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Missouri Revenue: Digging Out from a Hole Only to Go Over a Tax Cut Cliff

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Weak general revenue collections for fiscal year 2014 (FY 2014) combined with a flurry of ill-conceived tax cuts passed by state lawmakers during the most recent state legislative session have necessitated significant spending restrictions to the new state budget for fiscal year 2015, which took effect on July 1st. [1] **Unfortunately, these restrictions are just the beginning of a steep fiscal cliff for Missouri.**

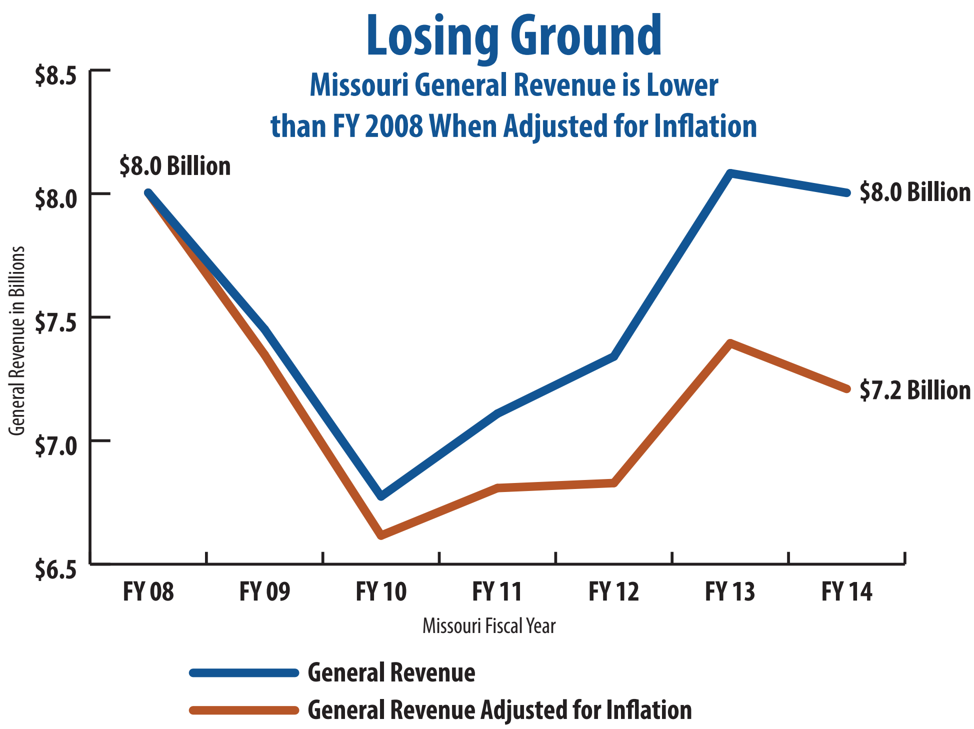
In addition to tax cuts that will take effect during the current fiscal year, Senate Bill 509, by far the largest of the tax cut measures, will be phased in over a period of years beginning in 2017. As a result, the total impact of the combined tax cut measures will not be realized until FY 2023, when that bill is projected to be fully implemented.

If Missouri were to simply maintain funding for services included in the FY 2014 budget, and fully fund the K-12 school funding formula, it would face a $1.15 billion revenue shortfall in FY 2015. ***But*, by the time the tax cut measures are all fully implemented in FY 2023, to maintain these same services, Missouri would face a $2.13 billion shortfall – a massive fiscal cliff.** In context, that amount is the equivalent of two-thirds of current funding for K-12 schools; *or* it is equal to Missouri's general revenue budget for public colleges, mental health, public safety and corrections combined.[2]

These tax cuts come at a time when critical public services can ill afford cuts. 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 $556 million below the legislature's own required funding levels, referred to as the "foundation formula."

Digging Out of a Hole: Missouri Still Recovering from Great Recession, Lags FY 2008 Purchasing Power

Missouri ended state fiscal year 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).[3]



[1]The Governor's FY 2015 spending restrictions and budget vetoes totaled $1.1 billion, including federal and other special funds. The general revenue restrictions included $144 million in line item vetoes and another $641 million in spending restrictions.
[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]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 bump in general revenue in FY 2013, creates a "flattening" of revenue in FY 2014 by comparison.

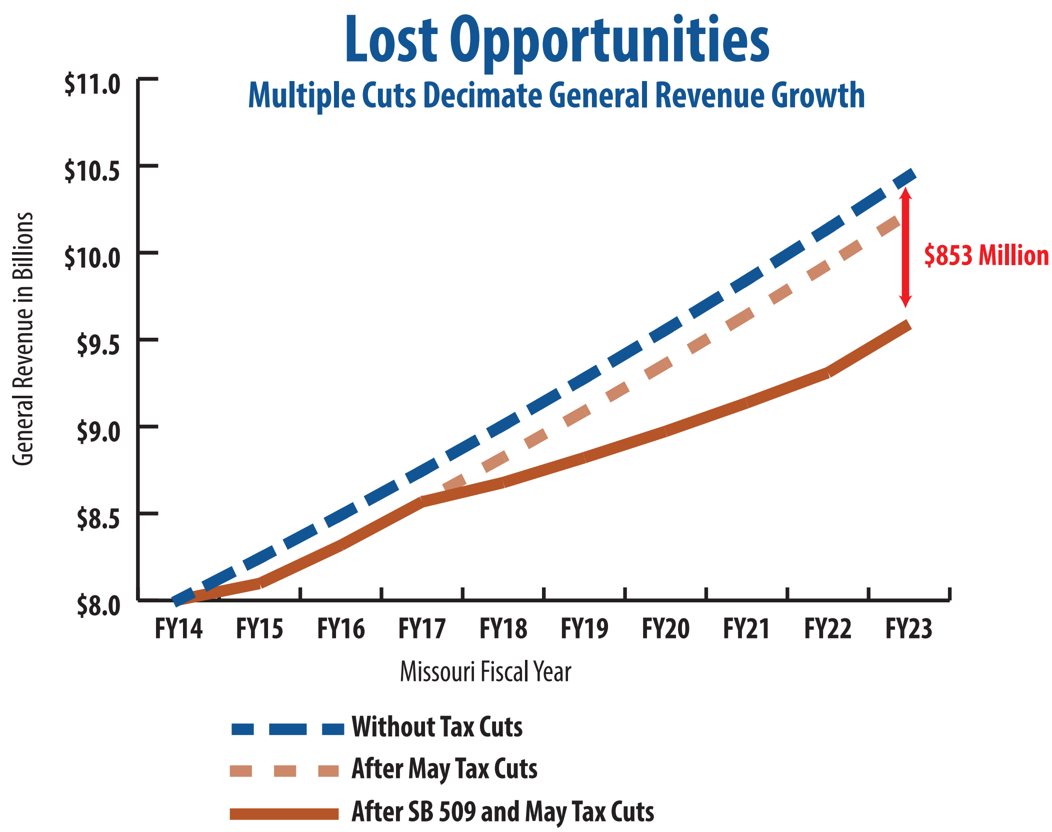
Moreover, it is notable that Missouri's general revenue is still recovering from the Great Recession. The level of general revenue attained in FY 2014 is nearly identical to the level of general revenue attained in FY 2008 of $8.0039 billion, indicating no growth in nominal dollars over the last six years. **However, when accounting for inflation, <u>the real purchasing power of state general revenue in FY 2014 remains nearly $800 million behind its FY 2008 level.</u>**

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 $556 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.[4] In addition, a shortage of hospital beds for acute psychiatric care resulting from funding reductions is impacting local law enforcement agencies, which often have to travel great distances to transport these individuals to an open bed.[5] Missouri's public higher education institutions received $93 million less in state general revenue funding in FY 2014 than they received in FY 2010.[6] And, Missouri cut 4,500 state employee positions between FY 2010 – FY 2014, increasing caseloads for child protection caseworkers and others, and compromising the safety of Missouri children as a result. 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.

Only to Be Headed for a Cliff: Tax Cuts Will Leave Missouri Billions Short

FY 2014 revenue was also approximately $241 million below legislative projections and approximately $307 million below the Governor's projection of revenue for the year. Because these higher estimates were used when determining the budget for the year, **despite its many cuts to services since FY 2008, Missouri ended FY 2014 with a revenue shortfall. The state begins the FY 2015 budget year needing to make up for that shortfall, <u>even prior to the implementation of tax cut measures that could take effect during the fiscal year.</u>**



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[4]Missouri Coalition of Community Mental Health Centers

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[6]FY 2014 state general revenue funding for community colleges & 4-year institutions combined is $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

[7]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) analysis estimates the fully implemented impact 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.

[8]The Office of Administration, Division of Budget and Planning has estimated that the bills will reduce state general revenue by an $282 million in FY 2016. In addition, the bills will reduce other dedicated funding streams that are funded through sales taxes, including conservation and transportation funding, resulting in total revenue loss of $425 million per year, also according to the Division of Budget and Planning.

This "short-term" weakening of general revenue was at least partially due to the "Great Recession" and may have been recoverable but for the flurry of shortsighted tax cut measures that were approved by state lawmakers in 2014. **Conservatively these measures will cost more than $800 million annually, when fully implemented.**

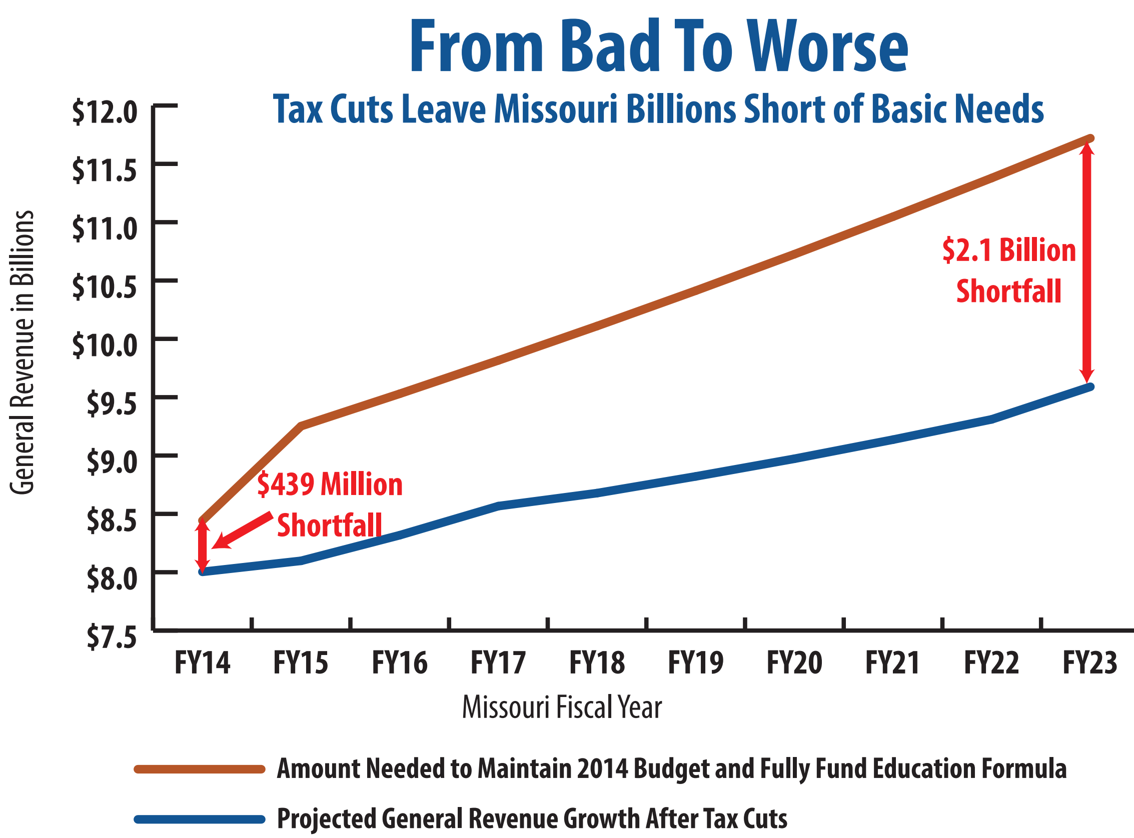
The cuts include:

Senate Bill 509: **The largest tax cut bill, which when fully implemented will reduce state general revenue by at least $621 million according to the official fiscal note for the bill.**[7] The bill 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 5 years. The bill was passed by state lawmakers in April, and vetoed by the Governor in May. The legislature voted to override the Governor's veto in May, putting the measure on course to become law.

"Last Day" Tax Cuts: On the final day of the state legislative session, lawmakers approved a series of bills that create a number of sales tax exemptions and other targeted tax cuts. **According to the official fiscal notes for the bills, the measures combined will reduce state general revenue by $145.7 million in FY 2015 and $173.5 million in FY 2016.** These amounts are the most conservative estimate of the impact of the bills.[8] These bills were vetoed by the Governor in June, but state lawmakers have the ability to override those vetoes during the September legislative veto session.

In order to the estimate the long term impact of the tax reductions on Missouri services, the Missouri Budget Project analyzed the impact of the tax cuts over the next ten years. Using the most conservative fiscal note estimates of the tax cut bills, general revenue growth is projected from FY 2014 through FY 2023.

This is 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 that all of the tax cuts are implemented, Missouri faces a $1.15 billion shortfall in FY 2015, increasing to a $2.13 billion shortfall by FY 2023, when all of the tax cuts have been fully implemented.**[9] The projected shortfall amount 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 for K-12, the shortfall does not include funding to restore services to their pre-recession levels.



[9]For the purposes of this analysis, MBP projected a 3 percent growth annually in general revenue prior to adjusting for the cost of the tax cuts. MBP also utilized a 3 percent inflationary growth formula to adjust the budgetary needs annually to keep pace with FY 2014 level of funding.

Under the tax cuts, Missouri will likely never be able to restore services to pre-recession levels and meet the needs of its citizens. 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.

APPENDIX – Detailed Tables

Impact of Tax Cuts on General Revenue FY 2014 – FY 2023 *Amounts in Millions*				
Fiscal Year	Projected General Revenue Without Tax Cuts	Cost of Senate Bill 509	Cost of the "Last Day" Tax Cuts	Projected General Revenue Under the Tax Cuts
2014	$8,003.3	$0.0	$0.0	$8,003.3
2015	$8,243.4	$0.0	$145.7	$8,097.7
2016	$8,490.7	$0.0	$173.5	$8,317.2
2017	$8,745.4	$0.0	$178.7	$8,566.7
2018	$9,007.8	$145.7	$184.1	$8,678.0
2019	$9,278.0	$267.2	$189.6	$8,821.2
2020	$9,556.4	$388.6	$195.3	$8,972.5
2021	$9,843.0	$505.5	$201.1	$9,136.4
2022	$10,138.3	$621.0	$207.2	$9,310.2
2023	$10,442.5	$639.6	$213.4	$9,589.5

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 Under Implementation of Tax Cuts	Shortfall Amount
2014	$8.4427	$8.0033	-$439.4 million
2015	$9.2520	$8.0977	-$1.1543
2016	$9.5295	$8.3172	-$1.2123
2017	$9.8154	$8.5667	-$1.2487
2018	$10.1099	$8.6780	-$1.4319
2019	$10.4132	$8.8212	-$1.5920
2020	$10.7256	$8.9725	-$1.7531
2021	$11.0473	$9.1364	-$1.9109
2022	$11.3788	$9.3102	-$2.0686
2023	$11.7201	$9.5895	-$2.1306

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	$8.0977	$7.1517
2016	$8.3172	$7.1944
2017	$8.5667	$7.2507
2018	$8.6780	$7.1728
2019	$8.8212	$7.1203
2020	$8.9725	$7.0726
2021	$9.1364	$7.0331
2022	$9.3102	$6.9988
2023	$9.5895	$7.0399
2024	$9.8772	$7.0811
2025	$10.1735	$7.1226
2026	$10.4787	$7.1643
2027	$10.7930	$7.2063
2028	$11.1168	$7.2485
2029	$11.4503	$7.2910
2030	$11.7938	$7.3337

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