REPORT FOR THE NORTH CAROLINA ECONOMIC DEVELOPMENT ASSOCIATION FOUNDATION

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The Future of North Carolina Revenue

2023 UPDATE

INTRODUCTION

The Future of North Carolina Revenue

A 2023 Update

The North Carolina Economic Development Association Foundation (NCEDA Foundation) has an interest in a tax system that promotes growth and development, while sufficient to fund the goods and services that government generally provides, such as public infrastructure, education, and workforce training. In a changing world and evolving economy, there is an interest in providing a long-term view of options policymakers could consider to allow North Carolina, its communities, and its people to prosper with the support, not the hindrance, of good government.

In 2022, the NCEDA Foundation contracted with Dan Gerlach LLC to produce an analysis of North Carolina state and local finances over the next few decades and revenue alternatives that could be used to a) provide needed resources and/or b) reduce other taxes to improve fairness and competitiveness. This **report** showed the results of that analysis and provided certain options for policymaker consideration.

The NCEDA Foundation has authorized a brief update on that report, taking into account changes in the economic situation and policy changes enacted by the General Assembly. This update also briefly summarizes appropriations that have direct impact on economic development practitioners.

Legislative Session: 2023-24

The State Over Realized Tax Receipts Once Again

As has been the case for the past several years, North Carolina experienced revenue growth that exceeded original forecasts. For the 2022-23 fiscal year, actual revenues were $3.025 billion above certified budget amounts, or about 10 percent above the original forecast of $30.5 billion.[1]

This is not an isolated occurrence. North Carolina has historically adopted conservative revenue forecasts, as reflected by the 2022-23 overcollections of $3.025 billion. Here are the differences between forecasts and actual collections in recent years.[2]

FY 2020-21 $6.23 billion
FY 2021-22 $4.24 billion
FY 2022-23 $3.025 billion

The General Assembly Enacted Some Tax Changes with Definite Impacts

This latest overcollection gave legislators confidence as they fashioned their budgets for the 2023-25 biennium. Tax actions taken include:[3]

1. Accelerate the reduction in the individual income tax rate to 3.99 percent more quickly than previously expected.

Tax Year	Income Tax Rate Before Budget	Income Tax Rate After Budget
2022	4.99 percent	
2023	4.75 percent	
2024	4.6 percent	4.5 percent
2025	4.5 percent	4.25 percent
2026	4.25 percent	3.99 percent
2027	3.99 percent	3.99 percent

This acceleration will reduce expected revenues over the next four years, but because the long-term rate is not changed, it does not have any effect after FY 2026-27. The reductions are:

- $162 million in 2023-24
- $620 million in 2024-25
- $974 million in 2025-26
- $560 million in 2026-27

2. Increase in the gross premiums tax resulting from the expansion of the state's Medicaid program to a new population of non-elderly adults. Medicaid prepaid health plans (PHPs) are liable for the same 1.9 percent gross premiums tax as other insurers. It is not a result of an action to affect the tax rate, but an outcome of an increased insured population. The yield is expected to be $175 million per year, a share of which will be used to pay for the nonfederal share of the new persons covered by Medicaid.

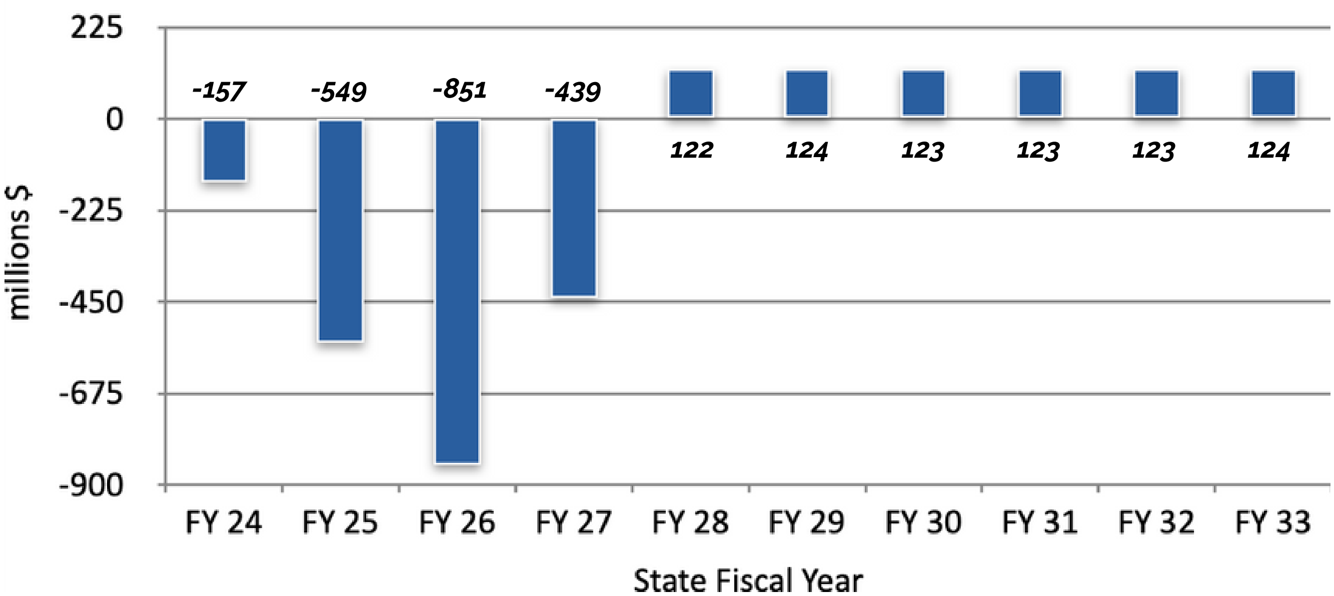
3. Reductions in taxes through various actions including: exemptions from the sales tax, a reduction in the state franchise tax, and elimination of the state privilege license tax on professionals. All of these actions total approximately $50 million when fully implemented.

4. New tax revenues resulting from the legalization of sports and horse racing that will generate an expected $45-$52 million annually for the General Fund.

By Themselves, These Actions Have Limited Long-Term Implications.

The chart below shows the net effects of these actions compared to current law. It must be remembered that the phase out of the corporate income tax and the individual income tax rate reduction were in place before the budget bill became law. As described above, the acceleration of the income tax rate reduction has a temporary effect.[4]

Difference Between Current Law Revenues and Budget Bill Revenues (without triggered tax cuts)

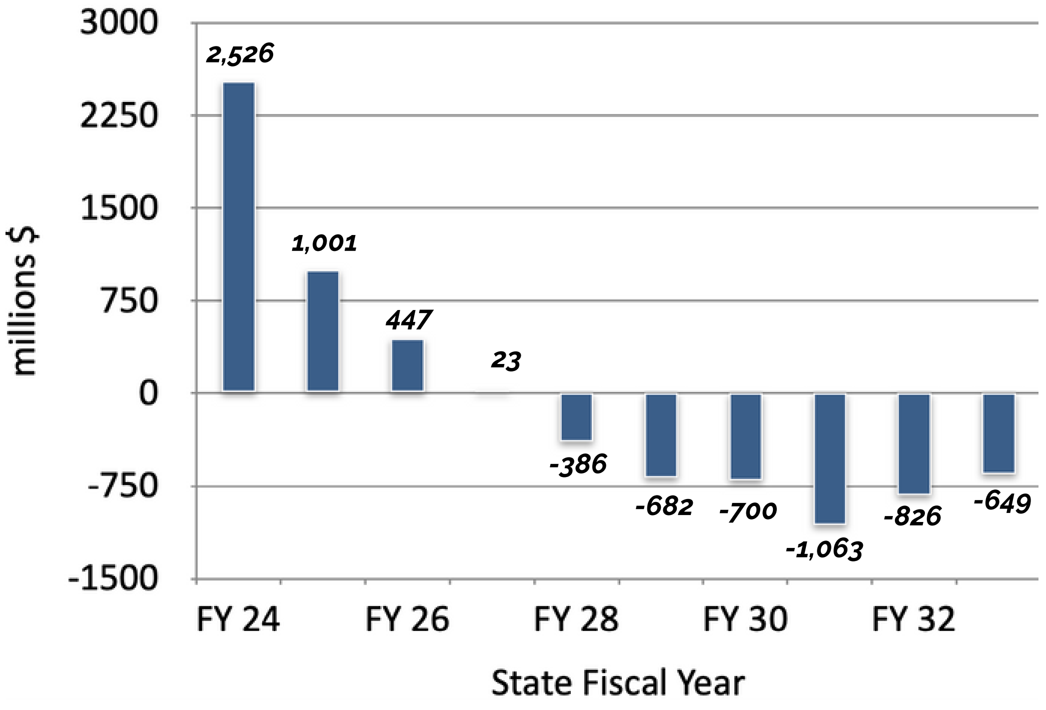


The Tax Actions Build on Tax Reductions Already Scheduled

The real question is how the state's fiscal condition appears to be in the long term compared to the state's spending patterns. The graph below shows the difference between the state's projected revenue and operating and the State Capital Infrastructure Fund (SCIF) spending levels. Consistent with recent General Assembly patterns, operating expenditures are capped at 3.5 percent growth per annum and SCIF patterns are held at statutory levels.

The long-term estimate shows a gap of $1 billion by FY 2030-31.

Difference Between Budget Bill Revenues (No Triggers) and Projected Spending at 3.5 Percent Growth



The General Assembly Allows for Additional Tax Relief Subject to Triggers

The most significant tax law change is the potential to enact additional individual income tax rate reductions beyond 3.99 percent. These reductions would be significant, with the possibility of reducing the rate to 2.49 percent. That would be a 48 percent reduction from the 2023 rate. Moreover, the rates would be reduced by 50 basis points (0.5 percentage points) at a time, rather than the current trend of 25 basis points (0.25 percentage points) per year.

In order to qualify for the reductions, General Fund revenues must meet or exceed an annual amount enacted in statute for a new reduction to take place the following tax year. The triggers are:

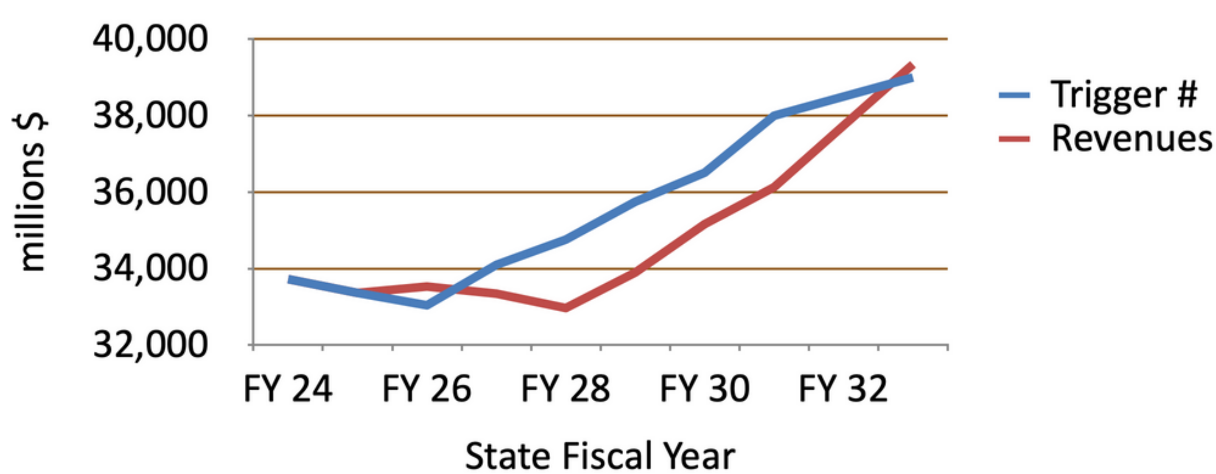
Fiscal Year	Trigger	Change from Previous Year Trigger Level
2025-26	$33,042 million	-0.9 percent
2026-27	$34,100 million	+3.2 percent
2027-28	$34,760 million	+1.9 percent
2028-29	$35,750 million	+2.8 percent

Fiscal Year	Trigger	Change from Previous Year Trigger Level
2029-30	$36,510 million	+2.1 percent
2030-31	$38,000 million	+4.1 percent
2031-32	$38,500 million	+1.3 percent
2032-33	$39,000 million	+1.3 percent

The 2025-26 trigger is set below the 2024-25 estimated revenue, thereby resulting in a situation that the state would likely hit that trigger and rates for the 2027 tax year would likely fall from 3.99 to 3.49 percent. Hitting the trigger once would reduce state revenues by an additional $2.1 billion annually by 2027-28. Therefore, additional trigger targets would be unlikely to be met.

The graph below shows a scenario:

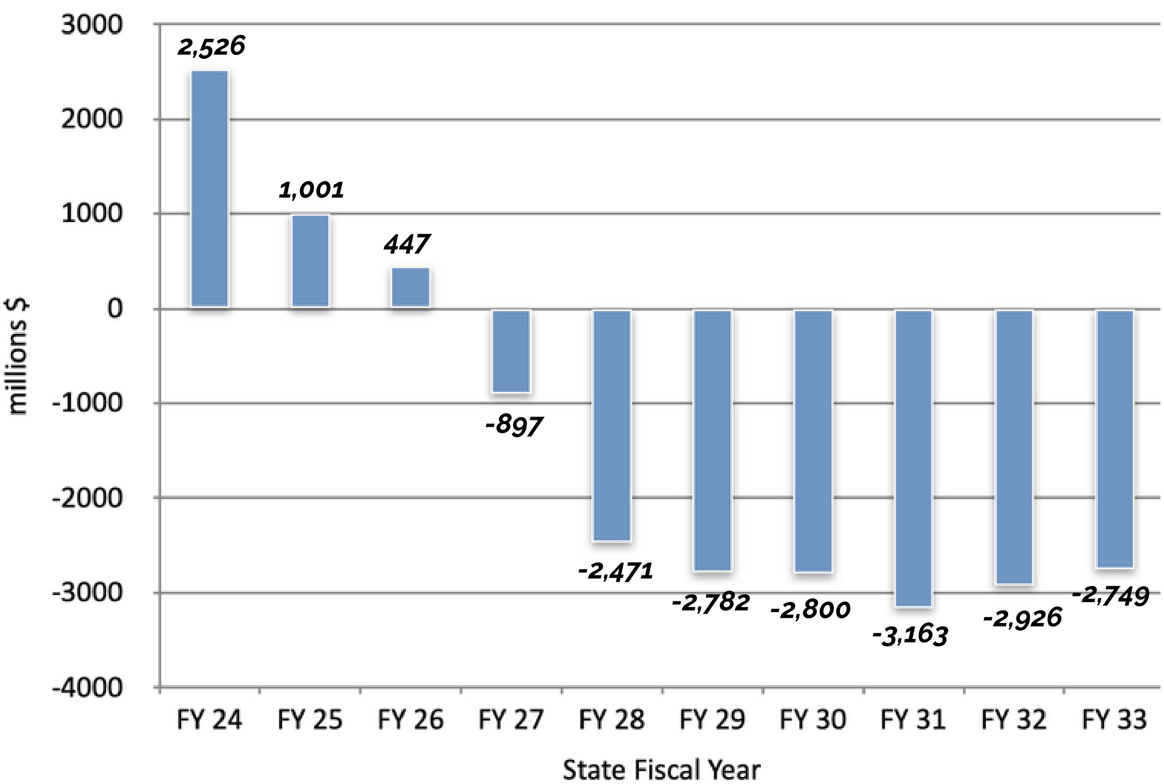
Triggers Compared to Revenues



It's a reminder that if General Fund revenues exceed the trigger by $1, tax relief of $2.0 billion per year would be enacted. This estimate shows that 2025-26 revenues would likely exceed the trigger by $490 million, based on current law and revenue projections.[5]

The graph below shows the difference between General Fund operating spending plus SCIF and General Fund revenues if one trigger is exceeded. If revenue forecasts hold, the state may not have the easiest time managing operating budget growth.

Difference Between Triggered Revenues and Spending at 3.5 Percent Annually



The General Assembly Also Considered Revenue-Producing Policies

Gambling Options

Various gambling options were discussed during the budget debate. The Governor proposed legislation that would legalize video lottery and e-instant gaming. Under his proposal, these new revenues would flow to the Education Lottery Fund for education uses. Together, these two new sources would generate $427 million during the biennium.[6]

The Governor proposed these items in order to fund education-related initiatives that he believed would help the state meet the constitutional requirements of the Leandro decision.

The Office of State Budget and Management also provided some estimates of revenues from expanded gaming options including:[7]

- Video lottery revenues (based on 40 percent tax rate) reaching $426 million annually by 2027-28
- Commercial casinos (based on 27 percent tax rate) reaching $289 million annually by 2027-28
- iGaming revenues (based on 27 percent tax rate) reaching $330 million annually by 2027-28

Regional Greenhouse Gas Initiative (RGGI)

Last year's NCEDA Foundation analysis listed the state's potential to join the Regional Greenhouse Gas Initiative (RGGI) as a revenue source for the state. The budget legislation, however, prohibits the governor or executive agencies acting to require public utilities to participate in cap-and-trade programs and from acting to enter into multi-state agreements on the acquisition of carbon dioxide allowances.[8] In essence, the legislature could act to establish such programs itself, but given the prohibition enacted this year, the General Assembly has acted in a manner that largely cuts off this revenue source as feasible.

The General Assembly Did Not Consider All Possible Options

The table below shows the policy options listed in last year's NCEDA Foundation report, with a note on the amount (if any) of consideration these revenue options garnered.

Revenue Option	Annual Value - Full Implement	Consideration in Session
Online Sports Betting	$50 million	ENACTED
Distributed Gaming	$745 million	Proposed by Governor; Discussed in conference

Revenue Option	Annual Value - Full Implement	Consideration in Session
Regional Greenhouse Gas Initiative	$498 million	RESTRICTED
Tax Expenditures	$9 billion	Not discussed
Consumer Services Taxation	$221 million	Not discussed
Marijuana Excise Tax	$150 million	Discussed at medical marijuana level
Statewide Property Tax	$614 million	Not discussed
Casino Legalization	$297 million	Discussed in conference

Through Appropriations, the General Assembly Relieved Local Government Burden

The General Assembly did not consider wholesale changes to local taxing authority. But the General Assembly did appropriate considerable funds for functions generally paid for by local taxpayers and ratepayers.

These appropriations include, but are not limited to:

- $2 billion over the biennium for local water and sewer projects, of which 98.7 percent is designated for specific governments and/or projects
- $300 million for local airport capital expenses
- Over $600 million for community college capital and equipment expenses, of which $100 million is not designated to a specific college or project
- Dozens of other directed grants to general purpose local governments (counties and municipalities) for government facilities and other similar expenses

The General Assembly has the wherewithal to do this at a time when revenues substantially exceed operating expenses. As discussed above, the gap between revenues and operating expenses will narrow, if not be fully eliminated, in the next few years. That development will limit the level of assistance local governments may expect to receive from directed grants.

Economic Development Support

The state's strong financial condition also provided state policymakers with the wherewithal to increase support for economic development. The most significant actions were increases in various reserve funds for specific purposes. The reserve funds receive their dollars from General Fund set-asides and may be used over several years.

Economic Development Project Reserve	$530 million 2023-24	$100 million 2024-25

The Economic Development Project Reserve was established in prior legislative sessions to receive funds that would support some of the state's megaprojects, most notably the Toyota EV battery plant in Randolph County. These funds were targeted to clearing and grading of sites, other site preparation costs, and infrastructure (especially roads and interchanges) to serve the megaprojects.

The General Assembly appropriated $130 million of the $630 million, primarily for product development. These funds will support:

$10 million in 2023-24 for due diligence expenses related to the seven megasites identified in the May 2023 **report**. Last year, the General Assembly authorized the creation of a Megasites Readiness Program to proactively address the shortage of large sites that could be marketed to major advanced manufacturing projects. This appropriation marks the first investment by the State in those sites.

$98.4 million in 2024-25 for site readiness expenses related to those megasites. After due diligence on these sites has been performed, the local governments or local government partnerships with nonprofit economic development entities that own or control the property will be eligible for assistance with site acquisition, site clearing and grading, provision of infrastructure to serve the site, and other related site readiness costs.

$10 million in 2024-25 for due diligence expenses related to the 15 selectsites that will be identified through an independent site evaluation. The EDPNC expects to receive applications from potential evaluators by year-end 2023, with the report completed by mid-May 2024. Selectsites are sites that are under 1,000 acres in size (and therefore are not megasites), but have the most potential and preparedness to accommodate a major advanced manufacturing project.

$10 million in 2023-24 for a shell building pilot program administered by the Golden LEAF Foundation. The Foundation has published guidance on applications that will be due December 28, 2023. Entities in seven counties (Ashe, Bladen, Columbus, Franklin, Harnett, Robeson, and Scotland) are eligible to apply. Details can be found **here**.

The remaining $1.6 million appropriated by the General Assembly will be used by the Department of Environmental Quality (DEQ) for a regional water and wastewater study ($1 million) and for the administrative oversight of the Megasites and Selectsites Readiness Programs ($600,000).

This leaves $500 million unappropriated and unallocated in the Economic Development Project Reserve.

Clean Water and Drinking Water Reserve	$1 billion 2023-24	$1 billion 2024-25

The General Assembly has appropriated $2 billion to clean water and wastewater projects across North Carolina. However, the vast majority of these funds have been directed to certain projects in certain cities, towns, counties, or water districts. The 213 projects individually named represent over 98 percent of total funds appropriated.

NC Innovation Reserve	**$250 million 2023-24**	**$250 million 2024-25**

The General Assembly has designated up to $500 million for NC Innovation, a nonprofit organization that has the mission of translating North Carolina University research and innovation into increased jobs, private investment, and wages across the state, especially in rural areas. NC Innovation would establish innovation hubs at East Carolina, NC A&T State, UNC-Charlotte, and Western Carolina Universities. Upon the meeting of certain metrics required in the legislation, NC Innovation would award grants to promising research and businesses emerging from research.

NC Agriculture & Manufacturing Processing Initiative (NCAMPI)	**$10 million 2023-24**	**$10 million 2024-25**

The General Assembly has created a new program to be administered by the NC Department of Agriculture and Consumer Services. These funds would support grants for infrastructure, site development, infrastructure costs, and cost-share of buildings and equipment for new and expanding agricultural manufacturing projects.

CONCLUSION

Once again, state government received more revenue than expected, generating considerable discussion and debate on the best uses of those unexpected resources. The state continued and accelerated its recent policies of individual income tax reduction, coupled with modest new revenues and discussion of additional potential sources of funds for state government. Local governments benefited from the deployment of hundreds of millions of dollars to assist with expenses traditionally the responsibility of city and county governments.

The long-term forecast reveals that the state may trigger additional tax cuts. Those tax cuts would make it difficult for government to remain at the same level, adjusted for inflation and population. This prognosis may lead to consideration of additional policy options.

The NCEDA Foundation is grateful for the support to produce the report. Any corrections or errors are solely the responsibility of Dan Gerlach LLC, the contractor who wrote the report.

ACKNOWLEDGEMENTS

The North Carolina Economic Development Association Foundation (NCEDA Foundation) was created in 2020 to advance the economic development profession, enhance the knowledge and skills of economic developers, and strengthen the broad, statewide economic development community in North Carolina through funding professional development activities, research, and education programs, especially to underserved, distressed, and rural counties and economic developers across North Carolina.

This “think tank” for economic development delivers cutting edge information via major research projects, blogs, and event presentations and is working to build a library of case studies and best practices. The Foundation benefits from funding by partners for expert research to improve North Carolina’s competitiveness.
In late 2021, the NCEDA Foundation was awarded a grant from the Charlotte 2020 Host Committee (CLT Host 2020, Inc.) to provide options for North Carolina state and local governments to raise revenues necessary for the efficient and effective operation of government.

The creators of this initiative expressed special concern about the varied needs of North Carolina communities, from fast growing communities placing a high demand on new infrastructure to shrinking, low-resourced communities struggling to meet current needs.

The NCEDA Foundation awarded Dan Gerlach LLC contracts in 2022 to develop the original report and in 2023 to complete this update.

ENDNOTES

[1] NC Office of State Budget and Management, Press Release, August 7, 2023, https://www.osbm.nc.gov/news/press-releases/2023/08/07/north-carolina-ends-fiscal-year-335-billion-revenue-3-billion-above-budget

[2] NC Legislative Fiscal Research Division, Revenue and Economy Reports, Various Years, https://sites.ncleg.gov/frd/revenue-and-economic-outlook/

[3] NC Legislative Fiscal Research Division, "Conference Budget Overview," September 20, 2023, pp. 29-34.

[4] Ibid.

[5] Ibid., p. 31.

[6] NC Office of State Budget and Management, Governor's Budget Recommendations: Special Provisions, p. 12, accessed at https://www.osbm.nc.gov/fy2023-25-budget-recspecial-provisions/download?attachment

[7] NC Office of State Budget and Management, personal communication to the author, "OSBM Estimates of Potential Revenues from Expanded Gambling Options," June 16, 2023.

[8] S.L. 2023-134, Section 12.5(a), pp. 372-373.