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A GEORGIA FISCAL HISTORY OF THE PAST FORTY YEARS

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 as 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 2, 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 3, 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

FIGURE 1. POPULATION SHARES FOR SELECT AGE GROUPS

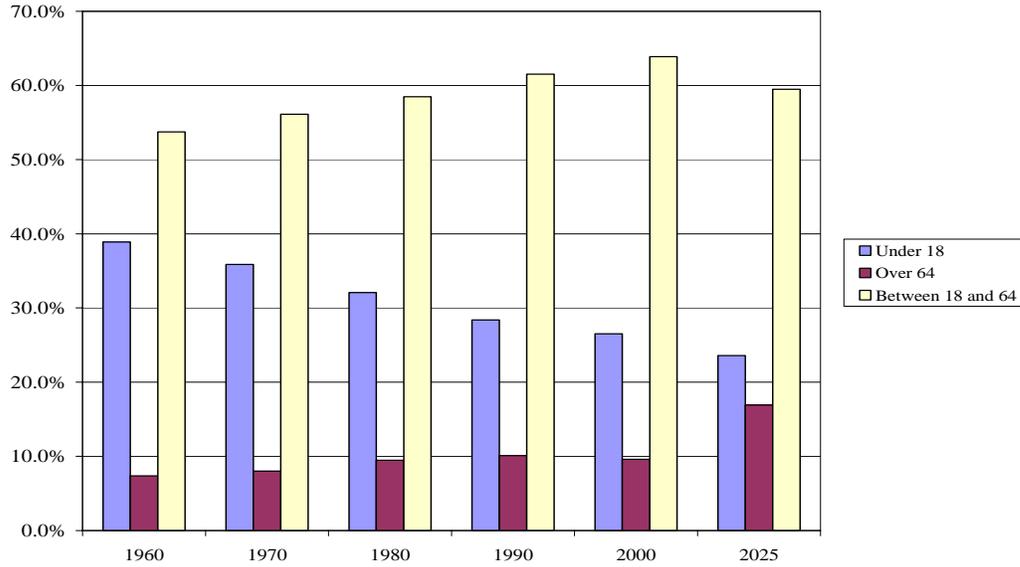


FIGURE 2. SERVICES AS A SHARE OF TOTAL U.S. CONSUMPTION

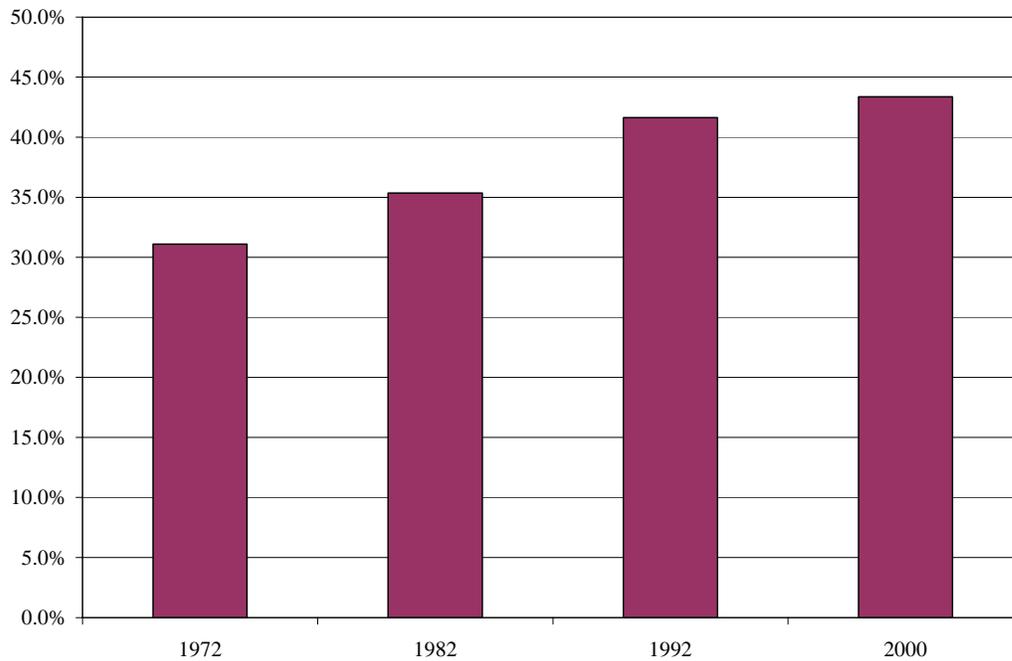
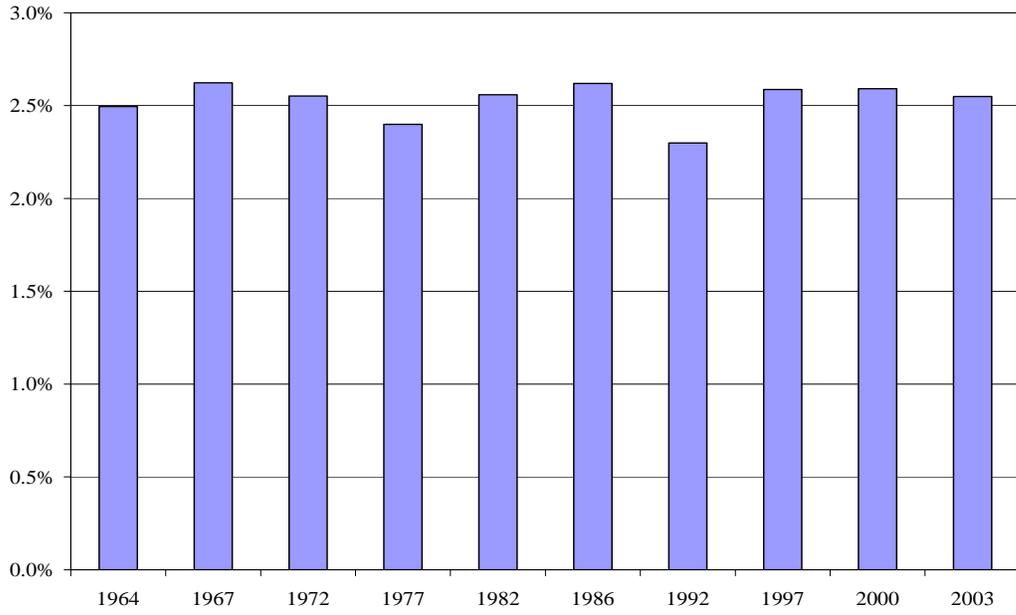


FIGURE 3. STATE K-12 SPENDING AS A SHARE OF PERSONAL INCOME



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 costs 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.

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