



# NC 2013 Legislative Session Budget and Fiscal Policy Highlights

Fiscal Brief

August 13, 2013

## Executive Summary

The 2013 General Assembly convened January 30<sup>th</sup> with Senate and House leaders announcing tax reform as one of the key components of their legislative agenda.

With that major effort underway, legislative budget writers focused on keeping spending within the range of various tax proposals taking shape in the House and Senate. On July 25<sup>th</sup>, the legislature enacted Senate Bill 402, Appropriations Act of 2013, appropriating \$20.6 billion and \$21 billion respectively, for the 2013-15 Biennial Budget. The following day, Governor Pat McCrory signed the bill into law.<sup>1</sup>

Since the legislature traditionally makes adjustments to the second year of its biennial budget in the subsequent legislative session, this brief will focus primarily on fiscal and budgetary actions affecting the FY 2013-14 Budget.

Major legislative actions taken during the 2013 Session include changes to tax law, steps taken to close a budget gap in the Medicaid program, efforts to strengthen the State's General Fund and reorganizations of certain functions of State government.

S.L. 2013-360, Appropriations Act of 2013 (S.B. 402), as amended by S.L. 2013-363, Modifications/2013 Appropriations Act (H.B. 112), appropriates \$20.6 billion for FY 2013-14, 1.9 percent more than the FY 2013-14 Continuation Budget.<sup>2</sup> When compared to the FY 2012-13 adjusted budget,<sup>3</sup> FY 2013-14

<sup>1</sup> S.L. 2013-360 (S.B. 402).

<sup>2</sup> As used throughout this brief, Continuation Budget refers to that portion of the Governor's Recommended State Budget proposed to fund State government operations in the next fiscal year.

<sup>3</sup> S.L. 2013-56, Medicaid/2012-2013 Additional Appropriations, and S.L. 2013-184, Continuing Budget

appropriations remain relatively flat. Table 1 provides a comparison of appropriations by subcommittee or area.

**Table 1**  
**Comparison of Appropriations by Subcommittee/Area**

Subcommittee/Area	Continuation Budget <sup>2</sup>		Enacted Budget FY 2013-14	Enacted 2013-14 vs. Con't 2013-14
	FY 2013-14	FY 2013-14		
Education	11,731,907,039	11,470,304,386		-2.2%
Health & Human Services	4,615,870,375	4,993,788,323		8.2%
Justice & Public Safety	2,372,758,253	2,368,675,193		-0.2%
Natural & Economic Resources*	345,916,108	371,247,970		7.3%
General Government Reserves, Debt Service, & Capital	421,067,414	424,758,845		0.9%
	756,149,861	1,001,992,928		-
<b>TOTAL</b>	<b>\$20,243,669,050</b>	<b>\$20,630,767,645</b>		<b>1.9%</b>

\* The increase in the NER budget is due primarily to moving programs from dedicated revenue sources to General Fund.

## General Fund Availability

### Revenue

Each year economists for the Office of State Budget and Management and the General Assembly's Fiscal Research Division provide a consensus revenue forecast that legislative budget writers use to develop the budget. However, the 2013 legislative session was different. With a major focus on reforming the State's tax code, the consensus forecast served as the starting point for legislators to negotiate major tax changes.

Authority, increased FY 2012-13 appropriations by \$308.1 million to cover a Medicaid shortfall.



S.L. 2013-316, Tax Simplification and Reduction Act (H.B. 998), reduces income taxes for both individuals and corporations. It eliminates the franchise tax on utilities and the tax on piped natural gas, taxing both utilities and piped natural gas under the sales and use tax. The Act also expands the sales tax to include warranties and service contracts tied to the sale of tangible personal property and eliminates many exemptions including preferential sales tax rates for movies and amusements. The impact is a reduction in State revenue of \$683.8 million over the biennium. The Act also repeals the earmark on corporate income tax for school capital construction and directs those funds back into the General Fund. After adjusting for all changes, General Fund revenue is forecast to grow 2.8 percent and 3.4 percent respectively for each year of the 2013-15 biennium.

*Adjustments to Revenue and Availability*

Total General Fund Availability for FY 2013-14 is \$20.88 billion. Significant adjustments to availability are highlighted below:

- Unreserved Fund Balance – The State’s Unreserved Fund Balance at the start of FY 2013-14 was an estimated \$968.4 million. After subtracting \$382.5 million in earmarkings and appropriating an additional \$308.1 million to a Medicaid shortfall, the remaining Unreserved Fund Balance available for appropriation and for use in balancing the budget is \$277.8 million.
- Tax Code Changes<sup>4</sup> – Various changes to tax law reduced revenue by \$171.0 million and \$512.8 million in each year of the biennium. These reductions were offset by directing \$84.4 million and \$75.0 million (in previously earmarked corporate taxes) back into the General Fund over the biennium.
- Other Adjustments – Fiscal policy changes in revenue earmarks, such as directing the real estate conveyance tax to the General Fund, and the sweeping of various special fund cash balances resulted in a net

increase of \$224.5 million in General Fund availability.

*Savings Reserve and Repairs and Renovations Reserve*

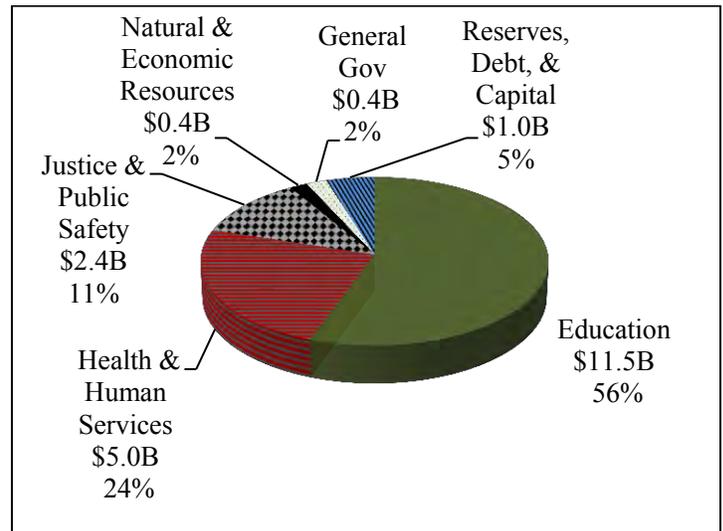
The State Budget Act<sup>5</sup> stipulates that the Savings Reserve and Repairs and Renovations Reserve each receive transfers of 25 percent of the unreserved fund balance remaining in the General Fund at the end of each fiscal year. These transfers effectively reduce the amount available for appropriation. Notwithstanding State Budget Act requirements, the General Assembly directed the State Controller to reserve \$232.5 million (an amount greater than 25 percent) effective June 30, 2013. The total in the Savings Reserve is now \$651.3 million.

Legislators also directed the transfer and appropriation of \$150 million to the Repairs and Renovations Reserve, an amount slightly less than the statutory 25%.

**General Fund Appropriations**

Due to a major focus on adjusting the State's tax base, budget writers made only modest adjustments to the 2013-15 biennial State budget. These adjustments did little to change the overall distribution of State spending. Education and Health and Human Services continue to receive the majority of State appropriations. (See Table 2 below.)

**Table 2**  
**State Appropriations by Subcommittee/Area**  
**FY 2013-14**



<sup>4</sup> S.L. 2013-316, Tax Simplification and Reduction Act.

<sup>5</sup> G. S. 143C-4-2; G. S. 143C-4-3.



## Education

The University of North Carolina (UNC) System saw the largest funding change among the State's three public education agencies, with a 4.7 percent decrease from the Continuation Budget. The majority of that decrease is the result of a \$65.8 million management flexibility reduction to the university system's \$2.6 billion budget for FY 2013-14.

The budget for the Department of Public Instruction (DPI) is \$7.9 billion or 1.5 percent less than the Continuation Budget. By reducing specific allotments in approximately the same proportion as Local Education Agencies have done the last two years, budget writers were able to eliminate a \$376.1 million management flexibility reduction that began during the 2009 session.

Other changes in public schools include a 21 percent or \$120 million reduction in funding for teacher assistants, phase-out of teacher tenure and education-based salary supplements, an additional appropriation of \$18.6 million for continued implementation of the Excellent Public Schools Act, and the creation of Opportunity Scholarships, a program to provide grants to students attending nonpublic schools beginning in FY 2014-15.

The Community College System budget of \$1.0 billion for FY 2013-14 remains flat when compared to the FY 2013-14 Continuation Budget.

### *Medicaid FY 2012-13 Budget Gap*

In early March budget writers were alerted to a potential budget gap in the State's Medicaid budget. In late May, to ensure adequate funding for provider payments, one time expenditures and other Medicaid costs, the legislature authorized a total of \$496 million<sup>6</sup> in additional funding, including departmental receipts. Sources of funding to cover the shortfall included departmental receipts, funds diverted from other Department of Health and Human Services' divisions, \$308.1 million in unreserved fund

<sup>6</sup> S.L. 2013-56, Medicaid/2012-2013 Additional Appropriations, authorized \$451 million and S.L. 2013-184, Continuing Budget Authority authorized an additional \$45 million in total appropriations from all sources.

balance, and projected FY 2012-13 over collections. For FY 2012-13, Medicaid is projected to have spent \$416 million or 13.4 percent more than was originally appropriated during the 2012 legislative session.

### *Department of Health & Human Services (DHHS)*

With the Medicaid budget gap covered, legislators turned their focus to the next biennial budget for DHHS. The legislature appropriated \$5.0 billion for FY 2013-14 or 8.2 percent more than the Continuation Budget. Most of the 8.2 percent increase in DHHS was dedicated to Medicaid. All other DHHS division budgets were reduced by an average of 3.5 percent; most areas of DHHS received either reductions or essentially flat funding.

The Medicaid budget is \$3.5 billion or 12.8 percent more than the FY 2013-14 Continuation Budget. The budget includes an additional \$539.6 million for Medicaid in FY 2013-14 to cover the structural shortfall from FY 2012-13, enrollment and utilization growth, the expected impact of the Affordable Care Act, and a variety of other changes. After adjusting for \$147.2 million in legislative reductions and federal receipts, the program increase is a net \$392 million.

### *Other Highlights*

- **Justice and Public Safety Facilities** – Five prisons and three juvenile facilities are slated to close in FY 2013-14, eliminating 774.7 fulltime equivalent positions and saving \$27.5 million.
- **Eugenics Sterilization Compensation Fund** – The legislature established a new fund to compensate victims of NC's former sterilization program. The \$10 million fund will be used to compensate an estimated 1,500 to 2,000 individuals across the State.
- **Transportation Reform** – S.L. 2013-183, Strategic Transportation Investments (H.B. 817), rewrites State law governing the Highway Trust Fund by requiring the Department of Transportation (DOT) to prioritize capital and construction projects across transportation modes. The Strategic Prioritization Funding Plan for Transportation Investments, among other things, eliminates projects from State law, provides incentives for local funding participation, phases out the Highway Fund



secondary road construction program, requires Statewide prioritization for unpaved secondary road paving; and authorizes up to five additional toll road projects, of which three may be constructed and operated through partnership agreements with private entities.

- **Salaries and Benefits** – Additional appropriations to the State Health Plan (SHP) and to the State's retirement systems were modest in comparison to previous years. Legislators appropriated \$33.5 million for FY 2013-14 to help the SHP Board address anticipated health care cost increases. The State's contribution to the retirement system for 2013-14 is increased by \$36 million.

State employee salaries remained unchanged for FY 2013-14. However, permanent full-time employees of the State, community colleges and local public schools were awarded five additional days of special annual leave that must be used by June 30, 2014.

**Budget and Fiscal Policy Highlights**

*Government Reorganizations*

The legislature enacted major changes for certain programs:

- Natural Heritage Trust Fund and Clean Water Management Trust Fund – Both funds were merged and a new nine-member board of trustees was created, eliminating the previous two boards totaling 33. The consolidated program is under the direct supervision of the Secretary of the Department of Environment and Natural Resources (DENR), is funded from the General Fund, and continues to grant funds for the purchase of certain lands, to protect surface water and other duties.
- Division of Water Infrastructure Authority – Disparate State programs, aimed at addressing various water needs, were consolidated into a new division. In

creating the new division, the legislature established an entity to administer state and federal grants and loans intended to address critical public water and wastewater needs.

- Rural Economic Development Division – A single division is established in the Department of Commerce to provide infrastructure grants to local governments. Combining programs formerly administered by the non-profit Rural Economic Development Center and the Department of Commerce, the legislature directed the new division to give priority to the most economically distressed counties and to develop a set of programs to address water and sewer, natural gas, electrical utility distribution lines, broadband, and the like.

*Strengthening the State General Fund*

In 2011 the legislature began its effort to strengthen the General Fund by eliminating certain earmarks of general purpose revenue, specifically those earmarks on the tobacco Master Settlement Agreement (MSA) funds and the dedicated sales tax earmarks for the Wildlife Resources Commission. More progress was made during the 2013 Session when the legislature repealed additional earmarks on certain taxes and MSA funds including:

- Real estate conveyance, scrap tire disposal, and white goods management taxes, totaling \$42.1 million.
- All remaining earmarkings of tobacco Master Settlement Agreement (MSA) funds for debt service and the University Cancer Research Fund,<sup>7</sup> totaling \$43.5 million.
- All funds previously directed to the Golden L.E.A.F., Inc., totaling \$68.7 million.

The total impact of these 2013 policy changes is an additional \$154.3 million in recurring funds deposited into the State's General Fund for FY 2013-14.

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<sup>7</sup> G.S. 116-29.1.



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