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Following a Decade of Deficits: Missouri's Revenue Crisis Continues

Tom Kruckemeyer, Chief Economist and Amy Blouin, Executive Director

Despite significant reductions to Missouri's general revenue budget over the last two years, Missouri's funding crisis will continue. Net general revenue dropped by 9.1 percent in the last year, following a decline of 6.9 percent the previous year. State general revenue is now about \$1 billion lower than it was a decade ago when adjusted for inflation. As a result, through the combined actions of the State Legislature and the Governor, more than \$1 billion was cut from the fiscal year 2011 budget (FY 2011), which began on July 1st.

The state has now reached a historically low funding level. Not only is state revenue below what it was a decade ago, it is lower, as a portion of Missouri's economy, than it was in 1985. All aspects of state services have been impacted, from school transportation to higher education scholarships, early childhood programs to mental health. All Missourians will begin feeling the impact in the next few months.

The cuts Missouri has witnessed have been somewhat mitigated due to federal economic recovery dollars and other temporary funds that have filled a portion of the hole. However, as these dollars wane over the next year, Missouri will begin to feel a more accurate consequence of our shrinking state revenue. The Missouri Budget Project now estimates that Missouri will face another budget shortfall in FY 2012 nearing \$1 billion.

The continued challenges facing Missouri's budget is further evidence that state policymakers must move toward a more balanced approach to this crisis. Over the last decade, Missouri's only action to address the ongoing crisis has been to make cuts to vital services. Missouri has many other tools available, including updating the state's outdated revenue structure to reflect the modern economy.

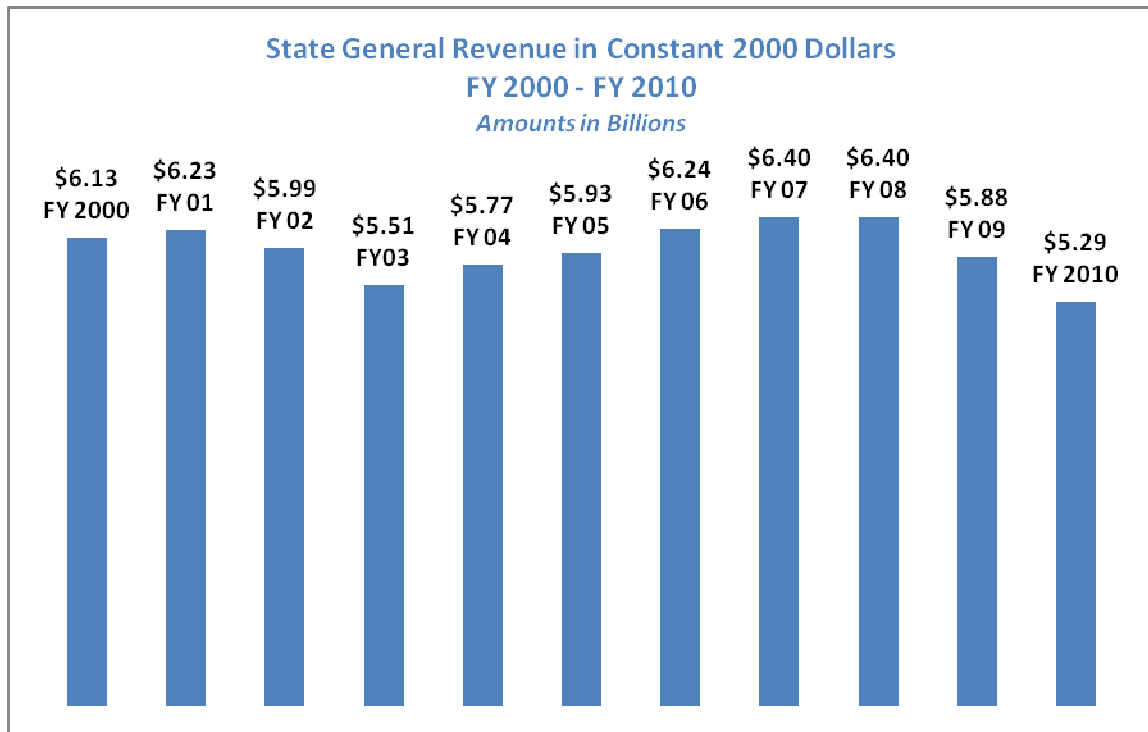
The Historic Decline and Erosion of the State Tax Base

Over the last decade, Missouri has faced a budget shortfall in every fiscal year except Fiscal Year 2006. In four of these years, state revenue receipts actually declined compared to the previous year, most recently dropping by 9.1 percent in FY 2010.¹ By contrast, between 1975 and 2001, Missouri did not have any years of revenue decline.

As a result of the declines during the last decade, Missouri's state general revenue funding is now nearly \$1 billion lower than it was in FY 2000. See chart 1 below.

¹ General Revenue data was collected from the Missouri Office of Administration. The FY 2010 figures are the most current, however, could adjust slightly as final receipts are tallied.

Chart 1²



Although Missouri began the decade in good financial condition, an unexpected economic downturn following 9/11 hit the nation. In addition, federal and state tax law changes in the early part of the decade reduced the state revenue base. As a result, between FY 2001 through FY 2003, net state revenue collections fell by 8.1 percent.

When the economy began to rebound in 2004, state revenue began to grow again. However, rather than restore funding for services that had been reduced in 2002 and 2003, policymakers chose to enact a series of ongoing tax reductions. Tax reductions made between 2007 and 2009, reduce state revenue by \$325 million per year when fully phased in. Spending on Missouri tax credit programs grew during the same period and increased by approximately 85 percent over the decade. Tax credits expenditures in FY 2009 totaled \$584 million, compared to \$314 million at the start of the decade.³ The combined impact of these tax changes and tax credit growth significantly reduced Missouri's tax base.

As a result, Missouri general revenue in FY 2010 is just 3.1 percent of the state economy.⁴ By comparison, the size of general revenue as a share of the economy is significantly below the peak of 4.5 percent attained in FY 1997 and remains well below the general revenue levels of 1985 when the Hancock Amendment to Missouri's State Constitution was adopted. In fact, the erosion of state general

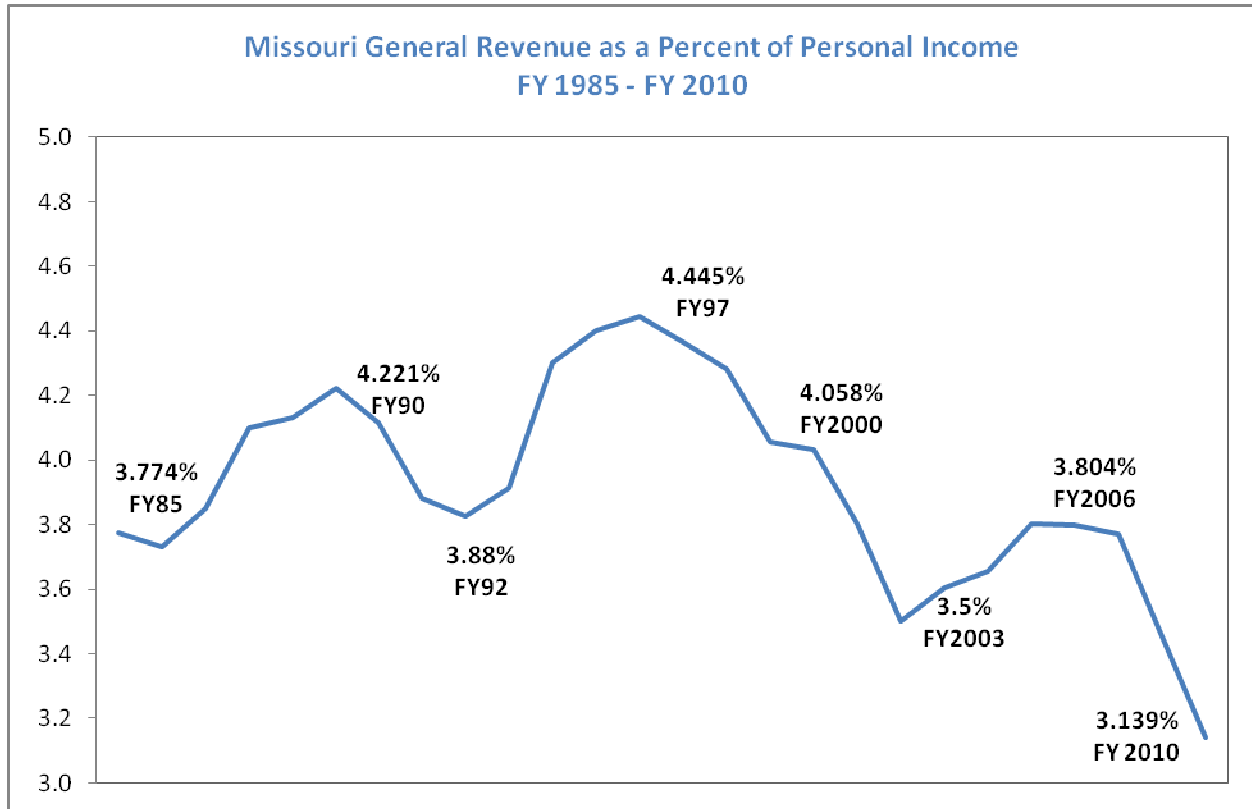
² Based on Missouri Budget Project analysis of State Revenue data from the Missouri Office of Administration and inflation figures from the Bureau of Labor Statistics.

³ Missouri Budget Project staff comparison of Tax Credit Redemption with Missouri General Revenue FY 2000 - 2010. Data on Tax Credit Expenditures is from the Missouri Senate Appropriations Committee Annual Fiscal Reports for 2006, 2007 and 2009.

⁴ As measured by State Personal Income.

revenue has been so severe over the last decade, that it is likely that Missouri may never reach the original Hancock revenue limit again.⁵ See Chart 2, below, for historic details.

Chart 2⁶



Use of One Time Revenues Hides the True Impact of Diminished State Revenue

Over the last 10 years, the Missouri budget has been augmented by a combination of temporary and extraordinary revenue sources totaling \$2.9 billion. These funds helped to plug holes in state revenue and effectively mitigated some of the impact of the state tax base erosion. As the sources dissipate over the next two years, the dire position of state general revenue will become clearer to Missourians.

The major sources of temporary funding included the following, which are detailed by year in the table that follows:

- Tobacco Funds from the Master Settlement Agreement: Since FY 2001, Missouri has received annual payments from tobacco companies as part of a multi-state lawsuit that was settled in 1998. Through the legal agreement, Missouri and 46 other states receive tobacco funds to offset the

⁵ Missouri's Hancock Amendment is a Constitutional restriction on the growth of state revenue. Missouri general revenue reached the restricted level during the late 1990s during strong periods of economic growth. As a result, tax refunds were sent to Missouri taxpayers totaling \$985 million over a five year period. In addition, the state legislature during that time passed a series of state tax cuts that lowered the general revenue tax base in order to avoid the Hancock lid.

⁶ Calculated by the Missouri Budget Project using general revenue data from the Missouri Office of Administration, and Personal Income figures from the U.S. Bureau of Labor Statistics. NOTE: FY 2010 figures could change slightly as final receipts are tallied and personal income figures adjust.

costs of treating tobacco induced illness. The amounts shown in the table represent only the explicit transfers to state general revenue, which totaled \$928 million since 2001.

- Federal Economic Recovery Funding: Since 2000, Missouri has received more than \$1.78 billion in extraordinary federal funding through enhanced federal matching funds for Medicaid (known as FMAP) and the American Recovery and Reinvestment Act. The amounts detailed in the table reflect only those funds that have been used to meet state general revenue needs. Hundreds of millions in additional extraordinary federal funds have come to Missouri for additional, earmarked purposes such as construction.
- State Revenue Bonds: Early in the decade, Missouri issued revenue bonds to garner additional funds to alleviate budget shortfalls. Funding from the bonds totaled \$279.8 million over three fiscal years, and has not been available since FY 2005.

Table 1⁷

Missouri Supplemented State General Revenue with \$2.9 Billion in One-Time Funding During the Last Decade <i>(Amounts in Millions Unless Indicated Otherwise)</i>				
Fiscal Year	Tobacco Settlement Agreement Funds	Extraordinary Federal Dollars	Revenue Bonds	Total
2000	\$0.0	\$0.0	\$0.0	
2001	\$126.9	\$0.0	\$0.0	\$126.9
2002	\$232.4	\$0.0	\$0.0	\$232.4
2003	\$160.6	\$95.1	\$150.0	\$405.7
2004	\$75.8	\$179.0	\$84.6	\$339.4
2005	\$75.0	\$0.0	\$45.2	\$120.2
2006	\$67.4	\$0.0	\$0.0	\$67.4
2007	\$36.9	\$0.0	\$0.0	\$36.9
2008	\$48.0	\$0.0	\$0.0	\$48.0
2009	\$58.1	\$250.0	\$0.0	\$308.1
2010	\$47.0	\$1.259 billion	\$0.0	\$1.3 billion
Total	\$822.6	\$1.783 billion	\$279.8	\$2.991 billion

⁷ Data from the Missouri Office of Administration, and Missouri Executive Budgets FY 2000 – FY 2010.

Outlook for FY 2012

Missouri's current year budget, FY 2011, which began on July 1st, contains nearly \$1 billion in cuts to core services. These cuts impact the array of state services that all Missourians need in order to be able to live healthy and productive lives and undermine the foundation upon which Missouri's economy is built. Some examples:

- The K-12 school foundation formula funding remained flat this year and school transportation funding was reduced. Not only will it be more difficult for children to get to school but the quality of education could be compromised once they get there;
- While Higher Education funding was reduced slightly by comparison to other budget areas, long proven student loan programs were more severely cut, including the state's only need-based scholarship program, impeding access to advanced degrees and training for work;
- Early intervention through services such as Parents as Teachers, mental health care for children and adults, and public health has been significantly compromised;
- Services for seniors through area agencies on aging has been reduced;
- Strain has been placed on local county and municipality budgets due to reductions in reimbursements from the state for select services and through increased demand placed on county budgets; and
- The state has stalled investments in infrastructure including public transportation, highways, and economic development.

These cuts would have been even harsher but for the use of the one-time funding included in the FY 2011 budget. In fact, in the current year, Missouri is depending upon \$858 million in federal stabilization funding resulting from the Recovery Act.

However, the outlook beyond the current year becomes very bleak as these dollars wane over the next two years. Missouri will begin to feel a more accurate consequence of the state's shrinking tax base. Based on the loss of one time funds and the full impact of phased-in tax changes, the Missouri Budget Project now estimates that Missouri will face another budget shortfall in FY 2012 nearing \$1 billion. Although the U.S. Congress is considering extension of the extraordinary FMAP funding which would at least partially plug this hole, this would only prolong this temporary balancing act.

Consequences for Missouri: Time to Pay the Piper

Over the last decade, Missouri policymakers have responded to the state's budget crisis by depending upon a series of extraordinary and temporary funding, and by making severe cuts to the array of state services. While economic recovery will improve the state's budget struggles, the erosion of Missouri's tax base is an ongoing crisis that must be addressed. It is a crisis that has been festering for ten years without an adequate response.

Further cuts to the state's budget would only limit the foundation upon which a strong economy is built, and impede Missouri's economic recovery further. Most recently, the quarterly AP Economic Survey was released. The survey, which includes commentary by 42 leading economists across the nation, reports for the first time that "*state budget shortfalls pose a significant or even severe risk to the national economy*".⁸

Missouri has many other options that present a more balanced approach to the state budget crisis. Options include updating the state's outdated tax structure by plugging loopholes, and reforming the sales tax to capture internet purchases. Policymakers need to utilize these tools to the benefit of Missouri families and the Missouri economy.

⁸ Jeannine Aversa, Associated Press, "AP Survey: A Weaker Outlook for the Economy in 2011", July 30, 2010