Research Report

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Anticipating the Effects of an Economic Recession on Florida's Budget

The State's Financial Health is Much Improved

Florida and the nation are experiencing the longest uninterrupted economic expansion in recent history. These economic "good times" mask the inevitable business cycle "bad times." Although predicting a recession is not possible, the longer this economic expansion continues, the more probable a recession becomes. Recessions put additional strains on state budgets lower tax revenues, increased demands for services, and budget cuts and reallocations from other programs and revenue sources. The purpose of this Florida TaxWatch report is to assess how well the State of Florida's finances and budget processes will be able to manage the next recession.

The last official national recession began in July 1990 and ended in March 1991[1]. Unlike the eight previous recessions since the end of World War II, the end of the 1990-91 recession did not coincide with a rebound in employment, either at the national level, or in Florida. High levels of unemployment continued, even after the economic recovery began, as indicated by the following table:

Unemployment Rate [2]

Calendar Year	**1990***	**1991***	**1992**	**1993**
Florida	6.0%	7.4%	8.2%	7.0%
U.S.	5.6%	6.9%	7.5%	6.9%

* Recession period: July 1990-March 1991

The rate of unemployment by category of worker and by industry sector changed in the 1990-91 recession from that of the previous eight. While earlier recessions were generally characterized by an increase in "blue-collar" unemployment (about a 50% increase) verses an unemployment increase of 20% for "white-collar" workers, in the 1990-91 national recession, blue-collar unemployment increased 43% and white-collar unemployment increased by 34%[3]. Also different from previous recessions were the industries affected. For the first time, employment declines were recorded in the finance, insurance and real estate sectors (mirroring the increase in white-collar unemployment). An additional element in the increased rate of white-collar unemployment is the general shift in the economy to the service sector[4].

In Florida, the national recession had three adverse impacts: (1) higher unemployment, (2) increased costs for "safety-net" programs to persons adversely affected (unemployed) by the recession, and (3) a reduction in the rate of growth in tax revenues to finance state activities. As shown in the preceding table, Florida's unemployment rate, while beginning at an even higher rate than the national rate (pre-recession), increased more in 1991 (+0.1%) and 1992 (+0.2%) than the national unemployment rate.

While state spending increased over the period 1990-91 to 1993-94, a significant percentage of this spending increase was for safety-net programs as shown below:

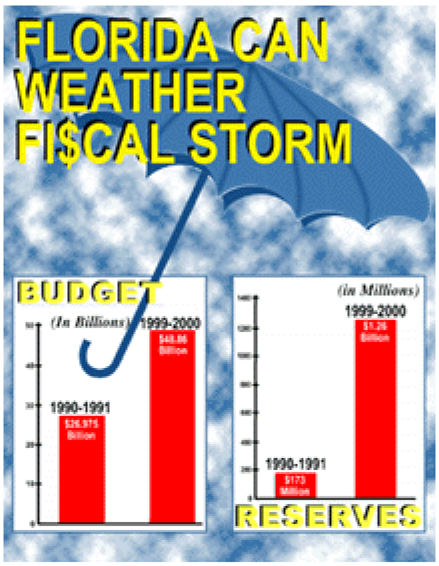
Total and Selected Program Spending - State of Florida[5]
($ in Billions)

Actual Expenditures/Fiscal Year	1990-91*	1991-92	1992-93
Total State Spending	$26.975	$30.439	$33.572
annual increase		*$3.464*	*$3.133*
Safety-Net Program Spending:			
Medicaid	$3.421	$4.375	$5.276
annual increase		*$0.954*	*$0.901*
Economic Services	$0.945	$1.140	$1.349
annual increase		*$0.195*	*$0.209*
Unemployment Compensation	$0.725	$1.336	$1.398
annual increase		*$0.611*	*$0.062*
Total Safety-Net Spending Increase		$1.760	$1.472
% of Total Spending Increase		**50.81%**	**37.41%**

* Recession period: July 1990-March 1991

The largest increase in safety-net spending occurred in 1991-92, after the official end of the recession, and continued at this higher (pre-recession) level in 1992-93. While the cost of the safety-net programs is partially offset by Federal reimbursement or trust fund draw-down, a significant portion of the increase is bourn by additional demands on the state's General Revenue Fund (an increased demand on a revenue source that is already under pressure because of reduced receipts). *[Note: In 1993-94, Unemployment Compensation spending declined to $1.054 billion total, consistent with the reduction in the unemployment rate for that year (6.6%), but spending for Medicaid and Economic Services (AFDC) continued to increase. Although not verified in this report, this may indicate the expiration of unemployment compensation eligibility for economically* *distressed persons, thus, causing further reliance on, and utilization of, the other two programs.]*

Revenue Shortfall - Budget Reductions



Source: Florida TaxWatch 1999

Florida's budgeting process is based upon very accurate estimates of revenues available to fund state programs. Constitutionally prohibited from "deficit spending," actual revenue receipts must equal or exceed spending during the budget year. If revenues received or projected to be received during the current budget year are less than the annual appropriation, a budget reduction (or new revenues/funds) is required. The earlier in the budget year the shortfall is identified, the easier it is to manage. For example, a 3.0% annual revenue shortfall identified at the beginning of the budget year would require a 3.0% reduction in spending, while the same 3.0% annual revenue shortfall identified at the midpoint of the budget year would require a 6.0% reduction in spending for the remainder of the year.

In the first year of the recession, 1990-91, the total state budget, as appropriated, was $27.744 billion, of which $11.261 billion was General Revenue funds. During the year, as the recession took hold, actual revenue receipts and revenue projections for the remainder of the year were significantly lower than the initial General Revenue appropriation, necessitating a budget adjustment (Total General Revenue receipts for the full fiscal year totaled $10.115 billion). The Administration Commission (the Governor and Cabinet) reduced state agency General Revenue spending by $781.7 million (primarily in the Departments of Education and Health and Human Services) and authorized the use of $173.0 million of Working Capital Funds to balance spending to revenues.

A similar situation occurred in 1991-92. Even though the recession had officially ended in March 1991, the continuing negative effects on employment, earnings (individual and corporate) and tax revenues persisted, requiring a General Revenue Fund reduction (twice during the year) of $993.7 million and a withdrawal from the Working Capital Fund of $137.0 million.

In 1992-93, the General Revenue Fund appropriation again was reduced (-$540.8 million). It should be noted that these reductions were not caused by declining revenues but, rather, by potentially optimistic projections of the revenues available, thus producing a higher level of appropriations than that which could be sustained by the actual revenues. The following table shows the increase in actual General Revenue Fund receipts:

Actual General Revenue Receipts[6]
($ in billions)

Fiscal Year	1990-91	1991-92	1992-93
Actual	$10.115	$10.912	$12.059
annual increase		$0.797	$1.147

While total General Revenue Funds increased over this period, a portion of the increase can be attributable to tax increases. For example, legislatively adopted new or increased General Revenue taxes in 1990-91 totaled $729.3 million, although actual receipts were less than projected. The following table reflects the change in selected General Revenue receipts:

Selected Sources of General Revenue Receipts[7]
($ in millions)

Fiscal Year	1990-91	1991-92	1992-93
Sales and Use Tax	$6,950	$7,636	$8,380
increase		*$686*	*$744*
Corporation Income Tax	$702	$801	$847
increase		*$99*	*$46*
Documentary Stamp Tax	$306	$359	$370
increase		*$53*	*$11*
Intangible Personal Property Tax	$290	$325	$492
increase		*$35*	*$167*

The Cost of the 1990 Recession in Florida

The 1990-91 recession had three distinct components: (1) tax and fee increases, (2) draw-down of the Working Capital Fund, and (3) reductions in state programs. Tax and fee increases and utilization of the Working Capital Fund can be considered a "direct cost" because they represent new funds required to meet necessary state obligations. Reductions in state programs can be considered an "indirect cost." Although painful, these reductions were prioritized; thus, high need programs were retained (though at a reduced level of funding), while low priority, inefficient and ineffective programs and other non-critical activities were reduced or eliminated. The following table[8] displays the direct costs of the 1990-91 recession in Florida:

Direct Cost:	1990-91	1991-92	1992-93
Tax/Fee Increase	$729.3	$148.8	$661.4
Working Capital Fund	$173.0	$137.0	$0.0

Total Direct Cost	$902.3	$285.8	$661.4

General Revenue budget reductions ("indirect cost") for the same three fiscal years were: -$781.7 million in 1990-91 (6.9% of the initial General Revenue appropriation), -$993.6 million in 1991-92 (8.5 % of the initial General Revenue appropriation) and -$540.8 million in 1992-93 (4.6% of initial General Revenue appropriation). While painful, no student was denied an education because of the reduction, no criminal was turned back to the general population because of the reduction, and no indigent Floridian was denied appropriate health care because of the reduction. The state budget was adjusted to accommodate these and other necessary needs of Florida's citizens and taxpayers.

Florida's Current Financial Position Better Able to Manage a Recession

Since 1990-91, Florida's budget has grown from $27.744 billion to $48.860 billion, a 76.1% increase. Assuming that the next recession will be of the same magnitude as the 1990-91 recession (only one of a number of possible scenarios that could occur), the direct recession costs would also increase 76.1%. In 1990-91, the direct costs (General Revenue Fund tax and fee increases of $729.3 million and the Working Capital Fund draw-down of $173.0 million) totaled $902.3 million. Projecting the 76.1% budget increase to the 1990-91 direct recession cost would indicate a potential direct cost of the next recession (as of this point in time) of $1.589 billion.

The 1999-2000 budget recently enacted by the Legislature projects a Working Capital Fund balance (after the Governor's vetoes) of $416.0 million and a Budget Stabilization Fund of $847.0 million. These reserves, totaling $1.263 billion, would be available to offset a General Revenue Fund shortfall due to a recession. This amount is more than seven times the Working Capital Fund reserves available during the first year of the 1990-91 recession and represents almost 80% to the total potential direct recession cost (which includes funding from a tax and fee increase). The significant increase in reserves, and with the appropriate use of unencumbered trust fund balances (or interest earnings), sufficient funds would be available to eliminate the need for a tax increase to cover a General Revenue shortfall caused by the next recession.

Florida learned its "fiscal lesson" with the 1990-91 recession. The next recession may require judicious budget reductions, but with utilization of the Budget Stabilization Fund and with the augmented Working Capital Fund, the costs can be better managed. To this end, Florida TaxWatch recommends that the Budget Stabilization Fund be gradually increased from 5% to 10% of General Revenues, which translates to $1.7 billion.

FOOTNOTES

1. Gardner, Jennifer M., "The 1990-91 recession: how bad was the labor market?" *Monthly Labor Review*, June 1994.
2. *Comprehensive Annual Financial Report*, June 30, 1998, Comptroller, State of Florida.
3. *Op cit*.
4. *Ibid*.

5. *Florida's Final Budget Report And Ten-Year Summary of Appropriations Data*, vols. #15, 16 and 17, and supplemental data, Executive Office of the Governor, Office of Planning and Budgeting.
6. *Ibid*.
7. *Ibid*.
8. "Florida's Fiscal Analysis in Brief, 1990," the Florida Legislature, and "State Budget Triples While Personal Income Doubles Over Last Decade," *Budget Watch* vol 3, issue 1, Florida TaxWatch, November 1994.

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