

SOUTH CAROLINA REVENUES AND EXPENDITURES HISTORICAL TRENDS AND PROJECTIONS TO 2010-11

Fiscal Sustainability Report Series

August 29, 2001

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The Jim Self Center on the Future



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Chapter 1

INTRODUCTION

State government in South Carolina has fared well since the mid-1990s. State revenue collections have exceeded expectations and unbudgeted surpluses have increased, year after year. This fortuitous combination allowed the General Assembly to increase spending on existing programs and add new programs as well as provide tax relief and broaden economic development incentives. Often, however, spending decisions were based on the expectation that funding would come from future revenue growth rather than on revenues available during the budget cycle.

In mid-2000 this rosy scenario began to dim. The Board of Economic Advisors (BEA) revised the state's general fund revenue forecast downward in May 2000 and downward further in its November 2000 forecast. These adjustments eliminated any surplus revenue that the General Assembly could expect to appropriate from fiscal year 2000-01 revenue. These adjustments also reduced the amount of *new money* forecast to be available for the General Assembly to appropriate for the 2001-02 fiscal year. This revenue slowdown left the state struggling to cut spending in order to balance the state's general fund budget for 2001-02.

This report looks at South Carolina's general fund revenues and expenditures—past, present, and future. It examines historical trends in the major components of state general fund revenues and expenditures and how the trends have contributed to the current budget crisis facing state government. It also makes projections of future state general fund revenues and expenditures through 2010-11.

The report is the third on the state's general fund revenues and expenditures in a series by the Strom Thurmond Institute of Government and Public Affairs. The first two reports, prepared in 1997 and 1999, focused on projected state general fund revenue and expenditure streams and the issues that would affect them. They also addressed projected local government revenues and expenditures.

This report adds a discussion of South Carolina's revenues and expenditures relative to those in other states. It also examines historical trends in the state's general fund revenues and expenditures. The methods used for constructing the revenue and expenditure projections are slightly different from those used in the two previous series, and the revenue projections contain several *what if* scenarios to address the effects of proposed policy shifts on state revenue streams. Because this report was prepared during a difficult budget year for the state, it considers the timely

question of why the state faced a budget shortfall going into 2001-02, even when revenues had grown over the previous fiscal year.

Chapter 2

ECONOMIC TRENDS AND STATE REVENUES

What is an economic slowdown? Is the economy in a recession? How are state revenues affected? The economy slows down when growth in the nation's gross domestic product (GDP) and South Carolina's gross state product (GSP) declines significantly over a period of time. GDP and GSP need not fall; they may simply grow at substantially slower rates. If growth of GDP or GSP is negative for two consecutive quarters, a recession is in progress. Latest data available indicate economic slowdowns at the national and state level in South Carolina, not a recession.

National Economic Trends

Between 1993 and 2000—the expansionary years since the nation's last recession¹—GDP growth averaged about 4 percent per year. Starting in July 1999 the Federal Reserve Board began increasing short-term interest rates to reduce the threat of inflation. By mid-2000 the nation's economy started to show signs of significant slowing. Although 2000 posted the highest GDP growth since 1985 (5.0 percent), GDP growth fell off considerably in the second half of the year. GDP growth for the third quarter was 2.2 percent, dropping further to 1.0 percent in the fourth quarter. By December 2000 the economy had cooled so much that the Federal Reserve started to decrease interest rates in order to stimulate borrowing and spending.

At the same time as interest-rate hikes began to take effect, energy prices approximately tripled on average across the country. As energy costs rose, many sectors of the economy experienced falling profits, and consumers found themselves with less discretionary income. Declines in purchases of U.S. goods by foreign countries experiencing their own economic woes also served to reduce GDP growth.

Personal income and employment figures mirror the changes in GDP. Over the period from 1993 to 2000, personal income growth averaged 5.7 percent per year. Personal income growth slowed from 6.7 percent in the first quarter of 2000 to an annual rate of 3.7 percent in the fourth quarter. By early 2001, U.S. employment growth slowed and the unemployment rate began to increase as layoffs by major employers made the news. In contrast, between 1993 and 2000 the U.S. unemployment rate declined fairly steadily from 7.3 percent to about 4.0 percent at the end of 2000.

¹The nation's last recession ended in March 1991.

The recent national economic slowdown is concentrated in the manufacturing sector and in automobile and nondurable goods manufacturing in particular. South Carolina's economy tended to lead in the recent slowdown because of its concentration in these sectors. The state ranked tenth in the percentage of GSP in manufacturing (23.6 percent) and second in the percentage of GSP in nondurable goods manufacturing (13.7 percent) in 1998. North Carolina led the latter category with 14.5 percent of its GSP from nondurable goods manufacturing.

Manufacturers of nondurable goods are among the first to feel the effects of spending declines as consumers scale back purchases of clothes and other similar items. Purchases of automobiles often are postponed when consumer confidence is falling, although South Carolina's automobile industry's slowdown has been less significant than that experienced in other states.

The Economy and State Revenues

Economic slowdowns and recessions can have a profound effect on state revenue streams, particularly income and sales taxes. When GDP is growing rapidly, new firms open and existing firms add capacity to meet increasing demand. But when the economy slows, production at higher levels may not be sustainable. As purchasers buy less, producers' profits drop and personal income growth slows as demand for labor stagnates. When income growth declines, state revenue growth from individual and corporate income taxes slows. Individuals and firms also have less money to spend, so sales tax revenue growth also declines.

Sales tax revenue and other revenue streams dependent upon the purchases of specific goods or services have also suffered as consumers have been forced to shift their purchases from taxable goods to energy due to rising energy prices. In South Carolina, natural gas and electricity are exempt from the sales tax when used for residential purposes. Like most states, South Carolina taxes gasoline at a flat rate per gallon and earmarks the revenues for transportation projects rather than depositing them as general revenue.

The Good Times

States benefitted from the expanding economy of the mid- and late-1990s. In its February 2001 *State Fiscal Brief*, the Nelson A. Rockefeller Institute of Government estimated that state tax revenue grew 8.7 percent from 1998-99 to 1999-2000. This annual growth rate is the highest identified by the institute since it began tracking state revenue growth in the early 1990s. Annual growth in tax revenue over this period ranged from 5.4 percent to 8.7 percent.

Rapid growth in state revenues allowed many states to cut taxes and increase spending in the 1990s. According to the National Association of State Budget Officers and National Governors Association in their December 2000 *The Fiscal Survey of the States* report, 2000-01 was the seventh consecutive year of net reductions in

state taxes and fees due to enacted legislation. In that year, thirteen states enacted changes to the sales tax that reduced revenue, and eighteen states enacted changes that reduced personal income tax receipts. Estimated state revenue foregone due to these legislative changes was \$5.8 billion nationwide. Legislated decreases in 1999-00 and 1998-99 were \$5.2 billion and \$7.0 billion, respectively. In contrast, during the recession years of 1990-91 and 1991-92, legislated changes in taxes increased state revenue by a total of over \$10 billion.

During the good times, South Carolina did what many other states were doing. According to the S.C. Department of Revenue, over the same seven-year period when many states reduced taxes, South Carolina added new programs and made adjustments to existing programs that reduced receipts from the individual income tax 18 times, the corporate income tax twice, and the sales tax four times. The state also enacted other programs that reduced general fund revenues, such as homeowners' and personal property tax relief and the phaseout of the soft drinks tax. The General Assembly's elimination of video poker in July 1, 2000, reduced state general fund revenue by about \$60 million.

The Current Slowdown

The current economic slowdown hit state tax revenues hard in the fourth quarter of 2000. In its March 2001 *State Revenue Report*, the Rockefeller Institute reports that state tax revenue from personal and corporate income tax and sales tax increased only 4.0 percent nationwide during the quarter compared with increases of around 10 percent to 11 percent in the first half of the year. Revenue from the sales tax grew at the slowest rate in over nine years. Average revenue growth in New England, the Mid-Atlantic region, the Southeast, Great Lakes and Plains states was well under three percent in the fourth quarter of 2000. The twelve states in the Southeast averaged 2.2 percent. States in the Rocky Mountains and Far West fared much better, with most states in this region seeing average tax revenue growth over 5 percent in the fourth quarter of 2000. The Rockefeller Institute reports 20 states with revenue coming in below estimates or expenditures exceeding the budget or both. Features on state budget difficulties have been reported by the national print and broadcast media in recent months.

In the fourth quarter of 2000 South Carolina reported a decrease of 2.2 percent in state tax revenues from the fourth quarter of 1999, according to the Rockefeller Institute. Personal income tax revenues declined 3.1 percent over the same time period, corporate income taxes declined 2.2 percent, and sales taxes increased 1.7 percent. South Carolina was one of six states that reported declines in personal income tax revenue in the fourth quarter of 2000.

In May 2000, South Carolina's BEA, recognizing early signs of the state's economic slowdown, revised its state general fund revenue forecast downward by \$30 million for 1999-00 and by \$40 million for 2000-01. The BEA further revised the 2000-01 general fund revenue forecast downward in November 2000. Due to sluggish rev-

enue receipts, the Budget and Control Board ordered a \$50 million budget cut in the second half of 2000-01.

Prospects for the Future

Prospects for the future are still uncertain, but nonetheless encouraging. Economists at Clemson University and the University of South Carolina have called for slow growth in the state's economy to begin in mid-2001. On the national level, current leading indicators show signs of coming improvement and Federal Reserve Board Chairman Alan Greenspan has estimated that the economy will turn around somewhat in the second half of the year. If it does, the state's revenue forecast should improve.

Chapter 3

REVENUE AND EXPENDITURE SYSTEMS: COMPARING SOUTH CAROLINA TO OTHER STATES

When evaluating the performance of a state's revenue and expenditure systems,² it is not enough to simply observe, for example, that total revenue per capita has risen or that the share of general revenue from sales taxes has diminished. Performance evaluation is always relative—it is relative to historical experience or relative to some external measure of what is desired. If total revenue per capita has risen, how does one know if it has risen enough? Likewise, how does one decide how much tax relief is too much? The answers to such questions come from the will of the majority or perhaps political interest groups through the democratic system of government.

What benchmarks can be used, then, to describe the recent performance of South Carolina's revenue and expenditure systems? A closer look at the major sources of state revenue and categories of state spending nationwide, in six Southeastern states, and in South Carolina can provide benchmarks for evaluating the performance of South Carolina's system.

The Composition of State Revenues

Most states receive revenue for state operations from three primary sources: taxes, other own-source revenues including fees and charges, and intergovernmental revenues. Income and sales taxes comprise the largest share of tax revenues. Intergovernmental revenue comes almost exclusively from the federal government as grants primarily for education, social services and income maintenance, and transportation.

The relative importance of revenue sources in the revenue stream varies widely. Nine states have little or no income tax and five states have no sales tax. Alaska and New Hampshire have neither. When a state does not have a major revenue source such as a sales tax, the remaining revenue sources are used more intensively. A diversified revenue system—like that in the state of South Carolina—does not depend as heavily on one revenue source, thus spreading both the risk and the potential for gain over several major types of revenue.

² In this chapter comparisons of state systems are based on statistics compiled by the U.S. Census Bureau. The bureau's general revenues and expenditures include all government revenues and expenditures except those generated by or expended by liquor stores, insurance trusts, and utilities.

South Carolina's state revenue system is well balanced among different sources of revenue when compared to most other states. It is similar in structure to the U.S. average and the average of selected Southern states (Table 3-1). In 1997-98, South Carolina raised 37.2 percent of its general revenue from the general sales tax and individual income tax combined, compared to the U.S. average of 36.6 percent and the Southeastern average of 38.6 percent. South Carolina ranks about in the middle of the Southern states in terms of the percentage of revenue raised from general sales and individual income taxes. The share of general sales tax in general revenue ranged from 11.5 percent in Virginia to 24.2 percent in Mississippi with South Carolina coming in at 18.9 percent. The shares of individual income tax in general revenue ranged from 10.1 percent in Mississippi to 28.1 percent in Virginia. South Carolina's share was 18.3 percent.

Table 3-1. State General Revenues, 1997-98

	U.S. (millions)	U.S. % Share	S.E.* (millions)	S.E.* % Share	S.C. (millions)	S.C. % Share
Total General Revenue	\$864,863	100.0	\$95,631	100.0	\$11,415	100.0
Taxes	474,392	54.9	51,667	54.0	5,683	49.8
General sales	155,971	18.0	15,260	16.0	2,163	18.9
Individual income	160,746	18.6	21,576	22.6	2,087	18.3
Selective sales	71,372	8.3	8,065	8.4	731	6.4
Corporate income	31,094	3.6	2,892	3.0	214	1.9
Other taxes	55,210	6.4	3,875	4.1	488	4.3
Charges, fees, & other own-source	149,682	17.3	17,280	18.1	2,290	20.1
Intergovernmental	240,789	27.8	26,685	27.9	3,442	30.2

*Calculated by authors. Alabama, Georgia, Mississippi, North Carolina, and Virginia were selected for comparison because of their relative proximity to South Carolina and because they derive significant revenue from income and sales taxes. Tennessee was excluded because it has a minimal income tax.

Source: U.S. Bureau of the Census, <http://www.cache.census.gov/govs/www/state98.html>

South Carolina's state revenue system is notable in its relatively low reliance on taxes and relatively high reliance on fees and charges in general revenue. The state's 49.8 percent share of general revenue from taxes was five percentage points lower than the national average and four percentage points lower than the Southeastern average in 1997-98. Correspondingly, the state's share from fees and charges combined with miscellaneous own-source revenue was 20.1 percent³—two to three percentage points higher than the Southeastern and national averages and surpassed only by Alabama (21.5 percent) and Virginia (25.7 percent) in the Southeastern state group. Alabama has relatively low taxes and high intergovernmental revenue; Virginia has high taxes and low intergovernmental revenue.

The census data show that South Carolina has steadily reduced its reliance on taxes and increased its reliance on fees and charges. In 1984-85, taxes were 60.1 percent of general revenue, and fees and charges were 10.0 percent. By 1997-98, the tax

³About one-third of the total is other miscellaneous own-source revenue.

share had dropped to 49.8 percent, and the share for fees and charges had increased to 14.2 percent.

The share of fees and charges went up somewhat nationally and in the Southeastern states, but Alabama was the only state to show a shift from taxes to fees similar to that in South Carolina. In 1984-85 taxes were 53.8 percent of the general revenue, and fees and charges were 11.8 percent. By 1997-98 the tax share had decreased to 46.2 percent, and the fee share had increased to 15.2 percent.

Revenue from fees and charges tends to be less tied to the business cycle than sales and income taxes, giving this revenue source a lower downside risk from recession. Fees and charges are also more directly tied to services received, which makes them more efficient from an economic standpoint. On the downside, most fees and charges are not deductible from federal income taxes and tend to be regressive in nature.

Examining South Carolina’s ranking among the states for different types of revenues and expenditures also reveals useful information. Changes in South Carolina’s rank over time indicate relative shifts in the structure of the tax system, although economic factors can also generate some shifts. South Carolina’s relative ranking among the states from the late 1980s to the late 1990s is based on per capita figures for different types of revenues and expenditures (Table 3-2). Because states vary in population, changes in per capita revenues and expenditures over time are more useful than total dollar figures alone when making comparisons and ranking the states.

South Carolina ranked 26 out of 50 states in per capita revenue from all sources from 1986-88 and dropped to 30 by 1996-98. The state’s ranking in general revenue per capita dropped insignificantly—from 30 to 31. This occurred despite a major decline in tax revenue per capita that caused South Carolina to drop from 27 to 43 over this same time period. General revenue per capita dropped less than tax revenues because of relatively high growth in fees and charges and intergovernmental revenue. In taxes, fees and charges combined, perhaps the most defensible measure of a state’s own revenue system because it ignores intergovernmental revenue, the state’s rank dropped from 31 to 36 over this ten-year period.

Table 3-2. South Carolina State Rank in Per Capita Revenue

Category	86-88*	96-98*	Revenue Growth Rank
Total Revenue	26	30	28
General Revenue	30	31	18
Tax Revenue	27	43	45
Fees & Charges	33	19	3
Taxes, Fees & Charges	31	36	29
Intergovernmental Revenue	35	23	12

*Averaging data over three fiscal years removes the effect of any unusual single-year anomalies.

Source: U.S. Census Bureau.

Some changes in state rankings are more significant than others. These shifts in rankings over time confirm that South Carolina has certainly experienced a shift away from tax revenue toward fees, charges, and intergovernmental revenue. The analysis of rankings in table 3-2 makes it clear that South Carolina stands below the U.S. median in the percentage of revenue from taxes and above U.S. medians in the percentage of revenue from fees and charges and miscellaneous own sources. Whether or not these differences are desirable depends upon the goals of the state. If the goal is to link revenues more directly to the services citizens receive from the state, then the changes reflect state policy goals. If the state's goal is to broadly spread responsibility for funding public services among all citizens, regardless of who uses the services, then these changes are counter to that goal.

It also appears that South Carolina increased its reliance on federal intergovernmental revenue from 1986-88 to 1996-98. To the extent that federal funding is beyond the control of the state, this change creates some risk in the event of a shift in federal policies. On the other hand, it should be noted that South Carolina is now very average in this category, ranking 23.

The evidence suggests that South Carolina has neither improved nor sacrificed the quality of its revenue system by changing its revenue mix. The state stands essentially where it stood in the late 1980s in terms of general revenue per capita relative to other states. While the composition of general revenue has changed, the desirability of those changes lends itself to different evaluations by different participants in the system. To the extent that South Carolina's general revenue per capita ranking has not changed from the 1980s to the 1990s, the state has chosen or at least allowed the substitution of fees, charges, and intergovernmental revenue for tax revenue.

The Composition of State Expenditures

The level and distribution of state expenditures are determined by a number of factors. They reflect state issues and values—what the citizens of the state feel are appropriate uses of the state's money. They also reflect how states choose to distribute responsibility for providing different services between state and local governments. For example, most states assume a significant share of the responsibility for elementary and secondary education, but New Hampshire has historically left most of the responsibility with local governments to fund through property taxes, while Hawaii's education spending is almost entirely the responsibility of the state.

The level and distribution of state expenditures also reflect regional costs of goods and services and different program needs based on characteristics of the state population. For example, a higher percentage of older, poorer, or immigrant residents may require a different mix of state services.

Finally, the level and distribution of state expenditures depend on revenue availability. When states have surplus revenue, they can expand existing programs and add new ones. But when state revenue growth slows or the demand for certain state services grows rapidly, states come under pressure to cut spending or shift spending among programs. In times of tightening budgets legislatures tend to be reluctant to cut programs directly, so historically they have tended to spread cuts among agencies, giving agencies the choice of where to make cuts. Because government provides services, and services require personnel, staff cuts are common. In tight budget years states also defer maintenance of state facilities, such as roads and buildings.

States spend on average 35.6 percent of general expenditures on K-12 and higher education (Table 3-3), the largest single general expenditure in 1997-98. Expenditures on Medicaid and cash assistance and other nonmedical welfare assistance follow. Each of the remaining spending categories accounts for less than 10 percent of the total.

South Carolina expenditure patterns in 1997-98, just as with distribution of revenues, are similar in most areas to U.S. averages and averages across selected Southeastern states. Although South Carolina is close to the U.S. average in spending on public welfare, the state exhibits a higher share of spending on hospitals and health than the United States and the Southeastern states. The state spends a lower than average share on highways and interest on general debt.

Compared to Southeastern states, South Carolina is more than five percentage points lower than average in the share of expenditures on education. In fact, every other Southeastern state spends a larger share on education, ranging from Mississippi at 35.7 percent to Georgia at 45.3 percent. South Carolina also had the lowest

Table 3-3. State General Expenditures, 1997-98

	U.S. (millions)	U.S. % Share	S.E.* (millions)	S.E.* % Share	S.C. (millions)	S.C. % Share
Total General Expenditure	\$827,654	100.0	\$94,836	100.0	\$11,846	100.0
Intergovernmental	278,853	33.7	29,337	30.9	3,142	26.5
Direct	548,800	66.3	65,499	69.1	8,704	73.5
Total General Expenditures by Function						
Education	\$294,814	35.6	\$38,790	40.9	\$4,209	35.5
Public welfare	207,926	25.1	20,868	22.0	2,955	24.9
Hospitals	28,928	3.5	4,926	5.2	707	6.0
Health	35,067	4.2	3,610	3.8	627	5.3
Highways	63,620	7.7	8,051	8.5	711	6.0
Police protection	8,038	1.0	1,082	1.1	170	1.4
Correction	30,601	3.7	3,671	3.9	423	3.6
Interest on general debt	26,776	3.2	2,010	2.1	221	1.9
All other	131,884	15.9	11,828	12.5	1,822	15.4

*Calculated by authors. Includes Alabama, Georgia, Mississippi, North Carolina, South Carolina, and Virginia.
Source: U.S. Bureau of the Census, at: <http://www.cache.census.gov/govs/www/state98.html>

share of spending on government administration (2.4 percent) and intergovernmental spending among Southeastern states.

The examination of revenue structures and spending patterns above shows that South Carolina is not unusual in terms of the way it collects and spends state revenues. This superficial analysis of shares and rankings does not, however, address other important questions about how South Carolina's revenue structure and spending priorities compare to other states. Issues that merit consideration include how the state's revenue system distributes the tax burden between different income groups, and how public education is financed in South Carolina compared to other states. Such analyses are beyond the scope of this report.

Chapter 4

THE SOUTH CAROLINA GENERAL FUND

To understand South Carolina’s current budget challenges and the events leading up to them, an in-depth examination of recent trends in general fund revenues, appropriations, and expenditures is in order.

General Fund Revenues

The general fund is the portion of state government revenue that is not earmarked for specific expenditures. These revenues are used to support *general* governmental operations such as government administration, parks and recreation, public safety and corrections, and health and welfare.

The general fund currently does not include monies funding property tax relief. Historically, until 1998-99, tax relief was funded from the general fund as part of the general appropriations process. Thereafter tax relief monies were allocated to the Trust Fund for Tax Relief.

In order to make meaningful comparisons of general fund revenues and appropriations in recent years with those prior to 1998-99, this report includes revenue transferred to the Trust Fund for Tax Relief as part of general fund revenue and general appropriations and expenditures. But, because the state’s general fund does not currently include the Trust Fund for Tax Relief, general fund figures without tax relief are also reported for comparison purposes. The Trust Fund for Tax Relief reimburses local governments for local property taxes lost because of the homestead exemption, the elimination of the business inventory tax, tax changes in depreciation of manufacturer’s property, school property tax relief, and most recently, personal property tax relief.⁴

Recurring and Nonrecurring Revenues

Nearly all funds appropriated in the general appropriations bill are recurring revenue—revenue that the state expects to receive every year from traditional sources, although actual revenue collections from a given source may vary from year to year due to economic conditions and legislative adjustments. Nonrecurring revenue

⁴ S.C. Code § 11-11-150 (2000).

cannot be relied on from year to year and includes one-time payments received by the state, surplus revenues from prior years, and unspent capital reserve funds.

Trends in General Fund Revenues

1999-2000 Revenues. In 1999-2000, the state's general fund revenues totaled \$5.0 billion.⁵ Adding the \$381 million allocated to the Trust Fund for Tax Relief, the total came to \$5.4 billion. Over 95 percent of these revenues came from taxes. The sales and use tax and the individual income tax comprise the two largest shares of general fund revenue (Figure 4-1).

Changing Revenue Shares. As a share of general fund revenue, the sales tax increased from 34.6 percent in 1984-85 to 36.8 percent in 1999-2000 (Figure 4-2). The individual income tax became much more important over the same time period, as its share increased from 35.5 percent to 45.5 percent. The corporate income tax dropped from 8.0 percent of general fund revenue to 3.9 percent. Other recurring sources⁶ dropped from 20.5 percent to 13.9 percent between 1984-85 and 1999-2000.

The income tax has grown in importance as a revenue source because personal income has grown significantly over this fifteen-year period (Figure 4-3). In times of rising personal income, revenue from the individual income tax grows faster than revenue from the retail sales tax. In addition, the retail sales tax base has eroded. Nationwide erosion of the retail sales tax base is occurring because of the proliferation of e-commerce, which remains largely untaxed. Rising energy prices have caused shifts in spending from taxed goods and services to spending on energy, which is taxed less intensively in South Carolina than other goods. Spending on services, which has also grown in economic importance in recent years, often is not subject to state sales taxes.

Revenue Growth. Between 1984-85 and 1999-2000, recurring general fund revenue (Table 4-1) in South Carolina grew at an average rate of approximately 5.6 percent per year (Table 4-2). Over this period, individual income tax and sales tax revenue grew the fastest—well above that needed to keep pace with population growth and inflation. Other recurring sources of general fund revenue grew more slowly, at an average rate of 2.8 percent per year. Corporate income tax revenue grew very little over this 15-year period, averaging only about 0.5 percent annual growth. Sales and individual income tax revenue grew even faster over the period between 1993-94 and 1999-2000. Growth in other taxes and fees slowed significantly, and corporate income tax revenue growth remained below one percent per year. When individual and corporation income tax revenues transferred to the Trust Fund for Tax Relief are removed from the totals, average annual growth in the portions of those revenue streams available for the general fund drops. When ad-

⁵Data used in this chapter are from the BEA, the Budget and Control Board's Office of State Budget, the Department of Revenue, and the Comptroller General.

⁶Fees and charges, such as motor vehicle licenses; other taxes, such those on beer and wine; and other revenue streams, such as earnings on state investments.

Figure 4-1. General Fund Revenue Shares, 1999-2000

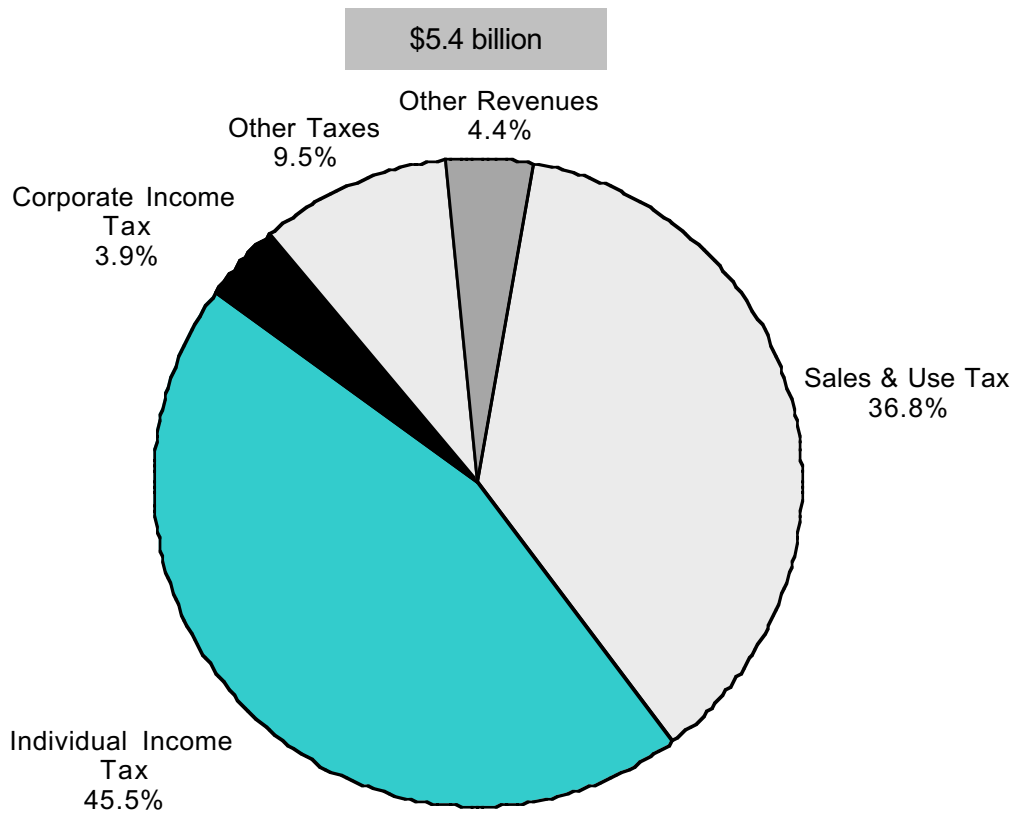


Figure 4-2. General Fund Revenue Shares, 1984-85

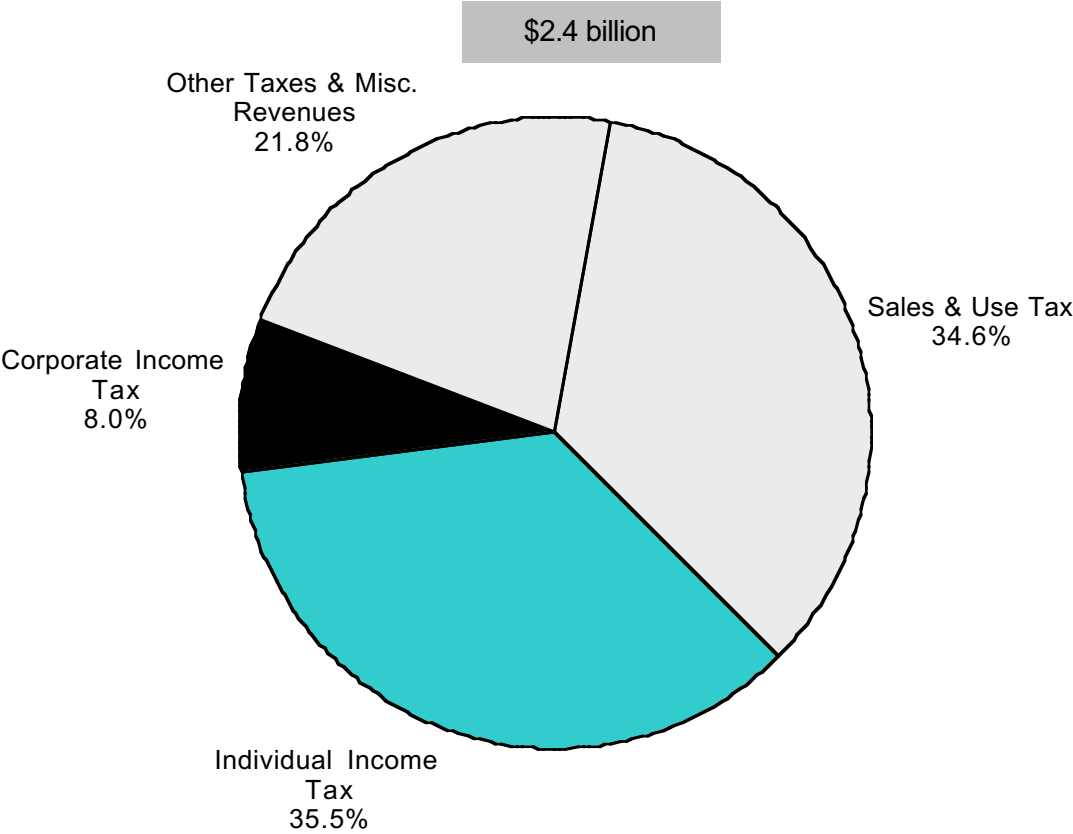
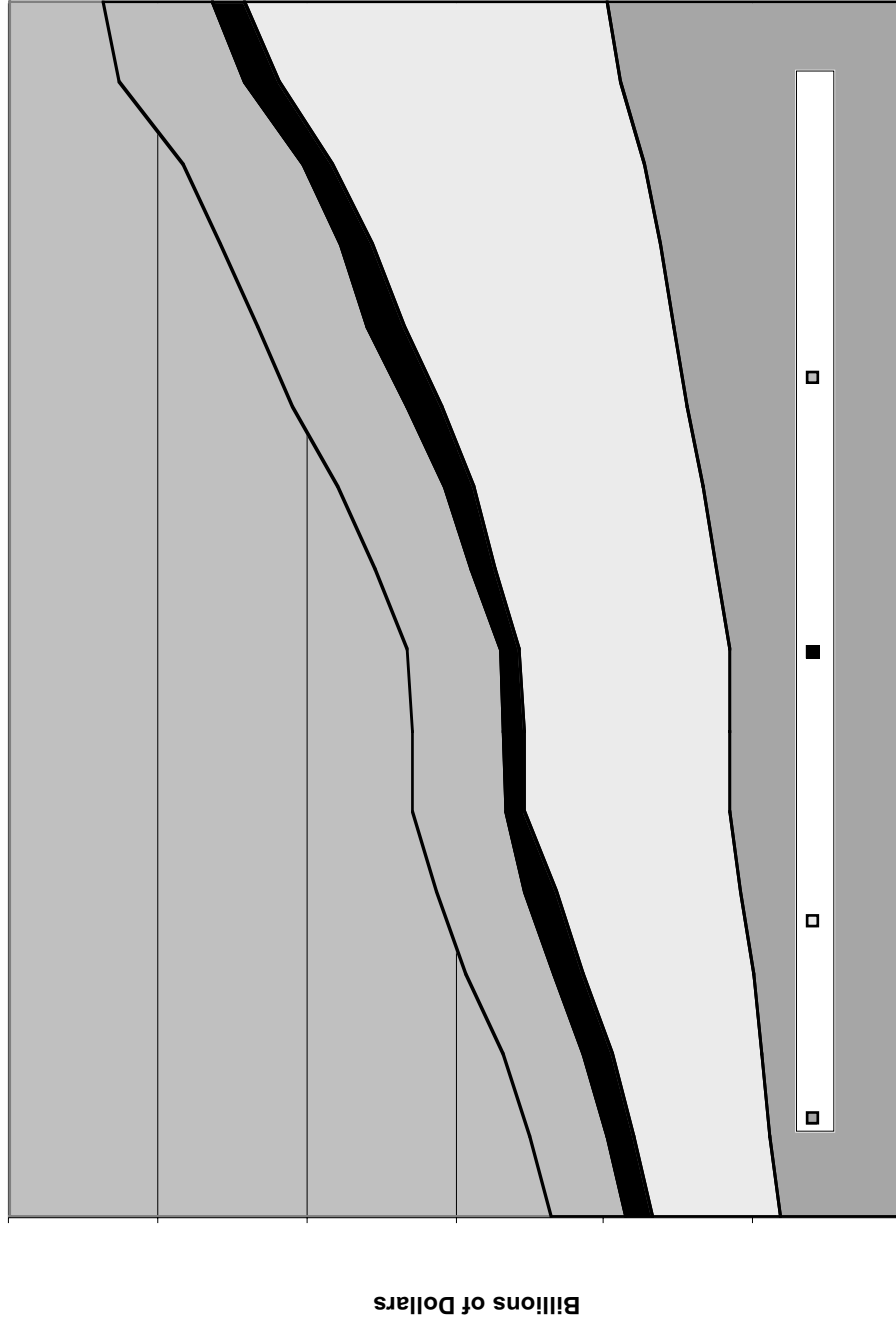


Figure 4-3. General Fund Revenues, 1984-85 to 1999-2000



**Table 4-1. Yearly General Fund Revenue Growth
(in millions)**

Fiscal Year	Revenue ^a	Yearly Increase	
1984-85 ^b	\$2,393		
1985-86	2,509	\$116	4.8%
1986-87	2,693	183	7.3%
1987-88	2,938	246	9.1%
1988-89	3,142	204	6.9%
1989-90	3,295	152	4.8%
1990-91	3,305	11	0.3%
1991-92	3,342	36	1.1%
1992-93	3,673	331	9.9%
1993-94	4,024	352	9.6%
1994-95	4,234	209	5.2%
1995-96	4,346	112	2.7%
1996-97	4,588	242	5.6%
1997-98	4,846	257	5.6%
1998-99	5,268	423	8.7%
1999-2000	5,380	111	2.1%
2000-01 ^c	5,616	236	4.4%
2001-02 ^c	5,838	223	4.0%

^aIncludes revenues for Trust Fund for Tax Relief beginning in 1998-99.

^bIncludes \$32.7 million in nonrecurring revenue.

^cForecast

Source: S.C. Board of Economic Advisors, *General Fund Revenue History*, September 25, 2000 and *General Fund Revenue Forecast, Fiscal Years 1998-99 to 2001-02*, November 9, 2000.

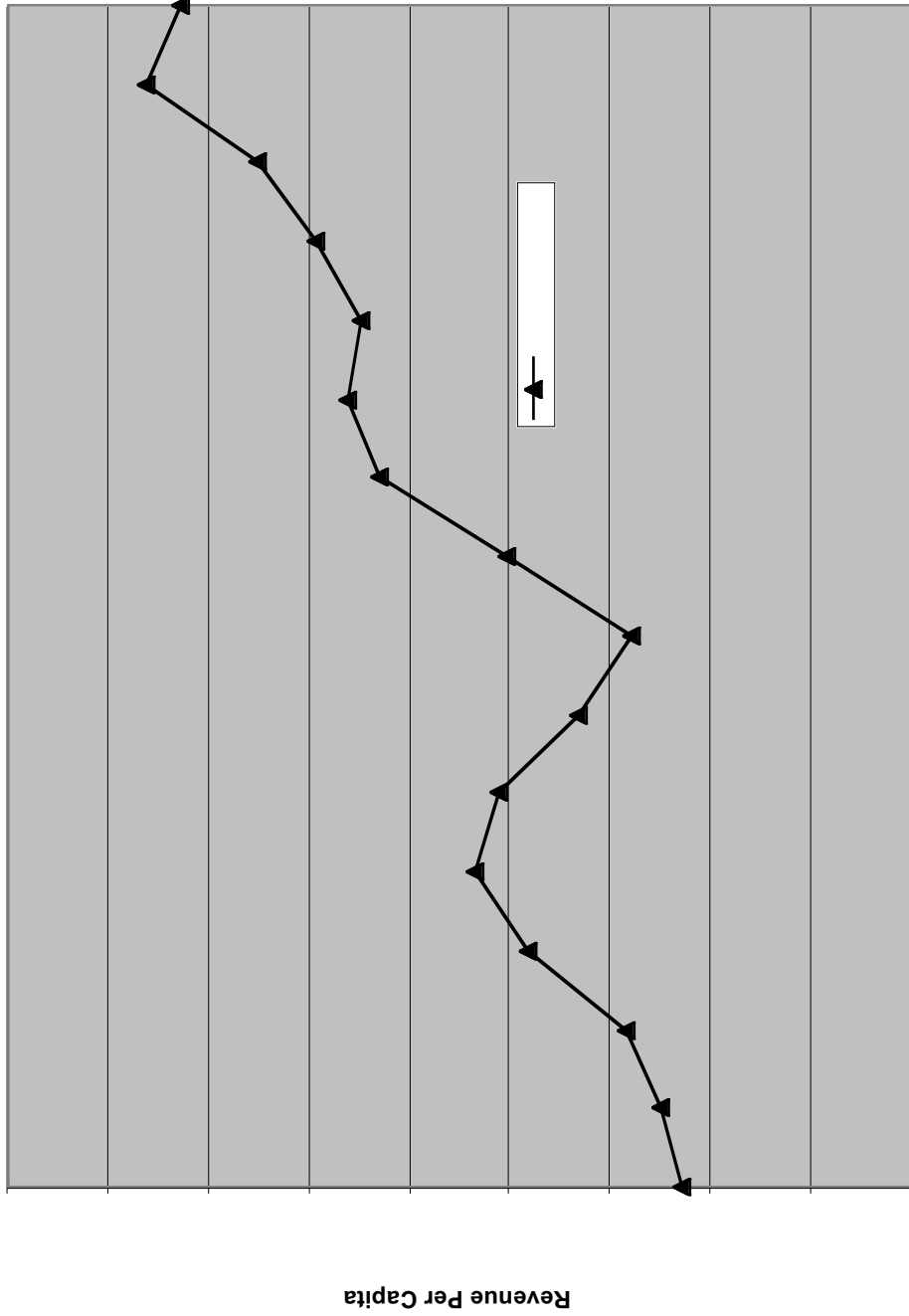
Table 4-2. Average Annual General Fund Revenue Growth

Revenue Source	1984-85 to 1999-2000	1993-94 to 1999-2000
Total Recurring Revenue		
with Trust Fund for Tax Relief	5.6%	6.0%
without Trust Fund for Tax Relief	5.1%	4.7%
Sales Taxes	6.0%	6.6%
Individual Income Tax		
with Trust Fund for Tax Relief	7.3%	8.1%
without Trust Fund for Tax Relief	6.2%	5.4%
Corporate Income Tax		
with Trust Fund for Tax Relief	0.5%	0.8%
without Trust Fund for Tax Relief	-0.7%	-2.2%
Other Taxes & Fees	2.8%	0.6%

Source: S.C. Board of Economic Advisors, *General Fund Revenue History*, September 25, 2000 and Comptroller General, *State of South Carolina Budgetary General Fund Financial Highlights—Budgetary Basis of Accounting Fiscal Year Ended June 30, 2000*, August, 2000.

justed for inflation, per capita general fund revenues including the Trust Fund for Tax Relief show a steady upward trend from 1984-85 (Figure 4-4).

Figure 4-4. Real General Fund Revenues Per Capita (1996 Dollars)



Other Revenues

General fund revenues support only a portion of state expenditures. The state manages a variety of other funds which use restricted revenues to fund specific types of activities. These include special revenue funds, enterprise funds, fiduciary funds, and higher education funds.

Special revenue funds. One cent of the sales tax is allocated to the Education Improvement Act Fund. The Department of Transportation Special Revenue Fund consists of gasoline taxes, fees, fines, and federal grants. Departmental general operating funds also include federal funds that are not part of the general fund. In 1999-2000, revenues from the general and special revenue funds used to support traditional state agency operations totaled \$11.6 billion (Figure 4-5). Thus, although general fund revenues were \$5.4 billion in 1999-2000, revenues available to support traditional state agency operations were twice that amount.

Other funds. Enterprise funds are associated with state activities that are self-supporting, like those of the State Housing Finance and Development Authority. Fiduciary funds include various trust and agency funds, including funds for the state's five public employee retirement systems. The financial activities of the state's sixteen technical colleges and ten universities are reported in the Higher Education Funds.

Appropriations from the General Fund

General Appropriations

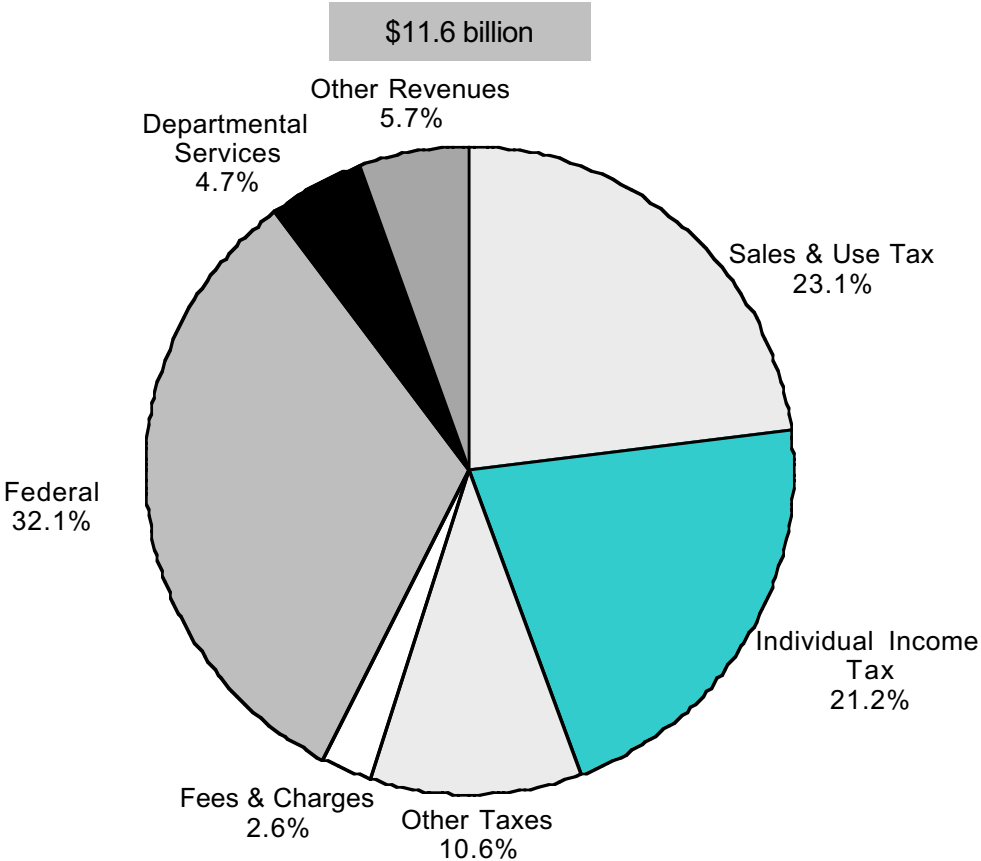
During each legislative session, the General Assembly writes a general appropriations bill or budget bill to operate state government for the following fiscal year. The general fund money a state agency receives through the appropriation process depends on past expenditure levels, current spending needs, and current political priorities.

In 1999-2000, in the general appropriations bill the legislature appropriated \$4.9 billion in revenue from the general fund. Total appropriations of general fund revenue were \$5.3 billion when revenue transferred to the Trust Fund for Tax Relief is included.⁷ Total funds from all sources appropriated in the budget bill in that year were \$13.0 billion.⁸

⁷ Because a discrepancy exists between trust fund figures reported by the Office of State Budget and those used by the BEA, BEA figures were used to maintain consistency.

⁸ Because some appropriations are not funded, appropriations and total expenditures may differ markedly, especially when federal funds are involved.

Figure 4-5. General and Special Fund Revenue Shares, 1999-2000



Supplemental Appropriations

Nonrecurring revenue may be appropriated in the general appropriations bill or through separate supplemental appropriations bills. Most supplemental appropriations are surplus revenue from a prior fiscal year. Because the general appropriations bill is based on a revenue forecast, actual revenue received may not equal appropriations. When revenue exceeds forecast revenues, the surplus from that year is appropriated for use in a subsequent year through a supplemental appropriation. In 1999-2000, supplemental appropriations of surplus revenues from prior years came to \$308 million.

Reserve Funds

The state maintains the capital reserve fund and the general reserve fund to guard against budget shortfalls. The capital reserve fund is funded yearly as part of general appropriations at two percent of general fund revenue in the most recently completed fiscal year; the general reserve fund is funded at three percent using surplus revenue. The capital reserve fund is the state's first line of defense against actual revenues coming in below forecast revenues and thus below general appropriations. The capital reserve fund is released for spending on capital projects and other nonrecurring items when revenue is on target or exceeds forecast revenue. Those funds are then expended in the subsequent fiscal year. The general reserve fund is held from year to year to support state spending obligations in the event of a major economic downturn. Appropriation of the 1998-99 capital reserve fund added another \$92 million to the amount of general funds available for expenditure in 1999-2000.

Other Adjustments To General Fund Appropriations

In any given fiscal year, some appropriated funds are not expended because anticipated spending needs do not materialize. Agencies are allowed to carry up to ten percent of their general fund appropriations forward into the next fiscal year. These previously appropriated funds increase the total amount of funds available for expenditure in subsequent fiscal years. In 1999-2000, state agencies carried forward \$175 million in funds from the previous year. Other adjustments to general fund appropriations include small amounts for open-ended appropriations and any legislative reductions.

Expenditures from the General Fund

Appropriations acts authorize state agencies to spend money. While general fund appropriations and expenditures are very similar, actual spending in a fiscal year differs slightly from appropriations because of funds from previous years that are appropriated or carried forward for use in the current year, plus unexpended funds from the current year that are carried forward into the next year.

Trends in General Fund Expenditures

1999-2000 expenditures. In 1999-2000, expenditures of general fund revenues were \$5.5 billion. Nearly three-quarters of the budget was allocated to elementary and secondary education, higher education, and health and social rehabilitation functions (Figure 4-6). If funds transferred to the Trust Fund for Tax Relief are excluded, general fund expenditures were \$5.1 billion.

Changing expenditure shares.⁹ Between 1984-85 (Figure 4-7) and 1999-2000, the shares of spending on health and social rehabilitation and corrections increased, while shares of spending on education, debt service, and all other spending decreased. Over this period, spending on health and social rehabilitation functions increased from 15.9 percent to 20.0 percent of the total, while spending on corrections increased from 5.3 percent to 7.9 percent of the total. The share of spending on higher education decreased from 17.8 percent to 14.7 percent, and the share of spending on elementary and secondary education and related services decreased from 38.5 percent to 33.5 percent of the total. Direct spending by the state on property tax relief in the form of transfers to local governments increased from less than one percent of total spending in 1984-85 to seven percent of total spending in 1999-2000.¹⁰

Expenditure growth. Between 1984-85 and 1999-2000, general fund expenditures in South Carolina grew at an average rate of approximately 5.6 percent per year (Table 4-3), the same rate as revenues. Over this period, tax relief transfers to local governments,¹¹ corrections, and health and social rehabilitation were the three fastest-growing areas of expenditure. The pattern of spending growth since 1993-94 shifted a bit. Spending on tax relief transfers; conservation, resources, and economic development; education (mostly K-12); and transportation grew noticeably faster than over the longer period; and spending growth in health and social rehabilitation slowed somewhat. While aid to subdivisions (mostly the Local Government Fund) increased 1.2 percent per year over the longer period, it has decreased 3.6 percent per year from 1993-94 to 1999-2000. Spending on public safety, a new agency in 1993-94, has grown rapidly.

Because spending on tax relief transfers to local governments has increased rapidly over the past six years, average annual growth in total expenditures from the general fund excluding the Trust Fund for Tax Relief was considerably lower than average annual growth in total expenditures including the trust fund.

⁹Major state government restructuring in the early 1990s makes comparisons of spending before and after 1993-94 difficult. The major spending categories used in this report should capture most of the spending in a given functional area, however.

¹⁰Homestead exemption reimbursement was the only program in place in 1984-85; three additional property tax relief programs were in place by 1999-2000: inventory tax reimbursement, depreciation property tax reimbursement, and school property tax relief.

¹¹The four programs that comprise the Trust Fund for Tax Relief.

Figure 4-6. General Fund Expenditure Shares, 1999-2000

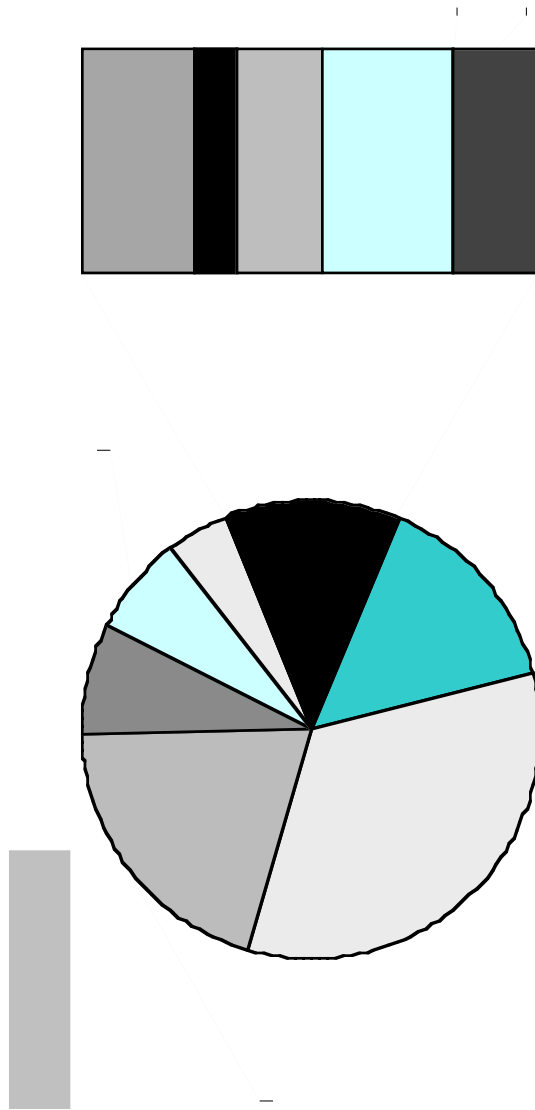
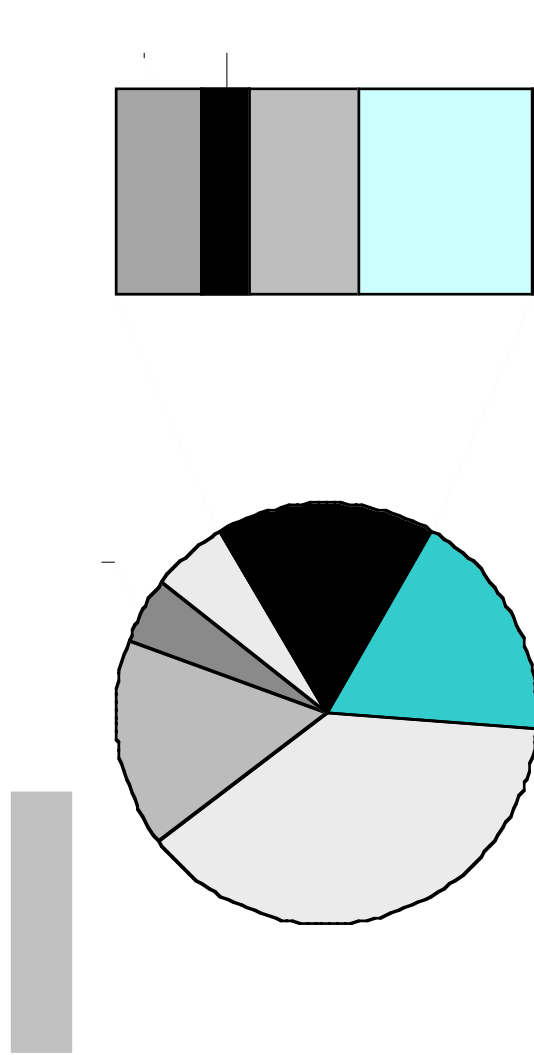


Figure 4-7. General Fund Expenditure Shares, 1984-85



Spending pressures and spending growth. Population growth and inflation are the two main drivers of government spending. Comparison of their growth rates is a rough but useful gauge of how annual state spending growth is keeping up with population and inflation. Population growth plus inflation was about 4.2 percent per year from 1985 to 2000. During this period functional spending areas grew above, below, or at about the same rate as population growth plus inflation (Table 4-3). Tax relief transfers to local governments; corrections; health and social rehabilitation; conservation, resources, and economic development; and education have seen spending growth above this level. Higher education has seen spending growth at about the same rate as population growth plus inflation, and the remaining areas have seen spending growth well below 4.2 percent per year.

As with revenues, real per capita spending (spending adjusted for population growth and inflation) shows an upward trend since 1984-85 (Figure 4-8). Much of this trend comes from steady growth in real per capita spending on corrections and health and social rehabilitation (Figure 4-9).

Population growth (Table 4-4) is the primary driver of the long-term demand for government expenditures, whether at the federal, state, or local level. As the popu-

Table 4-3. Average Annual General Fund Expenditure Growth

	1984-85 to 1999-2000	1993-94 to 1999-2000
With Trust Fund for Tax Relief ^a	5.6%	6.3%
Without Trust Fund for Tax Relief	5.1%	5.0%
Higher Education	4.3%	4.4%
Education	4.6%	6.1%
Health & Social Rehabilitation	7.3%	6.0%
Corrections	8.5%	8.5%
Tax Relief Transfers to Local Govts.	20.9%	28.5%
General Government	3.6%	2.2%
Conservation, Resources, & Econ. Devel.	4.9%	7.1%
Regulatory	2.2%	-8.9%
Debt Service	1.5%	-1.0%
Aid to Subdivisions	1.2%	-3.6%
Transportation ^b	-9.1%	6.8%
Public Safety	n.a.	11.5%

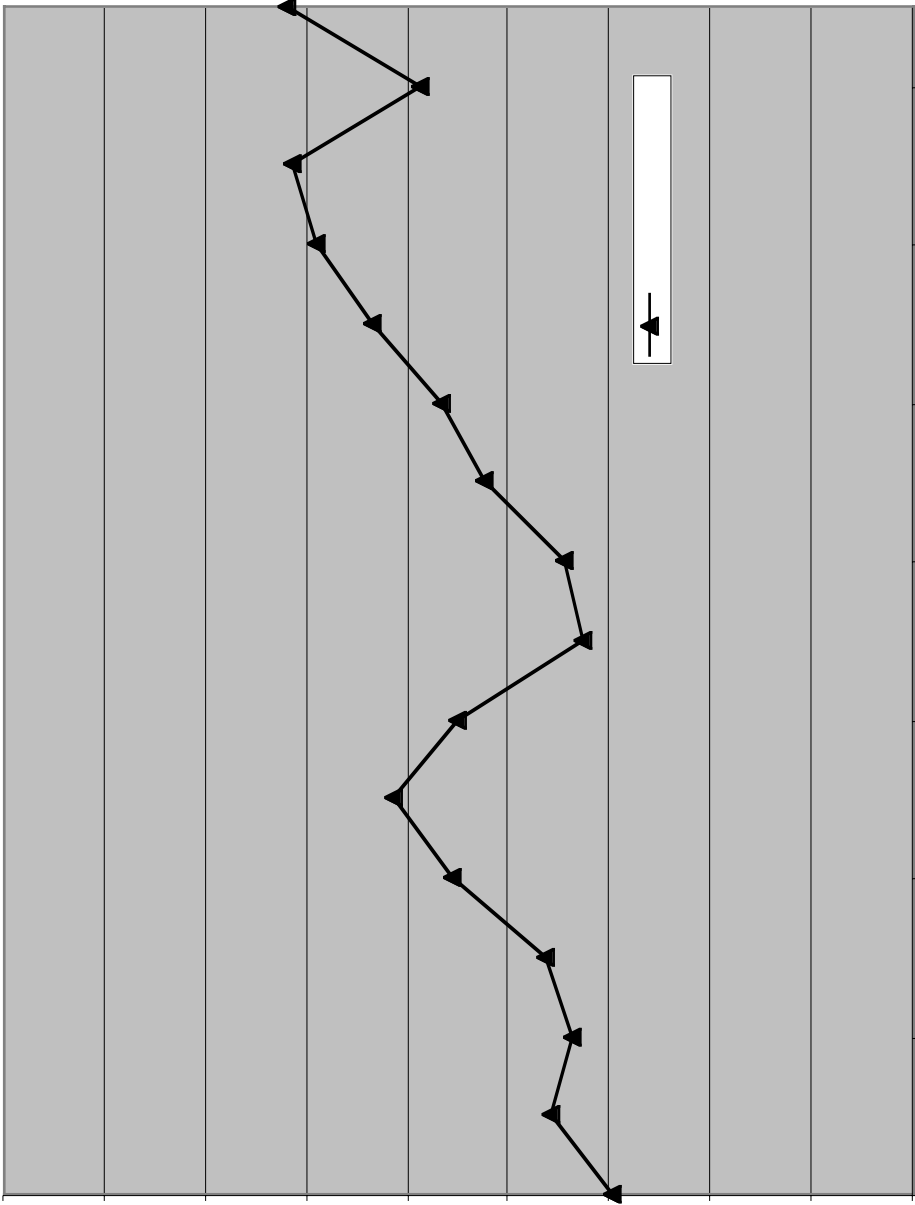
^aIncludes expenditures on the Trust Fund for Tax Relief in 1999-2000.

^bGovernment restructuring in 1993-94 removed the public safety function from the Department of Transportation.

Table 4-4. Average Annual Population Growth in S.C., 1985-2000

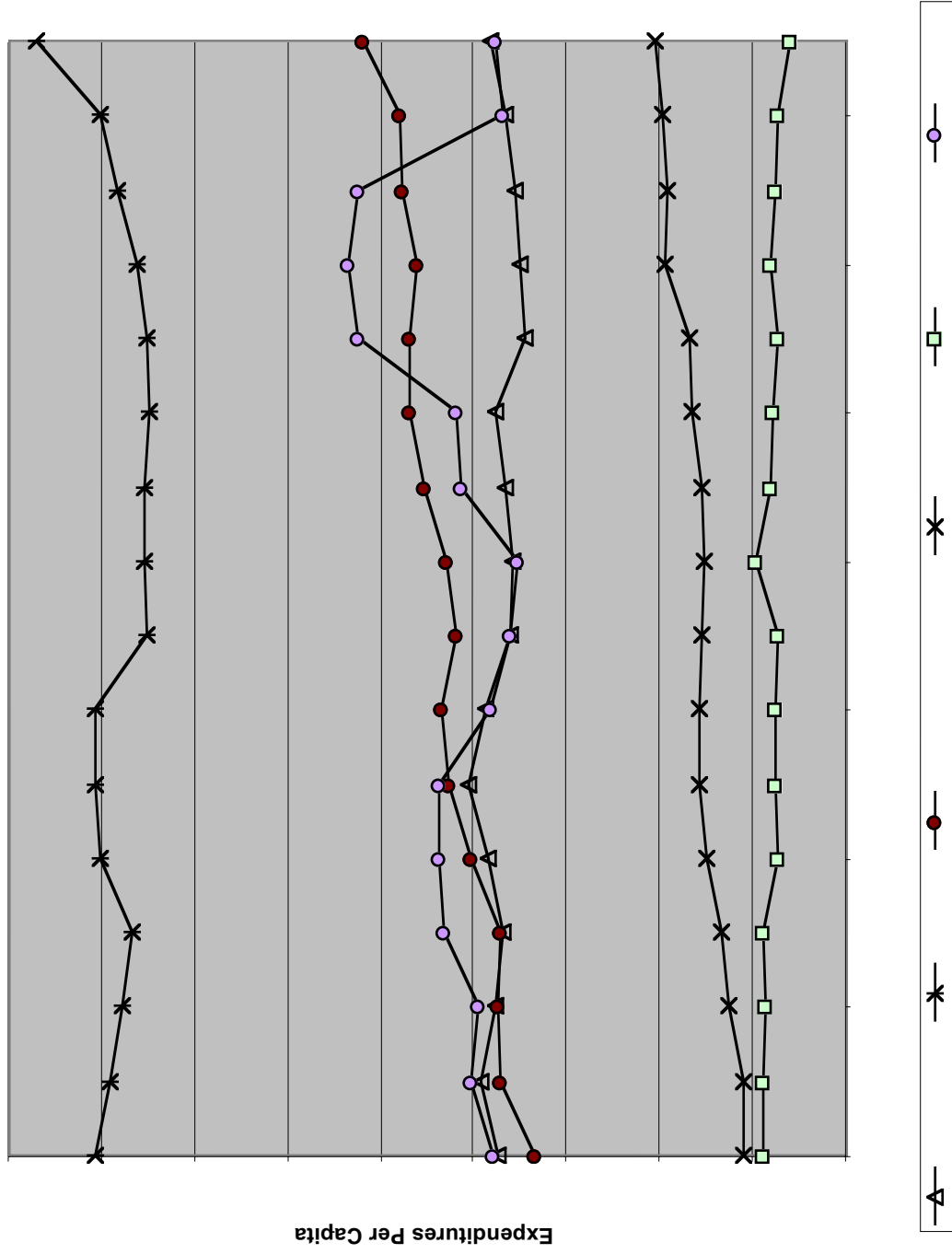
All Ages	1.2%
Age 5-19	0.4%
Age 20-24	-0.9%
Age 65 and up	2.4%

Source: Woods & Poole Economics, Inc., Washington, D.C., 2000.



Expenditures Per Capita

Figure 4-9. Real General Fund Expenditures Per Capita, by Category (1996 Dollars)



lation grows, the demand for goods and services provided by government increases proportionately. Because various segments of the population may have different growth rates, spending programs targeted at these groups may be affected in different ways. For example, growth in elementary and secondary education spending in South Carolina is linked in part to growth in the number of pupils in the public education system. Similarly, growth in the population aged 65 and over will affect large programs such as Medicaid.

Because this report is focused on state finances and not service provision, per capita state expenditures are reported in terms of the entire state population. To evaluate the benefits of specific programs, it would be necessary to evaluate spending levels per capita in terms of the population served.

Tax Relief and the General Fund

Tax relief programs affect the general fund in two ways. They reduce the amount of money produced by a given revenue source. Tax relief may also create a direct expenditure, as is the case with transfers to local governments to reimburse for revenue losses due to property tax relief.

The state has added tax relief programs since the mid-1990s that reduce revenue receipts from the individual and corporate income taxes and the sales tax. In 1999-2000, the Department of Revenue's Annual Report for 1999-2000 estimated that thirteen tax relief programs associated with the individual income tax resulted in \$169 million in tax savings.¹² Programs affecting individual income tax receipts include the retiree exemption, the exemption for children under six, the college tuition tax credit, and a number of business incentives. Three programs associated with the corporate income tax (tax rate reduction, jobs tax credit, and tax moratorium in certain counties) resulted in \$66 million in tax savings in 1999-2000. The sales tax credit for uncollectible sales produced \$1 million in tax savings. The sales tax holiday and one cent reduction on the sales tax on food plus exemptions and increases in the credit for uncollectible sales are estimated to increase this amount to \$30 million in 2000-01.

State direct spending on tax relief has increased to \$381 million in 1999-2000, with most of the increase taking place since implementation of homeowners' school property tax relief in 1995-96. In 1984-85, transfers to local governments for tax relief (homestead exemption reimbursement only) were \$21.7 million. The inventory tax reimbursement was added in 1985-86, followed first by school tax relief and then by the depreciation property tax reimbursement in 1997-98.

As is clear from earlier discussions, state spending on tax relief has also had an effect on the size of the state's official general fund. The size of the general fund affects the size of budget items that are funded based on a percentage of general

¹²Indexation of the individual income tax, which is estimated to reduce taxes by \$360 million in 1999-2000, is not considered a tax relief program in this report.

fund revenues. The Local Government Fund (aid to subdivisions) and the state's two reserve funds are among these programs. They would receive \$34.5 million more if expenditures for tax relief were still made from the general fund rather than from the recently established Trust Fund for Tax Relief (Table 4-5).

**Table 4-5. Dedicated General Fund Revenues, 2000-01
(in millions)**

	With TFTR ^a	Without TFTR ^a	Difference
Local Government Fund—4.5%	\$237.1	\$221.9	\$15.2
Capital Reserve Fund—2.0%	105.3	98.6	6.7
General Reserve Fund—3.0%	158.0	145.4	12.6

^aTrust Fund for Tax Relief

Chapter 5

GENERAL REVENUE AND EXPENDITURE PROJECTIONS

The key to a state's fiscal sustainability is the long-term balance between revenue and spending. If one grows faster than the other, legislators face a policy challenge to bring them back into balance, as they did during the recent budget cycle. So, what will South Carolina's general fund revenues and expenditures possibly be over the coming decade?

Projections¹³ of South Carolina's general fund revenues and expenditures from 2001-02 through 2010-11, using differing assumptions, can provide information for budget planners. Data describing the current and future state and national economies, historical revenue and expenditure patterns, and anticipated South Carolina population growth rates are considered in projections. Some projections reflect the revenue impacts of pending policy decisions and initiatives, as well as differing assumptions about key drivers of state expenditures. As in previous fiscal sustainability reports, revenue and expenditure projections were made independently and compared only toward the conclusion of the project. The projections can at best give approximations of the amounts of money that will pass through the state's general fund in the future.

General Fund Revenue Forecast

The state's official revenue forecast is made by the BEA, which uses a mix of forecasting and projection techniques. The BEA prepares general fund revenue forecasts for the state's budget cycle in November and February. The board prepares detailed forecasts by individual revenue stream for the current and upcoming fiscal years and then projects the major revenue streams at constant growth rates through the next eight years.¹⁴

¹³*Forecast* and *projection* have specific meanings in mathematics and economics. Generally speaking, a forecast involves a more complex analysis using more detailed information, while a projection simply involves the extrapolation of a trend. While some of the projections made in this study involve more than just simple trend analysis, the report reserves *forecast* to refer to the annual revenue estimation made by the South Carolina Board of Economic Advisors. The term *projection*, then, refers to the future revenue and expenditure estimations made in this study.

¹⁴In its longer term revenue projections, the BEA adjusts the constant growth rate to account for known future revenue patterns and legislative adjustments to specific revenue streams, such as the two-year payment cycle of motor vehicle taxes and the removal of the sales tax on food.

The BEA also monitors the state’s general fund revenue receipts throughout the year and modifies its forecasts midyear when economic conditions warrant. The board estimates the effects of specific tax relief programs on income tax and sales tax revenues in their revenue forecast. Funds that must be diverted from the general fund to the Trust Fund for Tax Relief are also part of the estimates.

General Fund Revenue Projections

In this report, state general fund revenue is projected using two different methods. The first method projects total general fund revenue using a straight-line trend based on the state’s historical revenue growth. The second method separately projects each of the major revenue sources. Three alternative revenue projections are produced with the second method using economic assumptions that differ from those used in BEA forecasts.

The BEA forecast is used as a starting point for the report’s revenue projections. Data used to project future general fund revenue come from the BEA’s general fund revenue history and February 2001 general fund revenue forecast.

Projections Based on Total Revenue

In making this revenue projection (Table 5-1, Figure 5-1), total general fund revenue includes all individual and corporate income tax revenues including those used to fund the Trust Fund for Tax Relief. All sales tax revenue, except the penny dedicated to Education Improvement Act funding, is also included.

Because an analysis of historical revenue growth since 1984-85 revealed a strong trend in real (inflation-adjusted) general fund revenue per capita, this annual trend was combined with the BEA’s 2000-01 forecast and extended to 2010-11 to produce the revenue projection. The real revenue per capita was converted to projected dollars using annual state population projections¹⁵ and a 3 percent annual rate of inflation. If future revenue follows the same pattern as historical revenue, and if the assumptions concerning state population growth and inflation are correct, then

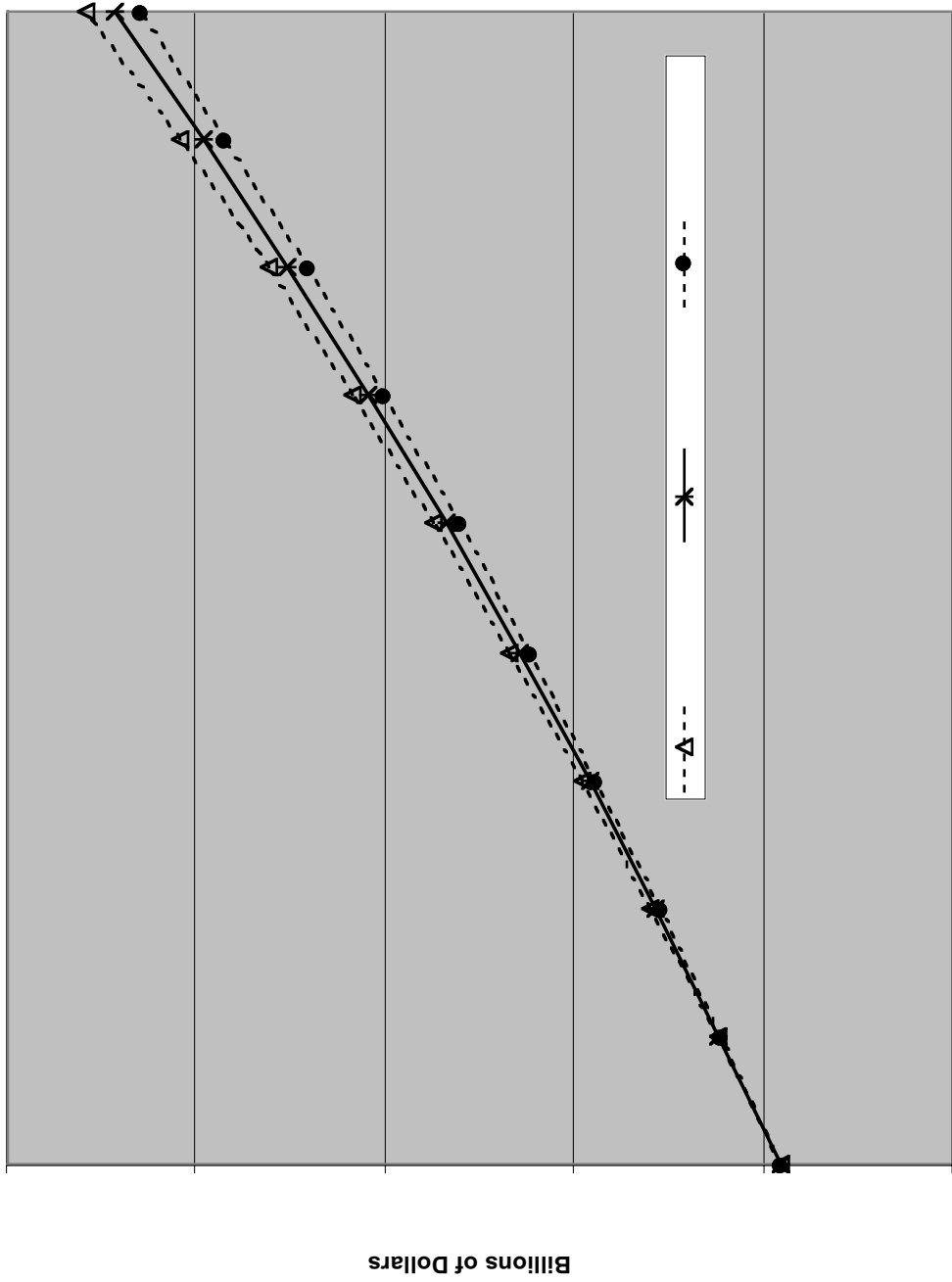
Table 5-1. Projection Based on Total Revenue (in millions)

	Base 2001-02	Projection 2010-11	Growth (%)
Upper Bound ^a	\$5,915	\$9,581	5.5
Linear Projection	5,915	9,440	5.3
Lower Bound ^a	5,915	9,299	5.2

^aThe upper and lower 95 percent confidence limits of the projection are also included to indicate the range in which future revenue is likely to fall.

¹⁵From Woods & Poole Economics, Inc., Washington, D.C., 2000. Woods & Poole does not guarantee the accuracy of this data. The use of this data and the conclusion drawn from it are solely the responsibility of the authors.

Figure 5-1. Projection Based on Total Revenue



general fund revenue in 2010-11 will likely fall between \$9.299 and \$9.581 billion, a range of \$282 million.

Projections Based on Major Revenue Components

Projecting total general revenue gives a useful range for future state general fund revenues, but a closer look at some of the major components of general fund revenue allows the incorporation of alternative assumptions about particular taxes, revenue sources, or tax relief measures. Three alternative projections are produced using this method: low growth, moderate growth, and high growth (Table 5-2, Figure 5-2). All revenue projections and revenue growth rate calculations use 2001-02 as the base fiscal year.

As in the projections based on total revenue, the revenue needed to fund the Trust Fund for Tax Relief is part of the projection. Because the historical data used to project these tax revenue streams reflect the effects of past changes in tax relief provisions, the revenue projection of each tax stream assumes that tax relief will continue along recent trends in the future. Each alternative projection uses a different combination of assumptions about economic factors and policy adjustments to revenue (Table 5-3). Appendix A contains annual revenue projection tables.

**Table 5-2. Projections by Revenue Components
(in millions)**

	Base 2001-02	Proj. 2010-11	Growth (%)
High	\$5,921	\$9,646	5.6
Net Sales Taxes	2,180	3,394	5.1
Net Individual Income Tax ^a	2,782	4,996	6.7
Net Corporate Income Tax ^a	208	208	0.0
Other Base Sources	750	1,048	3.8
Moderate	\$5,916	\$9,561	5.2
Net Sales Taxes	2,178	3,365	4.1
Net Individual Income Tax ^a	2,779	4,940	6.6
Net Corporate Income Tax ^a	208	208	0.0
Other Base Sources	750	1,048	3.8
Low	\$5,906	\$9,394	5.0
Net Sales Taxes	2,174	3,309	3.9
Net Individual Income Tax ^a	2,773	4,830	6.4
Net Corporate Income Tax ^a	208	208	0.0
Other Base Sources	750	1,048	3.8

^aIncludes revenue transferred to Trust Fund for Tax Relief.

Projecting Revenue in a Changing Economy

The tax revenue derived from South Carolina's tax base depends on the size and makeup of the tax base, the tax rate, and the responsiveness of tax revenue to

Figure 5-2. Projections Based on Revenue Components

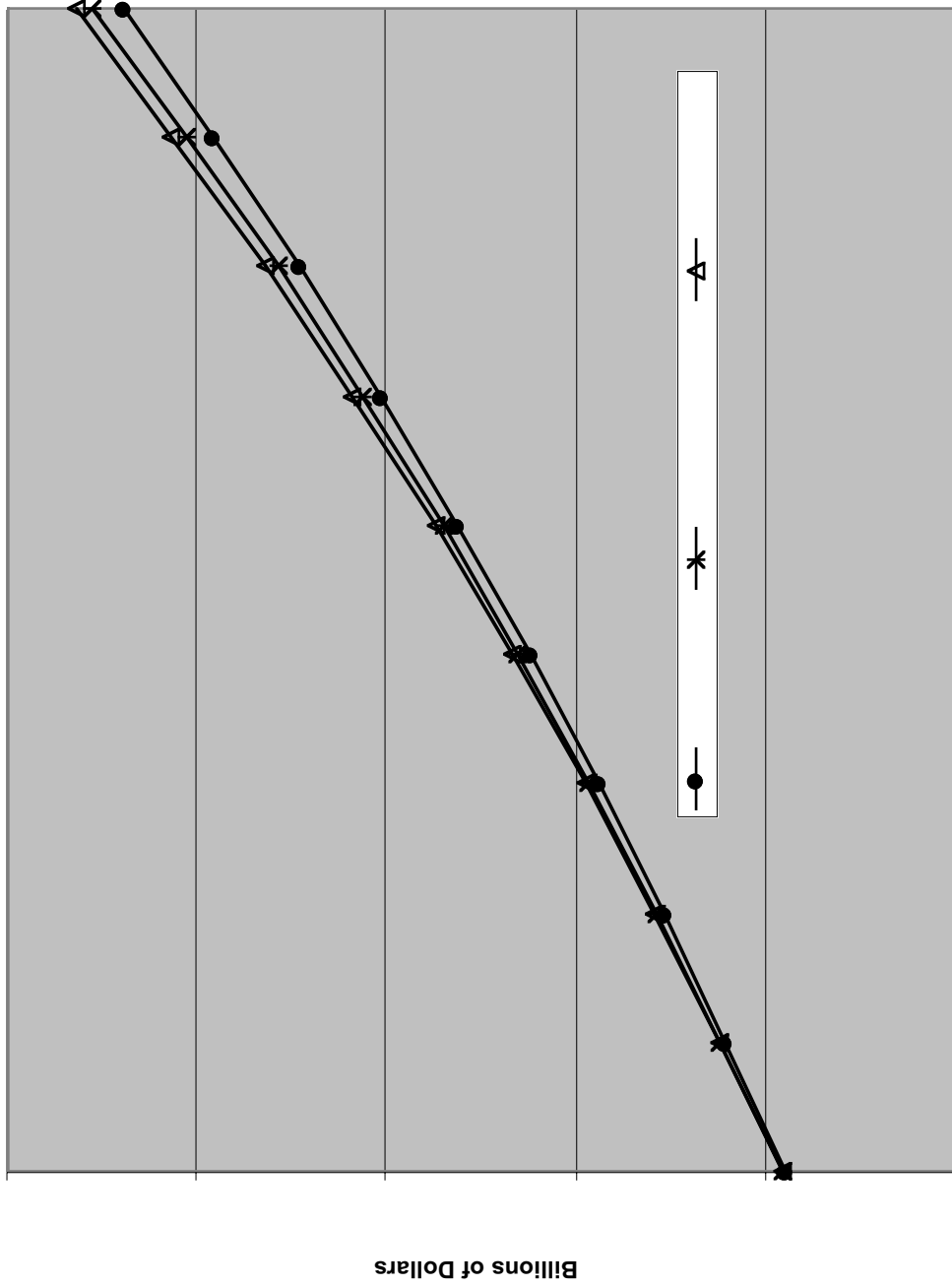


Table 5-3. Assumptions: Revenue Component Projections

Assumption	Scenario		
	Low	Moderate ^a	High
Average annual growth, personal income	5.3 % ^b	5.5 % ^c	5.6 % ^d
Personal income tax elasticity ^e	1.20	1.20	1.20
Retail sales tax elasticity ^e	0.9	0.9	0.9
Inflation rate, annual	3.0 %	3.0 %	3.0 %

^aClosely tied to the Feb. 15, 2001 BEA forecast, but adds revenue gained from additional use tax compliance and removes revenue loss from food tax phaseout.

^bCalculated from Woods & Poole data.

^cS.C. BEA forecast.

^dCalculated using U.S. Congressional Budget Office's forecast of U.S. GDP growth. On average S.C. personal income grows 10 percent faster than GDP.

^eS.C. BEA.

changes in the tax base. As changes are made in the items included in the tax base, revenue will grow or fall depending on the legislative changes.

For example, when the General Assembly initiated the phaseout of the sales tax on groceries in the 2000 session, it eliminated a stable part of the sales tax base. The Rockefeller Institute notes that states that have removed stable elements like groceries and clothing from their sales tax bases are more likely to see declines in revenue when economic conditions cause residents to reduce spending. During economic downturns optional items which are taxed are less likely to be purchased while spending on groceries and essential clothing continues during hard and good times. Exemptions in the individual income tax for retirees will also reduce the base of that tax as the size of the eligible population increases over the coming decade.

Responsiveness of tax revenue to changes in personal income is one of the most important considerations when projecting tax revenue.¹⁶ Personal income—the income received by individuals—is more relevant to projecting tax revenue than certain other broad measures of economic activity such as GSP because it is more closely linked to individual income tax revenues and to purchases which produce sales tax revenues.

When personal incomes are rising in a good economy, personal income tax collections increase. With the slowdown in the state's economy, the opposite effect can be expected. Personal income growth will slow, as will the growth of income tax revenues. And, as noted above with the sales tax, any amount of spending that varies directly with personal income produces less sales tax revenue.

Relatively small changes in the responsiveness of a revenue source to changes in personal income can produce significant changes in revenue collections. For ex-

¹⁶The relationship between tax revenue and personal income is captured by the economic concept of income elasticity. Income elasticity measures the percentage change in one quantity, such as income tax revenue or sales tax revenue, in response to a percentage change in personal income. When personal income goes up, tax revenue also goes up as people spend more on taxable items and pay more in income taxes. The income elasticity determines whether tax revenue will go up faster than, slower than, or at about the same rate as the increase in income.

ample, the BEA reduced its income and sales tax elasticity assumptions for its 2001-02 revenue forecast in response to the slowing economy. Using the BEA's revised income tax elasticity assumption of 1.2 reduced this report's projected income tax revenue by \$7 million for 2001-02 over what it would have been at the higher elasticity of 1.25. If this lower elasticity assumption holds to 2010-11, projected income tax revenue then will be \$129 million less. The BEA also forecast lower sales tax revenue by reducing sales tax elasticity from 1.0 to 0.9, producing a projection with sales tax revenue lower by \$11 million in 2001-02 and by \$179 million in 2010-11.

The revenue projections in this report are fairly conservative. The high revenue growth projection has average annual revenue growth of 5.6 percent through 2010-11. This growth rate is less than the 5.7 percent historical annual revenue growth rate from 1984-85 to 1999-2000. The assumed annual personal income growth rate of 5.6 percent used in the high-growth projection is also low by historical standards. Personal income in S.C. grew at an average annual rate of nearly 6.4 percent from 1985 to 1999.

Selected Tax Relief Programs and Their Impacts on Projected Revenues

The state of South Carolina provides tax relief to homeowners, parents, retirees, vehicle owners, students, and businesses, among others. Some tax relief programs reduce revenue receipts from the individual income tax, the corporate income tax, and the sales tax. Other programs such as the soft drink tax phaseout reduce other state taxes. Still other tax relief programs—such as the four local property tax relief programs in the Trust Fund for Tax Relief—have no direct effect on state revenue but instead reduce general funds available for spending, because the revenues pledged to those programs are removed from the general fund before the appropriations process begins.

Tax relief programs are a mixed blessing. In prosperous economic times, they allow legislators to give tax breaks to selected groups without affecting revenue growth enough to cause budget problems. Tax relief programs for businesses in particular are designed to make the state a more competitive environment for attracting and retaining large and small employers who create jobs and help maintain a stable base for the state's economy. But during economic downturns and recessions, tax relief programs can be costly for states. This is especially true in most states, including South Carolina, where tax relief programs remain in place annually and frequently grow in size as the affected population grows.

The general fund revenue projections include implicit assumptions about the overall effect of current tax relief programs on future revenue. But what might be the individual impacts of some of the state's larger tax relief programs on future state revenue? The retiree exemption, tuition tax credits, job development credits, and the Trust Fund for Tax Relief have relatively large impacts on general fund revenues when revenue is projected to 2010-11. Elimination of the sales tax on food would also have a large impact on general fund revenue.

Retiree Exemption. The retiree exemption is an individual income tax deduction against qualifying retirement income of not more than \$3,000 per person under the age of 65 and not more than \$10,000 per person over the age of 65. The BEA estimated that the effect of the retiree exemption on individual income tax revenue was a loss of \$36.9 million in potential revenue in 1999-2000.

In this report, the researchers used estimated growth in the retirement aged population to project the \$36.9 million anticipated cost of this program in the current fiscal year to a \$54.5 million revenue loss in 2010-11. The estimated annual growth rate of this exemption is 3.7 percent.

If the retiree exemption grows faster than expected, at about 5.0 percent per year—perhaps due to high in-migration of persons of retirement age—then the projected revenue loss in 2010-11 would be \$62.5 million, \$8 million higher than the base projection.

Tuition Tax Credit. The tuition tax credit in the individual income tax is designed to subsidize students enrolled in higher education. It allows credits against individual income tax liability equal to the amount of tuition paid during the year, up to a preset maximum. A three-year phase-in of this program began in 1998-99, so the credit is fully phased in as of 2000-01.

The effect of the tuition tax credit on revenue from the individual income tax in 2000-01 was estimated to be a revenue loss of \$25 million in this analysis. This figure is projected to grow at an annual rate of 2 percent to produce a base-line projection of \$30.5 million in revenue foregone in 2010-11. Because the projected average annual growth rate in the college-aged population is less than 1 percent over the next ten years, the 2 percent growth assumption allows for rising tuition and increases in the percentage of the state's population attending higher education institutions. If the tuition tax credit were to grow at 4 percent per year—twice the base-line rate—then the projected revenue loss in 2010-11 from this program would be \$37 million, a \$6.5 million difference from the lower growth assumption.

Job Development Credits. The job development credit program allows credits against employee individual income tax withholdings to new or expanding firms that create net increases in jobs. These credits are to be used to cover the expenses involved in the setup or expansion of the firm. A revitalization agreement detailing the conditions under which the credits will be given must be signed by the Economic Coordinating Council of the South Carolina Department of Commerce.

According to the South Carolina Department of Revenue's annual report, firms received \$18.9 million in job development credits in 1999-00. If this figure grows at the historical growth rate of announced investment in South Carolina (2.7 percent per year since 1995), then total credits in 2010-11 will be \$25.3 million. If, however, it is assumed to grow at the same rate as new job creation (8.0 percent per year

since 1995), then the projected outcome in 2010-11 is \$44.1 million, an \$18.8 million difference from the lower growth assumption.

Food tax phaseout. A five-year plan to eliminate the sales tax on groceries¹⁷ was implemented January 2001, reducing sales tax revenues for 2000-01 by \$24.6 million. The phaseout was cancelled beginning July 1, 2001. If this plan were to be reintroduced, a full phaseout of this tax would cost the state an estimated \$353 million in revenue in 2010-11.

The governor's 2001-02 executive budget proposal for food tax relief in the form of a \$25 million income tax credit was not addressed in the revenue projections. An income tax credit would benefit state residents only; under this option the state would continue to benefit from sales taxes paid by tourists and out-of-staters shopping in South Carolina stores. An income tax credit could also be targeted to give relatively more tax relief to individuals at the lower end of the income distribution, who spend a higher percentage of their income on food.

Second sales tax holiday. The governor proposed a second sales tax holiday in his 2001-02 budget proposal which was not included as part of the state's adopted general fund budget. The BEA estimates that a second sales tax holiday would reduce sales tax revenue by an additional \$2.5 million in 2001-02. By 2010-11, this figure would grow to \$3.3 million. Together, both sales tax holidays would reduce revenue by \$8.1 million in 2010-11.

Use tax compliance. The state has not routinely enforced individual payment of sales tax owed on out-of-state purchases. Beginning in the 2000 tax year, the income tax reporting forms included a line for reporting this information. Recent reports by the Department of Revenue that additional use tax compliance only added about \$100,000 in revenue suggests that this new policy will have a negligible impact on general fund revenue.

General Fund Expenditure Projections

General fund expenditures were projected using methods similar to those which projected revenues. First, a time trend in real per capita general fund expenditures was applied to 2001-02 appropriations. Then, the major functional areas of appropriations were projected separately, incorporating historical spending trends where relevant.¹⁸ The base year figures used in both projection methods are from the

¹⁷South Carolina General Assembly, House Bill 3649, General Fund Revenue Surplus Appropriations for Fiscal Year July 1, 2000, Part 1B, Temporary Provisions, 32.

¹⁸Traditionally, expenditures are projected keeping real expenditures per capita constant over the projection period. In this report and its predecessors, appropriations from the general fund are used as a proxy for expenditures because they are the most current source of information on state spending intentions.

general appropriations act for 2001-02.¹⁹ As with revenues, the BEA's estimate of the Trust Fund for Tax Relief is added to the total.

Because the decisions to appropriate and spend public funds are always political choices, any attempt to forecast expenditures presupposes how political forces will interact in the budgetary process. At any level of government—federal, state, or local—some elected officials will believe spending is too low in certain areas, while others will believe it is too high. In any given year, the revenue structure will only generate a certain amount of money to support government expenditures, so the public funds actually appropriated and spent depend on the revenue available and on which parts of the body politic are successful in accomplishing their agendas.

Population Growth

The 2000 Census reveals that South Carolina has grown 15.1 percent over the past decade from a population of nearly 3.5 million in 1990 to just over 4 million.²⁰ The state ranks 15th in percentage change in population over the decade. As expected, demands for goods and services provided by government have increased as South Carolina's population has grown. As growth rates of various segments of the population change (Table 5-4), spending programs targeted at these groups will also change.

Table 5-4. Projected Population Growth in South Carolina, 2000-2010

	Average Annual Growth 2000-2005	Average Annual Growth 2005-2010
Age 5-19	0.38%	0.17%
Age 20-24	1.26%	1.12%
Over 65	1.80%	2.62%

Source: Woods & Poole Economics, Inc. Washington, D.C. Copyright 2000.

An important assumption used in the expenditure projections is that real (inflation-adjusted) spending per capita remains constant over time. This requires that total dollar expenditures must grow enough to provide the same level of state goods and services for additional residents as well as keep pace with inflation. When total dollar expenditures grow at about the inflation rate plus the rate of population growth, real spending per capita—the true economic cost per state resident—re-

¹⁹S.C. General Assembly. Appropriations Bill, 2001-02. Act 66, June 2001. Viewed at: <http://www.lpittr.state.sc.us/>.

²⁰U.S. Department of Commerce. Bureau of the Census. Table 5: Resident Population of the 50 States, the District of Columbia, and Puerto Rico: April 1, 2000 (Census 2000) and April 1, 1990 (1990 Census). Viewed at: <http://www.census.gov/population/www/cen2000>, Internet release date December 28, 2000.

mains constant over time. This assumption is relaxed for certain spending areas in the projections of expenditure components. Projecting the state's 2001-02 appropriations bill to keep real spending per capita constant gives a projection of \$8.6 billion in 2010-11.

Projections Based on Total Appropriations

This method incorporates information on historical time trends in general fund expenditures into projections of current appropriations. A statistical analysis revealed the historical trend in real general fund expenditures per capita, and the resulting estimates were used to produce the projection (Table 5-5). Real expendi-

Table 5-5. Projection Based on Total Appropriations (in millions)

	2001-02	2010-11	Growth (%)
Upper Bound ^a	\$6,020	\$9,419	5.1
Projection	6,020	9,221	4.9
Lower Bound ^a	6,020	9,024	4.6

^aThe upper and lower 95 percent confidence limits of the projection are also included to indicate the range in which future expenditures are likely to fall.

tures per capita were translated into current dollars using state population projections and a three percent rate of inflation. If the assumptions concerning population growth and inflation hold true over the projection period, then general fund expenditures in 2010-11 are likely to lie within the \$395 million range between \$9,024 million and \$9,419 million (Figure 5-3).

Projections Based on Major Functional Areas of Appropriations

The second projection method examines the major functional areas of general fund expenditures (Appendix B) using assumptions about population growth, real per capita spending growth, and certain legislative changes. As with revenues, a closer look at major functional areas of general fund appropriations gives more insight into the importance of certain expenditures on the state's budget. This method of projection also lends itself to incorporating alternative assumptions about particular areas of expenditure or legislative adjustments. Three alternative expenditure projections are produced using this method: low growth, moderate growth, and high growth (Table 5-6, Figure 5-4).

All expenditure projections and expenditure growth calculations use 2001-02 as the base fiscal year. All projections and growth rate calculations have a base fiscal year of 2001-02 and a final fiscal year of 2010-11. The Trust Fund for Tax Relief is added separately so that expenditure and revenue projections can be compared. Each of the three alternative projections uses a different combination of assumptions about

Figure 5-3. Expenditure Projection Based on Total Appropriations

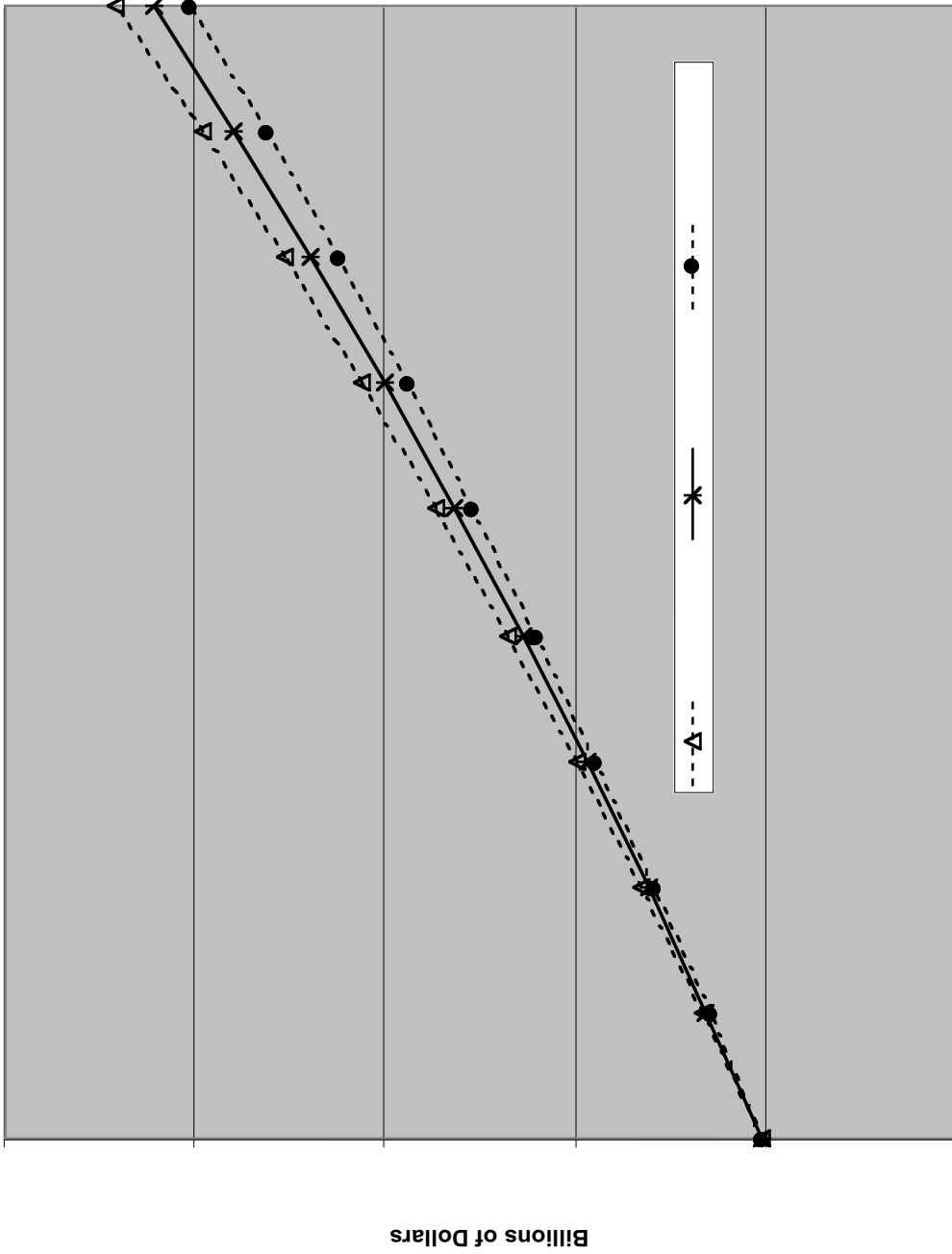


Table 5-6. Projections by Expenditure Category (in millions)

	Appropriations 2001-02	Projection 2010-11	Growth (%)
High Growth			
Higher Education	\$915	\$1,313	4.1
Educational	2,016	3,169	5.2
Health & Social Rehabilitation	1,100	1,861	6.1
Correctional	386	725	7.2
Debt Service	188	524	12.1
All Other Appropriations	967	1,390	4.1
Total without Trust Fund for Tax Relief	5,572	8,983	5.5
Trust Fund for Tax Relief	448	616	3.6
Total General Fund Expenditures	6,020	9,598	5.4
Moderate Growth			
Higher Education	\$915	\$1,313	4.1
Educational	2,016	3,169	5.2
Health & Social Rehabilitation	1,100	1,861	6.1
Correctional	386	725	7.2
Debt Service	188	436	9.8
All Other Appropriations	967	1,390	4.1
Total without Trust Fund for Tax Relief	5,572	8,895	5.4
Trust Fund for Tax Relief	448	616	3.6
Total General Fund Expenditures	6,020	9,511	5.2
Low Growth			
Higher Education	\$915	\$1,313	4.1
Educational	2,016	2,693	3.3
Health & Social Rehabilitation	1,100	1,861	6.1
Correctional	386	725	7.2
Debt Service	188	436	9.8
All Other Appropriations	967	1,390	4.1
Total without Trust Fund for Tax Relief	5,572	8,419	4.7
Trust Fund for Tax Relief	448	616	3.6
Total General Fund Expenditures	6,020	9,035	4.6

population growth, real per capita spending growth, and certain current or possible legislative changes (Table 5-7). Appendix C contains tables with annual expenditure projections.

Health and Social Rehabilitation and Corrections. Strong trends in historical real spending per capita from 1984-85 through 1999-2000 in the health and social rehabilitation and corrections areas were used in the three alternative expenditure projections instead of holding real per capita appropriations constant over the projection period (Figures 5-5, 5-6). Historical data show that, on average, inflation-adjusted health spending per capita has risen by \$5.46 per year, while inflation-adjusted corrections spending per capita has risen by \$3.31 per year. Because the analysis is based on total population, the figures show how the costs of these programs are spread across the entire population.

Figure 5-4. Expenditure Projections Based on Appropriations Categories

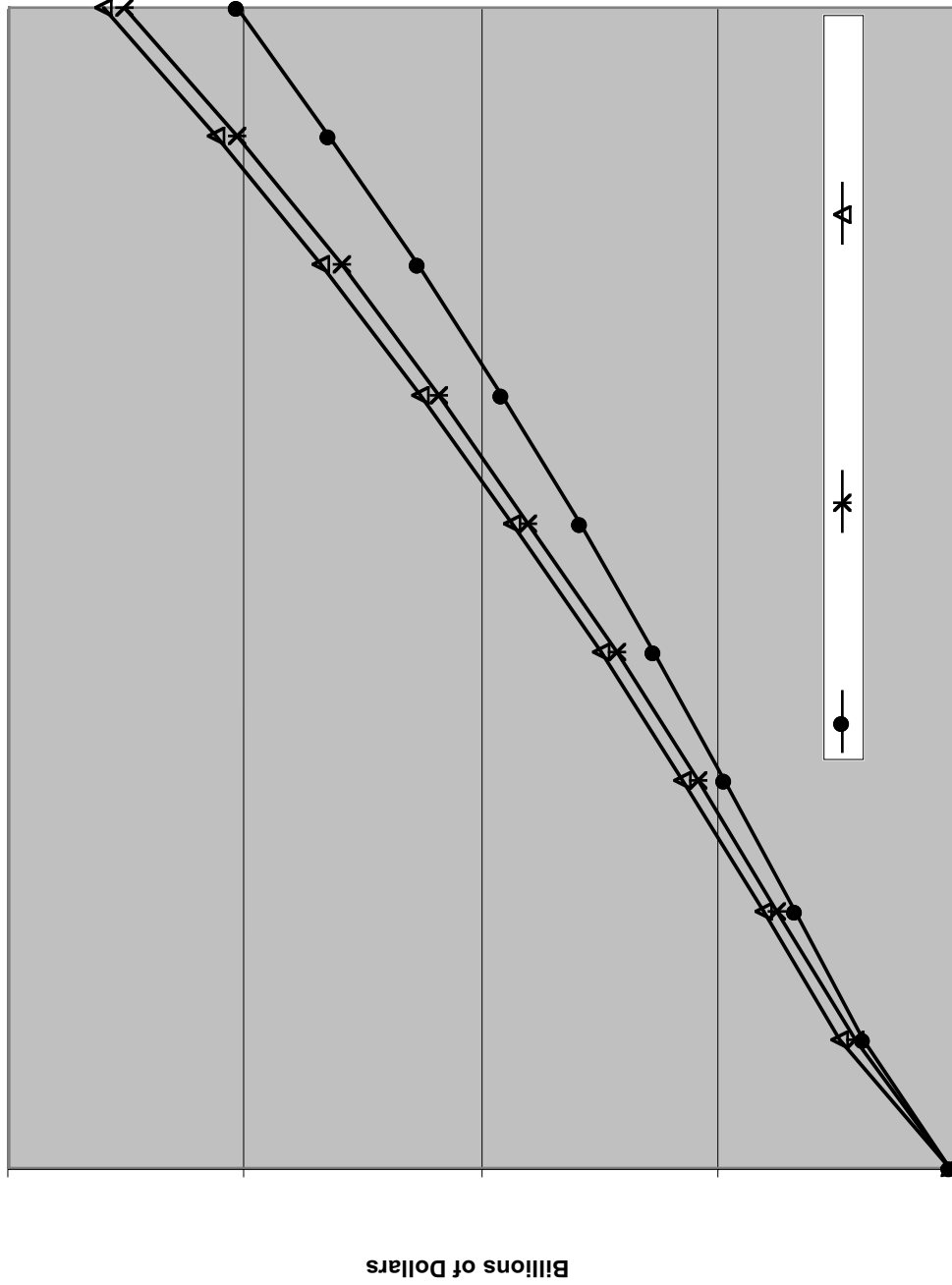


Table 5-7. Assumptions: Expenditure Category Projections

Low Growth	Moderate Growth	High Growth
<ul style="list-style-type: none"> • Constant real per capita \$ of higher education, educational, and all other • Historical real per capita growth in health & social rehabilitation and corrections • Debt service at 5 percent of general fund revenue • Trust Fund for Tax Relief from BEA forecast 	<ul style="list-style-type: none"> • Constant real per capita \$ of higher education and all other • 1 % annual growth of real per capita approp. in educational • Historical real per capita growth in health & social rehabilitation and corrections • Debt service at 5 percent of general fund revenue • Trust Fund for Tax Relief from BEA forecast 	<ul style="list-style-type: none"> • Constant real per capita \$ of higher education and all other • 1 % annual growth of real per capita approp. in educational • Historical real per capita growth in health & social rehabilitation and corrections • Debt service at 6 percent of general fund revenue • Trust Fund for Tax Relief from BEA forecast

Expenditure growth in the health and social rehabilitation area is occurring in the Medicaid program, a federally funded program that pays for health care for children, seniors, disabled persons, and pregnant women that meet income and other eligibility requirements. Medicaid is the single largest program in the state’s budget outside of education, according to a February 2001 report by the Legislative Audit Council. Payments for this program make up most of the Department of Health and Human Services’ budget. As an entitlement program, Medicaid is funded 70 percent from federal funds, while the state provides the remainder to eligible recipients. The Legislative Audit Council’s report notes that Medicaid payments to health care providers increased 128 percent between 1990-91 and 1999-2000 due to increased costs and eligible recipients and that there has also been an increase in the percentage of state general funds appropriated to the Department of Health and Human Services.

The forces underlying the strong historical trend in real per capita corrections spending were not explored in detail. However, it is likely that stricter sentencing requirements are driving higher spending because the population that can be used to track the prison population, males aged 20-29, is estimated to have declined slightly over the 1990s. This population is projected to increase somewhat between 2000 and 2010, so the prison system may come under additional pressures in the coming decade.

Education. In the low growth spending projection, inflation-adjusted per capita educational spending (mostly K-12) is assumed to remain constant over the projection period. In other words, the state is assumed to continue providing the same level of benefits per student throughout the projection period as is contained in the state’s 2001-02 appropriations act.

Figure 5-5. Real Health & Social Rehabilitation Expenditure Trends (1996 dollars)

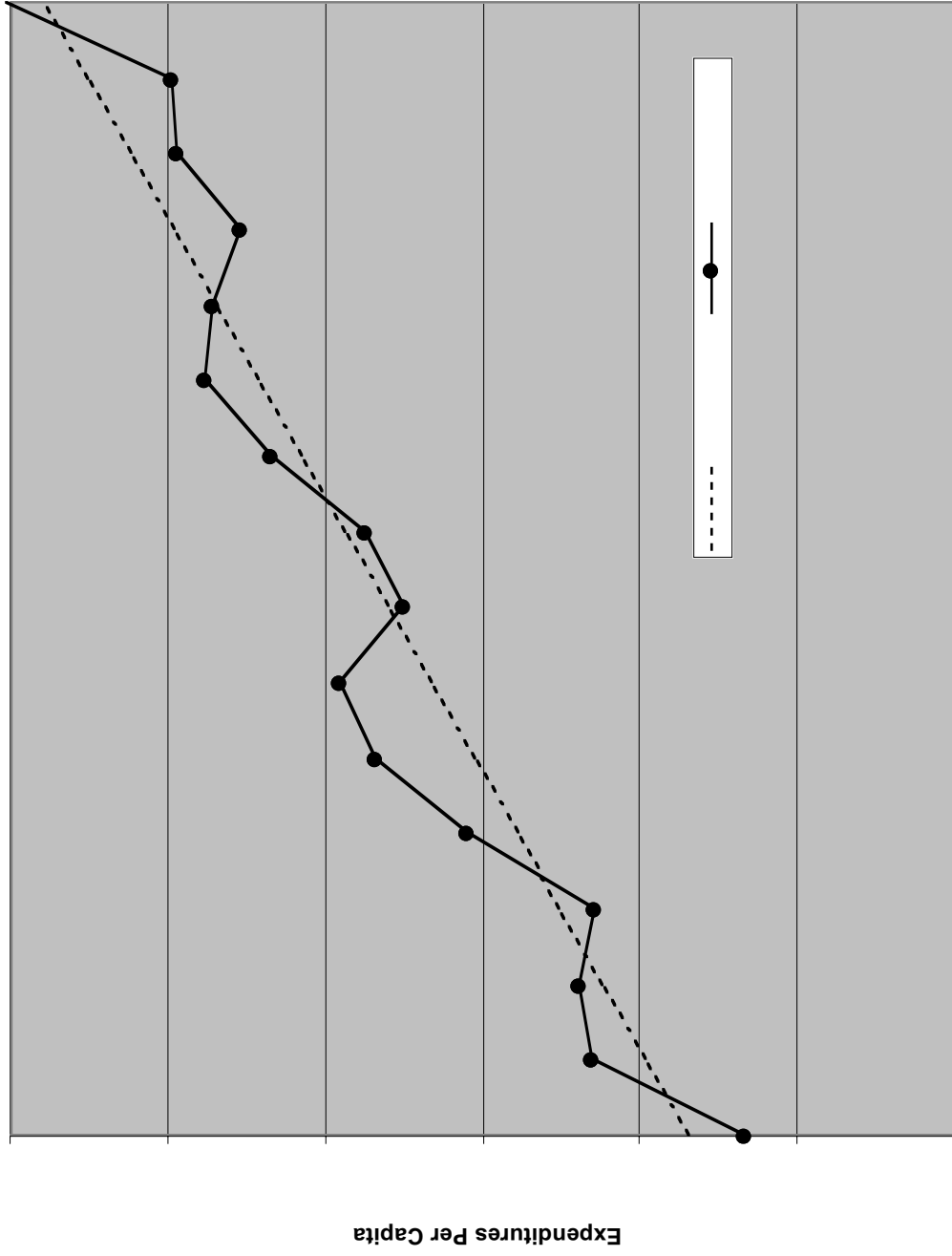
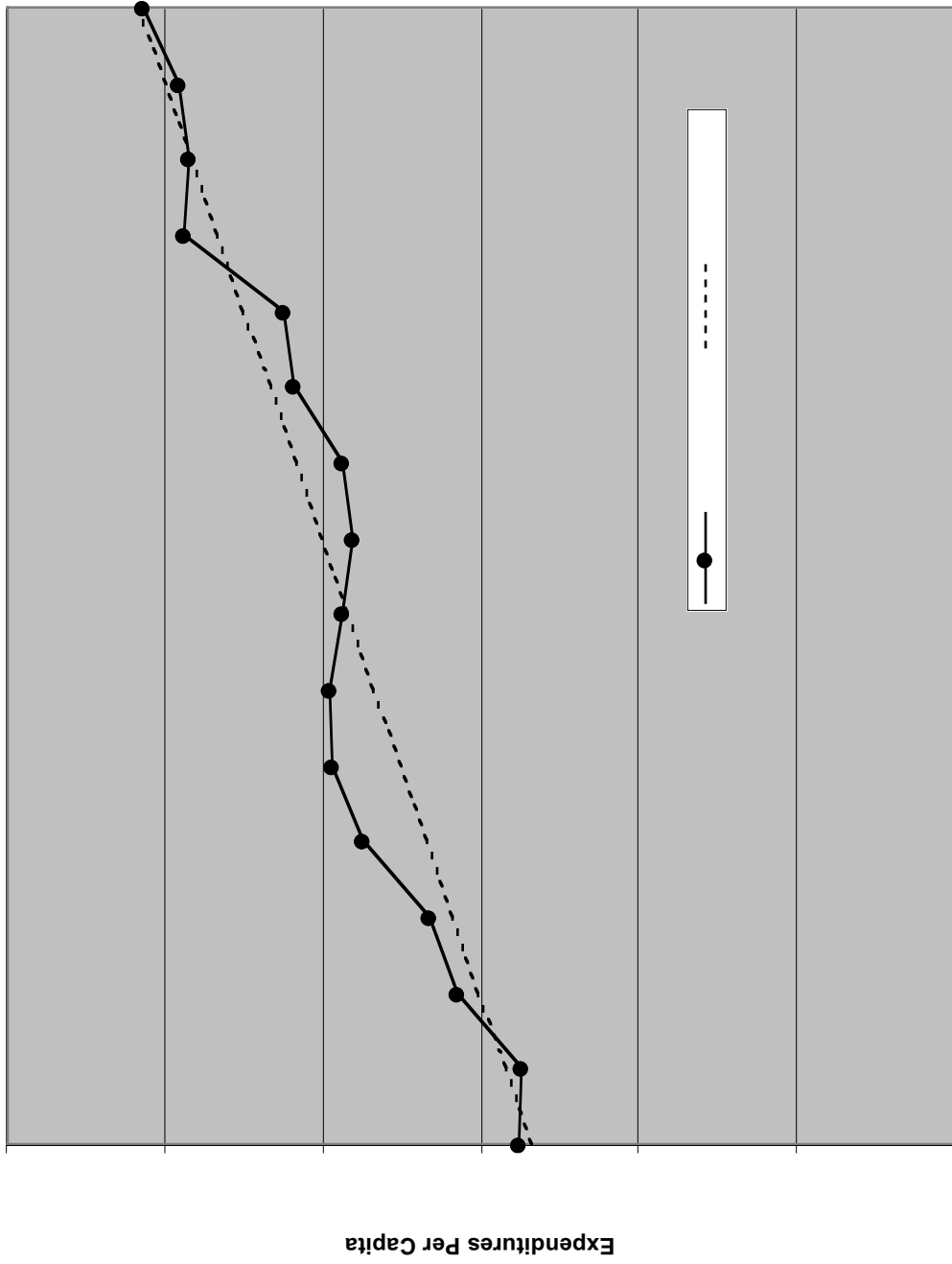


Figure 5-6. Real Corrections Expenditure Trends (1996 dollars)



In the moderate and high growth expenditure projections, modest growth of one percent per year in real per capita education spending is assumed. This assumption is included to reflect the current climate supporting continued improvement of the state's public education system. Pressures from population growth on educational spending are likely to be relatively low in the coming decade, as population in the age 5-19 group is projected to be well below one percent per year.

Debt Service. South Carolina's state constitution allows for a maximum debt service limit of seven percent of the latest completed year's general fund revenue for general obligation debt in the general fund. Currently, the debt service limit stands at five percent of general fund revenue and a vote by the General Assembly is required to raise it. Recent and planned general obligation bond issues subject to the five percent limit are expected to push the state very close to its debt limit within the next year. Slower current revenue growth will also cause the debt limit ceiling to grow slowly and restrict the state's ability to issue general obligation debt in the future.

In the low and moderate growth spending projections, the amount of debt service is assumed to remain at the current maximum of 5 percent of general fund revenue, with debt service at the maximum allowed level throughout the projection period. In the high growth expenditure projection, however, the debt service ceiling is assumed to be raised to 6 percent and debt service is assumed to be the maximum at this higher level. The BEA's current forecast of general fund revenue was used to compute the debt service limits in each projection year.

Trust Fund for Tax Relief. Tax relief is a direct expenditure, as is the case with transfers to local governments for property tax relief. The estimated \$433 million in reimbursements to local governments for property tax relief made through the Trust Fund for Tax Relief make up about 60 percent of the estimated tax relief programs offered by the state in 2000-01.²¹ Reimbursements to homeowners for school property tax relief comprised two thirds of the trust fund's total in 2000-01, an estimated \$262 million. These programs reimburse local governments for actions taken by the state that affect local governments' ability to raise revenue.

The BEA has estimated that the Trust Fund for Tax Relief will reduce individual and corporate income tax revenue by \$594 million in 2009-10. An extension at the BEA's 3.6 percent annual growth rate puts the trust fund at \$615 million in 2010-11. But what might the components of the trust fund amount to in 2010-11? The business inventory tax reimbursement is the easiest to project as it is capped. It has remained at \$40.5 million since the early 1990s.

²¹Includes \$37.5 million to increase the homestead exemption to \$50,000 and \$20 million for automobile property tax relief. Estimated total tax savings of \$705 million excludes \$385 million in individual income tax indexation. Estimate of Trust Fund for Tax Relief from South Carolina Board of Economic Advisors, General Fund Revenue Forecast, February 2001. Estimate of total tax savings from South Carolina Department of Revenue, Annual Report 1999-2000.

School property tax relief, the homestead exemption reimbursement, and the depreciation property tax reimbursement are more difficult to project. The homestead exemption is available to all persons aged 65 and older and exempts the owner from all property taxes (city, county, and school district) on the first \$50,000 in market value on an owner-occupied residence. The homestead exemption reimbursement can be estimated by projecting current levels at the rate of growth in the population over 65. This gives a projected level in 2010-11 of \$114 million, or an average annual increase of 2.2 percent. However, this projection ignores the problem presented by properties owned by seniors with market values below \$50,000. As property values increase over time, these properties will add to the level of reimbursement required until they reach the \$50,000 limit. When most properties in the state are above \$50,000 in market value, the homestead exemption will level off and follow population growth more closely. For this reason, the estimate may be conservative.

School tax relief presents the same problem as the homestead exemption reimbursement. Growth of school tax relief for homeowners depends on state population growth overall, the level of new owner-occupied residential construction, and the growth in assessed value for those new and existing homes below the limit of \$100,000 in market value. School property tax relief is capped at 1995 millage and is limited to growth in assessed value (up to the limit of \$100,000 in market value) from existing and new homes. Because many houses around the state have a market value below \$100,000, these properties will add to the level of reimbursement required until they reach the \$100,000 limit. These variables and the different levels of housing prices around the state make it difficult to accurately estimate how fast school property tax relief will grow. However, one simple estimate can be made by reducing the annual growth rate in the tax reimbursement from 5 percent (recent annual growth in the trust fund) to 3.6 percent (inflation plus projected state population growth) over the coming nine years. This method yields an estimate of \$426 million in 2010-11.

The depreciation property tax reimbursement is also difficult to predict. It depends on the growth in eligible manufacturers' machinery and equipment, which is depreciated on a number of different schedules. A simple estimate can be made by increasing the value of the reimbursement by 2.7 percent per year, the recent annual increase in announced investment in the state. This method suggests that the reimbursement may be in the area of \$30 million in 2010-11. The depreciation property tax reimbursement is also an open-ended reimbursement.

The very simple estimates discussed above suggest that the Trust Fund for Tax Relief may be around \$610 million in 2010-11, nearly the same as the BEA's estimate. The open-ended reimbursements in the Trust Fund for Tax Relief introduce uncertainty into the budget process. School tax relief is large and difficult to predict, and the growth in the homestead exemption reimbursement may be hard to predict until the state has a few more year's experience with the program at its new, higher level. In fact, the state's midyear 2000-01 \$50 million budget cut was due largely to unanticipated growth in school property tax relief. The depreciation property tax

reimbursement will be sensitive to the business cycle and to changes in the structure of business and industry in the state that are eligible for this reimbursement.

Conclusion

General fund revenue and expenditure projections are very sensitive to changes in underlying assumptions, including shifts in the economy (personal income growth and the level of inflation), population growth, and legislative adjustments (to revenue streams and spending commitments). As these and many other factors shift in the coming years, actual revenues and expenditures will certainly differ from the projections described herein. But nonetheless, the range of projected revenues and expenditures is probable and suitable for planning purposes.

The projections based on total revenues and expenditures suggest that revenues may be around \$220 million above expenditures in 2010-11. The projected ranges in which actual revenues and expenditures are expected to fall suggest that surpluses up to \$550 million as well as shortfalls of up to \$120 million could occur. The projections based on revenue and expenditure components suggest that when matching the low, moderate, and high growth scenarios, projected revenues are expected to be about \$50 to \$360 million higher than corresponding expenditures in 2010-11.

Although cuts to the general fund budget were needed for 2001-02, inflation-adjusted per capita expenditures in this year will remain well above the level that would be projected based on historical trends. According to the trend in total inflation-adjusted per capita spending from 1984-85 to 1999-00 actual appropriations per capita are 14 percent higher than would be predicted by the historical trend.

It is difficult to select a single combination of revenue and expenditure projections and claim it is the most accurate or most probable. What is important to take from these projections is the sense that small to moderate—a few percent of the total—budget surpluses and shortfalls are possible, with a bit more emphasis on possible shortfalls in the near term and surpluses in later years.

Chapter 6

THE BUDGET SHORTFALL

Each legislative session, the General Assembly prepares a balanced budget as required by law, based on the BEA revenue forecast. But in some years, like 2000-2001, actual revenue receipts fall short of the forecast. Falling revenue growth has also affected the recently adopted 2001-02 budget. A slowdown in the economy is the fundamental underlying culprit causing the lower revenue growth. But, given the inherent uncertainty associated with the economy, irresponsible budgeting is the primary factor contributing to the state's current general fund shortfalls.

How does an anticipated budget shortfall of about \$150 million in 2000-01 occur when reports made early in the fiscal year suggested that up to \$900 million in additional revenue was available? Why did the state have to cut \$500 million from its general appropriations for 2001-02 when revenue is growing? The answers to these questions depend upon the interrelationships among forecast revenues and actual revenues, general and supplemental appropriations, and annualizations.

Forecasts and Appropriations, Surpluses and Shortfalls

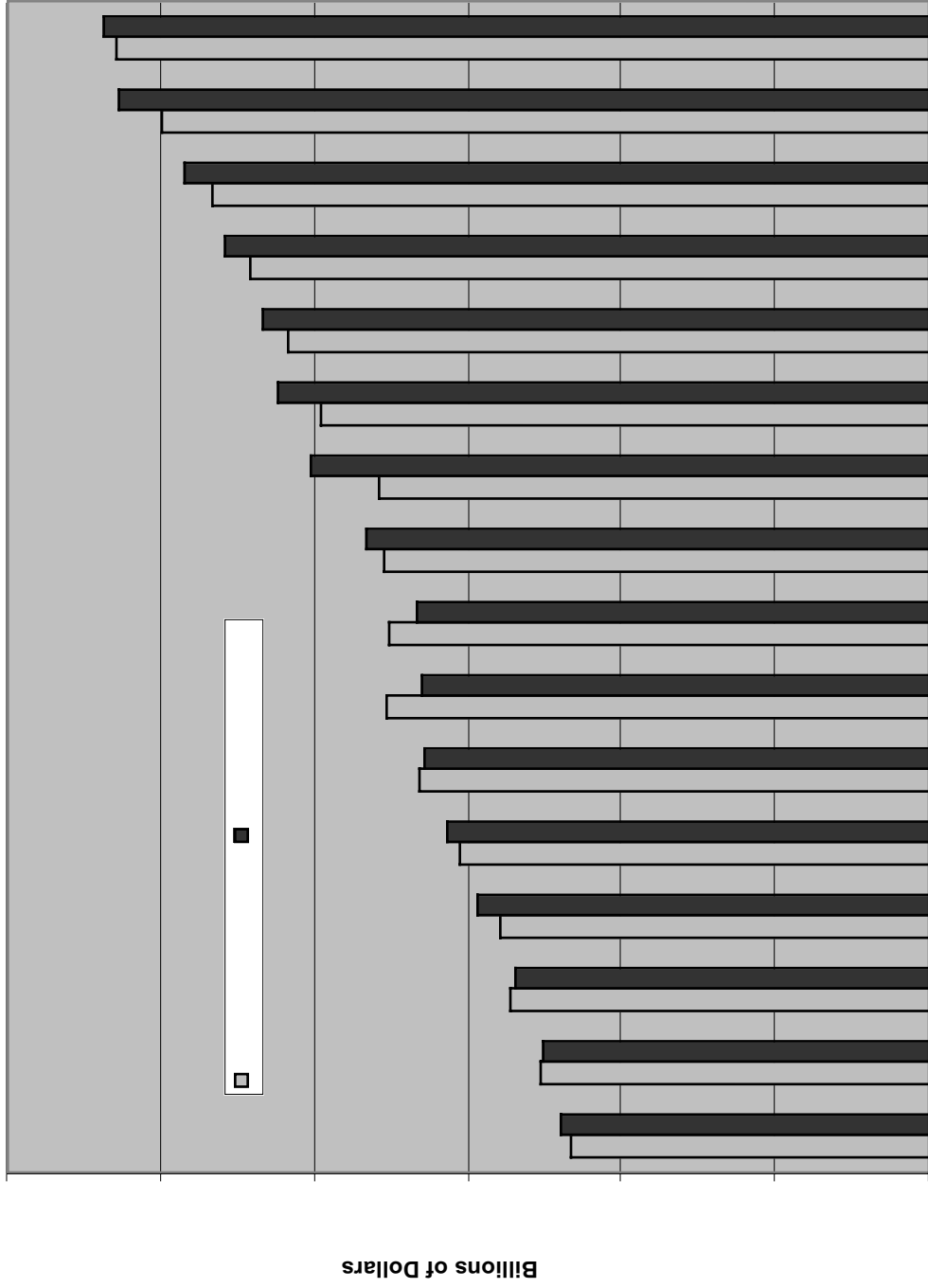
General appropriations are based on the BEA's general fund revenue forecast for the fiscal year. Supplemental appropriations permit additional spending when actual revenue receipts exceed the spending obligations created by the general appropriations bill. Supplemental appropriations bills appropriate various nonrecurring revenues, usually consisting of surpluses from prior completed fiscal years. In this report, appropriation of the capital reserve fund is treated as supplemental because it releases previously set aside funds for spending by various agencies and programs.

Surplus Revenues and Supplemental Appropriations

In recent years, the state has taken in revenue well in excess of the BEA's revenue forecasts (Figure 6-1),²² which became available for supplemental appropriation. From 1993-94 to 1999-2000, the yearly surplus averaged \$180 million, and not a single shortfall was recorded. In contrast, from 1984-85 to 1989-90, the average yearly difference between forecast and actual revenue was a shortfall of \$22 million.

²²Because a surplus is defined as excess unappropriated revenue, the difference between the BEA's initial revenue forecast and actual revenue will exactly equal the surplus only when general appropriations exactly equal the initial revenue forecast.

Figure 6-1. Forecast and Actual General Fund Revenues



Three of these six years saw shortfalls, while the other three years experienced surpluses (Figure 6-2).

These facts in part reflect changes in the state revenue forecasting and budgeting process in the early 1990s, when the BEA moved toward a more conservative approach to revenue forecasting and the state increased reserves. The primary impetus for these changes came from the desire to improve South Carolina's bond rating following the 1990-91 recession. All of the state's reserve funds had been lost to the recession, and South Carolina faced a higher cost of borrowing due to the increased risk of default. Consequently, beginning in 1994-95, spending limits and an additional reserve fund named the Carnell-Felder Set Aside were established. After 1996-97, these precautionary measures were dissolved as the state's bond rating recovered and they became politically unfeasible to maintain. Conservative revenue forecasting, however, has remained the preferred approach.

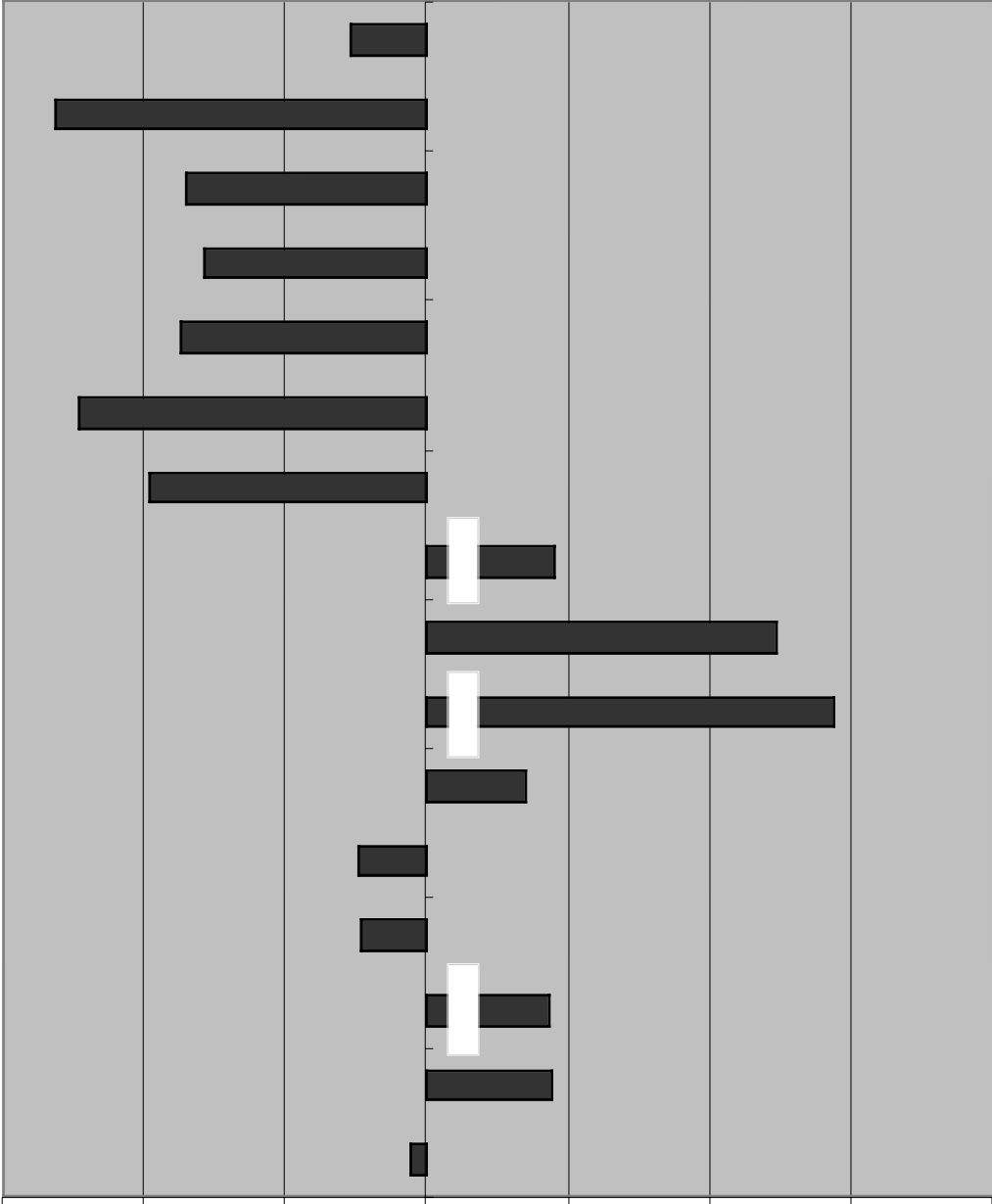
The state's conservative approach to revenue forecasting combined with the booming economy of the mid-to-late 1990s led to significant surplus revenues and, thus, significant supplemental appropriations (Figure 6-3). The average amount of supplemental appropriations per year in the pre-recession years 1984-85 to 1989-90 was \$51 million. From fiscal years 1993-94 to 1999-2000, supplemental appropriations averaged \$207 million per year.

The availability of significant surplus revenues for appropriation in recent budget years has played a role in the state's current budget situation. But the mere existence of these revenues and their appropriation by the General Assembly are not necessarily a problem. Instead, the problems associated with these surpluses are related to the programs for which these funds have been appropriated.

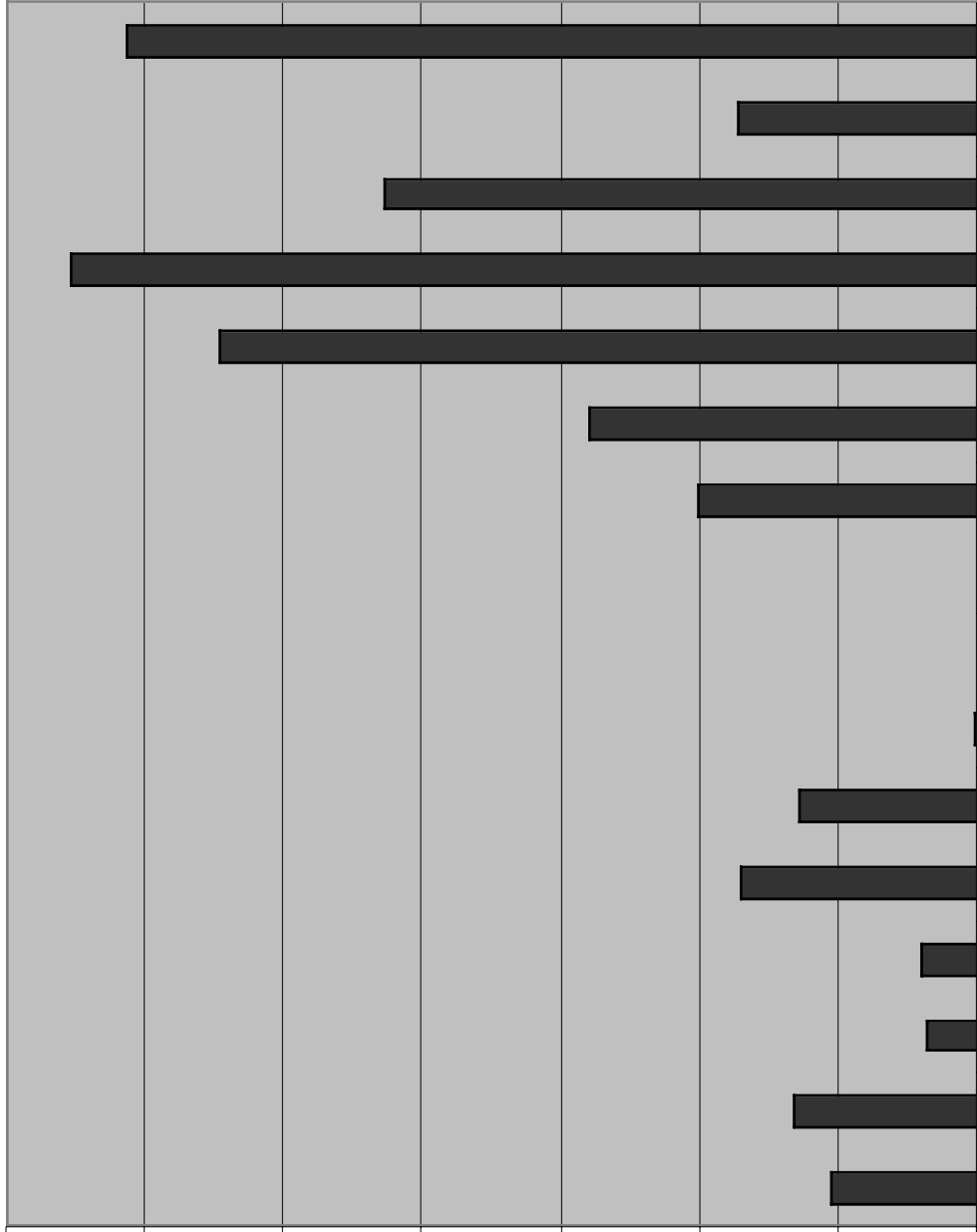
Annualizations

Recent supplemental appropriations bills have mostly funded *annualizations*—recurring expenditures funded by nonrecurring revenue—which logically should be part of the general appropriations bill. In order to assure continuance of the programs funded as annualizations, legislators must fund them from the general appropriations budget—or annualize them—at some future time. For example, annualizations for 2001-02 identified by the Office of State Budget include funding state employee benefits and pay increases, LIFE scholarships, higher education performance funding, and the Medicaid program among many others. These ongoing programs were all funded in 2000-01 using surplus revenues from prior years. In addition, some annualizations are revenue foregone from tax cuts, such as the reduction in the sales tax on food.

In the past four years, on average about 75 percent of supplemental appropriations (including capital reserve fund appropriations) have funded annualizations (Table 6-1). In many cases, total appropriations for recurring programs, including those funded as supplemental appropriations, have been much higher than the amounts



Millions of Dollars



Millions of Dollars

Table 6-1. Percent of Nonrecurring Funds Used for Annualizations, by Source

	1997-98	1998-99	1999-2000	2000-01
Supplemental Appropriations	95.0%	82.4%	64.8%	80.4%
Capital Reserve Fund	40.3%	75.7%	73.4%	82.9%
Supplemental Appropriations plus Capital Reserve Fund	75.3%	79.0%	66.9%	81.2%

included in general appropriations. General appropriations plus annualizations approximate the total recurring general fund spending obligations of the state.²³ A comparison of general appropriations and annualizations funded in supplemental appropriations bills with total actual revenue from 1996-97 to 1999-2000 reveals how the gap between recurring spending obligations and actual revenue has widened—a trend that is not sustainable, as the current budget situation clearly demonstrates (Figure 6-4).

The 2000-01 Budget Shortfall

In 2000-01, the state faced an estimated \$150 million shortfall because

- appropriations from the general fund were higher than the BEA's revised general fund revenue forecast for the year.
- several open-ended spending obligations required more funds than anticipated.

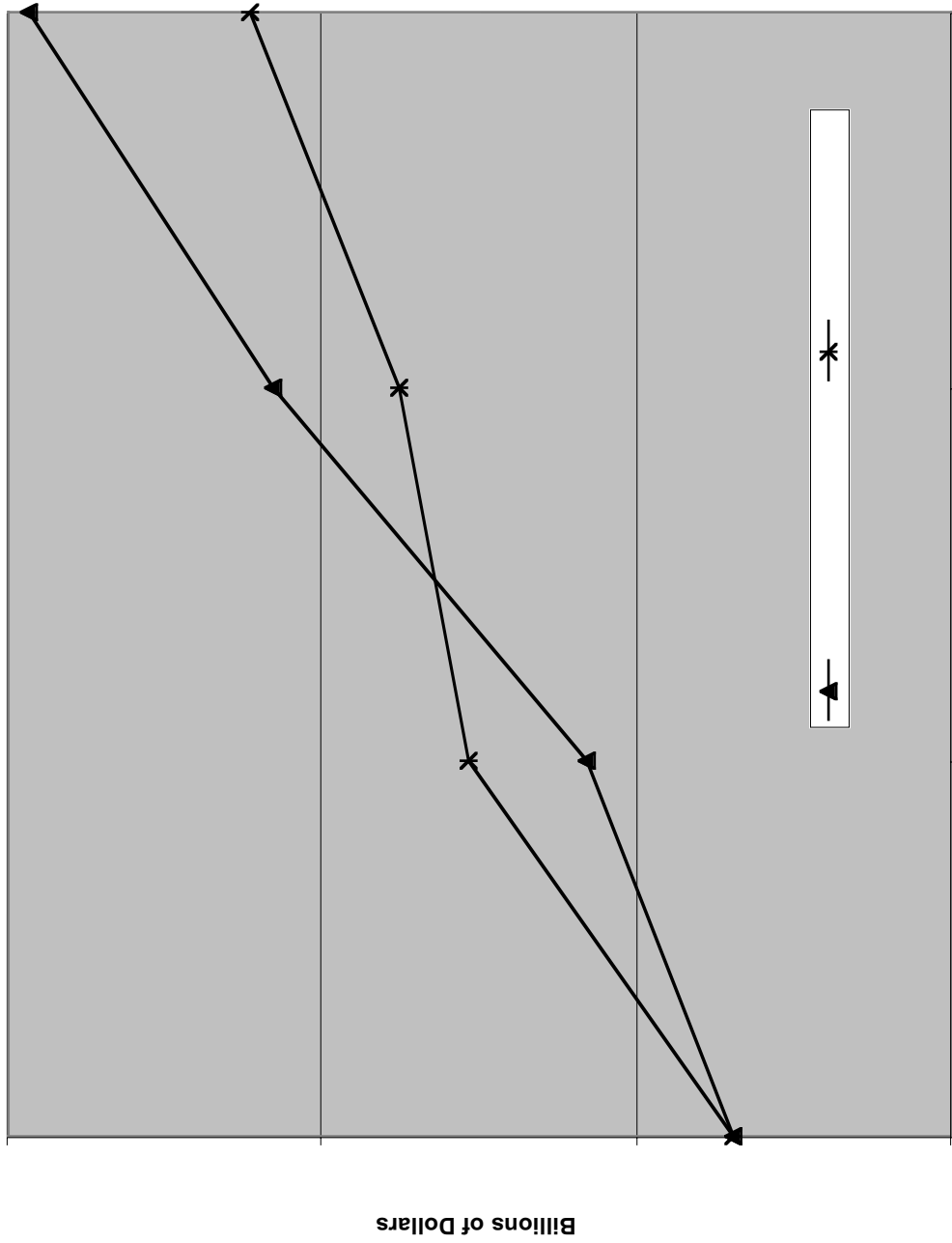
These situations also affect spending in 2001-02.

In such circumstances, the Budget and Control Board is authorized to take action to bring spending in line with revenue. The capital reserve fund is first used to cover the deficit and then spending cuts are ordered if further action is required. Only then will the state's general reserve fund be tapped. These measures ensure that spending does not exceed revenue and were last employed during the recession years of 1990-91 through 1992-93.

Earlier in 2000-01, the Budget and Control Board made the capital reserve fund unavailable for spending in 2001-02 so that it could be used to cover the \$96 million shortfall then forecast for 2000-01. A one percent mid-year budget cut of \$50 million in expenditures from the general fund was later ordered by the Budget and Control Board to cover open-ended appropriations that were coming in higher than anticipated. The cuts were mandated to cover approximately \$38 million in programs not fully funded by the legislature. Of the \$38 million, about \$24 million is tied to property tax breaks and \$6 million is due to the expansion of the LIFE scholarship program.

²³The general appropriations bill may include relatively small amounts of nonrecurring appropriations.

Figure 6-4. Recurring Spending Obligations and Actual Revenue



The state's 2000-01 general fund budget contains many annualizations. New revenue—the additional recurring and nonrecurring revenue above the level in the previous year—available for expenditure in 2000-01 was \$504 million. Of this total, \$184 million was part of the BEA's initial forecast for the year and was appropriated in the general appropriations bill for 2000-01. The remaining \$320 million was nonrecurring revenue consisting of \$130 million in surplus revenue from 1999-2000, \$93 million in surplus revenue from 1998-99, and \$97 million in capital reserve funds from 1999-2000.²⁴ Of this \$320 million, approximately \$260 million was used to fund recurring programs.

The widely reported \$900 million in new revenue for 2000-01 probably included the above amount plus forecast new recurring revenue dedicated to the Trust Fund for Tax Relief (\$52 million), \$195 million from the tobacco settlement and securitization, and \$138 million in bond revenue. Trust fund monies are not available for general appropriation, tobacco settlement funds were segregated from the general fund budget, and bond funds may only be used for designated capital projects.

In 2000-01 the state received a one-time payment of \$165 million from the multistate tobacco settlement agreement. About \$140 million of the settlement funds funded new and ongoing health and social service programs. In future years, around \$30 million in interest is expected to be generated by a health care trust fund created from the proceeds of tobacco revenue securitization. It will be the only revenue from the tobacco monies available for general appropriations. Thus it is likely that funding of the remaining \$110 million in 2000-01 tobacco settlement-funded programs—if they are maintained in future years—will fall to the general fund. In addition, according to the Office of State Budget, another \$90 million in possible annualizations obligations existed in 2000-01 that were not funded with the nonrecurring revenues listed above. The sum of all these annualizations, including a legislated \$12 million revenue reduction, is approximately \$500 million.

The Expected 2001-02 Budget Shortfall

Annualizations in the 2000-01 general fund budget played a significant role in the state's expected budget shortfall for 2001-02. For 2001-02, the BEA's revenue forecast is lower than total ongoing spending obligations in 2000-01. The use of the 2000-01 capital reserve fund to cover the budget shortfall and the likely unavailability of any surplus revenue from that year will prevent the General Assembly from relying on nonrecurring revenue to support spending in 2001-02. This situation has required the General Assembly to cut many agency budgets and slow spending growth in others in its general appropriations act for 2001-02 in order to balance the budget.

²⁴The \$320 million does not include bond revenue or tobacco settlement monies, nor does it include general fund revenue dedicated to the Trust Fund for Tax Relief.

State general fund revenues are forecast by the BEA to increase from \$5,615 million in 2000-01 to \$5,838 million in 2001-02, an increase of \$223 million or 4.0 percent over the level in 2000-01. Although an additional \$223 million in revenue is forecast for 2001-02, the amount of new money available is much less (Table 6-2). *New money* is the general fund revenue (net of the Trust Fund for Tax Relief) in excess of the previous year's general appropriations, not in excess of the previous year's revenue. New money available for 2001-02 is a much smaller \$74 million. Why? General appropriations are expected to exceed general fund revenue in 2000-01 by \$134 million, and the Trust Fund for Tax Relief is forecast to grow by \$15 million from 2000-01 to 2001-02.

Table 6-2. New Money Calculation (in millions)

Forecast General Fund Revenue, 2001-02	\$5,838	
Forecast General Fund Revenue, 2000-01	<u>- 5,615</u>	
New General Fund Revenue		\$223
Trust Fund for Tax Relief, 2000-01	\$433	
Trust Fund for Tax Relief, 2001-02	<u>- 448</u>	
Difference		<u>-15</u>
New General Fund Revenue net of Trust Fund for Tax Relief		\$208
Forecast General Fund Revenue, 2000-01	\$5,615	
General Appropriations, 2000-01*	<u>- 5,749</u>	
Excess 2000-01 Appropriations		<u>- 134</u>
New Money		<u>\$74</u>

*1999-2000 supplemental appropriations allocated \$37 million to pay for enhanced homestead exemption in 2000-01. The amount was counted as 2000-01 appropriations (\$5,712 + \$37 = \$5,749).

According to the Office of the State Budget, South Carolina faces \$565 million in annualization needs for 2001-02. With only \$74 million in new money available, the budget shortfall is \$491 million when annualizations are taken into account. This assumes, however, that general appropriations are held constant at 2000-01 levels without any growth. If general appropriations for 2001-02 are assumed to grow to meet inflation and population growth, then the expected shortfall quickly rises to somewhere in the neighborhood of \$700 million.

If annualizations did not exist, some budget cuts may still have been needed. New money of \$74 million would likely not cover growth in general appropriations due to inflation and population growth. In fact, \$213 million in new money would be required to keep real spending per capita constant at 2000-01 levels.

How Did We Get Here?

Unwise Spending Practices

We cannot continue . . . to use nonrecurring revenues for recurring expenditures.

Earle E. Morris, Jr., Comptroller General
Comprehensive Annual Financial Report for year ended
June 30, 1992

The use of nonrecurring revenue to fund recurring programs can be likened to winning a \$500 prize contest and using the money to make the first payment on a car loan when one's income already just covers the bills. If the General Assembly had spent recent surpluses on capital projects and other one-time expenditures, then the state would not be facing a \$500 million budget shortfall. It might be facing a much smaller shortfall, but not \$500 million.

Assuming that the \$5,712 million appropriated for 2000-01 is representative of what general fund spending would have been without the annualizations, the state would still have had to tighten its belt without the annualizations, as only \$74 million in new money is available for 2001-02. This amount is not enough to cover growth in spending due to inflation and population growth. An additional \$139 million would be needed just to maintain current real spending per capita.

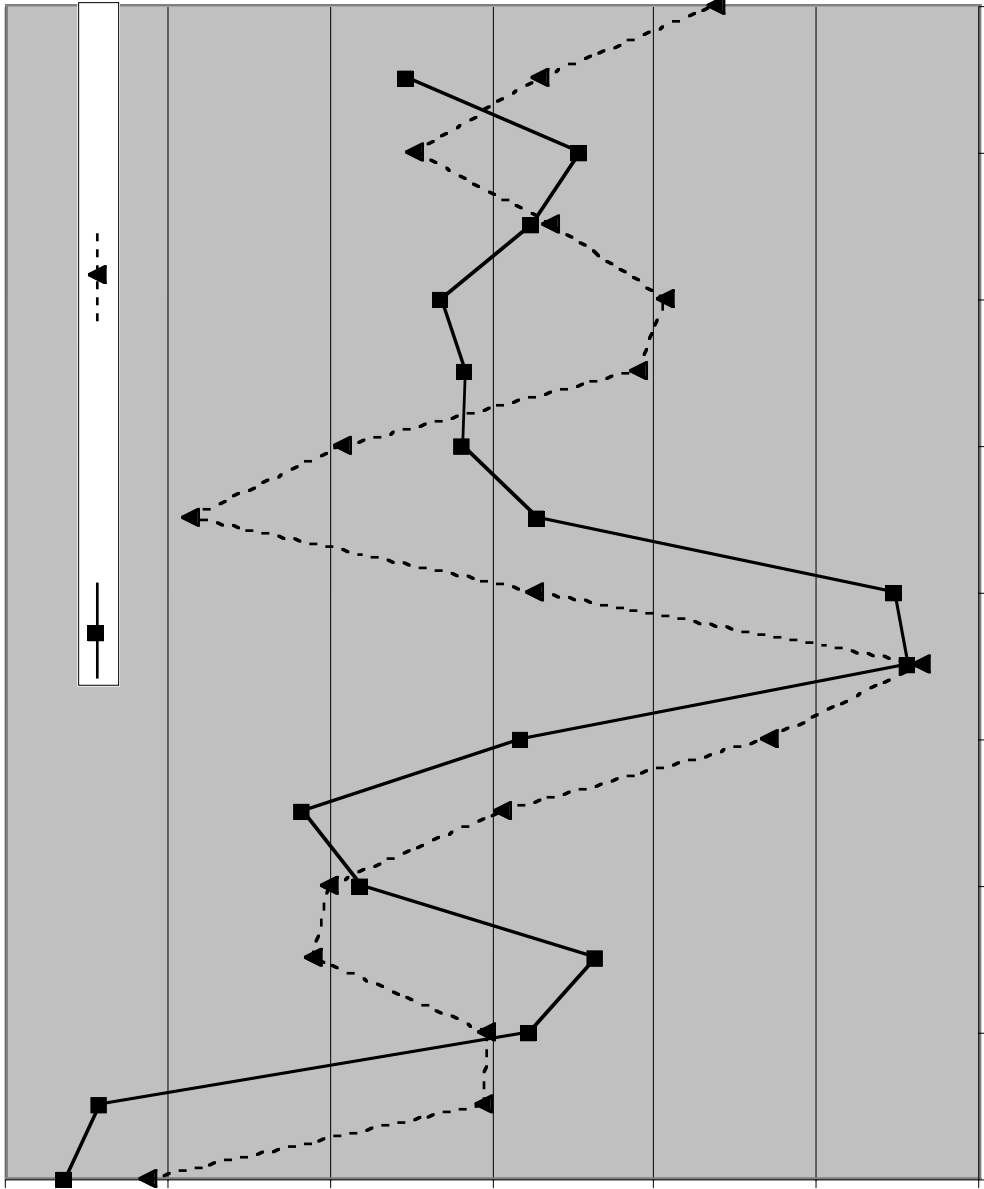
Shifts in the Economy

The main contributor to the current shortfall is the fact that revenue growth, *not revenue*, unexpectedly fell from very high levels. Revenue growth in the BEA's current revenue forecast is about 4.9 percent per year, while in recent years it has been as high as 8 percent. There is risk associated with the fact that the economy, and therefore revenue, cannot be predicted with certainty. Ultimately, the cost associated with that risk falls on citizens of South Carolina. Exactly how the burden is distributed depends on how the system is administered.

If large surpluses are reserved only for one-time expenditures, then the potential beneficiaries of programs initiated with nonrecurring money suffer. If annualizations are allowed, then the beneficiaries of programs that must be cut in order to balance the budget bear the costs. Any compromise must weigh the costs of budget cuts against the costs of not having certain continuing programs in good budget years.

Because the state budget is written in advance of revenue receipts, a lag is created between unexpected changes in revenue and changes in expenditures (Figure 6-5). In the relatively good years, some revenue is usually available to be passed into the next year in the form of supplemental appropriations of surplus, capital reserve funds, and other nonrecurring revenues. This process allows expenditures to temporarily exceed revenues in years when revenue growth slows. Generally, relatively

Figure 6-5. General Fund Revenue and Expenditure Growth (2-yr. moving average)



slow revenue growth will be reflected by slowing expenditures after the fact because slower growth in revenue will generate less surplus and other nonrecurring revenue for passing into the next year, thus the lag between revenue and expenditures.

The existence of the lag between revenues and expenditures itself is not necessarily a problem; it is a fact of life. Problems, such as budget cuts, associated with this lag come when revenue slows enough that the recurring spending obligations of the state cannot be met. Sharp falls in revenue growth, as well as extended periods of slowing revenue growth can create such a situation. Additionally, the usage of non-recurring revenue to create recurring spending obligations increases the likelihood of a shortfall when revenue growth slows. The revenue consequences of unanticipated economic changes are largely beyond the control of budget makers; the appropriation of nonrecurring revenue is entirely under the control of the budget makers.

Tax Relief

Tax relief programs reduce general fund revenue. The state would have this money if these programs were not in place. But would this money be available to bail the state out of its current situation? Probably not. Unless one believes that the money not dedicated to tax relief would have been set aside for a rainy day, the logical conclusion is that without so much tax relief the state would simply have higher expenditures.

Some exceptions to this argument should be noted. First, to the extent that tax relief has altered the structure of the revenue system so that it is more susceptible to economic slowing, then tax relief may have contributed to the current budget shortfall. A prime example of such a relief program is the recent food tax phaseout. Food purchased at grocery stores represents one of the steadiest parts of the sales tax base. People buy food even in bad economic times. Removing this part of the sales tax base would make revenue from the tax more susceptible to economic fluctuations. Other examples include corporate or individual income tax credits that can be exercised at the discretion of the beneficiaries. These programs produce additional uncertainty when forecasting revenue.

Secondly, alternative forms of tax relief could have helped to prevent the current budget shortfall. If tax relief were given as one-time reimbursements when surplus revenue permitted, then fewer annualizations would have been needed. One-time tax reimbursements are essentially identical to one-time expenditures. They can be eliminated when economic slowdowns occur. The fact that most tax relief given by the State of South Carolina has not been contingent upon availability of surplus revenue has indeed contributed to the current budget situation.

Conservative Revenue Forecasts

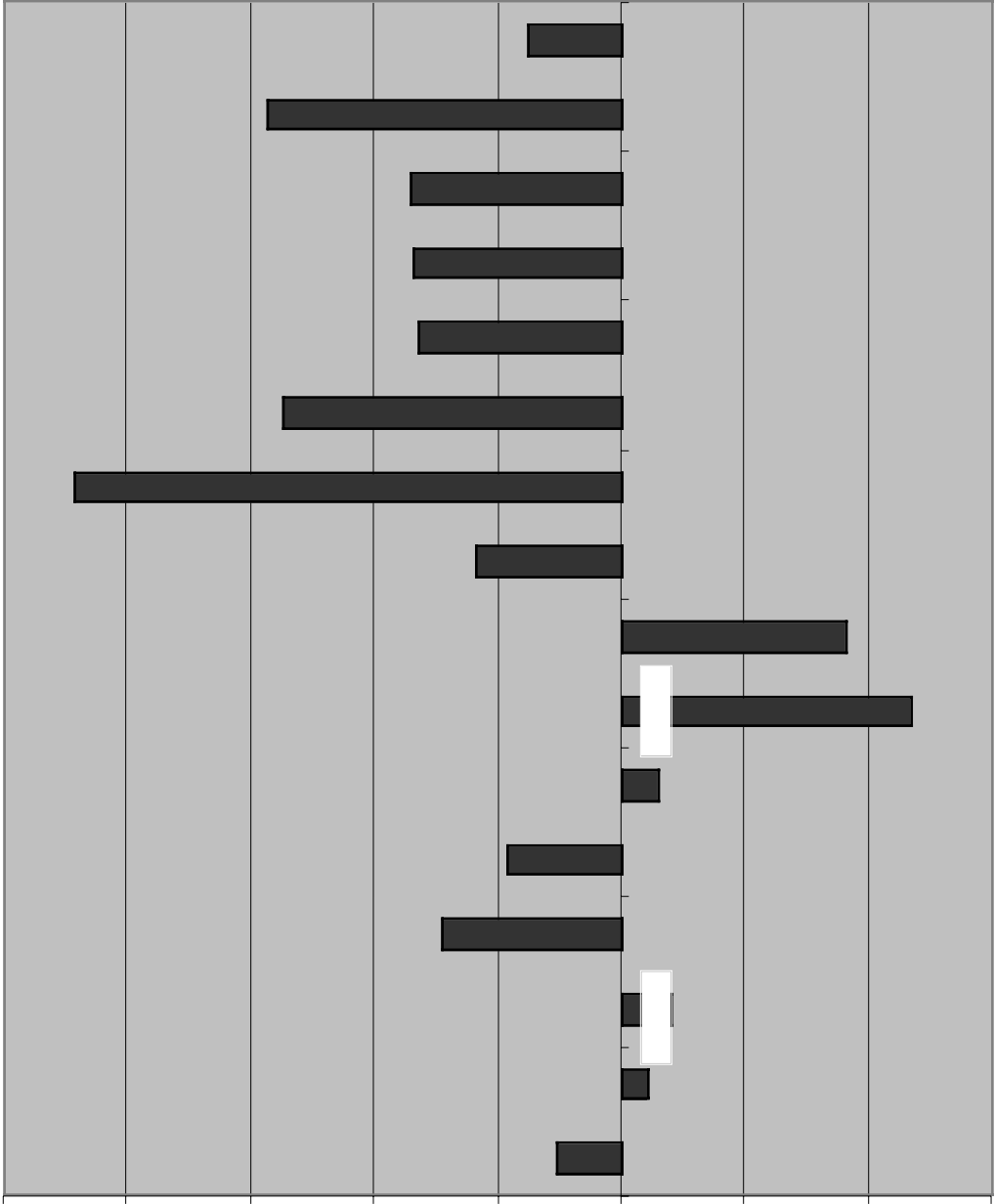
The state has enjoyed large revenue surpluses in recent years. The argument against large surpluses is that they create an expectation in the General Assembly

that more revenue will be available in each fiscal year than is actually forecast by the BEA. In recent years, this expectation has led to spending the excess money on the continuing operations of the state.

Traditionally, surplus money has been designated for use on capital expenditures and other nonrecurring program needs. However, much of the recent surplus revenue has been used to fund recurring programs. Is a BEA that systematically underforecasts revenue responsible for this behavior? The experiment has been performed before here in South Carolina. The previous Board of Economic Advisors produced arguably more accurate revenue forecasts. The average yearly forecast error from 1984-85 to 1989-90 was \$33 million, while the yearly error from 1993-94 to 1999-2000 averaged \$226 million (Figure 6-6). With the previous board, surpluses were smaller, and shortfalls were more common.²⁵ *However, a conservative forecasting strategy is not responsible for the current shortfall.*

Any BEA will have a difficult time forecasting downturns. To understand why a conservative forecasting strategy is not responsible for the current shortfall, one must realize that if the recent revenue forecasts had been more accurate, and therefore higher, those same funds would have been available for spending on the continuing operations of the state through general appropriations, rather than in supplemental appropriations bills. Higher general appropriations make shortfalls more likely when revenue does not perform as expected. To the extent that politicians exercise restraint by spending surplus revenue on conventional nonrecurring programs, the state is less likely to experience a shortfall with a conservative forecasting approach.

²⁵From a theoretical standpoint, if the revenue forecast is completely unbiased, then a shortfall should be just as likely as a surplus, even in good economic times.



Millions of Dollars

Chapter 7

CONCLUSION

The Good News

Where South Carolina's economy and state revenue and expenditure system are concerned, few red flags would indicate the risk of a fiscal catastrophe in the coming decade. For the most part, the state's economy is well diversified among the different sectors. The one troublesome statistic that stands out is South Carolina's reliance on nondurable goods manufacturing, primarily the textile industry. The state ranks second among the 50 states in the percentage of gross state product generated by nondurable goods manufacturing.

The state's revenue system is well balanced among different sources of revenue when compared to most other states and is similar in structure to the U.S. average. South Carolina's two major sources of revenue, the individual income tax and the retail sales tax, are unremarkable in their structures. Both taxes have seen average annual growth since 1984-85 above that needed to keep pace with state population growth and inflation. In particular, the state's individual income tax has become an increasingly important part of the state's general fund revenue base due to its relatively greater responsiveness to changes in personal income.

The structure of the state's revenue system has changed between the 1980s and the 1990s, with the state showing a significant decline in rank among the 50 states in tax revenue per capita combined with a significant increase in rank in revenue from fees and charges. Over this period, however, the state's rank in terms of total general revenue per capita did not change significantly.

In the future, projected revenue is likely to exceed projected expenditure needs, though not by much. Direct comparisons of the low, moderate, and high growth projections for revenue and expenditures show small surpluses in 2010-11.

The Bad News

In its recent budget deliberations, the South Carolina General Assembly faced a general fund budget shortfall of about \$500 million for 2001-02. This shortfall has caused many state agencies to cut programs and lay off employees. The impact of

the budget cuts on corrections, mental health, and revenue departments have received considerable attention.

The spending of nonrecurring revenue on recurring programs is at the heart of the current budget shortfall. These annualizations have accounted on average for three-quarters of supplemental appropriations over the past four years, making it inevitable that a shortfall would occur when revenue growth slowed. In the just completed fiscal year of 2000-01, close to \$500 million in recurring expenditures were funded out of nonrecurring revenue. Nonrecurring revenue from two previous fiscal years was available for spending in 2000-01 and was used to cover many of these annualizations. But little or no surplus revenue will be available to use in 2001-02. In addition, continuing slower revenue growth caused the Budget and Control Board to make the 2000-01 capital reserve fund unavailable for appropriation for 2001-02.

The 2001-02 shortfall would have been even higher had it included an increase in general appropriations to account for inflation and population growth. Expenditures generally grow from one year to the next, even without legislative adjustments. Cost of living increases to state employees and rising prices of goods and services purchased by state agencies cause spending to grow at close to the rate of inflation. Population increases in client groups and mandated and elective program changes also drive up spending. Even if state general fund spending per capita were held constant from year to year in inflation-adjusted dollar terms, total dollar spending would still need to grow enough to cover price increases and population growth.

Based on projections in this report, future revenue probably will exceed future spending obligations, particularly in later years. Chances of near term shortages remain. In several scenarios, relatively high spending growth coupled with relatively low revenue growth could create a need for more budget cuts. In addition, the margins by which revenues exceed expenditures are as low as \$48 million, increasing the possibility of negative consequences from an unexpected economic downturn.

Managing the Budget for the Future

The current situation in South Carolina does not represent the first time a state has had to cut its budget. In times of moderate to severe economic downturns, even the most frugal of states must make cutbacks. But while budget shortfalls cannot always be prevented, some actions can be taken to reduce the likelihood of significant budget shortfalls, particularly in years with positive revenue growth such as South Carolina is experiencing at the present time.

Limit Annualizations

Arguably the most important contributor to the current budget shortfall was the appropriation of large amounts of nonrecurring revenue for recurring expenditures.

This is foolish behavior, the consequences of which are predictable, had been predicted, and are now being felt in South Carolina. Windfall revenue occurs randomly and, therefore, should not be expected. Restraint must be exercised when appropriating it.

The capital reserve fund has repeatedly been used to finance recurring expenditures, yet legislation clearly exists that specifically defines the proper use of the fund. The South Carolina Code²⁶ puts it this way:

Revenues in the Capital Reserve Fund only may be used in the following manner: (a) to finance in cash previously authorized capital improvement bond projects; (b) to retire interest or principal on bonds previously issued; (c) for capital improvements or other *nonrecurring purposes* [emphasis added].

Part of the key to eliminating annualizations, then, is enforcing the rules that are already in place.

Link Tax Relief to Revenue Availability

One way to limit annualizations—while also providing tax relief that does not sacrifice the stability of the tax base—is to offer lump-sum tax reimbursements when revenue surpluses occur. All of the surplus need not be given back. It is also quite possible to provide incentives by tying the rebates to certain types of behavior by firms or individuals. Help also could be given to the needy based on income. Some states have adopted similar approaches.

Ohio has reduced income tax rates for six years when large surpluses were realized, but probably not this year because of economic conditions. Oregon has a *kicker law* that mandates tax rebates when revenue exceeds 102 percent of projection. This law was created by a constitutional referendum in fall 2000. Rebates are tied to the income tax. Colorado and Missouri have similar statutes requiring rebates when a revenue or spending limit is reached. Colorado's rebate is technically a sales tax rebate. Minnesota recently announced a sales tax rebate of almost \$800 million—the third in as many years—paid from surplus revenue. Individual rebate checks vary according to taxpayer income.

Make Entitlement Programs More Flexible

The existence of entitlement programs creates ongoing revenue needs. Entitlement programs can either be closed-ended or open-ended. A closed-ended entitlement guarantees program services based on the availability of revenue. This type of program allows some flexibility in the budget that could mitigate the need for budget cuts. An open-ended entitlement guarantees program services regardless of revenue availability. The programs must either be funded or cut when the economy turns sour. A mix of entitlements that is more heavily weighted toward the closed-ended type will help alleviate the need for budget cuts.

²⁶S.C. Code of Laws, Title 11, Chapter 11, Article 3, Section 11-11-320.

Maintain the Stability of the Tax Base

Attention should be given to the effects of tax relief programs on the tax base. The recent turnaround in plans for the full phaseout of the tax on groceries is a prime example. This type of tax relief would sacrifice more than 10 percent of perhaps the most stable part of the retail sales tax base. The same amount of relief could be given, and better targeted, without causing the same instability in the tax base by using individual income tax credits, exemptions, or deductions based on levels of household income.

Consideration could also be given to extending the sales and use tax to services, a potential tax base that is relatively untaxed. In addition, services tend to be more heavily consumed by wealthier individuals making a sales tax on services somewhat less regressive than a sales tax on essential goods. Furthermore, existing exemptions to the sales tax could also be revisited and critiqued for their incentive effects versus their revenue costs.

Other tax relief programs, such as job tax credits, add uncertainty to the revenue forecast because the beneficiaries are allowed some discretion on when they exercise the credits. Stricter rules concerning the timing of credits could alleviate some of the uncertainty while maintaining most of the incentive effects of the credits.

Maintain a Conservative Approach to Revenue Forecasting

If many of the preceding recommendations are to work, a conservative revenue forecasting approach must be maintained for the following reason: forecast revenue is available for general appropriations, and therefore available for expenditure on recurring programs. A forecast system aimed at producing accurate forecasts in very good years will drive up spending on entitlements, putting the state in the same position it is in now.

If a less conservative approach is adopted, then additional rules concerning allowable spending limits on recurring programs from general appropriations must follow to ensure that large amounts of forecast revenue in the good years do not create programs that cannot be funded in the slower years.

Final Comments

Many legislators, governors, and budget analysts over many years have pondered how to spend in the good times without having to face budget cuts in the bad times. In South Carolina, spending limits have been imposed, and additional reserve funds have been set aside.

Government programs do often get cut to make room for other priorities. This is part of the political process. However, the need for across-the-board budget cuts will not arise without the occurrence of some unexpected economic change. Even the

most myopic legislative body will not create a budget crisis when the economy performs as expected. Unwise spending practices are unwise because inevitably unanticipated slowdowns occur.

No policy can ensure that future budget cuts will never be needed, and costs are associated with trying to eliminate the need for cuts. For example, the potential returns that could be generated by funds otherwise tied up in large reserve accounts would likely outweigh the benefits associated with avoiding an occasional budget cut. The Council on Budget and Policy Priorities states that at least 40 states in the United States currently do not hold enough reserves to weather a moderate recession without cutting budgets or raising taxes. Some budget cuts will inevitably occur.

The ultimate question every legislature must answer is: what circumstances are considered reasonable enough to merit a budget cut? After those reasonable circumstances are defined, courses of action are available to provide some level of assurance that budget cuts will only be needed under those circumstances. No plan is perfect.

Whether or not the pattern of large annualizations and consequential budget cuts represents the optimal policy for South Carolina remains a question only the General Assembly can answer. If South Carolinians wish to avoid these circumstances in the future, then changes to the revenue appropriation process must occur.

Postscript: Comptroller General's Preliminary Report for 2000-01 (August 17, 2001)

According to the Comptroller General, South Carolina received general fund revenue of \$5,080 million in 2000-01 and spent \$5,422 million. The 2000-01 capital reserve fund of \$98.6 million and a midyear agency budget cut of \$48.1 million were not sufficient to make up the deficit, and so an additional \$87.4 million was transferred from the state's general reserve fund. South Carolina has no surplus revenue for appropriation in 2001-02, and the current general reserve fund balance stands at \$60.5 million, or only approximately a third of the required level for 2001-02.

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APPENDICES

Appendix A

REVENUE PROJECTIONS

Table A-1. Projection Based on Total Revenue

Table A-2. Revenue Projection by Components, High Growth Scenario

Table A-3. Revenue Projection by Components, Moderate Growth Scenario

Table A-4. Revenue Projection by Components, Low Growth Scenario

Table A-1. Projection Based on Total Revenue (in millions)

Total Revenue Projection	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11
Upper Bound	5,915	6,248	6,596	6,962	7,346	7,750	8,174	8,620	9,088	9,581
Projection ^a	5,915	6,236	6,573	6,925	7,295	7,683	8,091	8,519	8,968	9,440
Lower Bound	5,915	6,225	6,549	6,888	7,244	7,616	8,008	8,418	8,848	9,299

^aIncludes revenue transferred to Trust Fund for Tax Relief.

Table A-2. Revenue Projection by Components, High Growth Scenario (in millions)

Revenue Category	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11
Retail Sales Tax	2,165	2,274	2,389	2,509	2,636	2,769	2,908	3,055	3,209	3,370
PLUS: Incr. Use Tax Compliance	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Excise, Casual Sales Tax	18	19	20	21	22	23	25	26	27	28
LESS: Sales Tax Holiday	(4)	(4)	(4)	(4)	(4)	(4)	(4)	(5)	(5)	(5)
Net Sales Taxes	2,180	2,290	2,405	2,527	2,654	2,788	2,928	3,076	3,231	3,394
Net Individual Income Tax ^a	2,782	2,969	3,169	3,382	3,609	3,851	4,110	4,386	4,681	4,996
Net Corporate Income Tax ^a	208	208	208	208	208	208	208	208	208	208
Sales & Income Taxes	5,170	5,467	5,782	6,116	6,471	6,847	7,247	7,670	8,120	8,598
Other Base Sources	750	786	811	840	871	901	939	970	1,016	1,048
Total General Fund Revenue	5,921	6,253	6,593	6,956	7,342	7,748	8,185	8,640	9,136	9,646

^aIncludes revenue transferred to Trust Fund for Tax Relief.

Table A-3. Revenue Projection by Components, Moderate Growth Scenario (in millions)

Revenue Category	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11
Retail Sales Tax	2,163	2,270	2,383	2,501	2,625	2,754	2,891	3,034	3,184	3,342
PLUS: Incr. Use Tax Compliance	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Excise, Casual Sales Tax	18	19	20	21	22	23	25	26	27	28
LESS: Sales Tax Holiday	(4)	(4)	(4)	(4)	(4)	(4)	(4)	(5)	(5)	(5)
Net Sales Taxes	2,178	2,286	2,399	2,518	2,643	2,774	2,911	3,055	3,207	3,365
Net Individual Income Tax ^a	2,779	2,962	3,158	3,366	3,589	3,825	4,078	4,347	4,634	4,940
Net Corporate Income Tax ^a	208	208	208	208	208	208	208	208	208	208
Sales & Income Taxes	5,165	5,456	5,765	6,092	6,439	6,807	7,197	7,610	8,048	8,513
Other Base Sources	750	786	811	840	871	901	939	970	1,016	1,048
Total General Fund Revenue	5,916	6,243	6,577	6,932	7,310	7,708	8,136	8,580	9,065	9,561

^aIncludes revenue transferred to Trust Fund for Tax Relief.

Table A-4. Revenue Projection by Components, Low Growth Scenario (in millions)

Revenue Category	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11
Retail Sales Tax	2,160	2,263	2,371	2,484	2,602	2,726	2,856	2,992	3,135	3,285
PLUS: Incr. Use Tax Compliance	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Excise, Casual Sales Tax	18	19	20	21	22	23	25	26	27	28
LESS: Sales Tax Holiday	(4)	(4)	(4)	(4)	(4)	(4)	(4)	(5)	(5)	(5)
Net Sales Taxes	2,174	2,278	2,387	2,501	2,620	2,745	2,877	3,014	3,158	3,309
Net Individual Income Tax ^a	2,773	2,949	3,137	3,336	3,548	3,774	4,014	4,269	4,541	4,830
Net Corporate Income Tax ^a	208	208	208	208	208	208	208	208	208	208
Sales & Income Taxes	5,155	5,435	5,732	6,045	6,377	6,727	7,099	7,491	7,907	8,346
Other Base Sources	750	786	811	840	871	901	939	970	1,016	1,048
Total General Fund Revenue	5,906	6,222	6,543	6,885	7,248	7,628	8,037	8,461	8,923	9,394

^aIncludes revenue transferred to Trust Fund for Tax Relief.

Appendix B

FUNCTIONAL EXPENDITURE AREAS

Higher Education

State universities and technical colleges, Commission on Higher Education, Higher Education Tuition Grants, Technical and Comprehensive Education Board, Consortium of Community Teaching Hospitals.

Education

Department of Education, Educational Television Commission, State Library, Department of Archives and History, Museum Commission, Arts Commission, Wil Lou Gray Opportunity School, School for the Deaf and Blind, vocational rehabilitation.

Health and Social Rehabilitation

Departments of Social Services; Health and Human Services; Health and Environmental Control; Mental Health; Disabilities and Special Needs; and Alcohol and Other Drug and Drug Abuse Services. John De La Howe School, Housing Finance and Development, Commission for Minority Affairs, Human Affairs Commission and Commission for the Blind.

Corrections

Department of Corrections, Department of Probation, Parole and Pardon Services and Department of Juvenile Justice.

Debt Service

The state's principal and interest payments on general obligation debt.

All Other Spending

Agencies, boards, commissions, and departments in these areas: legislative, judicial, public safety, conservation, natural resources, economic development, regulatory, transportation, and aid to local governments.

Source: South Carolina Office of State Budget. *Historical Analyses*. September 2000.

Appendix C

EXPENDITURE PROJECTIONS

Table C-1. Projection Based on Total Appropriations

Table C-2. Projection by Expenditure Categories, High Growth Scenario

Table C-3. Projection by Expenditure Categories, Moderate Growth Scenario

Table C-4. Projection by Expenditure Categories, Low Growth Scenario

Table C-1. Projection Based on Total Appropriations (in millions)

	Final Act	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Total Expenditures Projection	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11
Upper Bound	6,020	6,331	6,657	6,998	7,355	7,730	8,123	8,535	8,966	9,419
Projection ^a	6,020	6,315	6,624	6,946	7,283	7,636	8,006	8,393	8,797	9,221
Lower Bound	6,020	6,299	6,590	6,895	7,212	7,543	7,889	8,251	8,629	9,024

^aIncludes Trust Fund for Tax Relief.

Table C-2. Projection by Expenditure Categories, High Growth Scenario (in millions)

	Final Act	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Expenditure Category	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11
Higher Education	915	957	1,000	1,037	1,071	1,107	1,144	1,188	1,247	1,313
Educational	2,016	2,121	2,230	2,346	2,466	2,593	2,727	2,867	3,014	3,169
Health & Social Rehabilitation	1,100	1,168	1,240	1,315	1,395	1,479	1,567	1,660	1,758	1,861
Correctional	386	416	447	481	516	553	593	634	679	725
Debt Service	188	350	366	383	400	422	445	470	496	524
All Other Appropriations	967	1,007	1,049	1,092	1,137	1,184	1,232	1,283	1,335	1,390
Total w/o TFTR ^a	5,572	6,020	6,333	6,653	6,985	7,338	7,708	8,103	8,529	8,983
TFTR ^a	448	464	481	498	516	535	554	574	594	616
Total General Fund Expenditures	6,020	6,484	6,813	7,151	7,501	7,872	8,262	8,676	9,123	9,598

^aTrust Fund for Tax Relief.

Table C-3. Projection by Expenditure Categories, Moderate Growth Scenario (in millions)

Moderate Growth Scenario Expenditure Category	Final Act 2001-02	Proj. 2002-03	Proj. 2003-04	Proj. 2004-05	Proj. 2005-06	Proj. 2006-07	Proj. 2007-08	Proj. 2008-09	Proj. 2009-10	Proj. 2010-11
Higher Education	915	957	1,000	1,037	1,071	1,107	1,144	1,188	1,247	1,313
Educational	2,016	2,121	2,230	2,346	2,466	2,593	2,727	2,867	3,014	3,169
Health & Social Rehabilitation	1,100	1,168	1,240	1,315	1,395	1,479	1,567	1,660	1,758	1,861
Correctional	386	416	447	481	516	553	593	634	679	725
Debt Service	188	292	305	319	333	352	371	392	413	436
All Other Appropriations	967	1,007	1,049	1,092	1,137	1,184	1,232	1,283	1,335	1,390
Total w/o TFTR ^a	5,572	5,961	6,272	6,589	6,919	7,267	7,634	8,024	8,446	8,895
TFTR ^a	448	464	481	498	516	535	554	574	594	616
Total General Fund Expenditures	6,020	6,425	6,752	7,088	7,435	7,802	8,188	8,598	9,040	9,511

^aTrust Fund for Tax Relief.

Table C-4. Projection by Expenditure Categories, Low Growth Scenario (in millions)

Low Growth Scenario Expenditure Category	Final Act 2001-02	Proj. 2002-03	Proj. 2003-04	Proj. 2004-05	Proj. 2005-06	Proj. 2006-07	Proj. 2007-08	Proj. 2008-09	Proj. 2009-10	Proj. 2010-11
Higher Education	915	957	1,000	1,037	1,071	1,107	1,144	1,188	1,247	1,313
Educational	2,016	2,083	2,153	2,229	2,304	2,381	2,461	2,541	2,619	2,693
Health & Social Rehabilitation	1,100	1,168	1,240	1,315	1,395	1,479	1,567	1,660	1,758	1,861
Correctional	386	416	447	481	516	553	593	634	679	725
Debt Service	188	292	305	319	333	352	371	392	413	436
All Other Appropriations	967	1,007	1,049	1,092	1,137	1,184	1,232	1,283	1,335	1,390
Total w/o TFTR ^a	5,572	5,924	6,194	6,472	6,756	7,055	7,368	7,698	8,051	8,419
TFTR ^a	448	464	481	498	516	535	554	574	594	616
Total General Fund Expenditures	6,020	6,388	6,675	6,970	7,272	7,590	7,922	8,272	8,645	9,035

^aTrust Fund for Tax Relief.