

THE BUDGET UNTOUCHABLES

Increased Spending Overwhelms Reported Cuts

Summary: Despite a \$1.3 billion deficit, Gov. Mike Easley will propose up to 6 percent higher spending in his 2005-06 budget, even with small proposed savings in most agencies. Medicaid and education spending have grown rapidly, and will continue apace. Instead, the governor plans to keep the temporary half-cent sales tax and add a large cigarette tax to pay for higher spending. This is no way to address what the Fiscal Research Division calls a structural budget deficit.

You have three places in your state budget that really are your real drivers of the budget . . . education, health care, and prisons. You can't let a lot of prisoners out, so that one's off the table. You certainly can't cut classrooms, not in this economy. The only place we have left to make some real cuts, savings, is in health care. . . . [But, in health care] we have a certain population that has to be served, and we have a duty, a moral obligation, to do that. — Gov. Mike Easley, 7 February 2005

Whatever Gov. Easley says in his State of the State address tonight, we can be sure it will not contradict the direction he laid out at the Emerging Issues Forum two weeks ago. In five sentences, the governor described the \$1.3 billion structural budget trap he helped build for himself. Education, Medicaid, and corrections are the three largest areas of the state's budget, a combined \$12.6 billion of \$15.9 billion spent from the General Fund last year, but the governor has declared them virtually untouchable.¹

Most departments will apparently have continuation budget savings of 1 percent to 2 percent (though adding expansion items will still mean higher spending in many agencies) and the top income-tax rate of 8.25 percent will be allowed to expire. Total spending will climb more than \$800 million, however. Medicaid alone will demand at least \$265 million more. Gov. Easley plans to reimpose a half-cent sales tax and add a reported 50-cent per pack cigarette tax to pay for the 5 percent to 6 percent growth.²

In fiscal year 2004-05, the state spent \$9.2 billion on education (57 percent of General Fund budget), the state's share of Medicaid was \$2.4 billion (15 percent), and corrections took just under \$1 billion (6 percent).³ That leaves less than 25 percent of the General Fund for debt payments, contributions to the rainy day fund, state courts, state police, health and human services, disaster relief, and the rest of government.

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The governor has supported a tuition freeze at state universities and plans to expand his "More at Four" preschool program as well as initiate a program for students to get an associate's degree with five years of high school. He previously demanded, and got, smaller classrooms through third grade even though there is no evidence that smaller classes in this grade produce higher student performance. All of these initiatives take operational funds from public schools, which will continue to add 20,000 new students for each of the next three years as they have in each of the last six. None of the governor's earlier initiatives has much improved the state's 63 percent graduation rate, six points below the national average.⁴

Medicaid spending has grown with rising medical prices and population, but the federal government and state legislature have also added entire groups to the program, further driving costs up. The state has justified moving some groups onto Medicaid as a way to "draw down" federal funds and cut costs in other areas. The first part has worked, but it is not clear how well the second part has. North Carolina's generous Medicaid benefits cost nearly \$900 per resident in combined state, federal, and local funds, up from \$600 per resident in 2000. If the governor does not want to tighten eligibility, cut services not offered by the state employee health plan or private insurance (e.g., dental and eyeglass coverage), or cut provider payments, he will have to rethink the role of individuals and the market in care delivery.⁵

Corrections spending has had slower growth than the combined growth in population and inflation, a conservative standard for spending growth, and is now 20 percent below the real, per-person level in 1994-95. Its share of the budget has also declined slightly to 6.3 percent. Despite the governor's rhetoric, the state has found a way to slow growth in at least this area.

The state has relied on one-time fixes to meet budget demands in recent years, leaving little in the rainy day fund and a \$1.3 billion structural deficit this year. Instead of significant budget savings and an end to temporary taxes, Gov. Easley hopes superficial cuts in some areas will mask his commitment to higher spending and higher taxation.

— Joseph Coletti, Fiscal Policy Analyst

NOTES

¹ Gov. Mike Easley, "A View from the Governor's Office," speech given at the Emerging Issues Forum, N.C. State University, Raleigh, February 7, 2005.

² Mark Johnson, "Sales tax to live on in Easley Budget," *The Charlotte Observer*, February 19, 2005.

³ "Budget Overview, Historical Trends and Outlook for FY 2005-06," North Carolina General Assembly (NCGA), Fiscal Research Division, February 15, 2005.

⁴ "Education Budget Overview," NCGA, Fiscal Research Division, February 16, 2005.

⁵ See Joseph Coletti, "Get Control of Medicaid: Bringing Costs Into Line Will Help State Budget," *Spotlight #248*, John Locke Foundation, February 3, 2005.

