

EXECUTIVE SUMMARY

The Future of North Carolina Revenue State and Local Options for the Next Few Decades

REPORT FOR THE NORTH CAROLINA ECONOMIC DEVELOPMENT ASSOCIATION FOUNDATION

Prepared by Dan Gerlach LLC

EXECUTIVE SUMMARY

The Future of North Carolina Revenue

State and Local Options for the Next Few Decades

When the COVID-19 pandemic began, state and local government revenue forecasters worried that a deep recession of unknown duration would begin. The steps necessary to combat the spread of the disease crushed economic activity. Governments believed that funds would dry up, leading to difficult choices about spending and revenue policy.

Within short order, the substantial infusion of federal aid to individuals, businesses, and even governments buoyed government revenues well beyond the forecast and well beyond historic levels. North Carolina state government had two years of double-digit growth.

But these times cannot continue. The uncertainty of the ups-and-downs of government budget fortunes must be understood and options developed ahead of time to meet the needs of a state that is growing unevenly and its communities that vary widely in economic momentum and status.

The North Carolina Economic Development Association Foundation (NCEDA Foundation) was awarded a grant from the Charlotte 2020 Host Committee (CLT Host 2020, Inc.) to conduct analysis addressing that reality. Dan Gerlach LLC was engaged to conduct the analysis and write a report. This report, "The Future of North Carolina Revenue: State and Local Options for the Next Few Decades," is the outcome of this nine month analysis. With an advisory board of economic developers, university experts, government forecasters, business leaders and a former state legislator, the report recaps recent developments, examines results of those developments, gives options for new revenue streams, and other ways to meet the differing situations facing our state and local governments.

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Key Findings

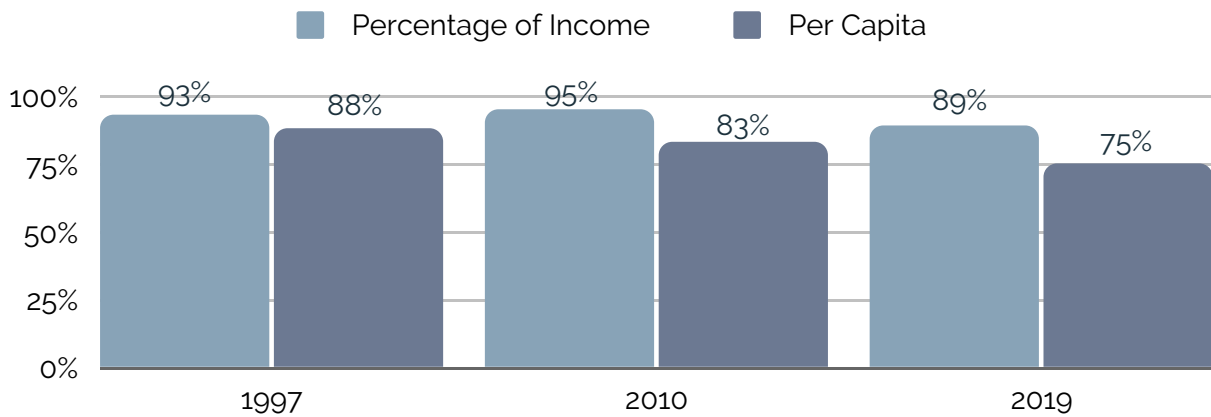
- North Carolina has a balanced tax system through the use of the three commonly used major state and local taxes: income, sales, and property taxes.
- North Carolina state and local burden on taxpayers has generally fallen as a share of the economy over the last decade and fallen in relation to other states.
- Despite substantial state tax changes, the income tax still brings a greater share of North Carolina state funding than happens in most other states. North Carolina retains a disproportionately higher amount of revenue raised by state government (versus the share coming from local governments).
- The property tax remains the dominant source of income for local governments.
- The pressure on revenues at the state level is highest toward the end of this decade, as state tax rates are scheduled to decline and even phase out for certain taxes.
- The DOT funds (Highway and Highway Trust Funds) are not forecasted to grow at even the rate of inflation.
- Numerous ways to end tax expenditures, create new taxes, and identify other revenue streams used in other states exist.
- The strength of some of North Carolina's urban areas benefits the rest of the state.
- A variety of strategies may be explored to help communities that are not faring as well.

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The Current Situation

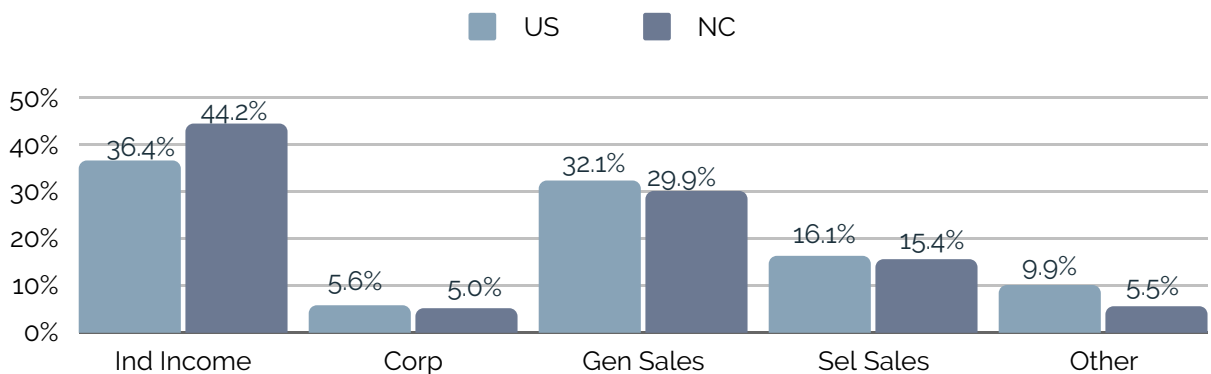
As shown below, the burden on North Carolina state and local taxpayers has fallen relative to the national average:

NC State & Local Tax Burden as Percentage of National Average



Despite reduction in burden, the state still gets funding from the income tax.

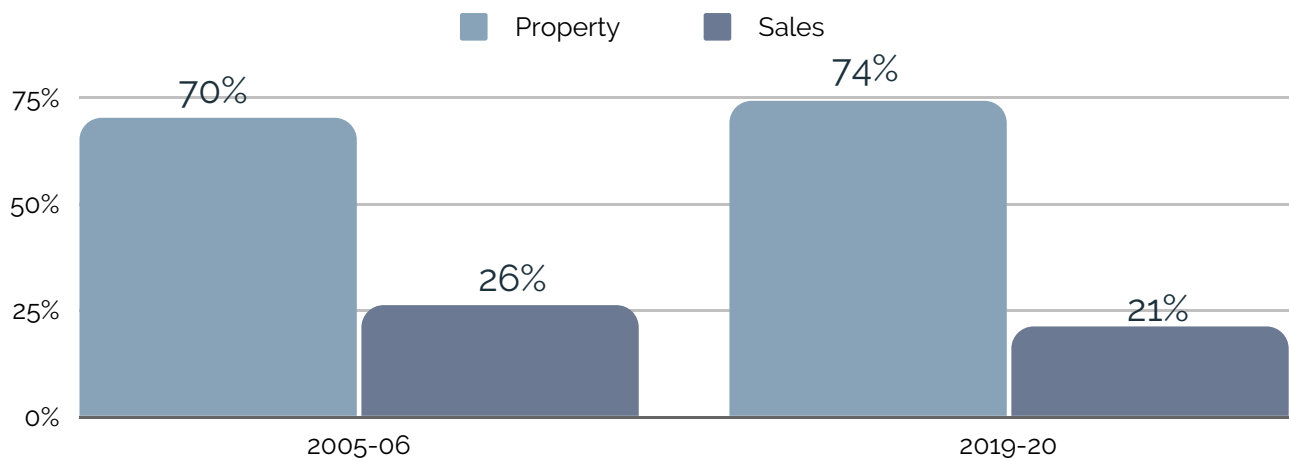
Percentage of Revenue By Source, US v. NC 2019



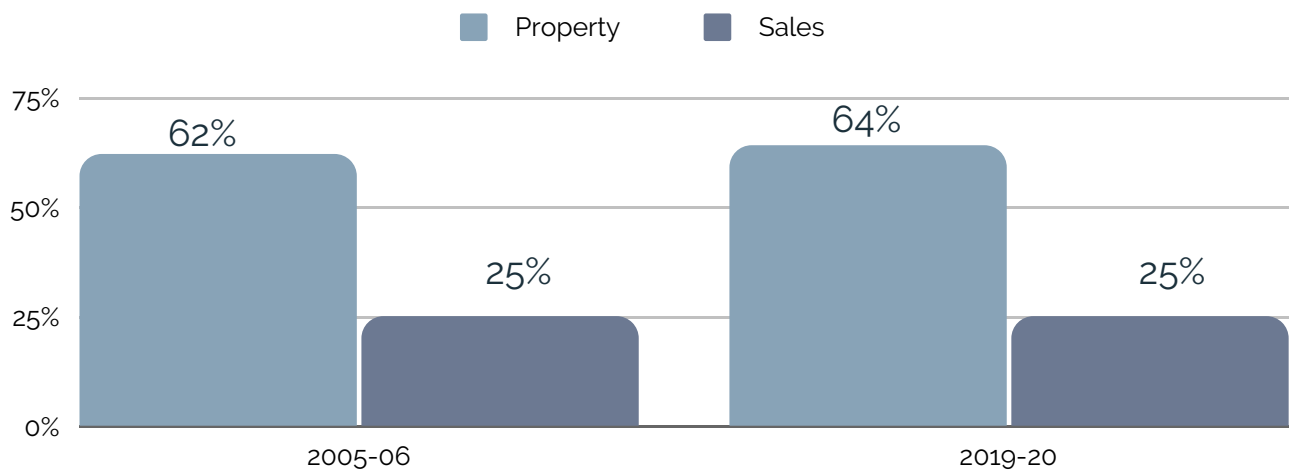
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Property taxes have been, and remain, the main source of revenue for local governments.

Share of Total Taxes from Property and Sales Taxes, County Governments



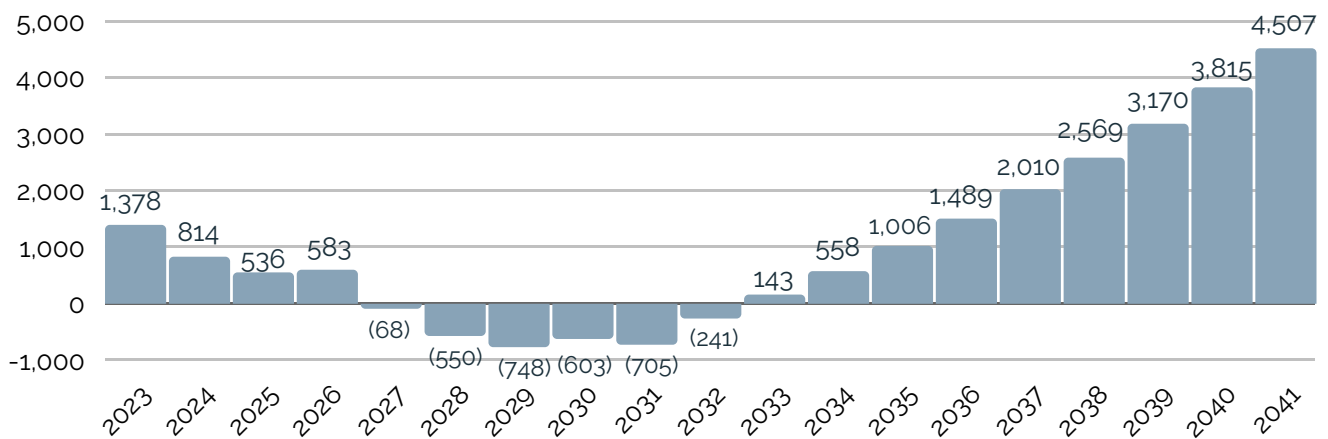
Share of Total Local Taxes from Property and Sales Taxes, Municipal Governments



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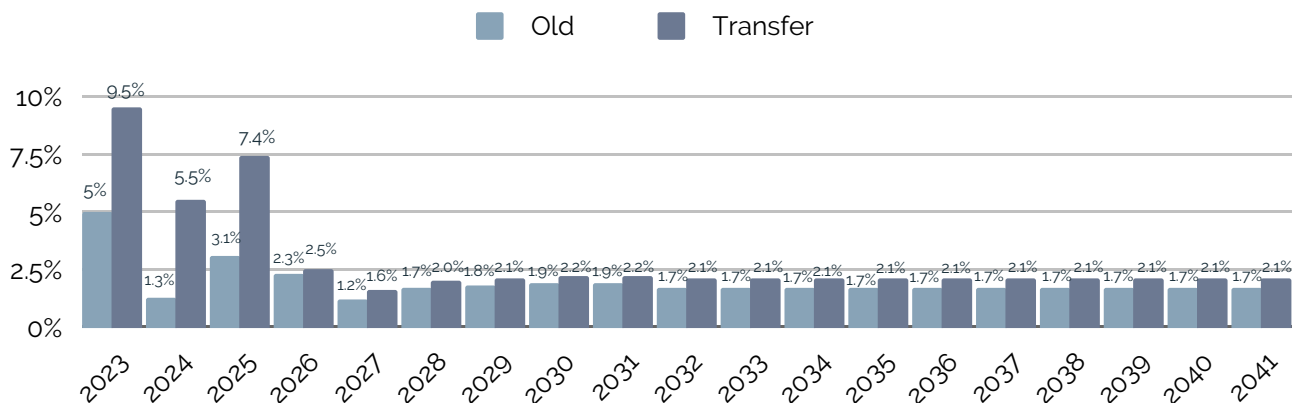
With the understanding that budget forecasts are rarely completely accurate, a long range forecast of state revenues shows a challenge peaking by FY 2029.

Difference between Revenues and Expenditures, Including New General Fund Transfer to DOT Funds with 3.5 Percent Estimated Annual Expenditure Growth



Transportation funding is challenged as well.

Highway Fund/Highway Trust Fund Growth (Before and After Budget Change)



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DISCLAIMER

Neither the NCEDA Foundation nor the CLT Host Committee 2020 are recommending any particular policy changes. Rather, the report provides options that are available for policymakers and others to consider.

Options Exist

The state has options to raise revenue to fill any budget gaps or offset additional tax reductions.

STATE REVENUE OPTION SUMMARY (ANNUAL, FULL IMPLEMENTATION)

BROADENING BASES

Value of 209 Tax Expenditures: The NC Department of Revenue reports the value of 209 exclusions, deductions, allowances, and preferred rates which reduce the amount of tax revenue otherwise collected.

\$9 Billion

Consumer Services: While many goods and some services are subject to the sales tax, there are services to which other states apply the sales tax that North Carolina could consider enacting.

\$221.1 Million

TAXES USED IN OTHER STATES

Online Sports Wagering: Legislation permitting such activity came very close to passage in the NC House in 2022.

\$26 Million

Marijuana Excise Tax: Other states have legalized the use of marijuana for both medicinal and recreational purposes. Should North Carolina follow suit, an excise tax similar to the alcoholic beverage and tobacco taxes could be implemented in line with those levied by other states.

\$133-184 Million

Statewide Property Tax (0.5 mills)

\$614 Million

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OTHER NEW REVENUE

Distributed Gambling: Other states have permitted video gaming terminals in bars, taverns, fraternal organizations and other locations. An analysis completed for the NC Education Lottery is the source of this estimate.

\$745 Million

Regional Greenhouse Gas Initiative (RGGI): Eleven eastern seaboard states sell carbon allowances to utilities in order to reduce emissions. This sale generates revenue for each state. A petition to join this initiative is before the North Carolina Environmental Management Commission.

\$498 Million

HIGHWAY USE TAX

Sales Tax Rate

\$827 Million

Estimated Trade-In Deduction

\$169 Million

While changes persist in a post-pandemic world, it will be good to start the discussion now on its long-term impacts on state and local economies and government revenues.

Please read the full report for more detail.

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