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REPORT

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SAVING FEDERALISM: HOW FEDERAL POLICY AFFECTS MISSOURI'S SPENDING

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KEY TAKEAWAYS

- Missouri's government has set a new record for state spending in each of the past ten years.
- Since 2011, total spending by Missouri's government has grown faster than the state's population and significantly outpaced inflation. The primary driver of this spending growth is funding from the federal government, which has grown by nearly 40% in inflation-adjusted terms over the past decade.
- Today, Missouri is more reliant on financial aid from the federal government than ever before, with more than $0.40 of each dollar spent coming from federal coffers.
- Going forward, if containing budget growth is a top priority, Missouri's elected officials must take steps to reduce the state's reliance on federal aid.

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INTRODUCTION

Dealing with COVID-19 over the past few years has shined a bright light on the impact that federal policy can have on state governments. Today, approximately $0.40 of every dollar spent by Missouri's government comes from federal coffers.[1] Over the past decade, Missouri has become increasingly reliant on federal funds, which has contributed to a rapidly growing state budget while also significantly reducing state spending flexibility.

The federal government primarily exercises its power over state policy through what are called grants-in-aid. These grants are transfers of money from the federal government to state or local governments to fund specific projects or programs. Upon accepting the federal funds, which are not loans and do not have to be repaid, state or local governments agree to spend the funds according to guidelines established by the federal government.

For most of American history, federal grants-in-aid were rarely used, but over the past 60 years, their influence on state budgets has skyrocketed. What were once seen as state prerogatives, such as maintaining roads, educating kids, and caring for the needy, are now areas where the federal government holds enormous power. It is important to note that this loss of state control comes at a real cost to state taxpayers, emphasizing the point that these federal grants are in no way "free" for Missouri.

This report will analyze the various ways Missouri's state government receives and spends federal aid, consider the strings attached to those dollars, and discuss how those policies have shaped the spending of state tax dollars. Finally, this report will discuss the broader implications of increased state reliance on the federal government and offer reforms for righting Missouri's financial ship for generations to come.

BACKGROUND

Federalism

Since America's founding, the relationship between the federal government and the states has been an issue of much contention. While this report does not attempt to dive into legal or historical debates on the topic, it's clear the founding fathers had a federalist vision. As the Bill of Rights famously states, "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."[2] Or, as James Madison eloquently stated in the Federalist papers (No. 45),

> The powers delegated by the proposed Constitution to the federal government, are few and defined. Those which are to remain in the State governments are numerous and indefinite. The former will be exercised principally on external objects, as war, peace, negotiation, and foreign commerce; with which last the power of taxation will, for the most part, be connected. The powers reserved to the several States will extend to all the objects which, in the ordinary course of affairs, concern the lives, liberties, and properties of the people, and the internal order, improvement, and prosperity of the State.[3]

The founding fathers understood that government would be more accountable, efficient, and responsive when it is closer to the people. But as time as passed, the federal government has centralized more and more decision-making in Washington D.C., shifting further and further away from the nation's founding principles.

Throughout most of American history, federal grants-in-aid were rarely used. As recently as 1902, there were only five total federal grants totaling $7 million per year.[4] Then, following the ratification of the 16th Amendment to the U.S. Constitution in 1913, which allowed the federal government to begin collecting an income tax, federal spending on grants began to increase.

In the decades that followed, the number of federal grants increased significantly during national emergencies and without reverting to previous levels at the end of the emergencies—a trend that continues today. As seen in Figure 1, from the Great Depression to World War II, the role of the federal government increased significantly, and never receded. During the 1960s, President Johnson's War on Poverty irreparably changed the federal grant-in-aid system. From 1960 to 1968, the number of federal grants nearly tripled. And since then, the number and size of federal grants has more than tripled again.[5]

Today, as Figure 2 shows, the federal government spends more than $1.2 trillion per year on state aid across more than 1,200 grant programs. And of those numerous programs, fewer than 100 account for nearly 95% of the funds granted annually, with the biggest being Medicaid.[6]

Federalism scholars point to the period of American history following the 1960s as the beginnings of what they call "coercive federalism." John Kincaid characterized the change in federalism from one of "fiscal tools to stimulate intergovernmental policy cooperation" to an increased reliance on "regulatory tools to ensure the supremacy of federal policy."[7]

These factors underscore the bigger issue, which is the evolving nature of cultural norms and expectations concerning government's role in American society. As Robert Jay Dilger of the Congressional Research Service describes it, "Over time, though the American public has become increasingly skeptical of government performance, they have also become increasingly accepting of government activism in domestic affairs. Federalism scholars attribute this increased acceptance of, and sometimes demand for, government action as a reaction to the industrialization and urbanization of American society; technological innovations in communications, which have raised awareness of societal problems; and exponential growth in economic interdependencies brought about by an increasingly global economy."[8]

While the remainder of this report will not discuss these federalism issues directly, they are important in explaining how the federal grant-in-aid system has affected Missouri.

Federal Grants to States: Crowd-in or Crowd-out?

To understand how federal grants have affected Missouri's government, it's instructive to start by reviewing how governments can or should respond to an influx of money (or grant).

Figure 1

Federal Grants to State and Local Governments

In 2018, the number of federal grants to state and local governments was more than forty times larger than in 1940.

Source: Congressional Research Service.

Grants are established to achieve a variety of goals, and the ways in which the federal government uses grants to incentivize state governments to put money toward federal priorities can have varying effects. As Figure 3 shows, federal grants can impact state budgets in one of three ways.

The first possibility is that each dollar of a federal grant replaces a dollar of state spending. This situation would be described as complete crowd-out, where total spending toward the aided goal doesn't change. The second possibility is that the state leaves its spending unchanged and the federal grants act as a supplement, causing total spending toward the aided goal to rise by the federal grant amount. The third scenario is that the federal grant crowds-in funding from the state, causing total spending toward the aided goal to increase by more than the amount of the grant.

Ultimately, the design of the grant determines which of the three scenarios plays out in practice. From a federal perspective, if Congress's goal is for total spending to increase on the activity the grants are created for, it makes sense that it would design the grants in such a way that they supplement state spending instead of substitute for and offset it. That said, states may not share the same priorities as the federal government, with states often preferring to maximize the dollars they can receive from the federal government while also minimizing the strings attached to give themselves the most budgetary flexibility.

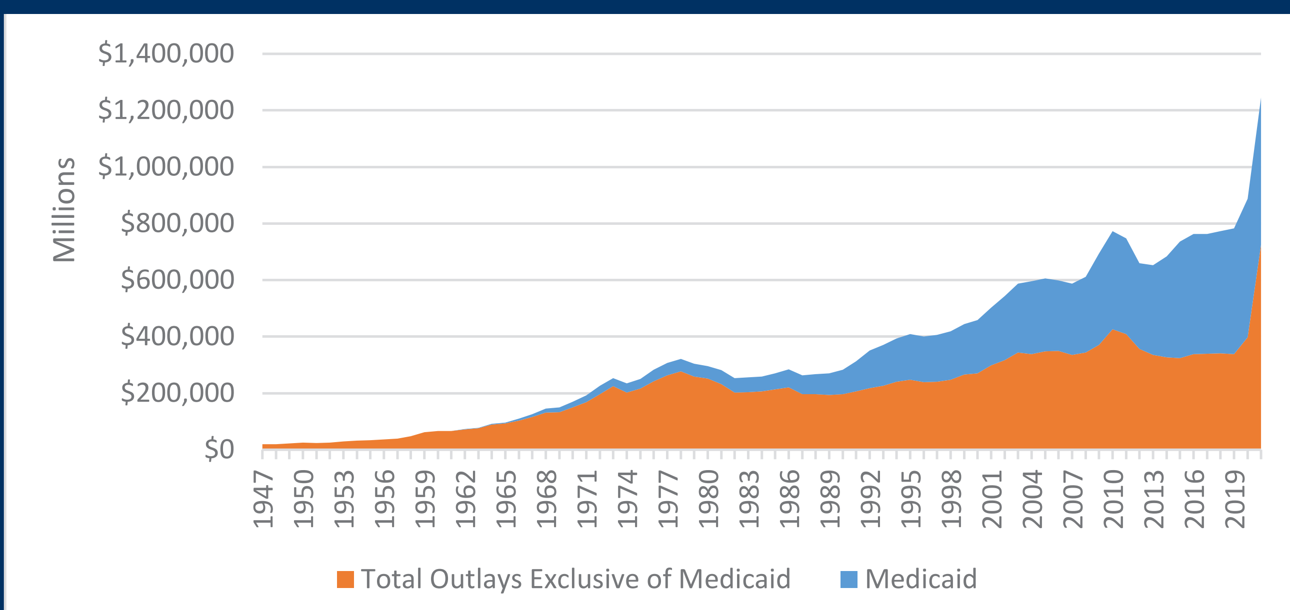
FEDERAL GRANT OVERVIEW

The determination of the number and size of federal grants isn't the only aspect of the federal grant-in-aid system that affects a state; the type of grant awarded also

Figure 2

Medicaid Share of Federal Grants to State and Local Governments

As federal grants to state and local governments have grown, Medicaid has become a bigger share of total spending.



Source: U.S. Office of Management and Budget.

plays an important role.[1] As seen in Table 1, there are three primary types of federal grants.

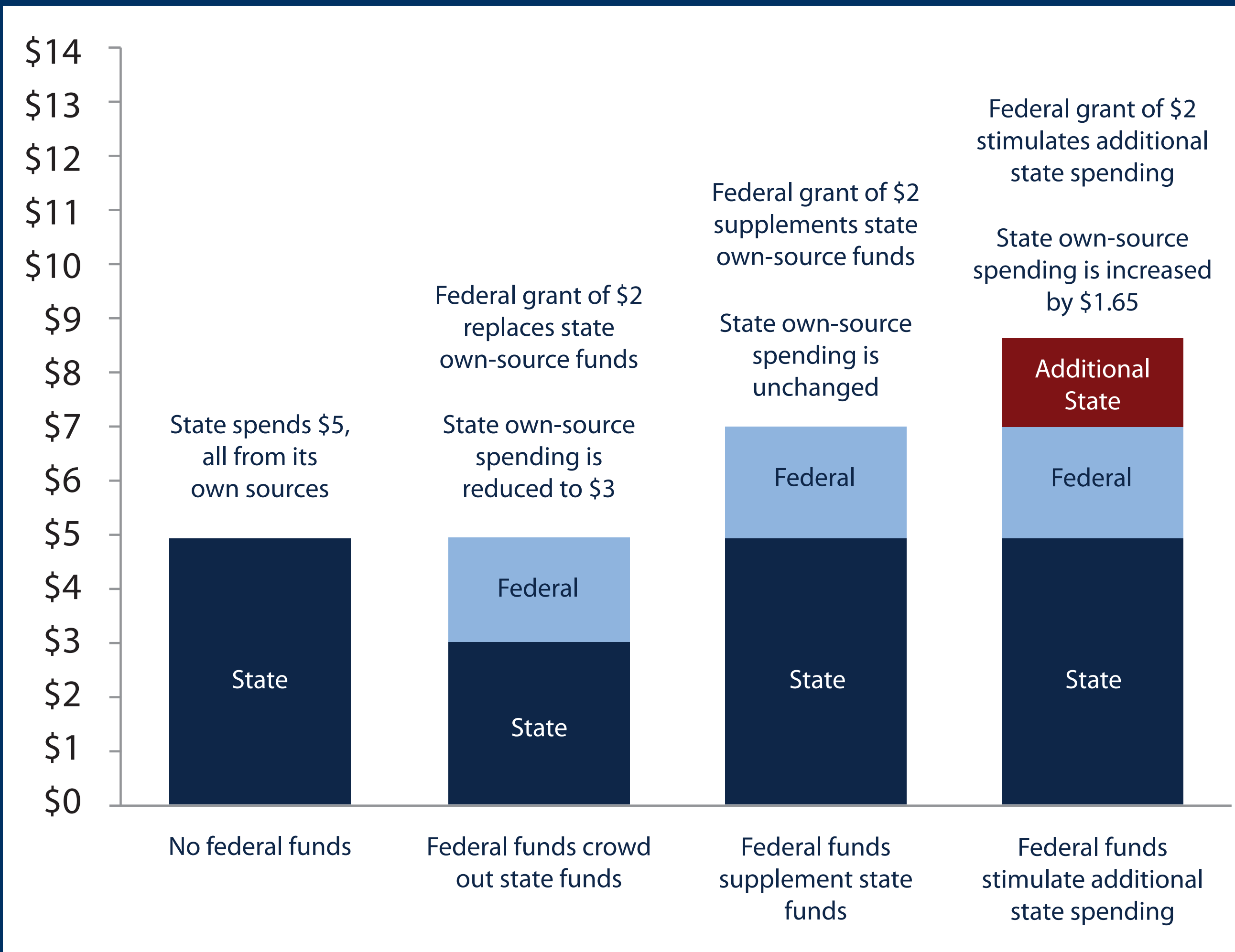
[1] It should be noted that there is disagreement among federal agencies, including the U.S. Census Bureau, The Government Accountability Office (GAO), and the U.S. Office of Management and Budget, regarding what constitutes a federal grant-in-aid program. As a result, the exact spending and number of grant programs differs depending on the source. For this report, the totals will be based off U.S. Office of Management and Budget definitions and totals.

Categorical grants are by far the most common and are typically targeted at specific goals and can only be spent on narrowly defined activities. Block grants are the middle ground and are targeted at specific sets of connected programs but allow more flexibility in how the aid can be spent. And general revenue sharing provides the maximum flexibility by being usable on nearly any purpose not expressly prohibited by federal or state law.

Figure 3

Illustrative Impacts of $2 in Federal Grants on State Spending from State and Local Revenues

State spending can increase, decrease, or remain unchanged as a result of federal grant funding.



Source: Fruits, Eric. "Impact of Federal Transfers on State and Local Own-Source Spending." SSRN Electronic Journal, Nov. 2015. https://doi.org/10.2139/ ssrn.2692705.

The impact of federal grants on states can be even more easily discerned by separating grants according to three defining traits: administrator funding discretion, recipient's spending discretion, and the extent of performance conditions. For comparing grant types here, categorical grants need to be further divided into four types, as shown in Table 1: project, formula, formula-project, and open-ended.

Table 1: **Classification of Grant Types by Three Defining Traits**

Federal grants can be divided into three defining traits: administrator funding discretion, recipient discretion in use of funds, and extent of performance conditions.

Federal Administrator's Funding Discretion		
Low	*Medium*	*High*
Formula Categorical Grant	Block Grant—Formula Project Categorical Grant	Project Categorical Grant
Open-ended Reimbursement Categorical Grant		
General Revenue Sharing		
Range of Recipient's Discretion in Use of Funds		
Low	*Medium*	*High*
Project Categorical Grant	Block Grant	General Revenue Sharing
Formula-Project Categorical Grant		
Formula Categorical Grant		
Open-ended Reimbursement Categorical Grant		
Extent of Performance Conditions		
Low	*Medium*	*High*
General Revenue Sharing	Block Grant	Project Categorical Grant
		Formula Categorical Grant
		Formula-Project Categorical Grant
		Open-ended Reimbursement Categorical Grant

Source: U.S. Office of Management and Budget.

Project categorical grants are probably what most people think of when they think of "grants." Project grants are typically awarded on a competitive basis through an application process (for a specific project) determined by the federal agency making the grant. The federal agency then chooses the recipient of the grant(s), specifies what those granted funds can be spent on, and can establish strict performance conditions to measure compliance.

Formula categorical grants are a bit different and are allocated among recipients according to factors specified within the enabling legislation or administrative regulations. For example, much of the federal funding for highways is decided via formula grants. The formulas for these grants are set by the Fixing America's Surface Transportation Act (FAST Act) and are based on metrics such as total lane miles per state, vehicle miles traveled on federal highways, and others. These grants allow very little discretion for the administrator of the grant or the recipients but can have strict performance metrics.

Formula-project categorical grants are just like they sound; they use a combination of the previous two fund allocation methods. Typically, this means the enabling legislation sets forth some formula to decide fund allocation and the grants are awarded on a competitive basis that requires candidates to take part in an application process. For example, imagine the federal government sets aside $100 million for 20 grants to state governments for transportation projects. States would then apply by laying out the reasons they think they should receive the funds, and then the U.S. Department of Transportation would pick the winners. These types of grants give more discretion to federal administrators than formulas, but less than project grants, while maintaining the low level of discretion and high performance requirements for recipients.

Open-ended categorical grants provide reimbursement for a specified proportion of the recipient's program costs, which eliminates the competition among recipients as well as the need for an allocation formula. An example of this grant type is the Medicaid program, where the federal government picks up a flat percentage of eligible health care costs. These grants provide little discretion to federal administrators or recipients but retain high levels of program performance scrutiny.

General revenue sharing imposes the least restraint on federal administrators and recipients, and has the fewest performance conditions. Perhaps for these reasons, it is also the least common grant type awarded by the federal government.

Block grants function as essentially the midpoint for the various grant characteristics. Federal administrators have some discretion regarding who receives the grants but typically less than for categorical types, recipients have greater discretion for how to use the funds, and the federal government typically relaxes some of the performance conditions.

Grant Influence on State Spending

As stated earlier, the overwhelming majority of federal grants are of the categorical type, which is the type that can be the most demanding of recipients. And this is understandable; the federal government's goal is not just to ensure money goes toward the priority (e.g., health care), but also to be sure that states don't take the money and lower their investment by the same amount, minimizing the impact of the grant.

Ultimately, the issue here is what impact the chosen grant designs are having on the governments that receive the funds. The U.S. Government Accountability Office (GAO) identifies two primary ways in which federal grants can directly increase state spending: matching fund requirements and maintenance of effort requirements.[2,9]

Many federal grants require that states contribute their own funds in order to receive federal revenues in return, often called a "match." Depending on the program or grant, federal funds are typically matched at a constant rate, not always 1:1, and sometimes have a defined cap. Such requirements are based on concerns from the federal government's side that states may simply use grants to substitute federal funds for state funds, thus leaving total spending unchanged. Research suggests that grants requiring matching funds result in less substitution of state funds than those that do not. According to a GAO analysis, grants with matching funds have a substitution rate of approximately $0.15, meaning that for each federal grant dollar, states reduce their spending by $0.15 while increasing total spending by $0.85.[10] In contrast, non-matching grants have substitution rates of nearly $0.60, four times larger than the rate for matching grants.

This means that if states are not completely substituting their funds for federal grants, these grants necessarily increase state spending (refer back to Figure 3), or at least increase state spending on the federal priority. In these cases, the impact of that spending on the rest of the state's budget is left for state elected officials to figure out. It should be noted that states are much less able to absorb increased spending obligations than the federal government. Congress can create a new grant program and send money to the states without the tax revenues to support it, because the federal government can deficit spend. Almost every state, including Missouri, has a balanced budget requirement meaning that it cannot ever spend more money than it brings in.[11] For this reason, when federal grants lead states to increase their own spending, the state can only find that money by diverting it from other priorities or by raising taxes.

The other way federal grants can contribute to state spending is through what are called maintenance of

[2] While matching and maintenance of effort requirements are direct means for the federal government to increase state spending, there are also indirect means where federal investment can lead to state investment in similar or complementary goals, but for the purposes of this report, are left out.

effort (MOE) requirements. They work like they sound: the federal government conditions funding on the state agreeing to maintain the existing level of spending on the aided program or service. Requiring the maintenance of a certain level of spending prevents states from substituting federal funds for their own up to a point but can also lead to some perverse incentives.

Maintenance of effort requirements inherently involve some base year of funding that must be maintained, which can be problematic over time. For example, the American Reinvestment and Recovery Act (ARRA—the stimulus bill from the 2008 recession) included federal funds to help states fund their higher education programs. These funds also came with a MOE component stating that to receive funds, state appropriations for higher education could not fall below 2006 funding levels. If states failed to meet these requirements, other federal stimulus funding from ARRA would be in jeopardy.

Did these MOE requirements have the desired effects? Analysis after the fact showed that across the country, states responded to the threats of federal funding loss, and appropriated right around the exact MOE threshold (2006 spending level).[12] This spending is money that could then not be allocated to other state priorities. So, what does this tell us? In the depths of the Great Recession, when state tax revenues plummeted, states were using their precious funds to meet federal MOE requirements for higher education, which also indicates this is likely not where they would have spent those funds otherwise.[3] These are precisely the ways in which federal grants can increase pressure on state governments to raise taxes.

Other Effects

One of the other ways federal grants increase state spending is by lowering the effective cost of state investment on a desirable project, because each dollar increase in total spending requires less than a dollar of higher state spending. When this occurs, federal grants convince states to undertake projects that they would not have otherwise had the means to accomplish. There are numerous examples of this, but the Delmar Loop Trolley in St. Louis illustrates a common situation. Prior to receiving federal grant money, there was not sufficient private investment to fund construction, but with the federal funds, the effective cost was lowered to a point that the trolley project was undertaken. The trolley example also offers a cautionary tale about federal grants, in that after construction the Loop Trolley proved to be economically unsustainable on its own. But since the project had received grant funds that came with strings requiring the trolley to function for a specified amount of time, the St. Louis region is now investing funds to keep the trolley up and running to avoid having to pay federal government back for the money it received.[13]

Another hazard associated with federal grants is what is called the "ratchet" or "flypaper" effect. In essence, the idea is that temporary federal grant aid can lead to permanent increases in the level or cost of government services. Similar to the trolley example above, occasionally the federal government will offer funding to achieve some goal, but once states or local governments accept the money and create a government program, it becomes difficult for them to eliminate or scale back the program, even after the federal grant funding runs out.[14] A current example of this effect in Missouri is the push for continuous Medicaid coverage for new mothers. As part of the various COVID-19 relief bills, the federal government fully funded one year of Medicaid coverage for women who qualified for the program because of their pregnancy following the birth of a child. Funding for this extension will end once the federal public health emergency for the pandemic expires, but in Missouri, there's momentum for making this policy permanent, regardless of the likelihood of lower future federal investment.[15]

Unfunded Mandates

Another issue that comes up frequently in federalism research is the problem of unfunded mandates. With the rise of "coercive federalism," the federal government began establishing new programs or requirements that states must administer or adhere to under the banner of "national priorities." With these new programs, the federal

[3] Since the spending by the vast majority of states was clustered around the maintenance of effort threshold, it's reasonable to infer that they would have likely preferred to spend less but didn't because they didn't want to experience a sudden decrease in federal funds.

government distributes funds, but typically not enough to fully fund them, leaving states with the job of making up the remaining required investment.

For example, the Medicaid program is now a mandatory entitlement; when first enacted, the program was technically optional for states. Today, the federal government requires states to provide health coverage to any individual who meets program eligibility requirements, and the state must foot the bill regardless of its current fiscal or economic situation. In exchange for state's abiding by the federal rules, the federal government picks up at least 50% of the bill, but there's still an enormous state investment required.[16]

Many federal grant-in-aid programs with state components are discretionary, or optional. The problem is that many of these optional programs come with real costs if states decide to end them after agreeing to the federal government's original terms for accepting aid. As described earlier, even discretionary grant programs can come with MOE requirements. Then, if a state wants to eliminate the program, it will have to violate its MOE requirements, which can lead to reduced federal funds for other state programs as well.

An example of this is Missouri's Supplemental Nursing Program. This is a longstanding program, but its enrollment is shrinking and it no longer receives any federal funding.[17] Nevertheless, the federal government contends that if Missouri were to end its yearly investment in the program, the state could risk losing the entirety of its federal support for the Medicaid program.[18] To be clear, this means that if Missouri were to cut a program that costs $25 million per year, the federal government might take away more than $7 billion per year in Medicaid funding. Of course, it's not clear if the federal government would follow through on that threat, but there are many similar funding threats that make reducing reliance on federal funds quite difficult and potentially costly. It may ultimately be up to the U.S. Supreme Court to decide the extent to which the federal government can punish states financially for violating MOE requirements, but that discussion is beyond the scope of this report.

MISSOURI ANALYSIS

For this report's analysis of Missouri, I compiled 11 years of state spending data from the governor's executive budgets, encompassing fiscal years 2011 to 2022. Each of the state's 15 executive departments and the office

Table 2: **Missouri's Nominal Spending Growth since FY 2011**

Over the past decade, Missouri's expenditure growth varied, but overall, non-inflation-adjusted state spending is more than 42% higher today than it was in FY 2011.

Missouri Expenditures				
	FY 2011	FY 2013	FY 2019	FY 2022
General Revenue	$7,582,453,427	$7,950,526,950	$9,440,056,740	$10,365,415,980
Federal	$7,229,158,823	$7,104,743,159	$8,472,612,939	$12,778,398,707
Other	$7,582,443,275	$7,683,150,049	$8,250,004,486	$8,774,926,433
Total	$22,394,055,525	$22,738,420,158	$26,162,674,165	$31,918,741,120
Expenditure Growth				
	FY 2011–2013	FY 2013–2019	FY 2019–2022	FY 2011–2022
General Revenue	4.85%	18.73%	9.80%	36.70%
Federal	-1.72%	19.25%	50.82%	76.76%
Other	1.33%	7.38%	6.36%	15.73%
Total	1.54%	15.06%	22.00%	42.53%

Source: Missouri Office of Administration.

of administration are broken into divisions as they are separated in the executive budget, to allow for as much comparison as possible.[19] The spending for each division is then broken into General Revenue, Federal, and Other funds. General Revenue is the state's own-source revenue fund, comprised of predominantly sales and income taxes, which can be spent, for the most part, as Missouri's legislature sees fit. The federal funds are various federal grants-in-aid that correspond to different programs.[4] And finally, other funds are revenues that are dedicated either by statute or the Missouri Constitution to a specific source. For example, Missouri's gas tax is categorized as an "other" fund because it is required to be deposited into the state road fund, from which money funds can only be spent on state road projects.

The data in this report cover FY 2011 (July 1, 2010 to June 30, 2011) through FY 2022 (July 1, 2021 to June 30, 2022), during which period several large legislative and reorganizational changes occurred, which complicates a full causal analysis. Thus, the analysis here focuses on uncovering patterns and trends that could serve as the starting point for deeper investigation going forward.

Missouri Budget

Missouri's budget today is the largest it's been in state history. In fact, for ten consecutive years, the state has set a new record for spending. Over that period, as Table 2 shows, the budget has grown by more than 42% in nominal terms. And the vast majority of that growth was driven by federal spending, which increased by nearly 76% during that time.

[4] Some federal funds are also included in the next group of spending, Other funds. Due to state data limitations, it is quite difficult to separate all the possible federal funds that could be deposited into Other funds, so for the purposes of this report, federal spending will correspond to how the governor defines them in the yearly executive budget.

As you can see in Table 3, the story is less extreme once you adjust for inflation, but the overarching conclusions remain the same. Since FY 2011, Missouri's budget has grown by slightly more than 12% in inflation-adjusted terms, with the primary driver of growth being federal funding. Even after accounting for inflation, federal spending increased by nearly 40% over the past decade. But as mentioned earlier, the past decade or so has been abnormal from a budgetary sense, so deeper analysis is required to gain insight.

In both FY 2011 and FY 2012, Missouri's budget still included millions of ARRA dollars (though they were winding down), which helped artificially prop up the state's spending following the 2008 recession. As shown in Tables 2 and 3, while Missouri transitioned away from federal stimulus between FY 2011 and FY 2013, total state

Table 3: **Missouri's Inflation-adjusted Spending Growth Since FY 2011**

After adjusting for inflation, Missouri's spending of federal dollars has increased by more than 39% since FY 2011.

Missouri Expenditures				
	FY 2011	FY 2013	FY 2019	FY 2022
General Revenue	$9,634,068,493	$9,632,123,866	$10,470,777,524	$10,365,415,980
Federal	$9,185,181,540	$8,607,450,371	$9,397,702,532	$12,778,398,707
Other	$9,634,055,594	$9,308,194,717	$9,150,788,382	$8,774,926,433
Total	$28,453,305,626	$27,547,768,953	$29,019,268,437	$31,918,741,120
Expenditure Growth				
	FY 2011–2013	FY 2013–2019	FY 2019–2022	FY 2011–2022
General Revenue	−0.02%	8.71%	−1.01%	7.59%
Federal	−6.29%	9.18%	35.97%	39.12%
Other	−3.38%	−1.69%	−4.11%	−8.92%
Total	−3.18%	5.34%	9.99%	12.18%

Source: Missouri Office of Administration.

budget growth slowed or even declined after adjusting for inflation.

The period from FY 2013 to FY 2019 is the only period of state spending data that doesn't include federal stimulus or relief, as the COVID-19 pandemic began in FY 2020. Over this period, Missouri's budget began growing more quickly, with federal funding once again being the primary driver of spending growth. In nominal terms, total state spending increased by approximately 15% over seven years, and spending of federal funds grew by more than 19%.

After accounting for inflation, federal spending increased by a little more than 9%, while general revenue spending grew by a little less than 9%. Total spending *only* grew by around 5%, as a result of a decrease in other fund spending over the period.

How can the budgetary growth over this period be explained? One likely explanation is the passage and implementation of the Patient Protection and Affordable Care Act (ACA). While the ACA was signed into law in 2010, many of its Medicaid-related provisions that would impact state budgets didn't go into effect until 2014.

As Table 4 shows, Missouri's Medicaid costs grew significantly between FY13 and FY19. In fact, over this period—when total federal spending increased by approximately $790 million—Medicaid federal spending grew by nearly $720 million, accounting for greater than 91% of the spending growth. And in state-tax-dollar terms, Medicaid general revenue spending accounted for approximately 44% of all growth over the period.

Of course, the most significant growth in Missouri's budget in the past decade has been over the past three years with the COVID-19 pandemic. As Table 3 showed, total spending increased by nearly 10% from FY 2019 to FY 2022, while federal spending skyrocketed by almost 36%, both in inflation-adjusted terms. The worse news for Missouri is that this COVID-19-related spending is still ongoing, with Missouri's FY 2023 spending expected to exceed $40 billion.[20]

Unfortunately, these aggregate figures still don't shine enough light on the impact of the federal government on Missouri's budget. The growth in federal spending has affected some state departments much more than others. In fact, once you adjust for inflation, as shown in Table 5, total spending for six of the state's executive departments declined from FY 2011 to FY 2022. Over

Table 4: **Inflation-adjusted Total State Medicaid Spending Since FY 2011**

Missouri's total spending on its Medicaid program has increased by more than 23% since FY 2011.

Total State Medicaid Spending				
	FY 2011	FY 2013	FY 2019	FY 2022
General Revenue	$2,061,126,384	$2,045,686,905	$2,414,187,209	$2,616,290,058
Federal	$5,477,474,490	$5,488,110,407	$6,207,950,781	$7,327,737,594
Other	$2,707,523,287	$2,878,075,165	$2,910,679,790	$2,681,973,420
Total	$10,246,124,161	$10,411,872,477	$11,532,817,781	$12,626,001,072
Expenditure Growth				
	FY 2011–2013	FY 2013–2019	FY 2019–2022	FY 2011–2022
General Revenue	–0.75%	18.01%	8.37%	26.93%
Federal	0.19%	13.12%	18.04%	33.78%
Other	6.30%	1.13%	–7.86%	–0.94%
Total	1.62%	10.77%	9.48%	23.23%

Source: Missouri House of Representatives Budget Fast Facts.

Note: FY 2011 & FY 2013 Medicaid totals are appropriated amounts while FY 2019 & FY 2022 are actual spending.

Table 5: **Missouri Spending since FY 2011**

While Missouri's spending has increased significantly since FY 2011, much of this growth is concentrated among a few departments, with some even decreasing in size.

Spending Growth FY 2011–2022 (Inflation Adjusted)				
Department	General Revenue	Federal	Other	Total
Public Debt	–73.50%	0.00%	–80.25%	–74.28%
Elementary and Secondary Education	5.25%	45.56%	11.33%	16.71%
Higher Education	–8.78%	28.67%	–45.56%	–16.00%
Revenue	–38.01%	–62.33%	2.41%	–4.97%
Transportation	522.73%	9.42%	–31.54%	–28.48%
Office of Administration	90.30%	311.45%	–59.50%	101.76%
Employee Fringe Benefits	1.46%	9.28%	2.99%	3.35%
Agriculture	–67.29%	126.49%	29.14%	–14.90%
Natural Resources	170.59%	–4.20%	25.95%	26.99%
Conservation	0.00%	0.00%	2.35%	2.35%
Economic Development	42.26%	128.04%	-42.09%	89.41%
Commerce and Insurance	0.00%	-5.39%	28.85%	29.77%
Labor and Industrial Relations	–2.21%	–8.33%	29.98%	12.95%
Public Safety	2.76%	65.27%	–11.19%	13.63%
Corrections	–9.98%	–33.62%	5.97%	–9.02%
Mental Health	32.23%	104.80%	–52.25%	63.87%
Health and Senior Services	19.99%	34.41%	47.60%	30.74%
Social Services	15.02%	22.72%	0.09%	14.79%
Statewide Elected Officials	3.17%	12.97%	–2.96%	1.52%
Public Defender	22.06%	–100.00%	–31.62%	19.42%
General Assembly	–5.40%	0.00%	–52.20%	–5.61%
Judiciary	3.75%	-15.77%	812.13%	56.16%
Real Estate	–46.40%	–33.14%	–31.08%	–43.15%

Source: Missouri Office of Administration.

that same period, the six fastest-growing departments are some of the most federally reliant and account for more than $3.4 billion dollars in inflation-adjusted new spending. This is approximately the amount that state tax revenues grew during the same years.

Another less discussed impact of federal grants on state budgets is the creation of future spending obligations. One of the ways the federal government "helps" states administer their grants is by allowing states to use the granted funds on personnel. The problem is that, like other grant spending, it helps hide the true cost of personnel being funded, putting future state taxpayers on the hook for their fringe benefits.

As shown in Table 6, in FY 2022, Missouri had more than 53,000 full-time equivalent (FTE) employees. nearly 20% of whom were funded by the federal government. While it makes sense that the federal government would include money to help states administer federal programs, the result is more employees than the state's tax base could otherwise afford. Additionally, after working for the State of Missouri for 10 years, state employees become eligible for the state's pension plan. So, by using federal funds to cover current salaries, state governments create future pension liabilities far beyond what state salaries and tax dollars can support, because federal funding for a grant administration today is not going to be available to cover the pension payments for the rest of the employee's life.

Department of Elementary and Secondary Education (DESE)

DESE receives federal funding in multiple ways and according to numerous federal laws. A list (though not exhaustive) of federal sources of funds includes Titles I, II, III, IV, V, IX of the Every Student Succeeds Act (ESSA); USDA for the National Student Lunch Program; the IDEA programs for students with disabilities; and the Early Childhood Block Grant. The largest programs that fall under ESSA have had significant strings attached, such as moving every student in the state towards proficiency in math and reading under the No Child Left Behind Act of 2002, although these strings are occasionally loosened or tightened by Congress.

DESE's inflation-adjusted federal spending was more than 45% higher in FY 2022 than in FY 2011, yet general revenue expenditures remained mostly the same. In FY 2022 DESE received categorical grants, formula categorical grants, and block grants. The vast majority of the federal funds are spent by the Division of Financial and Administrative Services and the Division of Learning Services. It should also be noted that the biggest jump in federal expenditures happened in FY 2022 with a large influx of COVID relief funds; DESE's federal budget nearly doubled compared to FY 2021. It remains to be seen whether or how much DESE's budget will decrease once the short-term increase in federal funds is withdrawn.

Table 6: **Full-time Equivalent Workers by Funding Source**

Today, nearly 20% of all state employees are paid out of federal funds.

FTE in FY 2022				
Department	General Revenue	Federal	Other	Total
Public Debt	0.00	0.00	0.00	0.00
Elementary and Secondary Education	816.72	933.86	21.75	1,772.33
Higher Education	44.03	344.02	21.80	409.85
Revenue	812.02	4.74	443.29	1,260.05
Transportation	0.00	14.29	5,487.58	5,501.87
Office of Administration	710.92	322.84	861.22	1,894.98
Agriculture	92.77	47.76	328.23	468.76
Natural Resources	126.85	349.86	1,219.94	1,696.65
Conservation	0.00	0.00	1,790.81	1,790.81
Economic Development	73.60	29.18	56.23	159.01
Commerce and Insurance	16.00	0.00	753.08	769.08
Labor and Industrial Relations	22.22	599.54	178.36	800.12
Public Safety	494.57	479.83	4,145.55	5,119.95
Corrections	10,257.85	43.00	287.88	10,588.73
Mental Health	4,846.07	2,309.83	20.50	7,176.40
Health and Senior Services	609.88	962.11	183.01	1,755.00
Social Services	2,371.74	3,813.40	362.64	6,547.78
Statewide Elected Officials	625.08	94.63	262.31	982.02
Public Defender	670.13	0.00	2.00	672.13
General Assembly	689.92	0.00	1.25	691.17
Judiciary	3,278.30	142.25	60.50	3,481.05
Real Estate	0.00	0.00	0.00	0.00
Total	**26,558.67**	**10,491.14**	**16,487.93**	**53,537.74**

Source: Missouri Office of Administration.

Department of Economic Development (DED)

The DED experienced the biggest percentage increase (nearly 128%) in federal funding between FY 2011 and FY 2022. Additionally, state general revenue spending also increased by a little more than 42%.

Much of this difference can be explained by the growth of federal investment in "affordable housing." And though the state of Missouri, as well as the federal government, has invested in supporting affordable housing for the entire FY 2011–FY 2022 window, the COVID-19 pandemic and associated relief bills sent enormous amounts of aid toward the cause. With many workers forced to stay home, many businesses forced to close, and an eviction moratorium in place, the federal government sent more than $300 million in housing assistance in the form of categorical grants to Missouri in FY 2022. While affordable housing will likely remain a salient issue in Missouri long after the American Rescue Plan funds run out and Missouri will continue investing in some affordable housing programs, without additional action from the state's legislature, the budget growth for DED is likely short lived.

Medicaid

Outside of COVID relief funds, the single biggest driver of spending growth over the past decade has been the Medicaid program, which is a major reason why all the state departments with Medicaid expenditures also rank among the biggest growers.

State Medicaid programs are reimbursed on an open-ended basis for eligible costs incurred. In Missouri, for each dollar the state spends on Medicaid, the federal government will contribute around $2. And for the recently expanded Medicaid population, the federal match is $9 for each $1 spent by the state. Since this federal funding is dependent on state investment, as program enrollment increases and health care costs go up, Missouri will spend more of its own tax dollars, even while the federal government pitches in more as well.

As Figure 4 shows, Missouri's Medicaid enrollment increased significantly between 2014 and 2018 before falling in 2019. Today, the state's Medicaid enrollment sits at approximately 1.2 million recipients, meaning that 1 in 5 Missourians is enrolled, with an enormous increase over the past two years. This is the highest level of enrollment in state history, and correspondingly, the most expensive the program has ever been.

Department of Mental Health (DMH)

The DMH experienced an over 104% increase in federal spending between FY 2011 and FY 2022. This was accompanied by an approximately 32% increase in general revenue spending. Each year, DMH receives hundreds of millions of dollars for Medicaid services, which is one of the biggest drivers of the department's spending growth. In addition, over the past decade the department was the recipient of an Excellence in Mental Health grant, a formula-project categorical grant, which resulted in Missouri being one of a select few states receiving hundreds of millions of additional federal dollars. As the Excellence in Mental Health grant is expected to expire eventually, an enormous looming question for the department will be how they can absorb such a significant funding loss. Will there be an effort to keep the level of services provided the same at the expense of greater Missouri taxpayer investment, or will the department shrink back to its pre-grant size?

Department of Health and Senior Services (DHSS)

DHSS increased federal spending by more than 34% between FY 2011 and FY 2022. The department also increased general revenue spending by approximately 20%, or $64 million. This growth can mostly be attributed to the increased cost of Medicaid and the COVID-19 pandemic. DHSS provides state and federal funding for local health departments while also administering the state's home and community-based services for seniors and the disabled.

Department of Social Services (DSS)

DSS experienced an increase of nearly 23% in federal spending between FY 2011 and FY 2022. This may seem small, but due to the size of the department's budget it is actually the single largest increase in dollars at more than than $1.1 billion. Additionally, state general revenue investment in the department increased by approximately 15%, which is second to DMH in inflation-adjusted general revenue increases over the same period.

DSS is where the state's Medicaid agency resides, called MO HealthNet. The department handles the state's child welfare system and other welfare payments such as the Supplemental Nutrition Assistance Program (SNAP) and the Temporary Assistance for Needy Families (TANF) program.

Much of the department's federal growth over the past decade is directly related to the increasing cost of Medicaid. The department receives categorical and block grants to administer the numerous federal programs under its purview.

Department of Public Safety (DPS)

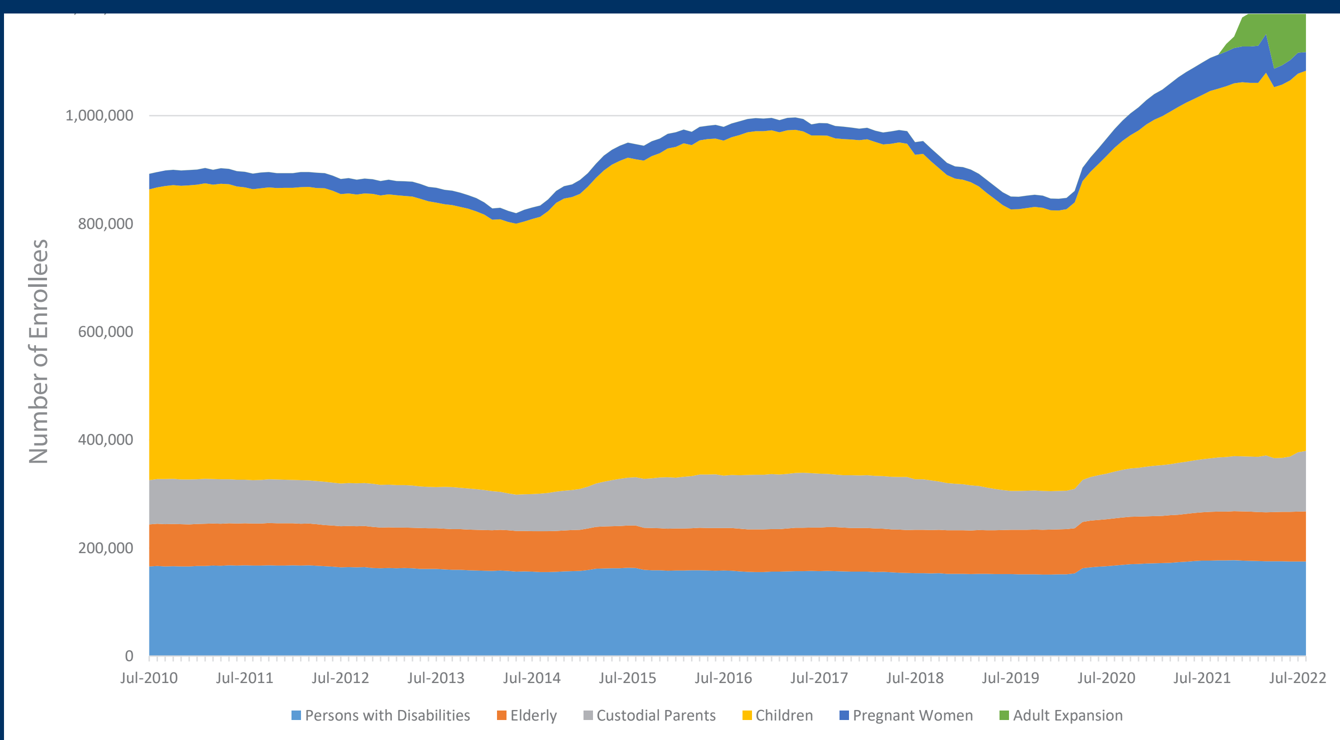
While the department of public safety's budget has grown significantly over the period being discussed, the biggest driver of growth has been the COVID-19 pandemic. DPS contains the state's Emergency Management Agency, which was charged with receiving, distributing, and coordinating a significant portion of the state's COVID-19 response. That is not to say that there aren't other areas of the department that have experienced spending growth over the same period, but the total spending as a result of COVID-19 dwarfs the rest.[5]

[5] The Missouri Department of Transportation also grew substantially during this period. However, the significant sum of federal funds the department receives is not considered federal spending for budgetary purposes, because they are deposited into the State Road Fund which is classified as an other fund.

Figure 4

Missouri Medicaid Enrollment

Missouri's Medicaid enrollment has increased significantly over the past three years.



Source: Missouri Department of Social Services.

Results

How much has federal policy affected Missouri spending? As a result of data limitations, this analysis cannot produce a causal estimate. However, using the aggregate figures we do have along with estimates from a collection of academic research, we can provide some insight on what's happening in Missouri.

According to analysis from the GAO, grant design plays a significant role in determining the effect of federal spending on total or state spending. For example, one analysis estimates that a $1 increase in federal grant aid for a program with a state matching requirement can increase total spending by up to $0.85.[21] On the other hand, if the grant doesn't have a matching component, a $1 increase in federal grant aid increases total spending by $0.42. In other words, between $0.15 and $0.58 of each dollar is used to substitute for state funds.

Alternatively, the effect on total spending for open-ended grant programs, like Medicaid, is much different. The same report as above estimates that a $1 increase in federal grant aid for an open-ended matching program increases total spending by $1.38. This means that these grants increase state spending by $0.38 in response to increased federal support. Or, as described at the beginning of this report, the third scenario in Figure 3.

Researchers have has also studied the size of the "ratchet" effect, or the effect of grant funding on total government spending. Results typically ranged in the area of $1 in increased federal grant spending increasing total state spending by $0.31 to $0.40, with an increase of $0.23 to $0.46 at the local level as well.[22] Very few have studied what direct impact federal grants have on state taxes, but one such effort suggests that for every percentage point increase in federal funding to states, state and local spending increases by 0.82 percentage point.[23]

For Missouri, it's not possible to determine the exact rate of substitution, but we do know how much Missouri's yearly revenues and expenditures have changed over the past decade. Since FY 2011, the state's federal expenditures have increased by approximately $5.5 billion while general revenue spending increased by nearly $2.8 billion in nominal terms. And as discussed previously, the growth in state spending is not evenly distributed across years, state executive departments, or even divisions within executive departments.

From FY 2011 to FY 2013, state spending increased in nominal terms while decreasing once adjusted for inflation. This period can be explained by the scaling back of federal stimulus funds following the 2008 recession, and also the shifting of more priorities that were temporarily propped up by federal funds onto general revenues.

Between FY 2013 and FY 2019, state spending increased significantly in both nominal and real terms. Following the passage and implementation of the ACA, Missouri's Medicaid program grew in cost and enrollment. For the period, the growth in federal spending on Medicaid accounted for more than 91% of the state's total federal spending growth. Spending of state general revenues was also severely impacted by Medicaid, as the program's growth also accounted for nearly 44% of the change in total spending.

Finally, between FY 2019 and FY 2022 Missouri experienced the greatest increase in state spending of the past decade. Federal spending exploded by more than 39% over the period, and the spending of federal COVID-19 relief dollars will continue after the publication of this report.

To combine the points from above, federal grants increase state spending, but not necessarily on a dollar-for-dollar basis because of substitution effects. In general, the grants that increase spending the most are open-ended matching grants, such as Medicaid. Missouri's budget has grown significantly over the past decade, with the primary driver of growth being federal funding. Outside of ongoing COVID spending, Medicaid following the ACA has been the biggest driver of state spending growth.

Growth in state spending, regardless of whether the source of funding is the federal government, has real cost to taxpayers. With Missouri's balanced budget requirement, increased cost pressures from Medicaid (which has a matching component) put pressure on state sources of revenue. There's a reason departments such as the Department of Higher Education and Workforce Development receive significantly less general revenue than they did in FY 2011, while the Medicaid-affiliated departments are among the fastest growers over the same period.

POLICY RECOMMENDATIONS

As the federal government slowly expands its grip on areas that were previously the responsibility of state and local governments, states must decide if they will push back or instead allow much of what is currently considered state governance to be curated in Washington, D.C. While the proposals listed below are ultimately issues that the federal government should tackle, Missouri can no longer afford to wait for Washington D.C., and should act now to begin improving its financial footing as it relates to federal grant aid.

Push for Greater Federal Flexibility

One of the key takeaways from this report is the coercive effect of the various strings the federal government attaches to the growing amount of funds they send to states each year. The strict use of categorical grants to fight state substitution of federal funds has made grants not only more expensive for states but also more difficult to administer. States should push the federal government to group more grants with like purposes into block grants that allow state governments greater flexibility in their use, which should allow for more efficient administration, lower costs to the states, and hopefully, better government service overall.

Unwind from Non-mandatory MOEs

As federal spending continues to grow, at some point states like Missouri need to start rejecting or rolling back some of the optional federal programs. These programs overwhelmingly come with MOE requirements that impose real costs to state taxpayers, and it's not financially wise to continue agreeing to the federal government's growing list of demands. As discussed earlier in this report, MOE requirements may make it more difficult to eliminate some programs than others, but it's important for states to consider the long-run costs and not only the immediate expenditures. Missouri should follow the model that Alaska and other states have adopted for their Medicaid programs, whereby they require periodic legislative review of discretionary services to evaluate whether a given service is fulfilling its originally intended purpose so that coverage of obsolete programs can be rolled back or stopped entirely. With so many grants and tangled strings of requirements, the long list of non-mandatory programs offers an excellent place to start the process of unwinding.

Improve Data/Accounting/Performance

Perhaps the biggest impediment to putting this report together was the data limitations at both the state and federal levels. If the GAO says the federal government has a data and accountability problems, I believe it—but Missouri's problem must be even worse. One of the original goals of this report was to attempt to measure how much increased federal spending had altered state spending. Accordingly, I went to Missouri's Accountability Portal, a website supposedly designed to allow Missourians to see how their tax dollars are being spent Navigating to the grant section, I found that the website either does not use the same definition of federal grant as the federal government does, or that participation in the website is optional among state departments. In total, the yearly amount of federal grant revenues falls implausibly short of what other sources show Missouri has received, let alone spent, in federal grant money.

As a result, I had to use publicly available budgeting documents, which appear to at least give an accurate total for the amount of federal funds being spent in a given year. The next tasks were trying to classify each dollar spent according to the grant type and measuring the match and MOE requirements, but these also proved to be impossible. As mentioned with regard to MoDOT, not every department classifies all the federal grants it receives as federal funds, and many departments don't even publish all of the information regarding the types or total number of grants they receive or what state spending is required. Due to these unfortunate data limitations, the website that accompanies this report only shows the types of grants each division receives, and even those might not be comprehensive.

Improving the grant in aid process will require at a minimum better and more accessible data so that taxpayers can determine what grants their government awarded and received, the requirements attached to those grants, and how that money was spent. Some of these improvements must be accomplished by the federal government, but there's clearly room for Missouri to do better.

Stop Spending Money Chasing Savings

One of the most pernicious lines of thinking surrounding federal grants is that they offer the recipient government some level of savings. Since state governments are constrained by current tax revenues, elected officials are often persuaded by the illusion of a deal in the form of a grant advancing a federal goal. The politician gets to demonstrate action and an investment, but what's left unsaid is where those precious state dollars could have otherwise been spent.

Whether it's unnecessary infrastructure projects like the famous Bridge to Nowhere in Alaska, or much more common and pervasive revenue-maximization practices like Medicaid provider taxes, the outcome is the same: excessive government spending today without regard for the long-term impact of that undertaking on state finances.

Reduce Overall Reliance and Prepare for the Next Recession

Finally, Missouri's elected officials should take a comprehensive look at the state's budget and begin taking steps to meaningfully reduce spending, which will require forgoing some federal funds. As illustrated in this report, among the federal government's most coercive expansions of power were the state bailouts during the 2008 recession and the COVID-19 pandemic. When states become overly reliant on outside sources of revenue without having sufficient savings of their own, they're more vulnerable to economic downturns. And when states cannot meet their spending obligations (for example, while revenues are declining during a downturn), they must depend on the federal government to bail them out as was done in 2008 and 2020. Such overreliance gives the federal government excessive power over the future of state governance and leaves states ill-equipped to tackle challenges in the future. Reducing federal reliance will not be easy, but it should nevertheless be a priority for our elected officials.

CONCLUSION

Over the past several decades, many decisions that have long been understood to be best made by those closest to voters and their communities have been shifted to Washington, D.C. For many, this issue may not seem like a cause for concern, but for those interested in small, effective governance, there aren't many issues of larger import.

Research on the impact of federal spending on state governments is clear. As the federal government grows in both size and scope, cost pressures on state governments and their tax bases will increase as well. Missouri has experienced this effect firsthand, with the state's spending increasing dramatically since FY 2011.

This report outlines several approaches for state policymakers to push back against federal excess. By advocating for greater flexibility in the spending of federal funds, and abandoning obsolete or duplicative federal programs, state taxpayers could realize both better government service and significant cost savings. In addition, improved data and grant accounting could make it much easier for Missourians to know what their government is doing while also making it easier for state bureaucrats to comply with the numerous federal grant performance requirements.

Finally, saving federalism will require a change in the mindset of Missouri's elected officials. Missourians are much better equipped to decide what level of government services they desire than those in Washington, D.C. By rejecting the dubious promises of continued future federal investment, Missouri can right its own fiscal ship without relying on the promise of a federal bailout.

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