BTC Brief

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MEDIA CONTACT:

ALEXANDRA F. SIROTA
919/861-1468
alexandra@ncjustice.org

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Raleigh, NC 27611-8068

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North Carolina communities need investment more than corporations and the wealthy need tax cuts.

BY ALEXANDRA F. SIROTA, BTC DIRECTOR

As the General Assembly returns for a short legislative session, their primary focus should be addressing the impending cuts to corporate and personal income tax rates in January 2019. After successive rate reductions on the income tax side since 2013 — which primarily benefited wealthy taxpayers and large, profitable corporations — the state of North Carolina is poised to continue to reduce its investments in people and places and leave needs unmet again this year.

Scheduled rate reductions for January 2019 will put the state's budgets out of balance in future years, requiring cuts to investments in public health, environmental protections and education, failing to keep higher education affordable and K-12 classrooms and schools funded to serve each child. North Carolina will lose roughly $900 million over a year in revenue from the reduction of the corporate income tax rate to 2.5 percent from 3 percent and from the flat personal income tax rate falling to 5.25 from 5.499 percent.[1]

At this point in the state's failed tax-cut experiment, it is time to return to an approach that prioritizes investments in people and places over tax cuts for corporations and the wealthy. Evidence shows it will not only strengthen the connection to prosperity for more people and places but will also grow the economy in more inclusive and sustainable ways.[2] It will also ensure that the state is pursuing a fiscally responsible path in light of its long-term needs and the uncertainty of federal fiscal policy.

Removing the scheduled tax cuts from statute this session is the first step to ensure that North Carolina can adequately invest in its future, strengthen the economy for the long-term and prepare for likely external shocks to the state's economic and fiscal health.

Put the prosperity of people and places first

North Carolina's failed tax-cut experiment is erecting barriers to prosperity for families and communities. In fact, the state's Fiscal Research Division has found

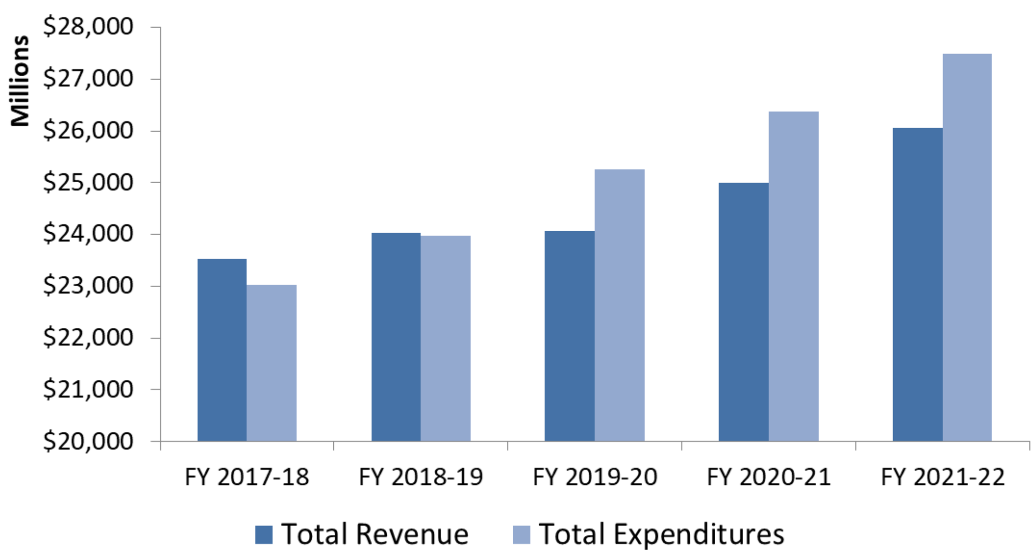
1 Johnson, Cedric. August 2017. Costly Tax Cuts in New State Budget Continue Precarious Road Ahead for North Carolina. BTC Brief: NC Justice Center, Raleigh, NC. Accessed at: http://www.ncjustice.org/?q=budget-and-tax/btc-brief-costly-tax-cuts-new-state-budget-continue-precarious-road-ahead-north

2 Williams, Erica. October 5, 2017. A Four-Point Fiscal Policy Blueprint for Building Thriving State Economies. Center on Budget & Policy Priorities: Washington DC. Accessed at: https://www.cbpp.org/research/state-budget-and-tax/a-fiscal-policy-agenda-for-stronger-state-economies?fa=view&id=3675

that our tax code will not be able to maintain the current — and already diminished — service levels for residents after 2019.[3] The estimates do not include consideration of unanticipated public health crises or natural disasters.

To keep the budget in balance, therefore, North Carolina leaders will have to reduce services for those already being served by programs or won't be able to deliver services to the state's growing population. Programs and services that could be impacted include job training for in-demand careers and current job vacancies, quality child care and pre-K programs for young children so that they are ready to learn, protection from abuse for children and older North Carolinians, and pay increases for teachers, for example.

FIGURE 1: Tax cuts for corporations, wealthy will lead to reduced services for growing state population



The tax cuts that will begin in January 2019 will result in $900 million in annual revenue loss, even though only $521 million was reported in the final budget due to the way in which lawmakers phase in the tax cuts. Because this change occurs in the second half of the second year of the two-year budget, lawmakers were not required to account for roughly $400 million of the annual cost of the tax cuts, as the fiscal impact of the tax cuts only reflect half of fiscal year 2019 (January 2019 through June 2019).

These additional tax cuts, added to annual revenue losses since 2013, means roughly $3.5 billion less in revenue each year to fund community and voter priorities like protecting children from abuse, building healthy schools, serving seniors meals, protecting our water and air, and training the future workforce.

Recognize who creates the majority of jobs in North Carolina

Much of the focus of leaders in North Carolina's General Assembly has been on how to provide large corporations with tax cuts with the misguided idea that this will result in more jobs and increase wages. Research shows that cutting the corporate tax rate largely benefits shareholders and investors (particularly out of state), while doing little to deliver benefits to

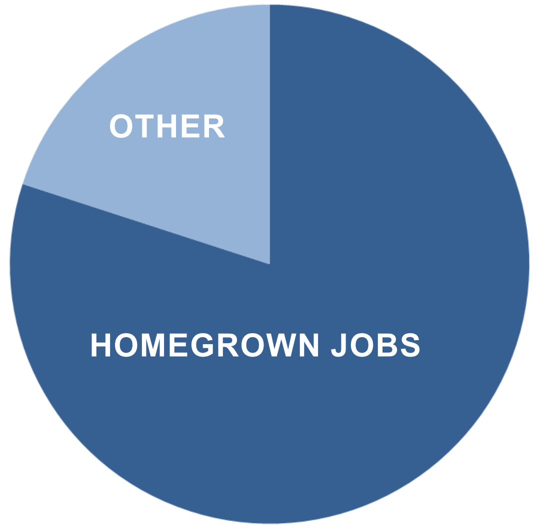
3 NC Fiscal Research Memo

workers through increased wages, and failing to reach small businesses.[4] A thorough review of the academic research also finds a lack of consensus on the benefits of state personal income tax cuts to economic growth.[5]

The reduction in the corporate income tax rate from 6.9 percent in 2013 to 3 percent today (and 2.5 percent in 2019), for example, cut the rate paid on profits by more than half. These additional dollars are likely to be turned over to shareholders and contribute to the increased use of stock buybacks to thwart the more broad-based returns of corporate growth.[6]

The vast majority of job creation is happening through homegrown and small businesses in the state, which are benefiting very little from these tax cuts.[7]

FIGURE 2: Most job creation stems from homegrown and small businesses in N.C.



SOURCE: MAZEROV AND LEACHMAN, FEBRUARY 2016

While the research finds that the small start-up firms are responsible for the greatest share of job creation, additional research finds that job creation is intimately tied to the ability of people to afford goods and services and generate demand that justifies business expansion or creation.[8] This role of people as job creators through their consumption and participation in the benefits of economic growth has been largely ignored under tax-cut approaches that have provided the largest breaks to the top taxpayers.

Boost the economy with proven strategies, not abandoned economic theories

Tax cuts are a poor strategy for boosting the state's economy and have rarely lived up their promised benefits when attempted nationally and in other states. The six states that made the biggest tax cuts in the 1990s created fewer jobs and had lower income growth than states that did not cut taxes. In the 1990s, six states cut their overall tax levels by 10 percent, more than any in the nation: Colorado, Connecticut, Delaware, Massachusetts, New Jersey, and New York. Yet, over the next decade, they experienced slower job growth than the 44 states that did not pursue this strategy: 0.3 percent vs. 1 percent per year. Personal income growth in the tax

4 Bivens, Josh, October 25, 2017. Cutting corporate taxes will not boost American wages. Economic Policy Institute: Washington, DC. Accessed at: https://www.epi.org/publication/cutting-corporate-taxes-will-not-boost-american-wages/

5 Mazerov, Michael, June 17, 2013. Academic Research Lacks Consensus on the Impact of State Tax Cuts on Economic Growth. Center on Budget & Policy Priorities: Washington, DC. Accessed at: https://www.cbpp.org/research/academic-research-lacks-consensus-on-the-impact-of-state-tax-cuts-on-economic-growth and Gale, William, Aaron Krupkin, and Kim Rueben, September 8, 2015. The Growth Mirage: State Tax Cuts do not Automatically Lead to Economic Growth. Tax Policy Center, Urban Institute and Brookings Institution: Washington, DC. Accessed at: http://www.taxpolicycenter.org/sites/default/files/alfresco/publication-pdfs/2000377-the-growth-mirage.pdf

6 Lazonick, William. 2014. "Profits Without Prosperity." Harvard Business Review. September. Accessed at: https://hbr. org/2014/09/profits-without-prosperity and http://rooseveltinstitute.org/wp-content/uploads/2018/03/Stock-buybacks.pdf

7 Mazerov, Michael and Michael Leachman, February 3, 2016. State Job Creation Strategies Often Off Base. Center on Budget & Policy Priorities: Washington DC. Accessed at: https://www.cbpp.org/research/state-budget-and-tax/state-job-creation-strategies-often-off-base

8 Toossi, Mitra, November 2002. Consumer spending: an engine for U.S. job growth. Bureau of Labor Statistics: Washington, DC. Accessed at: https://www.bls.gov/opub/mlr/2002/11/art2full.pdf; Madland, David, December 2011. The Middle Class Grows the Economy, Not the Rich. Center for American Progress: Washington, DC. Accessed at: https://www.americanprogress.org/issues/economy/news/2011/12/07/10773/the-middle-class-grows-the-economy-not-the-rich-2/ and Boushey, Heather and Adam Hersh. May 2012. The American Middle Class, Income Inequality and the Strength of Our Economy, Center for American Progress: Washington, DC. Accessed at: https://www.americanprogress.org/issues/economy/reports/2012/05/17/11628/the-american-middle-class-income-inequality-and-the-strength-of-our-economy/

cutting states was also slower.[9] North Carolina's job growth relative to its neighbors points to a similar failure of tax-cuts to deliver. North Carolina's 10 percent growth in private sector jobs since December 2013 puts it squarely in the middle of the pack.[10]

Researchers have found that increased educational attainment drives improved state-level economic outcomes, low levels of inequality and high levels of integration or equity across racial and ethnic groups are better approaches to boosting economic outcomes.[11] Analysts at the Federal Reserve Bank of Cleveland analyzed data from 1904 to 2004 and found that the greatest driver of per capita income growth is the number of educated workers, research institutions and other knowledge factors.[12]

Plan for federal cuts

The federal tax plan passed in December will further compound North Carolina's fiscal challenges. It will reduce federal revenues overall, forcing cuts to programs and services.

A third of the public taxpayer dollars circulating in North Carolina communities is from federal sources.[13] These dollars support community economic development, health care access and funding for public schools and after school program. Moreover, because of the cuts to the state's own revenue, North Carolina leaders have used federal dollars for services that were once state-funded. Professional development for teachers, pre-K slots for 4-year-olds, and development of affordable housing units are among the items that are increasingly being funded through federal dollars despite being state priorities.

In the coming year, North Carolina leaders should ensure that there is adequate state revenue available to meet state priorities and ensure that the reliance on federal funding would not result in the need to curtail the scope of services should funds be cut at the federal level.

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9 Leachman, Michael and Michael Mazerov, May 14, 2015. State Personal Income Tax Cuts: Still a Poor Strategy for Economic Growth. Center on Budget & Policy Priorities: Washington, DC. Accessed at: https://www.cbpp.org/research/state-budget-and-tax/state-personal-income-tax-cuts-still-a-poor-strategy-for-economic

10 http://www.ncjustice.org/?q=budget-and-tax/tax-cuts-have-left-nc-middle-regional-pack

11 Berger, Noah and Peter Fisher, August 22, 2013. A Well-Educated Workforce is Key to State Prosperity. Economic Policy Institute: Washington, DC, Accessed at: https://www.epi.org/publication/states-education-productivity-growth-foundations/; Fisher, Peter, February 2013. ALEC's "Tax Myths Debunked" Misses the Mark. Iowa Fiscal Partnership, Accessed at: http://www.iowafiscal.org/2013research/130211-IFP-alec.html; OECD, December 2014. Focus on Inequality and Growth. Accessed at: https://www.oecd.org/social/Focus-Inequality-and-Growth-2014.pdf; Benner, Chris and Manuel Pastor, 2015. Equity, Growth and Community: What the Nation can Learn From America's Metro Areas. University of California Press; International Monetary Fund, January 1999, Should Equity be a Goal of Economic Policy? Accessed at: http://www.imf.org/external/pubs/ft/issues/issues16/

12 Bauer, Paul W., Mark E. Schweitzer, and Scott Shane. State Growth Empirics: The Long Run Determinants of State Income Growth. Federal Reserve Bank of Chicago.

13 Sirota, Alexandra Forter, February 13, 2017. Federal funding supports North Carolina priorities. Prosperity Watch: NC Justice Center, Raleigh, NC. Accessed at: http://www.ncjustice.org/?q=budget-and-tax/prosperity-watch-issue-70-no-2-federal-funding-supports-north-carolina-priorities