Moving From “Surplus” to Shortfall:
The Critical State of Missouri’s Revenue and Policy Options

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With the 2008 Missouri Legislative Session now in its second month, deliberations over the upcoming Fiscal Year 2009 state budget will soon take center stage. Though the state’s revenue for the current Fiscal Year is more than adequate to meet the state’s current spending obligations, the Fiscal Year 2009 budget situation is tenuous. In fact, Missouri is one of more than 30 states that are expecting to face significant budget shortfalls within the next 17 months, totaling at least $35 billion combined.

A combination of tax and budgetary policy decisions coupled with an almost certainly weakening economy could result in a $555 million or larger shortfall by Fiscal Year 2010. As Missouri is required to operate within a balanced budget, a shortfall of this magnitude implies that substantial budget cuts to health care, education and many other vital services are almost certain to occur. There are steps that the Missouri General Assembly and policy makers can take to decrease the size of this shortfall and assure a fiscally viable future.

The Causes of the Shortfall: Declining Revenue

Through the end of January, Missouri general revenue collections after refunds had grown 4.9% for the current Fiscal Year as a whole as compared with the previous year. This overall growth rate is adequate to meet the current year’s spending needs. However, there is a deepening concern related to the stability of future revenue. Three of the four largest sources of state general revenue funding declined in January including the Sales/Use Tax: (-0.5%), the Corporate Income/Franchise Tax: (-8.8%) and the County Foreign Insurance Tax: (-24.7%).

These dramatic changes in these core revenue sources are indicative of a problematic economy. There are additional indicators that signify that an economic recession is looming in the nation:

After increasing at a 4.9% annual rate in the 2007 third quarter, U.S. Real Gross Domestic Product grew at only a 0.6% annual rate in the quarter ending December 31st; The U.S. Index of Leading Economic Indicators fell for the fourth consecutive month in January to 135.8; and Since the beginning of 2008, the stock market as measured by the Standard and Poors Index of 500 stocks has been weak. This Index, which began the year at 1447.2 dropped by 7.2% to 1342.5 at the end of February.

The data jointly indicate that the U.S. economy is in a fragile state and most likely in the beginning of a significant economic downturn. Assuming the economy further declines, Missouri’s state revenue collections will be even more negatively impacted. While the most recently completed full state Fiscal Year, Fiscal Year 2007, ended with state revenue growth of 5.2%, the economic indicators suggest that Missouri’s current Fiscal Year may end with only a 2.1% net growth rate. This steep decline results in hundreds of millions of dollars in less available state revenue to fund basic services.

In addition to the economic decline, several Missouri specific policy changes are significantly reducing the availability of state revenue:

- Through the November 2004 election Missouri voters approved “Amendment 3”. This amendment to the State Constitution diverts the sales tax revenue that is derived specifically from the motor vehicle sales tax away from state general revenue and earmarks it for transportation only. The diversion of this revenue was phased-in over several years. By July of this year, all the revenue received from this sales tax, estimated at $185 million will be allocated to transportation spending only, as opposed to general revenue funding;

- The legislature chose to pass a number of tax cuts in the Missouri 2007 legislative session and 2007 special legislative session. These tax cuts will reduce state revenue by $168 million by Fiscal Year 2010.

These two recent state policy changes will result in reducing state general revenue dollars by $353 million per year by Fiscal Year 2010. The amount of this reduction will be nearly double the amount of revenue growth anticipated per year for the next two Fiscal Years, resulting in a rapid decline in available state revenue. As a result, the Missouri Budget Project projects that state revenue will decline by -$336 million by Fiscal Year 2010, as depicted in the following chart:

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2 Missouri Budget Project’s revenue forecast based on the most recent economic trends.
3 Missouri Department of Transportation Estimate of Amendment 3 Revenue
Further compounding the state revenue crisis, the U.S. Congress recently passed the “Federal Economic Stimulus” bill. The bill contains a variety of tax reductions, including two significant corporate tax deductions. One of these is “Bonus Depreciation”, a corporate tax deduction that allows expenses associated with investment to be deducted more quickly. This tax deduction is expected to decrease Missouri revenue by $100 million in Fiscal Years 2009 and 2010 combined. Without legislative action in Missouri to “decouple” from the Federal Tax code on this provision, Missouri’s revenue situation for Fiscal Year 2010 will be further compromised.

All of these factors: a slowing economy, recent state tax and revenue changes, and federal tax policy changes have collided to create an expected and critical budget crisis for Missouri by Fiscal Year 2010.

The Causes of the Shortfall: Increasing Spending Obligations

In addition to curbing revenues, Missouri’s fiscal outlook is further complicated due to several long-term spending obligations that are placing a strain on the availability of general revenue. The state’s budget is similar to a family budget or that of a business: to keep pace with inflationary demands revenue must grow each year. All of the allocations in the state budget for a variety of services including transportation, public safety, construction, higher education and health care must grow to keep pace with the increasing costs of labor, utilities and other ongoing expenses.

As evidenced in Missouri’s recent state budget crisis, without the growth of base state revenue, the state loses its ability to meet these ongoing needs, and cannot provide the array of services at the same level as in the past. Since 2001 the state’s relatively stagnant revenue has resulted in severe cuts to an array of services: State aid to local school districts is currently $500 million under its required funding levels; Higher education reductions have resulted in tuition increases.

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4 Missouri Budget Project estimate.
of 75% since 2001; and more than 200,000 Missourians have lost access to public health care due to Medicaid cuts.

The cost to continue current 2008 programs and services alone will require Missouri revenue to increase by at least $155 million per year just to meet inflation in current services. In addition, Missouri faces several long-term revenue obligations that are just recently “coming due”:

- In Fiscal Year 2008 the state began paying the settlement on a telecomm court case. The case requires a $40 million payment beginning in Fiscal Year 2008, growing to $60 million in Fiscal Years 2009 and 2010;
- The Missouri General Assembly passed a new “School Funding Formula” in 2005 that requires the state to invest at least $126 million more per year over the next several budget years to eventually fill the current $500 million K-12 education funding gap.

As a result, even if Missouri does not make any new investments in services, the cost demands to maintain current programs and to pay off long-term obligations require state general revenue to grow by at least $350 million per year.

The projected decline in revenue, coupled with the mandatory spending increases described above, result in a very bleak outlook for Missouri’s revenue.

Moving from “Surplus to Shortfall and Back Again”: Policy Options

Many variables over the next several months will impact exactly how severe Missouri’s Budget Shortfall will be including the national and state economic conditions, legislative policy change and spending decisions. However, based on the best available current data, the Missouri Budget Project estimates that the state could face a budget shortfall of at least $555 million by Fiscal Year 2010, a size equal to 6.5% of the state’s general revenue fund. The size of this shortfall could grow to as large as $866 million in Fiscal Year 2010, depending on economic changes.

Missouri policy makers have a critical opportunity to advance several concrete policy steps in the current state legislative session to ameliorate and minimize this shortfall.

Decouple from the Recent Federal Tax Changes: As mentioned previously, the recently passed Federal Economic Stimulus bill contained a number of tax reductions that will result in a loss to state revenue. One of these changes, “Bonus Depreciation”, allows corporations to deduct expenses at an accelerated rate. This change will result in a loss of $100 million in Missouri over the next two fiscal years. The Missouri General Assembly should pass legislation to “decouple” from this change in the tax code prompted by the Economic Stimulus legislation. The state took similar action in 2002 when the Congress enacted Federal Fiscal Relief. Corporations would retain the accelerated tax reduction at the federal level without a cost to state revenue. ⁵

Federal Fiscal Relief: Although more than half of the States are projecting budget shortfalls in the next 17 months, the US Congress failed to pass Federal Fiscal Relief as part of the recent

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Economic Stimulus Act. In the last recession, the Congress provided fiscal relief to states through Direct Grants and an Increased Medicaid Matching Rate (“FMAP”). Missouri policymakers can encourage Missouri Congressional Delegates to support Fiscal Relief in the Congress.

Avoid Further Reductions in State Revenue & Proposals to Earmark: The Governor’s 2008 State of the State Address contained a proposal to eliminate state taxes on military pensions; several lawmakers have filed additional bills that would either mildly or significantly reduce the state tax base. However, as mentioned previously, the tax cuts that Missouri passed during the 2007 session are one of the significant causes of the pending budget shortfall.

In addition, Missouri policymakers are considering two resolutions, Senate Joint Resolution 43 and House Joint Resolution 67, that would require 10% of the growth in General Revenue to be “earmarked” to Transportation spending beginning in Fiscal Year 2010.

Missouri policymakers must avoid legislation that results in permanent reductions to the tax base or which further earmarks state revenues, resulting in reduced general revenues. These policies would widen the budget shortfall facing Missouri.

The Mission of the Missouri Budget Project is to advance public policies that improve economic opportunities for all Missourians, particularly low and middle income families, by providing reliable and objective research, analysis and advocacy. Contact the MBP through our website at www.mobudget.org