

spotlight

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BUDGETS ARE NOT UNICORNS

Gov. Perdue uses gimmicks instead of making choices

KEY FACTS: • Gov. Bev Perdue's budget proposal for fiscal year 2011 is another missed opportunity to improve state government finances and operations.

- It includes \$578 million in new federal stimulus money that does not cut total spending.
- The budget proposal, including stimulus funding, is \$400 million more than proposed in fiscal year 2010, and \$1 billion more than actual spending in fiscal year 2009.
- The state has no capacity to borrow more money.
- Families have little capacity to pay higher taxes.
- Total spending from all sources remains around \$50 billion, more than \$6 billion higher than in fiscal year 2008.
- Gov. Perdue will have another chance to correct past mistakes when she offers her plans to reorganize government.

gimmicks are at the core of Gov. Bev Perdue's budget proposal for fiscal year 2011. These gimmicks leave the state fundamentally unprepared for recovery. The governor's press release crowed about \$1 billion in cuts. But \$578 million of that is new federal stimulus money that simply replaces state dollars with no reduction in actual spending. All of this is in addition to more than \$1 billion in federal stimulus money already budgeted for fiscal year 2011 as part of the biennial budget passed last August.¹

State government has exhausted its ability to borrow money but has already borrowed \$2 billion from the federal government to pay unemployment benefits. The state and local governments also have unfunded liabilities for pensions and retiree health benefits totaling between \$29 billion and \$80 billion or more.²

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Figure 1. Federal revenue share of state spending is growing*(in \$millions)*

	<i>Actual</i> FY2008-09	<i>Budget</i> FY 2009-10	<i>Proposed</i> FY 2010-11
Fund Balance	\$644.3	\$92.2	\$83.2
Tax Revenue	\$16,779.1	\$18,055.1	\$18,298.3
Non-tax Revenue	\$1,640.9	\$871.4	\$767.9
Federal Bailout	\$680.4	\$1,387.8	\$1,611.4
Total General Fund Available	\$19,744.7	\$20,406.5	\$20,760.8
Total General Fund Appropriations	\$19,652.5	\$20,402.7	\$20,760.8
State-only General Fund availability	\$19,064.3	\$19,018.7	\$19,149.4
State-only General Fund appropriations	\$18,972.1	\$19,014.9	\$19,149.4
Total Federal Funding	\$11,855.6	\$14,190.6	\$14,183.1
Final Appropriation	\$44,532.6	\$49,276.4	\$49,931.0
Federal Share	26.6%	28.8%	28.4%
General Fund Share	42.6%	38.6%	38.4%

Gimmicks

Budget Director Charles Perusse acknowledged that adding back \$499 million in new federal dollars counted as cuts yields higher spending in the Department of Health and Human Services. This federal money, however, is temporary — legislators cannot rely on it for future years.

Despite the expected expiration of federal funds, the Perdue administration has encouraged local school districts to use that money for ongoing costs instead of one-time expenses. That is the equivalent of using lottery winnings to make your mortgage payment one month. The mortgage will still be there when the money is not.

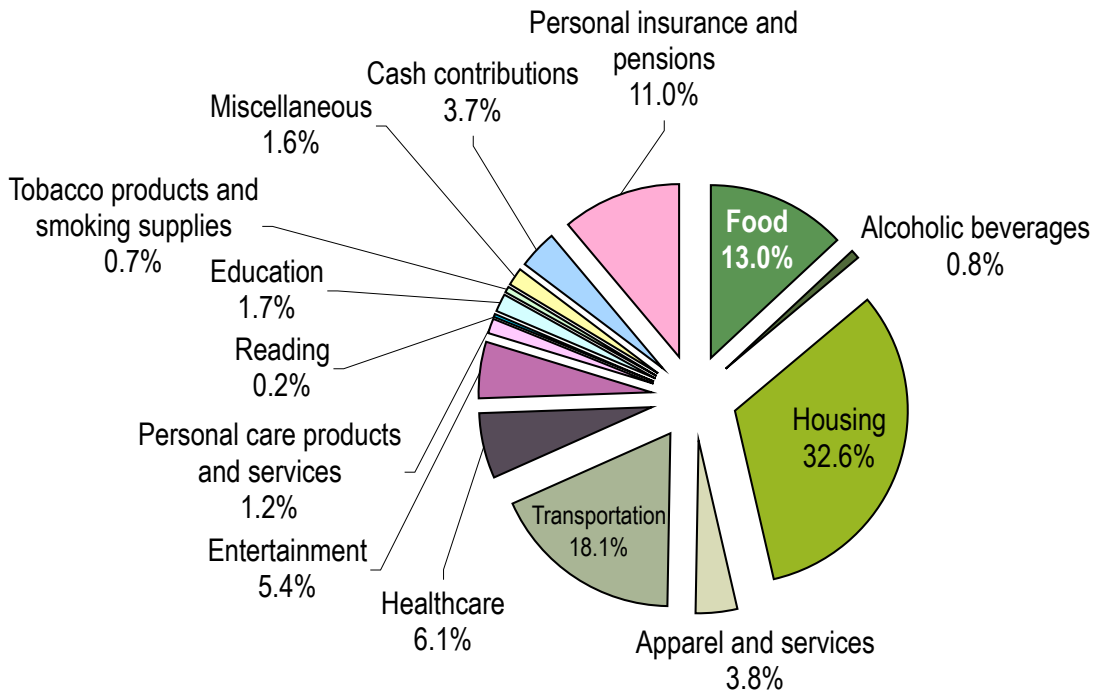
If one counts the short-term federal cash consistently from FY 2009 through FY 2011, the amount has increased from \$680.4 million to \$1.6 billion, helping to push the General Fund from an actual expenditure of \$19.7 billion in FY 2009 to budgeted appropriations of \$20.8 billion in FY 2011. Regardless how one counts these federal funds, total state spending from all sources will be near \$50 billion, with the General Fund accounting for less than 60 percent of the total.³

Another move that looks responsible is the addition of \$101.6 billion to the Savings Reserve Account, the state's rainy day fund. Gov. Perdue took \$637 million from the fund in FY 2009, leaving just \$150 million. Again, the reason for this addition became clear only in response to media questions. Most of the new deposit, \$85 million, will make up for lost state revenue if Congress does not extend the estate tax.

Tapped out

House Appropriations Committee Co-Chair Rep. Mickey Michaux told members to expect a \$1.2 billion shortfall for FY 2011. Medicaid is projected to finish the current fiscal year \$250 million over budget. Also, the state has borrowed more than \$2 billion from the federal government to pay unemployment benefits for the half-million jobless North Carolinians.

Figure 2. Expenditures of the average Southern family, 2008



Source: Bureau of Labor Statistics, Consumer Expenditure Survey

Members may want to raise taxes to pay for their favorite programs, but it will be difficult to do a year after raising taxes by \$1 billion. Elections in November could further encourage legislators to live within the state's means without a tax increase.

Legislators might also contemplate what expenses taxpayers should cut to pay for higher taxes or fees (Figure 2). The governor's budget includes \$72 million in new fees on drivers, but some of the money will pay for light rail, passenger trains, and other non-road purposes.⁴

Limiting the legislature's ambitions is its inability to borrow. Acknowledged General Fund debt is \$6 billion. Highway debt adds another \$1 billion. The Debt Affordability Advisory Committee concluded that, after nearly a decade of adding debt without a vote of taxpayers, the state cannot borrow another dollar until FY 2012 at the earliest.⁵

Future pension and retiree health care obligations add between \$29 billion and more than \$80 billion to the state's woes, depending on how one calculates the present value.⁶

Wishing it all away

A recent report from the Wells Fargo economic team stated:

Growth alone will not bail us out. Hard decisions on Medicaid, state college tuitions, state employee pensions and benefits and our tax statutes should have been addressed after the 2000 recession. The state needs to make up for that mistake now, recognizing that solutions may require challenging the status quo and their strong constituencies.⁷

Gov. Perdue's budget does little to address these long-standing issues. It pushes off the reckoning for past profligacy another year when the federal money is expected to run out and state government will have to find a way to cover that as well. Some indication of whether that approach is realistic will come in May, when the governor offers her list of 100 boards and commissions to cut.⁸

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End Notes

1. "North Carolina State Budget 2010-2011, Recommended Adjustments," Office of State Budget and Management, April 2010, http://www.osbm.state.nc.us/files/pdf_files/2010_budget.pdf.
2. "The Trillion Dollar Gap," Pew Center on the States, February 2010, http://downloads.pewcenteronthestates.org/The_Trillion_Dollar_Gap_final.pdf; Barry W. Paulson and Arthur P. Hall, "State Pension Funds Fall Off a Cliff," American Legislative Exchange Council, http://www.alec.org/AM/Template.cfm?Section=State_Pension_Funds_Fall_Off_a_Cliff; and Andrew Biggs, "The Market Value of State Pension Deficits," American Enterprise Institute *Outlook* No. 1, April 2010, <http://www.aei.org/outlook/100948>.
3. "Highlights: Fiscal and Budgetary Actions, 2009 Regular Session," North Carolina General Assembly Fiscal Research Division, p. 652.
4. Proposed Mobility Fund described in "Recommended Adjustments," pp. 23, 41-43.
5. "State of North Carolina: Debt Affordability Study," Debt Affordability Advisory Committee, February 2010, p.2, http://www.nctreasurer.com/NR/rdonlyres/328AA62B-F3C5-47D5-9593-009862F780A4/0/2010_DAAC_Final_1.pdf.
6. Present value is the value of future obligations or assets in today's dollars. It involves a discount for time, return, and risk. The state assumes a higher discount rate, and so lower present value for its pension obligations than other methods. See Biggs, *supra* 2.
7. "North Carolina Outlook," Wells Fargo Securities Economics Group, April 28, 2010.
8. John Hood, "Welcome the Urge to Merge," *CarolinaJournal.com*, April 27, 2010, http://www.carolinajournal.com/jhdailyjournal/display_jhdailyjournal.html?id=6360.