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## The State Budget

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This chapter summarizes, in broad outline, the budget process and the fiscal provisions of the 2005–06 state budget. More detailed information regarding budgetary actions that affect specific state departments and agencies is included in some of the chapters that follow.

### **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 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 regular session of the General Assembly in each odd-numbered year, the Governor presents to the legislature 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 current levels, and recommended appropriations for expansion of existing programs, for new programs, and for capital improvements.

Although the House and Senate appropriations subcommittees usually meet jointly to review the Governor's budget proposals, the House of Representatives and the Senate develop their own respective versions of the state budget. In recent years the House and Senate have alternated from biennium to biennium the responsibility for initially passing an appropriations bill for continuing operations, expansion, and capital improvements for state departments and agencies. In 2005 the Senate was responsible for taking the lead in preparing the budget. It passed an appropriations bill (Senate Bill 622) on May 5, 2005. The House passed its version of Senate Bill 622 on June 16. The Senate refused to concur with the House version, a conference committee was appointed, and lengthy negotiations commenced.

The budget negotiators failed to reach an agreement by June 30, the end of the fiscal year, so stopgap bills were enacted on June 30, July 19, and August 4, each authorizing continuation of state appropriations at the 2004–05 level for a few weeks. The conference committee finally agreed on a

compromise bill, which was adopted by roll-call readings on three separate days in each house in early August. The Current Operations and Capital Improvements Appropriations Act of 2005 became law as S.L. 2005-276 when it was signed by the Governor on August 13, 2005, six weeks after the start of the fiscal year. Budget negotiations apparently continued, however, because just over two weeks later, the General Assembly enacted S.L. 2005-345 (H 320) making extensive modifications to the appropriations act.

There were several reasons budget negotiations lasted almost two months. As in several recent years, the legislative leadership included revenue-raising measures in the same bill as the spending measures, forcing lawmakers to either support the tax and fee increases or go on record as opposing the budget. The differences between the two houses regarding tax increases took weeks to resolve. The Senate supported a higher cigarette tax increase than the House of Representatives; the two eventually compromised on a delayed phase-in of an increase from 5 cents to 35 cents a pack. The Senate budget would have made permanent the “temporary” state half-cent sales tax set to expire July 1, 2005, but the compromise bill extended the tax for only two more years.

The Senate budget would have reduced individual and corporate income taxes and closed a corporate income tax loophole by adopting the “throw-out rule.” The compromise bill included none of these measures; neither did it include two proposals from the House budget: to equalize the tax rates on movies and other entertainments and to give an income tax incentive to small businesses that provide employee health insurance.

Two substantive policy issues also created budget gridlock: the authorization of a state lottery and a proposed policy change affecting the UNC system. The House of Representatives had passed a separate bill (House Bill 1023) earlier in the session authorizing a lottery. The Senate held House Bill 1023 in committee but included in its budget bill numerous provisions that would have amended House Bill 1023 to relax restrictions on lottery advertising and change the purposes for which lottery proceeds would be spent. These provisions were the subject of intense negotiation that delayed the budget agreement process. The second substantive issue that complicated budget negotiations was a Senate budget provision that would have given trustees at UNC Chapel Hill and N.C. State University the freedom to set tuition without obtaining the approval of the UNC system Board of Governors. Critics argued that the proposal would undermine the state’s unified system of higher education while supporters believed the change was necessary to provide resources to attract top faculty. The Senate dropped the provision after weeks of debate, which included a public statement in opposition of the provision issued jointly by eight former governors and lieutenant governors.

Tax and substantive law provisions were not the only issues preventing a quick compromise on the budget. The House and Senate budget proposals were about \$154 million apart on roughly \$17 billion in spending, the major differences concerning state employee raises and overall spending levels for public schools and Medicaid. For details of these issues, see the chapters on education, public employment, and social services.

In the middle of budget negotiations, the General Assembly added a provision to its July 19 “continuing resolution,” S.L. 2005-201 (H 1631), making appropriations for enrollment increases in public schools, community colleges, and the UNC system. In an unprecedented move the following day, the Governor issued an executive order directing the executive branch to implement programs for which funding had been proposed but not yet appropriated, thus effectively appropriating the money, a power the constitution reserves for the legislature. The General Assembly later appropriated the funds released by the Governor in the executive order.

## **The 2005–06 Budget**

S.L. 2005-276 spends a \$681 million revenue surplus from the 2004–05 fiscal year as well as more than \$600 million in new or extended taxes and fees. In addition to the tax increases discussed above, S.L. 2005-276 includes higher driver’s license and title fees and higher taxes on candy, liquor, and cable and satellite television. The act is 364 pages long, and although most of it deals with the appropriation of funds, much does not. As in recent years, a significant portion of the act consists of

special provisions, which either amend or create substantive law and have little to do with the appropriation of state funds. This practice is widely criticized because the special provisions receive very little scrutiny before becoming law. According to an analysis by legislative staff, the 2005 budget included 1,225 special provisions, compared to 930 in the previous long session in 2003—an increase of 31.7 percent.

The fund from which most money is appropriated is the General Fund; smaller appropriations for specific purposes are made from the Highway Fund and the Highway Trust Fund. Total General Fund revenues for 2005–06 were estimated at \$17.3 billion. The sources making up this total include the following:

Beginning credit balance	\$ 472,375,000
Tax revenues	15,417,300,000
Nontax revenues	775,824,517
Adjustments	628,800,316

Many of the adjustments were tax related, including the following:

Streamlined sales tax changes	40,000,000
Extension of 4.5% sales tax rate for 2 years	417,100,000
Application of sales tax to candy	9,800,000
Application of general sales tax rate to cable	10,900,000
Tobacco tax rate changes	118,800,000
Extension of 8.25% individual income tax rate for 2 years	39,800,000
Conforming estate tax to federal sunset	29,100,000
Film industry jobs incentives	(3,500,000)

## Appropriations

The General Assembly made the following current operations appropriations for 2005–06:

General Fund	\$17,026,260,791
Highway Fund	1,683,010,000
Highway Trust Fund	1,093,230,000

Of the General Fund operating appropriations, education and health and human services claim the lion's share, as has been the case for many years. The appropriation for education—including primary and secondary schools, community colleges, and the university system—is \$9.48 billion, or over 55 percent of the General Fund operating budget. The appropriation to the Department of Health and Human Services is \$4 billion, or over 23 percent. Thus, these two services account for 79 percent of General Fund operating appropriations.

## Capital Appropriations

The General Assembly appropriated \$54.9 million from the General Fund for capital improvement projects in 2005–06. The Clean Water Management Trust Fund received full funding of a \$100 million annual appropriation mandated by G.S. 143-15.3B.

## Budget Highlights

The following are some of the highlights of the 2005–06 budget:

- Clean Water Management Trust Fund—\$100 million
- Savings Reserve Account—\$199 million
- Repairs and renovations—\$125 million

- More at Four program—\$16.5 million each year of the biennium for 3,200 additional slots and for an additional \$150 per slot for new and existing slots
- Full funding of enrollment growth for public schools, community colleges, and the UNC system
- Public schools—\$22.5 million for Disadvantaged Student Supplemental Funding, \$20 million in Low Wealth Supplemental Funding, and \$100 million (nonrecurring) for ABC bonuses (School-Based Management and Accountability Program)
- Fines and forfeitures—\$102.5 million in increased receipts from the Civil Penalties & Forfeitures Fund allocated to public schools through various allotment formulas, supplanting General Fund appropriations for these allotments
- 2.24 percent average salary increase for teachers
- Salary increase for most state employees of the greater of \$850 or 2 percent, with an additional 2 percent increase for community college faculty and professional staff
- One-time annual leave bonus of five days for most state employees
- Establishment of a minimum wage of \$20,112 for full-time permanent SPA employees and a pro rata amount for part-time employees
- 2 percent cost-of-living increase for retirees in the teachers' and state employees', judicial, and legislative retirement systems
- 2.5 percent cost-of-living increase for retirees in the Local Governmental Employees' Retirement System
- Cigarette tax increase of 25 cents effective September 1, 2005, and an additional 5 cents effective July 1, 2006, with corresponding increases in taxes on other tobacco products
- Continuation until July 1, 2007, of temporary 0.5 percent state sales tax
- Continuation until January 1, 2008, of temporary individual income tax increase of 0.5 percent for certain higher-income taxpayers

### **Conference Committee Report**

S.L. 2005-276 provides that the “Joint Conference Committee Report on the Continuation, Expansion and Capital Budgets . . . shall indicate action by the General Assembly on this act and shall therefore be used to construe this act, as provided in G.S. 143-15 of the Executive Budget Act, and for these purposes shall be considered a part of this act.” The report, which was prepared by the Fiscal Research Division of the General Assembly and updated to reflect amendments made to the budget act by S.L. 2005-345, is available on the General Assembly’s Web site at: [www.ncleg.net/sessions/2005/budget/budgetreport9-8.pdf](http://www.ncleg.net/sessions/2005/budget/budgetreport9-8.pdf). This important document specifies in detail how the appropriations made in the act are to be allocated and expended. Each year the Fiscal Research Division also publishes an overview of the budget, which can be found on their Web site at: [www.ncleg.net/LegislativePublications/fiscalresearchhd/](http://www.ncleg.net/LegislativePublications/fiscalresearchhd/).

*Martha H. Harris*