Vol. 8, No. 2

Summer 1997

THE COMMUNITY LEADER'S LETTER

NEWS & VIEWS FOR SOUTH CAROLINA'S GRASSROOTS LEADERS

Court Ruling on SPD Taxing Authority Forces Changes in Governing Methods

Special purpose districts (SPDs) emerged in South Carolina during an era when county government was constitutionally restricted in the types of services it could provide. Municipalities were also severely limited in their ability to annex new territory. So residents of fast-growing suburbs turned to local legislative delegations to create SPDs to provide essential, urban-type services. Some SPDs collect user fees to pay for operations, but more than a few are financed by property taxes authorized in the statutes creating them.

Local leaders need to examine how a recent S.C. Supreme Court ruling on special purpose districts (SPDs) affects their communities. If it does, they must evaluate the options in light of local circumstances and begin educating people to what is in store. Because the public services SPDs provide are important in many communities, the court made its ruling effective December 31, 1999 to provide time for adjustment.

The court ruling in *Weaver* v. *Recreation District of Richland County* interprets Article 5 of the state constitution to mean that no unelected body can levy a tax of any kind. Article V says "no tax . . . shall be established, laid, or levied, under any pretext whatsoever, without the consent of the people or their representatives lawfully assembled . . ." That language seems pretty straightforward. Yet for a very long time, the nonelected boards of some SPDs have exercised statutory authority to levy property taxes millage up to some limit.

So before South Carolina enters the new century, a major overhaul will be required in the way local communities provide services now offered by SPDs that have lost taxing authority. With the Weaver ruling deadline looming, options for overhauling local government services must be evaluated. There appear to be five options.

1. Do nothing. Allow affected SPDs to become extinct on December 31, 1999, and their services to lapse. This option may not be feasible in some situations where services are vital to the public health and safety. Yet perhaps it can safely be exercised in a few cases. Also, affected SPDs might be able to substitute user charges for the unconstitutional property tax levy.

2. Substitute grants of funds from county budgets for money raised from SPD millage. This option probably is not politically practical because county taxpayers not in the SPD would be subsidizing services that only benefit residents of the affected SPD area. In many cases, the grant might cause a county-wide tax increase.

3. Make previously appointed SPD commissioners subject to election by voters in the district. In some cases, commissioners of SPDs are now elected. This option would significantly increase the length of ballots, perhaps call for more special elections, and increase election costs. Making affected SPD commissioners elected officials would get around the constitutional problem, but it would be a cumbersome and unattractive option in many cases.

4. Authorize the General Assembly to set millages for SPDs. Rep. Mickey Whatley of Charleston has introduced a bill that sets the annual millage in the districts affect-

(Cont. p. 4)

ECONOMIC BRIEF NO. 28

The Basics of Revenue Forecasting

This series of economic briefs explores fundamental concepts in economics and community and economic development.

Every public official involved with budgets has an economist somewhere in the background providing forecasts of total revenue and estimating revenue impact of proposed tax changes. These numbers are crucial because work can't begin on the next fiscal year's budget without some idea of how much revenue will be available for allocation.

How do economists make revenue forecasts? Most have a recipe; but like cooking, revenue forecasting is as much an art as a science.

How do economists forecast revenue? Usually they have a recipe; but like cooking, revenue forecasting is as much art as science. The basic ingredients in the recipe are the income forecast and the tax and fee structure. The seasonings are what economists refer to as elasticities—historical measures of how tax revenue responds to changes in personal income or to changes in tax rates.

How well the forecast turns out depends on whether any surprises take place in the interim. Just as power outages can mess with a pie, unexpected events can make mincemeat of economic forecasts.

An income forecast is the starting point for state revenue because general fund revenue is closely linked to state personal income. So a simple forecast projects the general fund as a share of state personal income based on past numbers. Such a forecast isn't very precise, so economists usually look at individual components of revenue, mainly income and sales taxes. That's where elasticities come in.

Individual income tax revenue is closely linked to state personal income. A 10 percent income increase generates about an 11 percent increase in individual income tax receipts; or in economic jargon, income taxes have an income elasticity of 1.1.

Sales tax revenues are also linked to income, but not all spending is subject to sales tax. Most services are exempt, as are many business purchases; and as income rises, people tend to shift more spending to services, which are not taxed.

Thus, sales tax income elasticity is only about 0.78. A 10 percent increase in the state's personal income generates about 7.8 percent more revenue from sales taxes. Similar calculations are used for other state revenue sources like "sin" taxes and fees.

The revenue projections in the article on page 3 are different from forecasts. Projections of future revenue are based on past experience, plus changes in the tax structure already approved. Projections are typically for five to fifteen years. These multiyear projections are based on average income growth rates, whereas annual forecasts are based on a specific expected income level for the next year. Unlike projections, which assume no legislative changes, forecasts also reflect expected changes in tax rules and rates.

Revenue forecasts need to be as accurate as possible. The closer forecasts can come to actual revenue, the better spending decisions a public body can make.

In furtherance of Clemson University's land-grant mission, the Community & Economic Development Program at Clemson provides access for community leaders in South Carolina to expertise in all branches of knowledge on the University campus.

Researchers Look into Fiscal Crystal Ball To Project Revenue and Spending in 2010

When most families put together a household budget, they take it a year at a time, maybe two at the most.

But when a family takes on a big obligation like a mortgage or plans a big change in its financial life-style like starting a family or retirement, a household will usually try to project somewhat farther into the future to see if its income and spending plans are sustainable. A family's financial future is sustainable if its projected income maintains or improves a family's life-style.

But, if a family looks at its anticipated spending and income ten or fifteen years down the road and finds it's going to be deeper in debt, robbing Peter to pay Paul to pay monthly bills, or living on macaroni and cheese, its life-style certainly isn't sustainable!

At the Strom Thurmond Institute, the recently completed fiscal sustainability study was trying to answer the same kinds of questions for the state of South Carolina. Researchers explored whether the state's future revenue would cover its expected spending needs. The study projected South Carolina's general fund revenue and expenditures to the year 2010.

Changes in the state finances that prompted this question weren't mortgages or retirement plans, but rather homeowners' property tax relief, the 1997 bond bill, and expanded business tax incentives. Talk by state decision makers about future changes that would alter state revenue and spending, like more income tax relief for the elderly and reducing or eliminating property tax on automobiles, also was a concern.

Looking at past experience and taking account of recent tax changes, the study projected general fund revenue at $7.8 to $7.85 billion in 2010. General fund spending came to $7.64 billion.

Taken together, projected revenue and expenditures show moderate shortfalls through 2005 with small but growing surpluses from 2006 through 2010. The projections suggest the state's budget will be very tight for the foreseeable future with revenue exceeding expenditures by less than 3 percent in 2010.

Given the state's tax structure, revenue is driven mainly by the growth in citizens' personal income and growth in population. Eighty-five percent of revenue comes from the 5 percent retail sales tax, the personal income tax, and the corporate income tax.

The retail sales tax continues to be a workhorse of state revenue, but revenue from the sales tax always grows a little more slowly than personal income. Business incentives enacted in the last few years will slow the growth of revenue from income taxes. Under the incentive program firms are allowed to retain a portion of their employees' state income tax for specific purposes and to reduce their corporate income tax liability under certain circumstances.

Expenditure projections were based on maintaining the existing level of most programs and services.

Growth in state expenditures depends mostly on population growth and especially on the age mix of that growing population. Therefore, costs of Medicaid and corrections were projected at a higher growth rate than other expenditures. Most Medicaid goes to the elderly, the fastest growing segment of the state's population. The prison population is also expected to grow faster than the general population because of truth in sentencing legislation.

Although the cost of relief from school taxes for homeowners has been capped at 1995 levels, increases in housing values and the construc-

(Cont. p. 4)

Key assumptions in the study's projections:

Revenue projection was based on income growth of 5.5 percent a year, which included 3 percent for inflation and state population growth of 1 percent. The income growth percentage takes into account the effect of business tax incentives offered to attract industrial firms.

Yearly population growth of 1 percent.

Most expenditures were assumed to grow at 4 percent per year, the rate of population growth plus inflation—a rate simply maintaining the current level of services per person.

The Fiscal Sustainability of the South Carolina Revenue and Expenditure System **and five supporting working papers on state revenues, state expenditures, local revenues, the fiscal costs of business incentives, and the state retirement system are found on the Web at http://www.strom.clemson.edu**

Strom Thurmond Institute of Government and Public Affairs, Clemson University, Box 345203, Clemson, S.C. 29634-5203 Telephone: 864 656-4700

Nonprofit
Organization
U.S. Postage
PAID
Permit No. 10
Clemson, S.C.

COMMUNITY
AND
ECONOMIC
DEVELOPMENT
PROGRAM

CLEMSON
UNIVERSITY

The Community Leader's Letter *is printed quarterly. It is the newsletter of the Community & Economic Development Program at Clemson University, a joint program of the Strom Thurmond Institute, the Cooperative Extension Service, the S.C. Agricultural Experiment Station, the College of Business and Public Affairs, and the Office of Public Affairs. Program offices are in the Institute building on campus.*

Holley Ulbrich, Program Coordinator
Ada Lou Steirer, Research Associate
Jim Hite, Contributing Editor

Articles in the newsletter may be reprinted; however, please cite the newsletter as the source. To be added to or deleted from the mailing list or to correct an address, write or call. If you receive more than one newsletter, please notify us. Previous issues of the **Community Leader's Letter** *can be found on the Strom Thurmond Institute Web site at http://www. strom.clemson.edu/*

Court . . . *(From p. 1)*

ed by the Weaver ruling at an "amount equal to the maximum millage levy presently allowed by law in that district."

5. Transform the SPD into a special tax district (STD) wherein additional millage is levied to pay for special services that only residents of the STD receive. By law an STD, administered through County Council, is created by referendum by the voters receiving the service. So exercising this option requires the residents of the about-to-be-extinct SPD to approve its transformation to a STD.

Blanket endorsement of any one of the options for all SPDs is not appropriate. Different options will work in different situations. The Whatley Bill is seen by some as a stop-gap measure to cover outstanding bonded indebtedness in affected districts and is probably not a satisfactory long-term response to the Weaver decision. Transforming an SPD into an STD will probably be the most attractive option in many places, but it may not in all.

Important decisions affecting South Carolina local government for generations ahead will have to be made by December 31, 1999. The drop-dead date will not change.

Researchers Look into . . . *(From p. 3)*

tion of new homes are forcing this expenditure steadily upward. Debt service estimates reflect existing debt as well as new debt just authorized in the 1997 bond bill, but do not take into account any new debt service between now and 2010.

If state personal income grows faster than expected or if state auditors manage to produce big budget savings, then these tight budgets won't occur. On the other hand, if the legislature wants to improve education, introduce new programs, or work on the backlog of highway and other infrastructure needs, the revenue may not be there. And if the state experiences any major setbacks—a recession or a hurricane—the picture could be worse.

The projections are a caution flag for all South Carolinians. They suggest that legislators need to figure out how to pay for new programs or tax cuts before they exact them, because there isn't going to be a lot of *new money* to use for either purpose.

Supported by the Public Service Activities (PSA) of Clemson University. Printed on 50% recycled fiber containing 10% post-consumer waste.