AGENDA 2002

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

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TABLE OF CONTENTS

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THE STATE BUDGET

North Carolina's state budget reflects its governmental priorities. Unfortunately, over the past two decades governors and lawmakers have usually chosen to add new programs to the state budget without considering the merits of existing programs and finding ways to fund higher-priority items by eliminating lower priorities. As a result, the budget has grown by leaps and bounds, interrupted only briefly by retrenchment during recessionary periods, including the past three fiscal years. Until state leaders learn to exercise fiscal discipline or to write fiscal discipline into law via a strong expenditure limit the budget will continue to expand out of control during years of normal or superlative revenue growth, creating strong pressure on state lawmakers to raise taxes in the middle of economic downturns, as they did in 2001 and 2002.

THE RECENT PAST

Over the past 20 years, the state budget has grown by 362 percent. Even after adjusting for inflation and population growth, General Fund operating spending has grown 75 percent since 1981-82, with per-capita taxes rising accordingly on North Carolina families and businesses.

During the 1990s, the state budget trended upward, despite brief slowdowns during the 1991-92 recession and after the 1994 elections. Since 2000, spending growth has been essentially flat, after adjusting for increases in population and prices. However, it is important to remember that this period of tight budgets in the early 2000s followed a longer period in the 1980s and 1990s when lawmakers approved massive spending increases, creating new programs and expectations that could not be met with the current tax code and normal revenue growth.

SETTING BUDGET PRIORITIES

North Carolina's state budget is full of items, programs, or whole agencies that fall outside the proper scope of government and the highest-priority needs of the state. For example, the John Locke Foundation's alternative budget in 2002 identified $255 million in wasteful subsidies to corporations, $221 million in state services that should be the responsibility of users instead of taxpayers, $100 million in bureaucratic duplication, $218 million in non-teaching personnel and expenses in public schools, and $87 million in inappropriate subsidies for research and arts organizations that should be funded privately or locally, among other savings.

In evaluating state budget items, lawmakers should be asking these key questions:

- Does the item duplicate what other state agencies or the federal government are doing in that area?
- Does the item benefit primarily a definable local area rather than the state as a whole?
- Does the item attempt to accomplish a task that is best left to private firms, charities, or families?
- Are direct users or beneficiaries of the service paying a reasonable amount of the cost?
- Does the item create or expand an entitlement that cannot reasonably be taken back in the future?
- Has the item received significantly more money in recent years but not used it in the most effective way?
- Has the item been funded in the past by deceptive or inappropriate legislative or executive actions?
- Does the item use taxpayer funds for political advocacy or to discriminate against racial or ethnic groups?

PROTECTING THE TAXPAYERS

Faced with an inability on the part of lawmakers to set priorities, some states have had success with tax or expenditure limits that peg allowable government growth to changes in population, inflation, or other factors.

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In North Carolina, a proposed Taxpayer Protection Act to allow General Fund budgets to grow in tandem with inflation and population has previously passed the N.C. House but never the N.C. Senate. If a strict Taxpayer Protection Act had been in place during just the past five fiscal years, the state's General Fund budget would have been about $1.5 billion lower in FY 2001-02 — eliminating the budget deficit for that year.

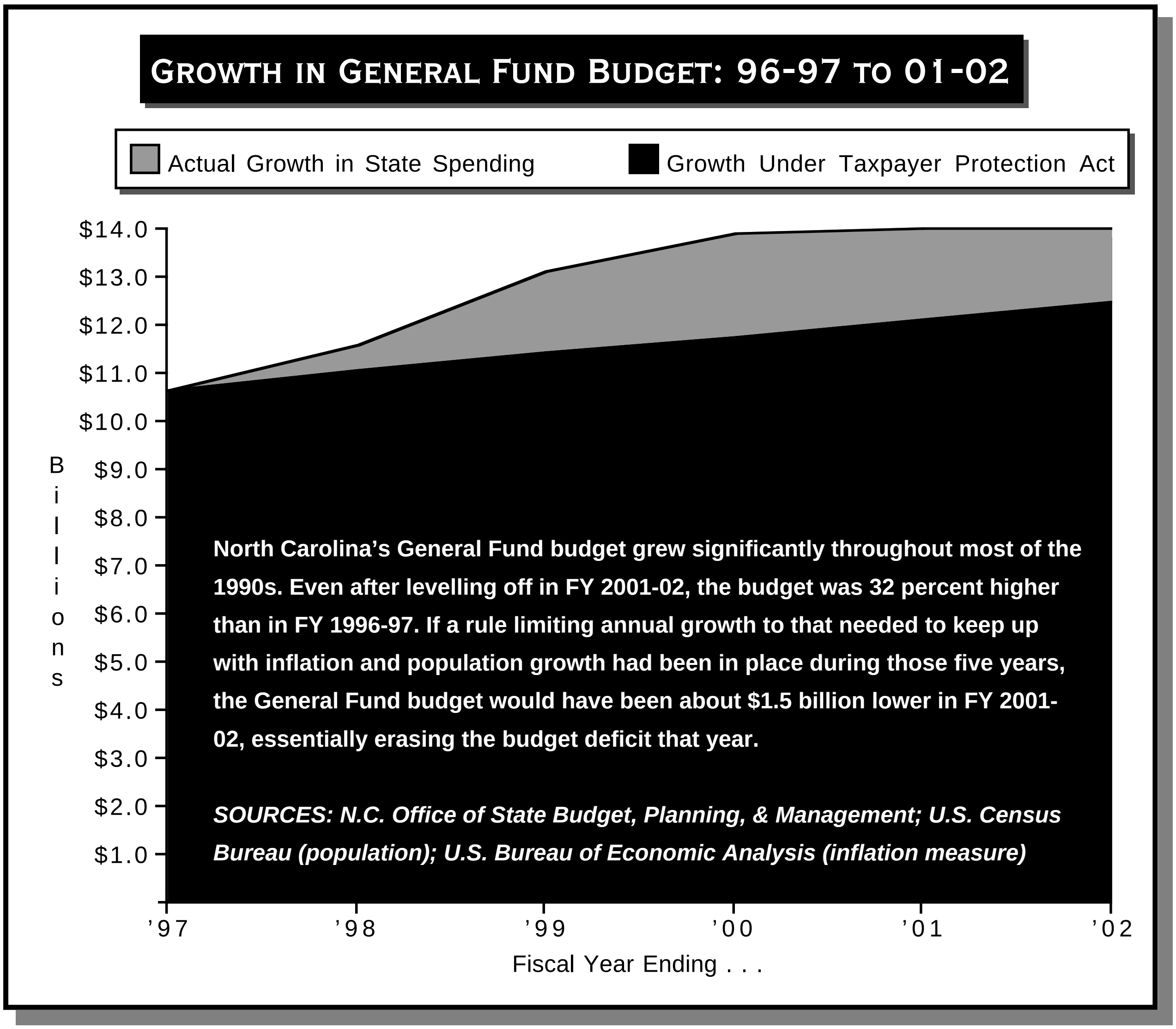
GOAL

To carry out the core responsibilities of state government at the lowest possible cost to taxpayers.

RECOMMENDATIONS

1. State leaders should set firm fiscal priorities every year and search the base budget for items or programs to cut if new spending is needed in other areas. In particular, lawmakers should reduce or eliminate corporate subsidies, pork barrel spending, and programs best left to local governments or private institutions.

2. State leaders should enact in statute, or better yet submit as a constitutional amendment to voters, a Taxpayer Protection Act to limit annual spending increases to a combination of population growth and inflation.



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THE STATE TAX BURDEN

Taxes represent the price we pay for government, so a reasonable tax burden is of benefit to the citizens who consume the services they fund. Unfortunately, the price of government in North Carolina has grown dramatically over the past two decades, and is no longer reasonable. More recently, while state lawmakers reduced taxes in the mid-1990s, they raised them even more earlier in the decade and then again in 2001 and 2002, resulting in an overall growth in the tax burden of more than $1 billion.

A GROWING TAX BURDEN

North Carolina's marginal tax rates on individual and corporate income are the highest in the Southeast (see table) and among the highest in the United States. This represents a strong disincentive for individuals to work, save, and invest in our state. Even after adjusting for exemptions and deductions, North Carolina's *effective* tax rate — tax collections divided by personal income — is 7.3%, ranking 21st in the nation. North Carolina also tops the Southeast in effective tax rates on individual and corporate income and has a high gas tax.

However, because North Carolina relies more heavily on state funding for such core services as schools and roads than its peers do, its high ranking on state taxes is somewhat offset by low ranking on local taxes. Still, the combined state and local tax burden in North Carolina of 10.1 percent of income is second only to Georgia (10.2 percent) in the Southeast, and is half a percentage point higher than in 1992. Overall, North Carolinians pay an average of 31 percent of their income in federal, state, and local taxes, ranking the state 35th in the nation.

Research has demonstrated clearly that taxes have a significant economic impact by discouraging out-of-state businesses from relocating and by limiting new business starts. High marginal rates on income, in particular, have been shown to reduce economic output, so North Carolina's relatively heavy reliance on high income tax rates is troubling. A 1997 study for the Locke Foundation by N.C. State economist Michael Walden found that state income taxes had a large negative impact on job growth and personal incomes in North Carolina.

RECENT STATE ACTIONS

Before the 1994 elections, the General Assembly had enacted or approved five major tax increases since 1983, including hikes in sales taxes, income taxes, motor fuels taxes, and excise taxes. The last two, implemented in 1990 and 1992, had a combined fiscal impact more than $1.8 billion in 2001. Subsequent cuts beginning in 1995 saved taxpayers $1.4 billion in the same year meaning that, over the decade, the state tax burden actually rose by about $427 million. Furthermore, while tax increases in the early 1990s hiked marginal tax rates, recent tax cuts have focused primarily on exemptions, deductions, and credits, leaving our high marginal tax rates intact.

The situation worsened considerably in 2001 when the General Assembly raised various income, sales, and business taxes by the annual equivalent of $609 million. Thus, from 1990 to 2002, North Carolinians experienced a net state tax increase of more than $1 billion. At this writing, it is likely that legislative budget decisions in the summer of 2002 will impose another $770 million in new state taxes by FY 2003-04, raising the state's tax burden significantly above the national average (see table).

RECOMMENDATION

North Carolina policymakers should make it a goal at least to reduce taxes enough to bring the state tax burden in line with where it was at the start of the 1990s. Of particular concern should be the state's high individual income tax rates. Over time, reducing the current 6%, 7%, 7.75%, and 8.25% rates to a flat rate of 5.75% would dramatically improve the state's economic competitiveness and save taxpayers well over $1 billion a year.

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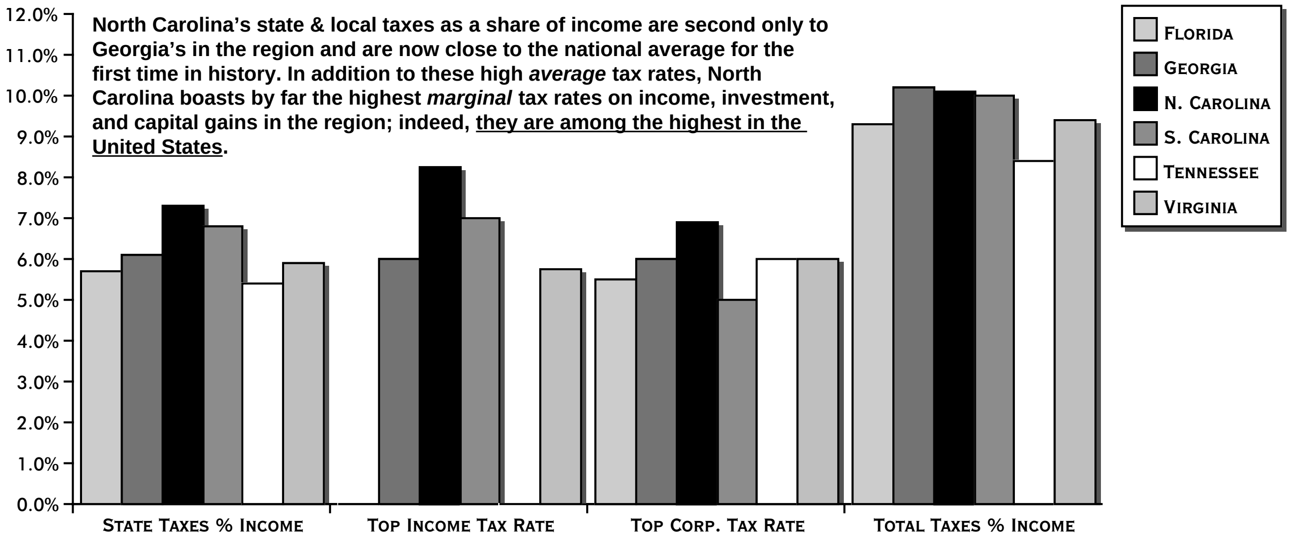
North Carolina's Real Economic Problem: High Overall Tax Rates

North Carolina's state & local taxes as a share of income are second only to Georgia's in the region and are now close to the national average for the first time in history. In addition to these high *average* tax rates, North Carolina boasts by far the highest *marginal* tax rates on income, investment, and capital gains in the region; indeed, <u>they are among the highest in the United States</u>.

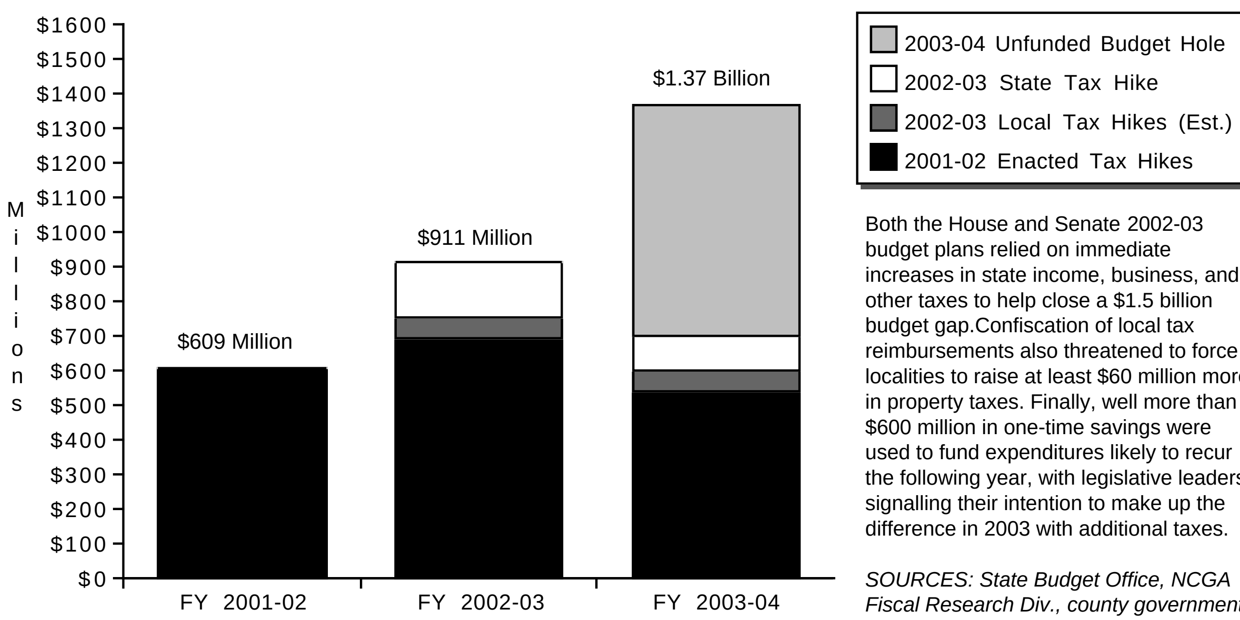


	State Taxes % Income	Top Income Tax Rate	Top Corp. Tax Rate	Total Taxes % Income
Florida	5.7%	0.00%	5.5%	9.3%
Georgia	6.1%	6.00%	6.0%	10.2%
N. Carolina	7.3%	8.25%	6.9%	10.1%
S. Carolina	6.8%	7.00%	5.0%	10.0%
Tennessee	5.4%	0.00%	6.0%	8.4%
Virginia	5.9%	5.75%	6.0%	9.4%

NOTE: "Total Taxes % Income" measure includes all state and local taxes, including income, sales, business, and property. It does not include the full value of the 2001 tax increases, and thus understates the competitiveness problem facing North Carolina.

SOURCES: U.S. Census Bureau, Tax Foundation

Tax Implications of Recent Legislative Budget Actions



Both the House and Senate 2002-03 budget plans relied on immediate increases in state income, business, and other taxes to help close a $1.5 billion budget gap.Confiscation of local tax reimbursements also threatened to force localities to raise at least $60 million more in property taxes. Finally, well more than $600 million in one-time savings were used to fund expenditures likely to recur the following year, with legislative leaders signalling their intention to make up the difference in 2003 with additional taxes.

SOURCES: State Budget Office, NCGA Fiscal Research Div., county governments

STATE TAX REFORM

North Carolina has a high state tax burden by regional standards, and its top marginal tax rates on individual (8.25 percent) and corporate (6.9 percent) income are among the highest in the U.S. Since 1990, the state legislature has imposed a net tax increase of more than $1 billion, with additional tax hikes likely in coming years. Clearly, more effort is needed to alleviate the tax burden on North Carolina families and businesses. But the issue before state policymakers is not only the total size of the tax burden but also whether the tax code is efficient, equitable, and comprehensible to average taxpayers.

PRINCIPLES OF TAX REFORM

The state should levy taxes in order to fund government programs, not to manipulate personal and family behavior or try to "steer" the state's economy in directions that politicians might like. There are three main principles that should guide the creation of a fair and efficient tax code:

• Simplicity — Can taxpayers understand the tax code and reliably predict their tax liability over time?
• Neutrality — Does the code create biases in favor of particular taxpayers, regions, or economic decisions?
• Equity — Do taxpayers pay for government roughly in proportion to the benefits they receive?

Tax codes that violate the simplicity principle waste time and resources trying to enforce complex rules that most taxpayers cannot understand without professional assistance (and sometimes even with such help). Tax codes that violate the neutrality principle attempt to use taxes to benefit special interests, thus interfering with the efficient operation of a free-market economy. If subsidies for particular forms of behavior or classes of businesses are justified, they should be appropriated in the normal budget process for all to see.

The equity principle is most frequently misunderstood. Some argue that equity means imposing taxes based on one's "ability to pay." That is nothing more than income redistribution or, less charitably, larceny. Rather, taxes should as much as possible relate to the benefits one receives from government programs. For enterprises such as highways that the state operates but for which individuals do not have a constitutional entitlement, equity demands that users pay for the system through such means as gasoline taxes and tolls.

For entitlements such as public safety or education, equity demands that citizens pay according to how much they benefit from a safe or well-educated society. At the state level, a good way to measure that benefit is annual consumption. A person consuming twice as much of his income as another, and thus presumably deriving twice as much benefit from living in the state, ought to be pay about twice as much in taxes. Similarly, the value of local services such as police and fire protection rises in proportion to the ownership of physical assets, so a property tax that compels one with twice as much property value to pay twice as much tax fulfills the equity principle. Of course, the tax code violates this principle when it imposes either "progressive" taxes — more than one marginal income tax rate, for example — or "regressive" taxes, such as per-home impact fees or stormwater charges that do not correlate with property value or the use of local services.

PROBLEMS WITH NORTH CAROLINA'S CODE

Like most states, North Carolina has developed its state tax code in a piecemeal fashion rather than using tax reform principles to build a coherent and efficient system. As a result, a variety of special rates, exemptions, exclusions, deductions, and credits litter the code. In the corporate tax code alone, special tax credits for job creation, research and development, machinery, worker training, and other expenditures will total $75 million in 2002, or about one-fifth of all corporate income taxes the state will collect. Another problem is the income tax

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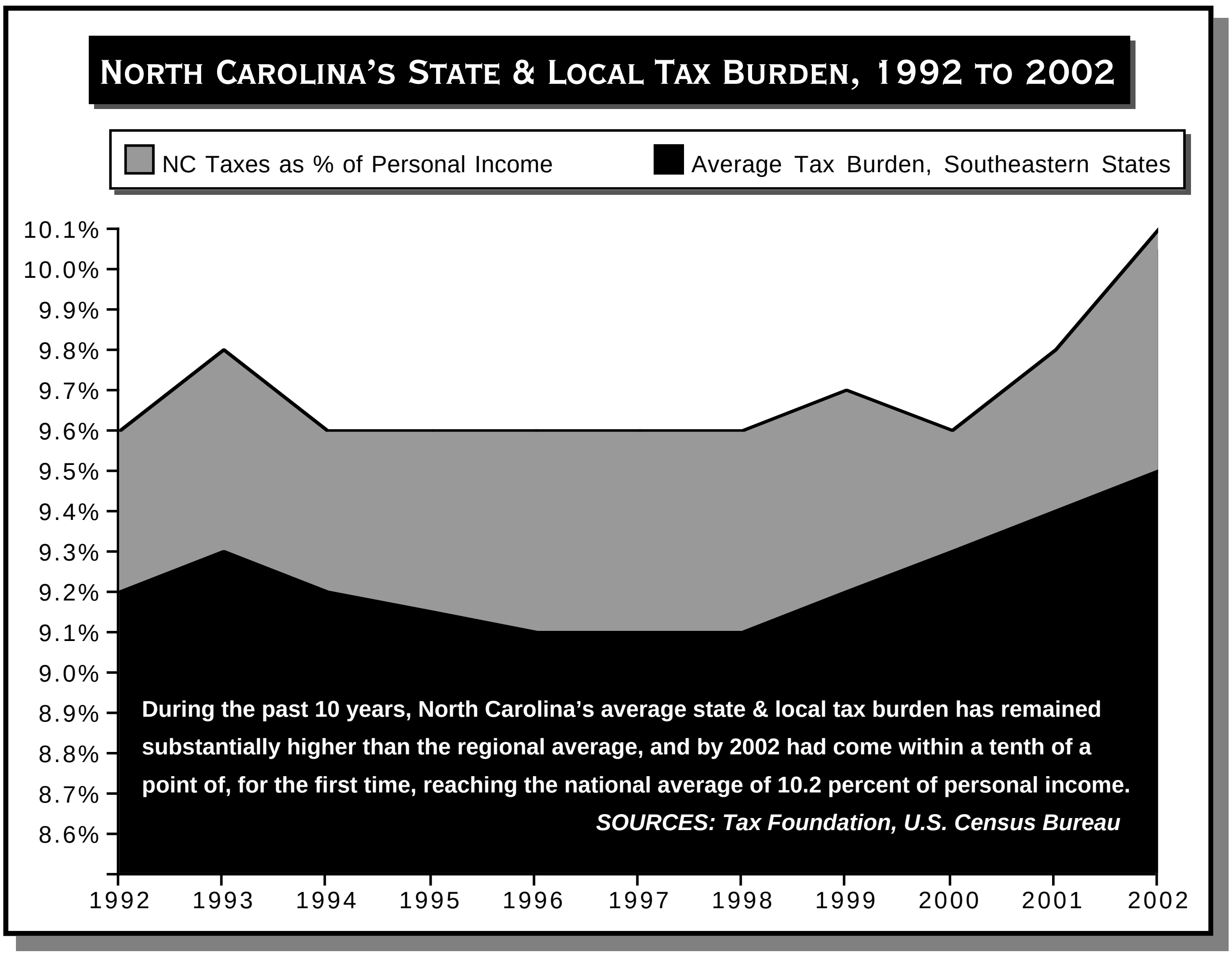
code's bias against savings and investment. A dollar of income that is immediately consumed is taxed only once. But income that is invested is taxed multiple times, particularly if used to purchase corporate equities; the dollar is reduced before it is invested, then the return is reduced by both corporate and individual income taxes. Neutrality demands that only current consumption, not future consumption (i.e., investment), be taxed.

Although many of the problems in the income tax code stem from the federal system, state leaders still have options for reform. The goal should be to broaden the tax base while reducing the number and amount of tax rates. For income taxes, North Carolina should move toward a flat consumed-income tax in which 1) one low rate is applied, 2) it is applied only once to the same dollars, and 3) the base is limited to consumption by subtracting savings from income. A sound income tax code, in other words, would not tax capital gains or corporate dividends. Such a system would also exempt as much as possible investment not just in financial capital but in "human capital" such as family expenditures for education, health care, and child rearing that, like other investment, yield future taxable income. Tax-free savings accounts for these expenses would suffice.

RECOMMENDATIONS

1. State policymakers should remove special exemptions, deductions, credits, and rates from the state tax code that are inconsistent with principles of simplicity, neutrality, and equity. In every case, the goal should be to lower tax rates while offsetting at least some of the revenue loss by broadening the tax base.

2. North Carolina should reform its income tax system over time to create a single-rate, easy-to-understand tax on consumed income that ends multiple layers of taxation on savings and investment, including human capital. This must include either making corporate dividends tax-deductible or abolishing corporate income taxes.



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STATE AGENCY CONSOLIDATION

The constitutional offices of North Carolina state government have changed little since the beginning of the century. As a reaction first to the tyranny of royal governors and then to the Civil War, the state has divided executive power among a number of separately elected offices. At the same time, governors and legislators have created many agencies under their direct control. The result has been a lack of coordination and focus on major functions, wasteful administrative spending, and a lack of accountability to the public.

THE NEED FOR CONSOLIDATION

State government departments need to be reorganized and consolidated. Departments or agencies that perform similar functions should be grouped together, both to reduce cost and improve the delivery of services. At the same time, the number of separately elected executive branch officers should be reduced to three at most — the governor and lieutenant governor, who should run as a team, and an independent state auditor. By electing too many officers to fixed four-year terms, the current system limits immediate accountability for poor performance by department heads and creates confusion among citizens and lawmakers.

For example, there are five major departments or offices that oversee state finances: the Department of Revenue, State Treasurer, State Controller, State Auditor, and the Office of State Budget, Planning, and Management. Most of these separate units could be merged into a Department of Finance, headed by an appointed secretary. It would include divisions similar to the previous departments, but would not require the staff or funding now necessary. Similarly, there are currently six departments or agency categories that attempt to regulate business activities in North Carolina. These should be consolidated (when not eliminated outright) to form a single Department of Commerce devoted to providing consumers with reliable information and protection from fraud.

Other opportunities for savings include forming a single statewide police force within a consolidated Public Safety Department and merging all disability services within the Health and Human Services Department.

Under the state constitution, the governor has constitutional authority to reorganize state government. If the reorganization affects existing law, the governor must file the changes as executive orders with the General Assembly during a legislative session. They become effective at the end of the session unless at least one house votes them down. Furthermore, if the governor and General Assembly wish to proceed with administrative reorganization that eliminates the major duties of the Council of State, they can do so. While the constitution mandates that Council of State offices be elected, it does not define their duties. The offices could be made part-time advisory positions with no administrative duties. The governor could reassign their duties by executive order, and could even appoint Council of State members to head departments in his or her administration.

GOAL

Consolidate state departments to eliminate unnecessary bureaucracy, clarify responsibility for governmental functions, and concentrate departments around core state functions.

RECOMMENDATIONS

1. Consolidate functions and reduce the number of major departments to 12 from 24 (as depicted on the next page). These and other agency reorganizations could save taxpayers as much as $100 million a year.

2. Amend the state constitution to eliminate all elected state executives except the governor, lieutenant governor, and state auditor, and to downsize and streamline accountability for appointed state boards.

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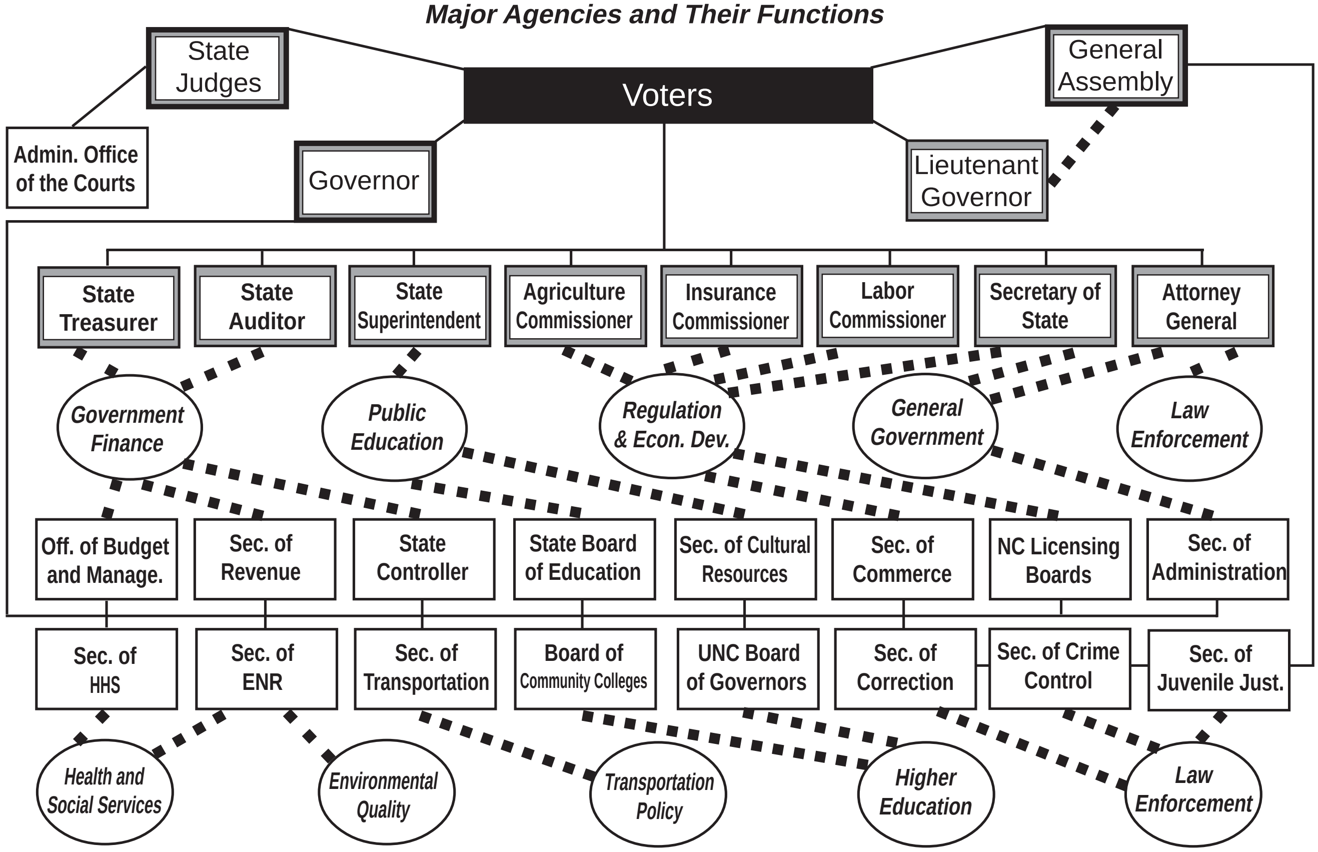
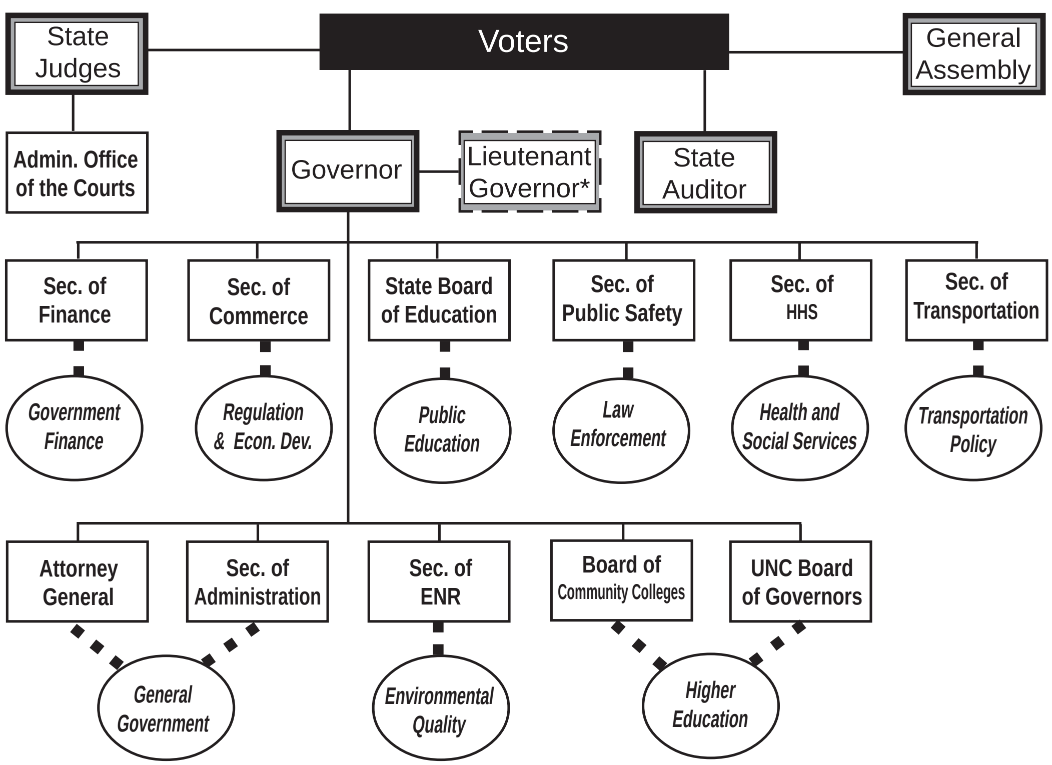
Current North Carolina State Government

Major Agencies and Their Functions



After Consolidation

* Lieutenant Governor would hold an appointed Cabinet post



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THE STATE LOTTERY

The idea of creating a state-run lottery in North Carolina has been a perennial issue in state politics for decades. While some say that the issue involves the personal freedom to gamble or the need to keep dollars circulating within the state, the real question is whether state officials should set up a gambling monopoly likely to attract players disproportionately from lower-income households and then impose punitive taxes on them to expand the size and budget of state government. The answer is clearly no.

RUNNING THE LOTTERY NUMBERS

North Carolina is the largest state in the U.S. without a state-run lottery, and is bordered by three states — Virginia, Georgia, and now South Carolina — that operate games and confiscate appropriately one-third of the gross sales as state revenues. While lottery advocates often state that “hundreds of millions of our dollars” are flowing to these neighboring state lotteries, they are either misinformed or trying to misinform North Carolinians. As the table on page 13 demonstrates, the real “revenue loss” to our neighbors is approximately $71 million, not enough by itself to justify the annual cost of running the games.

Because most state lotteries have had trouble in recent years meeting their revenue projections, it would seem to be wise to err on the side of caution when selling the idea to taxpayers. Yet Gov. Mike Easley and others say that a North Carolina lottery would generate $1.5 billion in gross sales annually — or nearly $500 per household — netting the state $500 million in revenues. The real net-revenue number is likely to be closer to $300 million, or 40 percent lower than Easley’s projection. The governor has already decided which new and existing programs to fund with lottery revenues, so his plans would likely generate additional large budget deficits in the future, hardly a way to restore fiscal soundness to North Carolina government.

CONSEQUENCES OF A STATE-RUN LOTTERY

If the experience of other state lotteries is any guide, a North Carolina lottery would generate several adverse consequences. Gamblers are not evenly distributed across a society; they are often concentrated in low-income and minority communities, where studies show that lottery sales are disproportionate. Furthermore, the propensity to purchase lottery tickets — or any other low-cost consumer good — declines as income rises, which guarantees that a lottery would impose a regressive tax burden (it is not likely that Easley and other wealthy North Carolinians would spend the thousands of dollars annually on lottery tickets it would take to equal the share of household income lower-income players would spend). Advocates who say that “people at every income level play the lottery” don’t seem to understand what “regressive” means. It’s about proportionality.

Another legitimate objection to a North Carolina lottery is that it would place the state in the position of endorsing and promoting an activity that many of its citizens believe is immoral. One need not oppose legalized gambling to oppose a lottery. At least privately operated casinos, horse tracks, or friendly poker games do not implicate government officials in swindling anyone and have the virtue — unlike a government-monopoly lottery — of offering choice and competition to improve the odds of winning. Necessarily, a state lottery would have to advertise aggressively on television, radio, and billboards, sending a government-approved message to young people that the way to get ahead in life is not to study and work hard but to gamble.

RECOMMENDATION

North Carolina should not enter the gambling business in any form. If desired, policymakers can remove barriers to legal gambling for private individuals and enterprises, collecting normal taxes on the business.

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Net State Revenues From NC Lottery Players

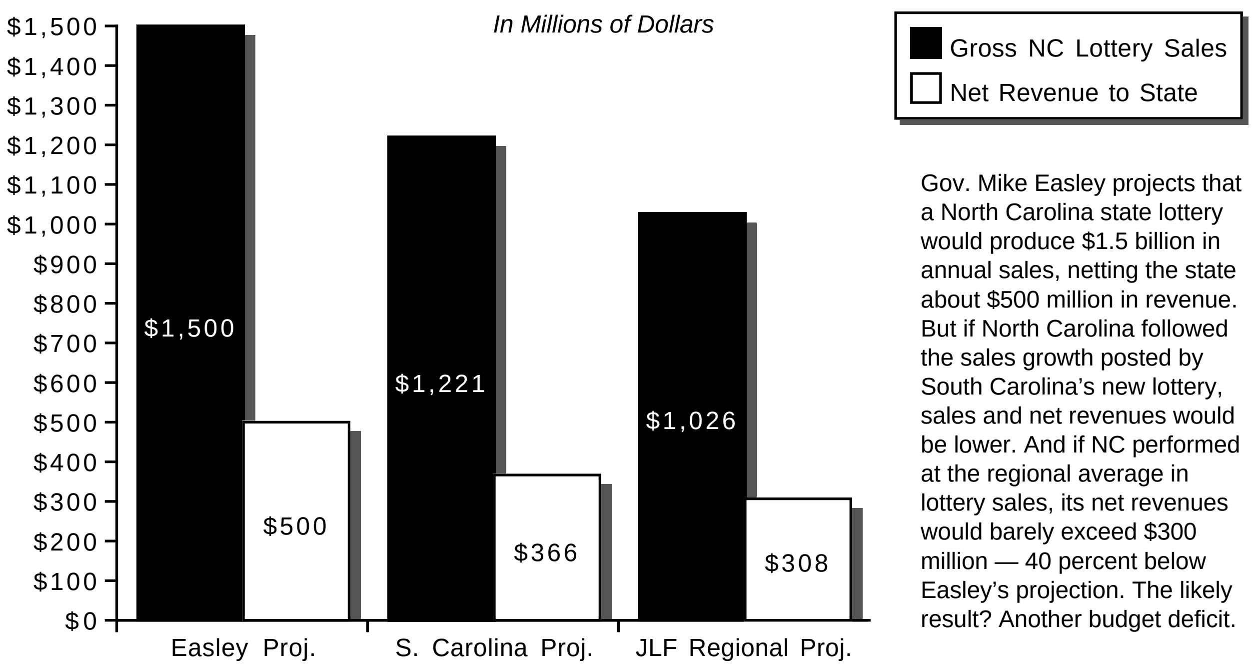
(Estimated for Virginia and Georgia, Projected for SC based on 20 weeks of sales)

Lottery State	Gross Sales to NC Players	Prizes Awarded to NC Players	Allocation of Administration	Net Revenues From NC Players
Virginia	$98,450,344	$54,147,689	$11,814,041	$32,488,614
Georgia	$10,534,717	$5,727,726	$1,320,000	$3,486,991
Subtotal	$108,985,061	$59,875,415	$13,134,041	$35,975,605
South Carolina	$106,899,000	$58,473,753	$13,148,577	$35,276,670
TOTAL	$215,884,061	$118,349,168	$26,282,618	**$71,252,275**

Projected Administrative Cost of NC Lottery $164,253,739
Projected Fee to Out-of-State Private Contractor $51,329,310

As the table reveals, North Carolina annual net "revenue loss" to neighbors due to the lack of a state lottery is only $71 million — far lower than the cost of setting up and running it each year, and only a little more than the annual management fee North Carolina would pay to an out-of-state contractor.

Revenues from Proposed NC Lottery, Three Estimates



Gov. Mike Easley projects that a North Carolina state lottery would produce $1.5 billion in annual sales, netting the state about $500 million in revenue. But if North Carolina followed the sales growth posted by South Carolina's new lottery, sales and net revenues would be lower. And if NC performed at the regional average in lottery sales, its net revenues would barely exceed $300 million — 40 percent below Easley's projection. The likely result? Another budget deficit.

SCHOOL STANDARDS & TESTING

With the implementation of the ABCs of Public Education, the Excellent Schools Act, charter school legislation, and other reforms, North Carolina lawmakers have put education at the top of the priority list. But even after some recent progress, repeated problems with the state testing program and the continued poor performance of N.C. students on reputable tests — particularly among minority youngsters — suggest that more fundamental changes are needed.

IMPROVEMENT — TO MEDIOCRITY

North Carolina's end-of-grade and end-of-course tests, used as the basis for ABC bonuses and sanctions, put its schools in the best light. In 2000-01, 72.5 percent of students in grades 3 through 8 scored at grade level in reading and math, up from 53 percent in 1993. That's a significant gain, reflecting the value of creating statewide tests and reporting the results. The ABC model offers a valuable structure within which to pursue reform.

Unfortunately, the state's tests are flimsy guides to student achievement. State officials were embarrassed in 2001 to discover that their new math tests were absurdly easy to pass — a product of poor judgment and a flawed system of field testing. The problems go far beyond this one episode. To achieve "grade level" often means that students need not get even half the questions right, so they can expect to pass simply through educated guessing. Most questions on math tests do not involve computation. Spelling and grammar don't count on most writing tests. And while both state tests and the well-respected National Assessment of Educational Progress (NAEP) use four levels of achievement, the performance necessary to earn Level 3 on state tests is lower than the NAEP's Level 2. In other words, North Carolina's expectations are too low.

A related concern is that while state tests have shown improved reading skills since 1994, NAEP scores show little or no gain, and even a slight decrease in reading proficiency in the 4th grade. Similarly, from 1993 to 2001 the state administered the Iowa Test of Basic Skills to a sample of 5th and 8th graders. The large upward trend on state tests was not mirrored in the Iowa Test results, which showed a more modest gain during the period (alarmingly, the state dropped the Iowa Test last year). On the other hand, North Carolina has realized major improvements on NAEP math tests and are at or slightly above the national average in most NAEP subjects.

Although the state's schools have improved, they still have a long way to go. According to recent NAEP tests, nearly 40 percent of our 4th-graders lack basic reading skills, while 30 percent of 8th-graders can't do basic math. If North Carolina were a country, our scores would be below those of most European and Asian countries. Furthermore, fewer than 60 percent of high school students graduate on time, the rest dropping out or falling far behind their peers. If the average performance of N.C. public school students is mediocre, the situation faced by our minority students can rightly be called a crisis. About 60 percent of black 4th-graders can't read at a basic level, while 58 percent of black and 43 percent of Hispanic 8th-graders lack basic math skills.

In an effort to provide parents and taxpayers with a comprehensive and comprehensible way of gauging the performance of North Carolina public schools, the Locke Foundation's North Carolina Education Alliance issues letter grades each year to school districts based on four measurements: 1) percentage of students passing state tests, 2) average scores on state tests, 3) graduation rates, and 4) average SAT scores. For the 2000-01 school year, nearly half of the districts received a D or F and only 7 received Bs. The statewide average was a C-.

DECLINING PRODUCTIVITY

The biggest challenge facing North Carolina public education is low productivity. What gains have occurred in recent years have come at great cost to taxpayers. Over the past decade, per-pupil spending in North Carolina grew at about twice the rate of inflation, much of it to hire new teachers and pay them more. In 2000-01, our public schools spent an average of nearly $6,800 per pupil. But there is no merit pay for individual teachers, no real way for principals to hire and retain whom they wish, and little competitive pressure placed on the public school monopoly . More money alone will not yield better results. Careful studies for the John Locke Foundation in 1997 and 1998, as well as those by other researchers, show no correlation between per-pupil spending and test scores. Moreover, students improved on state tests at roughly the same rate before and after costly and far-reaching reforms enacted in 1996, as the graph below reveals, calling into question their effectiveness.

RECOMMENDATIONS

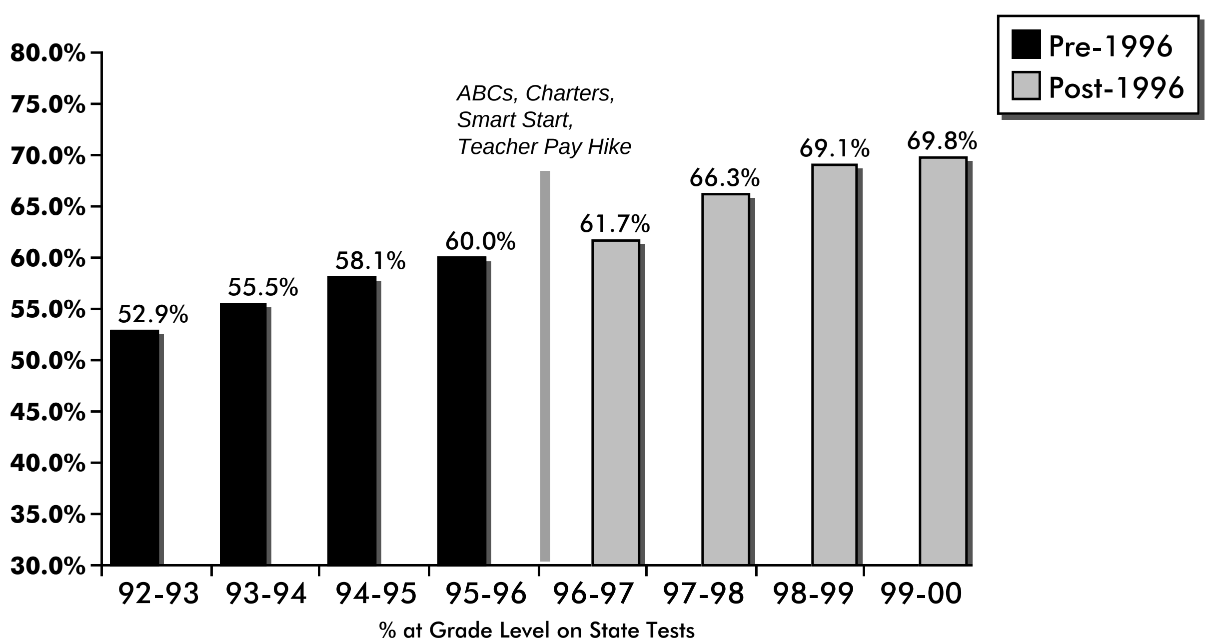
1. The state's end-of-year and end-of-course tests should be replaced with an independent, field-tested, and credible national test of student performance such as the Iowa Test of Basic Skills. ABC reporting should be revised to give schools letter grades so that parents can track not just growth but also objective performance of their students and schools. North Carolina should also set a goal of at least half of students showing proficiency and 90 percent testing at the "basic" level as defined by reputable national tests such as the NAEP.

2. In addition to measuring, reporting, and rewarding overall growth in school test scores, the ABC system should reward individual teachers based on the value they add to the performance of their students.

3. The state should move aggressively to comply with the new federal education bill by offering recognition and bonuses not just when average scores rise but when schools reduce or eliminate the performance gap among racial and socioeconomic groups through high expectations for all.

4. State policymakers should deregulate and decentralize public schools while maintaining accountability for results by abolishing tenure and rigid certification rules, giving districts more flexibility in spending existing dollars, and lifting the cap on charters to allow more innovative public schools to be created across the state.

NORTH CAROLINA SCHOOL PERFORMANCE: BEFORE AND AFTER KEY REFORMS



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SCHOOL CHOICE & COMPETITION

Public education is a core function 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 inflexible, bureaucratic government monopolies, as a diverse array of magnet, charter, and private schools are demonstrating across the country and, increasingly, in North Carolina. Parent choice and competition should be core elements in any school reform.

WHY CHOICE AND COMPETITION MATTER

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. Even in health care, where government pays about half the bill for medical services, patients are usually afforded the right to choose their hospital or medical provider. Indeed, to the extent that funding systems such as HMOs attempt to restrict patient choice, the quality of care declines and public and political pressure builds to enforce a "Patients' Bill of Rights." But don't parents, who are in the best position to assess their children's needs, deserve at least the same kind of protection?

Affluent families already exercise choice. They can move to neighborhoods where assigned schools are of good quality, or afford to pay twice for better education once for private school tuition and then again in taxes to fund schools they don't use. Poorer families with school-aged children have few such options. Nor do they have as much choice as those with preschoolers or college students, who have long been able to use taxpayer funds to help defray the cost of private, even religious, instruction. If a preschooler can stay in a church-run day care center, or a student attend a theological seminary, and receive public funds for doing so, why can't a poor, inner-city child needing effective instruction or special attention attend a private school without financial penalty?

EDUCATIONAL OPTIONS IN NORTH CAROLINA

An increasing share of North Carolina's students are exercising choice. Several school systems, including Mecklenburg and Wake, have established magnet schools or otherwise expanded parental choice within their districts. A 1996 law established a new category of public schools, called charters, that receive public operating funds and thrive only to the extent they attract students. In 2000-01, nearly 16,000 students were enrolled in charters. Among private schools, enrollment exceeded 91,000 by 2001, up 72 percent from its 1991 level, with home-schooled students rising from 4,100 to nearly 34,000. Finally, privately funded scholarship programs in Charlotte, the Triad, and the Triangle help more than 600 poor students afford private education. Overall, the proportion of North Carolina students attending schools of choice more than doubled during the past decade.

These programs and others like them across the country are showing early promise in boosting achievement and parental satisfaction and reducing the racial "performance gap." While North Carolina's charter schools still lag other public schools on state tests (66.4 percent at grade level for well-established charters compared to the statewide average of 72.5 percent), many perform better on national tests that more closely fit their unique programs — and enroll a disproportionately high number of poor students and those failing out of their previous school. More promising are private-school choice programs. An independent study of Charlotte's Children's Scholarship Fund found that low-income students receiving vouchers to attend private schools outperformed a control group of eligible but nonparticipating students by up to 8 percentile points on standardized tests. In one year, the performance gap for these overwhelmingly black students had been cut by one-fourth — an effect matching or exceeding that of any other school reform studied, including class-size reduction.

North Carolina could move forward with publicly funded scholarships for at-risk students without costing public schools. For example, the state could offer scholarships equal to the average cost of private education to

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the poorest 50 percent of students in North Carolina's low-performing schools for less than $60 million a year. If a significant number of students took the scholarships, the state would save more in operating and capital costs in the public schools (up to $71 million at full participation) than the program would cost.

For more affluent families, however, taxpayer-funded scholarships would have a greater fiscal impact and might also create a risk of government entanglement with private and religious schools that value their independence. A better way to promote parental choice for these families is to make expenditures or savings for their children's education tax-deductible. Just as investments in financial capital, such as IRA deposits, should be deductible in order to avoid the double-taxation of savings, so should family investments in the "human capital" of their children be deductible, since they yield future taxable income when the children enter the working world. Even a modest deduction of up to $3,500 per child would save families hundreds of dollars in state taxes and reduce the bias against private education investment that currently restricts parental choice.

RECOMMENDATIONS

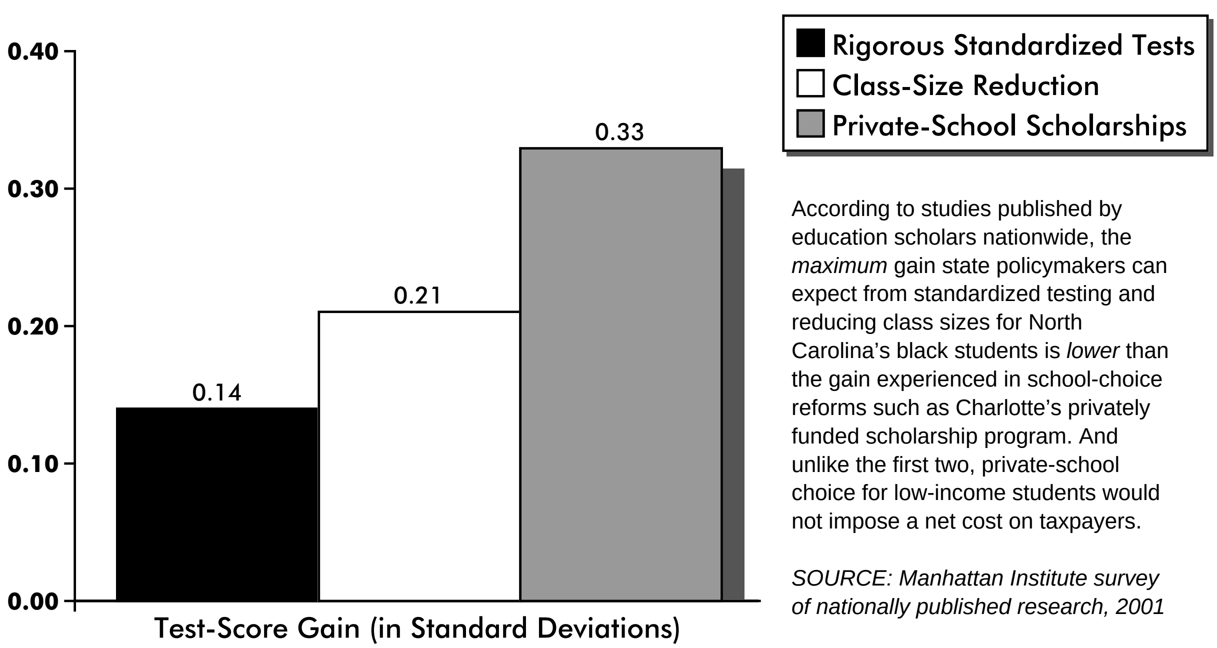
1. North Carolina school districts should make greater use of open enrollment and magnet schools, using choice and competition as tools to improve academic performance and allow diverse learning communities to form. Forced busing for social engineering is poor public policy, but voluntary busing for educational excellence provides children with the opportunity to receive the sound, basic education to which they are entitled.

2. The legislatively imposed statewide cap of 100 charter schools should be lifted, allowing the number of charters to grow as long as parents, educators, and oversight agencies ensure accountability for results.

3. All North Carolina families should be allowed to set up educational savings accounts, with an annual tax-deductible deposit of $3,500 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 half of students test at grade level should be given $3,500 scholarships to attend a school of choice. Public school spending per pupil would be unaffected or increased.

Maximum Gains from Different Reforms for African-American Students



According to studies published by education scholars nationwide, the *maximum* gain state policymakers can expect from standardized testing and reducing class sizes for North Carolina's black students is *lower* than the gain experienced in school-choice reforms such as Charlotte's privately funded scholarship program. And unlike the first two, private-school choice for low-income students would not impose a net cost on taxpayers.

SOURCE: Manhattan Institute survey of nationally published research, 2001

HIGHER EDUCATION POLICY

During the past several legislative sessions, the topic of state funding for the University of North Carolina system has frequently arisen. University leaders complain that years of insufficient funding have hurt academic programs and created a "brain drain" of talented professors. But critics point to other problems, such as an over-reliance on teaching assistants and part-timers, a tenure system that rewards research over teaching, and a tuition policy that provides disproportionate benefits to newcomers and the wealthy.

ARE STATE UNIVERSITIES UNDERFUNDED?

The notion of an underfunded UNC system is fallacious. Even though inflation-adjusted General Fund support per student declined a bit during the recession years of the early 1990s and again in 2001-2002, it rose dramatically during the intervening years. The long-term trend has been one of significantly greater taxpayer resources flowing into the system — a 15 percent increase per student, adjusted for inflation, over the past 10 years. Furthermore, North Carolina is a relatively generous funder of public higher education, ranking 20th in the nation in the share of personal income taken in taxes for college and university subsidies. North Carolina's rate is 2.1 percent of income. The national average is 1.7 percent, with 1.8 percent the average in the Southeast. The latest study of faculty compensation by the Pope Center for Higher Education Policy found that compensation at UNC-Chapel Hill and N.C. State ranked above the national average when adjusted for regional differences in cost and quality-of-life All but three of the 16 UNC campuses ranked above average for their peer groups. On the other hand, independent studies of community college pay suggest that North Carolina does rank low by any measure, and that inadequate salaries are harming the quality of instruction.

THE PROBLEM OF LOW TUITION

The UNC system covers only 20 percent of its costs from tuition and fees, compared to a national average of 33 percent and higher numbers for comparable systems like Virginia's (42 percent). Many people believe that the state's low tuition is mandated by the constitutional language that higher education be "extended to the people of the state . . . free of expense as far as practicable." While that provision is widely interpreted to mean that tuition must be kept extremely low, it could just as well mean that the UNC system is to be run efficiently. No court has defined the terms, but the phrase "as far as practicable" seems to grant lawmakers wide discretion.

The less students pay, the more has to be made up by the taxpayers. In North Carolina, the state's support for the system is more than $10,500 annually for each student enrolled. In 2000, the median family income of students in the system ($54,000) was significantly higher than the state's median family income ($42,000), with the differential far higher at UNC-Chapel Hill ($75,000). Therefore, the system has a "reverse Robin Hood" effect, taxing the less affluent to provide a benefit to the more affluent. Nor do tax collections from graduates compensate the state for the massive subsidy in any case except that of a few extremely high income earners who pay N.C. taxes for their entire careers. Individuals with such good prospects will attend college, subsidy or not.

A second problem with the low tuition policy is that it encourages students who are not particularly interested in serious academic work to enroll. If students had to bear more of the cost, they would consider their options more carefully. Many UNC students drop out (nearly half fail to graduate within five years) and many of the less able and motivated students who remain in school pull standards down owing to the desire of faculty members to receive favorable evaluations from them. Finally, the artificially low tuition at the state universities makes it difficult for private colleges and universities to compete, reducing choices for students.

A critical goal should be to increase productivity and the quality of instruction. Professors who are excellent researchers but only adequate teachers now receive tenure, but those who are adequate researchers and excel-

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lent teachers may not. These incentives weaken the ability of the UNC system to deliver its core service of undergraduate education. Furthermore, admissions standards should be raised to provide incentives for students to excel in high school, while preferences based on race or similar factors should be eliminated. If the experience of the University of California system is any guide, such race-neutral admissions policies would promote equality and academic rigor without reducing opportunities for minority students to attend college.

RECOMMENDATIONS

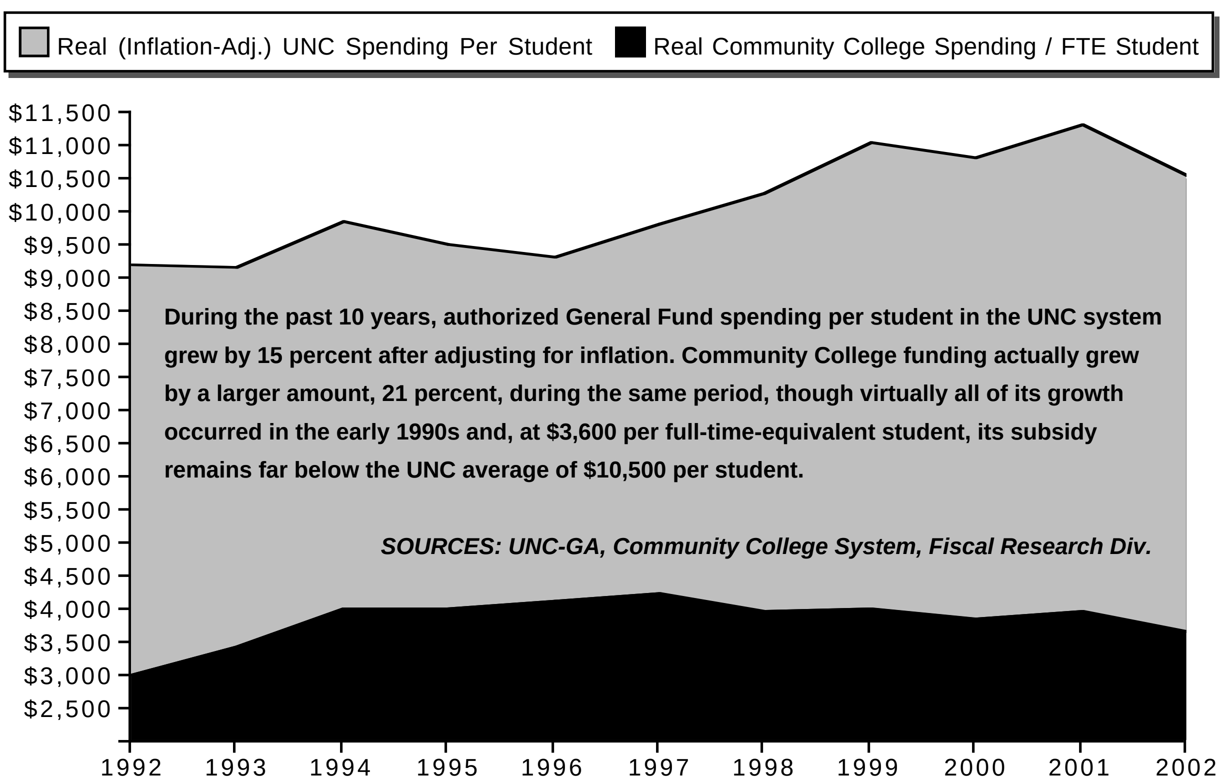
1. Higher education in North Carolina should become more productive and rigorous. Tenure rules should be changed to encourage excellent teaching. Admissions standards should be raised — and based on merit.

2. UNC tuition should be increased immediately by at least 35 percent, with the ultimate goal a system of differentiated tuitions funding half the cost of education at UNC-Chapel Hill and N.C. State, one-third of the cost at the regional universities, and one-quarter at the small schools that serve relatively poor families. Some of the $325 million in estimated savings should fund additional financial aid to ensure that poor North Carolinians can still afford to attend college. Community college tuition should also rise significantly, with much of the proceeds directed toward improving the system's woefully low compensation for faculty.

3. To give families more choices and encourage competition in higher education, the state's Legislative Tuition Grant (LTG) for students who attend private colleges should be increased to $4,000 a year. This would save the taxpayers the cost of expanding the UNC system and of having to subsidize students enrolled in it.

4. The state should make tax-deductible the first $3,500 a year of tuition payments or deposits into tax-deferred Educational Savings Accounts to reduce the current tax penalty for those saving for their children's education.

TRENDS IN GENERAL FUND SUBSIDY FOR NC HIGHER EDUCATION



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JOB TRAINING POLICY

For state and local policymakers, the issue of job training requires a significant amount of rethinking. North Carolinians spend a vast amount of money on training, but the benefits are difficult to quantify. In the 1999-2000 fiscal year, total expenditures for job training and placement services were about $270 million, spread wastefully and somewhat haphazardly over nine major departments and agencies. Adding state expenditures for community college and university education, North Carolina's total commitment to post-secondary education and training exceeds 10 percent of the state budget.

But the private investment in post-secondary education and training is itself massive. The largest system of employment training in the state may well be employers themselves. One study found that in any one year, as many as 20 percent of employees are undergoing some form of company-provided training. In North Carolina, where the workforce approaches 4 million, that means about 800,000 people receive training from employers each year — far exceeding the number of full-time students in universities, colleges, or training programs.

GOVERNMENT PROGRAMS FAIL

Most government training programs provided specifically to disadvantaged or other targeted populations fail to provide significant, long-term benefits. One study of the Job Training Partnership Act (JTPA) found that the program had no statistically significant effect on either the average earnings of young females or their employment, and even had a large (7.9 percent) negative effect on the earnings of young males. Likewise, virtually the only serious study of the federally funded Job Corps found that it did not significantly help single mothers obtain employment. In North Carolina, these programs have also provided little benefit. Records from JTPA showed that in 1993, 41 percent of participants either got no job, or jobs paying below the minimum wage. A 1995 study of another job training program found "it is not cost effective, and it needs to be changed to carry out those program elements that do work." Recent outcome data continue to show modest benefits (see graph).

Why don't these well-intentioned programs work? Many analysts believe that government training programs, regardless of their design, are doomed to failure because they lack the incentives that a private-sector trainer — or a public college competing for students, for that matter — has to successfully place trainees in jobs. Government is also less likely than other training institutions to keep up with the latest occupational trends and needs.

Skills, regardless of where or how they are acquired, show the strongest correlation with economic success. If one wants to improve the employment and earnings potential of workers while getting the best return on post-secondary education and training expenditures, the key is to match occupational choices with an appropriate provider of job training which is, more likely than not, an employer rather than a school or training center. Studies show that many workers learn their most valuable skills on the job, and are thus best served simply by having good job opportunities available rather than access to government-run training programs.

RECOMMENDATIONS

1. State leaders should consolidate state training programs as much as possible to reduce redundancy and increase oversight. Employees and contractors should be compensated according to performance, such as by paying them a percentage of the income their clients subsequently earn. Those eligible for training should have the option of converting some of their aid into cash to subsidize private employment at a (low) training wage.

2. All North Carolinians should be allowed to save money tax free in an educational savings account (ESA) for future post-secondary education and training investments, including retraining after a job loss.

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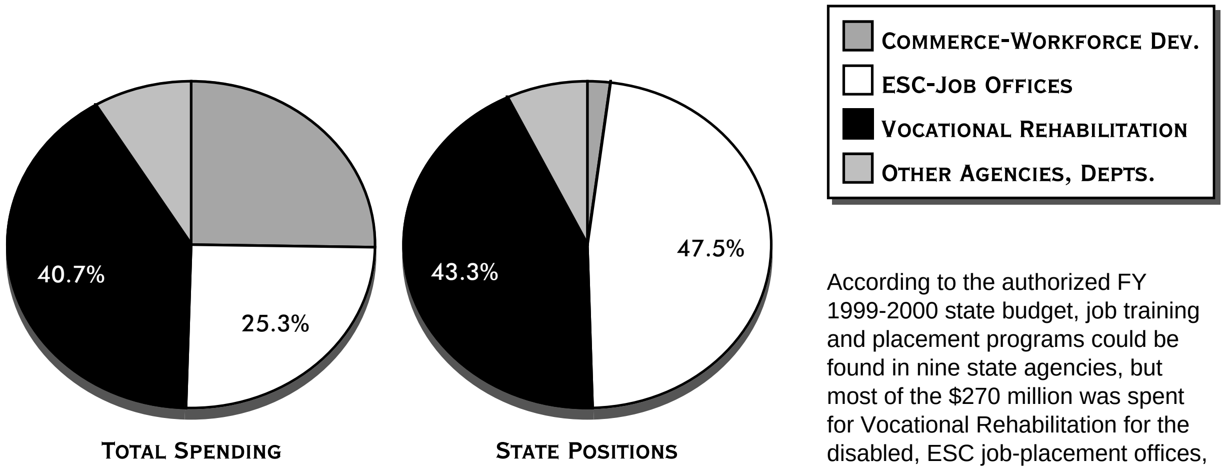
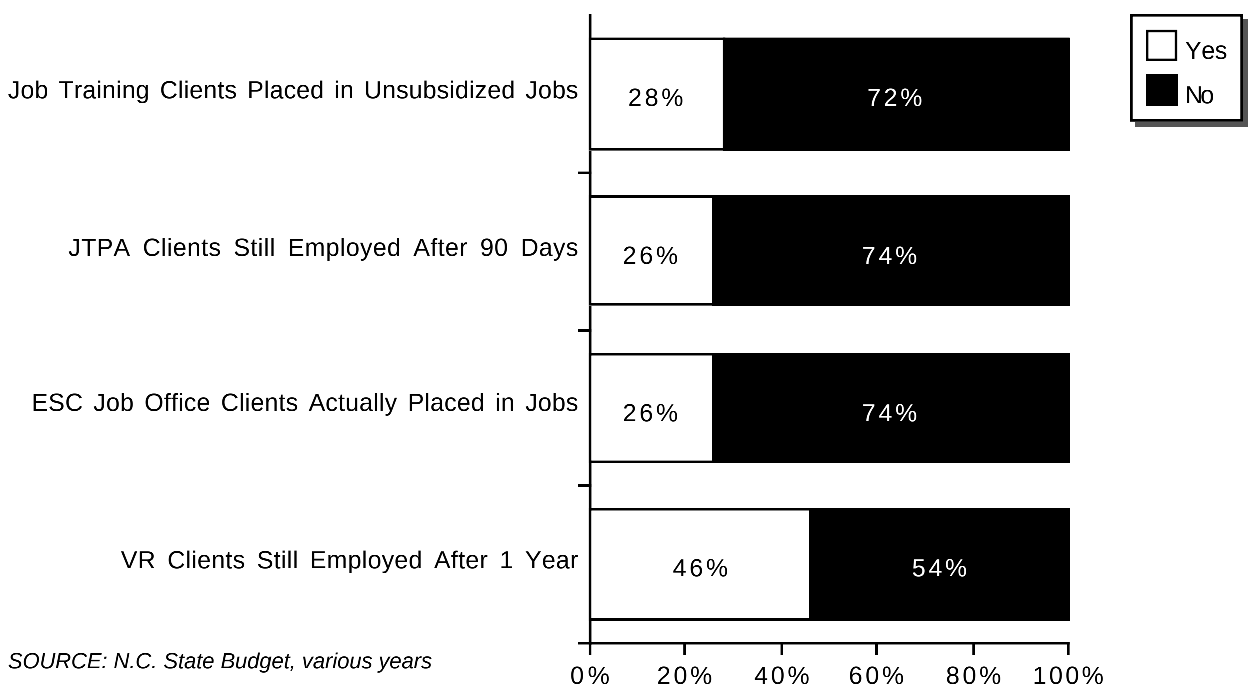
State Job Training & Placement Programs: Who Runs Them?



According to the authorized FY 1999-2000 state budget, job training and placement programs could be found in nine state agencies, but most of the $270 million was spent for Vocational Rehabilitation for the disabled, ESC job-placement offices, and federal job training programs run by the Commerce Department.

	Total Spending	State Positions
Commerce-Workforce Dev.	$68,368,023	42
ESC-Job Offices	$68,369,091	1,060
Vocational Rehabilitation	$110,054,438	967
Other Agencies, Depts.	$23,657,102	163

Outcomes for State Job Training, Placement Programs



SOURCE: N.C. State Budget, various years

LOCAL BUDGETS & TAXES

Local governments across North Carolina are complaining about increasing demands for public services, proliferating unfunded mandates from the state and federal governments, and insufficient revenue sources to meet their financial obligations. In recent legislative sessions, city and county governments have asked for new taxing authority, all the while using their existing control over property taxes and other taxes and fees to impose an ever-higher cost on North Carolina taxpayers.

THE REAL STORY ON LOCAL FINANCES

When compared to the national average, North Carolina has traditionally had low property tax rates and local government expenditures. This has helped to offset our rates of state taxation and expenditure, relatively higher by national standards. In critical areas of service delivery such as education and highways, North Carolina long ago chose statewide finance and control while other states opted for a less centralized approach. For decades, our combined state and local tax burden remained well below the national average but moderately above the average for the Southeast. In recent years, the picture has changed dramatically. In part because of sizable local property-tax increases — including at least $75 million in tax hikes in 2002 alone — North Carolina's tax burden is now at the national average and far higher than that of most of our neighbors.

Local government expenditures in North Carolina have actually grown more rapidly in real, per-person terms than has the state budget over the past 20 years. Although demands for core services such as law enforcement, school facilities, and infrastructure have risen due to rapid population growth, particularly in urban areas and along the "I-85 corridor," tax revenues have grown rapidly for the same reason. Not only has the tax base grown, generating new revenue from existing rates, but more jurisdictions have raised their property taxes (and added new fees) than have reduced them. In 1999 alone, 36 counties raised property tax rates. Only 3 cut them.

Comparative data show that, while many growing communities in North Carolina face similar challenges, they have chosen to address them in very different ways. Cities and counties that have made efficiency and tax reduction a priority have been able to keep their costs down, and maintain or improve their service quality, by using such tools as administrative restructuring, "rightsizing," competitive contracting, and eliminating low-priority expenditures in order to focus taxpayer resources on core public services.

Of the state's five largest cities, the amount of city and county property taxes collected per person ranges widely, with Charlotte's tax burden 30 percent higher than that of Winston-Salem. The *By The Numbers 2002* report published by JLF's Center for Local Innovation shows that the share of personal income going to local government, while growing statewide in recent years, is as high as 5 to 6 percent in such counties as Durham, New Hanover, and Mecklenburg and as low as 3 to 4 percent in Davidson, Alamance, and Iredell.

RECOMMENDATIONS

1. Local governments in North Carolina should make tax relief and spending restraint high priorities in setting their budgets. A local version of a Taxpayer Protection Act, which would limit annual spending increases to growth in inflation and population, would have saved hundreds of millions of dollars during the 1990s.

2. Localities should, as much as possible, reform their tax and fee systems to make growth pay for itself. This approach should include charging accurate prices for hooking up to water, sewer, and transportation systems. They should not, however, seek new ways to tax their citizens, through such regressive and economically destructive means as higher sales taxes or new impact or real estate fees for school construction.

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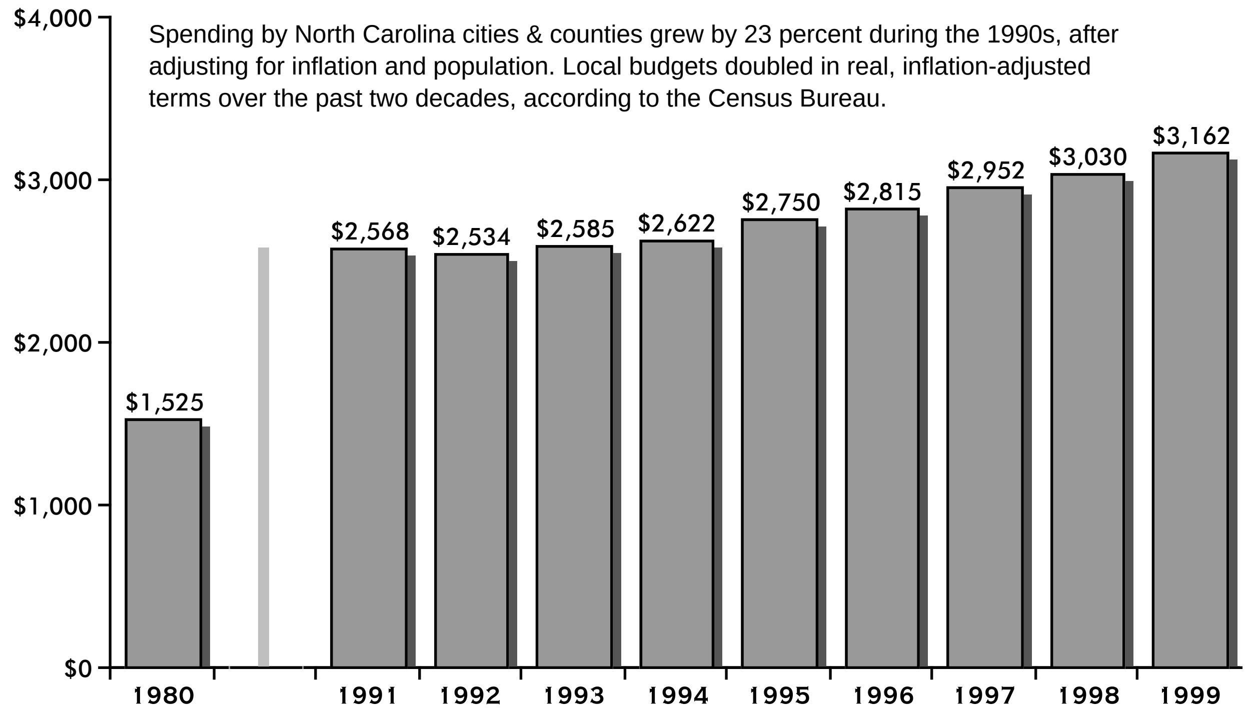
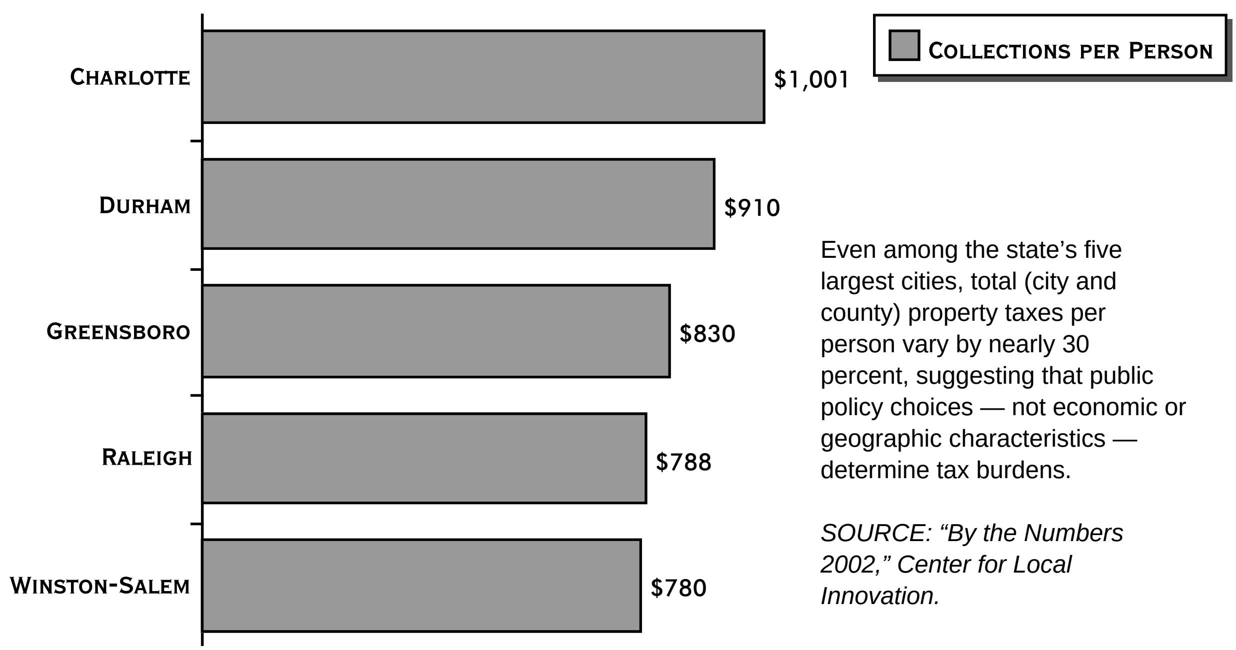
Inflation-Adjusted Local Spending Per Capita in NC, 1980-1999



2000 Total Property Tax Burden, 5 Largest North Carolina Cities



Even among the state's five largest cities, total (city and county) property taxes per person vary by nearly 30 percent, suggesting that public policy choices — not economic or geographic characteristics — determine tax burdens.

SOURCE: "By the Numbers 2002," Center for Local Innovation.

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HOUSING & URBAN DEVELOPMENT

Homeownership is widely viewed as a necessary first step for community development. Once renters become owners, they begin to take a proprietary interest in their own property and that of the neighborhood. They set down roots. They begin to accumulate assets (most families use homes to a greater degree than bank accounts or mutual funds to save for the future) and, as property taxpayers, participate in local public affairs. But state and local policymakers disagree about how best to promote homeownership. And problems associated with public housing projects and blighted downtowns continue to plague cities and towns across North Carolina.

THE ROLE OF EXCESSIVE REGULATION

In 1991, a commission organized by then-HUD Secretary Jack Kemp reported that one of the most serious barriers to affordable housing was the existence of costly and counterproductive government policies. "Exclusionary, discriminatory, and unnecessary government regulations at all levels substantially restrict the ability of the private housing market to meet the demand for affordable housing," the commission concluded, "and also limit the efficacy of government housing assistance and subsidy programs." The report estimated that regulations increased the average price of housing by between 20 percent and 35 percent.

North Carolina has long had a higher homeownership rate than the national average (see graph), and fewer regulatory and other impediments to the construction of affordable housing. Still, building codes, housing codes, and zoning regulations unnecessarily raise the cost of housing in North Carolina. A 1990 study by the John Locke Foundation found that housing codes (which regulate the amenities, but not the structural soundness, of houses) reduce the amount of space the families can rent or own and reduce homeownership rates among low-income residents by as much as 15 percent.

Local governments also reduce homeownership through zoning practices that discriminate against lower-income residents. Manufactured homes, for example, apply principles of factory production to homes and can cost far less than a comparably sized site-built home. But many municipalities strictly regulate the placement of manufactured homes, sometimes forcing them essentially out of the municipal limits. While these regulations are designed to promote higher-quality housing, in reality they restrict competition and make housing more expensive — pushing homeownership out of reach for many families. A 1998 Locke Foundation study concluded that the relative presence of manufactured homes in a North Carolina locality's housing mix had a significant impact on homeownership rates in that locality, suggesting that changing zoning rules to allow manufactured housing would be an effective policy to increase affordability and access.

THE PROBLEMS OF PUBLIC HOUSING

Faced with the difficulty of finding low-cost housing in closely regulated private markets, many North Carolinians of limited means enter public housing projects. Unfortunately, public housing projects in North Carolina, as in the rest of the United States, are typically in poor repair, are costly to administer, and serve as a breeding ground for crime, drug abuse, and welfare dependency.

One national study found that girls reared in public housing are five times more likely than their peers to bear children out-of-wedlock and boys in public housing are more than five times more likely to commit crimes.

Projects concentrate single-parent families with little work experience or role models, rather than dispersing them throughout a wider population of low- to moderate-income families that are stable and responsible.

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They also make residents essentially prisoners of bureaucratic bungling and government authorities' inability to enforce order. Finally, they reduce the incentive for tenants to develop self-sufficiency and take responsibility for their homes and their neighborhoods.

GOAL

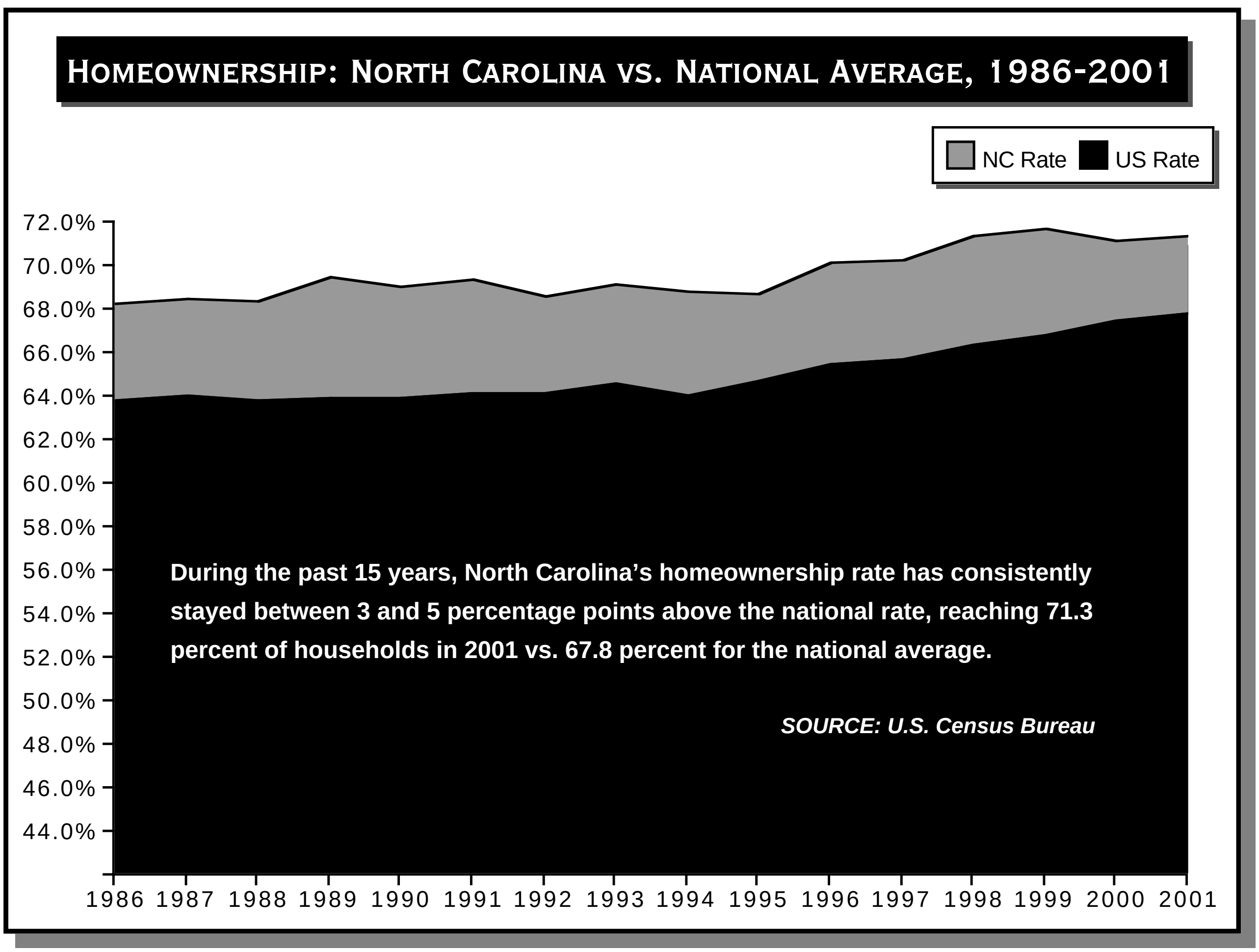
North Carolina should take steps to maximize the number of its citizens who can become self-sufficient homeowners — the first step to the American Dream as well as a precondition for healthy communities.

RECOMMENDATIONS

1. Local leaders should reduce or eliminate building, housing, and zoning regulations that increase the price of housing and aren't directly related to health and safety considerations. Localities should also avoid new policies, such as draconian growth controls, that have reduced affordability in cities such as Portland, Oregon.

2. City and county leaders should revise their zoning ordinances to end discrimination against manufactured and modular homes. All forms of housing with similar safety standards should be treated the same.

3. Local leaders should take the lead to reform public housing by employing tenant management and maintenance firms, instituting strict rules for residents, finding operational efficiencies, fighting crime, and pressing Congress to convert all public housing assistance into vouchers that can be used to pay rent or saved in Individual Development Accounts (IDAs) for future use in getting off welfare and buying a home.



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SMART GROWTH & TRANSIT

As communities across North Carolina cope with the challenges of rapid growth in population and economic activity — which are, it should be remembered, far less serious than the problems associated with a lack of such growth — some policymakers are embracing the idea of "Smart Growth." Unfortunately, this new debate about growth controls, zoning, open space, and transportation in North Carolina reflects too little consideration of the details of Smart Growth policies and market-friendly alternatives.

THE TRUTH ABOUT SMART GROWTH

Smart Growth is a national movement toward greater government control over development, housing, transportation, and consumer choice. It typically focuses on four activities: 1) redistricting the size of urban areas through growth boundaries; 2) requiring denser development through zoning changes; 3) discouraging driving with higher taxes and less road construction; and 4) increasing funding for mass transit. Because the choices of actual families, most of whom prefer cars and less dense development, would be subverted, they have little to gain from the new agenda. And though there are government policies that have helped subsidize some forms of growth, Smart Growthers rarely stop at ending unwise state or local incentives. Instead, they seek to legislate their aesthetic and economic preferences at the expense of what most citizens desire.

Even if Smart Growth principles are applicable in some parts of the country, North Carolina is unlikely to be one of them. Its urban areas lack sufficient density to make transit a viable alternative to auto commuting — bus systems in the state fulfill a public assistance, not a transportation, function — and its tradition of personal freedom clashes with the central planning inherent in Smart Growth policies. Also, the notion that growth is in danger of consuming the countryside is foolish, as the nearby graph demonstrates.

Attempts to increase significantly the ridership of transit will fail, primarily because commuters won't save time by taking the train and would have to sacrifice their current ability to run errands, pick up or drop off children, and otherwise benefit from the greater flexibility afforded by automobiles. Transit also costs far more per passenger mile travelled than highways do, imposing a larger burden on taxpayers for capital and operating subsidies. Moreover, taxpayers are wisely skeptical of government estimates of transit costs; a planned Charlotte rail transit system is now projected to cost at least $2.1 billion — or 1.5 times the amount voters would told the system would cost when they voted on the project in a 1998 referendum.

DOES "SPRAWL" HURT TAXPAYERS?

One of the assertions about consumer-led growth (called "sprawl" by its critics) is that it is expensive for taxpayers. Smart Growth proponents argue that building new schools, roads, water and sewer lines imposes additional cost on communities beyond the revenue generated by such growth. But a Locke Foundation study of growth and taxes in North Carolina communities refutes this assertion. The 1999 report found that:

• North Carolina towns with newer homes, on average, have lower taxes than those with older homes. This result challenges the idea that growth raises taxes by increasing service needs faster than revenues.

• The higher the percentage of single-family homes, the lower the tax burden. The standard argument is that it is more expensive to provide government services to single-family housing is not supported by existing data in North Carolina. Indeed, other studies suggest that the only kind of residential growth that does not "pay for itself" is high-density, multi-family development. Density increases law enforcement and sanitation costs, among others, thus offsetting infrastructure costs associated with lower-density development patterns.

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The findings of the study demonstrate that, of the three possible measures of sprawl examined, two suggest that sprawl reduces rather than increases the local tax burden in North Carolina, a result that is confirmed by studies in such Smart Growth communities as Portland, Oregon.

THE "FLEX GROWTH" ALTERNATIVE

A market-oriented approach to growth management, which Locke analysts have termed "Flex Growth," can help policymakers reconcile the conflicting desires of citizens not only to alleviate traffic congestion and other problems, but also to protect property rights and individual choice. Elements of the Flex Growth approach include: 1) pursuing neutrality by neither subsidizing nor penalizing growth; 2) letting growth pay for itself by adopting marginal-cost pricing for public services (such as connection fees for water and sewer that accurately reflect the full cost of providing service to a development); 3) using voluntary programs such as tax credits and land trusts to protect open space instead of rigid and costly regulations; and 4) strengthening private property rights so that prices can reflect the most valuable use of land in a local market.

RECOMMENDATIONS

1. North Carolina leaders should embrace a market-friendly alternative to Smart Growth in which consumer choices and prices are given deference over bureaucratic planning and guesswork. Flex Growth tools such as marginal-cost pricing, voluntary open-space protection, and more flexible zoning codes that allow mixed-use developments are available without additional state legislation.

2. Local officials should press the state to fulfill its responsibility to provide adequate roads. North Carolina's failure to maintain and expand its state-owned highway system has led to unnecessary traffic congestion, damaging potholes, unsafe bridges, and lost economic growth due to inadequate highway access. As mentioned in the Transportation section, the state should devote as much as $400 million a year in additional highway revenues to highway needs without raising taxes on motorists.

3. State and local policymakers should end wasteful rail transit projects in Charlotte and the Triangle and focus their efforts on improving the efficiency and service quality of existing city bus systems.

PUTTING NORTH CAROLINA LAND DEVELOPMENT IN PERSPECTIVE

Ten Most-Developed States			Ten Least-Developed States		
State	% Developed	Land Value	State	% Developed	Land Value
NJ	31.9	$5,414	NE	2.5	$453
CT	25.4	$3,830	SD	2.3	$243
MA	24.7	$3,177	AZ	1.9	$286
RI	24.5	$4,111	OR	1.8	$457
MD	16.4	$1,903	MT	1.2	$186
DE	15.7	$1,510	NM	1.1	$190
OH	13.5	$1,046	ID	1.1	$557
FL	12.4	$1,797	UT	1.0	$362
PA	11.8	$1,442	WY	0.9	$124
NC	10.5	$1,093	NV	0.6	$200

Source: U.S. Department of Agriculture, Economic Research Service. Land values are assessed values.

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ECONOMIC DEVELOPMENT

While economic development has dominated the agendas of many governors, legislators, and local elected officials in North Carolina, it is one of the most misunderstood activities that governments undertake. The political incentive to attract media attention through job announcements is frequently a substitute for a policy that maintains a balanced, efficient, and fair economic environment. Such a policy would provide the maximum amount of opportunity and prosperity for North Carolinians. It would respect the rule of law, protect private property, promote competition, and allow markets to operate freely.

DEFINING ECONOMIC DEVELOPMENT

Just what does the term "economic development" mean? Is it population growth? Is it per-capita income growth? Is it a reduction in the reported unemployment rate? While these measures are often useful, they provide us with very little information about the real economic well-being of citizens. Is population growth desirable if it does not pay for itself and results in higher taxes? Is per-capita income growth desirable if inflation and taxes consume it all? Are county unemployment rates reliable enough to disregard the N.C. Constitution's requirement for a fair and equitable tax system by basing tax credits on them? While these indicators can be useful tools for private businesses and government officials, a low ranking should not be used to justify state intervention in private markets that are more complex than numbers can convey.

The term "economic development" is not mentioned in the state constitution, so until recently state and local economic development programs were basically operating with no clear authority to intervene in the economy. On March 8, 1996, the N.C. Supreme Court gave governments an "economic development permission slip." The court ruled by a 5-2 vote in *Maready v. Winston-Salem* that publicly funded economic development incentives constituted a public purpose consistent with the intent of the constitution.

THE CORPORATE WELFARE BUDGET

The acceptance of economic development as a government responsibility has led to state and local policies that have collectively been called "corporate welfare." This category includes state tax and subsidy policies that favor individual businesses, selected industries, or certain geographic regions. Unlike the maintenance of low across-the-board tax rates or the provision of core public services such as education, highways, and public safety, corporate welfare doesn't benefit everyone. It requires public officials to intervene in private markets to decide which businesses or regions are worthy of support. This sets the stage for increased special- interest lobbying, strings-attached campaign contributions, and unethical behavior in public office.

A partial list of corporate welfare would include 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, below-cost state services offered to agricultural and other businesses, regional subsidies such as the state's investment in the Global TransPark in Kinston, and special tax breaks for job creation in "distressed communities," worker training, and research and development.

In its 2002 alternative budget, the Locke Foundation identified some $255 million in corporate subsidies and "economic development" tax credits. If these special programs were eliminated in favor of across-the-board tax reduction, <u>North Carolina could reduce its relatively high corporate tax rate to 5 percent *and* repeal the personal income tax hike passed in 2001</u>. Both actions would help to create a lower-cost environment in which businesses of all sizes could thrive, not just those large enough or powerful enough to attract political attention.

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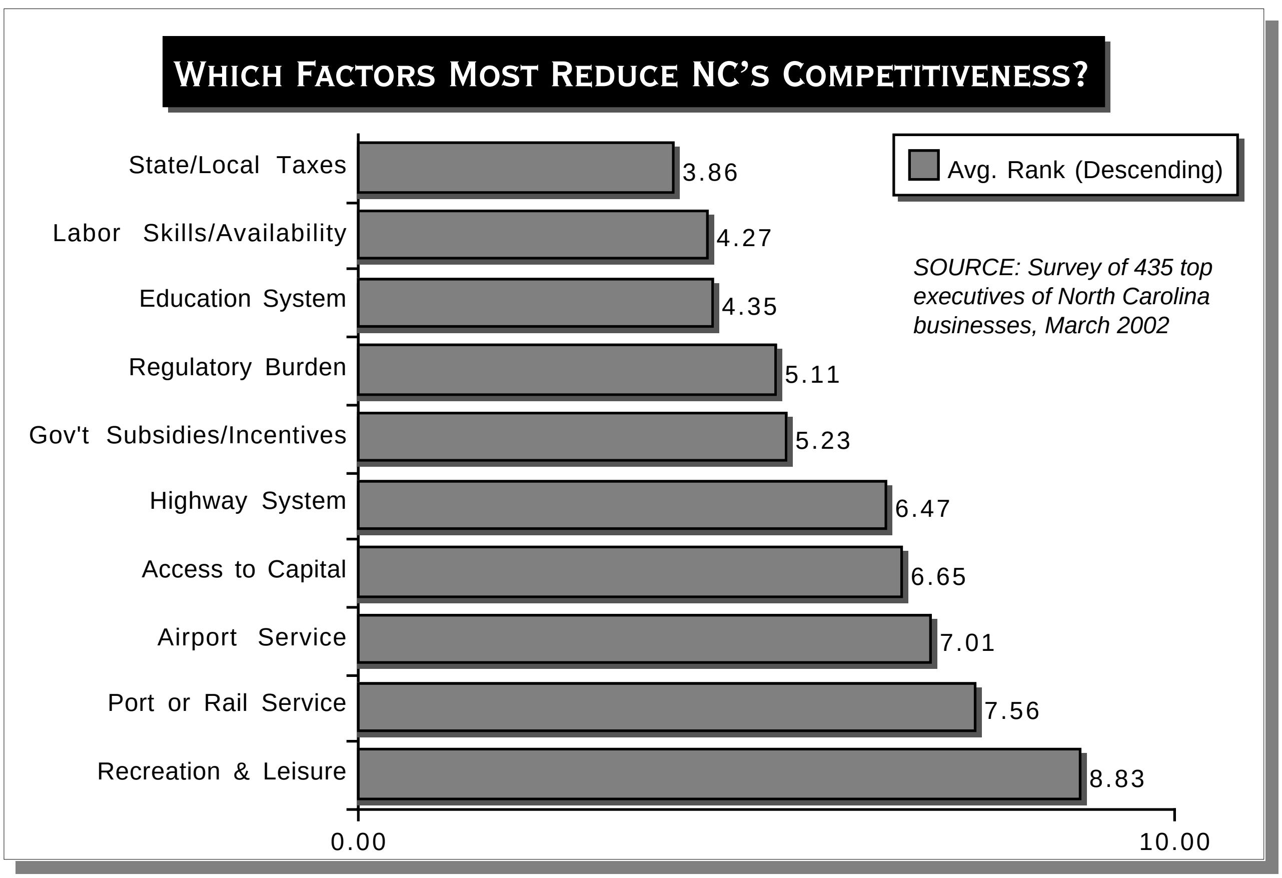
Research shows that government-subsidized economic development projects have few significant effects on business expansion or relocation decisions. For example, a 1999 study from the Kenan Institute of Private Enterprise at UNC-Chapel Hill concluded that “state incentives play only a marginal role in the location decisions of private firms.” Another study, by an economist with the General Accounting Office, found that most attempts by state governments to “guide” their economies fail. The report did identify three variables that had a statistically significant impact on state economic growth: the starting size of the state’s economy (smaller ones grew faster), marginal state and local tax rates (high is bad), and the amount of “rent-seeking behavior” in the state, measured by the percentage of workers employed in government, law, and lobbying.

If targeted tax breaks and interference in the market don’t generate economic benefits, what does? A 1996 study for the Locke Foundation by N.C. State economist Mike Walden found that spending on law enforcement activities had a large payoff in jobs and income growth. Education and highways had modest payoffs. Other government spending reduced jobs and incomes because the taxes levied to finance them took money away from more productive private investments. These and other research findings suggest that the safest course for policymakers is to concentrate on doing basic tasks well including tax and regulatory relief rather than letting themselves be distracted by politics, media spin, and peddlers of dubious projects such as the Global TransPark, state grants to biotechnology companies, or the ill-fated N.C. Information Highway.

RECOMMENDATIONS

1. State and local leaders should phase out business recruitment and marketing programs, and end targeted incentives and subsidies for unprofitable enterprises, saving hundreds of millions of dollars annually.

2. State and local leaders should pursue economic development by improving core government services, such as public schools and highways, and by further reducing taxes and reforming the state’s antiquated tax code.



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REGULATORY REFORM

Regulation is the "hidden tax" that governments impose on families and private firms. State and local governments clearly have an interest in protecting natural resources, regulating public health and the spread of disease, and facilitating the efficient operation of markets to deliver the high-quality goods and services that consumers demand. But regulatory policy often seems to be made in a vacuum with little examination of how governmental policies themselves might be causing problems. Furthermore, there are few realistic comparisons of the probable costs and benefits of proposed rules. In North Carolina, the legislature has taken a first step toward regulatory reform but still splits significant authority among a number of regulatory agencies, some headed by appointees and others by separately elected officials.

THE COST OF REGULATION

As of 2000, the State of North Carolina had about 26,000 rules in place, with the number growing each year. At least as measured by the number of pages of new rules published in the *North Carolina Register*, the total number of pages of new regulations added annually nearly doubled from 1987 to 2001. Furthermore, the number of full-time positions in North Carolina's state regulatory agencies has grown by 60 percent over the past two decades. In attempting to ascertain how many rules are currently in place, JLF called every conceivable state agency and learned that no one in state government has any idea how many rules have been foisted on the backs of North Carolina citizens, much less what their total cost will be in the year 2002.

We can reasonably expect state regulatory costs to be significant, given what we know about federal rules. By the year 2000, federal regulations imposed an estimated $721 billion in compliance costs, or nearly $6,000 per household. While taxes currently consume about one-third of the average family's income more than food, clothing, and shelter combined regulation makes the total cost of government even higher. In 1998, the average American had to work full-time until June 28 to pay the costs associated with taxation and regulations. This means that nearly half of every dollar earned was spent on government programs directly or indirectly.

Of course, the costs of regulation represent only one side of the ledger. Perhaps these costs are justified if the benefits, similarly quantified, exceed them. But the available evidence suggests otherwise. Environmental regulations in particular often cost far more than their benefits would justify. A recent Harvard study concluded that Americans incur opportunity costs of approximately $31.1 billion, 60,200 premature deaths, or 636,000 years of life lost every year in order to maintain our current inefficient regulatory structure.

These regulatory costs are unsustainable. Just from 1989 to 1992, the average burden of taxes and regulations per worker for a small business increased 34 percent. Job losses from excessive regulation are common, especially in industries such as logging and energy. Business owners cite paperwork and regulatory costs as among the highest barriers to new enterprises. And while these regulations are supposed to protect consumers, workers, and the general public, they often do not provide enough benefits to offset lost jobs and higher prices.

THE RULES REVIEW COMMISSION

In North Carolina, the 1995 General Assembly began to address the state's role in regulatory overkill by enacting a bill that gives the Rules Review Commission the power to review proposed regulations before they became law. But before the law became effective on December 1, 1995, some 24 state departments and boards filed over 2,250 proposed rule changes to beat the deadline. This breathtaking exhibition of the cavalier attitude state bureaucrats have toward regulatory reform is but one more reason lawmakers should take more extensive action to reform state rulemaking and enforcement agencies.

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Still, the bill has had salutary effects. The average number of state regulations proposed annually by agencies has fallen significantly since the 1995 reforms. Furthermore, the Rules Review Commission has helped to keep state agencies from exceeding the authority granted them in law by the General Assembly.

RECOMMENDATIONS

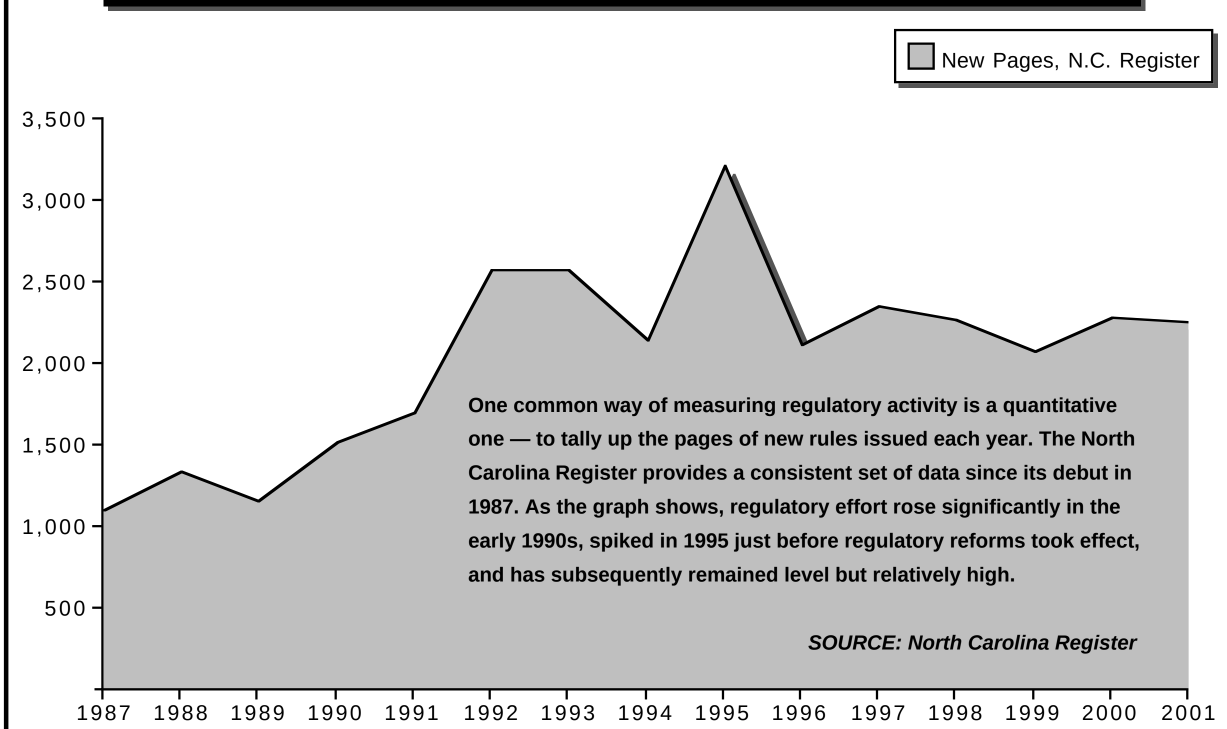
1. Eliminate regulations other than those necessary for promoting public health and safety and combating fraud in markets such as financial services. Where possible, compliance mechanisms other than fines, such as consultations with private firms and educational programs for professionals, should be employed. Sunset all new state rules after two years to allow an assessment of their real-life costs and benefits.

2. Amend the 1995 statutory language strengthening the Rules Review Commission to define legislative intent more clearly and to provide the commission with a staff and budget commensurate with its important and challenging responsibilities.

3. Require cost-benefit analysis for all state and local regulations, and set up a regulatory reform commission in each jurisdiction to put together a regulatory budget that would place a cap on the total regulatory cost a state or locality can impose on its citizens.

4. Consolidate state departments and agencies with similar regulatory missions. For example, banks, savings and loans, credit unions, insurers, stockbrokers, and financial advisors are all part of a developing financial services marketplace, and should be regulated by a single department.

MEASURING THE TREND IN STATE REGULATORY ACTIVITY, 1987 TO 2001



1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
1,092	1,339	1,147	1,509	1,688	2,574	2,574	2,139	3,212	2,112	2,345	2,264	2,072	2,282	2,251

TRANSPORTATION POLICY

Highways and transportation facilities are some of the most visible programs that state and local governments operate. But they are not without controversy. Some believe that North Carolina has in vested too much money in highways and not enough in mass transit. At the local level, bus systems receive significant operating subsidies, yet continue to attract only a small minority of commuters. Current projects such as outer loop highways and the proposed Global TransPark in Kinston have sparked a broader debate about the proper scope and amount of state transportation spending and the value of past infrastructure investments. Reforming the scandal-plagued N.C. Department of Transportation also must be a priority, especially in such areas as the Board of Transportation — a large, unwieldy body primarily composed of political activists whose role is largely unnecessary — and the Enforcement Branch of the Division of Motor Vehicles, currently mired in charges of corruption, influence-peddling, and political patronage.

TRENDS IN TRANSPORTATION SPENDING

North Carolina taxpayers pay for state highways through taxes on motor fuels and vehicles. Expenditures from the state's Highway Fund have grown significantly in nominal dollars over the past 20 years, to $2.1 billion in FY 2001-02, and North Carolina currently levies a relatively high motor fuels tax rate. But that's not the whole story. Adjusted for inflation and the numbers of vehicle miles travelled, highway expenditures actually decreased over the past two decades. Per-capita state and local spending on transportation grew at a much slower rate than spending on education, welfare, health care, and overall government spending.

Nevertheless, transportation remains a significant expense, and deserves the scrutiny of state and local lawmakers. The Government Performance Audit Committee (GPAC) recommended in 1993 that the N.C. Department of Transportation make greater use of private contractors for engineering and other oversight and preconstruction needs. GPAC also faulted the state for deferring highway maintenance needs in favor of new road construction. A more recent report by the State Auditor's Office found that cost estimates for the department's Transportation Improvement Program were wildly off-the-mark (see graph) and that pavement resurfacing alone was underfunded by about $95 million a year, putting commerce and the safety of North Carolina drivers at risk. A study by UNC-Charlotte found that North Carolina's highway system, ranked 8th in the country in 1984 for its quality and efficiency, had fallen to 25th by 2000.

THE TRANSIT DISTRACTION

Bus systems in North Carolina's major metropolitan areas continue to attract only modest ridership. Given the state's relatively low population density, this is unlikely to change, even if some activists are successful in their attempts to construct light rail in Charlotte and the Triangle. As data from across the country demonstrate, transit projects are almost invariably wasteful attempts to entice or coerce commuters out of their personal automobiles and into buses or trains. The percentage of commuters willing to use buses or trains is far below 10 percent in most communities, and is likely to stay that way regardless of expenditures on transit unless, of course, transit advocates are successful in forcing families to live in densely packed neighborhoods through rigid land-use policies. These policies should be resisted on philosophical grounds — they rob families of their chance at the American Dream of owning property — as well as on practical grounds. Highways are, to put in simply, a more useful transportation technology that allows maximum consumer choice and convenience.

More promising tools for relieving traffic congestion include new computer technologies and the use of 'peak pricing" on limited-access highways to charge variable tolls depending on the time of day. North Carolina should also pursue public-private partnerships to build new highways using electronic toll collection.

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One endeavor the state should abandon is the Global TransPark, which has yet to attract any significant interest on the part of manufacturers, as was originally intended. Projected to bring tens of thousands of new jobs to North Carolina by the late 1990s, it has resulted in no net job creation. Similarly, the state should explore the sale of the state ports as well as the North Carolina Railroad, which is now wholly owned by taxpayers. These capital assets are relatively unproductive for taxpayers, and should be made liquid for investment in higher-priority needs such as debt reduction or highway improvements.

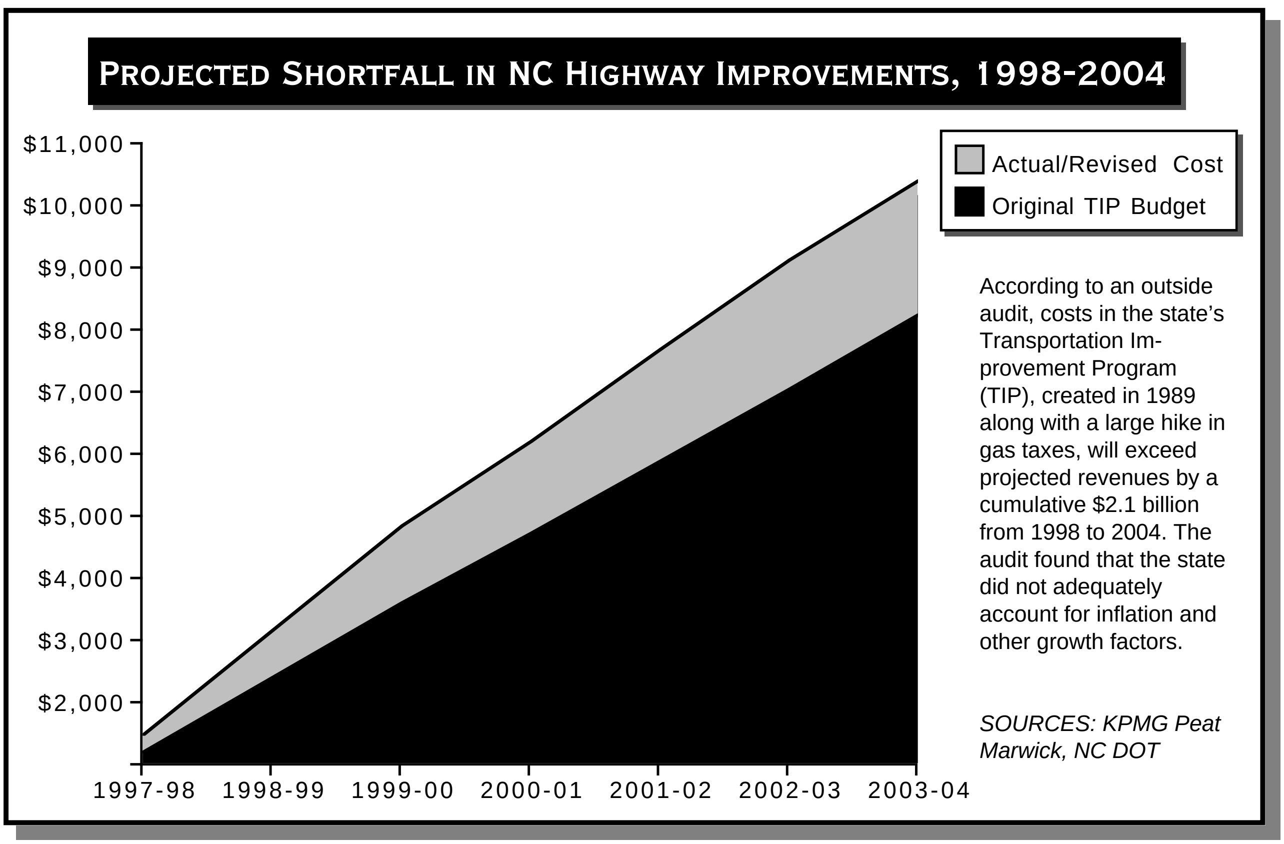
RECOMMENDATIONS

1. State officials should work to improve the efficiency and quality of North Carolina's highway system. New technologies and tollways should be used to relieve traffic congestions and promote economic development.

2. The state should end all subsidies for the Global TransPark and issue a request for proposals for the sale of the state ports at Wilmington and Morehead City and the state-owned North Carolina Railroad.

3 The Department of Transportation should be retooled to perform its job better. Reforms should include downsizing the Board of Transportation and making it an advisory panel only, merging highway divisions and eliminating bureaucracy, using competitive contracting for design and planning functions, and giving a portion of gas taxes collected directly to local governments for local needs. To reduce corruption in the Division of Motor Vehicles Enforcement Branch, it should be merged into the more professional Highway Patrol.

4. State lawmakers should end the diversion of highway user fees to non-highway uses. All revenues from motor fuels and auto use taxes should be dedicated to road construction and maintenance. Together with reductions in rural secondary road paving, DOT administration savings, and the use of public and private tollways, dedicating gas and car taxes only to their appropriate uses would yield <u>$400 million a year in additional highway spending</u>, which would eliminate the backlog of Transportation Improvement Projects over five years.



LEGAL REFORM

North Carolina has a good legal system, partly because punitive damages cannot reach the ridiculous "I-spilled-hot-coffee-in-my-lap" levels achieved in other states. But there are areas in need of both vigilance and reform. State lawmakers enacted tort reform a few years ago but efforts must be maintained to ensure full compliance and enforcement with no weakening of the punitive damages cap. Another issue that deserves attention is the state's "unauthorized practice of law" (UPL) statute.

TORT REFORM BASICS

There is often a legitimate need for lawsuits and there are certainly irresponsible businesses and individuals among us. This recourse to the law is one of the most important safeguards we as free citizens have to seek justice against criminal negligence. But when that safeguard is abused, especially in such a gravely irresponsible and routine manner as has been the case over the last few years (most obviously by lawyers and attorneys general in the tobacco settlement cases and more recently in lawsuits against gun manufacturers), prices go up, innovators are much less likely to take risks, free markets are stifled, and court dockets become jammed by a combination of overzealous complainants and often unscrupulous trial lawyers.

The state legislature acted wisely in 1995 when it passed a bill limiting the amount of punitive damages to $250,000. This has largely nullified the profit motive in suing, ostensibly limiting, if not abrogating, the possibility of potentially crippling punitive damages. Yet there is little more that can be done beyond this bold measure. Citizens, lawmakers, and judges who do not believe in the punishing tactics of aggressive trial lawyers must be vigilant against attempts to repeal or creatively "interpret" the limitation statute.

If the law becomes effectively neutered one way or another, savvy legislators could direct damages over a certain amount to worthy public causes. If the point is to "teach businesses a lesson," as lawyers claim, then plaintiffs and their attorneys should not object to, for example, a designation of the full amount of punitive damages for a burn from coffee purchased in a restaurant going to a burn center. Another alternative would be to mandate the diversion of all punitive damage awards to public education, as in Nebraska. The funds could also be designated for state tax cuts by taxing punitive damages above a certain amount at 100 percent, as has been done to some attorneys charging over $100,000 hourly rates in the tobacco lawsuits.

"UNAUTHORIZED" PRACTICE OF LAW

One principal area of legal reform gaining attention in North Carolina is the unauthorized practice of law, or UPL. UPL laws supposedly protect members of the public against incompetence, but the actual effect is to keep prices for legal services higher than they otherwise would be because of the prohibitive cost of entering the market — three years of law school. Competition and the need to keep a good reputation in business are stronger guarantors of good quality than is a licensing scheme based on largely irrelevant coursework.

There are many fields of work in which the law requires individuals to obtain a license from the state before they are allowed to sell their services. The judgment of most economists is that those laws have the purpose and effect of restricting competition — in most, if not all, instances — and thereby keeping earnings higher for workers in the occupation than would be the case if entry were not arbitrarily limited.

The legal profession is among the fields thus restricted. State law makes it a misdemeanor for anyone who is not a licensed attorney — a member of the North Carolina Bar — to do any work for another person that is deemed to be within the "practice of law." If a non-lawyer draws up a will for someone else, handles the closing of a real estate transaction, defends someone accused of a crime or does anything else that is "lawyer's work," he has broken the law. Competence and satisfaction are irrelevant. The legal violation depends solely on the performance of any legal service by a person not "authorized" to do so. Of course, the only way one can become licensed is to become a member of the State Bar by passing the bar exam. But one can't take it without graduating from an accredited law school which must have a three-year course of study and can admit only students with undergraduate degrees. So UPL locks in place a costly course of preparation for the legal services field.

The justification invariably given for UPL prohibitions is that we need to protect members of the public against incompetent and dishonest practitioners. But that justification fails. The law school/bar exam gauntlet is neither necessary nor sufficient to ensure a high degree of competence in legal service, because people can learn what they need to about the law in order to render competent service without having graduated from a law school. Lawyers learn almost everything they need to know to serve their clients after they have become members of the bar. Law school is just a costly prelude. But the high cost of entering the market suppresses competitors and keeps the cost high. <u>Many poor people are priced entirely out of the legal services market</u>. If they do manage to pay for legal work done, it is with considerable sacrifice of other needs.

Nor is bar membership a sufficient condition for competence. Lawyers make many errors, as do practitioners in all fields of human endeavor. No course of training or set of licensure requirements can eliminate error. The strongest disincentive to error is the harm it does to the person who commits it, and that disincentive is increased not one bit by the holding of a license.

BENEFITS OF A FREE MARKET IN LEGAL SERVICES

Competition gives consumers the widest range of options, keeps prices down, and motivates competitors to keep quality high enough to satisfy customers. As things now stand, people in need of legal assistance can either do it themselves or hire an attorney to do it. There is no middle ground, as there is in accounting, where one can hire someone who isn't a CPA if one so desires. In Arizona, where there has been no UPL statute since 1986, there are legal clinics in many cities where people with simple legal needs may go to acquire basic legal advice at a reasonable price. Qualified practitioners, such as paralegals, also provide many routine services.

Furthermore, the benefits of success and the costs of failure motivate market participants to keep the quality of their products or services high enough to satisfy customers. People who want to earn money in any market try to avoid the reputational damage that comes from poor quality work. Unlicensed practitioners in Arizona refer people who come to them with legal problems beyond their scope to attorneys who have the necessary expertise. By preventing the emergence of lower-cost legal service businesses, UPL statutes lower the overall quality of service for poorer people, sacrificing the interests of justice and efficiency for job protection.

GOAL

To ensure that North Carolinians have access to a fair, efficient, speedy, and affordable legal process where they can adjudicate disputes, seek redress of grievance, and pursue justice.

RECOMMENDATIONS

1. State leaders should maintain and possibly reduce the cap on punitive damages in order to ensure that courts are used primarily to compensate injured parties and enforce contracts, not to legislate or regulate in lieu of duly elected public officials and their appointees. Lawmakers should consider earmarking punitive damage awards for state, rather than private, purposes, such as funding education or providing tax relief.

2. Instead of mandating a law school education as the sole means of entrance into the legal services market, the state should establish voluntary certification programs in common legal fields and allow people who want to earn that certification to take the exam without regard to the means by which they learned the subject.

HEALTH CARE REFORM

Ever since the national health care debate began in earnest in 1993, policymakers in North Carolina have wondered how best to proceed with state measures to improve access, increase quality, and reduce the expense of medical care. The state has already made several reform attempts, including a costly expansion of Medicaid coverage and a law introducing greater regulation into small-group health insurance. But critics say these measures have had marginal or even counterproductive results.

In 1995, the General Assembly moved in a new direction by rolling back some insurance regulations, passing a tort reform bill, and endorsing the concept of medical savings accounts (MSAs) as a way of increasing access, portability, and efficiency of medical coverage. In 1998, the legislature took a major step forward by passing a limited tax credit for child health care insurance purchased directly by parents, though unfortunately a subsequent legislature eliminated the credit as part of a tax-increase package passed in 2001.

THE CORE OF THE PROBLEM

The health care issue consists of several different concerns. One is the extent of medical cost inflation, not only in the private sector but even more seriously in government programs such as Medicaid. Another is access — the existence of a sizable number of state residents who are uninsured against major medical conditions. Still another is insecurity created by families receiving health insurance primarily through employers, as well as concerns about the quality and choice of care available in employer-provided managed care.

While it might appear that these diverse concerns should have diverse causes, the common denominator is a federal and state tax system that encourages third-party insurance coverage over other ways that North Carolinians might take care of their health care needs. Because fringe benefits such as employer-provided health insurance are free from taxation, while individual purchases of plans or procedures are taxed, a system of third-party payment for medical bills has become widespread. When consumers have no personal incentive to shop wisely, they tend to consume inefficiently — such as going to the doctor or to emergency rooms for minor ailments. Managed care is a response to this problem, but it places employers in the role of consumer and has created incentives for some physicians to deny care to patients who really need it.

State regulators have compounded problems in the health care marketplace by restricting the supply of qualified medical practitioners through occupational licensing and by restricting the supply of medical facilities, particularly in rural areas, through certificates-of-need and other regulations. Lawmakers have also imposed costly mandates on the services that must be included in private health insurance sold in the state.

FORWARD IN 1998, BACKWARD IN 2001

A special session of the General Assembly called in early 1998 to debate child health insurance gave forward-thinking lawmakers an opportunity to begin reforming the tax treatment of health care. As part of a deal to use federal funds to create a $110 million state-run insurance program for children — a regrettable but inevitable increase in the welfare state given the actions of Congress in 1997 — the N.C. House insisted on a refundable state income tax credit for families who do not have access to tax-free benefits at the workplace. The original House proposal offered a 33 percent tax credit for out-of-pocket spending on child health insurance, representing the marginal state and federal tax rates on those expenditures, but the final deal watered down the tax credit, leaving it at $300 per child for families with incomes up to 225 percent of the poverty line, $100 per child up to $100,000 in income for a family of four, and no tax relief to families above that income cap who are forced to pay taxes on their child health insurance.

This tax credit represented the first step in the process of eliminating the tax code's distortion of the health care marketplace. Unfortunately, many lawmakers and state officials do not understand the underlying issues involved, and legislative staffers even incorrectly listed the health care tax credit as a "tax loophole." In 2001, lawmakers eliminated the credit as part of a massive tax increase on North Carolina families and businesses.

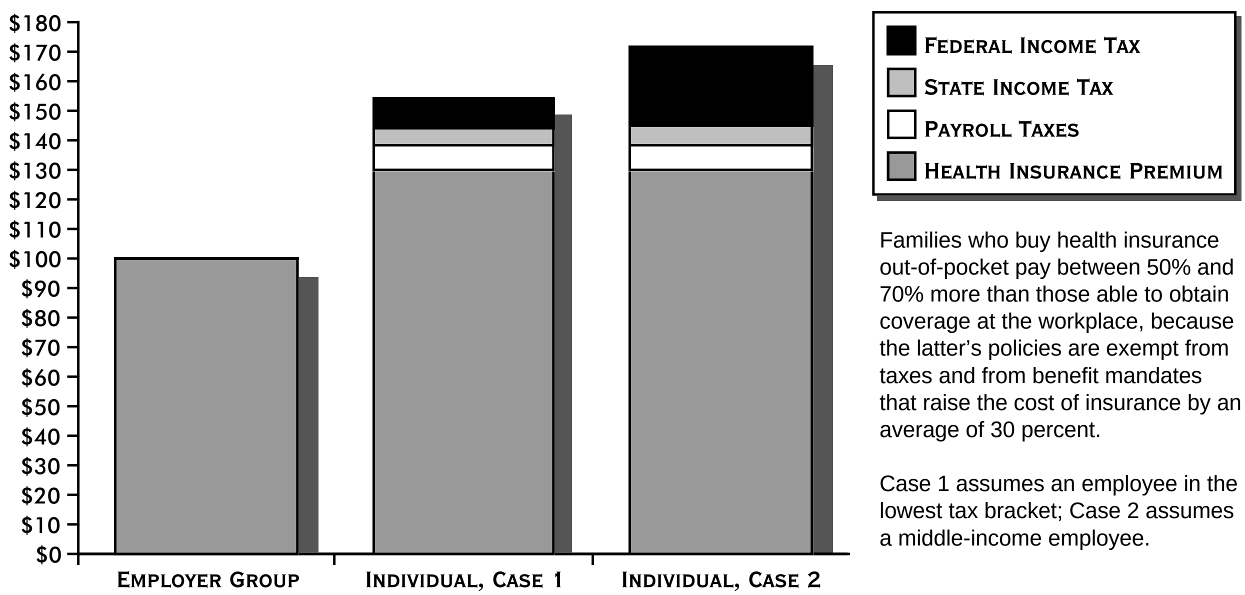
The future offers new prospects for reform, however. At the federal level, a 2002 ruling by the Treasury Department now allows companies to set up health reimbursement accounts (HRAs) for their employees in which unspent funds accumulate tax-free, just like the more limited MSAs. President Bush is also proposing a new federal tax credit for individual insurance purchases. North Carolina can adjust to these welcome trends towards market competition and personal control over health care by reinstating and broadening the previous state tax credit and applying it to adult health insurance. Family deposits in MSAs or the new HRAs should also receive the credit. These changes would treat everyone fairly and encourage families who lack employer coverage to provide for their own needs without going on the government dole.

RECOMMENDATIONS

1. State lawmakers should reinstate and expand the modest tax credit for child health insurance by giving a refundable tax credit to families for all out-of-pocket health care expenditures including insurance premiums, deductibles and copayments, and deposits into MSAs. The state's health plan for state employees and retirees should also include an MSA option to provide greater choice and help constrain the plan's exploding costs.

2. State policymakers should end certificate-of-need regulation and eliminate state benefit mandates on health insurance. The state should also reduce licensing restrictions on non-physician providers and create a subsidized assigned-risk insurance pool to assist those with preexisting conditions to obtain coverage.

How Taxes, Regulations Punish Individuals Who Buy Health Insurance



Families who buy health insurance out-of-pocket pay between 50% and 70% more than those able to obtain coverage at the workplace, because the latter's policies are exempt from taxes and from benefit mandates that raise the cost of insurance by an average of 30 percent.

Case 1 assumes an employee in the lowest tax bracket; Case 2 assumes a middle-income employee.

	Employer Group	Individual, Case 1	Individual, Case 2
Federal Income Tax	$0	$10	$27
State Income Tax	$0	$6	$7
Payroll Taxes	$0	$8	$8
Health Insurance Premium	$100	$130	$130

MEDICAID & HEALTH CHOICE

North Carolina's Department of Health and Human Services has long been one of the state's fastest growing institutions. This growth has been fueled in large part by increases in state and federal spending on Medicaid. With one of the most expensive Medicaid programs in the nation, North Carolina desperately needs to inject doses of market competition and common sense into its medical assistance efforts.

THE MEDICAID EXPLOSION

Medicaid was created in 1965 as a health insurance program for poor Americans. Since then, it has become an amalgam of at least four separate social welfare programs: 1) poor adults and children, 2) non-poor children and pregnant women, 3) disabled adults and children, and 4) elderly users of long-term care. Medicaid pays for nearly half of all births and three-quarters of all nursing home bills, the latter often benefitting middle-income North Carolinians who exploit porous eligibility rules to shield their assets while consuming long-term care.

The future solvency and affordability of North Carolina's Medicaid program is in serious doubt. During the past 10 years, Medicaid spending in North Carolina tripled — reaching $6 billion in FY 2001-02 (of which $2 billion consisted of state funds). Significant increases in eligibility and cost explained the rapidity of the increase. Unfortunately, state and federal decisions extending eligibility for households above the poverty line appear not to have resulted primarily in shrinking the ranks of the uninsured. Instead, Medicaid expansion largely "crowded out" private insurance as workers of modest means chose to cancel family plans for which they previously paid (directly or in the form of workplace withholding) in order to get free Medicaid coverage.

As the pie charts on the next page reveal, a similar pattern emerged after North Carolina created its "Health Choice" program in 1999 under the federal government's Child Health Insurance Program (CHIP). The main effect of the free or low-cost insurance, offered to non-poor families, was to induce some either to drop their private coverage or avoid buying coverage after leaving Medicaid. Health Choice, in other words, has mainly allowed lower- to middle-income families to shift the cost of their children's health care to taxpayers. Meanwhile, a parallel system of tax credits for families who refuse handouts was eliminated by the legislature in 2001.

Neither Medicaid nor Health Choice are structured to provide recipients with the incentives they need to leave the public assistance rolls. The benefits packages are more generous than what most North Carolinians purchase individually or at the workplace, and are free or virtually free to recipients. No time limits, work requirements, or pay-back provisions are imposed on able-bodied recipients. As a result, recipients are rewarded if they stay enrolled and consume high levels of care. This violates every principle of sound public policy.

The other fiscal time bomb in Medicaid is the aging of the population. Because most families expect that their elderly members will be able to tap Medicaid funds should they need long-term care, few are purchasing long-term care insurance or building their savings. These trends will make the promise of Medicaid coverage increasingly difficult to fulfill in the future without massive tax increases or drastic reductions in other state services.

RECOMMENDATION

State policymakers should significantly restructure Medicaid. The benefits package should more closely resemble private plans and be limited to services mandated by Washington. Poor families should be offered vouchers or refundable tax credits with which to purchase private insurance, enroll in managed care, or deposit into savings accounts. The Health Choice program should be significantly curtailed or eliminated, with the savings used to offer tax credits to families for private health care. Finally, the state should encourage families to plan for their long-term care needs by expanding tax relief for private long-term care insurance and medical savings.

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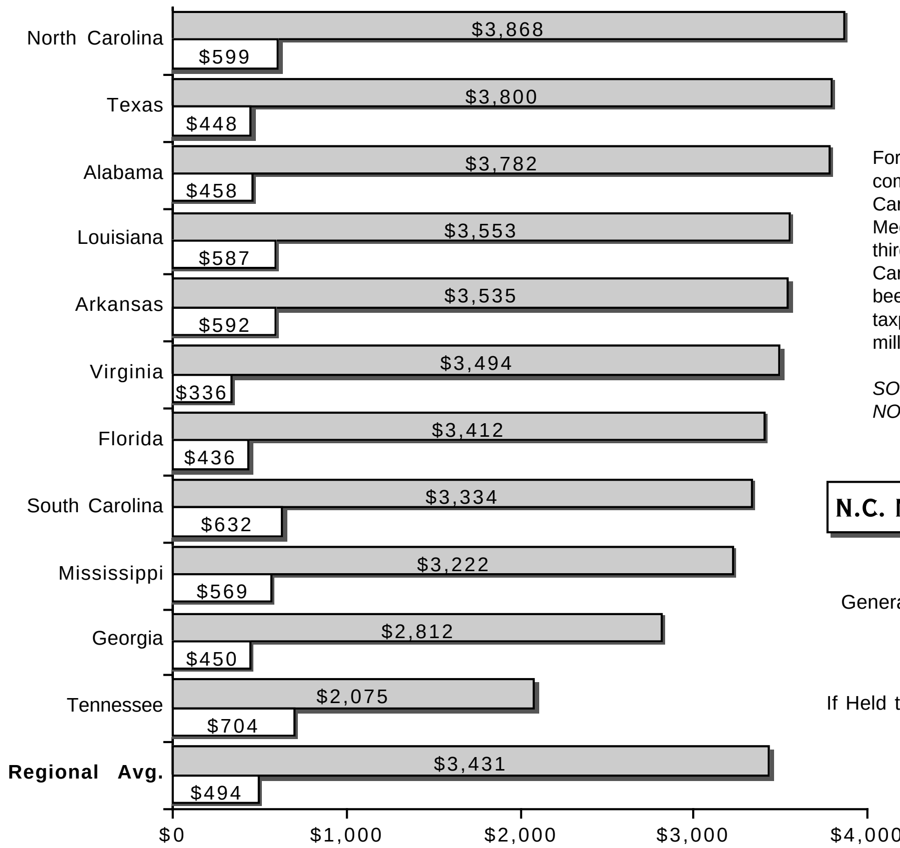
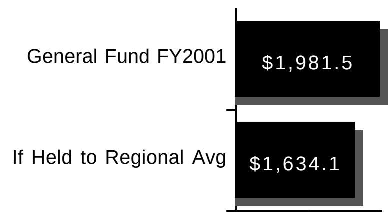
North Carolina Medicaid Spending vs. Other Southern States



For the most recent year for which there are comprehensive data (FY 1998) North Carolina ranked first in the South in total Medicaid payments per person served and third in spending per state resident. If North Carolina's Medicaid budget per capita had been held at the regional average in 2002, taxpayers would have saved more than $347 million (see below).

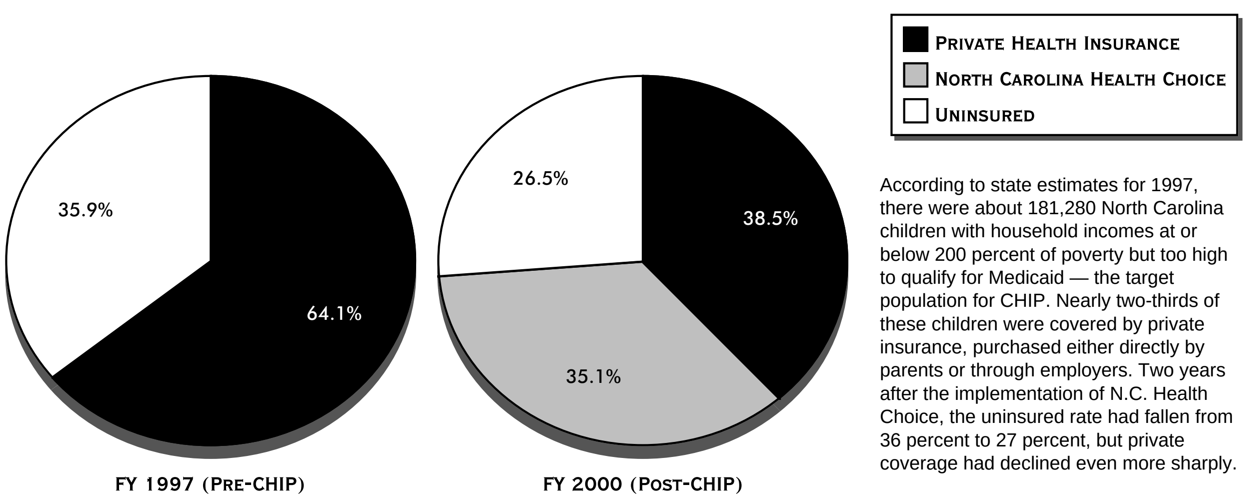
SOURCE: Health Care Financing Admin.
NOTE: Numbers exclude DSH funds.

N.C. Medicaid Budget: What If?



In Millions (Authorized)

Health Coverage of CHIP-Eligible N.C. Children, 1997 vs. 2000



FY 1997 (Pre-CHIP)

FY 2000 (Post-CHIP)

According to state estimates for 1997, there were about 181,280 North Carolina children with household incomes at or below 200 percent of poverty but too high to qualify for Medicaid — the target population for CHIP. Nearly two-thirds of these children were covered by private insurance, purchased either directly by parents or through employers. Two years after the implementation of N.C. Health Choice, the uninsured rate had fallen from 36 percent to 27 percent, but private coverage had declined even more sharply.

SOURCE: Author Computations and Estimates based on Annual Reports for N.C. Health Choice, FY 1999 and FY 2000

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DISABILITY SERVICES

State programs for the physically and mentally disabled, most of them funded to a significant degree by federal dollars (for the most part originating in North Carolina, it should be noted), have become one of the largest government enterprises in North Carolina, making up nearly one-fifth of the Health and Human Services budget and employing thousands of people. Unlike other HHS programs, such as welfare for the able-bodied or Medicaid for middle-class seniors, disability services have long been considered a proper function for government to perform. Unfortunately, the evidence suggests that North Carolina's disability services are poorly administered and delivered, too expensive, and too little directed toward promoting self-sufficiency and gainful employment.

BUREAUCRATIC BLOAT AND INADEQUATE RESULTS

Divisions within the state's HHS department engaged in disability services include Vocational Rehabilitation, Services for the Blind, Services for the Deaf and Hard of Hearing, Aging, Mental Health/Development Disabilities/Substance Abuse, and Medical Assistance. A separate advocacy council for the disabled is housed in the Administrative Department. Many of these divisions provide similar services to their clients and exist for reasons that are more political than operational in nature.

It is difficult to obtain solid outcome measures for the many disability services, which include acute and chronic medical care, education, job training and placement, advocacy, regulation, counseling, and independent living. Costs per disabled worker successfully rehabilitated and placed in jobs have risen significantly in recent years (see graph). Fewer than half of Vocational Rehabilitation clients are still working a year after having been successfully "placed." One culprit in the declining productivity of disability programs has been the Americans with Disabilities Act. By establishing a variety of rights, it encouraged individuals to seek disability status who previously had no reason to. The act also had the unfortunate effect of reducing employment rates among the disabled, most likely because employers felt more reticence to hire disabled workers if they could be compelled to spend significant funds to accommodate such employees in their workplaces.

The state's mental health system is itself teetering on the edge of collapse. State mental hospitals are poorly run, poorly maintained, and prohibitively costly, while private psychiatric hospitals are under-used and community-based alternatives are inadequate to handle problems created by deinstitutionalizing mental patients. The Easley administration has taken several steps towards sensible reform, including consolidation of county mental health efforts, privatization, and a study of whether to replace aging state hospitals with a new facility.

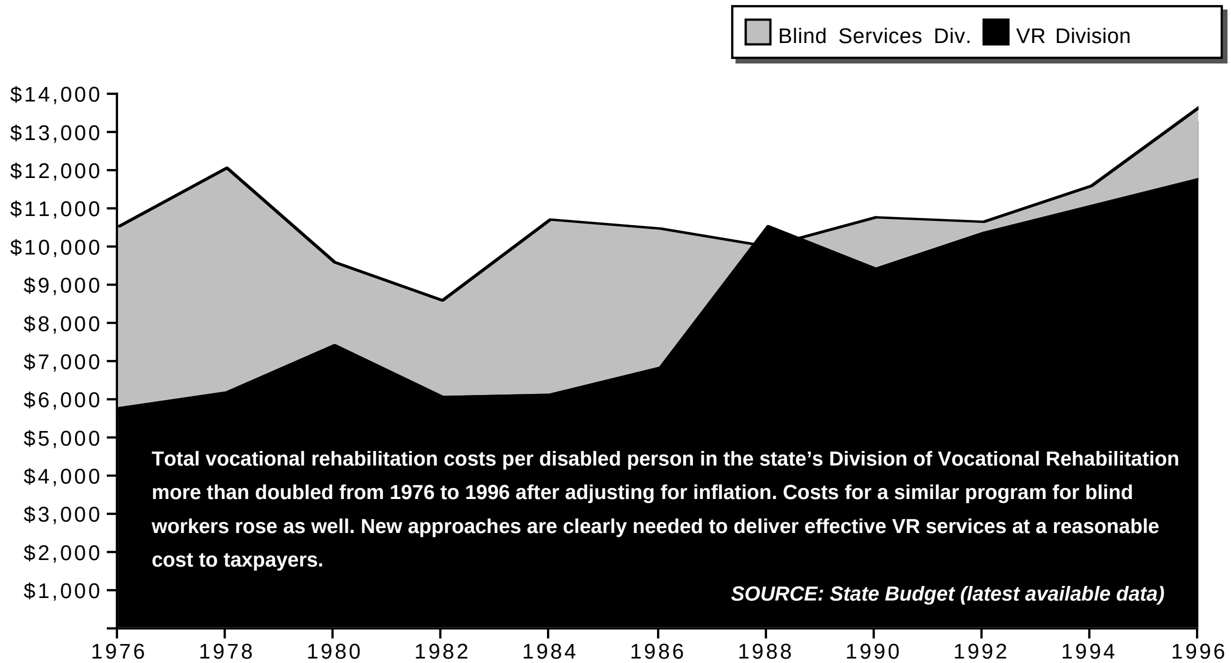
RECOMMENDATIONS

1. Lawmakers should continue efforts to merge most existing programs into a single Division of Disability Services, organized around services rather than disabilities, in order to improve performance and efficiency (see chart). State and local agencies should also make better use of competitive contracting, vouchers, and incentive pay for caseworkers to deliver a higher quality of service to disabled North Carolinians at an affordable price.

2. The state should revisit its definition of disability to target resources more carefully to those who truly need them, while setting self-sufficiency as an unambiguous goal for those with slight or modest disabilities.

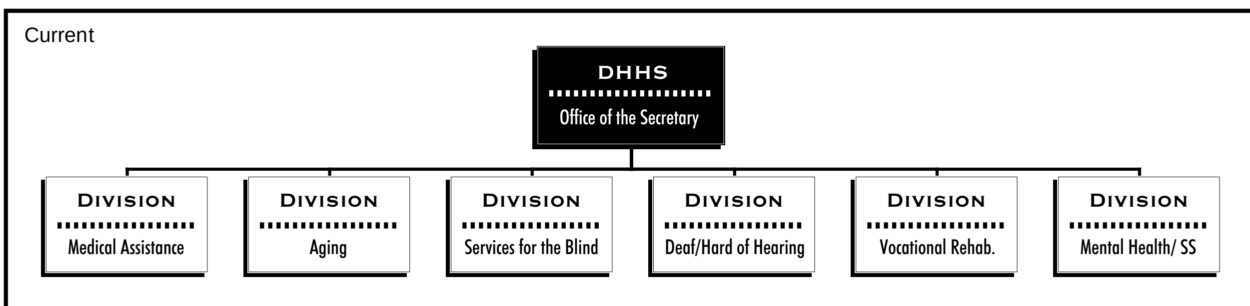
3. The state should transfer ownership and operation of its mental hospitals to local or private agencies and reform its funding process to route more patients into appropriate private hospitals or community-based care. Local mental health authorities should carry out the Easley administration's reform agenda by acting as informed purchasers of care from a variety of public and private providers.

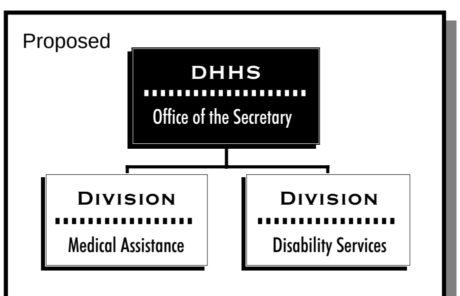
Inflation-Adjusted Cost Per Vocational Rehabilitation, 1976-1996



	1976	1978	1980	1982	1984	1986	1988	1990	1992	1994	1996
Blind Services Div.	$10,542	$12,069	$9,610	$8,577	$10,688	$10,444	$10,013	$10,780	$10,645	$11,585	$13,632
VR Division	$5,739	$6,155	$7,432	$6,033	$6,117	$6,808	$10,511	$9,394	$10,340	$11,049	$11,766

Current and Proposed Organization of North Carolina's Disability Services





The current organizational structure in the state's Department of Health and Human Services spreads responsibility for serving physically and mentally disabled North Carolinians over six different divisions, many of them providing such common services as job training, independent living, education, and counseling. An alternative would be to group these programs within only two divisions — Medical Assistance, which administers the Medicaid program, and Disability Services, which would administer a range of programs serving the disabled on the basis of what they need, not who they are.

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WELFARE REFORM

Reforming our welfare system is a popular idea with the general public. But the case for significant change would be dramatic even if it were unpopular. Built gradually over decades of accompanying economic and social change, the welfare state has provided some level of material comfort for its recipients but at a staggering cost in terms of dollars spent and lives wasted.

THE COSTS OF WELFARE

The dollar cost of North Carolina's welfare state is tremendous. The combined budget for public assistance programs — cash welfare, Medicaid, Special Assistance for Adults, and other programs either means-tested for low-income North Carolinians or intended for their direct benefit — makes up about one-third of the total state budget. Real public assistance spending per low-income person has roughly tripled in the past two decades.

More significant than the monetary cost of the welfare system is the toll it has taken on families and children. By providing cash and benefits to mothers who do not work and who are not married, the welfare state promotes longtime dependency, personal irresponsibility, indolence, and illegitimate births. One study found that a 50 percent increase in the value of cash welfare and Food Stamp payments resulted in a 43 percent increase in the number of out-of-wedlock births in a state. The unformed or broken families created in part through our welfare policies are damaging the health, safety, and life prospects of children. Single parenthood correlates strongly with the possibility that children will be poor, fall behind their peers educationally, drop out of school, use drugs, commit crimes, experience mental illness, commit suicide, or become single parents themselves.

SIGNS OF PROGRESS

Both at the national level and in North Carolina, welfare reforms have born fruit. Caseloads for the cash welfare program Temporary Assistance for Needy Families (TANF, formerly AFDC) have fallen dramatically. Unfortunately, poverty rates haven't fallen as quickly, partly because of an influx of poor immigrants whose incomes are higher than they would have been in their home countries but still below the U.S. poverty level. Furthermore, the state's out-of-wedlock birth rate has skyrocketed by nearly 100 percent over the past 20 years, and now stands at 33 percent — a troubling indicator about future social ills. Long-term success in combatting poverty will rest on changing behavior to encourage marriage, high school completion, and full-time work.

In 1997, the General Assembly took the unprecedented step of giving some counties the power to devise their own TANF programs. Local experimentation in such areas as "pay for performance" — giving recipients welfare benefits only after completion of required work — and privatization appears to have borne fruit. In the early- to mid-1990s, North Carolina's rate of caseload reduction was the lowest in the Southeast. By 2000-01, North Carolina moved into the top rank of states in successful welfare reform.

RECOMMENDATIONS

1. North Carolina should continue to implement welfare reforms to tighten time limits, promote marriage and personal responsibility, require work, target benefits to the most needy, and encourage efficient operation. Counties should be given significant authority to experiment, and privatization options considered.

2. The state should create a Private Assistance Tax Credit so that taxpayers can decide how much of their welfare spending should be directed to public or private agencies. The credit would allow taxpayers to write off donations, up to a maximum, to private anti-poverty programs with offsetting reductions in state spending.

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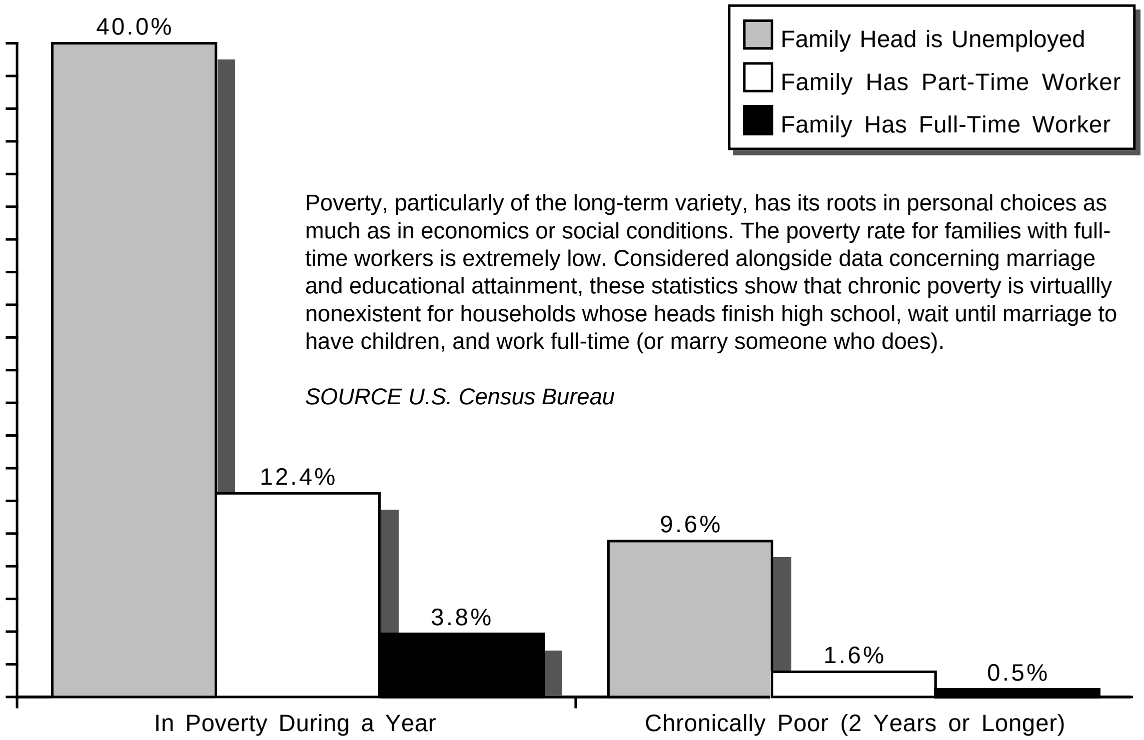
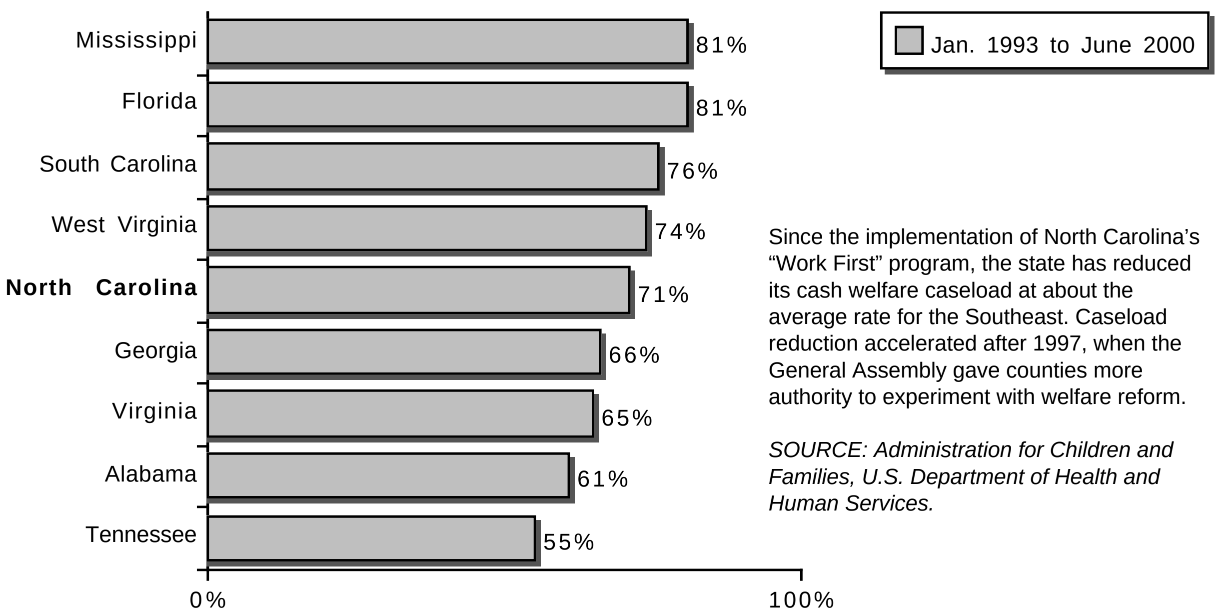
THE BEST ANTIDOTE TO POVERTY: A FULL-TIME JOB



Poverty, particularly of the long-term variety, has its roots in personal choices as much as in economics or social conditions. The poverty rate for families with full-time workers is extremely low. Considered alongside data concerning marriage and educational attainment, these statistics show that chronic poverty is virtuallly nonexistent for households whose heads finish high school, wait until marriage to have children, and work full-time (or marry someone who does).

SOURCE U.S. Census Bureau

AFDC/TANF CASELOAD DECLINE IN SOUTHEAST, 1993-2000



Since the implementation of North Carolina's "Work First" program, the state has reduced its cash welfare caseload at about the average rate for the Southeast. Caseload reduction accelerated after 1997, when the General Assembly gave counties more authority to experiment with welfare reform.

SOURCE: Administration for Children and Families, U.S. Department of Health and Human Services.

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CHILD CARE & PRESCHOOL

One of the most controversial issues in the past few years has been the proper role of the state in provid ing child-care and preschool opportunities to North Carolina children. The Smart Start program was intended to be an innovative public-private partnership to facilitate local coordination of children's services, but the program is mostly state-funded and focuses mainly on the minority of preschoolers in paid child care. North Carolina also affects the market through a tax credit for child-care expenses and through rules on personnel, facilities, amenities, and location of centers and homes that raise the price of care.

SMART START'S SHAKY DEBUT

Smart Start was created in 1993 to help get North Carolina preschoolers ready to learn and thus boost educational performance. Until recently its effectiveness as a school-readiness intervention was impossible to estimate. This has not stopped some politicians from proclaiming Smart Start "successful." In 1999, for example, Gov. Jim Hunt attributed apparent gains in North Carolina reading scores on 1998 national tests to the existence of Smart Start, even though the highest grade that students from Smart Start-supported preschools could have reached by 1998 was third grade and the reading tests were of fourth-graders.

Since early 1998, at least four studies of Smart Start's impact on school readiness have been published that can provide fair-minded observers with critical information about its effectiveness. Although portrayed by news reports and elsewhere as proving Smart Start's success, the studies, when closely read, suggest a far different conclusion. The most recent and most comprehensive study — published in September 1999 by the Frank Porter Graham Child Development Center at UNC-Chapel Hill — found that the vast majority of Smart Start expenditures had no statistically significant effect on participants' readiness to learn in kindergarten.

Researchers picked six counties where there were Smart Start partnerships and recruited an experimental group of children who had attended a Smart Start-supported child care center and a control group who had attended centers not involved in Smart Start. The researchers found no statistically significant differences between the two groups in kindergarten readiness assessments. There were positive results for a small subgroup of Smart Start children receiving the most attention, but they were so small in magnitude that, based on past experience with preschool programs such as Head Start, they are unlikely to last beyond first or second grade.

Previous research points to similar conclusions. In 1998, the Graham Center conducted a study of Smart Start in Orange County. A flawed study because it lacked a true control group, it still found no statistically significant impact on non-poor children and a modest gain for poor ones. A more valid study was conducted in 1998 in Mecklenburg County. It found no statistically significant impact on those who spent a single year in a Smart Start center. It did find a measurable gain for kids who stayed in such a center for three years, but once again, the gain was relatively small 2 percentage points on one measure and 7 percentage points on another. In early 1999 the Graham Center released a study of 200 Smart Start-supported centers that showed gains in child care quality but no impact on kindergarten readiness. More recently, a study of Charlotte-Mecklenburg's Bright Beginnings program, which focuses more attention on academic preparation for at-risk preschoolers, found that participating third-graders did not outperform a control group of eligible children who didn't participate.

PRESCHOOLERS AND DAY CARE

As the nearby graph reveals, most preschoolers do not spend their days in centers or homes where paid staff take care of 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. Even for four-year-olds, where the

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likelihood of enrollment in day care is higher, the at-risk families politicians say they want to help are infrequent users. According to one study, about two-thirds of mothers who lack a high school education use no paid day care prior to kindergarten, compared with 22 percent of college graduates. Day care subsidies, teacher training, preschool playground grants, and the like cannot benefit the majority of poor families. For those families who do use paid day-care in some form, Smart Start is less efficient aid than simply expanding the eligibility or amount of day care vouchers already distributed by counties.

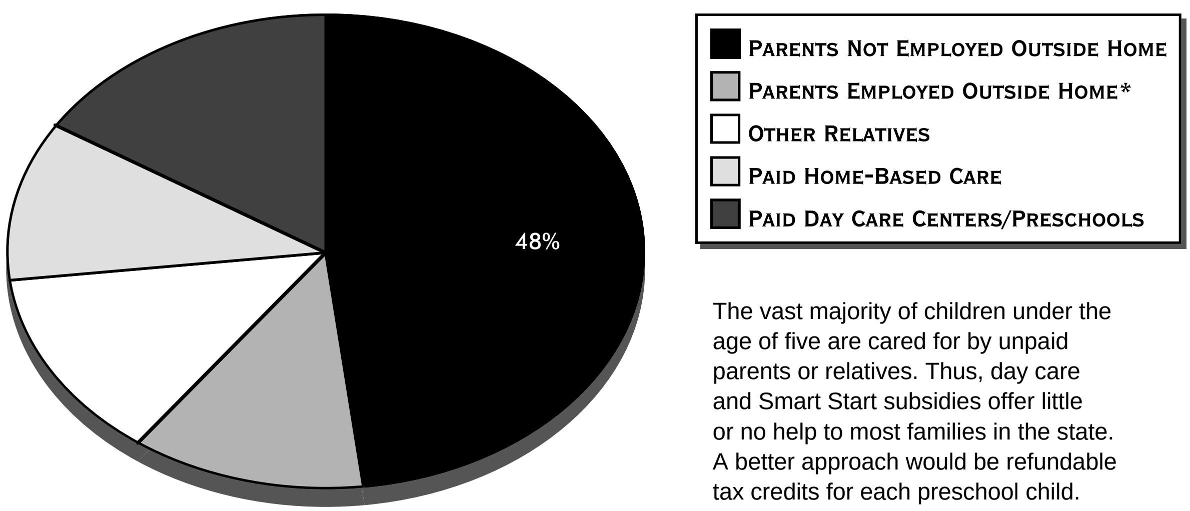
Families are by far the most important providers of preschool services. They do the most to get their children "ready to learn," whether it be purchasing a book, making a visit to a doctor, or sacrificing significant income to rear their children at home. All of these investments in child development deserve the same subsidy, if any, given to those who choose services provided for pay outside the home. Furthermore, parents are in the best position to judge the quality of the day care or services they do purchase for their children. Contrary to popular belief, most families in public opinion surveys say they are satisfied with their day care arrangements

RECOMMENDATIONS

1. Smart Start and other subsidy programs and tax credits for child-care and preschool expenses should be eliminated in favor of a refundable Smart Start tax credit for preschool children. 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. For a smaller subset of desperately poor preschoolers who lack functioning parents, a carefully designed state intervention may be justified.

2. Policymakers should limit regulation of day-care operations to health and safety requirements only, letting parents make their own decisions about the trade-off between price and child-staff ratios or qualifications.

WHO ARE THE PRIMARY CARETAKERS FOR PRESCHOOL CHILDREN?



% of Total

The vast majority of children under the age of five are cared for by unpaid parents or relatives. Thus, day care and Smart Start subsidies offer little or no help to most families in the state. A better approach would be refundable tax credits for each preschool child.

	% of Total
Parents Not Employed Outside Home	48%
Parents Employed Outside Home*	12%
Other Relatives	13%
Paid Home-Based Care	11%
Paid Day Care Centers/Preschools	16%

**** Includes parents with staggered schedules and home-based workers.***

SOURCE: U.S. Census Bureau

PRIVATIZATION & COMPETITION

Like other states and localities, governments in North Carolina are struggling to satisfy two apparently conflicting public demands: lower taxes and better services. Under the traditional model of public sector management, these two goals are diametrically opposed. To lower taxes, a government must reduce the amount or quality of services. To improve programs such as public schools or social services, citizens must be willing to "invest" more tax dollars in government.

But a new generation of leaders in North Carolina and other states is challenging this conventional wisdom. By introducing competition, markets, and volunteer participation into government programs and services, they are serving the public by both reducing cost and increasing quality. And they are doing so without sacrificing the government's role as funder and overseer of core government services.

THE CASE FOR COMPETITION

Although the term privatization has come to mean simply transferring tasks previously performed by government employees to private for-profit firms, the concept is much broader than that. It involves applying the discipline of competition to the public sector, but not necessarily to move services to private contractors if government employees and agencies prove to be the lowest cost, best quality provider. The appropriate strategy should be to transform the role of government from a monopoly provider of services to a purchaser of services from whatever set of public, business, or nonprofit providers is in the best interest of citizens.

What is it that makes privatization and competition so crucial to reform government? It changes the incentives. For most public managers, the monopoly status of government programs presents a set of incentives not found in private industry. In government, a manager's salary and satisfaction is highly correlated to staff size and budget. If Government Manager A underspends her budget or employs workers more productively, she will subsequently receive a smaller budget and staff, with the result that her salary will not rise and her career will be hampered. Alternatively, Government Manager B, who overspends his budget or inflates his workforce, will find that the costs of wasteful, inefficient spending can be passed on to others — the taxpayers.

Private-sector managers, of course, also like to increase their salaries and status by expanding operations under their control. But unlike their public-sector counterparts, these private managers also face the threat of failure. Unless they reflect increased demand for a firm's goods or services, increases in salary and budgets will cause financial problems over time. So the same managers or employees, with the same skills and talents, will naturally perform their jobs differently. When governments fail to restrain costs and provide good services, the managers and employees are usually not to blame. The system presents them with poor incentives.

NORTH CAROLINA CASES

While hardly a national leader in privatization and competition, North Carolina has begun to employ the strategies that governments across the country have used to reform government. Charlotte, Raleigh, Durham, Greensboro, Asheville, and other localities have all debated and in many cases implemented privatization in the past few years. Charlotte, with one of the most extensive privatization programs in the state, had by the mid-1990s contracted out 84 percent of its engineering and property management needs, half of its internal support services, 71 percent of transportation, 17 percent of finance, and 78 percent of airport operations.

Local leaders in North Carolina have contracted out a variety of services. Surry County saved almost $100,000 and improved coverage by seeking private bids for its insurance policies. Chapel Hill-Carrboro contracted out

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its school system's lunch program in 1995, while the Mount Airy school system has realized significant savings by contracting out maintenance and janitorial services. Charlotte-Mecklenburg found that when almost 100 schools contracted out their grounds maintenance, the process didn't save money but did improve school appearance. Gaston County has contracted out janitorial needs, lawn maintenance, tax billing and collection, a dental clinic, and day care operations (in which there was a 90 percent savings after privatization).

Health care and social services have been an especially popular area for contracting. Mecklenburg County saved almost half a million dollars by contracting out its food stamp distribution. Onslow County did the same, not only saving money but also making distribution more convenient.

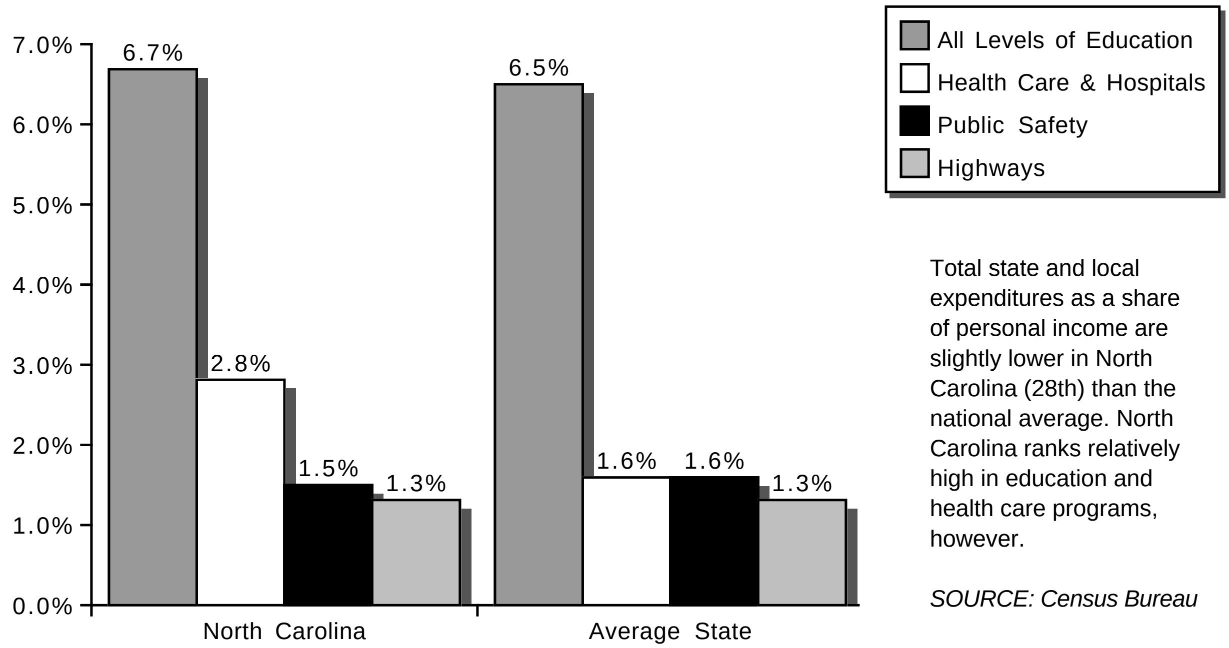
In other areas, privatization efforts by state and local government in North Carolina have not achieved their stated objectives. In many of these cases, however — including a state attempt to use private contractors to improve child-support enforcement — the culprit was not privatization itself but the design of the contract. Because taxpayer dollars are at risk, public officials must structure requests-for-proposals and contracts carefully to ensure that expectations are clearly stated and a truly competitive system is used to select providers.

RECOMMENDATIONS

1. State and local governments should set up permanent privatization and competition offices. This will create an institutional framework for introducing competition to government services. They should allow private firms to submit unsolicited bids to these privatization offices to operate programs or buy assets.

2. Lawmakers should eliminate legislative and administrative barriers to competition. Many state laws and regulations prevent privatization and competition. For example, in 1995 Wake County released a study purporting to show that contracting out its school bus operations would actually cost more than keeping it a school-district monopoly. Only later did the public discover the reason privatization would not have saved money: state regulations on insurance and other issues hide the true cost of public-sector provision.

HOW NORTH CAROLINA STACKS UP IN GOV'T SPENDING



Total state and local expenditures as a share of personal income are slightly lower in North Carolina (28th) than the national average. North Carolina ranks relatively high in education and health care programs, however.

SOURCE: Census Bureau

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CRIME & PUNISHMENT

Preventing crime is the most basic of government functions. But despite some important progress in recent years, North Carolina governments still have much to do to meet this fundamental responsibility. For example, the crime rate in North Carolina is about 20 percent higher than it was in 1984 and remains far higher than the rates of the 1950s and 1960s. Unless state and local governments can control crime, other goals such as improving education or promoting economic development will be difficult to accomplish.

WHY THE CRIME RATE ROSE

For much of this century, state and local officials gradually increased reliance on sentence reduction and lighter punishments as an alternative to increased incarceration. Even after the state began to address its prison-overcrowding problem in the mid-1970s, it failed to make incapacitating criminals a high enough priority. The results of North Carolina's policy are highlighted by a 1994 American Legislative Exchange Council study. ALEC found that from 1980 to 1992 the 10 states with the largest increases in their incarceration rates (250 percent) experienced an average 8 percent reduction in crime rates. The 10 states with the lowest incarceration rate increases (15 percent) experienced an average 51 percent increase in crime. ALEC found that from 1980 to 1992 North Carolina was the only state in the nation in which the overall incarceration rate declined (it dropped 6 percent). Simultaneously, the state's crime rate rose by 25 percent, the second-highest increase in the nation.

Instead of new cells, North Carolina had pursued a policy of alternative punishments (including parole and probation), designed to rehabilitate criminals or simply keep them from the "dehumanizing" conditions supposedly rampant in state prisons. By 1990 four-fifths of state convicts were enrolled in alternative programs, and just one-fifth were serving prison time. As a result, one-third of new prison admissions each year were convicts incarcerated for violating the terms of their alternative punishments.

In 1987, after two previous 1980s initiatives making parole more prevalent, the state adopted its infamous prison cap in response to federal lawsuits alleging violation of prisoners' constitutional rights. By 1994 the average sentence for misdemeanants in North Carolina was 23.9 months, but the average time served was 1.4 months, or about 6 percent of the sentence. The average sentence for felons was 8.8 years, but the average time served was 8.1 months, or about eight percent. Just in 10 years, parole came to play a shockingly significant role in offender dispositions. In 1985 the number of prisoners paroled equaled 48.7 percent of convicts admitted into the prison system. By 1994 parolees equaled 83.4 percent of admissions.

In 1994 Gov. Jim Hunt called a special legislative session on crime, and the General Assembly responded by enacting "Structured Sentencing," touted as the solution to the state's crime problem. It was to increase time served, both to incapacitate criminals and deter others from becoming criminals. The result was a decline in reported crimes. The new laws increased time served by violent offenders by doing away with parole. Unfortunately, the laws actually decreased sentence lengths for some crimes. By treating many nonviolent crimes as undeserving of serious punishments, the system ignored a fundamental rule of criminal behavior: criminals often begin their careers with petty crimes, then move up to more serious offenses. Still, building additional prisons and lengthening sentences have resulted in lower crime rates (see graph). Also contributing to the improvements have been local policies. Many cities have deployed additional police officers and used innovative "community policing" techniques to discourage petty crimes and build community trust.

To maintain these positive trends, we must continue to expand prison capacity as quickly and efficiently as possible so that more criminals can receive just (that is, longer) sentences. Using inmate labor and constructing larger, more cost-effective prisons than the current small, scattered ones can free construction money for other

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purposes, such as keeping criminals incarcerated longer. Privately built and operated prisons also can provide significant cost savings. One study found that privately operated prisons cost 35 percent less than publicly operated ones, while actually providing higher quality services in many areas.

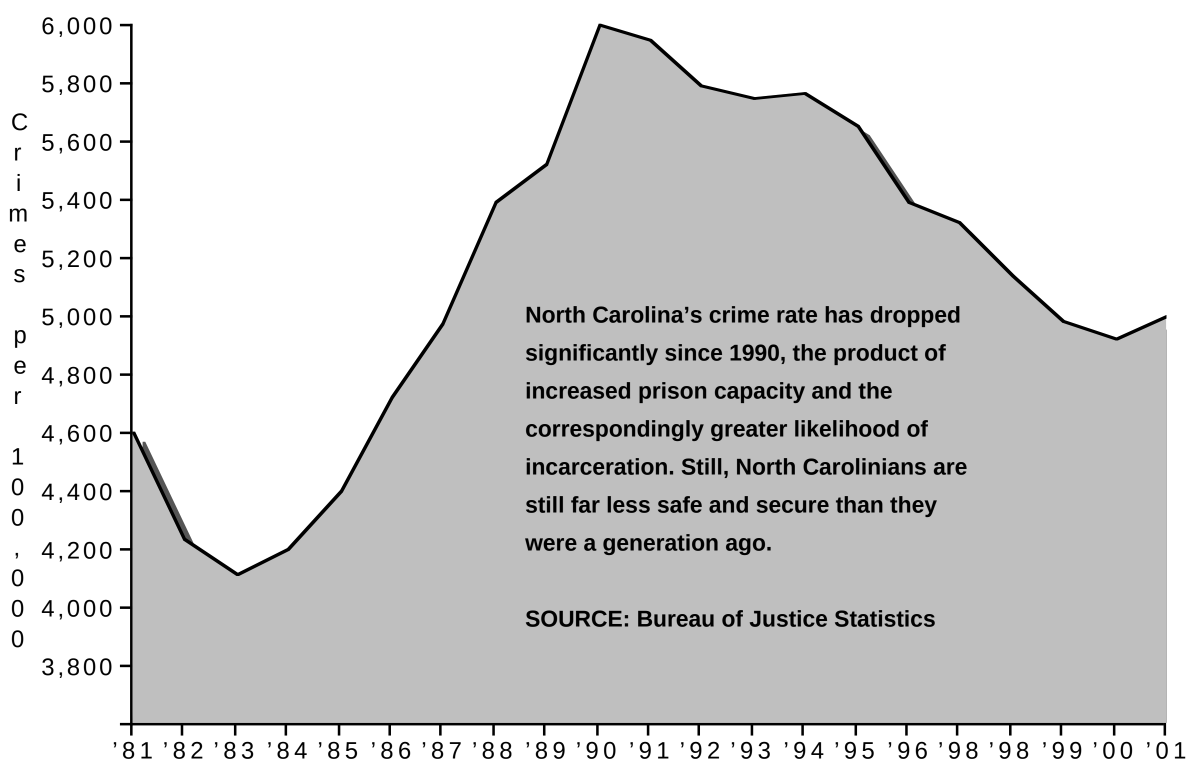
Incarceration alone will not solve North Carolina's crime crisis. We must also focus on preventing crime by addressing the conditions that give rise to it. That does not mean increasing government spending on jobs programs or social programs. There is no historical relationship between crime rates and either poverty, joblessness, or government social spending. Crime rates during the Great Depression were much lower than they are today. The real cause of crime is not a poverty of resources but a poverty of values. Research has clearly documented a relationship between out-of-wedlock births and the likelihood that those children will grow up to be criminals. That means that welfare reform and other measures to reduce government dependency and illegitimacy are irreplaceable elements of a successful crime prevention strategy.

RECOMMENDATIONS

1. State leaders need to devise a comprehensive plan for identifying and incapacitating the career criminals who commit a disproportionate share of crime in North Carolina. The state needs to build enough prison space to lengthen sentences for serious crimes, but should use prison labor, larger regional prisons, and privatization where appropriate to reduce the cost to taxpayers.

2. Local leaders should employ community policing, volunteers, and other ways to deter criminal activity in their communities. A major part of the prevention effort should be to continue to reform the welfare system, which destroys families and therefore creates the "poverty of values" that leads to criminal behavior.

TRENDS IN NORTH CAROLINA'S CRIME RATE, 1981 TO 2001



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CIVIL RIGHTS & EQUAL OPPORTUNITY

Civil rights and discrimination are among the most controversial subjects that state and local leaders must discuss. But they are also crucial issues that involve the core values of our political system: equality before the law, personal freedom, and the dignity of the individual. Affirmative action, originally proposed as a device for extending educational and employment opportunities to minorities and women previously excluded from fair and open competition, has in all too many cases become discrimination itself. The resulting disaffection and anger threatens to pull our society apart at the seams.

DISCRIMINATION AND ITS ENEMIES

Discrimination against women, racial minorities, and other groups is not only an historical legacy in North Carolina — it continues to be a reality in many workplaces and communities. When businesses discriminate on the basis of race or other factors, they are putting their own prejudices before the goal of maximizing profits and performance and will pay the price in the marketplace. In governmental services such as education and health care, the continued existence of discrimination is unjust, costly, and embarrassing, and should never be tolerated in a state and nation devoted to principles of individual liberty and dignity.

However, some of the tools currently used to combat discrimination have themselves become egregious violations of the principle of equal opportunity. In state government, a 1987 executive order established a goal of buying 4 percent of state goods and services from minorities, women, and the disabled. The General Assembly has created a separate 10-percent goal for state highway and other construction projects. Formal and informal employment targets and quotas exist throughout state government. Furthermore, many local governments in North Carolina have contracting and employment quotas of their own.

Race-based discrimination is especially prevalent in the University of North Carolina system. UNC awards so-called "minority presence grants" to black students who attend majority-white institutions as well as whites who attend majority-black institutions. At least some UNC campuses also use race as a factor in the admissions process. A December 1997 analysis by *The Charlotte Observer* found that if students were admitted to UNC-Chapel Hill on the basis of SAT scores and high school class rank alone, black enrollment at the school might drop by as much as 40 percent.

Most of these students would likely end up at other UNC campuses, such as Greensboro or Charlotte, or other public or private colleges. Nor would the black students who are academically prepared to succeed at Chapel Hill be affected. Indeed, the *Observer* grouped applicants into five quintiles, based on academic qualifications, and found that virtually all applicants in the top 40 percent, regardless of race, are admitted under the current system. But within the bottom 20 percent of applicants, only 7 percent of whites but nearly half of blacks are admitted. These black students are often woefully unprepared for the rigor of coursework at Chapel Hill, and they drop out at much higher rates than do white students. Their plight is caused not by a lack of affirmative action at the college level, but instead the poor preparation they receive in public schools (see graph).

The stated goal of affirmative action is unassailable, but the way affirmative action is practiced today is only increasing racial animosity. In a poll for *The News & Observer* of Raleigh, 41 percent of whites and 40 percent of blacks say that race relations are getting worse rather than better. This is troubling news. Racial preferences also fail to help the most disadvantaged minorities, for whom hiring and higher education preferences are irrelevant. These citizens are poorly served by public schools that do not effectively prepare them for citizenship and the world of work, by state and local law enforcement efforts that fail to protect them from criminal predators, from programs that foster dependency rather than self-sufficiency, and by government-imposed

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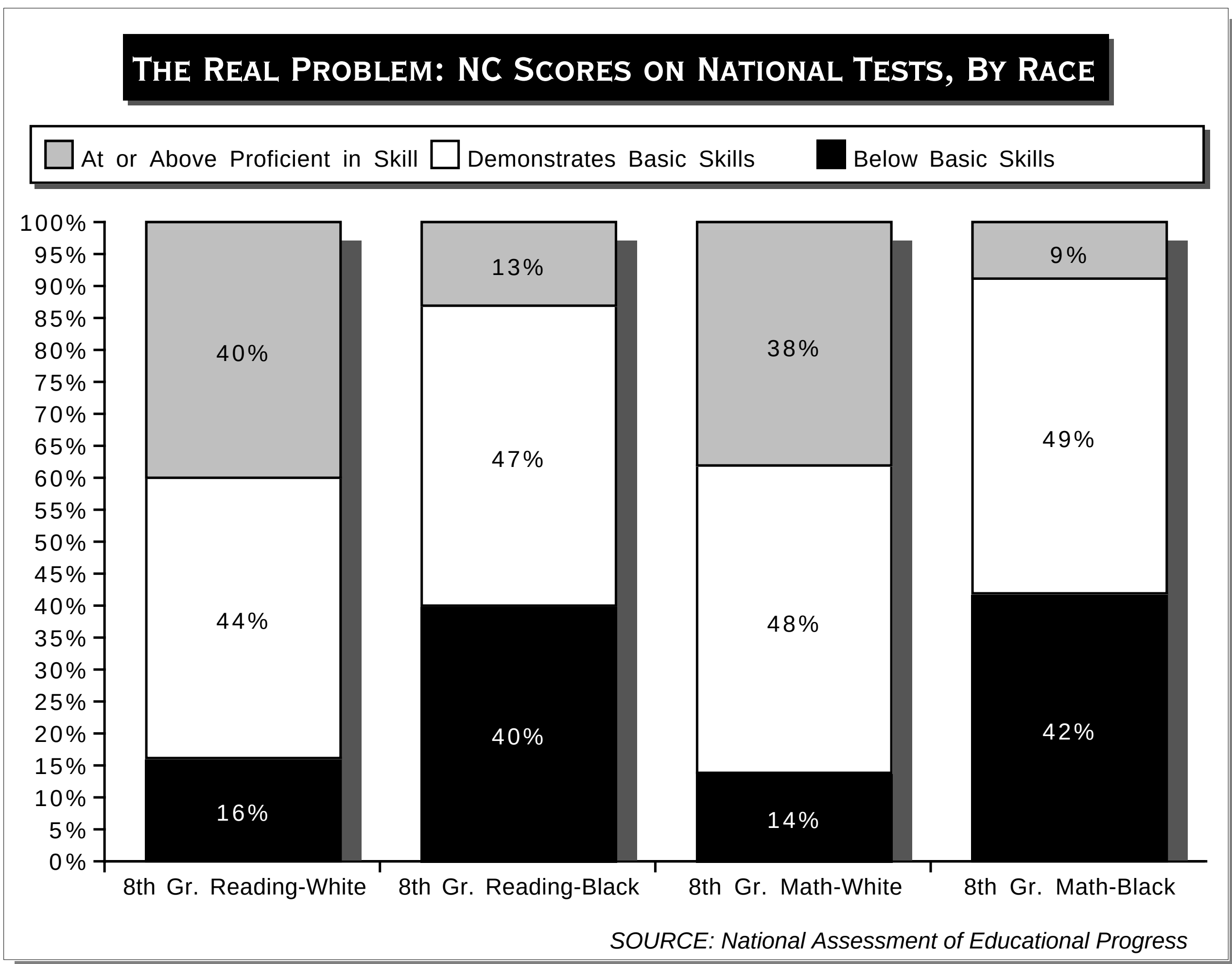
barriers to economic growth and entrepreneurship that leave them with few economic options. Addressing these needs would expand equal opportunity far more effectively than having the government discriminate in favor of historically aggrieved groups.

Not all forms of affirmative action run afoul of the principles of equal opportunity, however. The original meaning of the term included such commendable policies as outreach programs to make sure applicants of all racial and ethnic backgrounds are aware of opportunities for employment, contracts, and education. By "casting the net widely," states and localities can ensure that their applicant pool represents the best their communities have to offer. A merit-based selection process from the pool may or may not yield results that satisfy some self-styled civil rights activists, but it will best serve the interests of all citizens.

RECOMMENDATIONS

1. North Carolina state and local governments should eliminate all preferences, quotas, goals, and targets for suppliers, employment, and school admissions. Instead, government should vigorously enforce existing laws promoting equal opportunity and respect for the rights of all North Carolinians.

2. To expand opportunities for racial and other minorities in North Carolina to provide for themselves and their families, state and local leaders should offer private-school scholarships to students in low-performing school districts, expand efforts to combat crime, and promote true economic development across the state by reducing taxes and regulations, improving government services, and promoting individual freedom.



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CAMPAIGN FINANCE REFORM

While the issue of campaign finance reform barely registers in public opinion polls, many politicians and the media tell us reform is critical to the future of democracy in America. However, it is clear that they believe this is true only insofar as we accept the version of reform demanded by these same politicians and the media — public financing, contribution and expenditure limits, and an end to all independent expenditures. This version of reform will have little impact other than to stifle political debate and to further corrupt our political system. Instead, serious reformers should accomplish the effective liberation of campaigns and elections from arbitrary limits on the flow of money, information, and access.

Some critics of North Carolina's current finance system say that both wealthy individuals and political action committees (PACs) exercise too much influence over candidates. Other critics, however, argue that the current system, by limiting individual contributions, forces candidates to spend too much time fundraising rather than discussing issues and makes PACs a more important source of campaign funds than they should be. They also contend that restricting private financing of campaigns is a violation of freedom of speech.

THE PROBLEM WITH CONTRIBUTION LIMITS

The essential difficulty with current campaign finance laws is that they distort the political process. They give incumbents an electoral advantage and divert their attention from the execution of their constitutional duties in favor of an undue concentration on the need to finance future campaigns. Additionally, they discourage the average citizen, who often feels disenfranchised, from his responsibility to develop an informed base of knowledge with respect to what government is either authorized or able to do effectively.

Direct spending and contribution limits on campaigns are morally questionable and constitutionally suspect. Despite the U.S. Supreme Court's January 2000 *Nixon v. Shrink Missouri Government PAC ruling* — in which it upheld the *Buckley v. Valeo* contribution limits and refused to adjust the $1,000 campaign contribution limit for inflation — the highest court in the land should not be issuing edicts restricting the ability of American citizens to politically express themselves. This is the principal protection intended by the First Amendment. There are also more practical objections to any such limitation on financial support for a candidate. The real questions are: Do we wish to have an unelected judiciary determining the nature and extent of the political speech upon which our elections depend? And should such arbitrary restrictions append short of extensive and thorough public debate?

In essence, neither contributions to nor expenditures by political candidates or campaigns should be subject to any limits whatsoever. Unlimited financing and broadcasting of political speech is critical to the health of a free republic. So long as full and immediate disclosure is mandated and, in its absence, commensurately and severely punished, there is simply no logical or justifiable case to be made for anything less than unlimited, voluntary, and private campaign financing by free citizens in a free nation or state. Nonetheless, candidates must be held fully accountable for both the nature and use of whatever contributions they receive.

THE PROBLEM WITH EXPENDITURE LIMITS

Campaign expenditure limits are as unacceptable as contribution limits. There are two aspects to this issue. While the U.S. Supreme Court has ruled that campaign expenditure limits are unconstitutional this remains a double-barreled issue because there are two schools of thought tied directly to the issue of public financing of campaigns. If one accepts the constitutionality or even moral probity of some form of public financing does this leave the system open to the further distortions of limited, publicly financed campaigns competing against unlimited, privately funded campaigns? And, if that is the case, is it truly a problem?

If a candidate accepts public funding for a campaign he accepts a limit on expenditures and a ban on private funding. There may be an argument for imposing such limits only if a candidate accepts public funding of his campaign. The issue is whether taxpayer funding is constitutionally acceptable. The public funding of campaigns is an issue largely driven by two perceptions: 1) that too much money is spent on campaigns and 2) this money corrupts our politics. Aside from the moral issue of forcing taxpayers to pay for the promotion of ideas and candidates they may vehemently oppose, the actual dollar expenditures of political campaigns in America and North Carolina, although growing over time, are relatively small.

Candidates for federal office spent approximately $3 billion in 2000. This amounts to about one-eighth of what Americans spend annually on cosmetics. Americans spend more on Nike shoes, lipstick, and personal fitness trainers than on all local, state, and federal elections combined. In North Carolina, expenditures in legislative campaigns have increased significantly in percentage terms — the $15 million spent in 2000 was three times the total spending in 1994. Yet the numbers remain relatively small, an average of $88,000 per race in 2000.

Total contributions to state parties and campaigns remain a tiny percentage of business revenues or personal wealth. Nationally, campaign spending represents only about .05 percent of the gross domestic product. To suggest that too much money is raised and spent to elect public officials who set the law and have such immense power over our economy and our lives is to suggest that dispensable consumer products are more important than electing the people who make our laws.

Campaign contributions fund events, mailings, television ads, and other forms of communication. The right of an individual to spend his or her own money to communicate a political message to voters is indistinguishable from that individual's right to participate in political debate. Such contributions are simply an exercise in First Amendment rights. What's more, statutory limits on contributions or their replacement with taxpayer financing would only lead to more independent expenditures by individuals or interest groups on behalf of their favorite candidates and causes — an activity that is itself clearly protected by the Constitution.

There are two reasons politicians must spend so much time raising money. One is that government is far too powerful and so private interests vie for political influence to a far greater degree than they would if government were to stay within its constitutional confines. More often than not, donors financially support and vote for politicians to the best of their ability based on the degree to which they already agree with the particular candidate(s) they support. Donors are interested in increasing access and in bringing attention to those matters which most concern them. This is also true of most voters. The question is how to most effectively address the concern that people believe politicians are corrupted by the process and that voters are somehow excluded from any true influence.

GOAL

To ensure that all North Carolinians have the full protection of the First Amendment for their participation in the political process as well as the maximum amount of timely information possible about the financing of political campaigns.

RECOMMENDATIONS

1. Policymakers should replace the existing campaign finance regime with a system allowing unlimited donations and requiring full, immediate disclosure of the amounts and sources of all gifts.

2. Public officials worried about the corrupting influence of campaign contributions should work diligently to decrease the reach and authority of government at all levels so that so-called "special interests" will no longer feel required to curry favor with legislators and executive branch officials.

TERM LIMITS & LEGISLATIVE PROCESS

It is no exaggeration to say that term limitation continues to be one of the most popular ideas in American politics today, even though the issue has been on the national agenda for more than a decade. Large majorities of Republicans and Democrats, conservatives and liberals, whites and nonwhites, men and women, all support term limits. At the same time, one of the least popular aspects of the North Carolina General Assembly is its apparent inability to conduct its business in a timely and responsible fashion.

WHY TERM LIMITS ARE NEEDED

In political campaigns, the advantages of incumbency include government-paid staffs, access to media and information, and the lawmaking power that attracts contributions from interest groups. These advantages make it extremely difficult for challengers to win congressional or legislative seats.

Some opponents argue that the revolutionary 1994 elections proved that campaigns were sufficiently competitive. But even as partisan control of Congress and many state legislatures shifted from Democrats to Republicans, the vast majority of GOP gains occurred in open seats where a Democratic incumbent chose not to run for reelection. Over 90 percent of all congressional incumbents who ran for reelection won in the 1994 elections. In North Carolina, 81 percent of General Assembly incumbents won.

Term limits would weaken the power of special interests. So many members would be rotating in and out that it would be harder for lobbyists to do business. Thus most special-interest groups vehemently oppose term limits. A related argument is that longtime incumbency fuels government growth. The problem here is not back-room deals by lobbyists, but instead the routine efforts of bureaucrats to indoctrinate lawmakers about the merits of government programs. Studies of both Congress and state legislatures by the Heartland Institute, the Cato Institute, and the Locke Foundation have shown that, at least to some degree, longtime lawmakers are more likely to support higher taxes and larger budgets than are political newcomers.

REFORMING THE LEGISLATIVE PROCESS

Political observers have long recognized North Carolina's lack of formal length limits on its legislative sessions as unique in the Southeast, damaging to the process, and a form of incumbency protection. The legislature is losing good, serious lawmakers of both parties because of the growing length of sessions, the workload between the sessions, and the extent to which deliberations have been frustrating or infuriating. The problem reached a crisis point in 2001 when the regular session of North Carolina's "part-time legislature" lasted from January until December.

"There's a hundred people in my district who could do a better job than myself, but they won't run," one senator told *The Winston-Salem Journal*. "And the reason they won't run is because it takes so much time." Another lawmaker chimed in that "to call the legislature a citizens' legislature in this day and age is a joke."

There is disagreement about what this should mean. Some believe that it is time to throw in the towel on a part-time legislature and go the California route: 1) make state lawmaking a full-time job, 2) pay legislators a lot more, and 3) have them stay in session much of every year. But this course of action would be disastrous. Not only would it restrict legislative office to those willing to make politics a career, it would also further centralize power in Raleigh and expand the scope of government. The longer lawmakers have to legislate, the more their legislation will stray from constitutional moorings and insert the state in areas it has no business regulating.

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GOALS

To restore and preserve part-time citizen decisionmaking at the state and local levels, do the people's business in a reasonable period of time, promote electoral competition as much as possible, and make sure electoral office is open to folks other than retirees or the wealthy.

RECOMMENDATIONS

1. State lawmakers should impose term limits on themselves and other elected state officials. A reasonable term limit for the General Assembly might be six years in the House and eight years in the Senate. For statewide elected offices, a reasonable policy would be two four-year terms (in a lifetime, not just consecutively). Local officials such as city mayors, city council members, school board members, and county commissioners should also enact term limits.

2. Set firm lengths on sessions. North Carolina should adopt the Virginia approach of 60 days for long sessions and 30 days for short ones.

3. Set firm limits on the introduction of bills. Some critics of session lengths think that they would only exacerbate the tendency for lots of unread (and often shoddy) bills to be considered at the last minute. The real problem is that there are far too many bills introduced in the first place. The House already has a modest limit, but let's have a tough one: let each member introduce up to three per session.

4. Make legislative deliberations interactive. The technology already exists to wire committee rooms and the chambers and provide a feed via a World Wide Web site. Let lawmakers "attend" committee meetings via the Web, so those who live far from Raleigh don't have to waste their time (and the taxpayers' money) traveling. This would have the huge side benefit of allowing all North Carolinians to witness their government in action through a C-SPAN type service on the Internet, with excerpts broadcast on cable access.

5. Reform the legislative staff. There are many fine professionals who work at the General Assembly, but the staffing arrangements were designed for a different era of one-party rule. A significant percentage of staffers should be dedicated to the House and Senate majority and minority caucuses. This would shift some of the workload off of members and speed up sessions and deliberations.

6. Increase hourly legislator pay. Notice the modifier. The best way to pay lawmakers better is not to increase spending but to reduce the hours they spend on the job (or traveling to it).

Southeastern State Legislatures: Comparing Policies and Procedures

State	Term Limits	Regular Legislative Session Limitation
Alabama	No	30 legislative days within 105 calendar days
Georgia	No	40 legislative days
Florida	Yes	60 calendar days
Mississippi	No	90 calendar days; 125 days in year after gubernatorial election
North Carolina	No	None
South Carolina	No	Must adjourn by first Thursday in June
Tennessee	No	90 legislative days
Virginia	No	30 calendar days (odd years); 60 calendar days (even years)

SOURCE: National Conference of State Legislatures

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SUGGESTED RESOURCES

The brevity of this briefing book obviously precludes lengthy discussion of many of the important and complicated issues that face state and local policymakers. We recommend that interested North Carolinians request Locke Foundation Policy Reports and Spotlights on topics of interest, and that they contact one of the public policy research organizations below for additional information.

BUDGET AND TAXATION

• Americans for Tax Reform, 1320 18th St. NW, #200, Washington, DC 20036, 202-785-0266, www.atr.org.
• Cato Institute, 1000 Massachusetts Ave. NW, Washington, DC 2001, 202-842-0200, www.cato.org
• National Taxpayers Union, 108 N. Alfred Street, Alexandria, VA 22314, 703-683-5700. www.ntu.org.
• Tax Foundation, 1250 H Street NW, Suite 750, Washington, DC 20005, 202-783-2760, www.taxfoundation.org.

EDUCATION

• Center for Education Reform, 1001 Connecticut Avenue NW, Suite 920, Washington, DC 20036, 202-822-9000, www.edreform.com.
• Education Policy Institute, 4401-A Connecticut Avenue NW, Box 924, Washington, DC 20008, 202-244-7535, www.schoolreform.com.
• Fordham Foundation, 1015 18th St. NW, Suite 300, Washington, DC 20036, 202-223-5452, www.edexcellence.net.
• Heritage Foundation, 214 Massachusetts Ave. NW, Washington, DC 20002, 202-546-4400, www.heritage.org.
• Hudson Institute, P.O. Box 26-919, Indianapolis, IN 46226, 317-545-1000, www.hudson.org.
• American Council of Trustees and Alumni, 1625 K Street NW, Suite 310, Washington, DC 20006, 202-467-6787, www.acta.org.

HEALTH AND WELFARE

• Beacon Hill Institute for Public Policy Research, 8 Ashburton Place, Boston, MA 02108, 617-573-8750, bhi.sclaf.suffolk.edu.
• Family Research Council, 801 G Street NW, Washington, DC 20001, 202-393-2100, www.frc.org.
• National Center for Policy Analysis, 12655 N. Central Expressway, Suite 720, Dallas, TX, 75243, 214-386-6272, www.public-policy.org.

BUSINESS AND REGULATION

• American Enterprise Institute, 1150 17th Street NW, Washington, DC 20036, 202-862-5800, www.aei.org.
• Center for the Study of American Business, Washington University, Campus Box 1027, St. Louis, MO 63130, 314-935-5662, csab.wustl.edu.
• Citizens for a Sound Economy, 1250 H Street NW, Suite 700, Washington, DC 20005, 202-783-3870, www.cse.org.
• Competitive Enterprise Institute, 1001 Connecticut Avenue NW, Suite 1250, Washington, DC 20036, 202-331-1010, www.cei.org
• *Consumer Alert*, 1001 Connecticut Avenue NW, Suite 1128, Washington, DC 20036, 202-467-5809, calert@aol.com.

• Defenders of Property Rights, 6235 33rd Street NW, Washington, DC 20015, 202-686-4197.
• Heartland Institute, 800 East Northwest Highway, Suite 1080, Palatine, IL 60067, 847-202-3060, www.heartland.org.
• Institute for Justice, 1717 Pennsylvania Avenue NW, Suite 200, Washington, DC 20006, 202-955-1300, www.ij.org.
• Pacific Research Institute, 755 Sansome Street, Suite 450, San Francisco, CA 94111, 415-989-0833.
• Political Economy Research Center, 502 South 19th Avenue, Suite 211, Bozeman, MT 59718, 406-587-9591, www.perc.org.
• Reason Foundation, 3415 S. Sepulveda Blvd., Suite 400, Los Angeles, CA 90034, 310-391-2245, www.rppi.org.

OTHER ISSUES

• American Legislative Exchange Council, 910 17th Street NW, Fifth Floor, Washington, DC 20006, 202-466-3800, www.alec.org.
• Center for Equal Opportunity, 815 15th Street NW, Suite 928, Washington, DC 20005, 202-639-0803, www.ceousa.org.
• Free Congress Foundation, 717 2nd Street NE, Washington, DC 20002, 202-546-3000, www.fcref.org.
• U.S. Term Limits, 1125 15th Street NW, Suite 501, Washington, DC 20005, 202-463-3200, www.termlimits.org.

NORTH CAROLINA ORGANIZATIONS

• Children's Scholarship Fund-Charlotte, 926 Elizabeth Avenue, Suite 403A, Charlotte, NC 28204, 704-373-2378, www.csf-charlotte.org.
• National Federation of Independent Business-North Carolina Chapter, 3716 National Drive, Suite 109, Raleigh, NC 27601, 919-571-9800. www.nfib.com.
• North Carolina Education Alliance, 200 W. Morgan Street, Raleigh, NC 27601, 919-828-3876 (Raleigh office), www.nceducationalliance.org.
• North Carolina Citizens for a Sound Economy, 115 1/2 W. Morgan Street, Raleigh, NC 27601, 919-807-0100, www.cse.org/northcarolina/index.php.
• North Carolina Democratic Party, 3100 Spring Forest Road, Raleigh, NC 27616, 919-821-2777, www.ncdp.org.
• North Carolina Education Reform Foundation, P.O. Box 272, Winston-Salem, NC 27102, 336-768-3567.
• North Carolina Family Policy Council, 343 Six Forks Road, Raleigh, NC 27609, 919-807-0800, www.ncfpc.org.
• North Carolina Libertarian Party, 1821 Hillandale Road, #1B-253, Durham, NC 27705, 800-292-3766, www.lpnc.org.
• North Carolina Republican Party, 1506 Hillsborough Street, Raleigh, NC 27605, 919-828-6423, www.ncgop.org.
• Pope Center for Higher Education Policy, 200 W. Morgan Street, Raleigh, NC 27601, 919-828-3876, www.popecenter.org.

ABOUT THE LOCKE FOUNDATION

The John Locke Foundation develops and promotes solutions to North Carolina's most critical challenges. An independent, nonprofit think tank based in Raleigh, JLF seeks to transform state and local government through 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. Organized in six divisions and operating many distinctive programs, JLF is a source for cutting-edge research, a publisher of news and commentary, and an advocate for truth, freedom, and the future of North Carolina.

GENERAL RESEARCH

The Locke Foundation's General Research Division, directed by Dr. Roy Cordato, examines state public policy in North Carolina. It issues lengthy Policy Reports on issues such as the state budget, taxes, health care, the environment, and regulation. It also publishes shorter papers called Spotlights on specific issues before the General Assembly or other governmental bodies. These papers are prepared exclusively for JLF by policy analysts and their findings are publicized throughout the state in print, broadcast, public appearances, and at www.JohnLocke.org. Researchers appear frequently before legislative committees and government agencies.

CAROLINA JOURNAL

Since its debut in 1991, JLF's public affairs periodical *Carolina Journal* has published articles on education reform, transportation, crime, term limits, the state budget, taxes, and a host of other issues. Now published as a monthly newspaper with approximately 16,000 readers across North Carolina, *Carolina Journal* publishes the work of staff writers, contributing editors, elected officials, professors and policy analysts, and other guest contributors. In 1993, JLF began a weekly newsletter sent via fax and electronic mail to more than a thousand North Carolina lobbyists, business leaders, reporters, and public officials. *Carolina Journal Weekly Report* reports on major issues facing the state, provides short updates on government actions and public policy research, and provides timely coverage of the legislature while it is in session. In 1999, JLF unveiled www.CarolinaJournal.com, a daily web site featuring original reporting by Carolina Journal writers as well as extensive links to breaking news and information resources in North Carolina politics and public policy.

NORTH CAROLINA EDUCATION ALLIANCE

In 1998 JLF created a special project now called the North Carolina Education Alliance to assist school reformers across the state who seek fundamental change in elementary and secondary education through high standards, parental choice, innovation, and the principle that all children can learn. Directed by Lindalyn Kakadelis, a former classroom teacher and school board member, the NCEA publishes research papers that address topics such as teacher quality, curriculum, standards, finance, choice, and competition. Alliance staff also write and edit shorter articles on education for *Carolina Journal* and other publications in North Carolina. Its research receives extensive print and broadcast coverage. The NCEA advances education reform through public appearances, legislative testimony, media interviews, and a web site at www.NCEducationAlliance.org. Its Steering Committee includes educators, school board members, county commissioners, and community leaders.

POPE CENTER FOR HIGHER EDUCATION POLICY

JLF created the Pope Center for Higher Education Policy in 1996 to address public policy issues facing colleges and universities in North Carolina. Directed by JLF Vice President George Leef, a former legislative aide and college professor, the Pope Center issues Inquiry research papers on such issues as finance, faculty compensa-

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tion, capital needs, tenure, and curriculum reform. Leef and other staff members have testified before the General Assembly, appeared on numerous radio and television programs, and been quoted by major N.C. newspapers as well as *The Chronicle of Higher Education*, the *Christian Science Monitor*, National Public Radio, and the journal *Academic Questions*. The center publishes Clarion Call, a weekly newsletter on higher education that is distributed by fax and electronic mail. Pope Center staff also write and edit the higher education section of *Carolina Journal* and post research findings at www.PopeCenter.org. The center holds an Academic Issues Forum each year to bring together scholars to discuss emerging issues. Past speakers have included former UNC President William Friday and N.C. State University Chancellor Marye Ann Fox. At the forum, the center awards the Caldwell Prize for Academic Leadership, named after two early leaders of N.C. higher education.

CENTER FOR LOCAL INNOVATION

Outgoing Raleigh Mayor Tom Fetzer joined with JLF in 1999 to create a new project called the Center for Local Innovation. Now directed by adjunct fellow Thomas Stith, a Durham city councilman, CLI engages local leaders in dialogue about such issues as privatization, fiscal restraint, and growth management. Its Steering Committee includes mayors, county commissioners, and other current and former local officials from across the state. CLI publishes research papers called Innovation Guides designed to encourage efficiency in local government. These include the annual *By the Numbers* report on local tax burdens in North Carolina, which generates significant print and broadcast media coverage. An annual "Innovate" conference, held in January, gives newly elected local officials an opportunity to hear from prominent experts on local governance. Past speakers have included several members of North Carolina's congressional delegation and mayors of Charlotte, Raleigh, Greensboro, Winston-Salem, and Wilmington.

CAROLINA BEAT AND MEDIA APPEARANCES

JLF distributes several op-ed columns each week to every daily and community newspaper in North Carolina. Called "Carolina Beat," the columns regularly appear in major metropolitan newspapers such as *The Charlotte Observer, The News & Observer* of Raleigh, and the *News & Record* of Greensboro, as well as smaller newspapers from the mountains to the coast. A separate feature called "Carolina Critic" provides newspapers and magazines with timely reviews of books, movies, and cultural events with a North Carolina connection. In addition, JLF President John Hood writes a weekly syndicated column on North Carolina politics and public policy issues that appears in *The Herald-Sun* of Durham and 30 other newspapers across the state. In 2001, articles by or quoting JLF appeared nearly 3,000 times in North Carolina's print media. JLF is also tapped frequently as a resource for radio and television journalists. Including Hood's weekly appearances on the statewide "N.C. Spin" discussion program, broadcast on commercial stations in every state media market, JLF makes about 1,700 appearances on radio and television stations each year. National press appearances by JLF staff include *The Washington Post, The New York Times, The Wall Street Journal, USA Today*, "NBC Nightly News," "CBS Evening News," ABC's "Good Morning America," CNN, Fox News Channel, CNBC, and C-SPAN.

EVENTS

JLF's Headliner series of luncheons in Raleigh and other cities attracts sizable crowds and press attention to JLF. Headliner addresses are filmed for broadcast on a dozen cable television stations across North Carolina and taped for use in "LockeLines," JLF's monthly audio magazine, and *The Locke Letter*, its quarterly newsletter for patrons and supporters. Headliners have featured elected officials such as Vice President Dick Cheney, former Gov. Jim Hunt, former Gov. Jim Martin, former N.C. House Speakers Dan Blue and Harold Brubaker, N.C. Senate President Pro Tem Marc Basnight, and members of Congress. They have also included policy experts such as Cato Institute President Ed Crane and social policy scholar Linda Chavez; Washington journalists such as Robert Novak, Michael Barone, Christopher Hitchens, Fred Barnes, Rich Lowry, and Tucker Carlson; and other national figures such as Jack Kemp, Elizabeth Dole, Phil Gramm, and P.J. O'Rourke. Each fall and spring, JLF holds a series of regional meetings to provide analysis of key issues such as education and taxes. Another program is the Shaftesbury Society, a weekly discussion club in Raleigh that provides participants with the opportunity to discuss new ideas and meet other people interested in public policy.

20 Years of Vital Statistics on North Carolina Public Policy

MEASUREMENT	1981/ 1982	1986/ 1987	1991/ 1992	1996/ 1997	1997/ 1998	1998/ 1999	1999/ 2000	2000/ 2001	2001/ 2002	Change
Fiscal										
Total Annual State Budget (Millions, Authorized)	$5,753	$8,956	$13,610	$19,780	$21,125	$22,632	$24,290	$24,502	$26,566	362%
Total General Fund Budget (Millions, Authorized)	$3,435	$5,532	$7,826	$10,608	$11,586	$13,112	$13,912	$14,050	$14,530	323%
Inflation-Adjusted State GF Spending per N.C. Resident	$1,014	$1,255	$1,393	$1,527	$1,604	$1,755	$1,807	$1,774	$1,775	75%
Inflation-Adjusted State & Local Tax Per N.C. Resident	$1,454	$1,813	$2,062	$2,317	$2,388	$2,501	$2,508	$2,687	$2,769	90%
Inflation-Adjusted Public School Spending per Pupil	$3,578	$4,472	$5,201	$5,564	$5,820	$6,167	$6,484	$6,786	—	90%
State/Local Gov't Positions per 10,000 N.C. Residents	502.0	488.8	574.9	526.9	543.0	558.7	570.0	560.0	575.9	15%
State Expenditures for Debt Service per N.C. Resident	$17	$16	$17	$18	$22	$26	$31	$33	$37	122%
Outcomes										
Average SAT Scores of N.C. High School Seniors	925	942	952	976	978	982	986	988	992	67 pts.
Graduation Rate (% who finish high school in 4 years)	74%	70%	67%	61%	60%	60%	58%	56%	57%	-23%
N.C. 5th Grade Percentile Rank on National Tests	—	—	—	40.1	43.8	43.3	45.8	43.8	48.2	8.1 pts.
N.C. 8th Grade Percentile Rank on National Tests	—	—	—	41.9	44.6	45.8	45.5	46.1	49.2	7.3 pts.
Reported Index Crimes per 100,000 N.C. Residents	4,515.9	4,338.3	5,847.7	5,395.3	5,325.2	5,142.9	4,981.2	4,919.8	4,995.6	9%
Percentage of N.C. Births Out of Wedlock	19%	22%	32%	32%	32%	33%	33%	33%	—	75%
National Ranking of the Quality of N.C. Highways	—	8	15	38	35	35	27	25	—	-40%
North Carolinians w 4-Yr. Degrees: % of Nat'l Avg.	—	—	86%	89%	95%	95%	95%	91%	—	5%
Economic										
Index of Price Inflation (GDP Implict Deflators)	61.4	75.3	89.4	100	101.9	103.3	104.6	105.9	108	76%
Resident Population of North Carolina	5,956,653	6,321,576	6,784,280	7,500,670	7,656,825	7,809,121	7,949,361	8,077,367	8,186,268	37%
Inflation-Adjusted Personal Income per North Carolinian	$16,154	$19,282	$21,483	$24,138	$24,873	$25,783	$26,124	$27,415	$27,418	70%

SOURCES: Fiscal, General Assembly Fiscal Research Division, the Office of State Budget, Planning, and Management, U.S. Census Bureau; Outcomes, Department of Public Instruction, State Bureau of Investigation, Department of Health and Human Services, UNC-Charlotte Center for Transportation Studies; Economic, U.S. Bureau of Economic Analysis, U.S. Census Bureau.

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