FISCAL RESEARCH CENTER

A GEORGIA FISCAL HISTORY OF THE PAST FORTY YEARS

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Georgia State University | ANDREW YOUNG SCHOOL OF POLICY STUDIES

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Executive Summary

Georgia has changed dramatically over the last four decades. From 1960 to 2000, the state's population doubled, the population aged and per capita income climbed toward the national average. Over the period, the role of the state government has also changed. Some of the major changes in Georgia revenues, expenditures, demographics and in the Georgia economy are listed below.

In the 1960's,

- Total Georgia population grew by 16 percent and the composition changed toward working-age residents (fostering growth in state own-source revenue and spending);
- The personal income tax as a share of total statewide income leapt; sales tax growth was moderate at first, then strong to 1972;
- Libraries, correction and higher education were strong spending growth areas; The latter can be partially tied to initiatives during the Maddox administration;
- K-12 spending growth was moderate, but many new programs were priorities for Governor Sanders and Governor Maddox.

In the 1970's,

- Total population in the state grew by 19 percent over the decade;
- Since inflation accounted for most of the per capita income increase, state fiscal conditions were very different in this decade;
- Total state revenue slid against total state income in the latter half of the decade. The individual income tax was again an area of unusually strong growth. Slow growth for the sales tax was a surprise, but we now understand that (untaxed) services-sector growth was a key determinant; and
- Direct state spending growth also closely tracked the Georgia economy during this period. Prison spending was again an area of high growth. Medicaid spending started slowly, but accounted for 6 percent of the state budget in 1982.

In the 1980's,

- Population grew by 18 percent during the decade;
- Inflation slowed and real economic growth increased dramatically;
- The individual income tax again grew rapidly. Sales tax revenue grew slowly, but collections increased when the state rate increased from 3 to 4 percent in 1989. Selective charges (e.g. park admissions) also increased rapidly;
- Public welfare spending reached 32 percent of total direct spending and corrections climbed to 5.5 percent of total direct spending; and
- K-12 spending did not grow as rapidly as the Georgia economy. One reason was the slow transition to the Quality Basic Education program under Governor Harris.

In the 1990's,

- The strongest population growth occurred in this decade, 26.4 percent;
- Georgia experienced even faster population growth than in the previous decades;
- Buildup to the Olympic games produced a spike in the state sales tax;
- Spending grew almost as fast at the Georgia economy, with significant growth in natural resource and highway spending;
- Changes to the Medicaid program helped slow spending growth for that program; and
- The Georgia Lottery produced big headlines, but did not translate into fast growth in education spending.

In the early 21st Century, we believe five issues will challenge policymakers in Georgia and many other states:

1. Population Will Continue To Age.

As with most of the United States, the Georgia population will begin to age dramatically. Returning to Figure 1, the population share over 64 is expected to jump from just under 10 percent to almost 17 percent. On the revenue side, the aging will lead to slower income tax growth and possibly more political pressure on the property tax as a source of school funding. For state spending, growing senior services will represent a mix of new federal and new state obligations. For example, an increase in senior citizens generally leads to new Medicaid spending for nursing home services. The net impact of these aging pressures is not known with any degree of certainty.

2. The Price of Healthcare.

Recall from Figure 7, the relative inflation in the price of medical services is a serious cause of concern. Without a national initiative, states will have trouble managing Medicaid spending and will face difficult decisions on program eligibility and the scope of coverage.

The price increase also creates a feedback effect – where employers try to reduce coverage and states find themselves with more uninsured families. In response, Georgia hospital managers will continue to lobby for more favorable funding formulas for indigent care (Miller, 2005).

3. The Corporate Income Tax.

Legal tax avoidance schemes have partially undermined the Georgia corporate income tax (Grace, 2004; Cornia et al., 2005). The revenue impact for these schemes can be observed in Figure 5, where state corporate income tax collections used to track U.S. corporate profits very closely; but lately, state collections fell when national profits increased.

Georgia's reliance on the corporate income tax has declined, down to 0.3 percent of total state income, which helps lessen the impact of the avoidance trend. During the preparation of this report, however, a *huge* revenue increase (40 percent) was reported for fiscal 2005. Several plausible causes for the increase have been suggested, but we have little evidence beyond the revenue increase itself.

The problem, in our opinion, is that the tax still accounts for more than $400 million (not counting the 2005 surge) in state revenue and the future of this funding source is partially being determined by executives and avoidance-design consultants. If policymakers do not continually address these schemes, we believe corporate income tax collections will continue to fall in a growing Georgia economy, but we cannot forecast the speed of the decline – especially given the unexpected increase for 2005.

4. The Antiquated Sales Tax.

The sales tax still reflects its original design, a levy on inventory movement in an industrial economy. The modern economy continues to move away from the model the sales tax was based on and unexpected decreases (and increases) have become a norm.

The present challenge is whether Georgia has the will to continue dramatically simplifying the tax in order to induce online vendors to collect (Cornia, Sjoquist, and Walters, 2004). Beyond the flow of goods on the internet, the problem of consumer services still lingers. For example, 2002 e-commerce revenues for selected service industries were almost as large as e-commerce revenues for retail trade (U.S. Department of Commerce, 2004). Thus, taxing goods on the internet does not address the larger services problem – where consumption spending is treated unequally in the Georgia sales tax (Bahl and Hawkins, 1997).

5. Corrections Spending.

Many believe that mandatory sentences passed in 1990's have put the prison system on the verge of a crisis. The state facilities are aging while the inmate population continues to grow – from 20,000 in 1990 to close to 50,000 today to a commissioner-projection of 60,000 by 2010. Most of the fiscal pressure comes in the form of capital spending needs – an estimated 10 new prisons at a construction cost total of $500 million to construct and yearly operating coats of $180 million. With the revenue source problems described, it could become increasingly difficult for Georgia to find the money for carrying out mandatory sentences.

I. Introduction

Georgia has changed dramatically over the last four decades. From 1960 to 2000, the state's population increased from 4 million to 8.2 million, the population aged as the state moved from 39 percent of the population under 18 in 1960 to 24 percent in 2000, per capita income increased from 75 percent of the U.S. average to 94 percent and the service economy grew rapidly from 11 percent of gross state product in 1977 to 18.5 percent in 1997.[1] Over the period, the role of the state government has also changed. In the 2005 State of the State address, for example, Governor Sonny Purdue discussed a new virtual high school, new caseworkers for Georgia families and enhanced job tax credits. These policies reflect issues that were somewhat different to those confronting governors forty years earlier.

The goal of this report is to analyze the history of change in Georgia's revenues and expenditures over the last 40 years. We discuss how demographic and economic changes related to the fiscal changes in state government over the period. The analysis is developed in a way that allows us to say something about how Georgia's fiscal history may influence its fiscal future. After describing our definitions on fast, moderate and slow growth to characterize Georgia's fiscal changes (Section II), we review the state revenue and spending categories (in Section III). The following four sections cover major fiscal changes in the 1960s, 1970s, 1980s and 1990s. We then turn to challenges for the next decade (Section VII) before finishing with a conclusion.

[1] 1977 is one of the earliest years for which detailed gross state product are available by industry, by state. After 1997, the Bureau of Labor Statistics (BLS) changed its definition of industry classifications, so we report services for 1977 and 1997 as these are easily comparable years.

II. About the Definitions of High, Moderate, and Low Growth

In describing high and low growth in government, one must be careful to not impose personal judgments on the related trends. For example, if state park spending increases from $200 to $300 million, an environmentalist may view that increase as moderate while a libertarian may see it as extreme. Since both views are based on different goals and values, we cannot declare either to be correct.

To reduce the role of these values, we define growth of individual fiscal items relative to the growth of personal income. "High growth" means that a fiscal variable grows faster than personal income over a multi-year span. For example, if income grows by 260 percent over a decade – partially due to population growth, inflation and a growing economy – and hospital charges grow by 400 percent, we designate hospital charges as a "high growth" item.

Our "low growth" definition is based on per capita dollars after adjusting for inflation. For example, if motor fuel tax collections per capita increased by 234 percent over the period, but motor fuels collections per resident grew more slowly than overall prices, we designate motor fuel revenue as a low growth item. A "moderate growth" designation represents fiscal categories where the growth rate was slower than that of the Georgia economy, but greater than the combined growth in population and prices.

III. About State Revenue and Spending

Before beginning our discussion on Georgia's recent fiscal history – since the early 1960's – one should understand the basic state revenue and spending structure. On the revenue side, there are four basic sources from which the state draws its funding:

1. Taxes (about 46 percent of revenue in fiscal year 2000);
2. Intergovernmental revenue from the federal government (22 percent);
3. Insurance trust revenue, e.g., unemployment and state employee retirement contributions (21 percent);[2] and
4. Charges and fees, e.g., university tuition (12 percent).[3]

Federal intergovernmental revenue helps support numerous state-administered programs, e.g., Medicaid, and generally includes restrictions on use. We note that insurance trust revenue is tied to obligations, both current and in the future, on the part of the state.

For state spending, major uses include:

1. Intergovernmental transfers to local governments (about 29 percent in 2000);
2. Public welfare (22 percent);
3. Higher education (13.6 percent); and
4. Insurance trust spending (7 percent).[4]

Here, we note that intergovernmental transfers include state education funding. In fact, some of these funds pass from the federal government through the state to local school systems.

[2] U.S. Bureau of the Census (2000).
[3] For details on tax sources, see Fiscal Research Center (Annual). For the others, see Georgia Office of Planning and Budget (Annual).
[4] Local governments also operate utilities – and local budgets include the associated spending and revenue accounts – but the state of Georgia does not.

For fiscal and socioeconomic-demographic information, we generally use U.S. Bureau of the Census data on governments since it has the advantage of relatively consistent definitions (over time). For the state K-12 education transfer, we use the amounts reported in *The Governor's Budget* (distributed by the Georgia Office of Planning and Budget).[5]

We turn now to a summary of the fiscal position of the state decade by decade for the last 40 years.

[5] For analysis on how individual school systems are funded, see Doering and Gess (1998).

IV. The 1960's

During the 1960s, total Georgia population grew from 3.9 to 4.6 million (a 16 percent boost). The largest increase came in the adult, working-age group which grew from 53.7 to 56.1 percent of the population (Figure 1). The absolute number of residents for the other groups increased during the period, but the population shares declined. This relative change in composition – toward working-age residents – helped facilitate strong Georgia growth in own-source revenue and, ultimately, direct general spending.

The decade also featured remarkable economic growth. Per capita income – adjusted for inflation – increased by more than 50 percent, with the state realizing a significant income gain on the national average. For example, 1960 Georgia per capita income was 74.6 percent of the U.S. average and that share increased to 82.9 percent by 1970.

Turning to state government finance, we examine the differences between the Census of Governments reported fiscal items for fiscal years 1962, 1967 and 1972 to find how the Georgia government changed during the decade.[6] On the revenue side, the Georgia personal income tax as a share of total statewide income leapt from 0.6 percent to 1.2 percent (Figure 2). The tax brackets were instituted in 1931 and since that time, very few changes were made to the tax structure. Thus, part of the enhanced importance of the income tax occurred through bracket creep when policymakers did not adjust the Georgia tax brackets to inflation-driven wage and salary increases.[7]

Sales tax growth was moderate for the first half of the decade and then strong to 1972 (i.e.., the sales tax bar in Figure 2 declined and then grew), but the state also experienced significant increases in user charges and other non-tax revenues. Examples of this strong charge growth can be found for higher education and hospital collections. It should be noted that these were not trivial sources – total current charges accounted for $135 million in 1972. Finally, high growth also occurred during the period in federal intergovernmental revenue. In Figure 3, the bottom

[6] Census of Government data are available every 5 years.
[7] Wallace and Edwards (1997).

FIGURE 1. POPULATION SHARES FOR SELECT AGE GROUPS

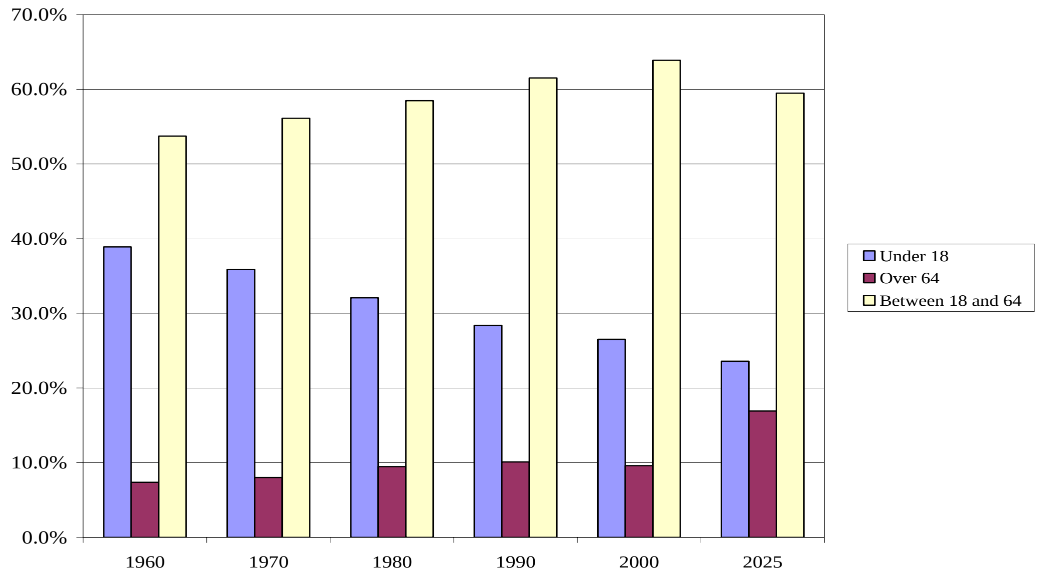


FIGURE 2. SELECT TAX REVENUES AS A SHARE OF PERSONAL INCOME

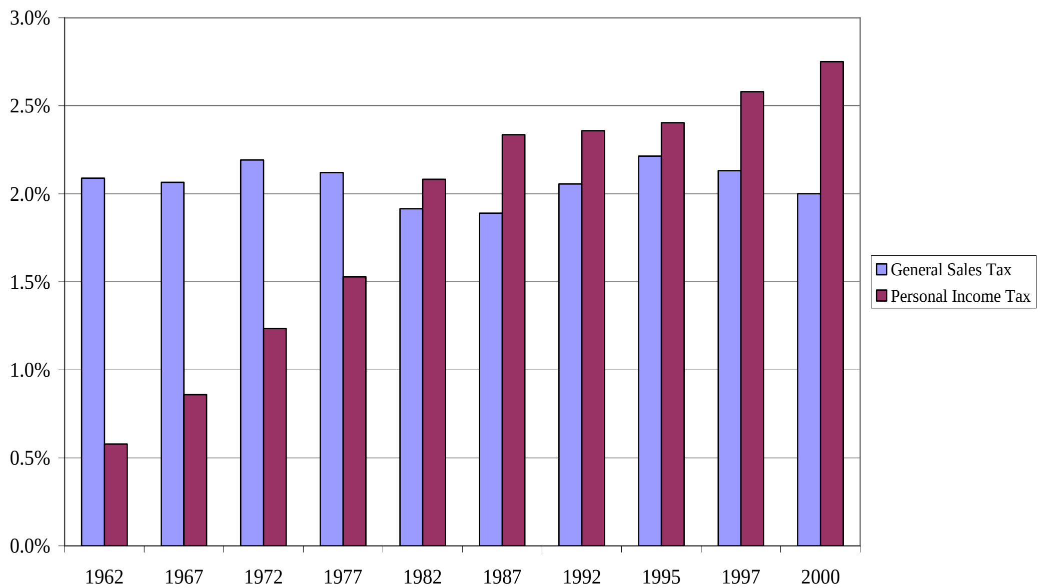
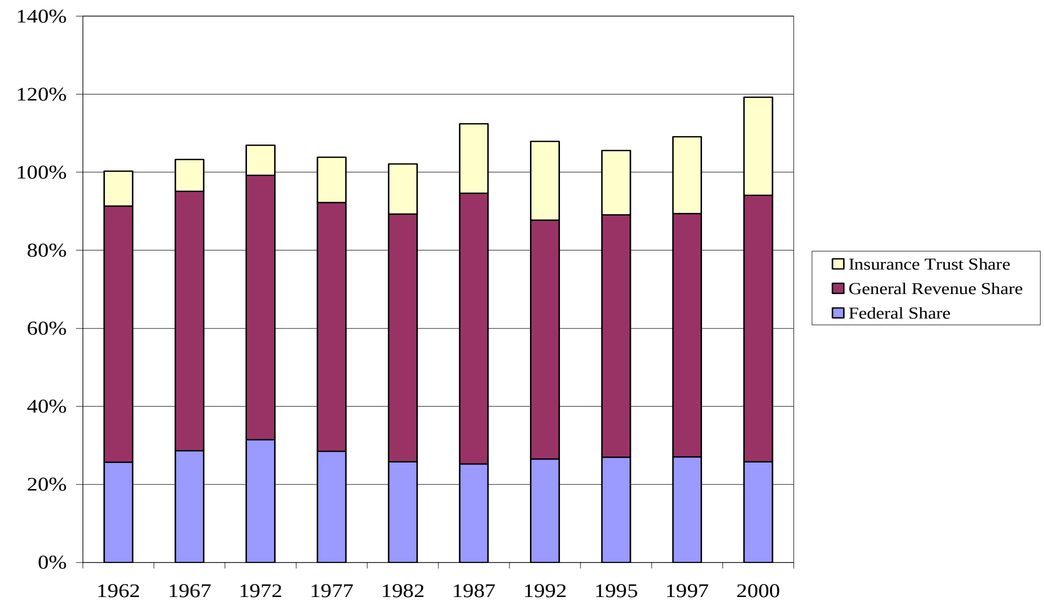


FIGURE 3. SELECT REVENUE SHARES OF STATE SPENDING



portion of the bar represents the federal share and through the decade, it increases from 26 to 31 percent.[8] This partially represents federal spending priorities through the Johnson administration and the first term of the Nixon administration.

With strong revenue growth, it comes as no surprise that spending increased in the 1960's, but the faster increase – relative to personal income – occurred in the latter half of the decade (Figure 4). In fact, across the major state spending categories, one never finds low growth in the decade.

Moderate growth, however, did exist in a few of the major spending categories, including both health and highway spending. One reason for moderate growth in the former lies in the history of the Medicaid program. The program was created in 1966, but states typically took several years to fully implement covered services (Klemm, 2000).

High spending growth areas that deserve special mention include libraries, correction and higher education. For the three categories, analyzing the actual spending levels is important to understanding the changing state budget in the 1960's.

[8] Note that because insurance trust revenue does not perfectly track insurance trust obligations, the total in Figure 3 does not equal 100 percent.

FIGURE 4. STATE DIRECT EXPENDITURES AS A SHARE OF PERSONAL INCOME

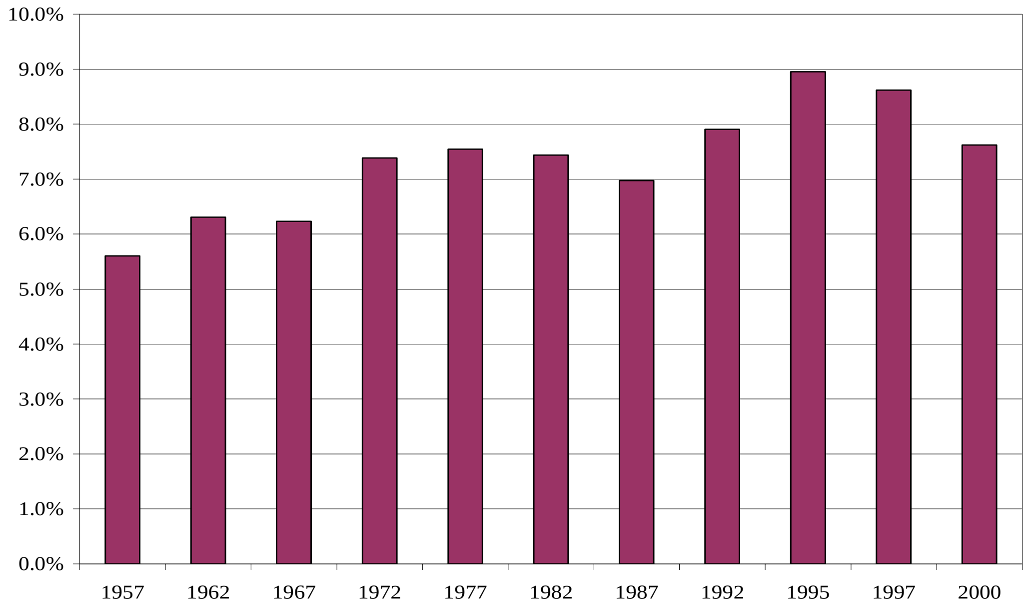


TABLE 1. STATE SPENDING TRENDS FOR SELECT HIGH-GROWTH EXPENDITURE FUNCTIONS 1962, 1967 AND 1972 (IN THOUSANDS OF DOLLARS)

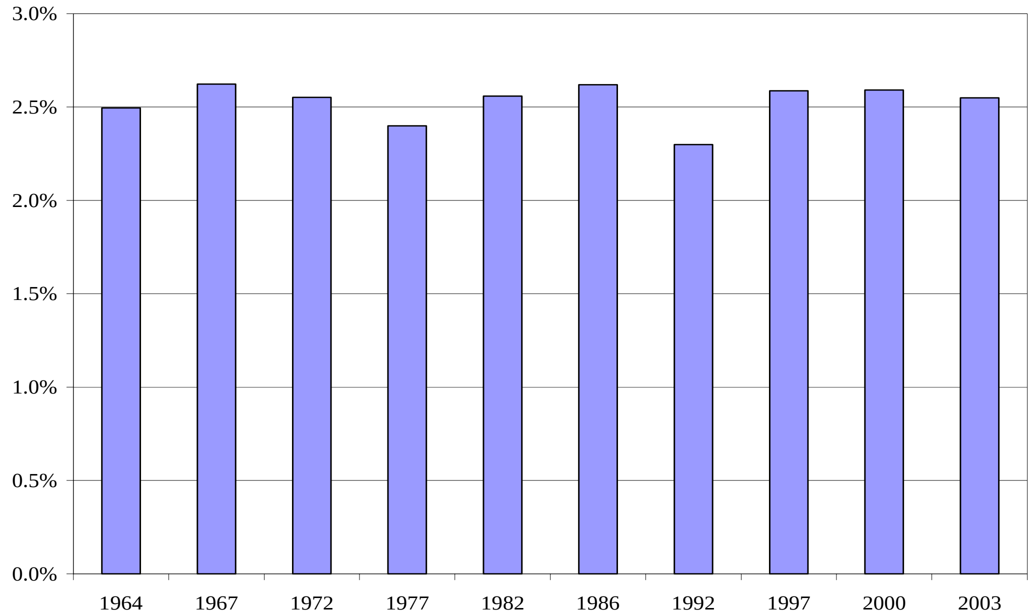
Year	Higher Education	Libraries	Corrections	Exhibit: Georgia Total Direct Expenditure
1962	58,495	170	6,299	475,168
1967	143,499	398	14,955	728,924
1972	303,915	935	32,702	1,433,190

Source: Authors' calculations on Census Bureau data.

When one examines the data in Table 1, the increase is clear across the three areas, but the relative dominance of higher education is also clear as the state spent considerably more on this function. In fact, spending on higher education grew from 12 percent of total direct expenditure in 1962 to 21 percent by 1972.

The spending trend for state K-12 support closely matched growth in the economy itself (Figure 5) leaving this category at the divide between "moderate" and "high" growth. Readers should recognize, however, that the decreasing population share for school-age children (from Figure 1) did not necessarily occur everywhere in Georgia and we suspect some uneven spending growth patterns across local school

FIGURE 5. STATE K-12 SPENDING AS A SHARE OF PERSONAL INCOME



systems. Unfortunately, we do not have the micro-level data for this period that is needed to analyze this hypothesis.

Even with moderate growth overall, enhanced school funding was a top policy priority of both Governor Sanders (1963-1967), and Governor Maddox (1967-1971). In 1963 Governor Sanders constituted a "Governor's Commission to Improve Education," a panel that issued recommendations for improvements in K-12. The environment around this panel is impressive as the group's findings were almost immediately included in an education package and implemented after the 1964 General Assembly session. The package included a $30 million tax increase in the state corporate income tax and a $100 million bond issue to finance construction of new school and college buildings. In addition, the State Board of Education was granted the authority to establish minimum standards and local education support was increased. By the end of the Sanders term the following were accomplished: teacher salaries for K-12 and the university system were raised; over 10,000 additional teachers were hired; the Department of Education was reorganized; more schools and classrooms were built than in any previous administration; the university system received more money for building construction in four years than it had received in the previous thirty; and additional junior colleges and vocational technical schools were established.[9]

Governor Maddox followed this initiative with teacher salary increases and university system funding increases that were greater than those under Governor Sanders. The percentage of appropriations for elementary and secondary education during the Maddox administration exceeded the increase of each of the previous two administrations. Four Junior Colleges were established and Georgia State College was approved for university status. Also, Columbia College, Southern Tech, Augusta College, Armstrong State, and Georgia Southwestern all became four-year institutions.[10] The level of spending and the identifiable outputs (the above mentioned higher education facilities and school construction projects) arguably identify this decade as one in which education was made a higher budgetary priority.

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[9] Henderson and Roberts (1988), pp. 169-92.
[10] Henderson and Roberts (1988), pp. 193-232

V. The 1970's

Economic conditions in the 1970's were very different from the previous period. From 1972 to 1982, per capita personal income in Georgia increased by 149 percent, but inflation accounted for the vast majority of the increase. In fact, after accounting for price and population effects, economic growth for the decade was less than 20 percent.[11]

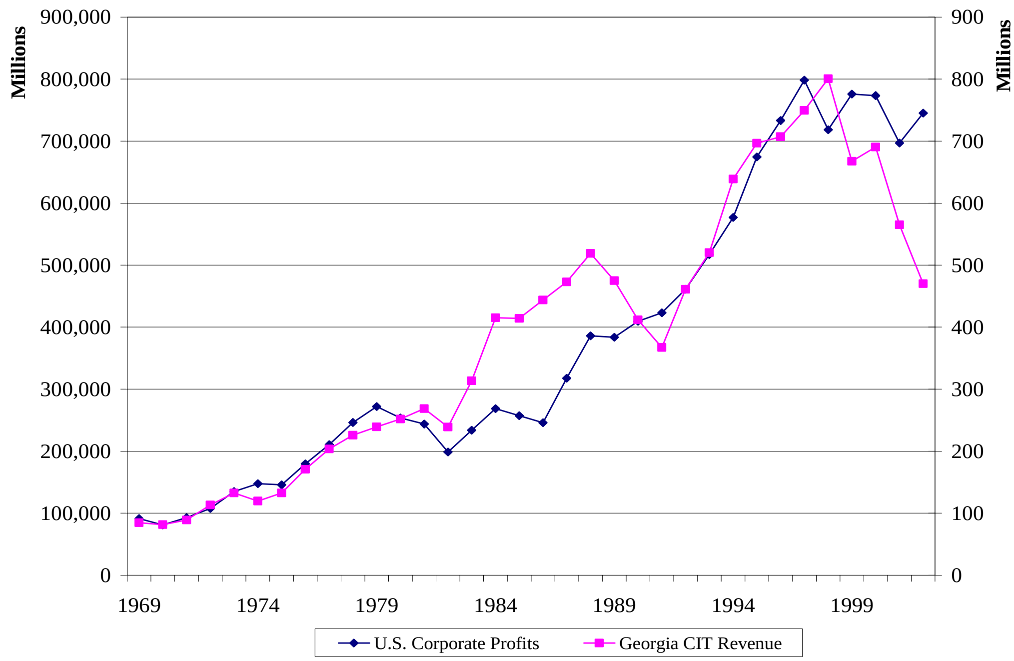
Despite slower economic growth, population growth remained strong through the decade. Total residents increased by 19 percent over the period and the same pattern of relatively strong growth in the working-age group continued. Again, the elderly share of the population also increased.

Total state revenue and total tax revenue did not fall into our low growth category, but slid against total income in the latter half of the decade (Thomas, 2000). This can be observed in the above-mentioned Figure 3, where the share variable increases from 1972 to 1977, but declines from 1977 to 1982. Within the major state revenue categories, individual income taxes were again an area of unusually strong growth with collections surpassing the general sales tax total by 1982 (Figure 2). Given relatively high inflation for the decade and generally static tax brackets, the switch of the top tax revenue source was inevitable. We note that income tax revenue remains above 2 percent of Georgia income even today.

For the other major state taxes, growth patterns were mixed. Georgia's corporate income tax collections fared well – with only a slight recession-driven decline in 1982 apparent in Figure 6 – while all of the sales taxes (e.g., general, motor fuel, alcohol and tobacco) declined in real, per capita terms. The relative "sin" tax (alcohol and tobacco) declines are not surprising for two reasons. First, economists refer to these commodities as income inelastic—so we expect that as income increases, consumption growth is slow. Second, these taxes are often specified in dollars per unit. When inflation occurs, the real value of the tax on pack of cigarettes declines unless the rate is increased.

[11] By pure economic growth, we mean a state income increase after holding population and prices constant.

FIGURE 6. U.S. CORPORATE PROFITS AND GEORGIA CORPORATE INCOME TAX REVENUE



Slow growth in the general sales tax, however, during this period was a surprise. Simply put, income "inelastic" means that if state income increases by 4 percent, demand for these items typically increases by less than 4 percent. Tax revenue grew more slowly than the economy (as measured by income growth)—which we term as "inelastic" revenue growth. We now know that the surprise was partially driven by a consumer spending shift toward largely-untaxed services that has been on the rise since the late 1950s (the shift can be observed for national spending in Figure 7).

Another revenue area where growth slowed was the current charge total. The two largest charge categories, education and hospital charges, fell in real, per capita terms through the decade. Port facility charges were an area of increase, and they accounted for almost $40 million in 1982, but the larger categories grew slowly and had a greater influence on the total Georgia state current charges for the decade.

Direct spending growth also closely tracked the Georgia economy during this period. Three areas of significant increase were health spending (but not hospitals), sea and inland port facilities and corrections (Table 2). Of the three, corrections might be the most interesting. By 1975, the Georgia prison system housed 11,000

FIGURE 7. SERVICES AS A SHARE OF TOTAL U.S. CONSUMPTION

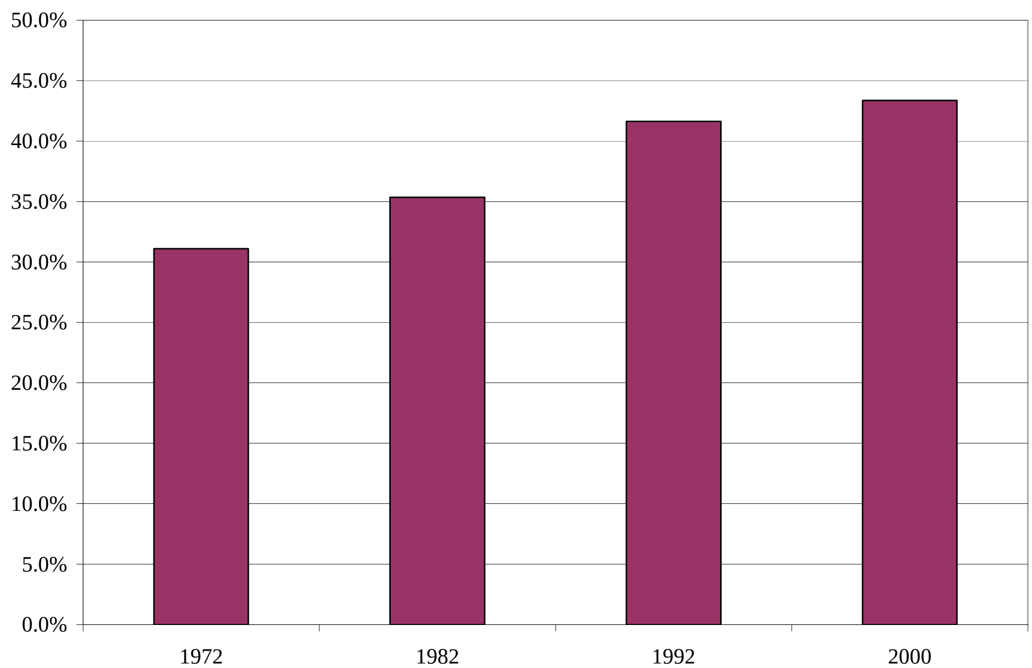


TABLE 2. STATE SPENDING TRENDS FOR SELECT HIGH-GROWTH EXPENDITURE FUNCTIONS 1972, 1977 AND 1982 (IN THOUSANDS OF DOLLARS)

Year	Health	Sea and Inland Ports	Corrections	Exhibit: Georgia Total Direct Expenditure
1972	12,400	7,957	32,702	1,433,190
1977	90,341	35,898	64,295	2,445,315
1982	107,960	51,675	153,432	4,225,312

Source: Authors' calculations on Census Bureau data.

inmates in facilities designed for 8,000; and the average net increase was 300 prisoners per month. One of the worst cases was the maximum security prison at Reidsville, where 3,000 inmates were living in a facility designed for 1,000. The 1970's saw many prison riots and several federal lawsuits due to overcrowding and violence. During the 8 years of Governor Busbee's term (1975-1983) spending for prisons increased dramatically with increased appropriations for new prisons, increased staff, medical supplies, clothing, food, and alternative programs. As one would expect, the budget for the Department of Offender Rehabilitation increased at almost three times the rate of the entire state budget, and the number of employees in the Department of Offender Rehabilitation increased by over 117 percent.[12] The reader will recall that corrections spending grew in the 1960's, but the total (as calculated from Census data) was still a modest 2 percent of state government. By 1982, corrections accounted for just over 3.5 percent of state spending.

The increase in health spending is partially explained by the implementation of the Medicaid Program after its introduction in 1968. During the 1970's, the Medicaid program was a joint state and federally funded health insurance program for low-income pregnant women and children. Spending for the program started slowly in the 1970's, but by 1982 state Medicaid spending totaled over $195 million (6 percent of the state budget).

A final area of strong spending growth can be found in the insurance trust accounts. Both trust revenue and spending increased as a share of personal income during the decade (not shown). Since the state unemployment rate climbed to 7.8 percent in 1982 and some of the balance funds unemployment compensation, this change is not surprising.

The Governorship of Jimmy Carter (1971 – 1975) resulted in major budget and state government reforms.[13] One centerpiece of this reform was "Zero-based budgeting," where the routine of submitting budgets with an inflation-inspired increase was eliminated. Under the plan, state departments and agencies were supposed to start from scratch, evaluating and justifying every dollar appropriated. Governor Carter also undertook the first comprehensive state government reorganization since the 1930's. Many agencies were combined for budget and policy efficiencies. For example, the Departments of Public Health and Mental Health, as well as the Medicaid, welfare and children's programs were combined into a new Department of Human Resources. Unfortunately, we cannot observe efficiency gains (or the lack thereof) in our spending trend analysis. Thus, the overall fiscal impact – through quality adjustments or the lack thereof – of these important policy initiatives is generally lost in the numbers.

[12] Henderson and Roberts (1988), pp. 261-85.
[13] Henderson and Roberts (1988), pp. 233-57.

VI. The 1980's

The 1980's were another decade of population growth, but not quite as strong as in the previous periods. The working age group climbed to 60 percent of the population, but the share of elderly also increased (Figure 1). Inflation slowed and pure economic growth (in real, per capita income) climbed to twice the rate of the previous decade.

For the decade, Georgia government spending as a share of personal income declined from 1982 and 1987 and then increased rapidly through 1992 (Figure 5). On the revenue side, rapid growth occurred in the individual income tax, but interestingly, this growth was stronger in the first half of the decade.

The selective sales taxes (e.g., gasoline) continued their slow growth pattern. General sales tax revenues also grew slowly, but were then propped up by a rate increase (the state rate increased from 3 to 4 percent in 1989).

Outside of tax revenue, one finds fast growth in hospital, highway and park charges. We have anecdotal evidence on the latter as some mid 1980's budget summaries gave examples of enhancements to revenue-generating-facilities. This spending generated new charges at properties such as Amicacola Falls State Park, Lake Lanier Islands and the World Congress Center complex.[14]

Turning to spending, direct state spending was a high growth item in the 1980's, but the rapid growth occurred in the latter half of the decade (Figure 4). Areas of particularly high growth include public welfare (reaching 32 percent of total direct spending), parks and recreation, housing and, once again, corrections. Recall that the latter began the decade at about 3.5 percent of total direct spending. By 1992, correction spending was above 5.5 percent of total direct spending.

An interesting feature of 1980's spending was the decline in real, per capita transportation infrastructure funding. In fact, inflation adjusted spending on highways, air transportation and port facilities all declined (not shown). The relative highway decline may have appeased some critics of growth, but may have led to

[14] Georgia Office of Planning and Budget (1986).

longer commutes in many Georgia cities – a condition that Governor Zell Miller addressed with significant spending increases in the following decade.

New state funding for K-12 education wavered during the decade (Figure 5). Initially, spending increased – to 2.6 percent of state personal income – but in the latter half of the decade, K-12 spending did not grow as rapidly as the Georgia economy. One reason for this relative decline was the transition to the Quality Basic Education (QBE) program under Governor Harris. This system was never fully funded, but significant aspects were phased in over several years.[15] The reader should recall (from Figure 3), however, that personal income tax collections were not increasing against personal income during the period and sales tax collections were only boosted by a rate increase; meaning that legislators were facing difficult spending choices between 1986 and 1992.

[15] Taken from the Governor's introduction to the Georgia Office of Planning and Budget, *Annual Budget* (various years).

VII. The 1990's

Population growth had been strong through the three previous decades, but the state population grew even faster in the 1990's (26.4 percent for the decade). The population age-group between 18 and 64 increased to 63.9 percent of the total state population and the share for the group over 64 actually declined slightly (even though the absolute number of Georgians of retired age increased).

Throughout the United States, inflation slowed considerably during the decade. This price stability did not, however, translate into stronger economic growth (in real, per capita income) as growth was more robust a decade earlier. That said, Georgia per capita income did gain somewhat on the U.S. average – reaching 94 percent in 2000.

Georgia state tax revenue and total revenue exhibited strong growth during the decade (here measured from fiscal 1992 to fiscal 2000). Taxes from individual income, corporate income and motor vehicle licenses increased faster than the Georgia economy. The increase in personal income taxes during the 1990's was largely driven by an increase in capital gains realizations (Sjoquist and Wallace, 2004). In regards to the increase in motor vehicle license fees, this was part of a $200 million user fee increase enacted under Governor Zell Miller in 1992. This increase extended to automobile registration, license plates and hunting and fishing licenses. Prior to 1992, many of these fees had remained constant since the 1950's.

Slow tax revenue growth occurred in the selective sales taxes. Motor fuel, alcohol and tobacco taxes all decreased in real, per capita terms. For the latter, we note that Georgia has joined a majority of states in increasing the tobacco tax rate since 2002 and that collections increased from $86 to $112 million (fiscal 2002 - 2003) following the rate change.

The growth pattern for the general sales tax can roughly be divided into the Olympics build up and post Olympics hangover. In Georgia, the purchase of a house or a piece of commercial real estate does not include a sales tax levy, but building material purchases are subject to the general sales tax. Thus, the related purchases during the build up (literal and figuratively) to the Olympics in 1996 led to the spike in the Georgia general sales tax -- as a share of the economy -- that one can observe in Figure 2 (roughly 2.2 percent of personal income). The sales tax share of personal income then declined in the last half of the 1990's, but this represented more than the effect of the Olympics. For example, the food exemption was phased-in by the General Assembly beginning in 1996 and commerce over the internet grew in the second half of the decade. Regarding the latter, tax base erosion to online vendors who do not collect has been a significant problem across the United States (Bruce and Fox, 2000).

Total charges increased over the decade as did miscellaneous general revenue. The latter category partially captures the introduction and growth of the Georgia lottery, minus lottery expenses and prizes.[16] Within total charges, however, some low-growth items (e.g., hospital and airport charges) can also be identified.

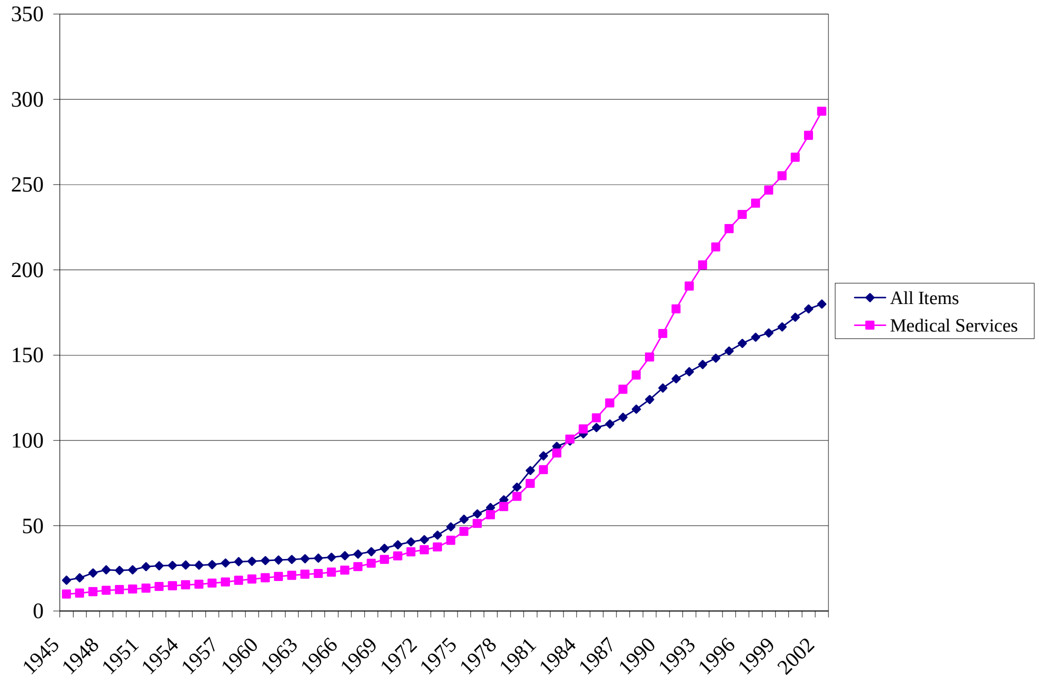
Over the 1990's, state spending grew almost as fast as the Georgia economy. Similar to many of the revenue trends described above, we find fast growth up to 1995 followed by relative declines (against the Georgia economy) in Figure 4.

Natural resource and highway spending were prominent fast growth items during the decade. We note that the former include a host of state activities including agricultural programs along with fish and game management. For the latter, at the tail end of the early 1990's recession, Governor Miller began implementation of an economic stimulus program called "Georgia Rebound." The program included new funds for highway construction, as well as capital improvements within the Board of Regents and the Department of Education in order to help create jobs.

Budgetary expenditures on health were a moderate growth item and hospital support was in the low growth category, findings that are somewhat surprising as the Consumer Health Care Price Index (Figure 8) increased dramatically in the 1990's. In fact, we find two distinct cycles for Medicaid spending in the decade. Between 1990 and 1994 the Medicaid budget increased by approximately 17.5 percent each

[16] The first instant lottery games began on June 29, 1993. The higher-profile Lotto Georgia game was introduced September 10, 1993.

FIGURE 8. CONSUMER PRICE COMPARISON: ALL ITEMS VERSUS MEDICAL SERVICES

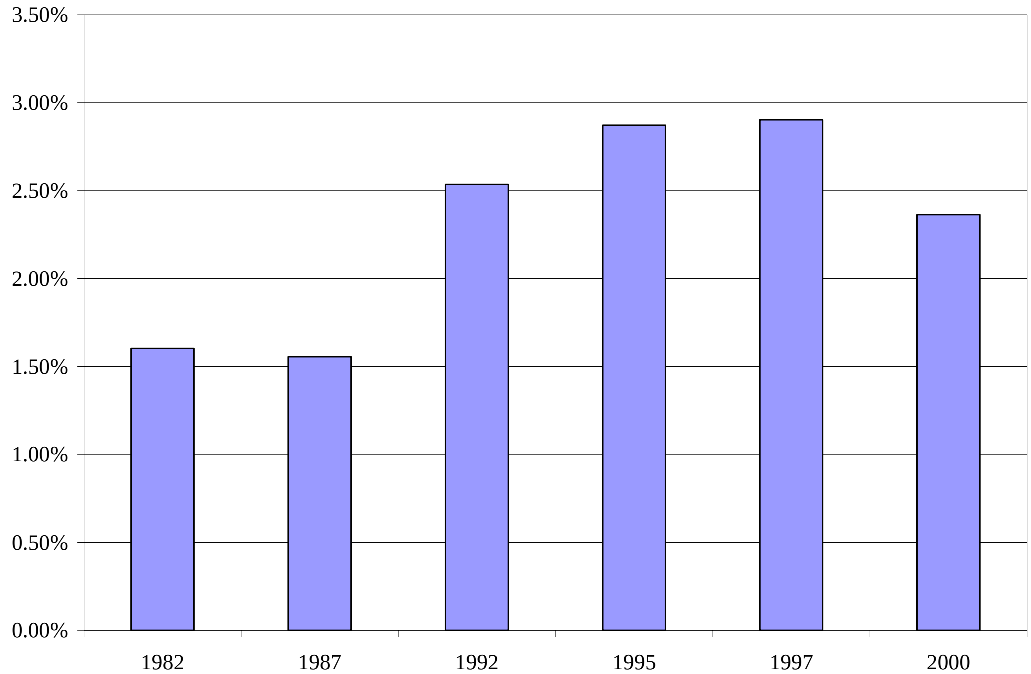


year – an increase largely driven by an increase in the number of recipients (13.9 percent each year). This enrollment boost was, to some degree, a product of the recession of the early 1990's. Between 1995 and 1999 the Medicaid budget, as well as the number of recipients, increased by just over 1 percent each year and we find three reasons for the slowdown. First, the combination of a strong economy and the implementation of welfare reform eased spending pressure. Second, Georgia took the first steps towards managed care in the Medicaid program over the period. Finally, in 1997 and 1998, the reimbursement rates for doctors and hospitals were reduced.

Corrections finally fell from the high growth category in the 1990's. We believe that moderate growth in corrections spending was partially due to a falling crime rate (from 1996 to 2000) and partially due to privatization and an efficiency focus in the industry, but we only have anecdotal evidence on the latter.

Public welfare spending, as a share of the Georgia economy, increased until 1997 and then fell dramatically (Figure 9). According to the Georgia Department of Human resources, calendar 1997 was the beginning of a significant Georgia caseload

FIGURE 9. STATE WELFARE SPENDING AS A SHARE OF PERSONAL INCOME



reduction and the decrease continued into 2000, followed by a slight increase post-2000 which many associate with the economic slow down (Georgia Department of Human Resources, 2004).

State support for K-12 education increased after 1992, but not beyond the relative levels of the mid 1980's (as a share of state income). The increase that did occur was the result of Governor Miller's efforts to increase teacher salaries (Essig, 2003). Between 1995 and 1999, Georgia teachers received salary increases over twice the rate of inflation. By 2000, support for education returned to roughly 2.6 percent of Georgia personal income.

In the higher education accounts, the absence of a HOPE scholarship spike is not entirely surprising. The program served almost 220,000 students in 2003 and awarded $360 million, but operating expenses for the university system were almost $4.4 billion.[17] Also, the rapid growth in the scholarship program occurred from 1994 to 1996, when the program was relatively small.

[17] Statistics are from Georgia Student Finance Commission (undated) and Board of Regents of the University System (2004).

We find a similar effect in the Georgia Pre-Kindergarten Program. The program features grants in excess of $250 million, but in the short history of this initiative, one finds slow percentage growth over the last four years (only 16 percent from 2000 to 2004, not shown). In fact, in terms of budgetary history, the HOPE and Pre-Kindergarten programs remind us of the 1960's. For both periods, policymakers created highly visible education initiatives, but those initiatives, in themselves, did not mean high growth for total education spending.

VIII. The New Century

In preparing this report, several issues emerged that will bring strong challenges to state policymakers in the future. The issues are not Georgia specific, i.e., neighboring states wrestle with almost identical problems, but they point to a bleak fiscal outlook. Here, we present the issues in no particular order.

1. Population Will Continue To Age.

As with most of the United States, the Georgia population will begin to age dramatically. Returning to Figure 1, the population share over 64 is expected to jump from just under 10 percent to almost 17 percent. On the revenue side, the aging will lead to slower income tax growth and possibly more political pressure on the property tax as a source of school funding. For state spending, growing senior services will represent a mix of new federal and new state obligations. For example, an increase in senior citizens generally leads to new Medicaid spending for nursing home services. The net impact of these aging pressures is not known with any degree of certainty.

2. The Price of Healthcare.

Recall from Figure 7, the relative inflation in the price of medical services is a serious cause of concern. Without a national initiative, states will have trouble managing Medicaid spending and will face difficult decisions on program eligibility and the scope of coverage.

The price increase also creates a feedback effect – where employers try to reduce coverage and states find themselves with more uninsured families. In response, Georgia hospital managers will continue to lobby for more favorable funding formulas for indigent care (Miller, 2005).

3. The Corporate Income Tax.

Legal tax avoidance schemes have partially undermined the Georgia corporate income tax (Grace, 2004; Cornia et al., 2005). The revenue impact for these schemes can be observed in Figure 5, where state corporate income tax collections used to track U.S. corporate profits very closely; but lately, state collections fell when national profits increased.

Georgia's reliance on the corporate income tax has declined, down to 0.3 percent of total state income, which helps lessen the impact of the avoidance trend. During the preparation of this report, however, a *huge* revenue increase (40 percent) was reported for fiscal 2005. Several plausible causes for the increase have been suggested, but we have little evidence beyond the revenue increase itself.

The problem, in our opinion, is that the tax still accounts for more than $400 million (not counting the 2005 surge) in state revenue and the future of this funding source is partially being determined by executives and avoidance-design consultants. If policymakers do not continually address these schemes, we believe corporate income tax collections will continue to fall in a growing Georgia economy, but we cannot forecast the speed of the decline – especially given the unexpected increase for 2005.

4. The Antiquated Sales Tax.

The sales tax still reflects its original design, a levy on inventory movement in an industrial economy. The modern economy continues to move away from the model the sales tax was based on and unexpected decreases (and increases) have become a norm.

The present challenge is whether Georgia has the will to continue dramatically simplifying the tax in order to induce online vendors to collect (Cornia, Sjoquist, and Walters, 2004). Beyond the flow of goods on the internet, the problem of consumer services still lingers. For example, 2002 e-commerce revenues for selected service industries were almost as large as e-commerce revenues for retail trade (U.S. Department of Commerce, 2004). Thus, taxing goods on the internet does not address the larger services problem – where consumption spending is treated unequally in the Georgia sales tax (Bahl and Hawkins, 1997).

5. Corrections Spending.

Many believe that mandatory sentences passed in 1990's have put the prison system on the verge of a crisis. The state facilities are aging while the inmate population continues to grow – from 20,000 in 1990 to close to 50,000 today to a commissioner-projection of 60,000 by 2010. Most of the fiscal pressure comes in the form of capital spending needs – an estimated 10 new prisons at a construction cost total of $500 million to construct and yearly operating coats of $180 million. With the revenue source problems described, it could become increasingly difficult for Georgia to find the money for carrying out mandatory sentences.

IX. Conclusion

In Georgia, change has meant more than population growth. For example, while the overall population climbed from 4.0 million to 8.2 million, 1960 to 2000, working-age adults reached 64 percent of the state's population. Meanwhile, per capita income increased from 75 percent of the national average to over 94 percent.

These demographic and economic changes helped generate several striking trends. These are summarized in the major revenue and spending issues of Table 3 and in the trends in real, per-capita revenue and spending totals in Table 4.

TABLE 3. FISCAL HISTORY SUMMARY

Period	Major Revenue Growth Trends and Initiatives	Major Spending Trends and Initiatives	Select Characteristics
1960's (to 1972)	Individual income tax	Broad, categorical spending growth	Income tax bracket creep. Demand for an enhanced education system.
1970's	Individual income tax again.	Corrections and health	More bracket creep. New, modernized prison.
1980's	Slow sales tax growth	Funding difficulties for the Quality Basic Education program. Slow transportation spending growth, fast correction spending growth.	Growth in untaxed consumer services. Slow revenue growth disrupted spending priorities.
1990's	Corporate and personal income tax growth, the sales tax spike and the lottery	Georgia rebound, the Medicaid spike, HOPE and Pre-K programs	Revenue growth generally returned. Reprieves in Medicaid and correction spending growth.
2000's and Beyond	Avoidance schemes for the corporate income tax, the gap between the antiquated sales tax and the modern economy	The cost of healthcare, corrections spending pressure	The aging of Georgia residents affects both revenue and spending trends.

TABLE 4. GEORGIA MAJOR FISCAL CATEGORY SUMMARY (IN REAL, PER CAPITA DOLLARS)

	Revenue from Federal Government	General Sales	Selective Sales	Individual Income	Charges and Misc. General Revenue	Higher Education	Public Welfare	Health and Hospitals	Highways	Corrections	Debt Outstanding
1962	$141	$127	$118	$35	N/A	$47	$73	$30	$117	$5	$356
1967	222	164	148	68	61	97	84	40	122	10	495
1972	318	212	186	119	89	151	179	62	120	16	490
1977	310	218	142	157	91	141	161	84	97	20	402
1982	285	200	112	217	98	139	167	69	141	28	302
1987	324	247	106	305	137	166	203	77	126	42	362
1992	393	284	86	325	141	N/A	350	78	91	61	472
1995	470	322	84	350	220	217	418	80	120	67	512
1997	505	333	84	403	239	216	453	77	91	73	525
2000	455	328	79	452	243	239	388	72	112	69	503

Source: Authors' calculations on Census Bureau data.

On the revenue side, the rapid growth of individual income tax revenue was extremely important toward modernizing state-provided services in Georgia. In the 1960s and 1970s, the general sales tax was the largest state tax revenue source. However, today, for every sales tax dollar, the income tax produces about one dollar and forty cents. The trend to current levels can be observed in Table 4 where the individual income tax never declines.

State direct spending grew from less than 6 percent of personal income to almost 9 percent in 1995. Since that spike, however, spending declined as a share of the state economy, measured by total personal income. We note that a slight decline in local government spending, as a share of total personal income, also occurred after 1995 (not shown).

Within total state spending, unusual growth occurred in public welfare and correction spending (summarized in Table 3 and Table 4). For the former, new programs and escalating costs led to the growth. Regarding the latter, the combination of a modern prison system and a higher crime rate produced the increase. For both, growth definitely slowed in the late 1990's, but two areas of calm in longer-term budget storms may be over. First, the brief calm in corrections spending needs only postponed a dramatic demand increase for new prison construction. Second, Medicaid trends in the late 1990's provided temporary relief, but that period appears to be over (might reference governor's newest budget).

Going forward, the overall picture is mixed. The relative decline in sales and corporate tax revenues through 2003 put state fiscal functions on the verge of a crisis. Recovery from the last recession now seems to be more steady and revenues have grown significantly since 2004. However, rapid population growth since 1970s, has largely allowed policymakers to ignore issues like widening the sales tax base, eliminating corporate income tax loopholes and preparing for a slowdown in revenue growth for the individual income tax since revenues have grown as population and economic activity have grown. In some respects, the 2001 recession was a reminder that Georgia's vibrant growth may not always been a given. If a relatively normal growth target – say 3 percent plus inflation – in education (formula funded K-12 and Regents), healthcare and corrections are attempted, new spending may dramatically outstrip revenue growth. In our opinion, Georgia policymakers face difficult choices over the next decade. They can address the looming budget issues with a fundamental retrench in areas like healthcare and education, a significant tax increase in the general sales tax or higher income tax rates or they can choose a combination of retrench and tax hike. For all concerned, we anticipate some very thorny decisions.

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