The MISSOURI BUDGET PROJECT

February 25, 2005

Show Me the Money: Real Fixes for the Fiscal Crisis

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Missouri Governor, Matt Blunt, has submitted the Fiscal Year 2006 State Budget to the Missouri Legislature for consideration. The Governor's budget would make "core reductions" in funding for state programs of $362.2 million in state general revenue and an additional reduction of $737.7 million in federal and other funds for a **combined cut to state services of $1.1 billion dollars.**[1]

In the past five years Missouri has been in the midst of one of the worst fiscal crises in state history. Net revenues have been at or below the amount collected in previous years with no growth to cover the inflationary needs of state programs. In fact, net general revenue collections for Fiscal Year 2004 were actually $44 million below collections in Fiscal Year 2001.[2]

As a result, Missouri has already made combined core reductions of nearly $1.4 billion in state services and programs. Half of these cuts came from the programs in the Departments of Health & Senior Services, Mental Health and Social Services. Governor Blunt's budget proposes to nearly double the impact of state budget cuts in the past five years for the Departments of Social Services and Mental Health, creating a disproportionate burden on programs that serve people in poverty and people with disabilities.

Department – General Revenue Core Cuts only (does not include federal)	*FY 2002*	*FY 2003*	*FY 2004*	*FY 2005*	*Total To Date*	*Governor's FY 2006 Plan - General Revenue Cut Amounts*
Elementary & Secondary Education	$20.1	$62.1	$58.0	$22.6	$162.8	$7.2
Higher Education	$9.6	$99.7	$42.9	$1.3	$153.5	$5.1
Social Services	$88.3	$303.6	$110.6	$55.3	$557.8	$264.2
Mental Health	$11.2	$36.5	$27.6	$12.5	$87.8	$50
Health	$3.4	$12.1	$13.6	$2.4	$31.6	$15.6
Public Safety	$5.6	$5.2	$8.4	$0.9	$20.2	$1.6
Corrections	$12.8	$39.1	$6.4	$20.8	$79.0	$.1
All Other State Departments	$56.7	$129.0	$75.8	$35.8	$297.2	$18.4
Total in Millions of Dollars	**$207.8**	**$687.3**	**$343.2**	**$151.6**	**$1,389**	**$362.2**

[1] Core Reduction refers to reductions in funding from the baseline of what is required to continue current state programs and services. The numbers provided were taken from the Governor's *Fiscal Year 2006 Budget in Brief* which can be accessed at http://www.oa.mo.gov/bp/execbudgets.htm.

[2] Several factors collided to create the State's Fiscal Crisis, including a series of state tax cuts that resulted in an 11% annual reduction in the State General Revenue. For more information, please see *Missouri's Fiscal Crisis Remains Severe: Revenue Options are Available as Compared to Continued Spending Cuts (PDF) January 2004* available at www.mobudget.org

The FY 2002 – FY 2005 Core Reductions: The core reductions the State has already made have had severe and lasting impacts. Some examples of the results of the cuts include:

- Higher Education Reductions have resulted in tuition increases averaging $1,180 per year at Missouri's 4-year institutions, impacting 80,000 Missouri resident students;
- Local Property Tax Increases have been passed in districts representing 22% of the student population in elementary and secondary schools. The taxes have been passed to offset the loss of state funds to local school districts. The average increase for a $100,000 home is $102.60 per year;
- More than 8,000 people have been impacted by cuts to mental health services including cuts to people with developmental disabilities, adults and children with severe psychiatric needs and others;
- Child Care Assistance eligibility levels for Missouri's families has dropped from 125% of the federal poverty level to 112% of the federal poverty level for a family of three, impacting thousands of Missouri low-income families; and
- Nearly 100,000 Missourians have lost access to health care services or have increased costs for health care access as a result of cuts to the state's Medicaid program and other health care programs. [3]

Why Missouri should get out of the "cycle of the cuts": The Core reductions above have very real consequences for Missourians due to diminished access to services as well as increased fees for a variety of services. They have very real economic consequences as well. For every dollar the state chooses to not spend on Medicaid, the state loses $2 in federal funding that comes to Missouri to support the health care industry and health care access. Some of the proposed cuts to mental health will take the State below what is required for federal maintenance of effort and will reduce federal funds for mental health for an extended period.

Further, although the economic perils of tax increases are often touted**, further spending cuts could actually be more damaging to the Missouri's economy than tax increases.** As Nobel Prize-winning economists Joseph Stiglitz and Peter Orszag of the Brookings Institution have pointed out, a $1 reduction in state public-sector spending typically results in a $1 reduction in a state's economic activity. A $1 increase in taxes, by contrast, is likely to result in a smaller reduction in a state's economic activity, because to some extent the tax increase would be financed out of reduced savings, or from reduced out-of-state consumption.

Revenue-Raising Options: The Missouri Legislature has a significant choice to make in the 2005 session. It can choose to continue the cycle of cuts, with human and economic consequences or it could choose to escape the cycle of cuts and address the fiscal crisis with several revenue raising options. **These options total $2 billion in new revenue.** Missouri would only need to generate $362 million in state funds in order to recoup the federal funding it is forfeiting in the Governor's proposed budget and to keep current programs funded. Some available options are detailed below:

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[3] For more detail on the core reductions in Missouri, see *Federal Policies are Worsening Missouri's Budget Problems* *September 15, 2004* available at www.mobudget.org

Utilizing the State's Rainy Day Fund $250 million: Missouri is one of only a handful of states that has chosen not to use the state's Rainy Day Fund during the budget crisis. While the Rainy Day Fund would do little to restore the long term sustainability of Missouri's tax structure, it would respond to the immediate need to stabilize the budget in the current year.[4] Utilizing the Rainy Day Fund would allow the state to consider more long term solutions. The barrier for the legislature in using the Rainy Day Fund has been the repayment requirement. Missouri statute requires that the fund be repaid over a three-year period starting in the next fiscal year. This "pay-back" mechanism is only required in eight states and creates a very real barrier in utilization. A more sensible design for the Rainy Day Fund would be to require "pay-back" only when economic growth creates strong revenue growth.

Eliminating the HMO Premium Tax Exemption $63.4 million: Missouri Law currently assesses on most insurance companies a "premium tax" of 2% on gross premium receipts. Expanding the law to include HMOs and other health services corporations would generate an estimated $63.4 million in new revenue.

Decoupling from the Federal Estate Tax and Accelerated Depreciation $167 million: Many states have chosen to decouple from the federal tax code on both the estate tax changes and the accelerated depreciation. Decoupling would allow the state to retain the accelerated depreciation and estate taxes it had in the pre-2001 federal tax code. Decoupling has the additional benefit of bringing relatively immediate fiscal relief in the fiscal year of passage. Missouri previously chose to decouple on the accelerated depreciation change for one year in 2002. This option has an additional advantage in that taxpayers who benefit from the federal tax cuts still maintain those tax reductions.

Closing Corporate Tax Loopholes $34.1 million: Significant to the decline of general revenue has been a decline of corporate income tax paid to Missouri. Corporate taxes previously brought in about $500 million in general revenue at their peak, but have declined to $200 million in recent years.[5] 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". This "Loophole" allows a corporation with national franchises to transfer profits to other states, thereby avoiding Missouri tax. At the same time, Missouri-bred corporations are required to make income tax payments. Adjusting this loophole could raise about $15 million annually.[6] 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. Missouri could regain those funds by applying the same tax rules that individuals have to abide by to corporations, and not allow companies to profit from paying taxes on time.

"$5 A Week" $680 Million: Eric Mink, of the *St. Louis Post Dispatch* in a February 2005 commentary suggested increasing Missouri's 2.6 million individual tax returns each by just $5

[4] Most significant tax alterations would require a vote of the people, delaying the potential fiscal impact they could have. The Rainy Day Fund could be used in the current year.
[5] January 16-22, 2004 Times Newspapers Online: *Legislature Looks to Overhaul State Tax System*, www.timesnewspapers.com/stories/20040116/taxsystem.html
[6] Governor's Budget Proposal Fiscal Year 2004, http://www.oa.mo.gov/bp/execbudgetdocs.htm

more per week. This would generate an additional $680 million in new revenue for the state. An increase in the individual income tax of this level would amount to $260 more in taxes per year for Missouri residents. The impact on low income taxpayers could be offset by exempting taxpayers who qualify for the Federal Earned Income Tax Credit from this increase. This is just one example, a more modest increase or an increase that's graduated based on income would generate different levels of revenue.

Increasing the Cigarette Tax by 40 cents per pack, Estimated $225 million: Proposed for several years, an increase in the cigarette tax could generate $225 million and bring Missouri in line with what other states, including Missouri's border-states, assess for cigarette tax. Taxes on other tobacco products could generate even more.

Increasing the Alcohol Tax $45 million: A proposal before the legislature for several years has been an increase in the beer, wine and liquor taxes. The amount generated would range from $21 to $45 million.

Taxes on Gaming $51 - $116 Proposals to repeal Missouri gambling loss limits for individuals and would add a 1% surcharge on a gaming boat's adjusted gross receipts (AGR) tax for boats with greater than $20 million in receipts would generate $65 million in new revenue. Other proposals to increase of the gaming boat admission fee by $5 would generate $51 million

Taxing Services, Between $335- $888 million:* A changing landscape of the economy from a manufacturing base to a more service oriented base and purchasing of citizens through e-commerce and other venues, makes current Missouri sales tax law volatile. One means to increase the stability of the sales tax is to broaden the base of what is taxed, to incorporate more service industries. Missouri currently taxes 11 services including services such as pet grooming, marina services, and residential gas. A more comprehensive approach would make the sales tax a more adequate revenue source for the future and lessen the year to year volatility of the sales tax revenue.[7] **Missouri taxes 11 services already. The $888 million estimate is taken from the Center on Budget & Policy Priorities estimate if Missouri were to tax all readily available services. Another useful number can be taken from the state's Tax Expenditure Report. When opting out Medical Care and Education of services that are taxed, Missouri could expect to raise $335 million in fiscal year 2004.*

Increase Sales Tax by 1% (1 Cent on each dollar) $670 million: Based on Fiscal Year 2006 General Revenue Sales Tax Estimates, included in the Governor's Executive Budget, the state could generate $670 million by increasing the state sales tax by 1%. The burden of a sales tax increase, or an increase in taxation of services could be offset for low income Missourians by

[7] A caution is that the sales tax is regressive and would impact low income families more significantly. However expanding the taxation of services could actually make the sales tax more progressive, if services that are utilized by more people with wealth, and businesses are the targets of reform. One option is to tax a limited number of more luxury based services. A second option is to tax via a more comprehensive approach, and exempt certain categories of service that meet basic needs, including health care and child care. To reed more about this, see *Expanding Sales Taxation of Services: Options and Issues,* Michael Mazerov, Center on Budget & Policy Priorities: http://www.cbpp.org/3-24-03sfp.htm

creating a State Earned Income Tax Credit, or Sales Tax Credit for Missourians who qualify for the Federal Earned Income Tax Credit. (also see footnote # 7 below).