

**APPENDIX B-17: NORTH CAROLINA**



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**Overview**

The North Carolina business environment is essentially very strong. The state boasts a gradually improving economy for more than 30 years. While the state was at one time mostly rural and fueled by manufacturing and agriculture, it has added vibrant tourism, financial services, high-tech industries, and established highly regarded academic institutions. It has a strong brand image as a “growth state” and is ranked well by economic development publications. *Site Selection* ranked it as the Best Business Climate five out of the last six years.

On a state ranking scale of 1-50 (with a ranking of one being the best) *Forbes* gave North Carolina an overall rank of three in its 2006 ranking of the “Best States for Business.” Each of the primary rankings is listed below:

<b>North Carolina’s <i>Forbes</i> Rankings</b>	
Overall Rank	3
2006 Rank	3
Business Costs Rank	6
Labor Rank	22
Regulatory Environment Rank	2
Economic Climate Rank	27
Growth Prospects Rank	5
Quality of Life Rank	30

Some of the positive business environment attributes cited by *Forbes* are:

- The Research Triangle Park continues to be a model for technology corridors around the country
- Charlotte, a major financial center, is the banking headquarters for Bank of America and Wachovia
- North Carolina is home to the Global TransPark business complex and education and training center
- North Carolina ranked number nine in high-tech exports in the American Electronic Associations Cyberstates report

- *Plants Sites and Parks* magazine ranked North Carolina the number four state for new business sites and facilities<sup>1</sup>

While North Carolina continues to progress as a “business friendly” environment, major economic restructuring has taken its toll. In recent years, North Carolina’s textiles, furniture, and telecommunications manufacturing industries have been hard hit by international competition.

According to the North Carolina Chamber of Commerce, “In the three years following the US recession of 2001, the combined Gross Operating Surplus of North Carolina businesses, a measure of profitability and investment in fixed capital (corporate net income + small business income + investments in new projects), grew 4.0%, compared with 6.5% for the nation as a whole. Over this same period, employee compensation growth equaled the US rate at 4.0% and taxes on production and imports (8.7%) exceeded the US rate (6.3%).”<sup>2</sup>

One of the major challenges for the state is to determine how to deal with businesses underperforming on profitability before wages and tax receipts begin to suffer.

While North Carolina faces many challenges, states across America are still looking to it as an example of a pro-business environment. North Carolina continuously improves its business climate by lowering business taxes, improving the legal climate, improving educational opportunities, managing healthcare costs, and improving workers’ compensation systems.

In 2006, the North Carolina Chamber developed a Competitive Index for the state. The purpose of this was to empirically measure the competitive positions of North Carolina and the attitudes of its business owners and operators as compared to other states in the country. Many of the findings from this index are referenced in this state profile. The report used ranks and stars. Ranks showed where the state was placed while stars demonstrated performance. The results of this system are detailed in the following chart below<sup>3</sup>:

<sup>1</sup> Kurt Badenhausen. “Special Report: The Best States for Business.” *Forbes Magazine*. July 2007.

[http://www.forbes.com/business/2007/07/10/washington-virginia-utah-biz-cz\\_kb\\_0711bizstates.html](http://www.forbes.com/business/2007/07/10/washington-virginia-utah-biz-cz_kb_0711bizstates.html)

<sup>2</sup> North Carolina Chamber “The State of the State” *Sustaining Success Breaking Away: A Special Report from the North Carolina*. 2007.

[http://www.ncchamber.net/docs/NCBusiness/state\\_of\\_nc\\_business.htm](http://www.ncchamber.net/docs/NCBusiness/state_of_nc_business.htm)

<sup>3</sup> “Economic Agents and Foundation.” North Carolina Chamber.

NORTH CAROLINA ECONOMIC AGENTS AND FOUNDATION				
		Five Star Scale		
	Rank 2006	2006	2004	2002
Economic Growth Index	24	★★★★	★★	★★
Economic Health Index	37	★★	★★	★★
<b>Economic Agents</b>				
Productivity & Labor Supply	16	★★	★★★★	★★★★
Research & Creativity	14	★★★★	★★★★	★★★★
	Rank 2006	2006	2004	2002
<i>“Strong Performance in Economic Agents and especially Capital Formation”</i>				
<b>Economic Foundations</b>				
Business Costs	15	★★★★	★★★★	★★★★★
<i>“Though still in the top half of the states, six-year slippage should be of concern.”</i>				
Education	10	★★★★	★★★★	★★★★
<i>“Consistent, good performance in Education.”</i>				
Workforce Preparedness	33	★★	★★	★★
<i>“Ranking in the lower half of scores, not enough movement in workforce preparedness.”</i>				
Infrastructure and Connectivity	39	★★★	★★★	★★★

\* Completed by the North Carolina Chamber of Commerce<sup>4</sup>

## Public Policy

The *State Competitiveness Report 2007*, (SCR) a study by the Beacon Hill Institute that examines businesses of all sizes, particularly praised North Carolina for its high venture capital investment and bank deposits per capita, ranking the state ninth in the nation for incubating business.<sup>5</sup>

The SCR noted that other challenging areas dragged down North Carolina’s overall ranking to 30<sup>th</sup> among the 50 states.<sup>6</sup> It gave the state low marks in the categories of openness (connectedness with the rest of the world, based on exports and other factors), security (crime and trust in public officials), and environmental policy. Still, the report noted, “Though these are the areas of greatest deficiency for North Carolina, they

<sup>4</sup> “How North Carolina Stacks Up.” North Carolina Chamber.

<sup>5</sup> David Tureck, Jonathon Haughton, Frank Conte, and Christopher Doyon. *State Competitiveness Report 2007*. Boston: Beacon Hill Institute for Public Policy Research at Suffolk University, 2007. 48. <http://www.beaconhill.org/Compete07/Compete2007State.pdf>

<sup>6</sup> Tureck.

also mark the areas with the greatest potential.”<sup>7</sup> Of surrounding states, Virginia ranked above (16<sup>th</sup>), while North Carolina and Georgia (24<sup>th</sup>)<sup>8</sup>, South Carolina (22<sup>nd</sup>)<sup>9</sup>, and Tennessee (26<sup>th</sup>)<sup>10</sup> trailed. The similar *Small Business Survival Index 2007* (SBS) gave North Carolina good marks in state and local government spending, as well as praising the five-year trend in government spending<sup>11</sup>.

## **Regulatory Affairs**

North Carolina ranks in *Forbes* as one of the best regulatory environments. The state is ranked 2<sup>nd</sup> out of 50 states.<sup>12</sup> Regionally, North Carolina ranks second in the South as well, just behind the regional leader Virginia.

North Carolina’s performance in Business Costs has slipped in the most recent years but is still above most US states in the NC Chamber Index. It achieved a rank of 15<sup>th</sup> and a four-star rating. Virginia ranked 5<sup>th</sup> with a four star rating, Georgia ranked 12<sup>th</sup> with a four star rating, South Carolina 24<sup>th</sup> with a three star rating, and Florida 38<sup>th</sup> with a two star rating<sup>13</sup>.

North Carolina’s Unit Labor Costs have continued to improve over the last few years, moving it from 8<sup>th</sup> in 2002 to its current position of 3<sup>rd</sup>. Especially in the most recent year, North Carolina experienced a continuous increase in industrial and commercial energy costs, ranking it at 18<sup>th</sup>, up from 27<sup>th</sup>.<sup>14</sup>

North Carolina has been the one of the leading states in the lowest business tax burden over the years as other states have increased their rates faster. Its state business tax structure ranked it consistently in the middle of the states.

## **Tax Policy**

The Tax Foundation’s 2007 *State Business Tax Climate* (SBTC) Index puts North Carolina, nearly across the board, in the bottom fifth for a tax climate favorable to business, including the categories of individual income tax, sales tax and property tax. The foundation did note, though, that the recent reduction in the state sales tax would likely improve the climate somewhat. Overall, North Carolina was ranked 40<sup>th</sup>, trailing neighbors Virginia (14<sup>th</sup>), South Carolina (26<sup>th</sup>), Tennessee (16<sup>th</sup>) and Georgia (20<sup>th</sup>).<sup>15</sup> In addition, North Carolina was ranked in the middle among states, ranked 25<sup>th</sup>, in

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<sup>7</sup> Tureck.

<sup>8</sup> Tureck, 25.

<sup>9</sup> Tureck, 55.

<sup>10</sup> Tureck, 57.

<sup>11</sup> Raymond J. Keating. *Small Business Survival Index 2007: Ranking the Policy Environment for Entrepreneurship Across the Nation 12<sup>th</sup> Annual Edition*. Small Business & Entrepreneurial Council, Washington, DC, 2007.  
[http://sbecouncil.org/Media/pdf/SBSI\\_2007.pdf?CFID=514256&CFTOKEN=91743709](http://sbecouncil.org/Media/pdf/SBSI_2007.pdf?CFID=514256&CFTOKEN=91743709)

<sup>12</sup> Badenhause.

<sup>13</sup> “Business Costs.” North Carolina Chamber.

<sup>14</sup> “Business Costs.”

<sup>15</sup> Chris Atkins and Curtis S. Dubay. *Background Paper: 2008 State Business Tax Climate Index*. Oct 2007, Number 52. The Tax Foundation. 10. <http://www.taxfoundation.org/files/bp52.pdf>

corporate tax climate and sixth in the nation on unemployment insurance tax. Virginia, by comparison, ranked fourth in corporate tax climate and 29<sup>th</sup> on unemployment insurances taxes.<sup>16</sup>

While North Carolina has received a significant amount of praise for its tax policy, it does not go without critics. A number of studies and reports have criticized the state's tax climate and administration. These reports illustrate a number of opportunities for improvement that can be seized. The findings include:

- North Carolina earned the lowest score in the nation, a "D-"" , from the Council on State Taxation in its recent report on "The Best and Worst of State Tax Administration."<sup>17</sup> That COST report gave the state positive marks for its even-handed statutes, but downgraded North Carolina on a number of other fronts, such as its short protest period, due date for state returns, lack of independence in the appeals process and a lengthy and cumbersome refund process, among other issues. A separate report by CFO magazine, based on a survey of corporate tax directors, also rated the North Carolina tax appeals process poorly for its separation of powers from the tax audit department. The same survey also reported that companies felt the state and Legislature were likely to attempt to take back incentives that fostered business and that the state was very aggressive with businesses on a number of taxation fronts.
- Another report by the Council on State Taxation reported that North Carolina, while slightly trailing the national average for the percentage that business paid in overall sales tax collections, had a higher share than Virginia, Tennessee and South Carolina.<sup>18</sup>
- The SBS Index ranked North Carolina in or near the bottom 10% for its personal income and capital gains tax rates.<sup>19</sup> The report noted that because the great majority of businesses are small ones with sole proprietorships, the state was taking money that otherwise could be plowed back into businesses, creating growth and jobs.<sup>20</sup>

## **Innovation**

To measure innovation in the state, investment and returns in innovative activities such as patents and research and development expenditures were examined. The New Economy Index<sup>21</sup> (NE) rates the states according to advancements in innovation (with a rating of one being the best) and the ability to compete in a new market that relies on the digital age. In this study, New York ranked about average at 26<sup>h</sup> in the nation. The state

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<sup>16</sup> Atkins and Dubay, 10.

<sup>17</sup> Douglas Lindholm and Stephen Krantz. Scorecard on Tax Appeals and Procedural Requirements. Council on State Taxation. April, 2007.  
[http://www.statetax.org/Content/ContentGroups/Home\\_Page\\_Content/COST\\_Studies\\_Articles\\_and\\_Testimony/2007BestAndWorstScorecardAmended.pdf](http://www.statetax.org/Content/ContentGroups/Home_Page_Content/COST_Studies_Articles_and_Testimony/2007BestAndWorstScorecardAmended.pdf)

<sup>18</sup> Lindholm and Krantz.

<sup>19</sup> Keating, 28-29.

<sup>20</sup> Keating.

<sup>21</sup> Robert Atkinson and Daniel K. Correa. The 2007 State New Economy Index.: Benchmarking Economic Transformation in the States. Innovation Technology and Innovation Foundation. February, 2007. 13. [http://www.kauffman.org/pdf/2007\\_State\\_Index.pdf](http://www.kauffman.org/pdf/2007_State_Index.pdf)

received relatively mediocre rankings for inventor patents (36<sup>th</sup>) and existing patents (27<sup>th</sup>)<sup>22</sup>. In addition the SCR ranks North Carolina slightly above average at 19<sup>th</sup> in the nation for technological innovation.<sup>23</sup>

North Carolina's performance in innovation positioned it above the majority of the states with continuous improvement over the five years with the NC Chamber Index. The state's rank of 14<sup>th</sup> (three stars) compares favorably to Georgia at 22<sup>nd</sup> and Florida at 27<sup>th</sup> (two stars each) and South Carolina at 39<sup>th</sup> and Virginia at 46<sup>th</sup> (one star each).<sup>24</sup>

North Carolina has been ranking in the middle of the states in Patents per Worker and Patents per R&D Dollar. The state slipped from 23<sup>rd</sup> to 28<sup>th</sup> in Patents per R&D Dollar but improved to 24<sup>th</sup> from 26<sup>th</sup> in Patents per Worker compared to five years earlier.<sup>25</sup> Industry and Government R&D measures both improved in their values and competitiveness to rank 23<sup>rd</sup> and 20<sup>th</sup>, respectively.<sup>26</sup> University R&D ranks higher at a rank of 16<sup>th</sup>. North Carolina's performs best in University Royalty and License Income at a rank of 7<sup>th</sup>, up from 14<sup>th</sup>.<sup>27</sup> It also fared well on the NSF Proposal Funding Rate, ranking 16<sup>th</sup> vs. 20<sup>th</sup> five years earlier.<sup>28</sup>

In the innovation economy, sound, basic "infrastructure" remains important, especially in a state like North Carolina with strong international trade ties. Infrastructure can be broadly defined to include both traditional physical infrastructure, such as roads, ports, water and sewer, and "virtual" infrastructure, or digital connectivity. The metrics chosen attempt to measure outcomes, productivity, and level of service, rather than inputs, such as capital expenditures per resident.

North Carolina's performance in Infrastructure and Connectivity slipped below the majority of the states in recent years, earning a rank of 39<sup>th</sup> and three stars in the Chamber Index. That trailed states in the region such as Florida at 2<sup>nd</sup> with five stars, Virginia at 3<sup>rd</sup> with five stars, Georgia at 9<sup>th</sup> with four stars, and South Carolina at 31<sup>st</sup> with three stars. North Carolina's Highway and Bridge Quality has stayed at 30<sup>th</sup> and 34<sup>th</sup>, respectively. Broadband Lines per 1,000 residents have not increased at the same speed as in other states, dropping North Carolina to 19<sup>th</sup> from 14<sup>th</sup> in 2002 but Broadband Coverage (share of ZIP codes with two or more providers) improved to a rank of 4<sup>th</sup> from 12<sup>th</sup>. The Technology in Schools index improved from rank 43<sup>rd</sup> in 2002 to 35<sup>th</sup> in the most recent year.<sup>29</sup>

## **Workforce**

North Carolina receives a relatively high ranking when it comes to its workforce. The SCR ranks the quality of its workforce in its "Human Resources" category. In this

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<sup>22</sup> Atkinson, 15.

<sup>23</sup> Tureck et al, 48.

<sup>24</sup> "Research and Creativity." North Carolina Chamber.

<sup>25</sup> North Carolina Chamber.

<sup>26</sup> North Carolina Chamber.

<sup>27</sup> North Carolina Chamber.

<sup>28</sup> North Carolina Chamber.

<sup>29</sup> "Infrastructure and Connectivity." North Carolina Chamber.

category, the state had a poor ranking at 37<sup>th</sup>.<sup>30</sup> The state received especially poor marks in the percentage of adults in the workforce where the state ranked 39<sup>th</sup>. Additionally the state also received below average rankings for its unemployment rate at 33<sup>rd</sup> and for the percentage of adults in the labor force where it ranked 34<sup>th</sup>.

However, North Carolina has an overall positive reputation on labor issues, when considering a few other factors. A few key points from the recent *Forbes* ranking are:

- North Carolina is a “right-to-work” state, with a unionization rate of 2.9%— the third-lowest rate in the nation
- The state’s workers have a strong work ethic; absenteeism rates are low
- Workers’ compensation and unemployment insurance rates are among the lowest in the nation
- The 782,000 person manufacturing workforce is the largest in the Southeast
- North Carolina offers free, customized skills training through an extensive system of 58 community and technical colleges
- A state-supported university system (one of the top-rated systems in the country) offers advanced educational opportunities at 16 campuses
- The R&D capabilities within the internationally recognized Research Triangle Park (RTP) provide support for diverse business and industry endeavors<sup>31</sup>

North Carolina has struggled for decades on how to upgrade productivity and has used demand-driven workforce strategies to advantage in this regard. This productivity driver measures the inflow and availability of labor and the efficiency with which a state produces goods and services.

North Carolina’s performance in Productivity and Labor Supply measures has kept it significantly above the majority of US states in all years of the NC Chamber Index. At the same time, the score of the best performer has moved further away, explaining North Carolina’s relatively low current rating of two stars at rank 16<sup>th</sup>. In comparison, Virginia is ranked 12<sup>th</sup>, Georgia 18<sup>th</sup>, Florida 26<sup>th</sup>, and South Carolina 41<sup>st</sup>.<sup>32</sup> Some of the key points to consider are:

- North Carolina has, throughout all years of the index, experienced a substantial and growing gain in Net Migration, ranking it currently 5<sup>th</sup>, up from 10<sup>th</sup> five years ago.
- At the same time, relatively low Labor Force Participation Rates have been falling slightly, moving North Carolina from 30<sup>th</sup> to 33<sup>rd</sup>.
- Productivity in North Carolina has improved in value and competitiveness in all three measures in this driver and ranks among the top 25 states. The most significant improvement occurred in Value Added per Hour in Manufacturing, where the state moved from 18<sup>th</sup> to 12<sup>th</sup> over the five years.<sup>33</sup>

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<sup>30</sup> Tureck, et al.

<sup>31</sup> Badenhausen.

<sup>32</sup> “Productivity and Labor Supply.” North Carolina Chamber.

<sup>33</sup> “Productivity and Labor Supply.”

North Carolina's performance in workforce measures has continued to lay just below the majority of US states. The state ranks and scores similarly to all surrounding states except Virginia. Improving customized training and the state's career technology and community college systems has long been a priority of state leaders. Key points to keep under consideration are:

- Bachelor's Degree Attainment in North Carolina has improved in value and from a rank of 33<sup>rd</sup> to a rank of 28<sup>th</sup> in the most recent year.
- North Carolina has lost competitiveness in Physical Science and Engineering Workers, moving from 24<sup>th</sup> to 32<sup>nd</sup>. As its share has remained stagnant, other states have been able to improve their share of these innovation workers in the workforce.
- Although North Carolina has been able to increase its share of High-tech Manufacturing Employment over the years, its already weak competitive position has slipped further from 41<sup>st</sup> to 44<sup>th</sup>. It has been able to hold its ground in High-tech Service Employment at 17<sup>th</sup> despite a falling share.<sup>34</sup>

## **Education**

A recent report by US Chamber of Commerce, *Leaders and Laggards: A State by State Report Card of Educational Readiness*, gave the state high marks in a number of categories, reflecting that the state had a healthy percentage of students going on to college and a good percentage of students passing rigorous advanced placement exams.<sup>35</sup> The U.S. Chamber report also gave North Carolina "A's" for return on educational investment and for making sure teachers are well qualified.<sup>36</sup>

The same report says the state could do a better job preparing younger students in math and reading. The report stated that its standards could be more rigorous and, in giving the state a "D", noted that state test scores too readily deem students proficient while other national tests show otherwise.<sup>37</sup>

North Carolina's performance in Education has continued to stay above majority of US states, earning a rank of 10<sup>th</sup> and four stars in the NC Chamber Index. Virginia was 7<sup>th</sup> with four stars, Florida 34<sup>th</sup> with three stars, Georgia 35<sup>th</sup> with three stars, and South Carolina 44<sup>th</sup> with two stars<sup>38</sup>. Key points in the area of Education are:

- Although High School Graduation Rates have improved over the last five years, North Carolina currently ranks at only 37<sup>th</sup>, up from 40<sup>th</sup>.
- North Carolina has shown significant improvement in SAT and ACT performance though still ranking only at 32<sup>nd</sup> for SAT and 39<sup>th</sup> for ACT.

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<sup>34</sup> "Productivity and Labor Supply."

<sup>35</sup> The Institute for a Competitive Workforce. *Leaders and Laggards: A State by State Report Card on Educational Effectiveness*. US Chamber of Commerce, 2007.  
<http://www.uschamber.com/icw/reportcard/default>

<sup>36</sup> *Leaders and Laggards*, 44

<sup>37</sup> *Leaders and Laggards*, 44

<sup>38</sup> "North Carolina Education." North Carolina Chamber.

- North Carolina's competitive position in Technology and Technician Degrees granted showed substantial improvement over the five years from a rank of 35<sup>th</sup> to 27<sup>th</sup> despite a decreasing share. Other states seemed to have decreased their performance even more.
- Other Innovation Degrees granted at the same time slipped in value as well as rank to a current position of 31<sup>st</sup>.<sup>39</sup>

### **Cost of Market Entry**

The Milken Institute releases an annual study in which it ranks the states with the highest cost of doing business on a scale of 1-50 (with a ranking of 50 being best for business).<sup>40</sup> In this study, North Carolina was given a relatively good rating with the 31<sup>st</sup> highest cost of doing business.

While the cost of doing business in North Carolina has steadily risen in recent years, *Forbes* recently gave the state high marks on low business costs. The main factors taken into consideration for this were:

- No inventory tax
- Electric rates for industrial, commercial, and residential customers are below the national average
- Grants and low-interest loan programs are available
- North Carolina has a AAA bond rating
- Tax credit incentives are available to new and expanding industries
- North Carolina enforces sound fiscal policy through a constitutionally mandated balanced budget<sup>41</sup>

However, the Competitiveness Index from the NC Chamber did show some areas where improvements could be made.

- **Energy:** Many business leaders in the state believe that the best way to minimize the cost of energy for businesses would be to either lower or eliminate the sales tax on energy. Eliminating or lowering this tax would result in likely savings for businesses. However, the state has fared positively in comparison with other states, ranking 18<sup>th</sup> in 2006 vs. 27<sup>th</sup> in 2002.
- **Business Liability Premiums:** As liability costs increase, so do workers' compensation premiums and general business liability premiums. These increasing costs are often driven by frivolous lawsuits. Even if a business wins a lawsuit, the cost for time lost and lawsuit expenses can be staggering.
- **Medical and Malpractice Premiums:** When professionals and businesses are forced to defend themselves against frivolous lawsuits, the cost of medical and

<sup>39</sup> North Carolina Chamber, "North Carolina Education."

<sup>40</sup> "2007 Cost of Doing Business Index." Milken Institute. December, 2006.

<http://www.milkeninstitute.org/pdf/2007CostofDoingBusiness.pdf>

<sup>41</sup> Badenhausen.

malpractice skyrockets. These increased premiums and other associated costs add significantly to the cost of doing business in North Carolina.<sup>42</sup>

Some key points to be considered when examining North Carolina's rating for cost of doing business are:

- The Kauffman Foundation Entrepreneurial Activity Index ranks North Carolina only at 38<sup>th</sup> in the most recent year in terms of new business owners
- Startup Rates at the firm level, however, rank North Carolina at 12<sup>th</sup>, implying that entrepreneurial engagement happens less at the individual level
- Although North Carolina has a relatively high Establishment Failure Rate at rank 31<sup>st</sup>, the New Business Churn rate in relation positions the state at a rank of 10<sup>th</sup>
- Foreign Direct Investment (share of employment in foreign-owned companies) has always been a competitive asset for North Carolina at a current rank of 9<sup>th</sup>, though they have slipped in value and from rank 6<sup>th</sup> in 2002
- The average number of High Performance Firms relative to all firms in the state has slipped in value and rank from 15<sup>th</sup> to 27<sup>th</sup>

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<sup>42</sup> "Competitiveness Gap." North Carolina Chamber.