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## **Economic Recovery Not a “Green Light” for Tax Cuts; Caution Advised as Basic Services Remain Underfunded**

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*“Those who cannot learn from history are doomed to repeat it.” George Santayana, philosopher*

Missouri’s improving economy, while a welcome development, must not be construed as a “green light” for significant tax cuts or credits. To-date in the 2007 legislative session, nearly 100 bills have been filed which have the potential to reduce state revenue by billions of dollars.

While most of these bills will not be enacted into law, the large volume of proposed legislation is indicative of a prevailing mood in the Capitol. A perceived “surplus” of revenue, which could likely be short-term, has given leeway to pursue unwise fiscal policy.

Legislators must proceed cautiously regarding proposed tax changes. Even if only a small percentage of the tax cut measures become law, Missouri stands to lose hundreds of millions in revenue annually. This would significantly affect the state’s ability to invest in health care, education, public safety and vital infrastructure—all of which is critical to the well-being of all Missourians and to the state’s economic development.

### **The State of Funding of Services in Missouri**

Unfortunately the word “tax” often carries a negative connotation. Yet, taxes support many vital services that benefit individuals and contribute to the common good: schools, roads, police, fire and emergency services, and public health among others.

As Missouri policymakers consider possible changes to the state’s tax policy -- including tax cuts -- it is important to keep in mind that Missouri already is a low-tax state. Missouri has: a lower corporate tax as a share of the gross state product than 44 other states; and a lower property tax than 38 other states and lower sales tax than 21 other states as a share of income<sup>1</sup>. Missouri’s cigarette and tobacco products tax is the second lowest in the nation, trailing even behind tobacco producing states<sup>2</sup>.

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<sup>1</sup> ITEP Data based on 2004 US Census Figures

<sup>2</sup> Citizen’s for Missouri’s Children- Issue Fact Sheet: “Children’s Health and Safety in Missouri”

In addition, Missouri has several outdated tax loopholes, particularly for corporations, which cost the state millions every year. Corporate taxes previously brought in about \$500 million in general revenue at their peak, but have declined to \$200 million in recent years.<sup>3</sup> Several states have chosen to close some of the gaps in legislative statute that allow corporations to avoid paying state income tax. One of the common gaps is referred to as the “Geoffrey Loophole” that allows a corporation with national franchises to transfer profits to other states, thereby avoiding Missouri tax. Adjusting this loophole could raise about \$15 million annually.<sup>4</sup> Additionally, Missouri allows corporations who pay their taxes on time to receive a “Timely filing discount”. The discount is not applied in any other state in the nation and reduces state revenue collections from corporations by \$19.1 million annually.

On the other hand, Missouri’s income tax structure places a disproportionate weight on low and moderate-income taxpayers. For example, Missouri taxes low-income families at a higher rate than 31 other states.<sup>5</sup> Policy makers interested in addressing tax reform should place a high priority on Missouri’s outdated individual income tax structure. Brackets are graduated only up to \$9,000. Above that amount, all taxable income is taxed at the same rate. The \$9,000 figure was set in 1931. The brackets and rates were set in 1971.<sup>6</sup>

### **Caution Advised Despite Revenue Growth**

During the last 18 months, Missouri has experienced solid revenue growth. The state ended its Fiscal Year (FY) 2006 on June 30 with net General Revenue (GR) collections increasing by 9.2% and exceeding the Consensus Revenue Estimate by about \$292 million.

For the current Fiscal Year 2007, the net revenue growth rate is 4.4% through December 2006 and the state’s overall financial situation remains reasonably good. Assuming that net general revenue grows 4.5- 5.0% and that there are no major spending changes relative to the legislatively approved budget, the Fiscal Year 2007 ending balance would be in the \$600 to \$650 million range. This leaves \$500-\$550 million available for budget enhancements, assuming that prudent budgeting requires a carry forward balance of at least \$100 million. Yet while the state’s financial position is certainly better than in recent years, careful analysis of recent revenue and tax policy trends indicates that prudent budgeting and tax policy is advised.

### **1990’s Tax Policy Led to Revenue Shortfalls**

In considering tax policy changes, it is important to examine recent legislative actions and their impact on Missouri’s fiscal status. During the economic prosperity of the 1990s, Missouri made a series of tax reductions including 14 state tax cuts and 21 new tax credits that reduced the base of tax collections by nearly \$1 billion annually.<sup>7</sup> As a result, Missouri’s tax base has slipped significantly in the last ten years.

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<sup>3</sup> January 16-22, 2004 Times Newspapers Online: *Legislature Looks to Overhaul State Tax System*, [www.timesnewspapers.com/stories/20040116/taxsystem.html](http://www.timesnewspapers.com/stories/20040116/taxsystem.html)

<sup>4</sup> Governor’s Budget Proposal Fiscal Year 2004, <http://www.oa.mo.gov/bp/execbudgetdocs.htm>

<sup>5</sup> Center on Budget and Policy Priorities, “State Income Tax Burdens on Low-income Families in 2003” <http://www.cbpp.org/4-8-04sfp.htm>

<sup>6</sup> Missourians for Tax Justice

<sup>7</sup> *Missouri’s Fiscal Crisis Remains Severe: Revenue Options are available as compared to continued spending cuts*, Missouri Budget Project, January 2004 available at [www.mobudget.org](http://www.mobudget.org)

Missouri's fiscal crisis began in Fiscal Year 2001 with the convergence of the national recession, loss of federal funds through program reductions, federal tax cuts and increased federal mandates, and the impact of 35 state tax cuts and tax credits of the 1990s took hold. The state responded by making a series of core reductions (ongoing cuts to the core of state programs) and one-time withholdings (temporary reductions in state department spending authority).

Significant cuts in funding for K-12 education, higher education, health care and public safety were made which have yet to be restored.

### **Good Times Are Golden Opportunity for Reinvestment**

Solid revenue growth in Missouri during the past 18 months presents policymakers with an opportunity to reinvest in basic state services. Just as an astute business person invests some profits back into the company during good times, the state has an opportunity to replenish funding cut during the lean years. Many Missouri families practice wise fiscal policy by saving for college education, making home improvements and having an "emergency fund" for future unanticipated expenses. Similarly, the state also can use its better-than-expected revenues to make sound investments for the future.

Missouri's expected surplus for Fiscal Year 2007, while not enough to adequately fund all core services, provides an opportunity to begin making up for the shortfalls of the past five years. Investments in health care and education, in particular, will contribute to the common good of all Missourians and ultimately strengthen the state's fiscal stability for years to come.

Specifically, the surplus could be used to:

- Restore health insurance to the nearly 123,000 low income Missourians who lost Medicaid coverage during FY 2006.
- Increase state aid to public colleges and universities which in Fiscal Year 2007 is below the levels attained as far back as fiscal year 2001.
- Increase state funding for K-12 education, currently about \$600 million below the required levels.

Through these investments in Missouri services and infrastructure, the state can foster the common good and simultaneously economic development that hinges on the state's ability to provide a high quality public education system and a good "quality of life" for residents.

### **Missouri Should Enact Provisions for Fiscal Discipline**

Prior to enacting any tax changes in Missouri, the state should adopt a "Pay-As-You-Go" Rule, such as that which is utilized by the U. S. House of Representatives. The application of PAYGO rules in Missouri would require fiscal discipline by requiring any bill that reduces revenue or increases costs to have provisions that would offset or *pay* for the loss of revenue or new cost. For instance, a tax decrease could be passed if the bill provides for an offsetting tax increase, or a cut to service to fund it. This Rule is commonly known as a "pay-as-you-go" rule because it institutes the same fiscal discipline that Missourians must use in their household budgeting, and businesses must use in their corporate budgets to pay for budgetary changes they make. Utilizing the PAYGO rule in Missouri would establish a means to ensure that services have stability.

Similarly, Missouri lawmakers should consider sunset provisions to any new tax reductions. If the intent of the legislature is to utilize the current year “surplus” to fund a tax reduction, then that tax reduction should be funded by *only* the surplus revenues and not create a *permanent reduction of state revenues*. If sunset provisions had been included with the tax cuts of the 1990s, Missouri may have been able to avoid many of the very significant cuts to service that occurred after the economic boom had ended.

*The Missouri Budget Project is a statewide, nonprofit, nonpartisan fiscal analysis organization that informs the public on Missouri’s budgetary and tax policy options...and their impact on low and middle income citizens. More information is available at [www.mobudget.org](http://www.mobudget.org)*