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Missouri's Revenue Situation: Is the Fiscal Crisis Really Over?

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Overview

On July 1st, Missouri entered the new fiscal year with the first sustained growth in revenue collections in nearly three years. The net general revenue increase for FY 2004 totaled 7.1%. The anticipated growth for FY 2005 is nearly 2.3%. This growth represents considerable improvement over recent years; however, it follows two years of nearly record negative revenue growth comparable only to the Depression era growth of the 1930s. In fact, even with the successful growth of FY 2004, the net general revenue was actually below what Missouri attained in FY 2001, the year preceding the state fiscal crisis. The following discusses the current revenue situation in comparison to FY 2001 and whether the anticipated growth for FY 2005 will be enough for Missouri to truly escape the fiscal crisis.

Update on Fiscal Year 2004

There is little question that the second half of FY 2004 saw remarkable revenue growth in several areas. After roughly two and one-half years of continuous decline in Missouri net General Revenue, the last six months saw a major turnaround in several key revenue categories. For this period, the following growth rates were observed:

Individual Income Tax Withholding	5.4%
Total Individual Income Tax	6.2%
Regular Sales Tax	7.5%
Gross Corporate Income & Franchise Tax	9.6%
Total Gross General Revenue Growth	6.7%

In addition to the growth in tax receipts, general fund tax refunds declined by 2.4%, resulting in a net growth in general revenue of 7%.² Nevertheless, the total net general

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² The decrease in tax refunds was largely due to a dramatic decline in Corporate Income tax refunds which fell by 32% for the fiscal year.

revenue collections of \$6.3458 billion remained \$44 million **below** the level achieved in FY 2001.

Historical Comparison – and Comparison with Fiscal Year 2001

To determine the adequacy of the current revenue growth, it’s appropriate to compare it with standard historical growth rates. While each year has economic fluctuations net General Revenue growth calculations show that between 1986 and 2004 Missouri averaged a 5.1% annual growth rate.³ Further, for fiscal years 1997 through 2001, the five years immediately preceding the state fiscal crisis, Missouri General Revenue collections rose an average of 3.8% per year, resulting in net General Revenue collections of \$6.3895 billion in FY 2001.

Both time frames indicate solid growth in the state’s general revenue. **By comparison, the last four fiscal years (FY 2001-FY 2004) have resulted in an average decline in general revenue collections of 0.6% per year** (or an average revenue growth rate of -0.6%).

Even with the improved growth of FY 2004, Missouri has fallen significantly behind the historical growth of the last 20 years. Given that Missouri was able to maintain the 5% growth rate over a twenty year period, it’s reasonable that a 5% growth rate is relatively attainable. The following table contrasts Missouri’s actual revenue growth rate of the last five years with what it might have been, had the historical 5% growth rate been sustained.

Actual General Revenue Compared with Sustained 5% Growth
Amounts in Millions

Fiscal Year	Actual Net General Revenue	% Actual Growth	General Revenue at 5% Growth	Net General Revenue “Deficit”
2001	\$6389.5	3.8%	\$6389.5	\$0
2002	\$6210.9	-2.7%	\$6708.9	\$498
2003	\$5926.1	-4.5%	\$7004.3	\$1078.2
2004	\$6345.8	7.1%	\$7356.5	\$1010.7
2005	\$6493.6 ⁴	2.3%	\$7724.3	\$1230.7

Based on this 5% standard growth, the table demonstrates that the Missouri budget is encountering a shortfall on the order of more than \$1.2 billion in FY 2005, compared with what it reasonably could have been based on pre-fiscal crisis levels.

Is FY 2005 Revenue Adequate - What About The Budget Cuts?

If the economic forecast and resulting revenue growth of 2.3% is accurate, the ability of state revenue to meet current and ongoing needs is questionable. The increase in general

³ General Revenue Growth was calculated simply by reviewing the history of General Revenue collections as recorded by the Office of Administration for this time period. The paper specifies and uses “net” general revenue numbers, indicating that state tax refunds amounts have already been deducted from total GR figures.

⁴ FY 2005 amount is based on the Consensus Revenue Estimate as agreed upon by the Office of Administration and Senate Appropriations Staff. This is the amount that was used to determine appropriations levels for FY 2005. It is likely that this amount could fluctuate as tax revenues are collected throughout the year.

revenue from fiscal year 04 to 05 is a net of \$147.8 million. This relatively conservative, albeit stable, growth may not be enough to sustain the increased need for funds to continue current state programs. For example, while general inflation grew by 2.2% in fiscal year 2004 as measured by the national consumer price index, health care costs grew by 4.1% for current programs, not including future expansions. Additionally, changes in federal mandates, including the new Medicare Prescription Drug benefit are expected to cost the state of Missouri tens of millions of dollars. These are dollars the state did not expend in FY 2004.

Moreover, the FY 2002 – 2004 fiscal crisis in Missouri resulted in significant core cuts to vital programs, totaling more than \$1.3 billion dollars. **As a result, the state enters FY 2005 with a series of unmet needs and program “deficits” in need of restoration including:**

- Missouri’s school foundation formula is “underfunded” by \$600 million, according to the Department of Elementary and Secondary Education.
- Higher Education cuts of \$70 million have resulted in a \$1,700 average tuition increase for Missouri’s four-year institutions, as well as class consolidations and limiting of course offerings. The cuts and tuition increases affect 80,000 Missouri students.
- Significant cuts to Medicaid eligibility resulted in at least 37,000 less Missourians having access to healthcare; at the same time health care costs are increasing, and more Missourians may be turning to publicly-funded health care for their families.
- Additionally, in the next decade, Missouri will start to see a dramatic increase in healthcare need for seniors entering retirement.
- In addition, should the Transportation Ballot Issue be approved by voters in November, this will result in additional loss to the General Revenue fund of between \$160 - \$180 million beginning in FY 2006.

While legislators and the public may disagree regarding whether or not the full level of budget cuts should be restored, it is clear that education and health care are priorities for Missourians. At minimum, the state would need more than \$900 million to restore these few basic services to their pre-fiscal crisis programming level. Clearly, the anticipated \$147.8 million growth in general revenue in FY 2005 will not be enough to meet this need. Further, even a 5% growth in FY 2006 would not be sufficient for this restoration.

While the revenue decline of the fiscal crisis has stalled, and general revenue is seeing positive and real growth, Missouri’s revenue has not rebounded fully from the fiscal crisis.

Implications for the Missouri Budget: Looking Ahead:

While the state general revenue growth of the last year indicates Missouri is moving in a more positive fiscal direction, the state is still well behind where it should be based on historical standards. The state remains unable to meet its basic funding needs such as education and healthcare. Further many of the factors that created the state fiscal crisis remain, and may make for unstable revenue collections in FY 2005 and beyond.

The legislative changes that continue to impact Missouri in FY 2005 include:

- **State Tax Cuts** - The Missouri General Assembly passed a series of significant tax cuts in the late 1990s that continue to impact state general revenue, costing the state \$700 million in the current fiscal year.⁵
- **Federal Tax Law Changes** - The three federal tax cuts signed by President Bush will continue to erode Missouri General Revenue. Most notably, the losses will result from the elimination of the estate tax which produced \$75.2 million in FY 2004, the increase in the standard deduction for married couples (marriage penalty) and the continued availability of so-called “bonus depreciation” for business equipment purchases.
- **Tax Credit Programs** – While improper use of tax credit programs is undergoing additional scrutiny, substantial potential tax credit redemptions remain that could substantially erode Missouri General Revenue. The timing and the magnitude of these redemptions is difficult to predict.

Economic factors that could impact state revenue estimates include:

- **A federal budget deficit in excess of \$500 billion.** The Congressional Budget Office currently projects “on-budget” deficits of \$638 billion and \$537 billion for federal fiscal years 2004 and 2005 respectively. Deficit amounts impact the federal government’s ability to provide adequate funding to states and localities for federal mandates.
- **Actions taken in June by the Federal Reserve to increase interest rates.** Many economists believe another round of interest rate increases is likely, which may curtail consumer spending.
- **Sharply higher gasoline prices** relative to last year coupled with the uncertainty of the Iraq/ Middle East situation. The national average price for unleaded regular gasoline rose 34.2% from June of 2003 to June of 2004, according to the Bureau of Labor Statistics. This may curtail consumer spending.
- **A stagnant stock market.** The Dow Jones Industrial average stood at 9815 at the close of trading on August 6, 2004, which is 6.2% below the level achieved at the beginning of 2004.

In summary, the U.S. economy is improving, but the above factors will almost certainly inhibit growth, and at minimum create an unstable economic environment. The sources of revenue Missouri historically depended on have been reduced and will continue to erode state revenue. The implication is that, without intervention, Missouri’s revenue will not likely ever return to its pre-fiscal crisis health if relying on economic growth alone.

⁵ These tax cuts now result in a loss of about \$700 million each year. For more information see *MISSOURI’S FISCAL CRISIS REMAINS SEVERE: Revenue Options are Available as Compared to Continued Spending Cuts*, Amy Blouin and Jennifer Hill, Missouri Budget Project, January 2004 at www.mobudget.org

Summary:

- Even with strong revenue growth in the last year, Missouri general revenue is still well below where it should be based on historical growth rates.
- The anticipated general revenue for FY 2005 may not be enough to meet the inflationary needs of the budget to continue current state programs.
- Additionally, Missouri has made severe budget cuts in the last four years that will continue to limit the overall fiscal health of state and impede the state's ability to adequately provide for basic services, including education and healthcare.
- Many of the "deficits" in state spending, created by the fiscal crisis, won't be able to be addressed in the next year unless the hole left in Missouri's revenue, resulting from the fiscal crisis, can be fixed.
- Economic conditions alone will not fill the deficit left in general revenue from the fiscal crisis, because many of the causal factors creating the crisis still exist.

While Missouri's general revenue situation is improved over the last three years of the fiscal crisis, the state has not yet attained the level of general revenue that it should feasibly have. Policy makers, the public and advocates will need to work together on proactive policy solutions to heal the state's budget woes. In other words, Missouri's fiscal crisis is not yet resolved.