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REPEALING THE STATE INCOME TAX BY 2020

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EXECUTIVE SUMMARY

Missouri suffers from a stubborn economic growth deficit that has grown larger over the past two decades. Signs of economic stagnation include below-average rates of job creation and population growth.

Part of the explanation for the widening "growth deficit" is a tax system that does not seem to be designed to improve the state's economic competitiveness. There is extensive economic literature showing that states with rising tax burdens lose jobs, income, and businesses to other states. Although Missouri is a relatively low-tax state, its tax advantage has been declining in recent years. Today its tax burden is roughly on par with those of its neighbors. It's not surprising that the state has had little success attracting new jobs and businesses.

We believe that Missouri can do better. The nine U.S. states with no income tax offer a particularly appealing model. They have enjoyed enviable success in attracting jobs, investment, and new residents. If Missouri phased out its own income tax, it could "break away from the pack" of Midwestern states. It would then offer a compelling alternative for prospective businesses and families interested in moving to the region and would increase wealth and opportunity for all of its residents.

This study provides an economically efficient and politically viable strategy for eliminating the state personal income tax (along with the state income tax and the capital gains tax) in Missouri within 14 years.

The proposal laid out in this study deals with the problems of mediocre economic growth and unsustainable growth in government spending. It is implemented in a way that does not lead to any reduction in real per capita state and local spending, meaning that public services will be maintained at existing real per capita levels. The plan does not require adding any debt to finance the income tax elimination. The proposal also provides a mechanism to deal with fiscal crises that may result from revenue shortfalls during recessions.

Generally speaking, high taxes stifle economic growth, while tax cuts can accelerate economic performance.

INTRODUCTION

Government spending and tax collections in Missouri have grown steadily over time. There is a voluminous literature suggesting that tax rates have a strong impact on economic growth in states and localities. Generally speaking, high taxes stifle economic growth, while tax cuts can accelerate economic performance, whether it is measured by income, output, job growth, new business start-ups, net migration rates, or other measures. Has Missouri's tax burden risen or fallen over time? And how does Missouri's tax burden compare with those of other states? They are both important questions. The absolute size of a state's tax burden directly affects the take-home pay of its workers, which is directly related to workers' quality of life. And low taxes give a state an advantage in the competition for new business investment and job creation.

In evaluating a state's tax burden it is customary to consider both state and local government together. Both impose burdens on taxpayers that impact the behavior of firms and workers. Moreover, the role of local governments in delivering public services and collecting taxes varies a good deal between states. Looking only at state tax policies can give a distorted view of the relative tax burdens in different states.

Because taxes impact economic growth, this study examines the trends in taxation in Missouri in some detail. It also examines the areas where Missouri is at a competitive disadvantage relative to other states. We start off by reviewing recent economic literature that explores the relationship between taxes and economic performance. Then we examine Missouri's economic performance in recent years. How has Missouri's economy performed, both absolutely and relative to its peers? And what can we do about it?

TAXES AND ECONOMIC GROWTH

Interpreting macroeconomic data is sometimes more an art than a science. An economy is a complex system, and it can be difficult to isolate the effect of any one factor on a state's economic performance. At the state level, that difficulty is compounded by a relative scarcity of high-quality data.

With that said, there are few better-supported macroeconomic propositions than this: high taxes are bad for economic growth. They lower the growth of income, wealth, employment, capital investment, and in-migration. Hardly a month goes by without some scholar writing a paper showing the adverse effects of tax increases and the positive effects of tax reductions. To demonstrate that point, we provide some quotations from four studies published by the nation's most prestigious economic research organization, the National Bureau of Economic Research:

> "Americans now work 50 percent more than do Germans, French and Italians. This was not the case in the early 1970s... this marginal tax rate accounts for the predominance of the differences at points in time and the large change in relative labor supply over time."[1]

> "Regressions on rich-country samples in the mid 1990s indicate that a unit

> standard deviation tax rate difference of 12.8 percentage points leads to 122 fewer market work hours per adult per year, a drop of 4.9 percentage points in the employment-population ratio, and a rise in the shadow economy equal to 3.8 percent of GDP."[2]

> "The individual income tax burden on dividends was lowered sharply in 2003 from a maximum rate of 35% to 15%... The surge in regular dividend payments after the 2003 reform is unprecedented in recent years."[3]

> "This evidence is consistent with the notion that wealthy elderly people change their real (or reported) state of residence to avoid high state taxes..."[4]

The first two of these studies (one by a winner of the Nobel Prize in Economics, Edward Prescott) say that high taxes lead to significant reductions in the amount of work people do. They find that both the number of workers and the average work week fall in response to higher taxes. The other studies find that when dividends are taxed less, there are more of them, and that people move into lower-tax states and out of higher-tax ones.

In the late 1970s and early 1980s, studies utilizing new computer-based statistical techniques confirmed that high taxes lead to lower growth. Pioneer academic studies and popular writings by Robert Genetski, Arthur Laffer and associates, Richard Vedder, Jay Helms, George Gilder, Alan Reynolds, the late Warren Brookes, and others all said in various ways that lowering taxes stimulated economic activity.[5]

With the passage of time, the studies became more sophisticated, using, for example, computable general equilibrium statistical methods to evaluate tax effects. But the results were essentially the same—high taxes are bad, if economic prosperity and growth are prime objectives. A few examples will give the flavor of this more recent research. The Dutch economist Jarig van Sinderen, using a complex macroeconomic model, concluded, "Balanced budget reductions in taxes on wages and profits exert favorable effects on employment and growth."[6] Similarly, the German economist Bernhard Heitger concluded that for "the most important OECD countries, taxation turns out to be growth-retarding."[7] In an important study Eric Engen and Jonathan Skinner reaffirmed and summarized the mass of evidence on the negative growth-tax relationship.[8]

In a more popular vein, many prefer to look at simpler examples that lack the technical sophistication of these scholarly studies but illustrate the effects of taxes on the economy. For example, the following are facts:

- From 1990 to 1999, nearly 2.9 million Americans moved out of the 41 states with individual income taxes and into the 9 states without income taxes;[9]
- From 1957 to 1997, real personal income rose 390 percent in the 10 states with the lowest average state and local tax burdens, compared with only 177 percent for the ten states with the highest burdens;[10]

The absolute size of a state's tax burden directly affects the take-home pay of its workers.

Low taxes give a state an advantage in the competition for new business investment and job creation.

- Low-tax states have consistently outperformed higher-tax states; low-tax Florida and Texas have outperformed higher-tax California; low-tax Tennessee has far outdistanced neighboring higher-tax Kentucky; low-tax New Hampshire has outperformed higher-tax Maine.[11]

The evidence is decisive: a state that values economic growth and wants a higher standard of living should work to lower its overall tax burden.

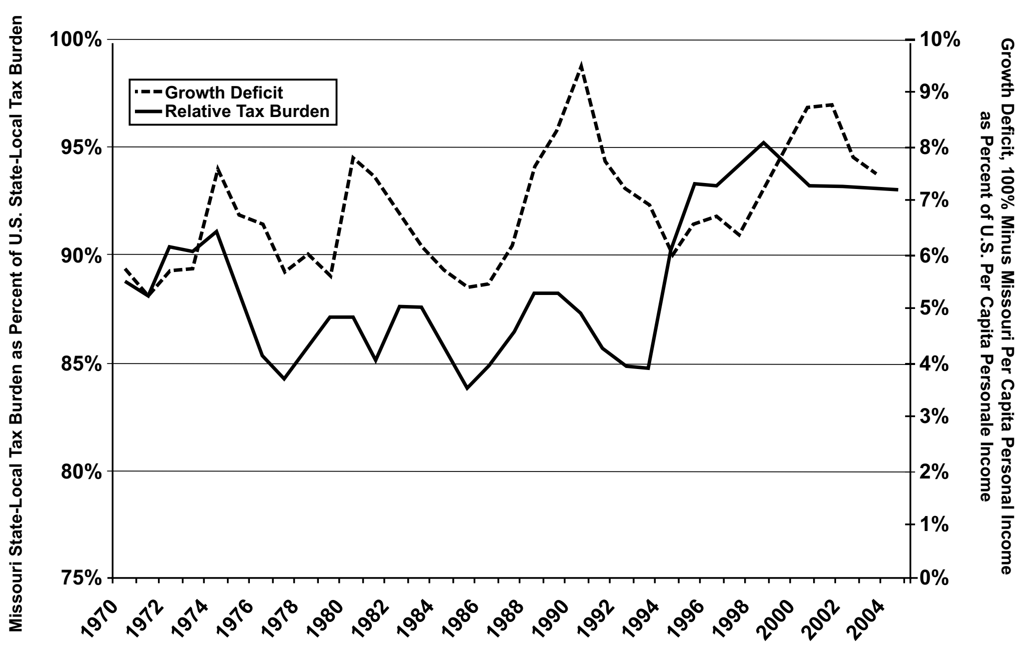
ECONOMIC GROWTH: MISSOURI'S MEDIOCRE PERFORMANCE

By most indicators, Missouri's economic performance in recent times is so-so; Missouri is not a high-performing state, but neither is it a "basket case." On the whole, we would characterize Missouri as moderately below average. The right reconfiguration of policies could bring Missouri from below average to above average over the next few years.

Figure 1 compares Missouri's tax burden as a percentage of the national average to Missouri's "growth deficit"—the extent to which Missouri's per capita income lags behind the national average. Two features are evident from the graph. First, Missouri has been falling steadily behind its peers in per capita income. Per capita income was just five percent below the national average in 1970, but the gap is nearly 8 percent today.[12] That's hardly an indication of a vibrant, growth-oriented economy. Second, Missouri's low-tax advantage nearly evaporated in the 1990s, dropping from 15 percent to just over 5 percent.[13]

Table 1 compares total income in 2005 and inflation-adjusted growth in total

Figure 1: Missouri Growth Deficit Increases as Relative Tax Burden Increases



Source: Tax Foundation State and Local Tax Burdens[14]; Bureau of Economic Analysis Regional Economic Accounts.[15]

income over the previous ten years for Missouri, Missouri's neighbors, and the states that have no income tax (excluding Alaska). Growth in Missouri's income is below the rate of growth of national income, the rates of growth of all but two of the neighboring states, and the rates of growth of all the states that have no income tax.

The signs of economic stagnation are not confined to personal income statistics. From 1990 to 2004, population increased by 17.6 percent nationally—but by only 12.2 percent in Missouri.[17] The reason is suggested by migration statistics. In the period 2000-2004, Missouri had modest in-migration of people (mostly from immigration)—but far less than was typical for a state of Missouri's size. People migrate in search of better economic opportunities. The fact that Missouri is a low in-migration state (with only 55,927 in-migrants from 2000-2004, compared with more than 100,000 for a typical state with Missouri's population)[18] is a sign that it is not perceived by potential migrants to have economic promise.

Finally, there is strong evidence that the productivity of workers in Missouri is below the national average, and, worse, that labor productivity growth in Missouri is below national norms. In the absence of barriers to wage setting, wages are a good proxy for the marginal product of labor. In 2002, the average pay of full-time year-round workers in Missouri was $33,118, 10 percent lower than the national average of $36,764. Average real wage growth in the U.S. from 1990 to 2002 was 10.6 percent, compared with only 8.3 percent in Missouri.[19]

Table 1: Missouri vs. the Nation: Total Income and Its Growth, 1995-2005

	TOTAL INCOME, 2005	PERCENT GROWTH, 1995-2005
Missouri	216	23.75
United States	12,403	34.33
BORDER STATES		
Arkansas	87	28.86
Illinois	560	22.67
Iowa	114	25.20
Kansas	105	30.39
Kentucky	140	22.78
Nebraska	70	24.36
Oklahoma	121	37.09
Tennessee	227	32.12
STATES WITH NO INCOME TAX		
Florida	674	56.64
Nevada	111	74.20
New Hampshire	56	32.82
South Dakota	31	37.42
Tennessee	227	32.12
Texas	982	53.21
Washington	269	36.92
Wyoming	27	45.28
Total income is in billions of current dollars. Growth is adjusted for inflation.		

Source: Bureau of Economic Analysis, Gross State Product.[16]

TAXES AND NON-TAX REVENUES: MISSOURI AND THE NATION

With this mediocre economic performance in mind, we turn to Missouri's tax and revenue system, as measured by state and local taxes (or other revenues) as a percentage of personal income. Table 2 lists the total per-capita tax burden for 2006 for Missouri and neighboring states as estimated by the non-partisan Tax Foundation. Taxes can be compared on a per capita basis or as a percentage of total personal income. Each measure has its uses, but tax revenue as a percentage of income is a better indicator of the tax burden or the overall tax rate that

High taxes are bad, if economic prosperity and growth are prime objectives.

A state that values economic growth and wants a higher standard of living should work to lower its overall tax burden.

Table 2: State and Local Taxes as a Percent of Personal Income, 2006

STATE	TAXES AS PERCENT OF PERSONAL INCOME	NATIONAL RANK
Missouri	9.9	34
United States	10.6	n.a.
Arkansas	10.3	27
Illinois	10.9	14
Iowa	10.4	26
Kansas	10.7	18
Kentucky	10.7	20
Nebraska	11.6	6
Oklahoma	9.6	40
Tennessee	8.7	47

Source: Tax Foundation[20]

taxpayers pay. Three thousand dollars in taxes per capita is a much larger burden on the population of Mississippi than on the population of Connecticut, a state with nearly double the per capita income.

The data suggest that Missouri is a moderately low-tax state but that it has no great advantage over its most important neighbors. While Missouri has an advantage relative to neighboring states Nebraska and Kentucky, its tax burden is somewhat higher than Tennessee's. And probably the two most important border states are Illinois and Kansas, which share with Missouri the metropolitan areas of Saint Louis and Kansas City, respectively. Missouri's tax burden is lower than the tax burdens in those two states, but only marginally so—by one percentage point or less. Missouri could do better.

The Tax Foundation data, while useful, lack some details helpful in making interstate comparisons and exclude important non-tax forms of revenue like fees, miscellaneous income, and federal grants. Table 3 compares Missouri with the U.S. average tax burden on several major sources of revenue. Unfortunately, the most recent Census Bureau data with great detail is from 2002.

Overall, including non-tax revenue sources, slightly over 18 percent of the personal income of Missouri residents goes to finance state and local government, a slightly smaller proportion than the national average (19 percent). The tax burden is about 8 percent less than the national average, and revenues from fees, charges, and miscellaneous

Table 3: State and Local Revenues Per $1,000 Personal Income, Missouri vs. United States, 2002

REVENUE SOURCE	MISSOURI	UNITED STATES	MISSOURI RELATIVE TO UNITED STATES
Taxes	95.03	102.92	- 7.7%
Charges, Misc.	41.53	47.68	- 12.8%
Total Own Revenue	**136.56**	**150.60**	**- 9.3%**
Federal Grants	46.05	41.00	+12.3%
Total Gen. Reven.	**$182.61**	**$191.60**	**- 4.7%**

Source: U.S. Census Bureau, 2002 Census of Governments

Table 4: Major State and Local Tax Burdens Per $1,000 Personal Income, 2002

TYPE OF TAX	MISSOURI	UNITED STATES	MISSOURI RELATIVE TO UNITED STATES
General Sales	$26.68	$25.36	+ 5.2
Selective Sales	11.30	11.49	- 1.7
Property	24.38	31.74	-23.2
Individual Income	24.69	23.07	+7.0
Corporate Income	1.57	3.20	-50.9
Other	6.41	8.06	-20.5
Total	**95.03**	**102.92**	**- 7.7**

Source: 2002 Census of Governments, Bureau of Economic Analysis, Authors' calculations.

sources (e.g., lotteries, interest income) are 13 percent lower than the national norm.

Missouri received more federal grant revenue than most states. Missouri got 25 percent of its total revenue from Washington, compared with 21 percent in the typical state. Some consider this to be a blessing. However, many federal grants come with strings attached that require the state to spend its own funds. That's clearly not an unmitigated benefit.

Tax revenues are larger than all the other revenue categories combined. Moreover, given the vast literature showing a negative correlation between economic performance and taxation, it is the most important category from a policy standpoint. Accordingly, in Table 4, we look at several major categories of taxes. Like most states, Missouri depends mainly on three types of taxes: sales or consumption taxes, property taxes, and income taxes.

Missouri's sales tax burden closely mirrors the national average. It is slightly higher in general sales taxes, but a bit lower in excise taxes, which are levied

Missouri has been falling steadily behind its peers in per capita income.

Table 5: Important Tax Rates, Missouri and Bordering States, 2004

STATE	INDIVIDUAL INCOME TAX (PERCENT)	CORPORATE INCOME TAX+ (PERCENT)	CIGARETTE TAX (PER PACK)	GASOLINE TAX (PER GALLON)
MISSOURI	6.00	6.25	$0.17	$0.17
Arkansas	7.00	6.50	$0.33	$0.22
Illinois	3.00	7.30	$0.98	$0.30
Iowa	6.20 (8.98*)	7.20	$0.36	$0.20
Kansas	6.45	4.00	$0.79	$0.24
Kentucky	6.00	8.25	$0.03	$0.15
Nebraska	6.84	7.81	$0.34	$0.25
Oklahoma	7.00	6.00	$0.23	$0.26
Tennessee	0.00	6.50	$0.20	$0.20

+Definition of income varies, including federal tax deductibility, so rates are not strictly comparable. *Full federal income tax deductibility is allowed, so for most income taxpayers, 6.2 percent is effective top rate.

Source: Tax Foundation.[21]

Table 6: Three Rankings of State Tax Systems, Missouri and Its Neighbors

STATE	TAX FOUNDATION RANKING	*BLOOMBERG* RANKING	SBSC RANKING	AVERAGE RANKING
Missouri	15	30	18	21
Arkansas	35	18	16	23
Illinois	25	31	23	26
Iowa	43	32	41	39
Kansas	31	38	31	33
Kentucky	39	24	28	30
Nebraska	44	44	32	40
Oklahoma	21	28	29	26
Tennessee	18	3	15	12

Sources: Tax Foundation,[22] *Bloomberg Wealth Manager* magazine, Small Business Survival Index 2005.[23]

on particular products like tobacco or alcohol. Missouri has a relatively low state sales tax, but makes aggressive use of local sales taxes. The one area where Missouri is clearly a relatively low-tax state is property taxes, where the burden is more than 20 percent below the national average. The relatively low property tax explains virtually all of the differential between Missouri and the nation in overall tax burden.

Growth in Missouri's income is below the rate of growth of national income.

The total (individual and corporate) income tax burden in Missouri closely approximates the national average. Missouri's individual income tax rate is moderately above the national average, while the corporate tax burden is markedly below average. In the category of "other taxes," Missouri is noticeably below the national average.

To provide even greater detail, we outline in Table 5 for Missouri and neighboring states the top rates of the individual and corporate income taxes, as well as two important excise taxes, those on cigarettes and gasoline. With regard to the income tax, Missouri's top rate of six percent is similar to the rates of several neighbors (Iowa, Kentucky, Kansas, and Nebraska), but it is markedly above that of its most populous neighbor Illinois, which has a flat rate income tax, and that of Tennessee, which has no general income tax.

Corporate taxation in Missouri seems roughly comparable to corporate taxation in several competing states, although definitions of taxable income vary, making comparisons difficult. Missouri has a relatively low cigarette tax, although the rate is markedly above the rate in neighboring Kentucky; the same is true, to a lesser extent, of the gasoline tax.

Tax burdens are important in an absolute sense, but also as they compare with other states. A number of organizations rank states' overall tax systems. Some also include other non-tax factors, such as the litigation environment, workers' compensation insurance costs, etc. Table 6 looks at three such rankings: the 2007 Business Tax Climate Index prepared by the Tax Foundation, a Small Business Survival Index done by the Small Business Survival Committee, and an index of "wealth friendliness" calculated by *Bloomberg Wealth Manager* magazine.

Missouri's performance on this ranking is respectable, but (unlike Tennessee's) it does not give the state a decisive advantage over its neighbors.
If you believe the Tax Foundation's Business Tax Climate index, Missouri has a pretty good tax system, better than any of its neighbors and at the bottom of the top quartile of American states—giving it a letter grade (with "C" being an average grade), it would probably get a "B." The Small Business Survival Committee, focusing on small business and including a number of non-tax costs such as worker

Table 7: Missouri's $11.8 Billion Tax Revenue Windfall

YEAR	TAX REVENUE (MILLIONS OF DOLLARS)	POPULATION (THOUSANDS OF PEOPLE)	CPI	POPULATION PLUS INFLATION GROWTH RATE (PERCENT)	CAPPED REVENUE (MILLIONS OF DOLLARS)	WINDFALL
1993	5,480	5,271	145		5,480	
1994	5,910	5,324	148	3.6	5,676	234
1995	6,752	5,378	152	3.8	5,894	858
1996	7,210	5,432	157	3.9	6,126	1,084
1997	7,816	5,481	161	3.2	6,323	1,493
1998	8,222	5,522	163	2.3	6,468	1,754
1999	8,564	5,562	167	2.9	6,658	1,906
2000	8,572	5,595	172	4	6,921	1,650
2001	8,837	5,637	177	3.6	7,170	1,667
2002	8,729	5,670	180	2.2	7,326	1,403
2003	8,627	5,704	184	2.9	7,536	1,091
						Total Windfall: 11,816

Sources: Bureau of Economic Analysis; U.S. Census; Bureau of Labor Statistics

and unemployment compensation, finds Missouri above the national average, but also below Arkansas and Tennessee (which by nearly everyone's account is a relatively low-tax state). Bloomberg Wealth Manager focuses on taxes imposed on wealth—capital gains levies, property taxes, etc., in an attempt to find out which states are most congenial to wealthy individuals. Missouri ranks below average at 30th, below several neighbors (especially Tennessee, but also Arkansas, Kentucky and Oklahoma), and only slightly above some others (Illinois, Iowa).

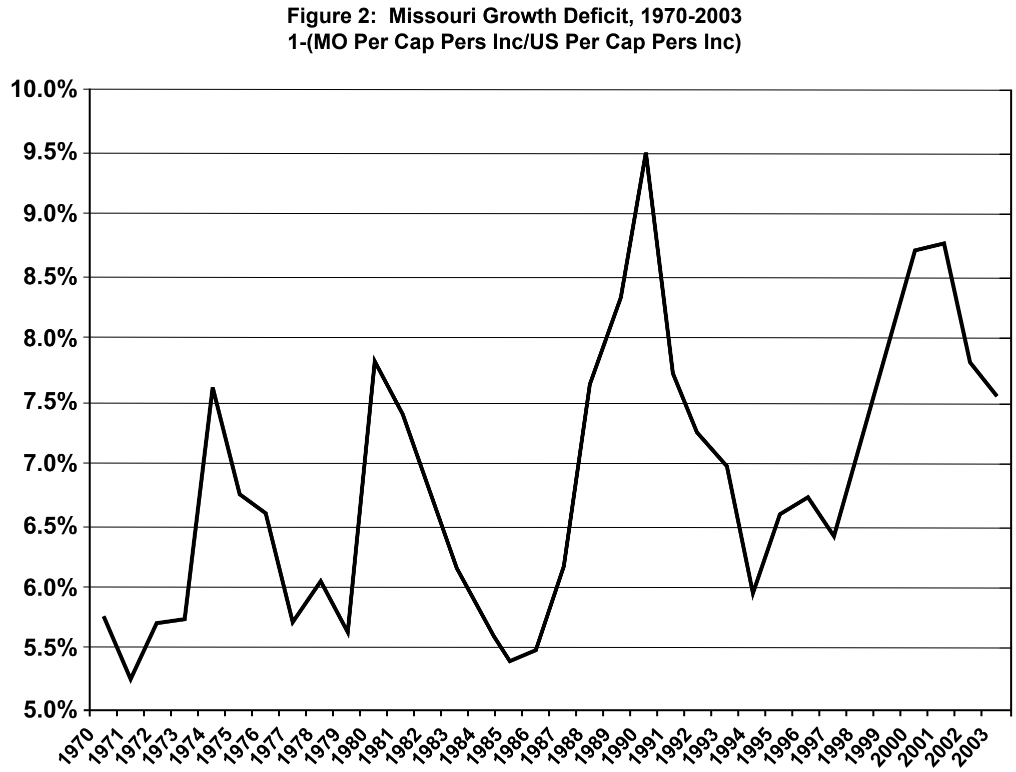
Taken as a whole, Missouri's tax system does not give it an advantage over other states in the competition for resources. The average of the three rankings, 21st, is a bit above the national average, but not enough to make Missouri stand out—unlike Tennessee, one of the best states, and a state that has achieved much more impressive economic gains in recent years.[24] The best that can be said is that Missouri is not a bad state, unlike neighboring Nebraska which ranks in the bottom quartile. The fact that a majority of Missouri's neighbors are also "near average" states suggests that a low-tax/wealth-friendly strategy might allow Missouri to "break away from the pack" and attract investors looking for higher returns on their physical and human capital.

MISSOURI'S $11.8 BILLION TAX REVENUE WINDFALL

A reasonable benchmark for state tax revenue collections is the growth of a state's population plus inflation. In this section we estimate the size of Missouri's excess tax collections by how much revenue intake has exceeded inflation plus population growth over the course of a recent ten-year period. The answer is provided in the table below. If Missouri had strictly adhered to such a revenue cap from 1994 through 2003, taxpayers would have saved a combined total of $11.8 billion, or over $2000 per person.

Average real wage growth in the U.S. from 1990 to 2002 was 10.6 percent, compared with only 8.3 percent in Missouri.

Taken as a whole, Missouri's tax system does not give it an advantage over other states in the competition for resources.



Source: BEA

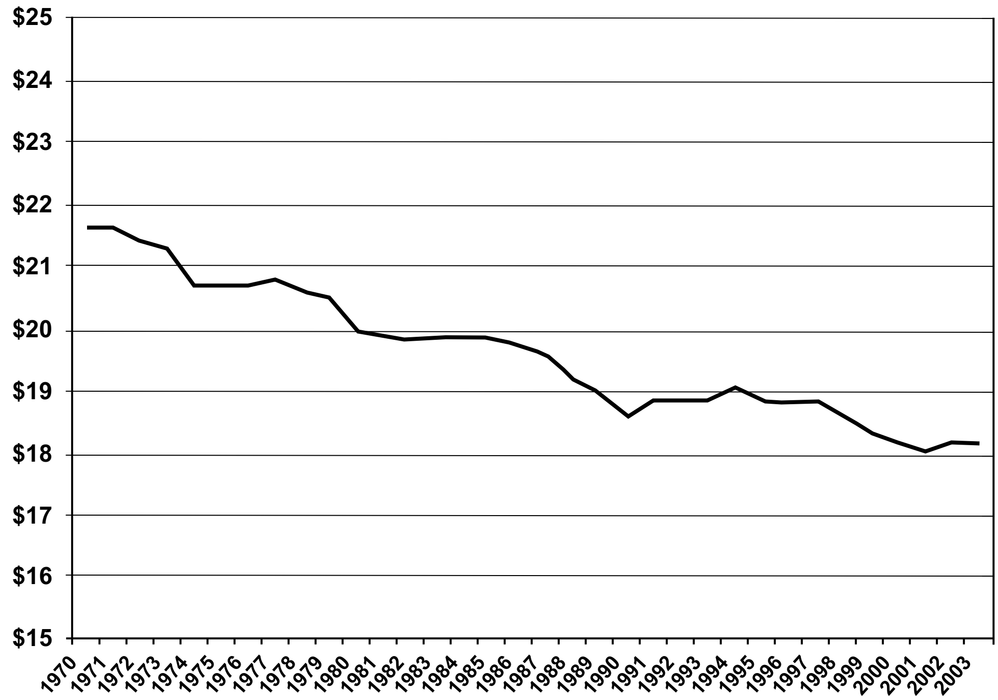
GROWTH AND TAXES IN MISSOURI: AN HISTORICAL PERSPECTIVE

Another method of examining economic growth in Missouri is to ask whether Missouri is heading in the right direction. In this section we provide an historical perspective on the economic and tax situation in Missouri. If the tax burden in Missouri had been steadily falling relative to the nation over the past several decades, then that fact would hint at an improving future, with Missouri moving towards a greater tax advantage in the long run. Similarly, if the mediocre record of economic growth in the past decade were contradicted by earlier, more encouraging trends, that would help us identify the beginning of economic stagnation and relate that to taxes and other developments.

Turning first to the issue of economic performance, the most comprehensive measure of economic well-being is usually considered to be per capita income. Data on personal income per capita are available for the states for several decades. In Figure 2, Missouri's growth deficit is analyzed over time. The growth deficit is defined as the percentage that Missouri's per capita income falls below the national average. In an economy with no interference by government in market processes, we would expect the growth deficit to decline over time, as Missouri's growth would converge on the national average.

Figure 2 shows increasing long-term divergence. In 1970, the growth deficit

Figure 3: Personal Income Generated by Missourians Per $1000 U.S. Personal Income



Source: BEA

was less than six percent of income, whereas today it is around 7.5 percent. That deficit rose particularly sharply in the late 1980s, fell in the early 1990s (although not to the previous low), and rose during the boom from 1993 to 2000, falling off some since. The long-run trend, however, is a rising growth deficit. By other measures, such as Missouri's personal income as a percentage of the national total, the downward trend in growth is even more pronounced.(see Figure 3) Missouri's economy has been in a slow decline relative to other states for decades.

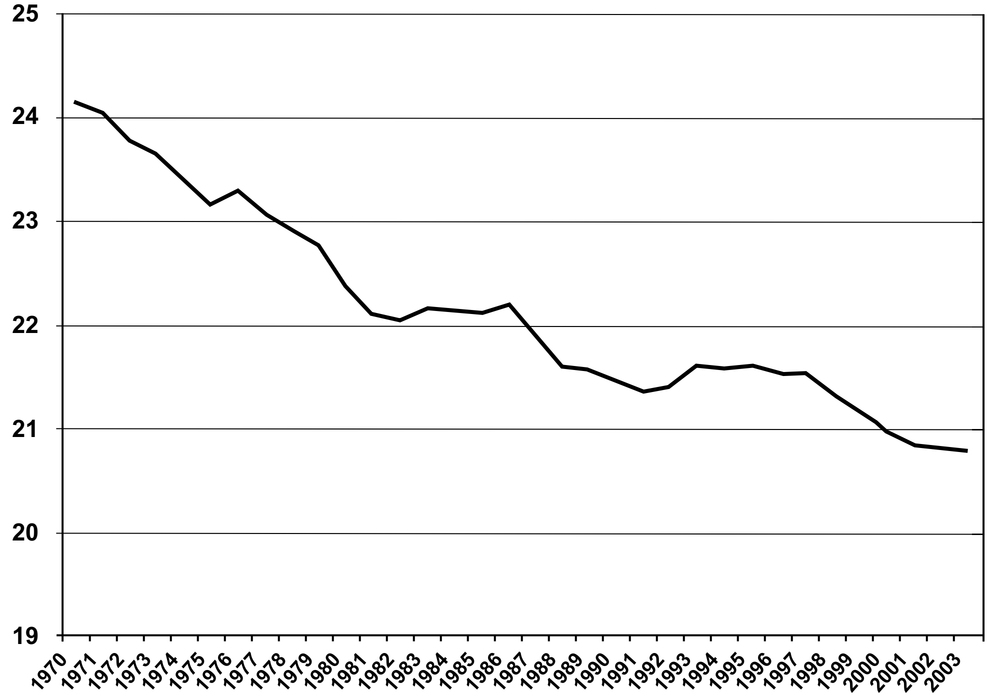
Figure 4 shows that the trend in employment is similar to the trend in income. Missouri's share of U.S. employment has steadily declined over time, falling by about 15 percent since 1970. No wonder migration statistics suggest that the Show-Me State is not perceived to be a land of economic opportunity.

The trends with respect to the state and local tax burden, presented in Figure 5, show that Missouri is converging on the national average, meaning that the state's "tax advantage" is narrowing. In the early 1970s, the tax burden in Missouri was about one percentage point less than the national average. While Missouri's tax burden fell in the late 1970s, the national burden did as well, so the differential changed little. In the 1980s, the tax burden rose somewhat in Missouri, but less so than for the nation as a whole, so by 1990 the tax advantage was exceeding 1.5 percentage points. Tax burdens were over 15 percent lower in Missouri. In the 1990s, the difference narrowed sharply, so today it is about 0.7 percentage points, actually less than in was in 1970. The tax burden in Missouri rose sharply from 1993

A reasonable benchmark for state tax revenue collections is the growth of a state's population plus inflation.

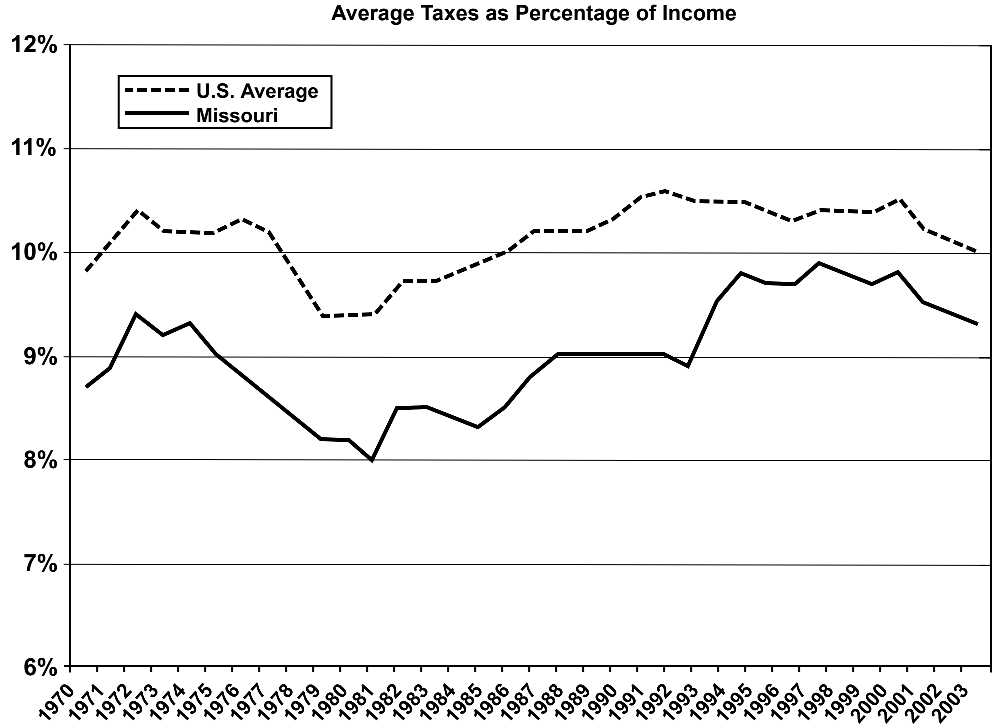
If Missouri had strictly adhered to such a revenue cap from 1994 through 2003, taxpayers would have saved a combined total of $11.8 billion.

Figure 4: Number of Missourians Working Per 1000 U.S. Workers



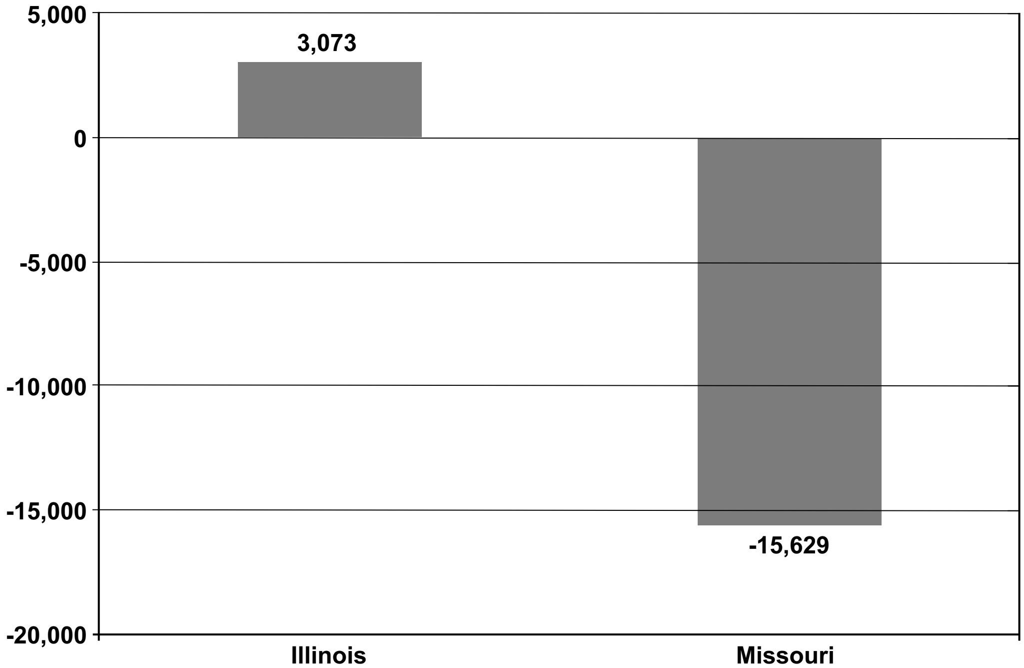
Source: BEA

Figure 5: Missouri State-Local Tax Burden Moves Toward National Average Taxes as Percentage of Income



Source: Tax Foundation

Figure 6: Saint Louis SMSA Domestic Migration, 2000-2004



Source: Census Bureau

Missouri's economy has been in a slow decline relative to other states for decades.

to 1998, while it was declining nationally. Although the Missouri burden has fallen somewhat since, so has the national burden.

SAINT LOUIS AND KANSAS CITY: CASE STUDIES IN THE IMPACT OF TAXATION

Missouri is unusual in that its two largest population centers—Saint Louis and Kansas City—both border on other states. People who work in these cities choose to live in one of two states. The existence of alternative tax policies in neighboring states allows for an interesting comparison between the Missouri portions of the Saint Louis and Kansas City Standard Metropolitan Statistical Areas (SMSAs), and the portions in the bordering states (Illinois in the case of Saint Louis, Kansas in the case of Kansas City).

The existence of an earnings tax in the two large Missouri cities means that the effective top marginal income tax rate is seven percent—a high rate by national standards, higher than the Illinois rate and marginally higher than the top Kansas rate. Income taxes are particularly devastating in their adverse economic effects, so one would expect that people would try to avoid the Missouri tax by living in one of the lower-tax states.

Recently released data from the Census Bureau verify this.[25] The Census Bureau has estimated population change and its components for every county in the United States over the period from April 1, 2000 (date of the last decennial census) to July 1, 2004). We examined the migration components of that change, concentrating on internal migration between the states.

As Figures 6 and 7 indicate, in both metropolitan areas, the non-Missouri parts are attracting residents while the Missouri parts are showing losses or little change. The best example is Saint Louis, where there is net migration into Illinois (top income tax rate of 3 percent) and out of Missouri (where for many the top rate is 7 percent). Kansas City's experience is only slightly better. In the entire metro area, there was net in-migration of 13,854 persons—but virtually all of that (nearly 95 percent) occurred on the less populous Kansas side of the border.

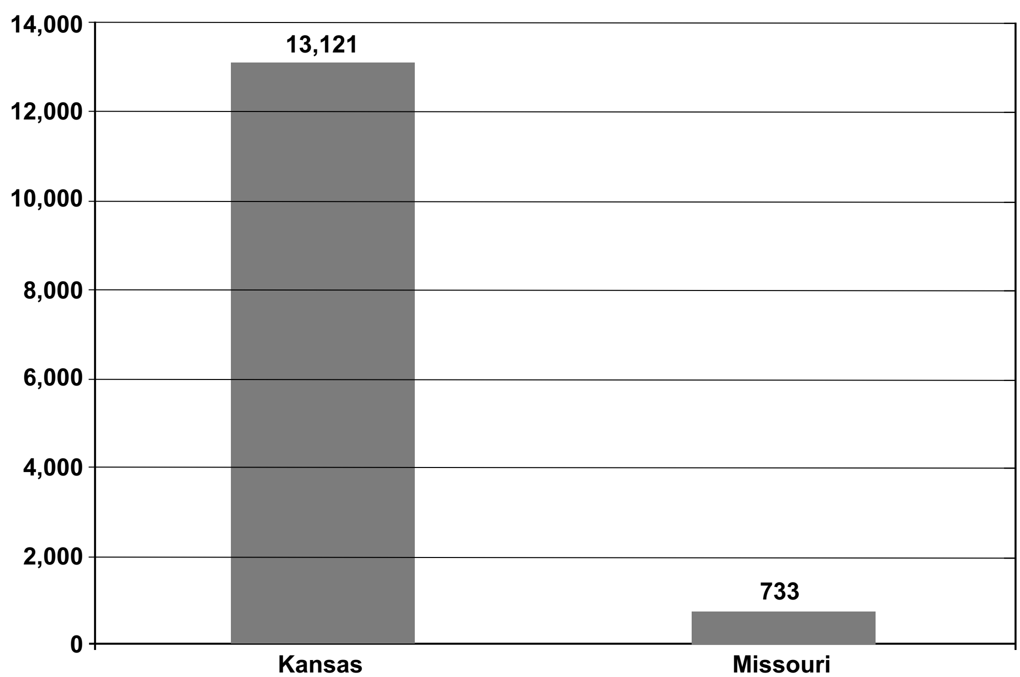
Income taxes are particularly devastating in their adverse economic effects.

An extension of this cross-border analysis would probably show similar trends in rural areas. For example, we looked at the two Missouri counties bordering Tennessee, Pemiscot and New Madrid, and compared them with the neighboring Tennessee counties of Dyer and Lake. The entire region is a poor rural area losing population. More than five-sixths of out-migration to other states occurred on the Missouri side. Net out-migration was 1,931, and well over 90 percent of that (1,771) occurred on the Missouri side. It is noteworthy that Tennessee has no tax on personal labor income.

BENEFITS OF LOWER TAXES

This analysis of Missouri's tax system relative to other states suggests that Missouri is not using its tax system in a way that enhances the state's economic performance. By many measures, the tax system is about average. Moreover,

Figure 7: Kansas City SMSA Domestic Migration, 2000-2004



Source: Census Bureau

whatever tax advantage Missouri once had has eroded over time—adding to the sluggishness of Missouri's economic performance relative to the nation.

The reason high taxes lower economic performance is simple: high taxes reduce the resources available to the private sector, which is motivated by profits and competition to be efficient and to improve the quality of the goods and services produced. While the private sector is largely competitive, governments are largely monopolies. While the private sector is driven by profits and market discipline, decision making in the public sector is isolated from such discipline, lacks a clear "bottom line," and is mired in inefficient political decision-making. It also suffers from what economists call "rent-seeking," actions by special interests who try to capture public monies for their personal financial gain, often by taxing more productive private interests. High taxes crowd out productive private sector activity, replacing it with less productive public sector spending.

Given all this, it seems Missouri would benefit from a more growth-oriented fiscal policy stressing lowering taxes on capital. Tennessee, which has had the most outstanding economic growth performance within the region,[26] and which has no personal income tax, should be the model.

We also believe that now is a propitious time to implement this program. Nationally, states are in a better fiscal condition than they have been in five years and perhaps ever, with surpluses now reaching into the tens of billions, thanks to ongoing economic expansion. Missouri is enjoying record surplus tax receipts, and at least some of those tax revenues should go towards phasing out the income tax.

Our plan calls on the state to limit general fund expenditures in each year to the rate of growth of population plus inflation—as several other states have done successfully. By dedicating the revenues above this spending amount to a phase-out of the personal and corporate income tax, within 14 years the state income tax regime could be ratcheted down to zero. Missouri would then be the tenth state in the nation without the economic impediment of a state personal income tax.

These estimates are based on static analysis of tax revenue generation, which means that our analysis assumes there will be no macroeconomic changes in the state as a result of phasing out the income tax. But we expect that eliminating the income tax will cause faster economic growth and will generate slightly more rapid growth in tax revenues. It is likely that if this dynamic feedback effect on revenues is properly accounted for, the state income tax could be totally eliminated more quickly than the 14 years predicted by our static forecast.

In the rest of this study we provide a detailed "roadmap" for phasing out the income tax in 14 years. We also show how much lower taxes would be today in Missouri if this plan had been implemented back in 1991. Finally, we offer evidence on the mostly favorable impact of tax/expenditure limits on other states—including Colorado, which enacted a Taxpayer Bill of Rights in 1992 and which is the model for the Missouri tax and spending limitation plan we propose here.

Missouri is not using its tax system in a way that enhances the state's economic performance.

While the private sector is largely competitive, governments are largely monopolies.

THE "ROADMAP" PROPOSAL

We propose that Missouri pass two constitutional amendments to create a growth-friendly fiscal climate.

- A tax and expenditure limitation (TEL) amendment strengthening the Hancock Amendment, which would reduce the fast rate of spending growth that is crowding out private sector investment and economic activity.
- A 14 year phase-out of the personal and corporate income tax, to be written into the state constitution in a "no income tax" amendment based on the Florida model. The top rate on the individual income tax, for example, would decline by slightly more than 43 basis points per year, going from 6 percent now to 5.57 percent in the first year of the phase-out, 5.14 percent in the second year, and so on. The spending reduction amendment would also allow for some additional tax relief to be enacted by statute. Under any reasonable scenario, funding would allow for the income tax elimination without any reduction in real per capita spending by state and local governments.

We anticipate that this fiscal plan would provide a major stimulus to economic activity in Missouri. The announcement of a continuously falling income tax rate should send a powerful signal that Missouri welcomes productive individuals and capital investments that create income and wealth. While the precise long-term economic effects are not known, historical experiences with other tax reductions suggest that over the long run an increase in gross state product of 0.3 to 0.5 percent a year is likely. The long-term impact would be to raise personal income in Missouri by several percentage points over what it otherwise would be. Also, based on the experiences of other states, we expect that eliminating the income tax would lead to an in-migration of productive human and capital resources.

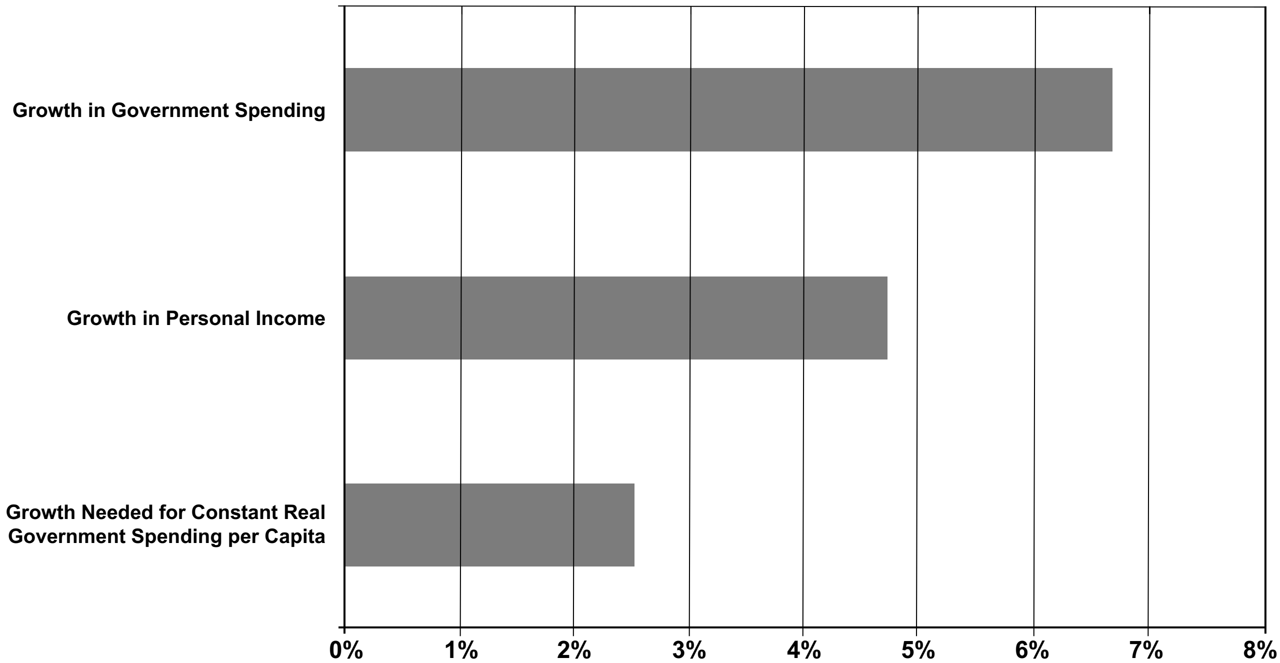
FISCAL FEASIBILITY OF THE PLAN

Throughout most of the past 15 years Missouri has had increases in expenditures that far exceeded what would have been needed to maintain levels of services after adjusting for inflation and population growth. The rapid rates of growth in spending and revenue are expected to continue. In the past, this growth in revenue has gone entirely for higher state and local spending.

Figure 8 shows that in the decade between fiscal years 1994 and 2004, state spending (excluding spending for government-owned public utilities) rose by 6.68 percent a year, more than double the increase justified solely on the grounds of inflation and population growth, and even substantially more than income in the state was rising, so government was claiming an ever increasing proportion of state resources.

This historical comparison led us to do a calculation of what would have happened if a 14 year phase-out of the income tax had been implemented between 1991 and 2004. Figure 9 shows actual 1991 state and local expenditures

Figure 8: Annual Growth in Income and Government Spending in Missouri, 1994-2004



Source: U.S. Bureau of the Census; 2004 government spending is estimated by the authors.

(excluding utility operations), 2004 actual expenditures, 2004 spending if the inflation plus population growth limits were in effect, the gap between those figures, and 2004 income tax revenues.

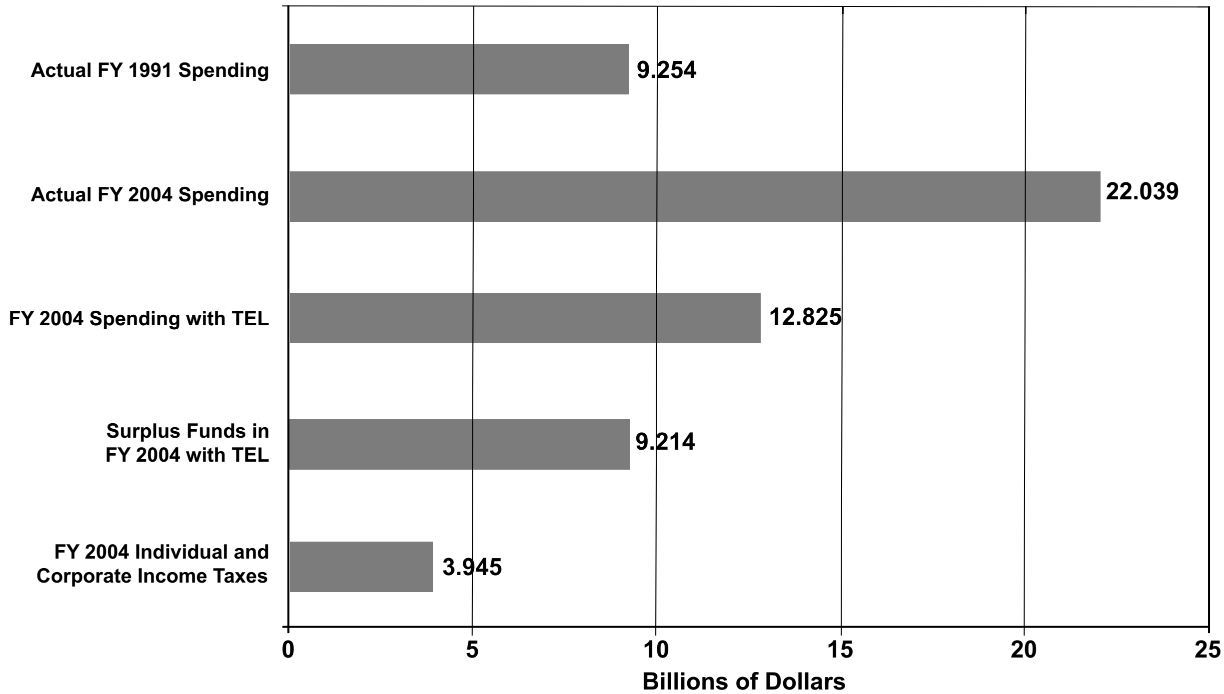
From 1991 to 2004, spending rose by $12.8 billion. An enforceable TEL capping the rate of spending growth to the rate of inflation plus population growth would have allowed an increase of $3.6 billion. This means that spending would have risen $9 billion less than it actually did. If the income tax had been phased out during this period, the tax elimination would have eaten up about 42 percent of the surplus generated from spending restraint, still leaving about $5.3 billion in additional surplus. This exercise suggests that eliminating the income tax over fourteen years in conjunction with a spending limit is not only feasible, but conservative. It allows a margin for error in the event that future economic growth is significantly less robust than it has been in the past.

This historical model needs to be qualified and modified in three important ways. First of all, in the 1991 to 2004 period, some of the spending increase that actually occurred was funded by tax and fee increases impermissible under a TEL, so the growth in spending would have been somewhat lower if a TEL had been in place. Second, a reduction in state and local spending almost certainly would have induced some reduction in federal grant monies provided on a matching basis. Third, the economic growth effects of income tax elimination would certainly have stimulated greater income growth, leading to higher tax and user fee collections than observed in the earlier period.

Suppose tax and fee increases enacted between 1991 and 2004 raised

High taxes crowd out productive private sector activity, replacing it with less productive public sector spending.

Figure 9: The Feasibility of Eliminating Income Taxes in 14 Years



Source: Authors' calculations from 2005 U.S. Bureau of the Census data and GDP Deflator.[27]

It seems Missouri would benefit from a more growth-oriented fiscal policy stressing lowering taxes on capital.

$1.5 billion in annual revenue in 2004 that was in turn spent (it is virtually impossible to know with certainty the exact amount, since many small local tax and fee increases are not readily measurable). This would be about 7 percent of 2004 revenues, a significant increase in burden. Suppose also that in the presence of a TEL amendment, federal support would have declined. Some federal assistance is on a matching basis, and a state-induced spending reduction would trigger some reduction in federal aid. We assume that federal revenues would be lower by $1.6 billion—a reduction of about 30 percent. Thus, the total loss would be $3.1 billion – reducing the surplus from spending reduction estimated in Figure 9 to $6.1 billion. That is still well above the $3.9 billion needed to offset the elimination of the income tax.

What if we are wrong and, because of a recession, in some year the revenues obtained with the 14 year income tax phase-out would be inadequate to prevent a decline in per capita expenditures? There are two possible ways to cope with such a situation. In good years, when government revenues are above the level needed to fund expenditures and the phased-in income tax reductions, excess funds could be placed in a rainy day fund that could not be touched by politicians. In bad years, when there is a revenue shortfall, the rainy day fund could be used to finance expenditures as well as the phased-in income tax reduction.

Second, if the rainy day fund were exhausted and revenues were inadequate to permit spending increases to cover inflation and population growth and to cover the phased-in income tax reduction, the income tax reduction could be postponed for a year (or even more if the funding shortfall were to persist). In such a case, it might take 15 or 16 years, rather than 14, to phase in the elimination of the income tax. But the elimination of the tax within two decades can be done without any material disruption of local services.

AN ALTERNATIVE METHOD OF CALCULATION

From 1995 to 2005, personal income per capita in the State of Missouri grew by 1.97 percent a year if one corrects for inflation using the broadest based price index, the gross domestic product price deflator. The growth is less (about 1.10 percent a year) using the Consumer Price Index for All Urban Consumers, but the CPI-U has been criticized repeatedly by economists for overstating inflation.

Let us assume that personal income per capita will grow slightly more than 2 percent a year during the period of income tax phase-out. We assume 2.02 percent real growth, only slightly greater than the 1.97 percent growth observed in the 1995 to 2005 period. That reflects very modest positive dynamic effects in the first years of the income tax phase-out. Let us assume that real per capita spending by the state and local governments initially equals real per capita state and local revenues—that the state operates on a balanced budget. Assume also that under the new TEL, real per capita spending remains constant. Let us include all state and local government spending, except utilities.

We assume that the phase-out begins the 2006 calendar year. In order to keep calculations easy to understand, we index 2006 state personal income per capita to 100. Since total state spending in Missouri is equal to about 10.5 percent of personal income, the value for state spending would be 10.5. And because income tax revenues are equal to about 2.97 percent of personal income, we give the value of 2.97 for income tax revenues, meaning non-income collections are 7.53 (10.5

Missouri is enjoying record surplus tax receipts, and at least some of those tax revenues should go towards phasing out the income tax.

Table 8: The Elimination of the Missouri Income Tax, 2006-2020

YEAR	PERSONAL INCOME	SPENDING	INCOME TAX	OTHER REVENUES	SPENDING AS % OF INCOME
2006	100.00	10.5	2.97	7.53	10.50
2007	102.02	10.5	2.78	7.72	10.29
2008	104.08	10.5	2.59	7.91	10.09
2009	106.18	10.5	2.39	8.11	9.89
2010	108.33	10.5	2.19	8.31	9.69
2011	110.51	10.5	1.98	8.52	9.50
2012	112.75	10.5	1.77	8.73	9.31
2013	115.02	10.5	1.55	8.95	9.13
2014	117.35	10.5	1.33	9.17	8.95
2015	119.72	10.5	1.10	9.40	8.77
2016	122.13	10.5	0.86	9.64	8.60
2017	124.60	10.5	0.62	9.88	8.43
2018	127.12	10.5	0.37	10.13	8.26
2019	129.68	10.5	0.12	10.38	8.10
2020	132.30	10.5	0.00	10.50	7.94

*All numbers are on an inflation-adjusted, per-capita basis.

Table 9: Spending, Revenues, and Personal Income under the Roadmap to Income Tax Elimination

YEAR	PERSONAL INCOME (BILLIONS OF 2006 $)	SPENDING (BILLIONS OF 2006 $)	INCOME TAX (BILLIONS OF 2006 $)	OTHER REVENUES
2006	189.20	19.37	5.48	13.89
2007	194.35	19.51	5.24	14.26
2008	199.63	19.64	4.99	14.65
2009	205.06	19.78	4.71	15.07
2010	210.64	19.92	4.41	15.51
2011	216.37	20.06	4.07	15.98
2012	222.25	20.20	3.72	16.48
2013	228.30	20.34	3.33	17.01
2014	234.51	20.48	2.92	17.56
2015	240.89	20.62	2.47	18.16
2016	247.44	20.77	1.97	18.80
2017	254.17	20.91	1.45	19.46
2018	261.08	21.06	0.89	20.17
2019	268.19	21.21	0.49	20.72
2020	275.48	21.36	0.00	21.36

Source: Fiscal Year 2006 Budget Recommendations[29] and authors' calculations

Our plan calls on the state to limit general fund expenditures in each year to the rate of growth of population plus inflation—as several other states have done successfully.

minus 2.97). We further assume that other revenues grow at a rate of 2.5 percent per year—well under the 4.7 average annual growth rate seen in the 1994-2004 period.

Table 8 lists the values of the critical variables for each year after 2006.

The 14 year income tax elimination plan is financed in part by expected growth in non-income tax revenues. We make very conservative assumptions about income growth, not assuming a high rate of growth as a result of tax reduction.

We convert this analysis into actual budget and income levels for Missouri in Table 9. We assume that the population grows at a rate of 0.7 percent per year, the average annual rate from 2000-2005.[28] Note that spending grows in every year, as does total tax revenue. Total personal income in the state rises from $189.2 billion to $275.5 billion—and this assumes only a very modest positive feedback from the tax cuts.

HOW TO PHASE OUT THE INCOME TAX RATES

The tax reduction could take several forms, but the simplest would be to reduce rates across the board by 0.43 percentage points per year for 14 years. This would bring the 6% rate down to zero in year 15. Since the top rate is reached at an extremely low income of less than $10,000 annually, the Missouri tax is, effectively, a flat rate tax with a high marginal rate. It would be simplest to simply go to a 5.57 percent flat rate tax in the first year of reduction, followed by

0.43 basis point reductions annually. But if the legislature wished to reduce all the rates by 1/14th each year, that would be workable as well.

By implication, the phase-out of the income tax would eliminate two related economically destructive taxes, each of which raises very little money for the state treasury. The first is the state corporate income tax. The second is the capital gains tax—which is part of the income tax, although a phase-out of the income tax would not require eliminating the capital gains tax.

These taxes are so inefficient that we strongly recommend that any income tax phase-out also eliminate them as well. They could be eliminated within the 14-year framework of the plan.

ECONOMIC EFFECTS OF AN INCOME TAX PHASE-OUT

What would be the economic effects of such a change? Historical data suggest that the dynamic growth impact would be significant, raising typical family incomes by thousands of dollars annually within a decade. The economic impact, of course, will grow over time, as it takes time for resources to adjust to the new tax environment.

One final issue that would add to the attractiveness of the income tax phase-out is that the federal government now allows the deduction of sales tax receipts from federal taxes. In the past, the bias in favor of income taxes has been presented as an argument in favor of retaining and even hiking income taxes, because state taxpayers could deduct the higher income taxes from their federal payments. Now they can deduct state and local sales and income taxes, so the bias in favor of income taxes has disappeared.

Furthermore, there is now talk of eliminating deductibility of all state and local taxes. This would give an advantage to states that lower their overall tax burdens as Missouri would under this plan. The recent report of the president's tax reform commission recommends the limitation of tax deductions for state and local income taxes. Such a move would dramatically increase the federal tax burden on individuals in high income tax states and increase the potential economic gains from resource movement and creation as a consequence of income tax elimination. The income gains of Missouri also are partly impacted by the reactions of neighboring states, with the positive economic growth effect in Missouri being greater the less other states respond. If the flat tax movement in Europe is any indication, within a few years, other states might lower their taxes on income to meet the competitive threat from Missouri. While this could have some modest short term negative consequences on Missouri (fewer resources moving in from neighboring states), it would make Missouri a model for the nation and an economic beacon that other states seek to follow.

ADDITIONAL ISSUES ON THE SPENDING CAP

The analysis above assumes steady 2.5 percent growth in government revenues. Obviously, economic growth

We expect that eliminating the income tax will cause faster economic growth.

We anticipate that this fiscal plan would provide a major stimulus to economic activity in Missouri.

is not uniform from year to year. In some years higher growth will generate surpluses, and in other years lower growth will cause fiscal strains. That is why some accumulation of surpluses into a rainy day fund may be appropriate, but only if those funds can be used to cover revenue shortfalls without increasing real spending per capita.

The analysis above includes a broad definition of government expenditures. It may be decided, for example, that government pension programs should be excluded from the spending constraint. We question the appropriateness of doing so, but their exclusion would not materially change the analysis.

Tax and expenditure limitation plans can cause tensions between state and local governments, and between agencies funded by taxes and agencies funded by fees. The state legislature will be tempted to squeeze local spending in order to increase spending at the state level in real terms, while local authorities will demand that their operations be allowed to grow in real terms at the expense of state programs. Obviously, changes in revenue-sharing arrangements between state and local governments are likely to be necessary in order to stay within the constraints of the constitutional spending limitation.

The problem with quasi-commercial operations also needs to be addressed. Suppose the University of Missouri decides to increase spending funded by tuition increases not explicitly authorized by the legislature. This would force non-University spending to decline, other things equal, to stay within the constitutional limitation. Given the rapid increase in university spending in modern times, and evidence of falling productivity, some constraints imposed on university spending growth are likely to be desirable, but this does mean that the autonomy of agencies with fee-granting powers may have to be circumscribed somewhat to meet the constitutional mandate.

An additional issue arises with outside funding, both federal grants and private gifts. Suppose someone gives the University of Missouri $50 million for a new science facility. Should that count against the spending limit? There are arguments either way. Regarding federal grants, excluding government-funded expenditures from the base for calculations could potentially alter the pattern of allowable expenditure. It seems to us that spending is spending, whether funded internally or externally, so as a general proposition it is best to include all spending in the base except perhaps business/commercial activities like utilities, hospitals, and, arguably, state universities.

IMPACT ON ADEQUACY OF PUBLIC FUNDING

Our analysis assumes that the state will curtail expenditure growth to the rate of inflation plus population growth. However, some would argue that government-provided services such as health and education services are facing a higher rate of inflation. As a consequence, they would argue, the proposed TEL forces a real reduction in government services. We would argue that the costs of most of these services have risen dramatically precisely because of the third party nature of payments involved, and because customers have little incentive to conserve on resource usage.

RECESSIONS

Our analysis of the historical growth path of the economy in Missouri takes into account recessions and growth periods. But what happens if a recession occurs during the phase-out period for the income tax? It is likely that a recession will occur sometime in the next 14 years, as occurred in 2001 and 2002 in many states. We would proceed with the scheduled phase-out in any case. Reducing the state income tax is one of the best pro-growth policies the state could undertake. To prevent erratic spending changes owing to some volatility in income growth, it might be desirable to use a three year moving average in calculating the permissible spending cap, even though this increases the complexity of the plan.

But it may well be that during a recessionary period, the political willpower to control expenditures and reduce tax rates will subside. If that happens, one possibility would be to postpone the spending cap and income tax phase-out for the period of the recession—particularly if tax receipts slowed dramatically. A trigger mechanism to temporarily delay tax reduction could take effect that might stretch the tax elimination program by one or two years, but the path to zero would be resumed after the recession ended. This would guarantee that the plan would not require cuts in vital infrastructure, public safety, education or social services.

Although many critics have claimed that TELs are not an effective means of restraining the growth of taxes and spending, the evidence says otherwise. In a 1994 Cato Institute study, economist Dean Stansel found that the five-year growth rate of per capita state spending in TEL states fell from 0.8 percentage points above the U.S. average in the five years before TEL enactment to 2.9 percentage points below the U.S. average in the five years after enactment.[30] Per capita spending in TEL states fell from 6.4 percent above the U.S. average in the year of TEL enactment to only 1.7 percent above the U.S. average in 1992. If the level of per capita spending in TEL states had not declined, the state spending burden per family of four in those states would have been, on average, $450 more in 1992 than it was.[31]

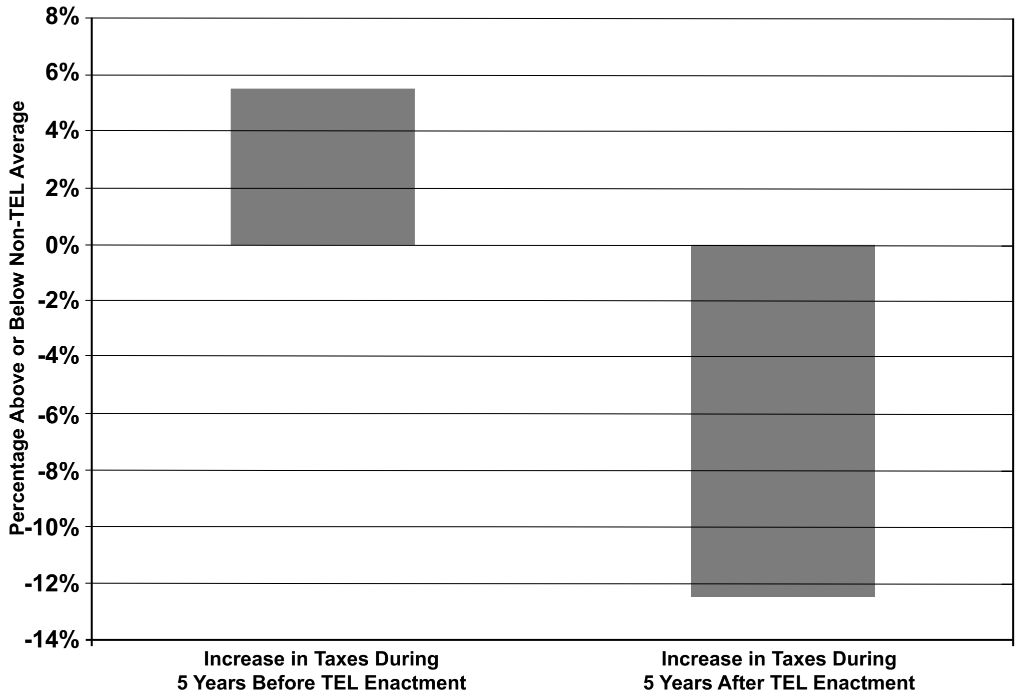
Stansel reached similar conclusions in a 1998 Cato study, finding that that "the five-year growth rate of per capita state taxes in TEL states fell from 5.5 percentage points above the non-TEL-state average before TEL enactment to 12.5 percentage points below the non-TEL-state average after TEL enactment" (Figure 10).

The study also found that the average growth rate of per capita state taxes in TEL states from the year of enactment through 1992, as opposed to just five years after enactment, fell even lower, to 13.2 percentage points below the non-TEL-state average.[33]

In another study, University of Colorado economist Barry Poulson found that the impact of TELs on state spending during their first four years of existence was "negative for all [TEL] states and

We expect that eliminating the income tax would lead to an in-migration of productive human and capital resources.

Figure 10: Growth Rates of Per Capita State Taxes Before and After TEL Enactment



Source: Cato Institute[32]

Reducing the state income tax is one of the best pro-growth policies the state could undertake.

significant for seven of those states. The implication is that for these seven states the absence of the TEL would have resulted in significantly greater increases in government expenditures in the short run."[34]

In sum, TELs appear to have imposed restraint on the growth of state budgets and taxes. But it is also true that some states have designed TELs that work better than others. Based on the experience of the 26 TEL states, we believe that a modified version of the Colorado Taxpayer Bill of Rights (or TABOR) would work best for Missouri.

A TAXPAYER BILL OF RIGHTS FOR MISSOURI

Colorado has probably the strictest tax and expenditure limitation (TEL) law of the 26 states that have such limits. Colorado voters passed TABOR in 1992 to end the undisciplined spending and tax increases of the 1980s, which increased the effective state income tax rate by 15 percent and the gasoline tax by 214 per¬cent. TABOR limits Colorado taxes and spending to the rate of population growth plus inflation and requires the state to rebate surplus tax revenues back to taxpayers annually. Colorado rebated $139 million in 1997, $563 million in 1998, $679 million in 1999, and $941 million in 2000. Indeed, Colorado's TEL (the Taxpayers' Bill of Rights) is the model for other states. Revenue growth above the growth rate of population plus inflation must be rebated. This bars the state government from increasing spending too quickly during periods of strong revenue growth.

As we propose for Missouri, Colorado devoted some of its surpluses for tax reduction. Since its inception, TABOR has been crucial to protecting the interests of individuals, families, and the economy from the harm caused by higher taxes and government spending. Because rev¬enues cannot grow faster than the com¬mon-sense combination of inflation plus population growth, TABOR resulted in taxpayer refunds of $3.25 billion over 10 years and a reduction in the state income tax rate from 5 percent to 4.63 percent. Yet schools, roads, and other vital services have been fully funded in the years since TABOR took effect. Colorado Governor Bill Owens has called the tax limitation procedure a "fiscal strait jacket on government that saves taxpayer dollars."

The one structural flaw in TABOR was a tight restriction on state spending during recessions that never lets the budget "catch up" to population and inflation in subsequent years because of a permanent reduction in the spending baseline. For example, when revenues dropped in 2003 and 2004, the TABOR limit fell to the new lower revenue level. The TABOR limit actually grew slightly (but not at the pace of population and inflation). Then when revenues recovered in 2005, the TABOR baseline was permanently lowered and was never allowed to jump back up to the previous level.

This has been called the ratchet effect, and has caused many critics to label TABOR a failure. In 2005, voters in Colorado called for a five year "time out" on TABOR to allow spending and revenues to spike back up to the population plus inflation baseline. A better solution to fixing this problem would be to allow revenues to build a "rainy day" fund of 6% of the budget and allow states to draw on those funds during recessions.

In sum, our plan calls for a constitutional amendment in Missouri to adopt a Colorado-style TABOR to limit spending more effectively than the current budget process. This TABOR for Missouri would have five features:

1. It would limit annual appropriations increases to the increase in state population plus inflation.
2. It would require that any increase in tax revenues above this amount be dedicated to a reduction in the income tax rate in the next year.
3. It would phase out the income tax in Missouri in 14 years (and perhaps sooner).
4. It would preserve the Hancock amendment limitations that are already part of the Missouri state constitution.
5. It would allow for the establishment of a rainy day fund and allow for the state legislature to spend down this rainy day fund during periods of recession.

CONCLUSION

This study documents that eliminating the state income tax in Missouri is achievable in a way that 1) does not impose new taxes or tax shifts, 2) does not require additional debt or long-term borrowing, and 3) allows reasonable growth in state expenditures to fund vital services. Repeal of the state personal income tax, capital gains tax, and corporate income tax can be achieved in 14 years or fewer through a reasonable

The plan would not require cuts in vital infrastructure, public safety, education, or social services.

Repeal of the state personal income tax, capital gains tax and corporate income tax can be achieved in 14 years or fewer.

spending restraint mechanism that devotes surplus receipts to tax rate reductions.

If Missouri's experience is at all like the experiences of other states, the Missouri economy will respond fairly rapidly, and we anticipate that the slow growth trend that has plagued Missouri over the past two decades would give way to an acceleration of migration of new capital, jobs, and businesses into the state. Finally, the average family would realize about $3,000 in added after-tax income from the combination of a lower tax bill and higher incomes.

APPENDIX 1

Tax and Expenditure Limits to Pay for Tax Reform

The key to making our income tax elimination proposal work is a fair and enforceable spending cap that will produce surpluses large enough over the next 14 years to invest in phased-in rate reductions. All told, 26 states now have TELs. These range from constitutional caps on state spending, to supermajority vote requirements to raise taxes, to voter approval of new taxes, to zero-based budgeting laws. A comprehensive list of the states with the most effective measures is provided below:

A breakdown of states that have enacted other forms of budget restraint measures either constitutionally or legislatively is shown below.

We anticipate that the slow growth trend that has plagued Missouri over the past two decades would give way to an acceleration of migration of new capital, jobs, and businesses into the state.

Table 10: Decription of Binding Tax and Expenditure Limitations

STATE	YEAR	CONSTITUTIONAL/ STATUTORY	INITATED BY	APPROVED BY	LIMIT APPLIES TO
Arizona*	1978	Constitutional	Legislature	Voters	Appropriations of state tax revenues
California	1979	Constitutional	Voters	Voters	Appropriations of state tax revenues
Colorado*	1977	Statutory	Legislature	Legislature	State general fund appropriations
Delaware	1980	Constitutional	Legislature	Legislature	State general fund appropriations
Hawaii	1978	Constitutional	Constituional Convention	Voters	State general fund appropriations
Idaho	1980	Statutory	Legislature	Legislature	State general fund appropriations
Louisiana*	1979	Statutory	Legislature	Legislature	State tax revenue
Massachusetts	1986	Statutory	Voters	Voters	State revenue
Michigan	1978	Constitutional	Voters	Voters	State revenue
Missouri	1980	Constitutional	Voters	Voters	State revenue
Montana	1981	Statutory	Legislature	Legislature	State appropriations
Oklahoma*	1985	Constitutional	Legislature	Voters	State appropriations
Oregon	1979	Statutory	Legislature	Legislature	State general fund appropriations
South Carolina	1980	Constitutional	Legislature	Legislature	State appropriations
Tennessee	1978	Constitutional	Constitutional Convention	Voters	Appropriations of state tax revenues
Texas	1978	Constitutional	Legislature	Voters	Appropriations of state tax revenues
Utah	1979	Statutory	Legislature	Legislature	State appropriations
Washington*	1979	Statutory	Voters	Voters	State tax revenues

Source: Advisory Commission on Intergovernmental Relations, Significant Features of Fiscal Federalism, 1993, vol. 1, pp. 14-19 (and other years); Kenyon and Benker, p. 437.
*These states have passed new measures or altered existing ones since 1990.

Table 10 continued on page 27

Continued from page 26

Table 10: Decription of Binding Tax and Expenditure Limitations

STATE	LIMIT IS	PROVISIONS FOR A WAIVER
Arizona*	Shall not exceed 7 percent of state personal income	2/3 approval of the legislature on specific additional appropriations
California	Yearly growth shall not exceed the percentage increase in population and inflation	Declaration of an emergency by a 2/3 vote and compensating reductions in spending over 3 following years
Colorado*	Yearly growth shall not exceed 7 percent	Statute may be amended by a majority vote of the legislature
Delaware	Shall not exceed 98 percent of estimated general fund revenue and prior year's unencumbered funds	Declaration of an emergency and 3/5 vote of the legislature
Hawaii	Yearly growth shall not exceed the average annual growth rate of state personal income over the preceding 3 calendar years	2/3 approval of the legislature on specific additional appropriations
Idaho	Shall not exceed 5.33 percent of state personal income.	2/3 approval of the legislature on specific additional appropriations.
Louisiana*	Shall not exceed FY 1978-79 state revenue as a share of 1997 state personal income, multiplied by state personal income in the prior calendar year	Statute may be amended by a majority vote of the legislature; certain tax sources (i.e, severance tax revenue) are excluded from computation.
Massachusetts	Yearly growth shall not exceed the average annual growth of wages and salaries over the previous 3 years.	Statute may be amended by a majority vote of the legislature.
Michigan	Shall not exceed FY 1978-79 state revenue of a share of 1977 state personal income in the prior calendar year or average state personal income over the previous 3 calendar years.	Declaration of an emergency by governor and 2/3 vote of the legislature.
Missouri	Shall not exceed FY1980-81 state revenue as a share of 1979 state personal income in the prior calendar year or average state personal income over the previous 3 calendar years.	Declaration of an emergency by governor and 2/3 vote of the legislature.
Montana	Biennial growth shall not exceed the percentage difference in the average state personal income over the 3 calendar years immediately preceding the biennium and the average state personal income over the 3 calendar years immediately preceding the current biennium.	Declaration of an emergency by governor and 2/3 approval of the legislature on specific additional expenditures.
Oklahoma*	Yearly growth shall not exceed 12 percent (adjusted for inflation) or state appropriations shall not exceed 95 percent of certified revenue.	None
Oregon	Biennial growth shall not exceed the growth rate of state personal income over the preceding 2 calendar years.	Statute may be amended by a majority vote of the legislature.
South Carolina	Yearly growth shall not exceed the average annual growth rate of state personal income over the preceding 3 calendar years, or state appropriations shall not exceed 9.5 percent of state personal income, whichever is greater.	Declaration of an emergency and a 2/3 vote of the legislature; every 5 years the legislature may review the composition of the limit.
Tennessee	Yearly growth shall not exceed the projected growth rate of state personal income for the calendar year in which the fiscal year begins.	Majority vote of the legislature on a specific additional amount.
Texas	Biennial growth shall not exceed the growth rate of state personal income.	Declaration of an emergency and a majority vote of the legislature on a specific additional amount.
Utah	Yearly growth may not exceed 85 percent of the increase in state personal income.	Declaration of an emergency and 2/3 vote of the legislature; legislature must also hold a public hearing.
Washington*	Yearly growth shall not exceed the average annual growth rate of state personal income over the preceding 3 calendar years.	Declaration of an emergency by a 2/3 vote in the legislature and 2/3 approval of the legislature on specific additional appropriations.

The average family would realize about $3,000 in added after-tax income from the combination of a lower tax bill and higher incomes.

Table 11: Fiscal Discipline Mechanisms in the States

STATE	TAX & EXPENDITURE LIMIT	SUPERMAJORITY REQUIREMENT	VOTER APPROVAL REQUIREMENT
Alaska	X		
Arizona	X	X	
Arkansas		X	
California	X	X	
Colorado	X		X
Connecticut	X		
Delaware	X	X	
Florida		X	X
Hawaii	X		
Idaho	X		
Louisiana	X	X	
Massachusetts	X		
Michigan	X		
Mississippi		X	
Missouri	X,*		
Montana	X	*	X
Nevada	X	*	
North Carolina	X		
North Dakota			X
Oklahoma	X	X	X
Oregon	X		
Rhode Island	X		
South Carolina	X		
South Dakota		X	
Tennessee	X		
Texas	X		
Utah	X		
Washington**	X		X

NOTES

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[10] Bureau of Economic Analysis, GDP by state, http://www.bea.gov/bea/regional/gsp/ revised June 2006.

[11] Ibid. According to BEA statistics, between 1997 and 2005, nominal GDP increased in Florida by 72 percent, in Texas by 65 percent, and in California by 59 percent. Over the same period, Tennessee enjoyed GDP growth of 49 percent, while Kentucky saw only 33 percent growth. New Hampshire's GDP increased 51 percent, compared with 46 percent in Maine.

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