

December 19, 2002

To the People of South Carolina:

For four years, it has been my privilege to present an Executive Budget to the people of South Carolina. Each year, I have used the Executive Budget to make a strong statement that public education must come first in our state. Even in the midst of the national recession, we have been able to lead the nation in SAT improvement, raise teacher pay, build new classrooms, and fund school accountability.

As a result of the national recession and the lingering economic impact of the September 11th terrorist attacks, most states, including South Carolina, have faced dramatic revenue shortfalls. We have been forced to make tough decisions and set priorities. Some of our sister states raised taxes in order to close their budget gaps. Instead, we chose to solve the problem by downsizing state government, while protecting vital education and health care priorities.

I have two goals for my final Executive Budget. First, I want our state to build on the progress that we have achieved during the last four years. Second, I want to present a balanced budget that incorporates the new revenue sources and cost savings proposed by my successor.

Improving education must remain our first priority. This budget continues our improvements to public education and sets the table for South Carolina's long-term economic vitality. The specific education priorities include funding the base student cost, increasing teacher pay, maintaining our commitment to accountability, providing early childhood education through First Steps, and providing local school districts with the financial assistance to build new schools. In addition, this budget protects funding for college scholarships, while delivering on the promise to provide students of all ages free tuition to South Carolina's two-year public institutions. Finally, we must redouble our efforts to fund healthcare for our most vulnerable citizens.

Despite difficult national economic times, we have wisely invested in classroom improvements, which are receiving national recognition. Student achievement and teacher quality have made dramatic strides. My hope is that my successor will continue to build on these educational accomplishments. The true measure of South Carolina's success and progress will be an unwavering commitment to excellent public schools. This should not be the work of just one administration, but the work of our generation.

Sincerely,

Jim Hodges

EXECUTIVE BUDGET FY 2003-04

PUBLIC EDUCATION

The investments South Carolina is making in improving public education are starting to pay off. Here is the evidence:

- A record number of South Carolina children tested ready for first grade last year.
- Student scores on the Palmetto Achievement Challenge Test rose in nearly every grade level over the past four years, including a 16 percent jump in 4th grade English-Language Arts scores between 1999 and 2001.
- The number of students passing all three portions of the High School Exit Examination on their first attempt reached its highest level.
- South Carolina is first in the country in SAT improvement. Since 1998, South Carolina's SAT scores have improved 30 points – the highest improvement in the nation, ten times the national average, and one of only two states in the country with an improvement of 20 points or more.
- In *Education Week Magazine's* Quality Counts 2002 Report, South Carolina ranked 3rd in the nation for improving teacher quality and 11th for raising academic standards.
- The *Princeton Review* rated South Carolina's accountability system as among the top ten in the nation.

How was this accomplished?

Education improvement starts with ensuring that every child begins school healthy and ready to learn. Our investment in First Steps is providing early education services for 15,095 South Carolina children. Secondly, we improved

teacher quality by providing incentives to teachers who improve their professional skills. Since 1998, the number of nationally certified teachers in South Carolina classrooms has increased by 13,841 percent. Today, thousands of our children are being taught by teachers who have undergone this rigorous training. As we demanded more from teachers, we paid them more. Average teacher salary in South Carolina has increased \$5,642, or over 16 percent, since 1998-1999. In addition, with the historic School Facilities Bond Act, South Carolina put \$1.1 billion dollars into school construction without raising taxes.

Finally, we worked to make higher education more affordable and accessible to South Carolina's students of all ages. By championing the education lottery plan, nearly 100,000 South Carolinians are working on advanced degrees thanks to tuition assistance through LIFE Scholarships, our new HOPE Scholarships, the Palmetto Fellows Scholarships, and tuition assistance at two-year institutions.

In the past four years, we have taken South Carolina's public schools in a new direction. Though our public schools still have a long way to go, the groundwork has been laid for continued success.

This budget lays out the path for the next four years and beyond.

Education Finance Act & Fringe Benefits

The Education Finance Act (EFA) provides the foundation for education funding in South Carolina. Recent cuts to the EFA undermine this very foundation and further jeopardize the ability of school districts to provide an adequate education to their children. In the best of circumstances, poorer districts struggle to provide the basics of an educational program. Moreover, many of these districts lack the capacity to provide the resources needed to provide disadvantaged students with an opportunity to learn. Consequently, I am recommending a \$329 million increase in EFA and Fringe Benefits to restore cuts, replace nonrecurring funding, meet inflationary costs, and provide teacher salaries. We must ensure that the Base Student Cost is adequate to meet the expectations placed upon local districts.

Salaries for Teachers and Bus Drivers

We are facing a teacher shortage, and without a sufficient number of quality teachers, our children will miss the opportunity to acquire the education and skills needed for a productive life. There is clear evidence that the quality of a child's teacher has a huge impact on a child's achievement. Though no one chooses a career in education for the salary, we must ensure that inadequate pay does not preclude education as a career choice for our brightest young people. Consequently, we must make teacher pay a priority, with a commitment of

achieving the national average within five years. I propose that teacher salaries this year be set at \$41,659, which is \$1,000 above the Southeastern average. Finally, I am also recommending a two percent increase in bus driver salaries.

Teacher Quality

I propose the expenditure of \$4 million to enhance teacher quality, including an expansion of the Teacher Advancement Program (TAP). This innovative program rewards exceptional teachers while providing a format for them to help less experienced teachers develop the skills necessary to raise the quality of their instruction.

Education Accountability

The Education Accountability Act requires that the State provide a host of services to schools that have been designated as “Unsatisfactory” or “Below Average”. I have proposed adding \$55 million to fund programs that the legislature has mandated to address the needs of these districts, most of which is to replace nonrecurring appropriations from the lottery.

First Steps

Effective early childhood programs help prepare students for school. Much progress has been made in recent years on early childhood development in South Carolina. We must continue to make progress in preparing our children for school by providing an additional \$19 million so that First Steps can continue to fund local partnerships at the current level.

Palmetto Builds!

Three years ago, we passed a bond bill that provided \$750 million in financial assistance to our local districts for construction needs without raising taxes. The bulk of the work is still unfinished because many districts lack the recurring resources they need to address the school facility problem. Palmetto Builds! provides the next step toward providing adequate and safe facilities for all our school children. I am proposing a \$10 million expenditure, to be expanded to \$70 million over four years, to address this need. Palmetto Builds! would act much like the State Infrastructure Bank and will provide efficiencies in architectural and bonding costs, as well as a state supplement to aid local districts building programs.

Education Agencies

In addition to restoring the mid-year cuts to local districts, I am restoring the five percent cut to the Governor's Schools for Science and Math, Arts and Humanities, Gifted and Talented, as well as the School for Deaf and Blind, Wil Lou Gray, John de la Howe, and DJJ.

HIGHER EDUCATION

State Support

We must begin considering our education system as K-16. My budget, therefore, includes restoring the five percent mid-year cut to higher education.

Scholarships

Scholarships are necessary to ensure that our brightest students attend college in South Carolina, that students with financial need are not denied access to higher education, and to ensure that students and families are not overwhelmed with huge college debt. To maintain our current programs, I am requesting \$43 million to replace nonrecurring funding and meet expected increases in eligibility.

Tuition Assistance

To ensure access to higher education for all of our citizens, I propose adding \$15 million to our tuition assistance program. This will ensure higher education opportunities for all of our citizens by providing tuition-free education at our two-year public higher education institutions. This expenditure will improve the quality of life for large numbers of South Carolinians and pay huge economic development dividends.

Capital Needs

Currently, about one percent of state appropriations fund debt service on higher education projects. I am recommending that debt service for higher education be increased to two percent of the budget over the next few years so that higher education institutions can have a stable source of revenue for capital projects without competing with general government needs. This would provide higher education with over \$100 million annually in either debt service or capital to

address facility needs. I also support granting these institutions more flexibility in addressing their capital needs without legislation. In the meantime, I support fully funding those projects which have been partially approved in past years. The schedule for funding these projects will be determined by the Joint Bond Review Committee and the Budget and Control Board as current debt limitations permit.

Data Base Infrastructure

The ability to share databases among institutions of higher education makes good economic sense, as well as enhances the research capabilities of these institutions. Sharing databases is a prudent way to meet the research needs of higher education, and I am proposing \$10 million to address this need.

HEALTH AND SOCIAL SERVICES

Maintaining Medicaid services for South Carolina's children, poor, and elderly has increasingly challenged our state finances. Healthcare costs have continued to far outpace inflation, and the federal government has reduced healthcare reimbursements to states during the economic recession. Despite these challenges, we have made progress in providing additional healthcare to our citizens. In particular, our SilverCard program is now helping 39,100 senior citizens with their prescription drug costs. South Carolina recently received a federal waiver and on January 1, 2003, up to 90,000 additional South Carolina seniors will become eligible for SilverCard prescription drug assistance. We need to continue to find ways to protect basic health care funding for our state's most vulnerable citizens.

Medicaid and Prescription Drugs

The Medicaid program infuses over \$2.8 billion annually into the state's health care system. Every effort must be made to maintain current levels of services for SilverCard and the Medicaid program.

Despite current economic conditions that have resulted in increased demand from the ranks of the uninsured, the Department of Health and Human Services has successfully contained costs and maintained current levels of coverage for over 800,000 children, low income families, the disabled, and the elderly. At the same time, the agency has secured federal matching funds to expand prescription drug coverage for our senior citizens.

While I have opposed tax increases of any kind, it is my understanding that my successor intends to support the legislature's plan for a 0.53 cents per pack

increase in the cigarette tax in order to maintain SilverCard and the current Medicaid program. Therefore, my budget incorporates this proposal. Health care advocates strongly support this effort and legislative leaders have outlined several proposals (House Bill 3173, Senate Bill 2) to increase the cigarette tax. With this increase, South Carolina's tax will equal the national average of 60 cents per pack.

This revenue of approximately \$171 million will be used to maintain the current Medicaid program. \$127 million will annualize nonrecurring funding for the current fiscal year, \$16 million will cover increased costs associated with increased utilization of services and expansion of managed care, and \$28 million will restore the five percent mid-year budget reduction imposed by the Budget and Control Board.

This \$171 million in funding will maintain the program only if additional savings are generated by the agency. The agency will implement supplemental drug rebates as soon as possible. This annual savings, approximately \$15 to \$20 million, will cover increased drug product costs that continue to skyrocket and will benefit both Medicaid and SilverCard. Should the General Assembly negate these rebates, an additional \$20 million of state funds will be necessary to maintain the current level of Medicaid program services.

Mental Health

To prevent further disruption in the mental health delivery system and maintain current year levels of operation, my budget recommendations include \$18 million for the Department of Mental Health. These funds annualize \$4 million of nonrecurring funding for the current year, restore \$9 million that was eliminated as a result of the five percent mid-year budget reduction imposed by the Budget and Control Board, and include \$5 million to address the court ordered contempt citation and to improve access to mental health emergency services. Two million dollars will replace one-time funds used to serve mentally ill persons who are currently in the State's jails awaiting an inpatient bed at the Department of Mental Health and the remaining \$3 million will be used to provide local services as an alternative to being hospitalized in a central institution during emergencies.

Social Services

In order to maintain critical services to protect children from abuse and neglect, my budget recommendations include \$786,000 to restore foster care board payments to fiscal year 2002 payment levels. These funds will restore payments by \$20 per month and represent a five to seven percent restoration in payments, depending on the age of the child.

Additionally, my budget recommendations include \$6.7 million, for the first of three years of funding needed to develop a statewide-automated Child Support Enforcement system as mandated by the federal government. These funds are necessary to acquire computer and telecommunications hardware and software for system development. An annual penalty of \$8.8 million will be assessed by the federal government until a certified system is in place.

REVENUE, COST SAVINGS AND TAX RELIEF

Proposed Cost Savings

My successor has said his government restructuring plan will provide “dramatic savings” for South Carolina taxpayers. The Governor-elect’s plan is to introduce market principles into the operations of state governance by a) instituting modern management techniques, b) focusing on the needs of our citizens and taxpayers, and c) rewarding thrift and efficiency by directors of state agencies, injecting the healthy rigors of competition into our system and investing in new technology to help maximize efficiency.

My budget anticipates a conservative five percent cost savings from these restructuring reforms that I expect will be adopted this year based on the Governor-elect's agenda. Hopefully, my successor will be able to realize more substantial cost savings than five percent. The Budget and Control Board is charged with adjusting appropriations to reflect these savings once the reforms are approved.

Revenue

The Governor-elect has proposed that South Carolina apply a five percent sales tax on gasoline purchases, generating an additional \$140 million in new revenue. Long term, the revenue from the new gas tax will be used to phase out the state income tax. However, my successor has made it clear that his plan will contain “a trigger mechanism” that will delay the income tax phase out during an economic downturn. Clearly, South Carolina is facing just such a situation that would warrant delaying the promised tax relief.

Furthermore, this budget closes several special interest tax loopholes. Specifically, I propose removing sales tax exemptions on newsprint, newspapers, and radio and television equipment and supplies. This action would generate \$15 million in new funding for education.

In addition to closing tax loopholes and expanding the state sales tax to gasoline, this budget increases state revenue by refinancing our tobacco bonds--which

creates a surplus of \$40 million--and tapping the additional \$22 million generated by the tax amnesty program.

Tax Relief

South Carolina has the 11th lowest total tax burden per capita in the nation. Our tax burden is 20.8 percent lower than the national average. In fact, we lead the South in tax relief – our tax burden is lower than North Carolina, Virginia, Mississippi and Georgia. [Source: US Census Bureau, Governments Division] We have worked to increase the homestead exemption for senior citizens to \$50,000. Now 123,882 South Carolina senior-owned homes pay no property tax – 44.6 percent of all senior owned homes in the state. Still, we can do more.

To relieve the fear many seniors have regarding unknown property tax increases on their homes, I am proposing that seniors be granted a fee-in-lieu of property tax option, similar to that offered for manufacturers. Upon qualifying for the seniors homestead exemption, homeowners can elect to pay a set fee for the remainder of their ownership equal to their homeowner taxes after the initial year of receiving the homestead exemption.

OTHER AREAS

Law Enforcement

My budget proposal recommends restoring the five percent mid-year cut to SLED, Public Safety, PPP, DJJ, and Corrections. I am also recommending that an additional trooper class for the Highway Patrol be provided.

Employee Salaries and Health Insurance

I recommend adoption of the Budget and Control Board study for a career path for state employees. This plan challenges agencies to develop a career path for employees and this budget sets aside one percent as a state match to help agencies reward employees who attain additional job skills, education, or responsibilities.

Finally, the State Health Plan is anticipating that a 17 percent increase in funding is needed to meet expected medical claims during 2004. To address this need, I am recommending additional state funding of \$52 million for school districts, higher education, state agencies, and retirees. With this increase, increases in employee premiums can be limited to \$9 a month, if no additional cost savings are found within the program.

Capital Projects

In addition to the capital needs for public schools and higher education, I am recommending approval for other projects, such as the full funding of the Colleton County Veteran's Nursing Home and the dredging at the Charleston Harbor. The allocation of funds for these projects will be determined by the Joint Bond Review Committee and the Budget and Control Board as debt limitations permit.