FLORIDA
Taxation & Budget Reform Commission

FLORIDA'S FISCAL FUTURE

Balancing Needs & Taxes

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Preface

THE concept of creating a commission of citizens to evaluate and recommend reforms in Florida's tax and budgeting systems was born in a year of economic prosperity, 1987. The motivation was that the robust state economy was apparently growing faster than government's ability to meet the demands for infrastructure and services. In 1987, the State Comprehensive Plan Committee report estimated that in order to implement the state comprehensive plan by 1997, the state would need an additional $35 billion and local government would need $17.9 billion. Efforts to provide funding for infrastructure through the short-lived services tax left the state wracked by political turmoil and uncertainty about funding future growth even though the Legislature substituted an additional one penny of sales tax as a replacement for the services tax.

Within that economic and political climate, 57% of the voters in the November 1988, election agreed that a tax and budget reform commission must be created. Following the passage of an implementing bill, the Governor, President of the Senate, and Speaker of the House appointed the 25 voting members who held their inaugural meeting in April 1990, in the Old Capitol. Subsequently, these 25 were joined by four non-voting legislative members, two from the House and two from the Senate, and together they began to fulfill the mandate given to them by the people of Florida.

Less than a year later the economic environment shifted as Florida followed the national economy into a recession that still persists. By April 1991, Florida was one of 30 states facing deficits projected by the National Conference of State Legislatures to range from 0.9% to 12.8%. Although modest compared to other high-growth states, California—$12.6 billion and Texas—$4.6 billion, the $1.029 billion shortfall in Florida required painful budget cuts in the 1990-91 fiscal year by the Governor and Cabinet. Tax and budget reform assumed a new sense of urgency as it became evident that Florida's 1990-91 recession, unlike the 1981-82 recession, was deeper than the national recession and could last longer.

The Taxation and Budget Reform Commission established its plan of action before the onslaught of the recession. In the minds of Commissioners, reform of the state budgeting and spending practices became the top priority. This decision was supported by evidence from public hearings, opinion polls, and the media showing that most voters thought government was wasteful and inefficient. Tax increases each year in the decade of the 1980's probably fueled the pessimism. For example, the Florida Poll conducted by Florida International University in 1989 revealed that 93.1% of the people believed government wasted "some" or "a lot" of money. In the midst of the 1991 recession, that percentage increased to 95.3%. Public confidence in government budgeting and spending was so abysmal that in spite of the much publicized budget slashing by the Governor and Cabinet and a $1 billion reduction by the 1991 Legislature, 50% of the voters questioned in a May 1991, *New York Times* poll believed there was no shortage of money in Tallahassee. Actually in the midst of the ravages of the recession and the revenue shortfalls, per capita state spending in 1991-92 will be slightly higher than the previous year.

The Commission's report released in February 1991, *A Program for Reform of Florida Government*, presented 14 major proposals, most of which addressed the problems and deficiencies of Florida's budgeting and spending practices. Aside from the inefficiencies, absence of a system to prioritize the use of funds, and lack of accountability, which the Commission wishes to correct, the proposals are also designed to make government transparent and understandable. The public cannot trust what it does not see and understand. These goals require the implementation of a budgeting process that subjects all government programs to routine re-evaluation, establishes the priorities for funding, and measures the

Florida Taxation and Budget Reform Commission Formal Responsibilities

Under Article XI, Section 6, the Commission shall:

1. Be established in 1990 and each tenth year thereafter.
2. Be composed of 25 voting non-legislative members and 4 non-voting legislative members. (Composition specified in Constitution.)
3. Elect a non-legislative member at its first meeting to serve as Chairman
4. Adopt rules of procedure at its first meeting.
5. Hold public hearings as its deems necessary.
6. Issue a report of the results of the review it carries out.
7. Propose to the Legislature recommended statutory changes related to the taxation or budgetary laws of the state.
8. File with the Secretary of State its proposal, if any, for a revision to the Constitution dealing with taxation or the state budgetary process, not later than 180 days prior to the general election in the second year following the year in which the Commission is established. (May 7, 1992)
9. Vote on proposed constitutional revisions by an affirmative vote of two-thirds of the full Commission (or 17 members) and with the concurrence of a majority of the members appointed by the Governor (6 members), the President of the Senate (4 members) and the Speaker of the House of Representatives (4 members). (Members are exempt from the prohibition on dual office holding established in Section 5(a), Article II of the Constitution.)

outcomes or results. The Commission is convinced that the public is unwilling to address tax reform or the possible need for additional revenue until convinced that the state is using current revenue more efficiently. The desire to have budget reforms precede tax increases was supported by the respondents in an April 1991, poll by TaxWatch, Inc. with only 24% opposing.

There was hope that the Legislature would see the wisdom of carrying out budget reform while the Commission moved beyond budget reform to its analysis of the tax system. Unfortunately, some legislators criticized the Commission's attempts to improve the way the Legislature budgets and spends money, and few of the Commission's recommendations were enacted into statute. The budget reforms, if ignored again by the Legislature in 1992, could and should be placed on the 1992 ballot for adoption by the voters.

The constitution requires the Commission to make the following determinations about the tax system: 1) the appropriateness of the tax structure; 2) the ability of state and local government to tax and adequately fund governmental operations and capital needs until the year 2000; 3) the extent of the need for revenue until the year 2000; 4) the ways to effectively gather additional revenue from existing tax sources; 5) the constitutional restrictions on taxes; and 6) the methods favored by citizens to fund the needs of the state, including alternate methods of raising revenue.

Tax reform, as interpreted by the Commission, does not necessarily mean new taxes. The Commission conducted its analysis of the tax system within the context of revenue neutrality. In other words, the primary goal is to make the tax structure more stable and equitable, keeping in mind that there must be a balance between needs, taxes, and the ability and willingness of the people to support government expenditures. The Commission believes these changes in the tax system must be made with a keen awareness that economic growth for Florida and the nation will be slower in the

1990's than it was in the previous decade.

Analysis of the existing tax system has been an ongoing process by the Commission and its staff since April 1990. Information and testimony came from government and private sector economists, legislators and other state officials, private citizens, and consultants employed by the Commission. Issues examined included the heavy reliance on the sales tax (70% of General Revenue), the growing myriad of sales tax exemptions, corporate income tax exemptions, the regressive impact of the tax system across income groups, and the lack of stability and predictability. This report represents the findings of the Commission and the recommendations being forwarded to the Governor and the Legislature. As indicated in the report, some of these recommendations will be subjected to additional analysis and debate prior to any final decision to propose them as constitutional amendments.

1990 Taxation and Budget Reform Commission Members

(appointing authorities indicated)

Mr. Hugh A. Anderson (Senate) of Ft. Lauderdale is president of Hugh Anderson Realty, Inc. in Ft. Lauderdale.

Mr. Hoyt R. "Barney" Barnett (Governor) of Lakeland is the executive vice president of Publix Supermarkets.

Ms. Martha W. Barnett (Governor) of Tallahassee is a partner with the Holland and Knight law firm.

Dr. James A. Bax (Senate) of Long Boat Key is president of ACSI, Inc., a national professional testing company.

Mr. Jacob C. Belin (Governor) of Port St. Joe is president of The Nemours Foundation.

Mr. F. Philip Blank (House) of Tallahassee is president of F. Philip Blank, P.A., a law firm based in Tallahassee.

Mr. R. Mark Bostick (Senate) of Winter Haven is president of Comcar Industries, Inc., of Auburndale.

Mr. Bill L. Bryant, Jr. (Governor) of Tallahassee is a partner in the law firm of Foley & Lardner.

Ms. Linda W. Chapin (House) of Orlando is chairman of Orange County. (Resigned - replaced by Dr. Adam Herbert)

Mr. Miles C. Collier (Governor) of Naples is the managing partner of Collier Enterprises, a financial asset management, land development and agricultural firm.

Mr. E. William Crotty (House) of Daytona Beach is a senior partner in the law firm of Black, Crotty, Sims, Hubka, Burnett & Samuels.

Mr. Andrew L. Duda (Governor) of Oviedo is the executive vice president of A. Duda and Sons, an agricultural and land development firm.

Mr. David W. Dunbar (Governor) of Dunedin is the owner of Dunbar Corporation, a financial consulting and development firm in Palm Harbor.

Dr. Adam W. Herbert (House) of Jacksonville is the president of the University of North Florida.

Mr. Homer Hooks (Senate) of Lakeland is Chairman of The Hooks Group, Inc., a communications consulting firm.

The Honorable Ken Jenne (D) of Ft. Lauderdale is currently serving his 11th year with the Florida Senate. He is chairman of the Senate Finance and Tax Committee.

The Honorable Bob Johnson (R) of Sarasota is currently serving his second term in the Florida Senate and had been a member of the House of Representatives for four terms. (Resigned - replaced by The Honorable Curtis Kiser)

Mr. Seth P. Joseph (Senate) of Ft. Lauderdale is a partner in the Miami law firm of Baker McKenzie.

1990 Taxation and Budget Reform Commission Members
(appointing authorities indicated)

Mr. Allan J. Katz (House) of Tallahassee is the managing partner of Katz, Kutter, Haigler, Alderman, Davis, Marks & Rutledge law firm.

The Honorable Curtis Kiser (R) of Dunedin (Pinellas County) is in his second term in the Florida Senate. He served in the House of Representatives for 10 years, 4 as minority leader.

Mr. Charles E. LeCroy (Governor) of Winter Park is senior vice president of Lehman Brothers, a national investment banking firm.

The Honorable Joseph R. "Randy" Mackey (D) of Lake City was first elected to the Florida House of Representatives in 1986. (Resigned - replaced by The Honorable Ron Saunders)

The Honorable Carrie Meek (D) of Miami is currently serving her second term in the Florida Senate and had previously been a member of the House of Representatives for two terms. (Resigned - replaced by The Honorable Ken Jenne)

Mr. Peter W. Mettler (Governor) of Palm Beach is a partner in the law firm of Mettler and Gilson.

Mr. H. Lee Moffitt (House) of Tampa is former speaker of the Florida House of Representatives and currently Chairman of the Board of Moffitt, Hart & Herron law firm. (Resigned - replaced by E. William Crotty)

Ms. Marta Prado (House) of Plantation is vice president of marketing and business development for EMSA Limited Partnership.

Mr. Thompson L. Rankin (Senate) of Tampa is the chairman of the board, president and chief executive officer of Lykes Brothers, Inc. and Shore Management, Inc.; chairman and CEO of 7L Corporation and Lykes Energy, Inc.; director and vice-chairman of First Florida Banks, Inc. Mr. Rankin is the Commission Chairman.

The Honorable Debby P. Sanderson (R) of Fort Lauderdale has served as a member of the Florida House of Representatives since 1982.

The Honorable Ron Saunders (D) of Key West was first elected to the Florida House of Representatives in 1986. He is chairman of the House Appropriations Committee.

Mr. Tom H. Slade (Governor) of Orange Park is president of Dozier and Gay Paint Company in Jacksonville.

Mr. Arthur E. Teele, Jr. (Governor) of Miami is a member of the Dade County Commission.

Mr. Parker Davidson Thomson (House) of Miami is the senior partner of the law firm Thomson, Muraro, Bohrer & Razook, P.A.

Mr. Pat Tornillo (Senate) of Miami is the president of the Florida Education Association United, executive vice president of the United Teachers of Dade and vice president of the American Federation of Teachers.

Mr. Steven J. Uhlfelder (House) of Tallahassee is a partner in the law firm of Steel, Hector and Davis.

Executive Summary

THE Taxation and Budget Reform Commission has a dual responsibility which is clearly indicated by its name. Both tax reform and budget reform are needed, but budget reform came first on the Commission's agenda because it seemed reasonable to begin with an analysis of how current tax dollars are budgeted and spent. This decision was reaffirmed by the strong, recurring message from the public that too much tax money was being wasted or spent unwisely. Any proposed tax reform would be doomed to a negative public reception unless preceded by a responsible effort to improve a state budgeting and spending system which the public perceived as wasteful.

As the Commission completed its analysis of the budgeting and spending system and submitted Findings and Recommendations to the Legislature in February 1991, in an effort to improve the system, its next challenge was to define tax reform. To some people in government tax reform means finding ways to raise more money in order to meet the immediate demands. To take such a simplistic approach would be an injustice to the citizens of Florida who created this Commission. Any attempt to meet the immediate needs of the present would only temporarily obscure serious flaws in the fiscal system and merely delay the onset of more acute revenue problems within a few years. For the Commission's work, tax reform means that the requests for more money now have to be set aside in order to concentrate on the fundamental structure and underlying principles of the existing tax system. Tax reform means that several basic questions about the existing system have to be addressed, such as:

The analysis reveals that Florida has a tax structure problem. But the state also has a spending problem.

- Is the existing tax system basically fair?
- Does the system extract a reasonable or unreasonable amount of taxes from Floridians?
- Does the growth of the tax system closely track the growth of the Florida economy without frequent and confusing tax changes?
- Does the system encourage or discourage job creation in Florida?
- Does the system create competitive disadvantages for Florida business?
- Does the system export a sufficient amount of the tax burden to tourists and out-of-state businesses who benefit from services provided in Florida?

Since February 1991, the Commission and its staff have been engaged in two separate, but complimentary projects related to taxes: 1) projecting the revenue needs and expenditures of the state and 2) examining the tax system in order to determine its appropriateness and adequacy. The analysis reveals that Florida has a tax structure problem. But the state also has a spending problem.

In this report the Commission has attempted to define the issues and problems and to offer recommendations for addressing both.

Revenue Needs and Spending Patterns

The Commission found it impossible to estimate spending growth based upon revenue needs because the definition of the term "needs" is subjective. Trying to define needs requires value judgements not only about what government does, but also about how much money it spends in the effort. The meaning of the term can be influenced by economic and political philosophy. Those who benefit from a program may have a different perspective than those who pay for it. As a result, the Commission determined that the most reasonable approach in projecting or estimating the revenue needs of Florida was to analyze the spending patterns of the decade of the 1980's. The major findings were:

- State spending increased by 196% from 1980 to 1990. After adjustments for inflation and population growth, it grew 35%.
- In years when the sales tax revenue increased by as much as 23.75% over the previous year, rather than placing some of the growth revenue in the Rainy Day or Working Capital Fund for use in years when revenue was down, all the growth revenue was spent and the Legislature also raised taxes.
- Taxes were increased every year during the 1980's, over 40 changes, by an average of 3% per year in addition to the average 9.3% growth of the existing revenues.
- State agencies typically prepare budgets by adding growth dollars to last year's annualized budget. They are not required to prioritize their budget, prepare cost-benefit analyses, or have an evaluation of the efficiency and effectiveness of their programs.
- New programs were introduced, in some cases over-lapping existing programs, without addressing the issue of how to resolve the duplication and without projecting the long-term fiscal impact.
- The Legislature expanded the eligibility of programs like AFDC and Medicaid without projecting the long-term consequences.
- Based upon Commission projections, if, in a non-recessionary economy, current state policies were maintained without change and General Fund spending increased only as fast as the increase in population and inflation, a one-half cent increase in the sales tax would be adequate to fund the General Fund cumulative deficit predicted by the year 2000.
- Based upon Commission projections, if, in a non-recessionary economy, current state policies were maintained without change and General Revenue spending increased at the same rate as in the decade of the 1980's, a 4.85 cent sales tax increase would be necessary to fund the General Fund cumulative shortfall predicted by the year 2000. If General Fund and Trust Fund spending increased at the growth rate of the 1980's, a 10 cent increase in the sales tax could be required.
- In the decade of the 1980's, expenditures for counties grew at an average annual compound rate of 12.6%, and for cities by 9.1%.
- If current spending patterns for counties and cities continue as projected, counties and cities, in the aggregate, will experience collective deficits by the mid-1990's.
- Florida's economy, like that of the nation, is predicted to grow at a much slower pace in the 1990's than in the previous decade.

Florida's Tax System

The Commission conducted a comprehensive analysis of Florida's state and local tax structures, making use of data from outside consultants to supplement the vast amount of information gathered by the Commission since April 1990. In its evaluation the Commission used its High Quality Revenue System Criteria which included such issues as equity, stability, balance, and predictability.

- Florida is a low tax state, ranking below 44 other states in the amount of state and local taxes per capita as a percent of personal income.
- State taxes as a percent of personal income remained at 4.1% during the decade of the 1980's despite many tax increases.
- The existing tax system produced more revenue in 1991-92 than the previous year in spite of the recession and budget cuts.
- The tax system is not balanced. According to tax experts, there are three tax bases to tax but Florida taxes only two, consumption and wealth, since this is one of only 6 states without a personal income tax.
- Florida's tax system is not stable because of its heavy reliance on the sales tax. While the average state gets about one-third of its General Revenue from the sales tax, Florida gets about 70%, the highest percentage in the nation.
- Taxable sales fluctuate much more dramatically than the rise and fall of the economy. Between 1980 and 1991 the variation in sales tax revenue ranged from 16.8% in 1983-84 to 0.1% in 1990-91.
- Florida's heavy taxation of consumption causes the tax

system to be regressive, i. e. lower income groups spend a higher percentage of their income on taxes than upper income groups, ranging from an effective tax rate of 5.9% on low income families to 1.7% on families with incomes above $100,000.

- Florida's tax structure discriminates against businesses based upon type of organization. For example, the principle business tax, the corporate income tax, does not treat all businesses fairly. Less than 25% of Florida businesses are C corporations, and 90% of the taxes are paid by less than 2.5% of them. Subchapter S corporations, partnerships, and proprietorships are exempt from the tax, although they benefit from government services as C corporations do.
- Florida is not collecting approximately $750 million in sales tax and $200 million in intangible taxes owed by businesses and individuals.

Commission Recommendations

Having conducted its examination of the tax systems of state and local governments, the Commission adopted several recommendations for legislative action. The Commission also placed several proposals on its Constitutional Calendar for further examination and discussion prior to a final decision to propose them as constitutional amendments. Proposals on the Constitutional Calendar are subject to revision or rejection based upon further Commission action following input from the public, the Legislature, and the Governor.

The recession has demonstrated dramatically how erratic and unpredictable consumption tax revenue can be. At the same time, the recession has demonstrated that the design of a tax system, in terms of balance, equity, and predictability, cannot by itself offer an ultimate solution.

Florida is one of at least 30 states which are currently experiencing fiscal crisis and actually has less serious problems than the three most populous states—California, New York, and Texas—and some of the smaller states like Connecticut or even Maine where the Governor is laying-off 20% of the state workers and abolishing 30 departments. It is a fortuitous coincidence that the Commission has been analyzing Florida's tax system during a recession because the recession has demonstrated dramatically how erratic and unpredictable consumption tax revenue can be. At the same time, the recession has demonstrated that the design of a tax system, in terms of balance, equity, and predictability, cannot by itself offer an ultimate solution. California has a balanced tax system which has been considered fair and stable, but California also had a shortfall of almost $14 billion.

Despite a strong economy through most of the decade of the 1980's, each year the growth in state spending exceeded increases in state revenue, resulting in annual tax increases. The United States and the state of Florida are predicted to experience a slower rate of growth in the 1990's, and probably beyond. If Florida's state government continues to increase spending growth at the same rate that it did in the 1980's, it will outspend the revenue of any tax system, no matter how stable, predictable, or equitable.

Budget & Spending Reform

THE initial challenge for any constitutional revision commission is to determine which issues should be addressed. For the Taxation and Budget Reform Commission, the issues emerged from the extensive reading and testimony in the 26 meetings of the Commission and its committees between April and October 1990. Desiring to provide an increased opportunity for the public to add its views to that of the experts, the Commission also held public hearings in Tampa and Miami. Commissioners received not only an intensive education on issues related to Florida's tax system and the state's budgeting and spending practices, but they also found a clear, strong sentiment expressed by the public in those hearings and in opinion polls: "the state wastes too much money through inefficiency and misplaced priorities, and we are not willing to pay more taxes until we are convinced that current dollars are being used more efficiently and wisely."

The constitution requires the Commission to examine the budgeting and spending practices of the state and to examine government efficiency and productivity, but the voice of the public helped make these issues the Commission's first priority. Furthermore, the Commissioners themselves had become convinced that the planning, budgeting, and spending system that had evolved in Florida over the past century had many deficiencies, such as:

- The State Comprehensive Plan does not provide guidance to state planning, policy, or spending, and is not regularly updated;
- Agency Functional Plans do not provide policy makers with information to assess the priorities or performance of agencies or the need for new programs, and are ignored in the budgeting process;
- The Governor lacks adequate authority over and responsibility for budgets of agencies under his control;
- The Legislative branch is exempt from the requirements of the budgeting law;
- The state does not have a unified accounting and management information system;
- The General Appropriations Bill format does not provide an easily understood break-down of state expenditures and not all appropriations are in it;
- Approximately 60% of the state appropriations are in trust funds which reduces public scrutiny, discourages the routine re-evaluation of spending priorities, and protects programs from budget cuts during revenue shortfalls;
- Legislators and the public are frequently given too little time to review the Conference Committee Report before the vote;
- There are no performance measures with which to evaluate productivity and efficiency; and
- The Working Capital or "Rainy Day" Fund is too small to provide much assistance during recessions.

The Commission and its four committees devised plans to improve the way Florida

Four Steps to Reform

The Commission identified four steps to reforming state government:

1. Review the existing situation.
   - How do we spend taxpayer dollars?
   - What do we spend it on?
   - Where do the dollars come from?
2. Fix what is broken before spending more money.
3. Make the existing revenue system more equitable.
4. Examine the need for the means of raising additional revenue.

budgets and spends the taxpayers' money and, in the process, to restore public confidence. In the 35 meetings held from November 7, 1990, to February 6, 1991, the Commission and its committees developed 14 major proposals, each with several recommendations. Accountability, an essential element in a well-functioning representative government, became a major theme. First, the proposals require effective planning to identify clearly the goals, methods, costs, and results of government spending. Second, they outline ways to make the budgetary and spending process more transparent and understandable to the people. Third, they recommend that the budget system be modernized in terms of the role of the Executive and in the accounting and management information systems. Fourth, there are recommendations to introduce operational flexibility for agencies. Finally, the proposals link plans, budgets, and appropriations to performance measures.

The Commission presented its recommendations to the Governor, President of the Senate, and Speaker of the House on February 25, 1991, in the form of a published report, *A Program for Reform of Florida Government.* The recommendations were submitted in bill form; however, the bill filing deadline had passed. Subsequently, the Speaker did permit a hearing for some of the proposals in the Appropriations Committee, and the House and Senate informally used a few of the recommendations during the session. Most of the Commission's proposals, however, were not debated, and none of the substantive reforms passed into law. The Legislature enacted annual budgeting, "truth in budgeting," and some changes in the performance audit process. The Commission is more optimistic about the 1992 session since the Governor has called for budget reform, and the chairs of the House and Senate Appropriations committees have introduced the Commission's budget reform bill and are conducting hearings.

Florida voters want budget reform before they will accept tax increases.

The Commission believes Florida voters want budget reform before they will accept tax increases. That view was substantiated by an April 1991, Mason-Dixon poll of 1,109 voters in the state which indicated people favored budget reform before tax increases by a margin of 59% to 24%. *A Program for Reform of Florida Government* provides a detailed analysis of the problems of the existing budgeting and spending system and the proposed improvements, but summaries of the Commission's proposals to improve that system are provided below.

State Comprehensive Plan and Agency Functional Plan Process

The State Comprehensive Plan (SCP) was intended to direct the state's long-term planning, but it is ignored and not updated. The Executive Office of the Governor (EOG) shall recommend revisions to the SCP by October 1 of every odd numbered year. These revisions shall be developed with a task force comprised of staff members from the state, regional, and local planning communities and interested private citizens, plus representatives appointed by each Cabinet officer, the President of the Senate, and the Speaker of the House. The revisions shall address the existing 26 goals and policies and include new program areas, such as government productivity and information resources management.

The revised SCP shall be presented to the Administration Commission by November 1 of odd numbered years and to the Legislature by December 15. The revised SCP shall go into effect on July 1 of the subsequent even numbered year, subject to legislative amendments, unless the Legislature re-adopts the existing SCP.

The Governor shall report annually on the state's progress in furthering the goals of the SCP. The report shall be made as a part of the Governor's State of the State Address and in a detailed written report which shall include the "Florida Benchmark Measures" and a section on capital facilities planning and budgeting. In addition, the Governor shall publish by February 1, of each odd numbered year a "Trends and Conditions Report" which shall project the long-term trends and conditions affecting the state and the SCP.

Each state agency shall be required to submit annually to the EOG by August 1, an Agency Functional Plan (AFP) consistent with the SCP which contains a mission statement, a trends and conditions statement, agency priority issues, agency objectives with strategies for achieving them, and a "Florida Benchmark Measures" section. AFP's shall provide the framework for agency budget requests and shall contain program measures. Each AFP shall have a 5 year outlook and shall include input from local and regional governments.

Implement the Office of Policy Analysis and Agency Review

The Legislature should implement the Office of Policy Analysis and Agency Review in order to subject state agencies to an agency evaluation and justification review every 7 to 15 years. This review shall include programs, performance, and the policies upon which agency activities are based. The Agency Functional Plans, as revised under the Commission's recommendation above, would be included in the criteria for evaluation of performance. Government needs this process to determine if programs are achieving the goals for which they were created, to determine which programs should still be priorities, and to determine if the goals could be achieved more efficiently and effectively in another way.

Executive Branch Budget Authority

The Executive shall be authorized to reduce state spending in the event of revenue shortfalls in order to maintain a balanced budget as required by the constitution in article VII, section 1 (d). This is essential for orderly and efficient fiscal management, and the constitution should be amended to specifically authorize the action because of the recent Supreme Court decision. Furthermore, the Governor as Chief Budget Officer of the state shall be authorized to review and recommend revisions to the budget request of the Legislative Branch in the Governor's Recommended Budget according to the same process used for the Executive and Judicial Branches.

The Governor shall require agencies to develop annually by September 15, "target budgets" within the existing revenues projected for the upcoming fiscal year and with budget issues prioritized. The Governor shall be authorized to add, delete, or modify budget issues in the Legislative Budget Request (LBR) for the agencies under the Governor's direct supervision. Planning and Budgeting Instructions shall be developed jointly by the EOG and the House and Senate Appropriations Committees and shall require cost benefit and/or cost effectiveness analyses and audit criticisms and/or recommendations to be addressed in the LBR. All budget documents shall include a "truth in budgeting" statement which provides a summary of currently estimated fees, taxes, and revenues or other income and a summary of any additional fees, taxes, revenues, or other income necessary to fund the proposed budget.

In order to improve operational flexibility, the Administration Commission shall be authorized to create or consolidate divisions of state agencies without legislative approval and shall be allowed to delegate authority to the EOG regarding the oversight of state budgets. State agencies shall be authorized to transfer up to 10% of their approved budget (appropriations, positions, and salary rate) within each major fund type without the approval of the Governor, Administration Commission, or Legislature.

The state shall implement generally accepted accounting principles (GAAP) into the budgeting process within 3 years. Until GAAP is used by all agencies, a reconciliation methodology shall be developed by the Governor's Office of Planning and Budgeting (OPB), the Comptrollers office, and the Auditor General's office for the budgeting and appropriations process. The state shall fully implement all components of the Florida Fiscal Accounting Management Information System Act (FFAMIS) within 5 years in order to have a unified financial management system which can be a key component in a decision support system. The state shall also develop a system to track and monitor the receipt and expenditure of all federal funds. All "double-counting" shall be eliminated in order to present an accurate budget.

Appropriations Review Process

The Legislature shall require that each agency's LBR be reviewed by the appropriate subcommittee of the Appropriations Committee of each house and that the review compare the major issues included in each LBR to the major issues in the Governor's Recommended Budget. The review process shall include a review of the AFP of each agency by appropriate legislative committees. Each appropriation in the General Appropriations Act shall have line item display in order to be available for gubernatorial review and possible veto.

Appropriations requests by local governments, private organizations, and non-profit organizations shall be reviewed by the appropriate subcommittee of the Appropriations Committee of both houses and shall not appear in the Conference Committee Report unless it previously appeared in either the House or Senate Appropriations Bill. Requests shall include a fiscal note which reflects the projected costs of operations and capital outlay for the next 5 years and the percentage of those funds to be provided by the state. State funds shall be conveyed as loans to private organizations and non-profit organizations, unless the Legislature approves a grant, and shall require local matching funds appropriate for the size and scope of the project and the applicant's ability to pay. A written contract shall specify terms for release of the funds, conditions related to interest income, repayment schedule, and interest rate, if any. The organization shall provide with the contract a copy of their current budget, list of board of directors, and project budget.

Annual Budgeting

The 1991 Legislature adopted the Commission's recommendation that the state adopt an annual budgeting process. The Commission further recommends the LBR, the Governor's Recommended Budget, and the General Appropriations Bill shall be accompanied by data in the Legislative Appropriations System/Planning and Budgeting System (LAS/PBS) showing annualized cost.

General Appropriations Bill Format

The state shall use a single appropriations bill and a separate section shall be required for each of the following program areas:

a. Education/Lottery
b. Education/all other funds
c. Human Services
d. Criminal Justice and Corrections
e. Natural Resources, Environment, Growth Management, and Transportation
f. General Government
g. Judicial Branch

Within each of the above sections there shall be a separate breakout for each of the following types of expenditures:

a. State Operations
b. State Capital Outlay
c. Aid to Local Governments and Non-Profit Organizations: Operations
d. Aid to Local Governments and Non-Profit Organizations: Capital Outlay
e. Federal Funds and Associated State Matching Funds
f. Spending Authorizations: Operations
g. Spending Authorizations: Capital Outlay

All appropriations shall appear in the General Appropriations Bill and shall be shown in the totals of the General Appropriations Bill.

General Appropriations Bill 72 Hour "Cooling Off" Period

Copies of the Conference Report on the General Appropriations Bill shall be made available to members of the Legislature and the general public at least 72 hours before it can be voted on by either house of the Legislature. The Conference Report on the General Appropriations Bill shall include all major issues from the Summary Statement of Intent and all documents or working papers that will be used to determine legislative intent. It shall be forwarded to the Governor no more than 72 hours after passage.

The EOG shall provide annually a "final" budget after vetoes which contains net appropriations for each budget item, estimated expenditures for the current fiscal year, actual expenditures for the 2 prior fiscal years, actual and estimated revenues and cash balances for the two prior and the current fiscal years, and a report on each state agency program containing expenditure data, program objectives, and program measures.

Abolition of Selected Trust Funds

The state is authorized to maintain trust funds created by the constitution and as required for federal programs or mandates; established for bond covenants, indentures, or resolutions; legally pledged by the state or public body to meet debt service or other financial requirements of any debt obligations of the state or any public body; used as clearing accounts or funds for the Comptroller, the Department of Revenue, or other state agencies; and held by the state in a trustee capacity as an agent or fiduciary for individuals, private organizations, or other governmental units. The Educational Enhancement Trust Fund, Florida Retirement Trust Funds, and State Transportation Trust Fund shall be specifically retained.

The Legislature shall review and abolish other trust funds and transfer the funds of each into segregated accounts within the General Fund. These segregated accounts shall be eligible to receive revenues to be used for earmarked purposes. The Governor shall be authorized to change the amounts appropriated from segregated accounts in excess of those in the approved budget pursuant to the receipt of federal funds or when grants and donations are received after the General Appropriations Bill has been passed by the Legislature or when deemed to be in the best interest of the state due to an emergency situation. Any new trust fund created after October 1, 1991, shall be extinguished no later than October 1, of the fourth fiscal year of the trust fund's existence and shall not be re-enacted by the Legislature.

Working Capital Fund

Beginning with the 1993-1994 fiscal year, at least 5% of an amount equal to the net General Revenue collected in the previous year must be retained in a Surplus Revenue Fund (Working Capital Fund). The amount shall not exceed 10% of an amount equal to the previous fiscal year's net General Revenue collections.

Each agency must adopt and implement an annual productivity plan . . .

The Surplus Revenue or Working Capital Fund may be used only to help mitigate revenue shortfalls and provide funding for emergencies. Funds may be used to cover no more than 50% of an estimated revenue shortfall for the General Revenue Fund only when the shortfall exceeds 1% of the estimated revenues upon which the General Appropriations Act was based. If the shortfall is less than 1%, the Administration Commission may authorize use of the Working Capital Fund.

Quality Management and Accountability

The Administration Commission must adopt performance measures as part of the original approved budget of each agency, and the measure shall include as a minimum the performance measures from each AFP. Each agency must adopt and implement an annual productivity plan jointly developed by managers and employees with standards and measures which shall assess the quality and cost effectiveness of the agency's operations. Each agency productivity plan shall be reviewed by the agency's internal auditor who shall make recommendations to the Administration Commission. Performance measures, training, rewards, and sanctions shall be used to create accountability.

The Governor shall provide to the Legislature and the public, as part of his budget recommendations, a productivity report evaluating each state agency's performance during the preceding fiscal year, comparing it to legislatively adopted standards and measures relating to the State Comprehensive Plan, Agency Functional Plans, and the major goals, responsibilities and functions of each agency.

The Commission recommends the creation of three voluntary programs to increase productivity: a Productivity Enhancement Program to reduce cost and the number of employees, a Productivity Bonus Program to encourage innovation, and a Reversion Recovery Reward Program to encourage budget savings.

Uniform Program Evaluation Criteria

A standard set of criteria shall be developed and used in program evaluations and planning processes. These criteria should include such elements as accountability, fiscal structure, efficiency and effectiveness, societal importance, origin and authority, and private sector alternatives.

Performance Audit Follow-Up

After the Auditor General issues comments as a result of a performance audit of an agency based upon the measures in its Agency Functional Plan, the agency's internal auditor shall be responsible for monitoring the implementation of the agency's response to the Auditor General's comments.

Other Proposals

In addition to these budgeting and spending reforms, the Commission had two recommendations not directly related to budget reform. The first related to local government finances. In order to enable counties and cities to pay for the costs of growth, the Commission recommends that the local governments be able to enact the Local Government Infrastructure Surtax (one cent sales tax) with an extraordinary vote of the county commission and the restrictions on the use of the funds be eliminated.

The second proposal involved taxpayer compliance. Based upon evidence that poor training of Department of Revenue employees and lack of modern technology was contributing to the under-collection of current taxes by more than $1 billion annually, the Commission recommended and the Legislature approved funds and programs to modernize the department and improve training.

The Taxation and Budget Reform Commission believes these changes will improve fiscal accountability and make certain that limited tax dollars are spent efficiently and effectively for the priorities of the state. Government must operate in more open and understandable ways which increase the ability of voters to hold it accountable. Governor Lawton Chiles has supported the recommendations of the Commission and endorsed its position that these proposals represent a first step which is necessary if state government is to gain the confidence of the people.

Balancing Revenue & Spending in the 1990's

THE constitution requires the Taxation and Budget Reform Commission to examine the revenue needs of the state; however, projecting state "needs" is a difficult task. One could define revenue needs as the funds necessary to provide levels of service required to achieve goals in specific government programs which, in turn, reflect the demands and expectations of certain segments of society. The difficulty is that the goals and service levels prescribed by an expert in the field might differ significantly from the goals and levels of service desired by a potential recipient of the benefits of the program or from the taxpayer who has to pay for the services and program. Another problem is that there are no clear definitions to indicate how and when success is achieved in relation to the goals.

Closely related to the above task is the Commission's obligation to review policy as it relates to the ability of state and local government to tax and adequately fund governmental operations and capital facilities required to meet state needs to the year 2000. Furthermore, the Commission is required to determine the methods favored by the citizens to fund the needs of the state. In other words, the Commission must examine the question of need from all perspectives. As it assesses the demand side of the equation, it must consider also the supply side of the equation, i. e. how much are Floridians willing and able to pay.

The Changing Economic Environment

The task of assessing revenue needs has become more complicated than most might have anticipated in 1988 when the decision was made to create the Taxation and Budget Reform Commission. For example, the political environment was shaped by positive expectations about Florida's economic future. Between 1985 and 1988 the state gained over 365,000 new residents annually, averaged over 210,000 new nonagricultural jobs per year, saw its unemployment rate drop at least 0.3 percentage points annually from the 1985 rate of 6%, and averaged 5.4% annual growth in real personal income, or 50% higher than the national average. The national economy also seemed relatively strong as growth in real Gross National Product averaged above 3%.

The Commission is required to determine the methods favored by the citizens to fund the needs of the state.

As one of the nation's fastest growing states, Florida's major problem appeared to be one of finding adequate revenue to pay for the infrastructure needed to accommodate the rapid growth and maintain prosperity. The State Comprehensive Plan Committee, commonly known as the Zwick Committee, had estimated in February 1987 that in order to implement the State Comprehensive Plan over the next decade and to maintain the quality of life which citizens desired, the state would need $35 billion in new revenue and local governments would need $17.9 billion. Since Florida ranked 33rd in state taxes per capita in 1988, it may have appeared that taxpayers had the ability to pay higher taxes if an acceptable source were found. It is possible that many citizens voted to create the Taxation and Budget Reform Commission in order to provide some outside guidance on these issues. The Legislature and Governor had already repealed the controversial services tax which had been created to fund infrastructure. It is true that the Legislature replaced the services tax by adding one cent to the state sales tax; however, by that time most legislators did not expect it to be adequate to meet the infrastructure and other growth needs in the 1990's.

The reason the Taxation and Budget Reform Commission has a more formidable challenge today is that the economic environment has been altered dramatically. A few months after the Commission began it's work, the United

States entered a recession. Unfortunately, early predictions for a brief economic downturn have been proven wrong. Not only has the national recession been more severe and lasted longer than expected, its impact on Florida has been more devastating than expected. During the 1981-82 recession, which was more severe than the present one nationally, Florida felt the impact later than the rest of the nation, had an unemployment rate one percentage point below the national rate, and recovered faster than the nation as a whole. In sharp contrast, Florida's unemployment rate in September 1991, was 8% compared to the national rate of 6.7%, and there are no signs of an early or rapid recovery.

Earlier concerns about paying for growth have been dwarfed by the worries of budget shortfalls. Following budget cuts of $1.029 billion by the Governor and Cabinet in 1990-91, the Legislature trimmed approximately $1 billion from the new 1991-92 budget to accommodate the lower revenue projections. By October the revenue forecasts were adjusted downward again to reflect an anticipated $621.7 million shortfall. The irony of the recession is that the need to reduce spending comes as more people move, albeit at a slower rate, to the state and require services and when the rising unemployment causes more residents to seek social services such as Medicaid. Given the slow pace of recovery now anticipated by most economists, the Governor and Legislature face the prospect of either deep cuts in the 1992-93 budget or significant tax increases.

Florida's financial crisis, far from unique, was typical of the economic woes of states across the nation as 30 of them faced projected deficits which could total as much as $40 billion. These deficits appeared in spite of an aggregate of $16.2 billion in new taxes levied in the Spring 1991 legislative sessions in 31 states. This was the largest annual percentage tax increase since 1971. Florida's problems seemed mild compared to Connecticut which faced the loss of 37% of its General Fund and to California where the combined 1991 and 1992 budget deficit of approximately $13 billion was larger than the total general revenue fund of all but four states. Lay-offs, pay cuts, and furloughs on a large scale have become common. The problems of Maine illustrate that this fiscal crisis is not merely the result of extravagant spending by high growth states. On November 6, 1991, Maine's governor announced plans to lay-off 20% of state workers, abolish 35 state agencies, cut aid to local government by $50 million, and eliminate the general assistance welfare program.

A major cause of the fiscal crisis for states and local governments is the national recession. States are predicted to use a combination of budget cuts and tax increases in order to cope with their current problems, but only a national economic recovery will truly end the crisis. In the last two budget cycles, states have had a combination of spending cuts and tax hikes totaling $32 billion, in total state budgets of $264 billion. There are other factors contributing to state problems in addition to recession-induced revenue reductions. Almost all states, regardless of their tax structure, have failed to exercise budget and spending discipline over the

Major Economic Growth Indicators: U.S. vs. Florida

	1980 to 1990 *Average Growth Rates*	1990 to 2000 *Average Growth Rates*
United States		
Real Gross National Product	2.6%	2.2%
Real Personal Income	2.7%	1.8%
Total Employment	1.7%	1.1%
Florida		
Population	3.1%	2.0%
Real Personal Income	4.9%	3.2%
Total Non-farm Employment	4.4%	2.8%

past decade when the economy was healthy. The states also place much of the blame on the federal government.

The new federalism of the 1980's resulted in a sharp drop in federal funding, from 21% to 15% of state and local budgets from 1981 to 1991. Simultaneously, federal mandates have increased. Seven bills pending in Washington, covering areas such as child welfare, Medicaid expansion, and waste disposal, would increase state costs by $1.7 billion, of which Florida's share would be $88 million in the first year. The federal government, in sharp contrast to states, this year will add more to the national debt than all 50 states will spend in their budgets. The added danger is that Congress will continue to require the states to implement and fund expensive programs without federal funds to pay for them. This will add not only to present budget problems, but create even greater ones in the future.

State agencies typically construct budgets by adding "growth" dollars to the previous year's budget without re-evaluating the policy assumptions and program objectives...

Economists differ on their forecasts on the pace of economic recovery, but are in general agreement that the national economy will be weaker and more sluggish in the 1990's than it was in the previous decade. The causes are diverse but include the still-soaring costs of the federal bail-out of savings and loans and banks, annual federal deficits in excess of $300 billion, the continuing decline in manufacturing jobs, a massive trade deficit, and the use of 29% of the budget to pay the interest on the national debt. Growth in the GNP averaged 2.6% in the 1980's, but is expected to grow at an average rate of only 2.2% in the 1990's. Personal income growth will average only 1.8% in the 1990's compared to 2.7% in the previous decade. Employment growth is expected to average 1.1% compared to 1.7% in the 1980's.

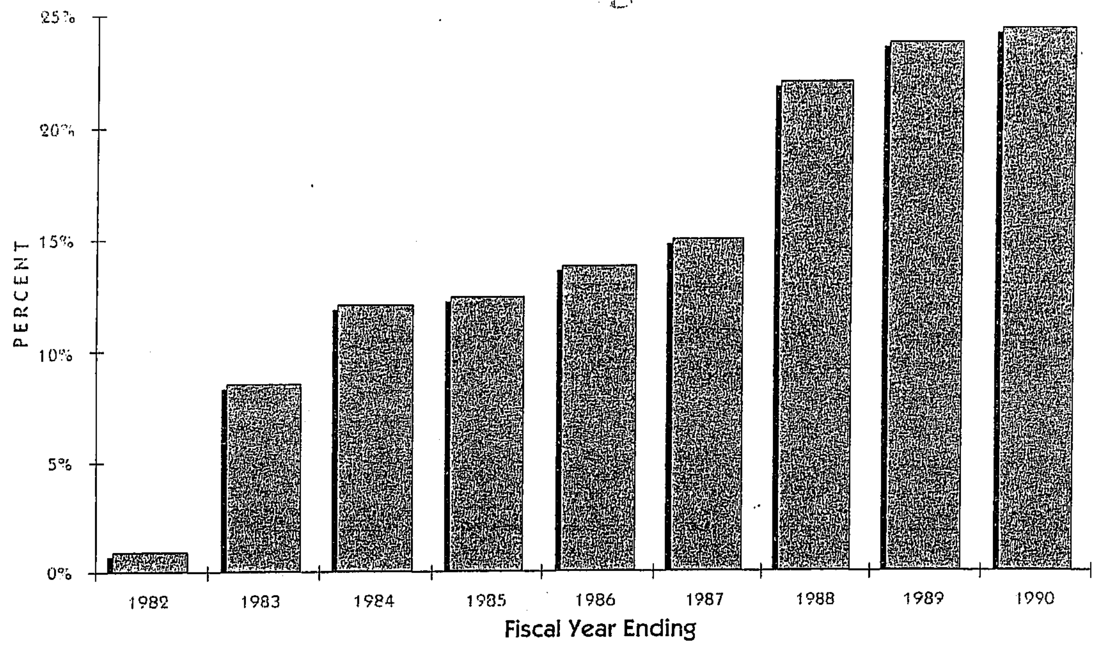
Florida with its services economy and heavy reliance on tourism cannot isolate itself from the effects of a shrinking standard of living at the national level. Florida's Economic Estimating Conference, in its latest report, has already predicted slower economic growth. Comparing the forecasts for the 1990's to the historic data of the 1980's, annual population growth will decline from 3.1% to 2%; annual real personal income growth from 4.9% to 3.2%; and annual non-farm employment growth from 4.4% to 2.8%. It has been argued that Florida's infrastructure deficit proves that growth does not pay for itself. Yet, no one can deny that much of the state's prosperity and job creation has been closely tied to the rapid influx of new residents. As that wave of migration ebbs, it will weaken the growth-related sectors of the economy, especially construction which is expected to decline 0.1% per year through this decade. Any decisions or forecasts about revenue and spending must factor in these economic realities.

State Spending Growth: The Historical Perspective

The Revenue Estimating Conference does ten-year economic and state revenue forecasts; however, it is necessary to analyze the spending patterns of the decade of the 1980's in order to predict spending growth in the 1990's. Since state agencies typically construct budgets by adding "growth" dollars to the previous year's budget without re-evaluating the policy assumptions and program objectives, a practice which the Commission wishes to change, the past may indeed be prologue in predicting future expenditures.

An extensive examination of the growth of the state budget was included in the Commission's first report; however, a brief review of the findings is essential. State appropriations of $7.82 billion in 1979-80 had increased to $23.15 in 1989-90, representing a 196% increase in actual dollars. While appropriations were annually averaging 12.3% above the previous year's expenditures, revenues were increasing at an average of 9.3% annually. Thus legislatures were increasing taxes and fees annually at the average rate of 3% to fund appropriations. The practice of the Florida Legislature is to decide how much money it wishes to spend

Percent of General Revenue Due to Tax Law Changes Since 1980



before it determines how to balance the budget. Taxes and fees were increased every legislative session during the decade of the 1980's. By 1990, 24.4% of the General Revenue Fund came from tax law changes enacted since 1980.

Certainly a more accurate measure of expenditure growth would require an adjustment for inflation and population growth. Inflation reduced the real value of the dollar at the same time 3.4 million new residents increased the state population by almost 35%. Adjustments for population growth and inflation still produce a significant growth in the expenditure of real dollars—35%. Some of that spending growth can be traced to programs to protect the environment from pressures of urbanization and for new services demanded by urban residents. Expenses for the judicial system, government facilities (Fixed Capital Outlays), and pension benefits also contributed to growth in spending.

Most of the spending growth, however, reflects the impact of demographic change, federal mandates, and crime. A prime example is the area of Health and Rehabilitative Services which increased from $1.401 billion to $5.546 billion or 295.9%, due mostly to increases in constituents or clients in federal mandated programs such as AFDC and Medicaid. The state itself expanded the eligibility for these programs, which contributed to the increased costs. As Florida's crime rate soared, Corrections contributed also, growing from $164 million to $741 million or 350%. Education spending did not grow as rapidly as appropriations in the aggregate, but expenditures per student

Examples of Spending Growth

($ in millions)

	1979-80	1989-90	Increase
Corrections	$164	$741	351.8%
HRS	$1,401	$5,546	295.9%
Education	$3,022	$7,994	164.5%
Total Appropriation	$7,800	$23,150	196.8%

more than doubled as spending increased from $3.022 billion to $7.994 billion, or 164.5%.

The funding trends exhibited during the 1980's continued with the 1991-92 Appropriations Act which totaled $29.48 billion or 6.2% above the previous year, before any adjustments for the revenue shortfall. The relative position of some areas of spending in the Appropriations Act, however, shifted from 10 years earlier, reflecting the influence of the factors mentioned above. Education has declined from 38.8% to 27.5% of the total, HRS increased from 21.7% to 28.6%, Corrections increased from 2.5% to 3.2%, and Fixed Capital Outlay increased from 3.8% to 16.1%. The significant change for HRS can be explained largely by Medicaid which cost $0.73 billion in 1982-83, but mushroomed to $4.33 billion by 1991-92. Evidence of the impact of the recession and retrenchment, however, can be seen in the 0.8% reduction in funded employee positions, reversing a four year trend of expanding state government employment by an average of 5.2% annually.

State Expenditure Forecasts to the Year 2000

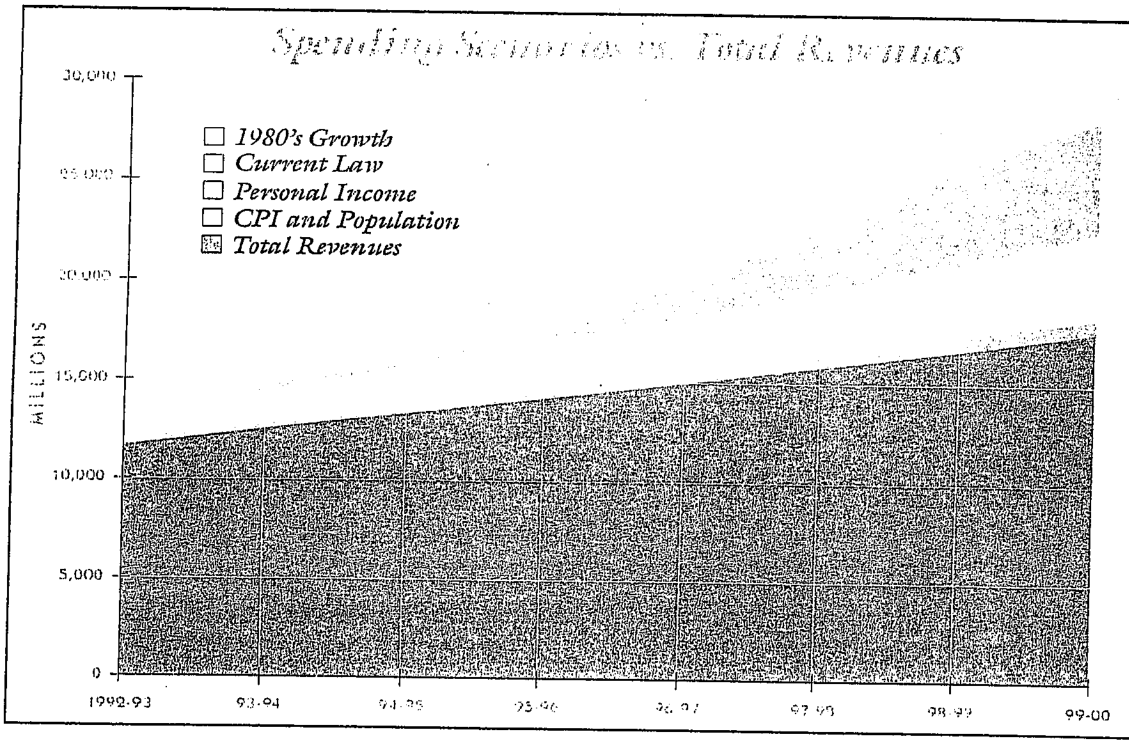
In conjunction with its responsibilities to review the tax structure of the state, the Taxation and Budget Reform Commission prepared and reviewed projections of state spending and anticipated state revenues. Unfortunately, state agencies do not engage in 10-year fiscal planning. Because the definition of needs is to some extent subjective and because the Commission did not wish to preempt the role of state officials who are elected to make policy, the Commission did not develop a projection of state "needs" per se. Another difficulty encountered in defining revenue needs is that

The significant change for HRS can be explained largely by Medicaid which cost $0.73 billion in 1982-83, but mushroomed to $4.33 billion by 1991-92.

the current budgeting process does not require agencies to prepare budgets which are linked to measurable, prioritized goals in the Agency Functional Plans or related to anticipated revenues, a problem the Commission wishes to correct. For example, state budget requests for 1991-92 totaled $34.11 billion and as such represented a list of state needs. Of the amount requested, $29.48 billion was appropriated. The total of all 1992-93 budget requests currently under review is $37.94 billion. Given these limitations, the Commission elected to prepare a range of spending alternatives which were compared to anticipated revenues generated by existing sources and by various revenue options.

The Appropriations Act passed by the Legislature (i. e. the state budget) represents authority to spend state dollars. The state budget contemplates several sources for the "dollars" it spends. Although they are the largest component, actual revenues such as the sales tax, gas tax, corporate income tax, documentary stamps, and various excise taxes are not the only funding source for the state's appropriations. Federal aid represents a significant portion of funding and is a component of state official "revenue" forecasts. There are also non-revenue sources utilized to fund Florida's budget. Proceeds from the sale of bonds are included in the appropriations and are a source of actual dollars. Trust fund balances unspent in prior years may be appropriated, but are not considered revenues in that fiscal year.

A final category of appropriation does not represent "real" dollars; this is interfund transfers, also described as "double-budgeting". For example, the 1991-92 appropriation of $29.48 billion, contemplated $11.65 billion from General Revenue and the balance of $17.83 billion from Trust Funds. However, the Trust Fund Revenues forecast for 1991-92 total $13.09 billion. The difference is primarily explained by bond proceeds and "double-budgeting" or interfund transfers rather than real revenue. Until the state implements the budget reform recommendations of the Commission, there will be no document which clearly identifies all sources of funds included in the appropriations bill, perpetuating the difficulties of analyzing and forecasting the state's true financial condition.



Spending and Revenue Forecasts

Revenue and expenditure forecasts were prepared to evaluate the state's projected financial condition. The forecasts for the General Revenue Fund and Trust Funds are prepared by the Consensus Estimating Conference. Because of the disparity between current trust fund receipts and appropriations alluded to above, the Commission had to forecast expected Trust Fund balances for future appropriations by applying the trust fund growth rate projected by the Consensus Estimating Conference to Trust Fund Appropriations in the base year, the 1991-92 budget. In each of the scenarios below, the projected General Revenue, without any tax increases, is the same--$117.14 billion cumulative.

Several state expenditure forecasts were generated based upon different spending pattern assumptions for the period from 1992-93 through the 1999-2000 fiscal year. The expenditure projections were based upon original 1991-92 appropriations amounts which have not been adjusted for the shortfall. All of these forecast scenarios result in varying deficit amounts. For illustrative purposes only, four revenue "options" have been detailed to demonstrate the magnitude of new taxes required to balance the budgets projected by the various forecast scenarios. These "options" are:

1) increases in the current sales tax (one cent equals $1.39 billion in 1993),
2) the current sales tax plus the 1987 services tax (produces $1.8 billion in 1993),
3) the current sales tax plus the 1987 services tax plus the corporate income tax to include business organizations currently exempted (raises $193.5 million in 1993), and
4) all of the previous items plus a 2.5% income tax on federal adjusted gross income, with the following deductions: $15,000 for individuals, $25,000 for single head of households, and $30,000 for married couples filing jointly (raises $2.8 billion in 1993).

The 1987 services tax was used because of the availability of data to calculate its impact and because it is the best available indicator of what the Legislature would tax if it decides to tax services in the future.

Four of the expenditure scenarios are for General Revenue expenditures only.

The first and most conservative expenditure estimate projects growth in the General Revenue Fund based upon population growth and increases in the Consumer Price Index as provided by the Consensus Estimating Conference. Over the entire forecast period, estimated General Revenue expenditures would total $121.55 billion while revenues would total $117.14 billion, yielding a cumulative deficit of $4.41 billion.

A second forecast estimated the General Revenue expenditures necessary to fund current programs operating under current law and current administration. This forecast incorporated population data, inflation forecasts, and the estimates of social service constituency growth from the relevant estimating conference. Significant increases are forecast for Medicaid and Aid to Families with Dependent Children (AFDC). The General Revenue Medicaid payments are expected to increase from $1.37 billion during 1991-92 to $3.99 billion in 1999-2000. The General Revenue portion of AFDC is expected to increase from $260.7 million to $539.3 million during this same period. The constituency growth is significant: from 193,306 in 1991-92 to 305,463 in AFDC and from 1,075,851 to 1,622,086 in Medicaid by 1999-2000 according to the estimating conference.

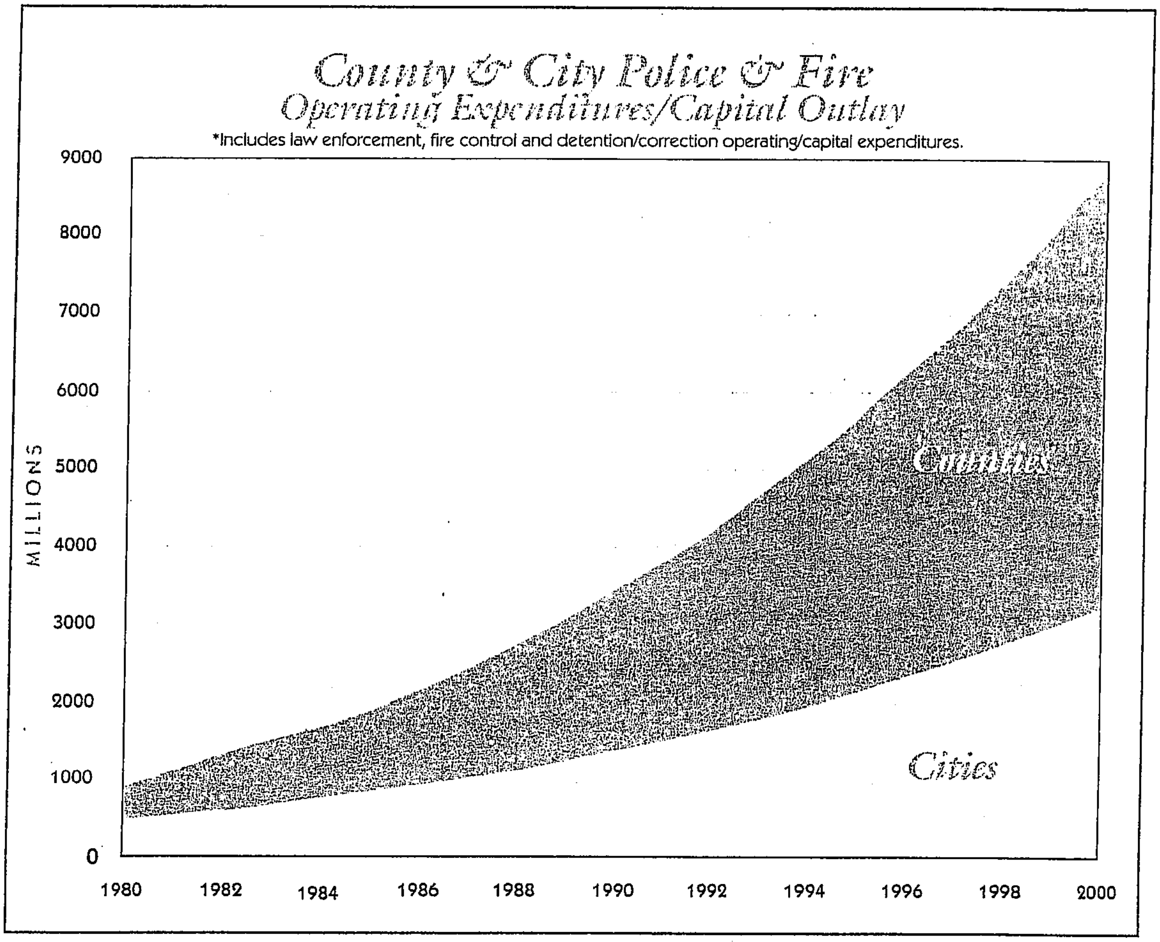
The forecast also included student population projections and related costs prepared by the Department of Education. For purposes of this forecast, the General Revenue portion of education funding was maintained at 54.3% (which is the same as the 1991-92 Appropriations Bill). The Department of Corrections provided cost information to continue current operations including operations of new prisons now under construction. No additional prison facilities were contemplated. Finally, Fixed Capital Outlay was assumed to be $100 million annually. No new or improved programs were included. These forecast assumptions suggest total General Revenue expenditures during the forecast period would be $141.93 billion, resulting in a cumulative deficit of $24.78 billion after subtracting revenues of $117.14 billion.

For illustrative purposes only, four revenue "options" have been detailed to demonstrate the magnitude of new taxes required to balance the budgets projected by the various forecast scenarios.

A third forecast scenario simply projected expenditures to increase at the same rate as the expected increase in nominal personal income. It should be pointed out that in the decade of the 1980's General Fund revenue as a percentage of personal income was relatively constant due to periodic tax increases. Total General Revenue expenditures for the forecast period would be $131.47 billion with total General Revenue funding lagging behind at $117.14 billion. The cumulative deficit would be $14.33 billion.

The fourth General Revenue Fund scenario projects expenditures based upon the assumption that the state would continue the expenditure pattern of the 1980's. This procedure, for example, calculated the 1982-83 increase over 1981-82. That percentage was then applied to the 1991-92 appropriation to yield the 1992-93 amount. The calculation was repeated for the appropriate years up to 1999-2000. In this scenario General Revenue expenditures are projected to total $158.1 billion through the year 1999-2000, exceeding the revenue projections by $40.9 billion.

A final calculation was done in an attempt to forecast trust fund revenues and expenditures in addition to the General Revenue projections. Of all the estimates, it is the most imprecise for a variety of reasons, including the fact that federal funds going into trust funds may not grow and could decrease. Furthermore, changes in the rates of dedicated revenues flowing into trust funds cannot be predicted. This scenario used the same expenditure growth pattern of the 1980's as the method above. It was applied to General Revenue and to trust funds by agency except in cases where there were new program initiatives or shifts in funding which produced distorted projections. In those cases and for the Fixed Capital Outlay estimates, the forecasts were



calculated on the basis of annual increases in inflation and population. These expenditures were compared with the General Revenue estimates and a Trust Fund estimate based on applying the Revenue Estimating Conference trust fund revenue growth rates to 1992-93 Trust Fund Appropriations. Cumulative expenditures using this method are $403.19 billion and revenues are $318.81 billion resulting in a cumulative deficit of $84.37 billion.

Again, these scenarios are not predictions, but rather illustrations of differing fiscal situations if various spending levels occurred compared with current revenue sources. The actual spending and funding levels will be determined by the Governor and the Legislature. In each of the methodologies used here, however, it is apparent that current revenue sources will not fund these expenditure levels. It underscores the point made by the Commission when it issued its budget recommendations: the state cannot afford to continue operating as usual.

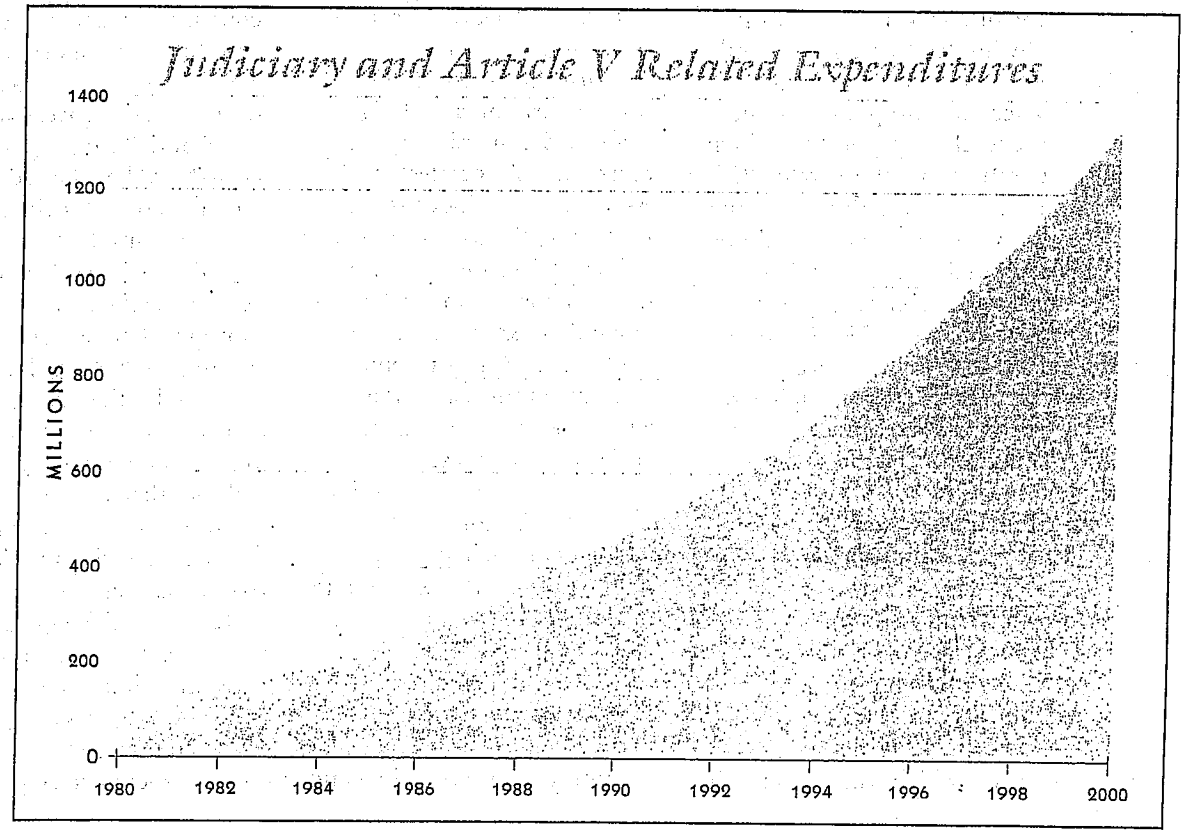
Local Government Spending Growth: The Historical Perspective

While the 3.4 million new residents gained from 1980 to 1990 added to the state government's responsibilities, most of the basic services of water, sewer, public safety, recreation, fire protection, waste disposal, and cultural services for these residents had to be supplied by Florida's general purpose local governments: 67 counties and 394 cities. In some cases one or more of these services may have been provided by the 931 special districts (usually single-function governments) scattered across the state. Demand for services and infrastructure has increased dramatically during the past decade due to population growth and to the urbanization of Florida because urban residents expect more services than rural residents.

As a result of the new federalism of the 1980's, increasing responsibility for service delivery has shifted from the state and federal government to local governments, often without funding or the fiscal flexibility to fund those services. For purposes of this discussion, the term local government will refer to general purpose local governments (cities and counties) only, except where noted. School district funding of education will be discussed elsewhere in this report. Florida local governments' own locally-levied revenues are 110% of the national average, reflecting a heavy reliance on user fees as well as taxes. By contrast, federal and state intergovernmental revenues sent to Florida cities and counties are 74% and 89.6%, respectively, of the nationwide index effort (U.S. = 100). Local governments annually spend more money than the state appropriates in the general revenue fund to provide services to Florida's population.

Despite a recession in the early 1980's, Florida city and county government expenditures grew in the decade to meet accelerated demands, particularly in the areas of public safety, judicial and court activities, health, and operating and capital outlay for utilities. This is in spite of the fact that federal aid to cities and counties was declining. The increased spending was driven both by population growth and by the increasing federal and state mandates which required counties and cities to provide services and benefits but provided no funding. Mandates usually have laudable goals, such as water quality, environmental protection, or human services, but present serious problems when limited funding is available.

Expenditures for counties grew from $3.44 billion in 1980 to $11.26 billion in 1990, or 12.6% annually, while revenues grew at an annual compound rate of 12.4%. Expenditures for cities grew from $3.10 billion in 1980 to $7.31 billion in 1990, an annual increase of 9.1%, while revenues grew at 8.8%. County spending on police and fire increased annually by more than 16% for operations



and 15% for capital outlay during the 1980's. Additionally, expenditures for police and fire operations and capital outlay represented over 21% of statewide counties' budgets compared to less than 13% in 1980. Judiciary related costs for counties increased by more than 18% annually.

As the cost of providing services has increased, restrictions on local government revenue sources have caused growing concern that local government will not be able to continue funding these demands. All taxing sources, except the property tax, are reserved to the state. Unless the state specifically authorizes cities and/or counties to use a tax source. Other forms of taxation currently allowed by the state are restricted either by rate, by use, or both. Even the property tax is constitutionally limited to a cap of 10 mills for each local government. There are also political limits on the level of property tax which a community will tolerate. Rising property values during the high growth of the 1980's combined with millage increases have inflated tax bills and provoked strong protest. The Truth in Millage (TRIM) notice requirements have emphasized the impact of increases. The average millage rate levied by counties and cities is 7.79 and 5.24 and represents 30.9% and 15.4% respectively of all tax, fee, and grant revenues.

The financial dilemma of local government is also impacted by declining intergovernmental shared revenues. Federal revenue sharing, which was $5 billion in 1980, had disappeared by 1986. Other federal and state shared revenues are declining as well. State revenues shared with local governments for 1990-91 were estimated at $2.050 billion, but actual receipts totaled only $1.886 billion. This was a decrease of $25 million from the previous year's shared revenues of $1.911 billion.

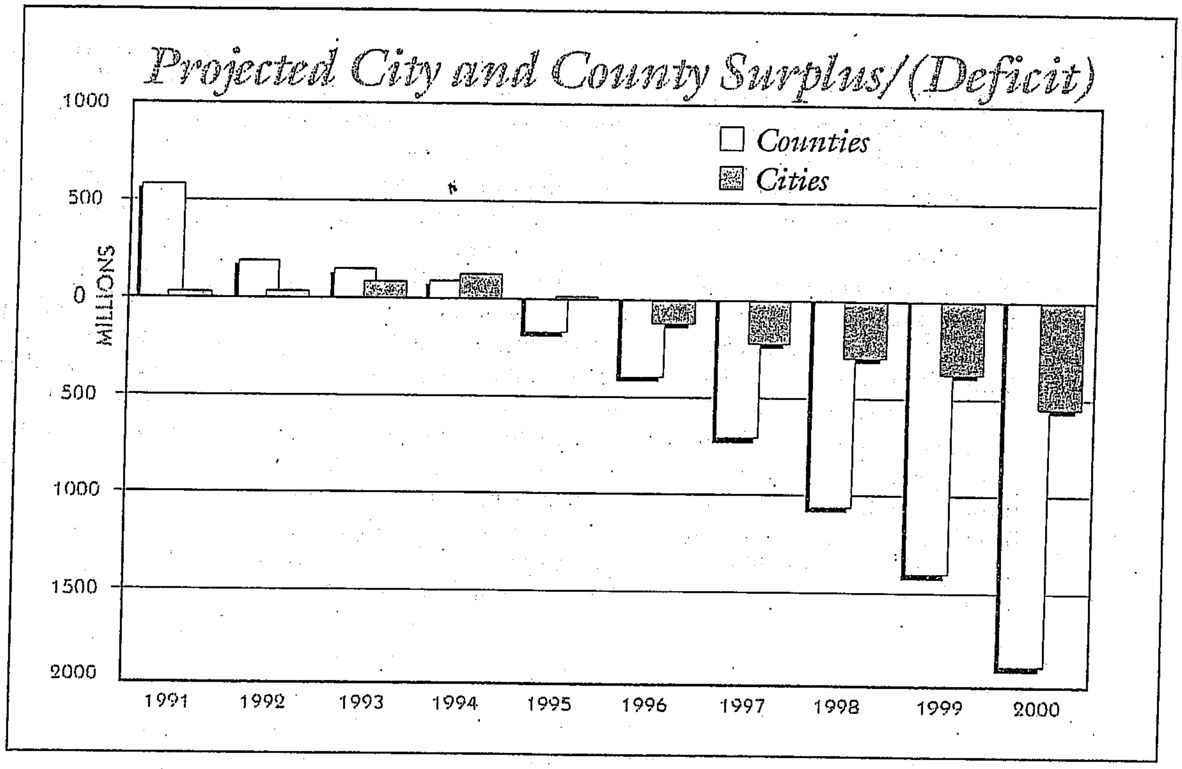
Local Government Expenditure Projections to the Year 2000

Projections to the year 2000 for cities and counties paint a bleak picture. A report entitled *Florida Local Government Revenue and Expenditure Forecasts 1991-2000*, prepared for the Taxation and Budget Reform Commission by Kurt Spitzer and Associates/CFF Associates, concluded that the fiscal conditions of counties and cities will deteriorate over the next ten years at an accelerated rate if they exhibit the same tendencies towards revenues and expenditures as in the last decade. Ad valorem millage is projected to increase to an average above the constitutional cap of 10 mills for counties (includes municipal service taxing units — MSTU's) and to an average of 7.37 mills for cities by the year 2000 because of the lack of flexibility for other revenue sources.

If current spending patterns continue as projected, cities and counties, in the aggregate, will experience collective deficits in the mid-1990's.

If current spending patterns continue as projected, cities and counties, in the aggregate, will experience collective deficits in the mid-1990's. Since local governments must have balanced budgets, predicted shortfalls must be addressed by one or more of the following options: new sources of revenue, service reductions, or the use of alternative service providers. Increased funding for police and fire needs have been accomplished in spite of budget cuts in the past, but at the expense of other services such as recreation, libraries and health. The fiscal estimates do not include any special fiscal efforts by local governments to deal with deficiencies in local infrastructure, which has an impact on concurrency requirements, or with future unfunded mandates which may be imposed by the federal or state government.

Florida's slower population growth will be reflected in the growth pattern for cities and counties. In 1980 there were 34 counties with less than 50,000 people. By the year 2000 it is projected there will still be 28 counties in this population range, indicating that most of Florida's growth will continue to occur in the existing urban and suburban areas of the state. Counties will be called on to provide increasing municipal services such as police and fire protection to the population residing in the unincorporated areas, in addition to the traditional services they provide on a county-wide basis such as tax assessment and collection,



judicial administration, and health and welfare program administration. The 64 cities with populations of over 25,000 people accounted for 56% of total aggregate municipal expenditures in FY 1990; but, by the year 2000, the forecast shows there will be 68 cities of this size whose expenditures will amount to 55% of the statewide municipal total. This reflects slightly higher growth in cities below 25,000.

Conclusion

In its efforts to comply with the constitutional obligation to determine the revenue needs of state and local government, the Taxation and Budget Reform Commission recognizes the difficult nature of the task. Any estimate of future revenue and spending will be, by its very nature, imprecise and subject to challenge; yet, the constitutional mandate is valid. In approving this constitutional language in 1988, the Florida Legislature recognized the inherent value of these long-term projections even though it has not required state agencies to do them in a systematic and meaningful way.

Most importantly, these projections represent a carefully calculated estimate of the long-term consequences of the state's current policies and present budgeting and spending practices. If the state pursued a very conservative policy of increasing spending only at the projected rate of inflation and population growth, the General Fund might require only a half cent sales tax increase. But if the state continues "business as usual" and increases spending at the same rate as the 1980's, a 16 cent sales tax could be required by the year 2000. This sobering realization should motivate a reassessment of what the state does, how it pays for it, and how it is done.

In the case of local governments, it is clear that they must engage in the same exercise. Budgets cannot continually be built on last year's base without an evaluation of priorities and a measurement of the results of prior spending. The state should re-examine the past policies of unfunded mandates and also the limited revenue sources permitted to local government.

Neil R. Pierce, a syndicated columnist and contributing editor for *The National Journal*, has suggested that the fiscal crisis of the states cannot be solved either by fiscal gimmicks like lotteries or casinos or by simply laying-off government employees. In fact, he questions if perhaps the national recession is not an indication of a declining standard of living which should force government to be more efficient and effective as it spends money to address public problems. His comments reflect the conclusions of the Commission that additional revenue alone will not enable Florida to meet the challenges of today and the future. It must be accompanied by reforms in the way the state budgets and spends public dollars.

The relatively strong economy of the 1980's could not produce sufficient funds to keep up with the pace of spending without significant tax increases. How much higher will taxes have to go if that rate of spending is continued during a period of much slower economic growth in the 1990's? Agencies must begin to prioritize their programs and measure the results. When the Governor and legislators seek to create new programs, they must first determine if they duplicate existing programs and project the 3 to 5 year fiscal impact. The Legislature should implement the Agency of Policy Analysis and Agency Review in order to routinely determine if existing programs are accomplishing their purpose, duplicate other programs, need to be continued, and are funded at the proper level. If these and other reforms are not implemented soon, the decade of the 1990's may be a period of recurring fiscal crisis and voter unrest.

Florida's Tax Structure: How Does It Measure Up?

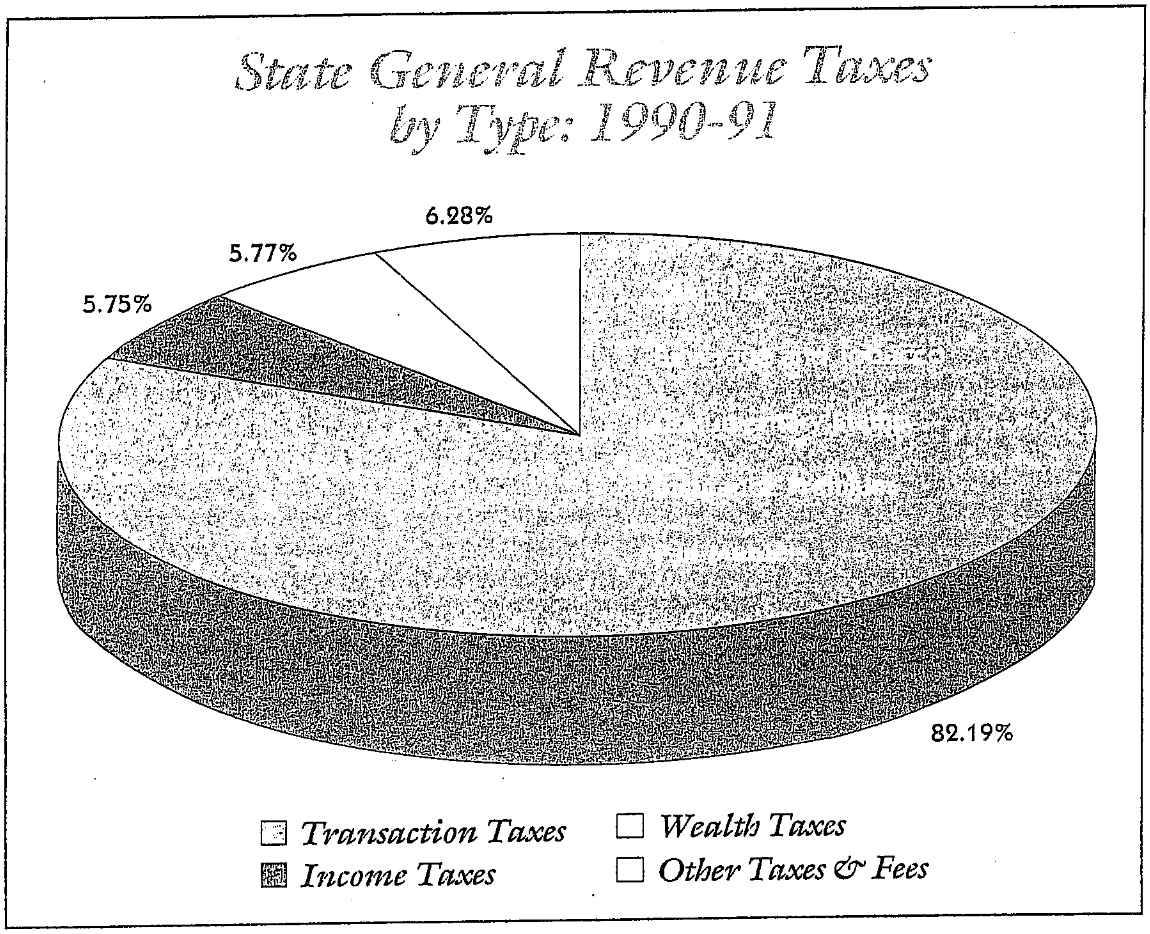
THE Taxation and Budget Reform Commission turned its full attention to tax reform in March 1991, reorganizing its committee structure for the task ahead. It was immediately apparent that the first step in tax reform was to define the term. If tax reform merely means revenue enhancement, a trendy term which, in plain English, means "tell the Legislature how to extract more taxes now," then there was no need for a special constitutional commission. The Legislature has consistently demonstrated its ability to find ways to raise more revenue. The constitutional mandate given by the voters in November 1988, empowered the Commission to determine the appropriateness and the adequacy of the tax system. Based upon its interpretation of the constitutional duties, the Commission determined that tax reform implies an examination of the fundamental characteristics and principles of the existing tax system in terms of its fairness and its ability to encourage and support the economic and social environment which would help enable present and future Floridians to prosper.

Having defined tax reform, the Commission's next step was to conduct the evaluation of the existing tax structure. Absent that analysis, reform of a tax system has no rational basis. Since no comprehensive evaluation was available, the Commission made use of existent economic literature, reviewed studies done by government and private sector economists, weighed testimony by government officials and private citizens, and employed consultants to compile and analyze additional data necessary for a comprehensive evaluation. The work included the preliminary findings included in the Commission's first report, *A Program for Reform of Florida Government.*

Tax systems are founded more upon cultural and political tradition than upon objective criteria or tax theory. The accuracy of this premise is validated by the diversity which exists in state tax systems nationally. Generally speaking, tax systems are created piecemeal in a political environment of competing interests by legislators who are forced by the political pressures, constitutional constraints, and time limitation to concentrate on addressing the most immediate and severe problems. Objective analysis and reform are difficult, if not impossible, within that context; therefore, study commissions are periodically created to address such issues as equity, balance, and predictability in the tax system. This practice has been used in Florida where major shifts in the tax system, such as the introduction of the sales tax, have been preceded by a study commission.

There are three major tax bases to be tapped for revenue: consumption, income, and wealth. Many economists and the U. S. Advisory Council on Intergovernmental Relations (ACIR) have for decades proposed guidelines for "balanced" or "high quality" revenue systems which suggest appropriate ranges of dependence on these tax bases by utilizing various taxes, such as taxes on sales, personal income, and estates; yet, few states consistently and deliberately emulate these models. Achieving a balance among revenues derived from various tax bases is analogous to the concept of reducing risk through diversification in financial management. Having a diversified tax system may help buffer state finances from the sudden "downturns" of the national or world economy. Yet, primarily for the reasons mentioned above, states have difficulty achieving this balance, and Florida is no exception. A review of the tax sources used to fund the General Revenue Fund reveals that only 5.77% comes from taxes on wealth, 5.75% results from tax on income (corporations), and 82.19% comes from the sales tax or other transaction taxes.

Based upon the findings which resulted from its efforts over several months in 1990, the Commission's Finance and Tax



Committee recommended the adoption of criteria to be used to evaluate Florida's tax system. The criteria were gleaned from the work of economists, fiscal experts, and other tax study commissions and were very comprehensive. The main principles embodied in this High Quality Revenue System Criteria are: the stability and reliability of the tax structure, the equity or fairness of the tax burden imposed by that tax structure, the impact of that tax structure on the economy in terms of efficiency and competitiveness, and the ease of tax administration and taxpayer compliance. In February 1991, the Commission approved the High Quality Revenue System Criteria for internal use in its evaluation of Florida's tax system and in its efforts to reform the existing system to better comply with the criteria.

Florida's Tax System

The state tax system is composed of a varied, if not balanced, assortment of taxes. For purposes of its analysis, the Commission has concentrated on the major sources of revenue and not on the array of minor taxes and fees that contribute relatively small amounts of revenue. These major taxes are: sales and general use tax, corporate income tax, motor fuels tax, alcoholic beverage tax, documentary stamp tax, estate tax, intangible tax, insurance premium tax, gross receipts utilities tax, and cigarette and tobacco tax. All of these are commonly used by other states; however, all but six use one revenue source which Florida does not utilize—the personal income tax.

In comparative terms, the state has used its taxing powers with moderation in spite of the rapid growth and increasing service demands. The most recent data available from the Bureau of the Census reveals that in 1989-90 Florida ranked

45th in state and local taxes levied per capita as a percentage of personal income. Floridians paid an average of 9.64% of personal income in state and local taxes, compared to a national average of 11.09%. Alaska led the nation with 19.32% followed by New York with 15.02% of personal income. Only Arkansas, Alabama, Tennessee, Missouri, and New Hampshire ranked below Florida. Taxes as a percentage of personal income is the best measure of ability to pay; however, Florida can also be compared to other states in terms of average actual dollars paid per capita. In 1989-90 the national average for state per capita tax was $1,211. Floridians paid an average of $1,027 per capita in state taxes, which placed the state 37th in the nation. To put the issue of tax burden in a more global perspective, federal, state, and local taxes in the U. S. equaled 32.6% of the Gross National Product in 1990. By way of comparison, the Japanese pay a slightly higher percentage and most Europeans pay significantly more.

Florida is, by any commonly used comparative measure of taxation, a low tax state. This is evidenced by the fact that taxpayers in 44 other states are paying a higher percentage of their per capita personal income in state and local taxes than Floridians. The ACIR has developed a representative tax system to measure variations in tax capacity. This system measures how much revenue could be raised in each state if each used the same system to tax sales, income, and wealth. With 100 representing the national average, Florida has a tax capacity of 104 and ranks 16th among the states. The ACIR then measures tax effort which is the extent to which each state utilizes its tax capacity. Florida, with a tax effort index of 82, ranks 48th compared to other states. Florida has a higher tax capacity and lower tax effort than any of the

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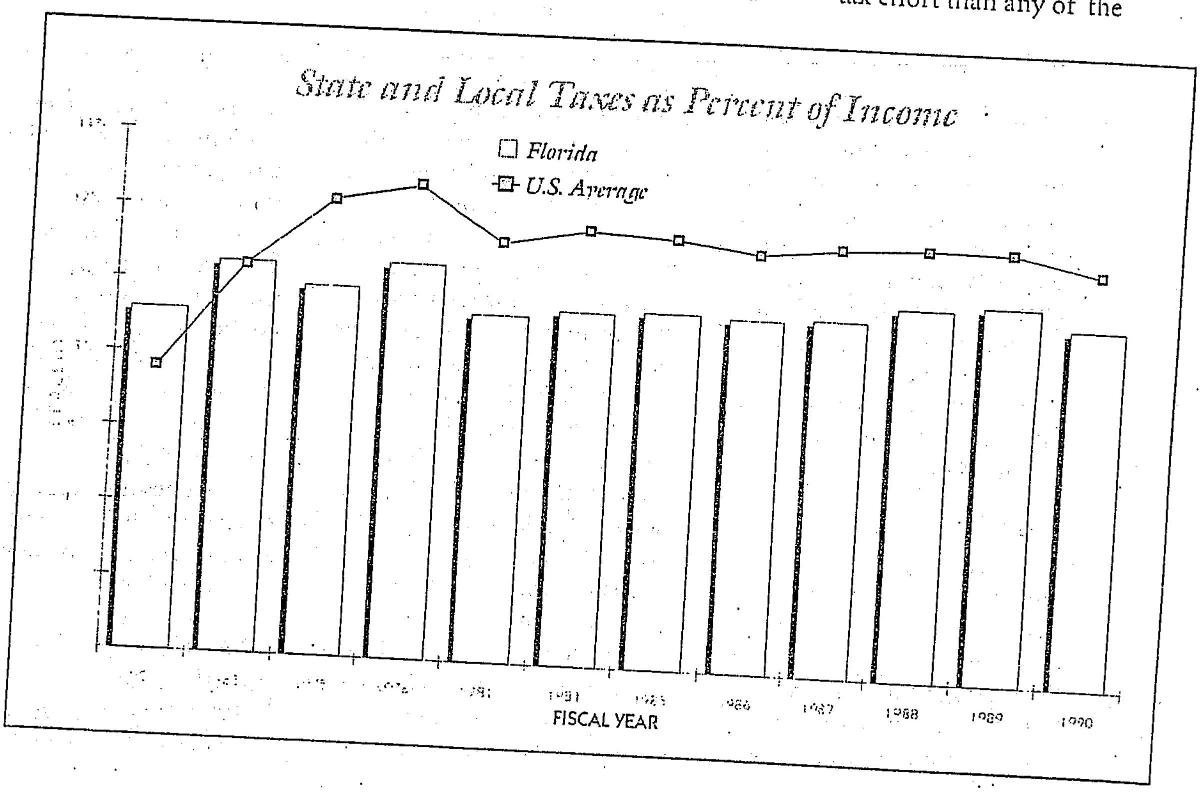
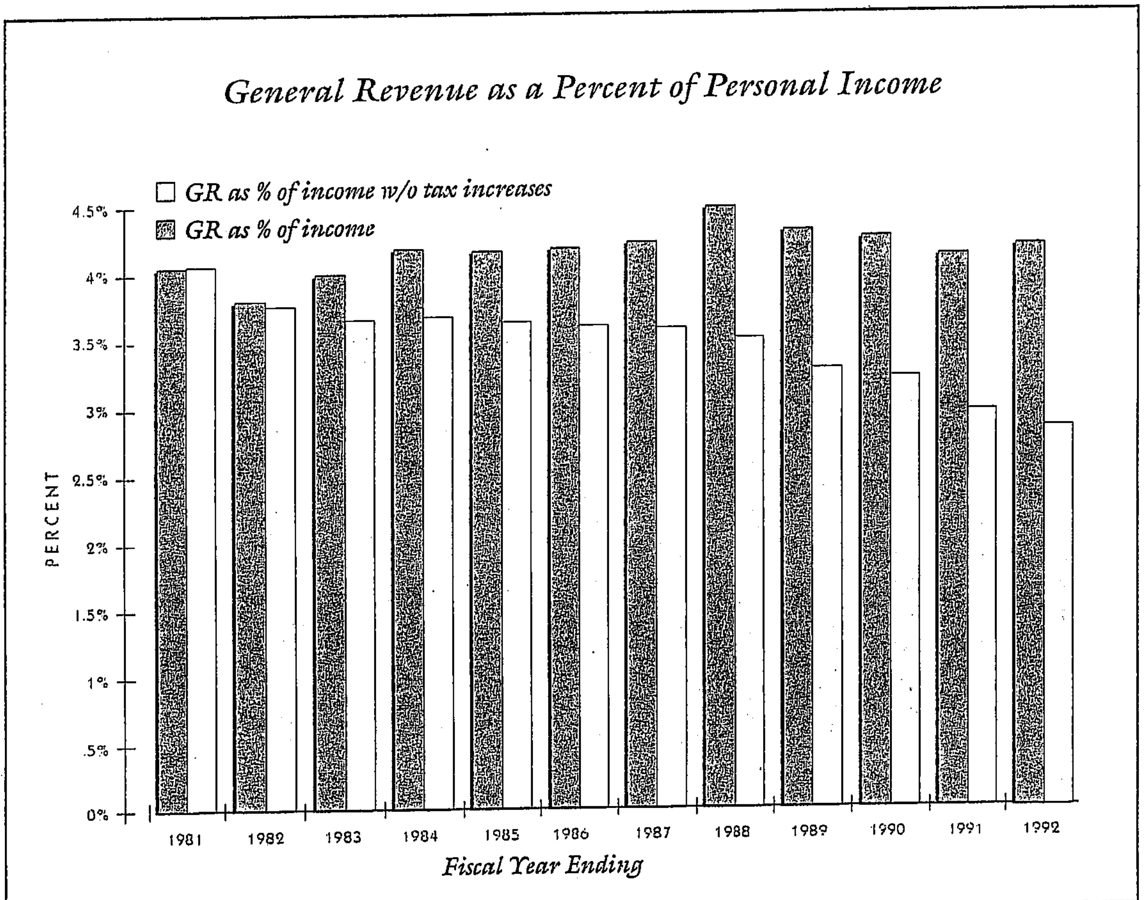




southeastern states considered to be regional competitors. In theory, this means that taxes could possibly be increased to some degree without impairing Florida's economic competitiveness; however, the potential impact of any tax change on the competitiveness of in-state businesses with out-of-state and international competitors must be considered.

Reliability and Stability

According to the High Quality Revenue System Criteria a tax system should produce revenue reliably over fluctuating economic cycles. Certainly no tax will remain absolutely stable in a recession, but the goal is to have tax collections vary only slightly rather than dramatically. These principles also imply that variations in the base and rate should require only slight and infrequent changes. This adds predictability to the process of taxation, which is helpful to businesses in their planning, pricing, and marketing strategies. In order to have this stability and predictability in the rate and base, the tax should be designed to produce revenues consistent with growth in the economy. The degree to which a tax system keeps pace with the rise or fall of personal income and the growth of the economy without rate changes is a measure of its elasticity. The Commission does not intend its advocacy for a more reliable and stable tax structure to be an endorsement of guaranteed increases in government spending. Government should not be immune from the constraints of economic slowdowns or recessions.

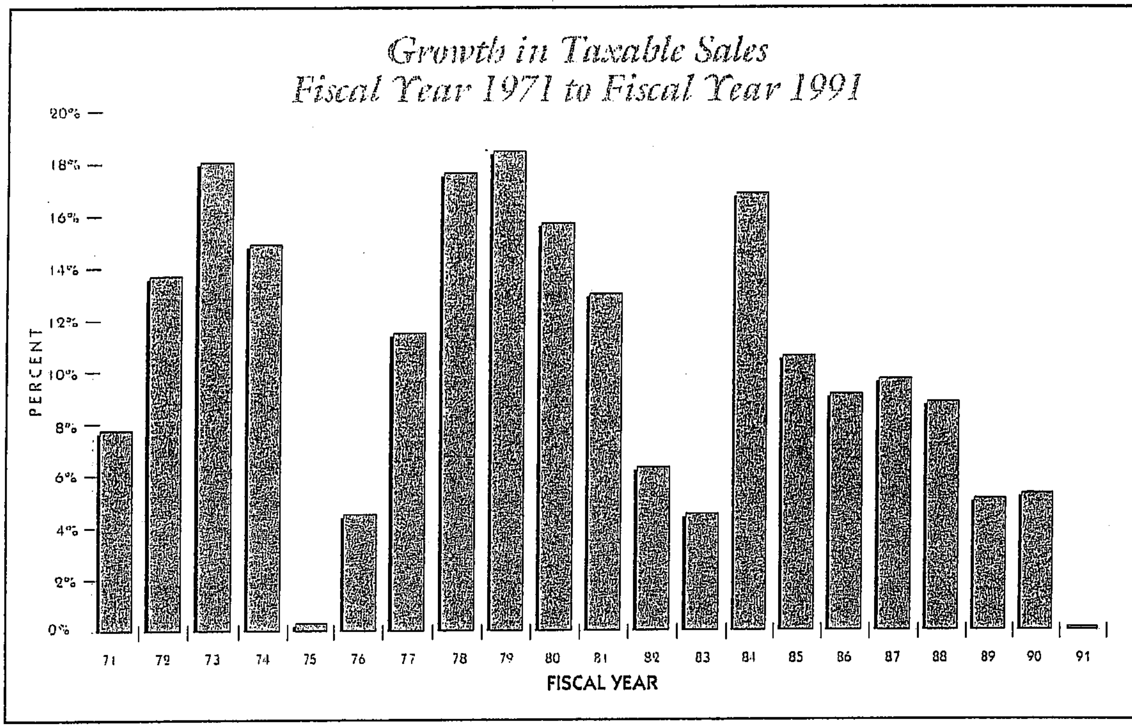
Previous analyses have concluded that Florida's tax system does not meet these criteria of reliability and stability and has not kept pace with growth in the economy without frequent tax increases. While it is true that tax receipts in the General Revenue Fund in 1990-91 were the same percentage of personal income as in 1980-81—4.1%—that apparent indication of stability is misleading. The only reason that the revenue appears to have been constant as a percent of personal income is that the Legislature enacted more than forty significant changes in the tax system during the 1980's. These changes in tax rates included: increases in the sales tax from 4 cents to 6 cents, increases in cigarette taxes from 21 cents to 33.9 cents, an increase in the gross receipts utility tax from 1.5% to 2.5% on a broader base, four increases in the documentary stamp tax on deeds, and replacement of the 4 cent per gallon gas tax with a 6% sales tax on gas. Note that all these rate increases were in consumption or transaction taxes which combined to produce over 82% of the General Revenue Fund in 1990-91. Had these and other changes not been made, general revenue taxes as a percent of personal income would have declined from 4.1% to 2.9% in 1990-91.

For the most part, the inability of Florida's tax structure to generate revenues commensurate with economic growth can be attributed to its lack of diversity and over-reliance on the sales tax as the main source of revenue. Through prohibitions and limitations in its constitution, Florida has created barriers to the taxation on income and wealth. In sharp contrast to diversity and balance, Florida in 1989-90 received 71% of its General Revenue Fund collections from the sales tax plus approximately 11% from other transaction taxes. In 1988-89, the last year for which there is data, Florida was more dependent on the sales tax (as a percentage of the General Fund) than any other state. Another 6% came from cigarette and alcoholic beverage taxes which are also consumption taxes. Compared to other states, Florida has the 7th highest sales tax, the 13th highest cigarette tax and the 2nd highest alcoholic beverage tax.

The Commission does not intend its advocacy for a more reliable and stable tax structure to be an endorsement of guaranteed increases in government spending. Government should not be immune from the constraints of economic slowdowns or recessions.

Sales tax revenues are highly volatile and sensitive to fluctuations in the economy. During recessions consumer confidence wanes and spending on durable consumer goods declines dramatically. There is a more moderate drop in the purchase of nondurables. Because Florida's sales tax law exempts the purchase of food and other necessities, which consumers continue to purchase during bad times, the corresponding drop in sales tax revenues is even more pronounced. Therefore, in a recession, sales tax revenue is lowered not only because of lower total income, but also because of reduced spending on taxable sales. Demand for public services, on the other hand, often increases during a recession because of higher unemployment.

A look at growth in taxable sales over the last twenty years further illustrates the volatility of sales taxes. Since 1970, taxable sales (which measures the growth in the tax base excluding the effects of tax rate increases) have increased at an annual average rate of 10.04%. Fluctuations in yearly increases are dramatic, however, ranging from a low of only 0.3% in 1974-75 during the recessionary trough to a high of 18.4% in 1978-79 when the nation recovered from the 1975 recession, a difference of 18 percentage points. When the next recession hit in 1981-82 it dropped to 6.3% and later, in 1982-83, to 4.5%. The following year the growth was 16.8%. The volatility continued as it gradually slowed to approximately 5.3% in 1989-90. The onset of the recession in 1990 cause taxable sales growth to plummet to 0.1%. Such dramatic fluctuations in the state's major source of revenue greatly complicate the budgeting process. The Commission included in its Budget Recommendations a proposal that the state maintain an amount equal to 5% to 10% of the General Revenue Fund in the state



Working Capital ("Rainy Day") Fund. If, during the years of high sales tax growth, surplus funds had been placed in the Working Capital Fund rather than being spent on "turkeys" or new programs, the state could have used the Fund to help meet state needs during revenue shortfalls. While the Commission endorses annual budgeting as long as the state engages in annual appropriations, government must maintain a 3 to 5 year perspective when budgeting and spending public funds.

Another reason that the sales tax does not grow at the same rate as the economy is that personal income has been growing faster than taxable sales since 1970. As family income increases, more money is placed in savings or investments; consequently, a smaller percentage of the income is spent on taxable sales. The average percent of personal income spent on taxable items has fallen by almost one-third from over 75% to 55% since fiscal year 1970. Without sales tax rate increases since 1979-80, sales taxes as a percent of income would have fallen from 2.5% in 1979-80 to 2.1% in 1990-91. A contributing factor to this growth disparity is that the Legislature has enacted a multitude of sales tax exemptions, ranging from tickets to the Super Bowl and the World Cup Soccer Games, to commercial movie and sound recording equipment, to rental of concession space at sports stadiums and pari-mutuel facilities. In 1970 Florida taxed 52.4% of gross sales, but this declined to 46.2% in 1988-89 according to the *Crossroads* report.

Other taxes which contribute revenue to the General Fund are also not reliable. A 1991 study of the Florida tax system by Peat Marwick measured elasticity (the degree to which taxes tracked personal income growth without rate increases) of several taxes. It found that if personal income increased by 10%, cigarette tax revenue would increase only 3.4% and alcoholic beverage tax revenues by 4.1%. The major reason for this is that these items are taxed on a per-unit basis and people do not consume larger quantities just because their income increases. This revenue, therefore, does not keep pace with population growth and inflation without periodic tax increases. Per capita consumption of wine has been relatively stable over the past decade while liquor and cigarette consumption has fallen.

The corporate income tax has also proven not to be a stable and reliable source of income. To some degree this is due to economic cycles which produce dramatic variations in its growth, similar to the sales tax. Before the present recession hit Florida corporations, collections for 1989-90 were down by 10%. The previous year it had increased by 12.5%. There is suspicion that exemptions may have contributed to the pre-recession downturn. Subchapter S corporations are exempt from Florida's corporate income tax, and it has been suggested that some corporations are converting to subchapter S status in order to pay the lower federal tax rate available since 1986 and to avoid payment of Florida's corporate income tax. Unfortunately, the Department of Revenue lacks sufficient data to determine the extent of the problem.

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Tax Equity

Equity or fairness is the goal that is most often sought and least often agreed upon in the formulation of tax policy. The High Quality Revenue System Criteria suggest that everyone should pay a fair share of taxes since all benefit under the system. Unfortunately, there is no universally-accepted definition of what is fair. Equity is usually characterized according to two divergent principles: the ability-to-pay principle and the benefits-received principle. The former calls for a distribution of the tax burden on the basis of ability-to-pay (generally measured by income in the broadest sense) and the latter specifying that taxes paid should be borne in proportion to benefits received. To apply the ability-to-pay principle one must look at tax equity in two dimensions: horizontal and vertical.

Horizontal equity refers to similar treatment of similarly situated individuals. It asks the question: do persons making the same income bear the same tax burden? For example, persons earning the same income but with different consumption patterns would pay different taxes depending on the relative importance of taxable items versus nontaxable items in the family budget. Horizontal equity would minimize these differences by having broad-based taxes.

Vertical equity relates to the distribution of the tax burden across income classes, or the unequal treatment of income groups with unequal incomes. If taxes as a percent of income increase as income increases, the distribution of the tax burden is considered to be progressive. Likewise, if taxes as a percent of income are higher for low income groups than for high income groups, a tax is considered to be regressive.

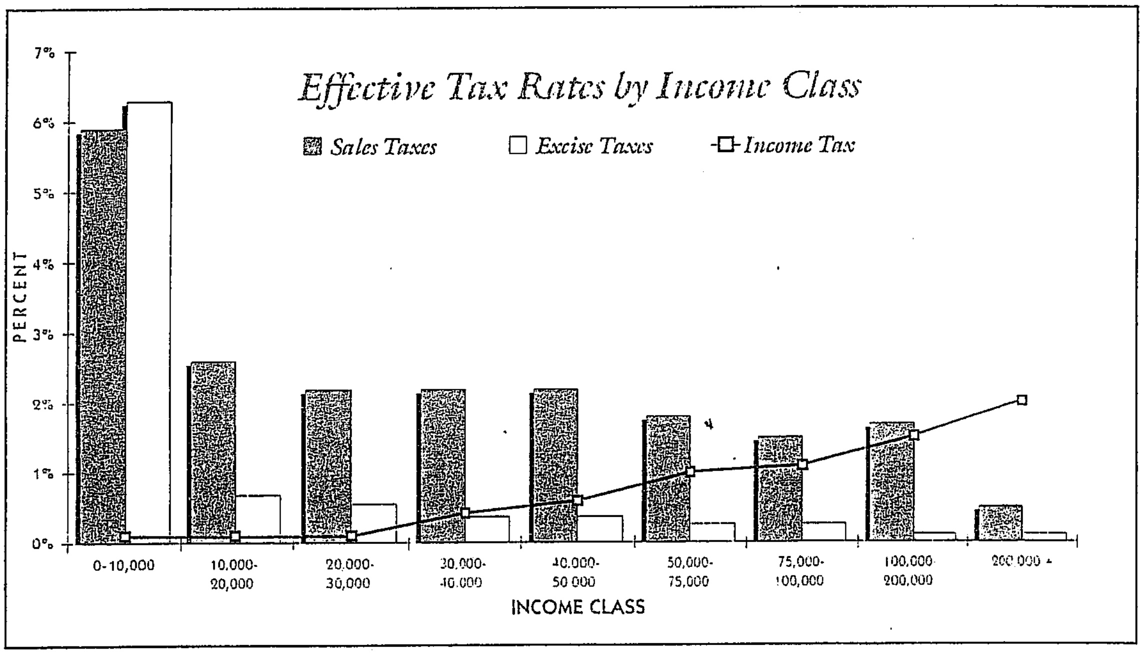
In basic terms, to be equitable or fair, a tax structure should shield genuine subsistence income from taxation (ability-to-pay), should not be regressive (vertical equity), and should require all households with comparable incomes to pay approximately the same amount of taxes (horizontal equity). Also relevant to the broad fairness issue is the distribution of the public expenditures funded by those tax dollars; however, analysis of the distribution of government expenditures is even more difficult and rarely done. As a result, tax studies may overlook the fact that a tax system which is regressive in rate structure may be balanced somewhat by the distribution of a disproportionate share of government expenditures to the lower income group.

Measured by the principles of ability-to-pay, vertical equity, and horizontal equity, Florida's tax structure is found to be deficient because it relies on consumption and transaction taxes for more than 82% of its General Fund. Sales taxes tend to be regressive because lower income individuals spend a greater portion of their income than do high income individuals who devote a portion of their income to investments and savings. Florida has attempted to mitigate this regressivity somewhat by exempting necessities such as food and prescription drugs from the sales tax; however, all income groups benefit from the exemptions. The Commission found evidence that regressivity is not unique to Florida since 45 states use the sales tax. In 1988 Ian Allen and John Peterson did a study of the tax burdens in the largest city in each of the 50 states plus Washington, D.C. and found that the tax liability (federal, state, and local) of a two income, two dependent family in Jacksonville, Florida was 49th. Nevertheless, all studies of the incidence of taxes in Florida have consistently shown a higher effective tax rate for low income groups than high income groups, although the degree of regressivity varies considerably.

Regressivity of the sales tax can be illustrated by analyzing the distribution across income groups to demonstrate who bears the burden. The Florida Multitax Simulation Model produced for the Commission by Price Waterhouse estimated the sales tax burden for families with incomes less than $10,000 to be 5.9% of their income. Families in the $40,000-$50,000 income range had an effective rate of 2.2%. The comparable figure for families with incomes between $100,000 and $200,000 was 1.7%. If the sales taxes paid by business and passed along to the consumer were included, the tax rates would be 9.34%, 3.51%, and 2.81%, respectively. In both scenarios, taxes as a percent of income for the lowest income group are 3.5 times that of the highest income group. Tax incidence or tax burden studies like this should be used for comparison purposes only because there is no definitive or universally-accepted study of tax incidence in Florida. The results of the Florida Multitax Simulation Model compare favorably to the results of other studies; however, some studies have estimated a higher effective tax rate for the low income group.

The use of annual family income may somewhat overstate regressivity because it makes no adjustment for variation in spending patterns or for benefits received from government programs. For example, younger families, especially those with children and many young single adults generally spend higher levels of current income than does the 35-50 age group. This is also true of many lower and middle income retirees, but some in this group also receive benefits from public health and social programs.

Other consumption based taxes are also regressive although the rates appear low when spread across the entire population. The 1991 microsimulation model of the Florida tax structure devised by KPMG Peat Marwick's Policy Economics Group analyzed the effective tax rates paid on alcoholic beverages and cigarettes. The effective



beverage tax rates are: 3.67% for families earning $10,000 or less, 0.22% for families in the $30,000-$50,000 range, and 0.07% for families earning over $100,000. In the case of the cigarette tax, the rates for the respective income groups are: 1.56%, 0.07% and 0.01%.

Florida does have two taxes, the estate tax and the intangible tax, which are based upon the ability-to-pay principle; however both of these are minor sources of revenue when compared to the $8.22 billion raised by the sales tax in 1989-90. In the same year the intangible tax on businesses and individuals (principally on stocks and bonds) produced $0.418 billion, and the estate tax totaled $0.257 billion. Individuals receive a $20,000 exemption on the first mill of the tax and a $100,000 exemption on the other half mill. The Florida constitution permits the estate tax to be levied only up to the amount allowed as a credit on the federal estate tax; thus, it does not add to the tax liability of those paying it. The maximum federal credit is $192,800. If the federal government ever eliminated the federal credit on its estate tax, Florida would lose all income from this source. The Commission reviewed this issue and determined that Congress was unlikely to eliminate this tax credit since all states levy the same type of "pick-up" tax as Florida.

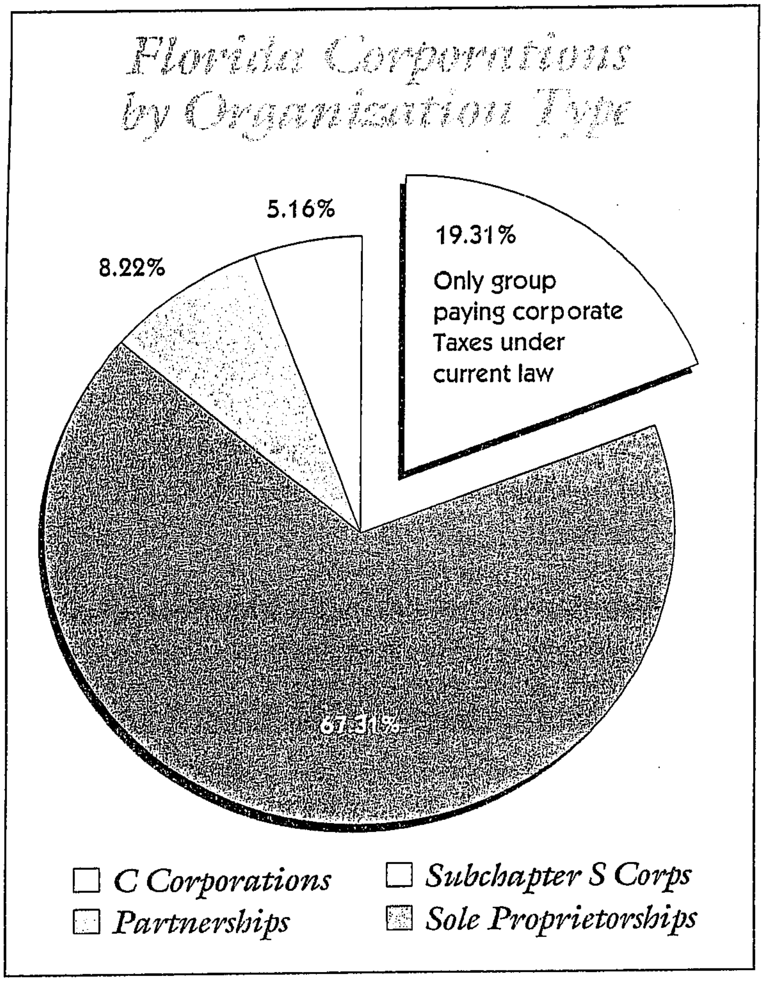
The Commission also reviewed two other revenue sources within the context of equity: the lottery and the constitutional provision which caps the millage rate of the Northwest Florida Water Management District at 0.05 mill while granting all other districts 1 mill. Some Commissioners were concerned that the lottery functions as a regressive tax since lower income people spend a greater percentage of their income on lottery tickets, a contention supported by a recent book on the lottery, The Economic Consequences of State Lotteries. In fact, the book asserts that Florida loses up to 23 cents in sales or excise taxes for every dollar spent on the lottery. The Commission decided not to pursue this issue since the lottery was, after all, voted into existence by the voters of Florida. Similarly, the Commission did not take action on the water management tax issue because the tax inequity was approved by the voters, it is public knowledge that the Legislature subsidizes the Northwest Florida district with state dollars. Most importantly, the Legislature has the power to place this matter on the ballot for a vote should public opinion change.

The Commission believes it is in the best interest of the state to create a tax structure which, to the extent possible, improves the competitiveness of Florida businesses with out-of-state competitors and encourages job creation within the state.

Level Playing Field

Closely related to the equity principle is the issue of creating a fair environment or level playing field for businesses in the state. Florida's complex web of business taxes, tax exemptions, allowances, and credits has no rational basis and results in many violations of the principle of maintaining a "level playing field." Insurance companies are subject to insurance premium taxes, corporate income taxes, and intangible taxes; however, they can deduct their intangible tax and corporate tax liability (up to a combined cap) from their insurance premium tax liability. Corporations subject to the corporate income tax, other than insurance companies and financial institutions, receive no offset for their tax liability for either the corporate income tax or the intangible tax.

Florida's tax structure also discriminates among businesses by type of organization. Subchapter S corporations, master limited partnerships, partnerships, and sole proprietorships are exempt from the corporate income tax. If the state had a personal income tax, the business income would be taxed on the individual returns. Since there is no personal income tax, these businesses escape taxation. The corporate income tax is the state's main tax on businesses; however, only C corporations are required to file corporate income tax returns. Businesses organized as subchapter S



corporations (65,000+), partnerships (103,600), and sole proprietorships (849,000) are exempt from the tax. These businesses account for over one million businesses operating in Florida, over four times the 225,000 C corporations filing corporate income tax returns. Of those corporations filing corporate income tax returns, only 2.5% of them pay over 90% of corporate taxes. Since 1986, the top marginal federal tax rate for individual incomes is less than the top marginal rate for corporations, providing an additional incentive for Florida businesses to reorganize in order to avoid corporate income taxes at both the federal and state levels. According to some estimates, over 40,000 corporations in Florida have converted to subchapter S corporations. A positive feature of Florida's corporate tax is a relatively low rate, 5.5%, making Florida 36th among states and well below the national average of 7.33%. This low rate in part reflects the fact that the Florida Constitution requires a three-fifths vote of the Legislature to increase the tax rate.

Florida businesses also desire to have a level playing field when it comes to competing on the national and international market. The state is geographically disadvantaged very often when it competes with other states for major manufacturing plants or national distribution centers; yet, there is a great need for jobs. The Commission believes it is in the best interest of the state to create a tax structure which, to the extent possible, improves the competitiveness of Florida businesses with out-of-state competitors and encourages job creation within the state. One negative and unintended result of having the 7th highest sales tax rate, higher than adjacent states, is that it provides some incentive for individuals and businesses to purchase major items outside the state. The Price Waterhouse Florida Multitax Simulation Model estimated that 42.6% of sales tax collections derive from business purchases and, therefore, indirectly affect the price of Florida goods and services. There should be some concern that the tax rate does not get too far out of line with other states competing in the same regional market area. On a positive note, out-of-state sales by Florida businesses are exempt from the sales tax. As a result, there is no damaging effect on the competitive position of Florida businesses relative to non-Florida competitors.

Exportability

Exportability is measured by the extent to which the tax burden is shifted ("exported") onto residents of another political jurisdiction, i.e., out-of-state residents and onto the federal revenue system. Taxing tourists while they are in Florida and using state taxes that are deductible from the federal income tax liability are alternative ways of exporting the tax burden. The Tax Reform Act of 1986 repealed the deductibility of state sales taxes on federal income tax returns for individuals but left state income taxes deductible.

One perceived advantage of Florida's heavy reliance on sales taxes as the dominant revenue source is that the 40 million tourists who visit Florida each year contribute to the funding of state government. Tourists and business travelers pay sales taxes on a significant proportion of their purchases: lodging, restaurant meals, cigarettes, alcoholic beverages, clothing, and admissions to events and tourist attractions. Many previous estimates of the percentage of sales tax paid by tourists have varied from 20% to 35%. In order to obtain a more current estimate, the Commission asked its consultant to review the subject. The Price Waterhouse Florida Multitax Simulation Model estimated that nonresidents pay 20.9% of Florida sales taxes through direct and indirect purchases. The KPMG Peat Marwick microsimulation model estimated that nonresidents pay 20.4% of the sales tax, 3.6% of the cigarette tax, and 21.2% of the alcoholic beverage tax.

Efficient and Effective Tax Administration

Because taxes do result in foregone consumption and investment, the tax system should strive to minimize the revenues necessary to administer the tax. Generally, broad-based taxes with few exemptions, deductions, and allowances can be more efficiently and effectively administered. They require less personnel for rule-making and technical assistance and are more easily understood by tax practitioners and taxpayers alike, thereby increasing compliance and lowering the costs of enforcement.

Florida's tax system is administered at a relatively low cost per dollar collected. Only 66 cents per $100 of sales taxes goes to administer and collect the tax. Each month the Department of Revenue processes 425,000 sales tax returns and 14,000 motor fuel tax returns for an annual total of 5.2 million returns, as well as another 347,000 corporate returns and 697,000 intangible tax returns annually.

Taxpayer Acceptance and Compliance

In Florida and most states, revenue systems depend upon the voluntary compliance of taxpayers. The level of voluntary compliance is a function of the ability of the taxpayer to understand and comply with the tax laws, which in turn depends on the perception of taxpayers that the tax laws are equitable and fairly administered. The most important sources, the retail sales tax, the alcoholic beverage and cigarette excise taxes, and the motor fuel tax are generally perceived by the public to be fair. Monitoring compliance is relatively simple. The consumer pays the tax liability at the time of the purchase transaction and the tax is remitted by the dealer. The individual taxpayer is caused little inconvenience, other than paying the tax, and is not required to maintain records or file tax returns. When compliance problems occur, it usually involves the dealer responsible for collecting and forwarding the tax to the Department of Revenue.

Consumption-based taxes may be criticized as being more regressive, more unstable, and less equitable than some other forms of taxation, but they usually receive a high degree of acceptance, even from lower income groups. The two major reasons are: 1) there are no records or filing deadlines and 2) sales and other consumption taxes are paid in small increments which appear to be insignificant sums of money. Rarely does the typical consumer make a purchase which results in a large sales tax amount on the invoice. Few individuals think about the aggregate amount of sales tax. By comparison, the property tax on the annual tax bill may appear intimidating even if it is less than the total sales tax paid in the same year.

The department estimates that over $1 billion dollars of state taxes are uncollected. About $200 million of this amount is uncollected intangible taxes (business and individual) and the remainder is uncollected sales taxes. The

Department of Revenue does not have current estimates of non-compliance on all taxes, but it does estimate an 8.5% (or $750 million) non-compliance on the sales tax and 28.4% non-compliance on the intangible tax on business.

Another area of non-compliance involves individual taxpayers who do not pay the intangible tax which is levied on stocks, bonds, mortgages, and other obligations secured by liens. A study by the Department of Revenue estimated that $103.6 million owed by individuals for intangible taxes goes uncollected. This high rate of non-compliance may be because citizens consider it unfair or because the Department of Revenue does not have a good system for informing citizens of their liability or enforcing compliance.

Fiscal Condition of Local Government

While the Commission's Joint Committee on Finance and Tax/Planning and Budgetary Processes conducted its analysis of the state tax system, the Joint Committee on Governmental Services/Procedures and Structure conducted an examination to determine the adequacy and appropriateness of the revenues available to Florida's local governments. The committee concentrated on counties and cities because they are the only general purpose local governments and have broad responsibilities. Education is a unique combination of state and local responsibility, with the state exercising funding and policy control. Because school boards are local governments, albeit single purpose, the committee and the Commission has reviewed their fiscal problems. The other category of single purpose local governments, special districts, was also examined.

The property tax is the sole source of taxation reserved to local governments under the Constitution...

Revenue sources available to local governments are limited. The property tax is the sole source of taxation reserved to local governments under the Constitution, subject to a cap of 10 mills for each city, county, or county school district. This restriction increases pressure on local governments to utilize the property tax to fund the array of services. Property taxes, as a percentage of city and county budgets, are increasing compared to other revenue sources. There is widespread intolerance of increases in this tax, however. The May 1991, Florida Poll by Florida International University with a sample of 1,204 people found that 76.2% of those polled "mostly", or "strongly", opposed increasing property taxes as a way to increase tax revenues.

While the state ranks only 23rd nationally in levying property taxes as a percent of income, there is a public perception in many areas of the state that it is too high and inequitable. It is true that, in general, higher income groups own more property and larger homes, but there are many exceptions. Some individuals have inherited family property which a generation ago had relatively low value and a small tax liability. Florida's high growth has escalated those property values significantly. In high growth urban areas, increasing demand may have inflated property values beyond the financial ability of a resident to pay taxes. This happens most often to the older, less mobile homeowners. Aside from these factors which are influencing the Florida situation, it must be recognized that experts in the field of taxation consider the property tax to be regressive. Donald Phares, a nationally recognized scholar in tax incidence or tax burden studies, has called the property tax the most regressive element of taxation at the state and local level.

The increase of the $5,000 homestead exemption to $25,000 in 1980 has helped to moderate the regressivity of the property tax and the impact of rising property values for many homeowners; however, it has, to some extent, undermined the viability of the property tax as the major revenue source for local government, especially in areas experiencing slow economic growth. The $25,000 homestead exemption has taken a large percentage of the homes off the tax roll, imposing a heavier burden on the non-exempt property. In 1990, 15.9% of all property was exempt from taxation because of the homestead tax statewide, but 16 counties had over 30% exempt, with Holmes County having the greatest percentage—54.3%. If viewed as a percentage of total residential value, the homestead exemption accounts for 52.18% to 74.81% in 12 of the 13 counties that levy 10 mills. The potential of the property tax is also jeopardized by organized groups of taxpayers who strongly oppose it as an unfair tax. In 1990 Duval County voters imposed a cap on property taxes which limits annual increases to 3%. A statewide group called Save Our Homes, Inc. has collected more than 150,000 signatures for an initiative to place a similar restriction in the Florida Constitution.

Revenue sources other than the property tax must be specifically authorized by the Legislature, and several have been allowed with restrictions. For example, Florida Statutes restrict the use of the Constitutional Gas Tax to meet debt service requirements or the acquisition or construction of roads, but prohibit its use for maintenance. The Local Government Infrastructure Surtax (one cent sales tax) has a requirement that the county commission hold a referendum. If a city wanted to use these local option taxes to pay for growth, but the county refused to call a referendum, there would be no election unless the city or cities represented a majority of the county population. If the Infrastructure Surtax were levied, it could be used to pay for police and fire stations but not for people to serve in them. Municipalities can levy a public service (utility) tax on electricity, water, gas, and telecommunications, but not on cable television or wastewater services. No county other than a charter county may levy the utility tax at all. There are several local option taxes which can be levied only by counties. The Municipal Resort Tax may be levied by only three cities in the state.

The state policy of trying to manage the fiscal affairs of cities and counties has created a host of revenue options, but has left local governments with a confusing and still inadequate tax base. Traditionally, states have compensated for tax restrictions on local governments by sharing state-generated revenue with them. Florida does share revenues from several tax sources with cities and a still greater number with the counties. In 1982-83 the state shared 12.7% of its own-source revenue with cities and counties. By 1989-90 the percentage had declined to 8.8%. Counties now get more of their revenue from User Fees, 27.6% in 1989-90 compared to 16.2% in 1979-80. Cities make an even greater use of User Fees which constitute 30% of total revenue, much higher than the national average which rose from 18.8% in 1980 to 23.2% in 1989. Because city residents must pay both county and city property taxes, there is greater public pressure to hold down city property taxes and rely more on user fees.

Local governments have long sought more fiscal flexibility in the funding of the services they have been asked to provide by both the state and the public. Local government officials claim that the government closest to the people should design locally acceptable revenue solutions for the problems confronting their communities and that the State has not been a "good trading partner" when mandating responsibilities, yet limiting access to revenue sources. Three hundred and sixty-two mandates requiring a local government to perform an activity, provide a service or facility, or restricting local government's revenues or revenue generating capacity were enacted in the decade of the 1980's. The total cost of these mandates is difficult to calculate, but a single 1988 mandate on pensions for police and fire personnel will cost local governments over $559 million dollars through the 1992 fiscal year and will have a recurring cost of over $200 million annually. Another bill that passed during the 1990 session, increasing county and city contribution rates to insure that the pension fund remains actuarially sound, was estimated to be $16 million for fiscal year 1990-91.

Local School Districts/ Education Funding

The third major level of local government is the county school district. These 67 districts are created for the single, but vitally important, function of operating the public school system. Elected county school boards are charged with the responsibility of providing funding and policy direction. The state constitution grants school boards the authority to levy up to 10 mills for school purposes. In the 1980 fiscal year, schools levied $895.3 million in property taxes. By 1990 the amount was $3.599 billion, an increase of 402%. Local officials had very little control over those increases, however, because the state has gradually assumed control of funding and policy decisions. The state also establishes limits on how much millage can be levied for capital projects.

The constitution provides that "adequate provision shall be made by law for a uniform system of free public schools and for the establishment, maintenance and operation of institutions of higher learning and other public education programs that the needs of the people may require." In 1973, the Florida Legislature passed the Florida Education Finance Program (FEFP) as the funding formula for the state's distribution of dollars to school districts in order to provide equal educational opportunity. The formula recognizes: 1) varying local property tax bases, 2) varying program cost factors, 3) district cost differentials, and 4) differences in per student cost for equivalent educational programs due to dispersion of student population.

School districts are required to levy a specific millage in order to participate in the FEFP allocation. The FY 1991 average required local effort is 6.373 mills. School districts are authorized to levy a maximum of only .510 mills above the required local effort for discretionary use in the local district. If local property owners were willing to be taxed at the unused 3 mills in order to enhance the local educational system, the state would not permit it.

...since implementation of the lottery, the percentage of the General Revenue Fund appropriated for education has decreased from 61.19% to 52.78%.

The FEFP is intended to "equalize" the amounts which can be generated by disparate property values. The landmark case, *Serrano v. Priest.487 P.2d 1241* (1971), held that a public school financing system which relies heavily on local property taxes and causes substantial disparities among individual school districts in amount of revenue available per pupil for the districts' educational grants, invidiously discriminates against the poor and violates the equal protection clause of the Fourteenth Amendment. The question remained, if the state will not appropriate more for education and will not permit school districts the option to levy more, how can additional funding be generated?

In 1986, 63.57% of the voters approved a constitutional amendment creating a state lottery. Proponents of the amendment promised the lottery would provide additional funding to enhance education. In response, the Legislature adopted legislation stating "that the net proceeds of the lottery games conducted pursuant to this act be used to support improvements in public education and that such proceeds not be used as a substitute for existing resources for public education." For every dollar spent on the lottery, 38% is deposited into the Educational Enhancement Trust Fund, winners get 50%, and ticket sellers and administration account for the remaining 12%.

Lottery proceeds to education in 1991 are estimated at $846.8 million, but many claim that the funds have been used to supplant state funding of education. While actual dollars appropriated for education have increased each year since implementation of the lottery, the percentage of the General Revenue Fund appropriated for education has decreased from 61.19% to 52.78%. Funds from the FY 1991 lottery accounted for about 8.1% of the combined total operating budgets of the Public School System, Community College System and the State University System. Predictions are that Florida's lottery, like those in other states, will eventually begin to lose some of its appeal, and revenues will decline. Since it cannot be expected to grow to any significant extent and since local school millage is approaching the 10 mill cap, most additional future revenue will have to come from a state source.

Special Districts

Special districts are single-purpose local governments which supplement city and county government services such as: fire protection, drainage, public lighting, medical care, roads, juvenile welfare services, and aviation facilities. Special districts are funded predominantly by charges for services; however, some special districts levy ad valorem taxes. In fact, special district ad valorem revenues, $543.8 million, constituted 12.2% of the combined ad valorem revenues for municipalities, counties, and special districts in 1988-89.

In the 1970's, there was widespread concern about the proliferation of and lack of accountability of special districts because the exact number and scope of activities of special districts were unknown. The Special Districts Disclosure Act was enacted in 1979 to establish minimum requirements for creation, elections, accounting, bond issuance and other aspects of special district operations, but problems persisted. In early 1986, the Advisory Council on Intergovernmental Relations commissioned an investigation of statutory requirements that could further enhance the special districts' accountability to the state, local governments, and the public. Many of the concerns were addressed when the Uniform Special District Accountability Act of 1989 was adopted.

Two areas of concern still remain. First, between one-third and one-half of all special districts were created by Special Act of the Legislature, but these special acts are not codified. Extensive research is necessary (and sometimes errors are made) when legislation regarding a special district is amended. Over the past five years, 317 special district bills were filed in the House during regular session. Second, there is no required review of special districts by the state or local governments that created them. Concern about abuses of special district powers has brought about changes in reporting, but the activities of 30 of the 931 districts are still unknown. Problems of lack of fiscal and political accountability to

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Hugh Anderson
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Representative Debby Sanderson (non-voting)
Parker Thomson

district residents are compounded by this lack of periodic review by the creating authority to determine if a special district is still the most efficient and desirable way to provide the service.

Commission Recommendations For Reform

The Florida Constitution requires the Taxation and Budget Reform Commission to "determine methods favored by the citizens of the state to fund the needs of the state, including alternative methods for raising sufficient revenue for the needs of the state; determine measures that could be instituted to effectively gather funds from existing tax sources; [and] examine constitutional limitations on taxation and expenditures at the state and local level." Having conducted its examination of the tax systems of state and local government, the Commission adopted several proposals which incorporate options for tax reform and changes related to government finance. Some are proposed as legislative recommendations and some have been placed on the Commission's Constitutional Calendar for further discussion and consideration as proposed constitutional amendments. Findings and Recommendations are printed in full in Chapter Five. No precise constitutional language is presented for the constitutional recommendations because proposals on the Constitutional Calendar are subject to modification or rejection after public hearings in January and February 1992, and after further discussion by the Commission.

The Commission's primary objective is to improve the equity and stability of the tax structure to enable it to better meet the future needs of the state. In order to focus on that aim, these recommendations assume changes would initially be revenue neutral. In other words, the expansion of the existing tax base or the use of a new tax assumes an initial corresponding reduction in the rate of an existing tax.

Repeal of State Tax Exemptions

Repealing most of the sales tax exemptions on services and goods, other than food, medicine, and housing, should help reduce the volatility of sales tax collections. Though technically not exemptions, the Commission has included business, professional and personal services in the exemption category. Not only would this *legislative action* significantly expand the base of taxable sales, but also, employment data show that the service sector of the economy has experienced positive rates of growth throughout the business cycle over the last forty years. This proposed base expansion would, over time, further increase the state's reliance on the sales tax; however, the revenue stream may become more stable. Creating a true budget stabilization fund by requiring an amount equaling

Sales Tax Burden: Existing Law vs. Services

Income Class	Effective Rate: Existing Sales Tax	Effective Rate: With Services	Average Liability: Existing Sales Tax	Average Liability: With Services
$0- 10,000	9.34%	9.47%	$372	$377
$10,000- 20,000	4.38%	4.38%	$662	$662
$20,000- 30,000	3.52%	3.45%	$919	$901
$30,000- 40,000	3.49%	3.42%	$1,255	$1,229
$40,000- 50,000	3.51%	3.45%	$1,557	$1,531
$50,000- 75,000	2.99%	2.94%	$1,881	$1,848
$75,000-100,000	2.55%	2.53%	$2,241	$2,220
$100,000-200,000	2.81%	2.90%	$4,051	$4,182
$200,000 and Up	0.94%	1.00%	$5,901	$6,297

5% to 10% of state revenues to be deposited in the Working Capital Fund, as the Commission has recommended, would help to level out the availability of revenue to fund the budget.

Many of the current sales tax exemptions are more reflective of the influence of certain interest groups than they are of tax equity. The use of the Commission's criteria, which are included in the Findings and Recommendations, would help the Legislature grant only those exemptions that are truly in the public interest. Having a *constitutional sunset* of exemptions every 10 years, unless re-enacted in separate bills, would force the Legislature to periodically examine the legitimacy of each exemption. Exempting expensive items like tickets to the Super Bowl does not indicate any consideration of the ability-to-pay principle. Subjecting to the sales tax those services which are used more extensively by upper income groups, such as accounting, legal, and architectural services, may slightly improve the fairness of a system which taxes consumption.

Repealing all tax exemptions except those that address a defined public purpose would also generate revenues sufficient to decrease the sales tax rate from 6 cents on the dollar to 4 cents according to the Price Waterhouse Florida Multitax Simulation Model. Eliminating the corporate income tax exemptions for subchapter S corporations and partnerships would also reduce the discrimination in tax treatment by form of business organization.

Implementing a sales tax on services would require that the Department of Revenue register an additional 250,000 businesses which currently provide only services and, therefore, are not required to be registered sales tax dealers under current law, which may call for phasing in the sales tax on services. In terms of acceptability, the Florida State University Policy Science Program's annual survey in 1989 indicated that if more revenue had to be raised, the option most preferred by 37% of the respondents was increasing the sales tax, followed closely by 32% preferring an expansion of the sales tax to include services. These results are comparable with other recent polls.

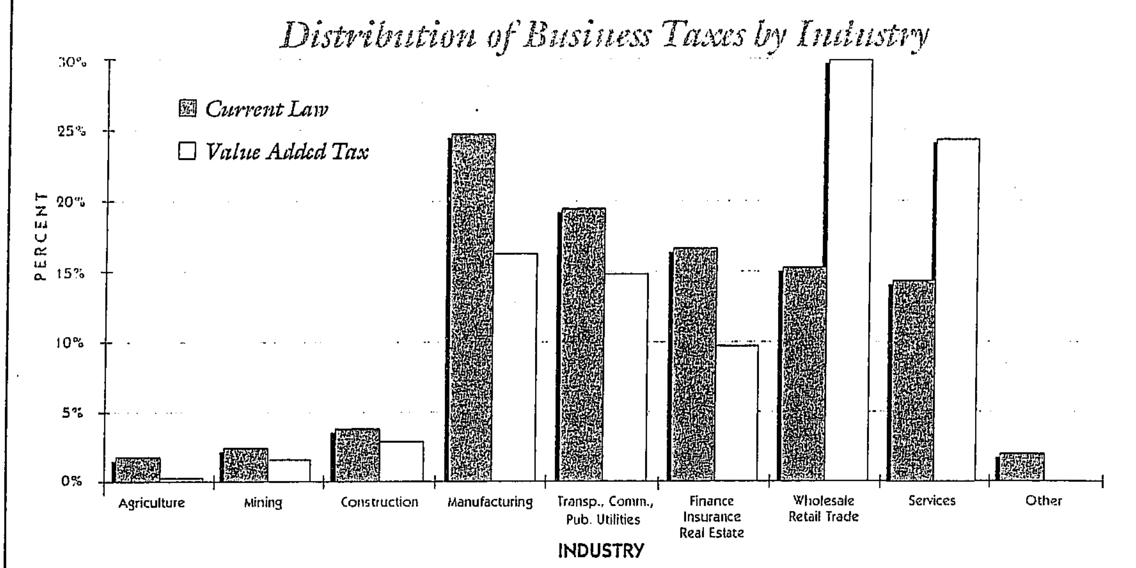
Value of State Tax Exemptions Recommended for Repeal

($ in millions)

Tax Exemptions	1992-93
Sales Tax on Goods	$778.7
Sales Tax on Services	$6,531.2
Corporate Income Tax	$230.2
Beverage & Cigarette Tax	$33.0
Other Consumption Taxes	$64.6
Total Repealed Exemptions at Current Tax Rates	$7,637.7

Comprehensive Taxation of Business

Enacting a comprehensive business tax based upon value-added could help to stabilize revenues. Michigan is the only state which levies a value-added tax; therefore, the *Legislature should explore* the advantages and disadvantages before making a final decision. Business capital investments, which are highly cyclical, are excluded from the tax base resulting in more stable revenue growth for the state as well as an incentive for business. From a taxpayer's point of view, tax planning would be more predictable, giving business an increased ability to incorporate taxes into their price structure and into marketing plans. The value-added tax base includes the services sector of the economy, which is expected to grow faster than the manufacturing sector. By the year 2000, revenue from the current corporate tax can be expected to grow by 24%; whereas, value-added tax revenues are projected to grow 40% according to Price Waterhouse. This is based upon a 2.4% value-added tax which would replace the 5.5% corporate income tax, the sales



tax on business purchases, and the intangible tax on business.

This type of tax could add a degree of equity since all types of corporations, partnerships, and proprietorships, other than those exempted by a small business income threshold, would be subject to the tax, there would be no discrimination in tax policy based upon organizational structure. It would also tax business according to the services-received principle. Government services are consumed by business, and the VAT treats government services as a factor in production just as labor, capital, and land, whether a profit is made or not. An important feature, is that only the value added by the business is taxed. It permits a business to deduct from its liability the taxes paid at an earlier stage of the production and distribution process, thereby reducing pyramiding.

Implementation of a value-added tax would have similar requirements as would an expansion of the corporate income tax base to include subchapter S corporations and partnerships, except that some proprietorships would also have to file returns. Since the implementation of value-added tax could include the elimination of the intangible tax on business and the sales tax on equipment purchases, savings in administrative costs for those taxes may balance out the new costs associated with the value-added tax for both government and business. The possibility of simplification of the tax system and the low rates applied to larger groups of businesses have caused many Florida business leaders to encourage the state to explore its possibilities.

Personal Income Tax

There is a constitutional prohibition against a personal income tax which dates from 1923 when the leaders of a sparsely populated and poor Florida recommended it as a way to persuade northern capitalists to relocate in Florida and bring their fortunes with them. Forty-four states levy a broad-based personal income tax, but public opinion polls in Florida over the past several years have shown that 70% to 80% opposed an income tax; however, an August 1991, poll of 601 Floridians by Frederick/Schneiders revealed that 64% of the respondents would vote for a tax on income if it were levied only on incomes over $75,000.

The Commission has not yet determined if it will place an income tax on the 1992 ballot, but has decided to keep it as one of the options *on the Constitutional Calendar* until after public hearings in January and February 1992. If added to the Florida tax structure, it could accomplish several improvements from a policy perspective. Since Florida already taxes consumption very heavily with sales and excise taxes and taxes wealth more moderately through the intangible tax, estate tax, and property tax, the only tax base left untapped is income. Should tax reform include a personal income tax with low rates?

In terms of revenue stability, personal income would provide a more stable and reliable tax base than taxable sales. Its annual average rate of growth is not only higher than growth in taxable sales, but it is less responsive to changes in the business cycle. Its rate of growth drops less than taxable sales during a recession and its rate of growth during the recovery is slightly less. Both of these characteristics could help Florida's financial situation by providing more money to fund public services during recessions and slightly less money than the current tax structure during recovery periods, lessening the tendency to fund new programs which cannot be sustained during the next slowdown in the economy.

Since 1970, personal income has grown at an average annual rate of 11.6% compared to the 10.4% growth rate for taxable sales during the same time period. While experiencing a higher rate of growth, personal income growth was also much more stable over the last twenty years, ranging from a low of 7.2% in 1990 to a high of 17.4% in 1973, a difference of only 10.2 percentage points. In 1974-75, when growth in taxable sales was virtually nil (0.3%), the growth in personal income was 8.2 %.

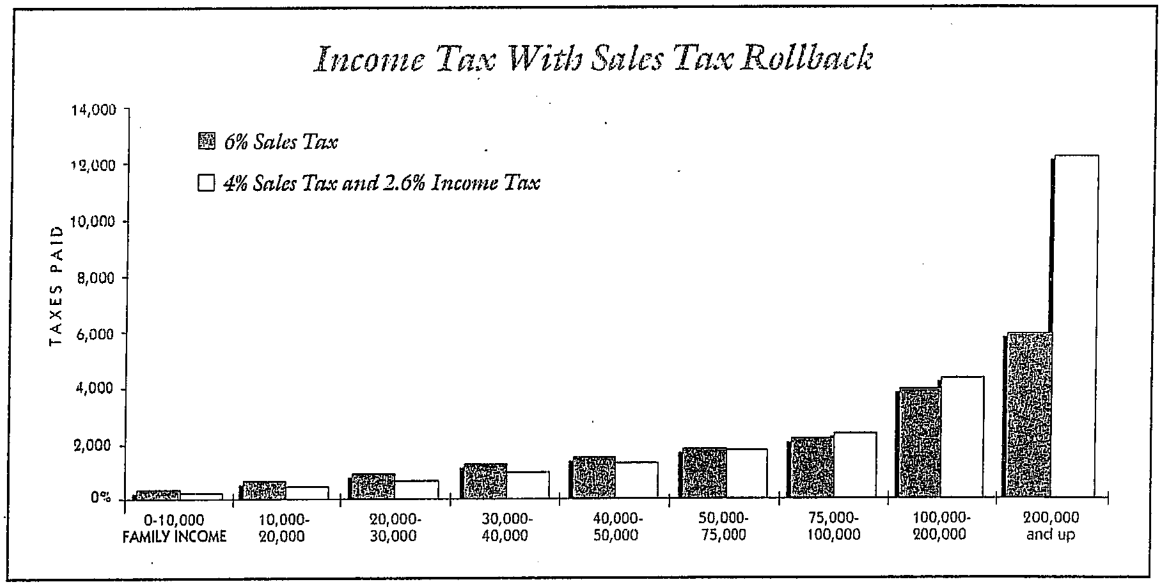
Assuming the ability-to-pay principle, an income tax would improve the overall equity of Florida's tax structure in that, holding total tax revenues constant, the tax burden of low income persons should decrease relative to the tax burden of higher income persons. The degree to which this occurs, however, depends on how the income tax is structured.

A low income tax rate with a broad definition of income would satisfy horizontal equity. Substantial itemized deductions can lead to different tax burdens for families with similar incomes but different earning or spending patterns. A flat tax rate with a standard deduction would have the advantage of making the tax structure more progressive (the effect of the standard deduction is to lower the effective tax rate at the low end of the income scale), but not so much so that the income tax would become a disincentive to persons with relatively high incomes. Another aspect of an income tax is the ability to target tax relief by income groups. In contrast, reducing the regressivity of the sales tax can only be done by exempting necessities for all consumers regardless of income.

The Florida Multitax Simulation Model compared average tax liabilities for families by income group under two scenarios: 1) with the current 6% sales tax and 2) with a combination of a 4% sales tax and a 2.6% income tax. The model demonstrated that families with incomes less than $75,000 per year would pay less taxes with a 2.6% income tax on federal adjusted gross income and a sales tax rolled back to 4%, than they currently pay under the existing 6% sales tax. Families with incomes less than $20,000 would experience a 32% reduction in taxes paid dropping from $662 to $452 annually. Families with incomes between $100,000 and $200,000 would experience a 6% increase in taxes. The average family's taxes would decrease from $1,314 to $1,268 per year, a 3.5% decrease. This calculation assumes a 2.6% tax on federal adjusted gross income minus a standard deduction of $15,000 for a single person, $25,000 for a single head of household, and $30,000 for married persons filing jointly.

Buying out a portion of sales taxes with the income tax would improve the overall exportability of the tax structure because income taxes are allowed as itemized deductions on individual federal income tax returns whereas sales taxes are not. One-third of Florida residents filing federal income tax returns itemize deductions, with the percentage of itemizers increasing as income increases. Tourists, however, would not pay Florida income taxes.

The enactment of an income tax would give policymakers the ability to reduce tax rates in other areas. The State of Connecticut used this option when it recently enacted a broad-based personal income tax. They decreased their sales tax rate from 8% to 6%. In Florida, it is estimated



that a 2% tax on federal taxable income would generate revenues sufficient to roll-back the sales tax rate from 6% to 4% (Price Waterhouse, 1991). A 4% sales tax rate would be comparable with the tax rates of Florida's neighboring states of Georgia and Alabama.

Levying a tax on personal income would lessen the impact of the current discrimination among business types by taxing most of the income of the owners of subchapter S corporations, partnerships, and sole proprietorships on their personal income tax returns. These businesses are exempt from payment of the Florida corporate income tax.

Implementation of an income tax in Florida would require a substantial increase in personnel in the Department of Revenue. The department might handle as many as 7 million individual tax returns, depending upon the definition of income and standard deduction amount. A system for withholding taxes would also have to be developed. There is insufficient data available to determine how these administrative costs, as a percentage of revenue, would compare with the sales tax dealer collection allowance ($89.3 million for the state in 1990-91) plus the personnel and audit costs for the existing taxes. The state has the ability to monitor non-compliance by matching state returns with federal income tax returns.

Would Floridians accept and comply with a personal income tax? Taxpayer distaste for the filing of annual federal income tax returns and dealing with the Internal Revenue Service is legendary, but the unpopularity was moderated to some degree by the Tax Reform Act of 1986. Opinion polls consistently indicate that the concept of a state income tax is unpopular with Floridians, but citizens in other states find state income taxes less objectionable than other types of taxes. A national poll conducted in September 1991, by the U. S. Advisory Council on Intergovernmental Relations asked people to choose the worst tax from four options. The results were: local property tax—30%, federal income tax—26%, state sales tax—19%, state income tax—12%, and Don't Know—14%. This question has been asked 18 out of the past 20 years with the same result, i. e. the state income tax was considered more acceptable than the sales tax, property tax, and federal income tax.

The Taxation and Budget Reform Commission is attempting to improve the overall reliability and equity of the Florida tax structure while maintaining revenue neutrality. No survey has asked Floridians if they would favor enacting an income tax with a corresponding reduction in some other tax, especially a more burdensome one such as the property tax. One variation being discussed by the Commission would use revenue from the income tax to "buy-out" the property tax on homesteads. As it explores the options of the income tax and other tax changes, the Commission recognizes that, in the final analysis, the best tax system for Florida is the one which the people support.

State Revenue Cap

As the Commission examined and debated the weaknesses of the state tax structure, there was a recurring concern that unless the state enacts the budget and spending reforms recommended by the Commission and learns to exercise fiscal restraint, the state can outspend any tax system, no matter how reliable and equitable. In the decade of the 1980's when sales tax revenue grew by 7.1%, the Legislature raised taxes, when growth was 11.6%, the Legislature raised taxes, and even when it grew by 23.75% (1987-88) the Legislature still raised taxes. Without well-defined goals and objectives and without measurable standards of performance to measure the progress, the state could spend unlimited amounts of money and perhaps never reach the laudable goals, whether that be quality education or adequate health care for children.

Other states have similar spending tendencies, and the citizens in more than 20 states have pressured their legislatures to adopt spending or revenue caps. None have worked very well because it is an extremely complex task to design a system which will enforce fiscal restraint, but at the same time enable the government to meet any number of unexpected challenges, such as: federal mandates, influx of immigrants, natural disaster, depression, or changing citizen demands. Is a spending or revenue cap for Florida necessary or desirable? In view of the reluctance of the Legislature to enact comprehensive budget reform, the

> *...unless the state enacts the budget and spending reforms recommended by the Commission and learns to exercise fiscal restraint, the state can outspend any tax system, no matter how reliable and equitable.*

Commission has voted onto its *Constitutional Calendar* a proposal to place a cap on state revenue. A state revenue limit by its very nature would force the state to limit expenditures. By proposing that the cap be tied to the growth in personal income, the Commission seeks to impose a realistic and workable cap. It would force the state to acknowledge that the growth of tax revenue cannot exceed the ability of the citizens to pay those taxes.

State Government Accountability

The desire to make government more understandable and accountable to the citizens has been a guiding principle of the Commission throughout its deliberations. Numerous budget reform recommendations have been offered in an attempt to institutionalize fiscal accountability; yet, the act of passing a statute may not be sufficient to inculcate the practices which will make government more efficient and accountable. Even if it were possible, the performance standards by which government is to be measured must be routinely re-evaluated and revised to make them workable or to adjust them to fit the changing roles of government. The most effective way to achieve the goals of the Commission is to have the *Legislature authorize* the creation of an appointed commission to monitor and to evaluate government performance and to review alternative methods of service delivery, such as privatization.

Executive Budget Authority

The October 1991, case in which the Florida Supreme Court declared unconstitutional section 216.221, Florida Statutes, has terminated the established practice whereby the Governor and Cabinet maintained a balanced budget by making budget cuts when there are revenue shortfalls. In preventing the Governor and Cabinet from taking this prudent fiscal step, the Court has ruled that only the Legislature can make budget cuts. This means that budget reductions cannot be made as quickly. For example, The Governor and Cabinet would have made budget reductions on October 23, 1991, but the Legislature will not meet to make cuts until December 10, 1991. The delay of approximately 60 days reduces the budget from which the same $621.7 million will have to be cut by some 16%.

To further complicate matters, some legislators feel that the barriers created between the executive and legislative branches by the Court will not permit the Legislature to enact some of the Commission's recommendations regarding executive budget authority. The Commission's recommendations are well within the reasonable authority of the Governor as chief budget officer and are consistent with prudent fiscal management; nevertheless, it appears that a *constitutional amendment* may be necessary to establish those budget reforms and to restore the authority of the Governor and Cabinet to reduce the budget during revenue shortfalls.

Taxpayer Compliance and Taxpayers' Bill of Rights

The earlier recommendations on taxpayer compliance were designed to aid the Department of Revenue collect the estimated $1 billion in taxes which were not being collected by instituting training programs for employees and educational programs for taxpayers and by modernizing the department's operations. In following up on the implementation of these reforms, the Commission concluded that the department needs additional personnel to improve audit coverage. It also appears that the electronic data processing equipment and the management information systems need to be updated. These plus other recommendations forwarded to the Legislature could assist in collecting as much as $196 million in intangible tax alone.

Improved audit coverage and enforcement by the Department of Revenue needs to be balanced by procedures to protect the rights of taxpayers. The Commission commends the department for adopting and following many of the principles of a taxpayers' bill of rights. The power wielded by government can often leave the individual taxpayer at an extreme disadvantage. The Commission recommends that in the area of taxation, there needs to be constitutional protection for the citizens rights. The *constitutional provision* will address the broad principle, but the Commission has recommended to the *Legislature* a set of subsidiary principles which should be included in a taxpayer's bill of rights.

Local Government Tax Authority

While the Constitution and Legislature may have given cities and counties home rule in theory, the fiscal home rule necessary to address the challenges facing local governments until the next century has not been provided. The Commission is concerned that the spending of cities and counties has grown at a comparable rate to that of the state, indicating a need to reform budgeting practices and to institute productivity plans with measurable performance standards. At the same time, it is clear that the financing tools available to cities and counties are nothing more than a patchwork which is increasingly inadequate.

The existing tax system represents a failed-attempt by the Legislature to micro-manage local finances rather than entrust to local citizens and their elected representatives the authority to choose the taxes best suited for the area. The current system is not uniform, but all too often the Legislature has attempted to mandate the uniform use of a revenue source which may meet the needs of one local government, but not another. If citizens of a county or city wish to finance garbage collection in part or entirely with a broad-based tax rather than user fees which may place a burden on the lower income group, they should have that option. A preferable system would be to preempt certain tax sources to the state and grant flexibility to counties and cities to impose the others, with minimal limitations when necessary. This approach, which the Commission recommends for *constitutional enactment*, would allow the state and local governments the fiscal flexibility to work in harmony in meeting

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the demands of growth in the 1990's.

Local Government Financial Reporting

While granting more fiscal home rule, it is in the best interest of the state to be aware of the fiscal and other policy practices and issues confronting counties and cities. The partnership between state and local government works best when there is communication and trust. It was in recognition of that fact that the Legislature created the state Advisory Council on Intergovernmental Relations (ACIR). Unfortunately, when the state enacted a requirement that local governments submit financial reports, it required that the data be collected by the Department of Banking and Finance rather than the ACIR. Moreover, the information is not policy oriented or consistent. Local governments get little feedback and generally believe that the reports serve no useful purpose As a result, it is not useful to the state in understanding the fiscal condition of local government or in formulating state policy.

Past experience indicates that effective utilization of the information and improvements to the current local government financial reporting process is not a priority at the state level; yet, the Commission feels this exchange of information could enhance efficient and effective service delivery. The first step toward improvement of the process is to have the *Legislature transfer* the data collection responsibilities to the ACIR, with appropriate funding, since it is charged with the responsibility to use the information in developing policy recommendations for the Legislature. Since the ACIR has representation from local government, the Legislature, and gubernatorial appointees, it is in the best position to determine what type of information is needed and in what form. Not only would an improved reporting system result, but the Commission feels the ACIR should be able to develop a relatively simple, uniform reporting system to be used by local government to report to citizens about the costs of services provided.

State Mandates

In the spirit of this new improved partnership between the state, counties, and cities, the state needs to refrain from future mandates, i. e. laws directing counties and cities to perform a service resulting in a cost, or reducing state shared revenues without providing funding. In 1990, voters approved Amendment Three which became article VII, section 18 of the Florida Constitution. It seeks to prohibit mandates but has several loopholes, such as the ability of the Legislature to impose unfunded mandates by a 2/3's vote. Furthermore, the Legislature passed implementing legislation for section 18 which was vetoed by the Governor because it "places extraordinary burdens on those local governments." Sorely needed state and local tax revenues would have been diverted to fund lawsuits if a local government felt that a state law constituted an unfunded mandate. Additionally, the Legislature sought to exempt legislation which had "insignificant fiscal impact." By their proposed definition, "insignificant fiscal impact" would have been approximately $1.4 million in FY 1990-91. The Commission urges the *Legislature to adopt* implementing legislation that does not impose undue legal and financial burdens on local government and defines "insignificant fiscal burden" as "an amount not to exceed $50,000," a definition which the Legislature has used in the past and is referenced in *Florida's Fiscal Analysis in Brief 1990*, a legislative publication.

Education Reform

The funding of Florida's educational system is of great concern to Taxation and Budget Reform Commission members. Clearly local property taxes can never provide a majority of the revenue necessary for a quality state educational system; statewide revenue must be used. Members are concerned that lottery dollars were used to replace General Revenue dollars and that the public has lost confidence in the Legislature to live up to the intent of the lottery amendment and subsequent legislation. Distributing lottery funds directly to schools on a per student basis for educational enhancement is the best way to fulfill the original commitment. The Commission recommends that the *constitution be amended* to require this and to distribute 70% of the proceeds to public schools, and 15% each to community colleges and universities.

The Commission is convinced that additional funding alone is not the answer to quality education. Part of the answer may be returning more control back to the local area. Involving teachers and parents, in conjunction with the school principal, to make decisions regarding the education of their students and to be accountable for those decisions is an important step in creating educational improvement. This local accountability has the support of the Governor and many legislators. There is also increasing support for school "choice" in Florida. Hailed as the "cornerstone of education reform" by President George Bush, choice empowers parents to select the school that best suits their child. Proponents argue that when schools compete for students, the quality of instruction improves and the diversity of programs offered expands. In August 1991, a Gallup-Phi Delta Kappa Poll of Public Attitudes Toward the Public Schools found that 62% of those polled favored allowing students and parents to choose the public schools in their community which the students will attend.

Though there is still much debate on the problems and successes of school choice, it is envisioned that the impact of parental school choice and competition between public schools, along with school based management, will indeed move Florida closer to having schools of excellence. The Commission recommends that the *Legislature adopt* the principles of school based management and explore the feasibility and merits of choice. While neither of these may be a panacea, they do offer viable alternatives. If these programs are combined with a policy of permitting counties to use for educational enhancement any millage not included in the FEFP, up to the 10 mill cap, counties will have the fiscal flexibility to engage in creative efforts at improving educational quality. Not only should the constitution be amended to permit county school districts to use this discretionary millage, they should be granted the right to levy up to 2.5 mills above the 10 mill cap for capital projects.

The results of all of these debates may hinge not only on the decisions of parents and legislators, but also with the courts. How equal must schools and school funding be? Can counties use discretionary funds without disequalizing education? In 1991 the School Board of Sarasota County filed for declaratory relief and asked the court to determine the validity of section 236.25(1), Florida Statutes, which limits the discretionary millage that can be levied. The Circuit Court ruled the state law unconstitutional; however, the case is currently under appeal. Proponents argue that allowing districts to utilize the difference in millage between the required local effort and 10 mills would allow property-rich counties to prosper while property-poor counties would realize little or no enhancement. The value of a mill per full time equivalent student in Monroe County, for example, is $699.40, compared to $38.66 in Union County.

Recent case law, *St. Johns County v. Northeast Florida Builders Association*, 599 So. 2d 363 (Fla. 5th DCA 1990), however, challenges the prevailing view on equal funding for each student in Florida. The Courts allowed St. Johns County the authority to impose a school facilities impact fee on new residential construction, saying: "The Florida Constitution only requires that a system be provided that gives every student an equal chance to achieve basic educational goals prescribed by the Legislature. The constitutional mandate is not that every school district in the state must receive equal funding nor that each educational program must be equivalent. Inherent inequities, such as varying revenues because of higher or lower property values or differences in millage assessments, will always favor or disfavor some districts." In view of this decision, the judicial constraints on future design of school finance is yet to be determined.

Homestead Exemption

As previously noted the $25,000 homestead exemption causes many local governments to receive no tax revenue from a significant percentage of homesteads which receive public services. In 1990, 43 of 67 counties had 30% or more of the total residential value off the tax rolls and 21 counties had 50% or more off the tax rolls. A heavier tax burden is thus shifted to the non-exempt property. Certainly the homestead exemption needs to be retained to moderate the regressivity of the property tax; however, the Commission believes that equity dictates that, since all homes receive services, all should make some contribution, with some legislatively-created safety net for low income persons.

The Commission has placed on the *Constitutional Calendar* for further discussion a proposal to exempt 50% of the first $50,000 of the assessed value of homesteads. In other words, a home assessed at $26,000 would be taxed on $13,000 of its taxable value, while a home assessed at $50,000 would be pay taxes on $25,000 of the value. The proposal would call upon the Legislature to define the parameters of "safety net" for low income persons. The exemption would decrease for homes valued above $200,000 and totally phase out above $250,000.

Special Districts

In an effort to provide more accountability, a periodic review of special districts is necessary to determine if services being provided are in the best interest of the public. The *Legislature should provide* the legislation necessary to require the review and enact the evaluation criteria necessary to ensure a complete and uniform review. In addition, the special acts which create and amend such districts must be codified to clearly identify under which laws the special district entities are allowed to operate.

Findings & Recommendations

The full text of the budget reform proposals summerized in Chapter 2 can be found in the Commission's first report entitled A **Program for Reform of Florida Government.**

Repeal of State Tax Exemptions

Findings

The Florida Taxation and Budget Reform Commission finds:

1 After its inception in 1949, the sales tax quickly became Florida's dominant and most acceptable funding source for the state's major public services.

In the 1990-91 fiscal year, total sales tax was $8.436 billion or 34.7% of state revenues. Of this amount, $7.176 billion was deposited in the General Revenue Fund, the major funding source for education, health and social services, and public safety. Sales taxes accounted for 67.8% of general revenues.

2 Although the sales tax generates substantial funding for state government, annual growth in collections is subject to dramatic fluctuations and often does not keep pace with growth in Florida's economy.

During the 1975 recession, sales tax collections grew only 0.3%, but experienced two years of 18% increases after the recovery from the recession. For the first time since 1949, sales tax collections actually dropped in 1990-91 from the prior year by 1.8%. For fiscal year 1991-92, collections are projected to increase by only 2.6% over the prior year.

3 Florida has experienced structural changes in the economy and in consumer spending patterns and a serious erosion of its sales tax base resulting from increased exemptions.

Taxable sales as a percent of gross sales (as reported on sales tax returns) has declined from 52.4% in 1970 to 46.2% in 1988-89.

Spending on taxable items as a percent of total consumer spending (measured by disposable personal income less savings) has declined from 88.6% in 1970 to 70.3% in 1990.

The vast majority of sales taxes stems from the sale of goods because current law does not tax the sale of professional, insurance, and personal services. The Florida economy, however, has been shifting from a "goods-based" to a "services-based" economy. Growth in the service sector, as measured by employment in the service industries, averaged 21% in the 1960s. It is expected to average 48% in the 1990s.

4 The sales tax is an efficient tax source to administer.

Total administration, collection, and enforcement costs were only 66 cents per $100 of sales tax collected in fiscal year 1990-91.

5 Florida has one of the highest sales tax rates in the nation which limits its ability to raise future revenues by sales tax rate increases.

Florida's sales tax rate of 6.0 percent (an additional 1.0% is levied by 23 counties) is exceeded by only four states (Nevada and Washington at 6.5%, and Illinois and Texas at 6.25%).

6 The value of sales tax exemptions surpasses collections.

The estimated value of goods and service exemptions from the sales tax exceeds $9.484 billion, an amount 12% higher than the $8.436 billion of total sales taxes collected in the 1990-91 fiscal year.

7 Florida's business tax base is very narrow and discriminates among businesses based on type of organization.

Repeal of State Tax Exemptions Findings (continued)

Subchapter S corporations, master limited partnerships, partnerships and sole proprietorships are exempt from the corporate income tax. Based on federal data, there are at least 168,000 S corporations, 12,600 limited partnerships, 82,000 partnerships, and 684,000 sole proprietorships in Florida.

Out of 325,000 corporations mailed returns by the Department of Revenue, only 225,000 (69%) file corporate returns. Of those 86,000 (26%) remit taxes, with only 66,000 (20%) corporations paying in excess of $100. Approximately 2.5% of corporations pay 90% of corporate income taxes.

8 Because of corporate tax law changes at the federal level, Florida has experienced a significant erosion of its corporate tax base.

Since the Tax Reform Act of 1986, over 44,000 firms have changed their status from C corporations to S corporations, master limited partnerships, or other forms of business organization that are exempt from the Florida corporate income tax. Since Florida has no personal income tax, this income escapes taxation in Florida, creating a tax inequity among types of business organizations.

Over the last decade, corporate taxes have declined as a percent of general revenue from 9.6% to 6.7% in fiscal year 1991-92. This has resulted from an actual decline in corporate tax receipts and not from slow growth relative to other tax sources. Over the last three fiscal years, corporate income tax collections were $898.5 million in 1988-89, $808.1 million in 1989-90, and $701.6 million in 1990-91.

9 Florida's complex web of business tax exemptions has no rational basis and results in many violations of the principle of maintaining a "level playing field."

For example, banks and savings and loan associations can credit their intangibles tax liability against their corporate tax liability while other types of businesses cannot. Insurance companies can credit their corporate tax liability against the insurance premium tax; however, other businesses cannot credit their corporate tax liability against other business taxes. Many retail businesses are subject to corporate income taxes and intangibles taxes on accounts receivables and must also collect and remit sales taxes.

10 While a number of existing tax exemptions can be justified on an individual basis, the overall structure of tax exemptions is not based on the systematic application of rational criteria consistent with the High Quality Revenue System Criteria used by the Commission in its evaluation of the state tax structure. Consistent application of these criteria would create a tax structure that would be equitable, neutral, reliable, adequate, exportable, accountable, administrable, and acceptable.

The following are just a few examples of inconsistent or irrational exemptions which not only confuse taxpayers but also complicate tax administration and enforcement for the Department of Revenue and make compliance more difficult for businesses:

Mineral water (minerals added) is taxable but mineral water (in natural state) is exempt.

Dog food is taxable as is food for zoo animals but feed for race horses is exempt.

Plastic sticks sold to bars for one time use are exempt, but other one time use items such as toothpicks, placemats, and menus sold to restaurants are taxable.

Chocolate drink is taxable, but Ovaltine isn't.

Insect repellent is taxable while ointments for insect bites are exempt.

Recommendations

It is the intent of the Taxation and Budget Reform Commission to improve the overall equity and reliability of the Florida tax structure in a revenue neutral context. Therefore, it is the intent of the Commission that any increase in revenue generated by this proposal shall be offset by a corresponding reduction in state taxes.

The Florida Taxation and Budget Reform Commission recommends:

1 That the Legislature abolish the following tax exemptions: the sales tax exemption for professional, insurance, and personal service transactions, except payments for personal services by employers to employees; all other sales tax exemptions, except those for the basic necessities of food, medical prescriptions, hospitalization, and housing; all exemptions from beverage, tobacco, pari-mutuel, motor fuel, gross receipts, and motor vehicle license taxes.

2 That the intangible tax credit for banks and savings and loan associations be reviewed for the purpose of determining whether it meets the criteria established in paragraph 7.

3 That the corporate tax exemptions for subchapter S corporations and partnerships be abolished.

4 That sales and purchases by non-profit institutions or organizations which are exempt under the existing general law shall remain exempt from the sales tax provided that such institutions or organizations:

a. serve a religious, charitable, educational or other exempt purpose under 501 (c) of the Internal Revenue Code of 1986 as amended by any successor statute;
b. have no part of net earnings inure to the benefit of any person, corporation, or shareholder;
c. upon dissolution, distribute all remaining assets to another non-profit organization or to the state.

This exemption shall not apply to those transactions stemming from unrelated business income. Non-profit institutions or organizations shall include, but shall not be limited to: homes for the aged, nursing homes, hospices; and religious, charitable, scientific, educational, artistic, and veterans' institutions and organizations as defined by existing general law.

5 That the definition of utilities subject to taxation under the gross receipts tax for utility services be reviewed to possibly include charges for: water, sewer, solid waste, cable television, pay-per-view and closed circuit broadcasts, and telecommunications charges for fiber optic transmissions, 900 call service, and electronic information services, according to the criteria provided in paragraph 7.

6 That sales and purchases by religious institutions remain exempt from the sales tax except for those transactions stemming from unrelated business income.

7 That the Legislature adopt the following criteria to be used as the sole basis for granting state tax exemptions:

a. The exemption is required by the U.S. Constitution or federal law.
b. The exemption is necessary to maintain a "level playing field" between Florida and non-Florida businesses and among Florida businesses.
c. The exemption is necessary to stimulate job formation or prevent the loss of jobs within the state of Florida.
d. The exemption is necessary to reduce the regressivity of the Florida tax structure.
e. The exemption is necessary to avoid double taxation or "tax pyramiding."

Comprehensive Taxation of Business

Findings

The Florida Taxation and Budget Reform Commission finds:

1 That all businesses consume public services, regardless of form of organization, and should contribute to their cost based on some measure of benefits received.

The Governor recommended and the Legislature enacted a joint resolution permitting a corporate income tax with a $5000 exemption in recognition of the fact that businesses are entities that consume public services and should contribute to their funding. The constitutional amendment authorizing the corporate income tax was approved by the voters of Florida on November 2, 1972.

Value-added is the best available measure of business size and activity and as such is representative of the governmental services consumed by a business. The value added by a particular business is the additional value which that business firm adds to the value of the materials and inputs it purchases from other businesses. As such it represents the incremental contribution of each business to total business activity and is therefore representative of that business's consumption of public services.

2 The burden of Florida taxes is not fairly distributed among businesses.

The corporate income tax is the state's main tax on businesses; however, only C corporations are required to file corporate income tax returns. Businesses organized as subchapter S corporations, partnerships, and sole proprietorships are exempt from the tax. These businesses account for over 945,000 businesses operating in Florida, over four times the 225,000 C corporations filing corporate income tax returns. Of those corporations filing corporate income tax returns, only 2.5% of corporations pay over 90% of corporate taxes.

3 Corporate income tax collections do not provide a stable or reliable source of revenue.

During the last recession, growth in Florida corporate income taxes was only 4.2% in 1981-82 and 1.1% in 1982-83. The increase in collections in 1988-89, however, jumped up to 12.5%. This growth was short lived and followed by two successive years of declining collections, a 10.1% decline in 1989-90 and a 13.2% drop in 1990-91. As a percent of general revenue, corporate income taxes have declined from 9.6% in 1980-81 to 6.7% in 1991-92.

During the previous recession, in fiscal year 1981-82, total state taxes nationwide increased by 5.3%, but corporate income tax revenue was 6.1% below that of the previous year.

4 Florida's complex web of business taxes and tax exemptions, allowances and credits has no rational basis and results in many violations of the principle of maintaining a "level playing field."

Insurance companies are subject to insurance premium, corporate income, and intangible taxes; however, they can deduct their intangible tax and corporate tax liabilities from their insurance premium tax liability.

Banks and savings and loan associations are also subject to corporate income taxes and intangible taxes; however, they can deduct their intangible tax liability, up to 65% of their corporate liability, from their corporate income tax.

Corporations, other than insurance companies and financial institutions, receive no offset for either their corporate tax liability or their intangible tax liability.

Comprehensive Taxation of Business Findings (continued)

5 A broad-based, single rate value-added tax would provide a more stable source of revenue than the corporate income tax.

A value-added tax is computed using total business activity and input costs, not profitability, which is more cyclical. The value-added tax base also includes the service-producing sector, which is expected to experience much faster growth than the good-producing sector of the economy. The service sector would pay 24.3% of a value-added tax compared to 6.7% of the current law corporate tax and 14.4% of the combination of the existing corporate income tax, sales taxes on business equipment and utilities, and the intangible tax on business.

The Florida Multitax Simulation Model by Price Waterhouse estimated the expected growth in current law corporate taxes compared to the growth in an additive type value-added tax (similar to Michigan's tax minus most of the exemptions). By the end of this decade, current law corporate taxes are projected to grow by 24%. A Florida value-added tax is projected to grow 40% over the same time period.

6 A value-added tax does not discriminate among businesses based on industry type or form of organization.

A business tax based on value-added would broaden the tax base to include subchapter S corporations and unincorporated businesses such as sole proprietorships and partnerships which are currently exempt from the corporate income tax. It would eliminate the distortion created by businesses choosing a form of legal organization primarily to gain favorable treatment under the tax laws.

The top marginal tax rate for individual incomes is less than the top marginal rate for corporations providing an incentive for businesses to no longer organize as C corporations and avoid corporate income taxes at both the federal and state levels. This incentive is even more pronounced for Florida corporations because Florida does not tax personal income, allowing the income of these business entities to escape taxation.

7 A value-added tax avoids "tax pyramiding."

With a value-added tax only the value added by each business is taxed. It allows taxes paid at earlier stages in the production process to be deducted from a business's tax liability thereby avoiding the pyramiding of taxes as each business sells goods and services in the chain of commerce. As a result, a value-added tax would avoid the pyramiding inherent in taxing business services under the sales tax.

8 A value-added tax lessens the burden on capital, thereby encouraging investment and economic growth.

A consumption-type value-added tax allows businesses to fully deduct business capital expenditures in the year of purchase. Therefore, the value added represented by capital equipment is not subject to tax until it is consumed in the production process. In effect, the immediate tax deduction granted to users of capital equipment imposes the tax only once on the gross proceeds of the sales of goods and services produced by the capital equipment.

9 The value-added tax is a broad based tax allowing relatively low rates of taxation in comparison to corporate tax rates.

For the 28 states with a single corporate tax rate, rates vary from 3.4% in Indiana to 11.5% in Connecticut, with an average rate of 7.3%. Florida's corporate tax rate is 5.5%. The tax rate for the Michigan Single Business Tax (a tax employing the additive approach to value added) is 2.35%, the same rate as when it was enacted in 1975.

The Florida Multitax Simulation Model estimates that a 2.4% tax on value-added, using the Michigan approach with a $100,000 statutory exemption, would generate $2.7

Comprehensive Taxation of Business Findings (continued)

billion. This amount would be sufficient to replace the corporate income tax, the franchise tax on banks and savings and loan associations, the intangible tax on business, and the sales tax on business equipment and utilities.

10 A value-added tax is economically neutral.

Effective tax rates are relatively uniform across industries. The average effective tax rate for the Michigan Single Business Tax is 1.52%. The effective rate is lowest for the service sector (1.27%) and highest for the automobile industry (1.76%). The effective tax rates are lower than the statutory tax rate because of the deduction for capital purchases and various exemptions and credits for small businesses and labor intensive businesses.

In contrast, the effective rates for Florida's insurance premium tax vary from a low of 0.33% for Florida based life insurance companies to 1.79% for foreign accident and health insurance companies. The statutory rate is 1.75%.

Recommendations

It is the intent of the Florida Taxation and Budget Reform Commission to improve the overall equity and reliability of the Florida tax structure in a revenue neutral context. Therefore, it is the intent of the Commission that any increase in revenue generated by this proposal shall be offset by a corresponding reduction in state taxes.

The Florida Taxation and Budget Reform Commission recommends:

1 That the Commission continue its discussion and investigation of this issue for the purpose of obtaining testimony in the public hearings regarding its proposed recommendations.

LEGISLATIVE

2 That the Legislature determine whether the current system of multiple business taxes should be replaced with a single comprehensive business tax based on value-added applicable to all business entities regardless of industry or form of organization, with the tax reflecting the fact that a business receives services from government and should bear its fair share of the cost thereof.

3 That the Legislature determine whether current business taxes should be repealed effective July 1, 1993 to achieve revenue neutrality while embracing the concept of a single comprehensive business tax.

4 That the Legislature determine whether small business, which is currently paying some business taxes, should pay some minimum tax to reflect the repeal of such taxes.

5 That the Legislature explore the specific ramifications of this proposal with the following considerations in mind:

a. There should be incentives to business development in Florida.

b. There should not be adverse impact on Florida based businesses as compared to out-of-state based businesses.

c. There should be no discriminatory impact on specific industries, and, in this regard, the impact on the banking/financial and insurance industries must be examined with care.

d. There should be an elimination of pyramiding.

Limited State Income Tax

Findings

The Florida Taxation and Budget Reform Commission finds:

1 Over the last twenty years, the State of Florida's revenue structure has not been able to keep pace with growth in the economy without several rate and base changes.

The Crossroads Report (1990) by the Florida Chamber noted that over the last decade there have been 52 changes in Florida's tax laws. Had those changes not been made, general revenue taxes as a percent of income would have declined from about 4.1% to 2.9% in 1990-91 (according to an analysis by the Senate Finance & Tax Committee).

2 Sales tax revenues are highly volatile and sensitive to fluctuations in the economy.

Since 1970, taxable sales (which measures the growth in the tax base excluding the effects of tax rate increases) have increased at an annual average of 10.5%. Fluctuations in yearly increases are dramatic, however, ranging from a low of only 0.3% in 1974-75 during the recessionary trough to a high of 18.4% in 1978-79 when the nation recovered from the 1975 recession, a difference of 18 percentage points.

3 Personal income would provide a more stable and reliable tax base than taxable sales. Its annual average rate of growth is not only higher than taxable sales, but it is less sensitive to the business cycle.

During an economic downturn the rate of growth of personal income drops less than taxable sales and its rate of growth during the recovery is slightly less. Both of these trends would improve Florida's financial situation by providing more money to fund public services during recessions and slightly less money than the current tax structure during recovery periods, lessening the tendency to fund new programs which cannot be sustained during the next slowdown in the economy.

Since 1970, personal income has grown at an annual average rate of 11.6 percent, a full percentage point higher than the growth rate for taxable sales during the same time period. Besides experiencing a higher rate of growth, personal income growth was much more stable over the last twenty years, ranging from a low of 7.2 in 1990 to a high of 17.4 in 1973, a difference of only 10.2 percentage points. In 1974-75, when growth in taxable sales was virtually nil (0.3%), the growth in personal income was 8.2%.

4 Sales taxes tend to be regressive because lower income individuals spend a greater portion of their income than do high income individuals who contribute to savings or other investments.

Florida has mitigated this effect somewhat by exempting food, prescription drugs, and other necessities from the tax. Nevertheless, all studies of the incidence of taxes in Florida have consistently shown a higher effective tax rate for low income groups than high income groups, although the estimated degree of regressivity varies substantially. A useful summary statistic is the ratio of the effective tax rate for the lowest income group to the effective tax rate for the highest income group, the higher the ratio the greater the regressivity.

The Commission's tax simulation model estimated the sales tax burden for families with income less than $10,000 to be 5.9% of their income. The comparable figure for families with incomes between $100,000 and $200,000 was 1.7%. The ratio between the upper income group and the lower income group was 3.5. The

Limited State Income Tax Findings (continued)

regressivity ratio for five previous studies of the incidence of Florida taxes ranged from 1.3 to 5.5.

5 Applying the ability-to-pay principle of tax equity, an income tax would improve the overall equity of Florida's tax structure.

Enacting an income tax, while holding the total tax burden constant, would decrease the tax burden of low income groups relative to the tax burden of higher income groups.

The tax simulation model showed that families with income less than $75,000 per year would pay less taxes with a 2.6% income tax (based on federal adjusted gross income) and a sales tax rolled back to 4%, than they currently pay under the existing 6% sales tax. Families with incomes less than $20,000 would experience a 32% reduction in taxes paid dropping from $662 to $452 annually. Families with incomes between $100,000 and $200,000 would experience a 6% increase in taxes. The average family's taxes would decrease from $1,314 to $1,268 per year, or a 3.5% decrease.

6 An income tax with a flat tax rate and a large standard deduction would result in a progressive distribution of the tax.

A generous standard deduction lowers the effective tax rate at the low end of the income scale, but not to the extent that it would discourage persons with relatively high incomes from moving to Florida. The effective tax rate increases as income increases resulting in a progressive tax burden compared to the regressive burden of the sales tax.

The Florida multitax simulation model estimated that the effective tax rate for a 2.6% flat rate income tax on federal adjusted gross income with the following standard deduction: $15,000 for single persons, $25,000 for single head of household, and $30,000 for married persons filing jointly. The effective tax rate ranged from 0.4% for families with incomes between $30,000 and $40,000 to 2% for families with incomes over $200,000.

An income tax would give the state the ability to target tax relief by income groups. In contrast, reducing the regressivity of the sales tax can only be done by exempting necessities for all consumers regardless of income.

7 Florida's tax structure should export a fair share of the tax burden to tourists and the federal government.

Exportability is measured by the extent to which the tax burden is shifted ("exported") onto residents of another political jurisdiction, i.e., out-of-state residents and onto the federal revenue system. Taxing tourists while they are in Florida, taxing corporations which shift taxes to nonresident shareholders in the form of reduced dividends, and using state taxes that are deductible via the federal income tax are alternative ways of exporting the tax burden. The Tax Reform Act of 1986 repealed the deductibility of state sales taxes on federal income tax returns but left state income taxes deductible.

One advantage of Florida's reliance on the sales tax as the dominant revenue source is that the 40 or so million tourists who visit Florida each year contribute to the funding of state government by paying sales taxes on a portion of their purchases: e.g., lodging, restaurant meals, cigarettes, alcoholic beverages, admissions to events and tourist attractions.

The Commission's multitax model estimates that 20.9% of sales taxes are exported to tourists; however, no sales taxes paid by individuals are exported via the federal income tax system because sales taxes are not deductible.

Limited State Income Tax Findings (continued)

8 Holding revenues constant, an income tax would improve the overall exportability of the structure because income taxes are allowed as itemized deductions on individual federal income tax returns.

One-third of Florida residents filing federal income tax returns itemize deductions, with the proportion itemizing increasing as income increases. Tourists, however, would not pay Florida income taxes.

The State of Connecticut used this option when they recently enacted a broad based personal income tax. They decreased their sales tax from 8 to 6 percent. The Florida Multitax Simulation Model estimates that a 2.6% tax on federal adjusted gross income would generate revenues sufficient to roll-back the sales tax rate from 6 to 4 percent (Price Waterhouse, 1991). A four percent sales tax rate would be comparable with the tax rates of Florida's neighboring states of Georgia and Alabama.

9 Spreading the tax revenues to be collected across several tax sources rather than just one keeps the tax rate lower on each source than it would be with more exclusive reliance on one major source of revenue. These lower tax rates in turn lead to greater economic efficiency and less distortion in the market place.

Only four states have a higher sales tax rate than Florida, providing some incentive for individuals and businesses to purchase major items out-of-state or via mail order to avoid taxation. Because out-of-state sales by Florida businesses are exempt from the sales tax, Florida business remains competitive relative to its non-Florida competitors.

The Florida Multitax Simulation Model by Price Waterhouse estimated that 42 percent of sales tax collections are derived from business purchases and therefore indirectly affect the price of Florida goods and services. There should be some concern that the tax rate does not get too far out of line with other states competing in the same regional market area.

10 Enactment of an income tax would give policymakers the ability to reduce the rate of other taxes which are regressive, for example, the property tax or the sales tax.

11 Broad-based taxes with few exemptions can be more efficiently and effectively administered.

Keeping exemptions and exclusions at a minimum requires less personnel for rule-making and technical assistance. Tax laws and rules are more easily understood by tax practitioners and taxpayers alike, thereby increasing compliance and lowering the cost of enforcement.

12 Defining taxable income as federal adjusted gross income gives the state the most control over income tax policy.

Using federal adjusted gross income as the tax base allows the state to determine the standard deduction, itemized deductions, tax rates and tax credits independent of the federal government. This approach minimizes tax windfalls or tax shortfalls like those that were experienced by states who used federal taxable income as the tax base or simply taxed a certain percentage of the federal tax liability as a result of the federal Tax Reform Act of 1986.

Twenty-six states conform to federal definitions of sources of income as well as adjustments to income such as Individual Retirement Accounts.

Limited State Income Tax (continued)

Recommendations

It is the intent of the Florida Taxation and Budget Reform Commission to improve the overall equity and reliability of the Florida tax structure in a revenue neutral context. Therefore, it is the intent of the Commission that any increase in revenue generated by this proposal shall be offset by a corresponding reduction in state taxes.

The Florida Taxation and Budget Reform Commission recommends:

1 That the Constitution of the State of Florida be amended to permit a limited tax on personal income to improve the equity, reliability, and balance of the tax structure of the State of Florida.

2 To lessen the regressivity of Florida's tax structure and minimize economic disincentives, the income tax should be broad-based, exclude a subsistence level of income, and use a flat rate structure.

3 For ease in administration and compliance, the tax base or definition of income should be linked to the federal code. Taxable income should be defined as federal adjusted gross income minus the following standard deduction: the first $15,000 of income for an individual, the first $25,000 of income for a single head of household, and the first $30,000 for married persons filing jointly.

4 The tax structure should avoid itemized deductions because they require a higher tax rate, disproportionately benefit upper income taxpayers, and they discriminate among taxpayers with equal incomes but different consumption patterns.

5 That one of the following amendments to article VII, section 5 of the state constitution, to be further refined, be submitted to the electors of Florida at the general election to be held in November 1992:

Option One: Removes the constitutional prohibition against the income tax, caps the tax rate, and specifies a standard deduction amount.

Option Two: Removes the constitutional prohibition against an income tax.

Option Three: Removes the constitutional prohibition against the income tax, caps the tax rate, and exempts owners of homestead property from ad valorem taxes contingent on passage of a state income tax, and requires reimbursement of local governments.

State Revenue Cap

Findings

The Florida Taxation and Budget Reform Commission finds:

1 Twenty-two states have enacted state revenue or spending limitations.

These states enacted limitations over a period of eight years. Fifteen states adopted caps in the late 1970s (1976 to 1979), and the remaining seven adopted caps in the early 1980's (1980 to 1984). According to Steven Gold of the National Conference of State Legislatures, many states adopted constitutional spending caps to prevent more drastic citizen initiatives from going on the ballot. For example, Florida's Proposition 1, which was put on the ballot in 1984 and later removed by Florida's Supreme Court.

2 Most state revenue/spending limits have had little effect on state spending.

3 Limiting revenues is preferable to limiting appropriations because appropriations do not always reflect actual expenditures.

First, appropriations include several interfund budget transfers and other accounting adjustments which result in a large difference between what is appropriated and what is actually spent. Appropriations have exceeded actual expenditures by $500 million to $1.3 billion per year over the last decade. State officials cannot use budget gimmicks as easily to circumvent a revenue cap as they can with a spending cap on appropriations by shifting funds, etc.

Likewise, actual expenditures exceed revenue collections. Most often this results from the issuance of state bonds. A $300 million bond issue would allow the state to finance $300 million worth of state facilities; however, the $300 million expenditures would be paid for through $30 million of actual state revenues for debt service in that year contributing to an excess of expenditures over revenues of $270 million in the year of issuance. Of course, the remainder of the cost of the project is financed by the expenditure of $30 million debt service per year over the next twenty-five years.

4 A spending limitation should allow appropriations for state capital outlay to be amortized over a period not to exceed 25 years and make debt service subject to the cap.

5 A revenue/spending limitation should include all state revenues, except federal funds, and cover all program areas.

Federal revenues received by the state are dependent on the actions of the federal government. Federal funds for Medicaid, unemployment compensation, etc. increase in economic downturns. A cap on revenues, including federal funds, could stop the state from spending federal funds in such critical times. However, state revenues to match the federal funds would be subject to the cap. If the expansion of the federal program were substantial, it is possible that the revenue cap would have to be exceeded to allow the state matching funds to increase correspondingly.

All state revenues must be included to prevent budget officials from earmarking funds or transferring funds from the capped revenue sources to the exempt revenue sources. This means that Florida should place both general revenue and trust revenues under the cap.

6 A constitutional limitation on revenue/spending should have an override provision which allows the cap to be exceeded for bona-fide fiscal emergencies but does not allow the cap to be circumvented.

State Revenue Cap Findings (continued)

Fiscal emergencies can result in nondiscretionary increases in spending which would require the cap to be exceeded or other programs to be cut in order to obtain the necessary funds. Examples are economic recessions creating a large increase in unemployment or welfare payments, natural disasters such as hurricanes requiring emergency aid or government facilities to be rebuilt, and court orders requiring large increases in spending, such as federal court orders regarding prison medical care or county jails.

Many states require an extraordinary vote of the Legislature to declare an emergency. Some states require the concurrence of the Governor. Another approach used by a number of states is to require a two-thirds vote of the legislature to approve specific appropriations in excess of the cap.

A New York task force (Legislative Commission on Public/Private Cooperation, 1990) recommended an emergency provision allowing the cap to be exceeded by a two-thirds vote of the Legislature only in cases involving natural disasters or economic recessions for programmatic areas directly related to the emergency such as disaster relief, civil defense, or public assistance costs.

7 A revenue/spending limitation should require a provision specifying the disposition of revenues in excess of the capped amount.

Excess revenues could first be deposited in a reserve or contingency fund, such as Florida's Working Capital Fund, up to a certain percentage of the prior year's spending. The National Association of State Budget Officers recommends a reserve of 5% of the prior year's recurring spending. Remaining revenues, if the balance in the reserve fund is at the capped amount, could be used for tax reduction. Examples are reducing the local share of property taxes to fund education or rolling back a state tax rate. With no personal income tax it would be difficult for the state to send a tax refund check to each Florida taxpayer.

Since growth in Florida's revenues is highly sensitive to economic cycles, it would be prudent to deposit revenues in excess of a revenue cap in the Working Capital Fund for later use to minimize program cuts during the next economic downturn. This would make more sense than refunding taxes in one year, only to make large budget cuts in a succeeding year. Revenues that exceed the cap by more than a certain percentage (2% for example) could be used for tax reduction.

8 A revenue limitation must mandate the appropriate data sources from which the revenue base and the expenditure base should be calculated so there is consensus regarding the capped amount.

For example, the cap should specify that annual increases in spending cannot exceed the growth in Florida's nominal personal income for the prior three years as published by the U.S. Bureau of Economic Analysis.

9 A cap should make some provision for the treatment of cases where there is a transfer of responsibility for government programs.

Half of the states with limitations have provisions for the transfer of program responsibility. Most make adjustments to the revenue limit or the spending limit if funding sources are moved from sources covered under the limit to sources exempt from the limit. Revenue from exempt sources that is moved to nonexempt accounts shall come under the limit, or if a program is transferred to local government, then the spending cap has to be reduced by an equivalent amount. Likewise, a program transferred to states by the federal government

State Revenue Cap Findings (continued)

would require an increase in the spending limit to incorporate the mandated program in the spending base.

10 A cap should be resubmitted periodically to the voters (every ten years, for example) to allow for revisions in the formula.

Recommendations

The Florida Taxation and Budget Reform Commission recommends:

1 That the Florida Constitution be amended to limit total state revenue in any given fiscal year excluding federal funds to a specified percentage of the state's economy as measured by total state personal income.

2 That this amendment be resubmitted to the voters for retention or rejection every ten years.

3 That the revenue cap be adjusted for the transfer of governmental functions between levels of government.

4 That state revenue in excess of the cap shall be transferred to a surplus revenue fund or refunded to state taxpayers.

Improving Taxpayer Compliance

Findings

The Florida Taxation and Budget Reform Commission finds:

1 Significant audit coverage is essential in developing a tax system that is fair and equitable to the citizens of the state and insuring that all citizens pay their required taxes. Current audit coverage for the Department of Revenue is approximately 2%.

Audit coverage of 4% is the generally recommended standard for effectively deterring abuses.

2 Efficient collection of revenues is an important element in administering the current tax laws and could assist in maximizing tax collections and filling tax gaps.

The current electronic data processing systems at the Department of Revenue are outdated and incapable of handling the massive burden of efficiently collecting the state's revenues. The productivity of the Department of Revenue is suffering and its ability to maximize tax collections is greatly hindered. State-of-the-art equipment would assist the Department in efficiently managing operations and identifying individuals who do not comply with the law.

3 There is an estimated tax gap of $196 million in the collection of intangible tax on personal property, much of which is related to the failure of approximately 2/3 of the stockbrokers and security dealers to report to the Department of Revenue as required by law.

4 Information sharing between the Department of Revenue and local governments would assist in narrowing the tax gap and enhancing compliance with current tax laws.

Sharing information regarding registered taxpayers could help with the collection of the estimated $1.5 billion in taxes that is currently uncollected, $750 million of which is in uncollected sales tax.

Recommendations

The Florida Taxation and Budget Reform Commission recommends:

1 That the audit coverage of the Department of Revenue be expanded to provide a clear deterrent effect.

2 In order to establish an efficient means of revenue collection, the state should consider and, where appropriate, take such actions that would expedite and increase tax collections and provide for an effective system that can keep pace with the growth of the state.

3 That the Legislature should adopt stricter penalties on stockbrokers and security dealers who fail to provide client listings to the department in a timely manner.

4 That the Legislature adopt a provision which provides for the sharing of information between the Department of Revenue and local governments.

5 That the Legislature review the electronic data processing and management information systems of the state to determine whether an integrated data processing system can be implemented that will effect more efficiency in state government operations, including not only the collection of revenue but also the provision of services.

Taxpayers' Bill of Rights

Findings

The Florida Taxation and Budget Reform Commission finds:

1 The procedures and policies of the Florida Department of Revenue affect over 2.2 million Floridians who conduct business or maintain investments in Florida.

The Department of Revenue administers an annual budget of $121 million and employs 2,644 people to collect $13 billion in taxes each year by processing 6.5 million tax returns.

Over 1.4 million taxpayers pay intangible taxes on items such as stocks and bonds, 347,000 pay corporate income taxes and sales taxes are collected by 436,000 vendors in Florida. In addition, other taxes such as those on motor fuels, certain documents, insurance premiums, estates, mineral severance, and oil and gas are collected.

Florida leads the nation in the formation of new businesses. In so doing, the Department of Revenue experiences a considerable number of new taxpayers on an annual basis to whom Florida tax laws and administrative rules must be explained.

2 The administration and enforcement of Florida's tax system is highly dependent on the voluntary compliance of taxpayers.

Of total taxes collected, 95% are remitted by voluntary compliance. According to the Florida Department of Revenue, 40% percent of non-compliance results from taxpayer misunderstanding rather than willful violation of the tax laws. Increased complexity in tax laws requires that taxpayers more fully understand their tax obligations in order to maintain and enhance voluntary compliance.

3 Laws regulating taxpayer rights and responsibilities in dealing with the Florida Department of Revenue are contained in several sections of the Florida Statutes and are generally in technical language. An integrated codification of these rights and responsibilities in laymen language would bolster public confidence in the fair administration and application of Florida's tax laws.

Toward achieving this goal, the Florida Legislature created a Taxpayers' Bill of Rights Task Force in 1989. This nine member body drafted legislation for a proposed Florida Taxpayers' Bill of Rights.

This legislation spells out, in non-technical language, a list of rights and responsibilities which can be readily comprehended by citizens and agency personnel alike. It would demystify and codify laws, protect taxpayers and ensure equitable, impartial collection practices.

4 In 1988, Congress passed a federal Taxpayer Bill of Rights. Since the federal action, twelve states have enacted taxpayer bill of rights legislation with a number of other states putting similar measures in place administratively.

5 The federal government has the same statute of limitations (three years) for both audits and tax refunds.

Florida law also had this provision until legislation enacting a tax amnesty and the sales tax on services passed in the 1987 regular session. This legislation increased the statute of limitations for audits to 5 years. When the services tax was repealed in a special session in December of 1987, however, the 5 year statute of limitations for audits remained. (section 95.091, F.S.)

Section 214.16, F.S. limits claims for tax refunds to three years.

6 At the federal level, taxpayers must pay interest on overdue assessments. Likewise, the federal government pays interest on money owed to taxpayers over a certain length of time.

Taxpayers' Bill of Rights Findings (continued)

Under current law and rules of the Department of Revenue, taxpayers are liable for interest at the rate of 12% per year for underpayment of taxes. The State of Florida pays interest on refunds or overpayment of taxes; however, this is only for corporate tax refunds paid more than ninety days from the date upon which the taxpayer files a written notice advising the department of the overpayment (s. 214.14, F.S.).

Recommendations

The Florida Taxation and Budget Reform Commission recommends:

CONSTITUTIONAL

1 That the Florida Constitution be amended to require a Florida Taxpayers' Bill of Rights.

LEGISLATIVE

2 That the Legislature shall include the following provisions in the Taxpayers' Bill of Rights:

a. the right to available information and prompt, accurate responses to questions and requests for technical assistance;

b. the right to obtain simple, non-technical statements which explain the procedures, remedies, and rights available during audit, appeals, and collection proceedings;

c. an equal time period for audit assessments and refund of overpayment of taxes;

d. the right to have the state tax collection agency begin and complete its audits in a timely manner after notification of intent to audit;

e. that interest be paid on all tax refunds not made in 90 days from the date of application;

f. the right to request assistance from a taxpayers' rights advocate who shall facilitate the resolution of taxpayer complaints and problems not resolved through normal channels, including any taxpayer complaints regarding unsatisfactory treatment by employees of the state tax collection agency;

g. the right to assurance that the individual employees of the state tax collection agency are not paid, evaluated, or promoted on the basis of the amount of assessments or collections from taxpayers;

h. the right to be represented or advised by counsel or other qualified representatives at any time in administrative interactions with the state tax collection agency;

i. the right to be informed of impending collection actions which require sale or seizure of property or freezing of assets, except jeopardy assessments;

j. the right to have all other collection actions attempted before a jeopardy assessment unless delay will endanger collection, and the right to have an immediate review of the jeopardy assessment;

k. the right to procedures for requesting cancellation, release, or modification of liens filed by the state tax collection agency and for requesting that any lien which is filed in error be so noted on the lien cancellation filed by the agency in public notice and notice to any credit agency at the taxpayer's request; and

l. the right to refund of taxes declared unconstitutional by the court of final jurisdiction.

State Revenue and Expenditure Projections

Findings

The Florida Taxation and Budget Reform Commission finds:

1 Article XI, section 6 of the constitution requires the Taxation and Budget Reform Commission to examine the revenue needs of the state.

2 Forecasts have been developed using four methodologies.

General revenue growth was projected to the year 2000 based upon the following:

a. Growth in the Consumer Price Index plus population;

b. Current law/current administration plus inflation and constituency growth. Increases in case load, student population, Medicaid and Aid to Families with Dependent Children is incorporated. The assumed General Revenue level of funding of K-12 is 54.3% of the total funding requirement indicated by the Department of Education (this is the same as the 1991-92);

c. Personal income growth; and

d. Growth patterns of the corresponding years in the previous decade.

Four revenue options were then applied to the four projection methodologies:

a. Current utilization of the sales tax only

b. Current sales tax plus 1987 services tax

c. Current sales tax plus 1987 services tax plus expanded corporate income tax to include sub-chapter S corporations and partnerships

d. All that is in (c.) plus 2.5% personal income tax on federal adjusted gross income

Assumption was made that the various forecast scenarios would be funded by one of the various taxing alternatives.

The evaluation of trust fund growth was complicated by the number of trust funds, the methods of funding of the various trust funds, and the difficulty of determining specifically where revenue enhancement occurred in the past decade. The 1991-92 Appropriations Bill shows $17.8 billion in appropriations, yet estimated revenues are $13.1 billion. The difference is comprised of bonding proceeds and double-budgeting in the appropriations process. There is, however, no document which clearly identifies all the sources of funds, whether revenues, bond proceeds or interfund transfers. To estimate "trust funds" available, the current year appropriation of $17.8 billion was selected as the beginning level. The amounts projected for subsequent periods were calculated from that beginning point by the same percentage of growth which was projected by the Revenue Estimating Conference to forecast trust fund revenues. The projected funds available were then compared to a projection of trust fund appropriations based upon the growth pattern of the previous decade. The projected deficit was combined with the General Revenue deficit obtained by the same methodology.

3 The Revenue Forecasts are from the October 1991 Revenue Estimating Conference. The General Revenue (GR) projections utilized do not include the impact of any future recessions. Projections which consider future recessions suggest revenue shortfalls of $1 billion, $1.2 billion and $800 million over a three year period.

4 The Working Capital Fund is currently $195 million (approximately 1.7% of the $11,539.3 million of GR originally estimated for the 1991-92 Legislative Appropriations). Approximately $600 million would be required to provide five percent of the current 1992-93 GR estimate.

State Revenue and Expenditure Projections Findings (continued)

5 In the past decade (1982-83 through 1991-92) state government appropriations have increased from $10.547 billion to $29.476 billion or 179%. During this same period, population increased thirty percent and the Consumer Price Index increased forty-one percent. Since 1988-89 the state has experienced budget shortfalls of $91.1 million, $435.3 million, 952.7 million and $621.7 million (the impact of the current budget shortfall is not contemplated in these forecasts). From 1981 through 1990 the state enacted taxes and fees in each Legislative Session to add new revenues of $3,892 million. The state budget includes approximately $5.6 billion in federal funds. Any future reduction in these funds would potentially affect state funding needs or program delivery.

6 If state spending continues until the end of this decade at the same rate as the corresponding years of the previous decade, significant tax revenue increases would be required. For example, a funding formula of a personal income tax at a 2.5% rate, an expanded corporate income tax at current rates, plus a sales tax on current goods and 1987 services of almost 11 % could be required for one of the shortfall projections.

Projected State Revenue & Spending Deficit

($ in billions)

GENERAL REVENUE FUND	1993	1994	1995	1996	1997	1998	1999	2000	TOTAL
Revenue*	$11.73	$12.55	$13.38	$14.19	$14.99	$15.81	$16.76	$17.73	$117.14
Spending Deficit**									
CPI and Population*	$0.62	$0.54	$0.48	$0.45	$0.50	$0.57	$0.60	$0.65	$4.41
Current Law + Inflation + Constituency Growth	$1.51	$1.87	$2.27	$2.73	$3.23	$3.81	$4.36	$4.99	$24.78
Personal Income Growth	$0.84	$1.00	$1.21	$1.48	$1.84	$2.26	$2.63	$3.05	$14.33
Historic Growth Pattern	$1.39	$2.05	$2.58	$3.31	$4.96	$6.98	$9.06	$10.63	$40.97

* *Projections are from the Consensus Estimating Conference forecasts (August 1991).*
** *Projected deficits are based on growth factors indicated.*

Required Sales Tax Rate in the Year 2000 to Fund General Revenue Deficit

($ in billions)

DEFICIT BASED ON THESE GROWTH FACTORS	CUMULATIVE DEFICIT (1993-2000)	OPTION A	OPTION B	OPTION C	OPTION D
CPI + Population	($4.41)	6.30%	5.01%	4.90%	3.21%
Current Law/Inflation/Constituency Growth	($24.78)	8.28%	6.59%	6.48%	4.79%
Personal Income Growth	($14.33)	7.39%	5.89%	5.77%	4.08%
Historic Growth Pattern	($40.97)	10.85%	8.64%	8.53%	6.84%

Option A = Current law sales tax base.
Option B = Current sales tax, plus services tax as adopted and defined in 1987.
Option C = Current sales tax, plus services tax, plus expanded corporate income tax to include subchapter S corporations and partnerships.
Option D = Current sales tax plus services tax, plus expanded corporate income tax; plus 2 1/2% personal income tax on Federal Adjusted Gross Income.

General Revenue & Trust Funds

($ in billions)

	1993	1994	1995	1996	1997	1998	1999	2000	TOTAL
Gen. Rev. & Trust Funds*	$31.11	$33.62	$36.02	$38.40	$40.82	$43.38	$46.21	$49.25	$318.81
GR & TF Spending **	$32.94	$37.58	$41.86	$45.71	$50.77	$57.04	$66.10	$71.18	$403.19
GR & TF REVENUE DEFICIT	$1.83	$3.96	$5.84	$7.31	$9.95	$13.65	$19.89	$21.93	$84.37

REQUIRED SALES TAX RATE IN THE YEAR 2000 TO FUND DEFICIT

A = Current law sales tax base	16.02%
B = Current sales tax, plus services tax as adopted and defined in 1987	12.75%
C = Current sales tax, plus 1987 services tax, plus expanded corporate income tax to include sub-chapter S corporations and partnerships	12.64%
D = Current sales tax, plus 1987 services tax, plus expanded corporate income tax; plus 2 1/2% personal income tax on Federal Adjusted Gross Income	10.95%

* *General Revenue projection from Consensus Estimating Conference forecasts (August 1991). Trust Fund projections based on Consensus Estimating Conference forecasted growth rates, applied to 1991-92 appropriations for trust funds (base year).*

** *Projections reflect historic growth pattern from the 1980s.*

Lottery Funds (with choice)

Findings

The Florida Taxation and Budget Reform Commission finds:

1 In November, 1986, Florida citizens voted to amend their State Constitution to allow creation of state-run lotteries. Voter and legislative intent indicate lottery revenues were to be used to "enhance" education.

A review of lottery proponent's literature, poll results, letters to newspapers legislative hearings and findings of a Florida Chamber of Commerce report entitled The Florida Lottery: A Study of the Intent Behind Its Passage and It's Effect on Education Appropriation Trends (The Florida Lottery Report) conclude that Florida voters intended lottery funds to be used solely to enhance education.

The Florida Public Education Lottery Act, which implemented the lottery constitutional amendment provides "That the net proceeds of lottery games conducted pursuant to this act be used to support improvements in public education and that such proceeds not be used as a substitute for existing resources for public education," s. 24.102(2)(a), F.S.

2 Since inception of the lottery, over $3.3 billion has been appropriated for education; however, lottery funds are being used to fill gaps in the general revenue budget. The existing statutory language is not strong enough to keep the Legislature from using lottery proceeds to supplant, instead of enhance, public education funding.

Inflation, more students, fewer taxpayers per student, and a decline in the annual increase in state personal income per student have all contributed to a deceleration in the rate of growth in real education spending. Because the high rate of student enrollment growth is expected to continue for at least the next five years, funding for education as a percentage of general revenue should be increasing instead of declining. Legislators are aware that lottery funds are being used to supplant sources of revenue normally used to fund education. Several bills intended to prevent this were filed in 1989.

3 The recurring education appropriations as a percentage of total general revenue fund recurring appropriations has significantly declined since the inception of the lottery.

In 1986-87, the recurring education appropriation as a percentage of total General Revenue Fund recurring appropriations was 61.19 percent. That percentage has decreased each year and is 52.78 percent for the 1991-92 fiscal year.

4 The Legislature has adopted a system of school improvement and educational responsibility which returns the responsibility for education to those closest to the students—the schools, teachers and parents. School Based Management is a local management tool which can be used to implement accountability.

"Blueprint 2000," as adopted, provides a comprehensive revision of Florida's system of school improvement. The Florida Commission on Education reform and Accountability was established to recommend details of the program and oversee the development, establishment, implementation and maintenance of an education accountability system. Schools will be required to develop school improvement plans designed to implement state education goals and student performance standards and shall be based on a needs assessment which includes goals, performance standards, strategies and evaluation procedures. To ensure that schools

Lottery Funds (with choice) Findings (continued)

are truly "accountable", School Based Management should be implemented.

5 Directing lottery proceeds to each school will allow the school, teachers and parents to utilize the total lottery proceeds to enhance education in their community.

Placing lottery money into public schools complements accountability. Local schools would choose enhancements and be accountable to the local community for disbursement of funds.

6 Florida's schools need to improve student performance, decrease student dropout rates and disciplinary problems, and provide better overall education for the children of Florida. Providing parental choice in education is seen as a way to increase competition and encourage schools of excellence in providing the service of education.

Recommendations

The Florida Taxation and Budget Reform Commission recommends:

CONSTITUTIONAL

1 The Florida Constitution shall be amended to provide that net proceeds derived from the lotteries and deposited in the State Education Lotteries Trust Fund should be distributed to each public school, community college, and university in the state on a per student basis. Proceeds shall be divided as follows: Public Schools (K-12) - 70 percent, Community Colleges - 15 percent, and Universities - 15 percent.

2 The Florida Constitution shall be amended to require the Legislature to appropriate the proceeds directly to the school districts, with consideration given for minimum distribution to small schools.

LEGISLATIVE

3 By July 1, 1994, the Legislature shall require each public school to implement School Based Management, pursuant to guidelines enacted by the Legislature, to be eligible to receive State Education Lotteries Trust Fund proceeds.

4 Before July 1, 1993, the Legislature shall enact, by general law, guidelines for school boards to use in offering parents choices in the public education of their children. The guidelines should permit a variety of options for school boards, and they shall not prohibit any school board from developing policies that permit intra-district transfers.

State Government Accountability

Findings

The Florida Taxation and Budget Reform Commission finds:

1 Public opinion polls have consistently reported the public perception that government wastes tax money and generally cannot be relied on to conduct public business efficiently.

A poll conducted for Florida TaxWatch in April 1991 indicated that the respondents believed that an average of 36 cents of every tax dollar collected is wasted (this was up from 33 cents when TaxWatch asked the question in 1987). The poll also found that 76% favored a system of performance measures to evaluate agencies' performance and to help determine their budgets and 59% favored "budget reforms" before any new taxes or tax increases are considered. A poll conducted by Florida International University (FIU) in the Fall of 1990 found that 52.5 % believed that state/local government wastes taxpayer money (this was up from 45% in 1989).

Interestingly, the FIU poll (1990) found that citizens are willing to spend more for specific programs or policies which they support. This poll, a survey conducted for the Florida League of Cities (1984) and the Florida Annual Policy Surveys (1986 91), conducted by Florida State University, have also shown that the public prefers to maintain services rather than to reduce taxes. This suggests that the public will support policies, with the provision of adequate funding, when the purpose of the polices and programs are communicated and understood. The Florida League of Cities found that while the public was misinformed about some aspects of city government, there was public support for cities to spend funds as necessary to ensure that the citizens are informed.

2 Two task forces have been established by Florida Governors to review state agencies and programs and make recommendations regarding productivity, program measures, accountability and reporting requirements.

In 1987 Governor Martinez established "Partners in Productivity" which is a cooperative effort between public and private sectors. This initiative, coordinated by Florida TaxWatch and The Florida Council of 100, is to identify cost savings, develop a "government performance and productivity measurement system", and to recognize and reward program efficiencies and innovations. The Productivity Task Force proposed 274 cost-saving measures and management improvements in 1988 89. Currently, Partners in Productivity and officials from each state agency are working to develop program measures which will become the basis for an annual report card. Partners in Productivity and the Governor's Office of Planning and Budgeting are working to link the performance and program measures to the budget process.

Governor Chiles established the Governor's Commission for Government By The People which is to make recommendations to "redesign" Florida government and make it more citizen-oriented. Among the items being considered by the Governor's Commission are "developing an accountability system that evaluates the performance of state government agencies based on how well they serve and the outcome of their activities, ...revamping key management systems in Florida state government—including the budget, procurement, and personnel systems..."

3 Several recent legislative initiatives have focused on performance improvements, accountability and visibility. The three largest state agencies have been the subjects of these reforms.

During 1990, the Legislature passed revenue enhancements (tax increases and bonding

State Government Accountability Findings (continued)

authority) for the Department of Transportation (DOT). Included in this legislation is the requirement that the Florida Transportation Commission, in conjunction with Partners in Productivity, adopt standards for evaluating DOT performance. If the DOT does not meet these standards its funding level may be reduced to the 1989 90 level.

The 1991 Legislature passed a bill reorganizing the Department of Health and Rehabilitative Services. Among other things, this bill requires the development of performance standards, the implementation of "unit cost budgeting" and annual client outcome evaluations. The Department received an appropriation of $750,000 to establish a "unit-cost" budgeting system and is authorized to assess each budget entity an amount not to exceed 0.05 percent of its operating budget to finance the outcome evaluation and program effectiveness activities.

The 1990 Legislature (Ch. 90-288, Laws of Florida) created the Commission to Improve Schools and Simplify Education Reports to establish a system of school improvement and responsibility based on the performance of students and educational programs, and provided an initial outline for such a system. The Commission to Improve Schools and Simplify Education Reports was renamed the Commission on Education Reform and Accountability by the Public Schools Accountability Bill passed in 1991. This commission is, among other things, to recommend performance standards for indicating progress toward state and local goals, methods of measuring progress and a definition of "adequate progress" and methods for reporting progress to the public.

Finally, the 1991 Legislature passed a provision in Chapter 91-282, Laws of Florida, that the Auditor General, when conducting performance audits, shall use Agency Functional Plans to evaluate an agency's performance.

4 The Florida Fiscal Accounting Management Information System (FFAMIS) Act was enacted in 1980. This legislation intended that Florida develop a unified financial management system which would provide accurate and timely information for decision making and management.

FFAMIS is comprised of seven subsystems: accounting, budgeting, personnel, revenue and regulations, banking and collateral securities, purchasing, and investment and debt control. The development of FFAMIS is the joint responsibility of seven agencies. These "functional owners" are the Executive Office of the Governor, the Treasurer, the State Board of Administration, and the Departments of Banking and Finance, Revenue, General Services, and Administration. A representative from each of these agencies comprises the FFAMIS Coordinating Council, which was established to act as the organization's working group. The Fiscal Accounting Information Board, comprised of the Governor, the Comptroller and Treasurer, was created to adopt rules and to issue orders to enforce implementation and compliance with FFAMIS.

5 The Auditor General issued a review of FFAMIS in April 1991. This report recognized the difficulties of developing FFAMIS, but observed that the intended results have not been realized. The report makes recommendations to facilitate the FFAMIS's development.

The Auditor General, in a review of FFAMIS, made several recommendations to facilitate FFAMIS's development. First, FFAMIS support staff should be established in the Comptrollers Office to serve as "data administrator and manager/operator" of FFAMIS. Also, design teams, comprised of the functional owners, the State Comptroller's Office and the Auditor General, should "be appointed to direct the design and implementation of such data gathering systems as are needed to implement FFAMIS." Finally, they

State Government Accountability Findings (continued)

recommended that "the Fiscal Accounting Information Board use their oversight authority to establish an Administrative Committee to actively coordinate and expedite the development of FFAMIS." This last recommendation has been implemented and the committee is in the process of developing an action plan and resource needs for review by the Cabinet.

6 The Governmental Accounting Standards Board (GASB) establishes "generally accepted accounting principles" for state and local governments. In recent years GASB has been encouraging and researching service efforts and accomplishments (SEA) reporting. Information about service efforts and accomplishments would be used to set goals and objectives, allocating resources, and assessing government performance by management, elected officials and the citizenry.

GASB is encouraging state and local governments to develop SEA reporting and is compiling and distributing data on projects and research. The Office of the Auditor General is actively participating with GASB on SEA reporting.

7 The Florida Tax and Budget Reform Commission has made several recommendations and findings related to program and performance measurement, accountability reporting, and FFAMIS.

In February 1991 the Florida Tax and Budget Reform Commission made recommendations requiring:

a. the adoption of performance measures as part of the approved budget,

b. agencies to adopt an annual productivity plan with standards and measures to assess quality and cost effectiveness of agency operations,

c. performance and productivity measures as an integral part of the state budgeting process,

d. the Governor to provide a productivity report evaluating each state agency's performance,

e. the use of a standard set of program evaluation criteria in planning and evaluating processes, and

f. the provision of resources and staff to implement all components of FFAMIS.

The Commission also noted in its findings that a performance and productivity measurement system, among other things, "should be an integral part of the budget process in order to provide a means of tracking the state budget expenditures in order to show how taxpayer resources are being spent and would contribute to increased public confidence in government."

Recommendations

The Florida Taxation and Budget Reform Commission recommends:

1 The Legislature should establish and implement a Commission for Government Accountability to the People, as recommended in the Final Report of the Governor's Commission for Government By The People (Volume II, 1991) to institutionalize the measurement of state government performance.

2 The Commission should be charged with the following responsibilities:

a. Adopt performance and productivity measures to be achieved by government in Florida.

State Government Accountability Recommendations (continued)

b. Audit the performance of agencies in meeting those standards and report its findings publicly.

c. Collect and publish other data relevant to the performance of government in Florida.

d. Review and report on Auditor General recommendations and the status of those recommendations.

e. Evaluate costs and levels of quality of services and recommend to the Governor and the Legislature regarding activities or services to be consolidated, eliminated, or provided by alternative providers such as the private sector, local government, and not-for-profit organizations.

f. Review and recommend improvement in the management structure of the state and its agencies, including consolidation of agencies and/or functions.

g. Review and recommend improvement in the state accounting system to develop a uniform accounting system that relates to the agency functional plan.

3 Previous recommendations of the Taxation and Budget Reform Commission regarding program and performance measures, accountability and FFAMIS should be implemented and then monitored by the Commission for Government Accountability to the People.

Executive Budget Authority

Findings

The Florida Taxation and Budget Reform Commission finds:

1 The case *Children A, B, C, D, E and F vs. Lawton Chiles, as Governor of the State of Florida, et. al.,* caused great concern for the Taxation and Budget Reform Commission. Article VII, section 1 (d) of the Florida Constitution requires a balanced budget, and for many years the Governor and Cabinet had, during times of revenue shortfalls, maintained a balanced budget by acting quickly to make budget reductions as authorized in section 216.221, Florida Statutes. By striking down this provision, the Florida Supreme Court forced the Legislature to meet in special session, at great public expense, to make the budget reductions. This litigation and ruling delayed the budget reductions by approximately 60 days or 16.4% of the fiscal year. The less time remaining in the fiscal year and the less unexpended funds remaining in the budget, the more difficult and painful it is to cut $621.7 million.

2 This court decision is not in keeping with the Commission's findings and recommendations in phase one of its work. In examining the budgeting and spending practices of the state, the Commission made several recommendations to increase the authority of the Executive in order to increase accountability and efficiency. Consequently, on October 23, 1991, the Commission voted to amend its "Executive Budget Authority" budget reform proposal to add the following provision when it was voted onto the Constitutional Calendar.

Recommendations

The Taxation and Budget Reform Commission recommends:

1 Article IV of the Florida Constitution should be amended to allow the Governor and Cabinet to establish and implement all necessary reductions in the state budget, including the legislative and judicial branches, in the event of a revenue shortfall.

General Purpose Local Government Financial Condition

Findings

The Florida Taxation and Budget Reform Commission finds:

1 In the decade of the 1980's county revenues and expenditures grew at annual compound rates of 12.4% and 12.6% respectively. Cities grew at 8.8% for revenues and 9.1% for expenditures.

2 Due to a decline in intergovernmental revenues (federal and state), the growth in expenditures during the last decade was increasingly financed through local sources of revenue.

This is in spite of the fact that all taxing sources except the ad valorem tax are reserved to the state.

3 In 1990, 19 of the 67 counties and 5 of the 394 cities were within less than 1 mill of the 10 mill constitutional cap. This count is estimated to increase to over 39 counties and 92 cities by the year 2000.

The average millage rate levied by counties is 7.79 and by cities is 5.24. Ad valorem revenue in 1990 represented 30.0% of the average county budget and 15.4% of the average city budget. Population growth and the accompanying demand for urban services, plus numerous state and federal unfunded mandates are two of the major reasons for this trend. The rising incidence and cost of crime and escalating costs of indigent health care also have a significant impact, especially on the counties. ("Florida Local Government Revenue and Expenditure Forecasts 1991-2000," September 1991, Kurt Spitzer & Assoc./CFF Assoc.)

4 During the past decade Florida cities and counties lost all federal revenue sharing, experienced reductions in other grant programs, and lost virtually all federal programs which in previous decades funded up to 90% of the capital costs of sewer and water plants.

Cities and counties in 1990 received $146.5 million less federal funds than in 1980.

5 Counties and cities in Florida (in the aggregate) will experience their first collective revenue shortfall by the year 1995 and 1996 respectively. By the year 2000, accumulated revenue shortfalls for counties are estimated to reach $4.6 billion. Cities are estimated to reach a $1.2 billion revenue shortfall. Small counties are experiencing fiscal crisis immediately.

During the next decade counties and cities in the aggregate are projected to consume their existing reserves, entering a period where service levels will no longer be supportable within the projected revenue growth. The pending fiscal crisis will not be felt uniformly; however, some jurisdictions are already in that condition and many more will enter that state before 1995 or 1996. Almost half of the counties have a population of less than 50,000 people, and 19 of these counties had operating millages at or near 10 mills in FY 1990. Some jurisdictions are not forecasted to encounter a fiscal crisis in the 1990's. ("Florida Local Government Revenue and Expenditure Forecasts 1991-2000," September 1991, Kurt Spitzer & Assoc./CFF Assoc.)

6 The property tax is the sole source of taxation reserved to local governments under the constitution. All other forms of taxation are preempted to the state except as provided by general law.

General Purpose Local Government Financial Condition Findings (continued)

Pressures continue to build to use additional property taxes in spite of citizen opposition to this tax. The use of this tax extends beyond the three levels of general purpose governments (counties, cities and school boards) to include special districts. The cumulative totals of all these levies creates a political barrier to tax increases.

7 Local government use of non-ad valorem sources is increasing to meet their service demands; however, their uses are strictly regulated and limited by the Florida Constitution or by the state Legislature.

8 Greater fiscal flexibility for local governments in designing and controlling a tax structure compatible with community needs is necessary.

Demographic, economic, environmental, and social variables are just a few drivers of community demands for services and preference for tax structure. Financing small rural county needs versus larger urban county needs requires diverse alternatives in designing an appropriate local tax structure. This is reflected in the May 1991 Florida Poll by Florida International University. When asked which level of government gave them the most for their money, the 1,043 respondents replied: local - 46%; state - 27%; and federal - 27%.

9 An increase in fiscal flexibility for counties and cities is needed for them to meet the demands of this decade until the year 2000.

The May 1991 Florida Poll by Florida International University, with a sample of 1201, found that only 23.9 % of the sample favored the property tax as a way to increase taxes. Additionally, a 1991 Florida League of Cities Poll, with a sample of 601, found that 67% favored local governments having flexibility as to what taxes they want to levy and how much they want to charge.

Recommendations

The Florida Taxation and Budget Reform Commission recommends:

CONSTITUTIONAL

1 Article VII of the Florida Constitution shall be amended to allow cities and counties to utilize any revenue source, unless such revenue sources are preempted or restricted by general law on or before July 1, 1993. Preemption or restriction of revenue sources after this date shall require the passage of a separate bill by a 3/5's vote of both houses of the Legislature. No preemption or restriction approved after July 1, 1993 shall prohibit cities and counties from collecting revenue from previously enacted revenue sources pledged for the payment of debt service on bonded indebtedness. Provided, however, counties and cities may not levy corporate and personal income taxes, the estate tax, the inheritance tax, the intangible tax, or the severance tax.

LEGISLATIVE

2 The Legislature should provide greater flexible financing tax alternatives to counties and cities to allow local design and control of a tax structure which is compatible with community needs. To provide that flexibility, the Legislature should remove conditions on the levy or utilization of taxation available to cities and counties.

General Purpose Local Government Financial Condition Recommendations (continued)

This includes: removal of restrictions on use of tax sources (e.g. constitutional gas tax requirement that funds be used for debt service, acquisition or construction of roads), requirements for referendums (e.g. Local Government Infrastructure Surtax), or limits on taxes or fees (e.g. occupational license taxes, public service fees).

3 The Legislature should consider the proposed revenue options outlined by the Advisory Council on Intergovernmental Relations.

Pursuant to section 163.705, Florida Statutes, the Advisory Council on Intergovernmental Relations identifies new sources of revenue required to fund the increased cost of, or to offset revenue loss incurred due to the enactment or adoption of any new state program, or increase in the level of services rendered in an existing program, which substantially increases the expenditures of or reduces the revenue or revenue-producing ability of counties or municipalities.

School District Required Local Effort/Discretionary Millage

Findings

The Florida Taxation and Budget Reform Commission finds:

1 In 1973 the Florida Legislature passed the Florida Education Finance Program (FEFP) as the funding formula for the states distribution of dollars to school districts.

2 Each year school boards desiring to participate in the Florida Education Finance Program allocation of state funds for current operation are required to levy a millage rate certified by the Commissioner of Education as the millage rate necessary to provide the District's local portion of funding for that year. This is known as the Required Local Effort. In addition, the Legislature prescribes annually in the Appropriations Act the maximum amount of millage a district may levy as a non-voted current operating Discretionary Millage.

The 1991-92 Required Local Effort for school districts is 6.373 mills and the maximum Discretionary Millage is .510 mills. These amounts change annually pursuant to the Appropriations Act.

3 Section 9, article VII of the constitution permits school districts to levy not more than ten mills of ad valorem taxes upon the assessed value of real estate and tangible personal property.

The Legislature has limited the school districts to less than the allowed ten mills. In an effort to provide equalization of educational opportunity in Florida, the FEFP recognizes:

a) varying local property tax bases;

b) varying program cost factors;

c) district cost differentials;

d) differences in per student cost for educational programs due to sparsity and dispersion of student population.

Though there is an effort to equalize spending, there is still a range of disparity in dollars spent per full-time equivalent (FTE) student.

4 Since school districts are limited by the Legislature in the Required Local Effort and Discretionary Millage levied, there is unused millage capacity in some school districts which can be used to enhance education.

Recommendations

The Florida Taxation and Budget Reform Commission recommends:

1 The Florida Constitution should be amended to allow school districts to levy a non-voted current operating Discretionary Millage of an amount not to exceed the difference between ten (10) mills and the District Required Local Effort established by the Legislature.

2 The Legislature shall take no action, directly or indirectly, to impair the levy or utilization by a district of its non-voted current operating discretionary millage, whether by amending the Florida Education Finance Program (FEFP) formula, or otherwise.

This amendment should not be construed to increase the maximum school millage levies as provided in section 9 of article VII (ten mills).

Non-Voted Capital Improvement Millage

Findings

The Florida Taxation and Budget Reform Commission finds:

1 Section 200.001(3)(d), Florida Statutes, provides county school boards with the ability to levy a non-voted district school capital improvement millage; however, that millage is restricted by s. 236.25(2), F.S. to two mills and is subject to repeal in 1995 and Legislative review by that date.

2 Due to continuous growth in student population, many districts are faced with an immediate need for capital improvement funds which may expand beyond the two year or two mill limit. The restrictions imposed by existing legislation do not allow for school district capital planning to meet their needs.

Student population in the public school system (based on full time equivalent students) is projected to increase by approximately 35% in the next ten years.

3 School boards need flexibility to build and finance needed capital improvements to meet the expanding needs of their district.

Recommendations

The Florida Taxation and Budget Reform Commission recommends:

1 The Florida Constitution should be amended to allow school districts the ability to levy a non-voted capital im-provement millage of up to 2.5 mills in addition to other amounts provided in the constitution.

Truth in Local Government Expenditure Reporting

Findings

The Florida Taxation and Budget Reform Commission finds:

LOCAL GOVERNMENT FINANCIAL REPORTING

1 Florida statutes, through the "Uniform Local Government Financial Management and Reporting Act," require each unit of local government to complete its financial statement within 90 days after the close of its fiscal year, and to file a financial report with the state within six months after the close of its fiscal year in such form to adequately assess the financial condition of the unit of government.

The statute defines local government as any municipality, special district (excluding district school boards and community college districts), or board of county commissioners or other governing body of a county.

2 The law requires the Department of Banking and Finance to file a "verified report" with the Governor, the Legislature and the Special District Information Program of the Department of Community Affairs one month after the financial reports are due from the local governments. The one month requirement does not allow enough time to perform the functions as outlined in the statute. Therefore, the data is generally: 1) incomplete if units of local government have not reported, and 2) subject to inaccuracies without the appropriate verification.

The Department of Banking and Finance, the Joint Legislative Auditing Committee, The Department of Revenue, the Department of Community Affairs, the Division of Retirement of the Department of Administration, the Division of Bond Finance of the Department of General Services, and the Department of Transportation have a responsibility in either compiling, verifying, analyzing, or compliance monitoring in the process. Current law does not provide adequate time for: appropriate test(s) needed to verify that the data is accurate and reliable; hearings to be held if reports are not submitted; analysis of data; and assistance to local governments who have not complied as required by the statute. (Though a relatively small percentage of local governments file late or not at all, Department of Banking and Finance staff have estimated approximately 60 to 70 percent of the reports have some level of error when submitted. The errors may not be corrected at the time the "verified" and compiled report is sent to the Governor, Legislature and DCA, and no number exists as to how many reports still contain errors.).

3 The current system is cumbersome and does not take advantage of automation or provide for full integration by all state agencies.

Improved automation of the data would provide for more efficient use of personnel. Local governments have expressed interest in providing the information on computerized disk. Currently the information is accepted in hard copy only, and state employees must manually enter individual line item data for over one thousand units of local government.

4 No recent analysis has been done to assess the type, format and usefulness of the data requested.

Users of the data have suggested that while the current information is beneficial, improvements could be made to the form, process, and manual to provide a more informative and

Truth in Local Government Expenditure Reporting Findings (continued)

useful report of the financial condition of local governments. In addition, recommendations to improve the reporting system made by the Auditor General in the latest Performance Audit of The Local Government Financial Reporting System (August, 1988) have not been implemented.

5 The activities of the Uniform Local Government Financial Management and Reporting Act could produce information useful to state and local governments in assessing the financial condition of local governments.

Section 218.503, F.S. (Local Government Financial Emergencies Act) requires any unit of local government to notify the Governor and the Legislative Auditing Committee when certain conditions exist which affect the fiscal solvency of that unit of local government. In addition, a state agency may notify the Governor and Legislative Auditing committee when one or more of the conditions specified in the Act have occurred or will occur. This report, if modified, could provide information on the conditions which would indicate if a unit of local government is in a state of financial emergency.

6 The local government financial information is necessary for the Advisory Council on Intergovernmental Relations (ACIR) to perform its functions and duties.

In 1977, the Legislature created the ACIR to:

a. *Involve local and state officials in an advisory capacity to the executive and legislative branches of state government.*
b. *Study problems of the intergovernmental aspects of governmental structure, finance, functional performance, and relationships at the local, regional, state and interstate levels.*
c. *Recommend solutions to intergovernmental problems.*
d. *Establish a regular system of reporting to state and local public officials on the progress of Florida and its political subdivisions toward meeting their intergovernmental responsibilities.*
e. *Encourage and recommend methods of effective and efficient delivery of services at the state and local levels through services integration and combination of complementary services delivery functions.*
f. *Assume such responsibilities for administering, coordinating, or providing intergovernmental services as may be required by the Legislature or Governor.*
g. *Provide the Legislature, the Governor, and other interested parties with advice on intergovernmental concerns.*

The data compiled in the Local Government Financial Reporting process is one of the primary sources used for much of the work done by the ACIR. In fact, ACIR is a primary user of this data.

LOCAL GOVERNMENT AUDIT REPORTING

7 Florida Statute requires local governments to submit audits to the Auditor General within 30 days after completion of the audit but no later than 12 months after the end of the fiscal year. The Auditor General reviews the audits and then reports on the deficiencies to the President of the Senate, the Speaker of the House of Representatives, and the Legislative Auditing Committee. The process does not require the Auditor General to notify the unit of local government of deficiencies and requests for corrective action.

It is likely that if deficiencies appear in a local government audit, and no feedback is given to the independent auditor or the unit of government, that the deficiencies will be repeated in subsequent audits. The Auditor General and Joint Legislative Auditing Committee have presented seminars throughout the state during the 1991 fiscal year to discuss accountability and quality in local government financial reporting and auditing. This provides useful information for those attending.

Truth in Local Government Expenditure Reporting (continued)

Recommendations

The Florida Taxation and Budget Reform Commission recommends:

LOCAL GOVERNMENT FINANCIAL REPORTING

1 The responsibilities defined in F.S. 218.32 shall be transferred from the Department of Banking and Finance to the Advisory Council on Intergovernmental Relations (ACIR). It is essential that appropriate and adequate resources should be reallocated from the Department of Banking and Finance for the purpose of implementation of these responsibilities. The ACIR shall biennially review the Local Government Financial Reporting and Auditing processes to recommend and make improvements and to present these recommendations to the Governor, Legislature and affected agencies. In addition, the executive directors of the statewide local government associations (e.g. Florida Association of Counties, Florida League of Cities) shall become voting members of the ACIR.

ACIR shall assume the responsibilities outlined above beginning July 1, 1992. The first report shall be completed within six months, with recommended changes to be implemented the following fiscal year.

The ACIR review should consider, but not be limited to:

- a. *Relevancy and utilization of the reported information;*
- b. *Efficiency of the reporting process, reporting form and instructions;*
- c. *Automation;*
- d. *Recommendations of the Auditor General in the Performance Audit of the Local Government Financial Reporting System;*
- e. *Reviewing each agency's role and compliance in the process;*
- f. *Recommending training, if necessary;*
- g *Assisting local governments in developing and implementing a uniform and "popular reporting" system to help inform managers and citizens of programs, costs and efficiencies of local governments. This information can also be used in privatization efforts by a unit of local government.*

2 Florida Statute 218.32(1)(c) shall be amended to require the Joint Legislative Auditing Committee to provide a record of the hearings held pursuant to that section, along with a recommendation for further state action, or no action, and the reason for their recommendation. These records shall be sent to the appropriate agencies defined in this section.

LOCAL GOVERNMENT AUDIT REPORTING

3 Section 11.45, F.S. shall be amended to require the Auditor General to notify a unit of local government of any deficiency in their audit. The unit of local government should be given 45 days to correct or respond to the Auditor General.

4 The Auditor General's report to the Joint Legislative Auditing Committee should summarize the deficiencies and the local government's attempt to correct these deficiencies.

Homestead Exemption Revision

Findings

The Florida Taxation and Budget Reform Commission finds:

1 The constitutional exemption from taxation on the assessed value of homesteads was adopted in 1934 and applied to the first $5,000 of assessed value.

It was designed to provide tax relief to homeowners following the hard economic conditions of the depression of the early 1930's. This exemption also was intended to encourage families to move to Florida and thereby stimulate growth of the economy.

2 In 1980 the constitution was amended to increase the homestead exemption from $5,000 to $25,000 by 1982.

This increase was placed on the ballot by the Legislature to offset enforcement of the full just value standard of property valuation required in the constitution. Vigorous enforcement of the just value requirement was brought about by the fact that statewide property assessments had slipped to approximately 70% of just value at that time.

3 Ad valorem property taxes comprise the largest single tax source for local governmental services provided by counties, municipalities and special districts.

According to the Commission's report on Local Government Revenue and Expenditure Forecasts 1991-2000, ad valorem taxes were $3.216 billion, representing 30.9% of all tax, fee, and grant revenue for counties and $1.012 billion or 15.4% for municipalities in fiscal year 1990.

During the 1980's, total county ad valorem tax revenue grew at an annual rate of 13.7% or nearly $2 billion over the decade, slightly outpacing the 12.5% annual rate of growth in the taxable base. Total municipal ad valorem taxes grew by 10.1% annually or slightly more than $500 million while the annual growth rate of the taxable base grew at a rate of 8.4% over the same period.

4 The homestead exemption removes a large proportion of property value from tax rolls. The owners of these properties receive the benefit of local government services funded through ad valorem taxes but contribute little or nothing to the funding of those services.

Due to the homestead exemption, 30% or more of residential parcels are totally exempted from paying ad valorem tax in 22 of Florida's 67 counties. In 42 of Florida's 67 counties, the value of the homestead exemption comprises at least one-third of the total residential value in that county.

5 The constitution limits to ten mills the millage which may be levied upon the assessed value of real property by counties, school districts and municipalities for their respective purposes. To the extent that total taxable value is reduced due to the homestead exemption removing assessed values from tax rolls, local governments must impose higher millages to provide a given level of services.

In 12 of the 13 counties with a tax rate of 10.0 mills, the value of the homestead exemption is at least 50% of the total residential value. Homestead exemption values account for between 52.18% and 74.81% of the total residential value in these counties.

6 The current proposal would exempt 50% of the assessed value of real estate up to $50,000 and phase out the ex-

Homestead Exemption Revision Findings (continued)

emption for assessed values beginning at $200,000 and disappearing at $250,000.

Based on the 1991 tax roll, this proposal would bring back onto the tax rolls homestead property valued up to $25,000. School taxable value would increase from $479.049 billion to $487.023 billion and the value of the exemption would decrease from $74.575 billion to $66.601 billion.

It also phases out the homestead exemption for properties valued at more than $200,000 with the exemption disappearing at $250,000. This change would increase taxable value statewide by 1.582 billion making the total increase in taxable value $9.6 billion, an increase of 2% statewide.

School Assessed Value	Current Taxable Value	Proposed Taxable Value	Current Exemption	Proposed Exemption
$10,000	$0	$5,000	$10,000	$5,000
$20,000	$0	$10,000	$20,000	$10,000
$30,000	$5,000	$ 15,000	$25,000	$15,000
$40,000	$15,000	$20,000	$25,000	$20,000
$50,000	$25,000	$25,000	$25,000	$25,000
$200,000	$175,000	$175,000	$25,000	$25,000
$225,000	$200,000	$212,500	$25,000	$12,500
$250,000	$225,000	$250,000	$25,000	$0

Recommendations

The Florida Taxation and Budget Reform Commission recommends:

1 That the current provisions of the homestead exemption, which have become an impediment to the funding of local governments, be modified to an extent that would allow more adequate funding of local governmental services but would not unduly impact low income residents.

2 That all owners of real property benefitting from local governmental services should participate in paying ad valorem taxes in support of such services.

3 That the Legislature revise the Truth in Millage process (TRIM) to prevent any taxing authority from receiving a windfall in ad valorem tax revenues as a result of the amendment without proper notification to taxpayers and public hearings.

4 That any changes in the homestead exemption provide a "safety net" for low income persons because lower income families spend a disproportionately large percentage of their income on taxes.

5 That the constitution be amended to change the current $25,000 homestead exemption to fifty percent of the assessed value of real estate up to an assessed value of $50,000 and phase out the exemption for assessed values beginning at $200,000 and disappearing at $250,000.

State Mandates

Findings

The Florida Taxation and Budget Reform Commission finds:

1 In November 1990, a constitutional amendment was passed adding section 18 to article VII of the Florida Constitution. This amendment limits the Legislature's ability to pass laws directing counties and municipalities to take certain actions resulting in the expenditure of funds, and its ability to reduce counties' and municipalities' level of state shared revenues, or to limit the ability of counties and municipalities to generate revenue.

The issue of state mandates has come to the forefront of the public's attention in recent years due to the increasing number of laws enacted directing local governments to address various problems without providing funding. Laws concerning growth management, Article V responsibilities, pension benefits, and environmental protection are examples of unfunded state mandates. According to reports of the Advisory Council on Intergovernmental Relations (ACIR), the fiscal impact of many of the mandates cannot be determined. In 1990, the ACIR reported that six of ten mandates determined to have significant costs imposed at least $29 million in combined new costs to local government. Because the constitution reserves only property taxes to local governments, their flexibility is limited to fund these mandates.

2 Proposed implementing legislation for article VII, section 18, provided procedures for cities and counties to follow should they feel a law was enacted in violation of s. 18 and established a threshold that would render a bill exempt from s. 18 because of fiscal insignificance.

The law established a process counties and municipalities must follow in seeking to afford protection under section 18. If a city or county believes the Legislature has violated article VII, section 18 of the constitution, it must, by ordinance, notify the Attorney General of its intent and then successfully defend its action when the Attorney General institutes legal proceedings against the local government. The bill also directs the Attorney General to institute a writ of mandamus to compel the local government to comply with the legislation unless the Attorney General finds the legislation violates the constitutional provisions "on its face."

Additionally, the legislation defined the term "insignificant impact," which would render a bill exempt from article VII, section 18, as an amount not greater than the statewide population multiplied by 10 cents, or approximately $1.4 million. The Legislature, for purposes of its appropriation process, defines "insignificant fiscal impact" to be an amount not greater than $50,000.

3 Legislation implementing section 18 of article VII passed during the 1991 legislative session, but was vetoed by the Governor.

At the urging of both the Florida League of Cities and the Florida Association of Counties, the Governor vetoed the legislation stating the legislation, "places extraordinary burdens on those local governments that elect to avail themselves of the protections afforded by the constitutional provision, and thus chills the clear will and intent of Florida's electorate in approving the constitutional provision."

State Mandates (continued)

Recommendations

The Florida Taxation and Budget Reform Commission recommends:

1 The Legislature shall enact implementing legislation for section 18 of article VII with a definition for "insignificant fiscal impact" which is consistent with the Legislature's definition for appropriation purposes or fiscal impact conferences and as defined in Florida's Fiscal Analysis in Brief (Insignificant = < $50,000).

2 The Legislature shall enact less burdensome procedures for local governments to follow, should they choose to avail themselves of the protections afforded by the constitutional provision, than those considered in the legislation adopted in 1991 and vetoed by the Governor.

Special District Review

Findings

The Florida Taxation and Budget Reform Commission finds:

1 Special districts are defined as local units of special purpose, as opposed to general purpose, governments within a limited boundary, created by general law, special act, local ordinance, or by rule of the Governor and Cabinet.

According to the Special District Information Program of the Department of Community Affairs, there are 931 special districts, of which 407 are independent, 466 are dependent, 28 are inactive and 30 are unknown. It is estimated that about one-third to one-half of the districts have been created by a special act of the Legislature.

2 Special districts provide a wide range of services including water management, roads, drainage, fire control, housing and urban development, hospitals and health facilities, libraries, jails, ports, mosquito control, beach preservation, juvenile welfare and more.

3 Florida Statutes were amended in 1989 to bring uniformity and accountability into the definition, creation, and operation of special districts. There were many problems of accountability. Progress has been made, but 30 special districts are still "unknown."

4 The Florida Legislature has found that independent special districts can constitute a timely, efficient, effective, responsive and economic way to deliver (these) basic services, thereby providing a means of solving the state's planning, management, and financing needs for delivery of capital infrastructure, facilities, and services in order to provide for projected growth without overburdening other governments and taxpayers. (Section 189.402(3)(a), Florida Statutes)

5 Special districts are financed primarily from taxes, assessments, fees and bond issues. Charges for services are the primary source of revenue for special districts at 72%, while property taxes follow at 11%. Total annual district revenues exceed $4.1 billion.

6 By law, there are three ways to dissolve special districts: (1) A special act of the Legislature, (2) A resolution of the governing body of the special district, and (3) Declaration by the Secretary of State when a district is inactive.

The act is not clear concerning the final dissolution of districts created by local ordinance or resolution. Since section 189.4043, Florida Statutes, gives the Legislature the authority to revoke the charter of any special district, it is assumed that dissolution by local governments occurs using the same method. By law, the dissolution procedures described in this section do not apply to water management or community development districts.

7 Special districts created by special act must be amended by special act. The acts are not currently codified, causing much research and errors when amending a special act.

Research into the special acts affecting a particular government entity is difficult and tedious. It is often nearly impossible to identify the exact laws under which a local government operates and to verify the precise language of these laws. At this time, only Florida's general

Special District Review Findings (continued)

laws are subjected to codification by the Division of Statutory Revision. This process reduces the number and bulk of laws, arranges them in logical order, removes inconsistencies, and improves clarity. In 1991 legislation directing the Joint Legislative Management Committee to contract for a codification of the special and local laws and general laws of local application of the state was approved by the House but died in the Senate.

Recommendations

The Florida Taxation and Budget Reform Commission recommends:

CODIFICATION OF ACTS RELATING TO SPECIAL DISTRICTS

1 **The Legislature shall codify special and local laws and general laws of local application of the state relating to special districts only and provide for publication and distribution of the codification.**

SPECIAL DISTRICT REVIEW

2 **The Legislature shall amend the Uniform Special District Accountability Act of 1989 to provide a decennial review of all special acts or general acts of local application relating to special districts which levy ad valorem taxes or fees. Further, the Legislature shall establish a process for special district review and initiation of legislative merger or dissolution.**

EVALUATION REVIEW CRITERIA

3 **The Legislature shall establish special district evaluation review criteria.**

Review criteria shall include, but not be limited to:

a. *Does the special district activity still provide a needed service or activity?*
b. *Can the activity be more efficiently and effectively performed by a local general purpose government?*
c. *Is the local general purpose government willing to absorb the activity?*
d. *What is the financial condition of the special district?*
e. *Has the special district complied with the Requirements of Chapter 189, Florida Statutes, known as the "Uniform Special District Accountability Act of 1989"?*
f. *Has the special district complied with statutory requirements for reporting?*
g. *How will the dissolution of a special district adversely affect contractual obligations?*
h. *Is there outstanding direct debt associated with the special district? Who will assume the debt if the district is dissolved? Will bond covenants be violated?*
i. *What consequences to district taxpayers will result from the dissolution of a special district?*

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This document was published by the Florida Taxation and Budget Reform Commission, 251 Holland Building, Post Office Box 20869, Tallahassee, Florida 32316-0869.

5,000 copies were printed at a total printing cost of $11.651 or $2.33 per copy to inform the public of the initial findings and recommendations of the Florida Taxation and Budget Reform Commission, created by the citizens of Florida through a constitutional amendment in 1988. Administrative support for the Commission is provided by the Florida Center for Public Management, Florida State University.