STATUS OF THIRD QUARTER REVENUES FY...

STATE OF SOUTH CAROLINA
BOARD OF ECONOMIC ADVISORS

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To: South Carolina Budget and Control Board

Subject: Status of Third Quarter Revenues for Fiscal Year 1989-90

In response to the request of the Budget and Control Board, a comparison of the first three quarters of actual revenues for Fiscal Year 1989-90 with the Forecast of revenues for Fiscal Year 1989-90 is provided herein.

Collections to date for Fiscal Year 1989-90 in the major categories of revenue, with the notable exception of the Corporate Income Tax, have been close to target. The Corporate Income Tax has fallen far short of the estimate. By the close of the fiscal year, it is anticipated that Corporate Income Tax revenues will have shown the sharpest percentage decline from a prior year since Fiscal Year 1952-53. This would put Corporate Income Tax collections at their lowest dollar level since Fiscal Year 1983-84.

Early warnings of a decline in Corporate Income revenues appeared after the February 15, 1989 upward revision. Steps were taken at the time of the November 1, 1989 estimates to adjust for the bleaker Corporate Income Tax outlook for this fiscal year by the $17 million downward revision made at the time. From the current perspective, a more proper adjustment would have been to apply the revision to the unrevised base. This explains one-third the decline but still leaves unexplained the remaining two-thirds, the cause of real decline, from $211.2 actually collected last fiscal year to the $162 million now estimated for this fiscal year. The decline is not unique to South Carolina or to other Southeastern States. It is affecting revenues throughout the nation, causing disruption to the budgeting process in states that do not have safeguards against such a phenomenon.

Historically, Corporate Income Tax collections have been the most difficult of the major categories to forecast. They do not immediately mirror trends in the economy as do those for the Individual Income and Sales taxes. With the latter, a good economic forecast will on balance bring a good revenue forecast. This is not true for revenues from the Corporate Income Tax for any particular year. Because this tax is one-fifth or less the size of either the Sales or Individual Income Tax, the deviation from forecast is usually counterbalanced by other major taxes. This year the steepness of the decline from $222 million estimated to $162 million anticipated has precluded that. The strength in the other four major categories has been greater than anticipated but will only contribute a combined offset of $23 million.

For this reason, the Board of Economic Advisors has determined that a downward revision for Fiscal Year 1989-90 revenues of $37 million to $3318 million is warranted. The distribution of the revision is shown in Table I.

At the same time, the Board of Economic Advisors has considered the effect of the revision for Fiscal Year 1989-90 on Fiscal Year 1990-91. The forecasts for Fiscal Year 1989-90 and Fiscal Year 1990-91 made in November assumed a period characterized by slow growth but no recession. Another assumption was that the pace of economic activity would increase after the close of the current fiscal year. These assumptions seem to be correct. Indeed, overall growth this fiscal year has been somewhat stronger than the national forecasters had anticipated and the encounter with recession less close. These developments will contribute a more favorable base for Fiscal Year 1990-91. Additionally, a turnaround in Corporate profits coinciding with next fiscal year is also being forecast. Further, the distribution of the revenue revisions made for Fiscal Year 1989-90 together with residual strength from the aftereffects of Hugo should provide a somewhat stronger thrust to Fiscal Year 1990-91.

On the basis of these developments resulting in upward adjustments in four of the major categories and downward adjustment in Corporate Income Tax in Fiscal Year 1990-91, the Board of Economic Advisors has concluded that no basis for change in the overall estimate of $3538.5 million for Fiscal Year 1990-91 is warranted with the exception of an appropriate allowance for the impact of the Federal minimum wage on the Individual Income Tax. With this adjustment the estimate for Fiscal Year 1990-91 is $3540.5 million.

Board of Economic Advisors

W.R.P.

April 9, 1990

TABLE I
GENERAL FUND REVENUES
Forecast FY 1989-90 and FY 1990-91
(In Millions of Dollars)

	ACTUAL FY 1988-89	ESTIMATE FY 1989-90	ESTIMATE FY 1990-91
TOTAL GENERAL FUND (1)	3142.5	3318.0	3540.5***
Total Regular Sources (1)	3098.0	3275.5	3495.2***
Sales Tax (1)	1085.6	1143.1	1205.0
Individual Income Tax	1248.1	1393.8	1503.7***
Corporation Income Tax	211.2	162.0	198.5
All Other	553.1	576.6	588.0
Miscellaneous Sources	44.5	42.5	45.3
Education Improvement Fund	272.318	285.775*	301.250*
Interest on Education Improvement Fund	1.771	1.900	1.900
TOTAL	274.089	287.675	303.150

	RATES OF CHANGE**	
TOTAL GENERAL FUND	5.6%	6.7%
Total Regular Sources	5.7	6.7
Sales Tax	5.3	5.4
Individual Income Tax	11.7	7.9
Corporation Income Tax	-23.3	22.5
All Other	4.3	2.0
Miscellaneous Sources	-4.4	6.5
Education Improvement Fund	4.9	5.9
Interest on Education Improvement Fund	7.3	---
TOTAL	5.0	5.8

(1) Net of Education Improvement Fund.
* One-fifth of total sales tax.
** Percent change based on unrounded figures.
*** Includes $2.0 million impact for federal minimum wage legislation.

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TABLE II

TOTAL GENERAL FUND REVENUES
QUARTERLY ESTIMATES
Fiscal Years 1989-90 and 1990-91
(In Millions of Dollars)

	FY 1989-90	FY 1990-91
FIRST QUARTER	785.0*	868.2
SECOND QUARTER	1614.3*	1760.7
THIRD QUARTER	2409.6*	2615.2
FOURTH QUARTER	3318.0	3540.5

PERCENT OF TOTAL REVENUES
COLLECTION BY QUARTER

	FY 1989-90	FY 1990-91
FIRST QUARTER	23.7	24.5
SECOND QUARTER	25.0	25.2
THIRD QUARTER	24.0	24.1
FOURTH QUARTER	27.3	26.2

* Actual Collections

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REVENUE FORECASTING PROCEDURES
BOARD OF ECONOMIC ADVISORS
FISCAL YEARS 1989 AND 1990

The procedures and methodology of the Board of Economic Advisors in comparing the first three quarters of actual revenues for Fiscal Year 1989-90 with the forecast of revenues for Fiscal Year 1989-90 and the impact on Fiscal Year 1990-91 involved four major stages beginning with a review of the November 1, 1989 estimates: 1) providing the economic background and setting at the national and State levels for the revenue forecasts; 2) interpreting recent and historical revenue relationships; 3) continued monitoring of developments in the State from the impact of Hurricane Hugo on economic activity, income, revenues, and refunds; and 4) evaluating the Corporate Income Tax situation in South Carolina and elsewhere.

A meeting of the Board was held on April 6, 1990 in Columbia following release and analysis of third quarter revenue collections. The purpose of the meeting was to prepare for the presentation by the Chairman at the Budget and Control Board meeting on April 9.

The Board members consulted as in the past with experts and professional economists for economic intelligence gathering. The resources of the national forecasting groups by which the SCOPE model and other forecasts are driven, Data Resources, Inc., Evans Economics, Inc., and WEFA, Inc., were avilable 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, the Chairman and the Executive Director participated in a seminar on Policy Issues for the 1990's in Washington, D.C. on February 27-28, 1990 with leading economic and budgetary officials sponsored by the National Association of Business Economists and attended a reception at the Federal Reserve Board with Alan Greenspan on February 27. Further, the Chairman and Executive Director attended a briefing of the Senate Budget Committee on February 28 by Secretary of State James Baker. On February 27, the Executive Director met with Robert D. Reischauer, Director of the Congressional Budget Office in his office in Washington, D.C. for a briefing on economic conditions and outlook. Also, Board and Advisory Board members and the Executive Director met on April 5 in Columbia with Alice Rivlin, Senior Brookings Institute Fellow and Former Director of the Congressional Budget Office following a luncheon sponsored by the Budget and Control Board Executive Institute and the University of South Carolina Institute of Public Affairs.

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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 economic model consists of 49 equations, of which 37 are stochastic* and twelve 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, and unemployment.

Durable Manufacturing Employment

The durable manufacturing employment block consists of six 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 seven 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.

* Stochastic is defined as a type of modeling for time series analysis explaining future probability from historical experience.

Nonmanufacturing Employment

The nonmanufacturing employment block is disaggregated into seven 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 ten additional equations for each of the ten 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 is being structured to emphasize four 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 two 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. The core economic model is completed and the reformulation and respecification of the revenue model is in progress.

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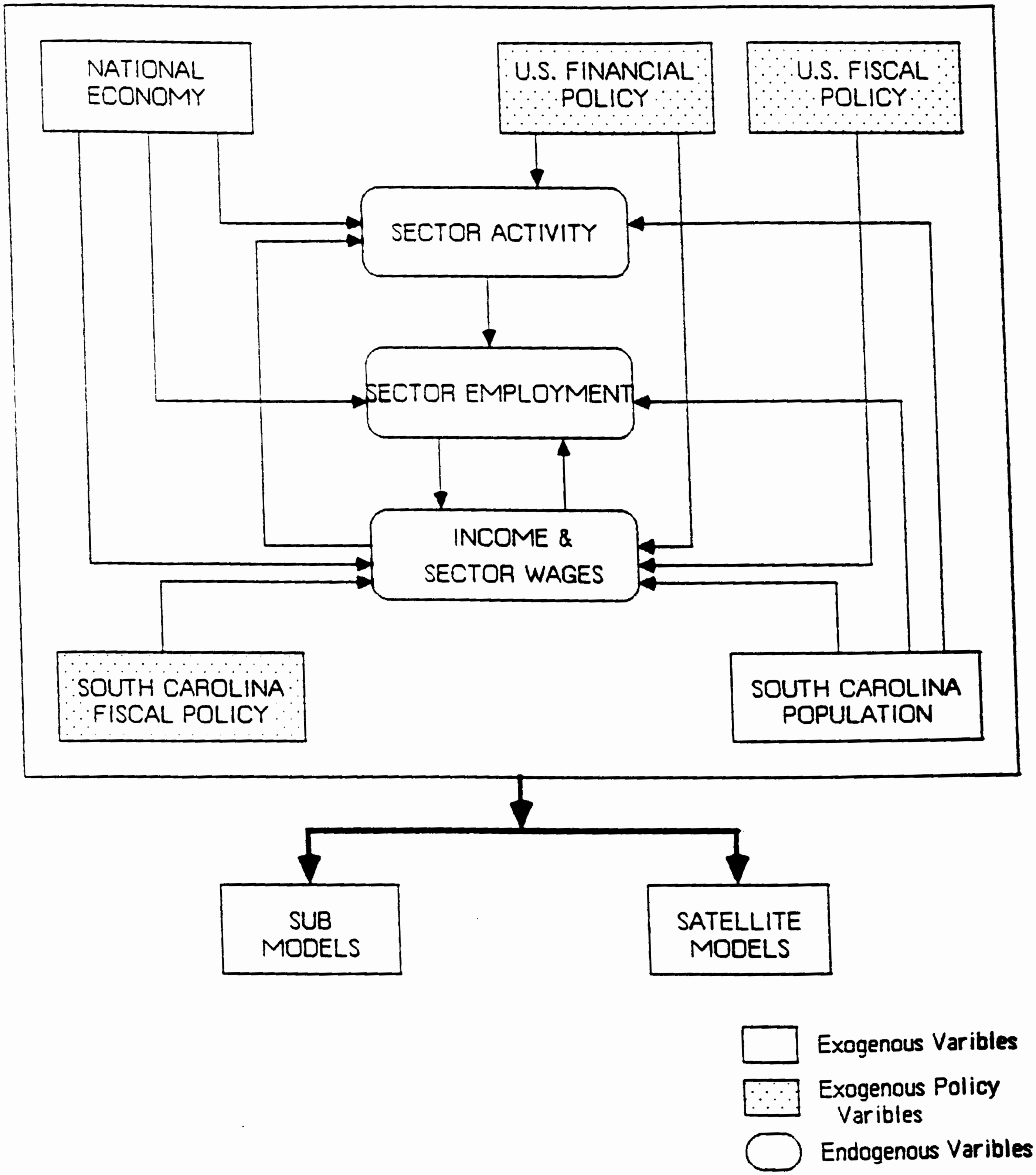
SCOPE MODEL

SOUTH CAROLINA OPERATIONS, PLANNING & EVALUATION MODEL



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