



Southern Education Foundation
www.southerneducation.org

ISSUE BRIEF

South Carolina And The American Recovery and Reinvestment Act

Increasing Educational Attainment: South Carolina's Best Means to Pay off School Debts Introduction

The new federal stimulus law, the American Recovery and Reinvestment Act of 2009 (Recovery Act) offers South Carolina a historic opportunity to improve public education from pre-school through college, especially for low income students. The Recovery Act allocates almost \$1.4 billion directly to South Carolina for education -- both to stabilize the state's education budget deficit and to improve schools and student performance. These funds supplement other federal monies that have already been allocated for South Carolina education.

The largest part of South Carolina's new education monies from the Recovery Act -- approximately 50 percent -- will be in the form of a "stabilization fund" for the primary purpose of helping prevent the loss of productive education programs and the layoff of teachers.¹ The state's stabilization funds totaling as much as \$694 million can be used over three years (2009-2011) to support the public education of students in South Carolina's elementary and secondary schools (P-12) and colleges and universities. There are other education funds that the Recovery Act provides for South Carolina

¹ The new federal law requires that 81.8 percent of these Recovery Act funds go exclusively toward stabilization. The remaining 18.1 percent can also go toward helping to reduce deficits in a state's education budget and in the budgets for other essential governmental functions. The Recovery Act has a separate large appropriation to each state to stabilize the Medicaid program, which is the second largest expenditure behind education for most states.

students. These added funds will go to special population groups -- students in high-poverty schools; students with disabilities; and low income college students.

Background

South Carolina is currently facing substantial deficits in the state's education budget for 2009 and 2010. In fact, without the Recovery Act's stabilization funds, the state will face very large cutbacks and layoffs. South Carolina Superintendent of Education Jim Rex testified on March 17 before the State Senate Finance Committee that more than 300 local educators will be laid off this year and more than 1,100 positions will be left unfilled. "These numbers could skyrocket next year because districts have already reduced their operating expenses and they have used their fund balances to absorb this year's cuts," Rex stated. "Eliminating thousands of teaching positions could be a disaster for South Carolina, and these federal stimulus dollars could forestall that possibility in the short-term and give our economy a chance to recover."

Earlier in March, South Carolina Governor Mark Sanford announced he would refuse the funding to help prevent increasing the government debt. On March 17, Governor Sanford revised his position in a letter to President Barrack Obama in which he stated:

I've made clear my opposition to using debt to solve a problem created in the first place by too much debt... In the spirit of moving forward, I'd offer the following as a clarification to our using a portion of the stimulus funds to paying down our state's sizeable debt.

Specifically, Governor Sanford proposed to use the stabilization funds to "pay down the roughly \$579 million principal for State School Facilities Bonds and Research University Infrastructure Bonds over two years." The Governor noted that such a debt payment would save the state over \$162 million in debt service and roughly \$125 million in interest payments over the next 13 years (Appendix 1).

On March 18, the South Carolina Senate Finance Committee voted 18-3 to adopt a concurrent resolution expressing the desire of the state legislature to accept Recovery Act funds. On March 20, on behalf of the President, the director of the federal Office of Management and Budget, Peter Orzag, informed Governor Sanford that the Recovery Act "does not support your proposed use of the State Fiscal Stabilization Fund monies to

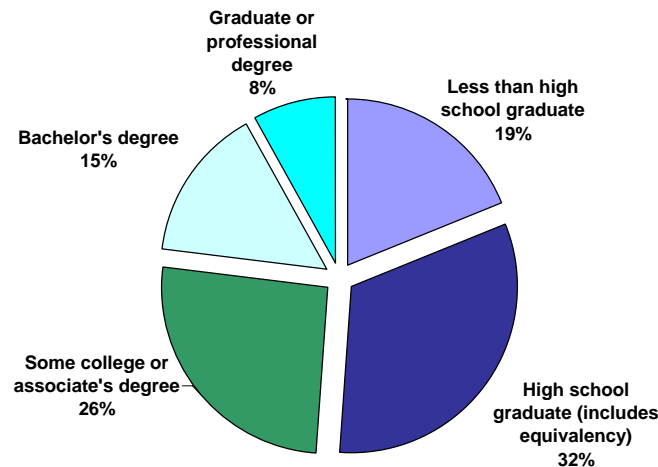
pay down the State's debt" (Appendix 2). Afterwards, Governor Sanford released a public statement saying that he intends to refuse the Recovery Act's education funding on behalf of the State of South Carolina.²

**Increasing Educational Attainment:
South Carolina's Best Method for Paying off All of South Carolina's Education Debt**

Governor Sanford has set up a false choice for South Carolina. The State does not need to choose between investing in education and paying off the state's education-related debts. In fact, education is the best means by which the state can put money into the pockets of individual South Carolinians in the years ahead and to increase the capacity of the State to pay off virtually all of the local and state school debt within the next 10 years of the current recession.

South Carolina has one of the nation's highest percentages of adults in the workforce without a high school diploma. The US Census Bureau estimates that in 2007 one out of every five South Carolinians (25-64 years of age) -- 19 percent of all adults-- had not completed high school in 2007. On the other end of the spectrum, less than one in four South Carolina adults in the workforce have a bachelor's degree or higher.

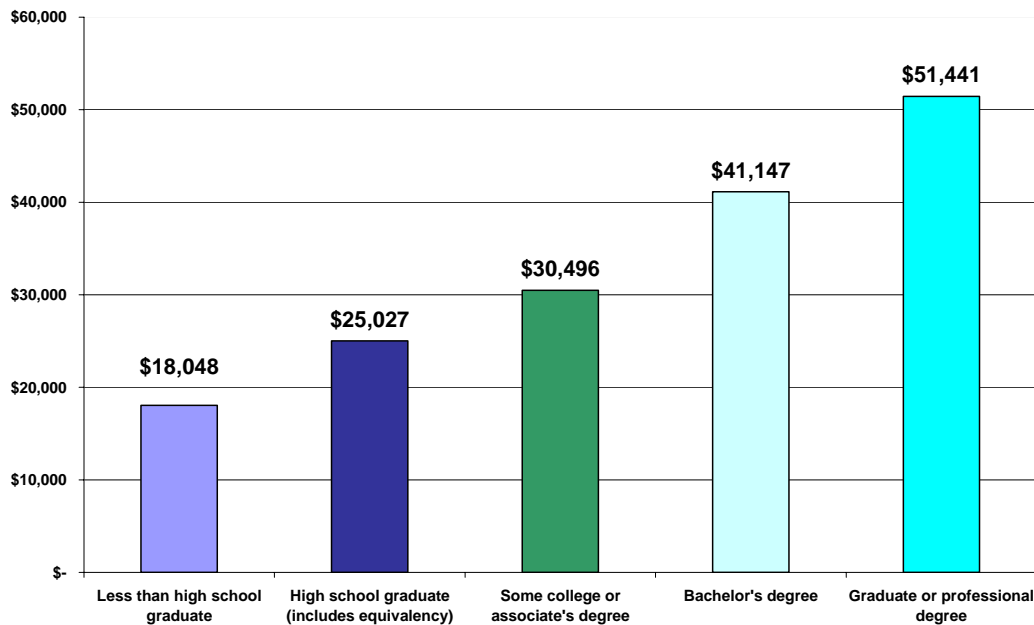
**2007 Educational Attainment in South Carolina
Population 25-64 Years of Age**



² Questions continue concerning the powers of the South Carolina legislature to accept funds in opposition to the governor in South Carolina. The Congressional Research Service has issued a memorandum raising questions about the inconsistent language of the Recovery Act on this point and suggesting that the Act's delegation of administrative authority to a state legislature from a governor may raise issues with the US Constitution's Ninth Amendment.

This trend is too costly for the State to ignore and shapes the earnings and income for every South Carolinian. In 2007, the annual median earnings for a high school dropout in the state was almost \$7,000 below that of a high school graduate and more than \$23,000 per year below the earnings of an adult in South Carolina with a bachelor's degree.

2007 Median Earnings by Educational Attainment: South Carolina



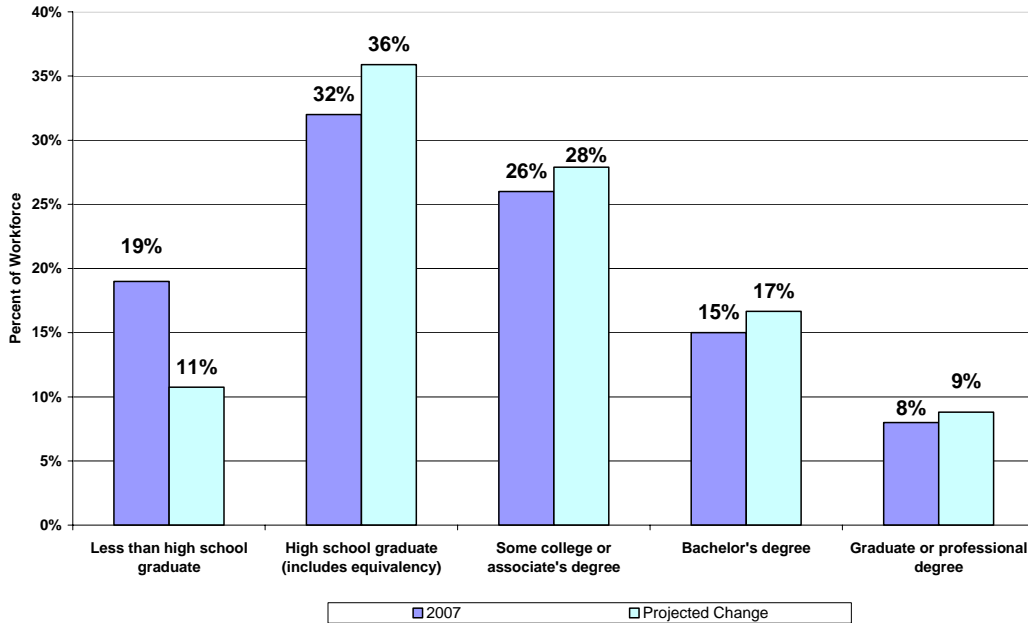
South Carolina has too many high school dropouts and too few college graduates in the state's workforce. This fact is the primary reason the State has not been able to develop an economy with mostly high-wage employment and a higher level of personal income and consumer spending that could help get the state out of a recession and out of debt.

The problem is not inevitable. It can change. If South Carolina, for example, made relatively modest gains in educational attainment by wisely investing in education in the State during the next few years, the State could come out of the current recession on a clear trajectory towards a higher quality of life for most citizens and a state that could eliminate far more than \$600 million in education debt.

What would happen in South Carolina if the State emerged in a few years from the current recession with a slightly more educated work force? What could happen if the state's workforce population between 25 and 64 made and maintained over time a

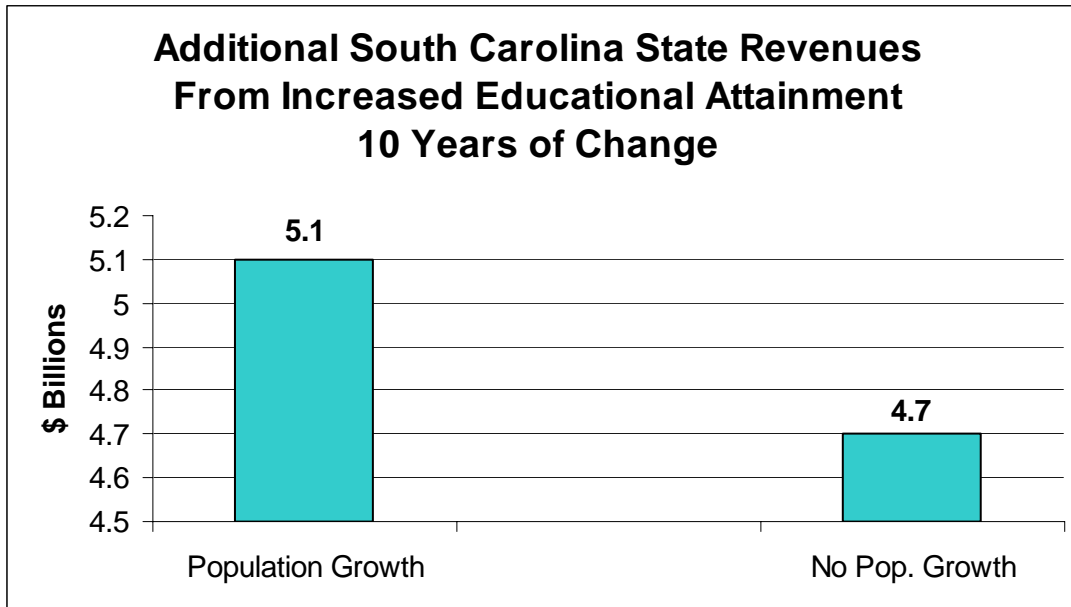
4 percent increase among current high school graduates; a 2 percent gain in current workers with some college or with a BA degree; and a 1 percent increase in adults with a graduate degree?

Projected Change in Educational Attainment: South Carolina



The answer illustrates the enormous economic power of education for South Carolina. In the first year of this scenario for change, the state’s citizens would begin to realize an increase of more than 1/2 a billion dollars in increased personal income. This trend would continue to increase personal income and, in turn, grow the state’s revenues. Over a period of 5 years, depending on population growth, the state would generate between \$1.9 billion and \$2.4 billion in additional state tax revenues at current tax rates.³ Within 10 years, the improved educational attainment of South Carolina would provide a total addition of between \$4.7 billion and \$5.1 billion in state income taxes and sales taxes beyond current revenues (see Appendix 3 for explanation of “change” scenario assumptions and calculations.).

³ This range of projections includes two assumptions about the labor force population: 1) an annual growth of 1.15 percent over 10 years and 2) no population growth. These assumptions account for the range in projected revenues. Each projection calculates for increased costs of improving educational attainment as well as enlarging state government savings from decreasing dropout rates. These scenarios of change calculate state revenues on the basis of current rates of South Carolina’s income tax and sales tax.



Of course, realizing these new added state revenues would not begin during the current recession -- with no job growth and increasing unemployment in the state. But, now is the time in which to build the state's human capital and new workforce through improved education for the growth that education can enable in the state after the recession.

Diverting the federal Recovery Act's education funding away from improving educational attainment and toward existing debt payments would be a short-sighted, foolhardy choice. By investing the federal funds wisely in education, South Carolina does not have to make a choice between increasing the education and incomes for its citizens and removing the state's debt. In truth, improving the state's education is the best way for the State to for build its capacity to pay off all its debts.

**Recovery Act's Funding for Education:
An Opportunity To Improve South Carolina's Low-Performing Schools**

Part of the federal funds for South Carolina education in the Recovery Act is designed to prevent massive cuts backs and layoffs in public education. This part will help prevent a rise in unemployment in South Carolina and keep money from wages and salaries flowing through the state's economy. Other parts of the federal education funding are designed to stimulate improvements in education among the state's

neediest students and the lowest-performing schools. There are also billions of dollars available for no-interest construction bonds to renovate and build public schools.

These new, one-time federal funds for school improvement can make be a big difference for South Carolina students. The federal stabilization funds can add up to as much as addition of \$788 per pupil. Each of South Carolina’s students with disabilities is due to receive increased support in the amount of \$2,928. And each student in a high-poverty school is due an increase of assistance amounting to \$1,129. And low income students in South Carolina attending college in the fall also will get an addition of \$4,836 to help cover tuition and fees.

Per Pupil Revenues from Recovery Act Funds By Major Programs
The Nation, the South and South Carolina

	Federal Stabilization	Special Education	Title 1	Per pupil Pell Grant: ARRA
Nation	\$761	\$1,873	\$1,327	\$4,898
South	\$716	\$1,843	\$1,198	\$5,086
South Carolina	\$788	\$2,928	\$1,129	\$4,836

Spending additional federal funds on South Carolina education will not guarantee school improvements or increased educational attainment. But, there can be little doubt that many school districts and many students in South Carolina need additional support and assistance in order to perform at higher levels in school and to graduate from high school and college. The school conditions in the state’s “Corridor of Shame” show why it is today self-evident why South Carolina needs more funds to advance education.⁴ The Recovery Act helps to provide more adequate funding so that South Carolina can come out of the current recession as a state preparing to become more educated and more capable of developing high-wage employment in the future.

Conclusion

There are many forms of debt that a State and its leaders can have. Almost a century and a half ago SEF’s primary benefactor, George Peabody, called education “a

⁴ See “Corridor of Shame: The Neglect of South Carolina’s Rural Schools,” DVD documentary, 2005 Directed and produced by Bud Ferillo.

debt due from the present to future generations.” Today, South Carolina should pay its debts in the most effective way -- by improving education for future generations of South Carolinians. The State of South Carolina and its Governor should accept and invest the federal Recovery Act’s new funds in the education for the direct and long-term benefit of children. It is the best way to increase the educational attainment of South Carolinians, to improve the state’s quality of life, to advance its economic growth beyond the current recession, and to generate a considerable amount of added revenues that can help pay off the South Carolina’s financial and educational debts.



State of South Carolina

Office of the Governor

MARK SANFORD
GOVERNOR

Post Office Box 12267
COLUMBIA 29211

March 17, 2009

The Honorable Barack Obama
President
United States of America
1600 Pennsylvania Avenue, Northwest
Washington, D.C. 20500

Dear Mr. President,

I'd first thank you and Director Orszag for your response of March 16 to my letter of the previous week. Likewise, I have to express my disappointment that our substantive dialogue about the best way to adapt this stimulus to the unique situations of states across this country was interrupted by the Democratic National Committee's launching of a petty attack ad against us even before we had received your response.

I've made clear my opposition to using debt to solve a problem created in the first place by too much debt – and I don't believe this to be an unreasonable position. What I find less reasonable is the way this DNC attack ad returns a nation indeed yearning for change back to the same old politics-as-usual. Because I believe you and I share a common desire to escape this worn-out "attack first" mentality, I'd respectfully ask you to immediately condemn and put an end to this unnecessary politicization of a truly important policy discussion.

In the spirit of moving forward, I'd offer the following as a clarification to our using a portion of the stimulus funds to paying down our state's sizable debt. With regard to the Education Stabilization Fund monies (ARRA § 14002(a)(1)) that must be used "for the support of ... education," we think it would be consistent with statutory requirements to use this \$577 million to pay down the roughly \$579 million of principal for State School Facilities Bonds and Research University Infrastructure Bonds over two years. This would immediately free up over \$162 million in debt service in the first two years and save roughly \$125 million in interest payments over the next 13 years, which could then be directed towards other educational purposes – just as paying off a mortgage early frees up the typical monthly payment for other uses.

Appendix 1

The Honorable Barack Obama

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March 17, 2009

Regarding the \$125 million in the Fiscal Stabilization Fund (ARRA § 14002(b)(1)) headed to South Carolina, we'd lay out a few options for your consideration: first, paying down debt related to the state's Unemployment Compensation Trust Fund that currently exceeds \$200 million and would directly impact those currently out of work in this struggling economy; second, paying down debt related to state retirees, since that would seem to satisfy the statutory requirement that these funds be used for "other government services"; or third, paying down other bonded indebtedness at the state level.

We trust these alternative proposals fit both the statutory requirements and spirit of the stimulus legislation. Thank you again for your response, and we would again appreciate your opinion as soon as possible given that we believe this course of action will do more to ensure South Carolina's long-term economic strength than would other contemplated uses of the funds.

I also await your response on pulling down the attack ads. A good part of your candidacy was fueled by the hope for change in the way political debate is conducted in our country. On this, actions will speak louder than words – words you have been so gifted in delivering – in determining where you really stand, not as a candidate promising to deliver on change, but as a leader now capable of bringing this change. I look forward to your response.

Sincerely,



Mark Sanford

cc: The Honorable Peter R. Orszag, Director
Office of Management and Budget

Appendix 2



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

THE DIRECTOR

March 20, 2009

The Honorable Mark Sanford
Governor of South Carolina
Columbia, SC 29211

Dear Governor Sanford:

Thank you for your letter to the President dated March 17, 2009. The President has asked me to respond on his behalf concerning your proposed use of State Fiscal Stabilization Fund monies to pay down your State's debt.

As you know, the American Recovery and Reinvestment Act of 2009 ("ARRA," or the "Recovery Act") was enacted in response to the severe economic downturn we are currently experiencing. The Recovery Act is designed to spur economic activity and private sector job growth; provide relief to individuals and families, as well as States and localities that are facing the prospect of cutting services and laying off teachers, police officers, and other vital public servants; and make critical investments in long-term economic growth, such as providing every child the chance for a world-class education.

The State Fiscal Stabilization Fund is a one-time appropriation in Title XIV of the Recovery Act. The Fund consists of approximately \$48.6 billion that the U.S. Department of Education will award to States to help address State and local budget shortfalls in order to minimize or avoid reductions in education and other essential services. As a condition of receiving stabilization funds, the Recovery Act requires States' assurances that they will advance essential education reform in four areas: (1) make progress toward rigorous college- and career-ready standards and high-quality assessments that are valid and reliable for all students; (2) establish pre-K-to-college-and-career data systems that track longitudinal progress and foster continuous educational improvement; (3) make improvements in teacher effectiveness and in the equitable distribution of qualified teachers between high- and low-poverty schools; and (4) provide intensive support and effective interventions for the lowest-performing schools. In addition, States must assure that they will maintain State support for elementary, secondary, and higher education at certain levels for fiscal years 2009, 2010, and 2011. (ARRA § 14005(d).)

You have proposed using the Stabilization Fund monies for "paying down [your] state's sizable debt." However, the Act does not authorize the Department of Education to award Stabilization Fund monies to a State for that purpose.

With regard to the 81.8 percent of a State's allocation of Stabilization Fund monies that must be used "for the support of elementary, secondary, and postsecondary education and, as applicable, early childhood education programs and services" (ARRA § 14002(a)(1)), the Recovery Act further specifies that those Federal funds must be used "first" to restore State

support to local educational agencies pursuant to the State's funding formula and to public institutions of higher education. (ARRA § 14002(a)(2).) Any remaining Federal funds within that percentage allocation must be used to provide subgrants to local educational agencies on the basis of a statutory formula. (ARRA § 14002(a)(3).)

With regard to the remaining 18.2 percent of a State's allocation of Stabilization Fund monies, the Act specifies that a State must use the monies "for public safety and other government services, which may include assistance for elementary and secondary education and public institutions of higher education, and for modernization, renovation, or repair of public school facilities and institutions of higher education facilities, including modernization, renovation, and repairs that are consistent with a recognized green building system." (ARRA § 14002(b)(1).) Although payment of public debt obligations is a necessary governmental expenditure, the Department of Education, in consultation with the Department of Justice and my office, has concluded that the paying down of past debt does not constitute the use of Federal funds for "government services" under the plain meaning of those words in the Act.

The language of the Recovery Act, as enacted by Congress, accordingly does not support your proposed use of the State Fiscal Stabilization Fund monies to pay down the State's debt.

Thank you again for your letter.

Sincerely,

A handwritten signature in black ink, appearing to read "P. Orszag", written over a faint, illegible typed name.

Peter R. Orszag
Director

APPENDIX 3
SOUTH CAROLINA:
PROJECTED STATE TAX REVENUE GAINS WITH INCREASED EDUCATIONAL ATTAINMENT
EXPLANATION OF METHODOLOGY

To project the effects of relatively modest increases in the educational attainment of South Carolina's adult work force, the Southern Education Foundation (SEF) created a scenario in which it assumes the State enlarges the graduation rates of its adult population by a sliding scale of improvement on the 2007 baseline estimates from the US Census:

South Carolina Educational Attainment Levels by Population Ratios

EDUCATIONAL ATTAINMENT LEVEL	CURRENT (2007) EDU ATTAINMENT PERCENTAGES	PROJECTED INCREASE EDU ATTAINMENT PERCENTAGES	DIFFERENCE IN CURRENT TO PROJECTED EDU ATTAINMENT
Less than high school graduate	19%	11%	(-8pts)
High school graduate (includes equivalency)	32%	36%	(4pts)
Some college or associate's degree	26%	28%	(2pts)
Bachelor's degree	15%	17%	(2pts)
Graduate or professional degree	8%	9%	(1pt)

Projected Population and Personal Income

SEF developed two optional trajectories for population growth: one with an annual rate of population of 1.15 percent (approximately half the rate of growth during the last 15 years) and no growth. For simplicity, SEF assumes in the scenario that the State maintains its improvements in educational attainment – neither increasing nor decreasing the gain—over a period of ten years.

Taxable Income and State Tax Revenues

Based on these population estimates over 10 years, SEF calculated the estimated growth in South Carolina's gross median income for adults ages 25-64, by level of education. For each population group, SEF calculated yearly the amounts of taxable earnings based on the maximum deductions and exemptions for a single taxpayer with an average of 1.25 dependents in accordance with South Carolina's published 2007-2009 Tax Tables. The total income tax revenues for the State were computed based on a range from 4% to 7% of total taxable income. To test the accuracy of using data on median income by levels educational attainment to obtain estimates of tax receipts, SEF calculated South Carolina income tax receipts by this method for 2007 and compared the results to the actual receipts as reported by the US Census for the same tax year. SEF's calculations appeared to understate actual receipts in 2007 by approximately \$48 million.

Because a state's general sales tax revenue is closely related to its residents' disposable personal income, SEF calculated South Carolina's annual sales tax revenues by determining the historical ratio between sale tax receipts and income tax receipts during the last 18 years. In addition, SEF calculated a ratio based upon receipts in the 3rd quarter of 2008. Using both the "recession" ratio (86.5%) and the "historic" ratio (103.9%), SEF calculated total sales tax revenues for 10 years. The yearly sums for both total state income tax revenues and total sale tax revenues were combined.

State Costs and Savings from Increased Educational Attainment

There are added school-related costs for the State to increasing educational attainment and SEF estimated the state costs by using South Carolina's most recent per pupil allocations in K-12 education, community colleges, and four-year colleges. The additional number of graduates at each level of educational attainment was multiplied by a cost factor: High School Diploma (K-12 per pupil costs x 2 years); Associate's Degree (community college costs per FTE x 2 years); and Bachelor's Degree (4-year college per FTE x 4 years). The calculations also are based on an assumption that the State would incur the cost of all new high school graduates, one-half of the new community college graduates and one-half of all additional four-year college graduates— a distribution of costs that generally reflects current financial aid patterns in South Carolina. All of these costs were combined to estimate the annual cost of increased educational attainment for the State. This annual cost was computed over a ten-year time period.

The annual cost of increased attainment was reduced by the amount of state savings from foregone costs in criminal justice. The number of additional high school graduates was multiplied by annual criminal justice system savings per high school graduate (\$2,440), a national estimate developed by economists associated with Columbia University. Annual savings were also computed over a ten-year span.

Results, Observations and Qualifications

The estimates for the 10-year, net state costs of increasing educational attainment were subtracted from the estimates of the total income and sales tax revenues for 10 years to arrive at the findings of the scenario. The results produced a range of increased state revenues that were lowest for the trajectory of no-growth and highest for the historical trends with an annual population growth of 1.15 percent. These projections are rough calculations, but they probably underestimate the effects of increasing educational attainment on South Carolina's state revenues. First, income and general sales taxes, which this projection calculates, comprise only about 75 percent of the State's total annual revenues even though increased education generally enlarges all of a state's economy (SDP) which is the source of most of the state remaining tax revenues. In this respect, SEF's projections of increased state tax revenues are conservative. Second, SEF reduced the State's most recent trends in population growth. Slower rates of growth in the adult population would mean lower receipts of tax revenues. Third, SEF overstated South Carolina's dependent population per tax filer in calculating exemptions for taxable income, especially for high income and high education groups. The effect of this assumption was to reduce taxable income and tax revenues.

In addition, there are cost savings that a State receives beyond those related to the criminal justice system when it increases high school and college graduation rates. These involve costs in state Medicaid and uninsured care, subsidized housing, reduced college remediation expenses and unemployment compensation, and welfare subsidies, including food stamps. These are often computed in econometric projections on the basis of a student's lifetime instead of annual savings. For the simplicity of the current projections, these savings were not included in this projection, even though they would have reduced the State's tax-supported costs and increase net tax revenues.

Sources: American Community Survey, US Census Bureau, 2007; Tax Foundation and South Carolina state tax forms and instructions; State Government Tax Collections, US Census Bureau, 1991-2007; National Center for Education Statistics, Common Core Data Set; South Carolina Department of Education; Southern Regional Education Board; The Cost and Benefits of an Excellent Education for All of America's Children, Teachers College, Columbia University (Criminal Justice Savings), 2007.