

Does Chowan Need a Sales-Tax Increase?

*County already has almost
\$4.5 million in available funds*

DR. MICHAEL SANERA, JOSEPH COLETTI, TERRY STOOPS
OCTOBER 2008

EXECUTIVE SUMMARY

- The Chowan County commissioners are asking county residents to approve a sale-tax increase on November 4.
- This request for a sales-tax increase occurs in the midst of a financial scandal that has already led to a nine-cent property-tax increase and a ten percent cut in county services.¹ The state Local Government Commission found that the county faces a \$4 million deficit in this year's budget. In addition, both the State Bureau of Investigation and the State Auditor's office are investigating Chowan's financial mismanagement.² It would seem that at a minimum voters should wait until the responsible state agencies report on the financial facts and possible criminal behavior before they approve a tax increase.
- This *Regional Brief* finds that Chowan County's problems are not created by a lack of funding. The almost \$4.5 million in savings and revenues identified in this report is more than 14 times the amount that the proposed sales-tax increase is estimated to produce (see Figure 1). If the county used this money instead, it could delay a sales-tax increase for over 14 years.
- County revenues have grown 30 percent faster than population and

200 W. Morgan, #200
Raleigh, NC 27601
phone: 919-828-3876
fax: 919-821-5117
www.johnlocke.org

The John Locke Foundation is a 501(c)(3) nonprofit, nonpartisan research institute dedicated to improving public policy debate in North Carolina. Viewpoints expressed by authors do not necessarily reflect those of the staff or board of the Locke Foundation.

inflation since Fiscal Year (FY) 2002 (see Figure 2). The total amount of revenue for FY 2007 was almost \$3.6 million more than in FY 2002. By FY 2007, the average family of four paid \$976 more in taxes than in FY 2002. It would take a 48 percent increase in family income (current dollars) to match the increase in revenues that the county has received over those five years.

- ♦ If Chowan County were to restrict its revenue increases to the increases in population and inflation, the county's revenues would increase 32 percent over the next ten years.
- ♦ Over the next ten years, the number of public-school students in Chowan County will *decrease* by 99 students or by about four percent.
- ♦ If the school district has facility needs, the county commission and school board need to show taxpayers how they would spend the \$3.7 million in state money provided for capital improvements over the next ten years.
- ♦ Chowan County benefited from the Medicaid swap above the state's promised "hold harmless" amount of \$500,000 a year for ten years. Chowan County receives an average of almost \$800,000 per year over the next ten years (see Figure 1).

BACKGROUND

In its 2007 session, the North Carolina General Assembly relieved all counties of paying the portion of Medicaid expenses that had been forced on counties, in exchange for the half-cent sales tax that the counties levied to help pay those expenses.³ In addition, the legislature voted to give counties the option to ask voters to approve new tax increases. Options include increasing the sales tax by one-quarter cent, tripling the land-transfer tax rate from 0.2 to 0.6 percent, or not hiking taxes at all.

The legislature also required counties to put those tax increases to an advisory vote of the people. If voters approved, county commissioners were allowed but not required to increase taxes. If both tax increases were on the same ballot and both were approved, commissioners could impose only one tax increase, not both.

Since November 2007, county voters across North Carolina have voted 58 times on such tax increases, rejecting nearly all of them. Voters have approved only eight of those 58 proposed tax increases. Undeterred by voter opposition, some county commissions have put the tax increases on the ballot more than once.

There is no limit to the number of times that county commissioners can place a proposed tax increase on the ballot, or how

.....
Figure 1. Chowan County Projected Revenue and Savings

Revenue Gains	1 year	10 years
Gain from Medicaid swap (FY 2008-09)	\$538,684	\$7,995,047
Estimated school capital (Avg based on projections)	\$390,039	\$3,747,495
Revenue Growth		
Revenue in excess of population and inflation (FY 2007)	\$3,566,730	\$35,667,303
TOTAL	\$4,495,454	\$47,409,845
Potential extra availability	\$4,495,454	\$47,409,845
Revenue from Sales Tax Increase	\$311,195	\$4,111,947

much tax money commissions can spend on public “education” campaigns requesting that voters approve the tax increase.

PUBLIC SCHOOL SPENDING⁴

By far, counties spend more money on public education than any other area. Total local government spending on public education was \$2.68 billion or \$1,934 per pupil for the 2006-07 school year. Nearly 25 percent of all expenditures on public schools come from local tax revenue. Given the amount of taxpayer money involved, sympathetic appeals for school funding should not come at the expense of sound fiscal policy

County governments and school boards should spend local tax dollars for education, as well as hire public school personnel, in proportion to changes in their school population. In Chowan County, from 2002 to 2007, there was a one percent increase in student population. At the same time, there was a 29 percent increase in local, inflation-adjusted per-pupil expenditures.

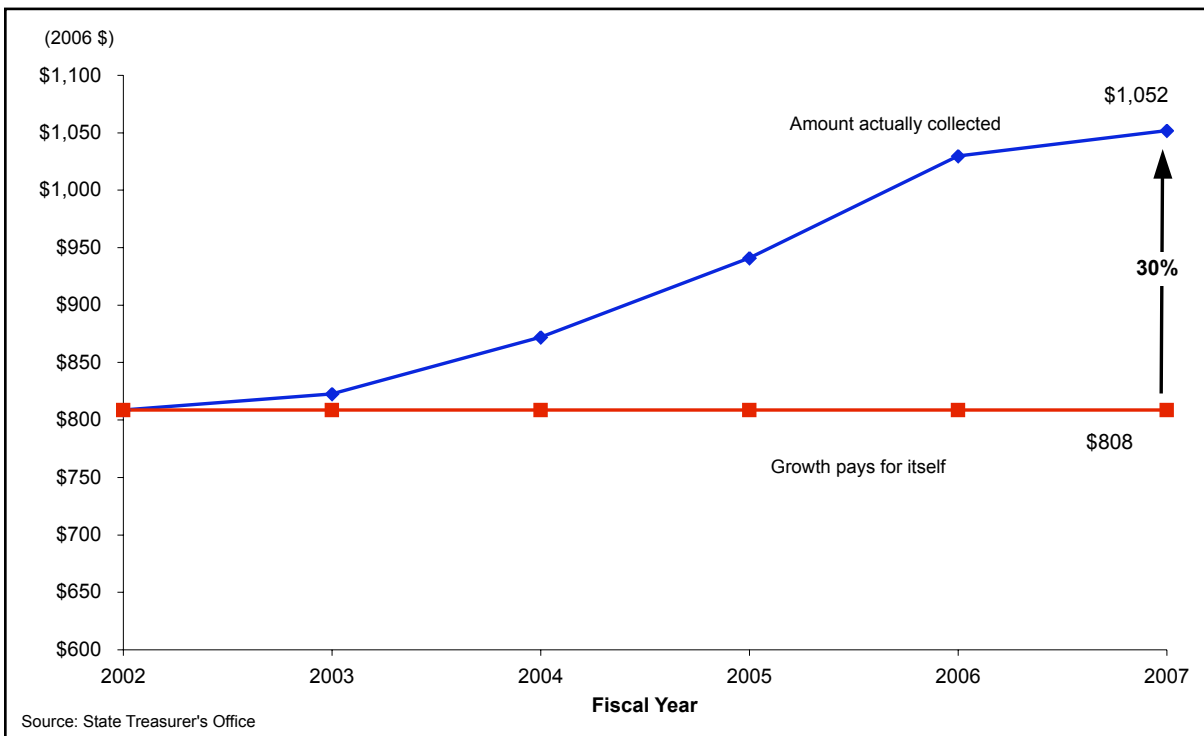
Over the last five years, the state in-

creased per-pupil expenditures in Chowan County by eight percent, adjusted for inflation. Federal per-pupil expenditures did not increase during the same period. Thus, local and state spending on the Chowan County Schools significantly outpaced enrollment growth.

The North Carolina Department of Public Instruction (DPI) projects that Chowan County Schools will lose 99 students over the next ten years, a 3.9 percent decrease. The Public School Building Capital Fund, which includes lottery funds, will provide Chowan County with an estimated \$3.7 million over the next ten years.

If new school facilities are needed, the school system should redirect funds away from low priority projects, reduce the size of the school bureaucracy, pursue ways to reduce construction costs, redirect existing revenue streams, and implement sound facilities alternatives. With proper planning and “out of the box” thinking, the school district can manage enrollment growth using proven, cost-effective construction, renovation, and

Figure 2. Chowan County Locally Generated Revenue Per Person, FY 2002–FY 2007 (adjusted for inflation, FY 2006 dollars)



maintenance solutions that are taxpayer-friendly and enhance educational opportunities for students.

PER-CAPITA REVENUE INCREASES

Between FY 2002 and FY 2007, Chowan County's per-capita revenues have increased by 30 percent after adjusting for inflation⁵ (see Figure 2). This means that new county residents are contributing more than their fair share of county revenues. In other words, population growth has been “paying for itself” because county revenues are growing at a faster rate than population. In addition, if the county had lived within its means — that is, if its budget increases had been in line with population and inflation increases, rather than exceeded them — over those five years, the county's FY 2007 revenues could have been almost \$3.6 million lower. That surplus amount could and should be returned to the taxpayers in the form of tax cuts.

If the county started living within the means of its citizens and held revenue increases in line with increases in population and inflation, county revenues would increase 32 percent over the next ten years.

MEDICAID SWAP

The state is taking over the county portion of Medicaid over three years, but it is also taking a portion of revenues from counties, too. The legislature included a “hold harmless” provision to guarantee that each county ends up with at least \$500,000 more available in its budget each year for ten years.⁶ Because Chowan County's net Medicaid savings were more than the \$500,000 “hold harmless” amount, the county gains an average of almost \$800,000 per year over the next ten years (see Figure 1).

CONCLUSION

This report shows that Chowan County is not in financial difficulty. In fact, most North Carolina counties do not face revenue crises that require tax increases. Nevertheless, county commissioners have placed tax

increases on the ballot 58 times since the legislature authorized county residents to vote on tax increases.

In all the counties voting on tax increases, revenues grew faster than population and inflation between FY 2002 and FY 2007. The average increase is almost 19 percent. In addition, state government has grown six percent faster than population and inflation between FY 2002 and FY 2007. Obviously, this government growth rate rapidly outstripping population and inflation growth cannot be sustainable.

The November 4 vote provides the opportunity for Chowan County citizens to be heard. The results of the 58 county tax votes since last November are informative. County voters rejected 50 of the 58 requests for tax increases. Citizens, when given the chance, are rejecting tax increases.

Regional Brief No. 63 • October 14, 2008

NOTES

1. “Chowan's woes just keep expanding,” *The Virginian-Pilot*, September 12, 2008.
2. Earline White, “Chowan board approved only \$2M in transfers: Most hospital-fund spending not approved,” *The Chowan Herald*, October 7, 2008.
3. Over the next three years, the state will take over the 15 percent of Medicaid expenses that the counties had previously been required to fund; see State Law 2007-323 (House Bill 1473, Sections 31.16 and 31.17).
4. N.C. Department of Public Instruction (NC DPI), School Planning Division, “ADM Growth Analysis, 2007–2017,” September 2007; NC DPI, School Planning Division, “Public School Building Capital Fund: 10 Year Planning Projections, 2007–2016,” June 27, 2007; NC DPI, Division of School Business Services, “FY 2007-08 Estimated Lottery Distribution,” August 2007; NC DPI, “Statistical Profiles,” 2003–2007, accessed September 2008; NC DPI, Division of School Business, “2006–2007 Selected Financial Data,” accessed September 2008; NC DPI, Education Statistics Access System, “Final ADM,” accessed September 2008. Inflation adjustments used the GDP Deflator published by the Federal Reserve Bank of St. Louis. Public School Building Capital Fund projections are based on 10 years of corporate income tax and lottery funding at the 2008-2009 level (estimated), adjusted for projected enrollment growth over ten years.
5. County Annual Financial Information Report (AFIR) from the N.C. Department of the State Treasurer, www.nctreasurer.com/lgc/units/unitlistjs.htm.
6. North Carolina General Assembly, Fiscal Research Division, “Medicaid 3 Year 500K” projections, 2007.