

Financing the Future

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Presentation Outline

- Who we are and what we did
- Changes in North Carolina's Economy
- Problems with North Carolina's system of revenue
- Elements of reform



Who We Are

- The Institute for Emerging Issues (IEI) is a public policy, think-and-do tank.
- We convene leaders from business, non profit organizations, government and higher education.
- We tackle some of the biggest issues facing North Carolina's future growth and prosperity.

What We Did

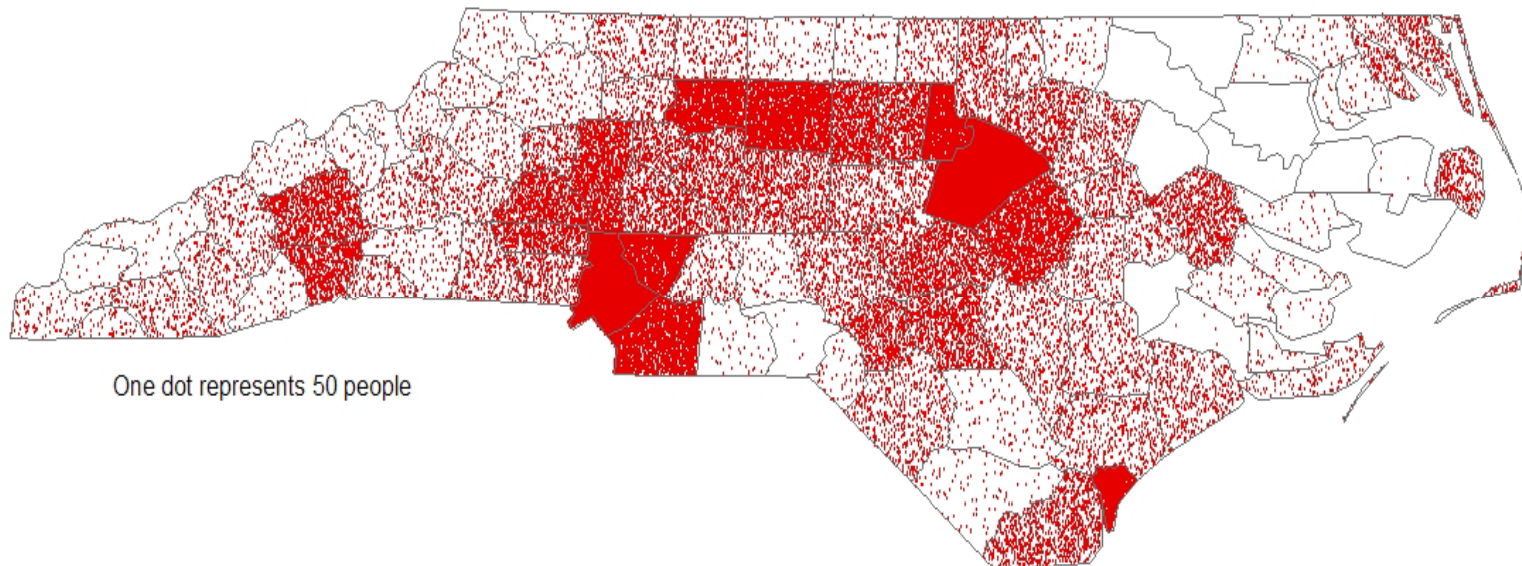
- In 2005 IEI convened three working groups
- 2006 Emerging Issues Forum--options for reform
- Five Community Forums held across the state
- Many presentations to local government, chambers and community groups
- Participation in Study Commission
- Organized Business Committee on Financing the Future (BCFTF).

North Carolina's Future

- **Population Change:** Urbanization, Composition, Dependency Ratio
- **Economic Transformation:** Knowledge and Service-based economy
- **Financial Demands:** Healthcare, K-12, Higher Education, Infrastructure

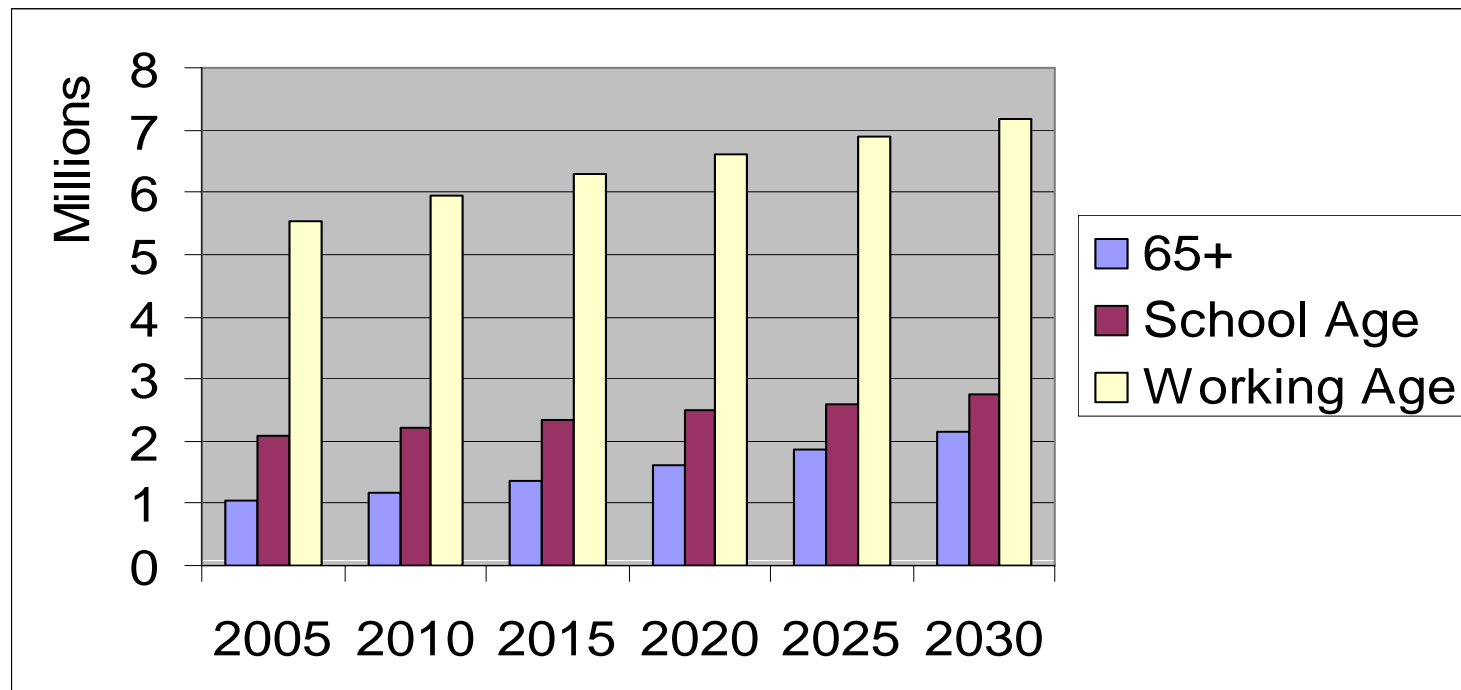
North Carolina in the Year 2030

Population growth will not be evenly distributed across the state.



North Carolina in the Year 2030

The population is aging, especially in rural areas.



Shift to a Knowledge Economy

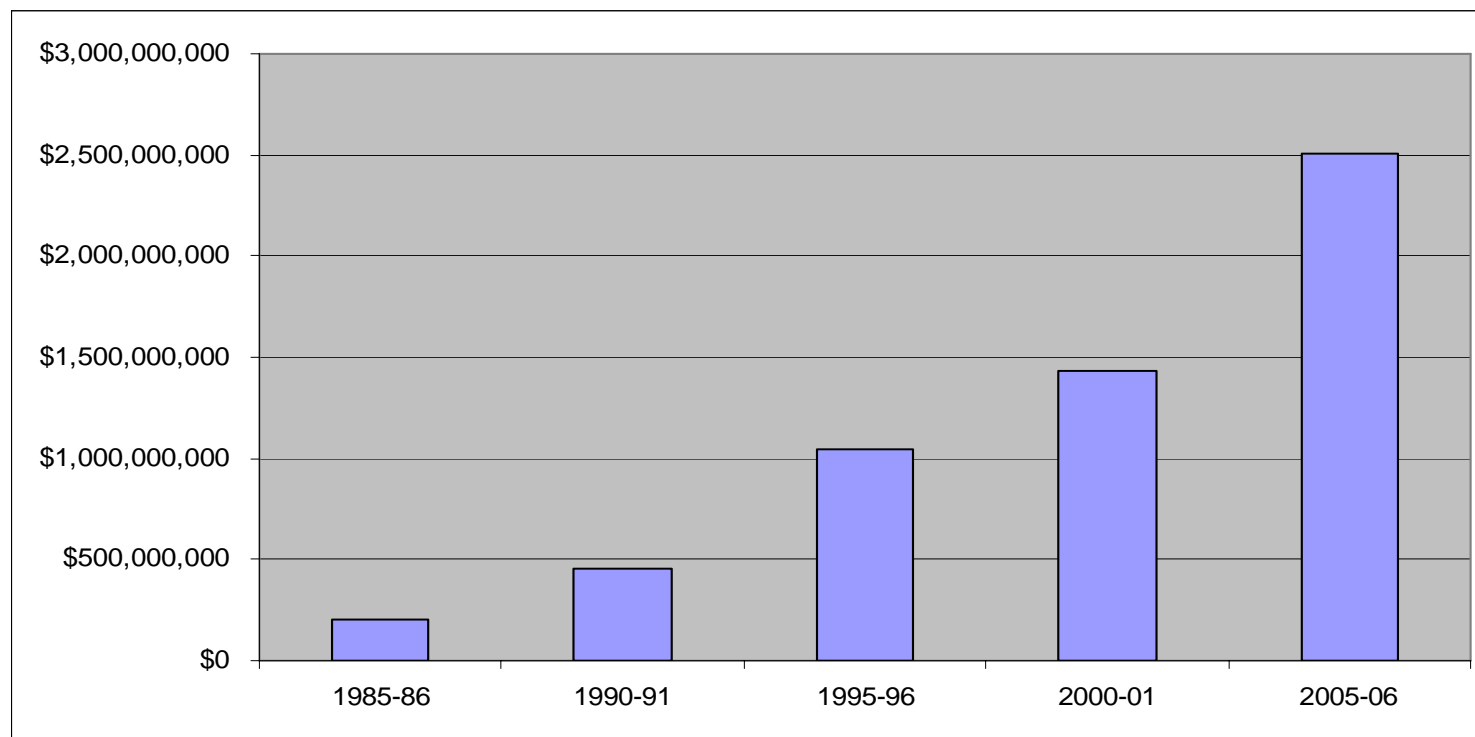
% Share of NC's Economy: Old Versus New Sectors

Sectors	1977	2005
Tobacco, Textiles and Apparel	22%	7%
Pharma, Technology, Food, Finance, Auto Parts	10%	17%
Total	32%	24%

Source: *North Carolina in the Connected Age* by Michael Walden
(UNC Press, 2008)

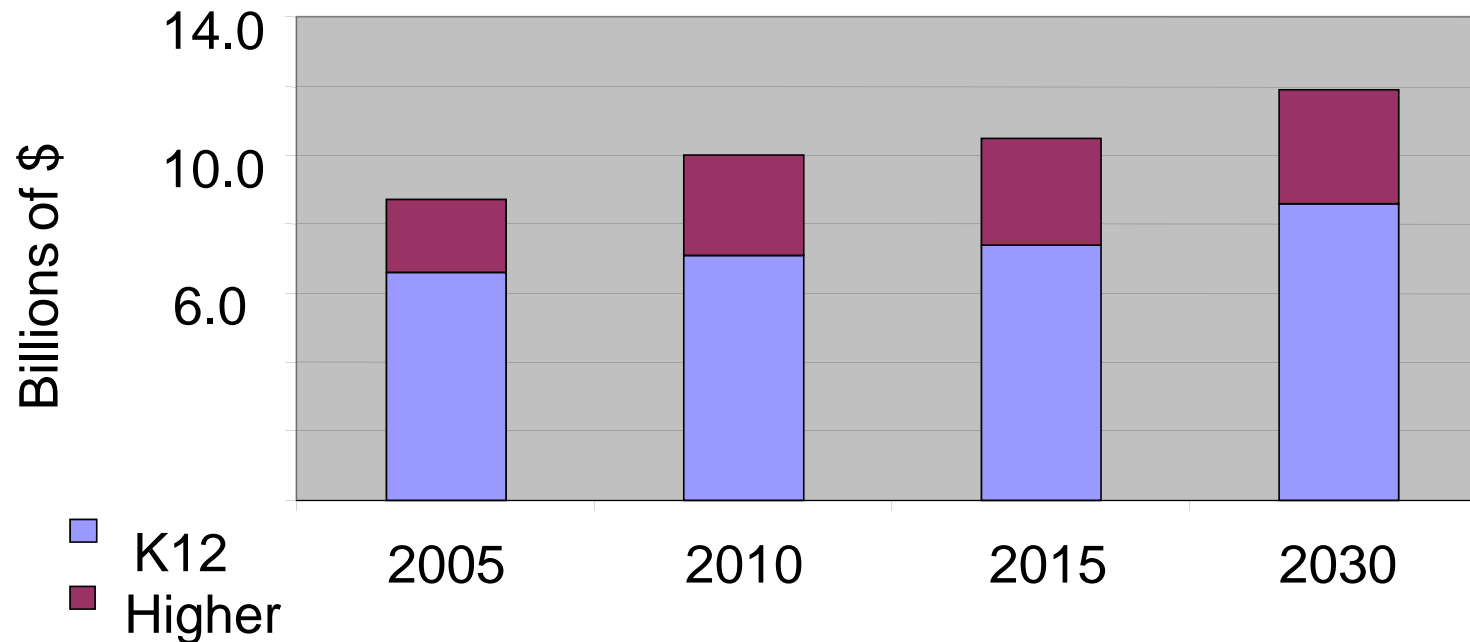
Financial Demands

Medicaid expenditures have risen rapidly and will continue to rise as the population ages.



Financial Demands

The cost of higher education will rise while the cost of new schools will be concentrated in rapidly growing urban areas.



Critical Question

What are the tax policy implications of the dramatic changes facing North Carolina?

State Revenues

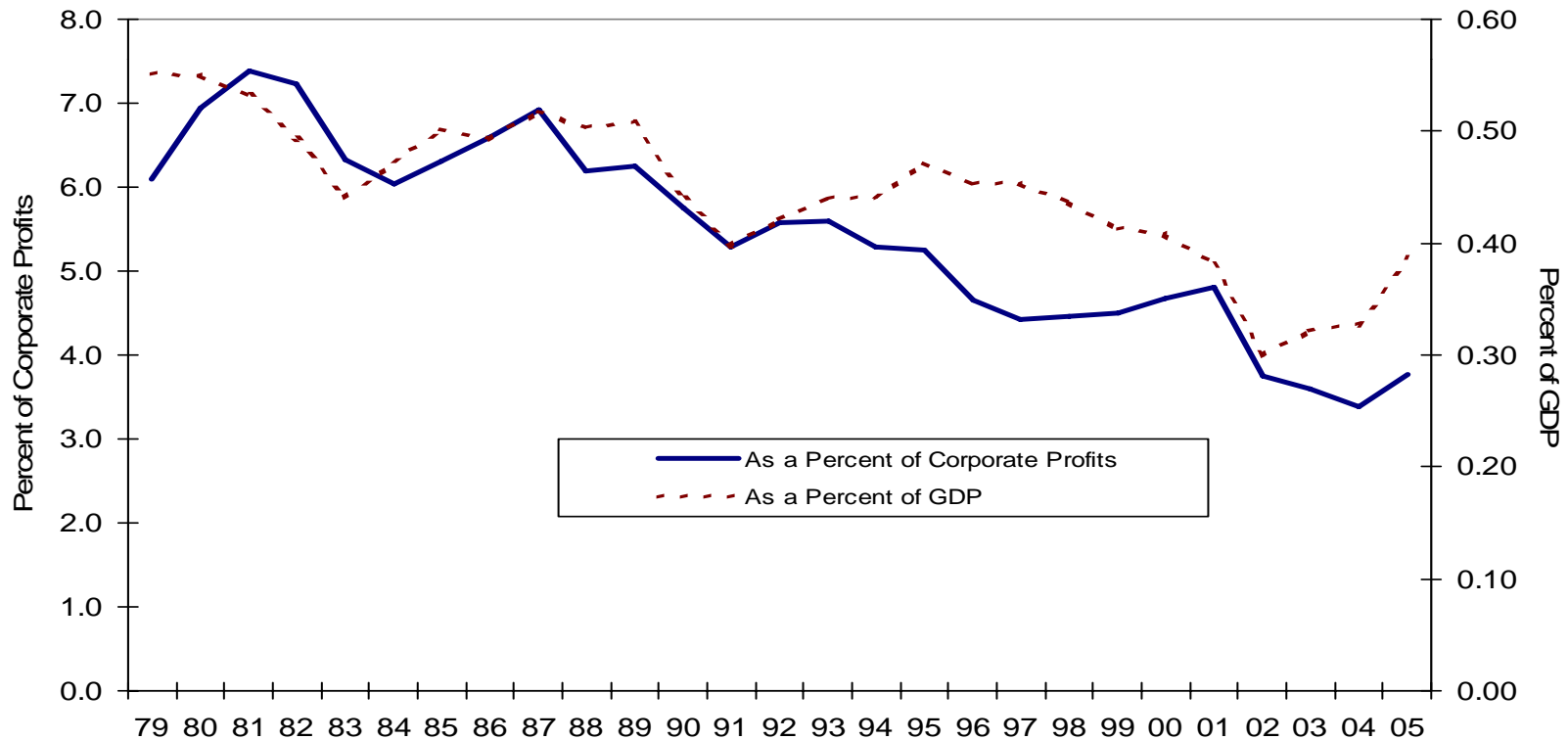
Problems

- Volatile
- Unfair
- Inadequate
- Complex

Causes

- Imbalance Among Sources
- Narrow Bases (loopholes, exemptions, credits)
- High Rates

State Revenues: Corporate Income Tax



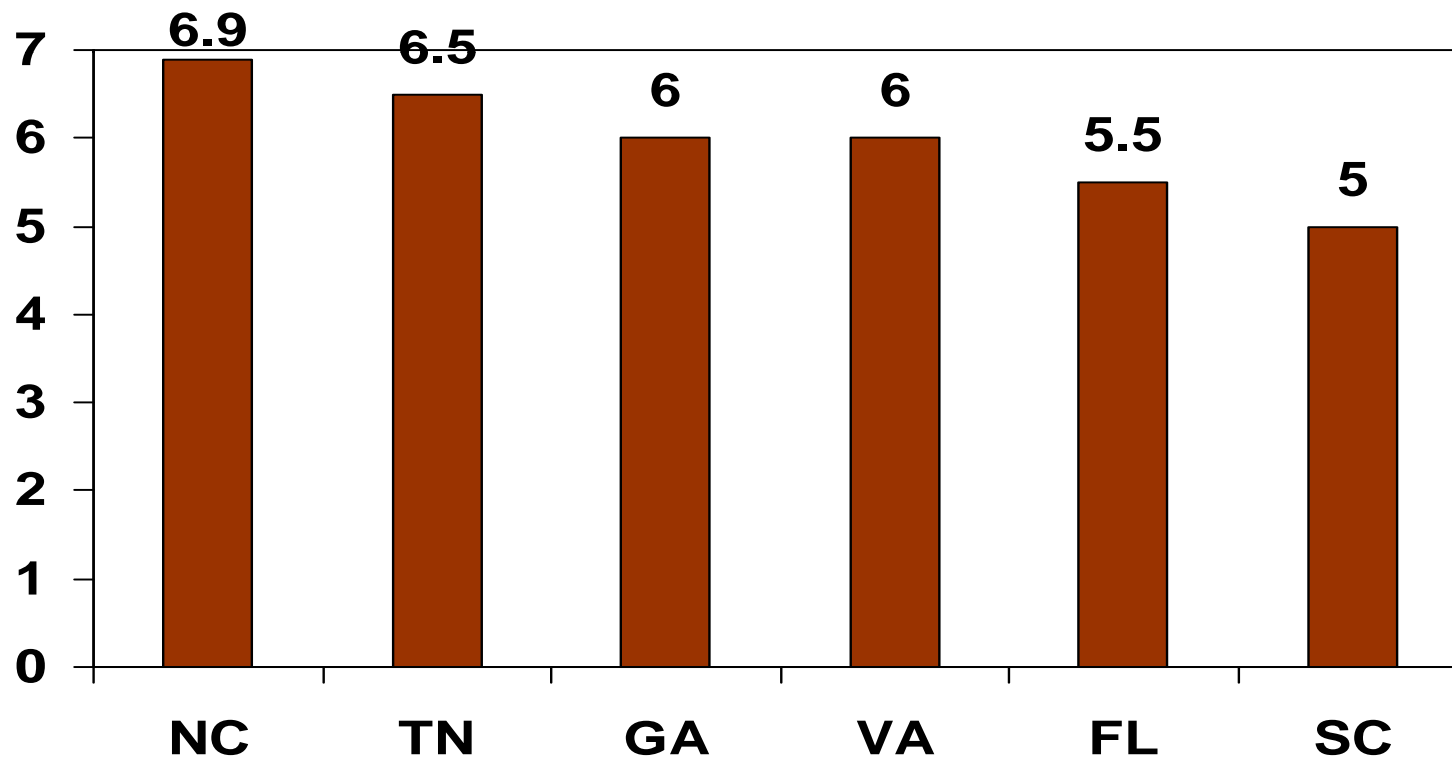
State Revenues: Corporate Income Tax

Causes of shrinking base:

- State credits and exemptions
- Tax planning
- Federal policy (depreciation etc.)

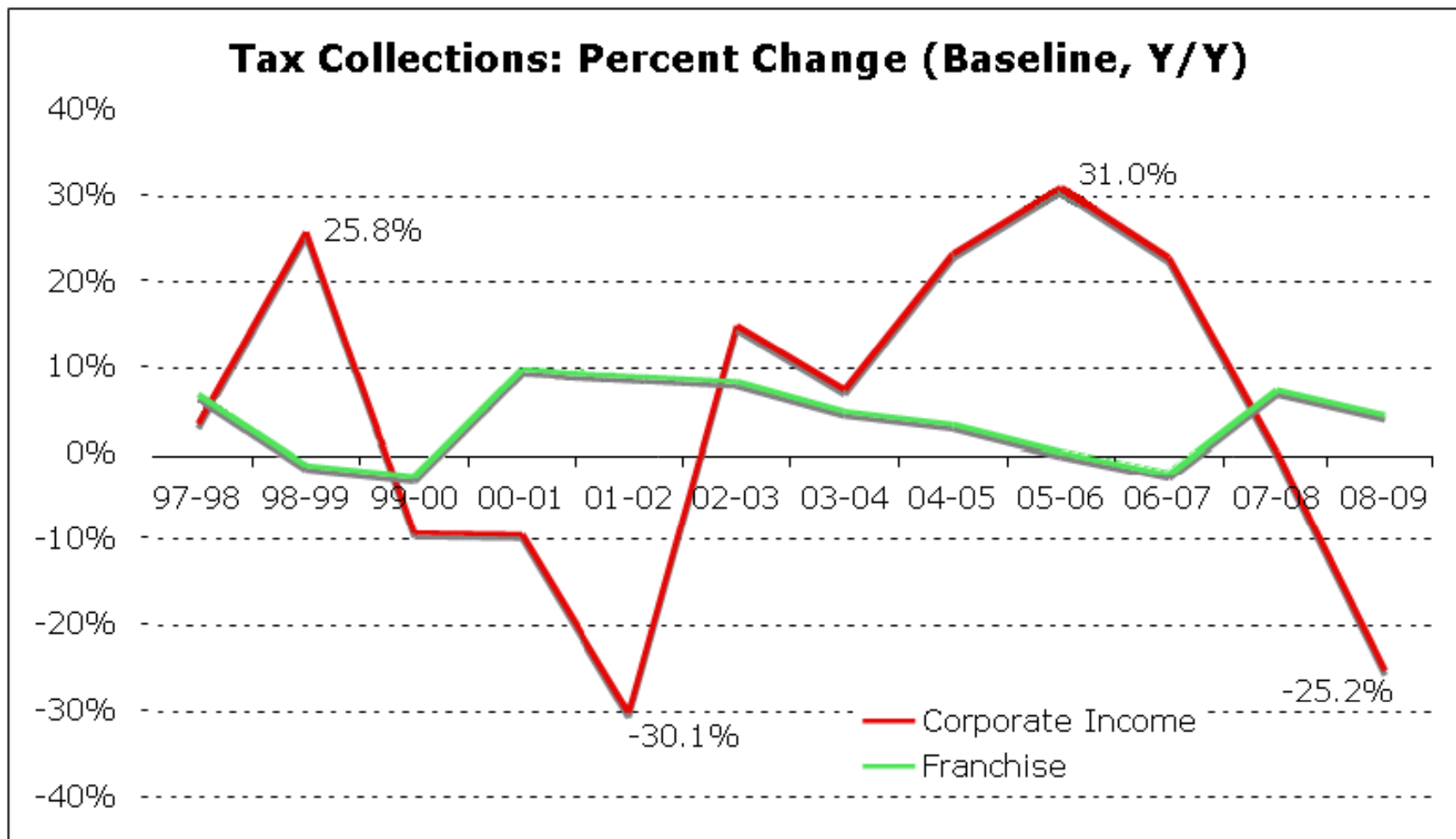
State Revenues: Corporate Income Tax

Corporate Income Tax Rate (TY 2008)



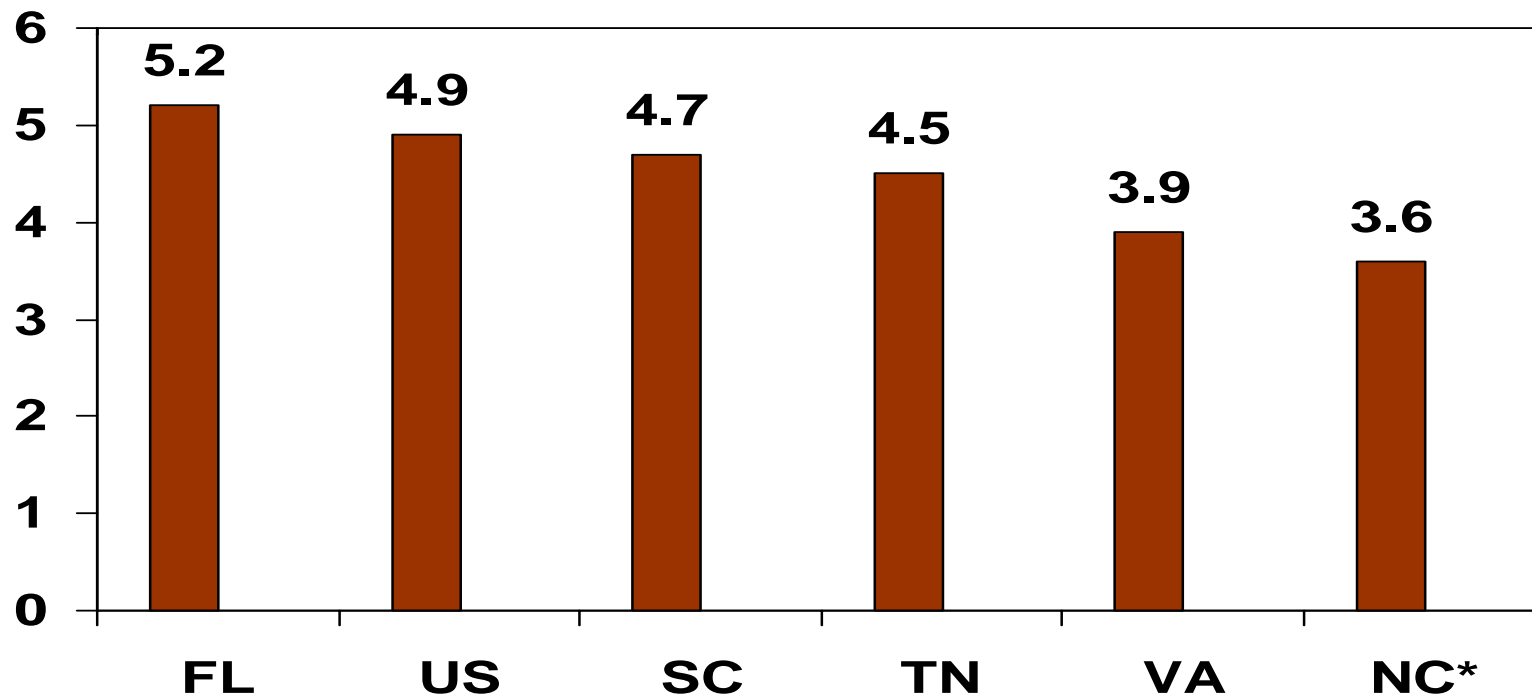
Source: Federation of Tax Administrators

State Revenues: Corporate Income Tax



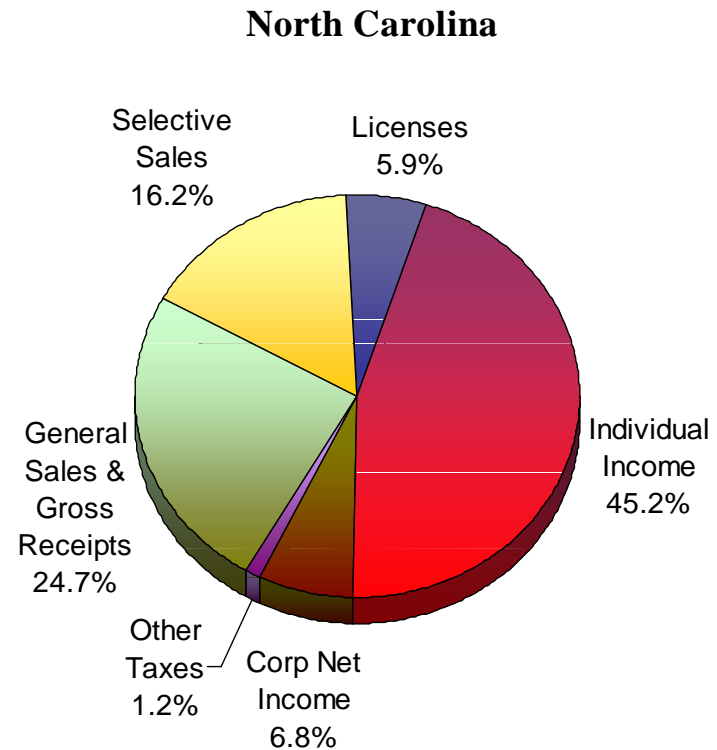
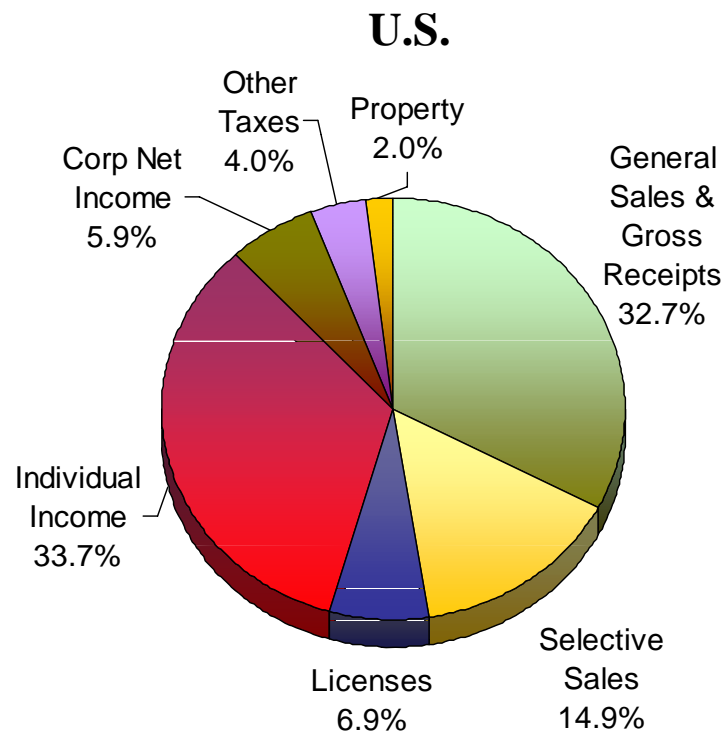
State Revenues: Overall Corporate Taxes

Business Tax Burden (as % of GSP)



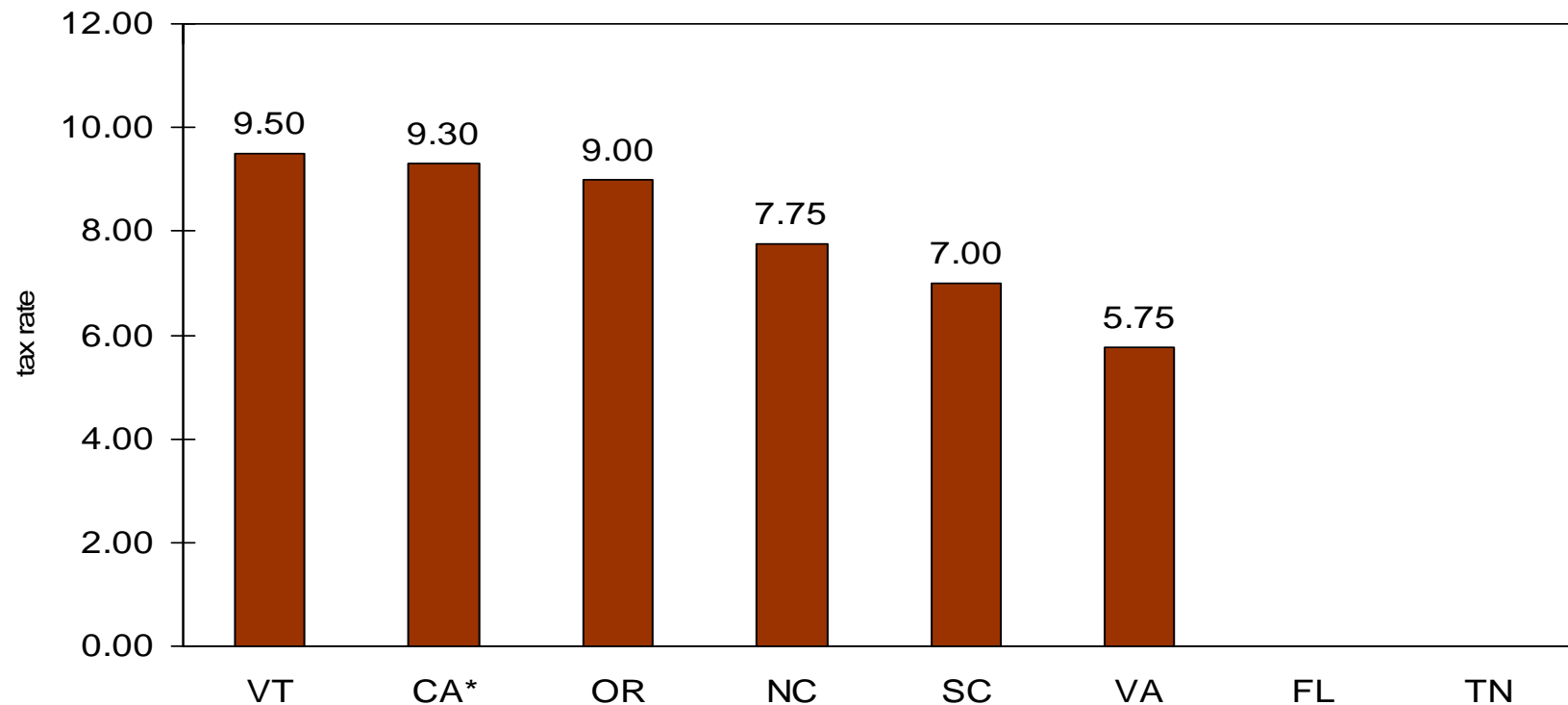
Source: Ernst & Young, "Total State and Local Business Taxes: 50 state estimates for fiscal year 2008," January 2009.

State Revenues: Personal Income Tax



State Revenues: Personal Income Tax

Top Marginal Income Tax Rate, Selected States, 2008



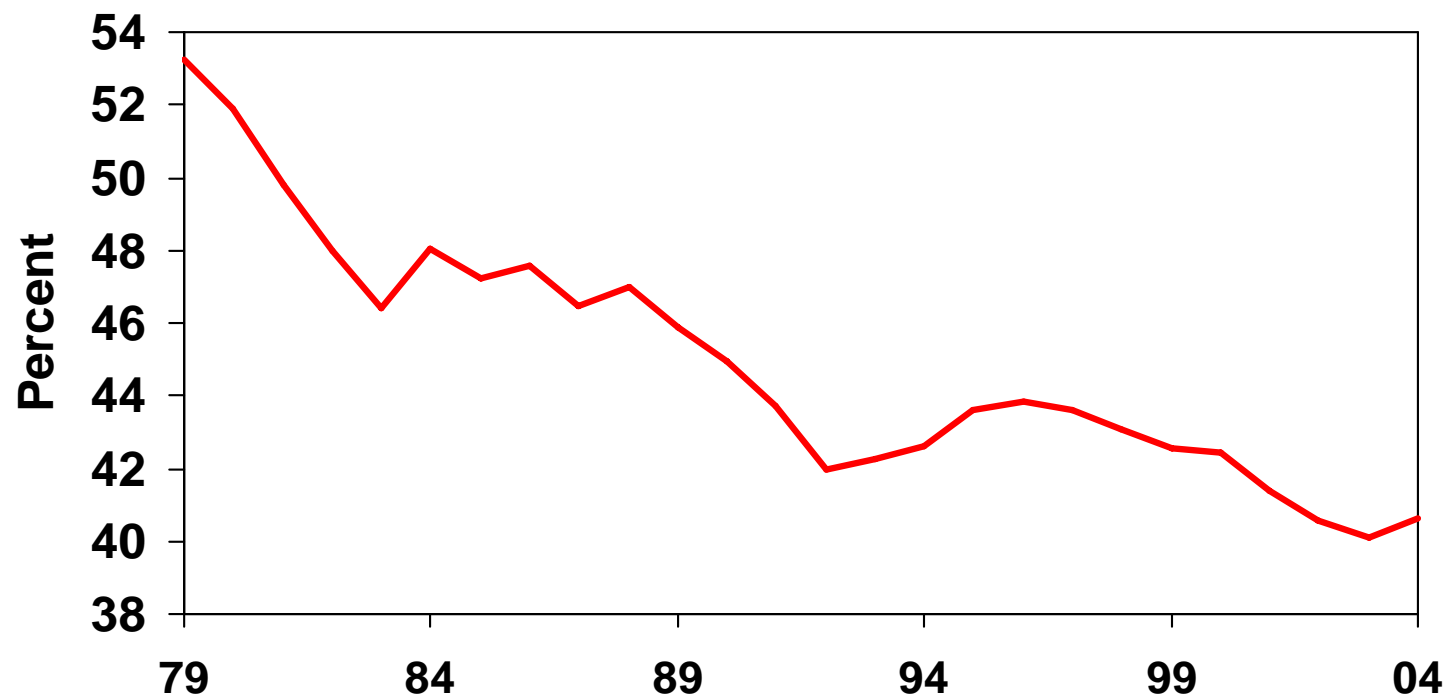
Source: Federation of Tax Administrators, March 2006.

State Revenues: Sales Tax

- Relies on a shrinking base.
- Regressive dependence on goods
- Complex
- Volatile

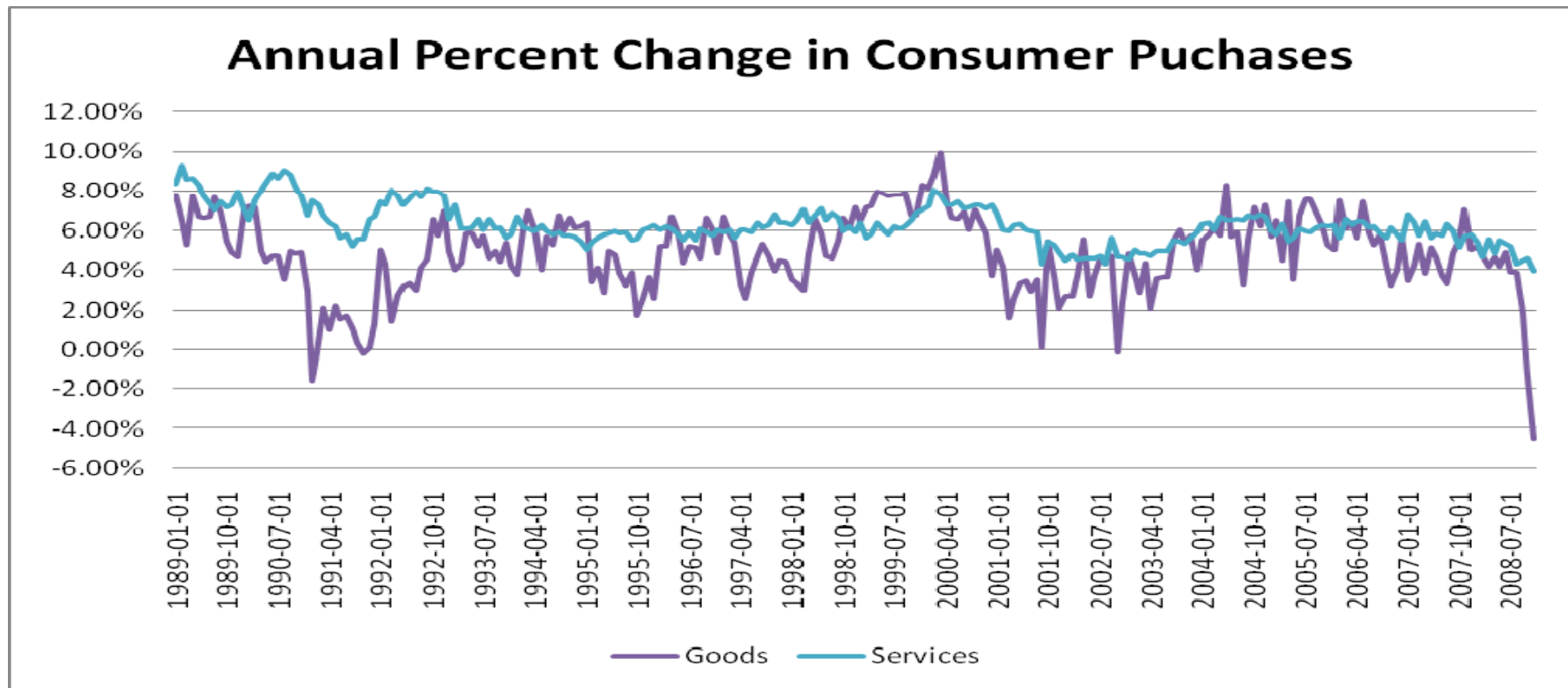
State Revenues: Sales Tax

The sales tax base is shrinking as percentage of the economy.



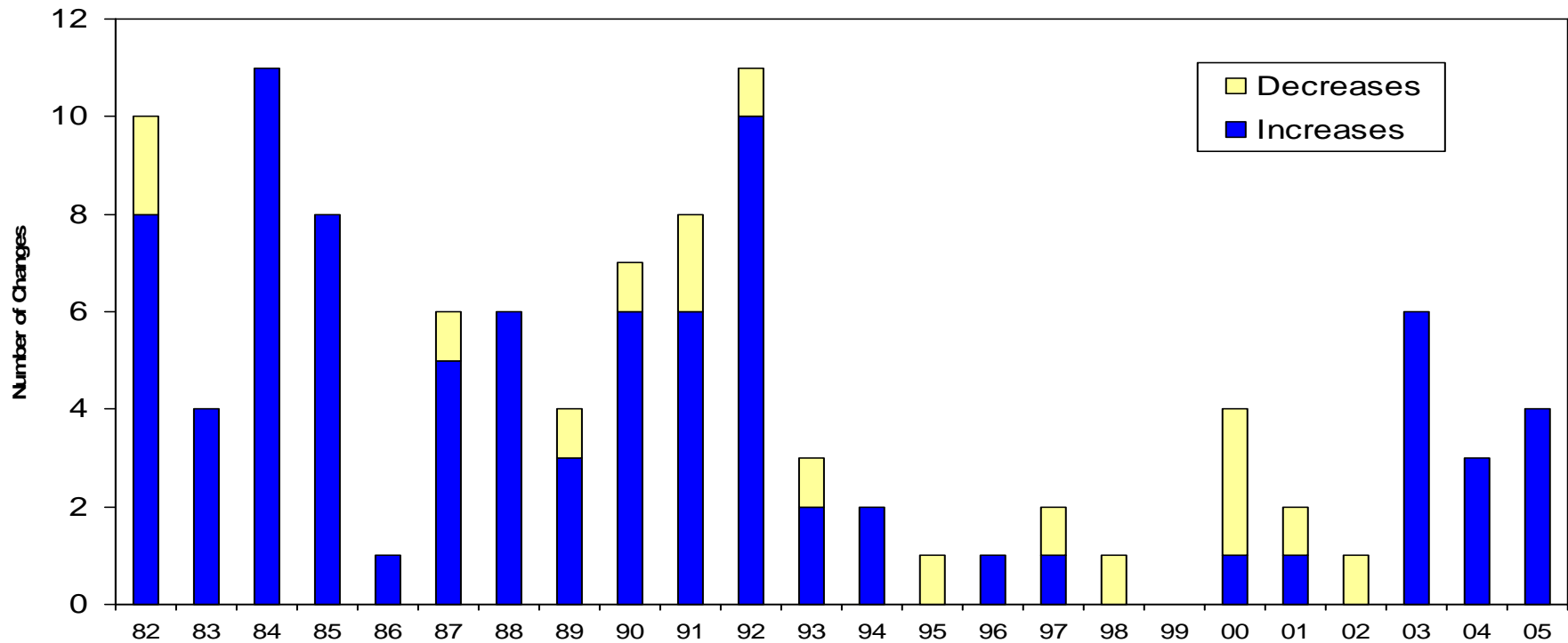
State Revenues: Sales Tax

The sales tax base rests on the more volatile component.



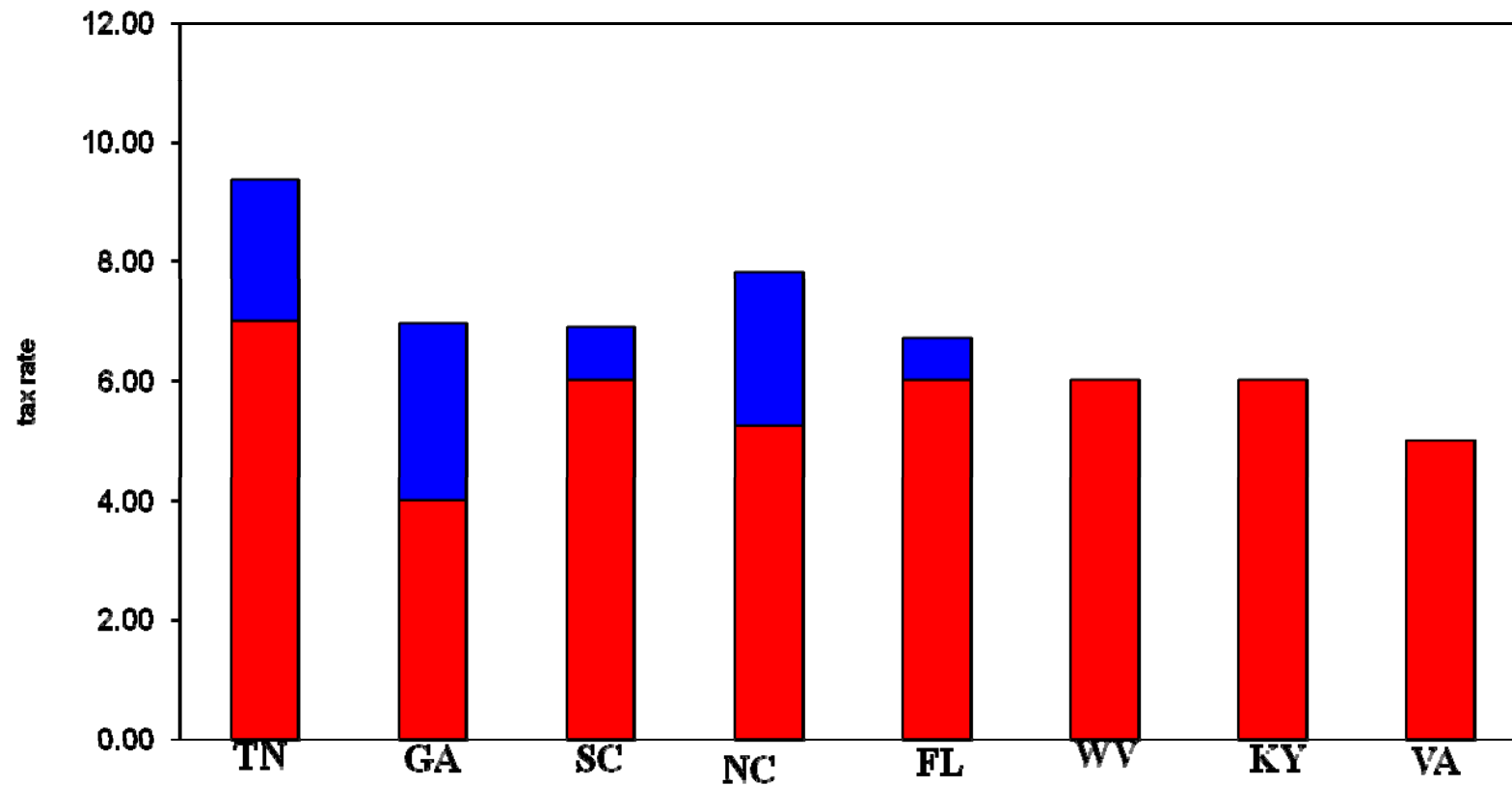
State Revenues: Sales Tax

As a result sales tax rates are constantly raised.



State Revenues: Sales Tax

The 2009 increase gives NC one of the highest rates

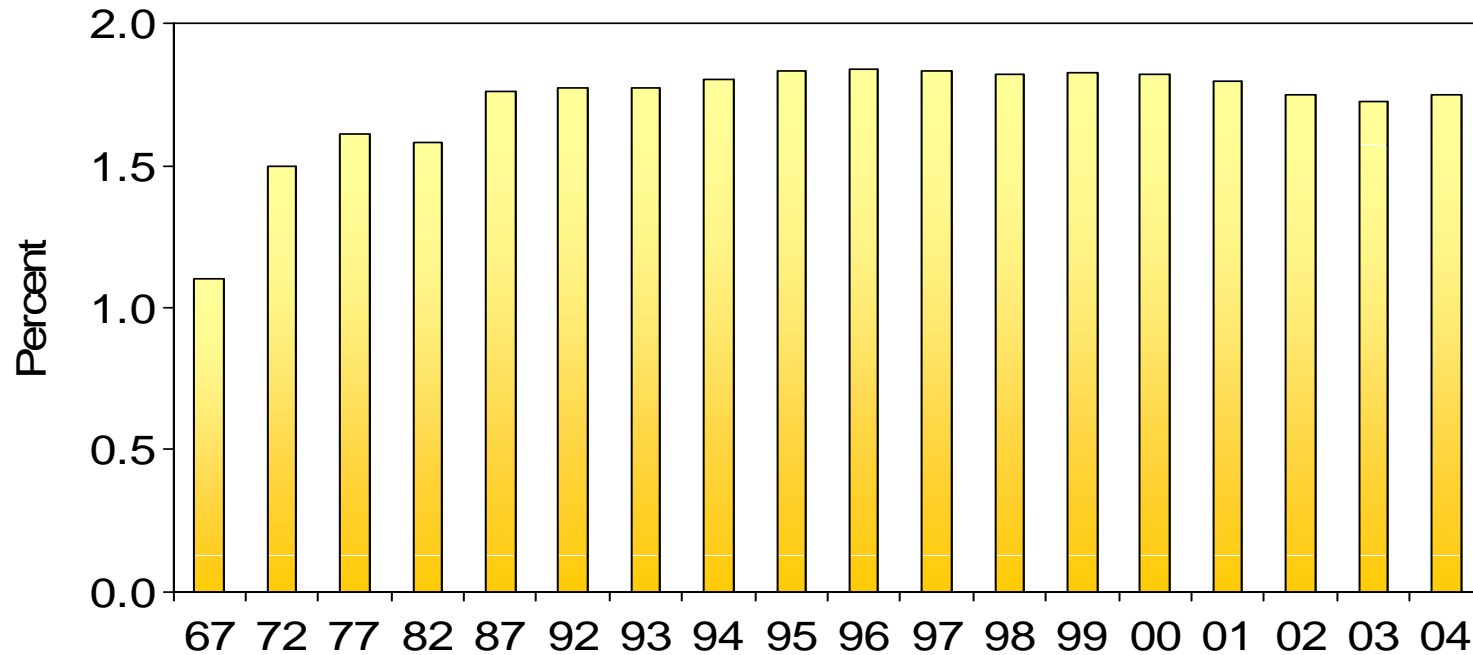


Source: Sales Tax Clearinghouse, November 2007

State Revenues: Sales Tax

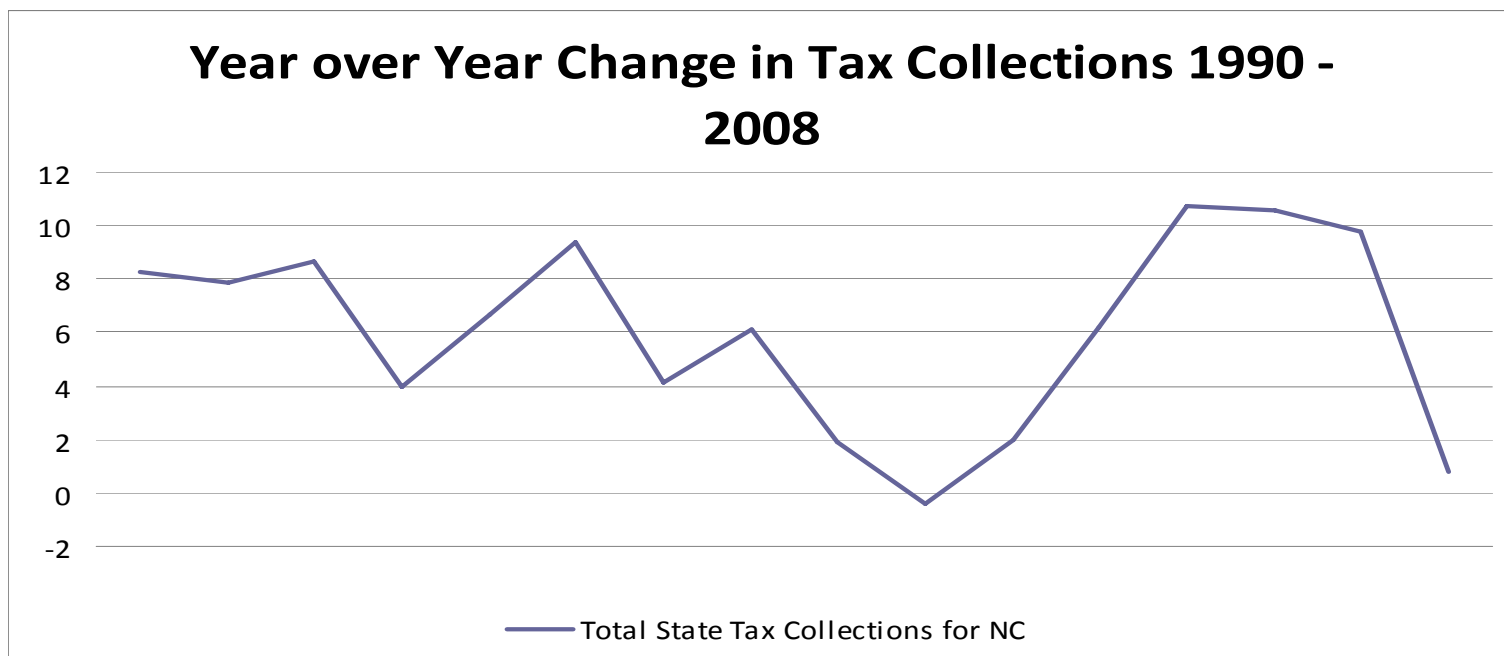
Yet rates increases do not raise total revenues

National sales tax revenues as % GDP.



State Revenues Overall

High rates and narrow bases contribute to volatility:



Local Revenues and Responsibilities

- Match revenues to responsibilities.
- Ensure adequate state funding for state responsibilities (schools)
- Provide local revenues for new local responsibilities (roads).

State Revenues: Solutions

Comprehensive change to be achieved through:

- Balance among sources of revenues
- Broad base
- Low rates

State Revenues: Solutions

BCFTF Recommendations:

- Explore alternative ways to tax corporations in the place of an income tax
- Use Federal Adjusted Gross Income for calculating personal state income taxes and reduce rates
- Extend the sales tax to many services and previously exempted tangible items and reduce rates
- Local responsibilities should have adequate and appropriate sources of funding

“North Carolina needs a tax system that is competitive, stable, adequate and fair if we are to prosper in the 21st Century economy.”

If not now, when? If not us, who?

For more information go to:

www.emergingissues.org