

May 27, 2008

The Honorable Robert W. Harrell, Jr.
Speaker of the House of Representatives
Post Office Box 11867
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Dear Mr. Speaker and Members of the House:

I am hereby vetoing H. 3567, R-288, which increases the tax on cigarettes by 50 cents per pack, but I take this action after careful study and pause as many people I admire have contacted our office about this proposal.

I do so because the revenue from this tax increase is dedicated to the start of additional spending on health care – for which there is no additional revenue as these programs grow. In that regard, the bill represents two tax increases – an immediate one with the bill’s passage, and a second over time to pay for these new programs. As much as this administration would have liked to have been able to support raising the cigarette tax, as we have long been advocates of doing so, in this case we cannot for the two raises to the tax load on South Carolinians that this proposal entails.

As Ways and Means Chairman Dan Cooper rightfully noted after the bill passed the House, “We’re just going to create a funding problem down the road.” Even casual observers know that Chairman Cooper and I rarely end up on the same side of an issue, but when we do, it is worth noting. If this bill survives this veto, then, by any account, taxpayers will be saddled with a very significant expense over the years ahead.

Before I get into the nuts and bolts of this proposal, I think it is important to lay out some of our overriding concerns.

Liberty is the hallmark of the American experiment. In this regard, above safety, health, and a host of other concerns, the Founding Fathers placed the principle of liberty as the foundational theme to what makes our republic special. The money that each one of us has to spend as we see fit, or so-called economic freedom, is a real bellwether on the larger notion of freedom. It is this administration’s view that we ought to maximize each person’s discretion in spending the money they earn over the course of working forty, fifty, and sixty hour weeks. Today, South

The Honorable Robert W. Harrell, Jr.

Page 2

May 27, 2008

Carolínians already spend 130 percent of the national average on their government. While we have long supported raising the cigarette tax and swapping it off by lowering yet another tax, if you care about economic freedom, why would you support raising the tax load on working South Carolínians?

There are now 6.5 billion people on earth, and because of globalization we are in a newfound competition for jobs, capital, and way of life – the likes of which we've never seen before. This administration does not believe that raising the aggregate tax load on South Carolínians makes us more competitive in today's world.

Finally, even if we are able to look past these first two concerns, we would still be compelled to veto this proposal based on our concerns on the sustainability of current programs in South Carolina government. Why would we add new programs when policymakers have been unable to come up with funding for current programs already promised to the people of our state? We now sit on a \$27 billion unfunded liability for health and retiree benefits. In the private sector this sort of unfunded liability would send you to jail. Although in any political environment there seems to be an unlimited bias toward making new and additional promises, rather than first addressing the commitments already on the table, it is the view of this Administration that we must do first things first. In this regard, no matter how meritorious the program, we believe we should pay for existing obligations before making new ones. Whether one's political persuasion is from the left or right, it would seem to me that we could all agree on the importance of sustainable government spending. This is especially true as Washington is now looking at materially revising the Medicaid system. What this means is at the very time that we raise South Carolina's commitment to Medicaid, Washington may reduce its – and, as a consequence, our system would find itself that much less sustainable in economic terms.

I will now go into a little greater detail tied both to the thoughts above, and others, which drove our decision on the cigarette tax.

We believe first that the key to making health care more available to the people of our state rests in reform to the system rather than simply raising taxes. There are two main components of coverage in this bill – first, expansion of the Medicaid and State Child Health Insurance Program (SCHIP) and premium assistance for the uninsured – and to sustain either over time will entail raising taxes.

Historically, when cigarette taxes are increased, the revenue generated will decline over time. That alone means that there will be less revenue coming in to the program the next year and benefits will have to be reduced or eliminated. Assuming, just for argument's sake, that the revenue remains constant for a two or three year period – the average annual growth of the Medicaid program is eight percent. This also means that services or benefits will have to be reduced in each year after the first. Try as we might, we cannot assume that cigarette tax revenues and expansion of Medicaid and SCHIP will somehow beat the overwhelming odds of reduced revenue and increased costs. Soon after this program begins it appears that either

cigarette tax will be raised again in what becomes a spiral of declining revenues and increased costs or, alternatively, policymakers will raise taxes again.

We have the benefit of learning from the mistakes of other states around the country. Just two years ago, Governor Arnold Schwarzenegger introduced a sweeping new plan in California to provide universal coverage for all Californians totaling \$14 billion. Though it gained national notoriety, the debate dragged on through this year and the plan ultimately faded because of the fiscal impact. In the aftermath of that, he has now proposed cutting roughly \$1.5 billion in health care services.

In Massachusetts, then-Governor Mitt Romney introduced a plan to provide “universal coverage.” However, inflationary demands have led to skyrocketing costs that may well limit many people’s health care options over the long run. The plan is currently underfunded by \$150 million and the current Governor has requested nearly twice the funding in the next year – and subsequently acknowledged that request was too little. The Massachusetts Legislature is considering an assortment of options, from reductions in provider payments, greater penalties to small businesses, increasing taxes, and even cutting some benefits to offset the program. In the next 10 years, the current plan is expected to cost an additional \$4 billion greater than anticipated. So bad are the cost overruns that the health plan is now being referred to as “The New Big Dig” – a reference to the Boston transportation project that was filled with excessive costs, mismanagement, and corruption – costing taxpayers billions.

Just as in those proposals, this bill fails to acknowledge the first problem of health care access – how we regulate and manage the marketplace. The health insurance market in South Carolina suffers the same problem that other states, and even the federally-regulated marketplace, suffer – the consumer has few options and little control of the product. Rather than wrap another layer of bureaucracy on top of a system that, over the long run, may well discount access to hundreds of thousands of South Carolinians, we need to first look at longer term fixes to the system.

Today, health care consumers have more than 30 different benefits mandated on them – raising the cost of health insurance by roughly \$550 a year on South Carolina families. Let me put that another way – the tax imposed in this bill would cost a married couple, who both smoke a pack a day, an additional \$365 a year. In essence, given our mandates, state law would continue to penalize a couple more for purchasing health insurance than smoking.

Just last week, the state of Florida enacted a law to allow consumers to purchase a “stripped down” insurance policy. Today, thirteen states allow such plans – and it strikes me that we should exhaust remedies like this before we simply raise a tax. In short, there are many examples of innovation in the health care market, and we need address the root cause of what ails our system.

Second, and as I just mentioned our state has \$27 billion in unfunded liabilities, but this is compounded by the fact that this bill came with a budget that raids nearly \$100 million from the Medicaid Reserve Funds intended to cover program reforms and anticipated growth in demand

The Honorable Robert W. Harrell, Jr.

Page 4

May 27, 2008

for Medicaid services. If we are serious about protecting Medicaid, it would seem to me that the first place to start would come in not borrowing over \$100 million from the fund.

Finally, going all the way back to my very first State of the State address in 2003, I have advocated the notion of increasing the cigarette tax. Concurrently, I have advocated dedicating those revenues toward reducing another, more economically destructive tax rather than use revenue that, historically, declines over time to create new programs or expand existing ones.

In the realm of taxes, we believe that they are not all created equally. We have consistently advocated the notion that the top marginal rate in South Carolina – the highest effective tax rate in the Southeast – weakens investment and stifles economic activity. On the other hand, a consumption tax such as the cigarette tax is more optional in nature, allowing the individual to make the choice as to whether they want to pay the tax. Through many different venues, we have tried to work with the General Assembly to raise this consumption tax, in exchange for a reduction in the income tax. I applaud the leadership of House Majority Leader Jim Merrill for offering an amendment during the House debate to do just that and thank the 51 members who joined him in supporting this common sense approach.

With our proposal, which would have raised the cigarette tax by 30 cents in exchange for an optional flat tax, South Carolina would have joined seven other states in bringing simplification to the income tax structure. If the General Assembly truly wants to provide an economic stimulus for the average South Carolinian, they would have adopted something closer to our proposal. This notion is supported by the Atlanta Federal Reserve Board which stated in a recent study, “Relative marginal tax rates have a statistically significant negative relationship with relative state growth.” Put another way, the lower the tax rate the greater the state’s economic growth.

In summary, the legislation is well-intentioned, and increasing access to care for the uninsured is a shared goal. However, this legislation requires substantial tax increases over time to provide the health care the bill promises.

Mr. Speaker, I would respectfully ask you and your colleagues to support this veto so that we can instead focus on providing meaningful, long-term solutions to the health care system here in South Carolina. Alternatively, send me a cigarette tax increase tied to offering a flat tax option for South Carolinians that would encourage productivity and investment for our economy, and I will sign it immediately.

For these reasons, I am vetoing and returning without my signature H. 3567, R-288.

Sincerely,

Mark Sanford