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SPOTLIGHT

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NOT ENOUGH BRIGHT SPOTS

Senate Budget Hides Hopeful Measures

Summary: Senators deserve a great deal of credit for decisions in their proposed budget to limit dual eligibility for Medicaid and Medicare, reduce the number of teacher assistants in public schools, and remove General Fund support for some activities that should rely on receipts. These changes do not reflect an overall return to fiscal rationality, however. The Senate still increases spending by $1 billion in FY2005-06 and pays for it with highway fund transfers and higher taxes and fees. It is too early to judge the impact of the lottery, but at least some of the money appears to be a replacement for existing funds.

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As the Senate rushes to pass a budget bill the bloat has become clear. Spending, already up $1 billion from FY2004-05 under Gov. Mike Easley's $16.89 billion budget, inches closer to $17 billion in FY2005-06, at $16.95 billion. The Senate budget includes a $248 million surplus in its first year and a $475 million surplus in FY 2006-07, when spending climbs to $17.52 billion.[1]

Political courage is evident in a freeze of reimbursement rates and tighter Medicaid eligibility for some recipients who also receive Medicare benefits. The Senate also prudently redirects $57.5 million from teacher assistants to higher priority areas. These are important first steps if the state is ever to focus on medical and educational results instead of costs.

In the Department of Agriculture and Consumer Services, the Senate has placed greater emphasis on receipts to fund a number of programs and positions. It also calls for the closure of the Southeast Agriculture Center farmer's market. In transportation, the Senate moved funding of the aviation grant program to the Highway Fund from the General Fund to save $12 million per year from General Fund spending. Transfers from the Highway Fund and Highway Trust Fund continue to add $268 million to the General Fund each year.

Subsidies and Incentives

Such steps, however, are far too infrequent in the Senate's proposal, which relies more on tax increases than spending cuts to reduce the state's reliance on transfers and other one-time fixes. Incentives and subsidies retain their place as key priorities for the legislature. Among these are nearly $37 million going for the NC Biotechnology

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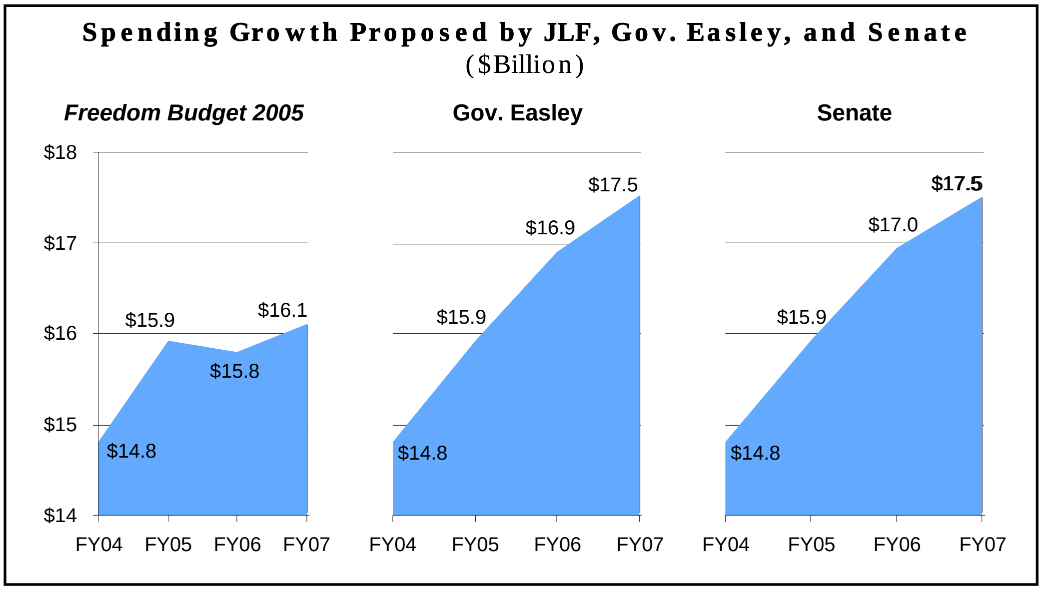
Center and Rural Economic Development Center, $8 million for Job Development Investment Grants (JDIG), and $600,000 for the Hosiery Technology Center.



Raising Taxes

Total tax increases are $778 million in FY2005-06 and $973 million in FY2006-07. The once temporary 0.5 percent sales tax increase officially becomes permanent. The top personal income tax rate goes to 8.0 percent in 2006 instead of 7.75 percent as scheduled. Honest language is a casualty of these changes. Somehow "maintain[ing]" the sales tax rate and "reduc[ing]" the income tax rate over two years produce over $400 million in new tax revenues.

In addition to the linguistically challenged tax increases, the Senate hikes the tobacco tax 700 percent to 40 cents a pack to put over $200 million in state coffers each year. It also incorporates language from a House bill to impose a new gambling tax in the form of a lottery, which will contribute $70 million to school construction and technology. But $50 million of that simply replaces corporate income taxes diverted to other educational purposes. There are no official estimates yet how much money the lottery will actually raise, although the governor has targeted $400 million a year.

Overall, the Senate has taken some positive steps toward fiscal restraint, but these have been overwhelmed by new programs, expansions, and the old reliance on tax increases. Although the Senate budget shows a surplus, this is largely due to the windfall from higher tax collections than expected this year. Raising taxes is no more of a long-term solution to the state's spendthrift budgets than relying on one-time transfers. Only fiscal restraint can prevent a return to structural budget deficits.

The John Locke Foundation's Freedom Budget 2005 presents such an alternative. It cuts taxes and spending by $1 billion compared to both the governor's proposal and the Senate bill (see above). Principles and priorities are the key.[2]

— Joseph Coletti, Fiscal Policy Analyst

NOTES

[1] Senate Budget Proposal, SB622, http://www.ncleg.net/

[2] Joseph Coletti, *Freedom Budget 2005: Principled and Pragmatic*, John Locke Foundation, http://www.johnlocke.org/policy_reports/2005050257.html