

# CHANGING COURSE IV

*An Alternative Budget for North Carolina*

May 2001

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# Changing Course IV

## *An Alternative Budget for North Carolina*

**N**orth Carolina faces significant fiscal and economic challenges over the next two years. But it need not resort to higher taxes, a state-run lottery, higher debt, or gimmickry to balance its budget. Nor does North Carolina need to skimp on crucial needs such as education and highways. By setting firm priorities within state government, eliminating unnecessary or duplicative programs, and charging users of some services a reasonable price, state leaders can generate sufficient savings to invest in the future needs of the state.

North Carolinians are not undertaxed. While a series of reductions in income, sales, and other taxes from 1995 to 1998 saved taxpayers more than \$1.4 billion, this welcome tax relief followed even larger state tax increases in 1990 and 1992. The tax burden in North Carolina is higher today than it was a decade ago, and continues to exceed that of any other state in the Southeast. Indeed, lawmakers would have to cut taxes an additional \$1.1 billion annually to reduce North Carolina's tax burden to the regional average.

Because the state's economy has slowed down, and in some regions and sectors is already in recession, now is the time to cut taxes, not raise them. Higher marginal income tax rates, in particular, depress entrepreneurship, discourage job creation, and hamper the state's economic development.

North Carolina's real fiscal problem is a lack of productivity in state government, not a short-run money crunch. The state's General Fund operating budget grew by an annual average of 7.3 percent from 1993 to 2001 — far faster than the 6.3 percent annual growth of personal income. Taxpayers are not receiving benefits commensurate with the escalating amounts their state government is taking from them.

*Changing Course IV* presents an alternative state budget for the next two fiscal years. In brief, the plan:

- Identifies General Fund savings worth \$1 billion in FY 2001-02 and \$1.3 billion in FY 2002-03. Major areas of savings include redirecting some public school and university spending, reforming the state's Medicaid program, merging some state departments and divisions, and slicing corporate subsidies.
- Spends some of the savings to benefit at-risk children with a private-school scholarship program and a targeted preschool program, while devoting \$184 million more than Easley's budget does to rainy-day savings and critical repairs and renovations to state buildings.
- Puts forward a comprehensive tax-reform package that would end \$382 million more in tax loopholes than Easley suggests but more than offsets it with income and sales tax cuts worth \$1.1 billion.
- Develops a new strategy for promoting statewide economic growth by increasing annual road maintenance by \$140 million, boosting major highway construction by \$220 million, and reducing marginal tax rates on individual and corporate income to create new jobs and increase personal income.

Under the alternative budget, General Fund spending would grow by 2.7 percent from FY 2000-01 to FY 2002-03 — far below the combined rate of inflation and population growth that a proposed Taxpayer Protection Act would allow. By comparison, the governor's budget increases spending by 11.6 percent over the next two years.

In last year's Agenda 2000 poll, the overwhelming majority of North Carolina voters rejected the idea that their taxes had been cut too much during the 1990s, and most favored state spending limits, additional tax relief, and other recommendations contained in *Changing Course IV*. With both recent history and public opinion on their side, North Carolina's leaders should now chart a new course towards fiscal restraint and economic prosperity.

# Introduction

## *The State's Fiscal Woes Stem from Excessive Spending*

**F**or the first time in nearly 10 years, North Carolina state government faces large and growing budget deficits. As newly elected Gov. Mike Easley and the N.C. General Assembly took office in January 2001 and began to grapple with hundreds of millions of dollars in red ink, both hopes and fears began to rise. Some taxpayers hoped that the state's fiscal challenges would prod leaders into taking a long and careful look at size and scope of state government. On the other hand, advocates for a variety of recipients of state spending became fearful. Across the state, citizens began to ask some troubling questions.

Would the budget deficit lead to massive layoffs, or dramatic reductions in state grants to localities or private organizations? Would the state attempt to borrow its way out of the problem, ignoring its constitutional obligation to balance its operating budget? Or would there be a big tax increase?

As we write in May 2001, these questions remain unanswered. Gov. Easley's has proposed budget savings as well as new taxes, including a state-run lottery. Members of the N.C. House and Senate are discussing a variety of budget cuts as well as possible increases in income and sales taxes. Local governments are demanding additional taxing authority of their own, partially to offset expected losses of state funding as well as increased costs for Medicaid and other social programs.

While the uncertainty may be unsettling for some, the budget debate in North Carolina must continue in a deliberative and thoughtful manner. Drawing up a budget is the most important task that the legislative and executive branches of state government must perform. A budget is simultaneously a statement of priorities and a plan for action. It reflects the basic assumptions of state leaders about the proper role of government in the lives of North Carolinians. It deserves a great deal of attention and independent thought on the part of lawmakers, administration officials, and the general public.

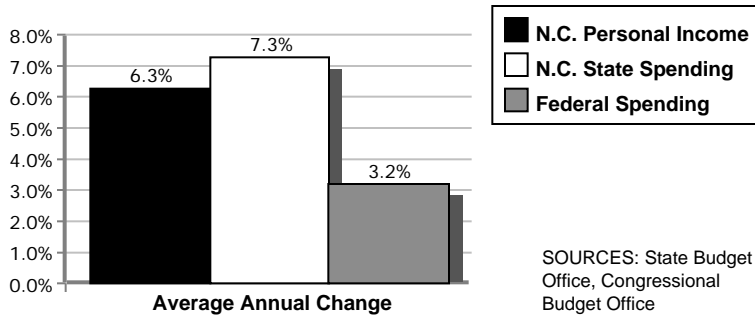
## *The Changing Course Project*

In 1995, the John Locke Foundation drafted and released its first alternative budget proposal in a report called *Changing Course: A Plan for Fiscal Responsibility and Future Prosperity in North Carolina*. This report called on state leaders to cut state taxes by \$1 billion in FY 1995-96 and \$1.3 billion by FY 1996-97. It relied on savings in the Continuation Budget and the Expansion Budget proposed by Gov. Hunt to offset the static revenue losses projected from the recommended cuts in the personal income tax, corporate income tax, sales tax, and other levies.

As lawmakers and observers of the legislative process will remember, the 1995 session was unique in the history of the state budget process. After years of rapidly increasing state spending, both Gov. Hunt and the General Assembly expressed an interest in controlling spending growth and cutting taxes. Although rancorous, the process resulted in significant savings for North Carolina taxpayers. General Fund operating spending grew by only 1.4 percent in FY 1995-96, by far the slowest rate of spending growth in a non-recession year this century. At the same time, lawmakers approved the largest tax-reduction package in the state's history, including a reduction in personal income taxes (\$235 million in FY 1995-96), elimination of the intangibles tax (\$124.4 million), a reduction in the soft-drink tax (\$9.6 million), and other items.

The 1996 short session of the legislature was also a good one for state taxpayers, who saw a cut in the sales tax on food, a reduction in the corporate income tax, a repeal of privilege license taxes, and other cuts. The legislature was less successful in maintaining control over state spending. General Fund operating spending grew 6.7 percent in FY 1996-97, far faster than the combined rate of inflation and population growth. The 1996 session also saw a shift of emphasis away from general tax relief towards targeted breaks for corporations.

## Rates of Annual Growth, 1993-2001



The 1997 legislative session offered more of the same – welcome General Fund tax relief but unwelcome spending growth. Lawmakers cut another penny off the state sales tax on food, but unfortunately further expanded corporate incentives. General Fund operating spending shot up by an astounding 7.7 percent, though the real spending increase was nearly 10 percent but masked by various fiscal shenanigans.

Finally, in 1998 lawmakers repealed the final two pennies of the state sales tax on food, junked the inheritance tax, and exempted schools from sales tax, among

other tax changes. Still, the budget grew — by 9.5 percent in operating spending and more than 13 percent in total spending after accounting for capital spending and off-budget fiscal tricks. With state bonded debt climbing rapidly during this period, too, many lawmakers gambled that increased spending and sizable tax relief wouldn't lead to tough choices later.

By 1999, these trends had obviously become unsustainable. Gov. Hunt and the legislature needed to resolve themselves to either control spending or reverse the previous tax cuts. But with the 2000 elections upon them, few were inclined to take bold steps. Hunt offered a budget “proposal” that neglected to close an estimated \$800 million hole in his nonrecurring budget, caused in part by judicial orders to refund illegally collected income and intangibles taxes. Lawmakers filled in the hole, but at the cost of sound fiscal policy. They shifted some funds among different reserves and pushed other expenses into the coming fiscal year. A similar bag of tricks helped the state stumble through the 2000 legislative session without a fiscal reckoning. Indeed, the General Fund operating budget for the last two years continued to grow even in the midst of widespread concern about projected deficits — posting a healthy 5.9 percent increase in 1999-2000 and a 5.6 percent increase in 2000-2001.

### Too Much Tax Relief?

Some lawmakers, interest groups, editorialists, and political observers believe that budget problems have arisen because of the tax cuts from 1995 to 1998. In other words, the problem doesn't lie with the legislature's spending decisions but with the fact that the citizens of North Carolina are not transferring enough of their income and wealth to Raleigh. Easley seems to agree if one considers that much of his attempt to grapple with the state's projected deficit today consists of creating a state lottery and closing “tax loopholes” — the former an abhorrent and unfair source of revenue and the latter being a noble goal only if offset with general tax rate reductions.

But insufficient revenues do not explain the current dilemma. Even as the state's supercharged economy has slowed down, state tax revenues have increased steadily — by 4 to 6 percent annually. In Easley's own FY 2001-03 budget, he projected that the base growth rate of General Fund revenues would be 5 to 6 percent annually over the next two fiscal years *without any new taxes*. This is a significant rate of growth by any reasonable standard. The real problem is that politicians refuse to restrain their spending appetites to stay within the projected rate of revenue growth. That is, they want to spend more than taxpayers are currently sending to them.

To suggest that taxpayers should give government an even greater share of their incomes when economic growth cools is to ignore the teachings of virtually every school of economics. Keynesians would counsel that governments should moderate economic slow downs by putting more money in people's pockets through tax cuts (and spending hikes). Their goal is to encourage more firms and households to consume. Free-market economists advise policymakers concerned about insufficient economic growth to cut marginal tax rates on working, saving, and investing so that entrepreneurs and households will have greater incentives to produce. The tax-increase mantra also ignores recent history. While tax cuts enacted since 1995 have saved North Carolinians \$1.4

billion by FY 2000-01, state spending grew by \$4.1 billion during the same period. In other words, for every dollar state government returned to taxpayers, it increased spending by nearly \$3.

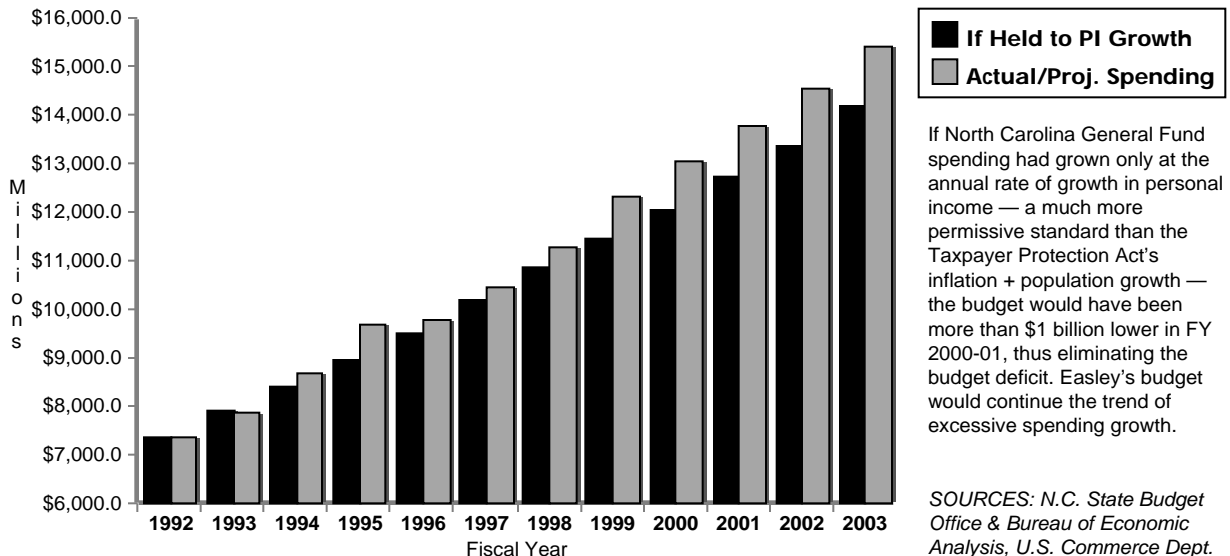
North Carolinians are hardly undertaxed. In reality, our tax burden grew rather than shrank during the 1990s. According to the Washington-based Tax Foundation, about 10 percent of average income in North Carolina was consumed by state and local taxes in 2000, up from 9.5 percent in 1990. We still have the highest average tax burden in the Southeast, according to data from the U.S. Census Bureau. We impose some of the highest marginal tax rates in the nation on individual and corporate income.

During the last two terms of Gov. Hunt, from 1993 to 2001 (projected), personal income in the state grew by a healthy 6.3 percent a year (see graph on opposite page). But General Fund operating spending grew by 7.3 percent annually. If state spending had grown at the same rate as personal income growth from 1993 to 2001 — 6.3 percent a year — the budget would have been \$1.04 billion lower in FY 2000-01, more than offsetting the projected budget deficit (see below). We and many other taxpayers would still have viewed such spending growth as excessive, but at least the current “crisis” would have been averted.

Of course, it is easier said than done to restrain annual budget growth. Because of factors such as school enrollment and Medicaid increases, a fiscally conservative budget must include not just slower growth across the board but the outright elimination of unnecessary, duplicative, or counterproductive programs. Advocates of fiscal restraint should be willing to offset fast-growing expenditures in public schools or human services with freezes or reductions in other areas. And, of course, advocates of additional tax relief must go even further in finding savings and implementing privatization and other initiatives to make government less costly.

The alternative state budget we recommend in this report lists 155 recommendations for savings in the base budget and 17 changes to Easley’s 2001-2003 expansion budget. Recommended savings total \$1.1 billion in FY 2001-2002 and nearly \$2 billion in FY 2002-03. These savings would finance a tax reform package phasing in \$719 million in income and sales tax reductions over the next two years as well as \$413 million in new spending in critical areas such as highway maintenance and public school reform. Our alternative budget would also add \$150 million to the state’s Rainy Day Fund and \$50 million to needed repairs and renovations. Admittedly, the plan would require state leaders to set very different priorities. But it is feasible, realistic, and principled.

## Slower Growth and the State Budget Deficit



# Principles of Fiscal Restraint

## *State Should Focus on Core Functions and Control Spending*

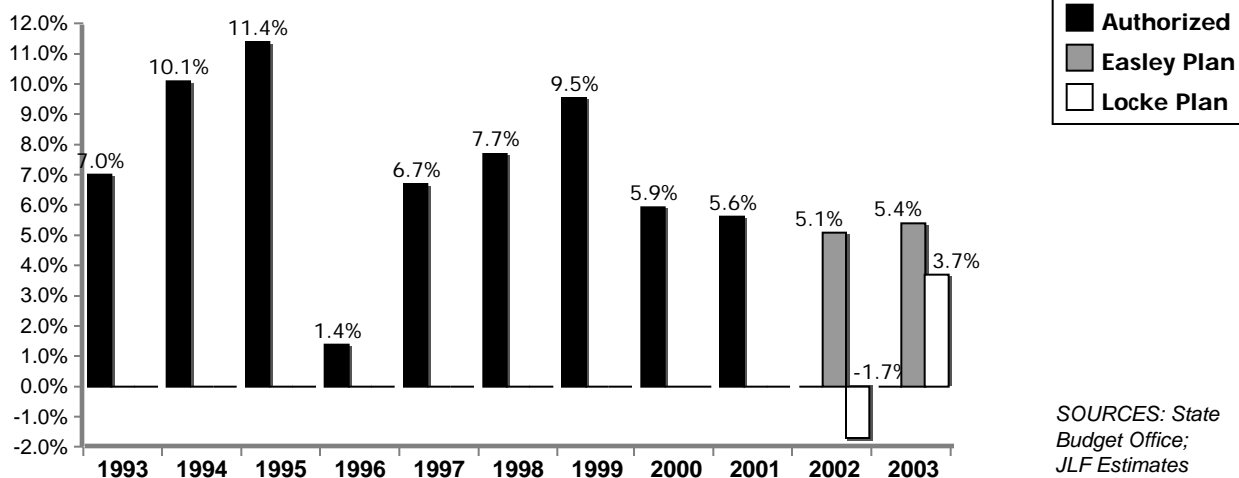
It is clear that North Carolina has yet to get control of its spending and truly reduce the tax burden to an acceptable level. The state has overspent itself into a \$700-\$900 million shortfall for the 2000-2001 fiscal year and Gov. Mike Easley's proposed budget for 2001-2003 only makes things worse. Instead of attempting to bring spending and taxation under control, the governor is calling for new programs, increased spending, and higher taxes. As the graph below demonstrates, his proposal only continues a trend of rapid annual growth in the state budget. Implicit in the governor's approach is the assumption that the citizens of North Carolina are not transferring enough of their income and wealth to Raleigh. This is made clear with his proposals to "close tax loopholes" and institute a state-run lottery.

The *Changing Course IV* plan offers a fundamental alternative to this tax-and-spend ideology. Our goal was not simply to find "waste, fraud, and abuse." Instead, we sought to define what North Carolina's government should be expected to do and how large it should be.

### *Principles for Fashioning a State Budget*

The Constitution of North Carolina opens with a "Declaration of Rights" that establishes "essential principles of liberty and free government." Article 1 begins by reiterating the opening phrase of the U.S. Declaration of Independence. But the N.C. Declaration adds an important clarifier. In addition to Thomas Jefferson's original list (borrowed from John Locke) — the rights to "life, liberty and the pursuit of happiness" — North Carolina's Constitution points out that all persons are "endowed by their creator with the right to the enjoyment of the fruits of their labor." It is incumbent upon North Carolina officials, when formulating tax and budget policies, to see to it that this right is preserved. The state is obligated to perform its basic functions efficiently while leaving to the people as much of the "fruits of their labor" as possible to use for their own "enjoyment."

## Changes to Gen. Fund Operating Budget, 1993-2003



Other provisions of the state constitution also informed our proposals to reorient state budget policy. For example, Article 1, Section 34 states that “perpetuities and monopolies are contrary to the genius of a free state and shall not be allowed.” Programs that grant exclusive franchises or limit consumer choice to government-run service providers run afoul of this principle. In Article V, Section 2, the constitution requires that “the power of taxation shall be exercised in a just and equitable manner, for public purposes only . . .” This clause helped guide our tax-reform package, which eliminates special preferences for private interests, as well as the identification of programs that state taxes should not fund — i.e. those that are primarily local or private responsibilities.

Finally, we took note of Article 1, Sections 35 and 36. These provisions serve to establish a constitutional preference for limited government. “A frequent recurrence to fundamental principles is absolutely necessary to preserve the blessings of liberty,” the constitution states. “The enumeration of rights in this Article shall not be construed to impair or deny others retained by the people.” State government, in other words, is not empowered to do whatever it wants to do. Rather, it is constrained to perform its constitutional functions — to maintain law and order and to ensure the availability of true public goods — and otherwise to leave North Carolinians alone to pursue their own interests and solve their own problems without state encroachment.

These constitutional provisions led us to construct the following set of criteria for evaluating state programs:

- **Duplication** — Does the program or item in question duplicate what other state agencies or the federal government are doing? The N.C. Department of Administration, for example, has a Veteran’s Affairs office, part of whose job it is to try to get N.C. veterans employed. Both the Employment Security Commission and the U.S. Department of Veteran Affairs already perform this task. This office should be abolished.
- **Local Responsibility** — Should the program or item in question be the responsibility of local government rather than state? The Department of Cultural Resources, for example, provides millions of dollars to local libraries and the Department of Commerce has a local Planning and Management office. These functions should be transferred to local levels of government where financial responsibility and accountability are best lodged.
- **Private Responsibility** — Does the program or item in question do something that is not a responsibility of government, but rather the responsibility of private firms, charities, or individuals? We found three main categories of programs that are clearly not part of the proper function of government: corporate welfare programs, charitable or philanthropic programs that should not be coercively funded, and cases where government agencies unfairly compete with private agencies.

Examples of corporate welfare would include economic development and marketing programs in the Department of Commerce, Agriculture, and Administration and state subsidies to private organizations such as the Biotechnology Center of North Carolina. Examples of charitable or philanthropic programs that should be funded through private donations include the Support Our Children mentorship program and the Senior Games.

- **User Responsibility** — When examining businesses operated by the state — as distinguished from services to which citizens are entitled, such as law enforcement — users should bear as much of the cost as possible to avoid taxing some citizens solely for the private benefit of others. Those who use institutions like museums and the N.C. Zoo should pay for the services they receive. It is clearly unfair to force those who do not use these facilities to subsidize those who do. It also divorces the funding of an institution from its patronage, thus subverting an important feedback mechanism that can help to guide how the institutions serve their users.

This issue is particularly relevant when it comes to college tuition. Less than 20 percent of the cost of education in the UNC system is covered by tuition and fees, compared to a third in South Carolina and close to half in Virginia. Because the average family income of UNC students is far higher than the state average, and will often be higher still after graduation, this policy transfers income from less-affluent taxpayers to more-affluent families. It also hurts native North Carolinians. Those families who live in the state and pay taxes over many years subsidize the low tuition of students whose families move into the state during their high school years. A better policy would be to lower taxes for all North Carolina families and encourage them to save for college, rather than holding tuition far below the national average by taxing everyone for the advantage of a few.

- **Limit Entitlements** — State programs to provide cash assistance, medical care, or other services to the disadvantaged exist to provide a basic “safety net.” Even philosophers of limited government such as John Locke have justified such programs as needed to ensure order and protect public assets and spaces. But these programs must be carefully structured to minimize dependency and encourage personal responsibility. When the state pays nursing home bills for the parents of the middle class, subsidizes the day cares of affluent families, and perpetuates social pathologies such as out-of-wedlock births, it strays far from its constitutional moorings.
- **Set Better Priorities** — Can new state spending be used more effectively? A good example is the governor’s proposal to reduce public school class size, to be paid for with a state lottery. Even if one assumes that class-size reduction is the best way to improve student performance, the state should look for ways to redirect current school funding to this purpose before taking more money from taxpayers. For example, the same Tennessee study that demonstrated benefits from reducing class sizes found that the presence of teaching assistants did not boost student achievement. Setting better priorities with existing tax revenues is a constitutional obligation.
- **Racial Discrimination** — Are state funds used to discriminate against racial or ethnic groups? Section 19 of the constitution’s Declaration of Rights states in part that no person shall “be subjected to discrimination by the state because of race, color, religion, or national origin.” Laws and programs that invoke racial or ethnic discrimination violate this basic principle of moral government. All such programs should be ended immediately.
- **Advocacy Group** — Are state funds used to subsidize groups that advocate policies or ideas before government bodies? Taxpayers should not be forced to pay for the propagation of ideas with which they may strongly disagree. As Article 1, Section 2 of the state constitution puts it, government “is instituted solely for the good of the whole,” not for special interests who use taxpayer money to advance their agendas.
- **Unnecessary** — Does the program serve a clear public purpose? Agencies that regulate bingo, auctioneers, barbers, beauticians, and quilts would be examples of unnecessary programs and agencies that should be abolished. They also clash with the constitution’s protection of consumer choice and individual liberty.

### ***Short-Term and Long-Term Savings***

Once we identified the programs that failed to meet at least one of the criteria listed above, we sorted them into two groups: 1) programs or items that could realistically be altered or eliminated in the short term, and 2) programs or items where savings could be realized only in the long term or with federal permission. The former group constitutes the *Changing Course IV* plan described in the remainder of this report.

Among those long-term savings recommendations are:

- **Reforming the Medicaid and Other Welfare Programs** — Medicaid, a joint federal-state program to provide medical assistance to poor persons, children, and the elderly, is one of the fastest growing areas of state government. Over the past decade Medicaid has grown from 6 to almost 14 percent of the state’s General Fund operating budget. A just released study commissioned by the General Assembly confirms arguments that have consistently been made in past John Locke Foundation studies, namely that North Carolina’s Medicaid program spends significantly more than it should. The study points out that the N.C. program is the most generous in the Southeast and one of the most extravagant in the nation.

Because Medicaid recipients pay little to nothing out-of-pocket, they have few incentives to economize in their health care consumption. Furthermore, the scope of Medicaid has grown far beyond its original intended coverage of the poor and now includes non-poor children, pregnant women and elderly residents of nursing homes whose backgrounds and family finances place them firmly in the middle class. In addition Medicaid in North Carolina now provides more generous coverage than most health insurance plans provided by private sector employers, including dental care, optometry and other benefits not required by federal law.

Starting this year, we suggest that the state reform the program first by scaling back benefits to only those required by the federal government and introducing more economy in the provision of prescription drugs and



the reimbursement of medical services rendered. In the long run we recommend replacing direct payments to health care providers with contracting out, vouchers, and medical savings accounts. This would give participants greater choice and promote efficiency through market competition, saving money for both the state and consumers of health care generally. Also, in order to get Medicaid out of the business of paying for nursing home care, our tax code should be reformed to encourage private savings and insurance for long term care.

Many of these same ideas can be applied to other welfare programs. In addition to making more use of private contractors and a greater dependence on private charities, we believe that additional work requirements, and time limits should be part of the reforming every public assistance program.

- **Restructuring State Employment and Retiree Benefits Programs** — In the private sector employers are moving away from defined benefits pension plans and replacing them with defined contribution plans (like a 401-k). With the latter, employees retain ownership and control of their own money. Making similar changes at the state level would save administrative costs and improve both employee welfare and management flexibility.

On health benefits, rapid growth in the state employee health plan is a major contributing factor to the current budget problem. Easley's budget sets aside \$150 million in FY 2001-02 and \$200 million in FY 2002-03 to cover expected increases in the plan. While few options exist in the short-run to alleviate the fiscal pressure caused by the health plan, policymakers should begin to examine long-run strategies to reform state benefits. For example, the state should consider increasing the alternatives available to state employees, including a medical savings account (MSA) plan. Such a plan would cover an employee's family for catastrophic health care costs through insurance while paying for routine expenses out of the funds held in the employee's MSA. This plan offers hope not only of giving patients more power and choice but also of reducing state health plan costs.

- **Expanding the Use of Privatization** — Over time, we believe that state government should be required to introduce competitive contracting and other privatization strategies to virtually all programs. In the short term we propose only one major sale of state assets, North Carolina's ports and railroads. But in the future the state should examine its entire inventory of properties and operations to find assets best converted to private ownership. Obvious assets to consider would include recreational facilities, office buildings, vacant land, and the entire Alcoholic Beverage Control system (the sale proceeds of which would go primarily to localities). If deemed necessary, privatization and asset sales can be made subject to public covenants and contractual restrictions to continue the desired public purpose while the state and ultimately the taxpayers benefit from the savings.

- **Executive Branch Reorganization** — We believe that there are many agencies or departments whose usefulness is unclear or whose services are duplicative. In addition to saving money, merging state departments could improve operations and make government more intelligible to average citizens. We believe that the total number of major departments and agencies should be reduced from 27 to 16, which would save the taxpayers a minimum of \$60 million. The governor should use his constitutional authority to reorganize state government.

Our *Changing Course IV* plan is the result of careful analysis of state government. We have made every effort to quantify our savings recommendations in detail. We expect and hope that state agencies, lawmakers, and other analysts will examine our plan with a critical eye, and we recognize that some errors may be found. We welcome review, comment, and corrections of our savings projections.

It should also be noted that the tax cuts we propose are based on conservative projections in that they use a "static" model to forecast the impact on tax revenues. For the purpose of this report we assume that every dollar cut in taxes is a dollar lost to the treasury, but economic analysis and actual tax cutting experience at both the state and federal level tells us that this is unlikely to be the case. Citizens will react to tax cuts by increasing their economic activity. This activity will lead to higher incomes and increased consumption, which will have an offsetting, positive impact on both income and sales tax revenues. Furthermore, returning the savings suggested here to the private sector should also have an expansionary impact on tax revenues. These revenues will be used in private sector economic activity increasing both private investment and sales, which in turn, will contribute to further economic growth and job creation. The fact that we do not take any of these compensating effects into account makes our plan extremely conservative in its fiscal projections.

# Changing Course IV At A Glance

## *How to Slow State Spending Growth over the Next Two Years*

**A**s was the case with previous Changing Course reports, *Changing Course IV* should be understood as a revision to the Continuation and Expansion budgets proposed by Gov. Mike Easley earlier this year. In other words, unless otherwise indicated, we accept all recommendations for savings and expansion detailed in the governor's budget, including salary increases for teachers and other state employees. Our recommendations should be treated as subtractions or additions to the Easley budget for the 2001-03 biennium.

In brief, our proposal identifies over \$1 billion in General Fund savings for FY 2001-02 and \$1.3 billion in FY 2002-03. Some of the major areas of savings include:

- Redirecting \$130.7 million in projected spending on non-teaching positions in public schools to fund teacher pay raises and class size reductions.
- Increasing tuition at UNC campuses by an average of 25 percent in each of the next two fiscal years. Combined with changes in student funding, research receipts, and subsidies for UNC Hospitals, the total savings in the UNC General Fund appropriation is projected to be \$146.8 million in FY 2001-02.
- Reforming the state Medicaid program to bring its costs in line with the Southeastern average by 2005, saving \$87 million in FY 2001-02. Changes would include eliminating optional services, renegotiating reimbursements, and introducing incentives for patients to consume care efficiently.
- Converting the Smart Start program into a more targeted preschool program for at-risk children (\$54.5 million by FY 2002-03) and a package of state income tax credits for preschool expenses, education, and child health insurance (\$235 million by FY 2002-03).
- Eliminating \$100 million in subsidies for corporations and other businesses in dozens of separate programs, including a 75 percent reduction in General Fund support for the Commerce Department.
- Selling the North Carolina Railroad and state-owned ports at Wilmington and Morehead City, using the proceeds to reduce debt. Together with a recommended two-year delay in issuing some bonds, these ideas would reduce debt service by \$65.9 million in FY 2001-02 and \$100 million in FY 2002-03.
- Offsetting about \$23 million in expenses for state-run enterprises and attractions such as museums by charging higher users fees and soliciting more private donations.
- Administrative savings of \$9.7 million from downsizing the state's Office of Veteran's Affairs, merging Correction, Crime Control/Public Safety, and Juvenile Justice/Delinquency Prevention into a single Department of Public Safety and creating a unified Division of Disability Services within HHS.

Outside the General Fund, *Changing Course IV* recommends \$161.7 million in savings in the governor's transportation budget, including the elimination of subsidies for rail, reductions in paving of rural secondary roads, and an end to funding for the Global TransPark. These savings were combined with \$200 million current or planned transfers out of the Highway Trust Fund to finance higher annual spending on road and bridge maintenance (\$140 million), urban loop construction (\$102 million), and intrastate construction (\$118 million).

*Changing Course IV* includes a comprehensive tax reform proposal for North Carolina. We identified income tax preferences and biases with a projected fiscal impact of \$382 million in FY 2002-03. But eliminating these "loop-

## 2001-03 GF Budgets At A Glance: Easley vs. *Changing Course IV*

(In Millions)

Spending Category	Authorized 2000-01	Easley 2001-02	% Change	Easley 2002-03	% Change	Change Course 2001-02	% Change	Change Course 2002-03	% Change
Public Education	\$5,792.3	\$6,056.4	4.6%	\$6,408.4	5.8%	\$5,901.9	1.9%	\$6,207.9	5.2%
Community Colleges	\$644.0	\$675.7	4.9%	\$675.7	0.0%	\$647.6	0.6%	\$620.5	-4.2%
UNC System	\$1,802.1	\$1,847.4	2.5%	\$1,854.7	0.4%	\$1,700.6	-5.6%	\$1,648.4	-3.1%
Health & Human Serv.	\$2,953.9	\$3,433.9	16.2%	\$3,726.5	8.5%	\$3,071.8	4.0%	\$3,241.4	5.5%
Agriculture	\$59.3	\$55.8	-5.9%	\$55.8	0.0%	\$40.8	-31.3%	\$36.4	-10.7%
Commerce	\$72.5	\$64.3	-11.4%	\$64.3	0.0%	\$17.8	-75.5%	\$17.8	0.0%
Labor	\$17.2	\$16.4	-4.7%	\$16.4	0.0%	\$14.5	-15.8%	\$14.5	0.0%
Environment/Nat. Res.	\$163.3	\$161.8	-0.9%	\$161.8	0.0%	\$143.6	-12.1%	\$143.5	0.0%
Correction	\$928.0	\$920.1	-0.9%	\$920.6	0.1%	\$914.7	-1.4%	\$915.1	0.0%
Crime Control/PS	\$37.7	\$37.1	-1.6%	\$37.1	0.0%	\$20.8	-44.9%	\$20.8	0.0%
Courts/Judicial	\$381.0	\$377.4	-1.0%	\$377.4	0.0%	\$375.2	-1.5%	\$375.1	0.0%
Juvenile Justice	\$147.2	\$144.6	-1.8%	\$146.3	1.2%	\$131.9	-10.4%	\$133.6	1.3%
Justice	\$76.9	\$75.6	-1.8%	\$75.6	0.0%	\$75.1	-2.4%	\$75.1	0.0%
Transportation	\$17.8	\$10.5	-41.1%	\$14.5	38.6%	\$1.6	-91.1%	\$6.0	281.4%
Other Departments	\$399.5	\$344.6	-13.7%	\$347.6	0.9%	\$313.0	-21.7%	\$307.6	-1.7%
Debt Service	\$239.7	\$276.3	15.3%	\$353.4	27.9%	\$210.4	-12.2%	\$253.3	20.4%
Other Items/Reserves	\$70.8	\$11.7		\$61.7		\$12.2		\$61.9	
Subtotal-Operating	\$13,803.3	\$14,509.3	5.1%	\$15,297.8	5.4%	\$13,593.4	-1.5%	\$14,078.8	3.6%
Capital/R&R	\$0.0	\$15.0		\$0.0		\$49.0		\$0.0	
Clean Water Fund	\$0.0	\$30.0		\$100.0		\$30.0		\$100.0	
Subtotal-GF Budget	\$13,803.3	\$14,554.3	5.4%	\$15,397.8	5.8%	\$13,672.4	-0.9%	\$14,178.8	3.7%
Rainy Day Fund	\$0.0	\$67.2		\$370.7		\$217.2		\$370.7	
Total Spending/Saving	\$13,803.3	\$14,621.5	5.9%	\$15,768.5	7.8%	\$13,889.6	0.6%	\$14,549.5	4.8%

holes” without any corresponding change in tax rates would constitute a dramatic and costly tax increase. Instead, we are recommending the following package of tax cuts, totaling \$1.1 billion by FY 2002-03:

- Cutting the top two individual income tax rates, currently 7 percent and 7.75 percent) down to 6.75 percent. This would save taxpayers \$583.8 million when fully phased in.
- Reducing the statewide sales tax rate to 3.75 percent from 4 percent, saving \$243 million.
- Cutting the corporate income tax rate to 6.5 percent from 6.9 percent, saving \$39.5 million.
- Creating a refundable Smart Start tax credit of \$250 per preschool child, saving \$156.2 million.
- Making tax-deductible the first \$2,000 of annual spending or saving for each child’s education. This would save families \$48.5 million.
- Doubling the current refundable tax credit for child health insurance premiums, to a maximum of \$600. This would save families \$30.4 million.

Finally, the *Changing Course IV* budget adds \$150 million more to the state’s Rainy Day Fund than Easley’s budget does and devotes \$50 million to repairs and renovations in FY 2001-02. We believe that these steps represent a more prudent approach to rebuilding state government’s financial cushion and infrastructure.

# Conclusion

## *It's Time to Cut Taxes, Not Raise Them*

**T**he public policy debate in North Carolina is suffering from a lack of perspective. Dominated as it is by those who shout the loudest outside Raleigh's Legislative Building — or pull the most strings inside it — the current debate about the state's budget priorities has been skewed against the interest of average taxpayers. Legislators, the Easley administration, interest groups, and editorialists have succeeded in framing the debate as one of how to take additional resources out of the private sector to fund government growth.

As the state's economy slows, in some counties to a halt, these political insiders are actively seeking to hobble entrepreneurship and economic development through higher taxes. And some business groups, supposedly representing the interests of large taxpaying institutions, seem more intent on protecting their own subsidy programs rather than on restraining state spending and cutting marginal tax rates.

According to a recent Tax Foundation study, North Carolina remains the highest-taxed state in the Southeast. About 10 percent of our personal income is consumed by state and local taxes (federal taxes take another 23 percent). By comparison, states such as Virginia, Georgia, and Florida impose lower taxes while delivering similar or in some cases better-quality services (see below). This relative lack of return on the massive investment of North Carolina taxpayers is the real fiscal problem our state faces — not a short-term money crunch.

Reducing our tax burden to the regional average of about 9.4 percent of income would mean cutting taxes by about \$1.1 billion. Even the alternative budget plan we present in *Changing Course IV* will take the state only part of the way to this worthwhile destination. Our goal should be to make North Carolina the most attractive place to live, work, and invest. We can and should improve our core state services — law enforcement, education, and transportation — while reducing the current, onerous tax burden.

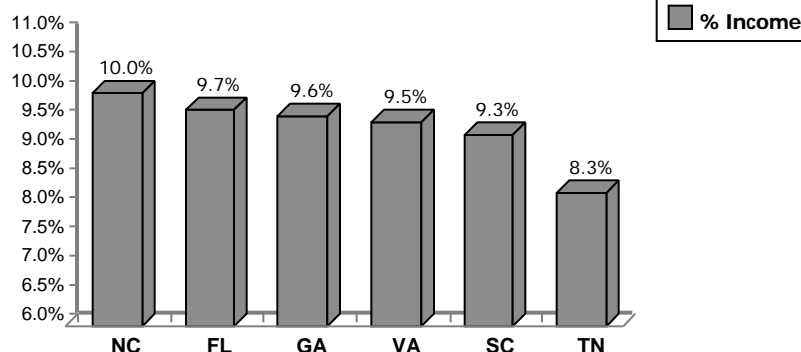
Those who doubt the importance of tax rates to economic growth should examine both economic theory and recent history. At the federal level, cuts in marginal income tax rates in 1962, 1981, and 1986 all led to rapid rates of job creation and income growth. Among states, a recent study by the Cato Institute found that those jurisdictions that cut taxes during the 1980s and 1990s grew faster than those that raised their tax rates. And recent academic research has proven that tax rates, along with the regulatory burden, the quality of education and

roads, and the availability of productive labor top the list of factors that impact both corporate relocations and business creation.

Nor are tax rates unrelated to growth in the tax base. A 1996 study by Dr. Michael Walden of N.C. State University found that state tax burdens were significantly associated with job creation and personal income growth. Indeed, based on his analysis, we estimate that economic growth resulting from the tax cut package in *Changing Course IV* will offset at least a quarter of the projected revenue "loss" to the state.

### Total State & Local Tax Revenue, 2001

SOURCE: Tax Foundation



While the governing class in Raleigh may believe that North Carolinians are undertaxed, their constituents don't agree. In October 2000, the John Locke Foundation commissioned a poll of 500 likely North Carolina voters. One of the strongest findings from the survey was that most North Carolinians did not consider the \$1.4 billion in General Fund tax relief since 1995 to be excessive. About 35 percent said they thought the tax cuts were "too little" and an equal percentage consider them "the right amount." Only 9 percent said the legislature had cut taxes "too much."

Other survey findings with particular relevance to the recommendations in *Changing Course IV* include:

- 69 percent of respondents favored a Taxpayer Protection Act that limited state spending growth to the combined rate of growth in population and inflation. Only 15 percent were opposed.
- By a 55 percent to 31 percent margin, North Carolinians favored across-the-board tax cuts to the targeted tax relief, such as corporate incentives, that the *Changing Course IV* budget zeroes out.
- By a 53 percent to 35 percent margin, North Carolinians favored the idea of providing tax credits to preschool children rather than the current design of Smart Start, which give grants to providers.
- 74 percent of respondents favored tax relief for parents who purchase health insurance for themselves or their children. An even larger number, 78 percent, support tax deductions for parental spending or saving for their children's education.
- By a 51 percent to 30 percent margin, voters supported the idea (included in our alternative budget) of offering private-school scholarships to students trapped in low-achieving public schools.
- And by a 55 percent to 37 percent margin, voters preferred to spend all revenues from taxes on gasoline and car sales to highway improvement rather than maintaining the current practice of transferring hundreds of millions of dollars a year to non-highway purposes. In *Changing Course IV*, we propose an end to such diversions and a \$330 million annual increase in highway spending.

Whatever the outcome of this year's budget debate, we hope that lawmakers in Raleigh will take into consideration the broadest possible spectrum of views. North Carolina is truly at a critical juncture in history. It can continue to float along in its current direction, which will inevitably lead to higher spending, higher debt, and higher taxes. Or its leaders can chart a new course, one that sets firm priorities for state government, focuses on core public services, and returns a greater percentage of tax money to the people who earned it.

With *Changing Course IV*, we have made our preference clear.

## Recommended Savings in 2001-03 Base (Continuation) Budget

John Locke Foundation-May 2001

### GENERAL FUND

#### Public Education

<u>Budget Item</u>	<u>Recommendation</u>	<u>FY 01-02 Impact</u>		<u>FY 02-03 Impact</u>		<u>Reason</u>
Non-Teaching Positions	Transfer 5% to Fund Teacher Positions, Pay Hikes; Make Block Grant	(\$45,645,400)	R	(\$46,324,778)	R	Set Better Priorities
Teacher Assistants	Transfer 25% to Fund Class Size Cuts, Salaries	(\$85,087,756)	R	(\$85,283,148)	R	Set Better Priorities
Lower Enrollment Growth	Redirect Savings as STARS Aid, ESAs Increase Private Enrollment	(\$70,270,329)	R	(\$71,442,758)	R	Duplication
Education Management	Reduce GF Appropriation to Superintendent 5%	(\$301,124)	R	(\$301,124)	R	Set Better Priorities
Cued Speech Center	End GF Appropriation	(\$73,750)	R	(\$73,750)	R	Set Better Priorities
AVID Program Pilots	End GF Appropriation	(\$150,000)	R	(\$150,000)	R	Set Better Priorities
Teaching Fellows Admin.	End GF Appropriation	(\$420,564)	R	(\$420,564)	R	Set Better Priorities
A+ Schools	End GF Appropriation	(\$400,000)	R	(\$400,000)	R	Set Better Priorities
Total Quality Education	End GF Appropriation	(\$400,000)	R	(\$400,000)	R	Set Better Priorities
Schools Attuned Prog.	End GF Appropriation	(\$643,100)	R	(\$643,100)	R	Set Better Priorities
Global Curriculum	End GF Appropriation	(\$150,000)	R	(\$150,000)	R	Set Better Priorities
NC Network	End GF Appropriation	(\$350,000)	R	(\$350,000)	R	Set Better Priorities
Explornet	End GF Appropriation	(\$2,500,000)	R	(\$2,500,000)	R	Set Better Priorities
Teacher Cadet Program	End GF Appropriation	(\$150,000)	R	(\$150,000)	R	Set Better Priorities
Geographic Alliance	End GF Appropriation	(\$50,000)	R	(\$50,000)	R	Set Better Priorities
Teaching Fellows	Withhold Increased Funds	(\$2,500,000)	R	(\$2,500,000)	R	Set Better Priorities
Scholarships/Loans	Withhold Increased Funds	(\$750,000)	R	(\$750,000)	R	Set Better Priorities
Subtotal-Public Edu.		(\$209,842,023)	R	(\$211,889,222)	R	

#### Community Colleges

<u>Budget Item</u>	<u>Recommendation</u>	<u>FY 01-02 Impact</u>		<u>FY 02-03 Impact</u>		<u>Reason</u>
Child Care Grants	End GF Appropriation	(\$2,000,000)	R	(\$2,000,000)	R	Private Responsibility
Human Resource Dev.	Charge Fees to Businesses to Cover Cost by 2nd Yr	(\$3,475,948)	R	(\$6,951,895)	R	User Responsibility
New Industry Training	Charge Fees to Businesses to Cover Cost by 2nd Yr	(\$3,014,271)	R	(\$6,028,541)	R	User Responsibility
Public Radio	End GF Appropriation	(\$299,824)	R	(\$299,824)	R	Private Responsibility
Small Business Centers	End GF Appropriation	(\$3,881,208)	R	(\$3,881,208)	R	Private Responsibility
Focused Ind. Training	Charge Fees to Businesses to Cover Cost by 2nd Yr	(\$981,016)	R	(\$1,962,032)	R	User Responsibility
Special Tech Centers	Charge Tuition, Fees Cover Third of Cost by 2nd Yr.	(\$616,456)	R	(\$1,116,912)	R	User Responsibility
Subtotal-Comm. College		(\$14,268,722)	R	(\$22,240,412)	R	

*UNC System*

<u>Budget Item</u>	<u>Recommendation</u>	<u>FY 01-02 Impact</u>		<u>FY 02-03 Impact</u>		<u>Reason</u>
Full-Time-Equiv. Status for Student Funding	Require 15 Class Hours per Semester for FTE Status	(\$22,085,736)	R	(\$24,206,012)	R	User Responsibility
Minority Pres. Grants	End GF Appropriation	(\$1,652,750)	R	(\$1,652,750)	R	Racial Discrimination
Nat. American Incentive Research Overhead	End GF Appropriation	(\$745,200)	R	(\$745,200)	R	Racial Discrimination
	Recover 50% of Receipts to Offset State Approp.	(\$42,515,042)	R	(\$44,478,548)	R	User Responsibility
Christ. Tree Specialist	End GF Appropriation	(\$100,000)	R	(\$100,000)	R	Private Responsibility
Model Teacher Consort.	End GF Appropriation	(\$800,000)	R	(\$800,000)	R	Set Better Priorities
Ctr School Leadership	End GF Appropriation	(\$786,743)	R	(\$786,743)	R	Set Better Priorities
Blue Crab Research	End GF Appropriation	(\$500,000)	R	(\$500,000)	R	Private Responsibility
Poultry Research	End GF Appropriation	(\$150,000)	R	(\$150,000)	R	Private Responsibility
Teacher Academy	End GF Appropriation	(\$250,000)	R	(\$250,000)	R	Set Better Priorities
Inst for Intern'l Underst.	End GF Appropriation	(\$218,573)	R	(\$218,573)	R	Set Better Priorities
Southern Politics/Media	End GF Appropriation	(\$225,000)	R	(\$225,000)	R	Set Better Priorities
Strategic Initiatives	End GF Appropriation	(\$3,000,000)	R	(\$3,000,000)	R	Set Better Priorities
Pathways Initiative	End GF Appropriation	(\$1,000,000)	R	(\$1,000,000)	R	Set Better Priorities
Manufact. Extension	Charge Fees to Users to Cover Cost by 2nd Yr	(\$450,000)	R	(\$900,000)	R	User Responsibility
N.C. Arboretum	Return to pre-1999 Funding	(\$250,000)	R	(\$250,000)	R	Set Better Priorities
World View Program	End GF Appropriation	(\$260,000)	R	(\$260,000)	R	Set Better Priorities
Cnt for Alcohol Studies	Return to pre1999 Funding	(\$500,000)	R	(\$500,000)	R	Set Better Priorities
Biotech Research Inst.	End GF Appropriation	(\$350,000)	R	(\$350,000)	R	Set Better Priorities
UNC Hospitals	Reduce GF Approp. 50%	(\$20,293,661)	R	(\$20,293,661)	R	User Responsibility
Subtotal-UNC System		(\$96,132,704)	R	(\$100,666,487)	R	

*Administration*

<u>Budget Item</u>	<u>Recommendation</u>	<u>FY 01-02 Impact</u>		<u>FY 02-03 Impact</u>		<u>Reason</u>
N.C. Council for Women	End GF Appropriation	(\$581,013)	R	(\$581,013)	R	Advocacy Group
Human Relat. Comm.	End GF Appropriation	(\$674,050)	R	(\$674,050)	R	Advocacy Group
MLK Commission	End GF Appropriation	(\$74,882)	R	(\$74,882)	R	Advocacy Group
Youth Involvement Off.	End GF Appropriation	(\$839,342)	R	(\$839,342)	R	Advocacy Group
Veteran Affairs-Admin.	Cut GF Approp. 50% by '03	(\$2,131,268)	R	(\$4,262,537)	R	Duplication
Gov. Council/Disabilities	End GF Appropriation	(\$531,594)	R	(\$531,594)	R	Advocacy Group
Commission/Indian Aff.	End GF Appropriation	(\$369,453)	R	(\$369,453)	R	Advocacy Group
Board/Science & Tech	End GF Appropriation	(\$637,726)	R	(\$637,726)	R	Private Responsibility
Subtotal-Administration		(\$5,839,328)	R	(\$7,970,597)	R	

*Insurance*

<u>Budget Item</u>	<u>Recommendation</u>	<u>FY 01-02 Impact</u>		<u>FY 02-03 Impact</u>		<u>Reason</u>
Senior Health Ins Info	End GF Appropriation	(\$104,000)	R	(\$104,000)	R	Duplication
Subtotal-Insurance		(\$104,000)	R	(\$104,000)	R	

*Cultural Resources*

<u>Budget Item</u>	<u>Recommendation</u>	<u>FY 01-02 Impact</u>		<u>FY 02-03 Impact</u>		<u>Reason</u>
Historical Publications	Cover 25% of Cost with Increased Donations/Fees	(\$188,257)	R	(\$188,257)	R	User Responsibility
State Historic Sites	Cover 10% of Cost with Increased Donations/Fees	(\$702,974)	R	(\$702,974)	R	User Responsibility
Tryon Palace/Gardens	Cover 50% of Cost with Increased Donations/Fees	(\$389,974)	R	(\$389,974)	R	User Responsibility
NC Maritime Museum	Cover 50% of Cost with Increased Donations/Fees	(\$551,933)	R	(\$551,933)	R	User Responsibility
NC Museum of Art	Cover 50% of Cost with Increased Donations/Fees	(\$1,854,627)	R	(\$1,854,627)	R	User Responsibility
NC Arts Council	End GF Appropriation	(\$6,240,187)	R	(\$6,240,187)	R	Private Responsibility
NC Symphony	End GF Appropriation	(\$345,236)	R	(\$345,236)	R	Private Responsibility
Grants-In-Aid to Arts	End GF Appropriation	(\$2,140,979)	R	(\$2,140,979)	R	Private Responsibility
State Aid/Loc. Libraries	Reduce Fund 50% by '03	(\$4,196,188)	R	(\$8,392,377)	R	Local Responsibility
NC Museum of History	Cover 50% of Cost with Increased Donations/Fees	(\$2,633,378)	R	(\$2,633,378)	R	User Responsibility
Roanoke Island Comm	End GF Appropriation	(\$1,878,245)	R	(\$1,878,245)	R	Private Responsibility
Subtotal-Cultural Res.		(\$21,121,978)	R	(\$25,318,167)	R	

*Secretary of State*

<u>Budget Item</u>	<u>Recommendation</u>	<u>FY 01-02 Impact</u>		<u>FY 02-03 Impact</u>		<u>Reason</u>
Land Records Manage.	End GF Appropriation	(\$136,549)	R	(\$136,549)	R	Local Responsibility
Subtotal-Sec. Of State		(\$136,549)	R	(\$136,549)	R	

*Governor's Office*

<u>Budget Item</u>	<u>Recommendation</u>	<u>FY 01-02 Impact</u>		<u>FY 02-03 Impact</u>		<u>Reason</u>
Dues to Nat'l Assoc.	End GF Appropriation	(\$358,682)	R	(\$358,682)	R	Advocacy Groups
Education Office	End GF Appropriation	(\$391,557)	R	(\$391,557)	R	Duplication
Fire Protection Grants	Phase Out Appropriation	(\$1,540,000)	R	(\$3,080,000)	R	Local Responsibility
Subtotal-Governor		(\$2,290,239)	R	(\$3,830,239)	R	

*General Assembly*

<u>Budget Item</u>	<u>Recommendation</u>	<u>FY 01-02 Impact</u>		<u>FY 02-03 Impact</u>		<u>Reason</u>
Food Service	Charge Fees to Cover Full Cost by 2002-03	(\$107,505)	R	(\$615,010)	R	User Responsibility
Subtotal-General Ass.		(\$107,505)	R	(\$615,010)	R	



*Health and Human Services*

<u>Budget Item</u>	<u>Recommendation</u>	<u>FY 01-02 Impact</u>		<u>FY 02-03 Impact</u>		<u>Reason</u>
Div. Facility Services	End CON Regulations	(\$1,630,078)	R	(\$1,630,078)	R	Unnecessary
Medicaid Payments	Adjust Optional Services, Reimbursement Rates to Meet Reg. Avg. by '05	(\$87,265,654)	R	(\$196,185,209)	R	Limit Entitlements
Disability Administration	Merge Divs Blind, Deaf, VR; Reduce Total Appr. 5%	(\$2,608,094)	R	(\$2,608,094)	R	Duplication
Special Assistance	Limit Ann. Increase to 3%	(\$1,177,188)	R	(\$1,932,291)	R	Limit Entitlements
Smart Start Program	Convert to Targeted Pre-K for At-Risk, Tax Credits	(\$255,566,442)	R	(\$255,566,442)	R	Limit Entitlements
Senior Games	End GF Appropriation	(\$175,000)	R	(\$175,000)	R	Private Responsibility
Elder Rights Program	End GF Appropriation	(\$442,309)	R	(\$442,309)	R	Advocacy Group
TEACH Program	Convert to Targeted Pre-K for At-Risk, Tax Credits	(\$2,600,000)	R	(\$2,600,000)	R	Set Better Priorities
Touching/Lives Program	Convert to Targeted Pre-K for At-Risk, Tax Credits	(\$300,000)	R	(\$300,000)	R	Set Better Priorities
Alzheimer's Association	End GF Appropriation	(\$150,000)	R	(\$150,000)	R	Private Responsibility
Cued Speech Center	End GF Appropriation	(\$135,000)	R	(\$135,000)	R	Set Better Priorities
Subtotal-HHS		(\$352,049,765)	R	(\$461,724,422)	R	

*Crime Control and Public Safety*

<u>Budget Item</u>	<u>Recommendation</u>	<u>FY 01-02 Impact</u>		<u>FY 02-03 Impact</u>		<u>Reason</u>
Civil Air Patrol	End GF Appropriation	(\$133,580)	R	(\$133,580)	R	Private Responsibility
Butner Public Safety	End GF Appropriation	(\$2,698,891)	R	(\$2,698,891)	R	Local Responsibility
Alcohol Law Enforce.	End GF Appropriation	(\$8,174,306)	R	(\$8,174,306)	R	Local Responsibility
Gov's Crime Comm.	End GF Appropriation	(\$1,414,927)	R	(\$1,414,927)	R	Duplication
National Guard Administration	Consol. Armories, Cut 10% Merge with Correction to Form Dept. Public Safety	(\$958,150)	R	(\$958,150)	R	Duplication
Subtotal-Crime Control		(\$16,098,323)	R	(\$16,098,323)	R	

*Juvenile Justice*

<u>Budget Item</u>	<u>Recommendation</u>	<u>FY 01-02 Impact</u>		<u>FY 02-03 Impact</u>		<u>Reason</u>
Administration	Merge with Correction to Form Dept. Public Safety	(\$2,317,850)	R	(\$2,317,850)	R	Duplication
Gov. 1-on-1 Program	End GF Appropriation	(\$1,781,176)	R	(\$1,781,176)	R	Private Responsibility
Support Our Students	End GF Appropriation	(\$7,190,802)	R	(\$7,190,802)	R	Private Responsibility
Cnt/Prevent Violence	End GF Appropriation	(\$513,110)	R	(\$513,110)	R	Set Better Priorities
Subtotal-Juv Justice		(\$11,802,938)	R	(\$11,802,938)	R	

*Agriculture*

<u>Budget Item</u>	<u>Recommendation</u>	<u>FY 01-02 Impact</u>		<u>FY 02-03 Impact</u>		<u>Reason</u>
Public Affairs	Cut GF Appropriation 50%	(\$298,990)	R	(\$298,990)	R	Set Better Priorities
Aquaculture Develop.	End GF Appropriation	(\$379,069)	R	(\$383,298)	R	Private Responsibility
Marketing Division	End GF Approp. By 2nd Yr	(\$4,331,862)	R	(\$8,703,894)	R	Private Responsibility
Agronomic Services	End GF Appropriation	(\$3,348,471)	R	(\$3,415,671)	R	Private Responsibility
Comm. Feed/Pet Food	End GF Appropriation	(\$841,522)	R	(\$862,972)	R	Private Responsibility
Comm. Fertilizer Analysis	End GF Appropriation	(\$875,119)	R	(\$769,864)	R	Private Responsibility
Seed Testing	End GF Appropriation	(\$853,912)	R	(\$844,787)	R	Private Responsibility
Plant Protection	End GF Appropriation	(\$3,350,175)	R	(\$3,331,556)	R	Private Responsibility
Ag. Finance Authority	End GF Appropriation	(\$133,980)	R	(\$133,980)	R	Private Responsibility
Raleigh Farmer's Market	End GF Appropriation	(\$120,343)	R	(\$120,343)	R	Private Responsibility
Western NC Ag. Center	End GF Appropriation	(\$204,909)	R	(\$204,909)	R	Private Responsibility
Subtotal-Agriculture		(\$14,738,352)		(\$19,070,264)		

*Commerce*

<u>Budget Item</u>	<u>Recommendation</u>	<u>FY 01-02 Impact</u>		<u>FY 02-03 Impact</u>		<u>Reason</u>
Administrative Services	Cut GF Appropriation 50%	(\$786,636)	R	(\$786,636)	R	Set Better Priorities
Executive Aircraft	Cut GF Appropriation 50%	(\$1,152,746)	R	(\$1,152,746)	R	Set Better Priorities
Ctr. Entre. & Technology	End GF Appropriation	(\$245,362)	R	(\$245,362)	R	Private Responsibility
Marketing/Custom Serv.	End GF Appropriation	(\$1,472,834)	R	(\$1,472,834)	R	Private Responsibility
Business/Industry Dev.	End GF Appropriation	(\$4,217,663)	R	(\$4,217,663)	R	Private Responsibility
International Trade Div.	End GF Appropriation	(\$2,673,490)	R	(\$2,673,490)	R	Private Responsibility
Tourism, Film, Sports	End GF Appropriation	(\$9,124,500)	R	(\$9,124,500)	R	Private Responsibility
Wanchese Indus. Park	End GF Appropriation	(\$466,870)	R	(\$466,870)	R	Private Responsibility
Industrial Finance Ctr	End GF Appropriation	(\$2,432,586)	R	(\$2,432,586)	R	Private Responsibility
Local Planning, Manage. Committee for Workforce	End GF Appropriation	(\$3,616,753)	R	(\$3,616,753)	R	Private Responsibility
Preparedness	End GF Appropriation	(\$93,396)	R	(\$93,396)	R	Private Responsibility
Biotechnology Center	End GF Appropriation	(\$6,637,830)	R	(\$6,637,830)	R	Private Responsibility
Rural Econ. Dev. Center	End GF Appropriation	(\$3,992,395)	R	(\$3,992,395)	R	Private Responsibility
Aid to Non-State Entities	End GF Appropriation	(\$5,200,000)	R	(\$5,200,000)	R	Private Responsibility
Regional Partnerships	End GF Appropriation	(\$6,425,000)	R	(\$6,425,000)	R	Private Responsibility
Subtotal-Commerce		(\$42,113,061)	R	(\$42,113,061)	R	

*Labor*

<u>Budget Item</u>	<u>Recommendation</u>	<u>FY 01-02 Impact</u>		<u>FY 02-03 Impact</u>		<u>Reason</u>
Retaliatory Discrim.	End GF Appropriation	(\$571,397)	R	(\$571,397)	R	Unnecessary
On Site Consultation	End GF Appropriation	(\$92,600)	R	(\$92,600)	R	Private Responsibility
Private Personnel Serv.	End GF Appropriation	(\$153,422)	R	(\$153,422)	R	Private Responsibility
Apprenticeship Train.	End GF Appropriation	(\$990,982)	R	(\$990,982)	R	Duplication
Subtotal-Labor		(\$1,808,401)	R	(\$1,808,401)	R	

*Environment and Natural Resources*

<u>Budget Item</u>	<u>Recommendation</u>	<u>FY 01-02 Impact</u>		<u>FY 02-03 Impact</u>		<u>Reason</u>
Environmental Education	End GF Appropriation	(\$437,490)	R	(\$437,490)	R	Advocacy Group
Forestry	Cover 33% of Cost with Increased Donations/Fees	(\$3,708,910)	R	(\$3,708,910)	R	User Responsibility
DFR Tree Improvement	End GF Appropriation	(\$489,781)	R	(\$489,781)	R	Private Responsibility
State Parks	Cover 33% of Cost with Increased Donations/Fees	(\$3,531,537)		(\$3,531,537)		User Responsibility
NC Zoo	Cover 50% of Cost with Increased Donations/Fees	(\$2,872,813)	R	(\$2,872,813)	R	User Responsibility
NC Aquariums	Cover 50% of Cost with Increased Donations/Fees	(\$2,979,186)	R	(\$2,979,186)	R	User Responsibility
Museum of Natural Science	Cover 50% of Cost with Increased Donations/Fees	(\$3,237,214)	R	(\$3,237,214)	R	User Responsibility
Subtotal- DENR		(\$17,256,931)	R	(\$17,256,931)		

*Transportation*

<u>Budget Item</u>	<u>Recommendation</u>	<u>FY 01-02 Impact</u>		<u>FY 02-03 Impact</u>		<u>Reason</u>
Airport Grants	Reduce GF Appropriation 50%	(\$3,304,583)	R	(\$6,125,000)	R	Local Responsibility
TransPark Support	End GF Appropriation	(\$5,503,426)	R	(\$2,236,443)	R	Private Responsibility
Subtotal-Transportation		(\$8,808,009)	R	(\$8,361,443)	R	

*Capital Assets*

<u>Budget Item</u>	<u>Recommendation</u>	<u>FY 01-02 Impact</u>		<u>FY 02-03 Impact</u>		<u>Reason</u>
State-Owned Ports	Privatize; Use Proceeds to Reduce State Debt	(\$5,600,000)	R	(\$5,600,000)	R	Private Responsibility
North Carolina Railroad	Privatize; Use Proceeds to Reduce State Debt	(\$30,000,000)	R	(\$30,000,000)	R	Private Responsibility
Higher Education Bonds	Delay Issuance of Bonds	(\$28,700,000)	R	(\$62,400,000)	R	Set Better Priorities
Subtotal-Capital Assets		(\$64,300,000)	R	(\$98,000,000)	R	

TOTAL CHANGES IN GENERAL FUND BASE BUDGET		(\$878,818,827)	R	(\$1,049,006,463)	R	
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**HIGHWAY FUND**

<u>Budget Item</u>	<u>Recommendation</u>	<u>FY 01-02 Impact</u>		<u>FY 02-03 Impact</u>		<u>Reason</u>
Aeronautics	End HF Appropriation	(\$1,988,486)	R	(\$1,988,486)	R	Local Responsibility
Bicycle Program	End HF Appropriation	(\$306,712)	R	(\$306,712)	R	Local Responsibility
Public Transport. Admin.	End HF Appropriation	(\$446,301)	R	(\$446,301)	R	Local Responsibility
Rail Program Admin.	End HF Appropriation	(\$562,074)	R	(\$562,074)	R	Private Responsibility
Ferry Division Admin.	Charge Fees to Users to Cover 50% Cost by 2nd Yr	(\$296,614)	R	(\$593,229)	R	User Responsibility
Construction-Secondary Ferry Operations	Reduce HF Approp. 25% Charge Fees to Users to Cover 50% Cost by 2nd Yr	(\$21,865,500)	R	(\$22,346,750)	R	Set Better Priorities
Railroad Program	End HF Appropriation	(\$4,936,783)	R	(\$9,873,566)	R	User Responsibility
Public Transport Grants	End HF Appropriation	(\$8,575,000)	R	(\$8,575,000)	R	Private Responsibility
DMV-Driver's License	Reduce HF Approp. 50%	(\$6,281,232)	R	(\$12,562,464)	R	Local Responsibility
TransPark-Reserve	Consolid. Offices, Cut 10%	(\$2,854,976)	R	(\$2,854,976)	R	Set Better Priorities
	End HF Appropriation	(\$1,211,098)	R	(\$1,259,542)	R	Private Responsibility
Subtotal-Highway Fund		(\$49,324,776)	R	(\$61,369,099)	R	

**HWY TRUST FUND**

<u>Budget Item</u>	<u>Recommendation</u>	<u>FY 01-02 Impact</u>		<u>FY 02-03 Impact</u>		<u>Reason</u>
Secondary Roads	Reduce HTF Approp. 50%	(\$20,491,402)	R	(\$42,791,571)	R	Set Better Priorities
Transfer to General Fund	End HF Appropriation	(\$170,000,000)	R	(\$170,000,000)	R	Set Better Priorities
Subtotal-Hwy Trust Fund		(\$190,491,402)	R	(\$212,791,571)	R	

**FEE-BASED ITEMS**

<u>Budget Item</u>	<u>Recommendation</u>	<u>FY 01-02 Impact</u>		<u>FY 02-03 Impact</u>		<u>Reason</u>
Board/Barber Examiners	Convert to Voluntary Cert.	(\$492,053)	R	(\$492,053)	R	Private Responsibility
Board of Cosmetology	Convert to Voluntary Cert.	(\$1,577,254)	R	(\$1,600,882)	R	Private Responsibility
Board of Opticians	Convert to Voluntary Cert.	(\$162,099)	R	(\$162,099)	R	Private Responsibility
Psychology Board	Convert to Voluntary Cert.	(\$518,407)	R	(\$518,407)	R	Private Responsibility
Auctioneer License Brd	Convert to Voluntary Cert.	(\$450,121)	R	(\$450,121)	R	Private Responsibility
Board/Electrolysis Exam	Convert to Voluntary Cert.	(\$18,499)	R	(\$18,499)	R	Private Responsibility
Grape Growers Council	Convert to Voluntary Prog.	(\$175,000)	R	(\$175,000)	R	Private Responsibility
Private Protective Serv.	Convert to Voluntary Cert.	(\$1,367,356)	R	(\$1,282,356)	R	Private Responsibility
Sleep Products	Convert to Voluntary Cert.	(\$500,729)	R	(\$500,729)	R	Private Responsibility
Subtotal-Fee Items		(\$5,261,518)	R	(\$5,200,146)	R	

## Recommended Changes to Governor's 2001-03 Expansion Budget

John Locke Foundation-May 2001 (\*Denotes JLF Proposal for Increased Spending)

### GENERAL FUND

#### Public Education

<u>Budget Item</u>	<u>Recommendation</u>	<u>FY 01-02 Impact</u>		<u>FY 02-03 Impact</u>		<u>Reason</u>
Teaching Fellows	Eliminate GF Expansion	(\$650,000)	R	(\$3,250,000)	R	Set Better Priorities
Character Education	Eliminate GF Expansion	(\$174,000)	R	(\$174,000)	R	Set Better Priorities
*Class Size Reduction	Cut Kinder. Class Size to 15; Eliminate Gov's					
	Reduction in 1st Grade Sizes	\$29,773,616	R	(\$9,114,377)	R	Set Better Priorities
*STARS Scholarships	Offer \$3,500 Scholarships to Poorest 50% of Pupils in Low-Achieving Schools	\$61,687,570	R	\$62,716,800	R	Set Better Priorities
Subtotal-Public Educ.		\$90,637,186	R	\$50,178,423	R	

#### Community Colleges

<u>Budget Item</u>	<u>Recommendation</u>	<u>FY 01-02 Impact</u>		<u>FY 02-03 Impact</u>		<u>Reason</u>
Tuition Increase	25% in each of next 2 yrs	(\$9,826,978)	R	(\$29,816,761)	R	User Responsibility
Subtotal-Comm. College		(\$9,826,978)	R	(\$29,816,761)	R	

#### UNC System

<u>Budget Item</u>	<u>Recommendation</u>	<u>FY 01-02 Impact</u>		<u>FY 02-03 Impact</u>		<u>Reason</u>
Tuition Increase	25% in each of next 2 yrs	(\$38,222,052)	R	(\$92,722,698)	R	User Responsibility
Biotech Funds	End GF Appropriation	(\$900,000)	R	(\$900,000)	R	Private Responsibility
Education Cabinet	End GF Appropriation	(\$500,000)	R	(\$500,000)	R	Duplication
Character Education	End GF Appropriation	(\$300,000)	R	(\$300,000)	R	Set Better Priorities
Subtotal-UNC		(\$39,922,052)	R	(\$94,422,698)	R	

#### Health/Human Serv.

<u>Budget Item</u>	<u>Recommendation</u>	<u>FY 01-02 Impact</u>		<u>FY 02-03 Impact</u>		<u>Reason</u>
N.C. Health Choice	Eliminate GF Expansion	(\$9,988,386)	R	(\$20,921,414)	R	Limit Entitlements
**More at 4"	Speed Up Creation of Targeted Pre-K Program	\$20,000,000	R	\$20,000,000	R	Limit Entitlements
Subtotal-HHS		\$10,011,614	R	(\$921,414)	R	

#### Commerce

<u>Budget Item</u>	<u>Recommendation</u>	<u>FY 01-02 Impact</u>		<u>FY 02-03 Impact</u>		<u>Reason</u>
Industrial Recruit Fund	End GF Appropriation	(\$2,000,000)	R	(\$2,000,000)	R	Private Responsibility
NC Rural Econ Dev Ctr	End GF Appropriation	(\$1,000,000)	R	(\$1,000,000)	R	Private Responsibility
NC Biotechnology Ctr	End GF Appropriation	(\$1,000,000)	R	(\$1,000,000)	R	Private Responsibility
Subtotal-Commerce		(\$4,000,000)	R	(\$4,000,000)	R	

*Other Adjustments*

<u>Budget Item</u>	<u>Recommendation</u>	<u>FY 01-02 Impact</u>		<u>FY 02-03 Impact</u>		<u>Reason</u>
Gov's Efficiency Comm.	Accept Savings Ideas	(\$84,584,506)	R	(\$92,474,394)	R	Set Better Priorities
*Rainy Day Fund	Additional Appropriation	\$150,000,000	NR	\$0	NR	Set Better Priorities
*Repairs/Renovations	Additional Appropriation	\$34,000,000	NR	\$0	NR	Set Better Priorities
Subtotal-Other Adjust.		(\$84,584,506)	R	(\$92,474,394)	R	
		\$184,000,000	NR			
TOTAL-GF EXPANSION		(\$37,684,735)	R	(\$171,456,844)	R	
		\$184,000,000	NR			
NET SAVINGS FOR REVENUE REDUCTIONS		(\$732,503,562)	R	(\$1,220,463,307)	R	

**GENERAL FUND REVENUES**

<u>Revenue Item</u>	<u>Recommendation</u>	<u>FY 01-02 Impact</u>		<u>FY 02-03 Impact</u>		<u>Benefit</u>
Indiv. Income Tax Rates	Cut Top Rates to 6.75%	\$345,566,249	R	\$583,805,276	R	Growth, Equity
Corporate Income Tax	Cut 6.9% Rate to 6.5%	\$36,394,203	R	\$39,460,870	R	Growth, Equity
Sales & Use Tax	Cut 4% Rate to 3.75%	\$231,287,500	R	\$243,075,000	R	Growth, Equity
Smart Start Tax Credits	\$250 Refundable Credit for Every Preschool Child	\$155,957,750	R	\$156,159,250	R	Reduce Tax Bias Against Edu. Invest.
Education Tax Relief	\$2,000 Deduction Per Child for Tuition or Edu. Savings	\$48,268,903	R	\$48,462,839	R	Reduce Tax Bias Against Edu. Invest.
Health Choice Tax Credit	Double Refundable Credit for Child Health Premiums	\$28,472,983	R	\$30,393,251	R	Reduce Tax Bias In Health Insurance
Governor's Loophole Committee	Accept Higher Estimates from Orig. Easley Budget	(\$700,000)	R	(\$25,000,000)	R	Neutrality
Social Security Benefits	Tax 50% of Benefits	(\$57,146,951)	R	(\$61,001,043)	R	Neutrality
Pension Benefits	Remove Special Treatment	(\$113,891,931)	R	(\$121,573,005)	R	Neutrality
Severance Pay	Tax as Compensation	(\$6,947,408)	R	(\$7,415,953)	R	Neutrality
Fuel Ethanol Distillery	Eliminate Credit	(\$2,847,298)	R	(\$3,039,325)	R	Neutrality
Qual. Business Credit	Eliminate Credit	(\$6,833,516)	R	(\$7,294,380)	R	Neutrality
Child Care Credit	Convert to SS Tax Credit	(\$24,714,549)	R	(\$26,381,342)	R	Neutrality
Bill Lee Act Credits	Eliminate Credits	(\$22,380,327)	R	(\$45,412,836)	R	Neutrality
Develop. Zone Credits	Eliminate Credits	(\$3,689,144)	R	(\$4,000,000)	R	Neutrality
Business Property	Eliminate Credit	(\$12,795,248)	R	(\$13,873,408)	R	Neutrality
Low-Income Housing	Eliminate Credit	(\$1,500,000)	R	(\$1,626,394)	R	Neutrality
Dry Cleaning Equipment	Eliminate Credit	(\$600,000)	R	(\$650,558)	R	Neutrality
Recycling Facility	Eliminate Credit	(\$454,269)	R	(\$492,547)	R	Neutrality
Recycling Transportation	Eliminate Credit	(\$8,050,000)	R	(\$8,728,313)	R	Neutrality
Historic Structures	Eliminate Credit	(\$2,877,038)	R	(\$3,119,465)	R	Neutrality
Cogeneration Plants	Eliminate Credit	(\$378,558)	R	(\$410,456)	R	Neutrality
Gleaned Crop	Eliminate Credit	(\$4,164,134)	R	(\$4,515,014)	R	Neutrality
State Port Usage	Eliminate Credit	(\$2,725,615)	R	(\$2,955,282)	R	Neutrality
Cigarette Export	Eliminate Credit	(\$6,586,903)	R	(\$7,141,932)	R	Neutrality
Out-Of-State Credit Card	Change Nexus Rules	(\$34,751,592)	R	(\$37,679,848)	R	Neutrality
Subtotal-Net Tax Cut		\$531,913,107	R	\$719,045,385	R	
HTF Transfer	End Transfer to General Fund	\$200,000,000	R	\$200,000,000	R	Set Better Priorities
State Lottery	Reject Lottery Tax	\$0	R	\$300,000,000	R	Set Better Priorities
TOTAL REVENUE REDUCTION		\$731,913,107	R	\$1,219,045,385		

**HIGHWAY FUND/TRUST FUND**

<u>Budget Item</u>	<u>Recommendation</u>	<u>FY 01-02 Impact</u>		<u>FY 02-03 Impact</u>		<u>Reason</u>
Public Transportation	Eliminate HF Expansion	(\$15,621,993)	R	(\$15,621,993)	R	Local Responsibility
Rail Program	Eliminate HF Expansion	(\$12,932,088)	R	(\$12,932,088)	R	Private Responsibility
CMAQ-Public Transport.	Eliminate HF Expansion	(\$14,000,000)	R	(\$14,000,000)	R	Local Responsibility
Charlotte Intermodal	Eliminate HF Expansion	(\$15,000,000)	R	(\$15,000,000)	R	Local Responsibility
Airport Grants	Eliminate HF Expansion	(\$5,000,000)	NR	\$0	NR	Local Responsibility
Additional HTF Transfer	Eliminate Diversion	(\$30,000,000)	R	(\$30,000,000)	R	Set Better Priorities
*Maintenance	Increase Investment 25%	\$142,156,110	R	\$140,400,368	R	Set Better Priorities
*Urban Loop Construct.	Increase Investment 50%	\$97,282,473	R	\$102,358,742	R	Set Better Priorities
*Intrastate Construction	Increase by 25% by '03	\$89,309,368	R	\$117,913,654	R	Set Better Priorities
<b>NET HF/TF EXPANSION</b>		<b>\$236,193,870</b>	<b>R</b>	<b>\$273,118,682</b>	<b>R</b>	

**Summary of Recommended Changes to Governor's 2001-03 Budget**

**GENERAL FUND**

	<u>FY 01-02 Budget</u>	<u>FY 02-03 Budget</u>
Total Gen. Fund Savings	(\$1,027,964,748)	(\$1,303,180,107)
New Gen. Fund Spending	\$145,461,186	\$82,716,800
• Subtotal-Net Savings	(\$882,503,562)	(\$1,220,463,307)
Total Gen. Fund Tax Cuts	\$845,947,588	\$1,101,356,486
GF Revenue Increases	(\$314,034,481)	(\$382,311,101)
• Subtotal-Net Tax Cuts	\$531,913,107	\$719,045,385
Easley General Fund Budget (Millions)	\$14,554.3	\$15,397.8
Education	8,579.5	8,938.8
HHS	3,433.9	3,726.5
All Other Depts.	2,540.9	2,732.5
Added to Rainy Day	67.2	370.7
Changing Course GF Budget (Millions)	\$13,672.4	\$14,178.8
Education	8,250.3	8,476.3
HHS	3,071.9	3,241.5
All Other Depts.	2,350.2	2,461.0
Added to Rainy Day	217.2	370.7

**HIGHWAY FUND/TRUST FUND**

Total HF/HTF Savings	(\$332,370,259)	(\$361,714,751)
New HF/HTF Spending	\$328,747,951	\$360,672,763

**FEE-BASED ITEMS**

Program Eliminations	(\$5,261,518)	(\$5,200,146)
Savings in Lower Fees	\$5,261,518	\$5,200,146

- **John Hood** is president of the John Locke Foundation. He serves as editor and publisher of *Carolina Journal*, JLF's monthly newspaper, and oversees the research, publications, and administration of the organization. In addition to his duties at JLF, Hood is a syndicated columnist on state politics and public policy for two dozen North Carolina newspapers. He is a regular radio commentator and a weekly panelist on "N.C. Spin," a discussion program on state issues that is broadcast on television stations in Charlotte, the Triangle, the Triad, Wilmington, and Greenville. His books include *The Heroic Enterprise: Business and the Common Good* (The Free Press, 1996) and the forthcoming *Investor Politics: The New Force That Will Transform American Business, Government, and Politics in the 21st Century* (Templeton Foundation Press, 2001).
- **Don Carrington** is vice president at the Locke Foundation and Executive Editor of *Carolina Journal*, its monthly newspaper. He joined the Foundation in late 1994, having previously written articles for *Carolina Journal*. His duties include investigative reporting and research. He writes articles and newspaper columns for the Foundation and in 1995 co-authored *Changing Course*, Locke's proposal for rightsizing state government and cutting taxes. Carrington's previous work experience has all been in North Carolina, including economic and employment research in state government, private-sector marketing and economic development, and political consulting.
- **Dr. Roy Cordato** is vice president for research and resident scholar at the Locke Foundation. From 1993 to 2000 he served as the Lundy Professor of Business Philosophy at Campbell University in Buies Creek, NC. From 1987 to 1993 he was Senior Economist at the Institute for Research on the Economics of Taxation (IRET) in Washington, DC. He has served on the full-time economics faculty at the University of Hartford and at Auburn University and as an adjunct faculty member at Johns Hopkins University. His publications include a 1992 book, *Welfare Economics and Externalities in an Open Ended Universe* (Kluwer Academic Publishers).

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