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Personnel Records Acts

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Harvesting pumpkins on Elmo's farm in Pilot is one of the special treats of a North Carolina fall. Photo by Clay Nolen, North Carolina Travel and Tourism Division

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A Mutual Fund for Investments by North Carolina Local Governments

Priscilla M. Wheatley

Editor's Note: In the Fall 1981 issue of *Popular Government* A. John Vogt explained the concept of local government investment pools and the 1981 North Carolina legislation that authorized cities and counties to invest in such pools after the State Treasurer or the Local Government Commission had issued regulations for using the pools. Vogt's article described the forms that local government investment pools have taken in other states. The following article describes the specific investment pool arrangement that North Carolina's Local Government Commission has recently selected and certified.

A unique new investment alternative is now available to North Carolina's local governmental units. The North Carolina Cash Management Trust is the first state-sanctioned investment pool to be registered with the Securities and Exchange Commission (SEC). Its purpose is to offer local governmental units a safe, convenient, liquid, high-yield investment alternative that can also serve as both a concentration account and a cash management tool. The units that are eligible to participate include school administrative units, local ABC boards, community colleges, and public hospitals authorized to use forms of investment allowed by G.S. 159-30, as well as local governments and public authorities as defined in G.S. 159-7.

The author is Associate Product Manager, Public Funds, at Fidelity Management & Research in Boston, Massachusetts.

The Trust is a result of legislation passed in 1981 (Ch. 445 of the 1981 Session Laws) that allows local governmental units to purchase shares of a mutual fund that invests only in instruments allowed under state law and is certified by the Local Government Commission (the Commission). The Commission and the State Treasurer established rules and regulations for the Trust's operation last winter and selected a manager after evaluating nine proposals. The Trust will be managed by a consortium of three firms—Sterling Capital Distributors and First Union National Bank, both headquartered in Charlotte, and Fidelity Management & Research of Boston.

Benefits of the Trust

The North Carolina Cash Management Trust is designed to provide several benefits to its participants:

- —Liquidity: The ability to make deposits or withdrawals at any time in any amount and to earn daily interest on all funds while they are invested.
- —Convenience: Participants may open as many separate accounts as they may require and use a variety of purchase and withdrawal options.
- —Professional Management: The Trust's portfolio will be managed by a team of professionals whose sole responsibility is investing over $10 billion in money market fund assets.
- —Diversification: Each participant will own an interest in a portfolio of securities with a wider variety of issues and issuers and in larger denominations than most local units can normally invest in.

—Higher earnings: The possibility of increasing investment earnings by having more money invested for longer periods of time, earning daily interest at current rates while the funds are invested.

—No direct cost: The yield paid to investors is net of the management and distribution fees. There are no direct charges to shareholders for any services.

The Trust's distributor will also be offering special technical assistance and specialized seminars and publications designed to assist public finance officials in managing funds more effectively and efficiently.

What is the Trust?

The Trust is a local government investment pool (LGIP) that, unlike most of the fifteen currently operating pools in other states, will be a registered investment company—a mutual fund in which investors purchase and redeem shares. This means that although the State of North Carolina, through the Local Government Commission, is involved with implementing the fund and will monitor its performance, the Trust will be registered with the Securities and Exchange Commission (SEC) and subject to the various rules and regulations designed to regulate the sale of securities.

LGIPs were devised in the early 1970s as a way to enable municipalities to pool funds that were available for investment to gain access to high-yield, large demomination investments that are normally impractical for local governments to invest in. In essence, therefore, LGIPs are shared capacity programs that allow each participant access to a level of professional investment management and a portfolio of securities that most units could not avail themselves of because of the expense and time requirements of full-scale investment programs.

The Trust is a money market mutual fund, a specialized type of mutual fund that arose during the 1970s as a means of giving small investors access to high-yield securities. Money market funds, including the Trust, generally maintain a share price of $1 and declare a daily dividend, so that the value of the shares in the account and the dividend paid are always equal to the dollars that have been invested. Also, the SEC permits most money market funds to use the amortized-cost method of portfolio valuation, which does not take into account the market value of the securities in the portfolio when the fund is priced. Since the Trust uses amortized-cost valuation, the SEC requires it to maintain an average portfolio maturity of 120 days or less and to buy securities with one year or less in remaining maturity. The SEC also requires the Trust to place certain limitations on the structure of the portfolio to avoid concentrating assets in too few issuers or in banks whose size limits the marketability of their securities.

The portfolio may include any of the securities authorized by G.S. 159-30 for use by North Carolina's local governmental units—subject to the limitations described above as well as the credit analyses carried out by the Trust's investment adviser. Authorized types of securities include various U.S. Treasury and federal agency obligations, obligations of banks, and commercial paper and banker's acceptances of the highest grade. The investment adviser's objectives are to structure the portfolio to achieve safety of principal, to meet the liquidity requirements of the shareholders, and to pay the highest level of current income consistent with the first two objectives.

How will the Trust operate?

The Trust is designed to offer a convenient and flexible program so that each local unit can determine how it can best use the Trust in its investment management program. Although current North Carolina statutes may limit use of some Trust features, the Trust's operational structure allows each shareholder to determine what constitutes appropriate use.

Participants in the Trust can use both wire transfers—a means of transferring funds for same-day credit by means of the Federal Reserve Wire System—and checks for purchasing or redeeming shares. Unlike most money market funds, the Trust has no limitations on either transaction size or account balance, and wire transfers will be processed on the same business day, provided that the Trust receives a telephone request by noon. Checks may be mailed directly to the Trust and will begin earning interest on the business day after they are received. The Trust also accepts federal revenue sharing transfer payments by direct deposit if the necessary forms have been completed. The Trust offers a special check-redemption feature that in effect allows participants to write checks against their Trust accounts. Each check continues to earn interest at the current rate until it clears the investment account with the Trust.

Because most public units are required either to segregate certain funds or to account for them separately, the Trust allows each participant to open as many accounts as it wishes. Each account is registered and administered separately. The Trust also offers a special subaccounting package to those shareholders whose transaction volume and account balances indicate that such service may be desirable.

All transactions are promptly confirmed by mail, and a monthly account statement that includes the amount of earnings is issued for all accounts. Special service personnel are available to answer questions, to service accounts, and to explain how the Trust can be used most effectively.

Obtaining information

All eligible participants in North Carolina have received information on the Trust by mail including the prospectus,

(continued on page 6)

Changes in North Carolina's Local Government Personnel Records Acts

Donald B. Hayman

In 1975 the North Carolina General Assembly enacted three bills governing the personnel records of state, county, and municipal employees. In 1977 and 1978 it amended the provisions that pertained to the personnel records of state employees. An article in the Fall 1980 issue of *Popular Government* described the problems that led up to the personnel records legislation, its provisions, and the problems that accompanied it.[1] The 1981 General Assembly amended the statutes that cover local government personnel records. This article summarizes those changes.

To recapitulate, the 1975 legislation exempted public personnel records from the North Carolina public records act, but it provided that (1) certain information would be available to the public; (2) all but two types of information would be available to employees; and (3) most information in each employee's personnel file would be available to the employee's supervisors, other officials, and persons with a court order. The 1977 and 1978 amendments to the state employees personnel records act (1) expanded the definition of personnel files to include "any information in any form gathered with respect to that employee," (2) extended coverage of the act to job applicants and former employees, (3) opened the files of employees separated for ten or more years except for documents regarding demotion or dismissal, and (4) permitted a department head to give the information in a personnel file to any person if he officially finds that such disclosure is essential to maintaining the integrity of the department. Table 1 contains guidelines for releasing information from the personnel files of North Carolina state employees.

By the time the General Assembly convened in 1981, some serious problems had been identified in the county and municipal personnel records acts, and HB 1221—introduced on June 11—was drafted to correct some of them. The bill was amended in both the House and the Senate and was ratified on the final day of the session.[2]

The 1981 amendments to the county and municipal acts make provisions similar to several of the 1977 amendments to the state personnel records amendments. "Personnel file" now includes any information in any form gathered with respect to employees, and the law now covers former employees (but not applicants). A governing board, or manager in manager cities and counties, may release personnel information if such disclosure is officially found to be essential to maintaining the integrity of the governmental unit.

The county and municipal personnel records acts in 1982 differ from the state act in at least ten ways.

The author is an Institute of Government faculty member whose fields include personnel administration.

1. Donald Hayman, "Problems in Administering Personnel Records Acts in North Carolina," *Popular Government* 46, no. 2 (Fall 1980), 24-30.

2. N. C. Sess. Laws 1981, ch. 926 amended G.S. 153A-98(a) and G.S. 160A-16(a).

1. The "files of applicants" for local government jobs are now apparently closed to the public and the applicants themselves.[3] While the news media may object to the closing of these files, some governing bodies and many applicants welcomed it for reasons outlined below.
2. The 1981 amendments to the local government personnel records acts did not open the files of employees separated for ten or more years as the 1977 state amendments did.

3. The 1981 amendments exempt the "files of applicants" from G.S. 132-6, the statute that governs access to public records. The amendments also provided that files of applicants are: subject to inspection and disclosure only as provided by G.S. 153A-98(a) and G.S. 160A-168(a). On the final day of the 1981 legislative session a Senate amendment deleted "applicants for employment" from the definition of "employee" in these two statutes. The amendments appear to close the files of applicants for local government jobs to the public and the applicants.

3. The 1981 amendments provide that the official who has custody of a county or municipal personnel record may release an employee's name, address, and telephone number from a personnel file in order to aid a criminal investigation.
4. The 1981 amendments provide that if an employee signs a written release, personnel information specified in the release may be provided to prospective employers, educational institutions, or other persons authorized in the release.
5. Testing materials used by a county or municipality for employment or promotion purposes need not be disclosed.
6. Investigative reports concerning possible criminal actions of a local government employee need not be disclosed until either (a) the investigation is completed and no criminal action is taken, or (b) the criminal action is concluded.

Table 1

Guidelines for Releasing Information from Personnel Files of North Carolina State Employees—May 1982[1]

	Recipient of Information									
Type of Information	General Public	Applicant, Employee, Former Employee	Employee's Authorized Agent	Supervisor	Official Inspecting in Line of Duty	Designated Licensed Physicians	Official Investi-gating for Tax Liability or Prosecution	Member of General Assembly[2]	Academic Researcher	Person with Court Order
Name	MUST BE AVAILABLE TO ALL									
Age										
Date of original employment										
Current position title										
Duties performed[3]										
Salary										
Date and amount of most recent increase										
Office to which currently assigned										
Date of most recent promotion, demotion, transfer, suspension, separation, or other change in position classification										
Personnel files of former employees after 10 years[4]										
Application	NOT AVAILABLE[5]	Must	Must	Must	May	No	No	Must	Governing body may	SUCH PORTIONS AS MAY BE ORDERED BY COURT
Previous salary		Must	Must	Must	May	No	No	Must		
Attendance record		Must	Must	Must	May	No	No	Must	-	
Home address		Must	Must	Must	May	No	May	Must	-	
Telephone number		Must	Must	Must	May	No	May	Must	-	
Previous title		Must	Must	Must	May	No	No	Must	-	
Previous employment		Must	Must	Must	May	No	No	Must	-	
Sick leave used		Must	Must	Must	May	No	No	Must	-	
Performance rating		Must	Must	Must	May	No	No	Must	-	
Disciplinary action		Must	Must	Must	May	No	No	Must	-	
Routine medical record		Must	Must	Must	May	No	No	Must	-	
Most recent personnel action		Must	Must	Must	May	No	No	Must	-	
Employment and promotion examinations		Need not	Need not	Must	Need not	Need not	No	Must	-	
Information in file *except*										
(a) reference letters solicited before employment		No	No	Must	May	No	No	Must	-	
(b) medical record that a prudent MD would not disclose		No	No	Must	May	Must	No	Must	-	

Notes
1. N.C. Gen. Stat. § 126-22 through -29
2. *Id.* § 120-19
3. While not mentioned in the personnel acts, job descriptions are public records.
4. Except for documents relating to disciplinary action that result in the employee's dismissal.
5. Department head may inform any person of any personnel action and the reason for that personnel action after determining in writing that the release is essential to maintaining confidence in the administration of services or the level and quality of services. The written determination shall be a public record and available for public inspection and become a part of the employee's personnel file. Files of employees separated for ten or more years are open except for documents regarding demotion or dismissal.

7. Information that might identify an undercover law enforcement officer or a law enforcement informer need not be disclosed.
8. Notes, preliminary drafts, and internal communications concerning a local government employee need not be disclosed unless they were used for an official personnel decision.
9. A professional representative of a training, research, or academic institution may have information in local government personnel files if the information is to be used solely for statistical, research, or teaching purposes.
10. Whereas formerly a county or municipal employee could be found guilty of providing illegal access to a county or municipal personnel file if he was shown to have acted knowingly and willfully, now he must also be shown to have acted with malice.

Table 2 contains guidelines for releasing information from the files of county and municipal employees.

Most local public officials welcome the 1981 amendments to the local government personnel records acts. They say that the local acts are now superior to the present state personnel records act. While the news media may react to the closing of the files of applicants, some public officials feel that this change was necessary. Several times in recent years, television, radio, and newspaper reporters have demanded to know the names of applicants for public positions and turned the interviewing of applicants for managerial or other administrative posts into a media event. Applicants for openings as manager have been interviewed by the press before they met the council. When confronted by TV cameras after an interview, some have withdrawn their names from consideration. To be known to be consider-

Table 2

Guidelines for Releasing Information from Personnel Files of North Carolina City and County Employees—May 1982[1]

	General public	Applicant, employee, former employee	Employee's authorized agent	Supervisor	Officials in line of duty inspect	Designated licensed physicians	Designated info to designated person[2]	Official investigating for tax liability or prosecution	Academic researcher	Person with court order
Name Age Date of original employment Current position title Duties performed[3] Salary Date and amount of most recent increase Office to which currently assigned Date of most recent promotion, demotion, transfer, suspension, separation, or other change in position classification	MUST BE AVAILABLE TO ALL									
Application	NOT AVAILABLE[4]	Must	Must	Must	May	No	IF DESIGNATED IN WRITTEN RELEASE	No	Governing body may	SUCH PORTIONS MAY BE ORDERED BY COURT
Previous salary		Must	Must	Must	May	No		No		
Attendance record		Must	Must	Must	May	No		No	"	
Home address		Must	Must	Must	May	No		May	"	
Telephone number		Must	Must	Must	May	No		May	"	
Previous title		Must	Must	Must	May	No		No	"	
Previous employment		Must	Must	Must	May	No		No	"	
Sick leave used		Must	Must	Must	May	No		No	"	
Performance rating		Must	Must	Must	May	No		No	"	
Disciplinary action		Must	Must	Must	May	No		No	"	
Routine medical record		Must	Must	Must	May	No		No	"	
Most recent personnel action		Must	Must	Must	May	No		No	"	
Employment and promotion examinations		Need not	Need not	Must	Need not	Need not	Need not	No	"	
Information in file **except**										
(a) Reference letters before employment		No	No	Must	May	No	No	No	"	
(b) Medical record prudent MD not disclose		No	No	Must	May	Must	No	No	"	
Reference letter obtained after employment but before promotion		Yes	Yes	Yes	Yes	No	Yes	No	"	
Notes, internal drafts, internal communication										
(a) Not used for any personnel decision		Need not	Need not	Need not	Need not	Need not	Need not	Need not	"	
(b) Used for any personnel decision		Must	Must	Need not	Need not	No	Need not	No	"	
Investigative reports										
(a) Before completion or conclusion of criminal action		Need not	Need not	Need not	Need not	Need not	Need not	Need not	"	
(b) After completion or conclusion of criminal action		Must	Must	May	May	May	Must	No	"	
Information identifying undercover law enforcement agent		Need not	Need not	Need not	Need not	Need not	Need not	Need not	"	

1. G.S. 153A-98 and 160A-168 as amended by Chapter 926 of the Session Laws of 1981. 2. Information released may be given by phone, mail or in person. 3. While not mentioned in the personnel acts, job descriptions are public records.
4. Manager with the concurrence of the governing body (or the governing body in cities and counties not having a manager) may inform any person of any personnel action, and the reason for that personnel action after determining in writing that the release is essential to maintaining confidence in the administration of services or the level and quality of services. The written determination shall be a public record and available for public inspection and become a part of the employee's personnel file.

ing leaving a position can damage an administrator's effectiveness in his present position. Only applicants who are unemployed or have understanding employers have little to lose when they interview for another job. Some employers see going for an interview as a sign of dissatisfaction or an act of disloyalty. Supporters may understand but still feel the administrator or employee "who is looking" is letting them down. To apply and not get a very desirable job will cause some citizens to ask, "Is there something wrong with him that we do not know about?" This result may be illogical or unfair, but recent events suggest that it happens.

Critics of the closure should note that the amendment does not alter existing law on two points. First, the veil of secrecy must be lifted at the time the governing board makes an appointment, which must be made in open session. Second, when the applicant begins work as an employee, he is subject to the public records act.

But despite progress, at least four problems persist in the provisions for local personnel records. First, the fear and confusion that resulted from the penalties contained in the 1975 acts caused some local officials to overreact. It will take time for them to become familiar with the amendments and determine who can be given what information while protecting the employees' rights.

Second, confusion would be reduced if the statutory listing[4] of information that is available to the public were revised and clarified. Does it make sense that the date of original appointment and current position title are public information but the title of first position held and date, titles, and salaries of subsequent positions (if before the current position) are confidential? Is it logical that the date of the most recent change in position classification or personnel action is public information, but the nature of that most recent action is not?

Third, certain federal, state, and local officials—although they have the right to inspect personally the personnel records that are necessary to their official functions—may not obtain the information from a records custodian by mail or telephone. Does it make sense in times of rising governmental workload and travel costs that officals must inspect personnel records in person (unless they have obtained a written release from the employee)? This situation is made even more illogical by the fact that the employee's supervisor, from his own personal knowledge, can give the official the information over the phone or by mail if the unit does not keep personnel records or if the supervisor does not know what is in the employee's personnel file.

Fourth, there are several gaps in the coverage of the local government personnel records acts. The Attorney General has ruled that area mental health department and district health departments are separate and apart from either county or city government.[5] If asked, he would probably say the same about ABC boards, councils of government, and water and sewer authorities. Should the local government personnel records acts be extended to all local government agencies? ●

4. N.C. Gen. Stat. § 153-98(b); *id.* § 160A-168(b).

5. Letter of Robert R. Reilly, Assistant Attorney General, to Sarah T. Morrow, Secretary of Human Resources, October 21, 1981.

Investment Fund

(continued from page 2)

information on opening accounts, and the Trust's toll-free telephone number. Trust representatives are available to call on individual local government finance officers, and informational meetings across the state were scheduled to be held during the early autumn of 1982.

Conclusion

The North Carolina Cash Management Trust is the first of its kind a money market mutual fund that will provide its participants with the benefits of both state involvement and SEC regulation. It is intended to give the state's governmental units another investment option as well as assistance in implementing and managing an effective cash management program. North Carolina local governments should reap substantial benefits from this program in terms of safety, earnings, and convenience.●

Antitrust Liability of Local Governments

Grainger R. Barrett

Nearly a century ago the Sherman Antitrust Act was passed to protect the nation from the growing tendency of industries and industrialists to enter into agreements by which they could eliminate competition and control their respective areas of economic activity. Since 1890 that piece of legislation has been a sturdy tool to be used against attempts by private business enterprise to establish monopolies. But clearly it had nothing to do with local government—at least, that is, until 1978, when the United States Supreme Court for the first time found against a local government that was charged with violating federal antitrust laws. Now a whole new area of potential liability—or at least worry and uncertainty—has opened up for local officials. The purpose of this article is to explain some basic aspects of antitrust law as applied to local governments and to offer some advice about avoiding antitrust problems.

The antitrust statutes

Though there are other federal statutes and state laws in the antitrust area,[1] the primary document is Section 1 of the Sherman Antitrust Act. Its relevant language is simple:

> Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade among the several States, or with foreign nations, is declared to be illegal.

The essential purpose of the Sherman Act is to preserve vigorous competition, as its provisions for the award of damages show. Once liability is found and the right to damages is established, the plaintiff is entitled to three times the amount it claims in damages—a result that makes a strong argument against violating the antitrust laws.

To establish that an activity is a violation of Section 1, it must be shown that the activity affects interstate commerce and that two or more parties are acting jointly, and the relevant product and the geographic markets must be defined (Does cellophane compete with aluminum foil? Does a coal mine in Illinois compete with a coal mine in Wyoming?). Furthermore, before Section 1 can apply, a not insubstantial (though not necessarily "substantial") amount or dollar value of interstate commerce must be affected by the conspiracy. The activity may occur all in one state, so long as the activity in that state, and similar conduct throughout the country, can be said to affect the "stream" of interstate commerce. In certain situations one factory or one chicken farm may affect interstate commerce. So the Sherman Act can extend to many activities of local governments even though most local governments may actually transact business across state lines relatively seldom.

Judicial interpretation of Section 1 of the Sherman Act has established that certain conduct—known as a "per se violation"—is illegal in and of itself; its effects are con-

The author is a former Institute faculty member whose field was local government administration. He is now deputy attorney for the town of Chapel Hill.

1. Section 2 of the Sherman Act, for instance, prohibits monopolizing a market; it can reach monopoly power exercised by just one party, without any combination or conspiracy. Section 3 of the Clayton Antitrust Act (1914) prohibits many exclusive dealing arrangements. Section 7 of that act reaches mergers and acquisitions that may substantially lessen competition. And the Robinson-Patman Act prohibits many types of price discrimination such as discounts to favored volume customers that are not strictly justified by the volume savings to the supplier.

clusively presumed to be anticompetitive. The major per se violations are price-fixing, group boycotts, and division of market territories.

All price-fixing arrangements are illegal. Indeed, price-fixing is considered the ultimate antitrust violation because it strikes at the heart of the free market—competition based on price.[2] Horizontal division of market territories is also a per se violation. Horizontal division occurs when direct competitors—companies at the same level of distribution—allocate business between themselves by either product lines or geography. One contractor may agree with others to bid only on water and sewer plant projects while the others will bid only on general construction, or only on highway work. Or the contractor may agree with competitors to bid only within a certain number of miles of its quarry or asphalt plants.

A "tying" arrangement is another per se antitrust violation. Tying occurs when a seller of one product or service requires the buyer to purchase another product or service as a condition of being allowed to buy the first. In a major decision by the U.S. Supreme Court on local government antitrust liability, two cities were accused of tying electricity service to their water and gas service. That is, it was alleged that they refused to sell electricity to potential customers unless the customers also agreed to buy water and gas from the two cities.

Certain joint conduct is illegal under the Sherman Act even if it does not amount to a per se violation. Such conduct violates the Sherman Act if, on balance, its anticompetitive effects outweigh its procompetitive effects. This method of analyzing a possible antitrust violation is called the "rule of reason" test. Only unreasonable restraints of trade are prohibited. To be unreasonable, the conduct must hurt market competition more than it helps competition.

Local government liability

Local governments across the country take actions every day that would be antitrust violations if taken by private parties. For example, if private competitors got together and decided that within a particular county only retail shops could be located in certain areas, only factories in other areas, only gas stations in other areas, only offices and clinics in yet other areas, only residences in still other areas, only large shopping centers in others, and only public facilities in certain places, they would surely be violating the antitrust laws. Yet in a general way that is exactly what zoning by local governments achieves—without violating the antitrust laws.

A local government can require that all pool halls or billiard parlors close at a certain hour. In the absence of unusual facts, this type of regulation is probably not an antitrust violation. Yet if the owners of all the pool halls in a community met and agreed to maintain common hours of business, they might well have committed an illegal restraint of trade.

Similarly, a town can require that all newsracks be placed only in certain restricted areas of the sidewalks in the downtown area. Again, a local government probably may do this without violating the antitrust laws, but newspaper vendors probably may not.

Virtually all local governments provide that police or fire protection may be offered within the jurisdictional limits by only one public or quasi-public agency. But no private company may restrict entry into an industry in such a way and still be on the right side of the antitrust laws.

Yet without moving too far from police and fire services—to water, sewer, electricity, waste collection, and even mass transit—we cross a significant line. Local governments have more chance of finding antitrust problems in these latter areas. When a town zones, or regulates pool hall hours, or restricts newsracks on sidewalks, it acts under its police—or regulatory—power. The regulatory power is the local government's authority to regulate and act for the public health, safety, and welfare. On the other hand, the provision of water or sewer services, for instance, is a "proprietary" operation of government. Governmental proprietary activities are economic activities, run as public businesses. Although by definition they are in public hands, usually they could as easily be owned and operated privately. Local governments face greater antitrust problems with these activities, because in regard to them the governments make business-like decisions and affect economic activity.

Although local governments are better shielded from antitrust laws when they exercise regulatory power than when they perform proprietary activities, they are not exempt from these laws even in connection with their regulatory activities, as the Supreme Court held in early 1982 (see *Community Communications Co., Inc. v. City of Boulder*, discussed below).

How can a local government be sued for performing acts that its citizens routinely expect from it? If it is sued, is it not true that any damages it might have to pay will only come in turn from taxpayers' money?

Briefly, a government may be sued because local governments are now held to be "persons" within the meaning of the Sherman Act and because private parties may sue to enforce that act—or, to put it another way, to recover compensation for the harm they may have suffered as a result of the antitrust violation. Local governments are

2. "Vertical" price-fixing is illegal in and of itself. For example, a candy maker that wants to keep a premium image of quality and maintain high profit margins at the sake of some volume engages in illegal price-fixing if it attempts to enforce the minimum retail prices of independent establishments that sell its product. "Horizontal" price-fixing is also illegal. For example, the marketing and sales vice-presidents of the companies that make paperboard for cardboard containers may not agree mutually on prices for various grades and quantities of paperboard. And setting maximum prices is just as illegal in and of itself as setting minimum prices.

not expressly exempted from the Sherman Act, and they have been included within its scope to some degree because the Supreme Court has always held that Congress intended the act to be broadly applied and to be vigorously enforced. With their public powers, local governments can affect competition in many ways for many reasons. So in some cases the potential harm or cost of the regulation to consumers of economic goods and services may outweigh the cost to one locality's taxpayers. A local government is not free to decide to use public powers to transfer an economic advantage from other participants in commerce generally to its own citizens or taxpayers without at least *some* scrutiny under the Sherman Act.[3]

The Supreme Court cases

The principle that local governments may be subject to antitrust suit for both proprietary and regulatory actions developed primarily in three cases before the U.S. Supreme Court. The Court has held that while states are exempt from the Sherman Act, local governments are not necessarily exempt; their activities—both proprietary and regulatory—may be subject to it.

Along the way, the Court has developed the parallel principle that a local government's actions sometimes can be considered to be the actions of the state government for purposes of the Sherman Act, which makes those actions exempt from the Sherman Act. This kind of exemption occurs only if the state government directs or authorizes the local government's anticompetitive conduct in a clear and affirmative way.

The state-action exemption. In 1943 the Supreme Court held in *Parker v. Brown*[4] that state governments can restrict competition as an act of government without violating the antitrust laws. Its underlying reasoning was that it is not to be assumed that in passing the Sherman Act, Congress meant to nullify a state's control over its officers and agents. Noting that in our federal system states are still sovereign powers, the Court said that in passing the law Congress did not intend to prohibit economic restraints by a state that was acting in a sovereign capacity. It thus allowed a California program to restrict competition among raisin growers by "stabilizing" the price of raisins to packers to stand. The program kept many raisin producers in business but resulted in higher prices to the packers.

Local governments are persons. In *Lafayette v. Louisiana Power and Light Co.* (1978),[5] the Court decided that local governments do not enjoy the same automatic immunity under the Sherman Act that states have—it held that local governments are "persons" who may be sued under the act. But it also raised the prospect that some anticompetitive actions of a local government government could result so much from state authorization or direction as to be considered acts of the state government itself and therefore exempt from the Sherman Act under the *Parker* decision.

The *Lafayette* case involved a complicated dispute between two Louisiana towns that jointly operated an electric utility system—clearly a proprietary rather than regulatory activity—and the Louisiana Power and Light Company (LPL), a large private power company that was competing with the towns in providing electric service. The towns sued LPL, claiming that it was trying to restrict their utility's access to reserve power for peak periods and its ability to expand in the areas outside their municipal boundaries. LPL filed a counterclaim that eventually took the case to the Supreme Court; it charged that the towns violated the Sherman Act in several ways—for example, by requiring purchasers also to hook up to their water and gas service before they could receive electricity.

The Court remanded the case to the federal district (trial) court, for a ruling on whether the Louisiana legislature, in its legislation allowing cities to own and operate electric utility systems, had intended to allow the actions of the two cities in the case. In reaching this decision, only four justices—a plurality—agreed on their reasoning. The Chief Justice agreed in the result on the basis of different reasoning—that local government's actions under their police (regulatory) power should be exempt from the Sherman Act but proprietary activities should not. But the plurality opinion's reasoning became the majority position in the *Boulder* case decided four years later (see below).

The four "plurality" justices in *Lafayette* held that, even though municipalities are political subdivisions of the state, their actions are not necessarily those of the state for Sherman Act purposes. Not all governmental agencies are exempt from the antitrust laws simply because they are governmental. The plurality also was skeptical that the economic choices of a multitude of local governments were "inherently more likely to comport with the broader interests of national economic well-being than are those of private corporations acting in furtherance of the organization and its shareholders." And if numerous localities are free to make economic policy decisions in their own ways, the anticompetitive restraints adopted as a policy by any one locality may reflect its own preference rather than the state's policy. Cities are not themselves sovereign, the plurality said, and will not be afforded the deference given to states in our federal system.

But the plurality also said that in some circumstances the actions of local governments may reflect a state policy to displace competition. The *Parker* decision "exempts only anticompetitive conduct engaged in as an act of

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3. Community Communications Co. v. City of Boulder, ____ U.S. ____, 70 L. Ed.2d 810 (1982). Taxpayers may not be the only people who ultimately pay damages for a local government's antitrust violation. If a utility or proprietary enterprise is involved, its customers may indirectly share the cost of paying those damages.

4. 317 U.S. 341 (1943).

5. 435 U.S. 389 (1978).

government by the State as sovereign, or, by its subdivisions, pursuant to a state policy to displace competition with regulation or monopoly public service"; the locality need but "point to a specific, detailed legislative authorization" to invoke the *Parker* exemption. An "adequate state mandate" may be divined by finding "from the authority given . . . in a particular area, that the legislature contemplated the kind of action complained of." This language clearly means that local governments may claim exemption from the antitrust laws, but it leaves one groping to understand just how the legislature's contemplation might be established. For instance, state law may authorize some cities to operate electric service enterprises as monopolies. But does that mean that the state meant also to authorize a town to require customers to take water service as a condition of receiving electricity?

This uncertainty about how much state "contemplation" will suffice to establish the local government's antitrust exemption led to the decision in *Community Communications Co., Inc. v. City of Boulder* (1982).[6] In that case another issue regarding the state-local relationship came to the fore: whether, as a prerequisite of the local antitrust exemption, the state must "actively supervise" the local government's anticompetitive conduct.

Police power, home rule, and active state supervision. The City of Boulder claimed that its regulation of a franchised cable television company was itself the equivalent of state government action because Boulder enjoys "home rule" powers under the Colorado constitution. The city contended that its acts were acts of government performed by its acting as the state in local matters under its home-rule powers. The Court rejected this argument, believing that our system of federalism means that "[w]e are a nation not of 'city-states' but of States." Cities and counties are not themselves sovereign. Furthermore, in reaching this result the Court extended the reach of the antitrust laws to encompass even regulatory actions of local governments.

The lawsuit resulted from a three-month moratorium that the city imposed on the cable company's expansion of cable lines within the city. The city had previously awarded a nonexclusive cable franchise to Community Communications, and for some years the cable operator provided only limited service within a certain limited area of the city. Over the years, technology improved and satellite service expanded the available programming. The city noted the attractive franchises being awarded in large cities across the country and decided to consider awarding a second franchise. It imposed the moratorium, reasoning that the more the current operator expanded, the less attractive any new franchise would be to prospective bidders. In violation of the ordinance the cable operator continued to construct new lines, which the city tried to have public works crews remove. The operator sued, alleging that the city was trying to restrain trade by conspiring with other interested cable companies in violation of the antitrust laws.

The Court—this time a majority (five)—followed the plurality opinion in *Lafayette* and reiterated that the exemption from antitrust laws under *Parker* is available only when local governments act pursuant to "clearly articulated and expressed state policy." The Court found no specific, affirmative grant of power by the state to the City of Boulder to regulate cable TV. When the state's position is, at best, neutral regarding the city's anticompetitive activity, the Court said, that activity was not exempt from the Sherman Act. The Court stated that a state must either direct or authorize the disputed practice in order for the exemption to apply to a local unit. It said that for the city to be exempt from the Sherman Act in regard to a given activity, the state must either *direct* or *authorize* the activity. This ruling leaves unanswered some important questions that I will return to later.

Antitrust claims against local governments. Various antitrust claims have been alleged against local government since 1978. Most of the reported opinions involve the procedural issue of whether the local government was exempt from antitrust law under *Parker*. The list that appears on the next page demonstrates that a great variety of local government activities may give rise to antitrust lawsuits. But so far, very few lawsuits have resulted in actual local government liability.

Issues remaining for the Court

So far the Supreme Court has told us that for anticompetitive activity by local government to be exempt from the Sherman Act, the state must either direct or specifically authorize it. But this leaves some important issues that the Court will probably have to settle in the future. For example, to make an activity exempt from the Sherman Act, is it sufficient for the state merely to authorize that activity in such a way that different local governments may choose whether to engage in it? Or must the state go even further and compel the activity, or even actively supervise it?

How specific must the state's authorization of local government anticompetitive activity be to make the activity exempt? Municipal franchising of cable TV companies is anticompetitive because it limits participation in an industry. To confer the Sherman Act exemption on this activity, may the state legislature merely *allow* towns, in a general way, to franchise cable TV—or must it be more specific? Would such a general type of authorization confer an exemption from the Sherman Act on, for example, a city's decision to: (1) Favor a local company over a large national company? (2) Grant an exclusive franchise? (3) Divide the city into districts and award one franchise in each district? (4) Give preference to the company that

6 ______ U.S. ______ 70 L.Ed. 810 (1982).

offers to provide an expensive production studio for TV programs that originate locally?

If the Supreme Court decides that local government anticompetitive activities, to be exempt from the Sherman Act, must be authorized by very detailed state legislation, or if it decides that exemption is conditioned on the state's compelling and or actively supervising the activity, then state legislatures may well conclude that to avoid antitrust problems, they must restrict certain activities to operation by the state, thus making those activities exempt under the *Parker* decision. For example, a legislature might decide that the safest approach to the franchising of cable TV is to have a state agency issue all franchises rather than to authorize local governments to grant them. The result could be an inflexible, uniform regulatory scheme, supplanting a system in which local governments can respond flexibly to some very important local needs. This is one reason why, in my opinion, the Supreme Court ought not to require too much state government involvement in order for a local government activity to be exempt from the Sherman Act.

The Court will also need to decide what standard of review is appropriate when a local government is challenged under the antitrust laws. It is difficult to conceive of applying per se rules to (especially) local regulatory activities. Localities routinely grant ambulance, taxicab, or waste collection franchises—to name a few—by territories. But territorial allocations are usually per se violations when done by private parties. Localities also routinely set rates for a variety of public and private activities. For instance, many large cities control rents in all rental accommodations. When local governments exercise their regulatory power, economic considerations are subordinate to public policy considerations. The Court has said that notions of social good are almost totally subordinate to analysis of economic effects when private parties are

SUBJECTS OF ANTITRUST SUITS AGAINST LOCAL GOVERNMENTS

Zoning

—Downzoning from high to low density was claimed to violate antitrust laws; it was alleged that the city was conspiring with other developers to prevent development.

—A town was alleged to be conspiring with downtown storeowners when it refused to rezone an outlying area for a shopping center.

—A city was alleged to be conspiring with redevelopers under an urban redevelopment plan; a disappointed prospective building of downtown hotel sued.

—Zoning restrictions on the location of liquor outlets were alleged to be in furtherance of an antitrust conspiracy.

Franchises

—The award of cable franchises has led rejected bidders to sue, alleging a conspiracy between the successful bidder and the city.

—A disappointed taxicab operator sued a city that granted a competitor an exclusive privilege for airport service.

—Awards of ambulance service franchises have prompted an antitrust challenge.

—Antitrust claims have resulted from a town's refusal to put a company on the rotation list for police-directed towing services.

—A rejected franchise applicant argued that denial of privileges to operate a rent-a-car facility at the municipal airport violated antitrust laws.

Airports and Hospitals

—A county's award of fixed-base operator status to one airline but not another prompted an antitrust suit.

—Practices relating to the sale of fuel at a city airport brought on an antitrust suit.

—Hospitals have been sued under the antitrust laws for granting staff privileges to some doctors in a community but not to others.

Utilities

—Ordinances establishing a municipal monopoly over local garbage collection and excluding private operators from waste collection have prompted antitrust challenges.

—Requiring electric customers to sign up for water service.

—The method of allocating territory between two neighboring public water systems led to an antitrust suit.

—The relationship between cities or city utilities and power companies has resulted in several antitrust suits.

sued under the antitrust laws. How will it accommodate that principle to the truism that the very role of public regulations is to subordinate economic processes to public needs and welfare? That is the heart of the difference between public and private actions.

The Court could adapt its "balancing approach" to the local government situation. In cases involving private parties the Court has often balanced the economic effects of competition against the economic effects that stem from no competition. Perhaps it will also balance a local governmental action's benefit to the public welfare against its effects on business competition. Thus courts become "super-legislatures."

Another issue the Court will face is whether treble damages—authorized by the Sherman Act—are appropriate against a local government. Taxpayers can be expected to pick up most of the cost of judgments against localities. It could be argued that the deterrent effect of treble damages should not apply when a locality is an economic actor—it is in the marketplace not to make a profit but rather to serve public purposes.[7]

What can local governments do?

Don't panic, but be prepared. It is easy to overreact to the threat of extensive antitrust liability. The prospect of treble damages can concentrate—and worry—one's mind wonderfully. Defending any lawsuit is expensive and inconvenient. But thus far not many local governments are being found liable for antitrust violations. And logic suggests that responsible, good-faith public operations or regulations run less risk under antitrust laws and any other legislation. A local official now must do a little extra homework and be sensitive to one more area of risk—a better reaction than becoming overly cautious and shrinking from some actions just to avoid lawsuits.

Assess significant proprietary and governmental actions. Local officials should review significant policies and actions. Whether the activity is proprietary or regulatory, one fundamental question must be, "If we do this, who stands to lose dollars because of it?" The ones who lose are the parties who will have an *economic* incentive to dispute the government's action. Assess the competitive, economic impact of significant actions. Does downtown revitalization benefit the entire community's economy or only the merchants of the central business district? How is the town's insurance business placed? Who gets the wrecker tow contracts? What financial institutions get the funds-deposit business? Does the county limit the number of ambulance operators or waste haulers? Why? Does the county independently review the territories granted to waste haulers when the suggested areas are drawn up by and suggested by a committee of the waste haulers themselves? Does a zoning ordinance provide that property owners within a certain distance of a prospective commercial activity may veto its location there under conditional-use procedures? Are zoning decisions, particularly variances and special or conditional uses, made on the basis of the entire community's welfare? Are purchasing decisions fairly processed and awarded to the lowest responsible bidder?

Certain kinds of regulations should be reviewed as a matter of course. Any area in which the local government regulates rates should be examined. Taxicab fares, fees for private garbage haulers, and basic service rates for cable TV are examples of regulations that the local government may want to evaluate—to assess both the reason for the regulations and the effects of the local government role. Utility operations and policies should be examined for antitrust problems as if the utilities were privately owned. Interlocal cooperation agreements or joint ventures between local governments should not be overlooked. By their nature they involve more than one party—and therefore by definition provide the element of conspiracy that is required for a violation of the statute. For example, joint planning arrangements and joint water and sewer extension policies have *intentional* economic effects on real estate developers. Purchasing procedures and sources should be chosen and used on the basis of objective standards. And regulations that appear to favor some types of businesses over others may create subtle incentives to sue on antitrust grounds—for example, regulations that discourage mobile homes or apartment construction. So might ordinances that favor downtown retail merchants over sidewalk or itinerant peddlers. A last suggestion for antitrust review is to examine carefully and objectively the local government's role in land development generally. So many dollars are at stake and the factors and motivations that influence local official action are so complex that special care should be given to this subject.

Ask some experts. Few local officials know much about antitrust laws. An objective, unbiased look at local government operations can bring a fresh perspective to official habits and policies that evolved long ago for reasons now obscure. But local officials already have plenty to do, and they cannot drop other matters and concentrate on a topic as broad and uncertain as local government antitrust immunity. Still, many sources of assistance are available to local officials for antitrust advice—state and national municipal, county, and professional organizations can discuss potential concerns with them and direct them to specialists. Academicians may be able to help. And antitrust attorneys are available for a fee.

(continued on page 41)

[7] But some local activities do earn "profits" (or "excess revenues") Furthermore, the Court has allowed treble damages against nonprofit organizations The critical issue seems to be *liability* Once someone has been found liable under the Sherman Act, the deterrent policy of treble damages logically should apply as it does to other violators So there is some doubt that the Court will reduce local governments' antitrust exposure by limiting the remedy of treble damages against them

Standing Around: Youth Unemployment in North Carolina

Clark G. Ross

A drive through a low-income neighborhood of any city or town will confirm what we regularly hear from the U.S. Labor Department. The groups of teenagers (16 to 19) who are out of school and spend their time congregated around the gas station or the fast-food establishment or similar place attest to the fact that the national unemployment rate among this age group is very high—2 1 2 times higher than the rate for the working population as a whole (see Table 1). This joblessness is a problem that has long-term consequences not just for the individual young person but also for society as a whole.

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Among the unfortunate results, four stand out. First, as with all unemployment, not fully using any factor of production (in this case labor) means that the nation's (or the state's) gross output, generally measured by the Gross National Product (GNP), will be less than the nation's (or state's) potential. It has been estimated[1] that a 1 per cent change in the overall unemployment rate corresponds to an approximate 3 per cent change in GNP.

Second, being unable to get a job can lead young people to withdraw permanently from the labor force, a phenomenon that economists term "the discouraged worker effect." A discouraged teenager may conclude that there really is no point in looking for a job and abandon the search. The loss of self-respect that accompanies this decision can be permanently debilitating.

Third, being unable to get a job means that the unemployed young person has no chance to acquire at a formative age those characteristics that employers seek in potential employees—dependability, experience, and ability to work with others and accept supervision. Without these characteristics, a young job-hunter is permanently handicapped in finding employment. Also, employers often view skeptically applicants for employment who have not held a job or been in school during the 16 to 24 age period.

Finally, youth unemployment tends to be concentrated in lower income groups, thereby reinforcing an unequal distribution of income. Young people from middle and upper middle income families are generally in high school or post-secondary school during their late teens and early twenties and escape the adverse consequences of chronic unemployment that lower income youth suffer. The lat-

1. Arthur Okun's law. For an explanation, see the book *Economics* by Loyd Atkinson (Homewood, Ill.: Richard Irwin Co., 1982), p. 158.

Table 1

Selected Unemployment Rates (Percentages)

	Annual Average							Feb.
	1970	1975	1977	1978	1979	1980	1981	1982
All Ages								
North Carolina	3.7	8.6	5.9	4.3	4.8	6.6	6.4	9.3[c]
U.S.A.	4.9	8.6	7.0	6.0	16.1	7.1	7.3	8.8
Ages 16-19								
North Carolina	[a]	20.4	15.4	14.2	5.8	18.6	[b]	[b]
U.S.A.	15.3	19.9	17.7	16.3	13.0	18.0	17.6	22.3

a. Statewide figures unavailable before 1975

b. Data have yet to be released by the Bureau of the Census

c. Not seasonally adjusted

Source: Publications of the U.S. Department of Labor's Bureau of Labor Statistics and publications of the North Carolina Employment Commission

ter group is primarily composed of young people with few marketable skills and no opportunity to acquire skills through higher education or training.

This article examines the extent of the youth unemployment problem in North Carolina, discusses a number of possible solutions, and recommends a comprehensive state approach to the problem.

Most economists recognize that during the 1970s the overall rate of unemployment[2] drifted upward. Allowing for the sharp rise during the recession of 1975, the figures in Table 1 reflect such a gradual trend. Economists do not agree on the cause of this rise. Various of them have suggested (1) the increased participation in the labor force by women and other groups who enter and leave the labor force frequently; (2) the increased generosity of state unemployment compensation and welfare programs that contain a work disincentive; (3) the minimum wage; (4) an inappropriate national economic policy, particularly the high interest rates of recent years; (5) excessively high marginal income taxes; (6) the change in the composition of the nation's economic activity and the inability of the work force to adjust to such changes; and (7) the increased segmentation of the job market, which confines many people to unstable employment.

North Carolina's total unemployment rate is generally below the nation's, but the advantage appears to be lessening. Regional differences in employment by occupational category and wage earnings narrowed during the 1970s. Thus it is predictable that North Carolina's unemployment characteristics will gradually approach those for the nation at large. Total unemployment rates for both the state and the nation attest to the serious and growing unemployment problem that policy-makers must address.

When we speak of youth unemployment, the youth we are talking about are between 16 and 19. Some labor economists extend the unemployed-youth category to age 24,[3] but such an extension can confuse the issue. The 16 to 19 group of unemployed persons contains those young people who are most disadvantaged in the labor market. They are not in school—secondary or postsecondary—and many have very little work experience. It is they who have the least to offer potential employers. In contrast, the 20 to 24 age group can include both recent college or technical school graduates and individuals with solid work experience who may be temporarily unemployed because of some shift in market forces. Any effort to relieve unemployment among young people should be aimed first at the 16 to 19 age group. Success there will soon reduce the unemployment rate in the 20 to 24 age group because those teenagers who are helped will likely remain employed when they reach their early twenties.

The reported unemployment rates do not include those people who become so discouraged about getting a job that they are no longer even looking. Economists differ about the size of this group; some argue that unemployment rates might be as much as 50 per cent higher if discouraged workers were included. Generally, the number of discouraged workers increases with the unemployment rate because the higher the rate, the more likely these people feel it is that they will not find a job. Thus in times of high unemployment the reported unemployment rate disproportionately understates the unemployment problem. This relationship, especially for teenagers, should particularly concern policy-makers because these discouraged youths could become permanent dropouts from the labor force and be more susceptible to drug abuse, alcoholism, and crime. Such a result is a tragedy to both the individual and society.

The unemployment rates for 1980 (Table 2) sketch a profile of the unemployed youth. Nationwide, the typical young (16 to 19) participant in the labor force is two to three times more likely to be unemployed than a labor force participant randomly chosen from the total working population. Also, the incidence of youth unemployment varies greatly with race. For both males and females, the nationwide youth unemployment rate for nonwhites is roughly twice that for whites. An equally large white-nonwhite difference probably exists in North Carolina,[4] as the general consistency of national data and North Carolina figures suggests. Table 2 shows that the unemployment rate for white youths is below the rate for all youths by roughly the same proportion in both North Carolina and the nation at large. The youth unemployment problem for nonwhites is further intensified by the "discouraged worker" syndrome. If discouraged workers were included in the unemployment figures, the percentage of nonwhite

2. Economists define the unemployment rate as the percentage of the work force who are not employed but are actively seeking employment. The work force comprises both those who are working and those who are looking for jobs.

3. The unemployment rate for the 20 to 24 age group falls between the aggregate rate and the rate for the 16 to 19 age group. The rate for the 20 to 24 age group is about 60 per cent of the rate for those aged 16 to 19.

4. Statistics on race from the State Employment Security Commission are consistent with the race differential for the country as a whole.

youths neither employed nor attending school would be increased from the weighted average of 35.8 per cent to above 40 per cent.[5] Considering the training in work habits and job skills that should be received at this age, this situation for nonwhites is catastrophic.

Differences for males and females within racial categories are not excessive. It is interesting to note that the unemployment rate among white youth is lower for females than for males, but the opposite is true for blacks and other races. Young female nonwhites have the highest unemployment rate—nearly 37 per cent.

The number of weeks unemployed is generally lower for youths than for the unemployed population as a whole, but this shorter duration does not mean that youths have an easier time finding work than adults. Rather, young people are less attached to the labor market—they enter and leave the labor force frequently. A youth may become discouraged as the unemployment rate rises and drops out of the work force, returning when the prospects of finding work seem better. Or he may go back to school. This is an option open to many young people whose parents will support them when they stop looking for work. Also, because many teenagers are new to the job market and therefore are not eligible for unemployment compensation, they do not—as adults do—continue to search for a job just to remain qualified for unemployment benefits. While about 40 to 50 per cent of all unemployed persons are classified as entrants (either reentrants or new workers), 65 to 75 per cent of the 16 to 19 age group are classified as entrants. This pattern of frequently entering and leaving the labor force is symptomatic of the discouragement and unstable behavior of the unemployed young—a pattern that must be recognized in designing an effective policy to counter youth unemployment.

5. Howard Sherman, *Stagflation* (New York: Harper & Rowe, 1976), pp. 10-12.

Table 2

1980 Unemployment Rate
(Percentages)

All Ages	%
North Carolina	6.6
U.S.A	7.1
Ages 16-19	
North Carolina (all)	18.6
North Carolina (white)	15.4
U.S.A (all)	18.0
U.S.A. (white)	15.5
U.S.A. 16-19	
Males (all)	18.2
White males	16.2
Nonwhite males	34.9
Females (all)	17.2
White females	14.8
Nonwhite females	36.8

Source: U.S. Department of Labor, Bureau of Labor Statistics

Table 3 projects the number of unemployed youths in North Carolina through 1990. Certain entries need explanation. First, the percentage of the state's population classified in the 16 to 19 age group will decline into the 1990s, as is consistent with the aging of the post-World War II "baby boom." (See the article by Charles D. Liner in the Summer 1982 issue of *Popular Government*.) The assumed rates of participation in the labor force, which are the approximate national averages of the late 1970s, differ by sex and race.[6] As the youth population declines, the number of unemployed youths at first will also decline. But although the total youth population is expected to stabilize between 1985 and 1990, the estimated number of unemployed youths will probably increase—mainly because the nonwhite youth population, with its higher unemployment rates, will grow while the white youth population will decline slightly.

6. The group's rate of participation in the labor force is calculated by dividing the number of people who are working or actively seeking employment by the total civilian population of that group. The participation rate is inversely related to the unemployment rate [see Ingrid Rima, *Labor Markets, Wages, and Employment* (New York: Norton Company, 1981), p. 47]. There is no *a priori* reason to assume a constant participation rate through 1990. The calculations in Parts 3 and 4 of Table 3 could, of course, be made with any assumed participation rate. Part 3 uses the 1980 youth unemployment rates shown in Table 2 to project the estimated number of unemployed youth in North Carolina for 1982, 1985, and 1990. That figure is found by multiplying the population by the participation rate and then by the unemployment rate.

The burden of unemployment is borne disproportionately by nonwhites. While representing 26 to 28 per cent of the youth population, nonwhites constitute roughly 40 per cent of unemployed youth. The figures in Part 3 of Table 3 do not include discouraged workers who have withdrawn from the labor force. The lower participation rates of nonwhites reflect their greater discouragement. If discouraged workers were added to the number of unemployed youths, the unemployed total would be significantly larger and the nonwhite proportion would increase.[7]

Part 4 of Table 3 projects the number of youth unemployed under somewhat more favorable hypothetical conditions: (1) somewhat lower unemployment rates for both whites and nonwhites; and (2) a smaller difference between the rates for whites and nonwhites. With these lower unemployment rates, unemployed youth would be 39 per cent fewer in 1985 and 1990 than they would be if the 1980 employment rates continued. Also, the proportion of unemployed youth who are nonwhite decreases slightly. Even with this hypothetical decrease in the unemployment rate, the number of unem-

7. In 1980 the Bureau of Labor Statistics estimated that there were 44,200 unemployed youths in North Carolina. Given the larger youth population in 1982 as well as the higher unemployment rate, the estimates in Table 3 appear reasonable.

ployed youths remains alarmingly high and disproportionately nonwhite. Nevertheless, a decrease of 39 per cent in unemployment among the 16 to 19 age group would represent real progress. The rest of this article discusses various strategies aimed at reducing youth unemployment in North Carolina.

The Reagan administration is relying primarily on the prospective improvement of the national economy to create jobs for all age groups. By reducing income taxes, the administration hopes to increase the incentive for productive use of labor and capital. If successful, this policy will at first stimulate more work and greater savings by those in higher marginal tax brackets, but it will not directly affect the unemployed youth whom we have been talking about. If the Reagan program significantly increases economic activity, all age groups will benefit from a better job market. But even so, the 16 to 19 age group would not be removed from its disadvantaged position in the labor market. At this writing, with unemployment rates rising, the immediate success of the President's program is open to question.

The Comprehensive Employment and Training Act (CETA) of 1973 included efforts to improve youth employment. In particular, it tried to consolidate many categorical grants into one larger program with greater local involvement. Within a state, prime sponsors receive CETA funds to administer local programs. In North Carolina there are thirteen prime sponsors that received approximately $95 million in fiscal year 1982. The most important sponsor in this state is the Division of Employment and Training in the State Department of Natural Resources and Community Development, which receives about $60 million annually for programming and subcontracting. The various CETA programs that directly or indirectly affect youth seem to fall into four broad categories. The first is basic education and motivational and vocational training in which participating students are paid while they attend an approved vocational program, often at a community college. As many as 10,000 individuals of all ages may have participated in this program during fiscal year 1981. The second effort is the work experience program, which includes such activities as summer youth employment (3,200 enrolled during FY 1981), in-school work programs (1,333 enrolled), and public service employment projects. These jobs are temporary, with little vocational training, and are not long-term remedies to the youth unemployment problem. The third aspect of the CETA program is on-the-job training, in which employers are reimbursed for certain expenses involved in training programs that reach a small number of youths (perhaps 200 under the Employment Service Division subcontract). Finally, the Division of Employment and Training, using CETA funds, provides counseling to approximately 4,000 youths. While the objectives of the CETA programs are laudable, it is evident that the CETA efforts alone cannot affect the youth unemployment problem significantly. Certainly, the statistics given earlier in this article attest to the need for new or additional approaches to this problem. CETA funding expires at the end of this fiscal year, and Congress is now debating the focus and scope of a new youth employment program. The Reagan administration urges locally based programs that are well integrated with the private sector.

Table 3

Projections of Youth Unemployment in North Carolina (1982-90)

	1982	1985	1990
1. **Population**			
16-19 population	470,256	391,022	391,301
State population	6,028,940	6,062,791	6,371,841
Youths aged 16-19 as % of state population	9.8%	8.1%	7.1%
White male youths	178,800	148,446	147,404
White female youths	159,960	138,620	132,343
Nonwhite male youths	68,392	51,886	57,410
Nonwhite female youths	63,504	52,070	54,234
2. **Assumed Labor Force Participation Rates for Youths (Percentage)**			
White male	60	60	60
White female	55	55	55
Nonwhite male	50	50	50
Nonwhite female	40	40	40
3. **Number of Youth Unemployed (1980 Rates Assumed)**			
White male (16% UNP)	17,165	14,251	14,151
White female (15% UNP)	13,164	11,437	10,918
Nonwhite male (35% UNP)	11,969	9,080	10,047
Nonwhite female (36% UNP)	9,399	7,706	8,027
Total	51,697	42,474	43,143
Percentage nonwhite	41.3%	39.5%	41.9%
4. **Number of Youth Unemployed (Lower UNP Rates)**			
White male (10% UNP)	10,728	8,907	8,844
White female (10% UNP)	8,776	7,625	7,279
Nonwhite male (20% UNP)	6,839	5,189	5,741
Nonwhite female (20% UNP)	5,081	4,165	4,339
Total	31,424	25,886	26,203
Percentage nonwhite	37.9%	36.1%	38.5%
5. **Difference between Entry 3 and Entry 4**	20,273	16,588	16,940

Source: Population estimates are from the North Carolina Office of State Budget and Management.

UNP = Unemployed

At the state level, the North Carolina Employment Security Commission maintains an active program aimed at improving job possibilities for young people. This program includes job counseling, testing, referrals to supporting services, placements in job-training programs, and job referrals. Within the limits of its financial support and its general objectives, this program has merit but by itself it cannot substantially reduce the youth unemployment rate. The state's efforts cannot reach many of the hard-core unemployed youth who are discouraged by the current labor market, have stopped looking for a job, or have not availed themselves of these services.

But there are other approaches being discussed or experimented with throughout the country.

1. Subminimum wage for teenagers. One proposed action is to amend federal law to permit a subminimum wage for teenagers. Proponents argue that a lower minimum wage for the 16 to 19 age group would induce employers to hire young people whose contribution to the firm is worth less than the mandated wage. Further, the new workers would receive valuable training by having some employment experience. Organized labor has vigorously opposed any attempt to reduce minimum wages, arguing that teenaged workers would simply be used to replace older workers, thereby changing the age composition of the unemployed and not the actual number. It has been suggested[8] that teenagers be given job vouchers that they would present to prospective employers who would then hire them at the minimum wage. The employer would redeem the voucher from the government, which would give him a refund of 30 to 40 per cent of the worker's salary, provided that an employee-training program was involved in the job. The young employee would benefit from getting a job with training and being paid the full minimum wage, while his employer would find him less expensive to hire when the government assumed part of the cost. This subsidy to business, as well as the reduced cost of young workers compared with the cost of mature workers, elicits considerable opposition.

2. Tax credits for youth employees. France has experimented with a system of tax credits to firms that hire members of generally hard-to-employ age categories. The state could give a firm a tax credit of X dollars per *new* teenaged employee hired. This is a "state" variant of the voucher system discussed above. This approach would have considerable merit if some way could be found to minimize the incentive to replace mature workers with less expensive, subsidized youngsters. The administrative costs to the state would be low, and the newly created jobs would be in the private sector.

3. Changes in unemployment compensation. A reduction or curtailment of state unemployment compensation would be of little or no value in alleviating the youth unemployment problem. As we have seen, although most state unemployment compensation programs probably increase the incidence and duration of unemployment, this effect is less pronounced for teenagers because 65 to 75 per cent of unemployed youth are either new workers or re-entrants to the labor force and thus do not benefit from unemployment compensation. Further, reducing the duration of unemployment compensation would tend to reduce job search time. While this strategy might be effective for older workers, for whom there is a greater selection of jobs, it would be counterproductive for the young, who may give up their job-hunting out of discouragement.

4. Urban enterprise zones. The Reagan administration has advanced the idea of urban enterprise zones. In inner-city areas with high unemployment rates, participating firms would receive a mixture of federal, state, and local tax relief, as well as exemption from certain governmental regulations. Several states are independently experimenting with this form of incentive for businesses to locate in depressed urban areas. The hope is that not only large enterprises but also smaller services like taxicab companies and child-care centers will find the reduced regulation and taxes attractive. This type of program, while aimed at the unemployed of all ages, could have significant benefits for the black community and for unemployed youth.

5. Public service employment. Since the Depression of the 1930s, public service projects have been advocated to reduce unemployment. The National Youth Administration and the Civilian Conservation Corps of the 1930s, the Job Corps and the Youth Corps of the 1960s, and finally the various CETA programs (Youth Community Conservation and Improvement Projects, Young Adult Conservation Corps) of the 1970s have all aimed to employ youths at government expense. Generally, the participants worked in the public domain in such activities as reforestation, park construction, road maintenance, and water projects. The appeal of these programs is that the young person has a job, does not drop out of the work force, and gains self-confidence and basic employment skills. Instead of providing cash grants for no work, these programs reward work and produce useful public projects. Critics claim that this public-sector employment is too expensive per person placed, rarely teaches him much, and is usually temporary. Government evaluations of these projects are mixed.[9] While the training provided is often inadequate and the jobs are temporary, the work experience is useful and some individuals are diverted from a life of crime or drug abuse.

6. Jobs for graduates or high school placement. In 1979 the State of Delaware began an experimental program entitled "Jobs for Delaware's Graduates." Job counselors in participating high schools selected, from among each school's seniors, those candidates most likely to become unemployed. These students had no educational plans beyond high school, relatively poor academic records, and no real employment possibilities. The counselors worked with them, stressing the importance of appearance, teaching them how to behave in an employment interview, and helping in job placement. Each staff counselor worked with about 30 to 50 students. Local boards composed of business people, educators, and community officials provide guidance and direction for the program. Placement has been almost exclusively in the private sector in fairly ordinary entry-level jobs. All assessments of the program have been very positive. Five other states are now experimenting with similar programs adapted to their particular characteristics. In Delaware the average cost per placement was $1,500, compared

8. Walter Guzzardi, Jr., "How to Deal with the New Unemployment," in *Solutions to Unemployment*, ed. David Colander (New York: Harcourt-Brace, 1981), p. 159.

9. Rima, *Labor Markets, Wages, and Employment*, p. 359.

with CETA's average costs of $6,000 (Title II) to $9,200 (Title IV). The program now has a national office, known as "Jobs for America's Graduates, Inc.," which advocates a national experiment with this form of community-based program.

In 1979 Vice-President Walter Mondale's Task Force on Youth Employment comprehensively reviewed the youth employment problem and drew several broad conclusions:[10]

(1) The problem is not likely to disappear in the 1980s, despite the demographic trends that will reduce the proportion of teenagers in the population.

(2) The lack of basic reading, writing, computational, and communication skills is a most serious handicap to a young person looking for a job.

(3) An unemployed teenager needs training in basic skills and work experience in order to present a more creditable resumé to employers.

(4) The problem is too large and complex to be solved at any one governmental level. Rather, a cooperative effort by federal, state, and local government is needed.

These conclusions agree with the analysis of youth unemployment in North Carolina presented in this article. I would like to suggest a three-part comprehensive strategy to reduce youth unemployment:

1. Create a small experimental state job corps program that would concentrate its activities in areas of high unemployment, including such counties as Cherokee (15 per cent of all age groups unemployed in January 1982), Dare (22.1%), Graham (17.1%), Montgomery (15.7%), and Swain (22.0%). In these areas of high aggregate unemployment rates, youths aged 16 to 19 are very likely not to find work. The program should be directed at the hard-to-employ youths like high school dropouts and should contain some remedial sessions in reading, writing, and arithmetic. Its participants should work at specific tasks like park-cleaning, highway maintenance, or library assistance. At an annual total program cost of $10,000 per participant, a pilot project involving 1,000 youths would cost about $10 million, in return for which the taxpayers would receive public-sector improvements or services.

2. Experiment with a youth-hiring tax credit for businesses. It is essential that such a plan minimize a company's incentive to replace older workers with teenagers, which might be accomplished by making a firm eligible for the tax credit for some proportion (20 to 30 per cent) of its total employment growth (number of full-time workers hired) that comes from the 16 to 19 age group. It could be required that the employee remain with the firm for some minimum time period before the firm would be eligible for credit for hiring that young worker. The amount of the credit could be a percentage of wages paid to the youths or a constant figure per employee. At a credit of $500 per employee, a thousand youths hired under this scheme would reduce state income tax collections from businesses by $500,000. Increased state income taxes from individuals and reduced welfare expenditures would somewhat compensate for this loss of business tax revenues. To encourage nonprofit organizations like hospitals and educational institutions to participate in a similar youth-hiring program, the state could provide an equivalent amount in the form of a grant to such an employer for each teenager hired.

3. Experiment, particularly in urban areas, with a jobs-for-graduates program similar to that used in Delaware. In this program job counselors would identify high school students most likely to be unemployed. They would devote special efforts to these youngsters, preparing them for the job market or referring them for remedial education, or both. At the $1,500 estimated cost per placement in Delaware, a program that served 2,000 youths would cost approximately $3 million.

My recommendations are generally premised on teenagers' need to receive special attention in their job-hunting efforts. Their major objective is to provide educational remediation when necessary, to give the young people actual employment experience, and to use the private sector. The estimated cost of these three recommendations is $13.5 million to reach 4,000 youths—less than 10 per cent of the unemployed youth in this state in 1982. If successful, any of these programs could be modified and enlarged. What seems necesssary now is to recognize the tremendous social and private costs of youth unemployment and to be willing to experiment with possible remedies. ●

10. U.S. Department of Labor, *Employment and Training Report of the President*, 1980 (Washington, D.C.: Government Printing Office, 1980), p. 74.

The Separation of Powers in North Carolina

Milton S. Heath, Jr.

The growth of government in all of its phases is increasingly being held up for critical view by citizens. Taxpayers are blowing the whistle on the expanded budgets of the executive branch. Increased resistance confronts judicial activism on many fronts. And now in North Carolina the legislative branch is meeting with a brand of public resistance that attacks its expanded powers on constitutional grounds.

This article will focus on the legal and political implications of a recent rash of decisions and opinions in North Carolina that has revived an old civics lesson for the North Carolina General Assembly—that the three branches of government shall be kept forever separate. These decisions have raised questions about service by legislators on executive boards, delegation of the powers of the entire legislature to legislative committees, and encroachment of the legislative branch on the administration of the state budget.

The Bone case

This analysis begins with the only contested case among the recent decisions and opinions, *State ex rel. Wallace et al. v. Bone et al.* (hereafter referred to as the "Bone case").[1] In January 1982 the North Carolina Supreme Court was asked to decide whether a 1979 amendment to the state's environmental management law violated the separation-of-powers provisions of the North Carolina Constitution by requiring that the membership of this seventeen-member executive board include two state representatives appointed by the Speaker and two state senators appointed by the Lieutenant Governor, who presides over the Senate. The Court was confronted with a clear-cut case that presented issues that have split the courts of other states. On the one hand the Court could choose to enforce strictly the State Constitution's mandate—Article 1, section 6—that "[t]he legislative, executive, and supreme judicial powers of the State government shall be kept forever separate and distinct from one another." On the other hand the Court might conclude, as at least two other state supreme courts have done, that a small minority of legislative members on an executive board do not represent a legislative attempt to usurp executive functions but rather an acceptable cooperative enterprise between the two branches.[2]

The *Bone* case was launched in 1981 when four citizen-members of the Environmental Management Commission—James Wallace, David Howells, the late Frederick Barkalow, and Brenda Armstrong—challenged the right of four legislators to continue to sit on the Commission—Senators J. J. Harrington and R. P. Thomas and Representatives Roger Bone and Robie Nash. The statute they attacked[3] had originated as a rider to a routine departmental bill that sought to bring the Commission's legislation in line with requirements of federal legislation. A consistent supporter of conservation programs, Representative Thomas Ellis, had proposed the rider as a House committee amendment in a friendly spirit, believing that the addition of legislators to this often-criticized commission might improve legislative understanding of its programs.

The overtones of the *Bone* case went far beyond the problems and concerns of the Environmental Management Commission. When Wallace et al. chose to contest the Ellis amendment, by implication, they were challenging the legal foundations of a widespread practice involving a number of executive boards and commissions.

Appointing legislators to executive boards first became commonplace in the Holshouser years (1973-76), the first Republican administration of this century in North Carolina. If the excuse for this development was the political interests of a Democrat-controlled legislature in a Republican administra-

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1. 304 N.C. 591, 286 S.E.2d 79 (1982).
2. See footnote 11.
3. N.C. Gen. Stat. § 143B-283(d); N.C. Sess. Laws 1979, 2d sess., Ch. 1158.

tion, however, this does not explain the continuance—and indeed the acceleration—of the practice in subsequent years. The practice seems to have developed a life of its own, and not without reason. For the affected executive departments, it often built bridges for cooperation between the branches in the spirit of the Ellis amendment. For the legislators who served on boards, there was often satisfaction in participating in decisions on projects, contracts, permits, and the like. Many legislators probably found that decisions to award contracts or build projects were more like the familiar world of business and more interesting than analyzing and evaluating proposed legislation. And the process accomplished these things without diluting the political power of the top legislative leadership.

There were 41 executive boards and commissions that could be affected by the *Bone* case, according to a letter addressed to legislators by the State Attorney General on February 19, 1982 (after the decision).[4] Three of them were created before 1973, 12 during the Holshouser Administration (1973-76), and 24 since 1976. (The origins of two agencies on this list are not clear.) Another list of 50 suspect boards and commissions that was included in the appellees' brief on appeal in the *Bone* case identified six pre-1973 agencies, 15 agencies created during the years 1973 through 1976, and 29 agencies created between 1977 and 1980. (To this, one could add five more that were enacted in 1981). With two notable exceptions, the Advisory Budget Commission and the Capital Building Authority, most of the pre-1973 agencies were permanent legislative study groups. By contrast, the typical post-1973 agency (like the Environmental Management Commission) was given significant operating and decision-making functions—for example, the Board of Transportation, the Wildlife Resources Commission, the North Carolina Ports Authority, the Housing Finance Agency Board, and the Teachers and State Employees Retirement System Board.

Evaluating service by legislators on state boards

This brief background should point up the considerations that were at issue before the Supreme Court in the *Bone* case. On the one hand, many legislators and executive officials had a stake in the continuance of a system of legislative service on state boards that "worked," in the sense that it met many of their mutual needs for cooperation in a way that they had come to accept. On the other hand, many people inside and outside of state government were concerned at the rapid and strong encroachment of the legislative branch on executive and even judicial concerns within the space of a few years.

As the final arbiter of contested issues of constitutional law, the courts may inherit the difficult task of resolving the complex and closely balanced issues that are involved in a case like *Wallace v. Bone*. How, then, are they to do so? Is this issue a problem that the founding fathers meant to prevent when they wrote the separation-of-powers concept into the Constitution? There are several obvious tests that might be applied by the courts in such as case, singly or in combination.

First, what was the original intent of the separation of powers and what has been its history? In the *Bone* decision, the Court cited with approval some interesting historical fragments that diligent counsel for plaintiffs had unearthed. These included choice quotes from the instructions of Orange and Mecklenburg counties to their delegates in the state constitutional convention, notably the admonition of Orange County:

> That no person shall be capable of acting in the exercise of any more than one of these branches at the same time lest they should fail of being the proper checks on each other and by their united influence become dangerous to any individual who might oppose the ambitious designs of the persons who might be employed in such power.[5]

The Court also quoted general references in Federalist Paper No. 51 to the need for "separate and distinct departments" and the familiar warning in Washington's Farewell Address concerning "the spirit of encroachment [that] tends to consolidate the powers of all the departments in one."[6]

But there is equally strong evidence of intent that points the other way, especially in the Federalist Papers. James Madison, writing in Federalist Paper No. 47, stressed that the separation of powers does not prevent the departments of government from having "*a partial agency* in, or no control over, the acts of each other; it only precludes the exercise of *the whole power* of one department by the same hands which possess *the whole power* of another department."[7] [Emphasis added.] John Adams maintained that the essence of the separation of powers is not any pure concept of separation but rather the checks and balances.

My reading of the available documentation concerning the original intent of the Constitution-makers is that it contains no clear answers and is, at best, inconclusive. The subsequent history of the separation of powers, both in North Carolina and in the federal system, is that as a doctrine of constitutional law the concept has rarely been a decisive factor in litigation. The most significant legal controversies under the banner of separation of powers are those recently decided or now pending in the courts.[8]

A *second test* could turn to political precedents, which abound on both sides of the issue. It would be easy to find examples of the practice of excluding legislators from service on executive boards. But equally abundant are examples that reflect the acceptance and workability of such legislative service. One need look no further afield for political precedent than the British parliamentary system. An example that strikes closer to home is the American local government system, in which simultaneous service on the local

4. Letter of February 19, 1982, from Rufus L. Edmisten, Attorney General, to all legislators (a) suggesting that those who serve on forty-one listed boards and commissions resign their seats, (b) requesting those who serve on the Advisory Budget Commission to act in an advisory capacity only, and (c) advising that the statute that created the Committee on Employee Hospital and Medical Benefits is unconstitutional.

5. 304 N.C. 591, 597-98 (1982).

6. *Id.* at 598, 599.

7. Alexander Hamilton, James Madison, and John Jay, in Max Beloff (ed.) *The Federalist* (Oxford: Basil Blackwood, 1948), No. 47, p. 247.

8. *See* John V. Orth, "Separation of Powers: An Old Doctrine Triggers a New Crisis," *N.C. Insight* 4 (May 1982), 36, 44.

legislative body (such as the board of county commissioners) and other local boards is commonplace. Indeed, the fact that many legislators got their start in local politics probably has conditioned them to accept without question proposals for legislators to serve on state boards.

A *third test* might examine the overall balance of power among the three branches and ask: Has the legislative branch grown so disproportionately as to jeopardize the balance of power? There is undoubtedly a feeling abroad in North Carolina that this is the case, but it is not clear that the facts support this sentiment. This is not the place for a full-scale analysis of the issue, but perhaps the most readily available evidence is the operating budgets of the three branches.[9] As I read that evidence, it is much easier to make the case that all three branches have grown strongly over the past half-century or the past decade, for example, than to prove that any one branch has outdistanced the others. Nor is the encroachment process totally a one-way street. For example, when the executive branch settles a lawsuit in a way that requires state government to fund new programs, the action may represent a significant infringement on the legislature's constitutional authority to appropriate funds, as one commentator recently noted.[10]

A *fourth test* that some state courts have used is a sort of rule of reason that asks: Does the arrangement in question (especially one that places only a small minority of legislators on a board) amount to a *legislative assumption* of executive functions, or is it rather an acceptable *cooperative enterprise* between two branches of government? By that test, the addition of four legislators to a thirteen-member Environmental Management Commission probably would be sustained in the courts.

On balance, under any or all of these first four tests, it would be difficult to make out a violation of the separation of powers from the facts before the North Carolina Supreme Court in the *Bone* case. But the Court did not address the second and third tests; it expressly rejected the fourth test and drew on the first only by way of collateral support for its conclusion that the Ellis amendment to the environmental management law violated the separation-of-powers clause of the State Constitution. In so holding, the Court followed the lead of state courts in Georgia, Colorado, West Virginia, and Indiana, which have reached the same conclusions on similar facts, and refused to accept the rule of reason, which the South Carolina and Kansas courts had applied to sustain similar laws that included a small minority of legislators on executive boards.[11]

The North Carolina court placed its principal reliance on a *fifth test*, essentially conceptual in nature: Does the act in question amount to giving an executive function to the legislative branch? Applying that test to the facts of the *Bone* case, the Court responded in an opinion by Justice (and former House Speaker) Britt with the only possible answer: "Yes."[12] Beyond dispute, the Environmental Management Commission exercises substantial executive functions in granting or denying permits, adopting standards that are given the force of law by the statute that created it, conducting investigations, issuing enforcement orders, and administering a large staff and budget in aid of these functions. It is no mere advisory or advocacy board.

The immediate effect of the *Bone* decision was to strip the Environmental Management Commission of its four legislator-members. Of equal or greater importance, the case has set in motion a chain of events that includes a series of legal opinions raising other separation-of-powers issues and culminating in action by the General Assembly to restructure more than thirty state boards and commissions whose membership had included legislators.

Subsequent opinions of the justices and the Attorney General

In rapid succession following the *Bone* decision have come (1) a rare advisory opinion of the Supreme Court (unsigned, but said to have been written by Justice Britt) that questioned the validity of the 1981 statutory requirements for prior legislative committee approval of block grants and appropriation line-item transfers, and (b) a series of Attorney General's opinions elaborating on the implications of the *Bone* case and related separation-of-powers issues. Though none of these opinions is a binding decision in a contested case, they all carry the persuasiveness of advice coming from the state's highest court or highest legal officer.

The opinion of the justices. The Supreme Court's advisory opinion responded to questions presented jointly by the Governor, the Lieutenant Governor, and the Speaker inquiring as to the constitutionality of two 1981 statutes that placed restrictions on executive budget powers:

* Section 63 of the 1981 State Operating Budget Act, which required the approval of the General Assembly (if it is in session) or of a joint legislative committee to review block grant funds (when the legislature is not in session) for state acceptance of these funds and for various actions involving the adminstration and use of these funds.
* Section 82 of the same act, which requires the approval of another

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9. *See* Milton S. Heath, Jr., "The State of the Separation of Powers in North Carolina," Proceedings, of the Annual Urban Affairs Conference of The University of North Carolina (March 1982). From 1930-32 to 1980-82 the legislative budget grew 10.8 times, the judicial budget 14.3 times, and the remainder of the General Fund 20 times (all figures adjusted to eliminate inflation). In the last decade, however, the legislative budget grew almost twice as fast as the budgets of the other two branches.

10. *Orth*, "Separation of Powers," pp. 42-43. Professor Orth identifies and analyzes five trends involving legislative intrusion into the executive or judicial realm. He also notes one trend toward executive infringement on the legislative power of the purse—executive settlements of lawsuits that require expensive new state programs. As an example, he cites the case of *Willie M. v. Hunt*, in which the state consented to initiate and maintain programs to assist violent and emotionally disturbed juveniles at an ultimate cost estimated by legislative analysts at $15 million. For a full discussion of this case, see Robert McDonnell with William P. Pope, "The *Willie M.* Case," *Popular Government* 47 (Winter 1982), 27.

11. Greer v. Georgia, 233 Ga. 667, 212 S.E.2d 836 (1975); Stockman v. Leddy, 55 Colo. 24, 129 P. 220 (1912); State *ex rel.* State Building Commission of West Virginia v. Bailey, 151 W. Va. 79, 150 S.E.2d 449 (1966); Book v. State Office Building Commission, 238 Ind. 120, 149 N.E.2d 273 (1958); State *ex rel.* McLeod v. Edwards, 269 S.C. 75, 236 S.E.2d 406 (1977); State *ex rel.* Schneider v. Bennett, 219 Kan. 285, 547 P.2d 786 (1976).

12. 304 N.C. 591, 606-9 (1982).

committee composed entirely of legislators, the Joint Legislative Commission on Governmental Operations, for transfers between state budget line items that cumulatively exceed 10 per cent of the amount appropriated to the item from which the transfer is proposed. (This section modified the previous generally unlimited authority of the Governor to approve transfers between budget items and objects.)

The justices found constitutional objections to both of these sections.[13]

As to the transfer provision, the justices noted the state constitutional scheme for the budget process: The Governor *recommends* a budget, the General Assembly *enacts* a budget (its own or the Governor's), and the Governor *administers* the enacted budget. The justices saw in these sections legislation that attempts to give a legislative committee certain powers that exceed those given to the legislature as a whole and encroaches on the Governor's constitutionaly delegated authority to administer the budget, thereby violating the separation of powers.

The justices also advised that the block grant provision involves in part an unlawful delegation of legislative powers to a legislative committee and in part an unlawful exercise of executive or administrative powers in violation of both the separation-of-powers principle and the Governor's constitutional authority to administer the state budget.

The Court also observed that the General Assembly has no authority to "receive" block grant funds, as Section 62 of the Operating Budget Act provides. Finally, it declined to say whether the General Assembly can determine by itself how the block grant funds will be spent, because the issue had not been adequately briefed.

The Attorney General's opinions. Collectively, the advisory opinions of the Attorney General conveyed these messages:

1. The *Bone* case prohibits legislators from serving on any of 41 listed boards and commissions that exercise executive or administrative powers.[14]

2. The *Bone* decision also precludes legislators from serving as members without voting rights of executive boards or commissions if they otherwise participate fully in the conduct of the board's business.[15]

3. The separation-of-powers principle likewise invalidates a 1981 statute that entrusted the awarding of state employee hospital and medical benefits to a legislative committee. This statute also violates the rule against delegation of certain powers by the legislature to a legislative committee.[16]

4. The *Bone* decision casts serious doubts on the validity of statutes that grant various budget-administering powers to the Advisory Budget Commission, a twelve-member group now consisting of ten legislators and two others. (Four of the legislator-members are required by law to be appointed by the Speaker and four by the Lieutenant Governor; Governor Hunt has given two of his four appointments to legislators, though he was not obliged to do so.) For this reason, the Attorney General advised that all functions of the Commission "which are other than purely advisory in nature cease immediately."[17]

5. Under the State Constitution's present language concerning the appointments of state officers and in light of the history of this provision, the General Assembly may appoint nonlegislators to state boards and commissions that exercise executive or administrative powers (other than to offices provided for by the Constitution). The North Carolina Supreme Court has not considered or decided whether the legislature could delegate this appointive authority to the Speaker or the President of the Senate (the Lieutenant Governor).[18]

The legislative response

In the wake of the *Bone* case and the justices' opinion, the Speaker of the House and the President Pro Tempore of the Senate appointed an ad hoc committee to review the effects of the decision and to develop legislative recommendations.[19] After considering a number of possibilities—ranging from a direct challenge of the *Bone* decision by constitutional amendment to a variety of lesser measures—the committee decided to recommend, as a short-term response, that the General Assembly accept the Court's decisions and reshape the boards most obviously affected by the *Bone* case. A bill embodying this proposal (H 1486) was introduced in the June 1982 legislative session and enacted as Chapter 1191.

In summary, these are the main features of Chapter 1191:

1. Legislators were prohibited from serving on thirty-two state boards and commissions beginning on June 17, 1982. Among the prominent bodies affected were the Environmental Management Commission, the Board of Transportation, the Board of Agriculture, the Coastal Resources Commission, the Wildlife Resources Commission, and the Social Services Commission.

2. Five more boards were stripped of their executive powers, or it was made clear that their powers are only advisory.

3. The Lieutenant Governor's and the Speaker's powers to appoint members of the Physical Therapist Examiners Board were eliminated.

4. The judiciary did not escape attention—the Chief Justice of the Supreme Court lost his authority to appoint a trial court judge to membership on the Criminal Justice Education and Training Standards Commission.[20]

5. One statute (the charter of the Municipal Board of Control) was

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13. Advisory Opinion *in re* Separation of Powers, 305 N.C. Appendix (Feb. 16, 1982).

14. *Op. cit. supra* footnote 4.

15. Memorandum of February 1, 1982, from Rufus L. Edmisten, Attorney General, to Liston B. Ramsey, Speaker of the House of Representatives, advising that where a state board exercises a part of the administrative or executive sovereign power, a legislator may not serve in any capacity on that board.

16. *Op. cit. supra* footnote 4.

17. *Id.*

18. Memorandum from Rufus L. Edmisten, Attorney General, to Liston B. Ramsey, Speaker of the House of Representatives, advising that (a) the General Assembly may appoint nonlegislators to state boards that exercise administrative or executive power, but (b) there is no definitive answer to the question whether that authority may be delegated to the presiding officers of the Senate and House.

19. Joint House-Senate Committee on Separation of Powers, established March 5, 1982.

20. John Orth pointed out an earlier legislative incursion on the judiciary (see *op. cit. supra* note 8). In Chapter 964 of the 1981 Session Laws, the General Assembly gave the Legislative Committee on Governmental Operations control over a restricted reserve fund that may affect the expenditure of funds for judicial personnel.

repealed, on the reasoning that its powers are legislative in nature and should not be delegated.

6. Notwithstanding these changes, the legislative leadership lost little of its patronage powers. The General Assembly will continue to appoint non-legislators to twenty-five boards by bills upon recommendation of the Speaker and the Lieutenant Governor—shades of the old practice of legislative appointments of justices of the peace. The procedure for appointment by bill will minimize risks of legal attack without diluting the leadership's power; practically speaking, it is quite unlikely that the members of either house will object to their presiding officer's nominees.

7. A fundamental change in legislative-executive relationships was adopted in connection with the Social Services Commission. Chapter 1191 eliminated that commission's powers to set rates or fees for social services, to set eligibility standards, and to designate services to be provided. Beginning on July 1, 1983, those powers will be exercised by the General Assembly itself, except that the commission may adopt interim rules, when the Assembly is not in session, that will expire at the end of the biennium. In effect, the General Assembly has displaced administrative rule-making with legislative rule-making in much of the social services field, except for interim administrative rules that will be sunsetted biennially. If this action proves to be the forerunner of similar procedures for other executive agencies, it could herald a virtual revolution in administrative law.

8. Under Chapter 1191, the Legislative Research Commission is authorized to make further separation-of-powers studies and specifically to study three agencies—the Environmental Management Commission, the Seafood Industrial Park Authority, and the Capital Building Authority. The Governmental Operations Commission is authorized to study the Housing Finance Agency.

Other statutes enacted at the spring 1982 session limited the authority of three legislator-dominated bodies to advisory or recommendatory powers: the Block Grant Legislative Committee, the Legislative Committee on Employee Hospital and Medical Benefits, and the Advisory Budget Commission (with respect to review of State Ports Authority bonds). [N.C. Sess. Laws 1981, 2d sess. 1982, Chs. 1389, 1181, 1398.]

In one area the General Assembly gave back some ground that it had recently taken from the executive branch. In 1981 the General Assembly had strengthened the Administrative Rules Review Committee, a group composed exclusively of legislators, by empowering it to delay significantly the effective date of rules adopted by a number of executive agencies whenever it has questions concerning an agency's statutory authority to adopt such rules. Such delays under the 1981 act could extend as long as four to five months, in view of all of the act's procedural requirements.[21] (Previously the Rules Review Committee's powers were only advisory and recommendatory.) The 1982 General Assembly essentially reinstated the status quo ante by eliminating the Committee's authority to delay rules. [N.C. Sess. Laws 1981, 2d Sess. 1982, Ch. 1233.] This action apparently was designed to forestall the threat of litigation challenging the 1981 amendments on the basis of the Supreme Court's advisory opinion.

Overall, the legislative response to the separation-of-powers opinions appears to comply with the letter of their requirements, at least in the most obvious respects.[22] But in the way it responded, the General Assembly sacrificed few legislative prerogatives and indeed took steps that are calculated to strengthen its long-range political position. On the whole the General Assembly appears, at the very least, to have made a virtue of necessity.

Conclusion

If Chapter 1191 and the related bills enacted in 1982 represent the General Assembly's short-term response to the separation-of-powers opinions, what are some of the longer-range implications?

The 1982 legislation shows the persistence of the tendency toward continuing legislative involvement in executive affairs, even as the General Assembly moves to accept the minimum demands of the separation-of-powers principle. Thus the General Assembly will continue to make appointments to executive boards, though the appointees will no longer be legislators. Again, the powers of the Administrative Rules Review Committee will be curtailed but, simultaneously, stronger controls will be installed over administrative rule-making by the Social Services Commission. It is only realistic to anticipate that this tendency will continue to be reflected in other ways, such as:

* More extensive legislative overview – through groups like the Commission on Governmental Operation and the Legislative Committee on Agency Review;
* Greater use of analytical tools like fiscal notes on bills;[23]
* Writing detailed appropriations bills with class limitations on transfers.

For every force, however, there is a counterforce. In a democratic society, governmental powers—whether executive, legislative, or judicial—cannot long outrun their sources of popular support. Popular skepticism in North Carolina about growing legislative prerogatives has been strongly signaled by the recent and overwhelming voter rejection of four-year terms for legislators. Many legislators share this skepticism, and their reservations are reinforced by personal frustrations over the increasing demands of legislative service on their time and the widening gap from the ideal of the citizen-legislator. In future

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21. With the concurrence of the Governor or Council of State (as to the departments under their respective control), the Rules Review Committee could bring about the repeal of a rule.

22. There may be further legal challenge to the legislative response. For example, the requirements of Chapter 1191 that any bill that carries out the legislature's appointment duty "shall" indicate the Speaker's or the Senate President's recommendations may be challenged on delegation-of-powers grounds. That is, if recommendation by the presiding officer is the exclusive route for legislative appointments, the practice may amount to a delegation of the responsibilities of the entire General Assembly to its presiding officers.

23. A "fiscal note" seeks to estimate a bill's long-term fiscal effects (on revenues and expenditures). Currently, G.S. 120-30.45 requires fiscal notes estimating the impact of some bills on local government finance for the ensuing biennium. Also, Senate Rule 42.1 allows the chairman or vice-chairman of any of the Senate "money committees" to request a fiscal note on any legislation if he believes that the fiscal effects are not apparent from the face of a bill.

North Carolina's Individual Income Tax

Paul Zipin

North Carolina relies more heavily on the individual income tax to support state and local services than most states do.

The individual income tax is North Carolina's most important revenue source. It accounts for over 38 per cent of the state's tax revenues, compared with 27 per cent for all states combined. Because North Carolina finances a higher proportion of state and local expenditures from state revenues than all but seven other states,[1] the income tax is crucial in financing many programs provided at the local level—like education, health, and social services. Thus the state's ability to provide vital services at both the state and local level is closely linked to the vitality of the individual income tax.

The income tax is potentially the most equitable of taxes for at least two reasons—the tax rate varies according to the level of the taxpayer's income, and the tax is designed to distinguish among taxpayers according to factors like family size that affect their ability to pay. In practice, of course, income taxation seldom matches the ideals of the principle of taxation according to ability to pay, and North Carolina's tax is no exception. This article will examine this state's income tax in light of these ideals and also current issues like indexing, productive capacity of the tax, and the use of special provisions that benefit certain groups of people or encourage certain types of activity.

The fiscal importance of the tax

The individual income tax is North Carolina's largest tax revenue source, accounting for 26.9 per cent of all state and local tax proceeds in fiscal 1979-80, compared with 17.9 per cent of all tax revenues for the nation as a whole in 1979-80.[2] Nationwide, property taxes and sales taxes were greater sources of revenue (see Table 1). In North Carolina the property tax, the general sales and use tax, and the corporate income tax yielded 22.8 per cent, 20.2 per cent, and 6.6 per cent, respectively of North Carolina's state and local tax collections.

The individual income tax is also North Carolina's fastest-growing revenue source. During the past decade this tax grew at an annual average rate of 15.9 per cent, compared with 9.6 per cent for the total General Fund tax collections. As a result, the contribution of the individual income tax to total General Fund tax collections increased from 34.4 per cent to 45.8 per cent during that period (see Table 2).[3]

An important characteristic of any tax is the weight of the burden it places on the taxpayer. Two common measures of this burden are amount paid per capita and amount paid per $1,000 of personal income. The first figure is found by dividing total tax payments by total population and the second by dividing tax payments by personal income. The latter figure is the more accurate and enlightening measure. For instance, a wealthy state capable of generating a high level of tax revenue could have large per capita tax payments but a low level of tax payments per $1,000 of personal income; in terms of economic sacrifice, the true tax burden would be low. The opposite could be true for a poor state.

Although the general tax burden as measured in dollars is lower in this state than in most other states, North Carolinians generally pay more state individual income taxes than most other Americans (but see the article by Charles D. Liner in this issue of *Popular Government*). For instance, in 1979-80 North Carolina ranked forty-second in amount of state and local taxes paid per capita and thirty-fourth in amount of taxes paid per $1,000 of personal income. But the state stood eleventh in amount of individual income tax paid per person and

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1. Those states are Alaska, Delaware, Hawaii, Kentucky, New Mexico, Vermont, and West Virginia. Advisory Commission on Intergovernmental Relations, *Significant Features of Fiscal Federalism, 1980-81*, M-132 (Washington, D.C.: ACIR, December 1981), Table 13, p. 23.

2. U.S. Bureau of the Census, *Governmental Finances in 1979-80*, GF80, No. 5 (Washington, D.C.: Government Printing Office, 1981).

3. Computed from data in North Carolina Department of Revenue, *Statistics of Taxation*, 1974 through 1980, and Office of State Budget and Management, *Supplement to the 1981 North Carolina Tax Guide*, June 1982 (Raleigh, N.C., 1982).

Table 1

Percentage Distribution to Total State and Local Taxes, by Type of Tax, for the United States and North Carolina in 1979-80

Tax	Percentage Distribution		Per Capita		Per $1,000	
	U.S.	N.C.	U.S.	N.C.	U.S.	N.C.
Individual income	17.9%	26.9%	$117	$201	$ 21	$ 29
Corporate income	6.8	6.6	67	50	8	7
General sales	23.0	20.2	226	151	27	21
Motor fuel	4.4	6.7	43	50	5	7
Property	30.6	22.8	302	171	35	24
Other	17.3	16.8	172	125	20	18
Total	100.0%	100.0%	$987	$748	$116	$106

Source: U.S. Bureau of Census, *Governmental Finances in 1979-80*.

eighth in individual tax payments per $1,000 of personal income.[4] As the next section shows, North Carolina's effective income tax rates are higher than the rates in all but a few states (see Table 6).[5]

The mechanics of the tax

To be equitable as a tax base, income should be defined to include all types of income—among them wages and salaries, payments in kind, investments returns, and changes in wealth like capital gains or losses, gifts, and inheritances (though the latter are usually taxed separately).[6] (Capital gains—taxed at preferentially low rates under federal tax law—are taxed at regular rates in North Carolina.) Gross personal income is adjusted by other factors like family size, medical expenses, and casualty losses to take further account of the taxpayer's ability to pay.

North Carolina law defines gross personal income as all economic gain received by an individual during the year, including earned income, realized capital gains, and transfer payments.[7] Adjusted Gross Income (AGI) is defined as gross personal income less expenses incurred to earn income—such as ordinary and necessary business expenses—and allowable exclusions.[8] Exclusions are preferential treatments given to certain types or sources of income by excluding the income from taxation. Most exclusions make distinctions among taxpayers for reasons that have little to do with ability to pay.

Net taxable income is defined as AGI less personal exemptions and deductions.[9] Personal exemptions—including exemptions for the head of the household, his or her spouse, and dependents—were originally granted to permit the taxpayer to reserve from taxation that portion of his income that is required to maintain a minimal standard of living. Special exemptions are also granted to people aged 65 and over, the handicapped, parents of mentally retarded children, parents of college students, and victims of certain diseases. But normal exemptions are no longer adequate to cover the cost of a minimal standard of living. For example, the exemptions for the head of the household and his or her spouse remained at their original 1921 levels of $2,000 and $1,000, until 1979, when they were raised to $2,200 and $1,100.[10]

Deductions commonly taken include charitable contributions, large medical expenses, interest on personal debt (including home mortgage interest), and certain work-related expenses. Rather than itemizing specific deductions, the taxpayer may use a standard deduction of 10 per cent of his AGI or $550, whichever is greater.

Instead of a deduction or exemption, a taxpayer may be granted a tax credit for certain kinds of expenditures. A tax credit is a dollar amount that is subtracted from taxes due in order to obtain one's final tax burden. Unlike deductions and exemptions, the dollar value of a tax credit is the same for all taxpayers regardless of income level. North Carolina grants tax credits for child-care expenditures and for the cost of energy-conservation devices.

After determining his net taxable income, the taxpayer computes his tax payments according to a schedule of rates that increases with net taxable income.[11] Typically, an individual's net taxable income falls across several tax brackets, as Table 3 shows. As income rises, the amount of income that falls into a particular bracket is taxed at the rate applicable to that bracket. Assume, for example, that after deductions and exemptions a person's taxable income is $15,000 per year. The first $2,000 of taxable income is taxed at 3 per cent; the next $2,000 is taxed at 4 per cent, the next $2,000 at 5 per cent, and the next $2,000 at 6 per cent. Any amount over

4. U.S. Bureau of the Census, *Governmental Finance in 1979-80*, pp. 18-26; U.S. Bureau of the Census, *State Finance, 1980* (Washington, D.C.: Government Printing Office, 1980), p. 7.

5. ACIR, *Significant Features*, Table 33, p. 52.

6. See Robert Murray Haig, "The Concept of Income—Economic and Legal Aspects," in R. M. Haig, ed., *The Federal Income Tax* (New York: Columbia University Press, 1921), p. 7; Henry C. Simons, *Personal Income Taxation* (Chicago: University of Chicago Press, 1938), p. 50.

7. N.C. Gen. Stat. § 105-140.

8. *Id.* § 105-141.3.

9. *Id.*

10. N.C. Sess. Laws 1921, Ch. 34, *id.*, 1979, Ch. 801.

11. There may also be tax credits, which are subtracted from taxes that are due as determined from the rate schedule. For instance, North Carolina grants a 7 per cent credit for child-care expenses up to a maximum of $2,000 (maximum credit of $140) and up to $4,000 for more than one child (maximum credit of $280).

Table 2

Growth Rates and Percentage Distribution of Selected North Carolina General Fund Tax Collections

Tax	Average Annual % Growth 1971-72 through 1980-81	Percentage of General Fund Tax Collections 1971-72	1980-81
Individual income	15.9%	34.4%	45.8%
Corporate income	10.0	11.6	9.8
Sales and use	10.0	30.9	25.9
Franchise	14.3	6.8	8.3
Other	6.1	16.3	10.2

Source: North Carolina Department of Revenue and the Office of State Budget and Management

Table 3

North Carolina's
Individual Income Tax
Rate Bracket Schedule

Bracket	Taxable Income	Tax Rate
1	$ 0 - $ 2,000	3%
2	$ 2,000 - $ 4,000	4%
3	$ 4,000 - $ 6,000	5%
4	$ 6,000 - $10,000	6%
Over	$10,000 - and over	7%

$10,000 (in our example, $5,000) is taxed at the highest rate—7 per cent. The tax rate applied to the income in the highest tax bracket is called the marginal tax rate.

Examples of individual income tax payments for three hypothetical families, each with two employed spouses and two dependents, are shown in Table 4. The computations are based on separate returns because North Carolina law does not allow a joint return (though the returns may be filed on the same form).

The effective tax rate is the amount of taxes due as a percentage of adjusted gross income. As Table 4 shows, the effective rate increases as a family's adjusted gross income increases, and therefore the tax has a "progressive" pattern of incidence. And although the highest marginal tax rate becomes effective at $10,000 of net taxable income, the effective tax rate continues to increase above this level. Comparing the two families with medium and high levels of AGI, we can see that their marginal tax rates for their combined income are 6.0 per cent and 7.0 per cent respectively. Their effective tax rates differ significantly, however. The high income family's effective rate (4.6 per cent) is about one and a half times as large as the medium income family's effective rate (3.1 per cent). The reason for this progressiveness is that personal exemptions and deductions "shelter" a lower percentage of the high income than of the medium income.

Concepts of equity

A widely accepted principle of tax equity is ability to pay: an individual should be taxed in accordance with his or her economic capacity. The principle is based on the idea that a wealthy person can afford to pay more for public services than a poor person can since his tax payments are made by giving up luxury goods while a poor man may have to sacrifice necessities. An income tax with a rate structure that increases with taxable income, as North Carolina's does, carries with it the assumption that wealthier taxpayers should pay proportionately more of their income in taxes—more of a wealthier person's income falls into a higher tax bracket with higher tax rates than does a less affluent taxpayer's income, and the wealthy person allocates a larger proportion of his income to tax payments.

North Carolina's tax rate schedule has remained unchanged since the 1930s (most of the schedule dates from 1933; the highest bracket rate was added in 1937). Rates begin at 3 per cent on the first $2,000 of taxable income and increase up to 7 per cent for all taxable income over $10,000 (see Table 3). Although the tax rates stop increasing when taxable income reaches $10,000, the rates are progressive for most taxpayers because most taxable incomes do not exceed $10,000, and the effective rate continues to increase as income increases. This is demonstrated in Table 5, which shows that (a) 79 per cent of returns in 1979 (the latest date for which information is available) had net taxable incomes of $10,000 or less, and (b) taxes due as a percentage of AGI continued to increase above this level.

How do income tax rates in North Carolina compare with those in other states? This comparison is difficult to make because specific provisions of state tax laws vary considerably. For example, since North Carolina does not provide for joint returns, both incomes of a married couple are subject to the income tax rate schedule, whereas in states that permit joint returns a husband and wife can combine their income. Some states have higher rates, but in many cases these rates apply only at higher income levels. The best way to compare tax burdens among states is to compute the effective tax rate—total tax liability as a percentage of adjusted gross income—for a hypothetical family. As Table 6 shows, North Carolina's effective rates are higher than the median rate for the forty states that have income taxes and higher than the effective rates in most states, though the relative difference between the rates is less at higher income levels.

Two components of the ability-to-pay criterion that deserve special mention are horizontal equity and vertical equity. Horizontal equity means that individ-

Table 4

Combined North Carolina Individual Income Tax
Statements for Hypothetical Families of Four With
Two Working Spouses and Two Dependents

	Income Level					
	Low $10,000		Medium $25,000		High $50,000	
	Husband	Wife	Husband	Wife	Husband	Wife
Adjusted gross income	$6,000	$4,000	$15,000	$10,000	$30,000	$20,000
Personal exemptions						
Head of household	−2,200	—	−2,200	—	−2,200	—
Working spouse, not head of household	—	−1,100	—	−1,100	—	−1,100
Two dependents	−1,600	0	−1,000	0	−6,600	0
Itemized deductions	−1,100	—	−3,000	—	−6,300	—
Standard deduction	—	400	—	−500	0	−550
Taxable income	−1,100	2,500	8,200	8,400	19,900	18,400
Taxes due	33	80	372	384	1,173	1,065
Total Taxes due (both)	$113		$756		$2,238	
Marginal tax rate	4.0%		6.0%		7.0%	
Effective tax rate	1.1%		3.0%		4.5%	

Notes: All income was assumed to be salaries and is divided 60 per cent from the husband and 40 per cent from the wife. Because North Carolina does not permit joint returns, the taxes due would be higher if one spouse received all the income. For example, for the medium income family the taxes due would have been $1,054 instead of $756, and the effective rate would have been 4.2 per cent instead of 3.0 per cent. Itemized deductions were taken by the husband and the standard deduction by the wife.

Table 5

Analysis of North Carolina Income Tax Returns
(Based on a Sample of Returns for Income Year 1979[a])

Taxable Income	Number of Returns[b]	% of Total	Average Per Return: Adjusted Gross Income[c]	Deductions	Net Taxable Income	Total Tax Credit	Average Tax Due After Credit As % of: Amount	Avg. AGI
none	348,230	11.5%	$ 1,470	$ 591	—	—	—	—
$ 1-$2,000	510,390	16.9	3,014	497	$ 950	$ 0.1	$ 28	0.9%
2,001-4,000	431,060	14.2	5,637	811	3,002	0.4	100	1.8
4,001-6,000	450,450	14.9	7,864	974	5,004	0.8	189	2.4
6,001-10,000	660,280	21.9	11,087	1,273	7,799	2.3	345	3.1
10,001-15,000	364,800	12.0	16,209	1,812	12,094	6.7	621	3.8
15,001-20,000	133,510	4.4	22,119	2,507	17,038	11.8	962	4.3
20,001-25,000	51,500	1.7	28,238	3,379	22,143	15.9	1,314	4.7
25,001-50,000	56,410	1.9	41,070	5,096	33,085	13.9	2,082	5.1
50,001-100,000	14,839	0.5	80,201	9,927	67,203	35.1	4,449	5.5
100,000-200,000	3,708	0.1	153,477	18,026	132,318	80.5	8,961	5.8
200,001 and above	960	0.03	551,865	42,715	506,205	312.5	34,902	6.3
Total	3,026,197	100.0%	ave. $10,004	ave. $1,256	ave. $ 6,891	ave. $ 2.9	ave. $ 345	ave. 3.4%

Notes:

a. Based on a 10 per cent sample of nontaxable returns and returns with not more than $20,000 net taxable income and a full survey of all other returns.

b. North Carolina does not permit joint returns.

c. Based on net adjusted gross income (after losses).

Source: N.C. Department of Revenue, Tax Research Division, Internal Worksheet.

Table 6

Comparison of Effective Income Tax Rates in North Carolina and Other States for a Married Couple with Two Dependents, 1980

Adjusted Gross Income Level	Effective Rate in N.C.	Median Effective Rate in All States	Number of States with Higher Effective Rate
$ 10,000	2.3%	1.0%	3
15,000	2.3	1.4	3
17,500	2.7	1.8	4
20,000	3.2	2.0	4
25,000	3.9	2.3	7
50,000	5.1	3.8	7
75,000	5.4	4.0	11
100,000	5.7	4.5	12

Source: Advisory Commission on Intergovernmental Relations, *Significant Features of Fiscal Federalism*, 1980-81, M-132 (Washington, D.C.: ACIR, December 1981), Table 33, p. 52. The deductions used to calculate rates are based on deductions taken on federal income tax returns.

uals in the same circumstances are taxed the same, and vertical equity means that individuals in different circumstances are taxed differently according to differences in their ability to pay. Taxing all income the same regardless of source is an example of horizontal equity, and taxing the identical incomes of persons with different-sized families differently is an example of vertical equity.

Ideally, the income tax should achieve horizontal equity by assuring that all taxpayers with equal ability to pay have the same tax liability, and it should provide vertical equity through its rate structure. But not all features of North Carolina's income tax promote equity. Let's consider some examples. North Carolina treats capital gains as ordinary income (unlike the federal tax system, which taxes it at preferential rates); this promotes horizontal equity. On the other hand, North Carolina grants exclusions (i.e., exempts from taxation) for certain kinds of income—for example, (1) interest on tax-free bonds, (2) $3,000 of federal pension payments and pensions of retired military personnel, (3) $1,500 of National Guard pay, (4) workers' compensation payments, (5) retirement benefits of state employees and teachers, and (6) the first $200 of interest paid on savings accounts. Whatever other desirable purposes these exclusions may serve, they do not promote tax equity according to the concept of horizontal equity because two people with the same income are taxed differently if one of them is eligible for one of these exclusions. The fact that joint returns are not permitted also violates the concept of horizontal equity in that two married couples with the same combined income would pay different amounts of taxes if in one family the husband earned all of the income and in the other both spouses

contributed equally to the family's total earnings.

Exemptions, deductions, and tax credits are, ideally, designed to adjust income to reflect ability to pay—by taking into account, for example, the taxpayer's expenses in earning his income (business, work, and professional expenses), his family size, and special factors like large uninsured medical expenses and losses due to fire or theft. Some exemptions and deductions do not necessarily promote equity, but they do encourage certain activities or assist certain groups of people—for example, the deduction for charitable contributions and the exemptions for elderly and handicapped family members. Still other deductions, like the deduction of interest on personal debt, are more questionable and violate the concept of horizontal equity. Some tax credits, which have been used for such purposes as encouraging spending on insulation and solar devices, are also not consistent with the concept of horizontal equity (they are worthless to people who have no tax liability).

Recent tax changes

In recent years the North Carolina General Assembly has passed several laws governing the individual income tax (1) to reduce the general tax burden, (2) to give preferential treatment to certain groups, and (3) to mirror changes in federal tax law.

Though reducing the general tax break is always politically popular, only one of these legislative acts, the Comprehensive Tax Act of 1979, cut taxes significantly. With the decline of federal assistance to the state for many programs that are in good part state-financed, it will become more difficult to lower the state tax burden.

The Comprehensive Tax Act of 1979, the state's first general tax-relief measure in about forty years, affects several types of taxes besides the individual income tax. Its provisions to reduce the individual income tax (1) raised all personal exemptions (except the exemptions for dependents) by 10 per cent, (2) increased the maximum allowable standard deduction by 10 per cent, and (3) provided a two-step increase in the exemption for dependents from $600 to $800. (Without these changes, a middle income family shown as earning $25,000 in Table 4 would have to pay $42 [about 5 per cent] more in taxes.)

Most of the legislative changes in the individual income tax in the past decade were designed to grant preferential treatment for certain categories of persons or specific types of activities. At each session of the General Assembly various groups petition for special tax treatment. Though most requests are denied, several pieces of preferential legislation have been enacted. The handicapped and the elderly obtained special tax treatment on the basis that they are often precluded from gainful employment and are subject to unusually large medical expenses. As a result of this argument, in 1949 the legislature granted an additional $1,000 personal exemption to taxpayers who are legally blind and in 1967 and to taxpayers who are 65 years or older. More recently various groups of advocates for the handicapped have secured an additional $1,000 exemption. The exemption goes to (1) parents of a severely retarded dependent (1973); (2) taxpayers who are or whose dependents are hemophiliac (1975); (3) taxpayers who are deaf (1977); (4) taxpayers with irreversible renal disease who require dialysis or whose dependent has that condition (1978); and (5) the taxpayer who is paraplegic or confined to a wheelchair (1979). Further, in order to help taxpayers defray the cost of postsecondary education, an additional $600 exemption was granted for each dependent in an institution of higher learning (1968). The Comprehensive Tax Act increased all of these exemptions by 10 per cent.

In 1979 the General Assembly granted an exclusion of the first $1,500 of National Guard pay to help the Guard meet its recruitment quotas. In 1972 retired military personnel were granted a $1,250 exclusion from gross income of retirement pay; this exclusion—increased to $3,000 in 1973—was intended to encourage military retirees to locate within the state. In 1967 the legislature excluded the first $1,200 (increased to $3,000 in 1969) of federal pensions from gross income; this measure was enacted in order to treat federal retirees similarly to retired North Carolina teachers and state employees, whose state retirement benefits are excluded from gross income for income tax purposes.

The General Assembly continually strives to make North Carolina's tax laws conform, whenever possible, with federal tax laws, both to facilitate tax compliance and to coordinate state procedures with national policy. Three recent examples of such conforming changes are noteworthy. (1) In 1975 the General Assembly approved a child-care deduction. The maximum allowable deduction was $4,000. In 1981 a 7 per cent tax credit with a ceiling of $140 for one child and $280 for more than one child was enacted in lieu of the deduction. The new legislation was broader in scope and conformed more closely to the federal tax policy than its predecessor. (2) In 1979 taxpayers aged 55 or older were granted a once-in-a-lifetime exclusion in the amount of $100,000 in capital gains

Table 7

Effects of North Carolina's Income Tax on a Family (Married Couple With Two Dependents) Whose Income Has Increased According to the Cost-of-Living Index

	Tax Year			
	1967	1972	1977	1982
Adjusted gross income in current dollars	$10,000	$13,310	$18,150	$28,430
Percentage increase	—	33%	36%	57%
Adjusted gross income in real dollars	$10,000	$10,000	$10,000	$10,000
Income taxes due	$ 144	$ 260	$ 469	$ 970
Percentage increase	—	81%	80%	107%
Effective rate (taxes due as a percentage of AGI in current dollars)	1.4%	2.0%	2.6%	3.4%
AGI in current dollars less income taxes due, adjusted for cost-of-living index	$ 9,856	$ 9,805	$ 9,742	$ 9,659
Marginal tax rate	4%	4%	5%	7%

Note: AGI is adjusted by the Consumer Price Index. Assumes that deductions are 12 per cent of AGI; other assumptions are the same as those used in Table 3.

when they sold their primary residence (the exclusion was increased to $125,000 in 1982, again in order to conform to federal law). (3) In 1980 the General Assembly granted a $200 exclusion of income earned as interest on savings.

Selected issues

"Bracket creep" and indexing. In a progressive income tax system, as a person's income increases, more and more of his income is subject to higher marginal tax rates. Because of the progressive nature of the tax, that person must allocate a larger proportion of his income to tax payments. This occurs even if the income increase is attributable to inflation, thus reducing the person's real income after taxes—a phenomenon known as "bracket creep."

Bracket creep is demonstrated in Table 7, which shows how the amount of income taxes due and the effective rate of the tax increases over time when a family's income increases at the same pace as the cost-of-living index. As the table demonstrates, a family whose 1967 income of $10,000 increased in proportion to the Consumer Price Index would have a 1982 income of $28,430. Though its real income did not rise during this period, the family's income tax liability grew from $144 to $970—*a gain of 574 per cent, compared with a gain in income of 184 per cent*—and the effective rate of tax would have increased from 1.4 per cent to 3.4 per cent of adjust gross income. The family's marginal tax rate would have increased from 4 per cent to 7 per cent, and its income after deduction of state income taxes would have fallen in real terms as a result of the income tax.

If bracket creep is to be prevented, the standard deduction, personal exemptions, and width of the tax brackets must increase with inflation. Efforts to this effect have been made, without success, in the General Assembly. Annual indexing of federal individual income taxes will begin with the tax year 1985, as the Economic Recovery Act of 1981 provides. Tax brackets will be adjusted and personal exemptions will be increased by the percentage growth in the Consumer Price Index that took place in the twelve-month period ending on September 30.

Productivity of the tax. As discussed earlier, the individual income tax is the state's most productive tax, and the revenue derived from it is increasing at a faster rate than revenue from any other state tax. A key measure of tax productivity is the income elasticity of the tax that is, how its collections respond to changes in income. The income elasticity of the individual income tax is measured by the ratio of the percentage change in tax collections divided by the percentage change in personal income. Adjusting for tax changes over the period 1971-72 through 1980-81, the elasticity of North Carolina's income tax can be expressed as follows:

$$\frac{\text{Percentage change in tax collections}}{\text{Percentage change in personal income}} = \frac{15.7}{11.2} = \text{1.40 income elasticity}$$

This means that for every percentage point increase in personal income during 1971-72 to 1980-81, North Carolina individual income tax collections increased by 1.40 per cent.[12]

Most state taxes, other than the individual income tax, have an elasticity of less than 1.0—i.e., they grow at a slower rate than income. The overall elasticity of *all* North Carolina state taxes is slightly less than 1.0 (0.95, to be exact). If the individual income tax is indexed, the low elasticity of other state taxes means that total state tax collections—and therefore state expenditures—will no longer increase faster than the taxpayer's real income.

Preferential tax treatment for certain groups and activities. Every time a new provision that provides preferential tax treatment to specific people is written into the tax law, the tax base is eroded and the tax burden is shifted to other taxpayers. In other words, a diminished number of people is forced to pay more in taxes. Also, the granting of preferential tax treatment appears to have a snowball effect. After one group successfully petitions the General Assembly for tax relief, other groups follow.

A prime disadvantage in granting preferential tax relief is that the unfavored taxpayers feel discriminated against, which increases the likelihood of tax avoidance or evasion. Perhaps an ideal income tax system would include a wide income base, large personal exemptions or tax credits for the head of the household and dependents, broad brackets with moderate rates, and no preferential tax treatment. Any special benefits would be placed on the expenditure side of the budget.●

12. North Carolina Office of State Budget and Management, *North Carolina Tax Guide, 1981* (Raleigh, N.C. 1981), p. 27

Separation of Powers

(continued from page 23)

legislative sessions they may be expected to offer other options, including:

* Greater selectivity about legislative involvement in executive affairs;
* Limited-length legislative sessions, perhaps combined with more active standing-committee work between sessions;
* Cutting back the legislative process to a more limited role—i.e., legislating but not also administering.

It is much too early to predict how these issues and forces will be resolved. But whatever the outcome, it is apparent that the 1981-82 separation-of-powers opinions are likely to leave a lasting imprint on state government in North Carolina.●

Government Spending and Taxation: Where Does North Carolina Stand?

Charles D. Liner

When California's voters approved Proposition 13 in 1978, they set in motion a movement to place limitations on state and local government spending that swept across the country.[1] Since 1978, 24 states have enacted 41 different limitations on state or local spending, taxation, or both, and as of 1981 only four states had no limitations.[2] Although not all of the limitation measures have been as drastic as Proposition 13, the movement to limit taxation and spending—or at least the current of taxpayer dissatisfaction that seems to underlie the movement—has undoubtedly affected the political climate in all states.

Although no formal limitation measures have been enacted in North Carolina, the state has not been immune to pressures to limit or reduce growth in state and local government spending and taxation. In 1979 the General Assembly enacted the first broad-scale tax cut since the 1930s in the form of an increase in the personal and dependents exemptions for the personal income tax,[3] and in subsequent sessions bills have been introduced to reduce income tax rates, adjust the rates for inflation, or place some limitation on state spending or hiring. Several organizations have been formed at the state and local levels to promote limitation measures or to maintain pressure on local governments to restrain spending and taxation.

A number of theories have been offered to explain the movement to limit government spending and taxation, and many studies and analyses have been made of the phenomenon and the more general change in political climate that seems to favor fiscal conservatism and even retrenchment. The purpose of this article, however, is not to explain the movement or to evaluate its merits, but rather to provide an analysis of government spending and taxation in North Carolina that will help us address the question "How high is government spending and taxation in North Carolina, and how fast have spending and taxation been growing?"

The first section of this article places recent trends in government spending and taxation, at both the national and the state and local levels, in a historical perspective by examining the context in which governments have operated during the past few decades. The second section examines various indicators of the current *level* of state and local government spending and taxation in North Carolina. The third section analyzes *growth* in government spending and taxation—how the level of spending and taxation has changed and the nature of those changes. The final section is a summary.

Background

During the period beginning with demobilization after the end of World War II and ending in the mid-1970s, the size and scope of government activity at all levels in domestic (that is, nondefense) affairs increased phenomenally.

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1. Although the California measure first captured the nation's attention, the current movement began in 1976, when New Jersey limited the increase in state expenditures to the increase in state personal income; Colorado, Michigan, and Rhode Island enacted limitation measures in 1977. About forty states limited property taxes before the mid-1970s. Morris Beck, *Government Spending, Trends and Issues* (New York: Praeger Scientific, 1981), p. 53.

2. Advisory Commission on Intergovernmental Relations, *Significant Features of Fiscal Federalism, 1980-81 Edition*, M-132 (Washington, D.C.: ACIR, 1981), Table 20, p. 30.

3. N.C. Sess. Laws 1979, Ch. 801.

Between 1949 and 1975, total nondefense public-sector spending almost doubled as a percentage of Gross National Product (GNP)—from 14.5 per cent to 27.2 per cent.[4] Per capita spending in constant 1967 dollars trebled—from $555 to $1,550.

Although a common perception is that the federal government has been largely responsible for the enormous growth of spending in the public sector, spending by state and local governments grew much faster than federal spending during this period. This is true whether one compares spending from all sources, including federal aid to state and local governments, or only spending from the respective governments' own revenue sources. Considering only spending from these governments' own sources, federal spending increased by 763 per cent, state spending by 985 per cent, and local spending by 790 per cent.[5] Total spending from all sources, including federal and state aid, gives a better indication of where spending actually occurred, and in these terms state and local spending far outdistanced federal spending—state spending increased by 1,073 per cent, local spending by 1,035 per cent, and federal spending by 672 per cent (these percentages should be compared with a 126 per cent increase in the Consumer Price Index).[6]

It is important to place these trends in spending in their historical context. In the late forties state and local governments were coming out of a period during which their spending had been severely curtailed—first as a result of the Great Depression and then as a result of World War II, when domestic spending was sacrificed in favor of the war effort (total state and local spending fell from 11 per cent to 7.8 per cent of GNP between 1939 and 1949).[7]

Also during those years the revolutionary change in government's role in the economy and in society generally that began in the 1930s resumed. In 1929 total public spending equaled only 9.9 per cent of GNP, and of that amount 75 per cent represented state and local spending.[8] As a result of the near-collapse in the national economy during the 1930s, the federal government in effect accepted two new roles. First, it provided a minimum level of economic security through Social Security, welfare, unemployment insurance, agricultural support, and other programs. Second, it used its leverage to revive and then to stabilize the national economy through its spending and tax policies. Although the federal government played both roles vigorously during the 1930s, not until after the war were economic security programs expanded into broad-scale programs and the federal government's new roles accepted, at least in practice. The expansion of these programs and policies accounted for much of the growth in spending. Transfer payments to persons increased from 4.5 per cent of GNP in 1949 to 9.6 per cent in 1974; Social Security expenditures alone increased from 0.3 per cent to 5.4 per cent of GNP between 1949 and 1975.[9]

After the Korean War, public spending entered a new phase in which defense expenditures began a long-term relative decline and federal spending on domestic programs rose sharply as the federal government launched new domestic programs in areas that previously had been left largely as the responsibility of states and local governments. The expansion began in the late 1950s with the interstate highway program and aid to public schools and burgeoned during the 1960s with the War on Poverty and massive programs for education, health care, the cities, law and order, and environmental regulation, and it continued in the early 1970s with programs in almost every conceivable area of activity. Although the federal government provided the stimulus and most of the funds for the new programs, the effect was felt most directly by states and local governments, which became the administrators of most of the programs devised in Washington and (if they wanted the programs) had to share in financing them. The result was that federal aid to state and local governments increased from 0.8 per cent to 3.5 per cent of GNP between 1949 and 1975, and the share of total state and local expenditures financed with federal aid increased from 11.5 per cent to 23.5 per cent.[10]

Along with these fundamental factors that contributed to growth in government spending were several major trends that substantially increased the demand for government services at the state and local level. First, population was not only increasing rapidly but also becoming more urban and more industrial. But at the same time, the population was becoming more dispersed as people, liberated by the automobile, moved from the center of towns and cities to suburbs and formerly rural areas, thus creating a large demand for expanded public facilities and services in those areas. The postwar baby boom dramatically raised the number of school-age children and led to large increases in spending—first for elementary schools and then for secondary schools and higher education. Finally, the end of the war and postwar prosperity brought a phenomenal growth in ownership and use of automobiles and trucks, and state and local governments had not only to upgrade roads and highways that had been largely neglected since the beginning of the Depression but also to provide several generations of upgraded highways to meet the needs of an increasingly dispersed population that depended very heavily on the automobile.

Ironically, by the time the movement to limit government spending gathered steam in the late 1970s and the country moved toward fiscal conservatism, the trend of ever increasing real (that is, adjusted for inflation) government expenditures had ended. In real terms local governments' spending from their own sources peaked in 1974, followed by state government spending in 1976 and federal aid in 1978.[11] Total public-sector spending as a percentage of GNP has actually fallen slightly since 1975, and real per capita spending is about the same as in 1975.

These historical developments affected government spending and taxa-

4. ACIR, *Significant Features*, Tables 1 and 2, pp. 10-13. Further analyses of growth in government expenditure may be found in Beck, *Government Spending*, and George F. Break, "The Role of Government: Taxes, Transfers, and Spending," in Martin Felstein (ed.), *The American Economy in Transition* (Chicago: The University of Chicago Press, 1980), pp. 617-56.

5. ACIR, *Significant Features*, Table 1, pp. 10-11.

6. *Ibid.*, Table 2, pp. 12-13.

7. *Ibid.*

8. *Ibid.*, pp. 10-11.

9. U.S. Department of Commerce, Bureau of Economic Analysis, *The National Income and Product Accounts of the United States, 1929-74*, Table 1.1, p. 2, and Table 3.1, p. 94; and ACIR, *Significant Features*, Table 4, p. 14.

10. ACIR, *Significant Features*, Table 4, p. 15.

11. *Ibid.*, Table 1, pp. 10-11, and Table 3, p. 14.

tion in North Carolina just as they did in all states. But several factors that were not common to all states were operating in North Carolina. First, at the end of World War II North Carolina was a predominantly agrarian and rural state with no major metropolitan areas and only a few small cities. Although the state, by Census Bureau definitions, is still one of the most rural states and still has no large cities, its economy has been transformed—from being predominantly based on agriculture to being predominantly industrialized and service-based. The state's economy has grown faster than the national economy during the postwar era—its growth in per capita income between 1960 and 1980 was 7th highest in the nation. Although North Carolina is still classified as heavily rural because a large portion of its population lives in small towns and rural areas, its towns and cities have grown dramatically, and a large portion of those who live in rural areas are not engaged primarily in agriculture. These developments have inevitably had a significant effect on demand for government services.

A second factor that has influenced growth in government spending and taxation in North Carolina is the state's structure of government and its tax system. North Carolina has a long tradition of centralized responsibility for government services. When the state took over responsibility for financing schools, highways, and prisons in the early 1930s, it set in place a state tax

Table 1

Comparison of State and Local Government Per Capita General Revenue and Expenditure, Employment, and Earnings of Public Employees, by Region and State, 1980

Region or State	Per Capita General Revenue		Per Capita General Expenditure		Public Employment per 10,000 Population	Average Monthly Earnings of Public Employees[2]	
	Amount or Average	As a % of per Capita Income	Amount or Average	As a % of per Capita Income		Amount or Average	As a % of U.S. Average
North Carolina	$1,316	16.8%	$1,300	16.6%	507	$1,147	91%
(rank)	(46)	(36)	(45)	(34)	(18)	(36)	
United States[3]	1,659	18.2	1,596	17.6	499	1,262	100
Census region[4]							
New England	1,653	17.9	1,579	17.1	468	1,261	100
Middle Atlantic	1,863	18.2	1,787	17.5	481	1,403	111
East North Central	1,606	16.6	1,588	16.4	457	1,398	111
West North Central	1,673	18.3	1,631	17.9	514	1,223	97
South Atlantic	1,528	17.4	1,478	16.8	518	1,169	93
East South Central	1,349	18.4	1,362	18.6	483	1,070	85
West South Central	1,469	17.1	1,382	16.1	502	1,082	86
Mountain	1,841	20.3	1,717	19.0	532	1,312	104
Pacific	3,343	29.3	2,742	24.5	556	1,638	130
(except Alaska)	1,952	19.2	1,865	18.4	495	1,507	119
Southeastern states:							
Alabama	1,364	18.2	1,326	17.7	504	1,093	87
Florida	1,359	14.9	1,309	14.4	471	1,191	94
Georgia	1,469	18.2	1,366	16.9	563	1,045	83
Kentucky	1,374	18.0	1,477	19.4	423	1,145	91
Louisiana	1,678	19.8	1,560	18.4	532	1,071	85
Mississippi	1,374	20.8	1,354	20.5	514	940	74
South Carolina	1,289	17.7	1,269	17.4	515	1,072	85
Tennessee	1,283	16.6	1,291	16.7	490	1,103	87
Virginia	1,460	15.5	1,440	15.3	503	1,195	95

Notes

1 Full-time equivalent

2 Based on October 1980 payrolls.

3 Unweighted averages for all states except Alaska, which was excluded because extraordinary circumstances there (oil revenues) cause most fiscal statistics to vary considerably from those of other states (for example, per capita general expenditures were $6,249 or 49 per cent of per capita income.)

4 New England: Maine, New Hampshire, Vermont, Massachusetts, Rhode Island, Connecticut, Middle Atlantic: New York, New Jersey, Pennsylvania, E. N. Central: Minnesota, Iowa, Missouri, North Dakota, South Dakota, Nebraska, Kansas; South Atlantic: Delaware, Maryland, Virginia, West Virginia, North Carolina, South Carolina, Georgia, Florida, E. S. Central: Kentucky, Tennessee, Alabama, Mississippi, W. S. Central: Arkansas, Louisiana, Oklahoma, Texas, Mountain: Montana, Idaho, Wyoming, Colorado, New Mexico, Arkansas, Utah, Nevada Pacific: Washington, Oregon, California, Alaska, Hawaii.

Source: U. S. Bureau of the Census, *Governmental Finances in 1960, Governmental Finances in 1980; State Distribution of Public Employment in 1960*, and *Public Employment in 1980*; U. S. Department of Commerce, "Revised State Personal Income, 1969-80," *Survey of Current Business* 61, no. 7 (July 1981), 29-72.

system based primarily on a progressive income tax, a general retail sales tax, and a gasoline tax. After World War II this system proved to be the kind of broad-based tax structure necessary to support the programs that all states were by then expected to provide. States that did not have all these taxes—and most did not—found in the postwar period that constant increases in property tax rates and increases in state tax rates as well as new taxes were necessary to keep up with popular demand for expansion in government services. North Carolina, on the other hand, found that its tax revenues grew automatically as the state's economy prospered and its population rose, and therefore the state could increase its spending at a rapid pace without having to increase tax rates substantially or enact major new taxes.

The level of spending and taxation

In this section we will examine the level of state and local government spending and taxation as of fiscal year 1980, the latest date for which data are available to make comparisons among states. There are no absolute standards by which to judge whether a level of spending and taxation is too low or too high, and each person must make his own judgment. Nevertheless, it may be helpful to compare the level of spending and taxation in North Carolina with levels in other states. Still, the reader should be cautioned that such comparisons can be misleading because of significant differences between states and regions, and it will be necessary to look beyond the most obvious statistics if we are to assess spending and taxation accurately.

Our analysis begins with the often-cited statistics that indicate that among the states, North Carolina consistently ranks near the bottom in per capita spending and taxation. Table 1 compares North Carolina, regional groups of states, and other southeastern states in regard to taxation and spending. It also includes other comparisons that will help us evaluate the level of spending and taxation. As Table 1 shows, in fiscal year 1980 the state ranked 46th in per capita general revenues and 45th in per capita general expenditures (general revenues and expenditures include all revenues and expenditures except those for utilities, liquor stores, and insurance trust programs like employee retirement plans and unemployment insurance). In both regards the state's level was considerably below the average level of states in other regions and somewhat lower than the level in some southeastern states.

Before drawing any conclusions from these statistics, however, we would do well to make sure that they indicate the level of spending and taxation accurately. We will first examine levels of per capita direct general spending (the term "direct" refers to actual payments to employees, suppliers, contractors, or other final recipients of government payments whether the payments are made from governments' own resources or from grants from other governments; thus direct spending includes all spending except grants to other governments) and then examine levels of taxation in more detail.

Analysis of spending levels. First we will examine three factors that might explain the state's low ranking in per capita spending: (1) differences in wage and salary levels between regions and states; (2) differences in levels of income; and (3) differences in the distribution of population among rural areas, small towns, and large cities and metropolitan areas.

Differences in wage and salary levels. Because state and local government services are very labor intensive, a large proportion of governmental expenditures goes for wages and salaries of public employees—teachers, policemen, firemen, and others. Wages and salaries of both public and private employees are set according to the levels that prevail in state or local labor market areas, and they vary considerably from region to region within the nation and also within states as rural areas, small towns, and large cities are compared (the differences are caused by cost-of-living differences and by other complex factors that we cannot explore here). Differences in wage and salary levels and costs of living also affect how much is needed in transfers like Aid to Families with Dependent Children payments and other public welfare and social services expenditures.

Table 1 compares earnings per public employee in North Carolina, in the United States, among regions, and within the Southeast. Average monthly

Table 2

Per Capita State and Local Government Spending, Public Employment per 10,000 Population, and Average Monthly Earnings of Public Employees, by Function, North Carolina 1980

	Per Capita Expenditure		Public Employment[1] per 10,000 Pop.		Average Monthly Earnings of Public Employees	
Function	North Carolina	As % of U.S. Average[2]	North Carolina	As % of U.S. Average[2]	North Carolina	As % of U.S. Average[2]
Education:						
Local schools	$ 351	83%	149[3]	112%	$1,258[3]	89%
Higher education	171[4]	102	58[5]	100	1,431[5]	98
Highways and streets	120	65	25	89	1,092	89
Public welfare	131	74	14	93	985	88
Health	{ 124[4] (Health and Hospitals)	93	11	107	1,138	92
Hospitals			53[5]	118	1,066[5]	101
Police protection	44	76	23	95	1,164	86
Fire protection	17	71	7	75	1,251	85
Sanitation	46	90	11	129	901	79
All general functions	$1,300	77%	507	102%	$1,147	91%

Notes

1. Full-time equivalent.
2. Excluding Alaska (see explanation in Table 1).
3. Instructional personnel only
4. Expenditures on university-operated hospitals are included under hospitals.
5. Noninstructional employees of university-operated hospitals are included under hospitals.

Source: U.S Bureau of the Census, *Governmental Finances in 1960*; *Governmental Finances in 1980*; *State Distribution of Public Employment in 1960*; and *Public Employment in 1980*.

earnings of public employees in North Carolina and in the other southeastern states were considerably below the levels in the nation as a whole and below the average in other regions—they were 91 per cent of the national average, 82 per cent of the average in the Middle Atlantic and East North Central states, and only 76 per cent of the average in the Pacific states (excluding Alaska).[12] As Table 2 shows, earnings of North Carolina's state and local employees were relatively low in all the major areas of government activity except higher education (a field in which the state must compete nationally in order to hire and retain scholars and medical specialists).

Because of these differences in wages and salaries, equal amounts of spending do not purchase the same level of public services in all states, and therefore comparing per capita spending among states may be misleading if the purpose is to evaluate the adequacy of public services. To get around this problem, we might examine the number of public employees per 10,000 population. As Table 1 shows, North Carolina had 507 employees per 10,000 population in 1980—a figure slightly higher than the national average and the 18th highest in the nation. Indeed, of the 44 states that had higher per capita spending, 28—or 64 per cent—had fewer employees per 10,000 population than North Carolina. As Table 2 shows, public employment per 10,000 population in North Carolina was equal to or greater than the national average for public school instructional employees and higher education, health, hospital, and sanitation employees; it was below the national average—though not so far below as for per capita spending—for highway and streets, public welfare, and police and fire protection employees.

Differences in level of income. Differences in per capita spending may reflect differences in ability to finance government services. Per capita income is an indicator of ability to pay, though it has shortcomings in this regard in not reflecting differences in wage and salary levels, which may in part reflect differences in costs of living, and it is a very aggregated measure that does not take into account the distribution of income or differences in the level of income among jurisdictions within a state. Measured solely by per capita income, North Carolina is a relatively poor state—it ranked 41st among the states in this statistic in 1980, and its per capita income was only 82 per cent of the national average.

If we express per capita spending relative to per capita income, North Carolina's ranking increased to 34th, and its spending level relative to income was higher than the spending level of many states where per capita income was much higher. As Table 1 shows, North Carolina's per capita spending in 1980 was equal to 16.6 per cent of per capita income. Its level of spending relative to income was slightly below the average for all states but higher than the average for the East North Central states, where per capita income was 25 per cent higher than in North Carolina. In fact, North Carolina's level of spending relative to income exceeded the level in several states that were ranked near the top in per capita income (for example, Colorado, Connecticut, Illinois, and New Jersey).

Differences in population distribution. Still another reason why comparisons of per capita spending between states and regions can be misleading is that there are substantial differences among states in the distribution of population between rural areas, small towns and cities, and large cities and metropolitan areas. Because per capita spending increases substantially with population size, aggregate per capita spending may be misleading if one compares a state like North Carolina, which has no large cities and where a large proportion of the people live in rural

12. Alaska is excluded from most comparisons in this article, though not from the national rankings, because of its unique fiscal situation caused by large oil revenues.

Table 3

Per Capita Direct General Expenditure by Size of County Area and Municipality, 1976-77

Per Capita Spending by All Local Governments in County Areas[1]				Per Capita Spending by Municipal Governments on All Functions Other Than Education and Public Welfare[2]			
Population Size of County Area	Entire U.S.	North Carolina Amount	North Carolina % of U.S.	Population Size of County Area	Entire U.S.	North Carolina Amount	North Carolina % of U.S.
Less than 10,000	$676	$490	72%	Less than 2,500	$147	$178	121%
10,000 to 49,999	601	545	91	2,500 to 4,999	169	183	109
50,000 to 99,999	642	562	88	5,000 to 9,999	194	233	120
100,000 to 249,999	724	650	90	10,000 to 24,999	218	245	113
250,000 to 999,999	840	807	96	25,000 to 49,999	261	239	92
1,000,000 or more	1,067	—	—	50,000 to 99,999	291	259	89
				100,000 to 299,999	351	358	102
				300,000 or more	516	—	—
Total	$802	$617	77%	Total	$324	$270	83%

Notes:

1. Counties or equivalent jurisdictions.

2. Spending on education and public welfare was excluded because in North Carolina municipalities are not responsible for these functions.

Source: U.S. Bureau of the Census, 1977 Census of Governments, *Compendium of Government Finances*, Governmental Finances, vol. 4, no. 5, Tables 52 and 53; and *Finances of Municipalities and Township Governments*, vol. 4, no. 4, Table 17.

areas or small towns, with states that have concentrations of population in large cities and metropolitan areas. Comparing per capita expenditures by size of area should therefore give a better indication of the level of spending.

No figures for 1980 are available to make such a comparison, but Table 3 shows an analysis for 1977 that compares per capita local government spending in counties and municipalities by population size (for municipalities, spending for education and public welfare was excluded because in North Carolina these functions are not responsibilities of municipal governments).

Table 3 shows per capita spending of all local governments within counties and then of municipalities specifically. Per capita spending generally increased substantially with population size and was much higher for the largest units. Considering all units together, per capita spending of local governments in North Carolina was considerably below the level for the entire nation (only 77 per cent of the national level in counties and 83 per cent of the national average in municipalities). But when these units were grouped by population size, spending in North Carolina, except in the smallest county areas, was much closer to the national levels—about in line with differences in wage and salary levels—and per capita spending by North Carolina's municipalities was actually higher than the national level in all but two size classes. Similarly, if we compare per capita spending by local governments in only counties with less than 250,000 population, differences between North Carolina and other states are reduced substantially or disappear (in the Southeast, for example, Alabama, Georgia, and Kentucky have lower per capita spending in this comparison, whereas their per capita total spending was higher than North Carolina's, and the differences between North Carolina and other states were reduced substantially).

It should also be noted that, as Table 2 indicates, in North Carolina public employment per 10,000 population is relatively low in the areas of fire and police protection and highways and streets—functions for which one would expect spending to be relatively high in states that have large concentrations of population—and relatively high in the other major areas (education, health and hospitals, and sanitation).

Analysis of levels of taxation. Just as the previous analysis suggests that North Carolina's ranking of 45th in per capita expenditures does not accurately indicate the level of state and local government services, further analysis suggests that the state's ranking of 46th in per capita taxation does not accurately reflect the level of taxation.

Two of the three factors discussed above as explaining North Carolina's low per capita spending are also relevant in explaining its level of per capita revenues. First, because North Carolina's wage and salary levels are relatively low, its state and local governments need not raise the same

Table 4

Comparison of State and Local Government Per Capita General Revenue by Source, North Carolina and United States, 1980

Revenue Source	North Carolina Amount	North Carolina Rank	North Carolina As % of Per Capita Income	United States Average[1] Amount	United States Average[1] Rank	United States Average[1] As % of Per Capita Income
Federal government	$333	36	4.3%	$382	26	4.3%
Own sources	983	40	12.5	1,277	40	14.0
From taxes	748	42	9.6	927	34	10.0
Property	171	40	2.2	291	41	3.1
General sales	151	41[2]	1.9	212	32	2.3
Motor fuel and vehicle license	72	28	0.9	75	15	0.8
Income taxes, total	251	17	3.2	205	14	2.2
Individual	201	13[3]	2.6	147	7	1.6
Corporation	50	21[4]	0.6	47	19	0.5
Death and gift	7	22[5]	0.1	8	20	0.1
Current charges	168	36	2.1	201	28	2.2
Total general revenue	$1,316	46	16.8%	$1,659	36	18.2%

Notes:

1. Unweighted averages for all states except Alaska, which was excluded because extraordinary circumstances there (oil revenues) cause most fiscal statistics to vary considerably from those of other states (for example, per capita general revenues from the states' own sources amounted to $7,831, or 69 per cent of per capita income).

2. Three states did not have a general sales or gross-receipts tax.

3. Six states did not have an individual income tax.

4. Four states did not have a corporation income tax.

5. One state did not have death or gift taxes.

Table 5

Comparison of Effective Rates of Individual Income Taxes, North Carolina and 40 States[1]

Tax Liability as a Percentage of Adjusted Gross Income, 1980

	Adjusted Gross Income						
	$10,000	$15,000	$20,000	$25,000	$50,000	$75,000	$100,000
North Carolina	2.3%	2.3%	3.2%	3.9%	5.1%	5.4%	5.7%
Median rate[2]	1.0%	1.4%	2.0%	2.3%	3.8%	4.0%	4.5%
Number of states with a higher effective rate	4	4	4	7	7	11	12

Notes:

1. States that had an individual income tax (other than Connecticut, New Hampshire, and Tennessee, which taxed only income from capital gains, dividends, or interest).

2. Includes the District of Columbia.

Source: ACIR, *Advisory Commission on Intergovernmental Relations, Significant Features of Fiscal Federalism, 1980-81 Edition*, M-132 (Washington, D.C.: ACIR, 1981), Table 33, pp. 52-53.

amount of taxes as governments in states where wage and salary levels are higher (as shown above, North Carolina compares well in terms of public employment and spending for areas of a given size). Second, the state's rank rises if per capita taxation is expressed in relation to per capita income. As Table 1 shows, per capita revenue of the state and local governments equaled 16.8 per cent of their per capita income, which placed the state 36th among all states in this regard; although this percentage is below the averages for all regions except the East North Central, South Atlantic, and West South Central regions, it is higher than the percentage of some states that have much higher per capita income (for example, Connecticut, Illinois, New Jersey, and Pennsylvania).

Although the third factor—North Carolina's distribution of population among rural areas, small towns, and cities—would partially explain the state's low per capita revenue just as it partially explains the state's low per capita spending, it is not possible to analyze taxation by size of county or municipality as we analyzed per capita spending, because only a part of government spending in local areas is financed from local taxes.

North Carolina, more than all but a few other states, uses statewide taxes—in particular income, sales, and gasoline taxes—to finance a large portion of state and local government spending. This fact is reflected in Table 4, which shows North Carolina's per capita revenue by source and the comparable figures for the nation as a whole. As the table shows, despite its relatively low ranking in per capita total revenue and per capita revenue from taxes, North Carolina ranked relatively high in per capita income tax revenues, which equaled 3.2 per cent of per capita income compared with 2.2 per cent of per capita income nationwide. The state ranked 17th in combined per capita individual and corporation income tax revenue, 13th in per capita individual income tax revenue, and 7th in per capita revenues from the individual income tax expressed as a percentage of per capita income. On the other hand, North Carolina ranked much lower with respect to property and general sales tax revenues. Its per capita property tax revenues equaled 2.2 per cent of per capita income, compared with an average of 3.1 per cent for other states, so that the state ranked 40th among the states in this regard. North Carolina's per capita general sales tax revenues equaled 1.9 per cent of per capita income, compared with a national average of 2.3 per cent, and the state ranked 41st.

Because the individual income tax is such a large and important revenue source in North Carolina—it accounted for about 38 per cent of state tax revenues and about 27 per cent of total state and local tax revenues in North Carolina in 1981—and because the tax's rate structure is progressive (see the article on the state's individual income tax by Paul Zipin elsewhere in this issue of *Popular Government*), the total burden of state and local taxes can vary considerably, depending on the income level of families and individuals. In assessing the level of taxation, therefore, one must examine the levels of taxation at given levels of income.

Unfortunately, figures were not available to make thorough, detailed comparisons among the states for this article. But two comparisons have been made, both limited in that they compare tax burdens in only the largest city in each state. The Advisory Commission on Intergovernmental Relations (ACIR) compared 1980 tax burdens on the basis of estimates for hypothetical married couples, each with two dependents, living in the largest SMSA that contained the largest city in the respective states and in the District of Columbia.[13] Each couple's income was assumed to equal the median income of families in their area who had FHA mortgages. For Charlotte, the 1980 median income was $21,900—84 per cent of the median income for the cities being studied and lower than the median in all

13. ACIR, *Significant Features*, Table 32, p. 50.

Table 6

Estimated Personal Income, General Sales, and Real Property Taxes Paid by Families[1] with Various Incomes, 1980

Tax	Family Income			
	$15,000	$25,000	$35,000	$50,000
Average for 50 states:				
Personal income	$172	$523	$872	$1,511
Real property	0	663	927	1,324
General sales[2]	210	308	427	597
Total	382	1,494	2,226	3,432
North Carolina (number of states where tax was higher in parentheses[3]).				
Personal income	345 (3)	975 (5)	1,533 (6)	2,550 (6)
Real property	0	475 (39)	665 (38)	950 (39)
General sales	280 (9)	393 (10)	518 (11)	724 (10)
Total	$625 (2)	$1,843 (11)	$2,716 (9)	$4,224 (9)

Notes:

1. For a married couple with two dependents. Estimates of income tax liability were based on ACIR computations of effective rates by state (effective rates at $35,000 were interpolated from those rates). The U.S. Bureau of Labor urban family budgets for autumn 1981 were used to compute general sales taxes. As in those budgets, the lowest income family was assumed to rent shelter, and the market value of residences of other families was assumed to be $50,000, $70,000 and $100,000 respectively in all states. Separate estimates of taxes in North Carolina based on different assumptions about income taxes yielded similar estimates.

2. The highest local sales tax authorized in each state was used for the estimate unless no local government was using a local sales tax, special sales taxes for transit systems were not used.

3. In most cases one or more states had the same estimated taxes as North Carolina.

Sources: Budget estimates: U.S. Department of Labor, Bureau of Labor Statistics, New England Regional Office, *Autumn 1981 Urban Family Budgets and Comparative Indexes for Selected Urban Areas* (April 16, 1982); Bureau of Labor Statistics, *Three Standards of Living for an Urban Family of Four Persons*, Bulletin No. 15705 (Spring 1967). Estimated effective income and property tax rates: ACIR, Table 33, pp. 52-53, and Table 37, p.57.

but 10 of these cities, but the estimated total amount of property taxes, state income taxes, and state and local sales taxes for the hypothetical family with this income, expressed as a percentage of income, was above the median percentage for all 51 cities and was the 18th highest percentage despite the lower income of the family (except for one family, if a tax burden was higher, the income level was also higher). The total estimated tax burden in North Carolina was estimated at 6.5 per cent of income, of which 1.8 per cent represented property taxes, 3.5 per cent represented state income taxes, and 1.2 per cent represented state and local general sales taxes; for these taxes the Charlotte couple's tax burden ranked 40th, 13th, and 20th, respectively.

The second comparison was based on estimates of both income and general sales, property, motor vehicle, and cigarette excise taxes paid by a family of four in the largest city in each state.[14] For families at income levels of $7,500, $15,000, $25,000, and $50,000, North Carolina ranked 22d, 22d, 18th, and 17th among the states in regard to tax burden at the respective income levels. Thus, although tax burdens in Charlotte were being compared with those in many much larger cities, the state was ranked closer to the top than to the bottom of the list.

These comparisons, together with Table 4, suggest that although the average tax burden and per capita property and general sales tax revenue may be low in North Carolina compared with tax burden and tax revenues in other states, the heavy reliance on the state's progressive individual income tax may cause the tax burden on families with even moderate incomes to be relatively high.

A comparison of effective property tax rates on single-family homes financed with FHA mortgages showed that the effective rate in North Carolina was 0.95 per cent of market value compared with a median rate of 1.28 per cent nationwide, and the state ranked 40th in this regard.[15] In 1980, 26 of the 47 states that had a general sales tax had rates higher than North Carolina's 3 per cent rate (not counting the 1 per cent local-option sales tax), but 19 of these states did not tax food sales and seven of the 26 states did not provide for a local sales tax (all but one county in North Carolina uses the local-option tax.)[16] But, as Table 5 shows, the effective rates of the individual income tax for married couples with incomes of $10,000 and above are higher in North Carolina than in most states. At income levels of $10,000, $15,000 and $20,000 the effective rates are higher here than in all but four of the forty states that have individual income taxes (states that rank higher at one of these levels include Delaware, Kentucky, Massachusetts, Minnesota, and Wisconsin). At the higher income levels, between seven and twelve states have higher effective rates.

Are the relatively high income tax rates in North Carolina offset by lower property and sales tax rates? The ACIR comparison of tax burdens in the 50 cities made up of the respective states' largest city discussed above suggests that the total burden of these three major state and local taxes is relatively high in North Carolina (at an income level of $21,900) despite lower property taxes and somewhat lower sales tax rates here.

Because other comparisons were not available, 1980 total income, general sales, and real property taxes for families at four levels of income were calculated on the basis of the estimated effective rates for income and property taxes found in the ACIR studies cited above and actual sales tax rates. Table 6 compares the estimated taxes paid in 1980 in North Carolina with the averages for all states. The total tax burden of these taxes in North Carolina was significantly higher than the national average at all four levels of income. At the $15,000 level, only two states had a higher combined tax burden; at the other levels, only as many as 11 states had a higher combined tax burden. The state ranked low in property taxes, but only a relatively few states had higher income and general sales tax burdens—only as many as six states had a higher income tax burden, and only as many as 11 had a higher sales tax burden (in most comparison of tax burdens, one or more states had the same level of taxes).

Even when the burden of these taxes was compared with the burden in the fifteen states (not counting Alaska) that had the highest per capita state and local general revenue, at the $15,000 level of income only one state (Wisconsin) had higher total taxes; at the other income levels, only as many as six of these states exceeded North Carolina in the estimated amount of taxes paid. Many though not all of the states whose estimated burdens of these taxes exceeded North Carolina's are relatively wealthy, and some are known as "high tax states" (the effective property tax in Massachusetts, for example, was 2.6 times that in North Carolina). As Table 6 shows, the relatively high combined burden of these taxes was not due solely to the individual income tax; although many of the other states had higher sales tax rates, many of them either did not tax food or did not have local sales taxes.

These comparisons of tax levels refer only to taxes paid by individuals and families. Although, as Table 4 shows, the state ranked 21st in per capita revenue from the corporation income tax, available evidence indicates that overall the level of business taxation in North Carolina is comparatively low. One investigator, using three indicators of business tax burdens, found that North Carolina ranked 28th in taxes with an initial impact on business as a share of state and local taxes, 44th in business taxes per nonagricultural private employee, and 42nd in tax burden on a hypothetical manufacturing corporation.[17]

Growth in spending and taxation

In this section we analyze growth in state and local government spending and taxation in North Carolina between 1960 and 1980. Table 7 compares growth rates in per capita general expenditures, public employment per 10,000 population, and average monthly earnings of public employees in North Carolina with average growth rates in the nation and in the various regions. Table 8 compares growth rates in per capita revenue by source with the national average.

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14. Stephen E. Lile, "Family Tax Burdens and Taxpayer Unrest," *State Government* 51, no. 4 (Autumn 1978), 194-203.

15. ACIR, *Significant Features*, Table 37, p. 57.

16. *Ibid.*, Table 25, p. 98.

17. Michael Kreschnick, *Taxes and Growth. Business Incentives and Economic Development* (Washington, D.C.: The Council of State Planning Agencies, 1981) Tables 3, 4, and 5, pp 9-11.

Table 7

Comparison of Growth Rates in State and Local Government
Per Capita General Expenditures, Public Employment per 10,000 Population,
and Average Monthly Earnings of Public Employees, by Region, 1960 to 1980

			Percentage Change[1]									
			Census Region[2]									
	% Change	N.C. Rank	United States[3]	New England	Middle Atlantic	East North Central	West North Central	South Atlantic	East South Central	West South Central	Mountain	Pacific (except Alaska)
Total general expenditure:	566%	8	461%	452%	504%	459%	448%	526%	533%	434%	395%	421%
Local schools	438	13	392	427	407	390	386	415	419	403	354	332
Higher education[4]	976	13	795	903	1,031	746	690	972	964	700	564	738
Highways and streets	249	9	197	115	161	165	213	250	246	212	196	194
Public welfare	730	21	694	821	1,271	913	576	835	600	329	406	795
Health and hospitals[4]	728	13	627	434	483	573	617	692	941	802	636	476
Police protection	658	4	568	470	418	483	572	830	607	546	547	423
Fire protection	576	3	407	341	284	326	414	450	496	389	477	386
Sewerage	622	23	651	646	835	649	805	661	748	511	482	608
Other sanitation	734	4	430	394	247	282	519	471	630	462	408	387
General central	535	16	490	461	448	468	479	563	551	464	482	451
Interest on debt	585	30	701	897	690	608	996	593	962	511	979	713
All other	1,776	7	1,406	1,254	1,165	1,338	1,689	1,551	1,828	1,407	1,134	1,236
Public employment[5] per 10,000 population, total	91	2	59	56	62	58	56	79	72	62	46	39
State total	92	20	84	67	86	91	85	103	113	89	66	57
Local total	91	3	49	51	57	49	45	72	57	51	37	24
Local schools	69	9	51	81	59	53	44	58	52	50	32	31
Higher education[6]	222	14	186	214	317	192	161	223	177	155	141	141
Highways	4	4	−12	−25	11	−17	−13	−10	−18	−15	−24	−31
Public welfare	264	10	169	107	227	151	158	242	236	163	137	117
Health	176	16	149	80	115	141	226	201	144	130	120	133
Hospitals[6]	140	5	54	25	29	36	56	91	106	90	31	18
Sanitation	64	16	46	57	32	12	74	41	72	40	40	41
Police protection	105	5	68	53	47	59	82	76	83	72	74	43
Fire protection	59	14	39	27	−3	19	36	46	80	45	52	27
Natural resources	28	20	30	27	57	36	64	30	29	1	8	16
Average monthly earnings of public employees,[7] total	245	19	241	238	232	227	248	251	259	239	239	228
Local schools[8]	194	39	213	213	218	211	225	200	221	196	208	232
Higher education[6]	241	18	231	212	212	231	221	266	282	216	203	238
Highways and streets	253	25	261	270	234	230	253	285	290	273	253	245
Public welfare	240	29	245	262	219	259	238	252	211	231	275	208
Health	235	29	241	242	247	213	227	236	253	275	260	220
Hospitals[6]	322	18	305	242	289	277	297	325	369	327	338	266
Sanitation	300	5	259	266	235	239	266	277	271	253	256	244
Police protection	248	33	258	269	240	249	264	260	261	242	261	265
Fire protection	263	22	261	277	244	244	268	265	247	263	262	265
Natural resources	307	5	242	223	201	218	244	265	268	263	253	211

Notes
1. Unweighted averages for United States and regions.
2. See Table 1 for listing of states by region
3. Unweighted average for all states except Alaska, which was excluded for reasons noted in Tables 1 and 2.
4. Expenditures on university-operated hospitals are included under hospitals.
5. Full-time equivalent.
6. Noninstructional employees of university-operated hospitals are included under hospitals
7. Based on October earnings.
8. Instructional employees only

Source: U.S. Bureau of the Census, *Governmental Finances in 1960*; *Governmental Finances in 1980*; *State Distribution of Public Employment 1960*; and *Public Employment in 1980*.

As Table 7 shows, North Carolina ranked 8th in growth of per capita expenditure and second (after Alaska) in growth of public employment per 10,000 population. Between 1960 and 1980 the state's rank in per capita spending increased only from 49 to 45, but in public employment per 10,000 population its rank increased from 48 to 18. In growth in per capita spending, the state ranked 20th or higher in nine of the twelve categories shown and 10th or higher in five of the categories. In growth in public employment per 10,000 population, North Carolina ranked 20th or higher in all twelve categories shown and 10th or higher in half of the categories. Especially noteworthy is the fact that the state ranked 3d in growth in local public employment per 10,000 population and 20th in state employment (in growth in actual employment, as measured in full-time equivalent employees, it ranked 6th in total employment, 22d in state employment, and 6th in local employment).

North Carolina's rankings in growth in average earnings of public employees were somewhat lower—between 5th and 39th (the latter for earnings of public school instructional employees). This slower growth in employees' earnings seems to explain why growth rates in public employment exceeded growth rates in expenditures.

As Table 8 shows, North Carolina ranked 14th in growth in per capita general revenues and relatively high in growth of all revenue sources except the general sales tax and the corporation income tax. The two revenue sources that grew fastest were revenues from the federal government and the individual income tax. The two largest state tax revenue sources, the general sales tax and the individual income tax, did not increase in revenue produced as much as they did in the nation as whole, but this is misleading because North Carolina has had these taxes since long before the 1960-80 period began, whereas many other states enacted one or both of the taxes during that period (the number of states with both taxes increased from 19 in 1960 to 37 in 1980).[18] Income tax revenues in North Carolina increased substantially not because of increased rates—the nominal rates remained unchanged during this period but because of bracket creep (inflation caused taxpayers to fall within higher income tax brackets that are subject to higher tax rates, thus causing the effective rate of the tax to increase even when real income did not increase), together with economic and population growth.

North Carolina ranked 6th in growth in per capita property tax revenue, and its increase in this area was substantially above the national average. This is somewhat surprising in view of the facts that North Carolina is usually regarded as a state with low reliance on the property tax and its property tax rates have seemed to be relatively stable. In fact, the comparisons cited above show (a) that the effective rate of the property tax in North Carolina is only slightly higher than it was in 1958, and (b) that it has declined substantially from the level of the mid-1960s and mid-1970s.[19] The apparent explanation for the growth in per capita property tax revenue in this state lies in the substantial economic growth that has occurred and in the escalation in property values together with generally higher assessments of property relative to market value.

As the analysis of the level of taxation earlier in this article shows, statistics on the level of taxation for entire states do not accurately reflect the effects of taxation on individuals, and therefore these effects were estimated separately. It would also be helpful to estimate the effects on individual families of growth in taxes. Such estimates exist for the nation as a whole. ACIR has calculated selected federal, state, and local taxes for hypothetical families of various income levels (adjusted for inflation) for 1953, 1966, 1977, and 1980.[20] For the "average family" (1980 income of $21,500), the total of the selected taxes increased from 11.8 per cent of family income in 1953 (when income was assumed to be $5,000) to 22.7 per cent in 1980; payments of the selected taxes increased 727 per cent, while the assumed level of income, which was

Table 8

Comparison of Growth Rates in State and Local Government Per Capita General Revenue, North Carolina and the United States, 1960 to 1980

	Percentage Change		
	North Carolina		United States (Average)[1]
Revenue Source	Percentage Change	Rank	
Annual revenue, total:	552%	14	493%
Federal government	882	13	779
Own sources, total	484	15	442
Taxes, total	446	11	375
Property	357	6	253
General sales	186	35[2]	249[3,4]
Motor fuel and vehicle license	152	28	162
Income taxes:			
Individual	897	19[5]	1,230[3,4]
Corporation	339	33	756
Current charges	447	16	391
Exhibit: Percentage change in per capita income	400	7	348

Note:

1. Except as noted, unweighted average for all states except Alaska, which was excluded for reasons noted in Tables 1 and 2.

2. Of 36 states that had general sales tax revenues in 1960.

3. Percentage change for the entire United States.

4. Eleven states enacted an individual income tax and 10 states enacted a general sales tax after 1960 ACIR, *Significant Features*, Table 74, pp. 95-96.

5. Of 33 states that had income tax revenues in 1960.

Source: Same as Table 1.

18. *Ibid.*, Figure 5, p. 94.

19. *Ibid.*, Table 37, p. 57.

20. *Ibid.*, Table 31, p. 49.

increased to reflect rises in the cost-of-living, grew by 330 per cent.

Figures are not available to calculate taxes for individual families in different states over such a period of time, but it may be helpful to examine how the burden of two of North Carolina's taxes on individuals—the income and general sales taxes—have changed over the past two decades. In this exercise we start with the hypothetical family with 1980 income of $25,000 whose taxes are computed in Table 9 and assume that its income in real terms—that is, adjusted for inflation—had not changed over the previous two decades. We can also carry the exercise into the future to show how the family's taxes might change in the future at current tax rates.

As Table 9 shows, this family's estimated amount of income and sales taxes paid increased from $229 in 1960 to $1,461—or by 538 per cent—and as a percentage of family income that amount grew from 2.6 to 5.9 per cent even though the family's real income did not rise. Projections at current rates show a further increase to 6.6 per cent by 1990. From 1960 to 1980 the estimated sales tax increased faster than the individual income tax—628 per cent compared with 510 per cent. But the sales tax increased because of legislated changes—the exemption of food was repealed in 1961 and the local-option sales tax was added in 1971. The structure and rates of the individual income tax remained essentially unchanged except for a 10 per cent increase in the personal exemptions and an increase in the exemption for dependents from $600 to $700 in 1980 (and to $800 in 1981).

Mainly because of the large increases in individual income tax revenues, taxes on business as a proportion of total tax revenue have declined steadily over the past few decades. As Table 8 shows, the state's growth in per capita revenues from the corporation income tax was less than half the national average. As a percentage of state tax collections, revenues from the corporation income tax, state franchise taxes, and other state license taxes on corporations in general declined as a percentage of total state tax revenues from 13.0 per cent in 1960 to 10.6 per cent in 1980 (during this period revenues from the individual income tax increased 1,186 per cent, while revenues from the corporation income tax increased 466 per cent).

Table 9

Estimated Individual Income and Retail Sales Taxes for a Family of Four in North Carolina with Unchanged Real Income, 1960 to 1980 (and Projected to 1985 and 1990 at Current Rates)

	Year							Percentage Change, 1960-80	Projected Percentage Change 1980-90
	1960	1965	1970	1975	1980	1985*	1990*		
Family income at constant real level	$8,985	$9,573	$11,781	$16,329	$25,000	$33,489	$44,773	178%	79%
State individual income tax	175	206	316	562	1,068	1,563	2,258	510%	111%
As percentage of income	2.0%	2.2%	2.7%	3.4%	4.3%	4.7%	5.0%		
State and local general sales tax	54	113	139	257	393	527	704	628%	79%
As percentage of income	0.6%	1.2%	1.2%	1.6%	1.6%	1.6%	1.6%		
Total	$229	$319	$455	$819	$1,461	$2,090	$2,962	538%	103%
As percentage of income	2.6%	3.4%	3.9%	5.0%	5.9%	6.3%	6.6%		

Note:

1 1980 income was adjusted for the Consumer Price Index (CPI) to obtain income for 1960 through 1975; 1985 and 1990 income levels assume a 6 per cent increase each year in the CPI. Income and sales taxes were computed by using provisions in effect each year and using current provisions for future years. In computing income taxes, all income was assumed to be earned by the husband

Summary

The commonly cited statistics showing that North Carolina ranks near the bottom of the 50 states in per capita state and local government spending and taxation give a misleading indication of the level and growth of government spending and taxation in this state. Contrary to what these statistics suggest, North Carolina participated fully in the expansion of state and local government that occurred throughout the nation following World War II, and its levels of spending and taxation are much higher than these statistics suggest.

Indeed, North Carolina was a leader in expanded spending and public employment and increased government revenue. During the past two decades the state ranked 8th in growth in per capita spending and 14th in growth of per capita general revenues. But the most telling comparison is that the state ranked second (after Alaska) in growth in public employment per 10,000 population. This growth raised the level of public employment per 10,000 population to slightly above the national average and improved the state's ranking from 48th in 1960 to 18th in 1980.

The discrepancy between the level of public employment and the level of per capita spending is partly accounted for by differences in wage and salary levels, which in North Carolina are substantially below the national average and the level in other regions. North Carolina's low rankings in per capita spending also reflect the state's relatively low level of income and the dispersal of its population among rural areas, small towns, and small cities, where the level of per capita spending tends to be relatively low.

An analysis of the state's level of per capita taxation that takes into account these factors and the fact that the state relies heavily on the progressive individual income tax and a general sales tax that is not in fact lower than in most states, shows that the level of taxation

in North Carolina is substantially higher than the state's ranking of 46th in per capita general revenue indicates. Indeed, the level of taxation of North Carolina's middle income families seems, when the estimated taxes paid in respective states are compared, to be higher than middle income levels of taxation in all but a few states, most of them relatively wealthy northern states.

Even though North Carolina has not made major changes in its tax structure, population and economic growth and inflation have caused the state's level of taxation to grow substantially in the past two decades. Each of three major taxes on families and individuals has contributed to this growth. The state ranked 6th in growth in per capita property tax revenues from 1960 to 1980; individual income tax revenues grew very fast because of the tax's progressive rate structure; and general sales tax revenues grew fast because of the repeal of the exemption of food in 1961 and the addition of the local-option sales tax in 1971. The level of business taxation, on the other hand, appears to be comparatively low, and growth in revenues from taxes on business has lagged behind overall growth in revenues.●

Antitrust Liability

(continued from page 12)

There are informal ways to learn the impact of local government decisions on local business. Officials can maintain contacts with the chambers of commerce, local developers, merchants or retail associations, real estate brokers, bankers, and businessmen generally. Advice or comments from this source should be sought very early in the process of developing new ordinances and regulations. Cost-benefit analyses can be used if they are available and practical. And local officials can review their operations to prune outdated policies, outmoded regulations and ordinances, and other obsolete provisions from their code books.

Consider state legislation. Finally, local governments may want to review state enabling legislation and authority. For instance, there is a special need for "affirmatively expressed and clearly articulated" state legislation in areas that involve price regulation or utility operations. The local government may be able to claim antitrust immunity under the state-actions doctrine expressed in the *Parker* case if the state mandate is specific enough. If the state gives local governments authority to franchise private businesses, for example, the legislation should make apparent the *state's* intention to displace competition readily apparent. Drafting new legislation may be a "shot in the dark" until the issues of state compulsion versus authorization and active state supervision become clearer. And some care may be needed to avoid giving an impression that by adopting legislation to displace competition in one particular area the legislature intended to withhold authority to displace competition in any other area.

Conclusion

Local governments have a new exposure to antitrust lawsuits since 1978. Local officials can reduce the chances of becoming defendants in such a suit by acting in good faith for the good of the whole community, by recognizing some of the more likely sensitive areas, and by perhaps asking for state legislation. Those officials who do find themselves in antitrust lawsuits will endure the expense and inconvenience of defending the suit; but most of them will not be held liable or pay damages. There are still some important areas for the Supreme Court to clarify. The uncertainty about what may provoke an antitrust suit may be uncomfortable for some time to come, but local officials should not overreact and become too cautious just to avoid lawsuits. They should continue to do their best to provide their communities with basic services and to preserve the public welfare.●

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