



N.C. CENTER FOR  
PUBLIC POLICY  
RESEARCH

# From The Center Out

The Newsletter of the North Carolina Center for Public Policy Research

*Your voice for good government*

*November/December 2008-January 2009*

## PREVIEW OF THE 2009 STATE BUDGET

Part of the Center's mission is to anticipate significant public policy issues that will face our state. In this newsletter, we look at the large budget issues facing the new Governor and legislators when the General Assembly convenes on January 28, 2009. There already are four holes in the 2009 budget: (1) holes created by the use of non-recurring money for recurring expenses in last year's budget, (2) the hole in our economy, (3) the hole created by commitments to new spending by candidates for President and Governor, and (4) the hole created by the federal budget, which has ripple effects on the states.

### I. THE HOLE CREATED BY DECISIONS IN LAST YEAR'S STATE BUDGET

Here are the decisions in the 2008 state budget that have consequences for the 2009 budget:

- (1) Lawmakers used \$156 million in one-time, non-recurring revenue to pay for ongoing expenditures.
- (2) They authorized \$857 million in new debt, which will add \$52 million in debt service payments next year and \$87 million a year at its peak. Next year, we'll pay a total of \$722 million in debt service, and that has to be paid first – before the first school teacher is hired, the first road is built, or first retirement check is paid.
- (3) Last year's budget enacted two tax cuts that are to go into effect in 2009 – an increase in the state Earned Income Tax Credit and a repeal of the state gift tax. Together, these two cuts result in lost revenue of \$39 million.
- (4) The State Health Plan, which pays for health insurance for state employees, is in financial trouble, and an estimated \$300 million will be needed to stabilize the fund. The State Health Plan spends \$10 million a day, so this hole can get deeper quickly.

### II. THE HOLE CREATED BY THIS YEAR'S ECONOMY

The second hole in the budget has been created by this year's economy. In preparing this newsletter for our Center members, we called the Governor's Budget Office, the Legislature's Fiscal Research Division, and the state Treasurer's Office. Here's the picture they draw of what the current trends in the economy are.

- (1) The first trend is that **revenue growth is already below budget** – The budget enacted for this fiscal year assumes revenue growth of 3.5 percent. But, because of those four 2008 decisions mentioned above, just to continue this year's budget commitments, revenues will need to grow by an unlikely 4.66 percent. That is not going to happen. Fiscal Research says as of the end of November 2008 we're already \$520 million behind in this fiscal year. Now, to be fair, the legislature did not know in July the scale of the economic downturn that would occur in October. Still it looks like the legislature will face at least a \$1.6 billion shortfall in a \$21.5 billion budget.

(2) The second trend is that **Governor Mike Easley has asked agencies for budget reduction options of 3 percent, 5 percent, and 7 percent.** This applied to all state agencies, but agency heads were asked to minimize the impact on direct services to citizens.

This has particular consequences for community colleges, whose funding formula allocates funding based on last year's enrollment. However, during economic downturns, guess what happens? More people go to community colleges for training or retraining in areas of the economy that do have jobs. So, enrollment this academic year is up 6.5 percent over last year at many community colleges.

(3) The third trend is that the state's **road budget has been cut by 6 percent** – In mid-October 2008, state Transportation Secretary Lyndo Tippet implemented 6 percent cuts in spending, which amounts to \$50 million. The highway budget is funded separately from the General Fund. The revenue comes from the state's gas tax and the highway use tax on car purchases, and revenues from both are way down, as people are driving less and buying fewer cars (down 14 percent in N.C.). If tax revenues continue at current levels, the Department of Transportation will have to cut \$200 million by June 30, 2009.

(4) The fourth trend is that the **plummeting stock market has caused a 12 percent** drop in the state pension fund for the year ending September 30, 2008. North Carolina has 47 percent of its pension fund invested in stocks. The good news – if you can call it that – is that during the same period, the California state pension fund dropped 17 percent, and the Standard and Poor's 500 Index dropped 24 percent, so North Carolina is doing better than most. Our state pension fund provides benefits to 820,000 current and retired state employees, including teachers, police officers, and firefighters.

(5) The fifth trend is **that the costs of certain programs are rising in the state budget**, so you need more money just to fund the same programs. One example is that North Carolina's population is growing rapidly and this means more students at all levels of education. So you see enrollment increases in public schools, community colleges, and public universities. A second example is that the cost of highway construction has doubled since 2002. And, a third example is that the Medicaid budget has doubled over the last 10 years and is now 16 percent of the state budget. Medicaid pays for health care for the poor, disabled children, and a lot of elderly people in nursing homes. As health care costs have risen at double digit rates, and the cost of prescription drugs has increased, Medicaid costs have also increased. And when the Baby Boomers start turning 65 in 2011, you're really going to see Medicaid and Medicare costs explode.

### **III. THE HOLE CREATED BY COMMITMENTS TO NEW SPENDING BY CANDIDATES FOR PRESIDENT AND GOVERNOR**

As they ran for President and Governor, all four candidates in both parties made commitments that would require new spending. This is the third hole in the budget.

President-elect Barack Obama has made national commitments in four key areas – energy, health care, infrastructure, and tax cuts. In federal energy policy, he has promised a clean energy/jobs program that would cost \$150 billion over 10 years. He has promised to expand health care coverage, which is estimated to cost \$50 to \$65 billion. He has promised \$60 billion in spending on new infrastructure or repairs. He has promised tax credits for college tuition (\$4,000 a year), child care (\$3,000 a year), clean cars (\$7,000 a year), and mortgage payments. And, he has promised tax cuts for 95 percent of American households, which will reduce revenues by \$3.5 trillion over the next decade. Now, we are not picking on Obama. We are focusing on his commitments because he won. John McCain's tax cuts would have reduced revenues by \$5 trillion.

At the state level, Governor-elect Beverly Perdue has also made new spending commitments. In education, she promised free community college tuition, to expand reading and math assessments in

elementary schools, and to ensure that high schools are wired for online classes. She's also committed to a plan to expand health care coverage for children and special mental health courts. She has said she will not increase taxes.

#### **IV. THE HOLE CREATED BY THE FEDERAL BUDGET AND ITS RIPPLE EFFECT ON THE STATES**

President-elect Barack Obama takes office on January 20<sup>th</sup> and has to present a new budget to Congress early in February. The new President will inherit a deficit that's expected to approach one trillion dollars. Medicare began running a deficit this year. In a bad economy, the amount of unemployment benefits paid goes up. American troops will be fighting in Iraq and Afghanistan in the biggest deployment of troops since Vietnam in 1969. And, the new President will have to implement a \$700 billion bailout plan passed by Congress in 2008. It's no wonder that 44 percent of the people say the new President will face the most serious challenges of any President in the last 50 years.

#### **V. THE GOOD NEWS**

When we were talking to the State Budget Office and Fiscal Research Division, we specifically asked, "Well, do you see anything that's encouraging, that's good news out there?" The first answer falls into the category of "It may be bad here, but it's a lot worse in other states." In the budget analyst's words, "Our housing situation is better because there hasn't been as much run-up on housing prices as in the rest of the country, and our foreclosure rate is one-third the national rate."

Also, gas prices have come down and may stay down for the next nine months, so that may save money budgeted for school bus fuel increases and oil-based asphalt used in building roads.

Financial market interventions by the Federal Reserve Bank (including Fannie Mae and Freddie Mac) have lowered mortgage rates and improved housing market prospects for those consumers with good credit.

The possibility of lower lending rates, lower gas prices, and lower grocery bills may improve consumer confidence and provide sufficient stimulus to keep us out of a prolonged recession.

And, North Carolina has a Rainy Day Fund with \$850 million in it. You have to credit the legislature for the foresight to do this.

Finally, perhaps the best news comes from N.C. State economist Michael Walden. He has a new book out about the changes in North Carolina's economy (*North Carolina in the Connected Age: Challenges and Opportunities in a Globalizing Economy*), and if you think about it, North Carolina has been going through a fundamental transition in our economy. As late as **1977**, the Big Three of textiles, tobacco, and furniture accounted for 20 percent of all jobs in the state, 22 percent of total economic output, and 64 percent of manufacturing output. By **2005**, those same three industries accounted for only 4 percent of jobs, 7 percent of economic output, and 32 percent of manufacturing output – half that of 1977.

The good news is we developed a new Big Five – information technology, chemicals (mainly pharmaceuticals), food processing, banking, and vehicle parts. By **2005**, these industries accounted for 10 percent of all jobs, 17 percent of total economic output, and 43 percent of all manufacturing output. In other words, the Big 3 were almost replaced by the Big 5. If you contrast this with a state like Michigan or Ohio, our economic transition has a brighter hue to it, and – except for food processing and maybe banking – it looks relatively good for the long-term.

## A PROFILE OF THE LEARN AND EARN PROGRAM

Another part of the Center's mission is to educate the public about state government programs. Because North Carolina recently won a national Innovations in Government award for its Learn and Earn program, we thought you might like to know more about this program.

In September 2004, Governor Mike Easley launched the Learn and Earn Early College High School Initiative in response to work force needs in North Carolina and to the state's persistent dropout rate. The initiative is administered jointly by the N.C. Department of Public Instruction and the North Carolina New Schools Project. Located on the campuses of two- or four-year colleges and universities, Learn and Earn early college high schools provide an academically rigorous course of study with the goal of ensuring that all students graduate with a high school diploma and two years of university transfer credit or an associate's degree, usually in five years. Learn and Earn early college high schools are intended to serve students who are typically under-represented in the college-going population, such as students who are first generation college-going, students from low-income families, those who are members of a minority group, and those who have met with failure in conventional schools. Nationally, 130 early college high schools serving over 20,000 students are open in 24 states.

In addition, each Learn and Earn early college high school is expected to implement and exhibit five design principles: ready for college – all students are prepared for college; powerful teaching and learning – an emphasis on critical thinking, application, and problem-solving skills; personalization – relationships between peers and with teachers are leveraged to improve student learning; redefined professionalism – staff takes responsibility for the success of every student, holds themselves accountable to their colleagues, and is reflective about their roles; and purposeful design – use of time, space, and resources so that best practices become common practice.

By 2007-08, 42 Learn and Earn early college high schools were open across North Carolina, serving just over 5,200 students in about 40 counties: 13 opened in Fall 2005, 20 opened in Fall 2006, and nine opened in Fall 2007. Of these 42, 37 are partnered with a community college, and five are partnered with a UNC campus. Another 18 opened in Fall 2008, bringing the total to 60 statewide.

Learn and Earn early college high schools sign a 5-year implementation agreement to receive funding and technical assistance from the state. Each school receives about \$285,000 each year: a school change and instructional coach (\$19,000); professional development for teachers (\$10,000) and the principal (\$6,000); one guidance counselor and one work-based learning coordinator (\$124,248); one college liaison (\$62,124); evaluation (\$3,500); money for additional expenses (\$26,556); and college textbooks and instructional supplies (\$35,645). For fiscal year 2008-09, the recurring appropriation for Learn and Earn is \$3.5 million, with \$110,000 in non-recurring dollars for start-up costs for new sites.

In 2006-07, 57 percent of the students were female, 43 percent male; 55 percent were white, 33 percent black, and 7 percent Hispanic; 63 percent were 9<sup>th</sup> graders and 22 percent were 10<sup>th</sup> graders. 82 percent met expected growth on our end-of-course tests (77 percent statewide), and 52 percent made high growth (34 percent statewide). Dropout rates appear to be lower than the statewide rate, and promotion rates appear to be higher – all promising if the data holds up over time.

Learn and Earn Online (LEO) is another component of the Learn and Earn Initiative, and unlike the early college, the online component of Learn and Earn is largely about access. Learn and Earn Online is coordinated by the North Carolina Virtual Public School. During the fall 2007 and spring 2008 semesters, LEO provided over 4,000 students with e-learning opportunities and college credit to prepare them to be future ready, globally competitive citizens. By the end of 2009, the benchmark set by the N.C. General Assembly is to serve 20,000 students through LEO.

All schools have the technical capacity to participate in LEO, and about 300 high schools have participated so far. Qualified students earn high school and college credit at no cost. Courses are offered through UNC-Greensboro's iSchool and 45 community colleges. The iSchool offers courses in mathematics, economics, social studies, English, health, and arts education. The community colleges offer courses in art, biology, economics, English, chemistry, history, mathematics, physics, psychology, technology, and other subjects. A pre-enrollment questionnaire is used to screen students and make sure e-learning is a good fit for each student. Projected program expenditures for 2007-08 were \$3 million, and the recurring appropriation for 2008-09 is \$6.5 million.

The third component of the Learn and Earn Initiative is EARN grants. Students who receive two years of college credit through Learn and Earn are eligible for the grants, which are intended to allow students to graduate from college debt-free. The two-year EARN grants, in combination with Pell Grants and other kinds of assistance, will replace the need for student loans. The EARN grants will be about \$4,000 per year. To receive the grants, students must be a resident of North Carolina and a citizen of the United States; graduate from a North Carolina high school, approved home school, or have a GED; be enrolled full-time; be claimed as a dependent for tax purposes; the student's family income must not exceed 200 percent of federal poverty level; and the student must remain in good academic standing.

In September 2008, North Carolina's Learn and Earn education initiative won a prestigious national Innovations in Government award from Harvard University's Kennedy School of Government. One of six programs to win the award, the Learn and Earn program was honored for its public-private cooperation to improve educational opportunity in North Carolina. The award included a \$100,000 prize for replication and dissemination of the program across the United States.

Meet Crystal Hickey. In 2006, Crystal was a middle school student in New Bern. One year later, as a 9<sup>th</sup> grader, she enrolled in an early college program on the campus of Craven Community College. As an early college student, she selected an engineering education pathway. In addition to being the only high school student in the classes, she was the only female in the class of approximately 30 potential future engineers. Crystal says she first started thinking about engineering in 8<sup>th</sup> grade because she had always been good in math, and when she took the Introduction to Engineering class she knew for sure it was what she wanted to do. She is on schedule to have completed college-level classes in pre-calculus, computer programming, and engineering prior to the start of 11<sup>th</sup> grade. "We may not have sports or a prom," she notes, "but we are getting a lot in place of it. We are getting an early start."



## CENTER ELECTS SEVEN NEW BOARD MEMBERS AND OFFICERS FOR 2009

The Center welcomes seven new members to our statewide 23-member Board of Directors. We also recognize and thank our officers for 2009.

### New Center Board Members

Elected to the Center's statewide Board of Directors for three-year terms (2009-2011) were Melinda Baran of Raleigh, Roger Bone of Rocky Mount, Lynn Holmes of Raleigh, Representative Danny McComas of Wilmington, Bill Parmelee of Charlotte, Jack Stanley of Greensboro, and Jolanta Zwirek of Charlotte.

"The Center's Board is carefully constructed to be representative of the citizens of North Carolina in terms of race and ethnicity, gender, region of the state, and political party affiliations," says Board Chair Betsy Justus of Cary. "We are very pleased to welcome these outstanding citizens and leaders to our Board."

### Officers Elected for 2009

Justus was elected Chair of the Center's Board of Directors for 2009. She is the Senior Business Development Executive for S2 Tech in Durham. Also elected as officers for one-year terms were Leslie Anderson of Asheville as Vice Chair, Wanda Bryant of Durham as Secretary, John Willardson of Wilkesboro as Treasurer, and Bob Burgin of Asheville as Treasurer-Elect. Anderson is President of Leslie Anderson Consulting, Inc. in Asheville, and Bryant is a judge on the N.C. Court of Appeals. Willardson is an attorney and senior partner in the firm of Willardson, Lipscomb, & Miller, LLP, and Burgin is the retired CEO of Mission Hospitals in Asheville.

Other members of the Center's 23-member Board of Directors are: Astrid Chirinos of Charlotte, Betty Craven of Chapel Hill, Natalie English of Charlotte, Ken Eudy of Raleigh, Dr. James Jones of Hampstead, Connie Majure-Rhett of Wilmington, Karen McNeil-Miller of Winston-Salem, Fred Stang of Durham, Gwynn Swinson of Raleigh, Gregg Thompson of Raleigh and Spruce Pine, and "B" Townes of Wilkesboro.

Burgin, McNeil-Miller, Swinson, and Thompson were re-elected to serve another term on the Center's Board. Board members normally serve staggered three-year terms, with a limit on service of two consecutive terms. Completing their exemplary service on the Board were Sen. Walter Dalton, Allen Feezor of Washington and Raleigh, Marilyn Foote-Hudson of Durham, Loleta Foster of Fayetteville, Randy Fraser of Raleigh, and Sen. Jean Preston of Emerald Isle.



Pictured from left to right: Bob Burgin, Leslie Anderson, John Willardson, Betsy Justus, and Wanda Bryant

**Special Thanks to Our Foundation and Corporate Contributors  
October 1 - December 31, 2008**

The Center recognizes and thanks the **Moses Cone Wesley Long Community Health Foundation** for their commitment of a grant up to \$30,000 in 2009 for our study of reforming mental health reform. And, we thank the **Annie Penn Community Trust**, which also committed \$5,000 to this important study.

The Center also recognizes and thanks the **Mission Healthcare Foundation, The Belk Foundation, and The Ettinger Foundation** for their generous support. Mission Healthcare Foundation awarded two grants totaling \$10,000 for our study of issues affecting the aging. The Belk Foundation contributed \$5,000 in general operating support, and the Ettinger Foundation contributed \$2,000 in general operating support. The Center also recognizes the **A.J. Fletcher Foundation** for their commitment of \$10,000 in general operating support in 2009. It's been a tough year for nonprofits like us, so we really appreciate these grants.

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