POPULAR GOVERNMENT

INSTITUTE OF GOVERNMENT ■ THE UNIVERSITY OF NORTH CAROLINA AT CHAPEL HILL

Fall 1988

Indigent Defense Alternatives to Trials

Election-Law Violations Injury Prevention

Personal Income Tax Governmental Investments

Generally Accepted Accounting Principles

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The Cover: Prosecutor argues a case before a Charlotte jury. This drawing and others in the issue by Michael Brady.

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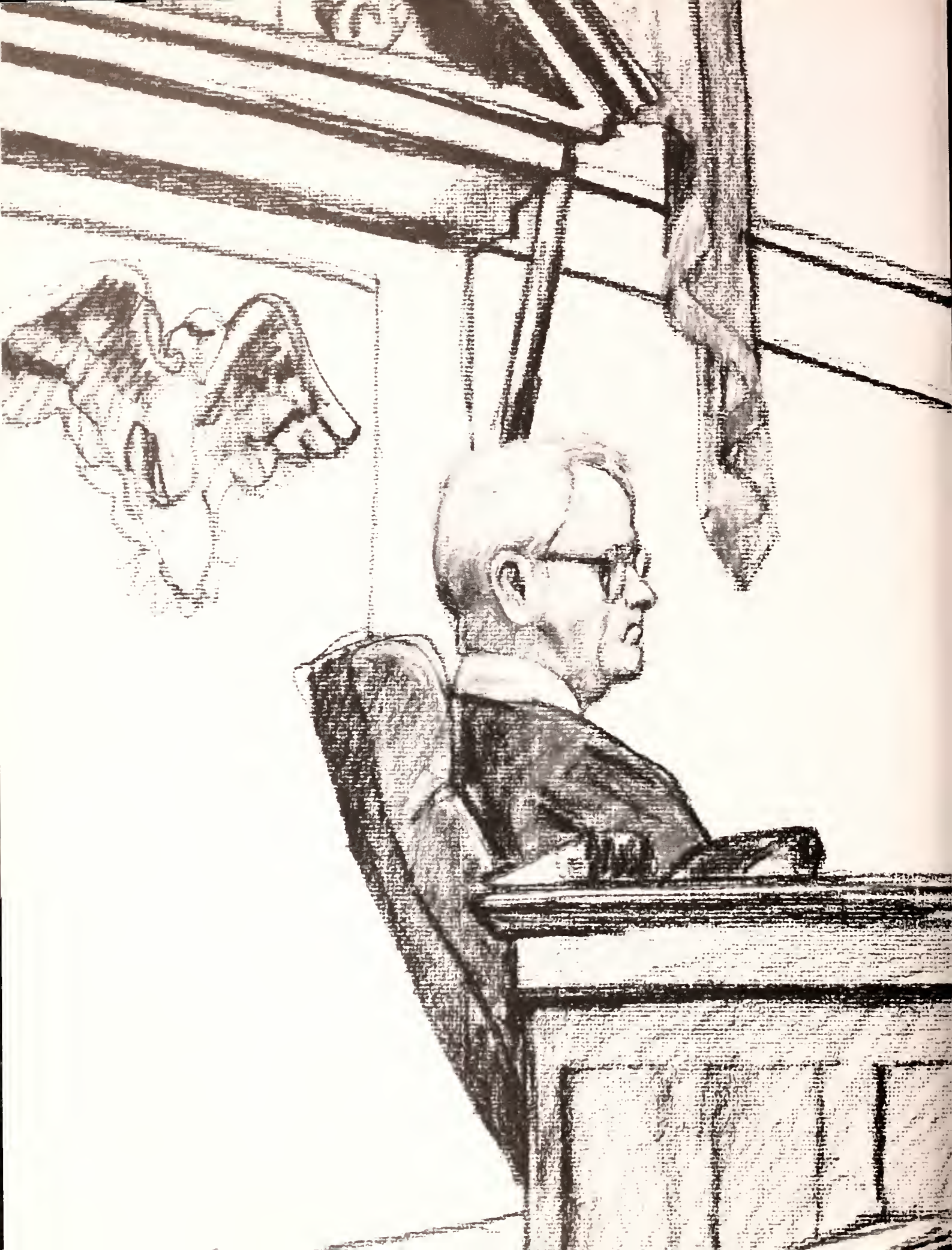
In This Issue



A Need for Reform
North Carolina's Indigent Defense System

Richard A. Rosen

Picture a business with a $19 million annual budget trying to operate with no board of directors and no chief executive officer—indeed, with no central management. Think of this business operating in over 100 counties with no way to take the lessons learned in one county and apply them in the others. Go one step further and imagine this firm trying to function with no one person or office having the authority to trim fat from the budget or ensure the quality of the services offered.

In fact, there are no businesses that operate in this manner, because no business could expect to operate efficiently without some form of centralized management. Neither do we in the governmental area usually operate like this. We have our departments of transportation and correction, for example, to administer the spending of public money. Yet this *is* the way we handle one of the most important governmental functions in our state—the delivery of services to indigent criminal defendants.

For both moral and constitutional reasons, our society provides lawyers for those accused of crime who cannot afford to hire their own attorneys. The notion of equal justice under the law, that rich and poor should be treated alike in our courts, is a cherished idea to many Americans. More important, at least in criminal cases, this notion has had a constitutional underpinning since 1963 when the United States Supreme Court held that the states must provide free legal representation for an indigent defendant charged with a felony,[1] and especially since 1972 when the Supreme Court held that an indigent person could not be imprisoned even for a misdemeanor unless the state provided access to an attorney.[2] Therefore North Carolina is in the business of providing defense services to indigent defendants in every county in the state, and how we do this is a matter of great importance.

The Present System

North Carolina uses two methods to provide legal representation in criminal cases to those who cannot afford it. In most of our judicial districts we rely solely on private attorneys. A judge appoints one of these attorneys to represent a defendant, and the state pays the attorney after the case is finished. The judge determines the amount of payment, and the funds are disbursed by the Administrative Office of the Courts (AOC).

In seven judicial districts we use a mixed system that combines a public defender office, where the attorneys are salaried state employees, and, to a greater or lesser degree, private appointed counsel.[3] The extent to which private attorneys are appointed in these districts depends on the staffing level of the public defender office, although in every district some private attorneys have to be used to avoid conflicts of interest in multiple defendant cases. For instance, in the 1986–87 fiscal year in District 3, where the public defender office serves only two of the four counties, about 41 percent of the indigent defendants were represented by private counsel, while in District 12, which has a fully staffed public defender office, about 12 percent of the clients were represented by private attorneys.[4]

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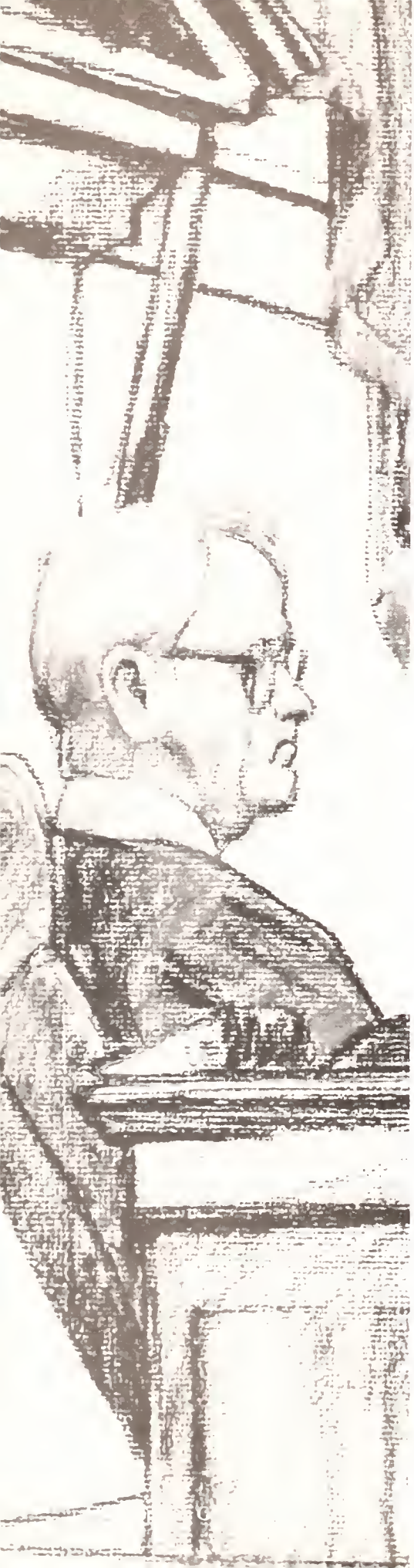

For the 1987–88 fiscal year, the state budgeted approximately $14.5 million dollars for private appointed attorneys and over $4 million for the seven public defender offices and the Office of the Appellate Defender, which handles cases in the appellate courts.[5] These funds pay not only for attorney fees (or salaries) but also for the cost of transcripts, expert witness fees, and other litigation expenses.

Nobody Is in Charge

The most striking aspect of our system for delivering indigent defense services is that despite the size, expense, diversity, and importance of this function, nobody is really in charge of the whole operation. The General Assembly, of course, has the ultimate power in this as in other areas of state government. But the General Assembly has neither expertise for nor interest in planning and managing an indigent defense system on an ongoing basis. The business of the General Assembly is to set broad policies, not to plan or administer, and it is at that level of planning and administration that our system is inadequate.

The AOC has been given some limited responsibility in this area. It prepares the annual budget, disburses funds, and makes recommendations to the General Assembly. But the AOC oversees the state's entire system of justice, and thus indigent defense funding is only one of its many duties. More important, the AOC has no authority to manage the indigent defense system in any meaningful manner. Given the inadequate resources and limited responsibility, the AOC has done a remarkable job of trying to improve the indigent defense system. It regularly conducts studies of what we are doing in the area of indigent representation and makes recommendations for improvements.[6] The AOC, however, cannot decide which method of representation should be used in any given judicial district, it has no authority to hire the personnel providing the representation, and it has neither the resources nor the authority to oversee the day-to-day operation of the system.

Similarly, the North Carolina Courts Commission is charged with evaluating the indigent defense system and making recommendations for improvements. Like the AOC, however, the commission has many other responsibilities and has no power to oversee the indigent defense system or to implement its recommendations. Thus, even though both the AOC and the commission have recommended several times that we add public defender offices in some of our more densely populated districts, and even though a similar recommendation was also made in 1976 by a special committee of the North Carolina Bar Association Foundation, the General Assembly has never adopted these recommendations.

The lack of cohesiveness and sound management permeates all aspects of the indigent defense system. We have, for example, no uniform method of determining which attorneys are competent to represent indigent defendants. Instead, the bar of each district devises its own plan for the appointment of attorneys. While these plans must be approved by a committee of the state bar, there is no mechanism for evaluating the quality of the representation actually provided, and, most often, under these plans eligibility for appointment is usually based solely on the amount of time the attorney has been practicing, without any consideration of competence or effectiveness.

Likewise, we have no uniform method of determining which defendants are "indigent." Under the state and federal constitutions and our statutes, the state is required to provide funds to assist only those defendants who are indigent—those who cannot afford a lawyer. However, we have no standards to guide the court clerks and judges who have to determine whether defendants are indigent. While it would be impossible, and probably undesirable, to develop inflexible rules, it certainly would make sense to provide clerks and judges with general guidelines.

This haphazardness of our indigent defense system is also evident in the way we pay appointed counsel. It is up to each individual judge to decide how much to pay in each case, which results in widely disparate fees that are not based upon the nature of the case or the quality of representation provided. As a result, lawyers come to expect that how much they will be paid depends on the judge who orders the fees as much.

and possibly more, as on the amount or quality of their work.

Given the lack of centralized authority and management, it is no surprise that our indigent defense system is now facing a number of serious problems. One of these is a large shortfall in funding. In late January of 1988, Franklin Freeman, Jr., the director of the AOC, warned court officials of an impending deficit in the Indigent Fee Fund. On April 11, 1988, he announced that the state was facing a $2.3 million deficit for the 1987–88 fiscal year and a $3.6 million deficit for the next fiscal year in the allotted funding for indigent legal fees and expenses.

Another significant problem is the increasing unwillingness of many attorneys, especially those most talented, to handle appointed criminal cases, primarily because of the inadequate, erratic, and unfair compensation.[7] Simultaneously, in those judicial districts with public defenders, the staff attorneys are overwhelmed by huge case loads.[8] Meanwhile, in Robeson County, it took years of vociferous citizen complaints about the quality of representation provided for poor and minority defendants, widespread unrest, and the murder of a popular leader of the minority community to convince the General Assembly to adopt a public defender office.

There are two ways to look at these problems. One is to view them individually and to opt for individual solutions. Under this approach, we could allocate another $6 million to meet the funding shortfall. If lawyers are not taking cases, we could increase the amount of compensation and set a standard hourly rate. We could hire more staff attorneys for the public defender offices, and the next time a situation like that in Robeson County arose, we could start another public defender office.

These are appropriate solutions, but they overlook the basic shortcoming of the way we are handling these issues. We do not have any way to identify problems such as poor quality of representation or insufficient indigency guidelines before they become serious; neither do we have any mechanism for instituting changes short of legislation by the General Assembly. These failings bring us to the other approach, establishing centralized management.

When I say that we need centralized management, I do not mean to imply that we should create some sort of "czar" who would have authority over every single aspect of indigent defense services. That would be both impractical and unwise. Neither do I mean that we should have a public defender office in every judicial district. That would be unnecessary and uneconomical. I mean, rather, that we should give someone, or some office, the authority to plan, manage, and coordinate the defense delivery system in the entire state.

The efficiency of this approach is clear if we look at each of the problem areas identified above and see how centralized management can help. No one can say that a central office would automatically eliminate funding shortfalls, but we can say that it makes sense in government, just as in business, to have someone with the joint responsibility for both planning and delivering services, with the authority to balance income and expenditures. Continuing the business analogy, how many businesses could survive if the people who planned the budget had no authority to oversee the spending of the budgeted funds, or if they had to go back to the board of directors (that is, the General Assembly) every time they wanted to try an innovation or to shift resources from one part of the business to another? Similarly centralized management could conduct ongoing evaluation and training of lawyers delivering indigent and defense services and could establish guidelines for determining indigency and for payment of counsel.

It was obvious for several years that we needed a public defender office in Robeson County, yet it took a political storm to get the General Assembly to act on this matter. Surely it would make sense to have someone continually assess the need for and quality of defense services in individual districts, someone with a mandate to institute changes after consultation with the local residents and bar, so that the next time a problem arose it could be handled before it reached the crisis stage.

Similarly, under our present system there is no one with a mandate to work with judges in improving or regularizing the compensation paid to appointed counsel, and it is doubtful that significant changes could be made without

resorting to additional legislation. The same is true for relieving the pressure on the public defender offices—no major changes can be made without the approval of the General Assembly.

In sum, because the General Assembly has not given overall administrative and management responsibility for the indigent defense program to any one body, we have a situation in which change or improvement is at best difficult. Given the amount of money we are spending and the importance of the services being provided, it makes no sense to continue on our present course.

Where Do We Go from Here

It is time for us to decide whether we should continue to spend our money in the present haphazard manner or should institute some form of comprehensive planning and management. If our answer is the latter, then we have two realistic options. One solution would be to vest the power to manage the indigent defense system in the AOC. At first glance this seems to be an attractive idea. As noted earlier, the AOC has done well with the limited resources and authority granted to it and, assuming additional staff were provided, would most likely manage the indigent defense system well. However, there may be problems with placing so much authority in the hands of an administrative agency that does not, by definition, represent any of the many constituencies affected by the indigent defense system. The system touches many people—lawyers, judges, defendants, and victims—and involves the expenditure of large amounts of money. We therefore need the overseeing authority to be both accountable and responsive to the needs of differing segments of our society.

To the extent that a centralized authority would be determining the type of delivery service in individual districts, it would be performing a function that up to now has been reserved for an elected legislative body. At the same time, the authority also would be encroaching on areas traditionally reserved for local officials, such as determining fees and setting standards for indigency. In both respects it would be wiser to have a centralized authority that is representative of a wide range of constituencies than is possible with a state administrative agency.

I propose as an alternative solution that we follow the lead of many other states and establish a statewide board that, under authority granted by the General Assembly, would have the authority to plan for the provision of indigent defense services, to request from the General Assembly the money necessary for those services, and to administer the funds and manage the delivery of services within broad guidelines set by the General Assembly.

This is neither a novel nor a radical idea. In 1976 a special committee of the North Carolina Bar Association Foundation conducted a comprehensive study of the legal services available in North Carolina for indigent persons in both civil and criminal cases. In its final report the committee recommended that a statewide organization be established to manage the delivery of legal services in both areas. As was recommended, Legal Services of North Carolina, Inc. (LSNC) was formed to manage the delivery of legal services to indigent clients in civil cases, and over the last decade LSNC has managed, even in the face of massive federal-funding cuts, to provide quality legal services for thousands of poor people in North Carolina.

In regard to criminal cases, the report noted the "ever-increasing demand for state resources" and prophetically concluded that unless a comprehensive plan was adopted to manage these resources, "the state will be spending more and more money merely to patch the walls of the dike. . . . The result will eventually be a crisis situation which could disrupt the criminal justice system. . . ."[9] The report's detailed recommendations for adopting a plan for criminal cases, however, have been largely ignored. We are now paying the price.

Many states, driven by the same problems that are now facing North Carolina, have moved towards a comprehensive, statewide public defense system. A 1986 report submitted to the American Bar Association lists twenty-two states that have adopted statewide systems.[10] Other states now are seriously considering this option.[11] There is no single prevailing model—each state has a system to reflect its own needs.

A System for North Carolina

If we do decide to adopt a statewide system for management of indigent defense services, the type of system will, as in other states, have to reflect the realities of our state, both political and economic. While I do not want to use this article to describe precisely the system we should adopt in North Carolina, I do believe that it would be useful to articulate, at least in general terms, a potential model. Many of these suggestions are similar to the recommendations contained in the 1976 Bar Association Foundation report and embody practices that already are being used by other states.

The state organization overseeing the system would be the North Carolina Board of Indigent Defense Services, composed of nonpaid members appointed for definite terms. Members could be appointed by the governor, the General Assembly, the chief justice of the North Carolina Supreme Court, the superior court judge's conference, the State Bar of North Carolina, and the North Carolina Bar Association. The board would be aided by an executive director and such other staff as were deemed necessary to carry out the following duties and responsibilities:

1. To adopt, in consultation with the local bar and after public hearings, a plan of indigent defense representation for each district.
2. To submit a budget to the General Assembly.
3. To prepare and submit an annual report to the governor and General Assembly.
4. To appoint the appellate defender and, in districts that have public defender offices, chief public defenders.[12]
5. To adopt case-load standards for public defender offices.
6. To adopt standards to assist judges in determining indigency.
7. To adopt uniform standards for the compensation of appointed counsel.
8. To adopt, in conjunction with the state bar, standards of qualifications for appointed counsel.
9. To adopt standards and a plan for procuring related services (for example, experts and investigators).

10. To provide supervision, training, support, and coordination for all attorneys, public and private, providing defense services to indigent clients.

Conclusion

Until now the debate about providing indigent defense services in North Carolina has been limited to arguments about whether we should use public defenders or private attorneys in one or another judicial district. This debate completely overlooks the basic problem. We traditionally have used both methods of service delivery and will continue to do so. The real issue is not public defender versus appointed counsel, but whether we will decide to develop a rational, systematic approach to meeting the problems that inevitably arise as we provide defense services for indigent criminal defendants.

The cost of providing these services, like the cost of everything else, has increased appreciably over the last several decades. In fiscal year 1974–75 North Carolina spent $5,029,019 for indigent defense services. For the 1987–88 fiscal year, once the shortfall in funds was made up, the cost was approximately $21 million. In many ways there is little we can do about the rising costs. Inflation, the increase in population, the public demand for longer terms of imprisonment—all are contributing factors. While we have no choice about the cost of providing legal services to indigent criminal defendants, we do have a choice about how the funds for these services are spent, in what manner, and under whose supervision.

We do not need a huge bureaucracy to run a statewide system, but we do need someone in charge, someone to plan, someone to supervise, someone to manage. We have ignored the warnings in the 1976 Bar Association report for twelve years, and we are now seeing the consequences of our inaction. The time has come for us to join the growing list of states that have decided to adopt a statewide system for delivering indigent defense services. ■

Notes

1. Gideon v. Wainwright, 372 U.S. 335 (1963).

2. Argersinger v. Hamlin, 407 U.S. 25 (1972).

3. Appointment of counsel, either public defender or private counsel, is governed by Article 36 of Chapter 7A of the North Carolina General Statutes (hereinafter the General Statutes will be cited as G.S.). G.S. 7A-451(a)(1) allows for appointment of counsel in any case in which a judge finds that the defendant cannot afford a lawyer and in which imprisonment or a fine of $500 or more is likely to be imposed.

4. Administrative Office of the Courts, Annual Report 1986–87.

5. Actually, these and other figures discussed in this article include the costs for representation of indigents in some noncriminal cases, such as proceedings to determine whether a child has been abused or neglected and proceedings in which a person can be involuntarily committed to a mental hospital. Criminal proceedings, however, consume more than 90 percent of the total state funding for indigents. Therefore this article will concentrate on that part of the problem.

6. For instance, the AOC has managed to persuade the General Assembly to institute indigency screening projects in several judicial districts, which has resulted in some cost savings in those districts.

7. See, for instance, "Lawyers, Courts Plead for Relief on Indigent Client Fees," News and Observer, 20 May 1988, p. 33A. This article notes that the fees awarded are often inadequate to cover the overhead cost of the appointed attorneys.

8. The AOC reports that in the 1986–87 fiscal year the average public defender disposed of 400 cases.

9. North Carolina Bar Association Foundation, *Final Report of the Special Committee on Indigent Legal Services Delivery Systems* (Raleigh, 1976), 2.

10. Robert L. Spangenberg and Patricia A. Smith, *An Introduction To Indigent Defense Services* (Raleigh: American Bar Association Standing Committee on Legal Aid and Indigent Defendants Bar Information Program, 1986).

11. John B. Arango, the project coordinator of the Bar Information Program of the American Bar Association Standing Committee on Legal Aid and Indigent Defendants, lists Iowa, Michigan, Maine, South Carolina, Nebraska, and Alabama as additional states that are either in the middle of changing to a statewide system or are seriously considering this option. "Criminal Justice," ABA *Section of Criminal Justice* 2, no. 4 (Winter 1988): 29.

12. I should note that our present system of having the senior resident superior court judge appoint the chief defender [see G.S. 7A-466] is in direct violation of American Bar Association Standards. Section 5-3.1 of the American Bar Association Standards Relating to the Administration of Criminal Justice ends with the admonition, "Selection of the chief defender and staff by judges is prohibited." The commentary to this standard explains that this prohibition is necessary to ensure both the appearance and reality of independence for the public defender office.


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Alternatives to Trials
North Carolina's Dispute Resolution Program

Frank C. Laney

As you are driving through town on a major, four-lane street, you approach an intersection where the traffic light has turned yellow. A slow moving car in the right lane stops, but you decide to go through the light. In the middle of the intersection, you are hit by a car coming from the left. The driver of the car swears that she had a green light, but you are certain that the light had not changed. Two witnesses, the driver in the right lane and a pedestrian, give conflicting reports as to whether the light had changed. Both parties' insurance companies, each citing the witness favorable to it, refuse to pay the $5,000 needed to repair your car.

In our legal system the usual way to resolve this conflict is through a lawsuit. But typically it will be two years before the lawsuit is finally settled in court—two years to simply determine who ran the red light. Crowded court dockets, high costs, and consumer dissatisfaction have caused the legal community to look for alternatives to litigation as a means of settling such disputes. In the last fifteen years many alternatives have been developed and tested across the country. These alternative methods are referred to as alternative dispute resolution (ADR) methods. Currently, if the collision cited above happened in Durham, the case would be submitted to arbitration, and a resolution would be reached within sixty days of filing the answer.

The North Carolina Bar Association is establishing ADR programs at different levels on a statewide basis.[1] This article describes three major pilot programs that have been successful.

Mandatory Child Custody Mediation Program

Probably the most wrenching, destructive litigation is a child-custody court battle. A custody fight typically involves two parents who have had a close, loving relationship and who still have a vital need to communicate and cooperate in raising their children. But under the current system, the best tactic for a divorcing parent to get some form of custody is by demonstrating that the other parent is unfit to raise the child. Lawyers and judges generally loathe hard-fought custody cases. In many instances the judge must decide the fate of small children based upon a few hours of near-slanderous, vicious testimony. The parents end up embittered and hostile, the children frightened and insecure.

In 1983 the North Carolina General Assembly authorized Mecklenburg County to establish a pilot program for mandatory child-custody mediation. Mediation is a dispute-resolution process in which a neutral third party helps to identify problems and encourages the parties to resolve their conflict by themselves. In the Mecklenburg program, mediation focuses solely on the issues of child custody and visitation, leaving aside the economic issues of divorce or separation. The goal of the mediation is a "parenting agreement," a written agreement that sets out the custody and visitation terms and conditions. Mediation saves time and money for both the parents and the courts. However, attorneys remain an integral part in the process, advising litigants of their rights, evaluating proposed agree-

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ments, and continuing to handle other aspects of the case.

All custody disputes filed in Mecklenburg County must be referred to mediation. In these cases the parents, unable to reach an agreement and enter into a consent judgment, have instituted litigation regarding custody. Custody cases that also involve domestic violence or substance abuse however are not referred.

The mediators in the program must have a master of social work or an equivalent degree. They receive additional training in family counseling and child development as well as training in the mediation process itself. Unlike most mediators, who are expected to be disinterested and neutral, this program's mediators focus on the best interest of the child, concentrating on the child's needs rather than solely on the parents' rights. Through this process they help the parents develop an agreement that is best for the child.

As a facilitator, the mediator makes no judgment, findings of facts, or evaluation. If the parties (who are usually parents but may be aunts, uncles, cousins, or grandparents) are unable to reach an agreement, the case is referred back to district court for standard court proceedings. The matter is then heard anew. Any matters that have been discussed in mediation are then confidential, and the mediator is not subject to subpoena. If the matter is resolved through mediation, the mediator helps the parties draft their agreement, which is then sent to the court and the parties' attorneys. If the parties and their attorneys are satisfied with the agreement, the court will sign an order adopting the mediated agreement as the court's order for custody.

The North Carolina Bar Association (NCBA) Committee on Dispute Resolution evaluated the program in 1986.[2] Between February of 1984 and April of 1986, the program handled nearly 600 cases and completed mediation in 300 of them. Overall, parents, judges, and attorneys were satisfied with the process, the mediators, and the resulting agreements. Generally, child-custody agreements reached through mediation were at least as likely to reflect the interests of the child and seemed more likely to be complied with. Most parents (85 percent) stated that they liked the process and that it should be required in all cases. One key to success seems to have been the high quality of the mediators used in the program.

Because the overall results of the pilot program have been positive, the NCBA has endorsed legislation that would establish a statewide program of custody mediation and evaluation services. That legislation did not pass in 1987, but the pilot program was expanded to Gaston County, and a voluntary program has been adopted by the lawyers and judges of Judicial District 15B (Orange and Chatham counties) and Judicial District 28 (Buncombe County).

Summary Jury Trials

A summary jury trial is a pretrial settlement procedure that brings the opposing parties together to provide each with an accurate picture of their respective cases. It is a one-day trial before a judge and jury. No witnesses are called, but each attorney is given about two hours to present a summary of the case.

The NCBA has sponsored a program

to introduce summary jury trials to the North Carolina superior courts.[3] The pilot program is being conducted in three judicial districts—Wake, Mecklenburg, and Buncombe counties. In each district, superior court judges and trial court administrators are determining which cases may be suitable for these procedures. Generally such cases are those that would take over a week to try. After the selection, the judge approaches the parties or their attorneys, advises them that a summary jury trial may be an effective settlement tool in their case, and requests their consent. The procedure is initiated when the case is ready for trial and discovery has been completed.

The first summary jury trial held in Asheville concerned a worker who fell to his death through an unbarricaded hole in a building under construction. He was a young, healthy man with no dependents and no close relatives except an elderly mother. The out-of-pocket damages were only his funeral expenses of a few thousand dollars. Workmen's compensation had already paid $50,000, but that left the question of whether a man's life is not worth more than that. Both sides agreed that they did not know what a jury would do with the case; therefore they submitted it to a summary jury trial. In one day—without having to pay witness fees to doctors, construction experts, and economists—the parties received a jury verdict of $100,000. Using the verdict as a basis, they were able to negotiate a settlement.

In another case, involving a permanent injury to the foot of a young, athletic woman in a car wreck, the attorneys agreed to a binding "high-low" verdict. Both sides agreed on a lower limit of $3,500 and an upper limit of $15,000. If the jury returned a verdict below or above these limits, the agreed upon limit would apply. If the jury returned a verdict between the high and low, the jury's decision would be binding. Thus the litigants received a binding final decision, limited their risks, and substantially reduced the cost of their trial.

The groundwork for the process is laid in one or more conferences between counsel and the court. Because the goal is to limit the trial to one day, evidentiary issues, jury instruction, stipulation regarding exhibits, and ground rules for presenting the case to the jury must be either agreed upon by the parties or decided by the court before the trial.

Jurors are drawn from the regular jury pool and may complete a biographical questionnaire that the parties have agreed to in order to expedite selection. Each party is given a limited time to question the jurors further. Jury selection should take no more than an hour and resembles federal jury selection.

In North Carolina it is suggested that the jury not be informed in advance that the verdict will be nonbinding. The rationale for this is to ensure the seriousness of their deliberation and thus to reflect as closely as possible the verdict of a conventional trial. Further, because the summary jury trial is a settlement process, the parties may stipulate at any time that the jury's verdict will be binding, including while the jury is deliberating. Across the nation, however, opinion is split on whether juries should be told that the verdict is nonbinding. Some courts maintain that not to inform the jury is improper.

Opening statements by the attorneys are kept to a minimum or dropped entirely. Evidence is summarized for the jury by counsel. All statements of counsel must be based on evidence that would be admissible at trial, such as documents, business records, depositions, or affidavits. Although it is expected that the evidence will be presented without live testimony, agreed-on portions of videotaped depositions may be used if the credibility of one or two witnesses is critical. Attorneys are encouraged to use photographs, charts, and other means to summarize evidence. All sources must be agreed on in advance by both parties in order to avoid delay. There should be no objections by the attorneys and few arguments to the bench during the trial.

To effectively summarize in two hours all the evidence for a complex case that would take six weeks to try is a difficult but not insurmountable task. It requires considerable ingenuity on the part of the attorneys involved. Catherine Arrowood, an attorney with Adams, McCullough & Beard of Raleigh, participated in the first summary jury trial in North Carolina and faced such a task. The case Ms. Arrowood tried involved complex, technical matters. Because of the large number of exhibits, she made an individual notebook for each juror. Although she initially had doubts about summary jury trials, she is now an enthusiastic promoter of the procedure and has used it in other cases. She finds that it forces attorneys to find and use creative methods to present the case to the jury, promoting efficiency for the courts, litigants, and attorneys.

At the close of the evidence, the judge briefly instructs the jury. Because the instructions are not subject to scrutiny on appeal, the judge may give a much more simple, plain-English set of instructions. While the jury deliberates, the judge is likely to suggest a settlement conference and may offer observations on the case to assist the parties in their negotiations. It is vital that parties who have authority to settle be present at the trial. Often the trial is the first time since the dispute began that the parties thoroughly assess the merits of their respective cases. Many parties settle before the jury returns a verdict.

In the event that the parties do not settle, the jury returns with a unanimous verdict if possible or, if not possible, with

as many verdicts as are necessary to reflect their opinion. The judge may allow a conference with the jurors in open court so that the litigants may hear the jury's feelings and the reasons for their decisions. The attorneys may attempt to ascertain general impressions only. They are not allowed to ask detailed questions of jurors to refine their evidence and thereby transform the process from a settlement technique to a rehearsal for trial. After the brief jury conference, negotiations continue with or without the judge's presence, as may benefit resolution.

Summary jury trials are being experimented with across the United States. Over 90 percent of the cases that use the procedure are settled before going to trial. Critics argue that 90 percent of all cases are settled anyway; so why use the procedure? While it is true that most litigants settle before trial, over two thirds of all superior court cases are dismissed by the parties or the clerk of court before reaching the trial stage. Therefore the procedure is settling 90 percent of the 30 percent of cases most resistant to settlement. In North Carolina, as of the fall of 1988, there had been three federal court and seven state court summary jury trials. Each trial was successful in that a binding settlement was reached before a full trial, yielding a 100 percent settlement rate.

Court-Ordered Arbitration

North Carolina is the first state in the Southeast to implement a state program of court-ordered arbitration. At the request of the NCBA, in 1985 the General Assembly authorized the Supreme Court to establish a pilot program of mandatory, nonbinding arbitration in three judicial districts and to establish rules for its implementation.[4] The program is operating through September 1989 as a pilot project in judicial districts 3 (Pitt, Craven, Carterett, and Pamlico counties), 14 (Durham County) and 29 (McDowell, Rutherford, Polk, Henderson, and Transylvania counties).

Court-ordered arbitration is designed to resolve civil disputes involving $15,000 or less. It is a procedure that preserves the parties' right to trial in that the arbitrator's decision is not final if either party subsequently requests a new trial. The goal of arbitration is to provide prompt, relatively inexpensive, fair, and less-formal resolution of civil cases while preserving the procedural and substantive rights of citizens.

Under court-ordered arbitration, the arbitrator acts as an official of the court, empowered with authority similar to that of a trial judge in conducting the hearings. The arbitrator weighs the facts, applies the law, and renders a decision within three days. The decision is brief, with no requirement of a statement of facts, law, or reasoning. The role of the arbitrator is basically that of a judge, not a mediator or counselor.[5] Arbitrators are trial lawyers with over five years of experience and receive a modest fee of $75.00 per case.

When a party files a complaint and serves it on the opposing party, the case is evaluated by a clerk to determine if it meets the clear criteria of the arbitration rules. If so, the case is set for hearing within sixty days of the filing of the answer. Because of the time constraints, continuances are rare.

The arbitration procedure is somewhat less formal than a bench trial. Before the hearing, the parties exchange information regarding the contentions, witnesses, and documents. Because one of the primary goals of arbitration is to save time, hearings are limited to one hour, although arbitrators allow extensions when necessary (the average hearing lasts about one and a quarter hours).

At the start of the hearing, the arbitrator identifies and defines the subject matter and issues of the case. Throughout the trial the arbitrator may ask questions in order to clarify and streamline the hearing. The rules of evidence are used only as a guide for arbitration and are somewhat relaxed in order to expedite proceedings. Attorneys are encouraged to limit their witnesses and, instead, to present affidavits and depositions, or simply to present the evidence in narrative form.

Following both parties' presentations, the arbitrator may render an immediate decision or may take up to three days to file a written decision. The arbitrator may allow post-hearing briefs, and a party that is not satisfied may request a new trial, whereupon the case returns to the trial calendar and is heard as if the arbitration hearing had never occurred.

Pursuant to the legislative authorization and to determine the true benefits of arbitration, the NCBA has contracted with the Institute of Government to conduct a controlled study of the arbitration program in the three districts.[6] In this study, half of the cases that meet the arbitration criteria will be assigned randomly to arbitration. The other half will be calendered with the trial court. The study will track both sets of cases through hearings and resolution, and researchers will interview the litigants and attorneys to gain their impressions of the process. In comparing the cases that went to arbitration with those that followed the standard litigation procedure, the Institute will consider (1) whether, and how much, arbitration shortened disposition time; (2) whether attorneys and litigants were more satisfied (or less dissatisfied) with arbitration than with the standard procedure; and (3) whether arbitration affected which parties won.

The program is in full operation in each district. About 30 percent of all civil cases filed are eligible for arbitration, but only about 10 percent of those cases go to hearing. The rest are settled or dismissed before the sixty day period is over. Of the cases that go to hearing, under 12 percent request a new trial, indicating great satisfaction with the program.

As these three programs indicate, the NCBA is firmly committed to making changes in the legal system to provide just and speedy resolution of disputes to all citizens. ■

Notes

1. Subcommittee on Bar and Public Awareness, Committee on Dispute Resolution, *Dispute Resolution Alternatives in North Carolina* (Raleigh: North Carolina Bar Association, 1985).

2. Committee on Dispute Resolution, *Mandatory Child Custody Mediation Program in Mecklenburg County: A Study and Evaluation* (Raleigh: North Carolina Bar Association, 1987). Copies of this report are available from the North Carolina Bar Association dispute resolution coordinator for $3.00 each.

3. Introducing Summary Jury Trials To the North Carolina State Superior Court, compiled by the North Carolina Bar Association Committee on Alternative Dispute Resolution Techniques (June 1987).

4. N.C. Gen. Stat. § 7A-37.

5. Dispute Resolution Committee, *Benchbook for Arbitrators Serving in the North Carolina Court-Ordered Arbitration Pilot Program* (Raleigh: North Carolina Bar Association, 1987), 3.

6. The study will be completed by January 1989, and copies of the research report will be available from the Institute of Government and the NCBA later in 1989.

Reducing Injuries *Opportunities for Government Leadership*

Laureen M. Tyler, Carol W. Runyan, Patricia F. Waller, and Elizabeth A. Gerken

Ms. Tyler was the legal advisor to a project sponsored by the Center for Health Promotion and Disease Prevention, The University of North Carolina, when this article was written. Dr. Runyan is a research assistant professor in the Department of Health Behavior and Health Education, UNC School of Public Health, and associate director of the UNC Injury Prevention Research Center. Dr. Waller is director of the UNC Injury Prevention Research Center and associate director for driver studies, UNC Highway Safety Research Center. Ms. Gerken is a research associate with the UNC Injury Prevention Research Center.

The local news on a typical day will present alarming evidence that injuries are a serious and prevalent part of our lives. Consider these stories:

- Cindy, age two; Ian, age four; and their mother Rebecca, age twenty-two, all died when a midnight fire destroyed their apartment, which had no working smoke detector.
- Loretta, a young mother working at a convenience store, was murdered with a handgun during a nighttime robbery.
- The parents of Jacob, age six, sued the city when their son fell from the slide in a public playground and seriously injured his head on the concrete surface below.
- Robert was hospitalized when the taxi he was riding in, which had no rear seat belts, was rammed by another car.

Even more than ordinary viewers, government officials—including those in city, county, state, and federal government—can exercise their leadership to reduce the toll from these and other injuries.

The Injury Problem

The injuries mentioned above are not isolated occurrences. Each year in North Carolina, more than 4,000 people die from injuries and approximately 60,000 are hospitalized. Injuries are the fourth leading cause of death overall in North Carolina and in the nation. Moreover, because they disproportionately affect the young, injuries account for more years of life lost before age sixty-five than cancer and cardiovascular disease combined, exacting enormous costs to society (see Figure 1).

The majority of North Carolina's fatal injuries are caused by, in order of frequency, motor vehicle crashes, firearms, poisonings, fires and burns, drownings, and falls (see Table 1). Our death rates for all of these injury types are worse than the national average.

Here, as in the nation, certain groups experience higher rates of injury, especially children, young adults, the elderly, minorities, males, and the poor.[1] These rates include not only unintentional but also intentional trauma. For example, for black men between ages fifteen and forty-four, both in this state and nationally, homicide leads all other causes of death.[2]

The injury problem is also expensive. Hospitalizations from motor vehicle crashes alone—less than half of all injuries—are estimated to cost more than $500 million in North Carolina each year.[3]

Injury Control

Many injuries could be prevented, and their costs in dollars and lives avoided. However, injury prevention has been hindered by the attitude that "accidents just happen," that they are caused by fate or chance. In fact, injuries, like most other health problems, are not random. They have identifiable, and therefore controllable, causes.

Like other health problems, injuries result from many factors. These factors include the way people behave (for example, whether bicycle riders wear hel-

mets and obey safety rules), the design of the products we use (whether bicycles have good brakes), and the environment in which injuries occur (whether there are bicycle paths or well-paved roads).

It is tempting to ignore the complexity of the problem and to attribute injury to one factor alone—to blame the victim for being reckless or irresponsible or to assume that some "accident prone" people are destined to be injured. These attitudes imply that injury prevention efforts must be aimed solely at changing the behavior of individuals. However, many of those injured were never in a position to avoid harm, no matter how they behaved—such as the child sleeping in a burning house. Furthermore, other strategies for preventing injuries often can be more effective, less expensive, and easier than getting people to change their habits. Strategies must be aimed at a combination of contributing factors.

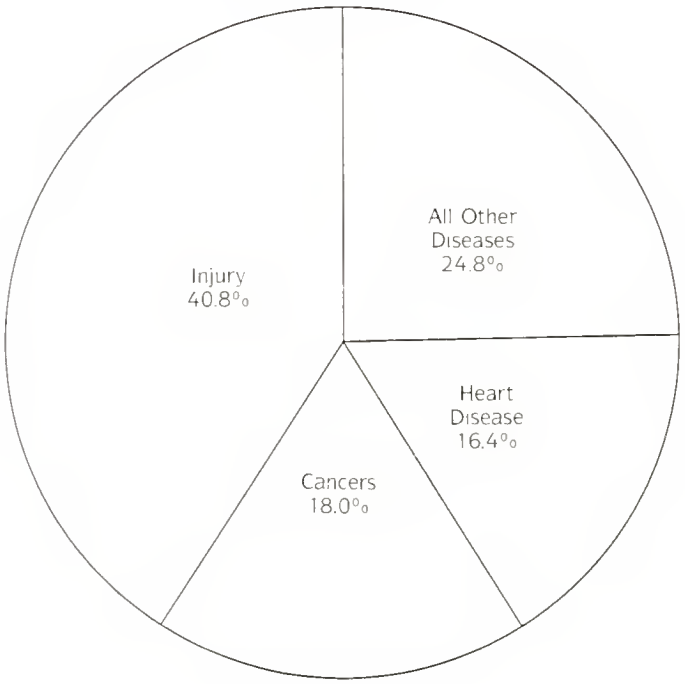
Some injury control strategies focus on changing behavior through education. For example, parents are taught to put a bottle of medicine out of their child's reach after each use. Because a single failure to do so can lead to poisoning, the cost of even a momentary return to old habits can be high. Changing behavior is never easy, especially when the new behavior must be repeated over and over again. Education aimed at getting people to do something only once is easier to accomplish. For example, rather than getting parents of young children to check the water temperature every time they turn on the faucet, it may be easier to get them to adjust the water heater thermostat once. This one-time behavior could be encouraged through educational programs or could be required by state or local regulations when a house is sold or rented.

Using governmental authority to regulate behaviors is another type of strategy and can help develop an informed constituency that is supportive of such injury control efforts. State laws mandating the use of seat belts exemplify the use of governmental authority to control injuries and have proven much more effective than educational campaigns alone.[4]

Strategies that involve product design or modification of the environment also frequently require regulatory intervention. For example, the 1970 federal Poison Prevention Packaging Act required medicines to be sold in childproof containers,[5] thereby preventing many childhood poisonings at relatively little government expense. Because such strategies do not require individuals to take repeated actions, they may be more effective in preventing injuries.

Policy-based approaches are as appropriate for preventing intentional injuries caused by violence or suicide as they are for preventing unintentional, or "accidental," injuries. Despite obvious differences in the underlying motives, both types of injury can be reduced effectively by changes in the environment or the products involved. For example, deaths due to fire could be reduced by installing smoke detectors, whether any given fire was caused by arson or by an overfilled kerosene heater.

Figure 1
Percentages of Years of Potential Life Lost Before Age Sixty-Five in the United States



Source: National Research Council, *Injury in America* (Washington, D.C.: National Academy Press, 1985).

The Role of Government

Doing something about injuries does not begin in the emergency room. It begins when a house is built, when a playground is designed, when a government car or taxi is inspected, when a baby goes home from the hospital. At all of these moments, and countless others, the factors that produce injuries are present and can be modified.

Government officials who have jurisdiction over the settings in which injuries occur can take action to prevent them, thereby fulfilling their responsibility to serve and protect the public. Federal, state, and local officials can collaborate with health professionals to find solutions. Changes in government policy can spur necessary modifications in the environment and in product design. And such preventive measures usually involve little government cost.

Unfortunately, prevention can seem to be a thankless job in comparison to heroic rescue. The entire nation watched in anxious anticipation while Jessica McClure was unearthed from a well shaft in Texas, and her rescuers were hailed as heroes. But where would the cheering crowds have been if town officials had ensured that well covers

Table 1
Leading Causes of Injury Mortality
in North Carolina by Age Group,
1980–1985

Part A. Ranking by Frequency

Age Group				
0–14	15–24	25–64	65 +	All
Motor vehicles	Motor vehicles	Firearms	Motor vehicles	Motor vehicles
Fires	Firearms	Motor vehicles	Firearms	Firearms
Drownings	Drownings	Poisonings	Falls	Poisonings
Firearms	Motorcycles	Fires	Fires	Fires
Bicycles	Sharp instruments	Drownings	Exposure	Drownings
Asphyxia	Poisonings	Sharp instruments	Poisonings	Falls
Child abuse & neglect	Fires	Falls	Drownings	Sharp instruments

Part B. Percentage by Cause

Cause	Age Group 0–14	15–24	25–64	65 +	All
Motor vehicles	34.89%	47.54%	27.28%	26.91%	32.38%
Firearms	6.20	20.82	29.75	21.08	24.80
Poisonings	1.10	2.51	8.43	3.37	5.83
Fires	13.28	2.01	4.51	10.09	5.37
Drownings	12.99	6.75	4.09	3.23	5.19
Falls	2.55	1.25	3.34	14.87	4.50
Sharp instruments	0.98	3.12	3.42	0.36	2.83
Bicycles	4.93	0.60	0.20	0.11	0.61
Motorcycles	2.03	4.58	2.14	0.44	2.44
Asphyxia	4.64	0.43	1.06	2.13	1.32
Exposure	0.41	0.14	1.64	3.43	1.47
Child abuse & neglect	3.25	—	—	—	0.23
Other[a]	12.75	10.25	14.14	13.98	13.03
Total	100%	100%	100%	100%	100%
Total deaths	1,725	5,614	13,687	3,619	24,645
Annual average	288	936	2,281	603	4,108
Annual rate[b] (per 100,000)	21.59	81.69	81.50	99.97	69.84

Source: Data were compiled by the Office of the Chief Medical Examiner.

[a]This category consists of more than twenty different causes, none of which exceeds 2.5 percent of the total.
[b]Based on the 1980 Census.

were installed to prevent such falls in the first place? Where are the children and adults who have avoided injury thanks to government action? Unfortunately, we cannot identify these individuals, and thus injury prevention successes may seem invisible.

Actually, successful injury prevention through government action can be demonstrated through statistical evidence. On a local level, statistical evidence can be difficult to obtain because the number of injuries in each unit is usually small. But instead of documenting the number of lives saved from a particular government action, we can show that the action reduced the risk facing the public. For example, the number of uncovered well shafts before government regulation can be compared to the number afterwards. Although we can only estimate how many children would otherwise have fallen into the unprotected wells, nevertheless the forward-looking government officials who take action to prevent tragedies like Jessica's rightfully should be counted among our heroes.

State-level measures

Injury prevention measures can be implemented at the federal, state, or local level. Federal action is very important but can be slow and may not address regional concerns; therefore it will not be discussed in this article. State-level measures are attractive for several reasons. State governments can act more quickly than the federal government to target specific problems facing their own residents. Unlike local government, the state has broad authority to act, limited only by the state and federal constitutions, the state budget, and the sentiments of its people. It is also easier to evaluate the effectiveness of state, rather than local, measures because the affected population is large enough to compare injury rates before and after government action. This fact is important because officials understandably are reluctant to act when they will be unable to demonstrate that their actions have done some good.

North Carolina's alarming rate of deaths due to house fires—one and one half times the national average—is one of several injury problems that state action could reduce. The current State Building Code requires that buildings erected since 1975 be equipped with smoke detectors. Strengthening this measure with a new requirement that *all* dwellings have working smoke detectors before they are sold, rented, or otherwise transferred would mean that smoke detectors would have to be installed, maintained, or replaced even in older buildings. Similarly, some states have regulated the use of portable kerosene heaters, which are known to cause more than a quarter of all fatal house fires in North Carolina.[6]

Vehicle injuries also could be reduced by action at the state level. For example, bicycle injuries could be reduced by requiring the use of headlights and rear and side reflectors at night.[7] Riders of mopeds currently are not required to be licensed or to wear helmets in North Carolina, although motorcyclists, who encounter similar injury risks, must meet both requirements.[8] Twelve states have laws that restrict late-night driving of motor vehicles by those under age eighteen,[9] and, as a result, crashes involving sixteen-year-old drivers during curfew hours have been reduced substantially—ranging from a 25 percent reduction in Louisiana to a 62 percent reduction in New York.[10] Likewise, North Carolina has made considerable progress towards reducing alcohol-related injuries through its 1983 Safe Roads Act,[11] despite the fact that it is still legal to purchase cold beer and wine at stores that dispense gasoline for motor vehicles and boats.

Local measures

Local governments also could adopt many injury prevention measures. Because cities and counties have only the

Table 2
Possible Injury Prevention Measures

Measure	Whose Authority	Statutory Basis for Local Authority[a]
Smoke detectors: Require that working smoke detectors be maintained in all dwellings, regardless of their age	City, County, or State	G.S. 160A-441
Handgun waiting period: Require up to a thirty-day waiting period to investigate an applicant's criminal and mental health records before granting a handgun permit.	County or State	G.S. 14-402 *et seq.*
Fall prevention standards for stairs: Implement National Bureau of Standards standards by modifying government buildings or by regulating the construction of interior steps in all buildings (see endnote 9 for reference).	City,[b] County,[b] or State	G.S. 143-138(e) 160A-441
Safe playground design: Require that playgrounds and play equipment conform to United States Consumer Product Safety Commission safety standards.	City, County, or State	G.S. 160A-174 or 153A-121
Fencing pools: Require that all pools, private and public, be fenced on all four sides to prevent drownings.	County or State	G.S. 130A-39(a) or 153A-77
Water heater thermostat control: Require thermostats to be set no higher than 120° F when a new tenant occupies a dwelling, or at any other specified time.	City, County, or State	G.S. 160A-441
Safety belts in taxis: Require that all taxis maintain usable seat belts in front and rear seats before granting a taxi franchise.	City or State	G.S. 20-37
Safety belts in government vehicles: Inspect and maintain seat belts in front *and back* seats and require that all employees wear them.	Government units that own vehicles	No legal authority needed
Poison control kits: Distribute kits, including ipecac, cabinet latches, emergency phone numbers, etc., to all new parents.	County health departments	G.S. 130A-34
Bicycle safety: Require riders to wear helmets, particularly while riding on city streets.	City or State	G.S. 160A-300
Mopeds: Require licensing of moped riders and make helmet use mandatory.	State	
Portable kerosene heaters: Regulate use strictly	State	
Handguns: Restrict sale or possession.	State	
Driving curfew: Restrict late-night driving by those under age eighteen.	State	
Restrictions on alcohol sale: Forbid sale of alcohol, or sale of refrigerated alcohol, at stores that dispense gasoline for motor vehicles or boats.	State	

[a] Local governments must have statutory authority from the General Assembly to implement these suggested measures; the statutes granting such authority are listed. State action needs no such authority; the General Assembly can simply pass a new statute implementing the measure.

[b] Approval of the State Building Code Council is required when local governments set standards for buildings other than dwellings, which can be regulated under local housing codes without council approval.

powers granted to them by the General Assembly, local authority to act is limited. Likewise, the population affected by the measure is limited by the size of the governmental unit. In spite of these limitations, local governments can play a valuable role in injury control.

Local governments have several advantages over state and federal bodies. They can be more responsive to local hazards, watching for dangerous sites at which a disproportionate number of injuries occur. They can attend to the special needs of their residents. For example, a city with a large elderly population can focus on implementing safe pedestrian walkways with traffic signals providing adequate time for crossing. Because a smaller number of officials need to be convinced to implement a local program, local governments often can be more creative than the state. A few local innovators can introduce a measure, test it, and then encourage state adoption of those actions that are successful. For example, interest from Wake and Onslow county officials in requiring hunters to wear blaze-orange clothing contributed to the enactment of a 1987 North Carolina state law.

Some possible state measures could also be within local authority. For example the local housing code could be amended to require that each dwelling have a working smoke detector. Local governments could also adopt established guidelines for steps and stairs to prevent falls.[12] Government-owned buildings could be scrupulously maintained at these standards, not only to protect citizens but also to avoid government liability for injuries. Those provisions that are not already included in the State Building Code could be adopted locally, upon approval of the State Building Code Committee. Finally, local housing codes could incorporate similar standards for all dwellings.

Local governments could also establish guidelines for safe playgrounds, requiring owners to take steps as simple as dumping a truckload of pine bark under play equipment to provide a forgiving surface when children fall. Again, such measures not only could prevent serious trauma but also could reduce government liability when applied to publicly owned playgrounds.

It is possible that, in some situations,

setting safety standards can make a government liable for injuries that result when those standards are not met. However where such standards already exist or where failure to establish safe conditions, even in the absence of adopted standards, is a foreseeable cause of injury, the government unit already risks liability. In such cases, establishing safety standards and ensuring that they are observed will reduce the government's risk of liability.

Local governments may also be able to prevent some of the firearm injuries that take a heavy toll in North Carolina. They do not have the authority to ban handguns, although this highly controversial step could be taken at the state level if the General Assembly were prepared to make that difficult choice. However, sheriffs who grant handgun permits do have the authority to spend up to thirty days investigating the criminal and mental health record of applicants and to deny permits to some individuals while enforcing a cooling-off period for others.[13] If John Hinckley had gone through such a screening process, it is unlikely that he would have been able to purchase the gun that he used to shoot President Reagan.

These are but a few of the injury prevention measures that could be implemented at the local level. Other examples are presented in Table 2. Each governmental unit may have distinct injury problems that need attention and can assess its problem areas and design its own injury prevention plan.

The Effect of Alcohol Use on Injury

Alcohol use is a major factor in many and all types of injuries. Intoxication not only increases the likelihood of an injury occurring, but also can exacerbate the severity by decreasing the individual's tolerance to impact [P.F. Waller et al., "The Potentiating Effects of Alcohol on Driver Injury," *JAMA* 256 (19 September 1986): 1461–66]. Nationally, nearly half of all driver fatalities in motor vehicle crashes involve alcohol. Deaths among motor vehicle occupants, pedestrians, and victims of other injuries, such as falls, suicides, drownings, and assaults, also often involve blood-alcohol levels above 0.10 mg percent. Moreover, alcohol has been shown to be a factor in up to 30 percent of all nonfatal injuries [National Research Council, *Injury in America* (Washington, D.C.: Academy Press, 1985), 27].

In North Carolina between 1977 and 1986, alcohol was involved in a substantial proportion of all injury deaths. For the selected events listed below, the percentage to the right indicates the proportion of those tested who had alcohol in their bloodstreams.

Event	Number of Fatalities	Number Tested For Alcohol	Percentage Tested with Alcohol Present
Motor Vehicle Crashes	15,135	11,952	48%
Driver/Occupant	10,698	8,722	48
Pedestrians	2,394	1,775	55
Bicycles	268	155	15
Firearms	10,140	9,064	45
Unintentional	379	288	24
Homicides	4,332	4,057	57
Suicides	5,429	4,719	35
House Fires	1,911	1,447	55
Falls	1,653	803	27
Under age 65	791	509	35
Age 65 or older	862	568	14
Pool Drownings	126	35	40
All Drownings[a] (1980–1984 only)	1,052	839	48

Source: Data were compiled by the Office of the Chief Medical Examiner.

[a]Data are from M. J. Patetta, "Drowning Deaths in North Carolina," *SCHS Studies* 42 (August 1986): 1–11.

Individual Freedom

Americans cherish individual rights and tend to be wary of government intrusion in their lives. Therefore, in considering proposed government action, the cost of such action to the individual must be weighed against both its benefits to other individuals and its value to the community as a whole.

The state law requiring use of motorcycle helmets illustrates this balancing process. Aside from monetary costs that may be imposed on others, the impact of a motorcyclist's injury or death is felt by family and friends as well as the cyclist's employer and community. Thus in passing G.S. 20-140.4 the General Assembly decided that an individual's right to choose not to wear a motorcycle helmet was outweighed by the impact of that choice on others. Similarly, government regulation limits individual freedom by enforcing speed limits on our roads, requiring the use of hard hats in construction areas, and so on.

The appropriate balance between individual and societal rights is never clear-cut, and each proposed government action must be evaluated separately. Communities that place a high value on protecting their members are sometimes willing to accept minor limitations on individual freedom to do so. For example, the city of Charlotte requires even private swimming pools to be fenced to reduce the risk that a neighborhood child will fall into the pool and drown. These officials have weighed the costs to those who might sacrifice some individual freedoms against the benefits to those who would otherwise be injured or killed, a balancing that any governmental action requires.

Summary

Injuries cause significant monetary and human costs in our communities, yet many in government may not fully realize that they can take action to reduce injuries. Government officials must choose either to protect citizens from causes of injury and death, even though that might entail some restriction on individual freedom, or to tolerate the risk that someone will be injured or killed. Along with this choice comes an opportunity to exercise leadership in

the community and the state by protecting North Carolina's citizens from injuries and their associated costs.

Notes

1. Susan P. Baker, Brian O'Neill, and Ronald Karpf, *The Injury Fact Book* (Lexington, Mass.: Lexington Books, 1984).

2. State Center for Health Statistics, *Detailed Mortality Statistics, North Carolina Residents* (Raleigh: Div. of Health Services, Dept. of Human Resources, 1983, 1984, 1985); Centers for Disease Control, *Homicide Surveillance: High Risk Racial and Ethnic Groups—Blacks and Hispanics, 1970–1983* (Atlanta, 1986).

3. Calculated from Nelson S. Hartunian, Charles N. Smart, and Mark S. Thompson, "The Incidence and Economic Costs of Cancer, Motor Vehicle Injuries, Coronary Heart Disease, and Stroke: A Comparative Analysis," *American Journal of Public Health* 70 (December 1980): 1249–60.

4. For an evaluation of North Carolina's seat belt law, see B. J. Campbell, "North Carolina's Seat Belt Law: Public Safety and Public Policy," *Popular Government* 53 (Winter 1988): 27–35.

5. 15 U.S.C. § 1471 *et. seq.*

6. *See, e.g.*, N.H. Rev. Stat. Ann. § 158:28 (Supp. 1981). For data on the number of house fires attributable to kerosene heaters, see Michael Patetta and Thomas Cole, *A Descriptive Analysis of Housefire Deaths in North Carolina*, SCHS Studies no. 46 (Raleigh: Div. of Health Services, Dept. of Human Resources, 1988).

7. N.C. Gen. Stat. § 20-129(e) (1981). Hereinafter the General Statutes will be cited as G.S.

8. G.S. 20-7(a)(1) (1983) and 20-140.4(a) (1983).

9. Illinois [Ill. Rev. Stat. ch. 95½, para. 6-10, ch. 23, para. 2371]; Indiana [Ind. Code § 31-6-4-2]; Louisiana [La. Rev. Stat. Ann. § 41:6.1 (West)]; Maryland [Md. Transp. Code Ann. § 16-113.1]; Massachusetts [Mass. Gen. Laws Ann. ch. 90, § 8 (West)]; Michigan [Mich. Comp. Laws Ann. § 9.2012]; New York [N.Y. Transp. Law § 501 (McKinney)]; Pennsylvania [Pa. Cons. Stat. Ann. tit. 75, § 1503 (Purdon)]; South Carolina [S.C. Code Ann. § 56-1-180 (Law. Co-op.)]; South Dakota [S.D. Codified Laws Ann. § 32-12-12]; Wisconsin [Wis. Stat. Ann. § 343.08 (West)]; Wyoming [Wyo. Stat. § 31-7-117].

10. David F. Preusser, Allan F. Williams, Paul L. Zador, and Richard D. Blomberg, "The Effect of Curfew Laws on Motor Vehicle Crashes," *Law and Policy* 6 (1984): 115–28.

11. 1983 N.C. Sess. Laws 435.

12. See, for example, John Archea, Belinda L. Collins, and Fred J. Stahl, *Guidelines for Stair Safety*, NBS Building Science Series 120 (Washington, D.C.: Government Printing Office, 1979).

13. G.S. 14-269 (1986). See also Philip J. Cook and Karen Hawley, "North Carolina's Pistol Permit Law: An Evaluation," *Popular Government* 46 (Spring 1981): 1–6, and Carolin Bakewell, "An Update on North Carolina's Pistol Permit Law," *Popular Government* 48 (Spring 1983): 30. Several of the proposed changes in Cook's article that were not adopted in the 1982 amendments to the permit law could be implemented at the local level, such as a waiting period, a routine PIN criminal history check, and a limit on the number of permits issued to each applicant.

Acknowledgments. This work was supported by a grant from the Centers for Disease Control to the University of North Carolina Center for Health Promotion and Disease Prevention (O. Dale Williams, Ph.D., Director). The authors would like to acknowledge Patricia Z. Barry, Dr. P.H., and Jill Moore, M.P.H., for their valuable work on this project.

Robert Phay Awarded Kenan Professorship

Robert E. Phay, program director of the Institute of Government's Principals' Executive Program (PEP), has been named the William Rand Kenan, Jr. Professor of Public Law and Government at The University of North Carolina at Chapel Hill. An Institute faculty member since 1965, Phay's primary field of teaching, research, and consultation has been education law as it affects both public schools and institutions of higher education.

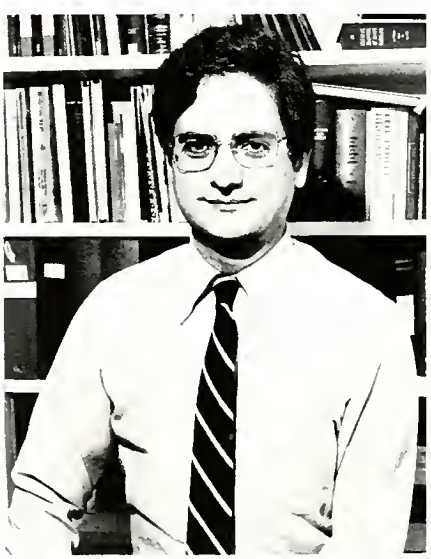
Phay has attained a national reputation in his specialty and has published widely in that field, including five books and sixteen monographs. In 1970 he founded the Institute's *School Law Bulletin*, a quarterly journal for school administrators and attorneys. In 1975 he served as president of the National Organization on Legal Problems of Education and in 1982 was the founding chairman of the North Carolina Bar Association's Education Law Committee. In recent years Phay has focused on administration of PEP, the nation's longest in-residence executive development program for school principals and superintendents. Since its inception the program has graduated more than 500 North Carolina school administrators, representing 137 of the state's 140 school districts.

"It is in recognition both for his long career in teaching school law and the work he has done on the Principals' Executive Program that he receives the Kenan professorship," notes John L. Sanders, director of the Institute.

Robert Joyce Rejoins the Institute of Government Faculty

Robert P. Joyce, who was a member of the Institute of Government faculty from 1980 to 1986, has returned to the Institute. During his absence, he practiced law in Pittsboro, North Carolina. He will work in the areas of school law (especially matters relating to personnel), higher education, community colleges, and news media-government relations.

Joyce received an undergraduate degree in journalism from The University of North Carolina at Chapel Hill, where he was a Morehead Scholar and member of Phi Beta Kappa. After attending Harvard Law School, he worked for a New York law firm before coming to the Institute in 1980.



UNC Photo Lab

Increasing Investment Earnings through Improved Cash Management

Charles Coe and Gary McConkey

Local governments should maximize investment earnings while ensuring that their principal is protected and that funds are available when needed to pay operating costs. Investment income is indeed an important source of income, amounting to $13.7 billion for the nation's local government units in 1982.[1] Investment income is also important politically, for proceeds directly reduce the amount of taxes that must be levied.

A sound investment program requires local units to adopt investment policies, to forecast the amount of cash available for investment, to invest in the most appropriate interest-bearing instruments, and to monitor the results. Governments must weigh the yield of an instrument against the risk of default and against how liquid (convertible to cash) it is.

The Local Government Commission (LGC) annually evaluates the percentage of funds being invested by local governments and the degree of diversification of their portfolios. The LGC views diversification in two ways. On the one hand, the commission does not want local units to invest too much in the riskier instruments; but on the other hand the LGC does not want them to invest too much in safe but low-yield instruments. The commission's data suggest that local units invest too much in the latter type and that they could increase their earnings safely by investing more in higher-yield instruments. This article describes the investment instruments used by local governments and suggests ways to increase investment earnings through improved portfolio diversification.

Investment Instruments Used

Local governments can invest in ten types of investment instruments. Each instrument varies with respect to its degree of risk, liquidity, and yield. Further, each instrument has particular characteristics of which cash managers should be aware. For example, instruments can differ with respect to the type of issue, maturity provisions, minimum and maximum limits, and security provisions. Table 1 summarizes some of the salient characteristics, and Table 2 illustrates how interest rates vary among the investment instruments. (See "Authorized Investment Instruments" on page 23 for descriptions of the different types of instruments that are authorized for local units: passbook savings accounts, bank certificates of deposit (CDs), negotiable order of withdrawal (NOW) accounts, money market deposit accounts, bankers' acceptances, commercial paper, repurchase agreements, Treasury and federal-agency obligations, and the North Carolina Cash Management Trust.

What to Invest In?

Given the variability of risk, yield, and liquidity, what should governments invest in? To help units decide, staff of the LGC have established five criteria, shown in Table 3, which are based on the professional judgment of the LGC staff and are suggested, but not mandatory, guidelines. The LGC advises against investing too much in passbook

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Table 1
Investment Instrument Characteristics

Instrument	Issuer	Original Maturity	Limits	Yield Basis
Negotiable CDs	Banks	30-day minimum	$100,000 minimum	B
Non-negotiable CDs	Banks, savings and loan institutions	30-day minimum	$1,000 minimum	D
Bankers' acceptances	Banks	Up to 6 months	$25,000 to $1 million	A
Commercial paper	Banks, commercial and industrial corporations	5 to 270 days	$100,000 to $5 million	A,B
Repurchase agreements	Banks, securities dealers	Overnight minimum	$100,000 minimum	E
Treasury bills	U.S. Treasury	91, 182, 270, or 360 days	$10,000 to $1 million	A
Treasury bonds	U.S. Treasury	10 to 30 years	$1,000 to $1 million	D
Treasury notes	U.S. Treasury	1 to 10 years	$1,000 to $1 million	D
Federal-agency obligations	Various agencies	30 days to 20 years	$11,000 to $25,000	A,B,C

A = Discounted; 360-day year
B = Interest-bearing; 360-day year
C = Interest-bearing; 30-day month
D = Interest-bearing; 365-day year
E = Established with each agreement

Table 2
Comparison of Interest Rates
as of October 19, 1988

Instrument	Rate (%)
Passbook savings accounts	6.05
Non-negotiable CDs[a]	
3 months	7.63
6 months	7.80
NOW accounts	6.45
Money market deposit accounts	6.85
Bankers' acceptances	
3 months	8.17
6 months	8.15
Commercial paper	
3 months	8.20
6 months	8.20
Overnight repurchase agreements	8.35
Treasury obligations	
3 months	7.61
6 months	7.93
Federal-agency obligations	
Federal Farm Credit[b]	
3 months	8.56
6 months	8.63
North Carolina Cash Management Trust	
Cash Portfolio	7.85
Term Portfolio	8.15

Source: Composite averages were provided by Telerate Systems, Inc.

[a]This is the Telerate composite average of CDs offered by twenty primary banks throughout the United States.

[b]The Federal Farm Credit Agency is an example.

savings, money market, and NOW accounts because of their relatively low yields. Conversely, the LGC recommends limits on repurchase agreements and commercial paper, which, though they have high yield, are more risky.

The LGC requires that all government units and public authorities report semiannually their investment instruments and the interest rate being received from each type. LGC staff members use this information to evaluate whether the five investment criteria are being met. The LGC then reports back to any units not meeting the guidelines.

Table 4 indicates how well governments and public authorities were doing as of December 31, 1985. For cities and counties, the smaller the unit, the more it exceeded the guidelines in passbook savings, money market, and NOW accounts. Only 5 (11 percent) of the 46 cities with a population of 10,000 or greater left more than 10 percent of their cash uninvested, but 104 (46 percent) of the 227 with 1,000 or less did not meet this criterion. Similarly, only 1 (3 percent) of those large cities had more than 10 percent in passbook savings accounts, compared to 50 (22 percent) of the small cities. Likewise, while no large towns had more than 75 percent in money market or NOW accounts, 23 (10 percent) of small towns exceeded this limit.

The fact that small towns tend to invest in lower-yield instruments is hardly surprising, considering that they generally can spend less time on cash management. Financial operations in smaller governments are typically handled by administrators doing many jobs in addition to cash management. In contrast, large cities and counties usually have a person who dedicates a large amount (sometimes all) of his or her time strictly to cash management.

Table 5 presents another way of viewing diversification. It shows the percentage of units that use the various instruments. Relatively few cities below a population of 10,000 invest in relatively higher-yield but more complicated bankers' acceptances, commercial paper, repurchase agreements, and Treasury and federal-agency obligations. Likewise, counties with a population of less than 100,000 tend to avoid bankers' acceptances, and Treasury and federal-agency obligations. But in comparison

to cities, counties of all sizes invest more in commercial paper and in repurchase agreements. Counties are less likely than cities to exceed the investment guidelines for passbook savings, money market, and NOW accounts (see Table 4). The reason for these differences is that most counties have a full-time finance director, and all have a county manager. In contrast, many very small towns have neither, leaving cash management to a clerk who typically has little background in cash management and little time to spend on it.

The commission's data further suggest that towns with a population of less than 2,500 tend to avoid the North Carolina Cash Management Trust. This is surprising, for the trust is an ideal investment vehicle for small towns having relatively small amounts to invest for short periods. The trust's yield compares quite favorably with other short-term instruments (see Table 2). No minimum amount is required, and funds can be invested for as short a period as overnight. Further, the mechanics of joining and using the trust are very simple. Governments need only complete an

Table 3
Investment Criteria of the
Local Government Commission

Criterion	Rationale
At least 90 percent of funds invested	Judgment of LGC staff
No more than 10 percent of portfolio in passbook savings	Passbook savings give the lowest investment yield of all instruments.
No more than 25 percent of portfolio in repurchase agreements	North Carolina law requires that a seller must transfer the security with a book entry via the Federal Reserve wire system. Because local units cannot keep accounts with the Federal Reserve, banks must keep the account. However, keeping accounts is very expensive, and this stipulation is not enforced. No seller has failed to honor a repurchase agreement in North Carolina history, but because the agreements are not fully collateralized, a 25 percent limit is recommended.
No more than 50 percent of portfolio in commercial paper	Local units can invest in commercial paper rated highest by Moody's Investors Service, Inc. or by Standard and Poor's Corp. Though highest rated, commercial paper is still unsecured; therefore a 50 percent limit is recommended
No more than 75 percent of portfolio in money market or NOW accounts	Money market and NOW accounts have low yields, relative to other instruments that mature after a longer period.

Table 4
Percentage of Local Government Units
Deviating from the Local Government Commission's Criteria
as of December 31, 1985

Unit	Total (#)	More Than 10% Uninvested	More Than 10% in Passbook Savings	More Than 25% in Repurchase Agreements	More Than 50% in Commercial Paper	More Than 75% in Money Market or NOW Accounts
Cities						
50,000 & above	10	10%	0%	20%	10%	0%
10,000–49,999	36	11	3	3	14	0
2,500–9,999	99	21	7	3	2	9
1,000–2,499	119	34	13	3	0	19
500–999	109	44	22	1	0	12
499 & under	118	48	22	1	0	9
Total	491	35	15	2	2	11
Counties						
100,000 & above	15	7	7	7	20	0
50,000–99,999	26	8	4	15	12	0
25,000–49,999	26	15	8	4	12	0
24,999 & under	33	21	3	9	6	12
Total	100	16	5	9	11	4
Public Authorities						
Schools	130	9	2	15	4	14
Housing authorities	99	17	9	0	0	6
Hospitals	52	19	2	0	0	6
Mental health centers	24	25	0	8	4	13
Sanitary districts	35	29	3	0	0	9
Regional airports	18	22	6	6	0	17
Regional libraries	14	21	21	0	0	0
Councils of government	18	28	0	6	0	11

Source: Figures were compiled by the Local Government Commission.

Table 5
Percentage of Local Government Units Using Investment Instruments
as of June 30, 1987

Unit	Passbook Savings Accounts	CDs	Money Mkt. and NOW Accounts	Bankers' Accepts.	Comm. Paper	Repur. Agrmts.	Treas. Obligs.	Fed. Ag'cy Obligs.	NC Cash Mgmt. Trust
Cities									
50,000 & above	34%	48%	73%	27%	44%	11%	80%	80%	100%
10,000–49,999	33	67	65	33	35	67	33	5	100
2,500–9,999	27	85	100	0	20	5	10	0	50
1,000–2,499	41	67	82	0	3	3	0	0	15
500–999	39	61	82	0	4	0	0	0	18
499 & under	43	68	68	0	0	0	0	0	11
Counties									
100,000 & above	64	93	79	50	86%	71	78	71	100
50,000–99,999	30	96	85	22	56	37	19	37	89
25,000–49,999	42	85	55	4	31	31	4	15	88
24,999 & under	31	82	73	2	9	11	2	3	36
Public Authorities									
Schools	28	52	88	0	12	23	0	0	35
Housing authorities	20	32	82	0	0	0	0	1	0
Hospitals	49	73	80	2	22	17	12	6	0
Mental health centers	12	31	54	0	4	15	0	0	31
Sanitary districts	23	37	37	0	0	3	0	0	3
Regional airports	28	44	83	0	6	11	0	6	0
Regional libraries	47	67	67	0	0	0	0	0	7
Councils of government	0	22	50	0	0	6	0	0	39

Source: Figures were compiled by the Local Government Commission

application form and send it to Sterling Capital Distributors, Inc., one of the firms that manages the trust. Deposits are made either by sending a check to Sterling Capital Distributors, Inc. or by transferring funds by wire to the trust's custodian, First Union National Bank.

Furthermore, governments in general tend to avoid some of the higher-yield instruments that would increase their investment income. For example, many governments invest more than 10 percent of their funds in passbook savings accounts (see Table 4). As Table 2 shows, the difference in yield (as of October 19, 1988) between passbook savings accounts and alternative instruments can be more than two percentage points. An increase of this size can amount to a substantial increase in earnings, depending on how much is held in passbook savings. Likewise, some governments invest too much in money market or NOW accounts, which in October, 1988, yielded 1 to 2 percentage points less than the higher-yield instruments. Again, the interest lost is significant.

Why do some governments rely too heavily on lower-yield investment instruments? Several explanations are possible:

- Some cash managers are not able to compute the interest yields of all possible investment instruments.
- Some cash managers are confused by the mechanics of investing in particular instruments.
- Some elected officials have an explicit, or more often an implicit, policy that their government's funds can only be invested in local banks.

Each of these barriers can be lessened.

Computing and Comparing Yields

To make sound decisions about what types of investment to make, a cash manager must know what the rates of return are. The yield must then be weighed against the risk of default and against how liquid the instrument is. Two problems can arise in determining rates of return. First, instruments vary with respect to how interest is calculated, making it difficult to compare the respective yields of different types of instruments. For example, bankers' acceptances and Treasury bills are purchased at a discount to their face value and are sold later at a higher price, the return being the difference between the two amounts. Moreover, some instruments pay interest based on a 360-day year, and others pay on a 365-day year.

Using a calculator, a cash manager can turn interest returns into comparable figures, but doing so is time-consuming. It is far easier to purchase a microcomputer software package or a specialized calculator that automatically calculates returns. Several of these are available at low prices. For example, one software package costs only $50.

A second problem in determining rates of return is knowing, at any time, what rates are being quoted for various instruments. Rates vary from day to day, hour to hour, and even minute to minute. To get the highest return, cash managers should have access to the latest information.

The LGC assists local units in this by issuing a weekly newsletter that summarizes the prevailing rates of thirty instruments. (Governments not receiving this service should contact the commission to find out how to be included.) For daily quotations, governments can either contact their local bank or subscribe to the *Wall Street Journal*. For the latest information on rates, Telerate Systems, Inc. of New York offers a wide range of finan-

Authorized Investment Instruments

Passbook Savings Accounts
An account with a bank or savings and loan institution that permits withdrawal at any time.

Bank Certificates of Deposit (CDs)
A deposit at a fixed interest rate. The North Carolina General Statutes [G.S. 159-30] require that deposits be made with banks having their principal offices in North Carolina. Most CDs are non-negotiable, that is, they are locked in for a fixed time period; however, negotiable CDs are also available and can be sold back to the seller before maturity.

Negotiable Order of Withdrawal (NOW) Accounts
An interest-bearing account with a slightly higher interest rate than passbook savings accounts and with check-writing privileges. Super NOW accounts provide a slightly higher interest rate but require minimum balances and proper notification before withdrawal.

Money Market Deposit Accounts
Similar to a Super NOW account, these accounts are limited to six preauthorized, automatic, or other third-party transfers per month, of which no more than three can be checks.

Bankers' Acceptances
Created from a letter of credit allowing a foreign vendor to draw a draft on an importer's United States bank for payment of merchandise sent to the United States. Bankers' acceptances can be purchased only from a bank or its holding company either (1) incorporated in North Carolina or (2) having publicly held obligations bearing the highest rating of at least one nationally recognized rating service and not bearing a rating below the highest by any nationally recognized rating service [G.S. 159-30].

Commercial Paper
An unsecured loan or promissory note issued by finance companies and large corporations, including bank holding companies. Paper must bear the highest rating of at least one nationally recognized rating service and must not bear a rating below the highest by any nationally recognized rating service [G.S. 159-30].

Repurchase Agreements
Must be bought from (1) a broker who is recognized as a primary dealer by the Federal Reserve System, (2) a commercial bank headquartered in North Carolina, (3) any trust organized to do business in the fifty states, or (4) any banking association whose deposits are insured by the Federal Deposit Insurance Corp. [G.S. 159-30]. Eligible securities include (1) direct obligations of the federal government or (2) obligations of federal agencies backed by the full faith and credit of the federal government. Market securities must be sold equal to 100 percent of the value of the repurchase agreement. Finally, securities sold must be delivered to the governmental unit or to its safekeeping agency, who must be someone other than the depository who sold the agreement.

Treasury Obligations (Treasuries)
Treasury bills, bonds, and notes, that is, securities offered by the federal government. All of these instruments can be sold before maturity in an active, secondary market.

Federal Agency Obligations (Instrumentalities or Federal Agencies)
Issued by agencies of the United States government, which does not assume liability for all of these instruments, including some of the most widely used. Nevertheless, they have the highest rating of any securities, except for Treasury bills, bonds, and notes.

North Carolina Cash Management Trust
A trust managed by Fidelity Management and Research, Co.; Sterling Capital Distributors, Inc.; and First Union National Bank. Cities can invest either for a short time in the Cash Portfolio or for a longer period in the Term Portfolio. Neither portfolio requires a minimum deposit, and funds can be withdrawn at any time.

cial information, including an up-to-the-minute listing of interest rates for every possible type of investment. If Telerate provides a terminal, the cost is $7,200 annually; however, if a government runs the Telerate system on its own microcomputer, the price drops to $2,100 per year. This service can pay for itself out of the money it saves when a unit buys investments from a bank or broker. Both Cary and Wake County have found that they can reduce the spread (the difference between what the bank or broker buys the investment for and the amount charged to the government) by as much as one thirty-second of 1 percent per $1,000,000 transaction, which amounts to $312.50. Because the government knows what the exact rate is as it asks for a quote on an investment, the bank or broker can only charge a nominal spread. Thus, if a government makes a minimum of seven transactions of $1,000,000 per year, the Telerate service will pay for itself.

One problem with using Telerate, however, is that some assistance is needed to learn how to use it. One possible source of help is a cash manager from a nearby government already using Telerate. Another way to get help is to call the staff of the LGC.

Mechanics of Investing

A second reason why some governments may not invest in higher-yield in-

struments is because they are unsure about the mechanics of investing in some or all of these vehicles. Each instrument has particular provisions of which cash managers should be aware. For example, instruments can differ with respect to the type of issuer, maturity provisions, minimum and maximum limits, and security provisions. Further, commercial paper and bankers' acceptances may be purchased only if the securities meet legal stipulations of the state of North Carolina (see "Authorized Investment Instruments").

Cash managers will find these provisions spelled out in Girard Miller's *Investing Public Funds*.[2] This book is also an excellent guide to cash management in general. For specific North Carolina provisions, readers should consult the LGC, which has written many helpful materials on cash management. A particularly useful one is *The* LCG *Cash Management and Investment Policy Guidelines*. Also very beneficial are training sessions in cash management periodically conducted by the commission, by the Institute of Government at The University of North Carolina at Chapel Hill, and by the Government Finance Officers Association.

Actually purchasing some instruments also can be confusing, especially the first time. For example, the purchase of any type except CDs requires a unit to wire transfer funds via a national bank through the Federal Reserve System. Small government units that have never used wire transfers may be somewhat intimidated by the process, but it is very easy. The local banker will assist units in making transfers. If a town has a state bank but no national bank, the state bank can handle wire transfers by using a corresponding bank.

Keeping the Money at Home

The third reason why governments may avoid higher-yield instruments is that some officials perceive investment in any of the instruments not offered by local banks as taking money out of the community. They think that the more funds a government invests with its local bank, the more loans the bank can make to local residents. This rationale might have some validity if the bank is truly local. However, many banks are not; instead, they are branches of larger regional banks. In that case, funds on deposit do not necessarily go to local areas but are pooled with funds from all of the bank's branches. Furthermore, even if a bank is truly local, government units should not invest in it indiscriminately. Rather, they should estimate the costs and benefits of a keep-the-money-at-home policy.

Local units should estimate the interest earnings being lost by investing heavily or exclusively with banks and, if they are using many CDs, should examine whether using the CDs is causing liquidity problems (because there is no secondary market for CDs and therefore they must be held to maturity). If interest losses or liquidity problems exist, these costs should be weighed against the possible benefit of investing only in a local bank.

Conclusion

To varying degrees, all but the largest cities and counties are not investing significantly in instruments other than those offered by their local banks. Yet bankers' acceptances, commercial paper, Treasury and federal-agency obligations, and the state trust offer interest rates considerably higher than all bank instruments except CDs. In some instances, governments are losing significant amounts of investment income by not having a more diversified portfolio.

The barriers to more diversification include not being able easily to compute and compare interest yields, confusion about the mechanics of investing in more complex instruments, and keep-the-money-at-home policies. None of these obstacles is insuperable. Many resources are available to help local governments develop and carry out sound investment programs that will maximize investment earnings while ensuring the protection of principal and availability of operating funds. ■

Notes

1. US Department of Commerce, Bureau of the Census, *Census of Governments, Governmental Finances* (Washington, DC: US Government Printing Office, 1983), volume 4, no. 5, Table 45.
2. Chicago Government Finance Officers Association, 1986.

Establishing Generally Accepted Accounting Principles

S. Grady Fullerton

Generally accepted accounting principles are the rules and practices that accountants must follow in presenting financial statements in order to conform to applicable laws,[1] regulations, and the standards of the accounting profession. The Governmental Accounting Standards Board (GASB) was created in 1984 to establish a set of standards for financial accounting and reporting by state and local government entities. The GASB determines what is meant by the phrase *in conformity with generally accepted accounting principles*, which comes to the attention of governing boards when they review the certified public accountant's opinion in the annual audit report.

This article both reviews the evolution of responsibility for establishing those principles and describes the current process of establishing them for state and local governments.

Historical Development

Before 1933 these principles were determined primarily from accounting textbooks, custom, and the consensus of opinion among accounting professionals. In the Security and Exchange Acts of 1933 and 1934, the Securities and Exchange Commission (SEC) was granted congressional authority to set accounting standards for all enterprises required to submit financial statements to the SEC under federal securities laws and regulations. Since then, the SEC has encouraged the accounting profession to carefully define the term *generally accepted accounting principles* and has delegated to the accounting profession the responsibility for setting accounting standards.

Primarily as a result of external pressures, in the 1930s the American Institute of Accountants [which became the American Institute of Certified Public Accountants (AICPA)] established its Committee on Accounting Procedure to cooperate with the New York Stock Exchange in creating standards for accounting procedures. That committee was responsible for narrowing the areas of differences and inconsistencies in accounting practices. The committee published fifty-one issues of *Accounting Research Bulletin* and four of *Accounting Terminology Bulletin*, which continue to be a part of current practice.

In 1959, the AICPA replaced the committee with the Accounting Principles Board (APB). Between 1959 and 1973, the APB issued thirty-one opinions and four statements: the opinions set requirements while the statements presented recommendations for improvements in financial accounting and reporting.

In the 1960s and early 1970s, the institutional arrangements by which accounting standards were being established came under fire. Critics implied that the APB was not entirely objective and complained that the regulations were being written by the individuals being regulated. The SEC informally made it known that if a satisfactory way of establishing accounting principles could not be found, it would undertake the task. Subsequently, the "Wheat" Committee was appointed (1) to study the issues and problems involved in setting accounting principles, (2) to make recommendations for improving the

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process, and (3) to make those setting the standards more responsive to the needs of those who rely on financial statements.

As the "Wheat" committee recommended, in 1973 the AICPA created three organizations:

- The Financial Accounting Standards Board (FASB), composed of seven full-time members, is responsible for establishing financial accounting standards and for directing the research program to support the standards-setting process.
- The Financial Accounting Standards Advisory Council (FASAC), composed of thirty-five members, advises the FASB and works closely with it in establishing priorities and task forces and in reviewing proposed standards.
- The Financial Accounting Foundation (FAF), composed of nine trustees who appoint members of the FASB and FASAC, raises funds to support the FASB and periodically reviews its structure.

These actions were greeted warmly by the SEC and by the business community in general. State and local governments and nonprofit organizations, however, were lukewarm in their reception of the FASB because its agenda was dominated by private sector accounting problems. Nevertheless, the FASB is now recognized as the authoritative body for promulgating generally accepted accounting principles.

Governmental Accounting

In 1934 the Municipal Finance Officers Association (MFOA), now known as the Government Finance Officers Association (GFOA), established the National Committee on Municipal Accounting (NCMA) to address accounting issues faced by municipal governments. The MFOA and NCMA issued a variety of publications that addressed governmental accounting and reporting issues as well as budgeting and auditing practices applicable to state and local governmental units. Many of these publications were codified and published in 1968 in a single document entitled *Governmental Accounting, Auditing and Financial Reporting*. This publication served as the first authoritative interpretation of generally accepted accounting principles specifically for state and local governments.

In 1974 the GFOA reconstituted the dormant National Committee on Governmental Accounting and changed its name to the National Council on Governmental Accounting (NCGA) to reflect an expanded scope. The council and its advisory board began in earnest to address the many accounting problems facing the governmental sector. The NCGA's first statement, *Governmental Accounting and Financial Reporting Principles*, was issued in 1979 and restated the principles contained in the 1968 publication. A year later the GFOA published a new edition of *Governmental Accounting, Auditing, and Financial Reporting*. While the 1980 publication was not an authoritative interpretation of these principles, it did provide guidance in applying NCGA standards to financial statements by state and local governments. The GFOA has recently published an updated 1988 edition of that publication.

The process of identifying generally accepted governmental accounting principles was significantly enhanced by the NCGA's contributions. Therefore the NCGA was restructured as a continuing body with the purpose of developing, promulgating, and interpreting accounting principles in the government sector. Its twenty-one members were drawn from a broad base of individuals interested in governmental financial reporting. The NCGA adopted formal due-process procedures similar to those employed by the FASB and, recognizing the importance of research, began in 1979 a research project to develop a conceptual framework for financial reporting by state and local governments.

The NCGA's structure, however, was weak because its members served part-time, were unpaid, and continued to work for various governmental units, accounting firms, and other institutions. The growing importance of establishing generally accepted accounting principles for units of local government demanded a full-time, paid staff and, as a bare minimum, a part-time, paid board.

Controversy

From the early 1930s until the establishment of the GASB in 1984, the MFOA (now GFOA) was the major authoritative source of accounting principles for governmental units. Indeed, the MFOA led the way in establishing certain accounting disclosure principles that now are generally accepted even in the commercial field, such as the recommendation that a statement of accounting policies be included in the Notes to the Financial Statements.

However, its counterpart in the private sector, the AICPA, long ignored the field of accounting for state and local government units and nonprofit organizations—it was not until 1974 that the AICPA issued its first publication aimed directly at those entities, *Audits of State and Local Governmental Units*. Moreover, the FASB, which in 1973 took responsibility for establishing standards of financial accounting and reporting in the private sector, limited its work to that audience. Thus the fundamental differences between accounting for commercial companies and units of local government created some problems in the application of the AICPA and FASB pronouncements to their financial statements, causing complaints.

In response to this controversy, the FAF concluded in March, 1980, that the FASB alone should establish generally accepted accounting principles for all entities, including commercial enterprises, state and local governmental units, and nonprofit organizations. However the FAF conceded that under certain conditions it was willing to accept a separate rule-making authority for state and local government units. This position was greeted with loud criticism from the governmental community.

As complaints continued, a number of organizations sought ways to resolve the conflict. In fact, at one time both the United States Senate and House of Representatives had separate committees studying the accounting profession. The FASB held hearings about its proposed responsibility for setting accounting standards for governmental and nonprofit entities, and there was considerable testimony that the FASB did not have the expertise, staff, or time to venture into this area, because it had

a very full agenda in resolving accounting problems common to the private sector.

Governmental Accounting Standards Board

In 1984, after considerable discussion and debate between the FAF and representatives of the governmental finance community, an agreement was finally reached that resulted in the FAF creating the Governmental Accounting Standards Board (GASB). Under the agreement, the GASB was to establish standards of financial accounting and reporting for state and local governmental entities, but not for nonprofit organizations. The FAF is responsible for selecting the members of the GASB and its advisory council, funding their activities, and exercising general oversight (except with regard to the GASB's resolution of technical issues). The GASB is independent of all business and professional associations. Funding is derived in part from the sale of its own publications and in part from local governments, the public accounting profession, and the financial community.

Its authority stems from three sources:

- Acceptance by governmental accountants and the financial and investment community as the appropriate standard-setting body.
- Appointment by the FAF, which has been accepted by the SEC, the accounting profession, and the public as the authoritative body to promulgate principles.
- Approval by the AICPA's council of a resolution recognizing GASB as the body designated "to establish financial accounting principles for state and local governmental entities pursuant to Ethics Rule 203" of the AICPA.

As presently constituted, the GASB has five board members, two full-time and three part-time, serving five year terms and chosen for their outstanding reputations in the accounting profession. Of the current board members, three have had distinguished careers in the field of state and local governmental accounting. The fourth was previously the controller general of the United States, whose office makes audits and investigations for Congress. The fifth member was the managing partner of one of the country's largest accounting firms. The GASB also has a staff of ten full-time professionals and, from time to time, employs consultants to work on specific projects.

The GASB is advised by the Governmental Accounting Standards Advisory Council (GASAC), which was established at the same time as the GASB. The GASAC has responsibility for consulting with the GASB on major policy questions, technical issues on the board's agenda, project priorities, matters likely to require the attention of the GASB, selection and organization of task forces, and such other matters as may be requested by the GASB or its chair. The GASAC also is responsible for helping to develop the GASB's annual budget and for aiding the FAF in raising funds for the board. At present, the GASAC has twenty-two members who broadly represent local government finance officers, independent certified public accountants, and users of financial information. It meets quarterly.

The principal purpose of the GASB is to issue statements of governmental accounting standards designed to improve financial reporting by state and local governments. It also is empowered by its rules of procedure to issue statements of concepts, standards, and interpretations. A statement of governmental accounting concepts sets forth the broad ideas that will be used by the board as a framework for evaluating existing standards and practices and for establishing future financial reporting standards. The standards series describes the criteria or rules by which one can judge what constitutes an acceptable, authoritative practice or manner of handling a major component or element of accounting theory. An interpretation provides guidance on a specific accounting problem that involves several accounting standards. The GASB staff also is permitted to issue technical bulletins, which are designed to provide timely guidance on issues of a limited scope.

In order to encourage broad public participation in the standard-setting process, the GASB has established a due-process procedure that is designed to permit timely, thorough, and open study of financial accounting and reporting issues. For major projects, this process includes the following steps: Through research, the board defines the issues and determines the scope of the project. A task force is appointed to advise the board and to aid in developing alternative solutions. The board then issues a discussion memorandum or invitation to comment that sets forth the problem, the scope of the project, and the issues involved. It also discusses relevant research and the alternative solutions identified by the board and task force. Making a special effort to deliberate the issues in meetings that are open to the public, the board holds a public hearing at which concerned individuals are encouraged to state their views. Finally, an "exposure draft" of a proposed statement is issued for public comment, and a final statement is issued upon majority vote of the board members.

Since its inception, the GASB has issued several types of pronouncements: seven statements on governmental accounting standards, one statement on concepts, two technical bulletins, one interpretation, and a number of discussion memoranda and exposure drafts. Because this process is on-going, there are several discussion memoranda and exposure drafts outstanding at any time. The GASB also has published a compilation of currently effective accounting and reporting standards for state and local governments. All of the current materials published by the GASB have been combined into one volume, *Codification of Governmental Accounting and Financial Reporting Standards as of June 15, 1987.*

Summary

The subject of generally accepted accounting principles for state and local governments has undergone considerable change in the past fifty-five years. It has moved from a position of relatively little importance in the accounting profession to one of great importance. The GFOA and NCGA have provided great leadership and service in gathering together practices that were widely recognized as being sound because they represented the best prevalent practice in the fields of governmental account-

ing, financial reporting, budgeting, and auditing. The codification of these practices provided a firm foundation for the GASB to build upon and, while much research is still under way, provides a ready reference for answering questions about generally accepted accounting principles for state and local governmental units.

The most immediate implication of these developments for local officials and administrators is that the GASB is requiring more mandated disclosures by units of local government, usually in the Notes to the Financial Statements. In the future, as the on-going process of establishing procedures continues, we are likely to see further changes. ■

Notes

1. For example, Chapter 159, Section 25(a)(1) of the North Carolina General Statutes requires the finance officer to "keep the accounts of the local government or public authority in accordance with generally accepted principles of governmental accounting and the rules and regulations of the [Local Government] Commission."

UPCOMING in PG

Organizational culture

North Carolina's small claims court

Legislative and regulatory response to AIDS

The role of the fund balance in budgeting and finance

Governmental user fees and charges

North Carolina Election-Law Violations

William A. Campbell

The people are entitled to have their elections conducted honestly and in accordance with the requirements of the law. To require less would result in a mockery of the democratic process for nominating and electing public officials.[1]

The integrity of the electoral process is essential to the effective functioning of a democratic government. To mark the importance of ensuring this integrity, the North Carolina General Assembly has surrounded campaigning and voting activities with a picket of criminal statutes. The table summarizes these criminal statutes; the remainder of the article discusses the special powers of the State Board of Elections and district attorneys to investigate election-law violations and prosecute or otherwise deal with those violations.

Criminal Statutes

In the table I have summarized the criminal provisions of Chapter 163 of the North Carolina General Statutes[2]—the election laws—under the following headings: absentee ballots; acts of election officials; campaign contributions; disruption of voting; improper influencing of voting; vote fraud; voter misbehavior; and miscellaneous. Next to each provision I have indicated the punishment for violating it. The statutory reference to the provision is given also so that the reader who wishes to see the exact language of the provision, with its qualifications and exceptions, may do so.

Investigating and Prosecuting Violations

The five-member State Board of Elections has special statutory powers to investigate alleged irregularities in the conduct of elections, including criminal violations.[3] Pursuant to these special powers and to its general power to supervise elections, the state board has adopted regulations governing the complaint and hearing process to review violations that may have occurred during elections. This process relies on the county board of elections as the first agency of review.[4] The procedure, in summary, is that any registered voter or candidate who alleges that an irregularity or violation of the laws has occurred with regard to an election may file a written complaint with the county board giving detailed information in support of the allegation.[5] As a general matter, any complaint must be filed by 6:00 P.M. of the second day after the county board has completed the canvass and declared the results of the election, which is the fourth day after the election.[6]

The county board must make a preliminary review of the complaint to determine whether it establishes "probable cause" that an irregularity or violation occurred. If the board finds no probable cause, it dismisses the complaint.[7] If it finds probable cause, it holds a hearing on the complaint and has the power to subpoena witnesses and documents.[8]

After the hearing, the board must issue a written decision, stating findings of fact and conclusions of law, and must either dismiss the complaint or issue an

The author is an Institute of Government faculty member who specializes in election law.

Election-Law Violations

Provision	Punishment	North Carolina General Statutes
Absentee Ballots		
Person other than near relative assisting absentee voter	C	163-226.3(a)(1)
Person other than elections official assisting absentee voter	C	163-226.3(a)(2)
One-stop absentee voter casting ballot outside voting booth or private room	C	163-226.3(a)(3)
Person other than near relative applying for absentee ballot or assisting voter who is in a hospital or nursing home in marking ballot	C	163-226.3(a)(4)
Person other than a near relative having in his possession an absentee ballot for delivery to a voter or return to board of elections	C	163-226.3(a)(6)
Absentee voter allowing person other than near relative or election official to assist him in marking ballot	C	163-226.3(a)(7)
Chairman of county board of elections willfully failing to comply with requirements for issuing and maintaining custody of absentee ballots	A	163-236
Making a false statement under oath in connection with absentee ballot	A	163-237(a)
Making a false statement not under oath to obtain or vote an absentee ballot	A	163-237(b)
Aiding or abetting fraud in connection with an absentee ballot	A	163-237(c)
Falsely certifying that the voter qualifies to vote absentee	C	163-275(16)
Any other violation of absentee voting statutes	A	163-237(d)
Acts of Election Officials		
Elections officers preparing books, ballots, or returns except in manner required by law	A	163-274(1)
Person serving as judge or registrar after having been removed from that position	A	163-274(2)
Person serving as a witness in an election in which he is a candidate	A	163-274(5a)
Willful or malicious failure of chairman of county board of elections to perform any duty in connection with any election	A	163-274(10)
Elections officer or board member making false or fraudulent entry or return	C	163-275(3)
Registrar or clerk making entry or copy with intent to commit fraud	C	163-275(8)
Elections officer making false return or altering any election record with intent to commit fraud	C	163-275(9)
Elections officer or board member receiving compensation from a candidate or other source, except as authorized by law	C	163-275(12)
Officer authorized to register voters knowingly and willfully registering a voter contrary to law	C	163-275(14)
Campaign Contributions		
Corporation making contribution or expenditure on behalf of any candidate or campaign committee	A	163-269
Insurance company making payment of money or property to candidate or political organization	A	163-270
Giving or accepting campaign contribution of more than $4,000 in an election	A	163-278.13
Corporation, business entity, labor union, professional association, or insurance company making campaign contribution, except through a political committee established by its officers, members, or employees	A	163-278.19
Soliciting campaign funds without disclosing name of candidate or party on whose behalf funds will be used	B	163-278.20
Failure of political treasurer to file organizational report with board of elections	A	163-278.27 and -278.7
Failure of political treasurer to keep proper accounts	A	163-278.27 and -278.8
Failure of political treasurer to file reports with board of elections	A	163-278.27 and -278.9
Failure of political treasurer to file statement of inactive candidacy	A	163-278.27 and -278.10
Failure of political treasurer's reports to include all contributions, expenditures, and loans	A	163-278.27 and -278.11
Failure of person other than candidate making expenditures of more than $100 to file report with board of elections	A	163-278.27 and -278.12
Accepting an anonymous campaign contribution	A	163-278.27 and -278.14(a)
Giving or accepting a campaign contribution of more than $100 in cash	A	163-278.27 and -278.14(b)
Receiving campaign contribution or making expenditure except through political treasurer	A	163-278.27 and -278.16(a)

Provision	Punishment	North Carolina General Statutes
Placing political advertisement in news media without identifying candidate or political committee that paid for advertisement	A	163-278.27 and -278.16(f)
Failure of news media to require written authority for advertising expenditure	A	163-278.27 and -278.17
News media charging higher than normal rate for political advertising	A	163-278.27 and -278.18
Failure of political treasurer of candidate in a municipal election to file organizational report	A	163-278.27 and -278.40A
Failure of political treasurer of candidate in partisan municipal election to file financial reports	A	163-278.27 and -278.40B
Failure of political treasurer of candidate in nonpartisan municipal election to file financial reports	A	163-278.27 and -278.40C
Failure of political treasurer of candidate in nonpartisan municipal primary to file financial reports	A	163-278.27 and -278.40D
Failure of political treasurer of candidate in nonpartisan municipal plurality election to file financial reports	A	163-278.27 and -278.40E
Making expenditure for unauthorized purpose from money obtained from North Carolina Campaign Election Fund or Presidential Election Year Candidates Fund	A	163-278.44 and -278.42
Failure to account for and report expenditures from North Carolina Campaign Election Fund or Presidential Election Year Candidates Fund	A	163-278.44 and -278.43
Disruption of Voting		
Interfering by force or violence with an election or with an elections officer in the performance of his duties	A	163-274(3)
Boisterous conduct that disturbs an elections officer in the performance of his duties	A	163-274(4)
Assaulting an elections officer while he is performing his duties	C	163-275(10)
Threatening or intimidating an elections officer while he is performing his duties	C	163-275(11)
Improper Influencing of Voting		
State or local government official threatening to dismiss or otherwise intimidating employee to influence employee's vote	A	163-271
Interfering with a voter when he is inside the voting enclosure	A	163-273(a)(3)
Interfering with a voter when he is marking his ballots	A	163-273(a)(4)
Attempting to persuade a voter, while in the voting enclosure, to disclose how he marked his ballots	A	163-273(a)(6)
Aiding a voter, while within the voting enclosure, in marking his ballots	A	163-273(a)(7)
Threatening to dismiss from employment or otherwise intimidating a person because of his vote	A	163-274(6)
Publishing statement about candidate intended to influence voters without signing the statement	A	163-274(7)
Circulating a false report about candidate, knowing it to be false	A	163-274(8)
Promising a political appointment or support for office in return for political support or influence	A	163-274(9)
Willfully and knowingly imposing a ballot on an illiterate or blind voter contrary to the voter's wishes	A	163-274(12)
Giving or accepting money or other thing of value in exchange for a vote	C	163-275(2)
Vote Fraud		
Fraudulently registering in more than one precinct, registering in a precinct where the voter is not qualified, or impersonating another voter to vote in that person's place	C	163-275(1)
Person whose right to vote has been denied because of a criminal conviction voting before suffrage has been restored	C	163-275(5)
Fraudulently registering or voting in more than one precinct or inducing another voter to do so	C	163-275(7)
Falsely making or presenting a document to qualify a person as a voter	C	163-275(13)
Voter Misbehavior		
Voter allowing his ballot to be seen by another person, except as authorized by law	A	163-273(a)(1)
Voter removing a ballot from the voting enclosure	A	163-273(a)(2)
Voter remaining in voting booth after being told his time has expired	A	163-273(a)(5)
Falsely making or signing a report of change of address within the county	A	163-274(13)
Corruptly taking the oath for voters	C	163-275(6)
Miscellaneous		
Making a false affidavit or giving false sworn testimony in connection with any voter challenge	C	163-90.3
Betting on an election	A	163-274(5)
Clerk of superior court refusing to provide certified copy of returns	A	163-274(11)
Officer authorized to register voters taking registration contrary to law	C	163-275(14)
Refusal to obey lawful command of State Board of Elections or its chairman	D	163-24
Disrupting or interrupting proceedings of the State Board of Elections	D	153-24

A = General misdemeanor punishable by imprisonment not to exceed two years, a fine, or both [14-3]

B = Special misdemeanor punishable by imprisonment not to exceed one year, a fine of $100 to $5,000, or both imprisonment and fine

C = Felony

D = Thirty days in jail on order of State Board of Elections

order to deal with the violation.[9] In its order the county board may refer the matter to the State Board of Elections or may direct that a recount be made or that the canvass be corrected and new results of the election be declared.[10] The county board's decision may be appealed to the state board,[11] and the state board may make its decision on the basis of the record of the hearing before the county board, may take additional evidence, or may hold its own hearing.[12]

Complaints regarding the conduct of precinct officials (registrars and judges) in an election are to be taken to the appropriate county board of elections.[13] However, complaints regarding members of the county board of elections are to be taken directly to the state board.[14]

In hearing appeals from county boards and in investigating violations on its own motion, the State Board of Elections operates as a quasi-judicial agency. The chairman of the board has authority to issue subpoenas to compel the attendance of witnesses and the production of books and records.[15] And the board has power to hold individuals in contempt for disobeying its orders.[16] Appeals of the state board's decisions must be taken to the Superior Court of Wake County.[17]

If the state board discovers violations, it is directed to report them to the attorney general and to the district attorney of the judicial district in which the violations occurred.[18] The board also has its own powers to deal with tainted elections. If a member of a county or municipal board of elections violates the election laws, it may remove that member from office.[19] Although not expressly stated, the state board appears to have the power to order a recount of the votes in any precinct, county, or district, such power being implied from its general supervisory authority over elections and its duty to declare the results of elections.[20] The state board may also set aside the results of a county canvass, determine the number of valid ballots cast, and order the county board to amend its returns in accordance with the board's findings.[21] And, finally, the state board may order a new election, provided that at least four members of the board vote in favor of the order. It is immaterial that the violations found by the board would not have affected enough votes to change the outcome of the election.[22]

A special duty is laid on district attorneys to investigate and prosecute all election-law violations, except those concerning campaign fund reporting and accounting, and district attorneys are given special subpoena power to compel witnesses to attend any hearings.[23] To aid district attorneys in prosecuting violations, individuals with knowledge of the violation may be compelled to testify. (Such individuals are given immunity if the testimony is self-incriminating.[24])

As a final safeguard, the law gives every registered voter certain enforcement powers. First, any registered voter may petition the superior court for an injunction to enforce compliance with the election laws.[25] Second, if either the state board or a county board has reported a violation of the election laws to a district attorney and the district attorney, after forty-five days, has not initiated a prosecution, any registered voter of the district may petition the superior court to appoint a special prosecutor to do so.[26] The county board of elections also may petition for such an appointment.[27] ■

Notes

1. Chief Justice Denny. Ponder v. Joslin, 262 N.C. 496, 500 (1964).
2. Hereinafter the General Statutes will be cited as G.S.
3. G.S. 163-22(d).
4. See generally N.C. Admin. Code tit. 8, ch. 2 (Nov. 1984).
5. N.C. Admin. Code tit. 8, r. 2.0001 (Nov. 1984).
6. N.C. Admin. Code tit. 8, r. 2.0001(e) (Nov. 1984).
7. N.C. Admin. Code tit. 8, r. 2.0002 (Nov. 1984).
8. N.C. Admin. Code tit. 8, r. 2.0004 (Nov. 1984).
9. N.C. Admin. Code tit. 8, r. 2.0005 (Nov. 1984).
10. N.C. Admin. Code tit. 8, r. 2.0005 (Nov. 1984).
11. N.C. Admin. Code tit. 8, r. 2.0006 (Nov. 1984).
12. N.C. Admin. Code tit. 8, r. 2.0007 (Nov. 1984).
13. N.C. Admin. Code tit. 8, r. 2.0200 (Nov. 1984).
14. N.C. Admin. Code tit. 8, r. 2.0100 (Nov. 1984).
15. G.S. 163-23.
16. G.S. 163-24.
17. G.S. 163-22(l).
18. G.S. 163-22(d) and -278.
19. G.S. 163-22(c).
20. G.S. 163-22(a) and (h).
21. Ponder v. Joslin, 262 N.C. 496, 138 S.E.2d 143 (1964). In this case before the suit was filed, the State Board of Elections was about to find that a majority of the votes cast in one county in a four-county senatorial primary were invalid and the finding would have changed the result of the primary election.
22. G.S. 163-22.1 and In re Judicial Review by Republican Candidates, 45 N.C. App. 556, 264 S.E.2d 338, *cert. denied*, 229 N.C. 736, 267 S.E.2d 672 (1980). In this case the violations concerned the handling of absentee ballots.
23. G.S. 163-278.
24. G.S. 163-277 for violations other than those regarding campaign contributions. G.S. 163-278.29 for violations regarding campaign contributions.
25. G.S. 163-278 and -278.28.
26. G.S. 163-278 and -278.28.
27. G.S. 163-278 and -278.28.

The Erosion in Value of Exemptions and Tax Brackets of North Carolina's Personal Income Tax

Charles D. Liner

When North Carolina's personal income tax was enacted in 1921, the state constitution required that a basic amount of each household's income be sheltered from taxation through personal exemptions. The exemption for the head of the household was set at $2,000 in 1921, and in 1923 an additional $1,000 exemption was authorized for spouses. Since then those exemptions have been increased only once, and then by only 10 percent.

Incomes have increased enormously since 1921, of course. However, much of that increase merely reflects inflation and therefore does not represent a real increase in economic well-being or in ability to pay taxes. While inflation has increased the amount of income subject to taxation, it also has eroded the value of exemptions. The result is that the personal income tax has been transformed from a tax that falls only on the well-to-do to one that falls even on families well below the poverty line. Today inflation continues to make more low-income people subject to the tax and to push both low- and moderate-income people into higher tax brackets, which have not been changed since 1937.

Let us consider a family of four living in North Carolina in 1960 whose previous year's income was $3,956. That amount was the state's median family income, meaning that half the families (and unrelated individuals) had lower incomes and half had higher incomes. In 1960 North Carolina's personal income tax rates were identical to those in effect today. But most of this family's income would have been sheltered from taxation by exemptions. One spouse would have been entitled to the head-of-household exemption ($2,000) and a total of $600 for two dependents, and the other spouse would have been entitled to an exemption of $1,000. These exemptions, totaling $3,600, equaled 91 percent of the family's income. In addition each spouse was entitled to a standard deduction of 10 percent of income or $500, whichever was less. Because spouses were required to file separate returns (as they would be today), the amount of income tax the family owed depended on how much each spouse earned. If each spouse earned the same amount, the family would have been subject only to the lowest tax-bracket rate of 3 percent and would have owed $23, which equaled 0.6 percent of its income.[1]

Now let us consider similar families that lived in North Carolina in 1970, 1980, and 1988 and whose income in the previous year also equaled the state's median family income—$7,770, $16,792, and $28,300, respectively. In 1970 the total amount of exemptions had increased to $4,200, but that figure equaled only 54 percent of the median family's income. The family owed taxes totaling $89, or 1.1 percent of its income. In 1980 the personal and dependents exemptions applicable to 1979 income remained the same as in 1970, but they equaled only 25 percent of the family's income. The family owed $469 in taxes, equal to 2.8 percent of its income. That percentage was four times greater than the percentage calculated for the median family of 1960. In 1988 the median family's total exemptions had been increased to $4,900 by changes made effective in 1980 and

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1981, but that amount equaled only 17 percent of its income, and part of the family's income was subject to the state's highest income tax rate of 7 percent. The family owed a total of $1,129, equal to 4 percent of its income. That percentage was over six times greater than the percentage of the median family of 1960.

If we adjust the incomes of these families to account for inflation, we find that the 1988 median family had a real (inflation-adjusted) income 83 percent higher than that of the median family of 1960. But its income tax liability was 4,800 percent greater than that of the 1960 family.

These calculations demonstrate how erosion in the value of exemptions and tax brackets has changed the personal income tax. In 1921 the $2,000 head-of-household exemption was sufficiently high that only the well-to-do were subject to the tax. During the 1930s, when the current rate schedule was established, a governor of North Carolina whose sole income was his salary would have been subject only to the lowest tax rate of 3 percent of net taxable income. Today, even a clerk-typist in the governor's office could be subject to the highest tax rate of 7 percent of net taxable income.

Indeed, taxpayers in North Carolina become subject to the income tax at lower income levels than in most states that have an income tax, and the tax on low-income families appears to be among the highest in the nation. A recent study found that only seven of the forty states that had a substantial income tax had a lower tax threshold (the income level at which families begin to owe tax) than North Carolina's threshold of $4,222 for one-earner families.[2] Sixteen states had thresholds above $8,000, and twelve states had thresholds above $10,000. Furthermore, the estimated income tax for a family of four with $10,000 income earned by one spouse was higher in North Carolina than in all states except Kentucky.

Importance of the Personal Income Tax

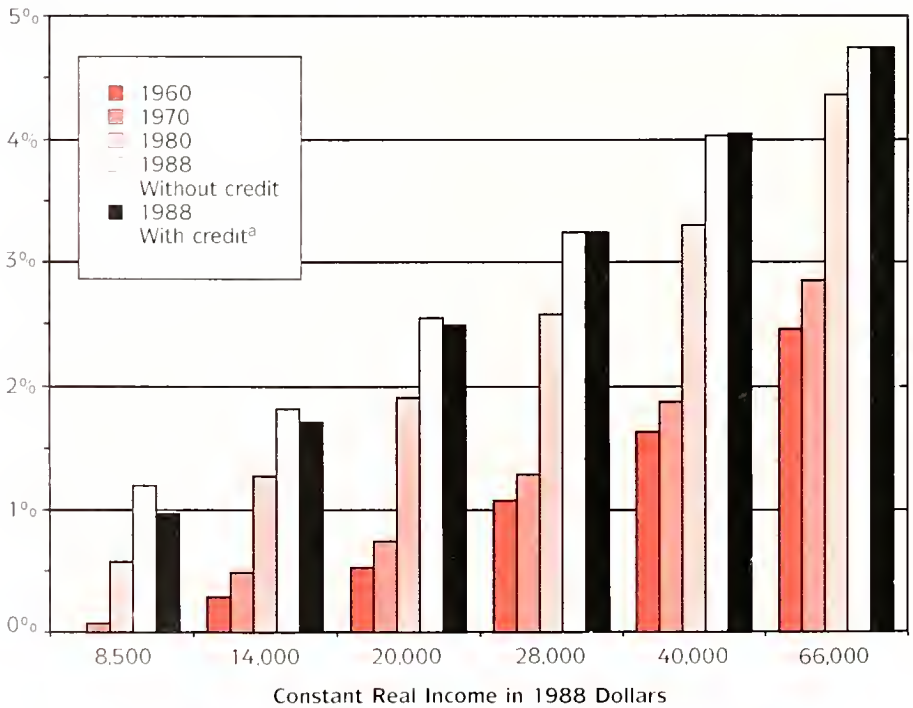
North Carolina's personal income tax is immensely important fiscally—it is by far the largest revenue source in the state and has accounted in major part for the substantial growth in state revenues during past decades. Because this revenue could be raised in other ways, however, the tax's primary importance lies in its role in achieving tax equity according to the principle that taxes used to support general government services should be imposed according to taxpayers' ability to pay. Unlike sales and property taxes, an income tax permits us to adjust the tax base according to factors, such as family size, that have a bearing on ability to pay, to shelter a minimum amount of income through personal exemptions and the standard deduction, and to impose a rate schedule graduated according to taxpayers' net income.

The personal and dependents exemptions and the graduated rate schedule together make North Carolina's income tax a progressive tax, meaning that the amount of tax owed as a percentage of income is larger for high-income taxpayers than for low-income taxpayers. As a progressive tax it offsets the disproportionate burdens imposed on low-income taxpayers by retail and selective sales taxes (such as gasoline, utility sales, and beverage taxes) and by user charges and fees. Without the income tax, the overall burden of North Carolina's state and local taxes would be regressive, meaning that low- and moderate-income taxpayers would pay a higher percentage of their income in taxes than would higher-income taxpayers. This aspect of the tax has been especially important in recent decades because of increases in the retail and selective sales taxes. Retail sales taxes in particular have been increased substantially—food sales became subject to the tax in 1961, and later, through measures adopted in 1971, 1983, and 1986, a local tax rate of 2 percent was added to the state 3 percent rate.

A Brief History of Income Tax Provisions

Although North Carolina has levied an income tax continuously since 1849, the tax was administered locally until 1921. The current state-administered tax was based on a model promoted by the National Tax Association. The 1920 constitutional amendment that authorized the tax required an exemption for each

Figure 1
Personal Income Taxes of
Representative Families As a Percentage of Income,
1960, 1970, 1980, and 1988



[a]The general credit for individuals with low and moderate incomes was calculated with the 1988 amendments in effect.

Table 1
Estimated Personal Income Tax Liability for Representative Families with Equal Real Incomes, 1960, 1970, 1980, and 1988

	Tax Liability (in Dollars and As a Percentage of Income)[a]					Percentage Change in Tax Liability			
				1988				1980–1988	
1988 Income	1960	1970	1980	Without Credit	With Credit[b]	1960–1970	1970–1980	Without Credit	With Credit[b]
$8,500	$0 (0%)	$2 (0.1%)	$35 (0.6%)	$102 (1.2%)	$82 (1.0%)	—	1,650%	191%	134%[c]
14,000	10 (0.3)	22 (0.5)	126 (1.3)	254 (1.8)	239 (1.7)	120%	573	102	90
20,000	27 (0.5)	49 (0.7)	271 (1.9)	512 (2.6)	497 (2.5)	81	453	89	83
28,000	78 (1.1)	121 (1.3)	516 (2.6)	909 (3.2)	909 (3.2)	55	326	76	76
40,000	167 (1.6)	251 (1.9)	941 (3.3)	1,615 (4.0)	1,615 (4.0)	50	275	72	72
66,000	416 (2.5)	632 (2.9)	2,055 (4.4)	3,132 (4.7)	3,132 (4.7)	52	225	52	52
				Percentage change in the Consumer Price Index		31%	112%	40%	40%

Note: Taxes were estimated for a husband, wife, and two children. Each spouse contributed half of the family's income. Deductions were estimated using data from the Bureau of Labor Statistics' consumer expenditure survey.

[a]The representative families of 1960, 1970, and 1980 had the same income, after adjusting for changes in the Consumer Price Index, as the corresponding families in 1988.

[b]The general credit for individuals with low and moderate incomes (G.S. 105-151.16). The amount of the credit depends on income, less personal exemptions, as follows: $0 to $5,000, $25; $5,001 to $10,000, $20; $10,001 to $15,000, $15. For married couples filing joint returns, eligibility is based on combined income and exemptions. Recipients of food stamps are ineligible for the credit. The credit was calculated with the 1988 amendments in effect.

[c]Assumes the family received no food stamps.

household of at least $2,000, and the head-of-household exemption was set at that amount (today's constitution requires only that personal exemptions and deductions be allowed; it does not specify amounts). In 1923 the spouse was granted a separate $1,000 exemption, which could be applied only against the spouse's income (since 1921, spouses have been required to file separate returns, though now they may do so on the same form). Those exemptions remained unchanged until 1979, when the General Assembly increased them by 10 percent, effective for the 1980 tax year. The dependents exemption, set originally at $200 in 1921, was increased to $300 in 1949, to $600 in 1968, to $700 in 1980, and to $800 in 1981.

In 1953 taxpayers were authorized to take a standard deduction of 10 percent of income rather than itemize deductions, subject to a maximum of $500. The maximum standard deduction was increased to $550 for the 1980 tax year. For married couples, the 1953 maximum standard deduction took effect when they both earned at least $5,000 and their combined income equaled $10,000, which was 2.3 times the national median family income that year. By 1985 the maximum standard deduction for such couples took effect when combined income reached $11,000, which in 1953 dollars equalled only $2,446 and was only 34 percent of the national median family income.

When the income tax was enacted in 1921, tax rates varied from 1 percent on the first $2,500 of net taxable income to 3 percent on net taxable income greater than $10,000. The current rate structure was established in 1933, except that the highest tax rate—7 percent on net taxable income greater than $10,000—was added in 1937. According to that schedule, which applies to the separate income of spouses, the tax rate is 3 percent on the first $2,000 of net taxable income, 4 percent on net taxable income of $2,001 to 4,000, 5 percent on net taxable income of $4,001 to $6,000, 6 percent on net taxable income of $6,001 to $10,000, and 7 percent on net taxable income greater than $10,000.

The 1985 General Assembly enacted a new type of income tax provision when it authorized the "general credit for individuals with low or moderate incomes."[3] The credit is available to individual taxpayers and to married couples. For married couples, the amount of the credit is based on their combined incomes and personal exemptions (they are ineligible if they file on separate forms). The credit is subtracted from the amount of taxes owed under other provisions. The credit is $25 if the taxpayer's income, less personal exemptions, is between $0 and $5,000, $20 if that amount is between $5,001 and $10,000, and $15 if it is between $10,001 and $15,000.

When the credit was enacted in 1985, eligibility was based on the separate incomes of spouses. That meant that the credit could be claimed by married couples with substantial or even very high combined incomes. For example, both spouses could qualify for a credit if each one earned $15,000, or if one spouse earned $100,000 and the other earned $10,000, the latter was entitled to the credit. Furthermore, the total amount of the credit could differ for married couples with the same income, depending on how much income the spouses contributed to family income. To limit the availability of the credit to low- and moderate-income families, the law was amended in 1988 so that eligibility of married couples is based on their combined incomes. While the amendment closed what was considered a loophole that allowed middle- and upper-income couples to benefit from the credit, it also substantially reduced the total amount of the credit for many low-income couples.

The Effects of Inflation

To analyze the effects of erosion in value of personal exemptions, the maximum standard deduction, and tax-rate

brackets, the amount of taxes that would be owed in 1988 income tax was estimated for hypothetical families of four with different levels of income. These families are called representative families because their spending patterns (on which estimates of deductions and other taxes are based) correspond to spending patterns of "consumer units" classified by income in the United States Bureau of Labor Statistics' consumer expenditure survey.[4] Estimates of income and other taxes were then made for similar families in 1960, 1970, and 1980 whose real (inflation-adjusted) incomes in those years were equal to those of the corresponding representative families of 1988. The spending patterns of families with equivalent levels of real income were assumed not to have changed between 1960 and 1988. In all cases income taxes were calculated on the assumption that the spouses contributed equally to family income.

Table 1 shows the estimated income tax owed by the representative families with the same real income in 1960, 1970, 1980, and 1988. It also shows the amount of tax owed as a percentage of family income (see also Figure 1). The table reveals several significant effects:

- Over the period 1960 to 1988, the income tax increased substantially for families at every level of real income, both in absolute amount and as a percentage of family income.
- Lower-income families had larger relative increases in income taxes than higher-income families. The lowest-income families had by far the largest percentage increases in all the periods shown.
- Because income taxes increased relatively more for lower-income families, the progressivity of the tax diminished between 1960 and 1988. This is reflected in the ratio of (a) the percentage paid in income tax by the highest-income families to (b) the percentage paid by the lowest-income families. That ratio fell from 29 to 1 in 1970, to 7.3 to 1 in 1980, and to 3.9 to 1 in 1988 (with the general credit in effect, the 1988 ratio was 4.7 to 1).

Effects of Increases in Income and Sales Tax

As mentioned above, the personal income tax is the key to achieving equity according to the principle that taxes should be imposed according to a taxpayer's ability to pay, because it compensates for regressive retail and selective sales taxes. Unlike personal income tax rates, which have not changed in half a century, retail and selective sales tax rates have been increased substantially in recent decades. Also, the base of the retail sales tax has been expanded to include food sales, and two new selective sales taxes have been enacted. Because these taxes tend to be regressive, increases in them tend to fall disproportionately on taxpayers with low and moderate incomes.

North Carolina has increased its use of the retail sales tax substantially during the past three decades. The state retail sales tax rate remains at the same 3 percent rate set in 1933. But in 1961 the exemption of food sales was repealed, which caused that tax's base to increase substantially. In the case of our 1988 representative families, for example, the taxation of food increases the taxable purchases of the lowest-income family by 54 percent, while it increases the taxable purchases of the highest-income family by 29 percent. In addition, the total retail sales tax rate has been increased by two thirds—in 1971 the General Assembly gave general authorization for local governments to levy a 1 percent local-option retail sales tax, and it increased that authorization to 2 percent in separate actions taken in 1983 and 1986. Local retail sales taxes now are levied in all counties.

Selective sales taxes also have been increased. The per-gallon gasoline tax was raised from six to seven cents in 1949, to nine cents in 1969, to twelve cents in 1981, and to fourteen cents in 1986. In 1986 a new tax of 3 percent of the wholesale price of gasoline was added to the original per-gallon tax. Tax rates on alcoholic beverage sales have been increased a number of times, and two new selective sales taxes, the cigarette and soft drink taxes, were enacted in 1969. The effective rate of taxation on utility sales has increased only slightly, but the form of that tax changed in 1985. Before then, sales of telephone service, natural gas, and electricity were taxed at a 6 percent rate under the utility franchise tax. In 1985 those sales became subject to the state's 3 percent retail sales tax, and the utili-

Figure 2
Combined Retail and Utility Sales Taxes Paid by Representative Families As a Percentage of Income, 1960, 1970, 1980, and 1988

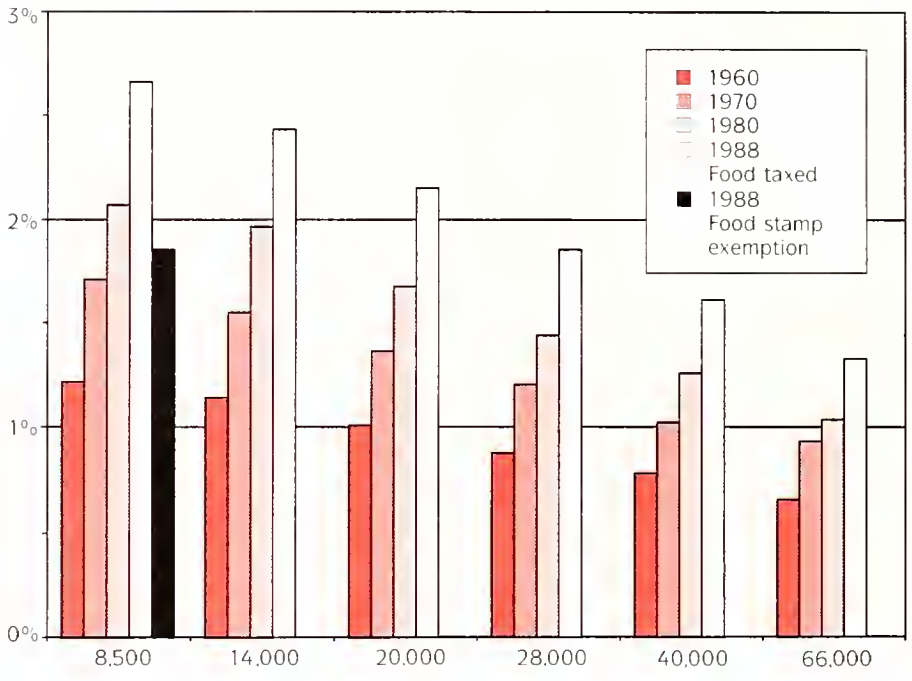
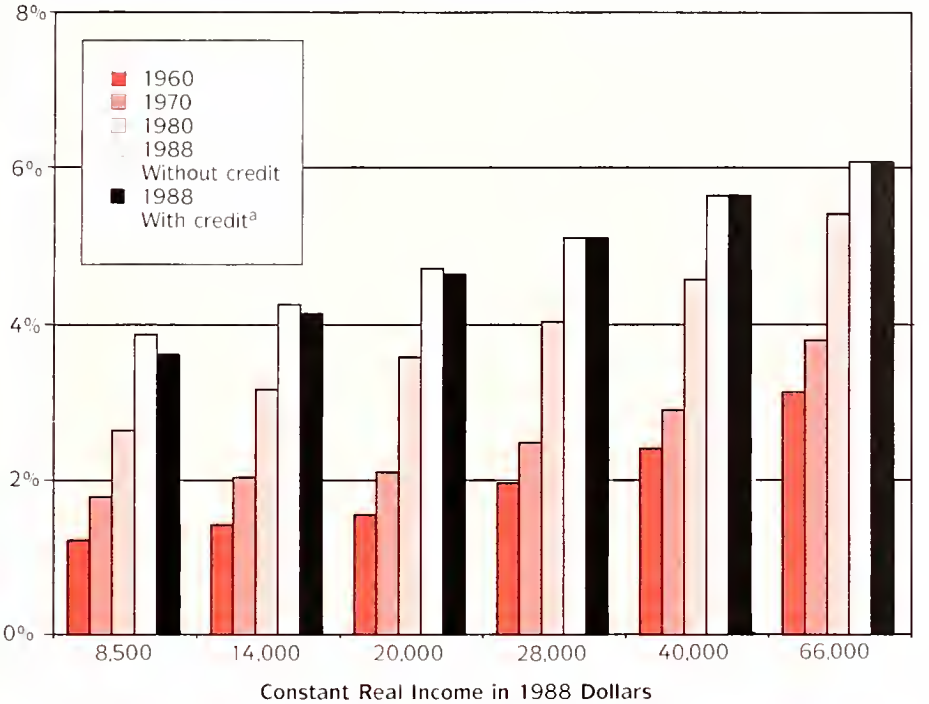


Figure 3
Combined Income, Retail Sales, and Utility Sales Taxes Paid by Representative Families As a Percentage of Income, 1960, 1970, 1980, and 1988



[a]The general credit for individuals with low and moderate incomes was calculated with the 1988 amendments in effect. The credit was not available to families that received food stamps (food purchased with food stamps is exempt from the retail sales tax).

ty franchise tax rate was reduced to 3.22 percent. Thus the combined tax rate on utility sales is 6.22 percent.

Figure 2 shows the estimated combined amounts of retail and utility sales taxes paid by the representative families in 1960, 1970, 1980, and 1988. As that figure shows, the estimated combined amount of these taxes paid by the representative families at all income levels increased substantially from 1960 to 1988.

Figure 2 also demonstrates the regressive nature of sales taxes—the lower-income families paid a higher percentage of their income in retail and utility sales taxes than did the higher-income families. In 1988, for example, retail sales taxes represented 2.3 percent of the income of the lowest-income family (assuming it did not receive food stamps) but only 1.2 percent of the income of the highest-income family.[5]

The effect of the 1985 exemption from the retail sales tax of food purchased with food stamps is illustrated by Figure 2 as well. For the lowest-income family of 1988, it shows the estimated amount of retail and utility sales taxes with and without that exemption, assuming the family had food stamps sufficient to cover its food purchased for home consumption.[6] The exemption lowered the percentage of income represented by those taxes from 2.7 to 1.9 percent of income (compared with 1.3 percent for the highest-income family).[7]

As Figure 3 shows, the combined increases in personal income taxes and retail and utility sales taxes increased substantially the amount of these taxes as a percentage of income. For example, the percentage for the lowest-income representative families increased from 1.2 percent in 1960 to 3.6 percent in 1988 (if the 1988 family was entitled to the general credit). The percentage for the highest-income families increased from 3.1 percent to 6.1 percent over this period. Thus the percentage for the lowest-income families increased by a factor of three, while the percentage for the highest-income families increased by a factor of two. That disparity would have been greater except for the two measures adopted in 1985 for the relief of lower-income families—the exemption from the retail sales tax of food purchased with food stamps and the general credit for taxpayers with low and moderate incomes. Without those two measures, the percentage of income represented by these taxes would have increased by a factor of 3.2 for the lowest-income families.

Alternative Approaches

Let us examine the alternative approaches that have been used, and could be used again, to adjust the income tax for inflation—adjustments in tax brackets, exemptions, and the maximum standard deduction and tax credits for low- and moderate-income taxpayers.

Adjusting tax brackets. As noted above, the income tax schedule has not changed since 1937, although the inflation-adjusted values of those brackets are now only a small fraction of their 1937 values. If the brackets continue to remain unchanged and the value of exemptions is not increased, eventually most taxable income would be taxed at the highest rate, the tax schedule in effect would be largely a flat-rate schedule rather than a graduated-rate schedule, and the tax would continue to become less progressive.

Some states adjust their rate brackets annually according to changes in the Consumer Price Index (this is called indexing). In 1987, seven of the thirty-three states that had graduated tax rates indexed their rate brackets annually.[8] Adjusting tax brackets for inflation eliminates so-called bracket creep, but of course it does not compensate for the erosion in value of exemptions or the maximum standard deduction (although these also can be indexed).

Adjusting personal exemptions. Personal exemptions are fundamentally important in achieving equity according to the ability-to-pay principle. By exempting a minimum level of income, they shelter from taxation the income of the poorest families. They also make the tax more consistently progressive. This is especially important in the lower range of incomes.

For example, suppose that a state's income tax consisted simply of a personal exemption of $5,000 for each individual and a flat tax rate of 5 percent of income remaining after the exemption. All taxpayers with less than $5,000 of income would pay no taxes—all of their income would be sheltered by the exemption. Above that level of income, the

tax as a percentage of income would increase because the exemption would shelter a diminishing percentage of income—the tax as a percentage of income would be 2.5 percent at $10,000, 3.75 percent at $20,000, 4.5 percent at $50,000, and 4.75 percent at $100,000.

This example illustrates two aspects of the role of personal exemptions in making an income tax progressive. First, although the allowed amount of exemptions is the same for all taxpayers, the relative value (the percentage of income they shelter) diminishes as income rises, and therefore exemptions are relatively more important to lower-income taxpayers than to higher-income taxpayers. Second, because the effect of exemptions diminishes as income increases, a graduated rate structure is needed in addition to the exemptions to achieve a higher degree of progressivity at higher income levels.

With a graduated rate schedule, an increase in value of exemptions is worth somewhat more in absolute value to high-income taxpayers than to low-income taxpayers. For example, an increase in an exemption of $1,000 could be worth as much as $70 to taxpayers subject to the highest rate but worth only $30 to those subject to the lowest rate. But the relative value of an increase in exemptions is still much greater for low-income taxpayers. This can be demonstrated using the 1988 representative families. If both the head-of-household and spousal exemptions were increased by $500, taxes owed by the lowest-income family would fall by 32 percent (one spouse would be subject to the 4 percent rate), whereas the taxes of the highest-income family would fall by only 2.2 percent.

Adjustments in exemptions for dependents. Whereas the General Assembly has increased personal exemptions only once since the early 1920s, and then only by 10 percent, it increased exemptions for dependents three times (once over a two-year period), from $200 to $800. The primary purpose of these exemptions is to adjust a taxpayer's income for family size, which of course has a bearing on a family's ability to pay—of two families whose incomes are equal, one with two children can more easily pay income tax than one with eight children. Increasing the exemptions targets tax relief to families with dependents and to those with the most dependents. Like increases in personal exemptions, increases in the value of the dependents exemption has a greater relative value for low-income taxpayers than for high-income taxpayers.

Adjustments in the standard deduction. Higher-income taxpayers are more likely than lower-income taxpayers to benefit from the deductions authorized under North Carolina's tax. For example, they are more likely to own their homes, and as homeowners they can deduct mortgage interest and property taxes. The standard deduction adjusts for this advantage, at least somewhat, and it increases the minimum level of income that is sheltered from taxation.

In North Carolina both the percentage standard deduction and the maximum standard deduction are low compared with similar provisions in other states' laws. Of the fifteen states that authorized a percentage standard deduction in 1987, only two states other than North Carolina authorized a percentage as low as 10 percent (the percentages in those twelve states ranged from 13 to 20 percent). Of the twenty-four states that had a standard deduction of a certain amount that year, none was as low as North Carolina's maximum standard deduction of $550. In eighteen of those states the standard deduction for individual taxpayers exceeded $1,000, in eleven states it exceeded $2,000, and in two states it exceeded $3,000 (comparisons of the standard deduction applicable to married couples show roughly the same degree of disparity). As already noted, the maximum standard deduction has been increased only once, by 10 percent, since it was enacted in 1953.

The general credit for individuals with low and moderate incomes. This credit, enacted in 1985, was an approach different from any the General Assembly had used before, making North Carolina one of a handful of states to use such a credit. The exact reasons for enacting the North Carolina credit are not entirely clear. In some states these credits are intended simply as relief to low-income taxpayers, while in other states they are intended to compensate for the disproportionate burden of sales taxes on low-income taxpayers. The North Carolina credit has been viewed by some as a means of compensating for the effects of sales taxes on poor families or, perhaps, for the taxation of food purchases (as suggested by the link of the credit to users of food stamps, whose purchases of food were exempted from the retail sales tax during the same session). The credit may have been intended to counterbalance a business tax reduction enacted during the same session, and the use of a credit enabled the General Assembly to give tax relief to lower-income taxpayers at a lower cost in reduced revenues than if it had used other approaches.

Whatever the reason for the General Assembly's choice of this approach, for some purposes the use of credits of this sort to provide tax relief has some advantages over other approaches. The primary advantages are that it permits tax relief to be targeted only to low-income taxpayers and that it costs much less in forgone revenue than would an increase in exemptions or a change in tax brackets that would yield the same benefit to low-income taxpayers. For individuals who qualify for the maximum $25 credit, the credit is equivalent to as much as an $833 increase in exemptions, but the cost to the state in reduced revenues is far less than if the value of all exemptions had been increased by that amount.

The use of a credit also may be advantageous because it offers flexibility in targeting tax relief to low-income taxpayers. For example, a credit could be designed so that it gradually diminishes with income until it reaches zero at a certain amount of income (see "How a Vanishing Credit Works" on page 00). A credit could also be used in conjunction with a "no-tax floor"—taxpayers whose income is below a prescribed level would owe no income taxes.[9] A credit can be used also to limit tax relief to certain kinds of taxpayers because the credit can be made contingent on whether they meet certain criteria (such as food stamp eligibility). Such credits can be designed deliberately to offset disproportionate effects of sales or property taxes on low-income taxpayers.[10]

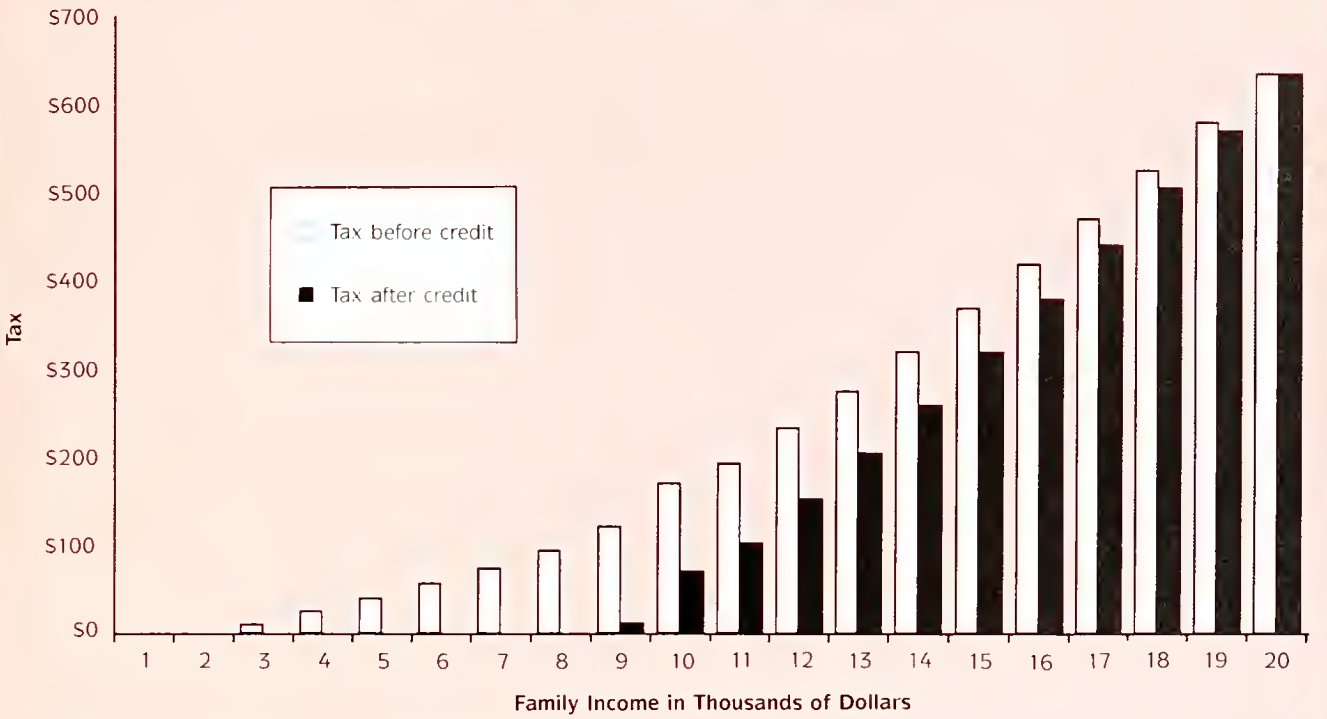
The primary disadvantage of the credit approach is that it does nothing about erosion in value of personal exemptions, the standard deduction, and

How a Vanishing Credit Works

A vanishing credit concentrates tax relief among low-income taxpayers. It eliminates income tax for those with the lowest incomes and gradually diminishes as income increases, until it "vanishes" at a certain level of income.

The figure below demonstrates how a vanishing credit would affect income tax liabilities. In this illustration the credit was set so as to vanish for taxpayers with incomes of $20,000 or more. The basis for the credit therefore was set at 1 percent of income at that level (that percentage was chosen arbitrarily for this illustration and can be varied). That is, the credit would be equal to $200 less 1 percent of income. For example, a taxpayer with $10,000 income (or a married couple with combined income of $10,000) would be entitled to a credit of $100 ($200 minus 1 percent of $10,000, or $100). If income were $15,000, the credit would be $50 ($200 minus $150), and if income were $20,000, the credit would be zero ($200 minus $200).

Effects of a Vanishing Credit
on Income Taxes of Low-Income Taxpayers



Note: Computed for a family of four with two dependents.

tax brackets, and therefore it does not correct the long-term effects of inflation on the structure of the tax, on overall tax equity, or on the general level of taxation. And the credit, like other adjustments, does nothing to reduce the burden of sales and other taxes paid by the poorest individuals and families, because they pay no income taxes and therefore do not qualify for the credit.

Conclusion

As we have seen, the General Assembly has been slow to adjust the provisions of the income tax to correct for the effects that inflation has had in increasing the effective rate of taxation and reducing the progressivity of the tax. The rate schedule has remained unchanged since 1937. The head-of-household and spousal exemptions remained unchanged for over fifty years, until they were increased by 10 percent in 1979. The dependents exemption has been increased only three times since 1921. The maximum standard deduction has been increased by only 10 percent since the standard deduction was authorized in 1953. Unlike these measures, which lowered taxes on taxpayers at all income levels, the general credit enacted in 1985 (as amended in 1988) limited tax relief only to families and individuals with low and moderate incomes who are liable for income tax.

Previous measures have halted only temporarily the long-term rise in income taxes as a percentage of income. Because of the structure of the tax, these increases have been proportionately greater for lower-income taxpayers, and over time they have continued to reduce the progressivity of the tax. Also, those measures have done nothing to offset the disproportionate effects of increases in retail and selective sales taxes on the poorest people, who are not liable for the income tax.

The same features of the income tax that are responsible for the long-term increase in taxation of families and individuals are also responsible for the phenomenal growth that has occurred in income tax revenue. Net collections increased from $92 million in 1960

to $2.7 billion in fiscal year 1987–88. Between fiscal years 1977–78 and 1987–88 annual growth in collections averaged 11.5 percent despite the recessionary period of the early 1980s. Today that average growth rate would produce additional income tax revenue of about $300 million each year.

The choices facing the General Assembly therefore involve not only how the income tax should be adjusted from time to time but also how much revenue growth the General Assembly is willing to forgo to make those adjustments. When the General Assembly delays action for many years, as it has in the past, adjustments in exemptions and tax brackets necessary to correct for the effects of inflation require substantial reductions in annual revenue growth. By using such measures as the general credit to target tax relief to low- and moderate-income taxpayers the reduction in revenue growth can be greatly lessened. But such an approach does not address the fundamental problem that inflation, by eroding the value of exemptions, the maximum standard deduction, and tax brackets, continuously increases the level of taxation of individuals and families even when their real incomes do not rise and causes a reduction in the progressivity of the income tax. ■

Notes

The estimated taxes for families in this and the following examples were calculated using the standard deduction. When deductions were estimated, the amount of tax was somewhat lower, but the increase in tax as a percentage of income was greater than when the standard deduction was used. estimated taxes as a percentage of income for the median families of 1960, 1970, 1980, and 1988 were 0.4, 1, 2.4, and 3.3 percent, respectively.

2. Steven D. Gold, *State Tax Relief for the Poor* (Denver: National Conference of State Legislatures, 1987).

3. N.C. Gen. Stat. § 105-151.1o, as amended by Chapter 1039 of the 1988 Session Laws. Recipients of food stamps are ineligible. Also ineligible are taxpayers who lived in the state for less than half the year, were inpatients in a hospital for at least half the year, were incarcerated for at least half the year, were claimed as dependents by other taxpayers, and whose gross income exceeds $30,000.

4. U.S. Department of Labor, Bureau of Labor Statistics, *Consumer Expenditure Survey, Interview Survey, 1982–83*, Bulletin 2246 (Washington, D.C.: Government Printing Office, 1986). The consumer expenditure survey is a continuous survey of American buying habits and is the basis for the Consumer Price Index.

5. Estimates of sales taxes reported in this article are lower that those found in most studies. In those studies, typically, average spending of low-income populations is used to estimate spending of poor families. That approach tends to be misleading because average total spending in low-income populations usually exceeds average income by a substantial amount. For example, in one recent study a family of four with income of $7,456 was estimated to pay 3.4 percent of its income in retail sales taxes in North Carolina. However, that estimate implied that a family with that income would spend 68 percent more than its income and that taxable purchases would be equal to 9.4 percent of its income (Citizens for Tax Justice, *Nickels and Dimes: How Sales and Excise Taxes Add Up in the 50 States* (Washington, D.C., 1988)). Estimates used here assume that low-income families did not spend beyond their incomes, and therefore their taxable spending was lower as a percentage of income (the retail sales tax base does not include all spending; spending on rent and mortgage payments, for example, are not taxable under this tax).

6. Eligibility for food stamps varies considerably according to a number of factors. For a family of four, the entitlements tend to disappear at an income level of about $14,000. Analysis of survey data suggests that the amount of food stamps received by the lowest-income family would have exceeded the amount of food it would have purchased without food stamps.

7. The amounts of other selective sales taxes were not estimated, partly because most of those taxes are relatively minor compared with income and retail sales taxes and partly because of the difficulty of making reliable estimates under the methods used here.

8. Comparisons of states' income tax provisions are from Advisory Commission on Intergovernmental Relations, *Significant Features of Fiscal Federalism*, vol. 1 (Washington, D.C., 1988), tab. 15, p. 26.

9. About five states have such floors now, and others are considering them. For example, Massachusetts has a floor of $12,000 for married couples (David Kahan, *The Next Frontier: Relieving State Tax Burdens on the Poor* (Washington, D.C.: Center on Budget and Policy Priorities, 1987), 37).

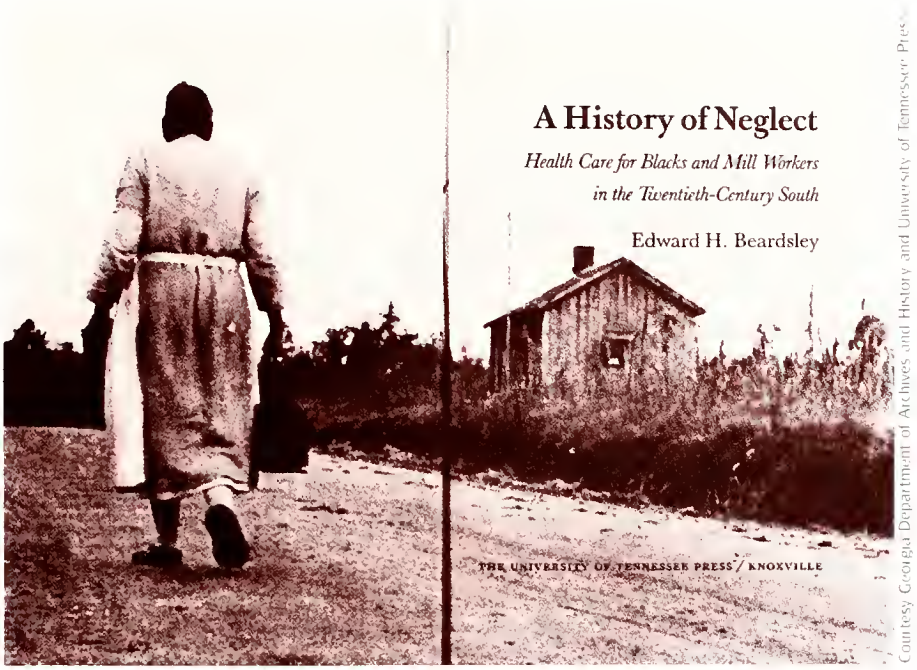
10. To be effective, such credits would have to be refundable, meaning that the state would pay individuals the amount of the credit that is not used to offset the income tax owed. This approach has been used before by some states to offset property and sales taxes on low-income or elderly taxpayers. See Charles D. Liner, "Property Tax Relief Through a Circuit-Breaker System," *Popular Government* 43 (Fall 1977): 28–31, 47.

The Past and Future of Public Health

A History of Neglect

a book review by
Anne M. Dellinger

Institute of Government



Courtesy Georgia Department of Archives and History and University of Tennessee Press

No man is so good, intelligent or wealthy as to be entrusted wholly with the welfare of his neighbor.—W. E. B. DuBois, *quoted by Edward Beardsley*

Applying DuBois' maxim to our region's recent past, Edward Beardsley asserts that southern blacks and textile workers bore the brunt of a ruling class "habit of exploitative paternalism" learned during slavery. His history focuses on Georgia and the Carolinas, sharply noting the differences in their responses to health problems as well as the fact that they had common problems. A North Carolinian is likely to read the book with regret and pride, in that order. The suffering described and pictured here is terrible, and some of it was needless. But North Carolina again and again escapes the author's harshest condemnation. Its public health efforts (both local and state) are cited repeatedly as the best in the region and occasionally as the best in the nation.

Beardsley observes that, from the last years of slavery through the Depression, southern blacks were, as a white physician put it, "'a sick people, outrageously sick, pathetically sick.'" (p. 11) Proof of it emerges from statistics on life expectancy, death and birth without medical attendance, and morbidity. Though black health status was not well documented, surveys of anemia, malnutrition, infectious disease, and birth defects among black school children and of malaria, tuberculosis, and venereal disease among adults reveal an alarming, disproportionate level of illness. Beardsley posits that as recently as the late 1930s "it is entirely possible that 35 to 40 percent of adult male blacks in the South were fairly sick, or just about to be, in any given year." (p. 22) Twenty years earlier, when the migration of blacks from farm to city raised their visibility, some medical authorities had speculated that the race would die of its ills.

Ironically, in the Depression's aftermath black prospects markedly improved. As Roosevelt's Washington bailed out southern health programs, it substituted its own priorities, among them service to blacks. Congress was generous to the South, establishing ability-to-pay eligibility criteria for the construction of hospitals and health centers, and the federal agencies charged with oversight of health programs looked the other way when state legislatures failed to match funds. The federal investment's returns included driving malaria from South Carolina's coastal lowland (black and white mortality from malaria dropped 75 and 80 percent, respectively, between 1935 and 1940); a dental program so massive that 8,000 rotten teeth were extracted in a single month; enlarging and integrating health department nursing staffs; teaching America's women to can food, thus breaking the "stone age cycle of summer abundance and winter scarcity" that caused pellagra and other forms of malnutrition; and feeding children through the Works Progress Administration's extensive and tremendously effective school lunch program.

The Second World War extended and consolidated gains for blacks. Malaria, venereal disease, and tuberculosis (all affecting blacks disproportionately) came to national attention because of their effect on draft rejection rates. Serious efforts were made to reduce the incidence of these diseases in the entire population. Draftees, in particular, had

their expectations of health care permanently raised:

> For the first time in memory millions of young Southerners of both races received medical and dental care housing, clothing, and food of first quality. Not only were they the more healthy for it but their war experience accustomed them to regard such care and living standards as a norm, which they would expect their communities to continue after the war. (p. 174)

After 1945, for the first time in United States history, the health status of middle-class blacks began to approach national norms in most categories. Beardsley credits the minimum wage with finally eliminating gross disparities between working-class southerners, black and white, and the rest of the United States industrial work force. On the other hand, the ill health of poor blacks persisted, closely tied to hunger and malnutrition. These conditions, the author charges, failed to motivate federal, state, or local health and welfare officials; worse, private interests actively opposed help. Food programs are said to have been instituted only if and when farmers benefited. Public health, which had done well with contagious disease and threats to maternal and child health, failed with chronic disease in the poor. Private medicine, operating on the assumption (mistaken, Beardsley thinks) that it would lose paying patients, is blamed most:

> Agencies failed to respond to hunger, malnutrition, and other personal health problems not just because they were looking elsewhere but also because to have done so would have offended their main constituency—private medical practitioners. To put it simply: local, state, and national health departments did not grapple with personal health problems because organized private doctors, for economic reasons, did not want them to do so and if necessary were willing to block them from trying. (p. 298)

The millworkers' story is similar but distinct from that of blacks (literally separate, in fact, because mill work was among the most rigidly segregated areas of southern life). Beardsley condemns the deliberate social blindness that left responsibility for the health care of mill workers in the hands of the mill owners:

> Dazzled by the possibility of economic revitalization through the manufacture of textiles, the South's commercial, political, and medical leaders proved more than willing to consign the welfare of mill employees to the keeping of their mill-owning employers, who for their part offered elaborate assurances about what they were doing to secure the health and well-being of the people put in their charge. The only problem was that there was little substance to owners' claims. (p. 42)

Conceding that the health of this poorest stratum of southern white society was deplorable before mills opened at the turn of the century, Beardsley insists that owners did nothing to ameliorate it. Infectious disease, congenital defects, and accidents were epidemic. In 1913 in Roanoke Rapids, North Carolina, for instance, 75 percent of the mill town's population was malarial. Mill women and children suffered and not infrequently died from pellagra, the niacin-deficiency syndrome. Even when pellagra's dietary base was revealed in 1916 and brewers' yeast was recognized as an inexpensive preventive in 1925, neither mill owners nor public health officials seem to have exerted themselves to stop the disease.

In addition to these ills, the heat, noise, and dust generated by their labor menaced the health of textile workers. Ten years in the weaving rooms, where noise levels above 100 decibels were standard, caused severe hearing loss in 40 percent of workers—and louder machinery was introduced as the century wore on. Not until the 1970s, through federal intervention, was the noise issue addressed. Dust inhalation, eventually producing byssinosis in 25 to 40 percent of workers, was the gravest threat. Beardsley's account of the repeated "discoveries" and losses of recognition of this disease in England and the United States is among the most interesting segments of the book. Rejecting "demonological characterizations of Southern textile magnates," he explains the fifty-year hiatus between the identification of byssinosis in Lancashire and in North Carolina on several grounds: British mills were known to be dustier, evidence from studies here was mixed, owners viewed recommendations as outside (that is, northern) interference, and southern physicians showed no interest in the matter. For these and other reasons, he suggests, it was 1971 before Burlington Mills' vice-president, leading the industry, stated publicly: "[B]yssinosis can be clinically diagnosed and is attributable to cotton dust." (p. 241) Efforts to lower dust levels and the search for an equitable compensation plan continue.

Beardsley's recital of both histories casts blame fully and frankly. The chapters on mill workers, for example, spare no group: mill owners, the rest of white society, physicians, public health officials, and the victims themselves share responsibility for tragic indifference in Beardsley's assessment. But he has heroes, too. Julius Rosenwald, the businessman-philanthropist, created a foundation that, along with the Duke Endowment, immeasurably improved the health of poor black southerners. The Rosenwald Fund, to name only one of its many successful projects, built 5,000 elementary schools for black children in the South between 1915 and 1935. Joseph Goldberger, the United States Public Health Service epidemiologist who identified pellagra as a distinct and serious disease, proved its dietary and economic basis, marshaled the campaigns against it, and discovered and publicized the marvelous properties of yeast as a cure. Modjeska Simkins, the South Carolina health reformer and civil rights activist, organized the efforts of the black community of that state to address health problems. Watson Smith Rankin, North Carolina's first full-time state health director from 1909 to 1925 (later director of the hospital section of the Duke Endowment), wins acclaim on numerous fronts. Beardsley writes of him, for example, "Facing black health problems squarely and making an honest effort at redress—those were the traits of Watson Smith Rankin that made him and his program unique in the South, if not in the nation." (p. 150)

North Carolina consistently scores well, as noted, when Beardsley judges comparatively. Rankin garners the major portion of credit, along with the Duke Endowment. The University of North Carolina's School of Public Health, and the State Board of Health (allegedly described by a Rockefeller Foundation officer about 1919 as the "most alert, wide-awake, efficient and progressive health department in the country"). While Beardsley notes that Georgia and South Carolina had less money for public health and (proportionately) larger black populations, he does not try to answer fully the question of why North Carolina performed better with respect to both groups studied.

Despite its accomplishments, North Carolina is faulted on some counts. For one, private physicians are said to have been among the last even in the South to accept integration of hospital patients and medical staffs and integration of the state medical society. (In contrast, North Carolina was among the first in the nation to integrate public health department staffs.) For another, as the leading textile manufacturing state, it might have done better in industrial health. The state's program started early in the 1930s, but it started on the wrong foot by ignoring the textile industry. Thirty years later the state board of health acknowledged the omission: the industry employing 85 percent of the state's manufacturing workers was receiving only 1 percent of the time expended on industrial health.

A *History of Neglect* is preeminently a history of two populations' experience with illness, but it is not exclusively that. Among the book's subtexts are the long exclusion from and eventual integration of black physicians into American medicine, the effectiveness of self-help and philanthropy in dealing with social problems, the positive side effects of the Depression and world wars, and the delicate balances required in federalism (when, that is, will federal funding prove an incentive to state and local effort, when a destroyer of incentive?). These and other issues are explored in varying depths in this well-written, sophisticated, and important analysis. ■

Edward H. Beardsley. *A History of Neglect: Health Care for Blacks and Mill Workers in the Twentieth-Century South* (Knoxville: University of Tennessee Press, 1987), 384 pages.

Institute of Medicine Releases Report on the Future of Public Health

Jeffrey S. Koeze

Institute of Government

In September the Institute of Medicine (IOM), a group chartered by the National Academy of Sciences, issued a report entitled "The Future of Public Health." The report, written by the IOM's Committee for the Study of the Future of Public Health, argues that the United States has "lost sight of its public health goals and has allowed the system of public health activities to fall into disarray." (p. xiii) The committee urges a series of reforms that it hopes will serve as a coherent guiding vision for rebuilding public health programs in America.

The committee based its conclusions on a two-year study of national demographic, epidemiological, and expenditure data; of state and federal public health agency programs and legal mandates; and of the public health systems in California, Mississippi, New Jersey, South Dakota, Washington, and West Virginia. This study revealed

> disorganization, weak and unstable leadership, a lessening of professional and expert competence in leadership positions, hostility to public health concepts and approaches, outdated statutes, inadequate financial support for public health activities and public health education, gaps in the data gathering and analysis that are essential to the public health functions of assessment and surveillance, and lack of effective links between the public and private sectors for the accomplishment of public health objectives. (p. 15)

The report argues that unless these problems are addressed systematically and permanent remedies are found, the public health system will be unable to cope adequately with current and future challenges to the nation's health. The report divides these challenges into three groups. As "immediate crises" it names AIDS and access to health care for the indigent. It labels injuries, teen pregnancy, high blood pressure, and smoking and substance abuse as "enduring public health problems." The third group, "growing challenges and impending crises," includes control of toxic substances, Alzheimer's disease and dementia of the Alzheimer's type, and rebuilding public health capacities.

It is to strategies for this last challenge, rebuilding public health capacities, that the report primarily addresses itself. The committee advocates improvement in every aspect of public health, from the training of its professionals to the structure of its agencies at every level of government. These recommendations, which are more remarkable for their breadth than for their creativity, cannot be summarized here. However, I will briefly discuss some of the committee's prescriptions directly related to government's role in public health and to issues of particular concern in North Carolina's public health community.

In general, the committee's recommendations with respect to the role of local, state, and federal governments are well in tune with today's trend toward emphasizing the role of states and local governments. The report contends that states should bear primary responsibility for the health of their residents. In addition, the committee makes a case for what might be called "bottom-up" policy making, arguing that state and federal government should encourage and pay careful attention to systematic local efforts to define and offer solutions for the health problems of individual communities.

Specifically, the report contends that the federal government must assume responsibility for supporting public health research, data gathering, and technical information exchange; for giving technical assistance to help states and local governments set their own public health objectives; for providing funds to states to achieve national objectives and to strengthen their capacity to provide services, at least at an adequate minimum level; and for ensuring the effective provision of those public services that are national in impact, such as control of communicable diseases, environmental regulation, and food and drug inspection.

States have a broader role in the committee's vision. They have the duty to assess their own health needs, based on statewide data collection; to ensure an adequate statutory base for health activities; to establish statewide health objectives, delegating power to local governments as appropriate and holding them accountable; to create an or-

ganized statewide effort to develop and maintain requisite personal, educational, and environmental health services; to guarantee a minimum set of essential health services; and to guarantee local service capacity, providing subsidies and technical assistance or taking direct action if necessary to compensate for disparities in local ability to raise revenue or administer programs.

Finally, in the committee's view local governments should assess and monitor health problems and identify local resources to deal with them; should engage in policy development and leadership that fosters local involvement, emphasizes local needs, and advocates equitable distribution of public and private public health resources; should ensure that high quality services, including personal health services, needed for the protection of the public health are available and accessible to all residents; and should educate the community about how to obtain health services and comply with public health requirements.

Several other of the committee's recommendations are of current interest in this state. Although the committee does not do so directly, it seems to endorse the continuing expansion of public health services beyond control of communicable disease and preventive health services to include the treatment of individual patients. In particular, the report charges state public health systems with seeing that each resident is able to obtain a minimum necessary level of health services. To the extent that these minimum services include clinical care for individuals, this is and has been a controversial proposal, nationally and within North Carolina. However, despite the controversy, in this state and others the public health system has become a provider of personal health services that are offered by the private sector either inadequately or at a cost out of the reach of many residents. (North Carolina, in fact, has a long history in this field. See the review of *A History of Neglect* on page 41 in this issue.)

Another of the committee's proposals is to reverse the disturbingly short median tenure of state public health officers, reported to be two years. Two years is not enough time to develop expertise in the complex problems a public health official must face. Even four years may not be enough time to formulate solutions, obtain legislative authorization and funding, and put programs in place.

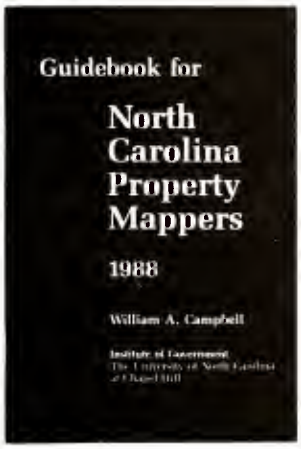
The committee attributes the rapid turnover to relatively low pay and a growing trend of hiring and firing public health officials for political reasons. North Carolina has not faced the turnover problem at the state level. State Health Director Dr. Ronald Levine has held his position under both Democratic and Republican governors, and is well-paid in comparison to other chief state health officers. Unfortunately, North Carolina does have a serious turnover problem at the local level. In the thirty-three counties that make up the North Carolina Division for Health Services' North and South Central regions, sixteen new health directors were hired in the past two and one half years, and twelve of them had no prior experience working as a public health administrator. The reasons for this turnover have not been studied formally, but many observers think that low pay and often intense political pressures are major factors.

Another timely recommendation concerns the organization of public health at the state level. The committee recommends that state public health and environmental programs related to health be combined in a single agency headed by a cabinet-level officer with both a doctoral degree in a health profession and a degree in public health. The committee does not specify which environmental programs it would combine with public health, but it says that some form of reorganization would bring proper focus and professional competence to policy questions that should be viewed first and foremost as health issues. The report recognizes that in states like North Carolina in which social service and public health programs have been combined in a single, cabinet-level human services department, such a scheme would reduce cooperation and policy coordination between them. However, in the committee's opinion that negative effect is balanced by the disassociation of public health from social programs, such as Aid to Families with Dependent Children, that the committee claims have less public support.

Finally, as part of the overall emphasis on local public health initiatives, the report encourages every local government to establish a formal body to advise elected officials on public health matters. North Carolina has such bodies in its county boards of health, but there is a perception among some board members and public health professionals that they have not served this function well enough. The three-year-old Association of North Carolina Boards of Health is actively trying to secure political and financial support for its efforts to strengthen local boards of health, and this report highlights the usefulness and urgency of those efforts.

The report is available from National Academy Press, 2101 Constitution Avenue NW, Washington, DC 20418; (202) 334-3313. ■

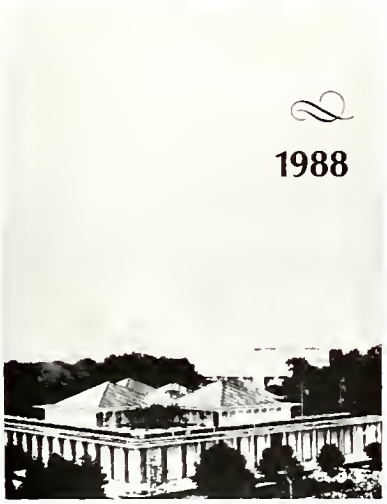
Off the Press



Guidebook for North Carolina Property Mappers

William A. Campbell

The guidebook is written for North Carolina property mappers, but it should also be useful to county assessors and city and county planners. It contains chapters on North Carolina real property law, where various kinds of land records are located and how to use them, determining land ownership for tax listing purposes and when changes can be made in the names of owners, and recording requirements for maps and plats. $7.00 [88.18]



North Carolina Legislation 1988

Edited by Joseph S. Ferrell

This comprehensive summary of the General Assembly's enactments during the 1988 legislative session is written by Institute faculty members who are experts in the respective fields affected by the new statutes. It contains articles on the legislative institution; courts; criminal law, state corrections and jails; elections; environmental protection and natural resources; health; local government; motor vehicles; planning, development, and land-use regulation; public education; public personnel; social services, juvenile, and related laws; state and local taxation; and state government. $9.00 [88.25]

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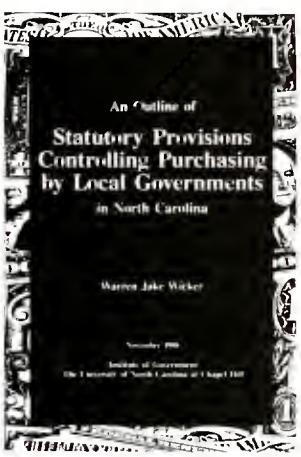

Warren Jake Wicker

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