



A Slight Acquaintance

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Senate Finance Committee



Recap of Last Year

Facts from the 2010 Presentation:

- State General Fund appropriations have dropped 25% over the past three years. (we are in a tepid recovery)
- The long-range growth rate for State General Fund revenues is 1.5%, less than expected inflation and population growth. (this will be increased)
- Many state agencies have budgets reduced to “threshold levels” where additional cuts will trigger federal intervention and mandates or effective closure of those agencies. (\$224M deficit recognized at DHHS in FY10-11)
- The State Budget list of obligations is almost \$900 million greater than available resources for Fiscal Year 2011-12. (Annualizations lower – in the \$400M range)
- Federal Stimulus Funds will be exhausted and many other federal sources will diminish as the Federal Government begins to address deficit and debt issues. (Debt Ceiling Debate and Super Committee Deliberations)

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.”

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.

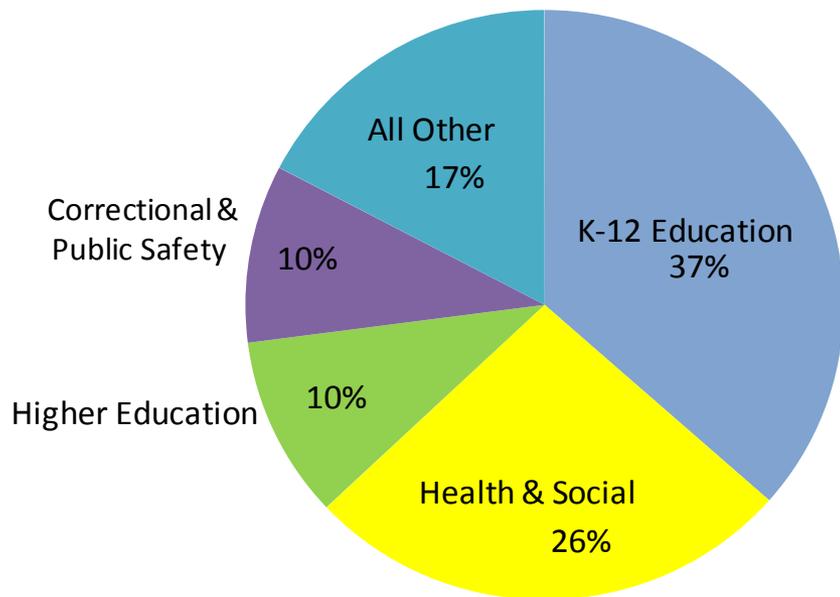
In other words, both major parties have now completed their primary 20th-century missions, first laid down by their standard bearers. The real question is which party is going to build America's bridge to the 21st-century – one that will strengthen our ability to compete in the global economy, while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



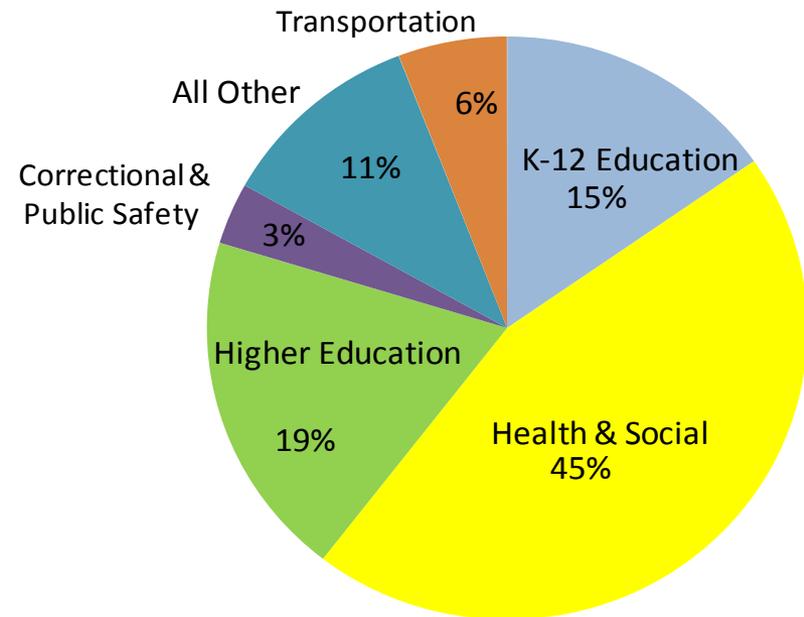
South Carolina - Budget Primer & Outlook

Where is the Money Spent? FY 2011-12 Appropriations

General Funds



Total Funds



Source: Office of State Budget

“Conflicted” Views

In a Gallup Poll taken during the last recession – and as state’s were struggling as to how to balance their budgets (raise taxes or cut spending – many did both) – 79% of Americans favored cutting spending, while just 13% favored raising taxes.

(Gallup, July 1, 2003)

“Conflicted” (cont.)...

- But what looks good in theory, loses “...its luster when it comes to specifics.” (Gallup)
- Those who favored cutting spending were asked whether they were willing to cut education and/or healthcare funding.
- 77% and 78% respectively, responded “No” to cutting those areas.
- The problem: That’s “hands off” to 2 areas that comprise well over half of state spending.
- The result: Deeper cuts (double or more) to the “rest” of state spending (e.g., see Higher Ed)

2011 (Pew) UPDATE – *If the state needs to balance its budget, it should decrease...*

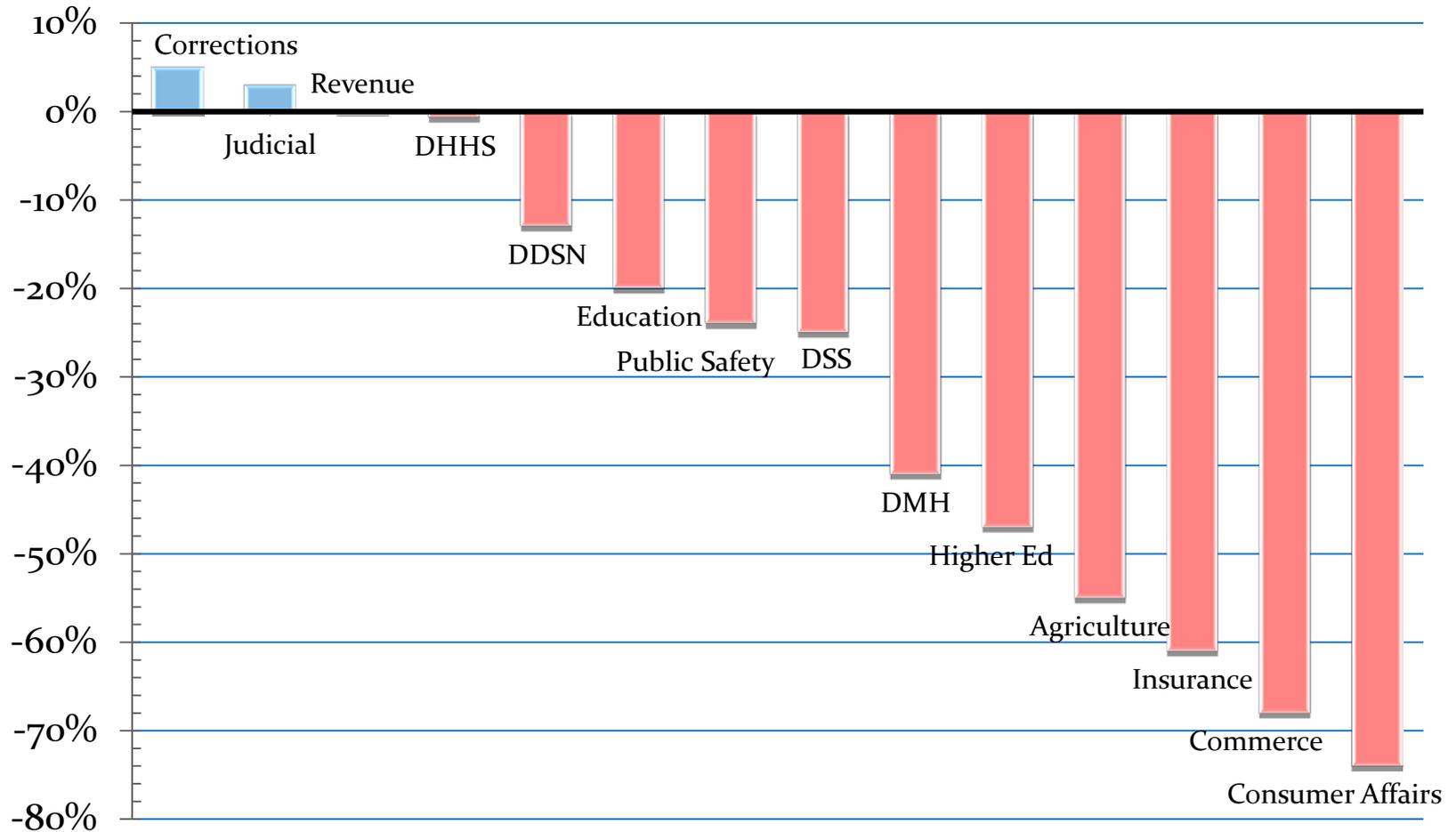
K-12 education

79% “No”

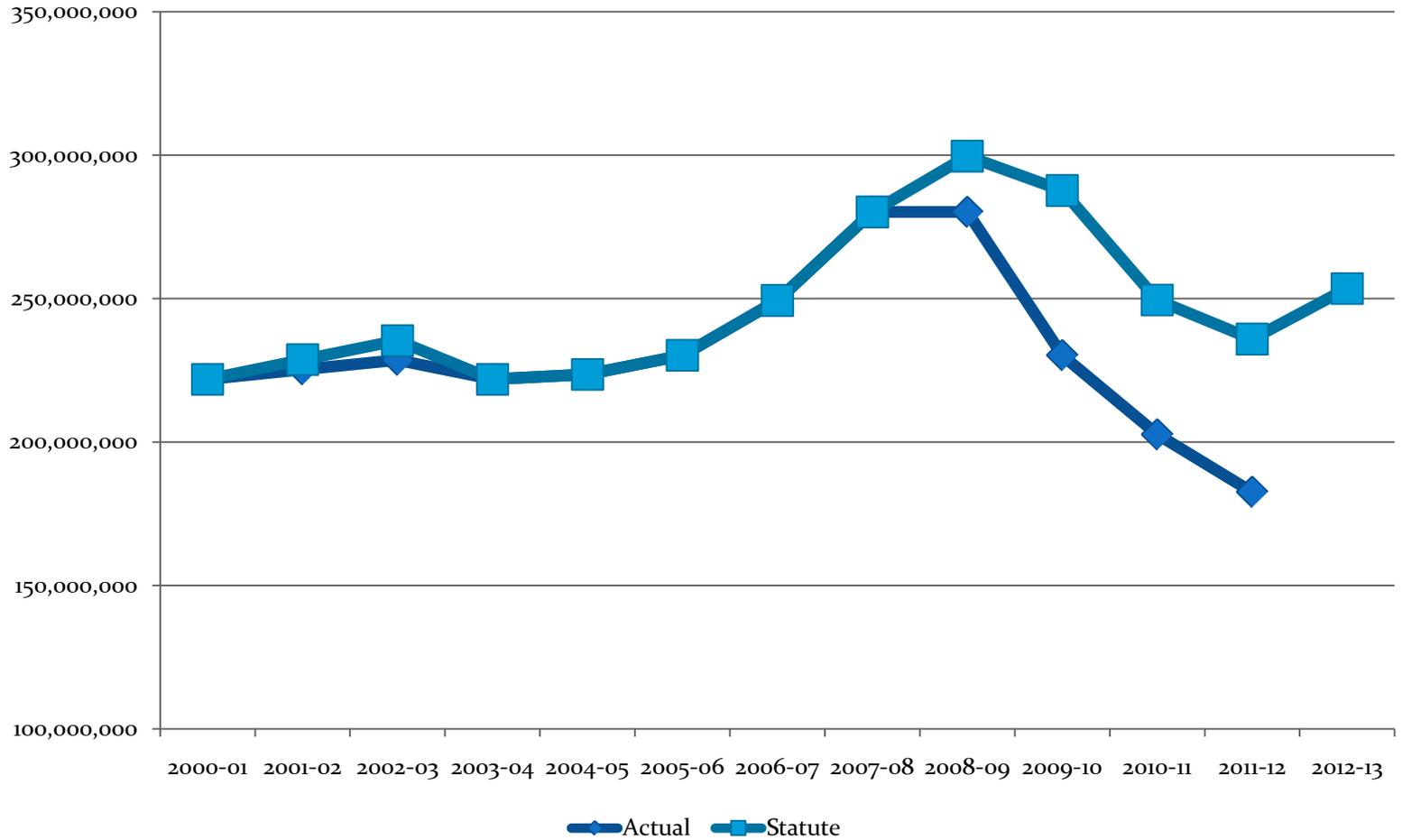
Health care services

76% “No”

Cumulative General Fund Changes July 2008 – July 2011



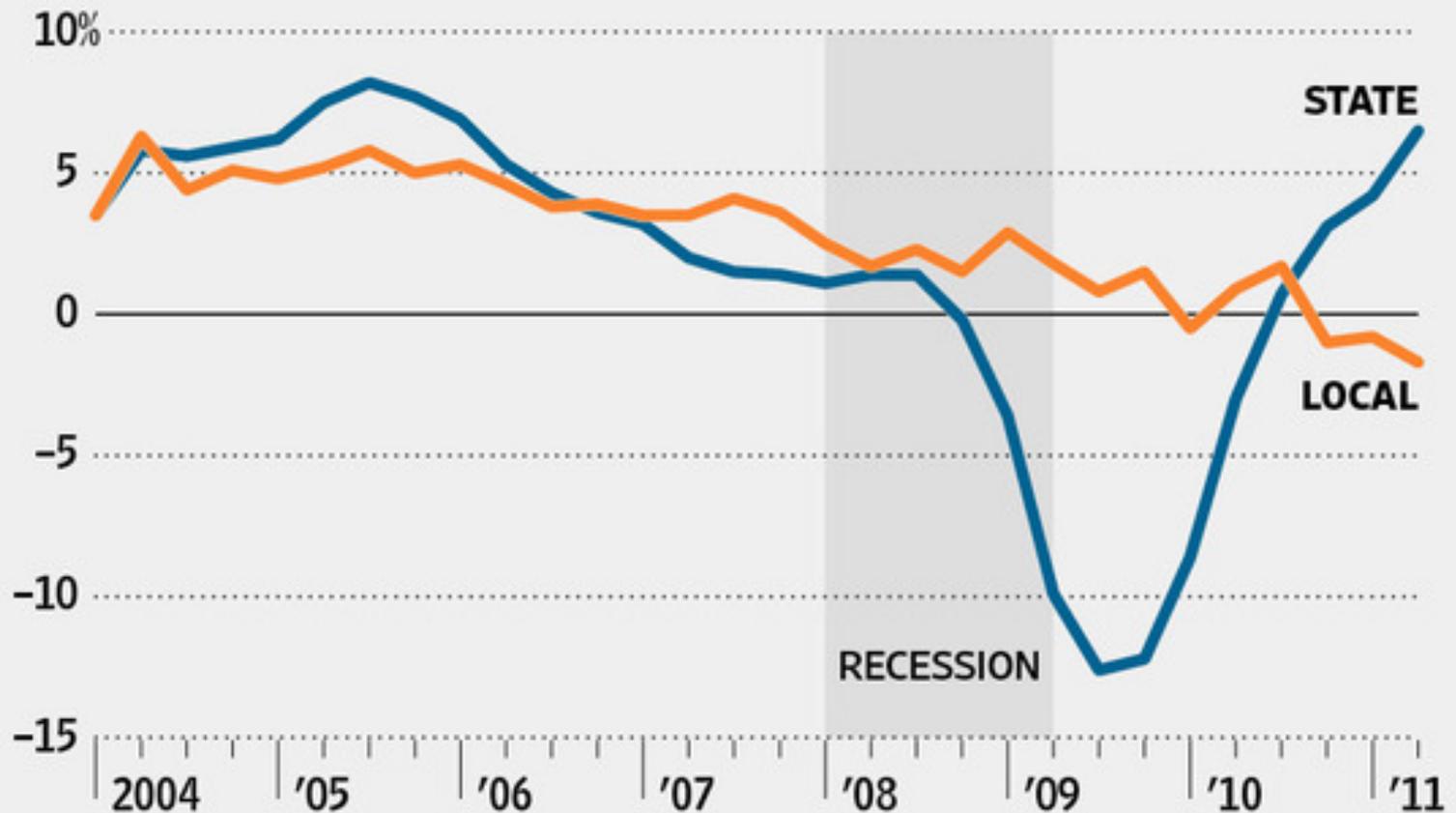
Local Government Fund



State Surge, Local Lag

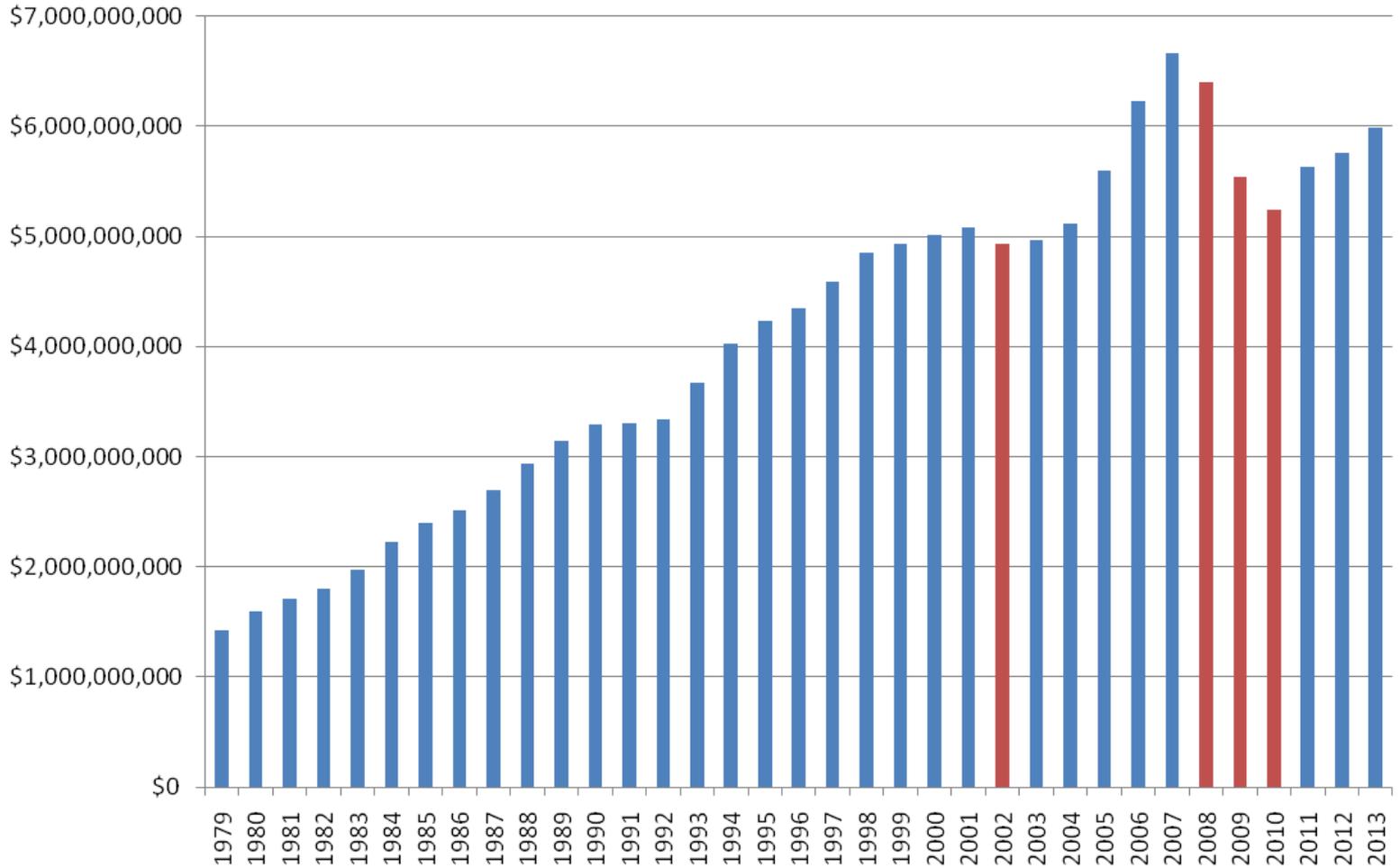
State tax revenue is increasing while local tax revenue is declining, in part due to smaller property-tax collections.

Change from year earlier in the four-quarter moving average, adjusted for inflation



Source: Nelson A. Rockefeller Institute of Government, State University of New York, Albany

General Fund Collections



A Growing Disconnect?

Year	Personal Income & Population Growth	Actual General Fund Revenue Growth		Average Elasticity
2000	9.0%	1.5%	1980-90	0.85
2001	4.3%	1.5%		
2002	3.7%	-3.0%		
2003	4.4%	0.8%	1990-00	0.84
2004	7.3%	3.0%		
2005	7.4%	9.3%		
2006	9.7%	11.4%	2000-05	0.42
2007	7.8%	6.9%		
2008	6.4%	-3.9%	2000-10	0.10
2009	1.4%	-13.3%		
2010	4.9%	-5.5%		
Average Annual Percent Change	5.6%	0.5%		

Updated May 2011. Sources US Bureau of Economic Analysis, Bureau of Labor Statistics, Census Bureau

General Fund Revenue Forecast

(BEA rev. 11/10/11)

Tepid Growth

- **FY 2010-11** 6.4% growth compared to actual collections for FY09-10.
- **FY 2011-12** is 3.4% growth.
- **FY 2012-13** is 3.9% growth.
- Long Range Forecast beyond FY 2012-13 is an average (officially) of 1.5%. This likely will be adjusted to 3.0% to 3.5% growth rate.

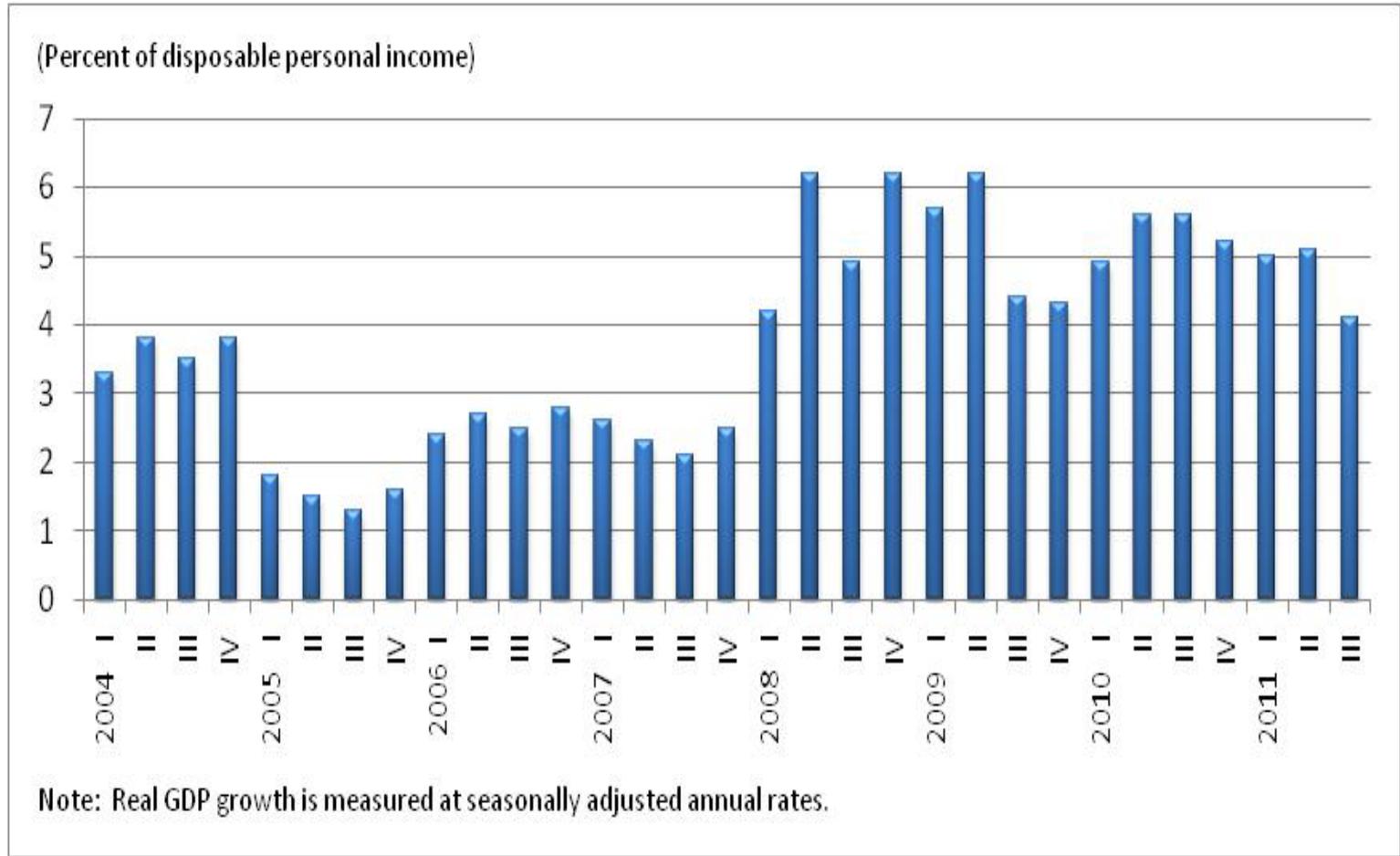
Economic Underpinnings

- Consumption versus Savings
- Taxable and Non-Taxable Consumption
- An Uncharacteristic Recovery
- Retooling the Tax Code – or Not
- Will We Ever Return to the “Old Normal?”

Pre & Post Recession – Where we Stand Today

	<u>Oct. '07 (FY08)</u>	<u>Today (FY12)</u>
<i>Stock Market (DJIA)</i>	14,165	11,894
<i>Unemployment Rate (US/SC)</i>	4.7%/5.6%	9.1%/11%
<i># Unemployed (SC)</i>	119,081	237,760
<i>Avg. Weeks Unemployed (US)</i>	17 weeks	40 weeks
<i>General Fund Revenue Forecast</i>	\$6.8 Billion	\$5.71 Billion
<i>Total Appropriations (SC)</i>	\$20.3 Billion	\$21.9 Billion
<i>Food Stamp Recips (US/SC)</i>	27M/575K	46M/843K
<i>Federal Food Stamp Expend in SC</i>	\$684 Million	\$1.5 Billion
<i>Medicaid Recipients (SC)</i>	888,000	1,000,000
<i>Total Medicaid Expend (SC)</i>	\$4.6 Billion	\$5.9 Billion
<i>Base Student Cost (General Fund)</i>	\$2,476	\$1,880
<i>Higher Ed Funding (State portion)</i>	\$771 Million	\$414 Million
<i># State Employees (State funded)</i>	37,420	32,444

Personal Savings Rate



Saving vs. Spending

- “The reasons behind the lack of consumer spending also are clear, as are the implications for state budgets. During past recoveries there has been a sharp acceleration in consumer spending as households “caught up,” buying cars and furniture and other luxuries that were put on hold during the downturn. That isn’t happening this time, however, because the recent recession came at the end of a period of unsustainable consumer spending.”
- “At the start of the recent downturn, Americans were saving barely 1 percent of their incomes, substantially less than the 6 to 7 percent that was the historic average, and much smaller than the 8 percent to 9 percent that many economists think necessary. Most of the current decline in consumer spending has been little more than a return to something closer to a sustainable level.”
- “The current lower level of spending is still too high. While savings rates are up to 5 percent of income, overall spending is still running at about 83 percent of income, compared to a more sustainable level of 80 percent.”

Inflation Adjusted Retail Sales Have Stabilized, but are Still Below “Peak” – S.C Lagging Nation*

	U.S. Recessions*					S.C.*
	1973	1980	1990	2001	2007	2007
12 mos	-8%	-4%	-2%	+2%	-11.5%	-0.13%
24 mos	-4%	-10%	-2.5%	+1%	-10%	-9.52%
36 mos	+0.5%	-8%	+2%	+8%	-4%	-8.09%
40 mos	3%	-4%	+4%	+7.5%	-3%	-8.13%*

*US Recession data approximations from Rockefeller Institute’s July 11 State Revenue Report., Dec. 2007 through April 2011. SC data from DOR “Gross Retail Sales” reports for SFY’s 07 thru 11 (48 mos).

Comparison of Gross and Net Taxable Sales

FY 2000 – FY 2011

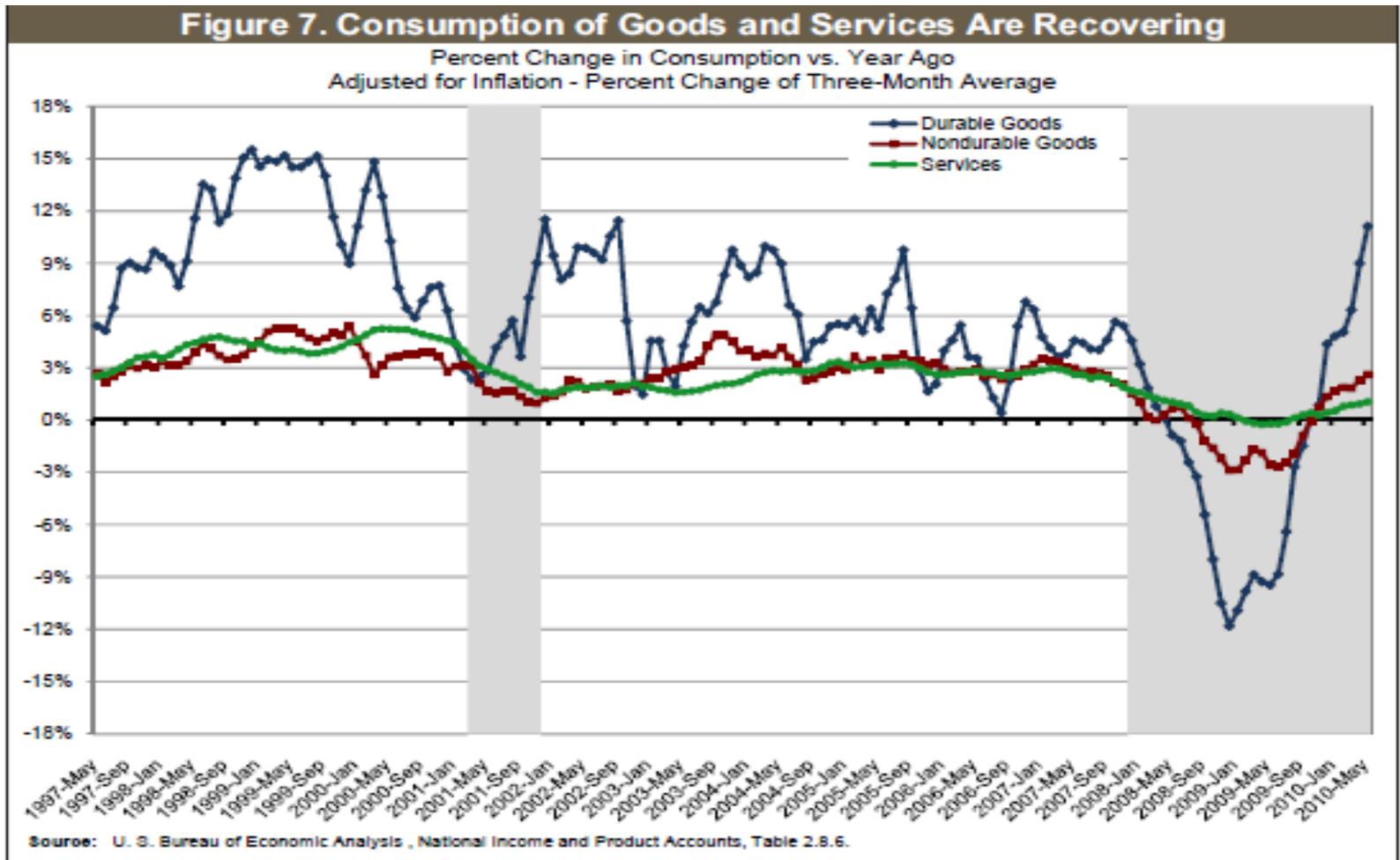
	<u>FY 2000</u>	<u>FY 2011</u>	
Gross Sales Amount	94,435,505,424	142,299,773,124	3.8%/yr.
Net Taxable Sales Amount	45,199,250,866	51,890,792,002	1.3%/yr.
Percentage of Net Taxable Sales	47.9%	36.5%	

	<u>FY 2010</u>	<u>FY 2011</u>	
Gross Sales Amount	139,097,145,909	142,299,773,124	+2.3%
Net Taxable Sales Amount	52,321,229,756	51,890,792,002	-0.82%
Percentage of Net Taxable Sales	37.6%	36.5%	

Source: Department of Revenue, Annual Reports.

The Base is Shrinking.

“Retail Sales: Services = Stability in a Volatile World?”



TRAC

Recommendations - Overview

- Sales and Use
 - Generally, State and Local
 - *Exemptions/Exclusions/Max Taxes*
 - Ecommerce vs. Brick/Mortar
 - *Services/Intangibles*
 - Streamline
 - Fair Tax
- Individual Income Tax
- Corporate Income Tax
- Timely Conformity
- Property Tax
- Fuel Tax
- Tourism Tax(es)
- Other Funds

FY 2012-13 Budget/Revenue Outlook Summary

BEA Revenue Estimates 11/10/2011

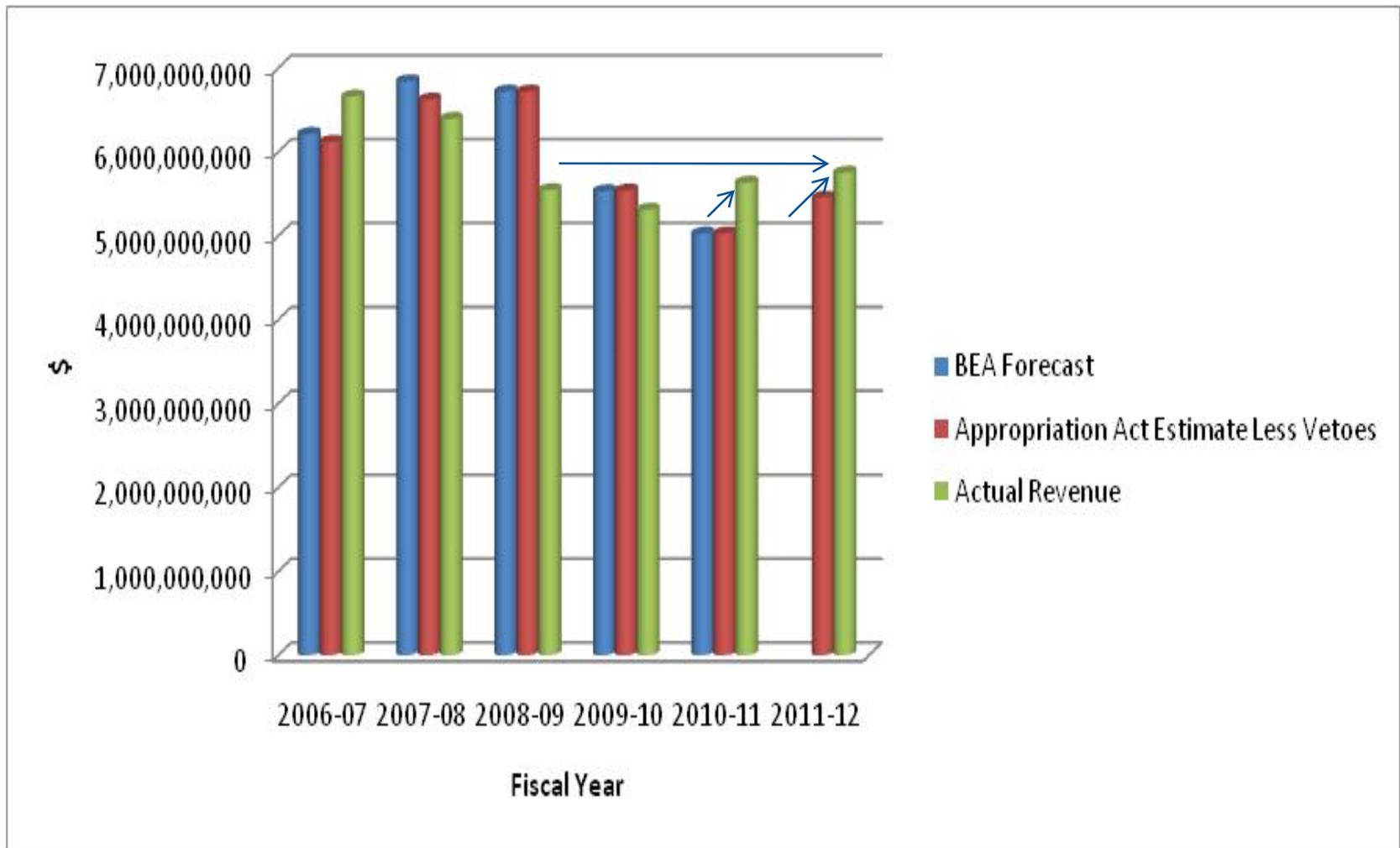
	Recurring Funds	One-Time Nonrecurring Funds
<u>FY 2012-2013</u>		
Projected "New" General Fund Revenue	493,370,377	1/
<u>FY 2011-2012</u>		
FY 2011-12 Contingency Reserve Fund		122,736,531
Projected FY 11-12 Surplus		<u>261,372,008</u> 2/
Total FY 2011-12 Surplus		384,108,539
<u>Capital Reserve Fund</u>		
FY 2011-12 Capital Reserve Fund		104,837,915

NOTES:

1/ FY 2012-13 'New Revenue' is the BEA forecast net of the Tax Relief Trust Fund and the General Reserve Fund contribution compared to the FY 2011-12 appropriation base of \$5,452,748,140.

2/ FY 2011-12 Surplus is the amount estimated by the BEA as of November 2011. Actual amount of surplus will be determined at year-end by the Comptroller General in August 2012.

A Welcome Change, but Will It Last?



Capitalism 4.0 by Anatole Kalesky

- **The reinvention of economic theory has started**
- “Predictions of the second Great Depression gave way to a new cliché in 2010: the Great Recession. But the truth is that the world in 2010 embarked on a Great Transition comparable to the transition forty years before from the Keynesian era to the Reagan-Thatcher market fundamentalism era and the even bigger transition forty years before that, from classical free-market capitalism to the Keynesian New Deal. It is not just the interaction of government with markets that is changing, it is also the debate about fundamental political and economic ideas.”



Federal Budget Outlook & Its Impact on the State Budget

Top 10 Statewide Federal Revenue Sources

Fiscal Years 1994-95 and 2009-10

Description	Amounts		Difference	Avg Annual % Change
	1994-95	2009-10		
<u>Federal Funds</u>				
1 DHHS Medicaid Assistance Payments <i>(FY 09-10 Includes ARRA)</i>	1,443,188,191	3,470,079,970	2,026,891,779	6.0%
2 DSS Food Stamp Coupons	301,893,005	1,032,207,479	730,314,474	8.5%
3 DOT Federal Grants	245,045,118	479,534,345	234,489,227	4.6%
4 DHHS Disproportionate Share	93,746,470	310,935,181	217,188,711	8.3%
5 ARRA Budget Stabilization Funds <i>(K-12, Higher Ed, Other Govt Serv)</i>		245,839,487	245,839,487	-
6 SDE School Food Services - District	93,806,685	206,644,704	112,838,019	5.4%
7 SDE Chapter I - Low Income	87,104,395	203,422,865	116,318,470	5.8%
8 DHHS Medicaid Asst Pymts - Refund Prior Yr Expenditure	-	164,151,993	164,151,993	-
9 SDE Title VI Part B Handicapped	29,305,979	141,259,215	111,953,236	11.1%
10 MUSC Health Services Research and Development Grants	39,884,506	136,116,711	96,232,205	8.5%
Totals	2,333,974,349	6,390,191,950	4,056,217,601	6.9%

Note: The listing of the top 10 Federal Funds sources represents 83% of the total of \$7,674,322,841.

Source: Office of State Budget, August 2011

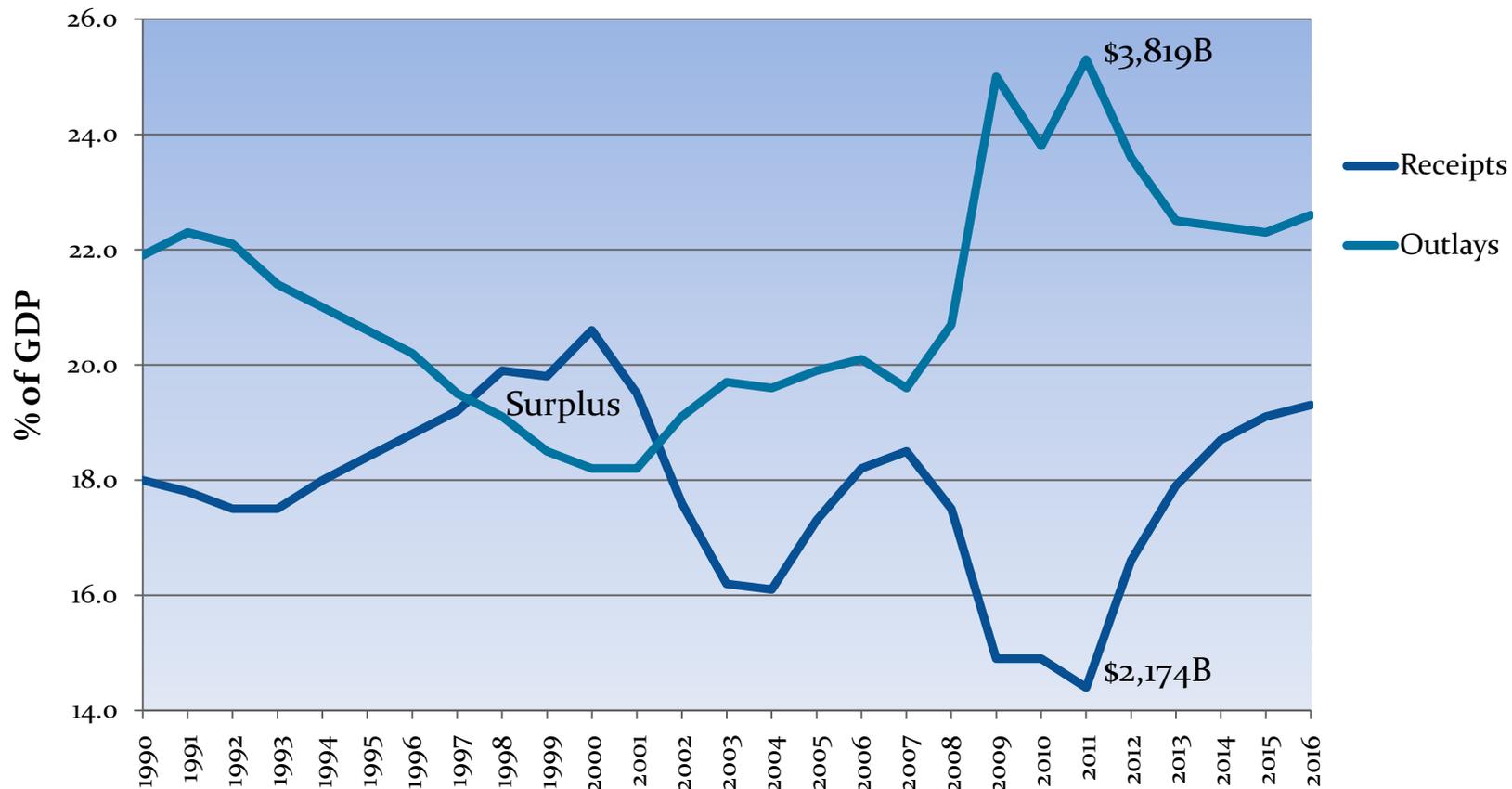
Top 10 Statewide Other Revenue Sources Fiscal Years 1994-95 and 2009-10

Description	Amounts		Difference	Avg Annual % Change
	1994-95	2009-10		
<u>Other Funds - Earmarked/Restricted</u>				
1 University Fees	428,475,336	1,772,288,257	1,343,812,921	9.9%
2 Medicare and Medicaid Reimbursements	375,563,268	553,616,642	178,053,374	2.6%
3 Sales Tax - EIA	366,650,309	551,283,727	184,633,418	2.8%
4 Gasoline Tax	214,376,940	410,915,981	196,539,041	4.4%
5 Auxiliary Enterprises - Sales and Services	182,278,795	311,607,591	129,328,796	3.6%
6 Contributions Hospitals/ Medicaid Hospital MIAA	93,746,470	268,754,468	175,007,998	7.3%
7 Lottery Proceeds	-	262,027,686	262,027,686	-
8 Medicaid CPE	-	156,861,265	156,861,265	-
9 Motor Vehicle Licenses	-	135,380,777	135,380,777	-
10 Special Fuel Tax	68,591,714	107,445,625	38,853,911	3.0%
Totals	1,729,682,832	4,530,182,019	2,800,499,187	6.6%

Note: The listing of the top 10 Other Funds sources represents 62% of the total of \$7,328,092,585.

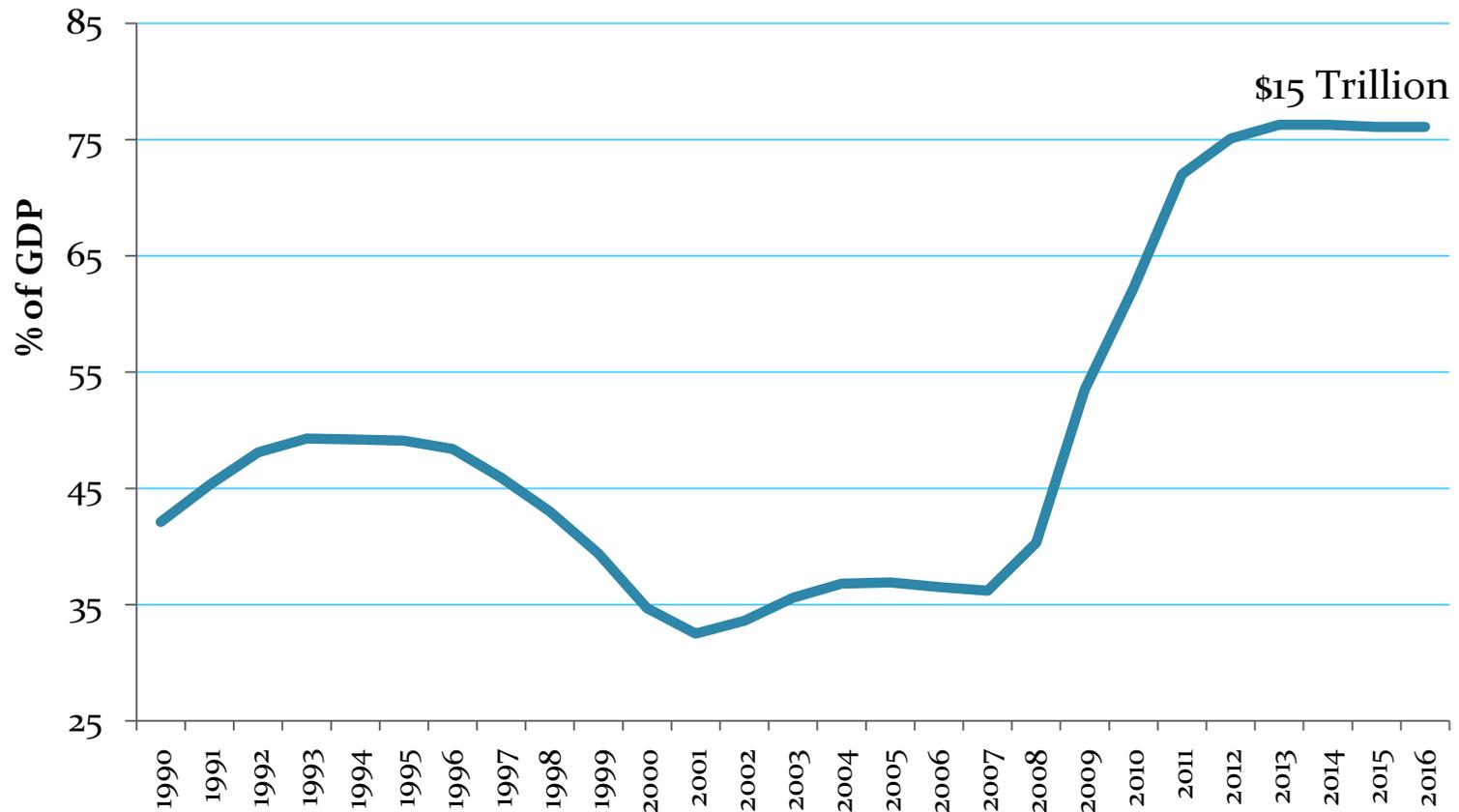
Source: Office of State Budget, August 2011

Federal Receipts and Outlays % of GDP



Source: US Bureau of Economic Analysis, July 2011

Federal Debt Held by Public



Source: US Bureau of Economic Analysis, July 2011

GDP and Public Debt

Debt as % of GDP CIA Factbook '10

- Japan 197.5%
- Italy 119.1%
- Greece 142.8%
- Canada 84.0%
- Germany 83.2%
- United Kingdom 76.1%
- Mexico 36.8%
- Ethiopia 47.9%
- China 18.9%
- Kuwait 11.9%
- Libya 3.3%

GDP CIA Factbook (Purchasing Power Parity)

- US \$14.66T
- China \$10.09T
- Japan \$4.31T
- India \$4.06T
- Germany \$2.94T
- UK \$2.173T
- Russia \$2.223T
- France \$2.145T
- Brazil \$2.172T
- Italy \$1.774T
- Mexico \$1.567T

Note : US Federal DEFICIT ≈ Mexico GDP

“A Slight Acquaintance” “An Essay on the Principle of Population” by Thomas Malthus, published 1798

- "Population, when unchecked, increases in a geometrical ratio. Subsistence only increases in an arithmetical ratio. A slight acquaintance with numbers will show the immensity of the first power compared to the second".

Monday, July 4, 2011

Samuelson: America's unhappy birthday

By Robert J. Samuelson
Washington Post

- **We are now engaged in a messy debate over big budget deficits and the size of government.**
- **Given an aging population — which boosts Social Security and Medicare spending — government is automatically expanding. Since 1971, federal spending has averaged 21 percent of the economy (gross domestic product); just continuing present programs could easily raise that to 28 percent of GDP by 2021. The liberal-reactionaries can't smoothly finance that. In 2011, the deficit is already twice the entire defense budget. The richest 10 percent already pay 55 percent of federal taxes. The blanket embrace of all benefits for the elderly — no matter how rich — will require much higher taxes or steep cuts in other programs, including those for the poor.**

Didn't We See This Coming? YES ...

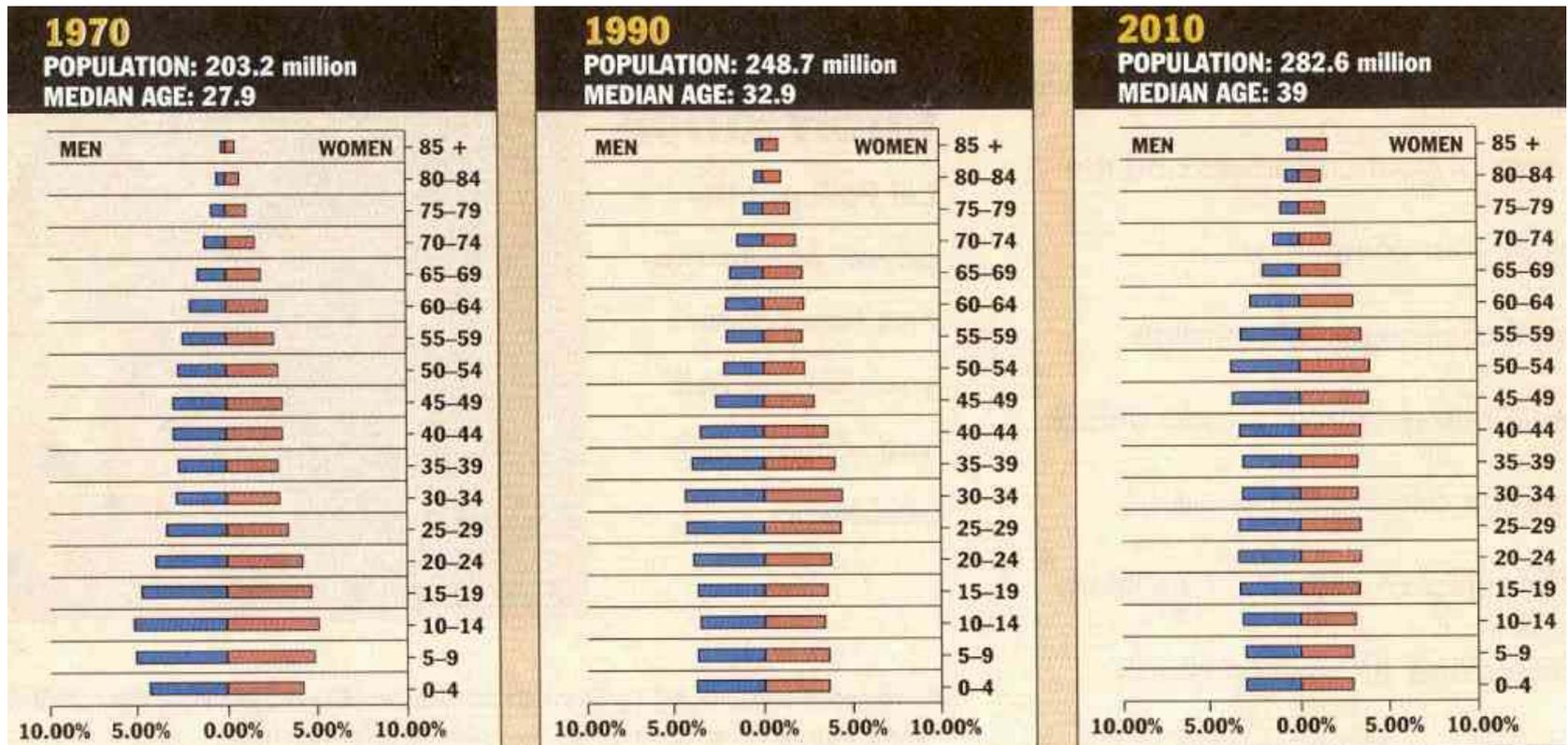
But,

**“The United States invariably does
the right thing.**

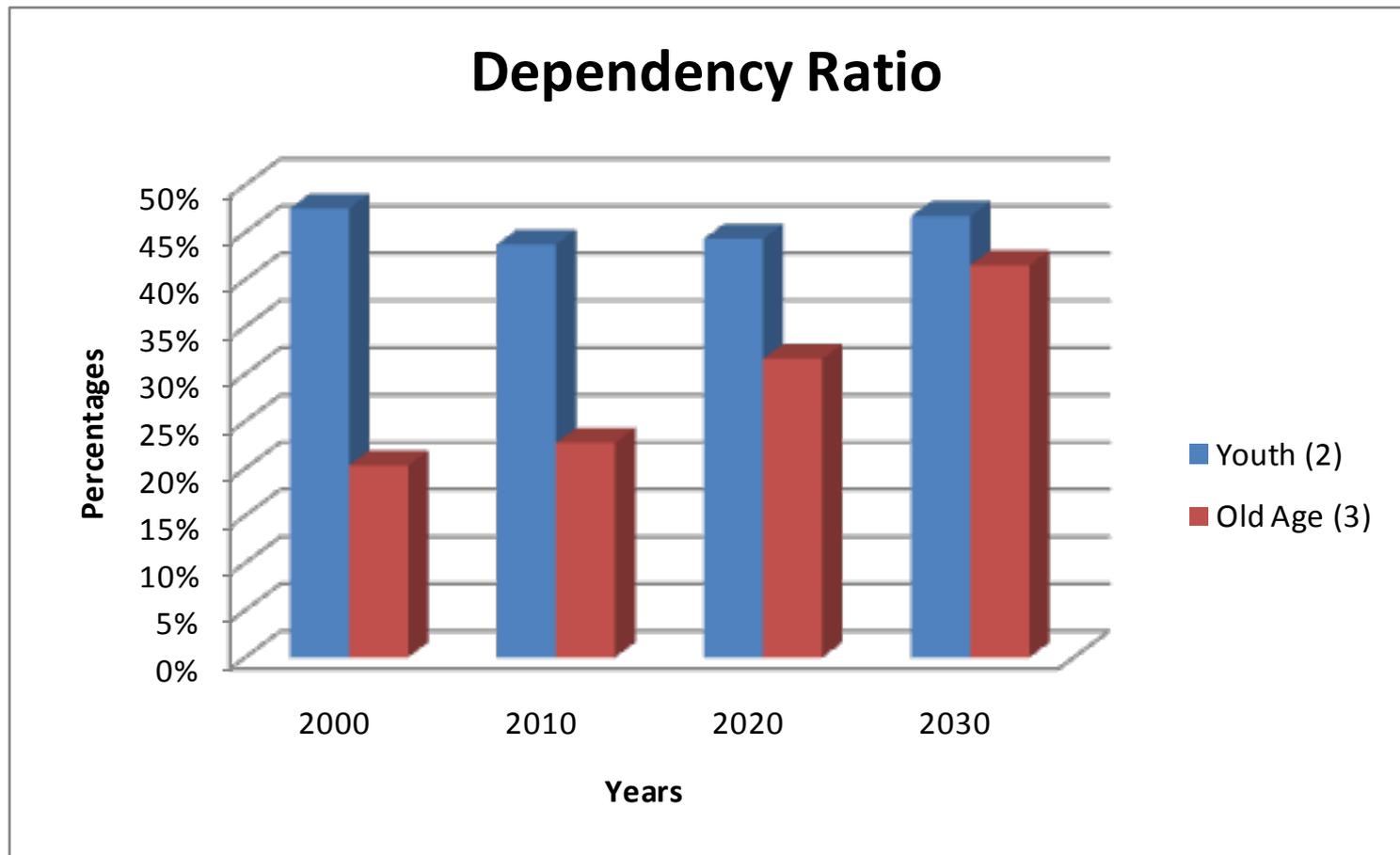
**After it has exhausted every other
alternative.”**

Winston Churchill

Population Pyramids



Dependency Ratios for South Carolina



Source: US Census Bureau

“The Lost Decade”

David Brooks, NY Times

September 26,. 2011

- The prognosis for the next few years is bad with a chance of worse. And the economic conditions are not even the scary part. The scary part is the political class’s inability to think about the economy in a realistic way.
- This crisis has many currents, which merge and feed off each other. There is the lack of consumer demand, the credit crunch, the continuing slide in housing prices, the freeze in business investment, the still hefty consumer debt levels and the skills mismatch — not to mention regulatory burdens, the business class’s utter lack of confidence in the White House, the looming explosion of entitlement costs, the public’s lack of confidence in institutions across the board.

Question:

- If these longer term trends have been evident for so long, how did the national economy produce such great gains in the 90's and the early 2000's?

America's grim budget outlook

By Fareed Zakaria

Monday, March 7, 2011

- America's growth and prosperity over the past few decades have been consequences of major investments made in the 1950s and 1960s. Some of those are the interstate highway system; a public education system that was the envy of the world; massive funding for science and technology that produced the semiconductor industry, large-scale computing, the Internet and the global positioning system. When we look back in 20 years, what investments will we point to that created the next generation of growth for the next generation of Americans?

“The Great Restoration”

David Brooks, NY Times, 10/17/11

- Quietly but decisively, Americans are trying to restore the moral norms that undergird our economic system.
- The first norm is that you shouldn't spend more than you take in. After an explosion of debt over the past few decades, Americans are now reacting strongly against the debt culture.
- Second, Americans are trying to re-establish the link between effort and reward. This was the link that was severed on Wall Street, where so many made so much for work that served no productive purpose. This was the link that was frayed by the bailouts, when people who broke the rules still got rewarded.
- The third norm is that loyalty matters. A few years ago there was a celebration of Free Agent Nation. But now most people, even most young people, would rather work long-term for one company than move around in search of freedom and opportunity.



What is the Prescription for a Return to Long Term Growth?

Five Pillars of Prosperity

Friedman & Mandlebaun, That Used to Be Us

- Providing Public Education for More Americans.
- Building and Continually Modernizing Our Infrastructure.
- Keeping America's Doors to Immigration Open.
- Government Support for Basic Research and Development.
- Implementation of Necessary Regulations on Private Economic Activity.

Thomas L. Friedman & Michael Mandelbaum: That Used to Be Us

“Let’s start with a simple declarative sentence: The merger of globalization and the IT revolution that coincided with the transition from the twentieth to the twenty-first century is changing everything– every job, every industry, every service, every hierarchical institution. It is creating new markets and new economic and political realities practically overnight. This merger has raised the level of skill a person needs to obtain and retain any good job, while at the same time increasing the global competition for every one of those jobs. It has made politics more transparent, the world more connected, dictators more vulnerable, and both individuals and small groups more empowered.”

Thomas L. Friedman & Michael Mandelbaum: That Used to Be Us

“The big change wrought by the merger of globalization and the IT revolution, argue Katz and Autor (*Grand Challenges in the Study of Employment and Technological Change*), was the creation of “a labor market that greatly rewards workers with college and graduate degrees but is unfavorable to the particularly less-educated males.” This trend is called “employment polarization,” or skilled-biased technological change. It means that a computer or a robot makes an educated person more productive and able to sell his or her goods and services in more markets around the world, but often makes a less-educated person less employable. When globalization and IT converge, the best-educated workers get raises and the least-educated get pink slips– or don’t get jobs in the first place.”

Thomas L. Friedman & Michael Mandelbaum: That Used to Be Us

Michelle Rhee, the former chancellor of the Washington, D.C., school system, put it this way in an interview in Washingtonian magazine immediately after stepping down from the job (December 2010):

“This country is in significant crisis in education, and we don’t know it. If you look at other countries, like Singapore—Singapore’s knocking it out of the box. Why? Because the number-one strategy in their economic plan is education. We treat education as a social issue. And I’ll tell you what happens with social issues: When the budget crunch comes, they get swept under the rug, they get pushed aside. **We have to start treating education as an economic issue.**”

Budget Outlook

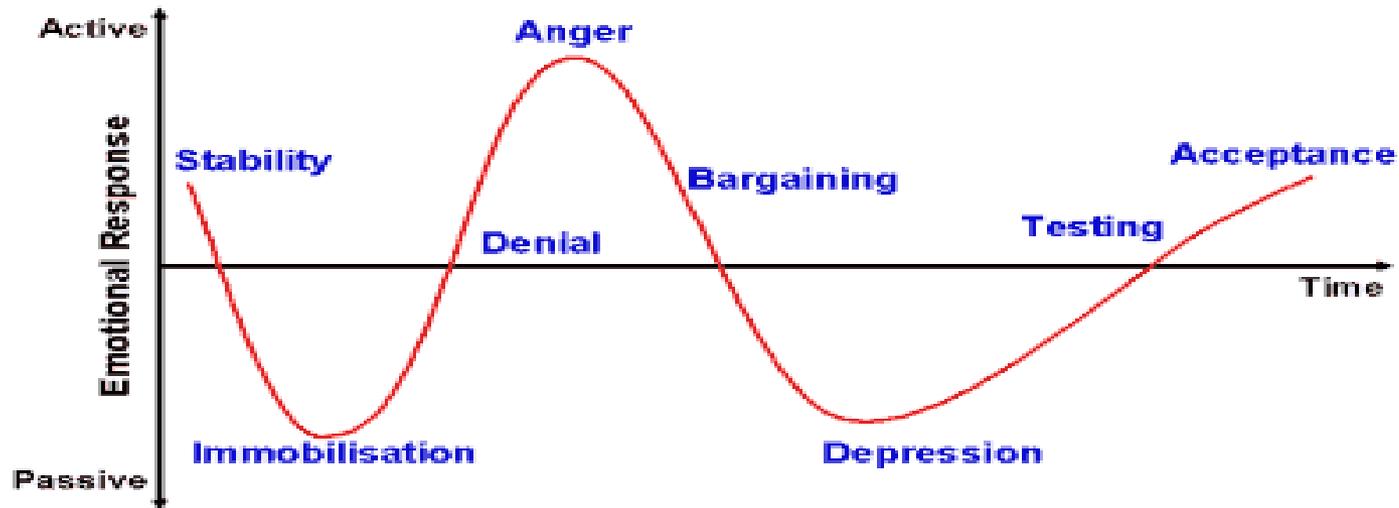
General Fund Revenue growth will be tepid for the foreseeable future.

Most Federal Funding will diminish as entitlements crowd out other federal programs.

The trend to other funds (fee for service) will likely grow.

Our budget discourse in the General Assembly will be dominated by the federal debate on the role and size of government ... And the federal debate is ...

Budget Outlook or The Stages of Grief



- Shock stage: Initial paralysis at hearing the bad news (9/15/08 Lehman Bankruptcy)
- Denial stage: Trying to avoid the inevitable (Past 30 years but acute recently)
- Anger stage: Frustrated outpouring of bottled-up emotion (2010 Town Hall Meetings)
- Bargaining stage: Seeking in vain for a way out (Debt Ceiling Debate 8/11)
- Depression stage: Final realization of the inevitable (11/7/12 day after General Election)
- Testing stage: Seeking realistic solutions (Beyond '12)
- Acceptance stage: Finally finding the way forward (WAY Beyond '12)

Peter Drucker

- “The greatest danger in times of turbulence is not the turbulence; it is to act with yesterday’s logic.”

Lottery & Scholarship Outlook

FY2012-13 (Preliminary)

Current Lottery Appropriations:	\$267,233,000	(FY12)
Scholarship Annualization:	+\$4,918,558	
Scholarship Growth (demand):	+\$7,346,132	(Est. for FY13)
Endowed Chairs Statutory Mandate:	+\$30,000,000	(SC 2-75-30)
Restoration of HE Technology Funds?:	+\$4,612,905	("Excess UP" FY12)
Restoration of HEEEP Funds?:	+\$1,700,000	("Excess UP" FY12)
Restoration K5 Science & Math?:	+\$18,122,729	
Unobligated FY11 Carry Forward:	-\$12,022,117	(Est. for FY13)
Excess Scholarship Funds FY11:	<u>-\$1,691,972</u>	(Est. for FY13)
Total Funding Require (FY13)=	\$320,219,315	
vs.		
Total Revenue to Appropriate (FY13)=	\$255,233,000	(Est. for FY13)

Resulting Lottery Shortfall/Deficit for FY12-13: \$64.99 Million



Thank You