

State Budget Outlook

“The Breach”

Mike Shealy
SC Senate Finance Committee

SC State Budget

(expenditures in FY07-08)

- General Funds \$7.04 Billion
- Federal Funds \$6.21 Billion
- Other Funds \$6.95 Billion

TOTAL: \$20.20 Billion

SC Personal Income \$140 Billion

(Budget is about 14% or 1/7th of economy)

Top 10 Statewide Other Fund Revenue Sources Fiscal Years 1994-95 and 2007-08

	Description	Amounts		Difference	Avg Annual % Change
		1994-95	2007-08		
	<u>Other Funds - Earmarked/Restricted</u>				
1	University Fees	428,475,336	1,511,136,830	1,082,661,494	10.2%
2	Sales Tax - EIA	366,650,309	607,243,384	240,593,075	4.0%
3	Medicare and Medicaid Reimbursements	375,563,268	462,834,903	87,271,635	1.6%
4	Gasoline Tax	214,376,940	411,573,221	197,196,281	5.1%
5	Auxiliary Enterprises - Sales and Services	182,278,795	279,654,562	97,375,767	3.3%
6	Lottery Proceeds	-	272,128,271	272,128,271	-
7	Contributions Hospitals/ Medicaid Hospital MIAA	93,746,470	261,226,527	167,480,057	8.2%
8	Medicaid CPE	-	198,539,310	198,539,310	-
9	Motor Vehicle Licenses	-	140,585,117	140,585,117	-
10	Special Fuel Tax	68,591,714	119,242,054	50,650,340	4.3%
	Totals	1,729,682,832	4,264,164,179	2,534,481,347	7.2%
	Note: The listing of the top 10 Other Funds sources represents 61% of the total of \$6,961,822,609.				

Top 10 Statewide Federal Revenue Sources Fiscal Years 1994-95 and 2007-08

	Description	Amounts		Difference	Avg Annual % Change
		1994-95	2007-08		
	Federal Funds				
1	DHHS Medicaid (MAP) Assistance Payments	1,443,188,191	2,521,008,241	1,077,820,050	4.4%
2	DSS Food Stamp Coupons	301,893,005	680,075,828	378,182,823	6.4%
3	DOT Federal Grants	245,045,118	425,585,936	180,540,818	4.3%
4	DHHS Disproportionate Share	93,746,470	305,524,767	211,778,297	9.5%
5	SDE School Food Services - District	93,806,685	194,634,741	100,828,056	5.8%
6	SDE Chapter I - Low Income	87,104,395	173,346,911	86,242,516	5.4%
7	SDE Title VI Part B Handicapped	29,305,979	168,520,323	139,214,344	14.4%
8	DHHS Medicaid Asst Pymts - Refund Prior Yr Expenditure	-	131,224,293	131,224,293	-
9	DSS Temporary Assistance to Needy Families	-	116,943,266	116,943,266	-
10	MUSC Health Services Research and Development Grants	39,884,506	116,724,042	76,839,536	8.6%
	Totals	2,333,974,349	4,833,588,348	2,499,613,999	5.8%
	Note: The listing of the top 10 Federal Funds sources represents 70% of the total of \$6,875,615,239.				

Breach

Pronunciation: \brēch\

Function: *noun*

Etymology: Middle English *breche*, from Old English *bræc* act of breaking; akin to Old English *brecan* to break

Date: before 12th century

1: infraction or violation of a law, obligation, tie, or standard

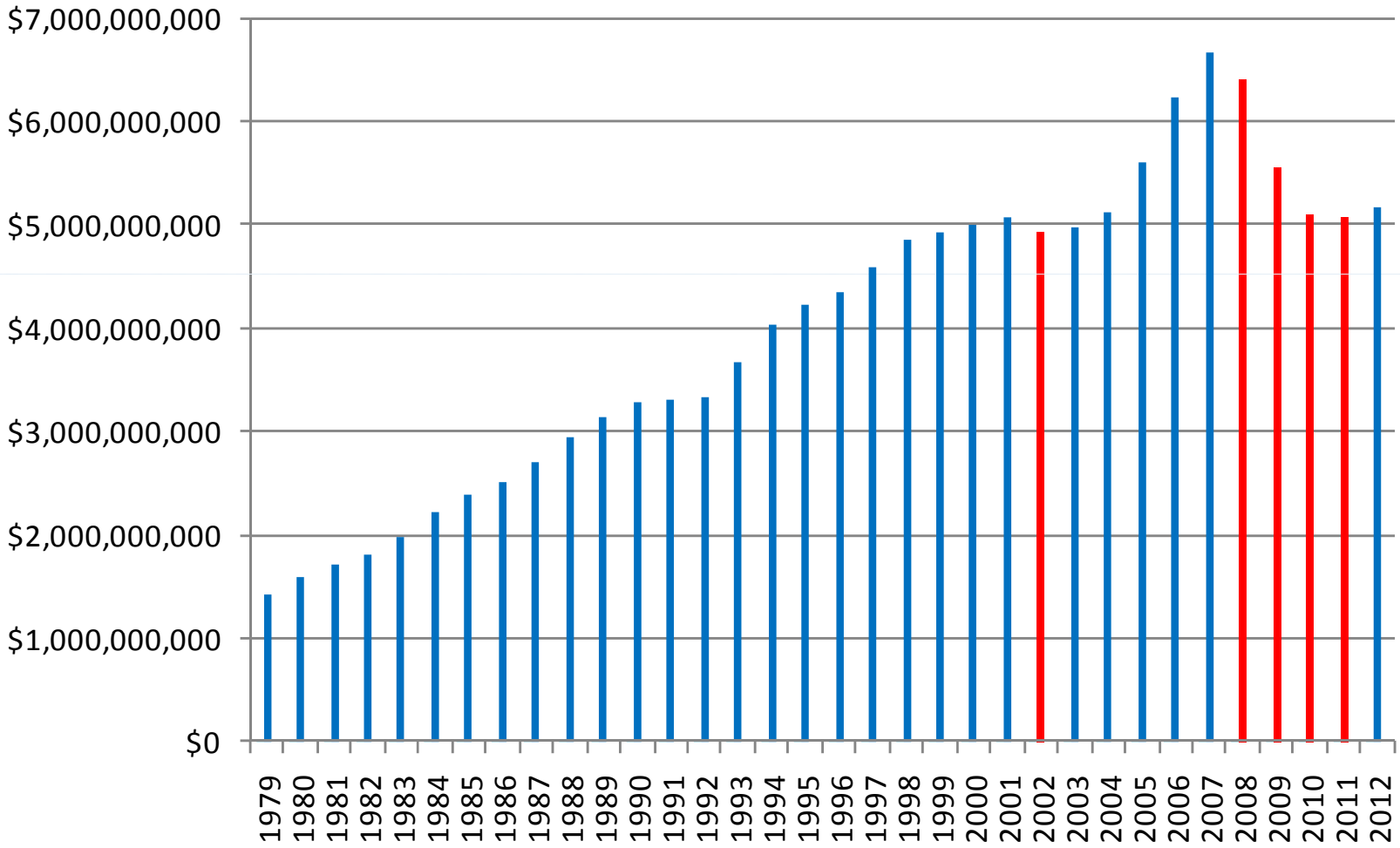
2: a broken, ruptured, or torn condition or area **b:** a gap (as in a wall) made by battering

3: a break in accustomed friendly relations **b:** a temporary gap in continuity

Unusual Circumstances Over the Past 12 Months

- General Assembly returns October 20-24, 2008 to pass Recission Bill in 5 days (-\$488M)
- HR1 American Recovery & Reinvestment Act, Budget Stabilization Fund (Supreme Court Order of 6/4/09)
- Senate Concurrence to House Amendment on H3560, the General Appropriation Bill on 5/13/09 (no Budget Conference Committee)

General Fund Collections



General Fund Revenue Collections

Average Annual Percent Change

FY 1980 - FY 2010

<u>1980</u>	<u>1990</u>	
1,598,097,635	3,294,770,987	7.5%
<u>1990</u>	<u>2000</u>	
3,294,770,987	5,006,736,929	4.3%
<u>2000</u>	<u>2010</u>	
5,006,736,929	5,085,590,670	0.2%
<u>2002</u>	<u>2007</u>	
4,929,959,859	6,658,502,908	6.2%
<u>2007</u>	<u>2010</u>	
6,658,502,908	5,085,590,670	-8.6%

From the peak of General Fund
Revenue collections in FY2006-07
through FY2009-10 (forecast)

Collections have dropped
\$1.57 Billion or 23.6%.

What were we thinking?

Incorrect Assumption: Revenue growth from FY04-05 through FY06-07 was recovery from “9/11” recession.

Reality: The revenue growth was a bubble mirroring the economic bubble caused partially by mortgage financing and other forms of borrowing.

Assumptions of Bubbles

**Economic: Housing prices will
always increase.**

**General Fund: Revenues will
always increase.**

Summary of Revenue Shortfall FY 2008-09

FY 2008-09 Appropriation Act Revenue Estimate (Net of Tax Relief Trust Fund)	6,718,657,837	
BEA Forecast Reduction July 21, 2008	(140,000,000)	
BEA Forecast Reduction October 8, 2008	(414,000,000)	
BEA Forecast Reduction November 7, 2008	(135,100,507)	
BEA Forecast Reduction December 10, 2008	(230,000,000)	
BEA Forecast Reduction March 11, 2009	(64,000,000)	
BEA Forecast Reduction June 11, 2009	<u>(92,000,000)</u>	
Total BEA Revenue Forecast Reductions		(1,075,100,507)
Additional Revenue Shortfall (FM13)		(129,784,560)
Open-Ended Appropriations		
Homestead Exemption Fund Shortfall	(52,995,831)	
DOC & DJJ Deficits (Recognized by B&C Board)	(51,795,768)	
Other Open-Ended Accounts	<u>(4,512,014)</u>	
Total Open-Ended Appropriations		<u>(109,303,613)</u>
Total Year End General Fund Shortfall		(1,314,188,680)
FY 2008-09 General Assembly and Budget & Control Board Actions		
B&CB Action 8/08/08--Reduce Capital Reserve Fund	133,170,058	
FY 08-09 Appropriation Rescission Act- Targeted Agency Reductions-Oct 2008	487,906,416	
B&CB Action 12/11/08--7% Across the Board Agency Reductions	383,475,665	
B&CB Action March 18--2% Across the Board Agency Reductions	<u>101,894,963</u>	
Total General Assembly and B&C Board Actions		1,106,447,102
Agency Lapsed Funds and Sustained Vetoes		<u>1,428,054</u>
Remaining Year End General Fund Shortfall		(206,313,524)
General Reserve Fund Balance Applied to Shortfall		<u>108,096,907</u>
FY 2008-09 Year End Deficit Remaining After Reserve Funds Applied		<u>(98,216,617)</u>

Summary of Revenue Shortfall FY 2009-10

FY 2009-10 Appropriation Act Revenue Estimate (Net of Tax Relief Trust Fund)	5,529,491,371
BEA Forecast Reduction June 11, 2009	(120,000,000)
BEA Forecast Reduction July 16, 2009	(208,300,000)
BEA Forecast Reduction November 10, 2009	(122,382,090)
BEA Homestead Exemption & Tax Relief Trust Fund Shortfall Nov 09	(1,767,239)
Total BEA Reductions to Date	(452,449,329)
FY 2009-10 General Assembly and Budget Control Board Actions	
B&CB Action 6/29/09--Reduce Capital Reserve Fund (CRF) effective 7/1/09	120,000,000
B&CB Action 9/3/09--Apply Remaining Balance of CRF (\$7.8m) and 4.04% Across the Board Agency Reductions (\$200.4m)	208,300,000
Total General Assembly and B&C Board Actions	<u>328,300,000</u>
FY 2009-10 Estimated Year End Deficit Remaining To Date	(124,149,329)

BEA General Fund Forecast Revision FY2009-10 (11/10/09)

\$-124,149,329

Equates to a 2.6% ATB cut

FY2010-11 General Fund Revenue Forecast (11/10/09)

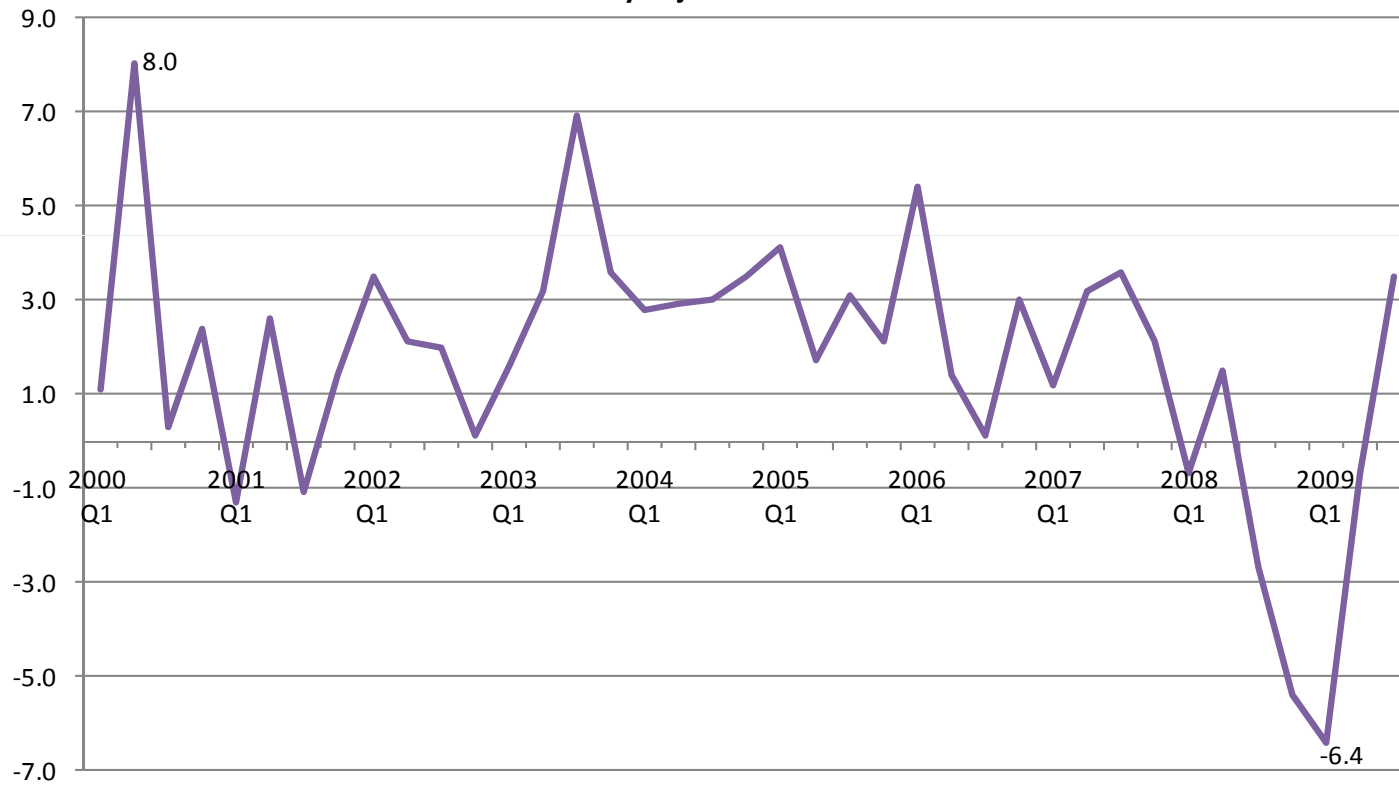
- Flat (no growth).
- Long Range Forecast for FY2011-12 and beyond is an average 2.0% growth rate.

How Did We Get Here?

- The National Recession
- The Structure of Our State Revenue System
- Taxation and Spending Policies

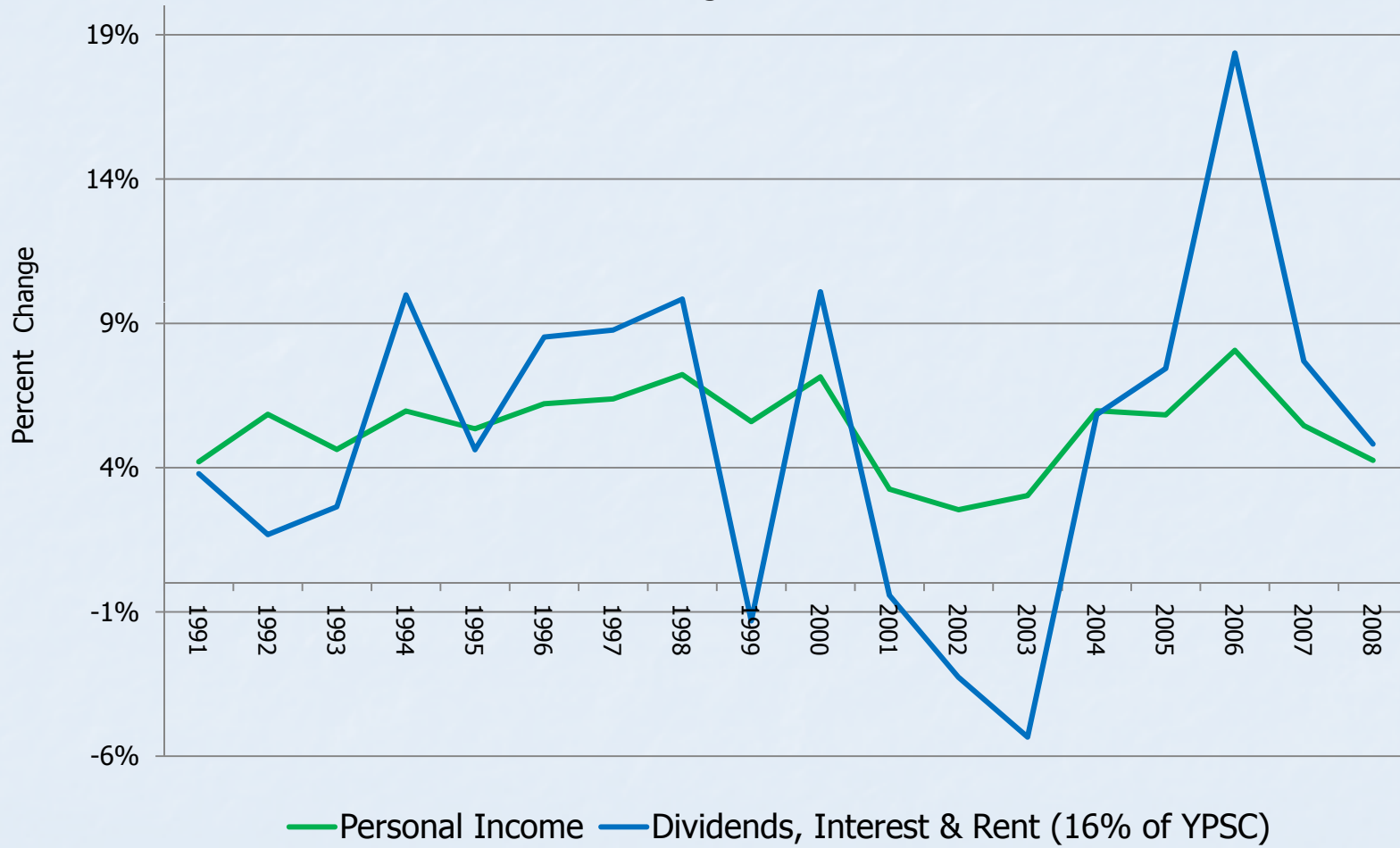
The National Recession and Its Effects on the State Economy

**Real GDP Growth by Quarter
2000 - 2009 Q3
Seasonally Adjusted Annual Rates**



South Carolina Total Personal Income and Dividends, Interest and Rent Income

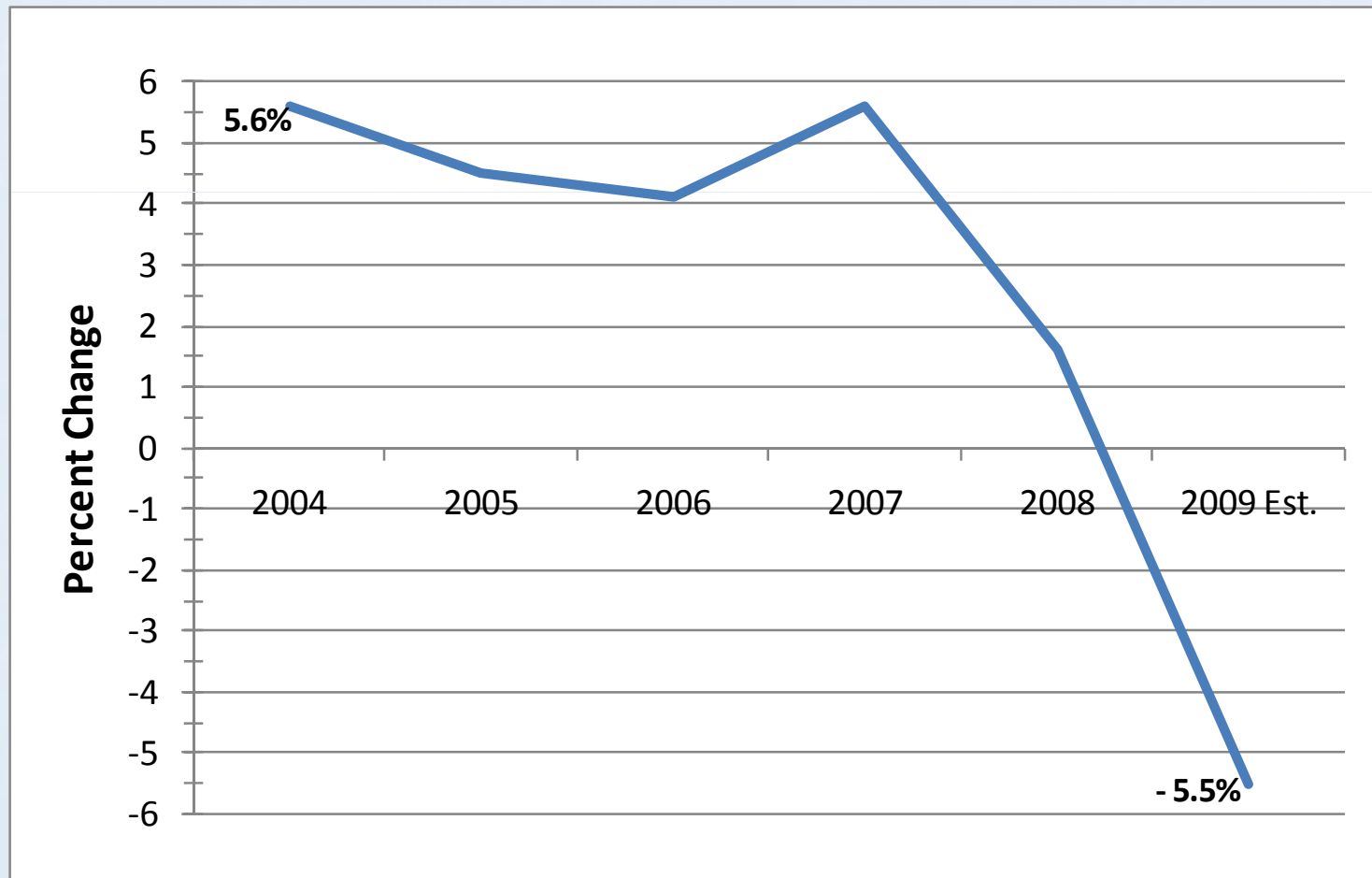
Percent Change from Previous Year



Consumer Credit Outstanding

2004 – 2009 Q3

Seasonally Adjusted

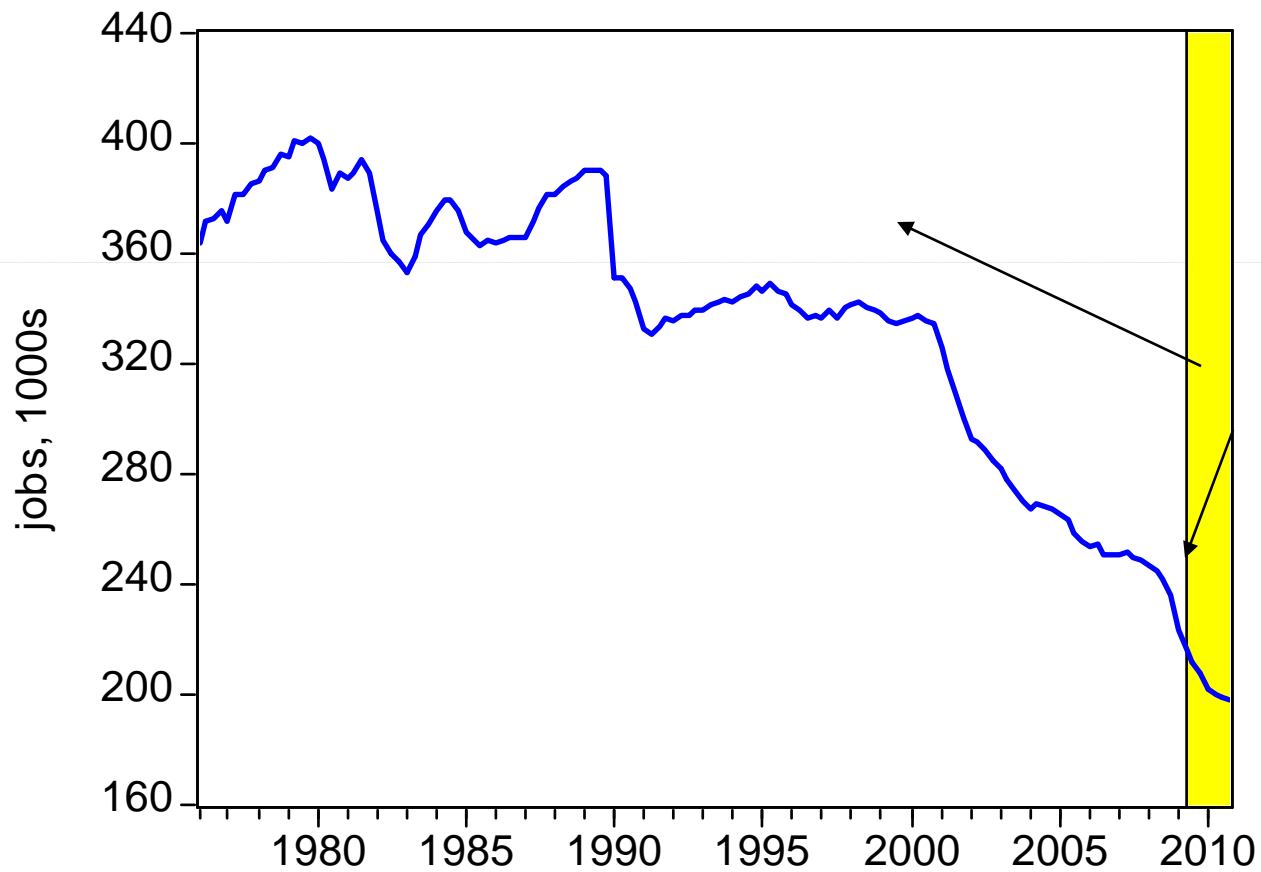


U.S. Recessions 1948 - 2009

Date	Duration (Months)
1948 - 49	11
1953 - 54	10
1957 - 58	8
1960 - 61	10
1968 - 70	11
1973 - 75	16
1980 - 80	6
1981 - 82	16
1990 - 91	8
2001 - 02	8
2007 - ?	20 ... and holding
Average 1945 - 2001	10 months

SC Manufacturing Employment

1970 Q1 – 2010 Q4 Source: Dr. Don Shunk CCU



140,000 net job
loss from
2000 - 2010

Michael Boskin, former Chair of the Council of Economic Advisors for President George H.W. Bush, Wall Street Journal, November 17, 2009, "An Alternative Stimulus Plan."

- There are five large interrelated headwinds to jobs and growth.
- First, continued deleveraging, unresolved toxic assets, and weak banks are constraining credit, especially for small business that is the source of most hiring. (translation: big boys bailed out, little guy still hurting).
- Second, household balance sheets depressed from declines in home values and portfolios are likely to constrain consumption growth. (translation: no home equity loan when you already owe more than the home is worth, so no new flat screen TV)

Michael Boskin, former Chair of the Council of Economic Advisors for President George H.W. Bush, Wall Street Journal, November 17, 2009, "An Alternative Stimulus Plan."

- Third, government industrial-policy micromanagement with subsidies and mandates from pay to products is forcing noncommercial decisions on wide swaths of the economy from financial services and autos to energy and health care. Such policies have never worked before—ask the Japanese, Koreans and Europeans. (translation: you always wanted a Cadillac, now you own the company)
- Fourth, the explosion of spending, deficits and debt foreshadows even higher prospective taxes on work, saving, investment and employment. That not only will damage our economic future but is harming jobs and growth now. (translation: for 30 years we got more government than we paid for and for the next 30 we will be paying for more than we get)

Michael Boskin, former Chair of the Council of Economic Advisors for President George H.W. Bush, Wall Street Journal, November 17, 2009,
" An Alternative Stimulus Plan."

- Fifth, the massive liquidity injections by the Fed raise the specter of future inflation. (translation: we borrowed from the Chinese and others to create more money. When that much more money chases the same things to buy, prices will increase a lot)

The Structure of Our State Revenue System

Comparison of Gross and Net Taxable Sales

FY 1999 – FY 2008

	<u>FY 1999</u>	<u>FY 2008</u>	<u>% Change</u>
Gross Sales Amount	94,435,505,424	146,328,024,474	55%
Net Taxable Sales Amount	45,199,250,866	59,660,508,895	32%
Percentage of Net Taxable Sales	47.9%	40.8%	

Source: Department of Revenue, Annual Report.

Consumer Expenditure Survey 1984 & 2007

Percent Distribution of Total Annual Expenditures

By Major Category

<u>Category</u>	<u>1984</u>	<u>2007</u>	<u>Difference</u>	
Housing	30.4%	34.1%	3.7%	Materials Taxed Documentary Stamp Tax
Transportation	19.6%	17.6%	- 2.0%	Per Unit Gas Tax, \$300 Cap on Autos
Food	15.0%	12.4%	- 2.6%	Restaurant Food Taxed Groceries Not Taxed
Personal insurance and pensions	8.6%	10.8%	2.2%	Not Taxed
Healthcare	4.8%	5.7%	0.9%	Not Taxed
Entertainment	4.8%	5.4%	0.6%	Admissions Tax
Apparel and services	6.0%	3.8%	- 2.2%	Apparel Taxed
Cash Contributions	3.2%	3.7%	0.5%	Not Taxed
Education	1.4%	1.9%	0.5%	Not Taxed
Miscellaneous	2.0%	1.6%	- 0.4%	Taxed
Personal care products and services	1.3%	1.2%	- 0.1%	Products Taxed, Services Not Taxed
Alcoholic beverages	1.3%	0.9%	- 0.4%	Taxed on Tax
Tobacco products and smoking supplies	1.0%	0.7%	- 0.3%	Taxed on Tax; SC is the Lowest Per Unit
Reading	0.6%	0.2%	- 0.4%	Books Mostly Taxed Newspapers Not Taxed
Total	100.0%	100.0%		

Source: Bureau of Labor Statistics

Taxation & Spending Policies

Tax Relief in South Carolina Netted Over \$500M in the last 4 years

Relief passed by the General Assembly since 2005 includes:

- **Property tax relief for homeowners – “The Swap” \$585 million**
- **Total elimination of the state’s “grocery tax”. \$354 million**
- **Elimination of the state’s bottom income tax bracket. \$86 million**
- **Reduction of the tax on small business from a top marginal rate of 7% to a flat rate of 5%. \$129 million**

Homestead Exemption Fund History

Fiscal Year	<i>ESTIMATED</i> Homestead Exemption Fund Revenue	ACTUAL Homestead Exemption Fund Revenue	<i>ESTIMATED</i> Homestead Exemption Fund School District Reimbursements	ACTUAL Homestead Exemption Fund School District Reimbursements ¹	GENERAL FUND OBLIGATION ²
FY 2007-08	<i>582,480,339</i>	550,484,062	<i>(527,290,536)</i>	(565,029,770)	(14,545,708)
FY2008-09	<i>530,646,607</i>	532,647,527	<i>(585,643,360)</i>	(585,643,358)	(52,995,831)
FY2009-10	<i>506,940,585</i>		<i>(614,398,619)</i>		(107,458,034)

¹ Growth in Reimbursement Allocation is a Function of CPI (Southeast Region) plus SC Population Growth (Act 388 of '06).

² Open-ended account.

Note : Supreme Court Ruling #26682 7/6/09 Berkeley County School District v. SC Department of Revenue could affect base.

The SC Taxation Realignment Commission (aka "TRAC")

<http://www.scstatehouse.gov/citizensinterestpage/TRAC/TRAC.html>

Sponsored by Sen. Leatherman and Others

Modeled after the federal Base Realignment Commission

11 members (credentialed), No Legislators & Lobbyist Protocols

Exhaustive Study (State and Local including exemptions)

Look for "adequacy, equity and efficiency" (aka, "Broad Base / Low Rates")
ie, 3.4% vs. 6.0% sales tax rate, etc.

"Modernize and Stabilize" the system

Recommend legislative changes to Money Committees

6 meetings scheduled through January '10 – initial recommendations due by March '10

The Temporary Plug in the Breach

H.R.1 of 2009

American Recovery and Reinvestment Act of 2009

\$787.242 Billion or about \$2600 per capita

South Carolina's Portion of Stimulus Funds

Total	\$7.86 Billion
Tax Cuts	\$2.86 Billion
Total Spending in SC	\$5 Billion*

*(includes Federal spending on Federal installations)

Of the \$5 Billion spent in SC:

\$3.4 Billion will be received by cognizant State agencies through the state budget. (The \$3.4 billion includes allocations received by state agencies and subsequently distributed to local governments, non-profits, etc)

H.R.1 of 2009

American Recovery and Reinvestment Act of 2009

ESTIMATED ALLOCATIONS BY MAJOR CATEGORY:		Percentage
BUDGET STABILIZATION FUND	\$ 694,060,272	21%
MEDICAID *	\$ 876,040,898	26%
TRANSPORTATION	\$ 504,200,000	15%
WATER AND SEWER	\$ 59,755,697	2%
ENERGY	\$ 111,700,000	3%
HEALTH AND HUMAN SERVICES	\$ 441,842,913	13%
HOUSING	\$ 77,600,000	2%
EDUCATION	\$ 406,064,498	12%
STATE AND LOCAL LAW ENFORCEMENT	\$ 42,484,716	1%
WORKFORCE/EMPLOYMENT SERVICES	\$ 168,620,882	5%
TOTAL ESTIMATED SC ALLOCATIONS	\$3,382,369,876	100%

* ARRA Medicaid is a temporary increase in the Federal Medical Assistance Percentage (FMAP). Approximately 9% increase in Federal share of Medicaid reimbursements from 70% to 79%. Increased FMAP in effect for 9 quarters from July 2008 through December 2010.

H.R.1 of 2009

American Recovery and Reinvestment Act of 2009

BUDGET STABILIZATION FUND

Distribution Requirements:

82% must be allocated to K-12 Higher Education and 18% may be allocated for other government purposes.

FY 2009-10 Allocations	Funding	Percentage
State Department of Education	\$184,992,339	53%
Colleges and Universities	\$ 99,922,339	29%
Public Safety	\$ 46,120,000	13%
Other Government Services	\$ 16,969,485	5%
TOTAL FY 2009-10	\$348,004,163	100%

The Outlook for the Next Several Years and Beyond

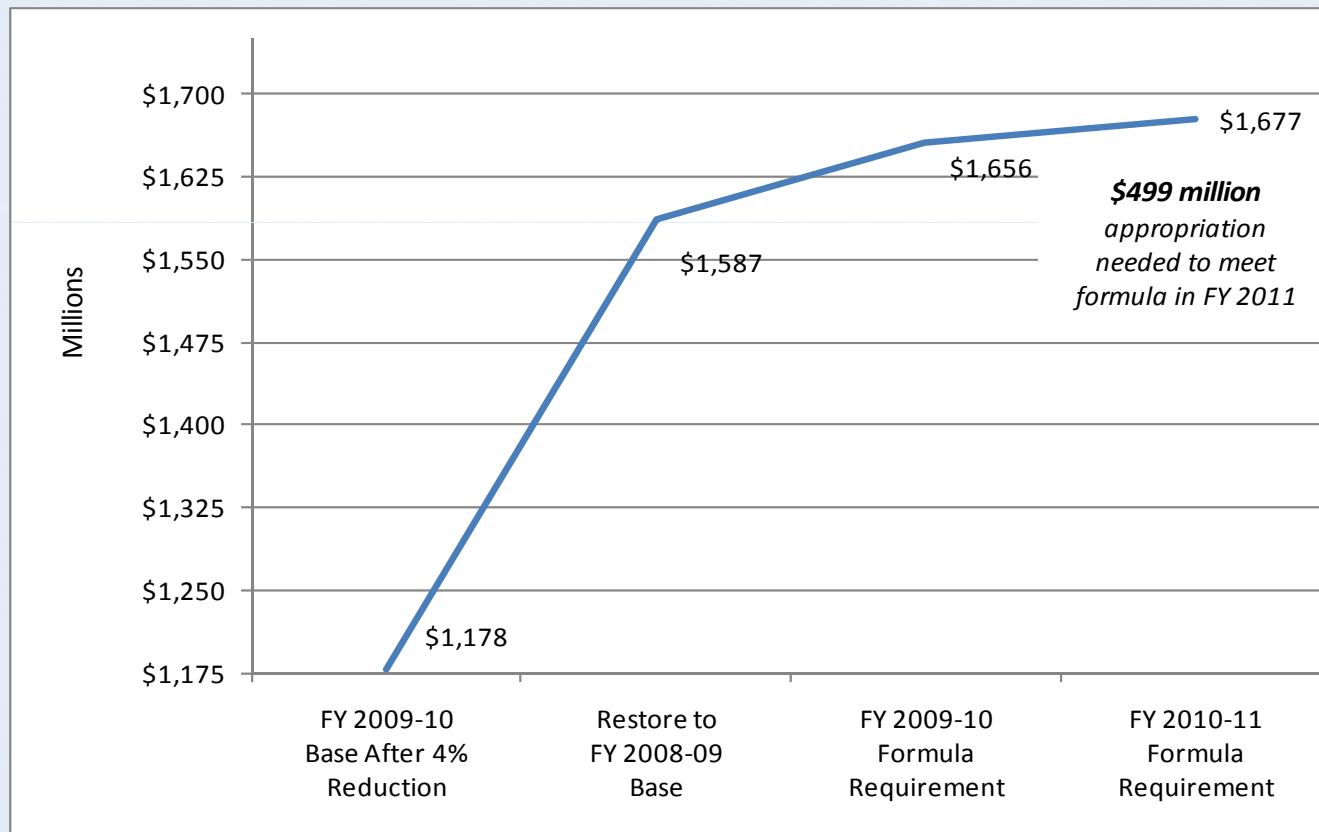
**Possible Annualizations Needed in FY 2010-11 & FY 2011-12
Based on FY 2009-10 Appropriation Act (H.3560) with Actual FY 2008-09 Revenues**

The Annualizations list is the State Budget Office's attempt to identify items that may be funding issues in the next fiscal year. The list is a subjective interpretation of items funded in the Appropriation Bill and is not intended or to be construed as a binding, legal document.

The Appropriation Act uses A.R.R.A. funding from the Federal Medical Assistance Percentage (FMAP) increases and funding of \$348 million from the Fiscal Stabilization Fund over two state fiscal years. It is assumed that the FMAP increases and the remaining \$346 million from the Stabilization Fund will be used in Fiscal Year 2010-11 for the same purposes. Therefore, the bulk of the annualizations from the A.R.R.A. expenditures will occur in Fiscal Year 2011-12.

	<u>FY 2010-11</u>	<u>FY 2011-12</u>
Statewide:		
Formula Driven by State, Federal, & Constitutional Mandates:		
FY 2008-09 General Fund Deficit - Repay the General Deposit Account	98,216,617	
General Reserve Fund	55,441,728	36,670,069
Capital Reserve Fund	(16,964,433)	(6,859,628)
Local Government Fund <i>(Restore to statutory formula)</i>	19,255,184	(15,434,163)
Homestead Exemption Shortfall	87,133,745	91,632,299
Recurring Appropriations Contained in Part 1A Supported w/ Nonrecurring Revenue	149,514,202	
Subtotal - Statewide Items	<u>392,597,043</u>	<u>106,008,577</u>
Subtotal - State Agencies	18,135,560	578,221,604
ANNUALIZATION OF FY 2009-10	<u>410,732,603</u>	<u>684,230,181</u>

Education Finance Act Formula Funding Requirement



Policy Questions

- Will Policy Makers put EFA Restoration at the Front of the Line?
- How Much More Funding Will Be Required to Underwrite Federal Health Insurance Changes?
- Have We Reached a Bottom Threshold on Funding for Corrections? DJJ?
- How Much More Will Policy Makers Tolerate Fee Increases (Tuition, License Fees, Ticket Surcharges) ?

The Breach

1: infraction or violation of a law, obligation, tie, or standard

State Government will be forced to change or ignore funding statutes.

2: a broken, ruptured, or torn condition or area b: a gap (as in a wall) made by battering

The state budget's structural deficit will become more pronounced over time. Changes to address the structural deficit will be incremental and very difficult to attain.

3: a break in accustomed friendly relations b: a temporary gap in continuity

State government will not be able to afford continuing business as usual so benefits currently provided to citizens will diminish. Citizens will become even more angry.