

# DOLLARS & DEMOCRACY

HOW THE STATE BUDGET CAN BUILD THRIVING COMMUNITIES

*2023 Edition*

North Carolina Budget & Tax Center

# Investing In Thriving Communities



**E**very North Carolinian wants to live in a thriving community. We all want well-staffed public schools for our children to learn the skills they'll need in adulthood. We all want safe, easy-to-navigate streets so we can get where we need to be. And we all want strong local businesses that support a robust local economy.

These are all elements of a thriving community. These are all values that we share.

So how do we as a state demonstrate our values? How do we make sure our values translate into our lived experiences?

## **The state budget.**

Our state budget represents our values in practice. This handbook will explain how the budget sets priorities for our communities and impacts our quality of life. This handbook will also tell you how you can make sure your community's needs are reflected in the state budget.

Whether every North Carolina family and community can support children's healthy development depends a lot on state-level policy and investment choices. Each year, North Carolina policymakers come together in Raleigh to set priorities for how taxpayer dollars will be spent. Where policymakers choose to prioritize billions in investments is important, and your voice can make sure that their choices reflect the goals and needs of your community.

This guide provides an overview of the state budget, the budget development process, and ways that you can use your voice and engage in ensuring the state budget supports children and families.

# How Does the Budget Affect Me?

The budget is the primary document that our leaders use to enact North Carolina’s values. By allocating taxpayer dollars to programs and services, policymakers prioritize the ways they want to reflect those values in our daily lives.

That means the budget should:

- **Represent smart investments and supports that best achieve our goals**
- **Effectively match investments with the growth and need we see in our state**
- **Ensure that — no matter where one lives and whether they are Black, brown or white— they can access the same opportunities and quality of public services**

## N.C. BY THE NUMBERS

WHEN IT’S GOOD TO RANK FIRST, NORTH CAROLINA IS ...

- **27th in income inequality (4.66:1)**
- **30th in early childhood enrollment (45.6% of 3- and 4-year-olds enrolled)**
- **38th in low-wage jobs (25.1%)**
- **33rd in poverty rate (13.3%)**
- **34th in adults reporting poor or fair health status (19.1%)**

Source: Prosperity Now

You benefit from the state budget when:	You contribute to the state budget when:
Your children or grandchildren attend school or a licensed daycare center, or visit the state zoo	You file and pay your annual state income tax
You attend a community college or university to upgrade your skills or take a course for personal enrichment	You make a purchase and pay sales taxes
You visit a state park, museum, or historic site	You renew your driver’s license
You ride on virtually any state highway, built and maintained with state funds and policed by the Highway Patrol	You buy a gallon of gas or license tag for your car
You attend a North Carolina Symphony concert in your hometown	You pay an admission charge or buy a souvenir at a state park, museum, or historic site
State aid to cities and counties offsets pressures to raise local property taxes	You buy any tobacco or alcohol product
A statewide system of courts administer a uniform justice system in all 100 NC counties	You pay a court fee or fine
State agencies respond to fire, flood, or storm emergencies in your community	You pay university or community college tuition

# Where NC Gets Its Money

The people and businesses that live and operate in North Carolina contribute to the state’s priorities through tax dollars.

North Carolina’s relative effort in tax dollars contributed by each person in the state, \$2,792, is below the national average (\$3,301) according to the latest 2019 Census data on State and Local Finances.<sup>1</sup> North Carolina is ranked 34th for its per capital total tax collections.

For Fiscal Year 2020-21 (FY2021), North Carolina collected \$28.8 billion in total tax revenue.<sup>2</sup>

The individual income tax is North Carolina’s biggest source of tax revenue, bringing in \$15.8 billion in the 2020-21 fiscal year (FY2021). As of Jan. 1, 2019, North Carolina has a flat individual income tax rate of 5.25 percent. The final budget passed in November 2021 implements a decrease in the individual income tax rate to 3.99 percent by 2027.

North Carolina collected \$9 billion from our state’s sales tax for FY2021. Sales of most goods are taxed at the state rate of 4.75 percent, unless the item is legally exempt or taxed at a lower preferential sales tax rate.

Corporate income taxes generated \$1.5 billion for North Carolina in FY2021. The final budget passed in November 2021 schedules reductions to the corporate income tax rate to zero in 2029 and beyond. Every corporation that does business in North Carolina or that has sources of income in the state must file a state income tax return. However, many businesses don’t organize as the type of corporation that has to pay corporate income tax. They often choose a different business structure that allows them to pass through business income to individual owners of the business and pay personal income taxes rather than corporate income taxes. Some businesses are also subject to the franchise tax, which in FY2021 provided \$870 million to the General Fund.

The image shows a sample of the North Carolina Department of Revenue (NCDOR) Form D-400, Individual Income Tax Return 2016. The form is titled "D-400 Individual Income Tax Return 2016" and includes a section for "AMENDED RETURN". It contains various fields for taxpayer information, including name, address, and Social Security Number. The form also includes sections for "Filing Status", "Adjusted gross income from your federal return", "Deductions from federal adjusted gross income", and "North Carolina Taxable Income". A table on the right side of the form shows tax payments and credits, with a total of \$0.00. The form concludes with a signature section and a footer containing contact information for the N.C. DEPT. OF REVENUE.

1 US Census Bureau Annual Survey of State and Local Government Finances, 1977-2019 (compiled by the Urban Institute via State and Local Finance Data: Exploring the Census of Governments; accessed 28-Apr-2022 02:28), <https://state-local-finance-data taxpolicycenter.org>.

2 NC Department of Revenue, Statistical Abstract of North Carolina Taxes, 2021. Accessed at: <https://www.ncdor.gov/statistical-abstract-north-carolina-taxes-2021>.

Of North Carolina's total revenue, 28 percent, or \$19.4 billion, came from the federal government in the 2019 fiscal year. Most federal aid goes to Medicaid, children's health insurance, and other health and human services.

North Carolinians also pay local taxes, such as property taxes, that fund local services like police and fire protection, education, and road maintenance. Revenue from local taxes and services are not part of the state budget.

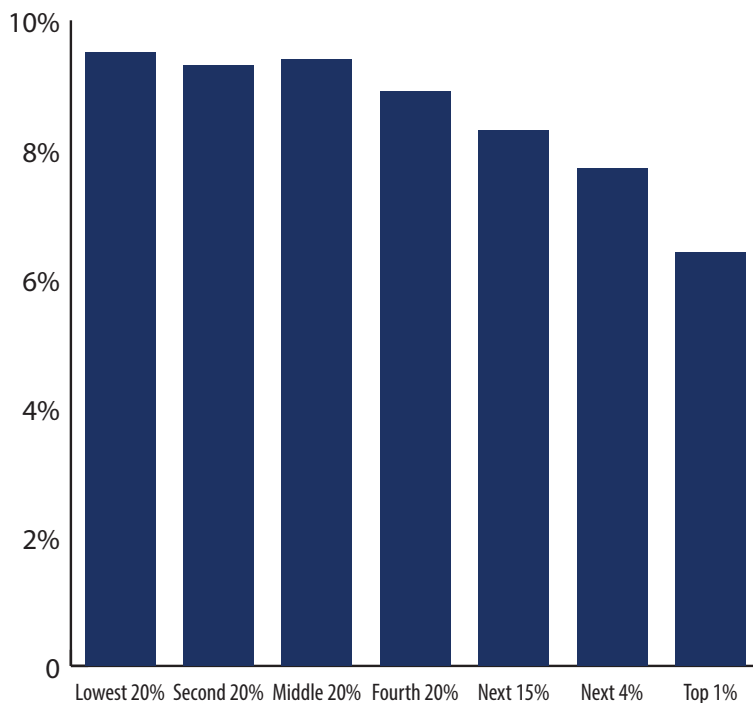
## How It Works

# We All Pay Taxes

Everyone in North Carolina pays taxes. Taxes are paid when North Carolinians earn income, when they buy things and when they own property, for example. These taxes fund things in our community that make a high quality of life possible.

Decisions about the state tax code are as important as the decisions about how to spend dollars. The state tax code decides how much each of us contributes as individuals or businesses. It also determines what form those taxes will take, such as income, sales, or property taxes. The way the state generates revenue impacts North Carolinians differently along the

**FIGURE 1:** Lower income taxpayers pay greater share of income in state and local taxes compared to higher income taxpayers



Source: Institute on Taxation and Economic Policy, Who Pays? 6th Edition, 2018.

## PRINCIPLES FOR EVALUATING TAX SYSTEMS

Evaluating a tax code's ability to raise the revenue needed for public services should follow these principles. *Source: Institute on Taxation and Economic Policy Guide to Tax Fairness*

### EQUITY

Equity in taxation is about who pays. There are two types of equity that should be considered. Vertical equity addresses how a tax affects different families from the bottom of the income spectrum to the top—from poor to rich. Three terms are used in measuring vertical equity:

- **Regressive tax systems** require that low- and middle-income families pay a higher share of their income in taxes than upper-income families. Sales taxes, excise taxes and property taxes tend to be regressive.
- **Proportional or flat tax systems** take the same share of income from all families.
- **Progressive tax systems** require upper-income families to pay a larger share of their incomes in taxes than those with lower incomes. Personal income taxes are usually progressive.

Horizontal equity is a measure of whether taxpayers with similar circumstances in terms of income, family structures, and age pay similar amounts of tax. For example, if one family pays much higher taxes than a similar family next door, that violates “horizontal” fairness. This sort of unjustified disparity undermines the public support for the tax system and diminishes people’s willingness to file honest tax returns. It would be hard to defend a tax system that intentionally taxed left-handed people at higher rates than right-handed people. Likewise, a tax that hits a wage-earner harder than an investor (as the federal income tax currently does), even if their total incomes are the same, fails the test of horizontal equity.

### ADEQUACY

An adequate tax system raises enough funds to sustain the level of public services demanded by citizens and policymakers. At the end of the day, adequacy is what separates successful tax systems from unsuccessful tax systems. Of course, at any given time, the primary concern for state lawmakers is short-term adequacy – making sure there’s enough revenue to fund public services in the upcoming fiscal year. But it’s equally vital for good government advocates and lawmakers to seek strategies that will achieve long-term adequacy, balancing budgets not just this year and next, but five years and ten years down the road. Factors that impact adequacy are STABILITY and ELASTICITY.

- **STABILITY:** A stable tax is one that grows at a predictable pace. Predictable growth makes it easier for lawmakers to put together budgets that match anticipated revenues to spending. But stability is not enough to achieve adequacy.
- **ELASTICITY:** This is a measure of whether the growth in tax revenues keeps up with the economy—an important consideration because the cost of providing public services usually grows at least as fast as the economy. An elastic tax system is one that grows faster than the economy during good times, and falls faster than the economy during bad times. Over the course of the business cycle, elastic taxes like the personal income tax help to ensure adequate revenue streams.

For more on evaluating tax systems, principles of taxation and details of how specific revenue sources match up to these principles, see the Institute on Taxation and Economic Policy Guide to Tax Fairness at <https://itep.org/the-itep-guide-to-fair-state-and-local-taxes/>

income ladder. That's why it's important that our revenue structure follows three central values: **equity, adequacy, and stability**. North Carolina's current tax code is regressive. It asks more from low-income taxpayers as a share of their income than high-income taxpayers.

## Key Features of North Carolina's Tax Code

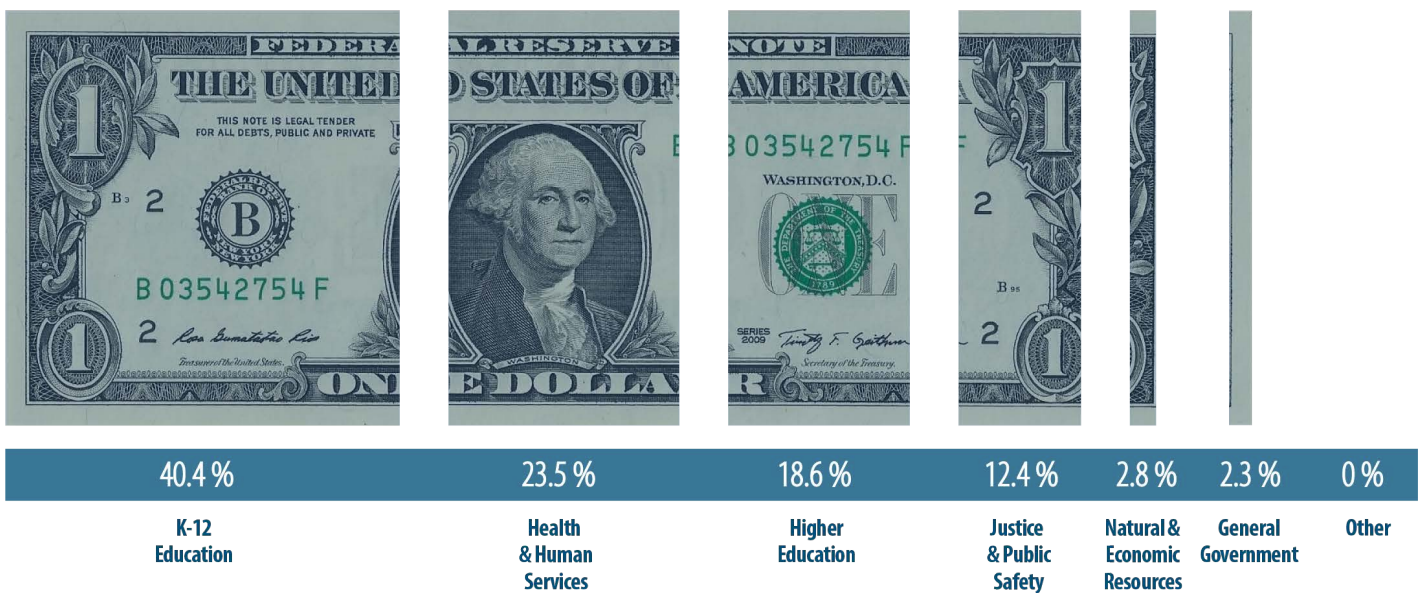
There are three main features of North Carolina's tax code that are important to assess performance against principles of a sound tax system that can meet community needs in a way that doesn't ask those with the least to contribute more and that considers the broader economic cycles in planning long-term for public investments.

1. North Carolina has a flat income tax rate. As of Jan. 1, 2019, North Carolina taxes income after deductions at 5.25 percent. This is down from where it was a year ago, and the flat structure is different from the graduated income tax rate structure that was in place before 2013. That structure applied higher tax rates on income over specific thresholds.
2. North Carolina maintains spending through the tax code that isn't consistently evaluated for public benefit. Our state budget is not just about the dollars that are appropriated through approval of the General Assembly, but should include consideration of the automatic spending that happens through the credits and deductions offered to individuals and corporations through the tax code. These tax breaks represent a significant annual loss of revenue.
3. North Carolina limits the revenue options available to local governments, which leads to their relying primarily on state revenue sources to fund public services. While the state responsibility to fund public programs and services provides an opportunity to achieve greater equity so that low-wealth communities aren't limited by the resources they have immediately available, it creates challenges when local governments have increased responsibility for meeting community needs or different priorities than how state funding aligns. In recent years, several revenue tools for local governments have been limited, and the discussion of local revenue options continues to be part of the annual budget discussion.

# What the Budget Pays For

Here's a breakdown of what your tax dollar pays for:

FIGURE 2: Where the Money Goes



North Carolina's 2022-23 fiscal year budget was \$27.9 billion, and this is how lawmakers appropriated that money:

- \$11.2 billion for K-12 education
- \$6.6 billion on health and human services
- \$5.2 billion on higher education (universities and community colleges)
- \$3.5 billion on justice and public safety
- \$770 million on natural and economic resources
- \$633 million on general government

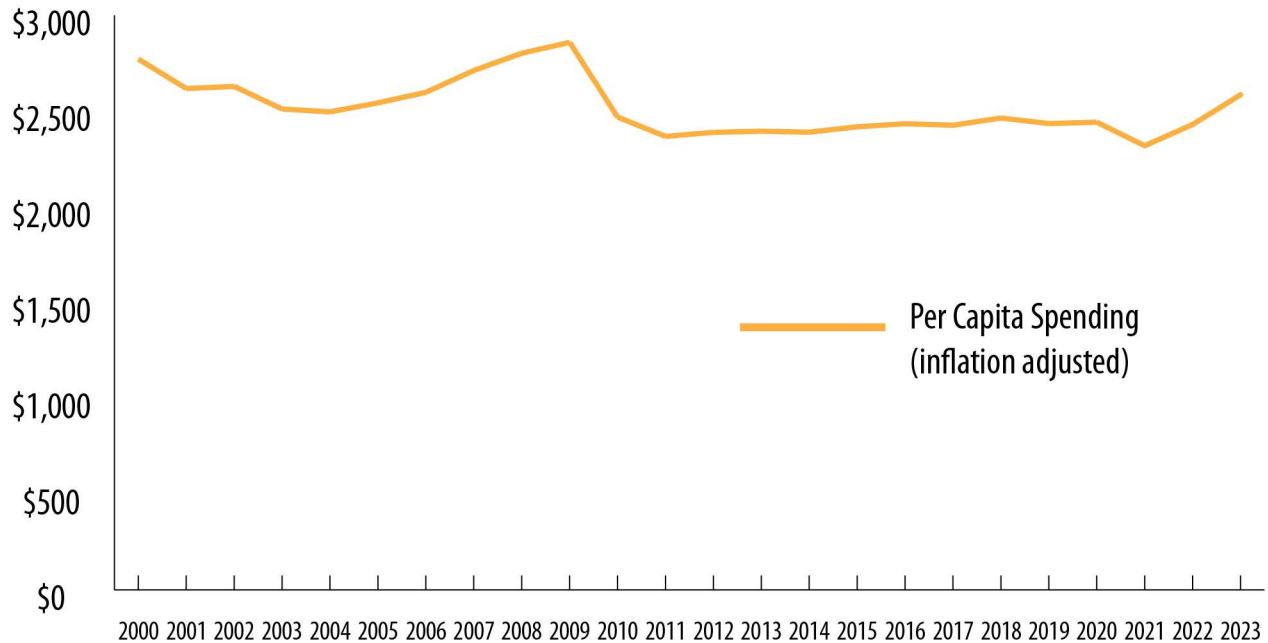


## Assessing whether investments are adequate

Sometimes it is difficult to assess whether these dollars reflect the need. There are several ways to assess whether an investment is approaching adequacy.

**PER CAPITA:** In this approach, one can look at the level of overall state spending for each person in the state.

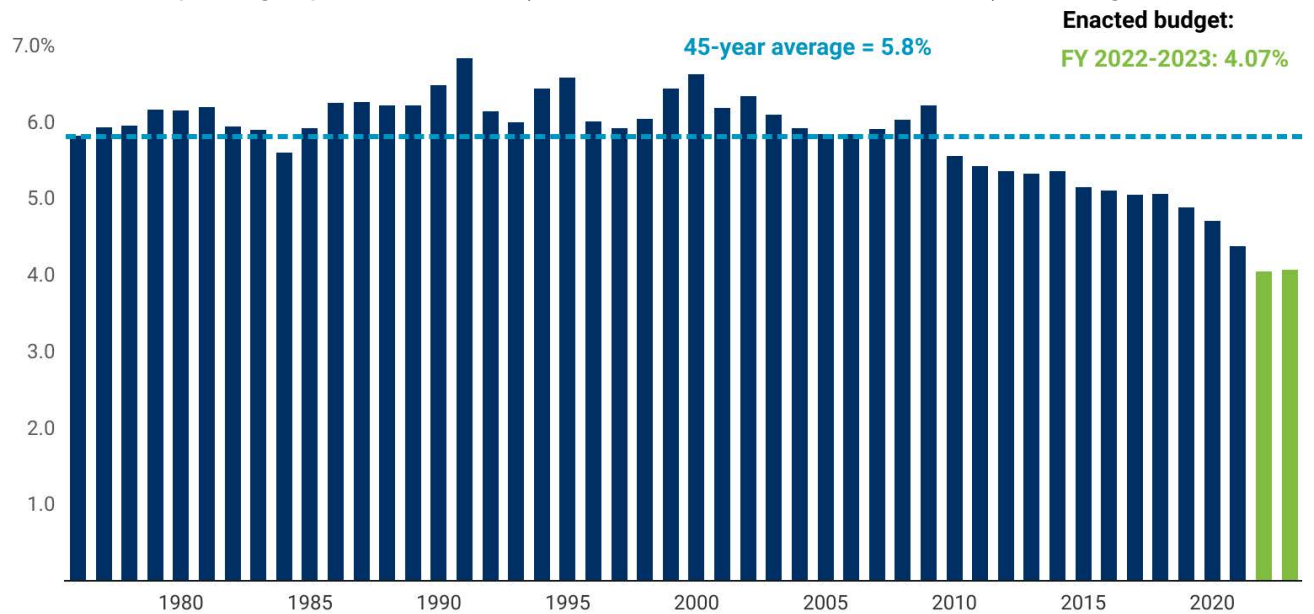
**FIGURE 3:** State spending per person in North Carolina, 2000-2023



Source: NC Budget & Tax Center analysis of enacted state budgets, NC State Demographer, U.S. Bureau of Economic Analysis

**SHARE OF THE ECONOMY:** In this approach, one can look at the level of overall state spending as a share of the size of the economy, most often measured as total personal income in a state. This allows for comparability over time.

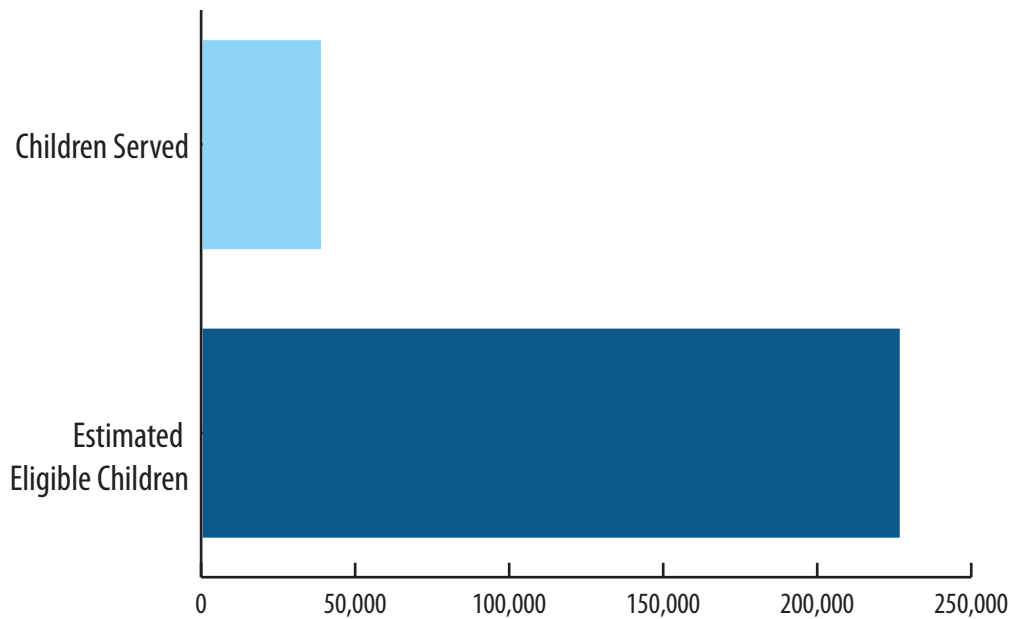
**FIGURE 4:** N.C. spending as part of the economy continues to shrink, remains below 45-year average



Source: NC Budget & Tax Center analysis of enacted state budgets, U.S. Bureau of Economic Analysis

**AGAINST SPECIFIC POPULATION OR OUTCOMES NEEDED:** This approach provides a more detailed look at specific line items in the state budget that go to programs and services and lines those up with measures of need in the population targeted with the service or outcomes that are desired.

**FIGURE 5:** Funding for child care subsidies leaves 83% of eligible children without access to child care



Source: NC Division of Child Development and Early Education Subsidy Expenditure Reports, March 2021; NC Budget & Tax Center analysis of American Community Survey data, 2015-2019

## How It Works

# How Does State Spending Work?

The state budget supports public services and programs that would otherwise not be delivered with the reach or quality that achieves better economic and social outcomes for our state. From universal public education to affordable health care, from protection of our natural resources to support for main street business development, the state budget includes investments that help further our goals in education, health, environmental protection, and economic development.

The state budget isn't the only source of public support for the programs and services you see in your community. The federal government, along with local governments, also commit resources to help support programs and services that reach North Carolinians. In many instances, all three revenue sources — federal, state, and local — aim to meet the needs in communities.

## Public investments matter

The decisions made to invest in communities, families and individuals matter for their well-being as well as the broader success of our state's economy and democracy. Here are just some of the ways

**FIGURE 6:** Sources for select public programs and services

	Federal	State	Local
<b>Early Childhood</b>	Funding for child care assistance, home visiting programs	Funding for child care assistance, pre-Kindergarten programming, Smart Start services, wage subsidies for child care workers	Funding for additional slots in pre-Kindergarten programs
<b>K-12 Education</b>	Funding for low-wealth schools, nutrition services	Funding for teachers, instructional supplies, and complementary support services. North Carolina public schools are primarily funded through the state.	Teacher salary supplements, school construction, and other needs based on availability of federal and state funds
<b>Healthy Communities</b>	Funding for health care access, public health programming, and pilot funding for healthy community efforts	Funding for healthy food options, parks, sidewalks	Funding for parks playgrounds, sidewalks
<b>Community Economic Development</b>	Funding for building affordable housing, supporting small business development and economic development projects	Funding for community college programs to support business start-up and expansion, and subsidies for corporations to locate in the state	Funding can be made available for main street revitalization, small business hubs, and subsidies for corporations to locate in the community

that researchers have identified public investments work to advance shared goals for better outcomes:

- TO EQUITABLE OUTCOMES:** State spending through the budget provides an opportunity to deliver services equitable by ensuring that communities without their own sources of wealth can continue to deliver quality programs and support the economic success of residents.
- TO WEATHER ECONOMIC DOWNTURNS:** State spending can stabilize local economies in times of economic distress or other shocks. The disruption of downturns or natural disasters can disrupt commercial activity and household budgets. By spending on targeted investments that both meet immediate and long-term needs, state budgets serve to help ensure that these events don't ripple further through communities. The greatest power of public investment in this way is often provided by the federal government.
- TO IMPROVE QUALITY OF LIFE:** State spending can improve quality of life by investing the infrastructure of communities and ensuring that people have access to the tools to live healthy, productive and connected lives in each community.
- TO BOOST HUMAN CAPITAL:** State spending can boost the human capital in a state by investing in the early education, public education and higher education and skills training of its people. These public investments have been demonstrated to have a significant positive effect on state economic growth.

## Bringing a race equity lens to public investment decisions

Race equity impact assessments provide a process and documentation of the impacts of a policy or budget decisions on different groups. These guides vary based on the local context and institutional uses but they consistently pursue answers to questions about how a decision will impact groups, encourage engagement of directly impacted groups in design and consideration of impacts, and prompt consideration of improvements that could result in more equitable outcomes.

Race equity impact assessments are being used in several local and state contexts to evaluate budget decisions and should be considered by North Carolina agencies, organizations and individual activists in their review and assessment of budget proposals.

Below are some guiding questions to conduct a race equity impact assessment of a specific budget proposal or the overall budget.

**FIGURE 7:** Racial Equity Impact Assessment Guide for Economic Policies and Public Budgets

Stage	Questions to Consider
<b>1. Analyzing Current Problems</b>	<p>A. What are the adverse effects that different disadvantaged racialized communities experience under current conditions, policies, practices, and expenditures?</p> <p>B. What are the causes or contributing factors (e.g. unfair policies and practices, inequitable or insufficient funding formulas) that produce or perpetuate the inequities?</p> <p>C. What data or evidence is available or can be collected to demonstrate the racial inequities, adverse effects, contributing causes, trends and current needs?</p>
<b>2. Developing and Advancing Proposed Changes</b>	<p>A. What steps can insure public input and participation by the most disadvantaged racial communities and stakeholders in developing proposed policies and budgets?</p> <p>B. What new policies, programs, funding streams are needed to address the needs and inequities that different racialized communities face?</p> <p>C. What changes in existing policies, programs, budgets would reduce racial inequities?</p> <p>D. What specific equitable outcomes will this achieve and what are the success indicators?</p>
<b>3. Analyzing Current Proposals</b>	<p>A. Will the proposal reduce, limit or eliminate programs that are vital to or disproportionately needed by, particular disadvantaged racial/ethnic communities?</p> <p>B. Will the proposal increase, expand or create programs that are vital to or disproportionately needed by, particular disadvantaged racial/ethnic communities?</p> <p>C. Will there be enough money allocated to address real racial inequities with fair and sustainable revenue streams?</p>

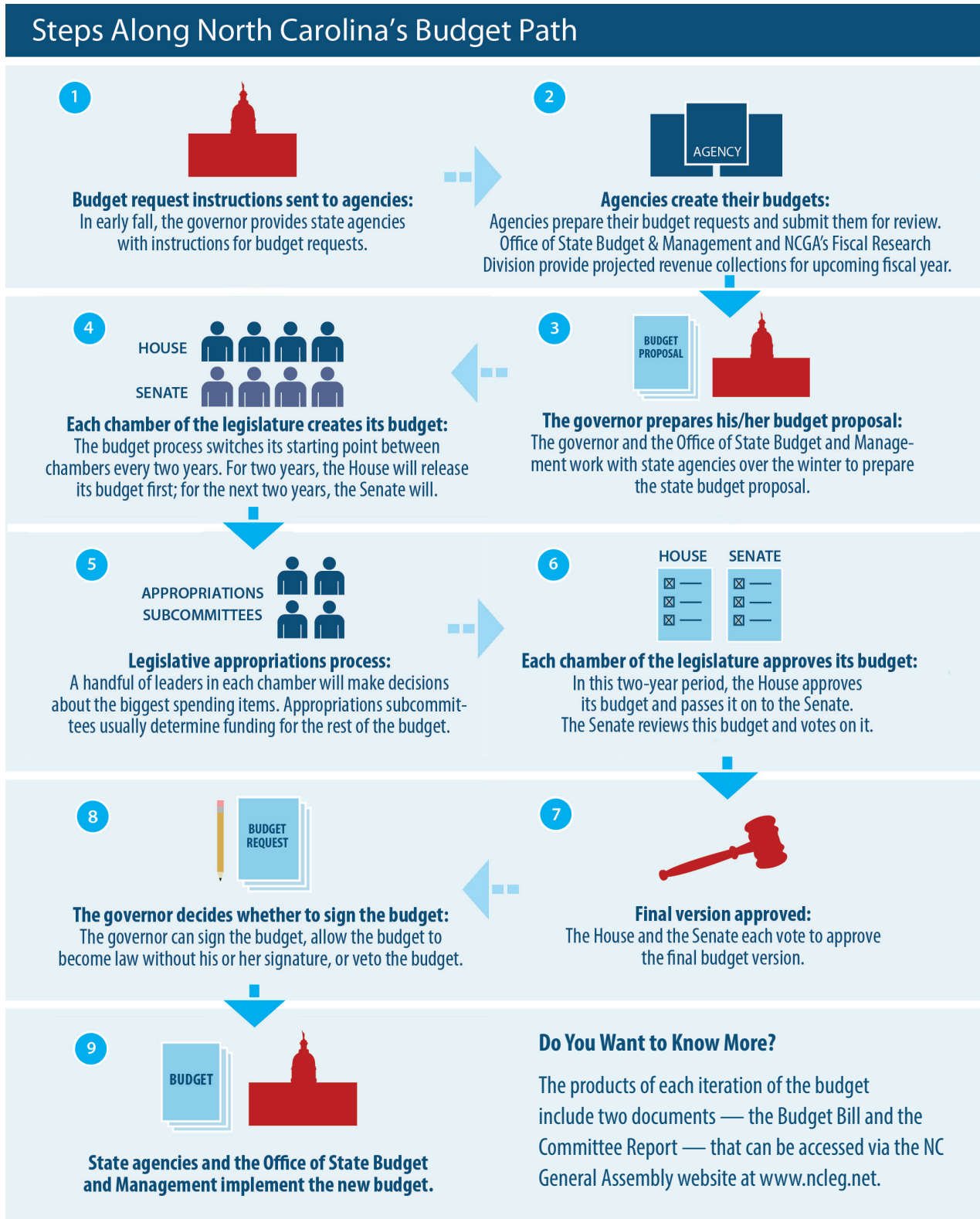
Source: [www.racialequitytools.org/resourcefiles/keleher1.pdf](http://www.racialequitytools.org/resourcefiles/keleher1.pdf)

### More tools and information:

- Race Forward: [www.raceforward.org/practice/tools/racial-equity-impact-assessment-toolkit](http://www.raceforward.org/practice/tools/racial-equity-impact-assessment-toolkit)
- Government Alliance on Race and Equity: [www.racialequityalliance.org/](http://www.racialequityalliance.org/)

# How Does the Budget Get Decided?

FIGURE 8: How the budget gets decided



## The Constitutional Framework

There are a few key aspects of state spending and tax decisions that are set out in the state Constitution and represent requirements in the decision-making process.

**Balanced Budget Requirement:** North Carolina’s constitution requires that the budget enacted by the General Assembly be balanced so that spending does not exceed revenues collected. In addition, the budget must include two fiscal years, beginning on July 1 of each odd-numbered year.

**Maximum Allowable Income Tax Rate:** As of November 2018, the state Constitution now contains a cap on income tax rates for individuals and corporations at 7 percent. This cap represents a lower rate than was originally placed in the state Constitution.

The state Constitution also sets out responsibilities for the funding of core public services, namely:

**Public Education:** The General Assembly shall provide by taxation and otherwise for a general and uniform system of free public schools, which shall be maintained at least nine months in every year, and wherein equal opportunities shall be provided for all students.

**Higher Education:** “The General Assembly shall provide that the benefits of The University of North Carolina and other public institutions of higher education, as far as practicable, be extended to the people of the State free of expense.”

**Well-Being of North Carolinians:** “Beneficent provision for the poor, the unfortunate, and the orphan is one of the first duties of a civilized and a Christian state. Therefore the General Assembly shall provide for and define the duties of a board of public welfare.”

and

“Such charitable, benevolent, penal, and correctional institutions and agencies as the needs of humanity and the public good may require shall be established and operated by the State under such organization and in such manner as the General Assembly may prescribe.”

## ABOUT THE BUDGET DOCUMENTS

The products of each iteration of the budget include two documents — the Budget Bill and the Committee Report — that can be accessed via the NC General Assembly website at [www.ncleg.net](http://www.ncleg.net).

- **BUDGET BILL:** This document provides the statutory language to authorize appropriations and to align the General Statutes with spending decisions. Often, the budget bill also includes policy changes that may not have an impact on the state budget.
- **COMMITTEE REPORT:** This document is also sometimes called the Money Report. It provides more detailed description of the spending decisions and some context as to the prior year spending and staffing impacts of spending decisions.

Additional budget documents that are useful for historic or current context are available at the North Carolina Office of State Budget & Management at [www.osbm.nc.gov/budget](http://www.osbm.nc.gov/budget)

# Our Collective Investments Matter

The state budget should be a clear reflection of North Carolina's values and priorities, for today and for our future. Our investments in schools, public health, and roads — in other words, in our communities — will determine how our state will grow and thrive.

The budget must also ensure that North Carolina has enough revenue to support our growing needs and changing economy. Our current revenue system is out of alignment with our day- to-day reality, and it's taking a toll on our economy. Because of bad policy, investment in our communities has declined, and that will create greater challenges for all of us in the future.

If we want our communities to thrive, now and in the future, we need a state budget that prioritizes thriving communities. We need a tax system that is equitable, adequate, and stable.

And we need to support our communities through collective commitment and investment so that our communities and democracy is built by North Carolinians, for North Carolinians.



# GLOSSARY OF TERMS

**Appropriations** – the amount of money approved by the General Assembly for a certain purpose.

**Budget deficit** – the amount by which revenues fall short of expenditures in a given period, usually a fiscal year.

**Budget surplus** – the amount by which revenues exceed expenditures in a given period, usually a fiscal year.

**Corporate income tax** – a tax on the entire net income of every corporation located in North Carolina or deriving income from sources within North Carolina.

**Current services budget** - outlines the cost of providing the same level of service in future years as was provided in the current budget year. Continuation budget allowances include covering public school and higher education enrollment increases, entitlement increases (mainly Medicaid), debt service, and inflation on mandatory expenses (gasoline, heating oil, electricity).

**Earned income** – money received in payment for a job or through self-employment.

**Expansion items** – may include funds to establish new programs or continue phase-in of programs initiated in a previous fiscal year, enhance compensation or other employee benefits, make major one-time equipment and information technology purchases, and replace lost federal funds.

**Federal funds** – U.S. government money approved by Congress to support a program or project.

**Federal poverty measure (also called the poverty line)** – standard used by the U.S. government to classify people as low-income.

**Fiscal year (FY)** – an annual accounting period. North Carolina’s fiscal year runs from July 1 to June 30. For example, the 2016 fiscal year runs from July 1, 2016 to June 30, 2017.

**Flat tax (also called proportional tax)** – a tax levied at the same rate on all levels of income.

**General Fund** – the state’s primary account. It includes revenue from North Carolina’s personal/individual income tax, corporate income tax, and sales tax. The money in the General Fund is spent on state priorities like education, public safety, and job growth.



**Graduated tax** – a type of progressive tax in which the tax rate is higher as the value of the taxed income or item increases.

**Household income** – annual income of all family members living in the same home.

**Income tax** – a tax on earned and unearned income.

**Living Income Standard** – the amount of money a family needs to earn annually to afford housing, food, childcare, health care, transportation, taxes, and other necessities. An alternative to the poverty measure.

**Medicaid** – a health insurance program, funded by federal and state governments and operated by the state, for persons below a certain income level.

**Medicare** – a federal health insurance program for the elderly and disabled.

**Payroll tax** – a tax on wages that is used to finance unemployment insurance, worker compensation, disability insurance, Social Security, and Medicare.

**Progressive tax** – a tax that requires people who make more money to pay a bigger share of their income than those who make less. A tax can be made progressive by the use of graduated rates, exemptions, deductions, or credits.

**Property tax** – a tax levied by state or local government on the assessed value of property.

**Rainy Day Fund** – If North Carolina gets more revenue from taxes than the General Assembly budgeted for, that extra money goes straight into the Rainy Day Fund. Lawmakers can choose to use the money in this fund for things like natural disasters or to cover obligations if the General Fund runs low.

**Regressive tax** – a tax that requires people who make less money to pay a bigger share of their income than people who make more money.

**Sales tax** – a tax levied by a state or locality on the retail price of an item, collected by the retailer.

**Tax base** – the total value of income, goods, properties, services, or activities subject to a particular tax or group of taxes.

**Tax rate** – the percentage of tax paid for a given level of income or value.

**Taxable income** – amount of income subject to income tax.

**Unearned income** – income such as dividends, interest, or rental fees that does not result directly from the recipient's labor.

## FOR MORE RESOURCES VISIT:

- **NC Budget & Tax Center: [ncbudget.org](http://ncbudget.org)**
- **N.C. Office of State Budget & Management: [www.osbm.nc.gov/](http://www.osbm.nc.gov/)**



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