Publicly Financed Elections

An Idea Whose Time Has Come?

Also In This Issue • The Medicaid/Sales Tax Swap and the Highway Handoff: Revolutionary? • Using Economic Development Incentives Prudently • Facts about Eminent Domain
Popular Government

James Madison and other leaders in the American Revolution employed the term "popular government" to signify the ideal of a democratic, or "popular," government—a government, as Abraham Lincoln later put it, of the people, by the people, and for the people. In that spirit Popular Government offers research and analysis on state and local government in North Carolina and other issues of public concern. For, as Madison said, "A people who mean to be their own governors must arm themselves with the power which knowledge gives."

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The School of Government at the University of North Carolina at Chapel Hill works to improve the lives of North Carolinians by engaging in practical scholarship that helps public officials and citizens understand and strengthen state and local government. Established in 1931 as the Institute of Government, the School provides educational, advisory, and research services for state and local governments. The School of Government is also home to a nationally ranked graduate program in public administration and specialized centers focused on information technology, environmental finance, and civic education for youth.

As the largest university-based local government training, advisory, and research organization in the United States, the School of Government offers up to 200 classes, seminars, schools, and specialized conferences for more than 12,000 public officials each year. In addition, faculty members annually publish approximately fifty books, periodicals, and other reference works related to state and local government. Each day that the General Assembly is in session, the School produces the Daily Bulletin, which reports on the day's activities for members of the legislature and others who need to follow the course of legislation.

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ON THE COVER: Will the campaigns behind the buttons soon draw more from public monies than from private donations? North Carolina has been experimenting with a public finance option for some judicial and statewide administrative offices. Cover art courtesy of Lew Powell Memorabilia, North Carolina Collection, Wilson Special Collections Library.
School Faces Budget Challenges

Like the rest of the country, North Carolina is facing budget challenges, and everyone expects the situation to get worse before it gets better. The School of Government is committed to working closely with our government partners to continue meeting the needs of all North Carolinians during these difficult times.

It is impossible to know exactly how bad the state budget will look in the upcoming fiscal year. The projected state deficit seems to increase each month, with some people speculating that it will reach $3 billion. Local government revenue sources (sales taxes, development fees, and others) have been affected negatively by the recession. A number of cities and counties have enacted hiring freezes, and some have restricted spending for travel and training.

The School also is directly affected by the budget crisis. Former Governor Mike Easley imposed temporary budget cuts in the 2008-9 fiscal year—the School’s budget has been cut by 6 percent since July 2008. Carolina is a public university, which means that any legislative budget cuts imposed later this spring will be passed along proportionally to the School. We are planning how we would manage a permanent state budget cut of 7 percent, but we recognize that it could be higher.

Our goal is to absorb whatever permanent budget cuts come our way with the least possible disruption in services to you. We will continue responding to your need for high-quality training, advising, and publications, realizing that you may require our assistance more than ever during this crisis. It will not be easy because state funding accounts for 60 percent of our total budget, and most faculty and staff salaries are paid from our state appropriation.

Please understand that we are committed to working with you to meet the needs of your citizens. We are looking hard for ways to reduce our costs, and we will explore even more effective and efficient ways to deliver training and other services. This is an opportunity to challenge ourselves to be innovative and entrepreneurial in what we do and how we do it.

These fiscal woes coincide with the School’s strategic planning process, which focuses on how we can have the greatest possible impact in our work. We will continue our strong partnership with government, which has served North Carolina well through good and bad times for many generations.

—Michael R. Smith, dean, School of Government

School Prepares Issue Papers for Perdue’s Transition Groups

In November and December, 24 School of Government faculty and professional staff, assisted by 11 Master of Public Administration students, participated in Governor-elect Beverly Perdue’s transition process by preparing issue papers based on input from diverse stakeholders.

Fourteen issue areas were identified by Perdue’s staff, among them military, aging, energy, health, corrections, education, and revenue. One-day input sessions were held for transition advisory groups (TAGs). Each TAG had 20-40 members representing different viewpoints. Sessions included presentations by relevant state agency leaders, followed by questions, comments, and discussion among the participants.

The TAG sessions were held in Wake County, November 19-25. Facilitators and recorders were provided by the Small Business and Technology Development Center (SBTDC, a unit of North Carolina State University). SBTDC and School personnel helped small groups identify key issues and potential actions for Governor-elect Perdue’s consideration.

School faculty and professional staff then prepared summaries, delivered on December 8. The summaries were sent to all participants in the input sessions and are available online at www.governor.state.nc.us/.

Dean Michael R. Smith said, “We are pleased to have been part of the transition planning for the new governor. This short-term effort complemented our nonpartisan work for leaders in the North Carolina General Assembly through the Legislative Reporting Service and faculty assistance to legislative committees.”
New Online Resource Available for LME Board Members

The School has developed an online training program for the governing board members of local management entities (LMEs), which are responsible for public mental health, developmental disabilities, and substance abuse services in their county or region.

School faculty member Mark Botts led the effort in partnership with School distance-learning specialists Joel Galbraith and Nancy Kiplinger. The program is publicly available, at no charge, at www.sog.unc.edu/programs/mentalhealth/.

The Essential Governing Responsibilities of LME Boards consists of five modules, whose topics are LME boards’ legal responsibilities, budgeting and finance, making decisions and setting direction, accountability, and working with others. Each module has a narrated presentation matched with visual information and learning activities. The learner can pause a module at any time, review earlier material, and download related resources.

"Although the School has been steadily adding to our distance-education offerings," says Dean Michael R. Smith, "this marks a big step forward in reaching community volunteers who are less likely to have time to come to the daytime courses we offer. We will keep working on making high-quality learning available to government officials and community leaders via videos, the Internet, and other means.” For more information about online media at the School, see pages 47-48.

School Hosts Webinar on New Neighborhood Stabilization Program

On November 18, the Community and Economic Development (CED) Program hosted a webinar in partnership with the North Carolina Department of Commerce, Division of Community Assistance (DCA). During the 90-minute online learning session, participants could both watch and listen to the presentation on their computers. They also had the option of listening on the telephone via a toll-free conference line.

The topic of this no-charge learning opportunity for local governments and nonprofit community development organizations was the Neighborhood Stabilization Program (NSP), a new effort with funds recently allocated by Congress to help respond to the home foreclosure crisis.

More than one hundred people participated in the webinar, representing all regions of the state. The majority of participants were local government officials (54 percent). They were joined by leaders of nonprofit organizations (17 percent), state government officials (12 percent), representatives of councils of government (5 percent), and other interested parties (12 percent).

Jennifer Lobenhofner, CED Program director, moderated the session. Vickie Miller, assistant director of the DCA, was the primary speaker. Miller presented the state’s proposed plan for using the newly available NSP funds to have the most impact in the state’s areas of greatest need. She described the state’s procedure for identifying the areas of greatest need; the eligibility of communities to receive a portion of the funds; the application process; and the

continued on page 45
A Revolution in Responsibilities of North Carolina Governments

Michael L. Walden

In 2006 and 2007, the North Carolina General Assembly made five legislative changes affecting the responsibilities and the finances of the state and local governments:

- It capped the state gas (motor fuels) tax at 29.9 cents per gallon through June 30, 2009.
- It gave counties the authority to participate in financing highway construction and maintenance.
- It provided for the state fully to take over the county share of Medicaid funding, by July 2009.¹
- In compensation for the state’s assumption of the counties’ share of Medicaid funding, it provided for the state to remove authorization for the counties to collect 0.50 percent of the local sales tax and to transfer this rate to the state sales tax.²
- It gave counties the authorization to enact either a 0.25 percent local sales tax or a 0.40 percent land transfer tax, but not both, with approval from a public referendum.³

Although one can consider these changes in isolation, one can connect dots among several of them. Obviously the state’s assumption of county Medicaid funding and the state’s takeover of 0.50 percent of the local sales tax are related. State lawmakers decided that because they were relieving the counties of a major expense, they were justified in transferring a local funding source to state coffers.

Perhaps less apparent, the freezing of the gas tax and the provision of authority for counties to finance roads also may

The author is a William Neal Reynolds Distinguished Professor in the Department of Agricultural and Resource Economics at North Carolina State University. Contact him at michael_walden@ncsu.edu.
be related. The freezing of the gas tax will result in reduced state highway revenues. Therefore one interpretation is that the state is encouraging counties to share in highway responsibilities by giving them highway-financing authority. Then, with the new tax options, counties have a direct financing mechanism for highways. Or they can use those options for alternative purposes and free up other public revenue resources for highways.

This article focuses on the implications of these connections for the state’s counties. First, it discusses trends in the two public functions involved in the changes, highways and Medicaid. Then it attempts to answer two essential questions: What will be the net financial impact of the changes on the counties, and if the impact is negative, what is implied for local revenue sources, including the newly authorized taxes?

**The Highway Hot Potato**

For many decades, North Carolina was known as the “good roads state.” A major reason was that the state’s financing system for highways kept pace reasonably well with both economic growth and prices. The primary source of financing for highway projects has been the gas tax. The tax is effectively a user fee applied to drivers, so as use of highways has increased—that is, as drivers have traveled more miles—revenues have automatically risen. However, being a rate (cents) per gallon, the tax is susceptible to declines in purchasing power as price inflation occurs. In the past, legislators addressed this issue either by increasing the rate periodically or, since 1986, by linking a portion of the rate to the level of wholesale gas prices.

Yet in recent years, these adjustments have not been adequate to maintain the gas tax’s purchasing power (see Figure 1). Since the early 1990s, the gas tax adjusted for inflation in highway construction prices has trended downward. For example, in 2005 the tax, in constant dollars, was 30 percent lower than in 1992. Also, as a percentage of the size of the state economy (the gross state product), total highway spending in the state from all sources, including the federal government, has been almost 40 percent lower in recent years compared with the early 1970s.

**Figure 1. North Carolina Gas Tax and Highway Spending, 1972–2005**


*The gas tax is adjusted for changes in the price index of highway construction.*
Further, vehicles have become heavier and therefore have generated more wear per mile. North Carolina perhaps is becoming a “poor roads state.” Indeed, North Carolina’s rankings on various measures of road quality have fallen in the past two decades. From 1984 to 2003, the percentage of North Carolina rural interstate pavement in poor condition almost tripled, and the percentage of urban interstate pavement in poor condition more than doubled. In 2003, North Carolina ranked in the 40s among the 50 states on these measures.

Three sources make up 80 percent of highway financing in North Carolina: the state gas tax (described earlier), federal highway assistance, and the state highway use tax. Federal highway assistance is funded through a federal gas tax per gallon, although monies collected from each state are not necessarily returned to that state. The state highway use tax is a sales tax on the retail sale of vehicles. All three revenue sources face issues.

As long as the gas tax remains capped, the purchasing power of its revenues will drop. For example, at a relatively modest annual inflation rate of 3 percent, the gas tax per gallon in constant dollars would fall 34 percent in ten years, and highway spending per vehicle mile (also in constant dollars) would drop 15 percent. After twenty years, the reduction in the gas tax would be 81 percent, and the fall in spending per vehicle mile, 41 percent.

The outlook may be even more dismal for federal highway assistance. The federal gas tax, at 18.4 cents per gallon, was last changed in 1996. Consequently its purchasing power has severely eroded, and payments from the federal Highway Trust Fund have exceeded receipts. The Congressional Budget Office estimates that the fund will be exhausted sometime during fiscal year 2009. Also, the federal gas tax will expire in 2011. Therefore, whether the federal government will be a source of highway financing for North Carolina (and other states) in coming years is uncertain.

Two issues confront the state highway use tax. First, the amount of the tax is capped for commercial vehicle sales. Second, the price of vehicles is not assured of rising with the increase in highway construction costs. In fact, average vehicle prices fell during the 2000s. As a result, the average annual increase in receipts from the highway use tax this decade has been only 1 percent, well below the average annual increase in highway construction costs prompted by significant jumps in worldwide use of concrete, steel, and other building materials.

The Medicaid Takeover

Medicaid has been one of the fastest-growing components of any government budget. For the Medicaid share of North Carolina counties, the average annual rate of increase since 1991 has been just under 10 percent. The Congressional Budget Office forecasts that Medicaid spending will increase at an average annual rate of 7.9 percent.
between 2008 and 2018.\textsuperscript{13} By the time the state takeover of county Medicaid spending is fully implemented, it will relieve counties of almost $700 million in annual spending, while counties will lose nearly $350 million in sales tax receipts.\textsuperscript{16}

However, all counties will not be relieved to the same degree. A 2002 analysis in \textit{Popular Government} by John Saxon clearly shows a relationship between the relative size of a county’s Medicaid expenditures and the county’s economic condition.\textsuperscript{14} In general, counties with a high poverty rate and low wealth pay a higher percentage of their budget for Medicaid expenses and devote a higher proportion of their property tax base to those expenses. For example, using fiscal year 2002 data, Saxon shows that Medicaid spending took five to six times more of the budgets of high-poverty/low-wealth counties than of low-poverty/high-wealth counties. Also, the cents per $100 of property value needed for Medicaid expenditures could be ten times greater in high-poverty/low-wealth counties than in low-poverty/high-wealth counties.

The General Assembly recognized that counties’ fiscal position would be

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Source: The calculations are mine. The dollar amounts of net gains are from the North Carolina Association of County Commissioners, www.ncacc.org/medicaid_1007.html. The county-raised public revenues also are from the North Carolina Association of County Commissioners, with the latest data for fiscal year 2005–6 projected to fiscal years 2010–11 and 2011–12 using the county average annual growth rate in revenues for 1995 to 2005.
affected in different degrees by the Medicaid/sales tax swap and that, indeed, some counties, particularly high-wealth counties with relatively low Medicaid rolls and high sales tax receipts, could lose from the exchange. Consequently, it added two components to the plan to guarantee that all counties would benefit financially. First, of the 2.0 percent local sales tax remaining after the 0.5 percent taken back by the state, 1.5 percent will be returned to the counties that generated the tax revenue, while 0.5 percent will be allocated to counties on a per capita basis. Without this change, 1.0 percent would have been distributed to the generating county, and 1.0 percent would have been allocated by the per capita method. The change favors counties that serve as regional retail centers, many of which are the higher-wealth areas with relatively low Medicaid rolls.

Second, the legislation added a “hold harmless” provision guaranteeing that all counties will come out ahead from the Medicaid/sales tax swap. Specifically, the state will calculate the reductions in county Medicaid costs and the net change in revenues from the loss of the 0.5 percent sales tax together with the change in the distribution formula of the remaining local sales tax. If the result shows that the county has lost more revenues than it has gained in spending reductions, the state will provide the county with additional revenues to make the net gain equal $500,000. Also, if the county shows spending reductions exceeding revenue losses, but the net gain is under $500,000, the state will provide revenues to bring the net gain up to $500,000.\(^{13}\)

County budgets will fare variously in the first two full fiscal years of the Medicaid/sales tax swap, measured by net gain as a percentage of county-raised revenue (see Table 1). In fiscal year 2011, the range will be from a low

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**Details of the Model to Evaluate the Tradeoff in a Highway Handoff**

The model estimated the net financial impact on counties over the seven years (2008–15) of the State Transportation Improvement Plan (STIP). For highway revenues, the focus was on the state gas tax.\(^{3}\)

To find savings to drivers from the capped gas tax, I calculated payments with and without the cap. These calculations used projections of vehicle miles traveled (VMT) in each county, fuel efficiency (miles per gallon), and gas prices. I based VMT projections on past county trends, I assumed that miles per gallon would increase at a rate of 0.4 percent per year, and I used three alternative paths for future gas prices: 3, 5, and 10 percent annual increases.\(^{2}\) For the capped gas tax, I based revenues on the cap of 29.9 cents per gallon. For the uncapped gas tax, I based revenues on the gas tax formula used before the cap.\(^{3}\)

I then estimated highway spending to be paid by the county. First, I estimated the reduction in the availability of state highway funding entailed by the cap in the state gas tax for each year of the projection period. Second, I distributed the reductions to each county on the basis of the county’s spending share in that year of the STIP.\(^{4}\)

I then calculated the net gain (gas taxes saved minus reduced state highway spending in the county) for each county for each year. I converted the stream of annual net gains for 2008–15 to an annualized present value in 2008 to provide a summary measure.\(^{5}\)

Last, I divided the annualized present-value net gain by a county’s own projected public revenue in 2008 to express the results in relative terms.

**Notes**

1. I examined only the state gas tax because of the article’s focus on the changing responsibilities of the state and the counties in North Carolina.

2. VMT trends by county are from North Carolina Department of Transportation data, compiled by the North Carolina Capital Area Metropolitan Planning Organization. The annual gain in fuel efficiency is an extrapolation of state trends from 1990 to 2004, also from the North Carolina Capital Area Metropolitan Planning Organization. The 10 percent annual increase in gas prices is the approximate rise since 1999, and the 3 and 5 percent rates reflect more modest increases.


4. The STIP is the largest of the state highway-spending programs, usually accounting for close to half of all highway spending in any year. A projection of total highway spending by county for 2008–15 does not exist. However, a high degree of correlation (0.865) exists between average county spending shares in the 2008–15 STIP and average county spending shares for total state highway spending from 1990 to 2004 (according to data gathered by the North Carolina Department of Transportation and compiled by the North Carolina Capital Area Metropolitan Planning Organization). Therefore the STIP county shares should be representative of average county spending shares for total highway spending.

5. Analysis of variations in highway construction costs and gas prices from 1976 to 2006 showed that highway construction costs increased at a rate equal to 70 percent of the increase in gas prices. Therefore the nominal discount rate used in the present value calculations varied with the assumed increase in gas prices. In all cases, a real discount rate of 2 percent was used. Tao Wu, “Estimating the ‘Neutral’ Real Interest Rate in Real Time,” FRBSF Economic Letter, no. 2005-27, October 21, 2005. For gas price increases of 3 percent, the inflation component was therefore 2.1 percent (0.7 multiplied by 3), and the total discount rate was 4.1 percent. For gas price increases of 5 percent, the inflation component was 3.5 percent, and the total discount rate, 5.5 percent. For gas price increases of 10 percent, the inflation component was 7 percent, and the total discount rate, 9 percent.
The Highway Handoff: Win, Lose, or Draw for Counties?

The dots that I have connected between the freezing of the state gas tax and the provision of new authority for counties to finance roads imply a partial handoff of the financial responsibility for highways from the state to the counties. Although no legislation mandates that such a handoff occur, as long as the freeze on the gas tax continues, state highway revenue (in constant dollars) will decline. Unless the state institutes a new source of revenue for roads, county financing will be needed to fill the gap. If this scenario unfolds, studying the resulting financial impact on counties is important.

Table 2. Average Annual Net Gains from Reduced State Gas Tax Payments and Added Local Highway Spending, as a Percentage of County-Raised Public Revenue, by County, 2008-2015

<table>
<thead>
<tr>
<th>County</th>
<th>Without Medicaid Net Gain</th>
<th>With Medicaid Net Gain</th>
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</thead>
<tbody>
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<td></td>
<td>3%</td>
<td>5%</td>
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<tr>
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</table>

continued on page 10
The potential highway handoff to the counties would have pluses and minuses. On the plus side, if gas prices continued to rise, drivers would pay lower state gas taxes (with the capped gas tax) and no federal gas taxes if the federal tax was eliminated. Also, counties that have been net donors of state highway taxes (those that have paid more state highway taxes than they have received in state highway funding) might gain from the shift to greater local funding of roads.

On the minus side, counties (and their residents, including drivers) might be responsible for funding that part of highway spending not now available because of the lower state and federal gas taxes. Also, counties that have been net beneficiaries of state highway taxes (those that have received more state highway funding than they have paid in state highway taxes) might lose from the move to local funding.

These tradeoffs would be complicated and have no obvious outcome. Therefore I developed a model to evaluate how counties might be financially affected by the highway handoff. The model estimated the net financial impact on counties over the seven years (2008–15) of the State Transportation Improvement Plan (STIP). It accounted for anticipated highway revenues and savings to drivers under two conditions: with the capped gas tax and without it (a condition that would require action by the General Assembly). Savings to drivers were based on calculations of vehicle miles traveled, fuel efficiency,

Table 2. Average Annual Net Gains

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<tr>
<th>County</th>
<th>Without Medicaid Net Gain</th>
<th>With Medicaid Net Gain</th>
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Figure 2. Average Annual Net Gains from Reduced Gas Tax Payments and Added Local Highway Spending, as a Percentage of County-Raised Public Revenue, 2008–2015, without Medicaid Net Gain

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# Greater than 5%
# 0% through 5%
# -5% to 0%
# Less than -5%
Table 2. Average Annual Net Gains

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<th>County</th>
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<th>Without Medicaid Net Gain 5%</th>
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<td>-0.62</td>
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<td>9.71</td>
<td>9.88</td>
<td>10.59</td>
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<td>Wilson</td>
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<td>12.48</td>
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<td>Yadkin</td>
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<td>5.32</td>
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<td>-46.12</td>
<td>-32.41</td>
<td>-36.00</td>
<td>-42.00</td>
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</table>

Source: The calculations are mine. I used the model and the data described in "Details of the Model to Evaluate the Tradeoff in a Highway Handoff," page 8.

Figure 3. Average Annual Net Gains from Reduced Gas Tax Payments and Added Local Highway Spending, as a Percentage of County-Raised Public Revenue, 2008-2015, with Medicaid Net Gain

and gas prices. The model calculated highway spending to be paid to each county on the basis of the reduction in the availability of state highway funding (because of the cap in the state gas tax), and it allocated those reductions according to each county’s spending share in each year of the STIP. (For details of the model’s construction, see the sidebar on page 8.)

If the net gain to counties from the Medicaid takeover was not included, the split between “winning” and “losing” counties would vary little with the assumed annual increases in gas prices: 60–40 for 3 percent increases, 58–42 for 5 percent increases, and 61–39 for 10 percent increases (see Table 2, columns 2–4). The size of the relative net gains also would vary little with gas price inflation. (For the results geographically for the mid-range case of a 5 percent annual increase in gas prices, see Figure 2.)

The reason for these outcomes is the strong correlation between the rate of increase in gas prices and the rate of increase in highway construction costs. The costs of both commodities (gas and highway construction inputs) are tied to the price of oil. Indeed, a separate analysis shows that highway construction costs would rise at a rate equal to 70 percent of the rise in gas prices. Therefore, higher gas prices, which in the model resulted in greater tax savings to drivers, would be countered by higher highway construction costs to be paid by the county.
The two effectively would cancel each other out.

A modest negative correlation existed between the net gain and the poverty rate in the counties, suggesting that the net gain would be higher for low-poverty counties and lower for high-poverty counties. This finding implies that some redistribution of funds would occur in the STIP from low-poverty, "net donor" counties to high-poverty, "net beneficiary" counties. Therefore, moving from state financing of highways to county financing would be an advantage to net donor counties and a disadvantage to net beneficiary counties. Some counties, most notably Tyrrell, would be severely disadvantaged.

Geographically, a mix of winning and losing counties would occur across the midsection of the state, but along the eastern coastal area and in the western mountain region, there would be a higher proportion of losing counties. This suggests that counties in both the far east and the far west have been net beneficiaries of the current formula for state highway funding.

If the net gains from the Medicaid takeover were added to the net gains from the change in highway responsibilities (see Table 2, columns 5–7), all the percentages would be greater (either more positive or less negative) because every county would experience a net gain from the Medicaid takeover. (For

(Savings in state gas tax + savings from Medicaid takeover) - increased local taxes = net gain for taxpayers. But communicating this might be difficult.

local taxes would be less than the combined savings in state gas taxes and local Medicaid funding), communicating this result to local taxpayers might be challenging for local officials.

To see the possible impacts of the Medicaid takeover and the highway handoff on local taxes, consider the mid-range case of a 5 percent annual increase in gas prices (see Figure 3). Of the 73 counties that would experience a net gain, 26 would garner enough savings from the Medicaid takeover to pay their local road expenses. Of the remaining 47 with a net gain, 25 would be able to meet their new highway responsibilities with the authorized 0.25 percent sales tax, and 4 could cover their road costs with the 0.40 percent land transfer tax. The other 18 counties would need to increase property taxes by an average of 3.6 percent to supplement whichever tax (the 0.25 cent sales tax or the 0.40 percent land transfer tax) provided more revenue.

Of the 27 counties that would suffer a net loss from the Medicaid takeover and the highway handoff, only 2 would collect enough revenue from either the 0.25 percent sales tax or the 0.40 percent land transfer tax to cover their new
highway responsibilities. The remaining 2.5 would require an average increase of 20 percent in property tax revenue to supplement the maximum that they would receive from either the 0.25 percent sales tax or the 0.40 percent land transfer tax. However, the range around this average is substantial. Five counties would need less than a 5 percent rise in property tax revenues, while 6 would require more than a 30 percent jump.

The Reality of the Revolution

North Carolina may be on track to experience the most significant realignment of state-local public responsibilities since the 1930s. The takeover of local Medicaid spending by the state government is a clear win for counties. Although the shift is progressive (in that high-poverty counties gain the most), thanks to the tweaking of the tax-distribution formula and the introduction of the hold-harmless provision, all local budgets will be winners. Issues of funding Medicaid and addressing its rapidly rising costs now shift completely to the federal and state governments.

The shift of highway responsibilities implied by the cap on the state gas tax and the new authority for counties to finance roads is more complicated. Drivers will pay less in state gas taxes than they would have paid without the cap, but the state will have fewer revenues for state-funded projects. Thus, if localities are to realize the same amount of highway construction and maintenance that they would have received without the cap, they will have to tap local public resources.

The results of a model for the next STIP show that the combination of the two shifts in responsibility would be, at net, beneficial to more than 70 percent of the counties. Although this finding is encouraging, it still would leave two issues for public officials. One is to convince drivers that their future tax burden is effectively being lowered by the capped state gas tax. Increases in the uncapped gas tax do not represent an increase in “real” (inflation-adjusted) highway taxes because such increases are prompted only by rises in gas prices. The formula for the uncapped gas tax represents a way for highway revenues to keep pace (partially) with highway construction costs. So, with continuing rises in gas prices, the capped gas tax represents an ongoing tax cut for drivers.

In reality, however, most drivers would not interpret circumstances in this manner. So if local taxes were increased to offset the decline in state highway funds, drivers would likely view such an action as a “real” tax hike. Hence economic education must be a crucial part of the new reality of state and local responsibilities.

The second issue rests with the counties that would not be net beneficiaries of the responsibility shift. For example, assuming an annual inflation rate of 5 percent in gas prices, 27 counties would be net losers from the combined Medicaid takeover/highway handoff. Only 2 of these counties would be able to fund the resulting deficit from either the new 0.25 percent local sales tax or the 0.40 percent local transfer tax. The rest would require supplementary increases in local property taxes, with several requiring more than a 30 percent increase. Such increases probably are unrealistic for counties.

The Medicaid takeover is a reality and will be a winner for all county public budgets. Such is not the case with the highway handoff. First, however, it may not happen. The General Assembly could unfreeze the state gas tax, which would slow, but not eliminate, the decline in inflation-adjusted state highway revenues. Alternatively the state could implement other revenue sources for highway funding.

If the highway handoff did occur, though, this analysis suggests that the
transition would not be easy. Even in counties where the financial result would be a net plus, residents would have to be educated about the relative gains and losses to their wallets and about the implications for how highway money would be raised and spent. The task would be tougher in the roughly 25 percent of counties that could experience a net loss from the combined Medicaid takeover/highway handoff.

The aftermaths of revolutions can sometimes be challenging, even disappointing. North Carolina appears to be in the midst of rethinking its division of responsibilities between the state and local levels. Education and analysis are part of the keys to making sure the crowd on the other side of the barricades is welcoming.

Notes

1. The state assumed 25 percent of the local Medicaid share on October 1, 2007, and 50 percent on July 1, 2008. The complete state takeover of the local share begins July 1, 2009.

2. The switch in the rate from the local sales tax to the state sales tax will occur in two stages, with 0.25 percent occurring in 2008 and another 0.25 percent occurring in 2009. Therefore the loss in the local sales tax will be 0.25 percent in 2008 and 0.50 percent in 2009 and thereafter.

3. Details on each of the laws can be found in North Carolina General Assembly, Summaries of Substantive Ratified Legislation—2007, available at www.ncleg.net. There is some question about the longevity of the option to adopt a land transfer tax, because bills were introduced in the 2008 session of the General Assembly to repeal it for local governments. Karl W. Smith evaluates the economic and political implications of the two taxes in “Evaluating New Revenue Sources for Counties,” Popular Government, Fall 2008, pp. 20–30.


6. Trends in other highway spending measures, such as inflation-adjusted spending per mile driven, show the same pattern. Gross state product is a measure of total economic production in the state in a given year.


9. Traditionally, North Carolina has received less than a dollar in federal highway assistance per dollar paid in federal gas taxes. The cumulative ratio of federal highway assistance received per dollar of federal gas taxes paid from 1936 to 2005 was 0.90, third lowest among all states. However, the ratio has improved in recent years. For example, in 2005 the ratio for North Carolina was 1.03. Jonathan Williams, Paying at the Pump: Gasoline Taxes in America, Background Paper no. 56 (Washington, DC: Tax Foundation, 2007).

10. Estimates of the reductions in spending per vehicle mile traveled are based on a regression analysis relating spending per vehicle mile (in constant dollars) to the gas
tax (also in constant dollars), federal highway spending in North Carolina as a percentage of North Carolina gross state product, and the North Carolina highway use tax.


14. North Carolina Association of County Commissioners, “Medicaid Spending by County,” www.ncacc.org. The data are periodically taken off the site. They are not available now.


18. The hold-harmless provision also takes into account municipalities’ loss of sales tax revenue. Municipalities are compensated for these losses.

19. As stated in text at reference note 17, Medicaid spending is expected to increase an average of 7.9 percent annually through 2018. During the ten years from 1995 to 2005, public revenues raised from local sources (that is, not including transfers from the federal and North Carolina governments) increased at an average annual rate of 6.3 percent for North Carolina counties, U.S. Census Bureau, “State and Local Government Finances,” www.census.gov/govs/www/estimate.html.

20. The findings result from conducting a regression analysis of the net gain on the county poverty rate. The poverty rate is from 2005, the latest year available (www.census.gov/did/www/saipe/index.html).

21. The correlation between the poverty rate and property wealth per capita also is weak, at only 0.11. Property wealth per capita is from the North Carolina Data Center and is for 2005, the latest year available (http://linc.state.nc.us/).


23. The correlation of the net gain with the poverty rate is –0.24. The correlation with property wealth per capita is only –0.06.


25. The large net losses for Tyrrell County are easily explained by looking at the county’s spending shares in the STIP. With only 0.05 percent of the state’s population and 0.30 percent of the state’s vehicle miles traveled, Tyrrell is scheduled to receive an average of 1.10 percent of state highway spending in the STIP during 2008–2015.

26. Indeed, this also is the finding of an analysis of state highway funding by the North Carolina Justice Center, Stephen Jackson, At the Crossroads: Recommendations for the Future of Transportation in North Carolina (Raleigh, NC: North Carolina Justice Center, 2008), www.ncjustice.org/assets/184_btcrap28feb08roadfund.pdf.

27. The winning-losing split is 74–26 for 3 percent gas price inflation, 73–27 for 5 percent gas price inflation, and 71–29 for 10 percent gas price inflation.

28. Estimates of county revenues from the 0.25 percent sales tax and the 0.40 percent land transfer tax are from the North Carolina Association of County Commissioners, www.ncacc.org/documents/revenueauthority_073107.pdf. Because revenues from the land transfer tax vary with the performance of the real estate market, revenue estimates from the tax were averaged for 2006 (a good year in real estate) and 2007 (a more modest year in real estate). All dollar values are adjusted to 2008. The four counties with highway expenses covered by the land transfer tax are counties where revenues from the one-quarter-cent sales tax would fall short of highway costs.

29. The average of 3.6 percent is a simple average of the increases for the sixteen counties. The range of the increase is from 0.3 percent to 9.0 percent.
Using Economic Development Incentives: For Better or for Worse

Jonathan Q. Morgan

State and local incentives to stimulate economic development have increased in North Carolina, as they have across the United States. State and local governments continue to deal with the realities of economic transition created by globalization and technological advances. The quest for private investment and jobs in an increasingly competitive global economy is raising the stakes of economic development. The jurisdictions that aggressively use incentives to succeed in the "job wars" can potentially win big—but at what cost and toward what end?

Some recent large deals in North Carolina illustrate how the immediate thrill of victory in the incentives game must be tempered by questions about the actual net benefit to the state and its communities. For example, assuming that Winston-Salem and Forsyth County had to promise about $280 million in state and local incentives to attract a Dell computer-assembly plant, was doing so worth it? What about the $262 million offered to land a Google data center/server farm in Lenoir and Caldwell County? A new state grant program to encourage Bridgestone/Firestone and Goodyear to expand and upgrade facilities at locations in eastern North Carolina could cost as much as $60 million. State incentives alone totaled $3.7 billion from fiscal years 2005–6 through 2007–8. Some observers have a nagging sense that the state and its local governments might be paying large corporations too much for jobs and investment while overlooking the needs of existing industries and small businesses.

The proliferation of business incentives for economic development is con-

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troversial, in part because public officials often fail to assess adequately the net return on the public investment in incentive deals. Other concerns about the growing use of incentives center on whether they work and what the rationale is for using them. The strongest argument offered by proponents for the continued and expanded use of incentives is that incentives actually influence business location decisions. Although some evidence supports this claim, skeptics cite numerous studies that show incentives having little or no positive direct effect on investment decisions.

This article provides public officials with a roadmap for navigating the debate on economic development incentives. The intent is not to take a position for or against incentives, but to discuss the enduring arguments from both sides and the latest research findings on incentives so that readers can make informed decisions. Many jurisdictions probably will offer business incentives into the foreseeable future. The article may help them be more strategic and judicious in using incentives to bring about desired economic development outcomes.

The Evolution of Incentives in North Carolina

The State of North Carolina had no comprehensive incentive policy until the General Assembly passed the William S. Lee Quality Jobs and Business Expansion Act (Lee Act) in 1996. Before that, the state had relied mostly on other sources of relative advantage, such as its low labor costs, well-developed transportation infrastructure, and responsive community college system. A limited tax credit for job creation and the Industrial Recruitment Competitiveness Fund (now the One North Carolina Fund) had been established in 1993, but economic developers and policy makers did not deem them sufficient. A spate of losses of industrial projects, including Mercedes-Benz to Alabama and BMW to South Carolina, prompted state officials to take a more assertive stance with economic development incentives.

The Lee Act created an expanded set of tax credits targeted at new and growing industries, with the aim of strengthening North Carolina’s competitive position. An important feature of the Lee Act is that it provides the greatest aid to the state’s most disadvantaged areas. The amount of tax credits available to companies in a particular county is based on the county’s level of economic distress. Counties are grouped into tiers on the basis of an index of economic performance indicators. Higher amounts of incentive dollars are available in Tier 1 (poorer) counties.

The Lee Act signaled that North Carolina was “open for business” and serious about securing its share of industrial projects. The act also sparked strategic thinking and ongoing debate.

Losing some big manufacturing plants to other states in the mid-1990s prompted North Carolina to become more assertive in offering direct financial and tax incentives.
Milestones in Policy on Economic Development Incentives in North Carolina

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>1993</td>
<td>Industrial Recruitment Competitiveness Fund created by N.C. General Assembly (now One North Carolina Fund)</td>
</tr>
<tr>
<td>1996</td>
<td>William S. Lee Quality Jobs and Business Expansion Act (Lee Act) enacted by N.C. General Assembly</td>
</tr>
<tr>
<td>2002</td>
<td>Job Development Investment Grant (JDIG) program created by N.C. General Assembly</td>
</tr>
<tr>
<td>2006</td>
<td>Article 3J tax credits enacted by N.C. General Assembly to replace Lee Act</td>
</tr>
<tr>
<td>2007</td>
<td>Job Maintenance and Capital Development Fund created by N.C. General Assembly</td>
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Local Incentives

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>1925</td>
<td>Local Development Act enacted by N.C. General Assembly</td>
</tr>
<tr>
<td>1996</td>
<td>Maready v. City of Winston-Salem decided by N.C. Supreme Court</td>
</tr>
</tbody>
</table>

that have resulted in the creation of additional incentives, like the Job Development Investment Grant in 2002 (discussed later).

In the first few years after enactment of the Lee Act, the governor’s office and the North Carolina Department of Commerce announced the decisions of several major companies to locate operations in the state. In 1998, FedEx decided to build a regional sorting hub at the Piedmont Triad International Airport, and steel producer Nucor agreed to construct a new plant in Hertford County. The state offered reductions in sales taxes and enhanced tax credits for capital investment to help close these deals. In 1999, North Carolina scored wins by using incentives to land a QVC distribution center in Edgecombe County, a DuPont plant in Bladen County, and TIAA–CRFF in Mecklenburg County.

These and subsequent projects raise an important and largely unresolved question: To what extent can the state’s success in locating these facilities be attributed to the Lee Act tax credits and other incentives? That a string of significant recruitment and expansion projects occurred in the post-Lee Act period is not in doubt. At issue is whether the projects would have happened without the incentives. Most economic developers and many public officials will say, “Absolutely not.” I come back to this question later in the article.

Over the years, the General Assembly amended the Lee Act several times to address apparent deficiencies. In 2006 the General Assembly replaced it with a new program (see the later section headed Types of Incentives).

The most recent shift in state policy on economic development incentives is evident in the General Assembly’s creation of the Job Maintenance and Capital Development Fund. This program emerged out of an extra session in 2007 when lawmakers worked out a deal with the governor’s office to aid major employers in some of the state’s Tier 1 counties. Lawmakers designed the program primarily to benefit two tire manufacturers with locations in eastern North Carolina. The program authorizes up to $60 million for Goodyear to upgrade a plant in Fayetteville and for Bridgestone/Firestone to modernize a facility in Wilson. Businesses located in the most economically distressed areas of the state that invest at least $200 million in property and capital improvements and maintain at least 2,000 workers are eligible to receive annual grant payments of up to $4 million over ten years under the program.

This new incentive program represents somewhat of a policy shift because it does not require a company to create jobs in order to receive a grant. Job creation has been central to the state’s economic development policy for obvious reasons. However, the Job Maintenance and Capital Development Fund recognizes that job creation is not the only goal of economic development. Retaining jobs can be particularly important in poorer areas, and large amounts of capital investment can have significant economic and fiscal impacts.

Still, the idea of awarding grants to companies that only maintain existing employment levels, or even reduce them (for example, from 2,500 to 2,200), makes some uneasy. This shift in state policy underscores the irony of the tension between business investments in labor and capital: as companies modernize and automate, they often can produce more with fewer workers.

The statutory authority for local economic development incentives exists in the Local Development Act of 1925. The statute authorizes cities and counties to provide a number of incentives in support of business recruitment, retention, and expansion (specific incentives are discussed later). Further, it grants broad authority to local governments to undertake a wide range of economic development activities—authority so broad that starting with what the act prohibits is easier than specifying what it allows. At least three incentives provided by local governments that often are permitted in other states are not allowed in North Carolina: property tax abatements, loan guarantees to a private company, and promises not to annex a certain parcel of property. Except for the incentives that state law forbids, coun-
ties and cities routinely use the various tools discussed in the next section.

A significant milestone for local government incentives in North Carolina occurred in 1996 with the state supreme court ruling in *Maready v. City of Winston-Salem*. This decision reversed a lower court ruling that had declared the business incentives used by Winston-Salem and Forsyth County to be unconstitutional because they did not serve a public purpose. At issue were twenty-four incentive deals offered by the city and the county between 1990 and 1995 that totaled more than $13 million. By affirming that local incentives serve a public purpose, the state supreme court cleared the way for cities and counties to continue offering incentives to lure, keep, and expand industry.

In the wake of the 1996 *Maready* decision, local governments moved quickly to ramp up their incentive programs. Later that year, Cabarrus County was one of the first to adopt an aggressive incentive policy that would essentially grant new or expanding industries a rebate of up to 85 percent of property taxes paid over five years. This idea of paying companies back a portion of their property taxes mimics tax abatement to some extent. However, it can be distinguished from prohibited tax abatement when such payments are contingent on the company creating a certain number of jobs or investing a minimum amount in real property and equipment. Indeed, such arrangements can help a local government avoid paying out more in incentives than it receives in tax revenue from the company. This type of incentive is thought to be more legally defensible when it is in the form of a cash grant that is not an explicit refund of property taxes paid by a company (see the later section headed Legality). The courts have not yet weighed in on the constitutionality of this practice.

(For a summary of state and local milestones in policy on economic development incentives, see the sidebar on page 18.)

### Types of Incentives

State governments offer both tax and nontax incentives to companies. North Carolina's state-level tax incentives consist primarily of corporate income and franchise tax credits and sales tax exemptions and refunds. The Article 3J Program, which replaced the Lee Act effective January 1, 2007, provides state tax credits to eligible businesses that create jobs, invest in business property (machinery and equipment), or invest in real property (buildings and land). The credit for investing in real property is available only to companies that invest at least $10 million and create at least 200 jobs in Tier 1 counties. Article 3J tax credits are nondiscretionary, meaning that any taxpayer that meets the eligibility criteria is entitled to claim the credits.

By contrast, certain nontax incentives are discretionary grant programs in which funds are awarded on a case-by-case basis. Examples are the Job Development Investment Grant (JDIG) pro-
Table 1. Incentive Tools Used by Local Governments in North Carolina

<table>
<thead>
<tr>
<th>Percent Reporting (n = 217)</th>
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<tbody>
<tr>
<td>Zoning and permit assistance</td>
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<tr>
<td>Infrastructure improvements</td>
</tr>
<tr>
<td>Cash-grant incentives</td>
</tr>
<tr>
<td>One-stop permitting</td>
</tr>
<tr>
<td>State development zone</td>
</tr>
<tr>
<td>Land or building acquisition</td>
</tr>
<tr>
<td>Site preparation</td>
</tr>
<tr>
<td>Subsidized land or buildings</td>
</tr>
<tr>
<td>Subsidized worker training</td>
</tr>
<tr>
<td>Low-interest loans</td>
</tr>
<tr>
<td>Relocation assistance</td>
</tr>
<tr>
<td>Employee screening</td>
</tr>
<tr>
<td>Regulatory flexibility</td>
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<td>Incentives for retail projects</td>
</tr>
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</table>


Table 2. Incentives for Dell and Google

<table>
<thead>
<tr>
<th></th>
<th>Dell (in millions)</th>
<th>Google (in millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>State Incentives</td>
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<td></td>
</tr>
<tr>
<td>Computer-manufacturing tax credit*</td>
<td>$200.0</td>
<td>NA</td>
</tr>
<tr>
<td>Tax credits (Lee Act and Art. 3J)</td>
<td>21.4</td>
<td>$2.6</td>
</tr>
<tr>
<td>Job Development Investment Grant (JDIG)</td>
<td>8.8</td>
<td>4.8</td>
</tr>
<tr>
<td>Job training</td>
<td>8.3</td>
<td>NA</td>
</tr>
<tr>
<td>Infrastructure</td>
<td>3.0</td>
<td>0.7</td>
</tr>
<tr>
<td>Sales tax refund</td>
<td>1.0</td>
<td>NA</td>
</tr>
<tr>
<td>Sales tax exemption</td>
<td>NA</td>
<td>89.0</td>
</tr>
<tr>
<td><strong>Total state package</strong></td>
<td><strong>$242.5</strong></td>
<td><strong>$97.1</strong></td>
</tr>
</tbody>
</table>

| Local Incentives (City and County) | | |
|-----------------------------------|-----------------|
| Cash grants¹                      | 17.2¹           |
| Site preparation and improvements | 13.0            |
| Land                              | 7.0             |
| **Total local package**           | **$37.2**       |

<table>
<thead>
<tr>
<th>Total State and Local Incentives</th>
<th>Dell</th>
<th>Google</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td><strong>$279.7</strong></td>
<td><strong>$262.1</strong></td>
</tr>
</tbody>
</table>

Source: The figures are my compilations from various news reports and data from the North Carolina Department of Commerce. NA = not applicable.

¹ Paid out over 15 years.
² Includes $3.3 million from the Golden LEAF Foundation.
³ Paid out over 30 years.

Two Cases in Point: Recruitment of Dell and Google

Although not typical of the scale and the scope of routine incentive offers, two recent projects to recruit major businesses illustrate how public officials in North Carolina combine various state and local incentives to create a winning package. Dell and Google are two household names connected to the knowledge-based economy. Any state or community would want to land projects of theirs. North Carolina public officials and economic developers aggressively pursued these projects to bring jobs and investment to areas of the state that badly needed them and to mitigate the loss of textile and furniture industries. (For estimates of the state and local incentive packages offered to lure the new facilities of these two major corporations, see Table 2.)

The largest part of the state package for Dell is a tax credit tied to the number of computers produced at the new North Carolina facility. The General Assembly enacted this special tax credit in 2004 during an extra legislative ses-
sion to ensure that Dell would locate somewhere in the Piedmont Triad region of the state.20 Once Dell chose North Carolina, local governments in the Triad region—Davidson County, the City of Greensboro and Guilford County, and the City of Winston-Salem and Forsyth County—proposed separate local packages to lure the facility to their respective jurisdictions.21 Winston-Salem/ Forsyth had been rumored to be the favorite and offered the largest package, which consisted of cash grants, land costs, and funds for surveying, grading, paving, road construction, public utilities, and other site improvements. It is not entirely clear how influential the local incentives were, but Dell decided on the Winston-Salem site in Forsyth County. The state and local incentives for Dell largely depend on the company meeting certain performance targets with respect to employment (1,500 jobs) and capital investment ($100 million). Most of the incentive dollars will be paid out annually over time. Dell did not receive a check up front for $279.7 million.

By contrast, Google’s state incentives are mostly in the form of a full exemption from the sales taxes that it would pay to purchase electricity and certain equipment for up to thirty years. The sales tax exemption on electricity is important for Google because a server farm uses an enormous amount of electricity to keep its many computers running around the clock. The exemption also matters because the company apparently would not have had to pay this tax in many other states that were under consideration. The local incentives offered by the City of Lenoir and Caldwell County are thirty-year cash grants based on 100 percent of business property taxes and on 80 percent of real property taxes paid by Google. These incentive grants are estimated to total as much as $165 million over thirty years, which prompts some to think that Lenoir and Caldwell County “gave away the farm,” so to speak, to get a server farm.22

The amount of public dollars put on the table for Dell and Google is significant. However, the cost of each incentive package must be considered in relation to the economic and fiscal benefits that the companies will generate (see Table 3). To receive the full amount of incentives, Dell must employ at least 1,500 workers at the facility in Winston-Salem. The jobs are expected to pay an average annual salary of $28,000. Critics point out that this is lower than the average annual salary of all workers in Forsyth County. Proponents contend that the project will have a strong multiplier effect on the state and the region because of its ability to attract supplier firms to locate nearby. The North Carolina Department of Commerce estimates that Dell’s initial direct capital investment of $100 million and ongoing operations will contribute more than $24 billion to the gross state product and net the state $743 million in revenue over twenty years. Dell’s ripple effect within the region is projected to generate an additional 6,000 indirect jobs at suppliers, service companies, retailers, hotels, restaurants, and so forth.

Google expects to employ 210 workers directly in Lenoir with an average annual salary of $48,300—significantly higher than the average annual salary of workers in Caldwell County. Yet there is concern that the company will not hire local residents and will bring in workers from elsewhere because much of the local workforce lacks the education and the skills required for the jobs at the Google facility. Although Google will employ far fewer workers than Dell, its level of capital investment—$600 million—is much higher. The state

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**Selected Business Incentive Tools Defined**

**Clawbacks:** penalty provisions in incentive contracts that require companies to pay back some or all of the incentive monies they received if they fail to meet performance expectations within a certain period.

**Employee screening:** assistance to new or expanding companies in hiring workers—preemployment services, job fairs, connections to employment agencies, and the like.

**Infrastructure assistance:** help in providing, paying for, or offsetting the costs of improvements to utilities such as water and sewer systems, roads, power lines, and telecommunications on behalf of a company.

**One-stop permitting:** co-locating, streamlining, and fast-tracking of government inspection, licensing, and permitting services to make it easier for businesses to apply for and obtain various permits.

**Regulatory flexibility:** taking of steps to clarify and streamline rules, and otherwise ease the burden of government regulations on businesses.

**Relocation assistance:** provision of help to new or expanding companies in relocating executives by paying relocation costs, assisting with spousal employment, aiding in sociocultural acclimation, providing housing and child care referrals, and the like.

**Site preparation:** provision of funds to cover the costs of specialized infrastructure, engineering or survey work, clearing, grading, demolition, paving, environmental assessments, and so forth, for a company to locate at a particular site.

**State development zone:** a designated area of high poverty within a North Carolina municipality where higher state tax credits are available to companies that invest and create jobs.

**Tax increment financing:** a mechanism by which local governments issue bonds, without a voter referendum, to make public improvements that are necessary to spur private investment in a designated area. This tool relies on the incremental tax revenues that result from increases in assessed property values. The bonds are considered to be self-financing because, if successful, the public improvements they finance will stimulate new private investment and generate tax revenues that will be used to pay off the bond debt.
commerce department estimates that Google will contribute about $1 billion to the state’s economy and net the state $37 million in revenue over twelve years. At the local level, Google will purchase a substantial amount of electricity from Duke Energy, help increase revenues from the utility franchise tax, and become Lenoir’s second-largest water customer.23 The company might end up as the city’s third-largest taxpayer, even after accounting for the incentive grants it will receive.24

**Issues in the Incentives Debate**

The Dell and Google projects raise important questions about the role of incentives in economic development. These and other recent incentive offers, including the new grant program aimed at Bridgestone/Firestone and Goodyear, underscore why the debate over incentives rages on. At least five points of contention fuel the debate: the extent to which economic development incentives are (1) legal, (2) fair, (3) efficient, and (4) effective, and the extent to which both the process for awarding incentives and the recipients are (5) accountable. To use incentives more wisely in fueling growth and prosperity, state and local officials must understand them in terms of these issues.

**Legality**

In the *Maready* decision, mentioned earlier, the North Carolina Supreme Court made it clear that local business incentives serve a public purpose and therefore do not violate the state constitution. According to the ruling, incentives meet the public-purpose test because they help create jobs and expand the tax base. Citizens benefit through increased economic opportunity and better public services. However, certain legal questions remain unresolved and continue to be pressed in the judicial system.

The North Carolina Institute for Constitutional Law, a group generally opposed to incentives, filed lawsuits challenging the constitutionality of the Dell, Google, and Bridgestone/Firestone–Goodyear deals. The lawsuit challenging the Dell incentives claimed that they primarily benefited the company, failed to serve a public purpose, and violated the Commerce Clause of the U.S. Constitution. The North Carolina Court of Appeals upheld the constitutionality of the Dell incentives, and the North Carolina Supreme Court refused to hear the case.25 The lawsuit against the Google deal, based on similar constitutional grounds, was dismissed by a superior court judge in November 2008.26 An appeal is possible. The lawsuit filed over Bridgestone/Firestone–Goodyear and the Job Maintenance and Capital Development Fund might reveal if the courts will view incentives that are not tied to job creation as sufficiently serving a public purpose.27 Also, as mentioned earlier, whether the courts will deem cash grants as being, in effect, the same as tax abatement is not entirely clear.

U.S. federal courts also have considered challenges to the legality of economic development incentives. A lawsuit filed in a federal district court claimed that two particular incentives in Ohio—a local property tax exemption and an investment tax credit—violated the Commerce Clause of the U.S. Constitution. DaimlerChrysler received these incentives to expand a Jeep plant in the state.28 The district court ruled that both incentives were constitutional. On appeal, the Sixth Circuit Court of Appeals upheld the local property tax exemption but declared Ohio’s investment tax credit in violation of the Commerce Clause.29

The Sixth Circuit Court ruling got the attention of economic developers and policy makers and created uncertainty about similar tax credits offered in other states. The case, *DaimlerChrysler Corporation v. Canon*, eventually made its way to the U.S. Supreme Court, which dismissed it on the basis that the plaintiffs lacked standing in the federal courts.30 By not ruling on the constitutionality of the tax credit in question, the Supreme Court has left open the possibility of future lawsuits.

**Fairness**

The concern about the fairness of incentives has to do with who reaps the benefits and who bears the costs of economic development policies. With incentives, some businesses clearly benefit, but others may lose. When government provides tax concessions, grants, and other assistance to certain businesses and not others, its doing so has the appearance, if not the effect, of treating comparable taxpayers unequally.31 The perception that incentives mostly go to new companies locating in a community can breed resentment among existing firms, particularly if they are direct competitors with the companies receiving aid. Moreover, the requirements of most incentive programs that a certain minimum number of jobs be created and a certain minimum investment be made typically make small businesses ineligible to participate.

The counterargument is that it is sensible to discriminate among taxpayers and provide special treatment to those who create large numbers of jobs and make significant investments in a community, because doing so benefits the greater good. For example, some evidence suggests that when economic development policies stimulate local growth, they also improve the distribution of income by enhancing job opportunities for minorities and people with lower education levels.32

### Table 3. Estimated Economic and Fiscal Impacts of Dell and Google on North Carolina

<table>
<thead>
<tr>
<th></th>
<th>Dell</th>
<th>Google</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jobs (direct)</td>
<td>1,500</td>
<td>210</td>
</tr>
<tr>
<td>Average salary</td>
<td>$28,000</td>
<td>$48,300</td>
</tr>
<tr>
<td>Capital investment (in millions)</td>
<td>$100</td>
<td>$600</td>
</tr>
<tr>
<td>Jobs (indirect)</td>
<td>6,000</td>
<td>372</td>
</tr>
<tr>
<td>Contribution to gross state product (in billions)</td>
<td>$24.50</td>
<td>$1.06</td>
</tr>
<tr>
<td>State revenue (net) (in millions)</td>
<td>$743</td>
<td>$37</td>
</tr>
</tbody>
</table>

Source: Data compiled from newspaper articles and conversations with staff of the North Carolina Department of Commerce, Division of Policy, Research, and Strategic Planning.
If economic development incentives do indeed serve a larger public purpose, then their benefits should extend beyond private companies and industries to other taxpayers. Such an effect is more likely to occur if the companies receiving incentives hire local residents and invest in distressed areas with high unemployment. The Google project in Caldwell County will certainly increase economic activity in a part of the state with above-average unemployment, but whether local residents will get many of the new jobs remains to be seen.

Google will tap into the excess water and electric power capacity created by the loss of major textile and furniture industries. This outcome will yield important public benefits. In the case of both Dell and Google, if the incentives convinced the companies to build facilities in places where they otherwise would not have done so, taxpayers will gain economic opportunities and resources that might justify the millions of dollars of incentives promised.

On the other hand, if the incentives were not the determining factor, they might be an inequitable transfer of business costs from selected corporations to other taxpayers. Is it fair for taxpayers in one jurisdiction to subsidize a business for creating jobs that go to the residents of other jurisdictions? This question hovers over the Dell project, given that the taxpayers in Winston-Salem and Forsyth County are on the hook for the local incentives, whereas the plant surely employs people from various other cities and counties. Ultimately the fairness of incentives is in the eye of the beholder and is a separate (though not unrelated) issue from whether they are effective, efficient, or worth the cost.

Efficiency
In one sense, interjurisdictional tax competition, including incentives, is thought to be an efficient way to allocate public resources as firms seek the best locations to achieve the optimal balance of taxes and government services. State and local governments offer incentives to make their jurisdictions more attractive to firms. Some argue that the efficiency effects of tax incentives are negated because incentive competition is a zero-sum game: one jurisdiction gains at the loss of another. From a national perspective, such beggar-thy-neighbor behavior produces no net economic gains because capital merely relocates from place to place. Others refute the zero-sum-game argument and suggest, “State and local economic development competition may increase productivity, redistribute jobs towards the high unemployment areas that need jobs the most, and increase national employment by using previously unemployed labor.”

Sharing project costs and revenues within a region and encouraging companies to hire locals and invest in distressed areas enhance the fairness of incentives.
In practice, any incentive may be zero-sum, positive-sum (benefits exceed costs), or negative-sum (costs exceed benefits), depending on how it is applied.\textsuperscript{36} The important point is that any incentive amount offered is above the absolute minimum required to attract a business is inefficient from a public-sector perspective.\textsuperscript{37}

When jurisdictions use incentives to compete with one another for jobs and investment, they can face a situation known in negotiation and decision-making theory as the “prisoner’s dilemma.” In this view, incentive competition becomes a counterproductive “race to the bottom” that could jeopardize the long-term fiscal capacity of states and localities. As a former mayor of Indianapolis, Stephen Goldsmith, notes, “You can’t say no, but you can’t afford to say yes” when companies request incentives.\textsuperscript{38} Moreover, the intense competition among jurisdictions can ratchet up the scale of incentive packages to the point of overpayment, and result in excessive costs per job created. Additional inefficiencies arise from the high opportunity costs of incentives and potential revenue shortfalls that might cause state and local governments to provide fewer critical public services such as education and infrastructure.\textsuperscript{19}

The argument that incentives are inefficient because they erode the tax base and undermine the provision of essential public services ignores a key assumption about how incentives should work. Incentives are supposed to help create new tax revenues. The revenues cannot be diverted from other uses if they never materialize in the first place. In a letter to the editor, former North Carolina Secretary of Commerce James T. Fain III correctly noted that Google’s incentives represented a claim on tax revenues that would not be realized unless the company decided to locate in the state:

> Incentives offered by the state are dependent on future tax receipts paid by the company. They are primarily reductions of future tax revenues that we do not now receive, nor would we ever receive if Google does not locate here. Google will receive future incentive benefits only if it creates the jobs and makes the investments that generate this tax revenue for their incentives.\textsuperscript{40}

This logic holds up as long as it can be demonstrated that Google would not have located in North Carolina if it had not been offered the incentives. If that cannot be demonstrated, then the state is merely subsidizing a business decision that would have happened without any incentive, and it is forgoing tax revenues that it would have otherwise received. Those forgone revenues are then not available for spending on education, infrastructure, and other public services or to facilitate lower tax rates overall.

The incentive package may have made the difference with Google, but it is difficult to know for sure. That Google announced plans for a similar facility in neighboring South Carolina within weeks of its North Carolina announcement casts some doubt on how significant the competition was and how decisive the incentives might have been.\textsuperscript{41}

**Effectiveness**

In the debate about whether incentives work, legal justifications and theoretical arguments must pass muster with the facts from empirical research. Unfortunately, the research findings on effectiveness are not conclusive and provide ammunition for both sides of the debate.\textsuperscript{42} However, they offer some insights when considered in the proper context.

Part of the inconsistency arises from differences in measures and methods across studies. There also is the difficulty of isolating the effects of incentives on economic outcomes, which requires controlling for many other variables. A more fundamental problem is knowing precisely what it means for a particular economic development incentive to be effective or not. The real question is, Effective at what?

A proper assessment of the effectiveness of incentives must take into account how specific tools are supposed to work and what they can realistically be expected to achieve. It also is important to distinguish between the micro-level effects on firms and the macro-level effects on states, regions, and communities. At the firm level, incentives aim to lower the cost of doing business in a way that boosts profitability.\textsuperscript{43} This is a
fairly immediate and direct effect on which there is little disagreement.

The next concern, then, is the extent to which incentives influence site selection. At the heart of this question is whether incentives actually function as incentives or inducements or whether they are mere subsidies to business. An "incentive" incites or spurs action, and an "inducement" stimulates or moves by persuasion. By contrast, a "subsidy" is simply a grant or a gift of money.

If tax and other financial incentives are to be considered as economic stimulus tools rather than "corporate welfare," they should directly sway decisions about business investment and job creation. On this matter, there is again a lack of certainty and clarity in the research findings. A study of state incentives in Ohio identified different effects on the actual employment growth of firms compared with the employment levels initially promised by the firms. The researchers found that incentives had a negligible effect on actual employment growth in firms, but were positively correlated with announced job growth. These findings suggest that incentives will cause firms to overstate the number of new jobs they will create.

A recent analysis of North Carolina's Lee Act tax credits suggests that "tax incentives go to firms without significantly influencing their decisions on investment and employment." A possible explanation for this is that taxes and incentives account for only a small portion of business operating costs and therefore do not matter all that much. In surveys, companies tend to emphasize the importance of incentives, and they have a vested interest in doing so. But according to Area Development's most recent corporate survey, incentives are only one of several factors that businesses consider in site selection (for a list of the fourteen most important ones, see Table 4). In that survey, incentives ranked 8 out of a possible 25 factors.

Despite the ambiguity about whether incentives result in the creation of jobs and investment by firms (microlevel) that would not otherwise occur, most studies conducted through the 1980s found that taxes and incentives have little to no effect on macrolevel economic growth. This is counterintuitive because lower business tax burdens are thought to be more conducive to growth. Later research indicates that taxes might matter more than initially thought and particularly that higher taxes can hinder economic growth. If that is true, then by easing the tax burden on firms, incentives could make a place more competitive for business investment and thereby spur economic growth.

Assuming that incentives are effective at promoting state and local economic growth, to what extent do they work for the people and the places most in need? This question is related to the fairness-equity concern discussed earlier, but also has implications for the overall effectiveness of incentives, especially those that target economically distressed areas. Some studies demonstrate that
poor people and places can experience the greatest gains from economic development incentives. In North Carolina, the Lee Act tax credits attempt to steer jobs and investment to poorer communities by offering larger credits to businesses that locate in counties with higher unemployment rates and lower income levels. There is evidence that this aspect of the incentive program is "particularly effective in encouraging firms to invest more and hire more workers in economically distressed areas." In some other states, traditional incentives appear to stimulate growth only in prosperous areas, with the result that growth begets growth. 

In sum, the research to date suggests that economic development incentives do not always induce firms to create substantial jobs and investment that would not occur without the incentives. This appears to be the case despite the fact that companies say incentives are important factors in site selection. The case for using incentives to promote growth at a macrolevel and in lagging areas is more compelling.

Ultimately, the empirical research findings must be interpreted in light of the economic and political realities of the new economy. Facing intense global competition, manufacturing plants continue to close and move offshore, and people continue to lose jobs. When this happens, local governments lose revenues and are sometimes left with underused public infrastructure. The political pressure grows to do something or at least to appear to be taking action to improve economic conditions. In this context, economic development incentives might prove effective in ways that are difficult to capture in numbers.

If nothing else, incentives probably improve the competitive positions of states and localities and help them close deals. To appreciate this relationship requires an understanding of the site-selection process that businesses—often assisted by hired consultants—use in deciding where to locate or whether to expand. Incentives do not typically matter until a firm has narrowed the list of possible locations to a few that meet all its other requirements for a site or a building—infrastructure, workforce, and the like. At that point, the incentives can tip the scale in favor of one location over another. From a competitiveness perspective, a jurisdiction has to decide whether to play to win or sit it out. Given how the game is played, incentives can help states and localities win, at least in the short run. Winning some of the time is better than always losing. In this way, incentives become a necessary evil in attracting and retaining businesses and securing the jobs and investment they create. Against the odds, public officials might be willing to tolerate the inefficiency of incentives if they provide an edge no matter how slight:

For every 10 plants offered such an incentive, the incentive would be decisive for about 3 of them. The incentives given to the other 7 plants would have no effects on business location or employment growth. The only effect would be an extra cost to state and local governments of these unneeded "incentives. Unless economic developers can somehow determine which of the 10 plants "needs" the incentive to tip its location decision, this loss on 7 of the 10 plants is a necessary cost to tip the location decision of the other 3 plants.

To return to a question I posed at the outset: Are the incentives worth it? A good cost-benefit analysis will provide a quantitative answer to this question for a given project. Ideally the public benefits of incentive deals should exceed their costs. However, a major business location or expansion project can benefit communities in quantitative and qualitative ways. It can serve as a beacon of hope that prosperity will return to communities hard hit by job loss. It can restore self-respect to displaced manufacturing workers who need employment to support their families. For these people, the debate over the effectiveness of economic development incentives is an academic exercise. Referring to the Google project, Lenoir Mayor David Barlow said, "Psychologically, the impact of this for our community would be greater than the reality." Projects like Dell and Google also have symbolic value to the extent that they put communities on the map for future economic development opportunities.

Accountability

One of the most common criticisms of incentives is that they are frequently provided without the recipients being sufficiently accountable to taxpayers and the broader public interest. Corporate mergers, changing economic conditions, and intense global competition can lead companies to change their investment plans drastically over time. This can create the possibility that companies will fail to deliver on their promises to create a certain number of jobs and make a certain amount of capital investment.

For example, in 1999 the state offered $35 million in incentives to Wisconsin Tissue to build a $180 million tissue mill and paper-recycling plant in Halifax County with 150 employees. But a few months after the deal was announced, the company was bought by Georgia-Pacific and scrapped plans for the facility, so it received no incentives.

In the same year, Corning opened a $600 million production facility for fiber-optic cable in the Cabarrus County town of Midland after being offered state and local incentives. The facility expanded to employ as many as 800 workers at one point and had 550 when it shut down in 2002 in the face of a steep downturn in the telecommunications industry. In 2007, Corning decided to gradually restore a limited amount of production at the Cabarrus facility in response to improved market demand.

In an interesting twist of fate, Dell is reportedly seeking to sell all its plants, including the one in Winston-Salem, in response to shifting corporate strategy. How this might affect its incentive deal or operations in North Carolina is unclear. Also, in December 2008, Google notified state officials that the slowing economy would inhibit its ability to add jobs and investment in Lenoir according to the timeline for the JDIG funds it was offered. Therefore, it would forgo receiving the funds.

Even when companies fulfill employment and investment expectations, the estimates of the ripple effect on a community are mere forecasts based on imperfect economic models. For example, a recent report suggests that the model used by the state commerce department...
to assess incentive packages tends to overstate the economic benefits that firms will provide and leads to overbidding. Using more conservative assumptions, the authors show the Dell project having a much smaller effect on the state's economy and a negative fiscal impact on state revenues. This demonstrates that economic and fiscal impact analysis is imprecise and must be used with care and interpreted with caution.

Another accountability concern is the secretive nature of early incentive negotiations. Companies require that their investment plans be kept confidential to protect trade secrets and avoid tipping their hand to competitors. State law allows for confidentiality, withholding of public records, and protection of trade secrets on economic development projects under certain conditions. As a result, state and local officials often commit public dollars before the details of a deal are widely known. Companies also demand confidentiality because they do not want information on pending plant closures elsewhere to leak out and they want to avoid excessive real estate speculation that might drive up the costs of land acquisition. Public officials face the dilemma of balancing the company's need for confidentiality and anonymity against the public's right to know.

Public officials are at a disadvantage in incentive negotiations because companies have access to much more information than public officials do on what other jurisdictions are offering and which alternative locations are viable. Only the companies know for sure the amount of incentives that will tip the decision in favor of one place over another. Google is alleged to have exploited this information imbalance in the negotiations with state and local officials over its incentive package.

Several mechanisms exist that might help jurisdictions win with incentives but avoid the "winner's curse" of paying too much for too little in return. These include some safeguards already adopted in North Carolina according to a survey that I conducted recently—such as using clawback provisions, tying incentives to company performance, requiring performance contracts, and conducting cost-benefit analyses (see Table 5)—plus others that I didn’t include in my survey because they are more commonly used at the state level—targeting distressed areas and establishing standards for wages and job quality.

Better Use of Incentives
Despite the ongoing controversy over economic development incentives, no end is in sight to the escalating competition among jurisdictions that has been likened to an arms race. It is foolhardy to think that state and local governments will unilaterally disarm and stop using incentives in the near future. National legislation calling for a
ceasefire in the economic war among the states has been introduced periodically in the U.S. Congress, but it is unlikely to be enacted anytime soon.

Where does this leave public officials in North Carolina?

As others have aptly noted, incentives are not inherently good or evil, right or wrong, wise or foolish. They are tools that public officials can use more prudently—or less so—depending on the application. Economic development incentives should be consistent with the letter and the spirit of the law to avoid potential legal challenges. Beyond legality, public officials should clearly understand the tradeoffs among fairness, efficiency, effectiveness, and accountability in using incentives to promote job creation and private investment. Current practice in North Carolina incorporates many good reforms in the use of incentives. Additional ones are possible:

- More enforceable contracts
- Greater transparency and disclosure
- More rigorous cost-benefit analysis
- Better state-local and regional collaboration
- Improved opportunities and support for hiring local residents and the unemployed
- A greater focus on small businesses, existing industry, and job training

Taken together, these enhancements in incentive policy will help jurisdictions strengthen their negotiating position with companies, maximize public benefits, and protect the public investment in incentive deals.

Notes


2. A legislative study committee of the North Carolina General Assembly (the Joint Select Committee on Economic Development Incentives) is considering these and other questions about incentives. UNC at Chapel Hill’s Center for Competitive Economics is doing extensive research to inform the committee’s work.


7. N.C. GEN. STAT § 158-7.1(b) (hereinafter G.S.).


10. Lawrence, Economic Development Law.


12. Lawrence, Economic Development Law.


15. Units of local government must provide a match to the One North Carolina Fund grant.


17. Article V, Section 2(b), of the North Carolina Constitution states, “Only the General Assembly shall have the power to classify property for taxation, which power shall be exercised only on a State-wide basis and shall not be delegated.”


24. Ibid.


28. The State of Ohio and the City of Toledo agreed to provide a 13.5 percent credit against the state corporate franchise tax for investments in machinery and equipment and a 100 percent local property tax exemption over ten years.


43. Merriam-Webster’s Collegiate Dictionary (10th ed.).


50. Luxer and Bae, “The Effectiveness of State Business Tax Incentive Programs,” 338.


61. G.S. 132-12 (Public Records Law); G.S. 66-152 (Trade Secrets Protection Act); G.S. 132-6(d) (confidential).


Voter-Owned Elections in North Carolina: Public Financing of Campaigns

Philip G. Rogers, Carl W. Stenberg, and Sarah J. Waterman

It was not a typical late-night public-service television advertisement. With the April 15 deadline for filing income tax returns on the horizon, two former North Carolina governors, a Democrat and a Republican, urged taxpayers to check off a contribution for the North Carolina Public Campaign Fund on their income tax return. The contribution was earmarked to raise money to support candidates for judicial offices and to publish a voter guide to state elections. The ex-governors’ efforts were part of a reform movement across the country to provide public financing of state election campaigns.

Public financing of elections in North Carolina became a topic of discussion and debate in the recent election year and will likely continue to be on the state’s political radar screen. This article looks at the pros and cons of public financing and examines the evolution of publicly funded elections across the nation. It summarizes the history of public financing in North Carolina, explores future directions, and identifies lessons from other states relevant to North Carolina policy makers.

The Pros and the Cons of Public Financing

The case for public financing rests on a desire to reduce the influence of special interest money in elections. By requiring candidates to show grassroots support and abide by spending limits, advocates of the system hope to curb the perceived and actual negative effects of private funding on the behavior and the policy making of public officials.

Common perceptions of money’s impact on politics include favoritism, corruption, and exclusion of minorities and women.

Public opinion surveys have revealed common perceptions about the impact of money on state politics, including contributors having greater access to public officials and seeking special favors from them; officials pressuring contributors for large donations; fundraising being a major source of corruption and conflicts of interest; officials spending too much time raising campaign contributions; money being the single most important factor in winning elections; and the current system of campaign financing discouraging women and minorities from running.

Proponents claim that public financing would have a number of benefits, as follows:

- More people would be willing to run for office, and the candidate pool would be more diverse.

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Instead of having to “dial for dollars,” candidates would be able to devote more time to meeting with voters, discussing issues, and engaging in debates.

Support from citizens, rather than the ability to raise money from special interests, would be the single most important asset in elections.

Races would be more competitive because challengers would be more willing to take on incumbents.

The campaign-spending gap between incumbents and challengers would be narrowed.

Special-interest campaign contributions would no longer lead to pork-barrel subsidies.

Citizens and groups would have the same access to elected officials that private donors have.

Proponents argue that these improvements would bolster citizens’ confidence in the integrity of public officials and produce more policy outcomes in the public interest.

Opponents point out the following philosophical, practical, and political limitations:

- Citizens often react negatively to using taxpayers’ monies to enable people to campaign for office, especially those whom they may not support.
- The high costs of competitive campaigns, especially in statewide and urban races, limit the attractiveness of public financing to viable candidates.
- Public financing encourages fringe candidates who seek a forum for their views but have little or no chance of winning.
- Groups created under Internal Revenue Code Section 527 to receive and disburse funds to influence the election of candidates can subvert restrictions on contribu-
**States with Public Financing of Election Campaigns, 2008**

**Public Funding (Full or Partial) for All Statewide and Legislative Offices**
- Arizona
- Connecticut
- Hawaii
- Maine
- Minnesota
- Nebraska
- Wisconsin

**Public Financing for the Governorship and Selected Other Statewide Offices**
- Florida
- Massachusetts
- Rhode Island

**Public Financing for the Governorship**
- Maryland (including the lieutenant governorship)
- Michigan (including the lieutenant governorship)
- New Jersey
- Vermont (including the lieutenant governorship)

**Public Financing for Selected Statewide Offices (Excluding the Governorship)**
- New Mexico (members of the Public Regulation Commission)
- North Carolina (the auditor, the commissioner of insurance, and the superintendent of public instruction)

**Public Financing for the Legislature**
- New Jersey (pilot program involving two district-based seats in the general assembly)

**Public Financing for Judges**
- New Mexico
- North Carolina

**Public Financing for Political Parties**
- Arizona
- Idaho
- Iowa
- Minnesota
- New Mexico
- North Carolina
- Ohio
- Rhode Island
- Utah
- Virginia

**Income Tax Refunds/Credits/Deductions for Contributions to Candidates or Political Committees**
- Arizona
- Arkansas
- Hawaii
- Minnesota
- Montana
- North Carolina
- Ohio
- Oklahoma
- Oregon
- Virginia


- Public financing is not completely voluntary because candidates may feel pressured to participate by the media, opponents, and public opinion.
- Incumbents will have an advantage in running as publicly financed candidates because if candidates have equal amounts of financing, name recognition will become more of a factor.

Publicly financed campaigns give the government too much control of political speech and are a form of welfare for politicians.

Opponents assert that for these reasons, entrenched special interests like incumbents, political leaders, and lobby groups have been able to defeat public financing legislation.³

**The Building Blocks of a Public Financing System**

Public financing was first authorized for presidential elections under the Federal Election Campaign Act of 1971. However, because of the costs of national campaigns, candidates have preferred private funding.

At the state level, more interest and activity have been apparent.⁴ As of 2008, twenty-five states have laws for public financing of state election campaigns (see the sidebar on page 32). Those states have two types of systems: one that provides public financing directly to individual candidates for the governorship, other statewide offices, and/or the state legislature (15 states); and one that provides public financing for political parties (10 states). Of the 15 states with the first type, 7 finance all statewide elective offices, 3 the governorship and selected other statewide offices, 4 the governorship only or the governorship and the lieutenant governorship only, 2 selected other statewide offices only, and 1 the legislature only. Two states (New Mexico and North Carolina) are unusual in also providing public financing of judges. Four states authorize public financing of council members in one of their cities (New Mexico for Albuquerque, New York for New York City, North Carolina for Chapel Hill, and Oregon for Portland).

The most common arrangement for financing individual candidates is a partial system by which candidates raise private funds up to a specified limit and then those funds are matched by public monies on a 1-1 or 2-1 basis. A recent innovation, adopted in three states (Arizona, Connecticut, and Maine),
U.S. and North Carolina Legal Challenges to Public Financing of Campaigns

Litigation related to public financing of election campaigns has been plentiful over the years, most often based on First Amendment concerns about the effect of such plans on the exercise of free speech. In response, the courts have upheld public financing programs that are based on voluntary participation.

The landmark decision on public financing, and still the controlling law, is the U.S. Supreme Court's 1976 ruling in Buckley v. Valeo.1 Partly in reaction to the developing Watergate scandal, Congress had enacted the first major reform of campaign finance laws in 1971. The act limited the amounts that individuals and political committees could contribute to candidates for federal offices, imposed new requirements for reporting those contributions, restricted the amounts that candidates could spend on their campaigns, and provided for the public financing of presidential election campaigns. The Buckley case challenged this law. When the case finally reached the Supreme Court, the justices struck down the limitations on campaign expenditures, holding that the right to freedom of speech encompassed the spending of money by candidates. The Court found, however, that the public interest in preventing corruption in government justified the limitations on the amounts that individuals could contribute to candidates and the reporting of those contributions. Most important, the Court upheld the public financing of presidential campaigns, including the provision that campaign expenditures could be restricted as a condition of a candidate voluntarily accepting public funds.

Buckley thus laid the structure for public financing of campaigns at all levels of government: It is constitutional to provide public funds to candidates for office, and as a condition of acceptance of such funds, the candidate may be required to agree to limit expenditures. Spending limits may not be imposed, however, on candidates who reject public financing.

No other case directly challenging public financing has reached the Supreme Court, but in 2006 the Court revisited some of the other Buckley issues when it decided Randall v. Sorrell.2 In 1997, citing new evidence of the corrupting influence of money in politics that had developed since the Buckley decision, Vermont attempted to strictly limit expenditures by all statewide and legislative candidates and to prohibit individuals from contributing more than $400 to gubernatorial candidates for a two-year election cycle, $300 to candidates for the State Senate, and $200 to candidates for the State House of Representatives. A divided Supreme Court affirmed the Buckley ruling of thirty years earlier that the state violated candidates' right to freedom of speech by limiting their campaign expenditures. The Court also found that the restrictions on individual contributions were so low as to violate the First Amendment rights of the contributors.

Several rules are clear from these and other federal cases: First, regulation of campaign financing implicates the right to freedom of speech and must clearly advance the public interest in reducing corruption if it is to be upheld. Second, public financing programs must be voluntary for the candidates. Third, as a condition of receiving public funds, a candidate may be required to limit campaign expenditures.

In North Carolina, the public interest in combating corruption was at issue in a 2005 unsuccessful challenge to the Judicial Campaign Reform Act. In North Carolina Right to Life Committee Fund for Independent Political Expenditures et al. v. Leake et al., the Fourth Circuit Court of Appeals rejected arguments that the reporting required of nonparticipating candidates was too burdensome; that the right to freedom of speech was violated by restrictions on contributions to nonparticipating candidates in the last twenty-one days before the election, when such contributions would trigger "rescue," or matching, funds for participating candidates; and that the rescue fund provisions had a chilling effect on nonparticipating candidates and independent groups' expenditures.3 The challengers to the judicial campaign financing law now are seeking review of the case by the U.S. Supreme Court.

Following the 2006 election, an unsuccessful candidate for the North Carolina Supreme Court, Ann Marie Calabria, protested the election results on the basis of the State Board of Elections' failure to award rescue funds to her after an independent organization, FairJudges.net, ran a last-minute television advertisement touting her opponent, Robin Hudson, as one of several "fair judges" who were on the ballot that year, although the ad did not mention the election or say to vote for the judges.4 The protest was denied, and Hudson, who had no involvement with the advertisement, was seated, but the episode led the General Assembly to modify the rescue fund provisions.

There also is a challenge to the part of the law on judicial campaign financing that imposes a $50 surcharge on licensed lawyers to support public financing. After the federal district court ruled that it did not have jurisdiction to decide the issue, a state lawsuit raising the same issues was brought in Wake County Superior Court.5 It is still pending.—Michael Crowell

Notes

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enables candidates for all statewide and legislative races to finance nearly all the costs of their primary and general election campaigns with public funds. These are sometimes called "Clean Election States."

The basic features of these systems vary, but due to First Amendment prohibitions on restricting candidates' spending (see the sidebar on page 33), a common component is their voluntary nature. Candidates are not required to accept public financing and the accompanying restrictions on private fundraising and spending. If they do, they may have to compete against privately financed candidates. They must first demonstrate grassroots support by collecting small contributions from voters. They also must agree to ceilings on expenditures, limitations on contributions, and requirements of disclosure. In some states, they must agree to participate in debates. Contribution limits and thresholds tend to be modest. For example, candidates in Arizona must raise 4,000 contributions of $5 each, and candidates in Maine, 2,500 contributions of $5 each.

Under most systems, participating candidates receive seed money up front, which enables them to pay for promotional materials and mailings. Once they obtain sufficient contributions from a specified number of voters (in their district or state) to meet the fund-raising threshold, they qualify for public funds for the primary and general elections. If a participating candidate is outspent by a privately financed candidate, the system provides him or her with "rescue," or matching, funds up to a specified amount.

Ten states rely on earmarked income tax check-offs (which redirect part of a taxpayer's income tax liability to a special fund) and add-ons (which increase taxes owed or decrease the refund due) as the chief sources of public election funds for candidates or political parties. Eight other states rely on appropriations for most of their funding. Revenues from fees and penalties, as well as voluntary contributions, supplement monies collected from earmarks and appropriations. For example, in North Carolina, a $50 annual surcharge on lawyers is an important source of revenue for the judicial campaign fund. An independent state commission on elections, ethics, or public finance oversees collection, distribution, reporting, and auditing of public funds.5

Public Financing of Elections in North Carolina

The history of public financing for elections in North Carolina dates to 1975, when a law was passed providing for a limited, trial system of public financing in general elections.6 The law was a response to concerns about the increasing costs of campaigns and the difficulties that political parties and candidates were experiencing raising money during hard economic times. It also reflected the reform movement taking place across the country in the wake of the Watergate scandal, featuring tighter re-

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### Organizations Supporting Clean Elections in North Carolina

#### Groups Specifically Concerned with Public Financing or Clean Elections

- AARP of North Carolina
- Common Cause North Carolina
- Common Sense Foundation
- Democracy North Carolina
- League of Women Voters of North Carolina
- North Carolina Center for Voter Education
- North Carolina Council of Churches
- North Carolina Public Interest Research Group
- Triad Pro-Democracy Nexus

#### North Carolina Fair Share

#### North Carolina Justice Center

#### Southern Piedmont Central Labor Council—AFL-CIO

#### SURGE (Students United for a Responsible Global Environment, a network of young leaders and youth organizations)

#### United Steelworkers of America, North Carolina Local 959

#### Western North Carolina Alliance

#### Groups Devoted to Specific Causes Unrelated to Public Funding but Standing to Benefit from the Furthering of Progressive Efforts

- American Planning Association—North Carolina
- Association of Early Childhood Professionals
- Conservation Council of North Carolina
- Covenant with North Carolina's Children
- Environmental Defense
- Federation of Business and Professional Women
- North Carolina Association of Educators
- North Carolina Coastal Federation
- North Carolina Conservation Network
- New River Foundation
- Self-Help—Center for Responsible Lending
- Southerners for Economic Justice
- United Holy Church of America

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34 POPULAR GOVERNMENT
requirements on campaign contributions and expenditures.

The temporary program (scheduled to expire on December 31, 1977) allowed taxpayers to designate $1 of their tax liability to be used by a political party specified on the income tax form. The funds were set aside in the North Carolina Election Campaign Fund and paid to the officially recognized parties in the state. The state party chairs were authorized to use the monies to assist candidates who were opposed in the general election for the positions of governor, lieutenant governor, members of the Council of State (attorney general, auditor, commissioner of agriculture, commissioner of insurance, commissioner of labor, secretary of state, superintendent of public instruction, and treasurer), U.S. senator or representative, supreme court justice, and court of appeals judge. In 1975, 6.45 percent of the tax returns made a contribution. The proportion climbed to 7.10 percent a year later. These rates were significantly below levels of taxpayer giving to candidates in federal campaigns or to candidates in the six other states that authorized such contributions at the time.

Political parties in the general election received campaign funds for the first time in 1976, an approach intended to strengthen the party system. Under the law, taxpayers could indicate on their tax form which political party should receive their donation. Unspecified monies were allocated to the officially recognized parties on the basis of their percentage of statewide voter registration. Contributions accounted for about one-third of the Democratic Party’s budget and about one-quarter of the Republican Party’s budget.

The political parties used different approaches to spending their funds. The Democratic Party took a “unified party campaign approach,” employing the funds for general assistance to the party and all its candidates, rather than for direct grants to individual candidates. The Republican Party divided public funds between general campaign expenditures and cash grants to selected candidates eligible for financing.

During the 1978 General Assembly session, the temporary check-off system was extended for three years. However, changes were made, in part because of the state Democratic Party’s allocating no funds to specific candidates. Jack Fleer explained the legislation in a 1979 Popular Government article: “This new legislation provides that, except for a transition period, future disbursements of public funds will be equally divided between party and candidates in both presidential-year and nonpresidential-year general elections. Allocation of funds among the candidates will be determined by a committee in each of the respective parties.” This compromise was unique. Other states with public financing had designated monies either to parties only or to candidates only, but not to both. Furthermore, North Carolina was the only state that had extended public financing to congressional candidates as a result of the new legislation.

Candidates’ response to the trial of public financing was unenthusiastic. The voluntary income tax check-off generated insufficient funds to attract their interest. New legislation was not enacted after December 31, 1981. However, taxpayer contributions continued to accumulate in the Election Campaign Fund until January 1, 2003.

The issue of publicly funded elections reemerged in 1999. Two nonprofit organizations, Democracy North Carolina and the North Carolina Center for Voter Education, led the advocacy effort. A larger coalition, North Carolina Voters for Clean Elections (NCVCE), was founded that year. This umbrella organization “seeks to improve the vitality of democracy in North Carolina by enacting a voluntary public financing program for state-level candidates who earn the public’s trust.”

NCVCE began promoting bills for public financing of all state-level political offices, but soon realized the need to take a more incremental approach. On the advice of supporters inside the General Assembly, it made achieving judicial public financing its first major goal.

The debate over funding judicial elections engaged a large and diverse assortment of stakeholders. The arguments advanced by supporters and opponents of public financing in North Carolina have generally mirrored those made in other states. Specific to North Carolina were two other factors: perceptions that partisan election of judges was inconsistent with fair and impartial decisions by judges; and fears that attorneys would have undue influence when they argued cases before justices to whom they had made large campaign contributions. Although judicial election campaigns in North Carolina had not experienced the significant infusions of private money or the bitterly contested races that had occurred in states like Alabama and Texas, there were concerns that these conditions could develop.
Members of NCVCE fell into three broad categories (see the sidebar on page 34):

- Groups specifically concerned with public financing or clean elections (9 organizations)
- Groups concerned with broader principles of equity and democracy (14 organizations)
- Groups devoted to specific causes unrelated to public financing but standing to benefit from the furthering of progressive efforts (13 organizations)

Opponents of public financing have included the John Locke Foundation, the John William Pope Civitas Institute, the Libertarian Party, and the Republican Party, as well as several members of the General Assembly, chiefly Republicans. The John Locke Foundation, for example, has argued that public financing (referred to as “taxpayer financed elections” in organization materials) violates First Amendment protections, favors incumbents, and provides insufficient funding for viable campaigns.

A Pioneering Approach: The Judicial Campaign Reform Act of 2002
The initial victory for campaign finance reformers was the Judicial Campaign Reform Act of 2002. The legislation changed the elections of supreme court justices and court of appeals judges to nonpartisan ones, called for publication of a voter guide profiling candidates in specific elections, decreased campaign contribution limits for individual contributors from $4,000 to $1,000, and provided a public financing option for judicial candidates. This law was the nation’s first publicly funded election program for judicial elections.

Beginning with the 2004 election cycle, the legislation provided full financing in the general election for supreme court and court of appeals candidates who chose to participate. Public financing depended on a candidate’s voluntary acceptance of fund-raising and spending limits. Among the conditions for participation were the following:

- Before declaring participation in the program, a candidate must not raise or spend more than $10,000 on the campaign after January 1 of the year before the election.
- After declaring participation, the candidate must demonstrate public support by raising the minimum in qualifying contributions as follows:
  - Contributions must be in amounts between $10 and $300 each, from a minimum of 350 North Carolina registered voters.
  - Contributions must be raised during the qualifying period beginning September 1 of the year before the election and ending on primary day.
  - All qualifying contributions must be in a range set to a multiple of the filing fee for the political office sought, the minimum total of qualifying contributions being approximately $3,000 for court of appeals judges and the maximum total being approximately $69,000 for supreme court justices.
- In the primary race, candidates may spend no more than the qualifying contribution cap, with excess funds typically returned to contributors. They must limit their expenditures to qualifying contributions plus any funds remaining from the $10,000 they can raise between January 1 of the year before the election and the date on which they file their declaration of intent.
- Candidates must agree to use only designated public funds in the general election plus any remaining funds raised during the qualifying period.
- Candidates may receive limited matching or rescue funds if a non-participating candidate or group makes independent expenditures opposing a participating candidate that exceed the amount of monies provided by the fund.

Eight of the 16 candidates for judge in 2006 qualified for public financing, and 5 of the 6 winners participated in the program.

The largest portion of the North Carolina Public Campaign Financing Fund comes from a $3 optional check-off on individual state income tax forms, with 1 percent of the state’s population usually participating. The second-largest portion is from a mandatory $50 surcharge, passed in 2006, on the annual fee charged to attorneys for their license to practice law in the state. (A lawsuit challenging this surcharge is pending in Wake County Superior Court.) The monies go directly to the North Carolina Public Campaign Financing Fund. Additional funding includes the accumulated balance from the North Carolina Election Campaign Fund established by the 1975-81 pilot programs, funds that certified candidates received from the public financing program that were unspent by election day, funds returned because of participating candidates’ violations of the law or decision to drop out of the public financing program, and donations from businesses, labor unions, and professional associations.

During its first two election cycles in 2004 and 2006, the North Carolina judicial public financing program gained much ground. The size of the public campaign fund across 2005 and 2006 reached about $3.4 million. The $3 check-off generated $1.12 million in 2005, $1.13 million in 2006, $1.27 million in 2007, and $1.26 million in 2008. The $50 surcharge on attorneys generated little funding in 2005, but $1.02 million was raised in 2006 when the contributions were changed from voluntary to mandatory. The total grew to $1.06 million in 2007 and $1.09 million in 2008.

Across 2005 and 2006, program expenses totaled about $2.4 million. In 2006, eight qualified candidates received about $1.5 million total for the general election. Sarah Parker, a candidate for chief justice of the supreme court, also received $155,000 in matching funds because her opponent, Rusty Duke, exceeded the fund-raising limit she had accepted. Other than awards to candidates, expenses totaled...
$650,000 for printing and mailing about 4 million voter guides in 2006 and $40,000 in administrative costs to the State Board of Elections. In 2007 and 2008, program expenses totaled $3.7 million. The program paid $1.9 million to candidates for the general election, not including matching funds. Ten certified candidates each received a share of $113,345 in matching funds. Costs for printing and mailing about 7.4 million voter guides (for the 2008 primary election and the 2008 general election) totaled $1.2 million. Administratative costs for 2007-8 totaled $61,196 as of October 31, 2008.

Twelve of the 16 judicial candidates qualified for public financing in 2004, and 8 of the 16 qualified in 2006. Over both cycles, about 71 percent of the candidates for the supreme court and the court of appeals enrolled in and qualified for the program in the general election. The demographics of the qualifiers included challengers and incumbents, men and women, and Democrats and Republicans. Three of the 5 winners in 2004 were enrolled in the program (Sarah Parker, Linda McGee, and Wanda G. Bryant), and 5 of the 6 winners in 2006 (Sarah Parker, Patricia Timmons-Goodson, Robin Hudson, Bob Hunter, and Donna Stroud).

This trend continued into the 2008 general election. According to the State Board of Elections' website, all but one of the candidates in contested judicial races filed notices of intent and were certified to participate in public financing. Candidates for the court of appeals each received an initial disbursement of $160,000. Candidates for supreme court associate justice each received $233,625.

With respect to the benefits of this pioneering reform, Court of Appeals Judge Robert C. "Bob" Hunter, a former legislator, thinks that the 2002 legislation has gone a long way toward removing the public's perception that lawyers were controlling elections and unduly influencing judicial decisions through their large campaign contributions. He says that public financing has allowed him and other participating candidates to demonstrate broad-based support by meeting the threshold requirements, and to campaign more actively during both the primary and the general election. Initially, Judge Hunter says, he was concerned about the ability of judicial candidates (in contrast with legislators) to raise qualifying monies, the possible presence of nonviable candidates, and the adequacy of available public funds to wage a statewide campaign, but he acknowledges that his concerns have proven unfounded. Combined with the shift to nonpartisan elections and the publication of the voter guide, the financing reform has produced positive benefits for the judicial system, in Judge Hunter's view.

Looking to the future, Judge Hunter suggests two changes: in the short run, significantly increasing the general funding levels to enable candidates to wage effective statewide races as the costs of campaigns rise; and in the long run, changing the judicial selection system from election, to merit selection by appointment with a subsequent
confirmation election by the voters. The latter reform, Judge Hunter points out, could ultimately free up public financing monies for use in other races.

**Expansion of Public Financing**

In 2005, advocacy groups launched efforts to expand public financing. They urged members of the General Assembly to support a bill providing for public financing of Council of State elections, but the bill was not introduced. In 2006, the House Select Committee on Ethics and Governmental Reform considered several legislative proposals, including a pilot program of public financing for two seats in the House and two in the Senate. After being passed by the House Judiciary Committee, this proposal failed to gain sufficient political support for further consideration before the end of the session.

The 2007 session of the General Assembly produced two statutes expanding the reach of public financing. One, the 2007 Voter-Owned Elections Pilot, established a pilot program for certain members of the Council of State (the auditor, the commissioner of insurance, and the superintendent of public instruction). The other, the Chapel Hill Campaign Finance Options, authorized the Town of Chapel Hill to initiate a program. Two bills were introduced to create a pilot program for public financing of the legislature, modeled on the judicial scheme, involving four districts in the Senate and six in the House, but no committee action was taken. Also, legislation was enacted to strengthen the judicial program by expanding the circumstances for releasing matching monies to participating candidates under challenge by nonparticipating candidates.

The pilot program providing public financing for participating candidates running for auditor, commissioner of insurance, and superintendent of public instruction began in 2008. Candidates who chose to receive funding under the program had to agree to strict fundraising and expenditure rules, and to follow qualification procedures to be certified by the State Board of Elections to participate. For example, candidates had to demonstrate voter support by obtaining qualifying contributions (no less than $10, no more than $200) from at least 750 registered voters. The State Board of Elections was authorized to produce a voter guide to the general election and distribute it to all North Carolina residences. The guide explains the functions of the offices affected by the law and provides candidate information, including limited endorsements and candidate statements. With respect to the general intent and impact of the law, according to John Thompson, executive director of the North Carolina Center for Voter Education, “It puts a big dent in any possible credibility problem, and it restores confidence in the voters that their vote does count and that people aren’t getting elected based on how much money they raised.”

Fund monies were distributed in two allotments: one-third within five business days of a candidate’s being approved to appear on the ballot in a contested general election and the remainder on August 1 before the general election. Under the law, if trigger conditions are met, funds may be used for contested primaries, with a cap of 200 times the filing fee for the office sought. For contested general elections, the funds are determined by the average amount of campaign-related expenditures made by all winning candidates for that office in the preceding three elections, but no less than $300,000.

An important aspect of this statute is that, unlike the financing program for judges, appropriations are made from the General Fund to bolster monies available from other sources, including unspent funds from previous elections. Money ordered returned because of civil penalties, funds that exceed allowed contributions before the qualifying period, and voluntary donations. For the 2007–8 fiscal year, $1,000,000 was appropriated, and for the 2008–9 fiscal year, $3,580,000.

The Chapel Hill authorization was the product of more than two decades of history. The precedent for Chapel Hill’s request was a State Board of Elections ruling on actions by the Town of Cary. Campaign spending in Cary’s 1999 town council election exceeded $500,000, half of which was contributed by political action committees. In reaction, Cary adopted the first scheme of public financing in North Carolina. To curb excess spending and eliminate the influence of special interests, Cary offered matching funds to the top vote-getters in the primary if they agreed to a spending limit. District races had a $10,000 cap, at-large races a $25,000 cap. In 2001 the State Board of Elections ruled that Cary’s actions were illegal. Although the board did not argue that Cary lacked authority to create a public financing scheme, it asserted that the Town of Cary was an individual contributor and thus subject to the state’s $4,000 contribution limit. The two council members who received the matching funds had to repay all but the $4,000 that the town was allowed to contribute to their campaigns. An appeal was not filed.

Since 1987, Chapel Hill proponents have worked to build support for a public financing program. In 1999 the General Assembly approved an individual contribution limit, and in 2003 Dennis Markatos, a Chapel Hill resident, brought a petition to the town council calling for a voter-owned election program. The council tabled the petition, citing the recent legal challenge in the Cary case and a bill proposed by State Senator Wil Gulley authorizing local governments of 50,000 or more to sponsor public financing. The council agreed to wait until the General Assembly considered this proposal before moving forward. In the 2007 General Assembly session, Representative Verla Insko introduced a local bill to allow public financing of Chapel Hill town council elections, and it was passed.

The law allows Chapel Hill to establish a public financing program during the 2009 and 2011 elections. Participation in it must be voluntary. Participants will receive public financing if they agree to stringent expenditure and fund-raising limits.
On June 9, 2008, following hearings in which proponents cited increasingly high costs for participation in council races and critics objected to the entrenchment of incumbents and restriction of free speech, the Chapel Hill Town Council passed the Voter-Owned Elections Pilot Program by an 8–1 vote, authorizing public financing of town council elections beginning in fall 2009. The ordinance was passed as written with three minor amendments: First, participants with campaign materials from previous elections will be required to sign a statement of their value and to agree to have the public grant reduced by that amount. Second, the value of mailings supporting multiple candidates will be divided across all participants. Finally, noncertified candidates who agree to raise or spend no more than $3,000 for the election cycle will be exempt from reporting requirements.

A Look Ahead

The new laws have encouraged proponents to predict a bright future for public financing in North Carolina. Interviews with advocacy group representatives from Common Cause North Carolina, Democracy North Carolina, the League of Women Voters of North Carolina, and the North Carolina Center for Voter Education suggest that North Carolina’s public financing of state election campaigns will continue to evolve in at least two areas.30

First, building on the 2007 program, the General Assembly might designate additional positions in the Council of State for public financing. An article in the Raleigh News & Observer in March 2008 indicated that 6 of the 11 candidates for auditor, insurance commissioner, or superintendent of public instruction were planning to participate in public financing. As one candidate for the superintendent position noted in that article, “It allows for regular, ordinary citizens to be involved in a campaign without having to raise millions and millions of dollars . . . I don’t think I would have done it if this had not happened.” The candidate’s opponent in the primary stated, “It really allows the candidates to focus on meeting people, talking with people about issues in education.”31

On the other hand, a candidate for superintendent who opposed public financing said, “I have a major problem accepting any sort of public money when there are children in our state living in poverty, when there are children who go to sleep hungry, when there are school buildings that are crumbling.”32 All but one of the candidates for auditor, commissioner of insurance, and superintendent of public instruction in the 2008 general election filed a notice of intent to participate in public financing, and all but one who did file were certified.33

Second, there is interest in increasing the number of local governments experimenting with public financing. Local progress is viewed as more feasible and having more bipartisan support than state-level progress.34 Likely communities are Asheville, Cary, Charlotte, Greensboro, Greenville, Raleigh, and Wilmington. Asheville, for example, has considered seeking authorization for publicly funded campaigns like those in
Chapel Hill. Citizens for Clean Elections, a group from Greensboro, is pursuing similar goals. Changes in election jurisdiction and the record-breaking expense of Wilmington’s recent mayoral race have generated conversations about reform in the eastern part of the state.²³

At some point, NCVCE and other advocates note, interest in public financing might spread to open-seat races (races in which there is no incumbent) for the General Assembly and other statewide offices. One indicator is the support that House Speaker Joe Hackney gave to the 2006 and 2007 public-funding legislative initiatives (serving as a primary cosponsor of the former), together with emergence of caucuses on campaign finance reform in both houses of the General Assembly.

Another indicator is the growing consensus in the reform community that too much money is needed to wage successful political campaigns, requiring candidates to pander to special interests to be viable. Indeed, in March 2008, Democratic Lieutenant Governor Beverly Perdue called for a $50 million Endowment for Positive Gubernatorial Campaigns, based on a 1995 proposal by Democrat Dennis Wicker, then lieutenant governor. The endowment would be governed by a twelve-member bipartisan board appointed by legislative leaders, which would determine candidate eligibility, distribute funds, and manage debates. A modified version of the endowment was endorsed by Democratic Treasurer Richard Moore. According to Lieutenant Governor Perdue, “The people of North Carolina, like the rest of the nation, are losing trust in the political system. The perception of corruption and a ‘pay to play’ environment has led to the belief that ordinary citizens do not have as much influence in politics as the rich and powerful.”²⁴ On January 12, 2009, her first day in office, Governor Perdue signed Executive Order Number 1, creating the Governor’s Task Force for the Development of an Endowment for Positive Gubernatorial Campaigns. The task force is charged with determining steps needed to establish an endowment, developing an organizational and legal structure for receiving pledges, and securing pledges.

As the cost of running a campaign continues to rise, support for publicly financed campaigns has grown and become more bipartisan. For example, former Republican North Carolina Representative Gene Arnold, former Democratic U.S. Representative Tim Valentine, and former Republican U.S. Representative and Lieutenant Governor Jim Gardner have recently declared their support for a publicly funded system. Citing the exponential increase in the cost of campaigning, all three called for the overhaul of a system that they consider to be “totally out of hand.” Unlike their party platform, which rejects public financing, Arnold and Gardner stood firm in their support, stating, “Finance reform would give the government back to the people.”³⁷

A 2007 poll of registered voters conducted by American Viewpoint for the North Carolina Center for Voter Education revealed continuing concerns about the influence of campaign contributions on elected officials’ decisions, with 87 percent of the respondents indicating such contributions exert “a great deal” or “some” influence. Sixty-nine percent favored continuation of the

Governor Beverly Perdue proposes to establish a fund for positive gubernatorial campaigns.
judicial public financing program, and 68 percent supported the program for selected Council of State offices. Similarly, 61 percent favored creation of a voluntary pilot program to publicly fund legislative campaigns in a few districts. The poll found that Republicans, very conservative voters, men aged 45–64, women aged 65 or older, and Raleigh-Durham residents were less likely than other voter groups to support this expansion of public financing.38

At the same time, proponents recognize that North Carolina’s experience with public financing at the state level has been limited to positions that some reformers think should be appointive, not elective, or if the latter, nonpartisan. Gaining incumbent and party support for higher-profile, partisan, and politically competitive offices like governor and state senator or representative will be much more challenging. Moreover, although advocates claim that the costs of a more expansive system would be less than a penny a day per eligible voter, in tough economic times, public financing of elections would have to compete with other priorities like education, transportation, and job creation. Opponents could argue that “paying politicians to run for office” would lead to tax hikes or cuts in popular programs.39

Voter-Owned Elections: Lessons from Other States

If interest in expanding public financing continues in North Carolina, lessons from other states could be instructive. Studies by advocacy groups, the U.S. Government Accountability Office, state study commissions, and academic experts have concluded that the following positive outcomes can be expected from publicly funded elections:40

- Candidate participation will increase as the system matures.
- Candidates will be generally pleased at having more time to meet with voters to collect qualifying contributions and discuss issues.
- The availability of public financing will attract candidates who might not otherwise run for office, especially women and minorities.
- Running as a “clean” candidate may be an advantage in open-seat races and occasionally against incumbents.
- More challengers will compete against incumbents in general elections, reducing the number of uncontested races and giving voters more choices.

Particularly useful might be the experiences of one recent addition to the roster of public financing legislation, the Arizona Citizens Clean Elections Act, which was adopted through a public initiative and referendum, not by the legislature.41 Public financing has made possible the successful campaigns of nearly half of the candidates for statewide and legislative offices since 2000, with increases in both participation and success reported in each cycle. Clean Elections candidates came from both political parties, and the total number of candidates running in contested primaries increased. The numbers of women, Latino, African-American, Native American, and Asian candidates grew, many of whom would not have otherwise run for office. Candidates were generally pleased that they spent more time meeting with voters and attending forums and less time fund-raising.42 In 2006, nine of 11 statewide officials (including the governor, the secretary of state, and the attorney general) and 38 of 90 legislators were elected with Clean Elections funding.43 Arizona’s system costs about $12 million per year. The Arizona Citizens Clean Elections Act has been challenged six times, most recently in American Association of Physicians and Surgeons v. Brewer, which alleged that the act neutralized the voice of independent spenders and coerced participation. When first heard in May 2005, the case was dismissed by the district court. The U.S. Court of Appeals for the Ninth Circuit dismissed it in February 2007.44

At the same time, public financing has encountered obstacles and limitations in a number of states:45
- Most state programs rely heavily on tax check-offs and add-ons to support participating candidates.
- They have raised only modest amounts of monies from appropriations and other sources.
- “Running clean” does not receive strong bipartisan support. Democrats seem to be more inclined to run as publicly funded candidates than Republicans seem to be.
- Name recognition and other advantages of incumbency remain formidable in both privately and publicly funded election systems.
- Spending limits can disadvantage a publicly funded candidate running against a privately funded opponent or an opponent who benefits from independent expenditures.
- Unregulated groups created under Internal Revenue Code Section 527 still can wield considerable influence in elections, undermining public financing reforms.
- Public financing has not significantly increased voter turnout, made general elections more competitive, or decreased campaign spending.
- If voters are told that “taxpayers’ money” will be used to pay for public financing of election campaigns, they likely will oppose it (unless the alternative language is “special interest money”). They will be less negative toward income tax check-offs or add-ons or even general appropriations.

These arguments, coupled with continuing concerns about possible First Amendment violations, have contributed to the failure of recent campaign-finance reforms in California, Maryland, Massachusetts, Missouri, Oregon, Virginia, and West Virginia.

In summary, proponents will have to overcome political, legal, philosophical, and financial hurdles as they seek to make a compelling case to skeptical incumbents, entrenched political leaders, and well-connected lobby groups. Moreover, convincing citizens that taxpayers’ money should be used to enable candidates to run for political office, and persuading governors and legislators that they should support general fund appropriations to bolster campaign coffers, are difficult tasks.
More time will be needed in the local and state "laboratories of democracy" to determine whether the experiment with clean elections will produce the outcomes promised by advocates and avoid the pitfalls claimed by opponents. In North Carolina, reformers seem cognizant of the challenges they face, but are optimistic that persistence, a smattering of scandals, and incremental successes will continue the march toward a comprehensive publicly financed election system.

Notes
4. Stenberg, "Running Clean."
6. N.C. GEN. STAT. ch. 775 (hereinafter G.S.).
8. Fleer, "Campaign Finance."
9. Ibid., 40.
10. Fleer, "Campaign Finance."
15. Judicial Campaign Reform Act, G.S. 163-278.61 through 278.70.
21. Ibid.
27. For a copy of the 2008 voter guide, see www.sboe.state.nc.us/content.aspx?id=29.
30. Representatives of advocacy groups, interviews.
31. As quoted in Ingram, "State Candidates," p. 1A.
32. As quoted in ibid.
34. Representatives of advocacy groups, interviews.
35. Hall, interview.
39. Ibid., 11.
40. Stenberg, "Running Clean."
41. ARIZ. REV. STAT. ANN. § 16-940 et seq.
43. Arizona Clean Elections Institute, "2006 Elections Statistics."
45. Stenberg, "Running Clean."
Ten Common Misconceptions about Eminent Domain

Charles A. Szypszak

Eminent domain is currently receiving much public attention, some of it emotionally charged. The realities of North Carolina law may be surprising to someone who has no direct experience with eminent domain. This article summarizes responses to ten common misconceptions about eminent domain, drawn from the book *Eminent Domain and Local Government in North Carolina: Law and Procedure* (for more information about the book, see the sidebar on page 44).

**Misconception 1. Eminent domain is a newly created power.**
Eighteenth-century English laws, which are the foundation of the American legal system, authorized the use of eminent domain to acquire land for roads, bridges, fortifications, and other improvements. North Carolina's courts always have viewed the state legislature as having the inherent power to do the same. Early state laws authorized local governments to use eminent domain to acquire land for roads. Some even authorized conscription of people living nearby to work on the road's construction, for up to six days annually east of the Blue Ridge Mountains and up to ten days west of them. Conscription for road construction was discontinued in the nineteenth century, but governments continued to use eminent domain to acquire land for highways and later for canals, railroads, and other public improvements. As the demand for public improvements has intensified and government projects have become more interrelated with private development, some particular uses of eminent domain have been questioned and challenged, but the use of the power for public projects has been a legislative prerogative for centuries.

**Misconception 2. Government pays only what it wants to pay for property that it takes by eminent domain.**
The United States and North Carolina constitutions require that "just compensation" be paid to an owner whose property is taken by eminent domain. "Just compensation" means payment of the market value of what is taken. Market value is determined according to recognized methods of real estate valuation, such as comparison with similar properties. Specific valuations often are contested, but the general principle of compensation at market value is well established.

**Misconception 3. State agencies and local governments determine their own powers of eminent domain.**
A government authority may not assume that it has the power of eminent domain merely because such a power would be useful. The legislature must authorize the use of eminent domain for the intended purpose. The North Carolina General Statutes authorize local governments to use eminent domain to...
carry out their common functions, such as building schools, roads, parks, hospitals, libraries, office buildings, and water and sewer systems. The statutes authorize state authorities, such as the Departments of Transportation and Administration, to use eminent domain for state highway and construction projects. They also have authorized public utilities and other authorities to use eminent domain for certain purposes.

**Misconception 4. Compensation must be paid for any interference with private property.**

Government activities usually have an impact on the neighborhood in which they are located. Government has a “police power” to restrict the uses of private property in order to protect public health and safety, even if a restriction results in a loss of value. The law tries to distinguish between changes in value that must be borne by landowners generally and those that unusually affect particular properties and constitutionally entitle owners to compensation. For example, the courts have held that the owners of land along a highway are not entitled to compensation just because changes are made to restrict travel, but if a particular parcel is negatively affected in an unusual and substantial way, compensation may be required.

**Misconception 5. Business owners must be paid for lost profits.**

When government takes the land on which a business is operated and the owners must move or curtail their operations, the owners may believe that they are losing future business profits. North Carolina law does not require compensation to be paid in such a circumstance. The general rule applied by the courts, subject to limited exceptions involving unusual uses of eminent domain, is that loss of profits from a business operation is not an element of constitutionally required compensation when eminent domain is used to acquire the land on which a business has operated.

**Misconception 6. Landowners can delay a project by contesting compensation.**

In most situations involving the use of eminent domain, the only issue that requires a court resolution is a dispute about the amount of required compensation. The law enables governments to move forward with projects without having to wait for a final resolution of compensation disputes. Under North Carolina law, most acquisitions rely on a “quick take” procedure, by which the government acquires title and the right to possession of the property as soon as the government files a complaint, a declaration of taking, and a deposit of estimated compensation with the court. The quick-take procedure applies to acquisitions for roads, sidewalks, schools, and utilities, among other purposes. If the government is taking property for purposes to which the quick-take procedure does not apply, in most cases the title will vest in the government when the owner files an answer. Contesting compensation does not further delay the transfer of title.

**Misconception 7. Government may use eminent domain only when there is no other way to construct the project.**

The North Carolina Supreme Court has held that authorities with the power of eminent domain have discretion to determine the property to be taken if the purpose is legislatively authorized and constitutionally permissible. Decisions about project needs are not subject to court approval except when facts indicate that the government is acting in bad faith on no conceivably legitimate basis. North Carolina’s courts presume that public officials act legally and in good faith. Someone claiming otherwise must be able to prove it in order to challenge the manner in which a government is exercising its authority to use eminent domain.

**Misconception 8. An eminent domain case can easily be abandoned.**

Once a government files an eminent domain case, abandoning the acquisition may be difficult, even if the government and the owner agree to do so. Usually the title to the property transfers as soon as an eminent domain case is filed, and in most cases, owners withdraw deposited compensation at that time. If the government has a change of plans, there likely will be complications to unravel, and the resolution of the issues may require court involvement.
Misconception 9. Judges have recently expanded the use of eminent domain.

In the much-publicized 2005 case *Kelo v. City of New London*, the U.S. Supreme Court upheld a Connecticut city’s use of eminent domain to acquire land for a private developer as part of a project to rejuvenate an economically troubled area. The decision reflected the Court’s historic deference to the elected legislature’s judgment about when to use eminent domain. The North Carolina Supreme Court has similarly tended to defer to the General Assembly’s judgment about when to authorize eminent domain. Although some may perceive eminent domain as being used expansively, legislatures are taking this step using the discretion that the courts have traditionally accorded them. Some state legislatures have been less inclined than others to authorize the use of eminent domain. The North Carolina General Assembly does not currently authorize the use of it for economic development in the manner employed in *Kelo*.

Misconception 10. “Playing hard ball is better than trying to reach an agreement.”

A government and a property owner have reasons to try to agree on a compensation amount rather than become embroiled in litigation over it. Governments have a constitutional obligation to pay compensation that is just, and they should be willing to discuss a reasonable amount with owners rather than take aggressive positions and incur litigation expenses. For their part, owners should not assume that intransigence will be rewarded. A government likely will be more flexible about compensation before positions have hardened and litigation expenses have begun to mount. Marginal gains in compensation by pursuing litigation are likely to be consumed by litigation costs. Owners typically recover some costs for appraisers, engineers, and plat in litigation, but the process quickly consume resources, and parties usually must bear significant costs themselves, including attorney fees.

Note


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Local Government Supports Better Coordination among Nonprofits

With schools, counties, and municipalities currently experiencing a budget crunch, tensions may heighten as cuts affect citizens seeking help from nonprofit providers and government agencies. How can vital services be maintained with less money? Instead of focusing only on the lack of money, nonprofits in one community came together in a daylong workshop on coping with the crunch in realistic, but creative ways.

In late October, the Orange County Human Services Advisory Commission convened a meeting of nonprofit directors to think proactively and discuss the question, What can the nonprofit network do within its own sphere to strengthen its capacity to provide effective, compelling services to residents? More than fifty participants spent time naming the strengths of the local nonprofit network, identifying shared interests, and creating new alliances for problem-solving.

Although money is tight for most nonprofit and government service providers, human capital and considerable experience are not in short supply. The challenge is to identify and make the most of the nonmonetary
resources that can sustain communities during economic stress. Orange County's assistant manager, Gwen Harvey, reports, "The meeting was an excellent opportunity to bring our nonprofit partners together for focused dialogue on increasing positive outcomes for the community. Everyone appreciated the flow of ideas with a clear-eyed view of challenges we face."

Communities that are interested in holding such a problem-solving discussion are invited to contact School staff members Lydian Altman, 919.962.0103 or lydian@sog.unc.edu, or Margaret Henderson, 919.966.3455 or margaret@sog.unc.edu. Their work on strengthening nonprofit-government relations is available through the Public Intersection Project, www.publicintersection.unc.edu.

Clerks' Institute Marks Thirty Years

The School of Government’s 2008 Clerks’ Certification Institute, held in February, June, and October, helped forty municipal and county clerks and other local officials progress toward professional certification from the International Institute of Municipal Clerks (IIMC). This year’s institute was the first in which class examinations were completed entirely online. Other class assignments also used Internet technology.

Since 1979, more than five hundred city and county clerks and council of government secretaries and their deputies have made use of the institute to fulfill a major part of the clerks’ certification requirements of the IIMC. IIMC is a professional organization of about ten thousand clerks in the United States, Canada, and other countries.

Many class members receive scholarships from the Local Government Federal Credit Union, the North Carolina Association of Municipal Clerks, and the School of Government to help defray the cost of attending the three-week program. meetings and public records, community engagement, civic engagement of youth, elections, and emergency management. Joyce, a long-time faculty member, cannot remember another time when the organization conducted training for troops about to be deployed.

School Faculty Train 82nd Airborne Division in Local Government

As part of a new military strategy in Iraq, 3,200 members of the 3rd Brigade Combat Team, 82nd Airborne Division, from Fort Bragg deployed to Baghdad in November 2008 with responsibility not only for military and security matters, but also for leadership and assistance to Baghdad officials in helping stabilize the local government. In October, before the brigade deployed, faculty members A. Fleming Bell, II, Norma Houston, Robert P. Joyce, Jonathan Q. Morgan, and Ricardo S. Morse, along with Civic Education Consortium Director Kelley T. O'Brien, traveled to Fort Bragg to help prepare one hundred officers at the rank of captain and above for the mission. The School’s team offered a day and a half of training in basic local government organization and functions, community and economic development, ethics and board proceedings, open

A. Fleming Bell, II
Norma Houston
Robert P. Joyce
Jonathan Q. Morgan
Ricardo S. Morse
Kelly T. O'Brien
Hunt and Joyner Honored

In September 2008 the International Association of Assessing Officers (IAAO), the international professional association in property appraisal, assessment administration, and property tax policy, honored School faculty members Joseph E. Hunt and Kenneth L. Joyner, lecturers in public finance and government.

Hunt, who joined the faculty in 1983, received the IAAO’s 2008 Presidential Citation. The award recognized his leadership in the course of his career and “his significant involvement in the Association, which has furthered the realization of the mission of IAAO.”

Joyner, who joined the faculty in 2008, received IAAO’s Member of the Year Award.

In November 2008, at the annual conference of the North Carolina Association of Assessing Officers (NCAAO) in Greensboro, Hunt received two additional honors: the Old North State Award, established by Governor Mike Easley for outstanding North Carolinians who have “a proven record of exemplary service and commitment to the state and their community,” and a renaming by the NCAAO of its Distinguished Jurisdiction Award as the Joseph E. Hunt Distinguished Jurisdiction Award.

Media Design Studio Increases Teaching and Learning Options

The completion of a media design studio at the School offers faculty new ways to expand teaching and learning opportunities. Funding to construct and equip the studio was provided by the Knapp Foundation of St. Michaels, Maryland, and many individual donors across the state.

The studio houses numerous multimedia-development tools, including a sound booth that makes it possible to produce high-quality audio recordings and to combine audio with learning tools such as PowerPoint and video for use in class or over the Web. According to Joel Galbraith, instructional analyst and studio manager, “Staff and faculty can use the studio equipment alone or with help to record and edit audio and video into fully produced multimedia products such as webinars, audio CDs, and DVDs. Recordings can be made in the studio,

Top, Joseph E. Hunt and IAAO President Guy Griscom; bottom, Kenneth L. Joyner and Griscom.
in the classroom, and in other locations as needed.”

In fall 2008 the Teaching and Learning Support team, working with several faculty members, used studio equipment to develop distance-learning materials for areas such as mental health services and indigent defense services.

“Online training for local mental health boards evolved as part of a project with the North Carolina Division of Mental Health, Developmental Disabilities and Substance Abuse Services,” said Associate Professor Mark Botts, who directed the project. “The division requested that a live regional training session be recorded for members who could not attend, as well as for future board members and directors, county commissioners, and consumer and family advisory committee members who work with the local mental health boards.

“Recording a regional session would have required trying to make ten hours of live audience presentation interesting and useful for individuals who would be viewing from their homes or offices,” Botts explained.

“The School’s new media studio and Teaching and Learning Support team made it possible to pursue a better approach by designing and producing five Web-based instructional modules that include visuals, narration, and interactive learning activities.”

Meredith Murray, program manager for the School’s Indigent Defense Education (IDE) group, says that their program had a similar experience.

According to Murray, “Many North Carolina indigent defenders are unable to attend training in person because of a number of factors. Our programs typically contain timely and essential information for indigent defenders, so it is important to be able to disseminate programs beyond our classrooms on a reasonably fast timeline.” To serve the defenders better, IDE faculty initiated an online presentation project led by defender educator Alyson Grine.

Like the mental health group, the IDE group used recorded narration synchronized with a PowerPoint presentation that is accessible over the Internet to participants at any time convenient for them. Students can view the entire presentation or use an included index to select certain parts of a lecture.

By increasing its capability to produce good-quality online and distance training, the School will supplement and enhance its educational programs in ways that are effective—and cost-effective—for local government officials and others who increasingly encounter time or financial limitations on obtaining important professional continuing education.

To access the mental health materials, go to www.sog.unc.edu/programs/mentalhealth/. For more information, see “New Online Resource Available for LME Board Members,” page 3. To access the indigent defense education materials, go to www.indigentdefense.unc.edu, and click on Online Training.

Wicker Scholarship
Available for First-Year Student Entering UNC at Chapel Hill in 2009

If you are a local government employee with a high school senior who has been accepted for next year by UNC at Chapel Hill, encourage him or her to apply for the Warren Jake Wicker Scholarship.

Each spring the UNC at Chapel Hill Office of Scholarships seeks first-year undergraduate applicants for this $1,000 scholarship.

The student must have at least one parent who has been continuously employed full-time by a North Carolina city or county government for at least five years before January 1, 2009. The scholarship is awarded on the basis of relative financial need and academic promise.

To apply, send a letter of application to Wicker Scholarship, UNC at Chapel Hill Office of Student Aid, P.O. Box 1080, Chapel Hill, NC 27514. For additional information or to e-mail a letter of application, contact Torie Davis at torie.davis@unc.edu or 919.843.1619.

The application must be received on or before April 1, 2009.
2009 • $15.00*
Jessica Smith

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Kara A. Millonzi
Using a question-and-answer format, this publication offers legal guidance to local governments on issues such as proper billing for utility services provided; liability for water, wastewater, and solid waste utility fees; and consequences of a customer’s not paying. Legal guidance is based on applicable constitutional and statutory provisions and case law from North Carolina and other jurisdictions that have developed over the course of many years and become common law.

2008 • $10.00* 
Charles Szypszak
The ninth edition of North Carolina Guidebook for Registers of Deeds, published in 2007, is a guide to the powers and duties of registers of deeds and addresses the recording and indexing of real and personal property records, the recording of plats, the issuance of marriage licenses, and the management of other records for which registers are responsible. This supplement discusses relevant 2008 legislation, which revises and clarifies the laws governing a register’s acceptance of electronic records and previously recorded documents. The supplement also clarifies the law describing the register’s responsibility for complying with technical indexing requirements and notes the increased fee for recording a deed of trust or mortgage. Link to a free PDF version at www.sog.unc.edu.

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