John Locke Foundation

AGENDA

Advancing Freedom In North Carolina Through Wise Public Policy Choices

AGENDA

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Table of Contents

About the John Locke Foundation

The John Locke Foundation was created in 1990 as an independent, nonprofit think tank that would work "for truth, for freedom, and for the future of North Carolina." The Foundation is named for John Locke (1632-1704), an English philosopher whose writings inspired Thomas Jefferson and the other Founders. The John Locke Foundation is a 501(c)(3) research institute and is funded solely from voluntary contributions from individuals, corporations, and charitable foundations.

JLF's Vision

The John Locke Foundation envisions a North Carolina of responsible citizens, strong families, and successful communities committed to individual liberty and limited, constitutional government.

JLF's Mission

The John Locke Foundation employs research, journalism, and outreach programs to transform government through competition, innovation, personal freedom, and personal responsibility. JLF seeks a better balance between the public sector and private institutions of family, faith, community, and enterprise.

20 Years of Agenda

Every two years, coinciding with the political campaigns for the North Carolina legislature, the research division at the John Locke Foundation produces a document that we simply call Agenda. It is meant to be a candidate's guide to the issues that we believe should be most important to them, both in their campaigns and, if elected, how they govern.

Of course, consistent with JLF's overall theme, the goal of the policy proposals offered in this document is greater individual liberty and consequently greater prosperity for the citizens of North Carolina. In particular, we know that both economic theory and economic history demonstrate that policies guided by the principles of liberty and free markets will help those at the bottom of the economic ladder the most, giving them the tools and the opportunities they need to climb into the ranks of the more prosperous.

All of our proposals and analysis are ultimately guided by Article 1, Section 1 of the North Carolina Constitution, which states:

> *"We hold it to be self-evident that all persons are created equal; that they are endowed by their Creator with certain inalienable rights; that among these are life, liberty, the enjoyment of the fruits of their own labor, and the pursuit of happiness."*

These principles are the foundation of all of the policy proposals that we have advanced over the years in our Agenda document, including, and maybe especially, the idea that people have a basic right to the "fruits of their own labor," which lies at the root of a free-market economy and a free society more generally. A basic underpinning of this "Creator endowed right" is the right to property. If you have a right to the fruits of your labor, it means you have property rights to it and to yourself, that is, your labor. The right to do with your property as you see fit is what ultimately gives moral justification to the free-market system. Agenda is meant to give practical application to these moral precepts.

All this is by way of pointing out the importance of this year's Agenda. It will be 20 years since the John Locke Foundation started the biennial publication, and this year's issue will be the eleventh edition of this showcase document. The first Agenda was published in 1996, when John Locke Foundation had only a handful of employees, and, for the most part, nearly all of the research and publication was being done by then President and current board chairman John Hood and investigative journalist extraordinaire Don Carrington. I was honored to be added to this team for the 2002 edition and in 2006, the year after the research division as now constituted was created, the entire process was transferred to the new staff.

For anyone who has kept up with all of the editions of Agenda over the years, one thing is likely to be quite clear: The more things change, the more they stay the same. I have compared this to a point made by Steve Forbes in his introduction to the 50th Anniversary edition of Henry Hazlitt's classic 1946 volume, Economics in One Lesson. Forbes noted, "every tenet of the new economics that Hazlitt dispels [in 1946] continues today to rear its head in one form or another." It is quite clear that this is true for questions of public policy in North Carolina. Indeed, there are problems and solutions that were noted in our first edition of Agenda back in1996 that will still be part of our discussion in 2016.

The players and the political parties in charge have changed, but many of the problems remain the same. And even when the specific issues have changed or the focus has shifted, the principles that are being applied have remained constant and, from the perspective of those of us at the JLF, more important and more cherished than ever.

Dr. Roy Cordato
Vice President for Research
John Locke Foundation

Economic Growth

Analyst: Dr. Roy Cordato
Vice President for Research and Resident Scholar

Beginning in 2013 with the passage of tax and regulatory reform, the North Carolina legislature has begun consciously to pursue policies that are meant to expand economic growth on a statewide level (See sections titled "Tax Reform" and "Regulatory Reform") i.e. policies aimed at allowing businesses to act efficiently and entrepreneurs to innovate and pursue opportunities as they see them.

For decades, North Carolina pursued what is generally referred to as "economic development policy," which is distinctly different from economic growth policy. Economic development policies focus on stimulating specific localities, regions, and businesses within the state, not growing the state's economy as a whole.

The Department of Commerce (DOC), which describes itself as "the state's leading economic development agency," notes that it "works with local, regional, national and international companies," giving them assistance and resources necessary to meet their unique business needs." Industries that the state, via the DOC, takes pride in subsidizing include tourism, the film industry, sports development, telecommunications, biotechnologies, health care, and financial services. But because the state cannot target one industry, locality, or region for "economic development" spending without draining resources from other parts of the state, these polices end up being little more than state central planning in which government picks winners and losers.

The premise behind policies to promote economic growth is that private entrepreneurs using their own money or the money of voluntary investors know best how resources should be allocated. The problem facing policymakers then is to see to it that property rights are secure, ensure that entrepreneurs can use their property rights in any way they believe will be most productive, and implement tax and regulatory policies that do not get in the way of this process. Economic development policies divert resources from this process, thereby moving resources to less efficient uses, hindering economic growth.

During the 2015 legislative session, nearly every proposal to implement new or expand existing economic development programs was passed into law. This schizophrenic approach to economic policy is like trying to increase the speed that a boat is traveling by investing in a bigger and more powerful motor while simultaneously tossing a heavy anchor over the side. Sure the boat may continue to move forward and indeed it may increase its speed if the force of the new engine is greater than the drag of the anchor. But clearly the new engine would work even better if the anchor is lifted completely.

Key Facts

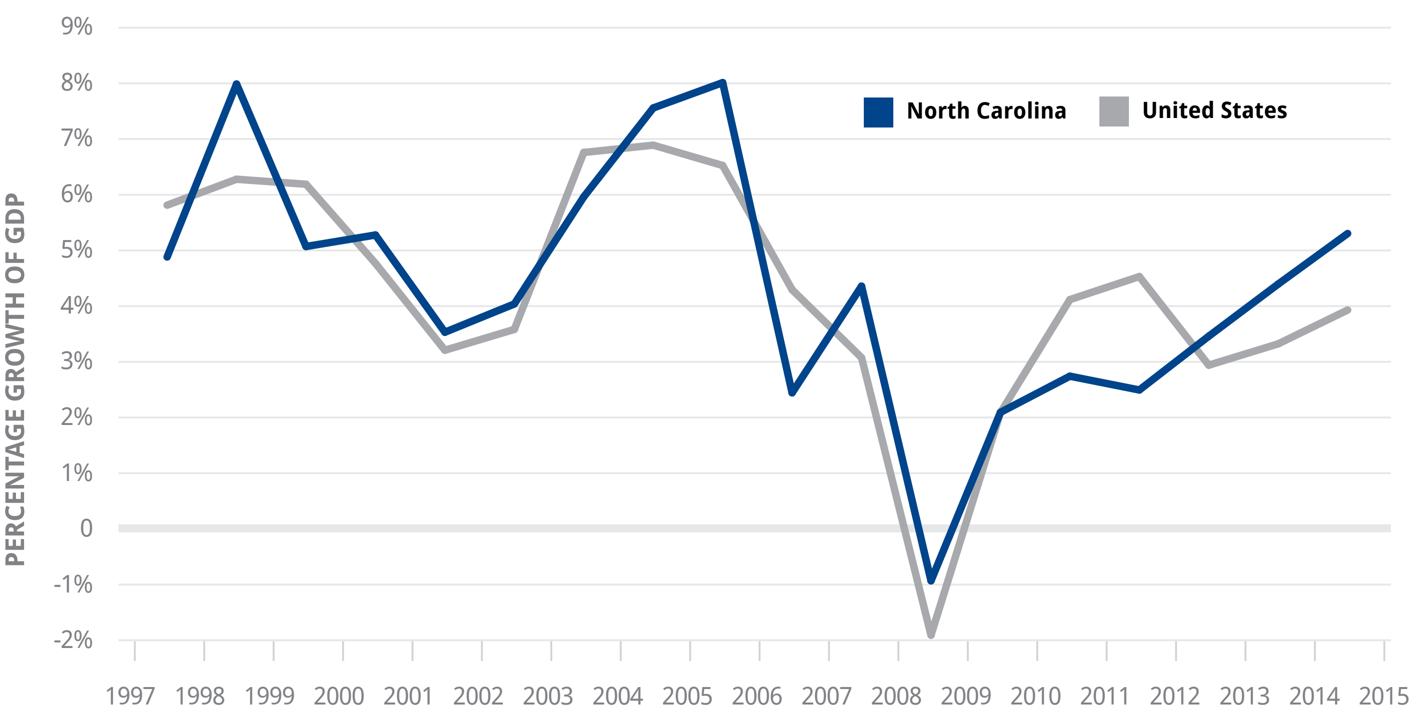
- Over the past several years North Carolina lawmakers have begun to craft policies with an eye toward enhancing economic growth. They have done this primarily by implementing pro-growth tax and regulatory reform and cutting taxes overall. (See sections titled "Tax Reform" and "Regulatory Reform".)
- Economic growth rates in North Carolina, relative to the rest of the country, attest to the success of this approach. Since 2013, the average economic growth rate in North Carolina has been well above the national average.
- North Carolina's economic development policies have led the state to create dozens of special programs that include tax breaks and subsidies for favored industries and companies, all of which distort resource allocation.
- The implicit belief behind economic development policy is that the decisions of entrepreneurs in a free market cannot be trusted. "Experts" in the state bureaucracy believe they can effectively decide what kinds of businesses and industries are best for the state economy and then centrally direct what would otherwise be private-sector resources toward chosen companies. By definition, these resources are being diverted from other, potentially more productive, opportunities that market participants may have chosen.
- Economic growth policy would seek to remove government from the resource allocation picture entirely, creating an environment that encourages private-sector entrepreneurship.
- True entrepreneurship, which is about identifying and investing in opportunities for profit in the free market, is what lifts economies out of recessions and creates jobs.
- Changes to the state's corporate income tax eliminated some of the special tax breaks that had been part of the tax code for some time. This was a step in the right direction.

- North Carolina's tax system still penalizes investment and entrepreneurship by double, and in some cases triple, taxing the economic returns to entrepreneurial activities and investment, thereby hindering economic growth.
- Business subsidies in pursuit of economic development might be most egregious [at the local level](#) with city and county governments in fierce competition with one another to attract particular investments. All of this activity is authorized by the Local Development Act of 1925.

Recommendations

1. Repeal all economic development policies that grant special favors to particular businesses or industries. These policies include The One North Carolina Fund, JDIG (Job Development Investment Grants), and the Golden Leaf Foundation.
2. Repeal the Local Development Act of 1925 that authorizes local government entities to harm economic growth by pursuing economic development policies using property tax collections to subsidize favored businesses.
3. Continue to pursue pro-growth tax reform by eliminating tax biases against investment and entrepreneurship by creating universal tax-free saving and investment accounts, abolishing or reducing taxation on capital gains, and allowing businesses to deduct all expenses from their taxable income in the year that they are incurred. (See section on Tax Reform.)
4. Continue to pursue regulatory reform by looking for ways to reduce outdated or ineffective regulations when the benefits don't outweigh the costs.
5. Eliminate or make changes to occupational licensing laws that may block entrepreneurship. (See section on Occupational Licensing.)

Nominal Gross Domestic Product Growth - North Carolina and United States



Source: US. Bureau of Economic Analysis

Film Incentives

Analyst: Jon Sanders
Director of Regulatory Studies

"Bull Durham," "Last of the Mohicans," "Dirty Dancing," and most other beloved "North Carolina films" were produced without film incentives. They were made years and years before state officials ever thought the industry required government help.

North Carolina is an attractive location for many reasons. It offers a diverse climate, rural to urban landscapes, mountainous to coastal terrain, a cornucopia of settings, a good production infrastructure, and it's a right-to-work state with competitive wages and cost-of-living expenses.

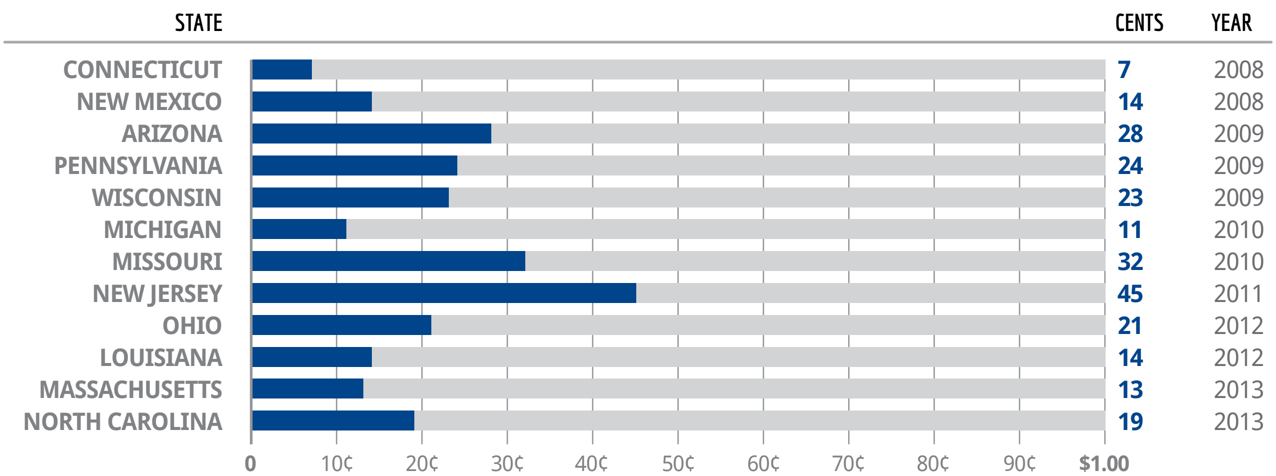
Key Facts

- The idea behind film incentives is simply this: Lower costs of doing business are good for business.
- The problem is, film incentives are special treatment for just one kind of business. Other businesses don't benefit; in fact, they effectively pay higher tax rates subsidizing the favored industry.
- Unlike other economic incentive programs, film incentives don't require recipients to earn them over time by fulfilling specific job-creation targets or other long-term promises.
- Those who benefit from film productions coming to North Carolina because of the incentives include state and local film offices, local studios, film crew workers, restaurants, hotels, hairdressers, carpenters, lumber yards, etc.
- The incentives' biggest beneficiaries are film production companies. And that is true even if they don't produce in North Carolina.
- North Carolina's incentives "bid" pressures other states to increase theirs, and vice versa.
- This aspect of film incentives is what *The Economist* called "a stupid trend" and a "beggar-thy-neighbor trade war."
- It means there can be no "right" amount of incentives. Competing incentives packages offered by other states — not to mention many other countries! — are in constant flux.
- The solution more and more states are realizing is to get out of the losing game entirely. This game is not that old, actually.
- From 2002 to 2009, the number of states with film incentives programs grew from four all the way to 44. By 2009, only six states were not offering film incentives.
- North Carolina started offering film incentives in 2005.
- Meanwhile, many state governments studied the returns on their film incentives and found they were getting only a handful of pennies per dollar revenue spent.
- By 2016, then, about one-third (16) of states were not offering film incentives.
- In North Carolina, the Commerce Department in 2014 found a net "negative budgetary impact" of the film incentives program, with the state getting a return of just over 19 cents per dollar of tax credit given.
- At that time the state offered a refundable income tax credit of 25 percent of qualifying production expenses with the maximum credit of $20 million, and there was no annual spending cap on the program.
- After some tinkering, now North Carolina's film production incentive is a grant program. It offers a rebate of up to 25 percent of qualifying expenses with differing maximum credits for TV series ($9 million), feature films ($5 million), and commercials ($250,000). The program has an annual cap of $30 million.
- Rather than lowering the costs of doing business just for specially favored industries through targeted incentives, state leaders should use corporate income tax cuts and regulatory reforms to lower business costs across the board.
- Such policies have solid empirical backing. They can be considered all-comers incentives, good for untold numbers of business ventures across the state and, therefore, the state's economic growth.
- Positive economic returns from the historic tax and regulatory reforms of 2013 underscore this broad incentive effect.
- A vibrant economy and lower costs of doing business can supplement the state's amenities to film productions as well as to hosts of other, overlooked business endeavors.

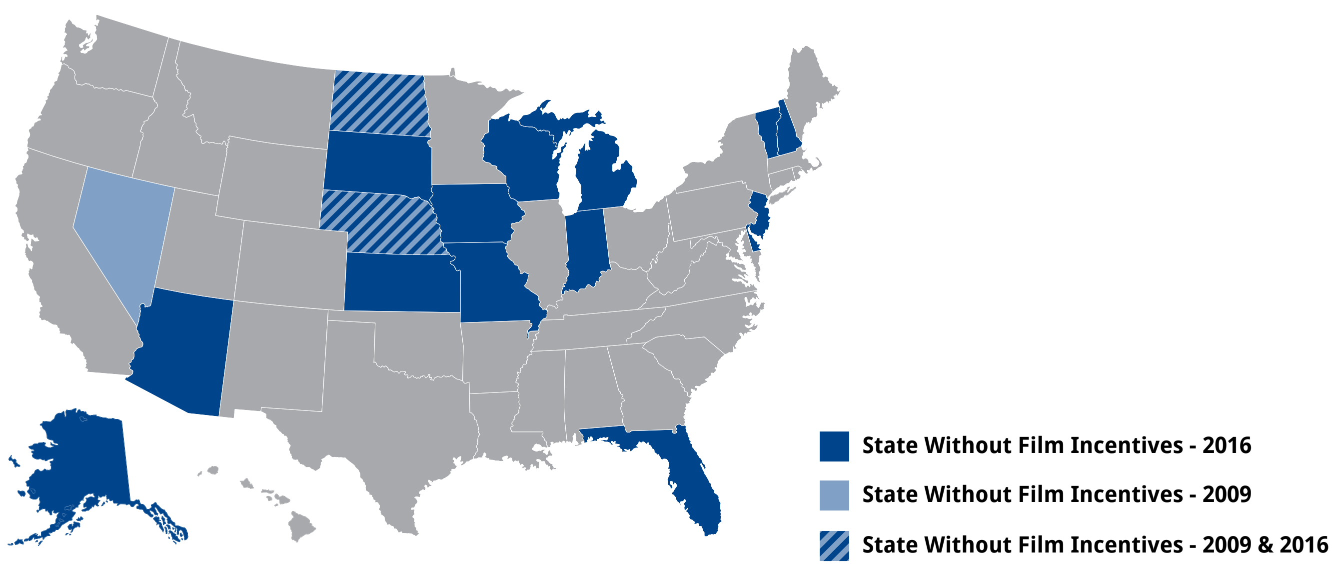
Recommendations

1. End the film production grant program.
2. Let across-the-board corporate and income tax cuts and regulatory reforms add to the state's many other amenities to attract productions.

PENNIES ON THE DOLLAR: State Film Incentives Returns per Tax Dollar Given (Various States and Studies, 2008-2013)



States Without Film Production Incentives



Source: Tax Foundation, EP Financial Solutions

Highways and Interstates

Analyst: Jon Sanders
Director of Regulatory Studies

North Carolina's road quality has been steadily improving in recent years. It is now at or above the national average in some studies.

Importantly, recent reform of the state transportation funding formula promises to keep this improvement on an upward trajectory. The state's new approach puts greater weight on easing congestion, promoting economic growth, and improving highway safety.

Transportation dollars are scarce, and people understandably dislike being made to pay more, no matter the mechanism. All the more reason that making more effective use of existing funds is wise, responsible policy.

Key Facts

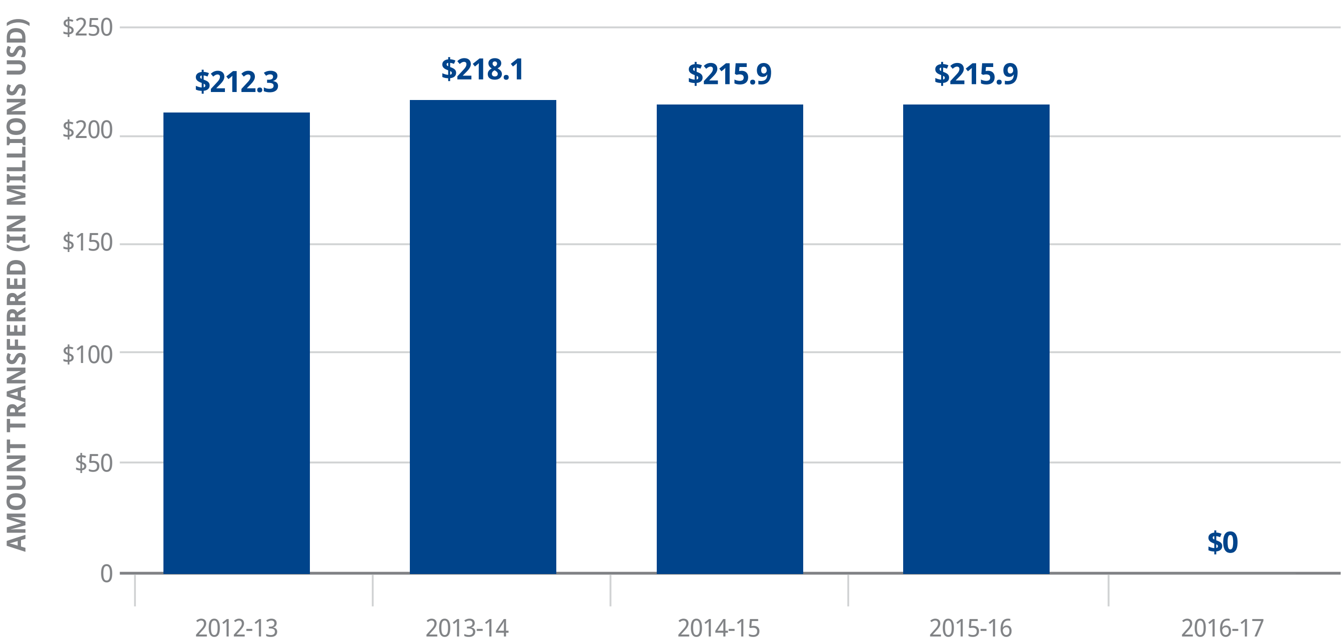
- Combined spending by North Carolina governments on transportation comes to about $4.5 billion a year. About 90 percent of that goes to roads and bridges.
- In 2013 Gov. Pat McCrory and the General Assembly enacted a new state transportation policy, the Strategic Transportation Investments law, a significant reform that changed how states, regions, and localities set transportation priorities. The new law has clearly stated goals upon which transportation projects compete with each other for funding: congestion relief, safety improvement, economic competitiveness, and the efficient movement of people and freight.
- With data-driven project prioritization, North Carolinians should expect better, more efficient use of highway funds. A 2013 study by transportation experts at the Hartgen Group and the Reason Foundation found that through better prioritization of projects, North Carolina could meet its highway needs without additional taxes.
- Data-driven project prioritization can be good even for North Carolinians who live outside of the most populous areas. Congested urban freeways can be a deterrent to business locations and also expansions. Keeping them more open means rural residents will have more opportunities to connect with more jobs, retail, and other amenities across metropolitan areas.
- North Carolina's reform is ahead of the curve. In February 2016 the Congressional Budget Office released a study of federal transportation priorities. Among other things, it found that transportation spending would produce greater benefits relative to costs if put toward these purposes:
  - adding interstate lanes in urban areas
  - making major repairs of interstates and other highways in urban areas
  - repairing bridges, especially on rural interstates and also primary and secondary roads
- Other changes have added hundreds of millions of dollars a year to North Carolina transportation budgets.
- Notably, in the 2015-16 state budget, the legislature ended the transfer of gas tax revenue from the Highway Fund to the General Fund. Ending the transfer kept over $215 million of revenue per year raised from motorists for use to maintain and expand North Carolina roads and bridges. That money no longer is taken for use in other state programs.
- A similar change under the latter Easley and Perdue administrations phased out the Highway Trust Fund transfer, keeping over $172 million in revenue per year to maintain and expand North Carolina roads and bridges.
- State spending for bridge repair and construction went up by 58 percent (to $242 million) in the 2015-16 budget. Spending on road resurfacing went up 22 percent (to $498 million).
- Other road maintenance and resurfacing went up by $68 million. Also, the Highway Trust Fund finances $337 million for new highway construction projects.
- Other recent changes include increasing Division of Motor Vehicles fees and changing how the state's excise tax on gasoline is calculated.
- The gas-tax change lowered tax collections in the short term, but it should allow greater revenues in the future along with inflation.
- A March 2016 poll from High Point University found North Carolina strongly opposed to several options for raising highway revenue: 63 percent opposed toll roads,

72 percent opposed increasing the gas tax, and 87 percent opposed taxing motorists per-vehicle-mile traveled. Such findings underscore the wisdom in making state transportation expenditures more efficient and effective.

Recommendations

1. Stay the course on recent reforms. North Carolina is at the vanguard of aligning scarce transportation dollars with high-priority transportation needs. Her motorists can expect better returns from a transportation policy that makes more efficient use of existing resources to improve transportation infrastructure where it's most needed.
2. Continue to look for projects and programs funded with transportation dollars that would be more appropriately funded with General Fund dollars.

Revenue Transferred Into the General Fund From The Highway Fund 2012-13 Through 2016-17



Source: North Carolina General Assembly

Minimum Wage

Analyst: Jon Sanders
Director of Regulatory Studies

Working for the lowest allowable wage is nobody's ideal. People are rightfully moved by the thought of their neighbors toiling in menial work for small wages. They know how hard it is to make ends meet, even with greater earnings.

They'd like to help. How? Some engage in charitable endeavors, not just ones that provide for their immediate needs, but also ones that offer job and life skill training to help people learn how to find and keep jobs. Some openly seek to hire them and build them up as employees and productive individuals who see they have something to offer society. Some offer education and training, and some provide ways to help employers find job seekers.

Some think the way to do it is have the government, federal or state, enforce a large increase in the minimum wage. They're joined by politicians, activists, and of course self-serving demagogues seeking to profit from their good intentions.

The Obama administration advocates raising the per hour minimum wage from $7.25 per hour to $10.10 per hour, a 39 percent increase. Some push for much, much higher: to $15 per hour, a 107 percent increase.

Here are things a higher minimum wage can't do: It can't increase the skill level of any worker. It can't expand payrolls. It can't keep the hours offered by employers steady. It can't make automation less price-competitive to more expensive human labor. Finally, it can't make employers stay in business. All it can do is make it more expensive to employ low-level workers.

Compassionate or not, raising the minimum wage has the bitter unintended consequence of putting the very people out of work that well-intentioned supporters think they're helping: the poorest, the least skilled, and the disadvantaged.

Key Facts

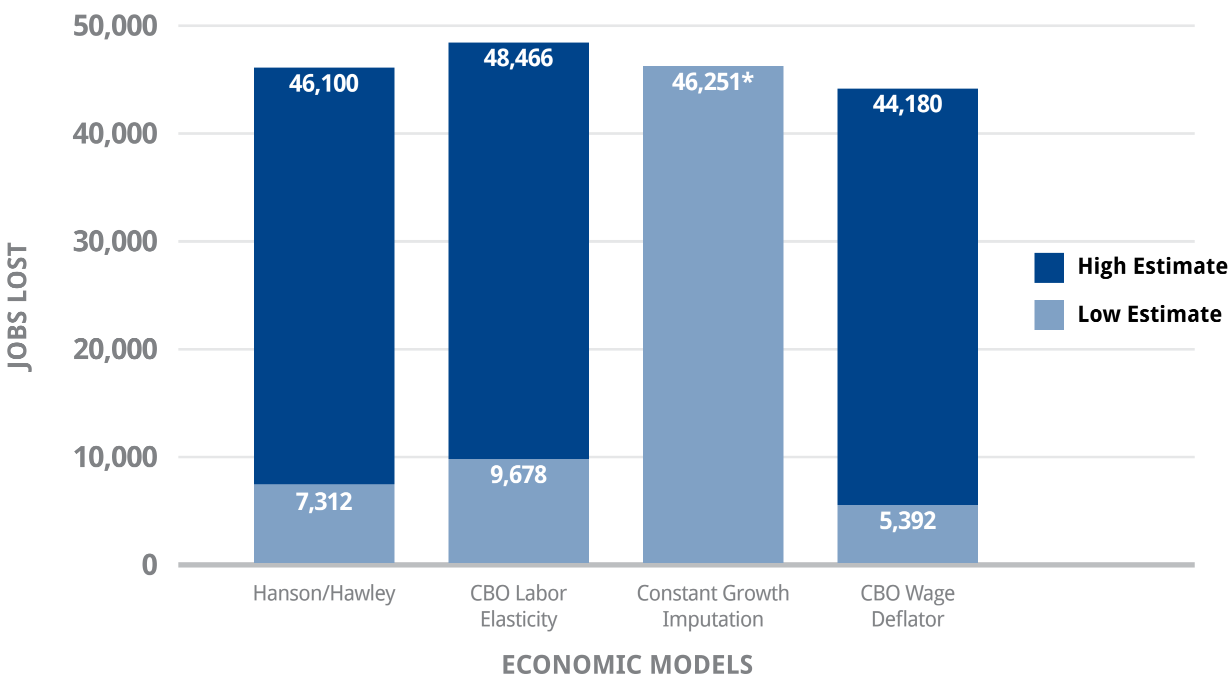
- Most minimum wage workers are new to the workforce, often unproven, and often not educated beyond high school. They are getting startup wages because they are startup workers.
- Pew Research Center found only about 2.6 percent of the nation's workforce is paid at or below the federal minimum wage. Slightly over half of them are between the ages of 16 and 24, and about one fourth are between the ages of 16 and 19.
- Raising the minimum wage to $10.10 per hour could cost nearly 50,000 jobs in North Carolina, according to a recent study published in the *Journal of Labor Research*. It would affect not just the small portion of minimum wage earners, but all workers earning below $10.10 per hour.
- Raising the minimum wage to $15 per hour would have an even harsher impact. That's because it would affect all workers earning below $15 per hour — over 40 percent of the wage and salaried workforce in North Carolina. According to new research from the Heritage Foundation, it would cost over 330,000 jobs in North Carolina (full-time equivalent jobs) by 2021.
- Economists agree that the minimum wage increases unemployment among young and unskilled workers. Why? Because employers are more likely to expect their output will be less than how much it will cost to employ them.
- In 2015 the University of New Hampshire Survey Center found vast majorities of economists believe a $15-per-hour minimum wage would result in:
  - Lost jobs
  - More skills required to get any job, even an entry-level job
  - Fewer young people finding work
  - Business closings
- After the last large increase in the minimum wage (in 2007), employment of teenagers fell by 10 percentage points within 5 years.
- A Today/Reuters analysis in 2012 found that the teens hardest hit were also "those who may need the money most: teens from poor families in which a parent is out of work." Least affected: teens from wealthier families with working parents.
- Fewer jobs and less opportunity is no small matter. Labor researchers describe a lifetime "ripple" effect of someone having held a job: they're more likely to keep working. A higher minimum wage that increasingly leaves poor teens and low-skilled workers behind only perpetuates the problem.
- A recent working paper from the National Bureau of

Economic Research on the effects of a minimum wage increase found "significant, negative effects on the employment and income growth of targeted workers." It keeps them from accumulating experience as well as income, and it limits their upward income mobility, even to rise just to the lower middle class.

Recommendation

1. Keep the state minimum wage no higher than the federal minimum wage. Create no greater harm to the poorest, least skilled, and least experienced workers in North Carolina.

Estimated N.C. Employment Losses From Raising the Minimum Wage to $10.10 From $7.25 - Multiple Models



Note: These estimates are based on raising the minimum wage to $10.10 as proposed by congressional Democrats and President Obama. That would be an increase of $2.85 (39%). Increasing the minimum wage to $15.00 (a much steeper increase of $7.75 or 107%) would result in even more dramatic job losses.

Source: Andrew Hansen and Zackary Hawley, "The $10.10 Minimum Wage Proposal: An Evaluation Across States", *Journal of Labor Research* (2014)

*Constant Growth Imputation low estimate is equal to high estimate

State Revenue and Spending

Analyst: Julie Tisdale
City and County Policy Analyst

The state must generate revenue to pay for government-provided goods and services. The main sources of revenue for North Carolina's government are the personal income tax and the sales tax, amounting to 87 percent of the state's tax revenue. The state's major spending priorities have been education and health and human services, with these two categories of expenditure making up 79 percent of the 2016-17 General Fund budget. Because the state constitution mandates a balanced budget, the tax burden is a function of spending levels. A lower tax burden depends ultimately on lower spending.

Few people object to paying taxes if the taxes are fairly assessed and the money is properly used. Taxes are the price citizens pay for government, so a reasonable tax burden can provide services that are of benefit to the citizens who consume them and pay for them through those taxes. However, problems arise when a complicated tax code creates targeted tax breaks for select citizens, thus creating an unfair tax assessment and uneven distribution of the state's resources. When writing legislation or creating policy around taxes, this needs to be in the forefront of lawmakers' thinking.

Most of the tax revenue collected is spent through the General Fund, which includes the majority of the state's operations. There are, though, some major components of the state's expenditure that are located outside the General Fund. In short, the General Fund amounts to around $22 billion, while total state spending amounts to more than double that, approximately $52 billion. The major differences between these two budgets are highways and the Highway Trust Fund, federal funding, and some debt service, which are located outside the General Fund.

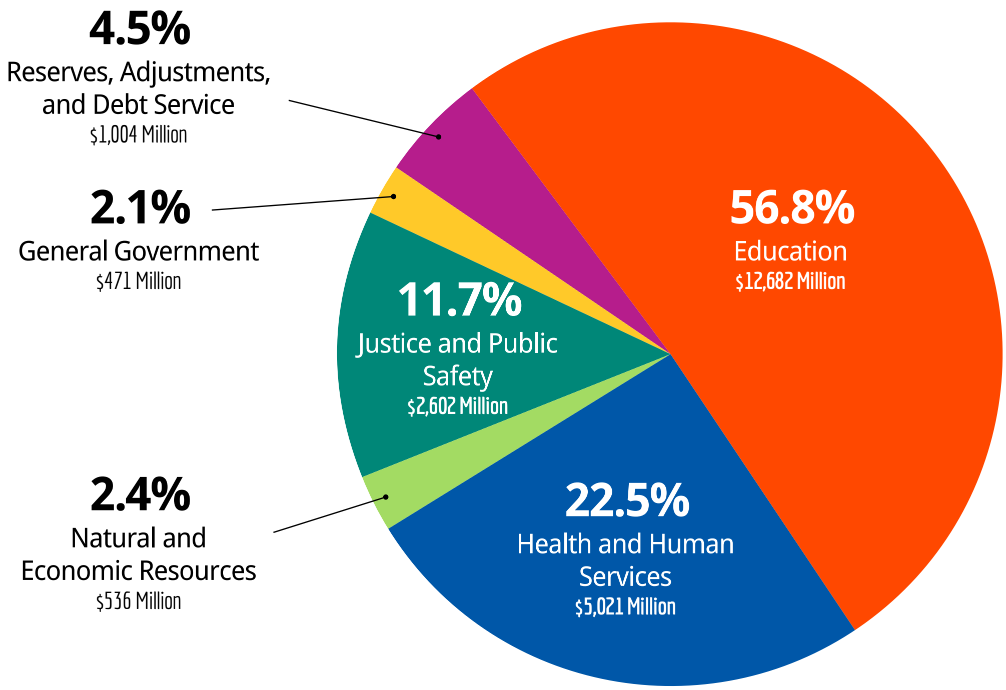
Key Facts

- Total tax revenue in the current fiscal year is forecast to be $21.3 billion, with 87 percent coming from personal income and sales taxes: 54.5 and 32.7 percent respectively. While the 2013 tax reform changed the rate, personal income tax will still be the largest source of revenue for the state.
- General Fund spending has decreased since 2009, but total state spending has increased. The shift of spending outside of the General Fund has created a lack of transparency in the state budget process.
- Federal spending continues to be a major part of North Carolina's total budget spending, accounting for one third of spending in 2016-17.
- Non-tax revenues will amount to $816 million this fiscal year, or around 3.7 percent of total General Fund revenue.

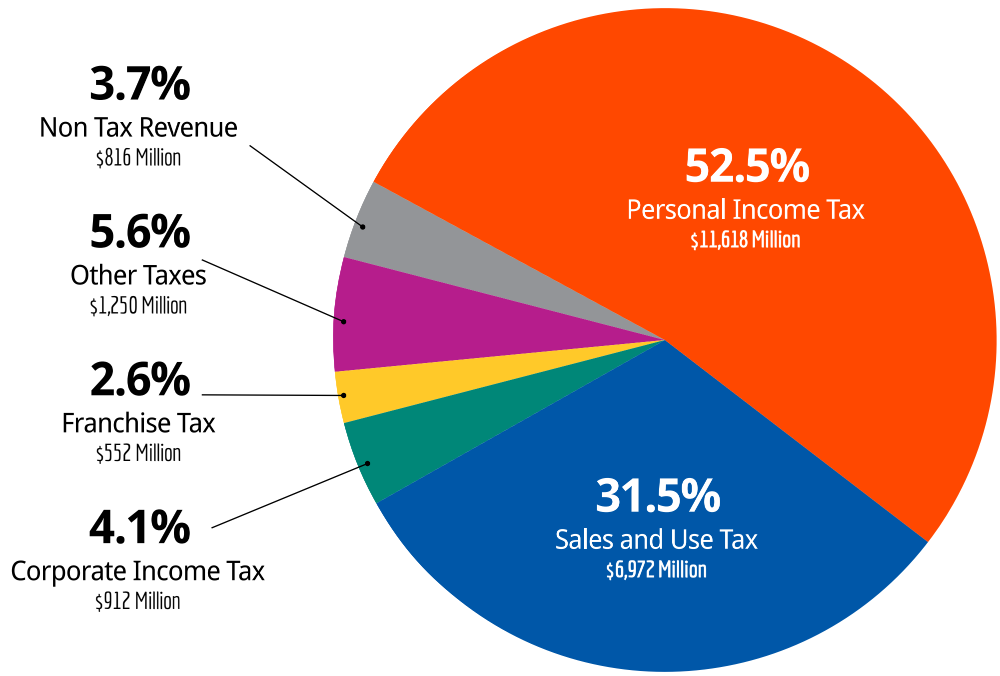
Recommendations

1. **Set fiscal priorities each year.** Search the base budget for items or programs to cut if new spending is needed in other areas.
2. **Eliminate existing and avoid future targeted tax exemptions, deductions, and other tax biases.** Tax breaks for select companies and higher taxes for certain activities complicate the tax code and feed wasteful lobbying. These special tax exceptions raise the tax burden while distorting economic decisions.
3. **Pass a constitutional amendment to limit spending growth such as a Taxpayer Bill of Rights.** Laws passed by the current legislature are not binding on future legislatures, and other attempts to instill discipline without the force of a constitutional amendment have been brushed aside.

FY 2016-17 General Fund Budget



FY 2016-17 Revenue Sources



State Spending Restraint

Analyst: Julie Tisdale
City and County Policy Analyst

North Carolina has a balanced budget amendment, but it was not intended to create a tax-and-spend state. Rather, it requires lawmakers to craft budgets that use tax dollars wisely. For several decades, North Carolina moved away from fiscal responsibility and created a political culture in which increasing taxes, with the intention to spend more, was an acceptable policy.

Polls reveal that a majority of North Carolinians support a cap on state spending. To date, however, lawmakers have been unwilling to ask North Carolinians to approve an amendment to the North Carolina Constitution that would limit the growth of state government indefinitely.

The Republican leadership in the N.C. General Assembly have imposed spending caps voluntarily, but without a constitutional amendment, that restraint is not guaranteed. A variety of pressures could lead future legislatures to return to the tax-and-spend patterns of the past. A constitutional amendment would help to protect North Carolina taxpayers.

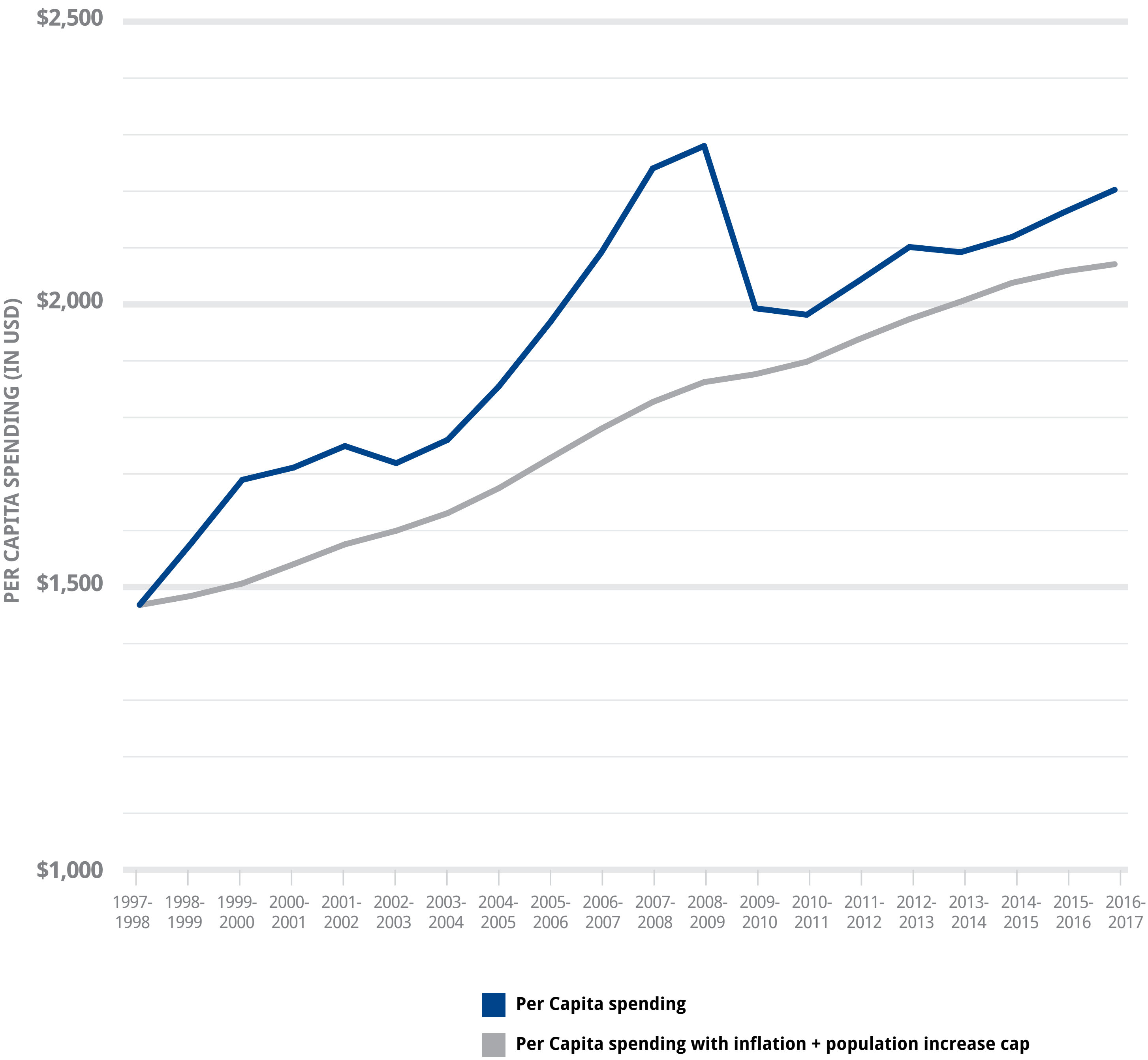
Key Facts

- Had state spending tracked inflation and population growth since 1997, as denoted in the figure on the opposite page, per capita expenditure would be $2,071 in 2016. That is 6 percent less than the current level of $2,203.
- Over the last 20 years, inflation and population growth have been much more steady than General Fund spending. The figure opposite shows the consistent, smooth growth of the General Fund had spending restrictions been in effect. That's in contrast to the large increases in spending during the early 2000s followed by a dramatic correction in 2009 that occurred without spending prohibitions in place.
- Budgetary oversight should extend to spending shifted outside the General Fund. While the state has limited control over federal funds and federally mandated programs, the state has total control of the many trust funds that are not included in the General Fund. Total state spending is approximately $52 billion, while General Fund spending is around $22 billion.
- Over the last four years, spending growth has been close to the level of inflation and population growth, but through much of the 2000s, spending growth far outpaced inflation and population growth.

Recommendations

1. **Add an amendment to the state constitution, limiting annual state spending growth to no more than the projected rates of inflation and population growth.** The amendment should allow spending growth to exceed the cap only if approved by public referendum. Such a spending cap would better align the long-term interests of taxpayers to the short-term interests of politicians.
2. **The amendment should mandate that any revenues collected above the annual spending cap be deposited into a rainy day fund or returned to taxpayers.**
3. **The amendment should be written to avoid the ratchet-down effect.** In periods of revenue shortfall, budget expenditures should be held constant until revenues recover and again exceed that limit. The rainy day fund or budget stabilization fund would be used to offset at least part of the revenue shortfall.
4. **The amendment should establish other constitutional constraints on fiscal policy**, such as a requirement that any state tax hikes receive supermajority approval from the state legislature.

General Fund Budget per Capita: 1998-2017



Source: North Carolina General Assembly

Tax Reform

Analyst: Dr. Roy Cordato
Vice President for Research and Resident Scholar

For many years, it was recognized that North Carolina's tax system was in need of a major overhaul. The system was a model of hodgepodge tax policy with high marginal rates on personal and corporate incomes and numerous exemptions carved out for the favored few. This led to tax system that penalized investment, entrepreneurship, economic growth, and therefore job creation.

The tax reform process began with the passage of sweeping tax legislation in 2013. In addition to implementing pro-growth reforms in the personal and corporate income tax, the legislation also incorporated across the board tax cuts that benefit most households in all income groups. The deliberative process that lead to these changes was thoughtful and, in large part, ignored the kind of special interest pleadings that typically plague such reform efforts. But there is more to be done.

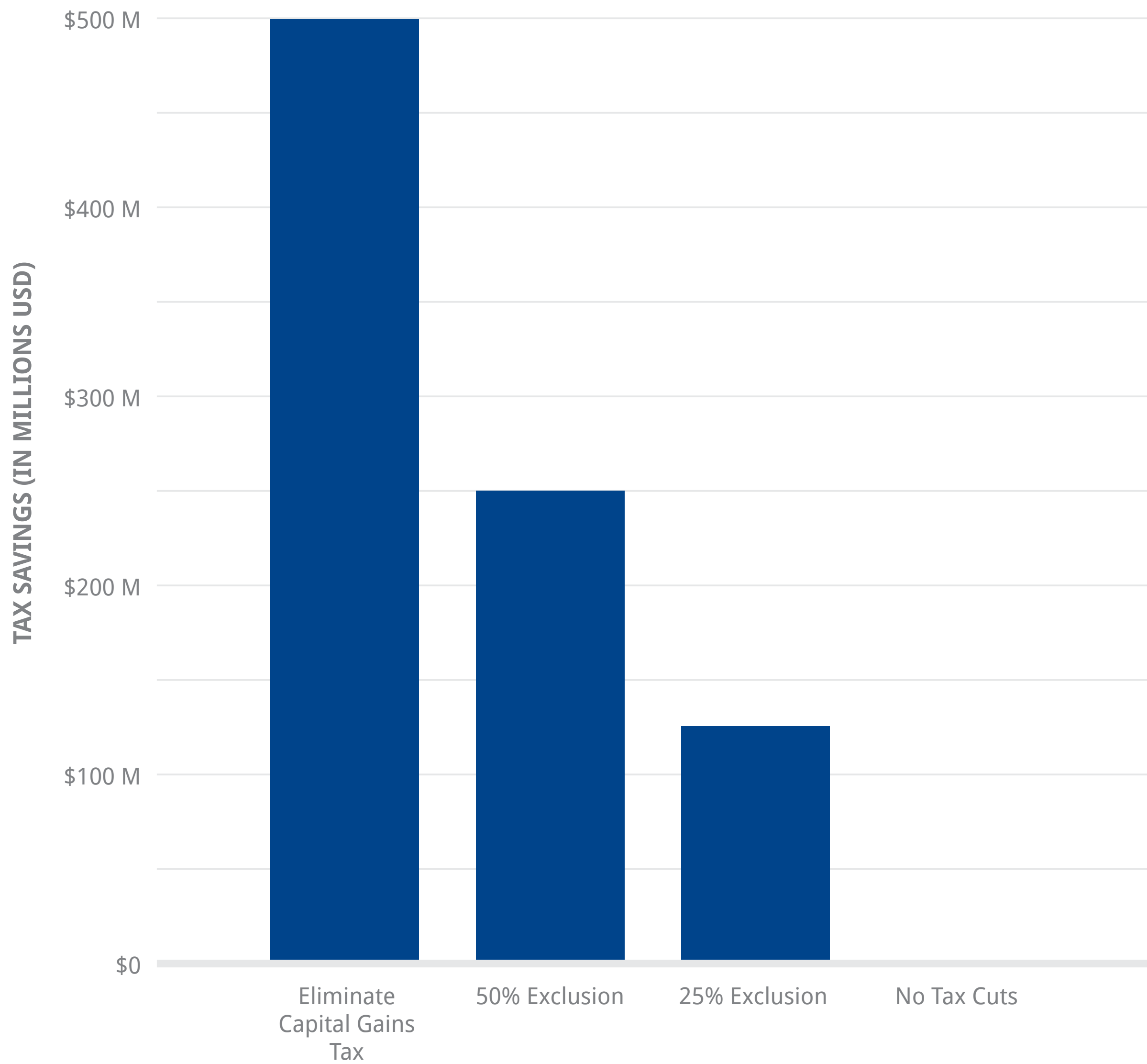
Key Facts

- In 2013, the state of North Carolina implemented fundamental tax reform which has become a model for states across the country.
- From the perspective of economic growth, the two most important reforms were those made to the personal and corporate income taxes.
- The new tax code replaced a three rate progressive income tax that ranged from 6.0 to 7.75 percent, the highest in the region, with a flat-rate tax of 5.75 percent. This rate is scheduled to be lowered even further to 5.49 percent in January 2017.
- The low flat rate has ameliorated the bias against work effort and productivity that plagued the previous progressive rate structure.
- The corporate tax rate has been reduced from 6.9 percent, also the highest in the Southeast, to 4.0 percent and could be reduced even further to 3.0 percent.
- To increase government transparency and spur economic growth, the corporate tax should be completely abolished.
- The sales tax rate did not change, but the base has been expanded to some services.
- The average North Carolina household in every income category received a tax cut from the 2013 reforms.
- North Carolina continues to double tax saving and investment by taxing investments and capital gains.
- Full repeal of the capital gains tax would save taxpayers $500 million but would require comparable budget cuts. A 25 or 50 percent exclusion would save taxpayers $125 million and $250 million, respectively.
- By following federal depreciation schedules for the deduction of capital equipment and real estate, North Carolina's tax code also penalizes investment in longer-term capital equipment.

Recommendations

1. Future reform efforts need to focus on eliminating savings from the tax base, which will eliminate biases against saving, investment, and entrepreneurship that remains in the tax code. A good first step in this direction would be to eliminate taxation on capital gains or, at least, create a capital gains exclusion.
2. The reduction in revenue from eliminating the capital gains tax should be paid for by eliminating economic development programs that subsidize particular enterprises and types of businesses. (See section titled "Economic Growth".)
3. Businesses should be allowed to deduct all business purchases in the year they are incurred. This would mean replacing the current system based on depreciation over time with immediate expensing.
4. In the long run lawmakers should seek to completely eliminate the double taxation of saving and investment returns by converting the current system into a "consumed income tax." This is done by adjusting the tax base to allow people to deduct saving and investment from their taxable income. Both the principle and the interest would be taxed when it is removed from saving and spent. This is similar to the way "individual retirement accounts" (IRAs) are treated under the tax code, except there would be no age limits or other restrictions on withdrawal.

Possible Changes to Capital Gains Tax - Taxpayer Savings



Source: Beacon Hill Institute, Suffix University

Child Care

Analyst: Dr. Terry Stoops
Director of Education Studies

The Subsidized Child Care Program is one of North Carolina's longest-running welfare programs. The state began offering subsidies for child care services in 1964. The program provides vouchers to eligible families for child care services offered in any number of settings — licensed child care centers, family child care homes, religious-sponsored programs, and informal arrangements such as care by a relative or care in the child's home.

To qualify, parents must meet both situational and financial criteria. Parents must be employed (or seeking employment) or enrolled in an education program. They may also qualify if their child has developmental needs or is receiving child protective and/or welfare services. Income eligibility depends on income and family size, but subsidy recipients are required to contribute between 7 and 10 percent of gross income to the cost of child care.

The Division of Child Development and Early Education, a division of the North Carolina Department of Health and Human Services (DHHS), oversees the Subsidized Child Care Program and evaluates the quality of all licensed child care centers and family child care homes in North Carolina. County social services departments actually administer the subsidy program. A third entity, the N.C. Child Care Commission, adopts regulations that ensure DHHS compliance with legislation passed by the N.C. General Assembly.

While state and county agencies manage the program, the federal government supplies most of the dollars for the Subsidized Child Care Program. Only about one-fifth of the funding for the Subsidized Child Care Program comes from the North Carolina General Fund. The remainder of the funding for the program comes from two federal grants, the Child Care and Development Fund (CCDF) and Temporary Assistance for Needy Families (TANF).

Although hundreds of millions of state and federal dollars are appropriated for child care subsidies, it is important to put the program in perspective. Most preschoolers do not spend their days in centers or homes where paid staff care for them. Stay-at-home mothers, working mothers and fathers, relatives, and neighbors supply the vast majority of care provided to preschoolers, and on a nonpaid basis.

Key Facts

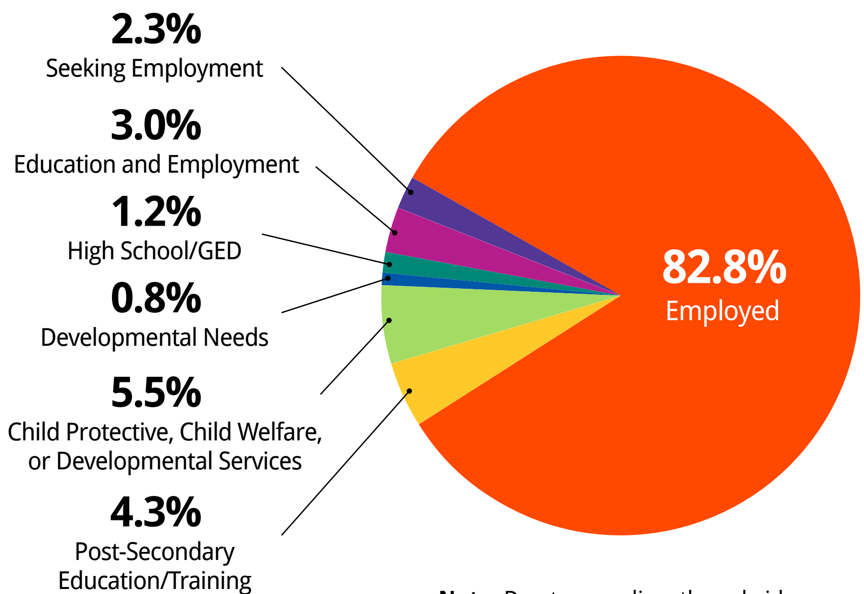
- The total budget for child care subsidies in North Carolina was $342.3 million in 2015-16. The North Carolina General Assembly provided $42.2 million of that total.
- Around 83 percent of parents who receive a child care subsidy are employed, another 2.3 percent are seeking employment, and 3 percent are working adults who are also enrolled in an educational institution.
- Nearly 84 percent of parents receive a subsidy due to household income.
- As of October 2015, an average of 67,000 children per month received subsidized child care services. This represents around a quarter of the nearly 250,000 children enrolled in regulated facilities throughout North Carolina.
- North Carolina has nearly 4,700 regulated child care centers and over 2,100 regulated family child care homes. Approximately nine out of 10 parents who receive a child care subsidy choose to send their children to child care centers.
- According to DHHS data, 73 percent of children receiving subsidized child care are in programs with a 4 or 5 Star Rating, the two highest quality ratings awarded by the state.
- Over 30,000 children were on wait lists for the Subsidized Child Care Program as of October 2015. In general, wait lists reflect economic conditions and federal government funding levels.
- Research suggests that subsidies expand economic opportunities for low-income families and improve the quality of care provided to children.

Recommendations

1. **Use longitudinal administrative data on child care subsidy participation to assess entry, exit, and reentry trends and the impact of eligibility, provider, and program funding changes on household income and child care arrangements.** Child care subsidies should furnish financial stability for adults and promote developmental gains for children.

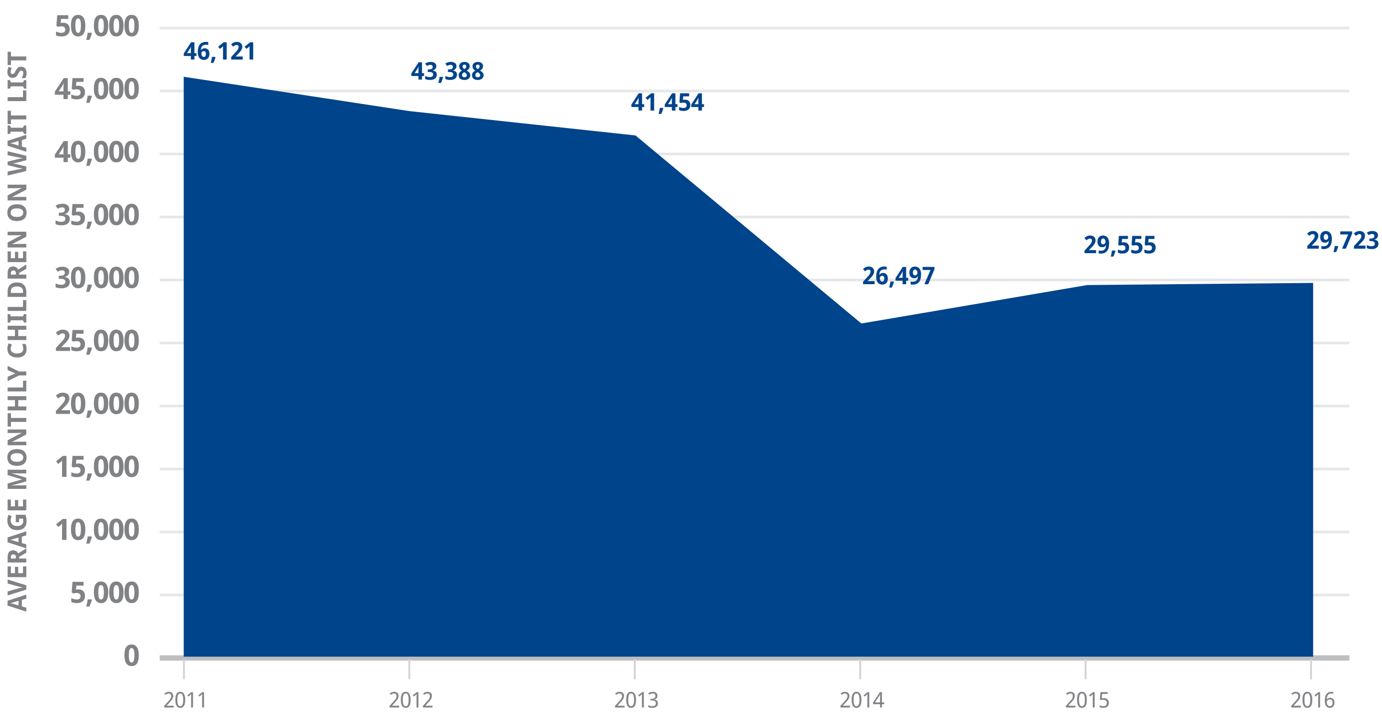
2. **Determine whether there is a relationship between subsidy use in North Carolina and children's social-emotional, cognitive, health, and behavioral development.** Child care subsidies should provide both short- and long-term benefits, not just supervision, for participating children.
3. **Policymakers should limit regulation of day-care operations to health and safety requirements only.** Parents should make their own decisions about the trade-offs between price and child-staff ratios or qualifications.

Child Care Subsidy by Client Need



Note: Due to rounding, the subsidy categories may not total 100%.

Subsidized Child Care Wait List Over Time



Childhood Health and Nutrition

Analyst: Dr. Terry Stoops
Director of Education Studies

As childhood obesity rates continue to rise, the debate over the National School Lunch Program and the sale of junk food in and around public schools has intensified. While elected officials continue their well-intentioned efforts to promote healthy lifestyles in our public schools, research suggests that passing new and stricter regulations will do little to make children healthier.

The Obama administration spearheaded passage of the Healthy, Hunger-Free Kids Act in 2010. This initiative is designed to combat childhood obesity by changing the nutrition requirements of school lunches.

As expected, the law produced a number of undesirable unintended consequences. A January 2014 Government Accountability Office (GAO) study found that the law multiplied costs, increased fruit and vegetable waste, created new menu planning problems, and decreased participation in the federal school lunch program.

Because implementation of the program requirements is ongoing, the overall effect of the legislation on childhood health, if any, will not be known for some time. Nevertheless, there have been no discernible short-term benefits. According to a May 2016 study published by the academic journal Obesity, there have been no statistically significant decreases in childhood obesity since the 2011-12 school year.

Public health advocates also contend that schools can curb obesity by banning the sale of junk food and soda. Their more radical proposals include taxes on unhealthy foods and beverages and zoning regulations that prohibit certain businesses from operating near schools.

Over the last five years, however, empirical research studies have reached a near consensus — stricter laws and regulations imposed by government officials do not reduce childhood obesity rates in any significant way. Why?

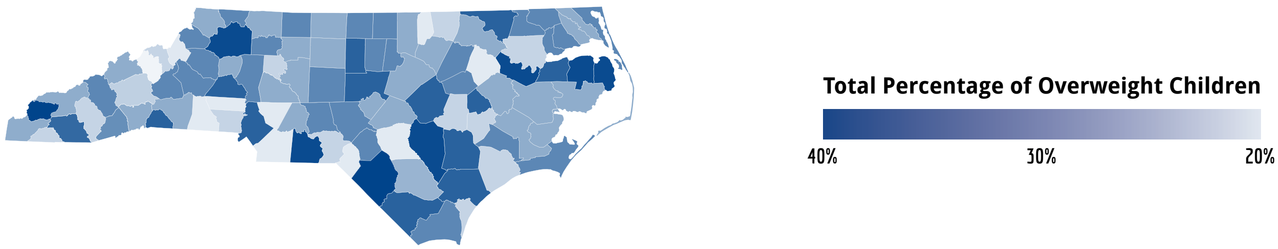
The consumption of unhealthy foods and drinks is inelastic. In other words, taxing or regulating certain food and beverage items will not necessarily reduce consumption of them by very much. Consumers, particularly children, simply shift their consumption preferences to other unhealthy, nontaxed foods and beverages. For example, public school students often respond to bans on soda by purchasing different kinds of sugary drinks, such as juices and sports drinks, from school vending machines. Yet even schools that ban all sugar-sweetened beverages from campus will not significantly reduce students' consumption of unhealthy drinks. Kids can (and will) simply bring them from home.

Key Facts

- A study from the January 2012 issue of *Sociology of Education* examined junk food consumption and weight changes in nearly 20,000 public middle-school students. Penn State University researchers found that the percentage of overweight or obese students did not rise in concert with the increased availability of unhealthy foods and snacks. In fact, the percentage of overweight and obese students decreased slightly as the availability of junk food increased.
- In 2011, *The Archives of Pediatrics and Adolescent Medicine* published a study that sought to nd a link between obesity and beverage consumption in schools. It concluded that soda bans in middle schools did not significantly reduce students' consumption of sugary drinks.
- Researchers have yet to establish a causal association between health outcomes and restaurant zoning restrictions. For example, a 2011 study published in *BMC Public Health* found no relationship between overweight or obese children and the proximity of fast food restaurants and supermarkets to their schools.
- A study in the September 2008 issue of the *American Journal of Preventative Medicine* hypothesized that there was a relationship between obesity-related eating behaviors and the presence of snack and soda machines in schools. To their surprise, they found little relationship between them.

Recommendations

1. Federal, state, and local governments should not impose arbitrary taxes, regulations, or prohibitions on the consumption of certain foods and beverages. We should remain dependent on parents and guardians to instill values of healthy and active lifestyles in children.
2. Public schools should ensure that all children participate in health and physical education activities several times a week. Additionally, public schools should invite all students to use sports and recreational facilities before school, after school, and on weekends.
3. States should ask Congress to reassess changes to the federal school lunch program. Lawmakers should try to nd ways to mitigate the unintended consequences produced by the Healthy, Hunger-Free Kids Act of 2010.



Underweight, Healthy Weight, Overweight, and Obese 2, 3 and 4-year-old Children in North Carolina Counties - 2012

COUNTY	UNDER WEIGHT	HEALTHY WEIGHT	OVER WEIGHT	OBESE
ALAMANCE	3.6%	62.1%	16.8%	17.5%
ALEXANDER	5.1%	65.5%	16.6%	12.8%
ALLEGHANY	6.5%	61.1%	13.0%	19.4%
ANSON	3.6%	58.9%	18.3%	19.2%
ASHE	7.4%	65.1%	14.0%	13.6%
AVERY	9.3%	64.7%	14.3%	11.6%
BEAUFORT	4.3%	66.5%	14.4%	14.9%
BERTIE	9.5%	64.3%	10.8%	15.4%
BLADEN	8.8%	60.4%	14.9%	15.9%
BRUNSWICK	6.0%	62.1%	17.3%	14.6%
BUNCOMBE	4.0%	66.1%	15.7%	14.1%
BURKE	3.5%	66.1%	16.1%	14.3%
CABARRUS	13.5%	62.3%	12.0%	12.2%
CALDWELL	4.0%	64.9%	18.2%	12.9%
CAMDEN	10.7%	60.9%	11.5%	16.9%
CARTERET	4.6%	63.2%	15.5%	16.7%
CASWELL	6.6%	61.9%	17.3%	14.2%
CATAWBA	4.0%	63.1%	17.8%	15.1%
CHATHAM	4.2%	63.0%	15.9%	16.9%
CHEROKEE	3.9%	67.1%	12.4%	16.7%
CHOWAN	10.2%	59.1%	13.6%	17.1%
CLAY	2.6%	71.8%	13.8%	11.8%
CLEVELAND	7.9%	68.0%	12.0%	12.1%
COLUMBUS	3.9%	63.2%	15.3%	17.6%
CRAVEN	7.7%	63.8%	16.0%	12.5%
CUMBERLAND	10.4%	68.7%	11.2%	9.6%
CURRITUCK	9.0%	59.6%	13.8%	17.6%
DARE	2.5%	60.0%	21.3%	16.2%
DAVIDSON	3.6%	66.6%	16.3%	13.5%
DAVIE	4.4%	69.6%	12.0%	14.0%
DUPLIN	7.6%	59.2%	14.9%	18.3%
DURHAM	6.3%	62.2%	15.0%	16.5%
EDGECOMBE	6.5%	68.7%	10.9%	13.9%
FORSYTH	4.0%	66.3%	16.0%	13.7%
FRANKLIN	19.9%	50.2%	15.3%	14.6%
GASTON	5.8%	67.9%	12.3%	14.0%
GATES	11.4%	56.9%	12.3%	19.4%
GRAHAM	4.9%	56.7%	12.7%	25.7%
GRANVILLE	4.7%	65.9%	13.7%	15.7%
GREENE	8.0%	59.4%	17.0%	15.6%
GUILFORD	4.7%	66.3%	14.7%	14.3%
HALIFAX	7.1%	63.1%	16.5%	13.4%
HARNETT	7.2%	64.2%	15.4%	13.2%
HAYWOOD	3.8%	64.8%	17.4%	14.0%
HENDERSON	7.3%	64.7%	16.1%	11.9%
HERTFORD	8.0%	61.8%	15.0%	15.2%
HOKE	6.4%	61.2%	14.3%	18.1%
HYDE	7.0%	63.4%	15.5%	14.1%
IREDELL	5.6%	63.8%	15.7%	14.9%
JACKSON	3.3%	69.6%	14.1%	13.1%
JOHNSTON	3.2%	63.5%	15.3%	18.1%
JONES	5.4%	64.1%	15.6%	15.0%
LEE	3.6%	67.2%	14.7%	14.5%
LENOIR	7.4%	66.3%	14.1%	12.1%
LINCOLN	10.8%	68.7%	10.6%	9.9%
MACON	3.6%	59.2%	16.7%	20.5%
MADISON	7.2%	64.9%	12.2%	15.8%
MARTIN	6.6%	57.0%	16.2%	20.3%
MCDOWELL	4.6%	64.4%	14.8%	16.3%
MECKLENBURG	4.6%	62.6%	16.1%	16.7%
MITCHELL	9.7%	62.9%	15.4%	12.0%
MONTGOMERY	4.8%	64.5%	15.4%	15.4%
MOORE	4.1%	65.1%	16.0%	14.7%
NASH	6.0%	63.4%	14.3%	16.3%
NEW HANOVER	5.4%	67.2%	14.9%	12.6%
NORTHAMPTON	5.1%	60.9%	19.1%	14.8%
ONSLOW	4.5%	68.5%	15.3%	11.7%
ORANGE	7.2%	62.8%	15.5%	14.6%
PAMLICO	8.1%	64.0%	15.7%	12.2%
PASQUOTANK	8.7%	62.1%	13.3%	15.9%
PENDER	6.8%	60.7%	17.2%	15.4%
PERQUIMANS	8.7%	61.3%	13.3%	16.7%
PERSON	4.0%	64.7%	16.5%	14.7%
PITT	5.6%	65.5%	13.9%	15.0%
POLK	2.4%	63.1%	13.6%	20.9%
RANDOLPH	4.7%	64.3%	15.2%	15.7%
RICHMOND	4.4%	69.7%	12.7%	13.1%
ROBESON	3.0%	58.4%	18.3%	20.3%
ROCKINGHAM	4.5%	67.3%	14.0%	14.1%
ROWAN	5.1%	66.8%	15.0%	13.1%
RUTHERFORD	5.5%	65.6%	14.5%	14.5%
SAMPSON	3.2%	60.0%	16.0%	20.9%
SCOTLAND	5.9%	70.9%	10.4%	12.8%
STANLY	3.9%	66.7%	16.1%	13.2%
STOKES	4.7%	63.5%	16.8%	15.0%
SURRY	13.2%	58.0%	13.0%	15.8%
SWAIN	5.9%	66.3%	15.0%	12.8%
TRANSYLVANIA	1.8%	64.1%	19.8%	14.3%
TYRRELL	8.5%	55.3%	13.2%	23.0%
UNION	20.5%	54.7%	12.9%	11.9%
VANCE	10.0%	66.8%	11.9%	11.3%
WAKE	7.3%	63.5%	14.7%	14.5%
WARREN	13.8%	60.7%	12.9%	12.6%
WASHINGTON	8.3%	58.0%	14.8%	18.9%
WATAUGA	5.1%	63.3%	15.9%	15.6%
WAYNE	5.4%	67.5%	13.6%	13.6%
WILKES	4.7%	57.9%	17.8%	19.7%
WILSON	7.2%	62.0%	15.8%	15.0%
YADKIN	10.3%	58.8%	16.9%	14.0%
YANCEY	8.6%	67.8%	12.6%	11.0%

Pre-Kindergarten Education

Analyst: Dr. Terry Stoops
Director of Education Studies

Taxpayer-funded pre-kindergarten education in the United States is a multibillion-dollar hodgepodge of state and federal programs.

The North Carolina Division of Child Development and Early Education, a division within the Department of Health and Human Services (DHHS), oversees two large state programs — NC Pre-K and the Subsidized Child Care Program. NC Pre-K is a preschool program for at-risk 4-year-olds. (The Subsidized Child Care Program is discussed separately.)

In addition, Smart Start is a public/private program that was established in 1993 to serve children from birth to five years old. The N.C. Partnership for Children and 77 local partnerships oversee the program. Smart Start provides child care subsidies, teacher training, health screenings, and support for families regardless of income.

North Carolina also has three federally funded pre-kindergarten programs — Preschool for Exceptional Children, Title I Preschool, and Head Start. Preschool for Exceptional Children is supported by state and federal funds and provides pre-kindergarten services for special-needs children. Title I Preschool allows school districts to set aside a portion of their federal Title I funding to provide pre-kindergarten programs for at-risk 4-year-olds.

Finally, the federal Head Start program is the largest and one of the oldest federal pre-kindergarten initiatives in North Carolina. Head Start provides education, health, and nutrition services to low-income children between the ages of three and five.

A handful of longitudinal studies have found that high-quality, state-run early childhood education programs may provide lasting benefits for children who live in poverty or have endured physical or emotional trauma.

But these benefits are not universal and may be short-lived.

In a landmark 2012 study of Head Start outcomes, researchers concluded that, by third grade, there was no significant difference between children who had been randomly assigned to a Head Start program and those who had not. This finding was consistent with previous studies that concluded that the initial advantages of preschool attendance for the typical child begin to narrow or "fade out" by middle school.

Empirical evidence of "fade out" is directly at odds with the most prominent and appealing argument used by proponents of taxpayer-run preschool programs. They contend that state lawmakers have a choice. They can pay now for expanded preschool programs or pay later for the costs associated with educational remediation, crime, underemployment, and welfare.

On the surface, the "pay now or pay later" argument embodies the kind of reasonable, responsible, and compassionate public policy that appeals to elected officials on both sides of the aisle. But longitudinal studies, including research conducted in North Carolina, suggest that taxpayers may have to pay now and later.

Key Facts

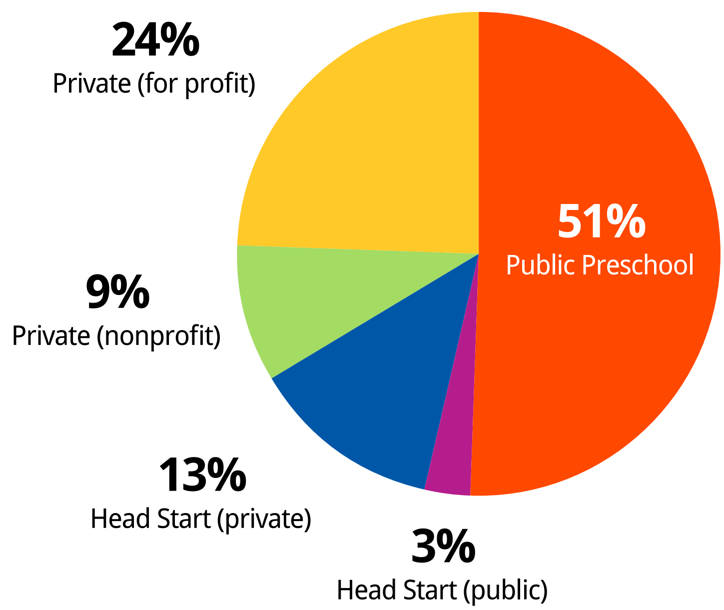
- To be eligible for NC Pre-K, families must have a household income that is 75 percent of state median income. Military families and families with a child who has Limited English Proficiency, special needs, disability, or extraordinary educational need may also qualify, regardless of income.
- During the 2015-16 school year, NC Pre-K received over $144 million in state and lottery funds and served over 26,000 children in nearly 1,200 child care facilities statewide.
- Approximately one in four NC Pre-K classrooms operated in a for-profit site. Of the remaining classrooms, just over half were located in public schools. Around 16 percent were in Head Start programs, a small percentage of which were operated by public schools.
- Five states – Idaho, Montana, New Hampshire, South Dakota, and Wyoming – have no state-funded preschool programs.

Recommendations

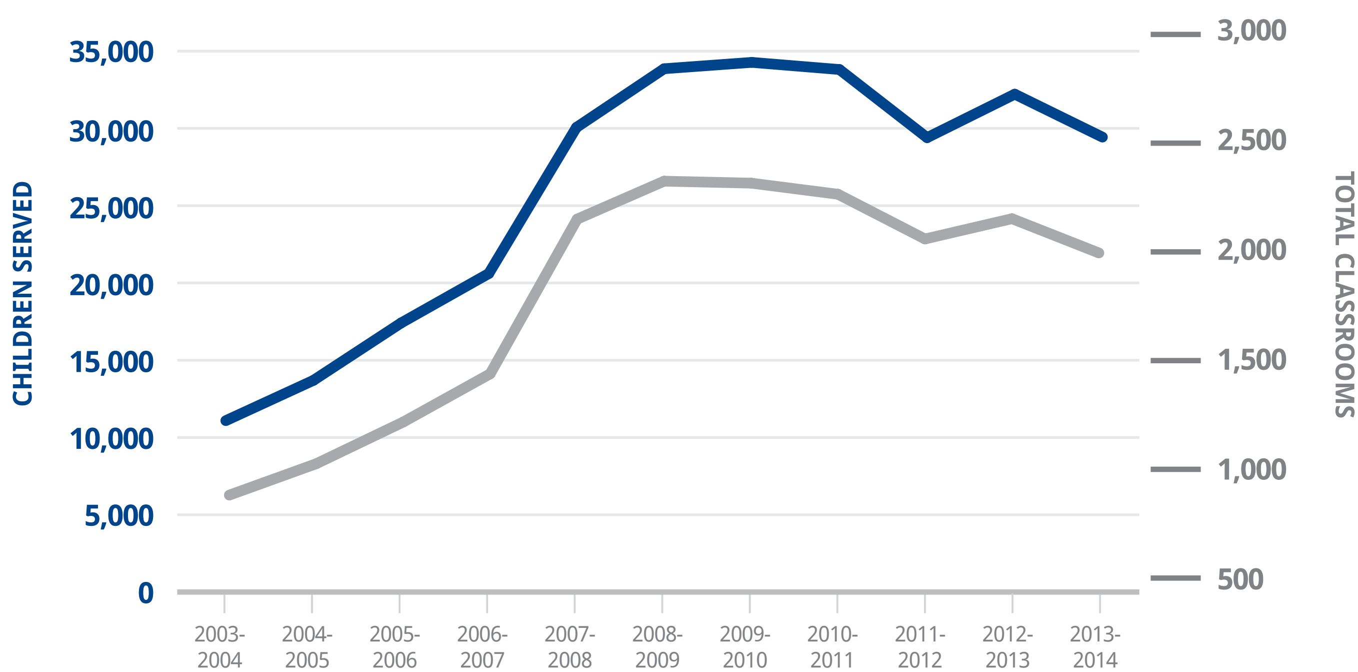
1. **Existing early childhood programs should be consolidated or significantly reorganized.** It is neither necessary, nor beneficial, to maintain multiple early childhood programs with different governance structures, funding distribution mechanisms, and accountability standards.

2. **NC Pre-K eligibility requirements should be narrowed to focus greater resources on education and services for low-income children.** State-subsidized preschool programs provide lasting benefits to children from distressed households but seldom help children from middle- or upper-income families. Narrowing the focus to aiding North Carolina's most vulnerable children would ensure that NC Pre-K prioritizes the educational needs of those who would benefit the most.
3. **Acknowledge and employ strategies that address fade-out effects.** Some proponents of state-funded early childhood education choose to disregard or dismiss evidence of fade out. Instead, they should concede that fade-out is not an anomaly or statistical artifact. Rather, they should focus on promoting research-based improvements in early learning that enable more children to retain behavioral and educational gains into elementary school and beyond.

NC Pre-K Classrooms, 2014



More at Four/North Carolina Pre-K Enrollment and Classrooms



Public School Finance

Analyst: Dr. Terry Stoops
Director of Education Studies

Discussions of funding levels are necessary, but not sufficient, for truly understanding the health of our public school districts. Researchers generally agree that how the money is spent is far more important than how much money is available to be spent. But no matter how many times researchers find weak empirical relationships between spending and performance, the public will insist that schools are one teacher pay raise away from educational glory.

Unfortunately, the American public too often equates the quality of public schooling with the condition of various inputs – per-student spending, educational technology, teacher pay, class size, school buildings, and the like. Presumably, schools will succeed so long as federal, state, and local governments use taxpayer money to furnish high-tech gadgets, pay all teachers much more, reduce class sizes, and construct magnificent school buildings.

But there is a better way for us to think about education finance – a focus on productivity.

Researchers use the term "educational productivity" to describe analyses that compare funding to student performance. To do so, they use quantitative methods to measure the relative return on investment for schools and school districts, while taking differences in cost of living, household income, English language proficiency, and special education services into account.

All things being equal, there are tremendous variations in productivity within North Carolina's public school system. According to a 2014 Center for American Progress study, Union County, Davie County, Mooresville City, and Surry County schools had the highest return on investment in the state. In general, these districts had below-average per-pupil expenditures but above-average test scores. Hertford, Anson, Washington, and Halifax county schools had the lowest return on investment. Per-pupil expenditures in these counties were relatively high, but their test scores were disappointingly low.

Whether you call it "return on investment," "educational productivity," or "bang for the buck," an assessment of the relationship between educational inputs and outputs is an essential starting point for good K-12 education policy.

Key Facts

- North Carolina spent $8,784 per K-12 student in federal, state, and local operating funds in 2015. When average spending for buildings and other capital costs are included, the total cost of public education in our state exceeds $9,235 per student.
- State funding is not distributed to all public school children equally. State and federal agencies allocate funds based on the needs, circumstances, and grade level of each student. During the 2015-2016 school year, for example, small, low-wealth school systems received $11,662 in state funds for each special-needs elementary school student with limited English proficiency from a low-income family. Federal funding may add up to an additional $5,880 per elementary student, depending on program eligibility.
- Over the last five years, state public school funding has increased by approximately 18 percent, from nearly $7.15 billion in 2011 to $8.44 billion in 2016.
- Federal No Child Left Behind/Every Student Succeeds Act funding to North Carolina public schools has remained relatively flat since 2013. Child nutrition programs received an additional $200 million in federal funds since 2012, largely to implement the Healthy, Hunger-Free Kids Act.
- Counties are responsible for financing their own capital programs and have spent almost $12 billion on school construction and maintenance since 1998. The state has contributed over $2.1 billion for capital expenditures during the same period. Taking all sources of revenue, school districts have spent over $14.2 billion for school capital expenditures since 1998.

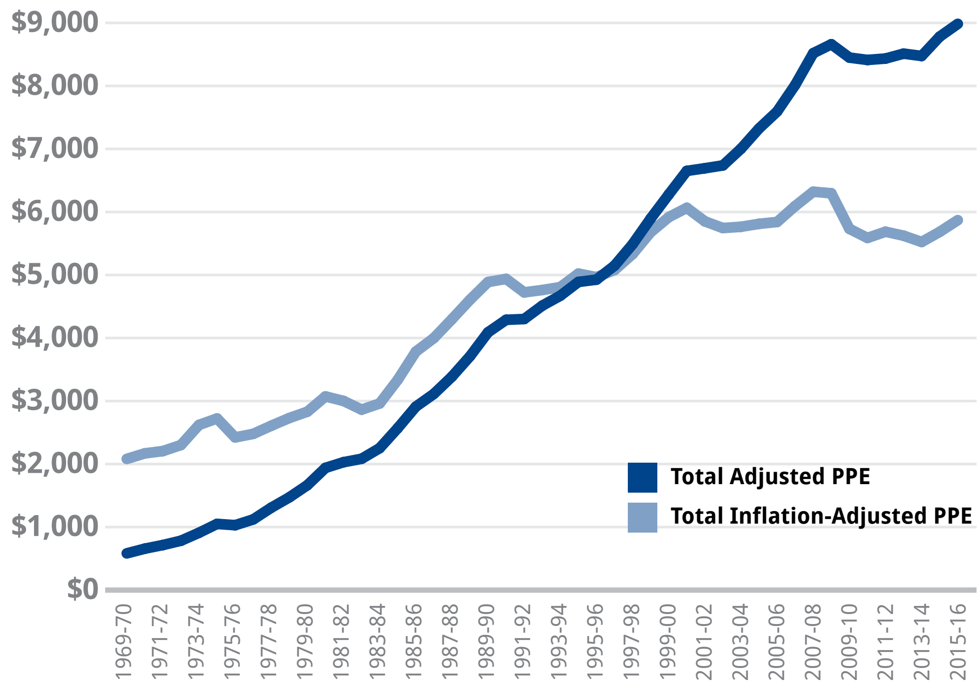
Recommendations

1. **Acknowledge that empirical studies find a weak relationship between education spending and student performance.** Embrace "educational productivity." It's not how much you spend, but how you spend it.

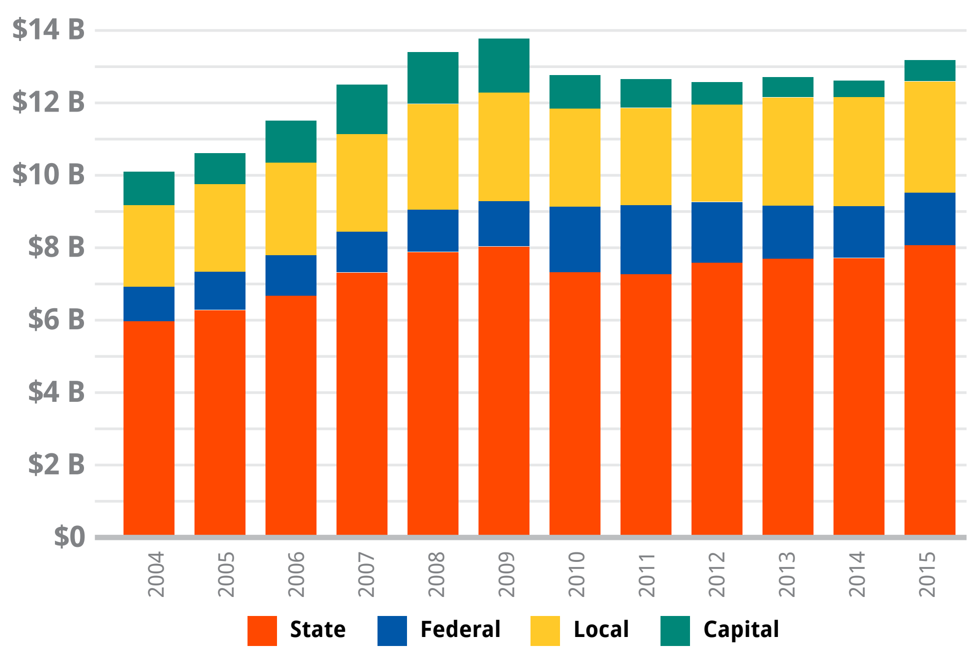
Research suggests that expenditures on classroom instruction provide the most "bang for the buck."

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

Total Inflation-Adjusted and Unadjusted Per-Pupil Expenditures, 1970-2016



Total Public School Expenditures (in Billions USD)



Class Size

Analyst: Dr. Terry Stoops
Director of Education Studies

Support for reducing class size usually cuts across political and ideological divides, garnering accolades from legislators, policymakers, and parents alike.

Nevertheless, the relationship between class size and student achievement has been the subject of scholarly debate for decades. While several large-scale studies suggest that students benefit from class size reductions, a number of high-quality studies conclude that smaller classes are not the "magic bullet" that many believe them to be.

But even if research showed a consistent and significant benefit to across-the-board class size reductions, the cost of implementing and maintaining smaller classes would likely exceed its benefit. Research suggests that class sizes must be reduced to between 15 and 20 students (depending on the grade) to have any positive effect on learning. Reductions of this magnitude would require a massive outlay of funds for additional teachers and new facilities.

Some lawmakers have tried to find a middle ground by requiring schools to limit class sizes in grades where such mandates are more likely to have a positive effect on student performance. Starting in the 2011 legislative session, lawmakers initiated a multiyear effort to reduce class sizes in grades K-3. These mandates require elementary schools to maintain a districtwide average of 21 students per class and an individual class size maximum of 24 students for each of these grades.

Beyond third grade, the N.C. General Assembly continues to give school districts maximum flexibility to establish class sizes in grades 4 through 12. Special education requirements and grant program mandates are the two notable exceptions.

As in the past, North Carolina charter schools are not held to class size limits. There is no evidence that the absence of class size requirements produces a harmful learning environment for charter school students or poor working conditions for charter teachers.

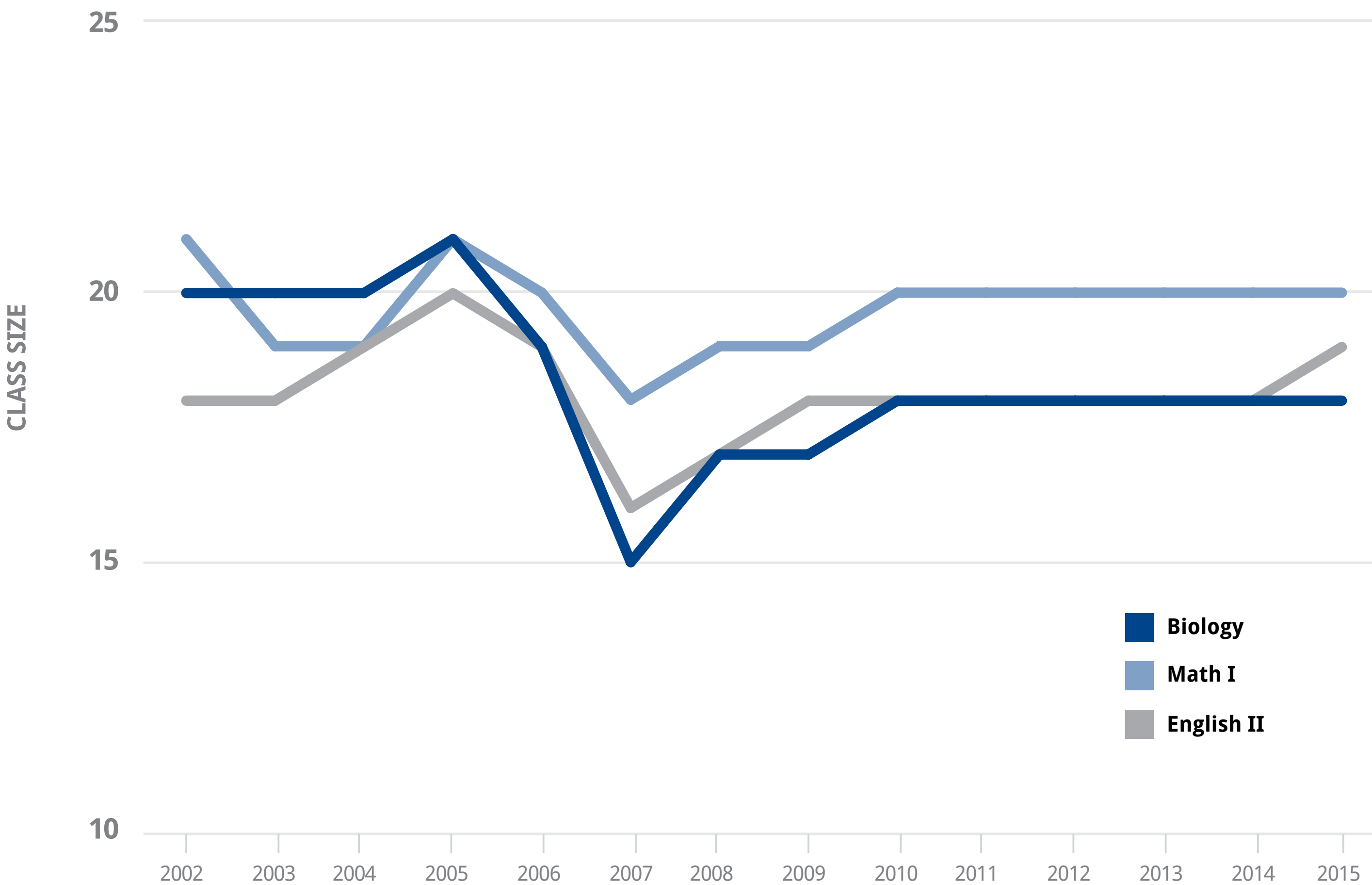
Key Facts

- Studies of class sizes in North Carolina public schools suggest there is little or no significant relationship between class sizes and student achievement. One research study also found that teachers' perceptions about their class sizes were not tied to teacher job retention.
- Results from the 2016 North Carolina Teacher Working Conditions Survey indicate that most teachers are content with current class sizes. Sixty-two percent of the over 101,000 respondents to the survey agreed or strongly agreed that class sizes "are reasonable such that teachers have the time available to meet the needs of all students." Twenty-eight percent of respondents disagreed, and 10 percent strongly disagreed with that statement.
- According to the latest data from the National Center for Education Statistics, North Carolina's average elementary class size was 18.8 students and average secondary class size was 25.8 students. Both were lower than the national average of 21.2 students and 26.8 students, respectively.

Recommendations

1. **State class size mandates should be eliminated across all grades.** School districts should have the authority to set class sizes for all grades and subjects according to the needs of their students and available resources.
2. **Class size reduction initiatives should target only those students who struggle in larger classroom settings and would benefit from individualized instruction in state-mandated courses.** Clearly, class sizes affect students and teachers differently. Statewide requirements do not account for district- and school-based factors, including subject, grade, student exceptionality, and facilities, that are more appropriate criteria for establishing class sizes.
3. **Class size reduction should be weighed against all other potential education reforms.** Lawmakers should always consider the "opportunity cost" of reducing class sizes. In other words, they should ask whether taxpayer money spent to reduce class sizes could be used in a more efficient and effective way. For example, budget appropriations that reduce class sizes by one or two students per grade should be redirected to efforts to recruit and retain high-quality teachers and excellent school leaders.

Average Class Sizes Over Time By Subject - Biology, Math I, English II



Average Class Sizes in North Carolina 2002-Present

GRADE/COURSE	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
KINDERGARTEN	20	19	19	19	19	19	19	19	19	20	19	20	N/A	19
GRADE 1	20	19	19	19	19	19	19	19	20	19	20	20	N/A	19
GRADE 2	21	20	19	19	19	19	19	19	19	20	19	20	N/A	19
GRADE 3	21	21	20	19	19	19	19	19	20	20	20	19	N/A	19
GRADE 4	21	21	21	21	21	20	21	21	21	21	21	21	N/A	20
GRADE 5	22	22	21	21	21	21	21	21	21	21	21	21	N/A	20
GRADE 6	21	21	21	21	21	21	21	21	22	22	22	22	N/A	22
GRADE 7	21	21	21	21	21	21	21	21	21	22	22	22	N/A	22
GRADE 8	21	21	21	21	20	20	20	20	21	21	21	21	N/A	22
BIOLOGY	20	20	20	21	19	15	17	17	18	18	18	18	18	18
ENGLISH II	18	18	19	20	19	16	17	18	18	18	18	18	18	19
MATH I	21	19	19	21	20	18	19	19	20	20	20	20	20	20

Standards and Curricula

Analyst: Dr. Terry Stoops
Director of Education Studies

Curricula are not standards; standards are not curricula.

In the debate over the Common Core State Standards, definitions of key terms, particularly "standards" and "curricula," vary considerably. For some, standards and curricula are one and the same. For others, standards are a framework by which curricular content is developed.

Although stakeholders may not settle on a definition, most education experts agree that it is important to make a clear distinction between the two concepts.

In general, standards are broad goals. In 2010, the N.C. State Board of Education adopted Common Core mathematics and English Language Arts standards for students in kindergarten through twelfth grade. The North Carolina Essential Standards inform all other core subjects and grades.

Curricula include specific course content either developed by the teacher or obtained from an external source. Teachers may use different curricula so long as it is aligned to the standards established for that subject and grade.

Arguably, the latter is more important than the former.

In fact, educational researchers have found no apparent relationship between the quality and the rigor of state standards, as determined by Common Core adoption and implementation, and National Assessment of Educational Progress (NAEP) scores. These findings suggest that the content that teachers teach and students learn likely has a much greater bearing on student achievement than what standards alone may provide.

Simply put, standards reform is not enough to boost student performance. Standards are only successful when they are buttressed by content-rich curricula that serve as the basis for classroom instruction in all North Carolina public schools.

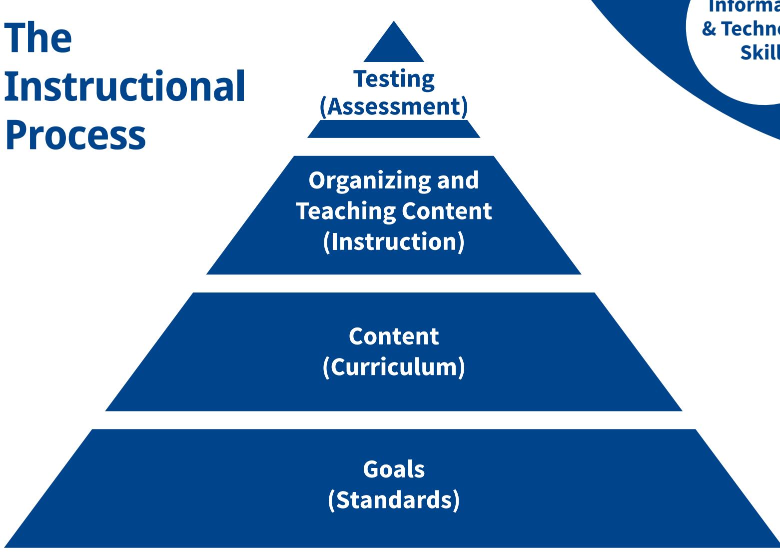
Key Facts

- Forty-two states, the District of Columbia, four territories, and the Department of Defense Education Activity (DoDEA) have adopted Common Core standards for one or both subjects.
- To date, the N.C. Department of Public Instruction has not released estimates of total expenditures related to Common Core implementation or assessed the relationship between Common Core adoption and student performance.
- In 2014, the N.C. General Assembly created the North Carolina Academic Standards Review Commission to assess Common Core English Language Arts (ELA) and mathematics standards. In their 2015 Report of Findings and Recommendations, the majority of the commission members recommended that the state revise the current ELA and mathematics standards. The proposed revisions, albeit substantial, would leave the shell of the Common Core ELA and math standards intact. The N.C. State Board of Education approved revisions to the standards for required high school-level math courses in 2016 based partly on the commission recommendations.
- Currently, the N.C. Department of Public Instruction provides curricular resources to teachers without mandating that they adopt any one of them. The state supports various online resources and, for districts and charters that opt in, the Home Base suite of instructional resources and assessment item banks.
- North Carolina state law prescribes teaching of content in certain grades and course areas. For example, state law prescribes inclusion of a civic literacy curriculum during an American History I high school course. Health education, character education, and financial literacy are other content requirements outlined in the statute. The requirements to teach multiplication tables and cursive writing are two of the more recent curriculum mandates passed into law.

Recommendations

1. **Legislators should create two permanent commissions that would be charged with raising the quality and rigor of state English Language Arts and mathematics standards, curricula, and assessments.** While the North Carolina Academic Standards Review Commission was a good start, a periodic and independent review of standards, curricula, and standardized tests would provide valuable feedback to state education officials.

2. **A standards, curriculum, and assessment commission should develop a rigorous state-developed curriculum.** Prescribing baseline curricular content would provide a more equitable education environment, ensuring that all students, regardless of socioeconomic circumstances, are exposed to the same essential content. It would also allow the state to compensate for knowledge and skill deficiencies identified by institutions of higher education, private- and public- sector employers, and other stakeholders.



Teaching Profession

Analyst: Dr. Terry Stoops
Director of Education Studies

No system of public education can thrive without a high-quality teacher work force. The problem is that state education bureaucracies enforce rules and regulations that fail to distinguish excellent teachers from poor ones. Indeed, a large body of research shows that certification status, advanced degrees, years of experience, education school courses, and teacher test scores are unreliable indicators of teacher quality.

Our continued use of an experience- and credential-based teacher salary schedule means, for example, that some superb educators are making less money than mediocre ones, simply because they have fewer years of experience, lack an advanced degree, or failed to obtain a specialized certification. That system does little to encourage our best public school teachers to stay in the classroom. Across-the-board salary and benefits increases may attract qualified candidates to North Carolina, but targeted increases are a much better long-term strategy for improving quality.

That said, the state's capacity to recruit and retain teachers depends on more than just compensation. Educators choose to teach in (or leave) North Carolina for any number of personal and professional reasons. It is equally important for lawmakers to ensure that the state maintains a low cost of living, strong economy, and superior quality of life.

Key Facts

- During the 2015-16 school year, North Carolina public school districts employed over 94,400 full-time teachers, and well over 90 percent of them were fully licensed by the state.
- Nearly 30 percent of North Carolina teachers earned an advanced degree, and around 22 percent obtained National Board Certification.
- According to the N.C. Department of Public Instruction, between 1994-95 and 2015-16, teacher pay has increased 126.5 percent. This outpaced the 54.3 percent increase for state employee salaries and the 64.3 percent increase in the Consumer Price Index.
- According to the state salary schedule for the 2015-2016 school year, teachers on the typical 10-month contract had a base salary range of $35,000 to $ $63,530.
- In addition to their state-mandated base salary, most teachers receive an annual salary supplement from their local school district. The average salary supplement was nearly $3,900 per teacher in 2016. Seven school districts provide no local salary supplement. Wake County Schools offered the state's largest average supplement at nearly $7,000 per teacher.
- For the 2016-2017 school year, the average base teacher salary was $45,970. Matching benefits for teachers add 7.65 percent for Social Security, 16.12 percent for retirement, and $5,471 for hospitalization to their base salary. To put a value to the benefits package, the average teacher receives approximately $16,400 in annual Social Security, retirement, and hospitalization benefits.
- Between 2010 and 2015, 10,380 out-of-state teachers received North Carolina teaching licenses and were employed as classroom teachers in North Carolina public schools the following school year. During the same period, 3,222 teachers reported that they left North Carolina to teach in another state. The net gain for the state was over 7,100 teachers.
- According to the 2015 Annual Report on Teachers Leaving the Profession, the teacher turnover rate for the state's 115 school districts was 14.84 percent. The rate includes teachers who retired, resigned to teach in another North Carolina public school, or resigned due to personal circumstances. The most recent attrition rate reported by the National Center for Education Statistics (NCES), which includes both leavers and movers, was 15.8 percent.

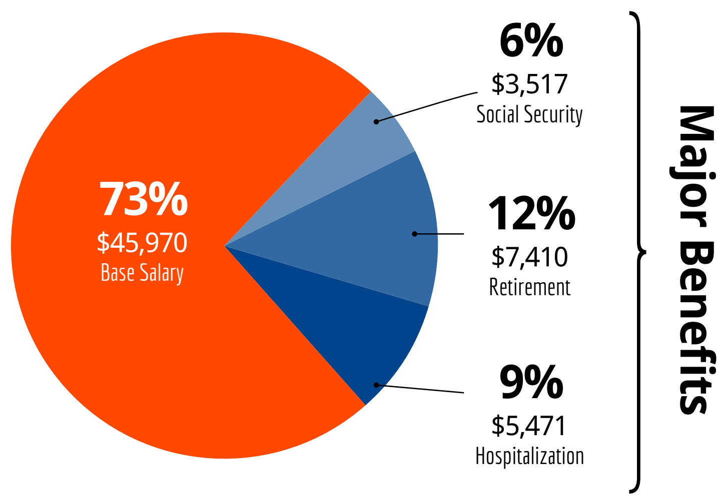
Recommendations

1. **Broaden the teacher applicant pool by loosening or eliminating certification and licensure requirements.** Although the state puts a premium on licensure, advanced degrees, and National Board Certification, there is little evidence that these factors guarantee good teachers or raise student performance.
2. **Evaluate teachers using the most accurate and objective measures possible.** North Carolina's public schools calculate and record value-added scores for teachers in a computer system called EVAAS (Education Value

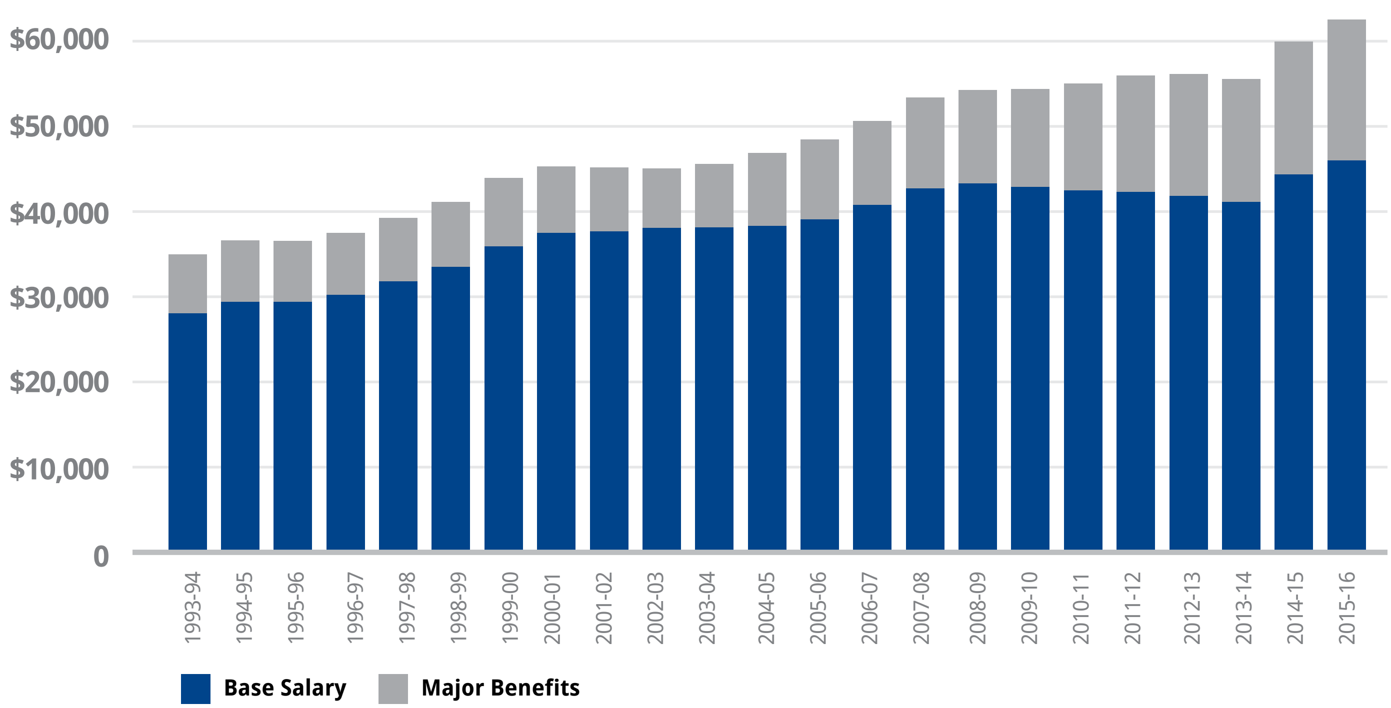
Added Assessment System). Research suggests that value-added analysis is the most accurate teacher evaluation tool available.

3. **Implement a comprehensive merit and incentive pay system that will pay a portion of teachers' salary based on the value that they add to their students' learning.** North Carolina's salary schedule is based on years of experience and credentials, neither of which are sound indicators of teacher quality.
4. **Improve the quality of education school graduates by raising program admissions standards, increasing subject-area course requirements, and providing rigorous instruction in research-based teaching methods.** If the University of North Carolina System refuses to reform schools of education voluntarily, sweeping legislative action may be required.

Teacher Compensation, 2016-2017



Unadjusted Average Teacher Compensation, 1993-2016



Testing and Accountability

Analyst: Dr. Terry Stoops
Director of Education Studies

Beginning with the ABCs of Public Education in 1996 and continuing with the implementation of the READY accountability model in 2012, the N.C. Department of Public Instruction authored, field-tested, administered, and analyzed nearly all end-of-grade and end-of-course tests. During that time, state tests were subject to countless modifications, deletions, and additions. Some of these changes were for the better, but most were for the worse.

Indeed, many teachers and parents remain incredulous about the state accountability system. According to the 2016 Teacher Working Conditions Survey, for example, 57 percent of the over 101,000 teachers who responded to the survey did not believe that state-developed assessments accurately gauge students' understanding of state learning standards.

Amid widespread discontent with the state accountability program, elected officials have taken steps to improve North Carolina's testing system. Even the most promising efforts to transform the state accountability program, however, may not mitigate the use of excessive, duplicative, or poorly designed tests.

That is because research suggests that school- and district-based testing mandates consume more time than tests required by the state or federal government. That said, it would be a mistake for state legislators or federal bureaucrats to impose one-size-fits-all rules that govern decisions made at the school and district levels.

Key Facts

- The federal government requires that the state administer and report results from end-of-grade tests in English and math for students in grades 3-8 and science tests for students in grades 5 and 8. High school students must take, at minimum, end-of-course English II, Math I, and Biology tests.
- Student test scores fall into one of five achievement levels. Levels 3, 4, and 5 meet the "on-grade-level proficiency" standard. Levels 4 and 5 meet the "career-and-college readiness" standard.
- Although some students elected to take the SAT, all N.C. students are required to take the ACT test. In addition, selected career and technical education students who are in twelfth grade will complete the WorkKeys assessment.
- In 2013, the N.C. General Assembly mandated that the state use test scores, academic growth measures, and other outcome measures to create a simple A-to-F performance grading system for all North Carolina public schools. Previous classifications of student performance on state tests were confusing to the public.
- As a result of the work of the Task Force on Summative Assessment, the N.C. Department of Public Instruction currently oversees a pilot program that replaces end-of-grade tests with through-course/interim assessments.
- North Carolina public schools also participate in the federal National Assessment of Educational Progress (NAEP). The rigorous NAEP tests are administered infrequently; a representative sample of students is tested in mathematics and reading every two years, while science, history, civics, and geography tests are administered every four years. Because of the nature of the sample, NAEP cannot provide data on individual school districts, only states. In most cases, only fourth- and eighth-grade students are tested.

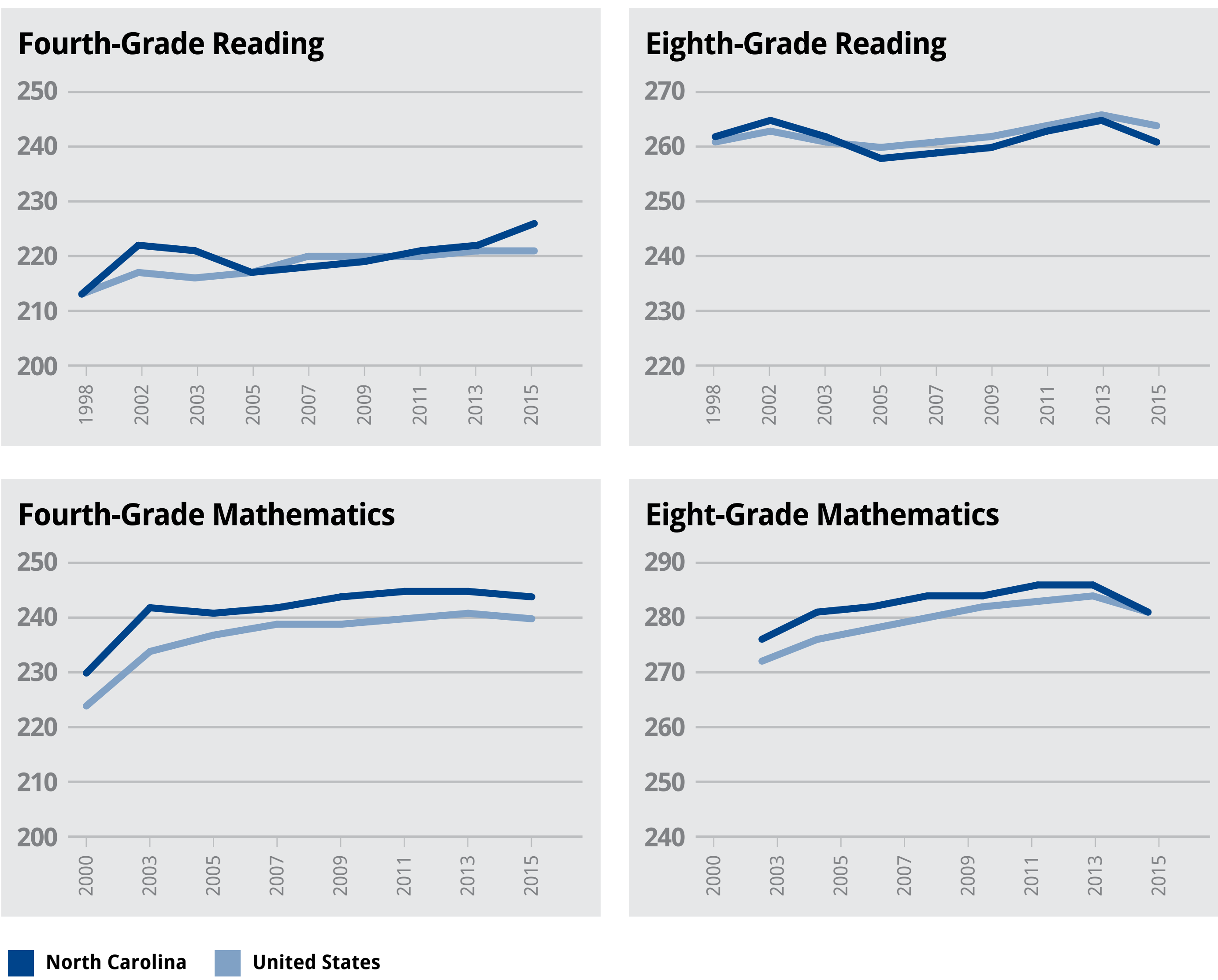
Recommendations

1. **Adopt an independent, field-tested, and credible national test of student performance.** There are a number of norm-referenced tests available for students in grades K-12, including the Basic Achievement Skills Individual Screener (BASIS), Metropolitan Achievement Tests (MAT 8), and the Stanford Achievement Test Series, 10th Edition (Stanford 10).
2. **Set reading and math performance goals based on reputable national tests such as the National Assessment of Educational Progress (NAEP).** The state should set a goal of at least half of students showing proficiency and 90 percent testing at the "basic" level as defined by the NAEP.
3. **The N.C. Department of Public Instruction should sponsor a comprehensive study that attempts to discover the causes of the state's dramatic increase in math achievement and relative stagnation of reading scores over the last decade.** North Carolina's public schools produced remarkable increases in fourth- and

eighth-grade math and fourth-grade reading scores in the 1990s and early 2000s. Researchers should conduct a similar study to determine why the state's graduation rate has been on the rise.

4. **The state should augment educational options for all families, thereby curtailing dependence on standardized tests and other measures of student achievement.** School accountability comes in two forms. Either parents keep schools accountable by "voting with their feet," or states compel public school districts to administer standardized tests. As educational options increase, the value and necessity of testing decreases. Likewise, as long as states such as North Carolina maintain stringent limitations on parental choice, test scores remain their primary method of keeping schools accountable for results.

National Assessment of Educational Progress (NAEP) Average Scale Scores



John Locke Foundation

School Choice

Analyst: Dr. Terry Stoops
Director of Education Studies

In North Carolina, public education is a core fiscal responsibility of state and local government. In the words of the N.C. Supreme Court, the state constitution recognizes the right to a "sound, basic education" for each child.

There are two ways to assess whether a school is satisfying that constitutional right.

On one hand, parents must rely on standardized testing and other metrics to gauge the quality of their children's assigned schools. Unfortunately, if those schools produce disappointing results or impose direct physical or psychological harm on their children, only a fortunate few have the option of relocating their children to a better district, public charter school, private school, or home school.

On the other hand, the parental choice model makes schools directly accountable to parents. Parents are given the financial means and unrestricted opportunity to move their children and tuition dollars to competing educational institutions.

Therein lies one of the major advantages of school choice – equity. No longer does family income or ZIP code dictate a family's access to a better school, as it does in most communities today.

In the end, education need not and should not be delivered by government monopolies. A diverse array of pre-kindergarten, primary, secondary, and postsecondary schools benefit both those who utilize educational options and those who do not. No system for delivering goods and services functions well without providing a means for consumers to make their desires known and express their levels of satisfaction.

Key Facts

- Between 2006-07 and 2015-16 there was a 72 percent increase in the number of homeschool students. During the 2015-16 school year, an estimated 118,268 students were taught in 74,653 home schools.
- In 2013, the General Assembly changed the state's homeschool statute to affirm that homeschool parents determine the scope and sequence of academic instruction and permit them to incorporate additional sources of instruction, including online and cooperative schools.
- Between 2006-07 and 2015-16, there was a 0.06 percent increase in the number of private school students. Private school enrollment dropped during the Great Recession and only recently began to rebound. In 2015-16, over 97,700 students enrolled in 742 private schools.
- The N.C. General Assembly passed two private school voucher programs in 2013. The budget included a $4,200-per-year Opportunity Scholarship for public school children in low-income households. In addition, legislators approved a $6,000-per-year Disability Grant Program for public school children with a documented disability. Disability Grant Program scholarships have since increased to $8,000 per year.
- Over 6,000 low-income children will receive an Opportunity Scholarship for the 2016-17 school year, which is well over five times the number of students who received a scholarship during the program's first year of operation.
- Over 800 students received a voucher through the Disability Grant Program in 2016.
- Lawmakers continue to increase state support for the Opportunity Scholarship and Disability Grant programs. In 2016, legislators increased Disability Grant scholarship funding by 137 percent. The $5.8 million increase boosted the annual Disability Grant budget to $10 million. Legislators also created an Opportunity Scholarship Grant Fund Reserve, which will increase funding for the program by $10 million per year for the next 10 years. The Opportunity Scholarship Program will receive $34.8 million in 2016. If scheduled increases are maintained in subsequent budgets, the program will have a $144.8 million budget in 2027-28.

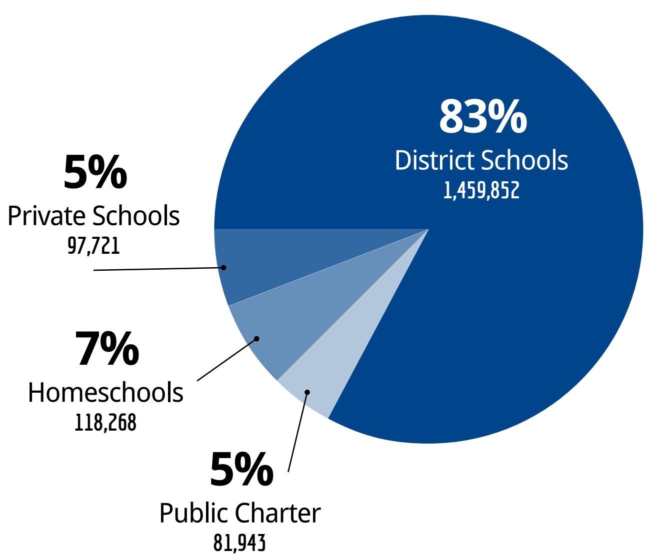
Recommendations

1. **The state should continue to increase funding for existing voucher programs to accommodate all eligible applicants.** In 2016, there were over 2,100 low-income students on a wait list for an Opportunity Scholarship. Over 300 special-needs students were on the wait list for a Disability Grant Program scholarship. The increasing popularity of both programs suggests that, at their

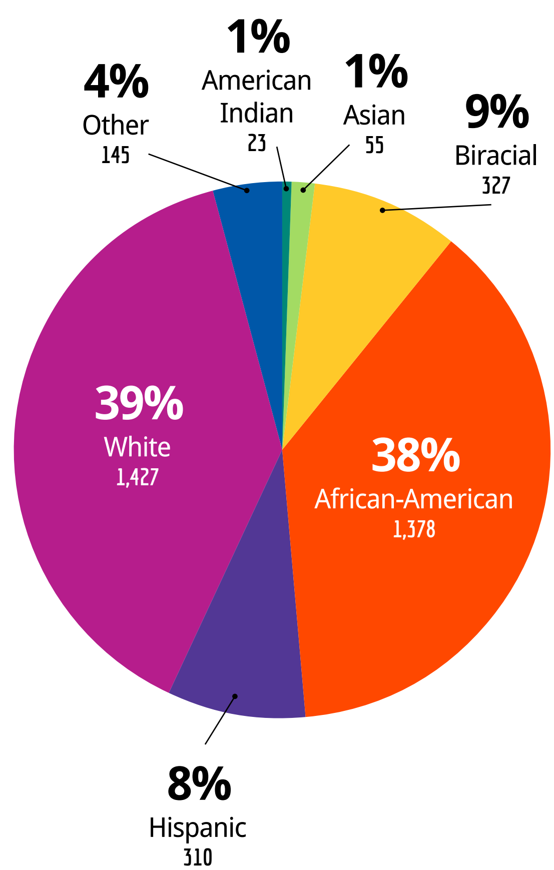
current level, the supply of scholarships will fail to meet annual demand.

2. **All low-income students should receive state-funded Education Savings Accounts (ESA)to receive educational services or attend the school(s) of their choice.** An ESA would give parents the maximum control of scholarship funds by allowing them to direct state-provided dollars to one or more approved schools, educational service providers, or vendors providing instructional materials and technology. Ideally, state law would allow unspent funds to be deposited into a college savings account, such as a 529 Plan or a Coverdell Education Savings Account.
3. **School districts should make greater use of open enrollment and magnet schools, allowing parents to send their children to the public schools that best meet their needs.** District leaders should employ choice and competition to improve academic performance within the district system.

K-12 Student Enrollment Market Shares, 2015-16



Opportunity Scholarship Recipients, 2015-16



Charter Schools

Analyst: Dr. Terry Stoops
Director of Education Studies

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

Much of the growth in charter school enrollment can be attributed to recent revisions of the state's charter school statutes. In 2011, the N.C. General Assembly eliminated restrictions on growth that originated in the 1996 charter law. Lawmakers removed the 100-school cap and authorized charter school enrollment to grow by as much as 20 percent a year, up from the previous cap of 10 percent, which had led to long wait lists and few open seats.

The 2011 charter school legislation also created a new oversight group, the North Carolina Charter School Advisory Board. The purpose of the board is to review and recommend charter applications to the N.C. State Board of Education for approval. The council also assists the Office of Charter Schools in its ongoing effort to ensure that charters maintain high academic and operational standards.

In 2013, legislators also approved a bill that permits established charter schools to add one grade per year without approval from the State Board of Education. Additional revisions to the state's charter school statutes provided much-needed stability and relief for families with multiple children by virtually guaranteeing sibling admission. Finally, lawmakers reduced teacher certification requirements for charter schools, allowing them to hire more teachers based on qualifications rather than credentials.

Finally, in 2014 lawmakers approved legislation that allows two virtual charter schools to begin operating in North Carolina. The following year, the State Board of Education approved applications submitted by N.C. Virtual Academy and N.C. Connections Academy, both of which began offering online courses in the fall of 2015.

Despite these positive changes, charter school applications continue to outnumber available seats. Unfortunately for families, there is no immediate relief in sight. It will take several years for new and existing charter schools to accommodate the pent-up demand created by 15 years of ill-advised restrictions on charter school growth.

Key Facts

- According to N.C. Department of Public Instruction data, the statewide average expenditure for charter schools during the 2014-15 school year was $8,080 per student. At the same time, the average district school spent $8,784 per student to cover operating expenses and an estimated $451 per student for capital expenses. Unlike school districts, charter schools do not receive state or local capital funding or county-funded debt service payments on their behalf.
- While North Carolina's 158 charter schools are physically located in only half of the state's counties, all families have access to charters. Students are permitted to cross county lines to attend the charter school of their choice. In addition, the state's two virtual charter schools allow students anywhere in the state to enroll.
- As of the 2015-16 school year, enrollment in the state's 158 charter schools had grown to nearly 82,000 students, an increase of 83 percent over the previous five years. Still, charter school students represent only 5.4 percent of the total public school population in North Carolina.
- According to data collected by the N.C. Department of Public Instruction in 2015, charter schools statewide had an estimated 32,000 students on wait lists.
- Since the authorization of charter schools in 1996, 43 charter schools have closed and 13 charters were relinquished before opening. Closure is a form of accountability unique to charter schools.
- Based on 2014-15 state test results, a higher percentage of charter schools earned school performance grades of A, B, or C than district schools.

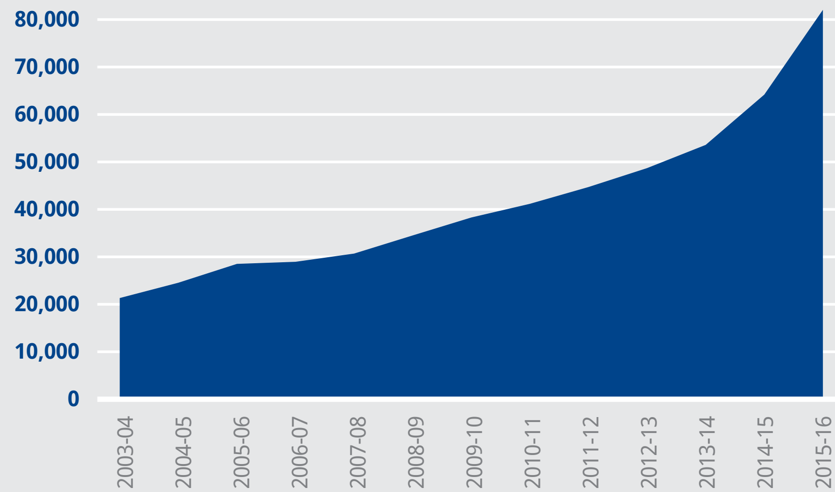
Recommendations

1. **The State Board of Education should repeal any policy or regulation that sets student performance standards for charter, but not district, schools.** All public schools that administer state tests should be subject to the same accountability rules.
2. **Lawmakers should allow municipalities and counties to support the capital needs of charter schools within their jurisdictions.** Elected officials should be allowed to add capital funding for charter schools into

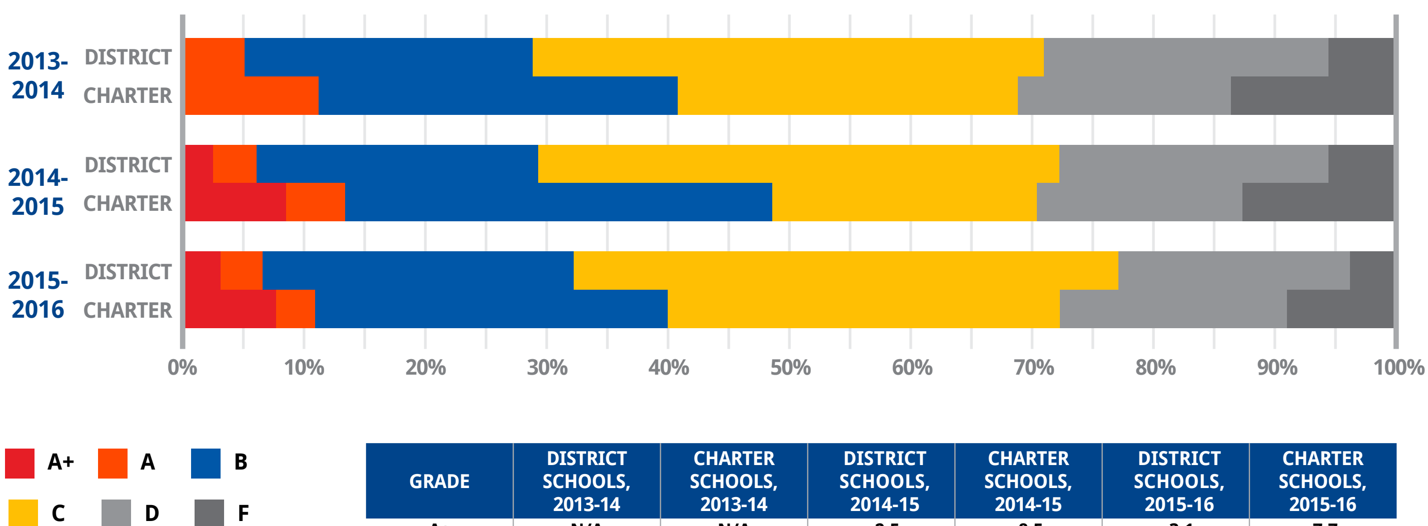
their annual appropriations or when incurring debt for capital outlay.

3. **The state should restructure the charter school funding system. State law should prohibit the practice of routing charter school funding through school districts.** Instead, all charter schools should receive their appropriation directly from its source, whenever possible.

NC Charter Schools Allotted Average Daily Membership (ADM)



Percentage Distribution of Performance Grades for District and Charter Schools



Note: Due to rounding, the percent of schools may not total 100%.

GRADE	DISTRICT SCHOOLS, 2013-14	CHARTER SCHOOLS, 2013-14	DISTRICT SCHOOLS, 2014-15	CHARTER SCHOOLS, 2014-15	DISTRICT SCHOOLS, 2015-16	CHARTER SCHOOLS, 2015-16
A+	N/A	N/A	2.5	8.5	3.1	7.7
A	5.1	11.2	3.6	4.9	3.5	3.2
B	23.7	29.6	23.2	35.2	25.6	29.0
C	42.1	28.0	43.0	21.8	44.9	32.3
D	23.4	17.6	22.2	16.9	19.1	18.7
F	5.6	13.6	5.6	12.7	3.8	9.0

Federal Education Policy

Analyst: Dr. Terry Stoops
Director of Education Studies

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

Since the rise of federal activism after World War II, Congress has continued to enlarge the federal government's financial and regulatory role in public education. By the late 1960s, the federal government had committed to redistributing federal revenues to supplement state education expenditures for special-needs children (IDEA), low-income students (Title I), child nutrition (National School Lunch Program), and vocational education (Perkins).

At no time before had the federal government's role been larger, or more controversial, than the reauthorization of ESEA in 2002, also known as No Child Left Behind. This bipartisan law imposed new testing, reporting, and accountability requirements on states, which they begrudgingly implemented to keep federal K-12 education dollars flowing to state coffers.

The Every Student Succeeds Act (ESSA) is the latest reauthorization of the Elementary and Secondary Education Act and borrows from the No Child Left Behind blueprint.

President Obama signed ESSA into law in December 2015, and states will begin full implementation in 2017-18. In the meantime, federal education officials will establish specific rules, requirements, and guidance for states.

ESSA will continue to give the federal government a sizable presence in state accountability efforts. States must select specific types of accountability measures and goals as part of a broad accountability plan that will be submitted to the U.S. Department of Education for approval. State education officials are also required to identify and initiate research-based interventions in the state's lowest-performing schools.

Similar to No Child Left Behind, ESSA requires states to administer math and reading tests to students in grades 3-8 and in high school. States must report those results in the aggregate and by student racial and demographic subgroups. State education officials have limited flexibility to choose the tests and how they are administered.

While ESSA is an improvement over No Child Left Behind, it preserves strong federal oversight of the nation's public schools, which has come to include increasingly aggressive advocacy by the U.S. Department of Education's Office of Civil Rights.

The federal government's growing financial and ideological encroachment into public education, by Republicans and Democrats alike, invites the kind of centralization of public schooling almost universally feared by the Founding Fathers and wisely resisted by subsequent generations of American citizens.

Key Facts

- While the vast majority of federal education funds are earmarked for special-needs children, low-income students, child nutrition, and vocational education, occasionally Congress will authorize discretionary, multiyear initiatives, such as the American Recovery and Reinvestment Act (also called the "Stimulus"), the Education Jobs Fund, and Race to the Top.
- Current expense expenditures from federal funds totaled $1.45 billion and accounted for only 12 percent of North Carolina's $12.6 billion public school operating budget for the 2014-15 school year. Virtually none of the state's capital expenditures included federal funds and seldom do.
- During the 2015-16 school year, North Carolina school districts used federal funds to support 12,614 public school employees or 7.3 percent of all district school personnel in the state.

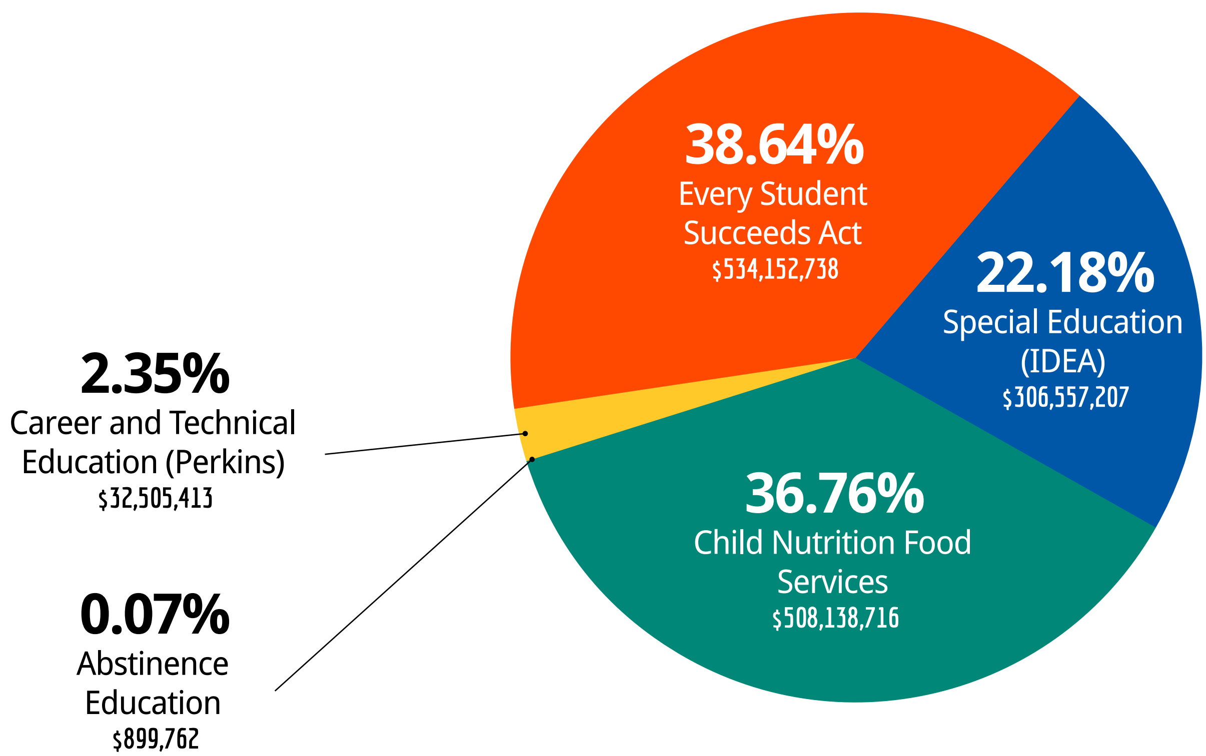
Recommendations

1. **Recognize that there is no such thing as "free money" from the federal government. Ever.** No state has ever received federal education funding without strings attached.
2. **Acknowledge that federal funds do not appear out**

of thin air. Current and future taxpayers, not elected officials and bureaucrats in Washington, D.C., bear the burden of repaying every dollar spent or borrowed by the federal government.

3. **Refuse to accept any federal grant that imposes an extraordinary burden on school administrators or interferes with the duties and responsibilities of classroom teachers.** The first question that should be asked is, "Will these federal funds detract, in any way, from school supervision or classroom instruction?"
4. **If using federal funds, use them prudently.** For example, school districts should reject invitations to use temporary federal grant dollars to fund permanent teaching positions.

Federal K-12 Education Grant Funding, 2015-2016



North Carolina Education Lottery

Analyst: Jon Sanders
Director of Regulatory Studies

The North Carolina Education Lottery is a very visible contributor to education funding in the state. That is the case even though the lottery has given less and less of a share of its proceeds to education over the years, with more and more going into prizes, administrative costs, and advertising.

Its visibility, through noisy advertisements and media amplification, would make the "education lottery" seem irreplaceable. Nevertheless, there are very real concerns over the lottery's actual effects on education spending.

Going further, people on both sides of the political aisle worry about the lottery's effects on North Carolinians, especially the poorest, least educated, and most economically desperate. The lottery itself was born of corruption: from its inception as a bill, to its lobbying, to its rushed enactment despite a constitutional requirement that revenue bills face multiple votes on successive days.

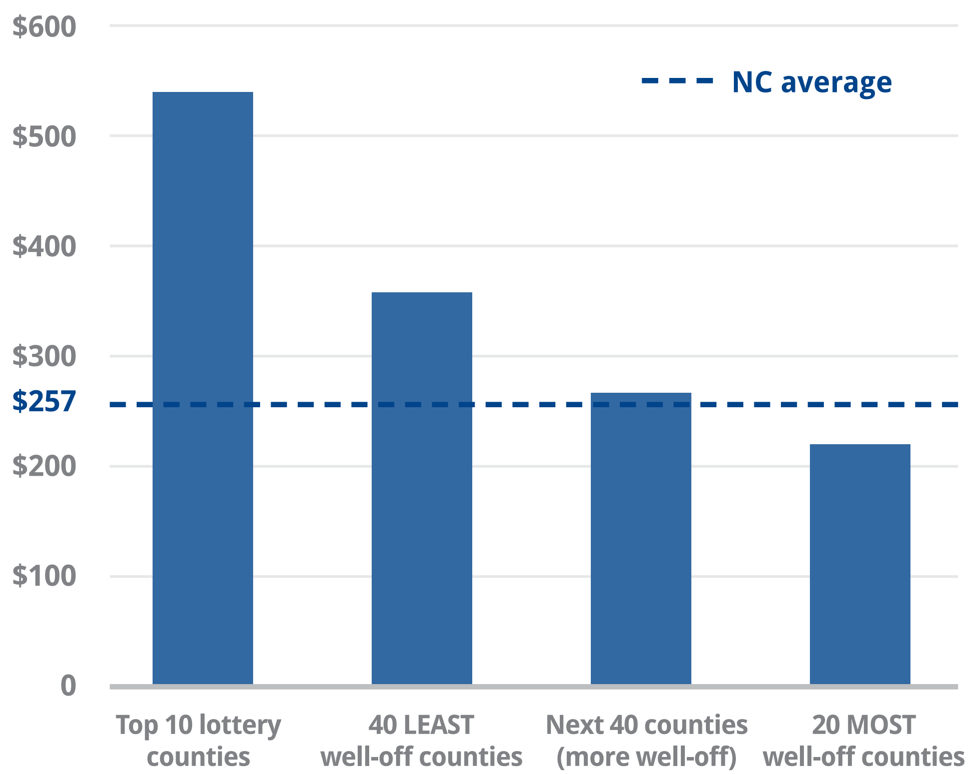
Key Facts

- The North Carolina Education Lottery was sold as a way to boost education spending in North Carolina. State education lotteries typically fail to deliver on that promise, as years of research has shown.
- States with education lotteries tend to have a declining rate of spending for education, especially compared with the rest of the budget. Some speculate that having an education lottery makes people and lawmakers think education needs are taken care of. This means they are less likely to regard other possible expenditures as competing with school funding for scarce dollars. As a consequence, those other budget choices get more favorable reception in appropriations decisions.
- Sometimes this supplanting is done directly instead of unwittingly. For example, in early 2006, before the first lottery ticket was even sold, Gov. Mike Easley announced that half of the expected lottery revenues would go to replace current education spending. In 2009 Gov. Bev Perdue transferred $50 million from the Lottery Reserve into the General Fund, as well as $37.6 million intended for school construction (later returned).
- Either way, what was expected to be new money in addition to an ongoing funding stream winds up basically taking the place of some of the funding in the stream.
- The lottery is a state funding source that many North Carolinians on both sides of the political aisle consider immoral. They think so either because of (a) religious objections to gambling, (b) ethical objections to taking advantage of the poor and undereducated, or (c) both. These concerns are heightened by the lottery being a state monopoly.
- Originally, over one-third (35 percent) of lottery proceeds would go to education funding. By 2013, that proportion going to education funding was down to 28 percent.
- By 2016, the share of lottery proceeds going to education was under one-fourth (24.5 percent).
- Counties with high poverty, unemployment, and property tax rates also tend to have high lottery sales per adult.
- In 2015, the top 10 counties in lottery sales per adult were among the least economically well-off counties in the state.
- Lottery sales per adult in those counties were nearly two-and-a-half times higher than in the 20 most well-off counties in the state.
- The best possible reform to address the many concerns about the state lottery would be to end the state lottery and return to a more direct, transparent form of education funding. That is, through the General Fund, after open debate and discussion.
- Ending the lottery monopoly wouldn't necessarily mean an end to the idea of gambling revenues helping fund education. If state leaders chose to legalize gambling, that would allow industries, games, and related jobs to develop. Those would contribute through responsible taxation to education spending and the General Fund.

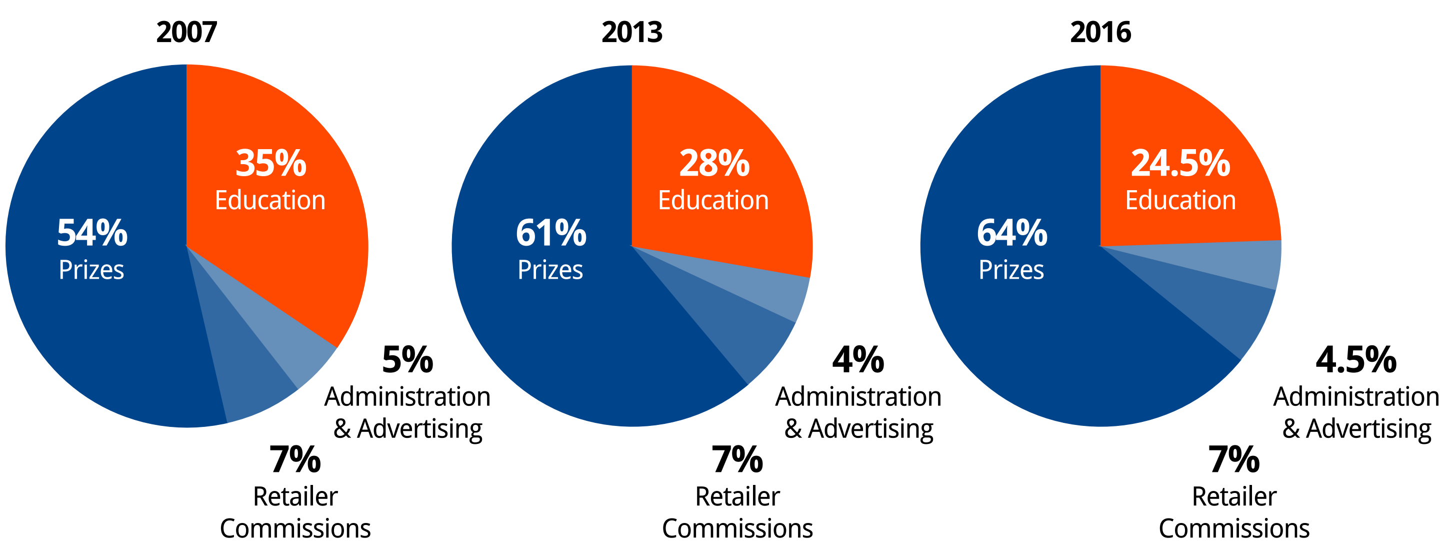
Recommendation

1. End the state lottery and return to direct, transparent education funding. North Carolina shouldn't have a gambling monopoly in place giving one dollar to the state for education for every four it gets mostly from poor pockets across the state.

NC Lottery Ticket Sales Per Adult, FY 2015



Distribution of NC Education Lottery Revenues Over Time



Note: County sales may be influenced by commuting, tourism, interstate travel, etc.
Source: NC Education Lottery (sales), NC Department of Commerce (county economic well-being)

Eminent Domain

Analyst: Jon Guze
Director of Legal Studies

The U.S. Supreme Court shocked the country in 2005 when—in *Kelo v. City of New London*—it upheld the use of eminent domain to force working-class citizens out of their homes so that the land could be given to a private corporation for "high-end" commercial development. In response to *Kelo* most states took steps to protect their citizens from this kind of eminent domain abuse, but North Carolina still hasn't done so.

Our failure to adequately protect the property rights of our citizens is one of the primary reasons why, when it comes to regulatory freedom, North Carolina languishes in the bottom third of states, both nationally and regionally. If we truly want to be "first in freedom," we must take decisive steps to prevent eminent domain abuse under state law.

Key Facts

- The issue in *Kelo* was whether New London's use of eminent domain to transfer property from one private party to another for the sake of economic development violated the Takings Clause of the Fifth Amendment to the U.S. Constitution ("Nor shall private property be taken for public use without just compensation").
- The Court held that, while the Clause might forbid transfers from one private party to another "for the purpose of conferring a benefit on a particular private party," it does not forbid such transfers when they serve a "public purpose" like promoting economic development. It also held that the question of whether a taking serves a public purpose is not one federal courts should attempt to answer. Instead, state and local governments need to be allowed to determine for themselves "what public needs justify the use of the takings power." *At the end of the opinion the Court added, "We emphasize that nothing in our opinion precludes any State from placing further restrictions on its exercise of the takings power."*
- In the years since *Kelo*, most states have taken steps to protect property owners from eminent domain abuse under state law, and states in the Southeast have done particularly well. Almost every state in the region has adopted highly effective measures. The measures adopted by Florida and Virginia are generally regarded as the best in the country.
- North Carolina has yet to do anything in response to *Kelo*, despite the fact that our state constitution is the only one that does not deal explicitly with eminent domain.
- With admirable diligence, several members of the N.C. House of Representatives have tried repeatedly to add an eminent domain clause to the Constitution and to make the sections of the General Statutes that deal with eminent domain more restrictive, but without success.
- Their most recent attempt consisted of a proposed constitutional amendment stating:

  > *Private property shall not be taken by eminent domain except for a public use. Just compensation shall be paid and shall be determined by a jury at the request of either party.*

- Unfortunately, this would have merely echoed the language of the Fifth Amendment, which—as the Supreme Court demonstrated in *Kelo*—can be interpreted in a way that makes it ineffectual.

Recommendations

Provide protections against eminent domain abuse under North Carolina state law that are as effective as the ones provided by Virginia and Florida. Ideally, these will include a constitutional amendment that:

1. States explicitly that private property may only be taken for public use and with just compensation.
2. Stipulates that the question of whether a taking complies with the public-use requirement must be decided by a court without deference to any legislative or administrative determination.
3. Defines public use in a way that forbids transfers from one private party to another for the sake of economic development and permits such transfers only when the property is needed by a common carrier or public utility to carry out its public mission or, in cases of blight, when the physical condition of the property poses an imminent threat to health or safety.
4. Defines just compensation in a way that ensures that property owners are reimbursed for all of their losses and costs, including loss of access, loss of business goodwill, relocation costs, and reasonable attorneys' fees.

Report Cards: Eminent Domain Laws in the Southeastern United States

Source: Castle Coalition

Civil Asset Forfeiture

Analyst: Jon Guze
Director of Legal Studies

Civil asset forfeiture is a legal process that empowers government agents to confiscate property when they suspect it was used for, or derived from, criminal activity. Because it is a civil action, the agents' suspicions do not need to be proved beyond a reasonable doubt—a "preponderance of the evidence" is sufficient. And because the action is against the property itself, the owner does not need to be charged with, let alone convicted of, a crime.

Civil asset forfeiture is inherently unjust and a violation of due process. Worse still, it perverts the proper relationship between the police and the public by turning the former into predators and the latter into their prey.

When it comes to protecting citizens from this abusive practice, North Carolina has always been a leader. Under North Carolina's criminal statutes, before property can be forfeited, the owner must generally be convicted of a crime, and, under North Carolina's Constitution, after property has been forfeited, the proceeds must always be used for "maintaining free public schools."

Unfortunately, these protections under North Carolina law have been increasingly undermined by federal "asset-sharing" programs. Under these programs, state and local police departments are encouraged to work with federal law enforcement agencies to seize and process assets under federal law. In return, they receive the bulk of the proceeds for their own use. To continue to lead, North Carolina must take steps to prevent, or severely curtail, participation by state agencies in these asset-sharing programs.

Key Facts

- The federal government revived the practice of civil asset forfeiture in the 1970s as a novel weapon in the War on Drugs. Its use by federal agencies has expanded rapidly since then. In 2014, U.S. Department of Justice seizures alone were worth $4.5 billion.
- Inspired by the federal example, most states adopted civil asset forfeiture laws of their own, but, to its credit, North Carolina did not. The features of North Carolina's forfeiture law listed above have been praised in repeated editions of the Institute for Justice's "Policing for Profit" report. Last year, North Carolina earned the top score in a report by Freedom Works titled, "Civil Asset Forfeiture: Grading the States."
- As noted, the Department of Justice (DOJ) has used asset-sharing programs to encourage state and local police departments to seize assets under federal forfeiture laws. Between 2000 and 2013, the DOJ alone returned $4.7 billion in shared assets to state and local agencies.
- According to the Institute for Justice (IJ), "When civil forfeiture is more difficult and less financially rewarding under state law, law enforcement agencies turn to federal asset sharing instead." This is what has happened in North Carolina. IJ ranks North Carolina among the 10 worst states in terms of asset sharing and notes that, "Law enforcement agencies in the Tar Heel State received more than $162 million in DOJ proceeds between the 2000 and 2013 calendar years [and] over $42 million from the Treasury Department."
- The best solution for North Carolina—and for the rest of the country—would be for the federal government to cut back or abolish its asset-sharing programs, and this may eventually happen. In the meantime, however, the states must take steps to curtail federal asset sharing under their own laws.
- New Mexico and Nebraska have already taken steps to do so. Recently enacted bills in both states not only abolished civil asset forfeiture under state law; they also imposed monetary thresholds that must be met before state agencies can participate in federal asset-sharing programs. The thresholds are $50,000 and $25,000 respectively.

Recommendations

1. Ideally, North Carolina should eliminate federal asset-sharing altogether.
2. If federal sharing is permitted to continue, it must be severely restricted. There should be a high monetary threshold. The police should be required to show, by clear and convincing evidence, that the owner of the seized property knew it was used for or derived from criminal activity. The state should ensure that shared proceeds are deposited in the General Fund and used for public education or tax cuts, rather than returned to the police department that seized the property.

Juvenile Justice

Analyst: Jon Guze
Director of Legal Studies

Whereas most states have stopped treating minors as adults for criminal justice purposes, in North Carolina the age of juvenile jurisdiction remains the same as it was in 1909. This is unfortunate. Compared to what happens in other states, processing 16- and 17-year-old offenders through the adult system results in higher costs and higher rates of crime. It also results in worse outcomes for the offenders themselves. It's time to raise the age of juvenile jurisdiction in North Carolina.

Key Facts

- In 41 states and the District of Columbia, the age of juvenile jurisdiction is now 18, which means that in all of these jurisdictions, 16- and 17-year-olds are ordinarily processed through the juvenile justice system.
- In seven states the age of juvenile jurisdiction is 17, but two of them, Louisiana and South Carolina, are considering proposals to raise it to 18.
- Only New York and North Carolina set the age of juvenile jurisdiction at 16, and in New York a reverse waiver provision makes it possible for 16-year-olds to petition for juvenile jurisdiction. **That leaves North Carolina as the only state where all 16-year-olds end up in the adult system as a matter of course.**
- Minors in the adult system are at higher risk of suicide and are more likely to be the victims of both sexual and physical violence than those in the juvenile justice system.
- Minors in the adult system have less access to education and other age-specific programming than those in the juvenile justice system, putting them at a serious disadvantage upon release.
- Only 6 percent of minors in the adult system in North Carolina are charged with crimes of violence, and only 3 percent are charged with serious felonies.
- Minors incarcerated in adult facilities are more likely to reoffend than minors who are incarcerated in juvenile facilities. As a result, raising the age of juvenile jurisdiction tends to reduce recidivism rates.
- A study commissioned by the General Assembly's Youth Accountability Planning Task Force projected that raising the age of juvenile jurisdiction would yield a net economic benefit to North Carolina of $52.3 million. The benefits would include reduced costs to taxpayers, reduced losses to crime victims, and increased earnings by juvenile offenders.
- In 2015 N.C. Chief Justice Mark Martin convened the N.C. Commission on the Administration of Law & Justice to evaluate the state judicial system and make recommendations. Its Criminal Investigation & Adjudication Committee is currently working on a proposal to raise the age of juvenile jurisdiction in North Carolina. The proposal will be published in 2017.

Recommendations

1. Raise the age of juvenile jurisdiction to 18, at least for nonviolent, minor crimes.
2. Preserve the current provision in the law that permits transfer to adult jurisdictions for minors who are accused of major, violent crimes and requires it for minors who are accused of first-degree murder.
3. Mitigate stresses on the existing juvenile system by developing an implementation plan that raises the age in increments with a corresponding incremental transfer of resources from the adult system to the juvenile system.

Regulatory Reform

Analyst: Jon Sanders
Director of Regulatory Studies

North Carolina's regulatory environment has improved steadily in recent years. The General Assembly under Republican leadership has passed Regulatory Reform Acts annually since 2011.

This effort is making North Carolina a national model for other states seeking ways to boost employment and job creation by giving risk-takers and job creators ever more room to move. Still, more work remains.

Key Facts

- The vast majority of studies of the effects of government regulation conclude that it harms economic growth.
- Economist Clyde Wayne Crews Jr. estimated that federal regulation cost American consumers and businesses $1.88 trillion in 2014, in terms of lost economic productivity and higher prices.
- Economists John W. Dawson of Appalachian State and John J. Seater of N.C. State found that, thanks to increasing red tape and regulation going back to 1949, the U.S. economy is only about one-fourth the size it could be.
- They computed the opportunity cost of federal regulations to be $277,100 per household and $129,300 per person. So without overregulation, the average household would have living standards enjoyed now by only the top echelon of society.
- Those estimates are for federal regulations. What about state regulations?
- A 2015 study by economists at Beacon Hill Institute at Suffolk University asked that question. Economists estimated that the burden imposed by state regulations in North Carolina on the private sector in 2015 was up to $25.5 billion. That is for just one year.
- The John Locke Foundation's First in Freedom Index ranked North Carolina's regulatory freedom 36th out of the 50 states — eighth out of the 12 Southeastern states.
- Areas for improvement identified by the Index include: restrictive certificate-of-need regulations, state benefits mandates on private health plans, burdensome insurance regulations for automobiles and homes, and extensive occupational licensing rules.
- In 2013, the General Assembly enacted a significant reform for administrative rules: sunset provisions with periodic review. By March 2016, over 6,000 total rules had been reviewed. Over half were retained, about one-third will undergo the readoption process, and 11 percent will be removed.
- The next step in reform could be a red tape reduction effort, such as seen in British Columbia (B.C.).
- In 2001, B.C. struggled to emerge from its "dismal decade." Leaders saw that B.C.'s regulatory burden was strangling the province's economic growth, so they committed to reducing it by one-third in three years. By 2004 they had cut out so much red tape they had reduced overall regulation by an astonishing 37 percent.
- Part of this reform involved giving up two to five old regulatory requirements for each new one. After reaching their goal, they capped it with a policy of no net increase in regulatory requirements (so any new regulation would require giving up an old one).
- So B.C. not only succeeded in reducing red tape, they also sustained their success. That's what inspired Canada's Red Tape Reduction Act of 2015, which requires the Canadian government to get rid of at least one regulation for each new one introduced.
- Another reform North Carolina leaders should consider is adding sunrise provisions to complement sunset provisions. Sunrise provisions affect new regulations before they are adopted.
- Regulations are basically laws made by executive agencies, using powers given them by the legislature. This makes sense when regulations are minor, but what if they're not?
- Agencies are staffed by bureaucrats who are not directly accountable to voters, and regulations are much easier to institute than laws. As a result, over 99 percent of proposed regulations in North Carolina ultimately come into effect, whereas fewer than one in five bills do.
- Because they are accountable to the voters for passing laws, legislators should have a direct say over regulations with major economic implications for the state. Regulations that meet a certain threshold for economic impact

(an example could be $5 million over a five-year period) should require approval from the General Assembly before they can be implemented.

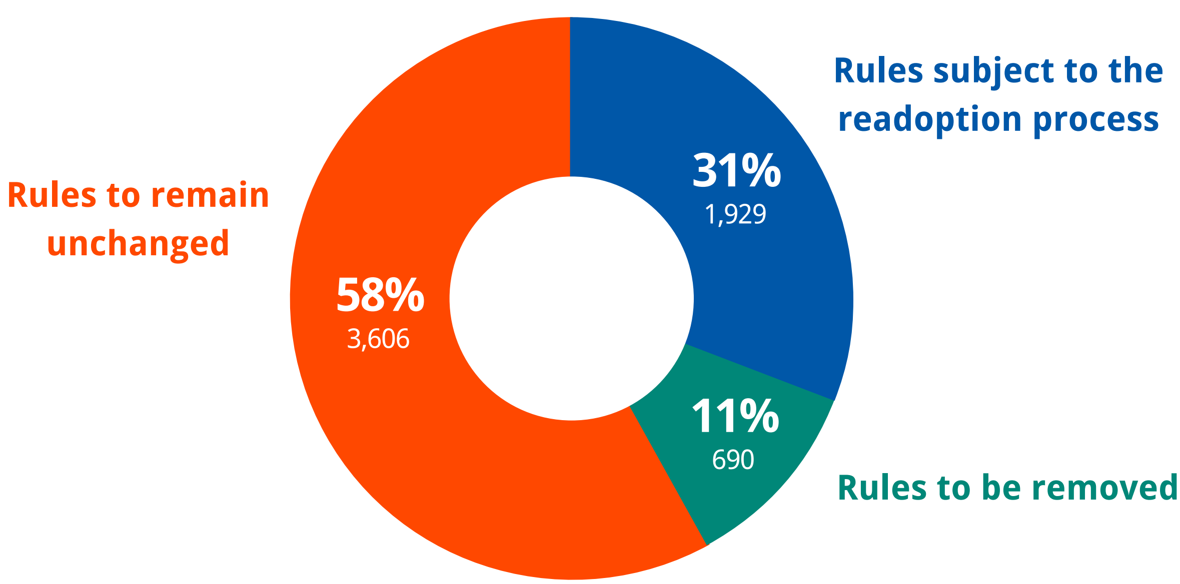
- Regulatory compliance is more expensive for small businesses, which make up 98 percent of North Carolina employers. The federal government and most U.S. states have adopted small business flexibility analysis to help mitigate this cost disparity. North Carolina is one of six states without it.
- There are roughly 25,000 individual regulations in the 30 Titles of the North Carolina Administrative Code. That's a breeding ground for compliance problems and over-criminalization.
- Furthermore, especially in crafting regulations, mens rea protection gets overlooked. *Mens rea* is common-law protection for someone who may break a law unwittingly, without meaning to.
- Enacting a default *mens rea* statute would mean that *mens rea* is considered present in a law or regulation unless lawmakers or regulators deliberately stipulated strict liability.

Recommendations

1. Set up a Red Tape Reduction initiative like British Columbia's, including capping overall regulations once the reduction target is achieved.
2. Require any proposed regulation that would have major economic impact on the state to receive direct approval from the legislature before being implemented.
3. Enact small business flexibility analysis and default *mens rea* statutes.

How NC's Sunset Provision with Periodic Review Is Working

Of the 6,225 rules reviewed as of March 2016



Source: Office of Administrative Hearings

Renewable Energy Portfolio Standard

Analyst: Jon Sanders
Director of Regulatory Studies

Households in North Carolina get electricity from a monopoly provider. In return for a guaranteed consumer base, electric utilities are expected to provide reliable power.

Utilities were also expected to provide the *least-cost* reliable power. That changed when the Renewable Energy and Energy Efficiency Portfolio Standards (REPS) law passed in 2007.

Key Facts

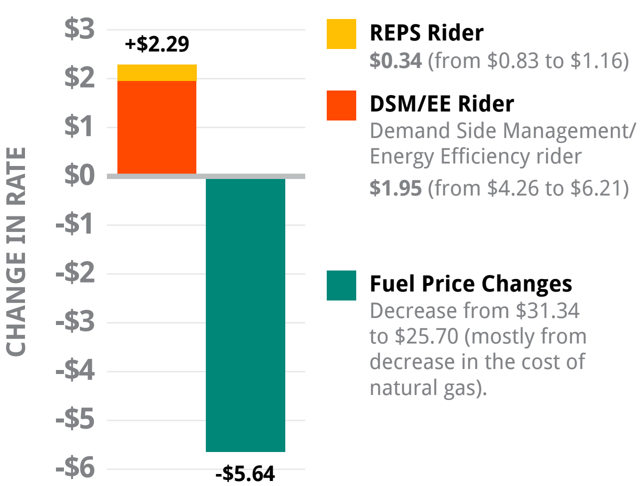
- Keeping consumers' costs as low as possible is the number one issue in electricity policy in North Carolina. Electricity is a basic human need.
- In 2015, electricity costs for the poorest North Carolina households (those earning less than $30,000 per year) averaged 9 percent of their after-tax income — a significant monthly expense.
- North Carolina has long boasted highly competitive electricity rates. That legacy is quickly being erased.
- Since North Carolina's REPS mandate took effect in 2008, North Carolina's electricity rates have increased by over twice the regional average increase and about 2.5 times the national average increase.
- From 2010 to 2014, North Carolina's REPS mandate had cost electricity consumers $276 million, according to economists at the Beacon Hill Institute at Suffolk University (BHI).
- Those additional costs were just from the lowest levels of REPS implementation. The REPS requirement was for only 3 percent of sales through 2012, going up to 6 percent through 2015 (a doubling) and 10 percent (more than tripling) in 2018.
- By 2021 and beyond, the REPS requirement is set to be 12.5 percent of sales. That is over four times the initial requirement.
- By then the REPS mandate — if the legislature allows it to be fully implemented — will have cost North Carolina about $2 billion (in 2013 dollars) and nearly 3,600 jobs, according to BHI estimates.
- Despite implications in media reports, renewable energy sources (wind and solar) aren't a one-for-one trade-off for traditional resources (coal, gas, nuclear). They are far less efficient.
- According to a Brookings Institution study by economist Charles Frank, it takes about seven solar plants and four wind plants to produce the equivalent output of a single, traditional power plant.
- But wind and solar are unreliable — the wind doesn't always blow, the sun doesn't always shine, especially not in coordination with up-to-the-minute consumer needs.
- So wind and solar still need a reliable resource — coal, gas, nuclear — always cycling in the background. That's costly and means they'll never "replace" those resources.
- Solar and wind can produce electricity at peak capacity for only a fraction of the time. So their main selling point (reducing CO2 emissions) only occurs a fraction of the time. The rest of the time they are imposing huge costs.
- Considering all those factors, Frank found solar and wind to be the most expensive ways to reduce carbon dioxide emissions in generating electricity, and natural gas to be the least.
- Energy-related CO2 emissions in the U.S. are down 12 percent since 2005, according to the U.S. Energy Information Administration. The main reason is the changeover to natural gas for electricity production.
- Researchers at the National Oceanic and Atmospheric Administration (NOAA) found that the increased use of natural gas for electricity generation (from 1997 to 2012) was responsible for lowering CO2 emissions by 23 percent, SO2 emissions by 40 percent, and NOx emissions by 44 percent.
- The European Union in 2012 classified natural gas as a green, low-carbon energy source.
- Solar and wind require far more workers per unit of energy generated than traditional energy sources.
- That may sound like it's good for employment, but only for jobs in renewable energy. It's not good for net employment, which is harmed.

- It also means that renewable energy sources are far less efficient — and more expensive — than traditional energy sources.
- Falling fuel costs, mostly in natural gas, are responsible for an actual cut in Duke Energy Progress electricity rates from 2015 to 2016, according to the Utilities Commission. They decreased by $5.64 a month for the typical residential customer.
- That is a net rate reduction. Costs imposed by the REPS law (REPS mandate and Demand Side Management/Energy Efficiency riders) went up by $2.29 a month for the typical residential customer.

Recommendation

- Cap and sunset the REPS mandate and return North Carolina to its standard of least-cost, reliable power.

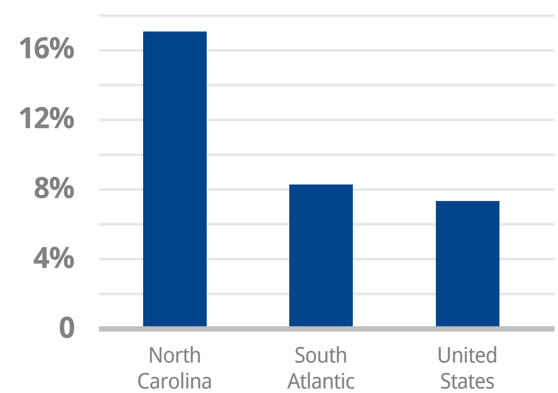
Rider Changes to Duke Energy Progress Rates, 2015-16



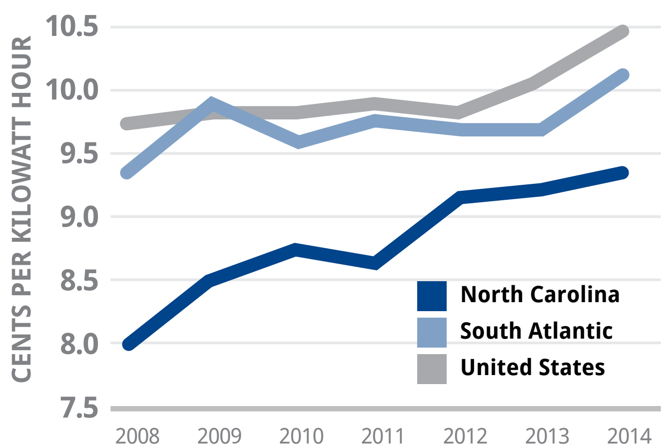
Note: Data is based on residential customers using 1,000 kWh/mo.

Source: North Carolina Utilities Commission

Percentage Increase In Average Retail Price of Electricity, 2008-14



Average Retail Price of Electricity, 2008-14



Note: Since its REPS madate took effect in 2008, North Carolina's electricity rates increased by almost 2.5 times the national average increase and over twice the regional average increase, which is quickly eroding North Carolina's legacy of highly competitive rates.

Source: U.S. Energy Information Administration

Occupational Licensing

Analyst: Jon Sanders
Director of Regulatory Studies

Everyone in North Carolina has a self-evident, inalienable right to "the enjoyment of the fruits of their own labor." That is according to North Carolina's Constitution, Article I, Section 1.

A person shouldn't have to petition and pay the state before he or she is allowed to enjoy a self-evident, inalienable right. At its core, however, that is what an occupational license requires.

Perhaps there are legitimate safety concerns behind an urge to license. But there are many other ways to ensure safety and quality before taking that extreme step.

Key Facts

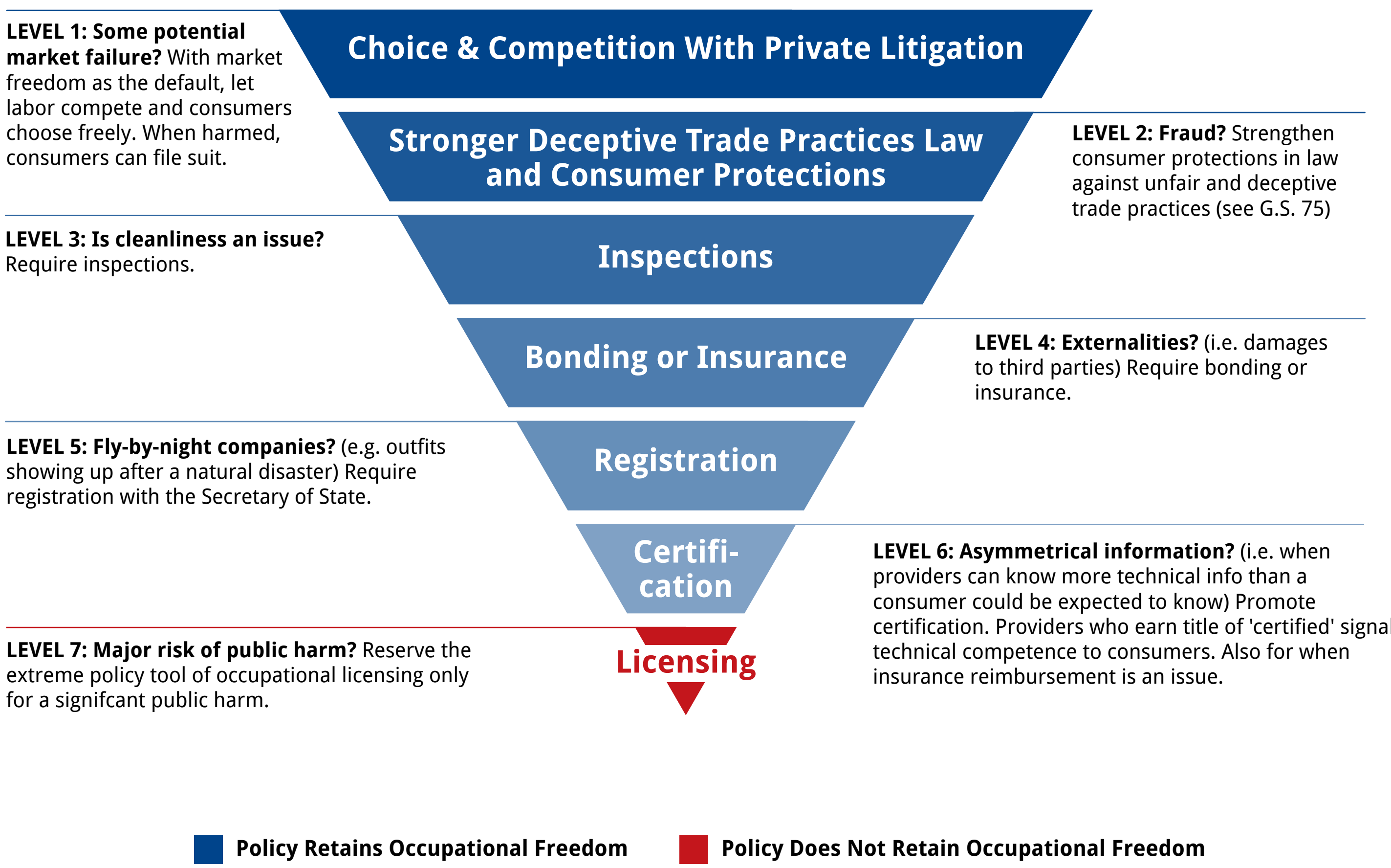
- Occupations come under state licensing supposedly to ensure safety and quality of service work.
- The most consistent finding in academic research literature on occupational licensing is not that it ensures safety and quality, however.
- Instead, it is that licensing boosts the earnings of those already in the profession by limiting the supply of competitors and driving up the price of service.
- Getting a license involves costs in money and time: satisfying educational credits, logging job experience, passing required exams, and paying license and renewal fees.
- These costs are very large hurdles for the poor, the less educated, minorities, mothers returning to the workforce, relocated military families, and older workers seeking a new career.
- Employment within an occupation grows 20 percent faster in states where it is not subject to licensure than in a state where it is.
- But states can hardly agree what occupations need licensing. Of over 1,100 state-regulated professions, only 60 (a little over 5 percent) are regulated by all states.
- That means there is widespread disagreement over whether any particular licensed profession actually poses a significant risk of harm to the public.
- North Carolina is one of the more aggressive states in terms of licensing occupations. Crossing the border into South Carolina reduces the number of licensed occupations by about two-thirds.
- According to the landmark White House report on occupational licensing released in 2015, 22 percent of North Carolina's work force is licensed by the state.
- In August 2014 the State Auditor identified 57 occupational licensing boards with over 565,000 licensees.
- From 1901 to 1969, North Carolina added a new occupational licensing agency about once every three years. From 1970 to 2008, the rate of creating new licensing agencies in North Carolina accelerated to about one every 10 months.
- Occupational licensing has grown so entrenched in North Carolina that it is difficult to get a complete accounting of licensing boards, let alone of licensed job categories.
- In December 2014 the Program Evaluation Division (PED) of the General Assembly identified 55 occupational licensing agencies in North Carolina. Among other things, PED found insufficient oversight of the agencies and recommended review and consolidation of several of them.
- The State Auditor also found that oversight of the (57) boards was ineffective, that their performance was unmeasured, and even that the official listing of boards was incomplete.
- If there are legitimate safety concerns in a profession, policymakers don't have to choose between the policy extreme of licensing or nothing. There are several options that preserve occupational freedom (see chart).
- Notably, voluntary certification addresses consumers' health and safety risks while not prohibiting entry into one's chosen field. We see voluntary certification in action all the time, such as by Underwriters Laboratories, Good Housekeeping, and the Better Business Bureau.
- Industry-specific examples of certification include the National Institute for Automotive Service Excellence for mechanics, the Associated Locksmiths of America, and the Behavioral Analyst Certification Board.
- In fact, there is even certification for private certification programs themselves, such as by the National Organization for Competency Assurance and the American National Standards Institute.

Recommendations

1. Subject licensing boards and their licenses to sunset with periodic review, eliminating questionable ones.
2. Seek policy options other than licensing first, with a strong preference for respecting the freedoms to work and to choose.
3. Expand recognition of other states' licenses.
4. Work with boards to reduce fees, education/experience requirements, and examination requirements when possible.

How to Protect Consumers and Freedom, Too

Policy options to address legitimate concerns without going the extreme of licensing



Note: Adapted from the Institute for Justice, "From Liberty to License: A Hierarchy of Regulatory Options"

Overcriminalization

Analyst: Jon Guze
Director of Legal Studies

In *The Federalist, No. 62*, James Madison, wrote:

> *"It will be of little avail to the people, that the laws are made by men of their own choice, if the laws be so voluminous that they cannot be read, or so incoherent that they cannot be understood."*

Nearly 230 years later, the list of activities that can result in a criminal conviction in North Carolina has continued to grow rapidly, and it is now far too voluminous and often incoherent, particularly for the average citizen.

The criminal code itself has grown excessively long and complex. In addition, the rules and regulations promulgated by administrative agencies have grown excessively criminalized, and, as a result, a large number of crimes—including drug and motor-vehicle offenses, regulatory crimes, and local ordinances—lie outside the state's criminal code.

Because there are so many of them, and because they are so obscure, it is impossible for ordinary citizens to know about, let alone understand, all of the laws that govern their everyday activities. Making matters worse, many of the new laws criminalize conduct that is not obviously wrong in any way. As a result, ordinary citizens cannot rely on their knowledge of the law or on intuition to alert them to the fact that they may be committing a crime.

Nevertheless, for many new crimes, and especially for many new regulatory crimes, there is no *mens rea* requirement, that is, no requirement that, in order to be convicted of the crime, the person being prosecuted must have intentionally done something he or she knew was wrong.

If we want to maintain a free and just society, we must reverse the process of overcriminalization in North Carolina.

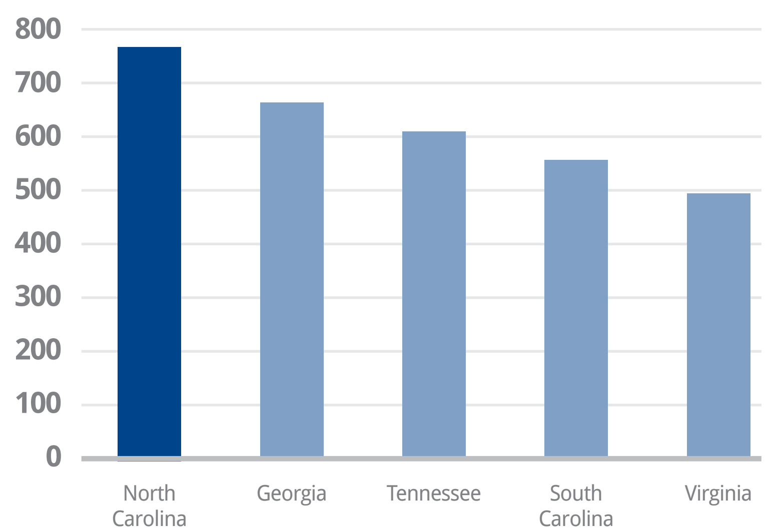
Key Facts

- North Carolina has been creating, on average, 34 crimes annually, over half of which are felonies.
- North Carolina's 765-section criminal code is now 55 percent larger than Virginia's and 38 percent larger than South Carolina's code.
- Under numerous "catchall" provisions in the General Statutes, administrative agencies and private licensing boards have criminalized entire sections of the regulatory code, including regulations dealing with public health, agriculture, and the environment.
- Many new crimes, including many new "regulatory" crimes, are strict-liability crimes, which means that criminal intent is not required for conviction. Instead, individuals can be held criminally responsible for unknowingly violating the new laws. This is particularly unfair given the number and obscurity of the new laws and given the extent to which they govern, in minute detail, a wide range of ordinary activity that is not self-evidently wrong in any way.
- Overcriminalization places individuals and small businesses in constant legal jeopardy.
- Overcriminalization wastes scarce law-enforcement resources that could otherwise be devoted to preventing and punishing serious crimes against persons and property.
- Overcriminalization reduces consistency in enforcement and erodes confidence in the rule of law.
- Other states have already started addressing the problem. Tennessee, for example, has created a commission that will make annual recommendations about which crimes can and should be eliminated, and Virginia has not only created such a commission, it has already started eliminating crimes pursuant to the commission's recommendations.

Recommendations

1. Create a bipartisan legislative task force to conduct hearings and establish guidelines for the creation of new criminal offenses. (See, Model Resolution on Regulatory Overcriminalization.)
2. Create a commission to review North Carolina's criminal statutes with the objective of consolidating, clarifying, and optimizing them.
3. Add a default *mens rea* provision to the General Statutes, i.e., a provision that would automatically make "criminal intent" a part of the definition of every crime unless the legislature specifically states otherwise.

Number of Crimes in State Criminal Codes



Source: Manhattan Institute

Direct Primary Care

Analyst: Katherine Restrepo
Director of Healthcare Policy

The excessive amount of government intervention that has encumbered our nation's health care system is pushing some physicians to scale back or cut off their relationships with middleman insurers to spend more time with their patients.

This innovative business model is known as direct primary care (DPC). In exchange for a monthly fee that covers a defined package of services, patients have guaranteed unlimited access to their physicians. DPC is similar to concierge medicine, but the key difference is that these practices deliver basic health care at an affordable price with no insurance billing whatsoever.

DPC has been around for years, but it's currently a niche market. Even so, it continues to pique physicians' interest. As of 2014, over 4,400 doctors in the U.S. had transitioned to direct health care delivery, a significant increase from just 146 in 2005. Currently, around 30 doctors in North Carolina practice in a DPC setting.

DPC restores the incredible value of personalized medicine, benefiting patients, doctors, employers, and the state.

Key Facts

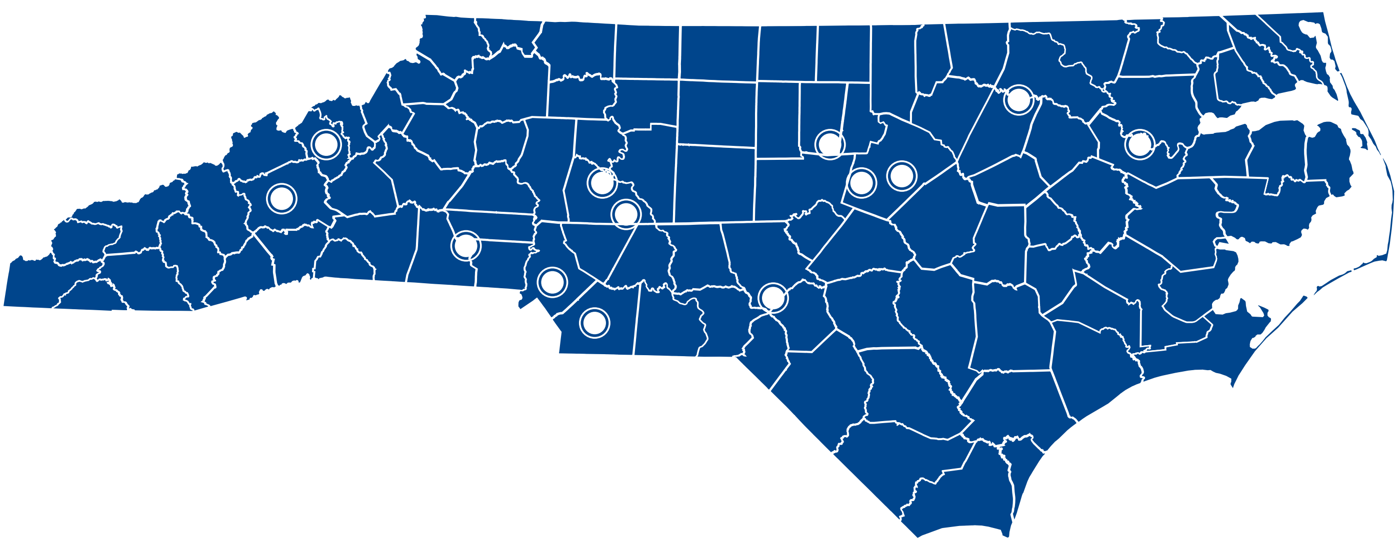
- Because primary care is relatively inexpensive to administer, DPC is an appealing option. Industry-wide data show that average monthly memberships vary from $25 to $85. In return, patients are entitled to around-the-clock care that may include services such as comprehensive annual physicals, EKG testing, joint injections, laceration repairs, and skin biopsies. North Carolina practices can even dispense prescription drugs in-house at wholesale cost.
- DPC restores the traditional doctor-patient relationship. Imagine physician practices that do not have to spend over 40 percent of practice revenue on overhead costs and personnel responsible for filing insurance claims. Opting out of insurance contracts allows smaller practices to break even on as little as four patients per day, rather than an average 32 in today's typical practice setting.
- A study conducted by University of North Carolina and North Carolina State University researchers found that patients seeking treatment from Access Healthcare, a direct care practice located in Apex, North Carolina, spent 85 percent less and enjoyed an average of 35 minutes per visit compared to eight minutes in a nondirect care practice setting.
- Fortunately, North Carolina ranks as one of the top DPC-friendly states. Unlike other state legislatures, ours does *not* subject these practices to government price controls, capped patient numbers, limited treatments, or a defined menu of services.
- Since DPC practices do not accept insurance, some question how physicians can still thrive under Obamacare's insurance mandates. Interestingly, section 10104 of the federal health law *endorses* DPC as long as it is accompanied by catastrophic health coverage that includes benefits outside of primary care. So, if patients purchase a wrap-around plan and seek care through a DPC practice, this theoretically fulfills the individual mandate.
- Since Obamacare's individual mandate requires everyone to purchase health insurance that includes preventative health care services, many perceive that direct care patients are paying twice for health care. But Americans with insurance are already committing to two payments for health care – monthly premiums in addition to co-pays and co-insurance. Direct care offers treatments for patients at lower out-of-pocket costs compared to insurance plan out-of-pocket expenses.
- While a majority of direct care takes place in small practice settings, there are DPC establishments that specialize in contracting with large self-insured employers. In North Carolina, Union County is on track to save $1 million in health care claims under its first-year contract with Paladina Health — a large-scale DPC franchise.
- Since Union County has incorporated an additional benefit option for workers to have a doctor spend more time managing their health care needs in either an on-site or near-site clinic, there has been a significant reduction in unnecessary emergency room visits, specialist referrals, and inpatient admissions.
- Another large DPC company is Qliance. Located in Seattle, Washington, Qliance's clients include Amazon and Expedia, Inc. A review of two years of health care claims data reveals that workers who opted to be treated

by Qliance saved their employers 20 percent on health care expenses compared to employees who chose a different provider. The table on the following page illustrates that an increase in direct care visits led to a reduction in specialist referrals, emergency room visits, and surgery.

Recommendations

1. For the DPC model to cater to Medicaid patients, the North Carolina Department of Health and Human Services (NCDHHS) could work within a federal waiver to administer and monitor health savings accounts (HSAs) or debit cards with a lump-sum contribution to eligible enrollees.
2. Implement a DPC benefit option for State Health Plan members.
3. Policymakers should pass legislation that simply states that direct care providers do not act as a risk-bearing entity, so that patients' monthly DPC membership fees are not classified as an insurance premium. To date, 13 states have enacted legislation that specifically defines DPC not acting as insurance. This would protect DPC providers from Department of Insurance regulations.

Proliferation of Direct Primary Care Practices



Qliance vs. Non-Qliance Patients

	INCIDENTS PER 1,000 QLIANCE PATIENTS	INCIDENTS PER 1,000 NON-QLIANCE PATIENTS	DIFFERENCE (QLIANCE VS. OTHER)	SAVINGS PER PATIENT PER YEAR
ER VISITS	81	94	-14%	($5)
INPATIENT (DAYS)	100	250	-60%	$417
SPECIALIST VISITS	7,497	8,674	-14%	$436
ADVANCED RADIOLOGY	310	434	-29%	$82
PRIMARY CARE VISITS	3,109	1,965	+58%	($251)
SAVINGS PER PATIENT				$679
TOTAL SAVINGS PER 1,000 (AFTER QLIANCE FEES)				$679,000

Certificate-of-Need Laws

Analyst: Katherine Restrepo
Director of Healthcare Policy

Certificate of Need (CON) is a regulation that limits health care supply unless a specific "need" is determined by state health care planners. If medical providers have plans to build or expand an existing health care facility, offer new services, or update major medical equipment, they will most likely have to ask permission from the State Health Coordinating Council, known as "The SHCC."

History explains Congress' intent behind enacting CON laws under the federal Health Planning Resources Development Act in 1974 — the goal was to cut down on health care cost inflation. At that time, reimbursements for services were based on the costs of production, or a cost-plus system. Providers therefore had strong incentives to build and expand the capacity of health facilities, knowing they wouldn't have to assess patient demand.

However, once the reimbursement system shifted to a fee-for-service prospective payment system, the federal government repealed the CON mandate in 1987, citing that the program did not effectively restrain health care costs. Fifteen states have since scrapped their CON programs. North Carolina burdens health care entrepreneurs with one of the most stringent CON programs in the nation, regulating over 25 services that range from kidney dialysis units to mental health services to ambulatory surgery centers (ASCs).

Despite the federal government admitting to CON's inadequacies, the SHCC argues that centralized decision-making must remain intact to prevent duplicative services and underused facilities that may yield low-quality care.

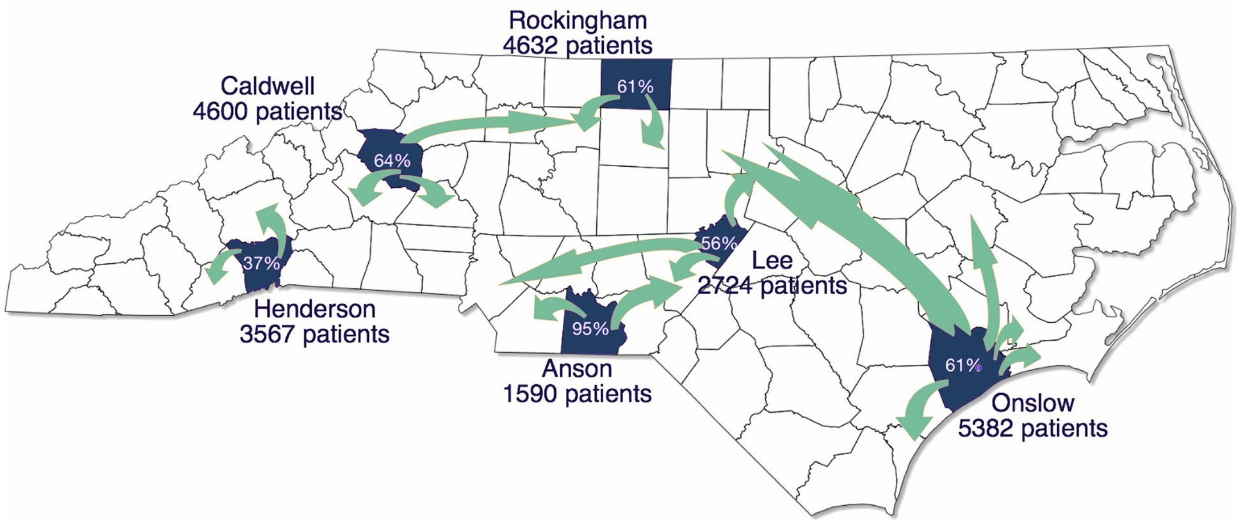
Key Facts

- CON stifles competition because competing applicants can contest the state's final CON award. Even parties *unaffiliated* with the application can appeal the state's decision. For example, Triangle Orthopedic Associates (TOA), North Carolina's largest private orthopedic practice, and Duke University Health System filed competing applications for a fixed MRI machine in 2004. TOA ended up winning the bid. While Duke did not petition against the decision, a separate company, Alliance Imaging, did. It had previously provided MRI services to TOA and feared the loss of business that would result if TOA procured its own machine.
- CON supporters agree that limiting health care supply raises health care costs. Hospitals further justify that cost-shifting health care costs onto paying patients helps offset total uncompensated care and ostensibly provides better access to indigent care. However, studies conclude that better metrics are needed to determine whether CON laws directly correlate with health systems providing more indigent care.
- CON supporters argue that the law helps preserve rural health care. For example, they contend that repealing the law could lead to a greater concentration of ambulatory surgery centers (ASCs) in more urbanized areas, which would attract more rural patients and put community hospitals at risk. But to the extent that market forces can operate under CON, patients are already migrating to access ambulatory surgical care outside of rural communities.
- Relaxing CON saves patients money and provides patients with more health care options. For example, independent ASCs – one of the facilities regulated under NC CON law – are typically reimbursed by Medicare 45 to 60 percent less for the same procedure compared to those being performed in a hospital outpatient setting. Today, over 70 percent of the 635,000 annual surgeries in North Carolina are performed in outpatient settings, and 70 percent of these surgeries are conducted in the highest-cost hospital systems.
- North Carolina did execute some reform in 2005, allowing gastroenterologists to perform colonoscopies in their own endoscopy units. Utilization of those services increased by 28 percent over four years, in part due to the state's baby-boomer population, but overall Medicare savings still amounted to more than $224 million within six years, since procedures performed in free-standing facilities are reimbursed at a lesser rate than those performed in full-service hospitals.

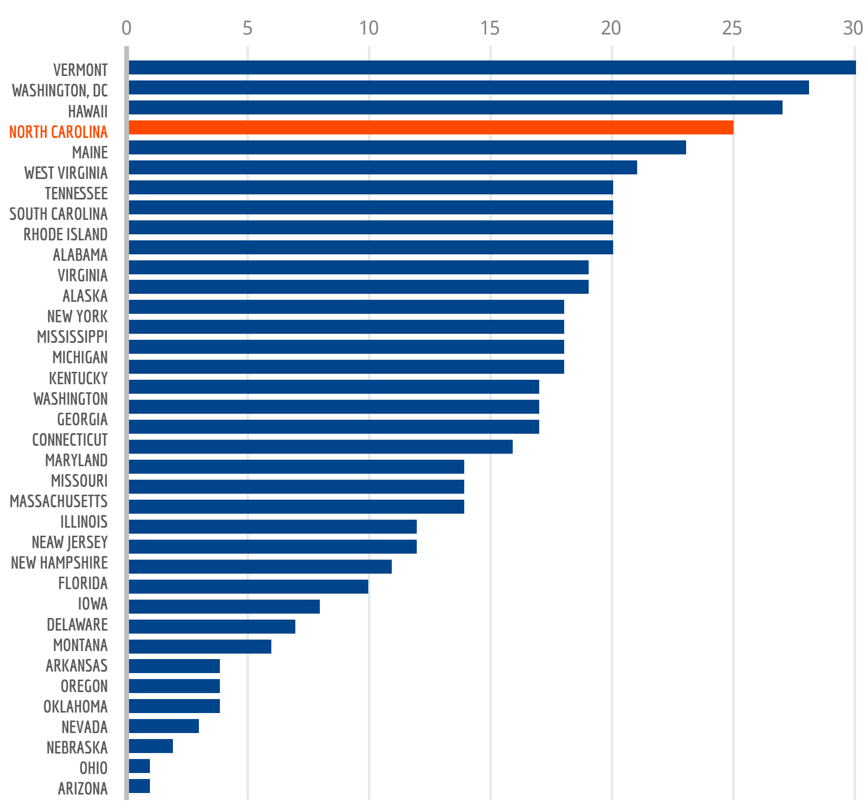
Recommendation

1. Repeal Certificate of Need.

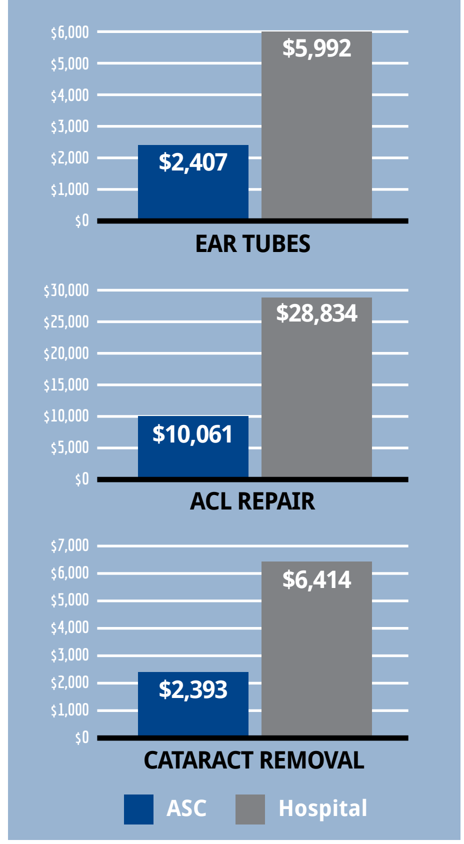
Patients Travelling For Outpatient Surgery



Ranking of States By Number of Certificate-Of-Need Laws



Cost Comparisons



Medicaid Expansion

Analyst: Katherine Restrepo
Director of Healthcare Policy

Medicaid is a program jointly funded by the state and federal governments. One of its core functions includes paying medical providers for services rendered to low-income parents and children, pregnant women, the elderly, the blind, and the disabled. The federal government currently funds two-thirds of North Carolina's $14 billion Medicaid program.

The Affordable Care Act (ACA), commonly known as Obamacare, gives states the choice to expand Medicaid eligibility to individuals earning up to 138 percent of the federal poverty level. This figure equates to an individual earning $16,242 a year or a family of four earning $33,465 a year.

If North Carolina were to expand Medicaid, the federal government promises to fully fund the cost until 2017. At that point, states will take on some of the financing, maxing out at 10 percent starting in 2020. To date, over 31 states have already gone forward with plans to expand.

Key Facts

- The federal government would be borrowing more money to fully fund a Medicaid expansion for three years, taxing future generations and applying a stronger chokehold on the federal deficit.
- Starting in 2020, expansion would cost North Carolina $6 billion over the next decade. In the longer term, this will either lead to a reduction in provider payments, diverting resources from other important parts of the budget such as education or transportation, or tax increases.
- At present, 25 percent of physicians in North Carolina do not accept new Medicaid patients.
- Expanding Medicaid eligibility puts traditional program enrollees at risk. They will have to compete with a half million more people for adequate access to health care — 82 percent of whom are able-bodied childless adults.
- Expanding eligibility levels for government health insurance programs crowds out access to private coverage. Studies indicate that the crowd-out effect contributes to the fact that six out of 10 people on Medicaid once had private coverage.
- The heavier the Medicaid caseload, the more providers will have to make up for being paid below market levels by negotiating higher payment through private carriers — ultimately passing on these costs to consumers in the form of higher premiums.
- Expanding Medicaid would add an additional 500,000 enrollees to our state's Medicaid program – of which 186,000 North Carolinians with incomes between 100-138% of the federal poverty level (FPL) would be thrown off Obamacare's subsidized private coverage Exchange plans.
- The 2008 Oregon Health Insurance Experiment (OHIE) is known as the gold standard of studies that assess Medicaid's overall effectiveness. Researchers randomly assigned eligible patients to the state's Medicaid program. Two years later, the authors detected that Medicaid had no statistically significant effect on major measures of health outcomes of those who had been chosen to participate and those who had not.
- North Carolina can learn from other states that have expanded eligibility to this population in the past. Arizona's expansion in 2002 originally projected slow enrollment growth, maintainable costs, a reduction in the number of uninsured, and reduced uncompensated care. All four of these projections were turned upside down. The expanded population (mostly childless adults) ended up costing two to four times more than low-income parents. Similar outcomes occurred in Oregon, Delaware, Maine, Washington, D.C., Utah, and Vermont.

Recommendations

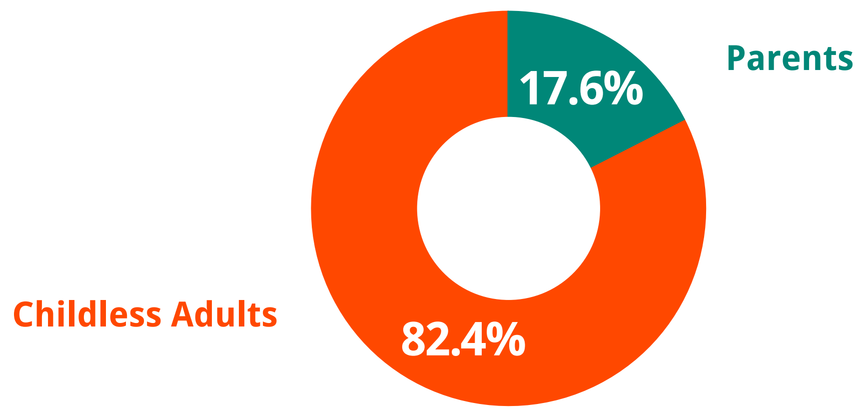
Medicaid can be thought of as multiple programs for different types of patients. It would be wise for Congress to grant North Carolina even more flexibility with its Medicaid reform plans by reconstructing the Medicaid program in its entirety:

1. Congress should allow states to have more flexibility experimenting with their long-term care Medicaid caseload.
2. Offer a universal refundable tax credit to able-bodied, working Medicaid patients and their dependents to offset the cost of private health plans sold on the

individual policyholder market. Shifting acute care patients onto the health insurance exchanges can reduce government dependence in the long term and instill consumer awareness and promote patient choice.

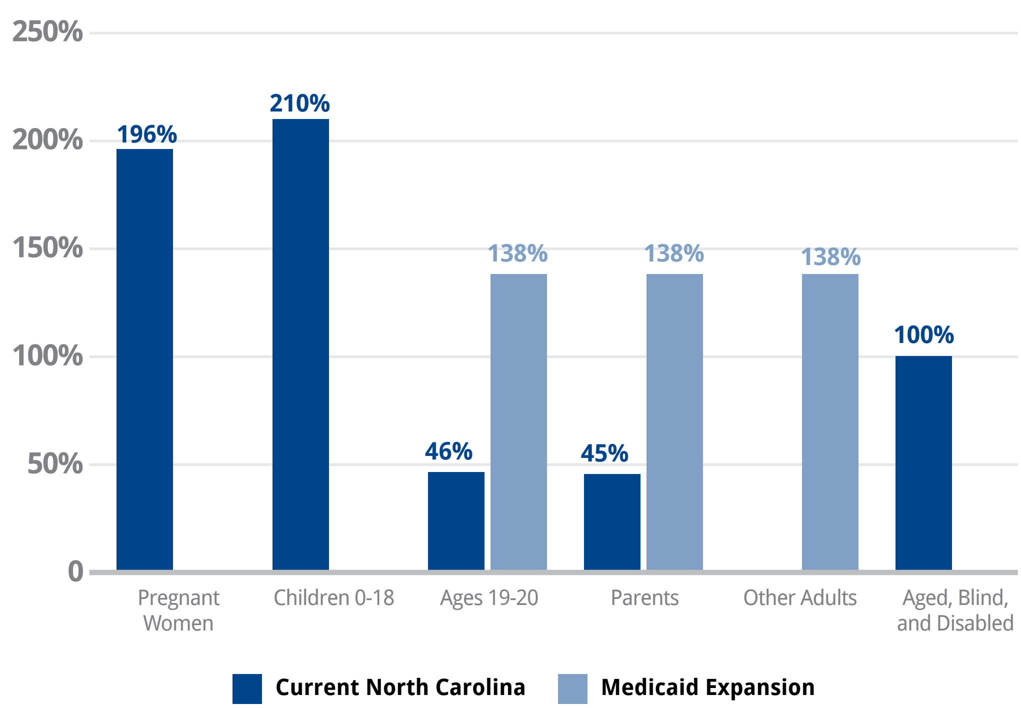
3. Change Medicaid's financial design. Historically, the federal government foots two-thirds of North Carolina's Medicaid bill. The match rate has produced perverse incentives for states to expand optional benefits or program eligibility since the program's inception in 1965. A federal block grant allocated to states will instead push North Carolina to budget accordingly with a defined amount of resources and take full ownership of any additional state Medicaid spending as policymakers see fit.
4. Funding a Medicaid expansion won't solve our nation's pervasive health care access problem. Congress should focus more on relaxing regulations that make health care more affordable, and less on how to extend health insurance for all.

Medicaid Expansion Gap Population



Source: Urban Institute

Medicaid Income Eligibility Categories in North Carolina: Current and Expanded



Source: Wake Forest University School of Law

Health Insurance Exchanges

Analyst: Katherine Restrepo
Director of Healthcare Policy

One of the Affordable Care Act's (ACA) key provisions is the implementation of health insurance exchanges — online marketplaces where individuals can shop for federally qualified health plans offered by participating insurance companies. Through the exchanges, the Obama administration intends to offer affordable, quality health care coverage and prohibits insurers from denying patients with pre-existing conditions. Consumers eligible to purchase an individual health policy through North Carolina's exchange do not receive health benefits through their employer and are not eligible for Medicare or Medicaid.

Key Facts

- The Affordable Care Act's health insurance exchanges offer four "metallic" levels of health plans: bronze, silver, gold, and platinum. Low-premium bronze plans cover 60 percent of expenses but require consumers to be responsible for higher out-of-pocket expenses, including co-pays, co-insurance, and deductibles. Platinum plans come with the most expensive premiums but cover 90 percent of expenses.
- Consumers with annual household incomes between 100 and 400 percent of the federal poverty level (FPL) may qualify for subsidies to offset some of the cost of insurance premiums. For a single-member household, the dollar amount ranges from $11,770 to $47,080. However, subsidy amounts greatly tail off beyond 250 percent of FPL (approximately $29,425 for an individual).
- Community-rating under the ACA mandates that a high-risk individual cannot be charged more than three times the amount of a low-risk individual's premium. This results in the elderly and sick benefiting at the expense of the young and healthy, because these low-risk individuals will pay higher premiums to subsidize the health care costs of the high-risk population. For the exchanges to maintain a balanced risk pool, the Obama administration projected that healthy 18-34-year-olds need to represent 40% of total enrollees. Of North Carolina's 600,000 enrollees, just 27% of signups are in this demographic.
- The individual mandate, in which the federal government makes the purchase of health insurance compulsory, is the centerpiece to the exchanges' viability. However, the exchange insurance market is unstable because weak tax penalties and a multitude of special exemptions make it a disincentive for low-risk consumers to sign up.
- Only two insurance companies offer plans on North Carolina's exchange - Blue Cross and Blue Shield (BCBS NC) and Cigna. BCBS NC is the only insurer operating in all 100 counties in the state. Cigna will begin offering plans in just five counties in the Raleigh/Durham area in 2017. In other words, 95 percent of North Carolina's counties will have Blue Cross and Blue Shield as the only insurance carrier offering non-group policies.
- UnitedHealth Group recently announced its exodus from North Carolina's exchange, citing that its operating structure and federal regulations that prohibit companies from accurately pricing policyholder risk have resulted in the carrier losing hundreds of millions of dollars on its Obamacare line of business nationwide. Aetna has subsequently announced its departure from 70 percent of its exchange market nationwide, inclusive of its entire market presence in North Carolina. Within the first two fiscal quarters of 2016, the company suffered $200 million in losses.
- BCBS NC has suffered losses of $400 million within two years on its exchange business, largely because medical claims are outpacing premium revenue. Just 5 percent of its customers incurred $830 million in health care costs during the first year of the law's exchange rollout in 2014. The carrier received just $75 million in revenue from collected premiums and federal funds from this population.
- BCBS NC has asked the North Carolina Department of Insurance (DOI) to be able to increase their 2017 Obamacare plan rates by an average of 18.8%.

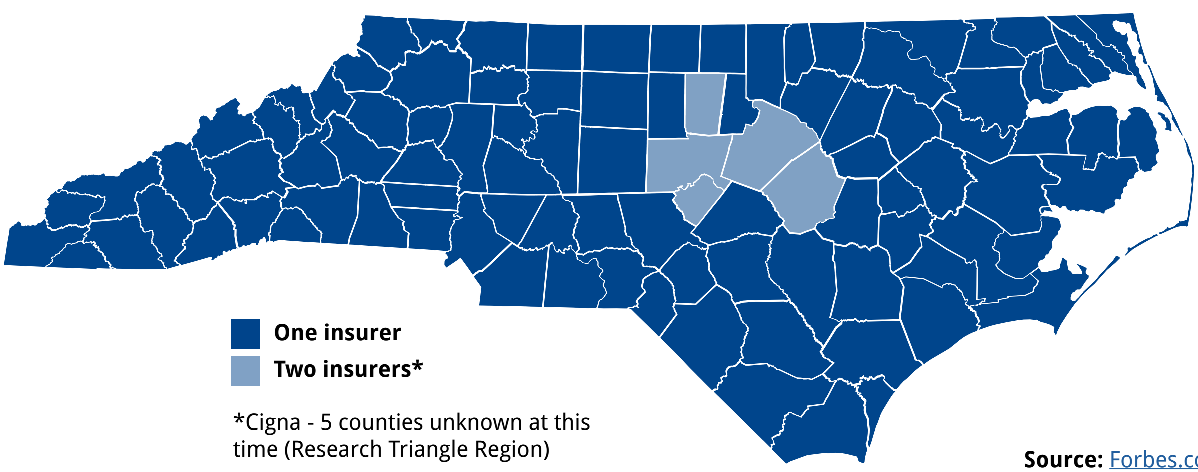
Recommendations

1. The Affordable Care Act has failed to live up to its name. The following consumer-driven principles could achieve real health care reform that emphasizes patient choice, affordability, access, and competition:

– Grant states - not Washington bureaucrats - total authority to create health plans that meet consumer preferences and demands.
– A refundable, universal tax credit could provide affordable private coverage for low-income patients.
– Repeal Obamacare regulations on Health Savings Account contribution limits.

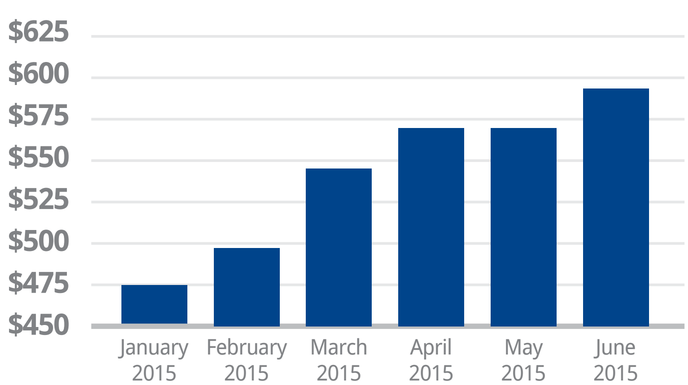
2. Let market innovations and state-based high-risk pools take care of the problem of individuals being denied health insurance coverage because of pre-existing conditions. Health insurance companies should offer health-status insurance to assist those with pre-existing conditions and prevent individuals from being priced out of the health insurance market if their health drastically changes.

Number of Insurance Companies Offering Health Plans on North Carolina's Federal Health Insurance Exchange



Source: Forbes.com

Health Care Spending Among New ACA Customers Over Time - BCBSNC



Notes: Government officials and the insurance industry knew that the ACA would bring a surge of people seeking needed care in 2014. However, the expectation that healthier ACA customers would enroll in 2015 has not proven true. Health care claims are not leveling out. Many ACA customers have chronic conditions, such as heart disease and diabetes, that contribute to higher health care costs. The current health care spending trend and mix of customers is not sustainable. Without sufficient rates, we will not be able to cover the cost of services that our customers rely on.

Source: Blue Cross Blue Shield of North Carolina

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