STATE OF NORTH CAROLINA
OFFICE OF STATE BUDGET AND MANAGEMENT

ROY COOPER
GOVERNOR

CHARLES PERUSSE
STATE BUDGET DIRECTOR

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To: Kristi Jones
Chief of Staff

From: Charles Perusse

Subj: Appropriations Act of 2017 (S.B. 257) -- Financial Management and Policy Concerns

There are two main areas of concern to the Office of State Budget and Management (OSBM) related to the recently ratified Appropriations Act of 2017 (S.B. 257): budget structural integrity and infringement on the authority of the Governor to properly manage the budget. In the area of structural integrity, this budget uses nonrecurring revenues to pay for recurring expenses and makes inadequate allowances for growth in future years. Additionally, the Act is littered with special provisions which infringe upon the Governor's ability to faithfully execute the laws, including this Act, as required by the Constitution.

Structural Integrity Concerns
In the second year of the budget, over $90 million in recurring, ongoing expenses are funded using nonrecurring, one-time revenues. This problem is compounded in later years, when tax reductions, combined with recurring expenditures, will not adequately meet growth in population and inflation. We estimate that this budget provides for less than 1% in expenditure growth (approximately $164 million) in FY 2019-20. North Carolina's population is projected to grow 1% in FY 2019-20 and inflation will most likely be in the 2-3% range. Thus, the tax structure as enacted in this budget will, in just two years, leave North Carolina unable to meet the same level of service as is delivered to citizens today. Conservatively, we anticipate this budget would blow a $600 million hole just to meet current service levels. As ratified in this Act, the tax reductions combined with recurring spending are structurally unsustainable.

FY 2019-20 Estimated	
Recurring Base Revenues (OSBM)	$23,926,700,000
Base Budget + Required Transfers	$23,762,746,157
Available for Growth	$163,953,843
% Available for Growth	0.69%
Shortfall to Meet Current Services	At least ($600M)

Article III, Section 5 of the North Carolina Constitution requires that the Governor prepare a budget where total expenditures do not exceed total receipts during a fiscal period. The conference budget severely strains the Governor's ability to uphold these constitutional duties. It creates a self-inflicted fiscal crisis that needlessly hinders the administration's ability to provide adequate service levels to the citizens of the state. Currently, the state's economic condition is stable and we are not facing an economic downturn or cash management challenge. If presented with an economic challenge in the next 2-3 years, the presented budget would needlessly exacerbate the state's economic recovery and risks higher job losses and more severe economic impacts when an eventual business cycle downturn arises.

Restricts Budgetary Authority of the Governor
The Governor is compelled by the Constitution (Article III, Section 5) to faithfully execute the laws and "effect the necessary economies in State expenditures." Several provisions in this Act create challenges for the Governor to perform these duties, as enumerated below.

- The Committee Report provides $9.7 million in nonrecurring funding for **statutory pay plan increases**; however, the estimated cost of the step increases is in excess of $20 million recurring. The pay increases are statutorily required, recurring expenses and mandated by the Act. Section 35.17 requires that agencies first use other appropriated salary and benefit funds to cover the increases, and only if those funds are insufficient can the pay plan reserve funds be allocated. This structure, in practice, will require agencies to pay for more expenses with the same amount of revenue. If the pay plan reserve is allocated as prescribed, it will create a structural budget problem as the funds are only available for one year and are not recurring.

- Section 6.6(a), revises the State Budget Act to require that the Governor include "statutory appropriations" in forthcoming biennial base budget packages. This requirement forces the Governor to increase the budget for programs that have demonstrated performance or accountability concerns. This also severely limits the transparency and public input into the growth of government services.

- The Committee Report **eliminates the recurring funding for the Contingency and Emergency Fund** ($5 million annually); Section 6.1 transfers $7 million of the fund's $8.8 million cash balance to general availability. These actions restrict the ability to adequately respond to natural disasters or emergencies, fund court or Industrial Commission orders, crime rewards, death benefits, and wrongful imprisonment payments.

- The Act **transfers two entities** from cabinet agencies to non-cabinet agencies. Section 13.14 transfers the Apprenticeship Program from Commerce to the Community College System Office and section 15.19A transfers the Industrial Commission from Commerce to the Department of Insurance.
    - G.S. 143A-6 provides for the transfer of all or part of an agency, but only to principal departments established in G.S. 143A, of which the System Office is not.

- Section 16B.10.(e) **prohibits the transfer of positions and any changes to the total authorized budget** for the State Capitol Police as it existed as of March 1, 2017.

- Section 17.5(b) **prohibits reductions or transfers** out of fund codes 1400 and 1500 within the budget for the Department of Justice.

- Section 26.7 **prohibits OSBM from transferring funds** (including any newly realized receipts) into budget code 13000 (the Governor's Office).

- Section 6.7 **limits the use of state funds** to pay for litigation services provided by private counsel. On a practical level, in FY 2016-17, the certified budget for legal services (which includes other items besides private counsel expenses) across state government is $102.8 million and year-to-date expenditures have already exceeded that by nearly $4 million. The base budget for FY 2017-18 as authorized in this Act provides for only $99.3 million in legal services.