

**State Treasurer's Economic Roundtable**  
**1:30 to 4:00 Wednesday, May 29, 2002**

**Ken Reece: President of the Triangle East Region of Bank of America**

Welcome:

Welcome, we are all aware of difficult economic times, we hope this forum will serve as a catalyst for dialogue that will provide valuable feedback to legislators and other state leaders who we all know are working tirelessly on this issue. All of us as part of a business or as citizens have a vested interest in how we deal with this budget crisis. That's why we're here and that's why BOA is sponsoring this forum. We all share a strong commitment to this state and its economic future and I particularly want to thank the members of the General Assembly that are with us today. In just your second day of session, we appreciate you taking the time to be a part of this forum.

The state of NC is fortunate to have Richard Moore as our State Treasurer. Since coming into office he has been faced with many difficult issues and has demonstrated his innovativeness and willingness to look at things in a different way. Treasurer Moore's idea of holding this roundtable today further demonstrates his leadership style as he gives us all the opportunity to be heard and provide valuable input into the difficult decisions that have to be made. Treasurer Moore, we appreciate your leadership and commitment and hope that you continue to do the wonderful job that you have been doing.

**State Treasurer Richard Moore:**

Opening Remarks:

I want to thank BOA for being a willing partner in hosting this event.

Why are we here today? Last August, I was spending a lot of time watching what was going on in other states and talking to business leaders in NC, many of them are seated here today. There seemed to be a real disconnect over what economic forecasts were saying and what common sense was telling me. Even as late as last August, early September, most people were saying that the revenues in NC were going to grow significantly. Well, I went over and I had my say. And I was politely listened to, but when I was done, the decision was made not to use a lower growth revenue figure, and it was the right decision using the information that was available to them. They made the right decision.

What today is, is an attempt to wed the two things we have to use in projecting the future. And projecting the future at this point is more important than anything the General Assembly has done in a long time. It's more important from the perspective that I have of protecting the bond rating so that NC can borrow money as cheaply as any governmental unit in America. Our reserves have been depleted, and every month it looks like your expectations are not going to be met, and so we must have a budget this session that we can, with all certainty possible in predicting the future, know that we will at least meet those target numbers. I cannot overestimate the importance of getting it right this time.

So what we're trying to do here today with our two economists is look at the signs and the way things are predicted, but then of equal importance is hearing from a cross section of NC, geographically diverse, that is out there meeting the payroll, looking at budgets, running businesses, everyday. And out of that, we're going to boil it down into a concise report and provide it to the General Assembly so that they, in conjunction with Gov. Easley, can get the kind of numbers that we're going to need for the coming year.

I'm very appreciative to have Dan Gerlach here with us today. He's the Governor's senior budget advisor. And I'm also grateful that the Governor has begun this discussion with a zero-growth budget. It's going to be a very, very important discussion that I think you all will find fascinating. It certainly did not begin today, and it will not end today, but a very important part of it will be contributed today. We have so many folks that I want to thank for being here today. We have Molly Broad with us and I want to thank her for taking time out of her schedule to be here. These are difficult times for everybody and she shows a lot of her concern by being here today to listen to this discussion.

We're going to go ahead and get started today with Ray Owens. \*His introduction follows.

**Ray Owens: Chief Economist, Federal Reserve Bank of Richmond**

Economic Outlook Presentation:

Today I want to focus on two areas, credit burden held by US households and monetary policy. The reason for this focus is two-fold. First, we've just come through a very mild recession, indeed by post war standards, the mildest recession on record. The official end of the recession hasn't yet been called, but I think there is broad agreement among economists and business analysts and those in financial markets that indeed we have emerged from the recession. If we go back and look at quarterly GDP growth, we see that these bars represent the annual rates of GDP growth per quarter for the last several years. Basically the mid-90s forward, we see that, save the third quarter of last year when the economy contracted at a 1.3% rate, there never was a second quarter of negative economic growth. If we look at the fourth quarter of last year, and especially the first quarter of 2002, we see fairly pronounced rates of economic growth underway.

I want to use this chart to talk about the mid-90s. During the mid-90s, we were in an unprecedented period where economic growth was expanding at an extraordinary rate. Typically we only saw rates of growth that quick in the brief periods when we emerged from a recession when there was demand in the economy and that was being caught up. Clearly in the late 1990s, we were several years into a business expansion in both the strength of the economy in terms of growth, as well as the duration of that growth, were almost unprecedented events.

During that period, the economy was often growing at four and five percent rates. To put it into context, normally during the strongest period of a business cycle we see that the economy is growing at about 2.5%. So we were running at about double the rate during the late 1990s.

Why? Well, the fundamental reason has to do with productivity in the economy. Now, productivity is in its simplest sense, what we produce every hour that we work. In the post Civil War period, basically the past 140 years, we have measures of productivity in the US economy and those have averaged about 1.25 to 1.5 %. There were only two significant deviations during that time. Productivity dipped well below that trend during the Great Depression, and rose significantly above it during WWII. Outside of those two times, productivity had pretty much been on trend, 1.25 or 1.5, since the Civil War.

So as economists, we began to treat productivity as sort of a natural law. There was a natural rate of growth in productivity in the US economy. We have natural laws in economics when we just can't figure out what makes something work, and that's what we have done with productivity. During the late 1990s, productivity was bouncing around, but it was running about double that normal rate. Lots of productivity is a good thing. Basically, productivity growth in the long run determines your standard of living and how fast it rises. When your productivity doubles for example, instead of your standard of living rising or doubling once every 70 years, it brings that back to about 30 years. So it dramatically increases how well off a society is. But in the shorter term, we also know productivity has a lot of impacts on the real economy as we call it.

When productivity growth is high, real wages, that is how much you can buy, is also high. This surge in the 90s was not anticipated by households. That is, they hadn't foreseen this, so when they found their productivity rising, they expected their real income to rise, their job prospects to be brighter going forward. And what happens in your household when you get a raise that's unexpected, you typically spend the money. And that's what households did in the 90s.

With this surge in productivity and the expectations of higher incomes, people began to spend. That's what they should do, that's what makes the US economy work. But there was a problem in the 90s. This chart shows the rates of growth both of real personal consumption expenditures and real disposable personal income. Over the long haul, you can spend as much as you produce. That is a law in economics. The early part of this period, with some small deviations, income growth was matching consumption growth. But then, as we get into the mid 90s, the two lines diverge. Consumption begins to grow at a very rapid rate and plateaus at a 5% or more rate. Income, despite high productivity, is not keeping up. This was an emerging imbalance, to cite the terminology Chairman Greenspan used during his speeches in this era. We knew that those two lines would have to come together again at some point in the future. Our concern was that instead of gradually converging together, a term consistent with a so-called soft landing, that they might, with a trigger event, crash together violently, causing repercussions throughout the economy. That would be referred to as a train wreck. We didn't want to see the latter; we didn't want to see the train wreck scenario. Of course we wanted to see the soft landing scenario.

Understanding that these two lines would have to come back together, the Fed began to engineer higher interest rates, as you'll see in the next slide. That then, had some repercussions. Indeed, consumption did slow down, income rose a little bit and the lines

converged. But businesses were not prepared for the slow down in consumption. This chart shows the inventory to sales ratio in the US economy, both for retailers and manufacturers. In the last slide, we saw that consumption was growing very rapidly, incomes weren't keeping up, then the two lines had to come back together. Part of that adjustment process was the rate of consumption growth lessened. We're still growing in our consumption, but at a slower rate. When that deceleration in the growth of consumption happened, it wasn't foreseen by businesses. We saw the inventory sales ratio being rather well behaved, and at that point, we saw it hop up so that little upward shift in the top green dotted line. All the sudden, storeowners found that their shelves were full. They weren't emptying them as they had anticipated. Once that happened, they stopped calling manufacturers to order more goods from them.

During this period, as I've said, the Fed was active in monetary policy. We had become accustomed to thinking of monetary policy as a policy whose sole purpose was keeping inflation at bay. Certainly during the 1970s, when we saw inflation rising at double-digit rates, we understood the devastation in the economy that could be caused by inflation. During the 80s and 90s, the Fed was always keeping its eye on inflation and quite visibly doing so. But during this period of really rapid growth, this surge of consumption, in the late 90s, you'll note that for the most part, the Fed was holding interest rates steady. Basically, the Fed was letting the economy run. Why? Well, the Fed understood that it was high productivity that was driving the events in the economy. And indeed, toward the end of that period of steady monetary policy, we see the Fed actually drop interest rates a little bit. That was in response to a shock, an international shock. When the Thai (bought?) other Asian currencies suddenly collapsed, and there was a great deal of uncertainty in world financial markets. So that little blip down, the Fed knew was very risky, but it was insurance the Fed had to engineer due to the unsettled state of world financial markets from June of 97 to August of 98 when conditions really got jittery. The Fed knew that was a bit of a risk, but it was a risk the Fed had to take.

Nonetheless, economic growth, which had been very rapid, picked up even more. That gap between consumption growth and income growth widened. The Fed then began a series of higher rate hikes in an effort to slow the economy to converge those two lines. Then as we all know, the economy turned, the Fed then had to start fighting a different kind of battle. It had to stimulate the economy to lessen the effects of the downturn to moderate the magnitude of the recession in early 2001, January 3 to be precise.

That's basically where we are now. The Fed took the Fed funds rate from 6.5 % when signs of recession began to emerge down to the current level of 1.75. So that's the history behind this.

What was really going on with monetary policy during this period? It was a shift; there was no inflation to speak of over this whole period. The lesson learned by the Fed and the lesson we're still acting on is that monetary policy has a number of effects on the economy. That is that you don't want to pump out too much money, you don't want to create inflation. That part we already knew. The new thing that we learned in the 90s is that the Fed also controls the real rate of interest in the economy. This so-called real rate

of interest determines the pattern of how people consume. Whether they consume today or in the future. So it balances income and consumption patterns. It also balances investment and the magnitude of investment.

What the Fed learned in the 90s was that when there's high productivity, when there's a new economy underway, it doesn't have immediate inflationary consequences, it also doesn't mean that the Fed can step back and let the economy run as they were doing for most of the 90s. It turns out that if you do that, if you have interest rates pegged too low, it encourages over consumption on the part of households and over investment on the part of businesses, and we learned that neither of those two actions are sustainable in and of themselves. We learned that when productivity goes up, interest rates have to follow to regulate consumption, investment and income growth over time. Learning that lesson, they engineered higher interest rates toward the end of the decade to bring these imbalances back in line. Ultimately we ended up with a mild recession, perhaps not solely due to monetary policy actions. To go back to the first chart for example, we saw that there was only one quarter of negative economic growth, the third quarter of 2001. And even there, before the events of September 11, the economy appeared to be on its way up. It's an open question as to whether we would have gotten negative economic growth in the third quarter of last year without the terrorist attacks of September 11.

The Fed funds rate at the moment stands at 1.75%. We've tried to stimulate the economy a great deal to stem the effects of the recession. If we adjust the Fed funds rate for inflation, we see that the "real" Fed funds rate is very stimulative indeed. Just barely above zero, less than 1%. It's widely believed that with this much of a stimulative monetary policy, eventually the economy will pick up and when it does, productivity will rise and the Fed will have to raise interest rates, as I made the point a bit earlier. And certainly that's what is expected.

This is a chart of the expectations in a market called the Fed funds futures market. With the instrument we use to conduct monetary policy is a very short-term interest rate called the Federal funds rate. In the late 80s, traders started to trade futures loans contracts, that is loans to be conducted in the future. The unique feature of these loans is that they were priced at the Fed fund interest rate. We effectively control that interest rate at the Fed in our conduct with monetary policy. So what these traders are betting on is where the Fed will have that rate pegged in future months. We can do a little bit of arithmetic and we can dissect these contracts, and we can pull out their expectations of this Fed funds interest rate at points of time in the future. And we usually do that around (FOMC dates?) when the Fed would need to be conducting monetary policy. By doing so, we can pull out the market's expectation of what the Fed is going to do.

So going forward with the economy picking up, with some solid signs of growth out there, what is being expected in terms of monetary policy? Well, if we go back to April, we see that there was a lot of optimism that the economy was going to surge ahead, and the Fed would correspondingly hike interest rates fairly sharply. Since that time though, especially with the troubles in the Middle East, with the kinds of risks that are facing our economy both domestically and internationally, traders have scaled back those

expectations and currently they look to the Fed to only push up rates by one quarter of one percent, 25 basis points through September. If we were to push this chart farther out, we currently only have about a hundred basis points embedded over the next year or more. Meaning that the real Fed funds rate currently is less than one percent, they're still looking for it to be 2% or perhaps a tad less even in a year out. An important factor gauging what the Fed will do going forward is obviously the economy and how strong it is, but I began this talk by saying that traditionally monetary policy has focused on inflation and the Fed is not taking its eye off of inflation. Here too we have much better measures of expected inflation going forward than we did some years ago. Financial instruments developed in the 90s allowed us to get market driven expectations of inflation, and that's what this chart shows. What traders expect the inflation rate to be over the next ten years. When we look at this, we see that it's a little bit noisy and they changed their minds a little bit. But basically inflation is still well contained in their minds going out for the next decade. They're pegging it currently at about 1.5%, perhaps a tad more. So we're looking at room to lead monetary policy in a stimulative position for longer than the Fed would traditionally leave it there. We have that room because inflation is out of the picture for the moment and we have an economy that is strengthening, but one that both world events and domestic developments appears to be expecting that strength to be less pronounced than a month or so ago.

When we look at the long-term financial markets and long-term interest rates, we also see a similar pattern. This shows long-term government securities, corporate securities and a whole host of long-term interest rates. There too as with the expectations of the Fed funds futures market, and that expectations of the gap between the ten-year treasury and the treasury inflation protected security tips, we see a steady as she goes path. Further suggesting that on the natural side, on the interest rate side, we're looking at a stimulative environment for the economy going forward.

That doesn't mean that there aren't risks out there. Certainly, we're aware of the international risks, and we're aware of the domestic risks as well, and one I'd like to focus on today is that of debt being carried by US households. US households carry the economy through the recession. In fact, consumption by households, which represents 2/3 of all consumption actually grew throughout the recession and grew at a pretty solid pace. That hasn't happened before in recent decades. That is very unusual. Households continue to expand their spending through the recession, every month. Very unusual. Going forward then, we might reasonably expect that households be shouldering the burden of driving economic growth forward, and I think we would all agree that that's going to be the case.

What might constrain household spending? If there's a constrain on household spending, it could have big ramifications on the economy overall. It could lead to much weaker growth than analysts had generally expected. It could even lead to the extreme, a double dip, the US economy slipping back into recession. The primary risk, as thought by some analysts, is the amount of debt they're carrying. It's often pointed out that household debt in the US is at a record high. It's often pointed out that debt in US households is growing faster than incomes. It's often pointed out that debt in the US didn't decline

during the recession. Typically US households shed debt around recessions. This time, debt actually went up, leaving some to speculate that households have taken on so much debt that they can't dig their way out, that they're beyond the point of no return. Those facts appear to be borne out somewhat by this chart. This shows two things over about the last 30 years or more. It shows real personal consumption expenditures, and it shows real consumer debt. Overtime, a couple of things are obvious. First, debt is always rising and during every business cycle or expansion, households take on a lot more debt. Debt rises to record levels. Why? Because debt is supporting consumption and it's also rising to higher and higher levels through every business expansion. Also, we see that debt is typically shed around recessions because consumers back away from purchases of durable goods, but then as they go back in and pick up those new cars and those new homes, as the expansion gets underway, we see a surge in debt. It's not a problem; it's typically the pattern in consumption spending in a business cycle, so it's quite normal.

Over the current period it is true that households didn't shed debt, but it's not that they were unable to do so, they may well have been able to do so, but they didn't slow down their consumption either. So the fact that they didn't slow down debt means that the debt-consumption relationship is pretty much on track. It's not signaling that there's a big problem out there. It's not suggesting that household spending is going to be constrained going forward. And lastly, it doesn't suggest that we need to pull back our projections of economic growth from the constraint on household spending.

Lastly, there are lots of different ways we can look at debt. Another way to look at it is the burden of carrying debt. To do that, we simply look at what proportion of a household's budget do they devote to carrying debt. We know that of late, households may take on more debt, but interest rates have come down, so the burden of carrying that higher level of debt is somewhat offset by the lower level of interest rates. When we do that, we see that the burden of carrying debt has gone up quite a bit. Consumer debt has risen quite a bit off the trough of a few years ago. And I might point out that if we look at this in a longer-term historic context, the burden of consumer debt is no greater than its historic point. So there's not an unusual burden being placed on households despite the high levels of debt. Even a little more positive is looking at mortgage debt. Here mortgage debt burdens really haven't gone up. Housing prices have, but mortgage rates remain quite low.

In conclusion, we're looking at monetary policy that is in something of a new era compared to what we thought in the mid-90s. We still keep our eye on inflation, but we now know that monetary policy plays a key role in balancing consumption and income growth in the economy. The lesson we learned last decade. Further, we know that as we go forward, productivity, which was quite high in the 90s, is expected to remain well above trend in the years going forward. And we know that as monetary policy makers, we need to keep our eye on that. As we see surges in productivity, real interest rates need to move up correspondingly to keep consumption and income growth balanced to avoid an unwinding situation like we found ourselves in in the late 90s.

Lastly, let me say that the big fear out there domestically is consumer debt. That fear seems to be justified by the data. But in the final analysis, when you put the debt numbers into context, at this point, it looks like those fears are a little bit overblown. We certainly hope that it stays overblown and doesn't mushroom, but at this point, there are no signs of that happening. So the outlook for the economy going forward remains relatively a positive one. With that, thank you very much.

**Richard Moore:**

I think we can take a minute to see if anyone has any questions. That's a very interesting perspective. You've put this in great context for the rest of our discussion today. Any questions? All right, thank you very much then. Ray has put a lot of the charts that I see in my daily duties into context.

We're very excited about having Dr. Lynn Reaser here with us to start way out and narrow in on what we can expect in North Carolina. \*Her introduction follows.

**Dr. Lynn Reaser: Chief Economist for Banc of America Capital Management**

Economic Outlook Presentation:

Thank you very much and it's an honor to be here this afternoon. I will try to put a little bit of humility in my comments, I should tell you that my associates at the bank continually remind me that economics is the only profession that makes astrology look a spectacle. This afternoon I thought I might share with you the big picture of the economy focused basically on four dimensions. First, the US economy, is the recession truly over and what kind of recovery are we likely to see? Second, the international story, what kinds of risks do we see for the rest of the world? Third, financial markets, how do we see the outlook for interest rates and will the stock market finally come out of this bear market? Fourth, what does this all mean for the State of North Carolina's economy as we move into the budget process?

Looking first at the US economy, looking at this first chart, you can see that the recession has been in some sense as Mr. Owens suggested fairly mild by (?something?) standards, but as you look at the story of NC with the worst budget situation we've seen since the 1930s, you look at the stock market, you look at manufacturing, in any sense this has been also a very severe downturn. Industrial production on a steady downward slide actually beginning well before the national recession was declared officially begun, and NC also peaked about the same time. The good news is that perhaps the good times don't really seem to be here, we look at many of the national economic indicators, there are signs that we've at least started to turn the corner and that some kind of recovery is in the making. In terms of the forces that have brought about the recovery, and those forces that we believe will keep this recovery going forward: we saw 11 interest rate cuts last year, we've seen tax cuts continue to filter into the economy, plus the accelerated depreciation that was enacted this year. We have the effect of continued increases in home prices, which have sustained the housing market. We've seen the effect of increases in federal spending, both defense and non-defense. In addition, we have seen the effect of inventory liquidation. We went through a very large build up, now that inventory has been liquidated and we're starting to show a little bit of signs of re-building. And finally,

after the shock of 9/11, we're seeing that travel and tourism is beginning to return to at least a more normal story. As we look at consumer confidence, consumers are a key part of this because they are 2/3 of our economy and you can see that consumers have shown a significant increase in confidence levels by both the University of Michigan and the (Karmet's board?) numbers that were released yesterday. It appears that confidence is pretty much back to where it was a year ago. On the business side though, there does appear to be quite a bit more reticence. As we hear from all of you, and as we talk to our clients at the bank, especially on the technology side, we haven't seen companies really unleash their budgets on technology spending. The worst is over in terms of an overall technology reduction.

In terms of where we go from here, this chart shows you the course of gross domestic product, as Mr. Owens showed you, the performance through the first quarter that was an extraordinary gain. This current quarter will be about half the growth of last quarter. I know the state is using the assumption of zero growth, which I think is very appropriate given the risk in the economy. We think this growth will not die, that it will show rates around 3 or 3.5 % over the next few quarters. It will not be the kind of recovery we've seen in the past, for three reasons. One, there's not a lot of consumer pent up demand because consumers kept on spending right through this recession. Second businesses are probably still cautious. Third, the rest of the world is following us rather than leading us out of the overall downturn.

In terms of what could go wrong with the outlook, I think there are three primary risks. First, the threat of war around the world, first the Middle East, now India and Pakistan. Second, the risk of terrorism remains very much in all of our lives. Third is the home grown risk, and I think that's what we'll probably hear from all of you is that businesses are still a little bit cautious of inquiring increasing capital spending, unless we see a much more optimistic view on the part of businesses, this recovery will have a little more difficulty going forward.

Oil markets have often been a problem in the past, while prices today are about \$25 a barrel; we have that risk premium because of our concern about the Middle East. We think oil prices will stabilize at their current level through the end of the year although significant risks remain from the Middle East. Overall in terms of inflation, last year we had the big drop in oil prices, which held inflation down. Again a lot of different cross currents in this economy. A lot of people worried about deflation. Pricing power in terms of basic commodities, but if your paying insurance or health care costs or education you worry about rising prices. Overall the inflation rate we believe is pretty much going to be 2 to 2.5% for the general economy as we move through the balance of the year.

Turning to the second issue, the global outlook, last year you can see the trend of the global economy in terms of GDP and we had growth about 1%. Anytime you're talking about 1% global growth, you are talking about a global recession. Indeed the US has acted as a huge locomotive, we had pretty much driven a lot of the world during the 90s, we pretty much pulled everybody down in recession last year, but the good news is that we are acting as a very powerful force, pulling most of the countries out of the downturn.

You can see that in Asia, outside of Japan, there is pretty strong recovery going on in China, Taiwan, South Korea, Malaysia, Singapore. Japan was starting to see some signs of activity although we're still concerned about the problem of bad debt in their banking system which is about twice what it was in this country at the height of our problems in the early 1990s. Europe we believe is about 3 to 4 months behind the US in the recovery process. Latin America should see a considerable pull from the US. Argentina on the other hand is in the midst of a very serious crisis as they face potentially much higher inflation rates with their currency dropping dramatically as they struggle to meet their overall financing pressures and struggle to reach an agreement with International Monetary Fund. There certainly are some big risks internationally, but generally, the economic recovery seems to be taking place around the world.

What's going on with the dollar? Here you can see the trend this year, which has pretty much been due south in terms of many currencies. The dollar is losing steam against the Euro, the Yen, but still if you compare it to where we were at the beginning of 2001, the dollar is still higher than what it was at that point, and generally I think the dollar will remain a major reserve currency. The good news though with some weakening of the dollar will actually give a lot of folks here in NC a better chance to be more competitive on the exports side and maybe have a little less competition in terms of imports.

The third topic, how do we see interest rates and the stock market. Following the comment of Mr. Owens, we are at a 40-year low in terms of the target federal funds rate. Our view is that the Federal reserve will see enough evidence of strength in the economy that we could see rates start to gradually move higher maybe as soon as around August. Taking the federal funds rate up about a percentage point by the end of this year at 3% early next year which would again still be a pretty low level of interest rates really matching the low point we saw in the last recession. Interest rates will move along with the economy. As the economy weakened, interest rates fell, as the economy begins to strengthen, interest rates will we believe begin to move somewhat higher. In terms of the benchmark that is very important in many pricing decisions, the 10-year treasury note yield. Today that rate is about 5.12%; we think we'll be at 5.5% by year-end. With respect to the impact on mortgage markets, we've seen rates recently on a 30 year fixed rate mortgage below 7%, then we think they'll be at about the 7 to 7.5% range through the balance of the year which will still make housing a pretty good sector and keep it relatively healthy.

What's going on with the stock market? It's been trying to get with the program now for a number of months, trying to find a low point. We think the absolute low was reached on Sept. 21 but there are three big barriers to the market at this point. First is tremendous anxiety and nervousness about the global scene, terrorism, war in the Middle East. Second, the whole accounting issue, can we believe any corporate earnings statement? Third, and probably most important, when will this economic recovery filter through to the bottom line? Still we think the fundamentals are relatively positive for the market. Price/earnings ratios are not cheap, in the low 20s, but represent a market that's at least fairly valued. Second there's a huge amount of liquidity of the (side lines?) and money market funds. And finally but most importantly, we believe an economic recovery will

generate an upturn in corporate profits. And to be specific after last years horrendous drop of about 18% of earnings, we believe that operating earnings will be up about 10% this year and about (16%?) in 2003. So overall after two back-to-back years of decline in the stock market, we think we have at least a reasonable chance of earning a modest return at least by the end of this year.

Finally and most importantly, what does this all mean for the state of NC? This chart really shows the trials and tribulations that we've all been through here by graphing a trend of employment since year 2000. And you can see that NC started out a couple of years ago well ahead of the US as it had been through much of the late 90s. And then as the manufacturing sector, both the old economy industries, textiles and furniture, started to slow down, we all saw the technology boom peak right here in May of 2000. That also hit NC very significantly. As you can see the job loss, very significant heading all the way through 2001. But the good news here, it does appear that perhaps, we're beginning to see some leveling off in the job market. The performance across areas has been significantly different. The unemployment rate has climbed rapidly. Here, it's now higher than it was during the 90s. It increased from about 5% a year ago to about 7% today. About a full percentage point above the national average. In terms of the performance across sectors, you can see the job losses have been throughout various industries hitting manufacturing and construction particularly hard. The only areas still showing increases are services, particularly health care and government, education particularly at the local level.

With respect to the positive forces, we think there are a number of reasons to be more optimistic about this state. First of all, the US economy should provide a pretty good pull as it has in the past. Second in terms of the budget situation, there are also some positives here. The state pension system is in good health, it's well funded. We also see generally NC praised by the debt agencies for having a low debt burden relative to other states. And finally over the next five years, we think the state is poised to outperform the nation at least by a small margin in terms of economic growth. So as a result if we look at the forecast for the NC economy, this next chart clocks the performance of employment growth rates since early 1980. You can see that the state of NC certainly is not an (island?). It clocks the nation almost like clockwork. Look here in the last recession, early 80s, dropping right in line with the US, recovery, dropping again with the US, recovery. In this recession what's been different is that we actually led the US into the recession and lost jobs. For last year, we lost about 33,000 jobs on average. We think we'll lose about another 20,000 jobs this year. There's a good chance that we'll show some recovery next year with a gain of about 62,000 jobs, just barely offsetting the losses of the past two years.

What are the reasons we would be more cautious at this point? It relates to the constraints that are in the picture. First, we have unprecedented risk facing the national economy including elements we have virtually no control over, war and terrorist threats that we've never faced before in our lifetimes. Second we see the continued impact of declines in the textile industry. We also see pressures in the rural areas in terms of furniture. Also tobacco manufacturing. Technology may take time to recover. At this point, we think that

IT budgets will start to pick up by the end of the year. Telecommunications may take 2003 or 2004 to recover. And finally in terms of the overall budget situation, as the ST indicated, the reserve fund is pretty much depleted and it's absolutely critical that we rebuild that fund.

As we look at the overall economy, we do believe that a recovery has begun. It will be a fairly solid recovery, but there are certainly risks in the picture. Internationally, those risks are also very pronounced. It does however appear that a global recovery is underway. Interest rates are likely to be moving somewhat higher. We are cautiously optimistic that the stock market will show some improvement. Finally in terms of the bottom line, our view is that NC will be resuming growth over the next 12 to 18 months, but at this point, we would advise great cautiousness with the budget process. If you look at the debt rating agencies, and I'm sure the ST shares their view on how important it is for NC to retain that AAA rating. What has been very important to these agencies has been the rapid response that NC has made in the budget process in the past in responding to these economic challenges. Again the low level of the reserve situation indicates that caution should be used in the budget process despite the fact that we believe that NC's economy will revive over the next two years. So with that, let me take questions.

**\*\*First question missing between end of first CD and beginning of second CD\*\***

**Dr. Reaser:** This is a big issue from two dimensions. One, the interaction of the stock market and the general economy. Secondly, the effect of the stock market on specific revenue flows into state and even federal governments. Mr. Owens has probably even heard Mr. Greenspan's comments, and he's made the statement in the last two or three years that all economic forecasters have had difficulty understanding why this economy was rising so rapidly in the late 90s and then dropped so precipitously. We know that there's been a huge impact of the stock market on wealth and (climate?) wealth but no one knows exactly what the lags are, how short or how long they are, and so it's going to take some time before we fully understand what the impact of the stock market is on the general economy. The second impact is why, look at the federal government, they were forecasting deficits for as far as the eye could see and then last year they were forecasting surpluses for as far as the eye could see, and now they're back to forecasting deficits. It does relate a lot to the effect of the stock market on overall capital gains taxes, stock options. That same forecast, the difficulty has been to the state, models. Some of the models that we've used have been based on very short track records. Since the stock market has become a much bigger factor in the US economy. I think as a result, one has to be a little bit cautious about just taking numbers that are dumped out of a computer model because we just don't have a whole lot of understanding. It may take some time before we fully understand, realistically, the impact or the interconnection between the market and the economy and the resulting effect upon overall revenue.

**Richard Moore:** Further questions from the panelists?

**Panelist:** You didn't seem particularly concerned about the housing market, and obviously consumer spending and housing seem to be the two prime ingredients that carried us through the recession. Given what you're talking about relative to the lagging

effect of the stock market, the fact that interest rates are going to go up albeit not high on historical levels, but also given the fact that in NC, unemployment is more significant than it is nationwide, is there not reason to be concerned about housing? Particularly given the fact that new housing continues to be built and as I'm understanding it, existing home sales are slowing down pretty substantially.

**Dr. Reaser:** Is there a reason to be concerned about the housing market? Again, the housing market has been important from two dimensions. One it sustains significant amounts of economic activity in terms of building and furnishing those homes. And second, the impact of wealth on some 2/3 of households that own their own homes. As we talk to most of our builders, they are still pretty positive about the outlook. I think generally, when you look at the housing market, we're not expecting it to be a driver in terms of economic growth, we pretty much see it leveling off at this point. The increase of mortgage rates will damp a little bit of housing demand, but even at 7.5%, that's still a very moderate rate by historical standards. And in general, what's been so different about this cycle that you've not seen in the past is the overbuilding of houses. There's not a lot of speculative homebuilding. Banks are not financing that kind of activity. Builders are still quite cautious. And so basically, although the unemployment rate is higher than it has been, the job loss has not been horrendous and we do think it will turn around over 12 to 24 months. Basically we see housing pretty much leveling off. We still have a pretty good level we don't see going through the renting cycle. Long term, we still see immigration coming in NC which is the biggest driving force for household (information?).

**Richard Moore:** Thank you again very much. Now we're going to ask the folks on our panel to make comments on two subjects, both or just one or something else if the spirit moves them. But particularly after hearing these presentations, first what do you see as you're running your businesses? There were a couple of slides in the presentations that were cause for concern and there were a couple of positives. What are you doing and what are you seeing from your perspective. As I said we really do have a very diverse group here in terms of geography and in terms of business relationships. The second thing is what are the things out there for future growth in speaking to the audience of the General Assembly. You know difficult decisions have to be made. What do you think we really need to do or what are we doing that we better not stop. Along those two lines.

The bios for all of these individuals are included in your information. Many of you will know these people personally, or know the companies they represent. Let's start on this end with Wills...

**Wills Hancock:** Thank you Richard. I want to thank you for including me in this panel discussion today. I've really found it quite interesting to listen to these economists. I run a small business in Oxford, NC and we sell a lot of real estate and we build a few houses and we are involved in industrial recruitment to a very large extent. I think the thing that strikes me the most is I had the misfortune to be an investment banker, stock broker in the early 1970s and I watched this economy do similar things like we are experiencing today

and I am hopeful that we will be able to grow ourselves out of this situation as well as we did in that particular situation.

As I was listening to the doctor speak and I was looking at some of the things she said were of concern, it struck me that we are on a very thin line as far as what could happen to this economy on a national level. We are at war, we seem to be having trouble at different parts of the country and I wonder what impact that really is going to have on this state if we should declare war against Iran or Iraq, or Pakistan and India should go to war against each other. What that might do to the NC economy because it's certainly going to affect the national economy. I had occasion to be in Lawrenceville, NJ a week or two ago talking to those people about listing a plant that recently closed in Oxford, NC and I think that's symptomatic of what's going on here. Lenox China, a very high profile, quality company announced that it was shutting down, a loss of about 400 jobs. Those people were very very concerned. Their perception was that NC was in a depression. As a matter of fact, they were being told by some of the national real estate marketing commercial groups that NC was in a large depression and that they should expect to sell their plant at half of what they thought the value ought to be and that there was an extreme excess of space available in the state. That's not exactly true and I took great exception to that when I had my opportunity to talk to those people. But I think it's very very important that we continue to fund and pay very close attention to the NC Dept. of Commerce and do everything that we can to retain and keep the industry that we have. But be very vigilant to see that in the future, we don't miss an opportunity to bring industry here. Yes, we've lost a lot of textile people and we've lost a lot of people in the furniture business, but the industry is out there. I would hope that we would work closely with Commerce, which has an excellent department to recruit and bring new folks in. I noted that last quarter, because I was having to prepare some information on the depression that NC was in, that during the last quarter, there were 125 projects that came through NC. We landed 17 of them and it created 3,500 additional jobs and over \$280 million in capital investment. That's the kind of stuff we need to continue to work on to stay vibrant. Thank you for the opportunity.

**Zack Blackmon, Sr.:** I appreciate very much being invited. When I walked in the door and looked around, I was glad we weren't playing the Weakest Link or I would have been dumped. I'm from Surry County and spent 45 years in the construction business. In the last 10 years, I've gotten into the hospitality business, and a little bit of high tech business, but our county has suffered tremendously from loss of textiles. The world's largest toaster manufacturer in Mount Airy is now in Mexico and our county is seeing sort of hard times in decline in employment. But on the brighter side, tourism is in our county, which I have learned to love. My hotel is operating at about 9% better than it did last year. Last year, it hung on at 1% less than it did in 2000. So there are some spots in our county that we're working hard at to improve employment, but we are looking for guidance from somebody in the economic world to direct us on what do you do when you lose your textiles, your cotton mills, your hosiery mills? Where are you going and what are you going to find to replace them. That's the big challenge for us. I think the state of NC needs to really promote its tourism; we get better grades on that than we do a lot of other things. That's the circumstances in our county and I appreciate being here.

**Tom Darden:** I'm the CEO of Cherokee Investment Partners. We are a Brownfield investment fund. We buy environmentally contaminated sites and clean them up and develop them or sell them. My general comments would mirror those of Wills Hancock in striking a note of caution. I'm not an economist or forecaster. I'm a little bit awkward in a setting of needing to predict the future, but I do talk to a lot of people out there and I sense a great deal of anxiety or malaise about the state of the economy. I don't know how it's supported by the facts and figures we've just seen, I have this intuition that it's all based on low interest rates.

Related to the question that Ron Bernstein asked about the housing market, I feel like that's been supported by what have been historically unusually low mortgage rates, and consumer debt is propping up the economy and a small increase in interest rates, which is going to happen, has to have a depressing impact on it. That to me is my greatest source of anxiety about what will be the nature of the recovery from the recession that we're in, and then add to that the external factors. It all leads to a pessimistic sentiment on my part. Based on that I commend you for keeping the forecast conservative, plan for the worst, hope for the best. I think to be cautious for the plans for the state budget in the coming year, maybe it will be better than zero percent growth, but I wouldn't assume that.

In terms of comments, suggestions, things to think about, I think that people are very sensitive to the marginal tax rate, whether corporate or personal. If those numbers start with an eight, we've got a serious problem. I'll just throw that out to pick a number. I know that's where the money is, at least on the personal side. If you need to raise revenues quickly, that's a place to go and get it. But I really worry about that. It affects decision makers, people who have a choice. I'm sure this number is known, but I'm sure that it's over 100 people who move to Florida when one event occurred and that was the sale of RJR to KKR in whatever year that was. These are people who can move and they will and the state loses based on that, so I encourage you to be sensitive about that. What is the margin rate?

I thought about what we can do about this. We buy contaminated sites, what in our little corner of the world is relevant to this. One thing I do worry about is urban areas as these plants close, many of them are located in rural areas, but especially if you think about smaller cities. We bought a textile plant in Mooresville NC. We didn't know what to do with it. We still don't know what to do with it. We're currently cleaning it up and trying to figure that out. It has over 1 million square feet of space, that's over twice the size of the BB&T or First Union towers here in Raleigh. Of course it's not oriented in that direction, it's flat. And we'll redevelop that, but think about how many of those there are and what can we do about the shape, the place, the nature of the place of these smaller urban areas is critical. And as we lose that it's not just the smaller areas, it could be Durham, it could be Raleigh. That's a scary thing in terms of what's going to happen in those communities in the future. So we have thoughts about what leads to redevelopment of these contaminated closed industrial sites. That was one concept I had there.

The last point I want to make is that I think the lottery is a very short-term solution and one that I find frightening. In our company, we say there's things we won't do for money and I would put that in that category. I know it's a place to get money, and we need money, and I understand that, but I just worry about what it leads to long term. Thank you.

**Steve Nelson:** My message will be one of investment. My job in the venture capital business is to find that next great thing and help create that next great idea or company. The hardest thing to do in this kind of environment is to continue to invest, but I think this is the best, most important time to continue to invest. In many ways, we have some fantastic state treasures, probably a great treasurer as well, who we need to figure out a way to support. These are the great universities. You probably don't know, but some of the best initiatives in the world are happening as we speak at our universities. World-class genomics out of UNC, a (?fatomic?) center that's probably the best in the world at Duke, the Centennial Campus, terrific at fetomics and optical networking initiatives at UNC Charlotte. This is not the time to cut; this is the time to invest. This is where all the job growth and technology is going to take the state to the next level.

We have some fantastic treasures as well in assets in companies like IBM, Glaxo SmithKline, Cisco, Nortel, Lucent, Ericsson, who have decided that this is the place to expand; this is a place to settle down, to attract other workers. You may not know, but the world wide wireless initiatives for Cisco, based here, for Nortel, based here. The Sony/Ericsson joint venture chief technology office, based here. Glaxo SmithKline, investing heavily in bioinformatics, biotechnology. Life sciences partnering with the medical schools at Duke and at UNC. And with the young companies being started by the people that are willing to risk their private equity all based here. So let's remember these fantastic assets we have. The Universities who will develop and create the workforce of the future, the great companies whose technology will be spun off where the research will make the difference and I think will take over for some of the job losses in other areas.

Again in my business the hardest thing to do in a tough environment is to invest, but if you look at history, Microsoft, Disney, Intel, Hewlett Packard were all invested in and started a year or within 18 months of a previous recession. Again, the hardest time to invest, but the most important time to do so. When we're thinking about cutting, let's think about protecting these great universities and really powerful initiatives. Let's think about listening really hard to the Glaxos and Nortels and IBMs, the people who have decided they're going to have tens of thousands of jobs here. Let's think about the Matthew Szuliks of the world who decided, yes, I can start a business in Boston or Silicon Valley, but I've decided to start it here. And so far to keep it here, and these are going to be the gazelles of the future that will also drive the economy in our state so everything we can do in our minds to balance the need to cut and to be fiscally prudent with the need to invest and do it in a very focused way. In my view, when we gather back in 3, 4, 5 years we'll be talking about this next great place to start and grow business and I think it's going to be because of some of the tough, but focused decisions we make in the near term.

**Richard Moore:** Thank you very much. Matthew, before I call on you, I'll give you another second to collect your thoughts. Jim Hyler is here with us today and this is really an unbelievable commitment for him to be here. He is the chair of NCCBI that, in a very short period of time, is having their major meeting of the year. Because we're running a minute or two behind schedule, I don't want to keep the chair of that organization. Matthew and everybody else, I hope you will excuse me; we're going to move up the table for Jim's comments. Thank you.

**Jim Hyler:** Mr. Treasurer, thank you very much for accommodating my schedule, and as soon as I get through, I do have to run, and I apologize for that, but we do have our legislative conference tomorrow and this afternoon we have our executive committee meeting that I need to attend. I'm a banker, I work for First Citizens Bank, but this afternoon, I'm going to wear two other hats. One is Chairman of NCCBI and the other is serving on the Governor's Efficiency Commission that's trying to address issues of efficiency in state government and trying to come up with ways to reduce state spending. In terms of the budget shortfall, how that's addressed will have an impact on the business community and all of us as we go into the next few years. NCCBI's position is that we oppose any kind of a tax increase. We bit the bullet last year and supported the tax increase, raised about \$600 million to cover the shortfall a year ago. But this year we really need to say no more tax increases. We can't continue to increase state spending and continue to raise taxes. Tom's point about starting with number 8 I think is a very valid point and it does make a difference to corporate executives, to retirees who might stay in NC, but otherwise would leave. We think that we really need to address the spending side of the ledger and use this as an opportunity to look at ways to address the structure of state government. How services are delivered, because they can be delivered in a more efficient way.

Segway into the Efficiency Commission. Darleen Johns also serves with me on that commission. We came into being in late February. We've just sort of gotten going. We have very limited staff to help us. We have offered up about \$45 million of suggested cuts for the short session to consider. We will do most of our work starting now and try to get ready for a final report in December, then we will go out of business. Just in the brief time that we've been in there looking, and this is just the volunteers who are doing this, there is opportunity to cut spending in state government, do it more efficiently, and not impact state services. Certainly not impact the classroom. I can sit here and give you a lot of examples, which I won't do, but we think that if there's a political will to take on some of these things, that we can make a major impact on our state spending. If you look at the growth in state spending over the last 20 years, it's grown at a compound annual growth rate of almost 8% and that far outpaces inflation and far outpaces the growth in the economy. We think from the NCCBI standpoint that we've really got to address the spending side, and that's where our energies will be focused.

**Richard Moore:** Thank you very much. Rep. Cunningham, did you have something?  
\*Can't hear the question on the CD\*

**Jim Hyler:** We have offered up a few things for the short session, but we really just kind of started, and the things that we're going to come back with will be things that you'll have to spend a little money to save a lot of money from an investment standpoint. These things will be long term in really realizing the ultimate benefit that you can get from them. I wish I could waive a wand and give you about \$200 million, but I can't do that. The Governor did put a plug of \$25 million in his budget, we surpassed that. Then we're going to work at looking at some significant things to offer up by the end of the year.

**Richard Moore:** Jim, we appreciate your leadership and we understand why you have to go. Matthew, thank you for your courtesies.

**Matthew Szulik:** Thank you Mr. Treasurer. My name is Matthew Szulik. I'm the CEO of Red Hat. I'm also the chair of the Science and Technology Board of the Economic Development Board. And I would like to use the time that I have with you to address some of the issues that have been voiced here. What we see is that this is a state with tremendous assets and assets that need to be leveraged. I'm not sure how many folks know that in the last 10 years, the state of NC issued more patents in the area of biotechnology, we rank 6<sup>th</sup> in the nation. The same holds true in the area of material research and science. They're tremendous assets in the state and as we look across this nation right now with 42 out of the 50 states facing significant budget deficits, I think they made a decision that helped to keep our company in the state of NC, which is a strong commitment to education. Because as these other states now face these budget deficits, it is historically true that education has been an area that has been traditionally negatively impacted. And as we attempt to build a sustainable great company here, publicly traded company, and choosing to compete against two of the greatest competitors in the technology industry. Try to build this in a location; it was our choice to build our company here based on our ability to partner with a high quality educational system because without the investment of intellectual capital, I don't have a business. We don't build houses, we don't have machines. Our company is built and our value is built based on our capacity to recruit intellectual capital into our business. And as our nation now shifts from what has been largely manufacturing based, and I'm not surprised to see the downturn in manufacturing, into one that is services based and information based, I think the state of NC is in a wonderful position that will require contemporary thinking to address this problem.

I think the educational field and the decisions that this state has made to invest are truly significant. Our decision to locate on the campus of NC State University was a strong statement that we're trying to make to back that up. Having access to 5,000 graduating engineers gives us an incredible opportunity to compete. But that by itself doesn't go too far. I think we're also faced with the General Assembly having to deal with issues of technology transfer, the issue of investment in qualified business tax credits to keep, retain and incent young emerging companies. I don't think the state necessarily has looked on that in a favorable way to make sure that there are future Red Hats, because that's simply our goal. My hope is that in 5 to 10 years, there are 15 to 50 to 100 Red Hats, not just one which makes it very difficult to recruit people for the long term. This is a state that has numerous, numerous assets and in light of the other states, new

benchmarks need to be established. Our benchmark should not be in South Carolina, or Virginia. Our benchmark should be China, it should be India, it should be Germany, it should be Israel. These are the nations that are investing rapidly and developing a rich set of intellectual capacity to compete for the next 25 years. So I think the opportunity is going to be left to the General Assembly to decide how do they want to create a regulatory environment that is proactive, that is forward thinking and continuing to invest so that in the future these research universities that we have stay leading edge. Continue to invest and lead the nation in the areas that Steve talked about. So that in the next 25 years there are 100 Red Hats, not just one. Thanks.

**Ron Bernstein:** I'm Ron Bernstein, CEO of the Liggett Group and we have two businesses we are currently operating in NC. We have our traditional cigarette business, which I am proud to say is the largest cigarette manufacturer in Mebane, NC. Secondly, we have a new start up company, Vector Tobacco, which is developing new high tech cigarette-related products that offer what we hope will be a category of reduced risk products that someday will likely put our traditional company out of business. This company is based in Roxboro, NC.

I just want to make a couple of points. First of all, referencing a couple of things that were mentioned by Steve Nelson, investing in the face of crisis is absolutely a critical thing to do. It takes some courage to do it, but it's necessary. I'm going to relate a brief experience that I had prior to returning to NC. I spent 5 years in Russia running a company that we had over there. While there, I lived through a succession of crises. Political crises, social crises, and then ultimately, economic crises. I woke up one morning and found out that the value of the ruble, which was mentioned by the economist earlier, had dropped by 40% literally overnight. 100% of our revenues were based in rubles, 80% of our expenses were dollar based. That was indeed a crisis for us and our competitors over there were some esteemed much larger names, Phillip Morris, RJR, Japan Tobacco, BAT.

In the face of the crisis, what we did was two things. We invested. We made a commitment to increase our capacity recognizing that the ability to import into Russia was going to decline because of the inherent expense involved with bringing in product. The second thing was we made a decision to dramatically reduce our profit margins in order to accommodate what the needs of our consumers were. And that's a critical element because in the face of any crisis, there is opportunity. The result for us is that we were able to catapult ourselves over a year, year and a half period to become the #1 manufacturer in Russia. Surpassing companies that were 100 times our size. The decision to make it wasn't easy, but it was clearly right. Fighting to make the right decision is what we have to do as business people. It's also what our legislators have to do. Certainly it strikes me right now that it is very important for us to hold onto the assets that we have within the state. Talking about the business related assets. As well as attracting new assets to the state. Just to give you one example, everybody is all fired up about the Carolina Hurricanes going and playing for the Stanley Cup, but it wasn't too long ago that they were the Hartford Whalers. Folks up in Hartford have lost and whether it's hockey or basketball, as we've just lost a team down in Charlotte, for any

number of businesses, it's absolutely critical that we have policies in place that enhance people's desire to stay in NC. No doubt in a period like that, it means investment tax credits, it means things that the state can invest in order to keep businesses in the state for the future. As somebody just referenced, while there may be some short-term costs, the long-term gains can't be ignored.

And I would just make the point that since there was a bit of lobbying relative to the state lottery, I absolutely believe that it's a revenue source that we cannot and should not ignore. Not to get into political issues, but the only argument that I've heard against it is that people who are not going to be able to deal with it responsibly, and to that I say, let's give people the chance to determine their own sense of responsibility and not dictate it for them. I think \$250 million in the state budget this year is something that we absolutely need to have and I think we should respect our people enough to let them make the choice whether they want to play or not. Thank you.

**Richard Moore:** I told you we had a diverse group here today. I promised you that.

**Isaac Green:** It's good to be here today, and I can start off by characterizing myself as an optimist. I started an investment management company, Piedmont Investment Advisors in August of 2000. Suffice it to say that the investment markets have not been kind since then, but I've been in that business for 20 years and as we've already heard the message down the table, the time to invest is now, in a crisis. It's been said that opportunity crouches beneath misfortune. Indeed what we see facing us in NC today is not so much a crisis as it feels like in the moment, but an opportunity for us to recognize that while our state has grown and prospered in many ways we couldn't have anticipated a generation ago. One of the offshoots of that growth and change is probably going to be more volatility in the economy, but just for a second before I say something about the economy, I moved my company's headquarters here to Durham, NC last summer. I moved to NC for a couple of reasons, one is I see NC having some of the richest opportunities for growth and leadership in the nation's economy during the next 20 years of any place in the country. That comes from our investment in intellectual capital and our investment in businesses that are based on intellectual property. It also comes from our leadership in financial services. North Carolina has, over the last decade, amassed leadership in the banking industry that maybe we'd hoped we'd see 10 or 15 years ago but it's still kind of hard to believe that we've gotten as big and dominant as we have. With that element of financial services growth, I think we then have to look and see that other areas of financial services will grow with and around that banking infrastructure. That is what caused us to bring our investment management business to NC. We're very excited to be here. It's been almost a year now, but I still pinch myself almost everyday just to make sure that I'm not dreaming and that I'm here.

In terms of the stock market, we talked about how important that is to the future economic outlook of the state. Well, the stock market is a discounting mechanism. The stock market looks ahead, it doesn't look back. It has made some small recoveries from what we believe was a bottom that was made in Sept. of last year, but it has not gone forward dramatically. We think that it's just a question of time. Our hearts are bearish.

We get nervous when we see the loss of jobs and the loss of revenue that takes place in the economy around us. Our heads and our rationality have to be optimistic at this point, and it has to be optimistic because we all know that there's a business cycle. There has been one since at least the time when Joseph interpreted the Pharaoh's dream. If I can give a nod to our leadership at the Federal Reserve, we've gotten quite a bit better at managing the economy. We've gone from seven years of fat and seven years of lean, to hopefully seven years of fat and just a couple years of lean this time, so we have gotten better in that regard. If you recognize that there's a business cycle, then you have to recognize that there are times when you have opportunities to invest and to save and then there are times when you have to recognize that good conditions won't persist and you have to save up against hard times. One of the questions we have to ask ourselves is do we have a revenue crisis today, or did we have a spending crisis at time, and shouldn't we look very hard at our rainy day funds if we're committed to a balanced budget concept and make sure that as we go through the next economic up cycle, that we build that fund up and that we keep it in tact so that when the inevitable future downturns come, we won't have our back quite as close to the wall as we do right now.

Finally, I think that we're going to be in better shape with each cycle that goes forward because as these two gentlemen talked about on the venture capital and the technology side, our economy has changed and it has changed meaningfully. We've gone into manufacturing capital goods now; technology is a capital item that is consumed by manufacturers more so than it is a consumable item. That's a good thing because capital goods tend to have the highest return on investment when they're sold in the marketplace. It's a bad thing because capital spending tends to be more cyclical. So our economy is going to have a higher rate of growth going forward and it's going to have higher profitability. More growth in productivity, more growth in income for the state as a whole. But it's quite likely to be more cyclical. I think we all have to think very seriously about how we buffer ourselves against that cyclical.

Finally, part of the reason that our state has been able to grow the way that it has, has been because we were a low cost place to do business. Part of it has been because we've had a strong investment in intellectual capital. We're losing that cost advantage as we grow, so we have to be sure to continue to invest in our intellectual capital advantage so that we can continue to attract and retain businesses that are part of the next wave of the American economy which is a movement from traditional manufacturing business to businesses that are centered around intangible property and intellectual capital. Thank you.

**Richard Moore:** Thank you very much. We are a little behind schedule, but not much and we're sticking fairly closely to our agenda.

**Don Curtis:** Mr. Treasurer, you're going to have to excuse me, I know you're trying to push our schedule, but I've got to tell one story. I got an email right before I left the office and it was from a friend of mine who said he was traveling back to Charlotte and he needed to go to the men's room so he stopped at a truck stop and went in. He went into the men's room and into the second stall. Just as he sat down, he heard in the next

stall, "Hey! How are you?" Which made him feel a little uneasy. He said, "Well, I'm fine." Then the voice in the next stall said, "So, what are you up to?" And he said, "I'm on my way to Charlotte." Then the voice in the next stall said, "Excuse me just a minute, the guy in the next stall thinks I'm talking to him."

I thought it was a great story. I'm in the advertising business. We operate radio stations, and if our very unscientific method of looking at the economy of the state is any indicator at all, we're in pretty good shape. We've typically found that in the recessions that I've watched here in NC, that the advertising business has a remarkable slowdown about 6 months before everyone else begins to complain about it and we usually come out of it about 6 months before. If you think about that, it has a great deal of sense to it because advertising creates demand; demand creates jobs and so forth. We saw in August of 2000, we were going along with nice increases, 15 and 20 %, and all the sudden the curtain fell down and we were flat as a flitter. And remained in that condition for 12 or 13 months. I think we saw some flicker of return right before Sept. 11, and then that delayed things. But just as rapidly as that curtain descended, it has risen in March. Our businesses are up 25 or 30% right now, our bookings. I don't think we have any inventory left for this month and very little for next month. So if the past is any indication, then I think we're going to see a return of the economy. Of course, that is in Raleigh, and Raleigh is a small exception to the rule.

On the long term, I think one of the things we all need to keep our eye on, as far as a developing trend, is that we may have sold the Internet a little short. I don't know exactly when the fax machine was invented, but I think it was around 1935, and we all know how long it took for that device to become a part of our everyday living. The Internet, as a means of commerce, did not blossom as rapidly as everyone had thought. But watch it, it is still a very effective way to sell goods and services. The reason I mention this is, the thing that worries me about this is the sales tax situation and what can happen when out-of-state firms are earning our dollars and not getting sales tax. There are appliances already that are just not popularly sold that do not involve the computer but do involve the Internet where you just go right straight to the broadband Internet and buy and sell things. Do all sorts of marvelous things via the Internet. We perhaps are a little early in the cycle. It's going to take a while to change long-standing habits, but the truth of the matter is it's going to be something we need to watch.

On the lottery, since it's popular to talk about it, the only thing that really bothers me about that, you know what a wonderful thing for the federal government's revenue because of the tax that is being paid on all those earnings. To me, if the states are going to sponsor lotteries, the federal government ought to at least exempt that revenue from the tax that's made on it. Anytime they give away \$300 million, they're giving away \$120 million to the federal government.

**Richard Moore:** That's an interesting point, Don. Between you and Carl Webb both in the advertising business, I have heard from many sources, the truth of what you said about the first ones to feel the pain and the first ones on the way out.

**Carl Webb:** I was just starting to believe that I was this fantastic businessman and our business was doing so great, but now after listening to Don, I realize on the advertising side of the fence, advertising, marketing and public relations is what the firm is involved with, things have turned around in a miraculous way. We've seen a 200% increase in our business over where we were same time last year, but what we've also noticed is that a lot of our clients have gotten back to the basics. A lot of our clients are focusing more on the core business functions. A lot of the services that they used to provide as ancillary services to support their core, they're starting to outsource. That is obviously creating some opportunities for new small businesses to create to fill that gap.

One of the things that I think the General Assembly should keep in mind, when you look at a lot of the small businesses as we start up, a lot of those businesses are undercapitalized and a lot of those businesses rely not on private sector dollars, but on public sector dollars. If we look at a lot of the state agencies that are dealing with uncertain funding, that has a direct impact on those small businesses set up to service those agencies. What often happens is those agencies end up relegated to less than top quality servicers because there's such uncertainty about whether or not you'll have funding to complete a project that you stop looking at state agencies as a source of funding and you start looking more into the private sector. And state agencies end up dealing with firms that are not as strong and they may not have all of the professional capabilities.

When you look at the infrastructure within state government, we know that purchasing, the whole e-procurement process is just not all that it needs to be right now. There are a lot of opportunities that small businesses in the state are not able to take care of or take advantage of. When we look at state purchasing, there are some efficiencies we need to realize there as well as looking at more and more companies bundling contracts. What happens when these contracts are bundled is that small business suffers because we're unable to participate in some of these mega deals that only national chains and national players can partake in. I would also want to make sure that we look at ways to unbundle some of these services so that small businesses as well as women and minority owned businesses can take advantage of some of these opportunities that will help stimulate some activity in urban areas where we don't see the economic prosperity that we see in some other parts of the state. When you look at more and more local municipalities, ending up with a lot less money coming back from the state, they're putting local communities in a tough position because of the fewer incentives to go into some of those underserved areas to provide those needed services. So again, I would want you to be mindful that there are more incentives that we need in those areas where we don't see growth.

The other area, if you look at the higher education and community bond referendum that was passed that our firm had the pleasure of working on, we know that a lot of construction dollars are going to flow into the state, and we know that it's going to take a long time to build all the facilities that we've been funded to build. I think that there's a tremendous opportunity for new small businesses on the construction side to partner with larger players and I think that state government has a role in trying to motivate those

major prime contractors to work with many of the small contractors. Again creating the jobs, but also getting those buildings built. The other thing to keep in mind, when we look at contracting on the state employment side, a lot of those contracts may not process through the system as effectively as they need to which means that we're going to deal with small businesses suffering because their cash flow is not turning over well. I also want to be mindful as we look at reducing staff, that we don't reduce staff in those critical areas that will have an impact on small business.

I, too, believe that the lottery is one of those things that is a self-selective thing, like faith and religion. A lot of things that we do, we claim that we don't do. One of the positive things that I can say about the lottery is that it will generate a lot of revenue for many outlets within NC. Not being totally self-serving, I think that that's a positive outcome of the lottery. Thank you.

**Darleen Johns:** Good afternoon, I'm Darleen Johns, and I'm the owner and president of Alphanumeric Systems. We're a Raleigh-based provider of technology consulting throughout the Southeast and we've been in business for about 23 years, employing about 250 technology professionals. We do a lot of state government business, but thankfully, we do a lot of commercial business right now. I think that has helped a small company like me to diversify between state and commercial business because if I had just had all my eggs in the state basket, it would not be a pretty picture for us right now.

Over the years, I've also been fortunate enough to be part of a number of state legislative bodies that dealt with the economy including the NC Economic Development Board and the NC Efficiency and Loophole commission. My perspective as a member of the recently formed Commission to Promote Government Efficiency is what I'll share with you today. I'll be a little more specific than Jim was. We also know that the state's budget shortfall is enormous and some of the factors that have contributed to the deficit have been largely out of our control like the disaster relief, the settlement of lawsuits and Sept. 11. Regardless of the causes, the budget shortfall still needs to be dealt with swiftly and efficiently, and our ability to do that will determine the speed of the state's economy recovery. Based on the events of the past year, the state is making a tremendous effort to ensure that mechanisms are in place not only to alert us of impending shortfalls in revenue, but also quickly enact the changes we need to have in place to put the state back in the black. We can't wait a year for an election cycle to move on information that we get that tells us that we're spending more than we're taking in.

These are some of the issues addressed by the Commission to Promote Government Efficiency. As the state charts its fiscal course for the future, the latest recommendations from this body address a number of ways to reduce spending and increase efficiency. One of the suggestions is changing current law to allow the state controllers office to hire collections personnel to recover income owed the state by individuals and corporations. Presently, that's about \$600 million. Also, consolidating facilities and support functions for example in the areas of technology, construction and equipment maintenance. Another is consulting utility functions to streamline billing and payments. This recommendation required that utility companies look at the number of state agents they

serve, rather than giving separate bills, they would then consolidate, and give one bill with a much larger rate structure. Negotiating state contracts. This is another one that is out there that, we have a tremendous number of contracts in this state and we can renegotiate some of these contracts without going out on bid each time to see if we can get a much better rate than what we have today. Also the state is identifying alternative revenue sources. It is looking into acquiring revenue from sources like the tobacco trust fund and the highway trust fund in order to offset some of the deficit. Those are funds that have normally been left alone.

Although there are differences in the economic forecasts for the state, the consensus among state officials is that although there will be improvement over the 1.5 billion shortfall of 2001-2002, the environment will remain challenging. Some even predict that we will have no economic growth for 2002-2003. This said, there is no question in my mind that the future is looking brighter. Although the textile sector of our economy may continue to see some losses, overall unemployment is anticipated to decrease. However, our information technology and biotech firms are well positioned to lead the nation in the increasingly knowledge based economy of the future. We need to continue with great prudence in making economic decisions, but it's my opinion that we have the critical tools to succeed.

**Richard Moore:** Darleen, thank you very much. She is on the same committee that Jim Hyler is on. We'll continue on.

**Suzanne Babcock:** First of all I agree with the cautious approach that we are taking towards the budget. I'm going to speak about my experience just recently with a small high technology startup. I've gotten two of them going since 1999. Before that, I was with a family owned business that's in the Research Triangle that is in the technology business for the highway construction industry. We have seen somewhat of an economic upturn in both of those industries. The highway construction industry looks like it's moving along, but there was a serious decline of about 30% immediately around Sept. 11, and that's starting to improve. I think many of our customers in that business are in the construction industry and there was a cautious approach to contract letting, and that's the reason for that.

The other thing that I thought I would bring up is that from a technology development standpoint, there seems to be a real shortage in the state and a highly competitive situation for seed funds and early seed money. I think that one of the investors here commented that it's hard to invest when times are tough and it's hard for companies to stay in business, especially small start-ups when times are tough. One of the things that we did in our company was to immediately reposition ourselves with the technologies that we had. For example, we were working on a product to measure hidden corrosion on aircraft and immediately after Sept. 11, we knew there would be quite a bit of use of F15s in the military. So we immediately started to work on a different application of our product, which would attract some Air Force funds and were lucky enough to get funded but it was highly competitive. Another thing we did was to go after some federal funds that were as a result of the Sept. 11 terrorist attacks. We put in a proposal to the federal

government and we got a response back that it would be a while before they could give us an answer. That our proposal looked very good but they had 12,500 to review.

So I'm just letting you know that I think it's become very competitive in the whole country, and I think it makes it even harder for start ups in NC to stay in business. Our company has done well by repositioning and cutting the fat and changing what we needed to change in order to stay in business. I think the government has to look at itself as a business and do the same kinds of things. That's why I feel that the conservative approach is one that we should take. At the same time, my recommendation is that we look very strongly at what provides the jobs in the future. I was on a task force a few years ago for the governor and we studied the small and mid-sized businesses and their contribution to the state and I think I'm right, it's been a while and I'm not an economist, but I think it was 65% of new jobs were going to come from those small start ups. It was a very large percentage. If it's becoming more competitive for funds and we have to cut the budget, and we do have to cut in those areas, I think it's going to hurt us in our long-term strategic future plan for the state. So I would advocate looking at programs such as SBTDC or loan programs or the opportunity to invest pension funds in our own homegrown businesses, and I think this is very critical to our future as a state.

Lastly, in terms of the budget shortfall, and what I think we ought to do. I think we have to look at the state as a business and we don't close businesses because we have a bad year, we look at it as an opportunity. But we also respond very quickly. I know it's very difficult for government to respond as quickly as a corporation can but I think it's very critical that we do so. I think the government and the agencies have been given a very daunting task, and that is we have to cut personnel, we have to cut wages, we can't have salary increases, and I'm speaking in general here. But, if you look at an organization and you have all those mandates, at the same time you're supposed to put together a strategic plan and get there, you need to leave whatever support that you can in place to ensure that that future plan happens. Because morale takes a hit and people are not retained maybe that could be and in the end maybe we don't have the staff to do what we need to do. So, I have a recommendation that I would look at, not being in government, I haven't really thought about it, but I would look at a good strategic plan, a 10 year plan and ask ourselves, why don't we go out and borrow the money we need to do some of the very good things we need to do to keep the companies that are providing jobs in NC in business. I think I'm taking a very progressive approach, but it's something we need to think about.

**Ben Ruffin:** Thank you very much. This audience has been very patient. I just want to take a few minutes to share a few things not from my corporation, but from my real job and that's Chairman of the Board of Governors where I spend about 75% of my time for the last four years. The question of our economy is a very very serious question and it's one that's going to take real leadership to overcome. As we look at our economy, I hope that we will look equally at our great economic and educational engine that has driven the development of our state.

One of the risks, and I'm intrigued by, Richard, the question that you raised, things that we should not stop. One of the things that we should not stop, it was alluded to earlier, but we should not stop educating our children, not just in higher education but in public education and in our community colleges. I think that's the one thing that's given us a real competitive edge throughout this nation. It would be a shame for the state with the oldest public higher education institution to deny its young people the chance to matriculate and get a better education. So, as we take a look at the economy, as we look at our state, I hope that we will be mindful, and I know that the members of the General Assembly will, I know that you already have. The Research Triangle Park that we brag and boast about so much occurred because of NC Central University, NC State University, and North Carolina and other institutions surrounding it because we had the brain power to develop that institute. And today it's throwing out revenues that will support our institutions.

I would also just remind us that the citizens of the state do not mind supporting education. If we come up with a tax over a period of years and sunset that tax, it's my belief that the citizens of NC will support it. If people will buy a \$3.1 billion bond package, they will certainly support education because they understand the real meaning of it and what it means to our state. As we look at education, at the threat of cutting off the economic engine, or the engine that supports our education, you should be reminded that just a few years ago, about 15 years ago, higher education received about 17% of the state's budget, today it receives about 14%, so we're going down. We should also be reminded that in the midst of our economic situation that the UNC System entered this year's budget with a \$70 million shortfall because 1,700 more students wanted to matriculate to our institutions. And enrollment funding is not in the continuation budget, but we have to come in and get that funding each year. So now we face a \$70 million deficit because of that. We have taken some action at the university to close that gap by raising tuitions, and we're taking other steps to help the university, to make sure that we support the economics of the state by increasing our class sizes, by putting a hold on some of the acquisitions, putting a hold on some of the jobs that we have open, and doing other things that we can help do to manage and support the crisis that we're in in this state. We've also taken a \$50 million hit in the last budget cut from the Governor, which means that we now have to reduce teaching positions by 1,000. If we continue this, some of the doors that were open when we matriculated into the schools will not be open for students who want to come in. So I would just say that as we look at our economy and trying to fix this economy, I hope we don't break something that's already fixed. We have the best education system in the country, but if we don't protect it and support it, then it won't be as strong. And our economy will not be as strong as it has been in the past.

I just want to make one more analogy and then I'll be finished cause it's getting late. We really got into trouble with the bond package because of denial. Over a number of years, we did not have a repair and renovation fund, and again, Mr. Treasurer, we have just lost \$160 million out of our repair and renovation funds. It doesn't take but about 10 of those and we'll be right back in the same position that we were in last year when we had to float a bond to take care of repairs and renovations for our institutions. Again, the

biggest thing I think we have going in our state to protect our economy is our education system. If we let that falter, we will not pay today, but we will pay 10 and 20 years down, and we will pay not only the payment, but also interest. Thank you.

**Doug Kahn:** I'm in the textile business and after listening to my imminent demise; I guess I should be depressed. But I'm not and I'll give you an indication of why in a moment. Croscill Home designs, manufactures, and markets home textiles for the bed, bath and window. Our products include things like comforters, sheets, towels, window treatments and bath accessories and we sell primarily under our own Croscill brand name to better department stores and specialty stores. At 315 million, we employ 1,200 people today, down from 1,500 at our peak. You may be surprised to know that that reduction has little to do with the economy, and very little to do with imports. What's happened in our industry, following Sept. 11, it's actually been cocooning. It's been a combination of a continuing strong housing market and a feeling that people want to spend a little bit more time in their homes. Our industry has benefited from that. The reduction that I spoke of has three major components. The biggest component is a gain in efficiencies through a wide variety of continuous improvements. I estimate about 40% of that reduction was from a gain in efficiency. About 30% of the reduction in workforce would have been self-inflicted through design and styling, which for our company is imminently correctable. The remaining 30%, I would estimate to be from a shift in product mix, and to a lesser extent, maybe half of that, 10 or 15% from imports. So while there's been huge damage done to primarily the apparel sector of textiles and somewhat to the weaving and yarn making on the home side. Imports, while they will have a steady rise, is not going to be as devastating as it was to the apparel sector and let me explain briefly why. Unlike the apparel sector, the relationship between labor and material in the home sector is inverse. In the shirt that I'm wearing, there may be 2/3 labor, 1/3 material and in the comforters that we produce, it may be 2/3 material and 1/3 labor. And that's why you haven't seen a huge shift in production to Mexico or the Caribbean base. On the other hand, there will be a slow but steady creeping of imports into our arena and they're coming from primarily the far east, China, India, Pakistan, to a lesser extent, Turkey and Brazil and it's because those countries have developed the ability through their apparel connection now to develop the piece goods that are coming into this country. As duties and quotas are reduced, that seep will continue. The one thing I would ask of the federal government, which is not necessarily this arena, but if we're going to have free trade, my request would be at least to have a level playing field so that our industries that have the ability to export could do business overseas. I'm not sure that's always the case. The bottom line is that we have bottomed out. We have as a company, we're in the 0 to 4% plus or minus, and I think the industry has worked off its inventory, so we've bottomed out for the near term. The long term is likely to be a slow but steady creepage as a result of imports.

Now, let me address the question about what should we do in this state? I come back to parallel what our industry has experienced. I don't know if you've noticed, but there have been absolutely no increases in the cost of any towel that you would buy at retail for 10 to 12 years. Our industry has absolutely no pricing power for a variety of reasons. When you want to get increases to your associates, 3% a year or you want to recover

health care costs, which are rising at double digits and then some. Similar situation that the state may be facing, you can't raise revenues, what do you do? The bottom line is we're forced to be more efficient through a variety of means. Restructuring our processes, taking a look at how we do things, and changing the way we do things. Occasionally outsourcing certain non-core activities. Automating with the use of technology and software and eliminating the nice-to-haves, the things that, gee, it would be great to do if we could, but. Sometimes it hurts a little bit and you have to be careful not to cut into the bone, but eliminating. I think it's terrific, I only recently learned, I know Jim Hyler and the other young lady were involved in looking at how to make government more efficient. We need to do that and talk about investing, and we need to invest seriously, because I'm confident that there are plenty of ways to make what we do more efficient without cutting services. We've had to do it. We had to provide the same quality or better product at the same price year and year after, if not at a lower price.

Another topic on education in terms of priorities, I believe in education. Ben talked about having the finest education system in the country and I think he was referring to the university system. We don't have the finest secondary school system in the country, and in fact we're lagging dramatically. If you talk about the future, if you want to help the underprivileged in our state, we need to continue to invest in education. I applaud the Governor's efforts in that arena, and I applaud the Legislature's efforts to have accountability in our schools. I would add one other thing that the Legislature ought to think about, and I know that this is a political football, but our teachers are not paid enough at the secondary level. They need to be paid more. The flip side of it is that tenure doesn't work. We couldn't possibly run a business if there was lifetime employment. You can't have accountability, you can't ask people to do more, to stretch. You have to trade off some increases, investing in our pool of teachers and get rid of tenure.

The last thought I have is that government regulation, increases in taxes, and rising health care costs. We have a serious crisis brewing in this country with the rise of health care. I don't know what the answer is, but we're going to have to deal with it because we will not be able to compete with imports in our industry. And the drip will accelerate if we don't have a solution to that, and make sure that we maintain the investment climate and keep government regulation to a minimum.

**\*Not sure who is speaking now. Lost between disk 2 and 3.\***

**Unknown speaker, David Royster? Or it could still be Doug Kahn:**

\*Missing first part\* We have to invest. We have to invest for the small companies. It's been discussed many times today and I think that's absolutely critical for the survival of existing businesses. It's one thing for the recruitment of new businesses, but we need incentives for our employers who are out there who are struggling with these rising costs. It has been mentioned many times today. I think that starts with individuals who are always looking for government to pay for something but we have to look within. Everybody wants government to be a part of providing something, but we have to look

for those programs and we have to do it for ourselves. I think that's a critical area that does bother me.

We're in the manufacturing business. We're very diversified in what we do, manufacturing homes. Our business is going very strong. We feel like the economy is rebounding and we're proud to be a part of that. The areas that we feel like need attention are to continue working with our employees, providing the stabilization that they need and to help them grow.

**Graham Moore:** Well, I'm glad to be here I think. I got conned into this last Thursday for all y'all who don't know that. It's been real interesting listening to the economists talk about how they feel like we had a mild recession and that we're coming out of it. I guess I represent the highway industry. I work for APAC Carolina. I used to be a small business owner myself in Fayetteville NC, (Froll?) Constructors. I'm also the President of the Carolinas AGC this year. From the highway perspective, I think our industry is on the verge of real serious problems. I think we're just beginning to see the economic impact and it's not just from the economics. They're other problems out there that are facing our industry. The normal process for this type of economic condition for us, as I have been through four of them, is about 60% of our work comes from the state, the highway trust funds. About 30% comes from commercial work and about 10% comes from municipalities. With the economic problems that we've had and the money being taken from the municipalities, that in turn trickles down to us in that they take their power bill money to help balance their budgets, and we've lost that 10%. In these types of terms, we usually lose half or 75% of our commercial work, which leaves us with the state work, which over the years has always been very steady in the process and the amount of money that comes out of the DOT. With some issues that have just happened in the last 30 days, it appears that due to some environmental reasons, they may be pulling a lot of the relocation work off the shelf or off the bid list for the next 6 to 8 months, which is going to really impact our industry. If you put on top of that what the Governor has proposed, taking \$400 million from the highway trust fund, our industry is going to be in some serious problems. That \$400 million represents about 17,000 to 18,000 jobs and between that and the environmental stuff, we're going to be faced at the end of this year with a very serious economic problem, no money and no work coming in.

So with that, I would maybe like to offer a little bit of advice, when you're sitting there looking at what to cut, and I agree that cuts have to be made and I would say the highway trust fund ought to take its share of whatever is coming down, I think you really need to look hard at what economic value you get from what you cut. The money that goes into infrastructure, which is what our business is, it is a tax that the citizens of this state pay to keep their roads in great shape. That money turns over 5 times in the economy very rapidly. So every job you lose in our industry is going to really effect the economic situation for years to come in this state. So I would just caution you to look at what you cut, and look at the economic value of it. On the national level, every economic stimulus package that has ever been put together has always been around infrastructure because that's something that always needs to be refurbished in this nation. It also pays for itself in economic development and goods and services that travel on our roads. Thank you.

**Richard Moore:** Alright Graham, thank you very much. I really do appreciate everybody's patience. My watch, I have 4:00, we're half an hour over and for that I do apologize. David, we've saved the best for last Mr. Albritton.

**David Albritton:** Thank you Richard. I appreciate being invited. I'm afraid we don't have time for my 30-minute presentation. I am just a small businessman from eastern NC so I must admit, sitting at this end of the podium I feel like a mule at the Kentucky Derby with our distinguished economists here. In our business, we do directly and indirectly, a considerable amount of business with the state and local governments and we have seen a flattening of our revenues over the last two years. Unfortunately, I'm not in a position where I can go and raise our prices to cover any shortfall. We've had to become more efficient and I think the governor has had to do what he's had to do to cover the hole, but what I would recommend, and it's been said earlier, the state needs to look at some systemic changes to become more efficient, not just a temporary hiring freeze or layoff. Every private business that's represented here today knows what it means to have to cut and tighten the belt to weather the storm, but we try to put in systemic changes so that we can become more efficient over the long run. I think the state needs to do the same thing. We have a tendency to study things to death in this state; we need to actually implement some of these things we've come up with that are good ideas. Give the Governor and these departments the ability to actually implement these changes and put them in effect so we can become more efficient. As someone said earlier, we're not just competing against Virginia and South Carolina; we're competing against the Chinas and other countries. You don't have to go far in Wal-Mart to find something made in China, so we need to be mindful of that. Keep the things that are working in our schools and our colleges and universities, but let's try to become more efficient where we can. Thank you.

**Richard Moore:** David, thank you. We've heard some really great topics. Some of the things we keep coming back to: we need to make sure we keep what we already have in NC, particularly the small businesses as well as the large, a lot on investing in education, investing in the future, becoming more efficient, and there's several other themes that we seemed to hear over and over, and we'll boil this down to a report. Before I turn this over to Ken to make any comments that he may have on behalf of BOA for this conference in particular, I do want to thank everybody for coming. My apologies again, we've tried to run a tight ship, but I was fairly ambitious today. I hope we have not inconvenienced anyone by running over, but I certainly do appreciate all of your time.

\*Someone asked a question about the AAA bond rating.\*

**Richard Moore:** Yes, and I said to the members of the General Assembly I know they get so much mail, but I sent you something awaiting you when you got back. I'm very optimistic that we will retain our AAA bond rating. I'm optimistic for a lot of reasons, one, the reputation that NC has is unparalleled and we have Bob High here today who has a great deal to do with us maintaining that reputation. Two, our General Assembly has shown a real willingness that I believe Dr. Reaser commented on a little while ago, that it

is documented, and I actually sent you a quotation from Standard and Poors, that we've shown the ability to do the tough things that have to be done to protect our credit and balance our budget. Thirdly, perhaps this is a horrible thing, but it's the situation we find ourselves in, all the other states are having tough times too. If the AAA bond rating is a bell curve, and I know not all professors grade on a bell curve, but if somebody's got to have it, we've got a real good chance of continuing to get that AAA. Thank you.

**Ken Reece:** Richard, I would first like to thank you for taking the initiative to gather this group together, and I personally appreciate all of the comments that have been made by the panelists. I'm particularly sorry that Jim Hyler left because it's rare that I compliment one of my competitors, but I want to do this, and if you see him, I want you to tell him I said this, but his work with NCCBI this year as well as his work with the Governor's task force on government efficiency is real important to us and I think that is the right path that we ought to be following. I think you've heard from several people today that the business community operates very strategically given down times like this, and what we want is state government to do the same thing. And we recognize that there are restraints to state government that the small business community and the big business community don't have, but we still think you need to be thoughtful about that, we think you need to take a conservative approach. We also believe that we've got to build back up our reserve fund. We all know why it got depleted, but if that is not a part of what we're building into the budget process, I think we're going to run into some problems based on some of the reports that I've seen from the rating agencies. They're going to have continued concerns as to whether or not we've addressed systemically the issues that we're dealing with. And what I think we need to do is get out of the crisis mode and get into the mode that says we're going to methodically and strategically deal with these issues and do it over a period of time. That would be my council to the group.

Again, we appreciate your leadership, Richard. I thank all the panel members and appreciate the patience of the audience. Now, we're also hosting, I'm not sure where it is, I'm being told it's this way, but it won't take us long to find a path to some refreshments. I encourage you to stay, engage in some more dialogue with both the legislators and panelists and Treasurer Moore. I thank you and I appreciate your attendance.