



TO BE RATHER THAN TO SEEM Fiscal Responsibility and the Political Economy of North Carolina

North Carolina has successfully weathered dramatic changes in its economy and positive reforms to its government, and the state currently sits at or above the median in many measures of state performance. Still, North Carolina is held back by a poorly conceived insurance regulation regime and an underfunded pension system, and has several opportunities to further improve its economy.

A new study written for the Mercatus Center at George Mason University analyzes North Carolina's performance on key issues, the way in which the state government manages itself, and opportunities for improvement. North Carolina has recently implemented proactive reforms to its tax system, indicating that state lawmakers are capable of executing the other positive policy changes outlined in this study.

To read the study in its entirety and learn more about its authors, economists Stephen Miller and Zachary Gochenour, please see [“To Be Rather Than to Seem: Fiscal Responsibility and the Political Economy of North Carolina.”](#)

NORTH CAROLINA'S GOVERNMENT SERVICES AND FUNCTIONS

Pensions

North Carolina's pension costs have more than doubled as a share of the state budget over the past 30 years. The state treasurer's valuations of future fund earnings and liabilities have been overly optimistic, leading the state to underfund its pension system and endanger its future fiscal health. North Carolina should continue its moves toward privatizing retirement benefits.

- The state's main pension system is currently facing a \$34.5 billion shortfall, 10 times the amount reported in the state's own estimates.
- Privatization efforts should be expanded, phasing out pension benefits entirely.

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Health Care

Health care now commands nearly 36 percent of North Carolina's budget, a threefold increase since 1970. Medicaid costs have grown at a rate above the national average and the state's spending on inpatient hospitalization is unusually high.

- North Carolina has one of the highest shares of spending on inpatient hospital services, at 37.5 percent versus the national average of 20.3 percent.
- Privatizing more hospitals can reduce costs for the state without compromising the social benefits those hospitals serve.

Education

North Carolina has gotten a remarkably good bargain for its education dollars. The state ranks among the lowest in per-student education spending but does very well in educational outcomes.

- North Carolina ranks 45th in education spending per student, yet it ranks 15th in reading and 6th in mathematics.
- Low teacher salaries drive these savings, a feature North Carolina shares with several other states that perform well in education.
- Privatization offers opportunities for further financial improvement without affecting core education functions.

Welfare

North Carolina's welfare spending has fallen in recent years, a result of the Great Recession ending and Governor Pat McCrory's administration reforming unemployment benefits. The state's below-average unemployment figures have helped encourage this decline in spending.

Transportation

North Carolina's transportation system could be improved, and costs to the state reduced, by privatization and modernization initiatives. Such initiatives include privatizing highway management, privatizing state highways, and peak-load pricing.

Taxation

Recent tax reform has greatly improved North Carolina's business climate, increasing transparency and simplifying the tax code while increasing revenue. Income taxes have been reduced and tax brackets eliminated in favor of a flat tax, while corporate taxes were cut and some sales tax exemptions were eliminated.

MANAGING THE STATE GOVERNMENT

The Problem of Fiscal Illusion

Debt financing has enabled state politicians to offer both lower taxes and higher spending, creating a fiscal illusion that relies on increasing levels of state debt. The state's balanced budget

amendment is a “soft” constraint that does not properly rein in spending. North Carolina should look to the experiences of other states for better methods of enforcing fiscal prudence.

Colorado’s Taxpayer Bill of Rights, for example, ties spending increases to the Consumer Price Index and population growth, requiring voter approval before policymakers can temporarily override these limits.

Targeted Incentive Programs

Targeted incentive programs aim to induce investment by favorable tax treatment or subsidies, but often encourage wasteful rent-seeking. Continuing North Carolina’s progress in eliminating incentive programs will lower the cost of doing business in the state.

- Targeted incentives encourage wasteful lobbying, an activity large and influential firms are best at.
- North Carolina should eliminate targeted incentives for politically favored technology and industries, replacing them with more general tax cuts.

Insurance Regulation

North Carolina’s insurance regulation regime is complex and burdensome. The state’s handling of automotive insurance is especially problematic because it increases rates and makes it difficult for many drivers to find insurance.

- North Carolina received a “F” rating from the R-Street Institute for its overly restrictive insurance regulation regime.
- The state should pare back all regulations of insurance except those involved in the monitoring of solvency and the prevention of fraud.

State Constitution Amendment Procedure

Constitutions are living documents, but North Carolina’s amendment procedure makes it far too easy to change the state constitution. Leaving amendments to a “convention of the people,” as North Carolina does, removes the obligation for serious deliberation. This process should be reformed.

CONCLUSION

North Carolina lawmakers have recently shown an appetite for aggressive policy changes, implementing a massive tax reform package that has improved the state’s economy and fiscal health. These tax reforms, together with impressive achievements in education and welfare reduction, have placed the state on a solid fiscal footing and have produced measurable gains in performance. Still, North Carolina lawmakers have work to do, and the decisions made now regarding the policy proposals in this study will shape the state’s economic and fiscal performance for years to come.