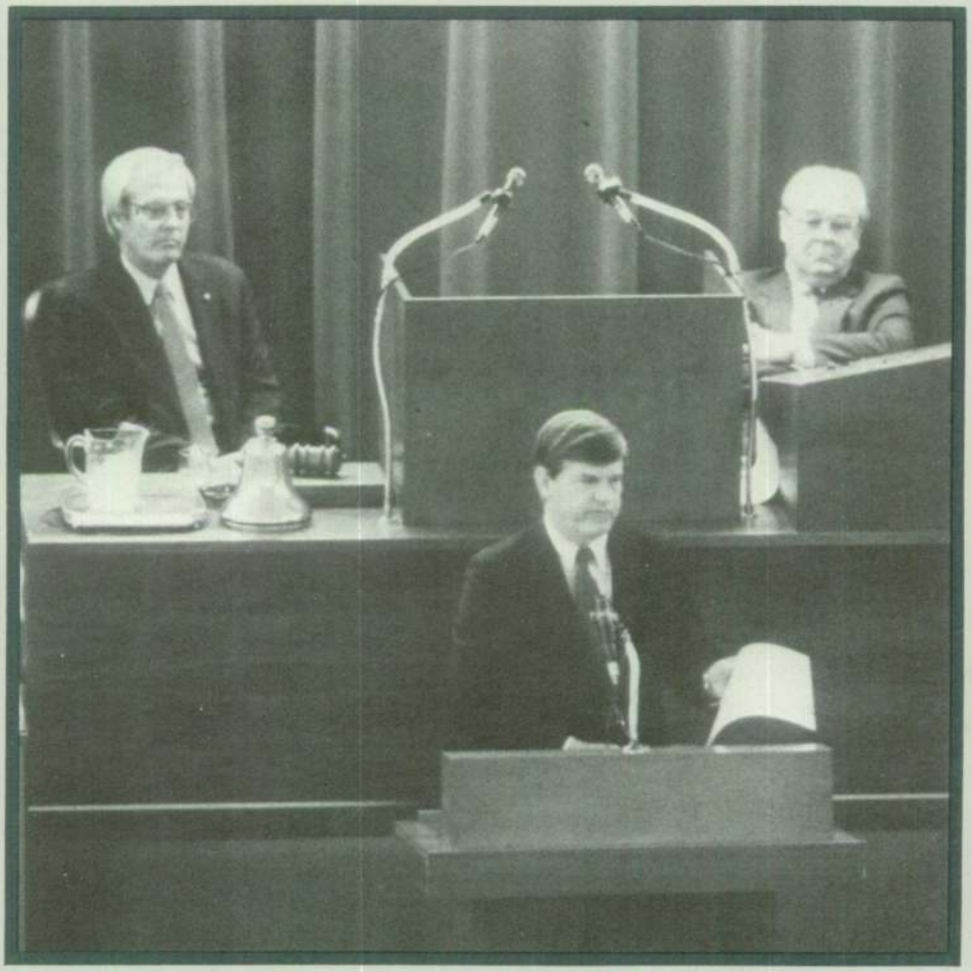
North Carolina Insight

April 1985 Vol. 7, No. 4



Rendering Unto Caesar

The tax debate of 1985

- Lotteries
- Gifted Education
- School Finance

N.C. Center for Public Policy Research

The North Carolina Center for Public Policy Research is an independent research and educational institution formed to study state government policies and practices without partisan bias or political intent. Its purpose is to enrich the dialogue between private citizens and public officials, and its constituency is the people of this state. The Center's broad institutional goal is the stimulation of greater interest in public affairs and a better understanding of the profound impact state government has each day on everyone in North Carolina.

A non-profit, non-partisan organization, the Center was formed in 1977 by a diverse group of private citizens "for the purpose of gathering, analyzing and disseminating information concerning North Carolina's institutions of government." It is guided by a self-electing Board of Directors and has individual and corporate members across the state.

Center projects include the issuance of special reports on major policy questions; the publication of a quarterly magazine called *North Carolina Insight*; the production of a symposium or seminar each year; and the regular participation of members of the staff and the Board in public affairs programs around the state. An attempt is made in the various projects undertaken by the Center to synthesize the integrity of scholarly research with the readability of good journalism. Each Center publication represents an effort to amplify conflicting views on the subject under study and to reach conclusions based on a sound rationalization of these competing ideas. Whenever possible, Center publications advance recommendations for changes in governmental policies and practices that would seem, based on our research, to hold promise for the improvement of government service to the people of North Carolina.

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NORTH CAROLINA INSIGHT is a quarterly magazine published by the North Carolina Center for Public Policy Research, Inc. (a non-profit, tax-exempt corporation), P.O. Box 430, Raleigh, N.C. 27602. Telephone (919) 832-2839. Annual membership rates: Individual, $24; Organizational, $30; Supporting, $50; Corporate, $100; Supporting Corporate, $250; Patron, $500. Third class postage paid at Raleigh, N.C. Printed by Theo. Davis Sons, Inc., Zebulon, N.C. The Center is supported in part by grants from the Mary Reynolds Babcock Foundation and the Z. Smith Reynolds Foundation, as well as by corporate contributions and 700 corporate and individual members across the state. The views expressed in this publication are those of the authors and are not necessarily those of the Center's Board of Directors or staff. Published April 1985.

Cover photograph by Jimmie Jeffries,
Greensboro News & Record

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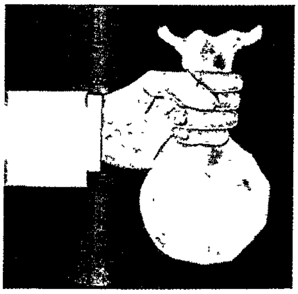
The Tax Debate of 1985



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Rendering Unto Caesar

A Taxing Problem for the 1985 Legislature

by Jack Betts

For more than two centuries, North Carolinians have debated what constitutes a reasonable and a fair tax. At the heart of the debate—which sometimes rages and sometimes merely whimpers—are questions of fairness and, more to the point, whether the next taxpayer is paying a fair share. Those same questions will be raised in this 1985 session of the General Assembly over proposals by Gov. Jame G. Martin to provide more than a billion dollars' worth of tax relief during the next four years.

The state's legislative history is littered with proposals to derive a fair system of taxation that will also provide enough revenue to fund state services and create a favorable climate for economic growth. Before the American Revolution, the colony raised revenues through poll taxes, an extremely unpopular levy, and certain types of land rents. In 1777, the state's first legislature elected by the people engaged in a great debate over taxation and adopted the principle of universal taxation of property. And the 1839 General Assembly adopted the notion of a balanced tax system. The system we have today in North Carolina sprang largely from those debates.

Governor Martin is but the latest in a long string of chief executives to discover that when it

Jack Betts is associate editor of North Carolina Insight. *Artwork and photographs by Carol Majors.*

comes to taxes, forging an agreement on who should be taxed—and by how much—is far easier in theory than in reality. In his February 28, 1985, State of the State address, Martin proposed a sweeping series of tax changes: repealing the sales tax on food by January 1986; dropping the sales tax on non-prescription drugs by January 1986; phasing out the property tax on inventories held by manufacturers, wholesalers, and retailers (from January 1986 through 1989) through a series of corporate tax credits; and eliminating the state tax on intangible property like stocks, bonds, and money on deposit by January 1986. (For more, see "What's in a Tax?" on page 4.)

The cost of this tax relief would come to $70.3 million in the first fiscal year but balloon to $258 million in the second year, $362 million in the third year, and nearly half a billion dollars ($489 million) by the fourth year. It all adds up to $1.2 billion in tax relief over Martin's four-year term.

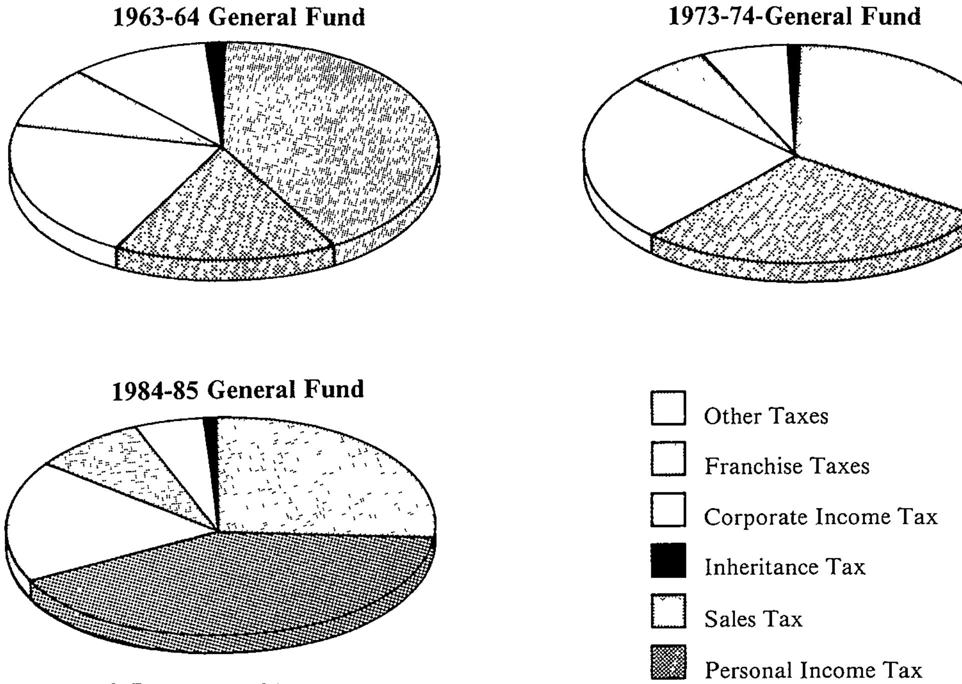
Martin swept into office last fall after campaigning for those tax cuts. During the campaign last year and again in his appearance before the General Assembly, Martin preached the gospel of cutting those taxes because they are "virtually unique, self-inflicting handicaps" that cut personal income, stifle economic growth, and discourage out-of-state manufacturers and retirees from relocating here.

What made Martin's proposals particularly appealing was his contention that his tax program could be effected without major spending cuts and without raising any other taxes. Not only that, Martin promised, but the state would also guarantee that county and city governments, which are the main beneficiaries of the intangible and inventory taxes, would suffer no loss of revenue. In fact, they would gain revenues in future years through general economic growth.

"And it came to pass in those days, that there went out a decree from Caesar Augustus, that all the world should be taxed."—Luke 2:1

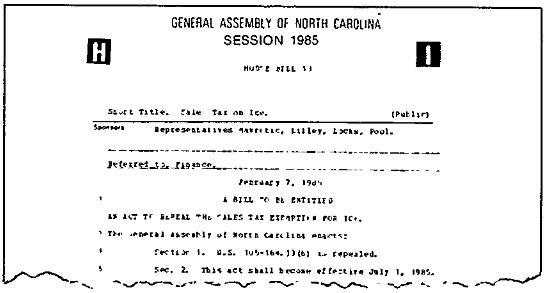
Democrats in the legislature immediately predicted there wouldn't be enough growth in the current budget to pay for all the tax cuts. And they warned that federal budget cuts proposed by President Ronald Reagan could cost the state further

Tax Revenue Sources



Source: N.C. Department of Revenue

funding. The Governor dismissed those fears, however, saying the state should not postpone tax reductions "on the remote, hypothetical possibility that federal spending is going to be cut substantially."


GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 1985

H

HOUSE BILL 11

Short Title. Sale Tax on Ice. (Public)

Sponsors Representatives Mavretic, Lilley, Locks, Pool.

Referred to: Finance.

February 7, 1985

A BILL TO BE ENTITLED

AN ACT TO REPEAL THE SALES TAX EXEMPTION FOR ICE.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-164.13(6) is repealed.

Sec. 2. This act shall become effective July 1, 1985.

But Martin, only the second Republican governor since the turn of the century, may not enjoy the success in the General Assembly that he enjoyed at the ballot box in November. Despite major GOP gains, the legislature remains solidly in Democratic hands, with the GOP outmanned 120 to 50. A February survey of legislators by *The Charlotte Observer* found broad support for some of Martin's proposals—particularly repeal of the intangibles tax—but less support for removal of the state sales tax on food.

Governor Martin's proposals are not, of course, the only tax relief measures to come before the General Assembly. In the first two weeks of the 1985 session alone, no less than a dozen tax bills were introduced by Democrats, and more were coming in daily. Among the major proposals were:

- A bill by Sen. Kenneth Royal (D-Durham) and others to increase state sales and use taxes by .5 percent; provide an individual income tax credit; exempt money on deposit from the intangibles tax; and establish a reserve account for capital construction for public schools.
- A bill sponsored by Sen. Dennis Winner (D-Buncombe) to exempt money on deposit from the intangibles tax and reimburse local governments for the loss; and to allow counties to exempt business inventories and intangible property from taxation.

What's In a Tax?

Exactly what are the taxes that Gov. James G. Martin proposes to eliminate? And how much revenue do they bring in? The General Assembly's Fiscal Research Division has supplied figures for those revenues. For Governor Martin's estimate of revenue loss, if his tax proposals were approved, see the chart on page 5.

Sales Taxes: that portion of the 3 percent statewide sales tax that is levied on food and non-prescription drugs.[1] Often called the most regressive of taxes, the food tax applies equally to every consumer, but it harms the poor more than the wealthy because food—and the food tax—consume a larger portion of the poor family's food budget. Levied at the point of sale, the statewide food tax would bring in an estimated $165 million in 1985-86, the fiscal year that begins July 1, 1985. The sales tax on non-prescription medicine would produce about $20 million in revenues for the state next year.

Inventory Taxes: a local property tax, part of the system of ad valorem property taxes. Cities, counties, and certain special districts levy and collect all ad valorem taxes, which is their major revenue source for schools, water and sewer plants, fire and police protection, and other local services. The inventory tax is not a separate category of taxation, and strictly speaking there is no such thing as an "inventory tax." Inventory taxes are simply part of the overall property tax system. To eliminate these local property taxes would require creation of a loophole specifically exempting from the property tax the inventories held by manufacturers, by wholesalers, and by retail merchants.

Since the early 1970s, certain types of manufacturers' inventories have been exempt from the tax. These include reductions in the rate of taxation for stored tobacco, peanuts, and baled cotton; and exemptions for merchandise held for export and for property in a foreign trade zone. In 1978, Gov. James B. Hunt Jr. pushed through another exemption for manufacturers aimed at enticing high-technology firms to the state.[2]

According to the Fiscal Research Division of the N.C. General Assembly, taxes applied to manufacturers' inventories in 1985-86 would bring in $68 million for local governments; the tax on wholesalers' inventories would bring in $28 million; and the tax on retail merchants' inventories would bring in $59 million. If no change is made in the inventory tax, revenues for 1985-86 would total some $155 million.

Intangibles Taxes: also a form of property taxes, applied to money and other instruments of wealth such as stocks and bonds. The N.C. Department of Revenue levies and collects this tax, deducts the cost of collections,

■ A proposed constitutional amendment by Rep. Josephus Mavretic (D-Edgecombe) and Rep. Martin Lancaster (D-Wayne) to allow individual counties to eliminate property taxes on business inventories.

■ A bill sponsored by Mavretic to repeal local sales and use taxes; to increase the *state* sales and use tax from 3 percent to 4.5 percent and to distribute the proceeds to local governments. This bill in effect would convert the present combination of state and local sales taxes to a statewide sales tax.

Other tax bills waiting when the legislature convened came courtesy of the Legislative Research Commission's study on revenue laws. These recommendations varied widely and wildly in scope—literally everything from the nuances of taxing slungshots versus slingshots to eliminating the sales tax on ice cubes.

Obviously, the buzzword of the 1985 session would be taxation—how to remove certain taxes, how to raise others, how to create new ones, possibly even raising revenues through a state lottery (see article, page 24). Governor Martin assured that it would be so by becoming the first governor in the post-World War II era to make tax relief the linchpin of his legislative proposals. No recent governor has proposed such sweeping *cuts* in the state's taxation system. These tax proposals, coupled with the Governor's supplemental budget package, gained for Martin the dubious distinction

"Taxes, after all, are the dues we pay for the privilege of membership in an organized society."—Franklin Delano Roosevelt

and then distributes the revenue to local governments according to where the taxpayers live. This is considered among the most progressive of taxes because the burden falls most upon the wealthy—those who are more able to pay—even though the rate is the same for all.

The tax is levied on four major types of intangible personal property (see chart at right). Money on deposit (or in lock boxes or stuffed in a mattress) is taxed at the rate of 10 cents per $100. Shares of stock, bonds, and other assets are taxed at the rate of 25 cents per $100 of valuation. The chart below shows projected revenue estimates by the Fiscal Research Division for 1985-86, by type of intangible property (in millions of dollars):

Type of Property	Gross Collections	Net to Local Government
Money on deposit	$19.4	$17.9
Shares of stock	35.5	32.8
Bonds	12.5	11.6
Accounts receivable	10.5	9.7
Other	3.3	3.1
TOTAL	$81.2 million	$75.1 million

FOOTNOTES

[1]Under state law, counties may levy a 1.5 cent sales tax. Governor Martin's proposals *do not* call for repeal of that local option tax.

[2]These measures were approved using the back-door "special provisions" approach, a practice to which the N.C. Center for Public Policy Research has long objected, as explained in *The 1983-85 North Carolina Budget: Finding the Missing Pieces in the Fiscal Jigsaw Puzzle,* 1984, pp. 17 and 61-62.

Governor Martin's Proposal

Type of tax relief (in millions of $)	1985-86	1986-87	1987-88	1988-89
Eliminate 3% state sales tax on food and non-prescription drugs	$70.3	$178.1	$189.6	$203.1
Intangible tax reimbursement	—	3.0	88.7	96.0
Inventory tax credit/rebate	—	77.0	84.0	190.0
TOTAL (millions)	$70.3	$258.1	$362.3	$489.1

TOTAL over his administration: $1.18 billion

(Figures supplied by Martin administration Office of Budget and Management and confirmed by Fiscal Research Division.)

of having one of the tardiest gubernatorial packages to be sent down from the Capitol to the Legislative Flats in the past two decades.

The dizzying array of tax proposals—from the Governor and Democrats alike—prompted Senate Finance Chairman Marshall Rauch (D-Gaston) to lay down the law early in the session. At his committee's organizational meeting, Rauch vowed to develop an omnibus tax bill that would include every tax-related measure that would be sent to the Senate floor. Rauch's aim was to move the tax bill out early—meaning late May or early June—so that it could be debated *before* the general appropriations bill hit the Senate floor. To do otherwise would be to jeopardize chances of any substantive tax relief in 1985, said Rauch. "Historically, it is shown that [the] Appropriations [Committee] will spend all the money," he explained, locking in spending at a high level and leaving nothing to allow any tax cuts.

Legislators from both parties have indicated strong interest in cutting taxes significantly in the 1985 session. The only questions, as both parties jockeyed for position on the legislative track, seemed to be which taxes would be cut, and by how much. Of particular concern to those interested in taxation was what to do about the tax on wealth—the intangibles tax—and the tax on businesses—the inventory tax. To help focus the debate on those questions, *North Carolina Insight* presents a debate on each of those forms of taxation—as the N.C. General Assembly moves toward making major decisions on how much should be rendered unto Caesar. □

Table 1: States with Inventory Tax and Intangibles Tax, 1985

The table below shows the states that levy taxes on business inventories and intangible personal property. Seven states—Georgia, Indiana, Kentucky, North Carolina, Ohio, Pennsylvania, and West Virginia—levy taxes on *both* business inventories *and* intangible personal property.

State	Inventory Tax[1]	Intangibles Tax[2]
Alaska	X	
Arkansas	X	
Delaware	X	
Florida		X
Georgia	X	X
Hawaii	X	
Illinois	X	
Indiana[3]	X	X
Iowa	X	
Kansas	X	
Kentucky	X	X
Louisiana	X	
Maryland	X	
Michigan		X
New York	X	
North Carolina	X	X
Ohio	X	X
Oklahoma	X	
Pennsylvania	X	X
South Carolina[3]	X	
South Dakota	X	
Texas	X	
West Virginia	X	X

FOOTNOTES

[1]Application of tax on retailing, warehousing and manufacturing inventories may vary broadly from state to state. Source: *State Tax Guide*, by Commerce Clearing House, Volume 1, 1985, p. 2022.

[2]Intangibles taxes levied by these states also vary in the rate and type of property assessed. Source: *State Tax Guide*, by Commerce Clearing House, Volume 2, 1985, pp. 662-663.

[3]Indiana and South Carolina are in process of phasing out taxes on business inventories. Indiana is also phasing out intangibles taxes.

Where Does North Carolina Stand?

Measurements of Tax Payments	North Carolina Ranking Among 50 States
Total tax burden with initial impact on business as a percentage of total state and local taxes	28
Taxes as a percentage of personal income	34
Total tax burden on hypothetical manufacturing corporation	42
Business taxes per non-agricultural private employee	44
Total taxes paid per capita	46

Source: Charles D. Liner of the Institute of Government, University of North Carolina. Various reports, Advisory Commission on Intergovernmental Relations.

"Vectigalia, nervos rei publicae."
(Revenues, the sinews
of the state)—Cicero

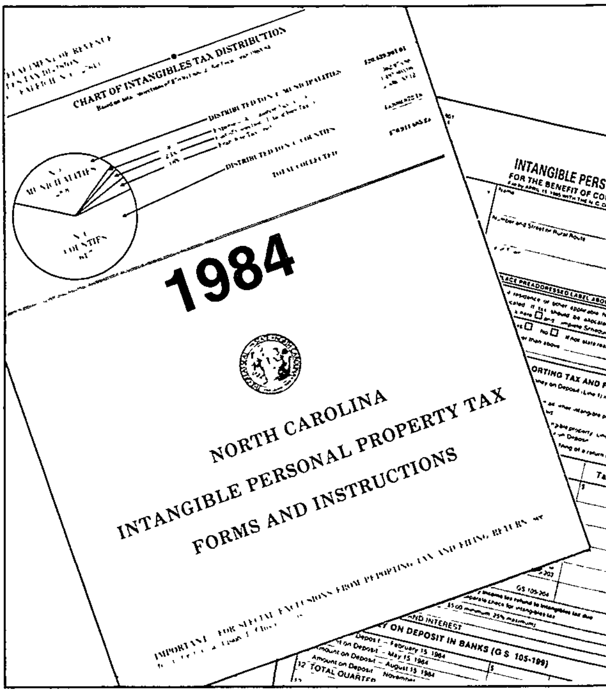
Table 2. Local Government Revenue Sources Combined City and County Amounts, By County

Intangibles and Inventories Tax (in 1000s of dollars)

County	Estimated 85-86 Collections From Tax on Intangible Personal Property (Net)	Estimated Net 84-85 Collections From Property Tax on Business Inventories	County	Estimated 85-86 Collections From Tax on Intangible Personal Property (Net)	Estimated Net 84-85 Collections From Property Tax on Business Inventories
Alamance	1,406	3,407	Johnston	541	2,112
Alexander	144	403	Jones	49	22
Alleghany	85	59	Lee	477	1,170
Anson	198	507	Lenoir	727	888
Ashe	134	231	Lincoln	283	783
Avery	98	57	Macon	221	167
Beaufort	397	589	Madison	82	99
Bertie	136	147	Martin	212	725
Bladen	188	202	McDowell	216	590
Brunswick	362	366	Mecklenburg	9,661	18,627
Buncombe	2,662	DNR	Mitchell	110	259
Burke	769	1,713	Montgomery	156	356
Cabarrus	994	2,142	Moore	1,600	1,337
Caldwell	833	1,698	Nash	800	1,113
Camden	35	5	New Hanover	1,625	3,200
Carteret	600	348	Northampton	137	29
Caswell	110	44	Onslow	550	602
Catawba	1,791	3,272	Orange	1,465	629
Chatham	306	514	Pamlico	76	11
Cherokee	118	DNR	Pasquotank	336	344
Chowan	136	178	Pender	161	58
Clay	39	DNR	Perquimans	53	27
Cleveland	689	1,673	Person	184	332
Columbus	339	485	Pitt	972	1,852
Craven	603	1,058	Polk	651	20
Cumberland	1,616	2,074	Randolph	829	1,775
Currituck	71	17	Richmond	334	606
Dare	222	DNR	Robeson	674	1,495
Davidson	1,258	2,416	Rockingham	753	2,615
Davie	254	2,088	Rowan	1,217	1,946
Duplin	246	643	Rutherford	425	1,108
Durham	2,593	7,621	Sampson	312	574
Edgecombe	464	1,247	Scotland	284	836
Forsyth	5,406	11,254	Stanly	378	1,158
Franklin	203	310	Stokes	166	2,239
Gaston	2,037	4,171	Surry	656	1,429
Gates	43	22	Swain	60	39
Graham	55	81	Transylvania	349	487
Granville	272	938	Tyrrell	21	22
Greene	96	126	Union	591	1,429
Guilford	6,774	12,838	Vance	543	618
Halifax	471	591	Wake	5,200	7,828
Harnett	406	531	Warren	108	DNR
Haywood	374	665	Washington	95	388
Henderson	1,415	781	Watauga	395	321
Hertford	183	401	Wayne	822	1,709
Hoke	113	552	Wilkes	575	1,106
Hyde	33	8	Wilson	686	1,357
Iredell	874	2,136	Yadkin	178	243
Jackson	214	159	Yancey	115	25

Source: Ad Valorem Tax Division, N.C. Department of Revenue.
Key: DNR — Did Not Report.

Pro —



The Intangibles Tax

Why it should be retained

by Sarah Denny Williamson

The intangibles tax is a property tax. It is a fair tax and it should be retained. Why? To understand, we need to first look at the background of property taxes.

Taxing property has long been the backbone of local government financing. *Real property*—land, homes, and buildings—has been taxed in North Carolina since 1777. *Personal property*, both tangible and intangible, has been taxed since the 1860s. Tangible personal property includes such items as automobiles, household furnishings, boats, farm equipment, etc. Intangible personal property includes stocks, bonds, notes, money market funds, mutual funds, and money on deposit.

City and county governments set their own rate of taxation on real property and on tangible personal property and collect those taxes at the local level. The same was true for intangible personal property taxes until 1937. That year the state took over collection and administration of the intangible personal property tax so there would be uniform tax rates on that class of property throughout the state. All taxes collected on intangible personal property (minus administrative costs and related franchise tax credits) are returned to the cities and counties for local government financing.

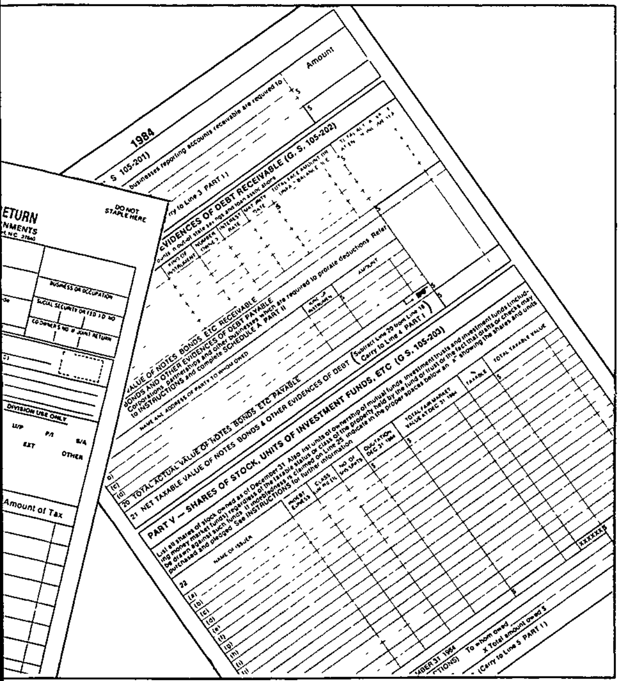
Why should this one type of property—intangible personal property—be exempted from taxation while the other two (tangible personal property and real property) continue to be taxed? Consider, for example, a person with $30,000 to spend or invest. Basically, he or she could invest the $30,000 in real property, such as a piece of real estate; in tangible personal property, such as a tractor or second-hand combine; or in intangible personal property, such as stock in a company.

If the investor chose real estate in the city of Raleigh, the property *tax would be $372* ($177, county and $195, city). For a tractor, the property *tax would be $177.* For the stock, the property *tax would be $0 to $75* (depending on where the corporation transacted its business). Yes, all of these are property taxes. And, yes, the investor would have to pay income tax on any income that came from the real estate, from the produce resulting from having the tractor, or from the stock dividends.

An investor has one obvious advantage in choosing intangible property over real estate or tangible personal property—the tax bill. In this example, an investor's taxes could range from $372 to zero. Moreover, the investor can support economic development in North Carolina while paying a reduced intangibles tax. If a company conducts 100 percent of its business in North Carolina, there is *no* intangibles tax on that company's stock. For a $30,000 investment in a company which conducts 84 percent of its business

see Pro, page 10

Sarah Denny Williamson, of Wake County, has paid intangibles taxes since 1959. She has testified on property taxes before committees of the N.C. General Assembly.



Con—

The Intangibles Tax

Why it should be repealed

by James Culberson

The intangibles tax is one of the least understood taxes in North Carolina, even though thousands of people pay this tax each year. Among all of the taxes that North Carolinians pay, including federal taxes, it is certainly one of the most unpopular. Repeated efforts have been made to have this tax repealed, and while changes have been made, the fundamental tax remains.

This tax is certainly not worth all of the time and money spent debating it over the past four decades. The roots of the modern-era debate lay in the turmoil of the Reconstruction Era. The Tax Research Division in the N.C. Department of Revenue traces the birth of the intangibles tax to 1868, when the state's new post-war Constitution broadened the property tax to include personal as well as real property. The 1868 Constitution directed that "a law shall be passed taxing, by uniform rule, all money, credits, investments in bonds, stocks, joint stock companies, or otherwise . . . ."

In 1921, the real debate began. North Carolina enacted a state income tax and gave up a statewide property tax. At that point, local governments got the levies from the intangibles property tax to themselves. Local tax jurisdictions set the same rates on intangibles as on other property, and the assessment ratio for intangible property was often higher than for real property. This resulted in a storm of protest. In 1927, the General Assembly considered a constitutional amendment calling for intangible property to be classified by the legislature at a uniform statewide rate. The amendment failed and the heavy levy on intangibles continued.

In 1937, the General Assembly approved a new constitutional amendment, approved by the voters two years later. It allowed the legislature to classify all property for taxation. The amendment led to the present intangibles tax law, which sets out the various assessment schedules and establishes fixed statewide rates for each component and exemptions for each. The law also places the responsibility for collection in the hands of the N.C. Department of Revenue. Most of the revenues, however, are still returned to the local government jurisdictions. In the fiscal year ending June 30, 1984, intangibles tax collections totaled \$70.9 million, of which \$66.3 million was returned to local governments.

Since 1937, the General Assembly has enacted changes in the intangible tax rates, in exemptions, and in distribution formulas. But the basic law continues. This historical context points out the antiquated nature of the intangibles tax. A tax of the "horse and buggy" days, it has survived into a modern era that has new and increasingly sophisticated investment vehicles. The law hasn't caught up with the times.

see Con, page 10

James Culberson is chairman of the subcommittee on taxation of the N.C. Citizens for Business and Industry, and is President of First National Bank of Randolph County.

Pro—The Intangibles Tax

in North Carolina, the intangibles tax would be $12 (the tax varies according to the percentage of business conducted in this state); for a company doing no business in this state, the tax would be $75.

Intangibles Tax is Equitable

Whether citizens pay real property tax, tangible personal property tax, or intangible personal property tax, they—as citizens—receive the same services provided by local governments: the public schools, the use of parks, paved streets, street lights, police and fire protection, water and sewer facilities, and more. Some say the intangibles tax is an unfair tax, but actually it is a very fair tax.

The intangibles tax represents a class of property, and property is a yardstick by which wealth is measured. Therefore, intangible personal property represents a class of wealth. Information gathered by the League of Women Voters of North Carolina reveals that "nationally, 88 percent of corporate stock is held by individuals with income over $60,000."[1] Why should this class of property be exempted?

Be Consistent — Address Money on Deposit

While the intangibles tax is fair, one element of the tax needs to be addressed. There are discrepancies in the levying of the tax on money on deposit. Currently, money on deposit in a commercial bank is taxed, but money on deposit in a savings and loan association or in a credit union is exempt from the intangibles tax.

There was a valid reason for the original exemptions — there were limits on what savings and loan associations and credit unions could do. Now with bank deregulation, those limitations have been removed, but savings and loans and credit unions still enjoy the benefits of the exemption. That is not fair. Banking institutions providing similar services should be treated alike.

> *"It is not a tax bill but a tax relief bill providing relief not for the needy but for the greedy."— Franklin Delano Roosevelt*

To address this issue, the legislature could:

- add the tax to savings and loan associations and credit unions (politically unlikely during a session when tax *cuts* are popular);
- eliminate the tax entirely on money on deposits, at a cost of $19.4 million; or
- raise the threshold on money on deposits so as to reduce the impact of the tax on persons with relatively small amounts of money on deposit.

While this discrepancy does need attention, it does not affect the overall fairness of the intangibles tax.

Con—The Intangibles Tax

Inconsistencies in the Tax

The intangibles tax is based on antiquated concepts that no longer apply to the modern era. It does not apply fairly to all forms of investment. For example, deferred annuities, electronic transfer of funds, and other types of computer-oriented investments have entered the finance world faster than the intangible tax law can be amended properly to insure fairness in the law. Television and mass-mail marketing now make possible out-of-state sales of goods and services by merchants who reap the the benefit of the North Carolina market but do not pay intangibles tax on the money they generate.

The changing nature of the investment world has resulted in many inequities in this tax. Specific examples include:

- the current law requires that taxes be paid on bank deposits but not on deposits at savings and loans, credit unions, and other thrift institutions;
- deposits in money market funds administered by investment firms such as Merrill Lynch are exempt from intangibles tax up to $6,000 while the deposits in banks are taxable starting at $1,000.
- merchants with all cash sales must pay a tax on their cash balance with no offset from their accounts payable, *but* merchants doing business on credit can offset accounts payable against their receivables;

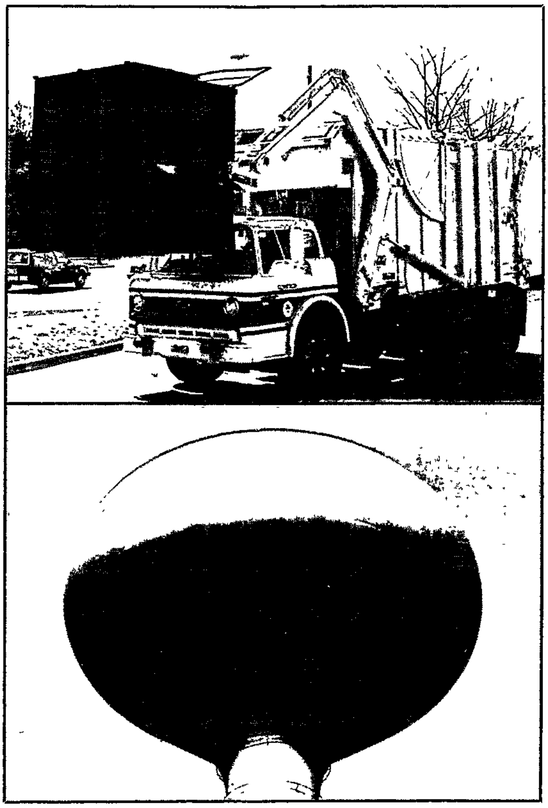
Industrial Development Not Hampered

There are those who claim that the intangibles tax hinders industrial development in North Carolina. There is absolutely no research or any other kind of evidence to support that claim. Moreover, the facts are to the contrary. Between 1977 and 1984, industries invested $15.5 billion in North Carolina, creating more than 250,000 jobs. Thomas B. Broughton, director of the Business Assistance Division in the N.C. Department of Commerce, said that in 1984, "investments by new and expanding industry, which includes land, building, and equipment, totaled $2.671 billion and created 46,821 industrial jobs."[2]

These industrial investments, as in recent years, reveal continuing diversification. Broughton notes that in 1984 North Carolina also led the nation in attracting *foreign* industries expanding into the United States. "Without question," Broughton said, "North Carolina should continue as a leader in economic development."

The intangibles tax has not hindered this economic growth. Mark Lynch, former N.C. Secretary of Revenue, summarized the burden of this tax on corporations in a report for the 1984 General Assembly. "A sample of large manufacturing companies in North Carolina shows their intangibles tax liabilities to be less than 0.1 of 1 percent of their net income before tax, or an average of about $545." Is this amount of tax going to keep a company from locating here? Of course not.

B. E. Dail, director of the Tax Research Division in the N.C. Department of Revenue, addresses the same issue in this way. "A sample of large manufacturing companies now in North Carolina shows their intangibles tax liabilities to be less than 0.1 of 1 percent of their income



- individuals who have borrowed money to use for a specific purpose—but have not yet disbursed those funds by the intangibles tax assessment date—are taxed on those funds even though they are borrowed money.

Inequities in the Tax

Proponents of this tax contend that in order to be equitable, the value of stocks and bonds should be taxed if real estate is taxed. What that overlooks are the extensive public services, such as streets and police and fire protection, that are required in connection with the real estate investment. A stock and bond portfolio requires no service from the city and county.

Capital Formation Thwarted

Since the Civil War, North Carolina has been plagued by a shortage of capital. North Carolina industries have had to import capital in order to expand. Although the economy has expanded since World War II—primarily because of favorable labor conditions—we still have had to import capital to sustain the growth.

The intangibles tax is a tax against capital. It discourages capital from coming into our state. Our great investment in the Research Triangle Park should result in new companies that spin off from the development at the park into other parts of the state. But this is not happening the way that it should. According to the Winthrop Rockefeller before taxes. If smaller manufacturing companies have similar proportional liabilities, it seems doubtful that industrial location decisions would hinge on this level of relative tax liability."[3]

Finally, in recent surveys by *Business Week* and *Fortune*, industrial managers across the country rated North Carolina as among *the most desirable states for new plants.*[4] Corporations look at the total picture—at the schools and universities, the labor force, roads, water and sewer systems, and the cultural opportunities, as well as the tax structures. They look at the "quality of life."[5]

Retirees Not Deterred

The assertion that the intangibles tax keeps away retirees is equally unfounded. The same "quality of life" that attracts industry also attracts retirees.

Catherine LaTour, reference librarian at the American Association of Retired Persons (AARP), when asked about the effect of the intangibles tax on retirees relocating, said, "We get calls asking about taxes in general, whether [a particular state] is a nice place to live, that kind of thing. The tax questions are about income tax, usually. I can't remember a question about the intangibles tax."

From Brevard in the mountains to Southern Pines in the Piedmont to Wrightsville Beach on the coast, retirees are settling in North Carolina. Newspaper and magazine coverage around the state suggests the importance of low taxes for the migration of retirees to North Carolina.

The News and Observer of Raleigh, for example, on March 20, 1983, profiled two couples who had moved to the state—one from New Jersey, the other from New York. The couple from New Jersey paid about one-fifth as much property tax in Southern Pines as they did in Montclair. The other couple said their property and school taxes in western New York state were about $3600 a year. In Hendersonville, their property taxes were about $300. To put it

Where Does North Carolina Rank for Attracting Retirees?

by Bill Finger

Very little data exists on exactly what attracts retirees to another state. And when it comes to the intangibles tax, the research is even thinner. "It is virtually impossible to measure the actual response [of retirees] to repeal [of the intangibles tax], however, because no data are available to show . . . how many individuals chose another state solely because of the intangibles tax," wrote B.E. Dail, director of the Tax Research Division, N.C. Department of Revenue, recently.[1]

In two studies on what attracts retirees, North Carolina ranked 7th and 12th. The Center for Social Research in Aging at the University of Miami at Coral Gables analyzed the

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Foundation, of the four states with nationally recognized research parks (including North Carolina), the other three (California, Massachusetts, and Texas) have received 99 percent of the investment capital going to these parks.[1]

Retirees Go Elsewhere

Time and time again, the argument has been made that we are losing retirees who are reluctant to come to North Carolina because of the intangibles tax. And yet, North Carolina is considered one of the best states for retirement. From first-hand experience as a banker in the retirement area of Southern Pines, it appears that the retirees who come to North Carolina may be those who are primarily dependent on income from pension plans rather than from investment portfolios.

In addition, when retirees settle in adjoining states to take advantage of a lower tax rate, we lose out on a significant increase in the ad valorem tax base. While no one has researched this issue, the additional ad valorem, state income, sales, and another way, North Carolina ranks 46th in per capita property tax burden, and that includes the intangible tax and the inventory tax.

Now, what about Florida, the state noted for attracting retirees? Florida has an intangibles tax. But it *does not have an individual income tax*, and its estate tax is much lower than North Carolina's inheritance tax. Florida also has warm weather, hundreds of miles of beaches, numerous retirement villages, and other attractions for retirees. All of these factors, taken together, determine where retirees move, not the intangibles tax alone.

Tax Doesn't Hurt North Carolina's Border Counties

Some people claim that the intangibles tax hurts rural, border counties, because neighboring states have lower taxes. These critics of

1980 U.S. Census data and found North Carolina ranked 7th in attracting people 60 and over.[2] The Census asked, "Did you live in a different state in 1975?" Based on this question, the top ranked states (and the ranking of states bordering North Carolina) were:

	State	Number Over 60 Who Said They Lived in a Different State in 1975
1.	Florida	437,000
2.	California	145,000
3.	Arizona	95,000
4.	Texas	78,000
5.	New Jersey	49,000
6.	Pennsylvania	40,000
7.	**North Carolina**	**39,000**
11.	Virginia	34,000
14.	Georgia	33,000
16.	Tennessee	29,000
25.	South Carolina	20,100

In a study done for *MONEY* magazine in 1979, Chase Econometric Associates Inc. ranked North Carolina 12th.[3] These analysts examined 10 factors and attached hypothetical "values" to each. The factors, with the "value" of each in parenthesis, were: metropolitanization (20), weather conditions (15), unemployment (10), housing (10), utility rates (10), nonmanufacturing employment growth (10), ratio of elderly to working-age population (10), property tax loads (10), living costs (10), and growth of retired population (5). Totaling the hypothetical values (excluding Hawaii and Alaska), the top ranked states (and the ranking of states bordering North Carolina) were:

	State	Rating		State	Rating
1.	Utah	305	8.	Arizona	175
2.	Louisiana	295	9.	Florida	160
3.	South Carolina	280	10.	Georgia	155
4.	Nevada	260	11.	Colorado	140
5.	Texas	230	**12.**	**North Carolina**	**110**
6.	New Mexico	200	13.	Tennessee	100
7.	Alabama	185	15.	Virginia	75

FOOTNOTES

[1]B.E. Dail, "An Analysis of Possible Modifications or Repeal of the Intangibles Tax," Property Tax Bulletin, published by the Institute of Government, University of North Carolina at Chapel Hill, No. 70, February 1985, p. 3.

[2]Charles Mangino et. al., *Retirement Migration Project: A Final Report to the National Institute on Aging*, Center for Social Research in Aging, University of Miami at Coral Gables, Table 2, p. 14. The study includes charts comparing North Carolina with other states. Copies are available for $30.00 (P.O. Box 248092, Coral Gables, Fla. 33124).

[3]For a good summary of the study, see Raymond Schuessler, "Best States to Retire To," *Modern Maturity*, October-November 1981, pp. 57-61.

other tax revenues might well exceed the income lost from repeal of the intangibles tax.

More and more, retired persons depend on dividends or interest from stocks and bonds, which exacerbates a kind of double taxation—a 7 percent state income tax rate (on the dividends and interest) *and* a levy on the value of the investments.

Most Neighboring States Don't Have the Tax

Among the 50 states, many have recognized that this is an antiquated and unfair tax and have repealed it. Now only seven states have both an intangibles tax and an income tax, and one of them (Indiana) is in the process of phasing the intangithe intangibles tax claim that tax differentials encourage corporations that might move to North Carolina to settle just across the border. There is no basis for this contention. Taxes do not differ markedly among North Carolina's neighbors—Virginia, Tennessee, Georgia, and South Carolina.

The April 2, 1984, *U.S. News and World Report* listed the per capita state and local property taxes for 1982. And remember, North Carolina's figure includes intangibles and inventory taxes. The U.S. average was $362, with such states as New Jersey ($591), New York ($574), and Massachusetts ($510) at the top. For North Carolina and its border counties, the per capita totals were: Virginia, $300; Georgia, $254; North Carolina, $206; South Carolina, $200; and Tennessee, $195. Eleven dollars less per person, per year in property tax is not going to send anybody to Tennessee, nor $6 less to South Carolina.

Maybe the reason rural, border counties are not drawing industry is not the intangible tax but a lack of water and sewer systems. "Some 140 communities have a moratorium on construction because wastewater treatment facilities are inadequate," says S. Leigh Wilson, executive director of the N.C. League of Municipalities. "Without new sources of funding for such facilities, economic growth is stymied in these communities."

Many of these communities are located in the rural, border counties. Just look down a recent list: Lake Waccamaw and Chadbourn in Columbus County; Spruce Pine in Mitchell County; Fairmont, Saint Pauls, and Red Springs in Robeson County; and Hendersonville in Henderson County. The list goes on and on. It is not the intangibles tax that is hurting the rural, border counties.

Local Governments Will Be Hurt by Repeal

The intangibles tax helps finance local government services. In FY 1984, the state returned $66.3 million to cities and counties from intangible tax revenue collections. This amounted to about 3 percent of total local government budgets. These funds go into the basic operating budgets of counties and municipalities across North Carolina.

Some people still cling to the belief that it will be okay to repeal the intangible tax if the revenue to the cities and counties is replaced. But there are fallacies to this theory. First of all, if the state replaces the money by paying the cities and counties from its General Fund, then the state is taking money paid to the state by all taxpayers, largely through income and sales taxes, in order to give a property tax break to those few taxpayers who no longer would be paying any tax on a certain class of property. And it is a small class indeed.

According to Mr. Lynch's 1984 report, 3.5 million income tax forms were filed by individuals and corporations for 1982, but only 195,000 intangible tax returns were filed. This would be exempting a few from a tax that is fair and reasonable and shifting their responsibilities to all.

In addition, even if the General Fund absorbs the lost revenues, local governments will be hurt, especially when seeking help for critical needs like water and sewer facilities. Furthermore,

bles tax out (see chart on page 6.) Two other states, Georgia and Kentucky, have a lower income tax and intangibles tax rate than North Carolina.

Protect the Local Governments

The proposals before the General Assembly to repeal this tax recognize that cities and counties should be protected from the the potential loss of revenue. The need for these revenues by local governments is well documented. Provision for the replacement of the funds should be part of any legislation to repeal the intangibles tax.

Repeal the Tax in 1985

A "horse and buggy" tax and the electronic age are not compatible. Repeal is the only solution, especially for a tax so unpopular as the intangibles tax. In summary, this tax needs to be repealed because it:

1) is not equitable because it is assessed against capital and cash which do not require services from the community as compared to ad valorem taxes;

2) is inconsistent in its application, not covering, for example, funds in the many new tax shelters of the modern electronic age;

the amount of intangible tax paid to cities and counties has been increasing each year. If a cap were put at any time on reimbursement payments to the cities and counties, then the cities and counties would not be realizing the fruits of their growth. From 1983 to 1984, the amount of intangibles tax returned to local governments increased 17.2 percent.

Also, the cities and counties would be losing a right that they have had since the 1960s—that of taxing their citizens on all three classes of property. And the "so-called compensation" would not be a reimbursement of the tax, for that tax would no longer be collected; it would simply become in reality "state revenue sharing." Is that what we want? And what the legislature gives, any session of the General Assembly can take away. We know that from federal revenue sharing. Where would that leave city and county governments?

"If there is no satisfactory state aid, and local property taxes are used as a replacement [for intangibles tax revenue], county [property tax] rate increases would average about 4.5 percent, based on 1982-83 figures." reports B. E. Dail.

Keep the Tax Alive in '85

The intangibles tax does not hinder economic development. It does not keep retirees from settling in North Carolina. And it does not hurt rural, border counties. Whether to repeal this tax is purely and simply a debate over whether to exempt one class of property or wealth from taxation while the other two classes of property and wealth carry their load. Who can call that fair? □

FOOTNOTES

[1]*State and Local Tax Revolts*, Conference on Alternative State and Local Policies, Washington, D.C., 1980, p. 204.

[2]Interview with Thomas Broughton, February 1985, and "Industry Development Diversifies," by Broughton in *The News and Observer* of Raleigh, February 3, 1985, p. 27G.

[3]B. E. Dail, "An Analysis of Possible Modification or Repeal of the Intangibles Tax," *Property Tax Bulletin*, published by the Institute of Government, the University of North Carolina at Chapel Hill, No. 70, February 1985, p. 3.

[4]*Why Corporate America Moves Where*, May 1982, prepared for Belknap Data Solutions, Ltd., as a *Fortune* market research survey; and *Plant Site Selection: A Survey of Management Subscribers in Industry*, September 1984, by McGraw-Hill Research at the request of *Business Week* magazine.

[5]For more information about how tax policy affects industrial recruiting, see the article on inventory taxation by Jane Sharp and Jan Ramquist. Other sources, which show industrial location decisions are based on factors other than taxation, are:

Locating Industry in Arkansas: York Hanover—A Case Study in Public Incentives, 1984, The Winthrop Rockefeller Foundation, 308 E. 8th Street, Little Rock, Ark., 72202;

State Tax Policy: Evaluating the Issues, 1983, Joint Center for Urban Studies, Massachusetts Institute of Technology and Harvard University, by Andrew Reschovsky, p. 166; and

Taxes and Growth: Business Incentives and Economic Development, 1981, The Council of State Planning Agencies of the National Governors' Association, by Michael Kieschnick.

3) is detrimental to capital formation which is of utmost importance in the further growth of North Carolina;

4) discourages many retirees from moving to North Carolina, resulting in a loss of ad valorem and other state taxes that might exceed the revenue currently generated by the intangibles tax;

5) is not imposed as heavily by neighboring states;

6) yields some $80 million annually, which will be absorbed (under current proposals) by the state's General Fund, not local governments; this is

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an insignificant amount relative to total state and local taxes and to the administrative cost of collection. □

FOOTNOTES

[1]*Responsible Choices in Taxation—The Corporate Contribution*, published 1984 by the Winthrop Rockefeller Foundation, 308 East Eighth Street, Little Rock, Ark. 72202.

Pro—

The Inventory Tax

And The Arguments For Retaining It

by Jane Sharp and Jan Ramquist

Adam Smith in 1776 described the principle of fairness in taxation as "the ability to pay," and wrote that "the subjects of every state ought to contribute towards the support of the government as nearly as possible in proportion to their respective abilities." Yet Governor Martin's plan to phase out the property tax on business inventories—without replacing it with another business tax or a new combination of taxes—would result in a dramatic case of tax inequity that would further shift the tax burden from business to individuals.

Why? Because it would give preferential property tax treatment to business by creating a tax exemption—a loophole—that in effect relieves business of the burden of paying ad valorem property taxes on the inventories of manufacturers, retailers, and wholesalers. But because local governments depend on property taxes as a mainstay of local financing, the burden could compound for homeowners and other taxpayers through an increase in the real estate property tax in order to replace lost revenues. Adam Smith would quake in his grave if he knew what the N.C. General Assembly was up to.

So would the state's taxpayers if they realized what this debate is all about. It's easy to lose

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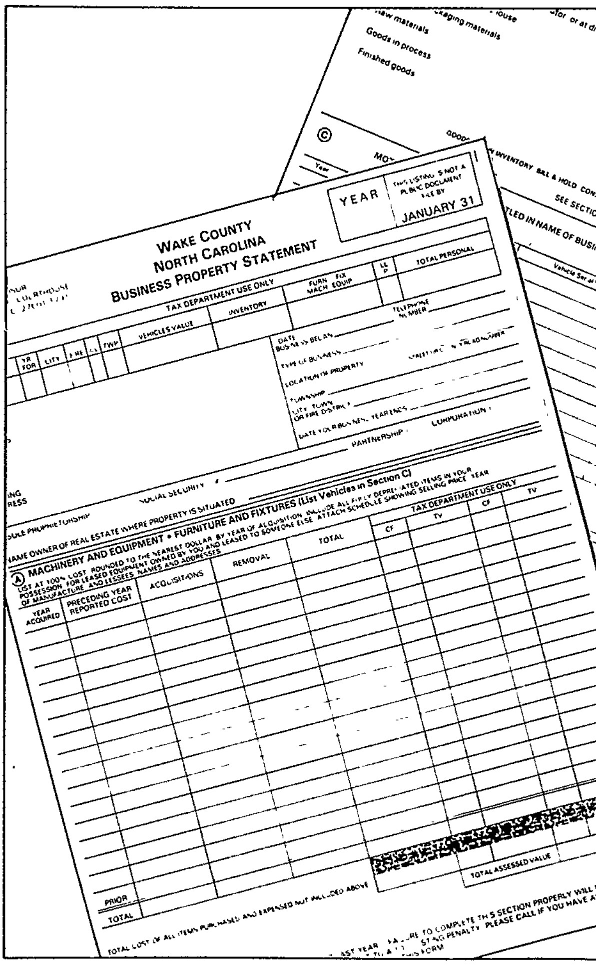
Jane Sharp is President of the North Carolina Consumers Council. Jan Ramquist is Second Vice-President and Legislative Chair of the League of Women Voters of North Carolina.



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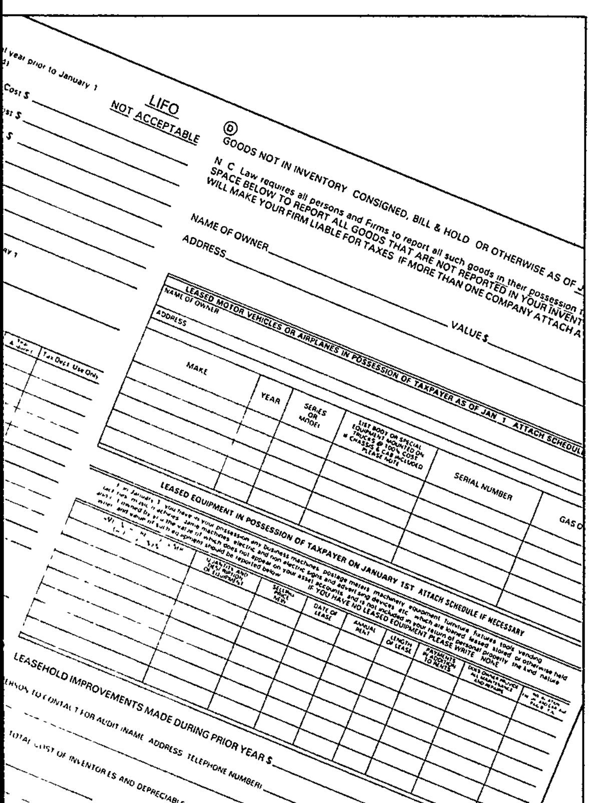
The Inventory Tax

And The Arguments For Relief

by William H. Armstrong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North Carolina's business interests are looking to the current General Assembly with unusually high hopes that, at long last, they may begin to obtain relief from one of the most burdensome and obnoxious of all their tax obligations—the local property tax on the inventories of manufacturing, retailing, and wholesaling firms.

The focus of business' hope for a start toward inventory tax relief is the state's new Republican Governor, James G. Martin. A major plank in Governor Martin's campaign platform was that of easing or eliminating the burden imposed upon business by the twin bugaboos of inventory and intangible personal property taxes. Several of our past governors—including Gov. James B. Hunt Jr. and his predecessor, Gov. James E. Holshouser Jr. most recently—have acknowledged the undesirability of the inventory tax, but none has ever thrown the weight of his office behind a program to ease the tax's financial drain on business and industry.

North Carolina Citizens for Business and Industry, the statewide organization that represents all types of business, has for years campaigned actively in behalf of various plans that would ease or eliminate the inventory tax burden. Relief legislation has cleared one legislative house in past sessions only to be bottled up in

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William H. Armstrong is editor of We the People of North Carolina, *magazine of N.C. Citizens for Business and Industry.*

sight of exactly what the inventory tax is, and what it is not. The inventory tax is not a special, discriminatory levy aimed at soaking businesses. It is an integral part of the North Carolina tax system, levied by local governments but subject to the General Assembly's authority. Local governments collect these property taxes as a major source of revenue for schools, public safety, water and sewer treatment plants, streets, and other local services.

> *"Tax reform means, 'Don't tax you, don't tax me. Tax that fellow behind the tree.'"—U.S. Senator Russell Long (D-La.)*

The inventory tax applies to materials and products stored in warehouses, in manufacturing plants, in wholesale houses, and in retail stores. Businesses themselves calculate, report, and pay the tax directly to the counties. And like the personal property tax for private citizens, the inventory tax revenue collections depend upon the memories, records, and honesty of those being taxed.

According to the latest estimates of the Fiscal Research Division of the N.C. General Assembly, the inventory tax generates $155 million per year for local governments.[1] That amounts to about 15 percent of the amount collected from all property taxes—3 of every 20 dollars. The Martin proposal offers a three-year phase-in of corporate tax *credits* to offset inventory taxes. In other words, counties would continue to assess and collect the tax, while corporations would deduct that tax from their state corporate income taxes. After 1988, the administration would have to decide whether to recommend continuing the tax credit system, or whether to seek outright abolition of the inventory tax.

A change in the tax structure of that magnitude raises three significant questions: Is it fair and equitable to further shift the burden of taxation from businesses to individuals? Can the state's budget afford the loss of funds and shrinking of the revenue pool? And will the tax cut endanger local governments, now or after 1988?

More Relief for Business Is Unfair

State tax revenues come primarily from four basic areas: taxes on sales and use, personal income, corporate income, and franchise. The sales tax on food, a part of the general sales tax, is regressive—that is, it is felt most by those who are least able to pay. Nationally, North Carolina is considered a fairly low-tax state, although in the Southeast it is about average. In personal income taxes we are highest in the region, but in corporate income taxes North Carolina is about in the middle.[2]

For decades in North Carolina, the business share of the state revenue pie has gotten smaller and smaller. Charles D. Liner of the University of North Carolina's Institute of Government put it this way in a 1983 report: "State revenues from the corporation income tax and franchise and license taxes on corporations in general *fell from 24 percent of all state tax revenues in 1950 to 9.8 percent in 1981*, while state sales and individual

the other chamber as those sessions adjourned. A token amount of relief was enacted in 1978;[1] it applied only to manufacturers of high-value-added types of inventories and afforded a limited state income tax credit for inventory taxes paid. That measure had virtually no effect on such bedrock industries as furniture, textiles, and apparel. Reeling from the flood of cheap imported foreign goods against which they must compete under severe handicaps, those industries still await inventory tax relief from Raleigh.

Businesses Need Relief

Why should business inventory taxes be abolished? Or, more practically, why should the state of North Carolina be expected to grant income tax credits to business to offset inventory tax payments to local governments? Admittedly, business will welcome the relief for reasons of self-interest. The property taxes they pay on inventories represent an increased cost of doing business and a damper on their profits.

income tax revenues increased from 67.5 percent to 81.8 percent of the total" (emphasis added).[3] Liner calculated those figures in another, more revealing way. In 1950, income tax revenues *from corporations exceeded those from individuals.* But by 1983, income tax revenues from individuals were *five times* greater than those from corporations.

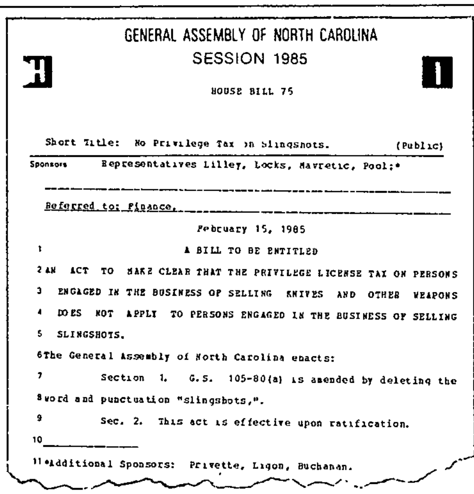
Does that sound as though North Carolina's tax policy is unfair to business?

Economic Development

Ostensibly, the purpose of inventory tax relief is to boost economic development. In theory, repealing this tax will remove an annoying and costly deterrent to industry wishing to relocate to North Carolina and to industry considering expansion of their Tar Heel operations. But the record doesn't bear out those contentions. If the inventory tax hurts industrial recruiting, for instance, then why have both *Fortune* and *Business Week* magazines rated North Carolina as one of the most attractive places for new industrial plants and businesses?[4]

In the same report in which he noted the declining share of corporate revenues, Charles D. Liner also concluded that "differences in taxes are not likely to be important in determining the state or community in which a new plant will be located."[5] Often, Liner wrote, firms did not even know if special tax incentives were available in the state in which they located. Further new research has bolstered that observation.

The Winthrop Rockefeller Foundation, headquartered in Little Rock, Ark., found in 1984 that *companies based their major relocation decisions on factors other than tax incentives.*[6] The study also found that rural Southern states expected too much from tax incentives they offer to attract new industrial development. In a study of one specific industrial recruitment case, the group found the major factors at work in a company's decision to move were, in order: available energy supplies; a good work environment with a ready pool of labor; availability of job training programs; good public transportation near the prospective plant site; and the general quality of life, including good schools, clean environment, sufficient housing, and cultural attractions. Actual tax breaks and other financial incentives were far down the list of priorities.


GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 1985
HOUSE BILL 75

Short Title: No Privilege Tax on Slingshots. (Public)

Sponsors: Representatives Lilley, Locks, Mavretic, Pool;*

Referred to: Finance.

February 15, 1985

A BILL TO BE ENTITLED

AN ACT TO MAKE CLEAR THAT THE PRIVILEGE LICENSE TAX ON PERSONS ENGAGED IN THE BUSINESS OF SELLING KNIVES AND OTHER WEAPONS DOES NOT APPLY TO PERSONS ENGAGED IN THE BUSINESS OF SELLING SLINGSHOTS.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-80(a) is amended by deleting the word and punctuation "slingshots,".

Sec. 2. This act is effective upon ratification.

*Additional Sponsors: Privette, Ligon, Buchanan.

The fact is that corporate income in North Carolina has not kept pace with individual income over the years. While some point to the fact that income tax revenues from individuals are greater than those from corporations, it is only fair to observe that there has been no increase in individual income tax rates and no decrease in corporate taxes. With inventory tax relief, corporate income would be in better position to keep pace with the growth in individual income—thus producing more capital for further economic expansion.

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Economic Expansion

But there is a larger and more compelling reason—one which benefits the public interest. If the state fails to take some sort of effective remedial action on inventory taxes in the near future, North Carolina's economic expansion through the remainder of this century is likely to be inhibited. Retail and wholesale businesses find the tax bothersome and burdensome. Although supporting statistics are hard to come by, it is reasonable to assume that many retailers and wholesalers of marginal profitability have failed because the inventory tax was an extra weight they were unable to bear. Certainly there are large wholesale operations that chose states other than North Carolina for the location of large new warehousing centers in order to reduce or eliminate inventory tax obligations.

Pro—The Inventory Tax

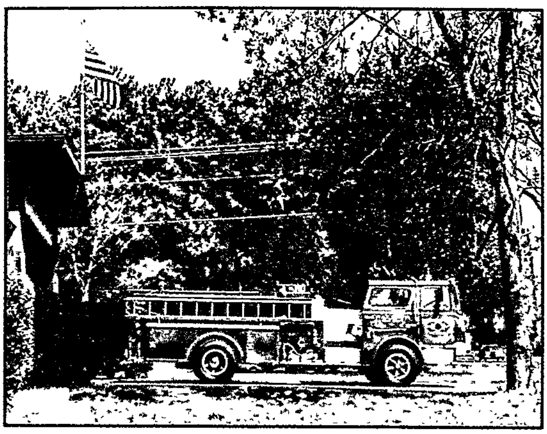
The study, which also examined industrial recruitment efforts in other states, concluded that because tax incentives are not a prime consideration in industrial plant relocations, states should not offer expensive tax breaks. Not only do they not succeed in luring industries, but they also are so costly that they may wind up "beggaring public services." In addition, the great smokestack factories that traditionally have produced large numbers of jobs are in decline now as the economy transforms itself into a service economy. Even high-technology plants don't always offer high-paying jobs, and those that do often prefer to relocate in large urban areas instead of states with dispersed populations. Instead of offering tax breaks that may have no real beneficial impact on industrial recruiting, the study said, states should instead concentrate on nurturing smaller businesses that will become stable enterprises with a potential for growth.

> *"It was as true . . . as turnips is. It was as true . . . as taxes is. And nothing's truer than them."— Charles Dickens, in* David Copperfield

Other recent studies have drawn the same conclusion. The Joint Center for Urban Studies of MIT and Harvard University found that "empirical evidence strongly suggests that taxes are of negligible importance in the regional location and investment decisions of firms."[7] And the National Governors' Association reported, "The evidence provides little support for those who believe that poor states, or stagnating states, can stimulate their economies in any significant way by a heavy reliance on either targeted tax incentives or across the board reductions in business taxes....In contrast, if the amount of time state legislatures spend debating

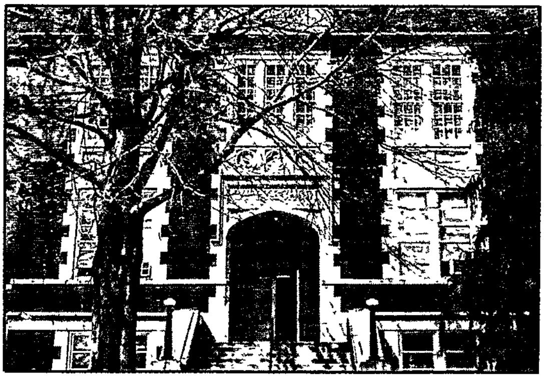
Con—The Inventory Tax

Over the past decade, the property tax on manufacturers' inventories has deterred a substantial number of corporations from constructing new production plants in North Carolina, and from expanding their existing operations in the state. Opponents of any change in the laws affecting local property taxes on business inventories often challenge those assertions. Opponents note correctly that manufacturing companies look at many factors within a state while deciding to place a new facility, and that for many of them the inventory tax is a minor consideration. North Carolina's many other attractions for industry more than compensate for the inventory tax, so the argument goes.



True in many cases, but not true in others. One cannot place an exact figure on the amount of investment dollars in new and expanded business and industry lost to North Carolina over a given number of years because of the inventory tax, because so many corporate officials decline to cite reasons for deciding against a state that was in the original running. Also, some industries that initially look at North Carolina are turned away by the presence of the inventory tax without state and local industrial recruiters ever becoming aware of the consideration.

Nevertheless, there is documentation that convincingly demonstrates the inventory property tax's chilling effect upon new and expanded economic development in the state. In 1977, the Committee on the Inventory Tax of the General Assembly's Legislative Research Commission issued a report in which 38 companies—all identified by name—were listed as having initially considered North Carolina for the location of new industrial plants before deciding to place them elsewhere.[2] Officials for most of those companies cited the inventory tax as a major



tax incentives and the effect of taxes on investment was redirected toward other areas, substantial progress might be made."[8]

North Carolina's attraction for new businesses and for local business expansion (a larger source of new revenues than incoming industries) manifests itself in the state's clean air and water, the generally favorable business climate, the technical school training system, the good transportation facilities, and the growing pool of willing workers who are not making excessive wage demands. Access to raw materials and markets are other important considerations.

Local governments understandably are concerned with the proposal to phase out the inventory tax through state corporate income tax credits. They fear those tax credits will not be redeemed by the state beyond a few initial years. Their fears may be well founded, especially if President Reagan's proposed tax simplification plans and budget proposals go through intact, leaving the states and local government with less federal aid for public works and other programs. While Governor Martin has played down the possibility of such disruptions, other state officials are more wary.

In an assessment in *State Government News,* N.C. State Auditor Edward Renfrow expressed his concern that property taxes and sales taxes would have to be raised just to pay interest on state and local bonds, let alone government services.[9] As bonds for local water and sewer development become more difficult to market, economic development suffers. No company will

disincentive—and often the sole one—that steered them away from North Carolina. Among them were Michelin Corp., which considered North Carolina before locating a $158 million, 2,500-job plant in South Carolina.

The committee report estimated that, had each of the identified companies chosen North Carolina, more than $500 million would have been added to the state's industrial investment total during the six-year period covered in the study, and more than 18,000 additional jobs would have been created. The report estimated that in one seven-year period, industrial firms that located in other states because of the inventory tax deprived state and local governments of $42.5 million in tax revenues. Another $8 million was estimated to have been lost to local governments from taxes that would have been generated by new employees, new homes, and new service industries.

It is true, of course, that North Carolina has done quite well for itself over the past quarter-century in expanding its industrial and economic base in spite of the inventory tax. As already noted, however, hundreds of millions of dollars worth of additional investment could have been applied to that industrial base if the inventory tax had not beeen an inhibiting factor.

The inventory tax has impeded growth in retail and wholesale business as well. William Rustin, executive director of the N.C. Merchants Association, pointed to the *North Carolina 2000* study, published by the state in 1983, which estimated that 80 percent of the jobs to be created at the turn of the century will come in the areas of retailing, transportation, distribution, and service organizations. "If we want to create those jobs," said Rustin, "we'd better put the opportunities there—and that means incentives like removing the inventory tax on retailers and wholesalers."

In December, Rustin said, he was advised by Rite Aid Corp. that it would locate a multimillion dollar warehouse facility in South Carolina rather than in North Carolina. Rite Aid Vice President James E. Krahulec told Rustin, "The fact that North Carolina still retains the inventory tax put it at an immediate economic disadvantage" in competition with South Carolina, which is phasing out its inventory tax.[3]

Now there are signs that North Carolina has lost ground, and could lose more, in its relative attractiveness to industry. The January-February 1984 issue of the publication *Industrial* build where it can't be assured of a dependable water and sewer system. Yet, according to the state's latest estimate, there are at least *$1.7 billion* in unmet water and sewer needs and *$2.4 billion* in unmet capital needs for public schools.

Will Local Governments Suffer?

During the political campaign last year, Governor Martin suggested that the state budget could accommodate tax repeal without program cuts. But the Governor got more specific on March 4 in his proposed supplemental budget. Martin suggested slashing planned increases in the rate of growth for various state budget programs, including education. Under Martin's overall tax and spending proposal, public education will suffer in order to pay for a tax break for business. Local governments which do not wish to suffer those education budget cuts will just have to raise other taxes—especially the property tax—to maintain education programs.

Another worry for local governments is whether the General Assembly will make up for lost inventory taxes in perpetuity. Not even the rawest freshman legislator would take that bet, because Martin will not be governor forever and because one session of the General Assembly cannot bind the next to a certain course of action.

There simply is no way to guarantee that sooner or later, local government won't be forced to pick up the tab for the loss of inventory tax revenues. The Governor's own proposal specifically cites the possibility of eliminating the inventory tax outright after 1988.[10] The counties, of course, could turn to the state to ask it to assume fiscal responsibility for functions which have traditionally been performed by local governments. But if the state is cutting its own income, how could it pay for those services? By further cutting other programs? Not likely. By raising other taxes? Which ones?

Tax Relief Not That Great

Businesses counting on deliverance from the inventory tax must face up to the fact that they will get less bottom-line relief than they seek. Currently, inventory taxes are deductible from federal and state corporate income tax returns. At the federal level, large businesses may write off 40 percent and, on state tax

Development ranked North Carolina last among the 50 states in terms of forms of financial assistance offered to industry by various public agencies.[4] In the same survey, North Carolina was tied at the bottom of the ranking in terms of tax incentives offered to industry.

Economic competition among the states is certain to intensify as new high-technology industry seeks congenial areas in which to locate manufacturing facilities. As we approach the year 2000 and witness the continuing changeover from a smokestack economy to a service economy, each of the 50 states will be busy devising new incentives to land those new industries and the jobs and tax revenues they will create. If North Carolina fails to keep up in terms of investment incentives, within a few years we could be left at a serious competitive disadvantage.

Local Government Revenues Won't Suffer

Were it not for the matter of revenues derived by local governments from inventory property taxes on business, the levy might have been abolished long ago. But local governments do depend on those revenues. If they were suddenly cut off, there would have to be substantial compensatory hikes in other property tax rates, or possibly the imposition of new types of local taxes. So long as the influential city and county government lobbies continue to operate in the General Assembly, the inventory tax will remain on the lawbooks, and the revenues will continue to flow into city and county treasuries. For that reason, all practical legislative approaches to the inventory tax problem, including those sponsored by N.C. Citizens for Business and Industry, have guaranteed the protection of local government revenues. So has Governor Martin's proposal.

Nothing in any of these approaches would actually abolish inventory taxes. Most of the bills considered by the General Assembly during the past decade have been based on the concept of granting state income tax credits to businesses for the inventory taxes paid to local governments. In all cases the credits would have been phased in over a period of years. Governor Martin's plan would phase in the tax relief over a returns, 6 percent. Thus, the federal and state corporate tax burdens are reduced. But if relief is granted, either through elimination of inventory taxes or by creating state income tax credits for inventory taxes paid, businesses won't be able to take those federal deductions, and their tax liability on federal returns will increase. That means a shift in tax revenues from state and local coffers to the federal treasury. In other words, the federal government gets more, while hard-pressed state and local governments get a smaller slice of the revenue pie. That makes it even harder to meet local needs.

Keep the Tax

How are those local needs going to be met? That's hard to say—but it's harder still if the General Assembly cuts out a prime source of revenue for local governments, even through the ploy of tax credits. To maintain tax equity, to nourish long-term economic development, and to support local governments' tax base, *keep the inventory tax.* □

FOOTNOTES

[1]Estimate prepared by Fiscal Research Division, Legislative Services Commission, North Carolina General Assembly, February 1985. That figure would be slightly higher were it not for partial inventory tax relief granted by the 1977 legislature in a special provisions section of the appropriations bill for certain categories of raw materials. Since that relief was granted, businesses have pressed for complete elimination of the inventory tax.

[2]Property Tax Study Committee report to the 1983 General Assembly, second session 1984, Sen. A. D. Guy, chairman.

[3]*Business Taxation & Economic Development in North Carolina,* published by Institute of Government, University of North Carolina at Chapel Hill, March 1983, by Charles D. Liner.

[4]*Why Corporate America Moves Where,* May 1982, prepared for Belknap Data Solutions, Ltds., as a *Fortune* market research survey; and *Plant Site Selection: A Survey of Management Subscribers in Industry,* September 1984, by McGraw-Hill Research at the request of *Business Week* magazine.

[5]Liner, *op. cit.*

[6]*Locating Industry in Arkansas: York Hanover—A Case Study in Public Incentives,* 1984, The Winthrop Rockefeller Foundation, 308 E. 8th Street, Little Rock, Ark., 72202.

[7]*State Tax Policy: Evaluating the Issues,* 1983, Joint Center for Urban Studies, Massachusetts Institute of Technology and Harvard University, by Andrew Reschovsky, p. 166.

[8]*Taxes and Growth: Business Incentives and Economic Development,* 1981, The Council of State Planning Agencies of the National Governors' Association, by Michael Kieschnick.

[9]*State Government News,* February 1983, p. 3.

[10]*Governor's Supplemental Budget and Tax Relief Package 1985-1987,* March 4, 1985, p. 20.

three-year period. (A decision would be made in 1988 whether to continue the credit on corporate incomes taxes for inventory taxes paid, or whether to simply abolish authorization for local governments to collect inventory taxes, according to Governor Martin's supplemental budget presented to the legislature on March 4.)[5]

Approve Inventory Tax Relief

Those who are active in North Carolina's industrial recruitment efforts believe the incentives created by the total or even partial relief from inventory taxes would inspire enough added industrial investment over a period of a few years to compensate for most if not all of the losses to North Carolina's General Fund from the tax credit method. Ultimately, perhaps in less than a decade, backers of inventory tax relief are convinced that economic expansion inspired by such relief will more than offset any General Fund losses.

Now, as debate on the tax picks up steam in the legislature, partisan considerations could endanger Governor Martin's proposals. It will be extremely unfortunate for the economic development in North Carolina if relief legislation founders on the rocks of partisanship. It's time for legislators and all those who deal with public policy issues to recognize that continuation of the inventory tax burden on business and industry can rob North Carolina of a substantial slice of the future economic progress that is potentially available to us. □

FOOTNOTES

[1]Chapter 1200, section 3, 1977 Session Laws, second session, 1978, as codified in NCGS 105-163.03.

[2]Legislative Research Commission Report to the 1977 General Assembly of North Carolina, second session, 1978, Report on Inventory Taxation, Appendix C, pp. 7-8.

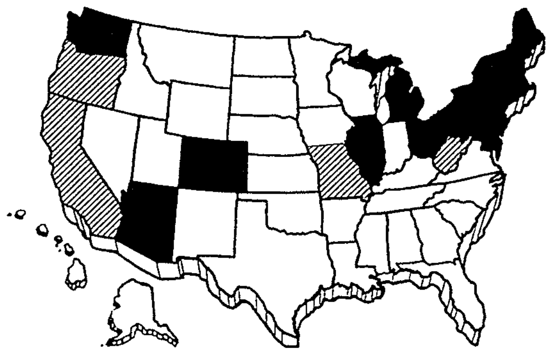
[3]Letter from James E. Krahulec, Vice President, Rite Aid Corp., Harrisburg, Pa., to William Rustin, Executive Director, N.C. Merchants Association, December 4, 1984.

[4]*Industrial Development,* January-February 1984, published bimonthly by Conway Data, 1954 Airport Road NE, Atlanta, Ga. 30341.

[5]*Governor's Supplemental Budget and Tax Relief Package 1985-87,* released March 4, 1985, p. 20.

A Lottery for North Carolina?

The Numbers Game



How have 17 states fared in marketing and administering their lotteries? And now four more states have authorized a lottery. Is a lottery a regressive tax? In the 1985 tax and spending debates, will North Carolina lawmakers again look to a new, easy source of funds—a lottery?

by Steve Adams

Former state Sen. Al Adams of Wake County likens a lottery to "a wild card." If the North Carolina General Assembly adopts part or all of Gov. James G. Martin's proposed tax cuts, some state spending programs will be cut—and the pressure will be on to find revenues to fund them. "When you have the combined forces of several groups looking for a bunch of money in a hurry, the lottery proposal might just pop up," Adams said in a March 13 interview with *North Carolina Insight.*

No one's gambling that a lottery will be passed this session. That includes Adams, whose law firm represents Scientific Games, the major supplier of expertise and equipment for state-run lotteries. But those familiar with how close the lottery bill came to passing in 1983 aren't betting the ranch against it either.

On May 12, 1983, the state Senate voted 26-21 in favor of a bill establishing a state lottery, if approved in a statewide referendum. Final approval was expected, and proponents were optimistic about prospects for the legislation in the House of Representatives. The General Assembly was on the verge of giving voters a chance to put the state back into the lottery business for the first time in 150 years.

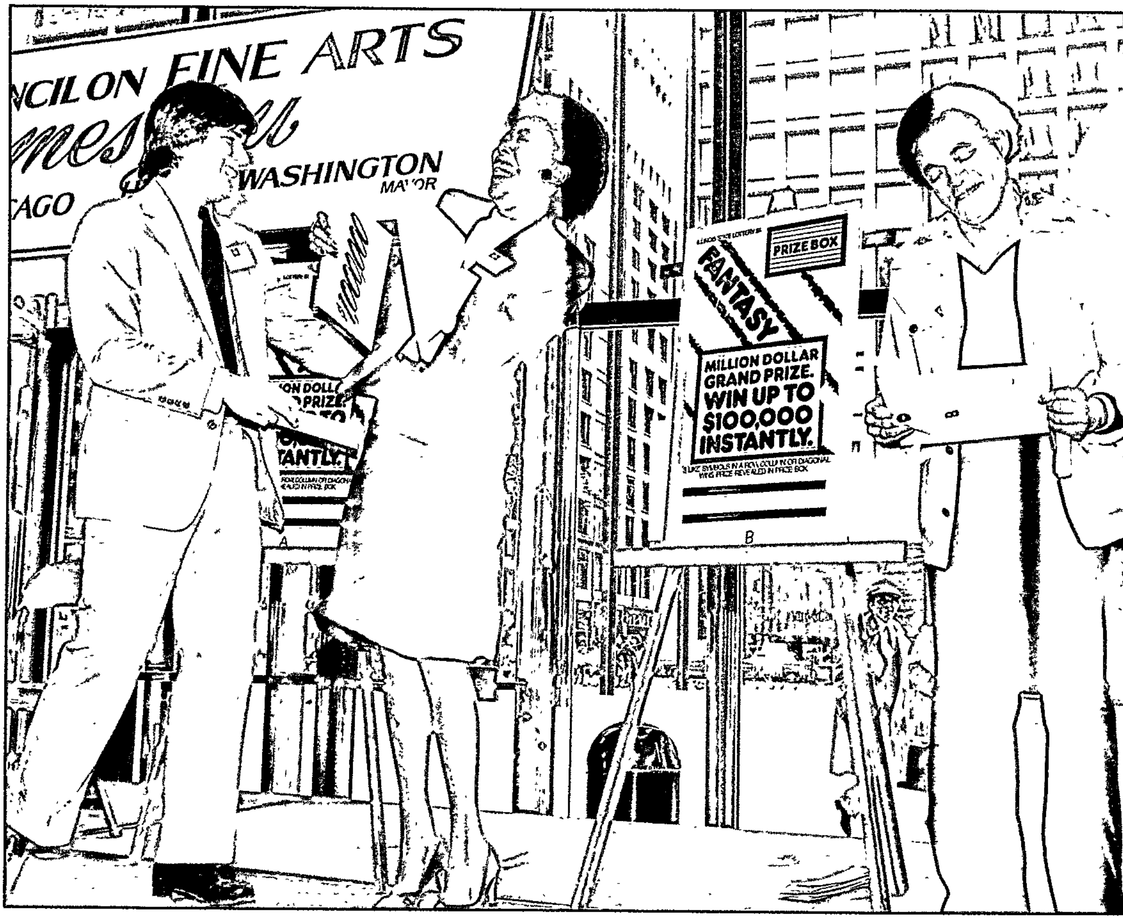
Then-Sen. Richard W. Barnes Jr. (D-Forsyth), the sponsor of the bill, argued that a lottery could raise $100 million a year without the pain of raising taxes. That argument had great appeal in 1983, when the state faced a General Fund shortfall of some $90 million and projections for another year of austerity. Barnes had the support of the Senate leadership, including Majority Leader Kenneth C. Royall (D-Durham), then-President Pro Tempore A. Craig Lawing (D-Mecklenburg), and Appropriations Committee Chairman Harold W. Hardison (D-Lenoir).

There was plenty of precedent for a state lottery. Money from a North Carolina lottery had gone for building churches, construction at the University of North Carolina at Chapel Hill (including the venerable South Building) and other public works and civic purposes. But the legislature abandoned lotteries in 1834, after they had come under attack on religious and moral grounds.[1]

In 1983, objections to a new lottery again came on moral grounds. "A lottery makes the state a pusher of gambling," said the Rev. Coy Privette, then the executive director of the N.C. Christian Action league and now also a state representative (R-Cabarrus). U.S. District Attorney Samuel T. Currin said a lottery would "create a betting mentality."

Other opposition also surfaced. Some newspapers, including *The News and Observer* of Raleigh and *The Charlotte Observer*, argued that a

Steve Adams, a Raleigh free-lance writer, contributes regularly to North Carolina Insight.



Courtesy Area Public Relations Services

The Illinois State Lottery awards "Fantasy" winner Pat Washington $1 million in April 1984.

lottery would place a disproportionate burden on the poor and called for an increase in the income tax or other taxes instead. The *Winston-Salem Journal* also argued against a lottery, saying the drawbacks of gambling and potential scandals weren't worth the revenues. Among the state's largest newspapers, only the *Greensboro Daily News* gave the lottery editorial support.

These objections appeared to have failed until the evening of May 12, when telephone calls from then-Gov. James B. Hunt Jr. and his lobbyist, Zebulon Alley, persuaded several senators to withdraw their support for the bill. The Governor, Alley said, felt a lottery was "not the course this state should be on. He just thinks it's a bad bill."

The next day, the bill's sponsors pulled the bill from the floor. A week later, the Senate killed it, 25-22. Because of a parliamentary maneuver known as the "the clincher," a two-thirds majority would be required to resurrect the bill in 1984. The "clincher" effectively killed the bill for the 1984 short session.

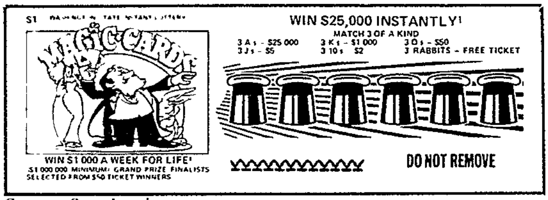
But the issue has risen again in the 1985 legislature. Rep. Frank W. Rhodes (R-Forsyth) has introduced a bill vastly different from the 1983 version. The bill, said Rhodes, could mean $175 million in new net revenues for the state, beginning as early as 1987.

Rhodes, a self-described "Old Right" conservative, hoped to gain credibility for his version of a lottery bill by including a number of strict safeguards on the lottery operation. "I realize we're in the Bible Belt, and the fundamentalists oppose it. That's their privilege. But my bill is squeaky clean," he said.

But Privette hasn't warmed up to it a bit. "It makes for bad law, bad morals, and bad politics," he declared.

Governor Martin has left no doubt where he stands. Lotteries, he said in an appearance in Winston-Salem on January 23, 1985, are "a tax on the weak" and shouldn't be considered for replacing state revenues lost through tax cuts. A state lottery, he said, "bleeds money from a lot of people who need it."

In the Bible Belt states, laws involving gambling carry a heavy burden of proof as a means of raising money for the state. Indeed, none of the 21 states that have a lottery—17 have operating experience, 4 have authorized but not implemented lotteries—was part of the Confederacy (see map on page 24



Courtesy State Legislatures

and Table 1). But moral doubts about a state lottery seem to be waning. In the spring of 1983, a poll by the University of North Carolina School of Journalism indicated that 59 percent of North Carolina's citizens favored a lottery and another 13 percent had no opinion. Only 28 percent said they were opposed.[2]

Nationally, the shifts in public opinion are even more pronounced. "Public acceptance of gaming has increased across the board, particularly for casinos, lotteries, and sports betting," reports *State Legislatures* magazine.[3] The magazine cites a Gallup Poll conducted in August 1982 where 82 percent of the persons polled approved of legalizing at least one form of gaming in their home state to help raise revenue, and 62 percent said they "preferred gaming to higher taxes."

In addition to increased public acceptance, the often expressed fear that a lottery might attract organized crime also appeared to be unsubstantiated.[4] Lotteries have encountered some difficulties, but none has involved organized crime. The New York lottery was suspended in 1975 after a computer error generated erroneous numbers on lottery tickets. In 1976, Maine's "Incredible Instant Game" had problems with players breaking its numbering sequence, and this game was ended. Three executive directors of the Ohio lottery have resigned under fire, two in 1975 amid charges of political patronage and one in 1978 after the state auditor alleged he had accepted favors from a vending machine company seeking a lottery contract. A scandal developed in Pennsylvania in 1980 over a rigged drawing. The security system was used to prove that the drawing equipment had been tampered with.

Table 1. State Lotteries, 1984[1]

State	Year Begun	How Authorized	Gross Sales (in millions)		Net Proceeds (in millions)		Net as % of General Fund	
			FY83	FY84	FY83	FY84	FY83	FY82[2]
Arizona	1981	I	$75.0	$59.0	$31.8	$23.0	1.90%	2.4%
Colorado	1983	R	138.3 (1/83-6/83)	118.3	41.7	41.0	2.80%	N.A.
Connecticut	1972	L	188.0	254.0	80.5	105.0	2.50%	2.4%
Delaware	1975	L	30.1	33.1	11.0	14.0	1.50%	1.4%
District of Columbia	1982	I	50.5	85.6	13.2	28.0	.74%	N.A.
Illinois	1974	L	495.4	902.0	214.1	379.0	3.00%	2%
Maine	1974	R	13.1	15.9	3.7	4.5	.55%	.4%
Maryland	1973	I,L,R	462.8	536.8	198.2	217.0	6.40%	6.8%
Massachusetts	1972	L	312.1	512.0	104.6	179.0	2.25%	2.1%
Michigan	1972	L	548.9	585.6	221.2	NA	2.50%	2.7%
New Hampshire	1964	L	13.8	18.7	3.7	5.4	1.20%	1.2%
New Jersey	1970	R	693.1	848.0	294.9	360.0	6.30%	5.3%
New York	1967	R	645.0	890.3	275.2	391.0	1.70%	1.1%
Ohio	1974	L	397.8	603.0	145.0	250.0	2.00%	2.4%
Pennsylvania	1972	L	885.4	1,236.0	355.4	516.0	4.80%	3.19%
Rhode Island	1974	R	43.0	52.9	14.7	18.0	1.30%	1.2%
Vermont	1978	R	4.4	5.1	1.1	1.3	.37%	.33%
Washington	1982	R	200.1 (11/82-6/83)	164.6	66.7	71.0	1.80%	N.A.
		Totals	$5,196.8	$6,920.9	$2,076.7	$2,603.2[3]		

FOOTNOTES

[1]In November 1984, voters in four more states authorized a lottery. Analysts expect two of the four, California and Oregon, to have a lottery functioning in 1985. In the other two, West Virginia and Missouri, the lottery probably will not be functioning until 1986.

[2]Note that this column is for FY 82. Data for FY 84 are not yet available.

[3]Note that this total does not include Michigan.

Source: State Legislatures (March 1984) and *Gaming & Wagering Business* (research department), with permission.

The cheaters were prosecuted and repaid most of the money.[5]

Thoughtful legislative action requires more than polls, however. Opinion about the social effects of state-sanctioned gambling need to be supplemented with facts and figures on the pragmatic aspects of a state-run lottery. Is a lottery fiscally sound? Is it, in effect, a regressive tax? Is it appropriate for the state to undertake the kind of aggressive marketing that typically accompanies state lotteries? Is it fair to players?

There are significant doubts on all counts. Yet in this session of the legislature, questions of facts and even of morality might well get pushed aside by current fiscal and political considerations. As Speaker of the House Liston Ramsey put it recently, "If the state's General Fund and Highway Fund are in good enough shape that we can cut taxes to the tune of $400 million or $500 million, we ought *not* to be trying to figure out how to raise more money for the budget by gambling. I just doubt the wisdom of that."

Disposition of Net Proceeds
Yearly minimum set by legislature for local transportation assistance fund, balance to general fund
50% capital construction; 40% conservation trust fund; 10% parks and recreation
General fund
General fund
General fund
General fund
General fund
General fund. Effective 10/31/83 lotto profits to 24 political subdivisions. To expire 10/84, Legislation pending.
Distributed to 351 cities and towns for discretionary use; first $3 million of Megabucks Lotto to the arts
Primary and secondary education
Education
Education and state institutions; $75,000/year for studies on compulsive gambling
Elementary and secondary education
Effective 7/1/83 - primary and secondary education. Previously to general fund.
Senior citizens
General fund
General fund (for debt retirement and capital construction)
General fund

Lt. Gov. Robert B. Jordan III, who as state senator opposed the lottery bill in 1983, is equally skeptical about a lottery. "I wouldn't think, with the changes in the Senate since last session and with the election of a number of fundamentalist Christians who object to it, that the lottery would have even as much of a chance this time as last," Jordan said in an interview.

Still, one never knows about a bill's chances until all the questions are answered, especially fiscal questions. "The amount of money we're talking about [from a lottery] would have a lot to do with its chances." Ramsey observed.

Generating Revenues—the Lucrative Pitfalls

Lotteries have been a cash cow for 17 states and the District of Columbia. "While the moral questions are never answered, questions on the number of dollars can be," says Steven Gold, director of the State-Local Finance Project of the National Conference of State Legislatures. "If you want to raise money from gambling, lotteries are the fastest way."[6]

At first blush, the statistics appear to support the view unequivocally. In fiscal 1983, gross sales from all operating lotteries totaled $5.2 billion. The net profit available to the states was $2.1 billion, 40 percent of the gross.[7] The other 60 percent of the lottery sales went to the winners of the various games and lotteries and to administer them.

Nationally, gross sales have been on a sharp upward spiral—from $5.2 billion in FY 83 to $6.9 billion in FY 84, a 33 percent jump. To show how rapidly sales are increasing, *calendar year 1984* sales totaled $8.1 billion.[8] In FY 84, Pennsylvania alone had *$1.2 billion* in gross sales, netting the state $516 million in revenues (see Table 1). Colorado sold $30 million worth of tickets in the first 20 days of its lottery [9]

Illinois took seven years to sell the first $1 billion in tickets but only 23 months for the second. By 1984, the lottery had become the fourth largest source of revenues for Illinois. "In 1984-85, we anticipate $1.1 billion in total sales, 40-42 percent net for the state—that's $450 million," said Richard Bostic, former analyst in the Illinois Bureau of the Budget. "We're counting on that $450 million in the budget. If we don't make our sales, we'll have to retrench somewhere. It's just like losing your income tax or sales tax."[10]

On a closer look, however, the revenue data appear more muddled. Net proceeds vary significantly from state to state, ranging from $2 per capita in Vermont to $46 per capita in Maryland. The average is about $19 per person. Lottery revenues account for only 0.37 percent of the general fund in Vermont. But, in Maryland, the lottery ranks as the state's third largest source of funds (6.4 percent of its budget)—the equivalent of 1 to 2 cents added to the state's 5-cent sales tax.[11]

In addition, lottery revenues may not be reliable over time. Washington state is realizing three times the projected profits since it began a lottery in 1982, but Maine is garnering less than 40 percent of the income it expected when it got into the game in 1974.[12] In pushing his bill in 1983, Sen. Barnes projected $100 million annual revenues for North Carolina, but he based that figure on the state netting $19 per capita. Would sales lag after the novelty wore off, or would they increase dramatically for several years? Would the state find it desirable to do the aggressive marketing required to milk the cash cow?

In Maryland, on whose law the 1983 North Carolina bill was modeled, House Speaker Ben Cardin is opposed to the lottery. "We're hooked on it," he says. "We're dependent on it. If we wanted to halt it, we couldn't. I don't mind people gambling. It's just not a good way to raise money. If the needs are there, for the elderly or the handicapped or students, then we should provide the [tax] money for it. And over the long haul, it's not a reliable source of revenue."[13]

The most important reason for the revenue uncertainty is marketing. Maintaining growth in revenues requires aggressive advertising and

Arguments against a Lottery	Arguments for a Lottery
1. A lottery is not a reliable source of revenue and has to be marketed aggressively to generate revenues.	1. In 1985, 21 states and the District of Columbia have authorized lotteries, which can generate revenue without a tax increase.
2. A lottery weakens the legislature's sense of responsibility about developing public support for a tax increase and generating the revenue necessary to meet a perceived need.	2. It is a voluntary tax.
3. a. Poor people pay a disproportionate share of their income, making a lottery a regressive tax. b. Lotteries must be aggressively marketed to succeed, putting the state in the position of encouraging the poor to play (i.e., to spend their more limited income).	3. Poor people participate in a lottery in proportion to their representation in the population.
4. Morally, the state should not encourage gambling.	4. North Carolina had a lottery in the 1830s.
5. In 1983, no more than 6.4 percent of any state's total general fund comes from lottery revenues.	5. Some lotteries net over 6 percent of a state's general fund, a significant amount.
6. Earmarking revenues is a bad budgetary practice.	6. Lottery revenues can be earmarked for a socially acceptable purpose.
7. There have been scandals in the administration of lotteries in Ohio and Pennsylvania and administrative problems with games in New York and Maine.	7. There is no evidence of Mafia involvement in state lotteries, and lottery officials report few law enforcement problems.
8. The odds of winning are small compared with roulette at casinos, off-track betting, and other types of gambling legalized by states in order to earn revenues.	

Table 2. Legalized Gaming in the States, August 1984

State or other jurisdiction	Lotteries	Sports betting	Off-track betting	Horse racing	Dog racing	Jai alai	Casinos	Bingo
Alabama	...	...	...	...	*	...	...	*
Alaska	...	...	...	...	...	...	...	*
Arizona	*	...	*	*	*	...	...	*
Arkansas	...	...	...	*	*	...	...	...
California	...	...	...	*	...	...	...	*
Colorado	*	...	*(a)	*	*	...	...	*
Connecticut	*	...	*	†	*	*	...	*
Delaware	*	†	...	*	...	...	...	*
Florida	...	...	*	*	*	*	...	*
Georgia	...	...	...	...	...	...	...	*
Hawaii	...	...	...	...	...	...	...	...
Idaho	...	...	...	*	...	...	...	*
Illinois	*	...	*	*	...	...	...	*
Indiana	...	...	...	...	...	...	...	...
Iowa	...	...	...	†	†	...	...	*
Kansas	...	...	...	...	...	...	...	*
Kentucky	...	...	*	*	...	...	...	*
Louisiana	...	...	†	*	...	...	...	*
Maine	*	...	...	*	...	...	...	*
Maryland	*	...	...	*	...	...	...	*
Massachusetts	*	...	*	*	*	...	...	*
Michigan	*	...	...	*	...	...	...	*
Minnesota	...	...	†	†	...	...	...	*
Mississippi	...	...	...	...	...	...	...	...
Missouri	...	...	...	...	...	...	...	*
Montana	...	*(a)	...	*	...	...	...	*
Nebraska	...	...	...	*	...	...	...	*
Nevada	...	*(c)	*(c)	*	*	†	*	*(b)
New Hampshire	*	...	...	*	*	...	...	*
New Jersey	*	...	*	*	...	...	*	*
New Mexico	...	...	...	*	...	...	...	*
New York	*	...	*	*	...	...	...	*
North Carolina	...	...	...	...	...	...	...	*(d)
North Dakota	...	...	...	...	...	...	...	*
Ohio	*	...	...	*	...	...	...	*
Oklahoma	...	...	†	†	...	...	...	*
Oregon	...	...	...	*	*	...	...	*
Pennsylvania	*	...	*	*	...	...	...	*
Rhode Island	*	...	...	*	*	*	...	*
South Carolina	...	...	...	...	...	...	...	*
South Dakota	...	...	...	*	*	...	...	*
Tennessee	...	...	...	...	...	...	...	*
Texas	...	...	...	...	...	...	...	*
Utah	...	...	...	...	...	...	...	...
Vermont	*	...	...	*	*	...	...	*
Virginia	...	...	...	...	...	...	...	*
Washington	*	*(a)	*	*	...	...	...	*
West Virginia	...	...	*	*	*	...	...	*
Wisconsin	...	...	...	...	...	...	...	*
Wyoming	...	...	...	*	...	...	...	*
Dist. of Col.	*	...	...	...	...	...	...	*

Source: Public Gaming Research Institute, Rockville, Md., as printed in *Book of the States, 1984-85,* The Council of State Governments, 1984, p. 172; and *Gaming Business Magazine,* August 1984, p. 53.

Key

* — Legalized and operative.
† — Legalized but not now operative.
... — Not legalized.

FOOTNOTES

(a) Includes betting at a track on races at other tracks in the same state (cross-track wagering), on races at tracks in other states (interstate wagering), telephone betting, branch office betting, or satellite wagering and bookmaking on racing.
(b) Keno.
(c) Operated by bookmakers licensed by the state.
(d) Limited to certain non-profit organizations.

frequent introduction of new games to keep players' interest. "[L]otteries are now promoted with huckster cunning and advertising practices that would be plainly illegal under federal law if attempted by private concerns . . . , " writes Curt Suplee in *Harper's.*

Suplee points out that the Federal Trade Commission requires the private sector to disclose in every advertisement the odds of winning and the prize structure. State lotteries have no such restrictions in their advertising. Exaggerated or misleading claims are often made. For example, the "instant millionaires" slogan of some state lotteries really refers to winners who receive $50,000 a year for 20 years. The prize costs a state $400,000 for an annuity.

Similarly, state lotteries do not publish their odds of winning. According to Suplee, a player is seven times as likely to be killed by lightning as he or she is to win. Typical lotteries pay 40 to 50 cents in prizes for every dollar of ticket purchases—or bets. By comparison roulette pays out 94.7 percent of bets, slot machines 75 to 90 percent, on-track horse race betting 82 percent, and off-track betting 77 percent.[14]

The technical problems of controlling advertising claims and publishing odds could easily be solved in a North Carolina lottery, if the General Assembly wished. The aggressive advertising, however, is an essential part of the proposition. Most states hire private firms for this task. By far the largest of these is Scientific Games of Atlanta, a subsidiary of Bally Manufacturing Corp, the pinball people and holders of the license to PacMan. Through 1984, Scientific Games had designed and produced games for all but one of the lotteries.

It doesn't matter which game you switch to," says John R. Koza, president of the company. "What is important is that it has a new face." One of the critical challenges, he says, is inducing occasional ticket buyers to play every week.[15]

Scientific Games described its marketing approach in a 1-and-1/2-inch thick book submitted to the legislature in 1983: "So far we have examined the demographics of over 6,500,000 adult winners of past lottery games. From this study, Scientific Games has developed specific, result-producing changes in advertising strategy and specific, measurable, and successful sales promotion programs."[16]

Aggressive marketing has aroused serious objections to lotteries even where moral opposition to gambling does not appear to be the primary issue. At least four states with lotteries—Colorado, New Mexico, Missouri, and Minnesota—are considering legislation banning advertising intended to induce people to participate in the lottery. Such a law might well cripple the goose that lays the golden egg.

Concern over this marketing issue also surfaced during the 1983 lottery debate in North Carolina. On April 21, 1983, *The News and Observer* summed up these worries in an editorial: "Once the state assumes the identity of Big Casino or master croupier, revenue increases from the progressive income tax on individuals and corporations and other taxes tend to go by the board. Pressures then mount on government for more and different kinds of games, weekly and daily. More seductive advertising must be geared to hyping ticket sales. . . . To this point fiscal expediency has been the overriding argument for putting this state in the gambling business. North Carolina shouldn't conduct its affairs with that kind of roll of the dice."

In a number of states, lottery revenues are earmarked for particular purposes. In Arizona, for example, the first $20 million goes to cities and towns for transportation and the rest to the general fund. Other areas of need specified to receive lottery revenues include: Colorado, for capital construction, conservation, and parks; Massachusetts, for local aid; Pennsylvania, for the elderly; and Vermont, for debt retirement and construction.[17]

In North Carolina, several specific projects have emerged as possible targets for lottery revenues, including children's programs, health care, and education. In 1982, Child Watch Inc., a private advocacy group for children, proposed earmarking lottery revenues for children's programs. Then, in 1984, a Salisbury doctor told a legislative study commission on health-care cost containment that lottery revenues could be used to provide health care for the poor and help people suffering from catastrophic illness or injury. The latest lottery proposal, pending before the legislature, would earmark all net revenues to education, specifically to improve teachers' salaries.

Targeting lottery revenues has the advantage of keeping the public informed on exactly how lottery funds are spent. It also can gain political support for a lottery. Earmarking revenues for specific programs, however, is a bad budget practice. Such a targeting requirement for revenues in effect locks in the targeted program as a budgetary priority for years to come. Normally, legislative deliberations change budget priorities from biennium to biennium.

Is a Lottery a Regressive Tax?

Is a lottery more regressive than other forms of taxation? Is a lottery a tax at all? If you don't want to play, you don't have to pay, which is what makes it so politically appealing. In essence,

Findings of the Commission on the Review of National Policy Toward Gambling

The Commission on the Review of National Policy Toward Gambling was commissioned by Congress to conduct a three-year study of all aspects of gambling in the United States. It issued its report in 1976. Its principal findings concerning state lotteries included the following:*

1. The basic weekly [lottery], as presently operated by all 13 [at the time] lottery states, does not have a harmful impact on society. Almost half the residents of those states play the game at least occasionally, and the average amount wagered is less than $25 a year. A negligible percentage [of people] wager more than $100 a year. All segments of society participate in lotteries and very little time and emotional involvement are expended by the players.

2. Where the Commission does find a serious potential for abuse in the present practices of the state lotteries is in their increasing reliance on the instant game as both a promotional and a revenue source. Since lotteries are more regressive (people in low income categories spend proportionately more on it than those in higher income brackets), and the odds against the player's winning a prize are greater than in most other forms of gambling, any lottery which in fact encouraged frequent participation might prove to be inimical to the general welfare.

3. As a source of revenue for the states, lotteries are relatively inefficient compared to broad-based forms of taxation. They are also more regressive. ... No state now [1976] derives more than 3 percent of its total revenues from lotteries, and it would be futile for state policy-makers to look to lotteries as a substitute for traditional forms of taxation.

4. The Commission recommends that... the earmarking of lottery revenues for specific state programs be avoided because this practice tends to warp the budgetary process and to deprive state officials of the flexibility required to meet changing needs.

5. The lottery agency should be headed by one individual who is directly responsible to the governor. ... The daily administration of state lotteries must be taken out of the political arena.

*Gambling in America: Final Report of the Commission on the Review of the National Policy toward gambling, *Charles H. Morin, Commission Chairman, Washington, 1976. The complete report is available from the U.S. Government Printing Office.*

a lottery is a voluntary tax.

Even if it is voluntary, is a lottery a regressive voluntary tax? That is, does it place a disproportionate burden on the poor? If it does, the necessity for the high-pressure hype to market a lottery becomes a particularly sensitive issue.

Unfortunately, a large proportion of the information before the General Assembly in the 1983 session came from companies that make their living in the lottery business. Most of the rest came from other state lotteries, which likewise get much of their information from the same companies. The understated presence of Scientific Games was everywhere.

Asked whether lotteries are regressive, the marketing companies choose to answer another question instead. Included in the legislative staff's report to the legislators on lotteries was a 10-page study entitled "The Myth of the Poor Buying Lottery Tickets" by John Koza of Scientific Games. Marshaling demographic data on more than 6 million lottery winners, Koza concludes: "[T]he poor participate in the state lottery games at levels disproportionately less than their percentage of the *population*. The assertion that the poor disproportionately buy lottery tickets is only a myth" (emphasis added).[18]

Other studies confirm that participation by the poor is at least no higher than their proportion of the population.[19] State lotteries themselves report that the *average* income of lottery players is relatively high.

These findings, however, miss the point about regressive taxes entirely. Most tax analysts agree that the sales tax is regressive, for example. But poor people do not pay sales taxes out of proportion to their representation in the *population*. Since virtually everyone pays sales tax, every demographic group presumably "participates" in the tax exactly in proportion to its share of the population. The point sounds confusing at first, but it is a critical one: The degree of participation in a lottery—or in a sales tax—has little, if any, relationship to how regressive it is.

Why is a sales tax regressive then? Because the poor must spend a higher *percentage of their income* in sales taxes than do middle or upper income persons. The same is true of lotteries, for those who voluntarily participate.

The marketers' ploy worked, emphasizing the percentage *of the population* using lotteries rather than the percentage *of a person's income* going towards lotteries. The legislative staff reported to the General Assembly that the poor do not play lotteries in greater number than their portion of the population as a whole. The staff never addressed the question of *whether the lottery is indeed a regressive (voluntary) tax.*

Several surveys conclude that lotteries are even more regressive than the sales tax. A Pennsylvania study found that families with incomes under $5,000 represented 3.2 percent of the state's personal income but bought 5.7 percent of the lottery tickets. In Connecticut, those making under $5,000 represented 1.3 percent of the state's personal income and purchased 5.3 percent. A 1974 study concluded that the poor bought tickets at 2.8 times their income share. In Michigan, families with incomes above $30,000 spend 0.02 percent of their income on betting, while those with incomes below $5,000 spent as much as 0.3 percent.[20]

"In terms of dollars spent, the biggest bettors on state lotteries are middle-income individuals," says Charles T. Clotfelter of Duke University. "Relative to their incomes, however, the poor buy a disproportionate number of tickets, according to studies of several states. In Maryland, for example, households accounting for the bottom third of all income made 60 percent of all expenditures on the popular daily lottery and 49 percent on the weekly lottery. As a percent of income, lottery expenditures fall from over half a percent of income at the lowest income level to less than a tenth of a percent at upper incomes."[21]

Daniel Suits of Michigan State University, who has analyzed lotteries for the U.S. Commission for Review of the National Policy Toward Gambling, also believes lotteries are regressive. "Lower income people play the lottery much in disproportion to their income. ... That is the classic definition of a regressive income source. It's 2.5 to 3 times as regressive as the sales tax. That's a fact and it hasn't been disputed."[22]

Nevertheless, voluntariness is an important difference between the lottery and the sales tax. It might be argued that the government should not regard discretionary expenditures by poor families differently from those financially better off. That argument is offset, on the other hand, by the fact that lotteries must be aggressively promoted to succeed, putting the state in the position of encouraging the poor to play.

Conclusion

Lotteries are profitable. "There's no question it's a money maker," Levenbook says. "No lottery has ever failed. ... Every director of a state lottery thinks it's the greatest thing since sliced bread." They spare legislators the political pain and citizens the financial distress of raising taxes. Yet, lotteries may not be as fiscally expedient as they first appear.

Lotteries are potentially unappealing in at least four ways: 1) Revenues may not be reliable. 2) They require the state to become an aggressive marketer. 3) The odds are terrible for the players. 4) The poor may be burdened disproportionately.

A lottery must be weighed against the political feasibility of the alternatives and the needs of the state. During the 1983 debate, for instance, Sen. Marshall A. Rauch (D-Gaston), a lottery opponent, distributed a handout listing a number of possible alternatives to the lottery, including raising various taxes to produce as much as $300 million to meet spending shortfalls. Rauch wasn't really proposing tax increases, of course, but he was making the point that if the state needed more revenue, it ought to examine all the potential sources of revenue.

The financial crunch of 1983 has long since passed. Now, in 1985, the talk is of cutting certain taxes and of slowing the rate of growth in state spending. In retrospect, it may be fortunate that the 1983 and 1984 legislatures did not adopt a major change in the state's philosophy of taxation in a time of financial exigency.

Important questions remain about the expediency and desirability of a lottery. This legislative session, in a time of relative plenty, may be the best time to answer them dispassionately. □

"Now mister the day the lottery I win,
I ain't ever gonna ride in no used car again."
—"Used Cars"
by Bruce Springsteen

FOOTNOTES

[1]See Memorandum to Daniel Long, Legislative Services, General Assembly, from Division of Archives and History, Research Branch, July 15, 1982, on "The history of lotteries in North Carolina." The memo summarizes the early involvement of the state in lotteries and includes attachments from various histories (see for example, *The Beginnings of Public Education in North Carolina: A Documentary History, 1790-1840* edited by Charles L. Coon, 1908; and *Fortune's Merry Wheel: The Lottery in America* by John G. Ezell, 1960). The memo also lists some of the major projects completed with lottery funds, including the Craven County poorhouse (1786), a cotton mill in Halifax (1796), churches in Wilmington and Brunswick (1759), and completion of the main building of the University of North Carolina (1801).

[2]Carolina Poll, University of North Carolina at Chapel Hill, School of Journalism, conducted between February 25 and March 3, 1983.

[3]*State Legislatures,* April 1983, p.2.

[4]"The directors of the various lotteries I spoke with unanimously said there was no organized crime involvement in the lotteries," legislative attorney Kenneth T. Levenbook wrote in a report to the 1983 session of the General Assembly. "Reasonable security precautions on lottery tickets and supplies and on-line computer terminals make interference in games virtually impossible. Also, the public nature of all drawings and awarding of prizes makes the lotteries unappealing to the criminal element."

[5]"Lotteries Raise Cash for States" by Elaine S. Knapp, *State Government News*, June 1983, p.6; "Gambling," *State Government News*, September 1977, p.4.

[6]"State Lotteries: Roses and Thorns" by Bill Curry *State Legislatures*, March 1984, p. 10.

[7]*Ibid.*, see chart on pp. 12-13.

[8]"Lotteries in the News," by Terri LaFleur, *Gaming & Wagering Business*, February 1985.

[9]Interview with Kenneth T. Levenbook of the General Assembly's Legislative Bill Drafting office, April 26, 1984.

[10]Interview with Richard Bostic, Illinois Bureau of the Budget, June 19, 1984.

[11]Curry, pp. 9ff.; "Lotto Boloney" by Curt Suplee, *Harper's*, July 1983, pp.15ff.

[12]Curry, pp.12-13.

[13]Curry, p.10.

[14]"Mastermind of the Instant Lottery" by Tom Stevenson, *The New York Times*, Jan. 2, 1977, Section 3, p.1.

[15]*Ibid.*

[16]*Background and General Information on Instant Lottery Games and Other Lottery Products*, Scientific Games, July 1982, Section 15 (unnumbered pages).

[17]"States Win in Lotteries" by Troy R. Westmeyer and Wesley Westmeyer, *National Civic Review*, September 1983, p.447.

[18]"The Myth of the Poor Buying Lottery Tickets" by Dr. John R. Koza, *Public Gaming*, January 1982, pp. 31ff.

[19]Reports cited by state lotteries in files of Kenneth T. Levenbook of the General Assembly staff, Curry, and Suplee. There appears to be general agreement, even among those who argue that lotteries are regressive, that the poor do not participate in lotteries in disproportion to their population.

[20]Studies cited in Suplee and Curry.

[21]"Stakes are high in state lottery" by Charles T. Clotfelter, *The News and Observer*, Raleigh, April 17, 1983, p. 5D.

[22]Curry, p. 11.

Gifted Education:

Nourishing A Natural Resource

Carol Majors

Students from Hunter Elementary, one of Wake County's gifted and talented magnet schools, inspect a bird house on a field trip.

A leader in education for gifted students since the early 1960s, North Carolina still offers widely varying programs for these children. The state has never defined "appropriate" services for gifted students. New criteria for identifying gifted children—based heavily on standardized testing—underscore the need for determining what types of services local systems should provide. Other policy issues also demand attention, from the discrepancies in funding among systems to the allowable pupil/teacher ratio.

by Susan Katz

Seven-year-old Emily went to the beach last May with her academically gifted class. Prior to the trip, the children studied pirates and shipbuilding. At the beach, they explored a shipwreck, visited Brookgreen Gardens, collected and classified shells, and competed in a sandcastle contest. The second-graders earned the money for this trip from a student production of *The Wizard of Oz* they had staged in January.

In another part of the same county, Kenneth, a bright 12-year-old, was sent out to mow the school's lawn because he'd finished his schoolwork. Neither teacher nor principal knew what else to do with him.

State law mandates a "free appropriate publicly supported education to every child with special needs," including those who are academically gifted.[1] But programs for gifted children across the state vary as widely as the terrain.

"North Carolina is a mature state in gifted education," says Dr. Lyn Aubrecht, associate professor of psychology at Meredith College and chairman for legislative action within the N.C. Association for the Gifted and Talented (NCAGT). "We have taken on the correct burden of trying to serve every gifted child in the state. For that, we ought to be proud.

"Yet, statewide," he adds, "there is a lot of room for improvement."

State policies affecting academically gifted (AG) children have often evolved through the context of "special education." At other times, the needs of AG students have required specific actions by policymakers. This article attempts to sort out the complexities surrounding education for academically gifted students. First it reviews the mechanics of state policy, then summarizes important policy issues for the future.

Susan Katz, a Raleigh-based writer, has written for American Baby, The Washington Post, *and other publications.*

Gifted Education from a State Perspective

North Carolina has a long history of ambitious projects in gifted education.

* Summer programs for gifted children abound across the state—from the Cullowhee Experience, begun in the '50's (one of the nation's oldest summer programs for gifted students); to the Duke TIP (Talent Identification Project) program, where high-testing seventh-graders can earn college credit; to a parent-sponsored summer program in Wilmington.

* The Governor's Schools program, begun in 1963, is the "oldest statewide summer residential program for gifted and talented rising [high school juniors and seniors] in the nation."[2]

* The N.C. School of Science and Mathematics in Durham has attracted national attention, and turned out nationally ranked scholars, since opening its doors in 1980.

* The Odyssey of the Mind, an international problem-solving competition among gifted high schoolers, came to North Carolina in 1982.

* All but 1 of the 142 school districts in the state now provide at least limited special services for gifted children. (As of the 1984-85 school year, only the Weldon City Schools offered no special programs.) In 1984-85, the basic public school system served more than 60,000 academically gifted students—more than 1 of every 20 public school children in the state, according to the N.C. Department of Public Instruction (DPI).

In 1961, the General Assembly set in motion the vehicle for gifted education in the public schools when it created the Division for the Education of Exceptionally Talented Children within DPI.[3] The legislators allocated $150,000 for each of the first two years of developing programs statewide for gifted students. Then, in 1968, Superintendent of Public Instruction Craig Phillips merged programs for gifted and handicapped children into a new agency—the Division for Exceptional Children.

Over the next nine years, the legislature enacted statutes requiring appropriate education for exceptional children, both handicapped and gifted. The Equal Education Opportunities Act in 1974[4] mandated education for all children to their "full potential." The Creech Bill in 1977[5] reiterated for North Carolina the federal special education law PL 94-142, but went beyond that act of Congress to include gifted and talented students. The Creech Bill required an appropriate education for all exceptional children, including "individualized education programs." Today, special education and the Creech Bill continue to receive the scrutiny of legislators and the support of a vocal special-education lobby. Among the activists are parents and teachers who want North Carolina to remain a leader in education for gifted children.

"North Carolina is one of the top states in the country regarding gifted education," remarks Patricia Bruce Mitchell, project director for the National Association of State Boards of Education. "You have had programs ongoing for a long time, which is important because it takes a long time to develop a good program, and you have good leadership in the state department of education and within advocacy groups." According to Mitchell, North Carolina is 1 of only 17 states with specific policies requiring special programs for academically gifted children.[6]

For North Carolina to maintain a national reputation in education for gifted children, educators and lawmakers will need to keep a close watch on how state policy affects the local level. North Carolina has a strong tradition of local autonomy in education. Consequently, a special-education curriculum, to a great degree, is a local matter. But the state exercises considerable control of gifted education by issuing guidelines for identifying gifted students and by providing special-education funds for their schooling.

Identification of Gifted Students. DPI maintains a count of students eligible for special education. They are classified in 15 categories of need, all specified by statute. Thirteen of the categories specify students with some kind of mental or physical disability—"mentally handicapped," "behaviorally, emotionally handicapped," "visually impaired," "multi-handicapped," and so on. Pregnant teenagers, with their particular educational needs, are a 14th category. "Academically gifted," the 15th group, reflects a special learning ability. Of a total of 182,346 children in all these categories in the 1984-85 school year, about 60,160—almost one-third—were classified as academically gifted, according to reports filed by local school systems with DPI.

The State Board of Education determines general procedures for serving special-needs children at the local level.[7] DPI has published the board's requirements as *Rules Governing Programs & Services for Children with Special Needs.* Ted Drain, former director of DPI's Division for Exceptional Children and now an assistant superintendent in DPI, considers *Rules* the "Bible" of the program.

According to *Rules,* academically gifted students are those "who demonstrate or have the potential to demonstrate outstanding intellectual aptitude and specific academic ability ... [and] may require differentiated educational services beyond those being provided by the regular school program."[8]

A day in the life . . .

Stephen McInerney and Fritz Gugelmann are two gifted nine-year-olds in different parts of the state. Stephen completed third grade in a self-contained academically gifted class at Southern Pines Elementary School; Fritz is a fourth-grader at Washington Elementary School, a G-T (gifted and talented) magnet school in Wake County. Both boys describe their school as the "best." A look at their school experiences illustrates what can happen in gifted programs that work well.

In Stephen's class, students stayed together all day with one teacher, LuShep Baldwin. When asked to describe a typical day, Stephen made his day sound much like any third-grader's: math and language arts in the morning; library, art, music, or gym just before lunch; science and "different things" after lunch. But this was no ordinary class.

During the year, the class studied North Carolina—"the different regions, the state symbols, state insect, state bird, state reptile, and state mammal," says Stephen. In June, Stephen's class, along with the second-grade gifted students, took an overnight trip to Raleigh, financed with $1,800 netted from their two-night public performance of *Peter Pan*. Stephen played John Darling. "Before *Peter Pan,*" he remembers, "we worked on smaller plays and did them for the school."

Students also kept weekly journals, with page-long assigned entries on their families, vacations, and class trips. When Stephen's math group was studying graphs, he produced one "showing how we spent our day."

A calendar hung on the classroom wall, marked with birthdates of notable people. At the beginning of each month, each student chose one of the people, then prepared a 5-minute class presentation for that person's birthdate. Mozart was Stephen's choice one month. He had been taking piano lessons, so he asked his piano teacher about the composer. The piano teacher helped him find a Mozart piano duet, which Stephen learned with his mother and then taped. On Mozart's birthday, Stephen gave his report to the class accompanied by the tape he had made.

Fritz attends Washington Elementary School, a G-T magnet in Raleigh. Located in a predominantly black neighborhood adjacent to a public housing project, Washington has attracted students of many backgrounds from all over the county and achieved a good racial balance. In keeping with the Wake County superintendent's philosophy of magnet schools, students may attend Washington simply upon nomination by their parents. There are, however, "G-T select" course offerings which are open only to those students identified as gifted. Fritz, for example, took a combination of third-to-fifth grade electives, chosen at the beginning of each semester.

A typical day for Fritz was divided into eight, 45-minute periods, beginning with two periods of language arts in his homeroom. The last two classes of each day were math and science, taught by another third-grade teacher. In between were three electives and lunch.

Fritz's Monday-Tuesday elective schedule included theater production, lifetime sports, and French. On Wednesdays and Thursdays, he took inventions, aeronautics, and French.

In theatre production, Fritz was a stage manager for the full-length musical, *The Princess and the Magic Pea,* produced in May. As stage manager he "had to block everything, and tell people when to come out." During fourth period he had lifetime sports—basketball, softball, roller skating, and gymnastics. In his second semester of French, he learned songs, conversation, and vocabulary.

Inventions was a G-T select course. "We learned how to think like an inventor," he says. "For instance an inventor could look at a straw as something other than a drinking instrument." Each student in that class, given instructions for a variety of simple machines, had to make one and modify it in some way. Fritz built a bubble-making machine.

Aeronautics was another G-T select elective. "Now, that was a good course," nine-year-old Fritz reminisces. There students learned "what keeps an airplane up in the air," learned about instrument panels, and designed and built their own model gliders. "We learned how to create lift and thrust, how to cut back on drag, and how to make it streamlined." Did the gliders work? "Some worked, some sort of worked," he responds diplomatically.

Although Fritz's bus ride to and from school is over an hour long, he and his brothers make the trip because they and their parents feel it's worth it. "I think G-T schools are great," says Fritz, "especially Washington."□

—*Susan Katz*

Until 1983, this special education category was called "gifted and talented." Then, in 1983, the legislature dropped the word "talented" and changed the terminology to "academically gifted," reflecting the program as actually implemented on the state and local levels.[9] Many schools provide for the development of artistic talent in students, but they must do so outside the AG funding structure. Some school systems—like Wake County's—offer gifted-and-talented "magnet" schools, but the "talent" components are outside state special-needs guidelines and are not funded with that pot of state money. In refining the statutory language on gifted education, some legislators felt that "talented" students were served best by a special school to develop their abilities, the N.C. School of the Arts in Winston-Salem. According to DPI, the 1983 change in language that dropped "talented" has not affected which children participate in AG programs.

To identify gifted children, local school officials employ an elaborate "point" system, as detailed in *Rules*. The process attempts to allow for a variety of "giftedness" and cultural background. Students may be nominated by their teachers, peers, or parents. They then face an assessment procedure which includes points for various tests and subjective judgments.

New criteria, which took effect on January 1, 1985, altered the point system somewhat. Under the new criteria, IQ and standardized achievement test scores are weighted evenly, each carrying a maximum of 50 points. Grades carry a maximum of 10 points. A student earning 98 points automatically qualifies for services. This ranking system puts less weight on subjective measures such as teacher recommendations. It weeds out the obvious "teacher-pleasers," who smile nicely in class but who might not really need special programming. It frees teachers to offer programming that truly is geared to those children who are significantly "different" from the standard population.

The new criteria are also intended to help identify children who might be gifted but disaffected, i.e., those who score high on an IQ or achievement test but who have been unmotivated or misplaced in school, earning low grades. Usually, individual teachers know their students best, but sometimes a child's exceptional abilities can be obscured by shyness, lack of motivation, or other factors.

Finally, the new criteria attempt to hone what have been some rough edges in identifying gifted minority students. The new criteria include a section labeled "Special Consideration/Further Testing."[10] This section recognizes that standardized tests "do not always adequately control for the lack of environmental or cultural opportunities to learn." But to compensate for this weakness in identifying gifted students, the section offers this remedy: "further standardized testing shall be completed and the scores used in determining eligibility."

Once identified, gifted children enter a special planning process to determine the most effective course of study for them. Until 1983, each gifted child—like every exceptional student—was entitled to an "individualized education program"(IEP). In 1983, however, in the same legislation that changed the term to "academically gifted," the General Assembly determined that gifted children may not require individual plans. Legislators decided that the greatly diminished paperwork required by *group* plans outweighed the benefits of individual programs, especially since most of those individual plans had been similar. Former state Sen. Gerry Hancock (D-Durham), who headed the legislative study of the Creech Bill, says that it was not the subcommittee's intention to dilute programming. Those gifted children whose needs are not met by a group plan, he says, "*shall* receive individualized treatment."[11]

Paying for Gifted Education. In a national study, Dr. James J. Gallagher, director of the Frank Porter Graham Child Development Center at the University of North Carolina at Chapel Hill, found that programming for gifted children costs about 15-to-45 percent more per pupil than standard curricula.[12] For example, if it costs $2,000 per pupil, per year, to run a regular school program, programming for gifted students would cost about $2,300-2,900.

"A little more than $114 million" is the amount of state funding going for *all* special education per year, according to Bill Pilegge, assistant controller for financial services at the State Board of Education. (For FY 1985, the General Assembly raised the figure to $141 million.[13]) How much of that is earmarked for gifted children? The complex funding formulas won't yield an answer, says Pilegge.

Funding for exceptional children comes from federal, state, and local sources, although programs for gifted students are excluded from federal money. State funding for exceptional children is determined by categories (i.e., physically handicapped, visually impaired, gifted, etc.). But state monies go to the local education agencies (LEAs) in a lump sum, not by categories. Each LEA receives a sum marked "exceptional children's funds," and the local school board can disburse it as it wishes.

This lump-sum distribution stems from the state's traditional attitude of encouraging local autonomy in education. But local autonomy in spending the money causes tremendous variance among school systems in program funding—and in educational opportunities for children with special needs.[14]

Gail Smith and Ruby Murchison, DPI's two state consultants to local schools for gifted education, report wide discrepancies among gifted education programs throughout the state. Smith and Murchison are available to consult with school personnel, run workshops, and interpret *Rules*. They can make recommendations to LEAs for program development, but they cannot prescribe how local schools spend their special education money. State law mandates "appropriate education" for gifted children, but many local programs for gifted students are much better developed—and funded—than others.

State regulations allow public schools to assign 175 children each week to an AG resource teacher, a student/teacher ratio that permits very little individual attention to each of these special-needs children. The state also offers little direction to ensure for these students an effective curriculum, one that can depart from standard textbooks and conventional class assignments. And, while some school systems begin identification of gifted students in kindergarten, the process more often begins no earlier than third grade.

While state funding formulas do not determine how LEAs *spend* their money, they can encourage the local systems to *identify* academically gifted children. Prior to 1980, funding for all exceptional children was based on Average Daily Membership (ADM) of all students. This did not encourage districts to identify gifted children, for the districts received a set amount of money from the state, based on their ADM.

In 1979, the General Assembly directed the State Board of Education to switch to a "headcount" system, where LEAs would receive funds according to actual numbers of exceptional children identified. Many special-education advocates prefer headcount, for it encourages schools to locate exceptional children. Says Lyn Aubrecht, "You don't find 'em, you don't get the money."

To prevent runaway funding, the State Board put limits, or "caps," on each of the 15 special-education categories. Academically gifted populations could not exceed 3.9 percent of the average daily school membership, a percentage of the population estimated to be gifted. In the State Board formula, local education agencies would receive one-third the funds for each gifted student that they receive for each handicapped child.

Some of the school systems with high ADMs, however, stood to lose funding in a headcount system. So the State Board wrote a "hold-harmless" clause into the formula, stating that if a school district would lose money by switching to headcount, the loss would not appear for three years. On July 1, 1983, the hold-harmless provision was scheduled to disappear, leaving a strict headcount formula in effect.

The 1983 General Assembly, however, decided to extend hold-harmless through the 1983-84 year and to modify it for 1984-85 so that school systems could lose only part of the funding difference by switching to headcount. In 1985-86, headcount was scheduled to become the sole basis for determining state funding for local special education programs.

In June 1984, increased state revenues greeted legislators arriving in Raleigh for the short session. The lawmakers decided to increase state support by $4.1 million (not including an across-the-board teacher salary hike) for all local special-education programs, including AG. With all LEAs thus scheduled to receive increased funds, the General Assembly eliminated the modified hold-harmless clause for 1984-85 and directed that strict headcount become the funding basis this school year instead of in 1985-86.[15]

What's Next in Gifted Education?

The school year 1983-84 was a time of reevaluation and change for gifted education in North Carolina, "a year of fine-tuning," according to Gail Smith at DPI and others throughout the state.

By changing from individualized to group educational programs, says Smith, teachers had a load of paperwork lifted off their shoulders without sacrificing their attention to individual students. In addition, she says that group plans "help teachers build in program consistency across schools in the same system," correcting a prior weakness in gifted education.

But other areas of education for gifted children wait to be addressed.

Increased opportunities for teacher training in gifted education would improve programs statewide. As long as no college or university east of Raleigh offers graduate level courses in gifted education, it is difficult or impossible for teachers in the eastern part of the state to keep up their own training. Graduate credits earned in locally run workshops are not sufficient to acquire or maintain skills for teaching gifted students. (For more on teacher training, see *Questions about gifted education,* p. 41).

The Palcuzzi Ploy

The following apocryphal tale is reprinted with permission from James J. Gallagher, Teaching the Gifted Child, *Boston: Allyn and Bacon, 1975, pp. 83-4.*

Mr. Palcuzzi, principal of the Jefferson Elementary School, once got tired of hearing objections to special provisions for gifted children, so he decided to spice an otherwise mild PTA meeting with *his* proposal for gifted children. The elements of the Palcuzzi program were as follows:

1. Children should be grouped by ability.
2. Part of the school day should be given over to special instruction.
3. Talented students should be allowed time to share their talents with children of other schools in the area or even of other schools throughout the state. (We will pay the transportation cost.)
4. A child should be advanced according to his talents, rather than according to his age.
5. These children should have special teachers, specially trained and highly salaried.

As might be expected, the "Palcuzzi Program" was subjected to a barrage of criticism. "What about the youngster who isn't able to fit into the special group; won't his ego be damaged?" "How about the special cost; how could you justify transportation costs that would have to be paid by moving a special group of students from one school to another?" "Mightn't we be endangering the child by having him interact with children who are much more mature than he is?" "Wouldn't the other teachers complain if we gave more money to the instructors of this group?"

After listening for ten or fifteen minutes, Mr. Palcuzzi dropped his bomb! He said that he wasn't describing a *new* program for the intellectually gifted, but a program the school system had been enthusiastically supporting for a number of years—the program for *gifted basketball players*! Palcuzzi took advantage of the silence that followed to review his program again. Do we have ability grouping on our basketball team? Yes, we do. No doubt, the player who does not make the first team or the second team feels very bad about it and may even have some inferiority feelings. However, this will not likely cause the program to be changed.

Do we allow part of the school day to be given over to special work? Generally speaking, the last hour of the day can be used, by tradition, for practice of basketball talents.

Do we allow these children to share their talents with other students from other schools and other cities? Yes, we do, and, what is more, we pay the transportation costs involved without very many complaints being heard.

Do we allow gifted basketball players to advance by their talents rather than by their age? Indeed, we do. Any sophomore who can make the team on the basis of his talents gets the privilege of playing with seniors, and no one worries very much about it.

Finally, do we have special teachers who are specially trained and more highly salaried than the ordinary teacher? Yes, we do, and although there is some grumbling about it from the regular teachers, this does not materially affect the program.

What does this tell us? The culture and the community will support the kinds of activities that they find necessary, valuable and/or enjoyable. If they feel that a program is sufficiently necessary or sufficiently enjoyable, all sorts of objections are put aside as being relatively inconsequential. If, on the other hand, the community is not fully interested or involved in supporting such a program, all kinds of objections can be raised as to why these things should not be done, or cannot be done. □

A concerted effort needs to be made to find gifted students—including minority students. By relying heavily on standardized testing, the new criteria for identifying gifted students will help differentiate "teacher-pleasers" from children needing special services. But some analysts worry about the long-term effects of these criteria.

"Under the new, tougher criteria for identifying gifted students, far fewer students will be labeled academically gifted," says Lyn Aubrecht of the N.C. Association for the Gifted and Talented. Relying so heavily on testing will require students in most cases to score well in order to meet the criteria, adds Aubrecht.

Identification of gifted minority students should continue to be a prime concern. Despite the new section in the *Rules* acknowledging the shortcomings of testing minority students, the main remedy prescribed for that problem is still more testing. Research indicates that, statistically, black and native American students do not generally test as high as white students.[16] Minority students, then, under the new criteria, are somewhat penalized when so much weight is given to IQ and achievement scores. In the absence of a good standardized measure for minority students, it is doubly important for teachers to be alert for gifted minority students.

The freedom to depart from standard textbooks and delve more deeply into subjects is mandatory for any program for gifted students. Third-graders who have already mastered fractions may need the fourth- or fifth-grade math book. Indeed, they may even need a hands-on math lab to practice the things they have learned and to be encouraged to discover more. They may need, for example, a class in aeronautics to discover velocity as a meaningful ratio.

Allowing LEAs to tailor programs to their own needs is part of the state's tradition of local autonomy. Such local flexibility allows for creativity to meet a diversity of needs. But this same flexibility results in some LEAs paying little attention to specialized curricula for academically gifted children.

The State Board of Education should evaluate the current student/teacher ratio requirement. The State Board's gifted education guidelines for pupil/teacher ratio allow up to 175 pupils per week for an AG resource teacher. This 175 to 1 ratio for a resource model is far more than any other category of special education student (35 to 1 for learning disability, 35 to 1 for educable mentally handicapped, 20 to 1 for hearing impaired, and 20 to 1 for behaviorally emotionally handicapped). School districts which do not improve upon this ratio may not be providing an adequate response to the special-education needs of gifted children.

If fewer students are labeled academically gifted under the new, tougher criteria, then there will be a reduction of state money for gifted education at the local level. "This could mean a substantial reduction in the number of teachers of the gifted in some local areas," says Aubrecht. "Too few teachers may be left to provide adequate programs for the widely scattered gifted students that remain."

Conclusion

The enhancement of gifted education over the next few years does not depend on a single policy decision by legislators or by state education officials. Instead, the system will need a series of adjustments if gifted students in every part of the state are going to receive creative teaching instead of lawn-mowing assignments.

Policymakers will address AG questions primarily through modifications to the Creech Bill and to the rules and regulations issued by the State Board of Education. Some issues will affect *all* special education. Others will affect gifted education only. These are a few of the concerns that state legislators and state education officials should be considering:

* discrepancies in funding, teacher quality, and curriculum among AG programs statewide;
* the headcount formula and its effectiveness in channeling special-education funds where they are needed;
* the accuracy of the 3.9 percent funding cap, which represents an estimate of academically gifted students within the school population;
* the current pupil/teacher ratio of 175 to 1, for a resource program;
* identification of gifted students, particularly among minority children; and
* improvement of teacher training, especially in the eastern part of the state.

As a society, we claim to value the special abilities of our citizens. And North Carolinians have shown a willingness to develop these gifts as they appear among our schoolchildren. But such a development in education is itself a learning process. The General Assembly, the Department of Public Instruction, and local school districts have all accumulated years of instruction in providing gifted education. The next few years will show how much they've learned. □

FOOTNOTES

[1] NCGS 115C-106(b) *et seq.*

[2] *The Governor's School of North Carolina*, a brochure by the Division for Exceptional Children, N.C. Dept. of Public Instruction.

[3] Chapter 1077 of the 1961 Session Laws.

[4] Chapter 1293 of the 1973 Sessions Laws, 1974 Session.

[5] Chapter 927 of the 1977 Session Laws, now codified as NCGS 115C-106 *et seq.*

[6] The other 16 states are Alabama, Alaska, Arizona, Florida, Georgia, Kansas, Louisiana, Nevada, New Jersey, New Mexico, Oklahoma, Pennsylvania, South Dakota, Tennessee, Virginia, and West Virginia.

[7] 16 NCAC .1500.

[8] 16 NCAC .1501(a)(2).

[9] Chapter 247 of the 1983 Session Laws, codified in NCGS 115C-109.

[10] 16 NCAC .1509(d).

[11] Chapter 247 of the 1983 Session Laws, codified as NCGS 115C-114(g), reads in part: "The State Board of Education shall promulgate rules and regulations specifically to address the preparation of these group educational programs . . . and shall also include standards for ensuring that the individual educational needs of each child within the group are addressed."

[12] James J. Gallagher *et al., Report on Education of Gifted, Vol. 1, Surveys of Education of Gifted Students, Executive Summary*, produced for the Advisory Panel, U.S. Office of Gifted and Talented, Washington, 1982, p.4.

[13] Chapter 971 of the 1983 Session Laws, 1984 Session, HB 1496. The increase includes teacher salary boosts and a line item to increase program support for exceptional children.

[14] For more on the recent history of special education funding, see " 'Hold-Harmless' to Equitable Distribution—Who Gets State Special Education Funds?" by Hilda Highfill, *North Carolina Insight*, Vol. 6, No. 2-3, Oct. 1983, p. 80.

[15] The General Assembly included a one-year, hold-harmless provision affecting seven local systems due to possible reductions of federal funds for handicapped children in those systems. The federal special-education law *does not* cover gifted education, and hence federal funds do not go towards a local system's gifted program. However, state special-education funds, which *do* cover gifted children, are distributed in a block fashion. Hence, the one-year hold-harmless provision was necessary for the state funds going to those seven systems.

[16] James J. Gallagher, *Teaching the Gifted Child*, Boston: Allyn and Bacon, 1975, pp. 371-81.

Questions about gifted education

Education policymakers at state and local levels have sometimes made decisions without adequate background on what "academically gifted" means. Even though the term "gifted" is not new, myths and misconceptions exist. Some frequent questions follow.

What is an "appropriate education" for gifted students?

The range of children's intellectual functioning is a bell curve. "Children at either end of the spectrum have similiar needs in terms of education," says Krista Oglesby, formerly of the Frank Porter Graham Child Development Center in Chapel Hill. "For both, the existing curriculum is not appropriate, and for both, special teaching strategies are needed."

Like mentally handicapped students, explains Oglesby, gifted students can be seen in terms of "mild," "moderate," and "severe." The appropriate program for each degree of giftedness depends on how a student's needs can be met in the regular classroom. For "mildly" gifted students, that might be enrichment within the regular classsroom. "Moderately" gifted students might profit from a resource room, with special time there on a daily or weekly basis. "Severely" gifted children would best be served by a self-contained classroom. (For more about the schoolday of gifted children, see sidebar, p. 36).

"Gifted children are children first," emphasizes Oglesby. "They have some of the same problems as other children, and they are as diverse as other children." Truly appropriate programming, she says, would include an array of services.

However, such an array of services is a rarity in North Carolina, according to Lyn Aubrecht, associate professor of psychology at Meredith College. "The concept is good," he says, "but there are few places where this happens." Aubrecht says that too often the issue is what is *affordable*, not what is *appropriate*. "Schools need to be practical, but we need to ask first what is appropriate and then ask how we can manage to get that done," he adds.

The N.C. Association of Gifted and Talented (NCAGT) recently voted to fund a year-long statewide task force to study this topic. The group will work to identify the issues involved, to articulate and begin to resolve them, and to perhaps offer examples of "appropriate services." The task force plans to report to the association's 1986 state conference, planned for Raleigh on the theme, "Appropriate Services for Gifted Students."

Appropriate services for the gifted have never really been defined, says Gail Smith of DPI. The state law inherited the federal language, which focuses on a "free and appropriate education" for handicapped children and the "least restrictive environment." "Advocates of the gifted recognize that the mainstream classroom could be a *restrictive* setting for the gifted child," says Smith. "That's why the NCAGT task force on appropriate services is so important."

What about the stigma of being labeled "gifted"?

"At one time there might have been a stigma, but we're over that now," says Pat Hickmon, founder of Cumberland County's Parents for the Advancement of Gifted Education (PAGE) and former chairwoman of the Cumberland County School Board. "Going to AG," she says, "is just like going to PE or any other class period."

In fact, long-running gifted programs often find students placing a premium on the slots, such as spaces at Enloe, Raleigh's only AG magnet high school.

Conclusions from a study of gifted programs nationwide found that "participants did not develop personality or social problems ... rather, participants showed improvement not only in academic areas but also in the personal and social areas."[1]

Do teachers and principals regret having the students taken out of their classes and schools?

What often happens when you take out the top one or two in a class is "you give others a chance to fill that void," says Dr. Linda Weiss Morris, president of the N.C. Association for

Gifted and Talented and a former elementary school principal.

This is what some principals and teachers have discovered since the creation of the N. C. School of Science and Mathematics at Durham. Initially reluctant to refer their best math and science whizzes to a residential program, some principals and teachers are now realizing that other students were just waiting for their time to shine.

Aren't gifted programs just a lot of extra homework?

"Gifted," states Morris, "does not mean *more* [homework]. Children should not be penalized for being bright."

Gifted often does mean, however, different ways of learning and looking at things. Dr. James J. Gallagher, director of the Graham Child Development Center, emphasizes developing skills of cognitive memory (as in, "Whom did Hamlet kill by mistake?"), convergent thinking ("Explain why Hamlet rejected Ophelia"), divergent thinking ("Name some other ways Hamlet might have accomplished his goals"), and evaluative thinking ("Was Hamlet justified in killing his uncle?")[2]—precisely those skills one would wish of a potential leader and original thinker. Those skills are not developed by a seventh-grade AG teacher who simply assigns a literature class "the 30 questions at the end of the chapter."

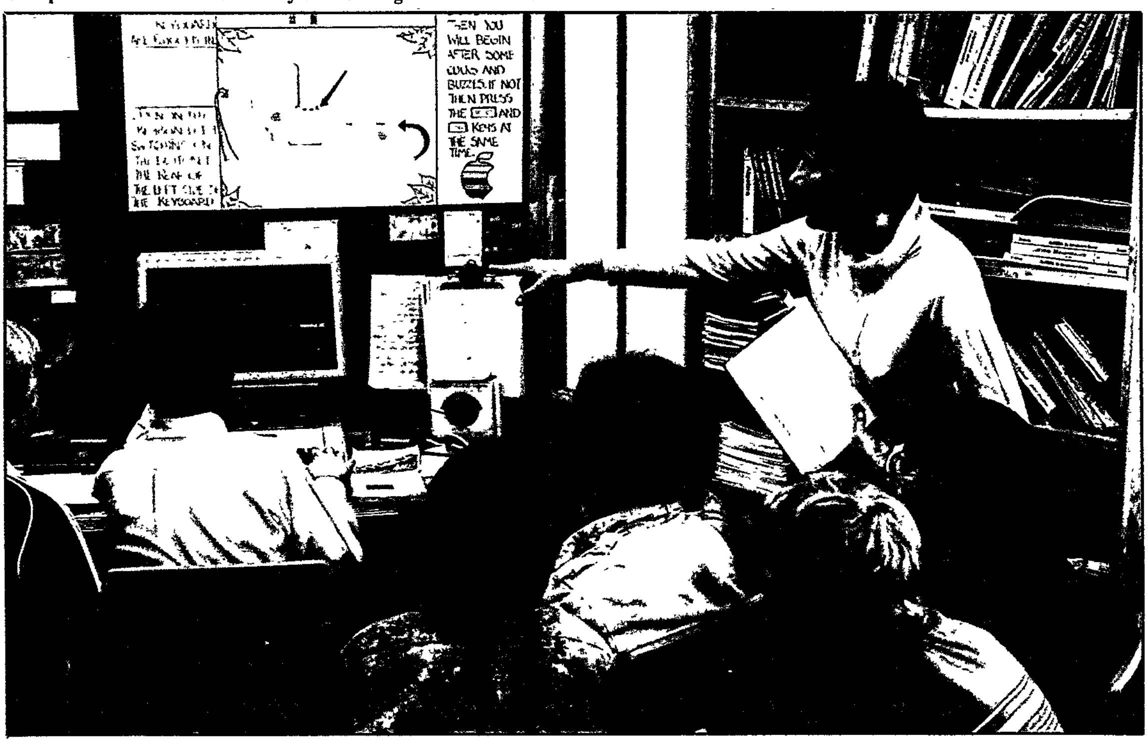
What's available for teacher training?

Teachers are required to achieve AG endorsement within three years of starting to teach classes of gifted students. Unfortunately, appropriate teacher training is not available in all parts of the state.

Ten North Carolina colleges and universities offer state-approved undergraduate or graduate teaching programs in gifted education, but none of these is east of Raleigh.[3] Teachers in the eastern part of the state are at a particular disadvantage in gaining their endorsements, especially while trying to hold down daytime teaching jobs. Currently it is possible for a teacher to receive endorsement credit at workshops, but the state exercises little control over the content or quality of locally run workshops. The improvement of AG teacher training will require that more colleges hire full-time faculty in gifted education and that DPI establish more oversight of workshops offering endorsement credit.

James Gallagher says that more teacher training programs would appear if they were "money-makers," that is, if they could receive federal or state subsidies. "There are major *federal* funding supports for teachers of all exceptional children, except the gifted," Gallagher says. Of the *state* money going to train teachers of exceptional children, he says, not much is channeled into gifted education. He says that a state subsidy of $60,000 could fund a college

Computer mini-course at Wiley Junior High in Winston-Salem.



Susan Carson

program in gifted education with a full-time faculty member.

Aren't AG classes just a scheme to keep white families in the public schools? And do minority children get to participate?

Students in AG programs often do come from white, middle-class backgrounds. Sometimes this fact has been used in integration planning, by the placement of AG programs in magnet schools in predominantly black neighborhoods.

It's important in statewide planning to direct energies toward finding gifted children from minority ethnic groups. "The gifted are from all walks of life," says Gallagher. "You have to look for them in different ways."

Some locales, however, rely on group IQ measures—standardized tests without individual interpretation—to identify giftedness. Dr. Michael Katz, Wake County clinical psychologist and a former Fairfax County, Va., school psychologist, questions whether group measures are adequate in searching out the gifted, particularly those from cultural minorities. He has a hunch that "some are going unidentified, because group measures won't necessarily pick up on those kids who are gifted but tuned out, poorly motivated to do well in a group setting, uncooperative in class, or untrained by their home environments to do more sophisticated thinking." A well-trained psychologist can pick up on other indications of exceptional academic ability more clearly in an individual assessment. "There are nuggets one can look for," says Katz. In an individual test, a good examiner will take note of those nuggets and look more closely. A group IQ test says, in effect, 'We're going to provide services to those kids who've learned the skill of standing out in a group test.' "

Dr. Smith Goodrum, associate dean of admissions and financial aid at Mars Hill College and former director of its Center for Gifted Education, suggests that emphasis on verbal ability may miss some kids. "I am more impressed by motivation, perseverance, and initiative than I am by IQ scores." In selecting students for Mars Hill's Summer Scholastics and Arts Program, Goodrum put more weight on the students' statements about *why* they wanted to participate.

Do parents of gifted children support programs?

While some parents don't wish to stand out from their neighbors and are reluctant to refer their child for placement, many others around the state are enthusiastic about the potential of gifted education. Currently there are 35 chapters of PAGE (Parents for the Advancement of Gifted Education) across the state, according to Don Russell, retired professor of education at UNC-G, and state coordinator for the group.

Most of the PAGE chapters are very active, Russell says. In Pasquotank County, for example, PAGE sponsored "Kids' Kollege" in cooperation with the local school system. During six winter Saturdays, about 300 children attended special classes at the College of the Albemarle in astronomy, photography, creative writing, and other extracurricular subjects.

Johnston County PAGE ran a summer program in 1982 with courses in language arts, math, science, dramatic arts, TV arts, and dance. Data General Corporation loaned the program $250,000 worth of equipment for the two-week program. Admissions were open; a child did not have to be identified as gifted to attend.

These organized parent groups can make a big difference. Parents monitor school board meetings and make their concerns known. Many generate financial support. Computers have been placed in schools through parent funding, and many PAGE chapters run Saturday morning enrichment programs in the schools. PAGE and the N. C. Association for the Gifted and Talented co-sponsor an annual statewide conference on gifted education.

In 1982, Wake County parents active in PAGE were divided over programs for the gifted. Some were delighted and others were upset. But the majority did not understand the complexities of the program. A special PAGE committee resulted, which produced a 27-page booklet, *Educational Programs for Gifted and Talented Children in the Wake County Public School System: An Overview with Observations and Recommendations.* The report and the meetings with school officials that followed not only reconciled differences but also provided a good example of what PAGE believes it can be—parents and educators working together toward a good and appropriate education of our gifted children. □

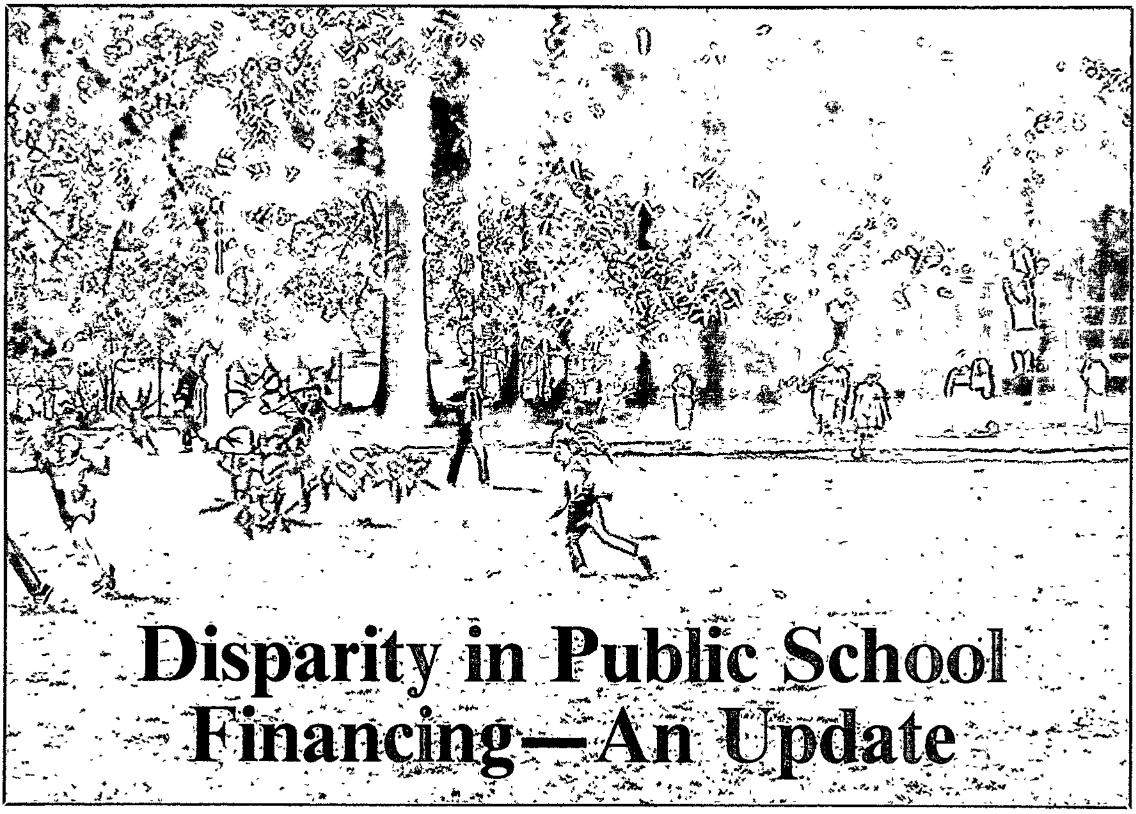
—*Susan Katz*

FOOTNOTES

[1] James J. Gallagher, *Teaching the Gifted Child,* Boston: Allyn and Bacon, 1975, pp. 292-3.

[2] *Ibid.*, pp. 238-9.

[3] These colleges are Appalachian State University, Catawba College, Lenoir-Rhyne College, Mars Hill College, St. Andrew's Presbyterian College, Wake Forest University, Western Carolina University, and the University of North Carolina at Chapel Hill, Charlotte, and Greensboro.



Disparity in Public School Financing—An Update

by Bill Finger

Philip Ray Dail, the state's 1984 Teacher of the Year, called disparity in funding among the 142 school districts the greatest problem in North Carolina education. The *Report of the Commission on the Future of North Carolina* recommended that the state "devise and apply a system of public school finance that will provide equal educational opportunity to all schoolchildren."[1] Most recently, the Public Education Policy Council concluded that a major clarification of state and local funding responsibilities is needed in order to assure an equal educational opportunity for all schoolchildren.[2] This 47-member council, created by the General Assembly in 1983 to study the public school system, is the latest and perhaps most important education reform effort in recent years.

Any student of the state's education system should by now—after the spate of reports in the last year—have read Article IX, Section 2 of the N.C. Constitution. Short and to the point, that section requires that the General Assembly "shall provide by taxation and otherwise for a general and uniform system of free public schools."

In June 1984, *North Carolina Insight* reported a widening gap in per-pupil spending among the 142 school systems, despite this constitutional guarantee. "Financial disparity is not the only factor leading to educational disparity, but financial equity does represent the cornerstone of any effort to build a 'uniform system of free public schools,'" wrote education analyst Lanier Fonvielle in *Insight*.[3]

Fonvielle's article, "Disparity in Public School Financing—Where North Carolina Stands," summarized the strengths and weaknesses in the funding system used in North Carolina and examined various school finance reform efforts in their historical context. Fonvielle pointed out the wide variety in course offerings among the 142 systems, and explained how spending relates to programs.

A recent graduate of Northern High School in

Durham, for example, had advanced Latin and computer math courses under his belt. But a graduate of the K-12 Blue Ridge School in the mountain community of Glenville (Jackson County) could take neither of those courses. In fact, the Durham County school had 56 more course offerings (28 academic and 28 vocational). Metropolitan area school districts can generally offer more courses than rural districts. While every school cannot offer advanced Latin and computer math, minimum course requirements and creative efforts such as cross-district services and access to community colleges can round out course offerings.

"Expenditure equity is not the same as program equity," cautioned Fonvielle. "By funding a minimum, comprehensive program and imposing statewide standards, the state could focus *on program equity as well as expenditure equity*."[4]

In 1985, the General Assembly has the opportunity to meet the challenge put forth by Fonvielle, the Commission on the Future of North Carolina, and the Public Education Policy Council. In February, Sen. Robert Warren (D-Johnston) and Rep. Jo Graham Foster (D-Mecklenburg) introduced legislation which recognizes that "the quality and the quantity of the school program is in part dependent upon where a child lives."[5] The 27-page bill attempts to clarify state and local funding responsibilities for public schools, including funding for the new "basic education program." The State Board of Education proposed the basic education program in October 1984 (with revisions in February 1985), as required by legislation passed first in 1983 and again in 1984.[6]

The basic education program incorporates both philosophy and details. For example, the program calls for mastery of integrated knowledge and skills necessary to cope with contemporary society. It also specifies a core curriculum, standards for student performance, and appropriate class size for each course.

The proposals put forth by Sen. Warren and Rep. Foster, who co-chaired the Public Education Policy Council, appear to address the issue of disparity among the state's 142 school districts. While far-reaching in its broad sweep and in its details, the legislation nevertheless raises some important questions that need adequate debate.

■ Under the state and local financial partnership, will raising the "foundation" level of state funding to all districts alleviate problems of disparity in financing among school districts? Or will this increased "foundation" only raise the overall state contribution and serve to perpetuate spending gaps among districts?

■ Can *program equity* (through the new basic education plan) be achieved by the funding system outlined in the legislation?

■ Along with proposals to fund the basic education program are proposals to increase local discretion in spending state funds. Where will responsibilities lie, as a practical matter, for ensuring that every child receives an equal opportunity for the basic program?

■ The legislation continues to allocate funds for instructional personnel, support personnel, instructional equipment, and general administration through the traditional "average daily membership" formula. Is this the most equitable means of funding a basic education plan?

■ Can program equity be achieved without addressing the question of a local district's ability to pay?

As legislators debate these and other questions, two basic considerations must be kept at the forefront: the *quality* of a "general and uniform system of free public schools" and the degree of *financial equity* among the districts. With the Fonvielle article last June, *Insight* published the top 10 and bottom 10 school districts, according to total per-pupil expenditures in 1982-83. After releasing the rankings to the media, reporters from around the state called asking, "Where does our system rank?"

The latest rankings in per-pupil spending—covering the 1983-84 school year—have recently become available from the State Board of Education Controller's Office. To be sure that reporters and legislators throughout the state can find at a glance where their districts rank, the newest per-pupil spending data for all 142 districts are included here. Note that the city districts are included under the respective counties.

In North Carolina, the state currently provides a "foundation" for a local school district's operating costs. About four of every five state public school dollars go for instructional salaries according to an allotment system. Using the projected average daily membership of each district, the state determines the number of positions eligible for state funding.

State per-pupil funding does not vary extensively among districts but *total per-pupil* spending does. In 1983-84, *total per-pupil* spending (excluding food service) ranged from a low of $1,686 in Davidson County to a high of $2,665 in Chapel Hill/Carrboro City—a difference of 58 percent. This wide range stems from the huge variation in *local* spending levels. In 1983-84, Cherokee County contributed $195 per pupil, the lowest in the state, while Chapel Hill/Carrboro contributed nearly six times as much ($1,159 per pupil).

Total Per-Pupil Expenditures, 1983-84

The Top Ten	*The Bottom Ten*
1. Chapel Hill-Carrboro	142. Davidson County
2. Asheville City	141. Randolph County
3. Hyde County	140. Iredell County
4. Durham City	139. Cherokee County
5. Hendersonville City	138. Gaston County
6. Fayetteville City	137. McDowell County
7. Greensboro City	136. Union County
8. High Point City	135. Alexander County
9. Mecklenburg County	134. Onslow County
10. Tyrrell County	133. Richmond County

In the last decade, the gaps in total per-pupil spending among districts have widened, because of two main trends. First, the share of school budgets from federal sources has decreased from 14.2 percent in 1972 to 10.5 percent in 1982. Second, local spending, the most flexible part of school budgets, has increased from 19 to 25 percent of the statewide total for schools. Consequently, the state foundation support for public schools is being diluted.

Those who want to understand the complicated issue of school finance should view these per-pupil spending figures only as a beginning point. Important factors do not show up in the per-pupil spending data for each district, particularly per-capita income, spending for transportation (which varies extensively among rural and urban districts), tax effort, and tax base.[7] Sampson County, for example, ranks only 115th in the local per-pupil spending but 27th in tax effort (.856 per $100 property valuation), reports the Atlantic Center for Research in Education in Durham. A low property tax base keeps Sampson County low in the rankings of local per-pupil spending. □

FOOTNOTES

[1] *The Future of North Carolina—Goals and Recommendations for the Year 2000,* Report of the Commission on the Future of North Carolina, N.C. Department of Administration, 1983. p. 30.

[2] "Report of the Public Education Policy Council," Report to the 1985 General Assembly of North Carolina, Sen. Robert D. Warren and Rep. Jo Graham Foster, co-chairs, December 1, 1984.

[3] Lanier Fonvielle, "Disparity in Public School Financing," *North Carolina Insight*, Vol. 7, No. 1, August 1984, p. 31.

[4] *Ibid.*, p. 36.

[5] Senate Bill 49, preamble. See also, House Bill 102 and Senate Bill 68.

[6] Chapter 761 of the 1983 Session Laws (SB 23), Section 86, and Chapter 1103 of the 1983 Session Laws (Regular Session, 1984) (HB 1567), Section 2.

[7] "Tax effort," as used here, refers to the portion of county taxes allocated for public schools. "Tax base" refers to overall revenues available to a county (countywide property taxes, school district property taxes, fines, license taxes, excise stamps, local sales taxes, ABC profits, intangibles taxes, beverage taxes, revenue sharing, and other miscellaneous sources). Both of these measurements are usually by *county, not by school district*, which further complicates this issue. (In North Carolina, there are 100 counties and 142 school districts.)

Resources on Disparity in Spending Among School Districts

Atlantic Center for Research in Education (ACRE), 604 W. Chapel Hill St., Durham, N.C. 27701, (919) 688-6464. ACRE is in the process of compiling per-capita income and property tax values for all 142 school districts. The group will also furnish interested legislators and citizens brief financial profiles of a school district. For more information, contact Elisa Wolper.

Lanier Fonvielle, "Disparity in Public School Financing." *North Carolina Insight*, Vol. 7, No. 1, August 1984, pp. 30-37. Fonvielle explains why per-pupil spending varies among school districts and how the disparity might be addressed.

The Future of North Carolina—Goals and Recommendations for the Year 2000, Report of the Commission on the Future of North Carolina, N.C. Department of Administration, 1983, pp. 27-32.

Jody George, "Courts Split on School Finance Issue," *North Carolina Insight,* Vol. 7, No. 1, August 1984, pp. 38-41. George puts the disparity issue in a national context, showing the major state court decisions that found disparities in school finance unconstitutional and those that found no constitutional violations.

Don Liner, Institute of Government, University of North Carolina at Chapel Hill, N.C. 27514. Liner has compiled data on disparity in school financing.

"Report of the Public Education Policy Council," Report to the 1983 General Assembly of North Carolina, 1984 Session, Sen. Robert D. Warren and Rep. Jo Graham Foster, co-chairs, June 1, 1984. See particularly pp. 14-18 and Appendix H.

"Report of the Public Education Policy Council," Report to the 1985 General Assembly, Sen. Robert D. Warren and Rep. Jo Graham Foster, co-chairs, December 1, 1984.

Table 1. Per-Pupil Expenditures (PPE) by School District, 1983-84 (Excluding Food Service)[1]

SCHOOL DISTRICT[2]	STATE PPE	STATE RANK	FEDERAL[3] PPE	FEDERAL[3] RANK	LOCAL PPE	LOCAL RANK	TOTAL PPE	TOTAL RANK
Alamance County	$1412	118	$ 92	125	$ 378	78	$1881	118
Burlington City	1412	116	102	113	602	19	2117	47
Alexander County	1436	86	118	99	246	134	1800	135
Alleghany County	1620	8	157	56	359	89	2136	39
Anson County	1493	47	172	43	290	118	1955	91
Ashe County	1628	7	183	32	308	113	2120	46
Avery County	1557	20	153	60	295	116	2006	78
Beaufort County	1423	100	187	28	244	135	1854	127
Washington City	1427	96	182	34	347	97	1956	90
Bertie County	1503	40	268	5	246	133	2017	74
Bladen County	1499	43	224	16	365	87	2088	54
Brunswick County	1406	120	125	89	458	47	1989	83
Buncombe County	1424	99	96	120	479	42	2000	80
Asheville City	1533	25	188	26	932	3	2653	2
Burke County	1437	84	99	118	391	72	1926	103
Cabarrus County	1436	85	96	121	358	90	1891	116
Kannapolis City	1393	130	122	92	415	61	1929	102
Caldwell County	1391	132	88	130	350	93	1828	129
Camden County	1650	4	218	19	382	74	2250	22
Carteret County	1361	140	96	122	371	83	1828	130
Caswell County	1506	36	156	57	229	139	1891	115
Catawba County	1394	129	72	141	414	62	1880	121
Hickory City	1431	90	110	103 (tie)	440	54	1981	85
Newton City	1476	54	132	81	430	58	2037	64
Chatham County	1481	52	123	91	505	38	2109	48
Cherokee County	1448	76	125	90	195	142	1767	139
Chowan County	1521	28	184	30	456	48	2161	33
Clay County	1596	14	157	55	265	125	2017	73
Cleveland County	1452	74	96	123	313	109	1861	126
Kings Mtn. City	1435	87	183	33	406	64	2024	69
Shelby City	1577	17	161	53	509	37	2247	24
Columbus County	1505	38	251	8	317	107	2073	58
Whiteville City	1459	68	147	65	291	117	1897	113
Craven County	1419	109	116	100	450	50	1985	84
Cumberland County	1345	142	160	54	394	71	1899	112
Fayetteville City	1499	42	176	40	782	10	2456	6
Currituck County	1503	41	147	67	535	29	2185	31
Dare County	1385	136	87	132	690	11	2162	32
Davidson County	1368	138	77	138	240	137	1686	142
Lexington City	1422	105	140	71	522	33	2084	56
Thomasville City	1492	48	132	80	396	69	2020	72
Davie County	1413	114	105	112	349	94	1867	125
Duplin County	1511	33	185	29	265	124	1961	87
Durham County	1399	125	86	133	790	8	2276	19
Durham City	1429	92	156	58	1000	2	2585	4
Edgecombe County	1484	51	221	18	379	77	2084	55
Tarboro City	1388	133	139	73	412	63	1939	100
Forsyth County	1469	61	102	114	787	9	2358	12
Franklin County	1462	67	170	46	381	75	2013	75
Franklinton City	1470	59	169	47	312	110	1952	95

SCHOOL DISTRICT[2]	STATE PPE	STATE RANK		FEDERAL[3] PPE	FEDERAL[3] RANK	LOCAL PPE	LOCAL RANK	TOTAL PPE	TOTAL RANK
Gaston County	$1367	139		$ 80	136	$ 333	104	$1779	138
Gates County	1644	6		224	17	463	46	2332	15
Graham County	1617	9		148	63	355	91	2120	44
Granville County	1427	94		152	61	333	103	1913	108
Greene County	1595	15		240	12	515	35	2350	14
Guilford County	1423	103		67	142	645	14	2135	40
Greensboro City	1495	45		110	105	840	6	2445	7
High Point City	1454	72		125	88	846	5	2425	8
Halifax County	1546	23		294	3	256	129	2095	52
Roanoke Rapids City	1432	89		127	83	539	27	2098	51
Weldon City	1612	10		250	9	402	66	2263	20
Harnett County	1407	119		120	97	281	122	1807	132
Haywood County	1462	66		121	93	479	41	2062	60
Henderson County	1386	135		120	95	373	81	1880	122
Hendersonville City	1505	39		184	31	806	7	2494	5
Hertford County	1506	37		244	11	375	80	2125	43
Hoke County	1398	128		194	24	278	123	1870	124
Hyde County	1761	1		244	10	593	20	2598	3
Iredell County	1392	131		84	135	284	120	1759	140
Mooresville City	1474	56		89	128	442	52	2005	79
Statesville City	1464	63		121	94	626	16	2210	27
Jackson County	1457	70		137	76	348	95	1942	98
Johnston County	1416	111		138	75	367	86	1920	106
Jones County	1653	3		260	6	344	99	2257	21
Lee County	1420	108		114	101	475	43	2009	77
Lenoir County	1515	30		175	42	436	55	2126	42
Kinston City	1423	101	(tie)	176	39	521	34	2120	45
Lincoln County	1422	106		92	126	328	106	1842	128
Macon County	1532	26		127	85	399	67	2058	61
Madison County	1605	11		178	36	211	140	1994	81
Martin County	1492	49		177	37	537	28	2206	28
McDowell County	1402	124		143	68	250	131	1795	137
Mecklenburg County	1441	79		101	115	859	4	2401	9
Mitchell County	1556	21		165	51	347	98	2068	59
Montgomery County	1463	65		148	62	282	121	1893	114
Moore County	1472	58		135	78	546	26	2153	34
Nash County	1402	123		171	45	379	76	1953	93
Rocky Mount City	1404	121		100	117	530	30	2034	67
New Hanover County	1373	137		107	108	557	23	2038	63
Northampton County	1519	29		318	1	304	114	2140	36
Onslow County	1353	141		139	74	311	111	1802	134
Orange County	1457	69		105	110	638	15	2200	29
Chapel Hill/Carrboro City	1429	93		78	137	1159	1	2665	1
Pamlico County	1565	19		182	35	289	119	2035	65
Pasquotank County	1439	82		169	49	354	92	1962	86
Pender County	1480	53		169	48	373	82	2022	71
Perquimans County	1596	13		232	14	523	32	2351	13
Person County	1497	44		176	38	465	45	2138	38
Pitt County	1439	80		162	52	480	40	2082	57
Greenville City	1413	113		167	50	547	25	2128	41
Polk County	1687	2		127	84	436	56	2250	23
Tryon City	1492	50		193	25	606	18	2291	16

SCHOOL DISTRICT[2]	STATE PPE	STATE RANK		FEDERAL[3] PPE	FEDERAL[3] RANK		LOCAL PPE	LOCAL RANK	TOTAL PPE	TOTAL RANK
Randolph County	$1387	134		$ 73	140		$ 262	126	$1723	141
Asheboro City	1430	91		105	109		513	36	2049	62
Richmond County	1422	104		126	87		257	128	1805	133
Robeson County	1439	81		272	4		249	132	1960	88
Fairmont City	1495	46		212	20		204	141	1911	109
Lumberton City	1421	107		142	70		348	96	1910	110
Red Springs City	1452	73		176	41		253	130	1880	119
Saint Pauls City	1414	112		201	23		257	127	1871	123
Rockingham County	1474	57		120	96		397	68	1990	82
Eden City	1438	83		88	129		396	70	1922	105
Western Rockingham	1413	115		136	77		384	73	1933	101
Reidsville City	1448	77		126	86		454	49	2028	68
Rowan County	1403	122		75	139		406	65	1884	117
Salisbury City	1514	31		206	21		654	13	2374	11
Rutherford County	1427	95		108	107		416	60	1951	96
Sampson County	1573	18		226	15		303	115	2102	50
Clinton City	1468	62		148	64		524	31	2140	37
Scotland County	1423	101	(tie)	172	44		427	59	2022	70
Stanly County	1464	64		87	131		367	85	1918	107
Albemarle City	1512	32		100	116		618	17	2230	26
Stokes County	1412	117		98	119		444	51	1955	92
Surry County	1450	75		113	102		342	100	1905	111
Elkin City	1539	24		120	98		581	21	2240	25
Mount Airy City	1435	88		109	106		561	22	2105	49
Swain County	1645	5		205	22		434	57	2284	17
Transylvania County	1417	110		95	124		440	53	1952	94
Tyrrell County	1602	12		303	2		470	44	2375	10
Union County	1398	127		86	134		314	108	1798	136
Monroe City	1456	71		134	79		499	39	2089	53
Vance County	1399	126		147	66		335	102	1880	120
Wake County	1424	98		92	127		683	12	2199	30
Warren County	1592	16		232	13		329	105	2153	35
Washington County	1511	34		187	27		337	101	2035	66
Watauga County	1527	27		110	103	(tie)	376	79	2013	76
Wayne County	1445	78		130	82		369	84	1943	97
Goldsboro City	1476	55		255	7		548	24	2279	18
Wilkes County	1470	60		105	111		241	136	1816	131
Wilson County	1425	97		155	59		360	88	1940	99
Yadkin County	1509	35		140	72		310	112	1958	89
Yancey County	1548	22		142	69		232	138	1922	104

FOOTNOTES

[1]Low-income students receive reduced price or free school meals, and others pay for meals. The figures in this chart *exclude* all food service funds. This data is rounded to the nearest dollar. In the original data (taken to the penny), two ties resulted. These two ties are noted in the table.

[2]This table covers 142 districts, the number in 1983-84 and in 1984-85. In 1982-83, there were 143 districts; in 1985-86, there will be 141.

[3]Federal funds are designed to **supplement,** not **supplant,** state and local efforts. Federal funds are included in this table to give the total funding picture for each school district. Federal monies, however, should not be considered as a way to address disparities in per-pupil spending among districts.

Source: "Selected Financial Data 1983-84," State Board of Education, Controller's Office, Division of Planning and Research, pp. 6-8.

Memorable Memo

DEPARTMENT OF PUBLIC INSTRUCTION

STATE OF NORTH CAROLINA RALEIGH

December 10, 1984

TO: Child Nutrition Program Sponsors

FROM: USDA Food and Nutrition Services
John M. Murphy, III, Director, Division of Child Nutrition

SUBJECT: Crediting Taco Shells and Pieces

In the past, the crediting of taco pieces in the Child Nutrition Program has been inconsistent and the cause of some confusion. This letter clarifies agency policy on crediting taco pieces and explains the rationale for this position.

We consider taco pieces in the same category as taco shells and they are creditable under USDA criteria as such. Taco pieces are simply smaller bits of taco shells. Taco shells, made from whole-grain corn and served as an accompaniment to, or as a recognizable integral part of the main dish, qualify as a bread component of reimbursable meals. Therefore, whole-grain taco pieces served in a like-manner are also creditable. Two recent Food and Nutrition Service publications contain references to taco shells and taco pieces. A Guide to Crediting Foods lists whole taco shells and taco pieces as a bread product which can be credited as a bread requirement. Information about purchasing and serving taco shells or pieces can be found in the Food Buying Guide (PA-1331).

However, taco chips with a coating of salt and spices, produced for use as a snack item do not qualify as a bread component. The amount of salt, or sodium, on the chips is relatively high; therefore, the use of taco chips as a meal component is inconsistent with the USDA guidelines which recommend reducing the consumption of sodium. The goals of the Child Nutrition Program are to provide wholesome foods children need, and to provide a model for establishing good eating habits. We feel the inclusion of a snack item high in sodium as an integral part of a meal is not consistent with either the USDA guidelines or the purpose of the Child Nutrition Program.

In summary, whole taco shells or taco pieces made from whole-grain corn and served as part of a meal are creditable in the Child Nutrition Program. Taco chips are not.

If you have any questions, please contact Cherie Woodward at (919) 733-7162.

Fed up with overblown bureaucratese? Had your fill of government jargon and convoluted rationalizations? Tired of swallowing your allotted ration of murky memoranda? If so, clean out your files—and send us your favorite candidate for Memorable Memo. Anonymity guaranteed.

FROM THE CENTER OUT

Center Report Hits the General Assembly

"By documenting in exhaustive detail the scope of boards, commissions, and councils in the executive branch of state government, the N.C. Center for Public Policy Research has dropped another issue in the lap of the General Assembly." Thus did *The News and Observer* of Raleigh, in a February 10, 1985, editorial, boil the Center's recent 618-page report down to the cauldron of politics.

And the pot has begun to bubble.

"I've already asked the State Government Committee to study the issue," Speaker of the House Liston Ramsey told *North Carolina Insight* on February 19. "We'll look at the [Center] report and do our own research, and then decide which [boards] we ought to try to abolish. We ought to be able to do away with 50 or 75."

On the Senate side, Lieutenant Governor Robert B. Jordan III plans to "clean up our own house first—to look at the boards established by the legislature," said Jordan in a February 27 interview. "The information [the Center] put out will be very useful."

Jordan said his legislative strategy will be to "target legislative boards that are non-controversial first and abolish them as quickly as possible. Then, for the controversial ones, there will be public hearings. We'll have to see what the public says."

After working through the boards created by the legislative branch, Jordan explained, "we'll look at those in the executive branch. It would be helpful if the Governor would join with us to look at those."

"He showed great zeal and ambition in municipal affairs, and was always acting on boards and committees and administrative bodies."
Thomas Mann,
Buddenbrooks (1924)

Gov. James G. Martin has formed his strategy as well. In a written response to the Center, Martin agreed "that there are too many boards in the executive branch with little thought given to their design or to how they best serve the citizens of North Carolina. One solution I have already implemented is the creation of the office of Special Counsel for State Boards, Commissions, and Agencies. It will be the responsibility of this office to act as a 'sunset' commission to review the current boards, commissions, and councils and make recommendations to consolidate or eliminate many of them."

The Governor said his first priority would be reviewing the boards created by executive order and taking steps to reduce their number. Then, he said, his administration would concentrate on working with the General Assembly to review those boards and commissions created by statute. Of the Center's three proposed alternative solutions to this bureaucratic kudzu, the Governor preferred the third—review and individually reform, consolidate, or abolish specific boards. And, Martin said, on those future occasions when he established a new board by executive order, he would make it an ad hoc entity "to be disbanded when its charge is completed."

News accounts in 48 papers and 21 supporting editorials from around the state pointed to the problems highlighted in the Center's study: boards that should be abolished, duplication among boards, violation of the state constitutional requirement of separation of powers between the legislative and executive branches, inefficiency in state government, and adequate representation of women and blacks. Most importantly, as Center Director Ran Coble said to the media, "The number of boards keeps growing like kudzu. Too much of this kudzu will choke off useful citizen participation."

The editorials challenged the legislature and the Governor to fight various tangles. "When Gov. Jim Martin was on the campaign trail, he made a point of an efficiency study," begins the January 30 editorial in *The Enquirer-Journal* of Monroe. "Among the places the Governor can look for improved efficiency is the executive branch—a bastion with a healthy belief in establishing boards."

The Charlotte News chided the legislature on another point. "As the figures from the Center for Public Policy Research indicate, the General Assembly's actions have done little to un-muddy the waters of the separation of powers issue."

The General Assembly has a major job in abolishing unnecessary boards and prohibiting legislators from serving on executive branch boards. But what about future boards? A good pruning of kudzu doesn't necessarily keep it under control.

The Center's report recommends several alternative methods of setting ceilings on the number of boards that can be established in the executive branch. Asked if they supported the concept of a ceiling, the Speaker and Lieutenant Governor took different tacks.

"First we ought to abolish them, and then we ought to put a ceiling on the number," said Ramsey. "We need legislation that would not let departments create as many boards as they want."

Lt. Gov. Jordan approaches the idea cautiously. "I haven't made up my mind yet whether ceilings would be a good idea," said Jordan. "I want to avoid any sense that the legislature is trying to encroach on the Governor's power. I'm sensitive to putting a ceiling on the Governor or the executive branch. I'm more apt to want to put a ceiling on [executive-branch] boards created by the legislature."

The executive summary of the Center's report, reprinted below, summarizes the major points of the three-year study. The seven-chapter report elaborates on each point (costs, separation of powers, etc.). Then, for the "exhaustive detail," seven appendices span 482 pages, with data on each of the 320 boards, commissions, and councils in the executive branch as of April 1984.

After reading the fine print and pondering the political problems, any kudzu fighter must come back to the purpose of these boards. "A modern state government requires advisory and administrative councils," says *The News and Observer* editorial. "They are crucial to citizen participation in government."

Or as Lt. Gov. Jordan put it, "The underlying issue here is to determine how we can get the most effective citizen input." □

Copies of the full report are available for $16.47 ($15.00 plus $1.47 postage) from the Center, P.O. Box 430, Raleigh, N.C. 27602, (919) 832-2839.

Executive Summary

by Jim Bryan, Ran Coble, and Lacy Maddox

A three-year study by the N.C. Center for Public Policy Research discloses that there are 320 boards, commissions, councils, committees, task forces, panels, and authorities in the executive branch of North Carolina state government. These are all part-time groups to which citizens are appointed by the governor and other executive officials. Of these 320 groups, about two-thirds (205) were created by the legislature, and one-fourth by the governor or other executive branch officials. The remaining 24 groups were required to be established by federal law.

The Department of Human Resources has the most boards, with 52 citizen groups advising agencies or making state policy. The Department of Administration is second with 44 groups, and the Department of Cultural Resources third with 36 groups.

The Center's research has uncovered boards that work extremely well and whose contribution greatly outweighs their financial costs. The Center's research has also uncovered boards that are inactive, ineffective, or duplicative, and which should therefore be abolished or their functions consolidated under other groups. The sections below review the major conclusions of the report and offer recommendations that might hold promise for improvements in government service by state boards, commissions, and councils to the people of North Carolina.

Appointments

Governor James B. Hunt Jr. and his cabinet secretaries had over 84.1 percent (2,882) of the 3,425 appointments to state boards at the disposal of executive branch officials. The Superintendent of Public Instruction controls the next largest bloc of appointments, with 6.5 percent (223) of the total. The State Board of Education has 190 appointments (5.5 percent of the total), while all other elected officials combined only have 130 appointments, or 3.9 percent of the total.

Governor Hunt has improved upon the record of Governor James E. Holshouser Jr. in appointing blacks, women, and Indians, but there is room for greater improvement still. Only 28 percent of Hunt's appointments have gone to women, whereas women constitute 51.4 percent of the state's population. Appointments of blacks were 13 percent of the total in contrast to their level of 22.4 percent of the population. Indian appointments (1.4 percent) were slightly higher than their representation in the population (1.1 percent). In our study, there were 59 boards with no women members, 106 boards with no blacks, and 287 boards with no Indians.

Geographic representation was also a problem. Over one-fifth of Hunt's appointments were from the capital area—the Fourth Congressional District counties of Chatham, Franklin, Orange, Randolph, and Wake—an area which contains only 9.1 percent of the population. Other congressional districts were not as well represented, as the Tenth and Eighth districts (also each with 9.1 percent of the population) supplied only 4.3 percent and 5.5 percent of the appointments, respectively.

Separation of Powers

In February 1982, when the Center issued a preliminary report on separation of powers questions, there were 203 legislators crossing the constitutional line by serving on 90 executive branch boards. At least 36 of these boards, commissions, and councils had administrative or executive powers and were unquestionably violating the separation of powers provision in the state Constitution. The other 54 groups had powers to advise the executive branch, and legislative service on these boards was characterized as "arguably unconstitutional."

Two years later, the N.C. General Assembly has removed legislators from 32 boards, altered the role of the Advisory Budget Commission, and passed other measures to address many concerns raised by the attorney general, the N.C. Supreme Court, and the N.C. Center for Public Policy Research.

Problems still remain, however. As of August 24, 1984, legislators still hold 142 positions on 56 different boards, commissions, and councils in the executive branch. This includes 38 seats on 12 boards with administrative or executive functions and 104 seats on 44 boards which are mostly advisory in nature.

Costs

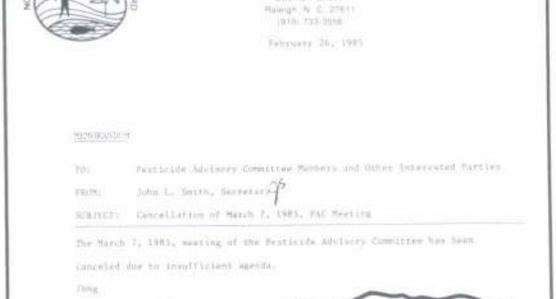
The 320 boards in the executive branch cost the state a total of $4.7 million each year. Three-fourths of that amount is required for staff support; the rest is for per diem allowances or reimbursement of travel and lodging expenses associated with board meetings. The average cost of a state board is $14,731, but the range varies from a reported low of $0 to a high of $332,482. Not all board members get per diem, subsistence, or travel payments, but all boards are staffed by agency employees. For this reason, the Center is skeptical of state agencies' explanations that 58 boards had no costs associated with their existence.

State funds supply almost two-thirds of the $4.7 million total. Federal funds supply another 29.2 percent, while the remaining funds are generated from other sources, such as receipts or interest on earnings. The total cost of boards per department is strongly related to the number of boards within the department and the extent to which agency officials use them. Generally speaking, policymaking boards cost more than boards with purely advisory powers.

The cost of boards and commissions must be balanced against the contributions made by the groups and the amount of citizen participation purchased with this money. Overall, the *reported* cost of the 320 boards discussed in this report is less than one-tenth of one percent of the state's total budget.

Organization and Powers

The most important power given to state boards and commissions is the power to adopt, repeal, or amend rules. There are 88 groups with rulemaking power. Most of these groups are commissions with specific grants of statutory authority to adopt rules.


NORTH CAROLINA PESTICIDE BOARD
P. O. Box 27647
Edenton Street
Raleigh, N. C. 27611
(919) 733-3556

February 26, 1983

MEMORANDUM

TO: Pesticide Advisory Committee Members and Other Interested Parties

FROM: John L. Smith, Secretary

SUBJECT: Cancellation of March 7, 1983, PAC Meeting

The March 7, 1983, meeting of the Pesticide Advisory Committee has been canceled due to insufficient agenda.

/bmg

Another important power of boards is the power to hear and decide contested cases in disputes between two parties. This quasi-judicial function is carried out by 45 different groups in the executive branch.

A third duty given to state boards is that of allocating funds to specific recipients or local governments once these funds are appropriated for general purposes by the legislature. Twenty-eight groups have the power to allocate funds.

Over 100 groups exercise powers to set eligibility criteria for government services or standards under which those services are to be provided. Another 46 groups set rates or fees that must be paid by citizens for services or in order to raise revenue to help cover the cost of a related program.

Twenty-two boards have the power to license individuals, issue permits for certain activities, or oversee a certification process. These groups usually have other functions as well. There are 35 additional occupational and professional licensing boards which exist solely for licensing purposes.

Other functions exercised by state boards, commissions, and councils are the powers to advise the executive branch, hire staff, buy property, enter into contracts or lawsuits, and assist in planning or program implementation. The most prevalent activity of boards is the role of coordinating government activities, which is done by 164 groups. The second most frequent function listed is that of providing citizen advice.

The Center's research on the organization and powers of state boards uncovered three problems. First, there are too many boards in the executive branch with little thought given to the overall design as to where citizen advice is really needed. Part of this problem is due to the fact that the guidelines of the Executive Organization Act of 1973—as to what powers reside with a "board," what powers should be given to a "commission," a "council," a "committee," etc.—have been largely ignored. Part of this problem is also due to the fact that no sunset commission or similar group regularly reviews the need for each of the 320 different groups.

Second, there are too many (88) groups with rulemaking power, which leads to too many rules, which in turn has led legislators to overreact and repeal much of the state's Administrative Procedure Act (APA). A better solution would be for the legislature to exercise more careful oversight of the number of grants of rulemaking power given in statutes other than the APA.

Third, the present use of boards and commissions as hearing bodies which decide contested cases has serious flaws in its design. A system that allows a group of citizens first to adopt rules and then to decide contested cases involving those same rules is unlikely to produce the neutral decisionmaker required under American constitutional principles of due process. In addition, the citizens who sit on state boards are usually not trained well enough to provide the kind of written record, hearing, and fair procedural process that would ensure an adequate record for judicial review by the courts.

Oversight of the System of Boards, Commissions, and Councils

From 1977 to 1981, the Governmental Evaluation Commission, or "Sunset Commission," evaluated the system of boards in North Carolina. Although its purview was narrower than this report's definition of boards, its recommendations did lead the legislature to examine the statutory authority for many groups, increase fees to keep certain boards self-supporting, and add more public members to various boards.

In 1981, North Carolina became the first state to sunset, or abolish, its own Sunset Commission. In its place, the General Assembly set up a Legislative Committee on Agency Review. The Legislative Committee on Agency Review had a much better record of getting its recommendations enacted by the General Assembly, partly because of its all-legislator composition. With a smaller budget (less than 10 percent of the Governmental Evaluation Commission's) and fewer staff, it made an interim report in 1982 and a final report to the 1983 General Assembly.

The most recent attempt by the legislature to review the performance of state boards has been through the Legislative Study Commission on Executive Branch Boards, Commissions, and Councils. Created July 21, 1983, the legislative group set out to examine ways to limit the number and duration of executive branch boards. However, its $5,000 budget and March 1984 deadline restricted the committee to review only inactive boards, or about 10 percent of the total.

That such systematic review is needed can be shown with a few illustrations. First, the number of groups in each department varies widely—from a high of 52 boards in one department (Human Resources) to a low of one per department (Revenue and State Auditor).

And so they made an industry out of government. State office buildings in the decaying downtowns. A proliferation of committees, surveys, advisory boards, commissions, legal actions, grants, welfare, zoning boards, road departments, health care groups . . .

John D. McDonald,
Cinnamon Skin (1982)

Departments of similar size in terms of budget and employees might have 7 boards (Crime Control and Public Safety, with 1,793 employees and a $67 million budget), 24 boards (Commerce, with 2,362 employees and a $92 million budget), or 44 boards (Administration, with 1,167 employees and a $40 million budget).

Second, the placement of boards within departments is like a Dada poem—without rhyme or reason. Boards in the Department of Natural Resources and Community Development are relatively well organized, with rule-making and other powerful commissions largely confined to the division level and smaller, less powerful advisory councils spread evenly throughout the next lowest level in the department. On the other hand, boards in the Department of Human Resources (DHR) are found at the division level, section level, branch level, and program level. They may have as narrow a charge as giving advice on a certain disease (the N.C. Arthritis Program Committee), a certain project (the N.C. Advisory Council on Health Statistics), or certain professions serving one type of disability (the Professional Advisory Committee to the Commission for the Blind). Some state institutions in DHR have their own boards (Board of Directors for the Governor Morehead School) while others share a board (the Board of Directors for the three Schools for the Deaf and the Mental Health, Mental Retardation, and Substance Abuse Services Commission, which oversees four mental hospitals, five retardation centers, three alcoholic rehabilitation centers, and several other residential institutions). Some divisions of DHR have more than 10 advisory groups (e.g., the Division of Health Services), while others (the Division of Youth Services) have none.

Strengths and Weaknesses of Boards and Commissions

If boards work well, the benefit is:	If boards do not work well, the liability is:
1. Boards are a major source of citizen participation and input.	1. a. Some boards do not meet, thus losing all their potential benefits. b. Certain segments of the population—blacks, women, and Indians—are underrepresented on boards. c. Legislators still serve on many boards, thereby thwarting active participation by citizens.
2. Boards provide state agencies with advice they cannot normally get: a. Citizens provide a statewide perspective. b. Citizen appointments can provide technical expertise. c. Citizens can act as sounding boards for proposed policies.	2. a. The Research Triangle area is overrepresented on boards, and other areas of the state are underrepresented. b. Boards may degenerate into rubber stamp operations. c. Some boards try to administer executive branch programs.
3. Board members can educate the public about state government.	3. Time constraints and other full-time occupations may prevent citizen appointees from learning enough to educate the public.
4. Boards can highlight a problem or get a new program off the ground.	4. a. Boards may outlive the problems they were supposed to address. b. Boards can be a vehicle for deflecting public outcry about a problem without ever doing anything.
5. Boards can serve as vehicles for coordination.	5. Complaints about lack of coordination have not declined as the number of boards has increased to 320 since state government reorganization.
6. Boards can provide consumer input and feedback on how governmental programs work.	6. The fox can be put in charge of the henhouse if more providers than consumers are appointed.
7. Boards prevent concentrations of power in the executive branch and serve as pressure valves for citizen complaints.	7. Boards can result in "government by committee" and a lack of accountability in state government.

Third, the system of boards and commissions presently lets some large government programs and serious problems go without citizen input, while giving other programs or problems an overdose. For example, heart disease and cancer rank as serious health problems in North Carolina, and government efforts to address these problems are properly overseen by the Health Services Commission and State Health Coordinating Council. Yet, less prevalent diseases like arthritis, sickle cell anemia, and sudden infant death syndrome rate their own advisory councils.

Other issue areas get multiple doses of advisory council input. For example, most citizens might agree that water supply and water quality problems are among the most significant issues facing North Carolina in the 1980s, but who would argue that we need all of the 11 water policy groups in the Department of Natural Resources and Community Development, including separate advisory councils for certain rivers and lakes (Chowan and Neuse Rivers and Lake Phelps and Kerr Lake)? What is the reason for having an Annual Testing Commission and a Competency Test Commission? What is the rationale for six different library groups and nine different groups organized around school subjects, none of which is as significant a subject as English, math, or science?

The answer to these questions is that there has been a history of constant growth in the number of boards and duplicative and illogical placement of them within departments. Both of these trends have been caused by the fact that there is no comprehensive executive or legislative oversight for this system of boards, commissions, and councils. For these reasons, the N.C. Center for Public Policy Research makes the following recommendations, posed in the form of three alternatives:

Alternative One: Place a departmental ceiling on the number of boards. The N.C. General Assembly should pass legislation placing a ceiling on the number of boards, commissions, councils, *Having served on various committees, I have drawn up a list of rules: Never arrive on time; this stamps you as a beginner. Don't say anything until the meeting is half over; this stamps you as being wise. Be as vague as possible; this avoids irritating the others. When in doubt, suggest that a sub-committee be appointed. Be the first to move for adjournment; this will make you popular; it's what everyone is waiting for.*

Harry Chapman, *Greater Kansas City Medical Bulletin,* 1963 issue.

committees, task forces, panels, and authorities in each department in the executive branch. Generally speaking, these limits should take into consideration the following three factors:

(a) the number of boards presently existing in the department;

(b) the number of employees in the department and the size of the departmental budget; and

(c) a general principle of no more than one group per division, although leaving some flexibility for the department head (secretary, commissioner, etc.) to establish a few groups to address problems of major statewide significance.

The total reduction in the number of boards in Alternative One is 132.

Alternative Two: Give the governor and other elected officials a ceiling on the number of boards they can maintain. The N.C. General Assembly should pass legislation placing a ceiling on the number of boards that could exist in the 10 departments under the control of the governor. The General Assembly should also limit the number of boards that could exist in the nine departments headed by other elected officials. The total reduction in the number of boards under Alternative Two is 135.

Alternative Three: Individually abolish specific groups.

1. The N.C. General Assembly should immediately abolish, in the 1984 short session, the 38 groups listed at the end of Chapter 7.* Many of these groups have not met during the last two years and all are ineffective or duplicate other groups' efforts. Some have completed the tasks they were created to accomplish. There was little or no objection to abolishing these groups by the parent state agency when each agency reviewed a draft copy of the Center's report, or in agency testimony before the Legislative Study Commission on Executive Branch Boards, Commissions, and Councils. In addition, the interim report of the study commission recommends that 24 of these 38 groups be abolished and the functions of two others consolidated under other groups.

2. In the 1985 legislative session, the N.C. General Assembly should abolish 60 other groups listed in Table 7.1. Reasons for each recommendation are given.

3. The N.C. General Assembly should also consider the actions recommended in Table 7.1 to transfer certain boards to other departments, to amend the statutory authority of some groups, to delete an inadvertent repeal of one group, and to place sunset dates on several task forces so that they will cease to exist when the task is completed.

The total reduction in number of boards under Alternative Three is 98. □

*In 1984, the General Assembly abolished 26 of these 38, Chapter 995 of the 1983 Session Laws, 2nd Session, 1984 (HB 1517). Chapter 7 of the full report includes Table 7.1, mentioned below.

Some appointees end up displeased with the group they're appointed to. Anne Gorsuch Burford, President Reagan's nominee to chair the National Advisory Committee on Oceans and Atmosphere, called the appointment "a nothing-burger." "They meet three times a year," she said. "They don't do anything. It's a joke."

Courtesy Duane Powell, News & Observer, 8/2/84

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