FFICE OF THE TREASURER

NORTH CAROLINA

JANET COWELL, TREASURER

Department of State Treasurer
Position on "Constitutional Amendment Maximum Income Tax Rate"
Senate 817

The Department has serious concerns about this legislation for the following reasons:

Potential Negative Impact on the State's AAA bond rating:

- Legislation of this type is viewed negatively by the rating agencies. They view legislation like this as a limitation on a State's ability to maintain flexibility in its budgetary and financial management. **It is a "credit negative" finding**, as supported by documents provided by both Standard & Poor's and Moody's credit agencies.

- While the Department cannot say that adopting this legislation would definitely result in a credit downgrade, the State would clearly be losing one of its strongest rating factors. Standard and Poor's best rating for "Revenue Structure" is a "1". However this becomes a rating of "3" when:

  > "There are …. significant constraints to adjusting taxes or revenues. These constraints can include constitutional prohibitions on tax increases, an above majority legislative threshold for approval, or the need to have voter approval for tax and revenue increases. "[1]

  Likewise, Moody's drop's their "governance" factor from a AAA to an Aa3 when, in their opinion, a state has: "constitutional restraints that can inhibit budget solutions."[2] Furthermore, Moody's states that in their experience:

  > "States that attempt to increase expenditures for popular programs and simultaneously pledge not to raise taxes or cut other programs generally see their balance sheets deteriorate as reserves are drawn down, debt loads grow and off-balance sheet devices are used to fund deficits."[3]

- A credit downgrade would force North Carolina to make higher interest payments and pushes up the cost of new bond-financed projects. Losing the State's coveted AAA rating would expose North Carolina not only to increased borrowing costs, but also sends a negative message about our overall management capabilities. It could also impair the State's ability to promote itself for economic development purposes.

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[1] "U.S. State Ratings Methodology," Standard and Poor's Global Credit Report. January 3, 2011. www.standardandpoors.com/ratingsdirect. Page 7.

[2] "Rating Methodology: U.S. States Rating Methodology" Moody's Investor Services. April 17, 2013. Report number 129816. page 9

[3] Ibid, page 7.

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The Legislation Increases the Volatility and Lessens the Reliability of the State's Revenue Stream

- The bill would result in greater dependence upon sales and other consumption taxes. These taxes are notoriously prone to fluctuation as a result of economic cycles and would result in a serious depletion of State revenue during an economic downturn. The bill would reduce the ability of the State to adjust and diversify its revenue streams as circumstances warrant and especially so during economic downturns or when natural disasters occur.

  This factor is also closely watched by the ratings agencies. Moody's states that during recessions, states with the most diverse revenue streams and the fewest restraints on flexibility generally fare better against downward economic pressures. Moody's gives its strongest rating (Aaa) to states having little volatility in their revenue streams. But they drop that rating to Aa3 to states that have an increased reliance on "volatile revenues."[4]

- Current political processes already ensure accountability to the voters. Public officials have, as part of their duties, the responsibility to prioritize programs and control spending. Future legislatures should be free to budget expenditures and impose taxes and fees as they feel is needed to provide services to the citizens of the State without limitations imposed by prior General Assemblies. There will undoubtedly be circumstances that will require an increase in expenditures that simply cannot be foreseen at the present. That is why the State needs to retain flexibility to adapt to changing circumstances and ultimately the voters will maintain control over state spending by their election of the legislature.

Other States Have Considered Such Legislation and Have Not Adopted It.

Since 2004 proponents of tighter or more restrictive constitutional limits on taxing power have led campaigns in over 30 states. In five of those states – Florida, Maine, Nebraska, Oregon and Washington these proposals reached the ballot. In every case, they were rejected by voters. Colorado remains the **only** state with a tight constitutional restriction but even there, voters approved a measure to suspend it for 5 years in order to allow the state to rebuild its public services. [5]

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[4] Ibid, pgs. 10- 12.

[5] "Policy Basics: Taxpayer Bill of Rights (TABOR)" Center on Budget and Policy Priorities. August 13, 2015. www.center@cbpp.org

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