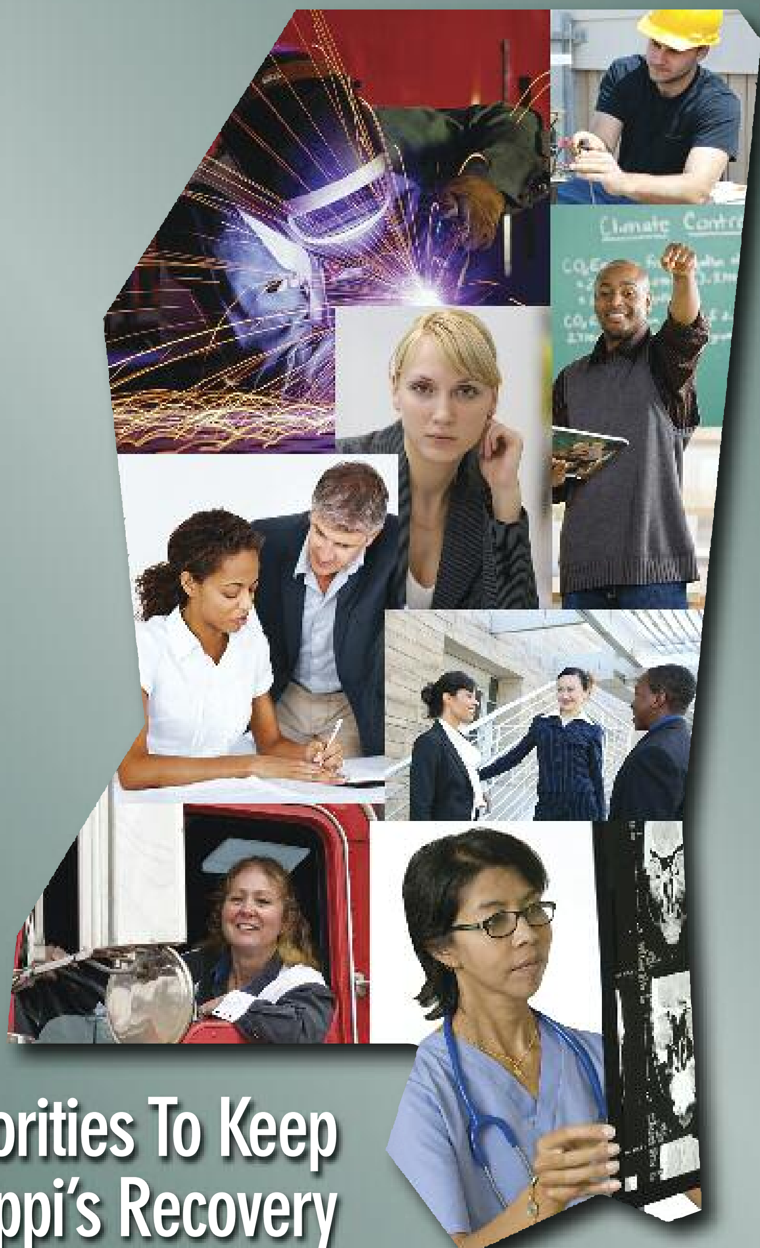
AFTER THE ARRA:



Setting Priorities To Keep Mississippi's Recovery On Track

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AFTER THE ARRA: SETTING

Over the last 17 months, the American Recovery and Reinvestment Act has played a vital role in the stabilization of families and local communities moving through the recession in Mississippi. From projects supporting roads and bridges to keeping teachers in the classroom, ARRA has preserved important services and jobs across the state. Since the inception of ARRA, over $2.4 billion has been awarded and over $1 billion has been expended. In the second quarter of this year alone, 8,829 jobs have been reported as being preserved by ARRA recipients.[1]

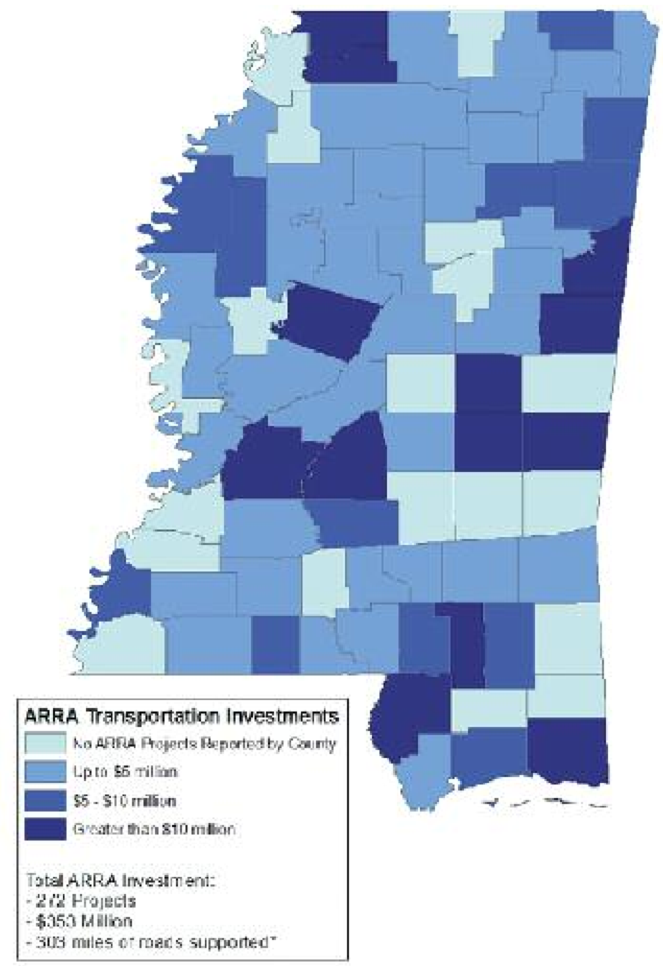
ARRA funding provided child care certificates for 23,921 children in Mississippi while their parents went to work. It also made investments to improve the quality of early childhood education systems across the state.

ARRA's implementation has been critical on a number of fronts. In the short term, the program has kept in place a number of state services to keep people employed and to blunt the effects of rising unemployment. From child care to summer youth employment, these services maintained opportunities for families across the state. For families encountering job loss, ARRA provided increased unemployment insurance payments, expanded access to the Supplemental Nutrition Assistance Program and significant provisions to keep healthcare for low-income children and families accessible.

Longer term, ARRA expedited the funding of infrastructure improvements including road resurfacing and water projects. The infrastructure projects offered employment opportunities and strengthened the economic competitiveness of the state for business development.

Finally, federal stimulus funding made available through ARRA's State Fiscal Stabilization Fund and the enhanced Medicaid match helped the state cover education expenses while General Fund revenues were falling. As a result, ARRA's State Fiscal Stabilization efforts mitigated the effects of state budget cuts and preserved important jobs – such as those filled by teachers.

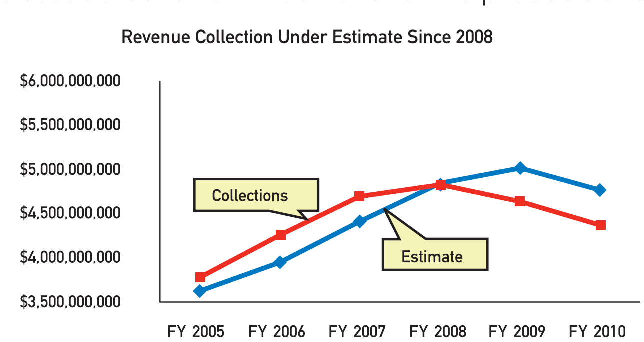
Moving forward, the wind down of State Fiscal Stabilization dollars and the enhanced Medicaid match (also known as the enhanced FMAP) pose one of the biggest hurdles for Mississippi's working families. In the absence of additional revenue through growth or tax increases, lawmakers will need to identify between $400 - $600 million in cuts to maintain 2011 levels of spending. With significant service reductions already in force, jobs will be lost, class sizes will increase and access to services will decline.



Source: Mississippi Department of Transportation; MEPC Analysis

Budgeting in Difficult Times

Over the last three budget years, the state of Mississippi experienced significant declines in revenue collections as unemployment rose and workers experienced cuts in wages and hours. With less income churning in the economy and the associated fall off in demand for the products and services produced by Mississippi's employers, the state saw decreases in sales tax, personal income tax and corporate income tax. As a result, Mississippi's General Fund collections came in under estimate each year for the past three years.



Source: Mississippi Department of Revenue, Monthly Report of Department of Revenue Transfers, June FY 2007-June FY 2010, State of Mississippi Budget Fiscal Year 2011, June 15, 2010.

After General Fund revenue collections peaked in Fiscal Year 2008, the effects of the recession followed. In the two most recently completed fiscal years, revenue came in under estimate in 21 of the last 22 months.

ARRA BUDGET ALLOCATIONS

	FY 2009	FY 2010	FY 2011	Total
MAEP	$ 49,000,372	$ 111,540,751	$ 128,365,837	$ 288,906,960
Community and Junior Colleges	9,831,362	--	10,210,188	20,041,550
IHL General Support	15,725,277	15,725,277	44,570,375	7,6020,929
IHL University of Mississippi Medical Center	3,083,862	17,327,310	19,905,438	40,316,610
IHL MSU College of Veterinary Medicine	840,152	840,152	1,681,525	3,361,829
Department of Rehabilitation Services	--	3,383,989	2,061,680	5,445,669
Department of Health	--	2,160,872	1,316,501	3,477,373
Medicaid	--	256,070,147	152,110,227	408,180,374
Dept. of Mental Health	--	37,701,656	22,969,561	60,671,217
Total	$ 78,481,025	$ 444,750,154	$ 383,191,332	$ 906,422,511

Source: State of Mississippi Budget Fiscal Year 2011, June 15, 2010

As mentioned in the introduction, federal recovery dollars played an important role in the development and stabilization of budgets for the provision of state services. In the budgets developed for Fiscal Years 2009-2011, over $900 million in ARRA dollars were allocated to address shortfalls. The table to the left provides an overview of ARRA budget allocations during those years.

Over the last three years, ARRA's State Fiscal Stabilization efforts primarily supported Medicaid and the Mississippi Adequate Education Program. The Stabilization Funds also provided resources for the provision of higher education and mental health services in Mississippi.

HOW DID THE RECOVERY ACT SUPPORT MISSISSIPPI'S BUDGET?

The Recovery Act provided fiscal relief to the state of Mississippi primarily through an enhanced match rate for state expenditures on the Medicaid program and through a program called the State Fiscal Stabilization Fund.

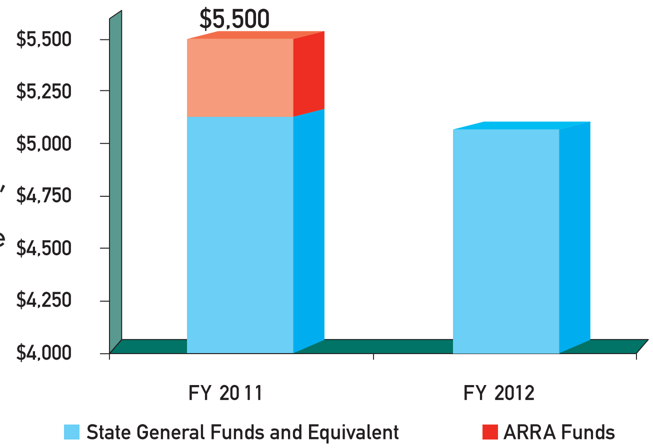
ENHANCED MEDICAID MATCH RATE (FMAP)
Prior to the passage of ARRA, approximately $0.24 cents from every dollar spent on Medicaid were funded by the state and the remaining $0.76 cents were funded with federal dollars. Through the enhanced match rate, Mississippi's share of Medicaid spending declined to approximately $0.15 of every dollar. The reduced requirement for state spending freed up dollars to be spent on other parts of the budget. In total, this provision made $719 million available to assist in fiscal relief.

STATE FISCAL STABILIZATION FUND
State Fiscal Stabilization Funds were awarded to states through two different avenues. First, the State Fiscal Stabilization Fund for education provided aid to states to help keep education funding at pre-recession levels. Mississippi received $392,100,000 for the support of early childhood, elementary, secondary and postsecondary education. Second, the State Fiscal Stabilization Fund for government service assisted with funding for education, public safety and other government services. Mississippi received $87,200,000 for government services.

Even with ARRA resources, building a budget has not been easy. Total state appropriations decreased by over $700 million from FY10 to FY11 (the current fiscal year). To address shortfalls encountered during the 2010 budget cycle, nearly $500 million in cuts were implemented.

After ARRA:

State Budget Resources Declining as ARRA Funds Go Away



Source: FY 2011 Executive Budget Recommendation, November 16, 2009

State Fiscal Stabilization funding is scheduled to go away during the 2011 Fiscal Year. The end of stimulus funding will ultimately result in a budget "cliff" as the program ends before state revenue collections recover from the recession. In the preparation of the 2012 budget, policy makers will need to identify between $400 - $600 million in cuts or additional revenue to keep appropriations at 2011 levels.

One of the budget areas most likely to be affected includes the K-12 education budget. Access to education not only improves the quality of life for Mississippi's children and families, it is also imperative for the development of a workforce capable of competing in the global economy. Since 2008, the budget for the Mississippi Adequate Education Program (MAEP) has decreased and remains below full funding levels. With the costs of providing an adequate education increasing each year, the effect of the reduction in resources to put together the FY2012 budget will be compounded. Without additional revenue, MAEP will see even further cuts unless those cuts are passed on to other areas of the state budget.

MISSISSIPPI ADEQUATE EDUCATION PROGRAM	FY 2007	FY 2008	FY 2009 (FY09 approp. Includes $21M re-approp. From FY08)	FY 2010	FY 2011
MAEP Full Funding	$ 2,139,211,904	$ 2,207,152,735	$ 2,207,233,362	$ 2,241,137,884	$ 2,284,848,636
Total Appropriations*	2,018,866,287	2,207,152,735	2,207,233,362	2,192,137,512	2,041,451,088
Additional and Deficit Appropriations**	0	0	49,000,372	33,908,173	
Mid Year Cuts	0	0	(76,627,825)	(196,201,512)	
Total Adjusted Budget	2,018,866,287	2,207,152,735	2,179,605,909	2,029,844,173	2,041,451,088
ARRA Appropriations (included above)	0	0	49,000,372	111,540,751	128,365,837
MAEP Budget without ARRA	$ 2,018,866,287	$ 2,207,152,735	$ 2,130,605,537	$ 1,918,303,422	1,913,085,251

Source: Source: Mississippi Department of Education

* Does not include $50M special fund authority. FY09 Addition included $3M that was appropriated for the MAEP Emergency Loan Programs and was not used to fund the MAEP formula

** For FY10 received a total of $160,541,123 in ARRA funds as part of the FY10 appropriated and $49,000,372 was specified for restoration of FY09 cuts.

Other areas in state government will also experience difficulty maintaining current levels of service delivery. The inability to fill critical positions in state government due to budget constraints such as Highway Troopers and teachers could potentially compromise the safety and education of Mississippians across the state – especially in its rural areas. Access to services could also decline as mental and public health facilities close down or reduce hours. Even basic business development services, such as the timely granting of permits required through the Department of Environmental Quality are at risk due to personnel shortfalls stemming from a lack of reources statewide.

Balanced Approach Needed including Raising Revenue

WHY ARE TAX INCREASES ON HIGH INCOME EARNERS BETTER FOR MISSISSIPPI'S ECONOMY THAN BUDGET CUTS?

According to Nobel Prize winner Joseph Stiglitz and Peter Orszag, director of the Office of Management and Budget, during a recession spending cuts are more harmful for a state's economy than tax increases. "This is true because spending cuts remove money from the economy dollar for dollar. Tax increases, especially on high income earners, do not pull money from the economy on a dollar for dollar basis because some of the money used to pay taxes would come from discretionary income that would have likely been saved and not entered the economy in the first place."[2]

For the state to be competitive as prosperity returns, Mississippi needs to take a balanced approach to the budget crisis that includes raising revenues. A cuts-only strategy hurts working families, hurts the economy and limits our ability to invest in the state's people.

While the state's overall budget challenges have been partially alleviated in recent years through use of the state's reserves and ARRA funds, these funds cannot be relied on for future budgets because they have largely been spent or are set to expire. Long term, a revenue solution must be part of the budget solution to preserve jobs and basic state services.

Four options to raise revenue include updating sales, personal and corporate income taxes and reducing tax expenditures. These four options could generate an estimated $200 million in additional revenue for the state budget. Like cuts or use of reserve funds, the proposed new revenue would not single-handedly solve the budget crisis. However, as a part of a balanced approach, it would improve the state's ability to invest in education and workforce development long term, and improve the equity of the state's tax system.

REVENUE PROPOSALS FOR A BALANCED APPROACH

Revenue Proposal	Estimated Annual Revenue
Broaden Sales Tax Base	$ 80,000,000
New 6% personal income tax bracket at $45,000	$ 64,000,000
New 6% corporate income tax bracket at $45,000	$ 55,000,000
Decrease Tax Expenditures 10%	$ 8,400,000
Total	$207,400,000

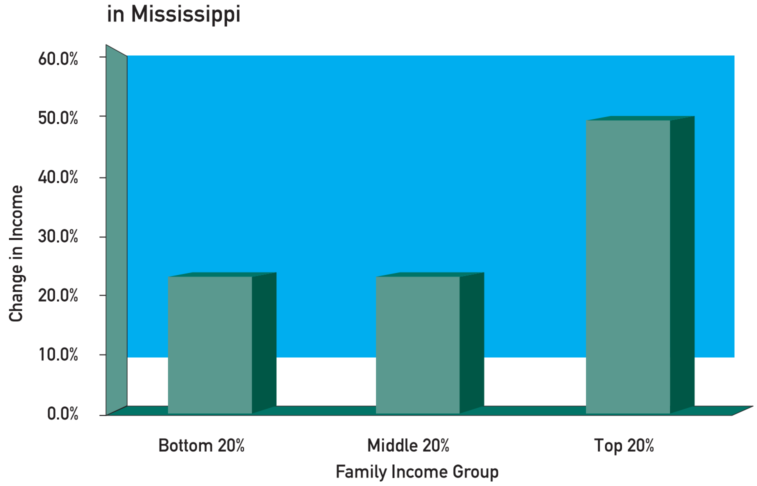
Source: MEPC analysis of data from the Institution on Taxation and Economic Policy, U.S. Census Bureau, and the Mississippi Tax Expenditure Report November 2009 prepared by the Mississippi Institutions of Higher Learning

UPDATE THE SALES TAX

Mississippi's sales tax was originally structured to capture a portion of the purchase of goods. As the economy has evolved, more Mississippians are also buying services. By expanding the sales tax to include more services, the state would generate additional revenue and spread out the tax burden on working families. Sales taxes in Mississippi are applied on all goods unless they are specifically exempt in law. Goods include items like food, clothing, motor vehicles and household items. Services are only subject to the sales tax if they are specifically listed in law.

In 2008, the Mississippi Tax Study Commission recommended, in part, expanding the sales tax base on services by adding 21 services including pet grooming, photographic services and salon services. Taxing those services could bring in an additional $80 million in revenue annually.

Income Growth has not Occurred Evenly over the Last 20 Years in Mississippi



Source: Center on Budget and Policy Priorities; MEPC Analysis

UPDATE THE PERSONAL AND CORPORATE INCOME TAX

As a percent of personal income, income taxes paid in Mississippi are among the lowest in the country.[3] By adding another bracket, the state would generate additional revenue while taking into consideration the ability of working families to pay the tax.

The state's income tax brackets have not been updated in the last 25 years. The highest tax bracket of 5% starts at a low $10,000 of taxable income. With standard exemptions and deductions for a family of four with two children, this would mean the top bracket starts when a family makes over $29,600 of income. While income tax rates have remained the same, in the last two decades the top 20% of income earners have experienced over twice the rate of income growth of the bottom and middle 20% of earners in Mississippi.

Adding a new state income tax bracket of 6% over $45,000 of taxable income (total income of $64,400 for a family of four with two children) would update the income tax to capture areas of growth in the state's economy while taking into account the ability of working families to pay the tax. Furthermore, only the top 40% of earners would see a tax increase under the proposal.

The new bracket for the personal income tax is estimated to raise $64 million in revenue. Corporate and personal income tax brackets are the same as established in law. An updated 6% bracket on corporate taxable income over $45,000 could raise about $55 million annually in Mississippi.

MOST MISSISSIPPI FAMILIES WOULD NOT BE AFFECTED BY INCREASE IN PERSONAL INCOME TAX

Group	Income Range	Average Tax Increase
Lowest 20%	Less than $14,000	$ -
Second 20%	$14 - $24,000	$ -
Middle 20%	$24 - 39,000	$ -
Forth 20%	$39 - $70,000	$ 61.00
Next 15%	$70 - $129,000	$ 98.00
Next 4%	$129 - $306,000	$ 384.00
Top 1%	$306 - and up	$ 3,861.00

Source: Institute on Taxation and Economic Policy; MEPC Analysis

TAX EXPENDITURE REDUCTION

Much like appropriations, tax expenditures constitute another type of spending by reducing the money available for funding state services. However, unlike appropriations they are not typically reviewed and renewed annually. Similar to budget cuts, tax expenditures could be reduced by a percentage to increase funding available in the General Fund.

Mississippi provides a number of corporate income tax credits and franchise tax credits. The most recent Tax Expenditure Report estimated that the state provided over $84 million in income tax and franchise tax breaks for FY 2010.

Tax expenditures should be subject to a regular review of their effectiveness and included in overall budget reduction measures. A 10% reduction in tax expenditures would provide an additional $8.4 million for the state budget, while a 25% reduction would provide an estimated $21.1 million.

Looking Ahead

Not only do state and local government services provide for the education, health and safety of families, they also play a vital role in the overall economy. When revenues are adequate, services continue and investments are made that promote prosperity and quality of life. Conversely, when states experience the effects of a prolonged economic downturn, communities feel the pinch. Public service workers who lose their jobs or experience wage reductions have less money to spend locally. Likewise, businesses that see reductions in demand for goods and services from state and local governments also struggle and may have to lay-off employees. At the national level, the economic recovery was hindered in the first quarter by state and local budget cuts which had a negative effect on GDP growth.[4]

The American Recovery and Reinvestment Act funds have preserved jobs and important state services while having a positive effect on the state's economy over the last two years. Even with the fiscal relief provided by ARRA, however, the magnitude of the recession has caused the state to make budget cuts. With stimulus funds going away and the recovery still in the distance, Mississippi must take a balanced approach that includes raising revenues to maintain jobs and to protect the state's investment in areas critical to the growth in the state's economy.

1 www.recovery.gov "Funding Awarded by State," Mississippi. Accessed on 8/2/2010.
2 Center on Budget and Policy Priorities, "Budget Cuts or Tax Increases at the State Level Which is Preferable When the Economy is Weak?," April 28, 2010.
3 MEPC analysis of data from the U.S. Census Bureau
4 U.S. Bureau of Economic Analysis, "Gross Domestic Product: First Quarter 2010 (Third Estimate)," June 25, 2010

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