

State Budget Outlook

“Era of Austerity”

Mike Shealy
SC Senate Finance Committee

European and American Debt Crises Signal an Era of Austerity

Michael Gerson, Washington Post, May 19, 2010

“America is about to enter its own period of austerity, which likely will be the dominant political reality for the next decade. The new game will have few winners and many losers.

If the federal government takes spending reductions seriously, the first wave of austerity would hit the states and public employees.”

Austere

Function: adjective

Etymology: Middle English, from Anglo-French, from Latin *austerus*, from Greek *austēros* harsh, severe; akin to Greek *hauos* dry

Date: 14th century

1 a: stern and cold in appearance or manner b : somber, grave

2: morally strict : ascetic

3: markedly simple or unadorned

4: giving little or no scope for pleasure

5 of a wine: having the flavor of acid or tannin predominant over fruit flavors usually indicating a capacity for aging

synonyms see severe

- aus·tere·ly *adverb*

- aus·tere·ness *noun*

“Welcome to the Lean Years”

Thomas Friedman, New York Times, February 23, 2010

- We’ve just had our 70 fat years in America, thanks to the Greatest Generation and the bounty of freedom and prosperity they built for us. And in the past 70 years, leadership – whether of the country, a university, a company, a state, a charity or a township – has largely been about giving things away, building things, from scratch, lowering taxes or making grants. But now it feels as if we are entering a new era “where the greatest task of government and of leadership is going to be about taking things away from people,” said the Johns Hopkins foreign policy expert Michael Mendlebaum... Let’s just hope our lean years number only seven... Our parents were the Greatest Generation. We, alas, in too many ways, have been what the writer Kurt Andersen called “The Grasshopper Generation,” eating through the prosperity that was bequeathed us like hungry locusts.

SC State Budget

	FY 08-09 (expenditures)	FY 10-11 (appropriations)
• General Funds	\$5.75 Billion	\$5.08 Billion
• Federal Funds	\$7.37 Billion	\$8.27 Billion
• Other Funds	\$7.44 Billion	\$7.76 Billion
TOTAL:	\$20.56 Billion	\$21.12 Billion

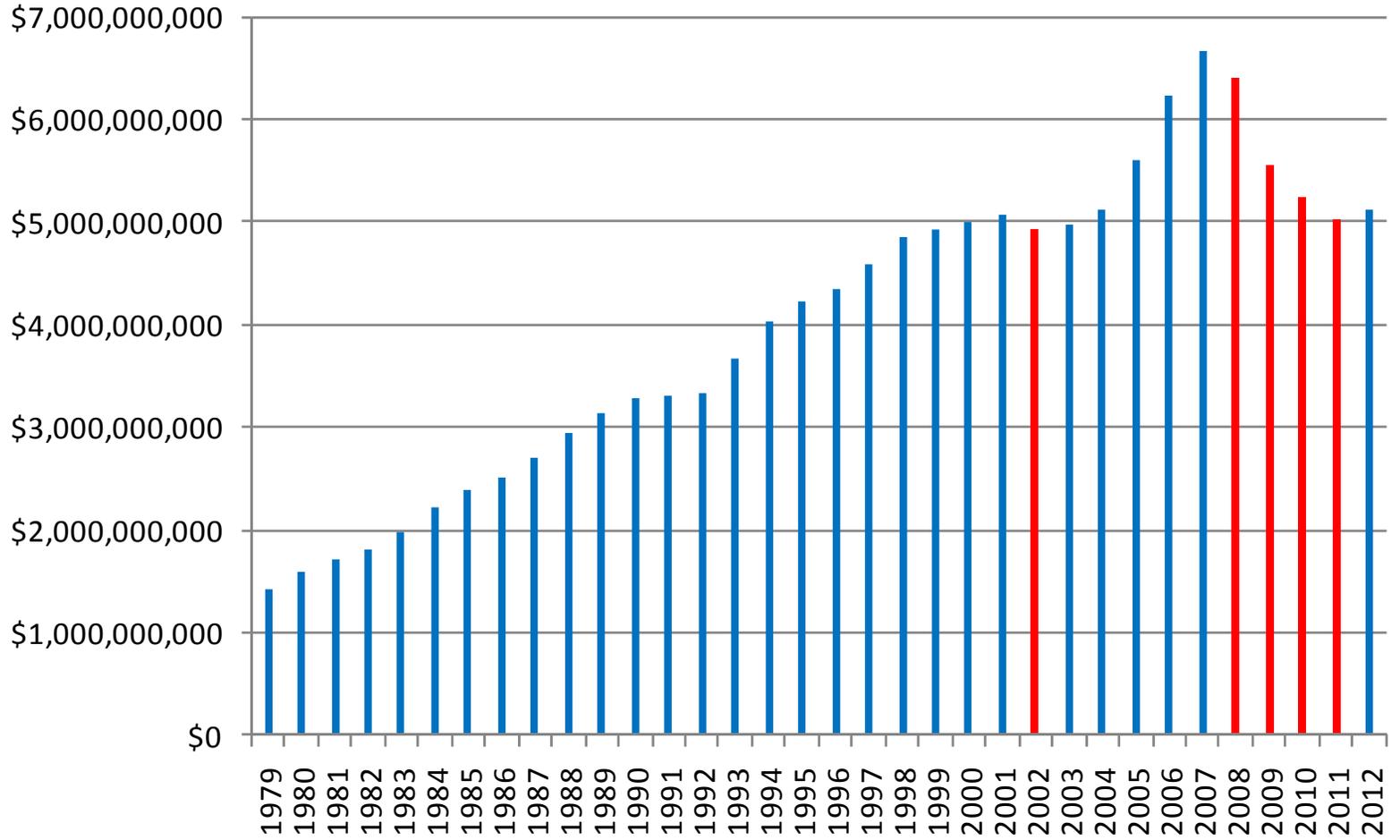
SC Personal Income \$145 Billion

(Budget is about 15% or 1/7th of economy)



THE CONDITION OF THE SOUTH CAROLINA STATE BUDGET

General Fund Collections



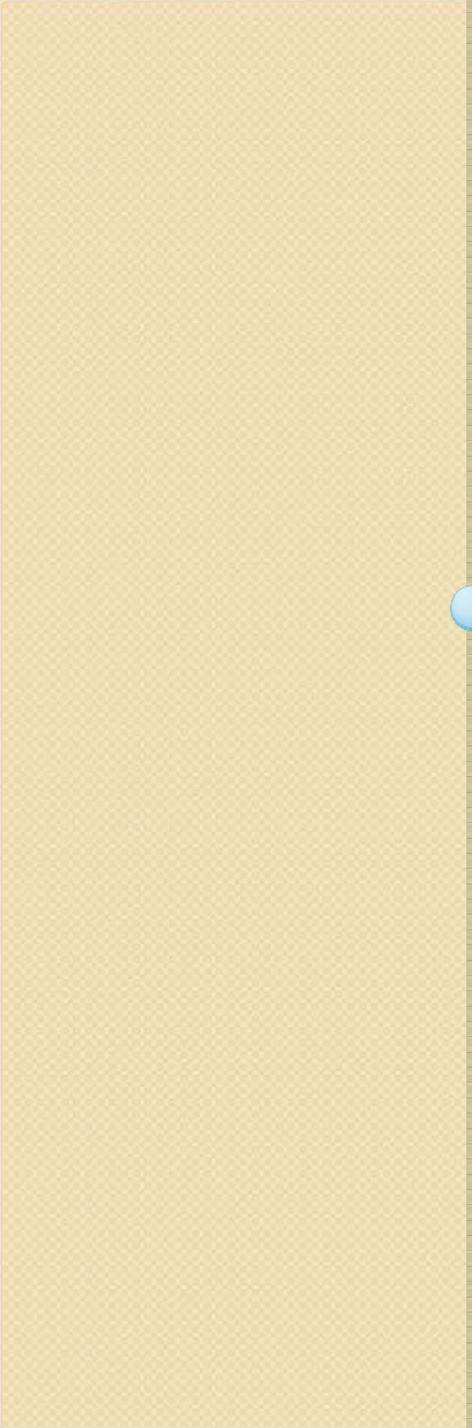


From the peak of General
Fund Revenue collections in
FY2006-07 through FY2009-10
Collections have dropped
\$1.42 Billion or **21.3%**.

Conventional Thought During the Growth Years

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.



**THE IMPACT OF THE
“GREAT RECESSION”
ON STATE FINANCES**

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 **(109,303,613)**

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 **1,428,054**

Remaining Year End General Fund Shortfall **(206,313,524)**

General Reserve Fund Balance Applied to Shortfall **108,096,907**

FY08-09 Year End Deficit Remaining After Reserve Funds Applied **(98,216,617)**

Summary of Revenue Surplus FY 2009-10

BUDGETARY GENERAL FUND
Fiscal Year Ended June 30, 2010

Appropriations Act Budgeted Revenues for FY09-10	\$ 5,552,002,165	
Actual Revenues	<u>5,241,895,775</u>	
Shortfall		\$ (310,106,390)
 <u>Mid-Year Budget Actions of Budget and Control Board:</u>		
Applied Capital Reserve Fund against Projected Revenue Shortfall -- June 2009	127,847,888	
Cut Agency Budgets 4.04 percent -- September 2009	200,452,112	
Cut Agency Budgets 5 percent -- December 2009	<u>238,227,922</u>	
		<u>566,527,922</u>
 <u>Closing Entries Directed by Statute or Proviso:</u>		
To Cover "Open-Ended" Appropriations	40,244,804	
To Liquidate FY09 Operating Deficit Carried Forward to FY10	98,216,617	
To Replenish General Reserve Fund	<u>46,959,511</u>	
		<u>(185,420,932)</u>
Net Budgetary Surplus		\$ <u>71,000,600</u>

Source: Comptroller General FY 2009-10 News Release August 2010



Fiscal Year 2008-09

The General Fund recurring base appropriation was **\$6,735,714,190**

Fiscal Year 2010-11

The General Fund recurring base appropriation is **\$5,080,373,895**

Source: Office of State Budget (Base after vetoes)

Cumulative General Fund Reductions

July 2008 – July 2010

- Department of Corrections 13%
- Health & Human Services 21%
- Department of Public Safety 24%
- Department of Education 25%
- Department of Social Services 25%
- Disabilities & Special Needs 33%
- Department of Mental Health 38%

- Colleges & Universities 44%
- Department of Agriculture 51%
- Department of Insurance 61%
- Department of Commerce 68%
- Human Affairs & Consumer Affairs 71%
- Budget & Control Board 100%

General Fund Revenue Forecast

(BEA rev. 11/10/10)

Minimal Growth

- **FY 2010-11** 1.5% growth compared to actual collections for FY09-10.
- **FY 2011-12** is 1.0% growth.
- Long Range Forecast for FY 2012-13 and beyond is an average 1.5% growth rate.

How Did We Get Here?

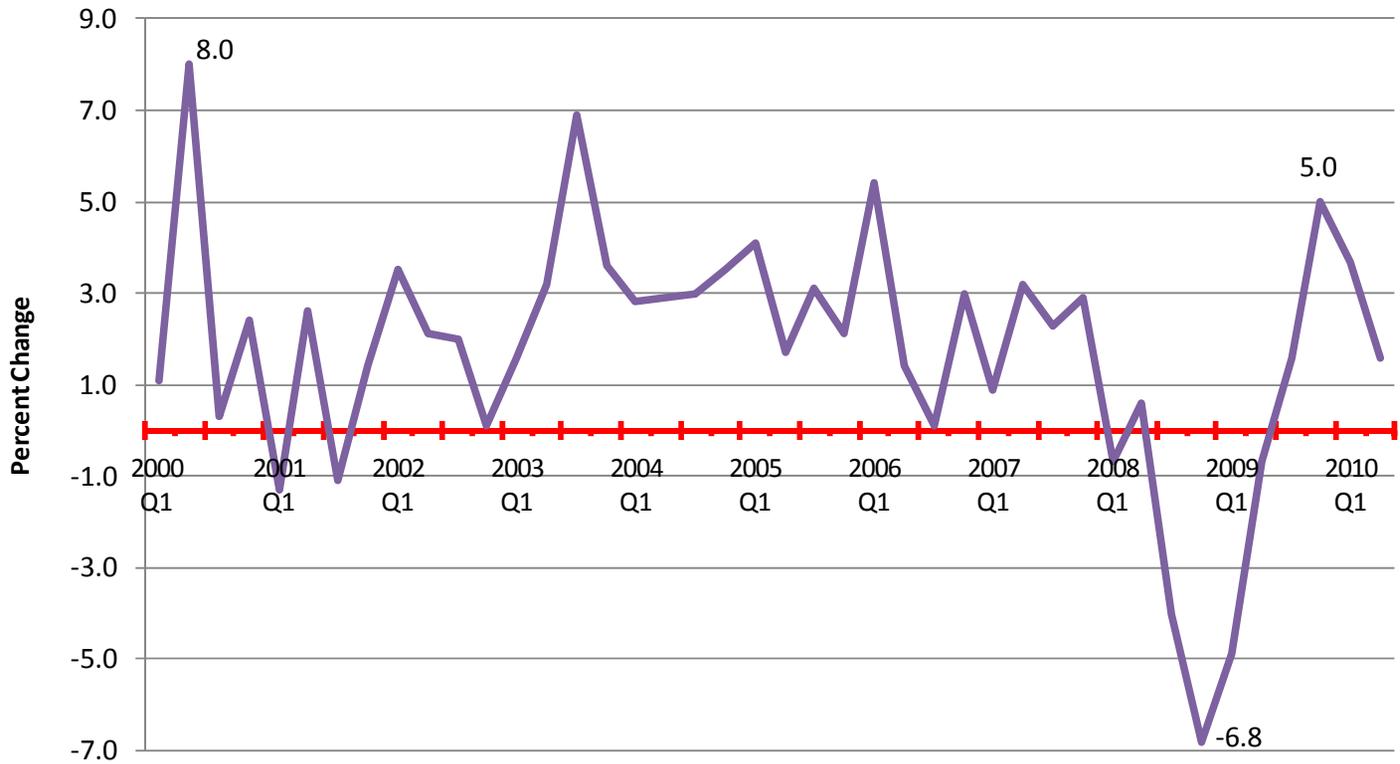
- The National Recession
- The Structure of Our State Revenue System
- Taxation and Spending Policies



**THE NATIONAL
RECESSION AND ITS
EFFECTS ON THE STATE
ECONOMY**

Real GDP Growth by Quarter 2000 - 2010 Q2

Seasonally Adjusted Annual Rates



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 - 09	22
Average 1945 - 2001	10 months

Source: Dr. Bruce Yandle, Dean Emeritus, Clemson University

Gross Domestic Product

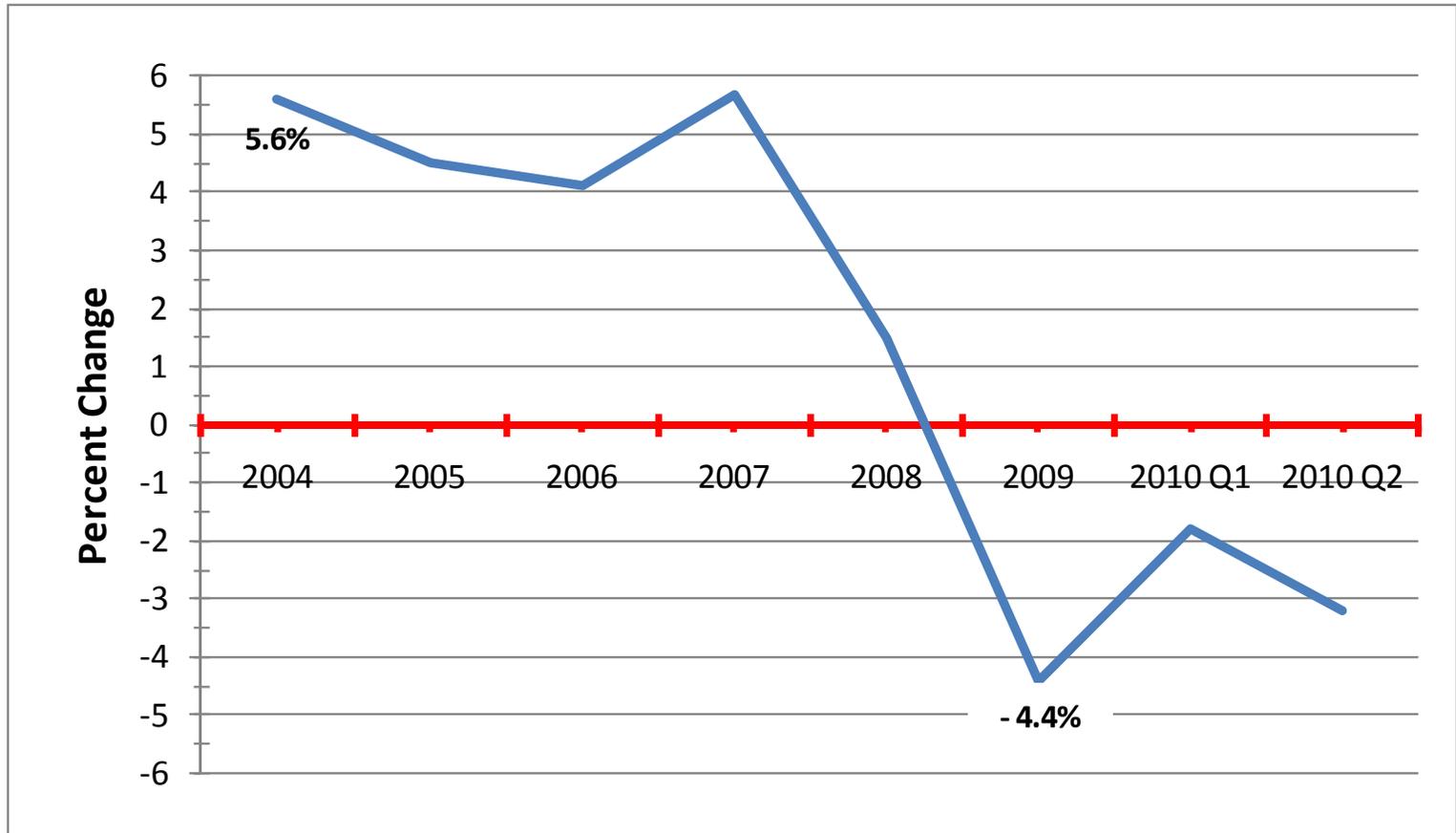
$$\text{GDP} = \text{Consumption} + \text{Investment} + \text{Government} + \text{Net Exports}$$

Consumption is about 70% of GDP.

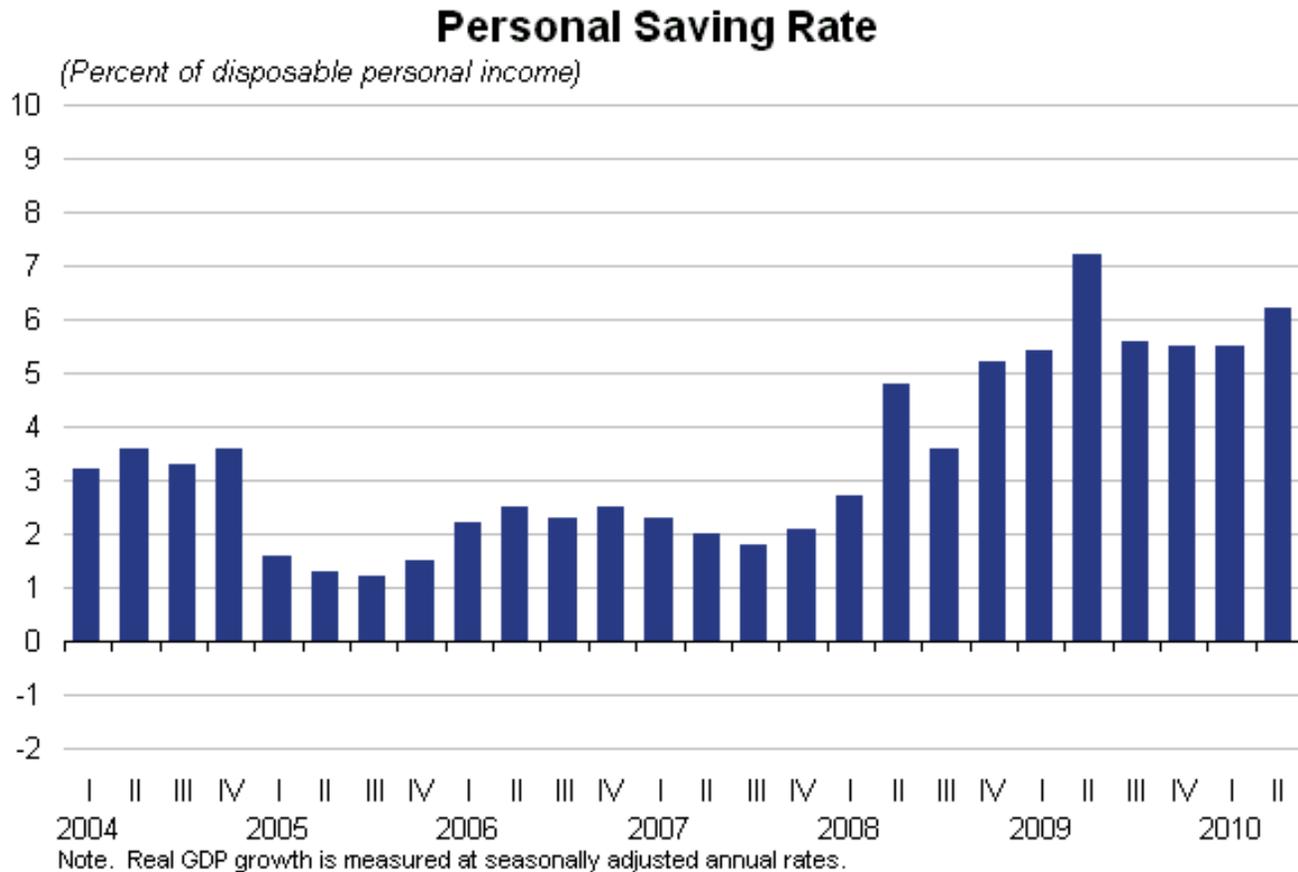
Consumer Credit Outstanding

2004 – 2010 Q2

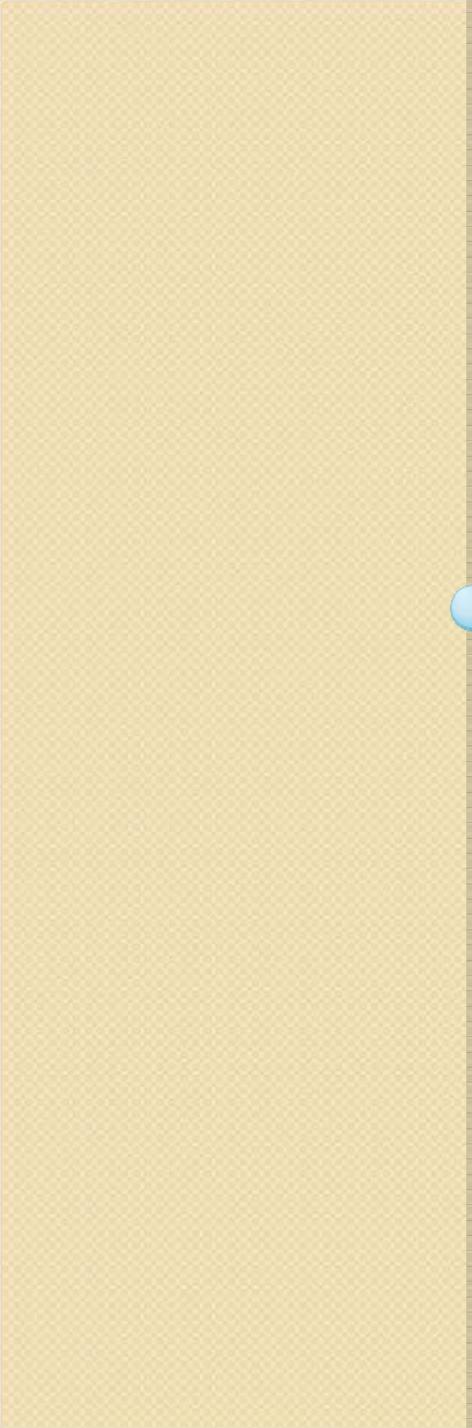
Seasonally Adjusted



Personal Savings Rate

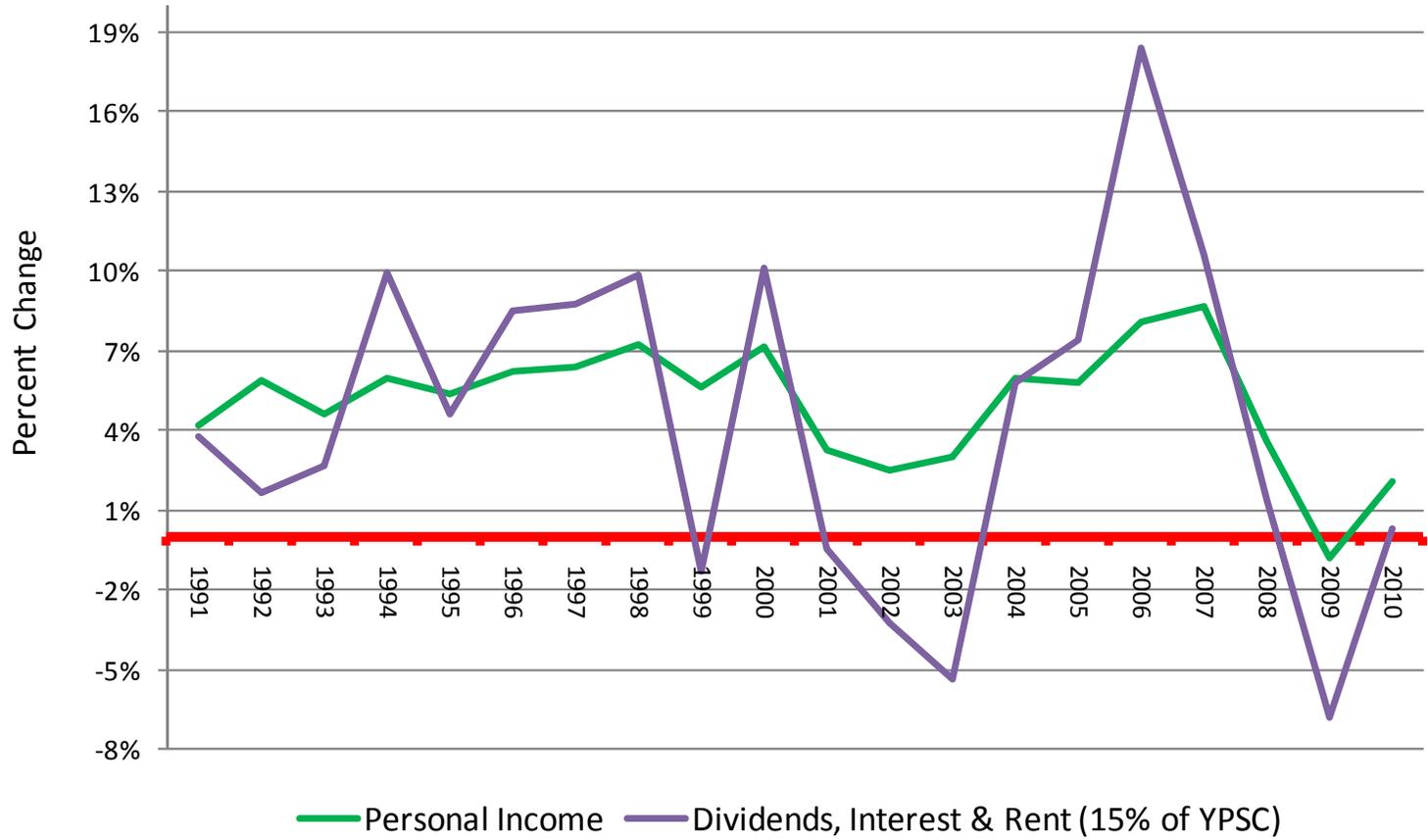


U.S. Bureau of Economic Analysis

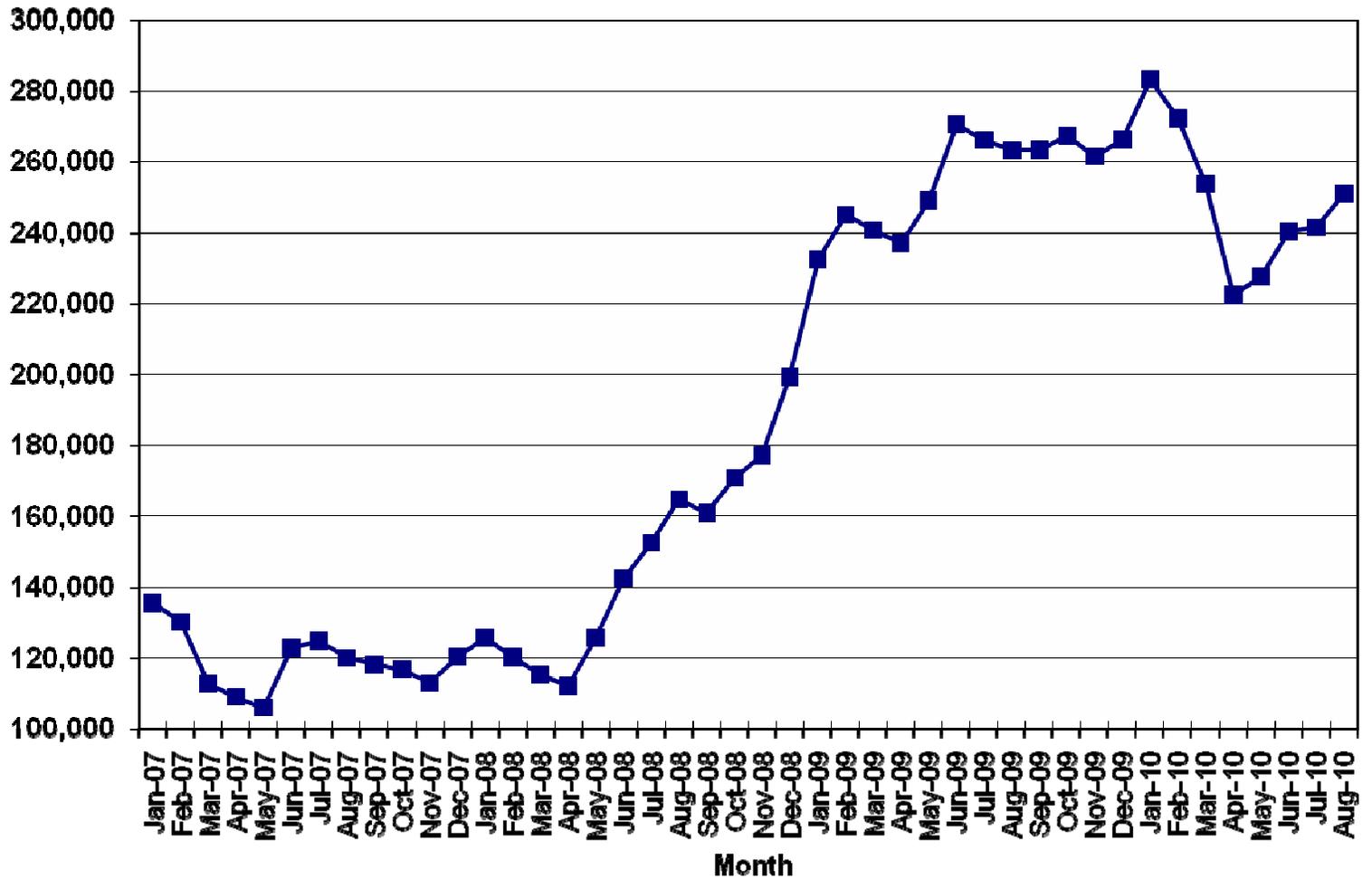


MEASURES OF THE STATE ECONOMY

South Carolina Total Personal Income and Dividends, Interest and Rent Income Percent Change from Previous Year

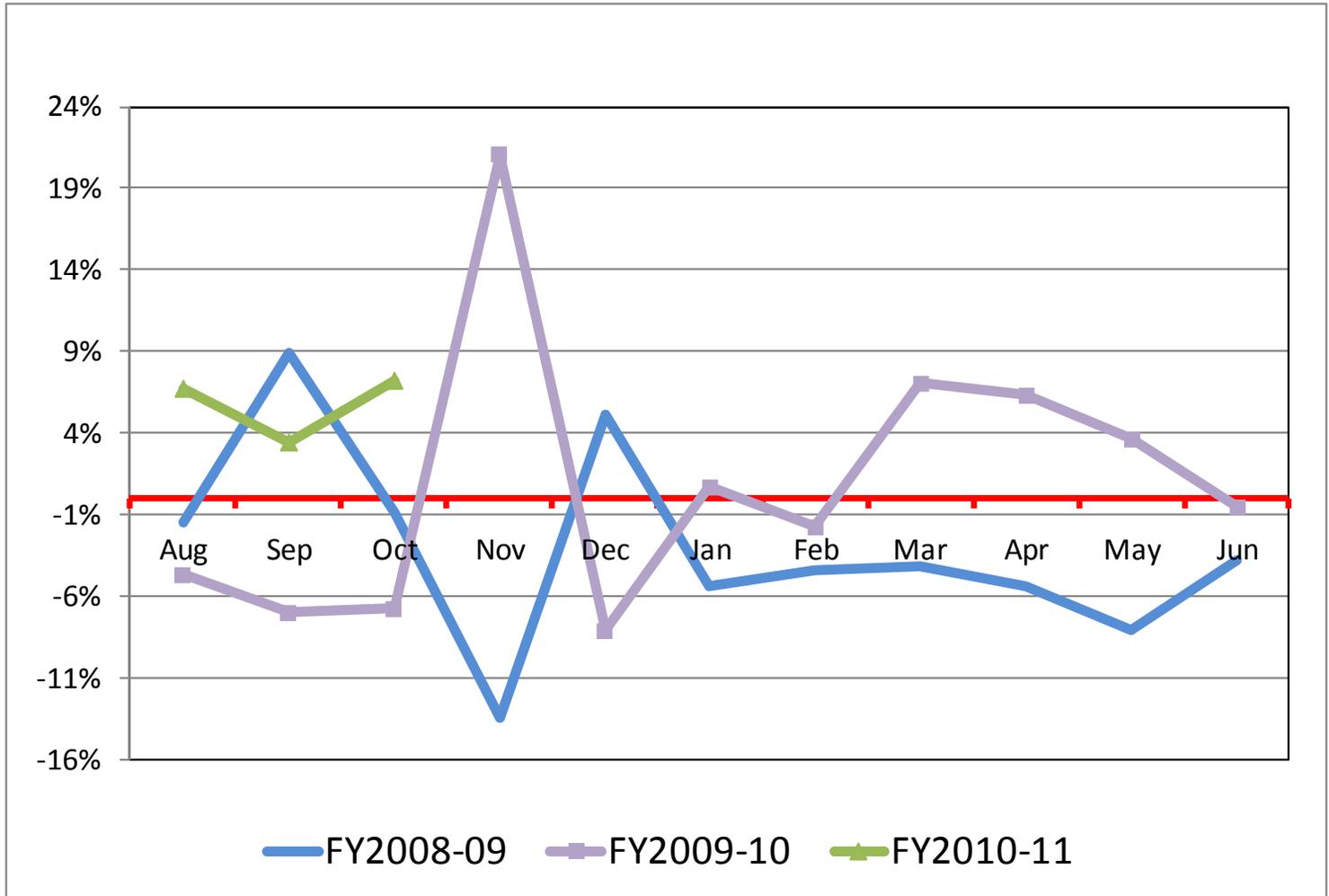


Total Unemployment in South Carolina



Source: Board of Economic Advisors

Monthly Individual Income Withholdings % Change Over Prior Year





THE STRUCTURE OF OUR STATE REVENUE SYSTEM

Comparison of Gross and Net Taxable Sales

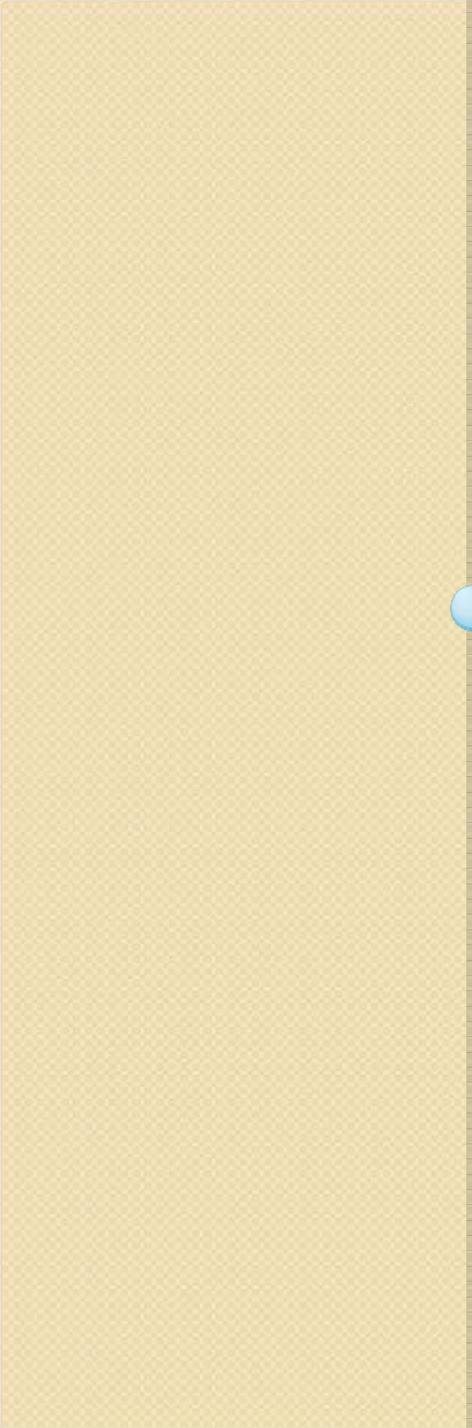
FY 1999 – FY 2009

	<u>FY 1999</u>	<u>FY 2009</u>	
Gross Sales Amount	94,435,505,424	135,859,825,695	44%
Net Taxable Sales Amount	45,199,250,866	52,667,993,248	17%
Percentage of Net Taxable Sales	47.9%	38.8%	

	<u>FY 2008</u>	<u>FY 2009</u>
Gross Sales Amount	146,328,024,474	135,859,825,695
Net Taxable Sales Amount	59,660,508,895	52,667,993,248
Percentage of Net Taxable Sales	40.8%	38.8%

Source: Department of Revenue, Annual Report.

The Base is Shrinking.



SOUTH CAROLINA'S TAXATION & SPENDING POLICIES

Tax Relief in South Carolina

Netted Over \$600M in the last 5 years

Relief passed by the General Assembly since 2005 includes:

- Total elimination of the state's "grocery tax". **\$425 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**

The Base is Shrinking.

Open-Ended Appropriations

<u>Agency</u>	<u>Description of Appropriation</u>	<u>Authority</u>	FY 2009-10 Existing <u>Appropriation</u>	FY 2010-11 Estimated <u>Increase</u>	Total <u>Appropriated</u>
Comm. on Higher Education	LIFE Scholarship Program Palmetto Fellows	Section 59-149-150 Section 59-104-20(D)	198,566,230	18,200,000	216,766,230
Dept of Revenue	Homestead Exemption-One Cent Sales Tax Swap/School Operating Expenses	Section 11-11-156(A)(6)	26,419,132	99,732,585	126,151,717
		Total	224,985,362	117,932,585	342,917,947

An open-ended account is an obligation that will be paid regardless of the amount actually budgeted.

Demands for these two programs automatically are considered first for funding in each budget cycle due to statute. This “crowds out” consideration for increases in other areas of the budget.



RESPONSES TO THE CONDITION OF THE STATE BUDGET

The SC Taxation Realignment Commission (aka “TRAC”)

- 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
- 14 meetings scheduled through September 2010
- Meeting information and research materials available on TRAC website:

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

TRAC Recommendations

Sales Tax:

- Expand the Base and Lower the Rate
- Autos - Ratchet up to \$600, \$1000, \$1,200 then no cap
- Food - Tax at 59% of Gross Proceeds
(effective rate 2.95%, Food stamp purchases exempt)
- Prescriptions - Tax at 25% of Gross Proceeds
(effective rate 1.25%, exempt Medicare & Medicaid)
- Residential Electricity - Tax at 25% Gross Proceeds
(effective rate 1.25%)
- Lower Rate to at least 5%
(including services the rate will be less than 5%)



**GDP = Consumption +
Investment +
Government +
Net Exports**

A Keynesian approach Macroeconomic Policy

President Kennedy's Revenue Act of '64
(marginal rate from 91% to 70% above \$400K)

President Bush's \$600 Tax Rebate '08

President Obama's ARRA of '09

An Extension of Stimulus Funding

HR1586 passed 8/10/10

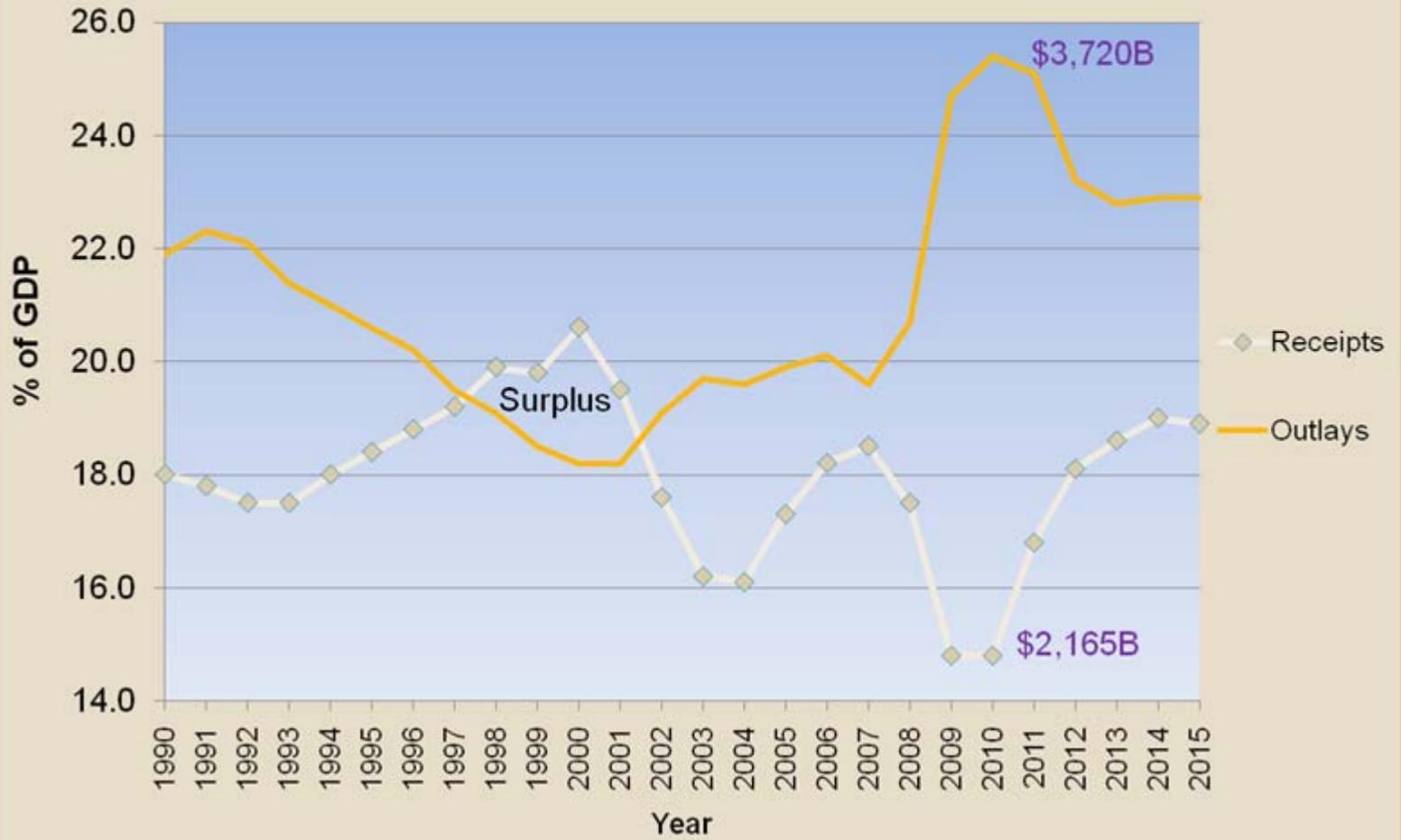
Extension of FMAP Stimulus \$149.6 million

Education Jobs Fund Program

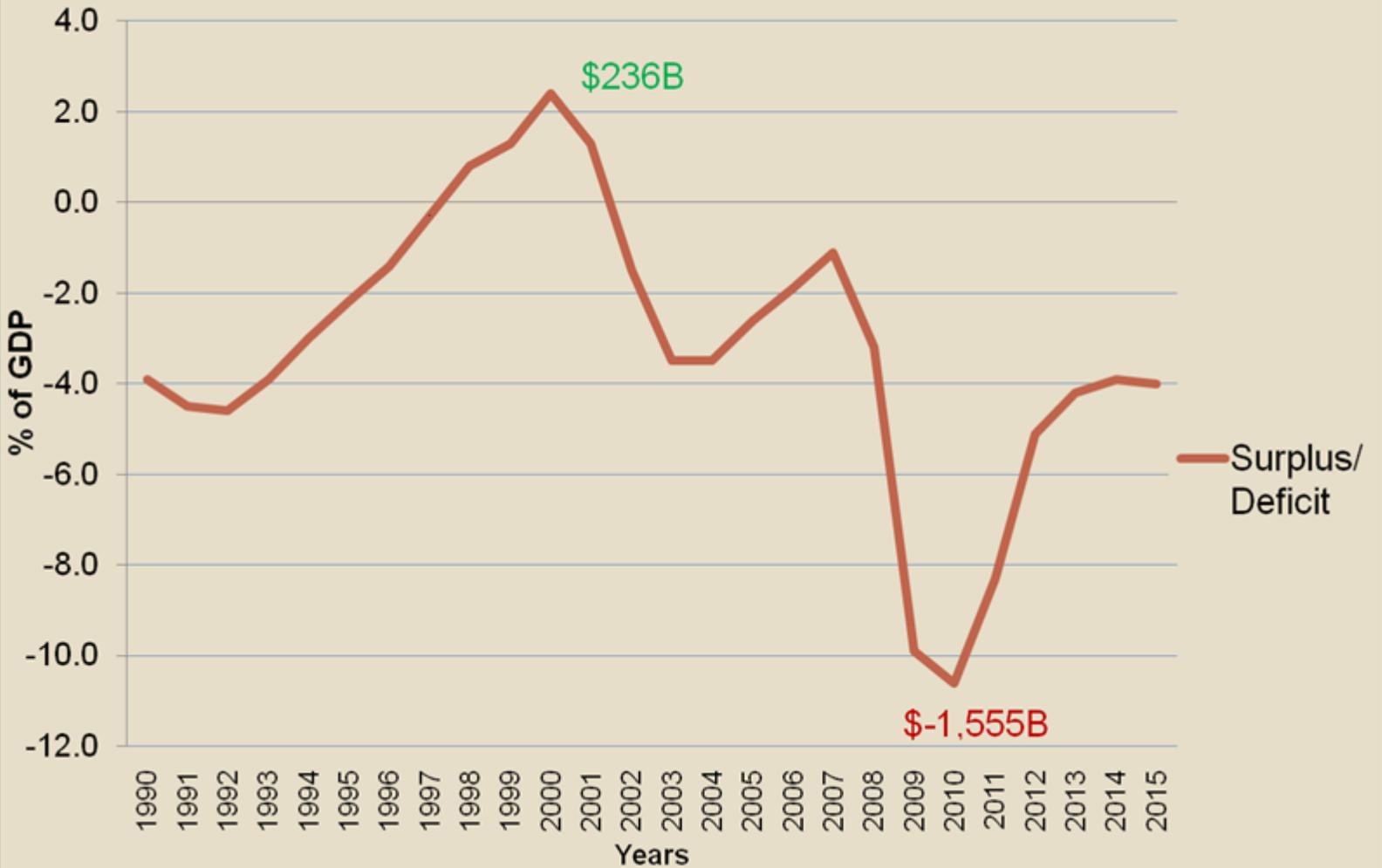
SC Ineligible for \$143.7 million

BUT, this will likely be the last large federal stimulus for some time, because ...

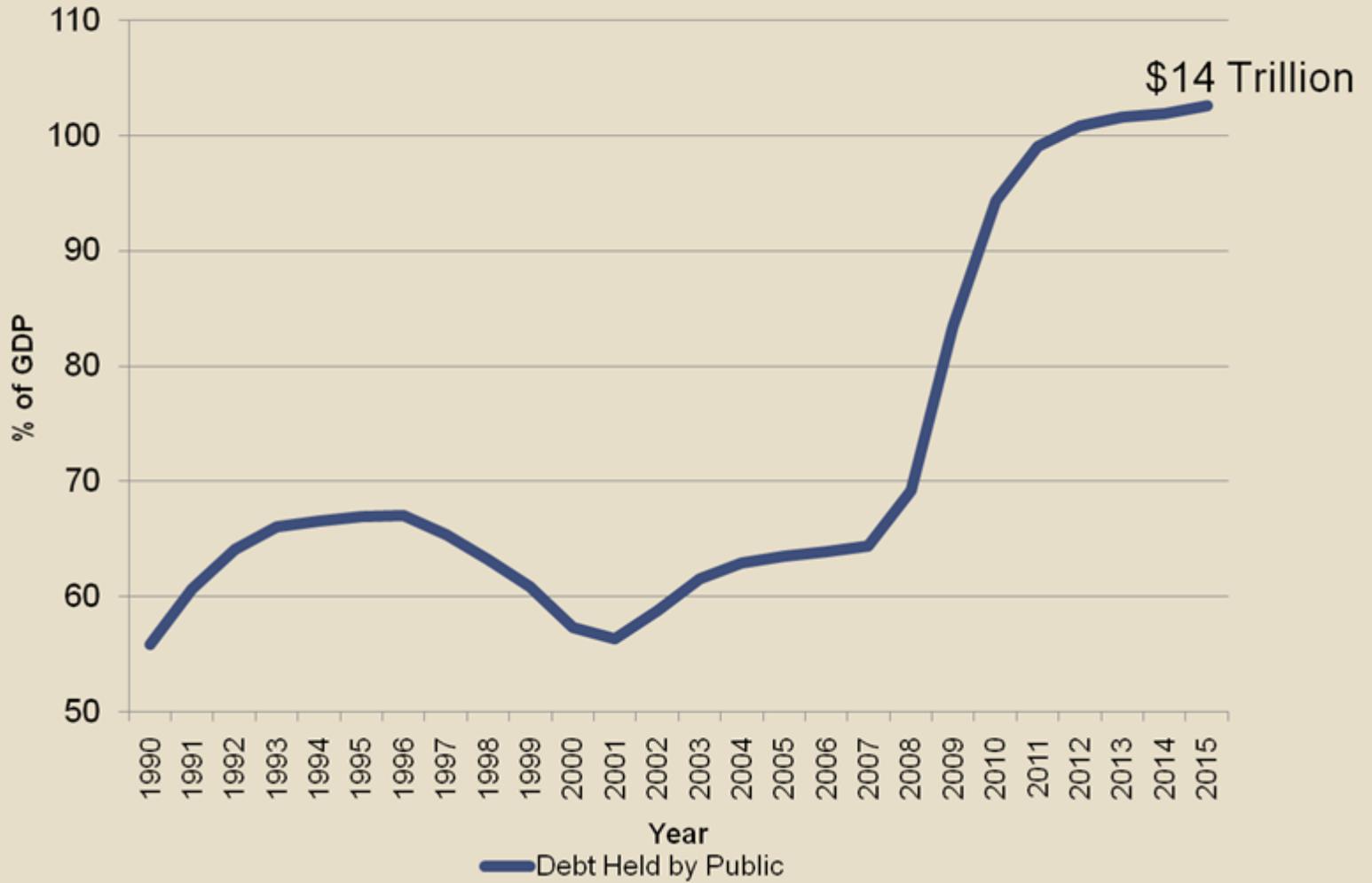
Federal Receipts and Outlays % of GDP



Federal Surplus/Deficit



Federal Debt Held by Public



“Federal Debt and the Risk of a Financial Crisis”

Congressional Budget Office - Director’s Blog 7/27/10

Unless policymakers restrain the growth in spending, increase revenues significantly as a share of GDP, or adopt some combination of those two approaches, growing budget deficits will cause debt to rise to unsupportable levels...

Options for responding to a fiscal crisis would be limited and unattractive. The government would need to undertake some combination of three actions.

One action could be changing the terms of its existing debt. This would make it costly to borrow in the future.

A second action could be adopting an inflationary monetary policy by increasing the supply of money. However, this approach would have negative consequences for both the economy and future budget deficits.

A third action could be implementing an austerity program of spending cuts and tax increases. Such budgetary adjustments, in the face of a fiscal crisis, would be more dramatic and painful than those that would have been necessary had the adjustments come sooner.

Does all this matter – No & Yes

Debt as % of GDP CIA Factbook '09

- Japan 189.3%
- Italy 115.2%
- Greece 113.4%
- Canada 75.4%
- Germany 72.1%
- United Kingdom 68.1%
- Mexico 37.7%
- Ethiopia 31.8%
- China 16.9%
- Kuwait 8.1%
- Libya 3.9%

GDP CIA Factbook (Purchasing Power Parity)

- US \$14.2T
- China \$8.8T
- Japan \$4.1T
- India \$3.5T
- Germany \$2.8T
- UK \$2.1T
- Russia \$2.1T
- France \$2.1T
- Brazil \$2.9T
- Italy \$1.8T
- Mexico \$1.5T

Note : US Federal DEFICIT ≈ Mexico GDP



**THE OUTLOOK FOR THE
NEXT SEVERAL YEARS
AND BEYOND**

Facts:

- State General Fund appropriations have dropped 25% over the past three years.
- The long-range growth rate for State General Fund revenues is 1.5%, less than expected inflation and population growth.
- Many state agencies have budgets reduced to “threshold levels” where additional cuts will trigger federal intervention and mandates or effective closure of those agencies.
- The State Budget list of obligations is at least \$900 million greater than available resources for Fiscal Year 2011-12.
- Federal Stimulus Funds will be exhausted and many other federal sources will diminish as the Federal Government begins to address deficit and debt issues.

Possible Annualizations Needed in FY 2011-12
Based on Final 2009-10 Revenues
(Includes Potential Agency Deficits)

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 Appropriations Act uses A.R.R.A. funding from the Federal Medical Assistance Percentage (FMAP) increases and funding of \$346 million from the Fiscal Stabilization Fund.

	<u>FY 2011-12</u>
Statewide:	
Formula Driven by State, Federal, & Constitutional Mandates:	
General Reserve Fund	17,141,169
Capital Reserve Fund	(6,045,540)
Local Government Fund <i>(Restore to statutory formula)</i>	33,265,899
Homestead Exemption Excess Amount Funded in FY10-11 ^(BEA 11/10/10)	(17,888,481)
Employee Health Insurance	29,119,844
Recurring Appropriations in Part 1A Supported w/ Nonrecurring Revenue	<u>151,542,533</u>
Subtotal - Statewide Items	<u>207,135,424</u>
State Agencies:	
State Department of Education	187,992,646
Department of Health and Human Services	183,778,486
All Other State Agencies	<u>282,294,651</u>
Subtotal - State Agencies	<u>654,065,783</u>
ANNUALIZATION OF FY 2010-11	<u>861,201,207</u>
A.R.R.A. FMAP Extension (January - June 2011)	149,000,000
Estimates of Potential Agency Deficits <i>(preliminary est. under review by OSB)</i>	
Department of Health and Human Services	227,786,198
Department of Social Services	28,800,000
Department of Corrections	7,500,000
ANNUALIZATION INCLUDING FMAP EXTENSION & DEFICITS	<u>1,274,287,405</u>

Source: Office of State Budget

Summary of Available Revenue Sources

FY 2010-11

Contingency Reserve Fund (FY 2009-10 Net Budgetary Surplus)	71,000,600
FY2010-11 General Fund Revenue Collections (BEA 11/10/10) Over FY2010-11 Appropriation Act Estimate	<u>242,055,055</u>
	\$313,055,655
FY 2010-11 Capital Reserve Fund	<u>110,883,455</u>
Total Available	\$423,939,110

FY 2011-12 Available "New" Revenue *(BEA est. 11/10/10)*

BEA Revenue Estimate	5,863,933,851
- Tax Relief Trust Fund	(545,680,709)
- FY 10-11 Appropriation Base	<u>(5,080,373,895)</u>
Projected Total Revenue	\$237,879,247

Education Finance Act

Formula Funding Requirement

FY 2010-11

Statutory Requirement

Base Student Cost	\$2,720	\$1,689,909,888
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Actual Appropriation

Base Student Cost	\$1,630	\$1,004,394,001
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Difference

Base Student Cost	\$1,090	\$ 685,515,887
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Note: Amounts do not include fringe.

Headlines

- “Spartanburg Detox Center Shuts Down over Budget Cut” - Jason Spencer, Spartanburg Herald Journal, July 5, 2010
- “SCDJJ Cutting School Jobs, Requiring Furloughs” – Seanna Adcox, AP, July 7, 2010
- “C of C Tuition Goes Up \$1,326: President Says State Cuts Behind Increase” – Diane Knich, Post & Courier, June 8, 2010
- “Cash-Poor Governments Ditching Public Hospitals” (Barnwell County) – Suzanne Sataline, Wall Street Journal, August 29, 2010
- “The new AIDS crisis” – Renee Dudley, Post & Courier, September 19, 2010

Who will Build the Bridges?

Thomas Friedman

New York Times, April 9, 2010

If you step back far enough, you could argue that George W. Bush brought the Reagan Revolution – with its emphasis on tax cuts, deregulation and government-as-the-problem-not-the-solution – to its logical conclusion and then some. But with a soaring deficit and a banking crisis caused by the excess of deregulation, Reaganism has met its limit. Meanwhile, President Barack Obama's passage of health care reform has brought the New Deal-Franklin Roosevelt Revolution to its logical conclusion. There will be no more major entitlements for Americans. The bond market will make sure of that.

In other words, both major parties have now completed their primary 20th-century missions, first laid down by their standard bearers. The real question is which party is going to build America's bridge to the 21st-century – one that will strengthen our ability to compete in the global economy, while practicing much more fiscal discipline.



Popular 20th Century English Philosopher

Sir Michael Philip Jagger

wrote in 1968:

You can't always get what you want

And if you try sometime you find

You get what you need.



Options for Next Year's Presentation Title

(based on old pop songs)

- “I Can See Clearly Now (the rain is gone),” Johnny Nash, 1972.
- “I Will Survive,” Gloria Gaynor, 1978.
- “Dust in the Wind,” Kansas, 1977.



Thank You

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