The MISSOURI BUDGET PROJECT

Shaping Policy... Creating Opportunities

March 19, 2012

Without New Revenue, Missouri Will Face Perennial Budget Shortfalls

Tom Kruckemeyer, Chief Economist and Amy Blouin, Executive Director

The state of Missouri has faced many years of budget shortfalls over the past decade. While the economic recession has certainly exacerbated the state's revenue shortfalls, an historic perspective shows that the state's budget woes are worse than in previous recessions and economic slumps, and that the state will not recover any time soon.

Not only will Missouri continue to experience annual budget shortfalls, but the state will not again achieve the purchasing power it had in fiscal year 2008 until fiscal year 2029.

Unless additional revenue sources are implemented, it will remain difficult for Missouri to make the critical investments that build a strong economy and create jobs.

Missouri Has Less Revenue to Invest in Critical Services

The erosion of Missouri's general revenue over the last decade has been significant. Between 2001 and 2010 Missouri had four fiscal years when revenue dropped lower than the previous year. By comparison, during the preceding 25 years (1975 through 2000), Missouri's general revenue grew every year. Even during recessions over that 25 year period, Missouri revenue had modest gains.

As a result of the drops over the last decade, Missouri general revenue from fiscal year 2000 to fiscal year 2010 grew by a net of just $600 million, from $6.1 billion to $6.7 billion. However, that growth fails to keep pace with inflation. **When adjusted for inflation, the purchasing power of general revenue in fiscal year 2010 was the equivalent of $5.4 billion in fiscal year 2000 – a decline of nearly 12 percent over the decade.**[1]

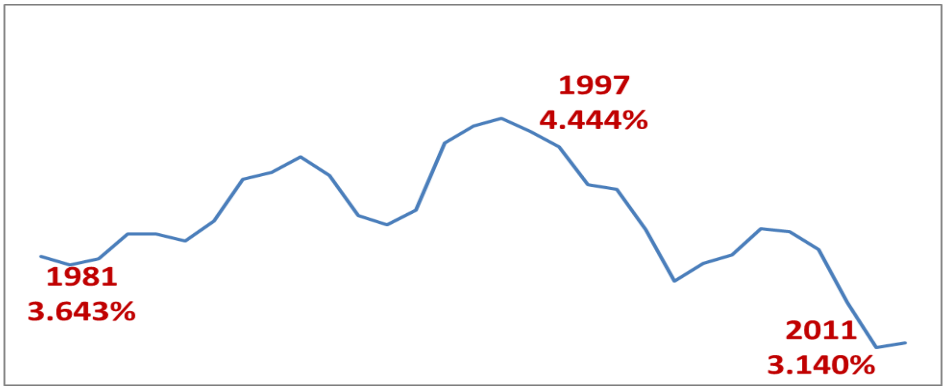
State General Revenue as a Proportion of the Economy Reaches Record Lows

Missouri general revenue, and its ability to invest in public services, has reached historic lows. **Relative to the size of the economy, general revenue is the lowest it has been in more than 30 years.**

[1] Adjusted for inflation using the Consumer Price Index-Midwest for All Urban Consumers

General revenue relative to the economy can be demonstrated by measuring Missouri general revenue as a percent of Missouri's personal income. Personal income is both a measure of the size of the state economy as well as a measure of the state's collective ability to contribute taxes to support government services. As indicated in the following chart, net general revenue collections as a percent of state income are lower today than in 1981.[2]

Figure 1: State General Revenue as a Percent of the Economy



The decline in this percentage represents a significant drop in available state revenue. For example, if Missouri had maintained general revenue at 3.5 percent of personal income, state general revenue would have been $813 million higher in fiscal year 2011. This additional revenue would have alleviated the state's budget shortfall and provided adequate funding in most areas.

Missouri's Investment in Critical Services Has Declined

As a result of the steep decline in general revenue, Missouri's investment in the array of state services that provide the foundation for a strong economy and quality of life has withered. The following describes just a few examples of this erosion throughout the last decade:

K-12 Education: Missouri has been unable to finance the statutorily required school funding formula. As a result, Missouri's state aid to local school districts is currently funded at just 92 percent of its required funding level. By fiscal year 2013, state aid for local school districts is expected to be as much as 15 percent below the required funding formula.[3]

As a result, school districts throughout the state are taking extraordinary steps to reduce costs. In 2010 alone, 90 percent of school districts reduced staff. Further, although student enrollment has remained relatively stable, the number of teachers over all Missouri districts has been reduced by five percent, resulting in larger class sizes.[4] In addition, some school districts are choosing to

---

[2] State net general revenues as reported in the relevant editions of the Missouri Executive Budgets; Missouri Personal Income annual data from the U.S. Department of Commerce-Bureau of Economic Analysis.
[3] Phone interview with Dr. Ronald Lankford, Deputy Commissioner for School Finance and Administrative Services, Missouri Department of Elementary and Secondary Education, Fall 2011.
[4] Data from the Missouri Department of Elementary and Secondary Education

reduce the number of days in the school year, instead adding five minutes of instruction per day to meet classroom instruction requirements. Funding for school transportation, continued education for teachers (such as Career Ladders), and successful programs such as Parents as Teachers has also been significantly reduced. In fact, despite increased need, Parents as Teachers funding was reduced by 60 percent since 2009.

Higher Education: From fiscal year 2001 to fiscal year 2012, state financing for Missouri's public colleges and universities dropped from $767 million to $722 million, while aid to Missouri's two-year colleges declined from $147 million to $132 million. As a result, tuition has increased dramatically, rising 83 percent at four year institutions and 52 percent at community colleges, making higher education less affordable for Missouri families.[5]

Other Services: Missouri has also made significant cuts to services that assist those with the greatest need, impacting an array of health and mental health services, training of child care providers, and services provided through Area Agencies on Aging. Reductions to mental health funding specifically resulted in an estimated 3,074 children and adults with severe mental illness losing access to services in fiscal year 2011 alone. Funding reductions in fiscal year 2010 eliminated acute psychiatric hospital care in two locations.[6] Cuts in fiscal year 2006 resulted in more than 100,000 Missourians losing access to health care services through Medicaid as eligibility for parents was lowered to an income of just $292 per month for a family of three.

The Causes of the Revenue Decline

Although the recession clearly impacted state revenue in the last decade, decisions by state policymakers over the years have had a substantial and lasting impact on the state's revenue decline. Over the past 15 years, reductions to the corporate franchise tax, changes in personal and dependent income tax exemptions, and the elimination of the general revenue sales tax on food have contributed to reductions in general revenue that will reach at least an estimated total of $633.9 million in FY 2012.[7]

In addition, over the last twelve fiscal years, the state has seen an explosion in tax credit utilization, which also reduced the amount of revenue available for state services. Tax credit redemption reached $545 million in FY 2011, up from $314.5 million in FY 2000 – an increase of more than 73 percent.[8]

---

[5] Missouri Department of Higher Education data

[6] Data from the Missouri Department of Mental Health

[7] $633.9 million is the total estimated FY 2012 impact of the: elimination of the general revenue portion of the sales tax on for off-premise consumption (HB 491, 1997); increase in the dependent exemption from $400 to $1200 per dependent (SB 675, 1998); increase in the personal exemption from $1200 to $2100 per person (HB 516, 1999); reduction in the corporate franchise tax and base HB 516, 1999); elimination of state income tax on social security benefits for those with adjusted gross incomes under $100,000 (HB 444, 2007); and the further reduction of the corporate franchise tax (HB 191, 2009). The figure does not include the impact of the elimination of the remainder of the corporate franchise tax (SB 19, 2011), as the legislation is not expected to impact FY 2012 GR collections.

[8] 2011 Senate Appropriations Committee Annual Fiscal Report (Red Book), www.senate.mo.gov/11info/Redbook11.pdf

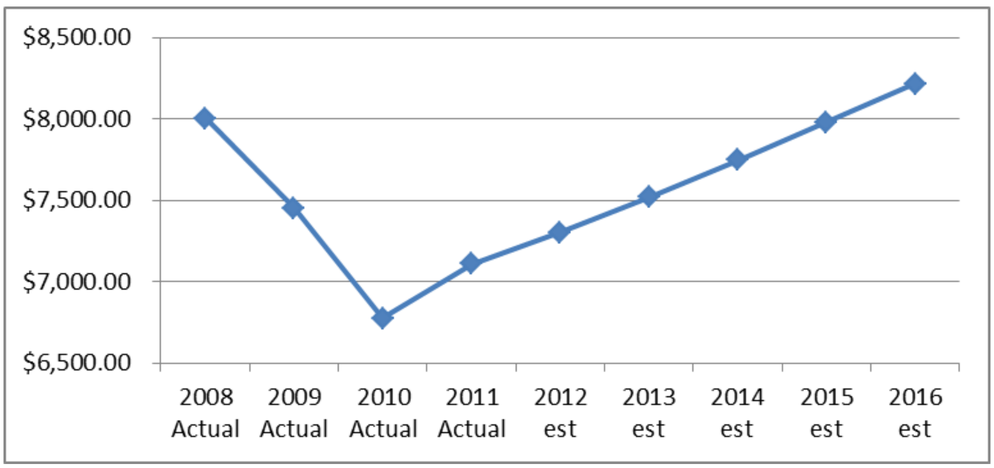
While tax reductions or tax credits may support worthy objectives or foster economic development, they have also substantially contributed to declining state revenue.

Revenue Will Not Achieve FY 2008 Purchasing Power until FY 2029

General revenue collections increased 15.12 percent in February, raising the FY 2012 fiscal year-to-date growth rate to 2.39 percent. Although net GR growth has improved relative to previous months, even if the state achieves the consensus revenue estimate in the current fiscal year and grows at a three percent annual rate thereafter, **the state will still not reach FY 2008 pre-recession levels until FY 2016.**

Moreover, once revenue is adjusted for inflation, <u>the state will not achieve FY 2008 levels of purchasing power until FY 2029.</u>

Figure 2: Net General Revenue by Fiscal Year, in Millions



Conclusion

Unless state policymakers make structural changes to the state's revenue streams, the state will continue to face budget shortfalls in the years ahead, making it more difficult for the state to invest in the critical services that build the economy and create jobs.