

## NEW STUDY SAYS FLORIDA'S FISCAL CONDITION IS RANKED SIXTH BEST IN THE NATION

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According to a study by the Mercatus Center at George Washington University,<sup>1</sup> Florida has the sixth best fiscal condition of the 50 states. The study uses data from each state's Comprehensive Annual Financial Report (CAFR) for FY 2012 to create four indices to attempt to create a "reliable and straightforward method to compare states' finances."

By the report's own admission, "state fiscal condition is multifaceted and difficult to measure." There have been numerous attempts in the past to measure state fiscal conditions, none of them completely satisfactory. Recent attempts have had the benefit of using CAFRs, which provide audited, consistent data. This new study attempts to improve on past research by weighting the indices to develop a comprehensive measure of fiscal condition.

The four indices are:

**Cash Solvency** – a government's liquidity and ability to pay its bills on time. This combines several measures of reserves and assets, both cash and other less liquid assets like investments, receivables, and total assets.

**Budget Solvency** – a government's ability to meet the current year spending obligations without causing a deficit. This measure has two components: surplus (or deficit) per capita and operating ratio (revenues divided by expenses). Since budget surpluses and deficits are defined differently by different states, the study uses change in net assets to measure surpluses for consistency.

**Long-run Solvency** – a government's ability to pay for all its costs, including those that may occur only every few years or many years into the future. This considers future costs such as debt, pensions, and workers compensation claims.

**Service-level Solvency** – a government's ability to provide and pay for the level and quality of services required to meet a community's general health and welfare needs. The study focuses on the ability to meet service obligations, not whether the level of service is appropriate. It uses per capita taxes, revenues and expenditures. The study assumes higher values means higher costs for services and less tax capacity to meet those costs.

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<sup>1</sup> Arnett, Sarah, Working Paper No. 14-02, State Fiscal Condition: Ranking the 50 State, January 2014.

The four indices are then combined to calculate an overall fiscal condition index. The indices are weighted differently: Cash (35 percent); Budget (35 percent); Long-run (20 percent); and Service-level (10 percent).

#### FLORIDA'S FISCAL CONDITION FY 2012

Solvency Measure	Rank	Index	High State	Low State	Median
Cash	4	4.82	15.25	-2.56	-1.04
Budget	13	0.24	8.76	-2.84	-0.21
Long-run	37	-1.19	8.77	-5.12	-0.29
Service-level	2	4.61	6.93	-7.69	0.30
Total (Fiscal Condition)	6	1.99	8.80	-2.81	-0.28

The solid ranking for Florida's fiscal condition is not surprising because we have known for some time that Florida's state bonds are rated highly. In May 2012, towards the end of the fiscal year examined in the Mercatus study, Florida was one of thirteen states to receive a "AAA" rating from Standard and Poor's, the highest rating available for bonds.<sup>2</sup> Florida has enjoyed this rating—which indicates an "extremely strong capacity to meet financial commitments"—since 2005. Bond ratings consider many of the same factors as the Mercatus study, such as the size of reserves and debt and pension liabilities, as well as more qualitative factors such as financial management practices.

### Florida and the Four Indices: Are They a True Representation of Fiscal Condition?

#### CASH

Florida's high ranking in cash solvency is also expected because of the Legislature's commitment to keeping significant cash reserves and the existence of the constitutionally-mandated Budget Stabilization Fund (BSF).

<sup>2</sup> Pew Charitable Trust, Infographic: S&P State Credit Ratings, 2001-2012

The housing boom fueled Florida's revenue growth and collections reached their peak in FY 2006. At the end of that fiscal year, Florida had reserves (unencumbered general revenue and BSF) of \$6 billion, or 22.4 percent of general revenue (GR).<sup>3</sup> As the recession wreaked havoc on Florida and the state's revenue collections, reserves dwindled but the Legislature was still able to not spend everything it had. Reserves hit a low of \$905 million (4.3 percent of GR) in 2009. Reserves started growing again and by FY 2012 (the year examined by the Mercatus study), reserves reached \$2 billion (8.5 percent of GR).

#### BUDGET

Florida's strict balanced budget requirement helps its budget solvency. It is often cited that 49 states have some kind of balanced budget requirements, but not all requirements are equal. While Vermont is the only state without any kind of balanced budget requirement, some states only require the Governor to propose a balanced budget and more importantly, seven states allow a deficit to be carried over.<sup>4</sup> Some states' requirements are only in statute, making it easier to circumvent in the short-term. Florida's requirement is in the Constitution. In addition, Florida also has prescribed steps for dealing with a budget deficit during a fiscal year. As a bond rating agency stated, "the Florida legislature consistently and promptly addressed numerous large negative revenue estimate revisions during the downturn, maintaining budget balance and an adequate reserve position."<sup>5</sup>

<sup>3</sup> Florida Legislature, Office of Economic and Demographic Research, Financial Retrospect, various years.

<sup>4</sup> National Association of State Budget Officers, Budget Processes in the States, Summer 2008.

<sup>5</sup> Business Wire press release, Fitch Affirms Florida GO Bonds at AAA; Revises Outlook to Stable, August 23, 2013.

### LONG-RUN SOLVENCY

Florida's relatively low long-run solvency ranking is surprising because of its relatively low debt and relatively sound pension system, two factors often cited for the state's high bond ratings. Net tax-supported debt and unfunded pension liabilities combined equal 3.6 percent of Florida personal income, the fifth lowest burden in the nation.<sup>6</sup> Since data for the individual states are not included in the Mercatus study, it is difficult to determine the cause for Florida's ranking.

### SERVICE-LEVEL SOLVENCY

Florida TaxWatch's analysis of the Mercatus study finds the service-level solvency index to be problematic. The report acknowledges that the low weight (10 percent) given to this index is due to concerns about the underlying measures and the difficulty in interpreting solvency. In effect, this index is basically a measure of tax burden, and Florida is a low-tax state at the state government level. The index does not account for service demands, the political environment concerning taxes, tax bases and tax capacity and the effect of the economy on revenues. Florida's per capita state tax burden and ranking among the states rose significantly during the first half of the 2000s, only to fall sharply during the recession.<sup>7</sup> This was due to the economy, not because of the way the state has dealt with service demands. Taxes in Florida fell 17.8 percent from FY 2006 to FY 2012, by far the largest decrease in the nation.

While some taxes were raised (tobacco taxes and motor vehicle fees in 2009), the Legislature largely dealt with shortfalls with budget cuts.

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<sup>6</sup> Ibid.

<sup>7</sup> Florida TaxWatch, *How Florida Compares*, March 2014 (soon to be released).

While this was a prudent way to deal with the recession, service levels were not "solvent."

Tax burden rankings point out another limitation of the study. It is very difficult to adequately compare state governments without considering the role local governments have in providing public services. Florida has the second largest reliance on local governments in the nation, measured by local government's share of total state and local revenue (55.6 percent).<sup>8</sup> In addition, while Florida's state revenue burden is low relative to other states, the local burden is much higher. Moreover, including local debt and pensions would likely have a negative impact on Florida's fiscal condition index. Florida's local governments have two and a half times more debt outstanding than the state does.<sup>9</sup> And while Florida's state pension system is adequately funded, many local government pension plans are seriously underfunded.

### CONCLUSION

The measurement of state fiscal conditions is indeed a difficult task. While the Mercatus report has its limitations, it does provide useful information about how Florida compares to other states. While it can be argued whether taxes in Florida are too low or too high and the levels and quality of public services are often debated, this report gives more evidence that Florida's state government fiscal house is in order.

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<sup>8</sup> Ibid.

<sup>9</sup> U.S. Census Bureau, *State and Local Government Finances*, 2011.

## ABOUT FLORIDA TAXWATCH

As an independent, nonpartisan, nonprofit taxpayer research institute and government watchdog, it is the mission of Florida TaxWatch to provide the citizens of Florida and public officials with high quality, independent research and analysis of issues related to state and local government taxation, expenditures, policies, and programs. Florida TaxWatch works to improve the productivity and accountability of Florida government. Its research recommends productivity enhancements and explains the statewide impact of fiscal and economic policies and practices on citizens and businesses.

Florida TaxWatch is supported by voluntary, tax-deductible memberships and private grants, and does not accept government funding. Memberships provide a solid, lasting foundation that has enabled Florida TaxWatch to bring about a more effective, responsive government that is accountable to the citizens it serves for the last 33 years.

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