State of South Carolina

Office of the Governor

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Dr. William C. Gillespie
Chief Economist, State of South Carolina
Rembert Dennis Building
1000 Assembly Street, Suite 442
Columbia, South Carolina 29201

Dear Dr. Gillespie:

I wanted to write and respectfully disagree with your recent testimony before the Senate Finance Committee stating that the economic slump will be short-lived. I wish I could share your optimism, but existing economic uncertainties, and experts' opinions, prevent me from doing so.

For instance, Martin Feldstein, Professor of Economics at Harvard and president and CEO of the National Bureau of Economic Research, recently expressed concerns that the economy "could slip into a recession and that the recession could be a long, deep, severe one." Similarly, Goldman Sachs recently expressed its expectation that the U.S. economy will fall into a recession this year as well.

Make no mistake; we believe South Carolina has had some success on the economic front in recent years. There are nearly 159,000 more people working in South Carolina than there were five years ago and we saw more Commerce Department-recruited investment last year – $4.1 billion worth – than during any other year in our state's history. For that matter, there have been over 3,000 new small businesses created over the last five years.

That being said, South Carolina's economic fortunes will largely follow those of the national economy, and it's for this reason that I'd offer a few points that in my view suggest we're headed more in the direction of a recession than the quick resurgence you suggested in Senate testimony.

First, we believe the financial troubles caused by sub-prime lending practices have not yet been fully felt. As a consequence of risky investments by major financial institutions and some people having dreams bigger than their wallets, a lot of people believe the housing market and several related sectors are in for a series of disappointing quarters. A number of these institutions have become insolvent or have had to write-down millions of dollars in lending losses already, with the result that many businesses and households have seen capital dry up and credit tightened. The severity of this problem was underscored as the Federal Reserve recently slashed interest rates by the largest amount in the last 24 years.

I believe a weak housing market intensifies these credit problems because of the way so much of the mortgage market is now securitized. Finally, the last leg of the housing stool has negative implications for the so called "wealth affect" and negative consequences for consumer spending. In layman's terms, people don't spend the same if they feel like the things they own are going down in value rather than up – and consumer spending has been one of the drivers of our national economy. In fact, Robert Shiller, Professor of Economics at Yale, recently predicted that the losses in real estate values could triple and that the "housing recession will go on for years."

On another similarly dour note, increases in oil prices over the past few years are having more of a negative effect than ever before. With oil approaching $100 a barrel, South Carolinians are feeling the effects of paying nearly $3 a gallon for gasoline. It represents a hidden tax borne by every consumer, and one that does not fit with your suggestions of a short-term downturn on the economy. I say this because this trend is in large part a result of vastly increased demand for oil in the global market in areas like China and India – and in areas where that demand is predicted to be sustained over time.

The bottom line is that I want to stress the importance of a realistic assessment of the economic situation for South Carolinians. I think the hardships many people will experience in our state as a result of cuts in government rests not only with legislators who were more than exuberant in their efforts to spend every last dollar that came into Columbia – but also with economic leaders like yourself who would not more vociferously argue the need for restraint in spending when times were good. At a minimum going forward I think it would be prudent not to simply paint rosy pictures on the possibility of short term slows downs – but to as well make policy makers fully aware of the scenarios that could entail much more pain to the budget and the people whose lives are impacted by it.

In short, if one prepares for the worst, one can afford to be surprised by the best. I'd ask you to keep in mind some of these economic indicators as you formulate the Board's projections over the months ahead. Take care.

Sincerely,

Mark Sanford

MS/gg

Cc: John S. Rainey
The Honorable Hugh Leatherman
The Honorable Dan Cooper
The Honorable Richard Eckstrom
The Honorable Converse Chellis