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Silent Spending: Florida's Shadow Budget Needs Greater Scrutiny
FY 2018-19

Silent spending, in the form of numerous types of tax expenditures, continues to drain billions of dollars in potential state revenues each year. Total tax expenditures will cost Florida in excess of $20 billion in Fiscal Year (FY) 2018-19, which is an increase of more than 10 percent over the previous year.

State tax expenditures are not inherently good or bad. The problem with them is, unlike spending through the budget, which is subject to yearly review and reauthorization, spending through the tax code is not routinely evaluated to ensure it is delivering on objectives that support the state's families, communities and economy. Once enacted, these expenditures tend to remain in law without an expiration date or regular review.

The elimination of unproductive tax expenditures would simplify the state tax code, make the tax system fairer and eliminate unfair business competition.

Enacting measures that make it very difficult to address ineffective tax breaks, such as requiring a two-thirds (supermajority) vote of each chamber to increase a state tax or fee, institute a new state tax or fee or eliminate a tax exemption or credit, would impede investment in K-12 education, affordable health care and other public services that benefit all Floridians.

What is "Silent Spending"?

Silent spending, also known as "tax expenditures," is spending through the state tax code rather than through the budget process. Special provisions in the state tax code exempt revenue collection from some taxpayers and activities. These provisions reduce potential state revenues by *not* collecting taxes as opposed to collecting and then appropriating them through the state budget. The ultimate impact on the state budget is the same as appropriation and annual expenditure of public funds.

THE MOST COMMON FORMS OF TAX EXPENDITURES IN FLORIDA

Credits

Reduce the amount of taxes owed to the government

Example:

Insurance companies can reduce their taxes by receiving credit for wages paid to Florida employees

Exemptions

Reduce taxable income for taxpayers because of their status or circumstances

Example:

Rent charges paid by permanent residents are exempted from sales & use taxes

Deductions

Reduce taxable income due to expenses taxpayers incur

Example:

Businesses can reduce their taxes by deducting university research & development expenses

The Legislature approves tax expenditures for a number of reasons. Some tax expenditures are intended to help families by decreasing household costs. Examples include tax breaks on purchases of groceries, medications and education supplies.

Others are aimed at helping businesses, with the expectation that lower taxes will encourage new business startups, attract businesses to the state, encourage investment in new plants and equipment, support research and innovation and create jobs. For example, one program offers businesses tax credits if they locate in certain urban areas.

Why Should We Care About Silent Spending?

When it comes to state spending in form of tax expenditures, there are several issues that must be considered:

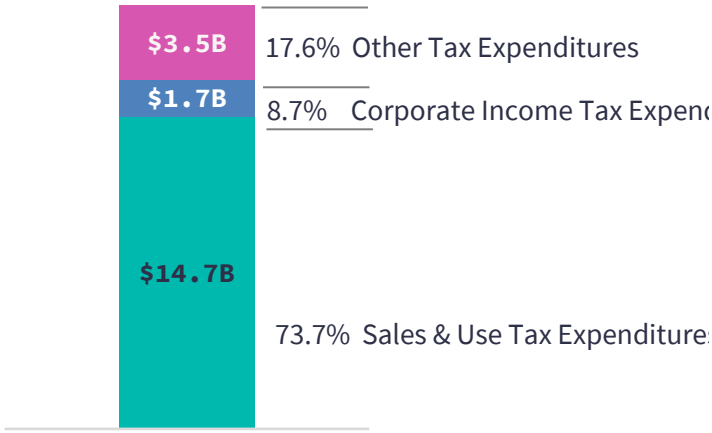
1. Tax expenditures cost billions of dollars each year, and the costs continue to grow
2. Tax expenditures reduce revenue available for investing in critical services such as education, health care and transportation
3. Tax expenditures are not regularly and rigorously scrutinized to ensure their effectiveness
4. Tax expenditure laws are often poorly designed, omitting key details to determine their success or failure
5. A supermajority requirement would hamstring legislators' ability to repeal ineffective tax expenditures and to raise needed revenue in the future

Tax expenditures cost billions each year and continue to grow

Florida's tax expenditures are projected to cost the state $20.1 billion in FY 2019, an increase of more than 10 percent ($1.8 billion) over FY 2018, according to the 2018 Florida Tax Handbook.[1]

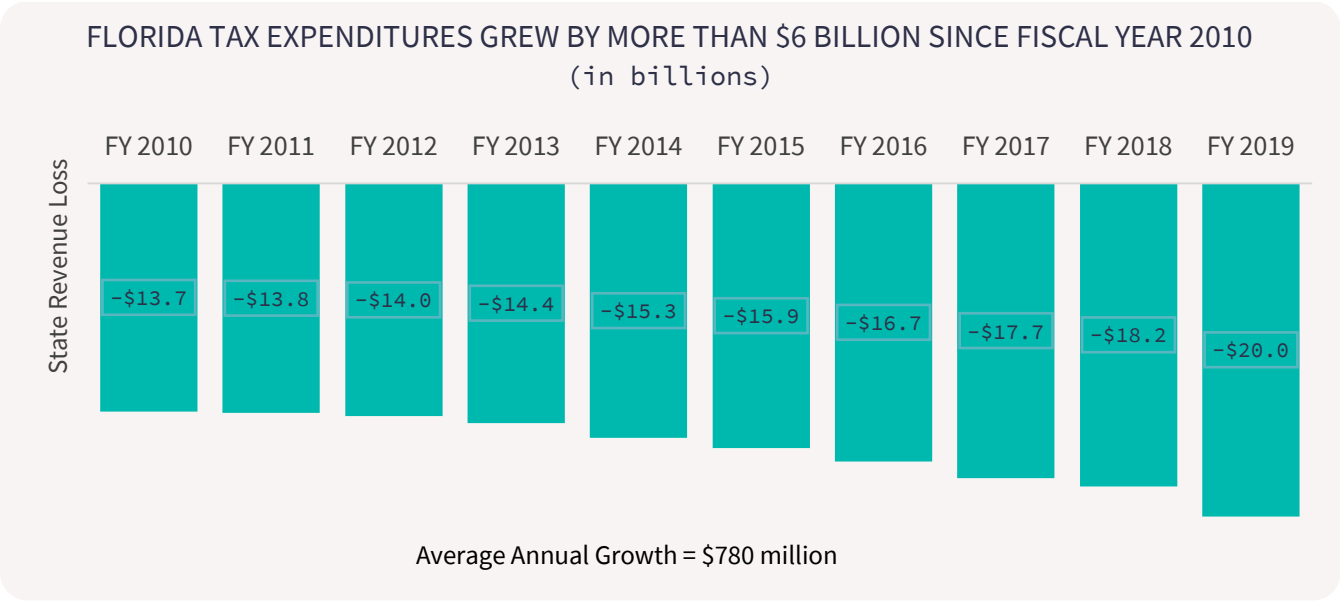
Almost $15 billion (74 percent) of the $20.1 billion in lost revenues come from exemptions to sales and use taxes. Roughly $1.7 billion (9 percent) comes from corporate income tax breaks, and the balance comes from a variety of other sources such as insurance premiums and lottery taxes.

FLORIDA TAX EXPENDITURES COST $20 BILLION IN FISCAL YEAR 2019



OTHER TAX EXPENDITURES:		
Insurance Premium Tax	$1B	5.1%
Communications Services Tax	$0.7B	3.7%
Gross Receipts Tax	$0.6B	2.9%
Beverage Tax	$0.4B	2.2%
Lottery Tax	$0.4B	1.8%
Documentary Stamp Tax	$0.3B	1.7%
Miscellaneous	$0.06B	0.3%

The cost of tax expenditures has increased by more than $6 billion since FY 2010, corresponding to an average annual growth of $780 million, or 4.8 percent. What is driving up these costs? New tax expenditures are often implemented over a span of two or three years. In any given fiscal year, the total cost of tax expenditures is driven by both previously-enacted and new tax expenditures.

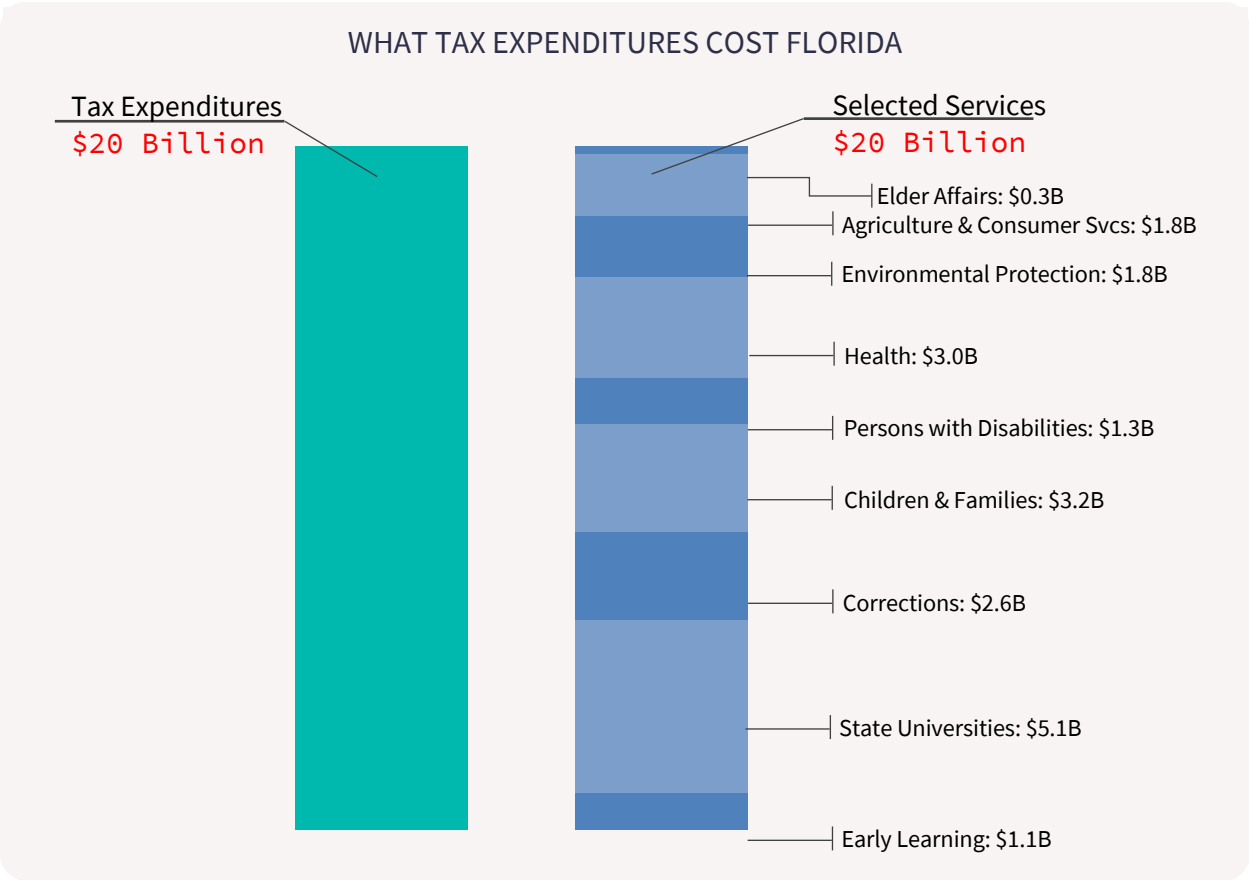


Tax expenditures reduce revenue available for investing in critical state services

The growing cost of tax expenditures creates a bigger hole in potential state revenue, making it increasingly difficult for the state to adequately fund critical public services. In FY 2019, the cost of tax expenditures ($20 billion) represents almost 23 percent of the state's $88.7 billion budget, although tax expenditures are not included in the budget.

For added perspective, the cost of tax expenditures in FY 2019 equals the total amount of money the state appropriated, collectively, for: Office of Early Learning, Department of Corrections, Department of Children and Families, Agency for Persons with Disabilities, Department of Health, Department of Environmental Protection, Department of Agriculture and Consumer Services, State University System and Department of Elder Affairs.

Although Florida's economy has largely recovered since the recession, state support for public services has consistently declined, while tax expenditure costs have only increased.[2] Over the last five fiscal years (FY 2014 to FY 2019), the cost of Florida's tax expenditures roughly equaled the amount of the state's $88.7 billion budget for FY 2019.



One can only imagine the social and economic gains, such as making college more affordable, increasing access to affordable health care services or modernizing the state's transportation system, that the state could have realized if some of the revenues lost to tax expenditures were invested in the state economy.

Tax expenditures are not regularly scrutinized to ensure their effectiveness

The Florida Legislature compiles and publishes annual estimates of the cost of tax expenditures in the Florida Tax Handbook but does not consistently estimate their benefits.[3] Unlike expenditures for education, health care and transportation, which undergo annual scrutiny, tax expenditures are not considered part of the annual budget review process and therefore are not subjected to regular evaluation to ensure they deliver on their intended purposes. Once enacted, these expenditures tend to remain in statute permanently.

This is not to say that evaluation is non-existent in Florida. In 2013, legislation was enacted (Section 288.0001, Florida Statutes) requiring the evaluation of specific economic development incentives on a three-year cycle. There is an insignificant share of tax expenditures for which systematic evaluation is required, compared to total tax expenditures. The state continues to spend billions each year without knowing whether these expenditures are actually helping or hurting taxpayers and the economy.

Rigorous evaluation of tax expenditures is only half of the process needed to ensure that sufficient revenues are collected and used in the most productive way. State lawmakers must follow through on legislative action based on the findings of such evaluation. In 2016, lawmakers failed to repeal multiple economic development

incentive programs despite analysis by the Legislature showing that they did not break even or generate a positive return. A year earlier, however, lawmakers took action to end the three-decades old Florida Enterprise Zone Program after studies by the Legislature showed that the program overall was not meeting its goals – a decision that saved Florida tens of millions of dollars thereafter. This type of legislative action and fiscal scrutiny should be the rule and not the exception.

Tax expenditure laws are often poorly designed

Tax expenditures are not inherently good or bad. There is no reason to expect that every tax expenditure is a poor use of public dollars. In principle, some of them serve important purposes that benefit the state's families, businesses and the economy.

The problem with these tax expenditures is that their exact purpose is frequently unclear. In many cases, there are no explicit goals stated in legislation enacting the expenditure. Even in instances where a public purpose is explicit, there is no determination and disclosure about whether stated goals have been met, despite the cost of the expenditure.

A supermajority requirement would make it difficult to repeal ineffective tax expenditures

With the cost of tax expenditures increasing year to year, it's critical that the state evaluate and take action when they are found to be ineffective. However, a supermajority requirement would make this exceedingly difficult; under the supermajority proposal, repealing a tax expenditure would count as a tax increase and would thus require a two-thirds vote.

There are 16 states that require a supermajority vote to increase revenue. Florida already requires a three-fifths supermajority to raise the corporate income tax rate. Six of the states apply the supermajority requirement to a limited range of taxes or fees, while the other 10 apply it to a broader range of revenue options.

The result has been a decrease in support for critical services and programs, leading some states toward a fiscal cliff. States with broad application of the supermajority requirement have seen the largest decreases in support for K-12 and higher education among all 50 states. One state in particular has experienced a fiscal crisis that should serve as a cautionary tale for Florida. Oklahoma adopted a supermajority requirement in 1992, and until recently — March 2018 — had not *once* been able to increase revenue. The state has made deep cuts to support for public schools, colleges and universities, health care and other services over the past 10 years. Efforts to reform Oklahoma's tax code have not been able to pass due to the supermajority requirement, despite bipartisan and widespread support.

Legislators would face a significant hurdle to eliminate any wasteful tax expenditures if a supermajority requirement was adopted in Florida. With this requirement in place, the state would be unable to free up new dollars for education, income supports or infrastructure projects that would generate economic benefits for all Floridians.

Benefits of Stronger Evaluation of Tax Expenditures

Rigorous and systematic evaluation of tax expenditures is beneficial to the state's budget, taxpayers and the economy. Evidence of the impact of each tax expenditure — both the cost and the benefit, including how well they are working — enable policymakers to craft informed tax and budget policies. Modifying or eliminating ineffective tax expenditures releases needed revenues to adequately fund investments, such as education, transportation and research, that are important for future economic growth. Additionally, the resultant changes in policy could help strengthen the state taxation system – a source of economic competitiveness for workers and businesses.

Of note, the evaluation of tax expenditures and subsequent policy reforms could help:

- **Simplify the state tax code.** The many types of tax expenditures currently in statute add to the complexity of the state's tax code.[4] By evaluating tax expenditures and modifying or eliminating those that are not serving a public good, lawmakers could make the state's tax system less cumbersome. This makes compliance easier for families and businesses, and it could reduce enforcement costs to the state.

- **Make the system of taxation fairer**. Many tax expenditures operate with special rules and formulas that provide benefits to a select group of people or businesses, resulting in unfair tax treatment and contributing to public dissent over the effectiveness of the state's tax system. The elimination of tax expenditures that are not working or benefiting everyone makes the tax system fairer by ensuring that everyone (both individuals and businesses) pays their fair share of taxes.

- **Eliminate unfair competition**. Business tax expenditures often provide large corporations — including out-of-state businesses operating in Florida — with the resources to take advantage of the complex tax code. This creates unfair competition, making it more difficult for Florida's small businesses to compete and grow.

Recommendations for State Action

There are simple steps lawmakers can take to bring current tax expenditure laws under scrutiny, assess their impact and adopt meaningful tax reforms. Doing so will ensure limited resources are spent in the most effective ways to promote real economic growth and benefit all Floridians.

The Florida Policy Institute recommends that the state adopt legislation incorporating tax expenditure evaluation into its annual budget review process. Specifically, the legislation should require all tax expenditures to:

- Include a specific explanation of what each tax expenditure law intends to achieve.

- Specify an expiration date for each tax expenditure to allow for its evaluation and require a new vote on the expenditure in light of new evidence of its success, or lack thereof.

- Require the Office of Economic and Demographic Research (EDR) and Office of Program Policy Analysis and Government Accountability (OPPAGA) to regularly evaluate tax expenditures to

determine how successful they have been in achieving their objectives. Such evaluation must include any recommendations for reform.

- Include specific recommendations related to any tax expenditure that has been recently evaluated in the annual budget presentation from the governor, House and Senate.
- Require the finance and tax committees of the Legislature to hold hearings on any tax expenditure that has been recently evaluated.
- Reauthorize only those expired tax expenditures that have demonstrated public benefits in excess of their costs.

The extent to which these recommendations would improve the state's tax policies depends on analysts having the resources needed to conduct rigorous evaluations and on lawmakers having a genuine interest in using the findings to inform their debate and policy decisions. If these conditions are met, the recommendations have the potential to enhance the quality of information needed for meaningful tax reforms, increase revenues and increase investment in core public services.

Conclusion

The cost of Florida's tax expenditure laws continues to grow and drain billions of dollars in potential state revenues each year. These laws are not regularly scrutinized to ensure they deliver a net benefit to taxpayers or the state's economy.

This issue would be exacerbated under a supermajority requirement, which would create a significant hurdle for lawmakers to eliminate any ineffective tax expenditures and redirect funding toward programs and services that generate economic growth in the long term.

State lawmakers should adopt legislation to regularly and rigorously evaluate tax expenditures to ensure that the foregone revenue is serving a legitimate public purpose. Tax expenditures that are unproductive or not serving a public purpose should be modified or eliminated. These actions would increase the revenues available for investing in critical services to meet the state's growing population needs and grow the economy. The elimination of unproductive tax expenditures would also simplify the state's tax code, make the tax system fairer and eliminate unfair business competition.

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[1] Unless otherwise noted, all figures are from the 2018 Florida Tax Handbook.
[2] Singh, Dhanraj (2017): Florida Support for Public Services Lowest Since the Recession and Trending Downwards.
[3] Leachman, Michael; Dylan Grundman and Nicholas Johnson (2011): Promoting State Budget Accountability through Tax Expenditure Reporting. Center on Budget and Policy Priorities.
https://www.cbpp.org/sites/default/files/atoms/files/5-11-11sfp.pdf
[4] U.S. Government Accountability Office. Key Issues, Tax Expenditures.
https://www.gao.gov/key_issues/tax_expenditures/issue_summary#t=0