John LOCKE FOUNDATION

SPOTLIGHT

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Let Public Vote on Debt

"Promise Now, Pay Later" Policy Has Hiked Taxes

Summary: State legislators are currently considering proposals to issue hundreds of millions of dollars in additional debt without seeking voter approval. The billions of dollars worth of bonds and other debt already approved since 1996 have more than quadrupled the state's debt service and represent as much as a third of the fiscal impact of the tax hikes passed by the General Assembly since 2001. It's no wonder politicians are wary of asking voters for more. But that's why they should.

200 West Morgan St.
Raleigh, NC 27601
Voice: (919) 828-3876
Fax: (919) 821-5117
www.johnlocke.org

The North Carolina General Assembly is currently meeting in Raleigh in its "short session" to adjust the FY 2004-05 budget. In early June, the House approved a $15.8 billion General Fund proposal and sent it to the Senate. This measure will increase authorized General Fund spending by more than $1 billion while tapping a similar amount of one-time revenues and budget savings for 2004-05. Unless state revenues surge by well over $1 billion in 2005-06, recurring expenses built into the House budget will force lawmakers in 2005 either to enact larger-than-ever budget savings or, more likely, to impose another round of state tax increases such as the reimposition of half-a-billion dollars in sales and income tax hikes.

Unfortunately, other legislation now moving through the General Assembly could worsen the already precarious fiscal position that the House budget proposal would create next year. Specifically, the North Carolina Senate has approved and sent to the House two measures to issue hundreds of millions of dollars in new state debts without a voter referendum. One bill, which passed the Senate earlier in the session, would authorize $240 million to finance new projects at East Carolina University and UNC-Chapel Hill. Last week, the Senate approved another bill to authorize up to $520 million in new debts for the Clean Water Management Trust Fund, the Parks and Recreation Trust Fund, and the Natural Heritage Trust Fund. The proceeds would be used to purchase land for recreation and conservation. The House is reportedly considering an even larger debt issuance — more than $300 million — for UNC projects.[1]

With few exceptions, the state constitution requires that "debts secured by a pledge of the faith and credit of the state" be approved by voters in a statewide referendum.[2] Advocates of these new debts argue, as did advocates of previous issuances to build state prisons, that because the debt is not being sold as a "general obligation" the

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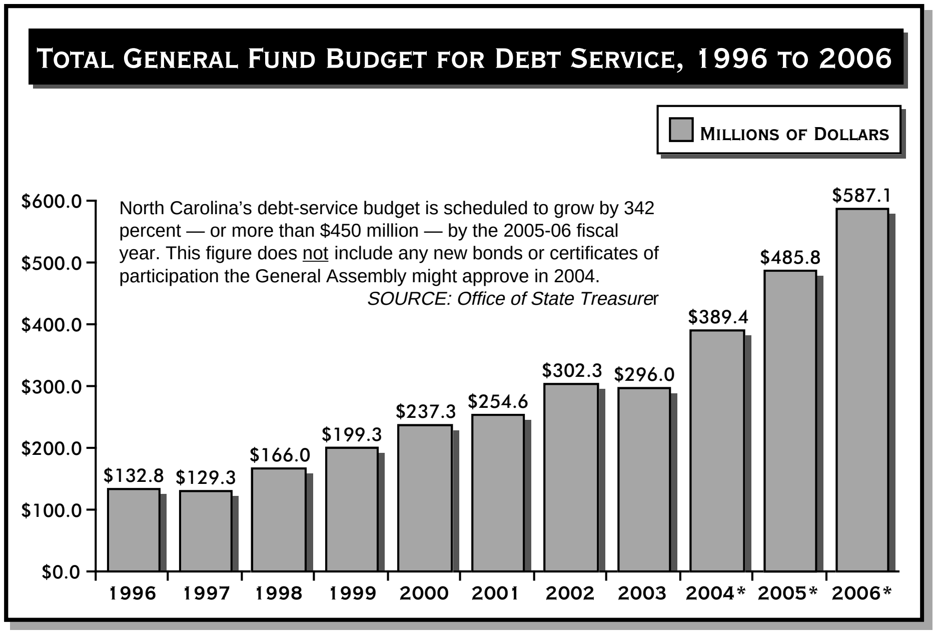
referendum requirement does not apply. This argument assumes that the state of North Carolina would allow certificates of participation or other kinds of special-obligation debt to go into default, which is simply not credible. More importantly, whatever the legality of these schemes, they are clearly an attempt to evade the *intent* of the state constitution that only voters themselves have the right to decide whether to take on long-term debts that obligate future generations of taxpayers.

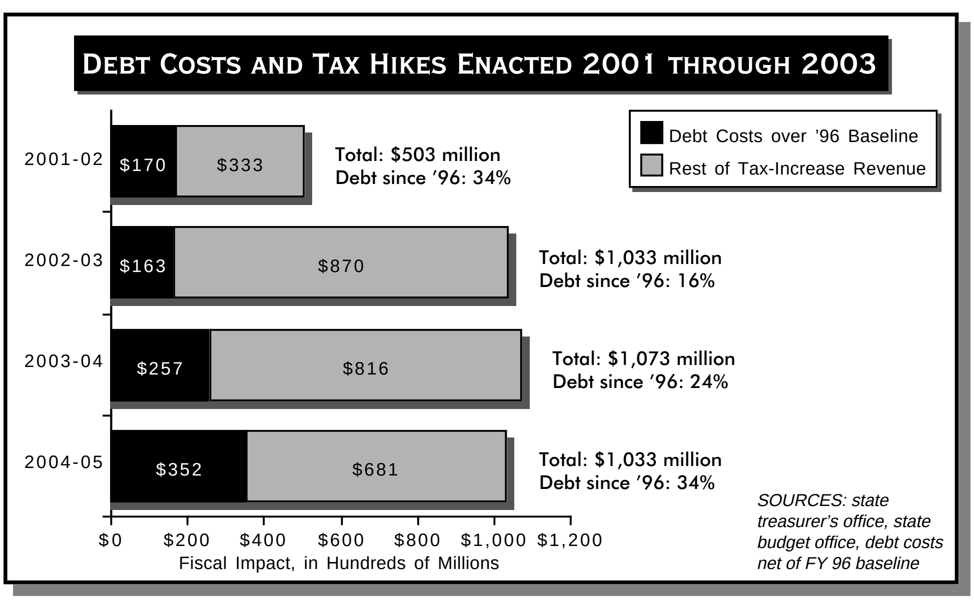


Why the evasion? Perhaps it is because since the mid-1990s, North Carolina voters have approved billions of dollars of state debt after being promised repeatedly that the new obligations "would not raise [their] taxes."[3] These successful referenda included a 1996 vote for $1.8 billion in school-construction bonds, a 1998 vote for $1 billion in bonds for water, sewer, and natural gas projects; and a 2000 vote for $3.1 billion for college and university construction. This is the main reason the General Fund budget for debt service more than quadrupled during this period, from $133 million in 1996 to nearly $600 million projected for FY 2005-06 (see above).

The promise to finance these additional fiscal obligations without raising state taxes has not been kept. In 2001, 2002, and 2003, legislators and Gov. Mike Easley approved a series of tax hikes that cost North Carolina taxpayers approximately half-a-billion dollars in 2001-02 and more than $1 billion in 2002-03, 2003-04, and (if current proposals become law) 2004-05. In each case, the cost of servicing the education bonds, infrastructure bonds, and other debts incurred since 1996 has accounted for a significant share of the higher taxes imposed on North Carolina households. As the graph below reveals, the increased debt service represented about a third of the fiscal impact of the 2001 tax hikes — enacted just months after voters were promised, via millions of dollars in statewide advertising, that voting yes for bonds would not be a vote for tax hikes. Other factors such as lower-than-projected revenue and surging Medicaid costs played a greater role in the 2002-03 tax increases, but by 2004-05 the percentage of new taxes required just to pay the post-1996 debt surge had risen back to one-third.

These trends help to clarify what it truly means when advocates of new state debt promise that it will "not increase taxes." Because all state bonds must, by definition, require state dollars to finance them — dollars that would otherwise be spent on other priorities or returned to those who earned them via tax cuts — a promise that new debts won't raise taxes is really a promise that increases in the debt-service budget will be offset by savings elsewhere in the General Fund budget. This is especially true during times of budgetary stress, as North Carolina has experienced since 2000, when debt obligations must be paid but other state expenditures are discretionary. Lawmakers have clearly paid no attention to these prior promises. So in a sense, it is not surprising that lawmakers are trying to authorize at least $760 million in new debt in 2004 without a public vote. They know that, given this past record, the voters wouldn't be likely to approve new debt. This is precisely why the constitutional safeguard against legislators enacting long-term debt needs to be respected, not evaded.

— *John Hood, President*



Notes

1. Sharif Durhams, "Black drops plan for university projects," *The Charlotte Observer*, June 3, 2004.
2. *Constitution of North Carolina*, Article 5, Section 3.
3. See, for example, "Higher Education Bonds Frequently Asked Questions," General Administration, UNC , www.northcarolina.edu, 2000: "Q: Will my taxes need to go up to pay for the bonds? A: No."