United States Senate
Democratic Policy Committee Hearing

"Is the Bush Economic 'Stimulus' Plan Effective, Fair, and Fiscally Responsible?"

Nancy Farmer
Missouri State Treasurer

January 21, 2003

The Fiscal Crisis Facing States Today

Before I comment on the President's current proposal, I think it's critical that you understand the extreme budget difficulties faced by the states today. Nearly every state is in fiscal crisis.

You are well aware that the sluggish economy has reduced state revenues. In Missouri, for example, 90% of our general revenues come from individual income and sales taxes. At the same time revenues are down, spending pressures – much of which we consider mandatory spending, such as Medicaid and Corrections – have increased dramatically. The President's tax cut in 2001 is contributing to the pain we're experiencing today; accelerating that plan and adding additional cuts turns our blood-letting into a hemorrhage.

Let me give you a quick snapshot of what's happening in my state of Missouri and other states today. Medicaid spending grew 13.2 percent in Fiscal Year 2002 alone – the fastest growth rate in a decade. As a result, 37 states were forced to reduce Fiscal Year 2002 enacted budgets by more than $12.8 billion. Missouri was no exception. Last year, Missouri government took in less money than in the previous year. The state's net general revenue receipts declined 3.5 percent. That's the first year-to-year decline since 1955.

Over the past two fiscal years, we in Missouri have cut nearly $1 billion from our $19 billion budget to meet our constitution's requirement that we maintain a balanced budget. Among the cuts was a 15 percent reduction in funding for higher education and the elimination of about 1,000 state jobs.

We are not alone. According to the National Governor's Association:

- More than 100 school districts in seven states are now shutting down their public schools one day a week.

- In California, the governor has called for reduction in health care spending that will deny service to at least 200,000 needy people.

- Kentucky has released several hundred prison inmates to cut corrections costs.

Today, even with the cuts we've made, Missouri faces a projected $1 billion budget shortfall for Fiscal Year 2004. Nationally, state governments are reporting $60 – $70 billion in potential budget shortfalls.

A $1 billion shortfall out of our $19 billion budget may not sound that drastic, but Missouri, like most states, has limited discretionary general revenue dollars. Only $6.8 billion of our budget is general revenue. The lion's share of our dollars is restricted: we have fuel taxes for highways, sales taxes for parks and conservation, and, of course we receive federal money which is earmarked for specific services. Of our general revenue, one-half is spent on education – $2.5 billion on K through 12 and over $800,000 on higher education.

The balance of our general revenue, about $3.5 billion, pays for everything else: the highway patrol, economic development, insurance and utility regulation, debt service, environmental protection, corrections, and services for the mentally ill and the disadvantaged, among other things. More than half of Missouri's employees who are paid with general revenue work in 24-hour institutions – our prisons, mental health hospitals, veterans' homes and group homes.

A $1 billion shortfall in a $6.8 billion budget is extremely painful. Missouri, like most other states, is wounded. What we need from you here in Washington is aid, not another slash as the President is proposing.

The Impact of the Current Proposal

Missouri – like many other states – ties its tax system to the federal tax system. Where the President proposes changes in federal tax rates or increases to tax credits will have little impact on us; in fact, accelerating the 10 percent bracket increase actually generates a little revenue for us because it reduces the amount of federal taxes Missourians deduct from their state taxes.

It's the accelerated changes in deductions and exclusion of dividends from individual income taxes that have an impact on our budget. Every dollar reduction in Federal Adjusted Gross Income (AGI), results in a dollar reduction in MO income taxes. Under the current tax relief act, Missouri would lose $23 million beginning in Fiscal Year 2006 increasing to over $90 million in Fiscal Year 2008 with a phased-in reduction of the marriage penalty. The President's proposal to accelerate that reduction to take full effect in 2003 will cost Missouri $90 million next year.

We can only estimate the impact of eliminating individual income taxes on dividends; we're projecting it would cost in the neighborhood of $100 million. The National Governors' Association projects this provision would cost state governments collectively $4 billion this year and $45 – $50 billion over the next decade.

Of equal concern on this provision is the impact it could have on municipal bonds. State and local governments can offer lower interest rates on our debt because of our tax-exempt status. These bonds will be less attractive – and frankly, we don't how much less attractive – to investors because stock dividends will have the same tax-exempt status. Any increase in the interest rate we have to pay for bonds drives up the costs of building schools, roads, airports, and other capital improvement projects.

Missouri is a low-debt state. What concerns me for my state is the impact higher interest rates would have on our state housing agency. Our mortgage revenue bond program uses proceeds from a mix of taxable and tax-exempt bonds to assist low to moderate-income first time homebuyers. Higher interest rates would mean that we could assist fewer families in attaining the dream of owning a home. Not including the potential impact for higher interest rates on debt, these two provisions – offset by a few million in increased revenues as a result of credits and rate changes – will cost Missouri $100 – $150 million. That increases our budget shortfall by 10 – 15 percent.

I haven't addressed the depreciation bonus. Last year, Missouri and Ohio among others, decoupled from the feds so this bonus did not impact state revenues. In Missouri, we decoupled for just one year. If our legislature does not act to decouple this year, it could cost another $70 million out of our budget.

In total, President Bush's attempts to stimulate the economy at the national level could undercut Missouri by nearly a quarter of a billion dollars.

No Relief for States

To add insult to our life-threatening injuries, there is no relief for states in this package. I've already mentioned skyrocketing Medicaid costs but we've also increased spending with implementing "No Child Left Behind" and homeland security programs. From my perspective in Missouri, and I think most other states, this proposal is a lose/lose and a lose/lose.

The proposal will diminish states' ability to provide services to those citizens who need them the most; those same citizens, with the greatest needs, get the least in direct relief. Under this proposal, wealthier states with more higher income taxpayers lose proportionately more state revenues, which will force them to reduce services or raise taxes. It negates any stimulus impact the proposal might have.

Finally, in less wealthy states like Missouri, fewer of our citizens will enjoy a benefit, but those who need our services will suffer. I think any federal economic stimulus plan is doomed to fail if it victimizes state governments and stifles their ability to provide services in the process.

Thank you for the opportunity to share my concerns.