he were to ask for more of a gas tax, he'd get more," Jordan acknowledges.

➤ Jordan proposes an alternative plan for highway funds that includes the governor's gas tax of 2 3/4 cents, plus a 3 percent increase in the wholesale state sales tax on gas.

➤ House Speaker Ramsey confesses that Jordan's plan is "the best way to get the money we need that I have seen." But, cautions Ramsey, "If the governor is opposed to it, I certainly won't ask Democrats to vote for it."

➤ After rejecting Governor Martin's plan to transfer Highway Fund programs to the General Fund, the Senate Finance Committee approves a compromise bill that increases the gas tax 2 cents, increases the wholesale gas tax 3 percent, and shifts driver education program costs to the General Fund.

Unquestionably, there is progress. The average American now pays out twice as much in taxes as he formerly got in wages.

H. L. Mencken

July

➤ The House version of the highway appropriations bill (HB 968) drops Governor Martin's $27 million driver education funding transfer request.

DID YOU KNOW?

In 2005, North Carolina had the highest state income tax rate (8.25%) in the South and the 8th highest in the United States.

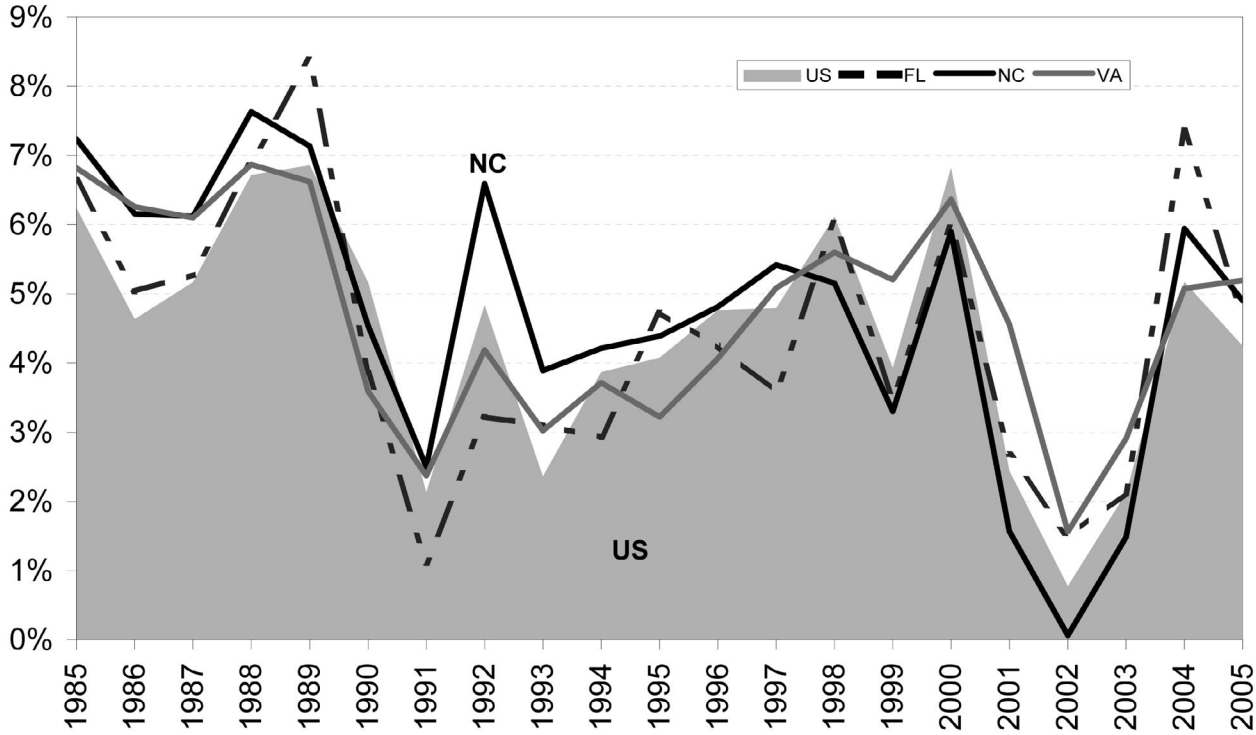
Source: The Tax Foundation

- The House approves a $435.9 million budget bill and sends it to the Senate. Teachers will receive a 6.5 percent raise and most state workers will receive a $900 raise.
- The General Assembly gives counties the option of raising the sales tax one-half cent, bringing the sales tax to 5 percent (recall that the tax was also increased by one-half cent in 1983) (S.L.1985-906).
- The Senate version (SB 866) of the highway appropriations bill prevails. The bill increases the motor fuel excise tax from 11 cents to 14 cents, plus 3 percent of the average wholesale price, and transfers funding for the driver education program to the General Fund (S.L. 1985-982).
- The budget bill (S.L. 1985-1014) passes both chambers on July 15. Teachers receive a 6.5 percent raise, double what Governor Martin originally proposed.

August

- The North Carolina Department of Transportation approves $1.2 million in highway safety improvements. Transportation Secretary James Harrington states, "Plans for many of them have been sitting on the shelf awaiting funding. Now that we have the

Nominal Per Capita Personal Income Growth: Select Southeast States, 1985-2005



money, we're going to put it to work."

September

➤ After receiving a smaller raise than teachers, state employees vow to ask for a 10 percent raise in 1987. Comments Lt. Governor Jordan, "Ten percent would be tough, not that they don't deserve it."

October

➤ Governor Martin proposes a $60 million loan program for water and sewer plant production. Cities and counties would pay back the loans with their sales tax earnings.

November

➤ Despite vigorous campaigning by Governor Martin, Republicans lose two seats in both chambers.

December

➤ Governor Martin calls for full funding – $800 million – of the state's Basic Education Program but requests that local school boards be given more autonomy on how to spend funds.

1986 Other Significant Changes

COMPENSATION

- Average salary increase of 6.5% for teachers
- Salary increase of $75/month (average of 6%) for most state employees
- Legislators get a cost-of-living and subsistence increase

HIGHWAYS

- $157 million for Highway Fund operations and capital increases, including $30 million as a special appropriation for highways

OTHER

- $8 million for corrections positions and programs; $12 million for prison capital
- $9 million for mental health

OVERVIEW

1985-1989

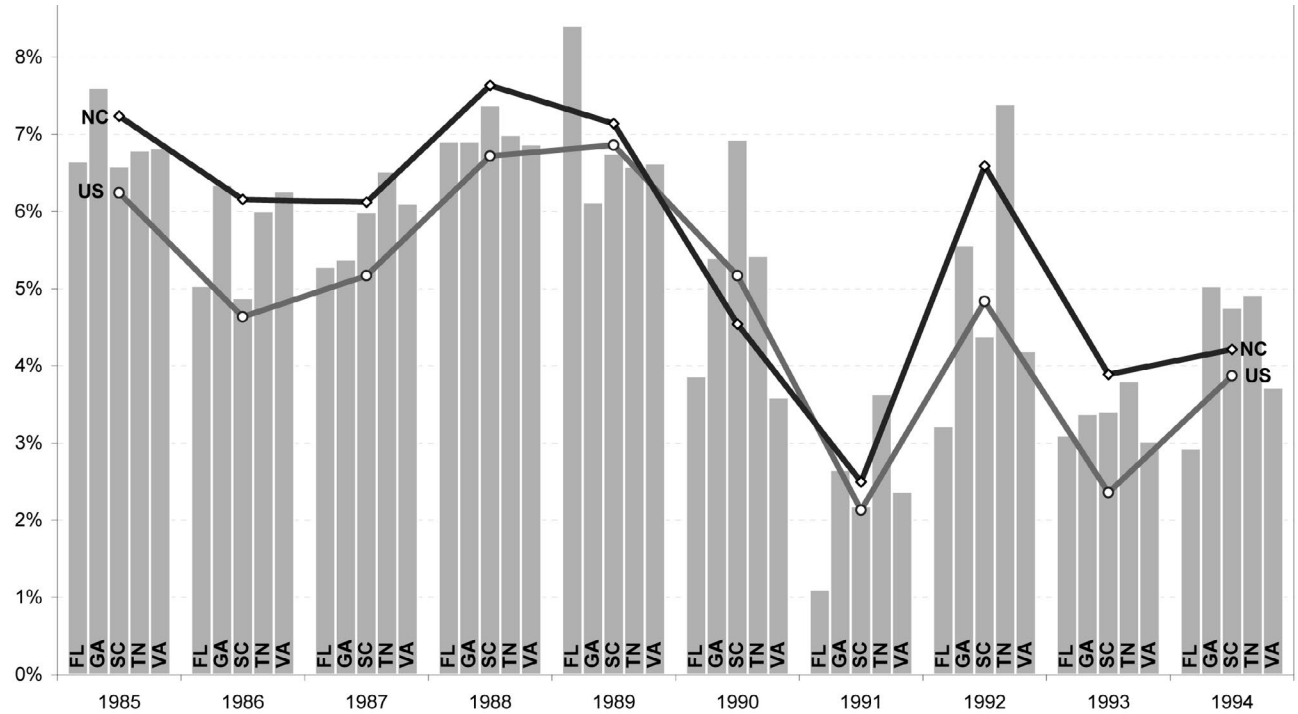
General Economic Trends: 1985-1989

During the latter half of the 1980s, the United States experienced a period of strong economic growth. The labor market also peaked at full employment right before the recession began in late 1990.

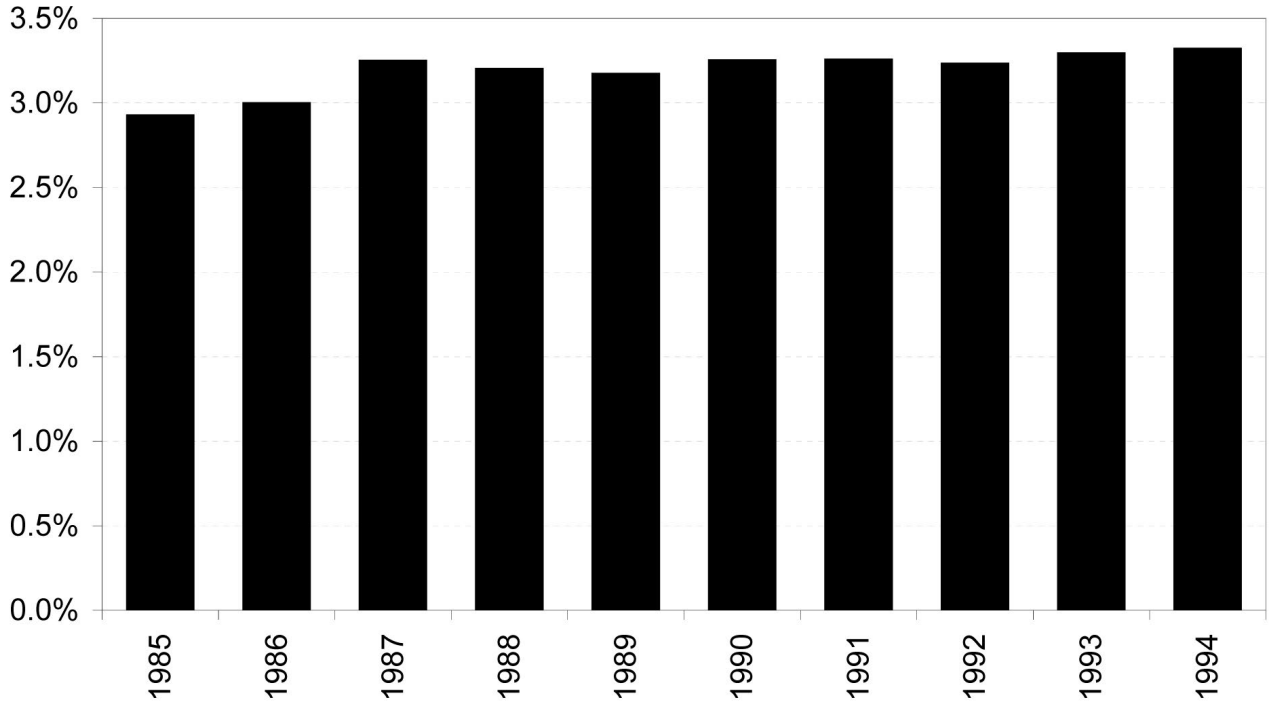
In terms of personal income, North Carolina gained on the rest of the country. The state's per capita personal income rose from 86 percent to 89 percent of the U.S. average. Income levels in nearby states remained the same, meaning that North Carolina's economy gained on or edged out its neighbors. At the same time, state personal income taxes also increased, going from 2.6 percent to 2.9 percent of personal income.

This gain in per capita personal income originated in strong state GDP growth. North Carolina's annual GDP growth rate was a whole 1 percent above that of the national economy. Like the United States as a whole, North Carolina's economy reached full employment at the end of the '80s, with unemployment dropping from 5.8 percent in 1985 to 3.6 percent in 1989.

Nominal Per Capita Personal Income Growth: Southeast States, 1985-1994



State/Local Taxes as Share of Personal Income: North Carolina, 1985-1994



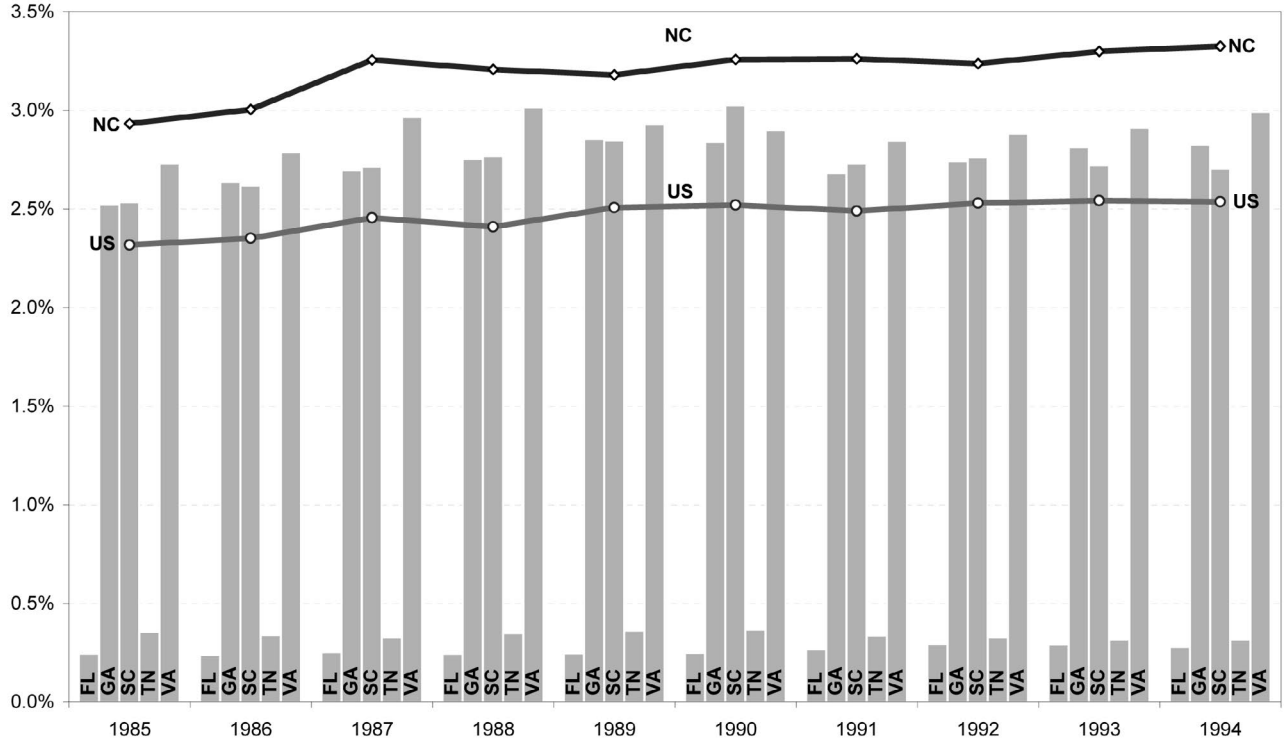
As seen previously, the private employment share in North Carolina increased steadily between 1975 and 1984. Over the latter half of the 1980s, however, private sector growth stabilized. A similar trend was seen in the share of state and local employees, which hovered at 11.4 percent of North Carolina's workforce. In absolute numbers, state and local governments added 57,650 employees to their payrolls in 1985-1989.

Although the public sector did not increase employment faster than the private sector, state and local governments disproportionately increased their employee compensation in relation to the private market. In 1985, a North Carolina state or local employee was compensated with, on average, $1.17 for every dollar of employee compensation in the private sector. By 1989, this share had increased to $1.23 per every private sector dollar. Over the five-year period, state and local government compensation thus increased 4.8 percent faster than in the private sector.

State employees also received a 5 percent raise in 1985, plus a one-step increase; teachers likewise received increases of one-step or more. Over the next four years, both state and teacher salaries increased at an average of 5.5 percent. (Recall that the Basic Education Program was launched in 1985.) Neighboring states also increased public sector compensation at a faster rate than in the private sector.

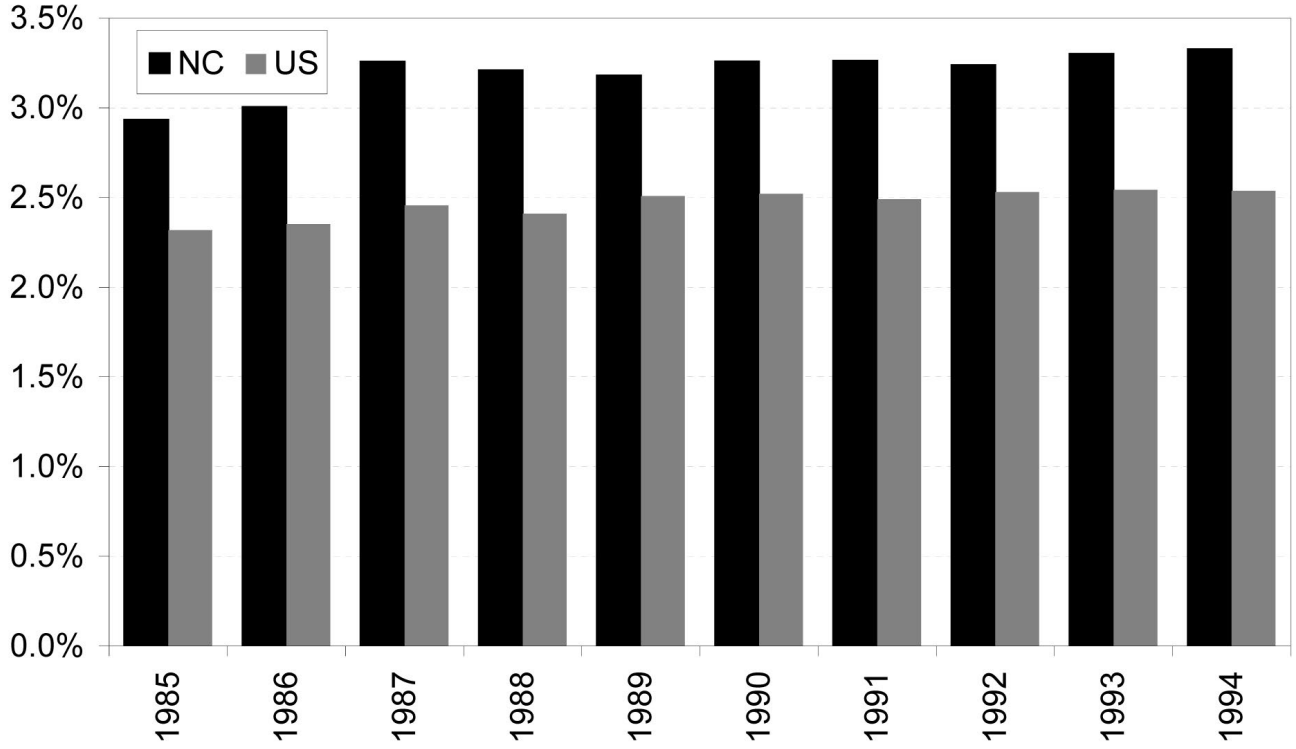
Meanwhile, private sector compensation in North Carolina increased by an average of 6.86 percent per year between 1985 and 1989, while inflation averaged 3.67 percent per year. The ramp up in public sector salaries reversed the positive trend from the late 1970s that brought government employee compensation more in line with the private sector.

State/Local Taxes as Share of Personal Income: Southeast States, 1985-1994



NOTE: This figure does not include sales tax, but is the standard measure used by the Bureau of Economic Analysis for "personal current taxes." As such, it includes income taxes and taxes on personal property.

State/Local Taxes as Share of Personal Income: North Carolina vs. U.S. Average, 1985-1994



1987 session

1987-1988 BIENNIUM
FY 1988: July 1, 1987 to June 30, 1988

General Assembly:

House Dems:	84	House Reps:	36
Senate Dems:	40	Senate Reps:	10

Governor:
James G. Martin (R)

The 1987 Long Session:
Budget Bill HB1514/S.L. 1987-738
Passed House: August 5, 1987
Passed Senate: August 6, 1987
Conference Version Ratified: August 7, 1987
Signed by Governor: August 7, 1987

Posturing for the 1988 gubernatorial election, both parties ostensibly united under the banner of bipartisan cooperation. In an effort to shed the traditional Republican image of being anti-education, Governor Martin began the year by promoting educational programs: in particular, a controversial plan to fund new school construction with a $1.5 billion local-option bond program. While Democrats in the General Assembly opposed Martin's plan because it burdened local districts with interest payments, the only alternative they proposed was to raise the corporate income tax from 6 percent to 7 percent. As news of North Carolina's slumping national test scores reverberated throughout the state, Republicans and Democrats alike tried to outdo one another in increasing educational funding. In the end, most of Governor Martin's education proposals were enacted, with the exception of the bond project. Instead of passing the bond, Democrats raised taxes.

January

- Changes in the federal tax code eliminating certain deductions promise to produce a windfall of $25 million to $40 million for N.C. budget writers if the General Assembly votes to conform to the new federal guidelines. According to Lt. Governor Bob Jordan, "Basic education will be the first priority, then pay increases [to state employees]."
- Governor Martin declares that his top priorities for the session are his "Career Ladder Program" and full funding for the "Basic Education Program" (BEP).
- Even though he "hasn't seen the governor's proposals," Lt. Governor Jordan has "some real problems" with Martin's new teacher development program.
- A study by Citizens for Tax Justice finds that low-income taxpayers in North Carolina pay the same taxes, measured as a percentage of income (7.0 percent),

as wealthy taxpayers. Middle-class taxpayers shouldered the heaviest tax burden, paying 7.1 percent as a share of their income.

➤ Governor Martin proposes a $19.59 billion budget for FY1987-1989. His recommendations include full funding – minus summer school expansion – for the next two years of BEP, expansion of the Career Ladder Program, and a 4.5 percent salary increase for teachers and state workers. Martin balances the budget without relying on any major tax increases.

➤ Senator Ken Royall (D-Durham) accuses Martin of hijacking the Democratic education agenda. States Royall, "That's our education plan. … I'm glad he's finally following us."

February

➤ The Advisory Budget Commission, which is dominated by Democratic legislators, rejects Martin's recommended budget.

➤ In his State of the State address, Governor Martin calls for bipartisanship in order "to unite for the good of all of North Carolina."

March

➤ The Public School Forum, a coalition of businessmen, educators and legislators, urges the General Assembly to raise taxes in order to fund education needs.

➤ Lottery proponents point to Virginia, whose November ballot will hold a referendum on a lottery.

➤ Representative Johnathan Rhyne (R-Lincoln) proposes a bill (HB 148) to limit the length of General Assembly sessions. Lt. Governor Jordan questions whether the bill is necessary, but also states "If we're still here this year on July 15, then this system is not working and we should look at something else." (Recall that in 1985, Jordan had supported shortening the legislative workweek to four days.)

1987 Other Significant Changes

COMPENSATION

- Salary increase of 5% for teachers and most state employees

CAPITAL

- $165 million in 1987-88 and $146 million in 1988-89 for capital improvements to state agencies, community colleges, universities, and non-state libraries
- Establish Public School Building Capital Fund and Critical School Facility Needs Fund

LOCAL FUNDS

- $328 million in General Fund and $68 million in Highway Fund state aid to non-state entities
- $7 million in new funds for specific local programs and nonprofit organizations

April

➤ In a speech before the Home Builders Association of Charlotte, Governor Martin reiterates that education is one of his top priorities and stresses his plan for a $1.5 billion bond issue that would pay for new school construction in those districts that choose to take part in the bond.

May

➤ With a projected surplus of $150 million, Governor Martin urges the General Assembly to cut

taxes. "Whenever we have an opportunity – with a very nice revenue growth rate – to cut taxes that uniquely handicap North Carolina, we ought to do it," he advises. Subsequently, Martin recommends a 15 percent tax cut on intangibles for each of the next two years, for a 30 percent cut overall.

➤ Lt. Governor Jordan attacks Martin's tax cut: "The truth of the matter is, with the way revenues fluctuate, I don't see in my own view any way we can make tax cuts at this time." Adds Jordan, "To cut taxes at this point in time may mean the state would have to go out and borrow money."

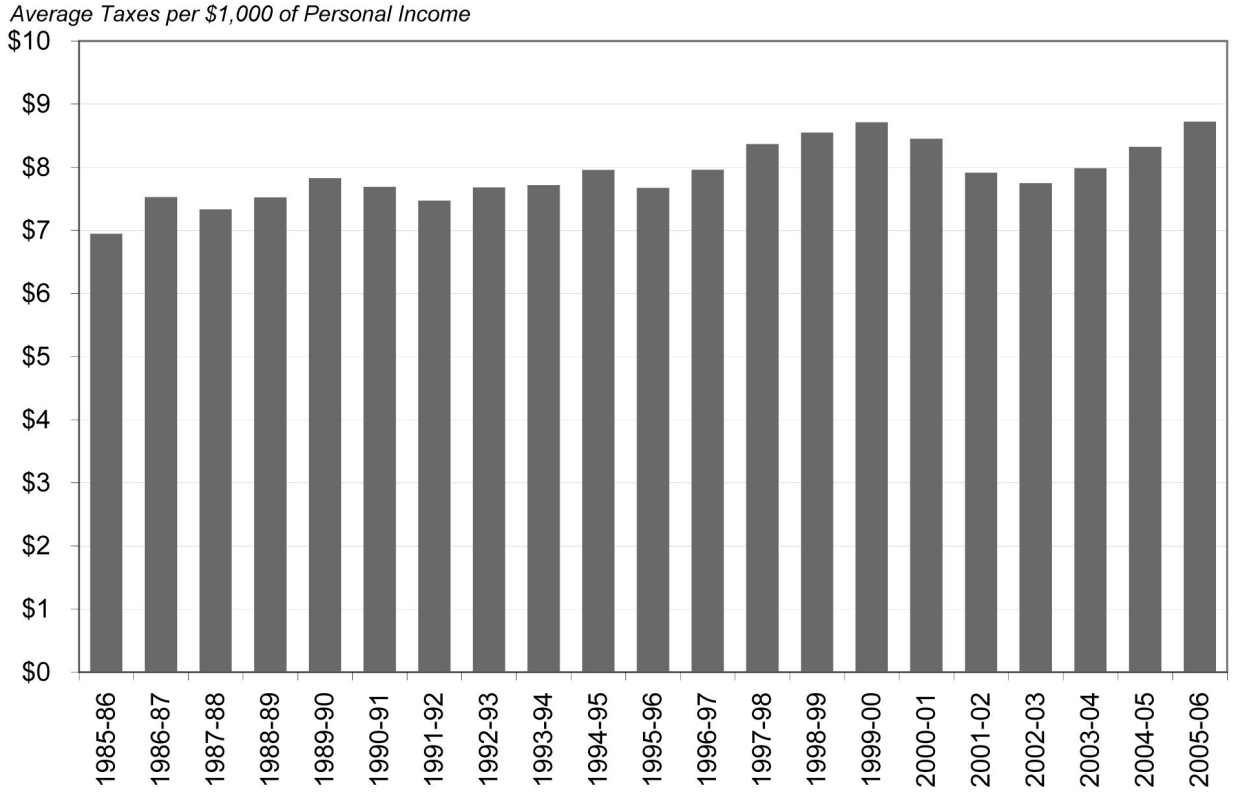
➤ In opposition to Governor Martin's bond proposal, the Democratic-controlled House approves a four-year "temporary" one-cent increase to the 5 percent sales tax. The revenue is to be used for school construction.

➤ The Senate Constitution Committee rejects Governor Martin's second request for veto power. His first request was rejected in 1985. Declares Martin, "[It is] shameful that for 211 years, only in North Carolina have the people never – not once – been allowed to vote on our governor having the veto."

June

➤ The *Charlotte Observer* reports that legislators filed over 700 bills during the 1987 session for local "pork barrel" appropriations totaling more than $100 million.

Individual Income Tax Revenue Compared to Personal Income



➤ The Senate indefinitely postpones consideration of the House tax increase while Lt. Governor Jordan claims he can find the needed revenue without raising taxes. House Speaker Liston Ramsey (D-Madison) claims that the disagreement over funding could be resolved by passing a stopgap measure to continue current funding, thus postponing debate until the 1988 session.

July

➤ With the House and the Senate unable to come to terms over a school construction bill that Democrats are trying to push through as an alternative to Martin's bond proposal, Lt. Governor Jordan offers a compromise. Essentially, Jordan's plan raises the corporate income tax from 6 percent to 7 percent, but repeals the local inventory tax (by promising that the state will

1987 Significant Tax Changes

⬆	The School Facilities Finance Act of 1987 [S.L. 1987-622, 1987-813]: ➔ Increase corporate income tax rate from 6% to 7% ➔ Repeal provision allowing merchants to retain 3% of retail sales tax collected ➔ Change remittance from quarterly to monthly for employers who withhold $500 or more each month ➔ Replace 40% income tax credit for property taxes paid on manufacturing inventories with a full exemption ➔ Increase 20% property tax exemption for wholesale and retail inventories to full exemption
⬆	Conform to Internal Revenue Code updates [S.L. 1987-778]
⬆	Enact new excise tax of 5¢ on each 30-dozen case of eggs sold for consumption [S.L. 1987-1402]
⬆	Increase excise tax on liquor from 22.5% to 28.0% [S.L. 1982-832]
⬆	Increase the per gallon credit for motor carriers' purchases of fuels from 12¢ to 14¢ per gallon [S.L. 1987-315]
⬇	New income tax credit for businesses that create jobs in "severely distressed" counties [S.L. 1987-568]
⬇	Lower employment security contribution (payroll tax) rate for employers from 2.70% to 2.25% of wages [S.L. 1987-17]
⬇	Tax credits for certain business investments [S.L. 1987-852]

1987 Other Revenue Sources & Actions

- Hold local governments harmless for losses due to School Facilities Finance Act

1987 EDUCATION FUNDING

ENROLLMENT CHANGES

- Public Schools: 590 (0.1%) decrease

TUITION & FEE INCREASES

- Average increase of 5% for in-state and 8% for out-of-state UNC students
- Increase of 12% for in-state and 39% for out-of-state community college students

OTHER EDUCATION CHANGES

- Increase funding for Basic Education Program ($125 million in 1987-88 and $260 million in 1988-89)
- Enhance BEP with additional teachers ($39 million in 1987-88 and $88 million in 1988-89)
- Increase funding for vocational education teachers ($21 million in 1987-88 and $41 million in 1988-89)
- $17 million for remedial summer programs in 1988-89
- Additional non-faculty positions ($15 million in 1987-88 for clerical positions and $42 million in 1988-89 for clerical and instructional support positions)
- $12 million in 1987-88 and $26 million in 1988-89 to continue a 16-pilot Career Development Program
- $12 million for medical education expansion at UNC
- $7.5 million for optical disk manufacturing training equipment at Central Piedmont Community College; $3 million for new and expanding industry support

reimburse local governments for the loss in revenue). The law wins approval after the House concurs with a Senate amendment that reimburses urban municipalities that will lose revenue from the repeal of the local inventory tax. As a result, business taxes increase by more than $1 billion (over 10 years); the first increase in 54 years.[1] The law also effectively raises the sales tax by eliminating the 3 percent merchant sales tax discount collected by many retailers.

➤ The governor ratifies the "School Facilities Finance Act of 1987" (S.L. 1987-622) on July 16. As mentioned above, the act raises the corporate income tax to fund school construction. In addition to creating the Public School Building Capital Fund and the Critical School Facility Needs Fund, the law also establishes the Commission on School Facility Needs, a five-member board appointed by the legislative leadership of the General Assembly.

➤ In response to whether he is concerned about having a tax label hung on him for raising the corporate income tax, Jordan says: "Some things you like hanging around your neck and some things you don't. I have no problem with that one."

➤ State Democratic Chairman Jim Van Hecke Jr. calls the Jordan compromise "a much, much better plan [than Governor Martin's bond plan]" while Phil Kirk, Martin's chief of staff, credits the governor for "getting school construction on the agenda."

August

➤ The General Assembly agrees to a 5 percent pay raise for state employees. This includes a raise for Governor Martin, who at $105,000 becomes the highest paid governor in the United States.

[1] Luebke, *Tar Heel Politics*, 46.

Martin, however, still makes less than UNC-system President C.D. Spangler, whose annual salary is $112,000.

➤ The Senate ratifies the $18.4 billion budget bill (S.L. 1987-738) on August 7. The final bill includes most of Governor Martin's requests, such as BEP funding for the next two years, funding for the Career Ladder program, and a 5 percent pay raise for state employees.

➤ Senate Minority Leader Larry Cobb (R-Mecklenburg) comments that "by and large, what we have in this bill is the lean budget which Gov. Martin presented."

➤ Legislature adjourns on August 14.

September

➤ Contemplating his own run for the governor's office, State Auditor Ed Renfrow (D) criticizes Governor Martin and other legislative leaders for their handling of the budget. Charges Renfrow: "When you don't adopt a budget by the beginning of the [fiscal] year, then you're not being fiscally responsible. I don't care what the reasons are."

October

➤ Governor Martin goes on retreat with his advisors in order to prepare for the 1988 election.

November

➤ In a speech before school administrators, Governor Martin continues to promote local bond votes as an alternative for funding school construction. Martin pledges to help "rally support" if participating counties agree to hold bond referendums on the same day.

1987 HEALTH & HUMAN SERVICES BUDGET

Total Appropriations $651 million

Major Items:

Medical Assistance (Medicaid):	$255 million
Hospitals & Centers:	$146 million
Social Services:	$73 million
Health Services:	$49 million
Vocational Rehabilitation:	$21 million
Mental Health:	$11 million

December

➤ North Carolina becomes one of eight finalists bidding for the $4.4 billion Superconducting Super Collider. The project would bring in 3,000 jobs and have an annual budget of $270 million. The U.S. Energy Department is scheduled to pick a site by July 1988.

DID YOU KNOW?

Over the last 20 years, Medicaid outlays have more than doubled as a share of the Department of Health and Human Services (DHHS) budget. For FY1985, Medicaid outlays were 28 percent of the DHHS budget; for FY2005, they were 63 percent. Over the last five years alone, the budget for the Division of Medical Assistance – which operates Medicaid – has increased by 59 percent.

Source: 1985-2005 Budget Bills

1988 session

1987-1988 BIENNIUM
FY 1989: July 1, 1988 to June 30, 1989

General Assembly:

House Dems:	84	House Reps:	36
Senate Dems:	40	Senate Reps:	10

Governor:
James G. Martin (R)

The 1988 Short Session:
Budget Bill HB2641/S.L. 1988-1086
Passed Senate: June 28, 1988
Passed House: June 29, 1988
Conference Version Ratified: July 7, 1988
Signed by Governor: July 8, 1988

Little of the acrimony of previous sessions pervaded this gubernatorial election year as both chambers seemed determined to finish the short session on time. Instead of squabbling with one another, legislators reserved their criticism for Governor Martin, who was running for reelection. As in 1987, the governor and Legislature mostly wrangled over how to fund transportation and education. Democrats again went along with Martin's education proposals, but they likewise refused to act on his proposed bond referendum—this time to pay for road construction and repair. As in past years, Democrats also accused Martin of co-opting their own initiatives. By the end of the year, projected revenue growth had slowed to almost half of the projected 6.3 percent increase—due to slower growth in tax revenue, but also declining investment returns and higher than anticipated bond payments. In November, Governor Martin easily defeated Jordan by a 12 percent margin, bringing with him a Republican Lt. Governor and 13 new Republican legislators. The election represented a watershed in North Carolina politics by confirming the Republican party's status as a viable statewide contender.

January

- Gubernatorial campaigns begin in earnest as Governor Martin and Lt. Governor Jordan (D) hit the campaign trail.
- While running for Lt. Governor, Senator Harold Hardison (D-Lenoir) promises to push for a statewide lottery ostensibly dedicated to raising teacher salaries.

February

- Governor Martin supports a plan to alter the manufacturer income tax formula so as to bring new businesses and jobs to North Carolina. Lt. Governor Jordan criticizes the plan as too expensive for North Carolina because it would lower taxes by some $26 million.

March

➤ Both Governor Martin and Lt. Governor Jordan pledge to support merit-based raises for state employees. Martin promises that his 1988-1989 recommended budget will mandate that half of state employee pay increases be treated as merit increases.

➤ Increased vehicle use and travel lead to a $23.6 million jump in Highway Fund revenue derived from vehicle registration fees, license fees, and the gas tax. At $592 million, the fund is running 4 percent ahead of projections for FY1987-1988.

➤ The Department of Transportation releases a report stating that $11 billion will be required to upgrade North Carolina's roads. Noting that Virginia passed a 0.5 percent sales tax increase to fund road construction, Senator Marc Basnight (D-Dare) argues, "I think the people of North Carolina would support and pay for it if they knew what the increase was going to build for them."

➤ In a speech before the N.C. Division of Aging, Governor Martin says he will ask the General Assembly to expand education and health care programs for the elderly, at a cost of $5 million. The proposal, claims Martin, will "address some of the most pressing concerns of our older adults in North Carolina," but "will in no way provide full and complete funding for all the services necessary."

April

➤ Lt. Governor Jordan attacks Governor Martin's Basic Education Program (BEP), charging that the governor failed to "support … the Basic Education Program when it mattered most, in 1985." The governor responds that he "ran in 1984 on a pledge to cut taxes" and that he "had an obligation … to deliver on that."

1988 Other Significant Changes

COMPENSATION

- Salary increase of 4.5% for teachers and most state employees
- 3.6% increase for state retirees

CAPITAL

- Increase of $85 million in capital spending
- $17 million for prison construction

OTHER

- $500,000 to establish a pilot program that will develop a Microenterprise Fund
- $3.5 million for the NC Zoo
- $1.5 million for chronically, mentally ill programs

➤ Democrats reject Governor Martin's initiative to consolidate state environmental activities under a new Department of Health and Environment. Martin says he will include the plan in his recommended budget so that legislators will have to deal with it.

May

➤ Governor Martin proposes $558.7 million in budget spending adjustments. Highlights of his recommended budget include a 4.5 percent pay raise for teachers and state workers, a plan to merge state environmental activities into a health and environment agency, and the creation of "senior centers" in 19 counties.

➤ Martin also proposes returning the sales tax commission – which permits merchants to keep 3 percent of the sales taxes they collect on the first $1.2 million in sales per year – to 90 percent (i.e., small to medium) of retail merchants. The discount had been abolished by the General Assembly the year before to pay for school construction.

1988 HEALTH & HUMAN SERVICES BUDGET

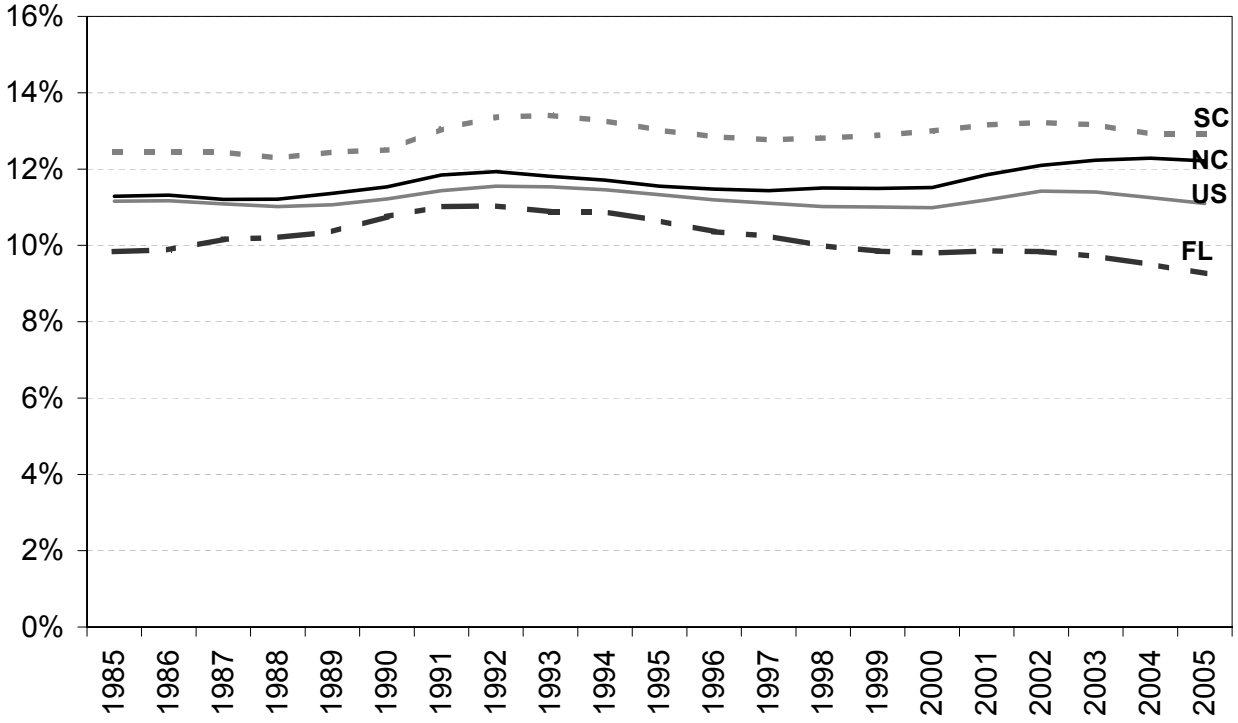
Total Appropriations	**$689 million**
Major Items:	
Medical Assistance (Medicaid):	$289 million
Hospitals & Centers:	$146 million
Social Services:	$73 million
Health Services:	$49 million
Vocational Rehabilitation:	$21 million
Mental Health:	$11 million

➤ After RJR Reynolds announces plans to build a bakery in Wake County, Governor Martin puts forth a proposal recommended by the company that would alter the state's "four-factor" business tax formula so as to allow companies to count sales tax twice. The tax cut will reduce state revenues by an estimated $26 million annually.

➤ Democrats staunchly oppose Martin's plan to place a $450 million road bond referendum on the November ballot. "I will not support it," declares House Speaker Liston Ramsey (D-Madison).

➤ The General Assembly's Executive and Legislative Salary Study Commission, comprised of 14 legislative members, recommends a 111 percent pay raise for legislators. Senator Ken Royall

State/Local Share of Total Nonfarm Employment: Select Southeast States, 1985-2005



(D-Durham) defends the study saying, "You can't expect people to serve over here and not have a living wage."

June

- Because of lower than projected tax revenues, Governor Martin says he will draft an amended budget that cuts $60 million in spending. Democratic leaders insist on cutting even more; $137 million.
- Lt. Governor Jordan claims Governor Martin intentionally proposed a budget that would have to be cut in an election year in order to make Democrats look bad. Charges Jordan, "They played politics with the state budget."
- The General Assembly approves the FY88-89 recurring budget (S.L. 1987-886), which includes a 4.5 percent raise for teachers and state workers, as well as a pay increase of about $900 (rather than 111 percent) for state legislators.

July

- House passes "An Act to Limit Campaign Expenditures and to Strengthen Public Financing of Political Campaigns" (S.L. 1987-1063). The new campaign financing system, slated to start in 1992, allows taxpayers to voluntarily contribute tax refunds to a publicly financed "Candidates Fund."

DID YOU KNOW?

In 1985, North Carolina ranked 29th among the 50 states in terms of ratio of state government employees to the private sector. By 2005, this ratio had jumped to 17th. In terms of absolute numbers, North Carolina had the sixth highest number of state government employees in the nation in 2004.

Source: Bureau of Labor Statistics

1988 Significant Tax Changes

⬆	Close loopholes that allow higher income taxpayers to claim the low-income tax credit [S.L. 1988-1039]
⬆	Expand the State Sales and Use Tax Act: the state may require out-of-state retailers to collect sales and use taxes on mail order sales to N.C. customers if the retailer has purposefully or systematically exploited the market in N.C. through solicitation by mail or advertising [S.L. 1988-1096]
⬇	Increase individual income tax deduction for federal civil service retirement pay and military retirement pay from $3,000 to $4,000 [S.L. 1988-936]
⬇	Create North Carolina Enterprise Corporations with income and franchise tax credits for 25% of the amount of an investment in such a corporation [S.L. 1988-882]
⬌	Establish the North Carolina Candidates Financing Fund, which permits taxpayers entitled to an income tax refund to contribute all or part of the refund to the Fund [S.L. 1988-1063]

1988 EDUCATION FUNDING

ENROLLMENT CHANGES

- Public Schools: 4,134 (0.4%) decrease

TUITION & FEE INCREASES

- Average increase of 4% for in-state and 8% for out-of-state UNC students
- No change for community college students

OTHER EDUCATION CHANGES

- $19 million to increase wages for adult bus drivers from $4.91 per hour to $6.10 per hour, plus additional benefits
- $7 million for the Uniform Education Reporting System
- $4 million in incentives to local school systems for after-school care (Latchkey)
- $12 million for a supercomputer for UNC research and training and science-based economic development
- General Assembly transfers fiscal functions to Superintendent of Public Instruction

➤ General Assembly passes two appropriations bills, one for public purpose funds (S.L. 1987-1085) and one (S.L. 1987-1086) authorizing funds for local projects, the North Carolina Zoo, drought relief, and water and sewer grants.

➤ The Legislature lets Governor Martin's bond proposal die.

August

➤ Lt. Governor Jordan attacks Martin's environmental record, stating that "the citizens of North Carolina are suffering from a lack of leadership at the top in the fight against pollution."

September

➤ Governor Martin and challenger Lt. Governor Jordan are expected to spend more than $4 million in television advertising by the November election. Both campaigns run commercials touting themselves as being the better education candidate.

October

➤ UNC system President C.D. Spangler Jr. laments the poor state of teacher salaries. Predicts Spangler, "In time, we will not be able to attract the best and most promising scholars and we will not be able to retain our best teachers and researchers."

➤ Tax revenue growth from September 1987 to August 1988 slows to 4.6 percent, the slowest growth rate over the same period since 1973-74. Senator Royall asserts, "If revenues don't improve, we're going to have to cut the budget." Including October, growth slows to 4.4 percent.

November

➤ Becoming the first Republican governor in North Carolina history to win a second consecutive term, Jim Martin captures 57 percent of the vote to defeat Robert Jordan.

➤ Republican Jim Gardner wins the Lt. Governor's election. Republicans also gain 13 seats in the General Assembly.

➤ Texas beats out North Carolina and six other states to win the $4.4 billion Superconducting Super Collider project.

December

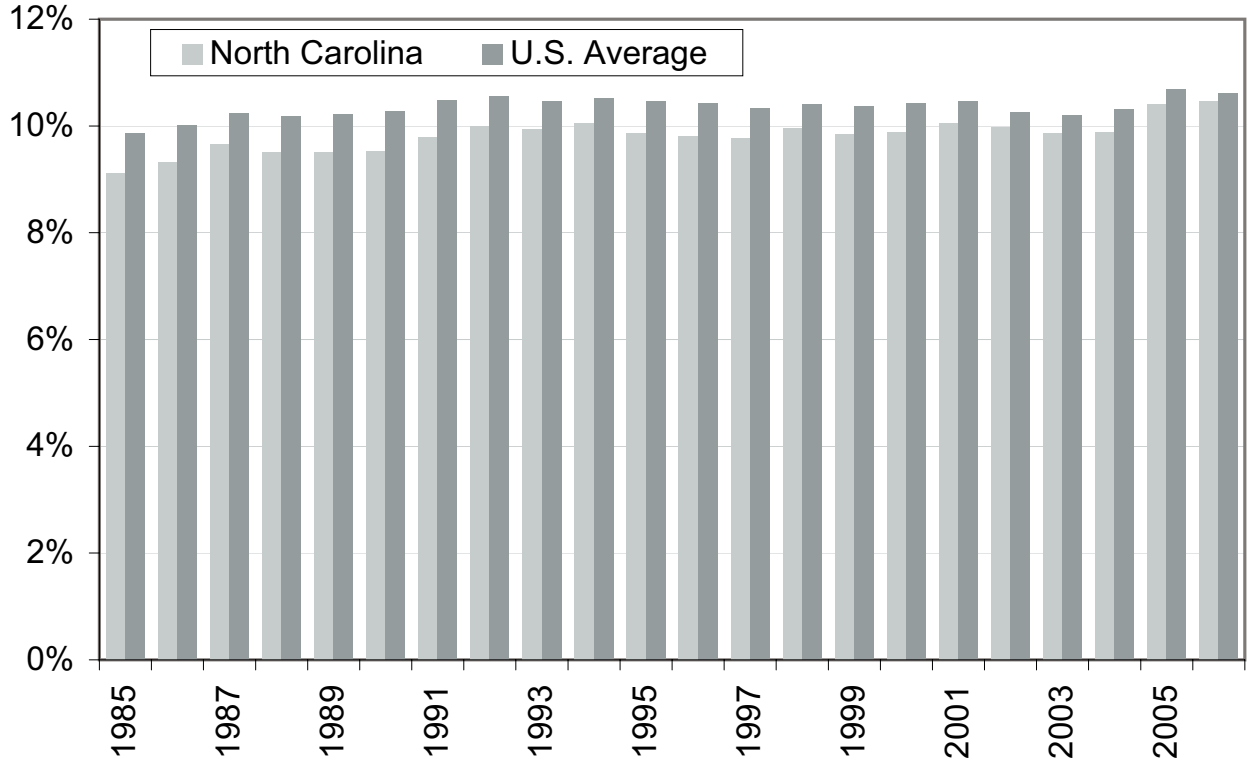
➤ Governor Martin orders a hiring freeze on 1,610 nonessential vacant positions due to lower than

expected growth in state revenue. The 3.5 percent rate of growth from July through November is almost three percentage points below the 6.3 percent rate presumed by the FY88-89 budget. Most of the loss in revenue, however, is due to declining investment returns and bond payments that have come due; tax collections are actually more than $4 million ahead of projected revenue.

➤ In reference to the economic slowdown, Senator Aaron Plyler (D-Union), chairman of the Senate Finance Committee, complains: "We won't have a lot of money. That means we won't be able to fund a lot of programs. And, as it stands now, there's no money for pay raises. That's very bad."

➤ At their biennial legislative conference, the North Carolina Association of County Commissioners votes to request authority from the General Assembly to impose new taxes, such as land transfer taxes and surcharges on personal and corporate income taxes.

State/Local Tax Burden for N.C. and the U.S.



1989 session

1989-1990 BIENNIUM
FY 1990: July 1, 1989 to June 30, 1990

General Assembly:

House Dems:	74	House Reps:	46
Senate Dems:	37	Senate Reps:	13

Governor:
James G. Martin (R)

The 1989 Long Session:
Budget Bill SB44/S.L. 1989-752
Passed Senate: June 28, 1989
Passed House: August 1, 1989
Conference Version Ratified: August 10, 1989
Signed by Governor: August 10, 1989

Taking advantage of the previous year's election gains, Republicans wielded more influence in the Legislature during the 1989 long session. At the direction of Governor Martin, Republican House members allied with a group of Democrats intent on ending Representative Liston Ramsey's (D-Madison) eight-year reign as Speaker. Ramsey's tight control over the budget process, as well as the atmosphere of secrecy under which he and his lieutenants operated, made him vulnerable to a revolt. In return for supporting Representative Joe Mavretic's (D-Edgecombe) bid to unseat Ramsey, House Republicans were rewarded with 40 percent of the cochairman positions on study commissions that met to prepare for the 1990 session.

In spite of Republican gains, the 1989 session ended with the largest single tax increase in half a century. The 5.25 cent gas tax increase was primarily used to finance the $8.2 billion Highway Trust Fund (HTF) that Governor Martin put forth as a solution to the state's decaying highway system. Education funding, especially for teacher salary increases, was also a primary budget driver. Governor Martin encountered major opposition to his plan to delay teacher salary increases for 9 months because of lower than projected revenue collections. After teachers mobilized to protest, Martin was forced to compromise by reducing funding for the Basic Education Program (BEP) and increasing taxes.

Gridlock between the House and the Senate over teacher raises and the Highway Trust Fund caused the session to drift into August. The 214-day session set a record (broken in 2001) as the longest in North Carolina's history.

January

➤ Governor Martin recommends full funding of the next two-year phase of the Basic Education Program. He also

proposes cutting 505 vacant state jobs to free up $12.6 million for education spending.

➤ State Auditor Ed Renfrow criticizes the proposed job cuts, saying: "Education is no more sacrosanct, as far as I'm concerned, than any other department."

➤ Lt. Governor Jim Gardner becomes the first Republican to preside over the Senate in more than 80 years.

➤ House Speaker Liston Ramsey (D-Madison) faces dissention among fellow Democrats, who join with Republicans in ousting Ramsey. Representative Joe Mavretic (D-Edgecombe) defeats Ramsey for Speaker of the House.

➤ In his State of the State address, Governor Martin outlines his $22.8 billion budget, which includes full funding for the next phase of the BEP and merit raises for teachers, but delays until April 1990 a 5.7 percent pay raise for teachers and a 4.5 percent pay raise for state workers.

➤ Martin renews his appeal for a referendum on executive veto power. He also calls on the Board of Education and the General Assembly to consider instituting a school choice program that would permit parents to pick the school their children would attend.

➤ Representative David Redwine (D-Brunswick) introduces a state lottery bill (HB 96).

February

➤ In the face of fierce opposition from teachers, Governor Martin proposes that legislators consider delaying implementation of parts of the BEP in order to fund teacher raises.

1989 Other Significant Changes

COMPENSATION

- Salary increase of 4% plus 2% merit funds for most state employees
- 6.65% average salary increase for teachers
- $22 million more than estimated for new salary schedule for public school teachers

DISASTER ASSISTANCE

- $18 million to match federal assistance for victims of Hurricane Hugo and a tornado in the fall

➤ Increased enrollment and a $1.5 million budget shortfall causes a shortage of funds in higher-education grants for private schools for the spring semester. The state program provides $1,100 per year in grants for North Carolina residents attending one of the state's private schools.

➤ Martin calls for a summit with education leaders to discuss teacher salaries.

➤ With House Democrats on the Legislative Highway Study Commission demanding that $6.9 billion in highway construction funds be evenly divided across the state (i.e., according to an equity distribution formula), Governor Martin threatens to pursue his own plan unless a compromise is reached.

March

➤ Governor Martin proposes eliminating the state sales tax on

food in order to excuse raising the state sales tax by one cent. The governor also pushes for a gasoline tax increase of 5.25 cents per gallon to fund road construction.

➤ It is discovered that due to a provision that allows the General Assembly to keep unspent funds, the Legislature has a $9 million surplus.

➤ House Majority Leader Dennis Wicker (D-Lee) hires former Representative Jim Black as an administrative aide. (Black served from 1980, but was defeated in 1984 and reelected in 1990.) Wicker says he "was looking for somebody who had served in the General Assembly and understood the legislative process … somebody with some political savvy."

April

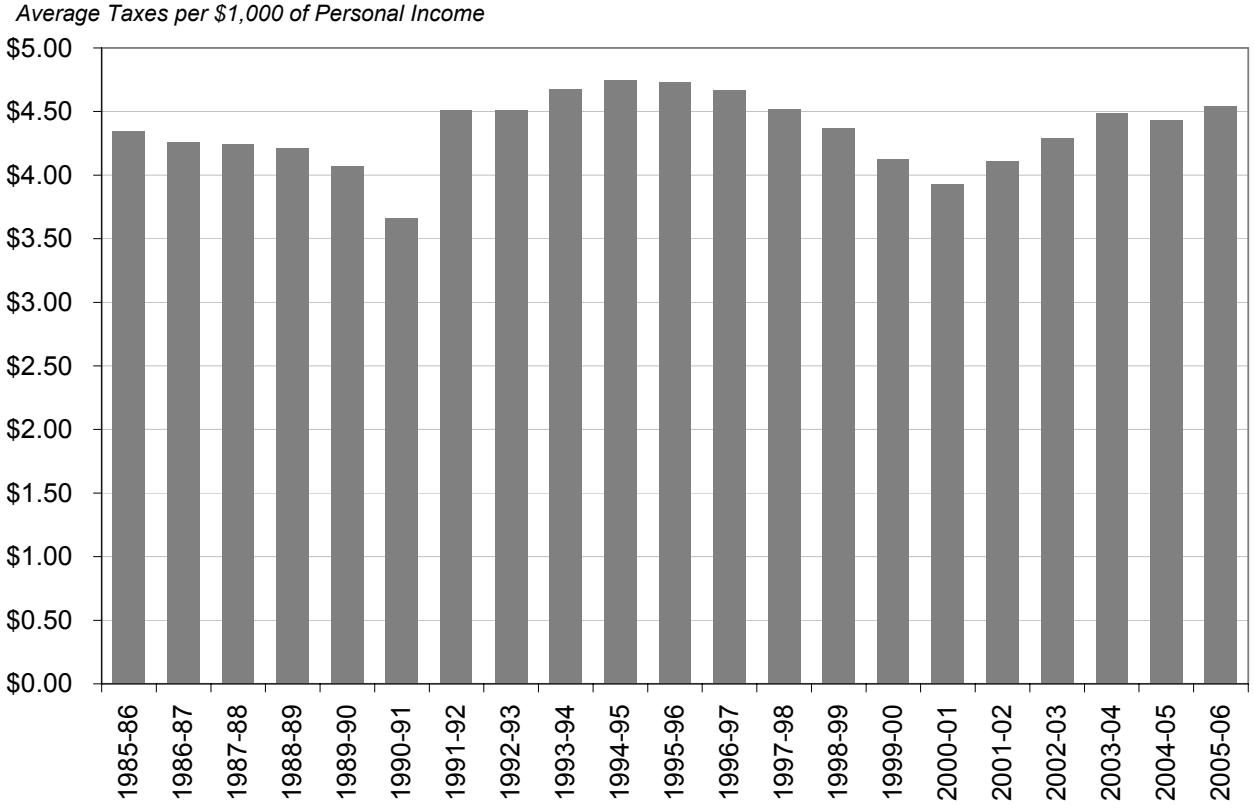
➤ Speaker Mavretic abolishes the pork barrel appropriation system that gives each House member $30,000 in discretionary appropriations.

➤ 2,000 teachers march on the Legislative Building in an attempt to pressure legislators to raise salaries.

May

➤ The General Assembly considers raising the state sales tax one cent while restructuring the personal income tax so as to exempt a family of four making less than $13,000.

Sales & Use Tax Revenue Compared to Personal Income



➤ A House appropriations subcommittee proposes the largest tuition hike in 20 years for the UNC system: 20 percent for in-state students and 15 percent for out-of-state students. Representative Martin Nesbitt (D-Buncombe) opposes the plan, saying that money should not be taken from students and parents until "we've exhausted the other possibilities, then we'll get their money."

June

➤ Gridlock hits the General Assembly as legislators cannot agree on how to pay for teacher raises. By late June, seven separate plans are being debated. The House and the Senate also cannot agree on highway funding.

1989 Significant Tax Changes

⬆	Revenue sources for the newly created Highway Trust Fund [S.L. 1989-692, as amended by -700, -770, -788, and -799]: ➔ Increase the motor fuel tax by 5¼¢ a gallon ➔ Increase certificate of title fee from $5 to $35; increase related fees to $10 ➔ Replace the 2% ($300 maximum) sales tax on motor vehicles that went to the General Fund with a 3% ($1,000 maximum) "highway use" tax payable when certificate of title is issued ➔ Transfer part of the increased revenue from the new highway use tax from the Highway Trust Fund to the General Fund in 1989-90 and 1990-91
⬆	Raise the sales tax cap on sale of a boat, aircraft, railway car, or locomotive from $300 to $1,500 [S.L. 1989-692, as amended by -700, -770, -788, and -799]
⬆	Increase estimated individual income tax reporting threshold from 80% to 90% [S.L. 1989-692, as amended by -700, -770, -788, and -799]
⬆	Increase the short-term rental rate for motor vehicles from 2% to 8% [S.L. 1989-692, as amended by -700, -770, -788, and -799]
⬆	Repeal the insurance premium tax sunset [S.L. 1989-346]
⬆	Create a one-time tax amnesty program and increase criminal penalties for failure to pay [S.L. 1989-557]
⬆	Change the individual income tax status of retirement benefits [S.L. 1989-792]
⬇	Tax savings of $85 million due to a change in the state income tax statutes allowing S-Corps to be taxed as if they were partnerships [S.L. 1989-728]
⬌	Tax Fairness Act: base the state individual income tax on a percentage of federal income tax liability and make other changes [S.L. 1989-728]: ➔ Designed to be revenue neutral (taxes reduced for 65% of low to moderate income taxpayers and increased for the remaining taxpayers)

➤ With no budget in sight, the General Assembly passes a Continuing Budget Authority bill (S.L. 1989-547) that extends funding until July 15.

1989 HEALTH & HUMAN SERVICES BUDGET

Total Appropriations $818 million

Major Items:

Medical Assistance (Medicaid):	$384 million
Hospitals & Centers:	$174 million
Social Services:	$78 million
Health Services:	$55 million

July

➤ Every day the General Assembly meets past June 30 costs taxpayers $39,000.

➤ House negotiators agree to endorse a Senate plan to pay for teacher raises over two years by raising taxes on auto sales if the Senate agrees that the Highway Trust Fund program will be completed in 12 years, instead of 15, at a cost of $8.6 billion. The House also agrees to raise the gas tax 5.25 cents per gallon to 20.95 cents, but leave the state sales tax untouched.

➤ Continuing budget authority bills are passed on July 15 (S.L. 1989-649), extending funding to July 28; and again on July 27 (S.L. 1989-689), extending funding to August 28.

➤ On July 22 the Legislature breaks the previous session-length record of 192 days set in 1983.

➤ A new House-Senate "compromise" brings about the establishment of the Highway Trust Fund (S.L. 1989-692) on July 27. The fund is to be used to finance a 13.5-year, $8.2 billion, highway/road expansion project. The fund's main source of income is derived from a 5.25 cent per gallon gas tax increase and a new 3 percent "highway use tax" levied on title transfers (i.e., a sales tax on vehicle purchases) that is to replace a 2 percent sales tax on vehicles. The law also increases vehicle title fees from $5 to $35 and increases the tax on vehicle rentals from 2 percent to 8 percent. "There's a tremendous tax increase here," says Representative Bob Hunter (D-McDowell). "But I'm proud of this bill." Adds Representative Herman Gist (D-Guilford), "This is about as much tax as the citizens of North Carolina can stand."

➤ For the first two years, however, the vehicle sales tax is to be used to fund a 6 percent teacher pay raise. Concern over how the state will fund the recurring increase once the HTF money runs out leads many Republicans to vote against the bill. Charges Senator Larry Cobb (R-Mecklenburg), "This bill is fiscal irresponsibility." Governor Martin also opposes the two-year HTF transfer – calling it "the highway robbery plan." Martin had recommended paying for the teacher raises with a one-cent sales tax instead. In the end, the bill passes primarily because legislators are afraid to vote down new road building projects in their districts.

August

➤ Passed on August 10, the new budget (S.L. 1989-752) contains a 6 percent raise for teachers.

➤ Although Governor Martin's proposal to expand his Career Ladder program fails, on August 12, the General Assembly passes "The School Improvement and Accountability Act of 1989." In effect, the new act (S.L. 1989-778) replaces Career Ladder with the "Performance-based Accountability Program," which permits local school systems to develop their own differentiated, performance-based pay scale.

➤ Governor Martin's attempt to acquire executive veto power also fails, as does Representative Redwine's lottery bill.

September

➤ On September 22 Hurricane Hugo strikes North Carolina, causing an estimated $1 billion in damage.

October

➤ House Speaker Joe Mavretic makes good on his promise and appoints Republicans to cochair 40 percent of the study commissions that meet to prepare for the 1990 short session.

November

➤ Governor Martin recommends using $21 million from a state worker health care cost reserve to help fund hurricane relief efforts.

➤ The Council of State decides to use $21.1 million from lapsed salaries (i.e., cost-savings created by job vacancies) for hurricane relief instead of Martin's proposal.

1989 EDUCATION FUNDING

ENROLLMENT CHANGES

° Public Schools: 3,401 (0.3%) decrease
° UNC: 4,802 (3.5%) decrease

TUITION & FEE INCREASES

° Average increase of 12% for in-state and 14% for out-of-state UNC students
° Increase of 18% for in-state and 19% for out-of-state community college students

OTHER EDUCATION CHANGES

° Increase funding for Basic Education Program ($69 million in 1987-88 and $181 million in 1988-89 for 6,343 teachers, support, and clerical positions by 1988-89)
° Through UNC, fund a portion of the recommendations of the Study Commission on Nursing
° $5 million in 1989-90 and $10 million in 1990-91 for a "Restoration Fund" to help fund program needs at a more sufficient level
° School Improvement and Accountability Act approved by General Assembly

December

➤ At 12.7 deaths per 1,000 births, preliminary statistics from the medical journal *Pediatrics* reveal that North Carolina ranks last among the states and ahead of only the District of Columbia in infant mortality rates for the year 1988.

➤ To meet overcrowding demands in the state prison system, Governor Martin proposes expanding the prison system by 53 percent. As with similar projects related to education and transportation, Martin proposes financing the expansion through $490.5 million in bonds.

Public Sector Employment Growth in North Carolina

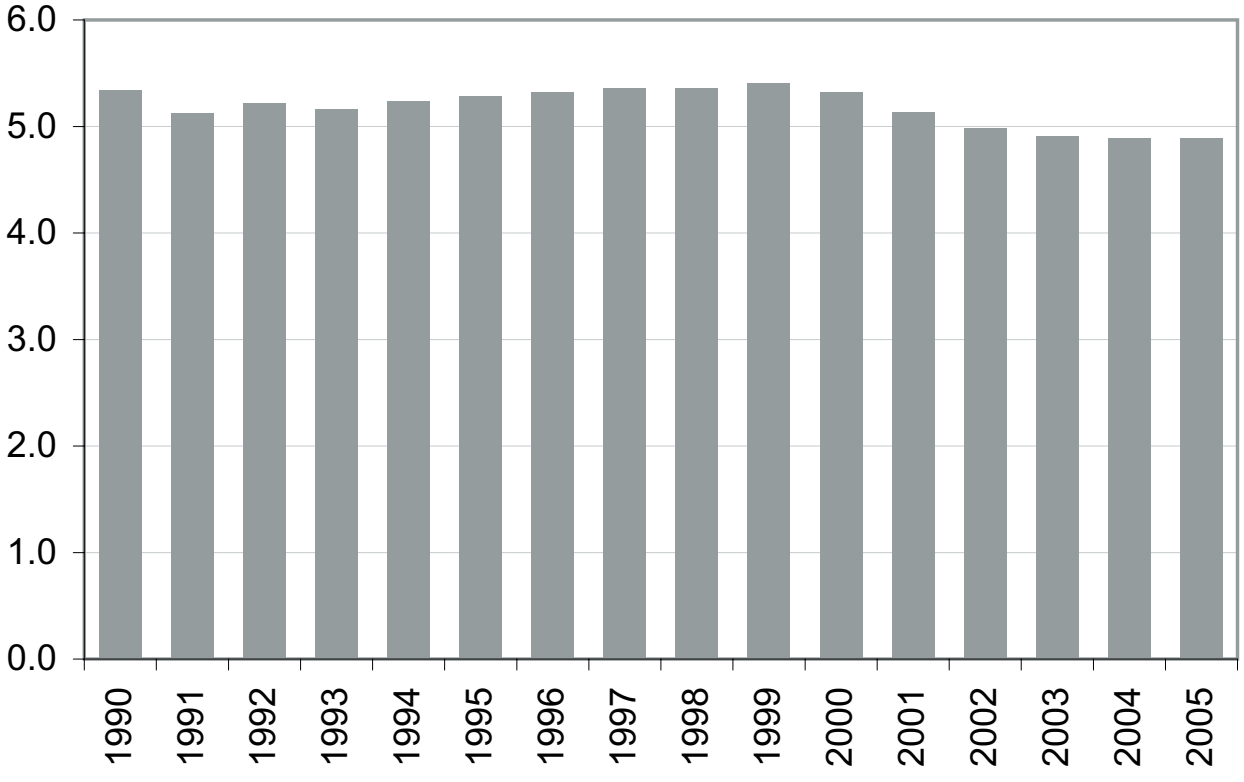
The size of the state government is arguably best measured by tracking the number of employees working for the state. People, after all, are what comprise the actual government. Similarly, the largest single expenditure in the state budget consists of salaries for state employees. By tracking the ratio of public to private employees we can thus get a good read on whether the size of the state government is actually increasing in relation to the private sector. What we find is that it is.

In 1985, North Carolina ranked 29th among the 50 states in terms of the ratio of state government employees to the private sector. By 2005, this ratio had jumped to 17th.

Today, the ratio of public employees to private employees is at an all-time high. As Figure 1 shows, in 2005 there were 4.9 private employees per public employee. This means that for every one public employee – state, federal and local – there were fewer than five employed in the private sector. (This ratio, however, does not account for those employees in the private market who are indirectly paid by the government – for example, farmers who receive subsidies and medical professionals reimbursed by Medicaid).

In order to understand what this trend indicates, we need to realize that the

Fig. 1. Private Employees per Government Employee



Though the hiring freeze instituted by Gov. Mike Easley early this year has caused some hardships among state agencies, it hasn't really resulted in any significant drop in the number of state workers. There were 112,317 employees on the state payroll as of Nov. 1, compared to 112,333 who were on the payroll a year ago, according to the Office of State Budget and Management. Those figures do not include teachers and other employees in the secondary and elementary school systems.

***News & Observer,* Nov. 13, 2001**

increase in public sector employment cannot primarily be attributed to ailing fortunes in the private sector. While employment in the private sector declined during the 2001-2003 recession, in 2004 and 2005 the private sector added 100,000 people to the payrolls. Unemployment in 2005 was 5.2 percent, down from 6.6 percent in 2003. Despite the state's late recovery from the recession – a recovery delayed by the 2001 tax increases (see Q & A: 11) – by 2006 the private sector had recreated the jobs lost during the recession.

The real cause of the surge in public sector hires is the refusal to make the politically difficult decision to cut the overall number of state jobs during economic downturns. From 2000 to 2003, for instance, employers in the private sector eliminated 163,000 positions. Meanwhile, the public sector – again, federal, state, and local – added some 19,200 people in North Carolina. Thus, even in spite of a hiring freeze instituted by Governor Easley in February 2001, the state added jobs – in part, because the freeze did not apply to "essential" and "critical" positions. Moreover, although the 2001 budget cut about 400 state jobs, state employees received an across-the-board raise of $625. The budget also provided for the hiring of more teachers in conjunction with the state's initiative to

Fig. 2. Private vs. Other Employment

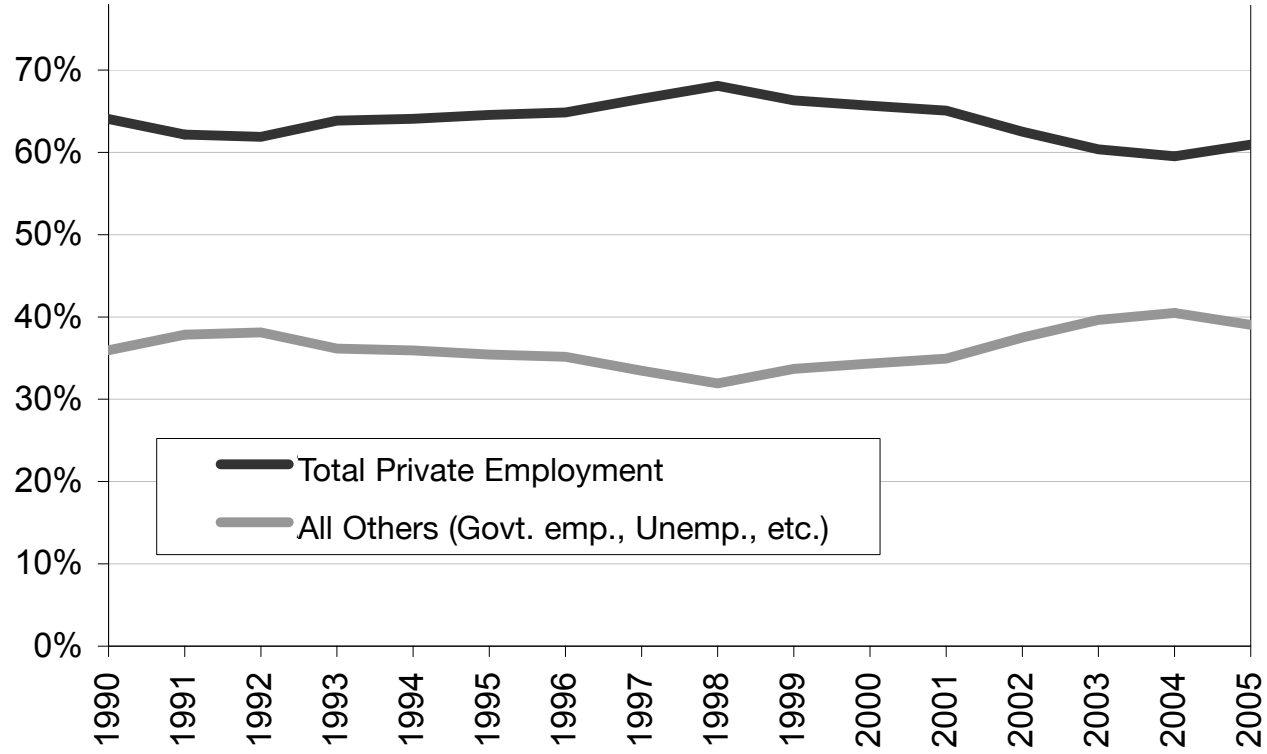
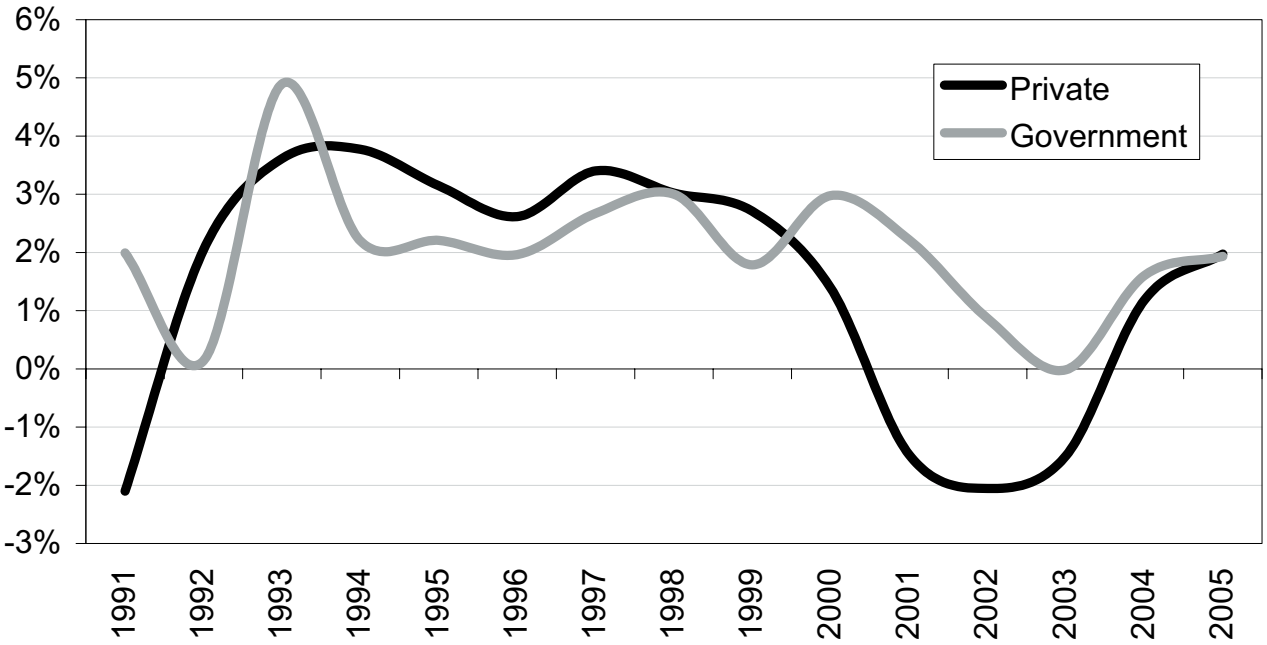


Fig. 3. Percent Change in Private vs. Government Employment



reduce class sizes. Teachers and university professors likewise received a 2.86 percent average pay raise. Similarly, in 2002, the state budget cut some 814 filled and unfilled positions, but then hired 1,050 new teachers and also gave teachers a 1.84 percent average pay increase. Indeed, according to numbers provided by the Fiscal Research Division of the General Assembly, total state employment increased by 26,195.5 positions from 2001 to 2005. This represents a 9.3 percent increase over the total state employee count (282,135) for 2001. Thus, even as the private sector was downsizing during the latter part of the recession, the state government expanded by almost 10 percent.

The continuous expansion of public sector employment has led to a drop in the number of private employees per public employee in North Carolina. As Figure 1 indicates, in 1990, 1995 and 2000 there were 5.3 private employees per public sector employee. By 2004 this figure had dropped to 4.9 private employees per public sector employee. This 7.5 percent decrease is all the more important because it occurred during a period when the private sector was cutting jobs – and thus during a period when per capita tax revenue was declining.

In summary, only 6 out of 10 working-age (aged 18-64) North Carolinians now hold a private sector job. This rate is the lowest it has ever been. This means that 40 percent of the workforce is either working for the government, unemployed or outside the workforce – i.e., early retirees, students, and unemployed no longer looking (Figure 2).

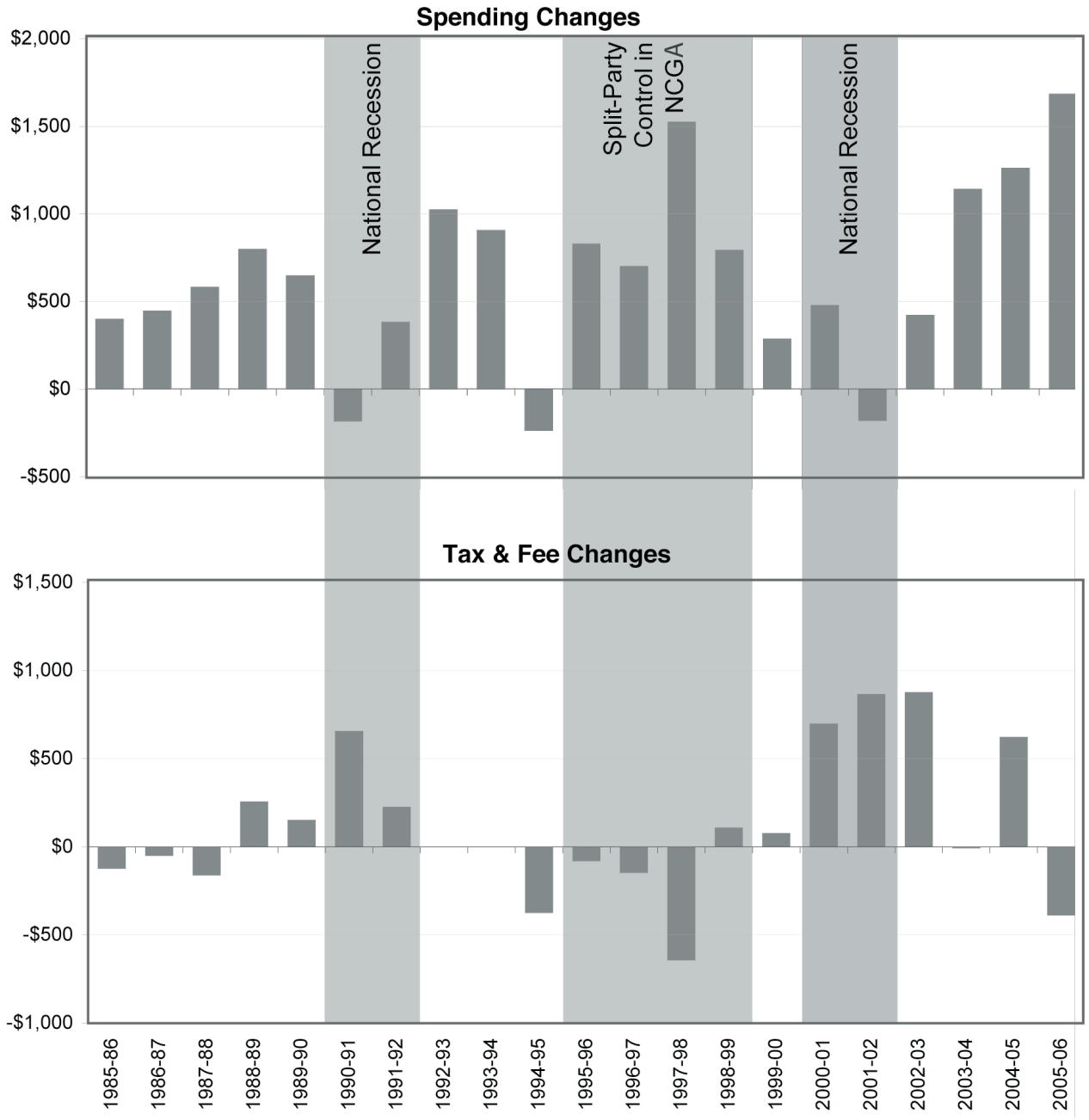
Indeed, if we concentrate our analysis on the active labor force (a statistically defined group), rather than just the workforce-aged population, the results are even more startling. In 2005, three out of four people (75 percent) of the active work force were employed in the private sector. This is down from an 80 percent peak reached in 1998-99. Thus, over the course of Governor Easley's tenure, the number of persons either employed by the state or outside of the active workforce – measured in relation to the privately employed labor force – has increased by 25 percent (Figure 2).

DID YOU KNOW?

Between FY1990 and FY2001, state tax revenues doubled in North Carolina – increasing 99 percent from $7.87 billion to $15.63 billion. By contrast, population growth, plus inflation, grew by only 67 percent.

Source: Cato Institute

Spending & Revenue Changes



1990-1994

General Economic Trends: 1990-94

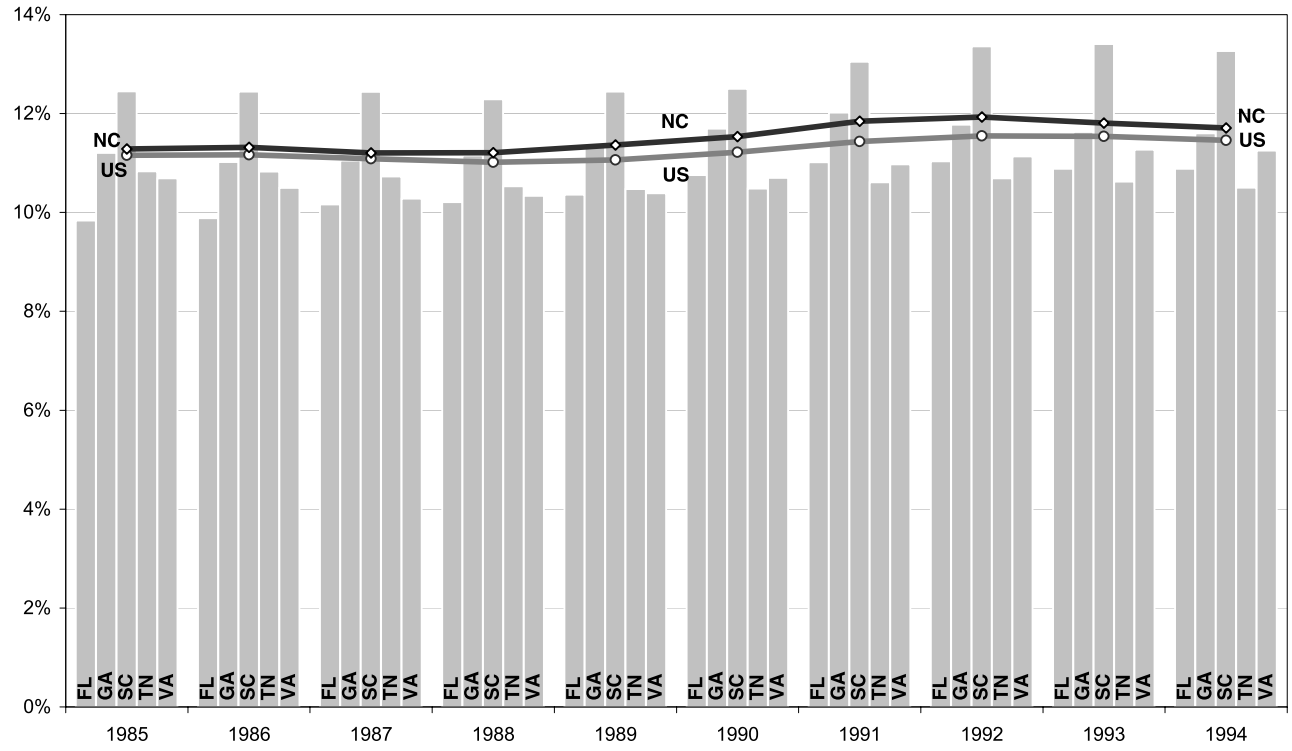
Overall, North Carolina's economy outperformed the U.S. economy during the 1990s. This growth was reflected by increases in per capita personal income, as well as private sector job growth.

In 1990 North Carolina's per capita personal income was 88.5 percent of the national average; by the end of the decade, it had grown to 91.5 percent of the national average.

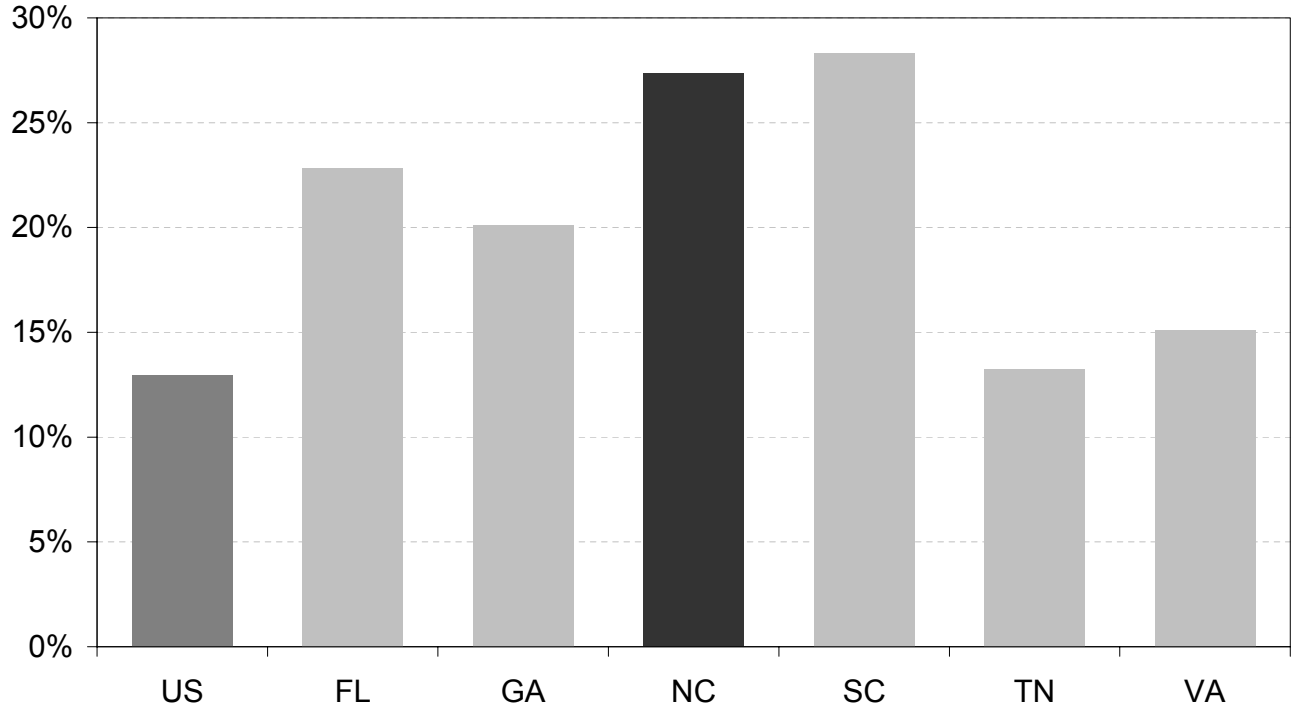
During the first part of the 1990s, the private sector weakened, losing some 39,000 jobs from 1990 to 1991. Beginning in 1992, however, the job market rebounded, adding 285,000 jobs between 1992 and 1994. Overall, the private nonfarm employment share increased from 81.9 percent in 1990 to 83.2 percent in 1999.

Earnings per private sector job grew by 4.2 percent per year between 1990 and 1994, although much of this increase can be attributed to a 7 percent jump

State/Local Government Share of Total Nonfarm Employment: Southeast States, 1985-1994



State/Local Government Employment Growth: Southeast States, 1985-1995

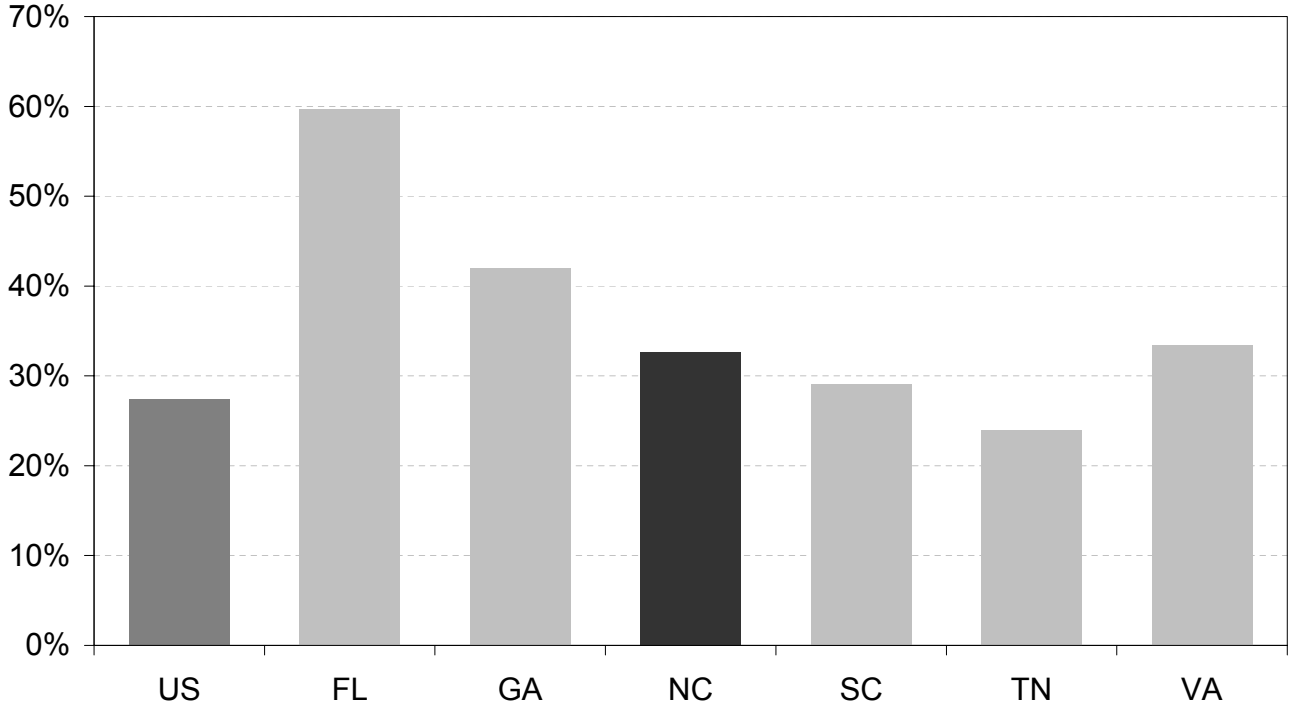


in 1992. This jump was probably caused by a normal rebound in the national economy, which led to a rapid rise in the demand for labor nationwide, as well as in North Carolina.

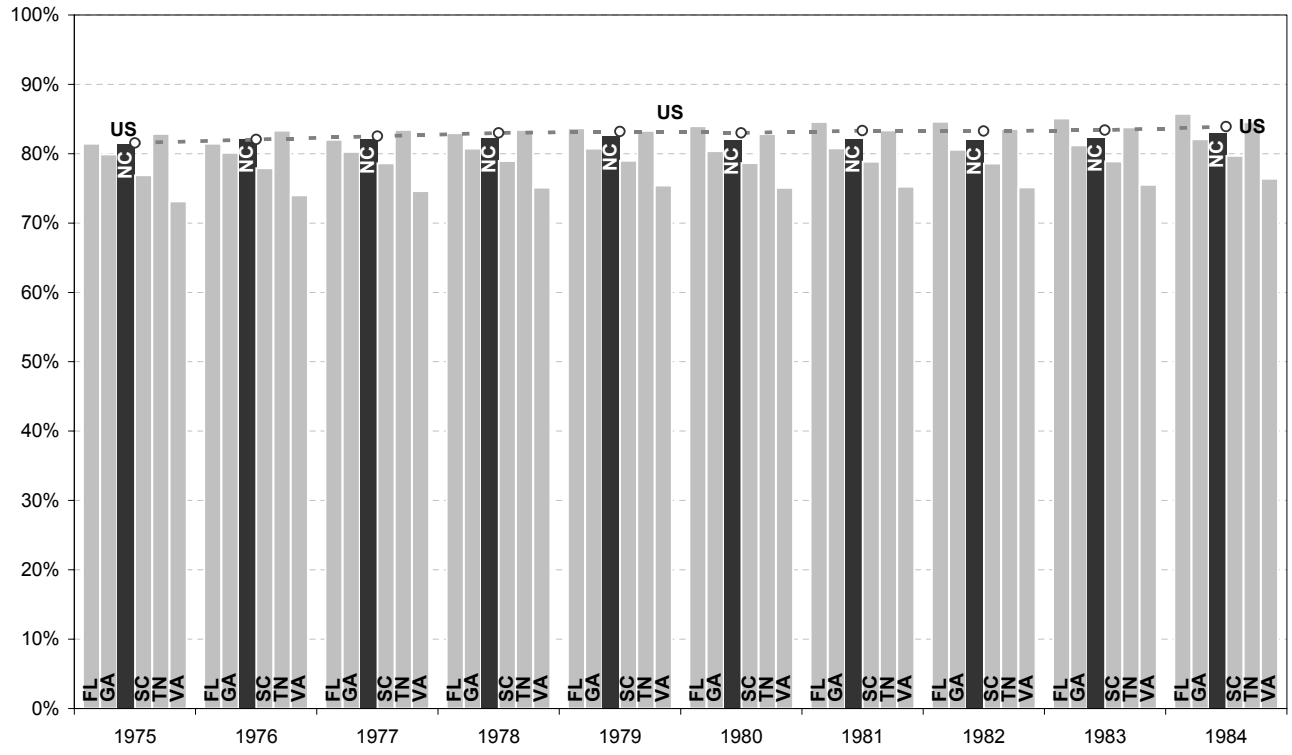
In spite of fluctuations in General Fund tax revenue from 1990 to 1994, state and local government employment increased steadily at an average of 2.3 percent per year for the period. Earnings per state and local position grew at 3.2 percent annually. As a result, earnings in the private sector began to catch up with earnings in state and local government jobs, a reversal of the trend that emerged between 1985-1989. By 1994, compensation for a public sector job was $1.12 per $1.00 of compensation for a private sector job, down from the $1.23 peak of 1989.

In terms of personal income, North Carolina continued to gain on the rest of the country. Per capita personal income rose from 88.5 percent of the national average in 1990; to 90.4 percent in 1992; to 92 percent in 1994. In relation to neighboring states, North Carolina increased its per capita personal income compared to Kentucky and South Carolina, who fell farther behind. Both Tennessee and Virginia, however, outperformed the Tar Heel state. Tennessee's growth rate was 5.4 percent per year from 1990 to 1994, although its stunning growth tapered off after that. Similarly, Virginia's per capita personal income grew steadily, remaining at four cents per dollar above the national average for the period.

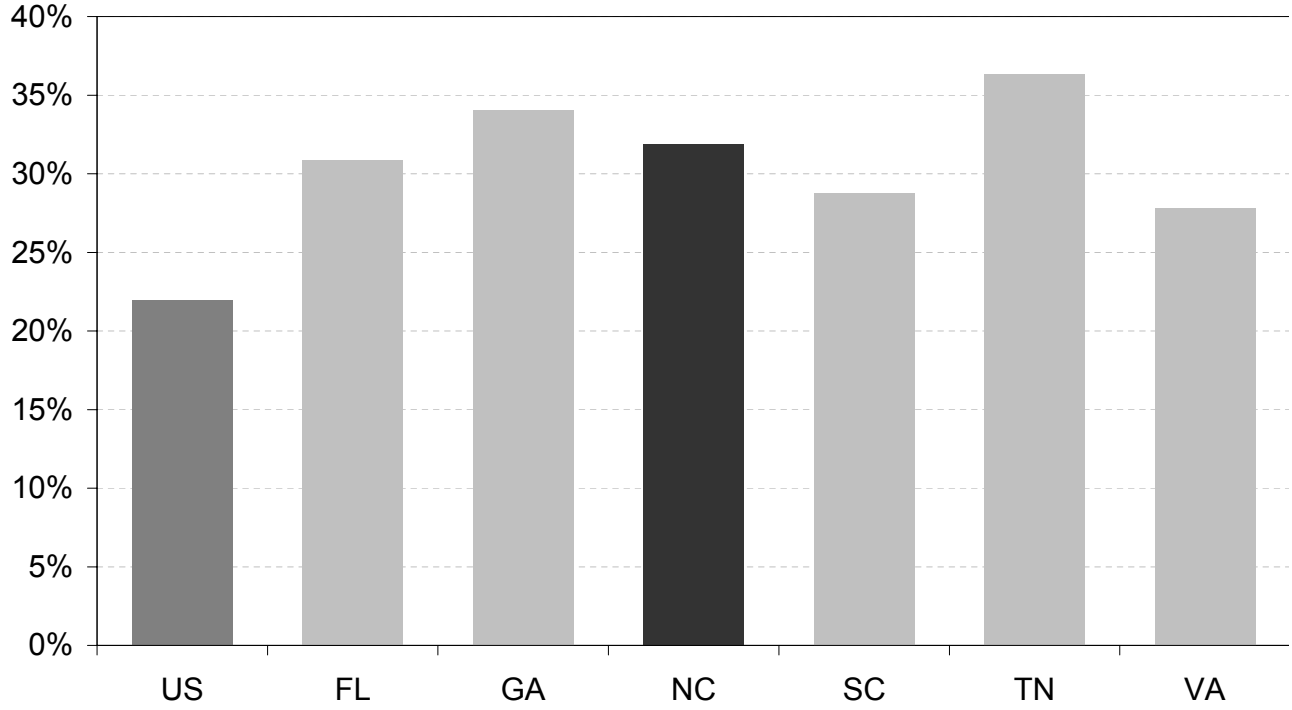
Total Nonfarm Employment Growth: Southeast States, 1985-1995



Private Share of Total Nonfarm Employment: Southeast States, 1985-1994



Total Private Employment Growth:
Southeast States, 1985-1995



1990 session

1989-1990 BIENNIUM
FY 1991: July 1, 1990 to June 30, 1991

General Assembly:

House Dems:	74	House Reps:	46
Senate Dems:	37	Senate Reps:	13

Governor:
James G. Martin (R)

The 1990 Short Session:
Budget Bill SB1426/S.L. 1990-1066
Passed Senate: June 18, 1990
Passed House: June 10, 1990
Conference Version Ratified: July 28, 1990
Signed by Governor: July 28, 1990

With the state still recovering from Hurricane Hugo, North Carolina's economy began to slow down, foreshadowing the 1991 recession. The subsequent decline in revenue collections caused a budget deficit for FY1990-1991. In response to the shortfall, Governor Martin called for across-the-board cuts in every department. Predictably, Martin's recommendation was met with opposition from Democrats in the General Assembly. Hesitant to arouse the election-year ire of voters, the Democrats failed, however, to pass a counterproposal that would increase taxes. Instead, the final budget enacted cuts in education, primarily to the UNC system budget; although the teacher and state worker raises passed in the previous year's budget were left untouched.

Responding to the news that North Carolina has the highest infant mortality rates in the country, Governor Martin also made prenatal and neonatal care a priority. Finally, in November's statewide elections, Republicans picked up two seats in the Senate but lost nine seats in the House. Voters also endorsed a less ambitious version ($200 million instead of $490 million) of Martin's prison construction bond. The year ended with reports of a further decline in revenue collections, thus setting the stage for a contentious legislative session in 1991.

1990 HEALTH & HUMAN SERVICES BUDGET

Total Appropriations **$883 million**

Major Items:

Medical Assistance (Medicaid):	$448 million
Hospitals & Centers:	$173 million
Social Services:	$80 million
Health Services:	$55 million

January

➤ Acting quickly on the December 1989 news that North Carolina's infant mortality rate is highest in the nation, Governor Martin creates the

Economic Snapshot: 1990

Population:	6,632,448	Five-Year Population Growth:	5.9%
Civilian Labor Force:	3,471,000	Unemployment Rate:	3.8%
Per Capita Income:	$ 17,295	Pct. of U.S. Per Capita Income:	88.3%

Top 10 Private Employers

1. Sara Lee Corp.
2. Food Lion, Inc.
3. Duke University
4. IBM Corporation
5. Burlington Industries
6. Fieldcrest Cannon, Inc.
7. Duke Power Company
8. RJR Nabisco, Inc.
9. US Air, Inc.
10. Harris Teeter, Inc.

Commission on Reduction of Infant Mortality. In addition to a $10 million package proposed by the commission, Martin also asks for $4.5 million to assist with the medical care of pregnant teens living with their parents.

➤ A revenue shortfall of $285 million is expected to force legislators to cut spending.

February

➤ With the budget shortfall threatening to eliminate or reduce the 6 percent raise teachers received in the 1989-90 budget, approximately 40 teachers hold a vigil in Charlotte to commemorate the one-year anniversary of their march on Raleigh.

➤ Governor Martin announces he will retire from political life. Citing the hostility from Democrats he has faced as governor, Martin says he has "lost interest in any other political office."

March

➤ Health Director Ronald Levine recommends $3.5 million in spending on infant mortality projects designed to increase pregnancy education and the number of maternity care coordinators throughout the state.

➤ The revenue shortfall is now expected to reach $205 million. Governor Martin states that tax cuts are not to blame, but rather the inability to "forecast revenue increases in a year with a major change in the tax code."

➤ Legislators ignore Governor Martin's $490 million bond proposal for prison construction, instead opting for a two-year plan that would add fewer cells and rely on community-based programs like house arrest. Governor Martin criticizes the proposal saying, "The reason we want to build more prisons is so we can lock up the more-dangerous offenders for a longer time."

April

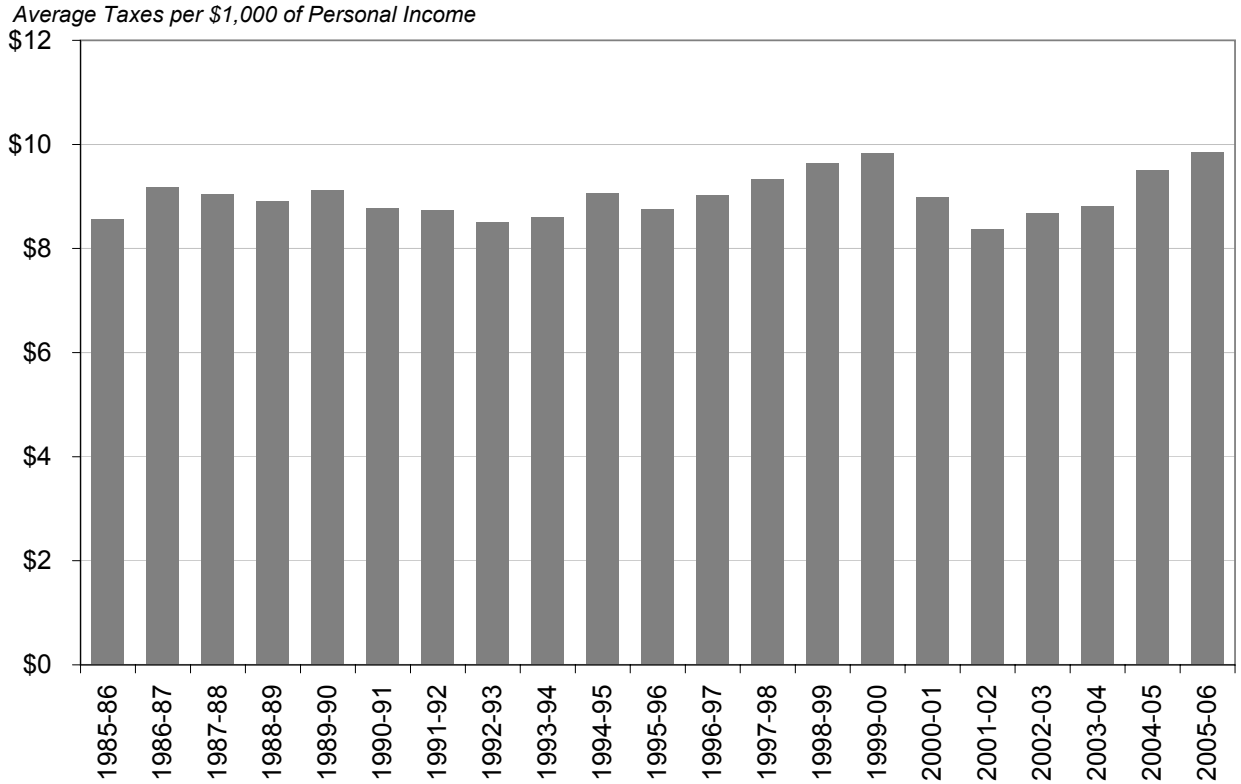
➤ A *Charlotte Observer*/WSOC poll shows that 62 percent of voters support a state lottery. Sixty-six percent also support an increase in taxes for schools, but voters are split on raising taxes for prisons and roads.

➤ The revenue shortfall is now projected at $419 million.

May

- As the revenue shortfall hits $504 million, Governor Martin issues an executive order freezing spending on nonessential items. Martin reassures the public that he is "working on proposals that will avoid temporary or permanent layoffs, reductions of pay increases for state workers or disruptions of summer school or the normally hectic closing days of the regular school year."
- The N.C. Board of Community Colleges reports that a 6.3% rise in enrollment, coupled with budget cuts, could lead to a 50 to 70 percent increase in tuition at North Carolina community colleges.
- In an effort to shift $201 million in expenses to the next fiscal year, Governor Martin proposes delaying the issue of state paychecks from Friday, June 29 to Monday, July 2. He defends the recommendation in a news conference explaining, "There are no attractive options, just available ones."
- The General Assembly rejects the governor's proposal for a 5 percent across-the-board cut for the next fiscal year that would give agency heads the flexibility to make their own cuts.
- Legislative leaders say they won't rule out a tax increase if it is needed to balance the budget.
- Lt. Governor Jim Gardner (R) releases his own budget reform plan that includes the creation of a "rainy day" fund that would use budget surpluses to pay for

Total Income Tax Revenue Compared to Personal Income



sudden emergency costs, like hurricane cleanup. Gardner's proposal also includes a line-item veto for the governor, as well as a provision to base the budget on revenue from the previous year instead of projected values.

➤ Representative Alex Hall (D-New Hanover) introduces a tax bill (HB 2232) that aims to generate $141 million in revenue for 1990-91. The bill will raise personal income taxes, taxes on cigarette manufacturers, and taxes on soft drinks. Warns Hall, "We're going to probably need more than that."

June

➤ Senate Republicans propose an additional one percent across-the-board cut, which would bring state government budget cuts to 4 percent. Senator Don Kincaid (R-Caldwell) comments, "We Republicans feel the problem that got us into this was overspending. … Because of that, we're going to have to find some more money."

➤ Despite calls from Senate Democrats to increase taxes, neither chamber is willing to raise taxes in an election year.

➤ Jeopardizing North Carolina's AAA bond rating, Standard & Poor's puts North Carolina on its CreditWatch list because of concerns over rising costs and a projected $360 million budget shortfall.

➤ Just days before meeting with representatives from Standard & Poor's, Governor Martin announces his support for a one-cent sales tax increase that would add approximately $500 million annually to state coffers. Martin claims the increase could help save the state's bond rating. Martin's election-year suggestion is roundly condemned by legislators, with Democrats referring to it as a "trick" and Republicans calling it "politically unwise."

1990 Significant Tax Changes

- No significant tax changes

1990 Other Revenue Sources & Actions

⬆	Move all proceeds from sales and use tax on mail order funds held in state and local Special Revenue Fund accounts to the General Fund
⬆	$356 million transferred from the Highway Trust Fund ($264 million to the General Fund, $17 million to the Highway Fund, and another $75 million to the General Fund)
⬌	$141 million taken from the General Fund to establish a Budget Stabilization Reserve within the Office of State Budget and Management to provide a mechanism to stabilize the annual funding availability for carrying out state programs and providing financial assistance to local government units

1990 EDUCATION FUNDING

ENROLLMENT CHANGES

- Public Schools: 4,898 (0.5%) increase
- UNC: 3,775 (2.6%) increase

TUITION & FEE INCREASES

- Average increase of 9% for in-state and 5% for out-of-state UNC students
- Increase of 16% for in-state and 17% for out-of-state community college students

OTHER EDUCATION CHANGES

- Defer some portions of the Basic Education Program ($72 million reduction)
- Defer school bus replacement ($20 million reduction)
- $45 million management flexibility reduction
- $39 million to fully fund the School Improvement and Accountability Act
- Eliminate 207 teaching faculty, 52 non-teaching faculty, and 241 other positions in the UNC system
- $17 million management flexibility reduction in UNC
- $12 million management flexibility reduction in community colleges
- $6 million to community colleges to partially restore $7.5 million reserve for equipment and books reverted during 1989-90 to help balance the budget

July

➤ North Carolina's infant mortality rate drops to a record-low 11.5 deaths per 1,000 births for 1989. While the state lowered its rate almost 9 percent since 1988, Governor Martin cautions: "The battle to lower North Carolina's infant mortality rate is not over. Far from it. … Other states are still ahead of us."

➤ The General Assembly and the governor compromise on the prison bond issue. The General Assembly will issue $75 million in bonds for new construction with a public referendum in November on the remaining $200 million.

➤ On July 28 the General Assembly passes the current and capital budget bills (S.L. 1989 -1066 and S.L. 1989-1074).

➤ In the $7.2 billion operating budget, education spending is cut by $100 million. Teachers and state workers, however, still receive their 6 percent pay raises.

➤ The new budget also includes $10.3 million to combat infant mortality.

➤ Bills on the lottery and governor veto referendums fail again.

August

➤ Iraq invades Kuwait on August 2, claiming that Kuwait was slant drilling Iraqi oil.

➤ North Carolina retains its AAA bond rating as Standard & Poor's removes the state from the CreditWatch list. Governor Martin applauds the good news, but warns "there is more work for us to do in the next session of the General Assembly."

➤ According to the 1990 U.S. Census report, North Carolina's population rose from 5,882,000 in 1980 to 6,552,927 for 1990. The population increase is enough to give the state an 11th seat in the U.S. House of Representatives.

September

➤ Governor Martin turns his attention to the upcoming elections and campaigns for Republican candidates.

➤ State officials begin looking for sites to build the new prisons to be constructed under the $75 million bond.

➤ 1,500 students at UNC Chapel Hill protest the 5 percent budget cuts for higher education.

October

➤ With deep education cuts underway, UNC system President C. D. Spangler Jr. comes under fire for being the highest paid person on the state's payroll. In response, Spangler donates his annual salary of $142,520, plus $17,480 of his own money, to give $10,000 to each of the UNC system schools. Claims Spangler, "I just felt it was the right thing to do."

➤ Governor Martin asks state agency heads to submit their agency goals for the next four years to aid the General Assembly in crafting the budget.

➤ David Crotts, a senior fiscal analyst for the N.C. General Assembly, forecasts that the 1991-92 fiscal shortfall will increase to $658 million, but could reach $900 million if oil prices continue to rise.

November

➤ In the November elections Republicans pick up two seats in the Senate but lose nine in the House.

➤ Voters endorse a $200 million prison construction bond referendum by only about 600 votes out of almost 1.4 million cast.

➤ House Speaker Joe Mavretic reports that the state's revenue shortfall is now in excess of $700 million and could reach $1 billion by the end of the year. Mavretic warns his fellow legislators to "get ready for what appears to be the most difficult session of the General Assembly since 1933."

➤ Reporting that the revenue shortfall projection is now at $850 million, Governor Martin declares he will propose a combination of spending cuts and new taxes to balance the 1991-92 budget.

December

➤ Lt. Governor Gardner calls the revenue shortfall a "myth" and lays the blame on "a classic case of legislative overspending on the part of the General Assembly."

➤ A survey by the National School Boards Association reports that North Carolina has made improvements in teacher-pupil ratios since the mid-1980s. The change is attributed to the BEP and an increase in the number of teachers in the state.

1990 Other Significant Changes

COMPENSATION

- Salary increase of 4% plus 2% merit funds for most state employees
- 6.15% average salary increase for teachers

OVERALL BUDGET & TAXES

- Change local government tax reimbursements and shared revenues from earmarking to direct appropriation
- Create the Economic Future Commission to review the revenue and budget structure and the state and local tax structure
- Save $40 million by not filling personnel vacancies

CAPITAL

- $69 million for capital projects

CREDIT RATING

- On June 8, Standard & Poor's put N.C. state bonds on CreditWatch list; the state changed due dates and shifted money around to avoid a downgrade

1991 session

1991-1992 BIENNIUM
FY 1992: July 1, 1991 to June 30, 1992

General Assembly:

House Dems:	81	House Reps:	39
Senate Dems:	36	Senate Reps:	14

Governor:
James G. Martin (R)

The 1991 Long Session:
Budget Bill HB83/S.L. 1991-689
Passed House: June 7, 1991
Passed Senate: June 13, 1991
Conference Version Ratified: July 13, 1991
Signed by Governor: July 13, 1991

As the state slipped into a recession, declining revenue created one of the largest budget shortfalls in state history. With less money to go around, Governor Martin's budget proposals were met with greater opposition than usual by the Democratic General Assembly. Throughout the budget process Martin fought to balance the budget by cutting spending rather than raising taxes. Again, the debate centered on education spending. Martin's proposal to allow UNC system administrators the power to set tuition was opposed by almost every college or university in the system, other than UNC Chapel Hill and NC State University. When the plan was rejected, the UNC system could not avoid major cuts in personnel and increases in tuition. Taxpayers were also pinched during the recession as the state raised income taxes and taxes on cigarettes. As the year ended, Governor Martin asked state agencies to restrain spending in preparation for another revenue shortfall in 1992.

1991 HEALTH & HUMAN SERVICES BUDGET

Total Appropriations	**$1.14 billion**
Major Items:	
Medical Assistance (Medicaid):	$523 million
Mental Health/D.D./Subst. Abuse:	$185 million
Hospitals & Centers:	$154 million
Social Services:	$130 million

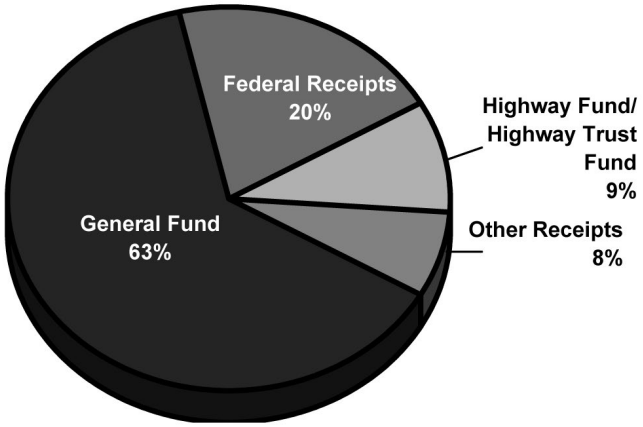
January

➤ A further $100 million projected increase to an already anticipated $850 million to $1 billion revenue shortfall spurs Governor Martin to freeze hiring for all state agencies, including education and teachers.

Future Speaker of the House Daniel T. Blue (D-Raleigh) declares tough times are ahead, saying that "not since the Great Depression ... has North Carolina gone through the kind of experiences it's going through now with budget deficits and projected deficits."

- Operation Desert Storm begins on January 17.
- Senate President Pro Tempore Henson P. Barnes (D-Goldsboro) claims giving greater autonomy to public schools and enacting the Highway Trust Fund has set the foundation for future progress in North Carolina. Urging fellow legislators to stay the course, Barnes states: "North Carolina in 1991 has found the road to progress and is moving on that road. The two roads that determine how much progress you make are highways and schools."
- Terrorism fears stemming from the First Persian Gulf War lead to heightened security measures at the General Assembly.
- Senator Kenneth C. Royall Jr. (D-Durham) calls for a referendum on a state lottery saying that it would help solve some of the state's budget problems.
- Governor Martin's $7.8 billion budget proposes temporarily holding back $242 million in annual tax reimbursements owed to local governments as part of the 1987 repeal of the business inventory tax and the partial repeal of the intangibles tax (See Q & A: 12). In return, Martin will allow local entities to raise the local-option sales tax one-half cent per dollar. Noted the *Charlotte Observer* about the plan, "If lawmakers approve Martin's plan, local governments would have to take the political heat for raising the sales tax – or find the money elsewhere in their budgets."
- In his State of the State address, Martin proposes that UNC campuses be allowed to set their own tuition and renews his call for executive veto power.

Source of Budget Funds: 1990-91



February

- Educators at smaller campuses in the UNC system resist Martin's proposal to give colleges control over tuition rates because they feel that the proposal would give a financial advantage to the larger schools.
- Durham city council members urge the General Assembly to resist Governor Martin's proposal to withhold $242 million in local tax reimbursement funds.
- Lt. Governor James C. Gardner (R) meets with Republican legislators and urges opposition to any tax increase, including Governor Martin's proposed half-cent local sales tax option.
- Kuwait is liberated as Desert Storm ends with a cease fire on February 27.

March

➤ Martin says he will use the $141 million "rainy day" or Savings Reserve Fund to help overcome the projected $695 million revenue shortfall. "My intention is to use the rainy day fund unless the General Assembly blocks me," he says.

➤ House Speaker Blue declares his opposition to Governor Martin's proposal to give campuses the power to set their own tuition. Declares Blue, "It is not my intention to let individual universities increase tuition while the rest of the system goes its merry way and perishes."

1991 Significant Tax Changes (Budget Bill Unless Noted)

⬆	Increase sales tax rate from 3% to 4%
⬆	Increase corporate income tax from 7.00% to 7.75% and levy a scaled surtax from 4.00% in 1991 to 1.00% in 1994
⬆	Add a 7.75% personal income tax rate for income above $100,000
⬆	Increase cigarette tax from 2¢ per pack to 5¢ and levy a 2% tax of wholesale price on other tobacco products
⬆	Increase deed stamp tax on real estate transfers from $1.00 per $1,000 to $2.00 per $1,000 and earmark 15% of the increase for Recreation and Natural Heritage Trust Fund
⬆	Update state income tax conformity to 1990 federal tax changes
⬆	Health Insurance Taxes: ➔ Raise insurance tax from 1.750% of gross premiums to 1.875% for 1991 and to 1.900% beginning with 1992 ➔ Establish a 6.5% charge against gross premiums tax liability (except HMOs and BCBS) for a special trust designed to eliminate General Fund support for Department of Insurance and allow a 20% credit against premium tax for Guaranty Fund assessments
⬆	Highway Fund: motor fuel tax increase of 1/2¢ to be divided equally between the Commercial Leaking Petroleum Underground Storage Tank Fund and the Groundwater Protection Loan Fund (1/4¢ increase scheduled to expire January 1, 1995, and other 1/4¢ set to expire January 1, 1999) [S.L. 1991-538]
⬆	Repeal certain inheritance tax exemptions [S.L. 1991-454]
⬆	Increase some liquor surcharges and ABC permit fees

Total tax increase and budget transfer from 1991 revenue changes:

1991-92: $637.5 million	1993-94: $786.4 million
1992-93: $738.8 million	1994-95: $836.6 million

- Governor Martin states he will only hold back $30 million of the reimbursement funds the state is to transfer back to counties and municipalities. "I need to hold a little reserve just in case the economy takes a downturn," says Martin.
- In an attempt to back the governor into a corner, Speaker Blue charges, "[Governor Martin is] going to have to start looking seriously now at the question of furloughs," for state workers in order to meet the budget shortfall. To which Lt. Governor Gardner responds, "I'd like to ask Speaker Blue how he'd like to be laid off for three weeks and have no income coming in."
- After budget analysts project legislators will have to make $400 million in cuts to balance the budget, legislators start to discuss eliminating thousands of public school positions.
- Appropriations committees in the Senate and House make recommendations to cut $59.2 million from the UNC budget.
- Governor Martin puts a temporary hold on a $56.7 million payment to the teacher and state employee retirement fund in case the budget gap widens. Explains Martin, "I've been taking all the precautions that I can take during the past year."

April

- Education administrators from the state universities, community colleges and public schools call for a one-cent sales tax increase in order to stave off more cuts to the education budget. In response, Governor Martin again pushes a half-cent increase: "I have my proposal on the table, and that's where it is."
- The press discovers a strategy memo from House Minority Leader Johnathan L. Rhyne Jr. (R-Lincolnton) instructing fellow Republicans to sit back and allow the Democrats to make the budget cuts. Says the memo, "Let the Democrats who got us in this mess in the first place get us out of it."
- Student protesters march on the Legislative Building to protest proposed cuts to the UNC system.

1991 Other Significant Changes

COMPENSATION

- No legislative increases
- Restore 3-day paid Christmas holiday that was changed in 1988 to a 2-day holiday if Christmas fell on a Tuesday-Thursday
- Direct the State Board of Education to develop a salary schedule for superintendents, principals, and other administrators

MENTAL HEALTH

- *Thomas S. v. Morrow* (developmentally disabled clients in state psychiatric hospitals; $7.7 million)

CAPITAL

- Appropriate $103 million of the prison bond funds for correctional facilities and $9 million for youth facilities

STATEWIDE

- $400,000 to implement Savings Reserve Account (Rainy Day Fund)

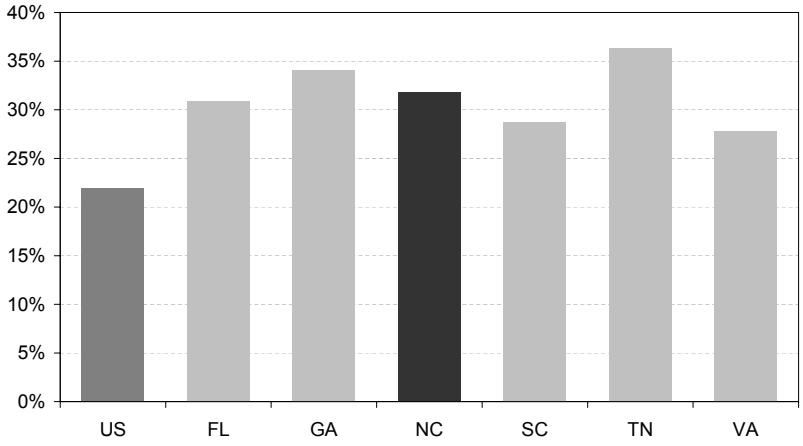
OTHER

- Create Air Cargo Airport Authority, which is later renamed Global TransPark Authority [S.L. 1991-749]
- Clean Air Act implemented with a graduated fee schedule for major source emitters [S.L. 1991-552]

➤ Approximately 2,000 teachers march in Raleigh to protest proposed education cuts.

➤ Along with several Republican legislators, Lt. Governor Gardner claims the proposed education cuts are irresponsible and a ploy by Democrats to prepare the public for more tax increases.

Total Private Employment Growth: Southeast States, 1985-2005



House Majority Leader Dennis A. Wicker (D-Sanford) calls the Lt. Governor's actions "a slick Madison Avenue campaign for governor."

Despite a Republican effort to cut administrative offices and support staff instead of teachers, the House Appropriations Committee cuts 180 UNC teaching positions.

Senate and House Appropriation committees draft similar proposals to save teaching positions by shifting the cost of driver education back to the Highway Fund. Driver education was moved to the General Fund in 1986 (see 1986 Timeline).

May

➤ Democratic legislative leaders announce that the revenue shortfall could reach $700 million. Senator Basnight threatens that if the revenue shortfall worsens, "it eliminates any conversation of no tax increase from any sector. We don't have many options."

➤ In reaction to news that the current year's revenue shortfall is now $729 million, the governor shifts $100 million in spending to the FY1992 budget. "The alternative," claims Martin, "would be to furlough all employees for five days."

➤ Governor Martin offers a supplemental budget proposal that includes $276 million in spending cuts to Medicaid and Aid to Families with Dependent Children; the elimination of 1,827 vacant state jobs; court fee increases; and early retirement programs for state employees and teachers with 28 years of service.

➤ Martin also says that in order for him to support any recommended tax increase he will have to see legislative support for executive veto power. "I think that's the necessity for getting bipartisan support for the kind of tax increase that might be needed."

➤ Governor Martin proposes another $36.9 million in cuts and increased revenue collections. He proposes lowering salaries for new employees who replace departing state workers, reducing service time bonus pay for judicial and legislative employees, and improving tax collection methods.

June

➤ Senate proposes $613 million tax package that includes a one-cent increase in the sales tax, a three-cent increase in the cigarette excise tax, a 1.25 percent increase in the corporate income tax for two years, and an increase in premium taxes paid by insurance companies. The Senate plan also reduces income tax deductions for those who make more than $100,000 annually.

➤ House proposes a similar $698.7 million tax package that includes raising the cigarette tax by 5 cents, raising the personal income tax from 7 percent to 8 percent on couples earning more than $100,000, and increasing the corporate income tax from 7 percent to 8 percent. Claims Speaker Blue, "It's fair and it's balanced and, remember, we proposed it only after making the biggest budget cuts in the state's history."

1991 Other Revenue Sources & Actions

- Freeze the amount of revenue distributed to local governments under existing revenue-sharing and reimbursement statutes; rather than a fixed percentage of tax revenues, the amount will be equal to the dollar amount that should have been distributed to localities under each statute in the 1990-91 fiscal year (result is an increase in state revenues)
- $20 to $40 increase in marriage license fee [S.L. 1991-693]
- $4 increase in court fees for criminal and civil actions in district or superior court [S.L. 1991-742]
- Transfer an amount equal to sales tax exemption for DOT purchases from the Highway Fund to the General fund
- Highway Fund fee increases:
  - ➔ $1 to obtain motor vehicle records
  - ➔ $5 to $10 for driver's licenses, learner's permits, and IC cards
  - ➔ $5 to $10 for oversize/overweight vehicle permit fees or $25 to $50 for an annual permit
  - ➔ Motor vehicle dealer and manufacturer license fees increased by varying amounts
  - ➔ $4 to $20 for penalty of late submission of title after transfer
- Department of Agriculture fees increase:
  - ➔ Plant pest certification [S.L. 1991-442]
  - ➔ Seed fees [S.L. 1991-588]
  - ➔ Bee and honey permit for $25 [S.L. 1991-349]
  - ➔ Tobacco assessment of 10¢ per 100 lbs. marketed [S.L. 1991-592]
  - ➔ Feed sample testing fee of $75 [S.L. 1991-649]
  - ➔ Assessment of 5¢ per pig for pork promotion [S.L. 1991-605]

Individual Income Tax Brackets

	Bracket 1	Bracket 2	Bracket 3	Bracket 4*
Tax Rate	**6%**	**7%**	**7.75%**	**8.25%**
Taxable Income				
Married-Joint:	$1-$21,250	$21,251-$100,000	$100,001-$200,000	>$200,000
Married-Separate:	$1-$10,625	$10,626-$50,000	$50,001-$100,000	>$100,000
Head of Household:	$1-$17,000	$17,001-$80,000	$80,001-$160,000	>$160,000
Single:	$1-$12,750	$12,751-$60,000	$60,001-$120,000	>$120,000

*Bracket 4 was added for the 2001 tax year as a two-year "temporary tax" and continued through 2008. The bracket was dropped effective Jan. 1, 2008.

➤ Legislators pass a continuing budget resolution that expires on July 6.

July

➤ Senate Finance Committee drops its opposition to a permanent corporate income tax increase on business from 7 percent to 7.75 percent. Senate Finance Chairman George B. Daniel (D-Caswell) states, "I didn't like it, I'll tell you that right now. But I'm a team player."

➤ Legislators pass another emergency resolution allowing state agencies to operate until July 13.

➤ $7.7 billion budget (S.L. 1991-689) passes on July 13. It includes a one-cent increase in the state sales tax, a three-cent increase in the excise tax on cigarettes, a 0.75 percent increase in the corporate tax, and the creation of a 7.75 percent income tax bracket on income above $100,000. The budget also eliminates 3,398 state jobs, in addition to 290 teacher aides and clerical workers, as well as 180 assistant principal positions.

➤ States Speaker Blue, "I think that this is a tremendous budget given the problems we have faced." Lt. Governor Gardner responds, "The entire tax package is one of the darkest days in the history of North Carolina."

➤ Governor Martin expresses his dismay with the budget, claiming the General Assembly ignored his proposals. "If I had the veto," declares Martin, "I would have used it in order to try to clean up the defects."

➤ Governor Martin announces plans to continue the hiring freeze until at least October. An exception is made for college and university teaching positions (public school positions were already exempt).

August

➤ Standard & Poor's, one of the country's leading bond-rating agencies reports that North Carolina will retain its AAA rating, but that the state outlook will receive a negative rating due to the recently passed budget.

➤ With July revenues $29 million less than projected, Governor Martin asks state agencies to reduce spending by $150 million.

September

➤ Democratic legislative leaders allege Governor Martin exceeded his constitutional powers by ordering state agencies not to spend $150 million in funds allocated by the General Assembly.

October

➤ According to the Board of Community Colleges, budget cuts and increased enrollment will force community colleges to abandon their longtime policy of open enrollment.

November

➤ Tax collections rebound from the July deficit and are now $40 million more than expected through the first four months of FY1992. State budget analysts caution, however, that $32 million of this surplus is derived from estimated quarterly corporate tax payments, which are unpredictable.

December

➤ As the General Assembly meets in a special session on redistricting, Governor Martin calls on them to also repeal a surtax on payroll taxes that was passed in 1987.

1991 EDUCATION FUNDING

ENROLLMENT CHANGES

- Public Schools: 9,926 (0.9%) increase
- UNC: 3,628 (2.4%) increase

TUITION & FEE INCREASES

- Average increase of 10% for in-state and 14% for out-of-state UNC students
- Increase of 50% for in-state and 53% for out-of-state community college students

OTHER EDUCATION CHANGES

- Basic Education Program ($29 million in 1992-93 for more teachers)
- $15 million to serve 3- and 4-year-old handicapped children
- $10 million increase for low-wealth and small school systems
- Restore 250 local teaching positions
- Eliminate funds for School Improvement and Accountability Act in 1992 ($39 million)
- Defer school bus replacement ($15 million reduction)
- Phase out funds for energy costs to local schools (reduction of $18 million in 1991-92 and $36 million in 1992-93)
- Reduce driver's education funds and transfer remaining support to Highway Fund ($29 million reduction)
- Shorten summer school from 6 to 4 weeks ($13 million reduction)
- Eliminate 336 vacant UNC positions, reduce non-teaching exempt positions by 5%, and increase student/faculty ratio
- Increase student/faculty and student/administrator ratios in the community colleges

1992 session

1991-1992 BIENNIUM
FY 1993: July 1, 1992 to June 30, 1993

General Assembly:

House Dems:	81	House Reps:	39
Senate Dems:	36	Senate Reps:	14

Governor:
James G. Martin (R)

The 1992 Short Session:
Budget Bill HB1340/S.L. 1992-900
Passed House: June 12, 1992
Passed Senate: June 20, 1992
Conference Version Ratified: July 8, 1992
Signed by Governor: July 8, 1992

With a nationwide recession underway, neither party wanted to increase spending nor raise taxes, especially in an election year. While the usual friction between Governor Martin and the General Assembly appeared to recede, the main issues that dominated the outgoing governor's eight-year tenure continued as Martin faced opposition to his plans for education reform. The Democrat-led General Assembly also lambasted Martin's proposed 2 percent raise for teachers and state workers. With both sides wishing to avoid appearing partisan, the governor and the Legislature compromised without much vitriol on most issues. The gubernatorial campaign between former Governor Jim Hunt (D) and current Lt. Governor Jim Gardner (R) turned into a smear campaign with Gardner being attacked for his personal business failings. This limited Gardner's ability to highlight Hunt's previous record as governor. Even a last minute accusation that Hunt had illegally placed wiretaps on the Gardner campaign was unable to tarnish Hunt's reputation. (Beverly Smith, a Democratic political operative, was subsequently convicted for intercepting and monitoring Gardner's cell phone calls).

Hunt won a third term as governor, defeating Gardner 53 percent to 43 percent. By the end of the year the economy began to show signs of recovery.

January

- The House Finance Committee approves a business tax break that suspends a 20 percent surcharge on unemployment taxes.
- Lt. Governor Gardner enters the race for governor pledging to fight the tax increases (e.g., personal income tax, cigarette tax, corporate tax, and sales tax) passed in 1991. "I want us to go back and revisit those taxes," Gardner declares. "Get those high personal income taxes off the backs of the hardworking people of this state. We are the only state in this nation that

taxes food and I think it's time we made a change in that direction."

February

➤ As the recession continues, the state Division of Social Services projects that 40,000 people will join the welfare rolls and 100,000 will become eligible for Medicaid. This unexpected surge puts pressure on budget writers to cut spending or raise taxes.

➤ In a debate with other Democratic candidates running for Lt. Governor, Representative Dennis A. Wicker (D-Sanford) praises the Legislature for its decision to balance the budget in 1991 by raising taxes and making budget cuts. "We ought to be very proud of the Democratic leadership of the General Assembly for having to bite the bullet to do some very tough things to fix this budget."

March

➤ Governor Martin announces that he has accepted a position as chairman of the Research Development Board at the Carolinas Medical Center in Charlotte.

April

➤ In an effort to curtail Governor Martin's use of executive orders in directing agency budget policies, Democrat legislators propose exercising greater oversight over agency expenditures – in particular, by prohibiting the use of funds for purposes not specified by the General Assembly and requiring agencies to report unspent appropriated funds. The legislation dies in committee.

1992 EDUCATION FUNDING

ENROLLMENT CHANGES

- Public Schools: 13,460 (1.2%) increase
- UNC: 4,249 (2.8%) increase

TUITION & FEE INCREASES

- Average increase of 3% for in-state and 10% for out-of-state UNC students
- Increase of 14% for in-state and 0% for out-of-state community college students

OTHER EDUCATION CHANGES

- $19 million increase for Basic Education Program
- $30 million increase for differentiated pay under the School Improvement and Accountability Act; the Act is also revised
- $6 million for low-wealth and small schools
- Complete implementation of end-of-course/ end-of-grade tests; 9th graders entering high school face tougher graduation requirements

May

➤ A Harris poll finds that 69 percent of North Carolina voters favor borrowing $300 million in bonds for building construction on UNC system campuses.

➤ Governor Martin submits his budget, which recommends: a 2 percent raise for teachers and state employees; a $300 million bond referendum for UNC capital improvements; and issuing the remaining $87.5 million prison construction bond.

➤ Martin also recommends that Basic Education Plan (BEP) funds for the year be spent in accord with "The School Improvement and Accountability Act of 1989," which permits local school systems to award teacher merit, or "career development," raises up to 2

percent for 1990-1991 (to reach a maximum of 7 percent in 1993-1994 and thereafter).

➤ Teachers hold rallies and march to the Executive Mansion to protest Martin's proposed across-the-board 2 percent raise.

1992 HEALTH & HUMAN SERVICES BUDGET

Total Appropriations	**$1.41 billion**
Major Items:	
Medical Assistance (Medicaid):	$602 million
Mental Health/D.D./Subst. Abuse:	$186 million
Hospitals & Centers:	$169 million
Social Services:	$138 million

June

➤ State employees hold a rally at the Legislative Building demanding a higher pay raise.

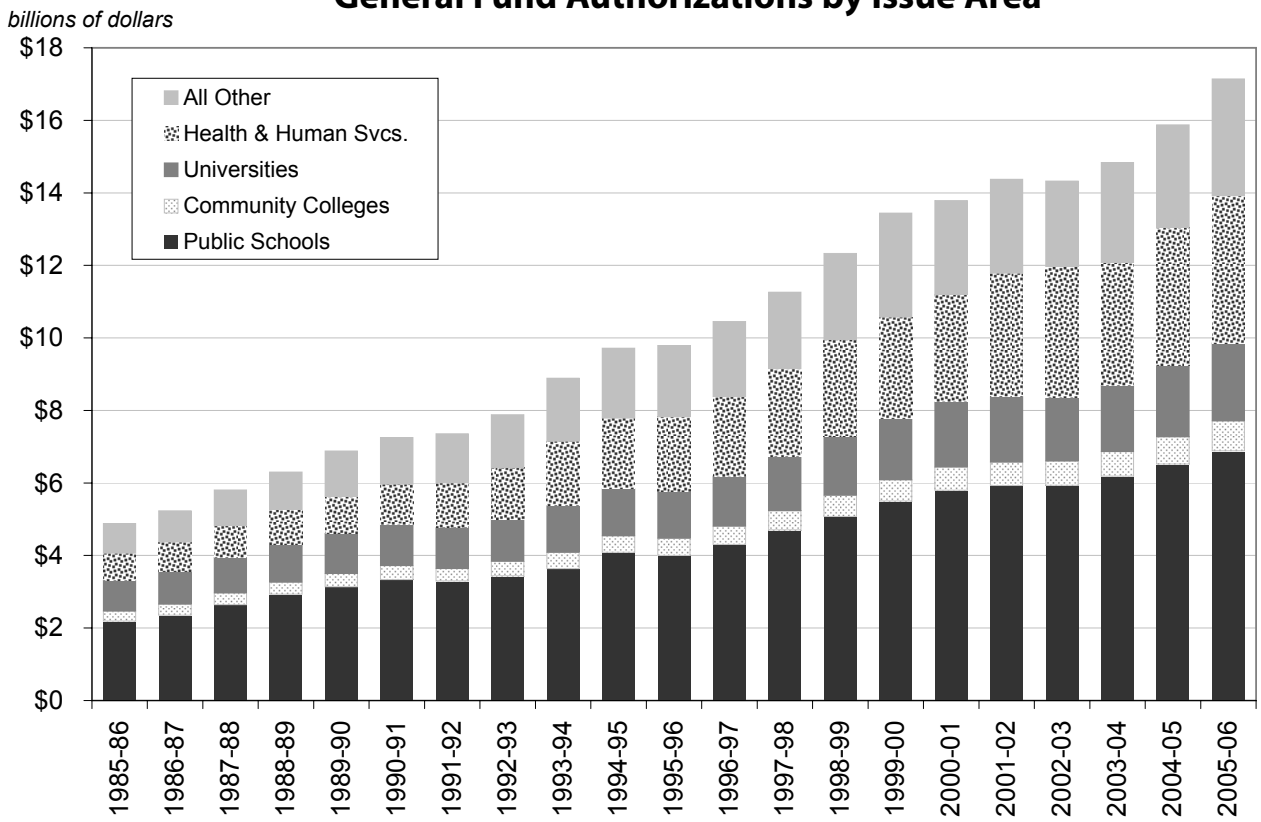
➤ The House Appropriations Committee proposes giving all state employees a $522 pay raise for the year.

➤ The House approves their version of the budget bill (HB 1340) which includes a 2 percent teacher raise based on experience and a $522 raise for state workers. Over Republican opposition, BEP is refunded.

➤ With regard to salary raises and spending, the Senate budget mostly mirrors the House plan, but the Senate also cuts the salary for the next governor from $123,822 to $91,938 – a reduction of $31,884. The Senate, however, refuses to endorse a pay cut for legislators.

➤ During conference negotiations,

General Fund Authorizations by Issue Area



legislators agree to tuition increases for UNC students and community college students.

➤ The House proposes an increase in state worker pay from a flat $522 to $600 in order to more closely approximate the proposed teacher pay raise.

➤ The General Assembly passes a continuing budget resolution (S.L. 1991-812) extending funding until July 8.

July

➤ Senate and House negotiators agree to forgo the additional $78 increase for state workers. "If the Senate does not want to give them a pay raise ... then we will recede," declares House Speaker Dan Blue (D-Wake).

➤ The $8.3 billion budget bill (S.L. 1991-900) is ratified on July 8. It includes pay raises for state workers and teachers, tuition increases and continued funding for BEP.

➤ The General Assembly approves the remainder of the prison bond funds, $87.5 million (S.L. 1991-1036).

1992 Other Significant Changes

COMPENSATION

- $522 salary increase for most state employees
- 2% average increase for teachers

CRIMINAL JUSTICE AGENCIES

- $3 million increase in Indigent Persons' Attorney Fee Fund for projected shortfall due to increased indigent defendants, increases in the cost of representation, and expenses arising from the "Little Rascals" Day Care case
- 122 new judicial branch positions

CAPITAL

- $95 million for capital improvements for state agencies and UNC

➤ The capital spending budget (S.L. 1991-1044) is ratified on July 25.

August

➤ Democratic gubernatorial candidate Jim Hunt announces a

1992 Significant Tax Changes

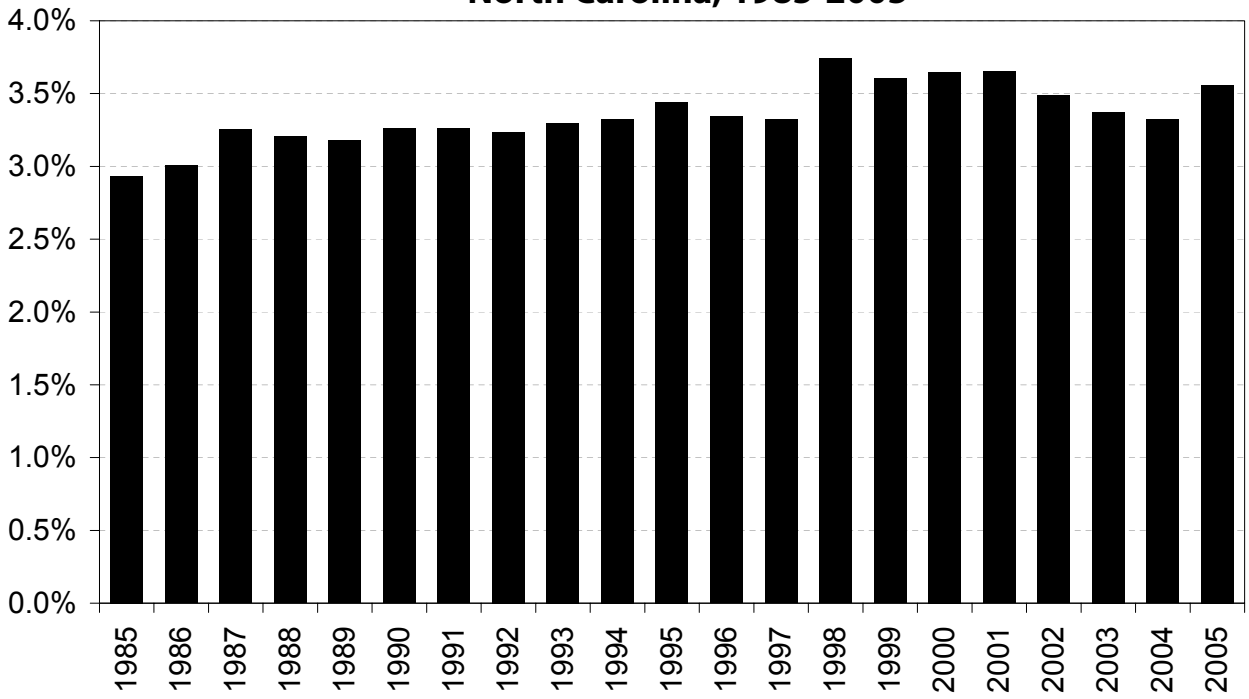
- No significant tax law changes

1992 Other Revenue Sources

- Justice and public safety fees ($8 million): increase court costs by $4, local court fees by $1, and estate fees by $5

- In 1990, the method of funding local tax reimbursements was changed from an earmarking to an appropriation; in 1992 the method was changed back to an earmarking for property tax on business inventories, homestead exemption, sales tax on food stamp purchases, intangibles tax, money on deposit, and certain account receivables (projected $237 million savings)

State/Local Taxes as Share of Personal Income: North Carolina, 1985-2005



"Republicans for Jim Hunt" group whose chairman, Bill Burkhardt, had previously contributed to Republican nominee Jim Gardner's campaign for Lt. Governor.

➤ Lt. Governor Gardner announces he will create a Governor's Teachers Advisory Council that will enable teachers to have more input in educational decisions.

September

➤ In a sign of easing recession woes, Governor Martin announces that state revenue has exceeded projections by $10 million to $15 million.

➤ Representative Doris Huffman (R-Catawba), a minor Republican figure who lost in the May primary for Lt. Governor, endorses Democrat Jim Hunt.

October

➤ Due to budget cuts and shifts in spending priorities, the university library at UNC Chapel Hill reports that it has canceled more than 170 journals and passed up buying more than 220,000 books over the last 7 years, causing it to drop in the Association of Research Libraries ranking of university book buying from 10th to 48th.

November

➤ The FBI investigates allegations that Hunt operatives illegally wiretapped the Gardner campaign.

➤ Governor Bill Clinton (D-Arkansas) defeats incumbent George Bush (R) and independent candidate Ross Perot (I) to become the 42nd President of the United States.

➤ Jim Hunt (D) defeats Jim Gardner (R) 53 percent to 43 percent to

return to the governor's office for the third time.

➤ The 1992 election brings in 12 new Senators and 43 new House members. Republicans pick up three seats in the House but lose three in the Senate.

December

➤ Governor-elect Hunt makes early child development his "signature piece."

➤ Senator Marc Basnight (D-Dare) is nominated for the majority position of president pro tempore.

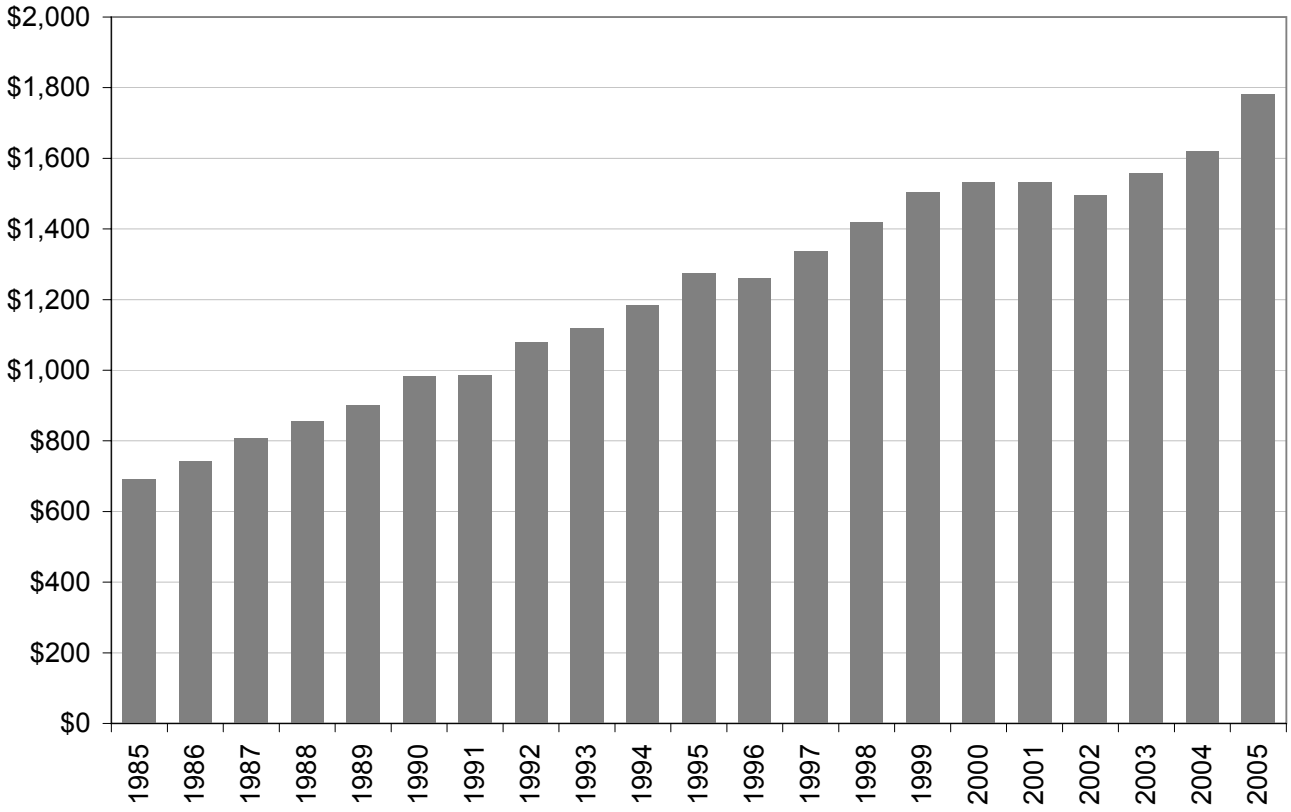
➤ Representative Daniel Blue (D-Raleigh) is unanimously nominated for a second term as speaker.

DID YOU KNOW?

Over the past 10 years, per capita taxes have increased by more than $1,000 in North Carolina. In 2005, per capita state and local taxes were $3,526 whereas per capita taxes were $2,330 in 1995. North Carolina's overall state and local tax burden for 2006 also ranked first in the Southeast (N.C., Fla., Ga., S.C., Tenn., Va.) and 23rd nationally.

Source: The Tax Foundation

State Tax Revenue per Capita: 1985-2005

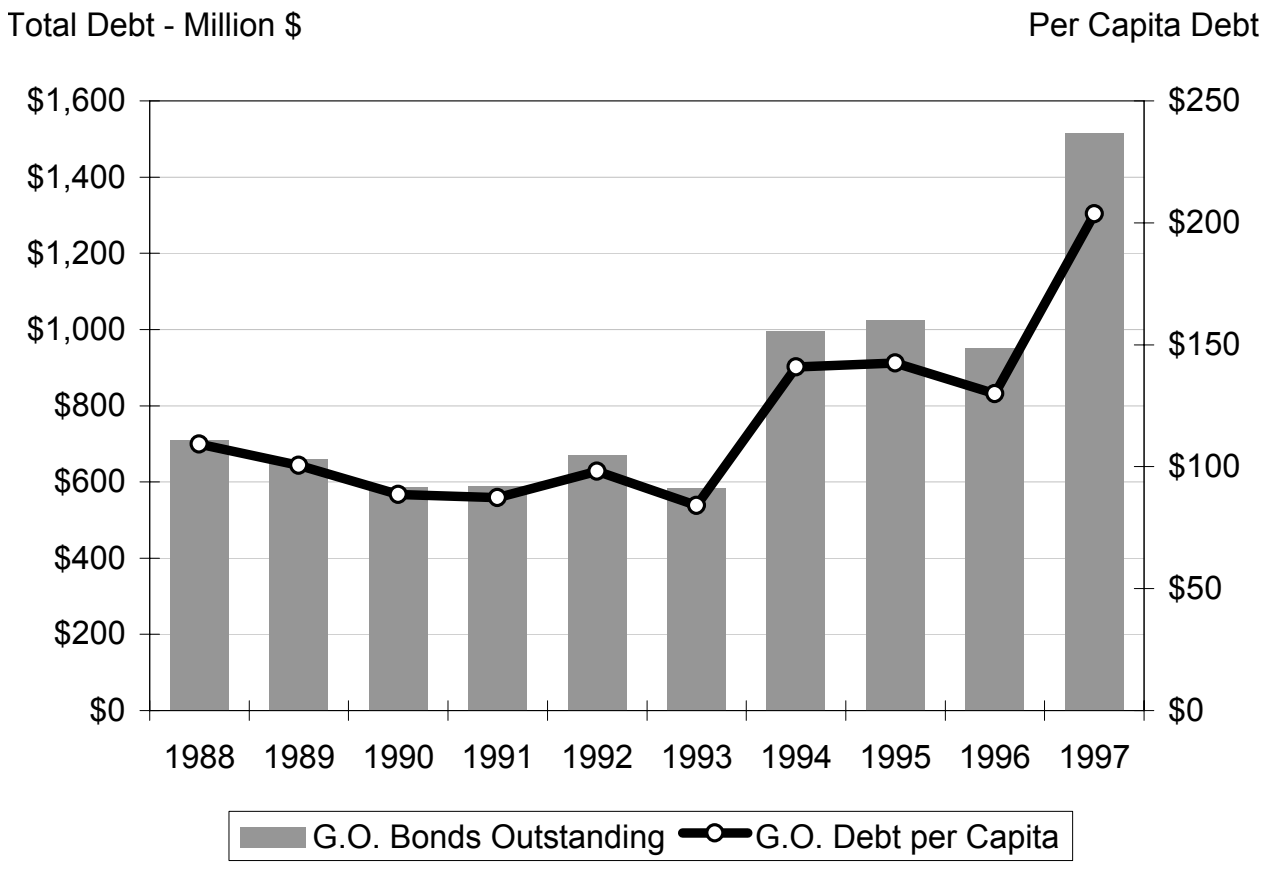


Why Bonds?

Throughout his eight-year tenure, Governor James Martin was an ardent proponent of using public bonds to finance various infrastructure projects – in particular, highway, school and prison construction. By contrast, Democratic lawmakers preferred to raise taxes for such projects, with the result that the corporate income tax was increased from 6 percent to 7 percent in 1987 to finance new school construction; and the gas tax and sales tax on new vehicle purchases were raised in 1989 to fund highway construction.

Martin preferred bonds over taxes for two reasons. First, he thought that by removing appropriations for new construction from the budget he could break the spend and tax cycle that has dominated North Carolina politics for the past 100 years. If new spending were removed from the budget, reasoned Martin, there would be less chance of increasing spending and thus being forced to increase taxes to cover the recurring spending. Second, Martin thought it was more fair to the people of North Carolina to let them choose for themselves whether to implement new spending projects that would lead to local tax increases. Democrats regularly assailed Martin's bond proposals as being more expensive (because of the resulting interest payments) than their own plans, often without actually knowing what the final cost of a project would be. (The Highway Trust Fund being a classic example).

General Obligation Debt Per Capita: 1988-1997



As an individual who undertakes to live by borrowing, soon finds his original means devoured by interest, and next no one left to borrow from – so must it be with a government.

Abraham Lincoln

In the fall of 1986, Martin proposed a bond plan for up to $2.2 billion in funds that counties could borrow from for school construction. The state's AAA bond rating would insure that the state could borrow the money at a lower rate than North Carolina's individual counties. According to the governor, savings would range from $50 million to $100 million depending on the size of the bond issue. In 1987 Martin formally requested a $1.5 billion bond package for school construction. At first, Lt. Governor Jordan supported the recommendation, but Jordan quickly backpedaled in the face of Democratic opposition. As a result, Martin's proposal failed. The governor accused Jordan of "punt[ing] on second down" by giving up too early. But this initial setback did not deter Martin from continuing to promote new bond issues.

In 1988, Governor Martin proposed another bond issue – this time for $450 million for new highway construction. Again, Democrats let the proposal die. In December 1989, Martin began pushing a third bond issue – for prison construction. The General Assembly took up his $490 million package in 1990, but would only acquiesce to allocating $75 million in bonds during the short session and placing an additional $200 million referendum on the November ballot. By the slimmest of margins – less than 600 votes – the bond referendum passed. In his final year as governor, Martin also asked for a public referendum on $300 million in bonds for UNC system construction. His recommendation was denied by the Legislature, which opted instead to raise tuition.

Ironically, once Democratic Governor Jim Hunt took office in 1993, the General Assembly suddenly reversed itself, passing the $740 million "Education, Clean Water, and Parks Bond Act of 1993." The bond package sought to fund improvements to community colleges, universities and state parks, as well as water and sewer improvements designed to attract new businesses. Voters approved the bonds later that year in November.

Throughout Hunt's tenure as governor, the General Assembly also passed bonds for $1.8 billion in school repairs and construction in 1996 (S.L. 1995-631) and $3.1 billion for building and grounds construction and repairs for the UNC system in 2000 (S.L. 2000-3).

1993 session

1993-1994 BIENNIUM
FY 1994: July 1, 1993 to June 30, 1994

General Assembly:

House Dems:	78	House Reps:	42
Senate Dems:	39	Senate Reps:	11

Governor:
Jim Hunt (D)

The 1993 Long Session:
Budget Bill SB27/S.L. 1993-321
Passed Senate: May 13, 1993
Passed House: May 28, 1993
Conference Version Ratified: July 9, 1993
Signed by Governor: July 9, 1993

In Jim Hunt's first year back as governor he found that the Legislature had become more powerful in controlling the state purse strings than he had remembered.[1] The difficult economic times of the 1980s and early 1990s, as well as opposition to Governor Martin, had taught the General Assembly how to craft a budget that reflected its own priorities rather than just the governor's recommendations. Because Governor Hunt was legally constrained by outgoing Governor Martin's budget, Hunt was only able to propose limited adjustments to the budget. One of Hunt's main objectives for 1993 was to create an atmosphere that would attract new business to North Carolina. As part of this initiative, Hunt set his sights on bringing the first Mercedes-Benz plant in the United States to North Carolina. Hunt also received $35 million from the General Assembly for a technology training center and $5 million for the Governor's Industrial Recruitment Competitive Fund, a personal negotiation fund used by the governor to close business deals. In September, Mercedes announced that it was passing over North Carolina and choosing Alabama instead. As the year came to a close, increased violence in schools and issues related to prison overcrowding led Hunt to call for a special session of the General Assembly. In a reversal from the anti-bond rhetoric that dominated the Martin era, the General Assembly passed the "Education, Clean Water, and Parks Bond Act of 1993" to fund improvements to community colleges, universities and state parks, as well as water and sewer projects designed to attract businesses. Voters approved the $740 million bond package in November.

January

➤ Anticipating slowing revenue growth for the next eight years, a report by

[1] For example, in 1985 the General Assembly had created an Office of Administrative Hearings to review agency rulemaking procedures and to investigate civil rights complaints on behalf of state and local employees.

KPMG Peat Marwick, LLP to the Government Performance Audit Committee (GPAC) recommends the state increase tuition at UNC schools and halt subsidies to North Carolina students who attend private colleges and universities in the state.

➤ The General Assembly's Government Audit Performance Committee recommends the state replace longevity pay with performance pay.

➤ According to Virginia lottery analysts, North Carolina residents contribute from 5 percent to 10 percent – or some $87 million – of annual ticket sales.

➤ GPAC approves two recommendations from the KPMG report: raising university tuition and shutting down the Department of Crime Control and Public Safety.

February

➤ The Raleigh *News & Observer* reports that legislative employees received additional merit pay raises ranging from 4 percent to 5 percent, along with the across-the-board $522 pay raise all state workers received in 1992. Remarks the *Observer*, "The raises are the latest example of the General Assembly setting different fiscal standards for itself than for other branches of state government."

➤ In response to the scandal, House Speaker Dan Blue (D-Raleigh) remarks: "I understand the concern about these salary increases. … However, I believe we need to do all we can as a General Assembly to keep the best people to help us set the budget and determine the policies of this state."

1993 Other Significant Changes

COMPENSATION

- 2% salary increase plus 1% one-time bonus for most state employees; 3% average increase for teachers

LOCAL GOVERNMENTS

- Authorize additional economic development tools, including the use of public money for industrial site preparation [S.L. 1993-536]
- Extend for 5 years the requirement that a portion of local governments' two 1/2¢ sales taxes be dedicated to school buildings unless other funds can meet those needs [S.L. 1993-255]

CAPITAL

- $226 million for capital improvements
- $740 million bond: Education, Clean Water, and Parks Bond Act of 1993 [S.L. 1993-542]

CRIMINAL JUSTICE

- Establish structured sentencing [S.L. 1993-538]

➤ In his State of the State address, Governor Hunt calls for an increase of $570 million in spending over the next two years, financed through budget cuts and increased revenue projections. Hunt earmarks $40 million for an early childhood development program, the "North Carolina Partnership for Children," that will increase day care and child protective services.

➤ House Minority Leader David Balmer (R-Charlotte) criticizes the governor's address by observing, "Basically, his speech outlined ways in which he is going to solve people's problems with more government, with more government programs."

➤ Speaker Blue attempts to defend the legislative pay raises by showing that more than 10,000 executive and judicial employees also received additional raises.

March

➤ House Speaker Blue makes health care reform a top priority for the session. "We are going to tackle this problem this session," claims Blue. "We are going to take care of the sick people in this state. We are going to provide help for our businesses, and we are going to do all we can to put a lid on out-of-control health care costs."

April

➤ In a plan that would increase incentives for businesses to relocate to North Carolina, Governor Hunt proposes that cities and counties be allowed to float bonds for "moving in" infrastructure improvements, such as sewage and water.

➤ Hunt also requests a $15 million "kitty" from the General Assembly that he can use to close business deals.

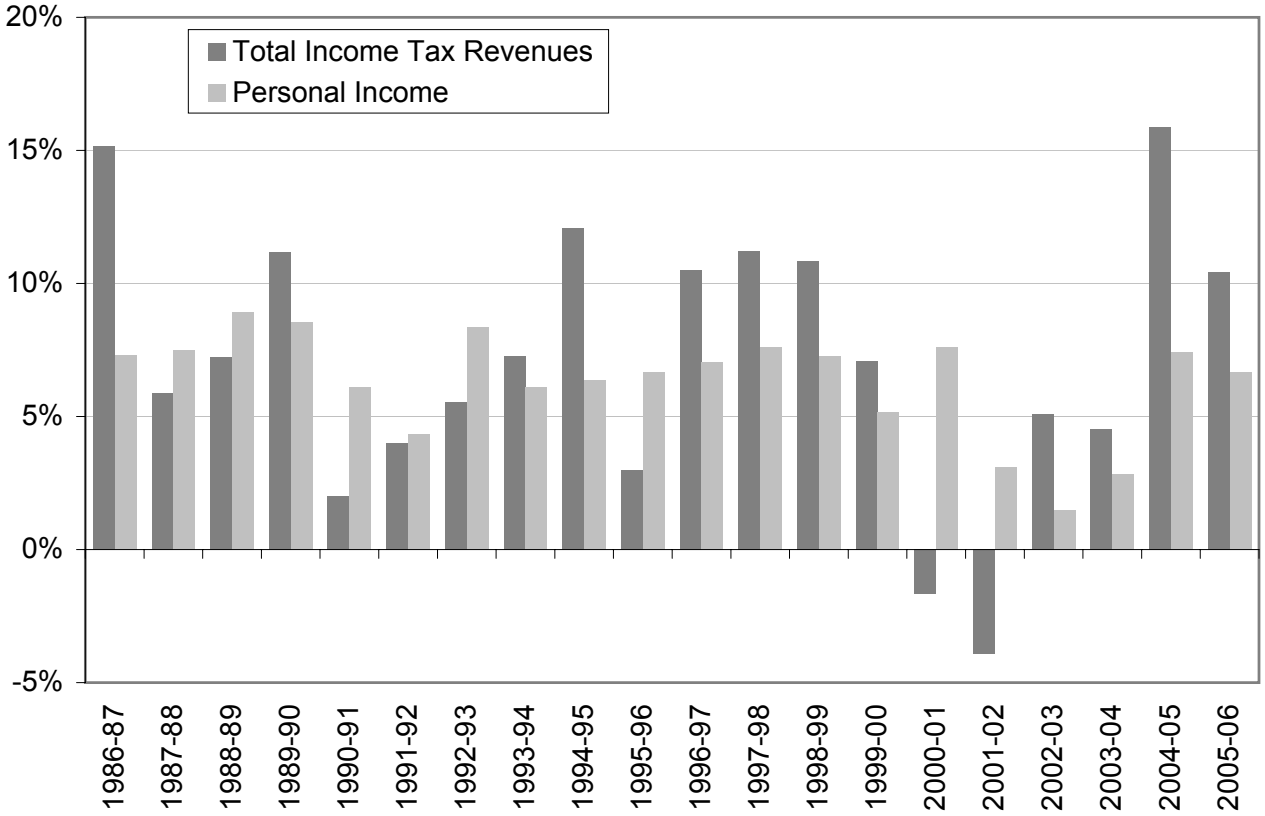
➤ While legislators generally support Governor Hunt's proposed early childhood program, many are concerned about the expected $28 million price tag.

May

➤ The Senate Appropriations Committee declines to fully fund Governor Hunt's early childhood program, cutting his $28 million request by two-thirds.

➤ The Senate and House consider

Personal Income and Income Tax Revenue Annual Growth



bills (SB 658 and HB 911) that would exempt computer software from local property taxes, a change that would save local taxpayers $10 million.

➤ In his $197 million capital budget, Governor Hunt asks for $36 million to put computers in public schools and to upgrade equipment in community colleges.

➤ The House and Senate pass their versions of the budget and send them into conference committee to negotiate the differences.

June

➤ The House and Senate debate over their respective bond bills (HB 664 and SB 14). The bills pertain to bonds for university and community college improvements, new building construction, infrastructure improvements to sewer and water systems, and state park improvements.

➤ The budget conference committee is unable to come to an agreement over a $200 tuition surcharge at NC State University and UNC Chapel Hill that would be used to fund teacher salaries and restore a June payday for state employees. (Two years ago the final state employee paycheck of the fiscal year was pushed to July in order to shift the cost to the next budget).

➤ A continuing budget resolution is passed (S.L. 1993-253) extending funding for government operations until August 1.

1993 HEALTH & HUMAN SERVICES BUDGET

Total Appropriations	**$1.70 billion**
Major Items:	
Medical Assistance (Medicaid):	$860 million
Mental Health/D.D./Subst. Abuse:	$441 million
Social Services:	$184 million
Facilities Services:	$75 million
Youth Services:	$53 million
Vocational Rehabilitation:	$24 million

July

➤ A compromise is reached on the tuition surcharge and July paychecks. Instead of a tuition surcharge, the House agrees to earmark $7 million for teacher salaries at all universities. In return, tuition at all universities will increase by at least 3 percent for in-state students and 6.5 percent for out-of-state students. The conference committee also agrees to the Senate's plan to restore the state employee payday to the end of June.

➤ On July 9, the General Assembly passes the $8.8 billion current budget bill (S.L. 1993-321).

➤ In an effort to lure Mercedes to North Carolina, Governor Hunt holds an "ice cream social" at the Executive Mansion where

1993 Significant Tax Changes

- Repeal reduction and sunset of 1/2¢ excise tax on gasoline used for underground tank storage and related cleanup [S.L. 1993-400]

1993 EDUCATION FUNDING

ENROLLMENT CHANGES

- Public Schools: 14,942 (1.4%) increase
- UNC: 920 (0.6%) increase

TUITION & FEE INCREASES

- Average increase of 11% for in-state and 8% for out-of-state UNC students
- Decrease of 0.2% for in-state and 0.0% for out-of-state community college students

OTHER EDUCATION CHANGES

- $13 million increase for low-wealth and small school systems
- Basic Education Program funding ($10 million for instructional support positions)
- $39 million increase for differentiated pay
- $24 million one-time increase for school bus purchases to make up for previous cuts
- $8 million reduction to the Career Development Program in 1994-95
- New end-of-grade testing program begins in grades 3 through 8
- $8 million for community college books and equipment
- Reorganize Department of Public Instruction and cut 86 positions

he announces a plan to build a $35 million training center for automotive technology workers. Hunt defends his proposal as follows: "This isn't a pipe dream. If we build this, it is going to create tens of thousands of new jobs and add millions of dollars in new tax revenues."

➤ The bill for a property tax exemption on computer software is ratified on July 23 (S.L. 1993-459).

➤ The $226 million capital improvement budget bill (S.L. 1993-561) passes on July 24. Governor Hunt's automotive technology training center – or as others call it, "Mercedes University" – is fully funded at $35 million.

➤ The "Education, Clean Water, and Parks Bond Act of 1993" is passed (S.L. 1993-542). Voters will decide on the bonds in November.

➤ The 1993 session ends with no lottery and no executive veto.

August

➤ A *News & Observer* poll finds that 53 percent of voters support bonds for community colleges and 56 percent support bonds for water and sewer projects. A majority of voters surveyed (53 percent) do not support bonds for state parks and universities.

September

➤ Mercedes-Benz announces that the finalists for its first U.S. plant are North Carolina, South Carolina, Georgia and Alabama. But in a blow to Governor Hunt's dealmaker image, Mercedes decides to locate the plant in Tuscaloosa, Alabama. In response, Governor Hunt explains to the press, "You win some and you lose some."

October

➤ UNC system President C. D. Spangler Jr. urges voters to pass the UNC bond referendum, claiming that if it fails, enrollment for qualified students could be restricted.

➤ Beverly Smith, a former Nash County Democratic Party chairman, pleads guilty to intentionally intercepting and monitoring the cellular phone

conversations of Lt. Governor Jim Gardner during the 1992 gubernatorial campaign. Smith is fined and sentenced to probation and community service.

November

- Voters approve $740 million in bond issues for parks, water and sewer projects, community colleges and universities.
- Phil Carlton and Charlie Lane, two former law partners of Governor Jim Hunt, plead guilty to reviewing notes and a tape made by Beverly Smith. Like Smith, Carlton and Lane are fined and sentenced to probation and community service.

December

- Governor Hunt proposes to provide free immunizations for all children and extend clinic hours to accommodate working parents. The controversial plan will initially cost $10.7 million over two years with additional funds of at least $1 million provided annually thereafter.
- Hunt calls on the General Assembly to convene for a special "crime session."

DID YOU KNOW?

With a rate of 6.75 percent in most counties, North Carolina has the 17th highest combined state and local sales tax rate in the country.

Source: The Sales Tax Clearinghouse

1994 session

1993-1994 BIENNIUM
FY 1995: July 1, 1994 to June 30, 1995

General Assembly:

House Dems:	78	House Reps:	42
Senate Dems:	39	Senate Reps:	11

Governor:
Jim Hunt (D)

The 1994 Short Session: Budget Bill SB1505/S.L. 1994-769
Passed Senate: June 2, 1994
Passed House: June 21, 1994
Conference Version Ratified: July 16, 1994
Signed by Governor: July 16, 1994

With the recession of the early 1990s coming to an end, state budget writers reaped the benefits of previous tax increases by taking in a $1.2 billion surplus. Instead of returning the money to taxpayers, the governor and the General Assembly increased spending. Governor Hunt began the year by proposing a new crime package in a special session of the General Assembly. During the short session, legislative priorities focused again on crime prevention and prison construction, as well as education. In the end, the General Assembly increased spending $1 billion during the 1994 session. As in previous years, much of the money was spent on raises for teachers and state employees. As Election Day approached, an energized Republican Party channeled its resources into clearly articulating its message for the next session by providing voters with a "New Contract" for North Carolina. In a landmark election year that saw Republicans retake the U.S. House of Representatives after 40 years in the minority, Republicans won a majority in the state House and came two seats shy of winning a majority in the Senate.

January

- Governor Hunt unveils his crime plan, estimated to cost between $118 million and $123 million for FY1994-95. The plan includes $27 million in construction costs for new prisons and $96 million in annual "administrative" costs that cover a variety of initiatives ranging from after-school programs for kids to substance-abuse programs for inmates. Hunt defends the increased spending saying, "Some people have called this a whopping big package. But it is nothing compared to the cost of crime."
- In spite of, or as some argue, because of, the multimillion dollar Basic Education Plan, a state education report shows that only 40 percent of North Carolina

high school students are proficient in core courses like English, history and biology. Setting the stage for the state's eventual decision to lower test score standards, local school officials begin to complain that standards are set too high.

➤ While briefing legislators on his crime package, Governor Hunt now estimates that his crime package will cost $563 million over the next five years.

DID YOU KNOW?

According to the North Carolina Budget & Tax Center, "Families earning less than $15,000 pay an effective state and local tax rate of 10.6 percent compared to the wealthiest one percent of North Carolinians, whose effective state and local tax rate is 6.1 percent."

Source: BTC Reports, May 2004

February

➤ The General Assembly convenes for a special "crime session."

➤ Governor Hunt makes a pledge to the General Assembly to cut $45 million from the budget in order to help pay for what is now a $118 million crime plan.

➤ State inspectors report that 273 bridges in North Carolina have serious structural flaws – e.g., cracked support pillars, rusted steel beams and rotted timbers. Another 1800 bridges are "intolerable" and in need of replacement.

➤ The UNC Board of Governors asks the General Assembly for $43.9 million to increase university faculty salaries by an average of 6 percent.

March

➤ Allocating funds for FY1994-95 and the remainder of FY1993-94, the Senate passes a $192 million crime bill (SB 150). A majority of the funds will go towards constructing new prisons, staffing needs, and renting prison space.

➤ The House amends the Senate bill and passes its own $271 million anticrime bill, with most of the funding applied to building and "renting" prison space from local entities and funding crime prevention programs. The House bill includes a $28.8 million proposal to hire more than 700 psychologists and guidance counselors for the public schools. The Senate wants to postpone funding the new hires until the scheduled short session when the education and appropriations committees can examine the proposal.

➤ In the end, the Senate and the House agree to use the crime bill to give $18 million to schools to hire new counselors and $10 million to "low wealth schools."

➤ The General Assembly passes the $257 million crime bill, which is subsequently incorporated into the FY1994-1995 budget bill (S.L. 1994-24es).

April

➤ The Public School Forum (PSF) of North Carolina releases a nine-month study that claims costs to

outfit schools with computers and Internet access could reach $1.5 billion – almost three times more than the $514 million estimated in a state Department of Public Instruction report. The PSF report accounts for capital costs to accommodate new technology, as well as the expense of teacher training on new equipment. The state report accounts only for equipment costs.

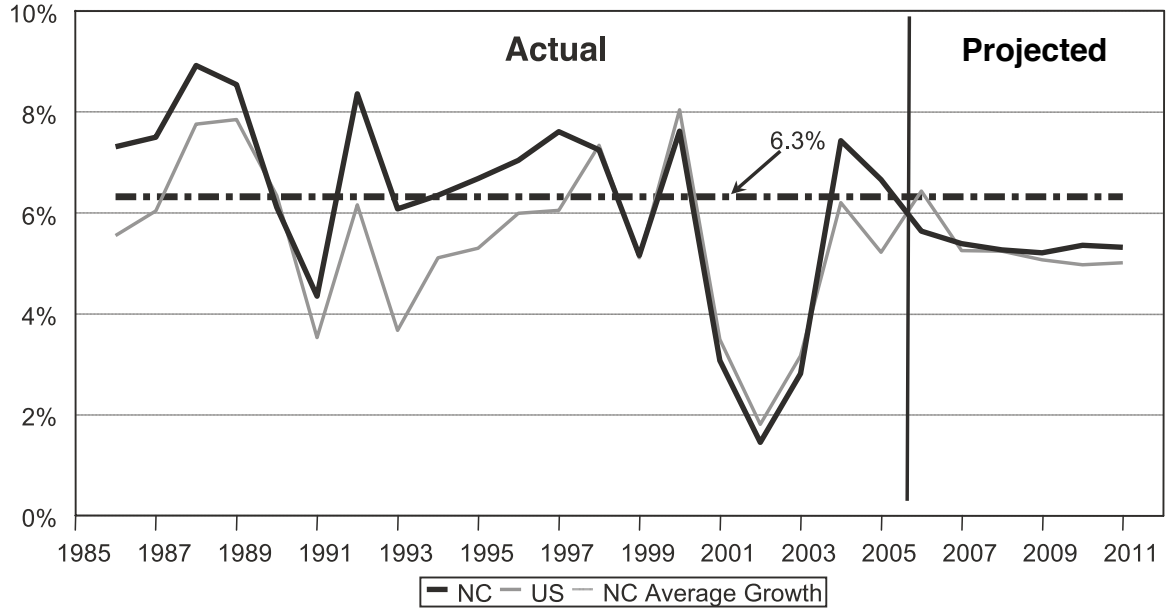
May

➤ Although no appropriations have been made, Jane Patterson, Governor Hunt's technology aide and former vice president of ITT Network Systems and Itt-Alcatel and Alcatel, NA, drafts a memorandum to school districts assuring them that the first year of phone charges for Internet access will be paid for by the state. The funding offer is extended without the approval of the General Assembly.

➤ The governor's estimated monthly costs for schools to gain access to the information highway increases from $3,400 per month in 1993 to $4,000 per month in 1994. As a result, startup costs for the program skyrocket from $30 million to $135 million.

➤ At the urging of Southern Bell, GTE South, and Carolina Telephone/ Sprint, state regulatory officials do not release cost study data on the information highway and redact any related information from public documents.

Trends in Personal Income: 1985-2011



Source: Bureau of Economic Analysis

1994 EDUCATION FUNDING

ENROLLMENT CHANGES

- Public Schools: 22,465 (2.0%) increase
- UNC: 796 (0.5%) decrease

TUITION & FEE INCREASES

- Average increase of 5% for in-state and 7% for out-of-state UNC students
- Increase of 0.2% for in-state and 0.0% for out-of-state community college students

OTHER EDUCATION CHANGES

- $40 million increase during Special Crime Session for low-wealth school systems, local programs for at-risk children, and intervention/prevention grants
- Additional $10 million for low-wealth and small school systems
- Basic Education Program funding ($26 million to reduce class size in kindergarten, $10 million for instructional support, and $10 million for textbooks)
- $42 million School Technology Reserve to be expended in accordance with legislation enacted by the 1995 General Assembly
- $120 million to restore teachers' 12th pay period from July 1 to June 30
- $13 million for community college books and equipment; $8 million for instructional support and literacy education
- $17 million for UNC priority items, such as library network and acquisitions, computing, and new degree programs
- Eliminate 185 vacant positions

➤ Hunt introduces Transportation 2001, a new highway proposal that aims to reduce the backlog of road projects by shifting funding to a "cash flow" model that will continuously fund construction instead of the current system which pays for phases of projects upfront and leads to half finished sections of highways.

➤ Governor Hunt offers his budget adjustment package for FY1994-95. The governor's recommendations include: a 4 percent raise for state employees and teachers, with a one-time, 1 percent bonus; an additional 4 percent raise for community college instructors; an additional 1.5 percent raise for university professors; $27.2 million for expansion of his "Smart Start" early childhood intervention program started last year; $5.3 million for schools to connect to the information highway; and $10 million for his industrial recruitment fund.

➤ It is revealed that a study used by Governor Hunt in support of his information highway plan was originally created by the WEFA Group for BellSouth.

➤ State Comptroller Ed Renfrow defends the use of the WEFA report, saying: "As far as I know about the WEFA study, it's a state-commissioned study. In response, Mike Raimondi a senior vice president at WEFA says: "BellSouth is a long-standing client of ours. … I don't know that we have any working relationship at all with the state of North Carolina. We just give the report to our client and they pass it on."

➤ Governor Hunt tells N.C. Citizens for Business and Industry that he intends to review the state's income tax structure to look into business tax cuts. But, adds the governor, "You can't be the lowest tax state and have the kind of universities that we have, and the kind of community colleges we have, and the kind of better schools we are about to have, and the best Smart Start program in the country."

June

➤ The Senate sends the House a budget plan that includes $1 billion in new spending. The Senate budget includes: a 4 percent raise, plus a one-time 1 percent bonus for state workers and teachers; an additional $51 million for the university system construction account; and $220 million that is to be saved for future needs.

1994 HEALTH & HUMAN SERVICES BUDGET

Total Appropriations $1.90 billion

Major Items:

Medical Assistance (Medicaid):	$1,010 million
Mental Health/D.D./Subst. Abuse:	$449 million
Social Services:	$193 million
Facilities Services:	$99 million
Youth Services:	$54 million
Vocational Rehabilitation:	$24 million

➤ The House budget differs from the Senate budget in several ways: a 4 percent raise, plus an additional one-time bonus of $480, for state workers; a 5 to 8 percent raise for teachers, depending on experience; $10 million to hire school workers to identify at-risk children; $20 million for a school technology fund; and the elimination of the proposed $51 million for university building construction.

➤ The month ends with two separate budget bills and no agreement.

➤ A continuing budget resolution passes on June 30 (S.L. 1993-591).

July

➤ After reviewing the state's drug prevention program, the Governor's Crime Commission declines to renew grants for enforcement, thus closing what are reported to be 11 "extraordinarily effective" drug task forces. The commission recommends that the state focus on education programs, instead of actual drug enforcement.

➤ The $1.2 billion current and capital budget bill (S.L. 1993-769) passes on July 16. The budget includes the $257 million crime package passed during the earlier special session; a 4 percent raise, plus a 1 percent nonrecurring bonus, for state workers; a 5 to 7 percent raise for teachers; an 8 percent raise for community college instructors; and a 6 percent raise for university professors.

➤ The General Assembly also approves a number of Governor Hunt's other recommendations, including $19.1 million in additional funding for Smart Start and $7 million for the Industrial Recruitment Competitive Fund. Skepticism over Governor Hunt's information highway program prompts the Legislature to allocate only $7 million in funding for school Internet programs.

1994 Significant Tax Changes

- No significant tax law changes

➤ Exuberant over winning new funding for his pet programs, the governor declares that North Carolina "is on a roll," even going so far as to promise a tax reduction. "The growth of the economy is going to be strong enough that we can cut some taxes and not have to add new ones," declares Hunt.

August

➤ In retaliation against legislators who voted to give teachers a larger pay increase than state workers, the State Employees Association of North Carolina (SEANC) does not endorse the following legislative leaders for the upcoming election: House Speaker Dan Blue, Finance Committee Co-chair Representative George Miller (D-Durham), Appropriations Committee Co-chair Representative Martin Nesbitt (D-Buncombe), and Senate President Pro Tempore Marc Basnight (D-Dare). SEANC Executive Director Bob Berlam defends the decision, saying: "We're still mad about pay raises."

September

➤ With new prison construction unable to keep pace with demand (see 1990), prison overcrowding forces State Correction Secretary Franklin Freeman to order the release of 347 nonviolent offenders ineligible for parole. Justification and authority for Freeman's actions is derived from a law passed in 1987 (S.L. 1987-7).

October

➤ As the campaign season enters its last month, Republican candidates vow to cut personal income taxes, enact term limits, build more prisons, eliminate the cap on prison populations, and give the governor veto power. Senate Minority Leader Bob Shaw (R-Guilford) promotes the "New Contract" for North Carolina, promising, "If we can get enough Republicans down here in Raleigh, we will get it done."

> I want a tax cut. I think we deserve one because there is a lot of money in Raleigh that is being spent unnecessarily, and we're all footing the bill for it.
>
> — Pilot Mountain resident Annie Ward, December 1994

November

➤ Riding on the coattails of the national Republican Revolution of '94, North Carolina Republicans win a majority in the House (67-53) for the first time and come within two seats of taking the Senate (24-26). Senate President Pro Tempore Marc Basnight claims, "It was the toughest night of my life."

December

➤ Responding to the antitax sentiment that helped carry Republicans to state and national victories, Governor Hunt proposes the largest tax cut in North Carolina's history. The $483 million tax cut will provide relief to

1994 Other Significant Changes

COMPENSATION

- 4% salary increase plus 1% one-time bonus for most state employees
- 5% - 7% increase for teachers

SPECIAL CRIME SESSION

- Funds to implement Structured Sentencing; increase General Fund operating budget by $193 million ($25 million NR), including:
  - ➔ More prison beds and money to house prisoners out-of-state or in county jails
  - ➔ Substance abuse programs and non-active punishments
  - ➔ Prevention through DHHS and education
  - ➔ Local Criminal Justice Partnership Programs
  - ➔ 500 new probation/parole officers
- $66 million for prison construction and other capital projects

working families and the elderly by increasing personal income tax deductions, child credits and the homestead exemption; repealing the intangibles tax; and reducing the corporate income tax from 7.75 percent to 7 percent. Claims Hunt, "North Carolina families need all the help they can get."

➤ Hunt tells the Advisory Budget Commission, a consultant panel comprised of lawmakers and citizens, he will have to make program cuts in order to pay for the proposed tax cut. With an eye toward cutting the state's bloated bureaucracy (which Hunt himself helped create), the governor suggests "flattening management is one of the ways we should go about that."

A New Contract with the People of North Carolina

"The New Contract with the People of North Carolina" was a fiscally conservative platform signed on October 4, 1994, by every Republican candidate running for the General Assembly during the 1994 election. The contract was inspired by the similarly named "Contract with America" that helped Republicans capture the U.S. House of Representatives that same year.

The contract was successful, at both the federal and the state level, for several reasons: 1) It was unanimously supported by every candidate; 2) It provided a clear direction and a specific agenda for the party; 3) It helped convince the people of North Carolina (and the United States) that Republicans were ready to govern.

Like the "Contract with America," the "Contract with the People of North Carolina" emphasized fiscal, institutional, and welfare reform, leaving in the background more controversial social issues, such as those related to abortion.

A NEW CONTRACT WITH THE PEOPLE OF NORTH CAROLINA

- [x] No new taxes of any kind
- [x] An income tax cut of at least $200 million
- [ ] Taxpayer Protection Act
- [ ] Legislation prohibiting "unfunded state mandates"
- [x] Legislation that removes the cap on the prison population
- [ ] Legislation denying welfare benefits to unwed parents who fail to cooperate in establishing paternity of children born out of wedlock
- [ ] Legislation granting effective control of public schools to local boards of education
- [x] Reduction in the size and responsibilities of the Department of Public Instruction
- [x] Legislation extending Workfare programs to cover all able-bodied adult recipients of social services benefits and providing for a Learnfare program to encourage youthful welfare dependents to take advantage of educational opportunities ***(partial reform passed in 1997 and expanded in 1998)***
- [x] A change in the rules of the House and Senate permitting a majority of the members to force legislation being held in committee to be brought to a vote on the floor of the body
- [ ] A constitutional amendment establishing term limits for members of the General Assembly and an amendment or legislation doing the same for the state's Congressional delegation
- [x] A constitutional amendment granting the governor the power to veto legislation ***(sent to voters)***
- [ ] A constitutional amendment enabling citizens to propose constitutional amendments through an initiative process

(Checked boxes signify contract goals that were at least partially accomplished)

Source: UNC Institute of Government, *North Carolina Legislation 1995: A Summary of Legislation in the 1995 General Assembly of Interest to North Carolina Public Officials* (Chapel Hill: Institute of Government, 1996), 1-1.

OVERVIEW

1995-1999

General Economic Trends: 1995-1999

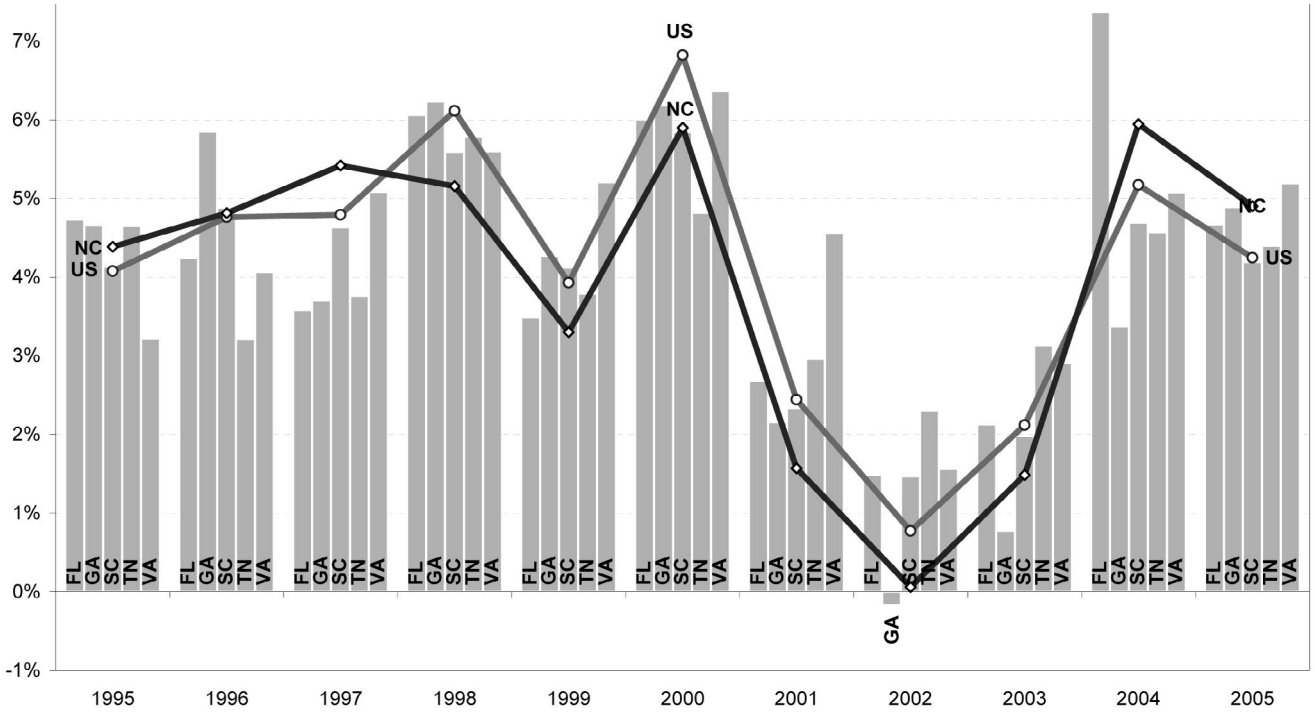
The economic growth that began in 1992 continued throughout the rest of the decade. Private job growth in North Carolina averaged 3.1 percent between 1995 and 1999, adding an average of 114,000 jobs per year to the private sector. Earnings per job grew at an average of 4 percent per year.

At the same time, state revenue from income taxes basically kept pace with personal income, with the exception of 1998. That year, the state's income tax revenues increased by a stunning 21 percent, three times the rate of growth in nominal personal income.

State and local personal property tax revenues also jumped by 20 percent in 1998 and by 19 percent in 1997.

It is interesting to note that these revenue increases coincided with the largest tax cuts in recent state history, passed when the Republicans held a majority in the House from 1995 to 1998. Thanks to the across-the-board (both on the

Nominal Per Capita Personal Income Growth:
Southeast States, 1995-2005



demand and the supply side) cumulative effect of the tax cuts, some $3.43 billion (between 1995 and 2000), was freed up for private use and investment.[1] The economic boom that accompanied the tax cuts led to a sharp increase in tax revenues.

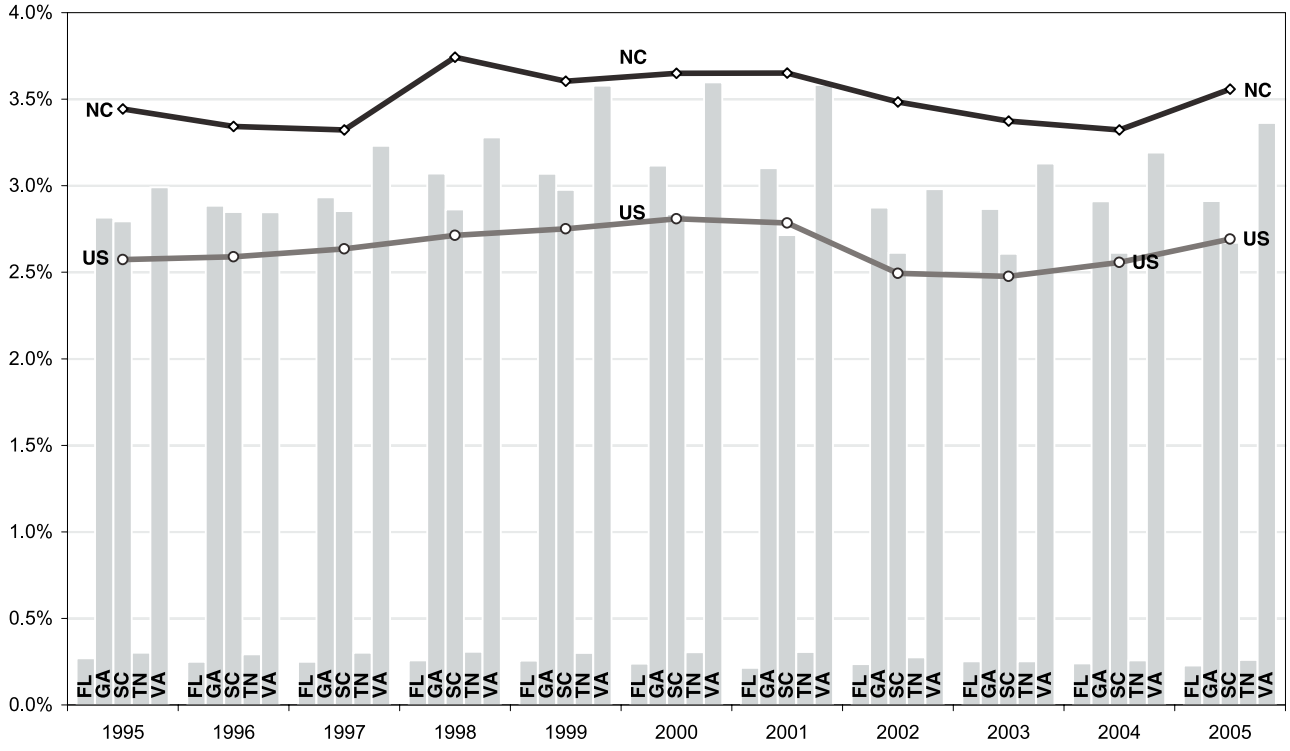
State and local job growth did not increase quite as fast as in the private sector. The state/local sector in North Carolina grew at 2.5 percent, or 12,600 jobs, on average per year. Earnings in the public sector, though, almost kept pace with private sector earnings, growing at 3.6 percent annually.

In terms of per capita personal income, North Carolina's gains in relation to the national average fell short during the latter half of the 1990s. The state remained at 92 percent of the national average from 1995 to late 1999. While North Carolina marginally outperformed Tennessee and also stayed ahead of Kentucky and South Carolina, it remained behind Florida, Georgia and Virginia. From 1995-1999, Florida's per capita personal income growth rate actually averaged 0.6 percent below the national average per year. As a result, Floridians earned 98 cents to the national average dollar in 1995 but only 96 cents in 1999. Georgia stayed steady at 94 cents to the national average dollar for the period.

[1] This amount is the total value, over the period 1995-1999, of the 1994 and 1998 state tax cuts. The state's revenue loss is smaller because the tax cuts were partly countered by other tax increases, but also because the tax cuts boosted growth in the state economy (cf. Q & A: 11). That growth, in turn, created more revenues at lower tax rates for the state.

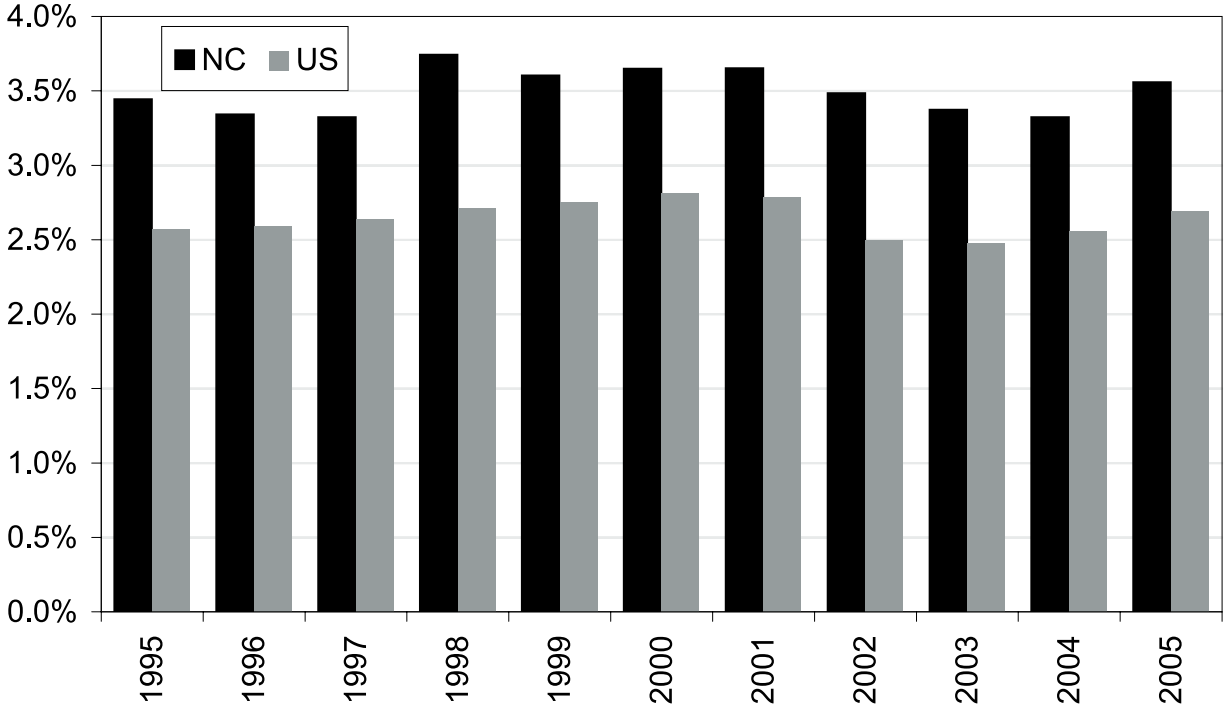
Virginia, however, continued to outpace the rest of the Southeast. Between 1995 and 1999 Virginia's per capita personal income held steady at 104 percent of the U.S. average.

State/Local Taxes as Share of Personal Income: Southeast States, 1995-2005



NOTE: This figure does not include sales tax, but is the standard measure used by the Bureau of Economic Analyis for "personal current taxes." As such, it includes income taxes and taxes on personal property.

State/Local Taxes as Share of Personal Income:
North Carolina vs. U.S. Average, 1995-2005



1995 session

1995-1996 BIENNIUM
FY 1996: July 1, 1995 to June 30, 1996

General Assembly:

House Dems:	52	House Reps:	68
Senate Dems:	26	Senate Reps:	24

Governor:
Jim Hunt (D)

The 1995 Long Session:
Budget Bill HB229/S.L. 1995-324
Passed House: May 3, 1995
Passed Senate: May 18, 1995
Conference Version Ratified: June 26, 1995
Signed by Governor: June 26, 1995

The new Republican majority in the House acted quickly to fulfill its campaign promises, passing various tax cuts, as well as a bill calling for a gubernatorial veto referendum. The Senate followed the House's lead in approving the veto referendum, which subsequently passed in the November 1996 election. In a concerted effort to share credit for the tax cuts with the House, both the Senate and the governor readily acquiesced to many of the cuts, making for a surprisingly uneventful session. The end result was that the 1995-1996 biennium brought about the largest tax cuts in recent state history.

1995 HEALTH & HUMAN SERVICES BUDGET

Total Appropriations $2.02 billion

Major Items:

Medical Assistance (Medicaid):	$1,045 million
Mental Health/D.D./Subst. Abuse:	$474 million
Social Services:	$197 million
Youth Services:	$71 million
Deaf and Hard of Hearing:	$26 million
Vocational Rehabilitation:	$26 million

House Republicans likewise passed a "Taxpayer Bill of Rights" (see Box Insert) that sought to limit General Fund expenditures (and thus tax increases) to a rate equal to the state's increase in population, plus inflation. In addition to prohibiting unfunded state mandates, such as county payments for the state portion of Medicaid, the bill also required that 25 percent of any remaining General Fund credit balances be transferred to an Emergency Reserve Trust Fund. After the Senate amended the bill, however, the two chambers were unable to reconcile their respective versions in conference committee.

Finally, as predicted by the Public School Forum of North Carolina during the 1994 short session, Governor Hunt's information highway program far outpaced original cost estimates. Two separate studies, one by the state auditor and one by Telecommunications Consulting Group,

DID YOU KNOW?

Sixty-one percent of North Carolina voters believe future state spending increases should be limited to population growth plus inflation.

Source: August 2006 Civitas DecisionMaker Poll

Inc., an independent consulting firm, predicted costs would run into the billions, concluding that the governor's estimates were unrealistic and vague.

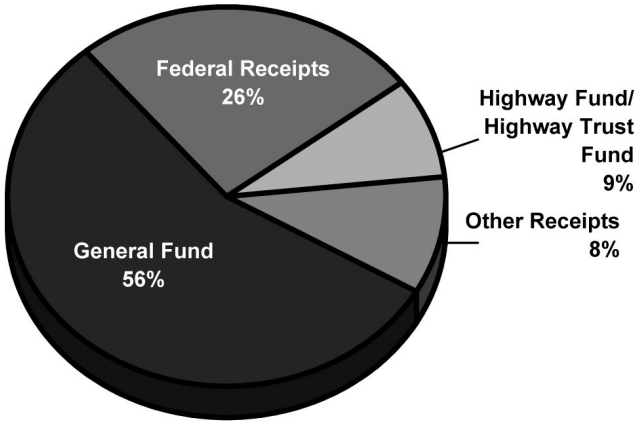
January

- Incoming Speaker of the House Harold Brubaker (R-Randolph) urges the House to pass the "Taxpayer Protection Act" (HB 3). States Brubaker, "The new Republican majority is committed to restraining government growth and giving relief to North Carolina taxpayers."
- Republican legislators begin drafting a bill for a constitutional amendment that would permit a gubernatorial veto.
- In an effort to strengthen the slim Democrat majority in the Senate, President Pro Tem Marc Basnight (D-Dare) changes the rules in the Senate so as to give himself the power to sit on every committee and also determine committee membership. Basnight defends the power grab, saying: "Today you saw a very slim majority strengthen its position of power." Republicans protest Basnight's actions.
- The Republicans likewise seek to strengthen their majority in the House with rule changes that limit the number of bills a member can introduce and also give the majority leader and speaker pro tempore voting rights on every committee and subcommittee. Democrats protest the changes.
- The Senate Judiciary Committee approves a bill (SB 3) on the gubernatorial veto.

February

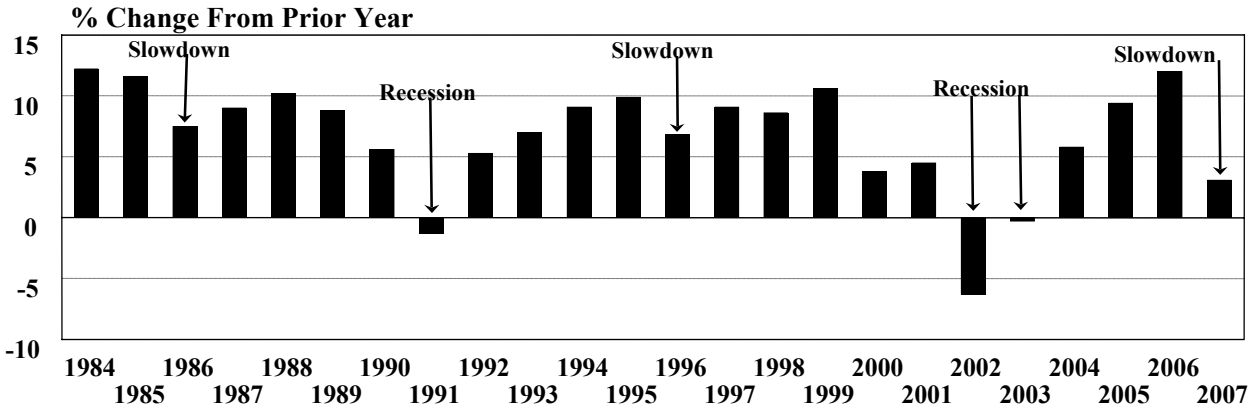
- The House approves the Senate gubernatorial veto bill.
- Governor Hunt calls for bipartisan cooperation in his State of the State address. Hunt proposes a $483 million tax cut on personal income, corporate taxes, and the intangibles tax. At the same time, he proposes increasing spending on prison construction by $100 million and expanding his "Smart Start" program to 24 more counties over two years.

Source of Budget Funds: 1995-96



- Hunt proposes an $18 billion budget that cuts taxes, provides for a 2 percent raise for state workers and a 5 percent raise for teachers, expands Smart Start by

General Fund Revenue Growth: 1984-2007
Adjusted For Tax Law Changes



FISCAL YEAR ENDING JUNE 30

NOTE: The 2007 amount represents the budget estimate.

$21 million, and eliminates 2,000 government jobs.

➤ The General Assembly approves a 23 percent tax cut to the unemployment tax for employers (S.L. 1995-4). It is estimated that this reduction will save employers $106 million over the next two years.

March

➤ The General Assembly approves a bill (S.L. 1995-5) permitting voters to decide in the November 1996 election whether to give veto power to the governor.

➤ House Republicans push for a repeal of the food sales tax, a reduction that would save $300 a year for an average family of four.

➤ The Commission for a Competitive North Carolina, a group of academic, business and government leaders created by Governor Hunt, recommends a state report card that would be issued by a new "Progress Board" to inform citizens of government performance on initiatives and programs.

➤ The state auditor releases a study that estimates Governor Hunt's information highway program will cost taxpayers $1 billion over nine years. The $111 million annual average cost dwarfs Governor Hunt's own recommendation of $8.3 million for 1995.

April

➤ The General Assembly passes a $364 million tax cut (S.L. 1995-42) that reduces personal income taxes by increasing personal exemptions to $2,250 for 1995 and $2,500 for 1996 for single filers with incomes $60,000 or less and married couples with incomes $100,000 or less. In the wake of a likely decision against the state in the U.S. Supreme Court challenge,

Economic Snapshot: 1995

Population:	7,194,238	Five-Year Population Growth:	8.5%
Civilian Labor Force:	3,634,000	Unemployment Rate:	4.4%
Per Capita Income:	$ 21,082	Pct. of U.S. Per Capita Income:	90.2%

Top 10 Private Employers

1. Food Lion, Inc.
2. Duke University
3. IBM Corporation
4. Wal-Mart Stores, Inc.
5. Sara Lee Corp.
6. US Air, Inc.
7. Duke Power Company
8. Burlington Industries
9. K-Mart Corporation
10. Fieldcrest Cannon, Inc.

Fulton Corp. v. Faulkner (1996), the Legislature also repeals the intangibles tax.

➤ Students at UNC-Chapel Hill protest proposed budget cuts that will eliminate 392 teaching positions and raise tuition 3.1 percent for in-state students and 30 percent for out-of-state students over the next three years.

➤ Republican lawmakers call for more accountability regarding Smart Start, demanding that Governor Hunt follow through on his promise to fund the program as a public-private partnership. With Republicans vowing to withhold future funding until the public-private funding ratio reaches 5 to 1, Governor Hunt vows not to compromise.

➤ House Republican leaders announce that state workers and teachers should not expect salary increases.

May

➤ Several hundred students and faculty from across the UNC system hold a rally at the Capitol to protest education cuts approved in the House budget bill.

➤ Governor Hunt proposes using an unanticipated $35 million revenue surplus to reduce teaching position cuts and tuition increases for graduate students.

1995 Significant Tax Changes

⬇	Increase income tax personal exemption from $2,000 to $2,250 for 1995 and to $2,500 for 1996 [S.L. 1995-42]
⬇	Establish tax credit of $60 for each dependent child [S.L. 1995-42]
⬇	Reduce tax on soft drinks by 25% [S.L. 1995-474]
⬇	Reduce unemployment tax for employers by 23% [S.L. 1995-4]
⬇	Repeal intangibles tax and reimburse local governments [S.L. 1995-41]
⬌	Reallocate real estate conveyance tax from General Fund [S.L. 1995-456]

June

➤ Governor Hunt offers a "compromise" on his Smart Start program that retains funding at the same levels for existing programs and expands Smart Start into 12 additional counties. The proposal requires a 20 percent match – half in cash and half in in-kind contributions – of private funding. Frustration with Hunt's refusal to permit greater legislative oversight over the program leads House Speaker Brubaker and House Majority Leader Leo Daughtry (R-Johnston) to declare that they will cease negotiating with the governor and turn to the Senate instead.

➤ Senate and House leaders agree to fully fund existing Smart Start programs at $58.1 million, but the expansion into new counties will receive planning funds only.

➤ The General Assembly passes the $9.8 billion continuation budget (S.L. 1995-324). The budget cuts over 600 vacant state jobs and repeals the prison population cap in order to prevent the premature release of prisoners to make room for new inmates.

July

➤ In its capital and expansion budget, the House saves $1 million by freezing pay for judges, court clerks, district attorneys and other elected and appointed state workers. The budget includes a 2 percent raise for teachers and other state workers, $65 million for state prison construction costs, and $48.5 million for community colleges.

➤ Telecommunications Consulting Group, Inc., a Washington-based firm hired by House Republicans to study Governor Hunt's information highway plan, advises the governor's program be overhauled, with particular attention paid to conducting a thorough cost-benefit analysis, renegotiating rates with providers, and requiring performance reports from providers.

➤ The General Assembly passes the expansion and capital budget (S.L. 1995-507). The budget includes a 2 percent raise for teachers and state workers; a $75 tuition increase for most in-state students; a 6 to 7 percent tuition increase for out-of-state students; and $75.6 million for prison construction: $34.6 million for FY1996 and $41 million for FY1997.

August

➤ It is discovered that R.W. Wilkins, a former agricultural advisor to Governor Hunt on voluntary leave

1995 Other Significant Changes

COMPENSATION

- 2% salary increase for most state employees and teachers

GOVERNMENT

- Direct Office of State Budget & Management to review and analyze administrative span of control of state agencies

CAPITAL

- $34 million in 1995 and $41 million in 1996 for 2,048 new prison beds
- $49 million in 1995 and $97 million in 1996 for UNC capital projects
- $31 million in 1995 and $19 million in 1996 for other state capital projects

1995 EDUCATION FUNDING

ENROLLMENT CHANGES

- Public Schools: 25,795 (2.3%) increase
- Community Colleges: 21,244 (2.8%) increase
- UNC: 969 (0.6%) increase

TUITION & FEE INCREASES

- Increase UNC tuition 9% for in-state students and 7% for out-of-state students; additional increases in the following year
- No change for community college students

OTHER EDUCATION CHANGES

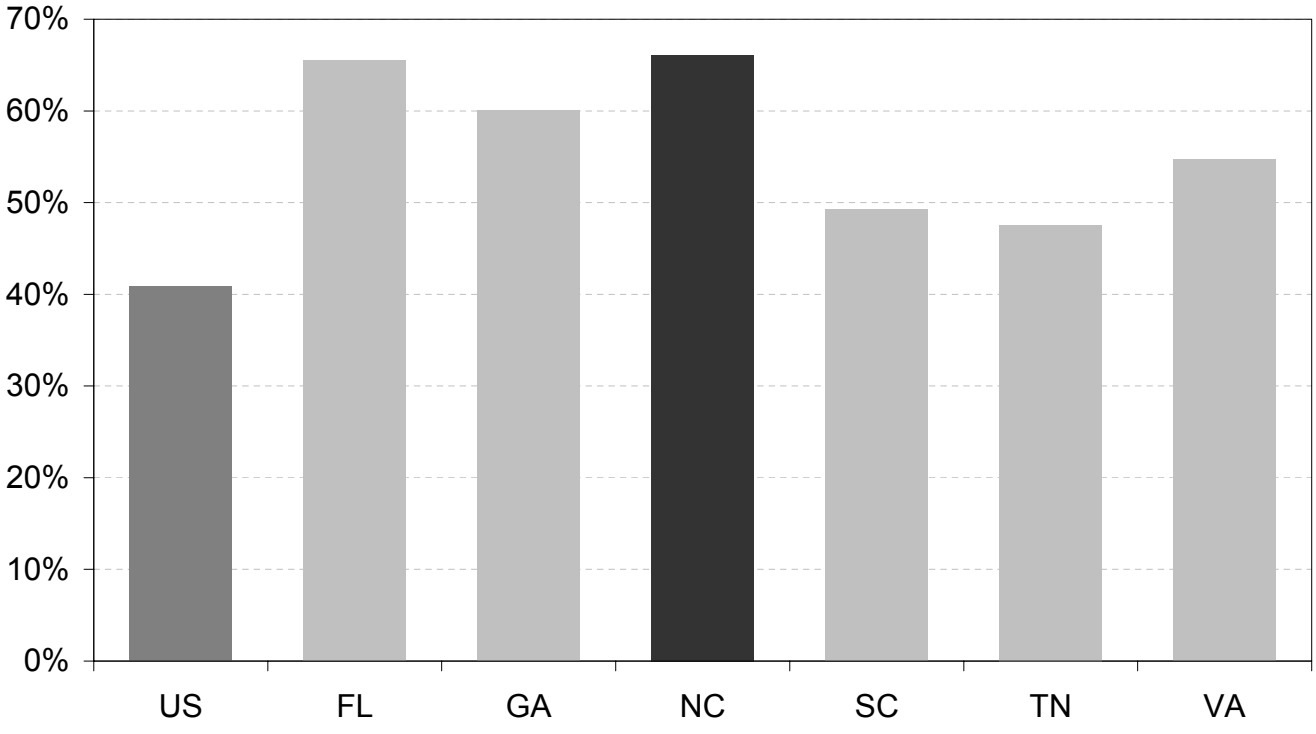
- Revise powers and duties of state superintendent; State Board of Education to develop plan to reorganize public education
- Approve charter school legislation
- Grade 1 class size reduction ($19 million); grade 2 class size reduction in 1996-97
- Increase school technology funds
- Repeal public school outcome-based education program to implement budget reduction

without pay, received $38,000 after his leave started. Wilkins left over accusations that he was "squeezing state workers for campaign contributions." In response to the scandal, House Speaker Brubaker comments: "That is unreal. … That really skirts the whole intent of 'leave without salary.'"

September

➤ With the permission of the General Assembly, UNC-Chapel Hill trustees vote to raise all undergraduate student tuition $400. Out-of-state graduate students will see increases from $1,000 to $3,000 per year. The increases are needed to pay for teacher salaries and student aid.

State/Local Government Employment Growth: Southeast States, 1985-2005



October

➤ NC State professors urge the university to raise tuition but to use the revenue for spending on library purchases.

November

➤ NC State University trustees vote to raise tuition $400 per year to raise money for library spending. More than half of the funds will be applied towards the library, with the remainder applied to financial aid.

December

➤ Governor Hunt credits his "Work First" program, which directs welfare recipients into jobs, for lowering by more than 10 percent the number of families receiving state aid.

DID YOU KNOW?

According to two separate studies
conducted by the
Small Business & Entrepreneurship Council
and The Tax Foundation,
North Carolina's state business tax
climate is among the worst
(ranked 40th) in the nation.
By contrast, Florida is ranked fifth;
Virginia, 13th; Tennessee, 18th;
Georgia, 19th; and South Carolina, 26th.

Source: Fortune Small Business; The Tax Foundation

Declaration of Taxpayer Rights

As promised in "The New Contract with the People of North Carolina," Republican legislators sponsored a bill in 1995 aimed at reforming the budget process. In particular, the bill prohibited unfunded mandates and instituted General Fund spending limits tied to population growth, plus inflation.

Popularly known as the "Taxpayer Protection Act" (HB 3), the bill passed the House by a vote of 94 to 22 in March 1995. The Senate also passed a drastically amended version of the bill that July by a vote of 28 to 21. The two chambers, however, were unable to reach a compromise in committee.

The final Senate version of the bill included a Declaration of Taxpayer Rights that read as follows:

§ 105-1.1. Declaration of taxpayer rights.

By means of the United States Constitution and the North Carolina Constitution, the people have bestowed upon the General Assembly the power to obtain a regular and adequate supply of revenue to serve the public good. In exercising this power, the General Assembly pledges to be ever mindful that the Assembly is the embodiment of the people and guarantees to the people the following rights:

(1) To have a balanced State budget, in accordance with Article III, Section 5 of the North Carolina Constitution.

(2) To be protected from uncontrolled growth in State government by limiting increases in State spending and in the number of State employees, in accordance with G.S. 143-2.1 and G.S. 143-10.2.

(3) To have the fiscal affairs of the State managed in the same prudent, responsible way in which the people of the State manage their fiscal affairs, in accordance with G.S. 143-2.1 through G.S. 143-2.4.

(4) To have a constitutional limit on the State income tax rate, in accordance with Article V, Section 2 of the North Carolina Constitution.

(5) To have the power to determine by vote whether the State or a unit of local government can issue bonds payable by tax revenue and, in order to ensure a good credit rating when bonds are issued, to have repayment of the bonds be the first funding priority of the State or local unit, in accordance with Article V, Sections 3, 4, and 6 of the North Carolina Constitution.

(6) To be told the truth in taxation, in accordance with G.S. 120-36.7, 159-50, 160A-20, and 105-286.

(7) To know the costs of proposed legislation and proposed administrative rules, in accordance with G.S. 120-36.7, 143-3.5, 150B-21.4, 96-4, 97-80, 105-262, and 143-138.

(8) To be treated fairly and promptly in any questions regarding tax liability, in accordance with G.S. 105-241.1, 105-241.2, 105-258.1, and 105-267.

(9) To have the people's investment in State buildings and other State facilities protected through adequate funding for maintenance and repairs, in accordance with G.S. 143-2.3.

(10) To be informed on how revenue is used, pursuant to G.S. 20-66(j), 105-248, 105-321.1, 143-10.3, 143-10.4, and 143-10.5.

1996 session

1995-1996 BIENNIUM
FY 1997: July 1, 1996 to June 30, 1997

General Assembly:

House Dems:	52	House Reps:	68
Senate Dems:	26	Senate Reps:	24

Governor:
Jim Hunt (D)

The 1996 Short Session:
Budget Bill HB53/S.L. 1996-18es2
Passed House: June 10, 1996
Passed Senate: June 16, 1996
Conference Version Ratified: August 3, 1996
Signed by Governor: August 3, 1996

With the state enjoying a revenue surplus of $700 million, Governor Hunt began his reelection campaign by calling for a special session of the General Assembly to temporarily cut the business unemployment tax for one year. Joining in on the early campaigning, the General Assembly returned to Raleigh in February and passed the legislation in less than 3 hours.

Once the short session began in May, however, the House and the Senate could not agree on what to do with the budget surplus. House Republicans wanted to use half of the surplus to cut taxes and save for emergencies while Senate Democrats wanted to spend most of the $700 million on environmental and education programs. The House vowed to – and actually did – leave Raleigh at the end of June when the Senate refused to compromise. In early July, the General Assembly reconvened for a second special session called by Governor Hunt. The resulting $10.6 billion budget was then passed, with additional tax cuts enacted. Despite winning the battle over the surplus, the House's strategy backfired with the electorate. In the November election, voters increased the Democrat majority in the Senate and almost – just short of two seats – elected a Democrat majority in the House. Governor Hunt easily won reelection, taking advantage of his popularity to finally acquire gubernatorial veto power.

January

- Speaker of the House Harold Brubaker (R-Randolph) asks Governor Hunt to call a special session of the General Assembly to approve a reduction in business unemployment taxes.
- Governor Hunt expresses his desire to reduce unemployment taxes on business but cautions that "there may be several ways to skin the cat" instead of calling for a special session that would cost taxpayers money.

1996 EDUCATION FUNDING

ENROLLMENT CHANGES

- Public Schools: 26,450 (2.3%) increase
- Community Colleges: 15,469 (1.9%) increase
- UNC: 874 (0.6%) decrease

TUITION & FEE INCREASES

- Increase UNC tuition 8% for in-state students and 6% for out-of-state students (increases in the 1995 Budget Bill)
- No change for community college students

OTHER EDUCATION CHANGES

- Approve ABCs of Public Education
- Grade 2 class size reduction ($19 million)
- One-time increase of school technology funds
- School safety and violence prevention
- Appropriate $18 million to enhance the competitiveness of "Research University I" UNC campuses (1995 budget also increased tuition at these same campuses)

➤ Hunt calls for a special session of the General Assembly to cut unemployment taxes by $140 million.

February

➤ On February 21, the General Assembly votes to suspend the unemployment tax paid by businesses for one year (S.L. 1996-1es). The special session lasts 2 hours and 39 minutes.

March

➤ Governor Hunt says he will "go to the mat" in order to make North Carolina teacher salaries equal to the national average by 2000.

➤ The Executive Budget Act Revision Study Commission, specially created by the General Assembly to study the gubernatorial veto, devises a plan that would limit the ability of the governor to change budgetary items between sessions without approval from the Legislature. Members of the Senate and House fear losing control over the budget process if the gubernatorial veto is approved.

➤ Governor Hunt assails the commission's plan, claiming that it adds "another layer of bureaucracy" and also hinders his ability to respond to emergencies and recruit industries by not allowing him to manage allocated funds as he sees fit.

April

➤ Approximately 100 graduate and professional students hold a rally at UNC-Chapel Hill to protest cuts in graduate programs, as well as ask for a health insurance plan and more tuition assistance.

May

➤ Despite endorsements from prominent Republicans and business groups, Charlotte Mayor Richard Vinroot is defeated by state Representative Robin Hayes (R-Concord) in the gubernatorial primary. Hayes will face Jim Hunt in November's election.

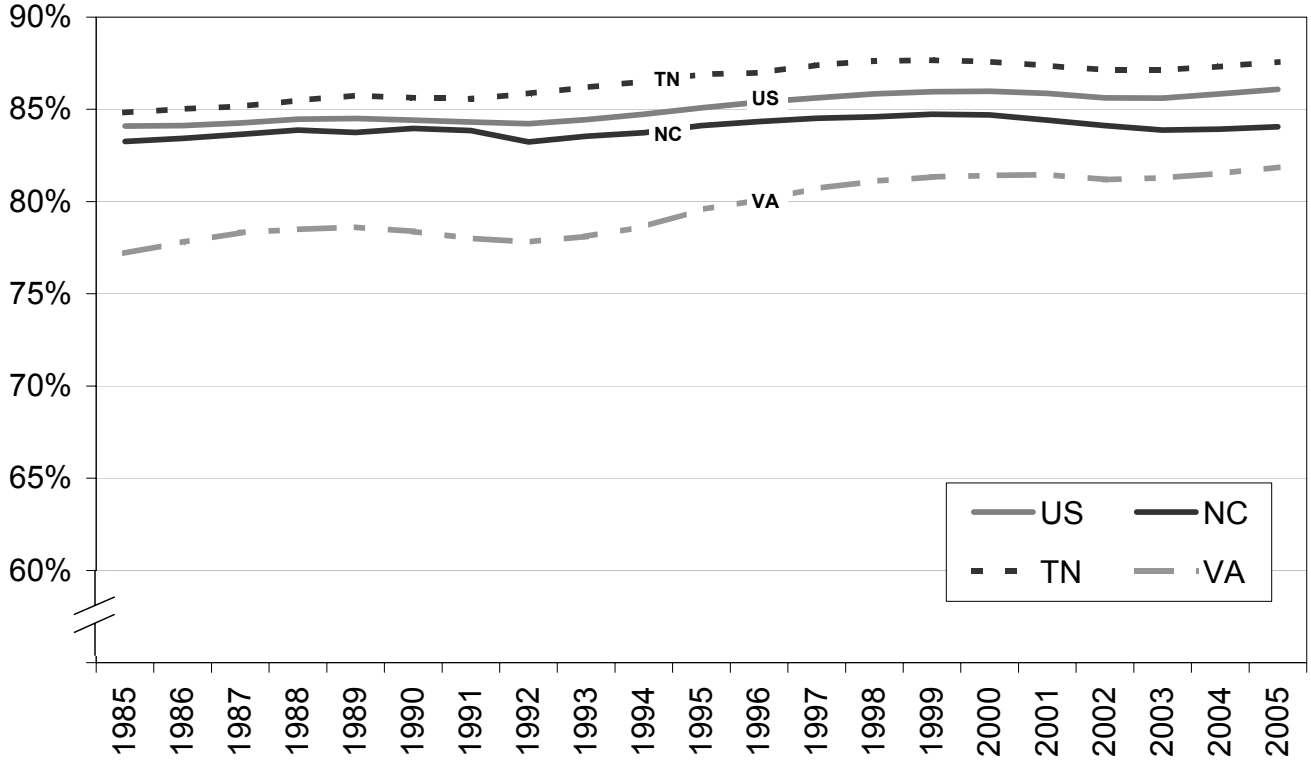
➤ Governor Hunt releases his proposed election-year budget, which calls for: the elimination of 1,000 government jobs; a 6 percent pay raise, with a 1 percent one-time bonus, for teachers and college professors; a 4 percent pay raise, and 2 percent one-time bonus for state employees; a $21.2 million expansion of Smart Start; a reduction of the food sales tax from 4 percent to 3 percent; and a decrease in the corporate income tax rate from 7.75 percent to 6.75 percent.

- Despite having a $700 million surplus to work with, Senate President Pro Tempore Marc Basnight (D-Dare) says he does not think Governor Hunt's tax cuts are viable: "I don't believe we can afford to do it at this time."
- Overlooking the overwhelming failure of "hot bunking" – inmates sharing beds and sleeping in shifts to alleviate prison crowding – in Alabama prisons, the House Appropriations Committee allocates $687,000 to support a similar proposal made by Governor Hunt for North Carolina.

June

- Speaking before the N.C. School Board Association, Governor Hunt repeats his call for a 7 percent pay raise for public school teachers. "There is money in the budget to do it," says Hunt.
- The General Assembly approves the "Public School Building Bond Act of 1996," a $1.8 billion bond referendum for school repairs and construction (S.L. 1995-631). The bond ultimately passes in November.
- The House amends and then approves a Senate bill that would give a $100 rebate to each North Carolina citizen who paid taxes in 1995 (SB981). The amended bill, however, never goes to conference committee and so is not ratified.
- The short session ends on June 22 with the House and the Senate unable to agree on budget

Private Share of Total Nonfarm Employment: Select Southeast States, 1985-2005



adjustments. The previous biennial budget thus remains in place.

➤ The obstacles to a final agreement include disagreements between the House and the Senate on the following items: raising teacher salaries (4 percent vs. 6 percent); raising state employee salaries (4 percent vs. 5 percent); expanding Smart Start ($0 vs. $21 million); creating more prison beds ($20 million vs. $0); and saving vs. spending part of the $700 million surplus. In short, House Republicans refuse to acquiesce to what is being called a "Democratic spending spree."

➤ Comments House Speaker Harold Brubaker about the budget stalemate: "North Carolinians have witnessed the differences between the two parties. Republicans believe in less government. Republicans believe in controlling spending. Liberal Democrats believe in spending and spending and spending."

➤ Governor Hunt orders the General Assembly to return to Raleigh on July 8 for another special session in order to resume budget negotiations. "North Carolina is in a state of crisis," declares Hunt. "And we've got an obligation to fix it."

1996 Significant Tax Changes

⬆	Reform unconstitutional tax provisions (Gain $19 million) [S.L. 1996-14es2)
⬇	Refund taxes paid on pensions by federal retirees [S.L. 1996-19es2]
⬇	Reduce state sales tax on food from 4% to 3% (effective January 1, 1997) [S.L. 1996-13es2]
⬇	Reduce corporate income tax rate from 7.75% to 6.90% over 4 years [S.L. 1996-13es2]
⬇	Expand jobs tax credit; create new credits [S.L. 1996-13es2]
⬇	Phase out soft drink tax over 3 years [S.L. 1996-13es2]
⬇	Repeal state privilege license taxes (loss of $11 million) [S.L. 1996-14es2]

1996 Other Revenue Sources & Actions

- Increase criminal court fees by $5 (equal to a $4 million revenue increase)
- Transfer $40 million to capital improvement fund
- Transfer $47 million to Clean Water Management Reserve
- Reserve $85 million for tax reductions and federal retiree refunds/credits
- Transfer $26 million to reserve for refunds for federal retirees

July

➤ House Republicans begin the second special session by proposing to cut taxes by $700 million by 2001. The plan (HB18) includes phasing out over four years the regressive and unpopular state sales tax on food, cutting the corporate income tax rate by 1 percent, and eliminating state inheritance taxes.

1996 HEALTH & HUMAN SERVICES BUDGET

Total Appropriations $2.15 billion

Major Items:

Medical Assistance (Medicaid):	$1,170 million
Mental Health/D.D./Subst. Abuse:	$471 million
Social Services:	$200 million
Child Development:	$120 million
Youth Services:	$69 million

➤ The House budget also allocates $398 million of the $700 million surplus to environmental clean-up and hog farm waste lagoon oversight; $3.5 million for Smart Start; and 4 percent pay raises for teachers and state workers. The budget also funds a program that rewards exceptional teachers with bonuses up to 10 percent. A total of $402 million would be set aside to pay for the tax cuts and other future expenses.

➤ An alternative Senate plan proposes cutting taxes by $185 million by 2001. The plan includes reductions of the sales tax on food (SB20) and corporate income taxes (SB14). The Senate budget also allocates $10.2 million for Smart Start and $70 million for the cleanup of state rivers and hog farm waste.

➤ On July 12, Hurricane Bertha makes landfall near Wrightsville Beach causing more than $200 million in damage.

August

➤ Prior to passing a new budget, the General Assembly also passes the "Tax Reduction Act of 1996" (S.L. 1996-13es2). The law reduces the state sales tax on food from 4 percent to 3 percent; cuts the corporate income tax from 7.75 percent to 6.9 percent over the next four years; and reduces inheritance and gift taxes. In addition, the act implements the "William S. Lee Quality Jobs and Business Expansion Act." The act institutes a five-tier tax credit ranging from $12,500 (tier 1) to $500 (tier 5) for businesses that create new full-time jobs, especially in underdeveloped parts of the state. Explains House Majority Leader Leo Daughtry (R-Johnston), "Taxes first, and then we do the budget."

➤ State lawmakers agree to a $10.6 billion budget (S.L. 1996-18es2).

➤ The budget includes the following provisions: $415.4 million of the surplus is used to fund 4.5 percent raises for state workers and 5.5 percent raises for teachers; $10.1 million is used to further expand Smart Start. The budget also funds hog farm regulation and environmental pollution control programs. Approximately $199 million of the $700 million surplus is set aside as savings.

September

➤ Hurricane Fran makes landfall near Cape Fear on September 6 causing

DID YOU KNOW?

More than half of those who filed income tax returns in North Carolina earned $15,000 or less. This bottom half of earners were responsible for only 5.5 percent of the state's income tax revenue. Taxpayers earning more than $200,000 accounted for 1.4 percent of the total number of returns, but paid 28.5 percent of the total share of income tax liability.

Source: N.C. Comprehensive Annual Financial Report (FY2006)

an estimated $4.5 to $5 billion in damage.

October

➤ A poll by FGI Research of Chapel Hill shows Governor Hunt leading Robin Hayes 68 percent to 25 percent, with 7 percent undecided.

November

➤ Governor Jim Hunt wins a record fourth term as governor, defeating Republican challenger Robin Hayes 56 percent to 43 percent.

➤ Boosted by Hunt's popularity, Democrats increase their majority in the Senate and gain seven seats in the House, leaving the GOP with a tenuous 61-59 majority.

➤ Referendums on the gubernatorial veto and the $1.8 billion school construction bond pass.

➤ President Bill Clinton (D) defeats Senator Bob Dole (R) to return to the White House.

December

➤ David Crotts, an economist for the General Assembly, reports that revenue growth is slowing for North Carolina and that the state's General Fund revenues are expected to grow around 6 percent per year, down from the 8 percent annual growth that spanned the 1980s.

1996 Other Significant Changes

COMPENSATION

- 4.5% salary increase for most state employees
- 5.5% increase for teachers

CRIMINAL JUSTICE AGENCIES

- $17 million in capital funds for prisons
- Reductions in various prison reserves; prison closures
- 148 new judicial branch positions
- Creates the Criminal Justice Information Network Governing Board to plan and coordinate major technology projects

NATURAL & ECONOMIC RESOURCES

- $38 million in one-time increases
- Establishes Clean Water Management Trust Fund (funded by 6.5% of the unreserved credit balance)

1997 session

1997-1998 BIENNIUM
FY 1998: July 1, 1997 to June 30, 1998

General Assembly:

House Dems:	59	House Reps:	61
Senate Dems:	30	Senate Reps:	20

Governor:
Jim Hunt (D)

The 1997 Long Session:
Budget Bill SB352/S.L. 1997-443
Passed House: April 23, 1997
Passed Senate: June 5, 1997
Conference Version Ratified: August 28, 1997
Signed by Governor: August 28, 1997

With Republicans maintaining a very slim majority in the House, the 1997 long session began with Governor Hunt proposing a major new education initiative. Designed to improve schools by raising teacher salaries and implementing new measures of student progress, the $1 billion, four-year "Excellent Schools Act" was passed in June with little resistance from House Republicans. In fact, most of the session seemed to be characterized by a spirit of bipartisan cordiality that led to the relatively easy passage of several important bills, including a measure to reduce the state sales tax and a law that increased the inheritance tax threshold by $150,000. By June, however, pent up tensions rose to the surface, leading legislators to abandon any pretext that the biennial budget would be passed by the June 30 deadline.

Emboldened by efforts in the U.S. House to reform America's ailing welfare system, House Republicans were anxious to pass welfare reform in North Carolina. With the state Senate having ignored similar legislation in the past, the House leadership inserted its welfare reform initiative into the $11.4 billion biennial budget. In particular, the House proposed that individual counties be permitted to create their own system for determining welfare requirements and benefits for recipients. The Senate refused to return this power to local communities, with the result that budget negotiations extended well into August. Eventually a House-Senate compromise led to an agreement that allowed counties with less than 15.5 percent total state welfare recipients to join the program. The session ended at 212 days, just two days shy of the 1989 record of 214 days.

January

- Governor Hunt meets with the Budget Advisory Commission, a bipartisan group of legislators, to outline his plan for increasing teacher salaries, again

expand Smart Start, and cut $700 million in state spending over the next four years.

February

➤ Despite facing a slowing economy and a tighter budget, Sen. Marc Basnight (D-Dare) feels teacher salaries need to be raised again. "Finding a way to commit to salary increases for teachers is important," says Basnight.

➤ Governor Hunt releases his budget proposal which includes $654.4 million in new spending. Among other items, his budget recommendations include: an average 8 percent raise for teachers; a 3 percent raise for state employees; and an expansion of Smart Start into all 100 counties over the next two years. Teacher salary increases and Smart Start expansion alone will cost $295 million.

➤ Hunt's "Excellent Schools Act" calls for raising academic standards, measuring student progress, improving teacher training and streamlining procedures to remove bad teachers. The act also delineates an aggressive schedule to raise teacher salaries to the national average. Early estimates forecast that the program will add $1 billion to the budget by the year 2000.

March

➤ Eager to fulfill their campaign promise to cut additional taxes, House Republicans propose slashing $30 million in taxes. Their plan includes: phasing out the inheritance tax, refunding the sales tax to school districts and community colleges, increasing the corporate charitable deduction from 5 percent to 10 percent, and introducing a charitable credit for non-itemizing taxpayers.

➤ The Senate approves Hunt's "Excellent Schools Act" (SB 272). Teacher pay raises average 6.5 percent each year for four years, with starting pay being increased almost $4,000 over 4 years to $25,000. The Senate proposal also gives raises of 10 to 12 percent to teachers who earn masters degrees and become nationally certified; in addition, teachers will automatically earn tenure after their fourth year.

1997 Other Significant Changes

COMPENSATION

- 4% salary increase for most state employees
- 4% to 9% increase for teachers
- $2.7 million for salary equity adjustments for SBI agents

CRIMINAL JUSTICE AGENCIES

- Reduction of $17 million in 2001 and $21 million in 2002 because new prison beds eliminate need for out-of-state housing
- Reductions in prison closures, as well as various prison reserves
- 358 new judicial branch positions

NATURAL & ECONOMIC RESOURCES

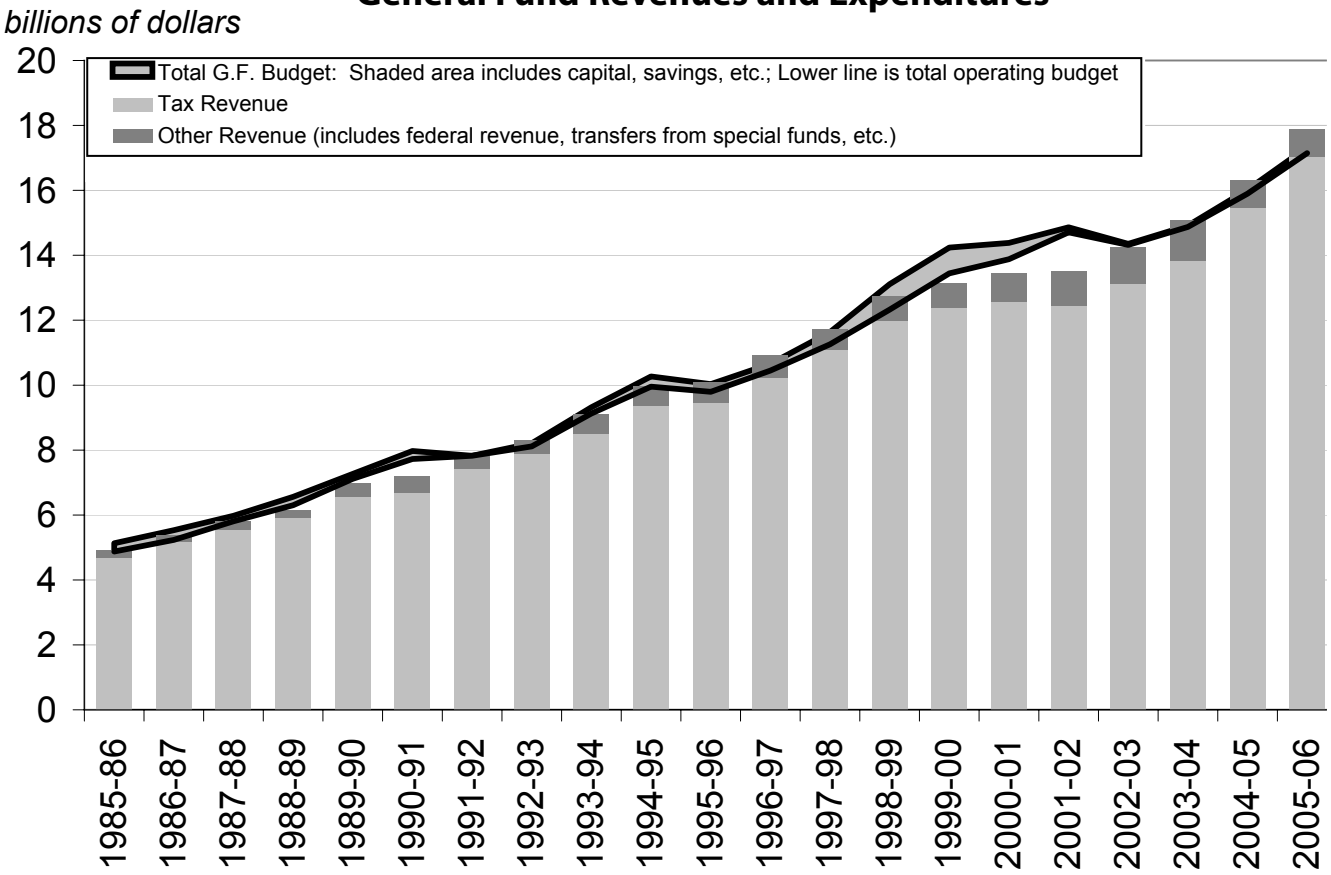
- $70 million in one-time increases
- Annual legislative reporting requirement for the Clean Water Management Trust Fund

CAPITAL

- $148 million in capital expenditures

➤ The General Assembly raises the threshold for filing an inheritance tax return from $450,000 to $600,000 (S.L. 1997-6).

General Fund Revenues and Expenditures



April

- Governor Hunt tells Senate leaders he will not sign a lottery bill unless some of the lottery profits are applied towards Smart Start.
- Senator Tony Rand (D-Cumberland) introduces a lottery bill that earmarks a fraction of lottery revenue for Smart Start (SB867).
- Senate approves $11.4 billion budget that includes a 6.5 percent raise for teachers, a 3 percent raise for state workers and $22.2 million for Smart Start.
- The House passes their version of Governor Hunt's Excellent Schools Act (HB351). Like the Senate bill, the House plan raises teacher salaries, but adds requirements for tenure review after the fourth year and dismissal if tenure is not achieved after six years. The House plan also requires competency tests for teachers in low-performing schools. Raises of 8 and 10 percent would be awarded to teachers who earn masters degrees and become nationally certified.

May

- An unexpected jump in April tax collections provides a surplus revenue of $219 million.
- Flexing his new veto muscle, Governor Hunt states that he "could not in good conscience sign

a budget that does not provide full funding for Smart Start." While the Senate has voted to give most of the funding Hunt wants for his pet program, the House balks at Hunt's $22.9 million request. Nevertheless, a House budget subcommittee later votes to give Smart Start $21.9 million – only $1 million less than Hunt's request.

➤ House Majority Leader Leo Daughtry (R-Johnston) introduces a bill to reduce the state sales tax on food from 3 percent to 2 percent. Explains Daughtry: "We have the money available. This is our chance to reduce it again."

June

➤ House members pass an $11.4 billion budget bill that includes: a 6.5 percent raise for teachers; a 4 percent raise for state workers; $21.9 million for Smart Start expansion; a 1 cent (3 percent to 2 percent) cut in the food sales tax; and welfare reform provisions that would give counties the ability to set their own rules regarding eligibility and benefits.

➤ The General Assembly passes "The Excellent Schools Act" (S.L. 1997-221). The final legislation includes the Senate provisions regarding teacher raises for national certification and/or master's degrees and tenure. Also included

1997 Significant Tax Changes (Budget Bill Unless Noted)

⬆	Non-resident withholding tax [S.L. 1997-109]
⬇	Reduce state sales tax on food from 3% to 2% (effective July 1, 1998)
⬇	Internal Revenue Code update [S.L. 1997-55]

1997 Other Revenue Sources & Actions

- Increase court fees by $15 ($13 million revenue increase)
- Local transit revenue options, including 1/2¢ sales tax for Mecklenburg County
- Transfer $115 million to Disaster Relief Reserve
- Earmark $49 million for Clean Water Management Trust Fund; revise statute to prevent annual transfer from dropping below $30 million
- Transfer supplemental $39 million to Repairs & Renovations Account
- Place $156 million in reserve for intangibles tax refunds
- Earmark $36 million for refunds for federal retirees
- Other sources of G.F. revenue: investment income, judicial fees, Medicaid Disproportionate Share, insurance, transfers from Highway Trust Fund and Highway Fund

is the House provision for teacher competency tests in failing schools.

1997 HEALTH & HUMAN SERVICES BUDGET

Total Appropriations	**$2.28 billion**
Major Items:	
Medical Assistance (Medicaid):	$1,171 million
Mental Health/D.D./Subst. Abuse:	$529 million
Social Services:	$179 million
Child Development:	$169 million
Youth Services:	$88 million
Office of the Secretary:	$37 million

➤ The Legislature passes a continuing budget resolution extending funding for government operations until July 31 (S.L. 1997-256).

July

➤ Budget negotiations come to a standstill over the following issues: a House-sponsored spending cap tied to population growth and inflation; a state employee salary raise of 4 percent vs. 3 percent that also entails cutting $40 million from the state retirement fund to pay for the raise; a 3 percent increase to in-state student UNC system tuition; and welfare reform.

➤ As the month drags on, a Senate panel recommends that the proposed House welfare reforms be tested in only three counties, instead of implemented in all 100 counties.

➤ A second continuing budget resolution extends funding until August 15 (S.L. 1997-347).

August

➤ Budget negotiators compromise in other areas, including adhering to, although not legislating, a spending cap for the FY1998 budget. Welfare reform, however, remains the main point of contention.

➤ House negotiators agree to limit their proposed reform to a 34-county pilot program.

➤ A third continuing budget resolution is passed, extending funding until August 22 (S.L. 1997-401).

➤ A fourth continuing budget resolution is passed, extending funding until August 29 (S.L. 1997-418).

➤ Lawmakers pass the $11.4 billion budget on August 28 (S.L. 1997-443). The budget contains the following items: a 6.5 percent average (4 percent to 9 percent) raise for teachers; a 4 percent raise for state workers; $22.9 million for Smart Start and expansion planning; and the welfare reform package.

➤ The budget also includes the first intangibles tax refund of $156 million, which is taken from the unreserved credit balance of the General Fund.

➤ The reform package allows participating counties to develop their own program requirements and benefits. Any county can participate, but the final group of participating counties must contain a cumulative total of no more than 15.5 percent of the state's families on welfare.

➤ The food sales tax is cut from 3 percent to 2 percent (S.L. 1997-475).

September

➤ Apparently distraught over the decade-long rise in juvenile crime, Governor Hunt appoints a Commission on Juvenile Justice and Crime. Wanting to replicate the success he had during the 1996 special session, Hunt hints at a possible special session aimed at reducing juvenile crime. The governor recommends first-time juvenile offenders be sent to a two-to-four week boot camp, instead of being placed on probation.

October

➤ Governor Hunt considers requiring two-parent welfare families to work or engage in a minimum of 35 hours of community service per week before receiving a check from the state.

➤ 23 counties sign up for the House welfare reform plan. The counties comprise 16 percent of the state's welfare families.

November

➤ After acquiescing to various tax cuts over the past few years, Governor Hunt suggests he will block future cuts. "Let's be careful that we don't go too far in cutting taxes," Hunt tells the Commission on Business Laws and the Economy.

➤ Six more counties volunteer for the new welfare program. The combined 29 counties are home to 22 percent of welfare-receiving households – more than the 15.5 percent cap set by the General Assembly. As a result of the overwhelming response, the General Assembly will wait until the next session to select what counties may participate in the program.

➤ Hunt continues to highlight juvenile crime, saying, "I would like to have this ready so we could have a short special session to deal with it, to deal with it as quickly as we can."

December

➤ The Commission on Juvenile Justice and Crime rushes to finish its report by the January 5 deadline. Although Hunt says a special session on juvenile crime is "still a real option," it appears unlikely because of the delay in finishing the report.

1997 EDUCATION FUNDING

ENROLLMENT CHANGES

- Public Schools: 20,577 (1.7%) increase
- Community Colleges: 84,744 (10.6%) decrease
- UNC: 2,500 (1.6%) increase

TUITION & FEE INCREASES

- Average increase of 4% for in-state and 1% for out-of-state UNC students
- Increase of 0.7% for in-state and 1.1% for out-of-state community college students

OTHER EDUCATION CHANGES

- $72 million for projected ABC bonuses
- $10 million increase for occupational education in the community colleges
- Allow UNC same budget flexibility with overhead receipts as with General Fund budget codes
- Establish Civil Penalty & Forfeiture Fund to transfer civil fines and forfeitures that were going to the County School Fund to the School Technology Fund instead
- Excellent Schools Act approved
- State Supreme Court decides *Leandro*

1998 session

1997-1998 BIENNIUM
FY 1999: July 1, 1998 to June 30, 1999

General Assembly:

House Dems:	59	House Reps:	61
Senate Dems:	30	Senate Reps:	20

Governor:
Jim Hunt (D)

The 1998 Short Session:
Budget Bill SB1366/S.L. 1998-212
Passed Senate: July 1, 1998
Passed House: July 22, 1998
Conference Version Ratified: October 28, 1998
Signed by Governor: October 28, 1998

Instead of declaring a special session for juvenile crime, Governor Hunt called the General Assembly back to Raleigh in March to discuss his new vision for health care for children. In the end, the Legislature agreed to extend taxpayer subsidized health care coverage to uninsured children in a program that would cost state and federal taxpayers $108 million per year, with North Carolina taxpayers contributing $28 million annually. At a cost to taxpayers of over $2 million, the extended session lasted six weeks – an omen of things to come during the summer short session.

With the tax cuts of the past few years fueling an economic boom in North Carolina, Republican legislators proposed returning a $1.2 billion revenue windfall back to the people. Specifically, the House demanded the repeal of the regressive 2 percent sales tax on food, along with a repeal of the inheritance tax. As the end of the fiscal year approached, the House and Senate were unable to agree on the tax cuts.

The Senate refused to send over its budget to the House until the end of June, with the apparent intent of using the delay to smear Republicans during the upcoming election. After the House amended the Senate bill to include the sales and inheritance tax cuts, the Senate refused to compromise. In an election-year gamble, however, House leadership insisted the cuts be made. In October, the Senate finally agreed to reduce taxes, and both chambers agreed to further welfare reforms. Despite delivering tax cuts to the people of North Carolina for three consecutive years, Republicans lost their majority in the House.

January

➤ In an effort to better investigate ethics conflicts for state board and commission appointees, Governor Hunt proposes allowing the N.C. Board of Ethics to prescreen appointees, as well as establish requirements for property, business and gift disclosure. The initiative was prompted by the

1997 resignation of three DOT board members (at least one of which, Odell Williamson, was a Hunt appointee) over allegations that they lobbied for road projects that benefited them financially. In January, the *News & Observer* likewise reports that an ABC commissioner appointed by Hunt has significant business ties to a major bar owner regulated by the commission.

February

➤ House Speaker Harold Brubaker (R-Randolph) outlines three goals for the next session: funding the second installment of the Excellent Schools Act; cutting taxes; and setting aside savings in the event of an economic downturn. The top priority is the elimination of the regressive state sales tax on food.

➤ Governor Hunt announces he will call for a special session of the General Assembly with the intention of expanding taxpayer-subsidized health insurance for children.

March

➤ The governor's Commission on Juvenile Crime and Justice releases its report. The commission's recommendations include: creating a new cabinet level agency; giving judges greater latitude in sentencing juveniles; holding delinquents in training centers until age 21, instead of age 18; creating a computerized juvenile justice database; and funding after-school programs and parental training classes.

➤ Commission member Representative Joe Kiser (R-Lincoln) thinks the reforms are good, but cautions, "We don't have the slightest idea what this will cost."

➤ The General Assembly meets in a special session in response to the governor's mandate to expand taxpayer-subsidized insurance for children.

1998 Other Significant Changes

COMPENSATION

- Salary increase of 3% + 1% performance bonus for most state employees
- 3% salary increase for governor, council of state and other executive officials, as well as judicial branch personnel
- Salary increases of 4% to 9% for principals, assistant principals, and teachers

ORGANIZATION

- Office of Juvenile Justice created from divisions of HHS and AOC; reserve for office and related programs of $17.3 million
- Transfer Boxing Commission from Secretary of State to Crime Control & Public Safety
- 227 new judicial branch positions

OTHER

- Year 2000-related technology funds
- Appropriation of $186 million for capital improvements

April

➤ Outflanking the Republican legislative leadership, Senate Pro Tempore Marc Basnight (D-Dare) signals that the sales tax on food should be eliminated. "[It] is something we need to go ahead and write into law," states Basnight.

➤ The House and Senate take six weeks to pass the "Health

1998 EDUCATION FUNDING

ENROLLMENT CHANGES

- Public Schools: 17,834 (1.5%) increase
- Community Colleges: 49,257(6.9%) increase
- UNC: 82 (0.1%) decrease

TUITION & FEE INCREASES

- Average increase of 3% for in-state and 2% for out-of-state UNC students
- Increase of 0.2% for in-state and no increase for out-of-state community college students

OTHER EDUCATION CHANGES

- Increase supplemental funding for small county and low-wealth districts ($13 million)
- $22 million for mentor teachers and additional pay for extra duties in low performing and at-risk schools
- $98 million for projected ABC bonuses
- High schools complete 1st year, K-8 schools complete 2nd year under ABCs

Insurance Program for Children Act of 1998" (S.L. 1998-1es). The program extends comprehensive health coverage (including dental and vision) to children who are ineligible for Medicaid or Medicare, but whose families earn up to 200 percent of the federal poverty level ($32,900 for a family of four in 1998). The bill also includes a modest child insurance tax credit of $100 to $300 for low- and middle-income families who actually purchase health insurance for their children.

May

➤ Ignoring calls from Republicans that the state set aside money for emergencies, Governor Hunt proposes spending the $1.2 billion "April surprise" windfall on a $1.4 billion package that will allocate $40 million for juvenile justice, $57 million for Smart Start, and, yet again, raise salaries for teachers (6.5 percent) and state employees (5 percent).

➤ Governor Hunt's spending spree is sidetracked by a N.C. Supreme Court order that the state refund $1 billion to some 250,000 local, state and federal retirees. The refund resulted from the eight-year-old class action suit, *Bailey v. State* (1998) (Bailey II), regarding the constitutionality of a 1989-1997 tax on retirement benefits. As a result of the ruling, the state will also lose an estimated $120 million in tax revenue. As with the intangibles tax lawsuits, future Governor Mike Easley is on the losing side as the state's attorney general.

➤ House Majority Leader Leo Daughtry (R-Smithfield) and Senator Tony Rand (D-Cumberland) negotiate a settlement with the *Bailey/Emory/Patton* plaintiffs, in which the state agrees to drop its appeal and pay a settlement of $799 million.

➤ The National Education Association releases it annual list of average state teacher salaries. Thanks to the Excellent Schools Act, North Carolina has risen five spots to reach number 38 (a figure that does not account for the state's below-average cost of living).

June

➤ The Democratic-controlled Senate refuses to vote on the budget, guaranteeing that the "short" session will carry over into August.

- ➤ On June 30, Senate leaders propose a $12.5 billion budget that includes: a 6.5 percent raise for teachers; a 4 percent raise for state workers; a $56.6 million expansion of Governor Hunt's Smart Start program; $19.8 million funding for juvenile justice reform; and $52.5 million for the Clean Water Management Trust Fund.
- ➤ House Speaker Brubaker laments that the Senate plan is "very short on tax cuts." Adds Brubaker, "I believe we can show [them] how the whole package can be implemented."
- ➤ Continuing budget resolution (S.L. 1998-23) is passed allocating funds for agencies to operate until the budget is enacted.

1998 Significant Tax Changes (Budget Bill Unless Noted)

⬆	E-911 Fee established (80¢ per month) [S.L. 1998-158]
⬇	1998 tax relief: ➔ Repeal 2% state sales tax on food ➔ Repeal income tax on retired government employees (*Bailey* case) ➔ Continue earmarked refund for federal retirees ➔ Repeal state inheritance tax; retain estate tax ➔ Add schools to entities eligible for sales and use tax refund ➔ Establish Long-term Care Insurance Credit ➔ Increase limit for Conservation Tax Credit ➔ Extend sunset on Qualified Business Credit; modify for movie industry ➔ Decrease insurance regulatory charge from 8.75% to 6.00% for 1998
⬇	Child Health Insurance Tax Credit [S.L. 1998es-1]
⬇	Conform to Internal Revenue Code updates: qualified tuition programs and net economic loss carry forward [S.L. 1998-171]
⬇	Reduce tax on appliances; increase percent going to Solid Waste Management Trust Fund, instead of counties [S.L. 1998-24]
⬇	Economic Opportunities Act of 1998: Bill Lee Act changes [S.L. 1998-55]

1998 Other Revenue Sources & Actions

- Earmark $400 million for *Bailey/Patton/Emory* lawsuit settlement
- Earmark $30 million of year-end credit balance for aquarium capital improvements
- Transfer $145 million to Repairs & Renovations Account
- Transfer $35 million from Medicaid Disproportionate Share 1997-98 reserved receipts
- Other sources of G.F. revenue: investment income, judicial fees, Medicaid Disproportionate Share, insurance, transfers from Highway Trust Fund and Highway Fund

1998 HEALTH & HUMAN SERVICES BUDGET

Total Appropriations $2.53 billion

Major Items:

Medical Assistance (Medicaid):	$1,386 million
Mental Health/D.D./Subst. Abuse:	$551 million
Social Services:	$184 million
Child Development:	$172 million
Youth Services:	$89 million
Office of the Secretary:	$33 million

July

➤ House Republicans release their own $12.3 billion budget. The House budget contains $25.6 million less for Smart Start and $13.8 million less for the new juvenile justice program than does the Senate budget. The package delivers over $200 million in tax cuts, eliminating the regressive state sales tax on food, repealing the inheritance tax, and raising the personal income tax exemption from $2,500 to $2,750.

➤ The Senate rejects the House's budget. Meanwhile, Governor Hunt travels across the state to generate public support for his requested funding for juvenile justice.

August

➤ House Republicans stand firm on their proposed tax cuts, sending the short session into September.

September

➤ In a half-hearted move to break the impasse, the Senate proposes to exempt family farms and small businesses from the inheritance tax. In response, Speaker Brubaker tells the Senate to go back to the drawing board: "If they keep trying, they might get it right."

➤ In a ploy aimed at breaking the will of House Republicans, the Senate moves to cut off legislator pay after September 10 (SB 1176). Standing firm, Speaker Brubaker replies, "We [the House] have no problem with that."

➤ Governor Hunt explains that he backs the Democratic Senate on the budget but also claims he is "not going to get into the blaming right here" on who is responsible for the deadlock.

➤ Contrary to prior boasts, House Republicans vote down the Senate plan to cut off legislator pay after September 10 (SB1176). Instead the House passes a bill that terminates only the Senate's pay on December 31. Explains House Rules Committee member Representative Jim Gulley (R-Mecklenburg): "We're up here; should it be for free?" Three Republicans and one Democrat do decide to no longer accept the $104 per diem.

➤ The House bill also includes a provision permitting the previously agreed upon 6.5 percent and 3 percent pay raises for teachers and state workers to go into effect.

➤ The Democratic Senate caves and offers to repeal the inheritance tax if the House agrees to fully fund Smart Start, the juvenile justice program and the Clean Water Trust Fund.

➤ The House counters with a proposal to expand the welfare reforms of the previous year by increasing the number of eligible counties.

- In spite of his earlier comments, Hunt declares, "The responsibility to do what's right now lies with the House leadership."
- Teachers and state workers receive their pay raises retroactive July 1 (S.L. 1998-153).
- An increasingly angry Hunt again criticizes the House: "The job of this legislature is to help state government serve the people," charges Hunt. "That's not happening right now because we don't have a budget. And that is wrong."
- On September 30, lawmakers strike a compromise (S.L. 1998-166) that creates two welfare-to-work programs: one run by Governor Hunt's Commerce Department and the other run by the independent Employment Security Commission. In reaching the last-minute agreement, North Carolina is able to receive federal matching funds that it would have lost on October 1. The 15.5 percent cap remains.

October

- The House and Senate approve the "Juvenile Justice Reform Act," which overhauls the state's current system (S.L. 1998-202).
- Because of the overwhelming number of counties that have signed up for the welfare reform pilot project, House Republicans stage a welfare reform "lottery" by picking the names of counties out of a hard hat. Twenty-one counties that account for almost 9,500 families are picked to participate in the welfare program.
- According to Representative Cherie Berry (R-Catawba), one of the leading proponents of the welfare reform plan, choosing the counties any other way "would have taken Solomon's wisdom."
- Four months after the beginning of the fiscal year, the $12.6 billion budget bill is adopted on October 30 (S.L. 1998-212). The budget repeals the food sales tax, repeals the inheritance tax, grants $42.5 million for Smart Start expansion into 100 counties, allocates $17.3 million for the juvenile justice system overhaul and fully funds the Clean Water Trust Fund at $47 million. Teachers receive a 6.5 percent salary raise and state workers receive 3 percent raises, with a 1 percent nonrecurring bonus.
- The budget also mandates the first reimbursement – $400 million – for the *Bailey/Emory/Patton* lawsuits. The money is taken from the year end 1997-1998 credit balance of the General Fund.

November

- Democrats retake control of the General Assembly by picking up seven seats in the House (for a total of 66); they also gain five seats in the Senate for a solid majority of 35.

December

- When asked about the possibility of a lottery bill vote in the House, Representative Jim Black, candidate for House Speaker, says that despite his opposition to the lottery he would allow a vote because "I have this philosophy about allowing things to be voted on – up or down."

1999 session

1999-2000 BIENNIUM
FY 2000: July 1, 1999 to June 30, 2000

General Assembly:

House Dems:	66	House Reps:	54
Senate Dems:	35	Senate Reps:	15

Governor:
Jim Hunt (D)

The 1999 Long Session:
Budget Bill HB168/S.L. 1999-237
Passed House: June 2, 1999
Passed Senate: June 17, 1999
Conference Version Ratified: June 30, 1999
Signed by Governor: July 1, 1999

The 1999 long session started off with an attempted coup by House Democrats. In an effort to restore Dan Blue (D-Wake) as Speaker of the House, black members of the House united with Republicans in an attempt to elect Blue over 1997-1998 Minority Leader Jim Black (D-Mecklenburg). Although Black was initially stunned by the strength of the coalition against him, he eked out a one-vote win by persuading various members to defect from the coalition.

Taking advantage of Democrat control of the Legislature, Governor Hunt again asked for more education spending – in particular, for Smart Start and the Excellent Schools program. With House Republicans again in the minority, the governor's spending recommendations were quickly voted through, with the FY1999-2000 budget passing before July 1 for the first time since 1979. The only area of friction between the House and Senate came when the UNC system asked for a $3 billion bond for repairs and construction. The Senate approved the package, but the House balked, not only over the amount, but especially because the bill did not provide for a public referendum. (The bond was a limited-obligation bond guaranteed by the value of university land and buildings, but still backed by the state.) As in past years, the House stood firm, and the General Assembly adjourned without approving the bond package. In September, Hurricanes Dennis and Floyd struck North Carolina, causing massive flooding and damage. Governor Hunt initially requested a bloated $5 billion federal aid package and ended up with less than half that. In December, the General Assembly returned for a special session in order to pass an $830 million hurricane aid package funded by withdrawing $286 million from the "rainy day" fund, using unappropriated funds, delaying capital improvements and cutting agency operating budgets.

January

- An economic analysis conducted by the General Assembly's Fiscal Research staff predicts a potential $800 million revenue shortfall. Democrats blame the shortfall on recent tax cuts while Republicans argue that the tax cuts actually fueled North Carolina's economic recovery, leading to higher tax revenues (see Q & A: 11).
- Senate leader Marc Basnight (D-Dare) claims a tax increase is inevitable and pushes for a regressive one-cent increase in the state sales tax. "I would say to you that an increase is coming at some point in time, because of the [tax] cuts that we made," states Basnight. "We cut [taxes] too deep."
- House Minority Leader-elect Leo Daughtry (R-Johnston) denies that a shortfall exists, pointing to estimates by legislative analysts that show over $600 million in added revenue for next year and

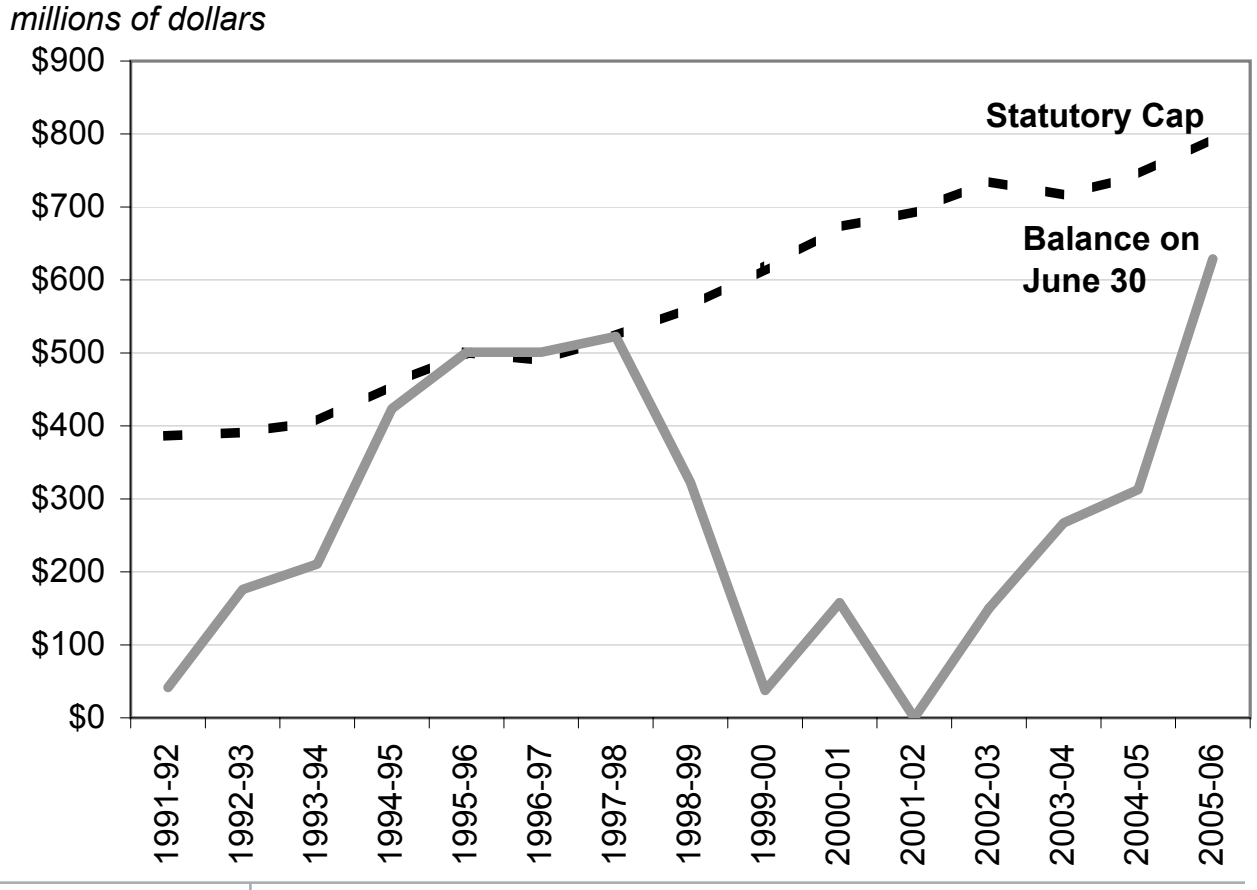
1999 Significant Tax Changes

⬆	Use tax, income tax, and state purchasing (small revenue increase due to changes in policies and procedures) [S.L. 1999-341]
⬆	Conform to Internal Revenue Code updates (income tax, statute of limitations) [S.L. 1999-415]
⬆	Sales tax/fee changes (increases for check cashing, pawnbrokers, used equipment, shoppers' guides) [S.L. 1999-438]
⬇	Corporate income tax credit for manufacture of exported cigarettes [S.L. 1999-333]
⬇	Bill Lee Act changes, including extending sunset from 2002 to 2006 [S.L. 1999-360]
⬇	Sales tax/fee changes: exemptions or reductions (for new business registration, loan agencies, prescription drugs, medical equipment, local airports) [S.L. 1999-438]
⬌	Pension tax withholding (no estimate of impact) [S.L. 1999-414]

1999 Other Revenue Sources & Actions

- Earmark $399 million for *Bailey/Patton/Emory* lawsuit settlement
- Transfer $200 million from the Savings Reserve Account for intangibles tax settlement; Legislature must allocate additional $240 million by July 10, 2000 [S.L. 1999-327]
- Earmark $30 million for Clean Water Management Trust Fund
- Transfer $150 million to Repairs & Renovations Account; then transfer $60 million of the $150 million to Hurricane Floyd Disaster Reserve
- Other sources of G.F. revenue: investment income, judicial fees, Medicaid Disproportionate Share, insurance, transfers from Highway Trust Fund and Highway Fund

Savings Reserve Balance and Cap: 1992-2006



an anticipated $300-$400 million revenue surplus this year. "There is not a shortfall problem; there is a spending problem," states Daughtry.

➤ House Republicans join with several renegade Democrats in an attempt to elect Representative Dan Blue (D-Wake) Speaker of the House. In return for their support, Republicans are promised co-chair seats on each committee. The coalition fails by one vote and Jim Black (D-Mecklenburg) is elected speaker of the House.

February

➤ In his State of the State address Governor Hunt again declares that education is his top priority. Hunt calls for making North Carolina's public schools the best in the nation by 2010.

➤ Senator Tony Rand (D-Cumberland) files a lottery bill (SB 21).

➤ UNC system administrators call for a 4.9 percent increase for in-state undergraduates and an 8.4 increase for in-state graduate students at UNC Chapel Hill and NC State University. A 6.9 percent increase for graduate students at other schools is also proposed.

➤ Hunt submits his $13 billion

recommended budget, which proposes increases in spending on teacher salaries and Smart Start. Hunt also requests funding for his juvenile justice program and $5.8 million for improving rest home conditions. As in past years, Hunt's compulsive spending package sets aside nothing in savings and fails to address the potential of an $800 million budget shortfall.

March

- A joint report by the John Locke Foundation and the N.C. Budget & Tax Center demonstrates that a state lottery could cost at least $36.3 million annually in lost sales tax revenue.

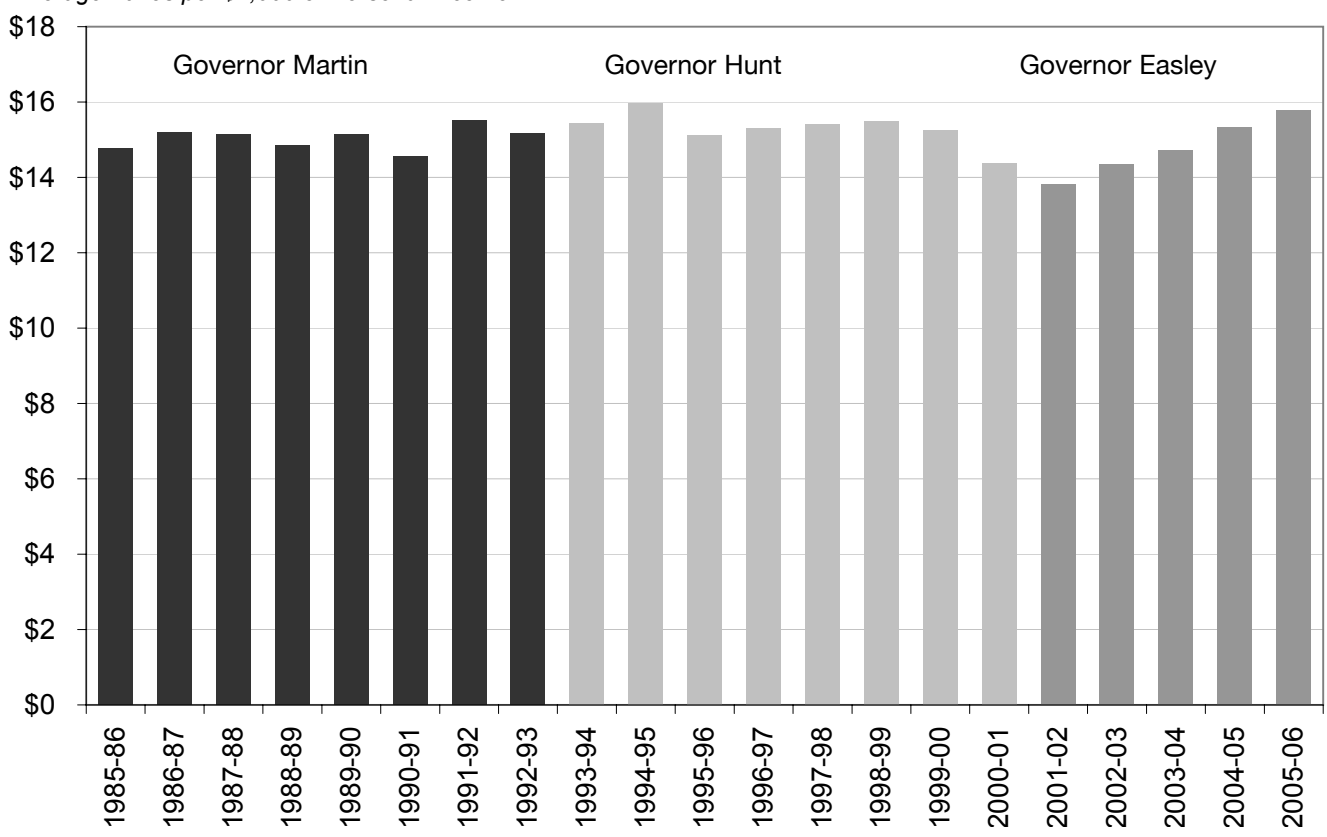
April

- Speaker Black announces he wants to send the budget bill to the Senate by May 1.
- With Republicans back in the minority, Governor Hunt moves to reverse the GOP welfare reforms that offered 21 counties financial incentives for reducing caseloads.

May

- When Black's May 1 budget goal is not met, he moves the deadline to May 20.
- The annual "April surprise" that usually brings news of higher-than-projected revenues is only $94 million more than anticipated.

Total Tax Revenue Compare to Personal Income



1999 EDUCATION FUNDING

ENROLLMENT CHANGES

- Public Schools: 16,048 (1.3%) increase
- Community Colleges: 2,191 (0.2%) decrease
- UNC: 2,029 (1.3%) increase

TUITION & FEE INCREASES

- Average increase of 5% for in-state and 1% for out-of-state UNC students
- Increase of 33% for in-state and 4.9% for out-of-state community college students

OTHER EDUCATION CHANGES

- Increase supplemental funding for small county and low-wealth districts ($13 million)
- $21 million to improve student accountability
- $14 million for mentor teachers
- $140 million for projected ABC bonuses
- UNC across-the-board reduction of 0.5%
- Student accountability standards approved by State Board of Education
- Free breakfast for kindergartners
- Judge Manning rules in *Leandro* that the right to an opportunity for a sound basic education may include the right to early childhood education before age 5

➤ When asked about the Senate lottery bill, Speaker Black says he will postpone a vote until next year's short session. "I don't see how we can vote this year," states Black.

➤ Governor Hunt's budget proposes spending the state's statutorily mandated "rainy day" fund payment of $40 million. The governor also proposes spending some $354 million that is to be set aside to pay for the all but certain second and third installments of the intangibles tax refund.

➤ Having again missed his self-imposed budget deadline, Black says, "I'm looking at [the House budget bill] being on the floor June 2 and 3."

➤ According to figures from the National Education Association, North Carolina teachers earn an average salary of $36,141: 89 percent of the national average. In only one year, the state has moved up 10 places to reach the 29th spot in terms of national teacher salary rankings.

June

➤ The House finally sends the $13.5 billion budget to the Senate. It provides for the third payment of the four-year Excellent Schools Act; $58 million for the continued expansion of Smart Start; $22 million in funding for community college building repairs and new technology equipment; a 3 percent raise with $125 bonus and prescription drug card for state workers; and $1.1 million for free breakfasts for kindergarten students (HB 168).

➤ The Senate passes its version of the budget. The budget is almost identical to the House bill in all but two points: 1) permitting university trustees to raise tuition by $250 in 2000-01 and 2001-02; 2) $500,000 in funding to assist the elderly with prescription drug purchases.

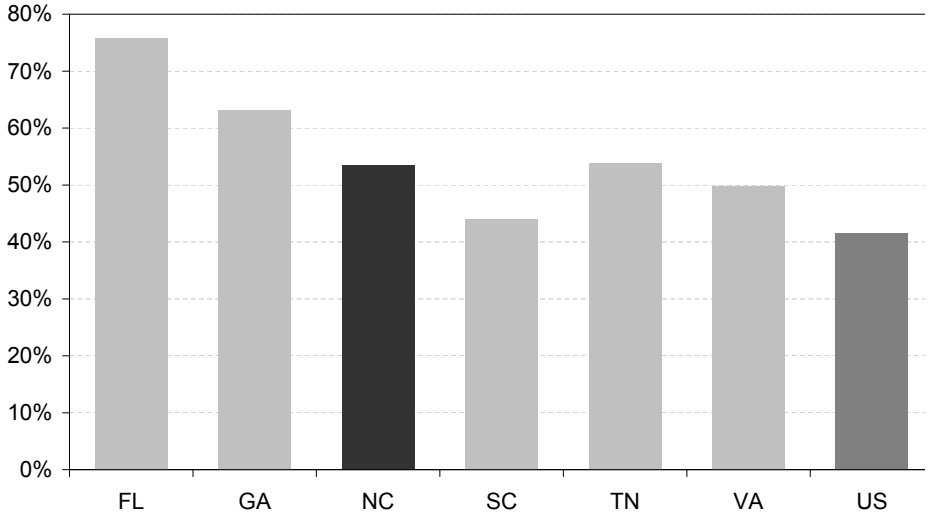
➤ Backed by Senate President Pro Tempore Basnight, House Speaker Black asserts the tax cuts of recent years have been "a bit reckless." Black proposes creating a special committee comprised of legislators, businessmen and tax experts to study ways to "modernize" the state tax structure. Black claims he is "not advocating raising new taxes," just "a [tax] policy for the 21st century."

- Democratic leaders in the General Assembly propose a $3 billion to $4.5 billion construction bond for the UNC system and community colleges. Because the bonds are backed by the value of university land and buildings, legislative leaders avoid having to submit the proposal to voter approval. The limited-obligation bonds, however, will cost the state an estimated $39.4 million in additional interest payments.
- The Senate approves the bond package (SB 912).
- For the first time since 1979 the budget is passed before the start of the fiscal year. The $13.5 billion budget is passed on June 30 (S.L. 1999-237). Teachers receive an average raise of 7.5 percent, and the education programs receive their funding. State workers also receive a raise of 3 percent. Seniors likewise receive $500,000 in assistance for prescription drugs.
- The budget also includes the second reimbursement – $399 million – stemming from the *Bailey/Emory/Patton* lawsuits. The money is taken from the General Fund.

July

- The UNC bond package runs into problems in the House. Republicans refuse to support the package without a public referendum. According to Minority Leader Richard Morgan (R-Moore), "We feel with that amount of debt, the people should weigh in."
- The General Assembly authorizes a second refund of $200 million to intangibles tax plaintiffs (S.L. 1999-327). The refund is supposed to be taken from the Savings Reserve Account, which is to be reimbursed the following year (but to date has not been repaid).
- UNC system administrators trim their bond request to a $995 million appropriation request. This request is subsequently reduced to $810 million. In a last ditch effort, the UNC system proposes borrowing the money using a $750 million "note" that would have a shorter repayment schedule than a bond. None of the proposals are approved.

Total Nonfarm Employment Growth: Southeast States, 1985-2005



➤ The House reduces the Senate request for a $3 billion bond package to $1.2 billion in bonds to be voted on in a public referendum.

1999 HEALTH & HUMAN SERVICES BUDGET

Total Appropriations $2.78 billion

Major Items:

Medical Assistance (Medicaid):	$1,349 million
Mental Health/D.D./Subst. Abuse:	$614 million
Child Development:	$286 million
Social Services:	$150 million
Public Health:	$133 million
Office of the Secretary:	$93 million

➤ Senate President Pro Tem Marc Basnight rejects the House bill, declaring: "We won't concur. … We would like the House to offer concessions, and we'll offer some as well."

➤ The House refuses to accept a bond proposal without a public referendum and no compromise is struck on the UNC bond issue. The General Assembly adjourns.

1999 Other Significant Changes

COMPENSATION

- Salary increase of 3% + $125 bonus for most state employees
- 3% salary increase for governor, council of state and other executive officials, as well as judicial branch personnel
- Average salary increase of 7.5% for teachers and 8.0% for principals and assistant principals
- Average salary increase of 3% for community college faculty

ORGANIZATION

- NCGA Joint Select Committee on Information Technology established; technology projects receive more oversight

August

➤ UNC leaders invite the General Assembly to send a legislative study committee to assess campus conditions.

September

➤ After battering the coast with tropical storm force winds, Hurricane Dennis reverses course and makes landfall on September 4, dumping up to 15 inches of rain on North Carolina, with storm surges devastating parts of the Outer Banks.

➤ On September 16, Hurricane Floyd strikes North Carolina. Up to 19 inches of rain fall on still saturated ground, causing widespread flooding, especially in the southeast portion of the state. Early estimates put the damage at $1.3 billion.

October

➤ On October 17, Hurricane Irene dumps more rain on North Carolina causing even more flooding.

➤ Governor Hunt warns that he may call a special session of the General Assembly, possibly over Thanksgiving, in order to facilitate recovery efforts for Hurricane Floyd. Proposals to generate recovery funds range from a $1 billion bond issue to implementing a freeze on spending and instituting a "temporary" one-cent sales tax increase (from 4 percent to 5 percent).

➤ State Department of Transportation officials estimate hurricane damage to state roads is at least $76 million, but caution

that they will not know the total damage for months.

➤ Meeting with President Clinton, Governor Hunt lowers his original, wildly exaggerated, $5.3 billion request for federal hurricane relief funds to $1.86 billion.

➤ Senate President Pro Tempore Basnight, responding to a Republican proposal to issue a $1 billion bond for hurricane relief funds, says he would "rather have the tax increase than borrow money. … I'm not one who likes borrowing."

November

➤ The General Assembly backs away from its initial proposal to fund hurricane relief efforts by increasing the state sales tax. Acknowledges House Speaker Black, "The temporary sales tax does not seem to have much support among the members I've talked to." Many Republican legislators, in particular, do not think that increasing the regressive sales tax will help the recovery effort.

December

➤ With the state receiving approximately $2.2 billion in total federal relief aid, Governor Hunt proposes an $830 million state aid package that does not raise taxes or rely on a bond issue. The relief package is to be funded by delaying various capital improvement, or "pork," projects, using department and agency budget savings, withdrawing $286 million from the Savings Reserve Account, and using $40 million in unappropriated funds from the Unreserved Credit Balance.

➤ Having called the General Assembly into special session on December 15, the Legislature takes one day to approve Hunt's $830 million "Hurricane Floyd Recovery Act of 1999" (S.L. 1999-463es).

DID YOU KNOW?

From 2001 to 2005, four out of five state budget bills raised taxes, increasing the overall annual tax burden by $1.4 billion.

Source: John Locke Foundation

OVERVIEW

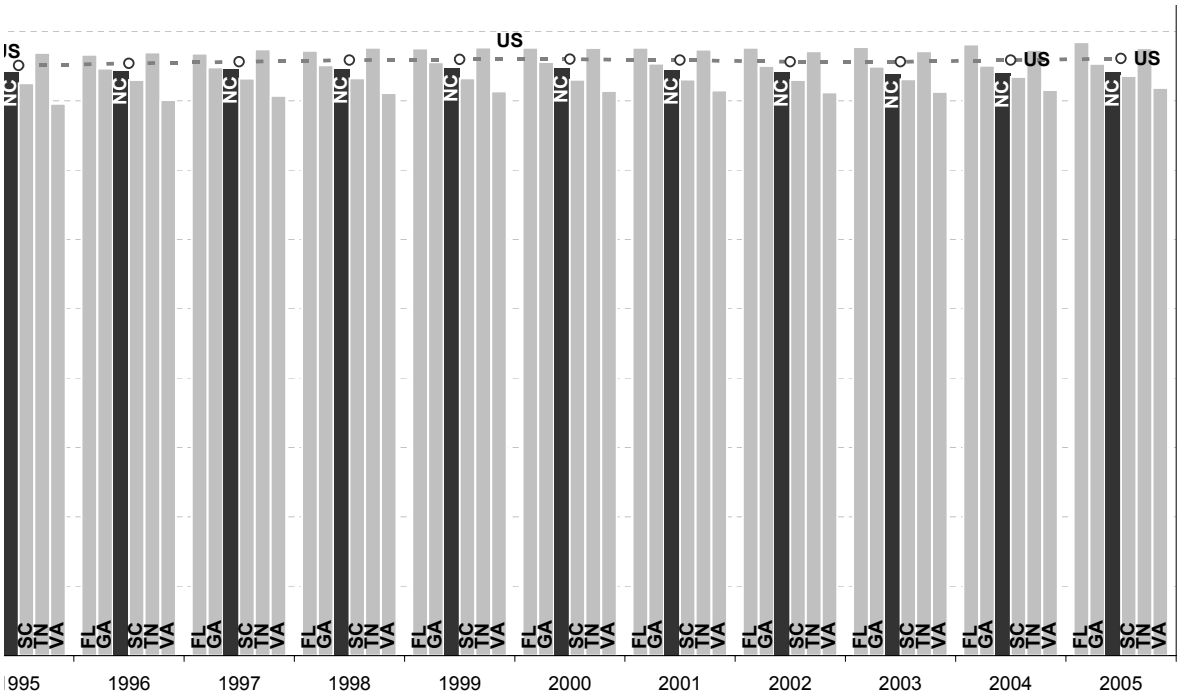
2000-2005

General Economic Trends: 2000-2005

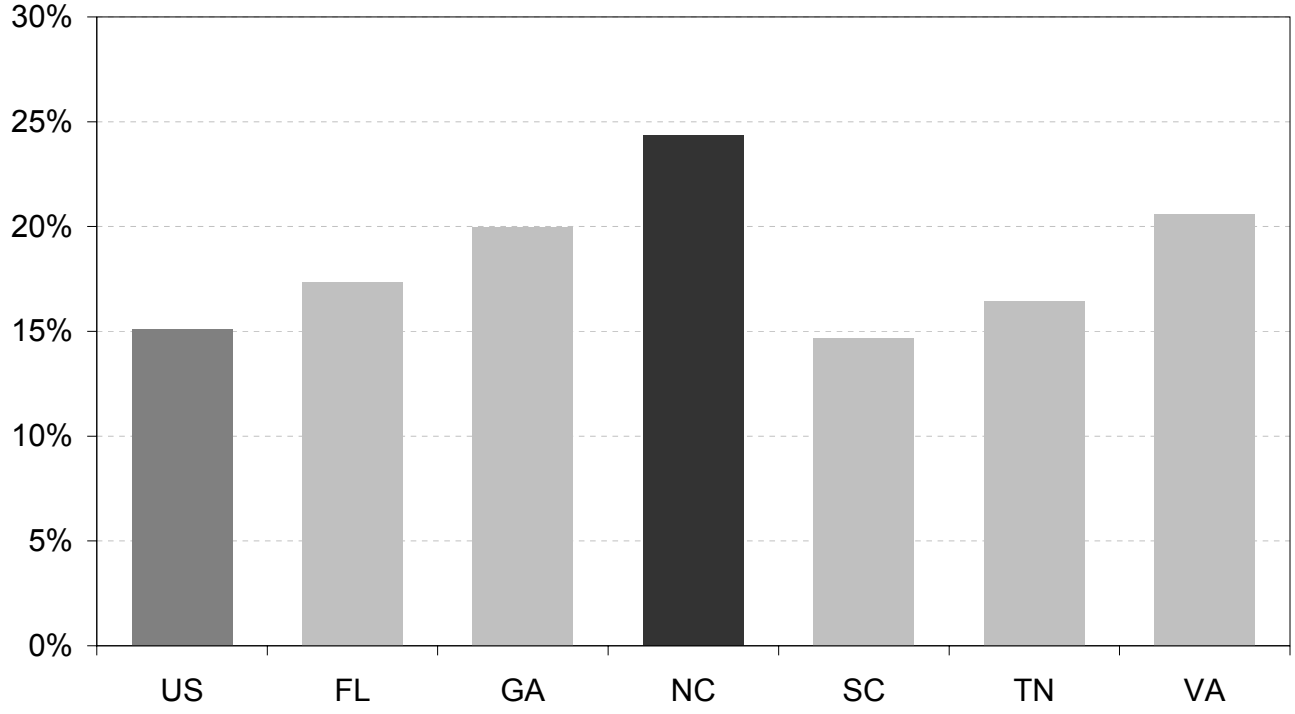
The new millennium saw the national economy dip into a recession (1999-2001), stabilize (2002), and then rebound (2003-2005). During the three-year recession, North Carolina's state GDP remained slightly more resilient than the national GDP. Thus the state experienced annual average real growth from 2000-2002 of 1.9 percent. Unlike the national economy, North Carolina's growth never dipped below 1.5 percent per year.

That being said, the state's recovery lagged one year behind the national recovery. A massive increase in taxes in 2001 siphoned approximately $1.1 billion from the economy over the course of the next two fiscal years. This tax increase represented a not insignificant amount for each consumer: $500 per year on average. As a result of the higher taxes, consumer spending, and arguably consumer confidence, declined. The renewal of the "temporary" income and sales taxes in 2003 (S.L. 2003-284) did little to reverse these trends.

Private Share of Total Nonfarm Employment: Southeast States, 1995-2005



State/Local Government Employment Growth: Southeast States, 1995-2005



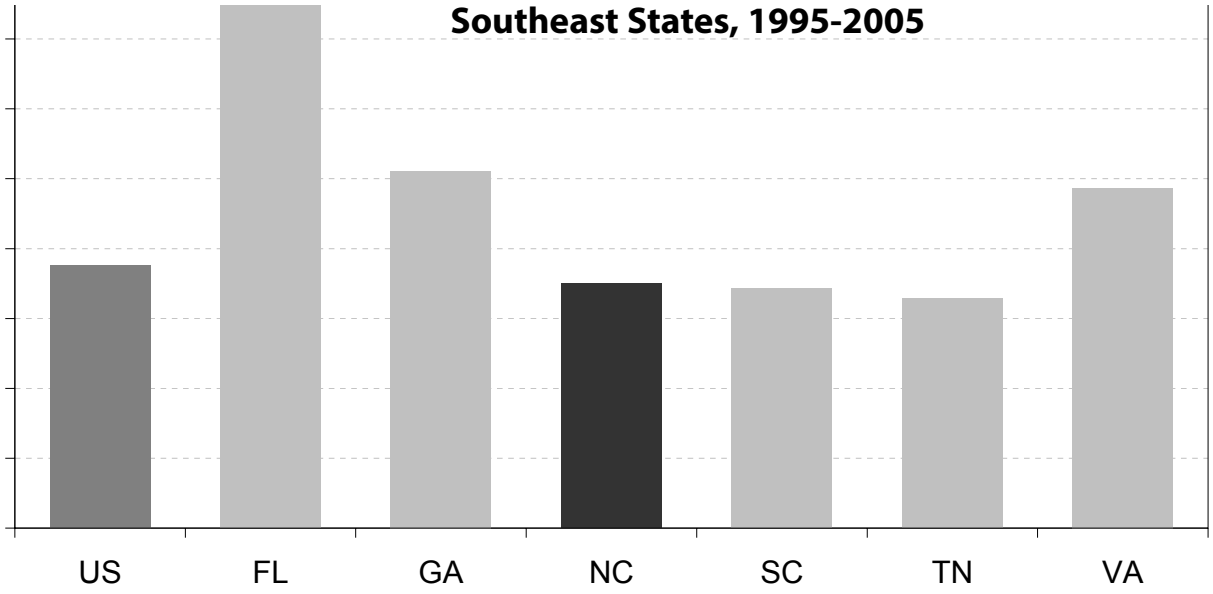
Thus while the national economy exceeded 4 percent in real growth in 2004, it took another year before North Carolina's economy hit 4 percent growth. From 2003 to 2005, real growth averaged 3.2 percent, two-tenths behind the national economic average of 3.4 percent for the same period.

Personal per capita income also declined in relation to the national average. In 2000 North Carolina was at 90.7 percent of the national average. In 2003, the state's per capita income had fallen to 88.7 percent of the national average, only rebounding to 90 percent by 2005.

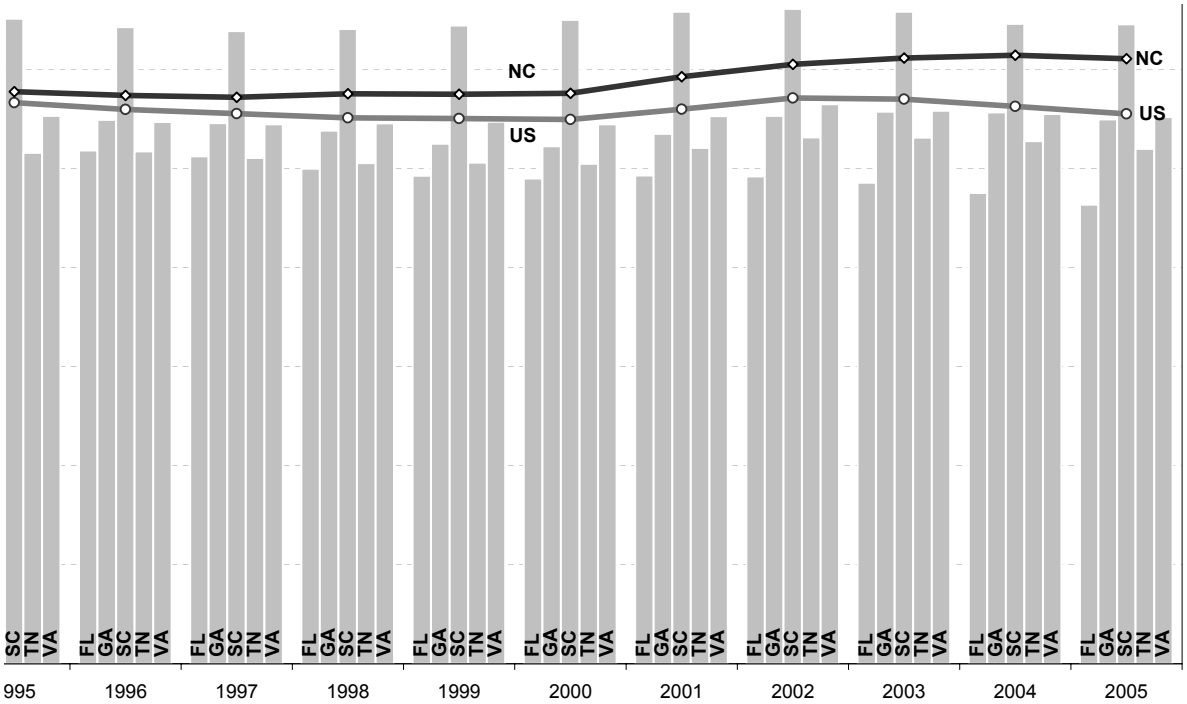
Owing to an expansion of Medicaid enrollment among working-age North Carolinians during the recession, the Medicaid share of the state budget increased significantly during this period. Historically, dependency on tax-paid entitlements does not go away once a recession ends. Thus we find that the Medicaid rolls swelled from 840,000 in 2000 to 1.06 million in 2003, with no drop off in 2004 or 2005.[1] During the same period (FY2000-FY2005), Medicaid spending in the state budget went from $1.35 billion to $2.44 billion.

[1] There was a slight decrease, however, in the enrollment for children age 18 and under in 2004; but this number increased again in 2005.

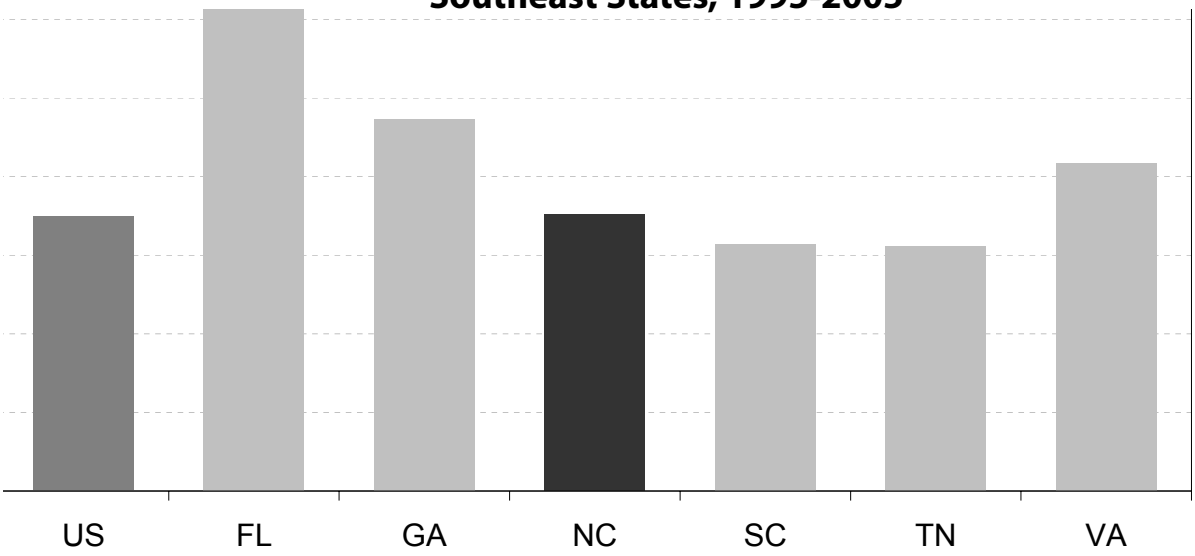
Total Private Employment Growth: Southeast States, 1995-2005



State/Local Government Share of Total Nonfarm Employment: Southeast States, 1995-2005



Total Nonfarm Employment Growth: Southeast States, 1995-2005



DID YOU KNOW?

For FY2002, North Carolina spent $841 in Medicaid dollars per resident, compared to an average regional cost of $716 per resident. Overall, state Medicaid spending averaged $6,640 per enrollee, compared to an average of $5,256 for the Southeast.

Source: N.C. Justice Center

2000 session

1999-2000 BIENNIUM
FY 2001: July 1, 2000 to June 30, 2001

General Assembly:

House Dems:	66	House Reps:	54
Senate Dems:	35	Senate Reps:	15

Governor:
Jim Hunt (D)

The 2000 Short Session:
Budget Bill HB1840/S.L. 2000-67
Passed House: June 14, 2000
Passed Senate: June 22, 2000
Conference Version Ratified: June 30, 2000
Signed by Governor: July 6, 2000

In Jim Hunt's final year as governor, the General Assembly again passed the budget bill before July 1. With the gubernatorial election in November, the short session was characterized by relative calm between the two Democratic-controlled chambers. In April, Governor Hunt called another special session of the General Assembly – this time to address the issue of punitive damages against corporations involved in civil lawsuits. A tobacco lawsuit in Florida spurred the governor to protect the state's tobacco industry from paying exorbitant damages, while disputed cases are still on appeal. In response, the General Assembly passed a bill staying damage payments in civil cases under appeal in which the judgment debtor posts a bond for a maximum of $25 million in noncompensatory damages.

With $830 million in state funds going to hurricane recovery efforts and a final payment of $240 million owed to intangibles tax plaintiffs, 2000 was a tight budget year. Nevertheless, Hunt's proposed budget increased spending by 6.8 percent. The governor's budget, however, presumed a 5.8 percent revenue increase while state forecasters predicted an increase of only 3.5 percent. Governor Hunt's plan to borrow $240 million in short-term bonds to pay the final installment of the *Fulton/Smith/Shaver* refunds was also not well received by a General Assembly already displeased over spending increases for Hunt's special pet projects, like Smart Start.

After failing to get a bond referendum passed in 1999, the UNC system won approval for a November 2000 $3.1 billion ballot initiative. Although Republican presidential candidate George H. Bush won North Carolina, Democrat Mike Easley defeated Richard Vinroot for governor. Republicans picked up four seats in the House, closing the gap between the two parties to a margin of 58 (R) to 62 (D). Meanwhile, Democrats remained firmly in control of the Senate.

January

➤ In a final effort to solidify his legacy as the "education governor," Governor Hunt attempts to launch the "First in America by 2010" project, which proposes issuing an annual report card that measures school progress.

February

➤ The N.C. Rural Prosperity Task Force, appointed by Governor Hunt and chaired by Erskine Bowles, releases a report that outlines a plan to stimulate rural economies. Highlights of the proposal include expanding high speed Internet access into rural areas, increasing investments in rural public schools, and developing new agricultural markets.

➤ To aid in rural Internet deployment, the task force recommends creating a Rural Broadband Fund that is funded with an 8-cent fee charged to all local phone customers.

March

➤ The Legislative Study Commission on the Future of Electric Service in North Carolina recommends that North Carolina delay electricity deregulation for six years.

➤ Fearing that putative damages yet to be awarded in a Florida civil suit could bankrupt tobacco companies in North Carolina, Governor Hunt calls the General Assembly into special session in an effort to protect North Carolina firms from this lawsuit and similar litigation.

April

➤ After four hours of debate, the General Assembly passes the "Enforcement of Foreign Judgments for Noncompensatory Damages," (S.L. 2000-1) a bill designed to protect companies from bankruptcy while they are fighting a judicial verdict on appeal. The act is designed to stay the enforcement of a civil judgment for noncompensatory damages during appeal by requiring the appellee to post a bond up to $25 million to cover noncompensatory and compensatory damages.

2000 Other Significant Changes

COMPENSATION

- Salary increase of 2.2% COLA + 2.0% career growth + $500 bonus for most state employees
- 4.2% salary increase for governor, council of state and other executive officials, as well as judicial branch personnel
- Average increase of 6.5% for teachers and 10.0% for principals and assistant principals

RETIREMENT

- Reduce retirement system contribution rate from 8.15% to 5.33%

DEBT SERVICE

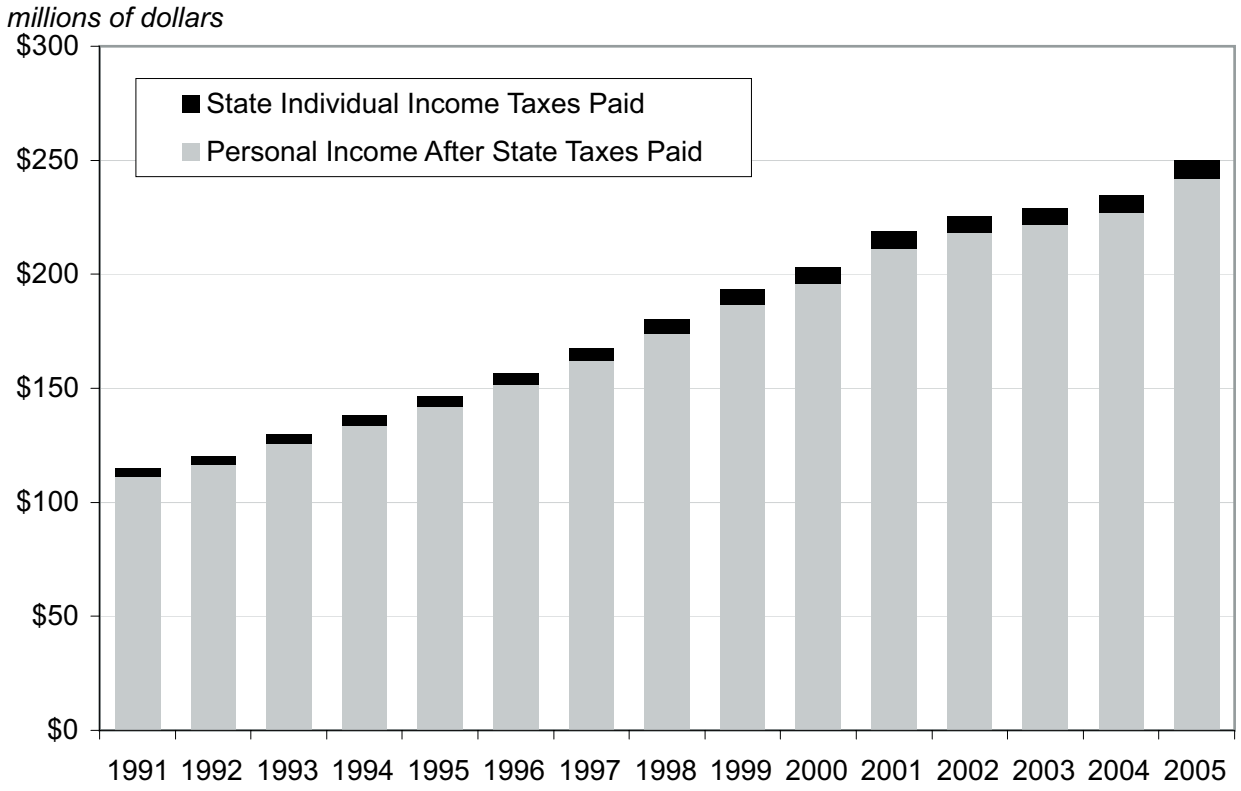
- Reduce $52 million in funds for debt service due to revisions in payment requirements

➤ Governor Hunt proposes increasing the Farmland Preservation Trust Fund to $1 million in the next budget in order to protect one million acres of farmland and forests from development. The trust is to be funded by a spate of new taxes and fees, in particular a real estate transfer tax.

May

➤ Richard Vinroot wins the

Amount of Personal Income Paid to State as Income Tax



Republican gubernatorial primary. In November he will face Attorney General Mike Easley.

- Unlike previous years, Governor Hunt waits for April revenue estimates before delivering his budget to the General Assembly.
- A bipartisan legislative committee recommends placing a $3.1 billion bond referendum for UNC system building improvements on the fall ballot.
- The annual "April surprise" brings bad news, as state revenues are $91.7 million below projections.
- House Speaker Jim Black (D-Mecklenburg) claims the reduction in revenue was primarily caused by Republican tax cuts, as well as the recent natural disasters and lawsuits. "When you cut taxes $1.5 billion along with having natural disasters and two major lawsuits totaling more than $1 billion, that adds up to no money."
- Hunt finally submits his $13.9 billion budget. In line with the Excellent Schools pay raise schedule, teachers will receive a 6.5 percent salary increase. State workers will also receive a 3 percent raise while Smart Start will get another $67 million, boosting its annual funding to $288 million. To pay for the new spending, as

well as close the current $450 million budget gap, Hunt proposes several minor cuts, such as reducing by $7.7 million the UNC system operating budget. Primarily, however, the governor wants to spend any available funds generated by cuts and make up the difference by borrowing funds using bond issues.

➤ Characteristically, Hunt's budget does not propose replenishing the Savings Reserve Account that was drained the previous year in order to fund intangibles tax repayments and hurricane relief efforts.

➤ In order to finance the final installment of the intangibles tax refund, Hunt proposes taking advantage of a little-used constitutional provision to issue $240 million in short-term general obligation bonds without voter approval. The bonds would cost

2000 Significant Tax Changes

⬆	Streamlined Sales Tax System: first step to creating remote collection system for Internet and catalog sales [S.L. 2000-120]
⬆	Repeal sunset on 3% tax on white goods (counties receive 72% of this revenue) [S.L. 2000-109]
⬆	Implement tax enforcement measures (small revenue increase anticipated) [S.L. 2000-119]
⬇	Exempt rental cars from property tax (impact local revenues) [S.L. 2000-2]

2000 Other Revenue Sources & Actions (Budget Bill Unless Noted)

- Increase all court fees by $3 to $10 [S.L. 2000-109]
- Uniform Commercial Code revision (increase filing fees from $15 to $30) [S.L. 2000-169]
- Direct appropriation of $120 million to Savings Reserve Account
- Direct appropriation of $100 million for Repairs & Renovations Account due to insufficient year-end credit balance
- Direct appropriation of $30 million for Clean Water Management Trust Fund due to insufficient year-end credit balance
- Transfer $240 million to Intangibles Tax Settlement Reserve (June 30, 2000)
- Transfer $48 million from Hurricane Fran Reserve
- Transfer $9 million from Y2K Reserve
- Other sources of G.F. revenue: investment income, judicial fees, Medicaid Disproportionate Share, insurance, other transfers

the state an additional $40 million to $60 million in interest over the next five years.

2000 HEALTH & HUMAN SERVICES BUDGET

Total Appropriations	**$3.01 billion**
Major Items:	
Medical Assistance (Medicaid):	$1,540 million
Mental Health/D.D./Subst. Abuse:	$608 million
Child Development:	$305 million
Social Services:	$186 million
Public Health:	$132 million
Office of the Secretary:	$90 million

- Hunt defends his budget, saying: "There is no question that this is a tough budget year, and we had to make some tough decisions. There are a lot of things, folks, I would like to have had in the budget that we didn't have in there."
- Legislators do not share the governor's outlook. Observes Senate Minority Leader Patrick Ballantine (R-New Hanover): "He just does everything for everybody and wants us to make the hard decisions." Similarly, House Speaker Black "commend[s] the governor for focusing his proposed budget revisions on children and families" but also says he will not support the plan to borrow money to make the final intangibles tax payment.
- The General Assembly passes the "Michael K. Hooker Higher Education Facilities Financing Act" (S.L. 2000-3) authorizing $3.1 billion in bonds for the UNC system. The bond proposal will appear on November's ballot for public approval.

June

- In a move that harkens back to the days of Governor Martin's account shifting techniques to balance the budget (e.g., shifting the final fiscal year payday to the next fiscal year), the General Assembly shifts the July and August teacher salary payments from the 2001 budget to the 2002 budget in order to pay the $240 million intangibles tax payment (S.L. 2000-67). The move permits the state to balance the budget without borrowing the money, cutting spending, or raising taxes – at least for the time being.
- The House passes its budget bill which allocates: $222 million for the last phase of teacher raises (6.5 percent) stemming from the Excellent Schools Act; $44 million to Smart Start; a 3 percent raise, with a one-time 2 percent bonus, for state employees; and $1.2 million for Governor Hunt's Farmland Preservation Trust.
- The Senate budget recommends a 6.5 percent raise for teachers, a 3 percent raise for state workers and $2 million for the Farmland Preservation Trust.
- The ratified $14 billion budget bill (S.L. 2000-67) includes the following: a 6.5 percent raise for teachers; a 4.2 percent raise, with a one-time $500 bonus, for state workers; $44 million for Smart Start; and no $7.7 million cut for the UNC operating budget.

July

- The General Assembly grants the Department of Transportation authority to grant a license to a private company to build a toll road (S.L. 2000-145) in a pilot program to alleviate the increasing

pressure on the state to meet the costs and demands of building new roads.

- The General Assembly passes the "North Carolina Rural Internet Access Authority Act" (S.L. 2000 149) which creates a new division in the Commerce Department to promote economic development and broadband deployment in rural areas.
- Lobbyist Don Beason writes House Speaker Jim Black (D-Mecklenburg) a personal check for $500,000 which Black deposits into a personal account. Days later, Black writes a check to his campaign fund from his personal account in the amount of $500,000,

August

- Democratic gubernatorial candidate Mike Easley proposes a "No Excuses" program to promote "character" education. Instead of teaching kids self-discipline and virtue, the program promotes the creation of more schools for poorly behaved students, as well as changes to the public school dress code. Easley offers no insight as to how the program would be funded.
- Black's campaign fund repays Black's personal account the $500,000. Days later, Black writes a personal check to Beason for $500,000. This short-term "loan" will come to light in 2007 during Black's sentencing hearing. Black will be convicted on state charges of bribery and obstruction of justice.

September

- A Mason-Dixon poll shows Easley (D) leading Vinroot (R) 48 percent to 37 percent with 2 percent in favor of Libertarian candidate Barbara Howe and 13 percent undecided.

> A democratic government is the only one in which those who vote for a tax can escape the obligation to pay it.
>
> Alexis de Tocqueville

October

- As the state prepares to resume executions after a one-year moratorium, 100 people hold a rally in front of the N.C. Department of Justice to protest the death penalty.

November

- Mike Easley (D) defeats Richard Vinroot (R) 52 percent to 46 percent. Republicans pick up 4 seats in the House, trimming the Democratic majority there to 62-58. Democrats remain firmly in

DID YOU KNOW?

Between FY 2004 and FY2005, combined state and federal Medicaid funding in North Carolina grew by 23.2 percent – an increase surpassed by only four states The national average was 12.7 percent.

Source: National Conference of State Legislatures

2000 EDUCATION FUNDING

ENROLLMENT CHANGES

- Public Schools: 15,713 (1.3%) increase
- Community Colleges: 14,533 (1.9%) increase
- UNC: 1,774 (1.1%) increase

TUITION & FEE INCREASES

- Average increase of 9% for in-state and 2% for out-of-state UNC students
- Increase of 17% for in-state and 14.2% for out-of-state community college students

OTHER EDUCATION CHANGES

- Increase supplemental funding for small county and low-wealth districts, as well as exceptional children ($15 million: $5 million each)
- $13 million to improve student accountability
- $13 million to increase rate of longevity pay for teachers to equal that of other state employees
- No appropriation for projected ABC bonuses; funding for 2000-01 bonuses instead funded in 2001 budget at actual amount
- Judge Manning rules in *Leandro* that the state's system for administering and funding public education is constitutionally sound but reserves judgement as to whether it is adequately serving every student; Manning also rules that the state must provide pre-kindergarten for 4 year olds who are at risk of failing academically

control of the Senate, winning 35 seats to 15.

➤ The $3.1 billion UNC bond issue garners 73 percent of the vote.

➤ In the U.S. presidential election, George W. Bush (R) defeats Vice President Al Gore (D) by winning the state of Florida by a slim margin. A mandatory recount shows Bush still winning, but Gore continues to ask for a hand recount.

December

➤ After Gore challenges the recount in court, the U.S. Supreme Court halts the recount and permits Florida to certify its results.

Economic Snapshot: 2000

Population:	8,049,313	Five-Year Population Growth:	11.9%
Civilian Labor Force:	3,941,000	Unemployment Rate:	3.4%
Per Capita Income:	$ 27,055	Pct. of U.S. Per Capita Income:	90.9%

Top 10 Private Employers

1. Wal-Mart Stores, Inc.
2. Food Lion, Inc.
3. Duke University
4. IBM Corporation
5. First Union National Bank
6. Harris Teeter, Inc.
7. Manpower Temporary Services
8. US Air, Inc.
9. Belk, Inc.
10. Lowes Companies, Inc.

General Obligaton Bond Acts Voted on by Public: 1971-2000

(Voted on by the Public)

Year	Authorization	Description	State Projects	Local Projects
1971	Chapter 909	Clean Water Bonds		150,000,000
1971	Chapter 953	NC Zoological Park Facilities	2,000,000	
1973	Chapter 657	Public School Facilities		300,000,000
1975	Chapter 854	UNC System	43,250,000	
1977	Chapter 677	Clean Water Bonds		230,000,000
1990	Chapter 935	Prison and Youth Services Facilities		
		Authorized for use in 1991	112,500,000	
		Authorized for use in 1993	87,500,000	
1993	Chapter 542	Education, Clean Water and Parks		
		UNC System	310,000,000	
		State Parks	35,000,000	
		Community Colleges*		250,000,000
		Clean Water		145,000,000
1996	Chapter 631	Public School Facilities		1,800,000,000
1998	SL 1998-132	Clean Water and Natural Gas		
		Clean Water	800,000,000	
		Extension of Natural Gas Service	200,000,000	
2000	SL 2000-3	Higher Education Bonds		
		UNC System	2,500,000,000	
		Community Colleges		600,000,000
		Grand Total	**4,090,250,000**	**3,475,000,000**

* $23.9 million was part of 1993 Issue but reserved to be addressed by 1994 Session.

Governor Hunt and Special Sessions

While Governor James Martin (R) attempted to use bond referendums to implement and fund various public programs, Governor Jim Hunt (D) preferred to use special sessions to bring attention to what he perceived to be important needs. During his third and fourth terms as governor, Hunt called a total of six special sessions.

Hunt called his first special session in February 1994 in order to deal with crime – specifically to "keep violent criminals behind bars longer and make prison a real deterrent." The session lasted from Feb. 8 to March 26. While Hunt told community leaders he thought that, at bottom, crime was a "a religious problem … a matter of getting people right in their souls," his initial $118 million, 36-point anticrime package called for tougher sentencing, after-school programs, juvenile training schools, and substance-abuse programs for inmates. The result of the two-month long session was a $257 million crime bill (S.L. 1994-24es) that implemented structured sentencing laws, passed a "Three-Strikes, You're Out" bill aimed at violent repeat offenders, funded the construction of five new prisons, and funded several school-based programs, as well as drug treatment programs for inmates.

In 1996, Governor Hunt called two special sessions. The first came on February 21 after Speaker of the House Harold Brubaker (R-Randolph) requested the governor call a special session to pass legislation to reduce business unemployment taxes. Although Hunt initially balked at the suggestion, he eventually acquiesced. Meeting for 2 hours and 39 minutes, the General Assembly overwhelmingly (remember, it was an election year) passed a $140 million unemployment tax cut (S.L. 1996-1es).

I place economy among the first and most important of republican virtues, and public debt as the greatest of dangers to be feared.

Thomas Jefferson

Governor Hunt called the second special session of 1996 after budget negotiations broke down during the 1996 short session. The main point of contention was saving, as opposed to spending, a $700 million budget surplus. The Republican House wanted to save no less than $398 million of the surplus and spend much of the remainder on building new prisons. The Democratic Senate wanted to spend the entire surplus, mostly on education. Although the two-year budget from the long session was already in place, an outraged Hunt declared the state was in "crisis" and called legislators back into session on July 8. After the legislative leadership came together behind closed doors to iron out a compromise, the budget was passed with no debate on August 3. The day prior, August 2, the Legislature also passed the "Tax Reduction Act of 1996," which lowered the sales tax on food, cut the corporate income tax, and instituted the "William S. Lee Quality Jobs and Business Expansion Act," better known as the Bill Lee Act.

In the fall of 1997 Hunt appointed a special commission to discuss proposals on juvenile crime, with the apparent intention of calling another special session

In 2004, Governor Easley estimated that every day the General Assembly is in special session costs taxpayers $100,000.

to address the issue. On February 27, 1998, the governor abruptly changed course and announced that he was going to call the General Assembly into session to pass legislation regarding his latest pet project – the expansion of taxpayer subsidized healthcare for children. Declared the governor: "There are tens of thousands of children of working families that are uninsured. Their parents work hard, but they make too much for Medicaid. … Too often, these families face a terrible choice: food and shelter for their children or health insurance." Accordingly, Hunt proposed a plan to cover some 71,000 children in families who make up to 200 percent of the federal poverty limit. The initial impetus for the expansion was the availability of an annual federal contribution of $79.9 million for children's healthcare that could only be tapped if the state increased its healthcare budget by $27.7 million per year.

As in 1994, the special session lasted nearly two months, from March 24 to April 30. The primary focus of debate was a Republican recommendation that families who opted in to the state program should have to help offset the cost by paying a monthly premium of up to $28. While the governor called the premiums a "bad idea," House Speaker Harold Brubaker (R-Randolph) defended the proposal as reflecting "fairness, accountability and personal responsibility." Debate over the governor's plan also stalled at the last minute over the Senate's refusal to consider a House-sponsored tax credit for families who purchase health insurance for their children. The final plan (S.L. 1998-1es) provided health insurance for children whose families earn up to 200 percent of the federal poverty limit, but required the families to pay an annual enrollment fee of up to $100 and a small co-pay for doctor visits and prescriptions. The General Assembly also agreed to a $100 to $300 refundable tax credit for families who actually buy insurance coverage for their children.

Hunt called his fifth special session in December 1999 so that the General Assembly could pass the $830 million "Hurricane Floyd Recovery Act of 1999" (S.L. 1999-463es). On March 30, 2000, Hunt called the Legislature back to Raleigh in order to pass a bill aimed at protecting North Carolina tobacco companies from potentially crippling lawsuits. The special session was prompted by a Florida lawsuit involving five tobacco firms (two of which were based in North Carolina: R.J. Reynolds Tobacco Co. of Winston-Salem and the Liggett Group of Durham) that was anticipated to result in a $100 billion to $300 billion punitive judgment (in the end, the jury awarded damages of $144.87 billion). The four-hour, April 5 session resulted in the passage of a law (S.L. 2000-1) that placed a $25 million limit on punitive damage bonds, that is, bonds filed during an appeal. In passing the law, North Carolina joined three other neighboring states: Georgia, Kentucky and Virginia.

Following Governor Hunt's example, Governor Mike Easley (D) has also called several special sessions: in 2002, for redistricting; in 2003, for economic development; another in 2003, for redistricting; and in 2004, for economic development. In 2004, Governor Easley himself estimated that every day the General Assembly is in special session costs "$100,000 per day of taxpayer money."

2001 session

2001-2002 BIENNIUM
FY 2002: July 1, 2001 to June 30, 2002

General Assembly:

House Dems:	62	House Reps:	58
Senate Dems:	35	Senate Reps:	15

Governor:
Mike Easley (D)

The 2001 Long Session:
Budget Bill SB1005/S.L. 2001-424
Passed Senate: May 31, 2001
Passed House: June 28, 2001
Conference Version Ratified: September 21, 2001
Signed by Governor: September 26, 2001

The 2001-2002 biennium was marked by a budget crisis caused by an economic downturn that began in the fall of 2000 and continued into 2001. During 2001 alone North Carolina lost 50,000 manufacturing jobs – the second-highest such loss in the country.[1] In 2002, the economy picked up slightly, but unemployment in certain sectors remained high. In Catawba County, for instance, the declining fortunes of the tech sector caused unemployment to soar from a low of 1.5 percent in the late 1990s to 9.4 percent in FY2002.[2] As unemployment rates rose, consumer spending and personal incomes dropped. For FY2002 alone, the state suffered a shortfall in receipts of $1.55 billion.

The immediate source of the budget crisis, as we saw above, was Governor Hunt's 1999-2000 budget. Hunt's budget included massive increases in education spending – in particular, for his pet "Smart Start" program – even as the state was hard pressed to pay for soaring Medicaid expenditures, not to mention the multimillion dollar *Fulton/Smith/Shaver v. State* and *Bailey/Emory/Patton v. State* lawsuits. The state's budget problems were exacerbated by the failure to set aside reserve funds to pay for true emergences, such as Hurricanes Floyd and Fran.

When legislators convened on January 24, 2001, the state was facing a projected budget shortfall of almost $791 million – one of the largest in the country – that worsened to $820 million as the year progressed. As a result, intense budget negotiations caused the 2001 legislative session to last until December 6 – the longest in state history.

1 Christensen, Rob, "Hard times grip state, region," *The News & Observer*, 2 December 2001, p. A-1.
2 *Financial Highlights,* Fiscal Year 2002, p. 3.

At least until the passage of the budget bill in September, much of the debate in the General Assembly centered on whether to cut spending or raise taxes.[3] In the House, where Democrats held a slim four-vote majority, calls to increase the sales tax by one-cent were fiercely resisted on the grounds that such a tax is regressive and would most hurt the poor. For its part, the Senate refused to agree with an initial House budget that did not raise taxes. As the impasse continued, the Senate also refused to agree with a House proposal to raise top-tier income taxes instead of the sales tax. Meanwhile, Governor Easley pushed for tax increases of various kinds while calling for a state lottery as the solution to the state's budget woes.

Defying the advice of top economists, the FY2002-2003 budget raised taxes – both sales taxes and income taxes, causing a further slowdown in an already weak economy. By so doing, North Carolina marked itself as the only state in the Union to raise income taxes (and one of only a handful to raise taxes at all) during the 2001 recession.[4] As in recent years, healthcare and education drove the tax increases, with roughly 80 percent of spending allocated to these two areas.

January

- Senate President Pro Tem Marc Basnight (D-Dare) and House Speaker Jim Black (D-Mecklenburg) dismiss suggestions that the General Assembly will raise taxes, suggesting instead that the budget shortfall can be made up by increasing operational efficiency in state agencies. Claims Basnight, "I don't foresee a tax increase."
- Facing an estimated $500 million budget shortfall, Governor Easley freezes state spending.

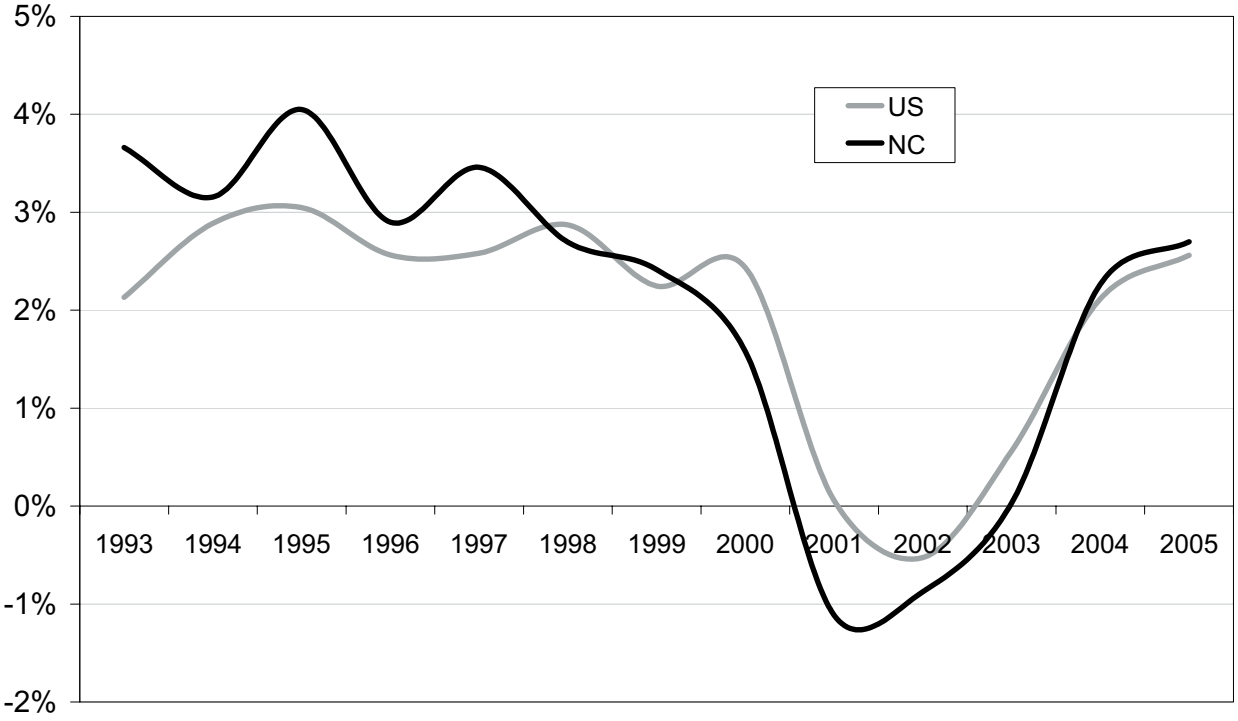
February

- With the projected budget shortfall increasing to $791 million, Governor Easley declares a "budget crisis," invoking his emergency powers as governor to create a $1 billion escrow account funded through various means – including taking $157 million from the Savings Reserve Account (Rainy Day Fund), $151 million earmarked for the state employee pension fund, $95 million in federal Medicaid payments, $50 million from the unemployment insurance fund, and $40 million from the Hurricane Floyd disaster relief

> It's one of the all-time stupidest things done by a legislature anywhere. You don't raise taxes in a recession, or even in a dismal economic environment.
>
> UNC economist James Smith, September 2001

[3] Redistricting proposals also contributed to the length of the 2001 long session.
[4] "State budget balances needs and pain," *The Chapel Hill News*, 30 September 2001, p. A4.

Private Sector Job Growth: North Carolina vs. U.S.



fund.[5] (Recall that Governor Jim Martin had set a similar precedent in 1991 by taking money from the Highway Trust Fund.) Easley also holds back $95 million in inventory tax reimbursements designated for local governments, prompting outraged local officials to file suit against the state (*Cabarrus County, et al. b. Tolson* (2002)).

➤ The Senate and House budget committee chairmen propose a "modified zero-based budgeting" plan to help cut spending.

March

➤ Governor Easley creates the N.C. Efficiency and Tax Preference Commission (The "Loophole" Closing Commission) to recommend proposals for eliminating "special-interest" tax breaks. Instead of eliminating corporate subsidies, the panel proposes broad-based tax increases on retiree benefits, candy, soft drinks, tobacco, vending machine sales, movie tickets, out-of-state phone calls, auto/home repair services, and various other items.

➤ All three major credit rating agencies – Fitch, Moody's Investors Service, and Standard & Poor's – reaffirm North Carolina's AAA bond rating.

➤ Governor Easley proposes a $14.6 billion budget for FY2002 and $15.4 billion for FY2003 that apparently freezes continuation spending at year 2000 levels. The

[5] Easley later decided not to raid the hurricane relief fund, as much of the money had already been appropriated for other uses.

budget increases overall spending by 5.6 percent, with most of the new spending dedicated to education. Despite the estimated $800 million budget shortfall, the governor's proposed budget gives state workers and teachers 2 percent raises and also funds two of the governor's pet projects – class size reduction and More at Four.

➤ Among other things, the proposed "balanced budget" presumes overly optimistic revenue forecasts, as well as $300 million in revenue from a state lottery that doesn't exist yet. The budget also proposes taking $181 million from the state employee pension plan. "It appears that a number of revenue sources in his budget are very vague," comments House Minority Leader Leo Daughtry (R-Johnston). "We don't have nearly the information we are going to need to craft a budget that makes sense."

➤ The House introduces a bill (HB571) to tax telecommunications providers. The bill proposes taxing gross receipts for all calls at 4.5 percent, replacing the current tax rate of 6.5 percent on toll calls.

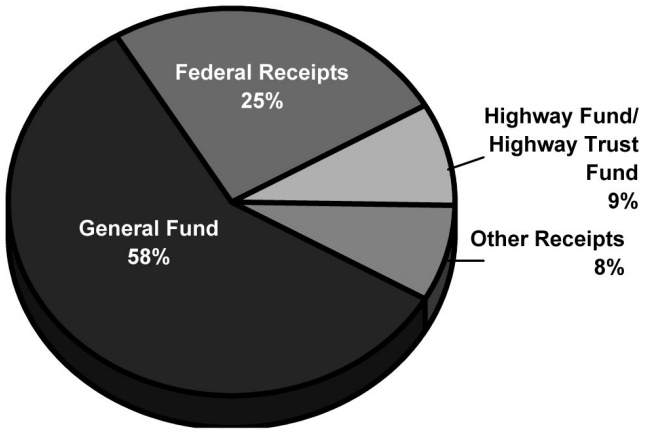
April

➤ Rejecting earlier proposals to tax candy and other items, Easley uses the Loophole Commission's recommendations to call for $150 million in tax increases on HMOs and limited liability companies; fertilizers and seed; satellite TV; newspapers; and luxury items, such as cars, boats and airplanes. Likewise, the governor proposes saving $91 million by taking minor steps to improve government efficiency – for instance, by eliminating the state boxing commission.

May

➤ As April tax collections fall $61 million short of projections, Governor Easley announces that the budget shortfall has worsened and could increase to $850 million by June 30. Easley indicates he will not release any of the funds he seized in February and that "these new numbers definitely indicate a worst-case scenario."

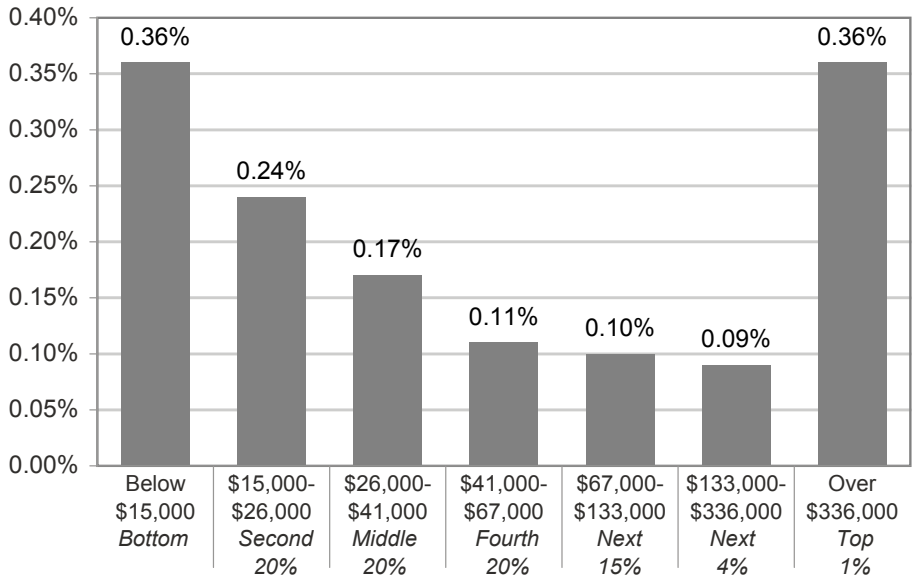
Source of Budget Funds: 2000-01



➤ The General Assembly seeks to recall and reallocate unused Hurricane Floyd relief funds. Appropriations Committee Co-chair Representative David Redwine (D-Brunswick) argues that recalling the funds is "sound money management," but that legislators would "make the money available [for hurricane relief] when it is needed rather than having it sit around in an account waiting to be spent."

➤ The Lewin Group, an independent healthcare policy consulting firm hired by the General Assembly,

releases a report describing North Carolina's Medicaid program as a "Cadillac" characterized by unusually high spending driven by politics, rather than medical and factual data.



➤ Two thousand students march from N.C. State to the General Assembly to protest proposed budget cuts in education.

➤ Senate Finance Committee Chairman Senator David Hoyle (D-Gaston) calls for a "temporary" one cent increase in the state sales tax.

➤ The proposed $14.7 billion Senate budget (SB 1005) causes controversy by increasing education spending, but cutting mental health services. In what proponents call a "targeted" tax increase, the Senate calls for higher taxes on television and long-distance phone calls, as well as a repeal of the child health-insurance tax credit. Teachers will receive a 2.86 percent pay increase while state workers will get a $625 raise. Governor Easley hails the proposed budget, which passes on a straight party vote, as a "victory."

➤ The State Employees Association of North Carolina (SEANC) sues Governor Easley for diverting $225 million in pension funds from the state's three retirement systems in order to cover the budget deficit. The lawsuit is dismissed in June 2001, but SEANC eventually wins the case on appeal before the North Carolina Supreme Court (*Stone et al. v. State of North Carolina* (2006)).

June

➤ Republicans in the House call the Senate budget a ruse that uses the threat of cuts in mental health to generate popular support for a tax increase. House budget writers promise not to raise taxes and not to set a timetable for shutting down mental health facilities.

➤ Senate President Pro Tempore Marc Basnight proposes raising alcohol taxes by $100 million and earmarking the funds for mental health.

➤ With eight Democrats led by former Speaker Dan Blue (D-Wake) coming out against a regressive sales tax increase, the House passes a $14.4 billion budget that does not raise taxes and keeps mental health institutions open. The House budget also includes a 2.86 percent raise for teachers, a one-time $625 bonus for

state workers and $6.5 million for More at Four.

➤ House budget writers balance the budget by decreasing funding for the Clean Water Management Trust, enacting more stringent delinquent tax collection measures, and phasing in class-size reductions more slowly by adopting a ratio of 19 (rather than 18) students per teacher.

➤ The General Assembly and the governor pass the first continuing budget resolution, extending current funding to July 16, 2001 (S.L. 2001-250).

➤ Governor Easley holds a news conference declaring that a state-run lottery will solve the state's budget problems. Claims Easley, "I still think a lottery for education is right for North Carolina."

July

➤ In an attempt to head off calls for the elimination of targeted tax loopholes, North Carolina Citizens for Business and Industry (NCCBI) urges lawmakers to pass a one-half cent statewide sales tax increase and a one-half cent local-option sales tax increase. Explains NCCBI President Phil Kirk, "It's good to spread out the tax burden. Everybody pays sales tax, and everybody uses government services."

➤ After holding back tax reimbursements from local governments in February, Governor Easley calls for a local-option sales tax increase of one-half cent so that localities will have "reliable and predictable sources of revenue." House Speaker Jim Black seconds the move for a local-option sales tax increase.

➤ While calling for increased taxes, Senate Democrats claim that budget forecasts may have to be revised downward by $300 million (the actual forecast is revised downward by $167 million). Meanwhile Speaker Black declares, "I doubt seriously whether we have the votes for a sales-tax increase."

2001 Other Revenue Sources & Actions

- Repeal reimbursements to local governments (effective July 1, 2003, will generate $333 million/year beginning in 2003-04)
- Hold local governments harmless for swap of 1/2¢ sales tax for reimbursements (effective July 1, 2003)
- Transfer $170 million from Highway Trust Fund; transfer $15 million from Highway Fund
- Education/Human Services/Mental Health revenue initiatives ($435 million)
- Transfer $23 million from Special, Trust, Internal Service, and Reserve Funds
- N.C. Railroad General Fund repayment of $19 million
- Credit $181 million to the Savings Reserve Account

➤ The House narrowly agrees to the closure of three tax loopholes regarding limited liability corporations, royalty payments and subsidiary dividends.

2001 Other Significant Changes

COMPENSATION

- $625 raise for most state employees
- Average 2.86% raise for teachers

FUTURE BUDGET CONCERNS

- $181 direct appropriation to Savings Reserve Fund
- Direct Sentencing Commission to develop alternatives for sentencing laws in view of the projected prison population growth
- Revenue Project Collect Tax implemented for $2 million [S.L. 2001-395]

OTHER

- Increase appropriation for Clean Water Management Trust Fund by $10 million in 2001 and $40 million in 2002

➤ Moody's downgrades North Carolina's economic outlook from stable to negative. Governor Easley again calls for tax increases.

➤ A second continuing budget resolution is passed, extending funding to July 31, 2001 (S.L. 2001-287).

➤ Governor Easley again threatens to raid the Hurricane Reserve Fund.

➤ According to the *News & Observer*, Governor Easley falsely claims that he repeatedly borrowed money "from the Highway Trust Fund two or three times to make payroll during the last fiscal year." The *N & O* attributes Easley's fabrication to an "effort to build support for a tax increase."

➤ House Minority Leader Leo Daughtry (R-Johnston) states: "I think tax increases are out. They may try to shame us and scare us."

➤ House Democrats call for $440 million in tax increases that include a half-cent local sales tax increase, a 1 percent personal income tax increase and new taxes on liquor and HMOs.

➤ Representative Art Pope (R-Wake) denies that the House budget cuts actual spending by $800 million, noting that spending hikes in other programs resulted in a $469 million increase in overall expenditures.

➤ The General Assembly passes a third continuing budget resolution, extending funding to August 29, 2001 (S.L. 2001-322).

➤ Governor Easley seizes the first payment – about $10 million – of the fiscal year to the state employee retirement fund and places the money in escrow.

➤ Easley also announces the layoff of 278 state employees and the elimination of 609 vacant positions.

➤ More than 600 people hold a "Tar Heel Tea Party" at the Legislative Building to protest the proposed tax increases.

August

➤ The Senate rejects a House proposal for an income tax hike, calling instead for a one-cent sales tax increase.

➤ In the wake of a budget impasse, Governor Easley appears on statewide television and declares

a budget crisis. As part of a "triple-targeted" overall tax cut, the governor proposes raising the sales tax by one cent.

➤ A statewide poll by Fabrizio, McLaughlin & Associates finds that 63 percent of voters would resolve the budget shortfall by cutting spending; only 17 percent favor increasing taxes.

➤ Governor Easley proposes a temporary sales tax increase in exchange for the passage of a lottery.

➤ In spite of the so-called budget crisis, Easley asks the General Assembly for $30 million for his Industrial Recruitment Competitive Fund (better known as the "deal-closing" fund), which is used to provide economic incentives to corporations. Traditionally, the Legislature had allocated $2 million annually for the fund; in 2001, the House and Senate budgets had both only allocated $1 million.

September

➤ A fourth continuing budget resolution is passed on September 28, 2001. The resolution (S.L. 2001-395) contains statutory changes that increases spending for education, in particular, a $20 million initiative to reduce K-3 class sizes. The resolution also continues the practice started by Governor Easley of withholding intangibles and inventory tax reimbursements from local governments.

➤ 9/11 terrorist attack on World Trade Center and Pentagon.

➤ Governor Easley declares he will not sign another continuing budget resolution.

➤ The General Assembly passes the $14.4 billion budget (S.L. 2001-424) on September 21. The budget passes along party lines, with Representative Monroe Buchanan (R-Spruce Pine) being the lone Republican to vote in favor of the budget. Easley's recommendations for class size reduction and More at Four are funded at $21.4 million. Teachers receive a 2.86 percent raise, and state workers receive a flat $625 raise, both retroactive to July 1.

2001 HEALTH & HUMAN SERVICES BUDGET

Total Appropriations	**$3.40 billion**
Major Items:	
Medical Assistance (Medicaid):	$1,981 million
Mental Health/D.D./Subst. Abuse:	$581 million
Child Development:	$289 million
Social Services:	$189 million
Public Health:	$109 million
Education Services:	$70 million

➤ The budget mandates a "temporary" sales tax increase of one-half cent that raises the state sales tax from 4 percent to 4.5 percent. By law, the tax increase is to remain in effect from October 16, 2001, to July 1, 2003. Likewise, the budget contains a local option one-half cent sales tax increase that is to go into effect (July 1, 2003) when the statewide temporary one-half cent sales tax increase expires.

➤ In addition, the 2001 budget implements a new "temporary" income tax bracket of 8.25 percent on earnings in excess of $100,000 to $200,000, depending on the manner of filing. The tax bracket increase of 0.50 percent (from

2001 EDUCATION FUNDING

ENROLLMENT CHANGES

- Public Schools: 18,488 (1.5%) increase
- Community Colleges: 2,488 (0.3%) increase
- UNC: 7,031 (4.3%) increase

TUITION & FEE INCREASES

- Average increase of 14% for in-state and 10% for out-of-state UNC students
- Increase of 12% for in-state and 2% for out-of-state community college students

OTHER EDUCATION CHANGES

- Net reduction of $190 million for public schools, $4 million for community colleges, and $15 million for UNC
- One-time reduction of $24 million in school bus funds based on revised schedule
- ABC bonuses earned in 2000-01 ($93 million)
- Reduce class size in kindergarten to 19 in 2001 ($12 million) and 18 in 2002 ($26 million)
- Reduce class size to 1:15 for grades K-3 in schools with 80% low-income students and 45% of students performing below grade level
- Establish More at Four Program and related grants in Development of Health & Human Services
- Judge Manning orders state and local leaders to develop "coordinated, effective educational strategy" to ensure all at-risk children have the opportunity for a sound basic education

7.75 percent to 8.25 percent) is to remain in effect from January 1, 2001 to January 1, 2004.

➤ The budget contains the governor's "triple-targeted" tax relief package, which entails increasing the child tax credit from $60 to $75 beginning January 1, 2002, and from $75 to $100, beginning January 1, 2003 – but also repealing the children's health insurance credit. The tax cut package also eliminates the marriage penalty (a cut of $500), effective January 1, 2003, for couples who file jointly. An annual sales and use tax holiday for clothing, school supplies, computers and other such items is established for the first weekend of August 2002.

➤ Even after the 2001 budget passes, Easley continues to hold back $142 million from state retirement funds; a hiring freeze begun in February likewise stays in effect. The governor also freezes $125 million in the repairs and renovations fund.

➤ Moody's retains its "negative outlook" rating for the N.C. economy.

➤ The telecommunications tax simplification bill passes (S.L. 2001-430). The measure applies a standard 4.5 percent tax rate on all telecommunications services and simplifies the distribution scheme of revenue to cities.

October

➤ In the aftermath of 9/11, the state's economy slows, bringing in lower than anticipated revenues.

➤ Governor Easley orders state agencies to cut their budgets by 4 percent. Medicaid, classroom instruction, and public safety programs are exempt from the mandate.

➤ As the General Assembly prepares to adjourn, Easley's push for a state lottery bill comes to an end for the time being. Acknowledges House Majority Leader Phil Baddour (D-Wayne), "[The lottery] is not being discussed in any real way. … It's just not on the front burner."

November

➤ Governor Easley says that the state must spend $13.6 million immediately in order to create seven regional bioterror response teams.

December

➤ A technical corrections bill (S.L. 2001- 487) passes that includes restoration of an electricity sales tax break for manufacturers – in particular, Alcoa Industries.

➤ The 2001 long session ends on December 6, 2001, having gone past the fiscal year end of June 30 by 159 days. The cost to taxpayers is at least $65,000 per day or some $10 million.

➤ Anticipated revenues for the first five months of FY2002 are down $189.4 million.

DID YOU KNOW?

Seventy-four percent of voters opposed the FY2006 budget, which increased spending by more than $1.2 billion and raised taxes by more than $900 million.

Source: August 2005 Civitas DecisionMaker Poll

2001 Significant Tax Changes (Budget Bill Unless Noted)

⬆	Tax gross premiums of HMOs and medical service companies [S.L. 2001-424, as amended by S.L. 2001-748]: ➔ New tax on HMOs of 1.1% in 2003 and 1.0% in later years; exempts HMOs from corporate income and franchise taxes ➔ Increase tax on medical service companies from 0.5% to 1.1% in 2003 and 1.0% in later years; these companies do not pay corporate or franchise tax
⬆	Create new 8.25% income tax bracket for highest income households (sunset after 2003 tax year)
⬆	Repeal children's health insurance tax credit (effective tax year 2001; tax increase of $19 million)
⬆	Enhance Department of Revenue debt collections (gain of $50 million each year) [S.L. 2001-380]
⬆	Accelerate tax payments: (mostly 1 year gain of $112 million) [S.L. 2001-427]
⬆	Taxes on spirituous liquor (net increase of $14 million in 2002-03): ➔ Impose 6% state sales tax (effective December 1, 2001) ➔ Reduce excise tax from 28% to 25% (effective February 1, 2002)
⬆	Remove $1,500 cap on highway use tax for most noncommercial vehicles; money goes to General Fund (gain less than $3 million)
⬆	Tax all telecommunications at 6% (gain of $35 million in 2001-02, $90 million in subsequent years) [S.L. 2001-430, as amended by S.L. 2001-424]; previous tax rate varied from 0.0% on interstate calls to 6.5% on intrastate calls
⬆	Impose 5% sales tax on satellite television service
⬇	Bill Lee Act changes, including new 30% tax credit for purchase or lease of real property [S.L. 2001-476]
⬇	Increase standard deduction for married filing jointly from $5,000 to $5,500 in tax year 2002 and to $6,000 in 2003 (tax reduction of $45 million by 2003-04)
⬇	Increase tax credit for children from $60 to $75 in tax year 2002 and to $100 in 2003 (tax reduction of $55 million by 2003-04)
⬇	Create sales tax holiday (reduction of less than $9 million state, $6 million local)
⬆	Authorize additional 1/2¢ local sales tax (local impact, effective July 1, 2003)

Nonmajor Special Revenue Funds

Fund	Assets on June 30, 2005
Clean Water Funds	$188,336,000
Clean Water Management Trust Fund	$217,624,000
Departmental Funds	$524,878,000
Ecosystem Enhancement Funds	$101,531,000
Educational Materials and School Buses Fund	$65,246,000
Employment and Training Administration Fund	$47,000
Employment Security Commission Funds	$12,259,000
Escheat	$838,356,000
Health and Wellness Trust Fund	$80,201,000
Higher Education and Public Improvement Bond Funds	$722,726,000
Highway Patrol Fund	$14,117,000
Leaking Petroleum Underground Storage Tank Cleanup Fund	$17,483,000
Natural Gas Funds	$246,216,000
Natural Heritage Trust Fund	$42,206,000
NC Infrastructure Finance Corporation	$268,920,000
Parks and Recreation Trust Fund	$39,556,000
Prison Enterprises Fund	$46,484,000
Public School Bond Fund	$16,215,000
Public School Building Capital Fund	$202,697,000
Tobacco Trust Fund	$12,026,000
Wildlife Resources Commission Fund	$26,275,000
Wireless 911 Fund	$18,471,000
Total	**$3,701,870,000**

A just security to property is not afforded by that government, under which unequal taxes oppress one species of property and reward another species: where arbitrary taxes invade the domestic sanctuaries of the rich, and excessive taxes grind the faces of the poor.

James Madison

2002 session

2002-2003 BIENNIUM
FY 2003: July 1, 2002 to June 30, 2003

General Assembly:

House Dems:	62	House Reps:	58
Senate Dems:	35	Senate Reps:	15

Governor:
Mike Easley (D)

The 2002 Short Session:
Budget Bill SB1115/S.L. 2002-126
Passed Senate: June 19, 2002
Passed House: August 13, 2002
Conference Version Ratified: September 20, 2002
Signed by Governor: October 1, 2002

As legislators began the 2002 short session they were greeted with increasingly gloomy news about a budget shortfall. Although the initial projected shortfall was $900 million, this number would grow to $1.6 billion, with the "April surprise" resulting in a 6 percent decline in revenue. Following Governor Martin's example from 1991, Governor Easley ordered state agencies to cut spending and proposed withholding tax reimbursement payments from counties and cities in return for accelerating the half-cent local option sales tax increase passed in 2001. As in 1991, the state was also warned that its bond rating might be downgraded. Unlike Martin, however, Easley actually did withhold local funds and Moody's Investors Service actually did downgrade the state's credit rating to Aa1.

2002 HEALTH & HUMAN SERVICES BUDGET

Total Appropriations	**$3.64 billion**
Major Items:	
Medical Assistance (Medicaid):	$2,219 million
Mental Health/D.D./Subst. Abuse:	$581 million
Child Development:	$289 million
Social Services:	$195 million
Public Health:	$104 million
Office of the Secretary:	$48 million

Having already raised taxes by a significant margin in 2001, Governor Easley was forced to consider cutting spending. He also found money to pay for current and new initiatives by raiding various funds, including the Highway Trust Fund and the Savings Reserve Account. While mandating across the board spending cuts for state agencies and departments, Easley called for continued increases in education – once more for class size reduction, hiring additional teachers, and More at Four. In an effort to use the so-called budget crisis to force the lottery through, Easley's budget anticipated millions of dollars (this time $250 million) in revenue from a lottery that did not even come close to passing in 2001.

In the end, the General Assembly agreed to fund the governor's education proposals.

While funds were appropriated to hire 1,000 new teachers, state jobs were cut and state workers did not receive a salary raise. Again, much of the budget deficit was resolved by raiding various state funds, like the Highway Trust Fund, and seizing local tax reimbursements, setting the stage for a massive $2 billion budget shortfall in 2003.

The General Assembly also accelerated the local option sales tax increase of one-half cent by pushing forward the implementation date for the tax from July 1, 2003, to December 1, 2002. Predictably, the "temporary" state sales tax was not reciprocally lowered to compensate taxpayers for the early tax increase.

In November, voters rejected the Democrats' handling of the budget shortfall by returning control of the House to Republicans and also electing seven more Republicans to the Senate.

January

- On the heels of the longest legislative session in history, North Carolina lawmakers start talking again about session limits. Senator Marc Basnight (D-Dare) contemplates that a "stopping point would have created a different work ethic."
- Governor Easley says there could be a budget shortfall of up to $900 million for 2002.

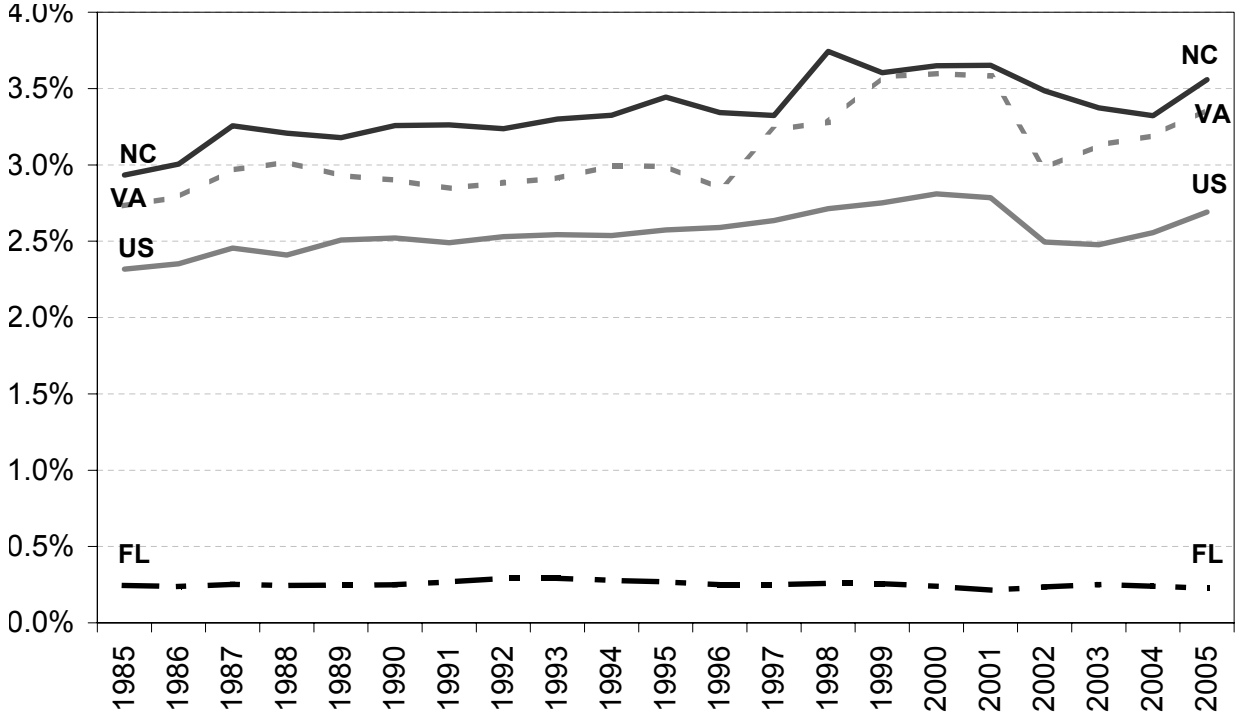
February

- Continuing to cite the state's tax structure as one of the causes of budgetary woes, Governor Easley appoints a Commission to Modernize State Finances. Comprised of legislators and businessmen, the commission will look at ways to "simplify" and "update" the tax code.
- Anticipating a projected $900 million shortfall, Easley declares the second "budget emergency" of his administration. Subsequently, the governor orders most state agencies (but not education) to cut spending by 3 percent (on top of the four percent ordered in October 2001). In addition, the governor moves to seize $313 million from the Savings Reserve Account, $80 million from the Highway Trust Fund, $37.5 million from the Mental Health Trust Fund, and $20.8 million from the Clean Water Management Trust Fund.

> This budget is going to be out of balance just like the year before and the year before that and the year before that. This is the fourth failed budget passed by this General Assembly in a row.
>
> Rep. Art Pope (R-Wake), September 2002

More than $200 million in taxes owed to local governments – e.g., inventory taxes, taxes on utilities, beer and wine – are also withheld by the governor.

State/Local Taxes as Share of Personal Income: Select Southeast States, 1985-2005



NOTE: This figures does not include sales tax, but is the standard measure used by the Bureau of Economic Analysis for "personal current taxes." As such, it includes income taxes and taxes on personal property.

March

- The UNC Board of Governors approves an 8 percent tuition increase for in-state students and a 12 percent increase for out-of-state students. UNC Chapel Hill tuition will rise by 18 percent; NC State University by 16 percent; and NC Central University tuition by 14 percent.

April

- Moody's Investors Service gives North Carolina a second warning and places it on its Watchlist because of successive years of budget shortfalls.

May

- According to the N.C. Department of Revenue, tax collections are down 6 percent. Comments Principal Fiscal Analyst David Crotts about the impending shortfall: "Everybody has hoped it would not be as bad as 1991, and it had not been until April."

- Legislative leaders project that the revenue shortfall could reach $1.6 billion.

- The governor's proposed budget includes the following reductions: cutting $726 million overall from state programs; no raises for state workers; and cutting over 2,600 jobs – 1,400 of which are filled. The budget increases spending in the following areas: hiring up to 600 new public school teachers, a 1.84 percent raise for teachers, $28

million for More at Four, $26.2 million to reduce class sizes in elementary education, and the hiring of over 600 new corrections officers.

➤ Easley intends to balance his budget by cutting state jobs, transferring $210 million from the Highway Trust Fund, keeping $200 million in reimbursements owed to cities and counties, and using $250 million in revenue from a nonexistent state lottery.

➤ Backpedaling from the "triple-targeted tax relief" he promised to North Carolina's "hardworking families," Easley advocates repealing the tax cuts that were passed in 2001 in return for temporarily raising the sales tax by one-half cent.

June

➤ Governor Easley emphasizes that a lottery is needed to fund education programs. Referring to North Carolina citizens who cross the border to play the South Carolina lottery, Easley charges: "Right now we're building schools in South Carolina while our children are in trailers."

➤ A draft of a House budget model anticipates a $1 billion to $2 billion annual shortfall through 2006-07.

➤ The Senate proposes resolving the budget shortfall by raising taxes. The resulting tax package (SB 1292) includes the following: raising various court fees and fines, delaying the sales tax holiday for a year, delaying the elimination of the marriage penalty for one year, and delaying the child tax credit for one year. The package also offers to swap inventory tax reimbursements to counties and cities in exchange for allowing them to increase the local sales tax by one-half cent in August 2002 – instead of July 2003 as planned.

2002 Other Significant Changes

GENERAL REDUCTIONS

- Reduction of $25 million by implementing Governor's Efficiency Commission recommendations
- Statewide *recurring* management flexibility reserve of $42 million
- Department-specific negative reserves and line-item reductions

PRISON INCREASES

- Operating funds for new prisons and funds for inmate medical costs

REVENUE

- S.L. 2002-120 (as amended by Section 65 of S.L. 2002-159) prohibits the governor from withholding or impounding local revenues

➤ Senator Ellie Kinnaird (D-Orange) files a bill (SB 1314) to raise the cigarette tax from 5 cents a pack to 50 cents per pack.

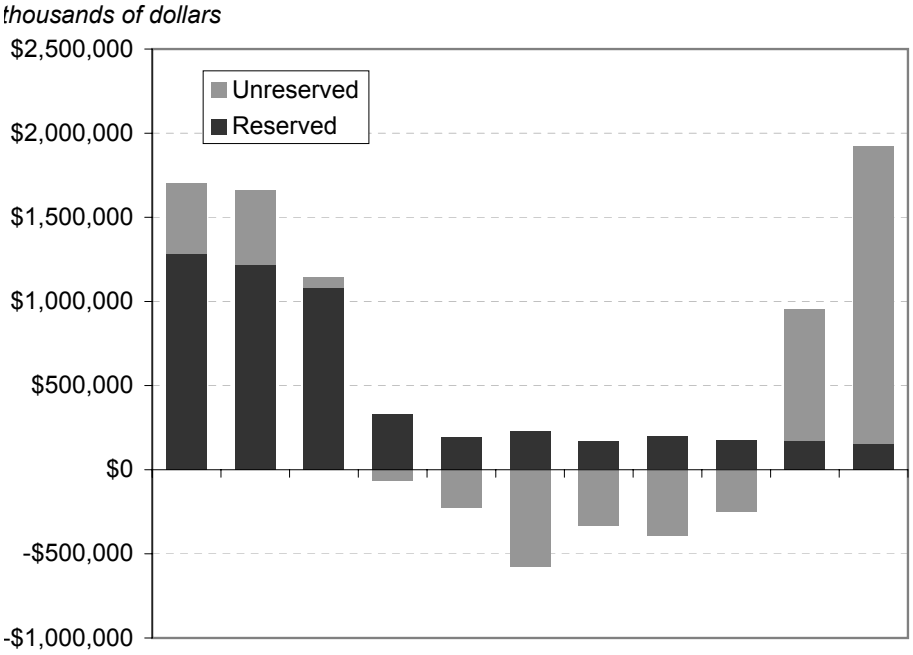
➤ Representative Mickey Michaux (D-Durham) files a bill (HB 1547) to raise the cigarette tax to $1 per pack. Neither Kinnaird's bill nor Michaux's bill passes.

➤ Governor Easley takes $150 million from the Hurricane Floyd relief fund and $50 million from the Tobacco Trust Fund in order to have cash on hand to pay for the final weeks of the fiscal year.

➤ The Senate approves its $14.2 billion budget. In order to close what is a $1.55 billion shortfall for

FY2002, the Senate recommends transferring $205 million from the Highway Trust Fund, taking $120 million from three different tobacco settlement funds and seizing $100 million from the Hurricane Floyd relief fund. Teachers will receive a 1.8 percent raise, state workers receive no raise, and there will be tuition increases of 8 percent for in-state students and 12 percent for out-of-state students.

General Fund Balances: 1997-2007



➤ The Senate does not provide expansion funding for Easley's More at Four program.

➤ Governor Easley declares a financial emergency for FY2002-03. The order grants him special powers to cut spending and order layoffs without having a new budget in place.

July

➤ The Senate passes a House toll road and bridge authority bill that was not acted upon by the Senate in 2001, but carried over into the 2002 short session (SB 701).

➤ The House rejects the Senate's local sales tax acceleration bill that would raise the local sales tax by one-half cent on August 1, 2002 (SB 1292).

➤ Governor Easley cuts 2,600 state jobs, saying: "The longer we wait to make the cuts, the bigger the budget hole grows."

➤The House approves its own $322 million tax package. The proposal requires voter approval for a plan in which the local option sales tax would increase one-half cent by January 1, 2003, in exchange for reducing the state sales tax by one-half cent on January 1, 2003. Thus the overall sales tax would remain the same while allowing local governments to recoup lost revenue. By contrast, the Senate proposal raises the overall tax rate by one-half percent.

August

➤ The House approves a $14.3 billion budget. The budget provides for a 1.84 percent raise for teachers but no raise for state workers; tuition increases of 8 percent for in-state students and 12 percent for out-of-state students; $56.3 million

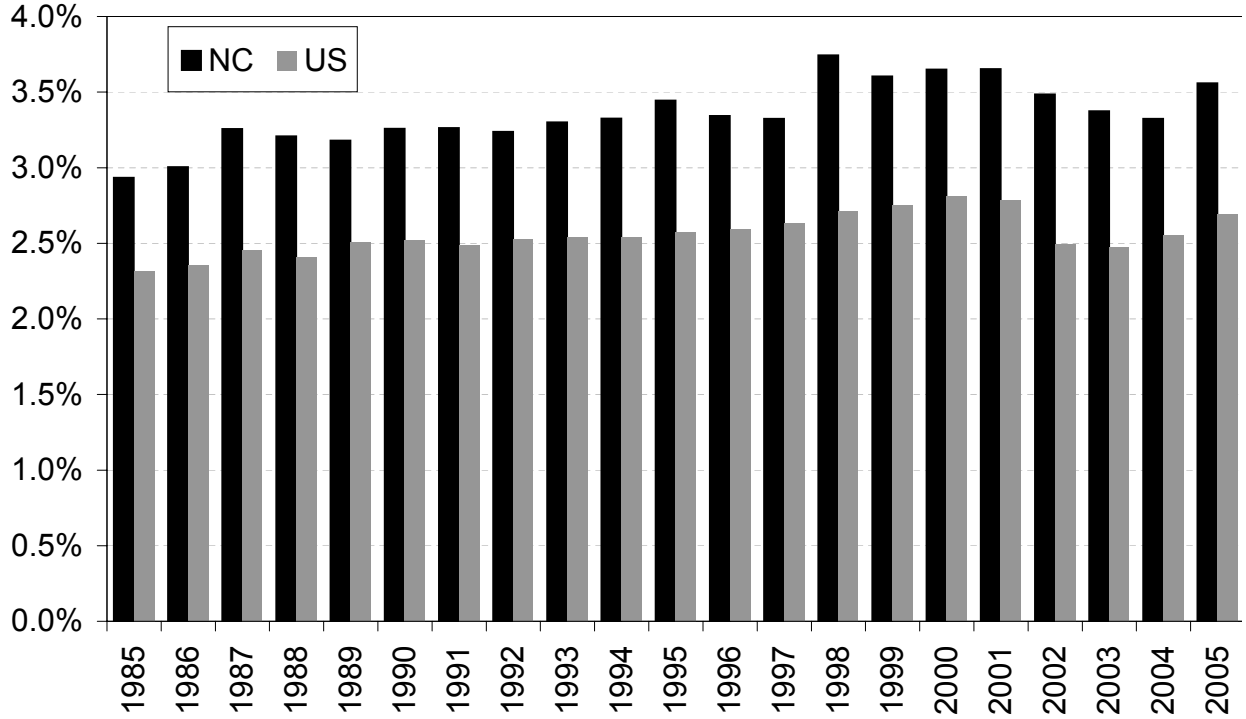
for class size reduction; and $28 million for Easley's More at Four program.

- Moody's downgrades North Carolina's bond rating from Aaa to Aa1. Moody's indicates in a letter to the state that a lottery or additional sales tax increases would raise more revenue, thus helping North Carolina regain its Aaa rating.
- Easley employs Moody's letter as a weapon in his lottery fight with legislative leaders, claiming Moody's is "very high on state lotteries, their stability and predictability."
- House Minority Leader Leo Daughtry (R-Johnston) says the downgrade is "like giving us a black eye. … We've spent all our resources, had three years of deficits and simply have not been able to control the rate of growth."
- With the "short" session drifting into September, House Speaker Jim Black (D-Mecklenburg) revises his earlier position on a constitutional amendment limiting sessions. "I've changed my mind about session limits," claims Black. "It does give people deadlines."

September

- A House session limit bill (HB 280) proposes limiting the long session to 135 days and the short session to 60 days. The bill is defeated 59 to 54.
- The House defeats a lottery bill sponsored by Representative Bill Owens (D-Pasquotank) (HB 1676).

State/Local Taxes as Share of Personal Income: North Carolina vs. U.S. Average, 1985-2005



2002 Significant Tax Changes (Budget Bill Unless Noted)

⬆	Delay 2001 tax breaks (standard deduction/marriage penalty, increase in child tax credit)
⬆	Broaden definition of business income
⬆	Close loophole in LLC franchise tax
⬆	Repeal reimbursements to local governments
⬆	Accelerate the local 1/2¢ sales tax option [S.L. 2002-123]
⬆	Conform to Internal Revenue Code changes (pensions and education, estate tax credit, accelerated depreciation)
⬆	Project *Tax Collect*

2002 Other Revenue Sources & Actions

•	Increase transfer from Highway Trust Fund to $252 million; "borrow" additional $125 million from HTF; transfer $15 million from Highway Fund
•	Divert MSA settlement proceeds from Tobacco Trust Fund ($38 million), Health & Wellness Trust Fund ($40 million)
•	Transfer Special Funds ($20 million)
•	Fee increases ($38 million)
•	**++Total Nonrecurring Revenue Generated: $223 million++**

- ➤ The General Assembly passes the $14.3 billion budget bill (S.L. 2002-126). The budget cuts over 800 state jobs and increases tuition for the UNC system by 8 percent for in-state students and 12 percent for out-of-state students. The new budget, however, also increases spending in several areas: teacher raises of 1.84 percent; 1,000 new teacher hires; $28 million for More at Four; and $27 million to cut class sizes.
- ➤ The 2002 budget postpones the tax cuts passed in 2001: shifting the increase of the child tax credit from $60 to $75 to January 1, 2003, and the increase of $75 to $100 to January 1, 2004. The elimination of the marriage penalty is also postponed by one year.
- ➤ In order to balance the budget, the General Assembly uses $800 million in nonrecurring revenue, thus creating a budget gap for next year. Laments Speaker Black about the budget: "There is a hole for next year. We'll have to get very innovative if the revenue doesn't come."
- ➤ Commenting on the upcoming vote in the House on the Senate proposal to raise the local sales tax by one-half cent, Representative Dan Blue (D-Wake) says that the bill's "fate is already determined, and it is doomed."

- Citing the state's inability to meet the demand for new roads and repairs, the General Assembly creates the North Carolina Turnpike Authority, which is supposed to be an independent public agency within the Department of Transportation (S.L. 2002-133). The Turnpike Authority is charged with planning, operating and maintaining three toll turnpike projects.

- After rejecting the same bill in July, the Democrat-controlled House reverses course and plays Scrooge by approving an increase in the local option sales tax beginning December 1. The Senate ratifies the bill and Easley signs it (S.L. 2002-123). As a result, the overall sales tax (in most counties) increases to 7 percent. This rate will ultimately remain in effect until July 2006, when the so-called temporary sales tax is finally cut by one-quarter percent.

October

- With elections one month away, Republican candidates promote a "Spending Control Act" that would limit spending to a formula tied to inflation, population, employment and economic growth.

November

- Republicans pick up three seats in the House to win a tenuous one-vote majority with 61 seats. Republicans gain seven seats in the Senate, shrinking the Democratic advantage to 28-22.

- Elizabeth Dole breaks the two-cycle Democratic win streak on major statewide elections by beating former Clinton Chief of Staff Erskine Bowles by 54 percent to 45 percent in the race for retiring U.S. Senator Jesse Helms' (R) seat.

- Governor Easley issues the first veto in North Carolina history by rejecting a bill (SB1283) regarding state commission appointments made by President Pro Tempore Marc Basnight and House Speaker Jim Black. Easley cites concerns that a number of Basnight's and Black's appointees are unqualified.

- Basnight reacts sharply to the governor's veto. Comments Basnight: "If the governor wants us to come back and fix the appointments, we will come back and fix the appointments." But, notes Basnight, it will cost $65,000 per day for the General Assembly to return to session – which, he claims, could add up to more than the cost of hiring the legislative leadership's appointments.

- House Minority Leader Leo Daughtry likewise calls the veto "bizarre."

- The Senate and House reconvene in a special veto session. Instead

DID YOU KNOW?

North Carolina was one of four states to raise total taxes by more than 1 percent in 2001, with a temporary half-cent sales tax increase, an increase in upper-end income tax rates, a new liquor tax and a levy on health maintenance organizations.

Source: *Governing* magazine, Feb. 2003

2002 EDUCATION FUNDING

ENROLLMENT CHANGES

- Public Schools: 21,117 (1.4%) increase
- Community Colleges: 10,427 (1.3%) decrease
- UNC: 7,175 (4.2%) increase

TUITION & FEE INCREASES

- Average increase of 17% for in-state and 14% for out-of-state UNC students
- Increase community college tuition by 10%

OTHER EDUCATION CHANGES

- Transfer of $45 million in capital funds to support school operations
- One-time reduction of $43 million in funds to local education agencies (LEAs); cuts to be taken at the discretion of LEAs
- Reduction of $20 million by switching to a lease-purchase plan for school buses
- Eliminate 412 non-instructional positions
- $101 million for ABC bonuses earned in 2001-02
- $27 million to reduce class size in grade 1
- Recurring reduction of $50 million to UNC (cuts to be taken at campuses' discretion)
- Judge Manning rules that the state is solely responsible for meeting the needs of all children and directs the state to provide written reports every 90 days on the steps taken to comply with his order
- State attorney general appeals Manning's ruling that the state has failed to provide equal educational opportunities to all children

of attempting to override Easley's veto, the General Assembly sends the bill back to committee and adjourns after officially meeting for just a few minutes.

➤ Leo Daughtry is the leading candidate for speaker, but faces opposition from some members. Believing Daughtry is ill suited for the task, Representative Richard Morgan (R-Moore) states his intention to run for speaker. "If we're going to elect a speaker, we've got to find somebody who is able to unify our caucus."

➤ Easley's Commission to Modernize State Finances recommends reducing or eliminating tax credits as an incentive for business recruitment. The commission also recommends expanding the sales tax so that it taxes services.

December

➤ The half-cent local option sales tax increase goes into effect. The overall sales tax is 7 percent, as of December 1, 2002.

ACROSS-THE-BOARD SALARY COST FOR EACH 1% INCREASE (MILLIONS)

YEAR	GENERAL FUND	HIGHWAY FUND
1971-72	8.40	$1.17
1972-73	8.43	1.17
1973-74	10.13	1.35
1974-75	12.27	1.51
1975-76	No Increase Granted	
1976-77	13.91	1.73
1977-78	15.79	1.84
1978-79	17.44	2.01
1979-80	18.86	2.13
1980-81	21.29	2.26
1981-82	25.14[a]	2.51[a]
1982-83	No Increase Granted	
1983-84	25.97	2.57
1984-85	27.60	2.70
1985-86	32.10	2.50
1986-87	36.45	2.66
1987-88	40.84[b]	2.72
1988-89	45.40	2.93
1989-90	47.75	2.93
1990-91	55.90	3.35
1991-92	No Increase Granted	
1992-93	54.11	3.39
1993-94	55.75	3.48
1994-95	58.28	3.64
1995-96	63.56	3.96
1996-97	66.77	3.98
1997-98	70.22	4.19
1998-99	75.33	4.64
1999-00	80.69	4.00
2000-01	86.45	4.33
2001-02	89.73	4.32
2002-03	91.05[c]	4.19
2003-04	91.35[d]	4.15
2004-05	95.13	4.37
2005-06	100.61	4.56
2006-07	106.89	4.79

a Figure reflects annual cost, even though the increase was not effective until January 1, 1982.

b Figure does not reflect adjustment to offset anticipated savings from the tax sheltering of employee Health Benefits from Social Security tax.

c No across-the-board salary increases were funded by the General Assembly for employees in the 2002-03 fiscal year except for the salary step increases funded for teachers and school-based administrators.

d No across-the-board salary increases were funded by the General Assembly for employees in the 2003-2004 fiscal year except for the salary step increases funded for teachers and school-based administrators and a one-half percent (.5%) average salary increase for Community College faculty and professional staff.

2003 session

2003-2004 BIENNIUM
FY 2004: July 1, 2003 to June 30, 2004

General Assembly:

House Dems:	60	House Reps:	60
Senate Dems:	28	Senate Reps:	22

Governor:
Mike Easley (D)

The 2003 Long Session:
Budget Bill HB397/S.L. 2003-284
Passed House: April 17, 2003
Passed House: April 30, 2003
Conference Version Ratified: June 30, 2003
Signed by Governor: June 30, 2003

Republicans began the year readying themselves for majority party status in the House only to lose the majority when Representative Michael Decker (R/D-Forsyth) abruptly switched party affiliation to become a Democrat. (Decker subsequently claimed he was bribed by House Speaker Jim Black (D-Mecklenburg) to switch parties.) Decker's perfidy led to a 60-60 tie in the House that was resolved by splitting the speaker's position and duties between Representative Jim Black and Representative Richard Morgan (R-Moore). Many predicted the new power-sharing agreement would cause even greater legislative gridlock, but as it turned out the budget was passed before July 1 for the first time in three years.

The House won the budget battle for 2003 by enacting two tax breaks opposed by the governor and the Senate: a $15 increase that raised the child tax credit from $60 to $75, as well as a phasing out of the marriage penalty. Both cuts were initially passed in 2001 and scheduled to go into effect in 2002; however, the Democratic-controlled General Assembly delayed the implementation of the cuts until 2003. Facing another budget shortfall, this time of $2 billion, Easley and the Senate favored delaying the cuts once more.

After an audit of Smart Start found that funds for the program were being mismanaged, the House was also able to push through a reduction in funding for Smart Start – albeit not the 10 percent cut initially sought. (The subsequent increase in funding for More at Four, though, was virtually identical to the decrease in funding for Smart Start.) The General Assembly also successfully fended off the governor's now annual attempt to push through an "education lottery" in order to help close recurring budget shortfalls. Following Hunt's example, Governor Easley called two special sessions. The first was related to malpractice lawsuits. The second special session was devoted to corporate

welfare and resulted in the passage of a tax incentive package for Merck & Co., Inc. to build a new vaccine plant in Durham and for R.J. Reynolds to expand its operations in Winston-Salem.

January

- A 20 percent increase in habitual-felon convictions in 2002 exacerbates prison overcrowding, despite the expected completion of three new prisons in 2003.
- As part of a lawsuit filed against Governor Easley and the General Assembly in November 2002, former state Transportation Secretary Jim Harrington (R) and former state Senator William Goldston (D-Rockingham) ask for a preliminary injunction prohibiting any further transfers of money from the Highway Trust Fund to the General Fund.
- Representative Michael P. Decker changes party affiliation from Republican to Democratic creating a 60-60 tie in the House. When asked if he struck a deal with Jim Black, Decker replies: "I didn't ask and he didn't offer."
- The legislative session begins with no speaker.
- Governor Easley seeks to take back the "triple-targeted" tax relief he promised to the "hardworking families" of North Carolina in 2001. "You are probably going to have to freeze the tax structure right now," warns the governor, [until we] "can get a better grip" on the tax system. In particular, Easley proposes renewing the so-called temporary state sales and income tax increases that are supposed to expire on July 1, 2003. He also again proposes postponing the increase of the child income tax credit (from $60 to $75) that was passed in 2001, as well as the elimination of the $500 marriage penalty.
- In spite of the $2 billion deficit, the governor also plans to ask for $25 million for More at Four and to reduce class sizes. "Those two efforts eliminate the achievement gap," explains Easley. "That's where the Hispanic kids learn English and get mainstreamed."

2003 Other Significant Changes

COMPENSATION

- One-time bonus of $550 for most state employees
- Less than 2% salary increase for teachers and principals
- $113 million increase in appropriation for state employees health plan

CLEAN WATER MANAGEMENT TRUST FUND

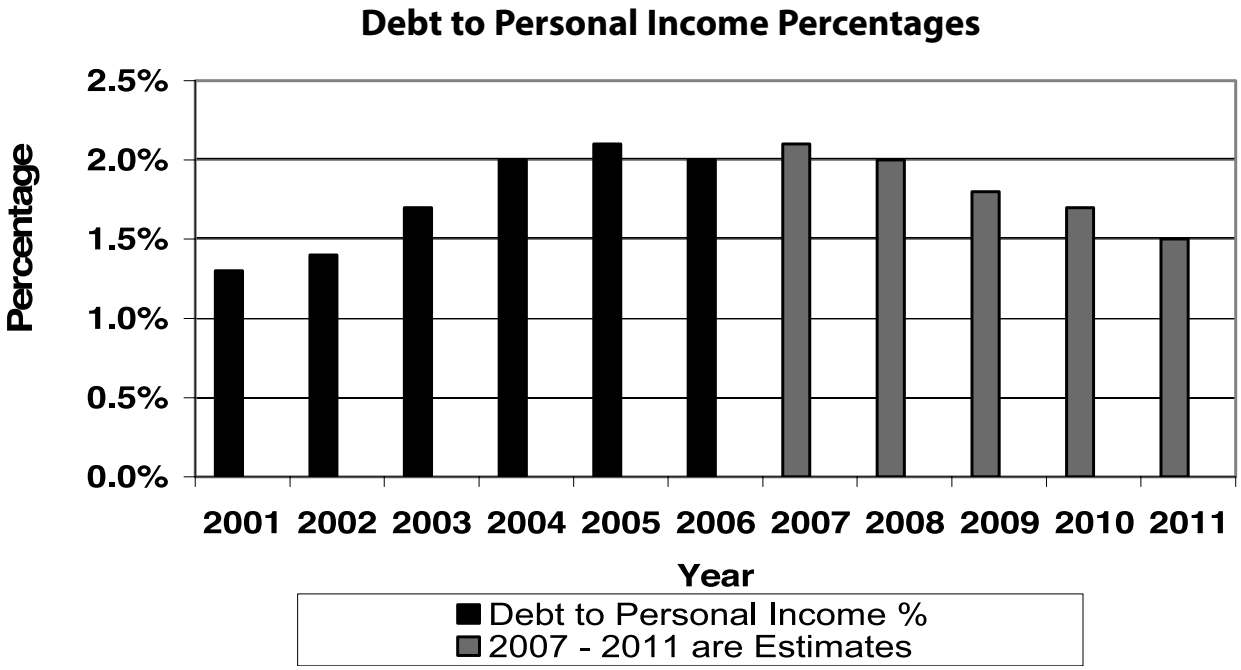
- 38% reduction ($38 million) in appropriation to fund for 2003 and 2004

CAPITAL

- $28 million for capital projects
- Authorize purchase of 2 privately-owned prisons and use of lease-purchase to finance 3 new prisons (estimated construction cost $344 million to $364 million)
- Authorize financing of $491 million for UNC projects, $110 million for a psychiatric hospital in Butner, and $300 million for state facilities and related infrastructure

LOCAL GOVERNMENTS

- Authorize local option project development financing (constitutional amendment must be approved by voters to take effect)
- Authorize counties to create special economic development and training tax districts



February

➤ Five Republicans join with Democrats to elect Representative Jim Black and Representative Richard Morgan as co-speakers of the House. Under the power-sharing agreement, Black and Morgan will alternate days as speaker and all committees will have equal membership. While most committees will have Republican and Democratic co-chairs, the powerful Rules Committee will be chaired by only one legislator: Representative Bill Culpepper (D-Chowan). The Appropriations Committee will be chaired by four Democrats and four Republicans, the "Gang of Eight."

➤ Co-speaker Black grants Representative Michael Decker one of the coveted 12 administrative assistant positions on the speaker's staff. Decker hires his son for the $46,496 per year job.

➤ Black defends the generous allotment to the former Republican saying, "There was absolutely no payoff to Michael Decker."

March

➤ In his State of the State address Governor Easley asks the General Assembly to enact session limits, limit spending, give the governor a line-item veto and pass his lottery bill.

➤ Easley releases his $15 billion budget. In spite of an anticipated $2 billion budget shortfall, the governor increases spending for his two pet projects: $25 million for class size reduction and $8.6 million for More-at-Four. Easley also proposes giving teachers a 1.8 percent raise and state workers a 1.6 percent raise. To pay for the new spending and to make up the budget shortfall, Easley's budget contains the tax increases he proposed in January.

2003 EDUCATION FUNDING

ENROLLMENT CHANGES

- Public Schools: 21,569 (1.7%) increase
- Community Colleges: 14,878 (1.9%) increase
- UNC: 6,380 (3.6%) increase

TUITION & FEE INCREASES

- Average increase of 6% for in-state and 5% for out-of-state UNC students
- Increase of 5% for in-state and 3.5% for out-of-state community college students

OTHER EDUCATION CHANGES

- Net reduction to public schools of $52 million in 2003 and $176 million in 2004
- Net reduction to UNC of $44 million in 2003 and $35 million in 2004
- Recurring reduction of $44 million in funds to local education agencies (LEAs); cuts to be taken at the discretion of LEAs
- Eliminate 533 non-instructional positions and 173 vocational education positions
- $96 million for ABC bonuses earned in 2002-03
- $25 million to reduce class size in grade 2
- $48 million recurring reduction and $14 million nonrecurring reduction to UNC (cuts to be taken at campuses' discretion)
- $11 million recurring reduction to community colleges (to be taken at campuses' discretion)
- N.C. Supreme Court hears the state's arguments for throwing out Judge Mannning's rulings and remedies related to the *Leandro* case

➤ Both chambers file bills to raise the cigarette tax. Although a total of seven separate bills are filed during the session, every bill dies in committee.

➤ Co-speakers Black and Morgan direct House legislators to draft and pass a budget by April 18.

April

➤ Co-speakers Black and Morgan move to reduce Easley's tax increases. In particular, they agree to re-enact the sales tax increase and the income tax increase, but permit the child tax credit and the marriage penalty deduction. As a result, the two tax cuts are permitted to go into effect as scheduled.

➤ An audit of Smart Start, Jim Hunt's pet day care/early education program for children under age six, finds that local offices are mismanaging funds. Some offices spent funds on building improvements and renovations, despite a freeze on capital spending. One office even purchased a dentist's office for $170,000 and hired a dentist for $10,000 per month. After questions arose regarding the dentist's quality of care, the contract was terminated. The purchase of the office is defended as a means of helping children 18 and under obtain quality healthcare.

➤ House budget writers cut $9 million from Smart Start.

➤ The House passes a $15 billion budget bill by the April 18 deadline. The budget includes the following items from Easley's recommended budget: a teacher pay raise of 1.81 percent, a 1.6 percent state worker raise, $23 million (instead of the recommended $25 million) for class size reduction, and $8.6 million for More at Four.

➤ The House budget also increases UNC tuition 5 percent for both in-state and out-of-state students, cuts $75 million in annual appropriations for the Clean Water Management Trust Fund,

implements a $15 increase to the child tax credit and includes the $500 increase to the deduction for married couples.

➤ Former House leader Leo Daughtry (R-Johnston) defends his vote against the budget. "[It] raises taxes," says Daughtry, "and I cannot support it."

➤ The Democratic Senate passes its own $15.1 billion budget bill. It delays all of the tax cuts scheduled for the year, allocates $25.3 million for class size reduction, $8.6 million for More at Four, cuts Smart Start by $7.7 million, and raises UNC tuition by 5 percent.

➤ The Senate also proposes diverting tobacco settlement funds to help close the budget shortfall.

May

➤ The "April surprise" is $400 million below forecasts, meaning both chambers will have to revise their respective budgets to account for the additional shortfall.

2003 HEALTH & HUMAN SERVICES BUDGET

Total Appropriations	**$3.38 billion**
Major Items:	
Medical Assistance (Medicaid):	$1,987 million
Mental Health/D.D./Subst. Abuse:	$577 million
Child Development:	$259 million
Social Services:	$179 million
Public Health:	$124 million
Office of the Secretary:	$82 million

➤ President Bush's new federal tax plan gives North Carolina an unexpected injection of $510 million in immediate federal aid. The tax plan is approved in a deal where the federal government will offer emergency relief funds to financially strapped states.

➤ In light of lower-than-anticipated April projections, as well as the increase in federal aid, the House revises its budget downward to $14.8 billion. Among other items, Medicaid spending is cut by $200 million.

➤ Governor Easley notifies legislative leaders that he anticipates a further loss of $55 million in revenue due to weak economic growth.

June

➤ Governor Easley vetoes a bill (SB 931) that would transfer power over teacher certification from the State Board of Education to the General Assembly. Explains Easley: "A section of the bill would strip the authority to set higher standards from the state board that has overseen the most gains in education in the country, and would put it in the political arena. Education is too important to be politicized."

➤ The Senate readjusts its budget to account for the April revenue statement shortfall, but instead of cutting spending, the budget raises "sin taxes" on cigarettes and alcohol by $330 million. The new Senate budget – at $15.6 billion – is even larger than the original.

When asked about the $767 million in tax increases and delayed tax breaks included in the revised Senate budget, Senate President Pro Tempore Marc Basnight (D-Dare) declares: "We did what was responsible."

➤ Budget negotiations between the House and Senate stall over Senate proposals to raise taxes on cigarettes and alcohol. If an agreement is not reached by June 30 the state sales tax decrease of

2003 Significant Tax Changes (Budget Bill Unless Noted)

↑	Maintain 4.5% state sales tax rate
↑	Maintain 8.25% income tax for top income tax bracket
↑	Conform to federal definition of "child" for state child tax credit
↑	Equalize insurance tax rate on Article 65 corporations
↑	Conform to streamline sales tax provision for soft drinks, prepared food, and modified software (net revenue increase)
↑	Adjust bonus depreciation (revenue loss in 2003, gain in 2004)
↑	Extend sunset on partial conformity to federal estate tax
↑	Revenue projects *Tax Collect* and *Compliance*
↓	Tax reductions for federal conformity [S.L. 2003-25]
↓	Tax soft drinks in vending machines at 50% of general sales tax rate

2003 Other Revenue Sources & Actions

•	Increase Highway Trust Fund transfer to $252 million; transfer $18 million from Highway Fund
•	Divert MSA settlement proceeds from Tobacco Trust Fund ($40 million), Health & Wellness Trust Fund ($25 million), other ($1.8 million)
•	Discontinue tobacco and alcohol discounts ($5.4 million)
•	Fee increases ($5.7 million)
•	Settlement Funds ($10 million)
•	Divert proceeds from 911 Fund ($33 million)
•	Transfer Special Funds ($20 million)
•	Federal Relief Package grant ($137 million)
•	Hurricane Floyd Disaster Relief Fund ($109 million)
•	Other sources of G.F. revenue: investment income, judicial fees, Medicaid Disproportionate Share, insurance, sale of surplus real property
	++Total Nonrecurring Revenue Generated: $386 million++

one-half cent will go into effect on July 1.

- Governor Easley expresses his support for the House tax package.
- The budget impasse ends with the House and Senate agreeing to extend the half-cent state sales tax another two years. They also agree to renew the .50 percent "temporary" personal income tax increase and to increase the soft drink tax, and allocate $25.3 million to Easley's class-size reduction program and $8.3 million to More at Four. Smart Start is cut by $7.7 million. Teachers receive Easley's proposed 1.8 percent salary increase and state workers receive a one-time bonus of $550.
- Even as the House and Senate agree to the $14.8 billion budget, Easley threatens to veto the bill. "This budget is not balanced, this budget is not real, this budget has no integrity and I will veto this budget," he claims.
- Unwilling to risk letting the "temporary" taxes he imposed expire on July 1, Easley nevertheless signs the budget bill (S.L. 2003-284; but cf. S.L. 2003-283).

July

- The General Assembly passes a bill delaying the 20 percent unemployment insurance surtax on businesses (S.L. 2003-405). Normally the surtax is triggered when the Employment Security Reserve Fund falls below $163 million. The legislation adds further criteria to prevent the surtax trigger. As long as the Unemployment Insurance Fund (the larger of the two unemployment funds) is $500 million or less the surtax will not be charged.

August

- Governor Easley vetoes his second bill of the year. The bill (HB 917) would have increased mortgage loan fees from 1 percent to as high as 3 percent. In rejecting the bill, the governor declares that it "has no economic benefit to North Carolina or our working families."
- In response to the governor's veto, the General Assembly meets in a "skeleton session" to refer the dead bill back to committee.

September

- The Senate meets in special session between September 15-16 to consider legislation regarding medical malpractice lawsuits. The resulting bill (SB 802) amends the rules of evidence and creates a method to curb runaway jury verdicts. In particular, both parties in a lawsuit would be required to submit an estimate of damages for consideration by the jury.
- The House declines to return to pass the malpractice bill and

DID YOU KNOW?

Eighty-six percent of voters stated they would be less likely to vote for a candidate who increased taxes when the state already enjoyed a budget surplus.

Source: September 2005 Civitas DecisionMaker Poll

decides to consider it next May. The bill is subsequently not passed.

October

- The state's proficiency and achievement test results somehow skyrocket from 35 percent in 2002 to 73 percent in 2003. As a result, more teachers earn bonuses than the Legislature initially anticipated, causing a shortfall of $44 million.
- While his 2003 budget recommended renewing the "temporary" sales tax and income tax increases passed in 2001, Governor Easley says he wants "to see the corporate tax rate come down from 6.9 percent."

November

- Easley announces that General Electric will be moving its nuclear division headquarters to North Carolina.

December

- Governor Easley calls for a special one-day session on job creation that will focus on attracting business to North Carolina. The governor justifies this latest round of corporate incentives by explaining: "We are poised to bring some high quality jobs and industry to the state, but we need to make some additional changes to secure them."
- The General Assembly approves two multimillion corporate welfare packages for R.J. Reynolds and Merck (S.L. 2003-435). R.J. Reynolds will receive a $126 million cigarette export tax credit over 13 years while Merck will get $36.8 million for land acquisition and tax breaks on building material and equipment.

2004 session

2003-2004 BIENNIUM
FY 2005: July 1, 2004 to June 30, 2005

General Assembly:

House Dems:	60	House Reps:	60
Senate Dems:	28	Senate Reps:	22

Governor:
Mike Easley (D)

The 2004 Short Session:
Budget Bill HB1414/S.L. 2004-124
Passed House: June 8, 2004
Passed Senate: June 24, 2004
Conference Version Ratified: July 17, 2004
Signed by Governor: July 20, 2004

The year began with signs that the economy was improving. With the "temporary" sales and income tax increases still in place, tax revenues brought in a budget surplus. Gearing up for reelection, Governor Easley proposed an "adjusted" budget that was $1.1 billion more than the biennial budget passed the previous year. Predictably, much of the new spending was devoted to education – in particular, for class size reduction and More at Four. With Democrats in control of the Senate and Republicans divided in the House, the General Assembly passed the budget in July.

In the November election, Governor Easley won a second term by defeating former state Senator Patrick Ballantine (R). Republicans also lost seats in the House and Senate giving full control of the House back to the Democrats. In the race for U.S. Senate, former U.S. Representative Richard Burr (R) defeated former Clinton Chief of Staff Erskine Bowles (D) to give the Republican party control of both of North Carolina's U.S. Senate seats.

In December Governor Easley called the General Assembly into special session to pass a tax incentive package especially for the computer manufacturer Dell. The package was passed in one day by the General Assembly.

January

- State budget analysts report that despite an increase in tax revenues that puts North Carolina $25.8 million ahead of the six-month, $7 billion revenue target, lawmakers could find themselves $900 million short by the spring. Cautions David Crotts, principal fiscal analyst for the General Assembly: "We've seen some dramatic improvement in the economy-based revenues in recent months. But by all means, we're not out of the woods yet."
- The UNC Chapel Hill Board of Trustees

votes to raise out-of-state tuition $1,500 and in-state tuition $300. If the tuition and fee increases are approved the university will augment its budget by $15 million.

February

➤ Governor Easley unveils a plan to attract more biotech companies to North Carolina. The plan includes: adding $15 million per year to the One North Carolina Fund, which is used by the governor to provide incentives to companies seeking to locate or expand in North Carolina; creating additional income tax credits for investors; and adding $10 million to university endowments from state education funds.

March

➤ The community college system assails Governor Easley's call for budget cuts between 1 and 3 percent. "For the community colleges, each percentage cut is a slashing of resources already stretched to the limit," states a press release issued by the colleges.

April

➤ House Co-speaker Black indicates that he does not think there is much interest in raising the cigarette tax.

➤ Governor Easley tells legislators he will not raise the cigarette tax in his budget proposal.

➤ A bipartisan group of legislators seeks to exempt small businesses from paying taxes on the first $10,000 to $20,000 of annual income. The proposed reduction is offered as an alternative to Governor Easley's plan to cut the corporate income tax from 6.9 percent to 5.9 percent.

➤ Even as he calls for an expansion of the state's corporate welfare program, Easley says he will support a tax exemption for small businesses only if it can be shown to be "fiscally responsible."

May

➤ Dave Crotts projects that the state will end up with a $190 million surplus for the year but cautions that this does not signify a major economic rebound.

➤ In reference to the unexpected surplus, House Co-speaker Black comments that "$200 million will generate $2 billion in requests."

2004 EDUCATION FUNDING

ENROLLMENT CHANGES

- Public Schools: 20,846 (1.6%) increase
- Community Colleges: 18,122 (2.3%) increase
- UNC: 6,268 (3.3%) increase

TUITION & FEE INCREASES

- Average increase of 11% for in-state and 4% for out-of-state UNC students
- Increase of 7% for in-state and 7% for out-of-state community college students

OTHER EDUCATION CHANGES

- One-time reduction of $28 million in funds to local education agencies (LEAs); cuts to be taken at the discretion of LEAs
- $108 million for ABC bonuses earned in the 2003-04 school year
- $50 million to reduce class size in grade 3
- $23 million recurring reduction to UNC (cuts to be taken at discretion of campus)
- Appropriate $11 million from Escheat Fund for UNC financial aid (reduce General Fund appropriation for one year)
- N.C. Supreme Court upholds Judge Manning's rulings in the *Leandro* case

Individual Income Tax Filers and Liability by Income Level

North Carolina Taxable Income	Calendar Year 2004 Number of Returns	% of Total	Tax Liability	% of Total	Calendar Year 1997 Number of Returns	% of Total	Tax Liability	% of Total
0 to $15,000	1,915,154	51.7%	$ 428,487,839	5.5%	1,905,113	55.1%	$ 488,197,412	8.6%
$15,001 to $25,000	503,980	13.6%	573,559,493	7.4%	511,583	14.8%	594,444,487	10.5%
$25,001 to $50,000	679,126	18.4%	1,505,488,492	19.5%	651,213	18.8%	1,439,015,941	25.5%
$50,001 to $75,000	298,366	8.1%	1,167,572,328	15.1%	216,854	6.3%	841,378,659	14.9%
$75,001 to $100,000	125,044	3.4%	712,487,586	9.2%	73,427	2.1%	418,097,539	7.4%
$100,001 to $200,000	124,333	3.4%	1,140,284,098	14.8%	70,304	2.0%	649,278,481	11.5%
$200,001 and up	52,807	1.4%	2,193,551,650	28.5%	32,224	0.9%	1,220,905,346	21.6%
	3,698,810	100.0%	$ 7,721,431,486	100.0%	3,460,718	100.0%	$ 5,651,317,865	100.0%

Adds Black, "Everyone's going to see it and say, 'Hey, this is the year. We've been waiting for this for a long time.'"

➤ Governor Easley indicates that state agencies will end the fiscal year with $100 million unspent. Easley wants to use the money to help legislators balance the budget.

➤ Governor Easley proposes a $15.9 billion adjusted budget. Easley's recommendations include: a 2.5 percent raise for teachers; a 2 percent pay raise for state workers, plus a $250 bonus; and $59.6 million for More at Four and class size reduction. Easley also requests an exemption on the first $20,000 of income subject to the corporate income tax.

2004 HEALTH & HUMAN SERVICES BUDGET

Total Appropriations $3.86 billion

Major Items:

Medical Assistance (Medicaid):	$2,449 million
Mental Health/D.D./Subst. Abuse:	$580 million
Child Development:	$259 million
Social Services:	$189 million
Public Health:	$123 million
Youth Services:	$81 million

➤ Senate Minority Leader Jim Forrester (R-Gaston) expresses his dismay that the budget is $1.1 billion more than the pervious year's budget of $14.8 billion. "It would be nice if we could see a reduction in spending," comments Forrester.

➤ Ever in search of new ways to increase revenue to cover increased spending, Senate President Pro Tempore Marc Basnight (D-Dare) declares that "a lottery or cigarette or alcohol tax would be a big help in getting us there."

June

➤ In spite of a Republican-Democrat split in the House, the House passes the governor's recommended budget with few alterations. The $15.8 billion House budget includes: a 2.3 percent raise for teachers; a $1,000 raise for state workers; a 7 percent raise for community college tuition; $9 million for More at Four; and $50 million for class size reduction.

➤ The Senate's $15.8 billion budget includes: a 2.75 percent raise for teachers; a raise of 2.75 percent, or at least $1,000, for state workers; $21.2 million for class size reduction; $4.5 million for

More at Four; and $8.8 million for an expansion of the state's child health insurance program.

July

➤ Governor Easley vetoes a bill that would require a local government to compensate a billboard owner if the county or city wants to remove the billboard (HB 429).

➤ The House overrides Easley's veto, but the Senate takes no action on the vetoed bill. The Senate instead guts a bill the House has already passed and creates a new billboard bill with less rigorous compensation requirements (HB 1213).

➤ Patrick Ballantine wins the Republican gubernatorial primary, but fails to win 40 percent of the vote, preparing the way for a runoff between himself and Richard Vinroot. Vinroot subsequently bows out of the race, conceding to Ballantine.

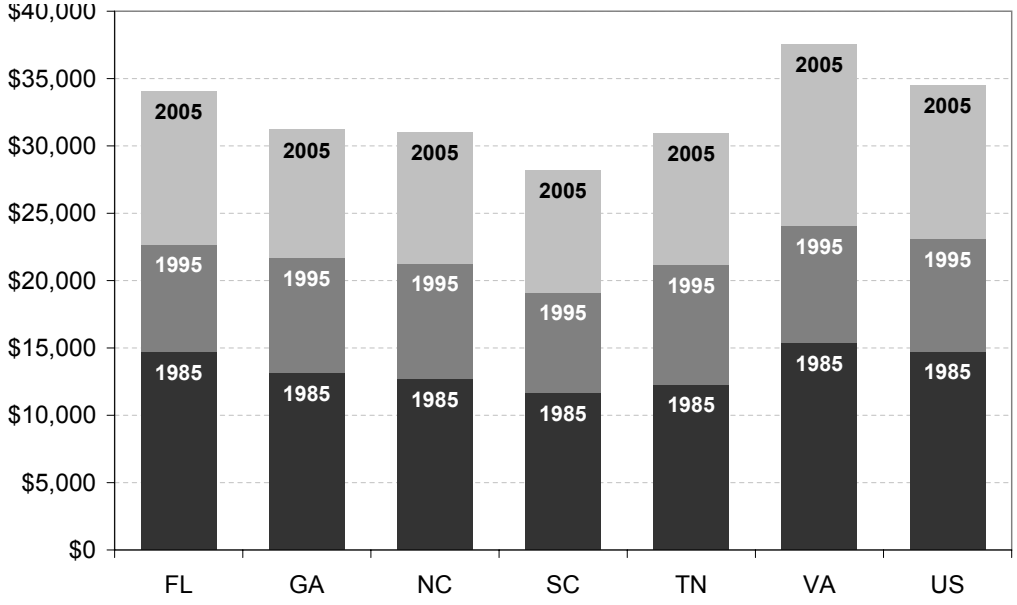
➤ The $15.9 billion budget passes (S.L. 2004-124). Governor Easley's pet projects – namely, class size reduction and More at Four – are funded at $50.5 million and $9.1 million. The budget also mandates: $6.6 million for an expansion of state subsidized health care for children; a 2.5 percent raise for teachers; a raise of at least $1,000, or 2.5 percent, for state workers; and an average 7.3 percent tuition hike at UNC universities and community colleges.

August

➤ Governor Easley signs the "new" billboard compensation bill (S.L. 2004-152).

➤ A poll by Research 2000 shows Governor Easley with an early lead over Republican candidate Patrick Ballantine – 51 percent to 37 percent.

Per Capita Personal Income: Southeast States, 1985-2005



September

➤ Marking the first time the organization has ever endorsed a Republican for governor, the State Employees Association of North Carolina (SEANC) urges its members to vote for Patrick Ballantine. The union is upset that Governor Easley neglected to give

state workers a pay raise in 2002 and only gave a marginal raise

2004 Other Significant Changes

COMPENSATION

- Salary increase of 2.5% or $1,000 - whichever is greater - for most state employees
- 2.5% average salary increase for teachers

CAPITAL

- Authorize financing of $355 million for UNC capital projects

in 2003 and 2004. (Meanwhile teachers received raises of 1.84 percent in 2002, 1.8 percent in 2003, and 2.5 percent in 2004.) Ballantine wins SEANC's support by promising state workers a 5 percent raise over the next three years.

➤ Easley claims that he expects the temporary half-cent sales tax increase and half-percent income tax increase will finally expire next year.

October

➤ Governor Easley announces that he will call the General Assembly back into session to consider a tax incentive plan aimed at bringing the computer manufacturer Dell, Inc. to North Carolina.

November

➤ Mike Easley wins a second term as governor, defeating Republican challenger Patrick Ballantine 55 percent to 43 percent.

➤ Democrats win back their majority in the House, gaining three seats to give them a 63-57 advantage. They also retain control of the Senate by a margin of 29-21.

➤ Richard Burr (R) defeats former Clinton Chief of Staff Erskine Bowles 52 percent to 47 percent in the race for the open U.S. Senate seat vacated by John Edwards. Republicans now hold both of the state's U.S. Senate seats.

➤ President George W. Bush (R) wins a second term, defeating Massachusetts Senator John Kerry (D) 51 percent to 48 percent.

➤ The General Assembly meets on November 4, 2004, to pass the "Tax Incentives for Major Computer Manufacturing Facilities" Act (S.L. 2004-204). The legislation provides Dell, Inc. $242 million in tax breaks over 15 years.

DID YOU KNOW?

North Carolina imposes an excise tax on illegal liquor and drugs, such as cocaine and marijuana. The tax can be up to $200 per gram, depending on the type of controlled substance.

Source: N.C.G.S. 105-113.107

December

➤ Although Republicans lost control of the House, former Co-speaker Richard Morgan (R-Moore) foolishly believes Democrats will continue to share power. Based on the results of the last two years, Morgan says: "I think coalition government is here to stay."

2004 Significant Tax Changes (Budget Bill Unless Noted)

⬆	Reduce alcohol and tobacco tax discount for wholesalers: ➔ Budget bill eliminates 4% tax discount ➔ S.L. 2004-84 reinstates the discount at 2%
⬇	Bill Lee Act changes: ➔ Extend sunset to 2010 [S.L. 2004-435] (2003 special session on economic development) ➔ Change employment levels [S.L. 2004-170] ➔ Modify formula used to determine tiers [S.L. 2004-202]
⬇	Expand number and type of sales tax refunds and exemptions
⬇	Extend sunset on low-income housing credit [S.L. 2004-110]
⬇	Extend sunset on Job Development Investment Grant (JDIG) Program
⬇	Qualified business investment tax credit
⬇	Research and development tax credit
⬇	Renewable fuel tax credits [S.L. 2004-153]

2004 Other Revenue Sources & Actions

- Transfer $243 million from Highway Trust Fund
- Tobacco payments decline $5 million
- Transfers from Fire Safety Loan Fund ($0.25 million), Veteran's Home Trust Fund ($0.5 million), Office of State Controller ($2.2 million), Insurance Regulatory Fund (increase by $4.1 million)
- Other sources of G.F. revenue: investment income, judicial fees, Medical Disproportionate Share, insurance

2005 session

2005-2006 BIENNIUM
FY 2006: July 1, 2005 to June 30, 2006

General Assembly:

House Dems:	63	House Reps:	57
Senate Dems:	29	Senate Reps:	21

Governor:
Mike Easley (D)

The 2005 Long Session:
Budget Bill SB622/S.L. 2005-276
Passed Senate: May 5, 2005
Passed House: June 16, 2005
Conference Version Ratified: August 11, 2005
Signed by Governor: August 13, 2005

Governor Easley began the year by discussing the possible repeal of the temporary sales and income taxes he had pushed through in 2001. By February, Easley had backed away from talk of letting the taxes sunset. Instead, the taxes were renewed again in June and then again in August, with a new expiration date of July 1, 2007.

Legislative gridlock prevented the passage of a budget until September, with issues pertaining to Medicaid and education spending driving the debate. In particular, the Senate tried to balance the budget by restructuring the Medicaid eligibility formula – a cut the House opposed. For its part, the House fought the Senate's plan to give tuition setting authority to UNC Chapel Hill and NC State. Instead of cutting Medicaid, the House budget made cuts in education in return for giving teachers another pay raise.

Education cuts were made easier to swallow by the passage of the so-called Education Lottery. While the lottery bill passed the House in April, Senate President Pro Tempore Marc Basnight (D-Dare) resorted to questionable procedural tactics in order to push the lottery through. During the latter part of the session, questions also began to emerge about the illicit fundraising activities of House Speaker Jim Black (D-Mecklenburg). Amongst other charges, it was revealed that Black was part of a triumvirate that used a hidden $14 million slush fund to win influence among legislators. Along

2005 HEALTH & HUMAN SERVICES BUDGET

Total Appropriations	**$4.03 billion**
Major Items:	
Medical Assistance (Medicaid):	$2,510 million
Mental Health/D.D./Subst. Abuse:	$603 million
Child Development:	$268 million
Social Services:	$189 million
Public Health:	$152 million
Office of the Secretary:	$114 million

with Senate President Marc Basnight and House Speaker Pro Tempore Richard Morgan (R-Moore), Black channeled the funds through three state agencies that redistributed the money to select groups in certain districts. In particular, money from the fund was used to create a position for former Representative Michael Decker (R/D-Forsyth) with the N.C. Department of Cultural Resources. By the end of the year it had also become clear that Black's political director, Meredith Norris, had violated state lobbying laws in connection with her work on the lottery.

January

- Governor Easley indicates he would like to see the so-called temporary one half-cent sales tax and one-half percent income tax increases he pushed through in 2001, and again in 2003, actually expire as scheduled on July 1, 2005.
- In response, legislative leaders claim that new taxes – in particular, increases in "sin taxes" on tobacco and alcohol – will be necessary to offset revenue losses. "I'd like to remind you that these are only taxes of choice," declares Senate President Marc Basnight. Adds House Speaker Jim Black, "[Tobacco companies are] open to sharing their revenues for the right issues."

> Each time the state goes through this kind of trouble, we react the same way—we radically cut budgets, reduce staffs, withhold pay raises and cut out programs. Then, as always happens, things improve. When things improve, the state cuts taxes, adds major new initiatives and otherwise acts as though we have been through a unique experience. During my three decades, we have gone up and down this road four times.
>
> James R. Leutze, Chancellor of UNC-Wilmington, May 2001

February

- Speaker Black states he would support a statewide referendum on a state-run lottery. At a meeting of N.C. Citizens for Business and Industry he says: "What we are now seeing is our money flowing out of the state. … If they are going to play the lottery, let's keep the education money here."
- The lottery plan continues to

Economic Snapshot: 2005

Population:	8,677,026	Five-Year Population Growth:	7.8%
Civilian Labor Force:	4,308,482	Unemployment Rate:	5.3%
Per Capita Income:	$ 30,336	Pct. of U.S. Per Capita Income:	88.8%

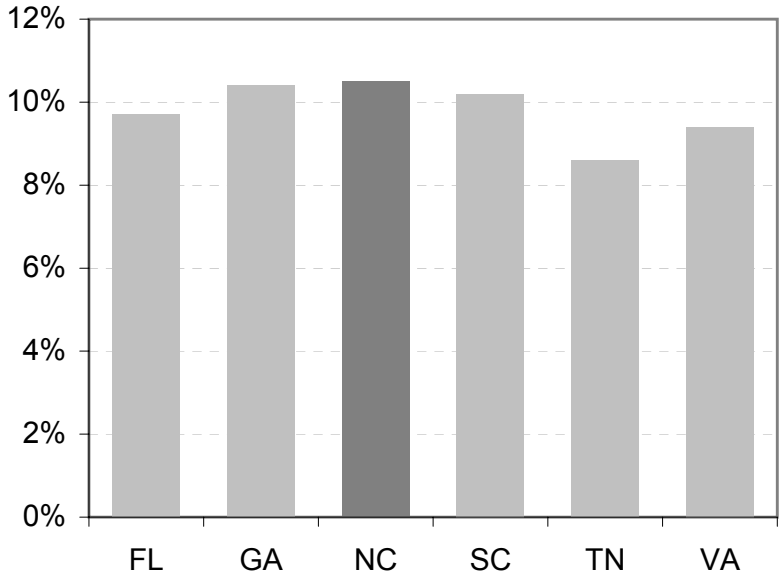
Top 10 Private Employers

1. Wal-Mart Stores, Inc.
2. Duke University
3. Food Lion LLC
4. Wachovia Bank, NA
5. IBM Corporation
6. Lowes Home Centers, Inc.
7. Bank of America, NA
8. Harris Teeter, Inc.
9. Sara Lee Corporation
10. Branch Banking & Trust Co.

gain steam under the guidance of longtime proponents Senator Basnight and Governor Easley.

➤ David Crotts, principal fiscal analyst for the General Assembly, reports that corporate tax revenues are about $50 million more than in November 2004.

Tax Burden in Southeast States: 2006



➤ Despite this growth in income tax revenue, Governor Easley backs away from his earlier proposal to let the temporary sales tax and income tax increases sunset. Easley claims the January surplus report does not give him enough confidence to end the temporary taxes.

➤ UNC Board of Governors freezes tuition for in-state undergraduate students for the 2005-06 school year.

➤ Senate passes a $214.5 million relief package for 2004 mountain flood victims. To pay for the package, $90 million is to come from state agency budgets, with the remainder taken from state reserve funds. Governor Easley opposes the plan as too costly.

➤ In his State of the State address, Governor Easley asserts that North Carolina's economy is on the mend after losing more than 160,000 manufacturing jobs in the three-year downturn.

➤ Senator Basnight acknowledges that instead of adopting Governor Easley's proposed sales tax increase on consumer items he would "rather go to alcohol" by doubling the beer tax to 10 cents a can. Says Basnight, "I can't believe you would lose one drinker for 5 cents more a can."

March

➤ An Elon University poll shows 60 percent support for a proposed cigarette tax increase of 5 to 50 cents over two years.

➤ UNC Board of Governors approves several fee increases, as well as a tuition increase for out-of-state and graduate students.

➤ Senate budget writers look to contain North Carolina's rising Medicaid costs (about 12 percent annually) by cutting several optional state-funded benefits and lowering the income threshold for certain recipients. The savings measure would cut 65,000 people from the Medicaid rolls, most of whom (an estimated 57,000) are already on Medicare. Warns Senator Kay Hagan (D-Guilford): "The state needs ideas for holding down Medicaid expenses. If we don't, there won't be enough money to cover other items."

➤ Governor Easley proposes a $17 billion two-year budget that includes a 35-cent increase to the cigarette tax in 2005 and an additional 10-cent increase in 2006.

April

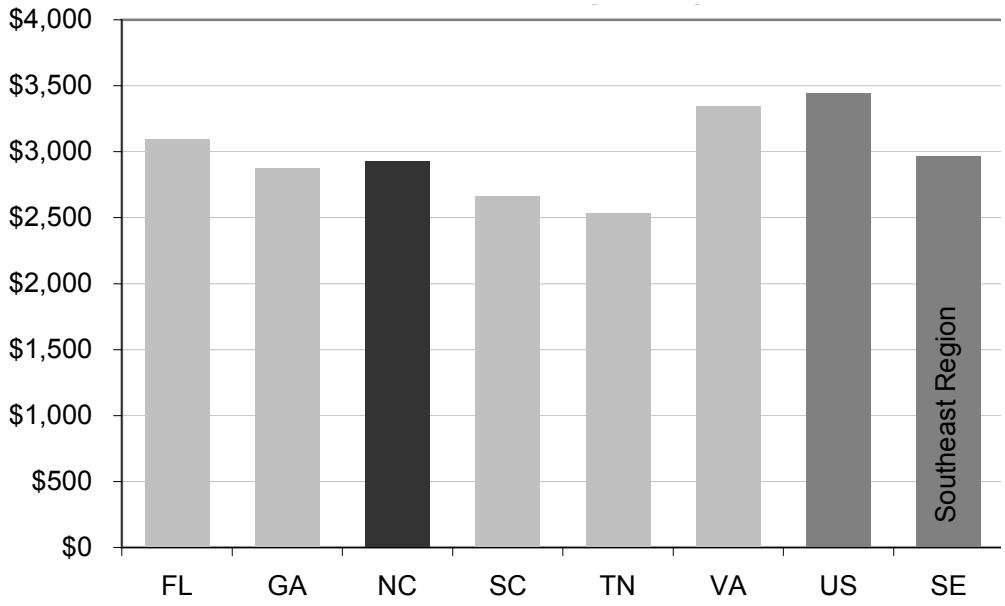
➤ The House approves the North Carolina State Lottery Act by one vote (61 to 59). Claiming that the lottery will generate $400 million per year for education, Governor Easley declares, "An education lottery in North Carolina will give us additional resources to continue to improve our schools and increase educational opportunities pre-K through college."

➤ Lottery money would be treated as new education funds with 50 percent used for public school construction, 25 percent for need-based scholarships at state universities and colleges, and the remaining 25 percent for a fund devoted to educational purposes.

➤ The Senate considers rolling alcohol and cigarette tax increases into the lottery bill so as to gain more traction for the tax legislation. Says Basnight: "We will consider things such as that. We like those taxes."

➤ Buttressed by claims that a lottery will generate $400 million per year in education funding; budget writers seek to make $245 million in education cuts.

State & Local Tax Burden per Capita: 2003-2004



May

➤ The Senate passes a $17 billion budget bill. The proposed budget increases taxes on cigarettes and tobacco, candy, satellite TV and digital radio service, phone bills and liquor. It also proposes cutting corporate income taxes from 6.9 to 6.4 percent and lowering sales taxes on film materials and equipment, farm machinery, fuel oil, and funeral services.

➤ The Senate budget cuts 65,000 people from Medicaid rolls. The bill also includes a controversial measure granting trustees at UNC

2005 EDUCATION FUNDING

ENROLLMENT CHANGES

- Public Schools: 31,686 (2.4%) increase
- Community Colleges: 4,335 (0.5%) increase
- UNC: 6,635 (3.4%) increase

TUITION & FEE INCREASES

- Average increase of 3% for in-state and 2% for out-of-state UNC students
- Increase of 4.7% for in-state and 4% for out-of-state community college students

OTHER EDUCATION CHANGES

- Establish state education lottery
- Numerous small increases for various public school and UNC programs; $26 million for capital improvements at individual community colleges
- Additional $42.5 million for disadvantaged student and low-wealth supplemental funding
- Add 3,200 More at Four slots in DHHS for $17 million
- $100 million for ABC bonuses earned in the 2004-05 school year
- Potential teacher salary increase, contingent upon study ($85 million)
- Redirect sales tax refundable to LEAs to the Public School Fund (enables General Fund reduction of $33 million in 2006-07)
- Budget (i.e., appropriate for General Fund line items) increased receipts from Civil Penalties & Forfeitures Fund (enables General Fund reduction of $103 million)
- Continue funding UNC need-based financial aid from the Escheats Fund (enables General Fund reduction of $24 million)
- $31 million recurring reduction to UNC (to be taken at discretion of campus)

Chapel Hill and NC State University the power to set their own tuition rates without the approval of the UNC Board of Governors.

June

➤ The House votes against raising the minimum wage from $5.15 to $6.15.

➤ The House proposes cutting hundreds of teaching positions and $44.3 million per year for public schools. In return, teachers across the state would receive an average raise of 2.5 percent. Such cuts enable the House to restore the Medicaid coverage cut in the Senate budget.

➤ "Take Back Our State" rally calls for lower spending and fiscal responsibility.

➤ House Speaker Black gives his staff pay raises ranging from 7 percent to 58 percent.

➤ The Legislature fails to pass a budget before the end of FY2005 on June 30.

➤ First continuing budget resolution extends funding for three more weeks. Known as the Budget Continuation Act (S.L. 2005-144), the resolution again renews the 4.5 percent sales tax – bringing in anticipated revenues of $417 million for FY2005-2006. This time legislators promise that "in no event is the tax extended beyond December 31, 2005."

➤ Included in the budget is a lottery distribution different than the bills passed in the House and Senate. The Senate worked effectively to change the allocation in the final budget, avoiding making any changes to the lottery bill itself. Primary changes include: more money allocated to retailers, less money for school construction and more money for class-size reduction and More at Four.

July

➤ Senator Basnight cancels all

DID YOU KNOW?

Sixty percent of North Carolina voters believe taxes are too high; 32 percent believe taxes are set at the right amount. Of those polled, 69 percent of Republicans think taxes are too high while 54 percent of Democrats agree.

Source: May 2006 Civitas DecisionMaker Poll

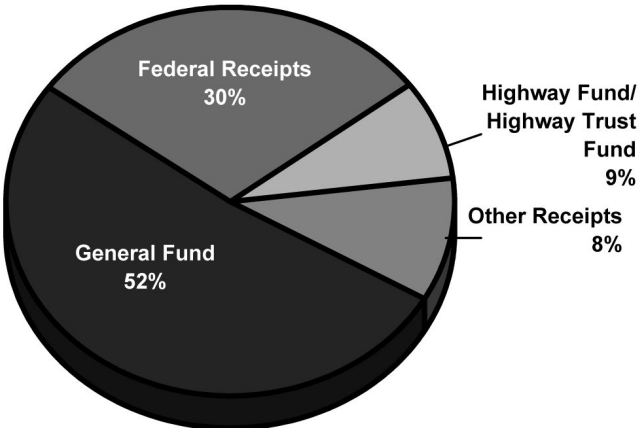
committee meetings until a budget is in place.

- The House passes another stopgap measure on July 19, extending funding another two weeks. The measure also provides increased funding for education: $125 million to public schools, $7.8 million to community colleges, and $73 million to UNC schools.
- House negotiators win back Medicaid coverage for 65,000 clients by agreeing to a Senate proposal to continue to study the problem.
- Disagreement over tuition setting authority in the UNC system continues to hold up the budget.

August

- A third stopgap bill is passed on August 4. Each additional month the Legislature remains in session costs taxpayers an estimated $1 million.
- In a flurry of last-minute deal making, House and Senate negotiators agree to a 25-cent increase to the cigarette tax effective September 1, 2005, and an additional 5-cent increase effective July 1, 2006. State employees are also given a pay raise of 2 percent or $850, whichever is greater.
- Senator Basnight announces that the Senate's proposal to grant UNC Chapel Hill and NC State special tuition setting authority is dead, eliminating one of the most contentious measures in the budget impasse.
- On August 13, the lottery bill (S.L. 2005-344) is defeated in the Senate by a vote of 24 to 26. Senator Basnight declares, "It's not over yet."
- After promising that the Senate has concluded its business for the year, Basnight calls the Senate back into session on August 30 to again vote on the lottery. With Senators Harry Brown (R-Onslow) and John Garwood (R-Wilkes) unable to return to Raleigh (Brown was on his honeymoon and Garwood recovering from a leg infection), the lottery bill passes

Source of Budget Funds: 2005-06



25-24. Lt. Governor Perdue casts the deciding vote.

September

➤ The General Assembly passes a $17.2 billion budget (S.L. 2005-276) on September 2.

2005 Other Significant Changes

COMPENSATION

- Salary increase of 2% or $850 - whichever is greater - for most state employees
- 2.24% average salary increase for teachers

RURAL ECONOMIC DEVELOPMENT CENTER

- $20 million to continue the North Carolina Infrastructure Program

RETIREMENT

- Repay $25 million of the funds taken from the retirement system to balance the budget in 2001

LOCAL, NONPROFIT, OR BUSINESS FUNDS

- $151 million for municipalities, nonprofits, local programs, and businesses

➤ Attorney General Roy Cooper concludes that Senate President Pro Tempore Basnight and co-House Speakers Jim Black and Richard Morgan did nothing illegal when they created a $14 million slush fund. Nonetheless, Cooper concludes, the fund was "problematic for its secrecy, its lack of accountability and its end run around the legislative process."

➤ A special provision added into the budget by Jim Black requires children entering kindergarten to submit to a comprehensive eye exam. The budget sets aside $2 million to assist low-income parents pay for the exams. As an optometrist, Black stands to personally gain from the requirement. The provision is diluted in the following year's budget from a requirement to a subsidy for optional eye exams for children who failed an eye exam from a pediatrician. The 2008 budget will completely eliminate the provision.

October

➤ House Speaker Black dismisses his political director, Meredith Norris, as questions surface regarding her work as a consultant for Scientific Games, a Georgia lottery company. Norris later pleads no contest to charges that she violated state lobbying laws.

November

➤ UNC Chapel Hill considers raising tuition up to $300 for in-state students and up to $900 for out-of-state students. NC State proposes raising tuition $325.

December

➤ Governor Easley and Attorney General Cooper grant House Speaker Black permission to recoup from the state up to $30,000 in legal fees connected to a federal grand jury investigation.

2005 Significant Tax Changes (Budget Bill Unless Noted)

⬆	Streamlined sales tax changes: ➔ Increase tax on telecommunications from 6% to 7% ➔ Increase tax on home satellite television services from 5% to 7% ➔ Increase tax on liquor from 6% to 7% (no local share by law) ➔ Increase tax on railway cars & locomotives from 3% (w/$1,500 cap) to 7% with proportional reimbursement to interstate carriers ➔ Exempt from sales tax, items ranging from horses to laundry machinery (previously 1% tax)
⬆	Extend 8.25% individual income tax rate for 2 more years
⬆	Maintain 4.5% state sales tax rate
⬆	Other sales, use and excise tax changes: ➔ Apply uniform sales tax to candy ➔ Apply general sales tax rate (7%) to cable (was only a local tax, up to 5%) ➔ Extend telecommunications tax to voicemail ➔ Extend sales tax to satellite radio ➔ Exempt potting soil for farmers ➔ School sales tax refund swap ➔ Motor and aviation fuels tax changes [S.L. 2005-435] ➔ Refund excise tax on unsalable cigars [S.L. 2005-406]
⬆	Tobacco tax rate changes (increase from 5¢ to 30¢ per pack through June 30, 2006; increase to 35¢ per pack July 1, 2006)
⬆	Continue use tax line on individual returns
⬆	Increase corporate gross excise tax for HMOs from 1.0% to 1.9%, the rate paid by all others (effective January 1, 2007)
⬆	Conform estate tax to federal sunset [S.L. 2005-144]
⬇	Partially conform to Internal Revenue Code updates (Working Families Relief Act; American Job Creation Act; and charitable contributions for tsunami relief)
⬌	Increase contribution to N.C. Political Parties Financing Fund (tax return designation) [S.L. 2005-345]

2005 Other Revenue Sources

- Court fee increases:
  - ➔ Increase criminal court fees by $9.50
  - ➔ Increase civil court fees, special proceedings, and estate fees by $10
- Transfer $253 million from Highway Trust Fund
- Transfer $34 million from Tobacco Trust Fund
- Transfer $5 million from Special Revenue and other funds
- Other sources of G.F. revenue: investment income, Medicaid Disproportionate Share, insurance

OVERVIEW

2006-2010

General Economic Trends: 2006-2010

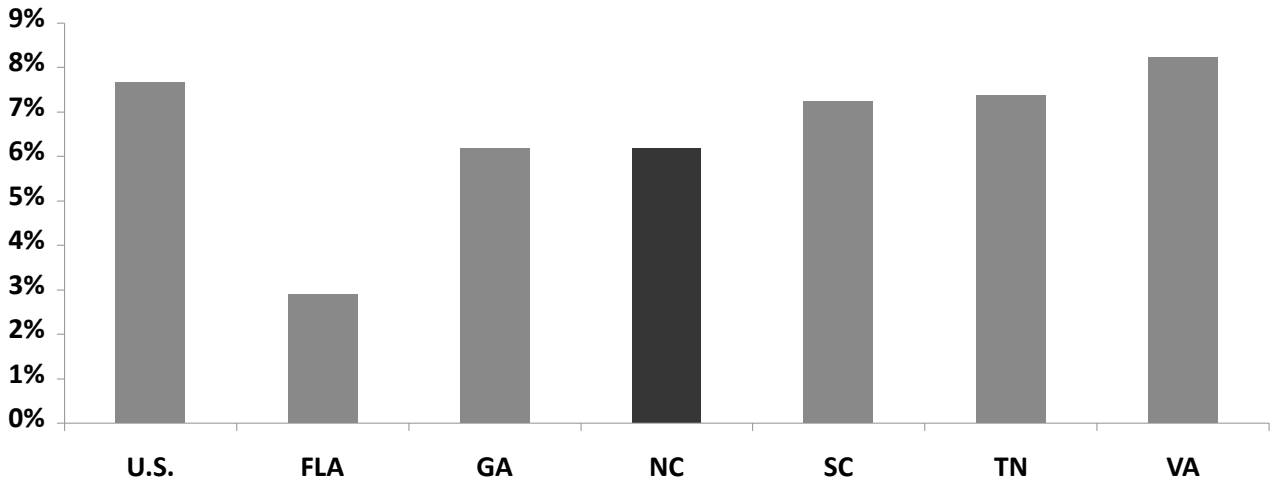
The years 2006 through 2010 unfolded like the "tale of two economies." Propelled by the housing market bubble, 2006 and 2007 featured robust growth and low unemployment. Like all booms, however, this one ended with a tremendous bust. Triggered by the implosion of the housing market in late 2008, the nation's – and thus North Carolina's – economy fell into what came to be commonly referred to as the "great recession."

Marred by arguably the deepest economic contraction since the Great Depression, the years of 2008, 2009 and 2010 experienced economic turmoil complete with a massive stock market plunge, a home foreclosure crisis and massive – but misguided – federal government responses to get the economy back on course.

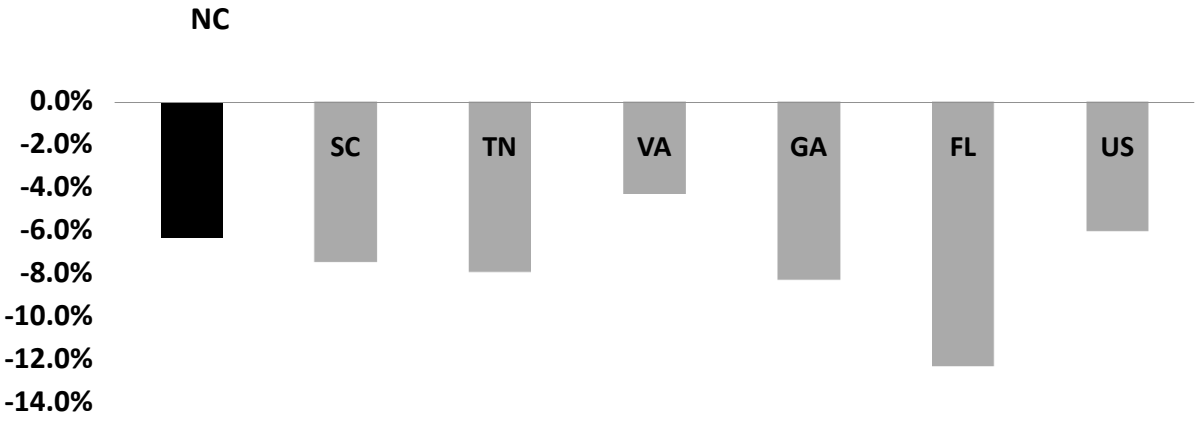
The Free-Fall

The nation's economy, as measured by Gross Domestic Product, ended 2008 flat. In 2009 the economy contracted by 2.7 percent, and stock prices plummeted.

Per Capita Income Growth: 2006-2010



Change in Total Private Employment: 2006 - 2010



From highs in October of 2008 to lows in March of 2009, the Dow Industrial Average dropped a total of 7,440 points – losing more than 50 percent of its value in just under six months.

The ranks of the unemployed swelled rapidly. The national unemployment rate skyrocketed from 5.4 percent in May of 2008 to 9.4 percent only 12 months later. National unemployment reached its high point of 10.1 percent in October of 2009, and remained stubbornly high. By the end of 2010, it still stood at 9.4 percent.

Joblessness hit North Carolina hard. In January of 2010, state unemployment peaked at 11.4 percent, more than double the rate of just 21 months prior. North Carolina's private sector economy lost more than 370,000 jobs during that time, a contraction of nearly 11 percent.

With plummeting housing prices and rising unemployment, home foreclosures reached an all-time high.

Government Response

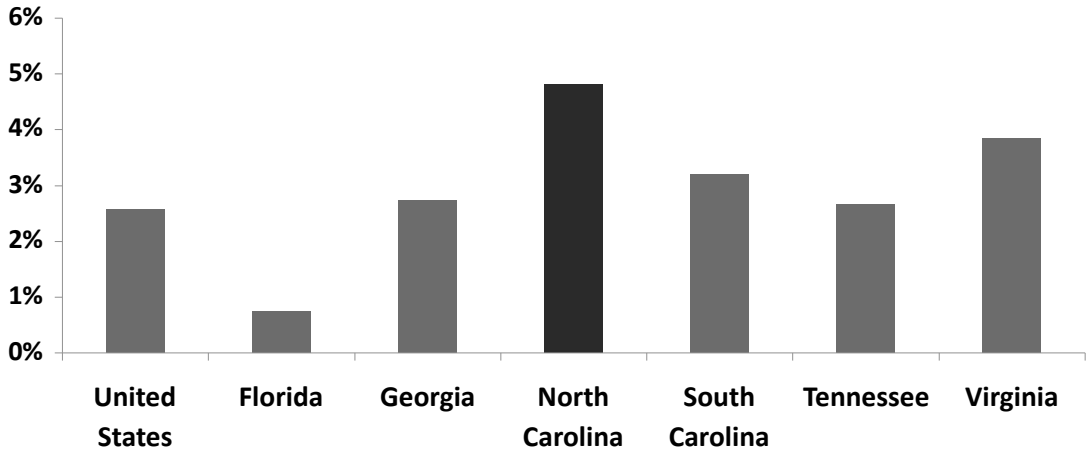
In an effort to "do something" to resolve the economic crisis, the federal government undertook numerous, and substantial, efforts aimed at correcting the recession. The first significant step was the $152 billion Economic Stimulus Act of 2008 signed by President George W. Bush. This act consisted primarily of tax rebate checks to citizens across the country. President Bush also authorized another $700 billion to "bailout" major banks. The money was spent on stock and purchases of troubled assets of major investment banks. The initiative was

highly unpopular with the American public who perceived it as bailing out irresponsible Wall Street banks while ignoring the plight of the common man. The Federal Reserve also got involved in efforts to stimulate the economy. It created trillions in new dollars to purchase financial assets from struggling banks and extend "emergency" loans to failing investment firms.

President Barack Obama continued the stimulus and bailout responses after he took office in January of 2009. He authorized more than $80 billion largely to prop up auto manufacturers Chrysler and General Motors, as well as hundreds of millions more for a notorious "cash-for-clunkers" program that paid people who traded in their old vehicles for destruction and purchased a new vehicle. Obama also approved another – and much larger – "stimulus" bill in February of 2009. The bill spent $787 billion, with a sizeable share going to state governments to help them shore up their ailing budget situations. North Carolina received more than $2.3 billion over the course of two years to help fill its sizeable budget gap. (You can read more about the Obama "stimulus" bill in the 2009 timeline.)

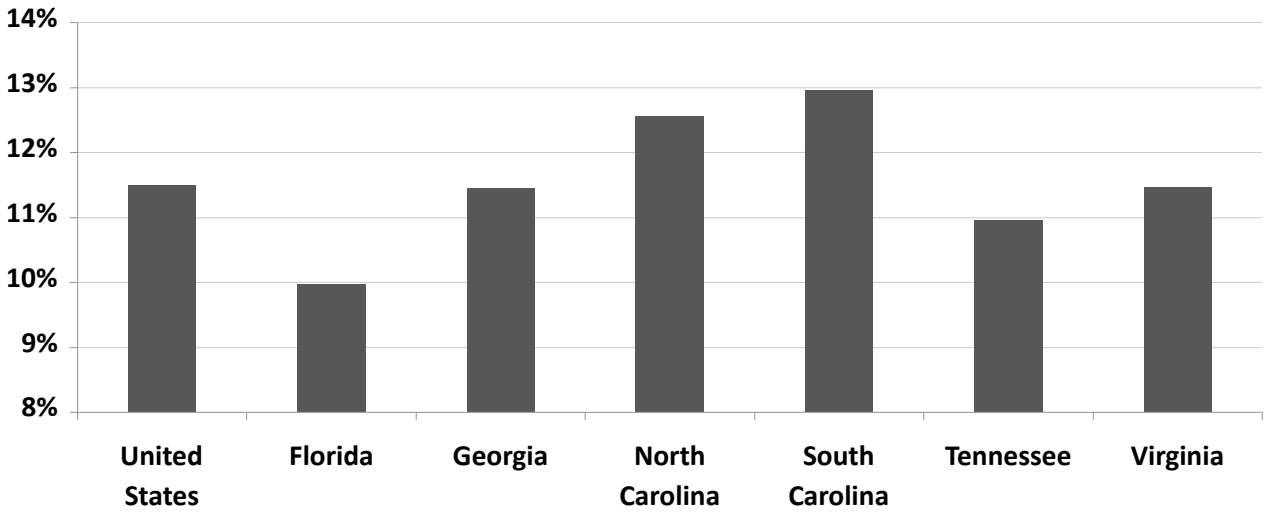
All told, federal government and Federal Reserve initiatives committed more than $11 trillion over 3 years to combat the recession. That's more than $35,000 for every man, woman and child in the nation. When the first stimulus was signed in February 2008 by President Bush, the national unemployment rate stood at 4.8 percent. Nearly three years and $11 trillion later, at the end of 2010, the national unemployment rate stood at 9.4 percent.

Change in State & Local Government Employees: 2006-2009



2009 is latest data available at time of publishing

State/Local Government Share of Total Nonfarm Employment: SE States, 2009



TIMELINE: 2006-2008

INTRODUCTION

The three legislative sessions from 2006 to 2008 in Raleigh featured sharp increases in state spending, and a dramatic and unaccountable rise in state debt.

Growth in Spending
Spending increased by $2.5 billion over just two years (fiscal years ending 2007 to 2009), which is an overall increase of 13 percent. Even after adjusting for inflation and population growth, spending per person still climbed by 2.5 percent.

Spending growth was fueled by more than $1 billion in new spending for K-12 education and more than half a billion in new state spending on Medicaid/NC Health Choice. In terms of spending growth rates by category, Medicaid/Health Choice spending led the way with a 20.5 percent growth over the two years. Spending on the UNC system climbed by 19.3 percent, while K-12 spending rose at a rate of 16 percent. By comparison, transportation spending increased by 15.4 percent.

State Debt Increased Dramatically – Without Voter Approval
State lawmakers authorized $2.2 billion in new state debt in the three budgets approved during the 2006, 2007 and 2008 sessions. None of the debt was approved by voters.

Because "special indebtedness" was used, the bonds were issued at a higher interest rate than bonds that do receive voter approval. The extra interest payments will cost taxpayers millions over the next several years.

Reflecting the state's growing debt, annual debt service payments were 13 percent higher in fiscal year ending 2009 than just two years prior – reflecting an increase of more than $72 million. As lawmakers continue to accumulate ever more state debt, this amount will continue to climb. The more money needed to finance state debt, the less money there will be available in the economy to create jobs, or for state government to finance public safety, roads and schools.

A new report released in 2008 reveals that the state of North Carolina is liable for $29 billion in unfunded retiree health premium benefits, as calculated Dec. 31, 2007. Basically, the amount of future retiree health benefit payments already accrued by current and future retirees is calculated to be $29 billion, with no money set aside to pay for these future costs. The General Assembly made no progress in addressing this massive shortfall during the three sessions from 2006-20008. Any proposed legislation to annually set aside more money towards future benefits, or to establish a Trust Fund, died in committee.

2006 session

2006-2007 BIENNIUM
FY2006-2007: July 1, 2006 to June 30, 2007

General Assembly:

House Dems:	63	House Reps:	57
Senate Dems:	29	Senate Reps:	21

Governor:
Mike Easley (D)

The 2006 Short Session:
Budget Bill SB 1741/S.L. 2006-66
Passed Senate: May 25, 2006
Passed House: June 15, 2006
Conference Version Ratified: July 6, 2006
Signed by Governor: July 10, 2006

The top stories of 2005 – the passage of the lottery and the ongoing federal grand jury investigation of House Speaker Jim Black (D-Mecklenburg) – continued to make news in 2006. The year began with a Rhode Island company being awarded the rights to manage North Carolina's new "Education Lottery." The launch of the lottery was marred, however, by charges that two individuals closely tied to Black had performed illegal lobbying services related to the lottery. The lottery also came under fire as Gov. Mike Easley (D) faced criticism that proceeds from the lottery were being used to supplant existing education spending, rather than expand new programs.

Throughout the year, reports continued to circulate that Black was being investigated on charges related to bribery and corruption. In an attempt to distance themselves from Black's questionable fundraising activities, lawmakers ended the session by passing a sweeping ethics reform bill. The new bill, however, was criticized for failing to address primary sources of lobbyist influence – namely large donations from special interest groups, as well as large scale fundraising events.

With excess budget revenue projections reaching $2.3 billion, the General Assembly used part of the surplus to give public school teachers and state employees their largest pay raise in roughly 15 years. Likewise, the General Assembly rolled back half of the "temporary" income and sales tax increases from 2001 – cutting the sales tax by ¼ cent and the income tax by ¼ of a percentage point. Overall, the budget increased spending by almost 10 percent – breaking a promise made by Easley that he would restrict increases in state spending to 5.6 percent.

Elections in November saw Democrats strengthen their majorities in the state House and Senate, while North Carolina Democrats gained a 7 to 6 edge in the number of U.S. Representatives in Washington. The gains by Democrats in the North Carolina General Assembly mirrored nationwide trends. In the U.S. House of Representatives, Democrats picked up 32 seats to win a majority for the first time in 12 years. In the U.S. Senate, Democrats picked up seven seats to win the majority in that body for the first time since May 2001. (Democrats briefly regained the U.S. Senate majority in 2001 with the defection of Vermont Republican Jim Jeffords, only to lose it again in the 2002 midterm election.)

January

- A working group comprised of about 50 economists, tax attorneys, and political and business leaders conducts a study organized by The Institute for Emerging Issues – a think tank founded by former Gov. Jim Hunt (D) – that evaluates ways North Carolina's tax system could be overhauled. While stopping short of making specific recommendations, the study mentions the following options as worthy of consideration: cutting or reducing the corporate tax rate,

DID YOU KNOW?

State government tax collections as a share of personal income in North Carolina are higher than that of New York, Massachusetts and Connecticut (as of FY 2006).

Source: N.C. Department of Revenue

reducing the top marginal income tax, expanding the sales tax to include services and giving local governments more taxing power.

- Attorney General Roy Cooper (D) recommends that the state amend the process through which spending items make it into the budget. Specifically, Cooper expresses concern about "pork" projects being inserted into the final budget without first appearing in either the House or Senate budget proposals. As such, these provisions are not subject to formal debate. "The General Assembly budget process often results in decisions being made at the last minute and middle of the night without open debate," Cooper charges.
- The State Board of Elections votes to formally investigate campaign donations made by video poker and optometry interests to House Speaker Jim Black.
- GTECH , a Rhode Island-based company, wins the rights to provide both scratch-off instant tickets and online lottery ticket sales. The terms of the contract call for ticket sales to begin before the end of March, with GTECH to be paid a percentage of the lottery's profits.

February

- Gov. Easley draws significant criticism over his new "Education Lottery" revenue allocation formula. Easley had previously promised that the lottery money would not replace tax revenue state officials already spend on education. With the lottery in place, Easley now claims it was his plan all along to use lottery revenue to supplant funds already dedicated to class-size reduction and preschool programs. Easley vows, however, that the supplanted money will stay in the education budget.
- Updated tax revenue estimates project a revenue surplus beyond what legislators have budgeted to spend. February projections show that tax collections are running about 7.6 percent ahead of last year's pace, or roughly $213 million ahead of schedule. The budget target is for 5.3 percent growth in tax revenues.

March

- Rep. Lorene Coates (D-Rowan) becomes the first Democrat House member to publicly call for the resignation of House Speaker Black. Coates says Black needs to step down because the scandal has become a distraction for other members.
- At 6 a.m. on March 30, North Carolina State Board of Education Chairman Howard Lee buys the ceremonial first ticket of the N.C. Education Lottery. Retail sales of four scratch-off games begin across the state, with the Powerball game expected to be available in late May.
- While claiming they will help Easley ensure that lottery money will not simply replace existing spending on education, legislative leaders warn that the lottery is not a cure-all for schools. "I think there is an absolute perception that the lottery's going to take care of everything. People call me every day asking for a leftover," cautions Rep. Jim Crawford

(D-Granville), a cochairman of the House Appropriations Committee.

April

- Revenue estimates continue to be revised upward, with fiscal analysts predicting a surplus of $1 billion available to carry over to the upcoming 2006-07 fiscal year. The surplus includes roughly $600 million in tax revenue above previous expectations, combined with a projected $617 million in unused money from FY 2005-06 that will likewise carry over. Representative Beverly Earle (D-Mecklenburg), a co-chair of the House Appropriations Committee, notes that a variety of special interests are lobbying for their share of the surplus. "Folks are just lining up. I'm probably one of the most popular people in the state right now. I know it's not because they like me," Earle says. Likewise, House Speaker Jim Black comments: "For an extra $1 billion there will be about $10 billion in requests. There's not really much extra money."

May

- With HB 2174 approved in the House by a vote of 72 to 43, an increase in the minimum wage creeps closer to becoming law. The bill would raise the state's minimum wage by $1 an hour, up to $6.15. Similarly, the Senate's proposed budget includes a $1 increase in the minimum wage. Thus, the two chambers merely need to agree as to whether the increase will be passed on its own or as part of the budget. Gov. Easley also expresses support for the increase.
- A surplus of excess tax revenues, combined with unappropriated and unspent funds from the current fiscal year, reaches a total of $2.3 billion, a record for North Carolina. "We had an April surprise, and it was very nice," observes Representative Crawford.
- First the governor and then the Senate unveil their proposed budget adjustments for FY 2006-07. The governor's recommendations include: a 9.6 percent spending increase over the previous year (in 2005 Easley claimed he would veto any budget that increased spending by more than 5.6 percent); an 8 percent pay raise for teachers and a 4 percent raise for state employees.
- The Senate's proposal includes pay raises of 8 percent for teachers and 5 percent for state employees.
- With regards to taxes, the Governor and Senate both recommend permitting half of the temporary sales tax rate to sunset, thus reducing the state sales tax rate from 4.5 cents to 4.25 cents, and capping the gas tax at its current rate of 30.15 cents per gallon. The two proposals differ regarding the temporary income tax rate. The Senate's adjustments include a proposal to reduce the top personal income tax rate from 8.25 percent to 8 percent while the Governor's plan makes no mention of the temporary income tax rate.
- The Senate approves its budget proposal and passes it along to the House.

June

- News from the Office of State Budget and Management that lottery revenue estimates are being revised downward causes concern among county school leaders. Donny Lambeth, chairman of the Winston-Salem/Forsyth County School Board, says the changing numbers make it hard for school officials to do their job. "You do have to plan, and if those numbers vary by 10 [percent], 15 percent, that's a concern," he explains.

- The House approves its proposed $18.9 billion budget, which is nearly 10 percent above last year's budget. House Majority Leader Joe Hackney (D-Orange) justifies the increase by saying: "We have some money this year. We are wisely investing it. And I'll tell you, the people of North Carolina want the same priorities that are in this budget."
- Highlights of the House budget include: partially rolling back the "temporary" taxes, including reducing the state sales tax by 0.25 cents (while making the remaining 0.25 cents permanent) and cutting the "temporary" income tax rate on the highest tax bracket by ¼ of a percentage point (leaving the remaining ¼ of a point intact until 2008).
- House Republicans who voted against the budget express concern over the sharp spending increase, as well as the fact that the budget uses one-time revenues to pay for recurring expenses. "This again, again, again … digs a structural deficit hole for next year of about a billion dollars," charges Rep. Paul Stam (R-Wake).
- Budget writers from the House and Senate fail to come to an agreement on a final state budget before the beginning of the new fiscal year (July 1, 2006). The "temporary" taxes, along with differences over roughly $100 million for UNC construction projects, prove to be the main areas of contention. "We're very, very close," says state Sen. Linda Garrou (D-Forsyth). "There are just a couple of capital items we disagree on. We're going to meet in the morning and see where we go from there."

July

- The Senate moves on the House's plan to implement a minimum wage increase as a separate bill, approving HB 2174 by a vote of 37 to 12. The minimum wage is increased by one dollar, to $6.15 per hour, effective Jan. 1, 2007.
- The FY 2006-07 budget bill becomes law. With $18.9 billion in total spending, the budget is $1.5 billion larger than the previous year – an increase of almost 10 percent.
- Advocates for fiscal restraint express concern over the sizeable increase in spending, as well as the use of one-time money to pay for recurring costs such as salaries. This practice of paying for long-term spending commitments with nonrecurring revenue leaves a hole that legislators will have to address in future budgets. "History tells us we're going to encounter an economic downturn," cautions Sen. Phil Berger (R-Rockingham). "It may not be this year, but it will happen. Until we get serious about controlling the spending side, we're going to go through these cycles of boom and bust." Berger estimates that such built-in commitments will contribute to a projected shortfall of $1 billion the following year. (Fortunately for the General Assembly, the economic downturn did not materialize in 2007. The result was a revenue surplus of roughly $1.4 billion.)
- The final budget allows the two "temporary" taxes first enacted in 2001 to partially sunset. The sales tax will decrease by ¼ cent to 6.75 percent as of Dec. 1, 2006, with the remaining ¼ cent still scheduled to expire on July 1, 2007. Meanwhile, the highest income tax rate will fall ¼ point to 8 percent, beginning Jan. 1, 2007, and finally return to 7.75 percent effective Jan. 1, 2008.
- The budget caps the gas tax rate at 30.15 cents per gallon for FY 2006-07 only.

- Public school teachers receive a pay raise that averages 8 percent. This marks the largest single increase in at least 15 years.
- State employees receive a pay raise of 5.5 percent, also the largest increase in roughly 15 years.

"Even the baby Jesus accepted gifts, and I don't think it corrupted him."

–Rep. Drew Saunders (D-Mecklenburg) on new ethics laws.

August

- Gov. Easley signs HB 1843 into law. The bill enacts sweeping ethics reform regarding lobbying and campaign activities. Among other things, the bill bans gifts – including dinners and drinks – from lobbyists; prohibits lobbyists from making campaign contributions to candidates; establishes an eight-member State Ethics Commission to conduct inquiries into possible ethics violations by members of all three branches of state government; requires increased disclosure of government officials' personal financial records; and lowers the threshold for reporting occupation/employer of campaign contributors from $100 to $50. Advocates for ethics reform are quick to point out what the legislation does not do. While the law prevents lobbyist campaign contributions, the special interest groups that hire these lobbyists are still free to contribute up to $4,000 per election cycle to the candidate of their choice. Lobbyists are also still allowed to sponsor fundraising events where thousands of dollars can be funneled to individual candidates. Furthermore, the legislation fails to place restrictions on elected officials' legal defense funds.

September

- House Speaker Jim Black confirms that he will seek reelection in spite of the controversy surrounding his political and campaign activities. "This will be the most difficult election I have faced in many years due to the onslaught brought on by my political adversaries and the media," writes Black in a fundraising letter.
- A report from the North Carolina section of the American Society of Civil Engineers (ASCE) raises concerns regarding the condition of North Carolina's infrastructure. Roads, airports, dams and bridges earn the poorest grades, ranging from D to C-, on the ASCE report card. Storm water, wastewater, and schools are all rated C- while drinking water earns a C+. The report estimates a shortfall of $29 billion in funding for roadwork and construction over the next 25 years, but N.C. Transportation Secretary Lyndo Tippett claims that number is closer to $60 billion.

"I don't believe ultimately voters care about scandal if it's dealt with. But if it's not dealt with, and it's an outstanding issue in the 2006 elections and every Democratic House member's got to basically defend themselves, and say, 'How much money you've taken from Black, are you going to vote for Black for speaker?' … That's a recipe for disaster for Democrats."

Joe Sinsheimer, former Democrat political consultant

October

- The education lottery makes its first payment toward education programs, but the amount is lower than initially promised. The first transfer is $95 million, which is at least $17 million less than projected. The shortfall is attributed to first quarter lottery sales falling $50 million short of lottery director Tom Shaheen's initial forecast.

November

- Republicans are unable to capitalize on the controversy surrounding House Speaker Jim Black as Democrats strengthen their numbers in both the state House and Senate. Democrats gain five seats in the House, providing a 68 to 52 advantage. They also pick up two more seats in the Senate, and now have a 31 to 19 majority.
- On the national level, all incumbents from North Carolina win reelection to the U.S. House of Representatives, except for Charles Taylor (R), who loses narrowly to newcomer Heath Shuler (D). North Carolina now has seven Democrats and six Republicans serving in the U.S. House of Representatives.
- For the first time in 12 years, Democrats take control of both the U.S. House and Senate. Election results show a 233 to 202 edge for Democrats in the House and a 51 to 49 advantage in the Senate.

December

- Tax and fee revenues outpace initial estimates by roughly $130 - $160 million for the first five months of the fiscal year. Lawmakers will need these excess revenues to help balance the upcoming budget, as spending increases and new programs built into the previous budget are projected to create a $1 billion structural deficit.
- An article in the News & Observer criticizes how the Clean Water Management Trust Fund is awarding grant money. The fund, financed by transfers from the General Fund, grew to $100 million annually beginning in 2005. Although the fund exists for the purpose of assisting local governments in poorer areas with sewerage treatment and water quality improvement efforts, it has been used to make questionable grants for an Outer Banks erosion control project, the construction of a training center industrial park in Robeson County, and various projects in Brunswick County (home of the fund's then-chairman Robert Howard). Senate Majority Leader Tony Rand (D-Cumberland) says he is concerned that the grant making process has become political. "Are the projects, the criteria by which they are judged, well founded and are they followed?" Rand asks. "Or is it somebody calling and saying 'give me that money'? If it's going to be a straight political process, we need to know that. Then we'll play politics. I didn't think we were doing that on this."

2006 HEALTH & HUMAN SERVICES BUDGET

Total Appropriations	**$4.2 billion**
Major Items:	
Medical Assistance (Medicaid):	$2.644 billion
Mental Health/DD/SAS:	$663 million
Child Development:	$296 million
Social Services:	$206 million
Public Health:	$169 million
Office of the Secretary:	$64 million
NC Health Choice:	$52 million

2006 Significant Tax Changes (Budget Bill Unless Noted)

- A portion of the "temporary" sales tax is allowed to sunset. The state sales tax will decrease by ¼ cent to 4.25 percent as of December 1, 2006. (Local governments add another 2.5 cents, with Mecklenburg Co. adding yet another half cent)
- The highest marginal income tax rate will fall ¼ point to 8 percent effective taxable year beginning January 1, 2007
- Cap the variable wholesale component of the motor fuels tax so that the total gas tax cannot exceed 30.15 cents per gallon for FY2006-07
- Provide tax credits to small businesses that subsidize employee health insurance premiums. The maximum credit is $250 per employee; total statewide credits will total roughly $7.2 million
- Provide tax credits to companies that construct and place into service renewable fuel facilities for both processing and dispensing fuel
- Offer tax credits up to a maximum of $500,000 for biodiesel providers
- Provide a refund to "professional motorsports racing teams" of 50 percent of sales and use taxes paid on specified racing vehicle accessories
- Grant an exemption for an "eligible Internet data center" (Google) on sales taxes paid on electricity; total amount of the exemption is estimated at $2.25 million.
- Reduce the sales tax from 2.83 percent to 2.6 percent on electricity sold to manufacturers

2006 Other Revenue Sources & Actions

- Transfer $425 million from State Lottery Fund to General Fund
- Transfer $252 million from Highway Trust Fund to General Fund
- Allocate $27 million to counties to freeze their share of rising Medicaid costs
- Create a reserve fund for the motor fuels tax ceiling by transferring $23 million from the Savings Reserve Account to the Reserve for the Motor Fuels Tax Ceiling

2006 EDUCATION FUNDING

ENROLLMENT CHANGES

- Public Schools: 53,731 (4%) increase
- Community colleges: 7,415 (0.92%) increase
- UNC: 6,133 (3%) increase

TUITION & FEE INCREASES

- Average increase of 11% for in-state and 3.3% for out-of-state UNC students
- Increase of 0.3% for in-state and 0.06% for out-of-state Community college students

OTHER EDUCATION CHANGES

- Transfers the More at Four program and the Office of School Readiness to the Department of Public Instruction effective July 1, 2006. The program and office had previously been a part of the Department of Health & Human Services since established in 2001
- Directs $127.9 million in the state Education Lottery proceeds to class size reduction, with another $66.6 million to the More at Four program
- Provides $90 million for ABC bonuses earned in the 2005-06 school year
- Allocates $8.2 million for the Kannapolis Research Center, establishing a "public/private" collaboration
- Expands Learn & Earn program by an additional $9.6 million

2006 Other Significant Changes

CAPITAL

- Allocate roughly $140 million for new UNC construction projects

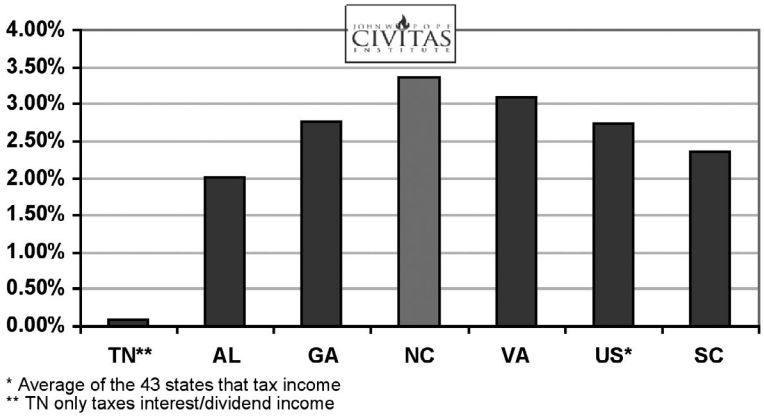
COMPENSATION

- 8 percent average salary increase for teachers
- 5.5 percent raise for state employees
- Modify eligibility requirements for state-paid retirement health insurance benefits so as to require future retirees to earn a minimum of 20 years of state service to become eligible for fully paid enrollment in the state health insurance plan; the previous threshold was only five years

OTHER

- Increase minimum wage by one dollar, to $6.15 per hour, effective January 1, 2007 (S.L. 2006-114)

State Income Tax Collections as a Percentage of Personal Income



* Average of the 43 states that tax income
** TN only taxes interest/dividend income

2007 session

2007-2008 BIENNIUM
FY2007-2008: July 1, 2007 to June 30, 2008

General Assembly:

House Dems:	68	House Reps:	52
Senate Dems:	31	Senate Reps:	19

Governor:
Mike Easley (D)

The 2007 Long Session:
Budget Bill HB 1473/S.L. 2007-323
Passed House: May 11, 2007
Passed Senate: May 31, 2007
Conference Version Ratified: July 30, 2007
Signed by Governor: July 31, 2007

2007 began with news of disappointing lottery revenues, with actual sales figures falling 25 percent below expectations. Education programs saw a shortfall of at least $75 million as a result. In spite of the deficit, Gov. Mike Easley (D) proposed a biennial budget that included significant increases for pet programs such as More at Four and Learn & Earn. Easley also proposed allocating $50 million to finance college scholarships for students from low income families.

With the election of Rep. Joe Hackney (D-Orange) as speaker, the House took a more liberal turn, casting the Senate in the atypical role of being the more conservative body. In spite of large Democratic majorities in both chambers, differences in philosophy and style led to very different budget proposals. Most notable contrasts were disagreements over the expiration of the "temporary" sales and income taxes, the implementation of a state Earned Income Tax Credit, and Medicaid relief for counties. The Senate's plan to issue $1.2 billion in new COPs (certificates of participation) debt – which does not require voter approval – also came under heavy criticism by Gov. Easley and State Treasurer Richard Moore (D).

Legislators concurred on a final budget on July 30, 2007, one month into the new fiscal year. The budget appropriated $20.7 billion in operating funds, up $1.8 billion from the previous year. The increase marked a 9.5 percent jump from the prior budget and a 20 percent increase in two years. The budget elicited conflicting reactions from members of each party. Gov. Easley praised the budget for creating educational opportunities for "generations to come." Conversely, Senate Minority Leader Phil Berger (R-Rockingham) criticized the spending plan for neglecting basic infrastructure needs.

In spite of the previous year's focus on ethics reform, a variety of scandals plagued the General Assembly throughout the year. In February, former House Speaker Jim Black (D-Mecklenburg) pled guilty to three felony counts, including bribery and accepting bribes. A month later, Rep. Thomas Wright (D-New Hanover) was accused of converting as much as $222,000 in campaign money for personal use and supplying false information on a real estate transaction. Rep. Mary McAllister (D-Cumberland) was likewise fined $16,000 for using campaign funds to make improper payments to herself.

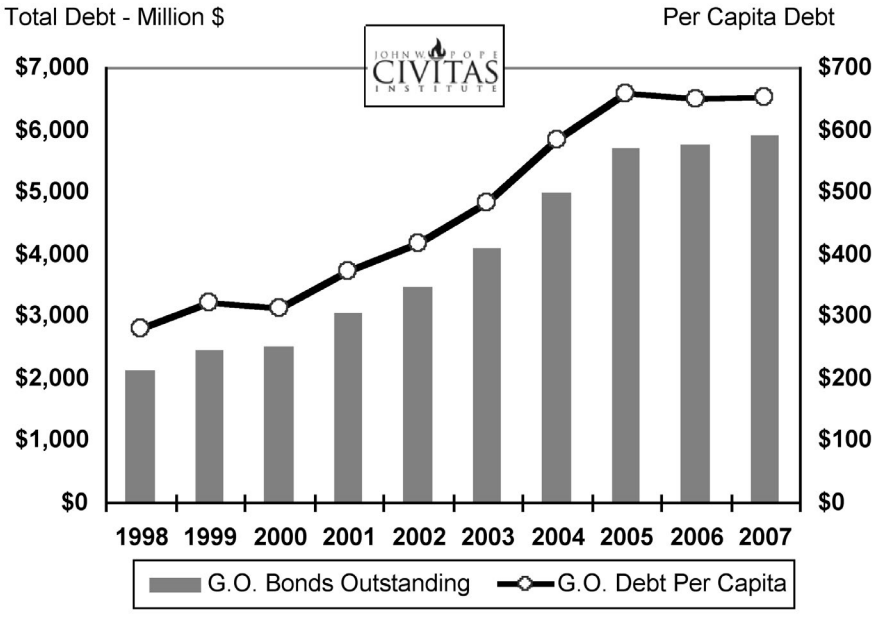
Finally, in September the Governor called a special session to address his veto of a $40 million economic incentives bill for Goodyear Tire. The result was a $60 million "compromise" package that included incentives for Goodyear, Bridgestone Firestone and as many as three other companies.

January

- Shortly after his election as House speaker, Joe Hackney (D-Orange) addresses the General Assembly. He declares, "I am no flash in the pan. I know a thing or two about this institution and its customs and procedures." In particular, Hackney promises to reform the budget process by adhering to

longstanding legislative rules regarding the last-minute insertion of substantive provisions into the budget. Says Hackney: "I will work to allow ample time for the study of legislation before we vote. I will try to keep substantive unrelated legislation out of the appropriations bill."

General Obligation Debt Per Capita: 1998-2007



Source: 2007 Comprehensive Annual Financial Report

Created by Brian Balfour
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February

- Gov. Easley releases his recommended biennial budget. His proposed budget includes $20.1 billion in spending, up 6.4 percent from last year. Easley proposes extending the remaining portion of the "temporary" sales and income taxes, in spite of last year's budget which called for their complete sunset by July 1, 2007 and taxable year beginning January 1, 2008, respectively. Easley also proposes what is billed as a tax cut for the state's poorest citizens. His plan would eliminate or cut in half state income taxes for North Carolina's lowest earners. Critics, however, point out that the governor's proposal would not help as many people as he claims. A report by the N.C. Justice Center finds that the plan would "impact an estimated maximum 649,000 taxpayers as opposed to his claim of 1.17 million."
- The Governor also asks for aggressive funding for some of his favorite projects. These include: a $56 million expansion of More at Four; $50 million for a new "EARN" college scholarship program for students from poorer families; and a $20 million expansion of Learn and Earn.
- State Treasurer Richard Moore releases the 2007 Debt Affordability Study. The report urges the state to limit new tax-supported debt to $384 million annually. The study also recommends that North Carolina reduce its reliance on the use of special indebtedness (i.e., certificates of participation) and instead "balance its approach and consider the authorization of General Obligation debt as the preferred, if no longer exclusive, method to finance capital projects." Since FY2001-02, the General Assembly has relied exclusively on COPs type debt, and has authorized more than $2.3 billion in debt without voter approval.
- Former House Speaker Jim Black pleads guilty to three felony counts: one of bribery, one of obstructing justice, and one of corruptly accepting things of value. Black's crimes include accepting $29,000 for pushing legislation favorable to chiropractors and extending a $50,000 bribe to former Rep. Michael

Decker (R/D-Forsyth) to switch party affiliation from Republican to Democrat so that Black could serve as co-speaker of the House during the 2003-2004 session. Black is sentenced to five years and three months in prison and fined $1.1 million. "It's corruption so severe, so egregious, that the people not only lose faith in politicians but lose faith in democracy itself," declares U.S. Attorney George Holding about Black's actions.

March

- The state lottery completes its first full year of operation, and sales are found to be significantly below forecasts. Sales total roughly $900 million, compared to the $1.2 billion predicted by Easley's office. By the end of the fiscal year, lottery revenue transfers will fall roughly $75 million short of the $425 million projected by Gov. Easley's office. Industry analysts claim the shortfall is due largely to economic factors, in spite of evidence of strong lottery sales in neighboring states. The shortfall prompts Easley to consider increasing the share of sales proceeds going to prizes in order to stimulate ticket purchases.

"I guess I'd like to say that the people in the west are the most intelligent. They've figured out that you have a better chance of getting struck by lightning than to win a big lottery prize."

Senator Martin Nesbitt Jr. (D-Buncombe)

- The state board of elections investigates Rep. Thomas Wright (D – New Hanover), a top lieutenant to Jim Black, for failing to report more than $100,000 worth of campaign contributions since 1992. State law makes it a misdemeanor to intentionally fail to report a campaign contribution and a felony (perjury) to knowingly submit a false campaign report.

April

- Gov. Easley urges legislators to support a $3 million tax credit for adoption as a means of refocusing the public debate over abortion to include positive alternatives and choices. The tax credit would offset normal costs associated with the adoption process and would be set at $5,480 – or 50 percent of the federal credit amount. Easley proposed the same credit last year, but it did not pass.
- After quick passage in the House and the Senate, Gov. Easley signs into law a bill abolishing the three-year-old N.C. Commission on State Property. The Commission, the brainchild of disgraced former House Speaker Jim Black, was created to initiate sales of state property deemed to be no longer needed. In its three year history, not one such sale was facilitated by the Commission.

May

- The House approves its FY 2007-09 biennial budget early in the month, with the Senate passing its own budget a few weeks later. The differences between the two plans foreshadow a lengthy negotiation process. In terms of spending, the House budget is largest, at $20.28 billion. Proposals by the Governor and Senate are almost the same amount, at $20.06 billion and $20.05 billion,

respectively. Highlights from the three plans include:

- ☐ **Certificates of participation (COPs), a form of bond debt not authorized by voters:** The Senate plan calls for $1.2 billion over four years. The House plan requests $449 million over two years. Meanwhile, $209 million over six years is recommended by the Governor.
- ☐ **"Temporary" taxes and gas tax:** Only the Senate proposes allowing the "temporary" sales and income tax increases to expire as approved in last year's budget. The Senate budget is the only plan that would permanently cap the gas tax.
- ☐ **Pay raises for teachers and state employees:** All three budget plans include an average teacher pay raise of 5 percent. The House plan (at 4.25 percent) offers up the most generous increase for state employees; the Senate and Governor propose raises of 4.0 percent and 2.5 percent, respectively.
- ☐ **Medicaid burden:** The House plan would appropriate $100 million to county governments to help alleviate their growing Medicaid burden. By contrast, the Senate proposal merely includes a declaration of intent to develop a plan to permanently end the policy of counties paying a share of Medicaid costs. The Governor's proposal makes no mention of Medicaid relief for counties.

- The House budget is approved by a vote of 67 to 50, largely along party lines. Democrats voice support for the budget because of the generous pay raises offered to teachers and state employees, the $100 million provided for county Medicaid relief, and the creation of a state level earned income tax credit (EITC). "We came up with a good, tasty product that everyone can enjoy," boasts Rep. Mickey Michaux (D-Durham).
- House Republicans are less pleased with the budget, which is said to be a continuation of a "Democrat-led spending binge that began in 2003." Comments House Minority Leader Paul Stam (R-Wake) about the budget, "Structurally, we cannot keep doing this year after year after year – spending greater and greater percentages way above population growth and inflation, and not keeping our word to the citizens of this state when we create temporary taxes."
- In the Senate, for the first time since 2000, Republicans join with Democrats to approve the budget proposal. "I find myself in the unusual position of speaking in favor of this budget," confesses Senate Minority Leader Phil Berger (R – Rockingham). "There's a big difference in this budget as far as I'm concerned, and I'm going to urge people to vote for it." Gov. Easley and State Treasurer Richard Moore criticize the Senate budget for proposing $1.2 billion in new COPs (certificates of participation) debt.

June

- The House refuses to concur (by a vote of 68 to 47) with the Senate's proposed budget, setting in motion negotiations that will continue past July 1, 2007 – the beginning of the new fiscal year. House Republicans follow the lead of their colleagues in the Senate and vote for the Senate budget, but are heavily outnumbered by House Democrats.
- Negotiations remain tense throughout the month despite news that tax revenue

projections have been revised upward by another $256 million. The total budget surplus swells to $1.4 billion. Holding up a final agreement are disputes over the "temporary" taxes and county Medicaid relief. The Senate would like to see both "temporary" taxes expire while the House wants to extend both taxes.

- There is also heated debate over how to finance a proposal in which the state will take over the county share of state Medicaid costs. Ultimately, budget writers propose a plan that was not included in either the original House or Senate budgets. The new plan includes a "swap" in which the state picks up the counties' Medicaid tab in return for keeping a portion of local sales tax revenues. Local governments would then be given authority to hold a vote on creating a new revenue source to replace the revenues sent to the state. Perhaps the most controversial part of the "swap" is a plan by House Democrats to permit localities to increase the land transfer tax as well as the local sales tax. In response to the proposed increase, the N.C. Realtors Association launches a well-funded publicity campaign against the land transfer tax.
- With the fiscal year coming to an end, the General Assembly passes a stop gap spending bill that keeps spending and taxes at their current levels for another month.
- Summing up the often frustrating, month-long negotiation process, Sen. David Hoyle (D-Gaston) states: "We haven't reached an agreement."

2007 Significant Tax Changes (Budget Bill Unless Noted)

↑	Make permanent the remaining ¼ cent of the "temporary" sales tax rate
↑	Close corporate tax loophole by implementing "combined reporting" method for business tax filing
↓	Increase the research and development tax credit rate (calculated as a percentage of qualified R&D expenses): ■ increase small business rate from 3 percent to 3.25 percent; ■ increase low-tier research (applies to companies in lower-income counties) credit from 3 percent to 3.25 percent; ■ increase university research credit from 15 percent to 20 percent; ■ apply "other research" credits according to the dollar amount invested
↓	Provide $2.3 million tax credit for constructing renewable fuel facilities
↓	Create adoption tax credit of $5,480
↓	Offer long-term care insurance tax credit, capped at $350
↓	Cap the variable wholesale component of the motor fuels tax so that the total gas tax cannot exceed 29.9 cents per gallon until June 30, 2009
↓	Expand the sales and use tax refund for certain aircraft manufacturers
↓	Establish a state level Earned Income Tax Credit (EITC) to be set at 3.5 percent of the federal credit; estimated cost to taxpayers of $48.3 million in its first year

2007 Other Revenue Sources & Actions

- Medicaid Swap: The state will assume the county share of Medicaid costs in a plan that is to be phased in over three years. In exchange for their Medicaid burden being lifted, counties will transfer ½ cent of their local sales tax revenues to the state. In return, the state gave counties the option of increasing the local sales tax by ¼ cent or increasing the local transfer tax from 0.2 percent to 0.6 percent.
- Appropriate $175 million for the Savings Reserve Account
- Increase court fees in various amounts; anticipated revenue increase nearly $36 million

2007 Other Significant Changes

COMPENSATION

- 5 percent average pay increase for teachers, judges, UNC faculty and community college instructors
- 4 percent pay increase for state employees

CAPITAL

- $554 million in certificates of participation (COPs) for capital projects, mostly for higher education

OTHER

- Require the state's power companies to increase the amount of energy created from renewable sources. The legislation will increase rates by roughly $3.6 billion over the next 10 years [S.L. 2007-397]
- Allocate $6.3 million for the N.C. Museum of History Chronology Exhibit Phase

July

- Budget negotiations in the conference committee are held up primarily by disagreements over the local option transfer tax. Committee members from the House want to include a transfer tax increase as part of the Medicaid "swap" plan, but members from the Senate are strongly opposed to the tax. House members force the issue by threatening to reject the Senate's plan to boost financing for the existing University Cancer Research Fund by $50 million annually beginning in FY 2009-10. In the end, the Senate capitulates and an agreement is reached that includes both the transfer tax increase, as well as appropriations for cancer research.
- The final budget passes both chambers, largely along party lines. Democrats hail the budget as a courageous document that prepares the state for a wave of new residents. "This budget really stands out," claims Senate Appropriations Co-Chair Kay Hagan (D-Guilford). "I think future generations will look at this and say we did great things for the future." Republicans respond that this is simply not true because the budget neglects basic needs in infrastructure and roads.

- Republican lawmakers also express concern over the number of provisions – in particular, the Medicaid Swap – included in the final budget that did not first appear in any of the previous budget proposals (a violation of General Assembly rules, cf. House Rule 44(b)). "We said at the start of the session we're not going to do that anymore," complains Rep. John Blust (R-Guilford). "Well, we're still in the same session and we're doing it."
- As July comes to a close, Gov. Easley signs the FY 2007-09 biennial budget into law. The budget spends $20.7 billion in FY 2007-08. The amount is $1.8 billion more than last year, an increase of 9.5 percent. The new budget is also $350 million more than the most expensive budget plan originally proposed by either chamber or by Gov. Easley.
- Highlights of the FY2007-09 budget include:
  - ☐ **"Temporary" taxes:** The 0.25 percentage point temporary increase of the highest marginal income tax rate is finally allowed to return to the pre-2001 rate of 7.75 percent. The remaining ¼ cent "temporary" sales tax is made permanent.
  - ☐ **Medicaid swap for counties:** The state will assume the county share of Medicaid costs in a plan to be phased in over the next three years. Counties will no longer pay any Medicaid costs, and the state will assume all nonfederal payments. In exchange, counties will transfer ½ cent of their 2 ½ cent sales tax revenues to the state. Counties will then have the option of replacing this lost revenue with new local option taxes (subject to voter approval). The tax options include an increase from 0.2 percent to 0.6 percent in the real estate transfer tax, or an additional ¼ cent added to the local sales tax rate. The swap includes a "hold harmless" provision that will use state funds to reimburse those counties that lose money under the new plan. The anticipated Medicaid burden for counties alone was expected to reach $571 million for fiscal year ending 2008.

Medicaid Swap and the Sales Tax:

The FY 2007-08 budget made the remaining ¼ cent "temporary" sales tax permanent. The changes made the state sales tax rate 4.25 cents and the local sales tax rate 2.5 cents, for a total of 6.75 cents. Under the Medicaid Swap, however, ½ cent of the local sales tax will be shifted to the state portion of the tax under a phased-in plan. The result will be that the overall rate will continue to be 6.75 cents, but the state's share will be 4.75 cents and the local share will be 2 cents. Furthermore, those counties that choose to do so are authorized to place a ¼ cent local sales increase on their ballots in the future.

  - ☐ **COPs debt:** The budget approves $669 million in certificates of participation (COPs) for capital projects, mostly in higher education. The COPs authorization is the largest in state history and represents over half a billion dollars in new debt not subject to voter approval.
  - ☐ **State Earned Income Tax Credit:** Beginning in FY2008-09, North Carolina will establish an EITC set at 3.5 percent of the federal credit rate. The program will cost taxpayers $48.3 million and result in an average payout of less than $5 per month per beneficiary.

- ☐ **Pay raises for teachers and state employees:** The budget provides for an average pay raise of 5 percent for teachers, judges, UNC faculty and community college instructors. State employees will receive a 4 percent pay increase.
- ☐ **Learn and Earn:** Governor Easley's venture will expand by $28 million over the next two years. Funding will go to both the creation of new Learn and Earn schools as well as a new online program.
- ☐ **NC Kids Care:** The budget creates a new government-subsidized health insurance plan that could expand government-run health care programs to roughly half of all families in North Carolina. Specifically, beginning in FY2008-09, the budget grants $7 million for "a program of comprehensive health care benefits" for children in families with annual incomes between 200 percent ($41,300 for a family of four) and 300 percent ($61,950 for a family of four) of the federal poverty level (FPL).

"Democrats annually make big promises about our education system and their plans for our public schools, yet, year after year, that system fails to show any comparative improvement."

–Senate Minority Leader Phil Berger (R-Rockingham)

August

- The newly approved budget receives mixed reviews – largely along partisan lines. Gov. Easley praises the budget, saying it took "more courage than I have ever seen by any Legislature since I've been in public office. This budget is absolutely magnificent." As Easley explains, the final budget not only increases spending for his favorite educational programs, but also includes new healthcare (NC Kids Care) and environmental (e.g., Land for Tomorrow) initiatives.
- Republicans express concern that while the new budget increases spending by 9.5 percent over last year and 20 percent over two years, very little is done to keep up with growing school construction and transportation needs. Senate Minority Leader Phil Berger (R-Rockingham) comments, "Twenty percent in two years, and what do we have to show for it? We have an education system that's failing students. We have a transportation system that's crumbling."
- The General Assembly passes an "Act to Create the Job Maintenance and Capital Development Fund" (HB 1761). Sponsored by Representative Rick Glazier (D-Cumberland), the legislation is to be used to allocate $40 million over 10 years to the Fayetteville Goodyear factory in return for Goodyear's promise to invest $200 million to upgrade the plant.
- Gov. Easley signs the "Promote Renewable Energy" bill into law (S.L. 2007-397) on August 20, 2007. The bill requires the state's power companies to increase the amount of energy created from renewable sources. Qualifying sources include solar, wind, hydroelectric, tidal energy and agricultural waste. Legislators cap the increased utility costs the program will create at $10 per year per residential customer, going up to $30 per year by 2015. The cap, however, does not apply to increased costs owing to new plant construction. According to a report by the North Carolina Utilities Commission, the legislation will increase

rates by roughly $3.6 billion over the next 10 years.

September

- Questions about economic incentives come to the forefront, as the General Assembly goes into special session to respond to Gov. Easley's veto of HB 1761. As indicated above, the legislation allocates $40 million to the Fayetteville Goodyear factory in return for Goodyear's promise to invest $200 million to upgrade the plant. Easley's main criticism is that the bill sets a minimum employment requirement of 2,000 workers, far below the plant's current employment level of 2,750. In effect, Goodyear could cut 750 jobs and still receive the subsidy. Easley says he cannot support a bill that would set such a precedent: "Never in the history of the state has anyone given a company up to $40 million and allowed them to lay off hundreds of workers."
- The two-day special session comes to a close on September 11. The result is not an override of the Governor's veto, but the approval of a new $60 million incentives bill (see sidebar).
- Critics from all points on the political spectrum lambaste the new legislation. Rep. Jennifer Weiss (D-Wake) chides her fellow legislators for passing "compromise" legislation that increased the overall incentives package by 50 percent. Warns Weiss, "We better hurry up and wrap things up before we get to $80 million." For his part, Republican candidate for governor and former N.C. Chief Justice Bob Orr questions the fairness of the deal: "We're not talking about a company moving into the state like Dell did. This takes it to an entirely new level and what I think is particularly offensive is that these multibillion dollar companies can cut jobs and still qualify. It's a huge slap in the face to businesses across the state who don't qualify."

October

- Tax receipts for the first quarter of FY 2007-08 come in roughly $75 million ahead of projections. Yet budget experts, such as Fiscal Research Economist Barry Boardman, downplay expectations for a budget surplus: "It's too early to get excited one way or the other. If we had been down, I'd be saying the same thing. The first quarter, really the first half, tells you very little about where you're going to end up at the end of the year."

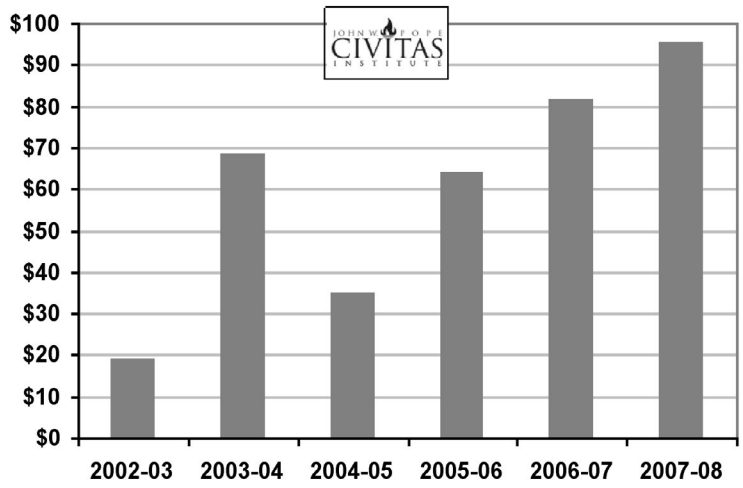
November

- A more detailed analysis of tax collections during the first quarter of the fiscal year reveals that corporate income tax collections have slowed significantly. Business tax revenues grew at only 0.5 percent over the previous quarter, much slower than the 20 percent annual growth rate experienced in 2007. The downturn foreshadows a faltering economy, caused in no small part by the housing sector slowdown.
- Voters in 16 counties soundly reject ballot proposals to create a local transfer tax. As part of the Medicaid swap, several counties propose a tax of .04 percent of the value of property to be assessed on the seller at the time any property is sold (in addition to the .02 percent statewide transfer tax currently in place). In county after county (16 in all) voters oppose the increase, with the average margin of defeat being three to one. (In Graham County 97 percent voted against the tax.) Those localities opting instead for a ¼ cent sales tax increase do not fare much better. Voters in 11 of 16 counties reject the tax hike.

December

- An "Economic Development Inventory" (EDI) study produced by the Fiscal Research Division reports that the state has spent an estimated $3.7 billion in the past three years on economic incentives to attract and retain jobs. The study was produced at the request of a legislative panel charged with evaluating the state's economic incentives program. Ninety percent of the inventory, which reached $1.2 billion for FY 2007-08, consists of targeted tax breaks. Committee cochairman Senator David Hoyle (D-Gaston) is among those who are skeptical that the tax incentives are really helping North Carolina. "That's a lot of money," observes Hoyle. "Are we getting $1.2 billion of benefit from it? I probably doubt it." Supporters of the tax breaks counter that they are necessary, even for inefficient industries. "I'm positive it's in our best interest to keep XYZ company with 1,000 jobs, even if they're making buggy whips," declares Rep. Pryor Gibson (D-Anson). The inventory does not include a cost-benefit analysis and also does not account for local government spending on incentives.
- The subprime loan foreclosure crisis causes substantial losses for North Carolina-based banking giants. Bank of America expects a fourth quarter investment value loss of $3 billion, while Wachovia faces a loss of $1.1 billion. Compared to other states, such as Ohio, Michigan and Indiana, North Carolina's foreclosure rate is relatively low, and below the national average. But the bursting of the housing bubble is expected to slow economic growth, with job growth already off the previous year's pace. In the Triangle area, job growth in October 2007 is up just 2.3 percent, compared to a 4.2 percent growth rate in 2006. Any economic slowdown will inevitably affect tax revenues, and thus the amount of money available for the 2008 budget.

General Fund Appropriations for "Economic Incentive" Programs: 2003-2008



Source: Fiscal Research Division, "Economic Development Inventory," December 2007

Created by Brian Balfour
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2007 HEALTH & HUMAN SERVICES BUDGET

Total Appropriations $4.63 billion

Major Items:

Medical Assistance (Medicaid):	$2.92 billion
NC Kids Care Report:	$0.368 million
Mental Health/D.D./Subst. Abuse:	$713 million
Child Development:	$307 million
Social Services:	$217 million
Public Health:	$192 million
Office of the Secretary	$71 million
NC Health Choice	$59 million

2007 Special Session:
Economic Incentives

Gov. Easley's veto of a bill (HB 1761) extending $40 million in economic incentives to Goodyear Tire & Rubber Company brought lawmakers back to Raleigh for a special session that lasted from Sept. 9 to Sept.11, 2007. According to North Carolina law, when a veto occurs after the General Assembly has adjourned, the Governor is required to reconvene the General Assembly within 10 days of the veto, or the bill becomes law.

Also known as the "Goodyear bill," HB 1761 would have granted $40 million in taxpayer funds over the next 10 years to a Goodyear plant in Fayetteville in return for Goodyear's commitment to invest at least $200 million to upgrade their tire-making facility. Typical in such incentive agreements are standards for job creation and wage rates. The only employment criteria contained in the Goodyear bill was a requirement that the plant maintain at least 2,000 workers. Because the Goodyear plant currently employed 2,750 workers, 750 jobs could have been cut and Goodyear would still have received the incentives package.

Gov. Easley's veto message explained that he was vetoing HB 1761 "because it extended up to $40 million in cash to an existing company in one county with little or no regard for how much the company actually pays in state and local taxes, what wages it pays now or in the future, or whether it lays off nearly 25 percent of its workforce." Other critics assailed the bill as creating a dangerous precedent by awarding incentives to a firm already operating within the state, as opposed to an out-of-state company considering a move to North Carolina.

Rather than override the Governor's veto, legislators passed a new bill, which Gov. Easley subsequently signed into law (S.L. 2007-552). Details of the new law include:

- Creation of The Job Maintenance and Capital Development (JMCD) Fund as a "restricted reserve" in the Department of Commerce. The fund is to be financed via transfers of taxpayer dollars from the General Fund. As much as $60 million over the next 10 years will be allocated to the JMCD Fund. Most of that money will likely go to Goodyear and Bridgestone Firestone, with as many as three more companies eligible for the incentives. According to an analysis in the Charlotte Observer, the incentives package will likely extend $2.5 million a year for 10 years to Goodyear, with a smaller Bridgestone Firestone plant in Wilson County getting up to $2.2 million a year.
- In order to receive the grant money, eligible companies must have a minimum of 2,000 employees and invest a minimum of $200 million in plant upgrades during a six-year period. The six-year time period is retroactive so that it can include the Wilson Bridgestone Firestone plant, which began investing in plant upgrades in 2005.
- The new bill features stricter employment and salary eligibility guidelines. Specifically, companies must provide health benefits, as well as pay average wages that are 40 percent above the county average.
- If a company cuts its worker rolls, grants will be proportionately reduced. If an eligible company's work force falls below 80 percent, it receives no payments until it increases employment above the 80 percent threshold.
- The economic incentives will entail the refund of 95 percent of sales tax on machinery, building materials and energy. Companies will also be reimbursed for a portion of their state income tax. Economic incentives will also cover all worker training costs and state permitting fees. The funding mechanism, however, includes a caveat that says that the payment calculation "is not necessarily limited to these factors."

Reactions to the new legislation were mixed. Gov. Easley hailed the bill as "a fantastic statement by the General Assembly that North Carolina is focused on the future and determined that our citizens will compete and win in the new world economy." Added Easley, "This legislation will create cutting edge economic competitiveness in North Carolina, unlike any state in America." A bipartisan coalition of legislators, however, criticized the measure as fiscally irresponsible. Rep. Paul Luebke (D-Durham) cautioned that the new incentives plan was "unprecedented in terms of public policy posture. We have not thought this through." House Minority Leader Paul Stam (R-Wake) also voted against the legislation. "Tomorrow morning every CEO in North Carolina is going to wake up and decide to hire lobbyists instead of engineers," declared Stam. "Forget about selling tires. Hire lobbyists!"

2007 EDUCATION FUNDING

ENROLLMENT CHANGES

- Public Schools: 19,136 (1.4%) increase
- Community colleges: 20,055 (2.5%) increase
- UNC: 6,678 (3.3%) increase

TUITION & FEE INCREASES

- Average increase of 6.3% for in-state and 3% for out-of-state UNC students
- Increase of 6.2% for in-state and 6.3% for out-of-state Community College Students

OTHER EDUCATION CHANGES

- Authorized $482 million in Certificates of Participation to finance UNC capital projects. The new debt is not subject to voter approval
- $27.6 million devoted to new EARN scholarship program, which provides tuition subsidies for families earning up to 200 percent of federal poverty limit ($41,300 for a family of four). EARN program slated to expand to $100 million next year
- $7 million appropriated to dropout prevention grants aimed at curbing the high school dropout rate
- $70 million for ABC bonuses earned during the 2006-07 school year
- Spends $37.5 million to maintain a student/teacher ratio of 18:1 for grades K-3
- $56 million expansion of More at Four to accommodate 10,000 additional children and finance a slight increase in per enrollee costs

DID YOU KNOW?

Sixty-nine percent of voters say they would prefer smaller government with fewer services, compared to fifteen percent who claim they would prefer bigger government that provides more services with higher taxes.

Source: July 2007 Civitas DecisionMaker Poll

2008 session

2008-2009 BIENNIUM
FY 2008-09: July 1, 2008, to June 30, 2009

General Assembly:

House Dems:	68	House Reps:	52
Senate Dems:	31	Senate Reps:	19

Governor:
Mike Easley (D)

The 2008 Short Session:
Budget Bill HB 2436/S.L. 2008-107
Passed House: June 5, 2008
Passed Senate: June 19, 2008
Conference Version Ratified: July 8, 2008
Signed by Governor: July 16, 2008

The beginning of 2008 saw an economy in decline. Fortunately for lawmakers, however, revenue stayed slightly above projections as fiscal year 2007-08 wound down – netting a mild revenue surplus.

In March, the North Carolina House of Representatives voted nearly unanimous to expel Rep. Thomas Wright (D – New Hanover) for campaign financing violations and illegal use of government grant money. Wright became the first North Carolina General Assembly member expelled since 1880. Although he maintains his innocence, Wright was sentenced to prison on counts of felony and fraud in April.

The fiscal year 2008-09 budget approved by lawmakers included an unprecedented amount of authorized debt. Limited by revenue estimates projecting a very minor increase in funds available to spend, lawmakers decided to borrow $857 million in order to finance an aggressive slate of government construction projects. New buildings for UNC campuses and new jail space dominated the debt-financed construction binge. Despite Civitas Institute poll results showing 77 percent of voters believe the General Assembly should not be allowed to issue debt without voter approval, not one penny of the $857 million in authorized debt will be subject to a vote by the public.

To balance the budget, lawmakers also raided approximately $60 million from several funds established for various purposes. Monies were taken from funds such as the Disaster Relief Reserve, the Tobacco Trust Fund, and the Health & Wellness Trust Fund.

The new fiscal year quickly uncovered troubling budgetary news. The meltdown in the national financial sector rapidly slowed the economy to a possible recession. Fall tax revenue reports revealed that North Carolina faced a budget shortfall in the 2008-09 fiscal year. Revenue was falling well short of projections, and legislative economists estimated the budget hole could grow as large as $1.6 billion. Making matters worse, it is discovered that the State Health Plan will have insufficient funds to pay its benefits – a shortfall estimated at close to $300 million.

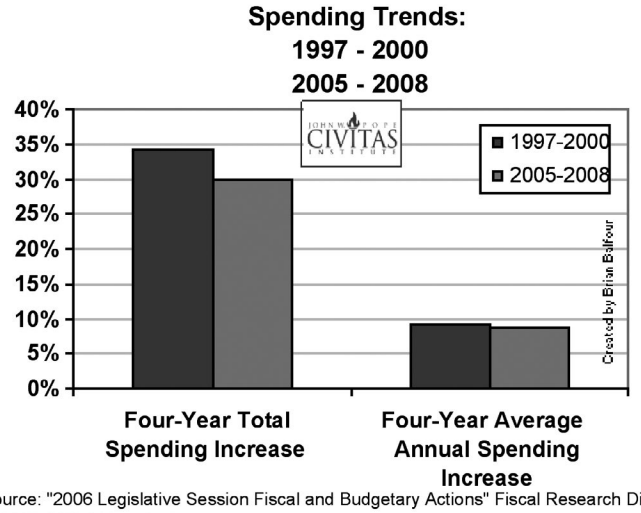
The looming budget crisis prompted Gov. Easley (D) in September to order most state agencies to cut spending by two percent. By November, Easley's Office of State Budget and Management (OSBM) unveiled the state's plan detailing how it intended to fill the budget gap. The OSBM plan holds back funds from every major state agency; with the cuts ranging from 1.5 percent to 5 percent (K-12 cuts are deemed "voluntary"). The plan also dips into the state's Rainy Day fund, and taps various reserves to fill the projected budget hole.

The oncoming crisis led some observers to note the similarities between Easley's first and last years in office. In both cases, a budget shortfall was preceded by rapid increases in spending during robust economic times. When the economy –and thus revenue – dried up, the state was simply unable to meet its spending obligations. (SEE CHART)

DID YOU KNOW?

Seventy-seven percent of North Carolina voters believe that state government should not be allowed to issue new debt without voter approval.

Source: May 2008 Civitas DecisionMaker Poll



Source: "2006 Legislative Session Fiscal and Budgetary Actions" Fiscal Research Division

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January

- Despite a slowing economy, North Carolina's state revenue for the first half of fiscal year 2008 is $125 million above projections. Conservative revenue estimates crafted by legislative economists last year are to be credited for the surplus, as revenue growth is slower than normal but still outpacing projections.

February

- Healthy growth of withholding tax revenue indicates that North Carolina's economy is thus far faring better than most states during a nationwide economic slowdown. "We think North Carolina will fare better than other states," says Fiscal Research Economist Barry Boardman.
- North Carolina's Education Lottery ticket sales measure $18 million above last year's sales at this time. The news comes a year after the General Assembly voted to allow the lottery to offer more winning payouts and prizes. A new "$100 Million Cash Spectacular" scratch-off game that began in January is at least partially credited with the boost in sales. Payouts for the new game are estimated to be 73 percent of ticket sales, compared to an average 53 percent payout in 2007.

March

- The N.C. Open Government Coalition sponsors a workshop to release a new booklet entitled "Guide to Open Government and Public Records." The guide was created by the N.C. Press Association and Attorney General Roy Cooper. The guide's release comes on the heels of a controversy surrounding Governor Mike Easley (D) in which Easley is accused of disposing of public records and enacting a policy allowing state employees to delete e-mail messages – also considered to be public records. The keynote speaker for the event is Debbie Crane, former spokeswoman for the state Department of Health and Human Services. Crane was fired at Easley's request on March 4. Crane claims that her job had essentially evolved into defending the Easley administration from negative media attention. "I don't think the taxpayers should be paying spin doctors," said Crane.
- By a vote of 109 to 5, North Carolina's state House votes to expel Rep. Thomas Wright (D-New Hanover). Wright faces allegations that he failed to report $180,000 in campaign contributions and used charitable grants for personal use. Wright is the first North Carolina General

Assembly member to be expelled since 1880. Wright continues to adamantly declare his innocence.

- National economic forecaster Moody's Economy.com predicts that North Carolina will most likely not fall into a recession. North Carolina General Assembly's chief economist largely agrees. "I'd put the chances (of recession) at one in three," said David Crotts. A recession is traditionally defined as two consecutive quarters of negative economic growth. North Carolina's economy is acknowledged to be slowing, in part evidenced by the slowdown in sales tax collections compared to last year.

"Let me make this clear: I'm innocent of the charges before me."

–Thomas Wright (D-New Hanover)
moments before House members voted overwhelmingly to expel him from the General Assembly.

April

- Thomas Wright is found guilty of three felony counts of fraud, and sentenced to 70 to 95 months in prison. Wright and his attorney, Doug Harris, maintain Wright's innocence. Wright contends that the charges were politically motivated while Harris declared that it was unjust to hold the trial just three weeks after Wright was expelled from the General Assembly. Harris insists the verdict will beoverturned as they plan on appealing the decision. "This verdict will be set aside because it's awful, awful justice to try somebody in this atmosphere," Harris said.
- Analysis of Federal Highway Administration figures reveals that North Carolina receives less from the Federal Highway Trust Fund than what it sends in. Since the creation of the federal fund in 1956, North Carolina has received only 90 cents in return for every dollar sent in. Each state sends revenue to the fund based on federal gas and use taxes as well as various vehicle-related fees. North Carolina has the third worst return in the nation, better than only Texas and Indiana. State Senator David Hoyle (D-Gaston) questions the necessity of the federal fund. "Why does it (the revenue) have to go to Washington and be laundered?" he asked.
- Skybus, the discount airline company offered up to $3.98 million in government incentives to locate in Piedmont Triad International Airport less than six months ago, closes up shop and considers declaring bankruptcy. Fortunately, none of the promised handouts have been realized because they were based on performance and job creation that never materialized. Overlooked by most observers, however, is the deadweight loss to the economy as millions of dollars worth of resources were squandered in pursuit of government handouts.
- Disappointing tax collections in March shrink the expected budget surplus for the current fiscal year. As recently as January, collections looked to be on pace for a $125 million surplus. The latest figures force lawmakers to revise down their expectations for a surplus of approximately $15 to $20 million.

May

- In spite of a significant spike in lottery ticket sales, the expected allocation to education appears to be falling short of expectations. The North Carolina Education Lottery Commission is projecting sales of $1.27 billion for the

current fiscal year, which would translate into $358 million devoted to education programs. The amount still will be $18 million less than what Gov. Easley's recently released budget proposal assumes.

June

- House budget makers unveil their $21.35 billion FY 2008-09 budget proposal. If approved, the plan would represent a biennial spending increase of 13.2 percent, and a 47 percent increase since 2001-02. Included in the House's plan is the authorization of $560 million in non voter-approved public debt to finance 14 capital building projects – mostly on UNC campuses. To adhere to the constitutional requirement to balance the budget, the House plan raids nine trust funds for more than $60 million to finance new General Fund spending. Included is $21 million from the Disaster Relief Reserve, and $5 million each from the Tobacco Trust Fund and Health & Wellness Trust Fund. Under the House budget, teachers would receive an average 3 percent pay raise, while state employees would receive the greater of a 2.75 percent raise or a $1,100 bump. House Speaker Joe Hackney (D – Orange) describes the House budget as "a sound, good government, fiscal stability budget."
- Two weeks later, the Senate releases its budget plan. The Senate proposal spends roughly $15.5 million more than the House, and includes a few notable differences. The Senate plan would devote $41 million to Easley's More at Four program, significantly more than the $23 million offered up by the House budget. Also under the Senate budget, $68.6 million more would go to the UNC system, a difference largely comprised of the Senate opting not to impose a 1 percent across-the-board spending decrease proposed by the House plan. Another significant difference in plans is that the Senate would cease enrollment in the State Children's Health Insurance Program as of Sept. 1. The House proposal expands the program size by 10,700 enrollees and $10.4 million. In terms of teacher and state employee pay, the Senate and House plans are in full agreement. "We all wanted to do more for teachers, but we all don't want to raise taxes," said Sen. Linda Garrou, D-Forsyth, co-chairwoman of the Senate Appropriations Committee.
- Amid the beginning of budget negotiations between the House and Senate plans, Senate Republicans release a list of all Senate bills filed in the current legislative session that would appropriate money for any reason. The report reveals that Senate Democrats sponsored $1.9 billion worth of spending bills, compared to only $80.7 million in Republican-sponsored bills. The report includes all appropriation bills and doesn't attempt to narrow focus to spending items commonly referred to as "earmarks." Republicans downplay any discrepancy, however. House Minority Leader Paul "Skip" Stam (R – Wake) says "the intent is the same" regardless of any official classification of earmarks. "I think (the Senate figures) showed that the Democrats are only constrained by the lack of money," added Stam.
- The annual transfer from the Highway Trust Fund to the General Fund is slated to be reduced in both House and Senate budget plans. Both plans would reduce the annual transfer by $25 million. The annual $172 million transfer is to be reduced by $25 million beginning FY 2008-09. The money would instead go to the N.C. Turnpike Authority to assist in the financing of Raleigh-area toll roads.

House and Senate proposals differ, however, as to the future of the transfer. The House plan would reduce the transfer by another $24 million by mid-2010. The Senate proposal would reduce the transfer by another $74 million by the middle of 2011. Both plans divert the funds to the Turnpike Authority to finance various toll projects and a bridge over Currituck Sound.

July

- The new fiscal year begins without the passage of a new budget bill. In the interim, a temporary authorization bill enables state government to continue functioning. Senate and House Republican leaders criticize Democrats for the manner in which the budget process is being carried out. "Here we go again," said Senate Republican Leader Phil Berger (R – Rockingham). "This is not unlike what has occurred in past years; Democrats conduct the people's business in secret meetings and those closed discussions are likely to result in a spending plan that hikes expenditures by amounts greater than either the House or Senate plans adopted earlier this session with potential serious adverse fiscal consequences."
- The FY 2008-09 Budget Bill (S.L. 2008-107) is signed into law on July 16. The budget spends $21.35 billion, an increase of roughly 3.2 percent over last year. The budget provides state employees the greater of $1,100 or a 2.75 percent salary increase. Public school teachers, UNC professors and community college instructors would receive average pay increases of 3 percent. Moreover, $90 million will be allocated to the state's ABC's of Public Education bonuses for K-12 teachers. North Carolina's SCHIP program, N.C. Kids Care, will be delayed until July 2009 pending the federal government's re-authorization of the SCHIP program, saving $7 million. N.C. Health Choice, another government insurance program for low-income children, will expand by $9.4 million. The annual transfer from the Highway Trust Fund to the General Fund will be largely phased out. For FY 2009, the transfer would be reduced by $25 million, with plans to incrementally decrease the transfer over the next three years. By FY 2010-11, the transfer will be reduced by $99 million. Instead the money would be directed toward paying off specific projects including: the Triangle Expressway, the Monroe Connector/Bypass, the Mid-Currituck Bridge and the Garden Parkway. Currently, the transfer is scheduled to be about $172 million. More at Four will expand by roughly $30 million, bringing total funding to more than $170 million annually.
- Perhaps the most discussed aspect of the newly-approved budget is the $857 million in new, non-voter approved debt. Most of the money will go toward capital building projects on UNC campuses. The $857 million figure raised eyebrows not only because it is $300 million more than in the House plan and about $180 million more than what the Senate proposed, but because it is an unprecedented amount of debt to be issued without voter approval. Republican leaders criticized the lack of fiscal restraint, comparing the borrowing to irresponsible credit card use. Sen.Phil Berger suggested, "It's like we have a credit card, and we just continue to max it out." Democrats defended the borrowing largely because it would be cheaper to finance the construction projects now rather than later, and because the projects will "create jobs." Said Rep. David Hoyle (D –Gaston), "So for us to put off some of

"They should not make our constitution irrelevant."

Rep. Bill McGee, R-Forsyth, complaining about non-voter approved borrowing contained in the state budget.
THE INSIDER, 7/08/08

these projects that are on the board, I think would be fiscally irresponsible. We are trying to build the things that will continue to make this state great."

- The budget-making process receives harsh criticism for its lack of openness from the N.C. Coalition for Lobbying and Government Reform. The coalition's directory, Jane Pinsky, claims "the current session highlights the need for greater openness and transparency and for making additional improvements in the budget process."

August

- State Health Plan administrators announce that the plan is projected to fall into deficit by December, and grow as high as $124.7 million by June 2009. The shortfall has occurred because revenue taken in by the plan trail benefits paid. The unexpected losses led to the firing of the plan administrator in July. Lawmakers hope that plan administrators can find enough savings to keep the plan afloat until legislators return to Raleigh in January 2009 to address the issue.
- In a cost-cutting move, the State Health Plan announces it is eliminating a wellness plan in order to save roughly $1 million. The wellness plan provided incentives for participants to be physically active or engage in other health wellness activities. It is estimated that only about 10,000 of the plan's 650,000 members have participated.

September

- North Carolina's Department of Transportation announces a hiring freeze. The Department is concerned over a potential shortfall in the Federal Highway Trust Fund, which annually directs millions to North Carolina's DOT. High gas prices have led to less vehicle usage and a decline in federal gas tax revenue. A bill to transfer $8 billion from the nation's General Fund to the Federal Highway Trust Fund is under consideration by federal lawmakers. Without the infusion, North Carolina's DOT could stand to lose as much as $300 million in expected federal funds.
- Legislative leaders determine that a special session to address the State Health Plan's shortfall will not be required. Recent estimates are revised upward to project a total loss between $264 million and $281 million by the end of this fiscal year in June 2009. Jack Walker, the plan's executive administrator, says the plan can stay solvent until March by holding back payments to vendors. At that point, however, something will need to be done if the plan's expenses are to be met. Options being discussed include raising premiums for spouse and dependent coverage and lessening benefits for enrollees.
- A rapidly declining economy provides tax revenue $70 million behind projections for the new fiscal year. The news prompts Gov. Easley to mandate a 2 percent budget cut for select state agencies. The cut will not apply to public education, Medicaid and student financial aid programs. The cuts are expected to provide roughly $200 million in savings. Rep. Mickey Michaux (D – Durham), senior co-chairman of the House Appropriations Committee,

admits that the affected agencies will be able to absorb the spending reductions relatively easily. "Two percent is not going to hurt agencies," said Michaux.

October

- New estimates by the General Assembly's Fiscal Research Division peg the revenue shortfall for the current fiscal year to be $112.8 million below projections. Revenue collections for the first two months, in fact, are below collections for the same time period the previous year. Conversely, budget-makers had been expecting a 3 percent increase of revenue, setting up a potential budget shortfall of $1 billion or more. In light of this news, Senate Republican leader Phil Berger (R – Rockingham) calls on Gov. Easley to take more extreme action than just his 2 percent spending reduction for select agencies. "There is no question that the Governor's two percent reduction is too little and, unless further steps are taken soon, we will find that it is too late to avoid either substantial tax increases or curtailment of government functions," said Berger. "Governor Easley should take further and effective action now to curtail spending this fiscal year, before it is too late."

November

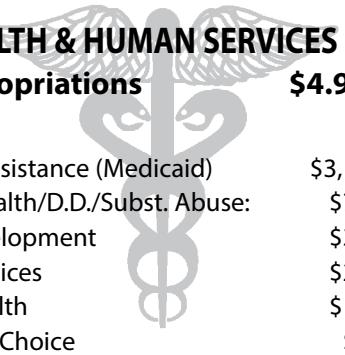
- Legislative economists release estimates projecting the current year budget gap to reach as high as $1.6 billion. The N.C. Office of State Budget and Management (OSBM) unveils a plan to "holdback" funds from state agencies. The holdbacks range from 1.5 percent to 5 percent of each agency's budget. Furthermore, the plan puts pay-as-you-go capital projects on hold and dips into the state's Rainy Day Fund. The OSBM plan is more aggressive than Easley's ordered 2 percent cuts of just a month ago. Making matters worse, the projected $300 million shortfall in the State Health Program is not included in the $1.6 billion estimate.
- Easley declares that his mandatory cuts are an effort to minimize any budget hole incoming Gov. Bev Purdue (D) will inherit. "It's a whole lot easier to be Governor Santa than Governor Scrooge and when the next governor comes in, if I have held back too much then they're able to release that money to the agencies and to projects and that would be good for them," said Easley.
- Corporate tax collections for the first quarter of the new fiscal year indicate North Carolina's economic woes may be worse than first anticipated. Revenue generated from corporate profits are down nearly 32 percent from the same quarter of the previous year. Legislative Economist Barry Boardman notes, "We're a little surprised that it's down as much as it is." The drop is the sharpest decline since a 64 percent decrease in the first quarter of fiscal year 2001-02, another year marred by recession and a budget shortfall.

December

- State agencies are doing their best to cope with the budget cuts mandated by Gov. Easley's office last month. "The main areas are obviously leaving positions vacant, reducing travel and training costs and eliminating purchase of equipment," said Deputy State Budget Director Charlie Perusse.
- A spokeswoman for the state's public schools, Vanessa Jeter, notes that she has "not heard anecdotally" about classroom teacher positions being cut. Meanwhile, Department of Juvenile Justice and

Delinquency Prevention spokesman William Lassiter says, "We're not cutting the programs we have but we're delaying the start of new ones across the state."

- Gov. Easley's office issues a memo to state department heads and chief financial officers of all state departments, institutions and agencies asking each agency to develop a list of options for potential spending cuts of 3 percent, 5 percent and 7 percent. Easley declares, "Reducing agency expenditures will be an essential component of providing a balanced budget to Governor-elect Perdue and the General Assembly." Also included in the memo is advice regarding how state agencies can best formulate their "reduction strategies." Included in the advice is the obvious notation that "Funding priority should be given to statutorily mandated or 'core mission' government services." No comment is made as how to define "core mission government services" versus non-core mission government services.



2008 HEALTH & HUMAN SERVICES BUDGET

Total Appropriations	**$4.91 billion**
Major Items:	
Medical Assistance (Medicaid)	$3,179 million
Mental Health/D.D./Subst. Abuse:	$743 million
Child Development	$305 million
Social Services	$222 million
Public Health	$189 million
NC Health Choice	$69 million

2008 Significant Tax Changes (Budget Bill Unless Noted)

⬇	Extend several targeted tax credits, including: the research and development tax credit until 2014, the low income housing credit until 2015, the state ports credit until 2014 and the small business health benefit credit until 2010
⬇	Increase the amount of the state EITC (just created last year but not yet implemented) from 3.5 percent to 5 percent of the federal amount
⬇	Create a property tax exemption for honorably discharged disabled veterans, exempting $45,000 of the appraised value from taxation
⬇	Enact a sales tax holiday for energy efficient appliances for the first weekend of November
⬆	Close a tax loophole by requiring "real estate investment trusts" to pay a franchise tax
⬇	Create sales tax exemptions for baked goods sold by artisan bakeries and interior design services "provided in conjunction with the sale of tangible personal property"
⬇	Allow five percent of the purchase price of a manufactured home community to be deducted from state and federal taxable income
⬇	Expand the renewable energy tax credit to include funds donated to units of local or state government to enable it to purchase, lease, or construct renewable energy property

2008 Other Revenue Sources & Actions

- Reduce by $25 million the annual transfer from the Highway Trust Fund to the General Fund. Instead, the $25 million is directed to the Turnpike Authority.
- Raise the newborn medical screening fee from $14 to $19
- Transfer more than $65 million from various funds – such as the Disaster Relief Fund, the Tobacco Trust Fund and the Disproportionate Share Reserve – to the General Fund
- Increase annual fees from $250 to $2,000 on businesses filing to offer securities for sale for a period in excess of one year
- No money set aside to the Rainy Day Fund

2008 EDUCATION FUNDING

ENROLLMENT CHANGES

- Public Schools: 40,004 (2.8%) increase
- Community Colleges: Data not yet available
- UNC: Data not yet available

TUITION & FEE INCREASES

- Average increase of 0.2% for in-state and 1.4% for out-of-state UNC students

OTHER EDUCATION CHANGES

- Authorize $523 million in Certificates of Participation (COPs) to finance UNC capital projects. None of the new debt will be subject to voter approval
- Provide $90 million for ABC bonuses earned throughout the 2007-08 school year
- Direct $19.75 million from the Education Lottery Reserve Fund to maintain a student/teacher ratio of 18:1 for grades K-3
- Appropriate an additional $35 million to accommodate transportation fuel costs. Original fuel estimates when the biennial budget was crafted in 2007 were roughly half of current gas prices
- Devote $15 million to dropout prevention grants – up from $7 million last year
- Realize an unexpected $36.5 million in extra civil penalty revenues, which will be allocated to local education agencies on a per ADM basis via the State Public School Fund

2008 Other Significant Changes

COMPENSATION

- State employees receive the greater of $1,100 or a 2.75 percent salary increase
- Public school teachers, along with UNC system professors and community college instructors receive average pay increases of 3 percent
- $90 Million for ABC bonuses to public school teachers

CAPITAL

- Authorizes $857 million in new debt – none of which is subject to voter approval
- More than $1.2 billion in future obligations is included in the capital budget – the amount deemed necessary to complete the projects being planned in this year's budget

OTHER

- Expand the Job Development Investment Grant (JDIG) program, a form of corporate welfare, by $10 million annually for the next twelve years

TIMELINE: 2009-2012

INTRODUCTION

Budget deficits, tax debates, historic election results and federal stimulus dollars dominated the two legislative sessions of 2009 and 2010.

Budget Woes
Both legislative sessions were plagued by sizeable budget gaps due to prior unsustainable spending obligations and a drop in revenue due to the ongoing "great recession." State agencies were hit with a steady diet of executive orders to reduce spending, as revenues in both fiscal years fell short of budgeted expectations.

Short-Term Fixes for Long-Term Problems
To address the state's budget problems, budget writers chose to rely on short-term revenue streams rather than implementing meaningful spending reform. Approximately $3 billion in federal stimulus funds, along with more than $2 billion in temporary tax revenue was used to plug a sizeable share of the state budget gap.

The systemic, long-term nature of Raleigh's spending problem is revealed by an examination of historic spending patterns. During the 30 year period leading up to the 2009 – 2010 budget crisis, it is readily apparent that out-of-control state spending is the primary culprit. From budget years 1979 to 2009, state budget spending grew at a pace three times that of population growth, even after adjusting for inflation.

Historic Election Night
November of 2010 will go down in the history books as a landmark shift in political power both nationally and in North Carolina. Riding a wave of anti-Obama sentiment, Republicans made major gains in Congress and gained vital Senate seats as well. In North Carolina, Republicans won majorities in both chambers of the state's General Assembly for the first time in over a century.

2009 session

2009-10 BIENNIUM
FY 2009-10; July 1, 2009 to June 30, 2010

General Assembly:

House Dems:	68	House Reps:	52
Senate Dems:	31	Senate Reps:	19

Governor:
Bev Perdue (D)

The 2009 Long Session:
Budget Bill SB 202/S.L. 2009-451
Passed Senate: April 9, 2009
Passed House: June 13, 2009
Conference Version Ratified: August 5, 2009
Signed by Governor: August 7, 2009

As legislators returned to Raleigh in early 2009, they were greeted with news about ongoing massive budget shortfalls. Due to the enduring national recession, state revenue was still slumping and was worse than expected. The 2008-09 budget year saw revenue fall short of budgeted expenses by almost $2 billion. Newly-elected Gov. Perdue was forced to impose budget-cutting measures on state agencies in order to make ends meet. Perdue orders the state budget office to hold back even larger percentages of state agencies' expected appropriations than first ordered by outgoing Gov. Mike Easley.

Turning to the 2009-10 fiscal year budget that lawmakers crafted in the 2009 session, budget writers were tasked with closing a gap between expected revenue and a continuation budget estimated as high as $4.6 billion.

A massive federal stimulus plan provided a partial life line to state budget writers in the form of about $1.4 billion in federal funding to be used to backfill state General Fund spending – mostly on Medicaid and public education

To plug much of the rest of the gap, lawmakers passed arguably the largest tax increase in state history. More than $1 billion in new taxes were introduced – mostly in the form of a one-cent increase in the statewide sales tax. Other tax increases included a tax "surcharge" on corporations and individual income tax rates, taxes on alcohol and tobacco products, and taxes on digital products and on-line retail purchases. The sales tax increase and tax surcharges were scheduled to be temporary – set to expire after two years, the same time the federal stimulus funds would run out.

Critics warn about the short-sighted nature of using temporary revenue sources to pay for ongoing expenses. State budget writers are just setting themselves up for a $3 billion structural budget deficit when they attempt to write the 2011-12 budget without the temporary revenues, they caution.

The ongoing recession continues to put added fiscal pressures on the state throughout 2009. By the end of the year, reports are produced showing that revenue for the first half of the 2009-10 budget year are falling behind estimates, prompting more budget cutbacks from the Governor's budget office. Lingering high rates of unemployment put a strain on the state's unemployment system, as North Carolina finds itself borrowing roughly $2 billion from the federal government to cover its unemployment claims.

January

- As new Governor Beverly Perdue (D) assumes office, she is confronted with a growing budget deficit. New projections estimate that state revenues for the current fiscal year could fall $1.6 billion short of the spending plan approved last session. Moreover, the projected budget gap for the coming

DID YOU KNOW?

From 1979 to 2009, North Carolina's state budget more than tripled, even after adjusting for inflation. Moreover, inflation-adjusted spending grew at a rate more than three times the rate of population growth during that time span.

fiscal year set to begin July 1 is nearly $3 billion. "I will not let it consume every breath that I take for the next year – although it could if one would let it because it is fundamentally unbalanced and there are tremendous challenges there," Perdue said.

- Exacerbating the state government's budget woes is the poor fiscal condition of the State Health Plan (SHP). The SHP is the health insurance program that covers more than 660,000 teachers, state employees, retirees and their dependents. Employees and retirees don't pay any premiums for enrollment into the SHP – that expense is paid by taxpayers. SHP officials estimate that the plan immediately needs $300 million in cash in order to pay its bills up through March or April. Further projections by SHP officials suggest the plan will need an additional $500 to $550 million over the next two years to ensure it stays current with its payments. One legislative option, which remains off the table, would be to alter benefits or ask state employees and retirees to pay a small amount of their premiums. Perdue spokesman David Kochman said Perdue "will be reaching out to legislative leaders, state employees, teachers and retirees to work together on stabilizing the plan." Perdue's office, however, offers no specifics.
- More than $700 million in debt-financed state building projects are approved two months ahead of schedule by the 10-member Council of State. The move was initiated by outgoing Gov. Easley late last year, and sold as a way to provide jobs during the ailing economy. Easley's office estimates that the construction projects will "create" more than 3,500 construction jobs and 25,000 jobs overall. State Treasurer Richard Moore, however, warns in the Office of the State Treasurer's annual debt affordability study that the added debt burden would max out the state's borrowing capacity. Any further borrowing, according to Moore, would place the state's bond rating at risk.
- Gov. Perdue travels to Washington to plead with Congress and President-elect Barack Obama for federal "stimulus" money to help shore up North Carolina's state budget woes. Preliminary reports suggest the federal government is considering a spending package of roughly $850 billion – a significant share of which would go to state governments to backfill spending on their programs. "This is the gift they can give me on behalf of North Carolina," Perdue said.
- A new report from the General Assembly's Fiscal Research Division released near the end of the month reveals that the state's budget situation is even more dire than predicted just a few weeks ago. New estimates assert the current fiscal year's shortfall could reach $2 billion. In response, Perdue orders state agencies to reduce expenditures even further. Outgoing Gov. Mike Easley had administered a previous plan to set aside $1.2 billion in savings, requiring state agencies to cut back by as much as 5 percent. Based on the new revenue projections, Perdue needs to find even deeper cuts. She orders state agencies to reduce expenditures by as much as 7 percent. "The global recession has forced

our state to make tough financial decisions," Perdue says in a news release. "I will meet my constitutional obligation to balance the budget, and I will meet it responsibly."

"I will not let it consume every breath that I take for the next year - although it could if one would let it because it is fundamentally unbalanced and there are tremendous challenges there."

–Gov. Bev Perdue on the state budget deficit

February

- The American Recovery and Reinvestment Act (stimulus bill) is signed into law. The bill totals $787 billion, and includes billions for states, grants for research projects, tax credits, infrastructure projects, food stamps and unemployment benefits. North Carolina is expected to receive roughly $6.1 billion in federal dollars via the stimulus bill over the next two budget years. The largest share – about $2.35 billion – will be directed toward subsidizing the state's share of Medicaid expenses. The bill also includes $1.2 billion for state public education, largely to avoid teacher and staff layoffs. Also included is $339 million for high-poverty schools, $334 million for special education, and $17 million for Head Start. Funding for infrastructure projects in North Carolina include $776 million for highways and bridges, $131 million for mass transit, $66 million for water treatment, $72 million for sewers, and $113 million for "weatherizing" low-income homes.
- Despite the massive influx of federal dollars to help balance the state budget, Gov. Perdue is still disappointed at the amount. She had hoped for more funds for the state, but concedes "At this point in time, anything is better than nothing."
- Gov. Perdue establishes a state agency to oversee the state's disbursement of the federal funds. Dempsey Benton, former Raleigh city manager and secretary of the Department of Health and Human Services, is chosen to lead the Office of Economic Recovery and Investment. Benton will earn $98,500 a year, and Perdue indicated that he is likely to be in the role no more than 18 months.
- Gov. Perdue orders state agencies to find even deeper cuts to their budgets, asking them to cut back expenditures by up to 9 percent in the remaining months of the current fiscal year. Last month, she asked for reductions of 7 percent. Major programs, however, are exempted from this requirement. For instance, public schools are asked to reduce spending by only 2 percent. "The state constitution requires that I balance the state budget, and I will do that while protecting public education as much as possible," Perdue says in a news release. Looking ahead, estimates for the budget gap for the coming 2009-10 budget year have risen to $3.6 billion.

March

- Gov. Perdue's office releases a partial list of cost-cutting measures being undertaken by state agencies in light of her request they reduce spending by as much as 9 percent to meet the current budget year's dwindling revenues. The primary measures include delaying filling vacant positions, limiting travel, reducing training and limiting purchases to only essential items. Other actions include shutting down computers at night at the Cultural

Resources Department and requiring park staff to handle lawn maintenance at state historic sites (rather than contracting out the work).

- Gov. Perdue releases her budget proposal for the coming 2009-10 fiscal year. The spending total of $20.98 billion includes $1.7 billion in federal stimulus dollars – primarily targeted for Medicaid expenses and public education. Given a budget projection of $20.38 billion for actual expenditures in the current fiscal year – Perdue's proposal would increase year-over-year expenditures by $600 million (3 percent).
- Among the spending reductions included in Perdue's plan is $238 million labeled "truth in budgeting." This program would fund state agencies according to actual filled positions, eliminating the long-time practice of state agencies keeping vacant positions on their budget rolls. Agencies would keep the extra payroll money they received for unfilled positions and redirect the monies elsewhere until they filled the vacant positions. House Speaker Joe Hackney (D-Orange) objects to this idea, saying: "It doesn't leave the state much margin or much wiggle room."
- Another part of Perdue's budget balancing act includes tax and fee increases. Taxes on a pack of cigarettes would rise from 35 cents to $1.35, and the purchase of alcohol would require an additional 5 percent surcharge. Perdue also proposes an increase in the annual license fees on professionals from $50 to $200. All told, the new taxes and fees would total $525 million in their first year.

April

- The Senate releases its budget plan for the coming fiscal year, and like Perdue's budget, it relies heavily on the short-term band-aid of federal stimulus funds while avoiding meaningful spending reform. The proposal totals $20.05 billion, significantly less on the surface than Perdue's plan, but the difference is in how the plans account for federal Medicaid stimulus funds. When factoring back in the federal Medicaid dollars as Perdue did in her budget, the Senate plan comes to more than $20.9 billion – almost an identical spending total as Perdue's plan.
- The most substantial differences between the Senate and Perdue's budget proposals revolve around public education, taxes and state workers. The Senate plan would increase class size by two students per class, for a savings of $322 million. Teachers would receive no across-the-board pay increase, but instead receive an experience-based step increase. Other state employees would receive no pay raise – as in Perdue's budget. The Senate plan allows for $500 million in tax hikes, but provides no specifics for which taxes would be adjusted. The Senate budget plan is estimated to lay off 712 state workers while keeping 910 positions vacant and unfunded throughout the year. Senate budget writers opted not to follow Perdue's "truth in budgeting" technique for vacant positions. Rather, they allowed for more state agency flexibility to determine how they are to reduce expenditures.
- Perdue reacts negatively to the growth in class size contained in the Senate budget plan. Perdue spokesman David Kochman says, "The Senate made some good investments in what we know of its budget so far, but at this point in

time Governor Perdue is troubled by the proposed increase in class size." State Senator and former teacher Linda Garrou (D-Forsyth) admits the class size increase was "a tough decision for me to make." But Garrou claims the change would be a temporary fix and that the reduced need for teachers could be met mostly through attrition rather than forced layoffs.

- Details regarding the Senate's potential tax increase package become clearer in Senate Finance Committee meetings. Members of the Committee claim to desire a significant overhaul of the state's tax system. Committee co-chair Dan Clodfelter (D-Mecklenburg) says that doing so is not an easy task. "Getting people interested in a major reform when they've got plenty of money sloshing around is a difficult thing to do," Clodfelter said. The tax reform plan includes extending the state sales tax to include many services, in order to better reflect the more service-oriented modern economy. Other changes include dropping the state corporate tax rate from 6.9 to 4.5 percent, and lowering personal income tax rates while changing how state taxable income is defined to mirror the federal definition. The overall goal is lowering rates while broadening the base. The reform package also includes increases to sin taxes on tobacco and alcohol. Estimates predict the tax overhaul would – once fully implemented – result in a net increase in taxes of $1.1 billion. Republicans are quick to criticize the tax reform plan. "North Carolina Democrats are trying to run a classic scam on N.C. taxpayers: the bait and switch," said state GOP chair Linda Daves. "Pretend to be reducing taxes by slight increments while at the same time creating new taxes to raise more revenue than ever before."
- Perdue issues another executive order designed to help balance current year state budget expenditures to the lowered level of revenues being collected by the state. The order includes a mandatory unpaid furlough of state employees equal to 0.5 percent of their pay. This means that teachers and other state employees will see reductions in their paychecks totaling 0.5 percent of their annual pay, to be taken out of their checks in May and June. In return, workers will be allowed to take additional time off. Perdue also orders state agencies to reduce spending by 7 percent for the remainder of the fiscal year. Further measures by Perdue to balance the budget include tapping the state's Rainy Day Fund, and using federal stimulus dollars ahead of schedule.

May

- While waiting for the House to craft its budget proposal, special interest groups turn up the heat to protect their budgetary interests. The N.C. Association of Educators begins to rally their members to voice their objections to the coming state budget they claim has the potential to cut more than 10,000 education jobs. NCAE urges members to call for emergency meetings with state lawmakers from their district, especially House members still deliberating their final budget plan.
- The mandatory unpaid furlough Gov. Perdue issued earlier this year runs up against some judicial resistance. Specifically, about 20 North Carolina judges are refusing to comply with the de facto pay cut Perdue ordered for state employees. "I personally think we have a brave governor," said District Court Judge

Lloyd Gentry of Caswell County. "She takes 3 percent of all state employees' checks in May and June. I respectfully disagree." Reasons offered by the resistant judges include the need for an independent judiciary and also that they simply couldn't take the furlough in the allotted time due to their busy work load.

- The state Senate introduces legislation negating a planned decrease in the state gas tax. In 2006, North Carolina capped its state gas tax to ensure it remains below 29.9 cents per gallon. Under the Senate's proposed bill, that cap would become a floor, meaning that the state gas tax would not be allowed to drop below 29.9 cents per gallon. The state gas tax is composed of both a flat rate and a variable rate. The variable rate is calculated as a percentage of the average price of gas, so as gas prices rise so too does the tax. Estimates project the gas tax changes contained in the legislation would cost motorists another $67.5 million over the next two years.

June

- The House approves its budget plan for the coming fiscal year. Included in the plan is substantial tax and fee hikes along with a curious decision to reduce public education spending more than any other agency. Spending in the House plan totals $19.97 billion, but that doesn't include $1.4 billion in federal stimulus money. With the stimulus money included, the House plan totals $21.2 billion –more than both the Senate and Perdue plan.
- The most noteworthy component of the House plan is its tax increase package totaling more than $860 million – significantly more than the $500 million in planned tax hikes in the Senate plan. Unlike the Senate budget plan, the House includes specifics for their intended tax increase. The most significant tax changes are an increase to the top marginal personal income tax rate and an increase and expansion of services liable to paying the statewide sales tax.
- Under the House plan, North Carolina's top marginal personal income tax rate would increase to 8.5 percent, up from 7.75. The new rate would rank North Carolina's as 7th highest in the country and far exceed the top rate among southeastern states. Personal income tax rates are especially relevant for small businesses, because the majority of small businesses are legally organized in such a way that they are subject to the individual income tax. Indeed, North Carolina's lowest marginal rate is already as high as – or higher – than every other southeastern state's highest marginal rate on small businesses. Understandably, critics decry this aspect of the House's tax hike package as especially damaging during an economic recession. Estimates peg the cost of raising the top marginal personal tax rate at a quarter billion dollars annually.
- The House's plan for sales taxes goes against the Senate's tax reform committee recommended path of "expand the base while lowering the

FY2009 -2010 HEALTH & HUMAN SERVICES BUDGET

Total Appropriations	**$3.9 billion**
Major Items:	
Medical Assistance (Medicaid)	$2,318 million
NC Health Choice	$77 million
Mental Health/D.D./Subst. Abuse:	$664 million
Child Development	$257 million
Social Services	$208 million
Public Health	$161 million
Central Management & Support	$75 million

rate." Their plan would expand the state sales tax to apply to services such as repairs, warranties, courier services and digital downloads. But instead of lowering the rate on this expanded tax base, the House plan raises the state sales tax rate by a quarter penny. The House changes to the sales tax would cost taxpayers an estimated $430 million in the first year alone.

- Similar to the Senate budget proposal, the House plan increases average class size in grades four through 12 by two students. Class sizes for grades K-3 would remain the same, but third grade teacher assistants would be eliminated. Interestingly, the House plan reduces public education funding relative to current budget year appropriations by seven percent – the largest percentage decrease among state agencies. This figure even includes $400 million in federal stimulus funds for public education. The next largest cut is in General Government with a decrease of 4.6 percent, while the rest of the agencies are essentially held even to current year expenditures or see a slight increase.
- State lawmakers enact a continuing resolution plan on June 30 in order to authorize the continuation of state expenditures as of July 1, the first day of the new fiscal year. The act is made necessary by the failure to ratify a budget bill. The resolution calls for spending levels to continue at a rate not to exceed 85 percent of the expiring 2008-09 state budget. This continuing resolution is set to expire on July 15.

July

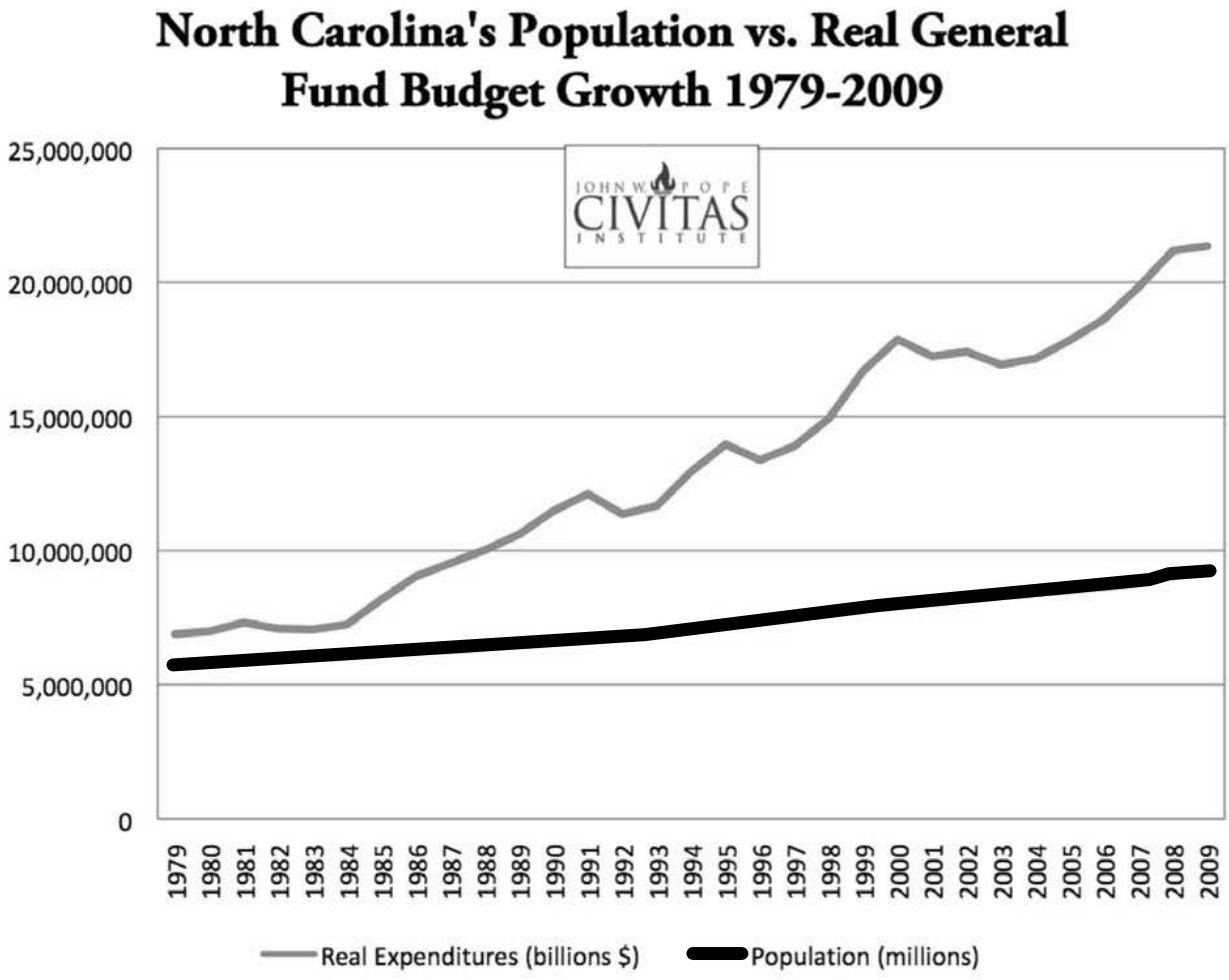
- An analysis of the first several months of federal stimulus spending in North Carolina reveals that rural counties are benefitting more than urban counties, when calculated on a per-person basis. According to the *Raleigh News & Observer*: "Federal funds allocated through June 30 under the American Recovery and Reinvestment Act add up to $328 for every state resident. The per-person share falls to $284 in Wake County and $252 in Durham County." According to Dempsey Benton, charged with overseeing the disbursement of the federal funds: "The Department of the Interior is spending money in the mountains and in the coasts. That's not going to help the Mecklenburgs and the Guilfords."
- Negotiations are ongoing between budget writers from the House and Senate to work out a budget deal to present to Gov. Perdue. The new fiscal year began on July 1 with no budget in place. Lawmakers passed another continuing resolution on July 15 to ensure funding of state government operations. The resolution limits spending to 84 percent of the 2008-09 level and is set to expire on July 31. As the end of July arrives with still no budget deal, a third continuing resolution is passed on July 31.
- Perdue expresses her frustration at the failure of House and Senate budget writers to come to a final budget agreement. She claims that due to spending reductions included in the continuing resolution along with a delay in the inevitable tax hikes, the state is "losing" out on $5 million a day. "I need the General Assembly to step up and come to consensus," said Perdue.
- Making negotiations even more difficult is Perdue's hinting that she would veto a budget that includes the newly agreed-upon tax package. The new tax plan being negotiated includes $980 million in total new taxes. The revenue is derived largely from a 2 percent

surcharge on all personal income tax brackets along with a one-cent increase in the statewide sales tax and increases on taxes on tobacco and alcohol. "Who in the world thinks, in these trying times for families, you can raise income tax for working families and middle class families?" Perdue said at a news conference

- Republican leaders questioned Perdue's intervention into the not-yet approved tax package. "Either she was in on it and changed her mind, or she wasn't consulted," said Senate Republican Leader Phil Berger of Eden. "Either way, it's not a good situation." Berger also went on to note a bit of hypocrisy in Perdue's comments, questioning why she would oppose an income tax increase on middle class families but support an increase in the sales tax. "Working families pay all those taxes," Berger said.

August

- Gov. Perdue signs the fiscal year 2009-2010 budget bill into law on August 7. When factoring in federal stimulus dollars, the state budget totals $20.4 billion. It also includes one of the largest tax increases in state history. Despite the cries of draconian cuts, this year's budget still marks an increase in per capita state spending of 83 percent over 30 years – even after adjusting for inflation.
- Teachers and teacher assistant positions are spared in the budget, thanks largely to $605 million in stimulus funds for education. Teachers and other state employees, however, receive no pay increase in the budget. An estimated



2,191 state positions will be eliminated in the budget, including 726 that are currently filled.

- Virtually all the remaining federal stimulus dollars, $867 million, are budgeted for the state's Medicaid program.
- In addition to the federal stimulus dollars, the budget relies on more than $1 billion in new taxes. Largest among these is the one-cent increase in the state sales tax, expected to cost taxpayers $804 million a year. A tax "surcharge" is also imposed on corporations and top income earners. Under the new law, corporations will be forced to pay 103 percent of their tax liability. The income tax surcharge will be assessed on individuals earning over $60,000 and couples earning above $100,000. The income tax surcharge will begin at 2 percent and rise to 3 percent on higher incomes. Another $69 million in new taxes is imposed on cigarettes, alcohol and tobacco products; and $11.8 million more in new taxes are assessed on digital downloads and internet retailers.
- In conflict with typical tradition, Perdue decides to sign the budget bill into law in private. Critics say this is because she doesn't want to be photographed signing on to one of the largest tax hikes in the state's history. Republican Party chairman Tom Fetzer says, "I don't think you'll see anyone clamoring for the pen that was used to sign this year's budget. No one associated with the passage of this budget should be proud." Perdue, however, defends the budget by touting its minimal reductions to public education. "I think the people of this state want public schools to have teachers and teaching assistants and good leadership. It's what's growing North Carolina's economy, has built North Carolina's future. I believe the public, as they understand what's gone on, will support the investment in education."

September

- In an attempt to reassure state employees upset about layoffs and the absence of pay raises, Gov. Perdue sounds an optimistic tone on the state of the economy. At a Greensboro meeting for the State Employee Association Perdue remarked, "There are rays of hope ahead for our economy, but we have a mountain of challenges right in front of us. And, you can rest assured, it will get better," she said. "Better for our state, for the citizens we serve, and better for state employees." Perdue's crystal ball proves a bit cloudy. At the time of her statements North Carolina's unemployment rate stands at 11 percent. A year and a half later, the unemployment rate will stand at 11.3 percent.
- Similarly rosy – and faulty – expectations are revealed in a Fiscal Research report. The report shows that revenue projections for the second year of the biennial budget just passed assume an increase in state revenue of 3.2 percent for the 2010-11 budget year compared to the current fiscal year. Such an assumption will help make budget-writing more difficult next summer when budget writers are faced with much lower than expected revenue levels.

October

- Gov. Perdue instructs the Budget Reform and Accountability Commission, a panel she assembled to examine opportunities for budgetary efficiencies, to study possible changes to North Carolina's current system of ABC stores. The system is overseen by the Alcohol Beverage Control Commission

and run through local governments. The system has been plagued of late with reports of unreasonable salaries and nepotism.

- Through the first quarter of the fiscal year, revenue projections are running 1 percent below projections. Fiscal Research chief economist Barry Boardman notes that North Carolina is still better off than many states, several of which are already 8 to 10 percent off projections.
- State Treasurer Janet Cowell reports that the state's pension fund fell below the fully-funded level last year. According to Cowell, it is the first time this has happened since 1997. The funding level as of the end of 2008 was 99.3 percent of the amount projected to fully pay out retirement benefits in the future. The retirement fund is supported by a combination of state worker contributions, taxpayer funds and returns on the fund's investments. Revenue from the fund's investments comprises 60 percent of its income, and the pension fund sustained substantial losses in the economic downturn. "State and local governments will need to continue to budget for increased contributions to the system" to keep it solvent, Cowell warns.

November

- State revenues continue to flow in below projections. The revenue stream is 1.5 percent short of what was planned for in the budget – roughly $95 million – but thanks to proactive measures by Gov. Perdue, the revenue should be sufficient to meet state agency needs. In August, Perdue ordered state agencies to reduce their expenditures by 5 percent. "The governor has measures already in place that will ensure we balance if there's a revenue shortfall for the entire fiscal year," said Charlie Perusse, Gov. Bev Perdue's budget director.
- In major national news, the U.S. House of Representatives passes historic health care legislation. Major components of the bill include a mandate requiring all citizens to have some sort of health insurance coverage, a significant expansion of Medicaid, greater restrictions on what health insurance companies can offer, and the establishment of health insurance "exchanges" in each state designed to offer consumers health insurance options that comply with mandatory government coverage options.
- Republican candidates for governor in both Virginia and New Jersey win their elections. The GOP victory in these two Democratically-leaning states creates a political buzz nationwide as pundits interpret the results as an indictment of the Obama presidency thus far.

December

- As the nation still struggles with high rates of unemployment, several states are forced to borrow massive sums of money from the federal government to continue sending out unemployment benefit checks. In order to meet rising unemployment claims, North Carolina has been borrowing from the feds since February. Experts estimate the borrowing will reach $2 billion by the end of the year. At this time, only five states have borrowed more than North Carolina. Lawmakers in the state have no plan how this money will be paid back. Fortunately for the state, because of clauses attached to the loans included in the federal stimulus plan, there are no interest payments on the debt due until the beginning of 2011, which buys the state additional time to figure out a repayment plan.

- In a Christmas Eve session, the U.S. Senate approves the massive healthcare overhaul bill. President Obama praised the action: "With today's vote, we are now incredibly close to making health insurance reform a reality in this country," he said after the vote. "Our challenge, then, is to finish the job. We can't doom another generation of Americans to soaring costs and eroding coverage and exploding deficits." The bill must first go through House-Senate negotiations to iron out differences, and then get final approval from each chamber before being sent to the president's desk.

2009 Significant Tax Changes (Budget Bill Unless Noted)

⬆	S.L. 2009-108 changes the state gas tax ceiling into a floor. The state gas tax can now no longer drop below 29.9 cents per gallon
⬆	Create a tax "surcharge" on upper-level income earners. A two percent extra charge is levied against the tax liability of single filers earning over $60,000 and married filers earning above $100,000. The extra charge increases to 3 percent for single filers earning above $150,000 and married filers earning above $250,000. Is scheduled to expire at the beginning of the 2011 tax year
⬆	Create a 3 percent tax surcharge on corporate income. Is scheduled to expire at the beginning of the 2011 tax year
⬆	Increase the statewide sales tax by a penny, from 4.75% to 5.75%. Is scheduled to expire on June 30, 2011
⬆	Extend sales tax to online click-through sales and digital products
⬆	Increase tax on beer, wine and liquor
⬆	Increase tax on cigarettes and tobacco products

2009 Other Revenue Sources & Actions

- Transfer $38 million from various "special" state funds
- Transfer $5 million each from both the Health & Wellness Trust Fund and the Tobacco Trust Fund
- Transfer $24 million from the Capital and Repair and Renovations accounts
- Projects an additional $150 million in business taxes to be collected through a "revenue compliance initiative"
- $47 million in increased Justice & Public Safety fees

2009 EDUCATION FUNDING

ENROLLMENT CHANGES

- Public Schools: -11,652 (0.7 percent) decline (change due to new starting age for kindergarten
- UNC: +6,630 (3 percent) increase
- Comm. Colleges: +10,635 (4 percent) increase

TUITION & FEE INCREASES

- Average tuition increase of 4.3 percent and 3.1 percent for full-time in-state and out-of-state UNC students
- Average tuition increase of 17 .5 percent for in-state and 2.6 percent for out-of-state full-time community college students

OTHER EDUCATION CHANGES

- K-12 state appropriations decline from $7.8 billion (2008) to $7.4 billion
- $225 million funding decrease to LEAs
- Provides $139 million to protect K-3 teaching positions
- Reduces funding for 100 programs, eliminates funding for 23 programs
- Budget includes no salary increase for teachers
- $44 million to UNC to meet expanded enrollment
- $23 million more in student financial aid
- Increases UNC tuition by lower of 8 percent or $200.
- Provides $9 million increase to nursing, dental and radiology technology and vocational/ technical programs.
- Eliminates 19 positions.

2009 Other Significant Changes

COMPENSATION

- No pay raises for teachers or state employees in the 2009-10 budget
- In April of 2009, Gov. Perdue orders an unpaid furlough to all state employees and teachers equivalent to ½ of one percent of their annual pay

FUTURE BUDGET CONCERNS

- The heavy reliance on temporary revenue, rather than sensible budget cuts, to balance the budget will likely result in a substantial structural deficit of $3 billion or more when the temporary revenue sources (temporary taxes, federal stimulus funds) run out in 2011-12

OTHER

- The state appropriation to the Clean Water Management Trust fund is cut in half to $50 million, but that is offset by $47 million in federal stimulus funds sent to North Carolina for that purpose

North Carolina's 2009 Tax Hikes Unique in Southeast

As part of the FY 2009-10 budget, North Carolina lawmakers introduced more than $1 billion in new taxes. Indeed, of the three major taxes typically imposed at the state level – income, sales and corporate – North Carolina managed to raise all three. Specifically, the sales tax was increased by a penny, and lawmakers created a "tax surcharge" to be levied onto the corporate tax and personal income tax of single filers earning above $60,000 and married filers earning above $100,000.

State lawmakers insisted that these steps were necessary to balance the budget. Apologists justify the tax hike by claiming that "everyone else is doing it," and therefore North Carolina's economic competitiveness will not be harmed. That's not true.

A report from the National Council of State Legislatures (NCSL) shows that among southeastern states, North Carolina stands virtually alone in its decision to impose massive tax hikes to balance its 2009-10 budget.

Recall that North Carolina raised all three major state taxes – sales, corporate and income. By comparison, no other southeastern state raised even one of the three major taxes in 2009.

The most significant tax raiser among other southeastern states was Florida, with about $1.2 billion in new taxes – almost all of that by virtue of a cigarette tax hike. Another billion was raised from increased vehicle registration fees. Bear in mind, Florida has no income tax. The other southeastern states imposed little or no tax increases on its citizens. States that did raise taxes merely introduced minimal, targeted tax increases – while not raising any of their major tax rates. Meanwhile, Georgia, Louisiana and South Carolina refrained from raising any taxes whatsoever.

Conversely, North Carolina imposed a laundry list of new taxes, including: a higher sales tax ($803 million), corporate and personal income tax surcharges ($196 million), higher "sin taxes" ($69 million), and the new "Amazon" and digital taxes ($12 million).

These developments showed that North Carolina's decision to impose massive tax increases to balance its budget was rather unique among states in the region. Aside from Florida, which was blasted by the bursting of the housing bubble, the next most significant tax hike in the southeast was a $200 million increase in hospital assessments in Alabama – a paltry amount when compared to North Carolina's billion dollars in new taxes. Why did North Carolina resort to such measures when virtually the rest of the southeast didn't?

2010 session

2010-11 BIENNIUM
FY 2010-11; July 1, 2010 to June 30, 2011

General Assembly:

House Dems:	52	House Reps:	67 (1 Ind.)
Senate Dems:	19	Senate Reps:	31

Governor:
Bev Perdue (D)

The 2010 Short Session: Budget Bill SB 897/S.L. 2010-31
Passed Senate: May 20, 2010
Passed House: June 4, 2010
Conference Version Ratified: June 30, 2010
Signed by Governor: June 30, 2010

The 2010 session picked up where the last one left off: daunting budget gaps and a struggling economy. The beginning of the year brings news of North Carolina's unemployment rate reaching a 34-year high of 11.2 percent, with few signs that improvement is coming any time soon.

Once again, state revenue lags behind expectations, meaning that state agencies must find ways to reduce spending below what they budgeted. A massive federal healthcare overhaul bill was approved in March, creating great uncertainty in the private sector of the economy and also in state capitals as they are unsure of the bill's implications – especially on their Medicaid programs.

When setting out to revise the second year of the two-year budget plan passed in the previous year, budget writers faced another multi-billion dollar gap. Fortunately for them, there was another $1.6 billion in federal stimulus dollars available to help fill that gap. Once again, however, state lawmakers neglected any meaningful spending reform and relied heavily on the temporary sources of federal funds and temporary taxes – both revenue sources that won't be available for them the following year.

Just a few months into the 2010-11 fiscal year, Gov. Perdue already recognized the fact that all the reliance on short-term revenue is setting the state up for a massive structural deficit the following year. By September, her budget office issues a memo requesting that state agencies submit suggested budget cuts of up to 15 percent to help guide the budget process for writing the 2011-12 budget. Such a request suggests that state budget officials have begun to recognize the significant hole they have dug for themselves.

November of 2010 featured historic election results, both nationally and in North Carolina. At the state level, Republicans took control of both chambers of the General Assembly for the first time in over 100 years. On the national level, in what many consider an indictment on the Obama administration, Democrats suffer the largest loss of Congressional seats in more than 70 years.

January

- 2010 begins with news that a special Department of Revenue initiative to settle millions in disputed corporate taxes has yielded greater than expected results. Actual collections exceed expectations by nearly $300 million. Thanks to the extra revenue, state revenue collections are now ahead of schedule.
- N.C. Department of Health and Human Services Secretary Lanier Cansler warns a legislative committee that the state's HHS budget may be $250 million short by the end of the fiscal year. Cansler blames the potential shortfall on higher-than-expected enrollment and federal roadblocks to cost-saving measures to the state's Medicaid system. "Trying to right this ship is one of the most difficult things I've ever done," Cansler said. Key budget writer Mickey

Michaux (D-Durham), however, grilled Cansler as to why the HHS budget wasn't living up to its expectations. "You came to us last year. We put your figures in the budget. Now you're telling us the numbers we put in the budget for you are not going to happen," Michaux said.

- North Carolina's unemployment rate reaches a 34-year high of 11.2 percent. The rate is above the national average of 10 percent. According to figures from the N.C. Employment Security Commission, North Carolina has lost 248,000 jobs since the beginning of the recession in December 2007. "I'm absolutely sure the unemployment rate has not topped out," said Wells Fargo economist Mark Vitner in Charlotte. "Layoffs have slowed, but the hiring rate is at an all-time low right now."
- Gov. Perdue reassures critics that her budget office is taking all the necessary steps to ensure the budget is balanced by the end of the fiscal year. "We are going through every piece of state government," Perdue said in a statement. "We don't have enough information to continue to cut. We need to find programs that have outlived their purpose so we can use those funds to do the things we need to do in the 21st century."

February

- North Carolina's Medicaid budget gets a bit of relief from the federal government. The feds determine that North Carolina's share of payments due is $400 million, not the $553 million previously estimated. The news comes on the heels of state HHS director Lanier Cansler's announcement that the Medicaid system may end up being $250 million short this year.
- Revenue for the first half of the fiscal year is found to be off by $35 million. The shortfall comes in spite of the spike in revenue realized by the Department of Revenue's special initiative on business taxes that yielded hundreds millions more than expected. The news is met with great pessimism from lawmakers. "It would not surprise me if it (the current year budget gap) hit $600 [million] or $700 million," said Sen. David Hoyle, (D-Gaston) co-chairman of the Senate Finance Committee. "But $500 million seems like a given."

March

- North Carolina receives word that it will not receive any grant money from the federal government's "Race to the Top" grant competition. The U.S. Department of Education solicited applications from states, and awarded a total of $600 million to winners Tennessee and Delaware. North Carolina applied for $469 million, and made it to the final 16 of states being considered. Gov. Perdue says that she is disappointed in the decision, but encouraged by North Carolina's showing in the evaluation process. "Our first round application was strong - North Carolina was in the final 16 applications out of 41 - but only two states were ultimately chosen," Perdue said."We clearly made a strong showing, and with more than $3 billion up for grabs in June, we will be back," she added.
- Advocates of charter schools blame the failure to be awarded any Race to the Top funds on the state's refusal to change the law capping charter schools at 100. Education Secretary Arne Duncan has publicly stated his support for charter schools. States were awarded

DID YOU KNOW?

Sixty-eight percent of voters believe it is more important to cut taxes to create jobs and stimulate the economy, versus only thirteen percent who think an increase in government spending is a better remedy. Those that prefer tax cuts outnumber those who believe in more government spending by more than five to one.

points in the grant process based in part upon how well states promoted charter schools. Duncan says that charter school policy was a "piece of the equation" for the grants but was not the determining factor.

- Gov. Perdue announces a new state initiative with IBM to crack down on Medicaid fraud. A software system will be used to scan the records of 60,000 health care providers and 2 million state residents enrolled in the system to find fraud and abuse. In exchange for running the program, IBM will receive 10 percent of all the fraud money recovered by their software system. "It is pretty evident to us that we have to do more to root out the waste and crack down on the people that we know are out there who are abusing the system," Perdue says. "I think we are going to save tens of millions of dollars."
- President Obama signs into law the "Patient Protection and Affordable Care Act," also referred to as Obamacare. The legislation weighs in at more than 2,000 pages and has generated significant controversy and debate. Critics charge that the mandate requiring all individuals to purchase or enroll in insurance coverage represents a serious infringement of individual liberty, and that even the lawmakers voting for the bill did not read or understand the entire content of the bill. As House Speaker Nancy Pelosi declared "We have to pass the bill so you can find out what is in it." Highlights of the bill include:

  - ☐ A mandate that all citizens, with a few specific exceptions for low income people, must attain insurance coverage either through a government program or an insurance plan.
  - ☐ More mandates on the products insurance companies can offer, such as forcing them to cover people with pre-existing conditions, and not allowing much variation in the premiums insurance companies can charge for customers of varying ages and medical backgrounds.
  - ☐ An expansion of the eligibility threshold for the federal and state-funded Medicaid program. Under the new legislation, people earning up to 133 percent of the federal poverty level will be eligible. Medicaid costs are shared by the federal and state governments. Medicaid expansion is expected to cost the states billions of dollars. Once fully implemented, some estimates place the price tag on North Carolina's share of expanded Medicaid programs to be as high as $600 million annually once fully implemented.
  - ☐ Government subsidies provided for those purchasing health insurance. Assistance is provided for households earning up to four times the federal poverty level – about $88,000 for a family of four.
  - ☐ Substantial new taxes, in large part to pay for the subsidies, as well as the growing expenses of Medicaid and Medicare. A new Medicare

payroll tax of 3.8 percent is to be applied to investment income, and also to high income earners.

- ☐ New state-based insurance "exchanges" established by 2014. The exchanges would offer insurance options that comply with the mandatory services required by the new Obamacare legislation. They would also enable individuals seeking insurance to join with others in a larger purchasing pool.

April

- A revised revenue forecast is presented by the General Assembly's Fiscal Research Division. In spite of the earlier business tax collection initiative, current fiscal year revenue collections have dipped to nearly $400 million below expectations. Projections for the coming 2010-11 budget year are similarly dour. A downward adjustment of $703 million - $19.7 billion to $18.9 billion - is revealed to budget writers, making their task even more challenging.
- Gov. Perdue releases her budget plan for the coming fiscal year. Total spending on state programs included in the Governor's proposal comes to $20.67 billion. This includes $19.15 million in state spending itemized in the budget, $1.04 billion in federal funds replacing state funding already embedded in last year's budget bill (but counted as cuts), and $578 million in additional federal funds mostly dedicated to cover rising Medicaid costs. Subtracting $101 million from the total to set aside into the Rainy Day Fund means the Governor's budget amounts to $20.67 billion in real spending. The total is nearly $300 million more than the current year's spending total (including federal stimulus funds). Perdue's budget includes a set aside of more than $123 million for a small salary step increase for teachers and monies to repay teachers and state employees lost wages from last year's unpaid furlough. It also eliminates roughly 600 state positions – mostly vacant. "This budget helps us set the table for the new normal," Perdue told reporters.
- In a curious display of priorities, Governor Perdue's recommendations would cut funding for K-12 education and public safety, while expanding spending on all other state agencies. Even after factoring in nearly $55 million in federal stimulus funds, the Governor's plan reduces funding for public education by more than $260 million – or roughly 3.5 percent – for the 2010-11budget. Among these reductions is an additional $135 million Local Education Agency (LEA) "flexibility adjustment." This would be in addition to the $225 million reduction enacted in last year's budget. Similarly, the Governor's budget proposal also reduces the budget for Justice and Public Safety by 3 percent.
- Conversely, every other state agency's budget would be expanded under Perdue's plan. The agency with the largest such increase would be Natural and Economic Resources, which would expand by 7.3 percent, followed by a 4.4 percent increase for HHS (once federal funds are included).
- The Governor avoids another round of tax increases in her plan, but proposes $75 million worth of new Department of Motor Vehicle fees. The new fees would be dedicated to financing Perdue's idea of a North Carolina Mobility Fund, which is dedicated to financing projects "of statewide and regional significance that relieve congestion and enhance mobility across all modes of transportation."

- Critics raise concerns over the long-term implications of Perdue's proposal, saying she once again refuses to implement meaningful spending reform or make tough budgetary decisions. Her reliance on more than $1.5 billion of non-recurring federal stimulus funds and $1.3 billion in temporary tax revenue to help balance the 2010-11 budget likely sets up North Carolina for a major state budgetary crisis in 2011-12. Absent those two significant sources of funding, state budget writers will be facing a revenue hole of $2.8 billion when they reconvene next year to craft the 2011-12 state budget. In a nationwide survey, economists project the economy to continue to be very sluggish well into 2011. Such realities suggest slow revenue growth (if any) for FY 2011-2012. More than likely, any revenue growth will fall well short of being able to replace the loss of stimulus funds and temporary tax revenues.

May

- The Senate approves its state budget plan for the coming fiscal year. Total spending on state programs in the Senate plan comes to $20.59 billion, slightly less than the Governor's plan. Total spending includes $18.99 billion outlined in the state budget, plus $1.04 billion in federal funds replacing state funds (but counted as cuts), and $561 million in additional federal funds added this year and dedicated primarily to the state's Medicaid program. The $20.59 billion in state spending would mark a $200 million increase over the budgeted real spending of $20.4 billion (including federal funds) included in the current 2009-10 budget. Indeed, compared to 2008-09 actual appropriations of $19.65 billion, the Senate's proposal would increase state spending over a two year period by nearly one billion dollars – roughly 4.8 percent – during the "greatest recession since the Great Depression."
- State employees receive no pay raises under the Senate plan, and local public education officials are granted flexibility to deal with their reductions with unpaid furloughs for teachers and staff.
- Similar to Gov. Perdue's budget recommendations, the Senate's plan reduces planned spending on public education and public safety, while increasing spending on virtually every other state agency.
- The Senate's plan would decrease appropriations on public education by $219 million relative to the spending plan first established last year in the state's two-year budget. Similarly, Justice and Public Safety spending would decline by $83 million in the Senate's 2010-11 budget proposal. Most of the cuts in JPS would come from corrections.
- Conversely, Community Colleges, the UNC system, Natural and Economic Resources and Health and Human Resources (aided by federal funds) each would see a bump in appropriations. Meanwhile, General Government would see a minor cut of 1.3 percent.
- The largest planned spending increase by the Senate would occur in Natural and Economic Resources, whose budget would expand by 9.4 percent. The increase would come mostly from an increase in the state Commerce Department expenditures on "economic development" measures.
- The Senate budget plan follows Gov. Perdue's lead in targeting North Carolina small businesses for tax relief. The Senate's proposal, however, differs greatly from Perdue's. The Governor's targeted tax relief featured a set of

ineffective tax credit gimmicks and rebates, without any change in the actual tax rates faced by entrepreneurs in the Tar Heel State. In contrast, the Senate's budget plan includes a reduction in the top marginal tax rate paid by businesses filing the individual income tax form. Nearly all small businesses in North Carolina, and most businesses generally, are organized as a "pass-through" business and pay taxes according to the individual income tax schedule rather than corporate taxes. The Senate's plan, therefore, would in effect be a tax rate cut on a significant number of small businesses throughout the state. Early estimates suggest that about a quarter million North Carolina businesses would receive a break from this tax cut.

June

- The N.C. House approves its proposed spending plan for 2010-11, which technically includes appropriations totaling $18.9 billion, but that doesn't tell the whole story. Like the Perdue and Senate budget plans, the $18.9 billion does not count $1.04 billion in American Recovery and Reinvestment Act (ARRA) – the federal stimulus act – funds already embedded as cuts via last year's two-year spending plan. That is money counted as a "cut" in the state budget, but backfilled by federal dollars. The House's recommended adjustments for 2010-11 include another $579 million in "cuts" that are also merely funding shifted to the feds. The $579 million includes $490 million in Medicaid dollars not yet approved by the U.S. Congress, so that money may not actually materialize. All told, spending on state programs including the federal funding comes to about $20.5 billion in the House budget, down slightly from the Senate's approved spending plan.
- In contrast to the Governor's proposal, the House Budget would add 861 full-time state positions; even as North Carolina suffers from double-digit unemployment. Most of those positions would come in the form of staffing needs for a new women's prison and a central prison hospital and mental health facility. The UNC system would also add more than 200 new positions for maintenance and security staff for additional buildings being put to use.
- The House plan raids $127 million of lottery proceed to preserve a reported 1,600 teacher positions. This amount is $90 million more than contained in the Senate's proposed budget. Under the House proposal, teacher and state employee salaries remain frozen for the second straight year. In addition, the House plan does not include the "payback" for last year's unpaid furlough contained in Gov. Perdue's budget.
- Similar to the Governor's plan, the House budget offers some targeted tax credits for small businesses in an attempt to create jobs. The plan includes a $250 credit for small businesses for each employee earning under $40,000 they provide health insurance for. Also included is a credit for small businesses of $1,000 for each job added and maintained for three years. In other words, the credit would work out to $333 per new employee per year. Such small, targeted tax breaks are not likely to sway the hiring decisions of business owners. Furthermore, even if the tax credit for hiring new workers lives up to the General Assembly's full expectations, only 7,200 new jobs would be created. By comparison, North Carolina has lost more than 250,000 jobs since January of 2008.
- For the first time since 2003, North Carolina's governor signs the state

budget into law before the start of the fiscal year. All told, once federal stimulus funds backfilling state programs are accounted for, the 2010-11 state budget spends $20.6 billion. The final budget most closely resembles the House budget plan as it adds 864 full-time state employees – mostly in new prison facilities and staffing for new UNC buildings. Spending is reduced for public education and public safety, but increased for every other major category save one. The budget for Natural and Economic Resources expands by 11 percent. Once federal funds are factored in, the Health and Human Services budget increases by 4.4 percent.

- Following the House budget's lead, the final state budget raids $121 million in North Carolina Education Lottery funds to preserve an estimated 1,600 teacher positions.
- Included in the final budget is $34 million designated for a targeted tax credit intended to encourage job growth among North Carolina small businesses. The temporary refundable credit will amount to 25 percent of a business's unemployment insurance liability. The credit would be limited to businesses with annual revenue of less than $1 million, and expire at the end of 2011.
- The new budget does not include any pay raises for teachers and state employees. The budget does authorize local education authorities to implement furloughs of state-funded teachers and staffers in order to meet their flexible spending reduction. The budget also authorizes UNC colleges the same option for staff reductions.
- Also included in the budget is authorization of $175 million more in non-voter approved state debt. In spite of warnings from the state Treasurer's office that the state has "substantially exhausted its General Fund debt capacity until FY 2012," state budget writers include the new debt to finance repair and renovations of state buildings and to purchase equipment for the UNC and Community College systems. The use of Certificates of Participation allows the debt to be issued without voter approval. North Carolina voters have been denied a vote over new state debt since 2000.
- Reaction to the budget is predictably partisan. Republicans say the budget didn't cut spending sufficiently, and sets the state up for a massive budget gap next year when $3 billion in federal stimulus funds and temporary state taxes will no longer be available. "What happens next year when that $3 billion problem is sitting there staring us in the face?" Sen. Phil Berger, the Senate minority leader said. Democrats defend their decisions and dismiss concerns over future budgetary issues "We came down here this year to face the longest recession since the Great Depression. Whatever happens next year, we'll face that too," said Sen. Martin Nesbitt (D-Buncombe).

I am in favor of cutting taxes under any circumstances and for any excuse, for any reason, whenever it's possible.

–Milton Friedman

July

- Finance Committee members receive a report stating that the amount of delinquent taxes owed to the state exceeds the $800 million shortfall budget writers had to close when crafting the state budget last month. "I

didn't realize it was that high," says Rep. Paul Luebke, (D-Durham) chair of the House Finance Committee. "It's definitely money that we could use."

- Gov. Perdue publicly signals her intent to consider privatizing a sizeable share of the state government's information technology operations. Research released by Perdue's office reveals that spending on IT functions totals more than $1 billion annually. Perdue's budget reform commission suggested asking a consultant to study the state's IT operations and recommend options for cost savings. "The goal is to move aggressively toward an improved IT infrastructure that will lower costs, reduce complexity and redundancy, improve the utilization of resources and increase security," Perdue wrote.
- Perdue signs legislation enacting modest reforms to the state's Alcoholic Beverage Control Boards. The law is designed to curb excessive salaries, eliminate poorly run stores and reduce corruption in the system. The move comes on the heels of several embarrassing stories about the ABC, including managers earning $200,000 per year and others receiving lavish gifts from liquor companies. Harsher critics of the ABC system had hopes of privatizing the entire system, but Perdue stopped well short of that, although she indicated she is still open to studying that option. North Carolina is one of 19 states to fully control liquor sales.
- Perdue states that she has already begun weighing options for balancing next year's budget. "This time next year, North Carolina will have a balanced budget," she said. "If that requires privatizing pieces of state government, I believe the General Assembly will have the courage and folks across the state will do what they need to do to stand up and make sure that North Carolina's core missions are carried on."

August

- North Carolina wins a $400 million grant from the U.S. Department of Education in the federal government's second round of "Race to the Top" grants. The state was one of ten winners, and will receive the award over four years with the intent to raise test scores, lower high school dropout rates and ensure students graduate high school better prepared for college or careers. The three primary uses of the grant funding, according the Raleigh *News & Observer*, are "money to recruit and retain quality teachers and administrators; a turnaround plan for low-performing schools, and handheld devices that would allow teachers to continuously track students' progress." Gov. Perdue was excited about the news. "North Carolina's children today are one step closer to being guaranteed the best education possible - something every child deserves," she said in a statement. "This grant will give us the resources to more aggressively implement our plan to ensure that all of our children graduate ready for a career, college or technical training."
- The Department of Revenue reveals a 15-year backlog of tax refunds owed to North Carolina taxpayers. Thousands of state returns have been flagged for errors, several of them due to overpayment. Many of these marked returns, some dating back to 1994, have been collecting dust with no follow up by the Department of Revenue. "If the state owes anyone money, we will get it to them, even if we have to ask the legislature to change the law in order to do it," assures Perdue spokesman Mark Johnson. For those returns in which it is

found the taxpayer owes more money, the three-year statute of limitation will be observed and the taxpayer will be relieved of their payment.

- The federal government enacts legislation providing billions for state Medicaid programs. According to the federal stimulus bill passed last year, the federal government was to pick up a larger share of the Medicaid tab. But these added payments were in doubt as the U.S. Senate was wavering in its support for this provision. North Carolina budget writers are relieved, as they won't have to resort to any contingency plan to compensate for the loss of more than $500 million in federal Medicaid funds they were expecting through the end of this fiscal year.

September

- Office of State Budget and Management head Charlie Perusse sends a memo to state agencies instructing them to put in writing plans detailing how they would cut 5 percent, 10 percent and 15 percent from their budgets. According to the memo, agency heads should look for "underperforming programs, unnecessary services and redundant employees." The agency responses will then be used as a basis for recommended cuts to next year's budget. State officials are concerned about the lapse of $3 billion in temporary revenue from the federal stimulus monies and the temporary taxes enacted last year. Republican leaders are encouraged by such a proactive measure coming from the governor's administration, but also hopeful for even more. "I am certainly encouraged that [Perdue] is thinking about the size of the real problem that we're facing," said Sen. Phil Berger, senate minority leader. "I hope that she'll take an additional step and look at this year's spending level."
- Amid all the budget-cutting concerns, some sizeable pay raises to top education administrators raise eyebrows. Department of Public Instruction chief academic officer Rebecca Garland saw a salary hike of 7.2 percent, bringing her annual pay to $152,000. Furthermore, Garland's deputy, Angela Quick, received a raise of 6.9 percent, bringing her salary to $130,000. DPI superintended June Atkinson defended the raises by stating that these positions recently assumed greater responsibilities and duties due to the elimination of a deputy superintendent position.

October

- In an effort to make government leaner and more efficient, Gov. Perdue announces new standards for state rules and regulations. Part of the new initiative is launching a new website for residents to suggest specific rules they find particularly burdensome and unnecessary. Perdue also will establish a committee to examine existing and proposed rules to ensure they "make sense" and don't hinder businesses.
- The General Assembly's Fiscal Research Division begins warning budget writers about the 2011-12 budget that they will need to craft in the coming spring. In addition to the $3 billion in expiring temporary revenue, the State Health Plan will need an additional $572 million over the next biennium to cover expenses. Other spending pressures will include expanding Medicaid enrollment, as well as growing student populations in K-12, community colleges and the UNC system.
- State Alcoholic Beverage Commission (ABC) Chairman Jon Williams tells the

state government Budget Reform and Accountability Commission that the number of local ABC boards suffering financial losses during the year outnumbers those realizing a profit by more than a two-to-one margin. Williams blames the losses, in part, on higher alcohol taxes enacted last year as eating into the system's overall profits. Over the summer, legislation was passed to allegedly streamline budgeting for local ABC boards and enhance performance standards. Gov. Perdue has claimed she will consider privatizing the ABC system, but has yet to act.

November

- State agency responses to Gov. Perdue's budget office request for recommended spending cuts of up to 15 percent are few and far between. Among the few actually submitted are some from the state's community college system. Recommendations include a tuition increase of $10 per credit hour, 1,000 teacher layoffs and a reduction of course selections. Some observers question if the nature of the recommended cuts represent agencies' best efforts at reducing redundancy or an attempt to garner political sympathy. "Obviously both on the federal and state level, on occasions like this, agencies understand some of the things they do are less valued by the public than others," says N.C. State political science professor Andy Taylor. "It makes sense to put the more valued services on the chopping block to make the public aware that they will have a tangible impact."
- In a historic election night, Republicans ride a national wave of voter disgust with big government and big spending politicians. Republicans gain control of both chambers of the state's General Assembly for the first time in more than a century. In the state House, Republicans enjoy a 67-52 edge over Democrats, with one independent who typically caucuses with the Republicans. Even with 68 votes, however, House Republicans fall a few members short of the 3/5 majority needed to override a gubernatorial veto. On the Senate side, Republicans gain a 31-19 majority; large enough for an override. In all, roughly 2.7 million votes were cast in the Tar Heel state in the 2010 elections – which amounts to 43 percent of registered voters.
- "We are going to govern in a different way," promises Rep. Paul "Skip" Stam (R-Wake), the current House minority leader, at the GOP victory party in Raleigh. "We're going to govern in a frugal way, in a responsible way."
- Democrats are conciliatory and recognize that their ruling majority had to come to an end sometime. "In serving the people, you understand a day like this may come," says Sen. Marc Basnight (D-Dare), Senate leader for the past 18 years. "You are hopeful that the change is beneficial, new ideas, different thoughts. This is only what the people want, so that means it is good."

FY2010-2011 HEALTH & HUMAN SERVICES BUDGET

Total Appropriations	**$3.9 billion**
Major Items:	
Medical Assistance (Medicaid)	$2,368 million
NC Health Choice	$88 million
Mental Health/D.D./Subst. Abuse:	$705 million
Child Development	$234 million
Social Services	$193 million
Public Health	$157 million
Central Management & Support	$71 million

- "It was just a wave," House Speaker Joe Hackney (D-Orange) says about the significant shift in power both in the state and nationwide. "I was here for the national Republican wave in 1994, and this is like that."
- On the national level, many observers say the election results are an indictment on President Obama's performance. The Democratic Party's loss of 63 House seats is its worst in 72 years. Democrats lose 5 seats in the Senate, but retain the majority. For North Carolina, Senator Richard Burr (R) retains his seat, and all but one incumbent Congressman wins re-election. The one incumbent falling is Bob Etheridge (D), who loses to newcomer Renee Ellmers (R). North Carolina's contingent now consists of 6 Republicans and 7 Democrats.
- President Obama worries that the election results are a signal that he has lost touch with the American public. "There is an inherent danger in being in the White House and being in the bubble," Obama says."The responsibilities of this office are so enormous, and so many people are depending on what we do. In the rush of activity sometimes, we lose track of the ways that we connected with folks that got us here in the first place."

December

- Gov. Perdue orders state agencies to reduce their budgets by another 2.5 percent. The savings are to be realized through a hiring freeze and tighter control on raises, travel and non-essential purchases. The move is seen as a proactive measure in anticipation of actual revenues once again falling short of budgeted revenues. "I'm delighted she did it," says Rep. Paul "Skip" Stam (R-Wake). "Some of the agencies were frankly not saving money. Some of the larger ones had not gotten the message that there was a budget problem." Stam adds that the new Republican leadership in the General Assembly is prepared to grant Perdue emergency budget authority to help alleviate the current budget crisis.
- Perdue suggests that she is still open to several ideas to help the state fill its budget gap, but not open to more tax hikes. One issue on the table is allowing for legal video poker, which could produce significant tax revenue to the state. She is also awaiting results from a consultant's report on privatizing the state's ABC system. "I have believed for a long time there has to be real examination of privatization," Perdue says. "I'm not quite there. I need to know what its worth. I need to know what its worth to the taxpayer. I need to know what kind of damage it would do to local governments."

2010 Significant Tax Changes (Budget Bill Unless Noted)

- ⬇ Create a temporary credit for small business equal to 25% of the companies' unemployment insurance tax liability. Small business is defined as those with gross receipts of $1 million or less. The credit applies only to 2010 and 2011 taxable years
- ⬇ Extend sunset for a number of targeted tax credits, including rehabilitation projects, interstate passenger air carrier, aviation fuel for motor sports events
- ⬇ Temporarily allow the state's estate tax to lapse

2010 Other Revenue Sources & Actions

- Transfer $5.4 million from the Health and Wellness Trust Fund
- Transfer $14 million from the motor fleet services fund
- Increase Justice and Public Safety fees by $14 million
- Collect an additional $110 million from a Department of Revenue settlement initiative
- Create the N.C. Mobility Fund with $39 million diverted from the Turnpike Authority; the Fund is established initially to finance the widening and improvement of the I-85 corridor north of Yadkin bridge

2010 EDUCATION FUNDING

ENROLLMENT CHANGES

- Public Schools: +10,552, an increase of 0.7 percent
- UNC System: -595, decline of 2 percent
- Comm. Colleges: +2,475, increase of 1 percent

TUITION & FEE INCREASES

- UNC: Average tuition and fees up 15.3 percent for in-state students and 6.8 percent for out-of-state students.
- Comm. Colleges: Average tuition and fees up 10.9 percent for in-state students and 1.8 percent for out-of-state students.

OTHER EDUCATION CHANGES

- State appropriations, $7.08 billion, down from $7.4 billion in 2009
- Transfers $442 million from Education Lottery to support 1,600 teaching positions
- Reduces Department of Public Instruction funds by 15 percent ($2 million).
- Includes no raises for teachers
- Directs UNC to reduce combined spending by $70 million and gives campuses flexibility on where to cut.
- Allows campuses to raise tuition by $750 to help meet budget shortfall.
- Gives UNC additional $5.6 million to address needs of expanded enrollment
- Directs Comm. Colleges to reduce combined spending by $15 million per year.
- Provides an additional $81 million to pay for additional 33,000 students.

2010 Other Significant Changes

COMPENSATION

- Teachers and state employees receive no pay raise again in the 2010-11 budget, and they do not receive any reimbursement for the unpaid furlough Perdue imposed on them in 2009

ECONOMIC DEVELOPMENT EXPANSION

- The 2010-11 budget includes expansions to several "economic development" causes, including: an additional $12.5 million to the One NC Fund, $1.5 million to Perdue's "Main St. Solutions" program and $5 million to the state's regional economic development commissions

CAPITAL

- Authorizes $175 million in non-voter approved Certificates of Participation debt to finance UNC and Community College equipment and repair and renovations of state buildings

OTHER

- The department of Forest Resources yields $1.5 million in revenue from selling some of its air fleet
- The state spends $8 million to open and staff two new women's prison hospital facilities

2011 session

2011-12 BIENNIUM
FY 2011-12; July 1, 2011 to June 30, 2012

General Assembly:

House Dems:	52	House Reps:	68
Senate Dems:	19	Senate Reps:	31

Governor:
Bev Perdue (D)

The 2011 Long Session:
Budget Bill SB 200/S.L. 2011-145
Passed House: May 4, 2011
Passed Senate: June 4, 2011
Conference Version Ratified: June 4, 2011
Vetoed by Governor: June 12, 2011
Veto Overriden by Legislature: June 15, 2011

The 2011 legislative session ushered in a Republican majority in both chambers of the North Carolina General Assembly for the first time in more than a century. The new leadership was swept into office largely riding a national wave of discontent over the Democratic majorities at the national level combined with frustration here in North Carolina over the state's economic struggles. North Carolina's economy was hit harder than most states in the recent recession, and its unemployment rate continued to be among the top five in the nation throughout the year.

The new majority promised more fiscal restraint, and most importantly, no new taxes. Those topics proved to be a major issue in the 2011 budget process, as temporary taxes approved two years prior were slated to expire along with the hundreds of millions of federal "stimulus" revenue. This combination of expiring revenue streams presented state budget writers with another multi-billion dollar budget hole that needed to be balanced.

2011 also became an historic year as it saw the first ever gubernatorial veto of a state budget in North Carolina, followed quickly by the first legislative override of a budget veto. The budget override is only the second time in state history any vetoed bill has been overridden.

Fiscal realities quickly began to set in early in the year, as 2011 opened with discussion about state employee layoffs, possible privatization of the state's Alcoholic Beverage Control system and legislation to utilize various state funds to help finance general government operations.

Taxes continued to be an issue at the end of 2011, as the state's adjustable gas tax received considerable debate. In spite of the House's actions to cap the tax, the Senate refused to take up the issue and allowed the tax to increase as the calendar turned to 2012.

January

- Gov. Perdue rules out any meaningful reform to the state's Alcoholic Beverage Control system. Plagued by scandals of reported outrageous salaries and nepotism, a serious study was conducted examining various ways for the state to loosen its grip on the sale of liquor. The option under most consideration – selling the system's assets along with licenses to private concerns – would yield the state a one-time windfall of $300 million. "The juice just is not worth the squeeze for the people of this state," said Perdue.
- As the new legislative session approaches featuring a Republican majority in both the House and Senate for the first time in more than a hundred years, House Speaker Thom Tillis (R-Mecklenburg) and Senate leader Phil Berger (R-Rockingham) discuss a few of their goals. Included among those are more open government, reducing legislative staff costs, empowering

state agency heads with discretion over how to reduce their costs and reducing business regulations. Berger also suggests that reducing the state government workforce will be a necessary step in helping to balance the state budget. "Layoffs will be part of the solution," Berger said. "How big a part remains to be seen."

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February

- Gov. Perdue unveils her biennial budget proposal that spends $19.9 billion in the coming fiscal year. The most attention-grabbing aspects of Perdue's plan are her intention of keeping ¾ of the "temporary" penny sales tax enacted two years ago along with the elimination of nearly 10,000 state positions, 3,000 of which are currently filled. The tax extension would cost roughly $825 million. Republican leaders in the legislature naturally criticized Perdue's tax proposal. "The governor would take $800 million out of the pockets of North Carolinians in order to balance this budget," said Senate leader Phil Berger. "It's time for government to tighten its belt."
- Republican leadership in the House and Senate hand out their spending targets to their respective appropriations committees. The spending targets create a goal for the level of spending and provide guidance on where to look for savings. The total spending target of $17.6 billion is significantly less than the $19.9 billion budget plan recently released by Gov. Perdue. "The spending targets announced today come at a time when decisive action is required to put North Carolina's fiscal house in order," said House Speaker Thom Tillis. "The new majority in the General Assembly did not create this budget shortfall, but we were elected to fix it."

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- Gov. Perdue vetoes a bill passed by the legislature that would have utilized funds from various pots of money in order to address the state's budgetary shortfall. The bill is intended to proactively address an anticipated $2.4 billion shortfall in the coming fiscal year by reducing some spending from this year's budget and sweeping up some dollars from various state funds – largely including monies used for various "economic development" programs. Perdue objects largely because she does not want to forego any of the money she claims is vital to job creation in the state. Lawmakers are also anxious to use the funds to pay for tax refund checks owed to state taxpayers.

March

- House Republican leaders propose an exceedingly rare move – turning down federal government funds. The funding in question is a total of $461 million in federal grants for improved train service from Raleigh to Charlotte. Republicans are leery of how much

in future operation and maintenance costs the state will be strapped with. "I just don't think we should be creating another unsustainable system for the citizens of North Carolina to bear the financial burden on," said Rep. Ric Killian (R-Mecklenburg). Should North Carolina reject the funding, it would follow the lead of Ohio, Wisconsin and Florida, who collectively turned down $3.6 billion in federal grants for rail projects.

- The Senate votes along party lines, 31-19, to override Perdue's veto of the legislative bill utilizing various pots of money to help balance the state budget and ensure tax refunds are paid in a timely manner – a measure vetoed by Perdue late last month. The House subsequently fails to override Perdue's veto.

April

- House budget writers approve their $19.3 billion budget proposal for FY 2011-12. Five Democrats crossed party lines to join the unanimous Republican votes in favor of the spending plan. The House plan spends $600 million less than Perdue's budget proposal, and does not include any tax increase. As in Perdue's budget, state employees would receive no pay raise, and an estimated 18,500 state positions would be eliminated in the House plan – compared to roughly 10,000 in Perdue's plan. The House plan also includes a $255 million reduction in funding for teacher assistants in grades K-3, a reduction of roughly half of that type of funding. Also included is more than $92 million in new fees and fee increases, such as an increase in the home foreclosure fee and new and higher fees to be imposed on coastal ferries.

May

- The Senate unveils their approved budget plan, which totals $19.4 billion, slightly more than the House plan but still $500 million less than Gov. Perdue's budget proposal. Like the House plan, the Senate does not include the ¾ cent sales tax hike proposed by Gov. Perdue. Unlike the Governor and House plans, however, Senate budget writers opt not to include a reduction to the corporate income tax rate. Instead they propose a tax credit for small businesses along with a slight drop in the individual income tax rates coupled with an expansion of the income tax base. State employees would not receive a pay raise in the Senate proposal, and the Senate budget would eliminate nearly 20,000 state government positions, with as many as 13,000 of those being teachers assistants. The Senate does, however, include $62 million to add 1,100 teaching positions to bring down the teacher student ratio. Also different from the House and Governor's budget proposals is the Senate's inclusion of a new system of merit pay for state employees – including teachers.

FY2011-2012 HEALTH & HUMAN SERVICES BUDGET

Total Appropriations	**$4.495 billion**
Major Items:	
Medical Assistance (Medicaid)	$2,958 million
NC Health Choice	$79 million
Mental Health/D.D./Subst. Abuse:	$666 million
Child Development	$266 million
Social Services	$186 million
Public Health	$190 million

- Legislation making changes to the State Health Plan that covers most state employees becomes law. For the first time, state employees and retirees will

DID YOU KNOW?

At 38.9 cents per gallon, North Carolina's state gas tax as of Jan. 1, 2013 will be fifth highest in the nation. The state gas tax is an adjustable rate based upon the wholesale price of fuel, as gas prices rise so too does the state gas tax.

pay a share of the premium costs for enrollment into one of the SHP plan options. Several out of pocket expenses such as co-pays are increased slightly by the legislation as well. Employees and retirees enrolled in the more comprehensive "80/20" plan will now need to pay about $21 a month toward enrollment into the SHP. Enrollment into the less comprehensive and less expensive "70/30" plan will still be free to employees and retirees. The move comes on the heels of reports that the SHP is facing a half billion dollar shortfall in the coming biennium.

June

- For the first time in state history, a North Carolina governor vetoes the budget bill approved by state lawmakers. Then, by a 31-19 vote in the Senate and a 73 to 46 margin in the House, the General Assembly finalizes the first veto override of a state budget. The primary source of conflict between Perdue and legislators is a ¾ cent increase in the state sales tax that Perdue wanted. A temporary, one-cent sales tax increase approved two years ago expires at the end of this fiscal year and Perdue didn't want to see any significant drop off in revenue due to the expiration of the tax.
- Perdue especially focuses her objection to the legislative budget in regards to public education spending. Upon reflection, critics say the Governor's comments that the state budget amounts to the legislature "turning its back on education" that will "cause generational damage to this state" are overblown given the tiny fraction of a difference in funding for public education between the budget Perdue vetoed and her own budget plan. The state budget passed in spite of Perdue's veto allocates $7.46 billion to public education, compared to $7.6 billion in Perdue's plan. Indeed, the final budget includes full funding for K-3 teacher assistants and provides more than $60 million in new spending to finance reductions in K-3 class size – something not included in Perdue's plan.

July

- Wake County Superior Court Judge Howard E. Manning Jr. issues an order stating that the state cannot create any barrier to prevent at-risk children from enrolling in the state-funded Pre-K program (formerly known as More at Four). The newly passed state budget reduced funding for the program by 20 percent, and created a co-pay for those children not deemed to be "at risk." "This case is about the individual right of every child to have the equal opportunity to obtain a sound basic education," Manning explained in the order. Conversely, House Speaker Thom Tillis stated: "I am disappointed in today's order from Judge Manning. The court ruling is unclear in key places and may be incorrect as a matter of law."
- The state's Program Evaluation Division releases a report recommending consolidating several smaller community colleges by merging them with larger, nearby colleges in order to save more than $5 million annually. Naturally, the State Board of Community Colleges unanimously passes a motion opposing the proposed consolidation. State lawmakers don't act on the report's

recommendations, but feel it has triggered a necessary conversation.

August

- Gov. Perdue's office issues a statement that the governor intends to develop a plan to accommodate all eligible 4-year-olds to the state's Pre-K program. This announcement comes in the wake of Judge Howard Manning's decision that the state cannot exclude any children deemed "at-risk" from the program. Perdue's office, however, admits there simply isn't sufficient resources such as staff and facilities to accommodate every four year old labeled at-risk. Last year, enrollment in the program was roughly 32,000, while estimates place the total of "at-risk" four year olds at 65,000.
- Standard & Poor's, one of the nation's premier credit rating agencies, downgrades the U.S. government's credit rating in an unprecedented move. U.S. government debt will now be rated AA+, a step below AAA. The move will likely prompt higher interest rates on government issued debt, making it more expensive for the federal government to borrow money. In light of this action, there are growing concerns among state and local governments regarding their credit ratings. In North Carolina, the State Treasurer warns that the state government has reached its maximum debt load – to borrow more in the near future would threaten the state's coveted AAA credit rating.

September

- Gov. Perdue announces a new project designed to streamline and improve how the state government purchases more than $4 billion worth of goods each year. The plan will implement recommendations from a private consulting firm, and is hoped to save $30 million a year. Greater collaboration, more training for purchasing agents and bulk buying deals with other states are among the cost-saving measures. "State government must be streamlined and nimble, finding every savings that we can, just as families and businesses across the state are doing," says Gov. Perdue.

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October

- Due in large part to projected savings that haven't materialized, North Carolina's Medicaid program will find itself in a $139 million hole this year. According to DHHS Secretary Lanier Cansler, the shortfall is the result of budgeted savings that are "unreasonable and unobtainable." Major shortfalls include: rate reductions to service providers written into the budget that did not receive federal government approval and savings by Medicaid's managed-care program falling well short of expectations.
- A report by the legislature's top economist shows that tax revenue for the first three quarters of the fiscal year are running about 3.5 percent above projections. The slight surplus translates into between $135 and $145 million in extra unanticipated funds for state coffers. Barry Boardman, lead economist for the General Assembly's Fiscal Research Division and presenter of the revenue data, calls the tax collection

figures "a wickedly odd report" that "seems to be defying gravity." Boardman's surprise is due to North Carolina's continued double-digit unemployment rate. Budget writers crafted their revenue projections based on an anticipated unemployment rate between 9 and 9.5 percent. "If we stay in double-digit unemployment numbers…it would be a very difficult feat for us to run a surplus," says Boardman.

November

- The state House approves a bill that would prevent the state gas tax from rising on Jan. 1, but the Senate leaves Raleigh without voting on the bill. As a result, North Carolina motorists can expect a nearly 4 cent spike in the gas tax as 2012 begins. The new tax is expected to rise to 38.9 cents per gallon, which would rank North Carolina's rate fifth highest in the nation. North Carolina's gas tax is calculated using a formula based on the wholesale price of fuel, and adjusts every six months. As fuel prices rise, so too does the gas tax.

December

- An audit of a state project to design and implement a new computer system for processing Medicaid claims reveals massive cost overruns and delays. The state contract with Computer Sciences Corp. for the new program totaled $265 million, but actual costs are running close to $500 million and the project is on pace to be completed 22 months later than originally promised. The federal government is expected to pick up 90 percent of the new system's costs, but the state's price tag is still significant and the delays have caused great frustration among state lawmakers. In spite of the results of the audit, head of the Medicaid Management Information Systems office Angeline Sligh tells legislators "I feel like I've done a good job leading the program. I would give myself an A." Rep. Justin Burr (R- Stanly) disagrees. "If this was the private sector, someone would have been let go long ago," says Burr. Burr also labels the project a "money pit."

2011 Significant Tax Changes (Budget Bill Unless Noted)

- ⬇ Small business tax relief tax package, exempts the first $50,000 in business income for start-up and small businesses having gross receipts less than $825,000.

2011 Other Revenue Sources & Actions

- Earmark $185 million for the state's Savings Reserve Account and $125 million for the Repairs and Renovations Reserve Account from excess revenue carried over from last year
- Transfer of $199 million from the Highway Fund to the General Fund to compensate for the switching of financial responsibility of the State Highway Patrol
- Increase judicial fees by $62 million
- More than $136 million is diverted from 11 various state funds to the help balance the General Fund. Funds being affected include: Highway Trust Fund, Golden LEAF, Parks & Recreation Trust Fund, Health and Wellness Trust Fund and several others

2011 EDUCATION FUNDING

ENROLLMENT CHANGES

- Public Schools: +5,323 (0.36% increase)
- Community Colleges (Curr. Programs) -8,716 (2.5% decrease)
- UNC System - 1,422 (0.64% decline)

TUITION & FEE INCREASES

- UNC: Average increase of 8.6% for in-state students and 5.2% for out-of-state students
- Comm. Colleges: 17.9 percent increase in tuition for in-state students; 4.6 percent increase for out-of-state students

OTHER EDUCATION CHANGES

- Final budget agreement adds $250 million to original budget legislation
- $61.7 million to add 1,100 teachers to reduce class size
- $124.2 million increase to management flexibility reduction for LEAs
- $414 million reduction for UNC System
- $446.9 million transferred from lottery to state

2011 Other Significant Changes

COMPENSATION

- No pay raises are included for state employees
- State employees and retirees now must pay about $21/mo. for enrollment into the more comprehensive of two coverage plans offered by the State Health Plan. Several out of pocket expenses such as co-pays are increased slightly as well. (S.L 2011-85)

2012 session

2012-13 BIENNIUM
FY 2012-13; July 1, 2012 to June 30, 2013

General Assembly:

House Dems:	52	House Reps:	68
Senate Dems:	19	Senate Reps:	31

Governor:
Bev Perdue (D)

The 2012 Short Session:
Budget Bill HB 950/S.L. 2012-142
Passed House: May 30, 2012
Passed Senate: June 14, 2012
Conference Version Ratified: June 21, 2012
Vetoed by Governor: June 29, 2012
Veto Overridden by Legislature: July 2, 2012

The Republican majority in the state legislature reconvened in 2012 to tweak the second year of the two-year budget they passed last year over Gov. Perdue's veto. For the second straight year, the House and Senate would need to override the Democratic governor's veto. The largest source of disagreement between Perdue and the legislature stemmed from public education funding.

Because past budget writers chose to fund ongoing education obligations with temporary federal stimulus dollars and temporary tax hikes, state lawmakers have had to reduce public education spending to reflect financial reality. Gov. Perdue, however, proposed to reintroduce a $760 million sales tax increase to prop up the inflated level of government spending. Republican leaders in the General Assembly staunchly opposed any tax increases and offered a budget that balanced without any tax hikes.

In spite of the fact that the legislative budget appropriated 99 percent of the amount Perdue included in her own budget proposal on public education, Perdue vetoed their budget plan for the second straight year. Also for the second consecutive year, the legislature garnered enough votes to override Perdue's veto.

With her announcement that she will not run for re-election, Perdue opened up the Democratic field for candidates to oppose the Republican candidate, former Charlotte Mayor Pat McCrory. McCrory lost to Perdue narrowly in their 2008 race. The Democrats settled on Lt. Governor Walter Dalton.

Election night saw a McCrory victory and Republicans strengthen their majorities in both chambers. The results mark the first time North Carolina Republicans have controlled both chambers of the General Assembly along with the Governor's office in nearly 150 years.

January

- Assistant Commerce Secretary Lynn Holmes is questioned in a state committee meeting regarding the $2.6 billion hole in the state's unemployment insurance fund. The state has had to borrow that amount from the federal government to keep up with benefit claims. "The crux of the matter is that 2009 was the insolvency and nothing was done from that period forward," said Sen. Bob Rucho, R-Mecklenburg and a committee co-chairman. "That's not a good way to run a business and very simply that is why we're sitting in the $2.6 billion hole." The debt will require higher unemployment insurance taxes in the future – placing an additional burden on employers.
- North Carolina's state tax revenues are ahead of schedule for the first half of the 2011-2012 fiscal year. The latest figures show revenues coming in $60 million above projections, with above-expected corporate and franchise tax collections leading the way.

- In the middle of the month, Gov. Perdue announces that a key plank of her re-election strategy would be to bring back a three-quarters of a penny increase in the state sales tax, estimated to cost taxpayers more than $800 million annually. By the end of the month Perdue, whose approval ratings are among the lowest of all sitting Governors, announces she will not run for re-election.

"The crux of the matter is that 2009 was the insolvency and nothing was done from that period forward," said Sen. Bob Rucho, R-Mecklenburg and a committee co-chairman. "That's not a good way to run a business and very simply that is why we're sitting in the $2.6 billion hole."

February

- "The slow recovery, in combination with the reduction of the state sales tax rate, has resulted in another year of no debt capacity." That's the quote from the latest debt affordability study issued by State Treasurer Janet Cowell. In short, the study recommends the state not issue any additional debt for the 2012-13 fiscal year in order to avoid a possible credit rating downgrade. The treasurer's office recommends the state keep its annual debt service payments below 4 percent of annual General Fund expenses. Any additional borrowing this year, according to the report, would exceed that limit.
- Gov. Perdue announces she is issuing an executive order to block new and higher tolls on coastal ferries included in the FY 2011-12 state budget and scheduled to take effect in April. "This new ferry tax – which I have always opposed – is both excessive and discriminatory," Perdue said in a news release. "It is unjust for the General Assembly to balance their budget on the backs of coastal working men and women." Perdue adds that she intends to impose a 12-month moratorium on the new tolls and orders the state Department of Transportation to find spending reductions to offset the foregone revenue.

March

- Waivers issued by State Schools Superintendent June Atkinson to 91 of the state's 115 school districts will exempt the majority of North Carolina public school students from a requirement passed in last year's budget mandating an additional 5 days of school. School district leaders cited additional costs and short notice for reasons they opposed the extra class time requirements. Legislative leaders say they will not oppose the waivers. "If we saw they were trying to circumvent the law, we'd put a stop to it," said state Sen. Jerry Tillman (R – Randolph) co-chairman of the Senate Education Committee. "We're not at that point." Lawmakers said they will likely take up the issue in May when the General Assembly reconvenes.
- An advertising campaign citing the fact that 2,000 additional state-funded school teachers were financed by the 2011-12 budget stirs up criticism and controversy. N.C. Real Solutions, an educational campaign funded and produced by the North Carolina chapter of Americans for Prosperity and the Civitas Institute, focuses the public's attention on this fact in a series of television and radio ads across the state. Critics have to concede that the data was factually correct, but complained that it may be misleading because it doesn't reflect losses of federally- and locally-funded

teachers. N.C. Real Solutions counters by stating those losses are a result of the short-sighted reliance on temporary federal stimulus funds, and that the 2011 legislature did an admirable job to find the state funds to save those 2,000 teaching positions that otherwise would have been eliminated. The advertising campaign gets the attention of Gov. Bev Perdue, who claims it "distorts the truth" and calls for the ads to be pulled off the air.

"If we saw they were trying to circumvent the law, we'd put a stop to it," said state Sen. Jerry Tillman (R – Randolph) co-chairman of the Senate Education Committee. "We're not at that point."

- The State Department of Transportation unveils new or higher tolls for several coastal ferries – rates that they will not actually be collecting. The 2011-12 state budget included a provision for the new tolls to begin being collected on April 1, but Gov. Perdue issued an executive order instructing DOT not to actually collect the new tolls. There are conflicting legal opinions regarding Perdue's authority to block the tolls.

April

- An historic Mega Millions jackpot of $640 million provides a substantial spike in North Carolina Education Lottery collections. Estimates suggest the NCEL netted more than $20 million in revenue from that specific Mega Millions game alone due to the intense demand for tickets for the huge prize. About half of the lottery ticket revenue goes to prize payouts, with more than a third of revenue going to fund various education programs. Since its inception in 2006, the NCEL has generated about $2.35 billion for North Carolina public education.
- A collection of 25 local public school superintendents discuss the impact of the 2011-12 budget on their districts at a special meeting of the State Board of Education in Durham. School leaders decry the reductions in funding. "Our children deserve better," declares the retiring superintendent of McDowell County schools. State Rep. Bryan Holloway (R- Rockingham), chair of the House Education committee, however, said the meeting was largely a partisan event, calling the State Board of Education "just a partisan group – they do all her (Gov. Perdue) bidding."

FY2012-2013 HEALTH & HUMAN SERVICES BUDGET

Total Appropriations	**$4.68 billion**
Major Items:	
Medical Assistance (Medicaid)	$3,101 million
NC Health Choice	$82 million
Mental Health/D.D./Subst. Abuse:	$696 million
Child Development	$263 million
Social Services	$177 million
Public Health	$169 million

May

- Gov. Bev Perdue releases her FY 2012-13 state budget proposal, a spending plan amounting to roughly $21 billion. The plan, which adjusts the second year of the two-year budget plan approved last year, most notably includes a three-quarter-cent increase in the statewide sales tax that would cost taxpayers an estimated $760 million. Perdue attempts to sell the tax hike as a means to avoid further spending reductions to public education. Legislative leaders

DID YOU KNOW?

Average state tax revenue collections per person in North Carolina ballooned by a stunning 300 percent in the last 30 years - nearly twice the rate of CPI (average inflation) growth. That means the average state tax bill of a Tar Heel taxpayer is now a full four times higher than it was just three decades ago.

Similarly, per capita state spending grew by 265 percent in that time span, growing at a pace 100 percentage points higher than the cost of living as measured by CPI.

are not impressed with Perdue's plan. "We must break state government's habit of throwing money at problems and adopt innovative solutions and meaningful reforms," said Senate leader Phil Berger (R-Rockingham). "The cycle of irresponsible taxing, borrowing and spending must stop."

"We must break state government's habit of throwing money at problems and adopt innovative solutions and meaningful reforms," said Senate leader Phil Berger (R-Rockingham). "The cycle of irresponsible taxing, borrowing and spending must stop."

- State House budget committees are busy finalizing spending proposals to be included in their final spending proposal. The Education Committee agrees to reduce the discretionary cut imposed upon local districts from $503 million to $170 million. House budget writers are aided by a surplus of revenue collections of more than $200 million along with unused pots of money in other state funds.
- The House unveils its final budget proposal of $20.3 billion, which is about $600 million less than Gov. Perdue's total spending plan. Unlike Perdue's plan, the House budget includes no tax hike. The House proposal also includes a one-time $250 bonus for state employees and teachers, and an extra five days vacation for workers, but eliminates $121 million from a reserve set aside for performance pay initiatives as well as reducing $62 million from the scheduled contribution to the state pension system.
- Lt. Governor and former State Senator Walter Dalton wins the Democratic primary and will face Republican Pat McCrory in this year's gubernatorial race. Dalton beat out former U.S. Representative Bob Ethridge to earn the nod.

June

- The Senate takes its turn at crafting a state budget plan for FY 2012-13. Overall, the Senate plan appropriates about $130 million less than the House plan. To their credit, the Senate budget resisted use of temporary revenue sources to fund permanent expenditures. The Senate's action stands in sharp contrast to the House's use of $227 million in nonrecurring funds to pay for ongoing expenses, which sets a bad example and demonstrates an inability to make tough decisions. The Senate intends to utilize the "Performance Pay" funds to help finance $160 million set aside for "Compensation Increases and Personnel Flexibility." These increases include a 1.2 percent pay raise for state personnel, excluding public school personnel. As

for teachers and other public school employees, the Senate plan sets aside $84 million for local school districts to use for pay raises or to retain personnel. By comparison, recall that the House budget would spend $79 million to distribute a one-time, across the board $250 bonus to permanent teachers and state-funded employees.

- The shortfall in state funding for Medicaid is larger than earlier anticipated. According to the acting secretary of DHHS, the hole is likely to be $75 million deeper than the $206 million estimated just last month. Legislative budget writers consider the issue a "cash management" problem and consider granting Gov. Perdue's office authority to raid several designated state trust funds to cover the shortfall.
- The state legislature agrees to a final budget proposal to send to Gov. Perdue's desk for approval. The budget is approved 71-45 in the House and 30-15 in the Senate, support that would be strong enough for the three-fifths majorities needed to override a Perdue veto. Perdue vetoed the legislative budget last year but that veto was overridden. The final budget proposal restores $251 million in funding to K-12 education from the reductions approved last year, and includes a 1.2 percent pay raise to teachers and state employees. The legislative budget spends $727 million less than Perdue's budget plan, but does not include the three-quarter of a penny increase in the state sales tax that was projected to cost taxpayers $760 million. Responding to budgetary critics, Rep. Bryan Holloway (R-Stokes) asks "If you don't like this budget, what's your answer; more tax increases?"
- Perdue vetoes the legislative budget, and the legislature overrides Perdue's veto for the second straight year. Perdue justified her veto largely on the basis of public education funding. According to Perdue's veto statement: "First and foremost, their budget does not invest enough resources in education." But many observers find Perdue's objections over public education funding puzzling, in light of the fact that her own budget proposal appropriated just one percent more money toward schools.

Responding to budgetary critics, Rep. Bryan Holloway (R-Stokes) asks "If you don't like this budget, what's your answer; more tax increases?"

July

- A pair of technical corrections bills altering the state budget are signed into law, and include a few notable changes. One such change is an additional five days of bonus leave for state employees, including public school teachers and university and community college employees, to be used in FY 2012-13. Another provision is the extension for another year of a tax credit offered to film production companies filming in North Carolina. The credit had been set to expire on Jan. 1, 2014.
- Also included in the technical corrections is a delay in the collection of tolls for coastal ferries. Last year's budget included a provision establishing new and higher tolls on several ferries, which was set to be implemented as of April 2012. The tolls proved to be a bone of contention for Gov. Perdue, who ordered NCDOT to not collect them. State lawmakers disputed Perdue's authority to circumvent this requirement, but the tolls never were implemented. The technical corrections bill moves the implementation of new tolls to take effect July 2013.

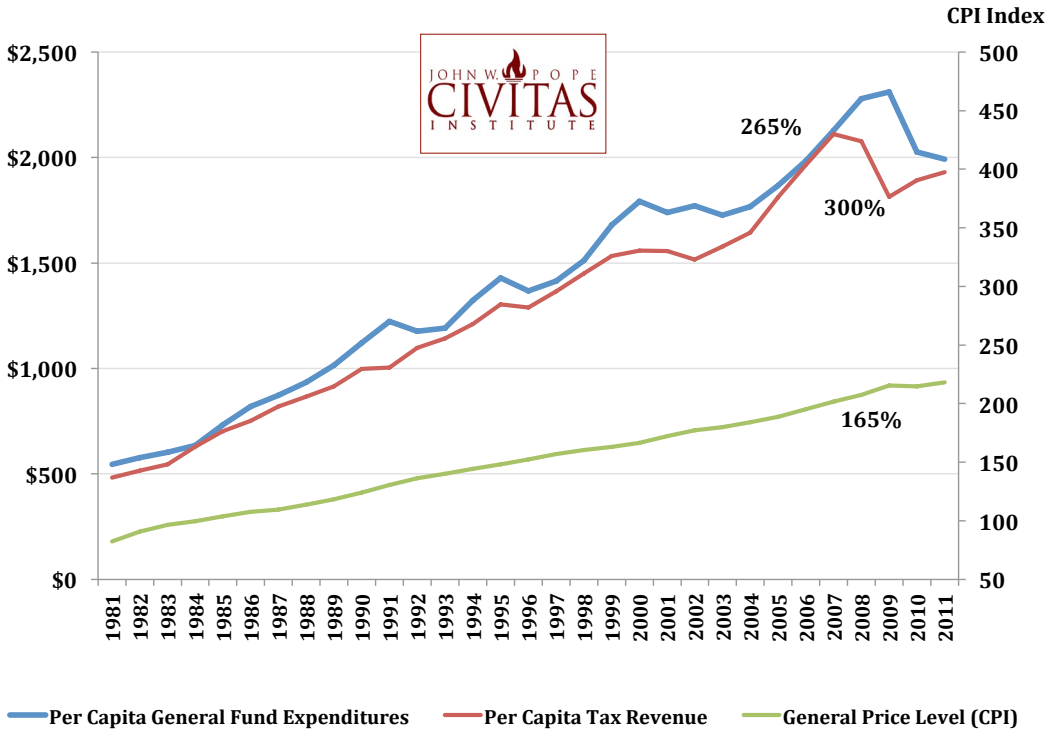
August

- The two gubernatorial candidates, Democrat Walter Dalton and Republican Pat McCrory, spar over the issue of state taxes. McCrory has accused Dalton of agreeing "with Beverly Perdue and … he wants to increase the sales tax in North Carolina – on you – by 15 percent." Dalton had supported Perdue's proposal earlier this year to increase the state sales tax by a penny, a move that would have cost taxpayers $850 million. But in a recent interview, Dalton insists he would not include a sales tax increase in his first budget plan should he be elected. In turn, Dalton attacks McCrory's remarks that suggest McCrory would prefer to reduce personal and corporate income taxes and possibly make up that revenue with an expanded sales tax. "He has talked about the redistribution of the tax burden we now have," Dalton explained. "His plan would absolutely kill small businesses." Dalton, however, fails to explain how reducing or eliminating taxes on small business income would harm them.
- Gov. Perdue signs a bill exempting newer cars from annual emissions inspections. Vehicles three years old or newer will no longer need to undergo the inspection starting in 2014. The emissions test cost car owners $16.40. All vehicles will continue to be required to pass yearly safety tests in order to renew their registration.

September

- The Fiscal Research Division of the legislature releases a report showing that revenue collections through the first two

Growth in Per Capita State Budget and Tax Revenue vs. Inflation: 1981-2011



months of the 2012-2013 fiscal year are running $26 million below the budgeted revenue target.

- The House Select Committee on Legacy Costs from the State Health Plan, Pensions and Employment Security Commission meets to discuss the financial condition of these programs. The numbers don't look promising. State debt is in excess of $7 billion (not counting interest payments), the state pension plan has an unfunded liability of $3.7 billion, the state owes $2.5 billion to the federal government for money borrowed to cover unemployment insurance benefits and the State Health Plan has accumulated $30 billion in unfunded liabilities for state retiree health insurance benefits. The $43 billion in total debt and liabilities works out to nearly $10,500 for every worker in the state.

October

- The state legislature's Program Evaluation Division issues a report stating that the North Carolina Railroad should begin sharing its revenue with the state government. The NCRR is operated as a private entity, but is owned by the state government. It hasn't paid the state any dividends since 2006, but is ordered by law to reinvest any profits in capital improvements. The report estimates the NCRR could provide the state with roughly $55 million over the next decade – but NCRR representatives claim such a move would reduce the amount it can invest in further track improvements.
- In the last state-level unemployment report before next month's elections, North Carolina's unemployment rate drops by one-tenth of a percentage point to 9.6 percent in September. The rate still places North Carolina at 5th highest in the nation.
- Mississippi Gov. Phil Bryant declares that his state will reject the Medicaid expansion included in the Obamacare law. In spite of the federal government financing most of the expansion, several states are declaring that the state share of the expansion would be too expensive, and would come with too many strings attached. "While some people say Obamacare will come as an economic boost with 'free'money, the reality is simple: No money is free," said Bryant, a Republican. "Since when did the federal government ever give free money without asking for something in return?" Mississippi joins Florida, Louisiana, Georgia, South Carolina and Texas on the list of states whose governors have stated they will reject the Medicaid expansion.

November

- A report issued by the State Auditor determines that state Commerce Department officials failed to sufficiently monitor $80 million in state funds earmarked for specific organizations, including the N.C. Rural Economic Development Center and N.C. Biotechnology Center. The audit suggested that Commerce officials did not follow up to ensure the funds were used for their stated purposes.
- Former Charlotte Mayor Pat McCrory (R) defeats Lt. Gov. Walter Dalton (D) to become the first Republican governor in North Carolina in 20 years. Republicans also increased their majorities in both chambers of the General Assembly, winning super majorities in both the House and Senate. McCrory's victory ensures Republican control of North Carolina's House, Senate and Governor's mansion for the first time since 1870.

2012 Significant Tax Changes (Budget Bill Unless Noted)

- ⬇ Cap the state gas tax for a year at 37.5 cents per gallon, the variable rate was projected to be at least a penny per gallon higher without the cap
- ⬇ Extend for another year a tax credit targeted specifically toward television and movie production. The credit had been set to expire Jan. 1, 2014. (S.L. 2012-194)

2012 Other Revenue Sources & Actions

- Direct appropriation of $123 million into the savings reserve account taken from unappropriated year end balance from end of FY 2011-12
- Transfer of $45 million from the One NC Fund to General Fund
- Transfer of $8 million above traditional annual transfer from Highway Fund to General Fund
- Divert $6.75 million of annual tobacco settlement funds typically going to Golden LEAF to General Fund
- Reverse measure passed in last year's budget bill to begin collecting new and higher tolls on coastal ferries, delaying their implementation until July 2013 (S.L. 2012-145)

December

- The Revenue Laws Study Committee issues its recommended plan to pay back $2.8 billion the state borrowed from the federal government to cover unemployment benefits. The proposal includes increases in unemployment insurance taxes along with a reduction in the maximum amount of benefits payable to recipients along with a reduction in the maximum number of weeks recipients can receive benefits. The proposal would pay off the debt three years earlier than the current repayment schedule, and avoid far more drastic tax increases on employers.
- A study by the consulting firm Arduin Laffer & Moore Econometrics suggests that a plan to eliminate North Carolina's personal and corporate income taxes would significantly bolster the state's job and income growth. The study was based on a plan being developed by legislative leaders, and expected to be introduced as legislation in the 2013 session. The tax reform proposal would be designed to be revenue neutral largely by expanding the sales tax base to goods and services currently not subject to the tax.

2012 EDUCATION FUNDING

ENROLLMENT CHANGES

- Public Schools +11,802 (0.8 percent increase)
- Community Colleges -5,053 in traditional curriculum students (a 2% decrease); overall enrollment: -7,970 (1.5 percent decline)
- UNC System + 865 (0.4 percent increase)

TUITION & FEE INCREASES

- UNC Average increase of 8.6% for in-state students and
- 5.2% for out-of-state students
- Comm. Colleges: 3.7 percent increase in tuition rate for in-state students, 0.9 percent increase for out-of-state students
- Other Educational Changes
- Legislature adds $91.7 million to total education spending over last year.
- Provides $71 million to reduce the LEA flexibility reduction to $360 million.
- Provides $29.7 million in need-based financial aid for UNC students.
- Appropriates $27 million to implement The Excellent Public Schools Act.
- Adds $5 million for NC Back-to-Work program for Community College students.

2012 Other Significant Changes

COMPENSATION

- Salary increase of 1.2% for state employees, including teachers
- The $121 million set aside in last year's budget for a merit pay program for state workers is seized and spent in the General Fund

RETIREMENT

- A 1% cost-of-living (COLA) increase is provided for state retiree pension benefits

APPENDIX

Significant Tax Changes	Year	Session Law
SALES & USE TAX CHANGES		
⬇ Repeal of sales tax on food purchased with food stamps	1985	S.L. 1985-656
⬆ Authorize local governments to raise sales tax an additional 0.5% with some restrictions on the use of the money; mostly designated for public school capital needs (estimated revenue $198 million)	1986	S.L. 1986-906
⬇ Exempt DOT from state and local sales tax	1986	S.L. 1986-982
⬆ Repeal provision allowing merchants to retain 3% of retail sales tax collected	1987	S.L. 1987-622, 1987-813
⬆ Enact new excise tax of 5¢ on each 30-dozen case of eggs sold for consumption	1987	S.L. 1987-1402
⬆ Expand the Sales and Use Tax Act: the state may require out-of-state retailers to collect sales and use taxes on mail order sales to N.C. customers if the retailer has purposefully or systematically exploited the market in N.C. through solicitation by mail or advertising	1988	S.L. 1988-1096
⬆ Increase sales tax rate from 3% to 4%	1991	S.L. 1991-689
⬇ Reduce tax on soft drinks by 25%	1995	S.L. 1995-474
⬇ Reduce state sales tax on food from 4% to 3% (effective January 1, 1997)	1996	S.L. 1996-13es2
⬇ Phase out soft drink tax over 3 years	1996	S.L. 1996-13es2
⬇ Reduce state sales tax on food from 3% to 2% (effective July 1, 1998)	1997	S.L. 1997-475
⬆ E-911 fee established (80¢ per month)	1998	S.L. 1998-158
⬇ Repeal 2% state sales tax on food	1998	S.L. 1998-212
⬇ Sales tax/fee changes: exemptions or reductions (for new business registration, loan agencies, prescription drugs, medical equipment, local airports)	1999	S.L. 1999-438
⬆ Sales tax/fee changes (increases for check cashing, pawnbrokers, used equipment, shoppers' guides)	1999	S.L. 1999-438
⬆ Repeal sunset on 3% tax on white goods (counties receive 72% of this revenue)	2000	S.L. 2000-109
⬆ Streamlined sales tax system (first step to creating remote collection system for Internet and catalog sales)	2000	S.L. 2000-120
⬆ Increase state sales tax rate from 4.0% to 4.5% for October 16, 2001 to July 1, 2003	2001	S.L. 2001-424
⬆ Impose 5% sales tax on satellite television service	2001	S.L. 2001-424

Significant Tax Changes	Year	Session Law
SALES & USE TAX CHANGES		
⬇ Create sales tax holiday (loss of less than $9 million state, $6 million local)	2001	S.L. 2001-424
⬆ Tax all telecommunications at 6.0% [S.L. 2001-430, as amended by S.L. 2001 424]; previous tax rate varied from 0.0% on interstate calls to 6.5% on intrastate calls	2001	S.L. 2001-424
⬆ Impose 5% sales tax on satellite television service	2001	S.L. 2001-424
⬌ Authorize additional 1/2¢ local sales tax (effective July 1, 2003)	2001	S.L. 2001-424
⬆ Accelerate the 1/2¢ local sales tax option	2002	S.L. 2002-123
⬆ Maintain 4.5% state sales tax rate	2003	S.L. 2003-284
⬆ Conform to streamline sales tax provision for soft drinks, prepared food, and modified software (net revenue increase)	2003	S.L. 2003-284
⬇ Tax soft drinks in vending machines at 50% of general rate	2003	S.L. 2003-284
⬇ Expand number and type of sales tax refunds & exemptions	2004	S.L. 2004-124
⬆ Increase tax on telecommunications from 6% to 7%	2005	S.L. 2005-276
⬆ Increase tax on home satellite television services from 5% to 7%	2005	S.L. 2005-276
⬇ Exempt from sales tax, items ranging from horses to laundry machinery (previously 1% tax)	2005	S.L. 2005-276
⬆ Maintain 4.5% state sales tax rate	2005	S.L. 2005-276
⬆ Apply uniform sales tax to candy	2005	S.L. 2005-276
⬆ Apply general sales tax rate (7%) to cable (was only a local tax, up to 5%)	2005	S.L. 2005-276
⬆ Extend telecommunications tax to voicemail	2005	S.L. 2005-276
⬆ Extend sales tax to satellite radio	2005	S.L. 2005-276
⬇ A portion of the "temporary" sales tax is allowed to sunset. The state sales tax will drop by ¼ cent as of Dec. 1, 2006. (most local governments add another 2.5 cents)	2006	S.L. 2006-66
⬇ Reduce the sales tax from 2.83 percent to 2.6 percent on electricity sold to manufacturers	2006	S.L. 2006-66
⬆ Make permanent the remaining ¼ cent of the "temporary" sales tax rate	2007	S.L. 2007-323
⬇ Expand the sales and use tax refund for certain aircraft manufacturers	2007	S.L. 2007-323
⬇ Enact a sales tax holiday for energy efficient appliances for the first weekend in November	2008	S.L. 2008-107

Significant Tax Changes	Year	Session Law
SALES & USE TAX CHANGES		
⬇ Grant an exemption for an "eligible internet data center" (Google) on sales taxes paid on electricity; total amount of exemption is estimated at $2.25 million	2006	S.L. 2006-66
⬆ Increase the statewide sales tax by a penny, from 4.75% to 5.75%. Is scheduled to expire on June 30, 2011	2009	S.L. 2009-451
⬆ Extend sales tax to online click-through sales and digital products	2009	S.L. 2009-451
INCOME TAX CHANGES		
⬇ Tax credits to people with low and moderate incomes	1985	S.L. 1985-656
⬆ Increase corporate income tax rate from 6% to 7%	1987	S.L. 1987-622, 1987-813
⬆ Close loopholes that allow higher income taxpayers to claim the low-income tax credit	1988	S.L. 1988-1039
⬇ Increases individual income tax exclusions for federal civil service retirement pay and military retirement pay from $3,000 to $4,000	1988	S.L.1988-936
⬆ Create North Carolina Enterprise Corporations. Income and franchise tax credits for 25% of the amount of an investment in such a corporation	1988	S.L.1988-882
⬌ Establish the North Carolina Candidates Financing Fund. Any taxpayer entitled to an income tax refund may contribute all or part of the refund to the Fund.	1988	S.L.1988-1063
⬆ Changes to the individual income tax status of retirement benefits	1989	S.L. 1989-792
⬇ Tax savings of $85 million due to a change in the state income tax statutes allowing S-Corps to be taxed as if they were partnerships	1989	S.L.1989-728
⬌ Tax Fairness Act: base the state individual income tax on a percentage of federal income tax liability	1989	S.L.1989-728
⬆ Increase corporate income tax from 7.00% to 7.75% and levy a scaled surtax from 4.00% in 1991 to 1.0% in 1994	1991	S.L. 1991-689
⬆ Add a 7.75% personal income tax rate for income above $100,000	1991	S.L. 1991-689
⬇ Update state income tax conformity to 1990 federal tax changes	1991	S.L. 1991-922
⬇ Increase income tax personal exemption from $2,000 to $2,250 for 1995 and to $2,500 for 1996	1995	S.L. 1995-42
⬇ Establish tax credit of $60 for each dependant child	1995	S.L. 1995-42

Significant Tax Changes	Year	Session Law
INCOME TAX CHANGES		
↓ Reduce corporate income tax rate from 7.75% to 6.90% over 4 years	1996	S.L. 1996-13es2
↓ Repeal income tax on retired government employees (*Bailey* case)	1998	S.L. 1998-212
↓ Increase non-itemizer charity tax credit	1998	S.L. 1998-183
↓ Establish long-term care insurance credit	1998	S.L. 1998-212
↓ Increase limit for conservation tax credit	1998	S.L. 1998-212
↑ Impose 1% gross receipts tax on movie admissions	1998	S.L. 1998-95
↓ Child health insurance tax credit	1998	S.L. 1998-1es
↔ Pension tax withholding (no estimate of impact)	1999	S.L. 1999-414
↑ Create new 8.25% income tax bracket for highest income households (sunset after 2003 tax year)	2001	S.L. 2001-424
↓ Increase standard deduction for married filing jointly from $5,000 to $5,500 in tax year 2002 and to $6,000 in 2003	2001	S.L. 2001-424
↑ Increase tax credit for children from $60 to $75 in tax year 2002 and to $100 in 2003	2001	S.L. 2001-424
↑ Repeal children's health Insurance tax credit (effective tax year 2001)	2001	S.L. 2001-424
↑ Delay 2001 tax breaks: standard deduction/marriage penalty (increase in child tax credit)	2002	S.L. 2002-126
↑ Broaden definition of business income	2002	S.L. 2002-126
↑ Close loophole in LLC franchise tax	2002	S.L. 2002-126
↑ Maintain 8.25% income tax for top income tax bracket	2003	S.L. 2003-284
↑ Conform to federal definition of "child" for state child tax credit	2003	S.L. 2003-284
↓ Qualified business investment tax credit	2004	S.L. 2004-124
↓ Research and development tax credit	2004	S.L. 2004-124
↓ Extend sunset on low-income housing credit	2004	S.L. 2004-110
↓ Renewable fuel tax credits	2004	S.L. 2004-153
↑ Extend 8.25% individual income tax rate for 2 more years	2005	S.L. 2005-276
↓ The highest marginal income tax rate falls ¼ percentage point to 8 percent, effective taxable year beginning January 1, 2007	2006	S.L. 2006-66
↓ Establish a state level Earned Income Tax Credit (EITC) set at 3.5 percent of the federal credit	2007	S.L. 2007-323

	Significant Tax Changes	Year	Session Law
	INCOME TAX CHANGES		
⬇	Increase the amount of the EITC to 5 percent of the federal amount	2008	S.L. 2008-107
⬆	Create a tax "surcharge" on upper-level income earners. A two percent extra charge is levied against the tax liability of single filers earning over $60,000 and married filers earning above $100,000. The extra charge increases to 3 percent for single filers earning above $150,000 and married filers earning above $250,000. Is scheduled to expire at the beginning of the 2011 tax year	2009	S.L. 2009-451
⬆	Create a 3 percent tax surcharge on corporate income. Is scheduled to expire at the beginning of the 2011 tax year	2009	S.L. 2009-451
	BUSINESS-RELATED TAX CHANGES		
⬇	Lower employment security contribution (payroll tax) rate for employers from 2.70% to 2.25% of wages	1987	S.L. 1987-17
⬇	New income tax credit for businesses that create jobs in "severely distressed" counties	1987	S.L. 1987-568
⬇	Tax credits for certain business investments	1987	S.L. 1987-852
⬇	Reduce unemployment tax for employers by 23%	1995	S.L. 1995-4
⬇	Expand jobs tax credit; create new credits	1996	S.L. 1996-13es2
⬇	Provide a tax credit up to $250 per employee for small businesses that subsidize employee health insurance premiums	2006	S.L. 2006-66
⬇	Offer tax credits of up to a maximum of $500,000 for biodiesel providers	2006	S.L. 2006-66
⬇	Provide $2.3 million tax credit for constructing renewable fuels facilities	2007	S.L. 2007-323
⬆	Close corporate tax loophole by implementing "combined reporting" method for business tax filing	2007	S.L. 2007-323
⬇	Extend sunset for a number of targeted tax credits, including rehabilitation projects, interstate passenger air carrier, aviation fuel for motor sports events	2010	S.L. 2010-31
⬇	Create a temporary credit for small businesses – equal to 25% of the companies' unemployment insurance tax liability.	2010	S.L. 2010-31
	DEATH-RELATED TAX CHANGES		
⬆	Repeal certain inheritance tax exemptions	1991	S.L. 1991-454
⬇	Repeal state inheritance tax; retain estate tax	1998	S.L. 1998-212

Significant Tax Changes	Year	Session Law
DEATH-RELATED TAX CHANGES		
⬆ Conform to Internal Revenue Code changes (pensions and education, estate tax credit, accelerated depreciation)	2002	S.L. 2002-126
⬆ Extend sunset on partial conformity to federal estate tax	2003	S.L. 2003-284
⬆ Conform estate tax to federal sunset	2005	S.L. 2005-144
⬇ Temporarily allow the state's estate tax to lapse	2010	S.L. 2010-31
MOTOR FUEL TAX CHANGES		
⬆ Gas tax increase 2¢ per gallon plus 3% sales tax on the wholesale price; raise Powell Bill distribution from 1 3/8¢ to 1 3/4¢	1986	S.L. 1986-982
⬆ Increase the per gallon credit for motor carriers' purchases of fuels from 12¢ to 14¢ per gallon	1987	S.L. 1987-315
⬆ Highway Fund: motor fuel tax increased by 1/2¢ to be divided equally between the Commercial Leaking Petroleum Underground Storage Tank Fund and the Groundwater Protection Loan Fund (1/4¢ increase schedule to expire January 1, 1995 and other 1/4¢ set to expire January 1, 1999)	1991	S.L.1991-538
⬆ Remove $1,500 cap on highway use tax for most noncommercial vehicles; money goes to General Fund (gain less than $3 million)	2001	S.L. 2001-424
⬇ Cap the variable wholesale component of the motor fuels tax so that the total state gas tax cannot exceed 29.9 cents per gallon until June 30, 2009	2007	S.L. 2007-323
⬆ S.L. 2009-108 changes the state gas tax ceiling into a floor. The state gas tax can now no longer drop below 29.9 cents per gallon	2009	S.L. 2009-451
"SIN" TAX CHANGES		
⬆ Increase excise tax on liquor from 22.5% to 28.0%	1987	S.L. 1987-832
⬆ Increase some liquor surcharges and ABC permit fees	1991	S.L. 1991-689
⬆ Increase cigarette tax from 2¢ per pack to 5¢ and levies a 2.0% of wholesale price on other tobacco products	1991	S.L. 1991-689
⬆ Taxes on spirituous liquor (net gain): ➔ Impose 6% state sales tax on spirituous liquor (December 1, 2001) ➔ Reduce excise tax on spirituous liquor from 28% to 25% (February 1, 2002)	2001	S.L. 2001-424
⬆ Reduce alcohol and tobacco tax discount for wholesalers (Budget Bill eliminates 4% tax discount)	2004	S.L. 2004-124

Significant Tax Changes	Year	Session Law
"SIN" TAX CHANGES		
⬆ In return, S.L. 2004-84 reinstates the discount at 2%	2004	S.L. 2004-84
⬆ Increase tax on liquor from 6% to 7% (no local share by law)	2005	S.L. 2005-276
⬆ Tobacco tax rate changes (increase from 5¢ to 30¢ per pack through June 30, 2006 and increase to 35¢ per pack July 1, 2006)	2005	S.L. 2005-276
⬆ Increase tax on beer, wine and liquor	2009	S.L. 2009-451
⬆ Increase tax on cigarettes and tobacco products	2009	S.L. 2009-451
OTHER TAX CHANGES		
⬇ Partial repeal of the intangibles tax	1985	S.L. 1985-656
⬇ Restructure insurance premiums tax system with a uniform rate; complete system repeal in 1988	1986	S.L. 198561031
⬇ Repeal of local government property tax on household personal property	1986	S.L. 1986-982
⬆ Raise insurance tax from 1.750% of gross premiums to 1.875% for 1991 and to 1.900% beginning with 1992	1991	S.L. 1991-689
⬆ Establish a 6.5% charge against gross premiums tax liability (except HMOs and BCBS) for a special trust designed to eliminate General Fund support for Department of Insurance and allow a 20% credit against premium tax for Guaranty Fund assessments	1991	S.L. 1991-689
⬇ Repeal intangibles tax and reimburse local governments	1995	S.L. 1995-41
⬇ Exempt rental cars from property tax (impact local revenues)	2000	S.L. 2000-2
⬆ Taxes on HMOs: ➔ New tax on HMOs of 1.1% in 2003 and 1.0% in later years; exempts HMOs from corporate income and franchise taxes ➔ Increase tax on medical service companies from 0.5% to 1.1% in 2003 and 1.0% in later years; these companies do not pay corporate or franchise tax	2001	S.L. 2001-424 (as amended by S.L. 2001-748)
⬇ Allow five percent of the purchase price of a manufactured home community to be deducted from state and federal taxable income	2008	S.L. 2008-107

Trends in the Total State Budget: 1983-2007

(In Millions)

Fiscal Year	Public Education	Higher Education	Community Colleges	Human Resources	Trans-portation	Correction
1982-83	$ 1,798.5	$ 856.4	$ 232.0	$ 1,462.2	$ 626.8	$ 176.1
1983-84	1,906.6	944.4	261.7	1,601.3	864.3	190.5
1984-85	2,170.4	1,058.9	288.2	1,719.6	893.4	212.7
1985-86	2,501.4	1,219.8	304.7	1,945.6	908.1	244.3
1986-87	2,660.6	1,300.7	337.1	2,032.8	1,005.7	261.7
1987-88	2,939.7	1,414.4	358.9	2,251.2	1,086.1	306.0
1988-89	3,230.8	1,483.2	364.7	2,435.8	1,111.7	343.1
1989-90	3,468.2	1,662.2	403.2	2,695.5	1,399.1	380.8
1990-91	3,672.0	1,700.0	433.5	3,012.3	1,378.5	428.0
1991-92	3,688.6	1,647.3	410.7	3,661.6	1,512.3	484.8
1992-93	3,829.0	1,728.9	476.8	4,244.2	1,614.3	517.2
1993-94	4,128.2	1,850.9	504.0	5,289.4	1,727.9	577.4
1994-95	4,417.1	1,932.9	534.6	5,616.5	1,850.1	732.5
1995-96	4,477.5	2,035.1	546.1	5,910.1	1,917.5	815.4
1996-97	4,783.6	2,121.3	576.6	6,324.4	1,987.6	833.3
1997-98	5,191.6	2,262.6	610.6	6,955.9	2,106.4	831.0
1998-99	5,549.9	2,321.1	659.9	7,604.9	2,125.4	859.0
1999-00	6,033.2	2,473.6	681.5	7,814.7	2,492.9	899.2
2000-01	6,366.8	2,555.3	724.1	8,213.6	2,635.8	883.0
2001-02	6,635.5	2,781.0	772.1	9,567.5	2,808.3	933.3
2002-03	6,534.6	2,814.1	825.6	10,404.5	2,598.5	890.6
2003-04	6,995.3	3,016.8	832.9	10,581.2	2,800.8	950.7
2004-05	7,118.6	3,103.5	880.6	11,553.0	2,831.3	959.1
2005-06	7,613.6	3,489.0	959.9	13,270.6	3,043.0	1,057.1
2006-07	7,710.7	3,530.1	959.9	14,213.0	3,525.0	1,072.3

Fiscal Year	Other Agencies	Debt Service	Reserves[a]	Capital[b]	Other[c]	Total
1982-83	$ 640.7	$ 114.2	$ 11.4	$ 72.4	$ -	$ 5,990.7
1983-84	698.4	117.8	2.9	116.0	-	6,703.9
1984-85	755.1	114.5	6.3	234.1	-	7,453.2
1985-86	843.4	114.2	21.1	298.0	-	8,400.6
1986-87	909.9	98.2	15.8	334.0	-	8,956.5
1987-88	972.4	111.9	18.7	265.3	-	9,724.6
1988-89	1,012.7	108.9	2.6	316.9	-	10,410.4
1989-90	1,270.4	107.6	-	377.6	231.8	11,996.4
1990-91	1,289.8	108.7	147.3	292.5	476.8	12,939.5
1991-92	1,375.7	117.9	0.9	242.6	468.0	13,610.4
1992-93	1,437.0	127.0	(5.4)	274.5	232.4	14,508.7
1993-94	1,701.9	129.6	221.5	910.1	236.8	17,277.7
1994-95	1,859.3	142.5	235.0	592.6	236.8	18,149.9
1995-96	1,735.0	157.0	6.9	456.0	-	18,056.6
1996-97	1,764.2	135.4	135.6	1,118.0 [d]	-	19,780.2
1997-98	1,693.5	167.2	104.6	1,201.4 [d]	-	21,124.8
1998-99	1,759.0	200.4	221.1	883.5 [d]	447.4	22,631.6
1999-00	1,922.5	244.1	222.6	877.1 [d]	629.0	24,290.4
2000-01	1,904.8	270.0	494.3	424.0 [d]	30.0	24,501.7
2001-02	1,949.5	302.6	13.2	762.9	40.0	26,565.9
2002-03	1,841.3	301.2	(5.4)	881.2	66.5	27,152.7
2003-04	1,907.6	438.1	278.3	1,533.3	62.0	29,397.0
2004-05	1,973.7	561.1	644.4	1,534.2	62.0	31,221.5
2005-06	2,223.6	660.3	257.8	1,206.7	62.0	33,843.5
2006-07	2,226.3	740.7	269.2	245.7	62.0	34,555.0

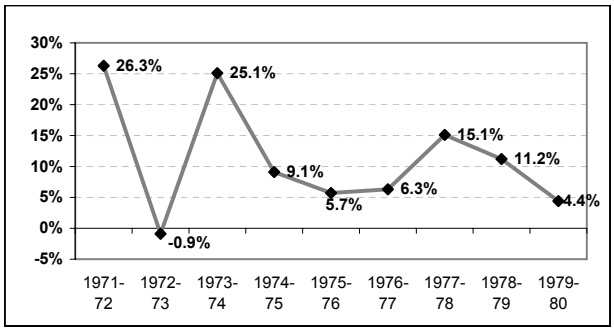
a. Includes funds transferred to the reserve for budget stabilization.

b. Includes the repair and renovation reserve.

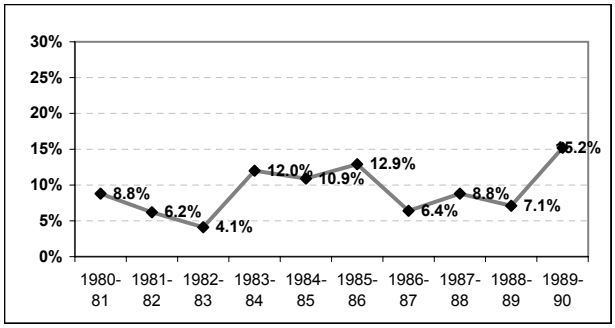
c. Includes the local government transfer and appropriated reserves.

d. Includes general obligation bonds.

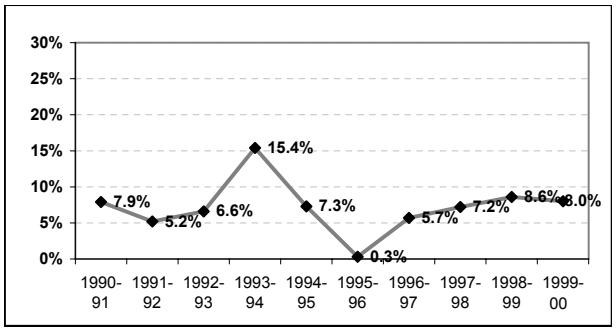
Average Growth in General Fund Budget: 1970-2007



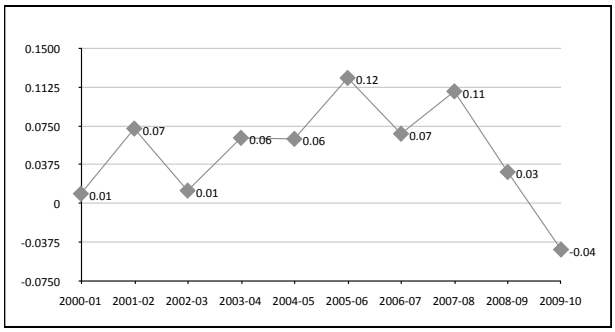
10.6% during 1970s



8.7% during 1980s



6.7% during 1990s



5.1% during 2000s

The charts above somewhat obscure the growth of the state budget over the last several years. In itself, measuring the growth of the state budget from year to year does not give an entirely accurate picture of long-term budget growth. From FY1972-1973 to FY1973-1974, for example, total General Fund authorizations went from $1.187 billion to $1.712 billion – an increase of $525 million or 44 percent. From FY2002-2003 to FY2003-2004, authorizations went from $14.351 billion to $14.914 billion – an increase of $563 million or 3.9 percent.[1] Thus while from one perspective – i.e., in terms of growth from year to year – the budget expanded more quickly during the 1970s, the budget is growing more quickly now in terms of actual dollars. Thus, taking FY2006-2007 General Fund authorizations of $19.102 billion as a baseline, even an increase of $1 billion would only register as a 5 percent increase.

[1] These numbers reflect adjustments for total current operations. Fiscal Research Division, North Carolina General Assembly Overview: 2006 Legislative Session Fiscal and Budgetary Actions (Revised) (Raleigh: Fiscal Research Division, 2006), Q2-Q3; available from http://www.ncga.state.nc.us/fiscalresearch/frd_reports/frd_reports_pdfs/Overview_2006.pdf.

Salary Increases: Teachers & State Employees

YEAR	STATE EMPLOYEES	TEACHERS
1970-71	2%	10%
1971-72	5%	5%
1972-73	5%	5% (employment extended 185 to 187 days = 1% salary increase
1973-74	5% + (5% for those under $2.75/hour	5% + (employment extended 187 to 200 days = 7% salary increase and 1 step added to schedule
1974-75	7.5%	7.5%
1975-76	-0-	-0-
1976-77	4% + $300 (average 7.2%)	4% + $300 (average 6.8%)
1977-78	6.5%	6.5%
1978-79	8%	8%
1979-80	5% + ($200 one-time bonus payment)	5% + ($200 one-time bonus payment)
1980-81	10%	10% (+ (Salary schedule changed = 2% to 10% added to each step of salary range)
1981-82	5% (effective 1-1-82)	5% (effective 1-1-82)
1982-83[a]	-0-	-0-
1983-84[a]	5%	5%
1984-85[a]	10%	10% + 4.8% salary classification adjustment
1985-86[b]	5% + 1 step increase (9.6%)	1-step increase (4.8%) second year teachers; 2-step increase (9.6%) third or more year teachers
1986-87	$75 month (average 6%)	6.5%
1987-88	5%	5%
1988-89	4.5%	4.5%
1989-90	4% + 2% merit funds	6.65% average
1990-91	4% + 2% merit funds	6.15% average
1991-92	-0-	-0-

Salary Increases: Teachers & State Employees (Continued)

YEAR	STATE EMPLOYEES	TEACHERS
1992-93	$522	2% average
1993-94	2% + 1% one-time bonus payment	3% average
1994-95	4% + 1% one-time bonus payment	5% - 1-3 years 7% - 4-29 years
1995-96	2%	2%
1996-97	2.50% COLA + 2% career growth	5.50%
1997-98[c]	2% COLA + 2% career growth	4% - 9%
1998-99	1% COLA + 2% career growth + 1% one-time bonus	4% - 9%
1999-00	1% COLA + 2% career growth + $125 Compensation Bonus	4% - 11%
2000-01	2.2% COLA + 2% career growth + $500 Compensation Bonus	2.5% - 13.8%
2001-02	$626	1.0% to 6.02% (2.86% average)
2002-03	-0-	0.0% to 5.85% (1.84% average)
2003-04	-0-	1.42% to 5.86% (1.81% average)
2004-05	Greater of a $1,000 or 2.5% across-the-board increase	1.41% to 5.90% (2.5% average)
2005-06	Greater of a $850 or 2.0% across-the-board increase	1.77% to 6.27% (2.24% average)
2006-07	5.5% across-the-board increase	6.45% to 14.05% (8.23% average)
2007-08	4.0% across-the-board increase	4.05% to 9.53% (5.0% average)
2008-09	Greater of a $1,100 or 2.74% across-the-board increase	2.39% to 6.63% (3.0% average)
2009-10	-0-	-0-
2010-11	-0-	-0-

[a] Salary increment program frozen
[b] Conditional upon continuous employment for one year
[c] Most teachers received between 4%-9%. Teachers receiving National Board of Professional Teaching Standards (NBPTS) certification were eligible for larger increases.

North Carolina Annual Debt Service: 1971-2006

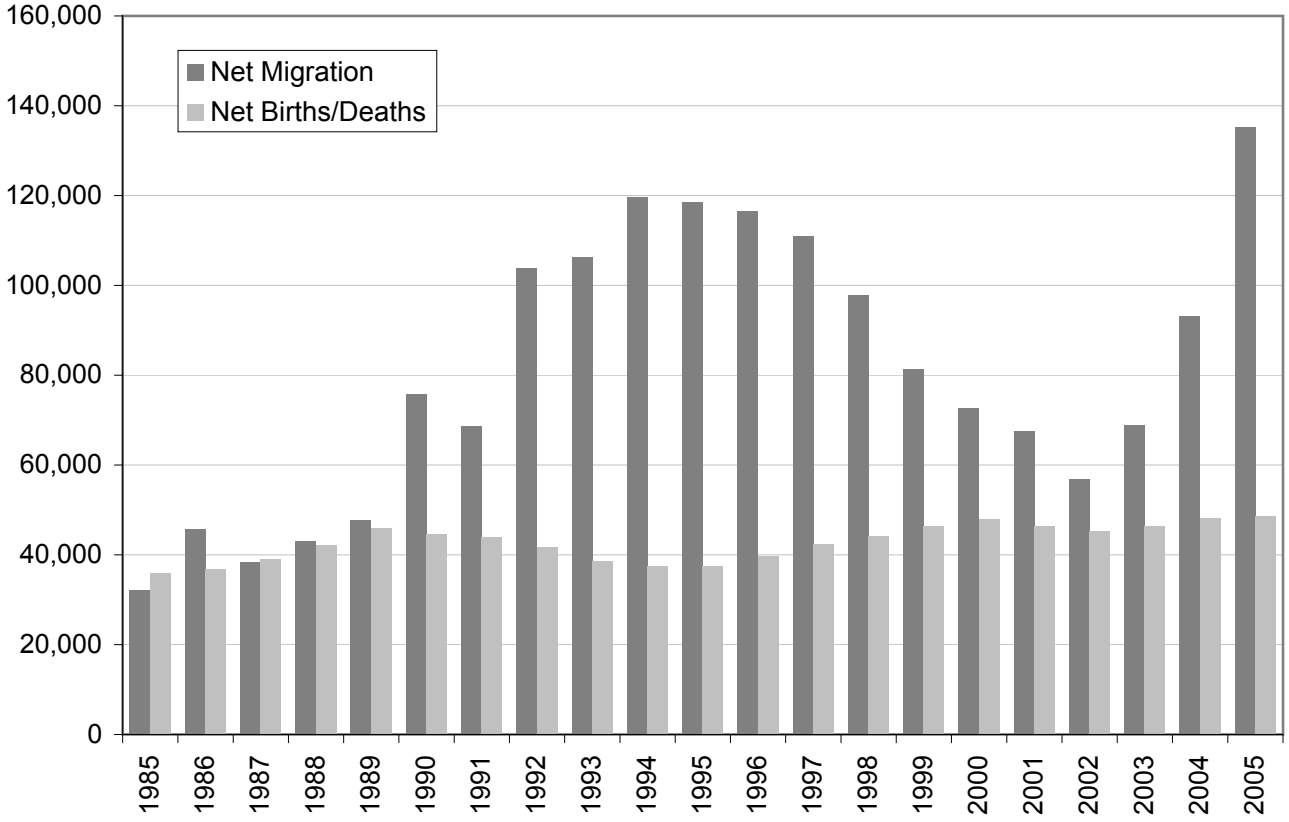
Fiscal Year	General Fund	Highway Fund	Special Revenue Funds	Total Debt Service	Total Per Capita	G.F. Debt Service as a % of G.F. Revenue
1970-71	17,757,503	25,599,500		43,357,003	8.32	1.8%
1971-72	18,631,260	32,617,500		51,248,760	9.67	1.7%
1972-73	21,466,030	25,749,000		47,215,030	8.77	1.6%
1973-74	48,147,042	25,083,000		73,230,042	13.40	3.2%
1974-75	0	24,415,500		24,415,500	4.41	0.0%
1975-76	34,870,615	23,776,500		58,647,115	10.48	2.0%
1976-77	40,024,500	23,156,000		63,180,500	11.14	2.0%
1977-78	49,202,210	27,522,500		76,724,710	13.35	2.2%
1978-79	53,000,000	29,596,000		82,596,000	14.22	2.1%
1979-80	55,341,050	29,292,661		84,633,711	14.36	1.9%
1980-81	62,173,700	30,329,757		92,503,457	15.53	2.1%
1981-82	65,062,550	30,062,040		95,124,590	15.81	2.0%
1982-83	75,020,500	38,772,567		113,793,067	18.73	2.2%
1983-84	79,525,500	38,288,000		117,813,500	19.11	2.0%
1984-85	76,077,250	38,401,500		114,478,750	18.30	1.7%
1985-86	75,781,250	38,445,500		114,226,750	18.06	1.5%
1986-87	64,506,250	8,984,917		73,491,167	11.47	1.2%
1987-88	73,929,627	32,453,812		106,383,439	16.41	1.3%
1988-89	71,636,370	37,295,105		108,931,475	16.58	1.2%
1989-90	69,083,445	38,491,163		107,574,608	16.15	1.0%
1990-91	71,259,383	37,392,600		108,651,983	16.02	1.0%
1991-92	79,683,770	38,227,230		117,911,000	17.10	1.0%
1992-93	89,020,478	38,018,250		127,038,728	18.04	1.1%
1993-94	86,368,214	37,359,875		123,728,089	17.22	0.9%
1994-95	113,399,264	27,631,295		141,030,559	19.21	1.1%
1995-96	124,742,353	25,133,780		149,876,133	19.99	1.2%
1996-97	127,038,338	4,978,215		132,016,553	17.24	1.2%
1997-98	165,973,573	5,841,462		171,815,035	22.00	1.4%
1998-99	192,350,072	28,357,925		220,707,997	27.76	1.5%
1999-00	238,355,819	27,607,550		265,963,369	32.92	1.8%

North Carolina Annual Debt Service
(Principal and Interest)

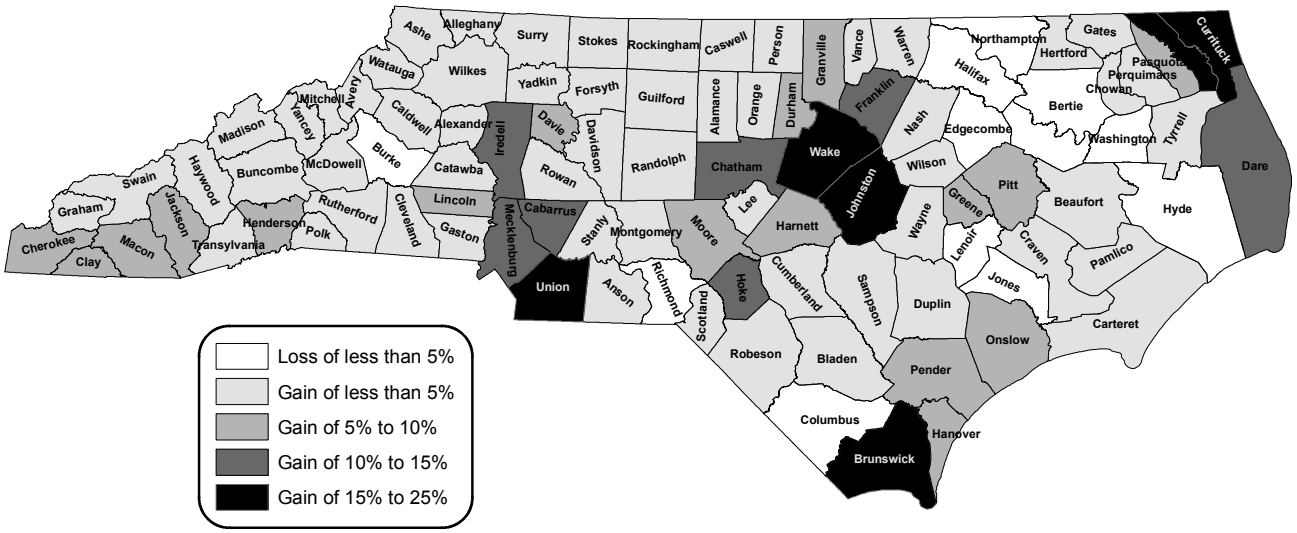
Fiscal Year	General Fund	Highway Fund	Special Revenue Funds	Total Debt Service	Total Per Capita	G.F. Debt Service as a % of G.F. Revenue
2000-01	254,819,455	26,857,175		281,676,630	34.87	1.9%
2001-02	302,612,023	26,106,800		328,718,823	40.10	2.3%
2002-03	304,506,218	25,356,425		329,862,643	39.68	2.2%
2003-04	390,389,698	32,568,237		422,957,935	50.22	2.6%
2004-05	476,124,775	70,057,016		546,181,791	63.95	2.9%
2005-06	561,598,242	93,449,000	3,958,191	659,005,433	75.90	3.1%

Note: Debt service requirements are updated annually by the Department of State Treasurer. Historical debt service amounts are updated to reflect the most current information available. Population estimates from State Data Center. Revenue estimates provided by Fiscal Research.

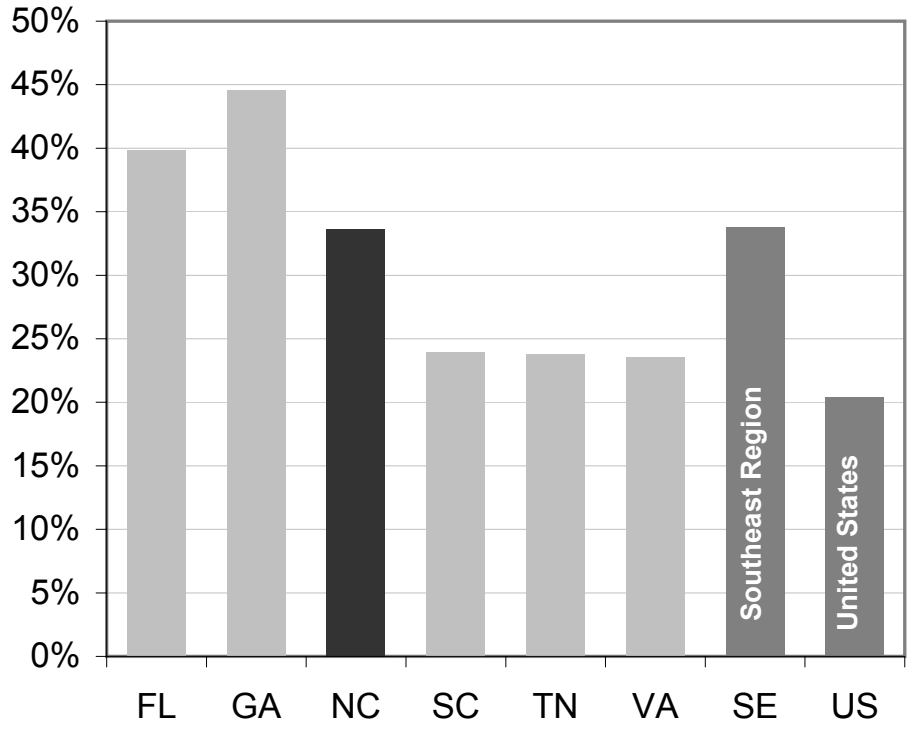
Reasons for N.C. Population Growth:1985-2005



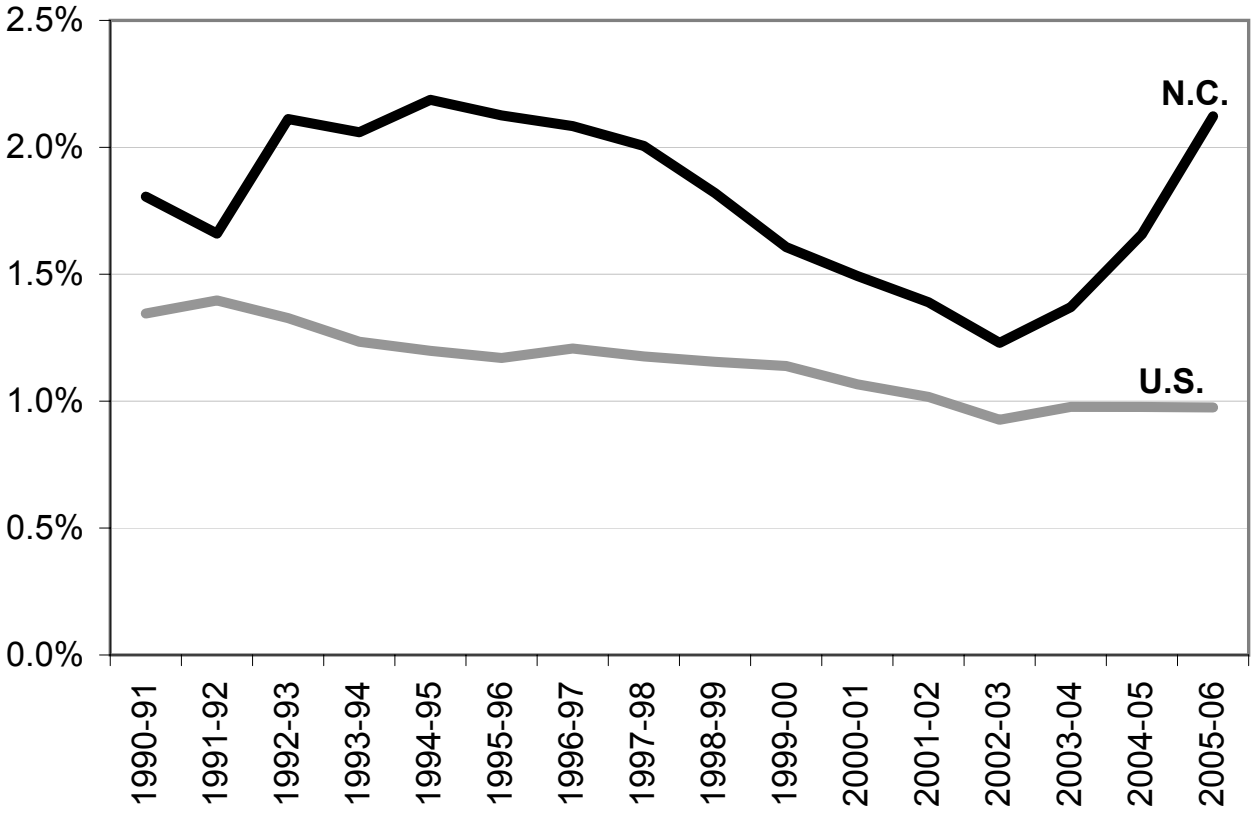
Population Change by County: 2000-2004



Southeast Population Growth: 1990-2006



Annual Population Growth: N.C. and U.S.



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Created by Civitas Institute, Brian Balfour. Data Source: Coletti, Joseph. "Spending Beyond Government Means," a John Locke Foundation Spotlight Report, January 7, 2009

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Created by Civitas Institute, Chloe Gossage. Data Sources: Fiscal Research Division, North Carolina General Assembly, *Overview: 2006 Legislative Session Fiscal and Budgetary Actions (Revised)* (Raleigh: Fiscal Research Division, 2007), Q-2, Q-3, Q-7 and U.S. Department of Labor, Bureau of Labor Statistics, Consumer Price Index, All Urban Consumers; available from ftp://ftp.bls.gov/pub/special.requests/cpi/cpiai.txt.

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State/Local Taxes as Share of Personal Income: Southeast States, 1985-1994

Created by Civitas Institute, Sven Larson. Data Source: Bureau of Economic Analysis, Regional Economic Accounts, State Annual Personal Income, Table SA50: Personal Current Taxes; available from http://www.bea.gov/regional/spi/default.cfm?satable=SA50.

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Created by Civitas Institute, Sven Larson. Data Source: Bureau of Economic Analysis, Regional Economic Accounts, State Annual Personal Income, Table SA50: Personal Current Taxes; available from http://www.bea.gov/regional/spi/default.cfm?satable=SA50.

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Total Outstanding Debt: 2001-2005

Created by Civitas Institute, Chloe Gossage. Data Source: Department of State Treasurer, as cited in Fiscal Research Division, North Carolina General Assembly, *Overview: 2006 Legislative Session Fiscal and Budgetary Actions (Revised)* (Raleigh: Fiscal Research Division, 2007), Q-17, Q-18.

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Created by Civitas Institute, Brian Balfour. Data Source: Annual Budget bills from FY 2000-01 through FY 2010-11

Q&A

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Created by Civitas Institute, Chloe Gossage. Data Source: Office of State Budget and Management, as cited in Fiscal Research Division, North Carolina General Assembly, *Overview: 2006 Legislative Session Fiscal and Budgetary Actions (Revised)* (Raleigh: Fiscal Research Division, 2007), Q-1.

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Created by Civitas Institute, Chloe Gossage. Data Source: Department of State Treasurer, as cited in Fiscal Research Division, North Carolina General Assembly, *Overview: 2006 Legislative Session Fiscal and Budgetary Actions (Revised)* (Raleigh: Fiscal Research Division, 2007), Q-17, Q-18.

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Created by Civitas Institute, Chloe Gossage. Data Sources: Fiscal Research Division, North Carolina General Assembly, *Overview: 2006 Legislative Session Fiscal and Budgetary Actions (Revised)* (Raleigh: Fiscal Research Division, 2007), Q-2, Q-3, Q-7 and U.S. Department of Labor, Bureau of Labor Statistics, Consumer Price Index, All Urban Consumers; available from ftp://ftp.bls.gov/pub/special.requests/cpi/cpiai.txt.

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State of North Carolina, Debt Affordability Advisory Committee, *Debt Affordability Study* (Raleigh: Department of State Treasurer, 2007), 10:chart 4; available from http://www.nctreasurer.com/NR/rdonlyres/599BB76E-EA20-4705-9D15A086DF3EB490/0/2007DAAC_Final.pdf.

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Created by Civitas Institute, Brian Balfour. Data Source: Annual Budget bills from FY 2000-01 through FY 2010-11

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Created by Civitas Institute, Brian Balfour. Data source: North Carolina Office of State Controller, Comprehensive Financial Report, 2010.

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Created by Civitas Institute, Chloe Gossage. Data Source and Template: John Locke Foundation, *Agenda 2006: A Candidate's Guide to Key Issues in North Carolina Public Policy* (Raleigh: John Locke Foundation, 2006), 5; available from http://www.johnlocke.org/agenda2006/statebudget.html. Used with permission.

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State Taxes Collected per Federal Dollar Received by North Carolina

Created by Civitas Institute, Sven Larson. Data Source: State of North Carolina, Office of the State Controller, *Comprehensive Annual Fiscal Report (CAFR)* (Raleigh: Office of the State Controller, 2005), 230-231.

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Corporate Income Tax as Percent of General Fund Tax Revenue

Recreated by Civitas Institute, Chloe Gossage. Data Source: Fiscal Research Division, North Carolina General Assembly, *Overview: 2006 Legislative Session Fiscal and Budgetary Actions (Revised)* (Raleigh: Fiscal Research Division, 2007), Q-6. Originally published as " Share of General Income Fund Revenues from Corporate Income Tax" in *Our State, Our Money: A Citizen's Guide to the North Carolina Budget* (Raleigh: North Carolina Progress Board, 2003), 9: Fig. 3.4.

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About the Civitas Institute

The vision of the Civitas Institute is of a North Carolina whose citizens enjoy liberty and prosperity derived from limited government, personal responsibility and civic engagement.

The mission of the Civitas Institute is to facilitate the implementation of conservative policy solutions to improve the lives of all North Carolinians. Towards that end, Civitas provides research, information and training to:

- *Empower* citizens to become better civic leaders and more informed voters;
- *Educate* emerging public leaders, enabling them to be more effective in the democratic process; and
- *Inform* elected officials about citizen-based, free-market solutions to problems facing North Carolinians.

For more information, or to obtain additional copies of this guide, please contact:

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