

The Outlook for State Income & Revenues

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Introduction and Background

Recall that the state ended the 2001-02 fiscal year on June 30 with a 3.2% decline in general fund revenues. The current 2002-03 fiscal year then began in July with state spending based on an optimistic 10.2% growth in general fund revenues. Following two months of disappointing revenue growth, the State Board of Economic Advisors (BEA) revised its 2002-03 estimate in September, cutting the estimate by 6.2%, to leave an expected growth of 4.0%. However, in a later September meeting, the State Budget and Control Board chose to leave state spending at the unaltered level, which assumed that revenue would grow 10.2%. The BEA called for 4.0% revenue growth. The Budget and Control Board continued to base expenditures on 10.2% growth.

The differences were reconciled after the November election. At its November 2002 meeting, the State Board of Economic Advisors (BEA) provided an estimate of 1.4% revenue growth for the 2003-04 fiscal year. This was followed by a meeting of the State Budget and Control Board, which cut 2002-03 budgeted expenditures 5% across the board for all state agencies. At the BEA's February 2003 meeting, the BEA, seeing evidence of weakening revenues, cut the estimate another \$137 million. The cut was ratified by the Budget & Control Board the same week. Currently, revenue growth of 1.4% is needed in this fiscal year to achieve the BEA estimate. The BEA estimate for revenue growth for fiscal year 2003-04 stands at 2.0%.

At the end of March, state general fund revenues had hardly grown at all. The net increase for the year at that point was 0.05%. Indeed, revenue growth had weakened. Through February revenue growth was 0.40%. With just three months to go in this fiscal year, the prospects for achieving 1.4% growth are slim to none. But while the outlook for this fiscal year is anything but bright, things look more promising for next year.

Revenue Estimates for the Next 18 Months

Estimates of state revenue growth are based largely on expected growth in total personal income. This, in turn, depends on overall economic performance of the nation and state. The most recent estimates of national GDP and state personal income growth provided by economy.com in March look almost too good to be true. Economy.com predicted state income growth will average 3.9% in calendar 2003 and 5.1% in calendar 2004. The estimate for 2002 was 3.4%. Now, let's adjust these numbers a bit. First, taking an average of these rolling years gives the following fiscal year growth estimates: FY 2002-03, 3.65%; FY 2003-04, 4.5%. Similar calculations for FY 2004-05 gives 5.4%, and for FY 2005-06, 5.5%. Next, we must adjust FY 2002-03 to 3.00% for the slower than expected growth over the last few quarters. Based on these adjustments, and assuming no

major modifications in state taxes, I expect state general fund revenues to grow 1.0% in this fiscal year, which means there must be a large influx in the next 90 days. I expect to see 3.4% growth in the next fiscal year, which is more than the 1.8% growth estimate used in current budget process, and 3.5% in FY 2005-06. In summary, there is a good chance of a shortfall in this fiscal year and a gain over plan in next fiscal year.

Graphical Presentation

The accompanying chart shows actual GDP growth, S.C. total personal income growth, and revenue growth for 1994-2002, all in nominal terms. Projections for the three series are shown for 2003-2006. The data for all observations are included with the graph. It should be noted and emphasized that the projections tend to be much smoother than past actual data. This suggests that the actual record will show more variation than implied by the estimates.

**S.C. Income Growth & General Fund Revenues
1990-2002
Estimates to 2006**

