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1989/90

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NOVEMBER 1 FIRST OFFICIAL ESTIMATE

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STATE OF SOUTH CAROLINA
BOARD OF ECONOMIC ADVISORS.

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To: South Carolina Budget and Control Board

Subject: November 1 First Official Estimate for FY 1989-90

In accordance with Sections 11-9-880 and 11-9-890 of the 1976 Code, as amended, the Board of Economic Advisors submits the first official estimate for Fiscal Year 1989-90 and corresponding quarterly estimates.

There are difficulties in preparing such an estimate inherent in the forecasting process at all times, but this year there is a series of unusually perplexing circumstances for consideration. The first is the revenue base from which to project the forecast. With final Individual Income Tax collections in FY 1987-88 in excess of the estimate and the proportion yet to be satisfactorily attributed between economic growth and changes due to conformity to the Federal Code, determination of the base from which to project the upcoming fiscal year becomes particularly complex. The second is the national economic setting and a proper assessment of the probabilities of a continuation of an expansion of such lengthy duration. Another uncertainty is the anticipated rate of inflation and a forecast of the Federal Reserve's assessment and response to it along with the impact of this on interest rates and the value of the dollar. Also, to be included is the political scene and the impact on the economy of the

policies of President Reagan's successor.

With all these factors taken into consideration, the scenario for the estimate is one of continued but uneven expansion throughout the forecast period but with a real danger of a downturn of either the soft landing or boom/bust variety occurring during the forecast period. With growth averaging in the 6.5 - 7.5% range accompanied by rising inflation but still at modest rates compared to the late 1970's and early 1980's, real growth should average 2 - 2.5% with inflation in the 4.5 - 5% range. Growth should be higher in the earlier part of the forecast period. These are consensus forecasts.

In South Carolina growth should be at or possibly somewhat above national rates depending significantly on the value of the dollar, the length of the time lag for changes in its value to affect the economy, and the rate of expansion at which the economy is operating at the critical point in the expansion cycle.

It would be prudent at this time to be cautious about the inherent danger of a greater probability of a recession occurring, if growth becomes too robust and inflation shows signs of seriously getting out of control. With plants currently operating at 83-84% capacity and many at capacity, labor shortages and production bottlenecks with uneven delivery schedules could develop. The Federal Reserve would then adopt a more restrictive monetary policy. If this is not done soon enough, or if the squeeze is too tight or not done over a long enough time period, a classic boom/bust cycle could occur and render the forecast too optimistic.

Given these assumptions, with great uncertainty of the year's pattern, the Board of Economic Advisors estimates revenue of \$3,102.7 million for Fiscal Year 1988-89 which exceeds the Appropriation Act for Fiscal Year 1988-89 by \$8.9 million. Revenues of \$3,280 million are estimated for Fiscal Year 1989-90. This is an increase of \$186.2 million or 6 percent over the 1988-89 Appropriation Act. A close monitoring of ensuing data and events will continue. A clearer picture of the direction of the economy through June 1990--whether continued modest but uneven growth, soft landing, or boom/bust recession--should be emerging by the first of the year.

Board of Economic Advisors

W.R.P.

October 25, 1988

TABLE I

GENERAL FUND REVENUES
Forecast 1988-89 and 1989-90
In Millions of Dollars

	ACTUAL 1987-88	ESTIMATE 1988-89	ESTIMATE 1989-90
TOTAL GENERAL FUND (1)	2931.6	3102.7	3280.0
Total Regular Sources (1)	2880.6	3058.0	3238.0
Sales Tax (1)	1006.6	1075.0	1119.0
Individual Income Tax	1142.0	1233.0	1329.0
Corporation Income Tax	196.2	206.0	219.0
All Other	535.8	544.0	571.0
Miscellaneous Sources	51.1	44.7	42.0
Education Improvement Fund	251.1	268.75*	279.65*
Interest on Education Improvement Fund	1.7	1.9	1.9
TOTAL	252.8	270.65	281.55
		<u>RATES OF CHANGE**</u>	
TOTAL GENERAL FUND		5.8%	5.7%
Total Regular Sources		6.2	5.9
Sales Tax		6.8	4.1
Individual Income Tax		8.0	7.8
Corporation Income Tax		5.0	6.3
All Other		1.5	5.0
Miscellaneous Sources		-12.4	-6.0
Education Improvement Fund		7.0	4.1
Interest on Education Improvement Fund		13.1	-
TOTAL		7.1	4.0

(1) Net of Education Improvement Fund.

* One-fifth of total sales tax.

** Percent change based on unrounded figures.

TOTAL GENERAL FUND REVENUES
 QUARTERLY ESTIMATES
 Fiscal Years 1988-89 and 1989-90
 (In Millions of Dollars)

	FY 1988-89 -----	FY 1989-90 -----
FIRST QUARTER	770.6	816.7
SECOND QUARTER	1555.6	1653.1
THIRD QUARTER	2281.6	2407.5
FOURTH QUARTER	3102.7	3280.0

PERCENT OF TOTAL REVENUES
 COLLECTION BY QUARTER

	FY 1988-89 -----	FY 1989-90 -----
FIRST QUARTER	24.8	24.9
SECOND QUARTER	25.3	25.5
THIRD QUARTER	23.4	23.0
FOURTH QUARTER	26.5	26.6

Board of Economic Advisors
 October 25, 1988

REVENUE FORECASTING PROCEDURES
BOARD OF ECONOMIC ADVISORS
FISCAL YEAR 1990

The procedures and methodology of the Board of Economic Advisors in the preparation of the first official revenue forecast for Fiscal Year 1989-90 involved four major stages: 1) providing the economic background and setting at the national and State levels for the revenue forecasts; 2) reconciling the February 12, 1988 Board of Economic Advisors Estimate for Fiscal Year 1988-89 with Legislative actions in the 1989 Appropriation Act; 3) interpreting recent and historical revenue relationships; and 4) interacting with officials of other states with responsibility for revenue forecasting.

The Board members had meetings as in the past with experts and professional economists for economic intelligence gathering. These included a meeting in Columbia on October 19, 1988 with David A. Wyss, Ph.D., Senior Vice President and Financial Economist, Data Resources, Inc.; Dan M. Bechter, Ph.D., Vice President, Federal Reserve Bank of Richmond; Ben E. Laden, Ph.D., Economist, Maryland Capital Management, Inc.; Bruce L. Williams, Corporate Economist, Southern Bell Telephone Company, Atlanta; Bruce Yandle, Ph.D., Alumni Professor of Economics, Department of Economics, Clemson University; Ronald P. Wilder, Ph.D., Chairman, Department of Economics, University of South Carolina; and James A. Morris, Ph.D., Distinguished Professor of Economics Emeritus, University of South Carolina. In which the outlook for the economy of the nation and South Carolina was discussed. The resources of the national forecasting groups by which the SCOPE model, when operative, and other forecasts are driven, Data Resources, Inc., Evans Economics, Inc., and WEFA, Inc., were available weekly and monthly to Board members and staff. Materials from a variety of sources--international, national and State publications--were also made available to Board members and staff. In addition, there was Board interaction with Martin S. Feldstein, Professor of Economics, Harvard University and President of the National Bureau of Economic Research, and former Chairman of the President's Council of Economic Advisors, and Roger E. Brinner, Chief Economist, McGraw Hill Financial Services Company, and others at the U.S. Economic Outlook Conference held on October 4 in New York City by Data Resources, Inc. Additionally, there was Board interaction with Lawrence Chimerine, Chairman, the WEFA Group; Mark Zandi, Director, U.S. Financial Services; Paul Getman, Director, Financial Services Group; and others of WEFA at a regional conference held on September 22 in Atlanta by the WEFA group.

In the absence of a duly constituted Board of Economic Advisors, the Chairman met on September 6 with the ex-officio Board member, Dr. James A. Morris as advisor and the Board's staff to develop an informal working estimate for FY 1989-90. On October 19 the newly constituted Board of Economic Advisors convened in preparation for the first official estimate for 1989-90. The Board considered several approximations for FY 1989-90 based on information received earlier from the visiting economic and financial experts as well as on revenue collections and further economic and revenue analysis.

Board of Economic Advisors
October 25, 1988

BRIEF OVERVIEW OF THE SCOPE MODEL

The SCOPE (South Carolina Operations Planning and Evaluation) Model was initiated in 1972 in the Office of Chief Economist (originally in the Governor's office). It was designed and operated as a policy and forecasting tool for top level executive, legislative and management decision making. SCOPE is an econometric model designed to reflect the South Carolina economy and to forecast the performance of major economic variables in the State, particularly tax revenues, employment and income. The model is based on a framework of economic activity in the State relative to national economic activity with approximately 85 exogenous national variables provided by leading national forecasting services such as Data Resources, Inc., the WEFA Group, and Evans Economics, Inc.

The SCOPE core model consists of 63 equations, of which 55 are stochastic* and 8 are identities. SCOPE attempts to reflect the diversity of the South Carolina economy by including 20 industrial sectors of manufacturing and nonmanufacturing employment, and a series of equations for wages, personal income, unemployment, taxable sales and State tax revenue.

Durable Manufacturing Employment

The durable manufacturing employment block consists of 6 stochastic equations for the major industries in the State as reported by the South Carolina Employment Security Commission. The employment equations for each separate industry are expressed as a function of a national consumption expenditure index appropriate for that particular industry, a national industrial production index corresponding to that industry and the national level of employment in that industry. The durable employment forecasts include the following industries: Lumber and Products, Stone, Clay and Glass, Fabricated Metal Products, Electrical and Nonelectrical Machinery, and Other Durables which includes Furniture and Fixtures, Instruments and Related Products.

Nondurable Manufacturing Employment

The nondurable manufacturing employment block consists of 7 stochastic equations for the major nondurable industries in the State. Like the durable block, the employment equation for each industry is expressed as a function of a national consumption index appropriate for that particular industry, a national industrial production index for that particular industry and the national level of employment in that industry. Employment forecasts are available for each of the following nondurable industries: Food and Kindred Products, Textile Mill Products, Apparel, Paper, Printing and Publishing, Chemicals, and Other Nondurables, such as Rubber and Miscellaneous Plastics Products.

Nonmanufacturing Employment

The nonmanufacturing employment block is disaggregated into 7 stochastic equations: Construction, Transportation and Public Utilities, Services, Trade, Finance-Insurance-Real Estate, State and Local Government, and Federal Government. Employment growth in these industries is specified as functions of State population, national employment in these industries and national consumption indices.

Personal Income

The personal income block is composed of 11 equations, one equation for the unemployment rate, and 10 additional equations for each of the 10 major components of personal income as published by the Bureau of Economic Analysis, Department of Commerce. These equations are specified as functions of their respective national and State income and employment variables. In addition, equations are estimated for wage and salary disbursements for all major industries and are specified as functions of national wage trends and State employment levels.

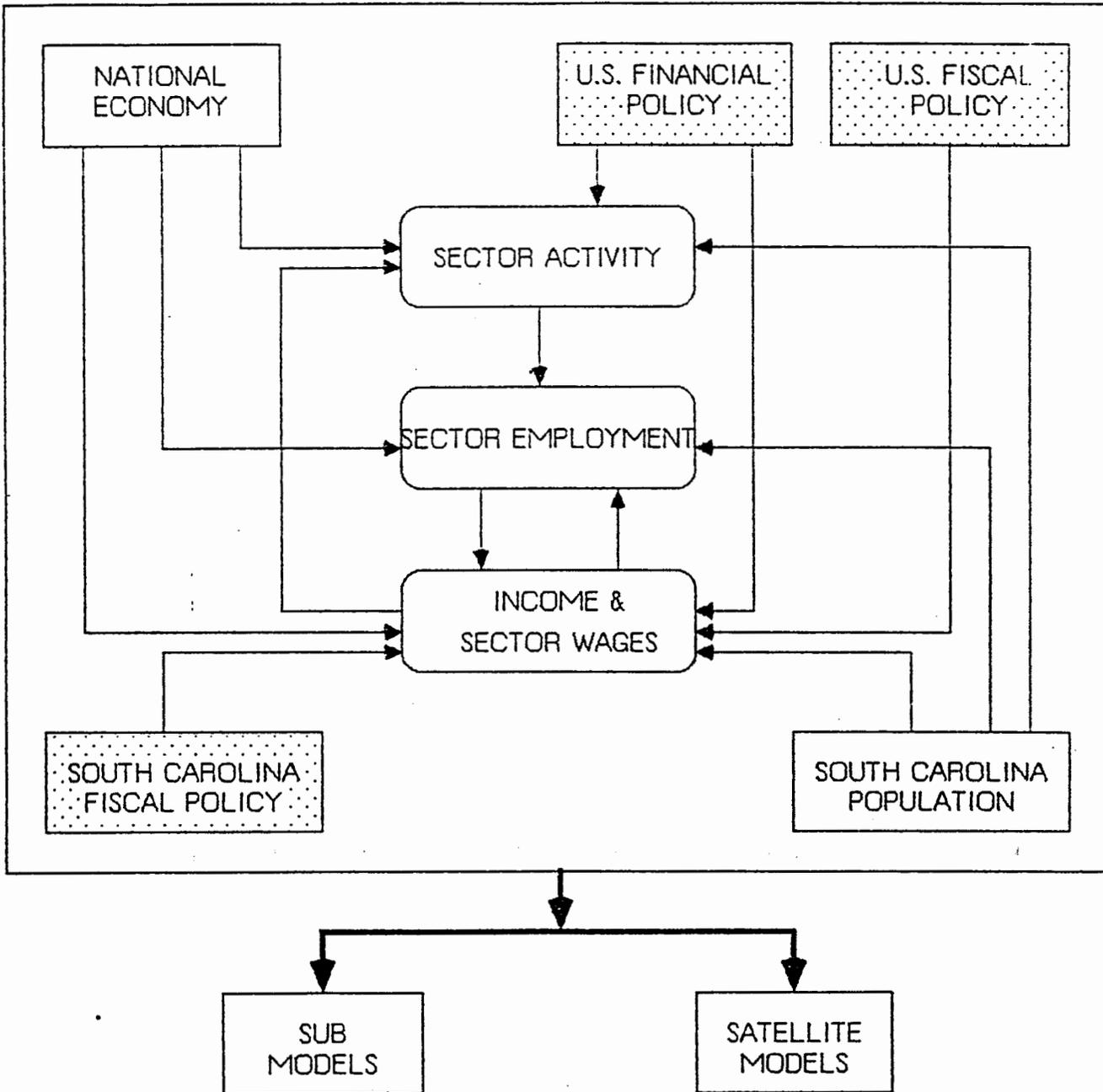
Revenues

The revenue section of the model emphasizes 4 major stochastic Regular Revenue Sources equations: 1) South Carolina corporate income tax, 2) South Carolina individual income taxes, 3) South Carolina retail sales tax, and 4) all other taxes. These equations are individually specified as functions of aggregate employment and income with their respective coefficients and constants. In addition, there are 2 stochastic equations for taxable sales and refunds.

The model is currently undergoing major revisions to incorporate recently developed econometric techniques and to reflect significant structural changes in the national and South Carolina economies.

SCOPE MODEL

SOUTH CAROLINA OPERATIONS, PLANNING & EVALUATION MODEL



- Exogenous Variables
- Exogenous Policy Variables
- Endogenous Variables