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Fiscal Year 2015 Budget Contains Critical Increases for Public Services; However, Weak State Revenue and a Plethora of Tax Breaks Make Funding Uncertain

Amy Blouin, Executive Director

Earlier this month, the Missouri General Assembly gave final approval to the state's fiscal year 2015 (FY 2015) budget. While the \$26.4 billion total funding included in the budget amounts to about a 3.4 percent increase compared to the previous year, these investments may be in jeopardy as a result of sharply decreased state revenue in the current year and a series of special interest tax breaks that will reduce state revenue. As a result, mid-year FY 2015 budget reductions or gubernatorial spending vetoes are likely.

Dynamics Likely to Reduce Funding Available for FY 2015 Budget

The FY 2015 budget, which begins on July 1st, contains \$26.4 billion to fund critical public services, including education, public safety, health, mental health and transportation. About one-third of the budget is supported by state general revenue dollars; two-thirds of the budget is supported by federal and "earmarked" state funding that flows to specific funding needs.

However, two significant dynamics may place the investments included in the FY 2015 budget in jeopardy.

- 1.) ***Reduced General Revenue in Current Year:*** Missouri's general revenue collections fell steeply in April. As a result, not only is state revenue for the current fiscal year well below the level that was expected, but the state faces a backlog of unpaid tax refunds. As of April 30th, state general revenue for the current fiscal year grew by 0.5 percent for the year to date compared to the previous year – well below the 2.8 percent estimate that was assumed when the current year's budget was developed. In addition, the state faces a backlog of about \$167 million in individual income tax refunds, and has delayed payment on these refunds due to cash flow issues. **Unless there is significant growth in the last two months of the current fiscal year, Missouri is likely to end the budget year at least \$100 million under expected levels.**¹
- 2.) ***Special Interest Tax Breaks:*** On the final day of the legislative session, state lawmakers approved a flurry of bills that provide a series of special interest tax breaks. **Combined, these bills will reduce state general revenue funding by as much as \$315 million per year, and total state funding by \$483 million per year beginning in fiscal year 2015.**² The tax breaks create a number of new sales tax exemptions, including exemptions for farmers markets, experimental medications, and electrical utility companies, as well as new incentives for data storage and processing centers, and changes to the allocation formula for determining the taxable

¹ For more information on current state revenues see "State General Revenue Declines Sharply: Could Lead to Budget Reductions," Missouri Budget Project, May 16, 2014

² The bills include Senate Bills 612, 584, 662, 693, 727 & 860 and House Bills 1296 & 1865. Cost estimates are preliminary and from the Office of Administration, Division of Budget & Planning.

income of multi-state companies. **The cost of these bills would be in addition to Senate Bill 509, the steep tax cut bill which begins being implemented in 2017. The annual impact of these bills, when combined with SB 509, will result in a reduction of at least \$1 billion annually from state general revenue.**

These dynamics will impact actual expenditures for state services. Because Missouri is constitutionally required to maintain a balanced budget, **the currently weak state revenue growth combined with reductions in revenue that will result from the recently approved tax incentive measures is likely to lead to withholdings (mid-year budget reductions) or gubernatorial vetoes of spending items.** This would be in addition to reductions to education announced on May 20th that are due to diminished lottery proceeds.³ Further, if Missouri ends the current year with less revenue than originally anticipated, then Missouri will also begin FY 2015 at a lower base of revenue than expected, making any increases in spending that are contingent on a stronger revenue growth rate more unlikely.

FY 2015 Budget Summary

An additional unique dynamic related to the FY 2015 budget results from the failure of state lawmakers and the Governor to agree on the expected level of tax revenue for the fiscal year.⁴ This agreement is referred to as the “Consensus Revenue Estimate,” or CRE. Because consensus on projected revenue in FY 2015 wasn’t reached, **the legislature made some of the increases in funding in the approved budget contingent upon revenue growth that exceeds the legislature’s own estimate.** This is referred to as “surplus” funding by the legislature, and in particular will impact the level of funding for K-12 education.

The following table provides an overview of some of the most significant general revenue funding increases that were included in the recently approved FY 2015 budget and details the “surplus” funding where utilized. How those increases compare to funding needs is discussed further, below.

Missouri State Budget FY 2015 ⁵ Significant <u>General Revenue</u> Funding Increases ⁶ Amounts shown are the <u>increases</u> in funding compared to current year (FY 2014)		
Budget Categories	Legislature-Approved Budget	Additional “Surplus” Funding
Education: Pre-K through Higher Education		
K-12 Education - Foundation Formula ⁷	\$114.8 million	\$163.2 million
Missouri Preschool Program	\$4.063 million	
Higher Education “Core” Funding: Distributed to Missouri’s public colleges and universities based on performance indicators	\$43.396 million	

³ News Release, “Continued decline in lottery and gaming revenues results in education funding shortfall in the remaining weeks of this school year, Gov. Nixon announces,” Office of the Governor, May 20, 2014

⁴ For more detail on this dynamic, see “Revenue Dispute Impacts State Budget Development for FY 2015,” Missouri Budget Project, February 2014

⁵ Detailed budget information is compiled from several sources including the Department Budget Requests for Fiscal Year 2015, the Governor’s Budget Request for Fiscal Year 2015, House Appropriations Committee “Notes” for specific budgets and the Legislative Conference Committee on Appropriations “Markup Sheets.”

⁶ Amounts shown are general revenue only and do not include increases in federal or earmarked funding streams unless indicated.

⁷ This amount does not include additional projected increases from Lottery proceeds

Community Colleges	\$6 million
“Bright Flight” and “Access Missouri” Scholarship Programs	\$20 million
Health & Mental Health Services & Services for Missouri Children and Seniors	
Community Mental Health Providers 2% Rate Increase: For community providers that provide psychiatric services for children and adults, providers serving Missourians with developmental disabilities and regional Autism Projects	\$10.489 million
Bond Payment: To cover the first year cost of a new \$198 million bond to rebuild the Fulton State Mental Hospital	\$14.2 million
Home Delivered Meals through the Area Agencies on Aging	\$400,000
Utilecare Energy Assistance for Low Income Families	\$4 million
Children’s Services Workers: Career Ladder to enhance experienced staff and staff supports	\$2.503 million
Medicaid- Restores Adult Dental Care	\$17.8 million

In addition to the increases in general revenue funding detailed above, some services received significant federal increases that will allow for enhanced services, while others received “flat” funding compared to the previous year. Those of particular note that fall into these categories include Child Care Assistance, Parents of Teachers and Crisis Care for children and teens.

Parents as Teachers, the early intervention program that provides specialized parent educators who work with parents to prepare young children for success in school, received an increase of \$1 million in funding from the “early childhood development, education and care fund” resulting in total funding of \$16 million in the FY 2015 budget. However, Parents as Teachers remains below the level of funding received in fiscal year 2009.⁸ Similarly, funding for **Crisis Care for children and teens**, care provided for children whose family is facing a crisis through organizations such as the Crisis Nursery, was also funded at the same level it received in the current year’s budget – \$2.05 million in general revenue.

Funding for **Child Care Assistance** for low income families received a notable increase in federal funding, which will be used to enhance eligibility and strengthen provider rates. The increase of \$10.345 million in federal funds will allow Missouri to provide a three percent rate increase for licensed and licensed-exempt child care providers, expand before- and after-school programs, and increase eligibility levels for child care assistance for low income families. Currently, Missouri provides child care assistance for children in families with incomes up to 175 percent of the federal poverty level (FPL). Missouri provides a “full” benefit (or covers 100 percent of the costs) for child care for children in families with incomes up to 123 percent FPL, and a transitional (or partial subsidy) to assist families with incomes between 123 and 175 percent of the federal poverty level. Missouri’s income eligibility limit to receive the full subsidy is currently 49th lowest among the states. The enhanced federal funding will allow

⁸ See “Cutting to the Chase,” Missouri Budget Project, September 2013.

Missouri to expand the full benefit from 123 to 130 percent of the federal poverty level, moving Missouri's ranking for the full benefit to 44th lowest of the states. Missouri will continue to provide the transitional, partial benefit up to 175 percent of the federal poverty level.

Discussion & Context

As mentioned, fully implementing the increases in these services will be dependent on the growth in state general revenue over the next several months. If the budget is implemented as written, it will put Missouri on a trajectory to restore many of the critical public services that were depleted due to the recession in 2008. However, even with the increases, the vast majority of these services will remain well below their pre-recession levels of funding:

State funding through the foundation formula,” the state’s aid for local K-12 schools, is currently more than \$600 million below the state’s own funding formula, or an average of nearly \$700 per pupil this year.⁹ Due to quirks in the formula, that shortfall was expected to shrink to \$556 million in FY 2015. The additional funding contained in the FY 2015 budget would reduce the shortfall amount to between \$441 million and \$278 million, depending on whether or not the “surplus” funding is implemented. In other words, even under the “best case scenario,” Missouri’s funding for local K-12 schools will continue to be lower than what is called for under Missouri law. Because of the existing shortfalls, local school districts have already reduced classroom instructors and limited course offerings and extra-curricular programs.

The shortfall in the K-12 funding formula is compounded when funding for early childhood programs is considered. As stated previously, the Parents as Teachers early intervention program for very young children continues to be funded below pre-recession levels. As a result, children are likely to enter kindergarten less ready to learn. Similarly, the \$4 million increase in the Missouri Preschool program pales in comparison to the Governor’s request, which was for an increase of \$20 million.

Higher education funding is similarly depleted. The increases included in the FY 2015 budget for Missouri’s public four-year and community colleges would result in total general revenue funding of \$915 million for Missouri’s public higher education institutions. This amount remains below the level attained four years ago in FY 2011, when the combined funding level was \$959 million. Adjusted for inflation, the FY 2015 funding would be \$51 million below the level attained in FY 2011.

Community Mental Health Services have been significantly underfunded over the last ten years. During the economic crises over the last decade, state-funded mental health safety net services were cut by \$18.7 million between FY 2003 and FY 2006, and again by \$17 million between FY 2010 and FY 2013. The two percent provider rate increase included in the FY 2015 budget is just the beginning of restoring funding for this neglected area of the budget. In addition to provider rates, a shortage of hospital beds for acute psychiatric care resulting from funding reductions is impacting local law enforcement agencies, which often have to travel great distances to transport these individuals to an open bed.¹⁰

⁹ Shortfall estimates from the Missouri Department of Elementary & Secondary Education; for details on per pupil shortfalls see “A Shaky Foundation: MO Underfunding the School Formula,” Missouri Budget Project, March 2014

¹⁰ Data on mental health funding needs is from the Missouri Coalition of Community Mental Health Centers