

NEW YEAR, NEW TAXES

Governor Seeks Nearly \$1 Billion in New Spending

Summary: Governor Mike Easley says his budget for the 2005-2007 biennium is the model of fiscal prudence, but the numbers belie this. Spending increases nearly \$1 billion to \$16.9 billion. The governor claims \$200 million in spending cuts, but they are far outweighed by the \$741 billion in higher taxes. Tobacco Trust Fund transfers and unreserved credit balance close the rest of the \$1.1 billion structural deficit. The General Assembly will need to be more forthright if it is to put real restraints on government growth.

Governor Easley presented his budget to the General Assembly Wednesday, calling it “a solid, balanced plan” targeting education, jobs, and fiscal discipline. He clearly has directed money at state schools, community colleges, and universities. It is also easy to spot the money allocated to corporate subsidies. Fiscal discipline, however, is not as readily apparent.

For starters, the 2005-06 general fund budget is 6.1 percent higher than the final budget approved for 2004-05, but expected supplemental items this year allow the governor to project a 5.5 percent increase, slightly less than the growth in personal income.

The governor claims to have \$203 million in spending cuts—\$74 million from public schools, \$55 million from Medicaid, \$64 million across the board (except debt service, public schools, and Medicaid), and \$10 million from other sources.¹ Of the cuts in education, \$24 million is from lower-than-budgeted salaries because of teacher turnover, \$28 million to local school districts was cut by the General Assembly in 2004-05, and \$15 million is redirected from local school districts to a state-level capital fund because of higher-than-expected corporate income tax receipts. Medicare prescription drug coverage yields \$11 million in savings for the state Medicaid budget and another \$5 million comes from the Medicaid Trust Fund. Even with the cuts, Medicaid spending will be 9.5 percent higher, with another 12.5 percent increase likely in 2006-07. Shifting incremental costs to counties or to Washington, tapping trust funds, and cutting funds that were not there to begin with do nothing to control the growth in government nor do they necessarily ensure long-term fiscal balance.

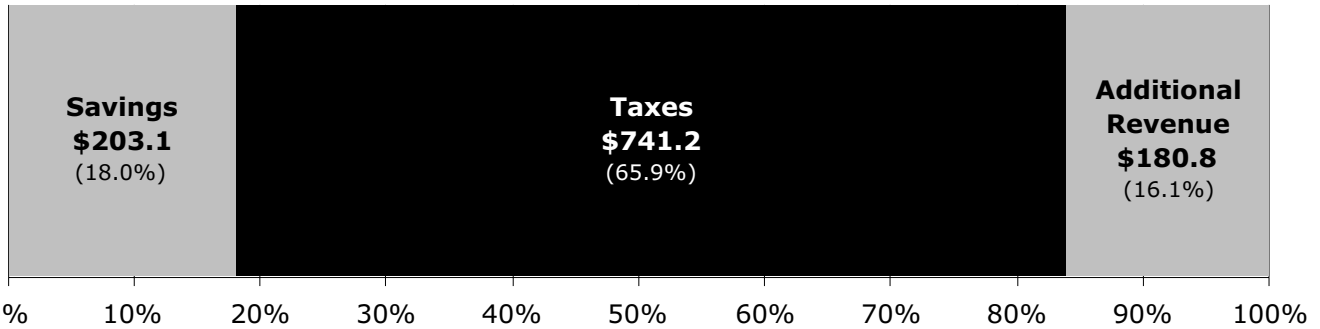
Higher taxes close nearly two-thirds of the \$1.125 billion projected deficit. Governor Easley labeled as a “tax cut” his proposed quarter-point hike in the top income tax rate to 8 percent from the 7.75 percent scheduled to resume in 2006. This “tax cut” raises taxes \$20 million. He does not consider the indefinite extension of the half-cent sales

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How Easley Closes His Projected \$1.1 Billion Deficit in 2005-06



Source: North Carolina State Budget 2005-2007

tax, which was set to expire, a \$413 million tax increase, although disaster relief for the mountains included in the 2004-05 budget took some of the blame. Increases in sales and privilege taxes for a number of other goods are hidden under the effort to streamline the sales tax system, though it represents \$105 million tax hike. Imposing a single sales tax rate may be worthwhile, but there was no prohibition against revenue neutrality or streamlining at a lower rate. Newspapers, movies, concerts and sporting events, video rentals, cable, satellite TV, liquor, and candy will bear a 7 percent tax rate. Funeral services are exempt, but the casket and related goods are not. Estate taxes and corporate taxes are kept high despite federal cuts. The only tax hike the governor clearly identifies as a tax hike is the cigarette tax, which would climb \$0.35 per pack on September 1, 2005, and another dime the following July, bringing the total excise to \$0.50 per pack, ten times the current rate. None of these changes helps ease the fact that North Carolina has one of the highest tax burdens in the Southeast.²

A high overall tax burden also provides more room to carve out incentive packages for individual companies and entire industries. The film industry gets \$4 million. The One NC Fund to attract new jobs gets \$5 million. The biotechnology industry receives \$5.5 million. Combined spending for incentives totals \$18.9 million. Both Gov. Easley and his fiscal policy advisor Dan Gerlach volunteered that the 8.25 percent tax rate led companies to look elsewhere for headquarters locations. As a result, the state pays for the jobs it gets and forgoes others that would create revenues.

The Senate and House should exercise more restraint than the governor has shown to demonstrate that words such as *solid*, *balanced*, and *discipline* have meaning in the state budget.

-Joseph Coletti, Fiscal Policy Analyst

Minding the Gap		
	Millions	% of Total
Projected Deficit (FY 2005-06)	\$1,125.0	
Recurring Reductions	\$157.4	14.0%
Nonrecurring Reductions	\$45.7	4.1%
Continuation Budget Reductions	\$203.1	18.0%
Extend taxes set to expire	\$464.1	41.3%
Streamline Sales Tax (eff. 9/1/05)	\$105.7	9.4%
Raise cigarette tax \$0.35 per pack	\$171.4	15.2%
Total Tax Increases	\$741.2	65.9%
Credit Balance	\$143.8	12.8%
Tobacco Trust Fund Transfer	\$37.0	3.3%
Other Revenues	\$180.8	16.1%
Total Additional Revenues	\$922.0	82.0%

NOTES

¹ All figures from North Carolina State Budget 2005-2007, Office of State Budget and Management, February 23, 2005

² Dr. Roy Cordato, "Liberty and Economic Growth: Principles for Reforming North Carolina's Tax System," John Locke Foundation, January 2005.

Five Largest General Fund Budget Items (FY 2005-06)		Source of Funds (FY 2005-06)			
	Millions		Millions	% of Total	% Growth
Public Education	\$6,678.9	Individual Income Tax	\$8,498.6	53.3	5.5
Medicaid	\$2,588.6	Sales and Use Tax	\$4,809.7	30.2	7.4
UNC System	\$2,111.3	Corporate Income Tax	\$975.3	6.1	-1.3
Correction	\$1,046.5	Franchise Tax	\$501.5	3.1	3.0
Community Colleges	\$763.7	Insurance Tax	\$466.0	2.9	5.5
		Cigarette Tax	\$213.8	1.3	389.0
		All Other	\$473.7	3.0	10.6
		TOTAL	\$15,938.6	100.0	6.8
Corporate Welfare Programs (FY2005-06)		Fund Uses (FY 2005-06)			
	Millions		Millions	% of Total	% Growth
OneNC Fund (from credit balance)	\$5.0	Education	\$9,553.9	56.6	3.5
Job Development Investment Grant (JDIG) Program	\$3.5	Health & Human Services	\$4,088.2	24.2	7.3
Film Incentives	\$4.0	Justice & Public Safety	\$1,746.8	10.3	5.3
NC Biotechnology Center	\$3.0	Debt Service	\$486.8	2.9	14.0
UNC Initiatives:		Natural & Economic Resources	\$373.5	2.2	5.6
Biomufacturing Training Center (NCSU)	\$2.0	General Government	\$357.3	2.1	-0.7
Bioprocessing Research Institute (NCCU)	\$0.5	Other	\$287.8	1.7	269.9
Small Business Technology Development Centers	\$0.9	TOTAL	\$16,894.3	100.0	6.1
TOTAL	\$18.9				