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March 8, 2013

Racing to the Bottom:
Senate Gives Initial Approval to Extreme Tax Cut Bill Which Would Devastate Missouri Services, Infrastructure, and the State's Economy

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An extreme tax cut proposal, perfected this week by the Missouri Senate would **slash Missouri's general revenue budget by nearly $1 billion** when fully implemented, resulting in devastating cuts to services throughout the state. Further, **the measure will require state lawmakers to cut $200 million from the FY 2014 budget proposal** that is currently being crafted. Instead of spurring the economy, the proposal will severely undermine Missouri's competitiveness by damaging our ability to invest in the very services that make Missouri attractive to business. As was recently experienced in Kansas, the proposal could compromise Missouri's bond rating. Instead of trying to match Kansas' shortsighted tax cuts that resulted in severe budget shortfall, Missouri should invest in what the state needs to improve its own quality of life.

Tax Cuts Would Cut Missouri's General Revenue Budget by nearly $1 Billion

The Senate Substitute for Senate Bills 26, 11 and 31 (referred to as SB 26) would make severe cuts to a number of state taxes, detailed below. Although the changes are phased in over a period of five years, the following portrays their impact when fully implemented to give a clear sense of their full impact.

- Cuts Missouri's top individual income tax bracket from $9,000 to $7,000, reduces the rate from 6 percent to 5.25 percent, *and* increases the personal and spouse exemption by $2,000 for those with adjusted gross incomes under $20,000, **reducing state revenue by $990 million annually;**
- Cuts the corporate income tax rate from 6.25 percent to 5.5 percent, adds an exemption for the first $25,000 of income, *and* gives exempts 50 percent of business income (including that for partnerships and s-corporations) from individual income taxes; **reducing state revenue by an $244 million annually,**
- Creates a new exemption from sales tax for fees paid for sporting, amusement and entertainment events, **reducing state revenue by $31 million annually, and**
- Increases the state general revenue sales tax by one-half a percent from 3 to 3.5 percent, increasing revenue by $306 million annually (Missouri has additional dedicated sales tax of 1.25 percent).
- The measure also implements provisions of the state Marketplace Fairness Act and makes other changes that would enable the state to collect some sales taxes on online sales; BUT it requires an additional .25 percent rate reduction for individual and corporate taxes if the Congress passes the federal Marketplace Fairness Act, negating any financial benefit from the proposals.

Altogether, the bill would cut state general revenue by $960 million per year, requiring severe cuts to state services. In addition, because the Missouri Legislature is largely restricted from increasing taxes under the Hancock Amendment in the State Constitution, the changes can't be overturned by lawmakers once implemented. In other words, even if lawmakers realize they made a mistake, they will not be able to fix it.

SB 26 Will Require $960 Million Cut
To State Budget When Fully Implemented
Missouri Budget Project Fiscal Assessment
Amounts in millions by state fiscal year

Fiscal Year	Sales Tax Increase	New Sales Tax Exemptions	Corporate Tax Rate Cut	Individual Income Tax Rate Cut	Business Income Exclusion	Personal Exempt.	Corp $25K Exempt.	Grand Total
2014	$31.8	($15.0)	($3.7)	($97.1)	($67.7)	($33.1)	($7.5)	**($192.3)**
2015	$96.4	($30.0)	($11.4)	($295.3)	($86.6)	($66.4)	($14.9)	**($408.2)**
2016	$162.8	($30.0)	($19.5)	($501.8)	($123.7)	($66.8)	($14.6)	**($593.4)**
2017	$231.2	($31.0)	($28.0)	($694.4)	($162.0)	($67.1)	($14.3)	**($765.5)**
2018	$301.7	($31.0)	($37.1)	($896.2)	($183.1)	($67.4)	($14.1)	**($927.1)**
2019	$306.2	($31.0)	($38.2)	($923.1)	($192.2)	($67.8)	($13.9)	**($960.0)**

Tax Cuts Would Require Drastic Cuts to Most Services

Missouri's general revenue budget is already at historic lows. In fact, revenue collections relative to the size of the state's economy are at their lowest levels in thirty years, and remain below their pre-recession level.[1] Moreover, MBP estimates that at this current rate of growth it will take 15 more years for the state to return to the level of general revenue purchasing power it had before the recession. As a result, Missouri services are already largely suffering from significant cuts and diminished investment. The severe tax cut will undermine the ability of Missouri to fully recover from the recession and will damage services further.

Put into context, the amount of the proposed tax cut is the equivalent of 32 percent of current state funding for local school districts. Missouri's funding for local schools is already $620 million below the required funding level as determined by the Foundation Formula.[2] The tax cuts will ensure that Missouri can never fully fund the formula and is likely to result in further cuts to state support for local schools.

[1]For more detail, see Missouri Budget Project's Report, " State Revenue is Growing, But Still Far Below Pre-Recession Levels," January 2013

[2] DESE Administrative Services request for FY 14 to fully fund the foundation formula was $3.69 billion. The Governor's recommendation of $3.075 billion leaves a shortfall of $620 million. Data from the Missouri Department of Elementary and Secondary Education

The tax cut is more than $100 million larger than the amount of funding Missouri provided to all of its four and two year colleges in the current fiscal year.[3] **Missouri's public four year colleges and universities and community colleges are already $292 million below the level of funding received in FY 2001 when adjusted for inflation.[4]** As a result, tuition for Missouri's four-year institutions has nearly doubled in the last decade. The tax cut will require further steep tuition increases to make up for likely further reductions in funding for higher education.

If lawmakers wanted to protect funding for local public schools and colleges, they could instead make dramatic cuts in a whole series of critical programs and ***still not meet the cuts required by the tax cut proposal***. For example, closing all 21 of Missouri's correctional facilities would only garner $272 million. However, that change would require Missouri to lay-off 7,900 employees within its correctional facilities and release 31,000 prisoners. Eliminating probation and parole oversight and offender rehabilitation services would garner an additional $245 million. Missouri could instead eliminate state general revenue funding for the highway patrol. However, that change would also require layoffs of highway patrol officers and would only garner slightly more than $30 million.

However, because a number of services are required under federal law, or at the very least are required in order to receive federal tax revenue into Missouri, **it is unlikely that lawmakers could protect education funding from cuts if a tax cut of this magnitude were to be approved.**

Bill Would Undermine Missouri's Economic Recovery and Future Prosperity

Because Missouri is required to have a balanced budget, without a corresponding increase in a another form of tax, the proposed state tax cut measure would in reality result in deep cuts to an array of services including education, health and public safety. The cuts would undermine Missouri's economy in three main ways:

1. Sharp budget cuts would directly decrease employment that is funded by state services, including teachers, corrections and highway patrol officers and more;

   For example, cuts in education funding over the last decade have already resulted in 2,500 fewer K-12 teachers and steep tuition increases for public college and university students.[5]

2. Reductions in education, workforce training, infrastructure and other services would make Missouri less attractive for business or entrepreneurial investment and could increase business costs;

[3] Missouri appropriated $845 million to 4 Year Colleges and Universities and 2 Year Community Colleges in FY 2013. Data from the FY 2014 Missouri Executive Budget, available at www.oa.mo.gov

[4] Based on FY 2001 levels of funding adjusted for inflation using CPI from the Bureau of Labor Statistics and compared to FY 2013 appropriated funding

[5] "Cutting to the Chase: What Multi-Year Budget Reductions Mean for Missourians," Missouri Budget Project, September 2012

The budget reductions make the state less attractive for business investment by diminishing the education system and infrastructure that businesses need to be successful.[6]

State tax reductions that result in less state spending could also increase costs for businesses. Companies may be forced to spend more of their own money educating and training their workers, providing health services for employees and their families, securing their workplaces, and repairing infrastructure.[7]

3. Reducing available state revenue could compromise Missouri's bond rating. Recently Moody's Investor Services downgraded Kansas' credit outlook. In their statement, Moody's said, **"Although subject to appeal, this ruling is credit negative for Kansas (Aa1 negative) and underscores challenges the state faces as it tries to offset revenue losses from the income tax cuts it enacted last year."**[8]

   Responsible financial management and a moderate debt burden are two factors that have allowed Missouri to hold a top credit rating for 46 years.[9] The strong rating allows Missouri to receive the lowest borrowing rates for bonds to undertake major improvements in infrastructure. Severe state tax reductions could lower Missouri's bond rating and result in diminished capacity to invest in infrastructure improvements at Missouri's universities, colleges, state parks and roads, further undermining Missouri's economy.

Tax Cut Package Largely Benefits only the Very Wealthiest Missourians: Harms Missouri's Seniors In Particular

A new analysis conducted by the Institute on Taxation and Economic Policy of the impact of the tax cut proposal indicates that only the very wealthiest Missourians would receive a significant benefit from the extreme measure. As demonstrated in the table, below, **the wealthiest 1 percent of Missourians (those with average annual income exceeding $1 million) would receive an average $8,253 tax cut. By comparison, the 40 percent of Missourians who fall into the lowest income levels, those with incomes below $33,000, would, on average, have a tax increase.**

Missouri seniors who rely solely on Social Security benefits for their income are among those who face a tax increase. Because Missouri already exempts Social Security from state income tax, those seniors who rely solely on those benefits for their income will not have an income tax decrease. However, they do face a tax increase due to sales tax changes. Similarly, the new personal exemption increase provides little benefit to the lowest income Missourians

[6] For more on business location decisions, see " Corporate Tax Rates Do Not Drive Business Decisions: Rate Cuts Could Impede Economic Growth," Missouri Budget Project, January 2013
[7] Robert Lynch, PH.D., "Rethinking Growth Strategies," published by the Economic Policy Institute, 2004
[8] Bloomberg News, "Bleeding Kansas Shows Peril of GOP Bid to End Income Tax," by Tim Jones, January 25, 2013
[9] Standard and Poor's, Global Credit Portal, Ratings Direct "Missouri Board of Public Buildings Missouri; Appropriations; General Obligation," August 2011

who already earn too little to pay state income tax. They will only face a tax increase due to sales tax changes.

Tax Cut Proposal Largely Benefits the Very Wealthy
Increases Taxes on Lowest Income Missourians

Impact of Personal Income, Corporate Income, and Sales Tax Changes Combined
Tax Change by Income Quintile

2012 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less Than $18,000	$18,000 to $33,000	$33,000 to $53,000	$53,000 to $85,000	$85,000 to $160,000	$160,000 to $394,000	$394,000 Or More
Average Income in Group	$11,000	$25,000	$42,000	$68,000	$111,000	$226,000	$1,038,000
Tax Change as Percent of Income	0.1%	0.1%	–0.0%	–0.1%	–0.3%	–0.5%	–0.8%
Average Tax Change	**$9**	**$16**	**-$8**	**-$70**	**-$288**	**-$1,129**	**-$8,253**

Analysis from the Institute on Taxation and Economic Policy, March 2013
Based on 2012 Income Levels

Moving Missouri Forward

In addition to its impact on the state's credit rating, Kansas' income tax cuts resulted in a $700 million budget shortfall, resulting in lower funding for services and increases in sales taxes. Research shows that families and businesses do not move for lower tax rates.

To truly compete with Kansas and other states, Missouri must invest in its quality of life and what families and businesses need to thrive: strong schools to educate our children and provide a skilled workforce, quality transportation to get to school and work and bring companies' products to market, and safe, stable communities.