

## South Carolina Taxation Realignment Commission (TRAC)

### Draft Report and Recommendations

#### “Other Funds”

September 21, 2010

Pursuant to SC Code Section 12-3-10(C)(2)(c), TRAC’s report “...shall consider...any fee, fine, license, or Other Funds.”<sup>1</sup>

#### Key Findings Include:

- State appropriations are comprised of three primary types of funds: 1) General Funds, 2) Federal Funds and 3) Other Funds.<sup>2</sup>
- **General Funds** are just that - general - because they can be appropriated to any functional area of state government and typically have the fewest “strings attached” related to their use.<sup>3</sup> More than 80 percent of the State’s general funds are derived from two primary sources; the State sales and use tax and the State individual income tax. General Fund revenue just completed its third consecutive year of decline, with a recurring base for the current year (FY2010-11) of approximately \$5.08 Billion. That is down from roughly \$6.74 Billion just three years ago (FY2008-09) and is the same level of general fund revenue collected in FY2000-01, not adjusted for inflation or population growth.<sup>4</sup>
- **Federal Funds** are usually categorical programs by the Federal government that often require matching State dollars first be “put up” so that the Federal funds may be “drawn down” (examples are Medicaid and Transportation, just to name a few). With little exception, Federal funds come with “strings attached” requiring compliance with federal regulations regarding how the money may and/or may not be spent. Failure to comply with those regulations often result in penalties and other sanctions for those found in non-compliance.<sup>5</sup> Federal funds expended by State agencies in FY2008-09 totaled \$7.37 Billion.<sup>6</sup>
- **Other Funds** are State funds derived from non-general and/or non-federal fund sources. In short, when a State appropriation cannot be classified as “general” or “federal”, it is categorized as “other”. Unlike general funds, other funds are almost always “earmarked” or “restricted”, and as such, much like federal funds, are usually allocated for expenditure on a specific program or activity (e.g. “strings are attached”). Interest from “earmarked” funds accrues to the State’s General Fund while interest from “restructured” funds accrues to that specific fund.<sup>7</sup>
- Examples of “other funds” are lottery proceeds, revenue from the State’s 16 cent/gallon gasoline and diesel “user fee”, and tuition and fee revenue from colleges and universities, just to name a few. In each case, revenue from these specific sources, as with most other funds are either earmarked or restricted and, as such, cannot be transferred among and between the general operations of State government. Lottery revenue must be spent on K-12 and/or higher education and cannot be spent on public safety or State parks. Gasoline and diesel user fee revenue must be spent on roads, not teacher salaries. Tuition revenue accrues to the benefit of the colleges that collect it and to the students that pay it, and not to upkeep of prisons or lakes and rivers, etc.

- As illustrated above, other funds, which are often derived from various “fees for service”, are characterized by a relationship between the cost borne by the individual purchasing the good or service and the benefit obtained by the individual using the good or service.<sup>8</sup>
- As such, TRAC finds that, with little exception, “other funds” are not malleable, and while other funds are a significant and growing component of State government expenditures, “other funds” growth in one functional area of government will not necessarily offset the sometimes dramatic decreases in other areas of State government because, as discussed above, those funds cannot be “shifted” from one functional area of State government to another.
- TRAC finds that other fund expenditures were the single largest category of expenditure by State government in FY2008-09, at \$7.44 Billion, slightly ahead of Federal funds (\$7.37 Billion) as noted above.<sup>9</sup>
- TRAC finds that there has been a gradual and definitive shift from State general fund revenue (primarily sales and individual income tax revenue) to “other” and “federal” funds over the past fifteen years. Specifically, in FY1994-95, general fund expenditures comprised 40 percent of total State expenditures, with federal and other funds representing approximately 30 percent each. By 2008-09, general fund expenditures had fallen to just 28 percent, with federal and other funds rising to roughly 36 percent each.<sup>10</sup>
- This noticeable shift in funding sources for State government is due, in part, to a combination of external factors (the economy) and internal factors (State tax policy).
- As such, TRAC finds that these three major funding sources are interrelated. Specifically, as economic externalities combined with State tax policy impact general fund revenue collections, and as federal program expansions create demand for requisite state matching dollars, pressure for “other” funds (fees, fines, etc.) will only continue to grow.
- Compounding the pressure on “other funds” is the fact that the State’s Board of Economic Advisors projects long-term general fund revenue growth at just 2 percent per year for the foreseeable future, forcing agencies and special interests to seek fee and fine revenue in place of general fund dollars - dollars that may not materialize.
- Furthermore, TRAC finds it likely that federal spending available for the states seems destined for retraction in the near term as well. Such will likely result from the exhaustion by the states of funds the federal funds they received from the various federal stimulus programs over the last several years, coupled with the reality of the fiscal condition of the federal government as it relates to current and projected levels of both deficits and debt at the federal level.
- Lastly, TRAC finds that the General Assembly appears cognizant of the findings that TRAC has considered with regards to “other funds” (as noted above), and, as a result, has created by temporary budget proviso in the current year’s (FY2010-11) appropriation act, an “Other Funds Oversight Committee” (OFOC).<sup>11</sup>
- TRAC finds that OFOC will be a “joint committee” comprised of eight members, four from the South Carolina House of Representatives and four from the South Carolina Senate. OFOC’s charge is to “review and examine the source of other funds in this State and recommend to the General Assembly the appropriate policy for the receipt, appropriation, expenditure, and reporting of other funds.”<sup>12</sup>

- TRAC finds that the General Assembly is right to have created OFOC given the reality of the long-term trend away from State general fund revenue to the use of other funds to operate certain functions of State government.
- Given this reality, TRAC finds it imperative that the General Assembly take a more proactive review and oversight of other funds. TRAC finds that OFOC gives the General Assembly an appropriate template by which to begin such a proactive role in “other funds” budgeting.
- TRAC finds that the General Assembly is to be commended for creation of OFOC and encourages the committee to vigorously pursue other funds oversight and review.

Therefore, TRAC recommends that:

- Rather than relying on a temporary budget proviso that may or may not be adopted in a given year, the General Assembly should codify, or make permanent, OFOC, to ensure that other funds oversight and analysis receives the proper long-term attention required of such an important undertaking.
- Given the sheer magnitude of the task set before OFOC as measured by the literally hundreds of fees and/or fines charged by the more than 100 agencies or departments of the State, (a fact that highlights the need for a long-term approach by OFOC), TRAC recommends that OFOC undertake a very detailed review of other funds at only a few State agencies over a longer period of time, rather than a more cursory review of all State agencies over a shorter period of time. In short, TRAC encourages OFOC to develop a process that is manageable, so that its product is meaningful. Utilizing such a process would allow OFOC to properly review other funds at all State agencies over a reasonable period of time.
- When examining the fees and fines that generate the other funds of State agencies, TRAC specifically recommends that OFOC consider, at minimum:
  1. What is the relative price of the good or service compared to the cost of providing the good or service?
  2. Related, does the fee charged to the individual consuming the good or service: cover, fall below, or exceed the cost to the agency for providing the good or service?
  3. Are other fund revenues properly accounted for by State agencies (based on the generally accepted principles of “Fund Accounting”) and are the amounts and uses of those funds readily available to members of the General Assembly and to the public for review?
  4. Statutory authority. Does the ability for an agency to levy, increase, retain, expend, and/or carry forward a fee relate back to a specific statutory or budgetary authority? If yes, which statute or budget proviso? If no, under what authority does the agency assess the fee?
  5. How does the fee compare to fees charged by similar agencies for similar purposes in neighboring states, states within the Southeast, and states nationwide (as applicable)?

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Notes:

1 Language from TRAC's enabling legislation (Act 81 of 2009) and codified in SC Code Section 12-3-10 et al.

2 Slide 2 - "Tax Realignment Commission - Other Funds Presentation", September 10, 2010, by Mike Shealy, Budget Director, South Carolina Senate Finance Committee.

3 Slide 6 - "Tax Realignment Commission - Other Funds Presentation", September 10, 2010, by Mike Shealy, Budget Director, South Carolina Senate Finance Committee.

4 FY2010-11 recurring general fund base figure from the Office of State Budget after vetoes sustained. FY2000-01 and FY2008-08 general fund revenue levels from the Office of State Budget's "Historical Analysis" published in 2009.

5 Slide 10 - "Tax Realignment Commission - Other Funds Presentation", September 10, 2010, by Mike Shealy, Budget Director, South Carolina Senate Finance Committee.

6 Office of State Budget's "Historical Analysis" published in 2009.

7 Slide 21 - "Tax Realignment Commission - Other Funds Presentation", September 10, 2010, by Mike Shealy, Budget Director, South Carolina Senate Finance Committee.

8 Slide 22 - "Tax Realignment Commission - Other Funds Presentation", September 10, 2010, by Mike Shealy, Budget Director, South Carolina Senate Finance Committee.

9 Office of State Budget's "Historical Analysis" published in 2009.

10 Office of State Budget's "Historical Analysis" published in 2009

11 Proviso 70.27 of the FY2010-11 Appropriations Act (H.B. 4657 of 2010).

12 Proviso 70.27 of the FY2010-11 Appropriations Act (H.B. 4657 of 2010). The proviso reads as follows:

"(LEG: Other Funds Oversight Committee) There is created a joint committee of the Senate and of the House of Representatives entitled the Other Funds Oversight Committee. The committee shall consist of eight members as follows: the Chairman of the Senate Finance Committee, or his designee; one member of the Senate Finance Committee appointed by the Chairman of the Senate Finance Committee; the Chairman of the House of Representatives Ways and Means Committee, or his designee; one member of the House Ways and Means Committee appointed by the Chairman of the House Ways and Means Committee; the Senate Majority Leader, or his designee; the Senate Minority Leader, or his designee; the House Majority Leader, or his designee; and the House Minority Leader, or his designee.

The committee shall review and examine the source of other funds in this State and recommend to the General Assembly the appropriate policy for the receipt, appropriation, expenditure, and reporting of other funds. In making its determination, the committee shall solicit and receive testimony from state agencies, departments, boards or commissions regarding the status of the receipt of other funds, the conditions of receipt, the expenditure of other funds, and any relevant statistic or measurement. The committee shall make recommendations to the General Assembly regarding any necessary action.

Each state agency, department, board, or commission shall cooperate with the committee and provide any information the committee determines is necessary.

The Office of State Budget must notify the committee of any request for an increase in interim budget authorization resulting from other funds collections that is made by any state agency, department, board, or commission. The committee shall review each request and recommend appropriate action.

Members of the committee shall serve without compensation, but are allowed the usual per diem and mileage as provided by law for members of boards, commissions, and committees while on official business.

For purposes of the proviso, 'other funds' means any revenues received by an agency which are not federal funds and are not general funds appropriated by the General Assembly in the appropriations act."