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September 15, 2004

FEDERAL POLICIES ARE WORSENING MISSOURI'S BUDGET PROBLEMS

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Summary

Federal policies were a major cause of the severe fiscal crisis Missouri has experienced over the past few years. The cost to the state of federal policies over the past four years — fiscal years 2002 through 2005 — has been $3.6 billion, an amount that exceeded the $2.3 billion state budget deficit Missouri experienced over that period. Most of these federal policies represent an ongoing problem and will continue to hamper Missouri's efforts to recover from the crisis and provide an adequate level of government services to its residents. Federal policies are likely to continue to cost the state more than $1 billion a year over the next several years.

The federal policies that have contributed to the fiscal crisis in Missouri and other states include tax cuts that reduce state revenue because of the linkages between federal and state tax systems, the federal ban on state taxation of purchases made over the Internet and other preemptions of state taxing authority, "unfunded mandates" such as the No Child Left Behind education initiative, and the shifting of prescription drug costs from the federal government to the states. In 2003 the federal government enacted a temporary program of aid to states, which provided $376 million to Missouri. But this aid offset only about one-tenth of the $3.6 billion cost to Missouri of federal policies during the state fiscal crisis.

Missouri has been particularly hard hit by these federal policies. The $3.6 billion in additional spending obligations and lost revenues resulting from federal policies over the past four years represent approximately 13.0 percent of the state's general revenue. This is a greater percentage than in all but three other states. Only Florida, Mississippi and Nevada have taken larger hits.

To cope with the fiscal crisis of the past four years, Missouri and its local governments have made cuts in government services that have affected millions of middle- and low-income families. There also have been tax and fee increases to close deficits at both the state and local level, creating additional burdens for families. If federal policies had been less costly for

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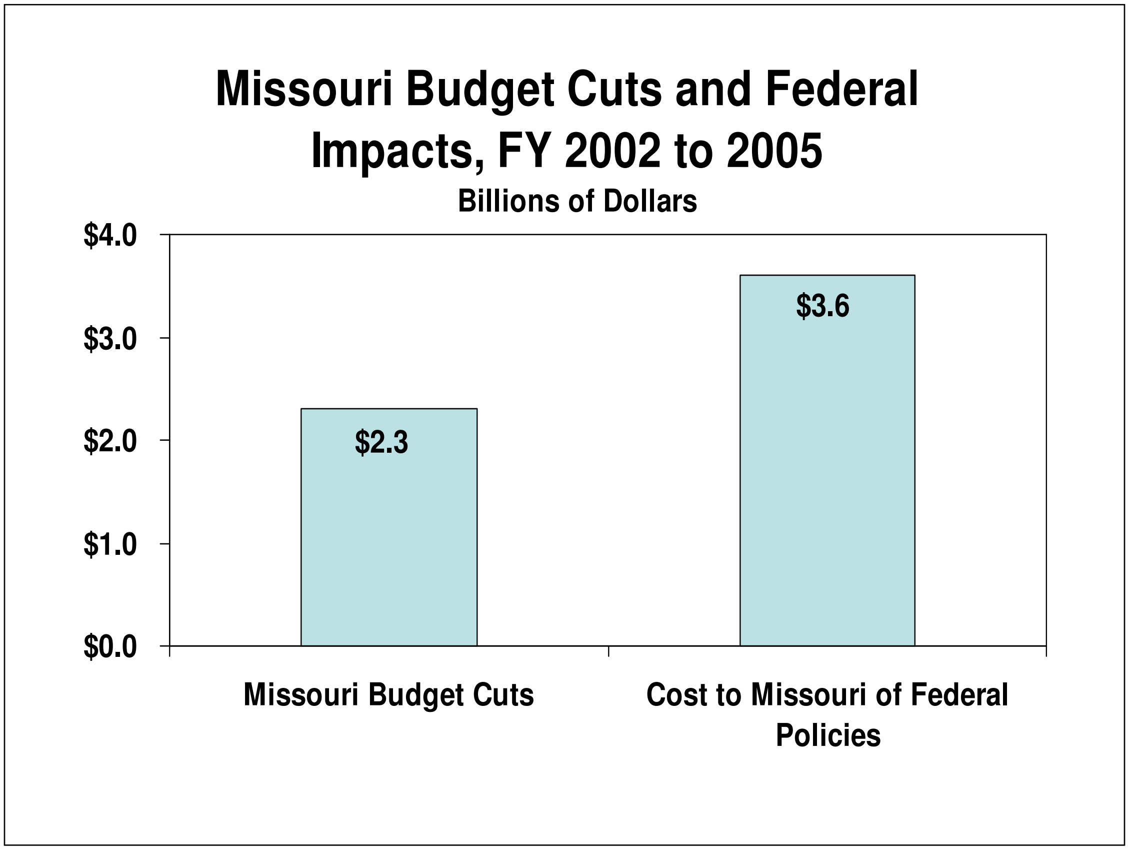
Figure 1



the state, or if the federal government had provided more funds to assist Missouri in its crisis, these program reductions and tax and fee increases could have been far less painful.

The impact on Missouri families of the actions taken by state and local government in response to the fiscal crisis has been substantial:

- Some 37,000 Missouri parents with low-paying jobs have lost eligibility for state-subsidized health insurance. Few of these jobs are likely to provide employer-subsidized care, so most of those parents will have to purchase insurance on their own, probably at a cost of thousands of dollars per year. Many of the parents will simply choose to forego insurance, exposing themselves to the risk of large medical bills and perhaps bankruptcy should they become ill.

- Some 88,000 Missouri families with children attending state colleges and universities are paying hundreds or thousands of dollars more each year in tuition. Tuition increases have ranged from $150 to $630 at two-year colleges and from $888 to $1,743 at four-year colleges.

- Working parents with incomes slightly above the poverty line are no longer eligible for child care subsidies. For a family with income between $21,000 and $24,000, those lost subsidies were worth more than $3,000 per year.

- Cuts in state payments to grandparents providing foster care and to legal immigrants are costing several thousand families $1,500 to $3,500 per year.

- Property owners and renters in roughly one-fifth of the state are paying more in school property taxes, as school districts seek to offset substantial losses of state aid. Although tax rate increases vary, many homeowners are facing tax hikes of $100 or more. Since the state is unlikely to reverse its cuts in education funding soon, these property tax increases may spread even wider.

- Local governments are increasing fees to keep their budgets in balance in the face of lost state aid.

- The draining of budget reserves and the increased use of debt by state and local governments will place added burdens on future taxpayers.

The federal tax cuts enacted in 2001 through 2003 are a major reason the federal government has pursued the policies that have worsened fiscal problems in Missouri and other states. At a time when the federal government could have been ameliorating states' fiscal problems, it instead has been cutting taxes, with most of the tax cuts targeted to high-income households. It is therefore instructive to compare what Missourians have *gained* from these federal tax cuts to what they have *lost* from the cuts in state and local services.

For a small number of very-high-income Missouri residents, the benefits of the federal tax cuts have probably outweighed the direct costs of state and local budget difficulties. For example, this year the wealthiest 1 percent of Missouri residents — a group with an average annual income of $722,000 — will receive an average benefit of $47,969 from the 2001-2003 tax cuts, according to the Institute on Taxation and Economic Policy.[2]

Table 1
The Cost to Missouri of Harmful Federal Policies, 2002-2005

FY 2002	$710 million
FY 2003	$774 million
FY 2004	$1.0 billion
FY 2005 (proj.)	$1.1 billion
Total	**$3.6 billion**

For a large number of lower- and middle-income Missourians, however, the benefit of the tax cuts is likely to be outweighed by the harm done by state and local budget cuts. For instance:

- In 2004, the average federal tax cut for a Missouri taxpayer in the middle fifth of the income spectrum is $846. That is half the average tuition increase for a University of Missouri student and well under the tuition increases at many other public colleges and universities as well.

- In 2004, the average federal tax cut for Missouri taxpayers in the poorest 60 percent of households is $458. That is a fraction of what it would cost a working parent who has lost state-funded health coverage to purchase insurance in the individual market for a year.

[2] State-specific data on the distribution of the federal tax cut come from the microsimulation model developed by the Institute on Taxation and Economic Policy from U.S. Treasury tax data.

- In 2004, about 28 percent of U.S. taxpayers are receiving a tax cut of $100 or less, according to the Urban-Brookings Tax Policy Center. That is less than the increase in property taxes paid by the owner of a $100,000 home in a typical school district that has raised taxes to compensate for state shortfalls in education funding.

In essence, low- and middle-income Missourians have been paying for very generous federal tax cuts for the highest-income Americans and will continue to do so unless federal policies are changed.

Federal Policies' Adverse Impacts on the Missouri Budget

Federal policies have made Missouri's fiscal crisis deeper and more prolonged by: a) reducing state revenue directly, b) restricting Missouri's ability to raise revenue, c) underfunding programs that Missouri and its localities operate, and d) imposing new costs on the state. Taken together, these federal policies cost Missouri $710 million in fiscal year 2002, $774 million in 2003, $1.0 billion in 2004, and a projected $1.1 billion in 2005. Although the $376 million in federal fiscal relief provided in 2003 has helped Missouri, the federal government could have done more to help it and other states avert damaging budget cuts and regressive tax increases.

Reducing State Revenue and Preempting State Taxing Authority

Because state tax systems are tied to the federal tax code in a number of ways, certain provisions of the federal tax cuts enacted in 2001, 2002, and 2003 have reduced state revenues as well as federal revenues. For example, Missouri is losing $219 million in revenue through fiscal year 2005, and $566 million through fiscal year 2007, from the phase-out of the federal estate tax credit.[3] This credit reduces the federal estate tax by a dollar for each dollar paid in state estate taxes. Formerly, each state levied a state estate tax that was tied to this federal credit; most states simply set their own estate tax at a level equal to the federal credit. Thus, the elimination of the federal credit effectively eliminates state estate taxes in most states.

Some 17 states and the District of Columbia have "decoupled" their estate taxes from this change in federal law in order to maintain their own estate tax. Missouri, though, failed to do so, and is losing hundreds of millions of dollars of revenue as a result.

In another example, Missouri is losing $208.6 million through fiscal year 2005 from a business tax cut known as "bonus depreciation." As originally enacted, this federal tax cut allowed businesses to deduct immediately 30 percent of the cost of equipment they purchase, rather than writing off the cost gradually over the equipment's useful life.

Like most states, Missouri ties its depreciation tax rules to the federal rules. After bonus depreciation was enacted in 2002, the state "decoupled" from the federal tax cut, but only for one year. Also, federal policymakers made the federal depreciation tax cut even more generous in 2003, allowing firms to deduct immediately 50 percent of the cost of equipment they purchase

[3] Estimates provided by the Missouri Office of Administration, Division of Budget & Planning.

and extending the tax cut through December 2004. These changes made bonus depreciation even more costly for Missouri.

Table 2
Missouri's Lost Revenue from Selected Federal Policies, 2002-2005

Ban on taxing Internet purchases	$1.1 billion
Phaseout of estate tax credit	$219 million
Bonus depreciation	$209 million
Ban on taxing Internet access fees	$83 million

Federal policies also prevent Missouri from raising revenues in certain areas. The Internet Tax Freedom Act, for example, bars states from collecting taxes on the monthly charges people pay for Internet access. This ban is costing Missouri more than $83 million over fiscal years 2002-2005.[4] Of course, Missouri and other states might choose not to tax Internet access even if the federal government allowed it. But the federal ban precludes even the possibility.

Missouri is losing much larger amounts — at least $1.1 billion over that same four-year period — as a result of federal restrictions on states' ability to tax purchases made over the Internet or in catalogs. Two Supreme Court decisions bar states from requiring sales taxes to be remitted when the vendor does not have a physical presence in the state. As a result, states generally cannot compel out-of-state sellers to collect sales taxes on Internet or catalog purchases, even though states can collect sales taxes if the same items are bought in a store. This inconsistency hurts small businesses and in-state retailers by making them less competitive with Internet and catalog sellers. It also prevents states and localities from collecting significant amounts of revenue that otherwise would be due to them. Congress could fix this problem, as the Court has suggested, but it has not done so.

In the past, an argument against federal action to enable states to collect sales tax on catalog and Internet sales has been that as a result of differences among state sales tax systems, a requirement to collect and remit sales tax would impose too great a burden on the out-of-state vendors. In the last few years, however, states have made substantial progress under their "Streamlined Sales Tax Project" in harmonizing state sales tax systems in ways that will substantially reduce the burden of collecting these sales taxes. Missouri representatives have participated in this project, but the state has not yet enacted legislation to harmonize its state tax system with those of other states, in part because it would require changes to how certain businesses collect the tax.[5] Were Congress to allow the collection of remote sales taxes by states that participate in the project, however, Missouri likely would choose to do so.

Donald Bruce and William Fox of the University of Tennessee estimate that Missouri's inability to tax Internet purchases is costing the state and its local governments more than $290 million this year alone.[6] Not all of this amount actually could be collected under a politically

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[4] The ban expired at the end of November 2003. As of this writing, Congress continues to debate the form in which it will be extended. Some form of extension is likely, and states and localities are acting as if the ban is still in place.

[5] One change that would be required by the streamlined sales tax approach in Missouri would be that local sales taxes on items sold by a retailer in one locality and delivered to a customer in another locality would be assigned to the customer's local government, not the retailer's as under current law.

[6] Donald Bruce and William F. Fox, *State and Local Sales Tax Revenue Losses from E-commerce: Estimates as of July 2004*, University of Tennessee Center for Business and Economic Research.

feasible solution to the problem. The state would have to compensate vendors for collecting the tax, and some exemptions would be needed to protect small vendors. A reasonable estimate is that the federal government's failure to address this problem is costing Missouri state and local governments at least $1.1 billion over the four-year course of the state fiscal crisis, or some 90 percent of the estimate by Bruce and Fox.

Beyond the Internet Tax Freedom Act and the E-commerce problem, there are many other examples of federal preemption of state taxing authority, though they tend to be harder to quantify.[7]

Underfunding Programs and Increasing State Costs

Over time, the federal government has placed an assortment of requirements on state and local governments without providing adequate funding. Many of these unfunded mandates, or underfunded obligations, are difficult to quantify, such as new responsibilities imposed on state and local governments in the area of homeland security. (See the box below.) For illustrative purposes, we focus on three areas: the education of disabled children, the Leave No Child Behind law, and new election reform requirements.

- The Individuals with Disabilities Education Act (IDEA), enacted in 1975 and most recently amended in 1997, guarantees each disabled child an assessment and an individualized education plan. When the law was enacted, the federal government promised it would fund 40 percent of the additional costs that the law requires states to incur. In Missouri, federal funding over fiscal years 2002-2005 has fallen nearly $858 million short of meeting this goal.[8]

- The No Child Left Behind Act requires schools to take a variety of specific steps with respect to the educational testing of children, including requiring school districts to pay for tutors and school transfers when schools are not meeting certain standards. The federal government, however, has not provided the promised level of support. During the four years of the state fiscal crisis, Missouri's funding has been approximately $469 million below the levels authorized in the Act. Moreover, this is a conservative estimate, because it is

[7] For example, federal law prohibits state and local governments from taxing airline and bus tickets purchased for interstate travel. Were states able to apply their sales taxes to such tickets, the revenue gain would be large. Federal law (P.L. 86-272) also prohibits states and localities from imposing a corporate profits tax on an out-of-state corporation if the corporation's only activity within the state is soliciting orders for physical goods. This allows corporations to have an unlimited number of salespeople in a state at all times, yet remain exempt from tax so long as the salespeople work out of their homes. When P.L. 86-272 was enacted in 1959, it was intended to be temporary. However, it has never been repealed, and over the years it has shielded tremendous amounts of corporate profits from state taxation.

[8] These and other estimates of spending and shortfalls in funding mandates are derived from data compiled by Federal Funds Information to States (FFIS), a joint service of the National Governors Association and the National Conference of State Legislatures that tracks and reports on the fiscal impact of federal budget and policy decisions on state budgets and programs. For details on sources and methodology, see Iris J. Lav and Andrew Brecher, *Passing Down the Deficit*, Center on Budget and Policy Priorities, May 2004.

Underfunding Homeland Security?

Ever since the tragedy of September 11, 2001, states and localities have received a host of new federal mandates intended to improve preparedness, strengthen food and agriculture security, upgrade interagency communication, and safeguard the water supply. To help meet the additional costs, the federal government has increased some grants to states and localities and created new grant programs. To date, however, no comprehensive study has been undertaken of whether states and localities have received sufficient federal aid to meet these new homeland security initiatives.

In addition, some estimates indicate that substantial new funding will be needed for upgrades in several areas, such as telecommunications, water systems, and airport security. Yet no consensus exists regarding the appropriate division of responsibility among federal, state, and local governments for funding the desired upgrades.

In the absence of data assessing Missouri's specific homeland security needs, we have excluded homeland security costs from this analysis. It is clear, however, that these costs are significant. The city of St. Louis, for instance, estimates that it spent $4 million in fiscal year 2003 alone to upgrade security at the city's airport. According to city officials, federal funds covered only a portion of these costs; the rest were financed from city tax dollars.[a]

[a] Interview with Paul Payne, Deputy Director, St. Louis City Budget Division, July 2004.

unclear how much it will cost states and localities to meet all of the new mandates in this law.

- The Help America Vote Act was intended to provide federal guidelines — and resources — for local precincts to update their voting technologies. Although the federal government has made a substantial commitment to fund new election equipment in 2004, minimal funding is expected in 2005, despite the slim likelihood that all problems will be resolved by then. In Missouri, the funding shortfall is about $12 million over four years.

Unfunded mandates are not new, but the recent confluence of the state fiscal crisis and both new and old mandates is making life increasingly difficult for Missouri's state and local governments. Federal requirements related to the No Child Left Behind Act, for example, are continuing to grow even though Missouri now has few resources to cover such new costs. The National Conference of State Legislatures recently estimated that unfunded mandates cost Missouri $522 million this year alone.[9] This report, which considers a narrower set of mandates, finds the *four*-year cost during the state fiscal crisis to be approximately $1.3 billion.

[9] National Conference of State Legislatures, *The Mandate Monitor*, March 31, 2004. We use a more conservative estimate of the federal funding gap than NCSL uses for its study. For example, NCSL includes delays in releasing already appropriated election reform funds and sanctions imposed on states that do not comply with federal drunk-driving standards; those costs are not included here. NCSL also includes national estimates of state costs of meeting water quality standards for which state-by-state estimates are not available; those also are not included in this report. Finally, NCSL counts costs associated with health care for individuals who are dually eligible for Medicare and Medicaid, an issue handled separately in this report.

The Federal Role in Rising State Medicaid Costs

Much has been made of the rapid growth in Medicaid costs, in Missouri and other states. This growth is largely the result of rising health care costs generally. However, it also reflects a gradual shift, from the federal Medicare program to state Medicaid programs, in the responsibility of caring for low-income elderly and disabled people who are covered by both Medicare and Medicaid. Such individuals are sometimes called "dual eligibles."

Table 3
Missouri's Added Costs from Selected Federal Policies, 2002-2005

Educating disabled children	$858 million
Drug coverage for low-income elderly	$784 million
No Child Left Behind requirements	$469 million
Updating voting technologies	$12 million

Dual eligibles have their hospital stays paid for by Medicare and some outpatient services and pharmaceuticals paid for by Medicaid. In recent years, changes in the provision of health care have led toward shorter hospital stays and a greater reliance on outpatient services and pharmaceuticals to manage health conditions. This trend has pushed costs from Medicare to Medicaid, and hence from the federal government to the states. (While Medicare is entirely federally funded, Medicaid costs are shared by the federal government and the states; Missouri pays about 39 percent of Medicaid costs in federal fiscal year 2005.)

The effects of this trend are quite significant: in Missouri, some 70 percent of all Medicaid expenditures, and 88 percent of Medicaid pharmaceutical expenditures, are made on behalf of low-income elderly and disabled individuals, most of whom are dual eligibles.[10] Missouri is spending roughly $784 million for outpatient prescription drugs for this population in fiscal years 2002-2005.

The 2003 Medicare drug law will leave states responsible for the large majority of these drug costs even after the new Medicare prescription drug benefit takes effect. Under the drug law, dual eligibles will receive drug coverage through Medicare beginning in 2006. This could produce significant savings for state Medicaid programs. Yet the drug law requires states to return the bulk of these savings to the federal government in perpetuity.

Moreover, states face new, unreimbursed costs over the next three years for implementing the new Medicare law. The Congressional Budget Office estimates that these costs will reach $1.2 billion; Missouri's share could well reach into the tens of millions of dollars.

The Fiscal Crisis and Missouri's Response

The costly federal policies described above have occurred at a time when Missouri has struggled to balance its budget. Missouri's fiscal crisis began in state fiscal year 2001 with an announcement of a projected $75 million budget shortfall. Additional shortfalls emerged over

[10] Data from the Missouri Division of Medical Services, October 2003 presentation by Christine Rackers, Director.

Table 4
"Core Reductions" to Missouri Budget, by Department and Fiscal Year
In Millions of Dollars

Department	FY 2002	FY 2003	FY 2004	FY 2005	Total	Department Cuts as % of Total Core Cuts
Elementary & Secondary Education	$20.1	$62.1	$58.0	$22.6	$162.8	$11.7%
Higher Education	9.6	99.7	42.9	1.3	153.5	11.0%
Social Services	88.3	303.6	110.6	55.3	557.8	40.1%
Mental Health	11.2	36.5	27.6	12.5	87.8	6.3%
Health	3.4	12.1	13.6	2.4	31.6	2.3%
Public Safety	5.6	5.2	8.4	0.9	20.2	1.4%
Corrections	12.8	39.1	6.4	20.8	79.0	5.7%
All Other State Departments	56.7	129.0	75.8	35.8	297.2	21.4%
Total	**$207.8**	**$687.3**	**$343.2**	**$151.6**	**$1,389**	100.0%

Source: Missouri Office of Administration.
Note: Some of these cuts may have been restored in later years; the vast majority of the cuts have not been restored, but the exact proportion has not been calculated by the Office of Administration.

the next four years, as revenues declined as a result of the national recession and other factors. Over fiscal years 2002-2005, Missouri faced a cumulative shortfall of $2.28 billion.

Missouri law requires a balanced budget, so over those four years, the state has enacted a mix of spending cuts, revenue increases, and other measures to bring the budget into balance. Most of the $2.28 billion budget gap has been closed through what are termed "core reductions" — cuts in the level of spending below what would be necessary to maintain public services at a constant level. These core reductions have totaled $1.4 billion. Another $900 million has been saved through "withholds," or temporary, mid-year reductions in agency spending.

The state has also shifted some costs to future years and accelerated some revenue collections, preventing even deeper spending cuts now but making it more difficult to balance the budget in later years. For example, the state identified $275 million in capital projects that in previous budgets it had planned to pay for in cash and instead sold bonds to pay for them, using the cash savings to help balance the current budget. These bonds will have to be repaid in the future. In addition, the state used much of the revenues it received from the national tobacco settlement, averaging $150 million per year, to plug general fund holes and fund ongoing health expenditures, leaving less money available to pay for such items as anti-smoking programs than had been expected.

As shown in Table 4, some 40 percent of the core reductions came in the Department of Social Services, which oversees most state programs designed to assist low- and moderate-income families. K-12 education and higher education accounted for another 23 percent of the budget cuts, while mental health and corrections accounted for about 6 percent each.

It is worth noting that even before these cuts were enacted, Missouri had one of the nation's leanest state governments. In fiscal year 2000, Missouri ranked 41st among the states in terms of state government spending as a share of personal income, according to U.S. Census data; on a per capita basis, it ranked 45th. Taking into account both state and local spending, government spending in Missouri ranked 48th among all states.

The funding reductions have had substantial impacts on state services such as health care, assistance to people with disabilities, and higher education.

Health Care

Reductions in the state's Medicaid program, which provides health insurance to low- and moderate income children, families, seniors, and people with disabilities, have largely been implemented by reducing the program's income ceiling. As many as 96,000 parents, seniors, and people with disabilities are estimated to have lost coverage as a result. Another 30,000 women have lost coverage through cuts in a separate health care program. Specifically:

- An estimated 37,320 working parents lost Medicaid coverage when the state eliminated Medicaid eligibility for working parents with incomes between 75 percent and 100 percent of the poverty line.[11] (For a family of three in 2004, this means that families with incomes between $14,137 and $18,850 lost coverage.) Since most jobs at this wage level do not provide affordable health coverage, it is likely that most of those parents are now uninsured.

- Some 18,322 Missourians lost state-funded health insurance when the state tightened eligibility for several other Medicaid programs for working parents, including a program that provided Medicaid to very low-income non-custodial parents who were current in their child support.

- Tens of thousands of Missouri seniors and persons with disabilities have lost access to Medicaid coverage since July 2002, when the state scaled back a Medicaid "spend-down" program that allowed people to receive Medicaid if their health care bills otherwise would reduce their incomes below the poverty line. It is estimated that 40,700 seniors per year who might have received coverage have not be able to because of those changes.

  It is important to note that even as many of those seniors and people with disabilities lost access to Medicaid coverage, others were coming onto the rolls; the total number of seniors and persons with disabilities receiving Medicaid actually has risen from 201,000 in August 2002 to 224,000 in May 2004. This increase results in part from factors like the weakening economy, declining availability of private-market health insurance, and demographic changes. It also results in part from a previously enacted increase in the income eligibility limit

[11] All information on the number of people cut from these programs was provided by the Missouri Department of Social Services and is based on the total number of people who received services in state fiscal year 2002. The number losing coverage in any given month is slightly lower.

that was phasing in over a three-year period. Separating out the effects of these various factors is hard to determine, but it is clear that Missouri's budget problems caused tens of thousands of seniors and people with disabilities to lose access to coverage for which they otherwise would have qualified.

(Meanwhile, under a separate law that was enacted before the extent of the fiscal crisis was known, the state is expanding Medicaid eligibility for the elderly and disabled from 80 percent of the poverty line to 100 percent over three years. The net effect of these changes remains unclear.)

These Medicaid reductions not only cost tens of thousands of Missourians their eligibility for health coverage, but also reduced reimbursements to health care providers such as doctors and hospitals. For providers that care for large numbers of these newly uninsured, the revenue loss may be quite significant.

Mental Health

Thousands of Missourians with mental disabilities have lost services due to cuts in the state's Department of Mental Health. Although some of the $87.8 billion in initial cuts were restored in later years, net reductions over the 2002-2005 period totaled about $58.2 million in state general revenue. Nearly 600 jobs have been cut from the department. Although some of the budget cuts were achieved with administrative efficiencies, consolidations and other changes, the cuts also resulted in reductions in the number of people with mental-health needs that could be served at state-operated facilities and at private community facilities that operate with state funding.[12]

Specific cuts have included:

- A $4.7 million reduction in support for alcohol and drug treatment and prevention programs. This has resulted in the loss of substance abuse treatment funding for approximately 4,000 individuals.

- An $11 million reduction in funding for provide services for people with mental retardation and developmental disabilities. Such services include respite care, day habilitation, and therapy. As of July 2004, the department had a waiting list for residential services and non-residential services of more than 4,000 individuals, who must instead rely on care by their families — or go without needed specialized care.

- The state's "family stipend" program — which helped some 800 families to care at home for their children with serious disabilities rather than institutionalizing them — was reduced in fiscal year 2003 and completely eliminated in fiscal year 2004. The average annual stipend under this program was $766 in 2002.

[12] Data in this section provided by Patty Henry, the budget administrator for the Missouri Department of Mental Health.

Cuts Affecting At-risk Children

Other state budget cuts have hurt Missouri children and families:

- Some 2,500 grandparents caring for grandchildren who would otherwise be in the state-supported foster care system had their monthly payments reduced from $188 to only $63. The new level is one-quarter of the reimbursement given to *non-*relatives who provide foster care.

- The state eliminated cash assistance for legal immigrants under the TANF program, costing some 394 families a monthly payment that averaged $292 per month for a family of three.

- The eligibility ceiling for the state's Child Care Assistance program, which provides child care subsidies to low-income families so the parents can maintain employment, has not been adjusted for inflation since 2002. As a result, the maximum allowable income for a family of four has declined from 125 percent of the federal poverty line to 112 percent between 2002 and 2005, which means that families of four with incomes of roughly $21,000 to $24,000 are no longer eligible for a child care subsidy. Such subsidies can be worth up to $281 per month or $3,370 per year.

Higher Education

Between 2002 and 2005, the state has made $153 million in spending reductions for its colleges and universities. Various colleges and universities have responded differently; some have scaled back course offerings or cut faculty.

One particularly visible result of the funding cuts has been dramatic increases in tuition: since 2002, tuition increases have ranged from $150 to $630 at two-year colleges and from $888 to $1,743 at four-year colleges. The largest increases have occurred at the state's largest campuses, those of the University of Missouri at Kansas City, Rolla, St. Louis, and Columbia (See Table 5.)

Many of the 88,000 Missourians who attend the state's public colleges and universities come from middle- and lower-income families and are likely to have difficulty absorbing these tuition increases, especially because state funding for grants and scholarships also has been reduced slightly.

Other Areas

The cuts in human services and education have been among the most visible, but other areas of the state budget have been cut substantially as well. For instance, the Department of

Table 5
Core Reductions and Tuition Increases by College and University

Institution	FY 02-05 Core Cut	Tuition Increase
Community Colleges		
Crowder College	$740,000	$150
East Central College	$898,000	$390
Jefferson College	$1,318,000	$180
Metropolitan Community College	$5,476,000	$450
Mineral Area College	$864,000	$540
Moberly Area Community College	$824,000	$320
North Central Missouri College	$426,000	$330
Ozarks Technical Community College	$1,569,000	$630
St. Charles County Community College	$714,000	$270
St. Louis Community College	$7,874,000	$540
State Fair Community College	$916,000	$510
Three Rivers Community College	$573,000	$390
Linn State Technical College	$1,077,000	$360
Four-Year Institutions		
University of Missouri System: Kansas City, Rolla, St. Louis and Columbia	$71,714,000	$1,743
Central Missouri State University	$9,208,000	$1,470
Southeast Missouri State University	$7,647,000	$1,050
Southwest Missouri State University	$11,459,000	$888
Lincoln University	$3,260,000	$924
Truman State University	$6,974,000	$924
Northwest Missouri State University	$3,221,000	$1,245
Missouri Southern State University	$2,185,000	$1,110
Missouri Western State College	$2,191,000	$1,240
Harris-Stowe State College	$1,678,000	$1,210

Sources: Missouri State Office of Administration, Division of Budget & Planning; survey of individual campuses by Missouri Budget Project. Tuition figures are averages for in-state residents (for community colleges, in-district Residents). University of Missouri figure is an average across the four campuses.

Public Safety and the Department of Corrections have been reduced by a combined $99.2 million in the last four fiscal years. As a result:

- Some 88 corrections department institutional staff have been eliminated. This has increased the burdens on the correctional officers that remain, forcing them to spend less time supervising inmates.

- Some 31 probation and parole staff have been eliminated. This has reduced community-based coverage of parolees.

- Funding for regional crime labs has been cut nearly in half. This has slowed the pace of police investigations.

The Impact of State Spending Cuts on Local Services and Taxes

The state's budget difficulties have also led to reductions in state funding to local governments. Missouri's local governments and school districts received 30.6 percent of their 2002 revenue from the state, more than they received from any other source, according to the latest available U.S. Census Bureau data. (Their second-largest revenue source is property taxes; See Table 6.) When the state reduces its aid to local governments, they must cut back on services or raise other revenues, such as by increasing property taxes.

The collective impacts of state budget decisions on local governments are difficult to measure because state aid is administered to localities through a number of different departments according to varying formulas**.** Nevertheless, certain specific cuts and their impacts can be identified.

Table 6
Sources of Revenue for Missouri Local Governments, Including Schools

Source of Revenue	Share of Revenue
State government	30.6%
Local property tax	25.4%
Local sales taxes	12.5%
Other local taxes	4.2%
Current charges (fees, etc.)	16.1%
Other revenues	11.2%
Total	**100.0%**

Source: U.S. Census Bureau, State and Local Government Finances, fiscal year 2002.

For example, the state has cut the Juvenile Court Diversion program by $1.6 million. As a result, Circuit Juvenile Courts will receive less state funding, and many of them will no longer be able to provide early intervention services to youth who are not at "imminent risk" of being committed to the custody of the Division of Youth Services. Other reductions in state payments to county juvenile detention centers caused a cut in state reimbursement rates from $17 to $14 per day for children in court custody, resulting in increased funding demands at the local level.

In another example, funding to train volunteer firefighters has been reduced by 39 percent. Some communities diverted local resources to provide trainings, but many trainings were not conducted in fiscal years 2003 and 2004.

In addition, state school district grants for school resource officers (police officers based in schools) were eliminated. Under these grants, the state, the schools, and local law enforcement each paid one-third of the officers' salaries. Some areas responded to the ending of the grants by eliminating the officers; others diverted local resources to cover the shortfall.

School Districts

Missouri's school districts have been among the local governments hit hardest by the state budget crisis. (In Missouri, school districts are independent of city and county governments.) School districts on average rely even more heavily on the state for revenue than other local government units do: the U.S. Census Bureau reports that state aid in the 2001-2002 school year provided about 45 percent of K-12 public school revenue in Missouri. Core

Table 7
Underfunding of Foundation Formula

	Estimated Required Funding	Actual Funding	Amount of Underfunding
FY 2001	$1.98 billion	$1.96 billion	$20 million
FY 2002	$2.06 billion	$2.04 billion	$21 million
FY 2003	$2.22 billion	$2.09 billion	$122 million
FY 2004	$2.43 billion	$2.07 billion	$364 million
FY 2005	$2.79 billion	$2.18 billion	$610 million

Source: Missouri Department of Elementary and Secondary Education

reductions over the last four years reduced K-12 funding by a cumulative $163 million; some but not all of those reductions were later restored. After adjusting for inflation and enrollment growth, University of Wisconsin economist Andrew Reschovsky calculates that state K-12 funding in Missouri dropped 7.8 percent from 2002 to 2004 — the 11th steepest decline in the country.[13]

Moreover, these cuts have come during a period in which Missouri's Foundation Formula, the mechanism by which the state distributes aid to school districts, has called for significant *increases* in K-12 funding. These required increases have resulted in part from rising enrollment and increasing costs. The Foundation Formula was created in 1993 to reduce disparities in wealth and income among different school districts, and there is evidence it has done so. But the cuts to K-12 funding in recent years have resulted in the state falling further and further below the funding level required by the formula and thus is likely to be doing a poorer job of reducing disparities. By 2005, the underfunding will rise to $610 million, meaning that school districts will receive $610 million less next year than if the state had adhered to the formula. (See Table 7.) School districts statewide are suing the state for its failure to fund the formula fully, but it is not clear how the state will finance the additional payments if their suit is successful.

In response to the drop in state funding, many school districts have cut spending. According to the Missouri Office of Administration, the state's elementary and secondary schools have eliminated 2,000 teacher positions and over 500 staff positions in the last two years, resulting in larger class sizes in some areas.[14] Many districts also have cut back on extracurricular activities, including sports programs and programs for gifted and at-risk students.

Less-wealthy school districts have had particular difficulty adjusting to the funding cuts. As in many other states, Missouri's low- and medium-wealth school districts rely on state aid more than high-wealth districts do because the state gives them extra aid to offset part of the funding advantage that wealthier districts derive from their larger tax bases.

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[13] Andrew Reschovsky, *The Impact of State Government Fiscal Crises on Local Governments and Schools,* December 2003. The Missouri figures are not specified in the published paper but were provided to the authors in an E-mail communication.
[14] Missouri Office of Administration, Division of Budget & Finance, *Executive Budget Fiscal Year 2005.*

Another effect of the cuts in state aid is higher property taxes. Nearly one in five Missouri school districts asked voters in the February, April or June 2004 elections to approve property tax increases. (Under Missouri law, local property tax increases require voter approval.) Some three-fourths of those property tax increases were approved. In April alone, voters in 66 of the state's 524 school districts approved tax increases; a 67th district, Springfield, approved a tax increase in June. These districts include about 22 percent of the state's school enrollment. (See Table 8.)

These increases range from the very modest to the substantial. The median increase approved in the April election was $.54 per $100 of assessed valuation, which translates into an annual tax increase of $102.60 for the owner of a $100,000 home.[15] Of course, people who own more expensive property or live in communities with bigger tax hikes would face larger increases in their tax bills. Renters, business owners, owners of vacation property, and others also would pay more than previously.

The Impacts of Federal and State Budget Policies on Localities: Two Examples

The experiences of local governments in two communities — St. Louis and Springfield — highlight the impact of the reductions in state aid.

St. Louis

In the city of St. Louis, the state aid reductions have had a direct impact on the budget. For example, the cut in state prisoner reimbursements to local communities is costing the city $840,000. Similarly, the cut in state reimbursements for Juvenile Court employees has cost the city $365,000. State reimbursements for the work of the local assessor's office have been reduced as well, costing the city $368,000 per year. (Part of this reduction is scheduled to be reversed in fiscal year 2005.)[16]

These reductions have come at a particularly inopportune time for the city. City revenues have not fared well as a result of the recession, and the city also faces rising costs for health insurance and workers' compensation insurance. Most notably, in an example of how new federal obligations can make it more difficult for local governments to cover their expenses, the city was obligated to spend $4 million in fiscal year 2003 on airport security to meet new federal homeland security requirements.

In response to the budget squeeze, the city has increased building permits and other fees by $2 million, delayed infrastructure improvements such as road, bridge, and building construction, and eliminated 731 personnel positions or 9 percent of its workforce, including 36 uniformed police officers.

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[15] Residential property is assessed at 19 percent of market value. Therefore, the $100,000 house in the example above would be assessed at $19,000; increasing the tax rate by $.54 per $100 would mean a tax increase for this homeowner of $102.60 (.54*19000÷100).
[16] St. Louis City core data from the St. Louis City Budget Division.

Table 8
Local Tax Increases Approved, February and April 2004 Elections

County	School District	Tax Rate Increase	County	School District	Tax Rate Increase
Andrew	N Andrew Co	$.40	Lawrence	Miller	$.60
				Aurora	$.27
Atchison	Tarkio	$.75	Linn	Bucklin	$.65
	Fairfax	$.65		Marceline	$.77
Bollinger	Leopold	$.30	Macon	Macon Co	$.57
Boone	Sturgeon	$.68	Marion	Palmyra	$.25
Buchanan	St. Joseph	$.63	Monroe	Middle Grove	$1.85
Cass	Belton	$.60	Nodaway	W Nodaway	$.42
				NE Nodaway	$.60
Chariton	Brunswick	$.76	Ozark	Dora	$.60
Christian	Nixa	$.41	Pettis	Smithton	$.60
Clay	Kearney	$.52	Phelps	St. James	$.02
	Excelsior	$.15			
Clinton	Lathrop	$.75	Platte	N Platte Co	$.47
	Clinton	$.75			
Cole	Cole	$.53	Polk	Bolivar	$.63
Franklin	Franklin	$.50	Randolph	Moberly	$.39
	Meramec	$.70			
Greene	Willard	$.55	Ray	Stet	$.55
	Republic	$.39		Orrick	$.53
Grundy	Grundy Co	$.45	St. Charles	Ft. Zumwalt	$.80
	Laredo	$1.40		Francis Howell	$.89
				Wentzville	$.29
				St. Charles	$.52
Hickory	Hickory Co	$.15	St. Louis County	Hazelwood	$.98
Holt	Craig	$.75	Saline	Miami	$.50
Howell	W. Plains	$.64	Stone	Reeds Spg.	$.20
	Glenwood	$.35		Blue Eye	$.25
	Junction Hill	$.30			
	Fairview	$.30			
Iron	Iron Co	$.37	Taney	Bradleyville	$.30
				Forsyth	$.57
Jackson	Grain Valley	$.75	Warren	Warren Co	$.47
	Lee’s Sum.	$.59			
	Grandview	$.45			
Jasper	Carthage	$.67	Wright	Manes	$.50
	Webb City	$.40			
Jefferson	Northwest	$.60			
	Hillsboro	$.54			
	Jefferson	$.75			
	Windsor	$.50			
Johnson	Chilhowee	$.25			

Source: Missouri Department of Elementary and Secondary Education.
Note: Missouri law allows school districts to raise taxes through two slightly different mechanisms: an increase in the “operating tax levy” or a “Proposition-C rollback.” In the April election, some school districts enacted one type of increase and some enacted both. From a property owner’s perspective, the two mechanisms are essentially the same; therefore, this table shows the combined effects of the two types of increases.

The St. Louis City Public Schools District, the state's largest, faces one of the grimmest financial situations of any district, in large part because of the loss of state funding. Between fiscal years 2001 and 2003, state funding for the district declined by $26 million, or nearly 7 percent of the district's operating budget. During the same period, school expenditures increased by 8.8 percent, almost entirely because of increases in employee health insurance costs and a previously negotiated teacher salary increase. The combination of decreased funding and increased costs resulted in a deficit of $12.3 million at the end of fiscal year 2003; a $38.6 million deficit was expected at the end of June 2004. [17] The fiscal year 2005 deficit is expected to reach $54.6 million. Although other factors have contributed to the district's financial problems, the state auditor concluded: "The substantial decrease in state funding was the most significant factor in the district's financial decline."[18]

The impact of these problems has been substantial. Twenty-one of the city's 113 schools have been closed and their students moved other schools. The city has also frozen hiring, eliminated an extended school year program, and cut other costs. Although some of the reductions in spending may have been appropriate in light of declining enrollment, continuing financial problems may well lead to additional, more painful cuts in the coming years.

Springfield

City leaders in Springfield have responded to the fiscal crisis in a different way. The city largely has been able to avoid laying off teachers or other employees or reducing services. But it has accomplished this by raising taxes and fees and by drawing down reserve funds.

In the Springfield school district, voters approved an operating tax levy increase of $0.25 per $100 of assessed valuation on June 8, 2004, resulting in a property tax increase of $47.50 for for every $100,000 in market value. With these funds, city officials were able to avert planned cuts and even provide teachers with a cost of living increase, the first in at least two years.

The city government did not raise taxes, but it did levy a $700,000 increase in various fees to keep the budget in balance. In addition, Springfield has drawn down its reserves by some $5.6 million.

What Does It All Mean for Missouri Families?

This analysis has described the fiscal problems that have been shifted from the federal to the state level and from the state to local governments and schools. Because state and local governments also have been facing their own fiscal difficulties, the overall effect has been a reduction in the level and quality of public services to Missouri residents.

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[17] *St. Louis Public School District's Financial Condition Remains Poor,* Office of the State Auditor, Report # 2004-47, June 14, 2004.

[18] *St. Louis Public School District Review of Financial Condition and Projections*, Office of the State Auditor, Report # 2004-09, February 2, 2004, pp. 2-3.

In many cases, it is difficult to quantify the effects of the decline in services. The closing of 21 schools in St. Louis, for instance, likely means that students must travel farther to school and attend larger schools (which possibly devote less attention to each student). But it is hard to describe those outcomes in economic terms.

In many other cases, though, the pocketbook impact of the state and local cutbacks on Missouri families is clearer. As described in the preceding pages:

- Property owners and renters in roughly one-fifth of the state are paying more in school property taxes, as school districts seek to offset substantial losses of state aid. Although tax rate increases vary, many homeowners are facing tax hikes of $100 or more. Since the state is unlikely to reverse its cuts in education funding soon, these property tax increases may spread even wider.

- Local governments are increasing various fees to keep their budgets in balance in the face of lost state aid.

- Some 37,000 Missouri parents with low-paying jobs have lost eligibility for state-subsidized health insurance. Few of these jobs are likely to provide employer-subsidized care, so most of those parents will have to purchase insurance on their own, probably at a cost of thousands of dollars per year. Many of the parents will simply choose to forego insurance, exposing themselves to the risk of large medical bills and perhaps bankruptcy should they become ill.

- Some 4,000 Missourians lost access to state-funded substance abuse treatment.

- Some 88,000 Missouri families with children attending state colleges and universities are paying hundreds or thousands of dollars more each year in tuition.

- Some 4,000 Missourians with mental retardation and developmental disabilities are on waiting lists for residential and other care.

- Working parents with incomes slightly above the poverty line are no longer eligible for child care subsidies. For a family with income between $21,000 and $24,000, those lost subsidies were worth more than $3,000 per year.

- Cuts in state payments to grandparents providing foster care and to legal immigrants are costing several thousand families $1,500 to $3,500 per year.

- The draining of budget reserves and the increased use of debt by state and local governments will place added burdens on future taxpayers.

Contrast with Federal Tax Cuts

One reason the federal government has pursued the policies that have worsened states' fiscal problems is that it has been focused on tax cuts. In other words, in a time when the federal government could have been ameliorating states' fiscal problems, it instead has been cutting taxes, with most of the tax cuts targeted to high-income households. The federal tax cuts enacted since 2001 have been more costly than any of the other budgetary actions by the federal government; in fact, the tax cuts have been costlier than the *combined* impact of new spending for homeland security, the war in Iraq, operations in Afghanistan, expanded anti-terrorism efforts, and all domestic spending increases over the last three years.[19] It is therefore instructive to compare what Missourians have *gained* from these federal tax cuts to what they have *lost* from the cuts in state and local services.

For a small number of very-high-income Missouri residents, the benefits of the federal tax cuts have probably outweighed the direct costs of state and local budget difficulties. For example, this year the wealthiest 1 percent of Missouri residents — a group with an average annual income of $722,000 — will receive an average benefit of $47,969 from the 2001-2003 tax cuts, according to the Institute on Taxation and Economic Policy.[20]

For a large number of lower- and middle-income Missourians, however, the benefit of the tax cuts is likely to be outweighed by the harm done by state and local budget cuts. For instance:

- In 2004, the average federal tax cut for a Missouri taxpayer in the middle fifth of the income spectrum is $846. That is half the average tuition increase for a University of Missouri student and well under the tuition increases at many other public colleges and universities as well.

- In 2004, the average federal tax cut for Missouri taxpayers in the poorest 60 percent of households is $458. That is far less than what it will cost a working parent who has lost state-funded health coverage to purchase insurance in the individual market for a year.

- In 2004, about 28 percent of U.S. tax filers are receiving a tax cut of $100 or less, according to the Urban-Brookings Tax Policy center. That is a smaller amount than the increase in property taxes paid by the owner of a $100,000 home in a typical school district that raised taxes in April 2004, as many districts did.

Moreover, the federal tax cuts are having a negative long-term impact on Missouri residents by contributing to the national debt. Most economists agree that the added debt eventually will have to be repaid, either through tax increases or in further reductions in public services.

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[19] See *Deficits and the Mid-Session Review,* Center on Budget and Policy Priorities, revised August 2004.
[20] State-specific data on the distribution of the federal tax cut come from the microsimulation model developed by the Institute on Taxation and Economic Policy from U.S. Treasury tax data.

Conclusion

The recent fiscal crisis in Missouri has been severe, and federal policies in a number of areas have made it worse. If federal deficits were not so large — a problem due in significant part to recent federal tax cuts — it is possible that the federal government's actions might not have been as deleterious to Missouri (and other states). The $3.6 billion cost to Missouri of these federal policies has contributed to a range of reduced services and increased taxes and fees.

Many of those reductions in services and increased taxes and fees have quantifiable costs to families, often hundreds or thousands of dollars per family. Hundreds of thousands of Missouri families — perhaps millions — have been affected. Some of these new costs to families can be traced back to the federal budget deficit and the tax cuts that largely created it. To put it another way, if federal tax cuts had not been so high a budget priority over the last several years, the federal government could have taken actions more beneficial to state budgets, and avoided some actions that hurt state budgets.

It is not too late for the federal government to undo some of the damage. Legislation now pending in Congress would help states pay new costs associated with implementing the Medicare prescription drug bill. But new threats — of federal tax pre-emption, for instance — are emerging as well. If the federal government takes better account of how its actions affect states, it can avoid some of the costly impacts on Missouri residents described in this report.