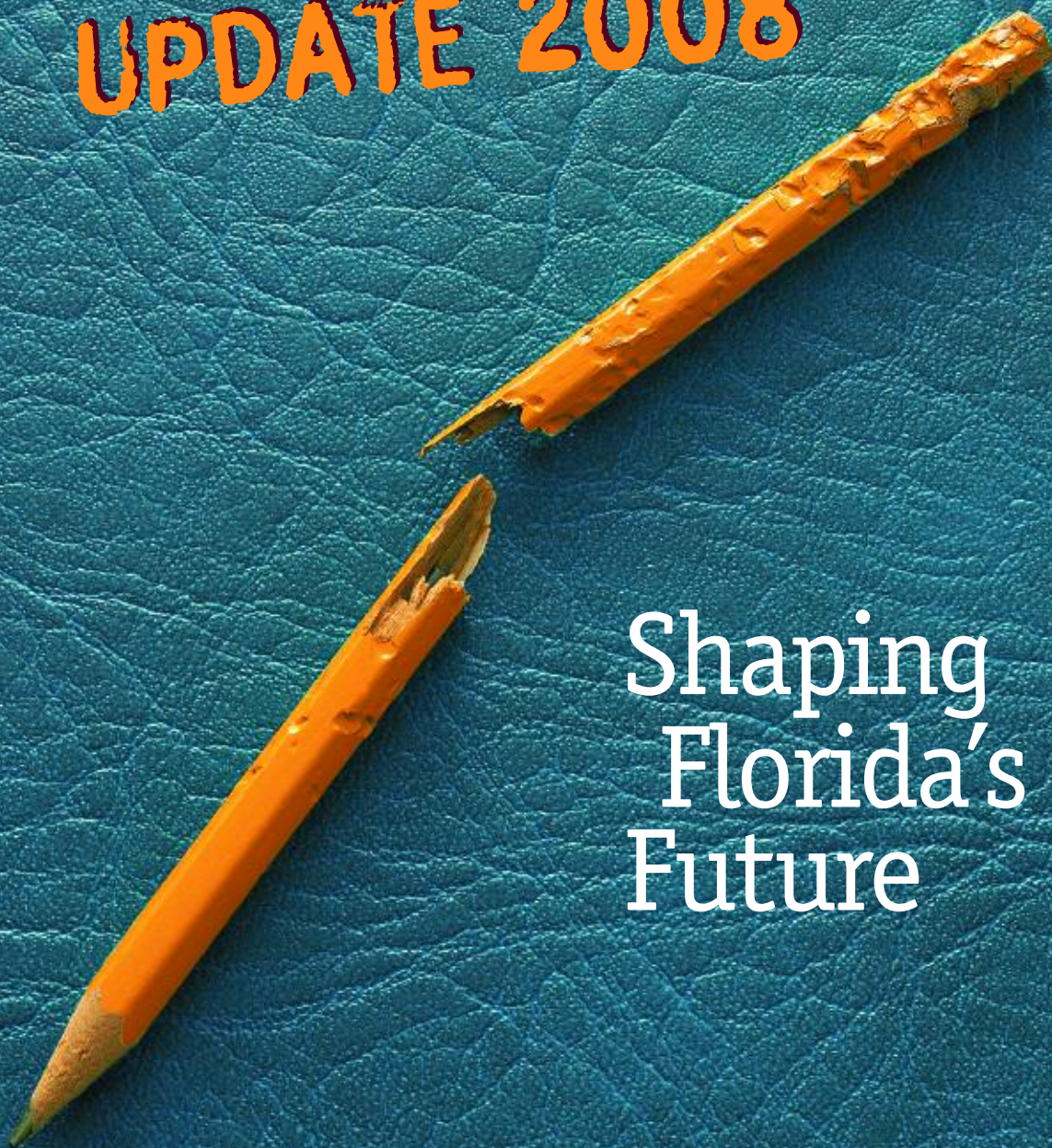


TOUGH CHOICES

UPDATE 2008



Shaping
Florida's
Future

A Report from the LeRoy Collins Institute

C O N T E N T S

In 2004, the trustees of the Jessie Ball duPont Fund supported Florida State University's partnership with the LeRoy Collins Institute to study Florida's future needs and how to finance those needs. The result was a book-length study titled "Tough Choices," with voluminous data and analysis, together with a shorter executive summary of the findings.

In our judgment, the report provided a basis for thoughtful Floridians to understand the state's future challenges, and proved prescient in predicting the current state fiscal crisis.

In 2007, the Fund's trustees provided support to allow Carol Weissert and David Denslow to update "Tough Choices," the results of which are included in this publication.

We recommend this update for your consideration, believing that "Tough Choices" delineates important future challenges facing our state and recommends strategies we should consider in planning our collective future.

– Sherry Magill
President
Jessie Ball duPont Fund

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Dear Floridian,

In November 2005, the LeRoy Collins Institute published a detailed analysis of Florida's revenue prospects and service needs, entitled Tough Choices. The thesis was that Florida had been riding the revenue crest of a housing boom with the added kicker of hurricane rebuilding. We cautioned, though, that the boom would run its course, perhaps even crash. Florida would still face a full plate of service needs but a shortfall of revenue.

Within weeks of the release of our report, state revenue estimators found an added \$1 billion for that fiscal year. Editorial writers treated our forecast, the work of economist David Denslow and political scientist Carol Weissert, with respectful attention. Official Tallahassee pooh-poohed it -- the good times were still rolling.

Without dwelling on "I-told-you-so's," we would say that Tough Choices was pretty much dead on. Revenue growth slowed drastically. Fortunately, Florida caught a couple of breaks with a surprising hiatus in K-12 enrollment growth and very moderate Medicaid growth. Still in 2007 -2008 and planning for 2008-2009, the state faces an obvious and painful budget crunch.

Our first report noted, matter-of-factly, that "property tax revenues for local governments soared as well" with the combination of a building boom and much higher valuations. Unnoticed, healthy increases in K-12 spending were mostly covered by the easily available funding for the local share.

Still in 2007-2008 and planning for 2008-2009, the state faces an obvious and painful budget crunch.

What we did not fully anticipate was the crescendo of protest over rising local taxes. Some homeowners were hit with rapidly rising property taxes, and all faced huge increases in property insurance -- a punishing double shock for many in the cost of home ownership. (At the same time, two quiet storm seasons put the Florida economy into withdrawal from the stimulus of hurricane rebuilding).

For this Tough Choices 2008 Update, we will not attempt any extended diagnosis or prescription for balancing this year's and next year's budgets or sorting out competing ideas for near-term tax relief. Instead,

we will try to look out a bit further. What we see is decidedly mixed.

- Economist Denslow predicts a powerful economic boost and revenue stimulus coming soon and lasting long as baby boomers retire. Solid evidence is appearing that Florida will attract many of the wealthiest of this huge cohort.
- On the other hand, political scientist Weissert forecasts intensifying pressure on the spending side. Lulls in K-12 and Medicaid growth are more likely temporary than long-range. Other services -- notably higher education -- took a drubbing even in the good years and now are stretched dangerously thin.

At the end of this report we revisit our previous recommendations and offer some new ones.

When the three of us presented a version of this update to the Florida Taxation and Budget Reform Commission November 1, 2007, several commissioners offered versions of the same question. What are the prospects for Floridians of middle and lower incomes? That may be the toughest challenge of all -- how to balance the tradeoff between keeping taxes low and offering adequate levels of service. How can we make the state a great place for all of its residents to live -- not just those who can afford a stunning waterfront view?

S. Curtis Kiser

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Tallahassee

Terri Jo Roach, Esq.
Jacksonville

Katherine Fernandez Rundle,
Esq., Miami

Stella Ferguson Thayer, Esq.
Tampa

CHAPTER 1 | REVENUES, REAL ESTATE AND DEMOGRAPHICS

We see the potential for a relatively rosy fiscal future, driven by a wave of wealthy retirees.

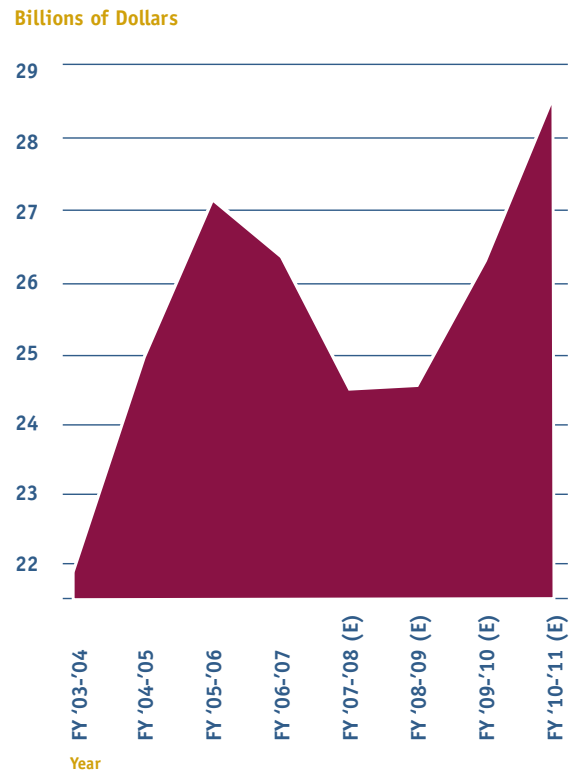
Right now, of course, we are in some rather tough times. We can't forecast just when things will get better. But as contrarians as we were in the original Tough Choices report, we recognize the potential for a pretty glowing fiscal future for Florida.

That is hard to see right now. We cannot forecast when real estate will rebound. Some analysts say Florida cities remain attractive and will be among the fastest to come back. Others think there is a lot of softness to play out with a potential wave of foreclosures and more nasty surprises like the sub-prime fiasco. Nor is it clear how deep a 2008 recession may be.

The dimensions of the shortfall we predicted in 2005 are stunning. (See Chart 1). In the three fiscal years between 2003 and 2006, general revenues (the discretionary part of the state budget) rose \$1.8 billion, then another \$3.1 billion, then \$2.1 billion more. Florida is now at the mid-point of the three fiscal years following. According to the March 2008 Revenue Estimating Conference, general revenues will level out roughly \$2.5 billion less than at the peak this fiscal year and next. Safe to say, then, that Florida will be pinched to get through this budget year and plan for 2008-2009.

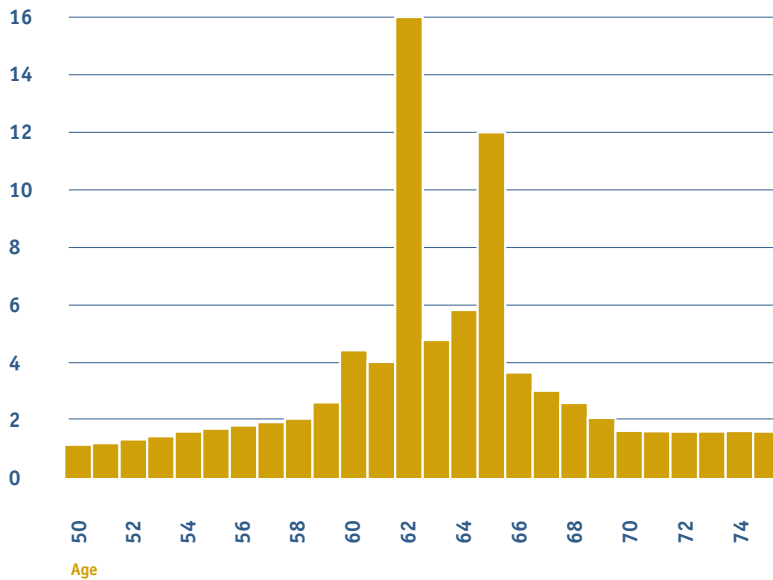
Here is what makes us optimistic about the state's economic and fiscal future once we get through the present lean times.

CHART 1
General Revenue Fund Growth and Decreases



SOURCE: Florida Revenue Estimating Conference, March 2008

CHART 2
Percentage Retiring by Age, 50-75



SOURCE: University of Florida Bureau of Economic and Business Research

Already there are strong signs that a sorting process is going on with the beginning wave of baby boomer retirees and Florida is becoming a chosen destination for the more affluent.

You might object that retirement age is still years away for most baby boomers, so how can we tell? Actually some number of them got an early jump on retirement while still in their 50s. The largest single group of retirees has been at 62 rather than the traditional age of 65. (See Chart 2). So, if not for the soft economy, 2008 would be a big retirement year

for the oldest baby boomers born in 1946 – and the wave of retirees will not flatten until early in the 2020s. (See Chart 3). So the potential benefit will be not for a year or two but sustained over 15.

For several decades, the price of Florida housing did not rise on an inflation-adjusted basis despite rapid population growth. Supply was keeping up with demand. That changed around 2000. Florida housing prices soared over the next five years on an absolute basis but also in comparison with the rest of the Southeast – about 100% in Florida compared to 20 to 30% in the region. (See Chart 4).

The likely explanation is that more affluent retirees began targeting Florida, seeking out oceanfront and other desirable property whose supply is limited. Further evidence that some scarcity drove up prices is analysis that shows the great appreciation was of land itself, not the structures that sit on it.

We are now experiencing declines in housing value greater than those in other states. People are slow to sell at reduced values, hoping for better times so the shakeout took a while to get started and is still ongoing.

Even so, when the market adjustment runs its course, Florida is going to have a big appreciation in property values – and fresh demand for housing supply in the most desirable and limited locations.

The weak dollar adds an international element to the strong longer-term demand for Florida housing. Any foreign currency from Euros to Loonies buys a lot here now.

The good news in all this for Florida's revenue/service equation has several dimensions. Of course, wealthy retirees drive up the taxable real estate base and generate plenty of sales tax revenue with their spending. Also retirees don't have children in schools, don't drive much during rush hour, and are not a heavy burden to the judicial system. So an average retiree, by our calculations, contributes \$2,000 more in revenues than he or she consumes in public services. For well-to-do retirees, the premium is higher.

That is the case for a much more positive outlook for Florida than present troubles would suggest.

At the same time, we have a pair of linked concerns. The short-term pinch will be with us for several years. As subsequent chapters detail, some service needs – our universities in particular – are sorely neglected. The demand for some others, like a growing preK-12 enrollment and spending on Medicaid, has been moderate for the last several years but likely to resume.

Weak public services, in turn, are going to diminish further the attraction of Florida to young working households. They may sort themselves to North Carolina, Georgia and other states where the housing is cheaper and the educational systems are better.

CHART 3
Estimate of New Retirees per Year
1950-2050

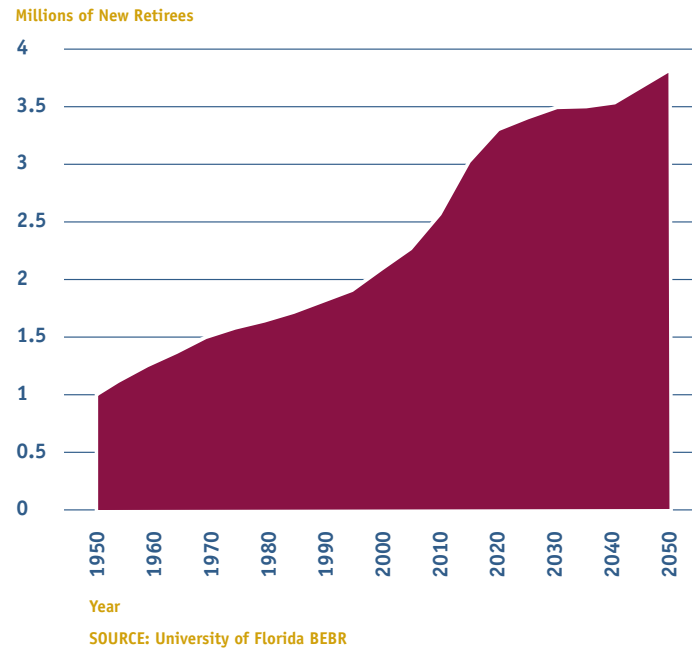
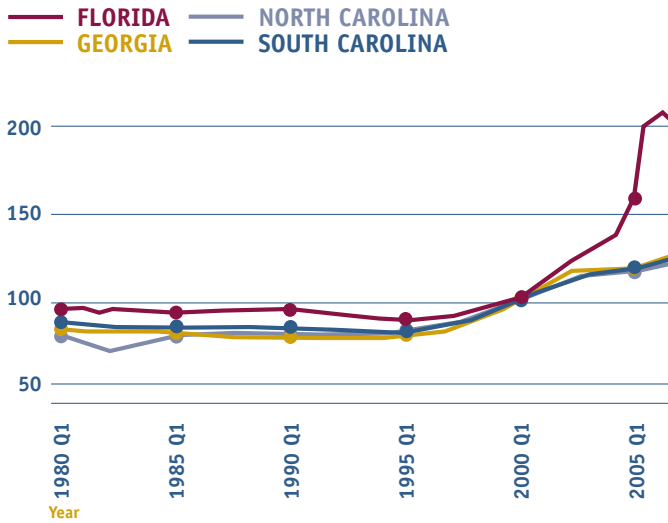


CHART 4
House Price Index in Southeastern States 1980-2006


SOURCE: Office of Federal Housing Oversight

While we do not have a ready answer, the question of what happens to Florida's middle class is taking shape as a big issue for the mid- and longer term future. Do the dynamics suggest we will more than ever be an economy of high-income people and free-spending tourists together with those who serve them, waiting tables and giving pedicures?

The tab for amenities like educational opportunity, navigable roads and affordable housing is building during these lean years.

CHAPTER 2

INCOME TRENDS, TAX BURDEN AND STORMS

Household income improves, the tax burden on small business worsens, and Florida remains uniquely exposed to hurricanes.

We gave some attention in the first Tough Choices report to what could be inferred about Florida’s job structure by an historical comparison of state versus U.S. income per resident. After slightly exceeding the national average in the 1980s, Florida lagged and that gap grew wider in the first years of this decade.

As several reports from the Florida Chamber Foundation concluded, the state seemed to be creating lots of jobs but mostly low-wage ones.

Rather unexpectedly, the trend reversed with two more years measured since our initial report. Florida income per resident is closing the gap compared to the national average. (See Chart 1).

We see two reasons for the uptick. Construction jobs grew at a fast rate during the real estate/hurricane rebuilding boom (See Chart 2). They, of course, have declined some since but will level out well above where they were at the start of the decade. And these are relatively well-paid jobs.

Second, the infusion of affluent baby boomer retirees, discussed in the first chapter, is beginning

CHART 1
Annual Income Growth per Resident
Florida and United States 1968-2006

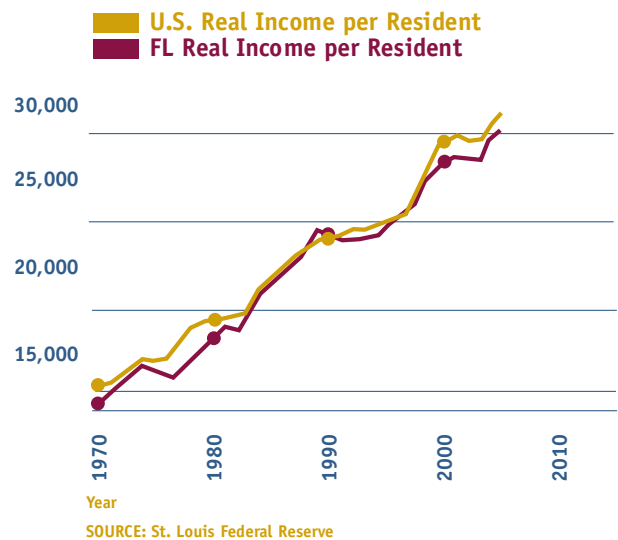
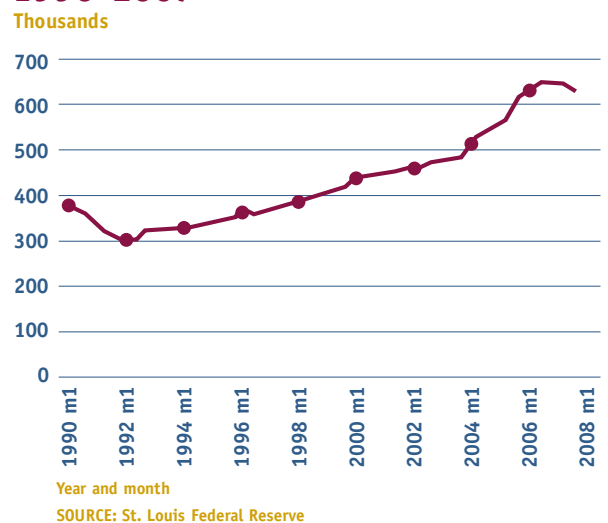


CHART 2
Construction Jobs in Florida
1990-2007

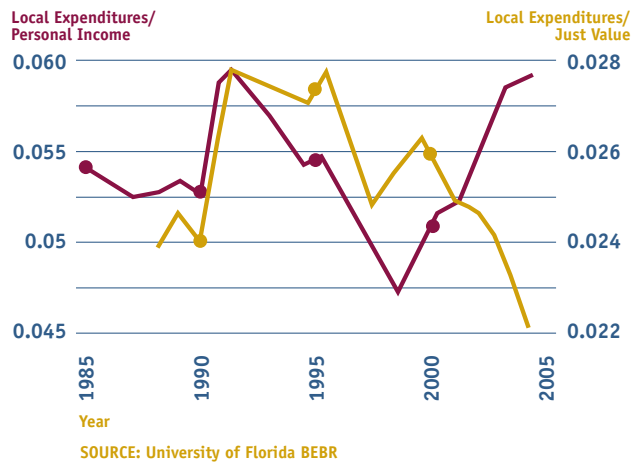


to have an effect. We are quite sure that within three years Florida will exceed the national income per resident average.

CHART 3

Local Taxes vs. Just Value and Total Personal Income 1985-2005

■ Local Expenditures/Just Value
■ Local Expenditures/Personal Income



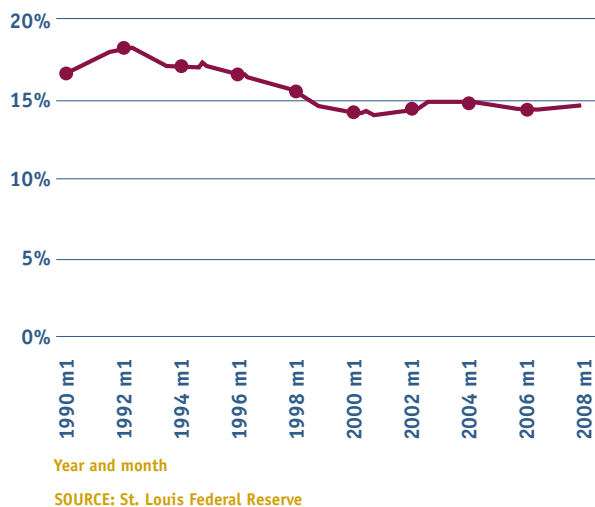
That's good news for the state's tax base with a small qualifier: as Florida grows more affluent, we get a smaller transfer of federal Medicaid payments (since the formula favors poorer states).

Turning to what has been happening with taxes and government spending, we see some confirmation of the public sense of a greater tax burden. However, the facts do not support a picture of runaway state and local spending, and they are totally at odds with the notion that business, in general, is only lightly taxed.

Co-author Denslow and his associates at the University of Florida Bureau of Business and Economic Research spent considerable time in fall 2007 trying to establish the trend lines in local government spending. The task is a good deal more complicated than just totaling county and city taxes since ours is a state of numerous independent municipal taxing units.

CHART 4

Government Share of Jobs in Florida, 1990-2007



With data for all counties but Duval, the result is shown in Chart 3. It may surprise some to see that the share of just value for real estate going to local taxes is actually down considerably. In other words, Florida's local government units helped themselves to some, but by no means the entire windfall from fast-rising property valuations. As the second line shows, local spending did rise compared to personal income; Floridians' incomes were obviously not rising as fast as the valuations.

Also, looking back to 1990, government jobs in Florida have risen as an absolute number, but are actually a smaller share of total state employment

now. (See Chart 4). Not much evidence there for the notion of bigger and bigger state and local government.

A final part of the tax story concerns business, and a part of the current citizen outcry for tax relief is a sense that individuals are being zapped as business wallows in tax breaks. Certainly business lobbies have been able to keep in place an assortment of sales tax exemptions and some big businesses have received relocation incentives

But, broadly, Florida is a state of small rather than large businesses. The interaction of the Save Our Homes Amendment (providing a substantial protection from rising assessments only to homeowners) and the increase in property valuations nets out to a big transfer of tax burden to businesses – whether they own or rent their quarters.

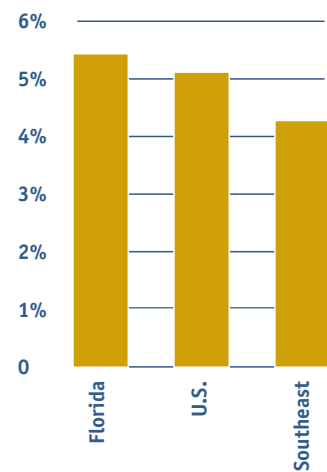
Data from Ernst and Young show that business taxes in Florida are proportionately somewhat higher than the U.S. average and much higher than the average for Southeastern states. That is true whether the measure is share of state and local taxes or business taxes as a percentage of gross state product. (See Charts 5 and 6).

Homeowners insurance, though not a tax and, to date, elusively beyond government control, may factor into the current citizens demands for tax relief. Since our initial report, a new Florida law makes the state a reinsurer of last resort in the event of a catastrophic hurricane. So far this has not resulted in lower insurance rates, though it does leave the state exposed to a potentially huge liability.

So we offer two observations on storms. William Nordhaus of Yale University recently conducted a study indicating that hurricane damage is proportionate to the seventh power of maximum wind speed. That mind-boggling multiplier reflects that storms with the highest winds are likely to also spread over a wide area and last longer, and that many structures which could withstand a lesser storm will collapse.

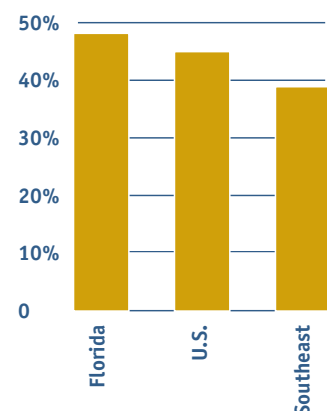
A separate study suggests that with Miami and Tampa Bay especially dense with homes and commercial structures, about half the dollar value of

CHART 5
Business Taxes
as a Share of
Gross State
Product 2007



SOURCE: Ernst and Young

CHART 6
Business Share
of State and
Local Taxes 2007



SOURCE: Ernst and Young

property at hurricane risk along the Atlantic and Gulf of Mexico coasts is concentrated in Florida.

More than half the property value in the United States at hurricane risk is in Florida.

This chapter and the previous one complete our update of the revenue side of Florida's prospects. It is a relatively bright picture – certainly in comparison to the current short-term fiscal gloom. Turning to the services side, the story is more somber. Florida faces choices among a variety of pressing needs, and it is a rainy day indeed for finding resources adequate to the task.

CHAPTER 3 | PREK-12 EDUCATION

After a pause in enrollment growth, intense funding pressure will resume.

In the first edition of *Tough Choices*, we saw Florida's public schools on a sort of fiscal collision course. The more rigid provisions of the Class Size Amendment of 2002 were beginning to kick in and K-12 enrollments continued to grow and grow. Hence we predicted a "bottomless pit of class-size compliance."

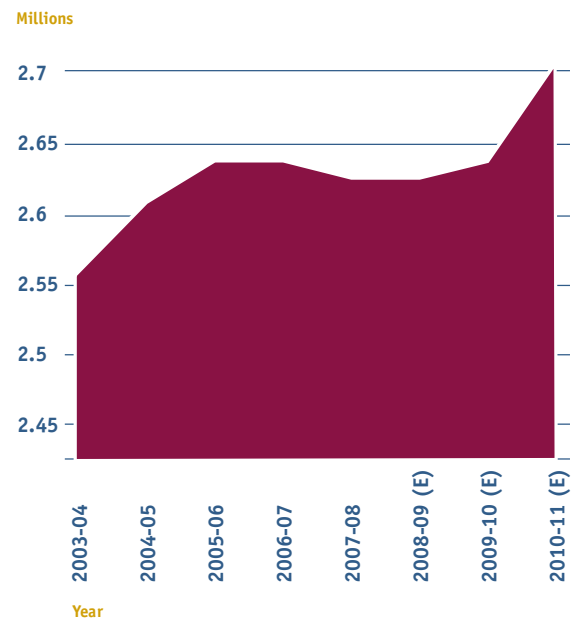
We had that half right.

Abruptly and unexpectedly enrollment stopped growing around the time of our November 2005 publication. After successive years of adding 50,000, then 30,000 more students, Florida's public school enrollment has essentially gone flat, even falling a bit. Enrollment is projected to stay level for another two years before resuming more typical growth of 30,000 in school year/fiscal year 2010. (See Chart 1).

There is no certain explanation for the decline. The most likely is that the run-up of real estate prices, combined with two bad hurricane seasons and the insurance increases that followed, influenced young working families with school-age children to locate elsewhere. (There is no evidence of flight to private schools. Private school enrollment is down slightly to about 350,000 compared to the 2,630,000 in public schools.)

With a dire revenue shortfall in progress, not having to pay an extra \$4,500 for each new student enrolled is a very helpful windfall. However, it has not taken all the sting out of the high cost of compliance with the 2002 constitutional initiative limiting the number of students in K-12 classes.

CHART 1
PreK-12 Enrollment
FY 2004-FY 2011

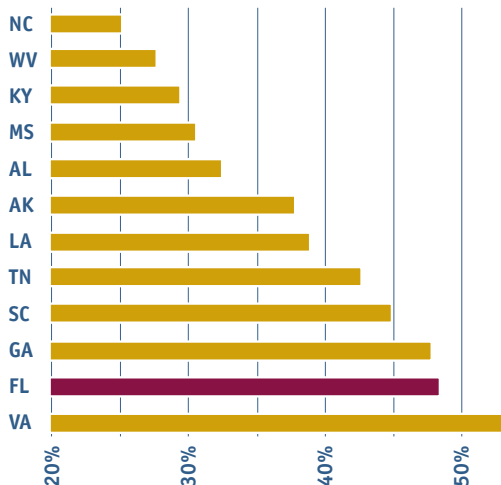


SOURCE: Florida Education Estimating Conference February 2008

CHART 2

Local Share of K-12 Funding in Southeastern States, 2004-2005

Rest of Southeast
Florida



SOURCE: National Education Association

Governor Crist's budget proposal for 2008-2009 anticipates spending \$3.2 billion on reducing class sizes, roughly 15% of a total \$20 billion for K-12.

As discussed in more detail in the recommendations section of this report, we continue to think that class-by-class compliance is prohibitively expensive. A combination of measuring class size based on school-by-school averages and granting emergency exceptions would be a prudent savings that does not do violence to what voters approved.

When Tough Choices was published two years ago, a second new educational expense was being phased in – a voluntary pre-kindergarten program.

Here our estimate of an ultimate enrollment level of a little over 100,000 at \$3,500 per student has proven roughly

correct. (Both the enrollment and expense are off-the-books of the K-12 budget since the program is administered separately and not funded by the same formula).

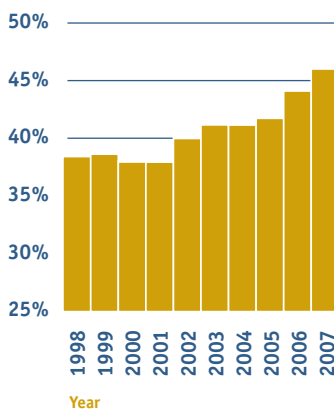
Florida has several of the largest school districts in the country and the largest schools at the elementary, middle and high school level. Huge schools are great for producing juggernaut football teams but otherwise can translate into a lack of personal attention and social control.

Some districts, especially the three in southeast Florida, are so big that the individual parent may not feel he or she has much of a potential input. That distancing is compounded by concentrating most critical decisions about schools – including those on how school money is spent – at the state level.

You might suppose that state control would make sense if the state also provides much school funding but that is not really the case. As Chart 2 shows, Florida puts more of the school funding burden on localities than any Southeastern state, save Virginia (with its substantial group of students in the well-to-do Washington D.C. suburbs). The most recent figures available were for 2004-2005, and the share shifting has continued in following years.

CHART 3

Local Share of K-12 Florida Education Funding 1998-2007



Year

SOURCE: University of Florida, BEBR

Chart 3 shows that the local share of school funding has risen eight percentage points in the decade between 1998 and 2007. More of the same is included in Governor Crist's budget proposal for 2008-2009.

We noted in the original Tough Choices report that in 2005-2006, the state had a meaningful K-12 funding increase of \$1.3 billion, but covered \$800 million of that with local property tax increases. In retrospect, it looks more and more as if the state took its foot off the pedal in school funding during the good years, devoting its rising revenues to other priorities and tax cuts. Nearly two-thirds of the mid-year cuts in the 2007-2008 budget were borne by K-12.

The assorted property tax reduction schemes of 2007-2008 typically have exempted schools. That could be a nod to voter commitment to public education, but it equally reflects that the gradual increases in local support were simply too much in aggregate to make a rollback feasible.

So, where do these cobbled-together funding increases and the phasing in of the class-size amendment leave Florida in comparison to other Southeastern states? Still a laggard in important categories.

In average teacher pay (as most recently measured in 2004-2005 – see Chart 4), Florida was in the middle of the pack among Southeastern states – trailing Tennessee, South Carolina, Virginia, North Carolina and Georgia. Georgia is the leader in this category and beginning or experienced teachers can earn \$5,000 a year more by choosing Georgia over Florida.

In students per teacher (Chart 5) Florida is dead last, a gap that may have closed a bit since the last available statistics from 2004-2005.

CHART 4
Average Teacher Pay in Southeastern States, 2004-2005

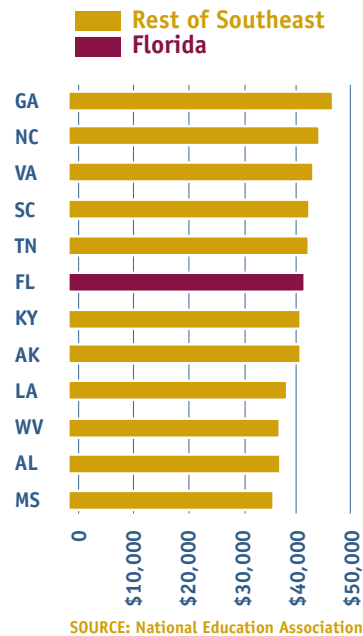
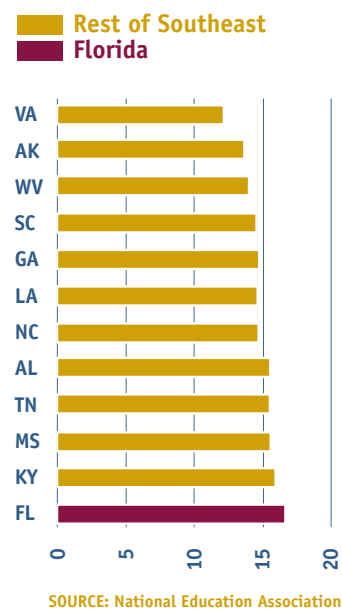


CHART 5
Students per Teachers in Southeastern States, 2004-2005



While the methodology for counting dropouts is disputed, most studies rank Florida at or near the bottom in that measure of school success. In effect, the system underperforms and under-invests by losing a high percentage of high-school students.

Looking out longer term, we have a hard time seeing teaching in Florida as an appealing career path for many graduating college students. Those inclined to teach have many opportunities to earn more elsewhere or pursue other more lucrative professions.

If the wave of affluent baby boomer retirees we are predicting materializes, that, of course, will have a positive impact on total property value available to be taxed, as well as increasing documentary stamp taxes on real estate transactions and sales taxes. At the same time, we wonder whether retirees from elsewhere will be willing to spend generously on educational excellence.

Even with a much older-than-average voter demographic, Florida has had a reasonable record to date in getting approval for local school referenda. But a series of academic studies shows that the mobile elderly, as opposed to those from the local community, do not support local services, especially education. That could be all the more an issue if the wealthy retirees are white (as they certainly will be) and public school enrollment shifts to a majority minority (as it quickly is).

While the property tax is currently out of favor, we think it is a pretty efficient tax now and in the future, certainly more stable than the sales tax, which will swing up and down with business cycles. You also could say that the federal interest deduction which encourages people to build bigger houses, fancier houses and new houses is creating value local governments can tax. Plus they can tap into the inexorable rise in the value of prime land.

In summary, Florida's public schools are below average in the resources they have to draw on and likely to remain that way through the current budget crunch. Long-term financing prospects are brighter. But the schools could also help themselves by shifting from the most rigid compliance with class size requirements to more strategic investments in educational improvement.

CHAPTER 4 | HIGHER EDUCATION

Years of funding neglect come home to roost during a budget crunch.

To characterize Florida's recent treatment of its higher education system, we borrow from the harsh old grading scale at Princeton. Six was a garden-variety F, but there was an even worse mark: a 7, for "flagrant neglect."

Florida universities are in their current fix of turning away students, losing professors and facing more rounds of cuts because, even during the boom times early in the decade, the state neglected to increase funding by much or allow meaningful tuition increases. Our public university tuition is currently second to last among the states.

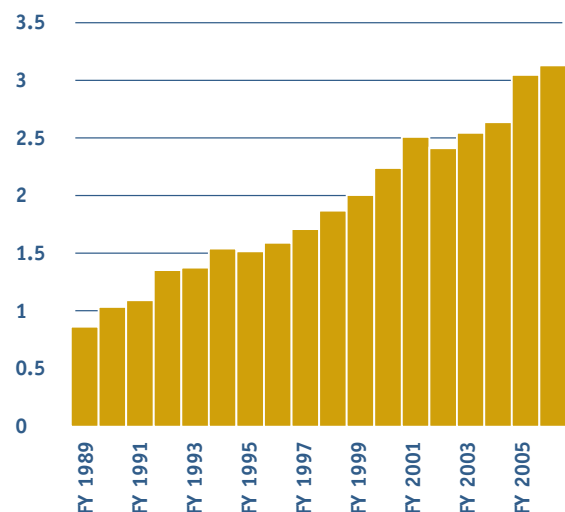
The first Tough Choices report discussed higher education issues relatively briefly. Given the LeRoy Collins Institute's academic ties, we wondered whether a bigger emphasis would seem self-serving. The last two years have made a bad situation so much worse that we want to lay out the particulars.

After lean years in the early 1990s, Florida universities received robust appropriations growth during the prosperous late 1990s. Starting with fiscal 1995-96 through fiscal year 2000-01, general funds grew by almost 60% cumulatively. The brief recession at the start of this decade was followed by the real estate boom years, but this time university funding barely increased. (See Chart 1 – the apparent jump in 2004-2005 is mainly due to an accounting change).

An index of the stall-out is that in 2002-2003 university funding was 9.3% of the state budget. By 2004-2005, it had fallen to just 7.9% (against a national average of 10.6%).

CHART 1
**Annual General Funds for
Florida Universities 1989-2006**

Billions of Dollars



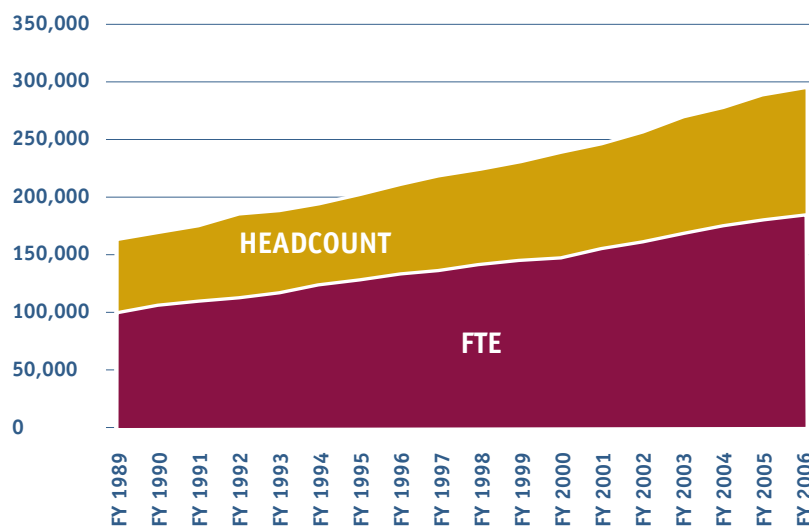
SOURCE: Florida Department of Education Fact Book 2006, Table 40

In Florida, state and local government support of public and private higher education was \$193 per capita in 2006, well below the national average of \$260.

All this occurs during a period when university full-time equivalent enrollment has risen from 100,000 in 1988-89 to more than 180,000 in 2005-2006. In that same period, headcount roughly doubled to 300,000. (See chart 2).

Between 2001 and 2006, enrollment in Florida public universities increased 25%, compared to 14% in other Southern states.

CHART 2
Full-Time Equivalent and Headcount Enrollment in Florida Universities 1989-2006



SOURCE: Florida Department of Education Division of Colleges and Universities

In contrast to the K-12 enrollment lull, demand for university enrollment continues to grow. Right now it is being held back by the expedient of not providing service. By some estimates, as many as 80,000 qualified students will be turned away over the next five years.

Looking at tuition, Florida remains very low compared to peer Southeastern states (See Chart 3). Between 2003 and 2006, tuition grew 24% across the country, 21% in the Southeast, but only 2% in Florida.

A version of the same gap is evident if you look at in-state tuition charges at flagship universities. (See Chart 4). Back in the day, the University of North Carolina was slightly cheaper than the University of Florida – now it is about a third higher.

The community college system has done somewhat better in state funding increases during this period, though it will likely take some of the brunt of current budget cuts. The Florida Resident Access Grant, which effectively subsidizes in-state enrollment at Florida's private colleges, has been zeroed out in

the Governor's 2008-2009 proposed budget.

A series of studies by business groups like the Florida Chamber Foundation and the Florida Council of 100 have documented the economic return on investments in higher education. The combination of strong university research capability and a workforce heavy with college and advanced degrees can foster clusters of high-wage jobs and fast development. North Carolina's Research Triangle provides the most obvious example in the Southeast.

Though recent governors and legislative leaders give lip service to the ideal of a more diversified economy, we think the evidence is clear that the sentiment hasn't been backed by investment lately.

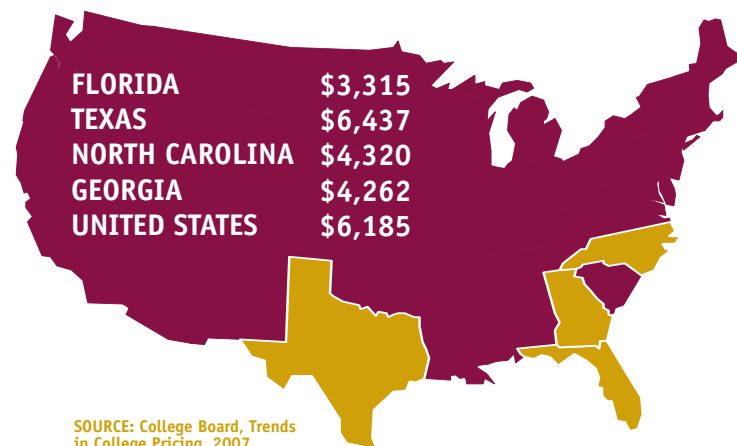
The Tough Choices report, like a number of other studies, noted that the Bright Futures scholarship program and Prepaid Tuition Plan together act as a powerful brake on tuition increases.

As discussed in the recommendations section of this report, we think Bright Futures is ripe for reform both in its lax definition of academic merit and its coupling of awards with tuition. Described by former Chancellor Charles Reed as "one of the dumbest public policies ever," Bright Futures works out to a massive subsidy for the well-to-do, for whom Florida's paltry tuition is not much of a stretch.

We would also observe that the Prepaid Tuition Plan has ample reserves to stay solvent if tuition were aggressively increased. The main effect of big tuition increases would be to raise the price of new contracts, which would still be a bargain and a good investment vehicle.

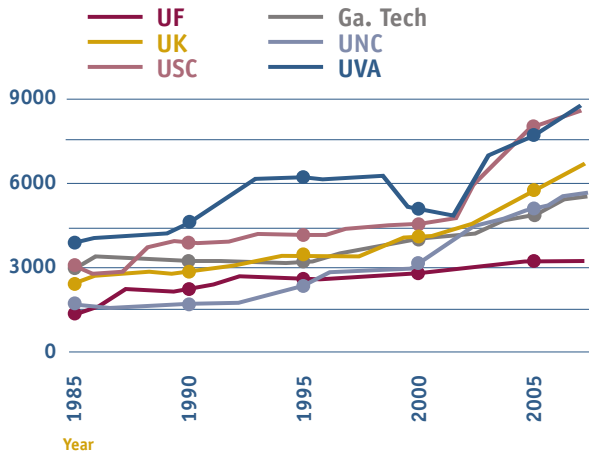
When Reed, now president of the California State University, spoke at a Collins Institute gathering in August 2007, he said Florida's neglect of its universities was a declaration that we're "cheap and proud of it."

CHART 3
Undergraduate Tuition and Fees FY 2008



He went on, though, to describe a better way in his adopted state, dating back to securing a multi-year commitment in the 1950s to a master plan to build a system that would combine excellence and access.

CHART 4
In-State Tuition 1985-2007



SOURCE: Chronicle of Higher Education

The commitment, now known as “the Compact,” gets renewed periodically and provides regular increases in base funding and defined increases for enrollment growth as well as allowing governing boards to set tuition. Governors Pete Wilson, Gray Davis and, most recently, Arnold Schwarzenegger have all agreed to honor the concept, in good fiscal years and bad.

Florida’s university presidents have proposed a five-year compact in the California vein with committed funding in exchange for delivery of agreed-upon performance goals. Tallahassee political leadership blew the idea off.

For now, Florida’s higher education policy amounts to wing it and wither.

CHAPTER 5

MEDICAID, KIDCARE AND OTHER SERVICES

Medicaid expense growth is likely to resume; Florida scrimps on KidCare and infrastructure.

We noted in Chapter 3 that just as the real estate boom crashed and state revenues stalled out, Florida providentially experienced a pause of several years in K-12 enrollment growth.

The same happened with Medicaid enrollment and expenditures, a second huge component of the state budget. (Medicaid spending is more than \$16 billion annually and makes up more than 20% of the state budget).

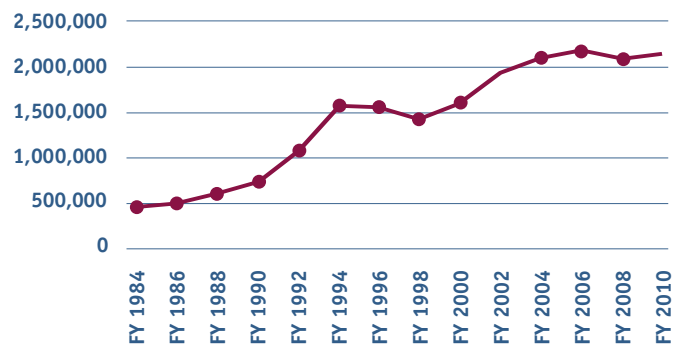
Medicaid enrollment leveled in the two years since the publication of Tough Choices (see Chart 1). Expenditure growth slowed to about 6% in 2004-2005 and spending actually declined in 2005-2006. But growth resumed in 2006-2007 and is expected to continue apace over the next few years (see Chart 2).

So that relief valve on spending pressure has closed.

As we wrote in the first report and as is evident in the charts, the history of Medicaid enrollment and spending is marked with periods of a few years where growth is not significant. Almost always it resumes, however, at a rate of 10 to 15% or even higher.

Besides leaving the medical expenses of many Floridians uncovered, big cut-backs in Medicaid spending are an unattractive option because that would waste an available federal match of around \$1.40 for every dollar the state spends.

CHART 1
Medicaid Enrollment Growth
Fiscal Years 1985-2011

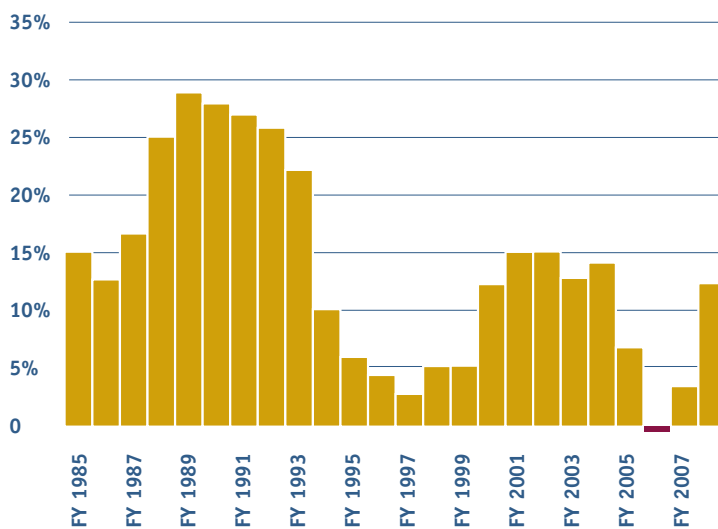


SOURCE: Social Services Estimating Conferences, 2007

When Tough Choices was released in November 2005, Florida was embarking on a pilot plan in two counties to privatize delivery of Medicaid services in a sweeping fashion. The experiment was not a disaster, but neither did it test out as showing demonstrable savings in a fall 2007 evaluation. So its future as a statewide solution to rising Medicaid costs seems in doubt.

CHART 2

Annual Medicaid Expenditure Growth Rate FY 1985-2008



SOURCE: A Snapshot of Florida Medicaid, Oct. 4, 2006. Updated by Social Services Estimating Conference – Medicaid Services Expenditures, Services Expenditures July 30, 2007

KidCare is a parallel story. The eligibility rules change with some frequency so there are both restrictions and some confusion holding down enrollment. The upshot is that enrollment peaked at almost 340,000 in spring 2004, fell to below 200,000 two years later and has been increasing very slowly since then. (See Chart 3).

So it is fair to conclude that the state (again with a federal funding match available) has cut its commitment to insuring children from poor families to about two-thirds of what it was a few years ago. The problem is made worse by the unwillingness of private health insurance to cover children. Florida is tied for second-worst

in the country in the percentage of uninsured children aged 0-18.

* * *

In Tough Choices our emphasis has been on the broad revenue picture and the biggest categories of expenditures. But the current budget pinch puts pressure on what might be assumed to be more routine spending and service – like adequately staffed courts trying cases in a timely fashion.

Our first report devoted an entire chapter to infrastructure needs. We will not attempt to revisit the issue here, in part because we are unaware of any broad new studies to quantify the problem. The St. Petersburg Times “For a Better Florida” series recently identified a backlog of more than \$1 billion for approved road projects alone.

We wrote in the original Tough Choices about the wildly uneven county impact fees on new construction to pay for the school building needed to accommodate additional students. The fees ranged from a pricey \$10,000 per unit in a few counties to the ludicrously low (\$192 for decades in Hillsborough County).

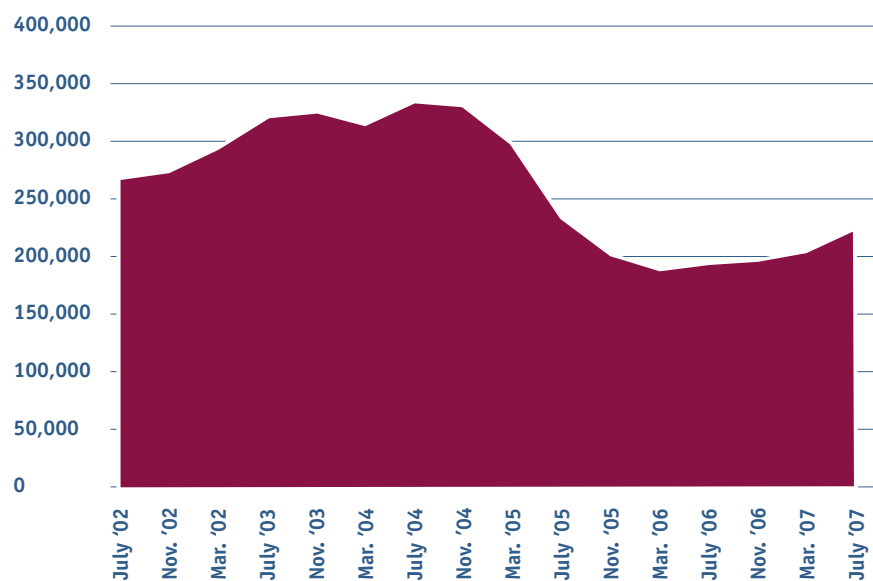
In the last two years, the trend has been to levy higher fees. At the same time the pressure for school construction eased in many, but not all, counties along with the enrollment pause. Our best guess is that construction needs will resume and enrollment begin growing again in a year or two. Class size amendment compliance requires both many more teachers and more rooms in which they can work.

In summary, the bright spots are few and appear to be transient when surveying Florida's government service needs. We are pressed on some major spending categories, woefully stingy on others, and the disparity of needs and resources is likely to get worse near term.

Whether Florida's tax structure will capture a reasonable share of the projected surge in retirees' wealth and real estate value is an open question.

We will close in the next and final chapter updating some of the original Tough Choices recommendations and adding a few more.

CHART 3
Florida Kidcare Title XXI Enrollment 2002-2007



SOURCE: KidCare program

CHAPTER 6 | RECOMMENDATIONS

Florida's bad habit of leaving revenue on the table and the case for a longer-term perspective on services.

If you see an investment advisor, one of the first things you will be told is to keep your portfolio diverse. That is a good principle too for state and local taxation – a diverse portfolio – one that is broad and growing so as to allow the lowest rates on the broadest base.

However we don't raise government revenue that way in Florida. Income taxes were taken off the table in the 1920s. Taxing services (or letting at least some group of exemptions sunset) is politically untouchable because a similar effort failed 20 years ago.

So the recent tax debate revolves around engineering a fair and substantial break on local property taxes and perhaps increasing the sales tax by a penny if the relief is generous enough.

We had hoped the first Tough Choices report would generate a broader look at matching state and local revenues with service needs. We are still hoping.

Martha Barnett of the Tax and Budget Reform Commission put it well after a Collins Institute group testified in November 2007. Noting the growing tax burden on small businesses (which have no protection equivalent to Save Our Homes), she said, "I would hope that we can get citizens who want to work with us in looking at ...not where we are today but ... what their vision is of Florida tomorrow...Does our current tax structure that we just heard is inequitable and narrow, does that fit today and will it fit tomorrow?"

A longer-range perspective would be equally helpful in addressing service needs. It is hard to build excellent public service systems without a plan (higher education is a particularly painful example), but Florida continues to define the extreme of ad hoc.

We are still hoping for a broader look at matching state and local revenues with service needs.

What is a realistic estimate of infrastructure needs over the next decade and a realistic financing plan? We don't know, and we doubt the legislature does. Could the state plan for fuller and more efficient delivery of health care services to Medicaid-eligible and poor children? And how effective are the continued state forays into the delivery of preK-12 education to the state's citizens of the future?

In building service systems, Florida continues to define the extreme of ad hoc.

Like the original Tough Choices report, this update is not a brief for a particular programmatic path or fiscal remedy. Rather we hope that these trend lines, projections and economic and demographic analyses make the case for looking out further than we have been accustomed to doing in Florida.

We will close, however, with several suggestions for capturing some low-hanging fruit on the revenue side and setting priorities on spending. Several are restatements of our earlier recommendations (largely unheeded). A couple are new.

* * *

Revenues

(1) Join the interstate Streamlined Sales Tax Project to increase tax collection on Internet sales. Even as Internet sales of goods increase year to year, Florida has yet to join the Streamlined Sales Tax Project, a compact among states to simplify differing tax codes and facilitate collection directly from Internet retailers. A Florida Tax Watch study in April 2007 estimated that Florida is leaving more than \$2 billion in annual revenue on the table. By 2008, the study says, the revenue foregone will have doubled in the five years since 2003. (In-state purchasers are supposed to pay sales tax on what they buy over the Internet. In practice, this is unenforceable, and they don't). For a state whose revenue base is so heavily dependent on sales taxes, this is a very significant omission. As the Tax Watch analysis observes, this is a formula for erosion of that base, now and indefinitely in the future. As a matter of equity, we also fail to see the point of giving the Amazons and L.L. Beans a 6½ to 7½% price advantage over Florida bricks-and-mortar retailers or out-of-state chains which operate Florida stores.

(2) Add new construction concurrently to the tax rolls. With Florida citizenry in virtual revolt over increases in their local property taxes, the state continues to give the developers and occupants of new buildings a break of up to a year before their property is taxed. As a matter of equity and public policy, this makes no sense to us. And the amount of money left on the table is not insignificant – probably several hundred million dollars a year.

(3) Welcome the coming wave of affluent baby boomer retirees but do not provide tax breaks or incentives. A surge of baby boomer retirees is virtually a sure thing, even if Florida gets a smaller share of that cohort than in years past. Studies show taxes play a small part in decisions on where to settle. Still, we need to be doubly sure that those retirees opting for Florida instead of home states with higher and/or more diverse taxes pay their fair share here.

(4) Recapture greenbelt tax breaks if agricultural lands are sold for development. Many other states do so while Florida continues to encourage land-banking with an untaxed windfall if the acreage is sold at a much higher valuation for development. Recapture could be combined with broadened use of conservation easements, preserving more of Florida's remaining vacant land in its natural state. Our patchwork system of locally varying impact fees is also always ripe for review.

Services

(5) Modify the class-size amendment. K-12 enrollment growth will resume. Thus the huge expense of exact compliance with the class-size amendment has been deferred for a few years, but it has not gone away. We continue to believe a somewhat more lenient standard – say, school-by-school compliance – would meet its main goals and free money for more strategic investments in K-12 improvements.

(6) Redress recent under-funding of higher education. Our updated data show that universities and community colleges are even more under-funded than before – and now subject to mid-year budget cuts. Low tuition and stingy state support for public universities have compromised their performance even as the number of students seeking admission increases. Community colleges are hard-pressed to maintain the tradition of open-door admissions as enrollments

Why give developers and new occupants a property tax break for as long as a year?

Bright Futures should define merit more rigorously and stop giving full stipends to families with no financial need.

rise and appropriations do not. Florida needs many year of aggressive tuition increases (10% or more) to begin to approach the national average – and budget increases as well. Right now we are significantly disinvesting in Florida's future economic vitality by trying to do higher education on the cheap.

(7) Reform Bright Futures. Since it began a decade ago, the Bright Futures scholarship program has been a candidate for reforms that would tighten its focus and control expenses. Without question, Bright Futures has increased educational opportunity for at least some of its recipients and provides high school students an incentive to stay in school and work hard on academics. Nonetheless, the grant should be for a fixed amount, raised periodically, rather than pegged to tuition increases. Otherwise it acts as a brake on tuition increases. Also the definition for merit needs to be set higher since the cutoff scores are actually below average for students at a number of Florida universities. While Bright Futures can claim some success in helping the best students to stay in state, full stipends to families with no financial need are not necessary. Even with cuts in Bright Futures grants and increases in tuition, our universities will remain a bargain.

To repeat our opening thought in this update, we expect that when another follow-up report is issued several years hence, it will not be in a time of budget crunch. Revenues should begin increasing at more normal rates year to year with good years ahead in prospect.

It is hard to be similarly optimistic, though, on where Florida will stand on the provision of public services. Backlogs, accumulated over many years, are only getting worse during a short-term budget crisis. We don't yet see a lot of political will or leadership to do better for working Floridians in such basics as schools, medical assistance, higher education and infrastructure. Tough choices remain for Florida policymakers and the citizens they represent.

ONLINE INFORMATION AND CREDITS:

This update and the two versions of the original Tough Choices report can be found at fsu.edu/~collins.

This summary was written by Rick Edmonds, based on charts and analysis by Dr. David Denslow of the University of Florida and Dr. Carol Weissert of Florida State University. It also draws on their testimony and that of Curt Kiser before the Tax and Budget Reform Commission November 1, 2007. Recommendations were approved by the Board of Trustees of the Institute.

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“Government is the one vehicle through which all the people can work together to accomplish the goals which they, as individuals and through private initiative and resource, are unable to achieve.”

**– Governor LeRoy Collins
November 1957**

The LeRoy Collins Institute
FSU Campus
506 West Pensacola Street
Tallahassee, Florida 32306-1601
(850) 644-1441 Fax (850) 644-1442