South Carolina House of Representatives

Legislative Update & Research Reports

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Legislative Update

Newspapers Review 1985 Legislative Session

Introduction

Theatre and film critics wait until the curtain falls or the movie ends before they write their reviews. Newspapers in South Carolina have been printing on-going critiques of the drama of the 1985 Legislative session, but when adjournment came they were ready to review the entire performance from start to finish. A short summary follows.

Budget Blues

The general appropriation bill was of keen concern to the knights of the keyboard. A number of them found at least something to dislike about it.

The Greenville *News* felt that the House and the Senate, despite their struggle over the budget, had "identical priorities." According to the *News*, "Each wants to settle the budget dispute by raising taxes in some form or another. Neither opts for critically examining agency spending requests and making appropriate cuts." The Greenville paper thought that the "General Assembly routinely rubber-stamps all past agency spending in continuation budgets, which permits state government to grow unchallenged."

In a similar vein, the Newberry *Observer* noted that "a number of alarming transactions have surfaced which rightly should cause concern to the taxpaying citizens of this state who supply the funds to propel our government." The *Observer* was talking about the increase in state employees which, it said, are "in the same category with adding new taxes--once they're approved, we're stuck with them until the end of time."

The Florence *Morning News* was against the famous helicopter; the *Index-Journal* of Greenwood was aghast at dues checkoffs for the State Employees Association; and the Charleston *Evening Post* roundly scolded legislators for putting permanent laws in Part II of the Appropriations Bill. The *Post* felt such actions were habitual to lawmakers. "Of course we recognize that the General Assembly isn't adverse to passing blatantly unconstitutional legislation. That's done regularly."

On a kinder note, the Lancaster *News* was ready to give lawmakers "a passing grade for this year's session." According to the *News,*: "Overall, this year's General Assembly was better than many previous ones ... Lawmakers were able to hold the line on spending."

Finally, the Columbia *Record* assessed the General Assembly's efforts and declared the budget bill "a respectable compromise." The indigent care package, and additional highway funding were singled out for special praise. The *Record* was concerned about the growth in state employees. It also recommended that the House and Senate be allowed to consider money measures simultaneously.

How to Run a Legislature

A number of newspaper editorials took the broad view. Instead of focusing in on one or two issues, they decided to study the whole institution of the General Assembly, and then offer advice how to make it work better. Did they find any problems? Did they ever.

First of all, editors did not like the appropriation bill coming up at the end of the session. The Florence *Morning News* opined:

> This is a poor way to run a railroad. Rational decision-making on budget matters become overwhelmed in the frenzied negotiations against the backdrop of the ticking adjournment clock. The atmosphere is ripe for political opportunism and maneuvering to slip things into the appropriation bill.

The Augusta *Chronicle* huffed from across the Savannah River: "Lawmakers are elected to do a job and that job is not getting done in South Carolina. Hijinks are making a mockery of the entire democratic process." The *Chronicle* offered no remedies to the hijinks.

How About a Biennial Budget?

Several papers supported a move to a two-year budget. Some called it "biennial," some called it "biannual."

The Charleston *Evening Post* had some criticism, calling the members of the Assembly "less responsive and less responsible." The paper also expressed the idea that "legislative pay and expense allowances have increased steadily to the point that some lawmakers no longer have the financial impetus to rush back home." The *Post* did offer a suggestion to improve the process:

> No question switching to a biennial budget would be a help. Lawmakers could devote one year to financial matters and concentrate the next on matters of policy. One flaw in that proposal, however, is the fact that South Carolina is a weak executive state and the legislators often use the budget to set policy.

The Anderson *Independent-Mail* was equally frank: "legislative government in this state is no longer working." The *Independent-Mail* offered two suggestions: move to a unicameral legislature, or go to a "biannual, rather than annual, budget."

The Beaufort *Gazette*, in an editorial titled "Budget process needs changing," also weighed in supporting a biennial budget. The *Gazette* was in favor of a constitutional adjournment date as well.

The Orangeburg *Times and Democrat* was skeptical about the value of a mandatory closing time, but did support a "biannual" budget. The paper concluded that "The session lasted as long as it did because the complexities of the budget have overtaken the process. And, with the state's responsibilities growing, the complexities will increase, not decrease."

Summing Up

The Columbia *State* said the "Cantankerous session" had earned some "good marks." The paper lauded the "far-reaching and significant laws and programs which will benefit the people of this state." In particular, indigent care, Blue Law reform and garnishment for child support were singled out.

The *State* was not uncritical in its review, and urged the legislature to improve its procedures, especially in writing the appropriation bill. It thought that "filling the budget bill with a lot of state laws is poor parliamentary procedure, and it should be stopped." The paper urged Governor Riley to veto such items next year.

So the 1985 session is ended and the newspaper have had their final say. At least for this session.

Interstate Banking: Regional Compacts OK Says Supreme Court; States Act

The Background: New England Banks Seek to Expand

Recently three New England bank holding companies decided to acquire banks or bank holding companies in New England states other than the ones where the three had their main offices. Such acquisitions are possible under an interstate banking compact agreed to by Massachusetts and Connecticut; the compact is similar to the one approved by the S.C. General Assembly last session.

Before the acquisitions could be made, the Federal Reserve Board had to give its approval. When the Board held hearings, Northeast Bancorp, Union Trust Company, and Citicorp opposed the acquisitions--and thereby challenged the entire concept of regional, interstate banking.

Citicorp Comes Out Swinging

Citicorp is the second largest bank in the nation, and has long opposed regional compacts, because they cut it out of potential markets. The Citicorp argument against the New England compact was four pronged.

First, such compacts violate the "Douglas Amendment" to the Bank Holding Company Act. Citicorp said the Douglas Amendment did not give states the right to allow partial or regional interstate banking; it was all or nothing.

Second, such compacts are in direct confrontation with the Commerce Clause of the U.S. Constitution, because they restrict the free flow of commerce across state lines.

Third, regional compacts violate the Compact Clause of the Constitution, which forbids regional agreements between states unless they are specificially authorized by Congress.

Fourth, the compact violated the Equal Protection Clause of the Constitution because it favored in-state banks over out-of-state banks.

The Federal Reserve Board rejected all four of these arguments, as did a Court of Appeals which later heard the case. In June the actors moved to the U.S. Supreme Court.

Justices Approve Regional Compact

In an 8-0 decision the Supreme Court upheld the New England compact, and rejected all four of Citicorp's arguments.

First, the Douglas Amendment. The Bank Holding Company Act has long forbidden interstate banking arrangements; the Douglas Amendment gave powers to the states to adjust this, and allow interstate banking under conditions set by the states. The Citicorp argument was that states could either remain totally closed to interstate banking, or open up to all interstate banking. There were no other options.

Concerning the Douglas Amendment, the Court looked to legislative intent, and decided that "there can be no other conclusion but that Congress contemplated that some States might partially lift the ban on interstate banking without opening themselves up to interstate banking from everywhere in the Nation." The Court thereby rejected the "all or nothing" argument of Citicorp, which had said a state could either have no interstate banking, or wide open interstate banking.

The Court next considered the issue of interference in interstate commerce. The Commerce Clause of the Constitution would apply in this case--except that Congress, by the Douglas Amendment, had specifically authorized the states to enact statutes governing interstate banking. "When Congress so chooses," the Court said, "state actions which it plainly authorizes are invulnerable to constitutional attack under the Commerce Clause."

The Compact Clause was addressed next. Citicorp maintained that the U.S. Constitution forbids interstate compacts unless specifically authorized by Congress. The Court said that the New England banking compact did not meet the definition of compact forbidden by the Constitution, mainly because it did not increase the political powers of the states to the harm of federal supremacy.

What About Equal Protection?

Finally, the Citicorp Gang turned to the Equal Protection Clause. A recent Supreme Court ruling in Alabama seemed to offer them some hope. In that case (*Metropolitan Life Insurance Co.* v. *Ward*) the state of Alabama had taxed domestic insurance companies at a lower rate than out-of-state companies. The state's purpose was to favor creation of new domestic companies, and encourage capital investment in the state by foreign companies, in return for a lower tax rate. The Court ruled (March, 1985) that these "were not legitimate state purposes which could permissibly be furthered by discriminating against out-of-state corporations in favor of local corporations." The same wrong is being done to us! Citicorp claimed.

The Court said no. Banking is a special case. In the words of a previous Court decision, "banking and related financial activities are of profound local concern." Historically, Americans have chosen smaller, more localized and more numerous banks in preference to a few large, centralized banks. Such legitimate, historical concerns were addressed by the New England regional interstate banking compact, and therefore differ from the Alabama case. There is thus no violation of the Equal Protection Clause of the Constitution.

Effects of the Ruling

When the Supreme Court first agreed to hear the New England compact case, it put consideration of all such compacts "on hold." No one wanted to take action until the high court had rendered its verdict. It now appears that such compacts are perfectly legitimate, arguments of Citicorp et. al. to the contrary. There is, of course, the possibility that Congress may legislate changes in interstate banking--a development to be watched in the future.

In Other Interstate Banking: D.C. Considers Compact

The District of Columbia City Council is considering joining the Southeastern banking compact, of which South Carolina is a member. This would exclude banks from outside the region--including our old pal, Citicorp.

According to *From the State Capitals,* Citicorp has argued against D.C. joining the compact. Instead, the New York financial giant wants a "trigger" date that allows the compact, but permits national interstate banking after a certain time period. The D.C. bill allows the compact for three years, with an option to renew after that.

Rhode Island: Extend Regional Banking Law?

Rhode Island has a law which permits interstate mergers of banks only within the New England area. The law is due to expire on July 1, 1986, after which national mergers would be allowed. There is movement to extend the statute until July 1, 1987. According to *From the State Capitals,* "the bill ... is intended to give the state's banks more time to prepare for full interstate banking."

As might be expected, the measure is opposed by Citicorp.

Proposed Federal Tax Reforms: Impact on the States

Summary

Tax reform on the federal level now appears more likely than in many years. Both the Reagan administration and Congressional leaders appear serious about revising the complicated federal tax code. There are many versions of tax reform circulating in Washington, but one proposal would have immediate and dramatic impact on state governments and their financial situations: eliminating the deductibility of state and local taxes.

Under current U.S. law, individual tax payers can deduct the following taxes from their taxable incomes: state and local real property, income, personal property and general sales taxes.

By striking these deductions the federal government would gain up to $30 billion in 1985, and as much as $50 billion 1989. Many observers feel that this move would severely cripple states in their operations; others maintain it is necessary to provide more money for the federal government and a fairer tax code for all Americans. This report examines the situation.

Deductions for State and Local Taxes: An Historical Assumption

There was a time when there was no federal income tax. The first tax was imposed in 1862 during the War Between the States; it was later declared unconstitutional. The present federal income tax was established in 1913. Even in the 1862 tax, state and local tax payments could be deducted from income; the 1913 tax code also allowed for this deduction.

There were four major reasons for the deduction:

1) It avoided levying a tax upon a tax.
2) It lessened the competition among governments.
3) It provided a more precise measure of ability-to-pay.
4) It avoided the possibility of confiscatory taxation.

These were all connected with the idea of fairness in tax paying, particularly for the individual. However, in the 75 years since the first tax code, the deductions have come to have important implications for state and local governments.

Federal Aid: The Forms It Can Take

As Dr. Donald Phares of the University of Missouri points out, federal aid to states can take three forms: 1) tax expenditures written into the IRS code, including the deductions under discussion; 2) categorical grants; or 3) general purpose and block grants.

Federal grants are direct flows of funds from Washington to the states (where the money originated in the first place). Categorical grants are earmarked for specific projects or programs; block grants have more flexibility, since the plans for spending them are developed at the state level using broad federal guidelines.

How do tax expenditures translate into federal aid to the states? According to supporters of the deductions, there are three ways:

First, they ease the burden on the taxpayer for state and local taxes. This has both a financial and a psychological effect. On the one hand, deductions reduce the economic burden on the tax payer, by lowering his or her income for the federal tax. On the other hand, the state taxes do not seem as burdensome because they can be "written off" against federal taxes.

Second, the money not taxed by Washington remains in the state and local economies—where it can be taxed, if needed, by those governments. Such tax increases can be made at least marginally more acceptable because of the federal deductions.

Third, the flexibility of state governments to raise taxes allows them to issue bonds with "full faith and credit" behind them, since the state has the option of increasing taxes to cover the bonds. This ability builds confidence in investors, which keep state credit ratings high and interest payments relatively low.

Phares sums up the benefits to states from deductions:

> It reduces the net price paid for state and local services. Second, it makes high-taxing areas more attractive relative to low-taxing areas by reducing the incentive for out-migration, or potentially even encouraging immigration. Third, elected officials may be more willing to propose tax increases knowing that part of the cost will be muted by the federal write-off. De facto, with deductibility in place, state and local services are cheaper because the federal government shares in the cost. The federal government becomes

a partner in financing state and local services. One scholar has estimated that spending is about 13% higher at this level of government that it would be otherwise.

If Deductions Go: Impact on the Taxpayer

No deductions of state and local taxes would mean more money paid on federal income taxes. This is one of the reasons for getting rid of deductions--to bring more money into the federal treasury.

No deductions would also mean that state and local taxes would appear to be higher, and their payment a greater burden. Where taxes are already high, people would have an incentive to leave. Where taxes are relatively low, people would have an incentive to keep them low--despite needs for increased government revenues for operations and services.

If Deductions Go: Impact on States

Carl E. Van Horn, a Congressional Fellow of the Joint Economic Committee of the U.S. Congress, recently spoke to the Executive Committee of the National Conference of State Legislatures (NCSL). Van Horn offered the following predictions as to what would happen to states and state governments should the deductions be repealed:

First, "the provision of public services will be jeopardized and the costs of providing services will go up." Van Horn noted that the "perceived price" of services would rise, causing discontent among tax payers and a determination to hold down state income taxes and local property taxes.

At the same time the bond market for states and communities will be less attractive because of higher interest charges. There would be two reasons for this: the decreased resources of states to cover bond issues, as discussed above; and the proposal to eliminate the tax exemption of many bonds--such as private purpose municipal bonds.

Second, "interstate and intrastate competition for economic development will increase." Van Horn predicts that states and localities will be pressured to decrease tax rates in order to attract and retain businesses. This could mean: reducing the tax to the point where it doesn't bring in enough operating revenue; drastically reducing services; or even losing businesses completely to another location with lower taxes.

Third, Van Horn foresees "negative revisions in state and local tax structures." While increased taxes on businesses are possible, they are less likely than "taxes that spread the costs across all income levels--namely, sales taxes..."

However, a study by Merrill Lynch casts some doubts on the states' options in this. A total elimination of deductions for all state and local tax revenues could mean that "a state with income taxes may not be able to increase sales taxes to compensate for the loss of the income tax deductibility."

In addition, some unfairness will be spread across the nation. According to Van Horn, the difference between the lowest and highest tax states--the total federal, state and tax bill--for a typical family of four is currently $4,250. That is, the family in the highest tax state, Wisconsin, pays $4,250 more in total taxes than a similar family in the lowest tax state, Alaska. The family of four in South Carolina pays $2,400 more than its counterpart in Alaska.

If the deductions are eliminated, the differences increase. The family in Wisconsin will pay $6,600 more than the family in Alaska; the South Carolina family will pay $3,750 more.

Arguments FOR Eliminating the Deductions

A major, if generally unspoken, argument for eliminating the deductions is that it would increase revenue to the federal treasury. The *Fiscal Letter* for May/June, 1985 estimates as much as $50 billion could flow into the federal coffers by 1989 with the deductions eliminated.

If this money is available, tax rates could be reduced--the President's plan calls for a 35% ceiling on the maximum rate. Supporters say this would be a fairer and more economically stimulating tax system than the present one.

Another argument for getting rid of the deductions is fairness. According to some, a number of high-tax states have overspent on public services, providing more than they could afford. The differences are made up through the federal income tax deduction, which is, essentially, a subsidy from the rest of the states. In other words, taxes are artificially high in some states, but tax payers don't mind as much because they can claim their deductions.

Third, most people don't use the deduction anyway. Thirty three million Americans itemize their returns--only about one-third of those filing. In Wisconsin, supposedly the highest tax state, only 42 percent of taxpayers itemize their returns. (Van Horn, in addressing this issue, points out that the middle income tax payers make use of deductions: one-half of all households earning between $20,000 to $25,000; two-thirds of households making between $25,000 and $30,000 use the state/local tax deduction.)

Fourth, no one said reform of the U.S. tax code would be painless. There are a number of special privileges and loopholes which have been created over the years; making the tax system fair and uniform is going to require some drastic revisions. One of President Reagan's stated goals is to "radically change a system that still treats people earning similar incomes much differently regarding the tax they pay."

Finally, reducing the income of governments is one way of reducing the <u>size</u> of governments. Supporters of tax reform advance the argument that, in the end, eliminating the state/local tax deduction will leave more money in the pockets of the private citizens, and less money in the treasuries of governments.

Conclusion

In its study of the situation, Merrill Lynch noted:

> With state and local government taxes no longer deductible from taxable incomes, many jurisdictions responding to local political pressures may very well be forced to reduce their income tax and property tax rates. Such actions could result in budgetary crises and fiscal shortfalls .... With federal revenue sharing for local governments possibly being eliminated at the same time, many states in particular will be under pressure to increase aid payments to their local governments. For some of them, 1986 could be a very difficult year.

If reform of the federal tax code leads to elimination of the state/local tax deduction, the impacts would be both immediate and long-term. Decline in federal aid and possible increases in state and local operating costs could force hard decisions upon legislators and legislatures.

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