BTC Brief

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Tax Policy Choices Continue to Constrain Opportunities for Progress Today

NC's state budget should build an economy for all.

BY ALEXANDRA F. SIROTA, BTC DIRECTOR

The upcoming biennial budget debate will be the first one since all of the tax changes written into statute in 2013 have gone into effect, and budget writers will once again feel the constraints of a state tax code that fails to support smart public investments that allow all communities in the state to thrive.

The final tax change from 2013 was the reduction of the corporate income tax rate from 4 to 3 percent on January 1, 2017, which will annually reduce the dollars available to the state by $500 million.[1] Subsequent additional cuts to the personal income tax rate passed in 2015 will mean that rate also dropped this year from 5.6 to 5.499 percent.

Policymakers face a self-imposed challenge of meeting the needs of a growing population, a changing economy and an opportunity infrastructure that fails to reach every community and neighborhood in the state. The decision to reduce revenue that could have been invested in schools, affordable housing, health care, and community economic development has had a cumulative effect on the ability of families and communities to get ahead.[2]

North Carolina's Tax Changes have Reduced Dollars Available to Invest in the Common Good

With the reduction in the corporate and personal income tax rate, estimates find that in the next fiscal year North Carolina will bring in $1.9 billion less than it would have under the tax code before the 2013 changes.[3]

Many policymakers point to the recent news that state revenue collections will come in over projections, this year by $552.5 million.[4] This is welcome news, but does not mean that North Carolina can meet the needs of families and communities across the state. To the contrary, more than $680 million in additional revenue next year is needed to meet required savings, enrollment growth in public schools and universities, and obligations to retired state employees and debt service. This figure also does not include the state investments needed to rebuild Eastern North Carolina after Hurricane Matthew, but it does include the $80 million the state must contribute to draw down federal dollars.[5] It does not include the mandate to align the foster care system with federal requirements; the need to better meet standards in achieving better health outcomes through school nurses, home visiting and access to healthy foods and active spaces; or ensuring access to affordable housing and loans for small businesses in rural and distressed communities.

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North Carolina's Revenue Collections Lag

North Carolina had not fully recovered to its pre-recession peak in revenue collections in the second quarter of 2016, the last quarter for which data is available for 50 states. Taking the longer view to pre-recession peaks for each of the 50 states, the overall change in tax revenue adjusted for inflation was 5.5 percent. North Carolina experienced revenue collections that were 0.2 percent lower in the second quarter of 2016 than its own pre-recession peak.[6]

North Carolina's revenue collections have lost ground due to the tax cuts, and they fall short of matching the performance of other states despite early indications in the recovery that the state would track the overall trend.

Even despite the announcement that revenue could come in above projections this year, North Carolina will fall short of the average growth rate in baseline revenue over prior periods. North Carolina revenue growth is expected to increase by 4.5 percent in the next fiscal year—below the pre-recession annual growth rate of 5.4 percent and the long-term average of 5 percent.[7]

Change in Revenue from Pre-Recession Peak to Second Quarter of 2016	
North Carolina	-0.2%
United States	5.5%

Source: Pew Charitable Trust, Fiscal 50: State Trends and Analysis, Tax Revenue accessed at: http://www.pewtrusts.org/en/multimedia/data-visualizations/2014/fiscal-50#ind0

North Carolina's projected revenue this year could be above pre-recession levels by $850 million, which falls short of expected performance in an expansionary period. State economists have pointed out that often in expansionary revenue periods, revenue growth exceeds the 5 percent average.[8] Had North Carolina's revenue performed at the average annual growth rate experienced in the three years of recovery prior to the tax cuts in 2013 (2010 to 2013), North Carolina revenues would have been another $551.9 million higher.[9]

1. Revised General Fund Revenue Consensus Forecast, Joint Memorandum to North Carolina General Assembly, NCGA Fiscal Research Division and Office of State Budget & Management, May 6, 2015. http://www.ncleg.net/fiscalresearch/generalfund_outlook_pdfs/15-16_Outlooks/Consensus%20Revenue%20Report%20May%202015.pdf
2. Tazra Mitchell and Cedric D. Johnson, "2017 Fiscal Year Budget Falls Short of Being a Visionary Plan for North Carolina's Economic Future," BTC Report, NC Budget & Tax Center, Raleigh, NC, July 2016. http://www.ncjustice.org/?q=budget-and-tax/btc-reports-2017-fiscal-year-budget-falls-short-being-visionary-plan-north-carolina%E2%80%99s
3. BTC analysis of major tax changes enacted by NCGA from 2013 to 2016
4. General Fund Revenue Consensus Forecast, Joint Memorandum to North Carolina General Assembly, NCGA Fiscal Research Division and Office of State Budget & Management, February 9, 2017.
5. Fiscal Research Division, Presentation to NC General Assembly Joint Base Budget COmmitttee Meeting, February 2017. http://www.pewtrusts.org/en/multimedia/data-visualizations/2014/fiscal-50#ind0
6. Revised General Fund Revenue Consensus Forecast, Joint Memorandum to North Carolina General Assembly, NCGA Fiscal Research Division and Office of State Budget & Management, May 6, 2015.
7. http://www.ncleg.net/fiscalresearch/generalfund_outlook_pdfs/15-16_Outlooks/Consensus%20Revenue%20Report%20May%202015.pdf
8. http://www.ncleg.net/fiscalresearch/generalfund_outlook_pdfs/15-16_Outlooks/Consensus%20Revenue%20Report%20February%202015.pdf
9. Author's calculation based on a three-year average annual growth rate of 6.3 percent.