North Carolina’s Economy in the Latter 20th Century: Change and Challenge

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NORTH CAROLINA'S ECNONOMY IN THE LATTER 20TH CENTURY: CHANGE AND CHALLENGE

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North Carolina's economy in the last third of the 20th century, when James. B. Hunt, Jr. was governor for sixteen years, underwent a major economic transformation. This essay documents that economic overhaul, its impact on people, places, and policies, and then looks ahead at the issues facing the state's commercial growth and standard-of-living in the 21st century.

Beginnings

Like most of early America, North Carolina's economy was dominated by agriculture in its early years. In the 1700s and 1800s turpentine, tobacco, and corn were the state's leading industries. In the latter part of the period a small number of textile mills began to appear, but they served mostly buyers within the state.

Then came the revolution in agricultural productivity that followed the introduction of mechanization – particularly the tractor – to farming. Farms could now produce more using fewer workers. Workers released from agriculture swelled the state's available labor supply and depressed wages. The combination of cheap labor, electric power from the state's numerous rivers, and access to expanding railroad connections and deep water ports made the state a prime candidate for manufacturing enterprises.

The first to take advantage of the state's attractiveness to manufacturing was the textile and apparel industry. The labor intensive industry had always shown an inclination to locate in regions with low cost workers. Increasingly, therefore, textile and apparel mills began to migrate from high-cost northern (primarily New England) locations to lower-cost southern locations, including North Carolina. By the 1920s, North Carolina had become the leading center of textile and apparel manufacturing in the country.

The state's furniture sector developed for similar reasons – low-cost labor, proximity to forests, and available rail transportation - and by early 20th century the center of furniture making in the nation had shifted to North Carolina. The state's tobacco and cigarette industry was actually indigenously developed. North Carolina had long possessed the perfect soil conditions and climate for the growing of flue-cured tobacco. When a machine for rolling tobacco into cigarettes was perfected, cigarettes were able to be mass produced in factories, and cigarette factories were established to complement the farm production of the raw component – tobacco.

Therefore, by the middle of the 20th century, North Carolina's "Big Three" – tobacco, textiles, and tobacco – were firmly established as the drivers of the state's economy. Together the industries accounted for over 20 percent of the state's economic production (gross state product) and over half of manufacturing employment. The industries dominated state politics and influenced public policies. North Carolina senators and representatives serving in Washington made it their goal to protect the "Big Three". National images of life in North Carolina were based on perceptions of the "Big Three".

The Winds of Economic Change

But the "Big Three" weren't able to withstand the multiple storms that were about to hit them in the final decades of the 20^{th} century. The first was the one-two punch of open world trade and deregulation. As modern communications and transportation effectively shrunk the world and made production increasingly possible anywhere, North Carolina's hold on industries using low-cost labor began to slip. There were now many places in the world with lower labor costs than in North Carolina, and it became increasingly feasible to put factories in those locations and use modern cargo ships to deliver the finished products to final consumers.

World leaders, including representatives from the United States, began to realize the benefits from more open world trade, and the result was a series of trade agreements, such as the North American Free Trade Agreement (NAFTA) and the General Agreement on Tariffs and Trade (GATT) , which slashed tariffs, cut quotas, and ended special protections for certain industries. North Carolina's "Big Three", which had effectively been shielded from international competition by tariffs, quotas, and special agreements, now were exposed to competitive forces. Even domestic competition was increased when the federal tobacco program, which had guaranteed the state's tobacco farmers prices and profits from their crop, was scrapped.

The result was a collapse of the "Big Three". From controlling over 20 percent of the state's economy at its peak, the three industries' share shrunk to just over 5 percent by the first decade of the 21^{st} century. Textiles and apparel alone cut over 250,000 jobs. The mighty "Big Three" were a mere shadow of their former dominance.

A second fundamental change impacting the state economy was the increasing returns to education. What was valued in the workforce gradually shifted from power and strength to brains and reasoning. Technology was largely behind the shift. Power and force could increasingly be accomplished with sophisticated machines,

Then, in the final decade of the 20^{th} century, a massive geopolitical change resulted – in the words of one author – in the addition of three billion more capitalists to the world economy. The change was the almost simultaneous collapse of the former Soviet Union, the institution of market-oriented economic policies in China, and the reform of stifling bureaucratic rules and regulations in India. These changes allowed three billion workers and consumers in Asia and Europe to join the world production and trading community.

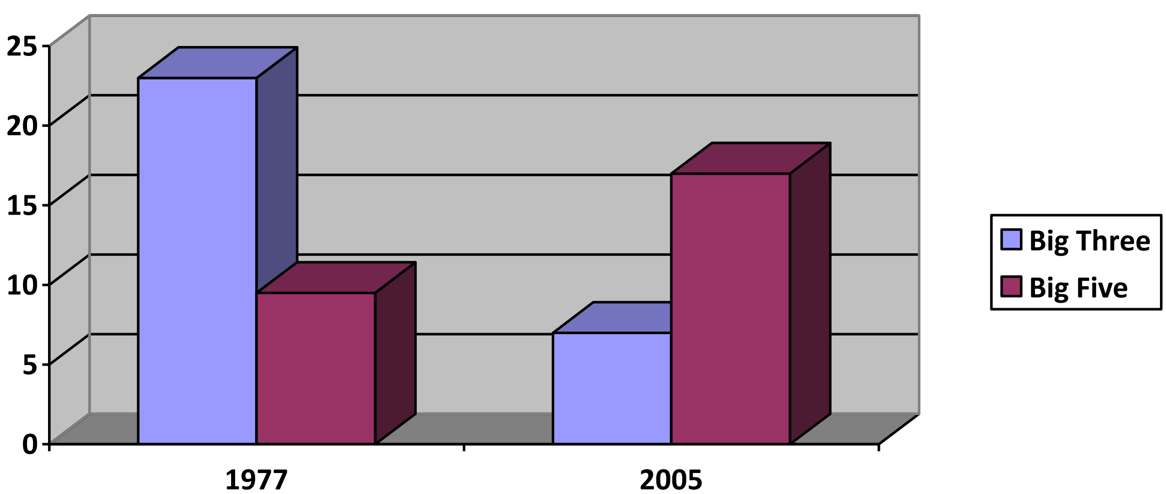
What the "winds of economic change" meant for North Carolina was truly transformational. North Carolina could no longer base its economy on the availability of low cost labor, particularly for manufacturing. Such labor was now widely available in numerous foreign countries and accessible with modern communications and technologies.

To survive, North Carolina's economy had to change, and it did. The state leveraged its long-standing investment in higher education to attract emerging technology and medical research (pharmaceutical) firms. North Carolina had a tradition of allowing branch banking in the state, and thus had become the home for financial firms with considerable geographic scope and range. Thus, when federal deregulation of the banking industry led first to regional banks, and then to national banks, North Carolina's banks were able to quickly expand. The result was Charlotte becoming the second largest banking center in the country.

The domestic auto industry was on the move in the late 20^{th} century, and North Carolina used it competitive labor costs and proximity to vehicle assembly plants in the South to attract a significant vehicle parts industry. Last, the state's agricultural industry, long a mainstay of the economy, also remade itself, shifting from a largely crops industry to a meats (swine, poultry) dominated industry. Taking advantage of American consumers' increasing consumption of processed (ready to eat) foods, the state develop a large food processing sector to complement its farm level meat production.

This was then the new "Big Five" of North Carolina's new economy – technology, pharmaceuticals, finance, vehicle parts, and food processing. The shift from the traditional "Big Three" to the new "Big Five" can clearly be seen in their changing shares of the state economy (Figure 1).

Figure 1. "Big Three" and "Big Five" Share of North Carolina Gross State Product, 1977 and 2005 (%)

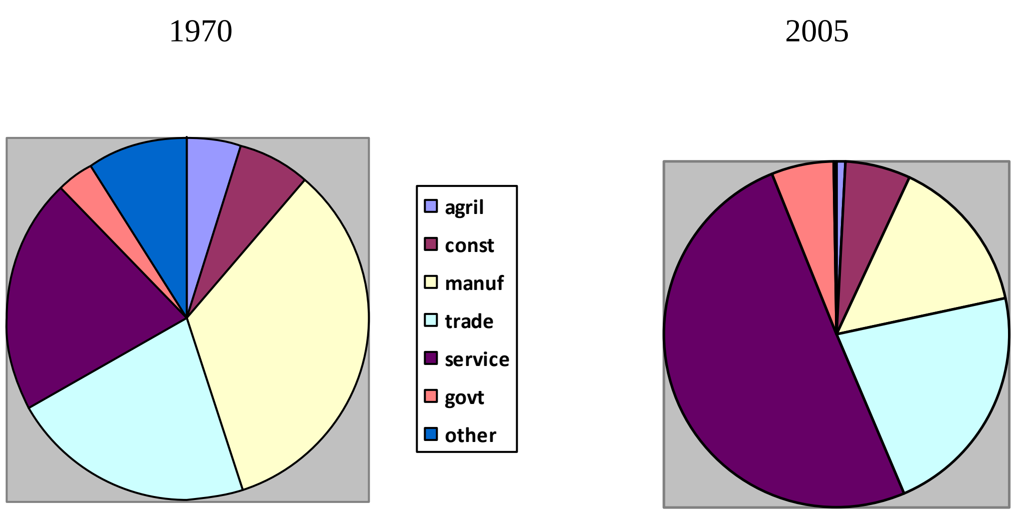


Source: Walden, *North Carolina in the Connected Age*, p. 27.

Winners, Losers, and Economic Divides

The transformation of the North Carolina economy has had profound impacts on the state's people. First is in terms of where and how they work. In 1970, over a third of the state's workers were still in manufacturing. That percentage was reduced by more than half by 2005. In contrast, service sector workers (including those in finance) grew from a fourth to over half of the workforce (Figure 2).

Figure 2. North Carolina Employment by Major Sector, 1970 and 2005 (%)[1]



1 transportation, communications, and public utilities included with trade

Source: Walden, *North Carolina in the Connected Age*, p. 91

How people worked – what they did – also dramatically changed. The rise of "white collar" jobs in technology, medicine, finance, management, sales, and service activities sparked a 50 percent increase in workers engaged in professional, managerial, sales, clerical, and service occupations. In contrast, "blue collar" jobs in farming, skilled crafts, and operatives declined (Figure 3).

Figure 3. North Carolina Employment by Occupation, 1970 and 2005 (%)

1970 2005

Abbreviations:

prof/man: professionals and managers

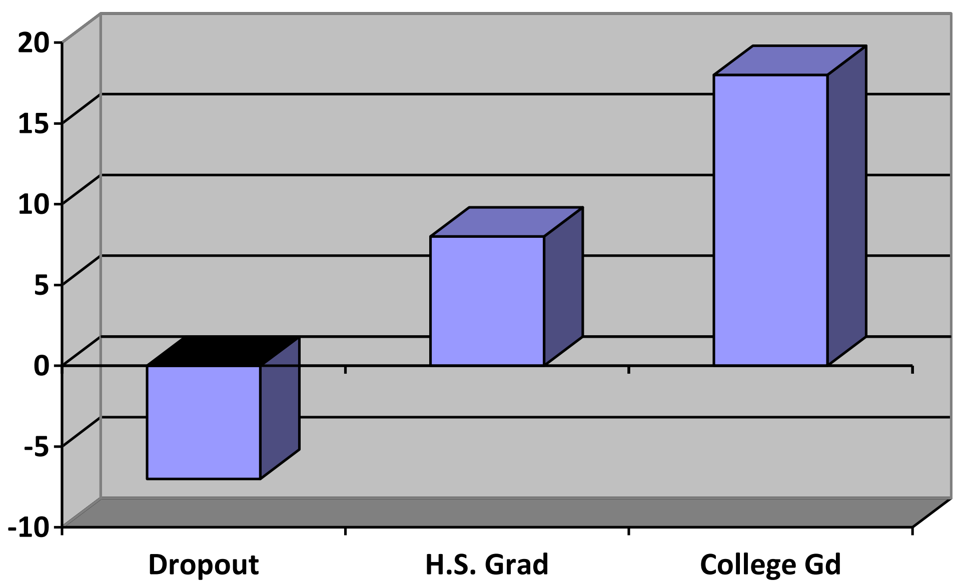
ser, sls, cler: service, sales, and clerical

sk crft, oper: skilled crafts persons and operatives

Source: Walden, *North Carolina in the Connected Age*, p. 91.

Various measures of earnings, compensation, and income all rose for the average North Carolina household in the last three decades of the 20th century. Yet these averages mask considerable variation between households with different attributes. The most defining characteristic of the period was education. Adjusted for inflation, the wage rate (earnings per hour) of workers with a college degree rose, it stagnated for high school degreed workers, and it fell for workers who were high school dropouts (Figure 4). Education was the defining economic characteristic during North Carolina's transformation.

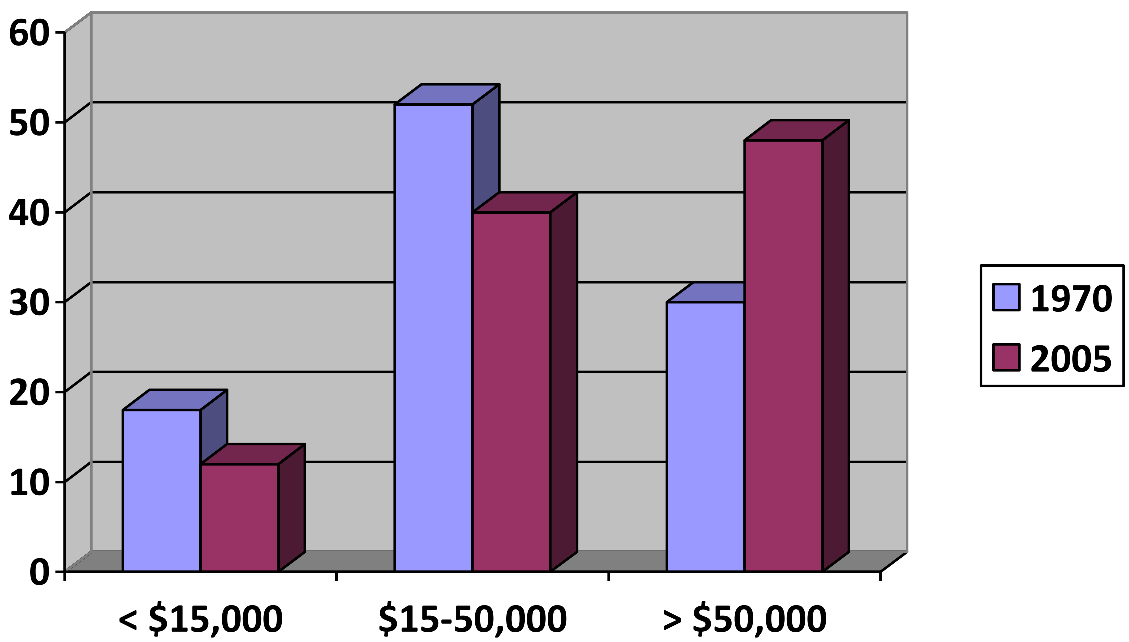
Figure 4. Real (inflation-adjusted) wage rate for North Carolina Workers With Different Levels of Education, 1980-2005 (%)



Source: Walden, *North Carolina in the Connected Age*, p. 94.

As a result, North Carolina's income distribution became more unequal during the period (Figure 5). The increased income disparity was primarily caused by increases in the percentage of higher income households and losses in the percentages of middle income households. This reflected the strong growth in high income (professional) jobs and the decline in middle income factory jobs.

Figure 5. Percentage of North Carolina Households by Income Category, Inflation-Adjusted 2005 $



Source: Walden, *North Carolina in the Connected Age*, p. 103.

It shouldn't be surprising that all regions of North Carolina didn't perform equally on economic measures during this time of transition. Just as for households, income disparities between North Carolina households also increased from the 1970s to the 2000s. Counties with more highly educated workforces ("Triangle" region counties), with fast growing industries (banking in Charlotte), or with natural amenities favored by tourists and retirees (Asheville and Wilmington area counties) grew and prospered. In contrast, counties which had been home to textile mills, furniture factories, and cigarette manufacturers struggled to add jobs and incomes.

The Push from Policies

North Carolina leaders, including Jim Hunt, were quick to recognize the forces shaping North Carolina at the end of the 20th century and understood that the state needed to adapt. The major focus was on improving the education and training of the workforce. Between 1970 and 2005, the percentage of adults in the state with high school degrees increased twice as fast as in the nation. SAT (Scholastic Aptitude Test) scores for college bound high school seniors increased more than four times as fast in North Carolina as in the nation. North Carolina increased spending per K-12 students faster than did the nation, and class sizes fell at a greater rate.

Just as impressive were the improvements made at the higher education level. The percentage of adults with a bachelor's degree increased 10 percent faster in North Carolina than in the nation. And the state, a long-time supporter of higher education, increased the share of the state's aggregate income allocated to higher education by a remarkable 50 percent between 1972 and 2005. In 2005, the share of the state's aggregate income allocated to higher education by the state government was 40 percent greater than for the nation.

North Carolina also increased spending on public safety during the period, thereby enhancing security and lowering risk for economic investments. North Carolina also began to make selective use of business incentives (essentially targeted tax reductions) in the last three decades of the 20th century, thereby acknowledging that business recruitment had become increasingly more competitive in the new global economy.

<u>The Challenging (But Exciting) Future</u>

The economy of the 21st century is changing faster than ever before. This is easily seen in the events of recent years, when the country went from a housing boom to a housing bust that pushed the country into the most devastating downturn since the Great Depression. North Carolina's economy is vulnerable to these booms and busts, registering very low unemployment rates when the economy is growing but very high rates when the economic engine stalls.

The immediate challenge is to return the state economy to growth and job creation, which many economists see happening in 2010, albeit slowly. But looking past the current recession, many challenges face North Carolina, all centered around the core issues of competing in a very competitive world and financing the basic needs and desires of the state's residents. Three important challenges are:

- *What industries will lead North Carolina through the rest of the 21st century?*

  North Carolina's economy will continue to change, with existing industries contracting and new industries emerging. The "Big Five" will transform into a new set of leading industries. But what will compose those new leading industries? What role will sectors like alternative energy, biotechnology, information management, and precision instrument manufacturing – to name a few – play in the next phase of the

North Carolina economy? And what roles will the private and public sectors play in promoting a smooth transition to the next economy?

- *Education will likely continue playing a major part in future economic development. How can North Carolina promote enhanced educational achievement for students and workers?*

  North Carolina made tremendous progress in improving educational attainment during the past thirty years. Yet progress can't stop here – more gains need to be realized to keep pace with a world where rapid educational improvements are occurring. How will these gains be achieved, and how can the gains be spread to all regions and all demographic groups? Education will be the solution to reducing the economic divides between workers and regions in the state.

- *How will North Carolina finance its public responsibilities in the new economy?*

  The public sector (government) in North Carolina is financed by five major taxes: the individual income tax, the corporate income tax, the sales tax, the property tax, and the motor fuels (gas) tax. There are issues with each of these. North Carolina has relatively high individual and corporate income tax rates, and the concern is this puts the state at a competitive disadvantage vis-à-vis other states in attracting new households and businesses. North Carolina's sales tax is primarily levied on tangible products, but this makes the base for the sales tax increasingly narrow as consumers shift spending to services. In most counties property reassessments are done only every four or eight years, which means property values are frequently out-of-date with market values. Finally, the motor fuel tax assessed on gallons of gasoline purchased is becoming an inadequate revenue source for highways as fuel efficiencies improve.

The solution to each of these issues is a remaking of North Carolina's tax system. Individual and corporate income tax rates could be lowered if the *base* (what is taxed) of the taxes was expanded. Similarly, the sales tax rate could be lowered and the tax base could keep pace with changes in consumer expenditures if the tax was expanded to include spending on services. More frequent property reassessments would keep taxed property values more in line with market values. And a mileage fee in place of a per gallon tax would improve the adequacy of the highway fund.

Rolling Up Our Sleeves

Jim Hunt has always been known as a person of action – both as Governor and as a private citizen. Once Hunt identified a problem, he'd roll up his sleeves and tell his staff and colleagues, "let's get to work". No challenge or issue is too big for Jim Hunt.

Perhaps more than any other single person in North Carolina, Jim Hunt is responsible for North Carolina's successful adaptation to the new economy of the late 20th and early 21st centuries. But, of course, the work is not done. As this essay has detailed, there are still major economic challenges facing North Carolina, and there will be new challenges to come. These challenges won't be solved in months, years, or perhaps even decades. Additionally, the responses will have to evolve as the challenges change.

But North Carolinians won't shy away from the future and what it holds. North Carolinians know how to adapt, how to change, and how to turn adversity into progress. Like Jim Hunt, North Carolinians will roll up their collective sleeves and simply "get to work"!

References

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