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OPINION | COMMENTARY

The Tax-Cut Payoff in Carolina

Even with lower rates, tax revenues have increased 6% this year, and the state has a $400 million budget surplus.

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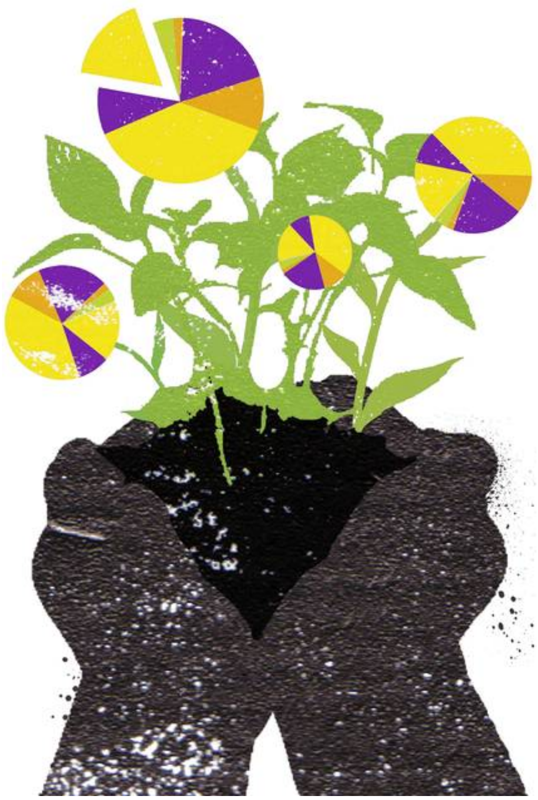

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Raleigh, N.C.

Four years ago North Carolina's unemployment rate was above 10% and the state still bore the effects of its battering in the recession. Many rural towns faced jobless rates of more than 20%. But in 2013 a combination of the biggest tax-rate reductions in the state's history and a gutsy but controversial unemployment-insurance reform supercharged the state's economy and has even helped finance budget surpluses.

As Wells Fargo's Economics Group recently put it: "North Carolina's economy has shifted into high gear. Hiring has picked up across nearly every industry."

The tax cut slashed the state's top personal income-tax rate to 5.75%, near the regional average, from 7.75%, which had been the highest in the South. The corporate tax rate was cut to 5% from 6.9%. The estate tax was eliminated.

Next came the novel tough-love unemployment-insurance reforms. The state became the first in the nation to reject "free" federal payments for extended unemployment benefits and reduce the weeks of benefits to 20 from 26. The maximum weekly dollar amount of payments, $535, which had been among the highest in the nation, was trimmed to a maximum of $350 a week. As a result, tens of thousands of Carolinians left the unemployment rolls.

In an interview at the governor's mansion, Gov. Pat McCrory tells me that when he took office in January 2013 he looked at the data and knew "we couldn't stay on the course we were on. We had the highest unemployment benefits and yet at the same time businesses were routinely complaining they couldn't find workers until benefits ran out. We heard a lot of stories of workers waiting until benefits ran out before going back to work." In sum, the state was paying people not to work.

While these measures were passing the legislature, the state capital boiled over with rancorous political rallies, called Moral Mondays, designed to block the "cruel" GOP agenda. Rev. William Barber II, one of the protest organizers, lambasted Republicans for making the Tar Heel State a "crucible of extremism and injustice." The national media piled on with claims that the Republican agenda cut taxes for the rich while slashing benefits for the poor.

Then a funny thing happened. After a few months, the unemployment rate started to decline rapidly and job growth climbed. Not just a little. Nearly 200,000 jobs have been added since 2013 and the unemployment rate has fallen to 5.5% from 7.9%. There is a debate about how many of North Carolina's unemployed got jobs and how many dropped out of the workforce or moved to another state. But the job market is vastly improved and people didn't go hungry in the streets. On the Tax Foundation index of business conditions, North Carolina has been catapulted to 16th from a dismal 44th since 2013.

The most recent news will make many other governors jealous. The state didn't take the extra federal benefits—which require repayments later to the feds—and it cut the weekly benefits. So the state government has been able to pay back $2.8 billion in unemployment-insurance money owed to the feds, and it now has a trust-fund surplus. This means it will be able to provide employers with at least $500 million in cuts from the state and federal unemployment tax on payroll over 18 months.

This comes at a time when other states are having to raise payroll taxes to pay off the loans for the rich benefits they doled out in the recession and its aftermath. The lesson: Handouts from the feds are never free.

An even bigger surprise—even to supporters—is the tax cut's impact on revenue. Even with lower rates, tax revenues are up about 6% this year according to the state budget office. On May 6, Gov. McCrory announced that the state has a budget surplus of $400 million while many other states are scrambling to fill gaps.

This is the opposite of what has happened in Kansas, where jobs have been created but revenues have fallen since the top personal income-tax rate was cut from 6.45% in 2012 to 4.6% today and the income tax for small business owners who file as individuals has been eliminated. North Carolina's former budget director, Art Pope, says one difference between the two states is that "we cut spending too. Kansas didn't."

The story gets better. Because North Carolina built in a trigger mechanism that applies excess revenues to corporate-rate cuts, the business tax has fallen to 5% from 6.9%, and next year it drops to 4%.

You won't hear much about this in national news media, where the preferred story line is that tax cuts don't work because they were followed by budget deficits in Kansas. In North Carolina, policies to reduce taxes and stop paying people for not working have created jobs and surpluses. Mr. Pope says: "I wish people criticizing Kansas would look at what's happened here."

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