



North Carolina's FY 2011-12 Budget Gap

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Fiscal Brief

State's preliminary estimated budget gap is \$3.7 billion.

Executive Summary

Much has been said about the size of the State's FY 2011-12 budget gap. A budget gap is simply the difference between projected revenues under current state law and the continuation budget or estimated spending required to maintain the current level of services.

Based on preliminary revenue and spending estimates, the State is expected to face a \$3.7 billion budget gap in FY 2011-12. This fiscal brief is intended to provide legislators with an estimate of the gap and to describe how the estimate was derived.

The estimated budget gap for FY 2011-12

When the FY 2010-11 budget was enacted on June 30, 2010, the nonrecurring revenue and reductions created a minimum budget gap of \$3.2 billion for FY 2011-12 assuming no adjustments for changes in revenue, education enrollment, healthcare cost, or other inflationary increases. The source of the \$3.2 billion gap is:

- \$1.6 billion in expiring federal American Recovery and Reinvestment Act of 2009 (ARRA) funds
- \$1.3 billion in taxes that expire June 30, 2011
- \$300 million in one-time reductions and transfer of fund balances

Fiscal Research is now projecting a preliminary budget gap of **\$3.7 billion** for next fiscal year. While this is not a formal estimate, the

preliminary estimate is a good barometer of the level of budget adjustments needed to enact a balanced budget for FY 2011-12.

Estimated Revenue

The revenue used in developing the preliminary FY 2011-12 budget gap is **\$18.2 billion**. This estimate includes \$17.5 billion in baseline revenue (revenue in the current budget, adjusted for non-recurring items such as expiring sales taxes and various one-time sources of funds) and assumes \$700 million in potential revenue. State revenue typically grows (controlling for tax law changes) four to six percent annually. Thus, this preliminary gap estimate uses the mid-point of revenue growth ranging from \$500 million to \$900 million. Fiscal Research and Office of State Budget and Management will issue a consensus revenue forecast either in conjunction or shortly before, the issuance of the Governor's Recommended Budget in early 2011.

Estimated Spending

The estimated spending used in developing the preliminary FY 2011-12 budget gap is **\$21.9 billion**. This includes the \$19.0 billion operating budget for FY 2010-11, adjusted for non-recurring revenue and reductions; legally mandated items; and other spending pressures.

The nonrecurring adjustments include \$1.6 billion in federal ARRA that will not be available in FY 2011-12 and \$.4 billion in other nonrecurring items. For purposes of this preliminary estimate, no inflationary increases for general operating expenses are included.

The State has a constitutional mandate to fund a system of public schools and to make provisions for the prompt payment of general obligation debt. As a participant in the federal-state partnership, NC also has a legal obligation to provide Medicaid services to those for whom there is a legal entitlement. Assuming existing funding formulas and service levels remain, estimates for the legally mandated items are:

- Public schools¹ – the preliminary estimate for K-12 enrollment growth cost is \$75 million.
- Debt service payments² – estimated to increase marginally.
- Medicaid³ – projected to increase by at least \$190 million.

Preliminary estimates for other spending pressures are as follows:

- Higher education⁴ – preliminary estimates for enrollment growth are up to \$89 million.
- State Health Plan – additional \$181.6 million to maintain current benefit levels and anticipated growth.
- State Retirement System – up to \$304.9 million (General Fund) and \$13.6 million (Highway Fund) to increase the employer contribution to the national standard⁵.
- Other Items - Savings Reserve Account (Rainy Day Fund), Capital and Repairs & Renovations Reserve Account, and Economic Development.

In conclusion, the preliminary revenue and spending estimates presented here are based on historical trends/priorities and are not predictions

¹ NC Constitution, Article IX, Section 2.

² NC Constitution, Article III, Section 5.

³ Social Security Act, Section 1902

⁴ NC Constitution, Article IX, Section 8.

⁵ Governmental Accounting Standards Board, Statement No. 27

of what the Legislature might do. Instead, the preliminary **\$3.7 billion** estimated budget gap for FY 2011-12 is a starting point for legislators as they begin work on next year's budget.

The chart that follows recaps Fiscal Research's preliminary budget gap estimate for FY 2011-12.

<u>Preliminary FY 2011-12 Budget Gap</u>	
(\$billion)	
	<u>FY 2011-12</u>
FY 2010-11 Revenue Availability	19.0
Expiration of State Taxes on June 30, 2011	
- 1% Sales Tax	-1.1
- Corporate & Individual Income Tax Surtax	-0.2
One-time funds used to balance FY 2010-11 budget	<u>-0.2</u>
Subtotal Availability	17.5
Mid-range Potential Revenue Growth (\$500 - \$900 million)	<u>0.7</u>
Preliminary Revenue Estimate	\$18.2
2010-11 Continuation Budget	19.0
State funds to replace expiring Federal ARRA funds	1.6
One-time Reductions & Spending	<u>0.4</u>
Subtotal Continuation Budget	21.0
<u>Potential Spending Items: 2011 Session</u>	
State Retirement System Contribution	0.3
State Health Plan	0.2
Education Enrollment Growth (K-12, UNC & Community Colleges)	0.2
Medicaid (preliminary)	<u>0.2</u>
Subtotal Potential Spending	0.9
Preliminary Spending Estimate	\$21.9
Preliminary "Budget Gap"	-\$3.7



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