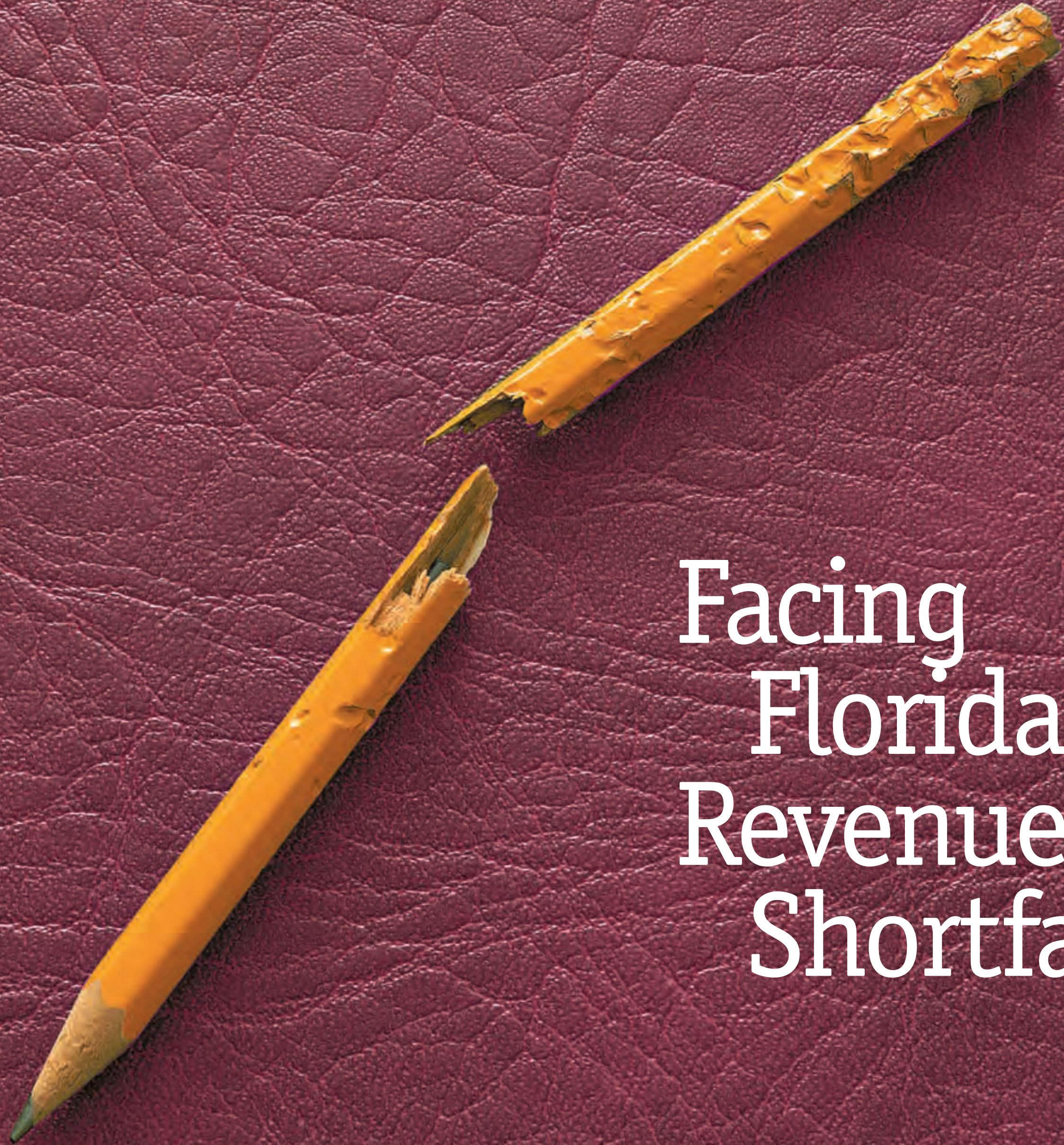
TOUGH CHOICES

Facing Florida's Revenue Shortfall



A Report from the LeRoy Collins Institute

Two years ago, the trustees of the Jessie Ball duPont Fund approved a request from Florida State University to produce a politically neutral study of Florida's tax policy, one that would include researchers from the Collins Institute and the University of Florida.

Researchers argued, and the Fund's trustees accepted their argument, that the people of Florida deserved a clear understanding of the future challenges current demographic shifts will place on the state's tax structure. In other words, researchers proposed answering this question: will Florida's current tax structure support the future needs of Floridians?

We trust that this executive summary, and indeed the full study, will attract the interests of thoughtful Floridians throughout the state and that they will have an opportunity to think about the study's recommendations.

– Sherry Magill
President
Jessie Ball duPont Fund

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Dear Floridian,

We are marking this year the 50th anniversary of the LeRoy Collins' governorship. His perspective of what state government can and should do remains relevant to our times.

Collins was not, as he once put it, a believer in strong government for the sake of strength alone. He was unapologetic, though, in his belief in government as "the one vehicle through which the people can work together to accomplish the goals which they as individuals and through private initiative and resource, are unable to achieve."

In practice, Collins shepherded Florida through the first difficult years of school desegregation, insisting that adequacy of the education effort was paramount and 'states rights' resistance a futile distraction. He had the ability too to look far out into the future, for example, with his vision of an institution of higher education within driving distance for every citizen. That was the impetus to building our state's widely admired network of 28 community colleges.

In 2005, Florida finds itself behind the growth curve in providing hard "public goods" such as roads, water supply, and school buildings. The need for services -- well-qualified teachers, health care for children and the needy, higher education capacity -- is pressing and likely to get more urgent in coming years. And the next five years, as this report documents, are likely to be ones of much less robust revenue growth than Florida has recently experienced.

The need for services -- well-qualified teachers, health care for children and the needy, higher education capacity -- is pressing and likely to get more urgent in coming years.

Hence we face a series of tough choices, coming sooner rather than later. This is not unprecedented, and Florida's government and growth will hardly grind to a halt. The default response, perhaps encouraged by year-to-year budget cycles, has typically been to cut to fit, but those have not always been the best choices for Florida. Most obviously we remain in a cycle where low educational spending and attainment reinforce an economy in which the number of jobs grows strongly, but real earnings for most Floridians are stagnant.

Tough Choices is in two volumes. The book version by economist David Denslow and political scientist Carol Weissert analyzes in careful detail where we are in provision of services, how we compare to national averages and peer southern states, and how we got here. It also projects service needs and revenue prospects over the next five years and beyond. The report you have here by writer Rick Edmonds summarizes their findings. It includes recommendations and strategies from the Collins Institute Board of Trustees to help Floridians be proactive in shaping a bright future for Florida rather than just getting by.

Curt Kiser
Chairman
LeRoy Collins Institute
October 2005

CHAPTER 1 | REVENUE

A great run of growth about to level.

Florida's explosive growth – in population and job creation – is a twice-told tale. For several decades with occasional slumps and surges, the state has experienced a net growth of roughly 1,000 residents a day. Florida has also led the nation in job creation with great consistency, even during the soft economy of the early years of this decade.

What is less well known is a chain of events that has caused state revenues and state government to grow as quickly as the state itself over the last 25 years.

It is our judgment that that rate of growth is almost certain to slow appreciably the next five years. The Florida Revenue Estimating Conference, the official consensus forecast says just that. Net general revenue grew $1.9 billion for fiscal 2003-2004 and $2.8 billion for fiscal 2004-2005. For FY 2005-2006, it slows to $950 million of growth and for 2006-2007, $500 million. The following three years are estimated in the $1.3 to $1.8 billion range, but no year rises to the growth level of the last two.

Bottom line, net general revenue is estimated to grow in the coming five years at barely half the rate the state has enjoyed for the last two.

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That's a dead mismatch to the cost side of the budget, where pressures to fund preK-12 education, Medicaid and other state needs will be as intense as any time in recent history.

Florida is staring straight at a significant shortfall – and some very tough choices.

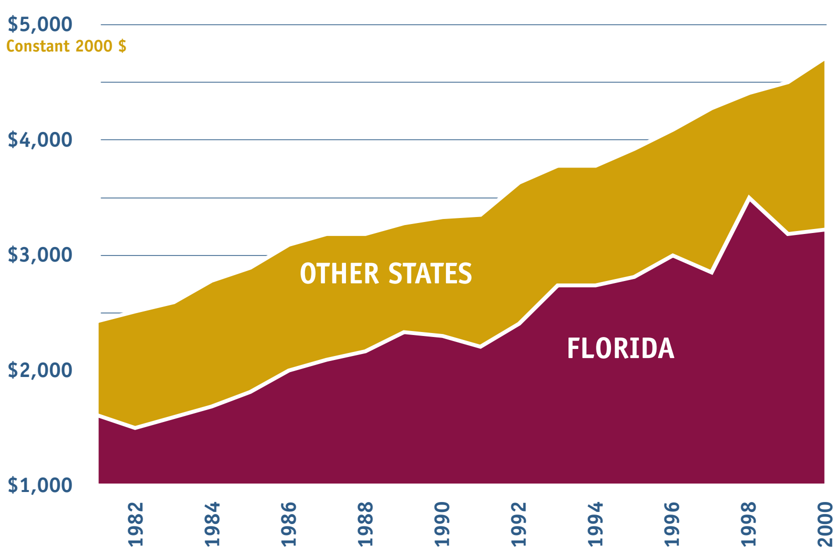
1980-2000 –– Twenty years of keeping pace

In 1980, Florida's growth boom was well underway. Population stood at roughly 10 million. By 2000, the state had nearly 16 million residents (and we have added 2 million more since).

Given that Florida's current level funding of government services trails that of most states, one might suppose that government growth didn't keep pace in these years. The numbers tell a different story.

Using the measure of total state revenues (rather than net general revenue alone as above), Florida grew from $9 billion in 1981 to $51.6 billion in 2000. That more than fivefold increase has much to do with inflation and population growth. But controlling for those factors, real per capita revenue in constant dollars still nearly doubled during the period, a rate of growth only slightly less than that of the other 49 states. (see Chart 1).

CHART 1
Real Per Capita State Revenue, 1981-2000



SOURCE: Florida Consensus Estimating Conference

How was such growth achieved?

For one thing, despite such notable anti-tax events as the passage and subsequent repeal of a sales tax on services in the first year of the Martinez administration, tax rates have increased. In 1980, the state sales tax stood at 4 percent. Now it is 6 percent in all Florida counties and 7 percent in the many counties that have chosen to levy an additional local option penny.

Population growth, job growth and long periods of prosperity in the 1980s and 1990s all have raised the base for the sales tax. So have millions more tourist visits with steady increases in the dollars spent per visit.

One could argue that local taxes and local government spending – especially on schools and infrastructure -- are part of a fully rounded picture of the state's revenue resources and service needs. Here too there have been notable tax rate increases. In 1980, the county-wide millage rate was less than 10 mills in five Florida counties, and no county had a rate as high as 20 mills. In 2000, there were no rates less than 10 mills and seven counties had rates exceeding 20 mills.

Growth machine or not, Florida is not immune from business cycles.

Of course, the base for local property taxes grew too. Then in the late 1990 real estate took off like a rocket – and it hasn't touched down since. The dimension and impact of the extraordinary real estate boom form the next phase of this revenue story.

2000-2005: Housing Boom to the Rescue

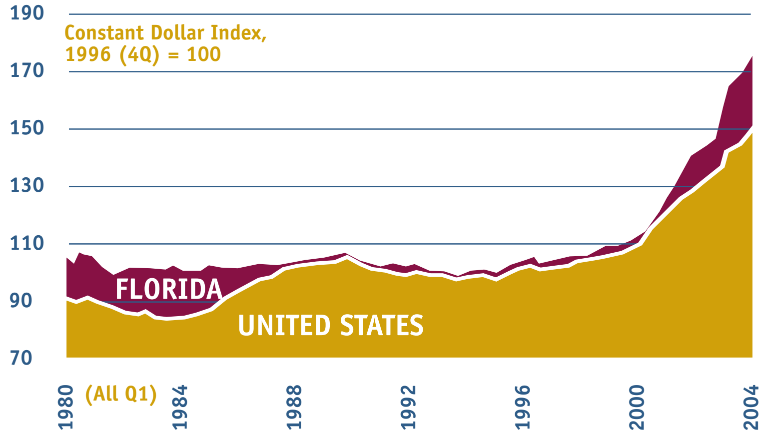
Growth machine or not, Florida is not immune from business cycles. When commercial real estate, construction and the savings and loan industry crashed in the late 1980s, followed by a sharp general recession, Florida was hit as hard as most states. After the service tax was repealed in 1989, one of those extra pennies in statewide sales tax was levied -- to balance that fiscal year's budget and provide adequate levels of service the following. The early 1990s were also the time of zero-tolerance, mandatory sentencing for drug offenses and a shortage of prison capacity. Spending on corrections pinched other state services, higher education particularly.

After the sustained prosperity of the rest of the 1990s, the economy entered recession again from 2000 to 2002. And there was an impact on state finances -- adjusting for inflation, net general revenues were nearly flat for those three years. But the pinch on state budgets was moderate at most, and the last two have been positively expansive.

Why?

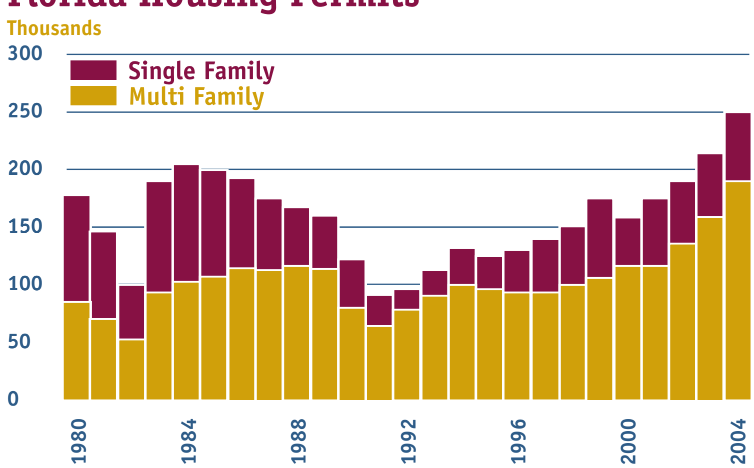
Florida is in the midst of a housing boom unlike any the state has experienced since the 1920s. Eight years and running, the boom combines fast-rising prices and strong growth in new housing permits. Add to that a hot market for trading up in existing homes, and you have a potent multiplier effect. More transactions at higher value send the state documentary stamp tax revenues soaring. A fast-expanding local property tax base makes for comfortable funding levels for city and county governments, even allowing some simultaneous easing of rates.

CHART 2
Inflation-Adjusted House Price Indexes



SOURCE: Calculated from Office of Federal Housing Enterprise Oversight Repeat Sales Index

CHART 3
Florida Housing Permits



SOURCE: US Census Bureau

Some detail on the boom and its fiscal impact on Florida:

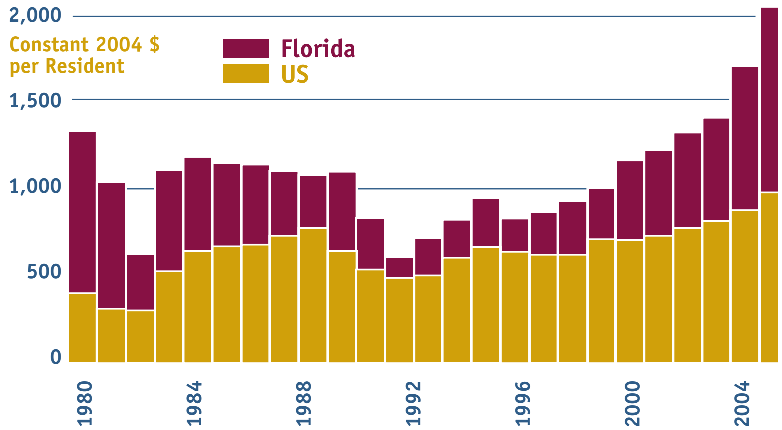
In the 16 years from 1980 to the end of 1996, Florida house prices, adjusted for inflation fell 7 percent. Over the next eight years prices rose by 70 percent, compared to 50 percent nationally. (Chart 2).

There is no scarcity factor driving the price rise. To the contrary, the number of housing units being built has reached unheard of levels. (Chart 3).

Another measure of the sudden rise is that the value of new construction permitted per resident in Florida reached $2000 in 2004, twice the national level and twice the normal level since 1980 for Florida residents (Chart 4).

Though the boom, its causes, and speculation on how long it will continue all began to receive major attention in national and Florida media during the spring and summer of 2005, the cumulative effect on state and local tax revenues has drawn comparatively little attention. The impact, of course, has been huge.

CHART 4
Housing Construction Per Resident



SOURCE: calculated from US Census Bureau

One easily measured is the revenue increase from the state's documentary stamp tax on real estate transactions. In just four years, it more than tripled -- from $479 million in 2000-2001 to $1.5 billion in 2004-2005.

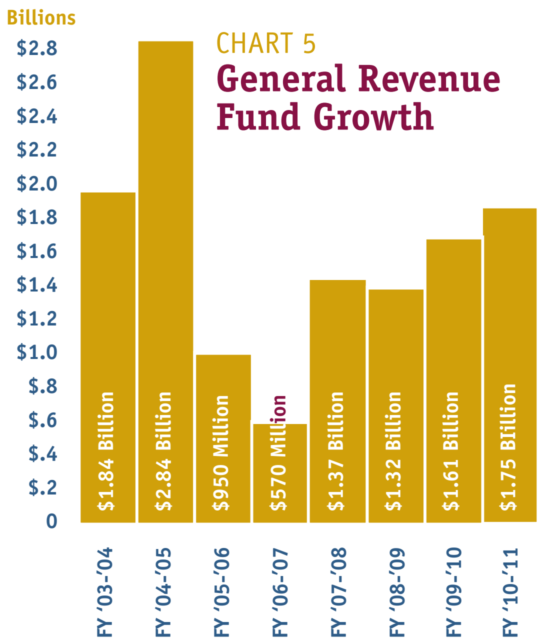
Property taxes for local governments soared as well. New houses add to the base. They are more expensive than existing homes and appraised at closer to their true value. Property taxes on existing homes rise too when they're sold by families moving up to new residences. The effect would be even greater were it not for the "Save Our Homes" constitutional amendment, limiting valuation increases to 3 percent yearly on homes not sold.

Somewhat less obviously, the housing boom has a very favorable impact on sales tax revenues as well. Builders are out buying lumber and concrete. Homeowners are buying plenty of new furnishings.

The four major storms of 2004 create yet more of that same effect. While hurricanes are a financial hardship to individuals and a potential tragedy to the uninsured, the are a net economic plus to the state once the rebuilding begins. The insurance settlements are plowed into another round of building and purchase of materials on which sales tax is paid.

We are unaware of any contemporary and comprehensive measure of the housing boom on local taxes in Florida. However, here is an indicator. The preK-12 education budget is prepared combining state contribution with local taxes designated for schools. For the coming year, the legislature was able to fund a healthy $1.3 billion increase in the preK-12 budget. More than $800 million of that is from increases in local taxes.

CHART 5
General Revenue Fund Growth



SOURCES: Florida revenue Esimating Conference, Fall 2004 and April 11, 2005. April 11 did not include new projections for 2008-2011.

2005-2010 – Predictable Slowdown

In April 2005, the consensus estimating conference announced that a surprise $2.2 billion dollars in additional general revenue should be added to its estimates. Technically that revision was split over two fiscal years, the one ending this June and the one beginning in July. On its face, the recalculation indicated that Florida has been living in even sunnier fiscal times than everyone had thought.

Predicting trouble ahead under these circumstances will sound counterintuitive and alarmist. However we do see a marked slowing in state revenue growth – and so does the official revenue estimating conference.

That is not to say Florida's longtime growth momentum and the tax benefits of the huge tourist trade are going to go away. Some argue that as baby boomers are entering their retirement years, our state's housing demand will remain strong for many years compared to that of the rest of the nation.

But real estate booms like the current one inevitably slow, stop or, worst case, crash. We can't say when, how or how severe the end will be. Even the drivers of the current boom are something of a mystery. Various analysts cite a glut of foreign savings investments, the wave of condo conversions, speculative investors looking to flip properties for profit, and novel mortgage formats attracting marginal buyers. Taken together that looks to be a set-up for a sharp fall eventually.

However assuming the best for Florida – a bit longer window of good times and a soft landing for housing, chances are still slim of duplicating recent feverish revenue growth.

The consensus estimating conference foresees a flattening of doc stamp revenues in the years to come, settling at a level a bit below 2004-2005.

The most likely progression for net general revenue growth according to the conference is shown in Chart 5.

If the forecast is accurate, the next four years together will produce less revenue growth ($4.2 billion) than did the last two ($4.7 billion).

Can Florida get by comfortably with the disposable income part of state revenue growing half as fast?

Senate President Tom Lee has noted that complying with the class size amendment alone – an estimated $2 billion a year obligation – outstrips expected revenues (keeping all other state spending flat or reduced.)

He and Governor Bush set aside two-thirds of the $2.2 windfall of this spring to another urgent need – making a dent in our state's backlog of infrastructure needs.

The balance of this report will treat these and other public service challenges that lie ahead. Florida faces some very tough choices. They are foreseeable right now. The revenue-service squeeze will be inherited by a new governor and new legislature in 2007 – whoever they may be, whatever party, whatever their agenda.

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CHAPTER 2 | SERVICES

The big two and big trouble ahead

Two categories of state spending – preK-12 education and Medicaid – far outpace all others, accounting for roughly half the state budget. It is a measure of Medicaid's sustained and explosive growth that it has pulled equal to education spending (a phenomenon common to many states, not unique to Florida).

There is a degree of discretion in funding both services, but they are fundamentally entitlements. "Adequate provision" of public education was defined as a "paramount duty" of state government in Florida's most recent constitutional revision. An important cause of rising Medicaid costs is that once eligibility rules and parameters of service have been set, all those who qualify get services.

The remaining half of this decade finds both programs under intense funding pressure. We will indicate in summary form here why that is.

Our low ranking among the states has a double significance looking out five years and beyond.

Our discussion also opens the topic of how Florida compares in spending and some other measures of service delivery to national averages and to other southern states. In short, we do not compare particularly well. Our low ranking among the states has a double significance looking out five years and beyond. One might reasonably make the case for improvements, be it teacher salaries or provision of health care to children. Conversely, squeezing spending still further is an unattractive option – we are down to a minimally acceptable effort already.

PreK-12 Education – Compounding growth, the bottomless pit of class-size compliance

For Florida's schools, just keeping up with enrollment growth of 50,000 students a year is expensive. As then Education Commissioner Betty Castor put it in the mid-1980s, we need to find a classroom and put a teacher in front of those students before we can begin to talk about additional spending on improvements. That was during the first wave of Nation-at-Risk school reform, when many other states were framing ambitious plans to do better with flat or even declining enrollments.

By our estimate, it takes $400 to $800 million in state funds each year just to stay even with serving the additional students.

The pace of enrollment growth in other states – Georgia, for example, -- has picked up considerably since. But routine expansion of Florida's system remains a significant cost pressure. By our estimate, it takes $400 to $800 million in state funds each year just to stay even with serving the additional students.

There is a great deal more, though, the state must do in the next five years.

The complement of students served is about to increase with voluntary public Pre-kindergarten for four-year-olds. Ramping up this fall, the program, mandated by constitutional amendment, has several variables that make the level of new funding commitment uncertain. Not every eligible four-year-old will register – some families prefer to keep the little ones at home; others may not know of the program or get around to enrolling. By mid-summer 2005, there were still many more funded spaces than commitments to attend. Also, not every existing day care and nursery school program will choose to meet the standards for the state funding. Finally, the funding per student has been subject to an extensive debate we will not recapitulate here. It begins at $2,000, but will likely to rise to nearly twice that – the level of established programs in Georgia and North Carolina.

Florida's first official Constitutional Amendment Initiative Impact Conference in 2002 estimated the ultimate cost of the program at between $425 and $625 million. Our estimate is at the low end of that range, predicting 100,000 students will be added to the system at $3,500 per year, plus added costs for upgrades for some of the estimated 68,772 four-year-olds in existing publicly funded programs.

The salient point is that phasing in pre-K and its associated costs takes place in the exact time frame covered in this report – 2005 to 2010.

However, it was a second constitutional amendment of 2002 – mandating that much smaller class sizes be phased in by 2010 – that ratchets up budget pressure to mind-boggling levels. Elementary (K-3) classes are to be limited to 18 students, grades 4 to 8 to 22 and high-school classes to 25.

The same constitution amendment impact estimate put the 10-year cost of compliance at $20 to $27 billion, leveling out at $2.5 billion in the out years. That has been rounded down since to a consensus $2 billion a year – still huge when compared to a total school budget of slightly more than $16 billion.

In signing the final 2005-2006 budget, Governor Bush noted that it included $1.5 billion for class-size reductions and that the state has now committed nearly $3 billion in operating funds and $700 million in capital to that end over three years. Well, that's a very good start, but it is still short of $2 billion a year and comes during a period of extraordinary revenue growth.

The spending pressure is twofold – hiring more teachers and providing class space. And while there may have been some slack in space use and scheduling efficiency to be captured in the initial years, that clearly will become less of a possibility as time goes on. California's experience, starting in 1996, with a similar class-size limitation initiative led to the hiring of a large number of uncredentialed teachers. Perhaps as a result, gains in achievement have been hard to document there. In fact, the earlier and often-cited STAR experiment in Tennessee found benefit only in the primary grades.

In Florida, compliance seems certain soon to put pressure on the available funding for teacher raises and other school improvement strategies. Governor Bush proposed during this last session putting modification of the amendment on the ballot in exchange for promising a $6,000 raise to starting teachers. The measure passed the House but failed in the Senate.

So we enter the most difficult period of compliance with continued speculation that some softening of these requirements, especially as affects the upper

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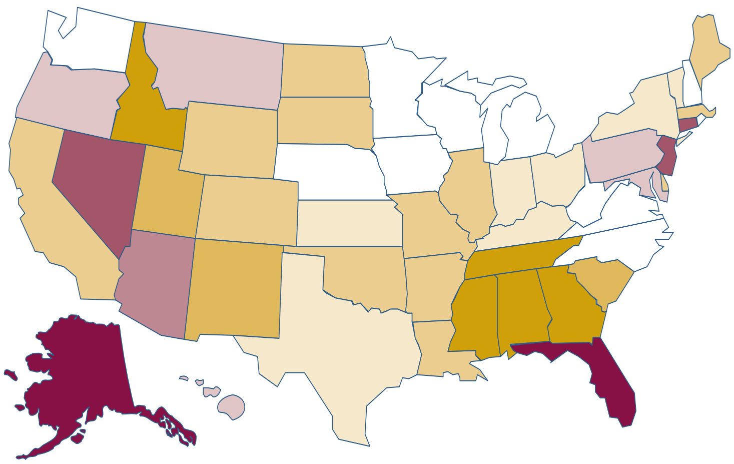
grades, could happen in the future. There is no particular evidence, however, that voters are ready now to make such an about face (as they did in narrowly repealing the bullet-train amendment in 1994).

CHART 1

% Change in K-12 Operating Spending per Student, Fiscal years 1992 to 2002

Constant 2002 $



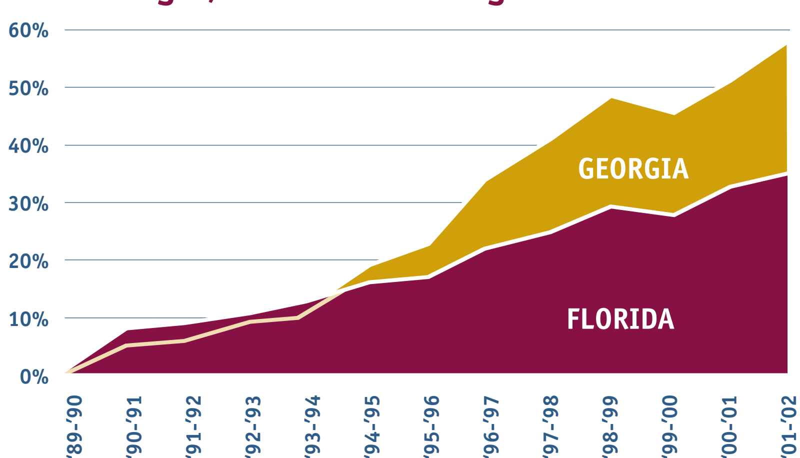
- +35% to 40%
- +30% to 34.9%
- +25% to 29.9%
- +20% to 24.9%
- +15% to 19.9%
- +10% to 14.9%
- +5% to 9.9%
- 0% to +4.9%
- -5% to 0%

TOP FIVE		BOTTOM FIVE	
ALABAMA	+40%	NEVADA	+4%
GEORGIA	+39%	NEW JERSEY	+3%
MISSISSIPPI	+38%	CONN.`	+3%
IDAHO	+37%	FLORIDA	-2%
TENNESSEE	+36%	ALASKA	-5%

SOURCE: To come

CHART 2

Nominal Wage Growth of Teachers in Florida and Georgia, 1989-'90 through 2001-'02



SOURCE: TO COME

Comparisons to other states

As of 2002, the latest year for which comparable data were available Florida was in the bottom 10 states in spending per student. (The three strong years since may have improved that rank). With Alaska, it was the only state to have decreased spending per student, after adjustment for inflation, between 1992 and 2002 (Chart 1).

Unsurprisingly, Florida also now substantially lags peer states in what it pays teachers.. To take the most commonly cited example, a teacher can increase pay $5,000 to $6,000 crossing the border to Georgia (Chart 2).

Noncompetitive salaries are likely to present more of a problem in the next few years than they have in the recent past. Studies show that better pay is not much of a factor in decisions of experienced teachers to move or quit. But the reverse is true for those entering the profession, especially recent graduates, who can get both higher pay and smaller class size should they choose to teach in Georgia.

The demands of the class-size amendment put a spotlight on recruitment. Turnover has been fast lately anyhow as baby-boomer educators qualify for full pensions and retire. The California scenario – getting by with a group less credentialed and less well-paid teachers is hardly desirable. Plus it would collide with the requirement of the federal No Child Left Behind law (subject to some further definition and modification) that all teachers be "highly qualified" by the end of the 2005-2006 school year.

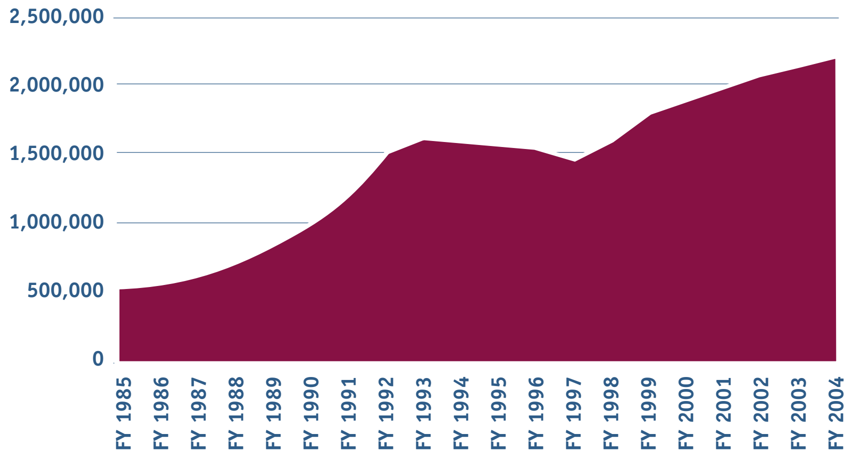
Together, these circumstances form a case in point of how a negative paper comparison can quickly escalate to a significant constraint on the effectiveness of the system.

There is a more speculative problem on the horizon too. Florida has achieved significant improvements in student achievement, starting from an admittedly low base, as measured by both our own FCAT and the National Assessment of Educational Progress (NAEP). Can those gains be sustained, or better yet improved upon, with revenue growth cut in half and a preoccupation with class-size goals?

Medicaid – An 800-pound gorilla with a mind of its own

For at least a decade, Medicaid has been the subject of intense cost-control efforts at both the state and federal level. Growth has moderated some since the 20 percent-plus annual norm during the late 1980s and early 1990s. But the stopper doesn't stay in the bottle for long (Chart 3).

CHART 3
Medicaid Enrollment Growth, Fiscal Years 1985-2004



SOURCE: Social Science estimating Conference, september 26, 2003

To illustrate, Florida experienced a nearly 10 percent increase in Medicaid expenditures in 2004-2005 and expects a 13.7 percent increase in the current fiscal year. The general revenue contribution, according to the February 2005 report of the Social Services Estimating Conference, will likely grow even faster – 21.2 percent.

In recent years, Medicaid has grown to more than 20 percent of Florida's budget. It roughly equals Pre-K-12 education as the largest single category of spending.

These current years are the long-running Medicaid saga in microcosm. Slowing the rate of growth, as one analyst, put it in 2003 "is back in the crosshairs," but taking aim and hitting the target remain two different things.

At the federal level President Bush's proposal to shift Medicaid to a block grant rather than entitlement format languishes in Congress, though a goal of cutting $10 billion over five years remains. States fear that the result would be more of a burden on their budgets over time. The National Governor's Conference Association has proposed an alternative reform model.

Florida, like many states, has made numerous efforts at containing Medicaid costs including disease management programs, discounted pharmaceuticals, preferred drug lists, fraud and abuse prevention programs, development of alternatives to nursing home care, fewer services and reduced payments to providers. In 2005 requires substitution of less expensive drugs for some behavioral health prescriptions. Doctors and patients are protesting loudly, and there is a provision for override in certain cases.

Florida, like many states, has made numerous efforts at containing Medicaid costs.

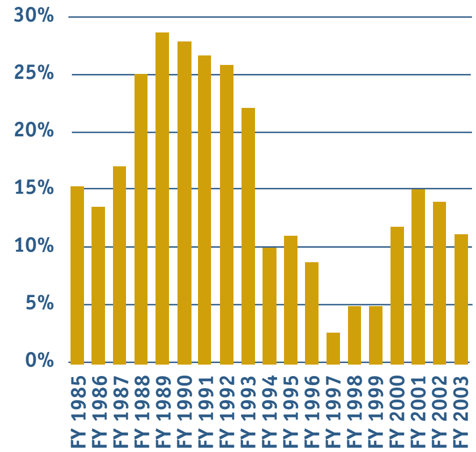
Governor Bush also has proposed a much more sweeping privatization of Medicaid that would fund recipients at varying levels and let them shop within the system. The 2005 legislature approved only a pilot of the plan for two counties, and Senate President Lee has expressed strong reservations about proceeding quickly to an untested alternative.

Medicaid was designed to fund health care services for the most vulnerable members of society – primarily the poor, elderly and disabled. However it has evolved into a complex array of programs serving an assortment of recipient groups, each with different eligibility standards and a different package of services.

That complexity is one cause of the difficulty of cost control. Another is that most of the constituent programs provide a match of more than a dollar in Federal aid for each state dollar spent. Hence, despite the runaway costs, Medicaid is an attractive proposition compared to spending unmatched state money on health care.

Also there is a compounding effect in the factors that drive costs up: enrollment increases, medical inflation, coverage of more and more expensive prescription drugs, and the growing costs of long-term care for an aging population. Over time, a dynamic has developed that employers have little incentive to provide coverage for low-wage workers who qualify for Medicaid – another built-in inefficiency of the program's structure. As private health care costs continue to rise, employers are increasingly dropping their employees' health coverage or impairing it with large premiums and co-payments.

CHART 4
Annual Medicaid Expenditure Growth Rate, Fiscal Years 1985-2003



SOURCE: AHCA, A Snapshot of Florida medicaid, 2004

The growth of Medicaid expenditures in Florida closely follows a national pattern. In the late 1980s and early 1990s, annual growth often ranged above 20 percent. It moderated greatly in the latter years of the 1990s, but 5 percent remained typical. Since then the norm is back to 10 percent and above. (Chart 4).

Medicaid has had its share of waste and fraud through the years. But it's worth noting that employer sponsored health plans were up 11.4 percent in 2004, the fourth consecutive year of double-digit growth. It is hardly surprising government hasn't done better.

A change back to more moderate levels of growth is certainly possible. A federal block grant that would allow Florida and other states to cap enrollment is one cost-cutting strategy under discussion. Should that combine with medical inflation only slightly above the general rate of inflation and more moderate growth in the amount of medical care consumed per enrollee, a return to mid-single digit increases might be possible.

But it is hard to look at recent history and find grounds for optimism. Medicaid spending has a surprisingly strong political constituency – less the recipients themselves than the physicians and institutions providing the care.

For Florida broad cutbacks would potentially raise another tough question. How skimpy a safety net is acceptable?

Comparisons to other states

According to estimates of the National Association of Budget officers, Florida's total Medicaid spending per resident in fiscal year 2004-2005 was $714 compared to $895 for the nation and $881 for other southeastern states. Excluding the federal contribution, Florida's own-source spending trailed the southeastern average by a more moderate 5 percent.

Spending per enrollee – an alternate measure – finds Florida lagging the national average but fairly comparable to other southeastern states.

The low spending is a bit of a puzzle. The state has a disproportionate share of the elderly, who dominate the enrollment for long-term nursing facilities and long-term home care. But another anomaly of Florida's Medicaid mix is that it spends comparatively more on acute care and less on long-term care than the norm despite the skew of the demographics.

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Those same demographics are working against Florida looking out to 2010. Florida expects to see its percentage of those 65 and older rise from 17.6 percent to 18.4 percent over the next five years.

Conclusion

To date the massiveness of the Medicaid program helps explain repeated disappointments in bringing its fiscal aspect under control. Perhaps there is potential there as well. A careful assessment of where Medicaid dollars go and why could set the stage for an overhaul that best meets the needs of current Floridians and eliminates some of the inefficiencies and perverse incentives nearly everyone agrees are embedded in the program as it exists. Looking out from the fall of 2005, however, that's a goal that appears years away.

CHAPTER 3 | INFRASTRUCTURE

Huge deficits, the coming crunch, a down payment

A third major expense looms on Florida's public agenda – staying even and better yet catching up on the road capacity, new schools and water systems our state's constant population growth demands.

Unlike pre-K-12 education or Medicaid, there is little element of entitlement to any of these. Spending is discretionary – responsibility split between federal, state and local jurisdictions – and adequacy a subjective matter.

What is pretty clear is that through some combination of low tax revenues and impact fees that don't have growth truly paying for itself, Florida has dug itself into a deep hole on basic infrastructure. How deep is difficult to quantify. Perhaps the best accepted number is a 2003 Department of Transportation study that concluded Florida should be budgeting $2 billion more a year to stay even and $4 billion more to improve – just on the state roads portion of the deficit.

That costs out to a $20 to $40 billion deficit to be addressed over the next decade – lest we opt for more crowding and gridlock.

An indicator of the seriousness of the problem is what happened this spring after the discovery of a windfall $2.2 billion in revenues (as discussed in the first chapter of this report). Rather than opt for tax breaks or loosened purse strings on local projects, Governor Bush and Senate President Lee had legislation at the ready and passed it, applying two-thirds of the additional funds to infrastructure needs.

While one legislature has limited power to bind a future legislature's spending decisions, the infrastructure legislation bonded much of the money and classified some of the doc stamp revenue as a "recurring" commitment to infrastructure. It also created study committees on impact fees, water and school construction needs.

We will have several recommendations in the final chapter of this report. But here may be the right place to credit Bush and Lee with leading a sharp public focus on the issue and making a good start on finding the fiscal resources to address it,

Infrastructure and Impact Fees

With so much official action already in progress, we will offer only brief comment on the broad infrastructure issue and its transportation component.

The growth management legislation of the mid 1980s arguably has failed to do much to influence the rate of growth or where it went. It did, however, bring a wave of impact fees charged to new construction.

We will not rehash the many succeeding years of growth management debate except to note that the term is wildly expansive including concepts of containing sprawl, encouraging urban infill and preserving the environment. One of Bush and Lee's contributions is that, without being dismissive of those important concerns, they have reframed growth management as a narrower fiscal question.

There has been a great deal of study, but again no agreed-upon answer, to the question of what it takes in impact fees for growth to pay for itself.

Persuasive numbers on the whole infrastructure backlog or expenditures required in future years are hard to come by. We should note (so as not to double-count a need of the near future) that school construction required to comply with the classroom size initiative is part of the $2 billion a year estimate cited in the second chapter of this report.

There has been a great deal of study, but again no agreed-upon answer, to the question of what it takes in impact fees for growth to pay for itself. Or to put it another way, for every 1,000 new residents or 100 new housing units, how much of the infrastructure need is unmet or deferred.

You might say that there are at least 67 answers to the question since the majority of impact fees are set locally. Water and sewer hookups charges may be set by local authorities. To some extent this makes sense -- land for a new school costs a lot more in Collier or Broward counties than in Walton; getting a fresh water supply to Miami-Dade is a lot more expensive than capturing the abundant natural supplies in North Florida.

The fresh wave of concern at the state level suggests, though, that in many counties, influential developers are still getting their way and a reduced-price ride.

A case in point of differing local answers to the impact fee question is schools. Roughly a third of the county-wide districts now charge a fee specifically for schools (meaning, of course, that more than half charge nothing). Also the amounts are rising precipitously. When the Orlando Sentinel surveyed the matter in 2003, the top of the range was $3,000 to $4,000 per new single-family home. Now a number of counties (Lee, Osceola and Volusia) are in the $10,000 per unit range.

Homebuilding interests are arguing (even suing) that impact fees that high are unfair and damage the cause of affordable housing since the charge is the same for a $125,000 or $500,000 home. It is hard to believe that the sudden wave of high fees is unrelated to the intense pressures of complying with the class-size amendment. There is a good deal of sorting out to be done about the facts and equity of the matter, and the between-session study commissions are a logical start.

Florida's spending on roads is merely average among the states, surprising given our rapid population growth and large complement of tourists.

Transportation

Nothing epitomizes infrastructure problems better than a traffic jam. Congestion has some obvious costs too – in time and fuel wasted.

The Texas Transportation Institute has been estimating these costs for 75 metro areas since 1982. The estimated total for Florida's six largest metropolitan areas was calculated to be $4.25 billion in 2000. That translates to $458 per person in those metros.

By our rough calculation, the value of federally funded transportation infrastructure per Florida resident is barely a third of the national average.

Florida's spending on roads is merely average among the states, surprising given our rapid population growth and large complement of tourists. However studies show that investment in roads and population growth do not necessarily correlate. Furthermore dense urban settlement like Florida's draws less federal highway spending than a more diffuse population. Since the Interstate program was designed for continental connectivity, federal spending is further depressed when most of the growth is coastal, as it on the Florida peninsula.

Florida's deficit dates all the way to the 1950s. With 1.8 percent of the nation's land area and population, the state received only 1.69 percent of the federal funding in the first three years of the Interstate program, 1957 to 1959. The sustained population growth that began in those years and continues today has only compounded the gap. By 2000, Florida's population has risen to 5.68 percent of the nation's total and federal-aid appropriations for Florida transportation projects were only 4.77 per cent.

Since roads are extremely long-lived assets, these deficits are cumulative. By our rough calculation, the value of federally funded transportation infrastructure per Florida resident is barely a third of the national average.

So it is fair to say that while growth probably hasn't paid for itself and the legislature has allowed huge deficits to accumulate, Florida has been deal a particularly tough hand in providing adequate road capacity.

Current efforts by our congressional delegation to get a fairer share of federal dollars can help. Public transportation and other strategies to reduce demand also hold some promise for reducing congestion. In the end, though, Florida is faced with the need for a whole lot of road building and widening in coming years – and the necessity of do-it-yourself financing for a large share of that work.

CHAPTER 4 | **OTHER SERVICES**

A bottom-level effort puts higher education and children's services at risk

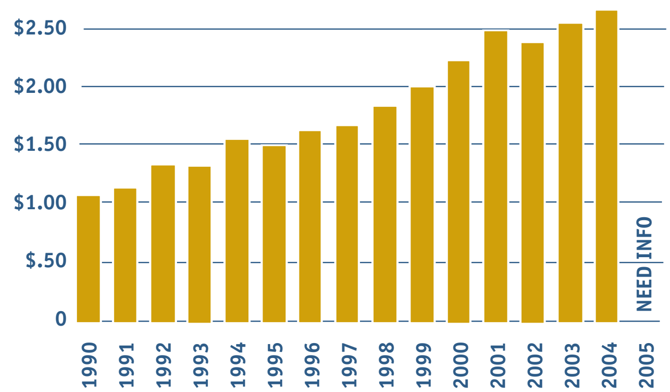
Rough estimates for 2005 place Florida's per capita spending on higher education, public and private, dead last among the states, about 55 percent of the norm. Later, more refined measures might improve that some, but it is safe to say we have a secure place in the bottom five among the states.

It is the purpose of this chapter to examine several state services and how they are likely to fare in the next five years of intense fiscal pressure.

Being an order of magnitude smaller than the likes of pre-K-12 education, Medicaid and infrastructure, unfortunately doesn't take these services out of play in budget tightening exercises. In fact, they may be more vulnerable.

Higher education is a good example. Specialists have noted that in most state legislatures funding progress is quite cyclical. After other needs are met, as one higher ed official put it, "higher education gets what's left." That has been the recent pattern in Florida. In the early 1990s, higher ed funding was squeezed by soft revenues and other demands, notably prison building. In the better years 1996-2000, the universities had healthy growth rates. But the increases have tapered off again this decade -- even with strong revenue growth, other priorities are gobbling up the available funding. (Chart 1)

CHART 1
Annual Educational and General Funds of the University System of Florida, Fiscal Years 1990-2005



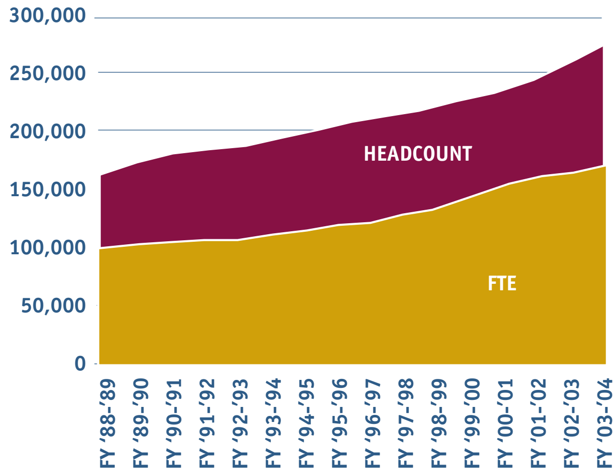
SOURCE: Florida Department of Education, *Fact Book 2003-04*, Table 40

What is not cyclical is enrollment growth. Given Florida's population growth momentum, it is unsurprising that university enrollments on both a head count and full-time equivalent basis have risen every year of the last 15 (Chart 2).

A second factor that holds Florida back is a peculiar financing structure. State appropriations on a per student basis do not trail the national average by all that much. But Florida universities, most of them young institutions, get comparatively less income from endowment and gifts and lag in federal grants (all three improving over time). What really keeps the spending down is low tuition. It is here we significantly trail the national average and are below our Southern peer states (Chart 3).

CHART 2

FTE and Headcount Enrollment, Florida Universities, Fiscal Years 1989-2004

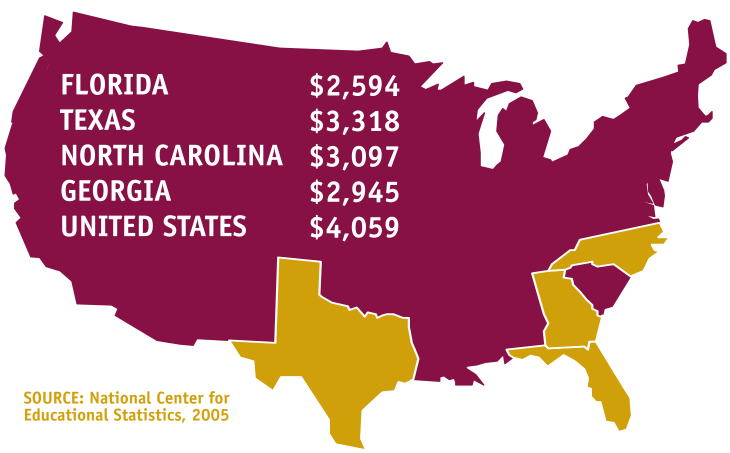


SOURCE: Florida Department of Education, retrieved July 26, 2005 from www.flbog.org/factbook/default.asp

CHART 3

Average Undergraduate Tuition and Fees

for Full-Time In-State Students in Four Year Degree-Granting Institutions, Fiscal Year 2003



SOURCE: National Center for Educational Statistics, 2005

Two popular programs have the effect of keeping tuition increases moderate. Since 1998 Florida has been awarding full or partial Bright Futures Scholarships to students with good high school grades and SAT scores. At elite universities nearly every student qualifies so for any large tuition increase, the state would end up paying the bulk of it.

Florida's Prepaid Tuition Plan has sold more than 1,000,000 contracts since it began in 1988. The great majority are future commitments, and the state has guaranteed to make good all contracts should the plan itself ever default. That is a second disincentive standing in the way of big tuition increases – in theory, the huge plan with so many constituents could run out of money and require a state bailout.

The Florida Council of 100 proposed a package of reforms in January 2004 that would have toughened Bright Futures qualification standards and increased the monthly payments on new prepaid contracts. That in turn could clear the way for aggressive tuition increases. Unfortunately in the two legislative sessions following, the plan got no political traction.

So it may be necessary to accept Bright Futures and Prepaid as untouchables anytime in the near future. That puts the full weight of paying for enrollment growth, competitive salaries or other improvements on the already pressed general revenue fund.

Children's health services present a parallel picture. Florida substantially trails the United States in health indicators for children, though in this instance roughly matches peer Southern states (Texas, Georgia, and North Carolina). There was a surge in the late 1990s, fueled by strong federal support, of health care coverage for children. Lately that has flattened so Florida faces the choice of taking on more funding from the state budget or watching the program shrink. That sort of squeeze looks likely to continue in the following five years.

The greatest discrepancy between Florida and the nation is in low birthweight babies. Smaller differences persist in infant mortality and child death rates. The most-recent "Kids Count" statistics, released by the Annie E. Casey Foundation in July 2005 but drawn from 2002-2003 show Florida 35th among the states, down two places in two years.

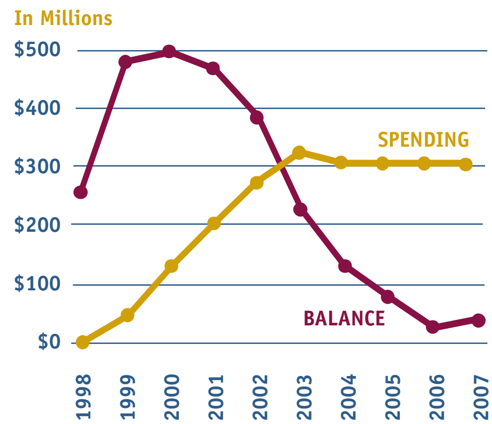
The child health insurance programs for the states were established in 1997 with 70 percent federal matching money. As in other states, enrollment grew quickly – from 56,265 in December 1998 to 319,477 in December 2003. Since then, while demand for the service continues strong, federal funding has tightened. There have been freezes and waiting lists for added spots. In the early years of the program Florida was able to bank carry-forward funds, but those balances are drying up as we head to the second half of the decade. (Charts 4 and 5).

CHART 4
Enrollment and Waiting Lists for Kid Care Programs, 2004

PROGRAM	ENROLLED	WAITING LIST
Healthy Kids (XXI)	269,109	68,290
Healthy Kids (Not XXI)	22,925	26,607
MediKids	34,405	20,355
Children's Medical Services	9,619	1,635
Medicaid Under Age 1	1,501	20,355

SOURCE: Alvarez, 2004

CHART 5
Spending and Remaining Balance in S-CHIP Program, Fiscal Years 1998-2007



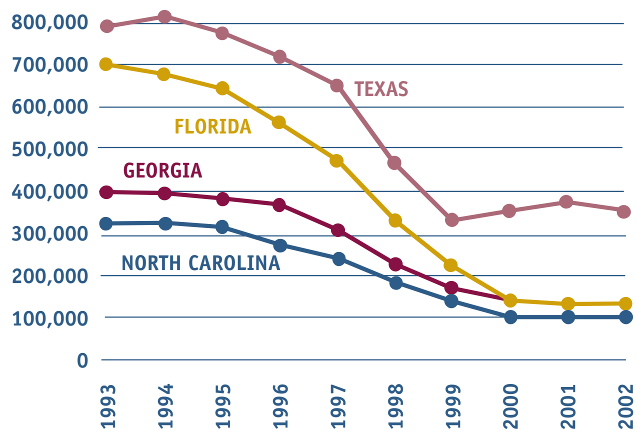
SOURCE: Florida Agency for Health Care Administration, Nov. 2004

It is not our aim in this report to be encyclopedic in tracing the trajectory of each Florida government service. But we would be remiss in closing if we failed to note that some have seen real improvement in recent years and do not look especially problematic for the balance of the decade. Three examples:

*Like many states Florida had a positive experience with welfare reform. With a few strategic increases in spending – for child care, for instance – the state has been able to realize big decreases in the number of recipients and program cost. (Chart 6).

CHART 6

TANF Recipients, Jan. 1992-Jan.2002



SOURCE: Administration for Children and Families, U.S. DHHS

*Public safety was a source of rapid spending growth at times in both the 1980s and 1990s. However corrections and other state-funded public safety services appear headed for only moderate growth over the next five years – thanks to favorable demographics, successful faith-based programs and a growing consensus that incarceration is not the most effective approach to drug abuse. Addition of nearly 10,000 beds is funded from 2005 through 2007. The incarceration rate is flat. Our estimate is of budget increases of as little as $450 million, a little over 10 percent for the five-year period.

*Protection of natural resources has been strong. Florida has spent more than $3 billion to date on environmental land acquisitions, with $3 billion more in the pipeline. An $8-billion federal-state restoration of the Everglades is in progress. Florida is pioneering market-driven environmental mitigation banking requiring developers to make up any loss of environmentally sensitive areas with restoration elsewhere.

In sum, slowed revenue growth will challenge Florida to stay strong where it is strong and will put particular pressure on services like higher education and children's health where the effort is barely adequate at present.

CHAPTER 5 | DEMOGRAPHIC FACTORS

Immigrants, retirees, job structure and voter attitudes

We turn in this section to a brief discussion of Florida's particular mix of residents, how that affects revenues, service needs and the practicality of possible solutions to the imminent shortfall.

In this case, we will refer interested readers to the longer version of the study for the economic modeling involved. The result is a fresh effort to quantify the gains and losses of some of our state's most important demographic groups and our job structure.

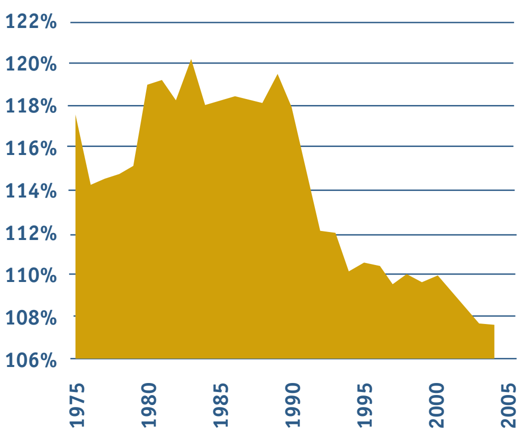
To state the obvious, Florida is an important destination for immigrants and almost certain to remain so. To be specific, Florida has roughly 5 percent of the nation's native population but 8.5 percent of its immigrant population. The 2000 census found 16.7 percent of the state's population to be non-native.

Are immigrants a net fiscal burden on state and local government? Yes, they consume services beyond what they contribute in revenue. However, as we will demonstrate, retirees and empty nesters, create a net plus in revenues over services and of comparable magnitude. Hence the two spikes in our demographic are offsetting – Florida does not have a problematic population pattern. It is worth noting too that immigrants do some of the low-wage work that keeps the economy humming. Over time, they and their children become fully contributing citizens.

To state the obvious, Florida is an important destination for immigrants and almost certain to remain so. To be specific, Florida has roughly 5 percent of the nation's native population but 8.5 percent of its immigrant population.

By our calculations an average immigrant household contributes $426 less to state and local budgets than a native household. In terms of public expenditure, we estimate that they receive $1,164 more in public preK-12 education and $221 more in state-funded Medicaid. Compared to a native household, the net effect of an immigrant household is roughly a $1,800 loss.

CHART 1
Florida Income per Resident Compared to the Southeast, 1975-2004



SOURCE: Unknown...

Almost half the net migration to Florida consists of people who are 55 years or older. Retirees are treated generously by the federal government with Medicare and Social Security payments. They pay somewhat lower taxes (92 percent of those for an average adult by our calculation). They are heavy users of Medicaid but incur virtually no education costs. By our estimate, the benefit to the state of having an extra retiree is roughly $1,200.

Empty nesters, it should be noted, are an even greater net benefit in the revenue services balance. They too are not consumers of education but also make lesser demands on Medicaid. Since most are working, they make an additional revenue contribution in the sales taxes and commercial property taxes their businesses pay. The net benefit appears to be three times as great as for retirees – roughly $3,600. Empty nesters form a slightly smaller portion of Florida's population than is typical nationally. That tilts the balance back to even (the benefit of a large retiree population would otherwise outweigh the extra cost of the immigrant group.)

The final chapter of this report will discuss in some detail why we see little potential in trying to induce more retirees to settle here with new tax incentives. One good reason why not is an empirical finding of many studies: taxes play only a small role in retirees' choices of where to locate.

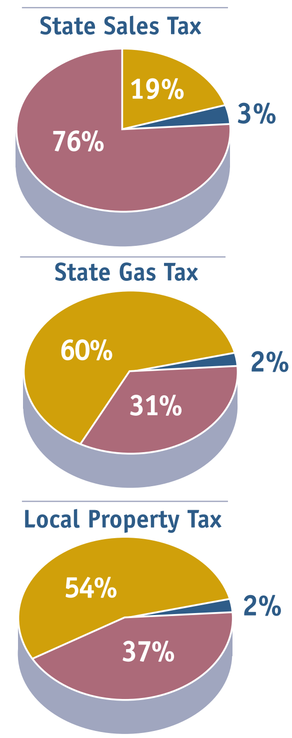
Turning to employment structure, Florida is prolific in creating jobs but stalled in its efforts to make more of those high-value/high-wage. Florida remains slightly above the average for Southeastern states in income per resident. However Florida declined against both national and regional averages from 1989 to 2002, reversing the trend of the previous decade. (Chart 1).

The goal of a more diversified state economy with a more competitive high-tech sector has been prominently recognized for decades. The size and natural momentum of the tourist/retiree service economy may simply dwarf these efforts. Arguably, warm weather, a slightly lower cost of living and other amenities paint a brighter quality-of-life picture for Florida than do salary comparisons alone.

Still we would agree with the Florida Chamber Foundation's original Cornerstone and New Cornerstone reports – a decade apart – that low public-school investment and educational attainment create a reinforcing cycle with the low-wage economy. Test scores are up in recent years. But Florida has a long way to go in pre-K-12 results, college degree production and investment in top-level university research before it can put a world-class labor force together with a dynamic high-wage segment of the state economy.

CHART 2
Public Perception of Taxes

They are...
TOO HIGH
ABOUT RIGHT
TOO LOW



SOURCE: University of Florida, BEBR Survey May-June 2004

Voters

As part of this study, we included a series of questions on taxing and spending in the University of Florida Bureau of Economic and Business Research surveys in May and June 2004.

To an extent the results were predictable and not heartening to those who would look to a greater tax effort as a partial answer to the likely revenue shortfall. Only a tiny fraction – 3 percent or less – thought the sales tax, the gas tax or local property tax was too low. For the sales tax, a wide margin did consider it "about right" rather than "too high." (Chart 2).

Nor did those Floridians surveyed feel good about the value received for what they pay in taxes. Only 9 percent said they received more than they paid; 55 percent report that they receive less.

A different interpretation is possible, though, if you consider the response to

Nor did those Floridians surveyed feel good about the value received for what they pay in taxes. Only 9 percent said they received more than they paid; 55 percent report that they receive less.

CHART 3

Percentage Supporting Increased Taxes for More Services in Five Areas

	More taxes, higher spending	Fewer taxes, less spending	Maintain tax and spending level
HIGHWAYS	7%	18%	68%
HEALTHCARE/ POOR AND NEAR POOR	27%	9%	56%
ENVIRONMENT	17%	11%	66%
K-12	28%	12%	53%
UNIVERSITIES	14%	11%	70%

SOURCE: University of Florida, BEBR Survey May-June 2004

another set of questions in which majorities favored maintaining the same level of taxing and spending in five areas. For K-12 and health care for the poor and near poor, there was a clear preference for more taxes and more spending rather than less taxes and less spending (Chart 3).

This supports a finding one might have hypothesized as a matter of political theory: the present state of affairs represents a rough equilibrium of what the voters (and their elected representatives) are willing to pay in taxes balanced against an acceptable level of service.

If the coming years, as this report suggests, bring intense pressure on pre-K-12 and health care spending as revenue growth slows, it is not a given that voters would opt for a trim-to-fit solution.

CHAPTER 5 | RECOMMENDATIONS

Shaping Florida's future

This work began as an analysis of revenue and public services trends in Florida – how we got here over several decades and where we appear headed in the remainder of the 2000s and beyond.

It remains just that – NOT back up documentation for a pre-set, pet reform proposal of ours. Unlike some earlier studies we do not find fundamental flaws with the main elements of Florida's tax structure. Taxing sales rather than income simply makes sense given Florida's huge tourist and snowbird economy. We don't advocate an income tax or expanding the sales tax to cover all services. We also agree with some conservative commentators that a number of Florida's business taxes are high enough already. A soak-business strategy for solving the coming revenue pinch might chill development of a parallel high-tech, high-value, high-wage sector of our economy. With Florida's Save Our Homes limits on increased valuations of owner occupied property, the state has already in place a structure that pushes a larger share of that tax burden on commercial properties.

All that said, having defined what we believe is an urgent issue that merits the attention of lawmakers and Florida citizens, we want to offer suggestions for shaping a bright future for our state.

Here are six:

(1) Form an official study commission to validate and expand our findings. The analysis needs to be made current for 2006 and tied more closely to the governor's and legislature's budget apparatus. We recognize that state government will need its own findings as a basis for timely action. This would not be an undertaking from a dead start. Florida's nationally admired consensus estimating conferences provide an abundance of data on the revenue and spending

Having defined what we believe is an urgent issue that merits the attention of lawmakers and Florida citizens, we want to offer suggestions for shaping a bright future for our state.

side. Besides committing $1.5 billion to Florida's infrastructure needs last session, the legislature and governor created interim studies on transportation and school construction needs. We think there is merit, nonetheless, to a broader umbrella study. The best of strategic plans don't get set in stone. Circumstances will force modifications. But Senate President Lee and others have observed that operating without any long-range compass is a bad mismatch to the scale of Florida and its public sector needs. We have attempted to make the case here that the year-to-year would be especially perilous given what is foreseeable for the next five years. A commission could make interim recommendations to the 2006 legislature and broader ones (to be considered by a new governor and legislature) in 2007.

The class-size approach has been tried (by statute in California) and didn't work especially well.

(2) Medicaid merits a comprehensive study of its own. Reform efforts to date – at both the state and federal level -- have had some episodic successes. Still, runaway growth of the expense of the program, has picked back up after a few years of moderating. The interlocking parts of the arcane program are so complex that it is typically viewed through the lens of one constituency – say nursing home operators – or another. It would be a big undertaking, but a worthwhile one to answer such basic questions as where the money is actually being spent and how Florida wants to be allocating its expenditures on the medically needy. Such a study, of course, would take place against the moving-target background of federal rules and federal spending commitment.

(3) Modify the class-size amendment with a concurrent commitment to productive state spending on pre-K-12 school improvement. The amendment is in place and in force until Florida voters decide otherwise. It becomes more apparent month-by-month, though, that the limits are all-consuming of available revenue, cutting off competing needs like raises to attract starting teachers. The class-size approach has been tried (by statute in California) and didn't work especially well. Studies showed little increase in student achievement there and a clear resort to hiring poorly credentialed, inexperienced teachers. That would be moving backward when the pressure is rightly on to do better in having a highly qualified teacher in every Florida public school classroom. It is our view, however, that voters will only buy repeal or modification if a credible effort is in place to relieve the worst of overcrowding at all grade levels and provide small classes in the critical primary grades. We also read the 2002 vote (a close one) to pass the amendment as indication that Floridians want a more generous and strategic commitment of state funding to accompany the demand for high standards and improved basic skills performance.

(4) On other services, look for policy adjustments, savings and innovations. At the same time we think there is a strong case for improved service levels where Florida is just scraping by. Higher education, to take an easy example, could benefit from more generous levels of funding. Modern facilities and pockets of research excellence notwithstanding, there is a mass production, on-the-cheap character to the system. With better support, Florida would realize a ready payoff in a more qualified work force and strengthened research capability in universities. However, our study, like that of the Florida Council of 100, suggests that the state leaves a big chunk of available funding on the table by charging comparatively low tuition and waiving much of that, even for families perfectly able to pay more. Our state has a strong record of innovation in prisons and environmental management. We expect necessity to be the mother or more of the same in coming years. And good ideas from elsewhere are importable. A modest example: a number of metro areas are having success allowing single-occupant drivers into HOV lanes, charging them electronically depending on how crowded the highway is. Such a system reduces congestion, and participating drivers – not all of them well off – don't object to the user fee for the convenience.

At the same time we think there is a strong case for improved service levels where Florida is just scraping by.

(5) Tax and revenue adjustments will be needed. Some possibilities would include:

*Concurrent addition of new construction to the property tax rolls. By waiting until once-a-year assessment season rolls around, localities can be passing on many months of revenue. With more and more expensive housing coming on line during the current real estate boom, the revenue opportunity lost has probably doubled.

*Extend the sales tax to Internet sales. The 1990s rationale that online commerce was a groundbreaking new thing that needed the encouragement of a tax break seems quaint. A compact for sales tax adjustment among the states is up and running. Added revenue is available, And where is the equity in giving Amazon and L.L. Bean a price advantage over on-the-ground Florida merchants?

*Impact fees, perhaps a combination of state and local, dedicated to pre-K-12 school construction. Part of what is to be determined in the inter-session study underway is how to craft a stronger revenue source for the state share of this problem with widely varying county-by-county approaches to school impact fees.

*Local option sales, gas and property taxes. This should include raising millage caps and shifts some of the burden for acceptable and well-targeted increases to the units of government closest to the people and most sensitive to local needs.

Our research suggests taxes are a minor factor in determining decisions of retirees on where to locate, and only very large reductions hold any promise of making a difference.

*Small special purpose taxes such as one on legal services to support courts. Some might view Florida as over-committed to special taxes and dedicated revenue streams already. But its is a strategy for getting at professional services and the like, now exempted from taxes. A targeted approach also circumvents voter suspicion and resistance to general tax increases.

(6) Do not add tax breaks or incentives for retirees. That is not an idea, we should stipulate, under active consideration in Florida to our knowledge. However some states have taken such action – Mississippi, for instance, designating as partially tax-exempt several areas for the development of retirement communities. Georgia debated, but did not pass an income tax waiver for retirees moving to the state. We anticipate more such action as the courting of baby-boomer retirees gathers momentum. Our research suggests taxes are a minor factor in determining decisions of retirees on where to locate, and only very large reductions hold any promise of making a difference. Besides we think it is fair to ask retirees to contribute to adequate provision of education and other services in their new state. Many received a recent tax break with the partial repeal of the intangibles tax.

* * *

Tradeoffs between keeping taxes low and delivering services at adequate levels are inevitable. We see Florida entering a period – perhaps not instantly, but within a year or two – where fiscal pressures become intense and these choices are especially tough. Cutting to fit is one way of coping, probably the default response in most of our state's recent history. However we believe there is an alternative that at least merits close consideration. Voluminous evidence suggests that our state has ample room for improvement in provision of education, medical assistance and infrastructure, should Florida summon the political will to assess the challenges of coming years and invest strategically.