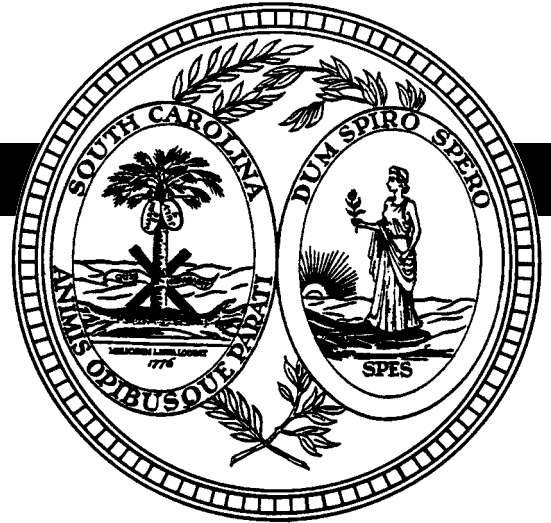


STATE OF SOUTH CAROLINA

EXECUTIVE BUDGET

FISCAL YEAR 2007-2008



MARK SANFORD
GOVERNOR

Executive Budget

Fiscal Year 2007-08



January 3, 2007

Submitted by

Mark Sanford
Governor
State of South Carolina

to the

117th General Assembly of South Carolina,
First Session



State of South Carolina Office of the Governor

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January 3, 2007

To the Citizens of South Carolina and the Members of the South Carolina General Assembly:

It is my pleasure and honor to present to you this administration's FY 2007-08 Executive Budget. Before going into some of the points included in the document, I would like to express my thanks to all of the review and results team members – many of whom were volunteers – who gave time, talents and focus to this effort.

As with our three prior budgets, our primary objective for the FY 2007-08 Executive Budget is to present to the General Assembly a balanced state budget that, without raising taxes, provides essential services to the citizens of South Carolina in the priority areas of education, health care and social services, economic development, public safety, and natural resources.

This objective is essentially the same for the General Assembly. Where we differ from the Legislature is that beyond this initial objective, our budget actually seeks a greater level of fiscal discipline than the Legislature's current fiscal discipline model which seems to merely want to "avoid tax increases to pay for government services." Rather, our budget holds FY 2007-08 spending growth to roughly the state's *population plus inflation* growth. We seek such a limit because we believe that spending by the state should not grow faster than the income of the people who are asked to pay for it.

By abiding by a population plus inflation spending limit, as we first proposed last year, revenues exceeding the spending limit will be available to address the state's unfunded liabilities and fund a permanent income tax cut. When we released our first executive budget in FY 2004-05, the state was coming out of an unprecedented period of revenue decline. This decline strained agency budgets – as agencies endured a series of across-the-board mid-year cuts – and led to the state closing its books with a \$155 million unconstitutional operating deficit during FY 2001-02 as well as the depletion of the state's General Reserve Fund (\$153 million) during FY 2001-02 and FY 2002-03.

As the fiscal crisis persisted, \$209 million was diverted from various trust and reserve funds to mitigate the impact of the mid-year cuts. In addition, there was an "embedded" GAAP deficit of \$105 million that resulted from the General Assembly taking a 13th

month of revenues for spending in a 12 month fiscal year in 1991, 1993, and 2001. The \$135 million shortfall in the State Health Plan reduced the standard 45-day payout ability down to as low as zero. By the time we presented our initial FY 2004-05 Executive Budget, the state faced financial obligations of three-quarters of a billion dollars.

We worked with the General Assembly in restoring trust and reserve funds last year. Nevertheless, serious challenges remain. Starting next year, the new accounting standards issued by the Government Accounting Standards Board will require all states to account for unfunded liabilities, and the State Health Plan has a \$9.2 billion unfunded liability in regard to its Other Post-Employment Benefits (OPEB). Amortizing this amount will require an additional \$535 million for the next fiscal year, and each year thereafter. While an incomplete step, after funding the operational needs of agencies, we propose dedicating \$439 million to establishing a trust fund to begin addressing the state's OPEB unfunded liability. The establishment of this fund, in conjunction with legislatively mandated adjustments to eligibility requirements and better health care expense management through plan design changes, should provide some relief for this looming fiscal crisis.

In addition to OPEB, a FY 2004-05 audit pointed to a sizable deficit within the Tuition Prepayment Program, with funds to be exhausted by 2017. Within our budget, we eliminate the Tuition Prepayment Program's current \$41 million deficit. While we seek to cover this deficit, we are fully aware that higher education tuition is rising too rapidly and must be reined-in for South Carolinians to continue to take advantage of affordable advanced learning opportunities. That is why we again seek tuition caps, and that is why we continue to discuss plans which restrain spending – as opposed to merely raising additional revenue such as tuition to meet budgets. In the end, our higher education plan is simple. We seek a quality, state-supported higher education system, yet one that is both affordable to the student and to the taxpayer.

The \$480 million used to either fully or partially cover the above cited unfunded liabilities represents 48 percent of the \$998 million in “new” funds available for allocation in our executive budget. This percentage of available funds – because of other fund revenue transfers into the OPEB trust fund – far exceeds the 37 percent of “new” funds we set aside last year to repay trust and reserve funds. When discounting the \$194 million impact of the other fund revenue transfers, revenue available for FY 2007-08 falls to \$804 million. Of this amount, we dedicate \$286 million (or 36 percent) to establishing the OPEB trust fund and eliminating the Tuition Prepayment Program deficit.

Beyond establishing an OPEB trust fund and covering the Tuition Prepayment Program deficit, dollars in excess of the spending limit should be returned to the state's taxpayers in the form of a small business and corporate tax cut and/or a personal income tax reduction. This action turn will foster a more competitive economy that will attract both jobs and investment to the state. As a result of the spending limit, this budget proposes permanently returning \$98 million in recurring funds back to businesses and/or individuals. In addition to this, we are proposing to raise the Cigarette Tax to

comparable levels of neighboring states, with the \$107 million in additional taxes generated by this increase offset by a permanent reduction in business and/or individual tax rates. Therefore, in total, we are proposing a \$205 million permanent small business and corporation tax cut and/or a personal income tax reduction with the FY 2007-08 Executive Budget. This reduction is important because we believe that South Carolinians deserve to share in the state's economic successes that they helped create.

As fellow conservatives, many Republicans in the House have pledged an allegiance to the idea of government spending caps – beyond the existing weak constitutional language – and returning such surplus revenues to the private sector to stimulate economic growth. Declaring such an allegiance to fiscal responsibility is, of course, the very essence of being a Republican. The late Milton Friedman, the great Nobel Prize winning economist and guide to many within the Republican Party, often spoke of this: “The preservation of freedom is the protective reason for limiting and decentralizing governmental power. But there is also a constructive reason. The great advances of civilization, whether in architecture or painting, in science or in literature, in industry or agriculture, have never come from centralized government.” Yet, as noted above, the reality is that “conservatives” within this state – whether affiliated with the Democrat or the Republican parties – speak somewhat of limiting taxes but little of limiting government growth. Such an unbridled position on government spending is certainly outside of the Milton Friedman concept of limited government. This FY 2007-08 Executive Budget strives to live within that concept.

Last year, we vetoed H. 4810, the FY 2006-07 General Appropriations Act, in its entirety due to excessive spending. Not including the Contingency Reserve Fund (CRF), Education Improvement Act (EIA), Lottery or Federal/Other Funds, last year's budget contained over \$1 billion in new recurring and non-recurring revenue.

Correlating to this increased revenue, the Appropriations Act spent \$689 million – or roughly 12 percent – more than the \$5.8 billion in recurring and supplemental spending realized during FY 2005-06. (When including the CRF spending increased \$861 million – or nearly 15 percent – above FY 2005-06 levels.) A 12-15 percent increase in state government spending – rates which exceed the state's personal income growth by nearly three times – is simply not sustainable given past historical trends and, accordingly, is not good stewardship of the taxpayers' money.

We are also again calling for the General Assembly to enact restructuring legislation that would increase accountability to the taxpayers and reduce duplicative government. Fractured government with limited accountability provides little benefit to the people we are supposed to serve. According to *Governing* magazine's *2006 Fact Book*, South Carolina government operates with a ratio of 234 state employees per 10,000 residents, 34 percent higher than the U.S. average of 174 state employees per 10,000 in population. The costs associated with this unusually high ratio of state employees take dollars away from direct benefits for the citizens served by South Carolina government and demands more in the way of funding from taxpayers. In addition, we are proposing for a third year giving agency heads the flexibility to target pay raises to recruit and

retain quality employees in high-need areas. Building on that proposal, we have also proposed funding a \$56 million merit pay program for teachers in South Carolina. This proposal, which will create a direct link between pay increases and student achievement, will allow school districts to reward the many great teachers who are succeeding and excelling in the classroom.

We also propose fully funding the Base Student Cost (BSC), increasing the BSC to \$2,476 for FY 2007-08, which brings total funding per student in South Carolina to an average of \$10,566. In addition, we propose fully funding the Education and Economic Development Act, which we hope will help us improve the abysmal drop-out rate in high school.

In total, we believe this budget corrects past fiscal management decisions, while setting the stage for more modest and predictable growth into the future. We also accomplish making major investments in education, health care, law enforcement, and quality of life within the confines of limited spending by setting budget priorities. We present this budget, the result of hundreds of man hours by citizens from around the state, and urge you to join us in creating a more affordable and accountable government to the taxpayers.

I look forward to working with the General Assembly on ways we can make such initiatives work for the taxpayers of South Carolina.

Mark Sanford

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Executive Summary

FY 2007-08 Executive Budget Summary

Mission Statement

The mission and objectives of this executive budget are similar to the ideas that have been laid out in our three previous executive budgets. Our primary objective is to present to the General Assembly a balanced state budget that does not raise taxes while at the same time funds essential services for the citizens of South Carolina in the priority areas of education, health care and social services, economic development, public safety, and natural resources.

Beyond this, our budget seeks to limit the growth of FY 2007-08 government spending. By abiding by a government spending limit as we first proposed last year, revenues exceeding the spending limit will be available to properly address the unfunded liability needs of the state. In addition to this, funds should be returned to the state's taxpayers in the form of a tax cut, which in turn will foster a more competitive economy that will attract both jobs and investment to the state.

Administration Goals

To achieve the above objectives, the administration first established nine major budget goals for the FY 2007-08 Executive Budget. Adhering to these goals, we then prioritized and funded the state's critical needs, while retaining the fiscal discipline demanded by both the citizens of the state and those organizations – such as the national bond rating companies – which analyze the state's financial performance. Our nine goals for the FY 2007-08 Executive Budget are as follows:

1. **Limit the annual growth of recurring general fund spending by not exceeding population growth plus the rate of inflation** – Throughout last year's legislative session, beginning with our submission of the FY 2006-07 Executive Budget, we advocated a budget that used a spending limitation of *population plus inflation over last year's recurring base*, for a very simple reason – state government spending should not grow faster than the income of the people who are asked to pay for it.

While current state law does provide for a spending limitation, we feel that it is far too liberal in its approach and allows government to grow at unsustainable levels. Under the current limit, state spending could grow by \$4.2 billion over FY 2006-07 levels. As such, revenues (i.e., taxes, fees) could be increased dramatically to support the current limit. In contrast, our recurring – and, for that matter, non-recurring (exempting Capital Reserve Fund and the Contingency Reserve Fund) – general fund spending plan limits growth to \$399 million during FY 2007-08.

According to the estimate provided to us by the state's Board of Economic Advisors, population plus inflation growth for the FY 2007-08 is projected at 5.503 percent. Exempting a handful of constitutional and statutory items,

this figure increases to 6.53 percent. Therefore, our commitment is to hold the line on state government spending to no more than an increase of \$399 million (or 6.53 percent) above the FY 2007-08 recurring base of \$6,108 million. While our limiting method for FY 2007-08, we will certainly entertain all such similar population plus inflation efforts from the General Assembly.

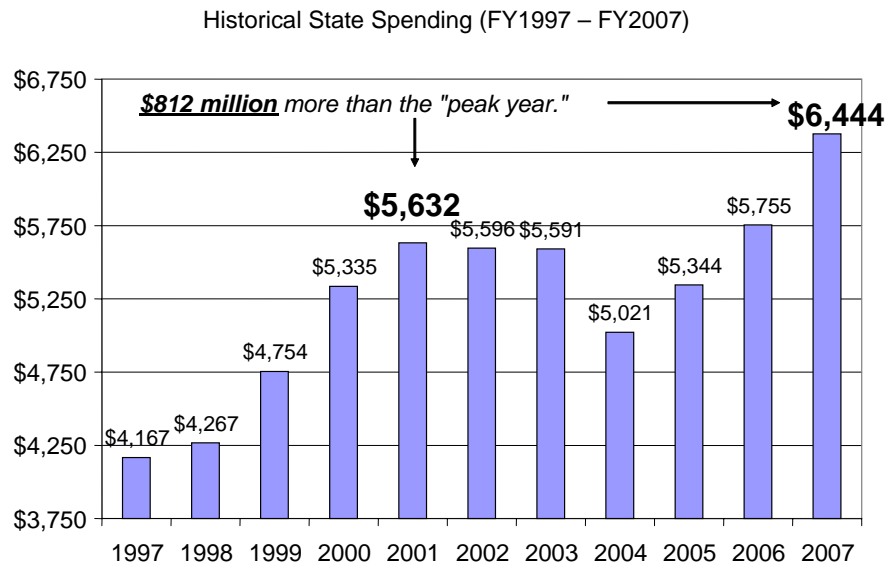
Regardless of which method is ultimately chosen, it is important to not compare apples-to-oranges when viewing our 6.53 percent growth rate versus potential legislative efforts at a spending limit. Prior efforts from the Legislature have typically limited government spending over recurring and non-recurring spending from the prior year. During FY 2006-07, this amount totaled \$6,444 million (or perhaps higher considering we have deducted tax savings plans, contingency reserve funding, and trust/reserve payments to achieve the \$6,444 million figure). By this standard, our spending plan of \$6,507 million (\$6,108 million + \$399 million) will be roughly 0.97 percent – not the 6.53 percent reflected above – over last year’s level.

While some will disagree with us for basing our spending limit on growth above the prior year’s recurring base, we feel that adding non-recurring spending to the denominator is equivalent to adding this amount to that base. Such an action increases the state’s annualization risks.

Further, from the shown differential in percentage increases associated with the two different denominator methods (recurring and recurring plus non-recurring), it is obvious that presenting growth above recurring plus non-recurring allows for a far greater increase in government spending while at the same time appearing fiscally conscientious.

We do not think government spending should grow faster than the growth of people’s pocketbooks and wallets, and with last year’s Appropriations Act it grew by more than twice as fast. This happened before at the earlier part of this decade, and it had unfortunate consequences. When the growth stopped, not surprisingly, the state had to make painful midyear budget cuts.

The argument we heard from Legislators last year was that “growing government 12-15 percent simply put us back to where we were before the midyear budget cuts in FY 2000-01.” That is simply not true as the following chart illustrates.



We have more than caught up from the lean times of four years ago, and the question we need to ask is whether it is a good idea to set ourselves up for the same fall again. The Appropriations Act was almost \$812 million above the previous budget high-water mark that people talk of “getting back to,” and the total state budget has moved consistently upward from \$15 billion to \$20 billion as a result of more money from the federal government and state government shifting to fees when revenues flattened in the early 2000’s.

This spending by the Legislature is unsustainable. These times of plenty will not roll on indefinitely. Yet, during this past legislative session, when the state’s economy continued to improve and hundreds of millions of unanticipated new taxpayer dollars poured into state coffers and were certified by the BEA, the commitment of many House Republicans’ to a spending limit pledge went out the window. Faced with the choice of either spending the record-breaking flood of new revenue or remaining true to their pledge to limit state government spending to a reasonable level and return the excess to the taxpayers, many House Republicans decided to ignore their pledge. In the days before the House first considered the budget, a House GOP leader (and one of the House budget conferees) actually said that the House had to spend all of the unexpected new revenues in order to beat the Senate to the punch – in other words, to put House members’ special projects in the best position of prevailing over Senate members’ special projects.

This “race to spend” approach to budgeting continued throughout the FY 2006-07 Appropriation Bill debate as more and more unexpected revenues became available for spending. Each time that the Board of Economic Advisors certified additional new revenues, the House or the Senate (depending on which body was considering the budget at the time the

FY 2007-08 Executive Budget

certifications were made) ratcheted up the rate of state spending. Absolutely no effort was made to keep state spending tied to the taxpayers' ability to sustain the spending in the future, the "cap" simply became whatever amount of new money that the BEA certified.

Therefore, in an effort to provide both stability and sustainability to the state's yearly purchases, we propose limiting the growth of recurring general fund spending to 5.503 percent during FY 2007-08, exempting yearly constitutional and statutory funding requirements. This rate is based on recent Bureau of Labor Statistics and U.S. Census Bureau population data. With the excess revenues that exceed the spending limit, and with transfers from several other fund revenue sources, we propose using these recurring and/or non-recurring funding sources to establish a \$439 million Other Post Employee Benefits (OPEB) trust fund to combat the unfunded liabilities associated with the benefits offered retirees under the State Health Plan; to provide \$41 million to eliminate the Tuition Prepayment Program unfunded liability; to accelerate debt repayment by \$21 million; and, to fund a \$205 million business and/or personal income tax cut (with \$107 million provided by a cigarette tax increase). We believe that such uses are consistent with the goal of fiscal discipline demanded by the taxpayers of South Carolina. This is summarized as follows:

REVENUES	FY 2007-08 BASE	FY 2007-08 EXECUTIVE BUDGET	\$ CHANGE
FY 2007-08 BEA Estimate Gross General Fund Revenue (11/10/06)		\$7,103,000,000	
Less: Tax Relief Trust Fund		(\$521,643,795)	
Plus: Tax Relief Trust Fund Carryforward		<u>\$13,797,464</u>	
Net General Fund Revenue Estimate Revenue Adjustments	\$6,108,004,521	\$6,595,153,669	\$487,149,148
– Use of BEA Certified Surplus Revenue (FY 2006-07)		\$306,929,588	
– Excess Agency Cash (State Ethics Commission)		\$250,000	
– Business License Tax – Reduction from decline in demand due to increase in Cigarette Tax		(\$2,182,000)	
– Taxes and Fees redirected from Economic Impact Zones		\$8,800,000	
– Taxes and Fees redirected from Redevelopment Authorities		\$2,824,632	

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Revenue Increases	\$6,911,775,889	\$803,771,368
Less: Spending Limit	\$6,108,004,521	\$6,506,699,775
Based on 5.503 percent with spending limitation exclusions:		\$398,695,254
▶ FY 2007-08 Capital Reserve Fund proceeds, \$111,821,213		
▶ FY 2007-08 Contingency Reserve Fund proceeds, \$171,541,103		
▶ FY 2007-08 Lottery appropriations, \$270,540,219		
▶ FY 2007-08 EIA appropriations, \$673,000,000		
▶ General Reserve Fund yearly funding requirements, \$19,048,978		
▶ Capital Reserve Fund yearly funding requirements, \$12,699,319		
▶ Local Government Fund, yearly funding requirements, \$30,823,468		
= Difference between revenue increases and spending limitation:		\$405,076,114
+ General Funds available from Medicaid shift to other funds generated by Cigarette tax increase of \$0.30:		\$107,270,000
Total in Excess of Spending Limit		\$512,346,114
 <u>Uses of revenue in excess of spending limitation:</u>		
– Permanent Tax Refund:		(\$205,166,526)
- Elimination of Tuition Prepayment Unfunded Liability:		(\$41,338,714)
– Debt Repayment:		(\$21,175,000)
– Establishment of OPEB Trust Fund:		(\$244,665,874)
Total Uses of Excess of Spending Limit		(\$512,346,114)
 <u>Other Fund Revenue Transfers to OPEB Trust Fund:</u>		
State Health Plan – Excess IBNR Reserves:		(\$136,800,000)
Lapsed Unobligated Competitive Grants Revenue FY2006-07:		(\$34,355,384)
<u>Unemployment Compensation Fund:</u>		(\$23,000,000)
Total Other Fund Transfers to OPEB Trust Fund:		(\$194,155,384)
Total Amount Used To Establish OPEB Trust Fund:		(\$438,821,258)

2. **Fund property tax relief and return a portion of the surplus to taxpayers** – Since 1995, the state has returned billions in property tax relief to the people of South Carolina. Last year, the General Assembly passed legislation which offers even more property tax relief by shifting K-12 Education funding responsibility from owner-occupied homeowners to the general populace in the form of a sales tax increase. While we feel that it is important to highlight the tax shift nature of this bill, we nevertheless agreed with and signed last year’s landmark property tax bill since we feel that the burden of being a homeowner within the state has become too great for some of our fellow citizens.

Yet, as important as the property tax relief actions are, we as a state can provide much more tax relief to our citizens. This is apparent when analyzing what we spend on state government compared with our neighbors the North

and South. Simply put, South Carolina spends significantly more on its state government than its neighbors.

Therefore, after we fund our priority items, fund a \$439 million OPEB trust fund, eliminate the \$41 million Tuition Prepayment Program unfunded liability, and eliminate \$21 million in outstanding debt, there still remains additional funds. We believe those dollars should be returned to the people who provided that revenue.

- a) **Fully Fund Property Tax Relief Trust Fund** – In 1995, the General Assembly passed legislation to provide relief for homeowners through the Trust Fund for Property Tax Relief. Since enacting that broadbased legislation, \$4.5 billion has been returned in the form of property tax relief. **In this budget, we set aside \$522 million for FY 2007-08 in payments back to local governments for property tax relief.**
- b) **A Tax Cut for Businesses and/or Individuals** – Since our first executive budget, we have advocated restoring our fiscal house by eliminating the unconstitutional \$155 million deficit, restoring the borrowed funds from trust and reserve funds, and finally eliminating the GAAP deficit created by the General Assembly beginning in 1991. In last year's budget, we finished that nearly \$750 million goal, while funding our priorities at the same time. However, we believe that South Carolinians should share in good economic times, just as they have to pay through the bad economic times.

Recognizing the administration's long-standing position on the current tax rate for small business, the General Assembly rightfully sought to decrease the tax burden on small business during the 2005 legislative session. Effectively, we reduced the income tax rate paid by S-corporations, LLCs, and sole proprietors from seven percent to five percent over a four-year period. When fully implemented, this reduction will put nearly \$124 million each year back into the hands of small-business owners.

While this is a great step in the direction of tax relief, we continue to believe more needs to be done. In looking at South Carolina's tax code, we believe our relatively high income tax rate for individuals stymies economic growth. This belief was shared by our friends in the House of Representatives – who twice passed our proposal to decrease the state's uncompetitive income tax rate for all South Carolinians.

We effectively have the highest income tax rate in the Southeast when applying the rate to the 2005 state per capita income of \$28,212. Our past proposal gave South Carolina an ending top marginal rate of 4.75

percent. This rate would put us just above the current Southeastern average for income tax rates being paid on per capita income. From a competitive standpoint, we would prefer to fall below the Southeastern average, but, at the very least, it is imperative that we bring our rate down. Failure to do so will keep us at a competitive disadvantage.

We once again have an excellent opportunity to provide income tax relief for all South Carolinians. Our proposal ultimately calls for an income tax reduction totaling \$205 million. By holding spending increases to population plus inflation, our budget is able to set aside \$98 million to be returned to taxpayers on an annual basis. Additionally, our budget proposes a cigarette tax increase of 30 cents per pack that would generate \$107 million yearly. We believe these dollars should be used to reduce the income tax burden for our largest taxpaying population – all individuals across South Carolina who work and pay income taxes.

With the excess revenue, we could reduce taxes in a variety of ways: (1) indexation of brackets, (2) lowering of the top marginal rate from 7 to 6.5 percent, (3) lowering of small business and corporate tax rates in a number of ways, and (4) any combination of these. The overarching goal with any tax plan is to have the greatest positive effect on increasing investment and creating jobs throughout the state. Therefore, whether it is higher business licenses, fees or taxes, higher tuition costs, or increased energy costs resulting from expanded demand for oil, **we are proposing to return \$205 million in excess tax revenue to ease the of burden taxpayers around the state.**

- 3. Appropriate funds based on a rational assessment, from the citizen's perspective, of the relative importance of the activities of government** – In an effort to prioritize and then provide for the core needs of the state, we again are utilizing the **Budgeting for Results** process that we established during FY 2005-06. In preparing our budget, in September 2006 we held a series of public budget discussions, open to the public and the press, with directors of 18 state agencies throughout South Carolina to discuss better and more efficient ways to achieve our state's budgetary goals.

In addition to public budget hearings, we worked with legislative staff and "results teams" made up of state employees and private volunteers to compile a list of more than 1,600 activities performed in our state. Using the Budgeting for Results process, we then worked with the results teams to rank all of these activities as they relate to the core outcomes we think government should provide. Instead of "funding" agencies, we "purchased" the activities and outcomes we believed would deliver the greatest results for our citizens.

Through these actions, our proposed budget recommends over **\$92 million in specific general fund savings** to the taxpayers through operational efficiencies, savings realized by our cabinet agencies, and by not purchasing lower-priority activities.

In addition to the new growth projected for FY 2007-08, we are recommending the re-investment of these savings into higher priority activities in the areas of education, health care and social services, economic development, public safety, natural resources and finally constitutional and statewide needs described as follows.

- a) **K12 Education – \$2.3 Billion General Funds / \$3.9 Billion Total Funds** – To provide for the state’s K-12 needs (683,600 students) during FY 2007-08, we propose increasing recurring spending for K-12 education by \$193 million to push our per pupil spending to an estimated \$10,566 per pupil. In this budget, K-12 represents 37 percent of general fund spending. Regardless of the increase, as with all other components of this budget, we believe tax dollars should buy results. In addition to increased funding, we offer several suggestions for receiving better value for those dollars and providing more flexibility at the local level.

A key function of the K-12 educational system is to prepare students for life and work. Unfortunately, for many of our students the quality of the service they receive is far from what will prepare them for life in today’s global economy. When an all-time high of 36 percent of schools are rated below average or unsatisfactory, nearly three-fourths of the state’s 8th graders are not proficient in reading or math, state SAT and ACT score rankings remain at the bottom nationally, and graduation rates continue to decline to the point where they are worst in the nation, it is clear that we need to take a targeted approach to education spending that can improve the performance of our students.

To assist with the state’s K-12 education needs during FY 2007-08, we propose increasing recurring general funds for the following activities (for a full list, please see attachment B2):

- **Base Student Cost full funding: \$94 million (also, this is the second year in which our executive budget “fully funds” education pursuant to Proviso 72.1);**
- **Keeping the average teachers salaries at \$300 above the Southeastern Average through the implementation of merit-pay incentives that will reward teachers who get the results that we so desperately need: \$56 million;**

- **Student Health & Fitness Act funding: \$29.9 million;**
- **Annualizing funding for 4K Child Development Pilot Program: \$23.6 million;**
- **Education and Economic Development Act funding to provide our students with the tools they need to choose a career path that will prepare them for today's competitive world: \$17.3 million;**
- **Providing South Carolina's 390 below average and unsatisfactory schools the flexibility to pursue innovative programs that will help them overcome the obstacles that have limited their success; and,**
- **Expanding public school choice options for students by providing start-up costs for Public Choice Innovation Schools through the South Carolina Public Charter School District: \$1.0 million;**
- ***Nonrecurring funds to provide safe, reliable transportation for the more than 683,600 public school students; complete the final phase of residential hall construction at the Governor's School for the Arts and Humanities; updating the School for the Deaf and the Blind to provide a secure learning environment; and modernizing the Wil Lou Gray facility to offer at-risk students the individualized attention they need: \$63.6 million.***

b) **Higher Education and Cultural Resources – \$786 Million General Funds / \$3.8 Billion Total Funds.** During FY 2007-08, the Higher Education and Cultural Resources goal area will increase significantly in spite of the fact that as recent as 2004, South Carolina had the second highest amount of higher education expenditures as a percent of total expenditures among Southeastern states. Only Kentucky, at 19.1 percent dedicated a higher level of their state budget to higher education.

By comparison to the entire nation, only six states dedicate a greater percentage of their budget to higher education than South Carolina: Iowa (26.3 percent), Nebraska (21.9 percent), Oklahoma (20 percent), New Mexico (19.8 percent), Kentucky (19.1 percent), and Kansas (17.3 percent). In fact, South Carolina exceeds that national average of 10.5 percent, by nearly seven full percentage points.

Expenditures to Higher Education compose the 2nd highest amount of total funding in the FY 2007-08 Executive Budget, compared to 3rd in the FY 2005-06 Executive Budget. Total funds to Higher Education and cultural resources will increase from 18.6 percent to 18.8 percent

of the budget and its total funds are up by \$170 million in next year's budget – largely because of another year of double-digit tuition increases. That being said, we do propose a decrease to their general funds.

Despite the reduction in proposed general funding, we are ensuring the accessibility and affordability of our higher education system by increasing the total funding to the states major scholarship programs:

- **LIFE Scholarships by \$8,285,186** for total funding of \$149,649,015;
- **Palmetto Fellows Scholarships by \$3,276,006** for total funding of \$21,106,764; and
- **Needs-Based Grants by \$2,479,027** for total funding of \$13,725,120.

According to the Southern Regional Education Board, South Carolina's tuition costs have increased by \$5,500 from 1994 to 2004 even after adjusting for inflation. Over that same period, state tuition increased \$1,300 higher than the national average and \$1,800 (\$180 a year) higher than the Southern Regional average over that same time period.

Tuition and fees at four-year institutions in South Carolina increased an average of 11.1 percent this year. In contrast, the technical college sector, which has a governing board with authority to set a range in which tuition and fees must fall, had an average fee increase of 4.3 percent this year. We believe the governance structure of the technical schools contributes to their lower tuition increases, and we will continue to seek legislation to reform how our colleges and universities are governed. We will also propose a proviso that would limit tuition and fee increases to the prior years Higher Education Price Index (HEPI).

- c) **Health Care and Protections of Children and Adults – \$1.5 Billion General Funds / \$8.4 Billion Total Funds.** South Carolina is currently ranked 46th in the nation in the health status of its citizens, up. We're 14th in smoking, at 22.5 percent of the population, which is an improvement from 25 percent two years ago but still above the national average. Other concerns remain: we're tied for 11th in adult obesity, 2nd in diabetes, and the age of Type II diabetes is creeping downward into the adolescent range. Also, 17.7 percent of our population lacks health insurance and the percentage of children vaccinated has slipped to just under the national average after years of being better than average.

To assist with the state's health needs during FY 2007-08, we propose increasing recurring general funds for the following activities (for a full list, please see attachment B2):

- **Increases at the Department of Health and Human Services (DHHS) which provide core health care benefits for the poor, elderly, and persons with disabilities: \$50 million in new general fund recurring dollars and \$10 million in tobacco deallocation dollars;**
- **Improvement of our frontline, direct client services provided through the Department of Social Services. We have had complaints about residents being abused at some of our long-term care facilities (especially those associated within the Department of Disabilities and Special Needs [DDSN]): \$15.8 million in increased;**
- **Annualizing Community Training Homes, Waiver, Family Support, Adult Supported Employment which was provided to the Department of Disabilities and Special Needs last year through Supplemental Sources: \$7.5 million;**
- **Continuing our focus on chronic disease prevention: \$4 million in recurring funding for the Prevention Partnership Grants program and \$2 million for Chronic Disease Prevention at the Department of Health and Environmental Control (DHEC);**
- **Annualizing Inpatient Care at the Department of Mental Health and for Nursing Home Care for South Carolina's veterans: \$5 million;**
- **Mental Health Nursing and Clinical Staff Recruitment and Retention through additional dollars provided to the Department of Mental Health: \$1.0 million;**
- **Helping healthy mothers have healthy children by providing an additional \$500,000 for Mothers and Infant Children programs and an additional \$1 million for vaccine purchases for uninsured children and adolescents through additional dollars provided to the Department of Health and Environmental Control;**
- **Chemical Dependency Community Based Prevention and Treatment Services through additional dollars provided to the Department of Alcohol and Other Drug Abuse Services (DAODAS): \$325,000;**

- **Stockpiling of vaccines for pandemic influenza and other public health emergencies through additional dollars provided to the Department of Health and Environmental Control: \$200,000 (plus \$1 million in non-recurring funds); and**
- ***Nonrecurring funds to renovate, improve and/or maintain facilities at the Department of Mental Health and the Department of Health and Environmental Control; to provide child support enforcement at the Department of Social Services; and, to implement safety improvements at Commission for the Blind facilities: \$28 million.***

d) **Economic Development – \$90 Million General Funds / \$1.5 Billion Total Funds** – Economic Development is a primary role for government in South Carolina. Yet, there is often a lack of understanding about how government should pursue this role and about how to track economic successes. As a case in point, we often hear about the successes of the 1990's when referring to state development efforts. However, 36 percent of the jobs announced by Commerce in the 1990's have moved elsewhere or never materialized. This administration early on realized that such "successes" were in fact unacceptable and looked for ways in which the agency could change the way it does business.

Our efforts are paying off. Whether it is record job creation, or jobs paying on average 39 percent higher than the state average per capita income, the agency's efforts are bearing fruit. Nevertheless, we have a long ways to go.

Specifically, to assist with the state's economic development needs during FY 2007-08, we propose increasing recurring general funds for the following activities (for a full list, please see attachment B2):

- **Park and tourism marketing/media through additional dollars provided to the Department of Parks Recreation and Tourism (PRT): \$13.4 million;**
- **Closing Fund to attract quality companies provided to the Department of Commerce: \$7 million;**
- **Research and development at Clemson University's International Center for Auto Research (ICAR): \$1.5 million;**
- **Agricultural marketing and promotions associated with the South Carolina Quality Program through**

additional dollars provided to the Department of Agriculture: \$400,000;

- **Venture Capital Program activities, as well as the state's CDBG match, through additional dollars provided to the Department of Commerce: \$348,000;**
- **Insurance actuaries for solvency monitoring and form and state review, as well as catastrophe modeling through additional dollars provided to the Department of Insurance: \$304,000; and**
- ***Nonrecurring funds to initiate the Myrtle Beach airport expansion, first-time funding of a Rural Broadband Fund which will allow the state to be competitive in the global marketplace, partial funding of the Ports Access Road, and, continued payment for harbor dredging: \$115 million.***

- e) **Public Safety – \$600 Million General Funds / \$1.1 Billion Total Funds** – Public safety continues to be a major concern for the citizens of South Carolina. The state was recently ranked as having the fifth highest crime rate in the nation as reflected by data compiled by the Federal Bureau of Investigation (FBI). While one should not singularly focus on a crime rate without regard to many other factors (such as population density, education levels, etc.) there nevertheless continues to be a pervasive crime problem within the state as evidenced by our sizable prisoner incarceration rate of 539 prisoners per 100,000 population – 10.9 percent higher than the national average.

South Carolina is also threatened by natural and technological hazards. The threat posed by these hazards can be both immediate (e.g., hazardous chemical spills, hurricanes, tornadoes) and long-term (e.g., droughts, chronic chemical releases). These hazards have the potential to disrupt day-to-day activities, cause extensive property damage and create mass casualties. Historically, the greatest risk was perceived to be from natural hazards (e.g., hurricanes, tornadoes, severe storms, floods, earthquakes). For instance, South Carolina has averaged 11 tornadoes each year since 1950, resulting in 47 fatalities and 1,057 injuries. Lately, however, the continued expansion of chemical usage is raising the risk posed by technological hazards (e.g., hazardous chemical releases/spills) in South Carolina such as the one experienced in Graniteville several years ago.

Finally, South Carolinians face numerous individualized hazards such as traffic collisions and hunting and boating accidents. In fact, South Carolina highways were recently cited as the second most deadly roads

in the nation with an average of three people dying on South Carolina roads each day.

Faced with such conditions and risks, it becomes apparent that an improvement for the safety of people and property is fundamental not only to the quality of life in South Carolina, but also to the vibrancy of its economy.

Specifically, to assist with the state's public safety needs during FY 2007-08, we propose increasing recurring general funds for the following activities (for a full list, please see attachment B2):

- **100 new Highway Patrol officers to provide greater highway traffic enforcement and to further reduce the response times to collisions: \$5.3 million (within the last three executive budgets, we have added 300 new HP officers);**
- **Annualization of operational funds for correctional facilities around the state: \$4.3 million;**
- **Increased intensive probation and parole supervision of juveniles: \$1.8 million;**
- **Upgrades of mental health services for adult offenders at the Department of Corrections: \$1.5 million;**
- **Twenty-five new State Transport Police (STP) officers to provide greater size, weight and other commercial motor vehicle enforcement to better preserve the state's road system: \$1.4 million (within the last three executive budgets, we have added 70 new HP officers);**
- **New State Law Enforcement Division (SLED) officers to combat the narcotic and vice crime throughout South Carolina: \$688,000;**
- **Greater retention of correctional officers through increased incentive pay: \$640,000;**
- **New forensic laboratory staff at SLED to improve turnaround times on forensic cases: \$511,000;**
- **Second year funding of Jessie's Law: \$500,000;**
- **Five new Bureau of Public Safety officers to provide greater protection and security coverage for the buildings which make up the state house complex: \$241,000;**
- **a "CJIS" sex offender registry system to better track potential offenders between states: \$200,000;**

- **Girls transition home operation funding at the Department of Juvenile Justice (DJJ): \$164,000; and**
- ***Nonrecurring funds to renovate and/or construct new juvenile and adult penal facilities at the Department of Corrections and the Department of Juvenile Justice; purchase equipment and vehicles for law enforcement; upgrade and construct weigh stations in order to better maintain the state's road system; and, make renovations at the criminal justice academy: \$47 million.***

- f) **Natural Resources – \$88.5 Million General Funds / \$322.5 Million Total Funds** – Quality of life is inexorably linked to the quality of an area's natural resources. No where is this more evident than in South Carolina, where we are blessed with both valuable and vulnerable expanses of timberland, shoreline and foothills teeming with wildlife. Preserving our lakes and our trees, our beaches and our marshland is paramount not only for us today, but for our children and our children's children for years to come.

Our natural resources provide both an immediate economic boon and a lasting benefit to the citizens of South Carolina, and, thus, the state's role in protecting our natural resources is five-fold: to market the socioeconomic value of South Carolina's natural resources; to produce statewide outcome-driven policies aimed at ecological sustainability; to minimize the negative effects related to industrialization and population growth; to regulate and enforce quality standards; to provide programs aimed at individual-level citizen stewardship and education; and to prevent and respond to irresponsible human behavior resulting in natural resource destruction.

In this spirit of both immediate economic benefit and long-term conservation and to provide for the state's natural resource needs during FY 2007-08, we propose increasing recurring general funds for the following activities (for a full list, please see attachment B2):

- **Improved water quality by providing additional dollars to the Hydrology Division of the Department of Natural Resources as well as increases to the Department of Health and Environmental Control: \$1.4 million;**
- **Funding of Contaminated Hazardous Waste Site Cleanup through additional dollars provided to the Department of Health and Environmental Control: \$500,000; and**

- ***Nonrecurring funds to the Conservation Land Bank in an effort to protect important tracts of timberland for future generation; provide for renovations/asbestos abatement at state park facilities; and, to protect the state's marine ecosystem: \$22 million.***

g) Central State Government and Other Governmental Services-\$664 Million General Funds / \$1 Billion Total Funds – To provide for constitutional/statewide needs during FY 2007-08, our executive budget funds \$31.7 million in constitutional items (e.g. Capital Reserve Fund; General Reserve Fund) and \$119.6 million in statewide/statutory items (e.g., Local Government Fund, an employee pay raise, and, the state employee health plan). Pay plan funding represents a \$52.3 million increase over last year's pay level to allow state agencies to address critical needs and provide incentives to their best employees – which would roughly be the equivalent of a three percent across the board pay raise.

Further, we propose a \$37.5 million increase in funding for the state employee health plan marking the second consecutive year that we have sought to cover the premium increases of non-tobacco use employees. For five years prior to FY 2005-06, employees saw increases in their health insurance premiums.

- 4. Decrease the size of state government by consolidating agencies, boards and commissions, and strengthening the cabinet form of government –** This administration has been committed to continuing the legacy of Governor Carroll Campbell by further restructuring state government to increase accountability and reduce duplication and waste. Our state government today is still largely fractured and duplicative, taking dollars that would otherwise go to the citizens of our state. Many agencies are run by boards and commissions comprised of well-intended people who give of their time, typically for little to no pay. While we are grateful to any citizen who is willing to give of their time to serve the people of this state, these are also people with families and jobs that keep them away from the daily operations of state government. We believe that the cabinet form of government significantly increases accountability, as we have seen with the cabinet agencies created during Governor Campbell's time in office.

In addition to a need for a Department of Administration, we also believe that changes are needed at the South Carolina Department of Transportation. Currently, that agency lacks the level of accountability found in other states. Forty-seven governors appoint the director of the Department of Transportation or appoint all Highway Commission members (South Carolina, Georgia, and Mississippi are the only states that do not). In South

Carolina, the governor can only appoint the chairman of the Commission, who can only vote in the case of a tie. The other commissioners (whose appointments are not subject to a full Senate vote) choose the director of the agency. Of the forty-seven states that do it different than we do, forty-one have a governor who appoints the Director of the Department of Transportation (i.e., cabinet agency) while six allow the governor to appoint the entire commission.

These restructuring proposals, when taken in total, will allow us to eliminate or merge duplicative state offices, departments, agencies, board or commissions. In doing this, the state will realize **restructuring savings of \$19 million during FY 2007-08.**

5. **Honor the promises and obligations of prior years** – When we released our first executive budget in FY 2004-05, the state was coming out of an unprecedented period of revenue decline. This decline strained agency budgets – as agencies endured a series of across-the-board mid-year cuts – and led to the state closing its books with a \$155 million unconstitutional operating deficit during FY 2001-02 as well as the depletion of the state’s General Reserve Fund (\$153 million) during FY 2001-02 and FY 2002-03.

As the fiscal crisis persisted, \$209 million was diverted from various trust and reserve funds to mitigate the impact of the mid-year cuts. In addition, there was an “embedded” GAAP deficit of \$105 million that resulted from the General Assembly taking a 13th month of revenues for spending in a 12 month fiscal year in 1991, 1993, and 2001. The \$135 million shortfall in the State Health Plan reduced the standard 45-day payout ability down to as low as zero. By the time we presented our initial FY 2004-05 Executive Budget, the state faced financial obligations of three-quarters of a billion dollars.

We worked with the General Assembly in restoring the diverted and shortfall funds last year. Nevertheless, serious fiscal challenges remain. As described within the February 2006 Actuarial Valuation Study of the state’s other post-employee benefits, starting next year, the new accounting standards issued by the Government Accounting Standards Board will require all states to account for unfunded liabilities, and the State Health Plan has a \$9.2 billion unfunded liability in regard to health insurance coverage for state retirees. Amortizing this amount will require an additional \$535 million for the next fiscal year, and each year thereafter. Further, a FY 2004-05 audit noted a sizable unfunded liability within the Tuition Prepayment Program, with funds to be exhausted by 2017.

After funding the operational needs of agencies, we propose dedicating \$439 million to establishing a trust fund to combat the unfunded liability associated with state retiree benefits. Further, we seek to cover the \$41 million deficit associated with the Tuition

Prepayment Program. Therefore, in total we seek to set aside \$480 million (or 48 percent) of the \$998 million in “new” funds available to us at the time we prepare our executive budget to either cover or partially cover unfunded liabilities. This percentage of available funds – because of other fund revenue transfers into the OPEB trust fund – far exceeds the 37 percent of “new” funds we set aside last year to repay trust and reserve funds. When discounting the \$194 million impact of the other fund revenue transfers, revenue available for FY 2007-08 falls to \$804 million. Of this amount, we dedicate \$286 million (or 36 percent) to establishing the OPEB trust fund and eliminating the Tuition Prepayment Program deficit.

6. **Reduce reliance on one-time funding for recurring costs** – The FY 2006-07 Appropriations Act passed by the General Assembly utilized \$128 million in one-time monies for recurring needs (“annualizations”) – creating a significant hole to be filled in the upcoming budget year. While much lower than prior years, yearly annualizations remain too high. **In the FY 2007-08 Executive Budget, we propose using \$73 million in one-time monies to fund recurring needs. If adopted, this would be the lowest annualizations level in well over a decade.**

7. **Reduce our recent growth in debt** – From 1997 to 2005, South Carolina’s *state* tax supported debt increased 142 percent, from \$1.16 billion to around \$2.81 billion, making South Carolina’s debt expansion the 14th fastest growth rate in the nation. For the same time period, statewide tax supported debt per capita and tax supported debt as a percent of personal income, both of which measure taxpayer debt burden, increased 114 percent and 56 percent, respectively. At \$661, South Carolina’s debt per capita ranked 31st in the nation, but grew at the 15th fastest rate among the 50 states. Likewise, at 2.5 percent, the state’s debt to personal income ratio ranked 26th in the nation, but grew at the 16th fastest rate among all states. This is in contrast to states such as Wyoming, Colorado, South Dakota, Nebraska and Arizona which carry no state debt whatsoever.

From 1997 to 2005, South Carolina’s *local* tax supported debt increased 121 percent, from \$2.4 billion to around \$5.2 billion. Local government borrowing includes obligations of counties, municipalities, special purpose districts, and public school systems. Statewide, local tax supported debt per capita increased 100 percent during the period, from \$625 to \$1,248. Local debt per capita exceeded \$1,000 in thirteen South Carolina counties, five of which have local debt per capita exceeding \$2,000 and one of which has local debt per capita exceeding \$3,000. Statewide, local debt as a percent of personal income increased 47 percent during the period from 3.1 to 4.6 percent. On a combined state and local basis, the average South Carolinian is responsible for about \$1,909 in debt.

South Carolina's tax supported debt per capita, excluding local debt, ranks 8th of the twelve states in the Southeast, but grew during the period at the 4th fastest rate – only North Carolina, Arkansas and West Virginia grew faster.

With all bonded indebtedness comes the cost of repayment. The bond costs may seem small, but they ultimately have a tremendous impact on the annual budget. According to the State Treasurer's Office, our annual obligation for debt service has increased from \$142 million in FY 1996-97 to an estimated \$232 million in the coming FY 2007-08, an increase of \$90 million. [In education terms, this \$90 million annual debt service increase equals roughly \$150 per pupil if added to the Base Student Cost.]

In this budget, we propose taking funds from the FY 2006-07 projected surplus using them to pay off some of those outstanding debts. In total, we propose \$21 million dollars to retire outstanding obligations. Although this spending represents a small percentage of the overall debt burden held by the state, as cited above, it is a down payment on a policy we believe is critical to making us more competitive and easing the overall burden to South Carolina's taxpayers. If implemented, our proposal to better manage statewide debt will free up \$1.9 million in recurring monies for FY 2007-08.

We also seek the maintenance of the state's overall debt no more than the present four percent level in the coming years. The state Constitution sets a five percent cap on the annual debt service, but gives the General Assembly authority to lower it to four percent or to increase it to as much as seven percent. Over the past few years, the General Assembly has increased the debt service limit from five percent to six percent in two separate pieces of legislation.

As cited earlier, within our budget **this year we propose the elimination of \$21 million in outstanding debt from non-recurring revenue sources which exceed the aforementioned spending limit. While certainly a small amount when compared to the state's annual debt service of \$232 million, this prepayment adds \$1.9 million in recurring general funds for FY 2007-08.**

- 8. Improve state financial performance through better fiscal management** – As was noted earlier, the state faces a serious unfunded liability associated with its retiree health insurance coverage. As a first step, we feel that it is important to limit the growth of government spending so that any dollars in excess of the limit may be used to address this liability

Further, we feel that it is important to reallocate state resources to address the liability. Currently, the state has excessive balances in its Unemployment Compensation Fund and its State Health Plan. The Unemployment Compensation Fund is currently receiving around \$3 million more per year in

premiums than it annually pays out in claims. As this has been going on for some time, the Unemployment Compensation Fund has grown to around \$27 million. In this budget, we seek to reduce agency premiums to a level which maintain historical payout levels. **Further, we propose removing \$23 million in one-time funds from the Unemployment Compensation Fund to assist with the establishment of an OPEB trust fund.**

Similarly, when we took office, we had as a financial goal to restore the State Health Plan's reserve from its near 0-day payout to the 45-day reserve typical of government and business health plans. This level has been met and indeed over the past several years, the plan's number of days in reserve has actually grown significantly above the 45-day payout to around 85 days. This excess is equivalent to around \$136.8 million. Therefore, in the same manner in which we propose using the excess from the Unemployment Compensation Fund, **we seek to shift \$136.8 million from the State Health Plan to assist with the establishment of the OPEB trust fund.**

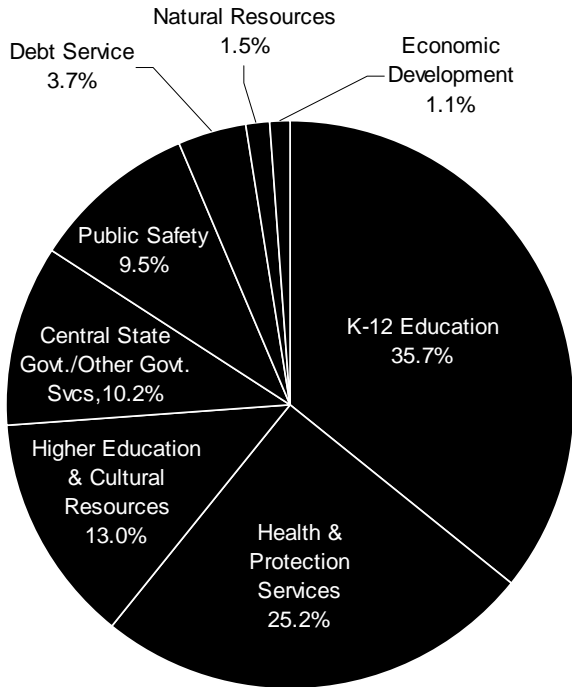
In addition to shifts between the trust funds mentioned above, **we seek to use \$34 million in lapsed unobligated Competitive Grant Program funds to assist with the establishment of the OPEB trust fund.** As a final source of start-up money for the OPEB trust fund, within the FY 2005-06 Appropriations Act, the General Assembly funded the State Ethics Commission \$318,000 from "Maybank" sources to establish an electronic filing system. As this system was eventually set up through a contract with South Carolina Interactive, Inc. at little to no cost to the agency, **we are seeking to recoup a portion (\$250,000) of the remaining funds which exist from the electronic filing system appropriation to assist with the establishment of the OPEB trust fund.** These dollars, like the shifts from the Unemployment Compensation Fund and the State Health Plan, will be combined with the \$245 million available from dollars in excess of the spending limit to establish a \$439 million OPEB trust fund during FY 2007-08.

Finally, over the past several years, we have sought to better manage the state's travel and lodging expenditures. From one of our first directives requiring the double bunking of state employees attending overnight functions to reviewing the impact of privatizing the state's fleet, this has been an administration engaged in curtailing wasteful travel and lodging expenditures. **Continuing with this initiative, within the FY 2007-08 Executive Budget, we are funding the creation of a Central State Travel Division within the Comptroller General's Office. This \$50,000 budget addition will be used to manage and monitor agency travel and will provide \$824,339 in recurring general fund savings during FY 2007-08.**

9. **Continue the process of reforming our retirement system so that we can honor our commitment to our state's retirees** – South Carolina's current retirement system crisis parallels the problems faced by other states as aging baby boomers in the nation's state government work force prompt fears that payouts of defined benefit pension plans – those plans with a guaranteed benefit – will break state budgets. For instance, from FY 1998-99 to FY 2005-06, the retirement system's debt increased from \$178 million to over \$9 billion, an increase of 4,952 percent. In FY 1998-99, it would have taken the state only two years to amortize that debt; today it will take us 30 years to pay off the debt. The constitutional limit is 30 years. This means the system is fiscally unsound. **To alleviate the problems associated with defined benefit plans, we will support legislation during FY 2007-08 which expands the current Optional Retirement Program administered by the South Carolina Retirement System. We believe the plan should be the only state plan extended to new state employees.** This would allow new state employees greater control over their retirement account, so that they have the opportunity to earn larger investment returns from their accounts and at the same time reduce the amount taxpayers will have to spend for future retirement benefits.

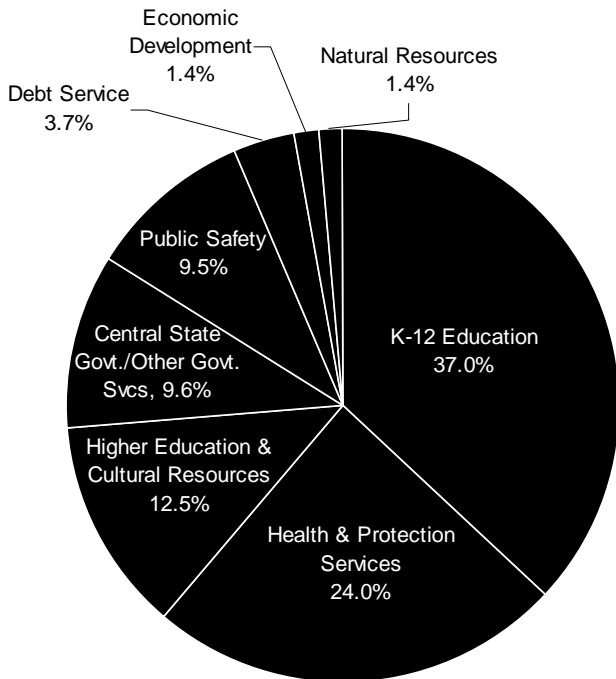
**Summary Comparison of
Recurring General Fund Appropriations**

Current Budget – FY 2006-07 Recurring General Fund Appropriations



Category	Dollars in Millions
- K-12 Education	2,180.4
- Health & Protection Services	1,540.5
- Higher Ed. & Cultural Resources	796.9
- Central State Government /Other Governmental Services	622.8
- Public Safety	578.7
- Debt Service	228.4
- Natural Resources	92.5
- Economic Development	67.8
TOTAL	6,108.0

Governor's Purchase Plan – FY 2007-08 Recurring General Fund Appropriations



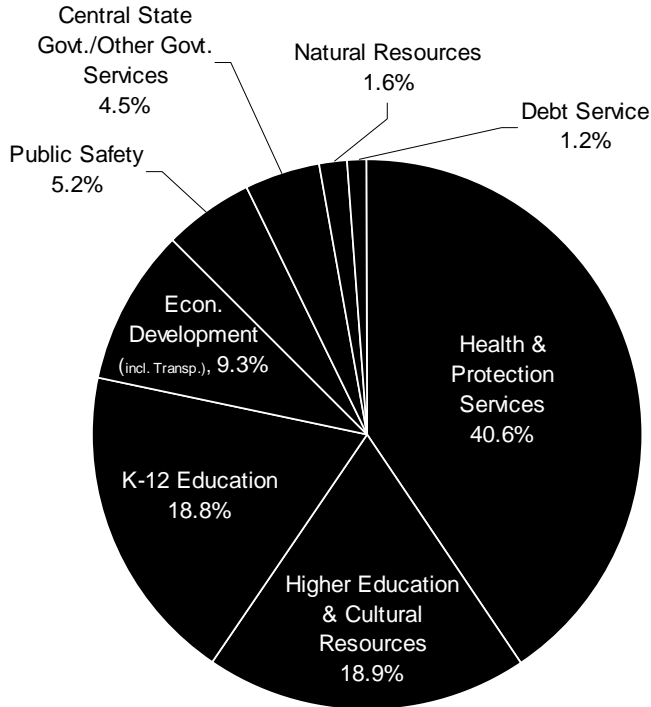
Category	Dollars in Millions
- K-12 Education	2,333.2
- Health & Protection Services	1,516.9
- Higher Ed. & Cultural Resources	785.9
- Central State Government /Other Governmental Services	664.3
- Public Safety	599.6
- Debt Service	230.6
- Economic Development	90.4
- Natural Resources	88.5
TOTAL	6,309.4

** Health & Protection Services reflects \$107.3 million general fund reduction due to a shift of the same amount to other fund sources during FY 2007-08. This shift is the result of our proposal to raise the cigarette tax \$.30 per pack during FY 2007-08. The above also does not include \$90 million to be allocated to agencies for the Employee Pay Plan (\$52.5 million) and Employee Health Insurance (\$37.5 million). With the \$197.3 million added to the \$6,309.4 million above, proposed appropriations equal spending limit of \$6,506.7 million.*

FY 2007-08 Executive Budget

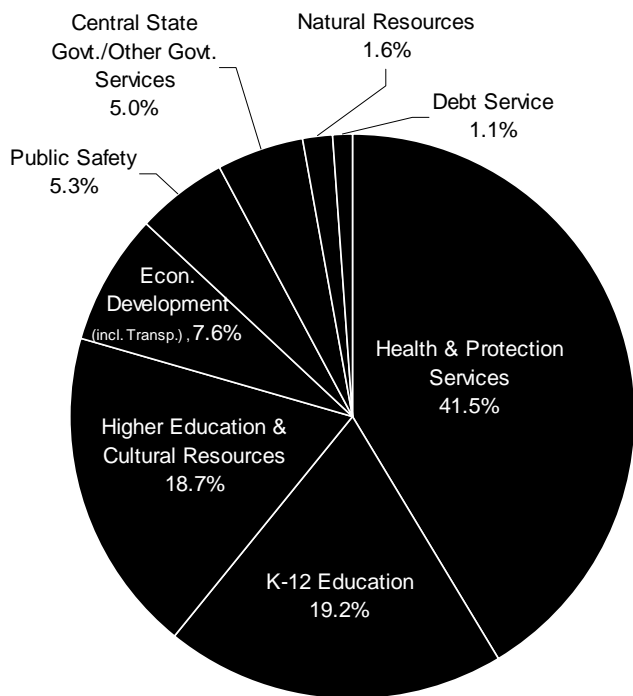
Summary Comparison of Total Fund Appropriations

Current Budget – FY 2006-07 Total Fund Appropriations



<u>Category</u>	<u>Dollars in Millions</u>
- Health & Protection Services	7,960.4
- Higher Ed. & Cultural Resources	3,714.9
- K-12 Education	3,676.7
- Economic Development (Including Transportation)	1,827.0
- Public Safety	1,017.8
- Central State Government /Other Governmental Services	872.6
- Natural Resources	307.3
- Debt Service	228.4
TOTAL	19,605.1

Governor's Purchase Plan – FY 2007-08 Total Fund Appropriations



<u>Category</u>	<u>Dollars in Millions</u>
- Health & Protection Services	8,367.7
- K-12 Education	3,865.6
- Higher Ed. & Cultural Resources	3,768.2
- Economic Development (Including Transportation)	1,535.5
- Public Safety	1,059.3
- Central State Government /Other Governmental Services	1,001.0
- Natural Resources	322.5
- Debt Service	230.6
TOTAL	20,150.4

** The above does not include \$90 million to be allocated to agencies for the Employee Pay Plan (\$52.5 million) and Employee Health Insurance (\$37.5 million). With the \$90 million added to the above of \$20,150.4 million, proposed appropriations for FY 2007-08 total \$20,240.4 million. Finally, Central State Government includes \$100 million for the Port Access Road which is funded from the Contingency Reserve Fund during FY 2007-08. We view this as an economic development item.*

\$21.4 Billion

Includes all funding such as the General Fund, Other & Federal Funds, Capital Reserve Fund, Surplus, Contingency Reserve Fund, EIA, Lottery, other Revenue Adjustments

Higher Priorities

Examples of what our plan buys:

\$8.37 billion	Health care and protection for nearly a million children and adults.
\$3.87 billion	K-12 education for over 683,500 students.
\$3.76 billion	Higher education for over 175,000 students and cultural resources.
\$1.54 billion	Economic development - Including 66,252 miles of roadways (Transportation).
\$1.06 billion	Public safety, including 295 new officers.
\$938 million	Central state government/other governmental services.
\$522 million	Property tax relief fund.
\$439 million	Establishment of OPEB trust fund.
\$323 million	Protection of our natural resources.
\$231 million	Debt service for General Obligation Bonds.
\$98 million	Permanent tax cut (with general fund shift associated with cigarette tax increase, tax cut increases to \$205 million).
\$90 million	Increased resources for state employee pay and benefits.
\$63 million	Constitutional/statutory funding requirements.
\$41 million	Elimination of Tuition Prepayment Program liability.
\$21 million	<u>Accelerated debt repayment.</u>
\$21.4 billion	TOTAL

\$126.3 Million

(\$91.9 million in General Fund cost savings; \$34.4 million in Lottery cost savings)

Lower Priorities

Examples of what our plan does not buy:

\$36.3 million	Activities that have been determined by the Budget Results Teams to either have spending inefficiencies or that are low priorities for the goal area.
\$19.8 million	Surplus build-up in funding for endowed chairs and other lottery activities.
\$19.0 million	Duplicative administrative costs that can be saved from restructuring.
\$14.6 million	Additional lottery ads and retailer commissions above the national average.
\$10.5 million	Employees being hired or rehired at the prevailing TERI salary when a TERI employee retires from a position following their 5 year extended employment cycle.
\$10.2 million	Less cooperation and collaboration at the state's higher education institutions.
\$5.7 million	Non-competitively awarded pass-through funds.
\$4.8 million	Annual lease and debt payments associated with matured and prepaid bonds.
\$3.1 million	Unemployment compensation premiums above historical payout levels.
\$2.3 million	Pharmacy reimbursements above the <u>Southeastern average.</u>
\$126.3 million	TOTAL

Additional Information

More details of agency activities can be found at the Office of State Budget's (OSB) website at <http://www.budget.sc.gov/OSB-agency-activity.phtm>. Further specific highlights of the Governor's Purchasing Plan for each goal area can be found later in this document starting with Improving K-12 Student Performance on page 132. The Governor's complete Purchasing Plan by goal area can be found in Appendix B-3; the complete Purchasing Plan by agency can be found in Appendix B-4; and the complete Savings Proposals can be found in Appendix C.

**Continuing and
Strengthening the Budgeting
for Results Process**

Continuing and Strengthening the Budgeting for Results Process

Results matter...or at least they should. Especially when it comes to tax dollars and public expenditures. Increasingly, taxpayers are demanding results and performance in return for their hard earned dollars.

– **Geoffrey F. Segal, Reason Foundation (2004)**

Most managers have no idea what their products and services really cost. At best, conventional cost accounting is marginally relevant to decisions about operations and management. At worst, it distorts reality and causes dysfunctional decisions.

– **Kehoe *et al*, *Activity-based Management in Government* (1995)**

This is our third executive budget emphasizing outcomes or results. As in the past, we are using an “activity-based” approach whereby we require agencies to break state government programs and processes down into literally hundreds of separate and distinct activities. We then establish key goals for the state to accomplish in major functional areas of government, such as education, public safety, and economic development. Next, we carefully select sound and verifiable indicators of success from reliable sources to measure both short- and long-term progress. Finally, we identify strategies that are considered “best practices,” or scientific evidence and documentation to bring about real, proven, significant, and lasting results.

Hence, this intensive activity-based budget method provides decision makers – our administration, legislators, public officials and administrators – with valuable and important information and data. Of note, it should also be pointed out that these detailed cost data are significant in that they give decision makers the opportunity to make optimal choices about how to allocate limited resources. Moreover, activity-based data permits decision makers to streamline, re-engineer, and innovate state agency operations and processes to produce the maximum results at the best cost.

Further, without activity-based data, it is difficult or near impossible to answer such questions as follows:

- Is this state governmental service or activity of good value?
Is it both cost-efficient and cost-effective?

- Are the costs associated with this activity competitive? In other words, can this activity be provided cheaper by competing service providers (public or private)?
- More importantly, is this activity even desirable or needed by the public?

Additionally, at this juncture, it is equally important to comment that many experts in public finance believe that the cardinal aim of activity-based budgeting is accountability. Performance information and data used in budgeting holds public officials, especially program managers, accountable for service quality, cost-efficiency, and program effectiveness. The focus of activity-based budgeting is, once again, on results, not simply inputs. For this reason, governors, legislators, service or program recipients, and the public generally can determine accountability with a degree of certainty with the use of activity-based methods, where this is not possible utilizing traditional or line-item approaches. This ability to assess performance and hold public managers and administrators accountable serves as a powerful incentive to ratchet up quality or positive service results.

As pointed out in previous budgets, it should be recognized that our administration's executive budget is a vast departure from the traditional state budgeting practices of the past – ones which, unfortunately, continue today to be used, in the main, by the state's Legislature. As such, budget or financial analysis utilized in the legislative spending process – the making of appropriations – is unavoidably limited or incomplete.

By the standards of today's financial practices, traditional governmental budget processes are by and large considered to be archaic, marginal, and avoid careful analysis and decision making as relates to the preceding year's "appropriation's base." Their focus is on "new monies" alone, that is, on those funds that result from revenue growth over the previous year. Generally, this new money represents only 5-10 percent of the state's total General Fund Revenues.

This incremental approach allows obviously for only a narrow, minor discretionary review of state spending. Thus, public policy is made in incremental or successive steps, resting on decisions made in prior years. Unfortunately, incrementalism does little more than *control* spending and *preserve* the status quo of the bureaucracy. Worse still, past spending decisions simply are unexamined. These "automatic" determinations – without consideration of the twin critical aims of 1) establishing cost-savings and 2) the effective formulation and discernment of productive results – prove to be counterproductive and often simply wasteful.

Traditional Budgeting vs. Budgeting for Results	
Incremental or Traditional Budgeting	Results-based Budgeting
Focus is on the allocation of "new monies" only (5-10 percent of budget total)	Focus is on nearly all monies or the entire budget amount (excepting certain obligations such as debt service, reserve fund requirements, etc.)
Concentration is on inputs (what you buy), e.g., "objects of expenditure"	Concentration is on outputs (what results are expected)
Narrow or marginal decision making	Comprehensive or enterprise-wide decision making
Subjective based	Objective based
Preserving the status quo	Determining new, creative approaches to problems and needs
Agency or bureaucracy driven	Outcome driven
Promotes restraints, restrictions, and red-tape	Encourages flexibility and ingenuity
Control orientation	Planning and management orientation
Emphasizes compliance and preserving legality	Emphasizes performance and innovation
Stresses audit trails and conformity	Stresses program evaluation and improvement
Involves agency heads, elected officials and advocacy groups	Involves everyone wanting to participate, especially those wearing a "citizen's hat"
Encourages and perpetuates single agency programs	Encourages intra- and inter-agency cooperation among programs and activities

Our administration utilizes what experts have described as a pioneering, state-of-the-art budget process that examines the entire budget – virtually every activity, and its associated funding, performed by government. Again, this is done ultimately in the context of a set of pre-established goals or results, ones that are determined by our administration to be of major significance to the citizenry. Called "Budgeting for Results" (BFR), it is a process that includes input or direct participation from ordinary citizens and subject-matter experts, designated as Result Teams, who develop purchase strategies to achieve the pre-set goals. Using these so-called "purchase strategies," the Result Teams then prioritize all state governmental activities, looking where possible for cost-savings, consolidations, and process improvements. The Result Teams then relay this information – indicators, strategies, priorities and innovations – to the governor. This extensive information then becomes a blueprint for our FY 2007-08 Executive Budget.

Definition of Terms
Goal Areas – Seven broad result or priority areas that the governor believes South Carolinians most want from their state government.
Indicators – Key measures or indices that provide the best evidence to the citizen that a statewide goal area is being achieved.
Strategies – Proven or promising approaches, influences or factors for achieving goals or results.
Activities – Individual or discrete actions taken by state government to accomplish goals and objectives. For the citizen, “What is the state doing, for whom, and does this accomplish something that is both valuable and needed?” “Precisely, why are we doing it?” “And at what cost?”

We feel confident that our budgeting approach is detailed, transparent, and rational. Overall, its focus is aimed toward bringing about positive consequences, again, both for the short- and long-term. In effect, the purpose of BFR and our executive budget for FY 2007-08 is: *To build and present a coherent, comprehensive spending plan for South Carolina based on clearly articulated statewide goals, effective strategies, creative and insightful thinking. To focus on the “keeps,” not the cuts. To underscore “results” in order to ensure that citizens – not agencies, special interest groups, or lobbyists – get their full money’s worth from state government.*

We adopted the Budgeting for Results process because of its logical and ingenious approach to public budgeting and fiscal decision making. It is a process, in a modified form, which has been adopted by several states (Iowa, Michigan, etc.) including a number of local governments (Los Angeles, Dallas, etc.). BFR was originally based on Washington State’s budget process model which was established in the fall of 2002. Of note, this budget process – as utilized in Washington State – has been recently recognized as a finalist for Harvard University’s prestigious Innovation in American Government Award.

As we remarked last year, the BFR process examines the entirety of government and nearly all statewide funding. Our priorities are clear. The executive budget for FY 2007-08 demonstrates how we will live within our means and invest in what matters by honing in on core goals and directing the whole of state government and its funding structure toward meeting those goals. It is our roadmap to a lean and results-producing government to serve South Carolina’s needs.

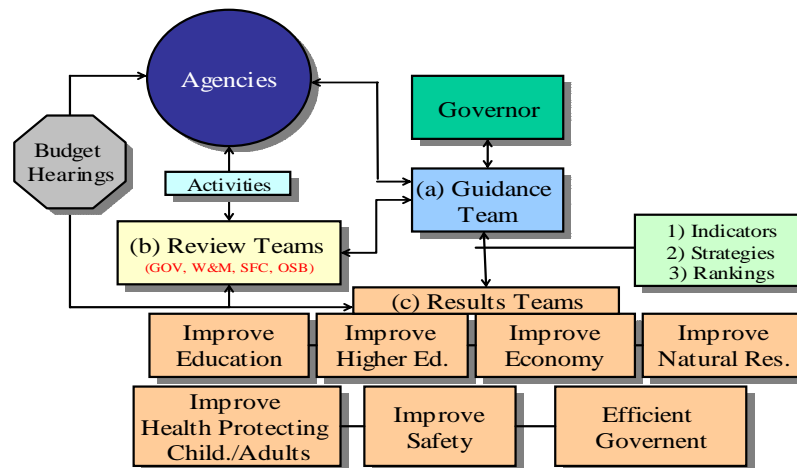
The Budgeting for Results Organizational Structure

A popular government without popular information or the means of acquiring it, is but a prologue to a farce or a tragedy or perhaps both.

– **James Madison, *The Writings of James Madison 103* (1910)**

The principal structural components of BFR are units or “teams.” These organizational units consisted of (a) a Guidance Team, (b) a Review Team, and (c) seven Results Teams.

Budgeting for Results Structure



1. **The Guidance Team (GT)** predominantly planned, supported, and monitored the BFR process. The Guidance Team consisted of our administration’s chief of staff and budget director as well as senior staff of the Office of State Budget. The GT also actively worked to energize the BFR process and met to coordinate and maintain the efforts of the seven Results Teams.
2. **The Review Team (TRT)** was designed to review and assess each agency’s detailed activities before the activities were submitted to the Results Teams. The TRT further ensured that the activities were properly defined or explained and formatted. Also, they placed activities into the appropriate, logical goal areas. Staffing consisted of personnel from the Office of State

CONTINUING AND STRENGTHENING THE BUDGETING FOR RESULTS PROCESS

Budget, the House Ways and Means Committee, the Senate Finance Committee, and the Governor's Office. It should be acknowledged that each of these staff members possessed extensive knowledge of the agency budgets within the various goal areas.

3. **The Results Teams (RTs)** were integral to the entire BFR process – in terms of sheer work and productivity. They were made up of groups of typically five to seven persons who possessed some expertise in relevant subject matter, but were asked to think like citizens, setting aside any agency or advocacy bias. Their chief roles and responsibilities were to identify those indicators that would best show progress toward their respective goal areas. Based on these indicators, the RTs also established key purchase strategies on how to best achieve each goal area. Most important, the RTs were then responsible for ranking and prioritizing agency or governmental activities that best met some aspect of their particular goal area. Finally, the RTs each prepared a *final* purchase plan detailing those activities to be funded to achieve their respective goal. These were subsequently submitted to the Governor's Office for consideration for inclusion in the budget.

Executive Budget Process Schedule (FY 2007-08)	
July 1, 2006	Finalized Goal Areas
August 10, 2006	Result Teams Appointed and Orientation Completed
August 18, 2006	Developed and Refined Activity Inventory
August 25, 2006	Budget Requests Submitted and Completed
August 31, 2006	Result Teams Developed Indicators and Strategies and Result Teams Developed Initial Plans
September 18-29, 2006	Budget Hearings Conducted
October 6, 2006	Result Teams Final Purchase Plan and Report to Governor
November 9, 2006	BEA Preliminary Revenue Estimate
December 15, 2006	Developed and Completed Governor's Executive Budget for FY 2007-08
January 3, 2007	Submitted Governor's Executive Budget to the General Assembly

The Budgeting for Results Process

The BFR process consists basically of six steps: 1) setting major goal or result areas, 2) reviewing and finalizing agency activity inventories, 3) developing or fine-tuning chief indicators of progress and key strategies for achieving results, 4) holding public budget hearings for select result or goal areas, 5) sorting and prioritizing agency or governmental activities and identifying savings, and 6) distributing resources among goal areas, i.e., the finalization of the purchase plans by result areas.

CONTINUING AND STRENGTHENING THE BUDGETING FOR RESULTS PROCESS

While each step in the BFR process is of importance and consequence, one point should be stressed, that is, the singular importance of indicators cannot be underestimated. Indicators are of course the “yardsticks” or measures by which progress toward goal areas can be assessed. This is integral to any performance-based budgeting system, especially activity-based budgets. Significant also in the context of the BFR process is that strategies or approaches for achieving goals or results are intertwined with and dependent upon the indicator of progress in that they are the guideposts for prioritizing agency activities. Hence, the right indicator combined with the right strategy will yield a composite of prioritized governmental activities that are goal-oriented and are expected to achieve concrete results.

Step #1 – Setting major goal or result areas. The first step was to set major goal or result areas that we felt were needed to be achieved – improved upon – in the state in the short- and/or long-term. Based on previous years experience with BFR, we ultimately came to the conclusion that seven statewide goals would represent where the citizens of South Carolina wanted to focus in terms of results and progress made. Incidentally, these seven goal areas roughly coincide to the focus areas of the subcommittees of the House Ways and Means Committee and the Senate Finance Committee.

The following seven wide-ranging goals or results areas were identified:

1. Improve the conditions for our economic growth
2. Improve the health and protections of our children and adults
3. Improve the safety of our people and property
4. Improve the quality of our natural resources
5. Improve our K-12 student performance
6. Improve our higher education system and cultural resources
7. Improve central state government support and other governmental services

Step #2 – Developing agency activity inventories. The next step was to develop an all-inclusive inventory of the activities that state government in South Carolina provides. For each activity, three main elements were required – a description of the activity, its expected outcome, and its cost.

To acquire this activity information and data, working in conjunction with the State Budget Office, we requested, as in previous years, that each agency breakdown their budgets into discrete and definitive activities. Each agency was instructed to provide a description of each and every activity they provided to serve directly or indirectly the citizens of South Carolina. An activity was defined as something an organization does to accomplish its goals and objectives and which consumes resources and produces a product, a service or outcome. Most importantly, an activity should describe in a citizen-oriented way the following: what is done; for whom; why; at what cost; and what is to be expected or accomplished.

Agency activities were submitted by state agencies to the Office of State Budget, where they were then entered into an existing database. Most activities presented were reflective of previous years' submittals, excepting enhancements and those activities which were new. Next, the Review Team examined the activities to evaluate the quality of the activity descriptions and outcome measures. Those activities requiring more work or improvement were sent back to agencies for appropriate corrections and improvements. Once this was completed, the Office of State Budget sorted the activities to correspond to the seven goal areas, or verified that assortments from previous arrangements were correct. For example, those activities – regardless of agency or department – that appeared to fall within the goal area of K-12 improvement were placed there; those activities that related to the improvement of health were directed there, and so forth.

Thus, the final product of this second step was the formation of a comprehensive inventory of activities, numbering over 1,600 separate and distinct activities that comprised the entirety of what state government does, for whom, why, at what cost, and for what effects or outcomes.

Unlike previous budget activity submittals over the past three years, agencies were additionally asked to conduct what was essentially a self-evaluation. The purpose of this self-assessment was to identify any cost-savings, at any activity level. Agencies were specifically asked to identify savings equivalent to two percent of their total budget.

This cost-savings self-assessment by the agency itself was based on several rationales, two of which are supremely important in our administration's aim to be a responsible financial steward of public monies. First, agencies should be held accountable to identify savings as simply a matter of good management practices. Businesses, for example, are constantly seeking ways to cut costs and generally reinvest these costs into production improvements or pass the savings along to customers. Our administration feels that public agencies, in this respect, should have the same aim and responsibility as a business. In a nutshell, that is, public sector entities should identify cost-savings, make these savings available for reallocation where priority or core public services are most needed and, whenever possible, return any remaining savings to the taxpayer. Second, public agencies, departments, or units understand best their operations and activities. Managers and other agency personnel – unlike those outside a specific agency operation or activity – are capable of seeing where productivity might be increased without additional resources and at a savings. This, in both public and private vernacular, is called process improvement and, in other cases, sheer cost-cutting measures.

This year, our challenge to agencies of the state – at all levels – is therefore to look inward, carefully and comprehensively to be more productive and achieve cost-savings when and wherever possible.

Step #3 – Developing chief indicators of progress and key strategies for achieving results. Again, seven Results Teams were put together consisting of experts and knowledgeable citizen participants, by varying degrees, versed in the subject matter of each goal area. Each RT was headed by a team leader from the Governor’s Office. The Office of State Budget provided financial subject matter and research expertise for each RT.

Step 3 first required each RT to identify chief *indicators* of progress based on verifiable and well-documented statistical sources (the U.S. Census Bureau, the U.S. Labor Department, USC’s South Carolina Indicators Project, etc.). These were representative, according to experts and specialists in the subject matter, as the best and most comprehensive indicators for a goal area.

After the identification of indicators, each RT then collectively identified *strategies* which they felt – based on scientific data and information and literature – demonstrated empirically broad and comprehensive achievement within a state goal area.

These indicators and, more importantly, their link to strategies, via a grid ranking table (illustrated below), would be later utilized by the RTs as the basis or mechanism to review, analyze, and ultimately prioritize and rank activities which advanced the state toward the preset statewide goals.

Coordinate Ranking Chart

	<u>Strategy 1</u>	<u>Strategy 2</u>	<u>Strategy 3</u>	<u>Strategy 4</u>
<u>Indicator 1</u>	<u>x</u>	<u>x</u>		<u>x</u>
<u>Indicator 2</u>		<u>x</u>	<u>x</u>	
<u>Indicator 3</u>	<u>x</u>	<u>x</u>	<u>x</u>	
<u>Indicator 4</u>	<u>x</u>			
<u>Indicator 5</u>	<u>x</u>			
<u># of Indicators Impacted</u>	<u>4</u>	<u>3</u>	<u>2</u>	<u>1</u>

This year each Results Team re-evaluated the efforts of teams last year in identifying indicators for each major goal. The indicators are key to the BFR effort and will allow the state – particularly our administration, the General Assembly, state agencies, and the public at-large – the opportunity to gauge the progress of accomplishing statewide policy goals, more specifically the seven goals designated in this FY 2007-08 Executive Budget. Also, these indicators will allow our administration, the General Assembly, and the public to determine if the strategies we have identified in achieving the statewide goals are effective, especially for both short-term and, more importantly, *long-term* evaluative purposes.

While RTs were identifying indicators and strategies, a new resource became available – a Web-based indicators system developed by the Institute for Public Service and Policy Research of the University of South Carolina. The *South Carolina Indicators Project*

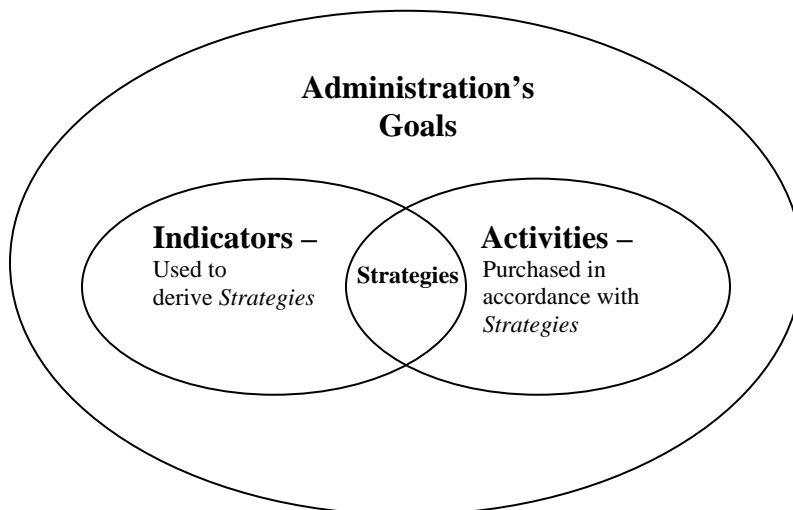
(SCI) was unveiled in September 2005. The site names 91 indicators across eight major areas of public policy, including the economy, education, the environment, public safety, health, social policy, culture and recreation, and government administration. Primarily, these indicators measure the relative status and position of South Carolina's performance and provide useful trend analyses. SCI represents the first major comprehensive effort to measure South Carolina's performance across all policy areas and, as such, will continue to serve as an invaluable resource for our administration, the General Assembly, and the public.

Additionally, it should be emphasized once again that BFR is a budgeting approach that places emphasis on logic, order, and proven cause and effect relationships. Utilizing the highest degree of objectivity and data analysis, this approach involves not only the setting of broad goals, but also dividing these further into specific objectives, and then identifying indicators or measurements, and strategies by which verifiable progress can be reasonably assessed over time.

Further, in Step 3, the BFR approach creates a strategic framework for RTs analysis and decision making. This framework comprises the following:

- Requires the consideration of the results citizens expect from government;
- Articulates those strategies that are most effective in achieving those results;
- Puts front and center those indicators which will best measure progress;
- And as relates to Step 4 (below), initiates an estimation or anticipation of prioritized spending to select or prioritize (buy) the activities that are most critical to implementing strategies and achieving (measuring) success;
- Helps keep the focus on contribution to priority results – lets RTs escape agency "silos" and consider instead statewide strategies;
- Makes performance information more relevant to budget choices;
- Helps frame the question, "Are we sure we're buying things at the best possible price?"; and
- Helps us describe the activities and results the *entire* budget will buy.

Diagram of Interrelationships of Goals, Indicators, Activities and Strategies



Step #4 – Holding public budget hearings for each result area. This step involved the opportunity for the governor, the governor’s policy staff, appropriate RT members, and other interested parties – including the general public – to meet with agency heads and personnel to discuss governmental activities particular to a goal area. This year there were three meetings held corresponding to the major goal area pertaining to education, public safety, and economic development.

The hearings typically lasted two to three hours and can be accurately depicted as interactive, providing a forum for conversation rather than formal presentations by agencies. A total of 17 agencies participated in the budget hearings, beginning on September 18, 2006, in Columbia, with discussions about the goal to “improve the conditions for our economic growth,” and concluding September 29, 2006, with the goal “to improve the safety of our people and property.” Generally, the discussions centered on how agency governmental activities were contributing to the results or goals set by our administration. Agencies were queried about their most beneficial, highest priority activities, as well as those that were marginal or less productive.

Executive Budget Hearings by Goal Areas with Appropriate Agency Participants for FY 2007-08	
Goal Areas	Primary Agencies
<i>Improve our K-12 student performance</i>	Department of Education, First Steps, ETV, Ed. Oversight Committee
<i>Improve the conditions for our economic growth</i>	Commerce, Dept. of Insurance, PRT, Labor, Licensing, and Regulation, Department of Transportation
<i>Improve the safety of our people and property</i>	Corrections, Juvenile Justice, SLED, Public Safety, PPP, Department of Motor Vehicles, DNR, Criminal Justice Academy

Step #5 – Sorting and prioritizing agency or governmental activities and identifying savings. This step basically involved the RTs prioritizing or ranking – “purchasing,” so to speak – governmental activities. The product or deliverable here was the development of a preliminary purchase plan of prioritized activities – an initial budget for each goal area.

Early on, the Office of State Budget had sorted activities by the designated goal areas (Step 2 – the developing of agency activity inventories). During the interim steps above, OSB had then sorted activities by strategies which were developed by the RTs in Step 3 (i.e., the developing of chief indicators of progress and key strategies for achieving results). At this point, each RT was now charged with reviewing the activities, heretofore not seen by the RTs, and deciding which *linked most closely* to their respective goal area, indicators and strategies. Eventually, these activities would be ranked by each team member (assigning an equivalent numerical value) based upon which goal area strategy it fell under. Obviously, some activities would appear unrelated or non-important to the goal area or especially to the major purchase strategies. They would be abolished, placed on a wish list, or sent to a more appropriate goal area or RT.

With this process completed, each RT, in effect, had ranked or prioritized its share or portion of the 1,600 activities to complete a goal-specific preliminary purchase plan, one which was – by all accounts among RT participants – perceived as both thorough and complete. The RTs also reviewed all costs associated with the activities regardless of the funding source (i.e., state General Fund, federal and “other” monies). Most importantly, perhaps, this step was an opportunity for RT members to challenge their previous assumptions and rationales for prioritization and to look for creative and innovative ways to do things differently and, hopefully, better. Central questions at this stage were, “As a citizen of South Carolina, are these activities the most efficient and effective ways to achieve the designated goal area(s)?” “Does this budget plainly make sense...can it *be easily understood* that it produces the results South Carolinians want and at the right

price?” Equally important, other questions that required answers, to the extent possible, included:

- Can these activities (those ranked, at a minimum, as “important”) realistically be measured in terms of performance or outcomes, and how?
- For those activities *not* purchased, what are likely to be the consequences?
- Can those activities that obviously appear to be duplicative, in and across agency structures, be eliminated or merged? If so, where can the cost savings be targeted in terms of other activities?
- What activities appear to be antiquated, no longer relevant to today’s citizenry? Can or should they be salvaged, or should they simply be abolished freeing up funds for more important, underfunded activities?
- What activities appear to be excessively funded, especially those ranked on the lower end of the prioritization list?
- In the final analysis, is this purchase plan for education, health, etc., the best possible budget – given the circumstances – for purposes of advancing the quality of life for all South Carolinians? Generally speaking, what more needs to be done in the future to make South Carolina great?

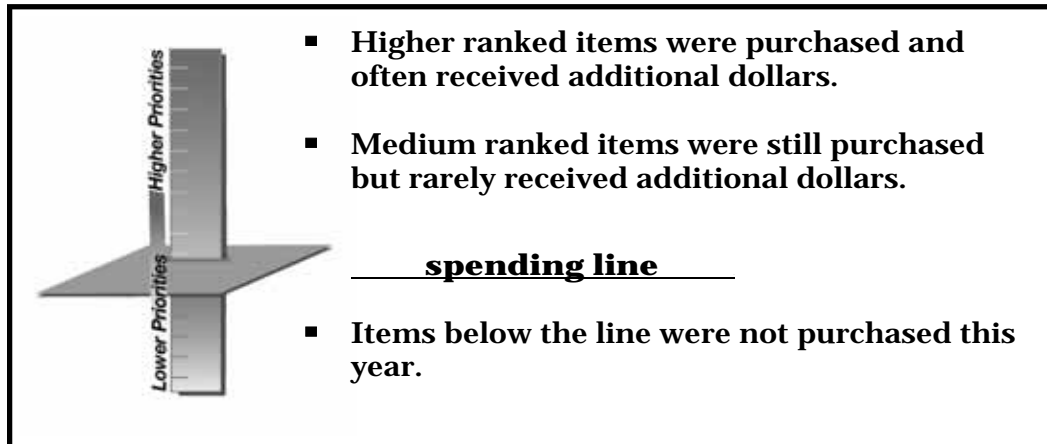
Step #6 – Distributing resources among goal areas, i.e., finalizing the purchase plans by result areas. The heart or quintessence of Step 6 was the methodical and careful review by our administration of the preliminary purchase plans submitted by the RTs and the finalization of a completed purchase plan reflecting our philosophy and policies. Ultimately, this final purchase plan took the form and substance of the FY 2007-08 Executive Budget.

It is noteworthy that the review of the RTs rankings or preliminary purchase plans and our administration’s finalization of priorities was not, by any means, an easy task. As was the case for the FY 2006-07 budget, many governmental activities were of nearly equal importance relative to purchase strategies and statewide goals. Further, we clearly stated that even though one activity was ranked below another activity, it was not correct to assume that the activity to be of lesser value or importance than those prioritized above it. We did point out, however, that activities ranked in the upper 15 to 20 percent of a goal area were clearly of the greatest significance and that those at or near the bottom of the rung were, based on our estimation and analysis, perhaps not as valuable or central to selected strategies within identified goal areas.

Further, during Step 6, the distribution of resources – available funds and FTEs were spread, based on historical spending patterns and our preferences, across the seven goal areas. This was done, of course, only after constitutional and statutorily mandated

expenditures were met (e.g., debt service, aid to subdivisions, and property tax relief). After this spread among the goal areas, we then began using the information and data from the RT preliminary purchase plans, along with other research and materials *to purchase*, so to speak, activities of the highest priority until the funds allocated to the specific goal areas were exhausted. The result was that those governmental activities that were of the greatest importance, or moderately so, to respective goal areas were funded. Those activities that fell below the “spending line” were not funded.

The “Spending Line”



Finally, some concluding observations about Step 6. As based on zero-based budgeting precepts and accepted activity-based procedures, we evaluated new activities on equal grounds as old or existing activities. The evaluation of a governmental activity was based again on indicators and their linkage to purchase strategies as related to the achievement of statewide goals. In other words, purchasing was done on the basis of anticipated outcomes rather than historical precedent. Additionally, once all ranking and the spending, i.e., “purchasing,” of resources were completed, we revisited the entire purchase plan to ensure that all cost-efficiencies were maximized. It should be noted, as well, that this year, as in the past, we emphasized a greater delineation between cost savings recommendations and below-the-line items.

As was the case last year, during this process, there were some activities that fell below the purchase line that gave us pause. However, given the priority ranking, the question that we had to ask ourselves was what activity above the purchasing line we would not purchase so that we could switch it with an activity below the line. This process, while difficult and tedious at times, helped us to prioritize our spending in a world of limited resources and, equally important, based on our spending cap. The resulting budget recommendations represent this new focus on maximizing results for the citizens of South Carolina.

A Change in Budgeting Models and Mind-Set

The man who is striving to solve a problem defined by existing knowledge and technique is not just looking. He knows what he wants to achieve, and he designs his instruments and directs his thoughts accordingly.

Rather than being an interpreter, the scientist who embraces a new paradigm is like the man wearing inverted lenses.

– Thomas Kuhn, *The Structure of Scientific Revolutions* (1962)

The Budgeting for Results process has proven to be successful and has been well-received by progressive-thinking legislators, the media, and the public. We believe that the process is innovative and pragmatic as a public budgeting mechanism.

This year's BFR effort was for us, as we stated last year, "a shift in paradigms." The outdated, traditional budgeting approaches of concentrating on apportioning new monies only, the concentrating on inputs alone, and the continuing bureaucracy-driven emphasis simply on self-preservation is no longer tenable in today's world.

In a sense, BFR was born out of increasing recognition and comprehension as regards South Carolina's socio-economic makeup, status and performance. More exactly, it resulted principally out of the understanding of our administration that conventional budgeting structures and processes were not keeping pace with the times.

In conclusion, we feel assured that the Budgeting for Results process for FY 2007-08 was another excellent step forward in the setting of goals and priorities critical to South Carolina. In light of this, and the willingness among some members of the General Assembly to find ways to improve and enhance budgetary processes and decision making, we propose that a similar proviso be introduced as was initiated by Rep. Dan Cooper two years ago and adopted by the House. As we did last year, we ask the General Assembly to adopt the following proviso in the FY 2007-08 appropriation bill:

NEW PROVISIO (GP: Joint Committee on Activity-Based Budgeting). *There is established the Joint Committee on Activity-Based Budgeting composed of nine members. The nine members shall be appointed as follows: three Senators appointed by the Chairman of the Senate Finance Committee; three members of the House of Representatives appointed by the Chairman of the House Ways and Means Committee; and three members appointed by the Governor. The*

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Governor shall appoint the committee chairman. The terms of members shall be coterminous with the term of their appointing authority. Members of the Senate and House of Representatives shall serve ex officio. The committee shall study activity-based budgeting processes and how they may apply to the budget and appropriations processes for the State. Because the intent is to reduce duplication of government services, maximize cost-efficiencies, and still continue to provide excellent customer services, all costs of implementing a new budgeting system must be considered, including technological and human resource applications. Further, the committee will consider those budget processes that incorporate zero-based principles, particularly those which examine the entirety of government and state funding. Such budget processes must additionally emphasize, to the extent possible, the establishment of clearly delineated statewide goals; activity outcomes and results; spending strategies and priorities; and the measurement of performance.

The committee may propose, by majority vote, a budget process not inconsistent to matters relating to the discharge of its duties. This proposal shall be reported to the Senate Finance Committee and the House Ways and Means Committee by no later than January 1, 2008.

Professional and clerical services for the committee must be made available from the staffs of the General Assembly, the Budget and Control Board, and other state agencies and institutions as needed. The members of the committee are not entitled to receive the per diem, mileage, and subsistence allowed by law for members of boards, committees, and commissions when engaged in the exercise of their duties as members of the committee. All other costs and expenses of the committee must be paid in equal proportion by the Senate, the House of Representatives, and the Office of the Governor, but only after the expenditures have been approved in advance by the President Pro Tempore of the Senate, the Speaker of the House, and the Governor.

Revenue

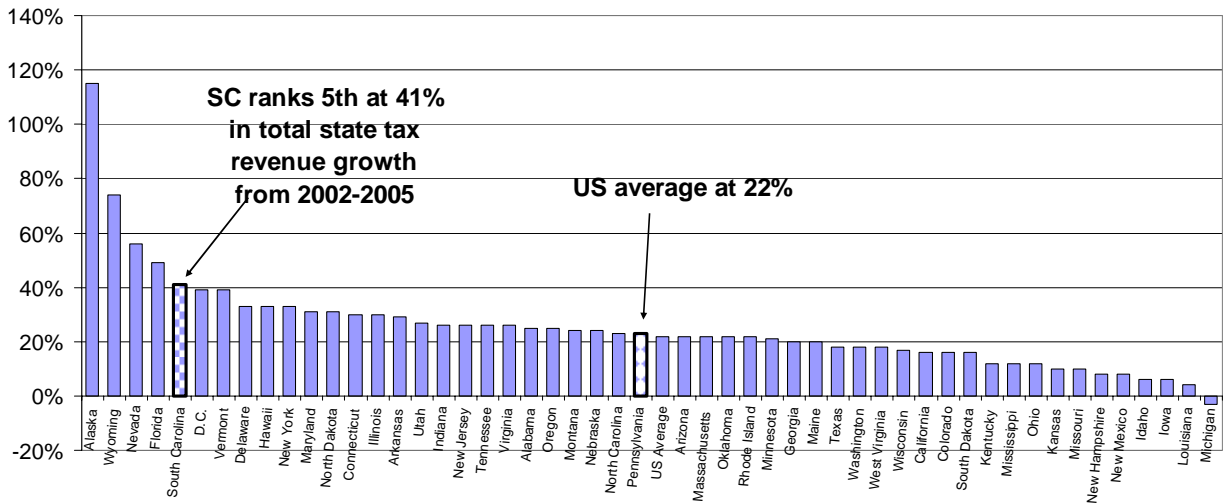
Revenue

Economy Continues to Grow

Strong revenue growth is a sign that an economy is on the rise. Consumers spend more, incomes increase, and businesses flourish – which was clearly the story when the books closed at the end of last fiscal year. In fact, the three primary revenue streams grew overwhelmingly with sales tax revenue up 8.1 percent, individual income tax revenue up 11.3 percent, and corporate income revenue up 33.0 percent. Looking at the big picture, the state closed the fiscal year ending June 30, 2006, with total general fund revenues up \$581 million from the previous year.

Many states across the nation are also benefiting from strong economic times with high revenue growth. South Carolina, however, is outpacing most. According to a recent Cato Institute report, South Carolina revenues have grown by 41 percent over the last three years – ranking us as the 5th strongest economy in terms of revenue.

State Tax Revenue Increase (2002-2005)
from January 2006 Cato Institute Report



As the revenue forecasters of the state, the South Carolina BEA predicted that future revenue will be sound once again. In setting the FY 2007-08 revenue estimate this past November, the BEA estimated general fund revenue to be \$7.103 billion, an over eight percent increase from the previous year. From this estimated number, there will be \$487 million in recurring dollars and \$307 million in non-recurring during this budget cycle – for a total of \$794 million in new money. When adding several other recurring revenue items which total around \$10 million, this amount grows to \$804 million. While this estimate proves that the state economy is growing, we once again urge the

General Assembly to display fiscal conservatism by holding expenditures to a population plus inflation cap.

Increases to General Fund Revenue

In our past two budgets, we have believed it was time to take an in-depth look at the benefit of the Job Development Fees that continue to be dedicated for the Redevelopment Authorities (RDA) of Charleston and Myrtle Beach. These monies have been dedicated since 1994 in response to previous base closings from the Base Alignment and Closure Commission. Each year the state is forced to remit back to the RDA's a portion of their individual income tax withholding. The Myrtle Beach RDA has long been defunct, and at the end of this calendar year the Charleston RDA will also become non-operational. These RDA's have done effective jobs of redeveloping the former military bases and bringing other jobs back to these areas. However, these entities have fulfilled their original mission, and we believe it is time the taxpayers stop supplementing a project that is already complete. To this end, we recommend these RDA income tax withholdings remain in the general fund, which will lead to **an increase of \$2,824,632 in general fund revenue next year.**

We also believe it is time to look at the benefits of the Economic Impact Zone investment tax credits that were also created in conjunction with the base closures of Charleston and Myrtle Beach. These tax breaks for new investment have been on the books since the mid-1990's and still exist even though the lost jobs in this part of the state have been made up for. But even more surprising, the incentive package is available in 27 of the 46 counties of the state. Under the current scenario, a company in Richland County will receive a tax break for a capital investment while the same company in Greenville cannot. This type of incentive structure – applying to only half the state – does not make good business sense. Therefore, as this administration continues to strive for policies that will strengthen the economic playing field for the entire state, we recommend repealing the EIZ credit for any future investments and instead use these revenues in a more effective manner within the Department of Commerce. This recommendation will lead to **an increase of \$8.8 million in general fund revenue next year.**

During the late 1990's, the four largest cigarette manufacturers reached an agreement with 46 states to settle state suits to recover costs associated with treating smoking-related illnesses known as the Tobacco Master Settlement Agreement (MSA). South Carolina began securitizing its MSA payments in FY 2000-01. In the past five fiscal years, the tobacco settlement has produced almost \$350 million in revenue – primarily dedicated toward health care purposes. It is estimated that the tobacco settlement will generate **\$10 million in revenue** for FY 2007-08.

As mentioned, we are also proposing to increase the cigarette tax by 30 cents in an effort to provide additional tax relief to businesses and/or individuals across the state. It is estimated that raising the cigarette tax to 37 cents will generate **\$107 million in revenue** for FY 2007-08.

FY 2007-08 Executive Budget

REVENUES	FY 2007-08 BASE	FY 2007-08 EXECUTIVE BUDGET	\$ CHANGE
FY 2007-08 BEA Estimate		\$7,103,000,000	
Gross General Fund Revenue (11/10/06)			
Less: Tax Relief Trust Fund		(\$521,643,795)	
Plus: Tax Relief Trust Fund Carryforward		<u>\$13,797,464</u>	
Net General Fund Revenue Estimate	\$6,108,004,521	\$6,595,153,669	\$487,149,148
Revenue Adjustments			
– Use of BEA Certified Surplus Revenue (FY 2006-07)		\$306,929,588	
– Excess Agency Cash (State Ethics Commission)		\$250,000	
– Business License Tax – Reduction from decline in demand due to increase in Cigarette Tax		(\$2,182,000)	
– Taxes and Fees redirected from Economic Impact Zones		\$8,800,000	
– Taxes and Fees redirected from Redevelopment Authorities		\$2,824,632	
Revenue Increases		\$6,911,775,889	\$803,771,368
Less: Spending Limit Based on 5.503 percent with spending limitation exclusions:	\$6,108,004,521	\$6,506,699,775	\$398,695,254
▶ FY 2007-08 Capital Reserve Fund proceeds, \$111,821,213			
▶ FY 2007-08 Contingency Reserve Fund proceeds, \$171,541,103			
▶ FY 2007-08 Lottery appropriations, \$270,540,219			
▶ FY 2007-08 EIA appropriations, \$673,000,000			
▶ General Reserve Fund yearly funding requirements, \$19,048,978			
▶ Capital Reserve Fund yearly funding requirements, \$12,699,319			
▶ Local Government Fund, yearly funding requirements, \$30,823,468			
= Difference between revenue increases and spending limitation:			\$405,076,114
+ General Funds available from Medicaid shift to other funds generated by Cigarette tax increase of \$0.30:			<u>\$107,270,000</u>
Total in Excess of Spending Limit			\$512,346,114
<u>Uses of revenue in excess of spending limitation:</u>			
– Permanent Tax Refund:			(\$205,166,526)
– Elimination of Tuition Prepayment Unfunded Liability:			(\$41,338,714)
– Debt Repayment:			(\$21,175,000)
– <u>Establishment of OPEB Trust Fund:</u>			<u>(\$244,665,874)</u>
Total Uses of Excess of Spending Limit			(\$512,346,114)

FY 2007-08 Executive Budget

<u>Other Fund Revenue Transfers to OPEB Trust Fund:</u>	
State Health Plan – Excess IBNR Reserves:	(\$136,800,000)
Lapsed Unobligated Competitive Grants Revenue FY2006-07:	(\$34,355,384)
<u>Unemployment Compensation Fund:</u>	<u>(\$23,000,000)</u>
Total Other Fund Transfers to OPEB Trust Fund:	(\$194,155,384)
Total Amount Used To Establish OPEB Trust Fund:	(\$438,821,258)

Education Lottery Revenues

We believe it is important that we make every effort to run our lottery as efficient by as possible so maximum dollars can go to educate our children. This has never been more obvious as students are now competing at an international level as well. For this reason, we again propose to change the current retail commission of seven percent to a commission of six percent – which is in line with the national average. A lower commission will generate more lottery revenue to benefit our education system.

Overall lottery revenues continue to remain steady. In fact, last year’s lottery produced a surplus of over \$30 million. The BEA, however, believes the start-up of the North Carolina lottery this past year will have an impact on ticket sales in the future. To this end, the BEA estimated there would be no increase in lottery revenue from the prior year. Coupling this estimate with revenues generated from reducing retailer commissions, we have an estimated \$270,540,219 to appropriate in total lottery funds in FY 2007-08.

LOTTERY REVENUES	FY 2006-07	FY 2007-08
BEA Revenue Estimate	244,000,000	244,000,000
BEA Interest Estimate	4,300,000	3,500,000
Unclaimed Prizes	8,400,000	8,400,000
Prior Year Surplus	30,600,000	
Limit Retailer Commissions to 6% of Sales		8,405,841
Education Lottery Revenue	287,300,000	270,540,219

Run a Fiscally Disciplined Government

Run a Fiscally Disciplined Government

Of course, a good many proposals are made by people that have very excellent things that they would like to have the Government do, but they come from people that have no responsibility for providing ways and means by which their proposals can be carried out. I don't think in all my experience, which has been very large with people that come before me in and out of Government with proposals for spending money, I have ever had any proposal from anyone as to what could be done to save any money.

– Calvin Coolidge, 30th President of the United States

Nothing focuses the mind better than the constant sight of a competitor who wants to wipe you off the map.

– Wayne Calloway, Former President and CEO of the Pepsi Corporation

When we presented our executive budget for FY 2004-2005, South Carolina was mired in a \$750 million financial hole. This budget crisis was caused by the Legislature overspending in FY 2001-2004 (\$512 million), accounting errors in 1991, 1993 and 2001 (\$105 million) and by underfunding the State Health Plan (\$135 million). We worked with the General Assembly in restoring the last of the diverted and shortfall funds last year.

The above crisis led to questions about how we spend as a state and how we intend to address such challenges going forward. In June 2004, we signed into law the Fiscal Discipline Act which set us on a path to repay the unconstitutional deficit and the General Reserve Fund over a three-year period. The Act – a joint effort by the executive branch and the Legislature – required us to hold spending growth at three percent annually in an effort to restrain government spending and maintain our AAA Bond Rating.

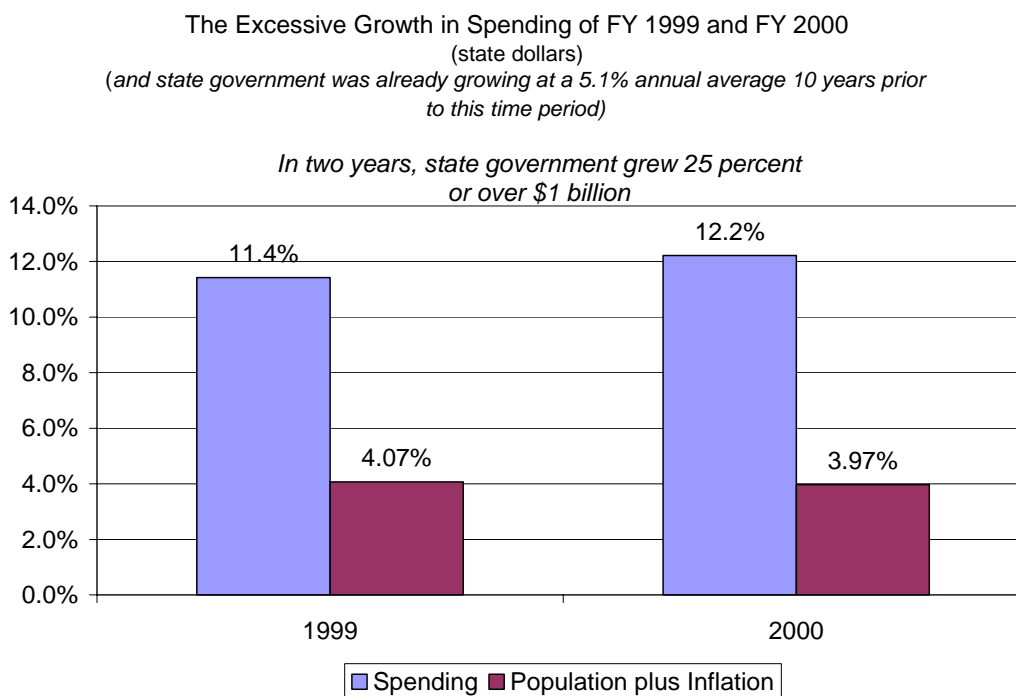
We believe that the reestablishment of the state's prestigious AAA rating will only occur through continued favorable economic conditions and with a fiscally disciplined government as prescribed by legislation such as the Fiscal Discipline Act. While this legislation was, unfortunately, short-lived, the essence of the Fiscal Discipline Act may be found within the FY 2007-08 Executive Budget's proposal for a government spending limit.

Fiscal Discipline Is a Must

This administration has long advocated that a fiscally responsible state should never operate with a deficit – which is why we felt so compelled to repay the remaining

depleted trust and reserve funds last year. We commend the General Assembly for making this a priority and fully replenishing this debt last year.

The fact remains, however, that more than \$1 billion in new revenue came into this state last year, and instead of taking a conservative approach, the majority of budget writers decided to spend the bulk of these dollars. Obviously, this type of revenue growth signifies a strong economy, but we believe when economic times are good, government must resist the temptation to spend greater sums of money on new programs that cannot be sustained when times are not so good. Last year the budget grew at over 12 percent – on top of a previous budget that had already grown over nine percent. Unfortunately, South Carolina has already been down this path of fiscal irresponsibility. In two short years (FY 1998-2000), state spending grew by 25 percent.



However, as revenues fell in subsequent years, this extra spending had to be curbed by a series of across-the-board, mid-year cuts totaling \$800 million and the use of trust and reserve funds. Across-the-board cuts hit effective programs the same as marginal ones, and using trust and reserve funds to compensate for agency reductions is akin to robbing Peter to pay Paul. Bottom line, an up-and-down business cycle is a constant in any market-based economy – including South Carolina.

We feel in order to maximize our competitive business environment we must stop South Carolina's out of line spending that has occurred during the past two years. When times of economic prosperity arrive, we ought to limit our spending and allow for a modest, constant, and sustainable rate of growth. Simply spending whatever comes into state coffers is unacceptable and is not fair for the taxpayer who ultimately pays for state government. In last year's budget, we laid out spending priorities in areas that we felt

would lead to a more fiscally sound state. Once again, we believe this is a necessity if we are to responsibly manage our fiscal affairs.

First, we propose again to limit increases in the annual budget to population plus inflation. We believe it is fundamentally wrong for government to grow faster than the incomes of South Carolinians and the rate at which people move into our state. Instead, we believe excess tax dollars are better invested in the hands of the private sector so our economy can continue to flourish. Excessive growth in the public arena will not allow this to happen – which is why it is so important to find some means to return revenue over the population plus inflation cap. The estimated revenue in the upcoming year has provided an excellent opportunity to do this. In fact, the estimated \$7.1 billion in the FY 2007-08 budget will allow us to fund government priorities while implementing a permanent reduction in business and/or individual income tax rates. We reduced the income tax rate paid by small businesses two years ago from seven percent to five percent, and when fully implemented, the reduction will annually return \$124 million to the small-business owners of this state. While this was a great step in the direction of tax relief, we continue to believe more needs to be done. Our proposal is two pronged. First, the BEA has estimated \$98 million in recurring dollars above the population plus inflation threshold. Returning \$98 million to South Carolina taxpayers represents only a small sliver of the more than \$800 million in new dollars projected to enter the state next year.

Second, we are proposing to increase the cigarette tax by 30 cents to offset an even further reduction in business and/or individual taxes. Coupling this proposal with the excess estimated recurring revenue for FY 2007-08 will provide over \$205 million in business and/or individual income tax relief.

Third, we believe the state should combat its unfunded liabilities. Just as we dedicated \$278 million to fully restoring money diverted from trust and reserve funds (\$173 million) and the aforementioned GAAP deficit (\$105 million) last year, this year we propose dedicating \$439 million to establishing a trust fund to combat the state's current retiree health insurance unfunded liability and to eliminate the \$41 million deficit associated with the Tuition Prepayment Program.

Fourth, we maintain a commitment to reducing our reliance on annualizations, and in this budget we propose the lowest level of annualizations spending (\$73 million) in over a decade.

Fifth, we propose taking funds from the FY 2006-07 projected surplus and using them to pay off some of the state's outstanding debts. In total, we propose \$21 million dollars to retire outstanding obligations.

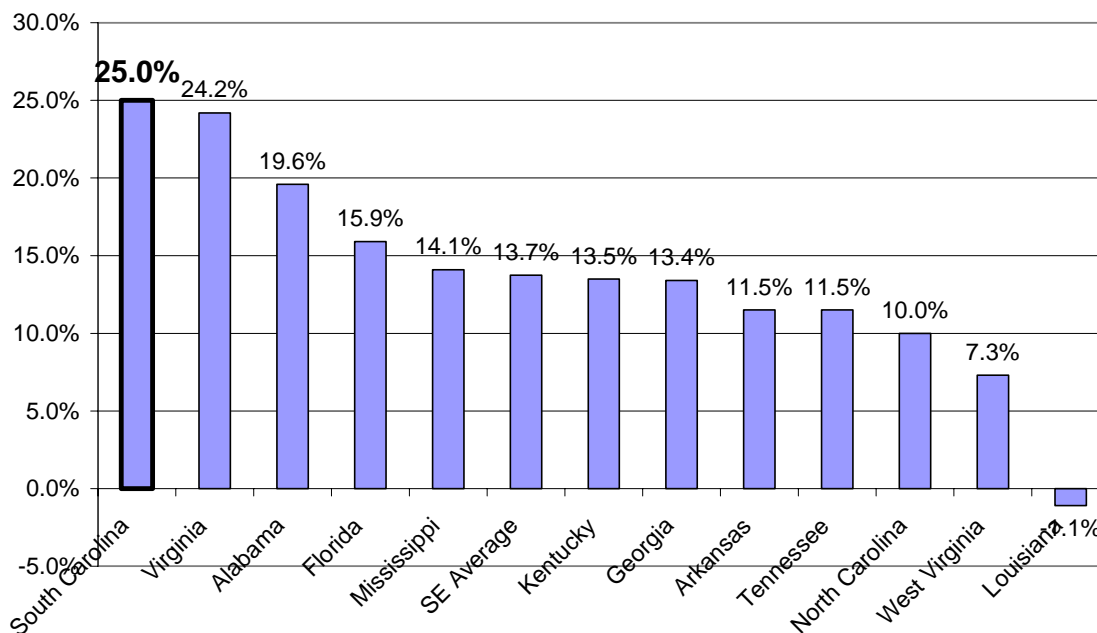
Finally, we will support legislation expanding the current Optional Retirement Program administered by the South Carolina Retirement System. We believe the plan should be the only state plan extended to new state employees. Within our last two executive budgets, we identified the immediate need to modify the state's defined-

benefit pension plans due to the fact that, from FY 1998-99 to FY 2005-06, the retirement system's debt increased from \$178 million to over \$9 billion, an increase of 4,952 percent. In FY 1998-99, it would have taken the state only two years to amortize that debt; today it will take us 30 years to pay off the debt. The constitutional limit is 30 years. This means the system is fiscally unsound. Our approach would allow new state employees greater control over their retirement account, so that they have the opportunity to earn larger investment returns from their accounts and at the same time reduce the amount taxpayers will have to spend for future retirement benefits.

The Taxpayer Empowerment Amendment

For the past two years, there has been a fundamental problem in the budget process: no accountability for the hard-earned tax dollars that South Carolinians send to Columbia. Instead, government has grown an average of double digits each year. According to the National Association of State Budget Officers, South Carolina spending has grown by 25 percent in just the past two years – ranking us fifth in the nation and first in the entire Southeast.

Southeastern General Fund Spending for the Past Two Years
(FY06 and FY07)



This sort of growth in government takes vital capital out of the private sector which in turn slows expansion of our economy. This administration believes giving taxpayers of this state tax relief helps improve economic soil conditions. That is why holding the line on spending is so important if we are to truly protect the financial security of the state. Controlled spending today will enhance our ability to grow the economy tomorrow.

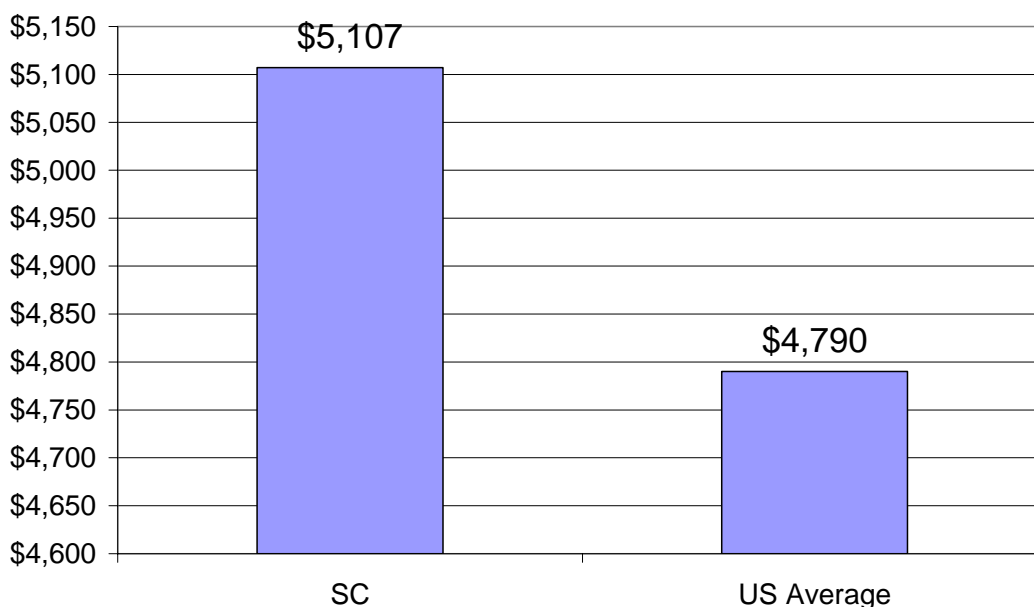
As mentioned, we are once again recommending state spending be limited to population plus inflation in this budget. We also believe if we are to protect the fiscal integrity of South Carolina in the long run, we must institute a lasting and meaningful way to hold budget writers accountable. That is why a population plus inflation spending limit is permanently needed – better known as the Taxpayer Empowerment Amendment.

Outspending our competition. Spending within the means of the state is at the core of the Taxpayer Empowerment Amendment. Last year this administration made it a priority to give back some tax dollars to South Carolinians when over \$1 billion new dollars streamed into Columbia. While there was some tax relief provided, we believed more could have been done.

The Appropriations Act last year contained over \$400 million more in spending than our executive budget, even though our budget addressed the state's core needs in education, health care and social services, economic development, public safety, and natural resources. In fact, while the budget increased spending \$177 per person in South Carolina, our neighboring state of Georgia only increased its spending by only \$109 per person.

Even at a national level, the same story is told. Currently, South Carolinians are paying more for government than our counterparts in other states. Across the nation, the average person can expect to see 13.9 percent of their paycheck being spent on state government. In South Carolina, however, 18.1 percent of the average person's income is being spent on state government. This is particularly troubling when South Carolinians only earn about 83 percent of the national average. In addition, growth in South Carolina's per capita spending has outpaced the national average. In fact, our state spends \$300 per person more than the average state.

Per Capita State Spending



We feel in order to maximize our competitive business environment we must reduce South Carolina's out of line spending on state government – especially as it compares to the national average.

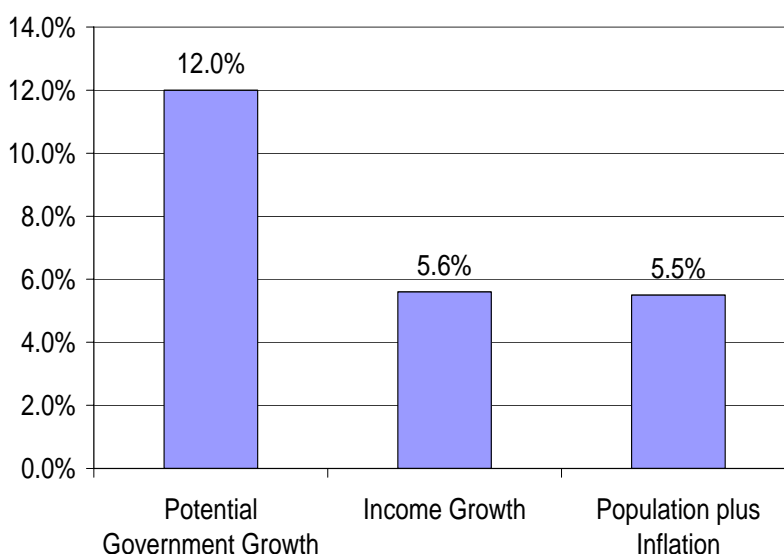
Limiting government growth. In last year's budget, excessive spending continued to be the theme. While the taxpayer's income only grew 5.9 percent and population plus inflation was at 4.8 percent during FY 2006-07, government still grew more than 12 percent. This administration is concerned that the General Assembly will again head down this path of fiscally irresponsibility.

If budget writers decide to grow government at a rate that is not sustainable in the long run and spend essentially all projected revenue coming into the state, government will again outpace the growth in paychecks across all of South Carolina. The amount of projected new revenue opens the door for government to grow a possible 12.0 percent – but this is at a time when paychecks are only increasing 5.6 percent and population plus inflation at 5.5 percent. We have consistently advocated for

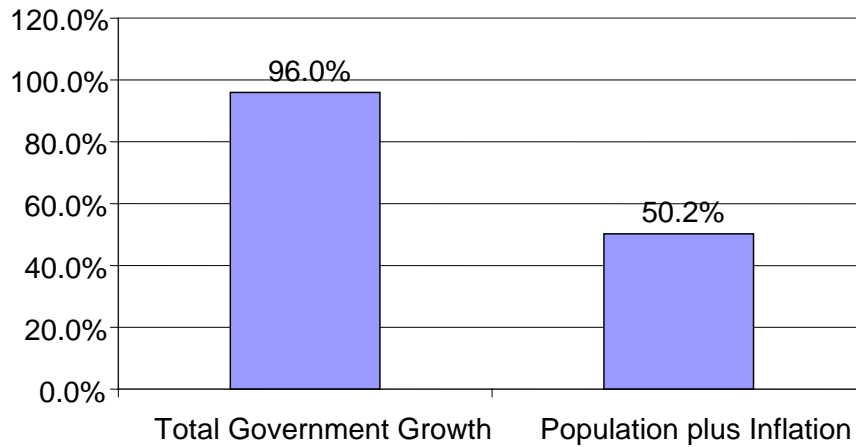
limiting the growth in state government to a rate that reasonably correlates with the people's ability to sustain it over time, and it will be unfair to ask the people of this state to grow government at a rate that is more than double the growth of their paychecks. A population plus inflation spending limit will help keep this from happening.

The effects of a spending cap. We are spending tax dollars at a rate that is much greater than the rate the economy is growing and much greater than the growth in population. This point has never been more evident when looking at government growth since the mid-1990's. Since FY 1994, total government has grown by \$10 billion or almost double the rate of population plus inflation – growing at 96 percent while the economy has only grown at 50.2 percent.

Government Growth if We Spend Everything in FY 07-08

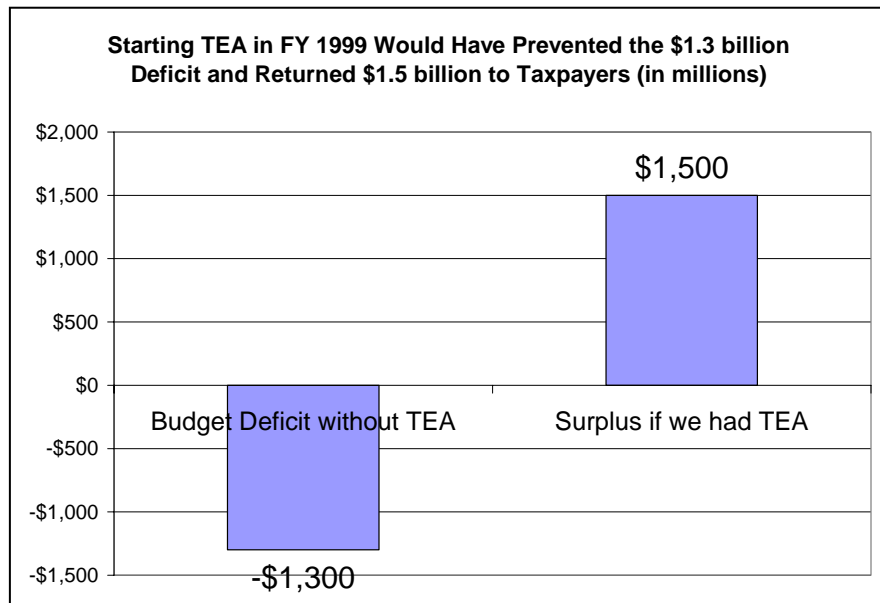


**Total S.C. Government Growth Almost Double
Population Plus Inflation – FY 1994 to FY 2007**



Past spending habits have unfortunately hindered the long-term fiscal security of the state. While times were good from a revenue perspective during the mid to late 1990's, dollars were appropriated to create new programs and grow existing ones. As the economy turned and revenues began to slow, budget writers found they were unable to fully fund these new and bigger government programs – creating large budget deficits.

If the taxpayers of the state had a spending limit during the late 1990's, the financial security of the state would have been in much better shape. In fact, trust and reserve funds would have remained untouched, and no mid-year cuts would have occurred. A Taxpayer Empowerment Amendment implemented in FY 1998-99 would have prevented a budget deficit of over \$1.3 billion – and instead would have returned over \$1.5 billion into the hands of the taxpayers.



Proposed FY 2007-08 Taxpayer Empowerment Amendment. Our proposal is simple: we must keep spending in line with population plus inflation. Specifically, the population plus inflation limit is to apply to all recurring and non-recurring appropriations during a fiscal year – excluding federal and other funds; EIA revenue; Education Lottery revenue; Capital Reserve Fund yearly funding requirements; General Reserve Fund yearly funding requirements; Local Government Fund yearly funding requirements; Capital Reserve Fund appropriations; Department of Transportation revenue; and, general fund revenue used for the tax relief trust fund, to replenish any trust or reserve accounts, or to prepay debt. Any excess revenue over the cap shall be deposited into a Taxpayer Relief Fund and held until the next fiscal year to be refunded to the taxpayer. Excess revenues sitting in the Taxpayer Relief Fund will be the first means used to fill any budget deficit and will not be refunded to the taxpayers.

A Tax Cut for Businesses and/or Individuals

Since our first executive budget, we have advocated restoring our fiscal house by eliminating the unconstitutional \$155 million deficit, restoring the borrowed funds from trust and reserve funds, and finally eliminating the GAAP deficit created by the General Assembly beginning in 1991. In last year's budget, we finished that nearly \$750 million goal, while funding our priorities at the same time. However, we believe that South Carolinians should share in good economic times, just as they have to pay through the bad economic times.

Recognizing the administration's long-standing position on the current tax rate for small business, the General Assembly rightfully sought to decrease the tax burden on small business during the 2005 legislative session. Effectively, we reduced the income tax rate paid by S-corporations, LLCs, and sole proprietors from seven percent to five percent over a four-year period. When fully implemented, this reduction will put nearly \$124 million each year back into the hands of small-business owners.

While this is a great step in the direction of tax relief, we continue to believe more needs to be done. In looking at South Carolina's tax code, we believe our relatively high income tax rate for individuals stymies economic growth. This belief was shared by our friends in the House of Representatives – who twice passed our proposal to decrease the state's uncompetitive income tax rate for all South Carolinians.

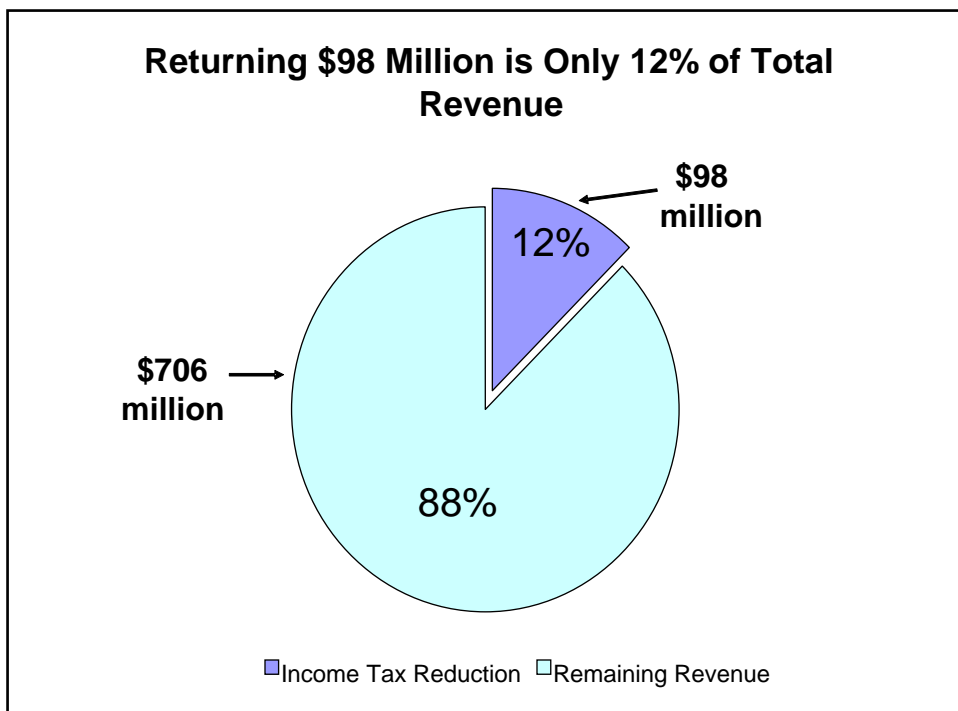
We effectively have the highest income tax rate in the Southeast when applying the rate to the 2005 state per capita income of \$28,212. Our past proposal gave South Carolina an ending top marginal rate of 4.75 percent. This rate would put us just above the current Southeastern average for income tax rates being paid on per capita income. From a competitive standpoint, we would prefer to fall below the Southeastern average, but, at the very least, it is imperative that we bring our rate down. Failure to do so will keep us at a competitive disadvantage.

We once again have an excellent opportunity to provide income tax relief for all South Carolinians. By holding spending increases to population plus inflation, our budget is

able to set aside \$98 million, which represents 12 percent of total revenue for FY 2007-08, to be returned to taxpayers on an annual basis.

Additionally, our budget proposes a cigarette tax increase of 30 cents per pack that would generate \$107 million yearly. We believe these dollars should be used to reduce the

income tax burden for our largest taxpaying population – all individuals across South Carolina who work and pay income taxes.



Proposed FY 2007-08 permanent tax reduction. Implementing a permanent income tax reduction is the most prudent way to ensure these dollars are invested back in the private sector. Naturally, there will be other times when the economy is booming and leads to an influx of surplus revenues. Coupling the above two proposals will provide over \$205 million in business and/or individual income tax relief.

With the excess revenue and cigarette tax proceeds, we could reduce taxes in a variety of ways: 1) indexation of brackets, 2) lowering of the top marginal rate from 7 to 6.5 percent, 3) lowering of small business and corporate tax rates in a number of ways, and 4) any combination of these. The overarching goal with any tax plan is to have the greatest positive effect on increasing investment and creating jobs throughout the state. Therefore, whether it is higher business licenses, fees or taxes, higher tuition costs, or increased energy costs resulting from expanded demand for oil, we are proposing to return \$205 million in excess tax revenue to ease the of burden taxpayers around the state.

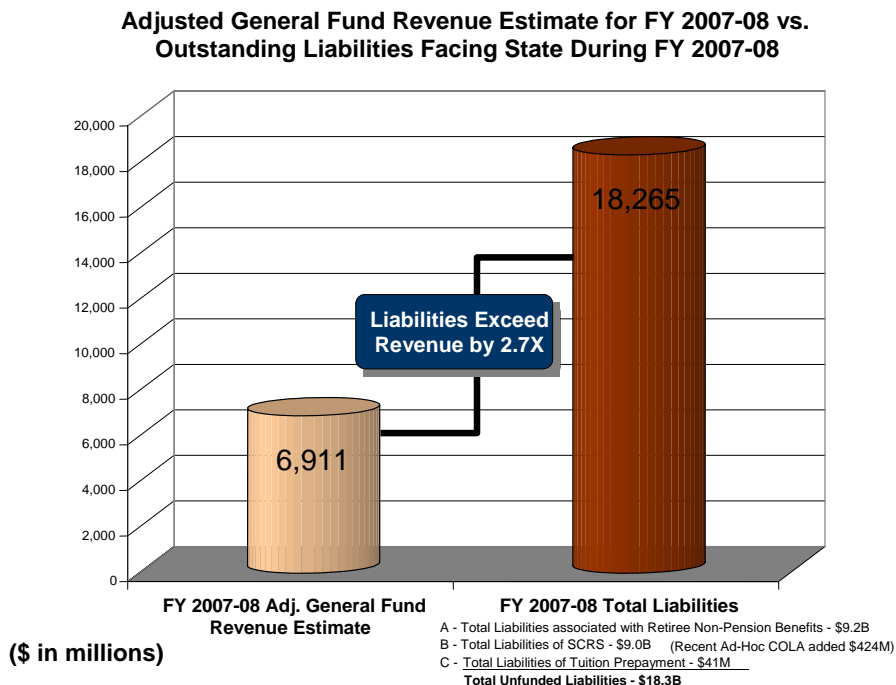
Unfunded Liabilities

Within our executive budget last year, we dedicated \$278 million to fully restoring money diverted from trust and reserve funds (\$173 million) and the aforementioned GAAP deficit (\$105 million). This amount represented 37 percent of the “new” funds

FY 2007-08 Executive Budget

available to us at the time of our executive budget. With work, we convinced the General Assembly to join us in restoring these diverted and shortfall funds.

Unfortunately, serious fiscal challenges remain. The state has a \$9.0 billion liability associated with its retirement system, a \$9.2 billion unfunded liability associated with health insurance coverage for retirees and \$41 million unfunded liability associated with the Tuition Prepayment Program. Together, these amounts far exceed the state's annual general fund collections.



Post Employment Benefits Other Than Pensions (OPEB) unfunded liability. States are wrestling with how to implement a recent ruling (#45) by the Governmental Accounting Standards Board that requires state and local governments to report and provide for the mechanism which will fully fund “Post Employment Benefits Other Than Pensions” (known as OPEB, i.e., largely State Retiree Health Benefits).

This issue is particularly concerning to “triple A” rated states because much like the GAAP deficit last year, this issue will be factored in by the bond rating agencies of Fitch, Moody’s, and S&P when assessing bond risk. Therefore, like the other “triple A” rated states, South Carolina must find a way to solve its other post-employment benefits shortfall created by this ruling.

Currently, the state provides funded health insurance for retirees who meet certain specified conditions. Generally, an employee who retires with 10 years’ service qualifies for retiree health insurance with the same employer contribution and same enrollee rates as active employees. Retirees are pooled with actives. At the same time, an employee who retires with five years’ service but less than 10 years qualifies for retiree health insurance but is obligated to pay both employer and enrollee shares of the premium. Unfortunately, this plan does not currently fund in the manner needed to sustain the program. In February 2006, an actuarial valuation was released which showed the State’s OPEB total liability at \$9.2 billion with annual needs of \$535 million to service the liability.

Recognizing the problem, the General Assembly, in its 2006 session, established a special study committee, pursuant to Proviso 63.41, to address the OPEB issue, with a mandate to report no later than January 15, 2007. To provide expertise and assistance, the committee hired an outside consultant, Gabriel Roeder Smith & Company, to outline strategies in which the state could deal with this fiscal crisis. The following are ideas put forth by the consultant that are being considered by the Study Committee:

1. Advance-funding in a Trust Fund

This recommendation lowers actual long term retiree health costs and liabilities by using investment returns to help pay for the benefits.

2. Adjust Eligibility Requirements

This recommendation raises the bar for eligibility.

3. Address Health Care Expense through Plan Design

This recommendation modifies the existing plan. Examples of design changes are: (a) time limits for benefits, (b) capping employer-provided benefits, and (c) tiered benefit levels (new vs. existing employees).

While it has been noted that we are implementing recommendation #1 by setting aside \$439 million to establish a retiree health insurance trust fund, we do not seek this fund to the exclusion of options #2 and #3. In fact, we remain open to discussing these options as well as many states around the country have done. In the states of Alabama, Utah and Ohio, benefits have recently been scaled back through increases in health care premiums while the length of time employees must work before becoming eligible for retiree health care has also increased.

Other states such as Alaska have recently adopted changes which require that new employees be enrolled in a defined contribution plan such as a health savings account. These accounts would allow employees to take them with them then they leave.

Tuition Prepayment Program unfunded liability. In addition to the state's "Post Employment Benefits Other Than Pensions" unfunded liability, the state's Tuition Prepayment Program has an unfunded liability of \$41 million. The program currently has \$112 million with 6,200 active accounts. If nothing is done, the program will run short of funds a decade from now. Knowing this, we are funding the elimination of this deficit within the FY 2007-08 Executive Budget. In conjunction with this action, we will seek either dramatic changes or the suspension of this program.

We understand that to change or potentially eliminate this program will not be a popular option for everyone. An April 30, 2006, editorial in *The Greenville News* suggested that the underlying problem is that state leaders have underfunded universities in the past several years and that has, in turn, forced college trustees to raise tuition at levels which jeopardize the program. While it is certainly true that colleges/universities have raised tuition, we believe this increase to be fueled not so

much by a shortfall in funding but by a lack of priority and efficient spending within the state's higher education sector.

Proposed FY 2007-08 unfunded liability coverage. In the FY 2007-08 Executive Budget, we propose dedicating \$439 million to establish a trust fund to combat the state's current OPEB unfunded liability. Further, we seek to cover the \$41 million deficit associated with the Tuition Prepayment Program. Therefore, in total we seek to set aside \$480 million (or 48 percent) of the \$998 million in "new" funds available to us at the time we prepare our executive budget to either cover or partially cover unfunded liabilities. This percentage of available funds – because of other fund revenue transfers into the OPEB trust fund – far exceeds the 37 percent of "new" funds we set aside last year to repay trust and reserve funds. When discounting the \$194 million impact of the other fund revenue transfers, revenue available for FY 2007-08 falls to \$804 million. Of this amount, we dedicate \$286 million (or 36 percent) to establishing the OPEB trust fund and eliminating the Tuition Prepayment Program deficit.

Annualizations (Non-Recurring Dollars)

Annualizations result from using one-time money to fund recurring needs. It is akin to making your mortgage payment based on a bonus you may not receive next year. It is important that we continue to address the problems associated with annualizations because these one-time funds may not be available in the next fiscal year for ongoing activities.

In many cases, these are important statewide core items. As an example, during FY 2004-05, \$90 million dollars in non-recurring revenues were appropriated to core functions within many agencies, including 20 percent for critical frontline services at the Department of Social Services.

Such practices highlight the poor fiscal management of the state as it is hard to imagine a commercial banker so misaligning the recurring revenue stream with recurring expenses when underwriting a loan for a business. Nevertheless, in the FY 2005-06 Appropriations Act, the General Assembly relied on \$128 million in annualizations to balance their budget as follows:

- \$3.1 million – Nonrecurring Part IA appropriations
- \$7.6 million – Employee Health Insurance
- \$62.6 million – Constitutional/Statutory
- \$55.0 million – Agency Items (e.g., \$8 million tobacco deallocation)

While much lower than prior years, yearly annualizations remain too high. As an example, annualizations from last year's executive budget were significantly lower at \$66 million.

Proposed FY 2007-08 annualizations. In the FY 2007-08 budget, we propose using approximately \$73 million in one-time revenue dedicated to the budget as follows:

- \$25.3 million – Employee Health Insurance
- \$15.7 million – Constitutional/Statutory
- \$10.0 million – Agency Items (\$10.0 million tobacco deallocation)
- \$22.0 million – School Bus Operational (Contingency Reserve Fund)

If adopted, annualizations will be at their lowest level in well over a decade.

Managing South Carolina's Statewide Debt

State tax-supported debt. From 1997 to 2005, South Carolina's *state* tax supported debt increased 142 percent, from \$1.16 billion to around \$2.81 billion, making South Carolina's debt expansion the 14th fastest growth rate in the nation. For the same time period, statewide tax supported debt per capita and tax supported debt as a percent of personal income, both of which measure taxpayer debt burden, increased 114 percent and 56 percent, respectively. At \$661, South Carolina's debt per capita ranked 31st in the nation, but grew at the 15th fastest rate among the 50 states. Likewise, at 2.5 percent, the state's debt to personal income ranked 26th in the nation, but grew at the 16th fastest rate among all states. This is in contrast to states such as Wyoming, Colorado, South Dakota, Nebraska and Arizona which carry no state debt whatsoever.

Local tax supported debt. From 1997 to 2005, South Carolina's *local* tax supported debt increased 121 percent, from \$2.4 billion to around \$5.2 billion. Local government borrowing includes obligations of counties, municipalities, special purpose districts, and public school systems. Statewide, local tax supported debt per capita increased 100 percent during the period, from \$625 to \$1,248. Local debt per capita exceeded \$1,000 in thirteen South Carolina counties, five of which have local debt per capita exceeding \$2,000 and one of which has local debt per capita exceeding \$3,000. Statewide, local debt as a percent of personal income increased 47 percent during the period from 3.1 to 4.6 percent. On a combined state and local basis, the average South Carolinian is responsible for about \$1,909 in debt.

South Carolina's tax supported debt per capita, excluding local debt, ranks 8th of the twelve states in the Southeast, but grew during the period at the 4th fastest rate – only North Carolina, Arkansas and West Virginia grew faster.

Proposed FY 2007-08 debt repayment. With all bonded indebtedness comes the cost of repayment. The bond costs may seem small, but they ultimately have a tremendous impact on the annual budget. According to the State Treasurer's Office, our annual obligation for debt service has increased from \$142 million in FY 1996-97 to an estimated \$232 million in the coming FY 2007-08, an increase of \$90 million. [In education terms, this \$90 million annual debt service increase equals roughly \$150 per pupil if added to the Base Student Cost.]

In this budget, we propose taking funds from the FY 2006-07 projected surplus using them to pay off some of those outstanding debts. In total, we propose \$21 million dollars to retire outstanding obligations. Although this spending represents a small

percentage of the overall debt burden held by the state, as cited above, it is a down payment on a policy we believe is critical to making us more competitive and easing the overall burden to South Carolina's taxpayers. If implemented, our proposal to better manage statewide debt will free up \$1.9 million in recurring monies for FY 2007-08.

We also seek the maintenance of the state's overall debt no more than the present four percent level in the coming years. The state Constitution sets a five percent cap on the annual debt service, but gives the General Assembly authority to lower it to four percent or to increase it to as much as seven percent. Over the past few years, the General Assembly has increased the debt service limit from five percent to six percent in two separate pieces of legislation.

As cited earlier, within our budget **this year we propose the elimination of \$21 million in outstanding debt from non-recurring revenue sources which exceed the aforementioned spending limit. While certainly a small amount when compared to the state's annual debt service of \$232 million, this prepayment adds \$1.9 million in recurring general funds for FY 2007-08.**

Retirement System Crisis

South Carolina's current retirement system crisis parallels the problems faced by other states as aging baby boomers in the nation's state government work force, prompt fears that payouts of defined-benefit pension plans – those plans with a guaranteed benefit – will break state budgets. Nationwide, states, counties and cities are facing shortfalls of nearly \$300 billion promised through their public employee retirement systems, making them time bombs for state and/or local budgets.

In the FY 2005-06 Executive Budget, we identified the immediate need to modify the state's defined-benefit pension plans due to the fact that from FY 1998-99 to FY 2005-06, the retirement system's debt increased from \$178 million to over \$9 billion, an increase of 4,952 percent. In FY 1998-99, it would have taken the state only two years to amortize that debt; today it will take us 30 years to pay off the debt. The constitutional limit is 30 years. This means the system is fiscally unsound.

This increase stems from the structural problems typical of defined-benefit plans when facing a large retiring population – the baby boomer population – as well as the benefit increases made by the Legislature in recent years. For example, since 1999, the state's retirement system has been strained by the addition of the Teacher and Employee Retention Incentive (TERI) program, the reduction of the years of service required to retire from 30 years to 28 years, and the continued payment of cost-of-living increases (COLAs). Another factor that has strained the state's retirement system is the reduced investment yield during FY 2000-01.

As an attempt to mitigate this, Senate Bill 618 (S.618) – a retirement reform bill – was passed by the General Assembly and signed into law by the governor on June 10, 2005. At the time of our signing, we wrote that S.618 provides the retirement system with

“temporary breathing room,” but that “it does not secure the long-term health of the system.”

In our FY 2005-06 Executive Budget, we wrote that the state had few options afforded to it under existing law for dealing with the enormous unfunded liability of the Retirement System. We noted that the state could increase employer and/or employee contributions to the system, reduce or eliminate benefits, or obtain increased investment returns on the current assets of the system. In essence, S.618 tweaked each of these items.

The changes associated with S.618 – while substantial – were essentially implemented to support the payment of COLAs for retirees and did little to reduce the unfunded actuarial liability impact. For instance, while the amortization period for the system’s unfunded liability moved from 27.9 years to 22.8 years with the implementation of S.618, with just a series of COLA payments, the retirement system would in effect be near its 30-year constitutional limit. Unfortunately, if history is any kind of guide, COLAs will continue to be paid for the foreseeable future. For, while a one percent COLA is provided for under S.618, the system has actually paid an average COLA over the past twenty years of 3.06 percent.

On May 16, 2006, the Budget and Control Board (Board) continued this trend by granting a 3.5 percent COLA for retirees that provided an instant \$424 million liability to the State Retirement System. This COLA will be paid for by tweaking employee and employer contribution rates – as spelled out within S.618. Such actions, which strain the budgets of agencies and partially offset the yearly pay increases of current employees, are in the end neither effective nor sustainable.

Therefore, much like our argument regarding the implementation of a population plus inflation spending limit, we see the solution to the state’s retirement crisis not in the continuation of a defined-benefit plan; rather, we see the solution in a defined-contribution plan.

The enormous costs of defined-benefit pension plans have resulted in many corporations abandoning them. Nationwide, only 17 percent of private sector workers are covered by a defined-benefit plan (versus a defined-contribution plan). Among South Carolina state employees, this figure is reversed as only 17 percent of those eligible employees for the defined-contribution plan participate in them.

It is our view that state employees should have more options and control over their retirement accounts. Nothing amplifies this as much as the legal battle fought this past year over the impact of S.618. In essence, this battle was between the funding of COLAs for the state’s retirees on the one hand, and the level of benefits received and contributions required of the state’s TERI employees on the other. While the TERI employees eventually won this lawsuit, the losers will ultimately be the taxpayers of South Carolina.

Proposed FY 2007-08 retirement system initiative. As a move toward greater control, we will support legislation expanding the current Optional Retirement Program administered by the SCRS. This program is a defined-contribution retirement plan for state, public school, and higher education employees. Under the Optional Retirement Program, the employee makes the investment decisions regarding his/her retirement account. The funds can be transferred to other eligible retirement plans if the employee leaves state service. We believe the plan should be the only state plan extended to new state employees. This would allow new state employees greater control over their retirement account, so that they have the opportunity to earn larger investment returns from their accounts and at the same time reduce the amount taxpayers will have to spend for future retirement benefits.

Several governors around the nation have recently proposed such private sector solutions to move their state employees from defined-pension plans – with a guaranteed payout – to a defined-contribution plan, such as the Optional Retirement Program, where the employer and/or employee contributes a set amount each month to an employee’s investment fund. When employees retire or leave the system, the money in the fund is theirs.

Last year the state of Alaska adopted a mandatory defined contribution plan for all state employees, beginning with those hired after July 1, 2006. This action was prompted by the nearly \$6 billion shortfall owed to Alaska’s public employees and teachers when they retire.

“Employers know up-front their costs, rather than having costs determined down the road....It adds certainty to the system.” says Becky Hultberg, then spokeswoman for the governor of Alaska.

As was discovered by the private sector years ago – and is now being discovered by the public sector in states such as Alaska – the long-term requirements of defined-benefit plans are so great as to jeopardize the financial integrity of a corporate or public retirement system. This is certainly the case in South Carolina where the ability to fund Consumer Price Indexed (CPI) cost-of-living increases for state retirees is now directly at odds with a financially sound retirement system.

Innovate Government

Innovate Government

It is dangerous to be right when the government is wrong.

- Voltaire, *Le Siècle de Louis XIV* (1752)

Innovation and government. This debate over the definition of “innovation” is not mere semantics. It reflects values—what citizens, managers and scholars think are important. After all, everyone likes innovation because it is the opposite of bureaucratization—because it is good.

- Saltshaker and Ben, *Innovation in American Government* (1997)

Why Innovate Government?

We began to understand very well that this government was antiquated in many areas and needed to be changed.

- Carroll Campbell

Innovation. It is a word that has far-reaching and meaningful implications. It is defined by *Webster* “as the introduction of something new, an improvement or advancement of a concept, thing, or action.” Today’s brave, new world is literally and figuratively defined by innovation, competition, and globalization. In effect, the world is in a rapid transformation of social and economic structures and processes, a dramatic transformation unseen since the industrial revolution more than a hundred and fifty years ago.

The socio-economic environment is propelled forward by new technology, new ideas, cost-savings measures, efficiencies, commercial and intellectual rivalry, and attention to ever-expanding human needs and desires. Governments, at all levels, are keen to stay abreast of these changes and adapt. They, through their political leadership, are working feverishly to innovate their governments – to keep pace with what many experts call the “emerging economy and its related ethos (way of life).”

To prepare for the challenges of tomorrow, our administration has been working diligently over the past three and half years to innovate and improve education, health care, social well-being, and economic opportunities.

Furthermore, we have been working determinedly on another important challenge, which is to innovate – to restructure – state government organizationally. In other words, to create an organization that is modern, adaptive to change, and responsive to the shifting demands and necessities of society and our citizenry.

After all, bottom line, government ultimately exists to serve and protect citizens. All three branches of government have their roles spelled out by the state Constitution. The Legislature makes laws and raises and spends revenues. The Judiciary provides for the adjudication and interpretation of the law.

The key role of the governor – as the chief executive of the state – is to carry out the administrative and executive functions of state government apparatus consisting of multiple agencies, departments, and other various divisions. But herein lies the difficulty. The problem is that the governor in South Carolina is not fully empowered to carry out this primary executive role due to many existing organizational arrangements within state government. Such arrangements are due to antiquated provisions found in the 1895 State Constitution. Others are due to a scattering of archaic state laws and regulations. The result is that the governor is hamstrung in many respects and cannot manage state government efficiently and effectively.

Why Restructure Now?

Families, businesses and nonprofits know what it means to do more with less. In the past decade, they have been forced to take a hard look at themselves, tighten their belts, set their priorities and change their ways. Now they are demanding that government do the same.

– *Making Government Make Sense*, February 1996

First, government is too big and costly. For every 10,000 South Carolinians, there are 234 state employees. That is 34 percent more than the U.S. average. Additionally, South Carolinians currently spend 130 percent the national average on the cost of government, due in large part to an inefficiently structured government.

Add to this the fact that in South Carolina more than 18 percent of our personal income goes to pay for government. The national average is less than 14 percent.

Consider this: average wages for state residents grew 3.8 percent last year, while state government grew 9.1 percent. That means for every new dollar earned by the average South Carolinian, government spent an additional \$2.39.

Second, respected and notable studies document the need to restructure government. All of these studies have found that government has too many agencies, which cause it to be cumbersome, unaccountable, and lacking coherence.

Third, government is duplicative and unaccountable. South Carolina's state government is a hodgepodge of some 50 independent agencies and departments. These bureaucracies provide hundreds of public programs or services, many of which are redundant.

For instance, with regard to the area of natural resources and the environment, the Department of Natural Resources, the Department of Health and Environmental Control's Division of Environmental Protection, and the Clemson Public Service Authority (PSA) all have water management programs. Bottom line: taxpayers are overcharged millions of dollars for this redundancy. With a total 27 board or commission members between the three organizations, the lack of accountability is self-evident.

Fourth, government's constitutional framework is outdated and chaotic. Multiple executive branch officers, as we have now, may appear to empower voters but this structure tends to erode real accountability. Parceling out executive branch power between the governor and eight other elected statewide constitutional officers often results in our government working at cross-purposes and producing inconsistent public policy. The governor, as the state's leader, must be able to administer the responsibilities of government efficiently and effectively.

Finally, modernization or restructuring of government is the cornerstone of recent innovation efforts among several states (according to the Council of State Governments 20 states in year 2003), including Illinois where administrative realignment alone saved more than \$529 million over the past two years.

Restructuring Revisited

For three years, I felt like Sisyphus. Right now, I like the down side of the hill.

– Gov. Carroll A. Campbell, June 1993

There was a very fortunate merging of interests here, and all of the parties... saw that government as it is currently structured was not workable.

– Rep. Jim Hodges, June 1993

Ronald Reagan's government reform initiatives, by most accounts, embodied his principal mission or priority. His "new federalism" was the hallmark of his presidency. Liberals, and even conservatives, may debate its consequences, but few question its aims to rein in a government that "over-spent, overestimated, and overregulated."

As last year, this administration remains committed to continuing the work of Governor Carroll Campbell by further innovating, restructuring, or re-engineering state government to increase accountability and reduce duplication and waste. We also recognize the efforts of many progressive and farsighted members of the General Assembly, who in 1993, worked hard likewise to modernize our state government. Without working diligently together, with goodwill and determination, the Restructuring Act of 1993 would have never been.

In 2007, however, more work remains to be done. Our state government in South Carolina remains still largely fragmented, chaotic and redundant, taking taxpayer's dollars and spending them on many programs and services of questionable value and priority to the citizenry of our state. Over the years, Governor Campbell and many leaders in the General Assembly commented, time and again, that the restructuring of 1993 was a first step.

During the past two years, and after considerable deliberation, legislation to modernize South Carolina's state government was before the General Assembly. Regrettably, it became bogged down in legislative protocol and politics and lost momentum despite our administration's best efforts to keep it a priority. This was a lost opportunity for "good government."

For example, during the 116th General Assembly, S. 80, a comprehensive restructuring bill sponsored by Senators McConnell, Moore and others, after much initial attention, fell into a state of neglect and simply languished for months. It would have consolidated a number of agencies and departments, refined the Budget and Control Board, and established an Office of Inspector General to eliminate fraud and waste.

This same is true for H. 3011, a joint resolution sponsored by Representatives Wilkins, Harrison and others. It would have allowed voters to decide in November 2006 whether to devolve the responsibilities of the Secretary of State and the State Superintendent of Education to the governor – reducing the long statewide ballot of nine to seven, lessening the ills of government largess, and diminishing the tendencies of a government to work at cross-purposes.

Within the boundaries of logic and commonsense, and given the will to overhaul an antiquated organizational framework, had S. 80 and H. 3011 passed the General Assembly last session, our state government would be on the highway – at last – to innovation. It would have additionally meant that the traditional reasons for restructuring would have resulted. These include increasing efficiency and effectiveness in management and service delivery, minimizing wasteful duplication of services, improving administrative coordination, shifting tax dollars from low- to high-priority

areas, improving productivity, streamlining work processes, improving communication, and funding government activities at a price the public is willing to pay.

What Must Be Done?

To succeed, our administration believes three important changes are necessary:

1. Shorten the statewide ballot.

Limits to executive power are inherent in a system of checks and balances. While they serve to prevent abuses in power, they also have the unintended consequence of thwarting our elected executives from implementing a coherent set of policies for the state in an efficient and business-like manner.

– Paul Mills, *Commentary*, 2002

Multiple executive branch officers, as we have now, may appear to empower voters, but this structure tends to erode real accountability.

Parceling out executive branch power between the governor and eight other elected statewide constitutional officers often results in our government working at cross-purposes and producing inconsistent public policy. The governor, as the state's leader, must be able to administer the responsibilities of government efficiently and effectively.

To meet the challenges of today and tomorrow, we propose that the following constitutional officers be made cabinet positions appointed by the governor with the advice and consent of the Senate: the Adjutant General, the Commissioner of Agriculture, the State Superintendent of Education, and the Secretary of State.

2. Streamline and consolidate agencies.

South Carolina's state government is a hodgepodge of some 50 independent agencies and departments. These provide hundreds of public programs or services, many which are redundant. This duplication makes our government expensive and inefficient.

Consider the area of health, human and rehabilitation services. We currently have five autonomous agencies or departments delivering similar services. Each provides drug treatment services (costing nearly \$41 million), which is wasteful; each has its own administrative arrangements (costing more than

\$15 million), which is duplicative and costly; and each has a separate governance board or commission (consisting of a total 35 persons), which results in a lack of accountability.

To streamline administration of health, human and rehabilitation services, we propose merging the majority of agencies and programs, with the exception of the Medicaid program, into two departments: a Department of Health Services and a Department of Rehabilitative Services.

By consolidating departments with similar missions, we can provide better service to clients and better value to taxpayers.

3. Make the central administrative functions of government accountable to the governor.

We must create a cabinet-level Department of Administration to provide better support services to state agencies. South Carolina is the only state in the country that empowers a quasi-legislative/executive board to oversee the state's administrative support functions.

Currently, the Budget and Control Board, consisting of more than 1,100 employees, provides nearly every state agency with a variety of services and support, ranging from procurement and mail delivery to human resources and building maintenance.

Accountability through a direct line of authority is an essential component for any leader, whether leading a well-run company or a well-run state, and our current system fails in this regard.

To improve accountability, we propose that two crucial Budget and Control Board-managed functions be placed under the direction of the governor: coordination of interagency activities and operations, and oversight of the state's personnel, fiscal and capital assets.

Thus, having said this, in order to achieve modernization – namely, innovation of state government – *our administration proposes three major changes, as last year's executive budget proposed, to create a centralized, accountable management structure:*

I. Modernize the Executive Branch's Organizational Structure

One of the weightiest objections to a plurality in the executive...is that it tends to conceal faults, and destroy responsibility.

– Alexander Hamilton, *The Federalist No. 70 (1788)*

As a result of this long ballot approach, the executive branch is fragmented structurally and uncoordinated operationally in its delivery of services, activities and programs, and is frequently unresponsive to citizens' needs, and on the whole, unaccountable to the governor.

– *Task Force report on Government Restructuring and Campaign Finance Reform, January 21, 2003*

It may appear that having numerous executive branch officers empowers the people; however, this structure really serves to erode any real accountability. Mainly, it disperses executive power among so many constitutional officers that the role of the chief executive of the state – the governor – is relegated to only a portion of executive authority and command.

This situation begs two critical questions: “Who is in charge?” and additionally, “Who should ultimately be responsible for the executive department's key constitutional functions?”

With the “long ballot,” responsibility and leadership are spread among eight other constitutional officers elected statewide. According to experts on the subject of restructuring in South Carolina, during the restructuring debates in 1993, some attention was directed to the possibility of appointing rather than electing the three constitutional officers whose responsibilities reside within focused policy areas (the Superintendent of Education, the Commissioner of Agriculture, and the Adjutant General). This idea was eventually abandoned for various practical and political reasons, mainly because *sine die* occurred before legislative action – in the form of separate joint resolutions – could be taken. Governor Campbell and legislative leaders put off restructuring efforts among constitutional officers recognizing this could be done in the future or in what has often been termed as the “next phase of reorganization.”

Having said this, we propose once more the reduction and restructuring of the state's constitutional officers as follows:

Place the Governor and Lieutenant Governor on the same ticket.

In the long-standing tradition of the federal executive branch, where the President and Vice President run on the same ballot, we propose having the Governor and Lieutenant Governor run together as a team (as they do in 24 other states).

Make the following cabinet positions appointed by the Governor, with advice and consent of the Senate:

1. **Adjutant General** – In an effort to depoliticize the military branch of state government and to provide a greater degree of accountability within the governor’s pre-established role as “commander-in-chief,” we propose having the Adjutant General appointed by the governor (as they do in 48 other states).
2. **Commissioner of Agriculture** – As with the Adjutant General, in an effort to streamline the executive branch and provide greater accountability, we propose having the Commissioner of Agriculture appointed by the governor (as they do in 30 other states).
3. **State Superintendent of Education** – As part of our plan to provide a centrally accountable management structure for the state’s public education system, we propose having the state Superintendent of Education appointed by the governor (as they do in 11 other states).
4. **Secretary of State** – In the tradition and rationale of the federal executive branch, where the Secretary of State is an integral part of the president’s cabinet, we propose having the Secretary of State appointed by the governor (as they do in seven other states).

In sum, a long ballot of constitutional or statutory executive officials detracts from public concentration and awareness of the governor as *chief* executive. Additionally, a long ballot diffuses executive powers from the governor, often creating power struggles, political or policy friction, and a lack of coordination.

As remarked in last year’s budget, the idea of inter-branch checks and balances requires three separate, but equal, branches of government; however, “intra-branch” checks and balances – among several elected statewide officers – can cripple the executive branch’s ability to perform its constitutional duties. The South Carolina Constitution, ratified in 1895 at a time when all women and most African Americans did not have the right to vote, established a very weak executive branch of government with the governor sharing the executive branch power with eight other elected statewide constitutional officers. Having such a large number of elected officials in the executive branch frequently results in our government working at cross-purposes and producing inconsistent and often conflicting public policy.

II. Simplify, Streamline and Create More Accountability in Government

There is no central point of accountability for the performance of these agencies. Because non-cabinet directors are not directly appointed or terminated by the Governor, the Governor is not directly responsible for the performance of these agencies...Governors in neighboring states have greater authority to appoint department heads than South Carolina's Governor.

– Legislative Audit Council Report, January 2003

In the past 86 years, South Carolina has conducted 18 major reorganization studies, all of which reached a similar conclusion – that state government in South Carolina has far too many government agencies, making it disjointed, unwieldy, and unaccountable.

The resulting overlap of functions and the duplication of efforts make our government both expensive and inefficient. Our agencies are aligned based upon antiquated funding streams rather than being citizen-centric and organized by the needs of clients. As stated earlier, *we need to consolidate departments with similar missions under the cabinet to provide better service to our clients and better value to the taxpayer.*

While a cabinet form of government was in some measure created in 1993, some 14 years ago, that consolidated 76 agencies into 13 cabinet-level offices, in 2007, more than 80 percent of state government still remains external to the management and oversight of the state's chief executive--the governor.

As premised in earlier reorganization studies, a framework for better state government is based on six principles:

1. Establish clear lines of authority, responsibility, and accountability;
2. Concentrate this authority and accountability at a single point, viz., the chief executive (governor).
3. Create a reasonable and manageable span of control.
4. Integrate governmental functions into a small number of departments.
5. Enhance state government's responsiveness to the needs of its citizenry.
6. Seek continuous improvement in the quality and effectiveness of state government through emphasis on customer service, strategic planning, and other quality management principles.

A recent example of the application of these principles is instructive.

In 2005, we proposed the merger of the Office of Indigent Defense and the Office of Appellate Defense. This merger was ultimately adopted by the General Assembly because it made sense. A united system with one oversight board provided more flexibility and eliminated competing budgetary interests. Most importantly, a merger of Appellate and Indigent Defense resulted in more streamlined and efficient delivery of services to indigent clients and ultimately benefits the judicial process.

Savings also resulted from this merger. As an example, we anticipate an annual administrative savings of \$190,210 at the newly created Office of Indigent Defense.

Like the merger of the Office of Indigent Defense and the Office of Appellate Defense two years ago, we propose that the following state agencies be consolidated, simplified, and made more accountable to South Carolinians – a task which becomes much more feasible if a strong cabinet form of government is brought to the executive branch. By restructuring, we anticipate savings in excess of \$19 million during FY 2007-08.

Restructure multiple educational entities of state government. Within our state education system, we have a State Board of Education that provides a duplicative level of administration above the statewide elected Superintendent of Education. We also have several special schools duplicating services or administrative structures and competing for scarce resources.

State Department of Education

1. Transfer the powers of the state Board of Education to the Superintendent of Education, who would be appointed by the governor subject to Senate confirmation.
2. Move ETV, the Wil Lou Gray Opportunity School, School for the Deaf and Blind, the John de la Howe School, the Governor's School for Science and Mathematics, and the Governor's School for the Arts and Humanities under the administrative direction of the State Department of Education.

The powers of the current Boards at ETV, Wil Lou Gray Opportunity School, School for the Deaf and Blind, the John de la Howe School, the Governor's School for Science and Mathematics, and the Governor's School for the Arts and Humanities would be given to the Superintendent of Education, and the members of the Boards would serve as an advisory board.

Create an efficient health and human service delivery system. As stated in last year's executive budget, the state health and human service delivery system is fragmented and disjointed with too many agencies providing redundant and costly services. As with the state's educational system, we propose that these state agencies be merged and established in a cabinet-level agency to improve accountability to the people of South Carolina. In accomplishing this task, we base our proposal on the findings and recommendations of the following Legislative Audit Council (LAC) reports.

In January 2003, as we discussed in last year's executive budget, the Legislative Audit Council LAC completed an in-depth study of the state's eight health and human service agencies. The report found that similar services are provided by multiple agencies, causing these agencies to spend extra resources on service coordination. The report noted that the overlap causes increased administrative costs in areas such as finance, personnel, and information technology.

The report also found that since most of the agencies were outside the cabinet, the result is "no central point of accountability for their performance." The report pointed out that "[a] cabinet system could increase accountability and responsiveness to client concerns by directly linking the performance of agencies with a single statewide elected official who is authorized to implement changes." The report concluded, "If programs with similar services were consolidated into fewer agencies, under the authority of a single cabinet secretary, obtaining help from state government could be made less complex. The need for different agencies to make referrals to each other could be reduced while planning and budgeting could be done more comprehensively. In most cases, administrative costs could be lower."

In October 2004, the LAC produced a follow-up to the January 2003 report. While the agencies have implemented some of the LAC recommendations, none of the 2003 recommended changes to state law were enacted. The LAC's recommendations to restructure the health and human services agencies have not been implemented. The LAC found that similar services are often provided by multiple agencies. It was further found that five of the eight agencies are not in the governor's cabinet, and there is no single point of accountability for their performance.

We largely agree with the LAC reports and have based much of our proposed structure around their findings. Our main concern is the need for services to efficiently and effectively meet the needs and choices of consumers. Our current system clearly does not. The following proposed system will be a health and human service delivery system that will be more accountable, more affordable, and most importantly, will provide for improved care for our citizens.

Department of Health Oversight and Finance

1. Rename the Department of Health and Human Services the Department of Health Oversight and Finance.
2. This agency will continue to be the lead agency for Medicaid oversight and finance of Medicaid expenditures.

Department of Health Services (Health Services)

1. Division of Public Health (currently the health programs at the Department of Health and Environmental Control). **{Proposed Restructuring Savings: \$5,839,407}**
2. Division of Mental Health (currently Department of Mental Health). **{Proposed Restructuring Savings: \$6,360,367}**
 - The powers of the current Mental Health Commission would be given to the director of Health Services and the members of the commission would serve as an advisory board.
 - Continuum of Care for Emotionally Disturbed Children would be moved from the Governor's Office to the new Division of Mental Health. **{Proposed Restructuring Savings: \$140,269}**
3. Division of Disabilities and Special Needs (currently Department of Disabilities and Special Needs) **{Proposed Restructuring Savings: \$2,171,659}**
 - The powers of the current Disabilities and Special Needs Commission would be given to the director of Health Services and the commission would serve as an advisory board.
4. Division of Addiction Services (currently Department of Alcohol and Other Drug Abuse Services). **{Proposed Restructuring Savings: \$456,233}**

Department of Rehabilitative Services

1. Merge the Vocational Rehabilitation Department and the Commission for the Blind. **{Proposed Restructuring Savings: \$467,424}**
2. The administrative responsibilities of the Vocational Rehabilitation Department and the Commission for the Blind would be given to one director appointed by the governor with advice and consent of the Senate.
3. The board members of the Vocational Rehabilitation Department and the Commission for the Blind would serve on advisory boards.

Create an accountable state transportation system. The South Carolina Department of Transportation lacks the level of accountability found in other states. As a result, citizens too often see low priority projects such as four lane highways to nowhere funded at the expense of crumbling secondary roads to and from elementary schools, hospitals and businesses.

Additionally, financial management continues to be an area of concern for the agency. Recently, a Legislative Audit Council report was issued concerning the financial actions of the South Carolina Department of Transportation. The following are highlights from this audit:

- **Federal Billings Delayed** – Evidence was found that DOT lowered their cash balances by delaying billings for reimbursements from the Federal Highway Administration – losing interest income. It is said that DOT did this to make it appear as though funding is lower than it really is. LAC estimated this **cost taxpayers \$1.5 million for just FY 2003-04 and FY 2004-05;**
- **No safeguards to ensure projects are cost-effective** – For some unknown reason, DOT paid some contractors with fixed payments – which is the normal practice to pay for work that has been completed. Because of this, DOT paid for work that was never done. LAC estimated this **cost taxpayers \$8.7 million;**
- **Program and Financial Management Fees** – Several contractors, prior to acceptance of DOT contracts, suggested program and management fees be no more than two percent of the total budget. However, of the fixed payments, \$62 million was for overall program and financial management – representing 4.5 percent of the budget. LAC estimated this **cost taxpayers \$32 million;**
- **Temporary Hires of Former Employees** – The agency hired two former DOT employees at \$120.07 per hour (over \$200,000 per year) to work in the department they left. Both employees had just retired from the department earning only \$55 per hour (including fringe benefits); and
- **Accepting Donations from Contractors** – DOT has accepted \$22,000 in sponsorship donations from contractors for conferences DOT has hosted. This is a clear conflict of interest.

We are concerned with the above LAC findings and believe that restructuring is needed to improve accountability at the agency. Our current system is clearly not in line with the structure adopted in other states. For instance, forty-seven governors appoint the director of the Department of Transportation or appoint all Highway Commission members (South Carolina, Georgia, and Mississippi are the only states that do not). In South Carolina, the governor can only appoint the chairman of the Commission, who can only vote in the case of a tie. The other commissioners (whose appointments are not subject to a full Senate vote) choose the director of the agency. Of the forty-seven states that do it differently than we do, the breakout is:

- 41 states have a governor who appoints the Director of the Department of Transportation (i.e., cabinet agency)
- the remaining six states appoint the entire commission

The following proposed system will be a state Department of Transportation that will be more accountable, more cost effective, and most importantly, will provide for improved transportation services for our citizens.

State Department of Transportation

1. Transfer the powers of the Commissioners of the state Department of Transportation to the Director of the State Department of Transportation, who would be appointed by the governor subject to Senate confirmation and serve in the governor’s cabinet.

Establish a Department of Environment and Natural Resources (DENR). Currently, the state’s environmental and natural resource programs are distributed among several state agencies. In managing these important resources, there should be, in our view, a closer connection between the agency that manages our natural resources and the agency that provides environmental regulation.

In order to reduce duplication, we have proposed – as we did last year – consolidating these agencies into a single agency accountable to the governor. By doing this, we will be more in line with our neighboring states. For instance, North Carolina’s Department of Environment and Natural Resources and Georgia’s Department of Natural Resources provide both regulation and enforcement of environmental and wildlife laws.

The inefficiencies of our current system are exhibited by the bifurcated approach to water quality, as DNR and DHEC are both actively involved in watershed management. Pooling the conservation activities from DNR with the regulatory activities from DHEC, as well as both agencies’ enforcement functions will provide for a more cost-effective and comprehensive management approach to this crucial state function.

We propose the creation of a Department of Environment and Natural Resources with a cabinet-level director, appointed by the governor with the advice and consent of the Senate. DENR would be structured as follows:

Department of Environment and Natural Resources (DENR)

1. Division of Environmental Protection (currently the Environmental Quality Control Division and the Ocean and Coastal Resource Management Division of the Department of Health and Environmental Control).
 - Maintain an environmental regulatory board.
2. Division of Natural Resources (currently the Department of Natural Resources). **{Proposed Restructuring Savings: \$932,077}**
 - The powers of the current Department of Natural Resources Board would be given to the DENR director, and the members of the Board would serve as an advisory board.

3. Division of Forestry (currently the South Carolina Forestry Commission).
{Proposed Restructuring Savings: \$513,588}
- The powers of the current Forestry Commission would be given to the DENR director, and the members of the Commission would serve as an advisory board.

Merge Departments of Corrections and Probation, Parole and Pardon Services.

The consolidation of the Department of Corrections and the Department of Probation, Parole and Pardon Services would establish a unified, coordinated system of correctional agencies and would substantially reduce administrative costs.

- ***Governor's Commission on Management, Accountability and Performance, September 30, 2003***

South Carolina is one of only ten states in which the functions of the Department of Corrections are separate from the responsibilities of the Department of Probation, Parole and Pardon Services. Indeed, more than half of all states house all of their probation, parole, and pardon functions within a unified corrections department.

We believe a unified Department of Corrections and Probation will ensure that offenders are managed and measured by one agency from admission to final release, whether that release is directly from prison or from a lesser level of state supervision. A unified corrections system will ensure that decisions about behavior and risk assessment are made consistently. The agency would be run by a cabinet-level appointment of the governor with advice and consent of the Senate.

We believe a unified system will have several benefits:

1. A unified system would immediately allow better coordination and the exchange of information, resources, and personnel.
2. Savings in eliminating administrative duplication would immediately allow for better use of our scarce programming resources in areas such as drug and alcohol treatment and re-entry programs.
3. Victims of crime would have a single point of contact to learn about the status of their offender from entry to completion of sentence.

This administration will be working with the leadership of the General Assembly to develop a new alternative sentencing option for non-violent offenders. Options such as restitution centers and electronic monitoring fall squarely between the missions of the two agencies charged with the oversight of criminals. By joining these related functions

into a single entity, as most other states have done, we will be able to improve coordination, better manage limited resources, realize significant financial savings, and improve protection for our law-abiding citizens.

In addition to combining the Department of Corrections and the Department of Probation, Parole and Pardon Services (PPP), we propose combining the state's two parole boards. Currently, the state has separate boards at PPP and the Department of Juvenile Justice. The parole board at PPP has seven members and a budget of \$753,347 while the DJJ board has a budget of \$721,561 with ten members. Regardless of similar-sized budgets, the DJJ board hears far fewer cases per year. Because these two parole boards have very similar missions, we feel this presents an opportunity to gain efficiencies and savings by merging them.

Department of Corrections and Probation

1. Division of Corrections.
2. Division of Probation, Parole and Pardon Services. **{Proposed Restructuring Savings: \$552,935}**
 - The PPP Parole Board would be combined with the DJJ Parole Board to perform probation, parole, and pardon functions. **{Proposed Restructuring Savings: \$425,000}**

Consolidate Job creation and economic development programs. South Carolina's business and political leadership recognizes an unprecedented rapid transformation of the national and international economies. In recent publications, this transformation was and is today frequently termed "the emerging new economy," and is defined by globalization with an ever-increasing reliance on knowledge-based technologies and highlighted by intense competition, creativity and inventiveness.

Our administration clearly acknowledges this economic phenomenon, and through cooperation and mutual interest, reflection, study and planning, we believe firmly that the traditional approaches to economic development are out of synch, to some extent, with the new economy and that a new modern and comprehensive strategy is called for to stabilize and energize South Carolina's economic "engine." As such, we accept the four key objectives set out by a coalition of private business-oriented organizations, PRT, and the Department of Commerce:

1. Bring together the relevant stakeholders – industry, academia, and government – to collaborate in developing a shared economic strategy for South Carolina.
2. Assess the competitive position of South Carolina and of the selected industry clusters in the state.
3. Identify key challenges, opportunities, and new strategic directions for South Carolina overall.

4. Promote consensus on an economic strategy and action agenda for South Carolina.

Our administration's primary goal is job creation and economic development. Federal, state, and local resources that help create jobs and promote economic development are poured into programs that promote that goal, but we fall far short of getting the most out of those dollars because the programs are inefficiently scattered among various state agencies. To maximize the effect of these dollars and to ensure that the mission focus is consistent, cohesive, and strong, we propose that the economic development programs, and in many instances the agencies that currently administer them, be housed in a single agency. In addition, the savings in administrative dollars would allow more funds to be dedicated to the core mission of job creation and economic development. This proposed consolidation, outlined below, offers us a great tool in strengthening the "laser-beam focus on economic development."

Department of Commerce

1. Retain the current functions of the Department of Commerce.
2. Office of Local Government (currently at the Budget and Control Board).

Two years ago, we were successful at moving Workforce Investment Act (WIA) funding to the Department of Commerce. WIA is a federal initiative that was created in 1998 to fund job training and employment programs. Moving WIA to Commerce – from the Employment Security Commission – will ensure that over \$60 million in WIA funds will be used to help build the high-skilled work force needed to attract new industry to South Carolina. The move will also result in better coordination of the spending of WIA funds within the overall framework of the economic development goals and strategies at the Department of Commerce.

Create a Department of Literary and Cultural Resources (DLCR). In 1991, the Commission on Government Restructuring recommended putting all four of our cultural and literary agencies together under the administration of one agency. However, no such change was made as a part of the Restructuring Act of 1993. As we have proposed consistently, we believe that merging all of these agencies together will streamline management and reduce administrative costs.

While we strive to eliminate administrative duplication in our arts and cultural agencies, our neighboring state of North Carolina has had a consolidated arts and cultural agency in place since 1971. The North Carolina Department of Cultural Resources was formed to provide cultural, artistic, and historic resources to the citizens of North Carolina in a unified manner. The department was formed by combining the Office of Archives and History with the then newly created Office of Arts and Libraries, which provides arts, literary, and cultural experiences to citizens throughout the state. Just as North

Carolina has eliminated administrative duplication in its arts and cultural agencies, we would propose to do the same in the following manner:

Department of Literary and Cultural Resources

1. Create a Department of Literary and Cultural Resources and DLCR Board.
 - The DLCR Board would be responsible for appointing the director of the agency.
 - The DLCR Board should have equal representation from each of the four areas to ensure fair and balanced weight.
2. Division of Archives and History (currently the Department of Archives and History). **{Proposed Restructuring Savings: \$172,418}** We also propose moving the Institute for Archeology and Anthropology from USC to this division. **{Proposed Restructuring Savings: \$496,812}**
3. Division of Arts (currently the Arts Commission). **{Proposed Restructuring Savings: \$179,384}**
4. State Library. **{Proposed Restructuring Savings: \$85,230}**
5. State Museum. **{Proposed Restructuring Savings: \$76,634}**

Create a State Trust Fund Authority. Currently, the state maintains various internal service funds that manage a variety of risks related to public buildings, torts, medical malpractice, and automobile use by public employees, health and disability, and workers' compensation. These funds include the Insurance Reserve Fund, Employee Insurance Programs Fund, State Accident Fund, Patients' Compensation Fund, Medical Malpractice Liability Insurance Joint Underwriting Association, and Second Injury Fund. These funds are currently operated independently of each other. As a move toward merging these various funds, we propose unifying the Insurance Reserve Fund, which manages the state's property and tort liability risks, and the State Accident Fund, which manages the state's workers' compensation risks. The risks managed by these funds are sufficiently related that they should be administered under the authority of one agency with one administrator. The creation of a trust fund authority will eliminate duplicative overhead costs and will allow the coordinated management of these funds. This approach would make it more likely that the funds would only be used for their prescribed uses. We believe other funds could be added over time. The administrator would be appointed by the governor for a six-year term, with the advice and consent of the Senate.

State Trust Fund Authority

1. State Accident Fund.
2. Insurance Reserve Fund.

III. Create Executive Accountability of Central Administrative Functions

One of the principal objections inculcated by the more respectable adversaries to the Constitution is its supposed violation of the political maxim, that the Legislative, Executive, and judiciary departments ought to be separate and distinct. In the structure of the federal government, no regard, it is said, seems to have been paid to this essential precaution in favor of liberty. The several departments of power are distributed and blended in such a manner as at once to destroy all symmetry and beauty of form, and to expose some of the essential parts of the edifice to the danger of being crushed by the disproportionate weight of other parts.

— James Madison, *The Federalist No. 47 (1788)*

We believe that we must create a cabinet-level Department of Administration to provide better support services to state agencies. We are the *only* state in the country that empowers a quasi-legislative/executive board to oversee the administrative support functions of our state.

The 1,100 plus employee Budget and Control Board provides to nearly every state agency a variety of services and support, ranging from procurement, mail delivery, human resources, real estate, data and telecommunications, retirement, construction, and building maintenance. The five-headed structure of the Board results in a lack of accountability and contributes to some services of the Board costing too much. While they may be named different things, it is important to note that *all* of the other 49 states have their administrative support agency under the sole authority of the governor. A Chief Executive of any well-run company or well-run state must have that direct line of authority in order to have the accountability needed to be successful. Therefore, we once again urge the General Assembly to create a Department of Administration.

As the state's chief executive officer, the governor should be responsible for the central administration of Executive Branch functions of state government. However, currently the Budget and Control Board assumes several functions that we have proposed putting into a single, cabinet-level agency to manage daily operations of state government. For instance, two of the Budget and Control Board's stated policy objectives, which we believe fall under the executive branch under the direction of the governor, are:

1. Provide a structure for coordinating inter-agency activities and operations.
2. Bring about the efficient and effective use of the state's personnel, fiscal, and capital assets.

The Department of Administration would be in the governor's cabinet to ensure accountability of support services and hiring policies in state government. We propose that the director of the Department of Administration be appointed by the governor with advice and consent of the Senate.

Department of Administration

From the Budget and Control Board and the Governor's Office:

1. Office of General Services – Our state owns over 8,000 buildings comprising 60 million square feet of space with no central authority to make management decisions. Tens or even hundreds of thousands of square feet of state-owned office space sits vacant, yet the state leases hundreds of thousands more square feet of office space from the private sector.
2. Office of Human Resources – Not having any one person in charge or responsible can allow for the perpetuation of programs that need fixing or ending. The Teacher and Employee Retention Incentive Program was created to retain our best teachers, but instead has resulted in the possibility of double or even triple leave payouts and has increased the unfunded liability of our state retirement system by over \$100 million. Our state has a generous retirement system that has run up \$4.2 billion in unfunded debt that is growing and must be addressed.
3. Employee Insurance Program.
4. Energy Office.
5. Division of Procurement Services – Our state's antiquated procurement system, currently overseen by the Budget and Control Board, sometimes serves as a roadblock that unnecessarily slows down time-sensitive projects. For instance, the Department of Parks, Recreation and Tourism recently engaged the procurement system to assist them in outsourcing the state's bait and tackle shops. What should have been a simple procurement matter was delayed, thereby preventing PRT from outsourcing these shops within a reasonable timeframe.
6. Division of Internal Audit and Performance Review.
7. Research and Statistics (excluding Digital Cartography and Precinct Demographics) – Digital Cartography and Precinct Demographics are related to redistricting after the Decennial Census, which is largely a legislative branch function.
8. One-half of the Executive Director's office.
9. One-half of the Internal Operations office.
10. Governor's Office of Executive Policy and Programs (excluding Guardian ad Litem Office, Continuum of Care, and the state Ombudsman).

By moving the above-listed central administrative functions to the governor's cabinet, the Budget and Control Board could then focus on key areas of state fiscal policy, specifically by:

1. Approving state revenue and expenditure projections.
2. Authorizing the issuance of bonds.
3. Addressing budgetary shortfalls.
4. Administering the State Retirement System.
5. Exercising such other specific fiscal responsibilities as may be enumerated by law.

In addition to those activities being moved from the Budget and Control Board to the governor's cabinet, we also propose that the Department of Administration provide administrative support for a Chief Information Officer (CIO) and a State Inspector General (IG).

Department of Administration – CIO and IG

1. Chief Information Officer – The CIO's Office would be responsible for establishing information technology standards and strategic plans across state government. Currently, there is a division of the State Chief Information Officer within the Budget and Control Board. This division would be transferred to the Department of Administration and the CIO would be appointed by the director of the Department of Administration.
2. State Inspector General – We propose creating a central office responsible for identifying waste, fraud, and abuse within the executive branch. The Inspector General's Office would be established and appointed for a six-year term in the same manner as the Chief of the State Law Enforcement Division. The Inspector General would be nominated by the governor and confirmed by the Senate, serving a six-year term.

Create a Sunset Commission. Ronald Reagan once said that “nothing lasts longer than a temporary government program.” We have found this to be the case in South Carolina – even if the activity is something that the public no longer needs.

According to the National Council of State Legislatures, “the sunset process was one of the first government accountability tools, dating back to the mid-1970's. Although individual sunset processes differ from state to state, a key feature of most processes is the inclusion of an automatic termination clause in the authorizing legislation for a particular state agency or program. Colorado was the first state to implement a sunset review process (1976) and within five years, more than two-thirds of the states followed suit.”

Generally, a sunset law is a law that automatically terminates a state regulatory agency, board, or function of government on a certain date. A state Legislature must act to

continue the entity or function by passing a bill. Sunset laws cause Legislatures to review periodically the need for state regulation or for advisory committees and to update the law creating the entity or function. These reviews seek to balance the need for regulation to protect the public interest with the need to ensure that state agencies, industry and the professions, and functions of government are not overregulated.

One of our country's most progressive sunset programs was enacted by Texas in 1982. As part of the creation of their Sunset Commission, the charter of nearly every agency in the state expires every 12 years unless it is renewed by the state Legislature. This expiration date, which actually includes a 13th year grace period, forces a legislative commission to review 1 out of 12 of their agency's charters every year and make suggestions as to whether or not the agency should continue as is, should continue with different functions, should merge with a similar agency, or should continue to exist at all. The Texas Sunset Commission has saved taxpayers over \$720 million since its inception, generating a return of \$42 for every \$1 invested in the agency.

In the 2000-01 bi-annual budget years, an impressive 207 of the 230 recommendations made by the Texas Sunset Commission were accepted by the state Legislature, which resulted in \$17 million in savings. The recommendations ranged from major changes such as restructuring the Texas Department of Economic Development for \$3 million in savings to smaller ideas such as a \$168,000 adjustment to the Texas State Board of Plumbing Examiners' budget. Florida uses a similar process under their Office of Program Policy Analysis and Government Accountability. This agency proposes an annual business plan to the Florida Legislature based upon agencies' performance and outcome measures. A total of \$443 million in recommended savings has been adopted by the Florida Legislature since 1994.

The results in both Florida and Texas have yielded benefits to the taxpayers in lower costs of government. In fact, both states have no income tax and operate with low state revenues of approximately \$2,800 per person. This number compares very well with the United States average of \$3,810 for states and especially when contrasted with South Carolina's revenue of \$4,140 per person. *Governing* magazine's 2005 *Fact Book* reveals that South Carolina state government operates with a ratio of 251 state employees per 10,000 residents, which is 43 percent higher than the United States average of 176 state employees per 10,000 in population. South Carolina's ratio is 64 percent higher than Texas at 153, and more than double Florida's number of 123 state employees per 10,000 residents.

Texas and Florida can offer some lessons for officials in South Carolina interested in running our government more efficiently and effectively. Two years ago, the South Carolina House passed a measure which would have created a Sunset Commission as a division of the Legislative Audit Council, but the bill stalled in the Senate. Because we strongly believe that a regular review of existing laws will provide substantial benefits to the taxpayers of South Carolina, our budget recommends \$585,000 to fund a Sunset Commission under the LAC.

Innovate Education

Innovate Education

Good is the enemy of great. And that is one of the key reasons why we have so little that becomes great. We don't have great schools, principally because we have good schools. We don't have great government, principally because we have good government. Few people attain great lives, in large part because it is just so easy to settle for a good life.

— Jim Collins, *Good to Great*

Great schools provide at least a year's worth of learning for a year's worth of schooling. Great schools engage students through a curriculum that stimulates their God-given sense of curiosity. Great schools are safe places that draw students in rather than push them out. Great schools produce high school graduates who are ready for college and work or some combination of the two. South Carolina needs more great schools.

The one thing that separates a good system from a great system of schools is the culture of low expectations that allows parents, students, teachers, and other stakeholders to accept mediocrity. Increasing global competition is forcing South Carolina to come to accept the fact that developing a great system of education is not an option to ponder; it is now a matter of economic necessity.

Transitioning from a system that generates incremental improvements to one that produces great outcomes year after year demands that we first get honest about the educational progress that our state has – or, in too many instances, has not – made. Armed with an objective analysis, we can target our energies on creating a seamless system of education, maximizing the return on our educational investment, and developing a system that is more responsive to consumer demands.

Continued Challenges in Student Performance

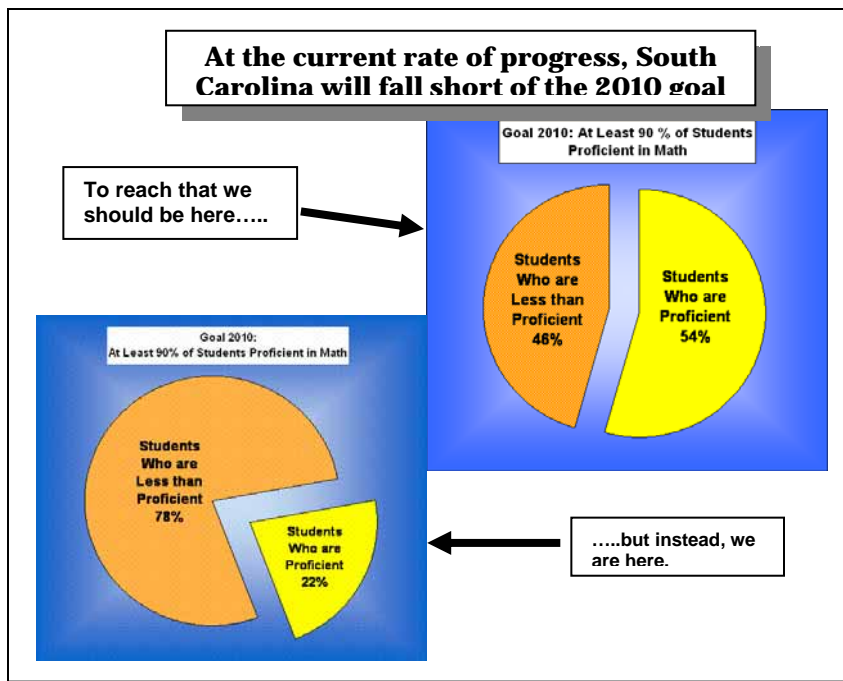
Measuring the success of South Carolina's education system has two components. First, we need an evaluation of benchmarks that are predictive of what will be the system's educational product. Second, decision makers need a clear assessment of the quality of the overall product of the education system. In real terms, assessing the education system requires that we monitor student proficiency at various points in elementary and secondary education at the same time that we evaluate the quality of the typical high school graduate, which represents the output of the education system. Additionally, a successful system offers quality service at a reasonable cost to taxpayers.

Falling short of the 2010 goal. The Education Accountability Act requires that by 2010, nine out of ten students will be proficient in math, reading, social studies, and science. While student performance has shown improvement, the current rate of progress is insufficient to reach the goal set by the Legislature in 1998.

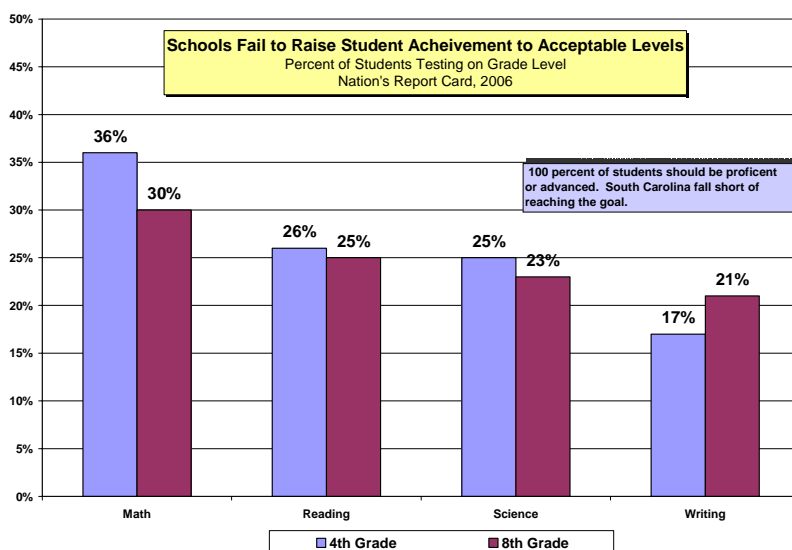
In addition to being off-target for reaching the goals set by the General Assembly, the education system's effectiveness is worse in secondary education than it is in elementary. Take for instance student performance on the Nation's Report Card, a nationally recognized assessment used to gauge the effectiveness of state education systems.

The likelihood that students reach proficiency declines

every year that they are in school. In effect, the more we expose our students to public school, the worse they do. National Association of Education Progress (NAEP) scores in



every subject attest to this fact. The one area that offers a glimmer of hope – writing – shows that in both 4th and 8th grade only one in five students is proficient at writing.



Student performances on the Palmetto Achievement Challenge Test (PACT) and on NAEP show the same reality. Our students enter elementary school ready to learn, but by the time they reach high school they either lack the motivation

or the skills to demonstrate a competent understanding of key subject areas.

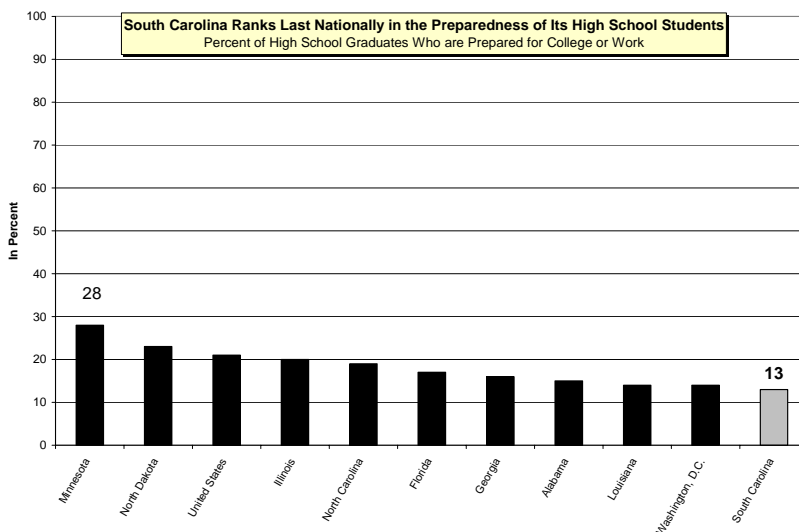
SAT and ACT national rankings. Student proficiency at various grade levels is merely benchmark. The ultimate measure of our education system is its ability to produce well-trained high school graduates. Compared to their counterparts in other states, the performance of students who successfully complete South Carolina’s K12 education system offers a stark reminder that our system has a long way to go before it is competitive.

National ranking on the average SAT score among high school graduates is a case in point. Over a 30-year period, South Carolina’s rank on the SAT constantly falls at the bottom of the nation, fluctuating between last and next to last from year to year. Our scores remain far below the national average and not even approaching that of high performing states such as North Dakota, Iowa, Minnesota, or Illinois.

SAT Performance by State		
	National Rankings	
State	1975	2006
North Dakota	2	1
Iowa	1	2
Illinois	22	3
South Dakota	6	4
Minnesota	7	5
Virginia	43	34
North Carolina	47	38
Georgia	49	49
<i>South Carolina</i>	<i>50</i>	<i>50</i>

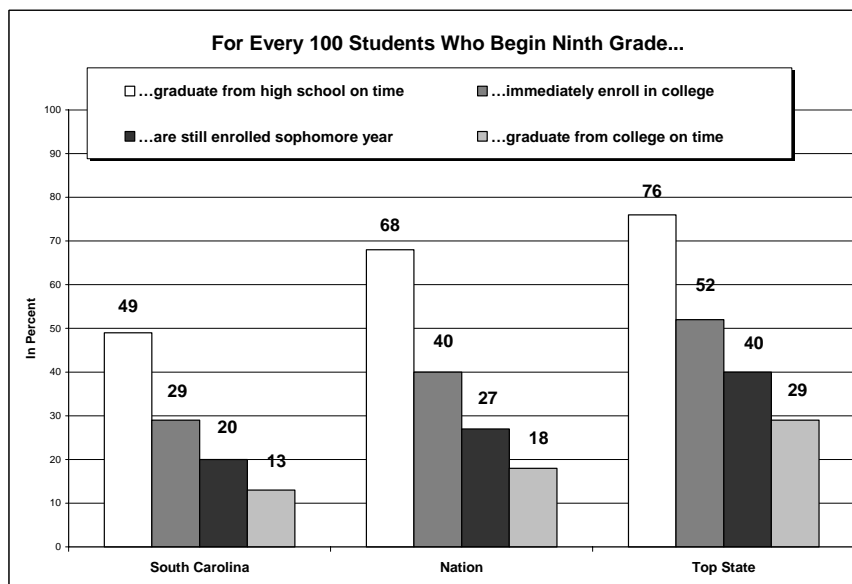
North Carolina and Virginia offer an interesting contrast. Since 1975, both states have seen significant improvements in their national rank while maintaining a student participation rate that is comparable to that of South Carolina; as a matter of fact, both states have actually increased student participation rate on the SAT. The student performance of Virginia and North Carolina demonstrate the fact that it is possible for states to raise student achievement on the SAT.

At the same time the system has failed to improve the competitiveness of our high school graduates, the economic well-being of our state has become more reliant on the public education system’s ability to fulfill that basic task. A successful high school graduate is no longer a luxury; it is an economic necessity. Take, for example, the fact that the skill set necessary to succeed in college has converged with the skill set necessary to succeed in work – the two are indistinguishable from one another.



An environment where only 13 percent of high school graduates are prepared for college and/or work is counterproductive to South Carolina's need to be competitive in a global economy. We fare poorly relative to other states in the nation. However, even reaching the national average is only a step in the right direction; less than one-fifth of the nation's high school graduates are ready for college and work.

Finishing high school on time – a coin toss. A flipped coin has a 50/50 probability of landing on heads. An entering high school student faces the same odds of graduating on time. For the student who makes it, those odds are acceptable, especially for those who are part of the fortunate 13 percent of high school graduates ready for college or work. However, for the mass of students who fail to complete high school on time, the current system is failing them.



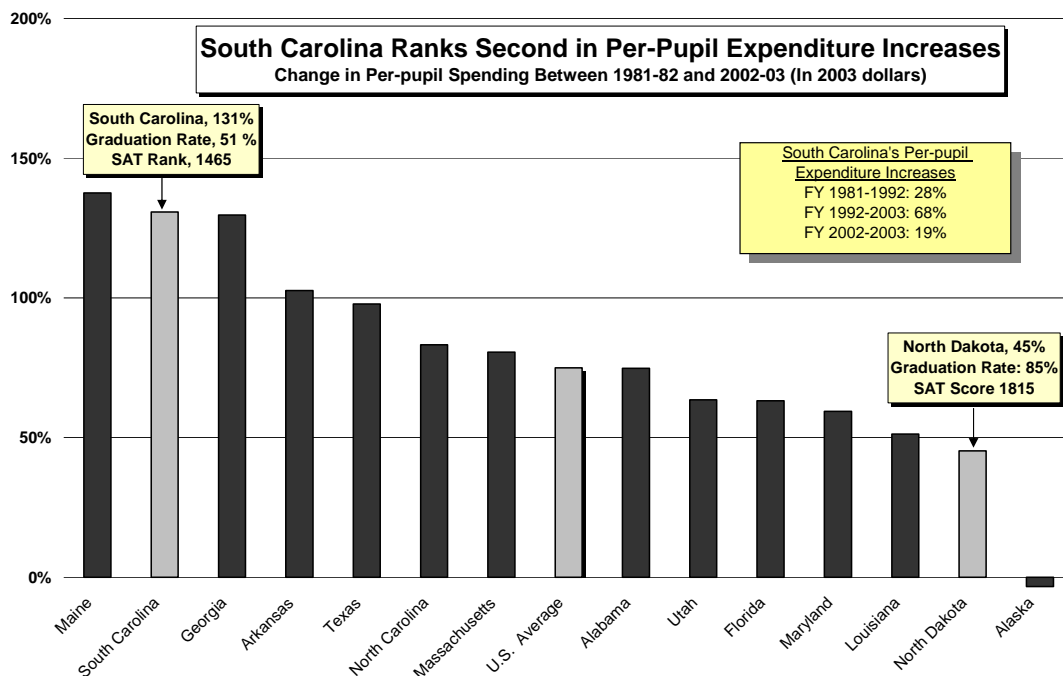
Among the high school students who began in fall of 2006, half will finish on time with a recognized high school diploma in 2010.

With all the hoopla surrounding absolute improvements in SAT scores and ACT scores, the fact is that a system that fails to get half of its students through on time represents an ineffectiveness that cannot be masked by having a few high-performing graduates.

South Carolina's Graduation Rate: Different Calculations, Same Result		
Source	Graduation Rate (in Percent)	National Rank
Higher Education Information Service (2003)	48	50
United Health Foundation (2004)	48	50
Postsecondary Opportunity (2002)	48	50
National Center for Public Policy and Higher Education (2004)	49	50
Urban Institute (2004)	51	49
National Board on Educational Testing and Public Policy (2004)	51	49
Education Week Study (2006)	52.5	50
Manhattan Institute (2003)	57	50
South Carolina Department of Education (2003)*	66.8	48
No Child Left Behind State Report (2005)*	78	48
<i>*In 2005 and 2006 the State Department of Education was criticized for inflating graduation rates reported to national organizations including the United States Department of Education.</i>		

No matter how it is measured – high school completion rate, high school graduation rate, dropout rate – the result is the same. South Carolina's system ranks last in terms of its ability to get students through. What's worse is the fact that the momentum reflects a downward trend: South Carolina's high school completion rate today is lower than it has been in fifteen years. Since 1990, the high school completion rate – the percentage of ninth graders who go on to finish high school on time – has plummeted from nearly 65 percent to less than 50 percent of each entering class. This decline cannot be explained away by factoring in the demographic composition of South Carolina's student population or graduation requirements. As a recent report released by the Monitor Group plainly points out, even when the prevalence of poverty, ethnic composition, and credit or testing requirements are considered, South Carolina's graduation rate is lower than it should be and is declining more rapidly than is justifiable. The momentum represents a downward trend wherein our school system, instead of becoming more effective at producing successful high school completers, is becoming more reliant on the adult education programs offered in our state.

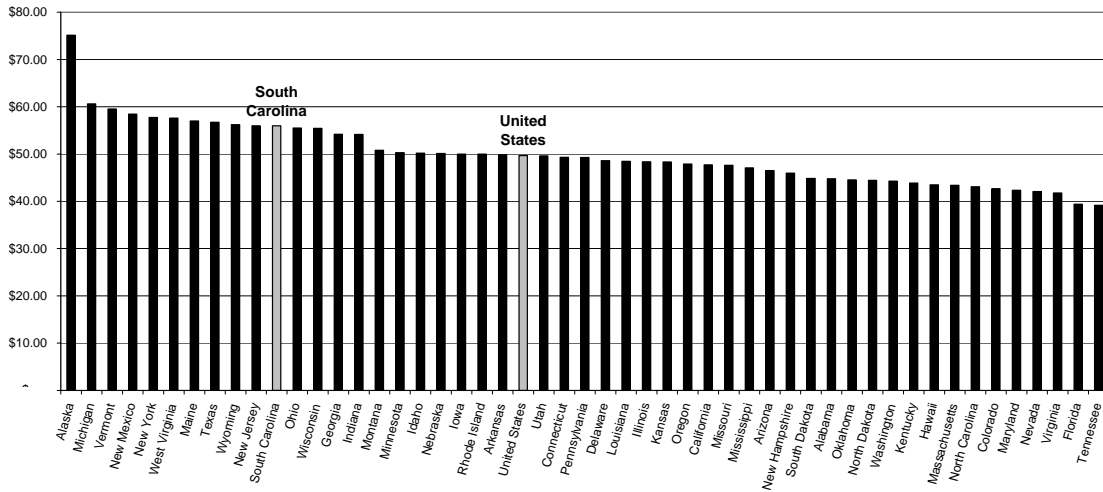
Spending more, getting less. With the overall output of our system being what it is, one would think that over the last decades South Carolina's investment in education would either be stagnant or even declining relative to the rest of the nation. In fact, South Carolina has seen the second most rapid increase in per-pupil expenditures when compared to other states. South Carolina's increase in per-pupil expenditures is greater than that of the national average as well as that of the Southeast.



Over the last few decades, South Carolina has aggressively increased the amount of spending in education, both in terms of total spending and in terms of per-pupil spending. These increases can largely be explained by growth in teacher salaries, class size reduction, and capital expenditures.

South Carolina's education spending as a percentage of personal income ranks 11th nationally. For every \$1,000 in personal income generated in South Carolina, \$55 is spent on public education. The state spends 13 percent more than the national average on educating its students when considered in relation to personal income.

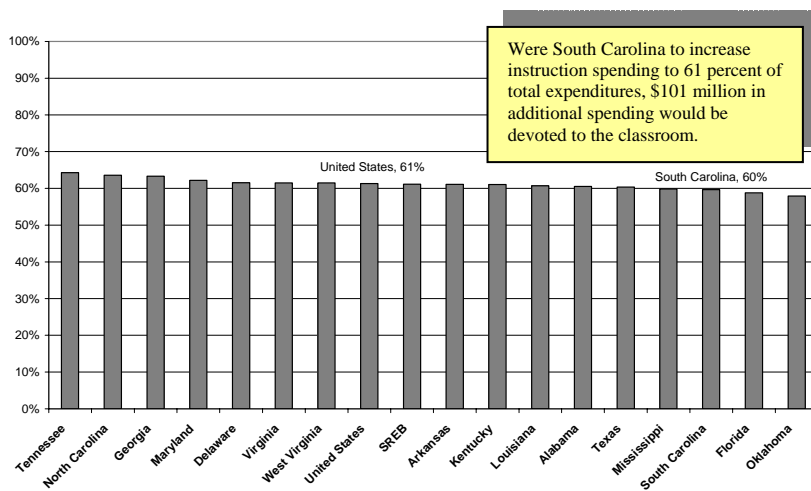
South Carolina Ranks 11th Nationally in Education Spending Relative to Personal Income
K12 expenditures per \$1,000 in Personal Income, FY 2003



This figure is significant as it ties the spending in education to the amount of pretax revenue the average citizens have at their disposal. By considering the fact that South Carolina’s spending on education relative to personal income is higher than the national average, one gets a clear picture of the fact that our citizens are putting more effort toward educating the children in this state than their counterparts nationally. Given the greater effort, our citizens should justifiably reason that their efforts should produce proportionately better outputs. Unfortunately, this is not the case.

We spend more than enough on education. A key problem is that a smaller portion of South Carolina’s education dollar makes it to the classroom.

South Carolina Education Spending Fails to Get to the Classroom



Were South Carolina to increase instruction spending to 61 percent of total expenditures, \$101 million in additional spending would be devoted to the classroom.

As the adjacent chart indicates, when compared to the rest of the nation or to other states in the Southeast, South Carolina spends less of its educational dollar on the function that best affects student achievement – high quality instruction. While there is consternation among school and district administrators over focusing solely on instructional spending, the fact is that so long as instructional spending in South Carolina is compared to similarly

focused spending in other states, the expectation should be that South Carolina's instructional spending should fall within the norm for the nation.

Within classroom spending, South Carolina targets a larger portion of its classroom spending to student support and instructional staff than other states. In expenditures devoted to non-instructional purposes, South Carolina spends a disproportionate amount of its resources on food and enterprises services, which exclude transportation. The state spends significantly more than the national average on non-instructional expenditures such as capital outlays (42 percent above the national average) and interest on school debt (32 percent above the national average). Reallocating resources to meet the Southeast or national average in these areas would translate to an \$83 million increase in instructional spending.

Our contention is not that spending 61 percent is a magic number. We simply believe that given the primacy of instruction in educational outcomes and South Carolina's need produce better results for our educational investment, it stands to reason that comparing instructional spending to other areas is a worthwhile exercise.

Even small changes in the way South Carolina spends its educational dollar could lead to a substantial increase in the amount of money that makes it to the classroom.

Creating a System that Responds to Consumer Demands

In creating a system that is easy to manage, the flexibility of the system in addressing the specific needs of each of the more than 683,600 students educated in public schools has been lost. Some parents have the economic, social, or political capital to demand and receive quality. Unfortunately, however, most parents lack such capital and consequently feel forced to accept whatever quality level gets doled out to them. The sheer size of the education system has grown to the point that the actions needed to successfully prepare an individual student for life and work often gets lost in the needs of the masses.

We believe that the state should work vigorously to create a system of education that offers greater incentives for schools to respond to the demands of parents.

Legislative reforms. Early Childhood Education Scholarship – Recognizing the need to improve the quality of the early childhood services offered to the young children of South Carolina, we called for an inventory of the early childhood services provided in the state. The General Assembly responded by passing concurrent resolution 4484, which required a targeted inventory of the early childhood education services provided to four-year-olds. Upon completing this inventory, the Education Oversight Committee provided a series of recommendations for how the state could more effectively serve its four-year-old children. These recommendations included addressing the need to coordinate early childhood education services through one agency as well as the importance of providing parents the flexibility to choose the best public or private education center for their child.

Based on the Education Oversight Committee's recommendations, the Legislature and this administration supported the creation of education scholarships issued through the South Carolina Child Development Education Program, which is currently being piloted. This scholarship provides a voucher worth up to \$4,000 to cover the tuition and transportation costs associated with serving at-risk four-year-olds in the state.

We have supported similar programs for all students in South Carolina. While disappointed that education scholarships stop at kindergarten, the fact remains that the General Assembly is beginning to recognize that improving educational outcomes in our state requires that we leverage all of the high-quality educational resources – public and private – available to the students in our state. Our hope is that similar opportunities will be expanded to serve students in first through twelfth grade.

South Carolina Public Charter School District. In 1996, South Carolina's General Assembly recognized the need to offer parents more options in directing the quality of the education that their child received. To fill this need, the General Assembly passed charter school legislation that gave parents, educators, business leaders, and community members the flexibility to collaborate to create schools that offer innovative opportunities for students.

As a result of the passage of this legislation, South Carolina has been able to create a variety of charter schools. Schools have formed that target at-risk students and offer them the opportunity to recover high school credit and work toward an Associates degree, transforming these would-be high school dropouts into the college degree candidates. A single-gender charter school has formed that offers parents the flexibility to place their middle school child into a school where classes separate boys and girls. Believing that the distractions of co-educational courses undermine their child's academic success, these parents worked with local educators to craft a program that worked for their children. Another variety of charter schools targets special needs students and offers them the academic and wrap-around services they need to be successful. Rather than falling through the cracks in the school to which they are zoned, these students are given an opportunity for success in a school where the entire faculty has expertise in serving special needs students.

There are some places in the state where such creative educational opportunities are blocked by local school boards of trustees or district officials. We have advocated for the creation of an alternative authorizer, the South Carolina Public Charter School District, to offer prospective charter schools another sponsor. In last year's executive budget, we continued our support of the creation of the South Carolina Public Charter School District. We are pleased to report that in spring of 2006, the General Assembly enacted legislation that allows the statewide district to be created. In this year's executive budget, we request that the school district receive the funding necessary to become operational.

Despite the accomplishment that is represented by the creation of the Child Development Education Program Pilot and the South Carolina Public Charter School

District, there is still much that needs to be done in order to create a system that is truly responsive to consumer needs. To accomplish this task, we offer several proposals.

Giving scholarships to students most in need of better educational opportunities. There is significant variation in the quality of education offered in South Carolina. Some of our districts, schools, and teachers do an awesome job of providing students a competitive education. Students in these environments are receiving a quality education that their parents are unlikely to forfeit. Not so for parents with children in one of the 390 failing schools that serve nearly 30 percent of the students in South Carolina. As we work to improve the quality of all districts, schools and classrooms, and until we can ensure that every student has access to high-quality instruction, it stands to reason that parents should have the freedom to enroll their child in a program that gets the results their child needs.

We continue to support means-tested education scholarships targeted to the student populations that are least likely to receive high-quality education services. These scholarships can include those that support special needs students, low-income students, students enrolled in failing schools, or students who score Below Basic on any component of PACT. Such scholarships have been a source of great discussion over the course of this administration. Our belief remains that until parents have the flexibility to control where and how their child is educated, our ability to create a high-quality system will be limited. Under the current system, South Carolina offers little educational freedom to its parents:

Education Freedom in the United States: Education Freedom Index Ranking of the States	
State	EFI Rank
Arizona	1
Minnesota	2
Wisconsin	3
New Jersey	4
Oregon	5
Texas	6
South Carolina	43
Virginia	44
Rhode Island	45
Maryland	46
Kentucky	47
Nevada	48
West Virginia	49
Hawaii	50

The Education Freedom Index is composed of measures of five types of educational options: public charter school options; publicly funded education scholarships; the ease of home schooling; the ease with which one can choose a different public school district by relocating; and the ease with which parents can send their child to a different public school district without relocating.

- Nearly four percent of students participate in self-selected public school choice programs such as magnet schools;
- Less than one percent of students are enrolled in public charter schools;
- Average inter-district transfer fees top \$4,000 per year per child;
- Only ½ of one percent of students participate in dual enrollment programs;
- Less than 4,000 students take advantage of credit-bearing online learning opportunities; and
- There are no publicly-funded education scholarships for students in first through twelfth grade.

Comparing Texas and South Carolina offers insight into the importance of educational freedom in raising student achievement. Both Texas and South Carolina are southern states with high minority populations at 41 and 31 percent of their state populations, respectively. They have similar median household incomes (Texas at \$33,072 and South Carolina at \$34,665) and per-pupil expenditures, both being below the national averages. While these similarities exist, the educational freedom levels in the states vary substantially; with Texas ranking 6th while South Carolina ranks 43rd nationally. It is no coincidence that Texas has higher test scores on NAEP at all grade levels and on the SAT and ACT. A greater percentage of Texas high school graduates are prepared for college and work. Additionally, Texas has a higher high school completion rate. South Carolina's ability to dramatically raise student achievement is directly tied to our ability to increase the educational freedoms available to the parents of our state.

Every year since 2003, there has been an education scholarship introduced into the General Assembly. In 2004, Put Parents in Charge was introduced to offer a tax credit of \$3,600 to all parents in the state. In 2005, Put Parents in Charge was modified to target low-income students in failing schools by providing them with a scholarship at the beginning of the school year. These vouchers were available for public and private sector use giving parents true flexibility in selecting the learning environment in which their child would be educated. The Education Opportunity Scholarship was introduced in 2006 creating a tax credit for middle-income families and a voucher for low-income parents of students in failing schools. The Education Opportunity Scholarship also offered a scholarship to special needs students regardless of income or school. Despite increasing public support, the Legislature has yet to give parents the freedom they demand.

We would like to see the same sort of scholarships that the state provides four-year-olds through the Child Development Education Program, and college students through the Life and Hope scholarships extended to all students in our state. We are not alone in our support of publicly funded education scholarships for elementary and secondary students. Several states have already introduced legislation to offer students the opportunities created through such scholarships.

FY 2007-08 Executive Budget

Publicly Funded Education Scholarships in the United States	
State	Description
Vermont	Town Tuitioning Parents are permitted to use up to \$7,500 toward transferring their child to a public or private school of their choice.
Maine	Town Tuitioning Parents are permitted to use up to \$6,000 toward transferring their child to a public or private school of their choice.
Florida	McKay Scholarship A student receives the full amount of funds for which he would have been eligible under the Florida Education Finance Program (FEFP). For the 2004-2005 school year, the FEFP rate was \$5700.
	Corporate Tax Credit Corporations receive tax credits for contributions to Scholarship Tuition Organizations. Credits are limited to 75 percent of a corporation's tax liability.
	Opportunity Scholarships Scholarships up to \$3,500 to attend private school or \$500 to change public schools. Scholarships are limited to students in "C" rated schools on the Florida accountability system.
Iowa	Deduction Families could deduct up to \$1,000 per child from their state income taxes for education expenses. Taxpayers using the standard deduction could take a tax credit of up to \$50 for education expenses for each child. Scholarships are limited to families earning less than \$45,000 per year.
	Tax Credit Tax credit of 25 percent of the first \$1,000 spent on their children's education.
Illinois	Tax Credit Parents receive a tax credit worth up to 25 percent of annual education related expenses. Tax credits range from \$250 to \$500 per family.
Wisconsin	Milwaukee Parental Choice Program Vouchers are worth the lesser of the full amount of private school tuition or \$6,000. Scholarships are limited to families earning less than 175 percent of the federal poverty level.
Pennsylvania	Education Improvement Tax Credit System Corporations can receive a tax credit of up to 75 percent of contributions made to School Tuition Organizations (STO), not to exceed \$100,000.
	Scholarship Program Full amount of state appropriation (\$3,700).
Washington, D.C.	School Choice Incentive Program Voucher is worth up to \$7,500 to cover tuition and/or transportation. Limited to households with incomes up to 185 percent of federal poverty level.
Ohio	Cleveland Scholarship and Tutoring Program Provides students in grades K-10 with vouchers for tuition to a private school of choice. Students may also choose to attend another public school or receive tutoring. Elementary school voucher is worth \$3,000. High school voucher is worth up to \$2,700.
Utah	Carson Smith Special Needs Scholarship Awards vouchers up to \$5,700.
Arizona	Universal Tuition Tax Credit Tax credit for individual contributions to private tuition scholarship programs. Couples may receive a \$625 credit. Individuals may receive a \$500 credit. Individuals may also receive a \$200 credit for contributions to extracurricular activities.
Minnesota	Tax Credit Tax credits are for 75 percent of education expenses. Credit cannot to exceed \$1,000 per child. Credit cannot exceed up to \$2,000 per household. Credit may be used to cover \$200 in computer equipment (hardware or software). Limited to households earning up to \$33,500
	Deduction All families qualify for a deduction worth up to \$1,625 for K-6 education expenses, \$2,500 for 7-12 education expenses, and \$200 for computer hardware/software expenses.

The state of Florida has one of the largest school choice programs in the country. Their program, known as Opportunity Scholarships, provides scholarships to students in consistently failing schools to go to another school. In Florida, test scores at schools that face losing students as a result of their taking advantage of Opportunity Scholarships have increased at twice the rate of other schools. A study by the Manhattan Institute for Policy Research demonstrates that competition from school choice in Florida improves performance in failing schools more dramatically than reducing class sizes from 25 students to 17 students. In a recent study of the Milwaukee Parental Choice Program, 64 percent of the students enrolling in high school in 1999 under the program graduated in 2003 – compared to 34 percent in Milwaukee Public Schools.

Reward teachers for the hard work they perform. Realizing the importance of teacher pay in influencing the ability of school leadership to recruit and retain high-quality teachers, South Carolina has been aggressive in raising the average teacher salary. This can be seen in the change in average teacher salaries over the last two decades.

South Carolina's Average Teacher Salary: 1985-2007 (In \$US)		
Fiscal Year	South Carolina	Southeast
1985	20,143	20,199
1990	27,217	27,134
1995	30,279	30,457
2000	36,091	35,869
2005	41,691	41,391
2006	42,737	42,437
2007	43,991	43,691

In past executive budgets, we have supported raising teacher pay in South Carolina to at least \$300 above the Southeastern Average. We continue to support such a pay increase as it is representative of our belief that teachers are the most important school controlled factor in educating children. However, even with these pay increases, the current system of pay is unconnected to the quality of the service that a teacher offers.

Teachers, like other employees, respond to the incentives that are placed before them. Merit pay, commonly referred to as pay for performance or diversified compensation systems, is an effective way to pay teachers in a manner that rewards success rather than cultivating mediocrity. Denver, Colorado, is a case in point. In 2004, teachers in Denver elected to implement a merit-pay program that distinguishes teachers who are getting results from those that are simply biding their time.

Denver ProComp is a program for Denver public schools. In 1999, the four-year pilot program was introduced, and by 2004 the final compensation plan was approved with more than 1,200 teachers currently enrolled in the program. The ProComp system is a results-based pay system that uses multiple criteria to assess a teacher’s performance. These criteria can be categorized into four areas: knowledge and skills, professional evaluation, student growth, and market incentives. Teachers do not receive a salary bonus until they demonstrate improvement on the criteria specified in the four areas identified above.

Components of the Denver ProComp Pay System		
	Criteria	Bonus Amount (Percent of Index, \$33,301 in 2006)
Knowledge and Skills	Professional Development Units	\$666 (2 percent)
	Graduate Degree/National Certificate	\$2,997 (9 percent)
	Tuition Reimbursement	\$1,000 (3 percent)
Professional Evaluation	Probationary	\$333 (1 percent)
	Nonprobationary	\$999, (3 percent)
Student Growth	Meeting Annual Objectives	\$333 (1 percent)
	Exceeding Student performance Expectations	\$999 (3 percent)
	Distinguished Schools	\$666 (2 percent)
Market Incentives	Hard to Staff Position	\$999 (3 percent)
	Hard to Staff Schools	\$999 (3 percent)

The Denver ProComp system reflects current knowledge about merit-pay systems. First, it is essential that teachers feel that they have a choice to participate in the program. ProComp allows existing teachers to opt-in to the program over a seven year phase-in period. Teachers may choose to continue with the traditional teacher salary schedule that bases salary increases on years of experience and inflationary adjustments. All new teachers are automatically enrolled in the program. This approach balances the fact that teachers new to the profession – either as first-time entrants into the work force or as career changers – are generally more receptive to merit pay as a way to increase their pay based on demonstrated proficiencies.

Second, the ProComp system takes into account the fact that teachers are able to demonstrate proficiency in several areas, all of which can ultimately improve the quality of the instruction they provide students. For instance, market incentive bonuses account for the fact that some teachers are willing to take on the challenge of hard to staff schools but are unwilling to accept a reduction in pay for taking such positions, which is often the case in a traditional salary schedule. There are other teachers that are not well-suited for such positions yet who possess the ability to raise student achievement in other positions. Both teachers are helping the Denver system meet its objective of raising the likelihood that all students will receive high quality instruction. Better yet, the ambitious teacher might pursue salary bonuses in all four areas, increasing their salary nearly \$10,000 in a school year.

However, we need not leave our state to see the benefits of merit pay. In South Carolina, merit pay has demonstrated its ability to raise student achievement. In John's Island Public Charter High School, Dr. Nancy Gregory, the founder of the school, implemented a merit pay system that rewarded everyone, from the principal to the janitor, for school-wide gains in test scores. Instituting such merit pay fosters team spirit and a focus toward the bottom line of education.

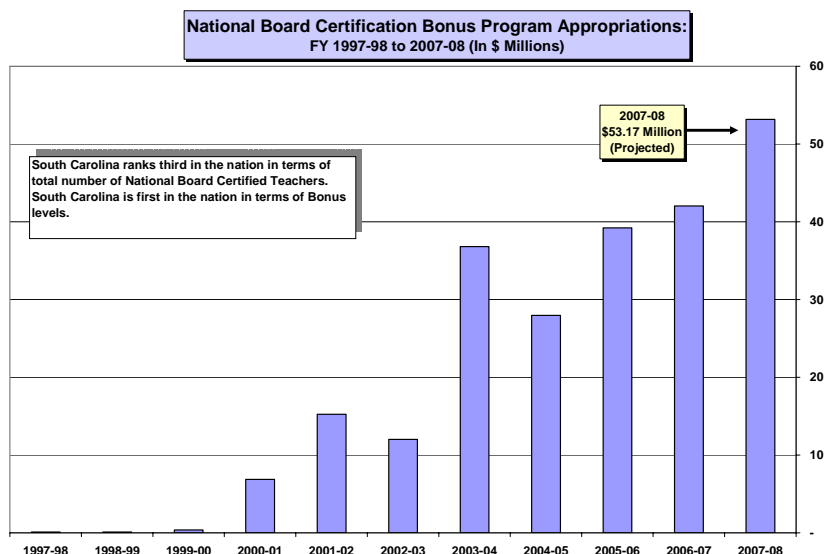
Additionally, through the implementation of the Teacher Advancement Program (TAP), 14 schools across the state have implemented school-wide pay for performance systems. South Carolina is one of 12 states and the District of Columbia to implement this research-based program. The TAP program builds on four elements that include merit-based compensation, multiple career paths for teachers, ongoing professional growth, and instructionally focused accountability. Schools choosing to implement the TAP model for pay for performance offer teachers a salary bonus structure that cultivates success. Teachers work along self-selected career paths that differentiate Master teachers from novice professionals. Master teachers teach fewer courses and spend more time offering novice teachers targeted professional input on ways to raise the achievement levels of their students. Career paths are not determined by years in the profession but by having demonstrated the ability to raise student achievement. Thus, young brilliant professionals have a real incentive to enter and stay in teaching – they receive support when they begin and are rewarded when they excel. So strong is the TAP model that when creating the Minnesota Compensation plan – QComp for *Quality Compensation* – Governor Pawlenty based the statewide initiative on the services being offered under the TAP model.

In 2006, South Carolina was awarded \$34 million by the United States Department of Education to create the South Carolina Teacher Incentive Fund (SCTIF). The SCTIF program will be implemented in 23 schools in six districts over a five-year period. Teachers in participating schools are eligible to receive salary bonuses ranging from \$2,000 to \$10,000 based on classroom observations, improved student achievement in their respective classrooms or school-wide performance improvements.

Upon accepting his position as the Superintendent of Richland One, Dr. Allen Coles immediately began a pay for performance initiative. Rather than imposing a pay for performance program onto teachers, Dr. Coles learned from the lessons of unsuccessful merit-pay programs and used teacher focus groups with teacher representation from across the district as well as representation from the local education association to craft a program that will meet the goals of raising teacher pay and student achievement. Together participants have created Pay for Results, which will offer individual as well as school-wide bonuses based on gains in student achievement on state-issued standardized assessments such as Terra Nova, PACT, and HSAP. Individual teacher bonuses of \$2,000 will be issued to high-performing teachers who raise student achievement on state-issued assessments beyond a district-established improvement expectation. Schools that demonstrate a significant overall improvement will receive a bonus of \$500 for each certified teacher in the school, regardless of their subject area or years of experience. By combining the use of individual and school-wide incentives, Pay

for Results will cultivate the sort of collaboration that is important to school success while it rewards stand-out teacher performance. Tying pay increases to gains in student achievement focuses all teachers and schools on being responsive to consumer demands.

Our purpose in implementing merit pay is to create a compensation system that encourages the right people to enter and stay in the teaching profession. Additionally, a strong compensation system creates an environment where the best teachers take on our biggest opportunities. We propose using the \$57 million in funding devoted to raising teacher pay to \$300 above the Southeastern average to provide districts and schools an incentive to adopt a research-based diversified compensation system.



State-level investment in National Board Certification Salary bonuses is an area where we believe the state's investment in teacher pay could be better used toward fulfilling our goal of raising student achievement. We are committed to honoring the work of teachers who have already completed the program. However, expanding the program beyond its current participation level limits

the state's ability to invest in raising teacher pay in a manner that has a real impact on student achievement. Rather than expanding the expensive bonus system, we propose limiting National Board Certification salary bonuses to teachers who complete the process prior to June 30, 2007. Going forward, funds currently devoted to National Board Certification salary bonuses should be set aside for a performance based bonus program. Specifically, we propose targeting these funds towards block grants that can be used by school districts to establish merit pay programs similar to the TAP model. By redirecting our efforts, the state can invest in a more responsive effort, beginning with an initial investment of \$1.9 million in FY 2007-08.

Funding student needs. All traditional public schools in the state receive local, state and federal funding. Despite having shared funding sources, schools are not equal in terms of their per-pupil expenditures. A simple comparison within any school district reflects this point. In 2005, the average per-pupil expenditure for Beaufort County was \$7,399. That year, district per-pupil expenditures ranged from \$5,400 to \$12,200. This variation is larger than what can be explained by variations in school characteristics. Within this school district, it is likely that two students with the same exact

characteristics might receive differing services based on the amount the district spends on students in the school. This ought not to be. Special needs students in one part of the state or in one part of a school district should receive the same services as they would if they attended another school. The same is true of low-income students or students with demonstrated learning deficiencies.

Outmoded budgeting practices create disparities like that described above. Disparities between districts have emerged as some districts benefit from program funding that disadvantage districts with lower enrollment levels. Within districts schools that serve lower income students receive lower overall funding as they typically employ less experienced and, thus, lower salaried teachers and administrators. Lastly, the current funding practice of the state creates disparity between school options. Students enrolled in magnet school programs receive disproportionately higher funding levels while students enrolled in public charter schools receive disproportionately lower funding levels.

We believe that the funding, and, thus, the services children receive, should be driven by the needs of the child and not the location of the school they happen to attend. For decades, the state has attempted to serve the needs of children through increasingly complex funding mechanisms that pile layer upon layer of programs on our schools. The result is a system of more than 90 revenue categories through which districts receive funds, with nearly half of the state investment in public education being tied to specific programs.

We propose that the state revisit all funding mechanisms at its disposal to restructure funding so that students rather than programs are funded. Specifically we support a system of funding that adheres to the following principles:

- Funds should follow children to whichever school they attend;
- Funding level should be directly tied to the individual needs of the child;
- School funding should arrive at the school as real dollars and not as staff positions or teaching ratios; and
- The funding system should be simplified and made more transparent.

We believe that all funding streams should be simplified, consolidated and dispersed directly to schools based on an updated Education Finance Act (EFA) formula that includes factors for English Speakers of Other Languages, family and school poverty, student disability, and student performance level. Under this approach, programmatic dollars would be redirected to flow out to schools through the new EFA formula. Schools would select the services that they believe best meet the needs of their students and purchase those services from district offices, the State Department of Education, regional consortia, or private vendors.

Schools in Edmonton, Alberta, have already seen the impact of such a simplified approach to school funding. Since the 1990's, the leadership in Edmonton has sought to put more control over spending into local hands. Money flows out of central office budgets and directly into schools where schools then "buy back" central services from the state or local districts. Today more than 90 percent of Edmonton's funding goes straight to schools. School leaders hire a mix of staff that is tailored to their students' needs. They have the power to opt out of any service provided by the district, leading to central office cutback or service quality improvements. Other districts have seen similar results. In Houston, simplified or weighted student funding has led to decentralized decision making. In Oakland, California, the shift to weighted student funding has led to a redistribution of the best-qualified teachers to the schools that most need to improve. The bottom line is that moving to a more simplified funding system can address the disparities that have been created by current budgetary practices, reduce the impact of perverse incentives established by programmatic funding, and force schools and districts to focus on responding to the needs of students rather than sustaining existing bureaucracies.

Holding schools accountable. In 1998, the passage of the Education Accountability Act (EAA) set ambitious goals for the performance levels of schools and students in South Carolina, with the target year being 2010. The EAA creates accountability measures that are used to publicize school and district performance. The EAA approaches but does not reach true accountability. True accountability occurs when parents have the flexibility to make informed decisions about their child's school and when principals, based on the performance of their students, have the flexibility to organize people and resources toward effective and efficient objectives. Many of the program decisions are already made for principals: they are paid to manage programs rather than being paid to manage success.

School and district leadership ranks second only to teacher quality among school factors that influence a student's performance. South Carolina's ability to create a competitive educational system will rely upon our ability to recruit and retain strong school and district leaders. This is even more the case in schools that have historically underperformed. If South Carolina is ever to significantly reduce the number of failing and average schools in our state, we need leaders that can forge the path to greatness in the schools they administer. Such change managers should be:

- Competent managers who are able to organize people and resources toward effective and efficient objectives;
- Effective leaders who can draw from those under them the commitment to and vigorous pursuit of a clear vision, resulting in high performance; and
- High level executives who can build enduring greatness through humility and professional will.

Unfortunately, the very way in which schools are regulated and funded limits the ability of superintendents and, especially, school principals to make site-based decisions that can dramatically raise performance.

There is no model for effective leadership that will work in all environments. The needs of a rural, affluent community will differ from those of a poverty-stricken, urban community. Schools where most students have college-educated parents will have needs that differ from those where a high school diploma is typically the highest level of education. A high performing school or district has different needs than districts and schools that have yet to reach high levels of academic success. Rather than focusing on the inputs a leader chooses, a good measure of quality will focus on the results a school leader produces.

South Carolina needs to consider whether the system by which education leaders are generated is one that increases or decreases the availability of innovative leaders. A key hindrance lies in the fact that much of what a school leader does is dictated by the state. Leaders in many cases are primarily program implementers. One of our main goals in the education budget is more dollars going directly to the classroom. Many dollars are tied to very specific funding categories and do not allow local school districts to put resources where they are needed most. An example illustrating this is found in the Education Improvement Act that was enacted in 1984 as a set of grants directed to schools to implement dynamic new programs aimed at improving educational achievement. However, over time, the EIA budget has become a collection of more than 70 different programs, which give Columbia greater leverage over dollars spent in communities around the state. Regulations are not lifted until the school has either performed so poorly that it is clear no current programs are working or the students perform so well that the school is given flexibility to operate outside of the confines of what regulations dictate. We believe that spending decisions are better made closest to the child they affect, and propose putting in place measures which would give school districts greater flexibility in those decisions.

Attempts to provide school leaders greater flexibility have been proposed. Most recently, the General Assembly adopted the flexibility proviso, which was first implemented in 2002-03. The proviso offered school districts the flexibility to transfer up to one hundred percent of the funds between programs to any instructional program provided the funds are used for direct classroom instruction. The idea behind adding such flexibility is that it would offer district leaders the flexibility to make less-regulated spending decisions.

District use of the flexibility proviso is instructive. Sixty three percent of the districts that consistently took advantage of the flexibility proviso were able to increase the per-pupil expenditures for instruction. Additionally, 62 percent of all transfers were funds that were originally allocated to the Reduce Class Size program, with more than 75 percent of those transfers being reallocated to Act 135 Academic Assistance Programs, which are significantly less restrictive than most program funding categories. Given

greater flexibility, districts gravitate toward reallocating resources to funding categories that are less restrictive.

The ability to extrapolate on the results of district use of the funding proviso is limited for several reasons. First, the proviso permits district-level flexibility, which is simply not the same as school-level or site-based flexibility. District use of the flexibility proviso is likely an accounting tool used to reduce funding in programs that require a local match and to balance district revenues and expenditures as the end of the fiscal year approaches. Second, one sees that spending decisions in a highly regulated environment are not driven by the quality or lack of quality in a program but by the need to balance the books.

Third, while well-intended, the flexibility proviso simply does not go far enough to truly demonstrate how school leaders would reallocate resources given student performance goals and real flexible spending. Of the more than \$3.4 billion in education appropriations for FY 2006, only \$302 million were subject to the flexibility proviso, representing only 9.2 percent of district revenue. According to Item 5 of the Funding Flexibility Procedures generated by the State Department of Education, several programs are excluded from this flexibility.

Programs Excluded from the Flexibility Proviso
Refurbishment of K-8 Science Kits
Teacher/Curriculum Specialists
Principal Leaders/Specialists
Junior Scholars Program
National Board Certification Salary Supplement
Teacher of the Year
Teacher Salary Increase
Teacher Salary Increase Fringe
Teacher Supplies
Principal Salary/Fringe Increase
Bus Driver Salary Supplement

We propose that the Funding Flexibility Proviso continue with three modifications:

- Public schools rather than school districts should be given the flexibility to reallocate resources;
- Reduce the list of programs excluded from this flexibility so that Education Accountability Act funding may be reallocated based on school-level managerial decisions; and
- Rather than focusing on inputs – simply increasing instructional spending – hold schools accountable for results, raised student achievement on a nationally recognized norm-referenced test.

Reducing program requirements and giving leaders larger blocks of money to use at their discretion can give school and district administrators the flexibility they need to make decisions based on the individual needs of their students. Funding flexibility cannot be provided without the appropriate accountability. Increased flexibility can be balanced with accountability that is connected to the performance of the school.

In addition to extending the scope of the Funding Flexibility Proviso, we propose that the General Assembly enact a permanent statute which would provide school districts more flexibility in how they spend the dollars allocated to them. This proposal, Streamlined Management and Accounting Resources for Teaching (SMART) Funding, would put more education spending decisions in the hands of the communities, rather than dictating policy from Columbia. First introduced by Representative Roland Smith in 2004, SMART Funding was later co-sponsored by Former Speaker David Wilkins and the then House Ways and Means Chairman Bobby Harrell, passed overwhelmingly in the House in 2003 and came very close to passing in the Senate. The SMART Funding bill languished in the Senate but was not enacted by the General Assembly in the 2006 legislative session. We will work closely with the General Assembly in the upcoming legislative session to enact this bill in 2007.

Maximizing the Return on Our Investment

Testing. In 2006 we were pleased to sign Act 254, which will incorporate testing that will provide student-specific results that are detailed enough to direct teachers and parents as to the learning needs of each student. Our support of such formative testing continues as we believe it to be a more effective manner of assessing students.

While testing is important, it is simply a means to an end, a tool used in educating our students. We continue to believe that our system could be more efficient, if only from a cost structure. In FY 2007-08, our state is projected to spend \$32.4 million on testing our 683,600 students. Combined with the \$6 million spent by local school districts on off-the-shelf assessments, South Carolina's testing expenditures amount to \$57 per student, per year. Costs continue to rise as the state considers expanding testing into first and second grades. While we certainly support the improved accountability efforts in our schools, this cost is significantly higher than the cost of many other states. For example, Idaho spends approximately \$10.50 per student on testing and Georgia spends \$15.85 per student.

Act 254 is beneficial in that it incorporates formative or diagnostic testing into South Carolina's accountability system. However, it does so by adding a new layer of testing rather than replacing testing that fails to offer the sort of data our parents and teachers need. Furthermore, it extends testing so that the first year of testing will eventually move to first and second grade, rather than in third grade.

As South Carolina enters the last year of its current assessment contract, we propose that South Carolina follow the example of states like Michigan and simply adopt a nationally recognized norm-referenced assessment that is aligned to our state's

standards. This transition can be made without undermining the strength of the current accountability system; student performance data on nationally recognized tests may be used to generate school and district reports cards just as easily as the current assessments. Additionally, student performance on such assessments could easily be used by businesses, colleges, and work force development agencies to gauge student preparedness for life after high school, reducing the need for duplicative assessments when students leave high school.

Transportation. The costs associated with transporting students to and from schools continue to be one of the largest direct expenditures made by the State Department of Education. We continue to be the only state in the union with such a centralized service and purchasing arrangement. The effectiveness of our purchasing practices are of particular concern as the average age of South Carolina's school bus fleet is well above that of what would be acceptable in the private sector.

In an August memo to the State Department of Education Director of Transportation, TransParGroup highlighted the efficiencies the State Department of Education would gain by leasing a portion of its buses from a private provider rather than making outright purchases. By leasing buses, the State Department of Education would reduce by 25 percent the time it will take to get to the industry standard of maintaining an average vehicle fleet age of seven years and would also reduce overall maintenance costs. The strategy recommended by TransParGroup included using \$9 million out of the \$36 million in annual bus purchase appropriations to lease 1,000 new buses rather than using the entire amount to purchase only 475 new buses. The TransParGroup proposal has been under discussion since January 2006. At present, the State Department of Education is delaying the release of the request for proposals for bids in anticipation of new Environmental Protection Agency regulations that may affect the services that pertain to a prospective lease contract. The State Department of Education has yet to fully implement the recommendations of the original Legislative Audit Council report that highlighted the need to change the replacement cycle dates back to 1999.

We support the State Department of Education's willingness to consider the possible benefits of leasing rather than outright buying a portion of the new school buses. Rather than continuing to delay the process, we propose that the State Department of Education issue a request for proposals for leasing agreements that could be used to accelerate the rate at which our older buses are replaced with newer, up-to-date vehicles.

Textbooks and instructional materials. South Carolina's textbook and instructional materials program offers no incentive for districts to effectively manage the use of textbooks by students. Textbooks are purchased by a line-item appropriation provided directly to the State Department of Education, which contracts out the management of the state textbook depository to The R.L. Bryan Company. School districts select the approved textbooks that they would like to use and place an order for textbooks directly with The R.L. Bryan Company. There are no district fees associated with the use of

textbooks. Consequently, districts have little incentive to consider local cost-savings efforts that could be made in the use of instructional materials.

Other states have considered potential cost savings in the management of their textbook adoption procedures. In 2003, Florida found that by permitting three pilot districts to purchase used instructional materials, districts were able to realize annual cost savings of nearly \$84,000. Extrapolated across the state, cost savings found in the used instructional materials pilot could amount to a two percent cost savings in instructional materials. In South Carolina, a similar cost savings could amount to a \$1.2 million savings to be committed to a multitude of educational purposes.

Additional efficiencies can be gained by providing incentives for school districts to explore using digital instructional materials to replace the traditional hardbound textbooks. The benefit of such an approach to supplying instructional materials is three-fold. First, using electronic textbooks addresses the fact that American textbooks are notoriously rife with factual errors that are not corrected until the updated copyright is adopted by the state. Second, digitized instructional materials are more representative of the way students acquire information today. Lastly, as the size of textbooks continues to increase, the need to reduce the weight students, particularly young children, carry home in order to complete assignments becomes a more pressing issue.

In 1999 Ohio's Legislature implemented a program statewide, originally anticipating that, while districts taking advantage of electronic textbooks might experience gains in efficiency, there would be no effective cost savings in textbook expenditures that could be redirected to other state activities. Districts adopting the use of electronic textbooks in the form of CD-ROMs, DVDs, software subscriptions or other magnetic technology have access to an accelerated adoption schedule relative to the four-year adoption schedule that is current practice for hardbound textbooks.

South Carolina's districts have the flexibility to use textbook and instructional materials funding to purchase digital resources. Rather than simply offering the flexibility, we propose that the portion of the line-item appropriation devoted to purchasing textbooks be issued to offer districts incentives to reduce costs, raise effectiveness, or simply adopt innovative service delivery.

Giving students an incentive to succeed. A cultural rite of passage in the public education system in South Carolina is the "senior year off." Our students expect the senior year of high school to be one of no real academic challenges and rife with social interaction and fun. This is particularly true of students who earn a substantial portion of their high school credits prior to their senior year, completing or nearly completing the required 24 course credits for graduation. Students in this position face the opportunity to either continue in a rigorous course load by taking more advanced math and science in order to prepare them for the postsecondary world. They also have the option of taking a light course load their senior year, having earned the right to enjoy their last year of high school. Too many of our students pursue the latter option.

The “senior year off” presents the state with two problems. First, it sets our high school graduates up for failure when they enter the postsecondary world. By the time these students graduate, they conceivably could have gone an entire year without a math or science course, making it difficult for them to draw upon essential skills when they need them in the postsecondary world. The second problem the senior year off creates is an unnecessarily high cost to educate the student. Though students are participating in less valuable coursework their senior year, the cost to educate the student, averaging \$11,423 in the 2007-08 fiscal year, is still extracted from the taxpayers’ wallets.

Several states have found ways to address the lack of rigor in the senior year. Texas has implemented the Early High School Graduation Scholarship Program to reward students who finish high school before what would be the spring semester of their senior year. Under the program, students receive a scholarship based on the amount of time they spend in high school. The sooner they finish high school, the greater the scholarship they receive.

Texas Education Agency Early High School Graduation Scholarship	
Scholarship Amount	Requirements
\$3,000	<ul style="list-style-type: none"> ◆ Successfully complete the high school curriculum in 36 consecutive months (spring of their junior year) ◆ Graduate with at least 15 hours of college credit
\$2,000	<ul style="list-style-type: none"> ◆ Successfully complete the high school curriculum in 36 consecutive months (spring of their junior year)
\$1,500	<ul style="list-style-type: none"> ◆ Successfully complete the high school curriculum in 36-41 consecutive months (fall of their senior year) ◆ Graduate with at least 30 hours of college credit
\$500	<ul style="list-style-type: none"> ◆ Successfully complete the high school curriculum in 36-41 consecutive months (fall of their senior year)

In the 2005-06 school year more than 5,600 students took advantage of the Texas Early High School Graduation Scholarship.

Connecticut has introduced a similar proposal that would reward students who graduate early with a college scholarship equal to one third of the high school’s annual per-pupil cost, translating to a \$5,000 scholarship for the student and a \$10,000 rebate to property taxpayers, as well as to state income and sales taxpayers who subsidized secondary education. Total projected taxpayer savings from the Connecticut Early Graduation Program are projected to range between \$38.7 and \$193.3 million in annual cost savings, depending on the number of students who choose to take advantage of the Early Graduation Program. In addition to benefiting students and taxpayers, early high school graduation programs make college more affordable for parents and, if properly structured, lower the need for costly new school construction for school districts.

We propose introducing the Palmetto Early Graduation Reward Program for students who complete the required 24 credit hours prior to the spring semester of their senior year. Based on the Texas Early High School Scholarship Program, the Palmetto Early Graduation Reward Program offers an opportunity to reward students who master the required course of study in a shorter period of time than the traditional four-year program of study at the same time that it reduces the cost of education for taxpayers. By extending students' scholarships worth up to \$2,000 for postsecondary training or education, we provide students a real incentive to focus on their individual graduation plans early in their secondary education, with the hopes that working hard early can lead to an actual financial incentive when they finish high school.

School and district service consolidation. District consolidation is a concept that has been underway in South Carolina for some time. Since 1950, the number of school districts in South Carolina has declined from 1,220 to 85 school districts shared by 46 counties in 2006. Despite the reduction in the number of school districts, there remains wide variation in district size, ranging from more than 66,000 in Greenville down to less than 875 students in Dillon One. More than \$26 million in cost savings could be realized by simply consolidating smaller districts to a minimum size of 2,500 students through a reduction in administrative overhead. However, as is the case with many things in education, econometrics does not drive decisions. There are political, cultural, and social issues that impede efforts to consolidate districts further.

Expenditures on District and Program Management 2005		
School District	Enrollment	Per-pupil Expenditure
Dillon	913	\$374
Barnwell 19	946	\$685
Barnwell 29	981	\$302
Marion 7	984	\$457
McCormick	1,028	\$836
Bamberg 2	1,078	\$1,008
Richland 1	25,909	\$161
Berkeley	26,998	\$161
Horry	31,036	\$104
Charleston	43,161	\$287
Greenville	63,313	\$112
State Average		\$277

Legislative reforms. In 2005 the General Assembly ordered an evaluation of the size of school districts in South Carolina to make recommendations on district size that will allow more direct spending on teacher salary and instructional support. The School District Study Committee, created under proviso 1.82, issued its report in January 2006 in which it concluded that the school districts could realize a cost savings of more than \$21.1 million by consolidating management functions that occur at the school level, namely at the district and regional levels.

Achieving the savings issued by the Study Committee does not require drastic changes in services, nor does it require increased oversight on the part of the State Department of Education or the General Assembly. By simply requiring that districts limit per-pupil expenditures on District Management Level and the Program Management Levels to the lowest average expenditure for each county, the General Assembly can force districts to consolidate governance, consolidate services, or offset per-pupil expenditures on District and Program Management Level activities with local operating funding.

Unnecessary expenditures on district and program level management hamper the impact of the education investment made by South Carolina's taxpayers. However, politics and local preference have limited the ability or willingness of county delegations to tackle the awesome task of consolidating school districts within the areas that they represent. While we remain optimistic that financial and economic realities will cause more district consolidations, the fact remains that, until there is initiative to reduce the number of smaller districts in our state, districts must become more effective at reducing administrative costs where there is the opportunity to do so. Other states are already realizing the benefit of shared services in driving more of the educational dollar into the classroom.

- In 2002 in Wisconsin two districts joined to share a superintendent, splitting her \$120,000 salary.
- Dallas and Houston Independent school districts pooled their resources to increase buying power in purchasing health insurance and to reduce duplicative administrative overhead in procuring employee health benefits.
- Lawrence area Massachusetts school districts have banded together to provide special education services, saving them approximately \$13 million over the next two decades.
- By sharing one food service director, the Cornwall-Lebanon and Northern Lebanon school districts in Pennsylvania have benefited from an increased food service employee substitute pool. Additionally, sharing services turned the net loss of \$20,000 in the food service sector into a \$100,000 profit cash cow for the two districts, creating more stable working conditions and contributing to lower employee turnover rates in the two districts.
- Through cooperative purchasing Shared Services Program in Middlesex County, New Jersey contributed to a five percent savings on electricity for public buildings during the first year of the program by reducing costs on water/wastewater programs as well as the purchase of natural gas, electricity, equipment, services and supplies.
- Rural districts in Texas have reduced accounting costs by 50 percent per year by sharing the service provision of accounting and payroll services.

The promise of shared services lies in the fact that it combines the benefits of larger economies of scale with those of local control of mission-critical functions. Less critical functions such as food services, information technology, transportation, procurement, human resource functions and the gamut of other functions are centralized as shared services across districts or regional consortia. The mission-critical functions such as class assignments and instructional decisions remain at the local or site level.

Sharing services need not be limited to school districts. District offices may consider sharing services with other local, municipal, county, and regional agencies as well as private providers. The public schools and township in Northville, Michigan, are an example. Since the early 1980's, the Northville Parks and Recreation Department and the local Public Schools have engaged in a joint services contracts wherein the public schools allow the department to use their facilities to provide youth and senior citizen recreational services. The Lincoln Unified School District in Stockton, California, created a mutually beneficial contract with a private fitness center operator to build a facility on site at a newly planned school. Clients use the facility in the morning and evening – outside of school hours – granting the school access to the facility during the school day. In South Carolina, potential service partners include other districts, other schools, institutions of higher education, municipalities, nonprofits, and privately owned businesses. This concept was supported in the recently issued South Carolina Education Reform Council Report to the governor in which the Council recommended providing “a structure and regulatory authorization for districts and schools to readily share resources developed for school districts with other community organizations or businesses for their needs, when those resources are not being used by the school.”

We continue to support efforts to improve the return on our educational investment by increasing the percentage of the educational dollar that makes it into the classroom. Consequently, we propose the General Assembly eliminate unnecessary district and program level expenditures by establishing a state commission similar to the federal Base Re-alignment and Closure Commission (the BRAC Commission) to review district lines and to propose modifications to existing lines with the ultimate goal of consolidating districts, sharing services, or both, with particular focus being paid to districts that have enrollment levels below a commission-established minimum.

Creating a Seamless System of Education

South Carolina's education system fails to produce enough high school graduates to supply a work force that is ready for existing or potential business. A cursory glance would lead one to think that this is a high school problem; test scores, however, indicate that the problem begins in elementary school and culminates with our having the lowest high school completion rate in the nation.

Preparing more students for first grade. In 1999, the General Assembly was cutting edge in creating the South Carolina Office of First Steps to School Readiness. The enabling legislation that created the Office of First Steps identifies it as the only agency charged to ensure that all children reach school ready to learn. Legislative support for the Office of First Steps was reinforced with the reauthorization of the agency in 2006, extending its existence to 2013. However, the reauthorization failed to address a key issue limiting the ability of First Steps to fulfill its purpose: the governance over early childhood services is scattered between multiple agencies.

The Education Oversight Committee's *Results and Related Recommendations of the Inventory and Study of Four-Year-Old Kindergarten Programs in South Carolina*

issued eight recommendations for how to improve the state’s success at preparing all students for school. One recommendation addressing governance highlights the need for a single state agency to administer early childhood education services.

We propose consolidating early childhood education services into one office, the Office of First Steps to School Readiness, by transferring the services executed by the Office of Early Childhood Services currently housed in the State Department of Education. In so doing, we can eliminate the divided effort of coordinating early childhood services in the public and private sectors that currently has the two sectors reporting to different state agencies.

Preparing students for high school. Elementary schools need to become more effective at preparing students for secondary education. In the traditional sense, elementary education begins in third and ends in seventh grade. Over this time period, our students see a significant decline in their achievement levels.

2006 PACT Performance			
Percent of Students Scoring at or above Grade Level (proficient or advanced) on PACT			
	Grade 3 (in Percent)	Grade 8 (in Percent)	Change in Performance (in Percentage Points)
English Language Arts	54.6	25	29.6
Mathematics	34.9	22	12.9
Social Studies	37.8	22.9	14.9
Science	24.3	21.7	2.6

Given the fact that only half of students are proficient or advanced in any given subject while only 10 percent of students are retained, one can draw the conclusion that grade promotion is not connected to student mastery of important concepts. In the current system, a student can barely or altogether fail to master the material of a given grade yet still get promoted to the next level – promotion is not tied to performance on standardized assessments. To the extent that one grade builds upon another, the chances that a student poorly prepared in one grade will attain proficiency once promoted to a higher grade is highly unlikely. These students are being set up for failure.

There is no silver bullet for this problem. Generally speaking, elementary schools, particularly those with large numbers of students classified as being basic or below basic, need to be more effective at identifying the skills students lack and remediation of those skills. State support for formative testing can help address this issue by arming more teachers in high poverty schools with diagnostic information necessary to focus on the skills their students are lacking. Both the state and federal governments attempt to address this issue.

In FY 2004-05, the U.S. government provided nearly \$100 million for supplemental services to students in schools that failed to meet Adequate Yearly Progress under based on the federal No Child Left Behind regulations. Of the student population eligible for these funds, only four percent took advantage of the services. The low participation rate stems from a lack of knowledge about the supplemental service provided under NCLB as well as the tendency for parents to make the convenient decision not to participate in such programs. Another limiting factor is the fact that in order to provide supplemental services to students, failing schools would have to shift Title I funding away from other programs, reducing the incentive for school leaders to ensure that parents take advantage of the provision. Schools are also limited by the funding level in that the amount of funding allocated for a student needing supplemental services may not cover the costs of receiving high-quality, private-sector tutoring for the course of the year or semester. Parents that work in the afternoons conveniently choose the lower-quality, school-based program that may last the entire year or semester over the higher-quality, private-sector service.

During the FY 2004-05, South Carolina has committed nearly \$120 million in state resources to the elementary and secondary schools that have low student performance levels. These funds support Teacher Specialists on Site, Principal Specialists on Site, Summer School programming, External Review Teams, and School Level Grants, all of which have failed to demonstrate the ability to raise student achievement in low-performing schools.

Combined, these state and federal efforts could lead to excellent opportunities for students in these low-performing schools. We propose refocusing Education Accountability Act technical assistance funding to providing incentives for schools to take advantage of private-sector supplemental-service providers, particularly those providers who have a long-standing history of quickly raising student achievement. We believe that by providing schools the flexibility to combine state-level technical assistance with federal funding for supplemental service, we can increase the likelihood that schools can overcome the barriers that have limited the emergence of high-quality partnerships.

Conclusion

Our education proposals reflect a simple goal of providing options for students in South Carolina to get the best possible education they can. We accomplish this goal through a combination of funding education at the front lines and reforming the system for better results. In a number of other states, reform initiatives are offering more and better education options to parents. As of this year, the Bill and Melinda Gates Foundation has contributed more than \$3 billion to small school initiatives across the country.

According to a study released by the foundation, students in small schools in New York had higher graduation rates than their peers in larger schools. Students in small schools in Chicago had a dropout rate one-third lower than students attending big schools. We have made progress over the last five years on some measurements of education, but we

still lag in many others. With the growth of more education choices in other states, we cannot afford to simply rely on incremental change to impact our competitiveness both nationally and internationally. We should stop aiming to get out of the bottom of the list and start aiming to get to the top of the list. We believe these initiatives offer that transformational opportunity to succeed.

Emphasize Economic Development

Emphasize Economic Development

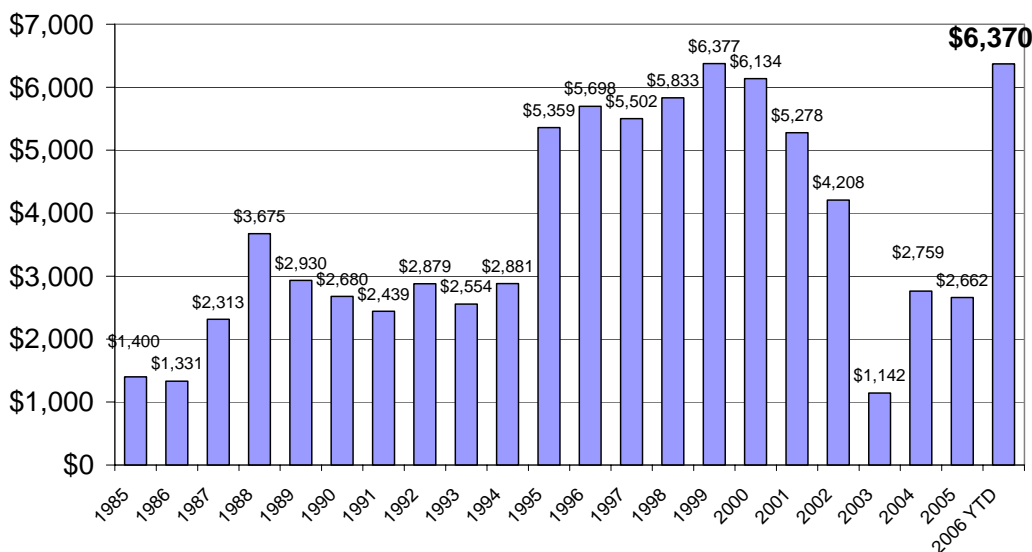
I was in Bangalore, India, the Silicon Valley of India, when I realized that the world was flat.

— **Thomas Friedman**

The above quote shows the reality that we are no longer just in direct competition with our neighboring states but now with other nations in a way never imagined before.

Despite mounting competition from all over the world, South Carolina continues to create an economic climate that attracts new businesses and allows existing ones to thrive and grow. In fact, South Carolina was named America's Most Business Friendly State by a nationally renowned corporate site relocation publication. The publication stated, "From A to Z, South Carolina understands economic development and is clearly making the effort to continue its attractiveness to business. When it comes to economic development, it is a state that other states should emulate." This speaks volumes to the efforts of this administration and our Department of Commerce and has translated into high levels of capital investments throughout the state. To this end, South Carolina is on track for its most promising year ever on this front – recruiting over \$6 billion in capital investments year-to-date.

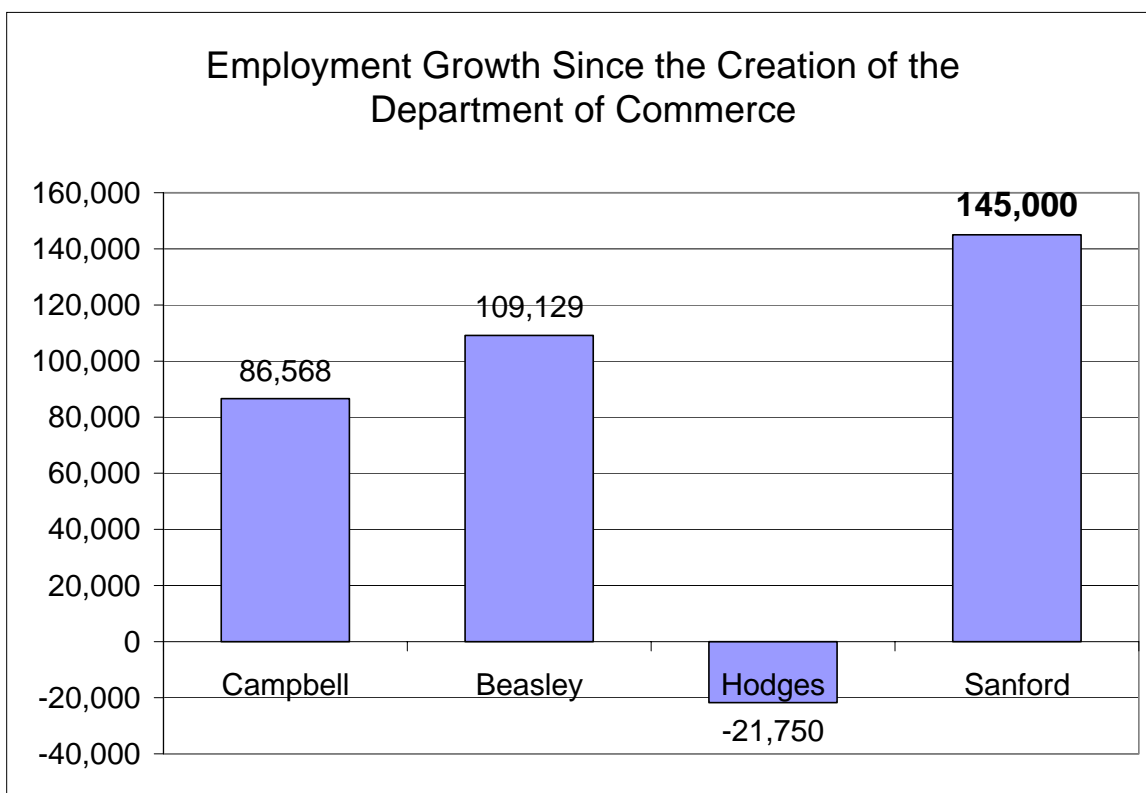
South Carolina Capital Investments (on pace for our best year)- in millions



At the same time, the Department of Commerce is recruiting companies that pay more. Of the over 12,000 new jobs recruited by Commerce last year, they paid an average

salary of \$39,283 or 39 percent higher than South Carolina's average of \$28,212. This is a direct indicator that we are recruiting the right kinds of companies and shows that our state is moving in the right direction in growing our economy.

It goes without saying that bringing new industries into the state leads to new jobs, and that is exactly what is happening in our state. According to the Bureau of Labor Statistics (BLS), South Carolina has 145,000 more people working now than in January 2003. Stacking this up against previous administrations also shows that our focus on economic growth leads to greater results in job creation.

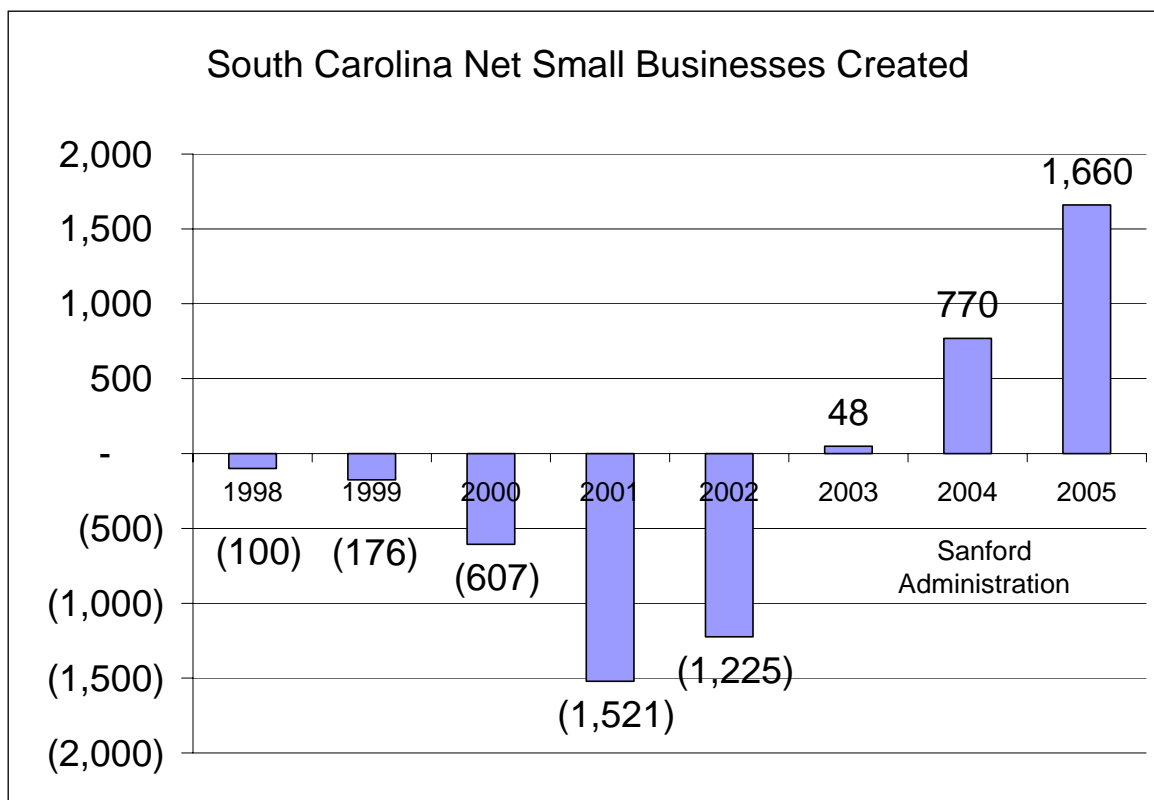


Entrepreneurs and their small enterprises are responsible for almost all the economic growth in the United States.

— **Ronald Reagan**

Many of these jobs are created by the very backbone of our economy – small businesses. With over 97 percent of all businesses being small businesses, this administration has always realized the importance of this community and from our constant push for income tax relief, we were able to reduce South Carolina's income tax rate from seven percent to five percent for all small businesses – making them more competitive,

stimulating economic activity, attracting capital investment and, most importantly, creating new jobs. This focus on small businesses is paying off. In each of the five years prior to this administration, more businesses were closing than were being created, with over 3,500 more businesses shutting their doors. But in each of the past three years, more businesses have been created than lost – with over 2,500 more businesses opening than closing.

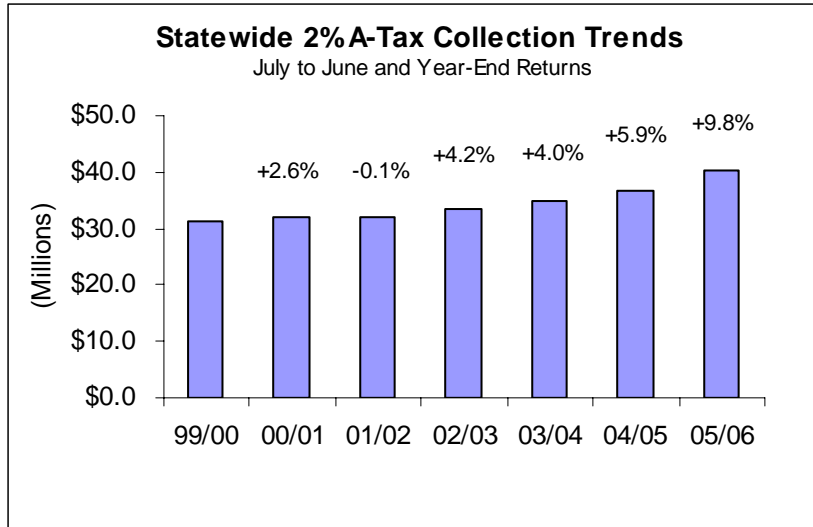


Tourism

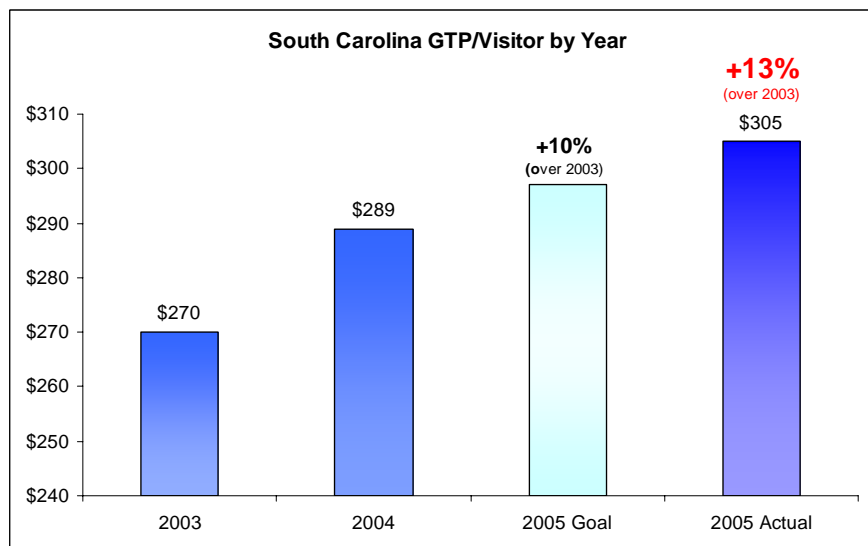
Tourism in our state generates 216,000 jobs or 10 percent of the entire work force. As an economic driver, tourism brings new dollars into the state’s economy rather than recycling existing dollars. Our Parks, Recreation, and Tourism Department does a great job on this front and helps create many jobs for citizens across the state. When talking about economic development in South Carolina, tourism is at its core – once again is the leading industry in our state.

Each year over 32 million people take trips in South Carolina and represent nine percent of our total Gross State Product or \$14.6 billion. In fact, when looking into the details of this overwhelming number, the tourism industry is only getting better. Last year, South Carolina had its highest level of hotel occupancy in the past six years – directly seen in an accommodations tax revenue increase of almost 10 percent from 2005.

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This administration continues to focus its finite tourism resources in areas that have the greatest impact. Promoting South Carolina’s assets through effective marketing techniques is critical to attracting visitors. In the past two budgets, PRT has realized an 18 percent increase in their marketing dollars from FY 2003-04 to FY 2005-06. Therefore, whether it is informing outsiders in England about Charleston, or making folks in Georgia aware of the 46 state parks, publicizing the South Carolina brand brings visitors into our state who, in turn, spend money. PRT continues to improve in this area. Gross Tourism Product (GTP) per visitor measures how much value or wealth each out-of-state visitor contributes to our economy. In 2003, GTP per visitor was \$270 but working together with its industry partners, PRT has helped raise South Carolina’s GTP per visitor to \$305 – or 13 percent higher than in 2003. The resulting fiscal impact on state and local tax revenues was an additional \$85 million.



EMPHASIZE ECONOMIC DEVELOPMENT

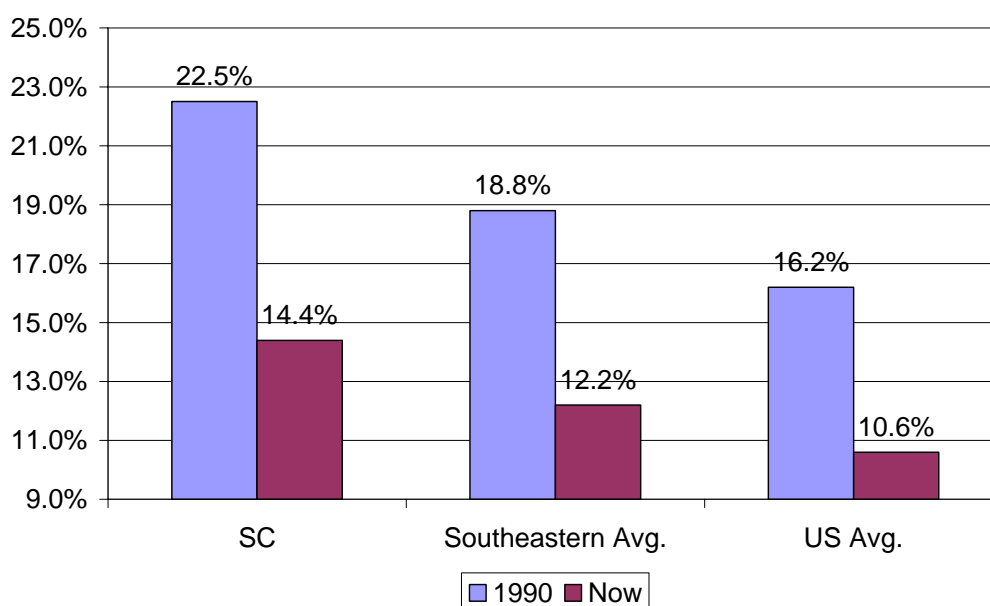
So, whether it is building on the number one industry in this state or recruiting additional capital investments, this administration continues to move further and further ahead in laying the ground work for a prosperous economy. That is why we are proud to say that in addition to income tax relief for small businesses, we have also made advances in the business community by passing the first ever tort reform bill and reducing the amount of government regulations imposed on small businesses. All of these things of course take us closer to being a more competitive state in creating new jobs, raising income levels and spurring economic growth throughout South Carolina.

However, Thomas Friedman states, “If you are going to deal with a system as complex and brutal as globalization, and prosper within it, you need a strategy for how to choose prosperity for your country.” If we want to accomplish this goal for South Carolina and carry on the positive trends that have already occurred, it is vital we recognize the outlying factors that are affecting us so that changes can continue to be made in our business development strategy.

Changes for More Job Creation

For past generations, our manufacturing sector has been the backbone of the national and South Carolina economy. Manufacturing jobs built the foundation that allowed thousands of families to live the American Dream. But it is important to note that South Carolina throughout the century has been more heavily entrenched by this sector than the rest of its neighbors and the nation. Going back to only 1990, this point is clearly shown when 22.5 percent of the work force was in manufacturing – 3.7 percent above the Southeastern average and 6.3 percent above the national.

Manufacturing Jobs as Percentage of Total Jobs in 1990 vs. Now



While we continue to aggressively recruit quality manufacturing companies, the fact is market forces in countries like China and India are competing at a higher level than ever before. This naturally is going to have a greater effect on a state that starts out with an economy more dependent on the manufacturing sector. But even as we fight this battle with other states and countries around the world, our focus remains on recruiting good companies with good jobs.

Recognizing the global economic revolution that was quietly taking place, this administration, along with other economic development stakeholders around the state, formed the Council on Competitiveness. Now business and political leaders are rallying around one critical goal – learning to compete in the global economy and raising the income level for all South Carolinians. Over the past four years, this administration has made this a top priority.

First, this group was able to identify a number of the state's strengths and weaknesses. The strengths recognized some of our long-standing selling points, such as the port and our technical college system, whereas the weaknesses identified the need for a stronger education system, a top-tier research university, a more-friendly environment for start-ups and small firms, and a defined network of industry clustering. Many people in the business community realized the benefits from these ideas and joined us in pressing for more educational choices, sought to implement a university governance structure, intensified our focus on small business, and embraced the concept of clustering in our recruiting strategy. Many of our policy decisions continue to be based on this very notion.

In a broader sense, we have discovered that we have to create an overall competitive economic environment that focuses on our strengths and existing framework for business. In fact, if you look at the proposals we have pushed for and passed as an administration, they revolve around the notion of broad based changes. Our proposal to reduce the income tax rate for all taxpayers led to the first significant income tax cut ever for the small business community. We passed a tort reform bill that allows us to have a more equitable civil justice system here in South Carolina.

By cultivating the economic soil conditions in the state and focusing on the principals of sustainable economic development, we can show companies all across the globe (including those already here) the benefits of locating and growing in South Carolina. In order to do this, all stakeholders in economic development must come together to rethink many ways we do business and recognize the benefits of the following reforms.

Tax cuts for a stronger economy. Recognizing the administration's long-standing position on the current tax rate for small business, the General Assembly rightfully sought to decrease the tax burden on small business during the 2005 legislative session. Effectively, we reduced the income tax rate paid by S-corporations, LLCs, and sole proprietors from seven percent to five percent over a four-year period. When fully implemented, this reduction will put nearly \$124 million each year back into the hands

of small-business owners. While this is a great step in the direction of tax relief, we continue to believe more needs to be done.

We once again have an excellent opportunity to provide income tax relief for all South Carolinians. Our proposal ultimately calls for an income tax reduction totaling \$205 million. By holding spending increases to population plus inflation, our budget is able to set aside \$98 million to be returned to taxpayers on an annual basis. Additionally, our budget proposes a cigarette tax increase of 30 cents per pack that would generate \$107 million yearly.

With the excess revenue, we could reduce taxes in a variety of ways: (1) indexation of brackets, (2) lowering of the top marginal rate from 7 to 6.5 percent, (3) lowering of small business and corporate tax rates in a number of ways, and (4) any combination of these. The overarching goal with any tax plan is to have the greatest positive effect on increasing investment and creating jobs throughout the state. **We are ultimately proposing to return \$205 million in excess tax revenue to ease the of burden taxpayers around the state.**

Workers' Compensation. A top priority for this administration is to find new ways to improve the conditions for running a business. As businesses have been faced with alarming increases to premiums tied to compensating employees who are injured on the job, the need to reform our current workers' compensation system falls into this category. This problem was never more evident than when the National Council on Compensation Insurance proposed a 33 percent overall rate increase for the upcoming year.

Fortunately, a recent ruling by a state administrative law judge will impose a lower average of 18.4 percent increase in workers' compensation insurance premiums for the year. However, there still are problems that speak to the need of reform.

In 2002, South Carolina ranked 42nd in the nation in workers' compensation premium rates at \$1.82 per \$100.00 of payroll – up from 49th in 2000. In 2004, national premium rates ranged from a low of \$1.06 in North Dakota to a high of \$6.08 in California. South Carolina rose from 42nd to 39th with a premium rate of \$2.08 per \$100.00 in payroll. Even more alarming are the numbers from the most recent ranking. Currently, South Carolina has the 25th highest premium in the nation – jumping 14 spots in just two years.

2006 Ranking	2004 Ranking	2002 Ranking	2000 Ranking	State
1	2	15	28	Alaska
2	1	1	3	California
3	7	4	16	Delaware
4	6	16	24	Kentucky
5	8	10	12	Montana
6	3	2	1	Florida

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7	17	25	33	Vermont
8	13	8	19	Maine
9	19	12	18	Alabama
10	18	9	6	New York
11	9	7	2	Louisiana
12	5	14	9	Ohio
13	15	19	11	Oklahoma
14	11	13	17	Connecticut
15	4	3	8	Hawaii
16	10	17	10	District of Columbia
17	14	5	7	Texas
18	20	23	25	Pennsylvania
19	12	18	20	New Hampshire
20	23	20	15	Illinois
21	21	22	22	Minnesota
22	16	6	4	Rhode Island
23	29	31	27	New Jersey
24	22	26	26	Missouri
25	39	42	49	South Carolina
26	25	29	31	Tennessee
27	27	36	42	New Mexico
28	28	38	39	Wyoming
29	31	23	14	Colorado
30	26	11	5	Nevada
31	36	33	30	Mississippi
32	24	27	29	Idaho
33	38	39	45	Nebraska
34	24	24	13	West Virginia
35	33	32	32	Wisconsin
36	35	45	38	Washington
37	32	24	42	North Carolina
38	46	44	47	Utah
39	30	30	23	Michigan
40	40	40	46	Maryland
41	37	28	21	Georgia
42	42	35	34	Oregon
43	44	41	48	Kansas
44	41	48	44	South Dakota
45	43	43	41	Iowa
46	49	46	37	Arizona
47	45	37	36	Massachusetts
48	48	47	40	Arkansas
49	47	49	51	Virginia
50	50	50	50	Indiana
51	51	51	35	North Dakota

It is important to point out this is not an insurance problem. This, instead, presents a problem for our business community – a problem that is becoming too costly. We believe workers’ compensation is the single largest threat to business and economic development in our state. The rising cost of workers’ compensation limits a company’s ability to hire new employees, or give raises to their current employees. These rising rates are also passed along to the consumer through higher prices on goods. Therefore, in July 2005, we appointed a Workers’ Compensation Task Force to examine the rising

EMPHASIZE ECONOMIC DEVELOPMENT

premiums, current laws, the existing claims and appeals process, and to make recommendations for improvements in the overall workers' compensation system.

Reforming the System

Reforming the current system to create an efficient forum to serve our state's injured workers would have a positive impact on both the injured worker and the employer. The Task Force recognized this and recommended five reforms. We support reforms that will relieve the upward pressure on premiums without undermining the core purpose of workers' compensation. We commend the House last year for passing a workers' compensation reform bill containing many of these recommendations but believe one critical component was left out – the adoption of more objective standards when reviewing a case. We strongly urge both the House and Senate to adopt this policy change. We recognize that “fixing” the workers' compensation system in South Carolina is an extensive undertaking and one that would require more research and attention than could be given in one legislative session, but feel strongly that significant reforms can and should begin now. The following are details of the five core recommendations that we believe are critical to successful reform – including the adoption of more objective standards.

1. Dissolve the Second Injury Fund

Last year carriers and self-insurers were facing skyrocketing assessments from the Second Injury Fund. These assessments had continually risen over the last few years, and businesses were facing more than 100 percent increase in the assessment last year.

As claims coming into the system have currently slowed, short-term stability in the fund has provided for a more workable system. However, to protect against the alarming premium increase from the past, we continue to believe that the time has come for the orderly dissolution of the Second Injury Fund.

Dissolving the Fund in no way prevents an injured claimant from collecting benefits they deserve; the fund reimburses employers or their insurers for workers' compensation payments to workers with pre-existing conditions who experience a subsequent injury. We need to simply level the playing field for businesses in South Carolina if we want to continue to compete in a global economy. Since 1992, seventeen states have abolished their Second Injury Funds.

Alabama	Kansas	Oklahoma
Colorado	Kentucky	Rhode Island
Connecticut	Maine	South Dakota
D.C.	Minnesota	Utah
Florida	Nebraska	Vermont
Georgia	New Mexico	

Employers know that the costs for the fund greatly outweigh any potential benefit received and that the fund has outlived its usefulness. Payments to employers from the fund are being driven up not only by increasing wages and medical costs, but also by a dramatic increase in claims accepted by the fund. When added to the proposed double-digit workers' compensation premium increase, these costs hurt the bottom line of both large and small businesses. Payments into the fund threaten the business climate by taking money away from activities like job creation. Two years ago 98 percent of companies that contributed to the Fund received no reimbursements. This means that small businesses that have fewer accidents and companies that do not have the resources to manage the paperwork and administrative hurdles associated with processing reimbursements contribute far more than they will ever recover from the Fund. The orderly dissolution of the Second Injury Fund is a positive step in the direction emphasizing this administration's commitment to a healthy business climate.

2. *Reform of the Workers' Compensation Commission*

The actual structure of the Workers' compensation Commission currently consists of seven commissioners appointed by the governor who serve six-year terms. The chair holds no more authority than any of the other members of the Commission. In addition, members held over will more than likely demonstrate the same philosophical belief as that of the previous administration when determining the outcome of specific cases.

Bottom line, there is no consistency of awards by commissioners, no objective standards upon which disability determinations are made. Objective standards should be developed to limit the discretion of the Commission in making awards, and mediation should be encouraged. The Task Force recommends that in order to obtain standards, the Commission should use the American Medical Association or other professional guidelines to establish awards.

3. *Restrict Repetitive Trauma Claims*

Court cases and Commission decisions have liberalized and expanded the definition of "accident" to include conditions that are the natural result of the aging process. Additionally, the requirement that an "accident" be identifiable to a time and place of occurrence has been eliminated, and there is no statute of limitations for bringing these claims. As a result, the workers' compensation system is absorbing costs for claims never contemplated for conditions experienced by the general public in the course of the normal activities of day-to-day life. The definition of "accident" should be restored to its original and intended purpose, and repetitive trauma injuries should be subject to objective standards that permit apportionment for non-occupational causes.

4. ***Reversing Decisions Made in Tiller vs. National Health Care***

This case allows non-expert testimony (i.e., that of the injured worker) concerning a medical condition. In other words, the testimony of the injured worker is allowed to trump that of an expert doctor during the decision making of the Commission. It goes without saying that this results in inappropriate and excessive awards that drive up the overall costs of the workers' compensation system.

5. ***Reversing Decision made in Brown vs. Bi-Lo***

The court held that communication between health care providers and a carrier, employer, or their representatives may only occur by written reports. This ruling complicates efforts by the employer to obtain information indicating when an employee is ready to return to work. Legislation is needed that allows doctors to communicate with either side in a workers' compensation case without fear of being sued by the patient for breach of patient-physician confidentiality.

Broad-Based Incentives

There are many tax incentives that serve due diligence in our efforts to recruit quality businesses to South Carolina. Some of these incentives are at the core of many business proposals put together by our Department of Commerce – which, at the end of the day, leads to large capital investments and the creation of high-paying jobs.

This past session there were numerous bills containing incentives carved out for one business or one particular area of the state: 1) granting Orangeburg County an unfair increase in their job tax credit amount from \$3,500 to \$8,000; or 2) making it easier to qualify for the job tax credit for service related businesses in the wealthier parts of the state.

But one incentive was so egregious that it clearly showed it was time to analyze all incentives that no longer serve their purpose. The unprecedented incentives were carved out for one particular retailer – Cabela's. The Cabela's incentive package allowed them to qualify for the job tax credit for the first time in this area of the state and allowed them to be rebated a possible 50 percent of their sales tax revenue for reinvestment in their infrastructure. Creating incentives for only one retail facility and asking the thousands of other retailers across the state to subsidize these incentives – while receiving none – is bad policy.

The special incentives opened the door for a long overdue discussion. We are heading down the wrong path by adding incentives to our tax code that are carved out for only one area of the state or for one business that might come to our state. This arrangement has gotten us further away from being globally competitive by not looking at more ways to create a tax structure composed of incentives that will broadly help all of South Carolina. The Department of Commerce has been tasked with looking at, before the beginning of next session, the reporting the current tax incentives that no longer serve

their purpose. We look forward to these recommendations and encourage the General Assembly to adopt them so that South Carolina can continue to compete at a high level.

Improving the economic soil conditions of our state so that we may better compete in the ever-changing global marketplace is always a priority of this administration. We believe these changes and others move us one step closer in being truly competitive and bettering the standard of living for all of our citizens. We look forward to working with you and other members of the General Assembly on this front.

Meet the Health Care Challenge

Meet the Health Care Challenge

[T]he market forces that have reshaped the rest of the economy are almost completely absent from health care. Patients have little incentive to look for a better deal. Whereas in a functioning market, information is readily available (think of shopping for a hotel room in New York City), the health care market remains a black box (now think about trying to find a hospital with the best outcomes for hip replacements).

— Dr. David Gratzner, Manhattan Institute

The companies that are most successful in stemming medical inflation tend to combine consumer-driven plans with other strategies like pay-for-performance, wellness or health improvement programs, health risk appraisals, claims analysis, purchasing coalitions, nurse help lines and giving workers provider cost information. In fact, the best performers experienced an average two-year premium increase of 3%, versus 11.5% for the poor performers.

— Leah Carlson Shephard, *careerjournal.com*, June 16, 2006

Health care encompasses more than a third of the entire state budget and greatly impacts the quality of life in South Carolina. Dealing with the rising cost of health care is one of the biggest challenges we face in preparing this budget.

The Past Year

We had several successes in the last year that will have a positive effect on the health of our citizens.

- If we improve the quality of our diet and exercise, we will get better results in the form of lower rates of chronic diseases. With that in mind, we launched the Healthy South Carolina Challenge, inviting counties across the state to engage in friendly competition on improving their physical activity rates, improving their body-mass index, and getting more people to quit smoking. The citizens of Darlington County won a trip to the Governor's Mansion for showing the most overall improvement, but the real winners were the citizens

of the state who took advantage of the opportunity to improve their health.

- Often, lifelong habits are formed in childhood. With that thought in mind, we began implementing the newly passed comprehensive physical education bill to help children become more physically active.
- Working with the administration, the Department of Health and Human Services put together our “South Carolina Healthy Connections” Medicaid transformation plan that was used as one of the models for Congress’ historic Health Opportunity Accounts provision in the Deficit Reduction Act.
- To help bring down the cost of prescription drugs for Medicaid patients, DHHS is combining its negotiating power with ten other states in a National Medicaid Pooling Initiative. Replacing the current one-state only contracts with NMPI contracts will save an estimated additional \$1.4 million in general fund dollars with no change in the state’s current Preferred Drug List.

While these successes are a step in the right direction, several challenges remain. South Carolina currently spends too little attention to investing in our health on the front end through prevention efforts, which leads to more health care dollars being spent on expensive trips to the emergency room and institutional care on the back end. We also scatter scarce Medicaid dollars over too many state agencies. Health care funding is a finite resource; money wasted on unnecessary administrative burdens or inefficient care is money taken away from important services for other citizens. We can and must do better.

Prevention

According to the Center for Disease Control and Prevention, “Three modifiable health-damaging behaviors – tobacco use, lack of physical activity, and poor eating habits – are responsible for much of the inordinate suffering and early death of millions of Americans. In fact, approximately 33 percent of all deaths (about 800,000 deaths) in the United States can be attributed to these behaviors.”

South Carolina has moved from 9th in smoking rates to 15th. However, there is still much room for improvement. Our smoking rate correlates closely to our being 14th in prevalence of lung cancer. Being 12th in the nation in adults who engage in no physical activity likely has something to do with our being tied for sixth in obesity. Stroke and diabetes are partially caused by a poor diet. A recent study found that 82 percent of men, 71 percent of women, and 83 percent of high school students in South Carolina eat fewer than five servings of fruits and vegetables per day. This likely contributes to our being second in stroke death and fifth in prevalence of diabetes. With this in mind, this administration will continue to encourage our citizens to make healthier choices in their day-to-day lives and thereby work to reduce the rate of health care spending.

Smoking cessation. State government is one of the largest employers in the state. We believe it ought to use the same best practices being used by other employers to improve the productivity and quality of life of their workers in controlling health costs. For example, many private programs are offering smoking cessation programs with premium incentives because it makes good business sense. Healthier workers are more productive workers. In August 2005, the Budget and Control Board voted to include smoking cessation as part of the State Employee Insurance Program, and the program began on January 1. It is our hope that a good number of our employees who smoke will take advantage of the new program. The original results are encouraging: through June 2006, 1,655 Plan participants have enrolled in the program. Eighty-nine percent of the participants attempted to quit tobacco with 49 percent of those participants actually quitting tobacco use.

In 2008, premiums could increase by approximately ten dollars per month. However, to encourage use of this new program, we propose that non-smoking employees, including those who complete a smoking cessation program and remain off tobacco afterwards, have their monthly premiums frozen for the third straight year. According to the Center for Disease Control, the health benefits of quitting smoking are numerous, and many are experienced quickly. Within months, coughing and other respiratory symptoms decrease and lung function increases. One year after quitting, excess risk for heart disease is reduced by half. The chance to have their monthly premiums frozen for another year is another incentive that we hope will encourage more of our employees to make a healthy choice regarding tobacco use.

State employee health risk assessment. Smoking cessation programs are only one tool that private businesses are using to control health care costs and improve the health of their workers.

For example, from 1990-2001, Union Pacific Railroad was able to reduce health-related costs due to lifestyle factors from 29 percent of their expenses to 18 percent of their expenses. This translated into \$53.6 million in annual savings. But for an employer to know what types of incentives and programs will best improve employee health, that employer needs a baseline understanding of the overall wellness and risk factors of the employees.

States like Arkansas and South Dakota have already begun giving health risk assessments to their employees. Our state employee health plan provider is introducing an online health risk assessment in 2007 to help members better evaluate their current wellness and receive feedback with suggestions to improve their health. We think this is a positive step toward empowering people to take more ownership of their personal health.

Association Health Plans

We support making health care more available by making insurance more affordable. One option is to allow small businesses to group together in purchasing pools for additional buying power when dealing with the insurance companies.

In 2003, the Governor’s Economic Development Task Force recommended that the state government, “Allow small business owners to qualify for and unite as a large group in order to obtain coverage at affordable rates. One of the biggest issues for small businesses is the high cost of health insurance premiums and lack of coverage (i.e., Associated Health Plan or State-Supported Insurance Company).” The recent Republican-controlled Congress tried but was unable to enact needed association health plan legislation on the federal level, and the new Democratic-controlled Congress is unlikely to even attempt it. Therefore, in the short term, meaningful health insurance reform for South Carolina’s small business employees is going to need to happen at the state level. We believe the most prudent path toward that end is to pass legislation authorizing small businesses to join together in purchasing pools for the purpose of buying employee health insurance through an association health plan.

The idea behind this is that by grouping together, small employers can gain the buying power of large companies. These cooperatives could be considered “self-insured” and thus, fall under federal ERISA laws, rather than state insurance mandates. The benefit of this approach would be two-fold: First, placing fewer mandates on coverage will lower the price of coverage, putting the cost of health insurance coverage within reach for more small companies. Second, it would open up the opportunity for small companies to be able to purchase health insurance across state lines. This would inject more competition into the insurance market, further reining in insurance costs.

Making Medicaid Better

South Carolina Healthy Connections reform plan. Across the nation and here at home, Medicaid is consuming an ever-increasing portion of state budgets. In 2000, \$1 out of every \$7 that South Carolina spent went toward Medicaid. This year, it was \$1 out of every \$5 spent. A decade from now, \$1 out of every \$3 we spend will go toward Medicaid. This brings us to the central question before us – with rapidly increasing costs, how do we continue to provide health care for some of our state’s neediest citizens? Do we simply cut people from Medicaid rolls like other states have done? Or do we make cuts to other critical state services like education and law enforcement?

Given those two options, we have chosen to instead take a third path – stop administering Medicaid as a one-size-fits all program, give individuals a choice in their health care plans, and empower them to pick the plan that best suits their needs. Doing this will ensure better health care outcomes, and at the same time help rein in the cost of a program that before long will be growing at a rate faster than new government revenue.

Our plan will provide a range of options for Medicaid recipients. One choice would be a pre-paid plan, something already offered by many private sector employers, and which a recent Harvard study found effective in reducing racial disparities in most areas measured. Second, Medicaid recipients could choose a medical home network, which would let them begin a relationship with a family physician. Third, we could help a recipient buy into his or her employer's health care plan. Finally, some recipients could get a health care account that could be used to directly pay for health care services.

We are pursuing this reform with a couple of things in mind. First, we believe tailoring Medicaid benefits to the patient will improve the quality of patient care. *Governing* magazine (basically a non-partisan trade journal for state governments) ranks South Carolina fourth in the nation in state and local spending on health and hospitals. The United Health Foundation now ranks South Carolina tenth in the nation in public health care spending, yet we rank only 48th in the health of our citizens. This is due in large part to Medicaid recipients not having a regular primary care doctor who knows them and understands their needs. Medicaid clients visit the emergency room 66 percent more often than other South Carolinians. Emergency room care is both much more expensive and far less personal than seeing a family doctor.

Second, we believe that our plan will rein in costs. Better results and lower costs have been achieved in other states where Medicaid recipients have been empowered with choices. In 1998, Arkansas started a program to give consumer-directed benefits to Medicaid disability patients. Five years later, an audit showed clients were more satisfied with their caregivers, that there was a decrease in unmet needs, and that caregiver neglect dropped by 38 percent. In Colorado, another pilot program allowed disabled Medicaid clients to hire and fire their own caregivers. Quality of care and patient satisfaction are up, and costs have decreased. Colorado plans to expand its plan to 33,000 Medicaid recipients statewide in 2006.

Medicaid is growing at an unsustainable rate, and unless change is made the state is going to be forced to cut benefits and beneficiaries down the road. By reforming the system now, we can both improve the services Medicaid recipients are getting, and put the growth of Medicaid spending on a more stable and sustainable path. Both recipients and taxpayers will benefit from a more results-oriented Medicaid program that provides the quality and responsiveness recipients need and the efficiency taxpayers deserve.

Electronic medical records. Physicians can provide better care and more effective preventive and ameliorative care if they can readily access information about the medical condition and history of a patient.

But while the past two decades have seen tremendous strides in medical science, and other areas of commerce have dramatically improved their information technology, the recordkeeping method of choice in many hospitals and doctors' offices is still pen and clipboard. Electronic medical records systems (EMR) are typically expensive, vendor based and not compatible with each other. In order to provide assistance to physicians who treat Medicaid beneficiaries, South Carolina is developing access to an electronic

medical records system based on its data maintained by the State Division of Research and Statistics. The EMR will provide information on all services provided including diagnosis as well as the ability for the physician to add information about health status and laboratory results. Information will be accessible when beneficiaries present to hospital emergency rooms to support comprehensive informed care. Because the state will provide the EMR format and access, the EMR system will be compatible across all providers, free to providers and generated through a system that will be continuously enhanced and, therefore, avoid the pitfalls of independent systems that quickly become obsolete.

Quality rating system. Our Department of Health and Human Services is establishing a quality rating system for Medicaid providers and plans. This will provide the information necessary for Medicaid beneficiaries to make informed decisions about which plans and providers to select to best meet their individual needs. It will also inform the providers about their relative status in ranking.

Providers who score well in the rating system are not only likely to attract more business, but may see financial rewards in the form of slightly higher reimbursement rates in the areas in which they excel. This “report card” system will serve as an incentive for plans and providers to offer services that beneficiaries need and to provide the type of personal, preventative health care that is better for the patient and more cost-effective for the state.

Health and Human Services Agency Restructuring

In September 2006, South Carolina recently won a million-dollar federal grant award for a new initiative to better recognize, diagnose, and treat adults with co-occurring mental health and substance abuse disorders. While in and of itself this is good news, it points to the real need to reorganize our government in a manner that better serves our citizens. National data suggest that a significant percentage of clients receiving either mental health or substance abuse services have co-occurring disorders; South Carolina data show that these co-occurring disorders are often not diagnosed and treated. Part of the underlying problem is that the people responsible for mental health and those for substance abuse are housed in different agencies miles away from each other with different chains of command. In the same manner, people with serious chronic illnesses like cancer or kidney disease often suffer from depression. People that are developmentally disabled often have both mental and physical challenges.

Our largest obstacle to improving health care in South Carolina continues to be the fractured health care system we have within state government. Currently, we have five separate government agencies, answering to four different authorities, providing health services. Many of the programs and services in these agencies overlap in functions and lack coordination. In addition, the administrative burden of operating those agencies takes dollars away from frontline services – providing expedient and adequate care and protection to the patient. In our restructuring proposal, we intend to overhaul the health care agencies into two separate cabinet-level agencies:

1. The Department of Health Services, to provide coordinated health service to clients, and
2. The Department of Health Oversight and Finance, which would act as the single point of contact with the federal government and with patients, and would monitor the quality of services being provided by the Department of Health Services.

Though a much larger restructuring bill is key to improving the accountability within state government, this administration strongly supports restructuring the state's health care and human services agencies. Our Health Care Restructuring Plan is discussed in greater detail in the "Innovative Government" section of our budget.

Improve K-12 Student Performance

Improve K-12 Student Performance

The bottom line of education is student performance. It is the measure by which all activities should be measured. As a business tests every investment against its ability to raise profit per unit, we must evaluate the ability of each activity to raise student achievement for every dollar invested.

Investing in high-yield activities is essential to our education system's ability to meet the challenge of preparing today's students to compete for business and against business on every corner of the globe. Thinking as a business, we have established five goals that are accomplished through the activities we purchase in our budget: increase the high school completion rate; increase participation and achievement in rigorous courses; raise the national performance ranking of South Carolina's students on the SAT and ACT; eliminate the achievement gap on NAEP, PACT, SAT, and ACT; and improve the efficiency with which education dollars are spent.

Governor Sanford's Goals for **Improving K-12 Student Performance** are to:

- ✓ Increase the high school completion rate.
- ✓ Increase student participation, completion, and achievement in Advanced Placement, International Baccalaureate, and dual enrollment courses.
- ✓ Raise the national performance ranking of South Carolina's students on the SAT, ACT, and NAEP.
- ✓ Eliminate the achievement gap of all students on NAEP, PACT, SAT, and ACT.
- ✓ Improve the efficiency with which education dollars are spent.

Increase the high school completion rate. South Carolina's education system needs to become more effective at getting its students through high school. From an investment perspective, the more students either fail to complete high school or take longer than four years to do so, the lower the yield on the educational investment made by taxpayers. Our goal is to increase the percentage of entering high school freshmen who complete the 24 credits required for high school graduation in less than or equal to eight semesters.

In our budget, we invest in activities that increase the likelihood that students enter high school ready for the course of study and complete their study four years later. We measure progress toward this goal by tracking high school dropout rates for grades eight through twelve. We also measure the proportion of students enrolled in ninth grade relative to those enrolled in grades ten through twelve.

Increase student participation, completion, and achievement in Advanced Placement, International Baccalaureate, and dual-enrollment courses. The strength of South Carolina's work force will rely heavily on the rigor of the education we give our students.

At the same time that we focus on getting more students to finish school on time, we must also monitor the quality of the education they receive. It is one thing to get students through high school; it is quite another to have our students finish high school ready for work or college.

Our budget plan invests in activities that will accomplish the goal of increasing participation and success in rigorous courses by funding activities that challenge students who are proficient, remediate students who have already fallen behind, or ensure that early childhood students have a strong foundation. In order to measure South Carolina's progress toward this goal, we will evaluate high school participation rates in college preparatory courses, dual-enrollment programs, and advanced credit bearing courses and participation in gifted and talented programs. Lastly, we will analyze student performance on the SAT, ACT, NAEP and AP exams as indicators of success.

Raise the national performance ranking of South Carolina's students on the SAT, ACT, and NAEP. The Education Accountability Act set ambitious goals for the performance levels of South Carolina's students by 2010. An important goal set as part of the 2010 Goal is for South Carolina to rank in the top half of the states on the SAT, ACT and NAEP. We have Placement courses. We measure elementary school rigor by tracking enrollment in made little progress on this goal. Though South Carolina's average test scores for graduating high school seniors on both the SAT and ACT have increased, these increases have had no impact on South Carolina's overall national ranking on these important measures of the output of South Carolina's education system.

Similar to gains on the SAT and the ACT, student performance on NAEP is mixed, with scores rising but failing to reflect true improvement in the educational system. South Carolina's NAEP scores have improved to the point that they approach and even surpass the national average on some assessments. A remaining concern is the fact that we could potentially meet the goal set in 2010 at the same time that the vast majority of our students fail to meet grade level proficiency in basic subject areas. Our science scores are an excellent example. We exceed the national average on the assessment, meeting our goal, while only 30 percent of our students test on grade level. This phenomenon is reflective of the fact that the proficiency rates – and, thus, national average scores – in the United States are low. The education system must become more effective at exceeding the national average on NAEP and increasing the percentage of students who are on grade level (scoring proficient or advanced) at every grade level in every subject.

We will measure progress toward this goal by tracking student performance on NAEP, the ACT and the SAT both in terms of average score, national rank, and proficiency levels in all subject areas.

Eliminate the achievement gap of all students on NAEP, SAT, and ACT. In education there are two achievement gaps to overcome. The first is represented in differing performance levels of more affluent students and students who come from low-income households. Another achievement gap is represented by the differences in the

performance of Caucasian and Asian-American students compared to African-American and Hispanic students. These gaps present our state with the challenges of finding the reasons these gaps exist and then closing the gaps by raising the performance levels of lower-achieving students.

We propose purchasing activities that raise the achievement of low-performing students. Progress toward this goal will be measured using scores on PACT, NAEP, SAT, and ACT. We will also track dropout and high school completion rates among low-income and/or minority students. The last statistical measure will be used to evaluate the time spent away from school due to disciplinary actions; our focus will be on expulsion rates, particularly among lower-performing subgroups.

Improve the efficiency with which education dollars are spent. In the world of limited resources in which we operate, reaching our educational goals is directly tied to maximizing the percentage of the educational dollar that is spent directly in the classroom. This is done by eliminating expenditures on services that are not linked to a specific goal, reducing or eliminating expenditures that are associated with activities that have weak outcomes, minimizing duplicative services, or improving productivity.

Our purchase plan maintains overall educational funding levels but redirects existing funding for activities in ways that improve productivity. There are activities that while inherently good are not essential to reaching the goals we have established. For this reason, we recommend an increase of \$167.2 million in new recurring dollars from general funds toward K-12 education. We believe that these additional dollars should be directed to the frontline of education – teachers and classrooms – which is why we are funding teacher salaries at \$300 above the Southeastern average. Rather than offering an across-the-board salary increase, we believe students will be best served by requiring that districts institute a merit-pay system to determine the salary increase each teacher receives.

We are also recommending a Base Student Cost of \$2,476. It is important to emphasize that this number does not represent all funding dollars. Including local, state, and federal dollars, the Board of Economic Advisors has estimated total funding per student to be \$10,566 in FY 2007-08.

Though the Base Student Cost is sometimes used as the ultimate measurement of education funding, we believe it is more important to consider all types of funding when making this analysis. Although we have made some progress in educational performance due to the tremendous efforts of teachers, students, and parents on the frontlines, we should not ignore the achievement gaps that exist among South Carolina students, the rest of the nation, and even many parts of the world. We also recognize the need to reduce the achievement gaps that exist among minority students and other students in our state. To this end, bold changes are necessary to realize greater progress in achievement levels for all of South Carolina students.

Developing Our Purchasing Priorities

In order to develop our educational purchasing priorities, we first looked at the major indicators of success to determine whether our state is reaching its goal to see every child make academic gains in kindergarten to twelfth grade and attain a traditional high school diploma. We have found that South Carolina is making some progress; however, there are many opportunities for improvement.

Having determined where opportunities for improvement exist, we next identified some proven or promising strategies that will enable us to set priorities for our purchasing plan and how best to achieve our goal. Following are the strategies we identified.

Provide all students a customized learning experience. Before the school system can even begin to provide a student with the skill set they need, the child's mind has already been shaped by key forces, each varying in influence from one child to another. These forces include their genes, family life, stress level, cultural factors, social life, health, emotions, and previous educational experiences, all of which work together to shape how a child's mind works. Knowing that there are so many factors that shape how, when, and whether a child learns any given lesson, it stands to reason that an effective school system is one that offers a multitude of learning environments so that all parents have the options they need to find the right fit for their child.

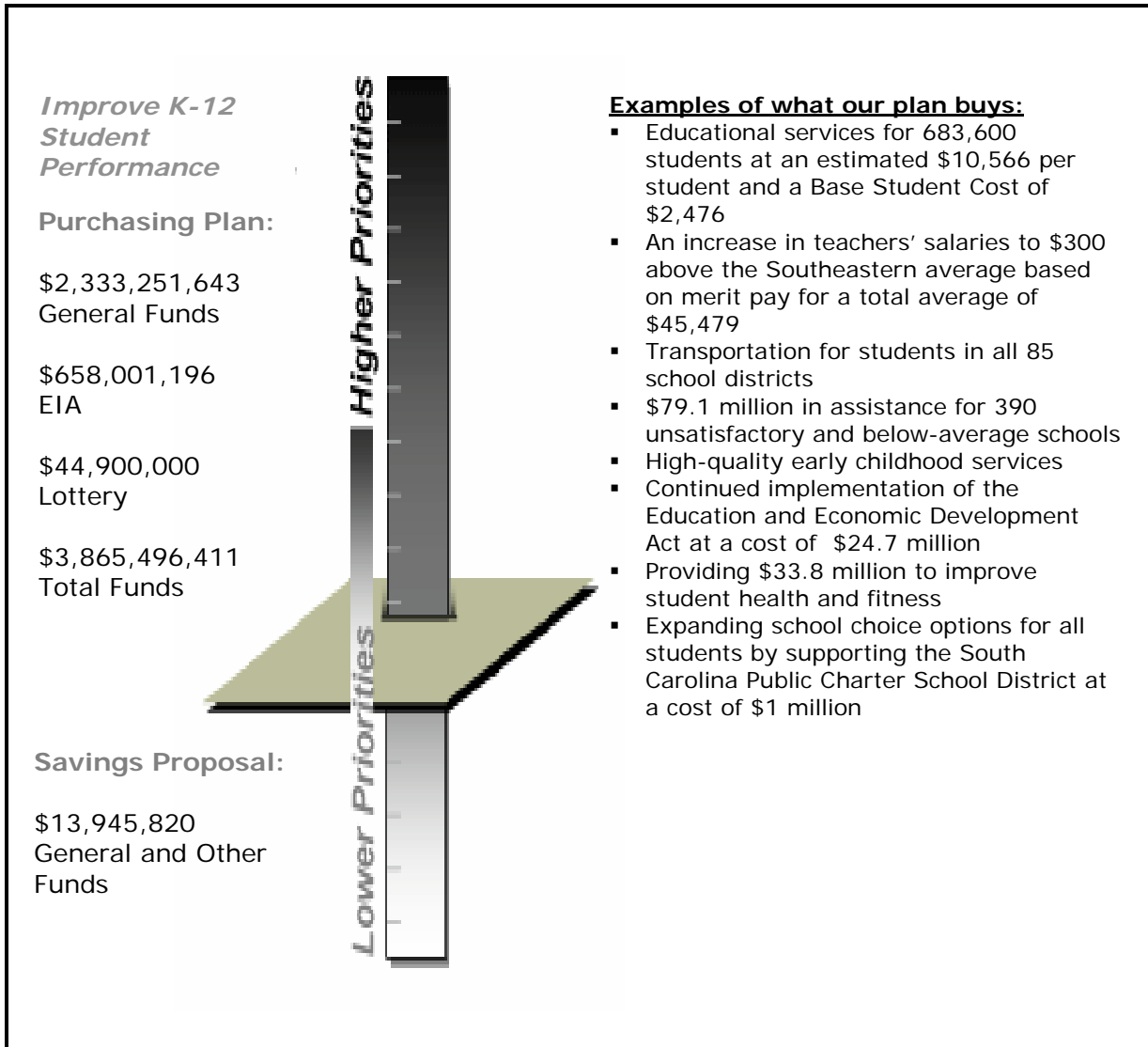
Ensure that every child enters first grade ready to learn. Making certain that all children are well-prepared for formal schooling requires that developmental deficits are addressed by early childhood educational experiences. Effective early childhood programs, whether public or private, are crucial for children whose home environments are not preparing them for a successful elementary school experience. High-quality early childhood developmental education will evolve as standards for developmental education are more clearly defined and communicated.

Provide each student an education that equips them with the skills necessary to compete in the regional, national, and international marketplace. Our investments in education activities cannot lose sight of the fact that one of the key functions of an education system is to cultivate a productive work force. A quality education is one that challenges students to meet high expectations while engaging them in experiences that are relevant to the real world.

Provide the public clear, specific, and timely data about the effectiveness and competitiveness of the public schools in the state. South Carolina's existent accountability system provides school- and district-level report cards that help parents understand how well their child's district or school fares in comparison to others. In addition to providing district and school data, an important strategy for improving student performance is providing student-specific data in a timely manner.

Governor’s Purchasing Plan – Highlights

The following table identifies key purchases within our executive budget’s total state K-12 purchasing plan. Detailed highlights of our purchasing plan are provided below the table.



Our Plan Buys:

Basic frontline education services for over 683,600 students served in the 85 school districts throughout the state. Our plan provides the required amount of funding per student according to the Education Finance Act. With funding of \$2,476 per weighted pupil unit distributed through the Base Student Cost formula, local school districts will be able to provide education services required for kindergarten through 12th

grade students. As mentioned earlier, it is important to note that the total statewide funding per student will be much higher when considering total dollars allocated from outside of the EFA as well. We propose **EFA funding for this activity of \$1.9 billion.**

With this budget, we commit **an increase of \$57.5 million to give district superintendents the ability to reward and recruit high-quality teachers.** By creating the South Carolina Quality Compensation (SCQComp) as a system of merit pay that rewards high-quality teachers for the results they produce, we believe that salary increases could be better connected to attaining our goal of improving K-12 student performance. We accomplish this task by tying salary increases to a demonstrated ability to raise student achievement on standardized assessments or to a teacher's willingness to accept the challenge of a hard-to-staff position. This approach balances the need to raise teacher pay with the fact that the state has limited resources at its disposal. The funding SCQComp is derived from the standard salary increase the state currently uses for across the board raises that keep average teachers' salaries to \$300 above the Southeastern average. Instead these funds will be used to create block grants that district superintendents may use to implement the Teacher Advancement Program, create their own model for research-based, merit-pay program, or to recruit teachers for hard-to-staff positions. Our stipulations are that salary increases must be based on increased student performance on a nationally or state recognized standardized test and that recruitment bonuses be tied to a three-year commitment to the school. By implementing this proposal, South Carolina can more effectively reward teachers based on the quality of the service they provide.

Establishing the South Carolina Public Charter School District to offer parents more educational options for their children. We commit **\$1 million to create state-funded, start-up grants for approved charter schools** and to provide the first year of funding for the administrative cost of hiring support staff for the newly created district.

Creating the South Carolina Early High School Graduation Scholarship Pilot Program in order to reward students who finish high school early through the creation of a grant that can be used to offset the cost of attaining postsecondary education or training. Beginning with the class of 2008, students who finish high school in less than eight semesters qualify for the program, which provides our high-achieving students with an incentive to finish their coursework early while addressing the need to eliminate the "wasted senior year" that has become an entrenched part of the student educational culture in South Carolina. By **committing \$1.46 million to the Early High School Graduation Scholarship**, we can provide grants worth up to \$2,000 for students who finish high school in six semesters.

Fully funding the Education and Economic Development Act in order to restructure elementary and secondary school curricula so that they are more effective. The Education and Economic Development Act can increase the chances that more students in South Carolina will receive a competitive education. To support the

objective of the Education and Economic Development Act, we **recommend appropriating \$24.7 million** for the second year of implementation of the legislation.

Shared administrative services in order to support school business officers in consolidating administrative services for our smaller school districts. There is a clear need to get more of our educational dollar to the front lines of our school system. District consolidation is one way to go about accomplishing this task. However, rather than rely only on the consolidation of actual school districts – a prospect rife with political tension and acrimony – we support the Education Oversight Committee proposal to provide \$100,000 in order to work with non-countywide school districts with less than 7,500 students in helping them consolidate administrative services. This model would require that all such districts share administrative services with other districts by the end of FY 2008-09. In so doing, we can move the state closer to reducing the per-pupil expenditures on administrative costs.

Expanding the South Carolina Virtual School pilot program in order to shatter the barrier that geography places on student access to high-quality educational experiences. Students in smaller, rural schools will be able to take advantages of rigorous courses such as advanced computer programming or Advanced Placement Calculus that currently are limited to students in schools with large enrollment levels. At the same time, we provide the opportunity for lower-performing students to receive high-quality remedial education that is currently denied them simply because their assigned school lacks that expertise to address their specific learning need. At both ends of the spectrum, **investing \$3,098,010 to create the South Carolina Virtual School** can go a long way in offering parents real choice in the educational options available to them.

High Schools that Work/Making Middle Grades Work are school-wide improvement models in which more than 1,400 schools participate nationally. Each participant school focuses on implementing at least one of the High Schools That Work/Making Middle Grades Work Key Practices. These practices include a rigorous curriculum, high expectations, instruction that is relevant to students' lives, research-based teaching strategies, and valuable professional development for leadership and teachers. Schools that participate in the High Schools That Work model improve student achievement on state and national standardized tests. The impact of the High Schools That Work model is so significant that the Education and Economic Development Act adopts its best practices for all high schools in South Carolina. Making Middle Grades Work undergirds the efforts of the Education and Economic Development Act as well as High Schools That Work by focusing on preparing students for the transition into high school, placing an emphasis on frameworks that raise student achievement in areas that are predictive of success in high school. We believe these programs can continue to improve the performance of South Carolina's high schools that are currently participating in the program. We propose **\$2,000,800 in funding for High Schools that Work**.

Providing transportation to and from school for 683,600 students. We understand the need to provide support for a state school transportation system which is crucial for those students who are unable to provide their own means of transportation. We propose **funding for the transportation needs of our students with an increase of \$60 million** through Contingency Reserve Funds out of next year's budget. We base the proposed spending increase on the projected \$2.60 price per gallon for fuel in FY 2007-08. In addition to fully funding fuel for our public school transportation system, our purchase plan provides more than \$30.5 million for school bus and service vehicle replacement and \$1,434,273 in maintenance staff salary adjustments. Some of the items included in our proposed transportation investment are beyond the scope of the capital investments usually supported in the Contingency Reserve Fund. We believe that modifying the use of the Contingency Reserve Fund will permit us to fulfill the transportation needs of the students of our state through the use of one-time funds that limit the creation of annualizations that may be cut from the State Department of Education budget as we rethink the management of the school bus transportation system over the next fiscal year.

Despite our recommended funding in this area, we still feel school transportation could be provided more efficiently if it were competitively sourced from a private company. The need to find efficiencies through privatization and better management of our transportation system is directly tied to the state's increasing reliance on annualizations that fund recurring items, such as transportation, with nonrecurring dollars. This year alone the state has more than \$73 million in annualizations, \$22 million of which come directly from the public school transportation system – representing a third of the state's annualizations. Reducing costs by improving efficiencies will have the immediate effect of alleviating one of the major contributing factors in the state's use of annualizations.

One area of potential cost savings in the school bus transportation system lies within bus purchase agreements. It is our stance that the funds we provide during FY 2007-08 would be better used by leasing a portion of the school bus purchases made during the fiscal year, rather than purchasing all of the buses out-right. An analysis by TransPar Group makes it clear that leasing rather than purchasing buses could reduce by half the time it will take South Carolina to get its school bus replacement cycle to more closely align with the industry standard for the simple reason that we could get more, newer buses sooner.

Funding the Student Health and Fitness Act of 2005 to address the growing obesity epidemic among the youth of our state. The Student Health and Fitness Act is an effort to combat the growing health concerns that are emerging as a result of the declining health of the students in South Carolina. Starting at an early age, increasing the awareness of citizens about health choices can lead to a healthier South Carolina. We are encouraged by the passage of this legislation and propose **appropriating \$34,028,200** for its continued implementation.

Providing instructional materials for over 683,600 students throughout K-12. Instructional materials include an array of educational tools that teachers can use to engage students in the learning process. Teachers compete with MP3 Players, Nintendo Wii's, Short Message Servicing, and a plethora of other interactive entertainment and communication devices in captivating the attention of their students. It is important that the instructional materials used in the classroom engage students in a manner that reflects the way today's students acquire, process, and deliver information. We are providing the funds to purchase the necessary materials that will meet state academic standards. We propose **funding this activity with \$67,464,562** in total funds, \$6.4 million of which we set aside for block grants that provide school districts an incentive to pursue research-based, non-traditional instructional materials.

Assistance and accountability to the 250 "below average" and 140 "unsatisfactory" schools. The 2006 Annual School Report Cards make it clear that our lower-performing schools need more technical assistance options than are currently being offered. These school ratings show that 29 percent of the schools in South Carolina received lower ratings in 2006, contributing to an increase in the percentage of schools rated unsatisfactory or below average from 26 percent in 2005 to 36 percent in 2006. While 65 schools in South Carolina improved their ratings, there remain several schools that are simply not improving at the rate necessary to reach the goals established by the Education Accountability Act.

Intermittent exposure to quality teaching will not improve the student achievement in our below average and unsatisfactory schools. Sustained improvements in schools that are in need of technical assistance will not occur unless the teacher and leadership turnover issues are addressed. Put simply, these schools need access to options that will mitigate the high teacher and principal turnover rates that cripple their efforts to improve. In order to assist these schools in overcoming the obstacles that have limited their success, we **fund technical assistance with \$79.1 million.** Our funding supports these schools in the following manner:

1. Funding technical assistance to the **140** unsatisfactory schools at **\$320,000** each – total funding – **\$44.8 million EIA dollars.**
2. Funding technical assistance to the 250 below average schools at **\$100,000** each – total funding – **\$25.0 million in EIA dollars.**
3. **\$6.3 million in EIA dollars** to continue supporting the Teacher Advancement Program in existing schools and to expand the program to 20 additional unsatisfactory or below average schools.
4. **Providing \$610,000 to continue supporting Homework Centers.**
5. Offering the mandatory support for External Review teams and Retraining Grants through \$2.4 million.

Providing formative assessments to give parents and teachers the information they need to properly serve South Carolina's students. **We propose increasing assessment funding to \$3.95 million.** We continue to believe that there are significant cost savings that could be realized if the state were to adopt the cost savings

proposed by the South Carolina Task Force on Testing as well as the Legislative Audit Council as it considers contract renewals for the state testing system. Additionally, we recognize the need to improve upon the existing accountability system and encourage the State Department of Education to adopt the recommendations of the 2004 Legislative Audit Council report, which advised the department to develop information on the cost per item for state-mandated assessments.

Classroom supplies to 51,000 teachers throughout the state. It is important that our teachers are given the resources to educate their students. Providing them with the financial resources for classroom supplies will relieve many teachers from out-of-pocket expenses that may otherwise result. To fund this activity, we propose to **allocate \$12.75 million** in EIA dollars to the local school districts.

High-quality pre-school programs that provide direct services for almost 25,000 children throughout the state. We feel that early education is an investment in a brighter future for South Carolina. First Steps works across our state to get kids prepared for school. Although it is a program that was started by the previous executive administration, we feel that by coordinating the services that are provided by state agencies and by fostering public and private community partnerships, First Steps can help prepare our children for the challenges they may face in the future education system. For this reason, we recommend **appropriating \$24 million** to support its efforts.

Making Tough Choices:

Similar to the challenges facing households across South Carolina, the finite resources of the state require that we make difficult choices about how we will direct the limited resources available to us. These choices are more reflective of our desire to be fiscally responsible with the taxpayer dollar, limiting government spending only to activities that are of the highest necessity. Our choices are not a criticism of the merit of the forgone activities. Following are items that represent some of the difficult choices we have made on educational activities that we choose not to purchase in this year's executive budget.

We limit **National Board Certification salary bonuses** to the teachers who complete the process by June 30, 2007. Study after study has demonstrated that both at the national level and within South Carolina attaining National Board Certification fails to lead to significant increases in the achievement of teachers receiving the bonus. While it is important for the state honor the commitment we made to teachers who have already completed the process, we believe that expanding the program to any newly certified teachers in FY 2007-08 would be an irresponsible use of taxpayer generated revenue. This will result in a cost savings of \$1.6 million.

Eliminating the funding for the State Department of Education school accreditation process and requiring the Department to completely adopt the 2004

recommendations of the Legislative Audit Council Review of the State Department of Education. We commend the State Department of Education for adopting a portion of the LAC recommendations, thus reducing annual state expenditures on this activity by \$280,000. However, we believe that the State Department of Education should fully adopt the recommendations of the LAC by completely eliminating the duplication of the accreditation the Southern Association of Colleges and Schools (SACS) accreditation process. The State Department of Education should encourage all eligible schools to pursue SACS accreditation, thus eliminating this duplicative regulatory function at the state level. This will result in a cost savings of \$644,718.

Public Radio Broadcasting, which, while a meritorious activity, simply does not pass muster in terms of its overall priority rating for educational activities. Given modern technology of radio broadcasts – XM and other satellite radio formats, online radio streaming, and podcasts – the support of public radio should be borne solely by those who actually benefit from the service. From an economic perspective, this non critical activity is rife with free riders who simply choose not to pay for the service from which they benefit. Services should be limited to the levels supported by listener contributions, federal support, or other agency generated revenue. This will result in a \$251,059 cost savings.

Interpretive and Resource Management curriculum development conducted by the Parks, Recreation, and Tourism represent another example of a worthwhile yet lower priority educational function. From the pedagogical perspective, the curricula used in student specific services such as field studies or family visits are largely developed, reducing the need for this recurring investment. We also believe that the demand for such educational services is on the decline as a result of the emergence of online virtual learning experiences emerge at the same time that fuels costs continue to rise. This will result in a cost savings of \$598,701.

Elimination of the ADEPT program is similar to the National Board Certification process, the program is input driven and untied to statistically significant increases in student achievement, which is the ultimate bottom line of the value of an education program. The Assisting, Developing, and Evaluating Professional Teaching (ADEPT) program obviously has merit in that, when properly implemented, it can lead to more introspective teaching. However, the quality of program implementation varies significantly from schools to school and district to district. Additionally, the professional development offered by the ADEPT program is duplicative of program specific professional development that the state currently funds at the same time it is less effective than other professional development models such as the Teacher Advancement Program and the South Carolina Teacher Incentive Grant, both of which we support. This will result in a cost savings of \$2,217,245.

Please see the Appendices for a complete listing of the Governor's Purchase Plan for this goal area and for a detailed listing of what our plan saves and what our plan does not buy.

Improve Our Higher Education System and Cultural Resources

Improve our Higher Education System and Cultural Resources

Our goals for South Carolina's higher education system are to better prepare our young people for the challenges of a competitive global marketplace, raise the standard of living for South Carolinians, meet changing work force needs, and create economic development opportunities. To achieve these goals, we believe our higher education system must be accessible, affordable and accountable. If current trends in tuition increases remain unchecked, many more South Carolinians will be unable to access our higher education opportunities and, in turn, be unable to survive in an increasingly competitive job market. If South Carolina's 33 public colleges and universities continue to operate independently without the guidance of a statewide plan, the system of higher education will remain uncoordinated, unaffordable and inefficient.

Our mission for higher education is simple: to provide a quality education at an affordable price for the citizens in our state. The result will be greater accessibility for more children in our state who want an opportunity to achieve a higher quality of life.

Our citizens enjoy a variety of cultural resources through our state's historic sites, arts agencies, and museums. The state is fortunate to have rich cultural opportunities and should maximize the flow of resources directly to community arts and cultural programs.

Developing our Purchasing Priorities

In order to develop our purchasing priorities, we first looked at the major indicators of success to determine whether state government is currently reaching its goal to improve our higher education system and cultural resources. While South Carolina is making progress, there are many areas that need improvement. This section identifies the measures that help explain whether our state is or is not achieving our goal.

Governor Sanford's Goals for **Improving our Higher Education System and Cultural Resources** are to:

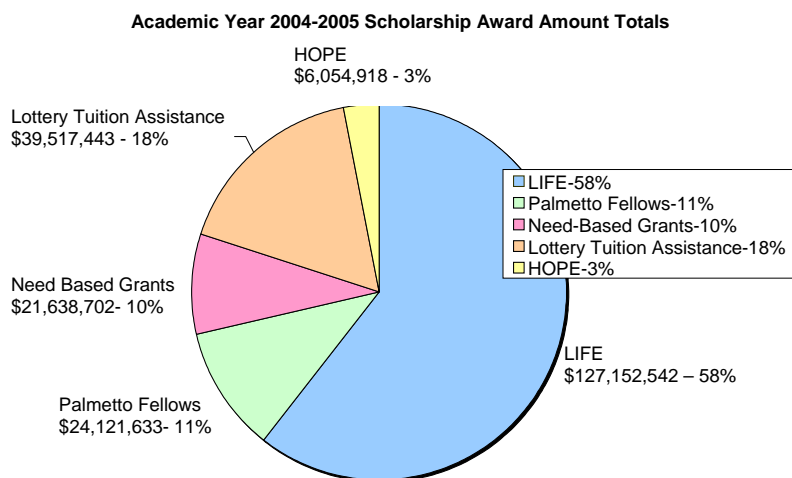
- ✓ Provide for greater access and affordability of our Higher Education system.
- ✓ Provide for employability and quality of life opportunities for graduates.
- ✓ Provide for an efficient and effective statewide Higher Education system through improved statewide planning.
- ✓ Provide for a greater level of South Carolina based, derived cultural opportunities.

Where We Are Succeeding

The number of degrees awarded has steadily risen at all levels of higher education. Over the last decade, we have experienced a 19.5 percent increase in the total number of degrees awarded by our colleges and universities. With our state scholarship programs, an average of 95 percent of all students who receive a Palmetto Fellows scholarship retain it the following year including 84.7 percent of all freshmen who receive the award. With our LIFE scholarships, 65.4 percent of all recipients retain the award, although fewer than half the freshmen who receive the award retain it the following semester. We have also experienced a slight growth in our higher education graduation rate of entering students, which is a key indicator of higher education success. These rates are measured nationally at the undergraduate level by considering first-time, full-time degree seeking students who complete degree requirements for graduation within 150 percent of normal time (six years for baccalaureate degrees and three years for associate degrees). In order to achieve this goal in the most efficient manner, our colleges and universities must continue to increase graduation rates and degree production at associate, baccalaureate, and graduate levels, particularly in fields critical to the information and technology economy.

Minority enrollment and success in institutions of higher education is also increasing. Over the past decade, participation by minority students has increased by 153 percent, while degrees awarded to African American men and women composed 21.3 percent of all degrees awarded in the state this past year.

LIFE, HOPE, and Palmetto Fellows scholarship programs provide awards ranging from \$2,650 to \$6,700 annually, reducing some of the tuition costs for parents and students. On the other hand, these scholarship programs have also made it easier for institutions to increase tuition rates. In order to make post-secondary education more accessible for our students, additional resources should be allocated to awarding more need-based grants. Placing more emphasis on need-based grants instead of merit-based awards can help close the established achievement gap that exists in South Carolina primarily along racial lines.

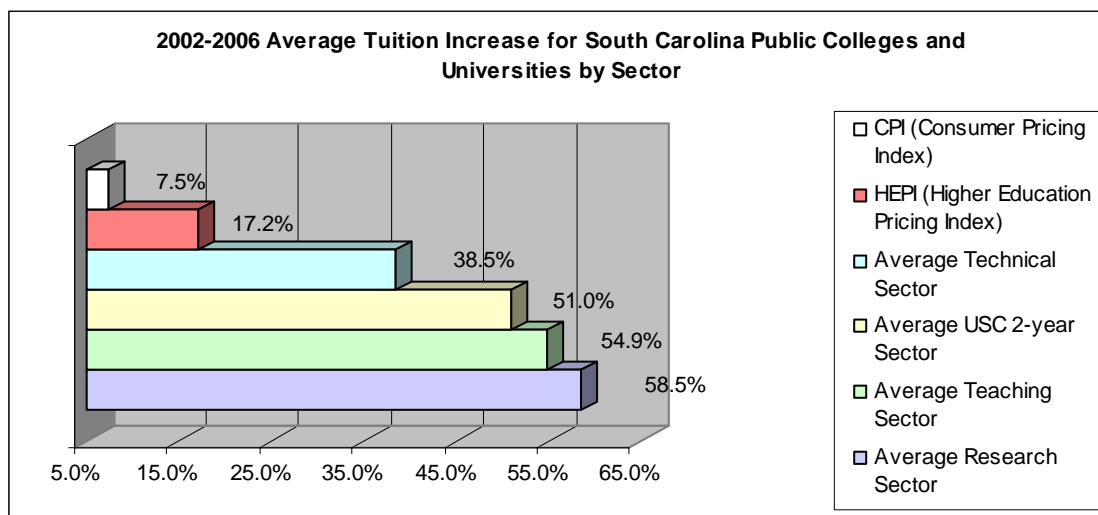


Opportunities for Improvement

Institutions of higher education must keep up with work force needs. This administration has focused on attracting higher-paying, knowledge-based jobs. One of the major factors in attracting businesses to any state is the number of qualified potential employees. In order to be more successful at attracting these companies, we need well-prepared graduates at varying degrees of education levels. There are four primary levels for preparedness: high school graduation, two-year completion, four-year degree completion, and graduate degree completion. If our state is going to be more competitive, we must increase the number of skilled workers currently available in the work force.

Rising costs of higher education. Having a top-notch, postsecondary program will serve little purpose if our citizens cannot afford to participate. Nearly double-digit tuition hikes in recent years are putting higher education out of reach for some in our state. South Carolina's higher education institutions continue to increase annual tuition and fees far above the ability to pay in this state. For FY 2006-07, the average increase at the four-year teaching institutions was 9.5 percent. Over the past ten years, the average annual tuition of South Carolina's four-year institutions has increased 141.8 percent and is currently the highest tuition among all Southeastern states.

According to the South Carolina Commission on Higher Education (CHE), the average tuition at our research universities has increased over 53.9 percent since 2002, and our teaching universities have increased over 49.1 percent in the same time period. As illustrated in the chart below, these increases dwarf the increases of the CPI and HEPI over the same amount of time.



Source: South Carolina Commission on Higher Education

An analysis prepared by the Southern Regional Education Board (SREB) further illustrates the dramatic rise in tuition revenue. By comparing South Carolina's total tuition and fees revenue from 2001-2004 with similar data from other Southeastern states, SREB found that our state saw tuition and fees revenue grow by \$337.6 million over that time period – approximately 120 percent higher than the SREB average. Over this same time period, state appropriations have declined by 20 percent. It is important to note that South Carolina's increased contribution to post-secondary education through lottery funds is not reflected in the SREB appropriations research. The alarming rate at which tuition increases are outpacing both the decline in higher education appropriations, as well as our citizens' ability to pay for college, is apparent and clearly demonstrates the need for cost controls and systematic reform.

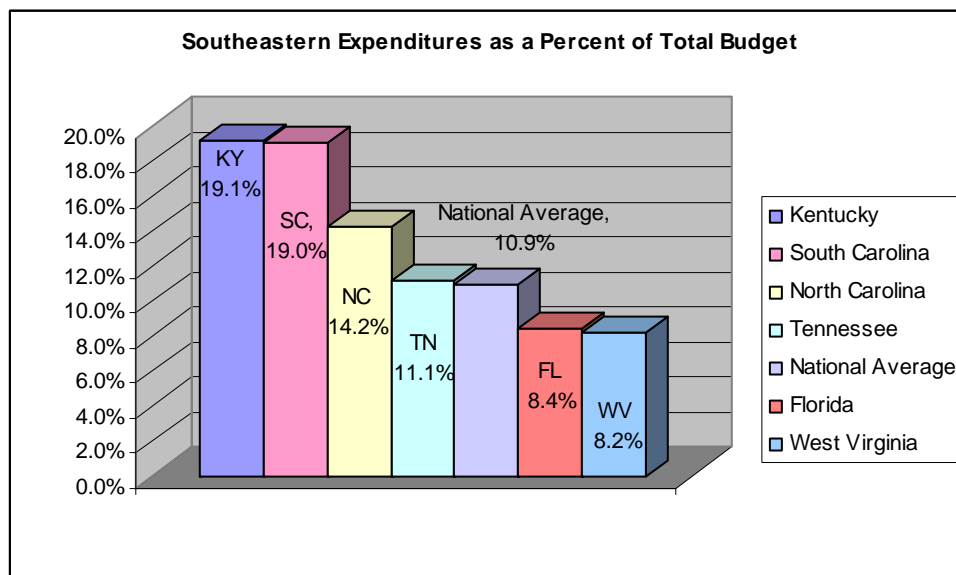
The need for reform. In last year's executive budget, we proposed capping tuition and fee increases to the prior year's Higher Educational Price Index. Unfortunately, the General Assembly removed this exemption from the budget. Even though not one South Carolina public institution has seen a reduction in its total funding in the past three fiscal years, our state's four-year colleges and universities increased their tuition by a combined average of 8.8 percent for FY 2006-07.

All of these increases have taken their toll on the average student's ability to obtain a higher education degree. In fact, the National Center for Public Policy and Higher Education recently gave South Carolina an "F" for affordability in their "Measuring Up 2006" higher education report. It is important to note that this report is done bi-annually, and this is the second consecutive report in which South Carolina has received the lowest possible grade reflecting its higher education affordability.

A significant driver in our higher education tuition increases has been faculty salary. Most institutions generally pay salaries out of tuition revenues instead of from state appropriations. Because an increase in state-funded payroll is unaccounted for in the institution's state funding, a mandatory pay increase causes an increase in tuition as well. According to SREB, South Carolina ranks eighth in average salary increases for full-time instructional faculty at public four-year colleges and universities from 1995-2005. The 9.8 percent increase for our state exceeds the national average of 7.2 percent over this same 10-year period. Without a meaningful examination of priorities for our statewide higher education system, each institution will continue to operate independently while higher education spending remains unchecked, uncoordinated, and inefficient.

Though some would attribute our tuition increases to reductions in state funding, it is important to note that according to the National Association of State Budget Officers, in 2004 South Carolina had the second highest higher education expenditures as a percent of total expenditures among Southeastern states at 19 percent of its total budget. Of states in the same region, only Kentucky spent a higher percentage on post-secondary education. On a national level, only six states – Maryland (22.4 percent), Iowa (26.6 percent), Nebraska (21.5 percent), North Dakota (22.6 percent), Kentucky (19.1

percent), and New Mexico (20.4) – spent more of their total budgets on higher education. It is the belief of this administration that appropriate dollars are being spent on post-secondary education in our state. It is the manner in which these dollars are being allocated which should be questioned.



With 33 public colleges and universities operating at 79 different campus locations, our state maintains too many post-secondary institutions with duplicative and overlapping programs. Because our Commission on Higher Education has little oversight authority, the political process has allowed too many schools with too few students. While this growth has happened with the intent of making higher education more accessible to everyone in our state, the unintended consequence is that the higher tuitions needed to sustain our inefficient system of underutilized campuses have actually made higher education less accessible to many in our state.

Purchasing Priorities

Our purchasing plan has been developed by prioritizing activities using proven or promising strategies that achieve the best results for our goal. The key strategies we identified are as follows:

Provide for an efficient and effective statewide Higher Education system through improved statewide planning. The current structure of our Higher Education system has 33 public institutions, each independent in mission and focus, and all controlled by its own governing board of trustees. While each campus is certainly entitled to establish its own identity, the absence of a plan for higher education has promoted mission creep, duplication, and the unnecessary politicization of how higher education funding is allocated. During the past three years, we have seen several examples of the need for a statewide plan for higher education. USC-Sumter was authorized to move from two-

IMPROVE OUR HIGHER EDUCATION SYSTEM AND CULTURAL RESOURCES

year to four-year status, and a culinary arts program was established at Trident Technical College in Charleston by a legislative amendment tacked on to an unrelated, but popular, economic development bill. The Commission on Higher Education, the coordinating body charged with effectively advocating for the best interests of the state system as a whole, did not approve either of these actions. Furthermore, Greenville Technical College, through its foundation, made a decision to construct student housing on its main campus – a marked departure from their mission.

USC-Upstate has entered into an agreement with Greenville Tech to build a USC-Upstate satellite campus in the Greenville area. This action completely undermines the purpose of the University Center of Greenville, a consortium of colleges in the Greenville area collaborating to offer four-year degrees to area residents. Most recently, Spartanburg Technical College used local legislation to attain the right to change its name to Spartanburg Community College. By doing so, they threaten to damage the nationally established brand name of our state’s technical college system.

In all the above instances, the universities went ahead in initiating their projects without notifying CHE either because the universities did not want the Commission’s approval, or it was unnecessary to have the Commission’s approval. This lack of planning and structural weakness will continue to contribute to rising costs and duplication in the higher education system; therefore, we propose that a statewide plan for higher education in South Carolina be developed.

Ensure access to and affordability of higher education. If students cannot afford to pursue education beyond the secondary level, they do not have any opportunity for a higher education. While our state provides resources to public institutions to help underwrite the costs of college, there will always be a portion that will be borne by the student. Our state

AFFORDABILITY	SC	SC	Top 3 States (Avg.) CA, HI, UT 2006
	1992	2006	
Family Ability to Pay			
Percent of income (average of all income groups) needed to pay for college expenses minus financial aid:			
at community colleges	22%	27%	20%
at public 4-year colleges/universities	28%	36%	24%
at private 4-year colleges/universities	48%	60%	47%
Strategies for Affordability			
State investment in need-based financial aid as compared to the federal investment	24%	25%	21%
At lowest-priced colleges, the share of income that the poorest families need to pay for tuition	15%	28%	9.6%
Reliance on Loans			
Average loan amount that undergraduate student borrow each year	\$2,874	\$3,614	\$3,683

must ensure that this portion is affordable and that there are opportunities for those qualified students without the means to fully fund their own education. These opportunities can be in the form of merit aid for students who can “earn” state assistance based on academic achievement or in the form of need-based aid for those

students who exhibit the ability to succeed in college. Our students have access to substantial financial aid through the LIFE, HOPE and Palmetto Fellows scholarship programs, the Tuition Grants Program for independent schools, and several federally-supported grant and loan programs.

We can also slow the growth of tuition costs by limiting tuition increases for in-state, undergraduate students to the Higher Education Price Index per academic year beginning with the 2007 fall semester. We believe an institution can control its own costs through internal savings and by coordinating duplicative programs, as well as finding internal cost-savings. Finally, we can also limit the growth and mission creep of our 33 public institutions and 79 campuses by strengthening the Commission on Higher Education and developing a statewide plan for higher education in South Carolina.

Increase the employability of graduates. Having a college degree does not necessarily ensure employability. Certainly a degree is a measure of achievement and an indication of a base of knowledge. However, today's economy requires more than just a diploma and a presumed proficiency. Graduates must have life skills, technology training, and communications strengths to go with their academic credentials, and they must be prepared to become productive citizens. Also, from a different perspective, students should be made aware of employment opportunities in critical areas as well as employment opportunities associated with chosen majors. While student choice is a cornerstone of the academic experience, we must be certain that students have a realistic understanding of the workplace and how their academic choices can impact their ultimate ability to support themselves.

Increasing the employability of graduates will play a major role in improving the economic climate of our state. The availability of a skilled and qualified work force is one of the major considerations for any business searching for a place to relocate. Creating a larger pool of qualified workers will ensure that South Carolina becomes an attractive option for potential employers and will attract higher-paying jobs and businesses to our area.

Increase the effectiveness and efficiency of cultural opportunities and agencies through consolidation of duplicative services. There are opportunities for consolidation among arts agencies and their administrative tasks which could prove beneficial. Converting the State Museum building into a South Carolina Cultural Center would provide the cultural agencies with a central location to operate from. Currently the Department of Revenue (DOR) shares a building with the Museum Commission. Relocating the Department of Revenue to a new location, and bringing the Arts Commission and possibly the Department of Archives and History (DAH) into the Museum building, would be beneficial for agencies that provide similar services. The administrative tasks among these agencies could then be shared and streamlined.

Increase awareness of available cultural opportunities through a coordinated marketing effort linked to tourism. Our arts agencies, historic sites, and museums must be

marketed in full cooperation with our tourism regions. The state's cultural resources complement the natural attractions, helping to make South Carolina a prime destination for visitors and potential future residents. We believe careful and constructive marketing would not only draw more attention to these sites but also attract economic benefits, such as capital investment and job creation.

Governor’s Purchasing Plan – Highlights

Taking into account the fiscal limitations of our state’s economy, we purchased only those higher education and cultural resource services most needed by our citizens. We do not purchase some services that, while still considered valuable, have been identified as lower priority. The following table identifies key purchases within our executive budget’s total state higher education and cultural resources spending plan as well as examples of what is not purchased. Detailed highlights of our purchasing plan are provided below the table.

<p><i>Improve our Higher Education System and Cultural Resources</i></p>		<p>Examples of what our plan buys:</p>
<p>Purchasing Plan:</p> <p>\$791,356,934 General Funds</p> <p>\$3,792,164,406 Total Funds</p>		<ul style="list-style-type: none"> ▪ Instructional and academic support for over 150,000 students in higher education institutions. ▪ Scholarship programs for over 73,000 South Carolina residents to increase affordability. ▪ A cap on tuition increases limited to the Higher Education Price Index. ▪ Funding for critical-need areas, such as nursing education and research. ▪ Multiple access points of educational opportunities for our citizens. ▪ Records and artifact preservation, museum exhibits, and arts funding.
<p>Savings Proposal:</p> <p>\$15,851,618 General and Other Funds</p>	<p>Examples of what our plan does not buy:</p>	
		<ul style="list-style-type: none"> ▪ Out-of-state arts supplemental funding. ▪ Duplicative support costs for instruction at neighboring schools. ▪ Funding for underutilized degree programs which are available at other institutions. ▪ State-funded raises for higher-education employees.

Our Plan Buys:

Educational and general funding for our state’s 33 two- and four-year campuses, research universities and technical colleges. This activity provides the core support for the operation of the higher education system in our state. Many of our states’ colleges and universities have increased their operational funding through tuition increases. As a result, recent trends in tuition increases are pricing higher education out of reach for many families. Tuition and fees at four-year institutions in South Carolina increased an average of 9.5 percent this year. We believe the lack of a statewide plan for higher education, allowing for duplication and mission creep, is a major factor in these tuition increases. It is our belief that the work of the Governor’s

Task Force on Higher Education has initiated the conversation in developing that statewide plan. We will also propose a proviso that would limit tuition and fee increases to the prior year's Higher Education Price Index. We propose funding these activities in the amount of **\$667,348,199 in recurring general funds**, which is essentially the same amount appropriated last year.

Funding for the Higher Education Task Force Study Committee. In February 2006, we convened a Task Force to work with the South Carolina Commission on Higher Education to identify steps to reduce tuition, encourage more collaboration among universities, and reduce duplication within the system. Ultimately, the Task Force found that many of the issues surrounding higher education in South Carolina were symptoms of a pressing need to coordinate activities through a comprehensive statewide strategic plan for higher education. The recommendation of the Task Force was that the governor and Legislature convene a committee of knowledgeable individuals to develop a plan for higher education in South Carolina. The Committee would be comprised of members of the higher education, K-12 education, and business communities. In order to ensure this committee can adequately complete their task, we propose to set aside **\$150,000 from existing agency resources**. This amount should allow the Committee to address staffing and operational needs it may incur in the process of fulfilling its charge.

Program coordination and oversight by the Commission on Higher Education. The CHE, while limited in authority at present, provides reviews of academic and scholarship programs, comprehensive data collection, and facilities coordination. We propose **recurring general fund increases** in the amount of **\$324,000** for this activity during FY 2007-08.

Allied Health Care Initiative for the Technical College System. Our state's technical colleges are committed to a coordinated approach that responds to the critical need for more qualified health care workers required to fill jobs created by industry growth and retirement. This activity will allow the System to enhance its educational pipeline for allied health workers, including nurses and radiological technicians. This resource will help relieve enrollment bottlenecks created by lack of teaching faculty and instructional infrastructure. Funding will allow the technical colleges to enhance programs that respond to health care providers' demands for additional allied health care workers in career fields where we have students waiting to enter our programs. We propose **new recurring general funding** in the amount of **\$3,500,000** for this worthwhile activity.

Nursing programs at USC, MUSC, Midlands Technical College, and Francis Marion University. Funding is made available to assist in the mitigation of the severe shortage of trained nurses. This shortage is most evident in the Pee Dee region, and state support for this discipline will allow us to continue addressing this need. We propose **maintaining recurring general funding** in the amount of **\$18,907,402** for this activity.

IMPROVE OUR HIGHER EDUCATION SYSTEM AND CULTURAL RESOURCES

Scholarship programs at all levels. The LIFE, HOPE, and Palmetto Fellows scholarships, along with need-based grants, help parents and students pay for tuition. Funding for these scholarships exceeds \$176 million annually. We propose that the overall scholarship program be re-evaluated to strengthen the qualifications for receipt of scholarship assistance. Far too many freshmen are becoming ineligible for scholarship retention because they were underprepared for the academic challenges of higher education. If the trends in our state continue as they have in recent years, less than 50 percent of the students who received a LIFE scholarship in the fall of 2006 will not retain it in the fall of 2007. However, it is still our priority to offer a greater level of affordability to higher education students. We, therefore, propose increasing the amount of lottery funds appropriated to these scholarship and grant awards as follows:

- **LIFE Scholarships by \$8,285,186** for total funding of \$149,649,015.
- **Palmetto Fellows Scholarships by \$3,276,006** for total funding of \$21,106,764.
- **Needs-Based Grants by \$2,479,027** for total funding of \$13,725,120.

Tuition grants for over 12,000 students attending independent colleges in South Carolina. This investment is returned many times over by using the capacity of these schools instead of additional “bricks and mortar” at state-supported colleges and universities. Since its inception in 1970, the tuition grants program has provided assistance to over 253,000 South Carolina students. In 2005, 44.1 percent of the grant recipients were African Americans, and more than 65 percent of the grant recipients came from families with incomes below \$50,000. We propose **maintaining funding** in the amount of **\$19,322,247 in recurring general funds** and **\$38,449,658 in total funds**.

The Lottery Tuition Assistance Program is designed to aid students bound for two-year technical colleges. Each student is awarded an amount based upon the number of eligible recipients and the amount of available funding each year limited to the cost of tuition. We feel this program assists in giving students an opportunity to achieve an education at a higher level and, therefore, propose **maintaining funding** in the amount of **\$45,000,000 in lottery funds**.

South Carolina’s Virtual Library known as DISCUS which gives all South Carolina residents free access to subscription electronic information and learning resources at K-12 schools, colleges, and public libraries, and from home and workplace Internet computers. This access results in a very cost-efficient investment as savings realized to citizens have been calculated at over \$22 million annually. We propose **maintaining funding** in the amount of **\$2,723,502 in total funds**.

The Statewide Electronic Library is a cooperative and collaborative effort among our public and private higher education libraries that is transforming how our state’s

citizens access vital academic information. It is a data network that connects South Carolina's 58 public and private higher education libraries to allow even the smallest library access to the millions of volumes held by all higher education libraries in the state. It is an enhanced and more cost-effective means of sharing academic collections statewide. Through South Carolina's Higher Education Libraries, 212,000 plus post-secondary students, faculty, and researchers will benefit from expanded access to sophisticated academic resources. Others in the state will benefit by gaining access to the higher education academic resources through the state and public libraries. The program helps the state avoid duplicated expenditures by enabling a mechanism for group purchases at better prices of essential sophisticated electronic academic databases that will be available to all of South Carolina's higher education libraries. We propose an **increase in recurring general funds** for this project in the amount of **\$2,000,000**.

Our Plan Saves By:

Reducing administration at four-year institutions and technical colleges. By reducing the costs of non-instructional personnel to an average benchmark of all schools in the category, we can realize **annual savings of \$1,593,316**. There is a wide range of administrative expenses among the campuses. By setting a benchmark, we can standardize the costs of non-instructional personnel at each institution based upon the average cost.

Four-Year Institutions	Administration as a percentage of Total Budget	Technical Colleges	Administration as a percentage of Total Budget
Lander University	6.548%	Tri-County Tech	13.702%
Francis Marion University	6.156%	Williamsburg Tech	10.434%
Coastal Carolina University	5.772%	Piedmont Tech	11.96%
South Carolina State University	6.215%	Lowcountry Tech	11.945%
The Citadel	5.608%	Spartanburg Tech	10.625%
Average Admin. as % of Total Budget	6.059%	Midlands Tech	10.574%
University of Charleston	5.498%	Northeastern Tech	10.669%
Winthrop University	4.781%	Orangeburg-Calhoun Tech	9.656%
		York Tech	10.903%
		Average Administration as a percentage of Total Budget	11.163%
		Horry-Georgetown Tech	9.899%
		Aiken Tech	9.745%
		Florence-Darlington Tech	10.025%
		Trident Tech	9.406%
		Greenville Tech	9.274%
		Central Carolina Tech	9.959%
		Denmark Tech	9.625%

We recommend a reduction over a two-year period for Tri-County Technical College.

Consolidating the Cultural and Arts Agencies. By combining the Department of Archives and History, Arts Commission, State Library, and State Museum under a Department of Literary and Cultural Resources administrative entity, we project **savings of \$513,665** in recurring general funds through a reduction in space requirements, and elimination of systems duplication and equipment. These agencies' major goals are to continually improve and restore the environment of literary, cultural, and historic resources.

Consolidating the Institute for Archeology and Anthropology currently residing at USC-Columbia into the Department of Archives and History. This function could be easily absorbed and housed at DAH and is consistent with their overall mission of cultural preservation. DAH has adequate physical space available to incorporate this function, and it fits with DAH's defined mission. Most of our neighboring states (Alabama, Virginia, North Carolina, Mississippi, and Louisiana) house their Archeology programs at their equivalent of our Department of Archives and History. **Annual savings** will amount to **\$496,812**.

Reducing funds to the Leadership Center at USC-Salkehatchie.

Although worthy, this program is designed for middle and high school students and should be funded by the local school districts. We proposed eliminating this funding last year and propose it again in this budget **saving \$100,460** in general funds.

Reducing expenses through collaboration and cooperation among the research universities. The USC/MUSC pharmacy schools merger is an example of a successful collaboration which will yield significant savings to the state without

Governor's Task Force on Higher Education

Developing a statewide plan

Through Executive Order, Governor Mark Sanford launched a Higher Education Task Force on February 8, 2006, to work with the South Carolina Commission on Higher Education to identify steps to reduce tuition, encourage more collaboration among universities, and reduce duplication within the system.

Chaired by Lyles Glenn, a Columbia area attorney and former official at the University of South Carolina, the Task Force met throughout the summer, reviewed recent research and data, and considered testimony from various state and national higher education officials and legislators.

Ultimately, the Task Force found that many of the issues surrounding higher education in South Carolina were symptoms of a pressing need to coordinate activities through a comprehensive, statewide strategic plan for higher education.

The recommendation of the Task Force was that the governor and Legislature convene a committee of knowledgeable individuals to develop a plan for higher education in South Carolina. The Committee would be comprised of members of the higher education, K-12 education, and business communities.

Now, more than ever, it is necessary to our success as a state that we must all work together better and our institutions must be more efficient and productive not only individually, but in collaboration with each other.

weakening the quality of the program. Through further such efforts, the research universities should continue to engage in additional partnerships that can produce additional savings. There are encouraging signs that they are continuing to pursue those objectives in other areas of overlap – such as colleges of nursing and medicine. We propose a one-percent reduction for Clemson, USC, and MUSC that will result in **savings of \$3,232,091** in general funds to further encourage such collaboration.

Eliminating a pass through to the Omega Project. This funding passes through Francis Marion University and is used solely to fund the Palmetto Project's voter initiative in the Pee Dee region. This is not a part of the university's core educational mission. We proposed eliminating this pass through last year and propose it again in this budget **saving \$56,147** in general funds.

Reducing funds for underutilized degree programs. The Commission on Higher Education conducted a Program Productivity Study in July 2004 that resulted in a number of degree programs being terminated for lack of participation or demand. Offering degree programs that have only a few students participating and graduating, especially when these degrees can be obtained elsewhere in the state, is a clear inefficient use of resources. We, therefore, propose eliminating several additional underutilized degree programs at The Citadel, South Carolina State University, USC-Columbia, USC-Upstate, and Winthrop University and correspondingly reducing funding for one teaching position at each of these institutions. By reducing this funding, we can **save \$241,282**.

Institution	Degree	Program	Enrollment Average	Completion Average
The Citadel	Bachelor	French Language and Literature	6.6	0.8
South Carolina State	Bachelor	French Language and Literature	0.4	0.2
USC-Columbia	Bachelor	European Studies	2	0.4
USC-Upstate	Bachelor	French Language and Literature	3.6	0.4
Winthrop	Master's	Mathematics	3.8	1.8

Facilities and Maintenance Cluster Initiative. Another opportunity for successful collaboration, which will yield significant savings to the state without weakening the quality of the institution, lies in maintenance and facilities expenses. Many of our state's four-year institutions are located within close proximity to either another four-year institution, or a technical college, yet these institutions have their own independent facilities and maintenance entity. An example of this lies in the city of Charleston, where MUSC, The Citadel, and the University of Charleston are all located within five miles of one another, yet all three have separate facilities and maintenance support staff. We believe that with three separate entities in such close proximity providing similar

services, there are opportunities to combine facilities and maintenance operations and reduce costs. These types of opportunities exist throughout our higher education system and we encourage institutions within a 25-mile radius of one another to reduce the costs associated with their facilities and maintenance activities. Reducing costs to the university, we will prevent significant tuition increases for our state's students and families. This initiative will provide **\$6,957,065** of general fund **savings** based on the centralization of facilities and maintenance management that will afford a reduction in overhead.

MRR Parity for our state's colleges and universities. Last year, the General Assembly gave most of our state's colleges and universities supplemental funds to be used to support initiatives such curriculum development, research, professional development, and other support services in areas demonstrating the highest need or greatest possible impact. Within our FY 2007-08 Executive Budget, we initially sought to annualize the amounts provided to each institution. We felt this obligation because nonrecurring funds should not be used to implement or permanently enhance programs. In the end, we chose not to fund these annualizations because we feel that there are structural concerns related to parity funding and higher education financial accountability and reporting.

First, the parity issue is made difficult with the continued insertion of special projects into an institution's budget by legislators with a particular interest in that institution. How can an accurate determination of parity funding be made when some institutions with more prominent legislators acquire additional funding for their local institutions, while other institutions are not privy to that funding?

Second, there is an issue of financial accountability and reporting within our state's current higher education system that must be addressed. When deciding how to adequately fund higher education in our state, it is important to assess the amount of carry-forward funding available to each institution per year. Continuous dollars which roll over from year to year should be seen as a first source of funding for new projects. Along those lines, this year, we analyzed the ability of all state agencies to "self-fund" their new requests with carry-forward dollars. Unfortunately, the current financial reporting system does not allow for easy viewing of carry-forward dollars at the state's higher education institutions since none of them are linked to the Comptroller General's office in the same manner as other agencies. This problem is compounded by the fact that the Commission on Higher Education apparently does not track such financial data either. How can we make a decision regarding higher education funding and parity this year when it is unclear how much funding an institution has remaining from previous years? Therefore, it is our hope that the Higher Education Task Force being assembled to develop a statewide plan for education will address both the issue of financial accountability and reporting and the parity funding issue. Until a better system is in place, it would be irresponsible to pour more money into a flawed system and annualize the Mission Resource Requirement (MRR) Parity amounts from last year.

Governor's School at the University of Charleston. This residential summer program for academically and intellectually gifted high school students was established in 1976 and represents slightly over one percent of the university's state appropriation. The state subsidizes about 80 percent of the costs to attend while current students pay only \$1,000 or about 20 percent of the actual cost for tuition, room, board (three meals a day), books, field trips, local phone service, and enrichment activities. Discontinuing state funding for this summer school program will result in a **savings of \$288,017** in general funds.

Co-education Initiative at The Citadel. These funds were originally appropriated to retrofit dormitories, construct new restroom facilities, and pay for the court-ordered activities necessary for incorporating women into the school's core of cadets. Since all the program's one-time expenditures have been paid for, we recommend funding only those activities that are essential to fulfilling the program's core intent of assimilating women into the institution. These core activities include salaries and fringe, a consulting and conference fee, and recruiting costs. Eliminating all other non-essential activities will result in a **savings of \$66,269** in general funds.

Making Tough Choices:

Given the state's finite amount of resources, we had to make some difficult choices regarding which activities to fund or not fund. While the activities listed below may well have merit, when comparing them with other activities, we did not think their anticipated outcomes would be as effective in achieving our goal. The following activities reflect some of those difficult choices:

Greenville Higher Education Center is a consortium of public and private colleges and universities offering degree programs to the citizens of the Upstate and surrounding areas. We believe that with seven institutions participating in the Center, including Clemson, Furman, MUSC, USC-Columbia, USC-Upstate, South Carolina State University, and Lander, this small amount of money can be provided by alternative sources of funding. This will result in **savings of \$180,287** in general funds.

Expenditure for the Arts Program through the Commission on Higher Education. This appropriation is used to pay the differential in tuition costs for students to attend the North Carolina School for the Arts in Winston-Salem, North Carolina. Funding South Carolina students' out-of-state tuition may be justified where equivalent programs are not offered by South Carolina's institutions of higher education (such as a veterinary school program), but art programs are readily available in-state. This will result in **savings of \$10,274** in general funds.

South Carolina Student Legislature is a statewide program allowing college students to simulate an active role in South Carolina political issues and discussion. We

believe funding for this program, though worthy, should be provided by alternative funding sources resulting in a **\$17,780 savings** in general funds.

National History Day in South Carolina. This is an educational program that encourages students in grades 4 through 12 to study, research, and develop topics related to history and to expand their knowledge through exhibits, performances, documentaries or historical papers. While this program is valuable in educating students about history, it reaches less than two percent of students (less than 9,000) statewide. Reducing state funding for this program will result in **savings of \$57,400** in general funds.

Please see the Appendices for a complete listing of the Governor's Purchase Plan for this goal area and for a detailed listing of what our plan saves and what our plan does not buy.

Improve the Conditions for Economic Growth

Improve the Conditions for Economic Growth

From A to Z, South Carolina understands economic development and is clearly making the effort to continue its attractiveness to business. When it comes to economic development, it is a state that other states should emulate.

— Pollina Corporate Real Estate, Inc., corporate relocation publisher

These comments speak volumes to the efforts of this administration, our Department of Commerce, and other economic developers throughout the state. We have constantly looked for policy changes that would enhance our state's competitive edge in terms of work force, infrastructure and quality of life – in return bringing to South Carolina many quality enterprises that help us move the ball forward in economic growth.

It is our goal to continue this trend. As South Carolina continues to compete with the rest of the world, never before has competitiveness been so paramount. Manufacturing jobs are not only being sent overseas, but also an increased productivity level by workers is reducing the number of bodies needed to produce the same product versus even five years ago. Take the tire industry, for example. Rapidly rising imports of tires, especially from China, are increasing pressure on American and South Carolina tire makers to become more competitive in the area of cost or face the possibility of plant closings. Passenger-tire imports into the United States, which have been steadily increasing every year this decade, topped the 100-million mark in 2005, with Chinese imports up 47 percent from 2004. The question is not just, "What are South Carolina companies doing to compete?" but also, "What are policy makers doing to provide an environment so companies can compete?"

From day one, this administration's goal has been to make South Carolina more competitive in attracting jobs and capital investment. Last year's Commerce budget clearly shows this effort. Allocating \$7 million for the first ever "closing fund," \$1.2 million in new money to hire a dozen new project managers, and another \$1 million for additional marketing were all significant steps taken to beef up Commerce's "tool box." We are committed to working with the General Assembly to make further progress and

Governor Sanford's
Goals for **Improving
the Conditions for
Economic Growth:**

- ✓ Capital Investment Growth.
- ✓ Small Business Community Growth.
- ✓ Provide jobs for existing work force.
- ✓ Increase personal income.

to create a friendlier business climate in South Carolina that will build on the successes our economy has already seen.

Developing Our Purchasing Priorities

In order to develop our purchasing priorities, we first looked at the major indicators of success to determine whether state government is currently reaching its goal to improve the conditions for economic growth. We have found that South Carolina is making progress; however, there are areas that need improvement. This section identifies the measures that help explain whether our state is or is not achieving our goal.

Where We Are Succeeding

South Carolina continues to improve its overall business climate. By working with the General Assembly on a number of pro-jobs and pro-growth initiatives, we have been able to send a clear signal to all prospective job creators – we are not only open for business but are also working to make South Carolina the preferred place to do business.

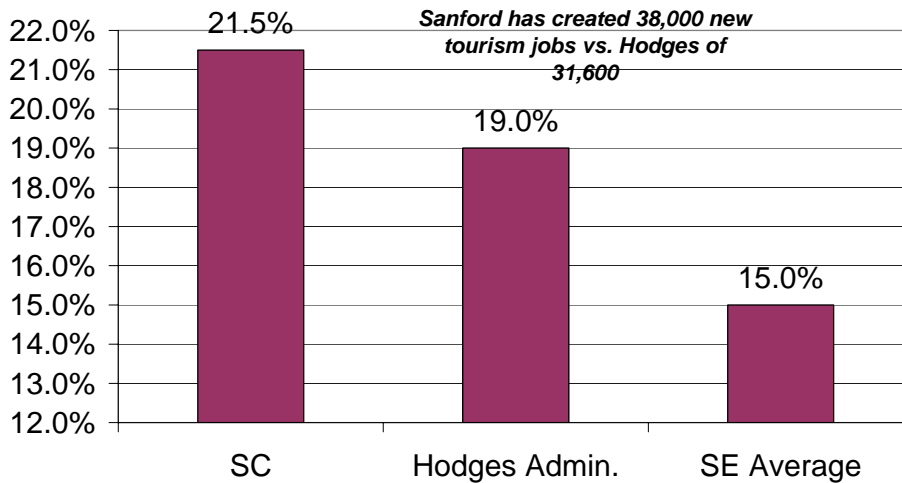
This session, from constant efforts by this administration, South Carolina passed film incentive legislation that will make South Carolina more competitive in attracting major motion pictures, independent films and television shows. The new law, which increases the wage rebate from 15 to 20 percent and the supply rebate from 15 to 20 percent, will couple our state's existing scenic competitiveness with more aggressive industry incentives. This was so important because the film industry pays high wages and does not have the same infrastructure needs as those of traditional business development. In fact, we are already beginning to see the impact of this legislation. According to Commerce, not only are new productions locating here, but now they are spending more than ever. In the past, production companies would spend between 33 percent and 50 percent of their budget in our state. Now, studios are spending an average of 70 percent of their budget in-state. We have finally sent a clear message to the industry that South Carolina wants its business.

A major factor that has assisted in record job creation and capital investments is our unmatched work force training programs. Through a coordinated effort between the Department of Commerce, our Technical College system, and the Workforce Investment Board, we offer companies trained workers who can be productive the first day on the job. This unique partnership was a big factor in Vought-Alenia's decision to locate their state-of-the-art facility in the Low Country. Approximately 200 workers will have been trained in a nearby classroom on the same machinery that will be used in their manufacturing process. This jump start will allow Vought-Alenia to remain on schedule for the delivery of pre-sold aircrafts.

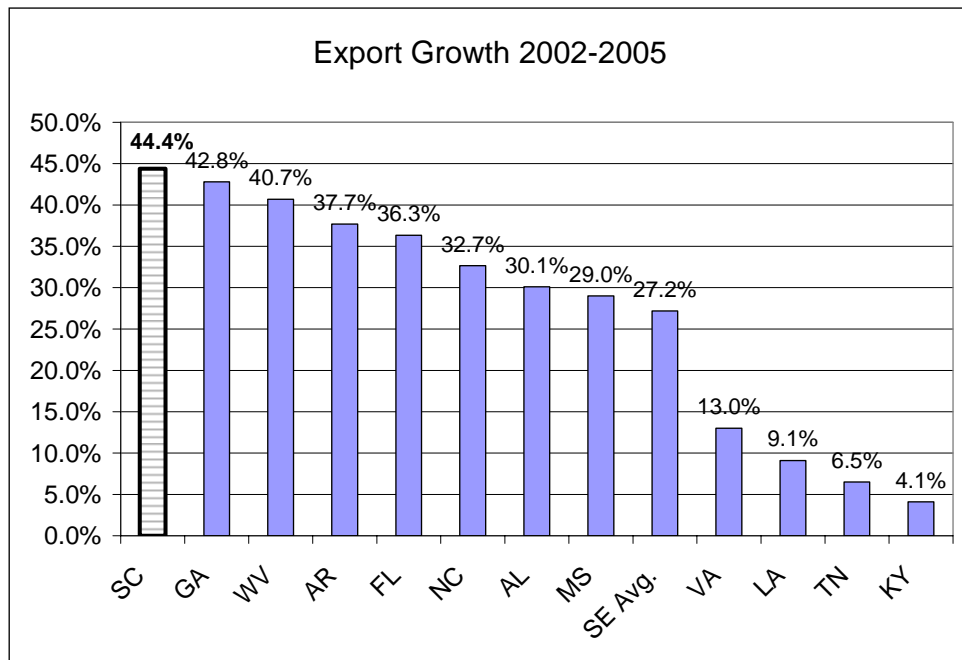
Separate and distinct from manufacturing, our state has a large dependence on service industry jobs. This sector has always been both a large employment base for our state and a significant form of revenue. In this category, tourism leads the pack and

continues to be the state's largest industry. To maintain this positive impact on the overall economy of the state, the Department of Parks, Recreation and Tourism has focused its marketing funds on attracting visitors who will stay longer and spend more dollars. This type of effort has helped South Carolina become a leader in the tourism economy – especially as it translates into jobs. Since 2003, South Carolina is clearly outpacing the previous administration and the Southeastern region in terms of new jobs created in the tourism industry.

Tourism Employment Growth Since Taking Office



South Carolina has also done a good job of utilizing particular state assets to their fullest. Our port system is a prime example of an asset that continues to reap huge economic gains. In fact, since we have taken office, South Carolina has led



the Southeast in growth of exported goods growing at a rate of 44 percent and clearly

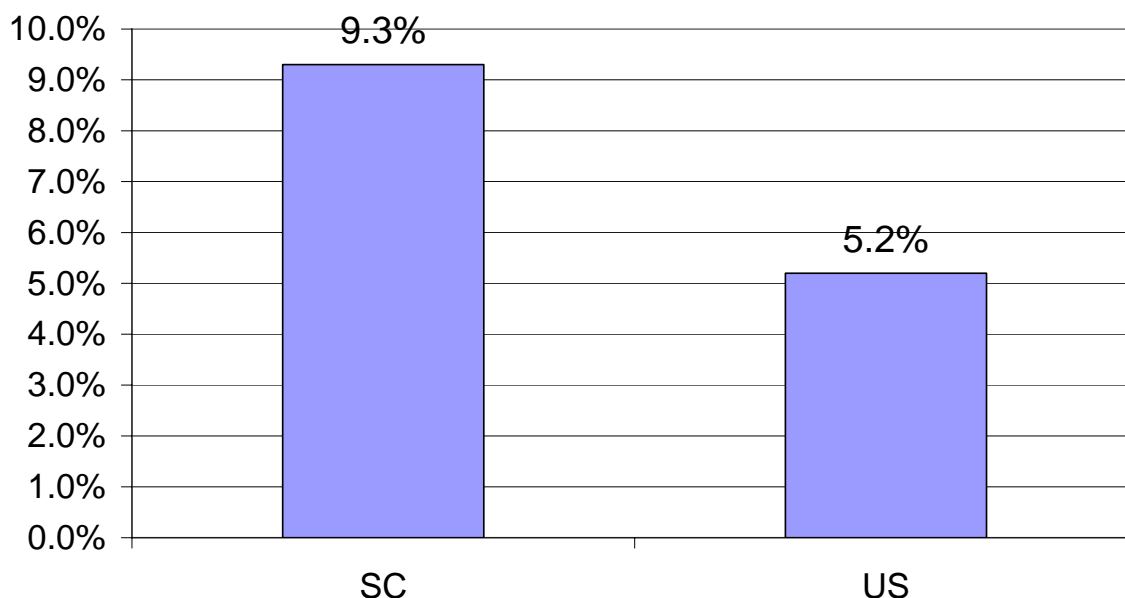
outpacing the Southeastern average of only 27 percent. We continue to look at ways to fully use the capacity that we have and for opportunities to increase container volume in order to meet demand.

Opportunities for Improvement

This administration continues to believe that comprehensive reforms are key to job creation and business growth. A focus on changes in the overall business climate is needed if South Carolina is to have further economic success. That is why the small business income tax reduction and comprehensive tort reform were so important. But the fact remains that this administration will not stop pushing for changes and evaluating the economy until every last South Carolinian is employed.

Since this administration has taken office, South Carolina has over 134,000 people employed that were not four years ago. But despite that growth in the number of jobs, we continue to have an amazing number of people coming to our state, which has accelerated our labor force growth. Naturally, a rapidly-growing labor force will impact our rate of employment. According to the U.S. Bureau of Labor Statistics, our labor force has grown 9.3 percent during our first term while the rest of the United States has only grown at 5.2 percent.

Labor Force Growth Since Taking Office (Dec. 2002 - Oct. 2006)



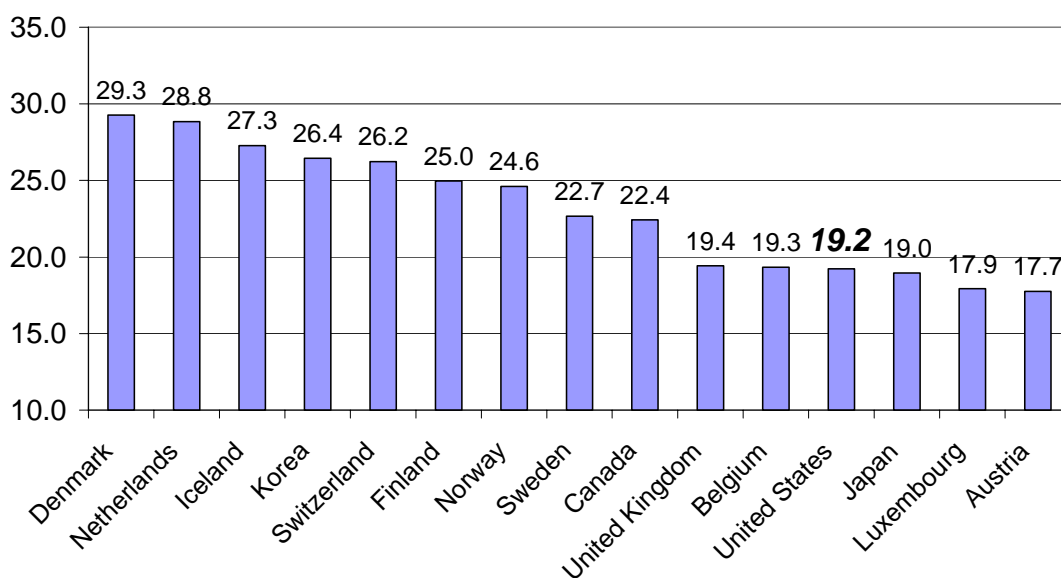
Typically, rising labor force participation is a positive sign for the economy – a greater portion of the population is becoming attached to the labor market. Yes, this may result in higher unemployment in the short term, but can also be beneficial over a longer period.

– Division of Research, Moore School of Business, November 2005

The labor force growth indicates that we must continue to put forth an extra effort when it comes to job creation. But also it speaks to the greater point that we must look at all economic indicators – and not just the unemployment rate – to have a true understanding of South Carolina’s economy. The fact remains that our unemployment rate does not match the number of jobs we have created, the rapid increase in our state revenues, and the decrease in the number of people filing for unemployment.

It was mentioned in our State of the State last year that to be competitive and thrive in today’s global economy, it is vital that people living in rural South Carolina have as much of a chance to get on the information highway as people living in our urban cores. At a national level, the U.S. leads all countries with 57 million total broadband subscribers. However, last year it was predicted China should overtake the U.S. in total broadband subscribers by the end of 2006. On a per-capita basis, the United States is only 12th among nations globally in broadband penetration with 19.2 connections per 100 inhabitants – with Denmark leading the way at a connection rate 53 percent greater than the U.S.

Worldwide Broadband Penetration (per 100 inhabitants) - June 2006



If we are to be competitive in this global economy, it is imperative that all South Carolina citizens have affordable high-speed Internet. A study by the Freedom Works Foundation shows that widespread broadband deployment would add nearly 13,000 jobs to South Carolina and increase the state GSP by \$4.55 billion.

This administration has taken steps to provide easier and more affordable access to the Internet in past years. In 2003, we signed legislation to deregulate broadband services by exempting them from regulation by the South Carolina Public Service Commission, and this past session we signed the Competitive Cable Services Act allowing for more cable companies to enter the market – who also provide Internet services. These two bills create an Internet market that is more open and in the long-run will reduce broadband prices. However, more must be done if we are to remain truly competitive.

We believe it is time to formulate a statewide policy that will help rural areas become better connected to the information highway. That is why in this year's budget we propose \$2 million to establish a Rural Broadband fund. This fund would prioritize allocated dollars to areas of the state that lag behind in the number of households connected to the Internet. Details of the proposal are to be discussed later in this section. The bottom line is we are committed to seeing what the public sector can do to help in leveraging the private sector's investment in this area.

Purchasing Priorities

The major funding priorities are those that we think will best achieve our goal of improving the conditions for economic growth. Our five major funding priorities are:

Provide for the growth and sustainability of all communities. Growing and sustaining the successes in all areas of the state are vitally important if we are to remain competitive in the global marketplace. A good portion of this success is in communities classified as developed/moderately developed. However, this administration has also seen steady growth in the rural areas with 43.9 percent of total investment being in rural counties last year as compared to 11 percent in 2004. This administration believes it is important to continue this trend of finding ways to grow all of South Carolina and not just one area.

Provide for more effective and broad based incentive and grant programs. This past session was highlighted with a number of bills crafted specially for one business or one area of the state. We believe it is time to take a look at incentives in a more holistic manner rather than in the piecemeal fashion that has been the practice for years. The fact is there are a finite amount of resources available to spur South Carolina's economy. To this end, each time an incentive is carved out for one business or area, we are taking away dollars that could be used for economic development statewide. The goal should be to focus the state's energy and resources on improving the entire business community by purchasing programs that will take South Carolina to the next level in creating jobs and attracting investments.

Provide a reasonable and safe business regulatory environment. For the benefit of consumers and businesses, it is important that the state have some degree of oversight. These business-friendly regulations should ensure some minimum level of skill for licensed practitioners to support health and safety, protect citizens from financially impaired companies, and enforce workplace safety in order to reduce injuries. When the safety or well-being of citizens is not an issue, market-based forces should replace the need for an excessive number of licensure boards. A large percentage of these functions are fee-based and require little general fund dollars.

Provide for a more unified and focused effort in the marketing of our state's assets. The role of government is to promote an inviting image of our state and its resources. Through a targeted marketing campaign, the state's cultural, natural, and man-made tourism resources are promoted for the purposes of attracting visitors to the state to spend their discretionary funds. There is a tangible economic impact from the state's investment – every dollar properly invested in marketing returns more than \$20 in direct tourism spending to the economy. The economic benefits of tourism are felt in all areas of the state, including rural and less-developed communities. Also, branding South Carolina as an attractive place for all businesses to succeed will help us continue down the path of economic success.

Provide for resources and infrastructure for a more skilled and prepared work force. South Carolina has received top rankings for programs that are dedicated to preparing tomorrow's work force. Expansion Management Magazine recently ranked South Carolina fifth for work force training. The Center for Accelerated Technology Training (CATT) program is a big reason for this success. We have also made a more collaborative effort on this front by bringing the Workforce Investment Act funds to the Department of Commerce. However, there are still millions of dollars being used for work force development in other agencies. If we are to provide businesses with a ready supply of trained workers, we must look to streamline these programs so the maximum amount of dollars can be dedicated to work force training.

Governor’s Purchasing Plan – Highlights

We address our state’s fiscal problems by purchasing only those services that deliver the greatest impact on improving the conditions for economic growth. We do not purchase some services that, while still considered valuable, have been identified as lower priority. The following table identifies key purchases within our executive budget’s total state economic development spending plan as well as examples of what is not purchased. Detailed highlights of our purchasing plan are provided below the table.

<p><i>Improve the Conditions for Economic Growth</i></p>		<p>Examples of what our plan buys:</p> <ul style="list-style-type: none"> ▪ Funding of \$2,000,000 to deploy broadband services to rural South Carolina. ▪ Increased marketing funds for our state’s economic development agencies. ▪ Hands-on training for more than 5,900 students. ▪ Funding for the development of the Myrtle Beach Airport. ▪ Replenishing dollars for the “closing fund”. ▪ Funding of \$100,000,000 for port access road.
<p>Purchasing Plan:</p> <p>\$90,370,764 General Funds</p> <p>\$1,535,514,143 Total Funds</p>		<p>Examples of what our plan does not buy:</p> <ul style="list-style-type: none"> ▪ Direct pass through funds. ▪ Less efficient, duplicative services. ▪ Many activities that fall outside agencies’ core missions.
<p>Savings Proposal:</p> <p>\$2,539,902 General and Other Funds</p>		

Our Plan Buys:

First-time funding for a Rural Broadband Fund. In order to be competitive in this global marketplace that now exists, it is crucial that all businesses and individuals have an opportunity to access the information highway – this includes the more rural areas of this state. This administration is committed to giving every person in South Carolina this opportunity. The fact remains, however, that there are many areas of the state that do not have access to the information highway. According to the Office of Regulatory Staff, some form of DSL is available in only 73 percent of the places where phone companies currently provide service. This is a clear indicator that broadband access is not available to all South Carolinians.

High-speed Internet access is rapidly becoming essential to competing successfully in today's global economy. It can play a critical role in enabling South Carolina citizens to improve their lives through technology. To this end, we believe the Department of Commerce is the most appropriate entity to make decisions in spreading Internet access across our state. We specifically recommend creating the South Carolina Broadband Advisory committee within Commerce composed of nine members and chaired by the Secretary of Commerce. The Council is to manage, oversee, and monitor efforts to provide rural counties and other local government entities with high-speed broadband services – including the oversight of all funding mechanisms. This year we propose **\$2 million in funding** to implement this program at the Department of Commerce.

Funding for a port access road. The South Carolina port system continues to be one of the state's strongest assets when it comes to recruiting quality companies. In fact, this success has helped businesses grow and call for greater capacity at our ports. The Ports Authority has taken steps to create additional capacity for the short term and has looked at other ways that will expand the port system to meet future demand. Specifically, the state is looking to expand future operations into the former Charleston Navy Base terminal. The plan for the Navy Base site calls for a new three-berth terminal that could handle more than one million 20-foot equivalent unit containers a year. The terminal, however, cannot open without a road that is sufficient in providing access to the new facility.

During last year's budget process, the Contingency Reserve Fund was created for the accumulation of revenues in excess of the FY 2006-07 Appropriations Act. Revenues credited to this fund may be appropriated during the following year and may be used for infrastructure needs such as a Port Access Road. Currently, this fund has accumulated \$171 million.

The port expansion is important to continue growing our state economy and funding is immediately needed to start the process of constructing a Port Access Road for the new terminal. The access road for the terminal will allow South Carolina businesses to continue to expand and thrive in new markets all over the world. To this end, we propose **\$100 million in funding** from the Contingency Reserve Fund for construction of a Port Access Road.

Marketing dollars for the state's agriculture and forestry products. This industry, with a more than \$2.5 billion economic impact, spends funds on traditional advertising, materials and trade shows for the South Carolina Quality Program. Last year we proposed additional funding for the first time in more than five years for this program. Once again, we believe additional funding is warranted. We propose additional **recurring funds of \$400,000** for this program.

A recurring increase for the Department of Parks, Recreation and Tourism's media placement budget. At the request of New Carolina (South Carolina Council on Competitiveness), a recent report by Ireland-based Tourism Development International (TDI) showed that South Carolina has the potential to

increase its return on investment if the proper steps are taken. The report stated that tourism contributes \$10.9 billion to South Carolina's Gross State Product and currently less than one-fifth of one percent of the state's earnings from tourism is reinvested into promoting state tourism. However, the report went on to say that tourism has the potential to contribute \$40 billion to Gross State Product by 2020.

We believe dedicating additional dollars will take us one step closer to obtaining this potential and will strategically encourage private investment in the right areas to achieve overall economic growth. The report makes recommendations such as dedicating additional funds to strengthen the overall state tourism marketing campaign and continuing a destination-specific marketing match grant program. Bottom line, we believe dedicating additional dollars towards our number one industry is a good investment. Therefore, we propose **an increase of \$13.4 million in recurring funds** for the agency's media placement budget.

Dollars to locate qualified investor for state venture capital. The passage of the Venture Capital Investment Act in 2005 provided access to \$50 million in tax credits which serve as collateral for private institutional lenders. These lenders extend capital to designated investment professionals who in turn invest in South Carolina companies. The returns from these in-state investments are used to pay back the private lenders before they utilize the state tax credits. When managed successfully, South Carolina is positioned to benefit from economic growth without added state expenditure. We propose **an additional \$197,500** for administrative costs of operating the venture capital program within Commerce.

Funding for the development of the Myrtle Beach Airport. Tourism is the leading industry in this state, and at the center of this success are the many activities occurring along the shoreline of Horry County. More than 13 million tourists visit the Grand Strand each year. Horry County leads the state in tourism, accounting for over 38 percent of revenues. The traditional tourist season (the summer months) is continually expanding. We believe that the economic value of tourism in Horry and across the state is too great an asset to jeopardize. In order to meet the demand of increasing tourists, we are proposing **additional funding of \$10 million** for the development of the Myrtle Beach Airport.

Dollars to market the state's resources to film makers and industry investors. The film industry has the ability to develop new sources of revenue for our state and create high-quality jobs, while putting very little demand on the state's education and infrastructure resources. To continue the state's successful efforts in recruiting film production to the state, we propose **maintaining current funding at \$591,648**.

"Closing Fund" for economic development. When trying to attract new companies to South Carolina, we often stay in the running until the very end. That is why last year the closing fund at the Department of Commerce was so important. Other states throw additional value-added items on the table to sweeten the deal, and we must

also continue to have the same ability. Last year \$7 million in one-time funds were appropriated to this fund. We believe in the importance of this program and that it deserves recurring revenue. To this end, we propose **\$7 million in recurring funds** to maintain this very important fund.

Agricultural biotechnology research at Clemson PSA. This research is used to improve agriculture, the environment, and human health. Efforts are coordinated with the South Carolina Biotechnology Incubation Facility and the Department of Commerce to recruit biotech companies and assist with new company start-ups. We propose **maintaining current funding** at **\$2,739,737** in general funds, amounting to **\$3,854,212** in total funds.

An electronic imaging and workflow system for the Department of Insurance. Last year we proposed one-time funding to move the Department of Insurance away from paper form filing to filing in a computerized system. With a requirement that everything be maintained for 100 years, the computerized system is very efficient. We propose **maintaining recurring funding** of **\$100,000** for an imaging system to continue making the agency more efficient.

Implementation of a comprehensive marketing program at the Department of Commerce. In today's global economy, it is important that businesses are aware of South Carolina's positive business environment. Funding is for business retention marketing, advertising, public relations, collateral materials, trade show participation, and industry specific events. For all of these efforts, we propose **maintaining recurring funding** of **\$2.2 million**.

Annual payment for State Ports Authority for harbor dredging. The economic impact of the ports continues to grow with the recruitment of companies, such as Vought-Alenia and Daimler-Chrysler and the expansion of international companies, such as BMW and Michelin. Making the harbor passage deeper will keep the vital state asset competitive. We propose **non-recurring funding** of **\$2.4 million** for the Charleston Port's continued deepening efforts.

Funding for the Center for Accelerated Technology Training. One of the largest drivers for companies to expand or locate in South Carolina is the worker training program that is coordinated through our Technical College system and the Department of Commerce. The latest annual data indicates that 5,900 students were trained for over 100 different employers. Because of the success of this program, we propose new **recurring funding** of **\$1.5 million** for this work force training program.

Recurring funding for the International Center for Automotive Research (ICAR) at Clemson University. This project is a successful example of South Carolina's efforts to focus on building knowledge-based industry clusters. The private-public partnership has created an opportunity for the state to become a leader in the United States for automotive research. Because of the current and expected economic impact of the partnership, we support the goals of the program and, therefore, propose

maintaining **recurring funding** of **\$1.5 million** for personnel and equipment for the campus.

Start-up and ongoing expenses for a statewide Hydrogen Fuel Cell Coalition. The coalition is made up of the five regional hydrogen research organizations. It would be housed at the Department of Commerce. We propose maintaining **recurring funding** of **\$367,640**.

Local work force investment to meet the employment, training, and labor market needs of businesses, job seekers, and at-risk youth. These federal dollars are spent in coordination with the state's economic development activities to help recruit high-paying jobs. The training programs are in areas of industries and companies that the Department of Commerce has targeted. **Projected FY 2007-08 federal funding is \$60 million.**

Our Plan Saves By:

Directing gasoline tax revenue to the petroleum inspection and testing program. The Department of Agriculture is charged with inspecting and testing gas pumps for accuracy and suitability for service. The current state law provides that, "For the purposes of providing funds for inspecting, testing and analyzing petroleum products and for general state purposes, there must be paid to the department a charge of one-fourth cent a gallon..." Currently, the department runs this program with general fund dollars. We propose directing the state amount of funds from the gas tax to run this program because it is statutorily required. This will allow the agency to hire the needed inspectors to ensure this program is run as expected. This will generate **General Fund savings** of **\$390,606**.

Directing the local government infrastructure grants at the Budget and Control Board to the Department of Commerce. As lead agency on economic development for the state, the Department of Commerce should be the agency in charge of all funds directed at growing the economy of our urban and rural areas. Since taking office, this administration has had unmatched success in the state's rural communities. As an example, in an effort to continue improvements toward work force readiness in rural South Carolina, the Rural Infrastructure Fund helped create Northeastern Technical College Information Technology Laboratory classroom at its Dillon County Community Campus. Looking at the big picture, in 2005, rural capital investment in our state was \$1.33 billion, up from \$635 million in 2004. We believe even more success can occur by moving this program and all associated grant funds to the Department of Commerce and would generate **General Fund savings** of **\$137,771**.

Making Tough Choices:

Given the state's finite amount of resources, we had to make some difficult choices regarding which activities to fund or not fund. While the activities listed below may well have merit, when comparing them with other activities, we did not think their anticipated outcome would be as effective in achieving our goal. The follow reflects these difficult choices:

Reducing pass through funding. This administration has always believed that any public-private endeavor should employ an open and objective competitive process so that the most worthy projects receive public investment. We continue to believe a competitive grants program is a more fair way to fund these projects than with pass through funding. This will **save \$1,631,274**, but will allow these organizations to apply for funding through the competitive process.

Clemson Public Service Activities reaching outside of their core mission of agriculture. The administration continues to recognize the valuable role Public Service Authorities have played in our rural areas over the past several decades. However, as we mentioned before, we think that the agency should narrow its focus to more closely concentrate on its core mission of serving our state's agricultural community. Those non-core activities we identified are within the Rural Community Leadership Development program. These activities represent a general fund **savings of \$380,251**.

Please see the Appendices for a complete listing of the Governor's Purchase Plan for this goal area and for a detailed listing of what our plan saves and what our plan does not buy.

**Improve the Health
and Protections of
Our Children and Adults**