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The State Budget

This chapter summarizes in broad outline the fiscal provisions of the 2001–2003 state budget and legislation affecting the development, enactment, and administration of the state budget. More detailed information regarding budgetary actions affecting specific state departments and agencies is included in some of the following chapters.

The Budget Process

North Carolina's state government operates on a fiscal year that runs from July 1 to June 30. During regular sessions in odd-numbered years, the General Assembly adopts a state budget that makes appropriations for each of the following two fiscal years. The General Assembly returns for a short session in even-numbered years to make adjustments to the state budget for the second year of the biennium.

The biennial state budget process begins with the formulation of budget recommendations by the Governor, who, by virtue of the state constitution, is the director of the budget. At the beginning of the first regular session of the General Assembly in each odd-numbered year, the Governor presents to the legislature his comprehensive budget recommendations for the next two fiscal years, including estimates of the amount of revenues available for appropriations, estimates of the appropriations needed to continue existing programs at their current levels, and recommended appropriations for expansion of existing programs, for new programs, and for capital improvements.

Although the House and Senate Appropriations Subcommittees initially meet jointly to review the Governor's budget proposals, the House and Senate each develop their own versions of the state budget. In recent years, the House and Senate have alternated from year to year the responsibility for initially passing a bill making appropriations for continuing operations, expansion, and capital improvements for state departments and agencies during the coming biennium. After the first chamber passes an appropriations bill, the second house revises the bill to reflect its own program priorities and policy considerations, and the differences between the two versions are resolved by conferees appointed by each chamber (or by a smaller group of

appropriations chairs and the leadership of the two chambers). The conference committee report incorporating the budget agreement between the House and Senate must then be adopted by both chambers and submitted to the Governor for approval.

In 2001 the Senate was responsible for taking the lead in preparing the state budget. It passed an appropriations bill (S 1005) on May 31, 2001. The House passed its version of S 1005 on June 28, 2001. The Senate refused to concur in the House version; a conference committee was appointed; and the committee's proposed bill was finally ratified by both chambers on September 21, 2001, nearly three months after the beginning of the fiscal year and nearly four months after passage of the Senate bill. It was signed by Governor Easley on September 26, 2001. The approved bill is S.L. 2001-424.

Although the Executive Budget Act [G.S. 143-15.1(a)] requires the General Assembly to enact a current operations appropriations act by June 15 of odd-numbered years, this was not possible in 2001 because the House and Senate could not agree on a budget before the beginning of the 2001–2002 fiscal year. Instead, the two chambers enacted a series of continuing budget acts that appropriated funds for state departments and agencies at their 2000–2001 levels from July 1 until July 16 (S.L. 2001-250); from July 16 until July 31 (S.L. 2001-287); from July 31 until August 29 (S.L. 2001-322); and from August 29 until September 28 (S.L. 2001-395). This last act was much more than merely an act to continue the budget. For example, it made appropriations for 2001–2002 of block grants for health and human services and natural and economic resources and for additional teachers to reduce kindergarten class sizes, and it enacted tuition increases for community colleges and universities.

The differences between the House and Senate bills that took so long to work out primarily involved where to make budget cuts and how deeply to make them, and whether taxes should be increased (and if so, which ones and by how much). The Senate version contained some drastic cuts in mental health services and education with which the House refused to concur, and the House generally wanted to see a lower increase in the sales tax and a higher increase in the individual income tax rates, if taxes had to be increased at all. It was a difficult task for all concerned because the state's financial situation was the worst it had been since 1991. On the date the General Assembly convened—January 24, 2001—there was a shortfall of approximately \$800 million in the 2000–2001 budget. But it was a financial situation—a crisis, really—that might have been foreseen. In the previous decade, the General Assembly had enacted tax cuts that amounted to 1.3 billion dollars a year, thereby permanently impairing the state's revenue structure. At the same time, it had significantly increased expenditures, especially for education. Also during the decade, the state had to deal with the extraordinary costs of Hurricanes Fran and Floyd and the refunds that had to be made as the result of losing lawsuits over intangibles taxes and taxes on the pensions of retirees. These events, however, should have been foreseen. North Carolina lies squarely in a hurricane zone; therefore, substantial hurricane damage should be anticipated every few years. Most informed lawyers would have predicted—at the time the suits were filed—that the odds were about 80–20 that the state would lose the lawsuit over the constitutionality of the intangibles tax and at least 50–50 that it would lose the suit filed by the retirees. These events could have been dealt with in several ways: rather than cutting taxes, the General Assembly could have increased the amounts appropriated to the contingency and emergency fund and the Savings Reserve Account in anticipation of extraordinary expenses; a temporary surtax could have been added to the sales tax or individual income tax; or bonds could have been issued. None of these measures was pursued, and thus when the state entered a recession in 2000, the unfortunate consequences of a decade of tax cuts yoked with new spending had to be dealt with by a new General Assembly and a new Governor. In an essay, Chancellor James R. Leutze, University of North Carolina at Wilmington, well summarized the situation:

Each time the state goes through this kind of trouble, we react the same way—we radically cut budgets, reduce staffs, withhold pay raises and cut out programs. Then, as always happens, things improve. When things improve, the state cuts taxes, adds major new initiatives and

otherwise acts as though we have been through a unique experience. During my three decades, we have gone up and down this road four times.¹

But the 2001 General Assembly chose not to go down this road again; instead, it made some rather modest cuts in programs and enacted some modest tax increases. Some cuts were made in the Medicaid program by reducing the reimbursements to physicians, but otherwise the program fared very well. Pay levels for public school teachers did not go as far toward reaching the national average as most teachers had hoped, but the budget did include a significant pay increase. The universities lost some nonteaching positions, but they received full funding for enrollment increases, and their overhead receipts for research were not tapped to help balance the budget. The broadest tax increase (0.5 percent) was in the sales tax, and an additional income tax bracket was added for upper income taxpayers. Also, some increases were made in taxes on alcoholic beverages, satellite television services, and certain telephone calls. In other words, there was nothing earthshaking on either the expenditure-reduction or taxation side.

The 2001–2002 Budget

The state budget is supported by four major sources of funding: (1) the General Fund; (2) the Highway Fund and Highway Trust Fund; (3) federal funds (including matching funds, categorical grants, and block grants), and (4) other receipts (such as tuition payments to state universities). The appropriations from these revenue sources, and the revenue sources themselves, are placed in four categories in the budget: (1) General Fund, (2) Highway Fund, (3) Highway Trust Fund, and (4) block grants of federal funds. For 2001–2002, the budget estimates that the following revenues will be available in these funds:

General Fund	\$14,530.0 (billions)
Highway Fund	1,318,690,000
Highway Trust Fund	988,723,000
Block Grants	783,782,668 Health and Human Services 45,000,000 Community Development

From these revenues, the General Assembly made the following current operations appropriations for 2001–2002:

General Fund	\$14,368,256,787
Highway Fund	1,318,690,000
Highway Trust Fund	988,723,000
Block Grants	783,782,668 Health and Human Services 45,000,000 Community Development

The General Fund appropriation is of most interest by far, and when newspaper reporters and others write about a 2001–2002 budget of “14.4 billion dollars,” it is the General Fund to which they are referring, although as can be seen, the total budget is considerably more than that. Of the General Fund appropriations, education and health and human services claim the lion’s share. The appropriation for education—including primary and secondary, community colleges, and the university system—is \$8.3 billion, or 58 percent of the General Fund budget. The appropriation to the Department of Health and Human Services is \$3.4 billion, or 24 percent of the budget. Thus, these two services share 82 percent of the General Fund appropriation.

1. James R. Leutze, *Raleigh News and Observer*, 7 May 2001.

Budget Highlights

The following are some of the highlights of the 2001–2002 budget:

- Mental Health Trust Fund for community based programs—\$47.5 million
- Clean Water Fund—\$40 million
- Savings Reserve Account—\$181 million
- More at Four program—\$6.5 million
- Kindergarten classes limited to 19 students
- 2.6 percent salary increase for teachers
- \$100 for each teacher to purchase school supplies
- \$625 annual salary increase for most state employees
- 2 percent cost of living increase for retirees in the Teachers’ and State Employees’, Judicial, and Legislative retirement systems
- Increase in the state sales tax of 0.5 percent, effective October 16, 2001, and expiring June 30, 2003
- Increase in the individual income tax rate of 0.5 percent for certain higher income taxpayers, effective January 1, 2001, and expiring December 31, 2003
- Sales tax holiday the first weekend of August each year on the purchase of school supplies, clothing, and footwear costing \$100 or less per item, and computers and accessories costing \$3,500 or less per item

Capital Appropriations

The General Assembly made the following appropriations from the General Fund for capital improvement projects in 2001–2002:

Repairs and Renovations Reserve Account	\$125,000,000
Department of Environment and Natural Resources	32,936,000

The Department of Environment and Natural Resources appropriation is to be expended on various water resources projects, the largest of which are deepening the Wilmington harbor (at \$22 million) and maintenance of the Shallowbag Bay channel (at \$2.5 million).

Conference Committee Report

The budget act was accompanied by a conference committee report on the bill, formally designated “Joint Conference Committee Report on the Continuation, Expansion and Capital Budgets, dated September 19, 2001.” This is an exceedingly important document because it specifies in detail how the appropriations made in the act are to be allocated and expended. Section 36.2(a) of S.L. 2001-424 provides that the conference committee report is to be used to construe the budget act, is to be considered part of the act, and is to be printed as part of the session laws.

William A. Campbell