

AGENDA

— 2012 —

*A Candidate's Guide to Key Issues
in North Carolina Public Policy*

John Locke
FOUNDATION


the best direction for north carolina



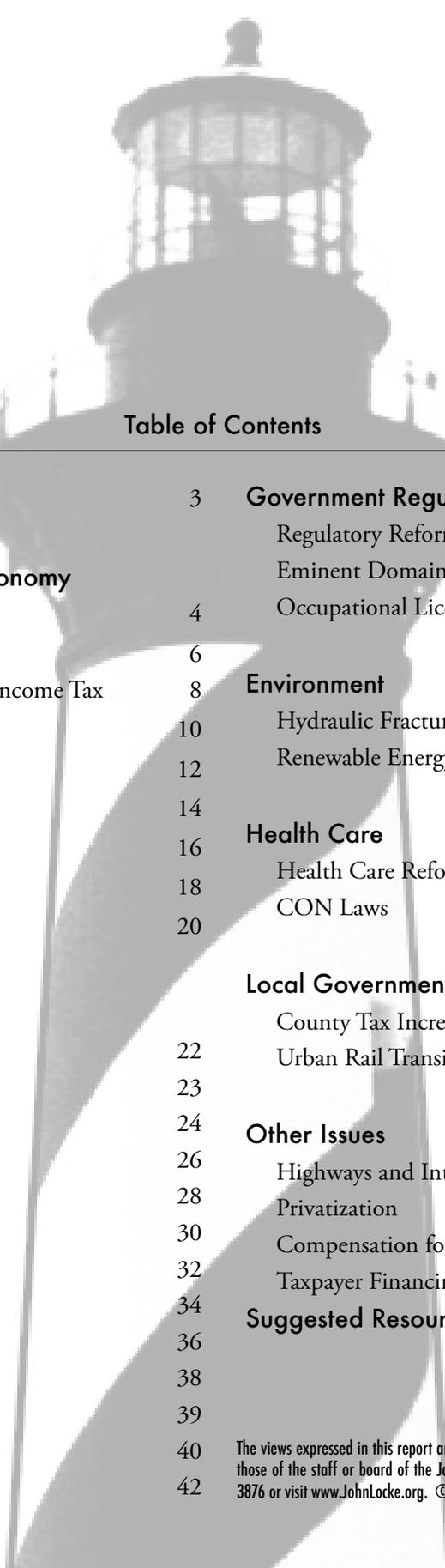


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About the John Locke Foundation

The John Locke Foundation is a nonprofit, nonpartisan policy institute based in Raleigh. Its mission is to develop and promote solutions to the state's most critical challenges. The Locke Foundation seeks to transform state and local government through the principles of competition, innovation, personal freedom, and personal responsibility in order to strike a better balance between the public sector and private institutions of family, faith, community, and enterprise.

To pursue these goals, the Locke Foundation operates a number of programs and services to provide information and observations to legislators, policymakers, business executives, citizen activists, civic and community leaders, and the news media. These services and programs include the foundation's monthly newspaper, *Carolina Journal*; its daily news service, *CarolinaJournal.com*; its weekly e-newsletter, *Carolina Journal Weekly Report*; its quarterly newsletter, *The Locke Letter*; and regular events, conferences, and research reports on important topics facing state and local governments.

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Introduction

Every two years since 1996, coinciding with North Carolina's races for governor and lieutenant governor, council of state, and the general assembly, the John Locke Foundation has published a revised edition of *Agenda*, our public policy guide for candidates and voters. Typically as we enter the campaign season, candidates for public office in North Carolina are faced with a daunting task: to develop informed positions on dozens of public policy issues. This year is no different. In the pages of *Agenda 2012* we provide a concise and easily digestible guide covering dozens of specific issues, from taxes and spending to energy policy and education.

In 1946 Henry Hazlitt wrote *Economics in One Lesson*, his now classic and timeless introduction to economics and economic policy. In writing the introduction to the 50th Anniversary Edition in 1996 (three years after Hazlitt's death), Steve Forbes noted, "every tenet of the new economics that Hazlitt dispels continues today to rear its head in one form or another." It is quite clear that this is true for North Carolina. Many of the problems and solutions noted in our first edition of *Agenda* back in 1996 persist in 2012. Concerns about misplaced spending priorities, high and increasing overall levels of spending, and a regulatory and tax burden that punishes productive activities are problems that plague North Carolina's citizens and economy. Education finance and performance, Medicaid, and the tax code all continue to cry out for reform. In some areas, energy policy for example, problems have been made worse, while in others, like educational choice and the expansion of charter schools, there has been improvement.

With this said, we have made some changes in this year's *Agenda* guide. The most obvious has to do with the specific topics covered. This year we have 35 separate entries covering about 66 pages. We decided that it would be more useful to cover some issues with greater specificity than in 2010. For example, in the past we have had a single entry titled "Tax Reform." In *Agenda 2012* under the general heading of "Tax Reform" we have three separate entries "The Income Tax," "The Sales Tax," and "The Corporate Income Tax." In 2010 we had one section titled "Energy Policy." In 2012 this is divided into two separate topic areas, "Fracking" and "Renewable Energy." By being more specific in the topic areas we cover, we believe that this document will be of greater value, both in content and in ease of usage.

Regardless of the number of specific topic areas covered, the unifying principles of *Agenda 2012* are the same as they have always been. All of our analysis and policy proposals seek to advance individual liberty, personal responsibility, and a free market economy. Whether we are discussing school choice, economic growth, or health care reform, these are the concepts that have animated the John Locke Foundation's analysis since its founding in 1989. We firmly believe that policies that advance these goals are also policies that will create employment opportunities, lower healthcare costs and improve access, reduce the costs of energy, and better educate our children. Both in the United States and internationally, it has been proven time and time again that liberty and prosperity go hand in hand.

Agenda 2012 is a joint effort of the research staff at the John Locke Foundation. We would like to thank research interns Baxter Rollins, Milton Mai, Shane Williams, and Daniel Simpson for all their help. We would also like to thank Nicole Fisher for her entry on "Obamacare."

Each of these entries is meant to be an introduction. For readers wanting more detailed analyses of the topics here, we offer several additional resources in a reference section at the end of this guide.

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State Tax Reform - Income Tax

North Carolina's state income tax penalizes people's income generating activities by reducing the rewards to work, saving, investment, and entrepreneurship. In a market setting, these are all activities that lead to the production of goods and services, spur economic growth, and generate employment. The income tax discourages these activities relative to non-income generating activities — leisure and consumption. The negative effects of the income tax are due to its high and steeply progressive rate structure and its poorly defined base. Its rate structure drives a "wedge" between the rewards to work effort and the rewards to non-work activities; the higher the tax rate, the greater the wedge, i.e. the greater the penalty against additional work effort. The design of the tax base results in the returns to saving and investment being double taxed. The combination of the two reduces the state's economic growth potential and depresses job creation. It is possible, though, to restructure the state's tax code such that some of these biases are eliminated and others are at least ameliorated.

Key Facts

- North Carolina's top income tax rate is the highest in the South and the 11th highest in the nation.
- The lowest rate in North Carolina is higher than or equal to the highest rate in all but two of the other Southern states.
- When a tax is placed on income that is earned through work effort, that tax reduces the satisfaction that the individual would otherwise gain from spending it on goods and services. It also reduces all returns that could be gained from investments.
- When North Carolina taxes interest, dividends, and capital gains, it is "double taxing" saving and investment relative to consumption.

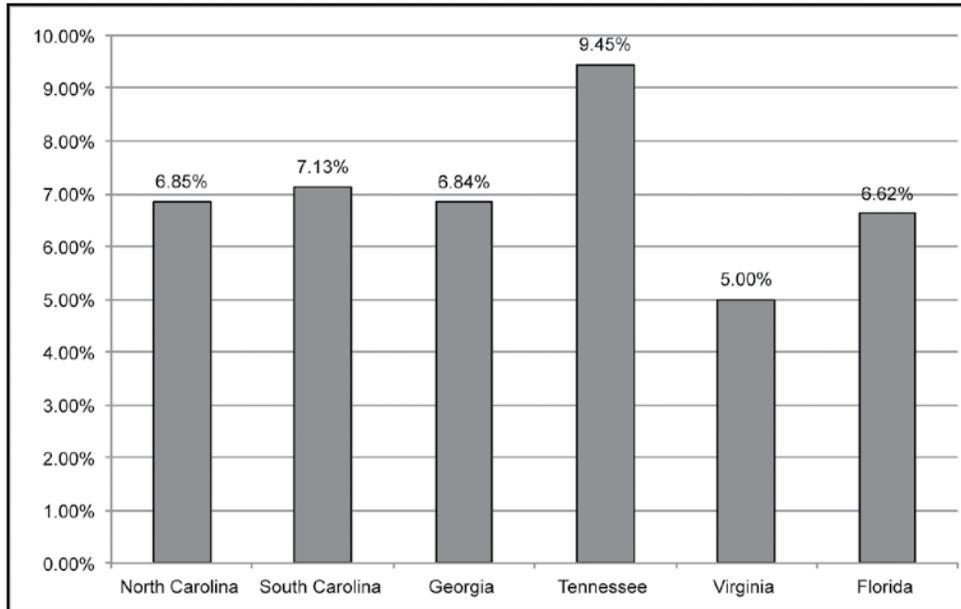
- While North Carolina's top marginal rate reduces the rewards to current consumption by 7.75 percent, it reduces investment returns by about 15 percent.
- The double taxation of investment returns not only reduces capital formation and economic growth in North Carolina, but also reduces employment opportunities and wage rates.
- Adding to this anti-productivity bias is North Carolina's steeply progressive rate structure, which penalizes increased productivity by taking a greater percentage of people's incomes as they earn more.

Recommendations

1. North Carolina should adopt a sweeping reform of its income tax.
2. The current rate structure should be collapsed into a low, flat tax rate on net income in order to diminish the bias against work effort and self-improvement geared toward income advancement — referred to as human capital.
3. To eliminate the double taxation of saving and investment returns, the tax base should be adjusted to allow people to save and invest their income pre-tax. It should tax both the principal and the interest when it is removed from saving and spent. This would be similar to the way "individual retirement accounts" (IRAs) are treated under the tax code except there would be no age or other restrictions on withdrawal. The effect would be to convert North Carolina's current income tax into what is called a consumed-income tax.

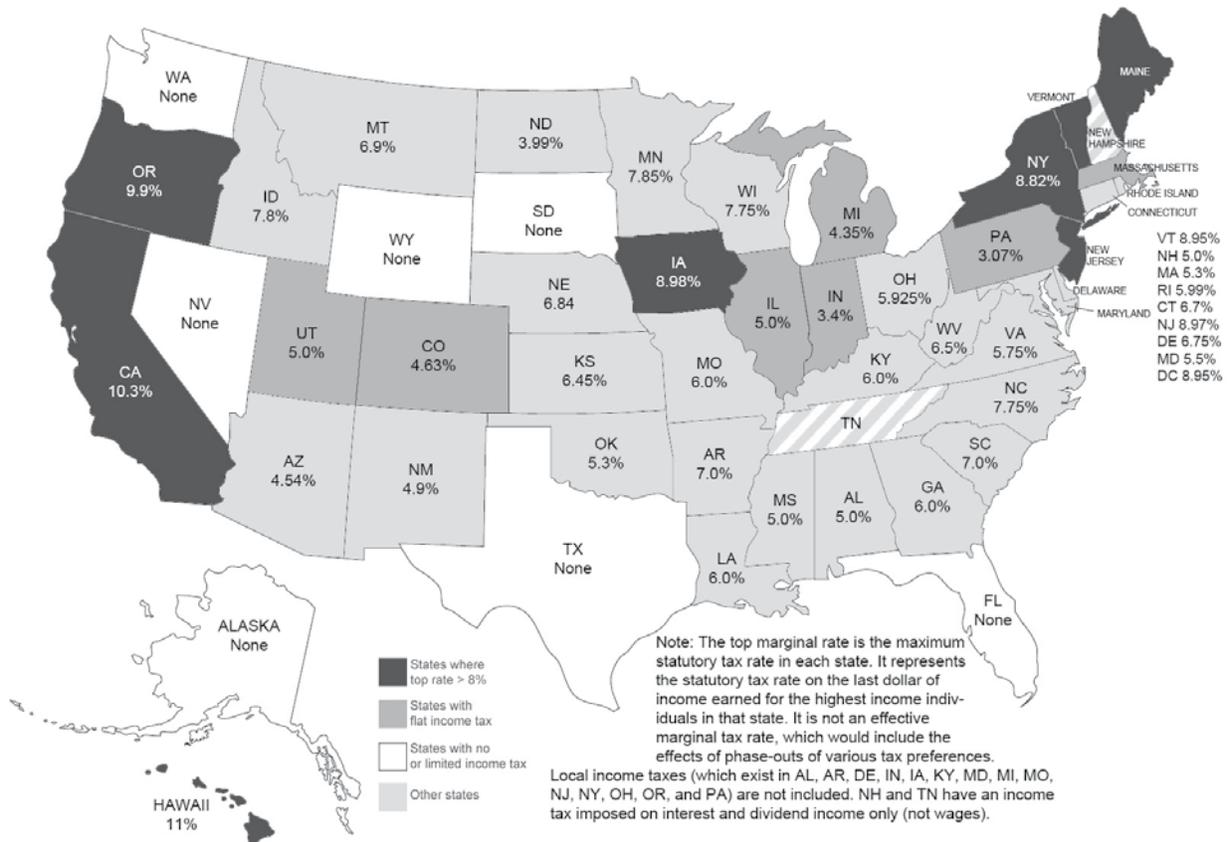
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Top Marginal Income Tax Rates



Source: Tax Foundation

Top State Income Tax Rates: Highest Statutory Marginal Income Rate by State, Tax Year 2012



Source: Tax Foundation



State Tax Reform - Sales Tax

North Carolina's tax on retail sales needs reforming. At the present time, there exists a hodgepodge of taxes on consumption and sales that show very little consistency or forethought. There are economic principles of taxation that should guide the formation of our sales tax system and that, if followed, would make the system more conducive to economic growth and prosperity. Unfortunately, they tend to be ignored. Some purchases that are part of the retail-sales tax base should not be, such as transactions between businesses, while other kinds of purchases that should be included are not, such as services sold to retail consumers. Also, special sales or excise taxes of different kinds are used apart from the main body of the sales tax to punish and reward consumption choices. In addition to being bad economics, this is inconsistent with the role of taxation in a society that respects individual liberty.

Key Facts

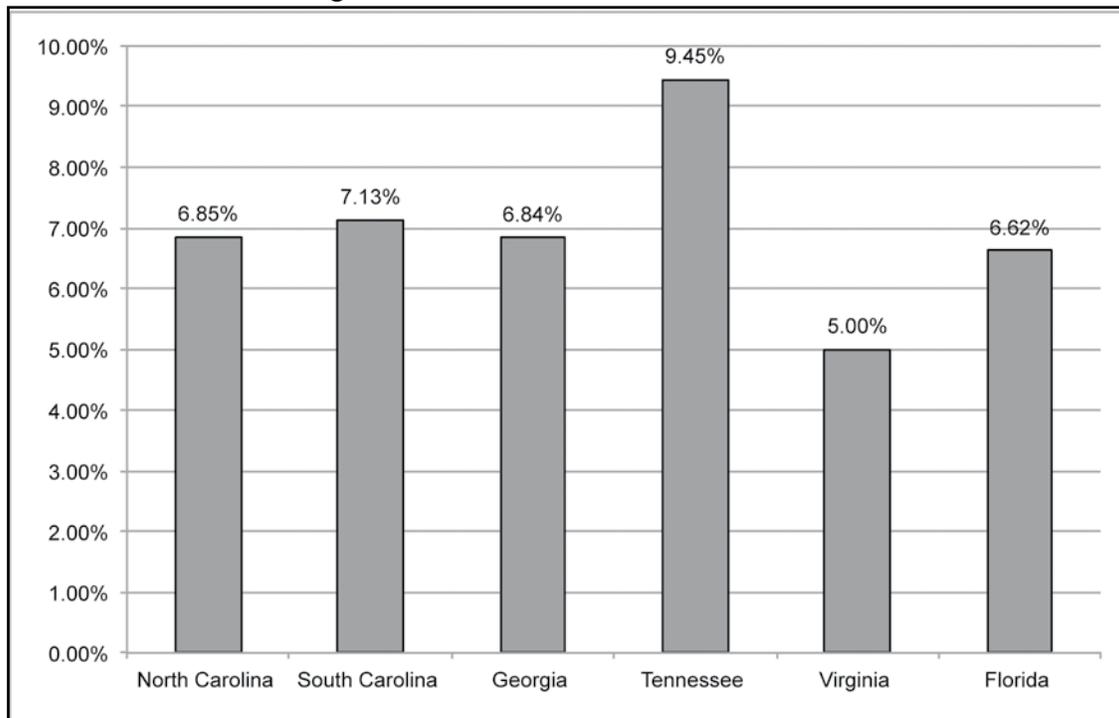
- In reforming North Carolina's sales tax, the focus should be on whether the tax base is what economists call neutral and whether the tax conforms with the principles of justice rooted in a respect for liberty and freedom of choice.
 - Over the past several years, the focus of most discussions about reforming North Carolina's sales tax have been almost exclusively on whether to expand the base to include services.
 - There has been almost no discussion about which services are appropriate to tax and which are not. In fact, basic principles of taxation have rarely entered into the conversation.
 - Sound principles of taxation argue that both goods and services be taxed but taxed only once and in a manner obvious to the taxpayer.
 - North Carolina's combined average state and local rate is 6.85 percent. This rate is slightly above the middle of the pack for the nation (23rd highest) and in the middle among our neighboring states. It should be noted that Tennessee and Florida have no income tax and that North Carolina has the highest top income tax rate in the South. In its latest analysis, the Tax Foundation ranked North Carolina's sales tax as 4th worst in the country because of the many biases and distortions contained within it.
- Some goods and services in NC are taxed at extraordinary rates. While the sales tax rate in North Carolina (not including local sales taxes) is 4.75%, alcoholic beverages, tobacco products, and rental cars are all taxed at higher rates. In a free society, the tax system should not be used to punish activities that are disfavored by politicians or to reward activities that politicians consider virtuous. It also shouldn't be used to extract disproportional amounts from some consumers just because they lack political power or reside elsewhere, i.e., rental car customers.

Recommendations

1. **The tax base should be broadened to include services sold to final consumers but only to final consumers.** This would include everything from haircuts and lawn services to accountants and lawyers.
2. **Sales taxes on all business-to-business sales should therefore be abolished.** In other words, while expanding the tax base to services, many goods currently being taxed should be removed from the base. To tax business-to-business sales and the sales of final products represents double taxation because the former tax will be incorporated in the price of the final product, which is also taxed.
3. **These same principles of tax reform should also be applied to products that are singled out for special penalties such as those mentioned above.** These goods and services should be taxed at no greater rate than other products subject to the sales tax. This disproportionate tax treatment is inconsistent with freedom and represents an unwarranted interference with private decision-making.
4. **In the process of broadening the base to include consumer purchased services, the rate should be commensurately lowered so as to keep the amount of revenue brought in by the tax constant, i.e., the reform should be revenue neutral.**

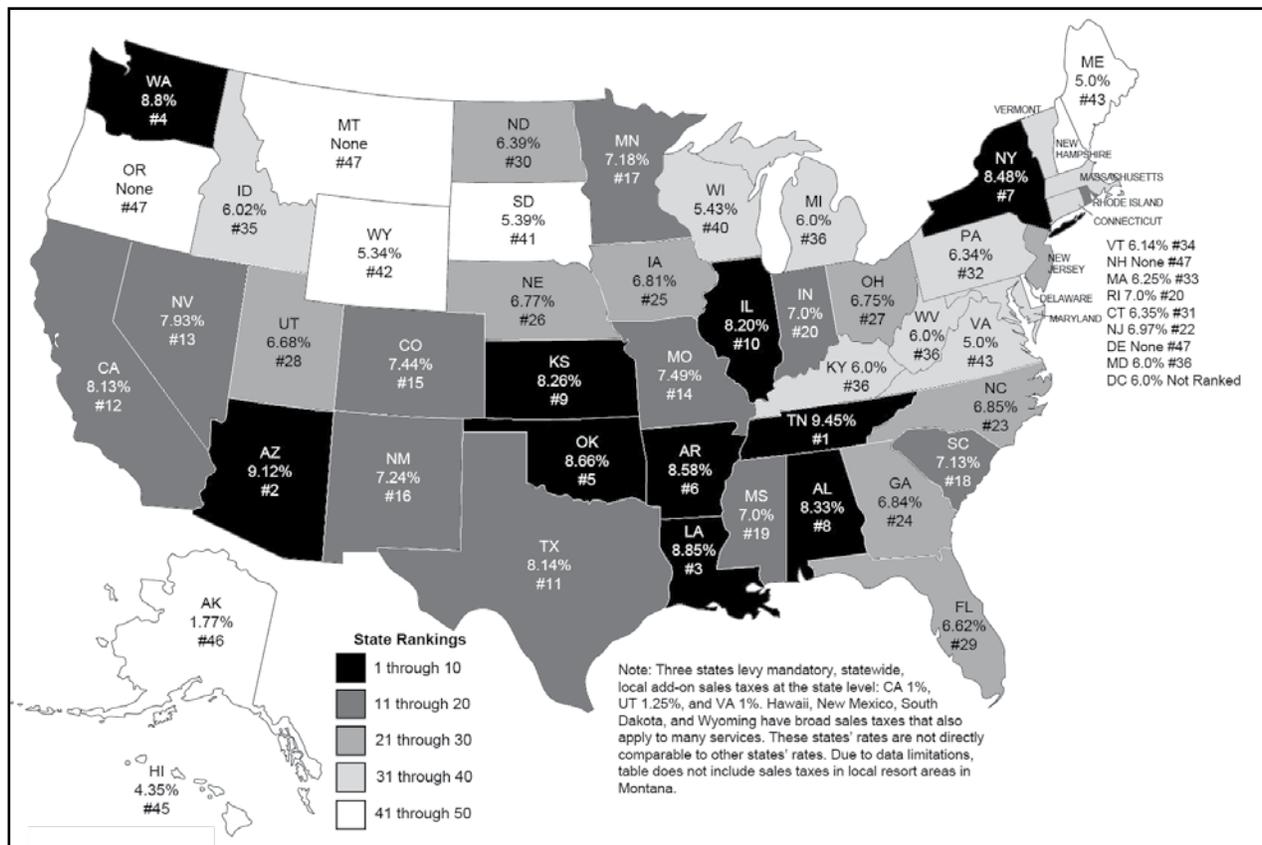
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Average State and Local Sales Tax Rates



Source: Tax Foundation

Sales Tax: Combined State and Average Local Rates, Tax Year 2012



Source: Tax Foundation



State Tax Reform - Corporate Income Tax

North Carolina's corporate income tax violates basic principles of sound economic policy and open government. It not only imposes a second and even a third layer of taxation on many people's incomes, but it is hidden, dishonest, and inconsistent with informed decision making in a free and democratic society. Ultimately, the tax serves as a tool of business subsidization and central planning. Most of the major economic incentive schemes launched by North Carolina state government have centered around granting exemptions from the corporate income tax in the form of tax credits. Politicians have come to see the tax as a way to gain power over market outcomes through the process of granting exemptions.

Key Facts

- North Carolina's 6.9 percent corporate income tax rate is higher than that of all our neighboring states and the second-highest corporate tax rate in the South.
- North Carolina has had a corporate income tax since 1921. Between 1921 and 1991 the rate increased from 3 percent to 7.75 percent. It was then lowered every year between 1997 and 2000 when it fell to its current rate of 6.9 percent.
- The corporate income tax is based on the myth that corporations actually pay taxes. In fact, corporations not only do not pay taxes; they cannot pay taxes.
- All taxes must ultimately come from some real person's pocket. These real people are shareholders who experience lower dividends and capital gains, customers who pay higher prices, and workers whose wages are lower.
- In order to make intelligent voting decisions, citizens need to be aware of how much their government is

costing them. The corporate income tax is deceptive because it is invisible to those who are paying it and it is dishonest because it gives the false impression that corporations are paying the tax.

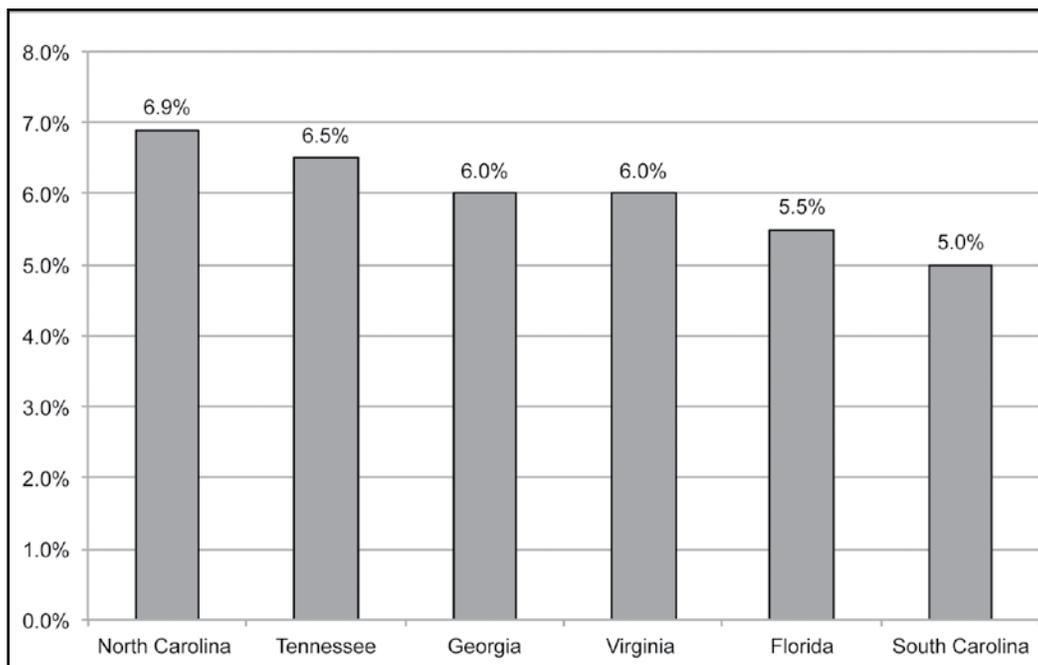
- The corporate income tax imposes a second and even a third layer of taxation on people's incomes. For workers and customers, it represents a second layer and for shareholders, whose investment income is already double taxed under the state's income tax, it is a third layer of tax.
- Partial or even full exemptions from the corporate income tax are granted for everything from building recycling facilities and installing solar power plants to using the state's ports (see a more complete list on the next page).
- Politicians have come to see the corporate income tax as a way to gain power over market outcomes through the process of granting special exemptions based on industry or location. These exemptions are a form of crony capitalism.
- The corporate income tax is best viewed as a type of "negative slush fund." Instead of using a stash of already collected tax money to directly subsidize favored businesses and political allies, politicians allow favored business interests to keep more of their own money than the tax would otherwise indicate.

Recommendation

Repeal the corporate income tax.

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Comparison of Corporate Income Tax Rates



Source: Tax Foundation

North Carolina Corporate Income Tax Credits

Business and Energy Tax Credits (Article 3B)

- Investing in Business Property
- Renewable Energy Property
- Constructing Renewable Fuel Facilities
- Small Business Employee Health Insurance
- Biodiesel Producers
- Work Opportunity
- Donations to Nonprofit Organization or Unit of State or Local Government for Acquisition of Renewable Energy Property

Tax Incentives for Recycling Facilities (Article 3C)

Historic Rehabilitation Tax Credits (Article 3D)

Low Income House Tax Credits (Article 3E)

Research and Development Tax Credit (Article 3F)

Tax Incentives for Major Computer Manufacturing Facilities (Article 3G)

Tax Credits for Growing Businesses (Article 3H)

Mill Rehabilitation Tax Credit (Article 3H)

Tax Incentive for Railroad Intermodal Facility (Article 3K)

General Tax Credits

- Dwelling Units for Handicapped Persons
- Construction of Cogenerating Power Plant
- Real Property Donated for Conservation Purposes
- Conservation Tillage Equipment
- Gleaned Crop
- Certain Telephone Subscriber Line Charges
- Supervisory Fees Paid by Savings and Loan Associations
- Use of North Carolina Ports
- Poultry Compositing Facility
- Manufacturing Cigarettes for Exportation
- Manufacturing Cigarettes for Exportation While Increasing Employment and Utilizing State Ports

Information obtained from the North Carolina Department of Revenue at <http://www.dornc.com/taxes/corporate>

State Spending Restraint

A majority of North Carolinians support a cap on total state spending at inflation and population growth. This expresses a healthy understanding that more government spending, whether borrowed or from immediate taxation, diverts resources away from personal consumption and the private sector. It also acknowledges that government spending ought to become more, rather than less, cost-effective over time, as occurs in other sectors of the economy.

Over the last four decades, however, voters will have failed to bring about that outcome. Despite a rapid population influx since the turn of the century, for example—an 18.5 percent increase between 2000 and 2010—state spending has grown at an even faster rate. That trend of growth beyond inflation and population growth included the recession years of 2007, 2008, and 2009, despite declining in-state tax revenues.

Key Facts

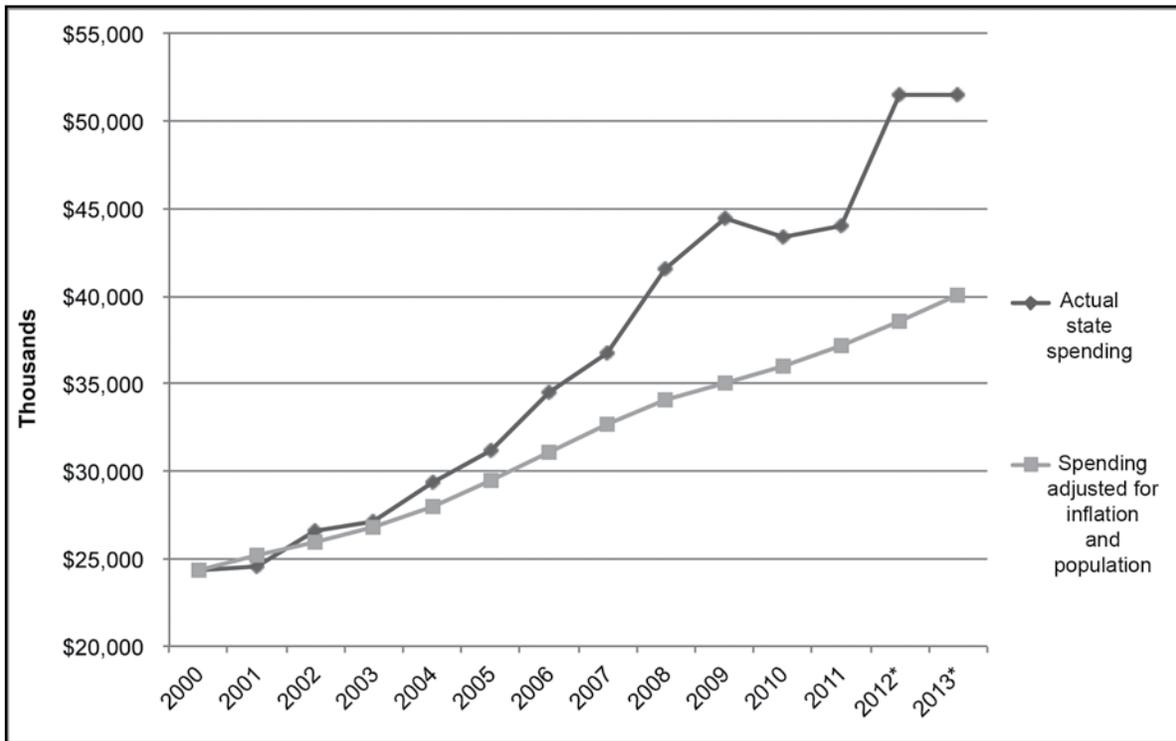
- When all sources of revenue are considered, including federal funds, North Carolina's inflation-adjusted state spending per person is at a record high in 2012 and more than triple what it was in 1970.
 - Had total state spending tracked population and inflation growth since 2000, as denoted in the Figure opposite, it would be \$38.6 billion in 2012. That's 25 percent less than the current level of \$51.5 billion.
 - Since the year 2000, total state spending has consistently grown faster than resident incomes. In 2012, it is set to be 14.4 percent of personal income, up from 10.7 in 2000 and 12.7 just last year.
 - The share of the total state budget represented by the General Fund has fallen dramatically. It is 38 percent of total state spending in 2012, down from 53 percent of state spending in 1970 and 59 percent in 2000.
- General Fund spending per person has declined by 16 percent since 2009 after adjusting for inflation. However, per-capita spending *outside* of the General Fund has increased by 26 percent, more than compensating for the General Fund's decline.

Recommendations

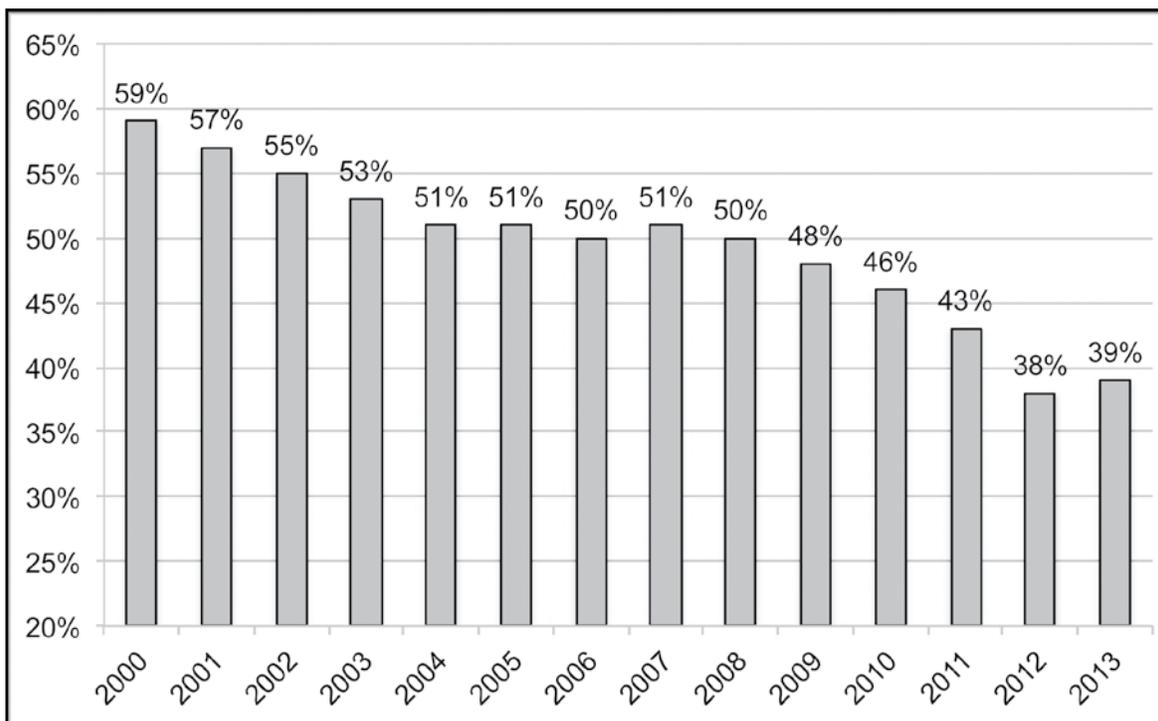
1. **Add a Taxpayer Bill of Rights (TABOR) amendment to the state constitution** that limits annual state spending growth to no more than the projected growth of inflation and population. The amendment should allow spending growth to exceed the cap if approved by public referendum. Such a spending cap would halt four decades of government growth and better align the long-term interests of taxpayers to the short-run interests of politicians.
2. The TABOR should establish other **constitutional constraints** on fiscal policy, such as a requirement that any state tax hikes receive supermajority approval in the legislature. The amendment should also mandate that any revenues collected above the annual spending cap be either deposited in a rainy day fund or returned to taxpayers. These measures should ideally be applied to total state spending, not merely the General Fund.
3. Mindful of the unsustainable growth in state spending over the past four decades and the current weakness of the state's economy, legislators should seek areas for budget savings and **apply "priority-based budgeting."** Promoted by the American Legislative Exchange Council in the State Budget Reform Toolkit, this is a plan to change status-quo spending trends and direct spending towards core functions of government.

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How a Spending Cap Would Have Affected Total State Spending



General Fund Spending as a Percentage of Total



State Tax Burden

Taxation is the taking of property and earnings in exchange for governmentally provided goods and services or for redistribution. Legislators may also structure taxes as a policy tool to manipulate constituent actions for or against particular goods or services. North Carolina state officials, for example, offer tax breaks for companies they deem particularly desirable while placing sin taxes on an array of items such as alcohol, candy, and tobacco.

The mandatory element of taxation means that to avoid paying, aside from breaking the law, one must either transfer assets or residency to another jurisdiction or choose not to generate the wealth in the first place. These two legal responses lead to an important tax policy trade-off known as the Laffer Curve (pictured).

Art Laffer popularized the economic reality that at some point higher tax rates lower the total revenue generated. That is because higher rates, particularly high marginal rates on high earners, discourage participation in the labor force and net inwards migration. They also dissuade investment in the taxing jurisdiction relative to consumption or investment elsewhere.

In addition to a tax burden's negative incentives, when legislators apply the burden in a discriminatory manner, they distort economic decisions and allocate resources away from where they would bring the greatest prosperity.

So jurisdictions such as the state of North Carolina are in a competitive taxation market. To serve constituents best, cause as little damage on economic opportunity as possible, and generate the revenue necessary for legitimate government activities, legislators would be best to keep rates low and spread in a simple, even manner.

Key Facts

- The Tax Foundation ranks North Carolina's business tax climate as 44th in the nation and by far the worst in the South. The states with the lowest tax burdens do without at least one of the five taxes measured — corporate, personal income, retail sales, unemployment insurance, and property. North Carolina imposes all of these taxes and many more. The same study gives poor rankings to North Carolina's personal income tax (43rd), corporate income tax (29th), and retail sales taxes (47th).

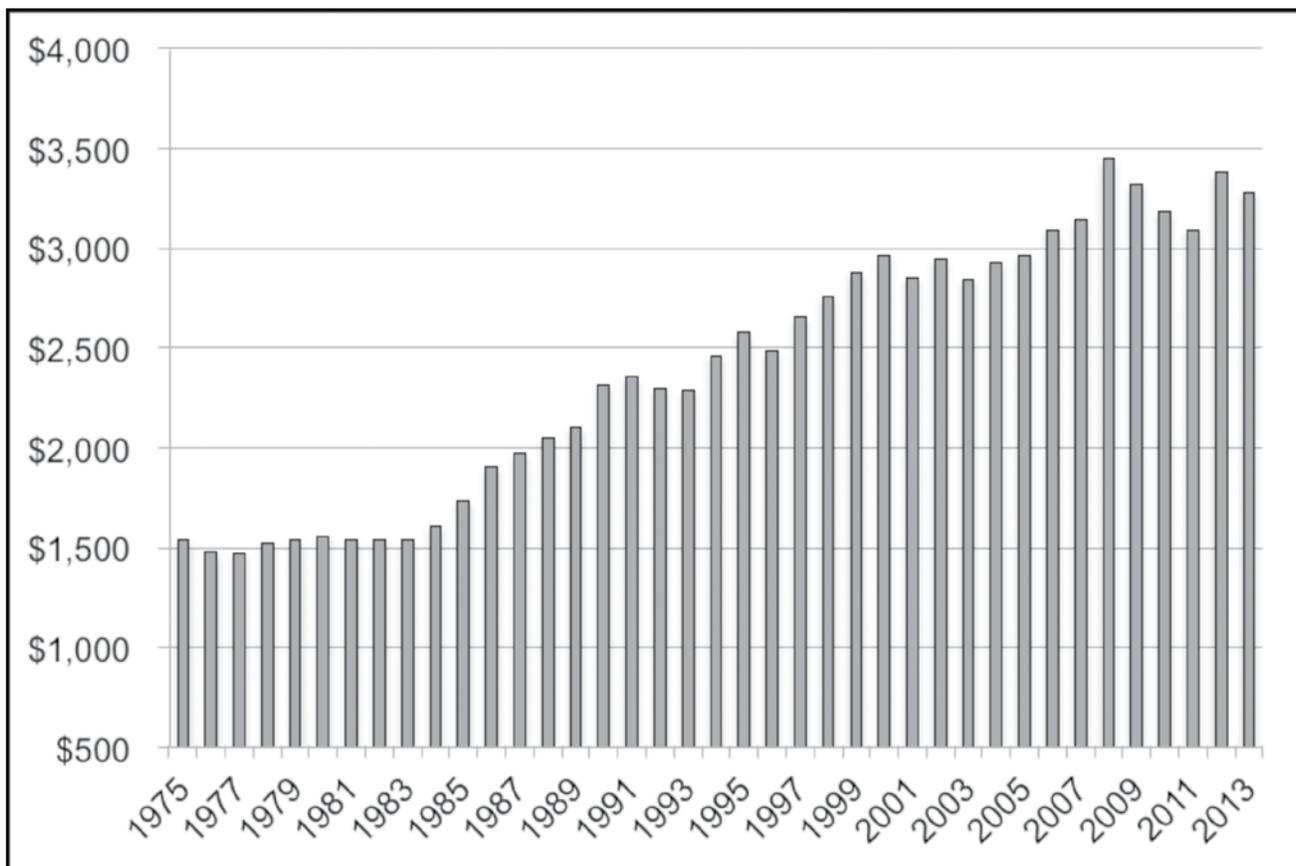
- The majority of the state's General Fund revenues, 77 percent, come from personal income and sales taxes — 50 and 27 percent respectively. These two taxes produce \$15 billion in total revenue. By comparison, North Carolina's corporate income tax generates 4 percent of General Fund revenues, or \$900 million.
- High personal and corporate income taxes hurt North Carolina's international competitiveness. If you include federal and state tax rates on dividends, capital gains, and corporate income, North Carolina's top marginal rate on corporate investment is 53 percent, the 4th highest in the industrialized world.
- North Carolina's highest personal income tax rate, 7.75 percent on all income over \$60,000, is the highest in the South and the 11th highest in the nation.

Recommendations

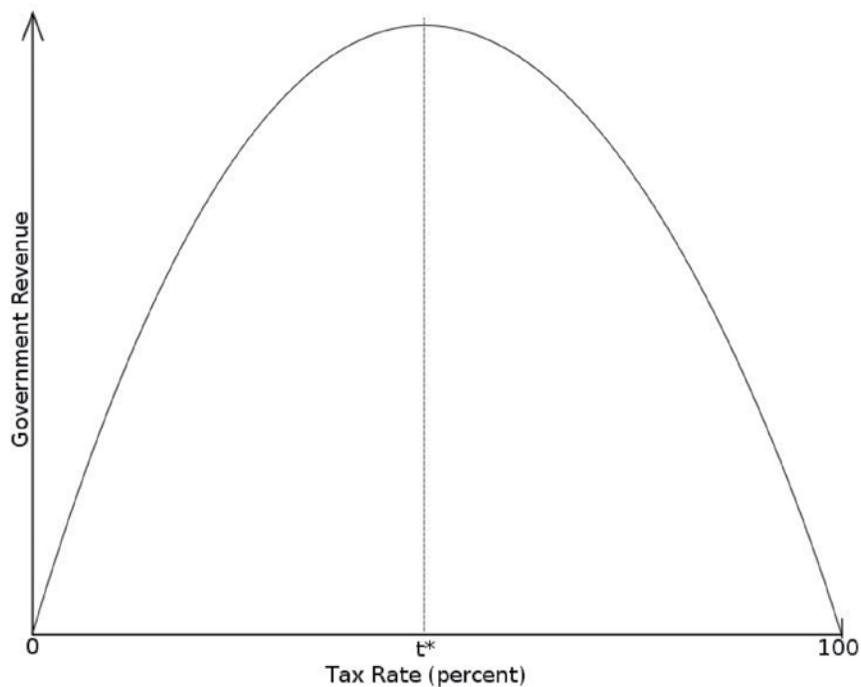
1. **Eliminate the corporate income tax**, which, along with being onerously high, promotes lobbying for exemptions. These distort investment allocation, further complicate the code, and undermine the goal of funding government, since the tax generates a tiny percentage of total state revenues.
2. **Avoid all targeted tax exemptions or penalties.** These undermine individual freedom, distort investment allocation, complicate the tax code, and feed wasteful lobbying.
3. **Enact a Taxpayer Bill of Rights** as an amendment to the state constitution. A North Carolina TABOR should cap annual spending growth at the combined growth of inflation and population, and require a supermajority in the legislature to raise state taxes.
4. **Eliminate the estate tax.** Along with the corporate income tax, research has shown the estate tax to have a disproportionately large impact on investment and economic growth. Given that it is projected to raise only \$92 million in 2013, or less than half of one percent of General Fund revenue, state government can clearly do without this extra layer of taxation.

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Inflation-Adjusted State Revenues Per Person (Excludes Federal Aid)



The Laffer Curve





Federal Aid Dependency

Since the onset of the Great Recession, federal legislators have rapidly expanded debt-financed aid-to-state programs. North Carolina is no exception to the trend of states with greater dependence, and federal aid is now roughly equal to general funds as a source of state revenue. (Two states, Louisiana and Oklahoma, now receive a majority of their revenues through federal aid.)

Federal aid erodes state sovereignty since federal officials often use the threat of reduced aid to dictate state policy. But it has two other, less obvious effects which merit attention since they tend towards long-run fiscal shortfalls.

First, when federal officials are borrowing money—or generating it anew through the Federal Reserve System—they are not subject to a balanced budget constraint. If they send that borrowed money to state officials, they allow them to bypass their own state-level balanced budget constraints and achieve deficit financing against the will of constituents.

Second, many federal grants have sunset clauses, but once created the recipients remain even after the money runs out. That means state officials face political pressure to perpetuate what were originally federally funded programs. The recent dispute over how to maintain and fund the number of taxpayer-funded teachers in North Carolina after federal “stimulus” funding ran out is one such example.

Key Facts

- After declining in 2006 and 2007, the flow of federal aid to state and local governments has grown in every year since—including by 15 and 12 percent in 2009 and 2010 respectively.
- In this fiscal year of 2012, federal aid comprises 36 percent of North Carolina’s revenues, up from 25 percent in 2000 and 21 percent in 1975. Federal aid for every North Carolina resident is \$1,865.

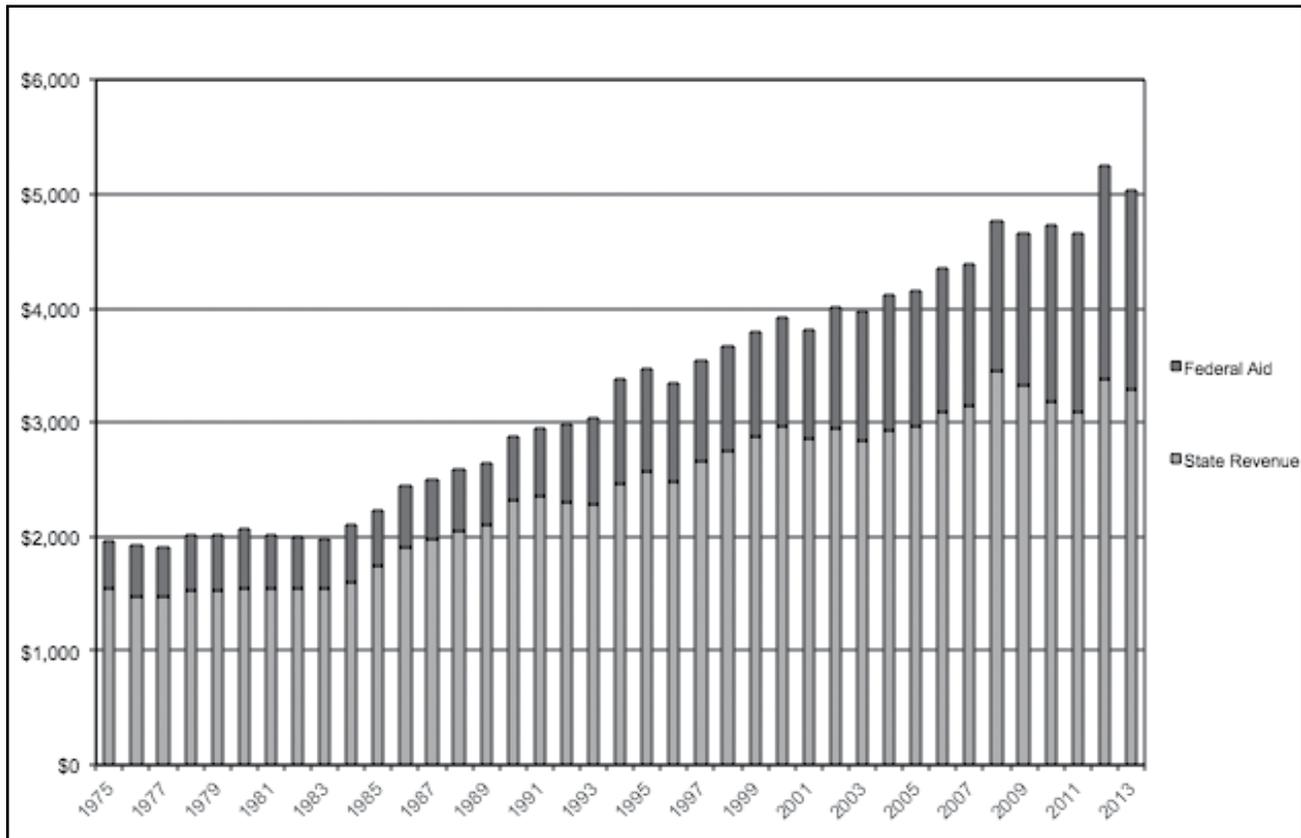
- 30 percent of that federal aid in 2012 was debt financed. As a portion of the \$18.3 billion that North Carolina received, it equates to a deficit of \$5.4 billion, or more than 10 percent of total state spending.
- Each dollar of temporary federal aid tends to raise taxes by 40 cents after cessation of the funding—as estimated by the Mercatus Center at George Mason University.

Recommendations

1. **Support a resolution for a state initiated amendments convention** for a fiscal constraint on the federal government. Forty-nine states have some form of balanced budget and a majority of United States residents support an amendment against further federal deficits. The National Debt Relief Amendment, endorsed by the American Legislative Exchange Council and passed in North Dakota and Louisiana, is one simple solution of this sort.
2. **Avoid all federal aid** that brings requirements more onerous than the benefits. Keep in mind that the requirements include both those stated explicitly in the grant legislation and the political pressure to perpetuate a program once federal officials discontinue the aid.
3. Align with federal officials who **support initiatives to restrain federal deficits** and discontinue federal aid as a normal course of policy.

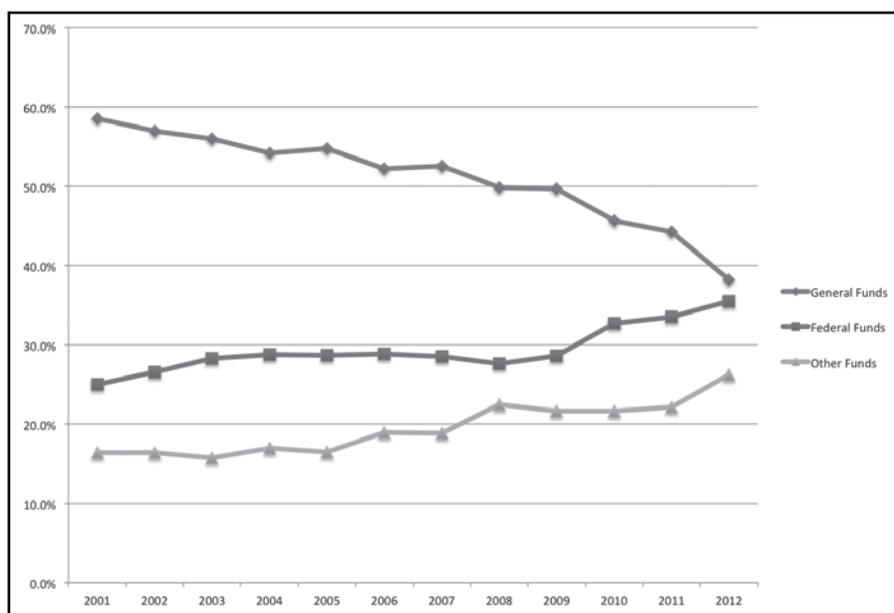
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Federal Aid Versus North Carolina In-State Revenue (per capita, 2012 dollars)



Sources: North Carolina Office of State Budget and Management, Bureau of Economic Analysis, U.S. Census Bureau

Federal Aid as a Percentage of N.C.'s Funds



Source: Sven Larson, "The Unitary State of America"

State Unfunded Liabilities

When you promise to pay someone in the future, you have a debt with him. However, were you to use cash accounting, as North Carolina's government does, you would not record it as such, because no cash changed hands.

While that may strike you as bizarre, state retirement benefits work in precisely this manner. In North Carolina, for example, state government has promised state employees and teachers a retiree health benefit worth at least \$35 billion — more than two-thirds of annual state spending — without recording the promise as an ongoing expense. Taxpayers in North Carolina are now indebted for this defined benefit, while lawmakers have put aside just \$684 million to cover it, 2 percent of the obligation.

Such deferred expenses are politically convenient because they get around the state's balanced budget amendment. Additionally, they allow governors and state lawmakers to reward interest groups, particularly government employees, while shifting the politically difficult burden of taxation onto future governors and lawmakers.

Key Facts

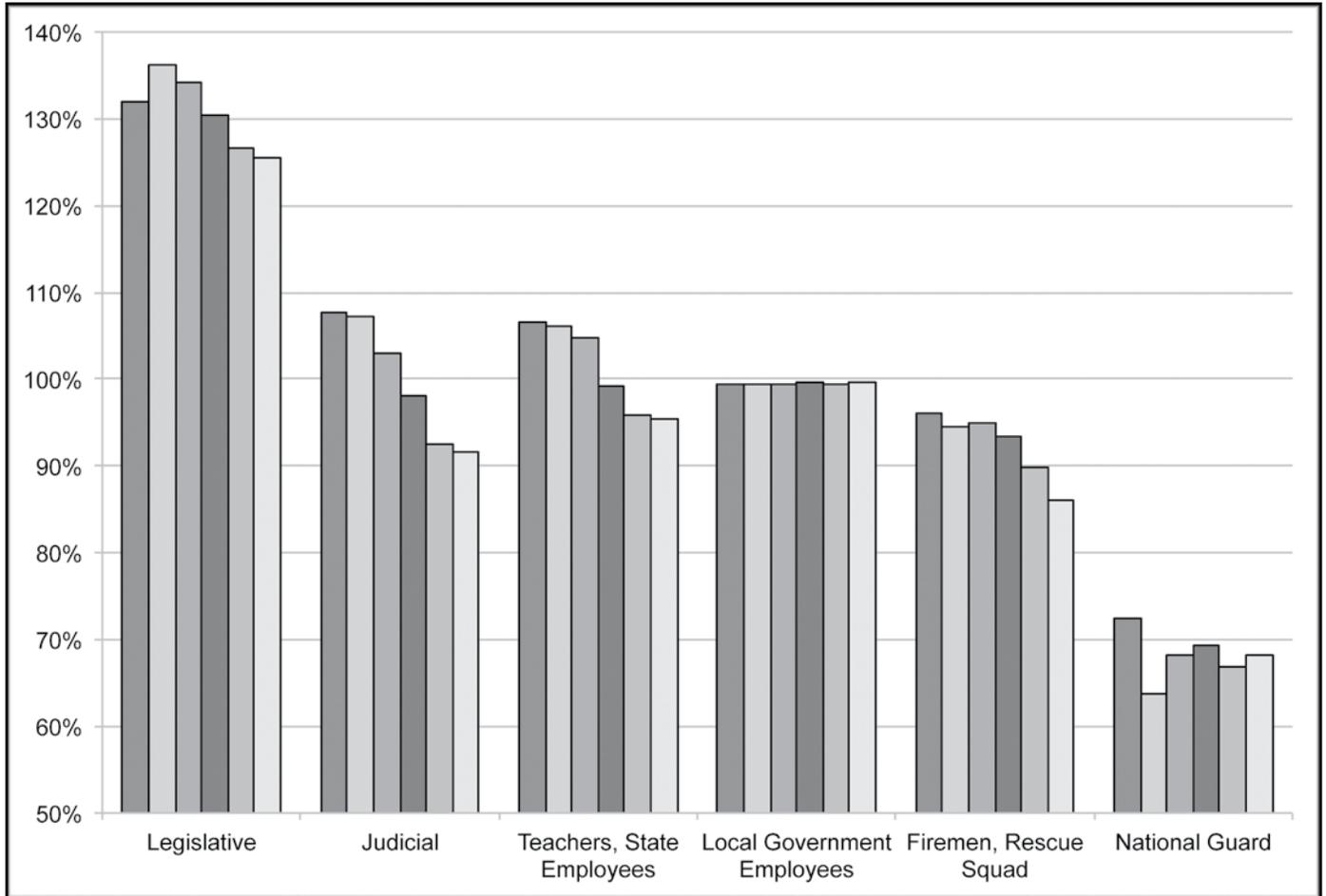
- Retiree health benefits are the state's largest and most vulnerable unfunded liability — \$34.2 billion at the end of the 2010 calendar year (accounting for the 2 percent set aside). Total unfunded state employee liabilities, adding in promised pension benefits and subtracting surpluses in some pension accounts, is officially reported as at least \$37.5 billion or \$14,740 per taxpayer (in 2012 dollars).
- The \$34.2 billion for retiree health benefits is up from \$29.8 billion at the end of 2008, an increase of \$4.4 billion in two years. To put that magnitude into perspective, the increase in retiree health benefits alone constituted about 5 percent of total reported spending in fiscal years 2009 and 2010 combined.
- The official measures of state unfunded liabilities published in the Comprehensive Annual Financial Report (CAFR) are underestimates since they confuse a discount rate with a return on investment. The Office of the State Controller discounts from an assumed investment return of 7.25 percent. Analysts from both the Congressional Budget Office and the Institute for Truth in Accounting recommend discount rates closer to 4 percent, and recent declines in the funding levels of state pensions have affirmed this vulnerability.

Recommendations

1. So long as the state maintains pension and other benefit programs for teachers and state employees, they ought to function as **defined contributions rather than defined benefits**. That means money is set aside now and returns accrue on that money — rather than promises now without money to match them. The switch will do nothing to reverse the unfunded liabilities that exist, but it will bring an immediate halt to their worsening. The switch is also in the interest of state employees, since it offers portability and guarantees the money will actually be there when they retire.
2. As more government employees retire and the relevant pension funds deplete, a reconciliation of the unfunded liability will have to occur. Given the magnitude of the liability — more than two-thirds of annual state spending and almost twice the General Fund budget — **the generosity of benefits will have to come down to better reflect the money originally set aside**, as opposed to the mere promises made without contributions. As younger individuals ought to prepare for life without full Social Security benefits, so too should government employees prepare for defined benefit plans that cannot eventuate.
3. To more accurately account for unfunded liabilities in the CAFR, **use a discount rate that reflects the near certain obligation** of retirement benefits. As promoted by the Congressional Budget Office, that would be around 4 percent, if not lower.
4. To avoid this mess of unfunded liabilities, which arises from cash-basis accounting, state legislators ought to **adopt understandable and accurate accounting based on accrued liabilities**. The Institute for Truth in Accounting proposes an excellent mode, called F.A.C.T. accounting (for Full Accrual Calculations and Techniques). The organization offers a pro-forma Truth in Accounting Act to formalize the conversion.

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State Pension Funds and Their Levels of Funding, 2005-2010





Economic Growth

For decades, North Carolina has pursued an “economic development policy.” The Department of Commerce is completely dedicated to this concept and its website emphasizes, “The N.C. Department of Commerce is the state’s leading economic-development agency, working with local, regional, national and international companies.” Economic development policy has come to mean state efforts to pick winners and losers by using tax breaks and direct subsidies to promote specific businesses and industries deemed worthy by government officials. It is a form of crony capitalism. On the DOC website, the agency boasts about the specific industries that it targets for special consideration, including tourism, film, sports development, telecommunications, biotechnologies, health care, and financial services. This is a model of state central planning of the economy and it should be abandoned.

North Carolina’s entire “economic development policy” should be replaced with “economic growth policy.” Unlike economic development policy, economic growth policy would not focus on one business, industry, or region of the state over another but would adopt policies to maximize economic growth rates for the state. It is overall economic growth that creates employment opportunities drives down unemployment rates, creates real prosperity, and lifts people out of poverty. A well known saying is that a rising tide lifts all boats. Creating the conditions for economic growth will create such a rising tide. Targeting favored businesses and industries in the pursuit of economic development sloshes water around, lifting some and sinking others. By replacing the decisions of entrepreneurs and investors in private markets with the decisions of politicians and bureaucrats, resources are misallocated, inefficiencies are created, and the state’s economic growth potential is reduced.

Key Facts

- North Carolina’s economic development policies have led the state to create dozens of special tax breaks and subsidies for favored industries (see table in the Corporate Income Tax section).
- The mindset guiding economic development policy has been one where “experts” in the state bureaucracy believe they can effectively decide what kinds of businesses and industries are right for the state and then centrally direct resources toward the chosen companies. By definition, these resources are being directed

away from other opportunities that market participants would have chosen.

- Economic growth policy would seek to remove government from the resource allocation picture entirely, creating an environment that encourages private sector entrepreneurship.
- True entrepreneurship, which is about spotting opportunities for profit in the market, is what lifts economies out of recessions and creates jobs.
- While North Carolina tends to track the national average in unemployment during boom times, it tends to do worse than the nation during recessions and recovery periods (see graph opposite, particularly 2001-2003 and 2007-present). The only way to improve this trend is to end North Carolina’s current policies that discourage entrepreneurship and investment, such as high marginal tax rates and burdensome regulation.
- North Carolina’s tax system penalizes investment and entrepreneurship by double and, in some cases, triple taxing the economic returns to these activities.
- North Carolina’s energy policies harm economic growth by raising energy costs for businesses. Because energy is an input into all production activities, the policies raise the cost of doing businesses across the economic spectrum.

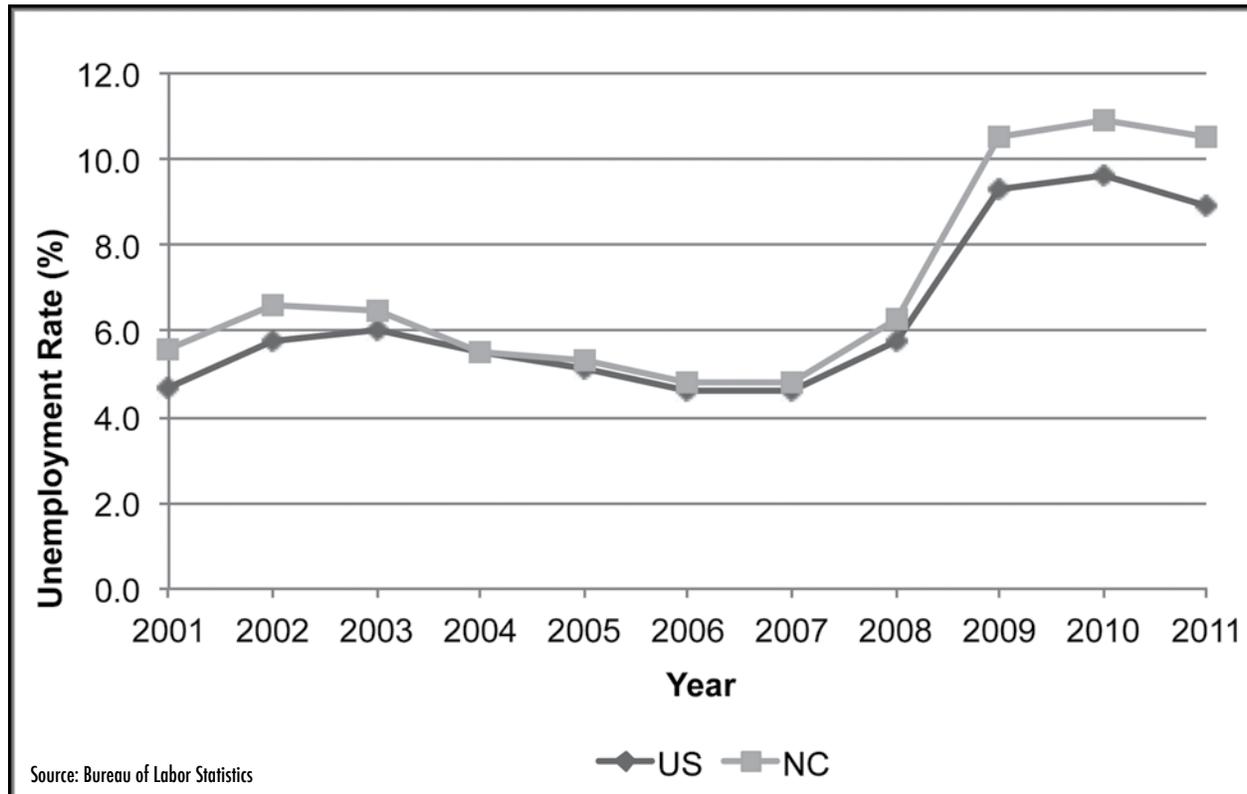
Recommendations

1. **Repeal all economic development policies granting special favors to particular businesses or industries**, including the One North Carolina Fund, Job Development Investment Grants (JDIG), and the Golden LEAF Foundation.
2. **Eliminate tax biases against investment and entrepreneurship** by adopting a low, flat rate consumed income tax (see section on income tax); abolishing the corporate income tax; and abolishing the estate tax.
3. **Pursue an energy policy that focuses on cost and reliability rather than renewable energy sources and conservation.** Start by repealing the state’s renewable portfolio standard and all special subsidies and tax breaks for renewable energy.

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Comparison of Annual Unemployment Rate: US and NC (2001-2011)



A Partial List of Economic Development Programs That Hinder Overall Economic Growth

- overseas advertising subsidies in the departments of Commerce and Agriculture
- special marketing programs for industries as varied as film production and meat goat farming
- state subsidies for private ventures such as the N.C. Biotechnology Center's venture capital fund
- state services offered below cost to agricultural and other businesses
- regional subsidies such as the state's investment in the Global TransPark in Kinston
- tax credits for renewable energy such as wind and solar power
- special tax breaks for "job creation" in distressed communities, worker training, and research and development

Programs that support these activities include the One North Carolina Fund, and the Golden LEAF Foundation. The latter's revenues flow from North Carolina's portion of the tobacco settlement.



Gas Tax Allocation

In March 2012, a new survey of the state line separating North and South Carolina resulted in 93 property owners being sent, as it were, into the other state. One of the affected properties was a gas station formerly in Lake Wylie, South Carolina. Upon his business being found to operate in North Carolina, the station owner told media he would probably have to close it — in part because he could no longer sell fireworks, but also because gas in N.C. costs almost a quarter more per gallon.

It's no secret that North Carolina has the highest gasoline tax in the region. Drivers here going on long road trips are encouraged to wait till they cross state lines, regardless of direction, before filling up. Contrary to public expectation, not all of those tax revenues go into road and highway needs.

Key Facts

- For the first half of 2012, North Carolina's tax on gasoline was 39.2 cents per gallon (cpg). The 2012 budget bill adjusted and capped the rate at 37.5 cents.
- North Carolina's gasoline tax rate ranked 6th highest in the nation, according to the Tax Foundation. It was also the highest in the South.
- The rates for neighboring states were these: South Carolina, 16.8 cpg (47th in the nation); Virginia, 19.8 cpg (40th); Tennessee, 21.4 cpg (36th); Georgia, 29.4 cpg (18th).
- North Carolina's gas tax rate is higher than South Carolina and Virginia's combined, or even South Carolina and Tennessee's combined. It's almost as high as the the combined rates of Virginia and Tennessee.
- Including the federal tax of 18.4 cpg, North Carolina drivers will pay 55.9 cpg for the remainder of 2012. In other words, each gallon of gasoline sold in North Carolina nets well over half a dollar in tax revenue for the state and federal governments.
- About one-fourth of highway funds are diverted annually into other, non-highway expenditures, and an increasing proportion of the highway funds are spent on planning and other pre-construction activities. These include such items as ferries, railroads, public transportation, and other non-road-related expenditures.
- Of the eight state highway funding distribution programs examined by transportation expert David

T. Hartgen in 2010, only one (Contract Resurfacing) allocated funds based on need. Major funds made allocations based on geography or discretion.

- A new "Mobility Fund" approved in 2010 would allocate highway funds to transportation projects considered of "statewide or regional significance" and would prioritize reducing travel times "across transportation modes" — but that means eligible projects for the fund include non-highway projects with low commuter demand such as rail transit.
- Unlike in many states, there is no county-based road system in North Carolina. Municipalities manage urban roads, and the state manages roads between municipalities.
- North Carolina is among the bottom states in the nation in road funding per mile.
- Since the early 2000s, after years of decline, the state's roads have improved on some performance measures.
- With the state's gas tax already high, it is neither wise nor feasible to meet additional highway funding needs through higher taxes. Hartgen found that the state could meet those needs through better prioritization of projects (using such needs-based measures as congestion, condition, accident rates, and traffic).

Recommendations

1. **Stop spending highway funds on non-highway, non-pavement expenditures.** North Carolina drivers should not pay one of the nation's highest gasoline tax rates to add to the General Fund or subsidize alternative modes of transportation with political rather than public support.
2. **Change funding formulas to focus highway spending on need.** This recommendation requires deciding the best ways to measure highway needs — i.e., through measuring congestion, road condition, accident rates, traffic, etc. — to allow for a more judicious management of existing highway funds.

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North Carolina's gasoline tax is the highest in the region

GASOLINE PRICE INCLUDES

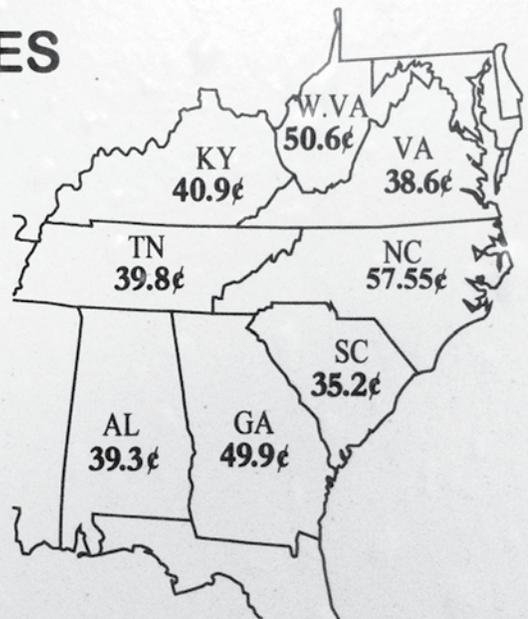
57.55¢ Per Gallon Tax
39.15¢ NC Tax*
18.4¢ Federal Tax

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Fueling North Carolina's Future

*State Tax Rates change semi-annually. Rate Based on January 1, 2012 figures.



State	Gasoline Tax Rate (¢)
W.VA	50.6
VA	38.6
TN	39.8
NC	57.55
SC	35.2
GA	49.9
AL	39.3
KY	40.9

Sticker affixed to a retail gasoline pump in Raleigh. Photographed April 4, 2012.



Standards and Curriculum

In 2012, the NC Department of Public Instruction will introduce new curricula and standards for all public school students. This will include the new North Carolina Essential Standards for social studies, science, arts education, and world languages, among others. In addition, the state will be one of 46 states and the District of Columbia to implement the national Common Core State Standards in K-12 mathematics and/or English Language Arts.

Of course, the burden of implementing completely new standards and curricula will fall on North Carolina's teachers. They must transform a catalog of new material into sound classroom instruction. Research suggests that the transition will be challenging for teachers and possibly disadvantageous for students.

Key Facts

- In 2008, the State Board of Education (SBE) directed the North Carolina Department of Public Instruction (DPI) to “overhaul the PreK-12 Standard Course of Study (SCOS) to focus on essential standards in order to narrow and deepen the state’s curriculum.” In response, DPI initiated the Accountability and Curriculum Reform Effort (ACRE). In 2012, DPI will introduce the North Carolina Essential Standards, ACRE’s revision of the Standard Course of Study.
- The North Carolina Essential Standards revised state science, social studies, information and technology, world languages, arts education, occupational course of study, healthful living, and guidance standards.
- In June 2010, the State Board of Education unanimously approved the adoption of national Common Core State Standards for English and math.
- Two independent organizations, the National Governors Association and the Council of Chief State School Officers, developed the Common Core standards. The U.S. Department of Education later added financial incentives and other advantages for states that adopted the standards. Over the past two years, the U.S. Department of Education has been one of the leading proponents of the Common Core.
- Adopting the Common Core standards may be costly for North Carolina taxpayers. Researchers from the Pioneer Institute, the American Principles Project, and the Pacific Research Institute estimate that implementation of Common Core standards in English and

math will cost participating states \$15.8 billion over seven years. They concluded that North Carolina will spend \$200 million for professional development, \$85 million for textbooks and materials, and \$240 million for technology over the next seven years to implement the Common Core standards. That is a total of \$525 million or an average of \$75 million per year.

- Educational researchers disagree on the quality of the Common Core State Standards. In general, they have been much more critical of the Common Core math standards than the English standards.

Recommendations

1. **The State Board of Education (SBE) should reconsider adoption of the Common Core standards.** North Carolina’s adoption of the Common Core State Standards is a testament to the growing influence of the federal government in matters that traditionally (and constitutionally) have been the responsibility of state and local governments.
2. **The NC General Assembly should approve legislation that protects North Carolina’s public school curriculum and standards from undue federal intrusion.**
3. **The NC Department of Public Instruction (DPI) should report all costs associated with implementing Common Core standards and North Carolina Essential Standards.** Further, NC DPI should make this information readily available on their website.
4. **NC DPI should contract an independent entity to evaluate the quality of the new standards and curricula.** At a minimum, these studies should answer three basic questions. First, are the new standards an improvement over the discarded ones? Second, are the revised standards of equal or greater quality than the curricula and standards utilized by the highest performing states and nations? Third, is there a significant relationship between student performance and North Carolina’s new curricula and learning standards?

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Testing Policy

Between 1996 and 2012, the N.C. Department of Public Instruction authored, field-tested, administered, and analyzed nearly all end-of-grade and end-of-course tests under the ABCs of Public Education accountability program.

The elimination of several tests and adoption of the Common Core State Standards in English and math will diminish the state’s test development role significantly. Unfortunately, there is no evidence that these changes will lead to more reliable measures of students’ knowledge and skills than the tests developed by the state in the past.

Key Facts

- Since 2009, the State Board of Education and the NC General Assembly have eliminated 14 assessments, including end-of-course tests in Chemistry, Physics, Geometry, Algebra II, Civics and Economics, Physical Science, and United States History.
- In June 2010, the NC State Board of Education unanimously approved Common Core English and math standards. States that have adopted the Common Core State Standards plan to adopt common reading and math tests by 2014.
- The federal government is bankrolling the development of common tests based on the Common Core State Standards. The U.S. Department of Education will distribute \$360 million in grants to members of two state consortia. North Carolina became a member of the SMARTER Balanced Assessment Consortium (SBAC). In its role as a governing state in this group, state education leaders will work with public education agencies from 28 other states to shape test-design policy.
- Beginning in 2012, students in fifth and eighth grades, as well as those enrolled in a high school Biology course, will take revised science tests that are based on the new North Carolina Essential Standards for Science.
- Students in grades 9-12 are required to take three end-of-course tests – Algebra I, Biology, and English I. The federal No Child Left Behind law requires states to administer all three.
- Most district and charter school students will be required to take the PLAN test in tenth-grade and the ACT test in eleventh-grade. The PLAN test assesses students’ preparedness for Advanced Placement courses and postsecondary coursework. Institutions of higher education commonly use the ACT in the col-

lege admissions process. North Carolina is one of nine states to require high school students to take the ACT.

- Selected career and technical education students who are in twelfth-grade will complete the WorkKeys assessment. WorkKeys scores will help students determine if they have the skills needed for a given job or profession. In addition, students who meet WorkKeys standards can earn a National Career Readiness Certificate (NCRC). The certificate shows that the individual has met basic requirements for entry into a profession.
- North Carolina participates in the federal National Assessment of Educational Progress (NAEP). The rigorous NAEP tests are administered infrequently; a representative sample of students is tested in mathematics and reading every two years, while science, history, civics, and geography tests are administered every four years. Because of the nature of the sample, NAEP cannot provide data on individual school districts, only states. In most cases, only fourth- and eighth-grade students are tested.

Recommendations

1. **Abandon the Common Core State Standards.** While researchers disagree about the English standards’ quality, there is a growing consensus that the Common Core math standards are abysmal. Poor standards invariably lead to inferior tests.
2. **Adopt an independent, field-tested, and credible national test of student performance.** There are a number of norm-referenced tests available for students in grades K-12, including the Basic Achievement Skills Individual Screener (BASIS), Metropolitan Achievement Tests (MAT 8), and the Stanford Achievement Test Series, 10th Edition (Stanford 10).
3. **Set reading and math performance goals based on reputable national tests such as the National Assessment of Educational Progress (NAEP).** The state should set a goal of at least half of students showing proficiency and 90 percent testing at the “basic” level as defined by the NAEP.

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Student Achievement

School accountability comes in two forms. Either parents keep schools accountable by “voting with their feet” or states compel public school districts to administer standardized tests. Simply put, as educational options increase, the value and necessity of testing decreases. Likewise, as long as states such as North Carolina maintain stringent limitations on parental choice, test scores remain their primary method of keeping schools accountable for results.

Key Facts

- State SAT scores have been on the rise. Although the state still trails the national average, North Carolina’s total SAT score soared from an average score of 988 in 2000 to an average of 1001 in 2011. This surge is almost entirely the result of higher math achievement.
- Similar to SAT trends, math gains outpaced English, reading, and science increases in ACT scores. Overall, the ACT composite score rose from an average score of 20.3 in 2004 to an average of 21.9 in 2011. North Carolina’s composite ACT score has exceeded the national average since 2008.
- On the rigorous National Assessment of Educational Progress (NAEP) math tests, North Carolina’s fourth- and eighth-grade students have had higher average scale scores than the national average since 2000. The state’s reading scores have remained at or below the national average since 2005.
- Between 2005 and 2011, North Carolina’s graduation rate increased by 9.6 percentage points. The causes of the increase are not known. One trouble sign is that the rate of incoming community college students who require remediation rose at roughly the same time, suggesting that schools may be increasingly likely to graduate students regardless of their performance.
- In September 2010, Achieve Inc. released results from the third annual American Diploma Project (ADP) Algebra II end-of-course exam. Nearly 2,100 high school students in North Carolina took the “no stakes” test. ADP found that only around 19 percent of the state’s students were prepared for college-level mathematics. This finding was in stark contrast to North Carolina’s 2009-2010 end-of-course Algebra II test, which con-

cluded that 85 percent of students had “proficient” or “advanced” knowledge of the subject. The state will no longer administer either assessment effective with the 2011-12 school year.

- The math and reading performance of North Carolina’s general school population hovers around the international average. Using statistical techniques that “link” results from two different tests, researchers found that approximately two-thirds of North Carolina students would not meet international proficiency standards in math and reading. The state’s performance would place North Carolina in the company of Poland and the United Kingdom and far behind the highest performing nations. Even more troubling, few of our students would reach the “advanced” level of performance. Only 8 percent of North Carolina students performed well enough to achieve this distinction, which is comparable to nations such as the Czech Republic and Hungary.

Recommendations

1. **The state should augment educational options for all families, thereby curtailing dependence on standardized tests and other measures of student achievement.**
2. **The NC Department of Public Instruction should sponsor a comprehensive study that attempts to discover the causes of the state’s dramatic increase in math achievement and relative stagnation of reading scores over the last decade.** Researchers should conduct a similar study to determine why the state’s graduation rate has been on the rise.
3. **Test scores and other outcome measures should be used to create a simple A-to-F performance grading system for all North Carolina public schools.** Current classifications of student performance are confusing to parents and the public.

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NAEP Math Scale Scores, 2000-2011

Year	United States		North Carolina		Difference	
	4 th Grade	8 th Grade	4 th Grade	8 th Grade	4 th Grade	8 th Grade
2011	241	284	245	286	4	2
2009	239	282	244	284	5	2
2007	239	280	242	284	3	4
2005	237	278	241	282	4	4
2003	234	276	242	281	8	6
2000	226	274	232	280	6	6

Source: National Center for Education Statistics

NAEP Reading Scale Scores, 2002-2011

Year	United States		North Carolina		Difference	
	4 th Grade	8 th Grade	4 th Grade	8 th Grade	4 th Grade	8 th Grade
2011	221	265	221	263	0	-2
2009	220	262	219	260	-1	-2
2007	220	261	218	259	-2	-2
2005	217	260	217	258	0	-2
2003	216	261	221	262	5	1
2002	217	263	222	265	5	2

Source: National Center for Education Statistics

SAT Scores, 2000-2011

Year	United States			North Carolina			Total
	Reading	Math	Total	Reading	Math	Total	
2011	497	514	1011	493	508	1001	-10
2010	500	515	1015	495	509	1004	-11
2009	501	515	1016	495	511	1006	-10
2008	502	515	1017	496	511	1007	-10
2007	502	515	1017	495	509	1004	-13
2006	503	518	1021	495	513	1008	-13
2005	508	520	1028	499	511	1010	-18
2004	508	518	1026	499	507	1006	-20
2003	507	519	1026	495	506	1001	-25
2002	504	516	1020	493	505	998	-22
2001	506	514	1020	493	499	992	-28
2000	505	514	1019	492	496	988	-31

Source: The College Board

ACT Scores, 2004-2011

Year	United States					North Carolina					Difference Composite
	English	Math	Reading	Science	Composite	English	Math	Reading	Science	Composite	
2011	20.6	21.1	21.3	20.9	21.2	21.2	22.4	22.2	21.4	21.9	0.7
2010	20.5	21.0	21.3	20.9	21.0	21.1	22.3	22.2	21.6	21.9	0.9
2009	20.6	21.0	21.4	20.9	21.1	20.9	22.0	21.9	21.1	21.6	0.5
2008	20.6	21.0	21.4	20.8	21.1	20.5	21.8	21.7	20.8	21.3	0.2
2007	20.7	21.0	21.5	21.0	21.2	20.2	21.4	21.4	21.0	21.0	-0.2
2006	20.6	20.8	21.4	20.9	21.1	19.6	20.9	20.9	20.2	20.5	-0.6
2005	20.4	20.7	21.3	20.9	20.9	19.3	20.4	20.6	20.0	20.2	-0.7
2004	21.4	20.6	21.0	22.2	21.4	20.3	19.4	20.4	20.6	20.3	-1.1

Source: ACT, Inc.

4-Year Cohort Graduation Rate, 2005-2011

Subgroup	2005-2006	2006-2007	2007-2008	2008-2009	2009-2010	2010-2011	Percentage Point Change 2005-2011
All Students	68.3	69.5	70.3	71.8	74.2	77.9	9.6
Native American Female	55.3	60.6	58.3	64.8	69.6	74.9	19.6
Asian Female	77.5	79.6	83.5	86.7	88.4	89.3	11.8
Black Female	67.8	68.8	70.0	70.4	74.6	78.7	10.9
Hispanic Female	57.2	58.0	60.3	63.9	66.7	72.5	15.3
Multi-Racial Female	68.3	70.4	73.2	77.0	76.6	81.0	12.7
White Female	76.5	78.2	78.7	81.4	82.9	85.6	9.1
Native American Male	47.1	50.0	49.2	55.4	66.3	64.7	17.6
Asian Male	73.1	78.3	78.7	81.0	82.3	84.6	11.5
Black Male	52.7	53.8	55.2	55.9	59.6	64.2	11.5
Hispanic Male	47.7	49.5	52.9	54.6	56.3	65.3	17.6
Multi-Racial Male	63.6	59.4	63.1	65.3	66.0	73.2	9.6
White Male	70.6	71.9	72.9	74.2	76.5	79.8	9.2

Source: NC Department of Public Instruction



School Choice

In North Carolina, public education is a core fiscal responsibility of state and local government. The state constitution, in the words of the N.C. Supreme Court, recognizes the right to a “sound, basic education” for every child in the state. But public education need not and should not be delivered by government monopolies, as a diverse array of home, charter, and private schools are demonstrating across the country and here in North Carolina. In the end, no system for delivering goods and services functions well without providing a means for consumers to make their desires known and express their level of satisfaction.

Key Facts

- During the 2010-2011 school year, just over 221,000 students enrolled in charter, home, and private schools. District school enrollment topped 1.4 million students.
- Between 2000-2001 and 2010-2011, there was a 126 percent increase in the number of home schools and a 147 percent increase in the number of home school students. During the 2010-2011 school year, 83,609 students were taught in 45,524 home schools.
- Over the last decade, there was a 5.6 percent increase in the number of private schools and a 7.2 percent increase in the number of private school students. During the 2010-2011 school year, 96,229 students enrolled in 693 private schools.
- The average county market share of North Carolina’s public and private schools of choice – charter, home, and private – continues to grow. In 2010-2011, their market share was 13 percent, a two percent increase from two years ago.
- Martin, Chowan, and Edgecombe counties had the lowest percentage market share (4 percent) among North Carolina counties, while Northampton County had the highest (46 percent).
- With passage of a special needs tax credit in 2011, North Carolina became only the 14th state in the nation to approve school choice legislation. Families with special-needs children recently enrolled in a public school have an opportunity to claim a nonrefundable income tax credit. As long as their children meet eligibility rules, parents can claim a credit of \$3,000 per semester (\$6,000 per year) for special education and

related services at a private or non-profit facility.

Recommendations

1. **The General Assembly should give parents an “Education Bill of Rights.”** An Education Bill of Rights should attach funding to the student and allow parents to take some or all that funding to the public, charter, or private school of their choice.
2. **North Carolina school districts should make greater use of open enrollment and magnet schools.** District leaders should employ choice and competition as tools to improve academic performance.
3. **All North Carolina families should be allowed to set up educational savings accounts.** Families should be able to make an annual tax-deductible deposit of \$5,000 per child, from which they can withdraw funds tax-free for educational expenses such as textbooks, educational materials, or tuition incurred at any time from preschool through college.
4. **Needy students in public schools where fewer than 60 percent test at grade level should receive \$4,000 scholarships to attend the private school of their choice,** provided that no additional regulatory burdens are placed on private schools that accept these students.
5. **The state should allow low and middle-income parents to receive or access education tax credits.** A family education tax credit would reduce the state income tax liability of families that incur out-of-pocket expenses for private school tuition and educational services and expenses. A philanthropy education tax credit would reduce the state income tax liability of individuals and businesses that donate to scholarship funding organizations. Research has shown that both types of tax credits are educationally and fiscally sound.

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Home, Private, Charter and Public School Market Share by County

County	Home School Enrollment	Private School Enrollment	Charter School (ADM)	Public School Students (ADM)	Market Share	County	Home School Enrollment	Private School Enrollment	Charter School (ADM)	Public School Students (ADM)	Market Share
Alamance	1,251	1,337	1186	22,133	17%	Jones	129	0	0	1,138	11%
Alexander	543	1	0	5,450	10%	Lee	331	601	0	9,565	10%
Alleghany	72	0	0	1,447	5%	Lenoir	353	1,002	485	9,128	20%
Anson	186	5	0	3,755	5%	Lincoln	822	43	1273	11,674	18%
Ashe	334	0	0	3,145	11%	Macon	587	63	0	4,272	15%
Avery	221	12	105	2,120	16%	Madison	386	70	0	2,550	18%
Beaufort	388	353	281	6,904	15%	Martin	133	0	0	3,745	4%
Bertie	105	437	0	2,730	20%	McDowell	563	193	0	6,300	12%
Bladen	250	49	0	5,066	6%	Mecklenburg	6,098	19,007	6175	134,598	23%
Brunswick	868	367	866	11,969	18%	Mitchell	169	82	0	2,055	12%
Buncombe	3,217	3,164	926	29,113	25%	Montgomery	311	118	0	4,104	10%
Burke	929	148	100	13,290	9%	Moore	788	972	464	12,378	18%
Cabarrus	1,974	1,734	509	33,584	13%	Nash	842	1,105	965	16,802	17%
Caldwell	729	186	0	12,555	7%	New Hanover	1,485	3,035	443	24,060	21%
Camden	89	0	0	1,906	5%	Northampton	141	235	688	2,328	46%
Carteret	493	344	250	8,342	13%	Onslow	1,503	855	0	23,365	10%
Caswell	267	0	0	2,880	9%	Orange	706	1,159	361	18,761	12%
Catawba	1,332	1,335	0	24,216	11%	Pamlico	96	17	338	1,391	32%
Chatham	611	129	810	7,750	20%	Pasquotank	434	407	0	5,884	14%
Cherokee	322	27	176	3,347	16%	Pender	475	0	0	8,156	6%
Chowan	98	0	0	2,288	4%	Perquimans	121	0	0	1,720	7%
Clay	71	14	0	1,328	6%	Person	397	178	951	4,926	31%
Cleveland	1,041	98	0	15,721	7%	Pitt	1,026	1,846	0	22,971	13%
Columbus	345	310	481	8,639	13%	Polk	267	38	0	2,331	13%
Craven	913	712	0	14,751	11%	Randolph	1,728	679	0	22,937	10%
Cumberland	2,291	4,096	215	51,631	13%	Richmond	278	385	0	7,546	9%
Currituck	224	11	0	3,862	6%	Robeson	793	620	111	23,296	7%
Dare	261	65	0	4,823	7%	Rockingham	881	365	183	13,527	11%
Davidson	1,604	1,238	0	25,499	11%	Rowan	1,461	949	0	20,002	12%
Davie	453	104	0	6,492	9%	Rutherford	727	269	1285	8,765	26%
Duplin	340	117	0	8,945	5%	Sampson	373	554	0	11,327	8%
Durham	1,303	4,300	2987	31,946	27%	Scotland	165	270	0	6,153	7%
Edgecombe	312	0	0	7,088	4%	Stanly	630	427	312	8,966	15%
Forsyth	2,515	5,056	1803	51,824	18%	Stokes	549	185	0	6,847	11%
Franklin	1,022	30	141	8,478	14%	Surry	407	81	458	11,227	8%
Gaston	1,762	2,109	1772	30,900	18%	Swain	145	40	169	1,888	19%
Gates	175	0	0	1,804	10%	Transylvania	443	108	146	3,511	20%
Graham	150	56	0	1,191	17%	Tyrrell	33	0	0	565	6%
Granville	738	70	0	8,545	9%	Union	3,192	1,595	1094	39,040	15%
Greene	112	85	0	3,191	6%	Vance	421	812	619	6,868	27%
Guilford	3,308	6,844	1713	71,227	17%	Wake	8,033	16,084	6119	142,351	21%
Halifax	322	713	0	7,742	13%	Warren	117	54	142	2,458	13%
Harnett	1,281	488	0	19,211	9%	Washington	103	0	0	1,749	6%
Haywood	653	181	0	7,582	11%	Watauga	493	90	145	4,297	17%
Henderson	1,467	898	173	13,177	19%	Wayne	797	1,231	155	19,033	11%
Hertford	79	428	0	3,095	16%	Wilkes	803	202	147	9,874	12%
Hoke	470	72	0	7,945	7%	Wilson	556	1,027	852	12,033	20%
Hyde	52	39	0	575	16%	Yadkin	376	42	0	5,805	7%
Iredell	1,743	1,007	2089	26,550	18%	Yancey	305	45	0	2,341	15%
Jackson	312	155	189	3,553	18%	AVERAGE	41,637	39,092	17,158	683,287	13%
Johnston	2,039	168	386	31,982	8%						

Source: NC Division of Non-Public Education, NC Department of Public Instruction



Charter Schools

Charter schools are tuition-free public schools that have more freedom than district-run public schools, but are required to meet certain state regulations, such as participation in the accountability program, the ABCs of Public Education. In 1996, the NC General Assembly passed charter school legislation. Sixteen years later, charter schools are among the most popular and successful schools in the state.

Key Facts

- Charter school enrollment has grown to about 45,000 students, an increase of 45 percent over the last five years. Still, charter school students represent only 3 percent of the total public school population in NC.
- In 2011, the NC General Assembly eliminated restrictions on growth from the 1996 charter law. Lawmakers removed the 100-school cap and authorized charter school enrollment to grow by up to 20 percent a year, up from the previous cap of 10 percent, which had led to long wait lists and few open seats.
- The 2011 charter school legislation created a new oversight group, the NC Public Charter School Advisory Council. The purpose of the council is to review and recommend charter applications to the NC State Board of Education. The council will also assist the Office of Charter Schools in ensuring that charters maintain high academic and operational standards.
- Since the authorization of charter schools in the state, 33 have closed for various reasons, but the State Board of Education has not revoked a charter since 2010.
- According to 2010-11 test results, 24 percent of charter schools received the state's top classification – Honor School of Excellence. Only 8 percent of district schools earned that honor.
- The average 2010-11 proficiency rate of NC's 2,351 district schools was 76 percent. The 98 charter schools had an average proficiency rate of 79 percent.
- In 2010-11, charter schools had a four-year graduation rate of 81.1 percent. That is comparable to the statewide rate for district schools of 81.4 percent.
- The average 2010-2011 per-pupil expenditure among the state's charter schools was \$8,732. The per-pupil district average was \$9,251. This reflects the fact that charter schools do not receive capital funding.
- In *Sugar Creek Charter School et al. v. The Charlotte-Mecklenburg Board of Education*, plaintiffs alleged that

Charlotte-Mecklenburg school leaders withheld funds that they were obliged to allocate to charter schools in their jurisdiction. A three-judge NC Court of Appeals panel ruled that Charlotte-Mecklenburg Schools unlawfully withheld reserve fund balances, Hurricane Katrina relief funds, sales tax reimbursements, pre-school funds, donations for specific programs, and capital reimbursements totaling \$1.3 million.

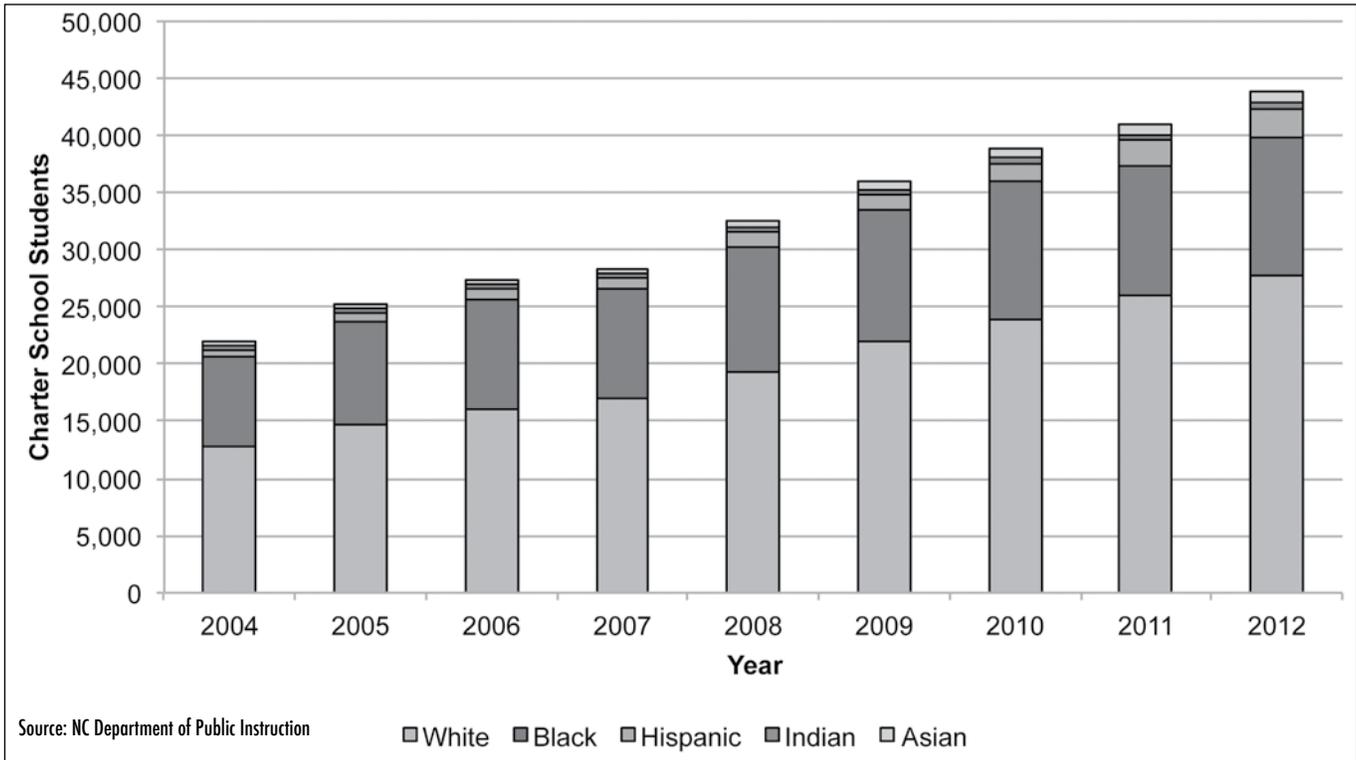
- State law mandates that charter schools reflect the racial/ethnic balance of the school system in which they reside. This contradicts another part of the statute requiring charter schools to use an enrollment lottery when applicants outnumber available seats. In an analysis of the statute, the NC Attorney General's Office determined that charter schools are not permitted to set aside seats for students based on race or ethnicity.
- Statewide, the distribution of students by ethnicity is reasonably similar in both charter and district schools. In 2011, for example, 26.7 percent of charter school students were identified as African-American, while 26.3 percent of district school students were in this category.

Recommendations

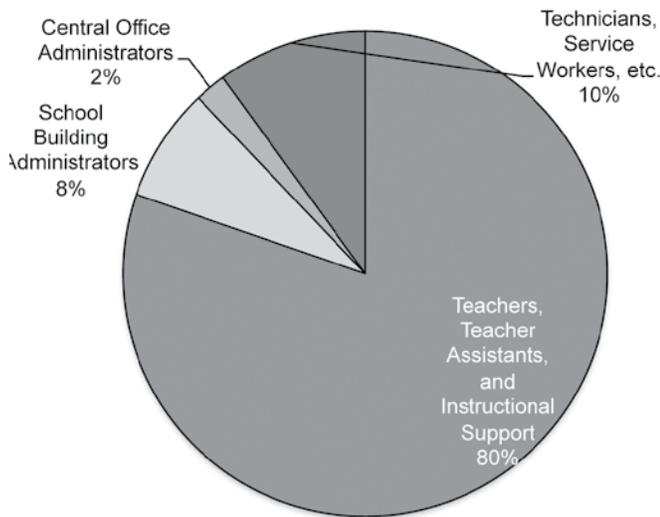
1. **Legislators should eliminate regulations that require charter schools to employ a minimum percentage of certified teachers.** Charter schools should have the freedom to hire the most qualified applicants, not just those with state-approved credentials.
2. **The State Board of Education should repeal any policy or regulation that sets student performance standards for charter, but not district, schools.**
3. **The NC General Assembly should discard any regulation or statute that requires charter schools to reflect the racial/ethnic balance of the school system in which they reside.** It is impossible for charter schools to use random (lottery) and non-random (affirmative action) student selection mechanisms simultaneously.
4. **The state should permit successful charter schools to replicate themselves through a special review and approval process developed and conducted by the NC Charter School Advisory Council.**

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Charter School Population by Ethnicity

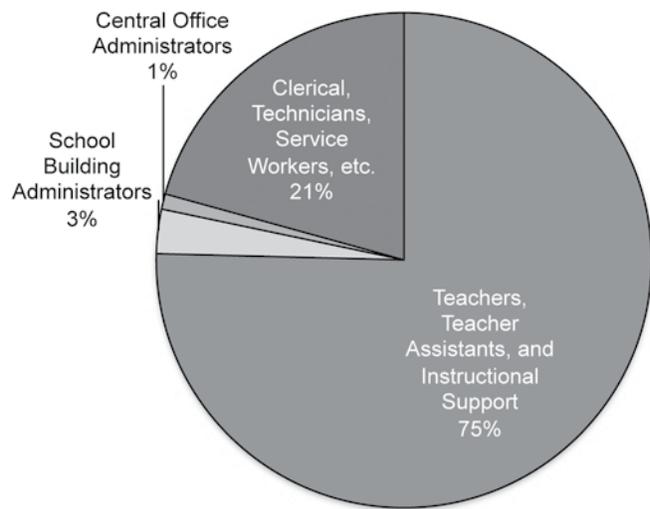


Charter School Distribution of Personnel, 2011-2012



Source: NC Department of Public Instruction

District School Distribution of Personnel, 2011-2012





Public School Finance

Will Rogers said, “Lord, the money we do spend on Government and it’s not one bit better than the government we got for one-third the money twenty years ago.” This is especially true for money that we spend on public education. Despite a 260 percent increase in inflation-adjusted per-pupil spending since 1970, it has become clear that more money alone will not yield better results.

Key Facts

- North Carolina spent approximately \$8,500 per K-12 student in federal, state, and local operating funds in 2012. When average spending for buildings and other capital costs are included, the total cost of public education in our state exceeds \$9,000 per student.
- Local public school funding has posted a 33 percent (\$662 million) increase since 2001. Federal funding to North Carolina public schools has nearly tripled during the same period, thanks to significant increases in No Child Left Behind, special education (IDEA), and stimulus (American Recovery & Reinvestment Act) funding.
- State public school funding has increased by approximately 32 percent, from \$5.7 billion in 2001 to \$7.5 billion in 2012.
- As in most states hit hard by the Great Recession, North Carolina’s state education funding remains lower than 2007-2009 levels. Nevertheless, total funding in 2011-2012 was higher than that of the two preceding school years.
- Between 2006 and 2009, the NC General Assembly added over \$800 million to the state public school budget but failed to maintain that level of funding between 2009 and 2011. By the time the 2010-2011 school year arrived, the legislature had reduced the public school budget to pre-2006 levels. In 2011, the General Assembly increased total state education funding to \$7.5 billion, which was higher than the 2006 appropriation of \$7.37 billion.
- According to *Rankings of the States 2011 and Estimates of School Statistics 2012*, an annual publication of the National Education Association (NEA), North Carolina ranks 42nd in total per-pupil expenditure (state, local, and federal funding) for the 2011-2012 school year. The 2011-2012 ranking is higher than the state’s

rankings for the 2010-2011 (45th) and 2009-2010 (43rd) school years.

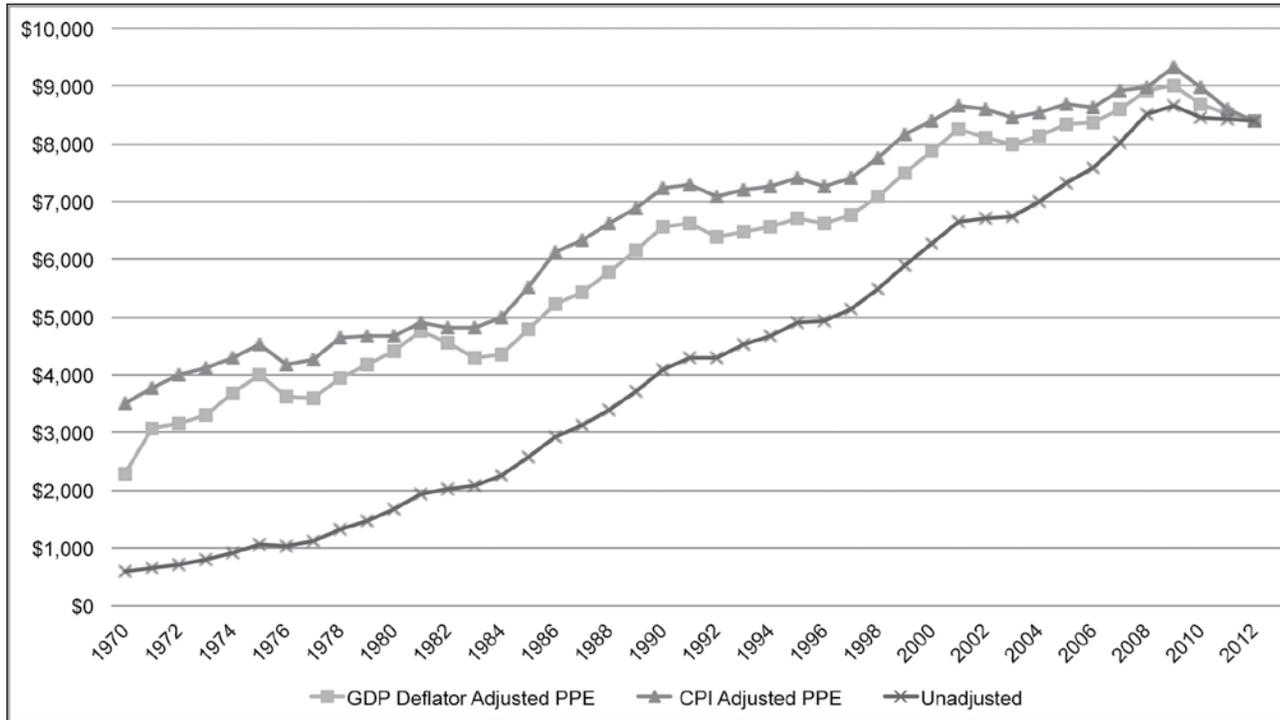
- State funding is not distributed to all public school children equally. State and federal agencies allocate funds based on the needs, circumstances, and grade level of each student. During the 2011-2012 school year, for example, small, low-wealth school systems received \$11,401 in state funds for each special-needs elementary school student with limited English proficiency from a low-income family. If the same child lived in a higher-income district, the state provided the school an allotment of \$10,416. Federal funding may add up to an additional \$7,095 per elementary student, depending on program eligibility.
- The state has contributed over \$2 billion for capital expenditures since 1995. School districts, which are responsible for financing their own capital programs, have spent almost \$12 billion during the same period. Taking into account all sources of revenue, school districts have spent nearly \$14 billion for school capital expenditures since 1995.

Recommendations

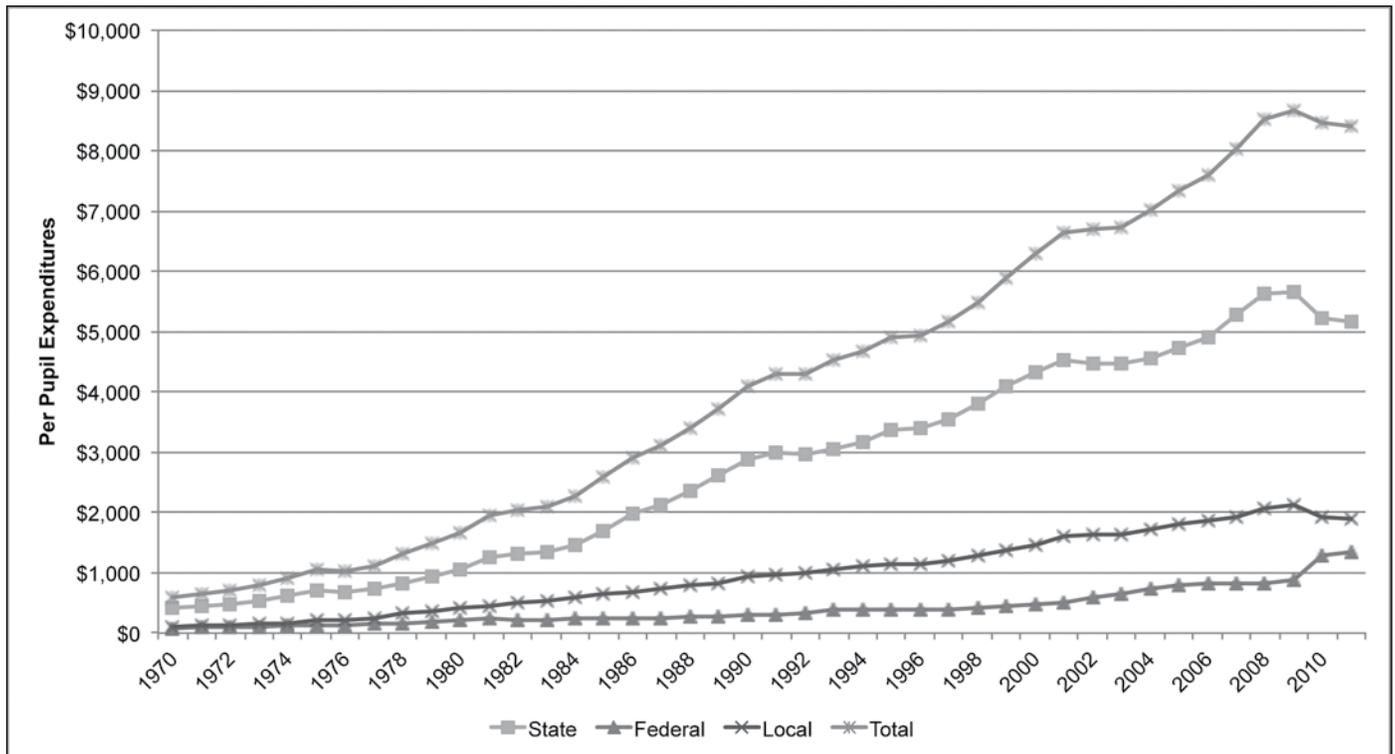
1. **Require school districts to post budgets, check registers, contracts, and other public documents online.** In addition, districts should be required to report per-pupil expenditures by school and grade level.
2. **Discontinue the confusing practice of allocating funds to each school district using various funding formulas.** Give school districts the freedom to allocate education funding according to the unique needs and circumstances of the district. This could be achieved by utilizing a block grant funding system to distribute state funds to school districts.
3. **Alternatively, change the way that North Carolina funds public education by attaching funding to the student.** Coupled with open enrollment for schools statewide, student-centered funding will ensure that schools of parents’ choosing receive funds necessary to educate each child — nothing more, nothing less.

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Inflation-Adjusted Per-Pupil Expenditures, 1970-2012



Unadjusted State, Local, and Federal Per-Pupil Funding, 1970-2011



Source: NC Department of Public Instruction



Class Size

Support for reducing class size usually cuts across political and ideological divides, garnering accolades from legislators, policymakers, and parents alike. Nevertheless, the relationship between class size and student achievement has been the subject of scholarly debate for decades. While several large-scale studies suggest that students benefit from class size reductions, a number of high-quality studies conclude that smaller classes are not the “magic bullet” that many believe them to be.

Key Facts

- Recent studies of class sizes in North Carolina public schools suggest that there is little or no significant relationship between small class sizes and student achievement. One research study also found that teachers’ perceptions about their class sizes were not tied to teacher job retention.
- Results from the 2010 North Carolina Teacher Working Conditions Survey indicate that most teachers are content with current class sizes. Sixty-one percent of the over 104,000 respondents to the survey agreed or strongly agreed that class sizes “are reasonable such that teachers have the time available to meet the needs of all students.” Twenty-nine percent of respondents disagreed and 10 percent strongly disagreed with that statement.
- From a fiscal standpoint, even limited class size reduction initiatives are costly to implement and maintain. Research suggests that class sizes must be reduced to between 15 and 20 students (depending on the grade) to have any positive effect on learning. Reductions of this magnitude would require a massive outlay of funds for additional teachers and new facilities.
- During the 2010-11 school year, 11 states, including North Carolina, loosened regulations on class size.
- In 2011, the NC General Assembly gave school districts maximum flexibility to establish class sizes in grades 4 through 12.

- During the 2011 legislative session, lawmakers initiated a multi-year effort to reduce class sizes in grades K-3. These mandates require all public school districts to have a district-wide average of 21 students per class and maintain an individual class size maximum of 24 students. If they meet their eventual goal of reducing class sizes to an average of one teacher for every 15 students, North Carolina will have the smallest elementary school classes in the nation.
- North Carolina charter schools are not held to class size limits.
- According to the latest data from the National Center for Education Statistics, North Carolina’s average elementary class size was 19 students and average secondary class size was 21 students. Both were lower than the national average of 20 students and 23 students, respectively.
- The Organization for Economic Cooperation and Development (OECD) reports that the average class size in United States primary schools (24) was higher than the international average (22). United States secondary schools had an average class size (23.2) that was slightly lower than the international average (23.7). Overall, many top-performing nations had larger average class sizes than the United States.

Recommendations

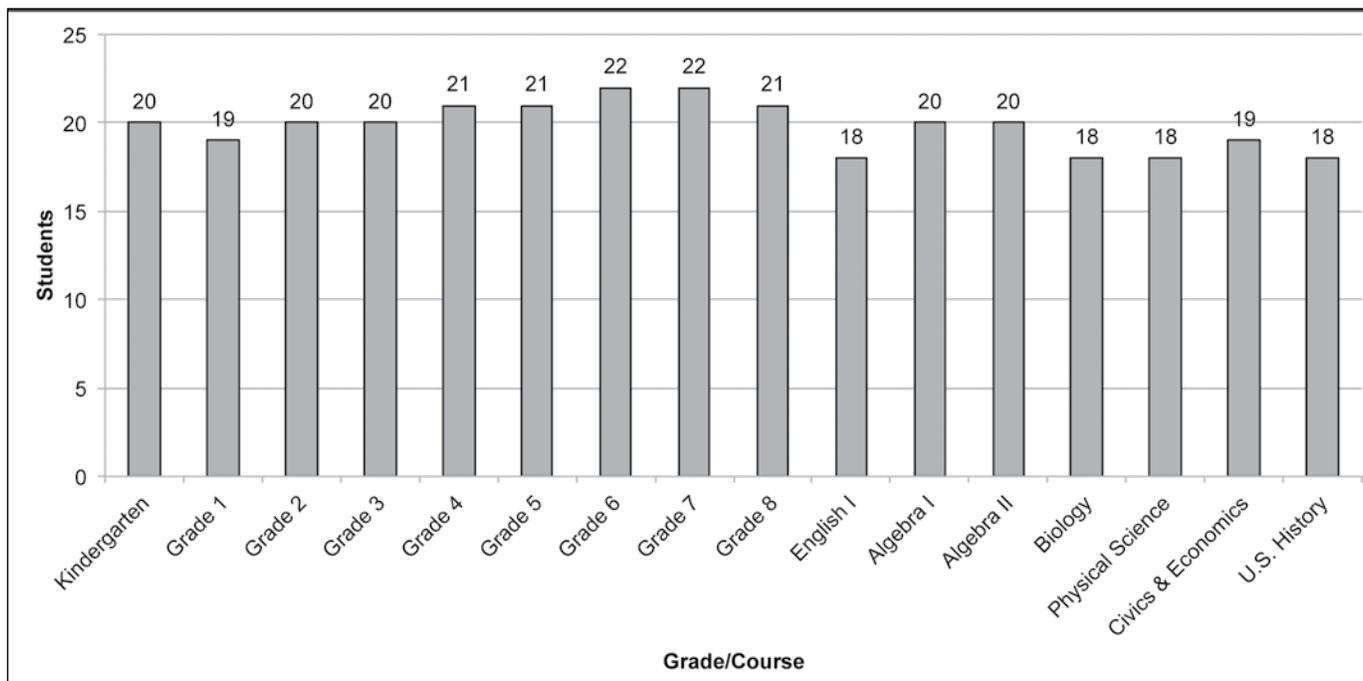
- 1. State class size mandates should be eliminated.**
School districts should have the authority to set class sizes for all grades and subjects according to their needs and available resources.
- 2. Class size reduction initiatives should target only those students who struggle in larger classroom settings and would benefit from individualized instruction in state-mandated courses.**

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Recent Research on Class Sizes in North Carolina

Author	Title	Type, Institution and Year	Sample	Findings
Adam Felix Nwankwo	“School-Based Accountability Indicators as Predictors of Academic Performance and Adequate Yearly Progress”	Doctoral Dissertation, George Washington University, 2009	369 public schools in NC	Class size and classes taught by highly qualified teachers had a relatively low positive, albeit a statistically significant, relationship with academic performance in reading and mathematics.
Jeffrey B. Maples	“An Analysis of the Effects of Class Size on Student Achievement in Selected Middle Schools in the Sandhills Region of North Carolina”	Doctoral Dissertation, Fayetteville State University, 2009	1,329 sixth grade classes, 1,548 seventh grade classes, and 1,425 eighth grade classes in 33 middle schools in the Sandhills Region of NC	Students that were enrolled in the large class size had a significant higher mean score in reading and mathematics than students enrolled in small size classes and a slightly higher mean score than students enrolled in medium size classes. The only exception was in 6 th grade reading where there were no significant differences.
Jenna-Marie Caron Nelson	“The Effect Of Class Size On A Teacher’s Job Satisfaction In A Southeastern Urban LEA”	Master’s Thesis, UNC-Chapel Hill, 2008	96 elementary schools in a large NC school district	Overall, the effect of class size, school size, percentage of ELL students, percentage of ED students, percentage of minorities, and teachers’ perceptions about their class sizes were not found to have a significant relationship to teacher job retention.
Metis Associates	“Third Annual Evaluation Report, High Priority Schools Initiative: 2004 – 2005”	Research Report, N/A, 2005	45 high priority schools in NC	From the first to the fourth year of the program, fewer schools met their ABC growth targets and even fewer made Adequate Yearly Progress (AYP). In addition, small class sizes failed to produce significant gains in reading performance.

Average Class Size in NC Public Schools, 2010-2011



Source: NC State Level Report Card



Federal Education Policy

Before passage of the Elementary and Secondary Education Act (ESEA) in 1965, the United States Congress generally adhered to the principle that the federal government had no authority to undertake functions and duties not enumerated in the U.S. Constitution. Because the power to fund or regulate public education is not expressly stated in the constitution, Congress relied on state and local governments to superintend the education of the citizenry. As an acknowledgement of this fact, many states, including North Carolina, included passages on public education in their laws and state constitutions.

Since the rise of federal activism in the 1960s, Congress has continued to enlarge the federal government's financial and regulatory role in public education. At no time before had this role been larger, or more controversial, than at the reauthorization of ESEA in 2001, also known as No Child Left Behind. Recently, Congress increased federal involvement even further through passage of the American Recovery and Reinvestment Act (ARRA), Race to the Top (RTTT), and the Education Jobs Fund (EduJobs).

Key Facts

- Historically, federal funds were designed to supplement state funding for special needs children (IDEA), low-income students (Title I), child nutrition (National School Lunch Program), and vocational education (Perkins). Nearly 90 percent of all federal funds are earmarked for special needs children, low-income children, and child nutrition programs.
- In 2009, North Carolina received a share of funds from the American Recovery and Reinvestment Act (ARRA), or stimulus bill, that provided approximately \$1.4 billion in temporary aid to our state's public schools.
- In 2010, North Carolina was selected to receive a four-year, nearly \$400 million Race to the Top

(RTTT) grant. The money will be used to develop standards and assessments, increase the quality of school-based personnel, construct a data system, and raise student achievement at low-performing schools.

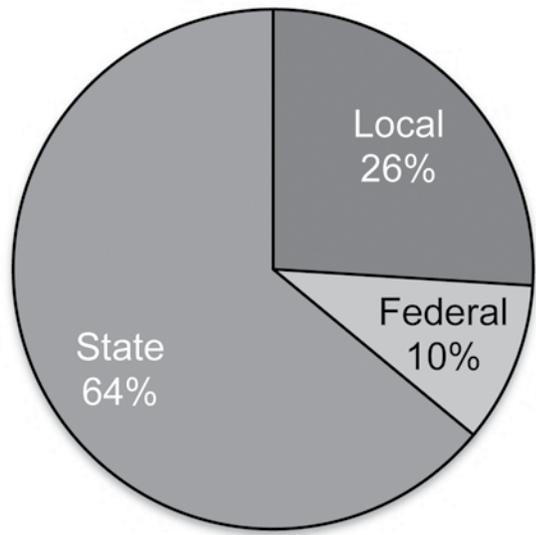
- School districts and charter schools shared nearly \$300 million in temporary Education Jobs Fund (EduJobs) grants to support nearly 5,500 teaching positions. EduJobs funded school-based personnel positions in 2010-2011 and 2011-2012 only.
- Before passage of the ARRA, federal funds typically supported approximately 10 percent of North Carolina's public school budget. During the 2009-2010 school year, the addition of stimulus funds increased the federal share to 15 percent. With the addition of EduJobs funding a year later, it rose to 16 percent. Between 2009 and 2011, North Carolina's public schools shifted funding for 6 percent of their K-12 education budget from state and local sources to temporary federal funds.

Recommendations

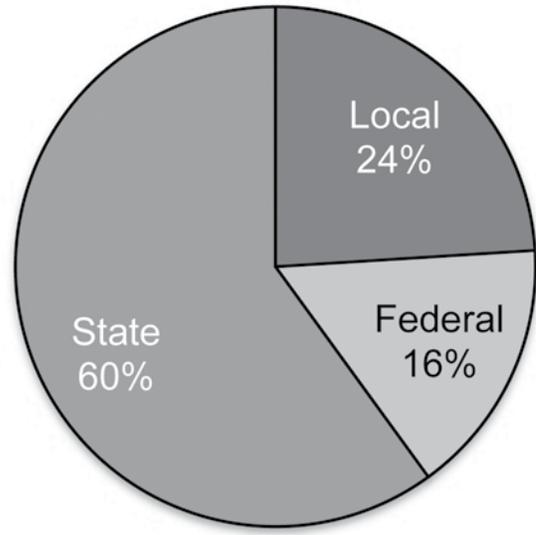
1. **Recognize that there is no such thing as “free money” from the federal government. Ever.**
2. **Refuse to accept any federal grant that imposes an extraordinary burden on school administrators or interferes with the duties and responsibilities of classroom teachers.**
3. **Use federal funds prudently.** For example, school districts should have rejected the invitation to use temporary ARRA and EduJobs dollars to fund permanent teaching positions.

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Source of Expenditures for NC Public Schools, 2008-09



Source of Expenditures for NC Public Schools, 2010-11



Source: NC Department of Public Instruction

Overview of American Recovery and Reinvestment Act of 2009 (ARRA) Funding

Program Name:	Title I, Part A ARRA	Title I ARRA School Improvement 1003(a)	ARRA School Improvement 1003(g)	ARRA - IDEA Part B, section 611	ARRA - IDEA Part B, section 619	ARRA - Education Technology	ARRA - Education Technology	ARRA - McKinney Vento Homeless
Total Funding Expected:	\$247,000,000	\$ 10,000,000	\$ 77,000,000	\$314,000,000	\$ 12,000,000	\$6,200,000	\$9,300,000	\$1,600,000
Type of Grant:	Formula	Formula	Competitive	Formula	Formula	Formula	Competitive	Application
Expiration Date:	9/30/11	9/30/11	9/30/13	9/30/11	9/30/11	9/30/12	9/30/12	9/30/11

Program Name:	Child Nutrition Equipment	ARRA Education Stabilization Funds	Construction: Qualified Zone Academy Bonds	Construction: Qualified School Construction Bonds	National Clean Diesel Funding Assistance Program	Education Jobs Fund	Race to the Top
Total Funding Expected:	\$ 3,000,000	\$ 778,000,000	\$ 65,000,000	\$ 187,000,000	\$ 509,000	\$ 297,000,000	\$ 400,000,000
Type of Grant:	Competitive	Formula	Competitive	Application	Partnership w/4 LEAs	Formula	Formula
Expiration Date:	9/25/09	9/30/11	N/A	12/31/09	9/30/10	9/30/12	9/23/14

Source: NC Department of Public Instruction



Child Care

North Carolina's child care subsidy programs represent a fraction of the nearly \$18 billion operating budget managed by North Carolina's Department of Health and Human Services. Amid concerns about the state's economic woes, however, some have begun to question whether government should spend hundreds of millions of dollars a year to subsidize child care expenses for a relatively small number of children.

Key Facts

- The Division of Child Development and Early Education of the Department of Health and Human Services (DHHS) oversees the Subsidized Child Care Program, but county social services departments actually administer the subsidy program. A third entity, the NC Child Care Commission, adopts regulations that ensure DHHS compliance with legislation passed by the NC General Assembly.
- The Subsidized Child Care Program provides vouchers to eligible families for child care services in daycare centers and family homes. Families typically contribute between 8 and 10 percent of the cost. Parent fees depend on income, family size, and the cost of child care services provided.
- About one-third of the funding for the Subsidized Child Care Program comes from state sources, including Smart Start. Federal funding makes up the remainder. As of January 2012, the total budget for child care subsidies exceeded \$400 million.
- During the 2011-2012 year, nearly 85,000 children received subsidized child care services from one of North Carolina's 4,900 regulated child care centers and 3,300 regulated family child care homes. This represents a third of the 260,000 children enrolled in regulated facilities throughout North Carolina.
- The child care subsidy program requires families to meet both situational and income eligibility requirements. Eligible families include 1) those who have a parent who is attempting to find work or is enrolled in an educational program, 2) those who have a child with developmental needs, or 3) those who receive child welfare services.

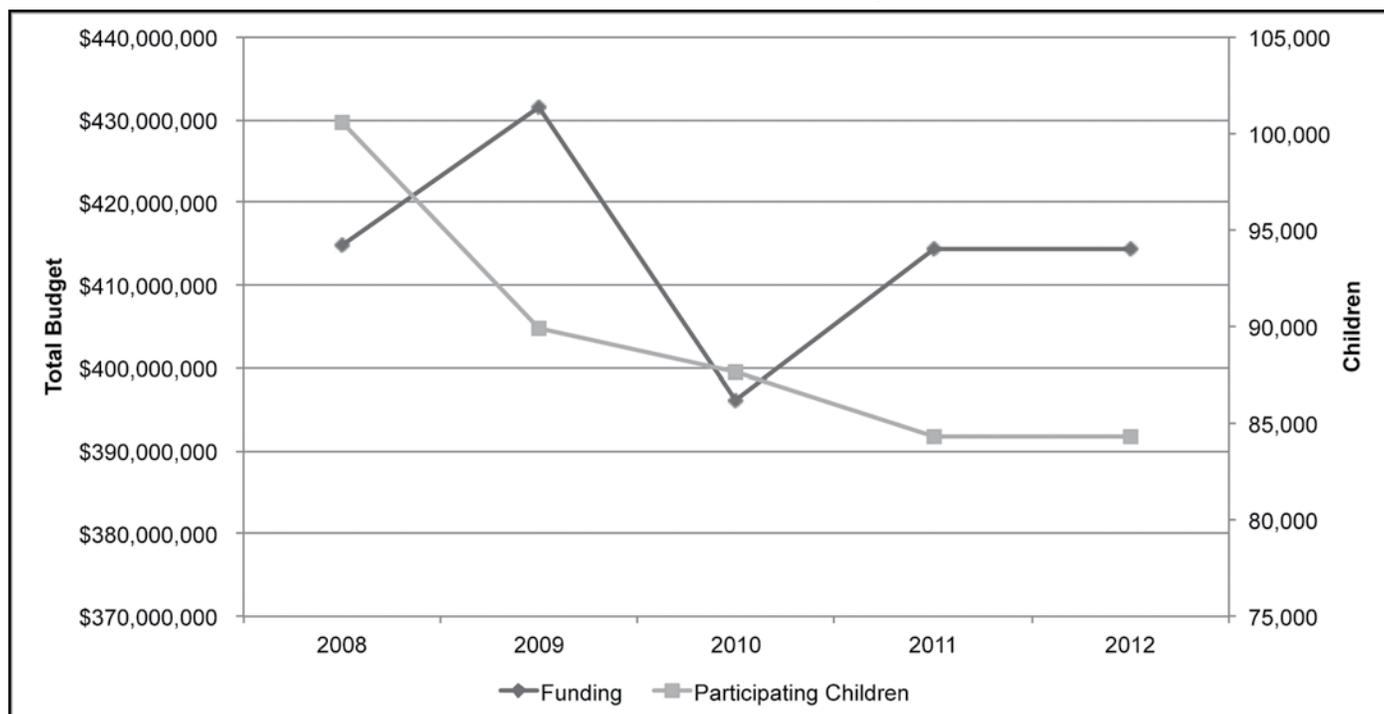
- The Division of Child Development uses a star rating system to evaluate the quality of all licensed child care centers and family child care homes in North Carolina. The lowest quality child care facility receives one star. The highest quality facility receives five stars.

Recommendations

1. **Child care subsidy programs should be eliminated in favor of a refundable tax credit for the families of preschool children.** In North Carolina, most preschoolers do not spend their days in centers or homes where paid staff care for them. Stay-at-home mothers, working mothers and fathers, relatives, and neighbors supply the vast majority of care provided to preschoolers, and on a non-paid basis. A refundable tax credit would provide a small measure of relief to these families.
2. **Parents should also be able to make tax-deductible contributions into Educational Savings Accounts for use in paying preschool expenses or accumulating assets for the future educational needs of their children.** Families are by far the most important providers of preschool services. Educational Savings Accounts would promote investment in the developmental and educational needs of children.
3. **Policymakers should limit regulation of day-care operations to health and safety requirements only.** Parents should make their own decisions about the trade-offs between price and child-staff ratios or qualifications.

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North Carolina Child Care Subsidy, 2008-2012



Total Combined Child Care Funding by County, April 2012

Alamance	\$ 6,376,214	Cumberland	\$ 17,294,099	Johnston	\$ 6,277,722	Randolph	\$ 5,527,364
Alexander	\$ 1,245,366	Currituck	\$ 764,039	Jones	\$ 550,059	Richmond	\$ 2,157,198
Alleghany	\$ 517,907	Dare	\$ 1,459,719	Lee	\$ 2,400,858	Robeson	\$ 7,911,466
Anson	\$ 1,158,369	Davidson	\$ 5,707,225	Lenoir	\$ 2,727,318	Rockingham	\$ 3,385,562
Ashe	\$ 1,443,829	Davie	\$ 1,401,429	Lincoln	\$ 2,090,521	Rowan	\$ 4,780,061
Avery	\$ 528,761	Duplin	\$ 2,917,077	Macon	\$ 1,332,997	Rutherford	\$ 2,837,500
Beaufort	\$ 2,282,399	Durham	\$ 14,743,144	Madison	\$ 792,857	Sampson	\$ 2,336,028
Bertie	\$ 828,559	Edgecombe	\$ 2,823,405	Martin	\$ 1,337,836	Scotland	\$ 1,669,402
Bladen	\$ 1,196,161	Forsyth	\$ 14,123,127	Mcdowell	\$ 1,688,335	Stanly	\$ 2,540,501
Brunswick	\$ 4,528,038	Franklin	\$ 2,170,755	Mecklenburg	\$ 44,623,143	Stokes	\$ 1,336,587
Buncombe	\$ 9,911,009	Gaston	\$ 8,211,631	Mitchell	\$ 655,660	Surry	\$ 2,581,003
Burke	\$ 3,257,961	Gates	\$ 362,248	Montgomery	\$ 1,002,656	Swain	\$ 954,244
Cabarrus	\$ 5,413,270	Graham	\$ 539,141	Moore	\$ 2,655,218	Transylvania	\$ 999,015
Caldwell	\$ 3,571,950	Granville	\$ 1,872,663	Nash	\$ 2,806,979	Tyrrell	\$ 184,888
Camden	\$ 219,813	Greene	\$ 735,752	New Hanover	\$ 8,413,571	Union	\$ 6,610,185
Carteret	\$ 2,069,313	Guilford	\$ 22,325,540	Northampton	\$ 893,706	Vance	\$ 2,360,514
Caswell	\$ 811,789	Halifax	\$ 2,381,928	Onslow	\$ 9,665,403	Wake	\$ 36,280,134
Catawba	\$ 6,939,546	Harnett	\$ 4,634,656	Orange	\$ 4,752,067	Warren	\$ 864,363
Chatham	\$ 2,583,908	Haywood	\$ 2,906,144	Pamlico	\$ 622,238	Washington	\$ 818,233
Cherokee	\$ 1,532,821	Henderson	\$ 3,970,141	Pasquotank	\$ 1,821,638	Watauga	\$ 1,069,080
Chowan	\$ 687,789	Hertford	\$ 1,092,339	Pender	\$ 1,838,649	Wayne	\$ 4,673,682
Clay	\$ 541,325	Hoke	\$ 2,106,596	Perquimans	\$ 528,563	Wilkes	\$ 2,000,681
Cleveland	\$ 4,381,284	Hyde	\$ 221,070	Person	\$ 1,540,311	Wilson	\$ 4,002,893
Columbus	\$ 2,601,566	Iredell	\$ 5,087,520	Pitt	\$ 7,930,022	Yadkin	\$ 881,063
Craven	\$ 5,222,498	Jackson	\$ 2,041,649	Polk	\$ 709,976	Yancey	\$ 425,928
						Total	\$ 400,590,360

Source: NC Department of Health and Human Services, Division of Child Development and Early Education



Childhood Health

As childhood obesity rates continue to rise, the debate over the role of public schools in promoting healthy lifestyles has intensified. Public health advocates contend that schools can curb obesity by banning the sale of junk food and soda. Their more radical proposals include taxes on unhealthy foods and beverages and zoning regulations that prohibit certain businesses from operating near schools. Over the last five years, however, research studies have reached a near consensus – stricter laws and regulations imposed by government officials do not reduce childhood obesity rates in any significant way.

Key Facts

- Public school students often respond to bans on soda by purchasing different kinds of sugary drinks, like juices and sports drinks, from school vending machines. Yet even schools that ban all sugar-sweetened beverages from campus will not significantly reduce students' consumption of unhealthy drinks. Kids can simply bring them from home.
- The consumption of unhealthy foods and drinks is inelastic. In other words, taxing certain food and beverage items will not necessarily reduce consumption of them. Consumers, particularly children, may simply shift their consumption preferences to other unhealthy, non-taxed foods and drinks. This problem raises the difficulty of defining which foods and drinks should be subject to taxes and regulations by state and federal governments.
- So-called “fat taxes” and regulations are unpopular with consumer groups, particularly those who consume unhealthy foods and beverages in moderation and generally lead healthy lifestyles.
- A study from the January 2012 issue of *Sociology of Education* examined junk food consumption and weight changes in nearly 20,000 public middle school students. Penn State University researchers found that the percentage of overweight or obese students did not rise in concert with the increased availability of unhealthy foods and snacks. In fact, the percentage of overweight and obese students decreased slightly as the availability of junk food increased.
- In 2011, *The Archives of Pediatrics and Adolescent Medicine* published a study that sought to find a link between obesity and beverage consumption in schools.

A team of researchers from the University of Illinois at Chicago examined the beverage intake of nearly 6,000 public middle school students in 40 states. They concluded that soda bans in middle schools did not significantly reduce students' consumption of sugary drinks.

- Research suggests that banning advertising or modifying land usage to create healthy “built environments” are ineffective deterrents. In a 2011 *Canadian Medical Association Journal* study, Mark Eisenberg and his colleagues reviewed the literature on advertising and obesity and acknowledged, “A true causal association with regards to neighborhood-associated risk factors and obesity has yet to be clearly established.” The authors concluded that “the link between poor health outcomes and advertising of unhealthy foods is still unclear.”
- Researchers have yet to establish a causal association between health outcomes and restaurant zoning restrictions. For example, a 2011 study published in *BMC Public Health* found no relationship between overweight or obese children and the proximity of fast food restaurants and supermarkets to their schools.
- A study published in the September 2008 issue of the *American Journal of Preventative Medicine* hypothesized that there was a relationship between obesity-related eating behaviors and the presence of snack and soda machines in schools. Much to their surprise, they found little relationship between the two.

Recommendations

1. **Federal, state, and local governments should not impose arbitrary taxes, regulations, or prohibitions on the consumption of certain foods and beverages.** Rather, we should remain dependent on parents and guardians to instill the values of a healthy and active lifestyle in their children.
2. **Public schools should ensure that all children participate in health and physical education activities several times a week.** Additionally, public schools should invite all students to use sports and recreational facilities before school, after school, and on weekends.

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Early Childhood Education

One of the most controversial issues in the past few years has been the growing role of the state in providing preschool opportunities to North Carolina children. All too often, proponents of state-run early childhood education programs spend more time tugging heartstrings than recommending sound public policy.

Key Facts

- Smart Start is a public/private program that serves children from birth to five years old. The NC Partnership for Children and 77 Local Partnerships oversee the program, which has existed since 1993. Smart Start provides childcare subsidies, teacher training, health screenings, and support for families regardless of income. Total Local Partnership expenditures neared \$177 million during the 2010-11 school year.
- The Division of Child Development and Early Education of the Department of Health and Human Services (DHHS) oversees two large state programs – NC Pre-K (formerly More at Four) and the Subsidized Child Care Program – and three federal pre-kindergarten programs – Preschool for Exceptional Children, Title I Preschool, and Head Start.
- During the 2011-2012 school year, NC Pre-K received \$128 million in state and lottery funds. The program served approximately 25,000 children in 1,190 public, private, and Head Start sites.
- The maximum gross annual income for initial eligibility for NC Pre-K is 75 percent of the state median income or around \$50,000 for a family of four. NC Pre-K may enroll up to 20 percent of children defined as “at-risk,” regardless of income. “At-risk” children include those who have a disability, a chronic health condition, a developmental need, Limited English Proficiency, or one or more parents in the military.
- Preschool for Exceptional Children is a program supported by state and federal funds that provides pre-kindergarten services for special needs children. Most participating students have a developmental delay, speech impairment, or Autism Spectrum Disorder, but participation is not limited to children with these conditions. During the 2011-2012 school year, the \$62 million program served over 15,500 children.
- School districts and schools that choose to participate in Title I Preschool set aside a portion of their federal Title I funding to provide pre-kindergarten programs for at-risk four-year-olds. In 2010-11, NC districts

allocated \$58.8m to serve nearly 9,400 children.

- The federal Head Start program is the largest federal pre-kindergarten initiative in NC. The U.S. DHHS awarded NC Head Start nearly \$170 million in 2011-2012. Of the 20,901 children served during that school year, 63 percent were four years old. The program provides education, nutrition, counseling, and health services for children from birth to five years old.
- A 2010 study of Head Start conducted by the U.S. DHHS concluded that cognitive and social benefits of the program largely disappear by the end of first grade.
- The Carolina Abecedarian Project study tracked the academic performance and occupational status of two groups of low-income students from infancy to age 30. The latest evaluation of the program found that those who received pre-kindergarten services were more likely to have a college education and steady employment and less likely to receive public assistance than those who did not receive the intervention. However, it showed no significant difference between the two groups on measures of income and criminal activity. Previous studies of cognitive outcomes revealed that the gap between the two groups began to narrow or “fade out” as students entered high school.

Recommendations

1. **Smart Start and other subsidy programs for pre-school expenses should be eliminated in favor of a refundable tax credit.** For a smaller subset of desperately poor preschoolers who lack functioning parents, a carefully designed state intervention may be justified.
2. **NC Pre-K eligibility requirements should be narrowed to focus resources primarily on low-income children.** This would ensure that NC Pre-K prioritizes the educational needs of North Carolina’s poorest.
3. **A qualified, independent research firm should conduct longitudinal evaluations of children who participated in Smart Start and NC Pre-K.** Taxpayers and policymakers should have access to longitudinal research studies that evaluate multiple outcome measures for children who have been served by state pre-kindergarten programs.

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Teaching Profession

No system of public education can thrive without a high-quality teacher workforce. The problem is that state education bureaucracies enforce certification and licensure rules that seldom distinguish excellent teachers from poor ones. Indeed, a large body of research shows that certification status, advanced degrees, years of experience, education school courses, and teacher test scores are unreliable indicators of teacher quality. Unfortunately, the state continues to use these criteria to determine who can and cannot teach in North Carolina's public schools, as well as how much we pay them.

Key Facts

- Since 1992-1993, teacher pay has increased 119 percent. This outpaced the 53 percent increase for state employee salaries and the 66 percent increase in the Consumer Price Index.
- According to the state salary schedule for the 2011-2012 school year, teachers on the typical 10-month contract had a base salary range of \$30,430 to \$67,280. The average teacher salary was \$45,947 during that school year.
- Position on the state salary schedule depends on the number of years of experience and credentials earned by the teacher. In addition to the base salary, many teachers receive a salary supplement from the local school district. The average salary supplement was nearly \$3,500 per teacher in 2011. Eleven school districts provide no local salary supplement. Wake County Schools offers the largest average supplement at just over \$6,000 per teacher.
- Matching benefits for teachers add 7.65 percent for social security, 13.12 percent for retirement, and \$4,931 for hospitalization to the 2011-2012 base salary. To put a value to the benefits package, the average teacher receives nearly \$13,000 in annual social security, retirement, and hospitalization benefits.
- During the 2011-2012 school year, North Carolina public school districts employed nearly 94,000 teachers. Districts averaged one teacher for every 14.6 students. Hyde County had the lowest teacher/student ratio, while Mooresville City Schools had the highest.
- The state's teacher evaluation system addresses six areas -- leadership, fairness, content knowledge, instructional abilities, self-evaluation, and student performance. Evaluators rated teachers in each area by a five-category scale: not demonstrated (lowest), developing, proficient, accomplished, and distinguished (highest).

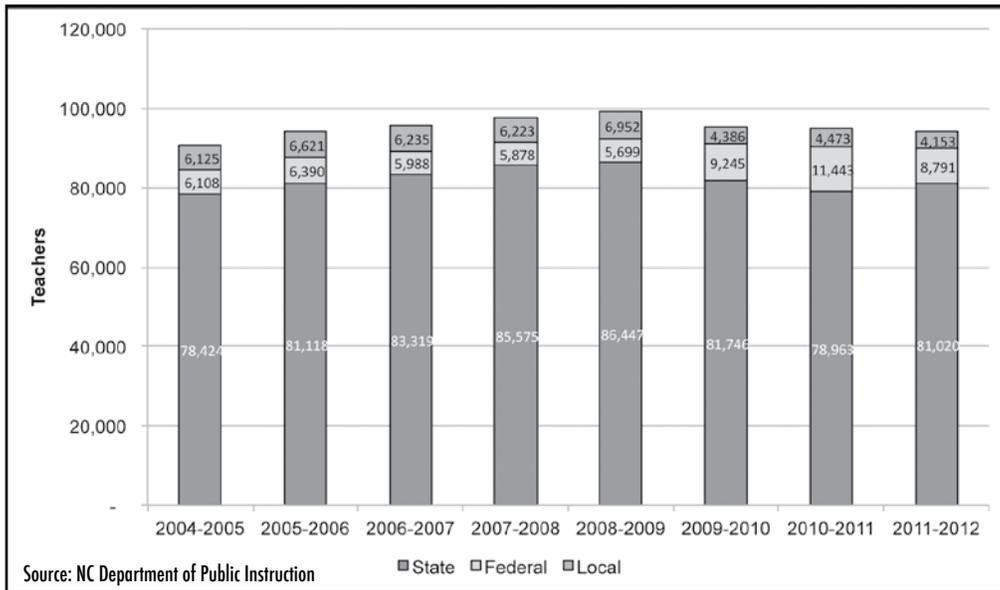
- Value-added analysis is the most accurate teacher evaluation tool available. This method uses standardized test scores to project the future performance of individual students based on their past performance. The difference between the projected and actual performance of students determines the value added by the teacher. North Carolina's public schools calculate and record value-added scores for teachers in a computer system called EVAAS (Education Value Added Assessment System). State officials have not released EVAAS data to the public.
- As of the 2010-2011 school year, 99 percent of North Carolina's teachers were fully licensed by the state and over 19,000 teachers (18 percent of all public school teachers) obtained certification from the National Board for Professional Teaching Standards (NBPTS).
- During the 2010-2011 school year, 72 percent of teachers had a bachelor's degree, 26 percent had a master's degree, and 2 percent had a vocational, advanced, doctoral, or no degree.

Recommendations

1. **Broaden the teacher applicant pool by loosening or eliminating certification and licensure requirements.** Although the state puts a premium on licensure, advanced degrees, and National Board Certification (NBPTS), there is little evidence that these factors guarantee good teachers or raise student performance.
2. **Implement a merit pay system for teachers that will pay a portion of their salary based on the value that they add to their students' academic performance.** North Carolina's salary scale is based on years of experience and credentials, neither of which are sound indicators of teacher quality.
3. **Improve the quality of education school graduates by raising program admissions standards, increasing subject-area course requirements, and providing rigorous instruction in research-based teaching methods.**

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Teaching Positions by Funding Source, 2004-2012



Student:Teacher Ratios by County

School District	Total Teachers	Students	Student:Teacher Ratio
Alamance-Burlington Schools	1,522	22,182	14.6
Alexander County Schools	343	5,434	15.8
Alleghany County Schools	120	1,416	11.8
Anson County Schools	255	3,708	14.5
Ashe County Schools	232	3,122	13.5
Asheboro City Schools	342	4,714	13.8
Asheville City Schools	318	3,990	12.5
Avery County Schools	149	2,131	14.3
Beaufort County Schools	509	6,841	13.4
Bertie County Schools	188	2,661	14.2
Bladen County Schools	349	5,091	14.6
Brunswick County Schools	748	12,038	16.1
Buncombe County Schools	1,587	25,439	16.0
Burke County Schools	788	13,005	16.5
Cabarrus County Schools	1,839	29,078	15.8
Caldwell County Schools	825	12,464	15.1
Camden County Schools	126	1,916	15.2
Carteret County Schools	605	8,377	13.8
Caswell County Schools	202	2,842	14.1
Catawba County Schools	1,031	17,104	16.6
Chapel-Hill/Carrboro City Schools	895	11,860	13.3
Charlotte-Mecklenburg County Schools	8,738	136,525	15.6
Chatham County Schools	556	8,003	14.4
Cherokee County Schools	256	3,360	13.1
Clay County Schools	96	1,329	13.8
Cleveland County Schools	1,121	15,585	13.9
Clinton City Schools	214	2,969	13.9
Columbus County Schools	424	6,384	15.1
Craven County Schools	911	14,749	16.2
Cumberland County Schools	3,470	51,044	14.7
Currituck County Schools	240	3,894	16.2
Dare County Schools	372	4,848	13.0
Davidson County Schools	1,191	20,141	16.9
Davie County Schools	439	6,465	14.7
Duplin County Schools	610	9,154	15.0
Durham County Schools	2,244	32,176	14.3
Edenton-Chowan County Schools	162	2,261	14.0
Edgecombe County Schools	446	7,020	15.7

School District	Total Teachers	Students	Student:Teacher Ratio
Elkin City Schools	74	1,173	15.9
Forsyth County Schools	3,394	52,277	15.4
Franklin County Schools	560	8,559	15.3
Gaston County Schools	1,864	30,896	16.6
Gates County Schools	136	1,778	13.1
Graham County Schools	88	1,189	13.5
Granville County Schools	523	8,525	16.3
Greene County Schools	221	3,188	14.4
Guilford County Schools	4,943	71,324	14.4
Halifax County Schools	252	3,630	14.4
Harnett County Schools	1,181	19,393	16.4
Haywood County Schools	535	7,636	14.3
Henderson County Schools	899	13,405	14.9
Hertford County Schools	218	3,025	13.9
Hickory City Schools	289	4,381	15.2
Hoke County Schools	567	7,941	14.0
Hyde County Schools	62	570	9.2
Iredell-Statesville Schools	1,327	21,337	16.1
Jackson County Schools	247	3,599	14.6
Johnston County Schools	2,155	32,422	15.0
Jones County Schools	91	1,125	12.4
Kannapolis City Schools	375	5,194	13.9
Lee County Schools	614	9,707	15.8
Lenoir County Schools	597	9,044	15.1
Lexington City Schools	225	2,999	13.3
Lincoln County Schools	748	11,765	15.7
Macon County Schools	344	4,326	12.6
Madison County Schools	185	2,534	13.7
Martin County Schools	276	3,686	13.4
McDowell County Schools	440	6,414	14.6
Mitchell County Schools	160	2,058	12.9
Montgomery County Schools	296	4,111	13.9
Moore County Schools	786	12,395	15.8
Mooresville City Schools	318	5,531	17.4
Mount Airy City Schools	114	1,636	14.4
Nash-Rocky Mount Schools	1,072	16,471	15.4
New Hanover County Schools	1,633	24,541	15.0
Newton-Conover City Schools	196	2,925	14.9
Northampton County Schools	174	2,206	12.7

School District	Total Teachers	Students	Student:Teacher Ratio
Onslow County Schools	1,436	24,236	16.9
Orange County Schools	527	7,310	13.9
Pamlico County Schools	108	1,387	12.8
Pasquotank County Schools	439	5,812	13.2
Pender County Schools	489	8,158	16.7
Perquimans County Schools	124	1,719	13.9
Person County Schools	342	4,820	14.1
Pitt County Schools	1,548	23,208	15.0
Polk County Schools	175	2,293	13.1
Randolph County Schools	1,163	18,471	15.9
Richmond County Schools	468	7,603	16.2
Roanoke Rapids City Schools	192	2,969	15.5
Robeson County Schools	1,539	23,551	15.3
Rockingham County Schools	863	13,537	15.7
Rowan-Salisbury County Schools	1,361	20,011	14.7
Rutherford County Schools	579	8,744	15.1
Sampson County Schools	553	8,511	15.4
Scotland County Schools	442	6,094	13.8
Stanly County Schools	636	8,931	14.0
Stokes County Schools	483	6,799	14.1
Surry County Schools	562	8,432	15.0
Swain County Schools	133	1,934	14.5
Thomasville City Schools	164	2,412	14.7
Transylvania County Schools	253	3,535	14.0
Tyrrell County Schools	52	566	10.9
Union County Schools	2,356	39,643	16.8
Vance County Schools	512	6,796	13.3
Wake County Schools	9,809	144,896	14.8
Warren County Schools	182	2,408	13.2
Washington County Schools	142	1,700	12.0
Watauga County Schools	311	4,377	14.1
Wayne County Schools	1,221	19,107	15.6
Weldon City Schools	83	996	12.0
Whiteville City Schools	148	2,221	15.0
Wilkes County Schools	617	9,942	16.1
Wilson County Schools	746	12,133	16.3
Yadkin County Schools	388	5,723	14.8
Yancey County Schools	176	2,356	13.4

Source: NC Department of Public Instruction



Higher Education Policy

North Carolina takes great pride in her university system. Nevertheless, the persisting recession is affecting all aspects of the state's economy, including UNC and its students. People who enrolled in UNC schools just a few years ago now face a daunting duo of uncertain job prospects and very real student loan payments.

For years thoughtful critics inside and outside academe have warned that too many students aren't academically engaged, too many courses and degree programs offer "brain candy" and fail to impart useful knowledge, too many students drop out or need six-plus years to earn a four-year degree, and all of the above leave too many with heavy loan debts but little to nothing to show for it.

Key Facts

- UNC schools appear to be raising enrollment standards. Higher standards help channel students to better academic fits, decreasing dropouts, student disengagement, and major-switching to less-intense fields.
- Better quality instruction would also help decrease negative student outcomes, but research pressures incentivize universities to limit professors' instruction time, leaving more undergraduate teaching duties in the hands of graduate students.
- A 2011 study found UNC faculty instructional workloads falling below state standards. Worse, a sizeable proportion of courses taught by faculty enrolled only one or two students.
- From 1993 to 2010, the number of administrative and professional (i.e., noninstructional) staff per 100 students in UNC system schools grew by 67 percent.
- Nearly two-thirds of N.C. high school graduates enrolled in community colleges required one or more remedial courses in math, English, or reading.
- A recent *Bloomberg Businessweek* study of return on investment in higher education ranked North Carolina 42nd among state university systems. There is no way at present to determine how much educational value a student gets from his time in a UNC school.
- Need-based financial aid offered by the state is on the increase, including need-based aid to students at private institutions in the state. Those programs currently include no consideration of whether the recipient can handle university-level coursework.
- A 2010 Supreme Court decision in *CLS v. Martinez* essentially allows universities to apply nondiscrimina-

tion codes against student religious groups so that, instead of hailing a diversity of student groups, schools would enforce ideology conformity within each. UNC-Chapel Hill has a history of trying to subvert campus religious groups with just such a tactic (see *Alpha Iota Omega Christian Fraternity v. Moeser*, 2006).

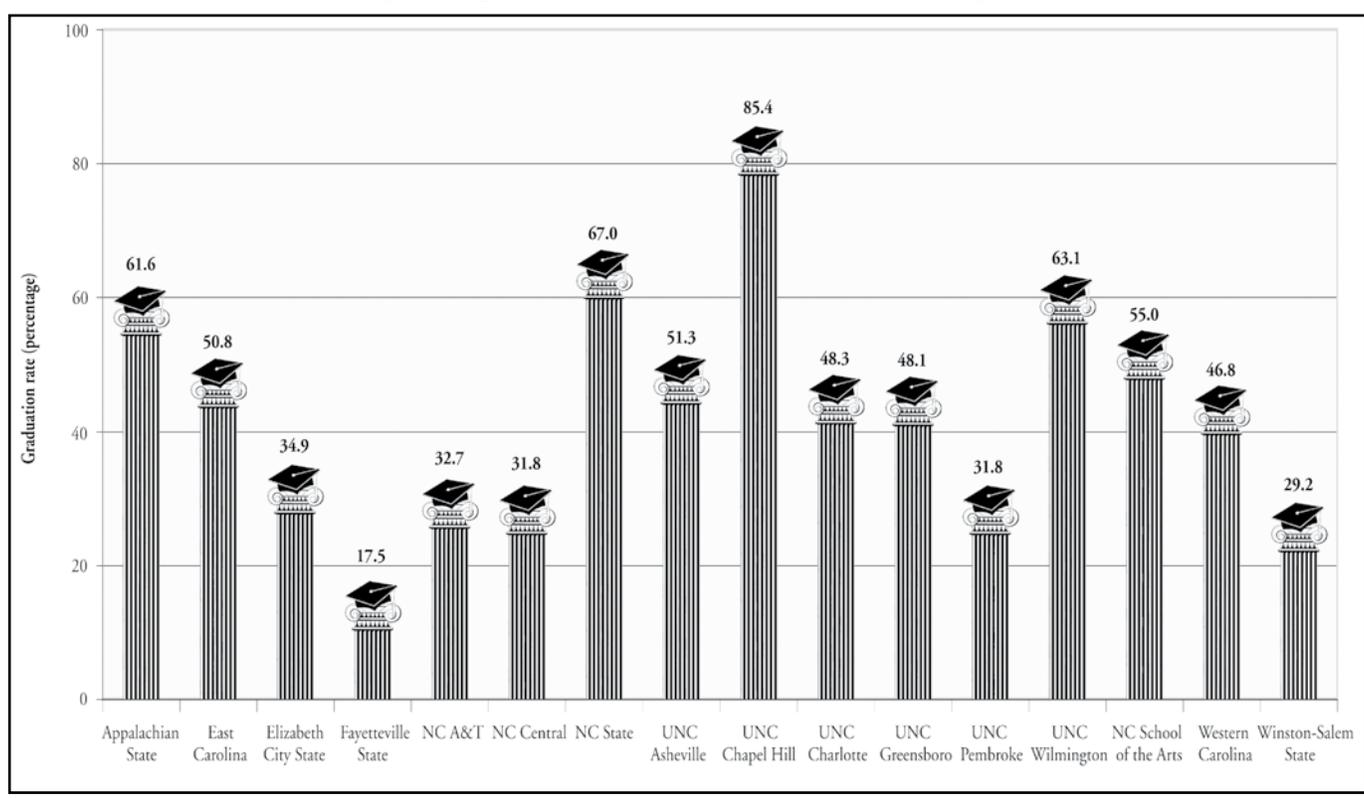
- There is a worrisome trend in academia to require students to adopt ideological, anti-religious doctrine as a prerequisite to obtaining a degree in certain disciplines such as social work, counseling, and nursing.
- In response, legislators in Ohio and Tennessee have passed bills to protect religious liberty on campus.
- The North Carolina Constitution contains an arguably stronger protection of religious liberty than does the First Amendment to the U.S. Constitution.

Recommendations

1. **Cut costs responsibly, without harming the universities' primary mission of educating students:**
 - Throttle back noninstructional staff.
 - Provide stricter enrollment standards for more academically prepared students and have community colleges offer remedial education. (Public schools must address the other side of this equation.)
 - Add merit components for need-based aid.
2. **Enable schools to deliver education more effectively:**
 - Raise faculty instructional workloads.
 - Relax research and publication standards, especially in less research-intensive disciplines such as humanities and social sciences, to allow faculty more time for teaching.
 - Seek and means-test ways to measure educational value added at the university or department level.
 - Return to a more rigorous core curriculum and pare back on ancillary "candy" courses.
3. **Uphold religious liberty and free association on campus.**
4. **Require public universities to be transparent in their finances as well as course syllabi.**

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Five-year graduation rates in the UNC system



Sample UNC System Faculty Courseload Per Semester, by Carnegie Classification

Classification (schools sampled)	Faculty in sample	Courses taught	Faculty courseload	Courses with only 1-2 students (supervised doctoral dissertations, etc.)	Percent of faculty-taught courses with only 1-2 students	Faculty courseload (excluding dissertations and other courses with under 3 students)	UNC/State standard courseload for faculty
Research I (UNC-Chapel Hill, UNC-Greensboro)	95	215	2.26	49	23%	1.75	2
Master's (Appalachian)	68	222	3.26	62	28%	2.35	3
Baccalaureate (UNC-Asheville)	12	32	2.67	3	9%	2.42	4

Source: Jay Schalin, A Common-Sense Look at UNC Faculty Workloads, John William Pope Center for Higher Education Policy, June 2011, www.popecenter.org/inquiry_papers/article.html?id=2530.



Regulatory Reform

Much has changed for the good concerning North Carolina's regulatory environment with the passage (and override of Gov. Bev Perdue's puzzling veto) of the Regulatory Reform Act (RRA) of 2011, tort reform, medical malpractice reform, and workers' compensation reform. Nevertheless, given the state's history for imposing onerous regulatory burdens, much more remains to be done.

Key Facts

- Surveys of small business leaders consistently find regulatory burden as a major obstacle to growth and job creation. Government regulations force businesses to bear compliance costs and legal fees, taxing man-hours without production.
- State agencies' rule-making power is legislative power delegated by the legislature to the executive branch.
- The Rules Review Commission is tasked with reviewing regulations and keeping agencies from exceeding their authority. The commission's practical authority is highly limited, however.
- Under RRA, state environmental rules can be no more stringent than federal rules without legislative action.
- RRA requires the state to review existing rules and encourages the elimination of those that are burdensome, outdated, unnecessary or vague.
- For disputes between a regulated party and a state environmental agency that are heard by the state Office of Administrative Hearings (OAH), RRA changed the way appeals were handled. Before RRA, if the OAH decision went against the agency, the agency could simply overrule it. Now both parties have to appeal to Superior Court. But this reform applies only to environmental agencies. Other state agencies can still overrule any unfavorable OAH decision.
- RRA requires agencies to provide cost estimates for many kinds of rules as well as give at least two alternatives to any proposal with "substantial economic impact" (over \$500,000). Those requirements are not, however, substitutes for true cost/benefit analysis.
- The federal government has required cost/benefit analysis of proposed rules for nearly 40 years. Also, 32 states require periodic review of existing state rules.
- 35 states require agencies to conduct "small business flexibility analysis" to test whether rules have a disproportionate impact on small businesses.

- The legislature has passed many deleterious measures without regard for costs outweighing benefits. E.g., the state's renewable energy portfolio standard hikes electricity costs, its Clean Smokestacks Bill costs ratepayers over \$3.2 billion, its high number of insurance mandates increases health insurance costs, and its high number of workers requiring occupational licenses (including barbers, auctioneers, and librarians) raises the cost of doing business and hurts job creation.
- Overregulation's costs frequently go unseen. A case in point is North Carolina's unique automobile insurance system. Five players influence auto insurance rates in North Carolina: Rate Bureau, insurance commissioner, Reinsurance Facility, court system, and private insurers. This system disadvantages safe drivers but helps protect insurance companies.
- A hidden tax — one auto insurers are forbidden from disclosing on statements — supports the mandated Reinsurance Facility, in which private insurers dump "risky" drivers. That surcharge on every auto insurance policy averages to about 6 percent a year.

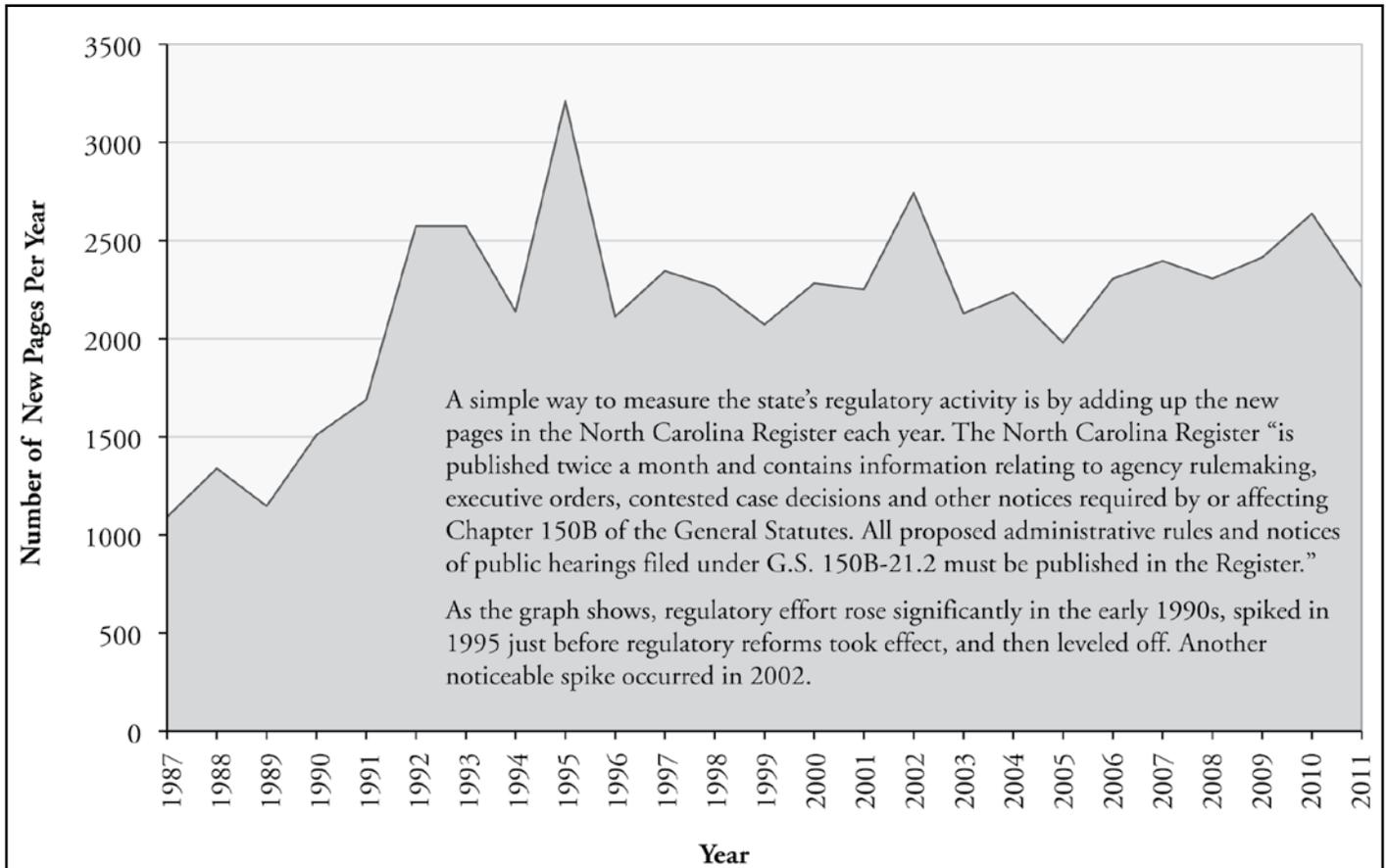
Recommendations

1. **Expand the Regulation Reform Act's** fix of the administrative appeals process to apply to all agencies, not just environmental agencies.
2. **Require agencies to quantify projected costs and benefits of proposed regulations**, and require rejection of rules for which the costs exceed the benefits. Apply the same cost/benefit test to laws previously enacted by legislators, repealing those that fail the test.
3. **Implement small-business flexibility analysis for prospective rules** to prevent regulations from running roughshod over small employers.
4. **Strengthen the Rules Review Commission** to reject regulations unless the relevant agency can prove the rules are clearly within the limited power delegated to it by the legislature.
5. **Reform North Carolina's auto insurance market** by eliminating guarantees of insurer profits, encouraging product innovation, disclosing any cross-subsidies on insurance bills, and reducing the extent to which ratepayers subsidize the premiums of risky drivers.

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Trend in state regulatory activity, 1987-2011

New pages in the North Carolina Register, by year





Eminent Domain

Eminent domain is the government's power to seize private property for public use. It is a constitutional power; the Fifth Amendment to the United States Constitution states, "Nor shall private property be taken for public use, without just compensation." What that means, however, is that the Founders envisioned the property seized to be used only for a public use after justly compensating the owner.

The U.S. Supreme Court has steadily expanded this power to take private property so far afield that a government can take property even for "economic development." The landmark ruling in *Kelo v. City of New London* (2005), building on the Court's expansion of "public use" to include "public purpose" and "public benefits," gave government even the power to take property from one citizen and transfer it to another for economic development (if the latter would, for example, build a shopping mall on it to generate more tax revenue or jobs).

Key Facts

- North Carolina has the weakest constitutional protection of property rights in the nation. North Carolina is the only state in the nation whose constitution lacks a "takings" clause, a provision that says property may be taken only for a public use.
- Prior to *Kelo*, the North Carolina Supreme Court had already approved takings for private uses. In *Piedmont Triad Airport Authority v. Urbine* (2001), the state's high court upheld the airport authority's taking of private property for a cargo facility to be used solely by Federal Express, stating that the purpose of the taking was to improve the airport, and that the obvious benefit to Federal Express was incidental.
- After *Kelo*, several states -- including the neighboring states of Georgia and South Carolina -- passed constitutional amendments to protect against eminent domain abuses. Since 2006, there have been several attempts to pass such protections in North Carolina, but they have all fallen short.
- In 2006, the legislature passed a bill that narrowed the definition of "blight" and prevented the government from seizing entire blighted areas (that merely contained some blighted properties) rather than just the blighted properties themselves. Those statutory changes should be enveloped within a constitutional amendment as a further protection of private property

against a government able to condemn desired property as "blighted" in a path-of-least-resistance gambit to take it for economic development.

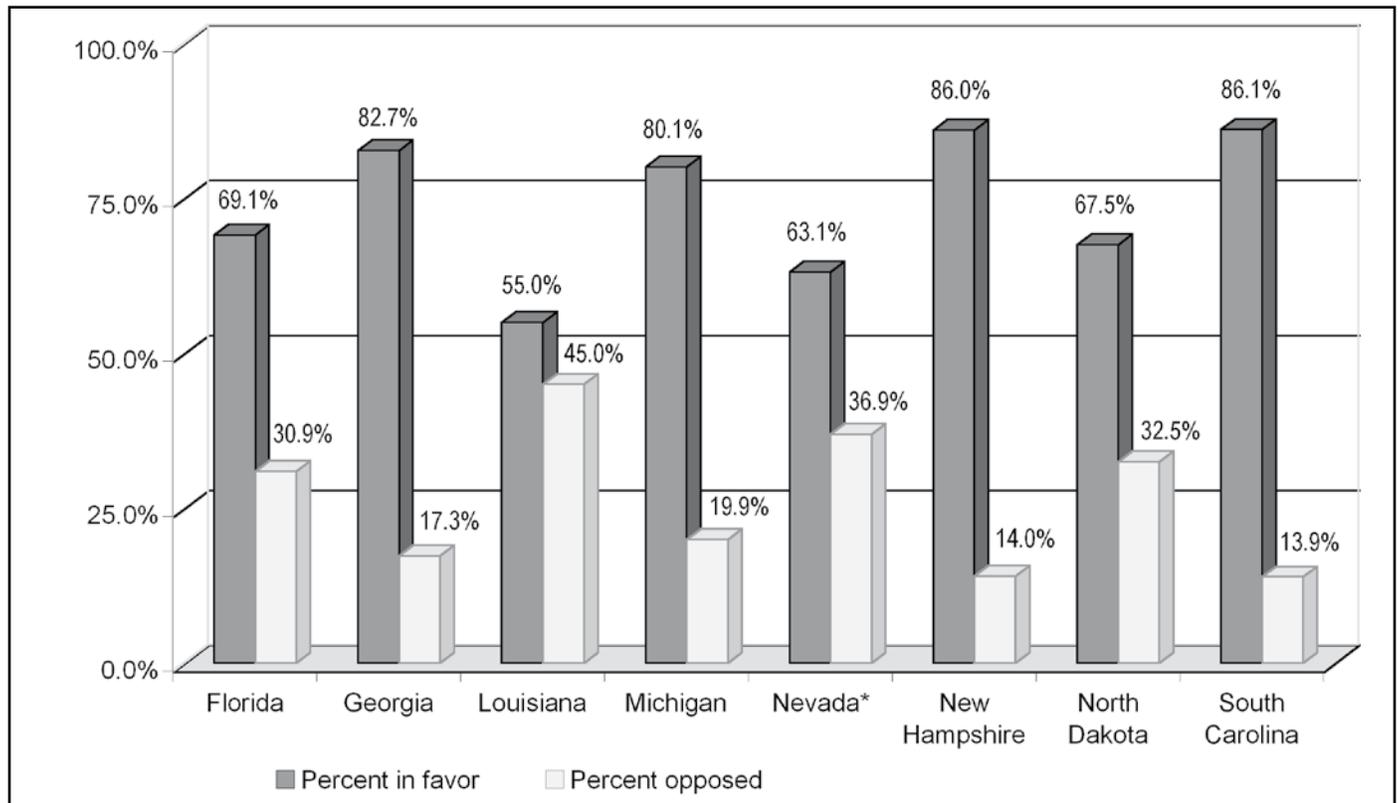
- Furthermore, a constitutional amendment should place the burden of proof on government to show that the taking is necessary for a public use and that the former owner receives just compensation. This compensation should cover more than "fair market value," also taking into consideration other costs incurred by the owner, such as relocation costs, attorneys' fees, loss of business goodwill, and other factors that financially harm property owners.
- The property owner should be able to request a jury of peers to decide just compensation.

Recommendations

1. **Amend the North Carolina Constitution to protect property owners from eminent domain abuse.**
2. **Prohibit takings for economic development.**
3. **Define blight narrowly and allow for the taking of blighted properties that present a concrete threat to the health and safety of the public.** This addition to the constitutional amendment would differ from a practice of seizing "blighted areas" that include some properties classified as blighted under a looser definition.
4. **Impose on government the burden to prove that a taking is for a public use, that a property is really blighted, and that compensation is just.**
5. **Include relocation costs, attorneys' fees, and loss of business goodwill in just compensation.** Re-compensating property owners only fair market value causes them to suffer significant financial loss.

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Voters strongly approve of protection from eminent domain abuse After *Kelo*, states overwhelmingly passed constitutional amendments protecting against eminent domain abuse in 2006



* Nevada voters are required to pass new amendments in two consecutive general elections. In 2008, Nevada voters again approved the amendment by a 60.8% to 39.2% vote. Source: Castle Coalition.



Occupational Licensing

Most people think of occupations requiring licenses as those like medicine and law. North Carolina, however, has made it state's business to certify auctioneers, barbers, librarians, manicurists, and over a hundred others. The neighboring states of Virginia, Georgia, and South Carolina are less restrictive.

Occupational licensing makes it harder and more costly for providers to enter an occupation. It leads to higher prices for licensed providers, more business for licensing programs, and revenue to the state through license fees.

Occupational licensing is supposed to protect the public from fraudulent or incompetent providers. The best available evidence, however, finds that punishing confirmed bad providers after the fact is just as effective, plus it doesn't raise consumer costs, limit job opportunities, or turn away young entrepreneurs.

Key Facts

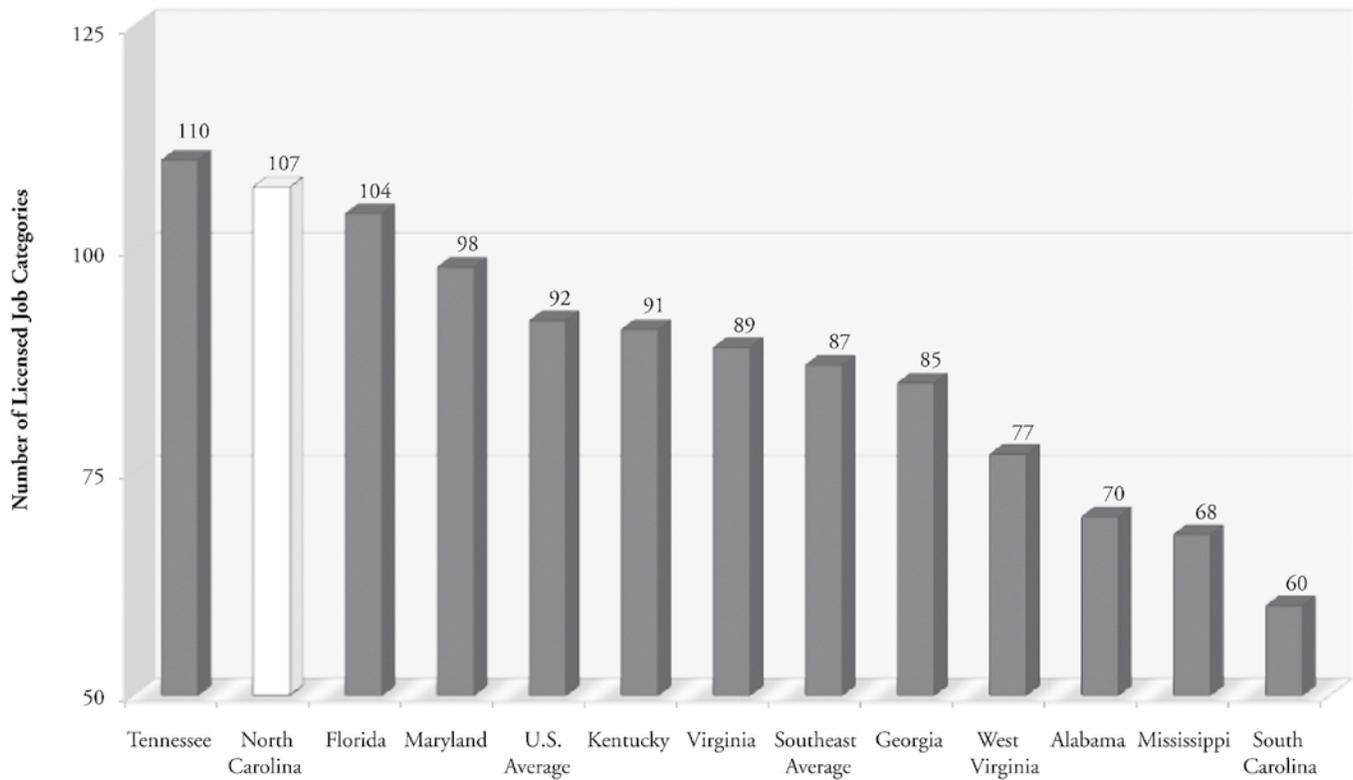
- North Carolina licenses access to over 100 occupations and over 700 commercial activities.
- North Carolina has over 50 licensing boards. Some have very few applicants, and many cover similar territory in fields such as personal care services.
- In 2006, University of Minnesota economist Morris Kleiner estimated that occupational licensing accounted for \$100 billion in lost economic output per year and transferred \$300 billion per year from consumers to licensed professionals. Kleiner found no impact or even a negative impact on the quality of services provided, an exceedingly poor showing for such a huge, forced transfer of wealth.
- Most occupational licensing is favored by individuals already in the regulated industry. They are helped by restrictions and hurdles to entry faced by potential competitors on the outside.
- Almost 80 percent of medical workers are licensed, Kleiner found, making medicine the most regulated industry in terms of occupational licensing — one reason why it's so expensive.
- Overregulation prevents, for example, nurse practitioners and physician assistants from providing routine medical care, which would expand basic care and make it less expensive.
- Teacher certification is a significant barrier to expanding state-mandated virtual schooling, blocking high-caliber out-of-state teachers, higher education faculty, private-sector professionals, private-school faculty, and independent scholars from teaching in online schools despite those schools' virtual elimination of physical limitations.
- In July 2011, African hair braiding — a traditional skill practiced often by West African immigrants — fell under state licensing. New entrants must spend 300 hours in cosmetology schools to gain a license. Complaints about “unlicensed” African hair braiders came not from customers but from licensed cosmetologists who resent competition.
- In 2012 the North Carolina Board of Dietetics/Nutrition threatened Steve Cooksey with jail time for unlawful practice of dietetics and nutrition. Cooksey had a web site wherein he recounted his experience with dieting in losing weight and curing his type-2 diabetes.
- In 2011, after the death of a newborn, Amy Medwin was arrested and convicted for practicing midwifery without a license. She was a licensed midwife in Virginia and had also assisted the births of the baby's siblings. She was not charged in the death of the child, who died of natural causes.
- In 2010, the Federal Trade Commission challenged the N.C. Board of Dental Examiners for its regulation against non-dentists offering teeth-whitening services. The FTC formally accused the N.C. Dental Board of “acting to suppress competition.”

Recommendations

1. **Reform North Carolina's licensing structure; abolish some licensing boards and reform and merge others to bring about more jobs and lower costs.**
2. **Allow nurse practitioners and physician assistants to provide more routine medical care.**
3. **Ease or eliminate traditional certification and licensure requirements for teachers.**

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Southeastern States by Number of Licensed Job Categories, 2007



Source: Adam B. Summers, Occupational Licensing: Ranking the States and Exploring Alternatives, Policy Study 361, Reason Foundation, August 2007, reason.org/files/762c8fe96431b6fa5e27ca64eaa1818b.pdf



Hydraulic Fracturing and Exploration

The presence of natural gas in shale rock formations, such as in the Deep River Basin in Lee, Chatham, and Moore counties, has long been known. Hydraulic fracturing (“fracking”), a process to extract natural gas from shale, has been around since the 1940s but has been cost-prohibitive. Very recent technological advances in combination with horizontal drilling have turned fracking into a low-cost method to recover natural gas. It has revolutionized the industry, bringing jobs and booming economies to local drilling sites and energy independence to the shale-rich United States. But North Carolina is one of just two states in the union that bans the process. (In late May Gov. Peter Shumlin of Vermont signed that state’s largely symbolic ban.)

Key Facts

- In 2011 the N.C. legislature passed a bill that would have led to a review and likely changes in state law with respect to hydraulic fracturing. Gov. Bev Perdue vetoed it, but in 2012 Perdue publicly changed her position on the viability of fracking in N.C.
- In May 2012, fulfilling a request by the legislature, the N.C. Department of Environment and Natural Resources issued a report which concluded that fracking could be done safely here with the proper regulations in place.
- Concerns over fracking include whether it could contaminate drinking water through either escaping methane gas or the chemicals used in fracturing the underground rock, whether underground fracturing causes earthquakes, and whether the increased trucking to and from drill sites creates congestion and air pollution.
- Numerous studies have found no link between hydraulic fracturing and groundwater contamination. Even U.S. Environmental Protection Agency administrator Lisa P. Jackson, testifying under oath before Congress in May 2011, stated she was “not aware of any proven case where the fracking process itself has affected water, though there are investigations ongoing.”
- Documented incidents of water pollution related to fracking have been found to be caused by faulty well construction, almost always owing to poor cement jobs. Those may be prevented by stricter regulation on well construction.

- Ohio regulators found that earthquakes thought to be linked to hydraulic fracturing were actually caused by wastewater injection into deep disposal wells. Several industrial activities other than hydraulic fracturing generate such wastewater. Ohio responded with tighter regulations on deep disposal wells.
- During his State of the Union Address of 2012, President Barack Obama hailed the benefits — from job creation to cheaper, cleaner electricity and fuel — of being able to extract natural gas from shale rock.
- A December 2011 PricewaterhouseCoopers study of the economic effects of shale gas development in the United States through 2025 predicted more affordable energy, higher demand growth for U.S. manufacturing, and approximately one million more workers in U.S. manufacturing jobs.
- As Daniel Fine of the New Mexico Center for Energy Policy has observed, the land in North Carolina with the potential for recoverable gas and oil is private or fee land, not federal or public. In recent years nearly all gas and oil production in the United States has occurred on private or fee land.
- Late entry to hydraulic fracturing would position state regulators to observe and apply the best practices of other states, such as regulations concerning well construction and disclosure of fracking chemicals.

Recommendations

1. **Allow hydraulic fracturing and energy exploration in North Carolina.** State officials should study best practices in states that have worked through regulatory issues regarding fracking, but the state should not block a potentially strong source of job creation, energy affordability, and economic growth. Caution is justified, but not inaction.
2. **Set up a regulatory body specifically devoted to natural gas and oil.** Board membership should be carefully crafted to foster dispassionate scientific and economic analysis as well as to ward off regulatory capture of one kind or another.

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Dan River and Deep River Basins: Sites of N.C. Shale Gas Potential



This map shows the exposed Triassic rift basins for the Dan River and the Deep River, which are the areas of greatest potential for shale gas in North Carolina. (Source: North Carolina Department of Environment and Natural Resources and the N.C. Department of Commerce, "North Carolina Oil and Gas Study Under Session Law 2011-276," April 30, 2012.)

Renewable Energy Portfolio Standard

In 2007 the North Carolina General Assembly passed far-reaching electricity regulations, typically referred to as Senate Bill 3. At the heart of this bill is a 12.5 percent “renewable energy and energy efficiency portfolio standard.” The renewable portfolio standard requires utilities to provide customers 7.5 percent of their electricity through renewable sources of energy, such as wind, solar, or biomass. These are all forms of energy that are significantly more expensive than traditional fossil fuels and nuclear power that North Carolina’s utilities voluntarily choose when they are left free to pursue truly efficient energy. The other 5 of the 12.5 percent is to come from reduced electricity usage owing to mandated energy-efficiency measures. In this case “energy efficiency” has nothing to do with actual efficiency, i.e. getting more for less, but simply refers to using less energy even if it is inconsistent with people’s actual preferences and needs.

Key Facts

- North Carolina’s renewable energy mandate is forcing electric utilities, and therefore their customers, to purchase electricity generated from wind and solar plants that is 3 to 4 times as expensive as electricity generated from traditional sources.
- All increased costs associated with the mandate are being passed on to electricity customers.
- In addition to the higher electricity costs the mandate is forcing taxpayers to bear an extra burden. Because of the mandate, new solar and wind power plants are being built in and planned for the state, all of which are being heavily subsidized with tax credits.

- Higher electricity costs hurt the economy. According to the Beacon Hill Institute at Suffolk University, North Carolina’s renewable energy mandate will cost North Carolina rate payers \$1.8 billion by 2021.
- Because higher electricity costs increase the cost of doing business, it is estimated that the mandate will lead to losses of \$140 million in GDP and 3500 jobs in the state.
- Tax revenues will be reduced by \$43 million. This is likely an underestimate since it does not include tax subsidies for the construction of new wind and solar power plants.
- Before passing the mandate, which was supported overwhelmingly by both political parties, there was no cost-benefit analysis done and no analysis of benefits to the environment. In fact, it has not been demonstrated that the mandate will have any environmental benefits for the state at all. Except for targeted special interests, such as favored companies in the wind and solar industry, the renewable energy mandate only imposes costs with no offsetting benefits.

Recommendation

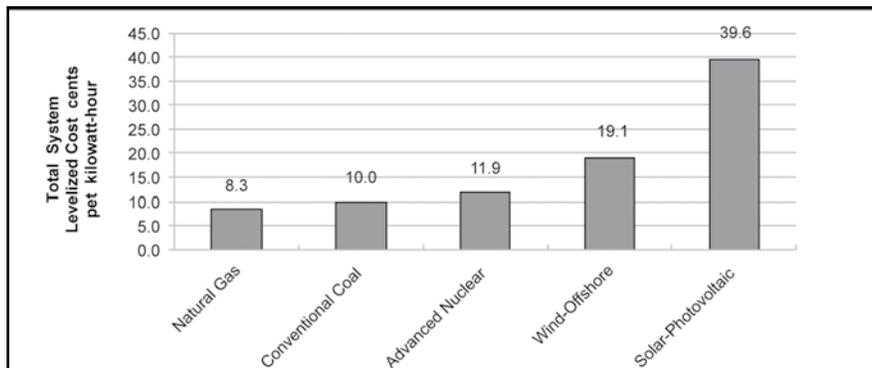
1. **Repeal Senate Bill 3, the overarching legislation that contains the renewable energy mandate or, at the very least, repeal that portion of the bill that contains the 12.5% renewable energy/energy efficiency mandate.**

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BHI Cost Estimates for Renewable Energy Mandates (in 2009 \$)

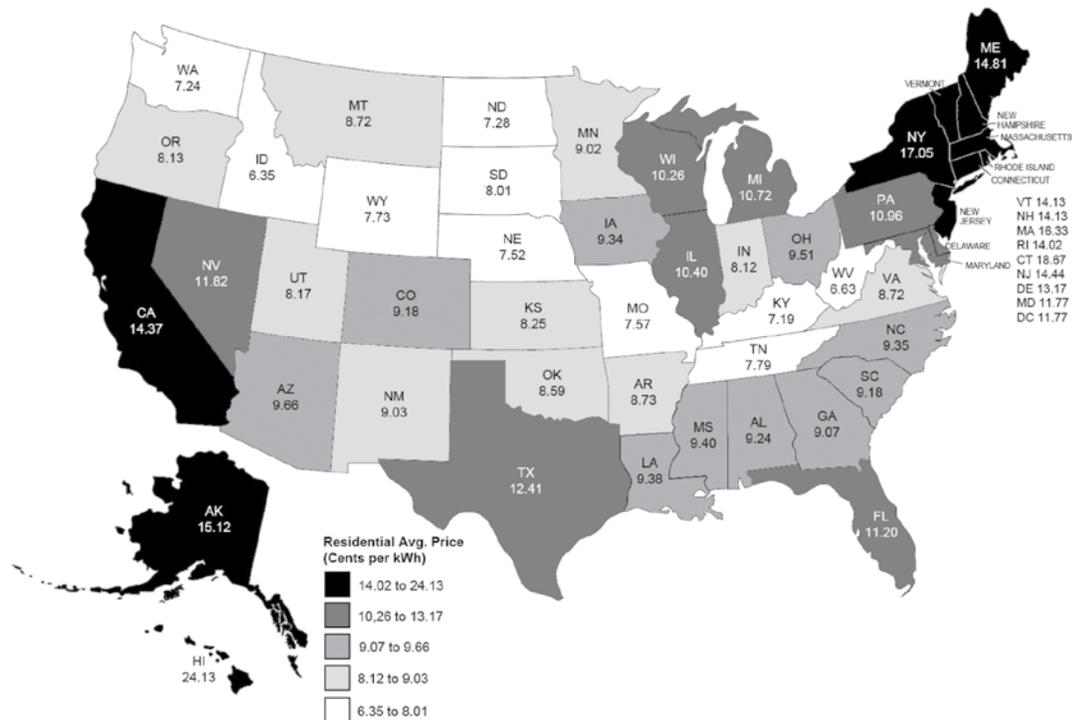
Year	Employment Loss (Jobs)	Investment Loss (\$ millions)	Real Disposable Income Loss (\$ millions)	Real State GDP Loss (\$ millions)	State and local Revenues Loss (\$ millions)
2010	1046	22.94	8.23	90.21	35.12
2012	3078	38.61	49.36	134.65	47.29
2014	3275	37.24	44.09	116.07	42.22
2021	3592	43.20	56.80	140.35	43.49

Cost of New Energy Generating Technologies, 2016 (cents/kWh) Solar & Wind vs. Other Energy Resources



Source: "Levelized Cost of New Electricity Generating Technologies", Institute for Energy Research, May 12, 2009, updated Feb. 2, 2010, using data from the Energy Information Administration's Annual Energy Outlook 2010, http://www.eia.gov/oiaf/aeo/electricity_generation.html

The U.S. Average Residential Retail Price of Electricity by State



Source: <http://www.electricchoice.com/electricity-prices-by-state.php>



Health Care Reform

The Patient Protection and Affordable Care Act (PPACA), also known as Obamacare, was passed in 2010 in a hurried process that allowed for little understanding of what was in the 2,700 page document. As the nation waits to see what the future of health care may look like, it is imperative that the states continue to take action at the state level to improve health outcomes and lower costs.

Of particular concern to the future of North Carolina has been the PPACA expansion of the jointly funded Medicaid program. Under PPACA, the state would see the largest expansion of this entitlement program in history. Instead of a federally controlled system, Medicaid, like other health programs, needs to be more focused on the particular cultures, ideas, and needs at the state level. The recent ruling upholding Obamacare has held that the federal government cannot enforce this provision on the states by withholding federal funding.

Some of the most effective and innovative health care reforms can be made at the state level. Some reforms would rein in the ever-growing costs of health care while others would create infrastructure to implement long-lasting reform for the future. The state does not have time to wait on improving health care and must do so with or without federal action.

Key Facts

- 2011 estimates indicate PPACA will add 15 million people to Medicaid rosters across the country, and 500,000 in North Carolina.
- Candidate Obama promised that health care premiums would go down by \$2,500 by the end of the first year.
- President Obama now acknowledges that insurance premiums will rise 10-13 percent on average by 2016, and 17 percent for young healthy individuals.
- PriceWaterhouseCoopers has projected that health care spending for 2013 will increase by 7.5 percent, more than three times the projected rates for inflation and economic growth.

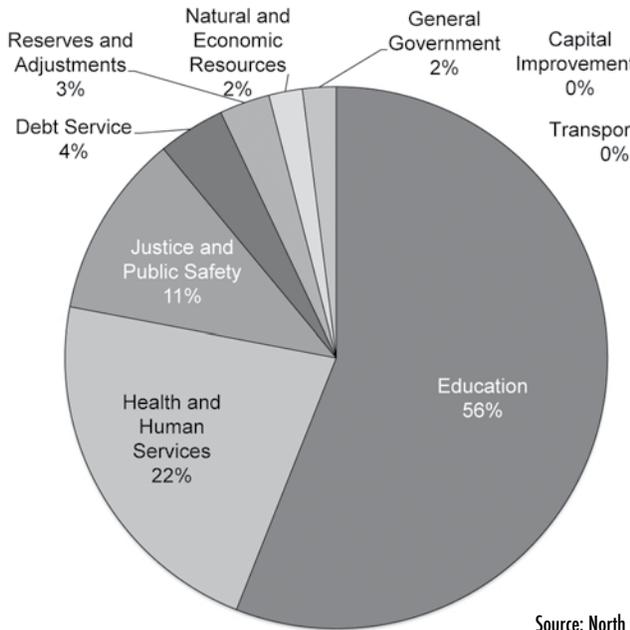
- Governments and insurance companies pay \$7 out of every \$8 spent on health care making consumers unaware of real costs, and this will not change under PPACA.

Recommendations

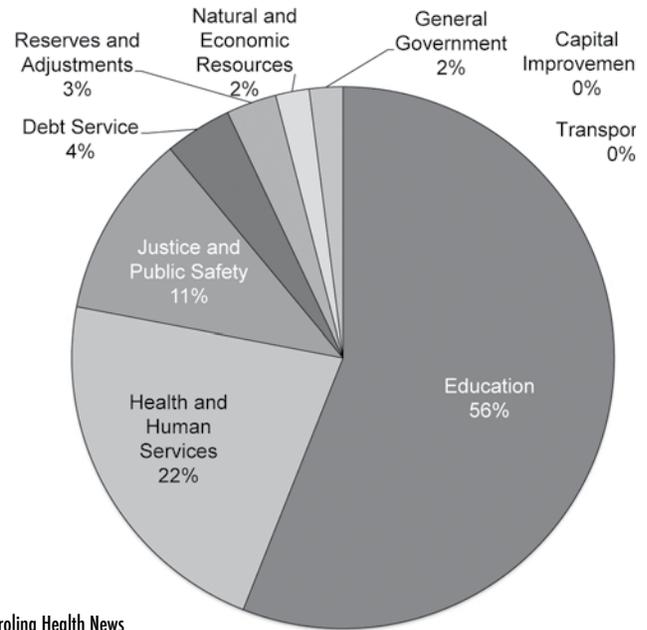
1. **Allow free enterprise to thrive.** State restrictions, especially those mandated by the federal government, on health insurance and care provisions mean patients will see alternatives leave the marketplace, potentially driving up costs. Some changes the state should make are:
 - Allow individuals and businesses to purchase insurance from other states,
 - Reduce mandated benefits for insurance companies,
 - Ease restrictive licensing burdens on medical professionals, and
 - Repeal Certificate of Need.
2. **Opt out of participating in PPACA's expansion of Medicaid.**
3. **Use block grants, managed care, and financial incentives to help control Medicaid costs.** North Carolina's Medicaid program is expensive and poorly structured. Providers and patients have few incentives to deliver care efficiently, and there is insufficient attention paid to detecting and ending Medicaid fraud.
4. **Wait to implement Insurance Exchanges.** Given the unreasonable time frame for setting up state-level exchanges and how many unknowns that still are associated with PPACA, the state should not rush forward to implement an expensive program it may not need.

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Recommended General Fund Budget by Function, 2012-13

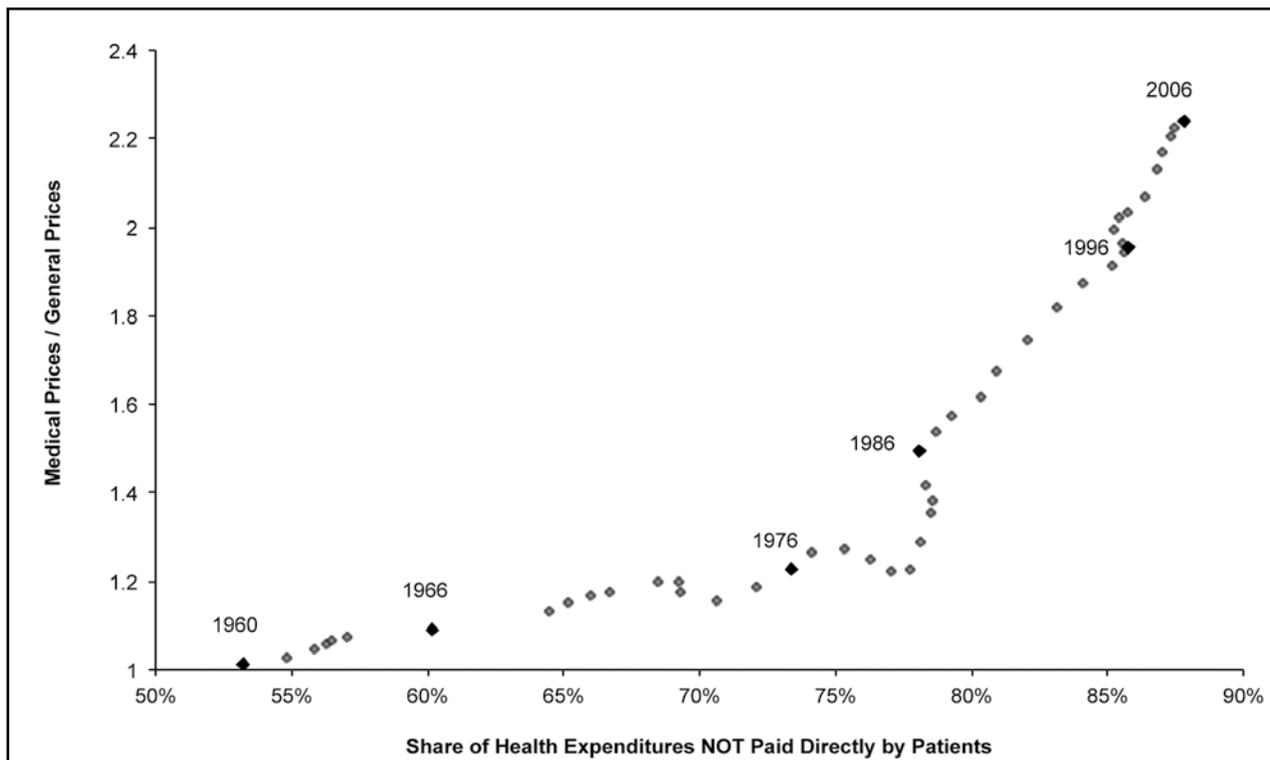


Of every \$8 spent on health care, patients pay less than \$1 out of pocket



Source: North Carolina Health News

As out-of-pocket share has fallen, medical costs have risen



Source: Center for Medicare and Medicaid Services, 2008 National Health Expenditures



CON Laws

North Carolina and 34 other states have what are called Certificate of Need (CON) Laws. The purpose of CON Laws is to restrict entry into the market for medical facilities and equipment. If you are a health care entrepreneur and you want to do anything from adding a new wing or extra beds to an existing hospital, to opening an office that offers MRI, X-ray or other services, you need a “Certificate of Need” from the state. The function of CON is summarized by the state as follows:

The North Carolina Certificate of Need Law prohibits healthcare providers from acquiring, replacing, or adding to their facilities and equipment...without the prior approval of the Department of Health and Human Services...The law...limits unnecessary health services and facilities based on geographic, demographic and economic considerations... All new hospitals, psychiatric facilities, chemical dependency treatment facilities, nursing home facilities, adult care homes, kidney disease treatment centers, intermediate care facilities for mentally retarded, rehabilitation facilities, home health agencies, hospices, diagnostic centers, oncology treatment centers, and ambulatory surgical facilities must first obtain a CON before initiating development. In addition, a CON is required before any upgrading or expansion of existing health service facilities or services.

The stated purpose of the law is to eliminate duplication of services in an attempt to reduce health care costs. In reality it protects existing facilities from competition by creating a legal, bureaucratic, and expensive maze that must be navigated by any person or company that wants to provide the kinds of medical services mentioned above. This maze usually takes years to negotiate with the outcome being very uncertain.

Key Facts

- North Carolina’s Certificate-of-Need Law is, with few exceptions, an all inclusive and all intrusive blueprint for state government control of all supply and pricing decisions with respect to the provision of institutional health care facilities.
- Depending on the number of reviews, the process can take anywhere from 90 days to over two years. If a denial is appealed to the state Court of Appeals, the process can go well beyond this two-year period.

- An April 2005 article in the *Triangle Business Journal* tells the story of a partnership of three neurologists who have spent three years and over \$250,000 in an attempt to set up an MRI imaging center in Garner. Their request was denied.
- The stated purpose of CON laws is to hold down health care costs. But, as noted by East Carolina University researchers Ellen Campbell and Gary Fournier “there are reasons to suspect that CON may have been adopted for other purposes...the states most likely to enact CON...were those with a highly concentrated hospital industry and increasing competitive pressures...hospitals were largely in favor of CON regulation, which is understandable considering that it protected them.”
- One of the most recent and widely referenced studies about CON laws was written by Duke University Professors Christopher Conover and Frank Sloan in 1998 in the *Journal of Health Politics, Policy, and Law*.
- Their results are consistent with “orthodox” economics. Output restrictions lead to higher, not lower costs, and higher profits for providers.
- CON laws resulted in a 2 percent reduction in bed supply and “higher costs per day and per admission, along with higher hospital profits.”

Recommendation

1. **Eliminate monopoly protections for hospitals and other health care facility providers, and Repeal North Carolina’s Certificate of Need Law.**

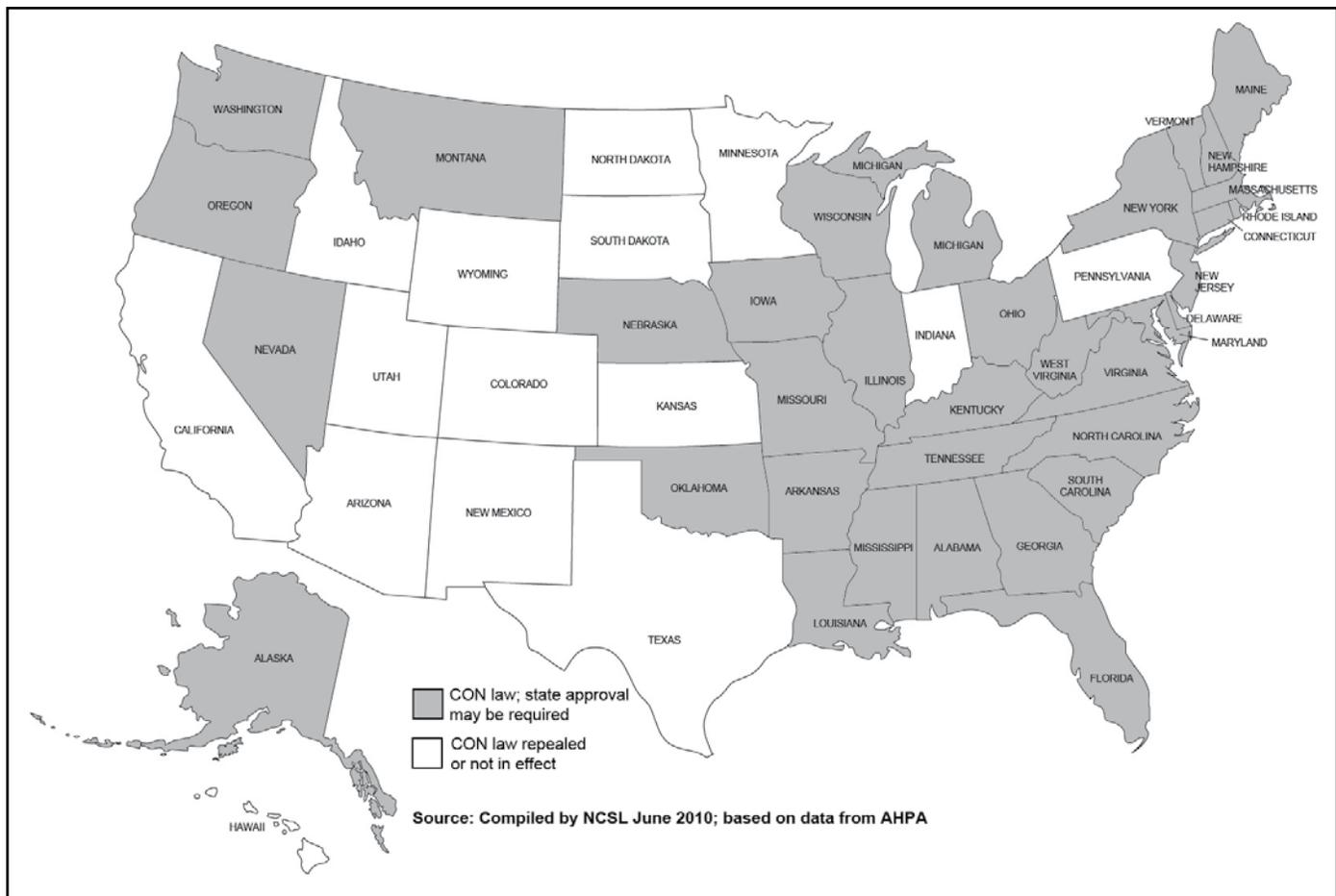
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Certificate of Need (CON) Process

Task			# Days to receive feedback
Submit letter of intent			0
Review period begins			0
CON Section makes decision			90-150
Denied/Approved ⇒	Petitions allowable for 30 days		120-180
	Judge makes recommendation ⇒	CON Section makes final decision	120-450
	Denied/Approved ⇒	NC Court of Appeals	Indefinite?

Source: Compiled by author using information from the <http://facility-services.state.nc.us/conpage.htm>.

State Certificate of Need (CON) Health Laws, 2010



County Tax Increase Elections

In 2007, county commissioners asked the legislature to give them more taxing authority. Ever increasing demands for services, especially related to population and student growth, created pressure for additional revenue sources. The legislature responded by providing counties with the authority to increase the county sales tax by one-quarter cent or to increase the land-transfer tax by 0.4 percent, but only after an advisory vote of the people. At the time, this seemed like a reasonable solution to the budget pressures on county government. (The land-transfer tax option has since been repealed.)

Unfortunately, legislators did not foresee how some county commissioners, desperate for more tax revenue, would game the system in order to get the “public” to vote for a tax increase.

The first tactic used by some county commissioners was to place the tax increase on the November ballot in odd numbered years when only municipal offices were on the ballot. This caused the county taxpayers to incur the expense of opening rural polling places for the tax increase vote. This strategy was used on Buncombe County and even the *Asheville Citizen-Times* noted the cynical nature of the decision by reporting that the more liberal city voters would turn out in higher numbers because they were voting on city council candidates than the more conservative rural voters who had no other issues or candidates on the ballot.

Asheville-Buncombe Technical Community College, the promised beneficiary of the estimated \$7 million per year from the quarter cent sales tax increase, offered to chip in the nearly \$80,000 needed to open the rural polling places. Some might call it unethical for a special interest group to subsidize an election that will likely lead to a monetary gain for that special interest group.

The second tactic used by some county commissioners to secure a tax increase was to call for a special election

outside the regularly scheduled May primary or November general elections with the tax vote the only measure on the ballot. For example, county voters were asked to vote in single-issue, tax increase elections on February 1, 2011, August 31, 2010, and January 8, 2008. (See Table)

Since 2007, 11 counties have used this tactic with a 64 percent pass rate compared to only a 13 percent pass rate when the votes were held on either the May primary or the November general election dates.

One of the reasons for the huge difference in approval rates is that holding single-issue elections outside the usual May and November dates tends to suppress voter turnout. (See Table) For example, the Halifax County turnout on February 1st was 6.5 percent, Robeson County turnout on August 3rd was 4.2 percent and Randolph County turnout on March 2nd was 4.9 percent. Also note that three of the four tax increase defeats had the highest voter turnout with the defeat in Clay County on August 29th achieving a 30.3 percent voter turnout.

The reason this gimmick works is that the county special interest groups, such as school district and county employees who would benefit from the tax increase, are more likely to turnout and vote than general taxpayers who would be paying the bills. This ploy is hardly democracy in action and commissioners should be ashamed at resorting to this trick to win “voter” approval.

Recommendation

- 1. Amend the local option sales tax statute to require counties to hold advisory elections on the November general election date in even-numbered years.**

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Recent Special Elections for County Tax Votes

Date	County	Tax	Voter Turnout	Result
May 17, 2011	Cabarrus	Sales Tax	3.5%	Passed
February 1, 2011	Halifax	Sales Tax	6.5%	Passed
August 31, 2010	Watauga	Sales Tax	3.4%	Defeated
August 3, 2010	Robeson	Sales Tax	4.2%	Passed
June 22, 2010	Wilkes	Sales Tax	7.7%	Passed
March 2, 2010	Hertford	Sales Tax	8.4%	Passed
March 2, 2010	Randolph	Sales Tax	4.9%	Passed
February 2, 2010	Davie	Sales Tax	10.4%	Defeated
January 8, 2008	Alexander	Sales Tax	9.1%	Passed
February 3, 2009	Avery	Land Tax	24.5%	Defeated
August 29, 2008	Clay	Land Tax	30.3%	Defeated

Source: NC Association of County Commissioners and County Boards of Elections data



Urban Rail Transit

Public transit systems in North Carolina have become less about helping citizens move around their communities in the way they desire and more about planners gaining enough political power to impose their transportation preferences and land use fads on those citizens. And this starts at the top. US Secretary of Transportation Ray LaHood recently admitted that his Livability Initiative "...is a way to coerce people out of their cars." Charlotte-Mecklenburg planning director Debra Campbell told *Governing* magazine

We always saw transit [Charlotte's light rail system] as a means, not an end.... The real impetus for transit was how it could help us grow in a way that was smart. This really isn't even about building a transit system. It's about placemaking. It's about building a community.

The terms "smart," "placemaking," and "building a community" are all euphemisms for anti-car, anti-suburb, pro-public transit, pro-high density living in the city center. In the words of urbanologist Joel Kotkin, planning bureaucrats at all levels are implementing "cramming" policies that will produce a "forced march to the cities." In order to accomplish their goals, transit planners must use government regulation to force the approximately 80 percent of the public that prefers a single family home with a yard into high-density housing and use of mass transit.

Key Facts

- Surveys and market trends confirm that approximately 80 percent of Americans prefer to live in single-family detached homes with yards, and that most people want to take advantage of the mobility offered by the personal automobile.
- Despite this, the US departments of Transportation, Housing and Urban Development, and the EPA have jointly used their powers and federal funding to force states and cities to adopt policies that push people into high-density housing and travel by mass transit.
- The massive effort to build or expand mass transit systems over the last 30 years has been accompanied by a

decrease in the number of people using transit in major metro areas, from roughly 8 percent to 5 percent.

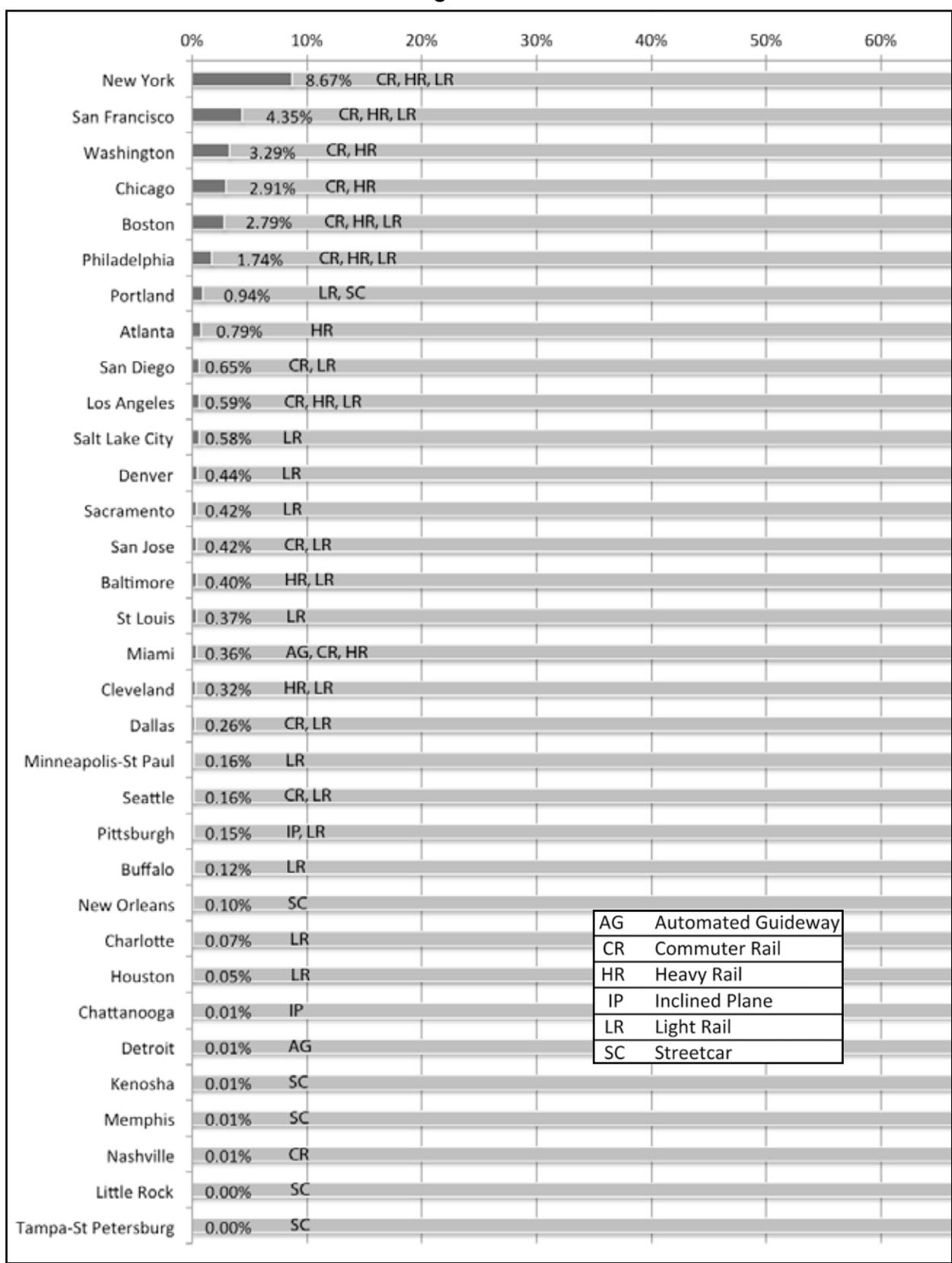
- Of the 33 urban rail transit systems in the country, only six carry more than one percent of the total motorized passenger miles and 22 carry less than *one-half of one percent*. Thus rail transit is a huge taxpayer expense with little or no impact on urban traffic congestion or air pollution. (See chart on the following page)
- The *Wake County Transit Plan* that proposes doubling bus service, a commuter rail on existing tracks from Durham to Garner, and newly constructed light rail from Cary to north Raleigh will not accomplish its goals. The \$4.6 billion price tag fails to include many costs such as \$2.2 billion to continue current services, cost of required spare vehicles, and cost to use existing private and public rail tracks. Each light rail trip will cost \$33 and each commuter rail trip \$92. Most commuters will not opt for rail because door-to-door travel times will be 2 to 4 times *longer* than the same trips by auto. And even if Wake County's population doubles by 2040, the population density will be only 2,158 per square mile. Few if any of the areas around proposed rail stations will have the density of 8,000 persons per square mile that would be necessary to make the system viable.
- "Over 90 percent of all jobs in American metropolitan regions are located outside the central business districts, which tend to be the only places well suited for mass transit." (Joel Kotkin "Forced March to the Cities" *Forbes*, March 16, 2010.)

Recommendations

1. **End state funding of rail transit projects.**
2. **Repeal the half cent local-option sales tax authorization for rail transit projects.**

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Rail's Share of Total Passenger Miles Traveled in Metro Areas



Source: National Transit Database, 2008 (most recent year available)



Highways and Interstates

The “good roads” state is quickly turning into the “traffic congestion” state. Both rural and urban interstates are poorly maintained and congested (see Figures 1 and 2).

One reason for the deterioration of the state’s roads is that the General Assembly has not dedicated all highway-related revenues to highway construction and maintenance. Since 1990, a total of over \$4 billion in proceeds from gas and car taxes have been spent on transit or General Fund programs (see Figure 4). While most of this transfer was originally intended to offset tax changes in the 1989 transportation bill, it is long past time that all gas and car taxes be dedicated to highway investment.

The legislature has ignored the politicized decision making-process at the Board of Transportation, which continues to misallocate road building funds based on political considerations, not documented transportation needs.

The General Assembly continues to allow the over-funding of public transit at the expense of roads. These failures have contributed to a deteriorating road system. The legislature must restore public confidence by spending highway user fees on highways, not on politicians’ pet projects.

Key Facts

- While North Carolina’s highway system ranks 21st of 50 states in overall performance, it ranks 42nd in urban interstate congestion (Figures 1&2).
- The state’s urban interstate congestion ranking (42nd) is the worst among its competitor states in the South-east (Figure 2).
- State officials have estimated North Carolina’s highway needs at \$50 billion to \$70 billion over 25 years.
- For the first half of 2012, North Carolina’s tax on gasoline was 39.2 cents per gallon (cpg). The 2012 budget bill adjusted and capped the rate at 37.5 cents. Both rates are the highest in our region (Figure 3 shows the comparison for early 2012).
- Since 1990 the General Assembly has transferred more than \$4 billion from the Highway Trust Fund to the General Fund (Figure 4).
- Spending \$8.2 billion in federal, state and local funds on rail transit in the Triangle that will carry less than one percent of the traveling public is a poor investment (see the “Public Transit” section).

- The state’s huge financial investment in the Charlotte LYNX light rail system has not paid off in reduced traffic congestion or air pollution since this system carries only 0.07 percent of the motorized passenger miles in the metro area.
- Nationally, rail transit has been a wasteful diversion of highway funds from effective and efficient traffic congestion reducing projects. Of the 33 major U.S. cities with rail transit, only 6 carry more than one percent of the passenger miles in the area and 22 carry less than one-half of one percent. This costly record has failed, in many cases, to produce measurable reductions in traffic congestion or air pollution.

Recommendations

1. **Stop transferring funds from the Highway Trust Fund to the General Fund.** While smaller amounts have been transferred recently, this practice diverts much-needed funds from highway construction and maintenance.
2. **Do not raise North Carolina’s already-high gas tax.** To make money available for high-priority road projects, the state should stop funding projects with low expected usage, and charge motorists directly for new limited-access highway lanes through electronic tolls.
3. **Institutionalize and extend the Governor’s DOT reforms by reforming the highway formulas and apply them only at the legislated geographic level.** In addition, increase competitive contracting, reduce and streamline DOT offices, and make the Board of Transportation’s policies advisory and reduce its membership to 5 to 7 members.
4. **End the disproportionate funding of mass transit.** Transportation funding should be based on the way people actually travel, not on transit planners’ attempts to use transit to reshape cities.
5. **End state funding of rail systems in the Triangle and Triad, and repeal the half-cent local-option sales tax authorization for rail transit.** (See section on “Public Transit.”)

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Figure 1: North Carolina performance by category, 2008 (overall rank: 21)

Category	50-State Rank
State-controlled highway miles	1
Total disbursements	3
Disbursements: capital and bridge	5
Disbursements: maintenance	4
Disbursements: administration	7
Urban interstate condition	24
% narrow principal arterial lanes, rural	41
Bridges, % deficit or obsolete	41
Fatality rate per 100 million miles driven	34
% rural arterial lanes in poor condition	27
% rural interstate in poor condition	35
Urban interstate congestion	42

Figure 2: Urban interstate congestion, 2008

State	Rank (1=least cong.)
Virginia	18
Georgia	31
Tennessee	34
Florida	35
South Carolina	38
Alabama	39
North Carolina	42

Figure 3: State excise taxes on gasoline (cents/gallon)

State	Gas Tax	Rank
North Carolina	37.5	8
Florida	35	10
Georgia	29.4	18
Tennessee	21.4	36
Alabama	20.9	37
Virginia	19.8	40
South Carolina	16.8	47

Figure 4: Budgeted transfers from Highway Trust Fund to General Fund

Fiscal Year	Transferred (\$millions)	Fiscal Year	Transferred (\$millions)
1989-90	\$164.7	2001-02	251.7
1990-91	231.1	2002-03	377.4
1991-92	170.0	2003-04	252.4
1992-93	170.0	2004-05	242.5
1993-94	170.0	2005-06	252.6
1994-95	170.0	2006-07	57.5
1995-96	170.0	2007-08	172.5
1996-97	170.0	2008-09	147.5
1997-98	170.0	2009-10	108.6
1998-99	170.0	2010-11	90.4
1999-2000	170.0	2011-12	76.7
2000-01	170.0	Total	\$ 4,125.6

Sources:

Figures 1 & 2: David T. Hartgen, Ph.D., P.E., Ravi K. Karanam, M. Gregory Fields and Travis A. Kerscher, "19th Annual Report on the Performance of State Highway Systems (1984-2008)", Reason Foundation, September 2010. Based on the most recent US Department of Transportation data.

Figure 3: Tax Foundation, "State Gasoline Tax Rates as of January 1, 2012"

Figure 4: NC Office of Management and Budget, NC Budget 2011-2013, Volume 6 Transportation.

Privatization

Privatization is an umbrella term to describe techniques that increase competition in the public sector. Private sector entrepreneurs must constantly look for ways to cut costs and improve efficiency to maintain a competitive advantage. State agencies, on the other hand, are often the only service provider or, when there is competition with the private sector, they have unfair access to taxpayer funds. State agency personnel secure agency income, not by satisfying customers, but by satisfying special interest groups who lobby for and legislators who pass their agency budgets. Taxpayers and citizens alike benefit from privatization through lower costs and improved quality of services.

Types of Privatization

Competitive sourcing uses a bidding process to allow private sector service providers to compete with public sector agencies. Existing state workers submit a bid as do private companies. The lowest bid receives the contract.

Public Private Partnerships (PPP) are joint ventures between public agencies and private firms to provide services or perform functions. PPP is commonly used in construction. Private toll roads can be built to state specifications with users paying the costs. After a time, the road usually reverts to state ownership.

Contracting out involves the public sector contracting with private or non-profit firms to deliver a service that previously was provided by a government agency. The government maintains control through the terms of the contract. Common examples are DMV drivers' license testing, food service in schools and prisons, parks management, and wastewater treatment. The NC Department of Corrections currently operates four minimum-security prisons using contracts with private firms.

Asset sales are a way for governments to increase revenues by shedding nonessential property or commercial-type enterprises. Governments have sold buildings and then leased back needed space. The budget crisis in California has prompted the state to consider selling the LA Coliseum, San Quentin Prison, and a number of state fairgrounds. Estimates of asset sales (also called divestiture) in California range up to \$1 billion.

State-level comprehensive approaches

The most effective way for North Carolina to save money through privatization is to create an independent

body to recommend and manage state privatization efforts. Recent successes in New Jersey, Louisiana, Ohio, and Arizona are added to those of a long list of states that have proven the cost savings of privatization of state activities

Key Facts

- **New Jersey** Governor Chris Christie is implementing privatization recommendations from the NJ Privatization Task Force. It is estimated that 40 recommendations, if fully implemented, will save over \$210 million dollars through such policies as privatizing highway maintenance, state parks, toll road collections, lottery, and correctional food service.
- **Louisiana's** Commission on Streamlining Government (CSG) provided Governor Bobby Jindal with 238 privatization recommendations estimated to save state taxpayers \$1 billion -- from privatizing Medicaid services and the public employee health care system to the sale of three prisons.
- In **Ohio**, Governor John Kasich moved to privatize the state's economic development functions. Passage of a February 2011 bill created JobsOhio, a semi-private, nonprofit organization to take over the economic development functions of the Ohio Department of Development. In addition, the state is moving toward the sale of at least one prison and private management of others, private management of the state lottery, and a long-term lease of the 241-mile Ohio turnpike.
- **Arizona** has fine-tuned its privatization process concentrating on institutionalization of privatization rather than one-time fixes. The state Commission on Privatization and Efficiency (COPE) recommends that the state move to activity-based costing program and statewide outcome-based budgeting. COPE also recommended a process to provide systematic review of agencies, boards, and commissions looking for elimination, merger, and privatization.

Recommendation

1. **The General Assembly should adopt a comprehensive privatization strategy by creating a Council on Efficient Government.**

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Examples of State Privatization

State Parks Privatization

- In Arizona, a study by the Arizona State Parks Foundation recommended the parks be transitioned to a quasi-governmental entity. This led the Arizona State Parks to issue a “request for information” (RFI) that solicited recommendations for moving the government run parks to private operations and maintenance.
- Utah parks are responding to an audit by the auditor general that recommends privatizing the operations of 33 state parks.
- California’s budgetary crisis motivated state leaders to consider a bill that would grant the authority for nonprofits to take over the operations of about 70 of the state’s 278 parks that were threatened with closure.
- Florida approved a plan to improve camping and RV facilities at 56 state parks by entering a “build and operate” contract that will allow private firms to finance, build, and operate these new facilities in return for fees paid by the users.
- New York and New Jersey are transferring the management of several state-owned golf courses to private management.

State Lottery Management

- In 2011, Illinois became the first state to privatize its entire lottery operations. The winning bidder will take over lottery operations, management and marketing functions. The private lottery operation is expected to generate \$1.1 billion more in state revenue than the state run system over five years. The contract provides the state with significant oversight and control of lottery operations.
- Arizona’s privatization commission recommends that the state adopt an Illinois-style lottery privatization contract. Privatization could boost revenues from the underperforming state lottery operation by \$107 to \$210 million.
- California’s Governor Jerry Brown expressed interest in the Illinois lottery privatization because it could bring an additional \$1 billion in revenue to the debt stricken state.
- In New Jersey, a consultant is working on a study that assesses the potential revenue gains from privatizing the state’s lottery.
- Ohio and Washington State have issued requests for proposals (RFP) for consultants to analyze the impact of lottery privatization.

ABC Store Privatization

- In North Carolina, Gov. Bev Perdue considered but did not pursue a possible \$800 million dollars in revenue from wholesale and retail liquor store license auctions and divestiture. Other states are moving full steam ahead with privatizing their state-owned liquor stores.
- In 2011, voters in Washington State approved the sale of its state-owned stores, leading it to becoming the first state in the nation to fully shift from a government run monopoly to the private sector.
- Pennsylvania may follow Washington State. Governor Tom Corbett hired a consulting firm to conduct a valuation study to assess the impact of sale of the state’s wholesale and retail liquor monopoly. The governor strongly supports sale of the monopoly. “Pennsylvania should not be in the business of selling alcohol. It’s time to...focus on essential public services—that’s what the taxpayers expect of us.”
- Virginia: Since he took office in January 2010, Governor McDonnell has urged selling the liquor monopoly, which could earn the state as much as \$500 million. The legislature, concerned about possible reductions in liquor-related revenue, handed him defeats in 2010 and 2011. Despite these defeats the governor will mount a renewed effort in 2012.
- It’s politics as usual in Utah. The legislative proposal to privatize the state liquor monopoly received support from the public frustrated by a Department of Alcoholic Beverage Control mismanagement scandal. In addition, the department responded to a \$2.2 million legislative budget cut by proposing to close ten of the most profitable state-run liquor stores. But the Privatization Policy Board supports the legislation and the chief sponsor redoubled his efforts by telling The Salt Lake Tribune, “It should not be a function of government to sell alcohol.”

Sources: Leonard Gilroy and Lisa Snell, Annual Privatization Report 2011: State Government Privatization, The Reason Foundation, April 2012. And also Reason’s Annual Privatization Report 2010



Compensation for Sterilization Victims

From 1929 to 1977, the State of North Carolina forcibly sterilized about 7,600 of her own people for possessing “undesirable” genetic traits in the name of eugenics. The practice, whose names derives from the Greek *eugenes*, meaning “well-born, of high stock,” was a program pushed by Progressives in the early 20th century intending to deliberately further human evolution by preventing undesirables from reproducing and thereby fostering the reproduction of “desirable” members of society.

North Carolina’s program got its start before Nazi Germany’s, and the state was by no means the only one infected by the eugenics movement. More than 30 U.S. states had similar laws. North Carolina was, however, one of only a few states not to cease its program after seeing the hideous results of the Nazis’ program.

All three branches of government in North Carolina failed to protect victims of its forcible sterilization program. The legislature approved the law, the executive branch implemented it through the North Carolina Eugenics Board, and the judiciary upheld the law as constitutional in *In Re Moore* in 1976, going so far as to declare it the “duty” of the legislature to enact sterilization laws and “limit a class of citizens in its right to bear or beget children with an inherited tendency to mental deficiency, including feeble-mindedness, idiocy, or imbecility,” so as to “protect the public and preserve the race from the known effects of the procreation.”

The state government itself committed the wrongs against sterilization victims. A state eugenics task force is currently discussing how North Carolina can provide victims compensation.

Key facts

- Over three-fourths of the approximately 7,600 victims of North Carolina’s forcible sterilization program were sterilized after 1945; i.e., after the fall of the Third Reich.
- As early as 1935, however, the North Carolina Eugenics Board understood that sterilization could not address the underlying concern for the “public good,” writing in a report that “We do not know precisely to what extent mental defects and psychopathic conditions are inherited.”

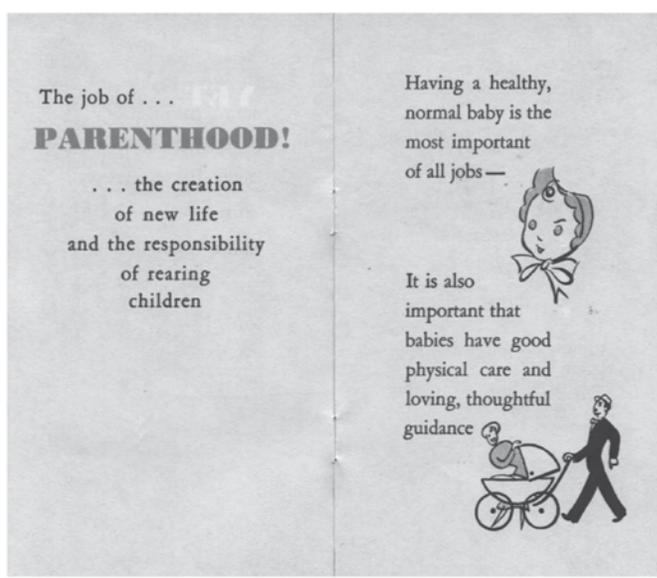
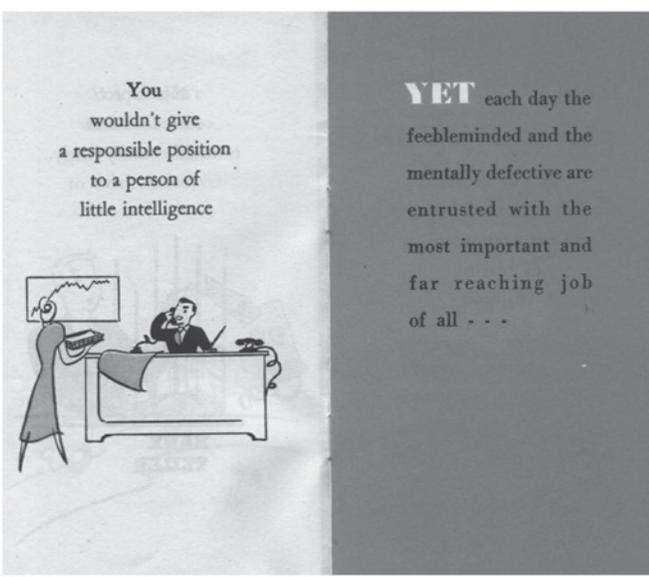
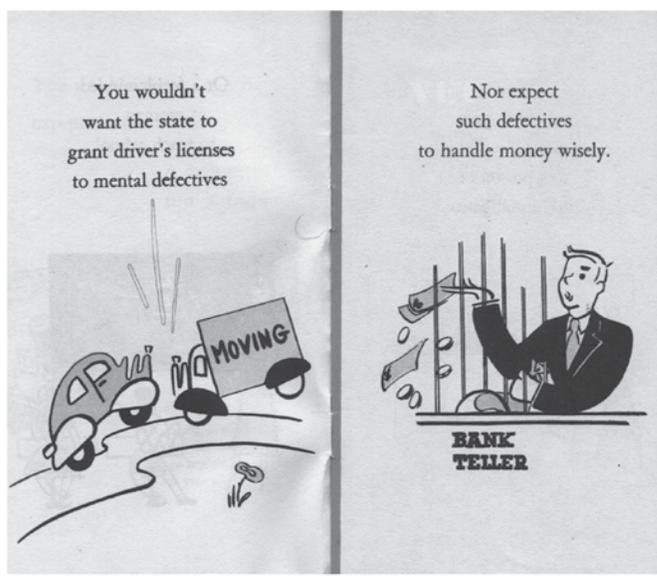
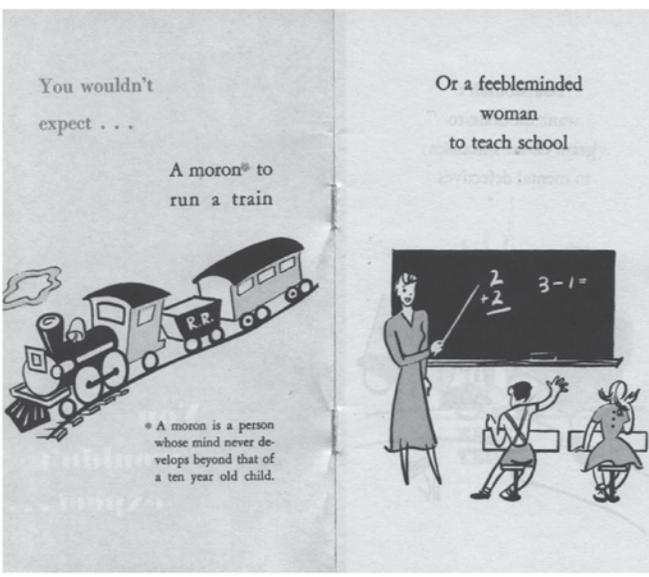
- Sterilization was recommended for people deemed to be epileptic or “mentally diseased.” Over 70 percent of sterilizations were of people assigned the vague, catch-all categorization of “feebleminded.”
- Victims had essentially no legal recourse. The U.S. Supreme Court in *Buck v. Bell* (1927) upheld the constitutionality of state sterilizations (the opinion written by Justice Oliver Wendell Holmes is chilling), setting the stage for eugenics laws in North Carolina and other states.
- The Eugenics Board approved about 90 percent of the sterilization petitions it received. Though victims could appeal the Eugenics Board’s decision to sterilize, few had the means or ability to do so.
- Most sterilizations were involuntary (about 6 percent were voluntary), and when informed consent was secured from parents or guardians, it was usually through threats or through parents not understanding what they were signing.
- Up to 2,000 victims of forcible sterilization are still alive, but just over 100 have been verified so far.
- Article I, Section 1 of the North Carolina Constitution declares, “We hold it to be self-evident that all persons are created equal; that they are endowed by their Creator with certain inalienable rights; that among these are life, liberty, the enjoyment of the fruits of their own labor, and the pursuit of happiness.” The state eugenics program violated fundamental rights of the state’s citizens for the “public good.”

Recommendations

1. **Provide compensation to living victims of the state sterilization program.**
2. **Be exceedingly wary of future legislation that would abridge fundamental rights for “the public good,” “the greater good,” or words to that effect.**

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The Campaign for Sterilization



Source: The North Carolina Digital Collections

Here are several pages from one of the pamphlets (titled “You Wouldn’t Expect . . .”) published by the Human Betterment League of North Carolina in 1950 in its education campaign pushing for the sterilization of “morons,” “defectives,” and the “feeble-minded.”



Taxpayer Financing of Campaigns

North Carolina has a public (meaning taxpayer-financed) campaign financing system for appellate court judges and three Council of State positions: Auditor, Commissioner of Insurance, and Superintendent of Public Instruction. In recent years, the U.S. Supreme Court has struck down similar systems in other states. In late May 2012, a federal judge struck down the state's matching funds system for appellate court candidates. By all appearances, North Carolina's system is unconstitutional.

Key Facts

- Under North Carolina's system, the state grants lump sums to the campaigns of candidates in the appellate court and Council of State races who agree to forgo raising money for the general election. The system is intended to equalize funding between candidates.
- To keep funding "equal," the state also issues matching funds to a subsidized candidate opposed by an unsubsidized candidate. Matching funds kick in once the traditional candidate — or any independent group supporting him — spends above a threshold amount.
- Taxpayer-financed campaign systems chill free speech. Matching funds punish traditional candidates for spending money on their campaigns or for having support from independent groups, causing both to avoid spending so as not to trigger the granting of state money to the opponent's campaign.
- Independent groups supporting a subsidized candidate, however, can spend whatever amount they want without fear of triggering matching funds. The system makes it possible for a subsidized candidate to receive matching funds even when there is greater overall spending in support of his campaign than for a conventionally funded rival.
- Forcing citizens to support candidates and political speech they oppose is a gross violation of the rights of free speech and association.
- It also protects incumbents unfairly. Incumbents have greater name recognition and the ability to make what are essentially campaign stops while supposedly conducting official business. Challengers may need greater spending and outside support to overcome those disadvantages.
- Despite the stated intent of public campaign financing systems, they don't limit the amount of spending in campaigns. Instead, they cause political donations to

shift from direct donations to campaigns to donations to PACs, 527s, etc.

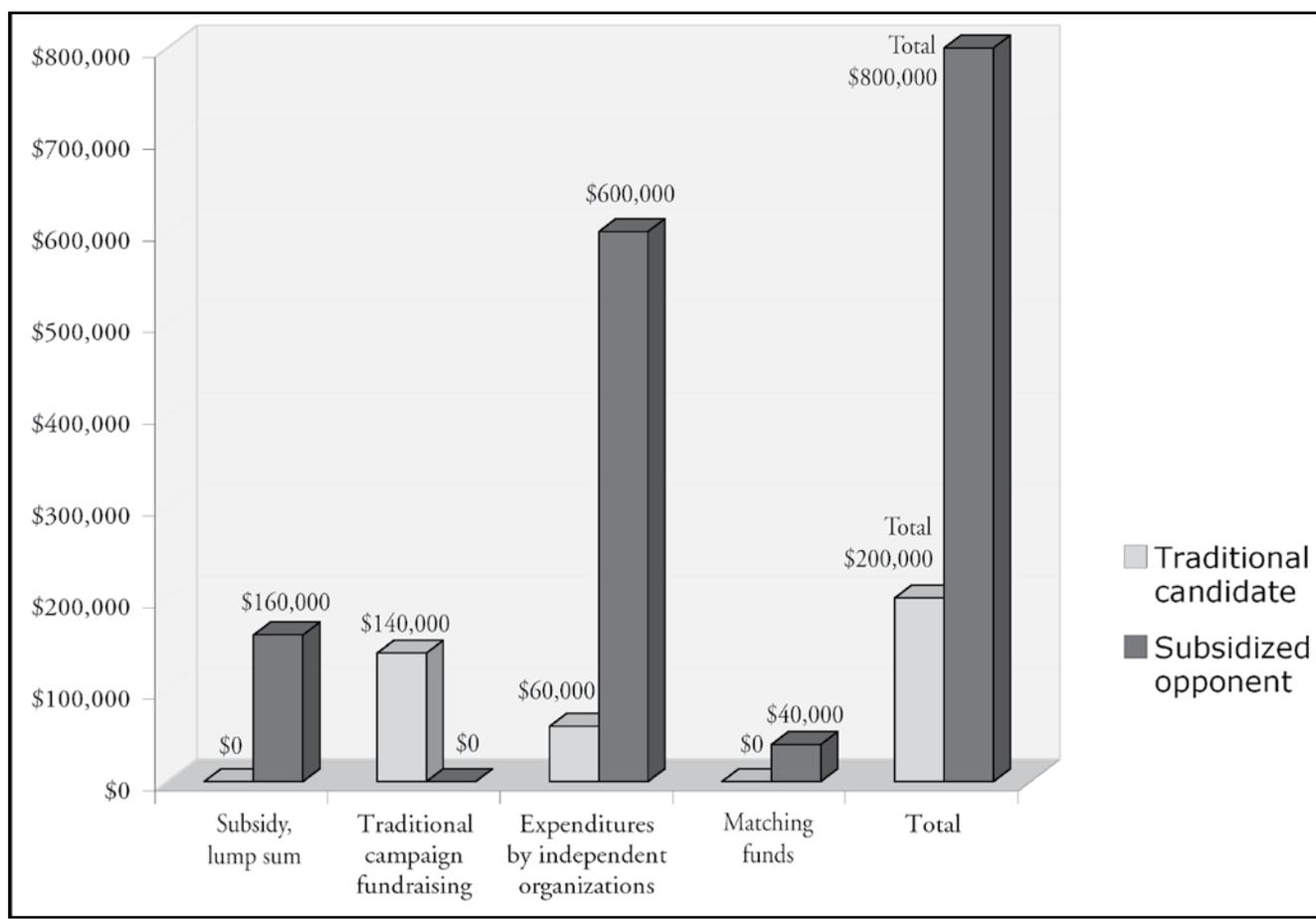
- North Carolina state income tax forms contain a checkbox for taxpayers who wish to divert \$3 of their taxes to public campaign financing systems. Only about 8 percent of taxpayers choose to do so, indicating very little public support for the system.
- In *Davis v. FEC* (2008), the United States Supreme Court held that punishing a self-financed congressional candidate for spending beyond a threshold amount was unconstitutional. In *Arizona Free Enterprise Club PAC v. Bennett* (2011), the Supreme Court struck down a matching-funds provision as an unjustifiable burden on political speech.
- In response to those rulings, the NC General Assembly has opted not to fund the system, but future legislatures could decide differently. Also, the federal judge's ruling doesn't apply to Council of State races.
- In 2011, a proposal to hold a constitutional amendment on judicial elections fell short in the legislature. Among other things, it would have put special interests in charge of selecting candidates for judicial races, among whom voters could then choose. Appointments would have been made by a commission of unelected, unaccountable members drawn from such special-interest groups as the North Carolina Bar Association, N.C. Advocates for Justice, N.C. Association of Defense Attorneys, N.C. Association of Women Attorneys, and N.C. Conference of District Attorneys.
- Whether public election of judges is the best approach for North Carolina is a legitimate issue for debate, but replacing it with an appointment process dominated by special interests risks creating a worse system, one in which the foxes guard the henhouse.

Recommendations

1. **Repeal North Carolina's public campaign finance systems.** Taxpayer financing systems are unwise and matching-funds provisions are unconstitutional.
2. **Beware of judicial election reforms that would replace voters with special interests.**

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Hypothetical Council of State race with a matching-fund threshold of \$160,000



In this example, the subsidized candidate starts out with a \$160,000 lump sum of taxpayer-provided campaign financing, which the traditional candidate doesn't get. The traditional candidate raises and spends \$140,000 for his campaign, while the subsidized candidate relies on public funding. So far the subsidized candidate has a \$20,000 advantage over the traditional candidate.

Both candidates receive support from independent organizations. The subsidized candidate receives ten times the amount of support from independent organizations as his traditional opponent: \$600,000 vs. \$60,000. Now the subsidized candidate essentially holds a \$560,000 funding advantage over the traditional candidate (\$760,000 in support vs. \$200,000).

Nevertheless, under the matching-funds system, when the traditional candidate's support went above the matching-fund threshold of \$160,000, it triggered an additional \$40,000 in matching taxpayer funds for the subsidized candidate. Now the subsidized candidate holds a \$600,000 advantage over the traditional candidate: \$800,000 vs. \$200,000. The subsidized candidate is given \$200,000 in taxpayer campaign support without respect for the massive difference in spending in favor of the subsidized candidate.



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*“To prejudge other men’s notions
before we have looked into them
is not to show their darkness
but to put out our own eyes.”*

JOHN LOCKE (1632–1704)

*Author, Two Treatises of Government and
Fundamental Constitutions of Carolina*



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