North Carolina Insight
November 1985 Vol. 8 No. 2

Public-Private Partnerships: Boon or Boondoggle?

Also:
- *Strange Laws*
- *Credit Insurance*
- *For-Profit Hospitals*

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DEPARTMENTS

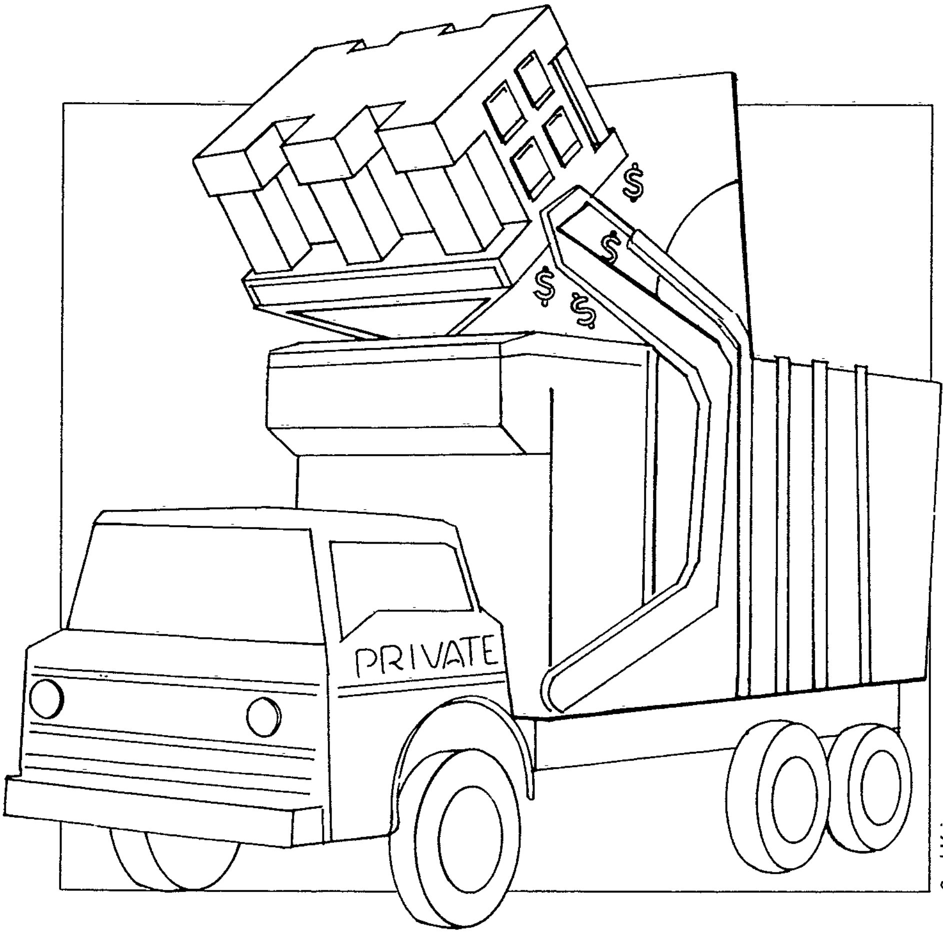
Editor
Bill Finger

Associate Editor
Jack Betts

Production Director
Carol Majors

Production
Theo. Davis Sons, Inc.

Public or Private?



The State of North Carolina: Getting Down to Business

by Bill Finger and George Frink

"We run our business as well as any private business can. We have no inclination to change."
—Doug Bean, Morganton City Manager

"We like to see the private sector do it if they can do it as cheap as the public sector."
—J. D. Foust, director, N.C. Local Government Commission

*Three general types of public-private cooperative arrangements exist: "privatization," private-sector initiatives, and public-private partnerships. **"Privatization"** refers to a governmental body turning a function it has traditionally provided over to a private company. **Private-sector initiative** refers to a private company providing a service before government becomes involved or to a company both delivering* and *funding a service once provided by government. **Public-private partnership** describes a cooperative arrangement between a governmental unit and a private company.*

Recent budget constraints and the "private-is-better" philosophy of the Reagan administration have prompted a vigorous debate on whether the public sector can deliver services to citizens as well as the private sector can. This article examines each of the three types of arrangements as they apply to North Carolina—from refuse collection and water systems to hospitals and prisons, from downtown revitalization to historic preservation.

If you live in Morganton, N.C., you pay 8 percent less for your electricity than if you live in Charlotte—even though Duke Power Company generates the electricity for both cities. Duke Power holds the franchise to the electric system in Charlotte. But in Morganton, the *city* owns and operates the system. Morganton also runs its sanitation, water, and sewer systems; each stands alone financially and is in the black. Running Morganton "goes beyond just providing services," says City Manager Doug Bean. "We're running a business."

One hundred and twenty miles to the northeast, the town of Mayodan has had the opposite experience. In 1983, with a state moratorium on expanding its waste treatment system, City Manager Jerry Carlton determined "we had problems that we just couldn't handle ourselves." Carlton found a private company in nearby Winston-Salem to run the plant. "We hope Hydro (Management Inc.) will continue to operate it," says Carlton. "And we want to talk to them about taking over our water treatment plant as well."

Until a few years ago, the contrast in how these two towns provide basic municipal services (and even electricity) would not have attracted attention beyond those who study how water or electric systems function. But now, the actions of Morganton and Mayodan fall into the growing debate over who can do it better—the public or private sector, government or private agencies. Should Morganton follow the route taken by Mayodan, for example? Should small towns, which have less in-house expertise on technical matters, rely on private companies more than larger towns? Should public agencies, in general, turn over more of their services to private providers?

The relationship between private enterprise and government has been under study since at least *The Federalist Papers*, if not since Plato. In recent years, presidents have drawn on business principles to try to implement their ideas. "President Nixon instituted management by objectives, and President Carter gave us, with much fanfare, zero-base budgeting," writes Terry Hartle of the American Enterprise Institute, a conservative think-tank. "Both were based on successful private-sector practices, and both failed to have significant government-wide impact."[1]

In 1981, the promotion of private-sector principles took a quantum leap forward. "We're asking to form a partnership between the private and public sectors," newly elected President Ronald Reagan said in creating his "Task Force on Private Sector Initiatives" (commonly known as the Grace Commission). What's new since 1981 seems to be the *vocabulary* being used, together with recent fiscal pressures on governments to cut costs.

"Privatization is one of those buzzwords that's been out there for the last four or five years," says Jim Baugh, assistant city manager of Greensboro. "It forces us to keep in mind what we're here for—to provide services to a group of citizens at the least cost. If we find a private company that can provide that service without sacrificing quality, we believe that is part of our mission."

As this buzzword has entered the jargon of state and municipal officials, discussions over whether government agencies should turn over more services to private companies have often

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Bill Finger is editor of North Carolina Insight. *George Frink is an editorial writer for* The Fayetteville Observer.

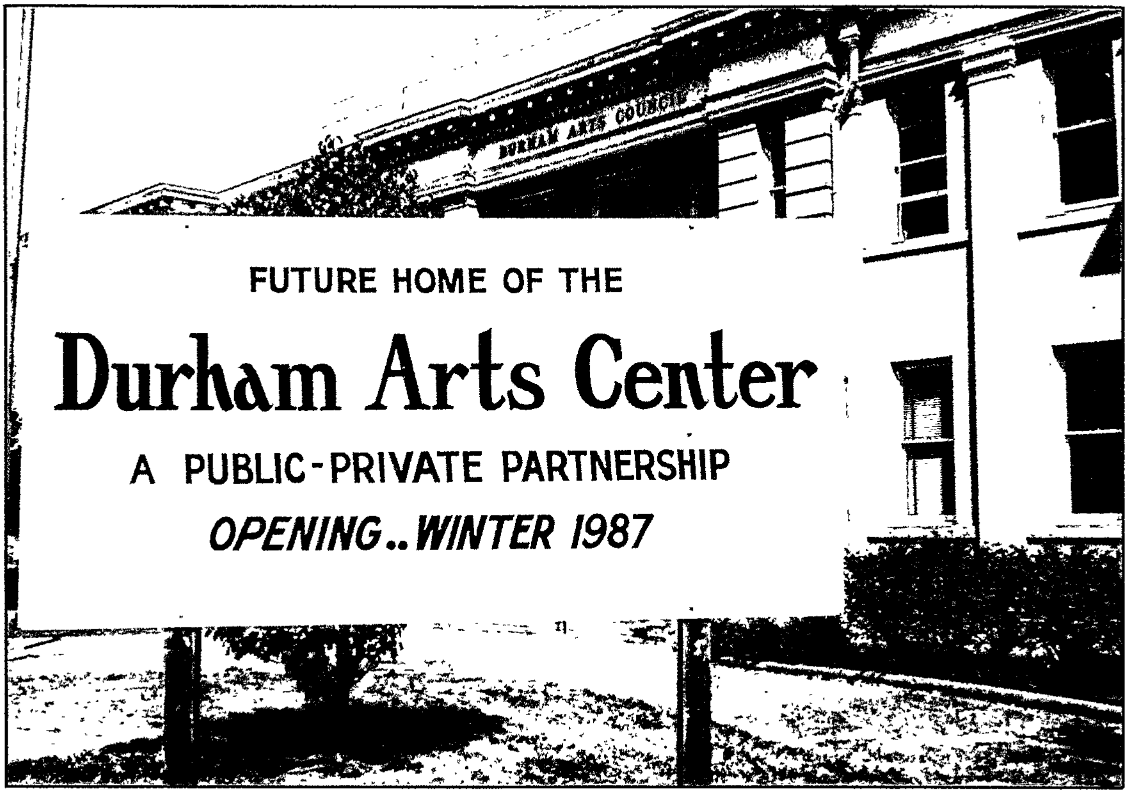
been simplistic or, ironically, too theoretical. "Private-is-better" advocates, led by former Reagan administration official E.S. Savas, contend that government is too big, unwieldy, and wasteful, and not to be trusted. Defenders of government, led by the American Federation of State, County, and Municipal Employees (AFSCME), the nation's largest union of government employees, portray "privatized" services as more corrupt, lower in quality, less efficient, and more costly than services provided by public agencies.

Three general types of public-private cooperative arrangements exist: "privatization," private-sector initiatives, and public-private partnerships. The Reagan administration's emphasis on private-sector involvement in government has stimulated some of these arrangements. Many others are part of longstanding situations that have little to do with recent changes at the federal level—or with the recent spate of books, articles, and public forums on "privatization."

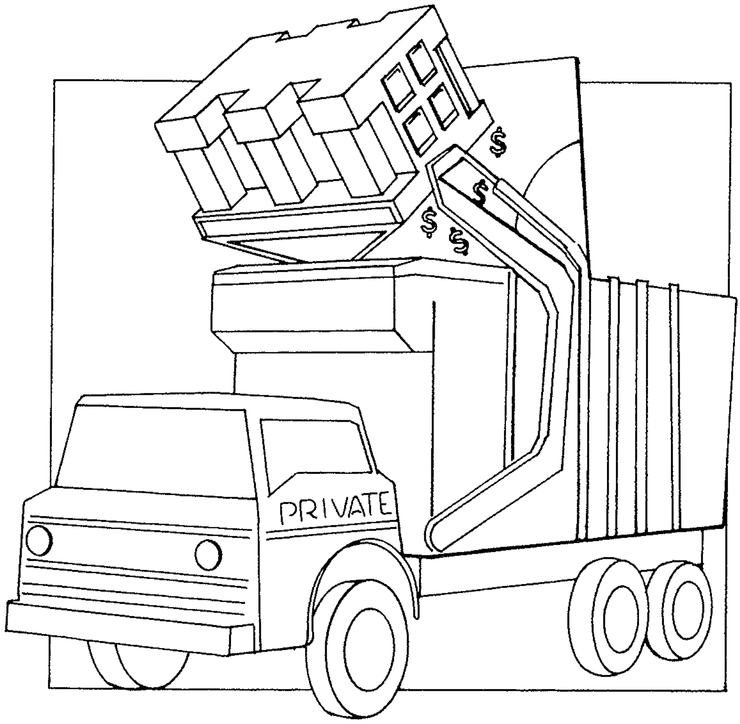
All three types of arrangements exist at the federal, state, and local levels of government, and to some extent, always have. Depending upon the level of government, these arrangements can vary enormously. Consider, for example, the differences between NASA contracting with companies like General Electric for parts of the space program, the N.C. Microelectronics Center selling a patent to a private software company, and Charlotte's urban revitalization efforts in its Third and Fourth Wards—all examples of public-private partnerships. In the case of "privatization," what about issues as complex as "privatizing" part of the federal Social Security system through Individual Retirement Accounts, contracting with a private company to operate part of the state's prison system, or turning over a town's garbage collection system to a private company—all subjects of recent articles in North Carolina.

The growing interest in relationships between private and public agencies stems from both money and philosophy. Various fiscal constraints have prompted local and state governments to look for a more cost-effective way to provide various services. Private companies can benefit more than a public agency from some tax provisions, such as depreciation write-offs for constructing and retaining a water system. "Then there's the philosophical judgment involved," says attorney Ellis Hankins of the N.C. League of Municipalities, who monitors public-private issues. "Some things are more appropriately done in the private sector."

The question becomes, then, what things are more appropriate and why? The best way to answer that question is to discuss three approaches to public-private arrangements: "privatization," private-sector initiatives, and public-private partnerships.



Jack Betts



Privatization

The word "privatization" refers to a public, i.e., governmental body, turning a function it has traditionally provided over to a private company (nonprofit or for-profit). The private-is-better camp traces its recent roots to Peter Drucker's 1968 book, *The Age of Discontinuity*. Drucker argued that government should spend more time governing and less time producing services, that *shaping policy* is more the mission of government than actually *delivering services*. The buzzword hit the headlines in 1982 with E.S. Savas' book, *Privatizing the Public Sector: How to Shrink Government*. On the cover of Savas' book, a clenched fist squeezes a shrunken U.S. Capitol. Designers of AFSCME's book, *Passing the Bucks*, answered with this cover: what appears to be a businessman's hand opening the Capitol dome and two other hands pulling out the bucks.

While the public relations battle over "privatization" has called on clever images, substantive thinking has produced some odd bedfellows. In long essay-reviews of public-private books, Terry Hartle of the conservative American Enterprise Institute appears to agree for the most part with Bob Kuttner, economics correspondent for *The New Republic*, a traditionally liberal magazine. Kuttner's viewpoint is obvious from the subtitle of his review, "The Dubious Case for Selling Off the State."[2]

Hartle develops his thesis slowly, first pointing out the limitations of comparing government to private enterprise: "In short, despite widespread and longstanding recognition that public and private management are different phenomenons, we remain fascinated with the idea that the efficiency and effectiveness of government can be improved by adopting private-sector management techniques."[3]

Hartle seems most concerned with simplistic generalizations. "Those who see the private sector as a fertile source of ideas for running government should take care to ensure that the techniques they use come from IBM and Schlumberger rather than Chrysler, Braniff, or Lockheed," he concludes after reviewing books about these companies. "This is not to argue that the public sector can learn nothing from the private sector. . . . But it is easy to confuse administrative improvements with changes in public policies."

Public policies survive contrary to logical business principles because they "satisfy a public need or a constituency group," explains Hartle. For example, in 1984, he notes, Congress extended the provision of the Hoover Dam's electric power to several western states at far below market values. "Any policy analyst can identify a dozen programs or policies that continue to exist despite manifold evidence that they are ineffective or inefficient."

Kuttner's essay focuses more specifically on Savas' book. "Like vouchers, contracting out is another Savas favorite," writes Kuttner. "Contrary to Savas, purchase of services often combines the least desirable aspect of the public sector—bureaucracy—with the least desirable aspect of the private—greed."

Persons advocating various degrees of "privatization" also cut across liberal and conservative lines. Savas stands firmly in the Reagan camp, favoring the least government that is possible. A wide range of other analysts have taken up the Drucker theme. Government should focus on policy decisions, not on providing services, argue Verne Johnson, formerly with General Mills and now head of Altcare in Minneapolis, and Ted Kolderie, a senior fellow at the Hubert H. Humphrey Institute of Public Affairs, also in Minneapolis.

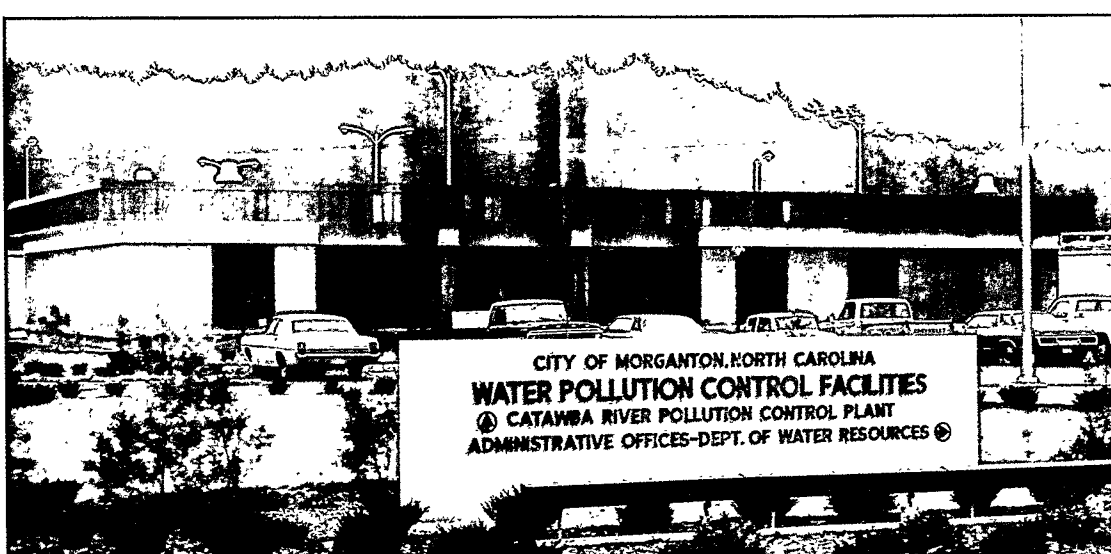
"We need to understand that the essential function of government is a policy function: to *decide* what shall be provided publicly, and to *arrange* for it to be paid for," contend Johnson and Kolderie. "It is not essential that the service in question then be *produced* by the government itself."[4]

"To arrange for it to be paid for" can mean one of three things: *contracting* with a private firm to provide a particular service (such as garbage collection); *giving vouchers* (i.e., cash or its equivalent) to particular groups of persons to purchase a service (such as vouchers to parents for educational services); and *turning over the entire operation* of a service to a private firm (such as a county selling its hospital).

Durward "Butch" Gunnells, executive director of the State Employees Association of North Carolina, is skeptical about "privatization." "In areas like prisons, I'm not certain that it has been demonstrated that 'privatization' is the most economical or that it accomplishes what it ought to be accomplishing," says Gunnells, speaking for himself, not for the 50,000-member association. "The association has taken no formal position on this subject." Formed in 1984 in a merger of the two largest state employee groups, the association is the largest non-union state employee organization in the country.

(For a summary of pro and con arguments, see box on pages 8-9.)

In North Carolina, no estimates exist on the current amount of state and local money going to private companies to provide public services. Nationwide, the Council of State Governments reports that the amount of such spending has grown steadily, from $27 billion in 1975 to $81 billion in 1982.[5] *State Government News*, the council's monthly magazine, reported that "privatization" arrangements include everything from providing care for mentally retarded persons to running transit systems.



N.C. League of Municipalities

How does the situation in North Carolina stack up with the points raised by the analysts above? How have contracts, vouchers, and turning over a service entirely worked in this state? Here's a rundown of four types of services where private companies are taking an increased interest: refuse collection, water and sewer systems, hospitals, and prisons.

Refuse Collection. In North Carolina, one of the best traditional examples of "privatization" has been garbage collection (janitorial services is another). Sanford, for example, has contracted with American Refuse System for 12 years to collect its garbage. "It's a little bit cheaper," says City Manager P.B. Stokes. "Plus the city does not have to face major garbage truck purchases periodically." Similarly, the town of Clinton contracts for the hauling of limbs and leaves.

Raleigh has awarded a three-year contract to Browning-Ferris Industries to collect garbage in recently annexed areas of the city. At first glance, Raleigh appears to be saving money with its contract service. If the city has to take over the service at the end of three years, however, it will have to make capital purchases which will apply to future years' costs but won't show up during the three years of the private service.

In 1982, 50 of the 59 municipalities that contracted for garbage collection were towns with fewer than 5,000 people, according to a survey by the N.C. League of Municipalities. These 50 towns represented 25 percent of the 199 towns under 5,000 that responded to the survey. These findings indicate that capital purchases—most difficult for towns with the smallest tax base—are an important factor in deciding whether to contract with private companies for garbage collection.

Contracting with a private company goes beyond the convenience of delaying a capital purchase, however. In 1985, the General Assembly passed a law requiring municipalities either to contract for two years with the private refuse companies serving a newly annexed area or to reimburse the companies a year's revenues—if the annexation was involuntary.[6] Initial capital costs, combined with the new law, will probably increase the short-term contracting of garbage collection to private companies. The impact on the long haul will be more difficult to determine.

The League is currently updating the 1982 survey. The results should indicate the extent to which two trends are developing. First, how many municipal officials agree with Hickory City Manager Wilfred A. Wells? The Hickory garbage collectors do much more than just collect garbage, says Wells. When it snows, they clear away snow. They clear away trees pushed down in storms, and they clear storm drains and clean sidewalks.

Second, what happens when initial contracts come up for renewal? The Robeson County contract for garbage collection will expire on December 31, 1985. Officials are considering the possibility of Robeson County again collecting its own garbage. But no decision has yet been made.

Water and Sewer Systems. Mayodan and Morganton illustrate just two of the many approaches being used in North Carolina to build and operate water and sewer systems. "We have 3,000 public water suppliers in North Carolina," says David Moreau, director of the Water Resources Research Institute at North Carolina State University. "Only 50 serve more than 10,000 people. The larger cities have the experience. But there is a place for it ('privatization'), particularly with the small systems."

Private arrangements could be particularly valuable with regional systems, says Moreau. "They (private companies) would have to meet the same operating criteria as cities would have to."

Thus far, private companies have generally limited their involvement to building or operating water and sewer systems. Cities (and in some cases counties) still own and finance the construction of the systems. Leigh Wilson, executive director of the N.C. League of Municipalities, sees capital projects, like water and sewer systems, as an area where "privatization" could move beyond the traditional contracting for services. Local governments have had the authority for some time to contract with the private sector to operate water and sewer systems.[7] In 1985, the General Assembly gave local governments a blanket authority to contract for any service they are allowed to provide themselves, including new water and sewer systems.[8]

Even so, municipalities are encountering barriers to contracting the entire water and sewer function to private companies. Planners envision a private company building a system and operating it, without the municipality (or county) having to pass a bond issue or invest major capital resources. After a 15-year depreciation period, the private-sector tax benefits would be exhausted, and the company would sell the facility to the governmental unit.

J.D. Foust, head of the state's Local Government Commission, says such private financing schemes haven't been pulled together yet, although negotiations are underway for facilities in Concord, Long Beach, and other North Carolina towns. "We can't use industrial revenue

Advantages of "Privatization"

1. Provides a timely answer to environmental and economic development needs.
2. Minimizes federal and state involvement in local affairs.
3. Avoids construction time delays and compliance with federal procurement regulations, which collectively may increase the capital cost of a facility by 20 percent to 40 percent.
4. Permits greater flexibility in key factors such as flow-matched sizing of the treatment works and billing users for services provided, and avoids indirect costs of grant administration and potential headaches of grant audits.
5. Privatization may provide 100 percent funding of sewage treatment plant construction costs, thereby preserving local debt capacity for other essential purposes. The grant program, in contrast, provides a percentage of funding for eligible costs only, and eligible costs are typically determined at the time a local project is placed on a state priority list, not when construction costs are actually incurred. Time delays may therefore significantly raise the local share.
6. Tax benefits which the private sector is capable of using should result in lower user fees than local debt financing would necessitate. Tax benefits available to the private sector include:

- Investment tax credit—10 percent of eligible project cost.
- Depreciation of machinery and equipment over five years.
- Depreciation of structural components over 25 years.
- Deductibility of interest expense.

7. Opportunity for community/private sector organizations to work together toward the issuance of industrial development bonds would further lower the interest cost of financing by the private sector, and may, in fact, equate the interest rate borrowing cost of the private group with that of the local community.
8. For many communities, proper operation and management of sewage treatment facilities is best achieved through a private-sector contractor. Community difficulties include pay scales to attract and retain key technical talent and limited career growth opportunities.
9. The private sector should experience significant economies of scale in the operation of multiple facilities, thereby resulting in lower user fees for operation and management. Reasons include factors such as:

- Ability to share licensed operators among multiple plants.
- Ability to centralize/consolidate common services such as preventive maintenance, accounting and administration, laboratory services, spare parts, etc.
- Ability to bulk order chemical supplies and other essential common commodities.
- Profit incentive for cost-efficient operations and search for revenue-generating capability of treatment plant resources in addition to local user fees. ☐

Taken from a report on "privatization" of wastewater treatment facilities prepared by the Arthur Young Company for the New Jersey Department of Environmental Protection. "Advantages" and "Disadvantages" articles reprinted by permission from special "privatization" issue of American City & County *magazine, January 1984.*

bonds in this state except for manufacturing facilities," says Foust. "So there is no tax-exempt financing available to the companies. And the (federal) accelerated depreciation is not as good as it was three years ago." Foust has not given up on having private companies finance new water and sewer facilities as a way to help municipalities faced with declining federal dollars for such projects.[9] "We hope that we can work out a way."

Is "privatization" better for water and sewer systems? Except for very small municipalities—which generally do not have sufficient in-house expertise—the decision does *not* depend upon efficiency in operating the system, says Moreau of the Water Institute. "You get the same people to work the systems," says Moreau. "Nationwide, customers pay more for water from private

—continued page 10

Disadvantages of "Privatization"

The nation's largest public employee union has announced a national public education program designed to alert policymakers to the drawbacks and abuse associated with contracting out, or privatization, of state and local government services.

As part of its effort, the American Federation of State, County and Municipal Employees (AFSCME) released a 116-page book entitled, *Passing the Bucks: The Contracting Out of Public Services*. The book, which is the result of two years of study and research, details dozens of examples of mismanagement, abuse, fraud and corruption as a result of contracting out at the local level.

"The on-the-job experience of AFSCME's one million members clearly has shown that contracting out has serious shortcomings. Contractors providing government services are frequently more costly; contracting out often results in reducing the quality and efficiency of services; it is inevitably accompanied by a lessening of public control; and there are documented cases of crime and corruption associated with contracting out," declares Gerald W. McEntee, president of AFSCME.

"The Reagan administration's cuts in aid to state and local government have greatly increased the budget problems of those governments and contracting out is being promoted as a quick fix," McEntee continues. "But, our report shows that contracting out is no panacea. In fact, contracting out much more often operates against the best interests of the public it is supposed to benefit."

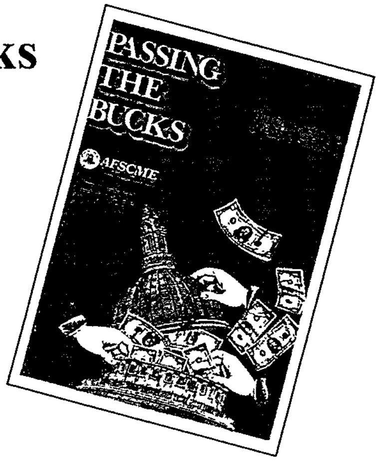
Among the findings of the report are:

- Rather than saving money, contracting out often results in higher costs. Hidden costs such as contract preparation, administration and contract monitoring usually increase the price of contracted services.
- Contracting out can result in a decline in the quality and efficiency of services. Contractors are tempted to cut corners by hiring inexperienced personnel, by ignoring contract requirements and by providing inadequate supervision.
- Corruption in contracting out has increased dramatically. Numerous cases of bribery, kickbacks and collusive bidding have characterized contracting out over the past several years. In addition, organized crime appears to have assumed an even larger role in illegal activities associated with contracting out.
- Contracting out is still a tool of political patronage in many areas.
- Contractors bidding to provide public services have sometimes encountered financial problems which have left cities, counties, and states in difficulty.
- Contracting out has often been characterized by "lowballing" or "buying in" at unrealistically lower prices in order to obtain a contract.
- The drafting of job specifications and contracts often leads to contractor performance which is too rigid or narrow to maintain quality public services.
- Competition for contracts to provide public services is too often the exception rather than the rule.
- Contracting out results in less accountability by government to the public.
- Contracting out is frequently used to mask the inadequacies of public officials who cannot manage their own operations properly.

"The lesson is clear for state and local government officials. They should proceed with extreme caution when tempted by the heady claims of contracting out," explains Linda Lampkin, AFSCME director of research. "At a minimum, public officials must be willing to explore the alternative. That's a basic management responsibility."

"The key to improving public services is good public management and efficient public services, not the selling off of government," says McEntee. "Public officials all too often have used contracting out as a crutch to prop up weak management. In every case of failure, in every case where the quality and efficiency of a public service has deteriorated and the cost increased, where control over public services has diminished, where corruption has come into play, the public is the chief victim. The public endures the consequences and the public pays the bill where the contracting out has not worked." □

Passing The Bucks



companies then from publicly owned systems because they are profit-making operations."

The crux of the matter, then, is *financing the capital expense of a new system*, "or measuring the private sector opportunity with capital," as Moreau puts it. "You weigh higher interest rates (since private companies have no tax-exempt bonds in North Carolina) versus the advantages in depreciation, plus the profit required."

Hospitals. For many years, the state has run specialized hospitals for mentally ill and retarded persons, children with cerebral palsy, and North Carolina Memorial Hospital, part of the University of North Carolina system. For the most part, however, county governments have been in the business of providing general hospital health care only since about the 1940s. After some 45 years, hospital care is swinging back to the private sector.

Counties are turning to private hospital management corporations for general hospital services by: 1) contracting for the management of hospitals; 2) leasing hospitals to a private group; or 3) selling hospitals outright. Counties are using one of these three arrangements with both for-profit and nonprofit corporations.

Currently, of the 129 acute care hospitals in the state, the state owns and operates one (North Carolina Memorial); 53 are owned by local governmental bodies, and 75 are owned by private corporations. Of the 53, local governmental units operate 39 themselves and contract with private companies (both nonprofit and for-profit) to manage the other 14 hospitals. Of the 75 owned by private corporations, 65 are owned and operated by nonprofit groups and 10 by for-profit companies.[10]

In 1984, the legislature's interim study committee on public health facilities held hearings on the trend towards "privatization" of county hospitals. C.B. Martin, chairman of the Edgecombe County Board of Commissioners and retired superintendent of the Tarboro City Schools, summarized the viewpoint of county officials who favor private-sector involvement. The Hospital Corporation of America had offered the county $3.6 million for the hospital, which would cover the $2 million the county had in obligations, leaving some $1.6 million for other expenditures. "They had the money. They were willing to provide the services, and they were willing to take the indigent patients," Martin told the legislative committee.

"After studying this thoroughly, we decided to sell the hospital," explained Martin. "That's a lot better off than we were before because if we had kept going, we would have had to close the place."

Some county commissioners have had a different experience from Martin's. Nolan O'Neal, a New Hanover County commissioner and board member of the county hospital, has objected to the county's considering turning over its hospital. The proposal under consideration would transfer the assets and management of the hospital to a private, nonprofit corporation. "The public hospital has continued to make money," says O'Neal. "It has a good medical and administrative staff. The hospital cost the taxpayers $14 million and is worth $80 to $90 million now," explains O'Neal. "Why mess with success?"

Confusion over the buzzword "privatization" shows up when discussing the transfer of county hospitals to the private sector. "Competition, and the use of private producers, does not mean 'privatization,'" contend Johnson and Kolderie, the Minnesota-based analysts. "It is 'privatization,' for example, when the government says it will no longer pay for the care of the medically indigent, not when it arranges with some other organization to run the county hospital."

When Edgecombe County sold its hospital to a private company, why shouldn't that be called "privatization"? The point is this: The word "privatization" can mean different things to different people. What's important is the impact of cost and quality of services and who is paying for the service, not the label given to the arrangement between the county and the private corporation.

Johnson and Kolderie call for a change of emphasis in judging the performance of public officials. For many years, they argue, "government came to be defined generally *by what it did rather than by what it decided*, with the unfortunate consequence that elected officials who should be concentrating on the success of the policy have come instead to see themselves as involved primarily with the process of implementation" (emphasis added).

Such a perspective seems years away from the realities that county commissioners are now facing. Take the case of Eva Clayton, who chairs the Warren County Board of Commissioners. "All Things Considered," the nightly news program for National Public Radio, recently aired a feature-length report on how Clayton has struggled, but failed, to keep the Warren County hospital running in the black. The program quoted Clayton supporters who held her and other county commissioners responsible for the hospital's problems—and not the changing nature of the hospital industry.

Prisons. One of the newest types of services now being offered by the private sector are detention centers, minimum-security prisons, county jails, and halfway houses. A leader in the field, the Nashville-based Corrections Corporation of America (CCA), tapped the same venture capital fund that launched the Hospital Corporation of America in the same city. Since January 1985, CCA has owned and operated a halfway house in Fayetteville under contract with the Federal Bureau of Prisons. The same corporation operates a county detention facility in Chattanooga, two federal detention centers in Texas, and has been hired to operate a county jail in Panama City, Florida.

In July, N.C. Secretary of Correction Aaron Johnson visited the Texas facilities run by CCA. He returned "extremely impressed" with CCA and has begun conversations with the company about building and operating a minimum-security state prison in North Carolina. Gov. James G. Martin has said that "he doesn't see a problem with it," although he has not yet given the go-ahead.

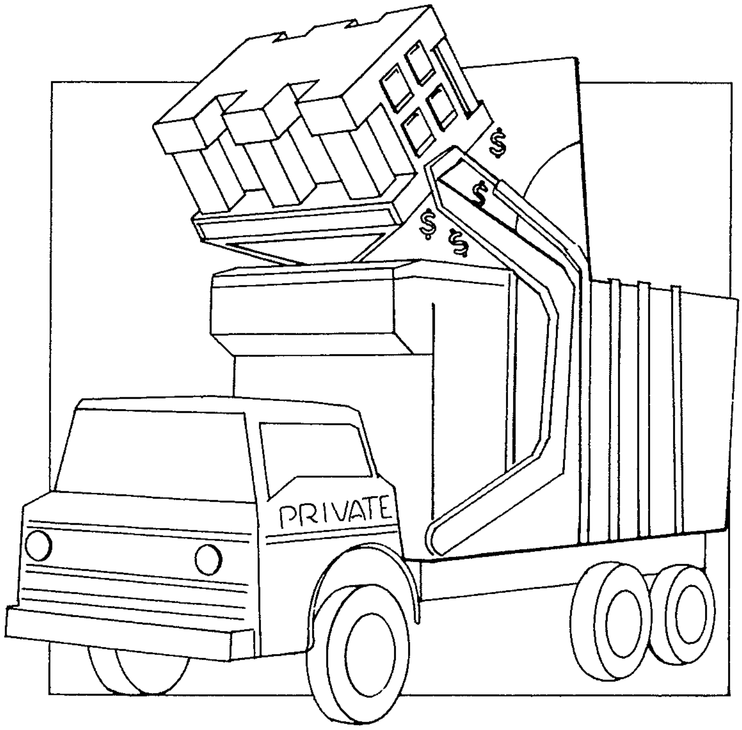
Like garbage, water and sewer, and hospitals, prisons sometimes go private because of cost considerations. Thomas Beasley, founder and president of CCA, and former chairman of the Tennessee Republican Party, contends that his company can build and operate a prison cheaper than can a governmental unit. Beasley points to cost savings through speed of construction (without the public bidding procedure) and the ability to negotiate with vendors quickly without slow-moving government contracts.

The *Winston-Salem Journal*, in an editorial on August 7, 1985, called the trend towards private-sector prisons a "free-lunch fantasy." If the state relies on private investments for new facilities, the editorial noted, the state becomes dependent upon that facility. This point is important in light of lawsuits filed on behalf of prisoners claiming overcrowded conditions.

Such a suit recently forced the state to commit $12.4 million to improve conditions in 13 southern Piedmont prisons. "The settlement is a long overdue response to shameful overcrowding and inadequate programs in correctional facilities in this area, and should lead to a push for similar upgrading of prisons statewide," opined *The Charlotte Observer* in its lead editorial on August 6, 1985. What happens if a private company does not perform adequately? Where does the state turn for other facilities if it has come to depend upon a private company for a certain number of beds?

Other opponents question various legal and ethical issues. "Prison officials serve a quasi-judicial function," explained *The Fayetteville Observer* in a February 19, 1985, editorial, with duties ranging from advising parole boards to administering a sentence imposed by the courts. "It is not clear that the state has a right to delegate that responsibility to a private corporation." Legal aid lawyers and American Civil Liberties Union officials also worry about turning over an "unpopular function of government" to a private company, which is driven by the profit motive. Finally, what happens if there is a prison riot?

In addition to the minimum-security facility, Secretary Johnson is considering other forays into the "privatization" field. For example, Johnson considers the Central Prison hospital in Raleigh a "disgrace," and is interested in having a for-profit hospital chain take over that hospital. Possible cost savings and the hope of improving services may win the first round in North Carolina.



Private-Sector Initiative

The terms "privatization" and "private-sector initiative" mean similar things to some people. Distinguishing between the two, however, shows how various services have evolved over the years, and more importantly, perhaps, suggests how future relationships between the private and public sectors might be forged. "Privatization" generally refers to a governmental unit turning over a specific service to a private company, as explained in the previous section.

Private-sector initiative refers to either of two patterns: 1) private companies (for-profit or nonprofit) providing a service, for the most part, *before* government becomes involved; and 2) the private sector both funding *and* delivering a service once provided by government. The day care industry, particularly for preschoolers, represents the first type of private sector initiative. The popular Individual Retirement Accounts (IRAs) could become an example of the second type of initiative, if IRAs become important enough to provide through the private sector some of the benefits now provided through Social Security.

The term "private-sector initiative" gained prominence during Reagan's first administration, especially during the budget-cut fights in Congress. Government is too involved in peoples's lives, argued Reagan and David Stockman, former director of the U.S. Office of Management and Budget; the private sector can take over the role of government in many ways. Reagan called for private-sector initiatives with his famous "safety-net" speech. The government's safety net would take care of the neediest people, said Reagan, and private-sector initiatives could take care of other persons no longer eligible for certain social welfare programs.

The "safety-net" image illustrates the difference between "privatization" and private-sector initiatives. Government-funded programs, at the reduced "safety-net" level, could be run by the public sector or by private companies under various contracts or vouchers—i.e., through "privatization." Private funds—through corporations, philanthropy, churches, and other groups—would fill in the gaps for those in need who no longer qualified for government-funded services, so the Reagan-Stockman theory went.

The jury is still out on whether church-sponsored food distribution projects have substituted adequately for cuts in food stamps, for example. Conservatives say churches are doing the job and poverty is declining. Social welfare groups contend the opposite, that poverty and hunger are on the rise.

The bitter partisan fights over budget cuts during the Reagan era have led to an identification of the term "private-sector initiative" with the recent rise in influence of the conservative political philosophy. In fact, private-sector initiatives have been around since colonial days, when frontier mothers educated children and farmers formed volunteer fire departments.

Over the generations, state and local governments have taken over such basic services as public education and the building and maintaining of roads (also built by private companies in the early days). President Franklin Roosevelt and his New Deal extended the arm of government into the social welfare arena, affecting virtually every American with the Social Security program and providing for those most in need through programs such as aid to the blind. The reach of government extended further in the 1960s during President Lyndon B. Johnson's Great Society, with numerous programs, ranging from Medicare to Medicaid, from Head Start for disadvantaged children to the Small Business Administration for struggling entrepreneurs.

Ronald Reagan's arrival as the nation's leading political spokesman has stimulated various proposals for enhanced private-sector initiatives. Some of the most enthusiastic advocates of the private sector, however, recognize the difficulties of shrinking government.

"As a proportion of GNP, federal spending is now well above the level of the Carter administration, forcing David Stockman last year to revise his estimate of the minimum size of government achievable to 23 percent (of GNP)—up from the 19 percent target when Reagan took office," writes Stuart M. Butler of The Heritage Foundation, a conservative think-tank. "Clearly the central plank in Reagan's platform to clamp down on government has been shattered. And if Reagan and Stockman cannot control spending, who can?"[11]

Butler builds a case in his article, called "For Serious Action on Privatization," for providing inducements and incentives to "encourage Americans to seek benefits and services from the private sector that they now receive from the government." Butler also maintains that "steps should be taken to weaken the coalitions now supporting federal programs, while fostering new coalitions committed to private alternatives."

Private-sector initiatives have been around since colonial days, when frontier mothers educated children and farmers formed volunteer fire departments.

To illustrate such a coalition, Butler points out that a pro-Individual Retirement Account coalition has emerged. IRAs have become so popular that "despite the fact that the revenue cost of IRAs has far exceeded Treasury forecasts, not only is there no effort to reduce the deduction, but there have actually been several attempts to increase it." Butler contends that such a coalition has built a private-sector initiative—i.e., promotion of IRAs by the finance industry. This initiative could lead to a "privatization" of one of the most highly protected of government services: "Diverting demand for retirement security into the private sector, the politics of Social Security will slowly but surely begin to shift to favor reform."

Private-sector initiatives, then, can lead towards "privatization"—i.e., the private sector taking over a service now provided by the government. Ironically, private-sector initiatives can also lead to the opposite result—*greater government involvement with a service.* Perhaps the best illustration of this is volunteer fire departments.

Traditionally, in rural North Carolina, volunteers have organized and provided fire protection. Since the 1950s, however, many volunteer departments have been unable to support their operations on money raised from fish fries and bake sales. New equipment costs too much for such modest funding sources. So the volunteer fire departments started asking counties for money, most often through the creation of a special fire district for tax purposes.

Counties have had the authority to establish such fire districts since 1951, and the number of districts has jumped dramatically in recent years.

From 1971 to 1982, the number increased from 170 districts in 40 counties to 485 in 61 counties. "There has been increasing public-sector aid to volunteer fire departments," says Ed Regan of the N.C. Association of County Commissioners, which compiled the data cited here. "Special tax districts have multiplied like rabbits."

Private-sector initiatives in building water and sewer systems sometimes result in *increased* public-sector involvement, as well. Often, private developers will include a water and sewer system with a housing development, particularly in a retirement area, explains Regan. But after five or 10 years, the system either breaks or becomes overloaded. Then the property owners go to the county for help. The public agency, the county, ends up funding what was once a private-sector project, adds Regan.

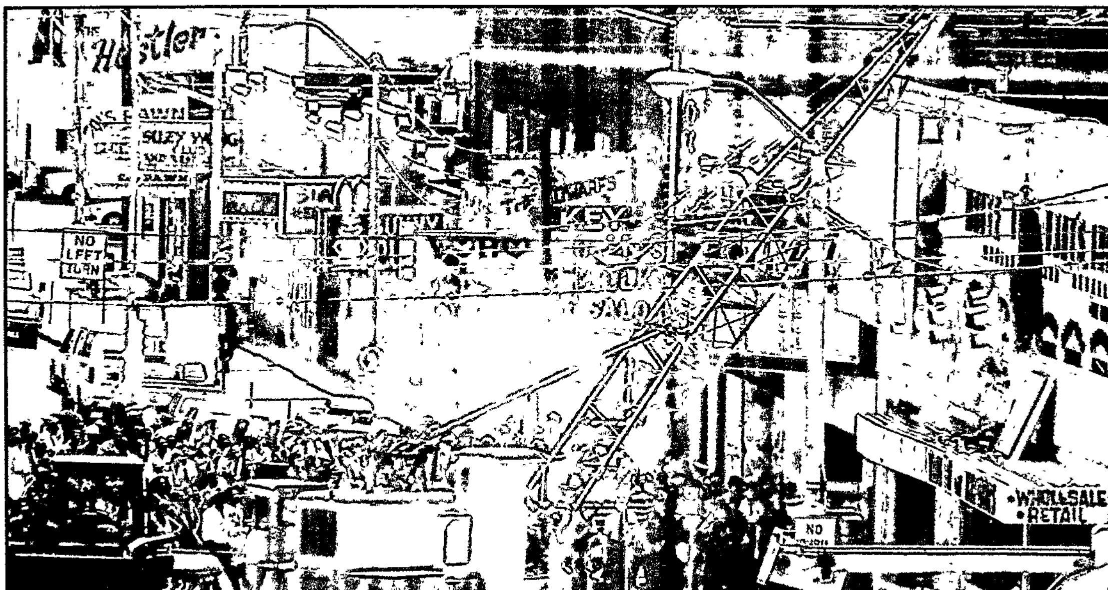
Such a process often happens to cities as well, explains Ellis Hankins of the League of Municipalities. Property owners go to cities for help, "whether located inside or outside the city," says Hankins.

Private-sector initiatives, then, can lead either to *reduced or increased* government support. "If there is the prospect of a 'free' government-provided service, while the private sector must charge the full cost, citizens will always tend to favor government provision," explains Butler of The Heritage Foundation. Both liberals and conservatives, to use the terms loosely, would agree with Butler on that point. But disagreements emerge over *which* services should be provided by the private and by the public sectors.

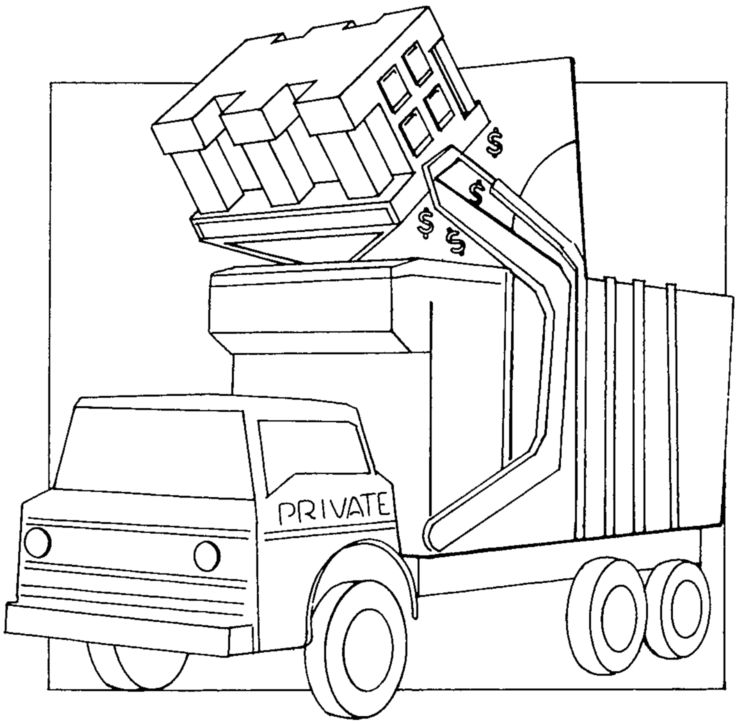
For example, the private sector has basically taken the initiative to meet a demand for preschool child-care. Now some states, including North Carolina, have become interested in adding a day-care program for preschoolers to the state-funded education system.[12] The private, for-profit day care industry has fought the proposals, and thus far little support has emerged, mostly because of the public expense involved. Private-sector initiative seems to have preempted the preschool market from government. But what about grades K through 12? Should vouchers be used to allow parents to send their children to public or private schools?

Under Butler's thesis, "a conscious campaign must be undertaken to create coalitions of beneficiaries, near-beneficiaries, administrators, and providers, committed to the private-sector delivery of a service." Would Butler's "delivery of a service" include educating children? The potential conflict between Butler's thesis and longstanding support for public education illustrates the crux of this entire issue. Deciding whether a private company might provide a service as well and as cheaply as a state or municipality depends upon the service under consideration.

Wrecking ball shatters a hole in one of Fayetteville's famous Hay Street establishments during the "block-busting" party, July 29, 1983.



Ken Cooke, The Fayetteville Observer



Public-Private Partnerships

Public-private partnerships have operated in four major areas in North Carolina: economic development, downtown revitalization, the arts, and historic preservation. A partnership between a governmental unit and a private company suggests a more cooperative arrangement than does privatization or a private-sector initiative. The public sector taps its resources and assets, as does the private sector. Together, they may be able to do things that neither could have done alone. While these four types of partnerships overlap to some extent, they each have their distinctive features, especially as they have operated in North Carolina.

Economic Development. Perhaps the most famous public-private partnership in the state is the Research Triangle Park, now internationally known as a planned industrial research and development park. "Key to the success of the early financing arrangements for the land purchases was the extensive involvement of a relative handful of the state's bankers, industrialists, and politicians—including the governor and the state treasurer—and the use of the institutional vehicle of the nonprofit corporation," writes Dale Whittington in an introductory chapter to *High Hopes for High Tech*. "Perhaps most importantly, the vehicle of a nonprofit corporation enabled the founders of the Research Triangle to obtain much of the financing from public funds (directly and indirectly), while at the same time keeping control of the development out of the hands of the state and local governments."[13]

Other prominent examples of economic development partnerships include industrial development bonds and the $40 million in state appropriations to the Microelectronics Center of North Carolina since 1980. In the first case, private companies, through a constitutional amendment that created the industrial development bonds, in essence get a tax break for building a manufacturing facility in a certain place.[14] In the case of the Microelectronics Center, a quasi-independent board uses the influence of the Center to negotiate sales of its technology to the private sector.

Downtown Revitalization. Dramatic, innovative partnerships have begun to remake downtowns from Wilmington to Asheville. Even the grubby bars and pornographic movie house on Hay Street's 500 block in downtown Fayetteville are giving way to neatly manicured townhouses, office complexes, and uptown urban living. In Fayetteville, a private, nonprofit municipal development corporation called Fayetteville Progress can take a hefty amount of the credit for fitting together the pieces of the urban revitalization puzzle.

At least 12 North Carolina cities have similar corporations, according to the North Carolina Downtown Development Association. Such corporations work to recruit downtown investors, develop low-interest loan programs, help assemble large loan packages, and coordinate the often complex cast of characters that might be involved in a downtown improvement project.

The Fayetteville experience illustrates the complexities involved in a major downtown revitalization effort. On the public side, the main characters have been the city and the county. On the private side, the central players recently have been the NCNB Community Development Corporation, the Hospital Corporation of America, White Oak Properties of Raleigh, and Owen Kugel Associates of Lancaster, Pennsylvania. Fayetteville Progress has often coordinated unconnected projects and promoted downtown revitalization as a unified affair. Fayetteville-area businessmen began Fayetteville Progress with individual investments of $5,000. The investors did not expect to get their investments back, except indirectly through a revitalized downtown.

For years, the city and county have financed various downtown revitalization plans, often through private consultants. This early form of public-private partnership blossomed into full-scale action with the creation of Fayetteville Progress and the work of the Charlotte-based NCNB Community Development Corporation. In 1982, Fayetteville Progress and the NCNB group started planning a middle-class housing project downtown. NCNB was no newcomer to such a task.

The NCNB Community Development Corporation had served as a catalyst for major private development in Charlotte's Third and Fourth Wards.[15] NCNB had first sought private developers to work in Charlotte's Fourth Ward, says Dennis Rash, president of the NCNB Community Development Corporation, but none could be found to take the risk. So NCNB successfully petitioned the U.S. Comptroller General for permission to form a nonprofit housing development corporation, the first of its kind in the nation.

The NCNB effort took advantage of tax law that eliminated federal income tax on the interest from loans made to municipalities for the purpose of financing urban renewal. Relieved of the tax burden, first the NCNB group and then other lenders loaned money to the city at rates far below market rates. The city, in turn, lent the money to homeowners. Since its successes in Charlotte, the wholly owned NCNB subsidiary has been involved in similar downtown revitalization efforts from Asheville to Fayetteville.

After the Fayetteville Progress and NCNB initiative, the city went into high gear. Mayor Bill Hurley pledged to excise that "cancer eating at the heart of Fayetteville," and the City Council committed up to $3 million to raze the seedy 500 block of Hay Street and prepare it for sale. Using its redevelopment authority, the city could purchase the properties at much cheaper interest rates than could a private company. The NCNB Community Development Corporation then started to work, along with NCNB proper, which was able to write mortgage interest rates down to an attractive level by way of the N.C. Housing Finance Agency.[16] Just months after a city-sponsored "block-busting" party, the first phase of the NCNB townhouse project was selling like hotcakes.

In 1984, a commercial venture joined the effort when Hospital Corporation of America (HCA) agreed to purchase a 3.2-acre site from the city for $750,000. In 1985, HCA began construction on a four-story medical office building, which will be across the street from Highsmith-Rainey Memorial Hospital, also owned by HCA.

The Raleigh-based White Oak Properties also joined the revitalization effort. It plans to redevelop Fayetteville's downtown farmers' market complex, complete with shops, offices, apartments, and a restaurant. The city council gave the developer a 25-year lease on the property with various stipulations, including getting a $200,000 grant from the legislature—which it did in 1984.[17]

At the heart of downtown, though, stood the rundown but architecturally striking Prince Charles Hotel. Fayetteville Progress began assembling the components of getting a private company to undertake a major rehabilitation and expansion of the hotel with fountain, parking, and public plaza. Thus far, no developer has pulled together the necessary components, but among several who might is Owen Kugel.

Kugel has recently contracted with Fayetteville Progress to have $5 million in downtown development under construction within 12


Scott Kane

Spirit Square in Charlotte

months. Fayetteville Progress, using no public funds, pays Kugel $5,000 a month. *The Fayetteville Observer* reported that Kugel has offered to buy the hotel, though no price has been discussed. Kugel's interest in Fayetteville is part of a statewide effort. Currently, Kugel is reported to have contracts similar to the arrangement in Fayetteville with 20 North Carolina communities, including Aberdeen, Clinton, Dunn, and Sanford. Kugel represents a new kind of "mass-market" downtown developer, who will work with municipalities through business groups like Fayetteville Progress.

The Arts. Charlotte and Winston-Salem have served as models for the many successful public-private partnerships in the arts—both within North Carolina and even nationwide. Both cities tapped resources unique to their areas, but used creative partnerships to multiply the impact of various arts projects. The arts have become a major drawing point for both cities—for downtown revitalization (where deteriorating structures have been transformed into major arts centers), corporate location decisions, housing decisions by individuals, shops, offices, and the general life of the cities.

In Winston-Salem, public-private projects have helped reshape the downtown area. In 1965, the new North Carolina School of the Arts was looking for a home. The city offered a former high school building, 22 acres of land, and almost $1 million raised in a telethon in 48 hours. For 20 years, the school, part of the University of North Carolina system, has been a central attraction to a growing downtown arts community. The city's arts council, the nation's oldest (begun in 1949), has also brought together municipal and private efforts to reinvigorate the city's downtown.

In 1970, the city completed the M.C. Benton Jr. Convention Center, connected by a mirror-lined tunnel to the 320-room Hyatt House across the street. These new buildings served to stimulate more public-private efforts. Major philanthropic gifts from individuals, corporations, and foundations, combined with the city's downtown arts efforts, culminated in 1983 with the completion of the Roger L. Stevens Center for the Performing Arts and Winston Square, both downtown arts complexes. R.J. Reynolds Industries, Inc. provided gifts of $1.2 million to the Stevens Center and $1 million to Winston Square. Piedmont Publishing Company donated the old Carolina Theater building to be converted into the Stevens Center.

In Charlotte, the public-private ventures in the arts have given a new vigor to the city.[18] Charlotte and Mecklenburg County have made major investments in the arts. The county, for example, bought the old First Baptist Church downtown for $300,000 and leases it to Spirit Square, Inc., a nonprofit group, for $1 a year. The city is paying the debt service on a $2.5 million bond issue for the effort. But the public effort alone would not support Spirit Square, a multifaceted complex with studios, classrooms, gallery spaces, a performance theater, and a restaurant. It depends upon substantial funding for its annual budget from private foundations and an annual Arts Fund drive among local businesses. The partnership between the private donors and the public support keeps Spirit Square alive.

Two other major Charlotte attractions have also turned into success stories through public-private partnerships—the "hands-on" science and technology museum, Discovery Place, and the Mint Museum, North Carolina's oldest permanent art museum. The city owns the Mint Museum and its grounds and supplies more than half its annual budget. In 1982, the city passed a $3.5 million bond referendum to expand the museum and build a new road to the museum. A 1977 city bond referendum provided $7.1 million for the Discovery Place building. Major corporate support has been essential for this unique museum. For example, the Knight Publishing Company contributed $200,000 for the Knight Rain Forest at the museum. First Union National Bank gave $100,000 for a science theater. The school system also has a cooperative program with the museum. "Every school child probably visits Discovery Place each year," says Doug Carter, director of finance for the city.

"It makes good sense to fund the arts," says former Mecklenburg County Commissioner Susan Green. "They are a strong drawing card that can tip the balance in a corporate decision to relocate to a particular area."

Historic Preservation. New Bern, like many other North Carolina towns, has established a historic district with a governing commission. The New Bern historic district works closely with Swiss Bear, the city's nonprofit development corporation, and with New Bern Preservation Foundation, Inc., the local historic preservation group. Swiss Bear is handling a major 13-acre riverside development.

The New Bern Preservation Foundation has established itself over the years as one of North Carolina's most noted local preservation groups. This group, like most of the local preservation groups around the state, began primarily through the efforts of individuals concerned about historic properties. Urban pioneers moved into rundown neighborhoods and began rebuilding old homes. Others donated time and money to save historic buildings. Eventually, the preservation group began a local revolving fund. With such a fund, the group helps save properties from destruction or deteriorating too far to be worth saving. The loan fund can help move a building, add a roof, coordinate stop-gap legal work, or the like. If necessary, the group buys the property and then sells it to a private buyer.

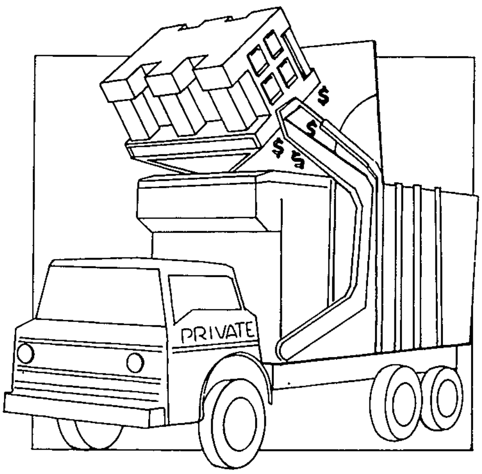
In North Carolina 17 such revolving funds exist, according to the Historic Preservation Foundation of North Carolina. In 1984, 13 of the 17 (including the New Bern group) joined together in the first statewide revolving fund in the country. "We have generated some $12 million in private investment through the local revolving funds," says Myrick Howard, executive director of the Historic Preservation Foundation, which coordinates the statewide fund. "Currently, we have about half a million dollars worth of properties that we are trying to market."

"North Carolina has long been a leader in historic preservation," says Stephen Dennis, assistant general counsel for the National Trust for Historic Preservation.

In 1981, the federal Economic Recovery Tax Act (ERTA) offered new tax breaks that have encouraged preservation. Developers who renovate historic structures into offices, restaurants, or some other commercial venture (apartments, for example) get a 25 percent tax *credit* on the renovation costs. With local historic preservation groups based in towns throughout the state, North Carolina was well prepared to take advantage of the 1981 ERTA tax breaks.

Many of the small towns throughout the state were prepared because of a program called "Main Street." In 1980, the National Trust for Historic Preservation selected North Carolina as one of six states for a model "Main Street" revitalization program. Focusing on towns of less than 50,000 people, the Main Street program has expanded to 15 North Carolina towns. Towns have to commit a staff person to work full time with downtown revitalization in order to qualify as a Main Street town. Towns get little money but a lot of technical assistance, including architectural skills and help in forming redevelopment loan pools of the sort pioneered by Dennis Rash of the NCNB Community Development Corporation. In essence, then, the Main Street program stimulates downtown revitalization with emphasis on preservation and restoration.

Consequently, downtown revitalization and historic preservation efforts have often joined hands. "New Bern is a good example of where the Main Street program and the revolving fund have worked together," says Howard.



Conclusion

Money, technology, and political philosophy—the big three—have catapulted the word "privatization" onto the front burner of public policy debate. Budget cuts at the federal level and budget crunches at the local level have prompted state and local officials to see the private sector as an alternative source to providing public services, from hospitals to garbage collection. As technology and the systems that manage the technology grow more complex, many local officials no longer feel competent to manage water and sewer systems, hospitals, and other sophisticated types of services. As money has gotten tight and technology more complex, the Reagan philosophy of private-is-better has gained increased respectability.

The current discussions of "privatization" refer to three interrelated, yet distinctive, types of arrangements between government and private companies: "privatization," private-sector initiatives, and public-private partnerships. Many of the arrangements have existed for years and have nothing to do with the current wave of "privatization" promotions from E.S. Savas, Stuart Butler, and others. State and local officials in North Carolina have taken more notice of various public-private arrangements in recent years—just as private companies have launched campaigns to take over government services, like running prisons or hospitals.

"Privatization has not been a front-burner concern with us," says Greensboro's Assistant City Manager Baugh. "But it has been part of our thought process as we go through budgets every year."

In contrast to modest trends towards turning over government services to private companies (i.e., "privatization"), public-private partnerships seem to be flourishing in North Carolina. Virtually every major city in the state has a revitalization plan at work, often with private foundations and corporations working closely with the city. The degree of success often depends upon the level of commitment of corporations based in a community, such as R.J. Reynolds Industries' contribution to Winston-Salem through major arts grants. But in recent years, developers from Texas, Pennsylvania, and other states (and countries) have broadened the traditional public-private partnerships.

Finally, private-sector initiatives in North Carolina can lead to either a reduction or an increase in government involvement. The recent pattern of volunteer fire departments seeking public funds (through special tax districts) shows how a private-sector initiative can be gradually incorporated into a government service.

North Carolina, like the rest of the country, has much at stake in the current wave of "privatization." Butler of The Heritage Foundation is looking past the Reagan era. "By establishing permanent coalitions committed to expanding private alternatives to federal spending, the momentum for privatization would continue long after Reagan leaves the White House," Butler concludes in his article. "Without such a strategy to break out of the current budget impasse, it will be back to business as usual for spending coalitions as soon as Reagan goes back home to California."

Analysts are also addressing the future from the perspective of local officials. "The seasoned local official will look at the possibility of contracting as just one alternative or option in the consideration of how to produce public services," explains Peter Holmes, director of the department of finance and management services of St. Paul, Minnesota.[19]

In North Carolina, the immediate decisions range from extending contracts with garbage companies to figuring out tax advantages for private companies to build water and sewer facilities. Such decisions will involve cost and the quality of the services being provided to the public.

What's important in the end, however, is not just cost or quality of services. "The tendency for most private enterprise is to cut every corner possible, to look at cost as the most important thing," says Gunnells of the state employees association. "But for some government services—such as human service issues and corrections, for example—it is not always appropriate to be looking squarely at the bottom line." □

FOOTNOTES

[1]Terry W. Hartle, "Sisyphus Revisited: Running the Government Like a Business," *Public Administration Review*, March/April 1985, page 341.

[2]Bob Kuttner, "Going Private: The Dubious Case for Selling Off the State," *The New Republic*, May 30, 1983, page 29.

[3]Hartle, page 341.

[4]Verne Johnson and Ted Kolderie, "Public/Private Partnerships: Useful but Sterile," *Foundation News*, March/April 1984, page 31.

[5]Keon S. Chi, "Privatization: A Public Option?" *State Government News*, June 1985, page 6. The Council of State Governments conducted a state-by-state survey in April 1985 to determine the extent to which state governments contract with private companies for professional services. For information on that survey, contact Mr. Chi at the Council, Box 11910, Ironworks Pike, Lexington, Ky. 40578, (606) 252-2291.

[6]Chapter 610 of the 1985 Session Laws (HB 941), now codified in four places: NCGS 160A-35(3)a; 160A-37.3; 160A-47(3)a; 160A-49.3.

[7]NCGS 160-312.

[8]Chapter 271 of the 1985 Session Laws (HB 771), now codified in two places: NCGS 160A-20.1; 153A-449.

[9]In the initial round of federal budget cuts in 1981, grants for water and sewer grants ranked fifth among all federal cuts to North Carolina. For more information, see Jim Bryan et al, *Federal Budget Cuts in North Carolina*, April 1982. N.C. Center for Public Policy Research, page 9ff.

[10]Elizabeth M. Maddox, editor, *The Investor-Owned Hospital Movement in North Carolina*, N.C. Center for Public Policy Research, 1985. This issue of *North Carolina Insight* contains excerpts from the executive summary of that report (see page 57).

[11]Stuart M. Butler, "For Serious Action on Privatization," *The Journal of The Institute for Socioeconomic Studies*, summer 1985, page 15.

[12]For the most recent report on this topic in North Carolina, see "Pre-kindergarten Programs in the Public Schools of North Carolina," a report to the State Superintendent of Public Instruction from the Pre-kindergarten Task Force, George A. Kahdy, chairman, May 1985. For information on this report, contact Charlotte Barnes at (919) 733-3512.

[13]Dale Whittington, "Microelectronics Policy in North Carolina: An Introduction," included in *High Hopes for High Tech: Microelectronics Policy in North Carolina*, edited by Dale Whittington, The University of North Carolina Press, in press, 1985.

[14]Article V, Section 9 of the North Carolina Constitution, enacted by the N.C. General Assembly in 1975 and passed in referendum in 1976.

[15]For background on housing programs in Charlotte, see Steve Johnston, "A Charlotte Housing Tour," *North Carolina Insight*, August 1982, page 22ff.

[16]For background on the N.C. Housing Finance Agency, see Bill Finger, "The North Carolina Housing Finance Agency," *North Carolina Insight*, August 1982, page 2ff.

[17]Chapter 1114 of the 1983 Session Laws, second session (SB 187, Section 417) and Chapter 1116 of the 1983 Session Laws, second session (HB 1376, Section 72.2).

[18]See Beth Briggs, "Funding the Arts in Charlotte and Mecklenburg: A Community Tradition," *North Carolina Insight*, February 1983, page 40.

[19]Peter Hames, "When Public Services Go Private: There's More Than One Option," *National Civic Review*, June 1984, page 280.

Other Resources on Public-Private Arrangements

In addition to the sources cited in the footnotes above, the sources below provide helpful background information.

American Federation of State, County and Municipal Employees, AFL-CIO, *Passing the Bucks: The Contracting Out of Public Services*, 1983.

Frances M. Froelicher, "A Bicycle Built for Three: Public-Private-Citizen Partnership in Baltimore," National Civic Review, February 1984, page 70.

Ann Green, "Government's Increasing Contracts with Private Firms for Public Services," *The News and Observer*, Raleigh, N.C., July 8, 1985, page 1A.

Richard S. Hodes, "Building a Foundation for Government-Business Cooperation," *State Legislatures*, July 1984, page 30.

Jane H. Macon, "Public/Private Partnerships: A Hope for the City's Future," *National Civic Review*, April 1985, page 182.

David Osborne, "The Most Entrepreneurial City in America," *INC.*, September 1985, page 54.

"Private and Public Performance of 'Government' Activity," *State Policy Reports*, Vol. 2, Issue 16, August 28, 1984, page 2.

"Privatization: Dividing the Pie Between Public and Private," *American City & County*, January 1984. This magazine covers privatization on a regular basis, including a sequel to the above special section, in February 1984.

E.S. Savas, *Privatizing the Public Sector: How to Shrink Government*, Chatham House Publishers, 1982.

William K. Woods, "Creative Local Initiative 1982-1983: Citizens Take the Lead in All-America Cities," *National Civic Review*, May 1984, page 221.

Governor's Efficiency Study: A Move Towards "Privatization"?

In February 1985, newly elected Gov. James G. Martin created the Governor's Efficiency Study Commission, chaired by Thomas I. Storrs, retired chairman of the board, NCNB Corporation. Storrs led a 37-member commission which was assisted by 73 "study team members," as the report dubbed them. These 73 were on loan to the commission from corporations, consulting firms, banks, and other North Carolina businesses. Divided into five teams, these executives studied all state departments for ways to improve government efficiency and save money.

On September 30, the Governor released the commission's report with 414 recommendations, itemized department by department in a 162-page book. Much of the report focused on computers and management issues, straightforward "efficiency" issues. In many instances, however, the report went a step further. "Like the Grace Commission put to work by President Reagan on the federal government, the Storrs Commission strayed from inefficiency into policy," observed *The News and Observer* of Raleigh in an October 6 editorial.

The policy-related recommendations reflect various themes and controversies, from environmental concerns to issues of "privatization." Three commission proposals addressed the "privatization" theme directly. Recommendations 263 and 266 proposed that the North Carolina Museum of Art and the North Carolina Symphony convert gradually to privately endowed and operated facilities. Recommendation 410 suggested that the University of North Carolina system contract for custodial services rather than use staff members.

Newspaper editorials generally disagreed with the proposals about the art museum and symphony. "The more distressing of these proposals is the one to toss the symphony out in the street," said the Wilmington *Morning Star* on October 2. "It has been North Carolina's pride fo 50 years. It takes symphonic music into every nook and cranny of the state and to every school child. Without the admittedly generous state subsidy, the orchestra would become something else entirely—probably the Raleigh Symphony."

The Raleigh Times, in an October 14 editorial, objected in stronger terms. "If efficiency were the only value, symphonies and art would not exist. Art is apples; efficiency is oranges."

Characterizing the proposals as "political landmines," the *Winston-Salem Journal*, in an October 6 editorial, advised Martin to reject the ideas. "The museum and orchestra, cut loose from the state budget, would face a death sentence. Is that the 'efficiency' the commission had in mind?"

Analyzing the structure of the North Carolina Art Museum and the North Carolina Symphony goes beyond the scope of the "privatization" issue (see "The State of the Arts?" *North Carolina Insight*, February 1983). But the prevailing assumptions in considering turning these institutions into private-sector enterprises raise important questions about "privatization" in general.

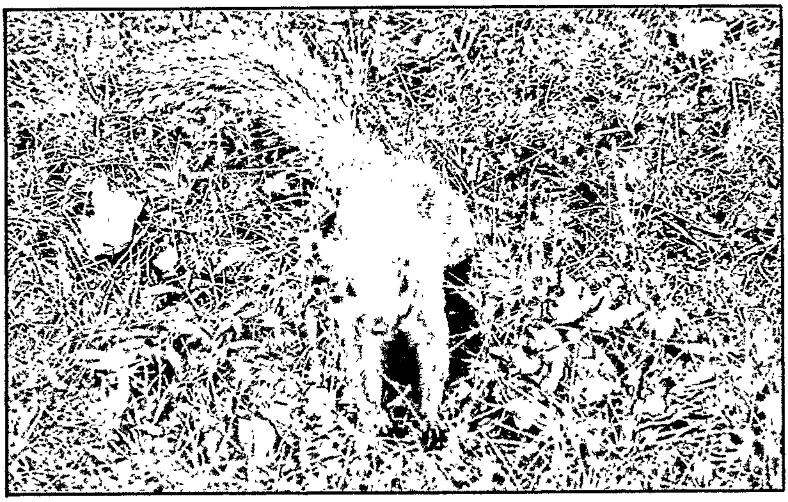
For example, J. Gordon Hanes Jr., chairman of the art museum's board of trustees, said the museum would have to raise an endowment of some $50 million in order to provide the $3.4 million it needs to operate each year. While this $3.4 million would cover the state appropriations *for operating expenses*, what about the taxpayers' money that went to build the $16-million museum building? And what about paying the state for the value of the state's art collection itself? How much would that cost?

Certainly, cost and efficiency studies involve the "privatization" issue. If the University of North Carolina system can save $10.6 million a year, as proposal number 410 says, perhaps the University should consider contracting for custodial services. But just as the art museum and symphony involve more than issues of efficiency, the custodial service involves the jobs of 769 people.

Reimbursements and finances aren't the bottom line, when addressing issues of "privatization." *The Raleigh Times* editorial framed the issue in dramatic terms. "The commission's weird logic stems from a bad case of today's fever to privatize everything that isn't nailed down and much that is. The passion to privatize has already reached the prison system [see page 11]. Maybe some corporation would like to buy the State Fair next. Or the Highway Patrol or the Raleigh Police Department. The public highways could be sold off and turned into private toll roads. And why not sell the University of North Carolina system?"

The final question—for "privatization" and for Governor Martin as he ponders whether to implement his commission's recommendations—is this: What is the proper role of government in providing certain services? Put another way, is a particular service a proper function for the public sector or the private sector?

—*Bill Finger*



Jack Betts

Strange Laws Enacted by the N.C. General Assembly

"If the law supposes that," said Mr. Bumble, squeezing his hat emphatically in both hands, "the law is a ass—a idiot."

—from *Oliver Twist*, by Charles Dickens

by Jack Betts

If only Mr. Bumble could take a look at the laws enacted by the North Carolina General Assembly and see what they suppose, he would have conniptions, the fantods, and a heavy dose of the vapors to boot. For the state's General Statutes, some of them more than two centuries old, suppose things that not even "a ass" or "a idiot" would suppose.

For instance, in North Carolina, it's a crime:

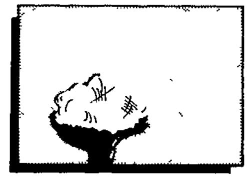
- to sell cotton lint at night;
- to hold a dance marathon or walkathon;
- to permit dogs to "pursue, worry or harass" any squirrel on the grounds of the state Capitol in Raleigh;
- to cuss aboard a passenger train (but not a freight train);
- to cuss anywhere in public, except within the counties of Pitt in the East and Swain in the West;
- to allow either a stone-horse or a stone-mule to run at large (except in the Dare County township of Hatteras);

Jack Betts, associate editor of North Carolina Insight, *has been covering dumb laws enacted by the legislature since 1977. Jody George, a former intern at the Center, assisted with research for this article. Art by Carol Majors.*

■ to speak to a student at a college for women while on school property; or

■ to allow the exhibition of a stallion or a jackass, or anything else of an unusual nature that can be exhibited, within half a mile of any place where the people are assembled for divine worship.

That's just a small sampling of the laws still on the books in North Carolina that might be reasonably construed by the average citizen as strange, unusual, far-fetched, or maybe just plain old out-and-out dumb. Some of those laws, of course, started out as serious efforts to solve a problem, prevent an incidence of unpleasantness, or perhaps simply make things better for a portion of the citizenry.



For instance, the ban on sale of cotton lint or seed by night was meant to protect the buyer and prevent fraud in the sale of cotton; the ban on dance marathons was meant to protect those indigent citizens during the Depression years from being exploited by unscrupulous dance-contest operators who might endanger the health of contestants by forcing them to dance for days on end; the law aimed at preventing harassment of squirrels on Capitol grounds was obviously

What's So Bad About Dumb Laws, Anyway?

Exactly what do the state's dumb laws say? And what's so bad about them that requires them to be repealed? Sometimes the answers to those questions are obvious. For instance, here's the precise citation and wording of a few of the choicer dumb laws, followed by the law's date of enactment.

■ "G.S. 14-200. ***Disturbing religious assembly by certain exhibitions.***
"If any person shall bring within half a mile of any place where the people are assembled for divine worship, and stop for exhibition, any stallion or jack, or shall bring within that distance any natural or artificial curiosities and there exhibit them, he shall forfeit and pay to anyone who will sue therefor the sum of twenty dollars and shall also be guilty of a misdemeanor; Provided, that nothing herein shall be construed to prohibit exhibitions at any time if made within the limits of any incorporated town, or without such limits if made before the hour of ten o'clock in the forenoon or after three o'clock in the afternoon. Any person violating any provision of this section shall be punishable by a fine not to exceed five hundred dollars, imprisonment for not more than six months, or both." Enacted in 1800.

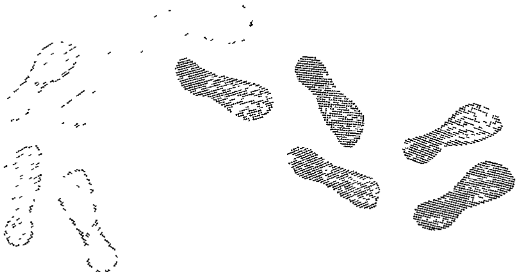
■ "G.S. 14-201. ***Permitting stone-horses and stone-mules to run at large.***
"If any person shall let any stone-horse or stone-mule of two years old or upwards run at large, he shall be guilty of a misdemeanor, and shall be fined not exceeding fifty dollars or imprisoned not exceeding 30 days." Enacted in 1907.

■ "G.S. 14-285. ***Failing to enclose marl beds.***
"If any person shall open any marl bed without surrounding it with a lawful fence, he shall be guilty of a misdemeanor, and upon conviction shall be fined not exeeding fifty dollars or imprisoned not exceeding 30 days: Provided, that this shall not apply to any person whose marl bed is situated inside his own enclosure." Enacted in 1886.

■ "G.S. 14-345. ***Sale of cotton at night under certain conditions.***
"If any person shall buy, sell, deliver or receive, for a price, or for any reward whatever, any cotton in the seed, or any unpacked lint cotton, brought or carried in a basket, hamper or sheet, or in any mode where the quantity is less than what is

—continued page 24

meant to . . . . Well, there must have been a good reason, though no one remembers what it was anymore.



North Carolina's collection of strange, silly, or stupid statutes might be broken down into several classifications. For instance, one might start with that category of well-meant—and actually necessary—laws that appear to do something other than what was intended. One might call this category *Good Laws That Sound Funny*.

For instance, there is G.S. 113-291.1(j), which declares, in its entirety: "It is unlawful to take deer swimming or in water above the knees of the deer."

—continued from page 23

usually baled, or where the cotton is not baled, between the hours of sunset and sunrise, such person so offending shall be guilty of a misdemeanor punishable by a fine not to exceed five hundred dollars, imprisonment for not more than six months, or both." Enacted in 1874.

- "G.S. 14-345. ***Digging ginseng on another's land during certain months.***
"All persons shall be allowed to dig ginseng at any time of the year for the purpose of replanting same. If any person dig ginseng, except on his own premises, or for the purpose of replanting the same, between the first day of April and the first day of September, he shall forfeit and pay the sum of ten dollars for each day's or part of a day's digging, and shall also be guilty of a misdemeanor." Enacted in 1866.

- "G.S. 14-396. ***Dogs on 'Capitol Square' worrying squirrels.***
"It shall be unlawful for any owner or keeper of a dog to permit the same to run at large on the Capitol grounds known as 'Capitol Square,' or to be thereon unless on leash or otherwise in the immediate physical control of said owner or keeper, or to pursue, worry or harass any squirrel or other wild animal kept on said grounds. Any person violating the provisions of this section shall be guilty of a misdemeanor punishable by fine not exceeding fifty dollars or imprisonment not exceeding 30 days." Enacted in 1929.

- "G.S. 39-9. ***Absence of wife's acknowledgment does not affect deed as to husband.***
"When an instrument purports to be signed by a husband and wife the instrument may be ordered registered, if the acknowledgment of the husband is duly taken, but no such instrument shall be the act or deed of the wife unless proven or acknowledged by her according to law." Enacted in 1899.

- "G.S. 73-2. ***Miller to grind according to turn; tolls regulated.***
"All millers of public mills shall grind according to turn, and shall well and sufficiently grind the grain brought to their mills, if the water will permit, and shall take no more toll for grinding than one-eighth part of the Indian corn and wheat, and one-fourteenth part for chopping grain of any kind; and every miller and keeper of a mill making default therein shall, for each offense, forfeit and pay five dollars to the party injured: Provided, that the owner may grind his own grain at any time." Enacted in 1777.

- "G.S. 76-51. ***Pay of pilots when detained by vessel.***
"Every master of a vessel who shall detain a pilot at the time appointed, so that he cannot proceed to sea, though wind and weather should permit, shall pay to such pilot three dollars per day during the time of his actual detention." Enacted in 1858.

Many of these outdated and outmoded laws would have been repealed with the passage of criminal code revision legislation that was introduced in the 1985 General Assembly.[1] Then-Rep. Timothy McDowell (D-Alamance), one of the sponsors of the bill, says the criminal code revision would have eliminated "all kinds of crazy laws" which are still on the books for no apparent reason.

But the bill got short shrift in the legislature, partly because of its length (240 pages) and partly because it was introduced

Carol Majors

in April, relatively late in the session. Before adjournment, the bill was withdrawn from the House Committee on Courts and Administration of Justice and shifted to Appropriations.

Rep. Daniel T. Blue (D-Wake), the prime sponsor of the bill, says the legislation was needed not only to update the state's criminal code, but also to repeal the outlandish laws still on the books. "Some of them are simply outmoded. They have remained on the books as a way potentially to harass people, and they should have been eliminated long ago. Some of those laws were just plain unfair."

Both Blue and McDowell say the bill was delayed largely by resistance from within the legal profession. "Chapter 14 (the criminal code of the General Statutes) needs to be recodified, but unfortunately there are a lot of old lawyers out there who don't want to learn new law and they're fighting change," says McDowell. "That's unfortunate."

Blue, an attorney himself, says his decision to have the bill sent to Appropriations "was to give the judiciary, which gave it a big chill, time to read it and allow time for some of their misconceptions to evaporate. A year's time should allow for that."

Blue says the bill remains alive in the Appropriations Committee, and vows, "You'll see it again in some shape or form." ☐

—*Jack Betts*

FOOTNOTES

[1]HB 406, "Criminal Code Revision," introduced by Rep. Dan Blue on April 9, 1985, and referred to Committee on Courts and Administration of Justice, withdrawn and re-referred to House Appropriations Committee.

Not many folks have their own deer, and fewer still would think of taking their deer to the neighborhood swimming pool or even, for that matter, of taking them wading in water above their knees. But what would be wrong with it if they did want to take their deer for a swim?

Not a thing. But this law, of course, is written in the jargon of sportsmen, and in this case the verb "take" means to "kill," although it does not say that.

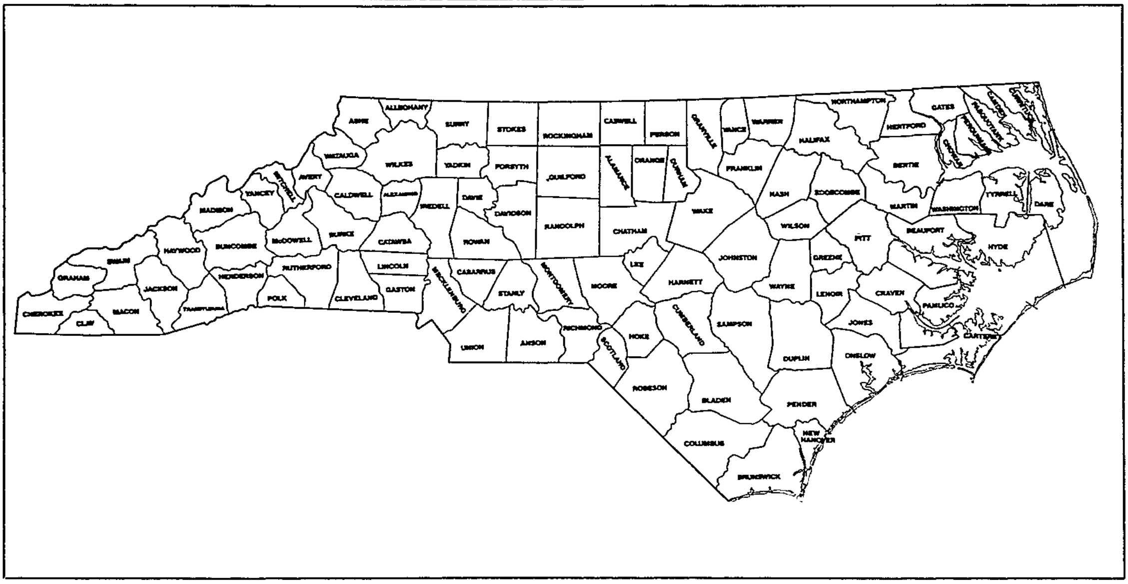
Then there is a certain category, admittedly a limited one, of laws still on the books that used to be enforced but aren't anymore because they have been struck down as unconstitutional. This category might be called *Hey, Anybody Seen My Speaker Ban?*

The lead candidate for this category surely is G.S. 14-336, commonly known as the vagrancy law. The law has been on the books since 1905, and identifies seven classes of persons who could be determined to be vagrants— and thus tossed into the pokey for up to six months. In 1969, however, in the case of *Wheeler V. Goodman*, a U.S. District Court declared the law unconstitutional and thus unenforceable. Yet it remains on the books, as useless as silk spats on a wart hog.

Then there's a certain category of state law that is quite obviously sexist, although none of the gender-based interest groups has taken up the cudgel against them. These statutes might be known as *Lady and the Tramp Laws: What Walt Disney Never Knew About North Carolina.*

The reference, of course, is to G.S. 14-338, which defines a tramp and sets a \$50 fine and up to 30 days imprisonment for anyone convicted of being a tramp (one who goes from place to place begging). However, only adult males can be defined as tramps. All females, and minors under 14, and any blind person, are exempt from the law. That appears to be a prima facie case of discrimination against adult male beggars based purely on gender. But then, others would beg to differ.

Another category of North Carolina law is that which was surely well-meant, morally



uplifting, and spiritually pure, but doesn't the legislature have anything better to do? Call this category *The Gol-Durnedest Laws in the Whole Danged State.* The leading offender in the category is G.S. 14-197, which makes it a misdemeanor to use profane or indecent language on public highways within the hearing of two or more persons, save within the counties of Pitt and Swain.

This particular law was the object of a lively debate in the 1973 General Assembly, when then-state Rep. Herbert Hyde (D-Buncombe) rose to argue against legislation that would eliminate the exemption for Swain County. Hyde, a remarkable orator and gifted lawyer, advised his colleagues that the law was "obviously unconstitutional," but said the good people of Swain County didn't like legal nitpicking and wouldn't want him to "stand on that kind of technicality and I'm not going to do that."

Rather, said Hyde, "There ought to be a refuge somewhere, where a man could go and when he really is provoked that he can say something with impunity. There's only two places left—Pitt and Swain. One in the East and one in the West. I think that's most appropriate."

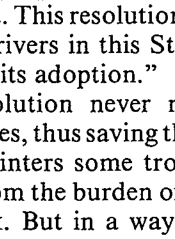
Hyde's speech carried the day, and that's why today it's still legal to cuss in only two counties. In the other 98 of North Carolina's 100 counties, watch what you say.

Then there's a special category of legislative foolishness that doesn't show up on the General Statutes, but which takes up legislative time and money and confirms the low opinion that some folks have of the legislature. It might well be called *Why Do We Put Up With This Truck?* The major suspect in this field is Senate Resolution 861, adopted in the North Carolina Senate on May 14, 1979, entitled "A Senate Resolution Honoring A Remarkable Pulpwood Truck."

The resolution described the pulpwood truck owned by former Sen. Joe Palmer (D-Haywood) which apparently violated most safety laws and which had figured prominently in a number of Senate debates over improving vehicle safety. The resolution said, "Section 1. The old pulpwood truck of Sen. Joe H. Palmer is hereby declared to be an item of State Historic Property, and is hereby proposed for entry in the National Registry of Historic Property, in sincere hope that entry into said Registry will get such a vehicle, which has questionable adherence to North Carolina motor vehicle laws, special attention from the people of the State of North Carolina so that they can stay out of the path of this particular pulpwood truck.

"Section 2. This resolution, in the interest of safety to all drivers in this State, shall become effective upon its adoption."

That resolution never made it into the General Statutes, thus saving the taxpayers some money, the printers some trouble, and drivers everywhere from the burden of watching out for Palmer's truck. But in a way, it's a shame the resolution didn't become a law. It would have had so much good company amongst all the other dumb laws of the state of North Carolina.☐



And If You Think North Carolina's Dumb Laws Are Dumb . . . .

You're right. But North Carolina is in good company. Every other state in the union has its share of stupid statutes, too. Here's an incomplete, highly selective, but absolutely straightforward list that *North Carolina Insight* has compiled (from a long list of reliable sources) of dumb laws that have been in effect at one time or another. They've been enacted by every sort of governing body from small-town aldermen to big-city councilmen, from county commissioners to state legislators. And they all have one thing in common: They're either dumb, or they at least *sound* dumb.

For instance:

In Brooklyn, it's illegal for donkeys to sleep in the bathtub.

In Youngstown, Ohio, it's against the law for cabbies to transport passengers on the roof of a taxicab.

In Berkeley, Cal., it's illegal to whistle for an escaped bird before 7 a.m.

In Erie, Pa., falling asleep in a barber chair while being shaved is against the law.

In Mexico, Mo., it's a crime for female jury members to knit while hearing evidence in a trial.

Those are among the dumb laws that *Parade Magazine* turned up a few years ago.

Student Lawyer magazine has its own list of favorites. Among them:

It's against the law to carry an unwrapped ukulele on the streets of Salt Lake City.

It's a crime for dead jurors to serve on juries in Oregon.

It's illegal to mistreat oysters in Maryland.

In Chicago, thanks to the efforts of one alderman who happens to own a large flower shop, it's illegal for street peddlers to peddle flowers.

In St. Louis, it's illegal to peddle ice cream within 100 feet of a church, a hospital, or a school—at least while classes are in session.

And in Boston, it's illegal for anyone, other than a registered voter, of course, to take sea worms within the city limits.

Not to be outdone by its capital city ordinance-makers, the state of Massachusetts has a law *requiring* each mayor in the state to "annually appoint two or more fence viewers, to hold office for one year and until their successors are qualified."

In nearby Vermont, it's illegal to paint or to disguise a horse. Not only that, but it's illegal to allow rams to "go at large" 'twixt August 1 and December 1 of any year.

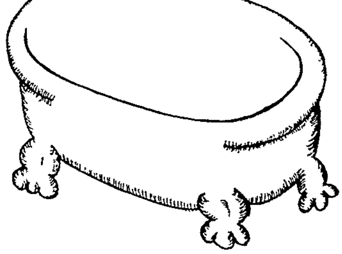
Then there's the compilation of silly statutes bound in a hilarious book entitled *The Trenton Pickle Ordinance And Other Bonehead Legislation.* The Trenton Pickle Ordinance declares it unlawful for anyone to throw tainted pickles in the street.

Perhaps acting on Trenton's leadership, other cities have boldly adopted their own pickle ordinances. For instance, Los Angeles prohibits pickle-making anywhere in the city that its aroma might offend the delicate nostrils of passers-by. Connecticut, on a binge of consumer mindedness, made it illegal to sell a pickle which, when dropped 12 inches, collapses upon itself in its own juice. Much better, the law admonishes, that the pickle "remain whole and even bounce." Oh. In Central Falls, R.I., it's against the law to pour pickle juice on car tracks.

And finally, in Kentucky, state law requires that every person must take a bath at least once a year.

Whether they need it or not, one presumes. □

—Jack Betts



DATE OF LOAN	CASH TO BORROW	NF INS PREM	LF INS PREM	A & H INS PREM	CASH ADVANCED	ESTIMATED INTEREST	ESTIMATED TOTAL OF PAYMENTS
10/ 3/85	$ 695.13	$ 0.00	$ 16.90	$ 42.24	$ 754.27	$ 301.73	$ 1056.00

DISCLOSURES REQUIRED BY FEDERAL LAW

ANNUAL PERCENTAGE RATE	FINANCE CHARGE	AMOUNT FINANCED	TOTAL OF PAYMENTS
The cost of my credit as a yearly rate 34.65 %	The dollar amount the credit will cost me $ 301.73	The amount of credit provided to me or on my behalf $ 754.27	The amount I will have paid if I have made all payments as scheduled $ 1056.00

MY PAYMENT SCHEDULE will be

FIRST PAYMENT DUE DATE	OTHER PAYMENTS ARE DUE THE SAME DAY OF EACH MONTH	NUMBER OF PAYMENTS	AMOUNT OF EACH PAYMENT	FINAL PAYMENT DUE (Maturity Date)	Final Payment Equal In Any Case To Unpaid Principal and Interest
11/ 3/85		24	$ 44.00	10/ 3/87	

SECURITY: You are giving a security interest in: / HOUSEHOLD GOODS
☐ your automobile ☐ your household goods ☐ the goods or property being purchased
☐ your real estate located at
☐ other property:

PREPAYMENT: If you pay off early, you will not have to pay a penalty. If you pay off early you may be entitled to a part of the finance charge (except when a real estate mortgage is given as security)

☐ ASSUMPTION (applicable only if a real estate mortgage is given as security) Someone buying your real estate cannot assume the remainder of the mortgage on the original terms unless the creditor agrees in writing to the assumption. See your contract documents for any additional information about nonpayment, default, any required repayment in full before the scheduled date, prepayment refunds, penalties, and security interests. "E" means an estimate

STATEMENT OF LOAN

$ 1056.00 Estimated Total of Payments

$ 301.73 Less. **FINANCE CHARGE** (Total Estimated Interest Charge to become due)

The Finance Charge as shown above, which is included in the Total of Payments, is the total amount of interest which will become due on this loan based upon the assumptions that the loan will be paid to maturity and that all installment payments will be made on the dates they are due

$ 754.27 Amount Financed

The Amount Financed will be disbursed to or for Borrower as follows.

$ 16.90 Credit Life Insurance Premium

$ 42.24 Credit Accident and Health Insurance Premium

$ 0.00 Non-Filing Insurance Premium

$ 0.00 GROSS BALANCE (OLD LOAN)

$ 0.00 LESS REFUNDS

$ 0.00 NET BALANCE (OLD LOAN)

$ 59.14 TOTAL DISBURSEMENTS

$ 695.13 CASH TO BORROWERS

Borrowers authorize Lender to disburse proceeds of the loan in the manner set forth in this Disbursement Schedule

34.65 % **ANNUAL PERCENTAGE RATE**

"NOTICE — The Federal Equal Credit Opportunity Act prohibits creditors from discriminating against credit applicants on the basis of sex or marital status. The Federal agency which administers compliance of this law concerning the office to which you are applying for credit is the Federal Trade Commission, 730 Peachtree Street, N.W., Atlanta, Georgia 30308."

INSURANCE

The purchase of Credit Life or Credit Accident and Health Insurance is not required by Lender in order to obtain a loan. Borrower, however, having first examined the cost of such insurance, does hereby voluntarily elect to purchase the following insurance coverages

Cost

$ 16.90 ☒ Credit Life Insurance

$ 42.24 ☒ Credit Accident and Health Insurance

Date 10/ 3/85 ________ (INSURED)

INSURANCE AGAINST LIABILITY FOR BODILY INJURY OR PROPERTY DAMAGE TO OTHERS IS NOT INCLUDED IN THIS TRANSACTION

DESCRIPTION OF COLLATERAL GIVEN AS SECURITY

Lender has acquired a security interest in the above described property to secure the obligations of Borrower to Lender as contained herein. It is agreed that future advances in the form of extensions or renewals of the above indebtedness may be made to Borrower and the same shall be secured thereby

PROMISSORY NOTE: For value received, the undersigned jointly and severally promise to pay to the order of Lender named above at its office, the actual amount of the loan (amount financed), it being the principal amount of this note, together with a Finance Charge (interest) at rates not exceeding three percent **(3%)** per month on that part of the unpaid principal balance of any loan not in excess of six hundred dollars **($600.00)** and one and one-quarter per cent **(1¼%)** per month on any remainder of such unpaid principal balance not exceeding three thousand dollars **($3000.00)**, as permitted by and in accordance with the North Carolina Consumer Finance Act. The Finance Charge is computed on the basis of the number of days actually elapsed, a month shall be that period of time from one date in a month to the corresponding date in the following month, but if there is no corresponding date, then to the last day of such following month, a day shall be one-thirtieth of a month where computation is made for a fraction of a month.

The principal sum and the interest accrued thereon shall be due and payable in consecutive monthly installments as indicated above; and each installment shall be credited first to the payment of accrued interest and then to principal. Interest after maturity shall be at the rate of eight percent (8%) per annum. Borrower may prepay this note at any time without penalty.

Each of the undersigned, whether principal, surety, endorser or guarantor jointly and severally waive demand and presentment for payment, notice of nonpayment, notice of protest of this note, and agree that the time of payment of principal and/or interest hereof may be extended from time to time without notice to any of them and without thereby releasing any of the rights of security interests of the Lender or its assigns.

Any default in the observance of the terms of this Note, or default in the terms of any condition contained in the security agreement set forth on the reverse side hereof, shall at the option of the owner and holder of this Note, and without notice or demand, cause the entire unpaid principal balance and all accrued interest due thereon to become immediately due and payable ... the Borrower by Lender ...

In cons... of the credit this day extende...

To your credit or to your debt?

Credit Insurance

The credit insurance system involves a complex relationship among consumers, the insurance industry, and lending institutions (banks, auto dealers, small loan companies, and merchants). A consumer buys credit insurance from a lender as part of a loan or installment purchase. The lender sells the credit insurance policy for an insurance company, functioning like an insurance agent. For making this sale, the lender receives about 50 percent of the premium price as a commission. This commission system results in credit insurance rates at the maximum rates allowed. Since 1975, these rates have been specified in state law. Before 1975, the commissioner of insurance regulated the rates.

Insurance is regulated at the state level. Among the 50 states, North Carolina ranks ***last*** *in the portion of credit insurance premiums used to pay off policy claims. A combination of factors have resulted in this ranking, including who sells and buys this insurance, how high the rates are, and who regulates the rates. How can these factors be adjusted to bring North Carolina in line with the rest of the country?*

by Bill Finger

His chair squeaks as the credit manager turns to his adding machine. He murmurs over your credit application, making notations beside your net worth column. You look at the pictures and plaques on the wall and nervously concentrate on being at ease.

You want what this money will buy, your first new car. You have driven a bargain with the salesperson, contingent of course upon your credit report, and you've mustered your nerve to talk eyeball to eyeball about interest rates. Your spouse is beside you, holding your hand in excitement, on the verge of a major new purchase. The credit manager's approval—plus a stack of papers to sign—are the only things standing between you and driving your new car out of the lot.

The credit manager completes his calculations and swivels back to face you. "Good news. You get your loan." Then the phone starts ringing for the third time since the cubicle door closed on you. Grabbing his coffee cup, the manager adds, "If you want credit insurance with your loan, you sign here."

You shuffle through the forms, wondering what they mean. You see the monthly payment figure he quoted earlier, with check marks for your signature. You stare at the long forms with tiny print, sweat dripping down the small of your back. The manager swings back, off the phone again.

"Got your John Hancock on all those lines?" he asks with a swift smile, standing up and reaching for the door. You and your spouse finish the job. The breeze from the large reception area welcomes you away from the forms and into your new car. Driving home, you're not thinking about what you just bought with that last signature on the credit forms. You are like most consumers who borrow money for a new car, new living room furniture, appliances, or your child's college education. You don't read the fine print on your loan application forms—the part about credit insurance.

The credit insurance system involves a complex relationship among consumers, the insurance industry, and lending institutions—banks, auto dealers, small loan companies, and others. A consumer can buy credit insurance with a loan or an installment sale. The lender, also called the creditor, sells the insurance to the consumer, known as the debtor. The lender buys the insurance for all his customers in a package, usually from a single insurance company. For selling the insurance policy to the customer, the lender gets a commission, much like an insurance agent.

The subtleties of this multi-level system receive little day-to-day regulatory oversight in North Carolina. Since 1975, the maximum rates that lenders can charge have been included in the statutes, not set by the commissioner of insurance. The commissioner sets the rates for other regulated lines of insurance. While the statutes specify *maximum* rates, these amounts are usually the *standard* rates.

"The majority of credit (life insurance) business is written at 80 cents (per $100 of insurance per year), the statutory rate," says Dan Boney, senior vice-president, Durham Life Insurance Company. "There's not competition to force the rates down. The competition comes in the services provided and the commissions paid by the insurance companies to the creditors."

Only five other states have credit life insurance rates higher than North Carolina—Alabama, Louisiana, Mississippi, Oklahoma, and South Carolina (see Table 1). Moreover, North Carolina has the nation's lowest "loss ratio" (tied with South Carolina), according to the National Association of Insurance Commissioners—29.67 percent (see Table 2). To explain "loss ratio" simply, companies paid out an average of only 29.67 cents in claims and related expenses for every dollar of premiums earned on credit insurance policies.

Another way to think of a loss ratio, from a consumer's point of view, is a "payback ratio"—i.e., measuring the ratio in terms of what is "paid back" to the consumer, not "lost" by the insurer. In other words, North (and South) Carolinians got less for their credit insurance dollar than did people in any other state, about 30 cents for

Carol Majors

every dollar. In 1986, the maximum credit life insurance rate in South Carolina will drop from $1.00 to 85 cents per $100 of insurance; this will effectively raise the state's loss ratio above that of North Carolina.

"Credit insurance is etched in stone," says William Hale, deputy commissioner of insurance and head of the department's legal division. "The rate levels are spelled out in the statutes. There's nothing we can do about it."

In neighboring Tennessee, a similar situation existed in 1979 when the newly elected governor, Lamar Alexander (a Republican), took office. Alexander appointed John C. Neff as Tennessee Commissioner of Commerce and Insurance. After a five-year crusade against high credit life insurance rates, Neff succeeded this year in getting the Tennessee rates reduced from 75 cents to 66 cents per $100. But more importantly, says Neff, the legislature transferred authority for establishing credit insurance rates from the legislature to the commissioner, effective in 1989.

"Credit insurance is the biggest known ripoff since the beginning of time," says Neff, a Republican. "There's no reason why Tennessee citizens should be charged a price by the legislature that rips off the public. We pointed out to the public that we had a 32 percent loss ratio in this state (for credit insurance). Under auto and homeowners, (the loss ratio) was about 65 percent or higher. And health insurance can run up as high as 90 percent."

North Carolina has a situation similar to that of Tennessee. The rates are high and are controlled by the legislature. In 1985, newly elected Commissioner of Insurance Jim Long took office, ending the stormy 12-year tenure of John R. Ingram. The question is whether Long will choose—or be able—to work towards lowering the credit insurance rates in North Carolina. State legislatures set credit insurance rates in only nine states, including North Carolina and Tennessee.[1] Will North Carolina remain in this small minority of states? More importantly, will North Carolinians continue to get the smallest return in the country for their credit insurance dollar?

What is Credit Insurance?

There are three types of credit insurance—credit life, credit accident and health, and credit property insurance. Lenders (i.e., creditors) sell credit insurance to consumers. The policies last for the term of the loan, and policy benefits go first to the creditor to pay off the debt. Consumers benefit primarily by having the debts paid off to the creditor, the "first beneficiary." Occasionally, a borrower's "secondary beneficiary" (a spouse, for example) will also receive some cash payments.

Table 1. Credit Life Insurance, States with the Ten Highest and Ten Lowest Rates, 1984

States (Ranked by Highest Rate)	Rate (per $100 coverage)[1]		States (Ranked by Lowest Rate)	Rate (per $100 coverage)[1]	
1. Alabama	$1.00	(tie)	1. Wisconsin	$ .40	
Louisiana	1.00	(tie)	2. California	.40 - .50	
South Carolina	1.00	(tie)	3. New Hampshire	.42 - .47	
4. Mississippi	.90		4. Arizona	.44	
5. Oklahoma	.85		5. New Jersey	.44 - .64	
6. **North Carolina**	.80		6. Vermont	.44 - .70	
7. Arkansas	.75	(tie)	7. Utah	.49	
Georgia	.75	(tie)	8. Washington, D.C.	.49	
North Dakota	.75	(tie)	9. Connecticut	.50	(tie)
Tennessee	.75	(tie)	Massachusetts	.50	(tie)
			Rhode Island	.50	(tie)
			Texas	.50	(tie)
			Wyoming	.50	(tie)

FOOTNOTE

[1]Rates shown are maximum allowed rates, either by statute or regulation. Some states show a range of rates because the state has different rate structures for different classes of creditors. California, for example, has five classes of creditors.

Table prepared by Marianne Kersey

Source: The Cost of Personal Borrowing in the United States, Financial Publishing Company, Publication No. 830, January 1984, with loose-leaf updates (varying dates for different states), Part VII, page 55ff.

Credit life insurance functions essentially as a term life insurance policy. "Term life" refers to a life insurance policy that covers a specified period of time; a couple often buys term life policies to cover their childraising period. Unlike standard term life policies, almost all credit life policies decrease in face value as the outstanding balance on the loan declines. If a borrower (i.e., debtor) dies during the term of a loan, a credit life policy pays the lender the balance of the loan in a lump sum. Credit life policies for "single" life coverage cost 80 cents per $100, per year. "Joint" life policies, which cover both husband and wife, cost $1.33 per $100.[2]

> *"Credit is a matter so subtle in its essence, that, as it may be obtained almost without reason, so, without reason, may it be made to melt away."*
>
> *—Anthony Trollope*

Term life policies are generally less expensive than credit life policies, according to the N.C. Department of Insurance. While term life and credit life are similar, there are two important distinctions. First, term life policies are based on age; credit life policies are not. Second, term life policies are "underwritten to eliminate bad risks," says Boney of Durham Life. Usually, anyone can purchase a credit life policy.

Credit accident and health insurance is essentially a disability policy for the borrower. It pays the creditor in the event a borrower becomes disabled during the life of the loan and thus cannot pay his debt. A number of types of credit accident and health (A&H) insurance are available, depending upon the number of retroactive days the policy will cover and other variables. For 12-month coverage, a 14-day retroactive policy costs $2.42 per $100 of insurance, the 11th highest rate in the country (see Table 3).[3]

Credit property insurance is the most recent type of credit insurance to develop. If the collateral for the loan is damaged during the life of the loan, credit property insurance pays a lump sum benefit to the lender equal to the

Table 2. Credit Life and Accident and Health Insurance, States with Ten Highest and Ten Lowest Loss Ratios, 1983 (Premiums and Losses in thousands of dollars)

State (Ranked by Lowest Loss Ratio)	Earned Premium	Incurred Losses	Loss Ratio	
1. **North Carolina**	$112,701	$33,442	29.67	(tie)
South Carolina	58,553	17,373	29.67	(tie)
3. Mississippi	41,055	12,213	29.75	
4. Minnesota	52,703	16,026	30.41	
5. Alabama	65,378	20,038	30.65	
6. Arkansas	18,899	5,994	31.72	
7. Louisiana	94,618	30,624	32.37	
8. South Dakota	10,376	3,361	32.39	
9. Oklahoma	49,521	16,235	32.78	
10. North Dakota	11,177	3,685	32.97	

State (Ranked by Highest Loss Ratio)	Earned Premium	Incurred Losses	Loss Ratio
1. Maine	$ 11,241	$ 7,871	70.02
2. New York	116,296	76,483	65.77
3. West Virginia	36,711	22,183	60.43
4. Washington, D.C.	2,258	1,314	58.19
5. California	149,612	85,867	57.39
6. Pennsylvania	148,102	83,381	56.30
7. New Jersey	59,031	31,323	53.06
8. Maryland	37,715	19,907	52.78
9. Michigan	96,059	49,972	52.02
10. Vermont	5,168	2,681	51.88

Source: National Association of Insurance Commissioners, September 1984, the latest published data.

Table prepared by Marianne Kersey

Table 3. Credit Accident and Health Insurance Premium Rates, States with the Ten Highest and Ten Lowest Rates, 1984

States (Ranked by Highest Rate)	Rate (per $100 coverage)[1]
1. New York	$3.15
2. California	3.00 - 2.43
3. Rhode Island	2.74
4. Kentucky	2.69
5. Oregon	2.65
6. West Virginia	2.65 - 2.30
7. New Hampshire	2.64 - 1.90
8. Michigan	2.61 (tie)
North Dakota	2.61 (tie)
Hawaii	2.61 (tie)
11. North Carolina	2.42

States (Ranked by Lowest Rate)	Rate (per $100 coverage)[1]
1. Vermont	$1.54 - 2.37
2. Arizona	1.82
3. Utah	1.84
4. New Hampshire	1.90 - 2.64
5. South Dakota	1.98
6. Maryland	2.00 (tie)
Nebraska	2.00 (tie)
New Jersey	2.00 (tie)
South Carolina	2.00 (tie)
10. Pennsylvania	2.13

FOOTNOTE

[1]Rates shown are maximum allowed rates, either by statute or regulation, chosen under a 12 month term, 14-day retroactive policy, a standard used in virtually all states. Some states show a range of rates because the state has different rate structures for different classes of creditors. This appears confusing in the case of New Hampshire, which appears in both lists above. New Hampshire has four classes, including a rate of $2.64 for finance companies and $1.90 for banks and motor vehicle dealers.

Source: The Cost of Personal Borrowing in the United States, Financial Publishing Company, Publication No. 830, January 1984, with loose-leaf updates (varying dates for different states), Part VII, page 55ff.

Table prepared by Marianne Kersey

amount of the damage or the amount outstanding on the loan. The collateral can be the property financed by the loan or some other property, such as a piece of art. Credit property insurance usually accompanies small loans for furniture or other household property. But traditional physical damage insurance covers loans for automobile purchases, not credit property insurance. Rates for credit property insurance range from $1.00 to $1.50 per $100 of coverage per year, depending upon the type purchased.[4]

National comparisons of credit property rates are difficult because of various reporting systems. In North Carolina, for example, the Department of Insurance reports aggregate data on credit life and A&H policies, but the N.C. Banking Commission's annual report contains the best data on credit property policies.

Credit insurance provides a benefit to the lender and to the borrower. For the lender, this insurance guarantees payment of a loan even though a debtor has died or become disabled, or the collateral has been damaged—events that could make a loan difficult to collect. Originally, lenders—not insurance companies—developed this form of insurance and did not charge their customers for that service.

From its beginning in 1937, for example, the State Employees' Credit Union provided credit life insurance at no cost on loans to its members. "It was not free, but the membership absorbed the cost," says R. S. "Bobby" Hall, executive vice-president of the credit union. In 1983, the cost reached $600,000, explains Hall. "We decided we had to have specific pricing for specific services, including fees for some checking accounts and for credit life policies." The credit union, today with 200,000 members, asked for bids and took the lowest one, from Pilot Life Insurance Company.

> *"Creditors have better memories than debtors; and creditors are a superstitious sect, great observers of set days and times."*
>
> *—Benjamin Franklin*

Consumers also benefit from credit insurance. It can cushion the financial strain caused by death, disability, or damage to the collateral.

This is especially true if the borrower does not carry life insurance, disability insurance, or property damage insurance.

"It's a comforting feeling that if Mr. Jones gets hit by a car, Mrs. Jones will not have to pay off his loan," says Tennessee Commissioner Neff. "(Credit insurance) is a socially desirable product."

Not only is it desirable, it also is big business. In 1984, North Carolina consumers paid $139 million dollars in credit life and A&H insurance premiums. Yet they received only $40 million in benefits.[5] Of the $139 million collected in premiums, about half went to the insurance companies to cover claims, expenses, and profits. The other half, *some $69.5 million, went to the lenders* who sold the policies, as their commissions. The lenders also benefited through the $40 million in benefits; these benefits paid off loans which might have been difficult to collect without the life and A&H credit insurance coverage.

Normal free-market competition results in ***lower prices****; the credit insurance commission system results in* ***higher prices.***

Credit insurance can be a "socially desirable product" or "the biggest ripoff since the beginning of time," as John Neff puts it. Four distinct, yet related, variables determine at which point on Neff's spectrum a credit insurance policy would fall—who sells it, who buys it, how high the rates are, and who regulates it.

Who Sells Credit Insurance?

Banks, auto dealers, mobile home dealers, small loan companies, and other lenders sell credit insurance, functioning in essence as insurance agents. These lenders do not have to be licensed as insurance agents in North Carolina. A 1975 statute exempts them: "The enrollment of debtors under a group policy issued to a creditor and authorized under this Article shall not constitute the issuance of a policy of insurance."[6]

"Those people ought to be licensed because they are selling insurance," says Fran DiPasquantonio, an attorney with the N.C. Department of Insurance. "They aren't enrolling someone into an employee benefit plan. Nobody regulates them. Who is going to hold them responsible? The department needs to control these salesmen."

Industry officials do not agree with the assessment by DiPasquantonio. "The industry believes the current statutes provide sufficient regulatory authority over the industry," says Boney of Durham Life.

Lenders usually sell credit insurance at the maximum rate allowed by the North Carolina statutes, 80 cents per $100 for credit life policies. "I would think that's the prevailing rate for credit life," says Wade Isaacs, executive vice president of the North Carolina Automobile Dealers Association. For selling the insurance, the lender gets a commission from the insurance company that holds the policy. The higher the price for the insurance, the higher the commission the lender will receive.

"It's generally acknowledged that a creditor, the agent selling the insurance, can make at least 50 percent on the sale," says James C. Gulick, director of the consumer protection section of the N.C. Attorney General's Office.

Asked if he agreed with the figure, Wade Isaacs answered, "Fifty percent sounds about right."

The higher the price, the more money the lender makes. This results in two important phenomena. First, insurance companies compete to offer the *most expensive* policies to lenders in an effort to get the lenders to sell their policies. The National Consumer Law Center and others call this process "reverse competition." Normal free-market competition results in *lower* prices; the credit insurance commission system results in *higher* prices.

Second, since a lender makes a commission of some 50 percent on every policy, there is a tremendous incentive to sell credit insurance. Credit insurance, by the nature of the product, is sold in conjunction with credit transactions.

The federal "truth-in-lending" law offers some protection from "tying" the purchase of credit insurance to the approval of a loan or an installment sale.[7] This law requires the creditor 1) to give a written disclosure that the credit insurance is not required, and 2) to obtain a separate signature of the consumer authorizing the credit insurance to be included with the transaction. If the creditor fails to do this, then the credit insurance must be included as part of the finance charge. This increases the interest rates that the creditor has to disclose and reduces the amount of other interest charges that the creditor can charge.

"North Carolina law goes even further," says Gulick. Consulting a number of statutes related to consumer loans, finance issues, and insurance, Gulick explains that the additional protections under state law are complicated and interrelated. For example, "Under state law, it is explicitly illegal to require credit life, accident, health, or loss-of-income insurance as a condition of a *consumer credit sale*," says Gulick,

"Private credit is wealth."
—Junius
(Nom de plume of an 18th Century letterwriter opposed to the policies of King George III)

distinguishing between a credit sale and a direct loan.[8] "In any event, requiring such insurance without including its cost in the finance charge violates the federal truth-in-lending law."

Despite the protections of the federal and state laws, Gulick says there is some illegal coercion to buy credit insurance in North Carolina. "Based on the complaints we have received, such illegal coercion is a live problem," says Gulick. The consumer protection section did not keep a log of complaints by category in the past, so there is no way to determine the number of such complaints, says Gulick. "But we intend to see how widespread the issue is. It's up to the state to put up or shut up on this issue. And we intend to put up."

While these legal protections are significant, *Consumer Reports* magazine recommends that the truth-in-lending law "should be amended to require that the cost of credit insurance be reflected in the finance charge, whether or not the insurance is bought voluntarily. Consumers would then be made aware of the true cost of credit from different lenders." [9] The 1979 magazine report links its proposal to the issue of reverse competition. "Such a provision would also give banks, car dealers, and finance companies incentive to shop for an insurance company that will sell credit insurance inexpensively rather than for a company promising the highest sales commission."

Since no such provision exists in the federal law, commercial lenders in most states, including North Carolina, generally sell credit insurance at the maximum rate allowed in the state. A significant exception to this pattern is the price of credit insurance purchased through credit unions, which are nonprofit lenders. The State Employees' Credit Union, for example, currently offers a credit life policy for 39 cents per $100 of insurance, compared to the 80-cent rate offered by most banks, auto dealers, and other lenders. The credit union does not subsidize that rate. It can sell at such a low rate because it took the *low* bid offered by insurance companies for its credit business, not the *high* bid, which commercial lenders take. The credit union charges only enough commission to cover its administrative costs.

Consumers who do not belong to a nonprofit credit union, however, must cope with the reality of 50 percent commissions and pricing by reverse competition. "There is a great profit incentive to sell it," says Gulick. "When there's money to be made, some people are not willing to live within the rules. And the more money, the greater the temptation."

Who Buys Credit Insurance?

Credit is sold to a captive market—those persons borrowing money or making an installment purchase. A consumer can buy credit insurance only through the creditor making the loan. Credit insurance *per se* is not available through regular insurance agents. (Conceivably, a person *could* borrow money from one lender and purchase credit insurance from a second lender; as a practical matter, this rarely, if ever, happens.)

In 1984, small loan companies made *118,500 loans* of $3,000 or less; *97 percent of these loans included credit life insurance,* according to the North Carolina Banking Commission. In addition, 92 percent of these loans included credit accident and health insurance.[10] The same year, so-called "small" loan companies made *330,800 loans* of $10,000 or less; 85 percent of these loans carried credit life policies and 61 percent included credit A&H policies.[11]

No data is available on the percentage of loans by North Carolina bankers and auto dealers that include credit insurance. Various surveys are available on national percentages, however. For example, a 1979 Federal Reserve Board marketing study found that when banks loaned money, credit insurance was included with 60 percent of the loans for new cars, 66 percent for used cars, 61 percent for durables and recreation, 59 for personal loans, and 56 percent for home additions and repairs.[12]

These figures show only one side of the coin, the percentage of those who bought credit insurance. What about the other side, the percentage *who know whether they bought this insurance*? "It's commonly alleged that consumers are browbeaten into buying credit insurance," says *Consumer Reports*. "The credit insurance industry denies the allegation."

Determining where the truth lies is difficult. Several surveys do speak to the issue, however. In a 1977 Federal Trade Commission survey, 2,004 consumers responded on the credit insurance issue. Nearly half of the respondents (45 percent) said they did not understand that they did not have to buy it. Of those who bought credit insurance, 41 percent said they wanted it, but 31 percent said they were "given the impression that it was required to obtain the loan." Another 8 percent said they were told "it was required to obtain the loan," and 7 percent said they "thought it would improve my chances of getting the loan."[13]

Virtually all analysts agree that low-income persons generally purchase credit insurance more often than do other income groups. This is true for two reasons. First, higher income persons have more adequate insurance portfolios. For example, homeowners fire insurance policies of any significant size almost always contain a personal property section. With such a policy, credit property insurance would not be needed on a furniture or appliance installment purchase. Similarly, higher income persons are more likely to have substantial life insurance policies, including term policies. Consequently, such persons would tend to rely on their existing life insurance policies to cover debts in case of death, not a credit life policy.

Secondly, higher income persons are more likely to understand the credit insurance transaction. In an intimidating setting with long forms and small print, credit insurance is difficult to understand. Generally, middle-income and high-income groups are more educated consumers of insurance. For example, those persons who have priced term life insurance policies through traditional insurance agents will realize that credit life policies are not as good a buy as regular term life policies (more on this comparison below).

The fact that low-income persons buy credit insurance more often than other groups is not necessarily bad. In fact, credit insurance offers protections to low-income groups which might be proportionately much more valuable to them than to other groups. Without property insurance on personal belongings, without disability insurance, and without term life policies, low-income persons might well benefit from credit insurance. But the value of credit insurance depends upon fair prices.

How High Are the Rates?

Explaining exactly how much a person spends for credit insurance is difficult because of the many variations in the length of the loan, the interest rate of the loan, and other factors. But understanding a few key parts of the credit transaction, together with some specific figures, will illustrate what a significant part of a credit transaction that credit insurance can be.

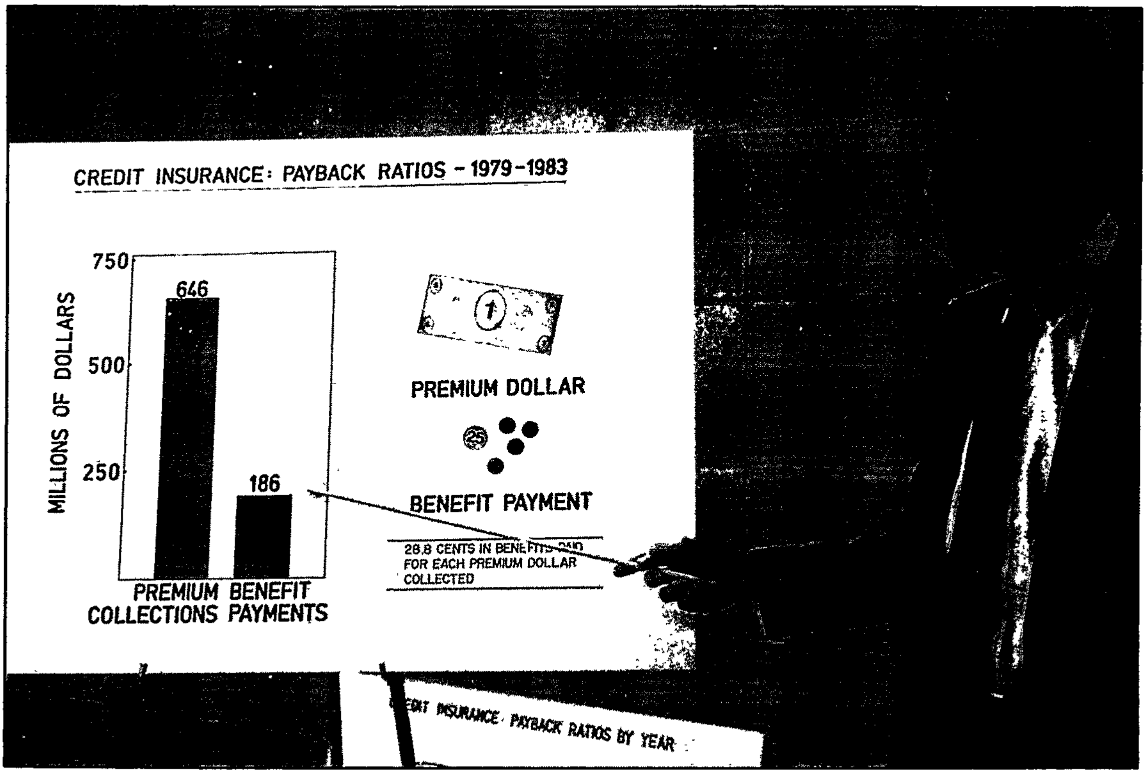
First, credit insurance policies can vary extensively in total cost, depending upon the length of time of the loan and the amount covered by the policy. To some extent, this is self-evident. The larger the loan and the longer the loan period, the higher the cost of credit insurance. But this point is not as simple as it looks.

"A $500 loan for six months with a 50-cent-a-month charge (for credit insurance) is a different ball game than a four-year loan for a car or mobile home," says Duke University Professor Joel Huber. Credit insurance on such small, short-term loans makes credit more available to people, says Huber, who has conducted polls for Montgomery Ward and other retailers. The amount of credit insurance on such small loans does not seem offensive to the buyer, adds Huber (see article on page 43 for more).

Mike Calhoun, an attorney with N.C. Legal Services, points out, however, that small loan companies include credit insurance on their loans far more frequently than do banks and auto dealers, which generally lend the larger amounts of money. "Even for a relatively small loan, the additional charge for insurance is substantial when all three types of credit insurance are included," says Calhoun. For example, consider a person who borrowed $3,000 at 21 percent for three years. If the loan had all three kinds of credit insurance, the total additional charge for credit insurance would be $720, calculates Calhoun, or *24 percent of the loan amount itself.*

Another critical point to note is that in most cases, the *total* of the credit insurance premium must be paid in advance for the entire life of the loan. If you can't pay the premium, you borrow it. Hence, you borrow money for the purchase or loan amount *and* for the entire cost of credit insurance.

For example, if you add credit insurance to a four-year, $10,000 loan at 15 percent to purchase a new car, you would have to pay $596.65 for credit life insurance, as shown below. The calculation assumes the maximum 80-cent rate is charged.[14]



N. C. Legal Services attorney Mike Calhoun makes presentation before 1984 Credit Insurance and Interest Rates Study Commission.

Credit Life Premium	$446.66*
Extra Interest Charged on This Premium *(premium is added to loan amount)*	149.99
Total Charge for Credit Life	$596.65

(*$223.33 to the lender as commission, assuming a 50 percent rate.)

Spending nearly $600 for credit life coverage on a $10,000 loan may seem like a lot. But the cost seems even higher when comparing credit life coverage to a traditional term life insurance policy. In 1981, James H. Hunt, a consulting actuary and former commissioner of insurance for Vermont, developed such a comparison. He found that a person 40 or 45 years old could purchase far more coverage through a traditional term life policy. Regular term life coverage remains at a constant level over the life of the policy while credit life policies decrease to cover only the outstanding loan (principal and interest). A 40-year-old, for example, could buy more than twice as much coverage through a traditional policy than through a five-year credit life policy, at year one of the loan. By the fifth year, the traditional policy provided 12 times the benefit that the credit life policy provided.[15]

While Hunt's analysis reveals dramatic cost differences, insurance industry spokesmen object to the nature of such an analysis itself. "I don't feel it's a fair comparison between annual renewal term (life policies) versus credit (life policies)," says Dan Boney of Durham Life Insurance Company. "It's like comparing apples and oranges." Boney points out that anyone can buy a credit life policy, regardless of age, but that term life policies are based on age. Also, underwriting can eliminate bad risks in term life policies, says Boney, but not with credit life.

Despite such arguments, *Consumer Reports* arrived at the view that "credit insurance makes economic sense only in a few special circumstances. A person 50 years old or more, *living in a state with a low maximum rate*, might reasonably buy credit life if an existing insurance program was inadequate" (emphasis added). Joel Huber and others argue, however, that the convenience of buying credit life at the time of obtaining the credit provides a service to persons who would not normally shop for a separate insurance policy. In either case, a person must contend in North Carolina with the fifth highest rates in the country for credit life and the lowest payback ratio among the 50 states.

The rates for credit accident and health (A&H) are not as high in North Carolina, compared to other states (see Table 3). Analysts of credit insurance attribute this to fewer claims. "People have a stronger work ethic in North Carolina," says N.C. Legal Services attorney Mike Calhoun, who favors a lowering of credit rates. "People here simply don't like to stay out of work, or can't afford to, or whatever. So they don't make as many claims on their credit A&H policies."

Boney of Durham Life, who supports the current credit insurance rates, echoes Calhoun. "We do better on credit disability here than say in West Virginia," says Boney. "We lost a lot of money in West Virginia. People must be sicker there because of the mining, I suppose. In North Carolina, people just don't seem to be as sick as much."

If North Carolinians make fewer claims on their credit disability policies than do people in other states, why don't rates reflect this fact even more? In most types of insurance, such as automobile or homeowners insurance, underwriters would adjust rates according to the risk factor. But with credit insurance, underwriting plays little role in the rates charged to consumers. In North Carolina, credit insurance rates simply rise to the maximum allowed by the statutes.

The value in offering credit A&H coverage to all consumers at the same rate is that a person's health does not affect the rates. Credit A&H policies do not cover pre-existing conditions for the six months immediately preceding and following the policy date.[16] But pre-existing conditions are not nearly the factor they can be in regular health insurance policies. Moreover, "People generally don't have to submit to physical exams to get credit insurance," says Isaacs of the Automobile Dealers Association.

The importance of underwriting is clear in most kinds of insurance. With auto insurance, for example, companies offer various rates depending upon various classes of risks. People who commute to work, for example, pay more than do people who use their car only for personal use.[17] Companies selling auto insurance determine their rates not only by the various classes of risks but also by the amount of premiums they think they need to meet their losses—the critical loss ratio calculation. In other words, for insurance rates to be meaningful, *they must be viewed in conjunction with the loss ratio that results from those rates.* The fact that North Carolina has the lowest loss ratio in the country for credit insurance—calculated over a period of years—becomes the overriding factor when viewing credit insurance rates (see Table 4).

From the insurance industry's point of view, this low loss ratio is a plus. The lower the loss ratio, the more money the industry (and the lenders) makes. As Dan Boney puts it, "We have a favorable loss ratio here."

Consumers, on the other hand, prefer the term "payback ratio." A low payback ratio means that a small portion of the premium dollar comes back to the consumer. Hence, having the lowest payback ratio in the country—29.7 percent—puts North Carolina consumers at the bottom in terms of benefiting financially from credit insurance policies.

In 1954, the National Association of Insurance Commissioners (NAIC) adopted a model act for regulating credit insurance. This model act recommended a payback ratio of 50 percent. According to the Consumer Credit Insurance Association, 39 states have some kind of loss ratio benchmarks which generally track the NAIC recommendation, either passed by the state legislature or issued through a departmental rule. While many states do not treat these benchmarks as mandatory, they at least have an established goal. North Carolina is one of 11 states that have no loss ratio benchmarks. In the late 1970s, the NAIC went a step further in its proposed model statute, raising the recommended loss ratio from 50 to 60 percent.

Top Ten Credit Life and Accident and Health Insurance Writers in North Carolina, 1984 (in millions of dollars)

1.	Northwestern Security Life Ins. Co.	$16.4
2.	Durham Life Ins. Co.*	13.7
3.	First Protection Life Ins. Co.*	8.0
4.	Sturdivant Life Ins. Co.*	6.8
5.	Union Security Life Ins. Co.	6.5
6.	Superior Life Ins. Co.	6.2
7.	Globe Life Ins. Co.	5.6
8.	Occidental Life Ins. Co. of N.C.*	5.0
9.	Old Republic Life Ins. Co.	5.0
10.	Integon Life Ins. Corporation*	5.0
	Total for Top Ten	$78.2
	Total for North Carolina	$139.4

*Indicates a company based in North Carolina.

Source: Annual Statements filed by companies with N.C. Department of Insurance.

Who Regulates Credit Insurance?

Until 1975, the N.C. Commissioner of Insurance regulated credit insurance rates. But in 1975, Commissioner of Insurance Ingram attempted to lower the rates dramatically, in line with the NAIC recommendations, and the legislature responded by setting the credit insurance rates directly in the statutes. In recent years Rep. Harry Payne (D-New Hanover) and others have attempted on several occasions to lower the rates, with no success (see article on page 42 for more on the legislative history).

The two basic choices in regulating credit insurance rates are through the statutes or through the commissioner's office. Having the commissioner regulate the rates does not necessarily mean lower rates. Of the 10 states with the highest credit life rates, four (Louisiana, North Carolina, South Carolina, and Tennessee) have their credit life rates set by statute. Placing regulation of rates under the insurance commissioner, however, usually does allow for more deliberate assessments by actuaries through a judicatory hearing process than does the horse-trading atmosphere of a state legislature.

"A commissioner's office represents a great deal of flexibility," says John Walker, general counsel for the Consumer Credit Insurance Association. "On the other hand, if you get a commissioner who's unreasonable, that can be a problem."

In 1985, the legislature had a chance to transfer the regulation of credit insurance from the legislature back to the commissioner. With Jim Long as commissioner, Rep. Payne, the sponsor of the bill, thought such a proposal had a chance. But the insurance and financial industries had such strong feelings about the commissioner's office, left over from the Ingram years, that Payne's proposal never had a chance.

"Jim Long is a fine man, but you could get another Ingram in there," says Wade Isaacs with the Automobile Dealers Association. "It's better to have a body like the General Assembly that would act on it thoroughly."

Long supports the Payne proposal in theory, but wasn't ready for such a fight in 1985. "We just couldn't get it done in the '85 session," says Long. "We had so many other things to do to get things going. But I'm in favor of the department setting the rates."

In addition to rates being regulated by the legislature and by routine orders of a commissioner of insurance, at least two other noteworthy efforts have been used to regulate rates—quasi-judicial decisions and banking department regulations. In Virginia, First Protection Life Insurance Company applied to the State Corporation Commission for a higher rate than that allowed by the Virginia codes and rules. The State Corporation Commission held a hearing on the request on April 8 and 9, 1981, and ruled against the company, finding that "the rate of 72 cents per $100 of single premium declining term coverage insurance is excessive and should be reduced from 72 cents to 49 cents" and that the rate of 49 cents "should enable both FPL (the insurance company) and automobile dealers to earn a fair return."[18]

On May 10, 1984, the Massachusetts Banking Department took an unusual step which has effectively lowered credit insurance rates far below the maximum level in Massachusetts of 50 cents per $100 of loan amount, which is set by statute. The banking department rule requires banks to seek at least three bids and *accept the lowest qualified bid.* Under this system, insurance companies set rates in competition with each other. "The results so far are dramatic. Relatively low Massachusetts rates have been reduced by more than 40 percent," reports the National Consumer Law Center (NCLC). "Previously, in nearly every instance, the insurance was sold at the maximum rate. However, when the first contracts were put out to bid, agents and insurance companies bid 28 cents per $100 and less." The Massachusetts regulation applies only to state chartered banks. "But if this approach should be adopted throughout the country, it could save consumers more than a billion dollars a year," reports the NCLC.[19]

Legal services attorney Mike Calhoun says the Massachusetts approach benefits consumers because "it turns the free enterprise system right side up again with respect to both price and competition."

Conclusion

Credit insurance can provide a valuable protection, all analysts agree. But when is it a sound purchase for consumers? Most analysts agree that certain consumers can nearly always benefit from credit insurance, such as older persons for whom term life policies would be very expensive. Beyond such small groups, however, the analysts fall into distinct camps.

Representatives of banks, auto dealers, small loan companies, and mobile home businesses praise credit insurance as a valuable protection for those borrowing money. And in candid moments, they also admit that in North Carolina, it is a lucrative business.

Table 4. Credit Insurance Loss Ratios in North Carolina, 1979-1984

Type of Credit Insurance	1979	1980	1981	1982	1983	1984	1979-84[1]
Life[2]	26.4	28.1	29.0	26.1	28.7	27.2	27.6
Accident & Health[2]	32.3	35.2	35.5	33.4	31.0	31.0	33.0
Property[3]	12.8	20.2	19.8	16.1	13.7	18.9	16.6
TOTALS[4]	27.2	30.1	30.6	27.9	28.1	28.0	28.6

FOOTNOTES

[1]The six-year averages shown in this column were compiled by adding the losses incurred for each year and dividing that total by the sum of the premiums earned for these six years.

[2]For credit life and accident and health insurance data, see "Master Summary," for the years 1979-1984, N.C. Department of Insurance. Dividing the "direct losses incurred" by the "direct premiums earned" yields the ratios shown here.

[3]For credit property insurance data, see "Annual Report of the Commissioner of Banks of the State of North Carolina on Consumer Finance Licensees," for the years 1979-1984. These booklets report credit property insurance sold through "consumer finance licensees" (commonly known as "small loan companies"). Data on credit property insurance sold by retail merchants are not available through any central source, but most credit property insurance is sold through small loan companies. During the 1979-1984 period, the law changed regarding how lenders classified themselves, whether making loans of $1,500, $3,000, $5,000, or $10,000 or under. Hence, data on two pages of the reports must be added together for some years: pp. 20 and 24 (1979), pp. 20 and 24 (1980), p. 20 (1981), p. 18 (1982), pp. 11 and 22 (1983), and pp. 11 and 23 (1984).

[4]The averages shown in the "totals" line, for the individual years, were compiled by adding the losses incurred for each type of credit insurance and dividing that total by the sum of the premiums earned for the three types.

Table prepared by Bill Finger

It is a "good system," says Wade Isaacs. Regarding the commission system, Isaacs says credit insurance is "just like any other product. (Commissions) give them an incentive to sell their product." Concerning the fact that credit insurance sells at the maximum rate, Dan Boney observes, "We are not in a marketplace that competes in lowering the rates."

Marketing experts such as Joel Huber at Duke University also view credit insurance as a product that most consumers like. "People appear to like the idea of credit insurance when it is described to them and to be remarkably satisfied with the policies they currently have," says Huber.

Most consumer advocates view credit insurance skeptically, especially when sold at maximum rates. The higher the loan amount, the greater the hardship on the borrower, says Mike Calhoun. "When people borrow enough to buy a mobile home, for example, they should definitely get insurance through a regular agent."

Consumer Reports goes even further. Credit insurance might "be better than nothing for a person with a health problem . . . or for the person who just can't afford conventional life insurance," concludes the magazine. "For most consumers, however, credit insurance makes no economic sense."

One point is clear, however, despite the sharp differences in these two camps of thinking. Consumers in North Carolina, compared to the other 49 states, receive the least financial benefit from credit insurance purchases. North Carolina has the lowest loss ratio among the 50 states, according to NAIC. And the 29.7 percent figure for 1984 represents a pattern, not a particularly low point for a single year, as Table 4 shows.

The question in North Carolina, then, becomes: How can the loss ratio in North Carolina be brought more in line with the rest of the country? And secondly, who will take the lead on this issue?

"I think credit insurance will be a very significant issue by the 1987 session of the General Assembly," says Commissioner Long. "The loss ratio is so low because of the reverse competition involved in the commission system. The rate structure definitely needs to be addressed."

There are three options for addressing the current rate structure in North Carolina. All of them have some possible benefits and some limitations. Long's task, in conjunction with related departments—such as the North Carolina Banking Commission—is to decide upon the option that will be fairest to both consumers and to the insurance and lending industries.

1. Lower the rates in the statutes. Both Tennessee and South Carolina lowered their rates this year. Given the experience of the last 10 years, however, this seems unlikely to occur in North Carolina. In the 1975, 1981, 1983, and 1985 sessions of the legislature, the combined influence of the insurance and financial lobbies defeated the reform efforts of consumer advocates (see article by Representative Payne).

2. Transfer rate regulatory authority to the commissioner of insurance. Both Representative Payne and Commissioner Long favor this option. Credit insurance rates have been set by statute for only 10 years, a relatively short time. Prior to 1975, the commissioner regulated rates. Returning to this system would be returning to the system favored by the legislature for all but the anomaly of the Ingram era. In doing so, the state would join 41 other states that set rates through administrative rules, not by statute.

3. Require competitive bidding through administrative rules. In Massachusetts, the banking department has effectively lowered credit insurance rates substantially by requiring a bidding process for credit insurance offered by state chartered banks. A similar procedure might be possible in North Carolina as well. Such an approach would return to the traditional free enterprise value of market competition.

Spokesmen for the insurance and financial industries would prefer that no change take place. As Wade Isaacs puts it, "If it ain't broke, don't fix it."

But the credit insurance rate structure in North Carolina is no longer based on competition in the marketplace or fairness to consumers. The credit insurance rate structure is based on the maximum rate that can be charged. The legislature put this rate in the statutes during the stormiest years in the state's history regarding insurance regulation—the Ingram years.

Now that the storm has passed, the time is at hand for another assessment of the credit insurance system. In the minds of many, the credit insurance system *is* partially broken, if not badly fractured. ☐

FOOTNOTES

[1]According to John Walker, general counsel for the Consumer Credit Insurance Association, the nine states are: Hawaii, Iowa, Kentucky, Louisiana, Massachusetts, Missouri, North Carolina, South Carolina, and Tennessee.

[2]NCGS 58-349(c) and (d).

[3]NCGS 58-350(d).

[4]NCGS 58-359(b).

[5]"1984 Master Summary," N.C. Department of Insurance. The $139 million comes from the "direct premiums earned" category. The $40 million comes from the "direct losses incurred" category.

[6]NCGS 58-352.

[7]15 USC 1601ff.

[8]Gulick interprets NCGS 25A-17(c)(ii) as going beyond the federal truth-in-lending law for *credit sales.* This prohibition would not appear to exist *with regard to loans,* says Gulick, except in connection with a second mortgage loan made according to NCGS 24-14. In interpreting the state statutes, Gulick considers a loan as borrowing money directly from a lender and a credit sale as getting the credit through the same business selling the product.

[9]"Credit Insurance: The Quiet Overcharge," *Consumer Reports,* July 1979, pp. 415-417.

[10]"Annual Report of the Commissioner of Banks of the State of North Carolina for the year ended December 31, 1984, on Consumer Finance Licensees," page 11.

[11]*Ibid.,* page 22. Note that loans made under this reporting category might also be less than $3,000 (see NCGS 53-176). In 1984, the average loan amount in this $10,000-or-less category was $1,941, according to data on page 22.

[12]Robert A. Eisenbeis, "A Report on the Federal Reserve Board's Credit Insurance Marketing Study," reprinted in the Consumer Credit Insurance Association (CCIA) Proceedings, April 1979, Table 2, page 5. Eisenbeis, then associate research officer, Division of Research and Statistics of the Federal Reserve System, includes excellent footnotes with his report. Eisenbeis was one of the principal authors of the longer study on which this CCIA report was based: "Tie-ins Between the Granting of Credit and Sale of Insurance by Bank Holding Companies and Other Lenders," *Staff Reports,* No. 101, Board of Governors of the Federal Reserve System, February 1979.

[13]Letter to U.S. Senator William Proxmire, chairman, Senate Committee on Banking, Housing, and Urban Affairs, from Lewis H. Goldfarb, assistant director for credit practices of the Bureau of Consumer Protection, Federal Trade Commission, February 5, 1979, Attachment C. For further information, see "Tie-ins of the Sale of Insurance by Banks and Bank Holding Companies," hearings before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, 96th Congress, 1st Session, June 14, 1979.

[14]Calculations such as the example given are extremely complicated, depending upon the method of computing and charging interest. The example given here is based on a "single premium basis" method, where the premium is collected up front and is financed as part of the loan. "An increasing number of (credit insurance) policies are based on a daily accrual basis," says Dan Boney of Durham Life Insurance Company. Under this system, says Boney, "the interest and insurance premium are collected monthly, as earned, thereby eliminating the finance charge on the insurance premium."

[15]Hunt based his comparisons on a five-year, $7,500 loan, at 18 percent. He first found the monthly payment necessary to cover the cost of credit life insurance and then determined how much traditional term life insurance that monthly payment would buy. He based his analysis on the monthly premiums of Fidelity and Guaranty, a subsidiary of United States Fidelity and Guaranty Insurance Company. A 40-year old could buy $29,218 of term life—compared to the credit life policy coverage of $12,169, at the beginning of year one, and declining to $2,434 at the beginning of year five. A 45-year old could buy $17,030 of term life. Mr. Hunt conducted this analysis for Legal Services of North Carolina.

[16]NCGS 58-350(a).

[17]For more, see "Auto Insurance Regulation: A System Out of Kilter?" by Steve Adams, *North Carolina Insight,* February 1985, pp. 28-56.

[18]State Corporation Commission, Commonwealth of Virginia, Case No. INS810004, April 21, 1981, page 2.

[19]"NCLC Reports: Consumer Credit & Usury Edition," Volume Three, May/June 1985, page 23.

A New Day in 1987?

Credit Insurance: In Need of Reform

by Rep. Harry Payne

The General Assembly does not set the price of any other kind of insurance. Why should it set the price of credit insurance? In theory, the legislature sets only the maximum rates that a lender may charge for credit insurance. But as a practical matter, these maximum rates are usually the going market rates. Moreover, North Carolina has the nation's worst "payback ratio" for credit insurance (or "loss-ratio," as the insurance industry says). What can we legislators—and you as the public—do about lowering the cost and improving the regulation of credit insurance?

North Carolina arrived at the present system through the politics, personalities, and policies of the John Ingram era, 1973-85. When Ingram was elected commissioner of insurance, credit insurance was essentially unregulated in North Carolina. The commissioner had statutory authority to set credit accident and health insurance rates (G.S. 58-260.2) and by tradition also set credit life insurance rates (with no explicit statutory authority). Past commissioners had also issued occasional regulations regarding credit life and accident/health. But essentially, credit insurance, until John Ingram's election, was unregulated and almost unnoticed.

In 1974-75, the Department of Insurance held extensive hearings on credit insurance. Commissioner Ingram then issued an order regulating credit insurance which generally followed the model statute developed by the National Association of Insurance Commissioners (NAIC). The NAIC model included various market protections for consumers and a recommended 50 percent payback ratio. The payback ratio in North Carolina in 1973 was about 30 percent.

Ingram's order would have reduced rates to a level consistent with the 50 cent payback requirement, cutting the prevailing credit insurance rates in the state almost in half. The lending and insurance industries appealed the order to the courts and obtained a stay preventing the order from taking effect.

While the decision was pending, the 1975 General Assembly stripped the commissioner of his power to set credit accident/health and credit life rates. The new statute, supported by the insurance and lending industries, set credit insurance rates at levels far higher than both the NAIC standard and Ingram's proposed order.[1] The Court of Appeals eventually ruled that Ingram had authority to set credit health rates but not credit life rates.[2] But the new 1975 legislation had passed before the court's ruling, thus rendering it a moot point.

Consumer advocates remained concerned over excessive rates as well as a number of complex marketing and repayment issues. For example, two types of credit life insurance were available, a confusing choice for consumers. The type known as "level term credit life insurance" cost much more than the standard credit life coverage.

In 1981, the General Assembly addressed some of the complex sales offerings within the credit insurance field in what became known as the Credit Insurance Reform Act.[3] This act included the proposed NAIC *marketing* protections but did nothing to bring the North Carolina *payback ratio* into line with the NAIC recommendation.

In 1983, a bill addressing the excessive rates went to the House Committee on Banks and Thrift Institutions. The North Carolina Automobile Dealers Association, the N.C. Retail Merchants Association, and various financial and insurance companies again led the opposition

see Payne, page 44

Harry Payne, a Wilmington attorney, has been a member of the North Carolina House of Representatives (D-New Hanover) since 1981. He has been a longtime advocate of reform of the credit insurance system.

"More Sinned Upon Than Sinning"

Credit Insurance: A System With Advantages

by Joel Huber

In the course of conducting four studies of consumers' attitudes toward credit insurance and reviewing many more, I have been struck by the fact that consumers actively favor credit insurance. This generally positive response on the part of consumers appears in sharp contrast to the attitude of some regulators and reformers who have an almost religious zeal in restricting its availability. More insidious still is the defensiveness on the part of those who offer credit insurance. Instead of actively defending its value to both their customers and to society, they adopt a low profile, hoping that in their silence, the criticism will go away.

The purpose of this paper is to put forth the somewhat novel proposition that the consumers' liking for credit insurance is not based on ignorance of alternatives and inept financial management but instead flows from rational economic motives. Further I will suggest that the reformers' zeal against credit insurance represents a misplaced attack on those who use credit—an insidious attack that inflicts particular hardships on lower income consumers.

* * *

Two studies have had direct bearing on consumers' perception of the pricing of short-term credit insurance (i.e., under three years). A survey conducted by Montgomery Ward described to customers their coverages and the cost of their policies and asked whether the cost was high, reasonable, or low. Out of 310 respondents in a national survey, 4 percent indicated that the cost was high, 77 percent said it was reasonable and 16 percent said it was low.[1] Similarly, in the recent Federal Reserve Board survey, 709 respondents were asked a similar question about their credit insurance coverage.[2] Of those responding, 18 percent said the coverage was expensive, while 52 percent said it was about right and 30 percent said it was inexpensive.

Thus it appears generally that fewer than 20 percent of consumers view credit insurance as expensive relative to the values it creates. This finding does not mean that the consumers have carefully considered the supply costs and determined that credit insurance is offered at a low price relative to its costs—that is the job of the state regulatory agencies. The results simply indicate that a great many people view the benefits of the coverages as being greater than their costs.

* * *

Until recently there have been no published studies on the effect of price on penetration, the percentage of customers that accept a given policy. In an attempt to remedy this lack of knowledge, a survey was designed whereby each respondent was asked to purchase insurance in connection with a hypothetical retail credit obligation of approximately $500.[3] To measure price sensitivity the new hypothetical packages were offered to different consumers at different rates. The estimated price elasticity was approximately one-half. That is, as price went up by 50 percent, penetration dropped by 25 percent while, conversely, a price decrease of 50 percent resulted in a 25 percent increase in penetration. Thus, it appears that although many consumers liked the insurance (average penetration was 62 percent), as the price increased their likelihood of purchase decreased.

Finding that the penetration of credit insurance is sensitive to price has implications on the

see Huber, next page

These comments by Joel Huber are excerpted, with permission, from a report presented by Huber to the 1980 annual meeting of the Consumer Credit Insurance Association (CCIA). The CCIA distributes this report as a brochure called, "If Credit Insurance Has So Many Friends, How Could It Have So Many Enemies?" Huber is Associate Professor in the Fuqua School of Business, Duke University.

Payne, *continued*

to reducing the rates. "Let's see what the 1981 changes will do," they argued. Car dealers claimed that these were hard times for small businessmen and that credit insurance profits were the margin which enabled many to weather the economic storm. Only the N.C. Consumers Council and N.C. Legal Services attorneys argued that the rates were unfair. The bill as originally written died in committee, but a committee substitute formed the basis for action the next year.

In 1984, the legislature established a credit insurance and interest rates study commission, which was to report to the 1985 session. The commission held only two meetings. Even though I co-chaired the study commission, my view was in a minority. As a whole, the commission concluded that "there was no need for further legislation regulating credit insurance."[4] The commission report expressed the sentiment of the insurance and financial industries which had controlled the legislative debate over credit insurance. "Consumers are not required to buy credit insurance. If they find it too expensive, they may refuse it," the commission report concluded.

In 1985, reform efforts took a new tack. I introduced House Bill 1290, which would give all power and authority to the commissioner of insurance to establish "fair and reasonable" credit insurance rates. In 1984, Jim Long had been elected commissioner. He had run on a platform of bringing a new spirit of cooperation to the Department of Insurance. Virtually all parties were optimistic about Long's tenure after the 12-year Ingram administration.

We argued that returning regulations to the commissioner was good policy, for two reasons. First, the General Assembly is ill-equipped to set rates and could not consciously and consistently determine a fair rate. Second, we argued that no one should have anything to fear from the commissioner establishing rates, because they must be "fair and reasonable."

The insurance industry and creditors presented unified opposition to the bill. "Two strong reasons bring us to this conclusion," said Wade Isaacs, executive vice-president of the North Carolina Automobile Dealers Association. "First, the General Assembly is considered to be more responsive to the citizens of this state. And secondly, our sensitive concerns over the performance and practices of the previous insurance commissioner will not be quickly dispelled." Dan Boney of Durham Life Insurance Company, a

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Huber, *continued*

way credit insurance is regulated. The reverse competition argument holds that since creditors can force insurance on credit customers, then there is motivation to charge very high prices for the coverage to increase commissions. If, however, as the survey suggests, the consumer is sensitive to insurance prices, then the creditor cannot charge arbitrarily high rates without losing significant penetration.

> *"Ah, take the Cash, and let the Credit go, Nor heed the rumble of a distant Drum!"*
>
> *—Edward Fitzgerald*

Thus, although consumer surveys hardly resolve the many complex aspects of the reverse competition issue, they do point to an image of a customer that is quite different from that of a helpless pawn.

* * *

The reaction of consumer advocates to these kinds of surveys is that the consumer is being irrational. But there are a number of good reasons why credit insurance benefits both the purchasers and the society at large.

When one goes into debt, the primary risk is that one will have to default. Such default exposes the debtor to possible legal procedures by the creditor and to a lessened ability to borrow in the future. The problems in making payments are particularly likely to happen to those who expressed the greatest demand for credit insurance—those with lower incomes who are insecure about their future. To the extent that credit insurance protects one's ability to pay against events (such as sickness or disasters) that are out of control of the debtor, credit insurance provides protection for both the debtor's person and family against the hardship that default could bring.

Credit insurance also *simplifies* the credit process. It has been argued that term insurance may be cheaper to purchase than credit insurance for the same coverage. Without commenting on the issue of relative prices, consider how much major credit life insurance company, took the same position. Finally, Isaacs invoked the old axiom, "if it ain't broke, don't fix it." Despite this opposition, the House defeated the bill by a vote of only 50 to 42 in a roll-call vote on June 19, 1985.

While the auto dealers, insurance industry, and other financial institutions stood together in 1985 over credit insurance, they had their differences over a related insurance matter. With the deregulation of the finance industry, financial institutions had broadened their reach to include the sale of insurance products. Segments of the insurance industry, particularly the agents, opposed this trend. Specifically, the insurance agents, along with consumer groups, objected to what is called "tying."

Selling an insurance policy to a borrower at the time of a loan approval, where the purchase appears to be a part of the approval of the loan, is called "tying." Making the purchase of an insurance product a condition of a loan approval is illegal under state and federal law (see main article for more on this point, including the citations to the relevant laws). But the word "tying" has come to refer to a lender's selling an insurance product, even if done in a legal way. Specifically, insurance agents' associations opposed tying the sale of homeowners insurance policies to mortgage loans.

In 1985, Rep. George Miller (D-Durham) introduced House Bill 1188, which forbade lenders from selling certain kinds of insurance policies. To focus on the relatively few lenders tying homeowners policies to mortgage loans, the bill specifically exempted other types of tying, including credit insurance. But even this narrow bill created confusion and some ill will between traditional allies. Insurance company lobbyists could side openly neither with their banker colleagues nor with their perennial friends,

> *"Pass the hat for your credit's sake, and pay—pay—pay!"*
> *—Rudyard Kipling*

see Payne, next page

easier credit insurance is than a term policy. First, credit insurance covers the precise amount of the loan, so that one does not have too little insurance in the beginning of a declining balance loan and too much at the end. Second, credit insurance is solely for the credit. In a credit life policy for example, there is no question of the benefits being used for a purpose other than paying the obligation. Finally, with credit insurance one does not need to go through the complex and indefinite calculations of how much insurance one has or ought to have; the additional liability is automatically covered. Thus credit insurance simplifies in the sense of limiting the additional problems and worries that can accompany being a debtor, and it is that comfort and simplicity that I believe lies at the base of consumer support for credit insurance.

Shifting from the perspective of the individual debtor to society at large, there are several reasons why society benefits when the individual buys a policy. First, credit insurance is countercyclical. Credit insurance, particularly accident and health, has higher claim rates during times of depressed economic activity. As such the coverage acts to transfer cash from periods of high economic activity to low periods, thus moderating fluctuations in the business cycle.

Second, it induces further stability in that it reduces the risks of personal bankruptcies and defaults that can cause a strain on the credit system. In a related benefit, by paying debts that might otherwise be difficult to pay, credit insurance represents an increase in the debtors' current payments to assure future stability. As such, credit insurance reflects the values of thrift and conservative financial management that should be particularly encouraged in today's society.

* * *

While it is risky to try to infer why a person dislikes anything, the degree of venom associated with attacks on credit insurance make it important to try to understand its sources. I have seen three possible reasons for disliking credit insurance. First, there are some abuses, although they provide reason to dislike the abuses, not the coverage. Second, the reformers may be projecting their own needs into those they seek to help, with the attendant distortion of regulatory policy. Finally, credit insurance certainly suffers from its association with credit and, thus may be considered at fault for helping what some believe to be bad.

see Huber, next page

Payne, *continued*

the insurance agents. The bill pitted lending institutions against insurance professionals in one of the more spectacular lobbying struggles of the 1985 session. Rep. Miller, with a decade of legislative experience, nurtured the bill out of the House Insurance Committee. But the votes weren't there on the House floor. The bill was compromised to be equivalent only to a warning, which passed the legislature.[5]

But dissension within the ranks has persisted. Insurance agents must "make every effort to see that financial institutions do not continue to unfairly coerce consumers," said former state Sen. William D. ("Billy") Mills. Mills, who served seven legislative terms, raised the issue after his recent election as president of the Carolinas Association of Professional Insurance Agents (CAPIA). In the press release announcing his election, Mills added, "Banks have coercive power to intimidate consumers by tying the purchase of insurance to credit transactions." Currently the chief executive officer of Seashore Insurance Associates, Mills favors an "outright prohibition against banks selling insurance because such a measure would protect consumers."

Mills and CAPIA are addressing the specific issued raised by Rep. George Miller's bill, tying homeowners insurance to a mortgage loan. But the risks and the needs for consumer protection are the same for credit insurance transactions. A union between consumers and insurance agents could provide the clout necessary to counter the strength of the banks, lenders, finance companies, and merchants' associations in the legislature. However, CAPIA appears somewhat like the banking industry, fighting over business turf. It appears that CAPIA simply doesn't want to lose the homeowners business to the mortgage lenders. If CAPIA added to its concerns the lowering of credit insurance rates (while still allowing the banks to sell credit insurance), then it would gain more credibility as a consumer advocate.

The most significant actor in the credit insurance issue is Jim Long, who, by definition, is Mr. Insurance in North Carolina. With a close relationship with the legislative leadership, easy access to the press, and wide respect from both consumers and the insurance industry, Long could heighten consumer awareness of the problem even as he directs efforts to solve the problems. Long has taken the clear position that

Huber, *continued*

Consider first the abuses. The 10 year-old Hubbard study lists a number of abuses, some of which are undoubtedly with us today.[4] However, it is significant that many are not, reflecting the progress due to regulation. For example, there are certainly *some* creditors who charge more than they could for credit insurance as there are *some* loan officers who intentionally leave their customers with the impression that the coverage is required. However, it is important to remember that credit insurance is regulated by the states in which it is offered. If the price is too high the state has power to enforce lower rates. And, indeed through just such a process the average price of credit insurance has declined in the last 10 years. Similarly, the states can and do define the process by which insurance is offered. If voluntary tie-ins are a problem, the states have remedy power. It appears, however, that the reformers are against more than abuses and have as their target the product itself. One reason for this may be simple projection. That is, consumer surveys have shown that the strongest support for credit insurance comes from those segments that have low incomes and high levels of financial insecurity. To the extent that the reformers are quite dissimilar from these groups, they may well be projecting from their own needs to those they are attempting to help, and concluding that credit insurance is not needed.

The final reason why credit insurance may be disliked flows paradoxically from the fact that it facilitates the credit process. Credit has reflected poorly on both its supplier and user ever since Biblical times when Jesus threw the money lenders out of the temple. Having to borrow indicates an inablity to save and exposes the borrower to the threat of repossession and other less palatable remedies, while being a creditor raises the specter of usury and control over the lives of debtor families.

* * *

To summarize, the studies of consumer attitude toward credit insurance have indicated a remarkably strong liking for the coverage. Furthermore, differences in liking depend quite rationally on the price of the coverage, the degree to which the consumer has other insurance coverage, the family income level, and their perceived financial insecurity. The source of this liking is seen as coming from the way in which credit insurance lessens the risk of being a the commissioner should regulate credit insurance rates. "The legislature doesn't set any other insurance or utility rates," says Long. "Why should it set credit rates?"

Those who seek to reduce credit insurance rates have never intended to lower them beyond the point of business profitability to both the insurance company and the extender of credit. Part of the dilemma of credit insurance is the need for a massive education campaign. Over time, the consumer must understand the excessive profit margin in this product and either force the reduction of rates or simply purchase less credit insurance—to the detriment of both consumer and lender.

In the short run, the means to address the problems of credit insurance will have to come from Commissioner Long. Whether Long can be successful in adjusting the rate structure depends on public awareness—on how many supporters he might have behind him. This truly is a function of heightened public awareness and the realization by merchants and businessmen that in the long run, a fair—but not excessive—profit will be in their best interest. Public awareness is growing. If it continues, we can look forward to a new day and a fair bill in 1987. □

FOOTNOTES

[1]Chapter 660 of the 1975 Session Laws (SB 660), codified as NCGS 58, Article 32.

[2]*State ex rel. Commissioner of Insurance v. Integon Life Insurance Company*, 220 S.E. 2d 409 (N.C.C.A. 1975).

[3]Chapter 759 of 1981 Session Laws (HB 1156), amending NCGS 58, Article 32 and NCGS 53-189(a).

[4]"Report of the Credit Insurance and Interest Rates Study Commission," Report to the 1985 General Assembly of North Carolina, February 15, 1985, page 6.

[5]Chapter 679 of 1985 Session Laws (HB 1188), codified as NCGS 58-51.5.

Carol Majors

debtor. From the perspective of society, moreover, credit insurance is seen as a force that helps stabilize the business cycle, that reduces the number of personal and creditor failures, that limits the need for various creditor remedies, and finally that reinforces the value of thrift by increasing current payments to insure future stability.

If the above reasoning is accepted, then certain implications follow for reformers, regulators, and suppliers of credit insurance. In any regulated industry reformers serve a valuable function in keeping both the regulators and the industry honest. However, it has been increasingly unclear to me, as an outside observer, whether those that label themselves consumer advocates really act in the consumer's best interest or in a rather narrow and hyper-rational conception of that interest. The consumer has spoken for credit insurance in purchase decisions and in surveys. Thus, while reformers should be making certain that the insurance is available to consumers at the lowest possible price, where terms are made as clear and fair as possible, I do not believe it is the consumer advocate's role to tell the consumer what to like. In short, the reformers should go after abuses that may still remain but not the product itself.

Given both the personal and the social benefits of credit insurance, the regulators should be trying to increase its availability. To be sure, at the same time it is their obligation to see that it is priced fairly and presented in terms that allow free choice and increased understanding on the part of the consumer. But rather than passively waiting for firms to present plans, regulatory commissions could take the lead in suggesting credit insurance plans that would benefit both the creditor and their customers.

Finally, suppliers of credit insurance, both creditors and insurance companies, should stop being defensive about their product and realize that credit insurance is a mutually beneficial service. Rather than quietly acquiescing to attacks, the industry should be proud of credit insurance and let others know it. □

FOOTNOTES

[1]Internal survey conduced by Montgomery Ward Company, 1975. Copy is available from Joel Huber at Duke University.

[2]Internal survey conducted by the Federal Reserve Board, 1978. Copy is available from Huber.

[3]The Cambridge Report, sold to participating companies, unpublished. Copy is available from Huber.

[4]Charles L. Hubbard, editor, *Consumer Credit Life and Disability Insurance*, Ohio University Press, 1973.

Advisory Opinions: The "Ghosts That Slay"

by Katherine White

Should the Supreme Court of North Carolina serve as a sort of hybrid policy advisor to the legislative and executive branches of government? That's the central question surrounding the practice of granting advisory opinions—a practice that's not widely understood.

The North Carolina Constitution authorizes state courts to hear two kinds of cases: civil actions between opposing parties, and criminal cases where the state prosecutes those charged with crimes.[1]

But since 1849, the N.C. Supreme Court—the final arbiter of what the state Constitution and state law say—has responded to at least 28 requests from the governor or the legislature for advisory opinions. These opinions have no force of law but indicate the Court's views on an issue. The Court has issued only four such opinions in the last quarter-century—in 1961, 1966, 1969 and 1982. But in the past three years, the governor and the General Assembly have sought the Court's advice on many occasions.

The Court has issued those opinions despite the fact that it has no guidelines on when it should issue advisory opinions—or any other rules regarding advisory opinions, for that matter. Chief Justice Joseph Branch, like some of his predecessors, questions whether such opinions should be issued. He fears, in part, that the Court could be swamped with requests for such opinions in the future.

Legislatures and governors alike have sought advisory opinions because it would help determine the constitutionality of a bill or resolve an issue. It would also help speed the resolution of issues. But there haven't been all that many advisory opinions granted—on the average about one every seven years since the Court first convened in 1789. The use of such opinions has hardly burdened the court.

"You're faced with the fact that over many, many years you've had the court issuing them," Branch said in an interview. "It's custom .... Whether there's any constitutional authority for it I don't know. Up to now no one's challenged giving the opinions—probably because (the opinions) are not binding."

In theory, the opinions are not binding on the Court because they are the individual views of the justices and not of the Court as an institution. But in practice, the opinions often are cited in later developments to support one position or another.

Branch himself acknowledges that the opinions carry weight. "When you get into giving advisory opinions it's a pretty strong indication of what you might do if you get a lawsuit," said Branch.

The latest request, submitted by Democratic Lt. Gov. Robert Jordan and House Speaker Liston Ramsey (D-Madison) in July, sought the justices' opinion on whether two sections of the new Administrative Procedure Act (APA) meet state constitutional requirements.[2] The new APA established an independent system of hearing officers under the chief justice of the Supreme Court and also established a commission—called the Administrative Rules Review Commission—composed of legislative appointees to review the rules executive branch agencies make.

In its deliberations, the Democratic-controlled House wanted to keep Republican Gov. James G. Martin from appointing the chief hearing officer and give the appointment instead to the General Assembly. The House also wanted to ensure control over the executive branch's rules and sought a legislative veto over those rules. The Senate membership expressed concern that the House position encroached on the constitutional provision of separation of powers, which requires that the three branches of government remain separate and distinct.

The two houses compromised on July 12—with no legislative veto of rules and with the chief justice appointing the chief hearing officer. But the compromise carried with it a condition: The two houses of the legislature would request an advisory opinion on the two contested issues from the Supreme Court—and one section of the bill would not take effect unless the Court

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Katherine White, a lawyer, is a Raleigh reporter for The Charlotte Observer *who covers state and federal courts.*

okayed it in an advisory opinion. In other words, the Supreme Court would have what the governor never had—an outright veto.

The N.C. Supreme Court rejected that request for an advisory opinion in a letter written on October 28, 1985, and filed on October 31—in effect probably killing the proposed Administrative Rules Review Commission. The Court's letter, addressed to Lt. Gov. Robert Jordan and House Speaker Liston Ramsey, noted: "To grant your request the members of the Supreme Court would have to place themselves directly in the stream of the legislative process. This kind of legislative power, we believe, should not be construed upon or accepted by this Court. . . ."

The request for an advisory opinion, founded in politics, placed the justices in a position of answering a legal question that the state Constitution does not *expressly* empower the Court to answer, because its stated powers are limited to review of civil litigation and criminal cases. It also places one branch of government in the position of advising another branch, blurring the separateness of the judiciary and legislative branches.

That blur between the two branches is the reason that the U.S. Supreme Court has never given advisory opinions. The justices in 1793 told President Washington that the federal separation of powers doctrine in which they were "judges of a court in the last resort" meant they could not give advisory opinions.[3] By establishing this doctrine requiring a "case or controversy," the U.S. Supreme Court in effect said it would decide only real fights between real antagonists, not serve as an ultimate legal advisor.

The N.C. Supreme Court's first advisory opinion—issued in 1849—was granted in almost a casual way, with no consideration of the separation of powers doctrine. There, the court settled a political dispute over which votes should be

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Advisory Opinions by the N.C. Supreme Court

—compiled by Lacy Maddox

1. *Waddell v. Berry,* 31 N.C. 516 and 40 N.C. 440 (1849)
2. *In re Martin,* 60 N.C. 153 (1863)
3. *In the Matter of Hughes,* 61 N.C. 64 (1867) (also cited as *In re Extradition*)
4. *In re Homestead and Exemptions,* Opinion handed down in 1869; reported at 227 N.C. 715 (1947)
5. *In re Legislative Term of Office,* 64 N.C. 785 (1870)
6. *In re A Convention of the People,* Opinion handed down in 1871; reported at 230 N.C. 760 (1949)
7. *In re Power of Supreme Court to Declare Act of General Assembly Unconstitutional,* 66 N.C. 652 (1872)
8. *In re Term of Office of Judges and Justices,* 114 N.C. 923 (1894)
9. *In re Leasing of the North Carolina Railroad,* 120 N.C. 623 (1897)
10. *In re Municipal Annexations,* Opinion handed down in 1917; reported at 227 N.C. 716 (1947)
11. *In re Omnibus Justice of the Peace Bill,* Opinion handed down in 1919; reported at 227 N.C. 717 (1947)
12. *In re Municipal Finance Bill,* Opinion handed down in 1921; reported at 227 N.C. 718 (1947)
13. *In re Emergency Judges,* Opinion handed down in 1925; reported at 227 N.C. 720 (1947)
14. *In re Proposed Changes in Judicial System,* No formal response, as the Resolution of the General Assembly requesting advice was later withdrawn. Resolution adopted in 1925; reported at 227 N.C. 721
15. *In re Advisory Opinion,* 196 N.C. 828 (1929)
16. *In re Proposed Constitutional Convention,* 204 N.C. 806 (1933)
17. *In re General Election,* 207 N.C. 879 (1934)
18. *In re Yelton,* 223 N.C. 845 (1944)
19. *In re Phillips,* 226 N.C. 772 (1946)
20. *In re Terms of the Supreme Court,* Opinion handed down in 1923; reported at 227 N.C. 723 (1947)
21. *In re Subsistence and Travel Allowance for Members of the General Assembly,* 227 N.C. 705 (1947)
22. *In re House Bill No. 65,* 227 N.C. 708 (1947)
23. *In re Advisory Opinion in re Time of Election to Fill Vacancy in Office of Associate Justice of the Supreme Court of North Carolina,* 232 N.C. 737 (1950)
24. *Advisory Opinion in re General Election,* 224 N.C. 748 (1956)
25. *Advisory Opinion in re General Election,* 255 N.C. 747 (1961)
26. *Advisory Opinion in re Work Release Statute,* 268 N.C. 727 (1966)
27. *Advisory Opinion in re Sales Tax Election of 1969,* 275 N.C. 683 (1969)
28. *Advisory Opinion in re Separation of Powers,* 305 N.C. 767 (Appendix, 1982)

The Citizen Legislature: Fact or Fable?

With this column, North Carolina Insight *launches another regular feature designed to examine policymaking—and the process of that policymaking—by the N.C. General Assembly. This initial column focuses on the difficulties involved in maintaining a citizen legislature. As the lawmaking process consumes more and more days, legislators have less time to earn a living and to maintain a family life. Future columns will examine specific legislative proposals, legislative ethics, study commissions and other facets of the legislative process.*

by Chuck Alston

Rep. Martin Lancaster (D-Wayne) did something in June that is unusual for a politician. He called it quits before someone else did it for him. And he did it while his star was still rising.

In the process of quitting, Lancaster rekindled the long-running debate whether North Carolina's General Assembly will survive as a citizen legislature.

A Goldsboro attorney, Lancaster is perhaps best known as the House shepherd for the Safe Roads Act, former Gov. James B. Hunt's package of laws to combat drunken driving. He is also one of the few House members tapped to chair a committee in his second term in 1981. Since 1983, as chairman of the House Judiciary III Committee, Lancaster has developed a reputation as a hardworking, bright legislator willing to tackle tough issues.

What most folks don't know about Martin Lancaster is what they don't know about most politicians: about his family. His two daughters, Ashley, 8, and Mary Martin, 7, have grown up while their father has spent much of his time in Raleigh. It has fallen to his wife, Alice, who teaches history at Wayne Community College, to attend the PTA meetings and drive the carpools and make sure Ashley and Mary Martin practice their music lessons.

Lancaster, 42, wants to spend more time at home, attending the PTA meetings and helping with driving his daughters to swim team practice at the Goldsboro Y. But not even a bright, hardworking lawmaker can legislate more than 24 hours into a day. So something had to give, and Lancaster decided it was the legislature.

Lancaster did something else unusual for a politician. He sat down and wrote a lengthy statement about why he won't seek re-election in 1986, not so much for its news value, but to bring attention to the problems he sees facing the General Assembly. Some excerpts:

"Service in the General Assembly is ostensibly part-time, but it requires so much time at so little remuneration that my profession and family have both suffered from my service."

"Since the 1979 session, every regular session that I have served in has been longer than the session before. I am hopeful that the 1985 session will reverse that trend. However, despite some progress in decreasing the length of the session, it is still difficult for a person to be away from his family and job for almost half a year at a time. As my seniority and influence have grown, so have my responsibilities. This has taken additional time away from my family and job."

"I believe the future of the General Assembly rests in a renewed commitment to the concept of the citizen, part-time legislature."

The statement once again raised the longstanding question: Is the concept of the citizen legislature, long revered in North Carolina, in peril? Or is that an outmoded precept?

Some defenders of current legislative practices would argue that life is much more complex now than in the days of Jefferson and Madison, who rode horseback to the Capital for a short legislative session before returning home for spring plowing. Legislatures need more time to study before decisions are made now, and the wish to maintain a citizen legislature may be a yearning for a return to a simpler time.

Chuck Alston is a Raleigh correspondent for the Greensboro News & Record *and covers the North Carolina General Assembly.*

The major problem for a citizen legislature is the time spent in session, and, thus, how much time a lawmaker spends away from home and work. North Carolina splits its regular legislative sessions into a long session, usually of about six months, in the odd years and a short session, usually of about a month, in the even years. Since 1975, the long sessions have ranged in length from as few as 108 days in 1979 to as many as 138 days in 1983. Those numbers reflect the days actually spent in session, so the actual length of the session on the calendar is much longer. The 1985 session, for example, met 118 days over 164 calendar days.

The most common tool used by other states to control the length of sessions is a constitutionally imposed deadline. But there is little sentiment among the legislature's leadership here to impose a hard and fast deadline on adjournment or to make the sweeping revisions in the committee system necessary to effect such a change.

North Carolina's problem is also the nation's problem. Increasingly, says Bill Pound of the National Conference of State Legislatures in Denver, Colorado, "the feeling exists in a lot of places" that the citizen legislature is in danger. Iowa, Colorado, and Alaska have taken steps since 1980 to limit sessions, according to Pound. Iowa imposed a date after which legislators could no longer collect per diem expenses; Alaska and Colorado added constitutional deadlines.

In the Southeast, North and South Carolina are the only two states that do not legislate under a constitutional deadline. Virginia to the north and Tennessee to the west do. Among the 10 most populous states, North Carolina is more at home. Of those 10, only two—Texas and Florida—impose a deadline. Eight of the second 10 most populous states do impose a deadline.

The barriers to a shorter session are many. Two of them seem most prominent. First, the growing complexity of state government itself causes long sessions. Increasingly, state government is beckoned by its citizens and the federal government into new areas of governance, increasing the legislature's workload. Moreover, the General Assembly is no longer content to pass the governor's budget without lengthy scrutiny, or at least the appearance of it. And the appropriations process gobbles up much of the legislature's time.

Lancaster has offered these solutions, both within and without the legislature, to hold down the length of sessions and prolong the tradition of the citizen legislature:

- Shorten the legislative week to three days, Tuesday to Thursday. Lawmakers now work Monday night to Friday noon when in session.
- Curtail committee assignments. Most lawmakers serve on eight or nine committees. Lancaster suggests a maximum of two or three to enhance expertise. He further suggests the standing committees meet year-round, replacing the current system of interim study panels. The standing committees would then be prepared to report bills as soon as the session convened.
- Lengthen terms to four years. Legislators now serve two-year terms. Lancaster suggests that a four-year term would allow "legislators to devote more time to their families and business and less time to politicking." Voters soundly rejected such a proposal in 1982.
- Pay higher salaries. Lancaster says that higher salaries would reduce the financial strain imposed by legislative service. In 1987, pay will rise to $9,240 a year (from the current $8,400) for the rank-and-file legislator, plus an expense allowance of $230 a month, up from a current $209 a month. Even at that rate, Lancaster figures the compensation per hour is less than that of a day laborer. North Carolina ranks roughly in the middle among the 50 state legislatures in terms of pay—28 have higher salaries, one is about the same and 20 have smaller salaries, according to the National Conference of State Legislatures.

From time to time, various other legislators also have taken a stab at reform, the most dramatic of which came from former state Sen. William G. Hancock (D-Durham). In 1983, Hancock drafted legislation called the Citizen Legislature Act. It proposed to limit the session to a total of 100 days over the two-year span, allow standing committees to meet throughout the year, impose a system of rigid internal deadlines for handling bills, and allow bills to be filed and considered by committees year-round.

The bill died, but some of its ideas survived. House and Senate leaders agreed in 1984 to delay convening until Feb. 5, 1985, three weeks later than normal. A May 15 deadline was imposed for the introduction of public bills, except for appropriations and pork-barrel spending bills. Bills filed after that deadline required not only a resolution passed by a two-thirds majority for introduction but also a two-thirds majority for passage. Although more than 200 public bills were filed after the deadline, it nevertheless was helpful in holding back the traditional flood of last-minute legislation. Only 58 public bills filed after the deadline were approved by the General Assembly.

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IN THE COURTS

—continued from page 49

counted in a close state Senate race. Chief Justice Thomas Ruffin wrote that the justices responded because they "deemed it a duty of courtesy and respect to the Senate." Few other state supreme courts extend that courtesy to the executive or legislative branches of government, and most of those states have a specific constitutional provision for advisory opinions.

Still, the N.C. Court hasn't always been courteous.

In 1869, for example, the N.C. Supreme Court refused to advise the General Assembly on how the 1868 Constitution affected certain classes of debt that were incurred before the new Constitution's adoption. Then, wrote Chief Justice Richmond Pearson, "The functions of this court are restricted to cases constituted before it. We are not at liberty to prejudge questions of law."

And in 1984, the justices did not respond to a request from Gov. James B. Hunt, Jr. on the constitutionality of sections of the Safe Roads Act of 1983. Their denial is not part of any written record. They simply didn't answer it, said Branch. The reason? People accused of drunk driving already were being prosecuted under the new law. Thus, any defendant's lawyer could raise the constitutional question. "With a pending criminal case, it's questionable whether we could give one (an advisory opinion). It would be bad on the man who was about to be tried," explained Branch.

Over the years, in other states, debate has centered on the appropriateness of the advisory opinion. U.S. Supreme Court Associate Justice Felix Frankfurter called them "ghosts that slay," meaning that they can come back to haunt a court that acted hastily in issuing an advisory opinion.

That can happen because requests for the opinion don't present a sharply defined controversy between opposing sides. The N.C. Supreme Court doesn't want to receive written briefs on the issues or to be presented oral arguments from people interested in the matter. Requiring briefs and hearing arguments "really gives it the stature of an opinion, it seems to me," Branch said.

North Carolina's expert on advisory opinions, the late professor Preston Edsall, explored these problems and recommended the the court take steps to avoid the pitfalls of advisory opinions. Based on the infrequency of such opinions in recent years, the practice has not been abused. Perhaps that has worked in the North Carolina Supreme Court's own best interest—as a sort of legal talisman to ward off those "ghosts that slay."[5] □

FOOTNOTES

[1]N.C. Constitution, Article 3, Section 1.

[2]See "Assessing the Administrative Procedure Act," N.C. Center for Public Policy Research, May 1985.

[3]Warren, The Supreme Court in United States History, 108-111 (1922).

[4]Felix Frankfurter, Note on Advisory Opinions, 37 Harvard Law Review 1002, at 1008 (1924).

[5]Preston Edsall, The Advisory Opinion in North Carolina, 27 N.C.L.R. 297 (1949).

IN THE LEGISLATURE

The measures trimmed about a month off the 1985 session when compared to 1983. Even more internal reforms are on the way, according to House Speaker Liston Ramsey and Lt. Gov. Robert Jordan, the Senate president. The two have discussed convening the session even later, perhaps in mid-February. "There is a lot of wasted time at the beginning of a session," Ramsey said. They have also discussed new internal deadlines: moving the deadline for public bills back to May 1, and requiring all bills to clear the chamber of their introduction by June 1 or else die. "My position has been let's take this logically and move one step at a time," Jordan says.

A major overhaul of the committee system is an idea whose time has not yet come. Ramsey, for one, is adamantly opposed to year-round meetings of standing committees, although he is considering naming members to fewer committees. Jordan would like to have not more than eight or 10 Senate committees instead of the current 29. However, he notes that fighting tradition isn't always so easy as it sounds. Majority-party Democrats with seniority are used to touting their chairmanships back home. Fewer committees mean fewer chairmanships and some disgruntled ex-chairmen. Jordan frames the committee dilemma as a question that could well apply to the broader issue of how to make sure the Martin Lancasters don't quit the General Assembly before their time—and whether the increasing demand for new laws can be balanced with the desire for a citizen legislature.

"How do you get from where we are to there?" Jordan asks. "That'll be difficult." □

Contributors to the N.C. Center for Public Policy Research

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IN THE MAIL

Letters to the Editor

Grantseeking Guide

I just wanted to drop you a note and tell you what a great job you did on the North Carolina guide to foundations. I think it is about the most complete statewide guide I have seen, and I hope other publishers of such guides learn from it.

Carol A. Hooper
Council on Foundations
Washington, D.C.

Having spent a good part of the last two weeks being drawn back with great frequency to *Grantseeking in North Carolina,* I feel I must write to congratulate and thank you! It is the most useable book of its kind that I have run across in almost 25 years of fundraising in several areas of the U.S. From information and format to type style and layout, you have given N.C. fundraisers and fundgivers an extraordinarily helpful tool. We are all very much in your debt.

Peggy Brown
Director of Development
N.C. Nature Conservancy
Chapel Hill

There is neither time nor inclination to "review" your latest publication, *Grantseeking in North Carolina,* but I am compelled to enter a word of congratulations to Anita Gunn Shirley and her many cohorts on a job well done and appreciation to the Center for undertaking such a project.

I have been anticipating the arrival of the volume, and in an action which I cannot explain to myself I read it cover-to-cover in one sitting last night. Only a hustler of the worst sort would do such a thing. The scope of the project as much as the details on the individual foundations is to be complimented. The narratives, for and aft, are well conceived and about as well stated as one will find in any of the advice-giving literature in the field. I applaud the decision to print the material in a uniform manner throughout for ease in making quick references.

Some unsettling thoughts, however, do arise from reading the material, and these ought to be the subject for others to consider. Those foundations that do their business well in North Carolina do it very well, but there are many whose grounds for public sanction could be debated. A goodly amount of capital that could serve the general weal is sheltered in inactive and unresponsive foundations. These sour ruminations arise from my reflections on material objectively presented in your publication.

Please convey to your staff and board thanks from one reaper in the field.

Samuel M. Stone
Director of Development
N.C. School of the Arts
Winston-Salem

Boards, Commissions, and Councils Report

House Bill 476, effective July 1, reorganizes the N.C. Marine Science Council, creates the Office of Marine Affairs (OMA) and statutorily places OMA in the Department of Administration. In addition, the act affects two bodies of particular interest to you. It abolishes the N.C. Marine Resources Center Administrative Board and gives OMA the authority to administer the OCS Task Force.

I am sure you and the staff of the Center are pleased that your work on boards and commissions is starting to get results. Our bill is just a small part of the overall effort, but it was your recommendation to abolish the Administrative Board that spurred our initiative to do just that in H.B. 476.

Donna D. Moffitt
Marine Policy and Legal Specialist
N.C. Department of Administration
Raleigh

I have just had an opportunity to read the Center's study entitled *Boards, Commissions, and Councils.* I thought this city-state of the District of Columbia had a problem of proliferating boards and commissions with 140 of them on which citizen members serve. However, North Carolina's 320 boards make us look like beginners, especially since our list includes some, such as licensure boards, which you excluded from your study. Somehow it is always reassuring to know that others may be worse off than we are!

I wish to commend you and your associates on a splendid job of work. If a similar study were done in the District, my reaction to specific recommendations might be similar to Ms. Patterson's. [Jane Patterson is the former Secretary of Administration. The Center reprinted the reactions to its recommendations by all major executive officials like Secretary Patterson.] But most of your general conclusions are applicable to citizen participation in government wherever it occurs.

Betty King
Special Assistant to the Mayor for Boards and Commissions
Washington, D.C.

Vol. 6, No. 2-3 Handicapped Persons

I would like to express my appreciation for the dedicated interest that the North Carolina Center for Public Policy Research has shown in advancing the cause of civil rights for persons with disabilities.

The timely publication of the October 1983 issue of *North Carolina Insight* provided a clear, comprehensive, and objective assessment of the state of the art regarding public policy and civil rights for handicapped persons. I cannot begin to calculate the value of having the Center for Public Policy Research focus on this area of need. Your findings dramatically underscored our appeal to the legislature to strengthen the laws protecting handicapped people and contributed significantly to the ultimate success of Senate Bill 272 or "An Act to Protect Handicapped Persons."

"An Act to Protect Handicapped Persons" is the most significant piece of social legislation regarding disabled persons adopted by the legislature in the past decade. Some observers have characterized the Act as the best piece of social legislation considered by the 1985 session of the General Assembly. You and the Center staff are to be commended for your contributions to the process.

Peyton Maynard
Governor's Advocacy Council for Persons with Disabilities
Raleigh

Vol. 7, No. 3 Insurance

Thank you so much for giving our Chamber permission to reprint Vol. 7, No. 3 of *North Carolina Insight.* We used parts of this issue to discuss insurance regulatory policy with our Guilford County Delegation to the N.C. General Assembly recently.

Much attention has been given High Point's Territorial Surcharge on auto liability. Hopefully the study will result in reduced rates for High Pointers.

The Center's *North Carolina Insight* was very helpful in our understanding of N.C. insurance industry and how it operates. We appreciate this timely study by N.C. Center for Public Policy Research, Inc.

James P. Armstrong, Jr.
Manager, Government Affairs
High Point Chamber of Commerce

Center Report on Administrative Procedure Act

Thanks for the copy of the Center's report on the APA. The survey findings were excellent background, and I generally agreed with most of the recommendations in the report. I am less afraid of the idea of creating a separate office to handle contested cases and appeals than the authors of the report seem to be. From my experience, albeit limited, I have found that it is hard to convince citizens who are in a dispute with an agency that the agency itself can fairly act as the rulemaker, prosecutor and adjudicator all in one. I do agree with your recommendation that hearing officers should have both legal and program experience, but this should not be impossible even with a separate office for hearings and appeals.

On a more general level, I think we need to add a seventh principle—to the six listed in the report—against which to measure the APA. The additional principle is fidelity to legislative intent as expressed in enabling legislation and substantive statutes. If we are concerned at all about separation of powers, then I think we must acknowledge this additional principle. In the concern over intrusion of the legislature into executive functions, we should not lose sight of the fact that administrative rulemaking is itself a departure from the constitutional principle that laws and rules are made by legislatures. Although administrative rulemaking may be necessary and appropriate, the only guaranty of its propriety is the extent to which it adheres to the basic intent of enabling legislation.

Of course, we have a severe practical problem in North Carolina because we lack any real sources for legislative history, in the form of published committee reports, records of debates, etc. This tends to cut both ways. On the one hand it makes it more difficult for courts and administrative agencies to carry out the intent of the legislature in cases where the words of a statute are intentionally or unintentionally ambiguous or vague. The risk of erroneous interpretation is thus increased. At the same time, however, it makes the need for interpretation by the courts and administrative agencies correspondingly greater, since there is little guidance in the legislative materials to guide the day-to-day application of the statute. The real need may be for more legislative history, more published studies, more printed reports, and so forth.

If I had to err, I would probably err on the side of a more narrow scope for administrative rulemaking, based on my preference for legislative rulemaking as a constitutional principle. We long ago passed the point at the national level where we could dispense with administrative rulemaking. The need for guidelines and directions to supplement broad enabling statutes is simply beyond the physical ability of Congress to produce. I do not know whether we are at the same point at the state level. If we are not and until we are I would prefer to keep as much rulemaking in the hands of the legislature as is possible.

Thanks for a thought-provoking study.

Daniel G. Clodfelter, Attorney
Charlotte

CENTER TO RELEASE FIRST REPORT ON FOR-PROFIT HOSPITAL TREND IN NORTH CAROLINA

The Center's latest major research project focuses on investor-owned hospitals in North Carolina. Since 1980, the number of investor-owned hospitals in North Carolina has increased dramatically—representing a significant new direction in health care. The Center is examining that trend with a series of three reports on for-profit hospitals in the state. The first report is due out this fall.

The first report reviews issues raised by for-profit involvement in the hospital industry. It contains individual profiles of the hospitals owned or managed by the 11 investor-owned multi-hospital systems operating in the state, and it identifies some of the possible factors leading to the acceleration of investor-owned involvement in North Carolina. The report also examines several other components of the health care industry, relatively new to the state, which are fast-growing and affect the viability of the state's community hospitals.

Below are excerpts from the executive summary of the first report, edited by Center Research Coordinator Elizabeth M. "Lacy" Maddox. For more information, contact Ms. Maddox at the Center, Box 430, Raleigh, N.C. 27602, (919) 832-2839.

Since World War II, most hospitals in this country have been locally owned not-for-profit or public facilities, but two interrelated structural changes are rapidly redefining the traditional patterns of hospital ownership and management. First, the proprietary or for-profit sector has taken an increasingly active role within the health care industry. Second, there is a growing tendency for independently owned hospitals to enter into multi-institutional arrangements.

Types of Hospital Ownership

Hospital ownership can be classified into three broadly-defined categories: (1) public; (2) not-for-profit (both secular and religious—also called voluntary); and (3) investor-owned (also called private for-profit or proprietary). The majority of the nation's public hospitals are community-based and are owned by counties, cities, local or regional hospital districts, or special hospital authorities. Wake Medical Center in Raleigh is one such hospital.

Not-for-profit hospitals (secular and religious) are privately owned and operated as charitable, community service organizations. They are tax-exempt. Mercy Hospital in Charlotte is a not-for-profit hospital.

Investor-owned hospitals are also privately owned; however, they are not tax-exempt. The major distinction between investor-owned hospitals and other types of hospital ownership is profit orientation. Humana Hospital of Greensboro is an investor-owned, for-profit hospital.

Since 1975, the number of investor-owned hospitals in the United States has increased dramatically. The Federation of American Hospitals says that between 1977 and 1982 there was a 43 percent increase in the number of beds owned by the investor-owned hospital sector.

Advantages and Disadvantages of Investor Ownership of Hospitals

The report identifies a number of possible advantages and disadvantages of for-profit hospital ownership and management. The potential **advantages** include:

■ *Access to private capital.* First, the major advantage investor ownership or management contracts *may* offer is access to private capital that can be used to repair a hospital building or to replace an old facility with a new one. Harrison Ferris, administrator of the Hospital Corporation of America-owned Raleigh Community Hospital, said that capital formation is an important advantage. "Profit is the cost of doing business tomorrow," said Ferris.

▪ *Access to a national personnel pool.* Second, investor-owned corporations may use their national systems to develop a pool of qualified personnel, particularly hospital administrators.

▪ *Management expertise.* Third, related to this is the advantage of management expertise. The skills required to be a good county commissioner or a good doctor are not necessarily the same skills that would guarantee a well-run hospital providing high-quality medical care at a reasonable cost in an up-to-date facility which doesn't lose money.

"Between 1977 and 1982 there was a 43 percent increase in the number of beds owned by the investor-owned hospital sector."

▪ *Volume purchasing.* Fourth, any multi-institutional system has the advantage of saving money through large volume purchases of basic medical necessities like intravenous solutions.

▪ *Promoting competition in the hospital sector.* The fifth possible advantage is that the presence of investor-owned hospitals in a community may increase competition in the health care sector generally.

▪ *Tax advantages.* The sixth advantage is that if the hospital changes from a county-owned or other public facility to an investor-owned facility, it may also change from being tax-supported to being a taxpayer, simply because investor-owned hospitals are subject to local property taxes and corporate income tax levies.

▪ *Taking local governments out of the hospital business.* The final apparent advantage applies only to hospitals owned by local governments. County commissioners or council members who turn over a facility that had been losing money to a private company frequently say a burden has been lifted from their shoulders.

The Center's research also turned up these potential **disadvantages**:

▪ *Investor-owned hospitals may have higher charges.* The chief possible disadvantage of investor-owned hospitals is that they may have higher charges. In January of 1984, Blue Cross-Blue Shield of North Carolina released a study of average charges to Blue Cross subscribers in 1981-82 for three procedures in North Carolina acute care hospitals that were owned by investor-owned chains that had enough cases to provide valid charge data. Their findings were that charges were higher in six investor-owned hospitals than for other hospitals of similar size in North Carolina.

▪ *Indigent care.* A second concern about hospitals affiliated with investor-owned corporations is whether they provide less indigent care than do not-for-profit hospitals.

▪ *Skimming the cream.* A third possible disadvantage of investor-owned operations can occur if the hospitals affiliated with investor-owned corporations narrow the range of services or alter the patient mix such that investor-owned hospitals get more of the *paying* patients — leaving fewer such revenue-producing patients or services for not-for-profit hospitals.

▪ *Changing the nature of health care.* And finally, just as there is a political factor that may be an advantage of investor-owned corporations, there is a philosophical factor that is sometimes suggested as a disadvantage. That is the question of whether profit considerations properly belong in the delivery of hospital care.

This report examines the 164 non-federal hospitals in North Carolina, which are located in 85 of the state's 100 counties. No hospitals are located in the remaining 15 counties, which are situated primarily along the more sparsely populated coastline.

Excluding the nine federal facilities in the state, North Carolina has 70 public hospitals. Of these 70 hospitals, 11 are owned and operated by the state, 49 by counties, five by specially created hospital authorities, two by cities, two by hospital districts, and one by a township. Of the 49 county-owned facilities, only 10 are county operated. Thirty-one are managed by not-for-profit corporations created solely for the purpose of hospital management or by the multi-institutional, not-for-profit company called SunHealth, Inc. Two county hospitals are managed by hospital authorities, and five are operated under management contracts by investor-owned corporations. The remaining county-owned facility is leased to an investor-owned corporation which exercises complete control over the facility. Of the 10 facilities owned by other local governmental units, seven are operated by not-for-profit corporations and three by the owner of the facility.

Sixty-eight of North Carolina's hospitals are owned by not-for-profit corporations. An example of a not-for-profit hospital is Presbyterian Hospital in Charlotte. Fifty of these hospitals (74 percent) are managed by the corporation that owns the facility. Eleven are part of the SunHealth Network or of the Sun-Alliance—management corporations owned by the not-for-profit SunHealth, Inc., based in Charlotte. Investor-owned corporations manage seven hospitals owned by local, independent, not-for-profit corporations.

Of the state's 40 hospitals operated on a for-profit basis, 26 are investor-*owned* and operated, 13 are *managed* under contract by an investor-owned multi-hospital system, and one is operated under a *lease* arrangement by an investor-owned system. Of the 26 investor-owned and operated hospitals, two are independent, doctor-owned facilities. One is managed by the owning physicians, while the other is operated under a management contract by an investor-owned multi-hospital system. Twenty-four hospitals are owned and operated by investor-owned multi-hospital corporations.

One hundred-thirty of North Carolina's 164 non-federal hospitals are general, acute care facilities. The remaining 34 provide a broad range of specialty care. Fourteen are psychiatric hospitals. Ten specialize in the treatment of alcohol or chemical dependency. The others include four rehabilitation hospitals; two eye, ear, nose and throat hospitals; one cancer institute; one orthopedic hospital; and two prison hospitals. The size of North Carolina's hospitals ranges from a low of 12 beds to a high of 946 beds. Seventy of the state's 164 nonfederal hospitals, or 43 percent, have fewer than 100 beds and are considered small hospitals. Seventy-four of the 164, or 45 percent, are medium-sized with between 100 and 399 beds. The twenty remaining nonfederal hospitals (12 percent) have 400 or more beds each and are considered to be large hospitals.

Eleven investor-owned multi-hospital systems currently are active in the state, owning and operating or managing under contract a total of 39 hospitals. One other is independently owned. Only one of these 11 systems—Hospital Corporation of America (HCA)—both owns and manages hospitals in North Carolina. Seven systems operate in the state only as hospital owners and operators. Three investor-owned systems are engaged exclusively as hospital managers.

Factors Affecting the Changeover to Investor Ownership

Many experts in the area of hospital management believe that each community hospital will eventually be faced with the decision to join, or sell to, a multi-institutional arrangement. They further conclude that the option to remain unaffiliated can be preserved through careful planning.

The rapid expansion of the investor-owned segment of the nation's hospital industry over the last 10 years has led observers to speculate as to the factors underlying the growth. Hospitals have had to cope with regulatory controls, competition from other health care providers, capital funding problems, political pressures, the growth of the elderly population, more expensive technology, cash flow problems, updating aging facilities, changes in Medicare payments—and the list could go on.

As part of its research, the Center tested two hypotheses. The first was that public hospitals are more likely to join investor-owned hospital systems than are not-for-profit or independent proprietary hospitals. But the Center found that *thus far*, this has not been true in North Carolina. However, *future sales* to investor-owned systems would have to come from not-for-profit and public hospitals because there is only one remaining independent, for-profit hospital in North Carolina.

The second hypothesis was that a decision by public or not-for-profit hospitals to join an investor-owned system frequently follows the defeat of a local hospital bond referendum. The Center's research found that this is not true. Based on available evidence, it appears that no significant relationship exists between these two events. From 1970 through the first quarter of 1983, only one public hospital (Lee County Hospital) was sold to an investor-owned corporation after the defeat of a local hospital bond referendum.

The traditional hospital has been likened to a bleeding porpoise surrounded by hungry sharks. The sharks are freestanding ambulatory surgery centers, urgent care centers, diagnostic centers, changes in reimbursement and physician practice, and a plethora of other new facilities competing with the traditional general hospital. Some health care experts believe that the very existence of many hospitals will be threatened as these competitors turn one hospital profit center after another into a money loser.

"If you pull out the parts of the hospital that are profitable," said John Young, a staff researcher with the N.C. General Assembly, "the hospital will be unable to stay afloat. ... The hospital system as we know it will fly apart."

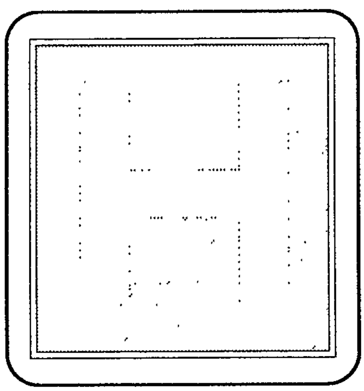

Table 1. Comparison of the 10 Largest Investor-Owned Hospital Management Companies in the United States, and the 11 Investor-Owned Management Companies in North Carolina

Company	Number of Hospitals[1]	Number of Beds
UNITED STATES[2]		
1. Hospital Corporation of America	417	59,946
2. American Medical International	142	19,673
3. Humana, Inc.	92	18,311
4. National Medical Enterprises	71	11,388
5. NuMed, Inc.	24	6,714
6. Charter Medical Corporation	56	5,798
7. Republic Health Corporation	33	3,935
8. Universal Health Services	30	3,486
9. Paracelsus Hospital Corporation	23	3,407
10. Hospital Management Professionals	24	3,016
NORTH CAROLINA[3]		
1. Hospital Corporation of America	16	1,727
2. American Medical International	4	492
3. National Medical Enterprises	1	492
4. Healthcare Services of America	5	296
5. Psychiatric Institutes of America	2	250
6. Charter Medical Corporation	3	241
7. Humana, Inc.	2	198
8. Hospital Management Professionals	1	133
9. The Delta Group	1	65
10. United Medical Corporation	1	64
11. Health Care Management Corporation	1	31

[1]The numbers of hospitals and beds include domestic and foreign-owned, leased, or managed hospitals, and hospitals under construction as of September 30, 1984.
[2]Source: *1985 Directory of Investor-Owned Hospitals and Hospital Management Companies*, published for the Federation of American Hospitals by FAH Review, Inc., Little Rock, Arkansas.
[3]Compiled from N.C. Center research.

In this initial report, the Center looks closely at those North Carolina hospitals which have opted for affiliation with an investor-owned corporation, and delves into some of the problems facing hospitals of the 1980s.*

In its second report, due out in 1986, the Center will present an analysis of the differences between investor-owned hospitals and other hospitals in the state. The report will examine the reasons underlying North Carolina hospitals' decisions to join investor-owned systems, and how community and hospital officials view the impact of investor ownership on hospital care in this state.

The final report will be intended for use primarily as a guide to assist the public, county officials, and hospital officials in making decisions about affiliating with a multi-hospital system, whether for-profit or not-for-profit. And the guide will discuss how community and hospital officials should go about making sound decisions regarding the future of their hospitals. □

**Since completion of this initial report, several changes in hospital ownership and management have taken place. Those changes are not reflected in this first report, but will be included in the second and third reports. Because of these changes, Table 2 shows a total of 40 investor-owned hospitals.*

Table 2. Investor-Owned and Managed Hospitals in North Carolina

	Name	Location	Number Beds	Type	Owned/ Managed	Date
1.	Hickory Memorial	Hickory	47	P	O-UMC	1979
2.	Frye Regional Medical Center	Hickory	218	G	O-AMI	1974
3.	Davis Memorial	Statesville	167	G	O-HCA	1983
4.	Humana Hospital	Greensboro	100	G	O-Humana	1977
5.	Central Carolina	Sanford	142	G	O-AMI	1980
6.	Highsmith-Rainey	Fayetteville	95	G	O-HCA	1983
7.	Raleigh Community	Raleigh	140	G	O-HCA	1977
8.	Community Hospital of Rocky Mount	Rocky Mount	50	G	O-AMI	1981
9.	Edgecombe General	Tarboro	127	G	O-HCA	1982
10.	Highland	Asheville	125	P	O-PIA	1981
11.	Appalachian Hall	Asheville	100	P	O-PIA	1981
12.	Orthopaedic Hospital	Charlotte	166	S	O-HCA	1982
13.	Charlotte EE&T	Charlotte	68	S	O-Humana	1981
14.	Mandala Center	Winston-Salem	75	P	O-CMC	1981
15.	Charter Hills	Greensboro	100	P	O-CMC	1981
16.	McPherson	Durham	32	S	O-Ind	1926
17.	HSA Cumberland	Fayetteville	154	P	O-HSA	1983
18.	Life Center of Fayetteville	Fayetteville	34	P	O-HSA	1984
19.	Holly Hill	Raleigh	58	P	O-HCA	1981
20.	Brynn Marr Treatment Center	Jacksonville	34	P	O-HSA	1983
21.	Life Center of Jacksonville	Jacksonville	47	P	O-HSA	1984
22.	Life Center of Wilmington	Wilmington	27	P	O-HSA	1984
23.	Charter Northridge	Raleigh	66	P	O-CMC	1984
24.	Blackwelder Memorial	Lenoir	31	G	O-HCMC	1985
25.	Charter Pines	Charlotte	60	P	O-CMC	1985
26.	Medical Park	Winston-Salem	136	G	O-Ind/ M-HCA[1]	1985
27.	Angel Community	Franklin	81	G	M-HCA	1983
28.	Spruce Pine Community	Spruce Pine	88	G	M-HCA[2]	1982
29.	Burnsville Hospital	Burnsville	24	G	M-HCA	1982
30.	The McDowell Hospital	Marion	62	G	M-Delta	1982
31.	Ashe Memorial	Jefferson	76	G	M-HCA	1981
32.	Person County	Roxboro	88	G	M-HCA	1981
33.	Cape Fear Valley	Fayetteville	473	G	M-NME	1982
34.	Johnston Memorial	Smithfield	180	G	M-HCA	1982
35.	Brunswick County	Supply	60	G	L-HCA	1981
36.	Franklin Memorial	Louisburg	76	G	M-HCA	1983
37.	Lowrance Hospital	Mooresville	121	G	M-HCA	1983
38.	Morehead Memorial	Eden	133	G	M-HMP	1984
39.	Rutherford Hospital	Rutherfordton	165	G	M-HMP	1985
40.	Hugh Chatham Memorial	Elkin	96	G	M-HMP	1985

G — General hospital (primarily)
P — Psychiatric
S — Specialty

O — Owned
M — Managed
L — Leased

Full names for the corporations listed above are as follows:

AMI .... American Medical International
CMC/Charter .... Charter Medical Corporation
Delta .... The Delta Group, Inc.
HCA .... Hospital Corporation of America
HMP .... Hospital Management Professionals
HCMC .... Health Care Management Corp.
HSA .... Healthcare Services of America
Humana .... Humana, Inc.
NME .... National Medical Enterprises, Inc.
PIA .... Psychiatric Institutes of America
UMC .... United Medical Corporation
Ind ..... Independently owned, not affiliated with a chain.

[1]Medical Park Hospital is an investor-owned hospital that is also managed by an investor-owned hospital management company, Hospital Corporation of America.
[2]Spruce Pine Community Hospital and Burnsville Hospital are the only hospitals in the Blue Ridge Hospital System, which is managed under contract by Hospital Corporation of America.

MEMORABLE MEMO

This memo does not come from The Twilight Zone, but from the North Carolina Department of Correction, and it's a lulu. We're still not sure whether the writer is in elliptical orbit or just plain lost in space. Perhaps Mr. Spock will enlighten us on that point. And in the meantime, if you've seen any Memorable Memos of cosmic proportions—or even of more earthly origins, send it along to Insight. *As always, anonymity will be guaranteed. And may the force be with you.*

DOC WORKSHOP
DEPUTY SECRETARY PRESENTATION
AUGUST 1,2, 1985

The goals presented today and tomorrow are expected to be many and varied. They will surely be the product of considerable reflection on the part of each presenter. They may even controversial.

If we don't, however, invite your uninhibited expression, the Secretary and I may lose much in the process of developing our game plan for the next few years. You have the hands-on experience and expertise. Thus, we have set no pre-conditions other than time limitations and the exercise of self-discipline for your proposals.

In the interest of deriving all we can from this Workshop, Richard Ripley will control our collective discipline.

In a few days following this event, the Secretary and I will begin a review process. The process will involve determination of consistency with Martin Administration policy and Departmental policy. A judgment will be made regarding our ability to achieve the goals. Priorities will be assigned.

As time goes on and experience suggests revisions to these goals or to the ways we hoped to achieve them, we shall not be afraid to make appropriate adjustments. Your inputs will continue to be solicited.

In the meanwhile, adopted goals will be made a part of our package of goals for the Governor's consideration.. The date will be August 21.

About September 6, 1985, we shall have the final package for our mutual guidance for the forthcoming year.

Everyone has been asked to provide a forward to his presentation - a mission statement. Perhaps restating what the Secretary has already said - the basic mission is to provide for the safety of the public, our prison inmates, our parolees and probationers. We are to treat the people under our supervision in a humane manner using national guidelines as much as possible. We must be perceived as reliable in all our actions. We must offer hope to inmates, their families and the public.

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So what are the Deputy Secretary's goals for this year and beyond. The first is to assist the goal setters - that is all the people in this group achieve their goals by securing services and support to which this office has access.

The second is to broaden the working relationships already established between the Department of Correction management team and external influences. The purpose is to enhance our ability to secure the services and support we need.

I plan at least 100 (what I will refer to as) sales calls among members of the General Assembly and elsewhere. These calls will supplement the good work of Ben Irons, Bob Mooneyham, the Secretary and Myrna Eakes.

I plan to direct and follow measures to reduce some of the unfavorable expense/budget ratio we seem to experience year after year. I'll act aggressively in expense areas over which we have some control. In total we'll shoot for cutting our shortfall in half. This effort will be made within the guidelines set by the Secretary

Finally, I expect to explore aggressively the possibility of putting in service a privately run prison unit by next spring.

Thank you.

W. Scott Harvey
8/1/85

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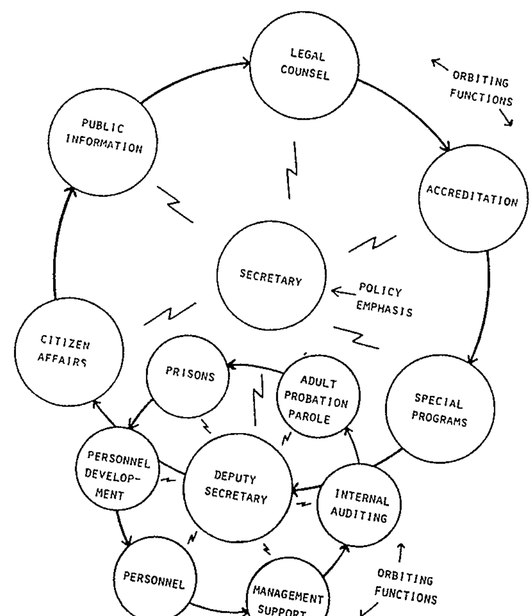
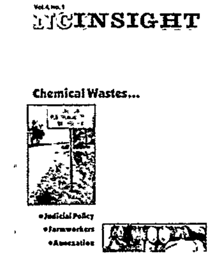
DOC UNIVERSE

THE MANAGEMENT NUCLEUS AND INTERACTION



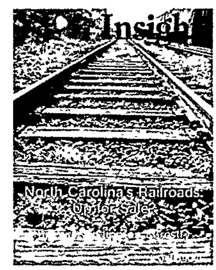
Stuck for ideas on gift-giving this holiday season? At a loss for a thoroughly unique present? Well, here's one stocking-stuffer you won't find at Nieman-Marcus or Bloomingdale's—a year's gift membership in the North Carolina Center for Public Policy Research.



Just think of all the advantages:

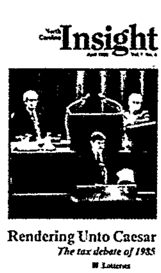
- No batteries required
- No warranty cards to fill out
- It won't break
- It's always the right size and color
- It never goes out of style
- And it's the gift that keeps on coming.

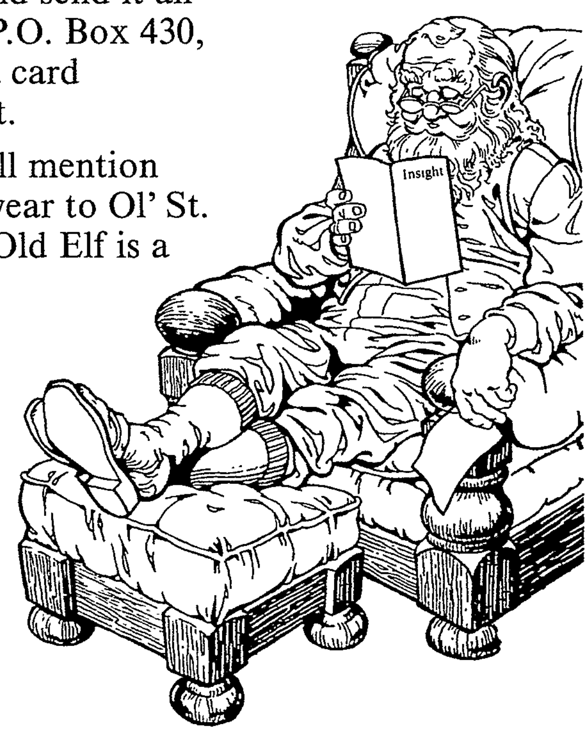
So don't be a holiday humbug. Get in the spirit of giving, with the knowledge that your gift will do double duty: It'll please the recipient, and it'll help the NCCPPR continue doing the job of performing high-quality research on public policy in North Carolina.



And giving a gift membership is easier than stuffing a stocking. Just pull out the insert card in this issue of *North Carolina Insight*, fill it out along with a check for $24, and send it all to Santa's helpers at the Center, P.O. Box 430, Raleigh, N.C. 27602. We'll send a card notifying the recipient of your gift.

And when we get your check, we'll mention that you've been extra good this year to Ol' St. Nick himself. After all, the Jolly Old Elf is a member, too.





N.C. Center for Public Policy Research
P.O. Box 430
Raleigh, North Carolina 27602

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