## Economic Transition: Levying Taxes in the New Economy

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### Article:

Better economic times are around the corner, but that can't mask the historic and difficult transformation our economy is undergoing. Many have blamed our economic sluggishness on the 2001 recession, but that explanation goes only so far, and it has very little to say about such industries as textile and apparel manufacturing, which was hemorrhaging workers long before the recession. Others blame NAFTA and international trade in general, but those people are really just pointing at a symptom, not a cause.

The transformation of our economy is moving us away from a manufacturing past and toward a post-industrial future, the so-called New Economy. Just as agriculture declined as a source of employment in the early 20th century, manufacturing's share of total employment has declined in recent decades. To be sure, manufacturing output is as healthy as ever, thanks to steady improvements in technology and labor productivity. But in proportional terms, manufacturing will likely never employ as many people as it once did.

Here in the Triad, the economic transformation has been especially painful. Measured in terms of manufacturing's share of total employment, the Triad is the most manufacturing-intensive region in one of the top manufacturing states in the country. We may always specialize in this sector relative to other states, but the decline of manufacturing employment is likely to continue.

There are many ways in which the economic transformation reveals itself. There's the employment picture, to which I've alluded above and in previous columns. There's the changing business culture, as indicated by such best-selling authors as Robert Reich and Richard Florida, who trumpet (respectively) the roles of "symbolic analysts" and "the creative class" as vehicles to our post-industrial future. And there's the local property-tax system.

That's right. The way Guilford County taxes business property says a lot about what kind of economy we've had in the past and will have in the future. Business property is made up of capital assets such as machinery and equipment, and so it is tangible, not virtual. But the most important capital assets in the New Economy will be virtual, not tangible. The human capital of brain power and innovation will matter more and more, while the physical capital of muscle power and machinery will matter less and less.

North Carolina counties tax various types of property. There is real property, which is land and anything attached to the land. There is personal property, which is movable and not attached to the land. There is a separate category for motor vehicles. And finally, there is a category called certified property, which includes real and personal property owned by utilities and transportation companies, such as gas pipelines and railroad cars, which require special treatment under tax laws.

The category I want to focus on here is business personal property. Strictly speaking, households can own personal property, such as boats and motor homes. But most of us don't have such luxury items, and therefore the vast majority of personal property is made up of machinery and equipment owned by businesses.

A piece of machinery in a manufacturing plant, say a big loom or a cigarette-rolling machine, generates a tax stream for the county year after year. In comparison, the typical New Economy set-up of a desk, a chair, and a computer generates much less tax revenue. And most high-tech equipment depreciates pretty quickly. The more our economy evolves in this direction (and we have to hope that it will!), the greater the pressure it will exert on local tax revenues.

Let's take a look at the figures in the accompanying table, which compares the value of personal property in Guilford County to the value of all property.

| Year | Value of All Property | Value of Personal Property | Share of Total |
|---|---|---|---|
| 2000 | $33.2 billion | $3.8 billion | 11.4% |
| 2001 | $35.6 billion | $4.0 billion | 11.1% |
| 2002 | $36.8 billion | $3.8 billion | 10.4% |
| 2003 | $38.3 billion | $3.6 billion | 9.4% |
| 2004 (est) | $39.5 billion | $3.4 billion | 8.6% |

Source: Guilford County Tax Department

According to the table, total property value has increased in recent years and is expected to approach $40 billion this year. But the value of personal property has fallen, from $4.0 billion in 2001 to an estimated $3.4 billion this year. Remembering that almost all personal property is owned by businesses, we can infer that the value of business personal property has fallen in absolute terms by about 15 percent since 2001. The slowly improving economy hasn't altered that fact. And the figures in the table don't even factor in inflation, which means that the true decline is even greater.

The right-hand column in the table gives personal property's share of total property value, and hence it also approximates personal property's share of total property *taxes*. (It's not exact because the figures for total property value have been adjusted to reflect the actual market value of real property between revaluations.) Before 2000, the tax on personal property tended to hover around 10 to 1 1 percent of the total. But since then that ratio has fallen, and it's expected to be only 8.6 percent in 2004. Personal property is contributing less and less to the county's bottom line, which mirrors the transition away from manufacturing and toward the New Economy.

There is an unfortunate irony here. Because brain power and innovation will be the primary tools of the New Economy, education and training will undoubtedly play a central role as we evolve toward that economy. But this evolution is happening at the same time that a significant source of funding for local education is declining. In fact, the evolution is *why* that source of funding is declining. It seems inevitable that property taxes will have to be restructured to take into account the changing structure of the economy.

How should this be done? One might imagine that we could just raise tax rates on businesses' remaining tangible assets, but that would create more problems than it would solve. For example, higher rates would place much greater scrutiny on how the county values property. It could even end up forcing the county to spend more on its valuation and appeal processes than it would gain in tax revenue.

It seems clear that the solution lies in giving counties the right to find new revenue sources. In particular, as business property gradually converts from tangible to intangible, at least some of those intangible assets will eventually have to be taxed. To be sure, taxes on intangibles have a uncomfortable history in North Carolina.

But it hardly makes sense to force counties to tax only assets that happen to be drying up. If the value of businesses in the future will lie in virtual assets like computer software and other forms of intellectual property, then we may have no choice but to authorize counties to tax them. After all, the schools of the New Economy won’t fund themselves.