MISSOURI BUDGET PROJECT

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Tax Cuts Fling Missouri Toward Massive Budget Cliff

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Following the legislative veto session held in September, the Governor released a number of his previous restrictions to the state budget. The release of funding included $143 million for K-12 and higher education, and an additional $22 million for mental health services, aid to counties, and job training. This action was possible because the legislature upheld the Governor's veto of a number of new sales tax exemptions that would have taken effect in the current year and would have compromised the state revenue available for public services.[1]

However, weak state general revenue collections continue to necessitate reductions for state fiscal year 2015, which began on July 1st. Specifically, $730 million in spending restrictions and $275 million in spending vetoes remain in the budget, reducing funding available for an array of critical public services including dental and mental health care for Missourians with disabilities, newborn health screenings, services for seniors and more. **Unfortunately, Missouri's current budget challenges are just the beginning of a steep and largely self-imposed fiscal cliff brought about by additional tax cuts approved by lawmakers this year.**

After tax cuts are fully implemented, Missouri will be <u>$1.95 billion short</u> of the revenue needed to fully fund education & maintain the level of state services provided last year.

The following analysis demonstrates that if the state were to simply maintain funding for services included in last year's budget, and fully fund the K-12 school funding formula, it would face a $1 billion revenue shortfall in FY 2015. **But by the time the tax cuts are fully implemented in FY 2023, to maintain these same services, Missouri will face a $1.95 billion shortfall – a massive fiscal cliff.**

In context, that amount is the equivalent of about two-thirds of current funding for K-12 schools, or Missouri's general revenue budget for public colleges, mental health, public safety and corrections <u>combined</u>.[2]

This cliff results from tax cuts enacted by Senate Bill 509 (SB 509), which are phased in over a period of years beginning in 2017. Because the cuts are phased in, the total impact of the measure will not be fully realized until FY 2022, at which time the cost will be at least $621 million annually, according to the legislature's own fiscal note. **However, the cost of the tax cuts only tells a portion of the story.**

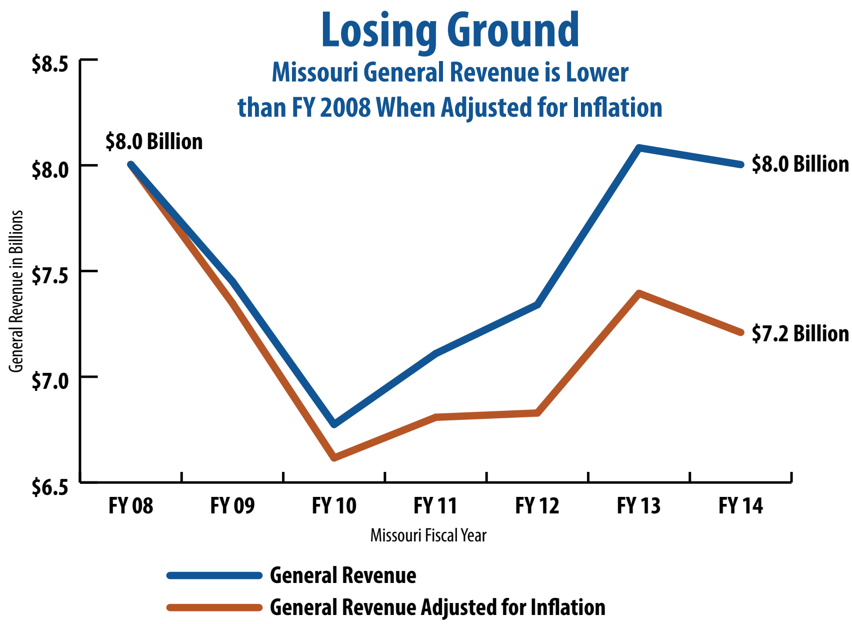
These tax cuts come at a time when critical public services can ill afford cuts to services. Many public services, including higher education, early childhood education, mental health care and public health, are still recovering from reductions made during the Great Recession. Weak state revenue over the last decade has also already compromised Missouri's ability to fully fund its local K-12 school districts, which are funded about $540 million below the legislature's own required funding level, referred to as the "foundation formula."[3]

Missouri Still Recovering from Great Recession

Missouri ended state fiscal year 2014 (FY 2014) on June 30th with a decline in general revenue collections compared to the previous year. Total general revenue reached $8.003 billion in FY 2014, about one percent less than the $8.082 billion reached in fiscal year 2013 (FY 2013).[4]

Moreover, the level of general revenue attained in FY 2014 is nearly identical to the $8.0039 billion attained in FY 2008, **indicating no growth in nominal dollars over the last six years. However, when accounting for inflation, the real purchasing power of state general revenue in FY 2014 remains nearly $800 million behind its FY 2008 level.**

As a result, Missouri's general revenue services are still struggling to recover from the Great Recession. Not only is state funding for K-12 schools currently about $540 million under the required level, but a number of other critical public services are still below pre-recession levels:



- State funding for non-Medicaid mental health services for children and adults with severe mental illness and developmental disabilities was cut by $17 million between FY 2010 and FY 2013.[5]
- Funding reductions have contributed to a shortage of hospital beds for acute psychiatric care, straining local law enforcement agencies that often have to travel great distances to transport individuals to open beds.[6]
- Missouri's public higher education institutions received $93 million less in state general revenue funding in FY 2014 than they received in FY 2010.[7]
- Missouri cut 4,500 state employee positions between FY 2010 and FY 2014.[8]

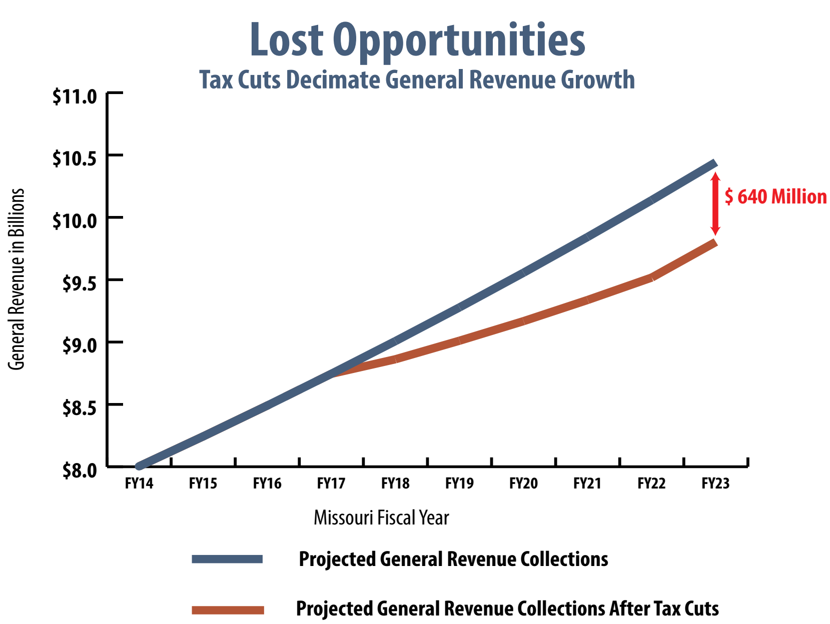
These are just a few examples of the current position of critical public services in Missouri. However, as tax cuts are implemented, Missouri will be unable to fund even this greatly reduced level of services.

Tax Cuts Will Leave Missouri Billions Short

Despite its many cuts to services since FY 2008, Missouri ended FY 2014 with a revenue shortfall. FY 2014 revenue was approximately $241 million below legislative projections and about $307 million below the Governor's projection of revenue for the year. Because these higher estimates were used when determining last year's budget, **the state begins the FY 2015 budget year needing to make up for that shortfall, even prior to the implementation of tax cuts.**

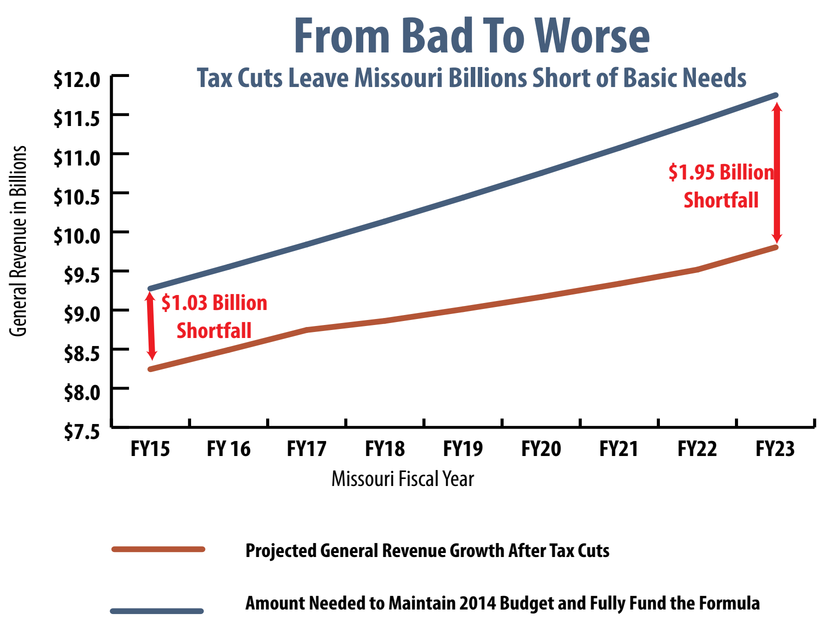
This short-term weakening of general revenue was at least partially due to the Great Recession and may have been recoverable but for the passage of Senate Bill 509. **Conservatively, the tax cuts required under SB 509 will cost at least $621 million when fully implemented, according to the official fiscal note for the bill.**[9] Due to inflation, this increases to $640 million in FY 2023 and will continue to increase annually.

The measure includes a reduction in the top rate of income tax from 6 to 5.5 percent and a business income deduction of 25 percent. It will be phased in beginning in 2017 over a period of at least five years.[10]



To estimate the long-term impact of the tax reductions on Missouri services, the Missouri Budget Project used the most conservative fiscal note estimate of SB 509, projecting general revenue growth through FY 2023. These projections are then juxtaposed with the amount of general revenue needed to simply maintain the already anemic FY 2014 general revenue funding levels for state services and fully fund the requirements of Missouri's K-12 foundation formula. **The result is stark.**

Assuming all of the tax cuts are implemented, Missouri faces a $1.03 billion shortfall in FY 2015, increasing to a $1.95 billion shortfall by FY 2023 when the bill is fully implemented.[10] The projected shortfall takes into account only what it would take for Missouri to meet its obligations for funding K-12 education and continue the FY 2014 budget. Other than fully funding K-12, the shortfall does not include funding to restore services to their pre-recession levels.



Under the tax cuts, Missouri will likely never be able to meet the needs of its citizens and restore services to pre-recession levels. Further, it is likely that Missouri will struggle to provide adequate funding to meet the K-12 funding formula requirements.

Missouri's lack of revenue to deliver quality education, health, infrastructure, and other critical services will compromise its ability to compete for and maintain quality 21st century jobs and slow the state's economic growth.

Endnotes

[1] In July, the Governor enacted a number of spending restrictions and budget vetoes to the FY 2015 Budget, which totaled $1.1 billion, including federal and other special funds. The Governor released a number of these restrictions in September, but also added some. As of October 6, 2014, the net total restrictions, including all funds, for FY 2015 remain at about $730 million. The spending vetoes remain at $275 million.

On the final day of the state legislative session, lawmakers approved a series of bills that would have created a number of new sales tax exemptions and other targeted tax cuts. According to the official fiscal notes for the bills, the measures combined would have reduced state general revenue by $145.7 million in FY 2015.

[2] The calculations are based on the FY 2014 Appropriations, as detailed in the "2013 Annual Fiscal Report," prepared by the Missouri Senate Appropriations Committee.

[3] Missouri Department of Elementary and Secondary Education

[4] The decline in general revenue is broadly attributed to an artificial jump in state income tax revenue collected in FY 2013 that is related to accelerated reporting of capital gains for tax purposes and connected with federal tax changes that took effect in 2013. That FY 2013 bump in general revenue creates a "flattening" of revenue in FY 2014 by comparison.

[5] Missouri Coalition of Community Mental Health Centers

[6] Missouri Coalition of Community Mental Health Centers

[7] FY 2014 state general revenue funding for community colleges and four-year institutions combined was $866 million; in FY 2011 the combined funding level was $959 million; in FY 2001 the combined funding level was $914 million – the equivalent of $1.2 billion when adjusted for inflation to today's dollars.

[8] Missouri Executive Budget, Fiscal Year 2014 Summary

[9] The official Fiscal Note for the Senate Floor Substitute for Senate Bill 509 indicates a cost of $620 million. However, Missouri Budget Project's (MBP) believes the actual cost could be closer to $799 million when fully implemented. The main distinctions between the MBP analysis and the fiscal notes appear to be: MBP utilizes calendar year 2013 individual income tax data as a base, while the fiscal notes use calendar year 2012; and MBP utilizes IRS data to determine the impact of tax changes on business income, which begins with a larger base of what is considered business income as compared to the data sources relied on in the fiscal note. However, for the purposes of this analysis, MBP uses the official fiscal note to project out the long term impact on the budget.

[10] Although the bill was vetoed by the Governor, the State Legislature voted to override the Governor's veto in May, putting the measure on course to become law. The tax cuts are phased in over a 5 year period, beginning in 2017. The phase-in includes a "trigger" which requires state revenue to grow by $150 million for each step in implementation to occur. However, that "trigger" would not even allow state revenue to grow to the degree needed to account for inflation, let alone make up for the reduced spending levels resulting from the recession. Further, if the $150 million amount is not triggered in one year, the phase-in will simply be extended. The resulting impact is

APPENDIX – Detailed Tables

Impact of Tax Cuts on General Revenue FY 2014 – FY 2023 *Amounts in Billions Unless Otherwise Noted*			
Fiscal Year	Projected General Revenue Without Tax Cuts	Cost of Senate Bill 509	Projected General Revenue After Tax Cuts
2014	$8.0033	$0.0	$8.0033
2015	$8.2434	$0.0	$8.2434
2016	$8.4907	$0.0	$8.4907
2017	$8.7454	$0.0	$8.7454
2018	$9.0078	$145.7 million	$8.8621
2019	$9.2780	$267.2 million	$9.0108
2020	$9.5564	$388.6 million	$9.1678
2021	$9.8430	$505.5 million	$9.3375
2022	$10.1383	$621.0 million	$9.5173
2023	$10.4425	$639.6 million	$9.8029

Projecting the Shortfall FY 2014 – FY 2023 *Amounts in Billions*			
Fiscal Year	Amount Needed to Maintain the FY 2014 General Revenue Budget AND Fully Fund the K-12 Formula	Projected General Revenue After Tax Cuts	Shortfall Amount
2015	$9.2749	$8.2434	-$1.0315
2016	$9.5531	$8.4907	-$1.0624
2017	$9.8937	$8.7454	-$1.0943
2018	$10.1349	$8.8621	-$1.2728
2019	$10.4390	$9.0108	-$1.4282
2020	$10.7522	$9.1678	-$1.5844
2021	$11.0747	$9.3375	-$1.7372
2022	$11.4070	$9.5173	-$1.8897
2023	$11.7492	$9.8029	-$1.9463

The Missouri Long Term Revenue Outlook

In inflation-adjusted dollars, Missouri general revenue is unable to return to pre-recession levels due to the 2014 tax cuts

The Purchasing Power of General Revenue FY 2008 – FY 2030 Under Tax Cuts, General Revenue May Never Reach Pre-Recession Levels *Amounts in Billions*		
Fiscal Year	General Revenue in Nominal Dollars	General Revenue Adjusted to FY 2008 Dollars
2008	$8.0039	$8.0039
2009	$7.4508	$7.3479
2010	$6.7743	$6.6160
2011	$7.1096	$6.8084
2012	$7.3406	$6.8286
2013	$8.0827	$7.3945
2014	$8.0033	$7.2097
2015	$8.2434	$7.2803
2016	$8.4907	$7.3445
2017	$8.7454	$7.4020
2018	$8.8621	$7.3249
2019	$9.0108	$7.2733
2020	$9.1678	$7.2266
2021	$9.3375	$7.1879
2022	$9.5173	$7.1546
2023	$9.8029	$7.1965
2024	$10.0969	$7.2387
2025	$10.3999	$7.2811
2026	$10.7119	$7.3237
2027	$11.0332	$7.3667
2028	$11.3462	$7.4098
2029	$11.7051	$7.4532
2030	$12.0563	$7.4969

Notes for the Tables

1. All numbers through FY 2014 are "Actual," provided by the Missouri Office of Administration
2. General revenue from FY 2015 and beyond is estimated to grow by 3 percent in each year prior to the impact of the tax cuts
3. Net general revenue in constant fiscal year 2008 dollars is calculated by the Missouri Budget Project using inflation estimates provided by the Congressional Budget Office