

Tax cuts largely to blame for S.C. budget crisis, economists say

By John O'Connor · & 2008 The (Columbia) State
Updated 12/03/08 - 12:51 AM |

COLUMBIA -- The hundreds of millions of dollars that have been cut thus far this year from the state budget have more to do with recently approved tax cuts than the faltering economy, state economists say.

Ominously, they think the worst of the nation's economic problems have not yet hit South Carolina.

More than two dozen states, including South Carolina, are facing budget deficits. South Carolina's inclusion in that group is unusual. The state typically trails national economic trends, meaning its budget problems normally appear later in an economic cycle.

Still, the state already has been forced to cut its budget by \$621 million, with more cuts to come. Economists say those cuts largely result from tax cuts by the state and are not the result of the economy.

Those tax cuts include the Legislature's elimination of the sales tax on groceries, at an estimated cost of \$375 million, which took full effect a year ago, as well as the \$81 million cost of eliminating the state's lowest-income tax bracket.

University of South Carolina economist Doug Woodward said the tax cuts have created an "exaggerated crisis" for the state budget.

The worst, perhaps, is yet to come.

A recent report from the Nelson A. Rockefeller Institute of Government concluded state budget problems will worsen early next year. Second-quarter state revenues were "superficially strong," the report said, and states will begin to see income tax revenues fall by April.

As unemployment increases, Woodward said, fewer people pay income taxes.

State lawmakers said they have no plans to rescind the sales tax exemption on groceries.

"There're a lot of states that don't tax groceries," said Rep. James Smith, D-Richland. "I don't think we can blame it entirely on the sales tax."

However, the state's budget problems have many legislators reconsidering more than \$2 billion in items that now are exempt from sales tax.

Others, led by Gov. Mark Sanford, believe there are budget woes because the state has been spending above its means.

A telling month

Since July, the state has been running \$113 million behind its revenue estimates. Sales tax collections alone are \$72 million behind expectations.

William Gillespie, the state's chief economist, said the lost tax on groceries makes up almost the entire decline in sales tax revenues 10 percentage points of the 10.8 percent decrease.

As a result, the state's Board of Economic Advisors earlier this month lowered its revenue estimates for the fourth time since May.

Of the \$600 million in revenue shortfalls, roughly two-thirds are a result of tax cuts.

Many think the grocery sales tax cut has cost more in lost state revenue than originally estimated in 2006. Gillespie said the estimate has been accurate.

However, consumers have been spending more of their paychecks on items groceries and gas not subject to the sales tax.

The price of many grocery items, for example, has increased by a third in the past year, according to federal data. And while the price of gas has plunged in the last month, \$4-a-gallon gas this summer also might have affected tax collections.

Economists told the Board of Economic Advisors last month that anecdotal evidence suggests S.C. families are dining out less and eating at home more -- another shift away from a taxable sale, since restaurant food is taxed.

The downturn has puzzled state leaders and economists, who typically see signs in other states before they affect South Carolina. But the tax cuts, coupled with slowing growth, meant South Carolina was among the first states to experience budget deficits.

USC's Woodward said lawmakers were hoping revenue growth would make up for the tax cuts.

Still, he noted, retail sales were up in September and, adjusted for inflation, are up for the year. Likewise, S.C. employment is strong despite an 8 percent jobless rate, he said.

Business officials point to New York Conference Board data showing 55,000 S.C. help wanted ads were on the Web in October.

"It makes you wonder what's causing this state's fiscal crisis," Woodward said. "There is a bad economy, but that hasn't even hit us yet."

This month could be telling.

November sales tax data, available at the Board of Economic Advisors' December meeting, will be the first time the state will have revenue comparisons showing income for a month versus the same month a year earlier with all the tax cuts in place both months. Recent large tax revenue declines could be much smaller.

Who's to blame? What can be done?

House Speaker Bobby Harrell, R-Charleston, does not blame the tax cuts for the state's budget woes. If taxes had not been cut, Harrell said, legislators likely would have spent the money.

Sanford says much the same, laying the blame for the deficit on a 40 percent increase in state spending over the past four years.

But a recent report from the Strom Thurmond Institute of Government and Public Affairs at Clemson University said state spending, adjusted for inflation, amounts to less per person than it was a decade ago. According to the report, state spending has increased by 4.1 percent annually since 1987.

But, the report added, recent changes to the tax code have made South Carolina more vulnerable to economic swings. Those changes have made many key services, including education, more dependent on sales tax collections, which fall with a flagging economy.

Budget shortfalls, some lawmakers said, have made it clear South Carolina depends far too much on its sales tax.

That includes taking a second look at the state's tax code, specifically state law exempting more than \$2 billion in sales annually from the sales tax. Those exemptions include groceries, but also specific arthritis drugs, materials and power purchased for manufacturing, and even newsprint.

Each exemption has its defenders; eliminating any will meet with someone's disapproval.

Senate Finance Committee chairman Hugh Leatherman, R-Florence, wants a committee to suggest changes to the sales tax law that must be approved all or nothing by the Legislature.

"It will be a Pandora's Box of issues that will come out when you open it up," said Rep. Mike Pitts, R-Greenwood. "We need to eliminate sales tax exemptions."

House Ways and Means chairman Dan Cooper, R-Anderson, said political opposition will make any changes difficult despite what he sees as a need.

"It certainly puts more urgency at looking at what we exempt and why," Cooper said of the budget crunch. "(But) it's going to be tough to do it anytime in any year."

All rights reserved. This copyrighted material may not be published, broadcast or redistributed in any manner.

Ads by Yahoo!

[Online College Education](#)

Jumpstart your career. Find the right online degree for you now. StudentCorner.com

[10 Min for \\$10 Online Psychic](#)

Prof tested readers available 24/7. Get a 10 min reading for LiveReaders.com

[Top Degrees in Your Field](#)

Studies show that education pays off. Classes enrolling now. onlinecareeredu