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Staff Analysis and Economic Impact Statement

Measure:	CP 41	REFERENCE:	ACTION:
Sponsor:	Finance and Tax Committee	1. FTC	Pre-meeting
		2.	
Subject:	State and Local Revenue Limitations	3.	
Date:	February 7, 2008		

I. Summary:

Constitutional Proposal 41 proposes an amendment to the State Constitution to limit revenue increases for special districts, municipalities, counties, and the state to inflation plus the percentage change in population. Revenue increases for school districts are limited to inflation plus the percentage change in enrollment. The Legislature may increase the state revenue limit by a supermajority vote. Voters may approve local government revenue limit increases by a majority vote or suspensions by a supermajority vote.

II. Present Situation:

Article VII, s. 1(d), Fla. Const., requires the Legislature to provide by law for "raising sufficient revenue to defray the expenses of the state for each fiscal period." However, the Constitution also places several limits on the power of the state to raise revenue. These limitations address: ad valorem taxes, personal income tax, estate tax, corporate income tax, state bonds, and state revenue. Section 1 of Article VII limits state revenue collections to the revenue collected in fiscal year 1994-1995 plus an adjustment for growth based on the growth rate of state personal income over the preceding five years. Excess collections must be deposited in the budget stabilization fund until it is fully funded. Excess revenues at this point are then refunded to taxpayers. The Legislature is allowed to increase the revenue limit by a vote of two-thirds of the membership of each house. According to Article VII, section 1(e) of the Florida Constitution:

> State revenues means taxes, fees, licenses, and charges for services imposed by the legislature on individuals, businesses, or agencies outside state government. However, "state revenues" does not include: revenues that are necessary to meet the requirements set forth in documents authorizing the issuance of bonds by the state; revenues that are used to

> provide matching funds for the federal Medicaid program with the exception of the revenues used to support the Public Medical Assistance Trust Fund or its successor program and with the exception of state matching funds used to fund elective expansions made after July 1, 1994; proceeds from the state lottery returned as prizes; receipts of the Florida Hurricane Catastrophe Fund; balances carried forward from prior fiscal years; taxes, licenses, fees, and charges for services imposed by local, regional, or school district governing bodies; or revenue from taxes, licenses, fees, and charges for services required to be imposed by any amendment or revision to this constitution after July 1, 1994.[1]

State Revenue Flexibility

Appellate court opinions have not examined the scope of the Legislature's authority under Art. II, s. 6, Fla. Const. However, arguably, the provision may permit the Legislature to raise revenue from restricted sources during an emergency resulting from an enemy attack. Article II, s. 6, Fla. Const., states:

> Enemy attack.—In periods of emergency resulting from enemy attack the legislature shall have power to provide for prompt and temporary succession to the powers and duties of all public offices the incumbents of which may become unavailable to execute the functions of their offices, and to *adopt such other measures as may be necessary and appropriate to insure the continuity of governmental operations during the emergency. In exercising these powers, the legislature may depart from other requirements of this constitution, but only to the extent necessary to meet the emergency.*[2]

Article IV, s. 13, Fla. Const., gives the state some procedural flexibility to address revenue shortfalls. The constitutional provision states:

> Revenue Shortfalls.—In the event of revenue shortfalls, as defined by general law, the governor and cabinet may establish all necessary reductions in the state budget in order to comply with the provisions of Article VII, Section 1(d). The governor and cabinet shall implement all necessary reductions for the executive budget, the chief justice of the supreme court shall implement all necessary reductions for the judicial budget, and the speaker of the house of representatives and the president of the senate shall implement all necessary reductions for the legislative budget. Budget reductions pursuant to this section shall be consistent with the provisions of Article III, Section 19(h).[3]

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[1] Article VII, Section 1, Fla. Const.
[2] Article II, Section 6, Fla. Const.
[3] Article IV, Section 13, Fla. Const.

Article IV, s. 13, Fla. Const., was proposed by the 1990 Taxation and Budget Reform Commission in response to an opinion of the Florida Supreme Court requiring all revenue reductions to be made by the Legislature.

Traditional Tax and Expenditures Limitations

At least 30 states, including Ohio, Maine, Colorado, and Massachusetts, currently operate under a tax or expenditure limitation. Twenty three states have spending limits, four have tax limits, and three have both.[4]

Traditional tax and expenditure limitations include revenue, expenditure, or appropriation limits such as:

- Revenue limits. Revenue limits tie allowable yearly increases to personal income or an index which may include inflation or population, and allow for the refund of excess revenues to taxpayers.
- Expenditure limits. Expenditure limits are also tied to personal income or a growth index. In many states, the limit is tied to a growth index related to the expansion of the economy.
- Appropriations limited to a percentage of revenue estimates. This variation of a spending limit simply ties appropriations to the revenue forecast. Delaware, Iowa, Mississippi, Oklahoma, and Rhode Island have this type of appropriation limit in place.
- Hybrids. States also have combined components of various limits. For example, Oregon has a state spending limit tied to personal income growth, and a provision requiring refunds if revenues are more than 2 percent above the revenue forecast. This law limits spending and, in a sense, limits revenues by tying them to the forecasted amount. Colorado is another hybrid state.[5]

The most restricted type of limit includes voter approval requirements. All taxes or increases over a specified amount must receive voter approval to implement this type of limit. Missouri and Washington require voter approval for tax increases over a specified amount. Sixteen states require legislative supermajority votes to increase some or all of the taxes. Of the 30 states with tax and spending limitations, seventeen have constitutional provisions and thirteen have statutory provisions for revenue limits.

Tax and Expenditures Limitations Pros and Cons

There are arguments in favor of, and against, tax and expenditure limitation issues. Proponents indicate that limits will:

- Make government more accountable and control the growth of government;
- Make government more efficient;
- Provide a means for citizens to become more involved in the process and vote on tax increases;

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[4] National Conference of State Legislatures, *State Tax and Expenditure Limits –2007*: http://www.ncsl.org/ (Last visited January 30, 2008).

[5] National Conference of State Legislatures, http://www.ncsl.org/ (Last visited January 30, 2008).

- Help diffuse the power of special interests; and
- Force government to evaluate programs and prioritize services.

Opponents of limits indicate that they will:

- Shift the decision process from the representatives elected to serve the citizens;
- Fail to provide sufficient funds for growth in social services and education;
- Cause a "ratchet-down" effect decreasing the spending base without the ability of growth to bring the base to its original level;
- Fail to provide funding for "shortfall years" and respond to quick changes in the economy;
- Make it harder for states to raise new revenue; and
- Result in declining government service levels over time.

The details of the design of a tax and expenditure limitation will impact the effectiveness of the limitation and its influence on government spending. In a research report from the New England Public Policy Center,[6] the growth index and base are highlighted as powerful determinants of the limitation's impact. The growth index is the annual rate at which a tax and expenditure limitation allows the state or local government expenditures, appropriations, or revenues to grow and the base is the amount of money expended, collected, or appropriated.

TABOR (Taxpayer's Bill of Rights)

The most well-known tax and expenditure limitation is the Colorado initiative known as "TABOR." In 1992, the TABOR constitutional amendment, a citizen initiative, was adopted by Colorado voters. TABOR limits the growth of Colorado's state revenues to inflation plus population. The limits do not apply to federal funds, private gifts, and a few other specified revenue sources. The TABOR amendment also requires voter approval for any tax increase proposed by the state, counties, cities, towns, school districts, or special districts. Revenue funds in excess of the revenue limit must be returned to the voters; however, the voters may vote to allow the state to retain the excess funds. TABOR limits the revenue that the state government can retain in a year to the previous year's allowed collection.

Dr. Barry Poulson, Professor of Economics at the University of Colorado, proposed a framework for the development of a Taxpayer Protection Amendment for Florida and reasons why an amendment is necessary in "Taxes in Florida Are At An All Time High: Time for a Taxpayer Protection Amendment."[7] The reasons presented indicating why an amendment is necessary are:

- To limit the growth in revenue and spending to the growth of population plus inflation;
- To stabilize the budget over the business cycle;

[6] New England Public Policy Center, Research Report 06-3, Reading the Fine Print: How Details Matter in Tax and Expenditure Limitations, http://www.bos.frb.org/economic/neppc/reserchreports/2006/rr0603.html.

[7] Barry Poulson, "Taxes in Florida Are At An All Time High: Time for a Taxpayer Protection Amendment," Presentation to the Taxation and Budget Reform Commission, September, 2007.

- To ensure that some surplus revenue is invested in an emergency and budget stabilization fund;
- To ensure that additional surplus revenue is rebated to taxpayers;
- To require voter approval for increased taxes, debt, or expenditure of surplus revenue;
- To establish a hard budget constraint that would create incentives for tax reform;
- To provide much needed property tax relief, and reduce property tax rates;
- To create opportunities for home ownership for all Florida citizens;
- To create a more favorable tax climate that Florida needs to attract business investment and create jobs; and
- To improve incomes and standards of living for Florida citizens.

The framework provided for the development of an amendment included that:
- It is a constitutional rather than a statutory provision;
- It would impose a stringent limit on the growth in spending equal to inflation and population growth;
- This limit would be applied to a broad measure of state revenue and spending, with few exceptions;
- Some surplus revenue would be allocated to a budget stabilization and emergency fund;
- Some surplus revenue would be allocated to tax relief, including property tax relief;
- Voter approval would be required for any increase in taxes, debt, or expenditure of surplus revenue; and
- This limit would be applied at the local, as well as the state, level.

III. Effect of Proposed Changes:

Constitutional Proposal 41 proposes an amendment to the State Constitution to limit revenue increases for the state, school districts, and local governments. Revenue limits are based on inflation and population changes.

The proposal provides long-term revenue limits for school districts, the state, and local government. Revenues collected by a special district, municipality, county, or the state are limited to the 2007-2008 fiscal year adjusted for the percentage change in inflation and population. Revenues collected by a school district are limited to the 2007-2008 fiscal year adjusted for the percentage change in inflation and enrollment.

The State Constitution limits Florida's state revenues to the average growth rate in state personal income for the previous five years. Personal income is determined by the Legislature through information available from the United States Department of Commerce. Colorado and several other states with limitations based on population and inflation use the Consumer Price Index (CPI) as an inflation indicator. The CPI measures change in the total cost of a "market basket" of goods and services purchased by a typical urban consumer. Since a typical urban consumer spends a majority of his or her income on housing, transportation, and food and beverages, those items are the primary drivers of the CPI. However, governments spend revenues primarily on education, health care, transportation, and corrections. Therefore, the market baskets of spending are entirely different. CP 41 proposes using the United States Department of Commerce Bureau of Economic Analysis Price Index for State and Local Government Consumption Expenditures and Gross Investor, which is an indicator of government spending, in lieu of the CPI.

Revenues as defined in CP 41 are consistent with the current definition under Section 1, Art. VII. These include taxes, fees, licenses, and charges for services imposed by the legislature on individuals, businesses, or agencies outside state government. The revenues currently excluded from the state's revenue limit include:

- Revenues that are necessary to meet the requirements set forth in documents authorizing the issuance of bonds by the state;
- Revenues that are used to provide matching funds for the federal Medicaid program with the exception of the revenues used to support the Public Medical Assistance Trust Fund or its successor program, and with the exception of state matching funds used to fund elective expansions made after July 1, 1994;
- Proceeds from the state lottery returned as prizes;
- Receipts of the Florida Hurricane Catastrophe Fund; and
- Balances carried forward from prior fiscal years; taxes, licenses, fees, and charges for services imposed by local, regional, or school district governing bodies; or revenue from taxes, licenses, fees, and charges for services required to be imposed by any amendment or revision to this constitution after July 1, 1994.

Revenues excluded from the limit in CP 41, in addition to the current exclusion, are revenues representing utility costs and revenues of a government-owned business that receives less than ten percent of its revenues in grants from government sources.

The proposal includes a maximum annual revenue increase if the prior fiscal year revenue is below the long-term limit. The maximum rate of revenue increase for school districts is revenues collected in the prior fiscal year plus 3 percent for inflation adjusted by the percentage change in enrollment. The maximum rate of revenue increase for a special district, municipality, county, or the state is revenues collected in the prior fiscal year plus 3 percent for inflation adjusted by the percentage change in population.

CP 41 includes a revenue limit override component which is consistent with current State Constitution language regarding the override of the state revenue limit. A two-thirds vote of the Legislature is required to override the current state revenue limit. CP 41 also contains override parameters for local governments and school districts. The revenue limit for a special district, school district, municipality, or county may be increased by a majority referendum vote of the electors. A special district, school district, municipality, or county may suspend a revenue limit, for up to four years, with the approval of three-fifths of the electors.

The State Constitution states that revenue which exceeds the state revenue limit will be transferred to the budget stabilization fund until it is fully funded in accordance with Section 19 of Article III. After the budget stabilization fund is completely funded, the excess revenues are refunded to the taxpayers. The Legislature is required to develop the method for refunding the taxpayers. CP 41 requires that excess revenues for state, school districts, and local governments be returned to the taxpayers or deposited in a reserve fund. The funds deposited cannot exceed 10 percent of the budget for the prior fiscal year and the funds must be used for an emergency declared by the Governor.

CP 41 requires the Legislature to develop a method for calculating the adjustments to a revenue limit when funds are transferred between governmental units.

IV. Constitutional Issues:

A. Constitutional or Statutory Issue:

Constitutional Proposal 41 is appropriately classified as a constitutional issue.

B. Other Constitutional Issues:

There are no other constitutional issues for Constitutional Proposal 41.

V. Economic Impact and Fiscal Note:

A. Tax/Fee Issues:

CP 41 limits revenues for state and local government; however, it does not increase any taxes or fees.

B. Private Sector Impact:

None.

C. Government Sector Impact:

CP 41 will limit the fiscal growth of the state and local governments, including school districts. These limitations will impact services provided at all government levels, if passed by the electors. At the state level, services impacted may include education and social service programs.

Under Art. XI, s. 5(d), Fla. Const., the Secretary of State must publish in newspapers throughout the state proposed constitutional amendments and notice of the date of the election at which it will be submitted to the electors. According to the Department of State, the average publishing costs for citizen initiative amendments is $60,000. However, the cost to publish lengthy amendments will exceed that amount.

VI. Technical Deficiencies:

"Population" is not defined in CP 41. An amendment may be necessary to provide a definition.

VII. Related Issues:

None.