

WARNING SIGNS

*A Survey of North Carolina Business Leaders
on Competitiveness, Taxes, and Reform*

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Warning Signs

A Survey of North Carolina Business Leaders

A new survey of North Carolina's most politically active business executives suggests that they do not necessarily agree with the current direction of public policy in the state. A sample of 435 respondents from every region of North Carolina answered questions about fiscal policy, education, transportation, tax rates, regulation, and ways to improve economic competitiveness. This report provides not only data from the statewide sample but also from five regional subgroups: the Research Triangle, the Piedmont Triad, the Charlotte area, Eastern North Carolina, and Western North Carolina.

Among the major findings in the *Warning Signs* survey were:

- By 59 percent to 37 percent, most respondents said that the state's current economic challenges reflected long-term problems rather than simply a cyclical downturn from which North Carolina would recover quickly and strongly. Pessimism about the economy was strongest in the Piedmont Triad and Eastern and Western North Carolina — all areas suffering far more severe economic dislocations than the Triangle and Charlotte areas.
- Asked which factors were most harmful to the state's competitive position, respondents picked North Carolina's high state and local tax burden as the number-one impediment to economic growth. A lack of skilled workers, an inadequate education system, and an onerous regulatory burden were also cited as significant factors. Airports, port and rail service, and recreational and leisure amenities were considered the least important.
- Nearly two-thirds of responding executives said that elected officials should close state and local budget deficits without raising taxes by reducing government spending. Asked to gauge the "rate of return" on existing spending programs, respondents gave a positive rating to higher education but indicated less confidence in other major categories. Nearly 80 percent said that there was only a "fair" or "poor" return from taxpayer dollars spent on elementary and secondary education, Medicaid and welfare programs, environmental and safety regulation, and state business recruitment and development programs.
- Most survey respondents (73 percent) said that the current rate of progress in North Carolina public schools was "too slow" and that new approaches were needed to boost the effectiveness of the education system. The business executives surveyed showed overwhelming support for such school-choice options as magnet schools, charter schools, and tuition tax relief, with a smaller majority (57 percent) supporting government scholarships for children attending private schools.
- Improving the quality of existing roads and expanding North Carolina's highway system were by far the highest transportation priorities for survey respondents. Expanding intercity rail, improving the state ports, and expanding alternative modes of transportation such as walkways and bike paths received low rankings.
- Given a choice of tax-cut options to boost North Carolina's economy, most survey respondents preferred to reduce the income tax burden either through overall rate reductions (37 percent) or tax breaks for investment and capital gains (36 percent). Only a fifth chose targeted tax incentives as their priority.

The survey was conducted by mail during the months of February and March. The Triad region had the largest representation among respondents, at 26 percent, followed by the Charlotte area (23 percent), Eastern North Carolina (21 percent), the Triangle area (18 percent), and Western North Carolina (12 percent).

Introduction

North Carolina Businesses Adjusting to Adverse Fiscal, Economic Conditions

At the beginning of 2002, North Carolina found itself facing a number of daunting fiscal and economic challenges. A nationwide slowdown was, in North Carolina, amplified into a full-fledged recession — with major job losses in such dissimilar areas as information technology, fiber-optic production, textile mills, and furniture manufacturing. The state’s unemployment rate rose to its highest point in two decades, and exceeded both the national and regional averages.

In part due to the economic situation, tax revenues to state and local governments fell below expectations. In Raleigh, state leaders grappled with the prospect of three consecutive years of budget deficits close to or exceeding \$1 billion. In 2001, Gov. Mike Easley and the state legislature enacted one of the largest tax increases in state history, approximately \$700 million in annual fiscal impact. It boosted the top income tax rate to the 6th highest in the country, raised the statewide sales tax rate by a half-cent, and edged up a number of other taxes on businesses and consumers. Dozens of cities and counties did the same, generating more than \$120 million in additional taxes on North Carolinians. With 2002 an election year, state leaders seemed intent on avoiding another big tax increase, with one result being a decision to withhold more than \$200 million in local revenues to cities and counties. This promised to lead to tax increases or painful budget adjustments during the spring and summer as many local jurisdictions were also experiencing a second-year of lower-than-projected revenues.

With pressure coming from lower demand for their goods and services, higher state and local taxes, higher energy costs, and greater national and international competition, North Carolina businesses were going through a difficult period of adjustment to these adverse conditions. Bankruptcies surged statewide, and included longtime stalwarts of the state’s business community such as Burlington Industries. At the same time, leading business executives were asked by Easley and many local government leaders to participate in commissions and forums designed to generate solutions to the state’s fiscal and economic problems. Never before was it as critical for North Carolina business leaders to demonstrate their leadership and to make their voices known.

The state has a number of well-respected organizations that seek to represent the views of business in public policy debates. North Carolina Citizens for Business and Industry acts as the statewide chamber of commerce. The National Federation of Independent Business has an active state chapter. Other groups and trade associations such as the Manufacturers and Chemical Industry Council, North Carolina Home Builders Association, and the North Carolina Farm Bureau Federation have a major presence in Raleigh. And local chambers of commerce in dozens of North Carolina communities serve the same function in organizing and representing the interests of business leaders as they address state and local issues of concern.

However, these organizations do not always base their issue positions and involvement on direct membership surveys. With some exceptions, they do not typically poll their members before offering opinions on issues or lobbying for or against legislation. It is not a criticism of this form of business organization to observe that its public pronouncements might not always “represent” a consensus of business opinions (if such a consensus exists at all in a state of diverse geographies, cultures, ideologies, and local economies).

For this reason, the John Locke Foundation — North Carolina’s largest public policy research institute — decided to conduct a major new study of the opinions of the state’s business leaders on these and other key issues. Our goal was to identify a diverse group of survey participants, representing businesses of all sizes, types, industry sectors, and regions of the state, and to ask a series of timely and important questions. What are the major factors affecting North Carolina’s economic competitiveness? What should our priorities be in expending taxpayer dollars? Which taxes have the greatest negative impact on the business climate? Which direction should North Carolina choose in reforming and strengthening its transportation and education systems?

Methodology

Brief Survey Mailed to Statewide Sample of North Carolina Business Leaders

In February 2002, John Locke Foundation research staff assembled a mailing list of some 3,700 business executives across North Carolina. The list included the entire business membership of North Carolina Citizens for Business and Industry (non-business members of the organization, such as public schools or colleges, were excluded) as well as large employers who were members of local chambers of commerce in the following cities: Raleigh, Charlotte, Greensboro, Winston-Salem, Asheville, and Wilmington. In addition, we added chief executives from companies listed in the most recent “Book of Lists” publications for the Charlotte area, the Triangle, and the Triad (the first two were published by *The Business Journal* company, the last by *Triad Business News*, a weekly publication of the *High Point Enterprise*).

In choosing these sources for the list, while eschewing others, we consciously decided to weight our sample with business executives who had shown an interest in public policy issues, by joining either the functional equivalent of a state chamber of commerce or local chambers in the largest metropolitan areas. We also chose to ensure that North Carolina’s largest businesses were well-represented in the survey (even though many smaller firms were also included) because of their historical importance in affecting the legislative process in the state legislature and in local governments. We also sought to ensure representation in the sample from each of six regions: the Charlotte area, the Triangle, the Triad, Western North Carolina, Northeastern North Carolina, and Southeastern North Carolina. Admittedly, however, the first three regions together represent a large share of the state’s population, the state’s business community, and, therefore, the list of executives surveyed.

To encourage participation and keep data collection as simple as possible, we designed a brief, two-page questionnaire with only 10 questions. One of these asked for the county or counties in which the business was located for an independent check to make sure that the mailing address accurately reflected the region of the state of a respondent. Most of the items were straightforward, close-ended questions allowing one answer among two to four options. Three questions allowed for more complexity; two asked respondents to rank options in ascending order of importance, while a third asked respondents to rate nine major areas of state spending on their perceived rate of return, allowing a response of either “good,” “fair,” or “poor.”

Finally, the questionnaire left space after the prepared questions for “additional comments . . . on North Carolina’s business climate.” As expected, most respondents left the section blank, but many did give additional comments or suggestions.

Pros and Cons of the Survey Design

As with any mailed survey, the methodology chosen here had some important drawbacks. First, unlike a telephone survey, it is difficult to guarantee that a respondent in a mail survey is who he or she claims to be. Second, response rates tend to be lower for mail surveys than for personal interviews or telephone surveys because mail surveys ask more of respondents (they must fill out the form and return it rather than simply answer a few questions verbally). Finally, because the brief length of the survey was deemed to be important in maximizing participation, the design did not allow for in-depth probing of issues or responses.

On the other hand, as will be demonstrated, the mail survey did yield a rich and informative body of results. This kind of survey design is relatively inexpensive, and can therefore be replicated easily in the future to see if opinions evolve along with changing economic or political conditions. The limited number of questions allowed for a quick turnaround in calculating and publishing the results, ensuring the timeliness of the data — which was important given the fast-moving nature of some of the public policy debates about which respondents were asked to comment.

Findings

Most Believe North Carolina's Economic Problems are Long-Term

A total of 435 business executives returned their surveys, in most cases providing useful responses to every question. The respondents were distributed across the state, with the largest representation from the Piedmont Triad region (about 26 percent of the total), followed by the Charlotte area (23 percent), Eastern North Carolina (21 percent), the Triangle area (18 percent), and Western North Carolina (12 percent).

More Than a Quick Dip

With North Carolina's unemployment rate now the highest in the Southeast, and higher than the national average for the first time in decades, many economists and policy analysts are trying to separate out the affects of a national recession from factors intrinsic to the state's economic development in explaining the current slowdown. In the survey, respondents were asked whether North Carolina's economy was "experiencing only a temporary dip from which the state will recover quickly and strongly" or "serious long-term problems that will require fundamental changes in public policy?"

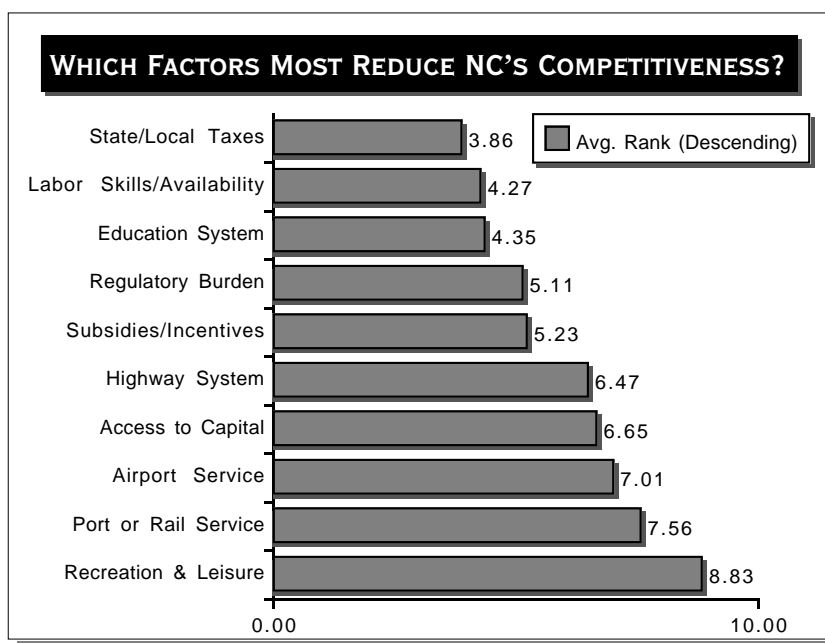
By a 59 percent to 37 percent margin, respondents indicated that they believed North Carolina's economic problems were long-term rather than reflective of a temporary dip. On a regional basis, executives were most likely to evaluate the recession as reflecting long-term problems in the Triad (67 percent) and Western North Carolina (67 percent) while Eastern North Carolina respondents had views similar to the statewide sample. Triangle respondents were more sanguine, with 55 percent picking "long-term problem," while Charlotte-area respondents were roughly split on the issue at 49 percent saying long-term and 45 percent saying a temporary dip.

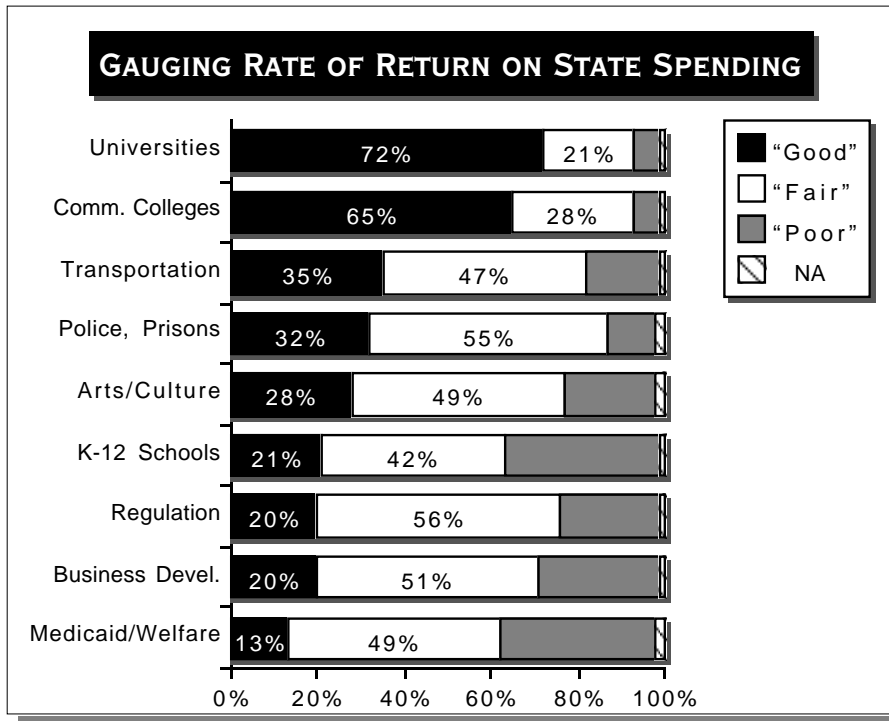
This is, perhaps, not surprising since traditional manufacturing, agricultural, and natural-resource industries in the Triad, the east, and the west seem to be declining — often losing ground in tough national and international competition — while industries such as financial services and technology, critically important in Charlotte and the Triangle, continue to be sectors where North Carolina companies remain strongly competitive despite some recent restructuring and layoffs.

Climate Change

Respondents were asked to "rank the following factors affecting North Carolina's competitive position with regard to our neighbors and other competing states." There were 10 options available, and respondents were asked to assign the number "1" to the "most significant factor reducing our competitiveness," the number "2" to the next-most significant, and so on.

Most respondents answered the question as asked, though some chose to list "ties" for some rankings and others ranked only a few factors, leaving the rest blank. As much as





possible, the scoring system for this question attempted to preserve the intent of the respondent by assigning a "10" to any blank space as representing the lowest possible ranking available. As is common practice with ranking systems, all ties were adjusted downward when necessary, so that, for example, a tie for first place would yield two "2" rankings, not two "1" rankings.

The results are summarized in the graph on the preceding page. North Carolina's state and local tax burden was ranked as the most significant factor reducing the state's competitiveness, with an average score of 3.86.

"Lack of skilled workforce" was the next-highest ranked factor at 4.27 followed by "inadequate education system" at 4.35, "regulatory burden" at 5.11, "inadequate business subsidies or incentives" at 5.23, "inadequate highway system" at 6.47, "lack of access to capital" at 6.65, "inadequate airline service" at 7.08, "inadequate port or rail service" at 7.56, and "lack of recreational/leisure amenities" at 8.83.

Regionally, respondents from every part of the state clearly identified the state and local tax burden as the number-one problem in North Carolina's economic competitiveness. The average ranking ranged from 3.6 (in Western NC) to 4.12 (in the Triangle). However, there was disagreement about which factor had the second-biggest impact, with Triad respondents picking workforce skills and availability (as did the total state sample), Charlotte and the Triangle picking educational adequacy, and Western North Carolina picking inadequate business subsidies or incentives.

As an aside, the available data comparing states in the Southeast tend to support the rankings of the responding executives. While North Carolina's tax burden is, in fact, the highest in the region, its public schools, transportation access, and other factors affecting business climate are not at or in most cases near the bottom of the list. It would be difficult to explain the state's weakened economic position, and its relatively high unemployment rate, based on the factors in which North Carolina is at or near the average.

Clear Preference on Fiscal Policy

In part because of the economic downturn, North Carolina state and local governments have been experiencing significant fiscal pressure in recent months and years. Despite last year's large state tax increase, as well as dozens of property tax hikes in communities across the state, 2002 promises to be another year of belt-tightening and possible tax-rate increases.

Respondents were asked for their preference between three strategies for state and local governments to "close budget deficits in the coming months and years." A resounding 64 percent of respondents said that policymakers should "make significant cuts in government spending while avoiding tax increases." Only 32 percent agreed with the strategy to "mix smaller spending reductions with some tax increases" while 12 respondents, making up 3 percent, said that policymakers should "raise tax rates sufficient to preserve existing programs intact."

Respondents were somewhat more likely than the statewide total to favor the no-new-tax approach in the Charlotte (67 percent) and Eastern North Carolina (68 percent) regions, and somewhat less likely in the Triangle (62 percent) and Western North Carolina (54 percent) regions. The Triad-area results were nearly identical to the averages for the statewide sample.

The Rate of Return on Government Spending

In an attempt to gauge the budgetary priorities that responding executives might offer to the state, we decided to ask whether the state government “gets a good return, a fair return, or a poor return on the taxpayer dollars it expends” in nine different areas representing the bulk of the state budget. By a striking margin, respondents indicated that they perceived a higher rate of return from higher education spending; indeed, the only choices for which a majority of respondents said the rate of return was “good” were public universities (74 percent) and community colleges (67 percent). As indicated in the nearby graph, a majority or plurality of respondents rated all other categories of state spending as having a “fair” return. There were only two categories for which the percentage rating the rate of return “poor” exceeded one-third: elementary and secondary schools (37.2 percent) and Medicaid and welfare programs (36.9 percent). Interestingly, these two categories are the most expensive in the state budget, together representing about two-thirds of the authorized FY 2001-02 budget.

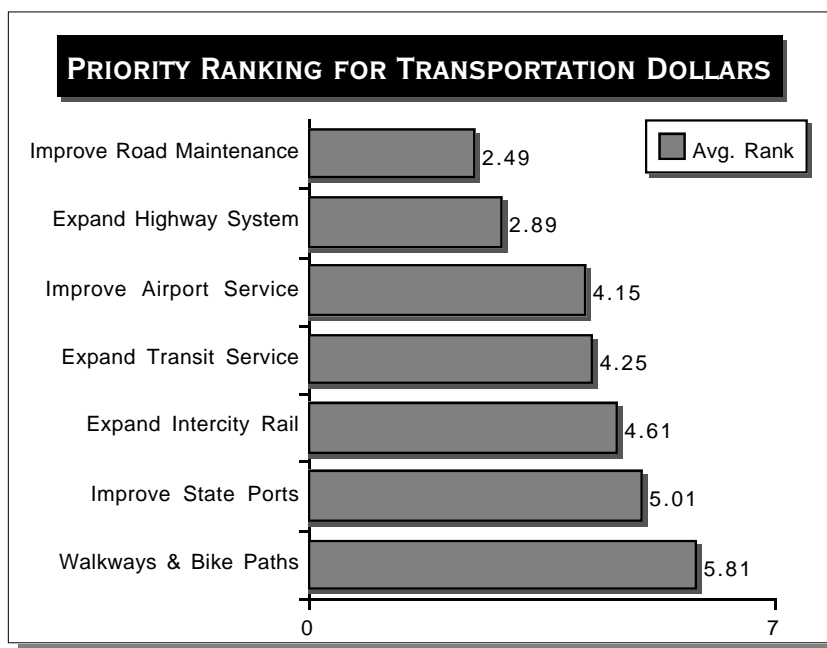
Respondents in the Triangle and Triad areas were even more critical than the statewide sample of the productivity of spending on K-12 education (42 percent and 41 percent indicating “poor,” respectively). Triangle respondents were also more likely than the statewide sample to call police and prison spending a “good” investment (at 42 percent). Respondents in Western NC were the most likely to say transportation spending had a good rate of return (at 46 percent in each case). Eastern NC respondents were the most critical of Medicaid and welfare spending, with 50 percent saying the spending category yielded a low rate of return. Charlotte respondents gave answers virtually indistinguishable from the statewide averages.

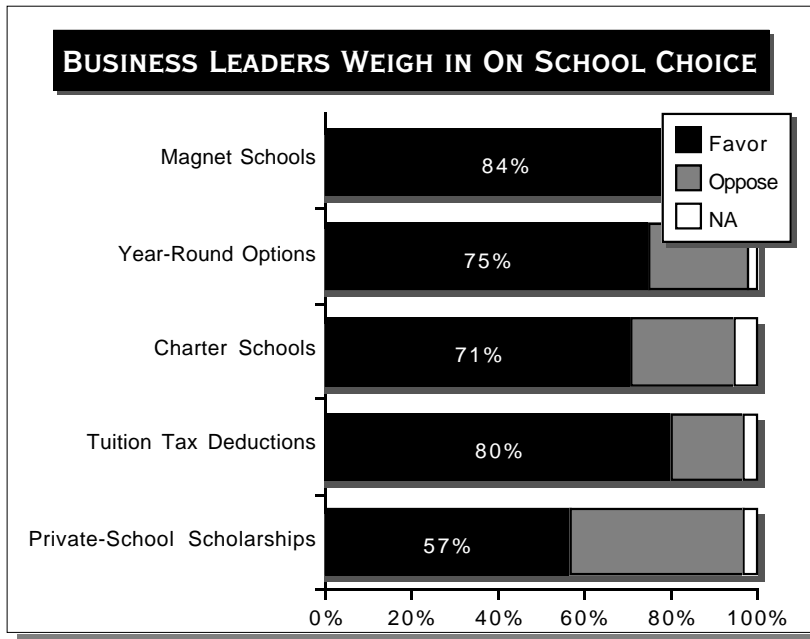
Setting Priorities for Transportation Improvement

North Carolina policymakers have long considered expenditures for transportation to be investments in a more productive economy and more attractive business climate. However, there has long been disagreement about where scarce transportation dollars would generate the best return on investment.

Survey respondents were asked to rank seven options for “spending North Carolina’s existing dollars” to improve the transportation system. Road maintenance (with an average ranking of 2.49) and highway expansion (2.89) were by far the most popular options. As depicted in the nearby graph, none of the remaining options ranked higher than 4.15 out of 7, with alternative models of travel such as walkways and bike paths gaining relatively little interest.

On a regional basis, there were no significant deviations from the statewide average in the top two rankings (improving road maintenance and expanding the highway system). However, the Triangle, Eastern NC, and Western NC respondents picked airport improvement as third-most-





important while those in Charlotte chose local transit improvements and Triad respondents picked expanded intercity rail service.

Dissatisfaction with Education

The quality of North Carolina's education system was near the top of concerns expressed by survey respondents. In a follow-up question, the survey asked respondents to communicate their opinions about the state of education reform in North Carolina by choosing between these two statements: "I am satisfied with the current rate of progress — continue existing efforts" and "the current rate of progress is too slow — we need to pursue other approaches."

The overwhelming majority of survey respondents expressed dissatisfaction with the current pace of education reform. Specifically, 73 percent agreed that the current rate of progress was too slow and new approaches were needed, compared with 26 percent who indicated that the current approach was generating satisfactory progress.

The call for new approaches was especially high in the Charlotte region, at 83 percent, which may reflect the impact of the Charlotte-Mecklenburg busing controversy and the resulting change in student-assignment policies in the state's largest school district. Respondents in the Triad (73 percent) and Eastern North Carolina (72 percent) had levels of dissatisfaction similar to the statewide total, while those in the Triangle (64 percent) and Western North Carolina (62 percent) had lower levels of dissatisfaction.

On the much-debated issue of expanding parental choice in education, the business executives surveyed expressed varying levels of support. Asked whether they favored or opposed several choice options, huge majorities favored district-run magnet schools (84 percent), year-round optional schools (75 percent), charter schools (71 percent), and tax deductions for private-school tuition or educational savings (80 percent). Respondents had somewhat lower levels of support for the most controversial type of choice, private-school scholarships or vouchers. Still, a majority (57 percent) supported the idea with 40 percent opposed.

On a regional basis, most respondents had opinions about school choice that were similar to those of the statewide sample. However, Triangle executives were far more likely (69 percent) to favor private-school scholarships, while Western NC respondents were somewhat less likely (52 percent) to support the idea.

Addressing Tax and Regulatory Problems

As demonstrated earlier, respondents were of the strong conviction that tax and regulatory burdens were among the major factors affecting North Carolina's business climate. Two subsequent questions asked for more information on these issues.

The first asked if "North Carolina's regulatory process [did] a good job of approving only regulations likely to generate health or safety benefits greater than their cost" or if it "allowed the imposition of too many costly rules that lack real benefits for workers and consumers." The answer was among the most lopsided in the survey. More than three-quarters of respondents (76 percent) said that the regulatory process approved too many unjust-

tified rules, with 17 percent saying it did a “good job” of approving rules with health or safety benefits higher than the compliance and economic costs.

All regions yielded a strong disapproval of the current process, although the dissatisfaction was somewhat lower in the Triangle (69 percent) and Western NC (62 percent) and was very high in Eastern NC (85 percent).

On tax policy, respondents were asked what “one change in state tax policy” they would make to “improve North Carolina’s business climate.” The four alternatives were “cut income tax rates, cut sales tax rates, cut taxes on investment or capital gains,” and “expand targeted tax incentives.” The two most popular answers were cutting income tax rates (37 percent) and cutting investment or capital gains taxes (36 percent). Tax incentives, a much-debated element of North Carolina’s economic development strategy, came in at 22 percent, while only 5 percent said their top priority would be cutting the sales tax rate that was recently hiked by the state legislature and the Easley administration.

The strongest support for cutting income-tax rates was to be found in the Triangle (44 percent) and Charlotte area (41 percent). Triad respondents were more closely split on the issue with 38 percent citing income-tax rates and 32 percent citing investment taxes. Interestingly, Eastern North Carolina respondents were far more likely to favor cutting investment taxes over income-tax rates (42 percent to 26 percent) while Western North Carolina respondents were the only ones to choose targeted tax incentives (38 percent) as their top priority over investment taxes (29 percent) and income-tax rates (25 percent).

Given what by all accounts is a greater level of economic distress and pessimism about long-term growth in the eastern and western counties, their business leaders seem more interested in tax reductions aimed at generating new investment (be they capital-gains tax cuts or incentives) while residents in the state’s major metropolitan areas tend to put more emphasis on overall tax-rate reduction.

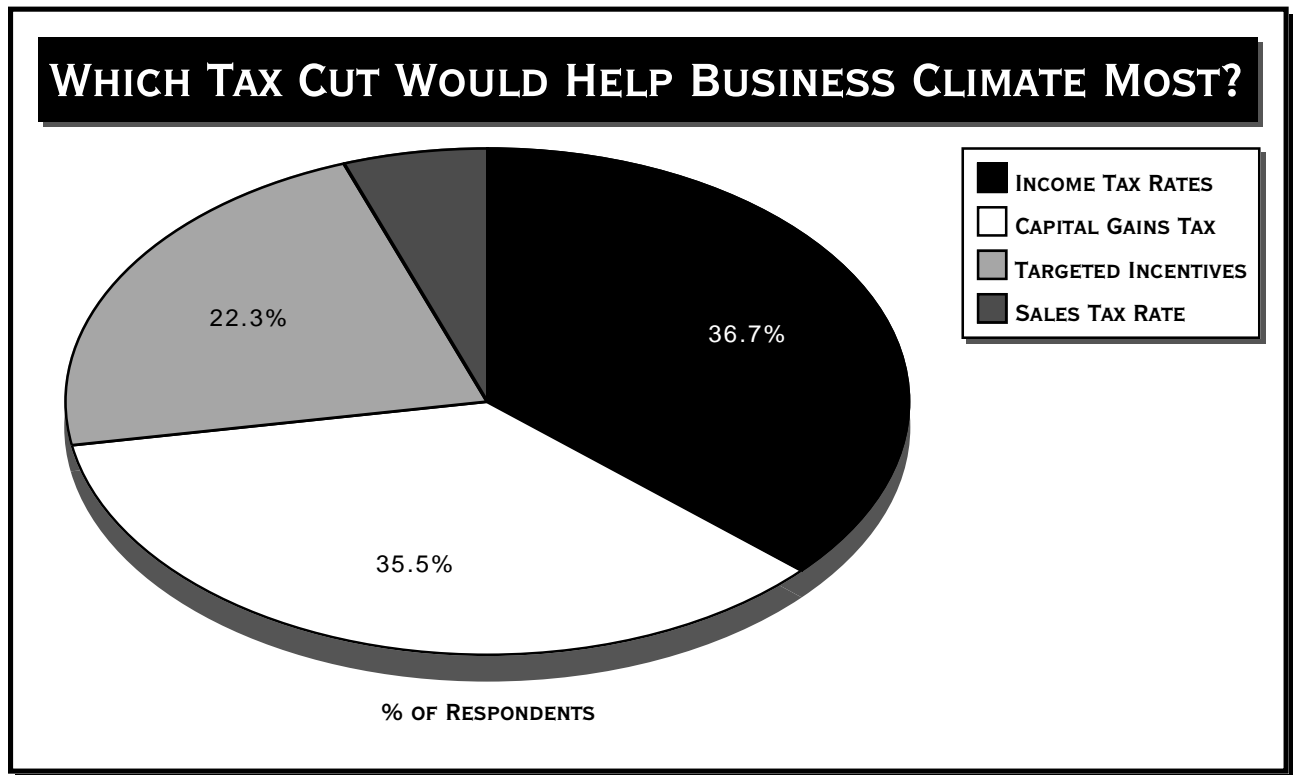
Conclusion

North Carolina Executives Express Clear Policy Preferences

The respondents in this survey of North Carolina business executives expressed a clear set of policy preferences. Most believe that the state's economic challenges reflect long-term rather than short-term problems, and that cutting North Carolina's state and local tax burden would have a larger effect on the business climate than many other policies offered by elected officials and policymakers with the intention of improving competitiveness. Furthermore, a majority of respondents preferred to address the current fiscal crisis in state and local governments by reducing spending rather than raising taxes — in fact, there was strong support for improving North Carolina's economy through tax reduction, particularly in the areas of income-tax rates and taxes on investments and capital gains.

By expressing their perception of the productivity of various spending programs, the survey respondents can be seen as providing useful guidance to those seeking to reconcile a commitment to lower taxes with the need to balance state and local budgets. Respondents expressed little confidence that taxpayer dollars are being spent well on Medicaid and other welfare programs, which comprise the fastest-growing element of the state budget. Medicaid alone is projected to exceed projected expenditures by approximately \$1 billion over two years. Also, nearly 80 percent gave a fair to poor rating to the state's business recruitment and development programs and regulatory efforts.

Another spending category where business executives expressed what might be considered a surprisingly low rating of productivity was public elementary and secondary education. Although a perceived inadequacy in the state's public education system was highly ranked as a negative factor in North Carolina's economic competi-



tiveness (3rd out of 10 options, just below the tax burden and workforce skills, which is a related worry for many), executives surveyed do not seem to believe that current reform efforts are spending taxpayer dollars wisely, with 78 percent gauging the rate of return as fair or poor.

Only a quarter of respondents indicated that the current rate of school progress was satisfactory, while the vast majority said that new approaches were needed to improve the productivity of K-12 education spending. One area where business executives do express strong support is the push for greater parental choice in education, ranging from district-run magnets and year-round options to charter schools, tuition tax breaks, and private-school scholarships, though the latter enjoyed a somewhat lower level of support.

There are other areas, as well, where much of the recent public policy debate in Raleigh seems out-of-sync with the opinions of business leaders. In the regulatory arena, for example, survey respondents expressed strong disapproval with the output of the current process, which most believe leads to the imposition of new rules that are not justified on a cost-benefit basis. Over the past year, however, much of the regulatory debate in Raleigh has centered on a sweeping regulatory proposal to tighten emissions standards for the state's coal-fired power plants. The piece of legislation, known as the "Clean Smokestacks" bill, will likely come up for consideration again in the 2002 legislative session.

On transportation, much of the focus of policymakers in recent years has been on alternatives to highways such as intercity rail service and two massive transit projects on the drawing boards in Charlotte and the Triangle. Survey respondents ranked these ideas well below the more traditional formula of improving the quality of existing roads and highways in North Carolina and expanding the system to accommodate more traffic and create new opportunities for economic growth.

Taken together, the survey results in this report suggest that responding executives are looking for their political leaders to make tough decisions, to focus significant efforts on fiscal restraint to boost North Carolina's economy, and to be willing to embrace new ideas in a search for more productive ways to spend taxpayer dollars. The theme seems to be for policymakers to focus on the basics — keeping taxes and regulations modest while improving the performance of core public services such as education and highways — rather than being distracted by highly touted proposals that might have only a marginal impact on the future growth and prosperity of North Carolina.

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