

Florida's Tax Structure: An Overview and Evaluation

by

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Executive Summary

- Florida's tax structure is well designed to provide for the state's future revenue needs. Throughout the 1990s, revenue grew faster than both inflation and the population, providing increased revenues per person. Minor refinements could be made to the tax system but Floridians should ensure that proposed changes would improve rather than worsen the system.
- Florida is one of nine states with no personal income tax. The general sales tax provides slightly more than half of the state's tax revenues. The sales tax base is appropriate to Florida's tourist economy. Out-of-state visitors, who also use state services, pay sales taxes on their purchases, whereas a state income tax would be paid only by residents.
- The absence of a state income tax is beneficial because income taxes slow economic development. Since revenues from income tax tend to decline more than revenues from sales tax during recessions, Florida's tax revenues are more stable over the business cycle than if the state had an income tax.
- There is some concern that e-commerce could erode Florida's sales tax base, but research shows that while the Internet provides an inexpensive way to access many potential customers, it is not a threat to sales tax revenues.
- Florida's intangible property tax is undesirable for many reasons and the legislature appears to be phasing it out. Overall revenue growth is strong enough that the tax should be repealed in 2001.
- The most problematic aspect of Florida's tax structure is its heavy reliance on motor fuel taxes to finance transportation. Despite increasing overall tax revenues throughout the 1990s, transportation revenues were almost unchanged. As cars get improved gas mileage and motor vehicles that use alternative fuels are developed, the gas tax will be an increasingly less productive source of transportation revenues. For this reason, tolls and user fees would be more suitable sources. While there is no crisis in transportation funding, now is the time to begin developing alternatives.

A major concern about any tax system is its fairness. Florida's tax system is equitable. It charges people for their use of government services as much as is feasible and it levies higher taxes on those with a greater ability to pay. Because the sales tax exempts food and rent, two major expenditure categories, it also provides a substantial tax break for residents at the lower end of the income distribution.

Introduction

Florida, one of nine states with no personal income tax, is reputed to be a low-tax state.¹ Some Floridians view these features as an asset, while others see them as a liability. Higher taxes in general would provide additional resources for state programs, while the lack of an income tax raises a host of issues. Other citizens contend that an income tax would enhance the revenue-generating capability of the state's tax structure. In addition, the sales tax is often viewed as regressive when compared to an income tax, leading to the argument that an income tax would make Florida's tax structure more equitable. And while revenue growth has been strong in recent years, critics of Florida's heavy reliance on sales taxation contend that it leaves the state vulnerable in several ways that an income tax could remedy. When the next recession inevitably arrives, an income tax might provide more of a revenue cushion to help Florida through tough times. Moreover, as the Internet economy continues its rapid growth, the state's sales tax base will be increasingly eroded as on-line purchases replace in-store sales.

This study considers these and other issues, and finds that despite several legitimate concerns, the state has a sound tax structure, one that is well-poised for prosperity at the beginning of the 21st century. While some improvements could be made in the tax structure, major changes are not needed, and there is always the danger that even minor ones will make it worse rather than better.

One reason people disagree about tax policy is that they view the tax system as playing different roles in the economy. Individuals who regard taxes as the price we pay for government goods and services have a different idea about the ideal tax structure than those who consider taxes as a penalty levied on those who earn income or accumulate wealth.

This study starts from the first premise, that taxes are the price we pay for government goods and services. While taxes inevitably have a dampening effect on economic activity in the private sector, the tax structure should enhance the state's prosperity as much as possible and discourage productive activity as little as possible. Having a tax structure designed to encourage prosperity is vitally important because Florida competes with other states for businesses and residents.

Revenue Sources

More than 60 percent of Florida's appropriations are funded by taxes. Table 1 shows that total appropriations for the 1999-00 fiscal year were \$48.7 billion and total taxes were \$30 billion. Taxes financed 61.6 percent of total appropriations in that year.² State lottery revenues and other educational fees, which added up to another \$1.4 billion or 2.8 percent, were not included in taxes. Federal grants made up slightly more than 21 percent of total appropriations, and those three categories amounted to more than 85 percent of total appropriations. The remaining 14.5 percent was raised by other miscellaneous charges and fees, by borrowing, and by gifts to the state (for example, donations to university foundations).

Appropriations were greater than total state spending because of double appropriations. If money was appropriated from one trust fund to another and then spent out of the second fund, that money was counted twice in state appropriations even though the state spent it only once. (Double appropriations probably make up several billion dollars in the state budget.)

Table 1
Sources of Florida's State Government Revenue, FY 1999-2000

	Billions of Dollars	Percentage of Total
Appropriations	48.7	100.0
Taxes	30.0	61.6
Education	1.4	2.8
Federal grants	10.3	21.1
Other	9.0	14.5

Table 2 separates tax revenues in fiscal year 1999-00 into the component sources. Keep in mind that this analysis includes state, not local, taxes.

By far the largest revenue source was the general sales tax, which made up slightly more than half of Florida's state tax revenues. Fuel taxes and fees, which also included other motor vehicle fees, made up 8.7 percent. All other tax bases raised less than 5 percent each of total tax revenues. These include the corporate income tax and documentary stamp tax, (more than 4 percent each); the intangible property tax (3.4 percent); and the gross receipts tax on utilities (2.2 percent); the estate tax (2.6 percent); and severance taxes of various types including those on oil, gas, and other mineral extractions (1.9 percent).

Table 2
Components of Florida's State Tax Revenue, FY 1999-2000

Item	Millions of Dollars	Percentage of Total
Sales and use tax	15,780.1	52.6
Fuel taxes and fees	2,602.6	8.7
Corporate income tax	1,356.8	4.5
Documentary stamp tax	1,231.9	4.1
Intangible property tax	1,028.2	3.4
Utility gross receipts	664.7	2.2
Estate tax	779.6	2.6
Severance taxes	56.8	1.9
Total of above taxes	23,500.7	78.3
Total taxes	30,008.9	100.0

Revenue Growth

One issue surrounding Florida's tax structure is the degree to which it allows revenue growth. Table 3 indicates tax revenues nearly doubled from the 1990-91 fiscal year (\$15.2 billion) to the 1999-00 fiscal year (\$27 billion)³ The table also shows a substantial annual increase in revenues in the 1990s that is truly impressive when compared to earlier decades. Three main factors contributed to this:

- Florida's population has expanded, increasing the state's tax base.
- Inflation has contributed to higher dollar amounts of tax revenue.
- The state's economic growth has increased taxes collected per person.

Table 3
Florida's Tax Revenue Growth, FY 1970-2000

Fiscal Year	Tax Revenues (Billions of Dollars)	Percent Increase	Inflation Adjusted Taxes Per Person	Percent Increase	Taxes as a Percent of Income
99-00	27.0	5.4	\$1,873	2.3	6.6
98-99	25.7	5.4	\$1,831	2.1	6.7
97-98	24.3	7.6	\$1,794	3.2	6.7
96-97	22.6	5.1	\$1,739	2.3	6.5
95-96	21.5	4.9	\$1,735	0.0	6.7
94-95	20.5	3.6	\$1,735	-0.1	6.8
93-94	19.8	6.7	\$1,750	1.7	7.0
92-93	18.6	11.1	\$1,721	5.7	7.0
91-92	16.7	9.6	\$1,628	2.1	6.6
90-91	15.2		\$1,594		6.2
85-86	9.2		\$1,256		
80-81	5.2		\$1,086		5.4
75-76	2.9		\$987		
70-71	1.6		\$1,027		6.1

Since increases due to inflation do not enable revenues to buy more in terms of state services, the ability of Florida's tax revenues to fund programs is determined more accurately by adjusting the data for inflation. The fourth column in the table lists inflation-adjusted state taxes per Florida resident. (This adjusts for both inflation and population growth.) Table 3 shows a substantial rise in inflation-adjusted taxes per person, from \$1,594 in 1990-91 to \$1,873 in 1999-00, or an increase of 17.5 percent in the decade. In the 1980s, Florida's inflation-adjusted taxes per person increased from \$1,086 to \$1,594, an increase of 46.8 percent, while in the 1970s, Florida's per-person taxes increased by only 5.7 percent. This slower revenue growth in the 1970s was largely due to a decline in inflation-adjusted motor fuel taxes as well as to a sluggish economy, whereas the 1980s saw substantial tax increases, creating revenue growth.

The rise in inflation-adjusted per-person taxes during the 1990s was primarily due to Florida's economic growth, not to rate increases or new taxes. One argument often given in favor of tax increases or against tax cuts is that the state will need additional revenue to finance future expenditures. However, most tax revenue growth over time comes from the growth of the economy, and increasing tax rates and creating new taxes works against economic growth, as the data in Table 3

show. The better long-term strategy is to create a tax structure that both preserves incentives for economic growth and generates increasing tax revenues through a healthy economy.

The fifth column shows steady tax revenue growth through the 1990s. In both 1994-95 and 1995-96, revenues stagnated but they increased in most years of the decade, averaging a 2.1 percent annual rate of increase over the decade. (This increase in inflation-adjusted per-person taxes resulted in the average amount by which Florida's per-person tax revenues increased over and above inflation and population growth in the 1990s.) The tax structure Florida now has is well-designed to provide increasing revenues in the future to finance the state's expenditure programs.

Florida's state taxes as a percentage of income remained fairly stable through the 1990s but are considerably higher than they were in earlier decades and are shown in the sixth column. In 1990-91, taxes were 6.2 percent of income, but increased rapidly to 6.6 percent the next year and 7 percent the following year. In 1999-00, Florida's taxes were 6.6 percent, down slightly from their highest point, but still higher than at the beginning of the decade. In contrast, Florida's taxes in 1980-81 were only 5.4 percent of personal income and in 1970-71 were slightly higher at 6.1 percent. Thus, Florida's taxes were consistently higher throughout the 1990s than in 1980 or 1970.

Critics contend that Florida needs additional revenue to meet the demands for government services that currently go unsatisfied. But this must almost always be the case and if it were not, government would clearly grow too large. Most government services are given away or, like higher education, are priced well below cost. Because consumers do not pay the full cost, or sometimes any cost at all, they will always want the government to produce more for them. This applies not only to items in the budget but also to regulations that do not require any outlays. Thus, if government is producing efficiently, it must leave some demands unfulfilled. To fulfill them all would mean producing output that has a much lower value than its cost to taxpayers. The legislature's job in the face of so many unfulfilled demands for government action is to decide which demands are worth the cost that would be imposed on Florida's citizens to meet them. When government gives most of its services away, there will always be demands for more government spending, but this is not a suitable reason to raise taxes.

Florida Compared with Other States

Florida ranked 40th in state taxes nationally in 1997, the latest year for which consistent data are available for all states.⁴ Table 4 lists the highest 10 states and lowest 13 states by state tax revenue, as well as the average for the 50 states. The first column shows the state rank from highest tax revenues to lowest, the third column lists total state tax revenue per person, and the last column shows that state as a fraction of Florida's tax revenues.

The last entry in the table ("United States") indicates that the average U.S. taxpayer paid 16 percent more in state taxes than Floridians. If Florida's state tax revenues rose to the national average (1.16 percent), state and local government expenditures would increase by less than 5 percent. A 16 percent increase in state taxes would finance less than a 5 percent increase in state and local expenditures for two reasons:

1. The state gets only about 60 percent of its revenues from taxes
2. State expenditures are only about half of state and local expenditures.⁵

Thus, Florida is very close to average on state taxes. When one considers financing government services, however, it makes sense to look at state and local revenues together, and Florida ranks 30th for combined state and local revenues.⁶ Florida, then, is below average on both state taxes (40th in the nation) and combined state and local revenues (30th), but bringing it up to the national average would produce a relatively small benefit in terms of government goods and services that could be purchased.

A closer look at Table 4 shows that Florida is not a particularly low tax state when compared to its neighbors. Florida is very close to Georgia and Virginia in state taxes per person and higher than Alabama. Alaska, at the top of the list, is clearly an outlier due to oil revenues. Massachusetts, regarded as a high tax state, has state taxes more than 50 percent above Florida's, and California's state taxes per person exceed Florida's by about one-third. At the bottom of the table, New Hampshire has low state taxes because it relies more on local governments to provide services.

Table 4

State Government Taxes Per Person and State Rankings in Per Person Taxes, FY 1997

Rank	State	Taxes Per Person	Florida/State
1	Alaska	\$2,656	1.85
2	Hawaii	\$2,590	1.80
3	Connecticut	\$2,493	1.73
4	Minnesota	\$2,394	1.67
5	Delaware	\$2,371	1.65
6	Massachusetts	\$2,176	1.52
7	Michigan	\$2,030	1.41
8	New Mexico	\$1,927	1.34
9	New York	\$1,916	1.34
10	California	\$1,455	1.33
38	Georgia	\$1,445	1.01
39	Missouri	\$1,455	1.01
40	Florida	\$1,436	1.00
41	Virginia	\$1,429	1.00
42	South Carolina	\$1,421	.99
43	Wyoming	\$1,380	.96
44	Colorado	\$1,359	.95
45	Louisiana	\$1,297	.90
46	Alabama	\$1,269	.88
47	Tennessee	\$1,232	.86
48	Texas	\$1,188	.83
49	South Dakota	\$1,042	.73
50	New Hampshire	\$780	.54
NA	United States	----- \$1,659	1.16

Source: *Statistical Abstract of the United States*, 1999 edition, p. 326 and author's calculations.

The figures show that while Florida is a low tax state, it is only slightly lower than average. The figures also show that regardless of whether one would like smaller state government or would prefer larger government to provide better services, Florida's tax revenues are adequate to supply services comparable to other states.

The Sales Tax

With so much of Florida's revenue raised through the sales tax, one of the most important questions for the state's future is whether this will provide an adequate revenue stream in the 21st century. The answer is "yes" for these reasons:

- The sales tax will grow along with the state's economy.
- It is more compatible with economic growth than an income tax.
- It is especially well-suited to a heavily tourism-oriented economy.

Sales tax revenues have increased consistently over the years. Total sales tax collections, which were about \$7 billion in the 1990-91 fiscal year, rose to \$13.8 billion by 1999-00, thereby nearly doubling in a decade. There is no reason to think that this growth will stop. Some growth has been due to inflation and some to the population expansion, however, so a better way to look at sales tax revenues is to adjust for these two factors. Table 5 shows Florida's inflation-adjusted per-person sales tax revenues, and even after adjusting for these two factors, Florida's sales tax revenues have grown steadily. In 1990-91, inflation-adjusted sales tax revenues per Florida resident were \$680 and by 1999-00, they had grown to \$908, an increase of 33.5 percent in a decade.

Table 5
Florida's Sales Tax Revenue, FY 1970-2000

Fiscal Year	Inflation Adjusted Taxes Per Person	Percent Increase	As a Percent of Total Taxes	As a Percent of Personal Income
99-00	\$908	5.1	48.5	3.4
98-99	\$864	3.9	47.2	3.3
97-98	\$831	3.1	46.3	3.3
96-97	\$806	0.7	46.3	3.2
95-96	\$800	4.5	46.1	3.3
94-95	\$765	1.9	44.1	3.2
93-94	\$751	2.8	42.9	3.2
92-93	\$731	4.8	42.5	3.2
91-92	\$697	2.6	42.9	3.0
90-91	\$680		42.6	2.8
85-86	\$621		49.4	
80-81	\$523		48.2	2.6
75-76	\$427		43.3	
70-71	\$464		45.2	2.8

Sales tax revenues have grown faster in the 1990s than in the previous two decades. In the 1980s, they rose from \$523 to \$680 per person for a 30 percent increase, and in the 1970s from \$464 to \$523, for a gain of only 12.7 percent. While the sales tax rate has been increased periodically, it has remained at 6 percent throughout the 1990s, so the increase is due primarily to economic growth, not to changes in the rate. The third column lists the percentage increase in inflation-adjusted sales tax revenues per person through the 1990s, and shows it to be consistently positive. The fourth column shows sales tax revenues as a percentage of Florida's total tax revenues. The sales tax has been responsible for an increasingly larger share of Florida's total tax revenues throughout the 1990s, going from 42.6 percent of total taxes in 1990-91 to 48.5 percent in 1999-00. (Total revenue here includes education fees and lottery revenues, unlike the total in Table 2.)

The fifth column in Table 5, which indicates sales tax revenues as a percentage of personal income, shows the strength of the sales tax base more convincingly. In the 1990s, sales taxes as a percentage of income rose from 2.8 percent in 1990-91 to 3.4 percent in 1999-00 without a rate increase or any major changes in the tax base. Note that in 1980-81, sales taxes composed only 2.6 percent of income and in 1970-71, only 2.8 percent of income (with lower sales tax rates). These figures show that the sales tax base is not eroding but rather has been growing in importance as a source of Florida tax revenues.

Part of this growth is due to the fact that non-resident visitors use government facilities and services, buy sales-taxable items, and as a result, pay state sales taxes along with residents. Thus, while sales tax collections per Florida resident are 3.4 percent of income, typical Floridians pay less of their incomes in sales tax; the difference is paid by non-residents. This is one of the strengths of the sales tax for the state in particular. With tourism as a major industry, the sales tax levies taxes on out-of-state residents in a way that an income tax could not.

The sales tax also has the advantage that it is more difficult to avoid than an income tax. To use one example, profits from underground businesses (for example, drug-dealing) would go untaxed by an income tax because the profits are not reported. But when those profits are used to buy goods in the Florida economy, the sales tax collects revenues from that income.

Some people are concerned that as the economy turns more toward producing services rather than goods, the sales tax base will be eroded. Table 5 shows no evidence of that process thus far. In fact, sales tax payments as a percentage of income have actually grown in the past decade. The service economy is no threat to the sales tax. Even if non-taxable services as a percentage of the economy grew, that still would not imply a shrinking of sales tax revenues. As long as there is a growth in the purchase of sales-taxable items, which surely will be the case as personal income increases, sales tax revenues will continue to grow.

Another issue that has recently been raised is the taxing of Internet sales. Clearly, Internet sales will remain a small part of total sales, and many sales will be from in-state businesses that collect sales taxes.

The most significant threat to Florida's sales tax revenues is not erosion of the tax base but rather erosion of revenues because of sales tax exemptions granted by the legislature. The evidence shows that the tax base (taxable sales) is growing, but the legislature always faces the temptation to exempt interest groups. Consequently, these exemptions erode the revenue-generating capacity of the tax even though sales are growing. The enticement to exempt special interest groups is especially strong when a healthy economy brings with it vigorous revenue growth. If the legislature exercises restraint in this area, the sales tax will remain a strong source of revenue as taxable sales grow.

Taxing Services

Many Floridians will recall the short-lived services tax that was imposed in 1987 and repealed less than a year later. Some observers placed responsibility for the repeal on the intense pressure levied by the advertising industry, because advertising was one of the services taxed. Advertisers understandably lobbied for the repeal of a tax on their industry; there is, however, a valid objection to extending the sales tax to advertising. Advertising is not a final consumer good, but an intermediate one purchased by businesses which then include the cost of advertising in the cost of their products. By taxing advertising and also the sale of the products being advertised, taxing advertising results in double taxation. Ideally, the general sales tax would be levied only on all final sales, not on intermediate sales. To tax intermediate goods is to place a tax on top of a tax, which is inefficient. It means that ultimately, different goods will be taxed different amounts depending upon how many intermediate sales were made before the final retail sale.

Also, double taxation encourages “inefficient vertical integration,” a practice in which firms undertake production activities in-house rather than purchasing from other firms. For example, if a sales tax covered all sales rather than just retail ones, an auto manufacturer who bought steel from a steel mill would have to pay sales tax on the steel, and the steel manufacturer who bought iron ore from a mining company would have to pay sales tax on the iron ore. This tax could be avoided if the auto manufacturer mined its own ore and made its own steel, but to avoid the sales tax, inefficient vertical integration of the firms would occur. Whether an auto manufacturer makes its own steel or buys from a steel manufacturer should be determined by the requirements of efficiency, not by avoiding the payment of taxes.

The same problem with placing the general sales tax on advertising is true of other services covered by Florida’s services tax. Legal, accounting, and consulting services are intermediate, not final, goods, so taxing them also would create a double tax. Firms would have an incentive to hire their own legal and accounting staff to avoid the tax that would be imposed when they buy these services from outside firms, even if the independents provided lower costs and improved service. Furthermore, businesses that used more legal and accounting services would have a larger percentage of sales taxes in the price of their final goods and services, again distorting prices in the economy.

Florida’s short-lived services tax would have raised more revenue, but almost all of it would have come from the taxation of intermediate goods, thereby creating a negative impact on Florida’s economy. In the campaign supporting the tax, the argument was given that there was no reason why services such as dry cleaning and haircuts should escape taxation when products such as clothing and scissors were taxed. While there is some merit to this argument as stated, it ignores the fact that almost all of the services tax revenue would have been raised from intermediate services. While some consumer services may currently escape taxation, little revenue is raised by taxing them, and there are good reasons to tax final, rather than intermediate, services.

The Sales Tax in the Internet Economy

With e-commerce beginning to flourish, some people are concerned that it will crowd out local sales and erode the sales tax base. While Internet sales are growing rapidly, they are a small fraction of total retail sales and will remain so. Despite the hysteria in some quarters, e-commerce is not a threat to Florida’s sales tax base.

Sales through the Internet are new enough that there is little useful data on them, but there is data on a closely related business phenomenon, mail order sales. These make up about 6 percent of total retail sales in today’s economy and have much in common with Internet sales. In effect, the Internet provides the catalog and the mechanism for placing the order, but its main advantage is that it provides a low-priced way to reach many buyers. With catalog sales, a catalog must be delivered to potential customers, whereas on the Internet, one catalog in the form of a web site serves all customers. The main competitors for e-commerce are current mail order retailers rather than the traditional brick-and-mortar retail stores, and one can see from the share of the economy made up of mail order that Internet sales have a limited potential to displace Florida’s sales tax base.

Shopping at a local store offers advantages. The purchaser can see the available products first, use the selected item immediately after the purchase, and contact local service in case of any problems. Furthermore, shipping charges limit the degree to which Internet sales can displace local sales, even if Internet sales are not taxed. The local Wal-Mart can ship in a truckload of merchandise relatively inexpensively, so when a consumer buys one of its items, shipping is a small part of the total cost. In contrast, an item ordered from an Internet supplier must be shipped individually from a central warehouse in another part of the country at much higher UPS or FedEx shipping charge rates, negating any advantages related to the sales tax. Not only that, the customer has to wait to get the product.

In the future, the largest e-commerce firms will also be the largest firms with a local presence. Currently, most e-commerce firms are operating at a loss, aspiring to profitability some day. When e-commerce does become profitable, the nation's retailing giants will be substantially involved.

Income Taxes and Economic Growth

Taxes impose a cost on the economy beyond simply the money taken from taxpayers in that they create a disincentive for the taxed activity. One issue that has been in the background for decades is whether the state would benefit from having a personal income tax. The question is largely academic because instituting a personal income tax would require an amendment to Florida's Constitution, which is exceedingly unlikely. Nevertheless, it is reassuring to see that the current tax structure is capable of funding state government without a personal income tax, as the previous section has shown.

Recent research at Florida State University examined the effect of state income taxes on state income growth and concluded that higher state income tax rates slow economic growth.¹ This is consistent with research by academic economists for decades showing that income taxes reduce income growth.² This finding should not be a surprise. Any tax discourages the taxed activity and a tax on income directly discourages the earning of taxable income. The effects tend to be larger with state rather than with federal taxes because it is relatively easy to move across state lines. Thus, the design of Florida's current tax structure will attract residents who earn high incomes—those individuals who tend to pay more in other types of taxes and make few demands on public services.

In today's political climate, it is unlikely that Florida could adopt a personal income tax even if it were desirable. However, all evidence shows that the state is better off without an income tax.

The Intangibles Tax

In an earlier James Madison Institute study, I argued the merits of repealing Florida's intangible property tax and it appears that it is being phased out.³ In 1999-00, the tax raised just over \$1 billion in revenues, which was less than the increase in total tax revenues from 1998-99 to 1999-00. In other words, if the intangibles tax had been repealed entirely last year, tax revenues still would have increased.

While the intangibles tax raises a small amount of revenue, it imposes major costs on Floridians and on the state's economy. It is a tax on capital and on savings, discouraging those activities, and perhaps also discouraging residency for the wealthy. Also, the tax tends to fall on older persons who have accumulate wealth over their lifetimes, many of whom make few demands on the state's services. Those who pay the tax are unlikely to be on welfare or to have children in public schools, for example. Floridians with millions of dollars in intangible property easily avoid the tax, albeit at a price for the legal services to do so. Thus, the tax tends to be avoided by Florida's richest citizens and falls on the well-off but not on the exceptionally wealthy. It is also the only state tax that requires residents to complete a return. Filing a return is not a large burden for many taxpayers, but others pay for tax preparation.

More details on the debate over the intangibles tax are in my earlier study that is still available from the Institute. The intangibles tax appears to be on its way out, but because the state's total tax revenues are growing and because it is a small part of Florida's tax revenues, a strong argument can be made for eliminating it entirely in 2001, rather than phasing it out over several years.

Florida's Transportation Taxes

One tax that bears close examination is the motor fuels tax, the largest component of Florida's earmarked transportation revenues. The motor fuel tax is allocated to the transportation trust fund and is used mainly for funding roads. Other sources of revenue for the trust fund are transportation-related taxes such as automobile title and lien fees, licenses, and other fees and charges on motor vehicles. Appropriating automobile taxes for roads, as is done in Florida, closely links the payment of the tax to the government service that is delivered. Some analysts are critical of earmarked taxes because they reduce the flexibility of the legislature to reallocate revenues, but in this case, such reduced flexibility is an advantage. It means that the relationship between those who pay the tax and those who use the service remains close. One potential problem is the temptation to siphon off some of the revenues raised from taxes on motor vehicles and fuel to finance other transportation projects, such as intercity rail or mass transit. Doing so severs the link between tax payments and benefits received, reduces the funds available for roads, and makes motor vehicle drivers pay for transportation options they may not use.

Diverting funds also can create opposition to the motor fuel taxes. One of the complaints Floridians have had for decades is the traffic congestion that has come with a growing state. Florida's drivers are willing to pay additional fuel taxes to help fund roads, but will oppose tax increases if they think that the motor fuel taxes are used for non-roadway projects. Redirecting even a small portion of motor fuel taxes creates an impression that drivers are paying for unused transportation options, so the tax will be resisted.

There are potential long-term problems with Florida's current motor fuel taxes and assigned transportation funds system. These revenues have barely kept up with inflation and have declined significantly as a percentage of total tax revenues. Table 6 shows Florida's inflation-adjusted transportation taxes per person. In addition to motor fuel taxes, these include auto title and lien fees, motor vehicle and mobile home licenses, and other motor vehicle fees and charges. In 1990-91, these taxes were \$113 in inflation-adjusted dollars per person, and rose in 1992-93 to \$130. They remained at about this level at the end of the decade. Thus, while total Florida taxes have increased by 8.8 percent from 1992-93 to 1999-00, transportation taxes remained about level. In 1991-92, transportation taxes were 4.8 percent of total Florida taxes and by 1999-00, they had fallen to 4.3 percent.

Table 6
Florida's Transportation Tax Revenue, FY 1970-2000

Fiscal Year	Infl. Adj. Taxes Per Person	As a Percent of Total Taxes	Fuel Taxes as a Pct. of Trans. Taxes
99-00	\$131	4.3	61.4
98-99	\$130	4.4	61.4
97-98	\$128	4.4	61.5
96-97	\$128	4.5	60.1
95-96	\$127	4.6	63.3
94-95	\$128	4.5	60.1
93-94	\$130	4.4	59.2
92-93	\$130	4.7	61.2
91-92	\$121	4.8	63.7
90-91	\$113	4.0	56.4
85-86	\$80	3.9	61.7
80-81	\$58	4.0	73.7
75-76	\$62	6.4	100
70-71	\$92	9.0	100

The motor fuel tax component of Florida's transportation taxes remained fairly constant over the decade of the 1990s, at around 60 percent of the total. In the 1970s, it was responsible for almost all allocated revenues into the transportation trust fund until other revenue sources were added.

The motor fuels tax has the virtue of being levied almost exactly on the users of roadways. However, it is almost sure to erode over time as a revenue source for several reasons:

- Historically, the per gallon tax rate has not kept up with inflation, which is why gas tax revenues eroded in the 1970s, a decade of high inflation.
- Another problem is that automobiles are getting improved fuel mileage, so even at a constant tax rate per gallon, car owners are paying a lower tax per mile driven. To be an actual charge on road use, the rate should rise not only with inflation but also with average miles per gallon for motor vehicles.
- The introduction of vehicles that run on alternate fuels is a more threatening problem. As gas mileage improves and alternative fuel vehicles become more common, the tax on gasoline will become a less viable source of transportation revenues.

Looking for alternatives to motor fuels taxes is not urgent; there will be no crisis if the legislature does not deal with it this year or next. Nevertheless, planning now can improve Florida's future transportation situation greatly.¹⁰ While the gas tax accurately places the tax burden with the users of highways, it is not as effective as tolls in this regard. The gas tax charges all drivers the same amount per gallon regardless of the roads they use, whereas tolls price roads individually. Toll roads also have the advantage that they can be changed according to the degree of road congestion and used to ration space on the roads. For example, they could be raised during rush hours or on especially congested roads.

Some citizens resist toll roads, especially to toll charges on roads that did not previously have them. Drivers already pay for roads through their gas taxes, so charging a toll makes drivers pay twice. This objection can be met by building new toll roads in congested areas to relieve some congestion. Drivers then can take their old routes or avoid congestion by taking the toll road. Toll roads help even drivers who choose not to use them because they divert traffic from other roads. One example is the Veteran's Expressway in Tampa that runs parallel to Dale Mabry, a major traffic artery. Drivers can choose the Veteran's Expressway as a popular alternative to the more congested thoroughfare that parallels it. Also, if tolls are relied on more to finance roads, the gas tax can be reduced. This in turn will further cementing the connection between driving on roads and paying for them and reduce driver resistance to paying tolls. While toll booths are the norm now, new technologies such as bar code readers and radio transponders can make toll collections easier and cheaper, and are being used on a limited basis now.

Is Florida's Tax Structure Fair?

Heavy reliance on the sales tax has sometimes subjected Florida to the criticism that its tax structure is unfair. Critics say that the poor pay too much while the rich do not pay enough. Of course, fairness is a value judgment and to evaluate these charges, one must consider the premise of this report, that taxes are the price we pay for government goods and services. Do Floridians pay a fair price for the government goods and services they consume?

I examined this question in an earlier study of Florida's taxes and found that residents in the upper 20 percent of the income distribution pay about three times as much in Florida taxes as the average resident.⁴ This is about \$5,619 per person or \$22,476 for a family of four.⁵ Is this enough? Considering that affluent individuals rarely use government services, they undoubtedly pay more than their share as measured by the services received. Such persons are more likely to send their

children to private rather than public schools, they are not welfare recipients, and among the highest income group, are even likely to pay for private law enforcement in the form of security guards rather than relying heavily on publicly provided law enforcement.

In terms of taxes paid, wealthy Floridians benefit the state. Should we raise their taxes? As a matter of policy, the state should want to attract those who more than pay their way, and making their tax burden relatively low compared to other states is one way.

Florida's tax structure is relatively easy on those at the other end of the income scale. The sales tax is often viewed as a regressive tax that hits lower-income taxpayers harder, but it exempts food and rent, two expense categories that take a major share of the incomes. Furthermore, the homestead exemption helps needy homeowners with their local property taxes. A rough calculation suggests that a family of four at the lower 20 percent of income distribution would pay about \$665 a year in state taxes.⁶ When compared to an estimated \$22,476 paid by a family of four in the upper 20 percent of the income distribution, upper-income Floridians pay about 34 times more in state taxes in Florida than the lower 20 percent of the distribution. They surely do not receive 34 times more in state services.

Stability over the Business Cycle

Florida's tax revenues have shown steady growth due to a sound fundamental tax structure and a strong economy. However, one area of concern is how the state will fare when the next recession inevitably arrives.

When the 1991 recession slowed Florida's tax revenue growth, some proponents of a state income tax argued that Florida needed an income tax to increase the stability of its tax system. At first glance, such an argument for an income tax seems wrong. Sales taxes should be more stable over the business cycle than income taxes, so an income tax should actually be destabilizing. Think of it this way—an income tax is a tax on income, whereas a sales tax is a tax on consumption. During a recession, income tends to fall more than consumption. When people lose their jobs or otherwise see a drop in their incomes, they tend to pull money out of savings, or borrow if they can, or receive government transfers to keep their consumption expenditures from falling very far. It is true that consumption expenditures fall, but not as much as income, so a sales tax should provide better revenue stability during an economic downturn than an income tax. Following this argument, if Florida added an income tax, its revenue would fluctuate more during downturns, not less.

There is, however, one possible flaw in that line of reasoning. An income tax does not tax all income and a sales tax does not tax all consumption. It omits food and rent, as noted above, as well as many services and it taxes many non-consumption items. For example, Florida's sales tax taxes construction materials and construction tends to slow down substantially during recessions. Thus one would have to look at what happens to state government revenues over the business cycle to verify that it is true.

With this in mind, I worked with Russell Sobel, an economics professor at West Virginia University, to look at the data to see whether sales taxes were more stable over the business cycle than income taxes, and we found that sales taxes are more stable.⁷ After a detailed analysis of the data, it is clear that Florida's heavy reliance on the sales tax does not destabilize the state's tax system, that it has a relatively stable tax system for its economy, and that if Florida did adopt personal income taxation, the state's tax system would be less stable as a result.

Florida's Taxes in the 21st Century

When compared to other states, Florida's tax structure appears to be solid and its design will help the state prosper. Still, the tax structure could be improved in several ways.

The Intangible Property Tax. One improvement would be to repeal the intangibles tax, and while it appears that it is being phased out, Florida's revenue growth is strong enough that the tax should be completely repealed in 2001.

Sales Tax. The sales tax could be fine-tuned to be more of a consumption tax by eliminating the tax on some non-retail purchases and by consistently taxing retail services (but avoiding taxing wholesale services such as legal, advertising, and accounting.) A threat in trying to alter the sales tax is that the legislature will be tempted to grant exemptions to special interest groups rather than to improve the tax structure.

Transportation Trust Fund. The biggest area of long-term concern lies with transportation taxes. Currently, the transportation trust fund is funded by designated taxes on transportation-related activities, and primarily motor fuel taxes. These make up about 60 percent of Florida's earmarked transportation taxes, but motor fuels will be increasingly difficult to tax in the future. The data in this report shows that while Florida's tax revenues in general have been growing throughout the 1990s, transportation revenues have not. The search for innovative alternatives should begin now before a crisis develops.

Overall, the state has had revenue growth well beyond inflation and the population growth throughout the 1990s, and it promises to have similarly strong revenue growth in the coming decades. Florida's taxes are below the national average and it is only one of a handful of states without an income tax. Because the state's sales tax is paid by both residents and tourists, the sales tax structure suits Florida's tourist economy better than an income tax, which would fall only on residents. Attempts to modify Florida's taxes to make them conform to the national average could be counterproductive.

As mentioned earlier, Florida's tax revenues have grown substantially over the decades, from \$1.6 billion in 1970-71, to \$5.2 billion in 1980-81, to \$15.2 billion in 1990-91, to \$27.0 billion in 1999-00. Economic growth is the engine that has driven this growth. Increasing tax rates and adding new taxes can temporarily increase revenues but ultimately, increasing taxes costs the state because this action slows economic growth. Conversely, reducing tax rates and eliminating taxes may temporarily cut into revenues, but such actions enhance revenues because of the increased economic growth.

In the long run, holding the line on Florida's taxes and reducing them wherever feasible allows taxpayers to keep more of their money. It also strengthens state government because income growth is the engine that creates tax revenue increases. Economic growth is the key to the health of both Florida's economy and its government.

Footnotes

¹ Randall G. Holcombe and Donald J. Lacombe, "The Effect of State Income Taxation on Per Capita Income Growth," Florida State University working paper, August 2000.

² References are listed in the study cited in the previous footnote.

³ Randall G. Holcombe, *Florida's Intangibles Tax: A Large Burden for a Small Return*. Backgrounder No. 20, The James Madison Institute, 1997 (an earlier version was released in 1994 as Backgrounder No. 14).

⁴ See Randall G. Holcombe, *Florida's Tax Structure: An Evaluation*. Backgrounder No. 3, James Madison Institute, 1991.

⁵ This was calculated by taking \$1,873 per person in taxes, as reported in Table 3, tripling it to represent the taxes paid by an upper-income Floridian, and multiplying it by four to represent taxes for a family of four.

⁶ From my earlier study, Florida taxes on lower-income Floridians tax only about 72 percent as much of their incomes as the average Floridian, and family income would fall in the range of \$20,000 and below for the bottom 20 percent of Floridians. The median of this group (those with family incomes below \$20,000) would have a family income of about \$14,000. The average Floridian pays about 6.6 percent of income in state taxes, and 72 percent of this is 4.75; 4.75 percent of \$14,000 is \$665.

⁷ Our work has been published in a book, *Growth and Variability in State Revenue: An Anatomy of State Fiscal Crises* (Westport, CT: Greenwood, 1997) and in several articles, including "The Relative Variability of State Income and Sales Taxes over the Revenue Cycle," *Atlantic Economic Journal* 23, no. 2 (June 1995), pp. 97-112, and "Measuring the Growth and Variability of Tax Bases over the Business Cycle," *National Tax Journal* 49, no. 4 (December 1996), pp. 535-552.s

