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STATE EXPENDITURES PROJECTIONS TO 2010

BY

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WORKING PAPER 3

IN A FOUR-PAPER SERIES ON
FISCAL SUSTAINABILITY OF THE SOUTH CAROLINA
REVENUE AND EXPENDITURE SYSTEM
1998-2010

STROM THURMOND INSTITUTE OF GOVERNMENT AND PUBLIC AFFAIRS
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STATE EXPENDITURES: PROJECTIONS TO 2010

This report presents projections of the state of South Carolina's general fund expenditures for the 12-year period from fiscal year 1998-99 through fiscal year 2009-10. It is an update to the 1997 report, *State Expenditures: Projections to 2010*,¹ which was prepared as part of that year's Fiscal Sustainability Project. As in the 1997 report, spending projections are made for key program areas, including: education, corrections, Medicaid and social services, state aid to local governments, and debt service.

In this report, expenditures in 2009-10 are projected on the basis of 1998-99 appropriations *plus* supplemental appropriations, the closest approximation to actual spending in the program areas of interest.² As a general rule, it is assumed that per capita expenditures for major program areas in the South Carolina general fund budget will remain constant in real (inflation-adjusted) terms. In program areas such as education, corrections, and Medicaid, projected expenditures are held constant on a per capita basis for the affected segment of the population; i.e., per pupil, per prisoner, and per person over 65. The inflation rate used in this report is 2.5 percent per year.

This report differs in two important ways from the 1997 report. First, future spending is projected from appropriations *plus* supplemental appropriations, rather than appropriations alone, as was done in last year's report. This change was made to better reflect how the state has operated, in terms of actual expenditures, over the past few years. A large share of supplemental appropriations is for recurring items, which must be provided for in the following year's budget. Therefore, these items should be a part of the expenditure base.

Second, this year several categories of state aid to local governments—inventory tax reimbursement, depreciation property tax reimbursement, and other miscellaneous aid—were removed from the all other spending category and included in the state aid to local governments category total. The research team believes that this change better reflects the role of aid to local government in overall state spending and makes it easier to integrate this report with the report on local revenues. In addition, to maintain comparability with last year's report, components of the newly created Trust Fund for Tax Relief—school property tax relief, homestead exemption, inventory tax reimbursement, and depreciation property tax reimbursement—are included in this analysis. The Trust Fund for Tax Relief removed these spending obligations from the general fund for this and future years.

EDUCATION

Expenditures for both K-12 and post-secondary education are projected by assuming that real per pupil expenditures will remain at 1998-99 levels. Estimates of the school-aged population (5-19 years for K-12 and 20-24 years for post-secondary education) were derived from Census Bureau forecasts of population by age group (Table 1).

¹James C. Hite, *State Expenditures: Projections to 2010* (Clemson, S.C.: Strom Thurmond Institute of Government and Public Affairs, October 23, 1997).

²S.C., *General Appropriations Bill 1998-99*, Act No. A419 (1998).

Table 1
Projected Annual Population Growth by Age Group

<i>Years</i>	<i>Age 5-19</i>	<i>Age 20-24</i>	<i>Age 65 & over</i>	<i>Total All Ages</i>
1995-2000	1.00%	-1.72%	1.67%	0.99%
2000-05	0.50%	1.15%	1.58%	0.89%
2005-10	-0.17%	1.44%	2.47%	0.84%

SOURCE: Paul R. Campbell, Population Projections for States by Age, Sex, Race, and Hispanic Origin: 1995 to 2025, PPL-47 (Washington, D.C.: U.S. Bureau of the Census, Population Division, 1996), Table 4.

The baseline for education expenditures in 1998-99 was the amount provided in the appropriations bills. These appropriations were \$1,568.3 million for K-12 and \$744.3 million for post-secondary education (Table 2). Combining the appropriate population growth rates with the inflation rate provides the average annual growth rate between 1998-99 and 2009-10 of 2.8 percent for K-12 and 3.5 percent for post-secondary expenditures. Projected expenditures for 2009-10 are \$2.1 billion for K-12 and \$1.1 billion for post-secondary education.

Table 2
Appropriated and Projected Education Expenditures
(in millions)

<i>Expenditure</i>	<i>1998-99 Appropriations</i>	<i>2009-10 Projected</i>
K-12	\$1,568.3	\$2,112.8
Post-secondary	744.3	1,091.6
Total	\$2,312.7	\$3,204.4

Note: Detail may not sum to totals due to rounding.

CORRECTIONS

Expenditures for the corrections program are projected in four separate components: prison system operations, the juvenile justice system, probation and parole, and the operations for newly or soon-to-be-constructed facilities. Overall, total corrections expenditures are projected to grow at an average annual rate of 5.5 percent, with total spending projected to be \$697.6 million in 2009-10. Appropriations for 1998-99 and projections for 2009-10 are presented in Table 3.

Operations and juvenile justice expenditures are assumed to be primarily determined by inflation and the prison population. Growth in the prison population is assumed to be two percent per year, a higher rate than the general population that is due in part to tougher sentencing guidelines. Therefore, both operations and juvenile justice expenditures are assumed to grow at 4.5 percent per year. Projected expenditures in 2009-10 are \$475.3 million for operations and \$120.2 million for juvenile justice.

Inflation and growth of the probation roll also determine probation expenditures. Because of the stricter sentencing guidelines, the study assumed that the growth of the probation roll would be slower than that of the prison population at 0.5 percent per year. The annual growth rate for probation expenditures is assumed to be 3.0 percent. Projected probation expenditures in 2009-10 are \$30.5 million.

The state is in the process of adding several new prisons to its corrections system. The cost of constructing these prisons will be paid by federal grants. However, the state is responsible for covering the operating costs of these facilities. The SC State Budget and Control Board has forecast these expenditures through 2004-05.¹ Their figure is extended to 2009-10 at the inflation rate, yielding projected operating expenditures for new prisons of \$71.5 million in that year.

¹S.C., State Budget and Control Board, Office of Research and Statistics, *Long Range General Fund Expenditure Plan, Fiscal Years 1995-96 to 2004-05*, February 1997.

Table 3
Appropriated and Projected Corrections Expenditures
(in millions)

<i>Expenditure</i>	<i>1998-99 Appropriations</i>	<i>2009-10 Projected</i>
Operations	\$291.4	\$475.3
Juvenile Justice	73.7	120.2
Probation	22.0	30.5
New Prisons	40.5	71.5
Total	\$387.1	\$697.6

Note: Detail may not sum to totals due to rounding.

SOCIAL SERVICES

Social service expenditures are divided between Medicaid and all other social services. Appropriations for 1998-99 are \$364.3 million for Medicaid and \$116.2 million for other social services. Both Medicaid and other social service expenditures are assumed to remain at 1998-99 real per capita levels through 2009-10. Total social services spending in 2009-10 is projected to be \$761.8 million (Table 4).

The population base for Medicaid expenditure projections is the population cohort that is 65 years old and over, the fastest-growing segment of the state's population. Medicaid provides services to all individuals who have insufficient resources for covering their health needs. However, the bulk of Medicaid spending is for the elderly, as is most of the projected spending growth. Projected to grow at an average annual rate of 4.5 percent, Medicaid expenditures in 2009-10 are projected to be \$593.9 million.

The other social services category covers a variety of services, including child protective services, foster care, adoptions, adult protective services, and employment and training services. These programs impact all segments of the state's population. Therefore, projections of these expenditures are based on total state population growth. The average annual growth rate of 3.4 percent reflects both projected population growth and assumed inflation and maintains future spending at 1998-99 real per capita levels. Other social services expenditures are projected to be \$167.9 million in 2009-10.

Table 4
Appropriated and Projected Social Services Expenditures
(in millions)

<i>Expenditure</i>	<i>1998-99 Appropriations</i>	<i>2009-10 Projected</i>
Medicaid	\$364.3	\$593.9
Other Social Services	116.2	167.9
Total	\$480.6	\$761.8

Note: Detail may not sum to totals due to rounding.

STATE AID TO LOCAL GOVERNMENTS

State aid to local governments includes property tax relief programs, the Local Government Fund, and several smaller items. This category is modified slightly from last year. In last year's report, this category did not include all of the property tax relief programs nor did it include other aid to local governments. To better reflect the amount of general fund revenue that is appropriated to local governments these figures were included in this section this year. There was also a major policy change in 1998 that will reduce the amount of Local Government Funds appropriated for local governments beginning in 2000-01 and beyond.

Local governments also receive a variety of grants from various state agencies, but these grants are reflected in agency budgets. Thus, the state aid described in this section understates total state aid to cities, counties, and school districts. A fuller description of total state aid is provided in the paper on local revenue in this series.¹

Table 5
Appropriated and Projected Property Tax Relief Expenditures
(in millions)

<i>Expenditure</i>	<i>1998-99 Appropriations</i>	<i>2009-10 Projected</i>
School Property Tax Relief	\$240.0	\$521.0
Homestead Exemption	52.7	76.9
Inventory Tax Reimbursement	40.6	40.6
Depreciation Property Tax Reimb.	21.1	43.3
Total	\$354.3	\$681.7

PROP-

Note: These four programs constitute the Trust Fund for Tax Relief, which was separated from the general fund beginning in 1998-99. Detail may not sum to totals due to rounding.

PROPERTY TAX RELIEF PROGRAMS

Over the years, the state of South Carolina has initiated several programs to reduce the burden of property taxes on both individuals and corporations. The school property tax relief and homestead exemption programs provide tax relief to individual homeowners, while the inventory tax reimbursement and depreciation property tax reimbursement provide property tax relief for businesses.

The school property tax relief program exempts the first \$100,000 in appraised value of residential property from incurring property tax liabilities for school operating costs. This program reduces taxes on primary residences only; it does not reduce the tax liability on rental property. The homestead exemption exempts from property taxes the first \$20,000 in assessed value of an owner-occupied residence for the elderly (65 years of age or older), permanently disabled, or legally blind.

For corporations, the South Carolina statutes exempt all inventories from property taxes. Inventories are defined by the Attorney General's Office as properties that are held by a business establishment for sale in the normal course of its business. The Department of Revenue adds that any merchandise purchased for resale is inventory for purposes of this exemption. The statutes also exempt intangible personal property.

In 1997, the state began to phase in an increase in the maximum depreciation allowed for manufacturers' machinery and equipment. Before 1997, the maximum amount of depreciation was 80 percent. The phase-in will end in 1999, when the maximum depreciation allowed will be 90 percent.

These programs reduce property tax revenue for local governments. As a remedy for the revenue losses to local governments associated with these programs, the state agreed to at least partially reimburse local governments for their loss. The fiscal costs of these programs to the state are summarized in Table 5. This group of property tax relief expenditures constitutes the new Trust Fund for Tax Relief, which is discussed in more detail below.²

The total for these four tax relief programs is \$354.3 million in 1998-99 and a projected \$681.7 million in 2009-10. The figure for 1998-99 was taken from the general and supplemental appropriations bills. The projections for the period from 1999-2000 to 2009-10 assume that these expenditures will continue to grow at the same annual rates of growth as were observed from 1995-96 to 1998-99. These annual growth rates are 7.3 percent for school property tax relief,³ 3.5 percent for homestead exemption, and 0 percent for inventory tax reimbursement. The depreciation property tax reimbursement is in the last year of its phase-in and is expected to increase by 56 percent in 1999-2000, but by only 2.5 percent per year thereafter.

¹Holley H. Ulbrich, *Local Government Revenues and Expenditures: Projections to 2010* (Clemson, S.C.: Strom Thurmond Institute of Government and Public Affairs, March 15, 1999).

²The Trust Fund for Tax Relief is separate from the general fund but is included in this analysis to allow comparisons with last year's report and this year's revenue projections based on fiscal year 1997-98 data, and also because its component programs are important sources of state revenue to local governments.

³This study assumes that the school property tax relief will grow at a smooth rate to the year 2009-10. However, the amount of the relief provided each year is determined in part by the assessed value of state residential property. Since reassessments do not impact an equal percentage of property each year, actual expenditures for property tax relief will increase in unequal increments.

Table 5
Appropriated and Projected Property Tax Relief Expenditures
(in millions)

<i>Expenditure</i>	<i>1998-99 Appropriations</i>	<i>2009-10 Projected</i>
School Property Tax Relief	\$240.0	\$521.0
Homestead Exemption	52.7	76.9
Inventory Tax Reimbursement	40.6	40.6
Depreciation Property Tax Reimb.	21.1	43.3
Total	\$354.3	\$681.7

Note: These four programs constitute the Trust Fund for Tax Relief, which was separated from the general fund beginning in 1998-99. Detail may not sum to totals due to rounding.

LOCAL GOVERNMENT FUND

In addition to the programs that reimburse lost property taxes, the state also shares general revenue funds with local governments. Through the Local Government Fund (LGF), the state distributes general fund revenue to counties and municipalities on a per capita formula basis. The LGF level for any given fiscal year is calculated at 4.5 percent of general fund revenue in the most recently completed fiscal year—the year two years prior to the distribution year. Thus, the \$211.3 million appropriated in 1998-99 is based on reported 1996-97 revenue (Table 6).¹

A major change affecting future appropriations of the LGF occurred when the Trust Fund for Tax Relief was created in 1998. All monies allocated to this fund are deducted from general fund revenue prior to calculating LGF. Specifically, all appropriations for the school property tax relief, homestead exemption, inventory tax reimbursement, and the depreciation property tax reimbursement are directed to the Trust Fund for Tax Relief. Due to the two-year lag between determination of general fund revenue and appropriations for LGF, the impact of this change will not be felt until the 2000-01 fiscal year. In that year, LGF will be lower than it would have been absent the policy change.

Based on projected 1998-99 state general fund revenue discussed in a companion paper,² appropriations for LGF for 2000-01 are projected to be \$207.7 million, or \$15.9 million lower than they would have been without the policy change. LGF appropriations are projected to be \$285.3 million in 2009-10. This amount is based on projected general fund revenue of \$6.9 billion and Trust Fund for Tax Relief estimates of \$606 million in 2007-08.

Other state aid to local governments includes aid to fire districts, aid to planning districts, and categorical grants to counties for state-mandated functions. These categories of state aid have been consistently funded at around \$7.1 million since 1995-96. This study assumes that these categories will continue to be funded at that level through 2009-10.

¹The figure of \$211.3 million was taken from the general and supplemental appropriations and is slightly higher than 4.5 percent of reported revenue of \$4.6 billion (\$206.4 million).

²Holley H. Ulbrich, *State Revenue: Projections to 2010* (Clemson, S.C.: Strom Thurmond Institute of Government and Public Affairs, December 31, 1998).

Table 6
Appropriated and Projected State Aid to Local Governments
(in millions)

<i>Expenditure</i>	<i>1998-99 Appropriations</i>	<i>2009-10 Projected</i>
Local Government Fund	\$211.3	\$285.3
Other Aid to Local Governments	7.1	7.1
Trust Fund for Tax Relief	354.3	681.7
Total	\$572.7	\$974.1

Note: Detail may not sum to totals due to rounding.

DEBT SERVICE AND ALL OTHER EXPENDITURES

Appropriations for debt service expenditures are \$152.4 million in 1998-99. Future debt service spending was estimated using annual debt service spending growth between 1990-91 and 1997-98. Over this period, average debt service increased by roughly \$9 million each fiscal year. Thus, this study assumes debt service will continue to increase by \$9 million annually, an average rate of 4.7 percent per year, which leads to projected spending on debt service of \$251.4 million in 2009-2010 (Table 7). This projection differs from the one in last year's report, which focused on known debt commitments.

The all other expenditures category was assumed to grow at the rate of inflation plus the rate of growth in the total population, or 3.4 percent per year. This assumption keeps per capita expenditures constant at 1998-99 levels. All other expenditures are appropriated at \$1.2 million in 1998-99 and projected to be \$1.7 million in 2009-10. This category accounts for 23.2 percent of total general fund expenditures in 1998-99 and 22.7 percent in 2009-10.

Table 7
Appropriated and Projected Debt Service and All Other Expenditures
(in millions)

<i>Expenditure</i>	<i>1998-99 Appropriations</i>	<i>2009-10 Projection</i>
Debt Service	\$152.4	\$251.4
All Other Expenditures	\$1,181.2	\$1,706.0

Note: Detail may not sum to totals due to rounding.

SUMMARY

Because of the reduction in assumed inflation from three percent to 2.5 percent in this report, most projections for 2009-10 are lower than they were in last year's report. The exceptions are debt service, school property tax relief, and homestead exemption. In general, state general fund expenditures *plus* the Trust Fund for Tax Relief are projected to grow at an average rate of 3.7 percent per year through 2009-10 to a level of \$7.6 billion. Excluding the Trust Fund for Tax Relief, state general fund spending is projected to grow to \$6.9 billion at an average annual growth rate of 3.5 percent. The growth of the Local Government Fund will be slowed by the creation of the Trust Fund for Tax Relief, so it is only projected to grow at 2.8 percent per year. However, there are some categories that will grow more rapidly because of different growth rates for certain population groups. School property tax relief, corrections operations and juvenile justice, and Medicaid are projected to grow at a faster rate than the average rate for all expenditures. These expenditure projections are detailed in Table 8.

Table 8.
Projected South Carolina General Fund Expenditures, 1999-2000 to 2009-10 (in millions)

FISCAL YEAR	1998-99(a)	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
State Aid to Local Governments	\$572.7	\$610.7	\$622.0	\$648.3	\$681.0	\$715.7	\$752.7	\$791.8	\$833.3	\$877.4	\$924.3	\$974.1
State Aid in General Fund	\$218.4	\$225.1	\$214.7	\$217.8	\$225.8	\$234.1	\$242.8	\$252.0	\$261.5	\$271.3	\$281.6	\$292.4
Local Government Fund	211.3	218.0	207.7	210.7	218.7	227.0	235.7	244.9	254.4	264.3	274.6	285.3
Other Aid to Local Govts.	7.1	7.1	7.1	7.1	7.1	7.1	7.1	7.1	7.1	7.1	7.1	7.1
Trust Fund for Tax Relief (TFTR)	\$354.3	\$385.6	\$407.3	\$430.5	\$455.2	\$481.6	\$509.9	\$539.8	\$571.8	\$606.0	\$642.6	\$681.7
School Property Tax Relief	240.0	257.5	276.3	296.5	318.1	341.4	366.3	393.0	421.7	452.5	485.5	521.0
Homestead Exemption	52.7	54.5	56.4	58.4	60.4	62.5	64.7	67.0	69.3	71.8	74.3	76.9
Inventory Tax Reimbursement	40.6	40.6	40.6	40.6	40.6	40.6	40.6	40.6	40.6	40.6	40.6	40.6
Depreciation Property Tax Reimb.	21.1	33.0	34.0	35.0	36.1	37.2	38.3	39.2	40.2	41.2	42.3	43.3
Education	\$2,312.7	\$2,373.4	\$2,449.9	\$2,528.9	\$2,610.5	\$2,694.7	\$2,781.6	\$2,861.1	\$2,943.1	\$3,027.6	\$3,114.7	\$3,204.4
K-12	1,568.3	1,623.6	1,672.5	1,722.9	1,774.8	1,828.3	1,883.3	1,927.1	1,972.0	2,017.8	2,064.8	2,112.8
Post-Secondary	744.3	749.8	777.4	806.0	835.7	866.4	898.3	934.0	971.1	1,009.7	1,049.9	1,091.6
Corrections	\$387.1	\$458.9	\$478.5	\$499.1	\$520.5	\$542.9	\$566.3	\$590.3	\$615.4	\$641.6	\$669.0	\$697.6
Operations	291.4	304.6	318.5	333.0	348.1	364.0	380.5	397.8	415.9	434.8	454.6	475.3
Juvenile Justice	73.7	77.0	80.5	84.2	88.0	92.0	96.2	100.6	105.2	109.9	115.0	120.2
Probation	22.0	22.7	23.4	24.1	24.8	25.6	26.3	27.1	27.9	28.8	29.6	30.5
New Prisons	40.5	54.5	56.2	57.9	59.6	61.4	63.2	64.8	66.4	68.1	69.8	71.5
Social Services	\$480.6	\$500.0	\$519.8	\$540.3	\$561.6	\$583.8	\$606.9	\$635.1	\$664.6	\$695.5	\$727.8	\$761.8
Medicaid	364.3	379.7	395.3	411.6	428.6	446.2	464.6	488.0	512.5	538.3	565.4	593.9
Other Social Services	116.2	120.3	124.4	128.7	133.1	137.6	142.3	147.1	152.0	157.2	162.4	167.9
Debt Service	\$152.4	\$161.4	\$170.4	\$179.4	\$188.4	\$197.4	\$206.4	\$215.4	\$224.4	\$233.4	\$242.4	\$251.4
All Other Spending	\$1,181.2	\$1,222.7	\$1,264.5	\$1,307.6	\$1,352.2	\$1,398.4	\$1,446.1	\$1,494.7	\$1,544.9	\$1,596.8	\$1,650.5	\$1,706.0
TOTAL (w/o TFTR)	\$4,732.3	\$4,941.5	\$5,097.8	\$5,273.1	\$5,459.0	\$5,651.3	\$5,850.1	\$6,048.6	\$6,253.9	\$6,466.3	\$6,686.1	\$6,913.5
TOTAL (w/TFTR)	\$5,086.7	\$5,327.1	\$5,505.1	\$5,703.6	\$5,914.2	\$6,132.9	\$6,360.0	\$6,588.4	\$6,825.7	\$7,072.3	\$7,328.7	\$7,595.2

^a1998-99 expenditures are from: South Carolina General Appropriations Bill 1998-99, Act No. A419 (1998).

Note: Detail may not add to totals due to rounding.