BudgetWatch
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Florida TaxWatch

PROJECTED FUTURE BUDGET SHORTFALLS REQUIRE IMMEDIATE ATTENTION

The 2017 Legislature will be facing a very tight budget year. After a string of three straight years with projected budget surpluses ranging from $336 million to $846 million, it is now estimated that during the next legislative session there will be just enough money to fund a continuation budget for FY2017-18. What's more, significant budget shortfalls loom in subsequent years.

HIGHLIGHTS

State economists estimate the 2017 Legislature will have an estimated General Revenue (GR) budget surplus of only $7.5 million when they develop the next state budget (FY2017-18). This is the amount remaining after funding what could be considered a continuation budget. However, without budget or revenue changes, a budget shortfall is forecast in each of the following two years, totaling $1.3 billion and $1.9 billion, respectively.

- As it did for the first time last year, the *Outlook* assumes there will be tax cuts ($261.6 million) and trust fund sweeps ($242.5 million) in each of the three years. These two items largely offset each other in the first year, but the compound effect of the tax cuts results in a $769.6 million reduction in year 3.

- "Critical needs" will require an additional $484.9 million over the recurring GR base budget in FY2017-18 and "high priority needs" will require an additional $1,145.1 million. In total, these needs require an additional $1.630 billion to fund a continuation budget.

- Medicaid accounts for the majority of this protected spending, with increased costs making up 55.1 percent of all critical and high priority needs.

- It is assumed that the Required Local Effort (RLE) school property tax millage rate will stay at the current 4.638 mills, which reflects the 2016 Legislature's school property tax relief efforts. Maintaining that rate would still produce an additional $494.4 million from rising property values. If not all of the tax relief is recurring, RLE revenue could be less than estimated, requiring additional GR.

Surpluses/Shortfalls Projected by the Long Range Financial Outlook
($ millions)

2008-09	($2,334.5)
2009-10	($3,306.3)
2010-11	($2,654.4)
2011-12	($2,510.7)
2012-13	$273.8
2013-14	$71.3
2014-15	$845.7
2015-16	$336.2
2016-17	$635.4
2017-18	$7.5
2018-19	($1,300.9)
2019-20	($1,897.7)

- The *Outlook* further assumes a 2.73 percent increase in per student funding, which would rise from $4,028 this year to $4,138.
- The *Outlook* assumes a GR reserve (unobligated cash) of only $1 billion. The Legislature has left a larger reserve than that in each of the last six years, ranging from $1.1 billion to $1.6 billion. Any reserve larger than $1 billion would reduce the surplus.
- It will take some combination of budget reductions or revenue increases totaling $483 million in each of the next three years to erase the projected shortfall.

Budget Outlook — FY2017-18 through FY2019-20

General Revenue - $ in millions

REVENUES	FY17-18	FY18-19	FY19-20
Unspent GR from Prior Year	$1,413.2	$1,007.5	$1,000.0
New General Revenue	$30,782.5	$31,896.5	$32,918.2
Tax Cuts	($261.6)	($261.6)	($261.6)
Trust Fund Sweeps	$242.5	$242.5	$242.5
Total GR Available for Appropriation	$32,176.6	$32,884.9	$33,899.1
EXPENDITURES			
2015-16 Base Budget	$29,507.2	$30,578.4	$32,632.4
Increase - Critical Needs	$484.9	$1,493.0	$1,087.1
Increase - High Priority Needs	$1,145.1	$1,064.1	$1,009.6
Transfer - Budget Stabilization Fund	$31.9	$50.3	$67.7
Total Needed for Continuation Budget	$31,169.1	$33,185.8	$34,796.8
Cash Reserves	$1,000.0	$1,000.0	$1,000.0
Surplus/(Deficit)	***$7.5***	***($1,300.9)***	***($1,897.7)***

Source: Florida TaxWatch from data in the 2016 Long Range Financial Outlook

The *Long-Range Financial Outlook*—recently adopted by the Joint Legislative Budget Commission—forecasts that after funding a continuation budget, there will be $26.6 million in General Revenue (GR) left over. Such a budget would fund all "essential" spending plus the other programs and projects historically funded by the Legislature (based on the average of the last three years). The two biggest cost increases come from growth in Medicaid and public school enrollment. This leaves very little for new initiatives without cutting other things in the budget. What's more, maintaining this budget status quo would produce a budget shortfall exceeding $1 billion in each of the next two years.

This also leaves very little for tax cuts, and following the release of the *Outlook*, the Governor has reiterated the he will again seek to reduce taxes. Another scenario in the *Outlook* shows there is enough money to enact $261.6 million in GR tax reductions, as long as the Legislature also transfers—or "sweeps"—$242.5 million from state trust funds. Both of these amounts are the annual average of what the Legislature has done over the last three years. This approach would leave only $7.5 million in excess GR for the next budget. However, due to the recurring impact of most of the tax cuts versus the non-recurring revenue from trust fund sweeps, the subsequent years' budget deficits would be increased by nearly $300 million in FY2018-19 and more than $500 million the following year. The FY2019-20 deficit would grow to $1.9 billion (see table).

These new estimates are contained in the constitutionally-required *Long-Range Financial Outlook* that was recently adopted the Legislative Budget Commission. This valuable budget planning tool looks ahead three years, comparing estimated revenues and expenditures. This summer's round of state estimating conferences was the basis for the *Outlook*, which is produced annually by the legislative Office of Economic and Demographic Research and the House and Senate Appropriations Committees. The *Outlook* focuses on General Revenue (GR)--the funds that can be spent by the Legislature on anything and that are major source of funding for education, human services and criminal justice. The *Outlook* also forecasts some trust funds that can affect the need for GR spending in certain areas of the budget, such as the Educational Enhancement Trust Fund, which provides Lottery revenue for education.

The *Outlook* first projects the amount of GR that will be available for the budget. That amount is then compared to the base budget (recurring appropriations in the current budget) plus an estimate of increased spending needed for a "continuation budget." The difference in projected revenues and expenditures is the projected surplus or shortfall.

The forecasted growth in expenditures is made up of two categories. **Critical Needs** are mandatory increases (based on estimating conferences and other essential items), representing the minimum cost to fund the budget without significant programmatic changes. New initiatives and funding increases above what is required are not included. For example, the cost of funding additional students is included but an increase to per student funding is not. Maintaining per-student Pre K-12 student funding levels and increased Medicaid costs comprise 87.1 percent of these new "critical needs."

High Priority Needs are historically funded issues that are typically viewed as "must fund" in normal budget years. These can include the continued funding of programs paid for with non-recurring revenues, as well as non-mandatory increases for recurring programs. These are usually calculated by using the three-year average appropriations for that program. For example, while Critical Needs include only the cost of maintaining per-student funding, this year's High Priority Needs include a 2.73 percent increase in per-student funding (the average increase of the last three years).

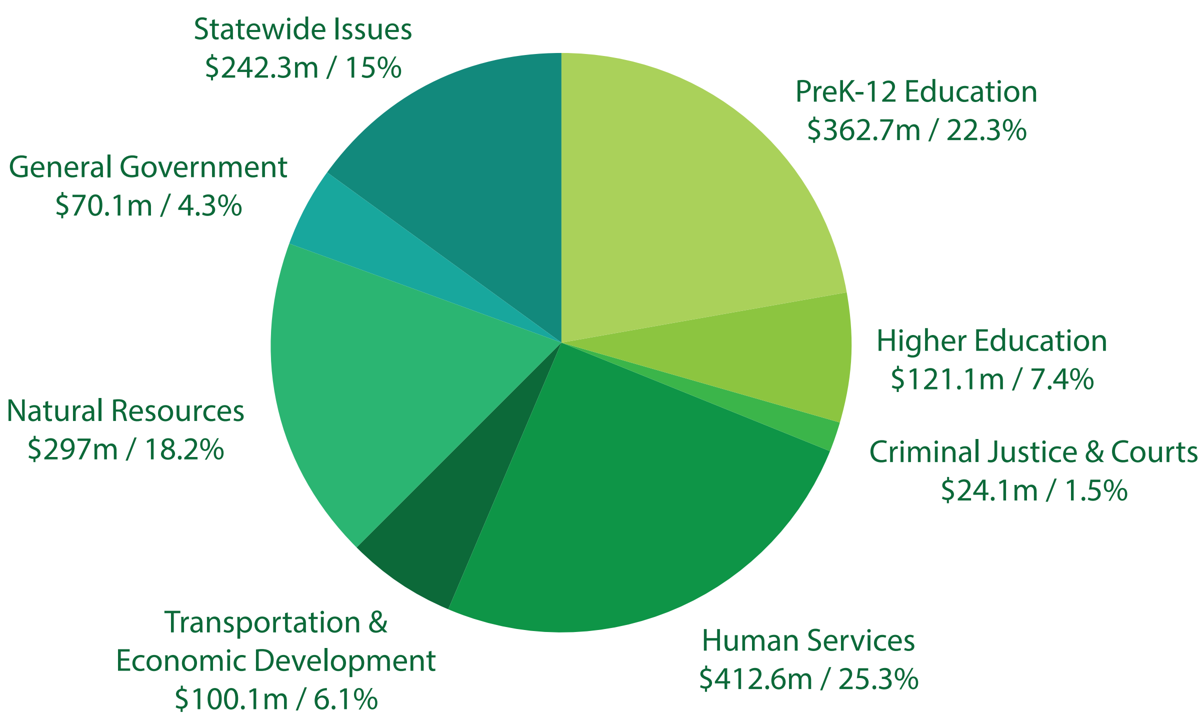
Adding these two categories to the recurring expenditures in the current budget comprises what can be thought of as a continuation budget.

REVENUE ADJUSTMENTS

Last year, the *Outlook* began assuming that the Legislature will cut taxes (reducing GR) and sweep trust funds[1] (increasing GR). It the past, the size of any estimated surplus was used by some as a gauge of the likelihood that there would be tax reductions. Now, tax cuts are built in. This year, it is assumed the Legislature will enact $261.6 million[2] in net tax and fee reductions that reduce GR in each of the three years. This is the average of the last three years' worth of tax relief. This includes $194.1 million in recurring cuts (such as permanent tax rate decreases or new exemptions) and $67.5 million of non-recurring cuts (one-time reductions such as sales tax holidays.)

In the short-term, this reduction is largely offset by the new inclusion of trust fund sweeps, which are estimated at $242.5 million each year. Including these two revenue adjustments results in a negative impact on available GR for next year of $19.1 million. However, over the next years of the *Outlook's* forecast horizon, the net impact of these two factors increases significantly. The recurring portion of the tax cuts compounds each year, resulting in a net reduction from tax cuts and trust fund sweeps of $527.1 million in FY2019-20, pushing the estimated shortfall to $1.9 billion.

What Are the $1.6 Billion in Estimated Increased Needs for FY2017-18?



** Includes state employee salary and benefit increases, capital improvements, statewide technology issues, etc.*
Source: Florida TaxWatch from data in the 2016 Long Range Financial Outlook

1 The Legislature often transfers money from trust funds, which has specified uses, to GR, which may be used for anything. For more information see Florida TaxWatch, Putting the Trust Back in Trust Funds, March 2014.

2 This is the first year impact of the tax cut. Because recurring tax cuts usually have delayed effective dates, the first year impact is less than the annualized amount. The annualized amount (plus the non-recurring cuts) is $321.5 million.

CRITICAL NEEDS

Pre K- 12 Education – In terms of all revenue, the Florida Education Finance Program (FEFP) is the largest critical needs budget driver, but increases in other funds lessen the GR needed. It is estimated that the FEFP, which allocates funds to school districts, will need an additional $816.1 million to maintain the current K-12 budget and fund nearly 31,000 new students. However, local property taxpayers are expected to pay for more than half ($494.4 million) of that increase. In addition, increased revenue into the Educational Enhancement Trust Fund (EEFT) from the Lottery and the State School Trust Fund will provide another $169.2 million, leaving the need for additional GR at $152.5 million. The other critical need in the Pre K – 12 area is the 2,487 new students in Voluntary Pre-K (VPK). Another $6.4 million is needed to meet that enrollment increase, bringing the total additional GR needed for Pre K-12 Education to $158.9 million.

Higher Education – The increased revenue estimates for the EEFT also impact higher education, reducing the amount of GR needed to maintain current spending. This added revenue, along with reduction in the number of students eligible for Bright Futures scholarships, means that $137.2 million less in GR will be needed for the critical needs in higher education.

Health & Human Services – Medicaid is a $26 billion federal and state program, the largest single program in the state budget. Not surprisingly, its growth creates the largest need for additional funding in a continuation budget. Total Medicaid beneficiaries are expected to reach 4.4 million. This is a 5.0 percent increase in caseloads for next year, adding 210,000 persons to the program. Growth is expected to slow in the next two years of the *Outlook,* increasing by 4.6 percent and 4.4 percent. Total expenditures (federal and state) for Florida's Medicaid program are expected to grow by $540 million (2.1 percent) next year, reaching $24.9 billion. The GR share of the increase is $269.1 million.

The Patient Protection and Affordable Care Act increased the federal share of funding for Florida's Kidcare program by 23 percentage points. Starting in the current year, the feds are now paying almost 96 percent of the total cost for Kidcare through FY2018-19. Still, an increase of 11,664 beneficiaries will require an additional $1.8 million in GR.

Two issues will decrease the amount of GR for new critical needs in Health & Human Services. A decline in Temporary Assistance for Needy Families (TANF) caseloads will reduce needed GR by $10.6 million. In addition, there is expected to enough money in the Tobacco Settlement Trust Fund to use $28.2 million to reduce the amount of GR needed to fund costs throughout the policy area. The critical needs in Health & Human Services total $232.1 million.

Transportation and Economic Development – The Department of Transportation's work program is not funded with GR, so transportation system needs are not reflected here. One critical needs item is included: $20.5 million for the state match for federal FEMA disaster funding.

Criminal Justice & Courts –While there is a small estimated increase in the prison population, there is a current surplus of prison beds so only an additional $1.0 million for operational costs is needed.

General Government & Administered Funds (Statewide Issues) – A state law requiring the Legislature to provide money to fiscally constrained counties to offset property tax reductions arising from two constitutional amendments will cost an additional $24.5 million.

State contributions for state employee health insurance are expected to increase by $233.0 million next year, which will require $57.4 million in GR. An expected increase in the unfunded liability of the Florida Retirement system (due to lower investment return) will require $128.3 million to amortize. Non-Florida Retirement System pension and benefit programs (such as those for the Florida National Guard and disabled justices and judges) will cost $0.5 million less in the next budget.

HIGH PRIORITY NEEDS

Pre K-12 Education – In addition to maintaining per student funding as discussed above, the *Outlook* includes an increase in per-student funding equal to the average of the last three years. This would be a 2.73 percent increase for the Florida Education Finance Program (FEFP), costing $153.7 million next year. There is $24.4 million provided for the Gardiner Scholarship Program for children with unique abilities. Increases are also included for VPK ($3.3 million), the Florida School for the Deaf and Blind ($1.4 million), the Florida Best and Brightest Teacher Scholarship Program ($16.3 million), and incentives for school districts to require students to wear school uniforms ($4.7 million).

Higher Education - Increased funding based on the three-year average appropriations increase is provided for universities ($172.4 million), colleges ($50.4 million) and financial aid programs ($23.7 million). An increase of $5.3 million is also provided for the Benacquisto Scholarship Program for National Merit and National Achievement Scholars. Another $6.4 million is provided for operational costs for newly constructed university and college facilities already authorized by the Legislature.

Health & Human Services - $71.1 million is included for additional Medicaid waiver slots for the elderly and individuals with brain and spinal cord injuries, and Medicaid provider rate increases. Increases for the following agency programs are also provided:

- *Children and Families* ($53.7 million) – This includes increases for Community Action Teams, adoption subsidies, community based care lead agencies, Family Intensive Treatment Teams, child abuse investigations, foster care, homeless coalitions, and mental health and substance abuse initiatives.
- *Health* ($24.5 million) – Funding increases are provided for Early Steps, cancer and biomedical research, pregnancy support, and Alzheimer's research. Nonrecurring funding for poison control centers and health centers is also restored.
- *Persons with Disabilities* ($18.7 million) – These dollars are for reducing the waitlist for the developmental disability waiver, supported employee and internship programs, and Medicaid Waiver provider rate increases.
- *Veterans Affairs* ($1.5 million)

- *Elder Affairs* ($5.4) – Additional funding is provided for reducing the Community Care for the elderly waitlist and Alzheimer's disease respite services.

The *Outlook* also includes $2.9 for human services information technology costs.

Criminal Justice and Courts – Funding is provided for increased due process costs ($3.0 million), juvenile justice prevention and intervention programs ($7.2 million), replacement of vehicles for the Department of Corrections ($2.0 million), inmate health services ($5.9 million), a shortfall in the State Courts Revenue Trust Fund ($0.5 million), and small county courthouse repair and renovation ($4.5 million).

Transportation and Economic Development –$2.7 million in GR is included for economic development and workforce programs (in addition to $63.4 million in trust fund spending). Funding is included for National Guard armories and other military affairs priorities ($7.9 million). Funding for the Department of State's library, cultural, historical, and election priorities ($69.0 million) is also included, reflecting the Legislature's increased funding for these programs in recent years.

Natural Resources – Although there are no additional critical needs identified in Natural Resources in the *Outlook*, significant high priority needs are included. Funding of $438.2 million ($297.0 million in GR) is provided for a myriad of environmental and agricultural programs including Everglades restoration, conservation land acquisition, Lake Apopka restoration, local parks, beach restoration, local water projects, water quality and supply programs, aquaculture grants and citrus research. Funding is based on the average of the last three years of appropriations. No money is included here for springs protection—a recent legislative priority—because the 2016 Legislature appropriated $50 million in recurring funds for springs, therefore it is included in the base budget.

General Government – GR of $17.4 million is included for general repair and maintenance of the state building pool, $24.1 million for the replacement of the state's accounting system (FLAIR) and $3.4 million is provided for other general government activities.

Administered Funds (Statewide Issues) - GR of $7.2 million is provided for state employee bonuses and competitive, merit and retention pay adjustments. $49.5 million is provided for critical capital improvements of state buildings.

CONCLUSION AND OPTIONS FOR ADDRESSING THE SHORTFALL

It a nutshell, the problem is that recurring GR spending is growing faster than available recurring GR, which the *Outlook* calls a "structural imbalance." And the longer it takes to address the problem, the more expensive corrective action will become. If the state spends all the available GR next year (regardless of whether it is a continuation budget or some current spending is redirected to new initiatives), the shortfall in FY2018-19 will be more difficult to address.

The *Outlook* estimates it will take some combination of revenue or spending adjustment worth $483 million in each year, starting with the upcoming budget, to erase the shortfall in FY2019-20. It the Legislature waits until FY2018-19 to address that year's shortfall, it will take $1.3 billion in adjustments to clear the shortfall. Even If all those adjustment are recurring, another $600 million will be needed the following year.

It should be remembered these scenarios still mean there is no money for new initiatives without additional budget cuts and revenue hikes. There are five options to address these shortfalls:

- Budget reductions and reduced program growth
- Revenue increases and redirections
- Reduction or elimination of the assumed tax cuts
- Additional trust funds sweeps
- Reductions in reserves

Of the options, revenue increases and reducing state reserves are the least likely to be utilized by the Legislature. The Governor and most legislative leaders are adamantly opposed to any tax increases. As for reserves, the $1 billion in unallocated GR assumed by the *Outlook* would already be the lowest reserve since FY2010-11, right after the Great Recession. What's more, spending reserves is a non-recurring fix, it can only be spent once. Revenue redirections, where the statutory distribution of an existing revenue source is changed to direct more of the revenue to GR, is a possibility. However, while some trust funds do carry a surplus, redirecting revenue may reduce non-GR spending in another area of the budget.

Additional trust funds sweeps would not be a surprise. While the *Outlook* already assumes $242.5 in sweeps, past legislatures have shown they will do more. The 2012 and 2013 Legislatures sweep a total of more than $900 million. But again, trust fund sweeps are a non-recurring fix.

The Governor and the Legislature have said they will pursue tax relief next session, but any new tax relief may not be as much as the $261.6 million assumed by the *Outlook*. The average of the last three years is what is assumed, and those have been good years for tax relief. Many in the Legislature, particularly in the Senate, are taking a more cautious stance heading into session.[3] After tax cuts of $401 million and $342 million in 2015 and 2016, the 2017 Legislature provided only $42.3 million in tax relief. Any amount below $261.6 million will increase the surplus next year and reduce the shortfall in the following years.

The largest impact on the shortfalls will likely (and should) come from reductions in appropriations. Incoming House Speaker Richard Corcoran has said he believes there is a lot of unnecessary and wasteful spending and the Legislature will cut the budget.[4]

There is enough GR available to fund the "critical needs." It is the "high priority needs" that that are stretching GR too thin. There are many valuable programs in this category but the Legislature does not have to fund everything that is in the current budget, especially at the same level as the last three years. The recent increased funding focus on some areas—such as environmental programs and library, cultural and historic grants—may overstate some estimates made in the *Outlook*.

The recurring base budget also deserves a close look. This is where spending can become imbedded in the budget, even after it has outlived its usefulness.

Florida TaxWatch applauds the Legislature's commitment to scrutinize state spending but cautions against "penny-wise and pound-foolish" cuts such as reducing state advertising aimed at bringing tourists to Florida. Care should also be taken to protect spending for direct essential services to individuals.

One way to help achieve the needed budget fix is to implement the recommendations of the 2016 Government Efficiency Task Force (GETF). The 29 recommendations within the final GETF report range on issues from telehealth to criminal justice to efficiency in state contracting. The state could realize savings and cost avoidance upwards of $2 billion if these recommendations were implemented.

The outlook for the next state budget could change before the 2017 Session. There will be two more GR estimates made before the 2017 Legislature appropriates the money and while it is possible the revenue estimates will increase, economic uncertainty makes a downward revision at least as likely. The Outlook also points out several significant risks to the forecast, which includes the state's costs for responding to hurricanes and the Zika virus.

It is clear that this "structural imbalance" in the state budget and the impending budget shortfall need to be addressed. The Legislature needs to begin as soon as possible.

3 AP Florida in the Tampa Bay Times, "Despite recovery, Florida won't have much extra money in '17," September 7, 2016. http://www.tbo.com/news/florida/despite-recovery-florida-wont-have-much-extra-money-in--ap_floridaefb51eb014fd450181703b11a3ae5c58

4 Florida Politics, "Lawmakers get grim budget news for next year," September 12, 2016. http://floridapolitics.com/archives/221752-lawmakers-get-grim-news

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