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THE MISSOURI COMPROMISE

By Arthur Laffer

ADVANCING LIBERTY WITH RESPONSIBILITY BY PROMOTING MARKET SOLUTIONS FOR MISSOURI PUBLIC POLICY

As unlikely as it may seem, the slightly overweight, middle-aged, middle-income, Midwestern state of Missouri is pushing the envelope on its way toward radical tax reform. A tax-swap proposal to eliminate both the state's personal income tax and corporate income tax in favor of a static revenue-neutral sales tax increase, an idea previously analyzed by Show-Me Institute, is currently edging ever-closer to becoming a constitutional amendment.

Only one state — Alaska, in 1980 — has actually removed its progressive income tax. For Alaska, the decision to eliminate the state's income tax was relatively easy to make, given the huge new revenues coming from the state's severance tax on oil during the boom years in oil prices in the early 1980s. Replacing a state's income tax by levying a tax on the other 49 states is a political no-brainer. For Missouri, however, there is no such easy answer. Missouri doesn't have a relatively painless tax it can levy to offset an elimination of personal and corporate income taxes. However, even though Missouri's tax reform is far from a no-brainer, the benefits from reform could be enormous if the process is administered well and the constitutional amendment is carefully crafted.

I. SUMMARY AND CONCLUSIONS

In considering the tax-swap issue facing Missouri, we must first determine the potential downside. Tennessee is quite similar to Missouri in its basic economic profile. Tennessee, however, already has a similar tax structure to the one that Missouri would adopt through the proposed tax swap legislation — and, leaving aside recent natural disasters, Tennessee's economy has been growing more rapidly than Missouri's economy. As a result, it's hard to argue that Missouri would face an undue risk by adopting the tax-swap proposal.

Second, in the absence of significant expected benefits — even if there were no downside risk — it wouldn't make much sense to expend so much time and effort to achieve a tax swap for Missouri. To assess the potential benefits for Missouri, we have compared the nine states with no personal income tax to the nine states with the highest personal income

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tax rates. The differences in economic performance between the two groups during the past decade are astounding, illustrating that a tax swap could be a huge benefit for the citizens of Missouri.

A third way to gauge the benefits of a tax swap for Missouri is to look at the economic consequences that have befallen the 11 states that have adopted personal income taxes during the past 50 years. Every state that has initiated a progressive income tax has caused a deterioration in that state's economic performance over the ensuing years. For several of those states, the economic deterioration has been catastrophic. Presuming that Missouri does the opposite of those 11 states, by instead abolishing the income tax in favor of a sales tax, Missouri citizens should expect to see a significant economic improvement based on the time series data we have collected from states that have initiated an income tax.

A fourth consideration is the expected consequences such a tax swap would have on overall Missouri tax receipts. Here, the results are as clear as they can be. Tax revenue growth for the states with the nine highest tax rates is substantially lower than tax revenue growth in the states without an income tax. In addition, Tennessee's tax revenue growth exceeds Missouri's tax revenue growth. Finally, states that have implemented a progressive income tax where none had previously existed have significantly underperformed the nation in tax revenue growth. Implementing the proposed tax swap would likely be a successful method for Missouri to achieve fiscal solvency.

The fifth consideration for Missouri is the volatility of state tax receipts. State sales tax receipts are far less volatile than are state income tax receipts, so swapping the state's current income tax for a higher sales tax would allow Missouri to benefit significantly from a more stable tax revenue stream.

The last section of this paper derives from an analysis by Dr. Joseph Haslag, an economist with the University of Missouri–Columbia. It lays out the locus of sales tax rates and the size of the sales tax base that would allow Missouri to effectuate the proposed tax swap.

II. MISSOURI: THE STATE

Missouri is fairly representative of the nation as a whole. It is centrally located within the continental United States, has a mix of Northern, Midwestern, and Southern neighbors, and features a range of both urban and rural areas. The land that constitutes present-day Missouri was purchased from France as part of the Louisiana Purchase, eventually admitted into the Union as the 24th state in 1821. Missouri, with a population of about 6 million people, is now the 18th-most populous state, and the 21st-largest state by area, encompassing 69,704 square miles. Missouri also has a state population density — 86.9 people per square mile — closer to the national average of 86.8 than any other state.

Missouri has become something of a bellwether politically, with residents having selected, on aggregate, the president-elect in all but two elections since 1904. Currently, the state's elected representatives are as evenly split as possible, with one Republican and one Democratic senator, five Republican

and four Democratic House members, a Democratic governor, and a Republican lieutenant governor.

Missouri had a gross state product (GSP) in 2008 of $238 billion, about 1.7 percent of the nation's gross domestic product. That works out to a per-capita personal income of $36,766, which ranked 32nd in the nation. The economy is varied, with Missouri home to the second-largest number of farms in the United States, a variety of mining, manufacturing, tourism, services, and a number of other industries that contribute to the state's output.

Income from the earnings of those professional pursuits is taxed in 10 different earnings brackets at the personal level, with marginal personal income tax rates ranging from 1.5 percent to 6.0 percent — as high as 7.0 percent if one includes local Kansas City and Saint Louis earnings tax rates. The state sales tax rate is 4.225 percent (as high as 12 percent after including widely varying local additions), and the state's maximum statutory corporate income tax rate is 6.25 percent, which becomes 5.81 percent after federal deductibility and local levies are taken into account. The state does not levy an estate tax. The minimum wage in Missouri is the same as the federal minimum wage of $7.25, and the state is not a right-to-work state.

As a personal note, I, Arthur Laffer, have a special fondness for Saint Louis, which has erected the world's largest Laffer Curve — also known to local inhabitants as the Gateway Arch.

III. THE PROPOSAL

Although not complete at present, a summary of Missouri's contemplated tax reform is similar to the summary of Missouri Senate Joint Resolution 29 (2010), included below:

> SJR 29 - Upon voter approval, this proposed constitutional amendment replaces the state individual and corporate income tax, the corporate and bank franchise tax and state sales and use tax with a tax on the sale, use, or consumption of new tangible personal property and taxable services equal to five and eleven-one hundredths percent beginning January 1, 2012. Component parts or ingredients of a new tangible personal property to be sold at retail, federal government purchases, and business-to-business transactions including agriculture will be exempt from the new tax while all other exemptions and tax credits will be eliminated. The enactment of any new exemptions will require a two-thirds affirmative vote by the General Assembly and approval by the Governor. The conservation sales tax, the soil and parks sales tax, and local sales taxes will be recalculated to produce substantially the same amount of revenue.
>
> Each qualified family will receive a sales tax rebate based on the federal poverty level guidelines to offset the sales tax on basic necessities.
>
> The Tax Adjustment Commission is created to recommend a one-time adjustment to the new sales tax rate to ensure revenue-neutrality. A rate adjustment may only be recommended to the General Assembly upon a unanimous vote of the Commission.

State sales tax receipts are far less volatile than are state income tax receipts, so swapping the state's current income tax for a higher sales tax would allow Missouri to benefit significantly from a more stable tax revenue stream.

At present, Missouri collects 68 percent of its state revenues from its income taxes. The state exists and functions through this source of revenue, whether or not its current fiscal system is ideal.

A concurrent resolution, offered in the house of representatives, must be adopted by both houses and sent to the Governor in order to make the one-time rate adjustment recommended by the Commission.

This act is identical to HJR 56 (2010).

IV. THE DOWNSIDE RISK: MISSOURI AND TENNESSEE

At present, Missouri collects 68 percent of its state revenues from its income taxes. The state exists and functions through this source of revenue, whether or not its current fiscal system is ideal. Although an underachiever, Missouri is by no means the worst-performing state in the nation, and is far from being in a desperate situation that demands a new course of action. If you'll forgive a backhanded compliment, Missouri is not California. In fact, we ranked Missouri 14th out of the 50 states in the 2010 ALEC-Laffer State Economic Competitiveness Index. Missouri's decision whether to enact serious tax reform is not one forced on it by necessity, but one of choosing to improve the current system. Whenever changes are made out of choice, rather than necessity, the old Latin phrase "*Primum non nocere*" (first, do no harm) applies. Demonstrating that this reform entails only a minimal risk of doing harm is the first serious hurdle. Why should we fix something if "it ain't broke"? What's the downside?

Judging by the numbers alone, Missouri and Tennessee have a lot in common. The most significant difference between the two states is how each state's government chooses to collect its revenues. If the proposed tax reform we're considering here were to be enacted, Missouri's tax structure would look a lot like Tennessee. Today, Tennessee has no broad personal income tax — which would be the case in Missouri, as well, if the tax reform proposal were passed — but does have a corporate income tax, which the proposed reform would also eliminate in Missouri. Tennessee has lower property taxes than Missouri, and derives the bulk of its revenues from a broad-based sales tax — again, a feature of the tax reform proposal for Missouri — with intrastate

Table 1: Missouri vs. Tennessee Various Metrics

	MISSOURI	TENNESSEE
Gross State Product (2008, millions)	$237,797	$252,127
10-Year Growth (98-08)	*44.8%*	*56.7%*
Gross State Product per Capita (2008)	$39,923	$40,402
10-Year Growth (98-08)	*34.20%*	*39.89%*
Gross State Product per Employee (2008)	$85,155	$90,791
10-Year Growth (98-08)	*39.12%*	*48.90%*
Personal Income (2008, millions)	$218,992	$219,025
10-Year Growth (98-08)	*56%*	*60.7%*
Personal Income per Capita (2008)	$36,766	$35,098
10-Year Growth (98-08)	*44.6%*	*43.5%*
Population (2008)	5,956,335	6,240,456
10-Year Growth (98-08)	*7.9%*	*12.0%*
Net Domestic Migration (2008-09)	-124	20,605
10-Year Sum as % of Population	*0.77%*	*4.18%*
Nonfarm Payroll Employment (2008)	2,792,525	2,777,017
10-Year Growth (98-08)	*4.1%*	*5.3%*
Public Employees per 10,000 (2008)	555.19	528.32
Percent of Total State Workforce Unionized (2008)	11.20%	5.50%
Personal Income Tax Rate (state and local)	7.00%	0%
Corporate Income Tax Rate (state and local)	5.81%	6.50%
Sales Tax Rate (state)	4.23%	7.00%
Individual Income Taxes (2007, millions)	$5,168	$253
Corporate Taxes (2007, millions)	$391	$1,121
State Sales Taxes (2007, millions)*	$5,020	$8,454
Property Taxes (2007, millions)	$5,258	$4,375
Alcoholic Beverages Taxes (2007, millions)	$31	$250
Total Taxes (2007, millions)	$19,193	$18,364
10-Year Growth (97-07)	*52.38%*	*72.82%*

* Sales tax revenue numbers are for the specified state only, whereas the revenue numbers are both state and local.

and local sales tax rates in the range of 9 percent or slightly higher. In short, if Missouri were to enact the proposed tax reform constitutional amendment, it would transform the state's political economy into something very similar to Tennessee's current political economy — which really does work. In fact, metrics show that Tennessee's fiscal system works quite a bit better than does Missouri's fiscal system. Table 1 lists some of the key metrics for both Missouri and Tennessee.

In 2008 Tennessee had a GSP $15 billion higher than Missouri's GSP, a difference that is increasing rapidly. Tennessee has recently passed Missouri in GSP per capita, and is far ahead of Missouri in GSP per employee. Tennessee is also attracting many people from the rest of the nation, while Missouri is a little better than even — in terms of net domestic in-migration during the past decade.

Tennessee's tax receipts are slightly lower than Missouri's, but are growing quite a bit faster. In fact, Tennessee's total tax receipts have risen much faster during the past decade than has Tennessee's GSP, while Missouri's growth in tax receipts has only slightly exceeded Missouri's GSP growth. So much for an income tax solving a state's budget problems.

Table 1 shows, from a broad perspective, that Missouri's reform proposal can work. Tennessee provides a real-life example of the practical success of a tax policy very similar to Missouri's proposed system. Tennessee is quite similar to Missouri as a state, and Tennessee's tax/fiscal structure is also quite similar to the tax/fiscal structure being proposed for Missouri. In addition, Tennessee has performed far better than has Missouri, without any major advantages such as special taxes on oil, gambling, or other targeted industries. If Missouri did nothing other than copy the tax structure of Tennessee, it could virtually eliminate any chance of a major downside contingency.

It's fairly easy to answer questions about a potential downside to Missouri's tax proposal; there's not much of one.

V. CROSS-STATE TIME SERIES COMPARISON

The case to be made for Missouri's tax reform has to hinge on improving the overall performance of Missouri's economy. Missouri's proposed tax reform would eliminate all income taxes in favor of higher sales taxes (in Missouri, both the state sales tax rate and sales tax base would most likely increase). Therefore, the first evidence to be marshaled for or against Missouri's tax reform is a comparison of those states without broad-based income taxes (as would become the case for Missouri if the tax reform proposal were implemented) with those states that have the highest rates on broad-based income taxes (as is the current case in Missouri).

In Table 2, we have listed: all nine states that do not have a broad-based income tax; the U.S. state average; Missouri; and, the nine states with the highest state marginal personal income tax rates. For each of these states, and the U.S. average of all states, all for the 10-year period 1998–2008, we have columns for the current: a) top marginal personal income tax rate; b) GSP growth; c) population growth; d) non-farm payroll employment growth; e) GSP per capita

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Table 2: The Nine States with the Lowest and the Highest Marginal Personal Income Tax (PIT) Rates 10-Year Economic Performance

	TOP PIT RATE*	GROSS STATE PRODUCT GROWTH	POPULATION GROWTH	NON-FARM PAYROLL EMPLOYMENT GROWTH	GROSS STATE PRODUCT PER CAPITA GROWTH	GROSS STATE PRODUCT PER EMPLOYEE GROWTH	TOTAL STATE TAX RECEIPTS GROWTH***
Alaska	0.00%	106.8%	11.0%	17.2%	86.3%	76.5%	105.3%
Florida	0.00%	78.4%	19.0%	17.1%	49.9%	52.3%	104.8%
Nevada	0.00%	106.2%	41.1%	36.8%	46.1%	50.8%	128.7%
New Hampshire	0.00%	53.5%	9.6%	9.7%	40.0%	40.0%	72.4%
South Dakota	0.00%	77.9%	7.8%	14.3%	65.0%	55.7%	63.4%
Tennessee	0.00%	56.7%	12.0%	5.3%	39.9%	48.9%	72.8%
Texas	0.00%	94.5%	20.6%	18.7%	61.3%	63.8%	88.3%
Washington	0.00%	64.9%	13.8%	14.0%	44.9%	44.5%	68.2%
Wyoming	0.00%	137.6%	8.6%	30.7%	118.8%	81.8%	161.3%
9 States with no PIT**	**0.00%**	**86.28%**	**15.95%**	**18.20%**	**61.36%**	**57.13%**	**96.12%**
U.S. Average**	**5.67%**	**66.34%**	**10.08%**	**10.39%**	**51.39%**	**50.40%**	**74.20%**
Missouri	**7.00%**	**44.76%**	**7.87%**	**4.05%**	**34.20%**	**39.12%**	**52.38%**
9 States with Highest Marginal PIT Rate**	**9.92%**	**59.81%**	**6.32%**	**8.44%**	**50.29%**	**47.27%**	**73.86%**
Ohio	8.24%	35.2%	1.9%	-2.1%	32.7%	38.1%	58.2%
Maine	8.50%	56.7%	4.8%	8.2%	49.5%	44.8%	57.9%
Maryland	9.30%	68.8%	8.7%	11.7%	55.2%	51.0%	82.4%
Vermont	9.40%	59.7%	3.4%	7.4%	54.4%	48.6%	81.2%
New York	10.50%	66.6%	3.8%	6.8%	60.5%	56.0%	77.6%
California	10.55%	70.1%	10.9%	10.3%	53.4%	54.1%	91.1%
New Jersey	10.75%	51.2%	4.5%	6.7%	44.6%	41.6%	87.7%
Hawaii	11.00%	70.0%	5.9%	16.6%	60.5%	45.9%	70.6%
Oregon	11.00%	60.1%	12.8%	10.2%	41.8%	45.2%	58.1%

* Highest marginal state and local personal income tax rate imposed as of 7/1/09 using the tax rate of each state's largest city as a proxy for the local tax. The effect of the deductibility of federal taxes from state tax liability is included where applicable. New Hampshire and Tennessee tax dividend and interest income only.
** Equal-weighted averages
*** 1997–2007
Performance between 1998 and 2008 unless otherwise noted.

Just catching up to the national average in growth would add $50 billion to Missouri's GSP.

growth; f) GSP per employee growth; and, f) growth of total state tax receipts.

The numbers in the table above are truly striking. During the past decade, for total GSP growth, the zero personal income tax rate states have, on average, outperformed those states with the highest personal income tax rates by 26.5 percent, and have outperformed the U.S. average by 20 percent. The nine states without a personal income tax also outperformed Missouri by a whopping 41.5 percent.

For a state like Missouri, with a GSP growth of 45 percent over the past decade, each additional 10 percent in growth would add an additional $24 billion to GSP over the coming decade. Just catching up to the national average in growth would add $50 billion to Missouri's GSP, while catching up to the states without an income tax would add $100

billion to Missouri's GSP. That's a lot of money.

Quite a bit of the extra growth in average GSP between the states with the highest and the lowest income tax rates comes from higher population growth and higher employment growth. Here, again, Missouri has trailed the rest of our sample by a significant amount.

For those states with no personal income taxes, population growth over the past decade averaged about 15.95 percent — 9.6 percentage points higher than the average of the nine states with the highest personal income tax rates, almost 6 percentage points higher than the U.S. average, and more than 8 percentage points higher than Missouri. With respect to the 10-year growth of non-farm payroll employment, the average difference between the states without an income tax and those with the highest tax rates was a similar 9.76 percentage points higher (18.2 percent *versus* 8.44 percent). Comparing the states without an income tax to the U.S. average, the difference was almost 8 percentage points, and more than 14 percentage points for the difference between those states and Missouri. Comparatively, Missouri is in terrible shape. Change is needed. If Missouri could transform itself into one of the states without an income tax, it would be in much better economic shape. Combining GSP growth with population growth and employment growth yields, respectively, the critical standard of living and productivity metrics of growth in GSP per capita and GSP per worker. For those states without personal income taxes, average GSP per-capita growth over the past decade was about 61.36 percent, or 11.07 percentage points higher than the average of those nine states with the highest personal income tax rates, 9.97 percentage points higher than the U.S. average, and an unbelievable 27.16 percentage points higher than Missouri. In relative terms, Missouri's performance is awful.

If, during the past decade, Missouri had caught up with the average of the states without an income tax, the average Missouri resident's income would be more than $12,000 higher. That is amazing. Taxes really do matter. And, for growth in GSP per employee, the average differences were slightly less but still a significant 9.86 percentage points higher (57.13 percent *versus* 47.27 percent) for the states without an income tax *versus* the states with the highest personal income tax rates. This lead increased to 16.73 percentage points when compared to the U.S. average, and 18.01 percentage points in comparison to Missouri. The difference is dramatic.

Given the data at hand, it is hard to imagine any more conclusive results from a cross-section time series of states that could be obtained in favor of Missouri's tax proposal. Missouri needs help badly, and from the looks of it a switch out of income taxes to broad-based sales taxes is exactly what the doctor ordered.

VI. STATES THAT HAVE IMPLEMENTED AN INCOME TAX

The previous section compared the economic performance of the nine states with no personal income tax to the nine states with the highest income tax rates. Although the results were robust and

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conclusive, there still are a number of lingering concerns. For example, each of the United States has its own unique characteristics. Even when some of those characteristics are shared with a few other states, it is difficult to disentangle exactly which factor has caused or influenced which outcomes. In looking at the previous section, one could question the reliability of its comparison of the nine states without an income tax states to the states with the highest income tax rates, because the two groups of states may feature many other differences that affect the data we compare. This section helps to narrow the focus by providing a before-and-after comparison of states that have implemented a state income tax. Each of these states is much the same before and after, save for the fact that a state income tax was adopted.

Each of the United States has its own unique characteristics. Even when some of those characteristics are shared with a few other states, it is difficult to disentangle exactly which factor has caused or influenced which outcomes.

At various times during the past 50 years, 11 states have adopted a progressive state income tax where none before existed. This section focuses on the consequences for those states that have actually implemented an income tax. In this way, we can control for variations across states, which was not possible in the previous sections. This time series cross-section analysis should help Missouri make a reasoned choice if, in fact, implementing an income tax results in a noticeable effect on a state's prosperity. The logic is that eliminating an income tax will have the opposite effect from instituting one.

The 11 states in which income taxes were adopted, from most recent to least recent, are: Connecticut (1991), New Jersey (1976), Ohio (1972), Rhode Island (1971), Pennsylvania (1971), Maine (1969), Illinois (1969), Nebraska (1968), Michigan (1967), Indiana (1964), and West Virginia (1962).

Appendix A lists GSP growth rates for the five years prior to implementing an income tax, and then in five-year intervals for the 15 years following the date of inception of an income tax for each of the above 11 states. The first and other odd columns display growth in GSP over the five-year periods, and alternating even columns show the compound annual growth rates (CAGR) of the proceeding column. The next row, *i*, shows in its odd columns the state's GSP percentage of total U.S. GSP for the dates listed above, and in parentheses displays annual total U.S. GSP growth for the preceding five years. For the next three rows, *ii*, *iii*, and *iv*, the same comparisons are provided for personal income (PI) per capita relative to U.S. personal income per capita, for population as a percentage of U.S. total population, and for state and local tax revenues as a percentage of total federal, state, and local tax revenues.

It is absolutely astonishing to see how the size of the economy of each of these 11 states, as a share of the total U.S. economy (row *i*, Appendix A), has fallen subsequent to introducing an income tax. Some of the declines are quite large. Connecticut, for example, dropped from 1.74 percent of U.S. GSP in the 1986–1990 period to 1.53 percent in 2008. New Jersey fell from 3.66 percent of U.S. GSP in the 1971–75 period to 3.35 percent in 2008. From 1967 to 1971 Ohio stood at 5.42 percent of total U.S. GSP, yet in 2008 it was only 3.33 percent. Rhode Island and Pennsylvania, respectively, dropped from 0.44 percent and 5.72 percent of the U.S. GSP in the 1966–70 period to 0.33 percent and 3.91 percent in 2008. Maine's

and Illinois' pretax period of 1964–68 boasted GSP proportions of 0.39 percent and 6.52 percent of the total U.S. GSP, but after implementing a state income tax, they dropped to to 0.35 percent and 4.77 percent in 2008. During 1963–67, Nebraska stood at 0.67 percent of the U.S. GSP, but fell to 0.59 percent in 2008. Lastly, Michigan, which seems never to get a break, declined from 5.08 percent in the 1962–1966 period to 2.70 percent in 2008.

Also worthy of consideration are the critical measures of the change in a state's GSP and personal income per capita relative to the United States as a whole (see Table 3 and Table 4). Personal income per capita is the closest measure to be found that represents the state's standard of living, and GSP is the truest measure of a state's output.

Table 3: Personal Income Per Capita Relative to the U.S.

	YEAR RANGE	PRIOR TO INCOME TAX	2009
Connecticut	1986-1990	135%	139%
New Jersey	1971-1975	116%	126%
Ohio	1966-1970	102%	90%
Rhode Island	1966-1970	102%	104%
Pennsylvania	1966-1970	99%	101%
Maine	1964-1968	82%	92%
Illinois	1964-1968	115%	106%
Nebraska	1962-1966	94%	99%
Michigan	1962-1966	110%	87%
Indiana	1958-1962	97%	86%
West Virginia	1956-1960	74%	81%

Table 4: Gross State Product Relative to the U.S.

	PRIOR TO INCOME TAX	2008
Connecticut	1.74%	1.53%
New Jersey	3.66%	3.35%
Ohio	5.42%	3.33%
Rhode Island	0.44%	0.33%
Pennsylvania	5.72%	3.91%
Maine	0.39%	0.35%
Illinois	6.52%	4.47%
Nebraska	0.67%	0.59%
Michigan	5.08%	2.70%
Indiana	2.61%	1.80%
West Virginia	NA	0.44%

The declines in personal income per capita relative to the overall United States are more than depressing; it's an absolute tragedy when you realize just how much opportunity the citizens of these 11 states have lost following their adoption of a progressive income tax. On a human level, it's appalling.

Declines in GSP relative to the overall United States tell the same sad story as the loss in personal income per capita relative to the United States. Lower output leads to fewer jobs, less goods and services produced, and a diminished capacity for prosperity and wealth generation. Slower growth should never be the goal of any jurisdiction, and it's clear that a progressive income tax has a decidedly negative impact on growth.

The change in personal income for the states that have instituted a personal income tax has been disappointing. **In each case, the state's economy has become a smaller portion of the overall U.S. economy, and, in most cases, the state's citizens have had their standards of living dramatically reduced.** Judging by these results, eliminating the income tax would improve a state's economic outlook, and Missouri needs a lift.

To provide an anecdote of what is possible with tax cuts, we would like to point out the experience Delaware had with total state tax revenues when that state drastically cut income tax rates. While Delaware isn't part of the set of states with which we usually compare Missouri, the Delaware experience is relevant in

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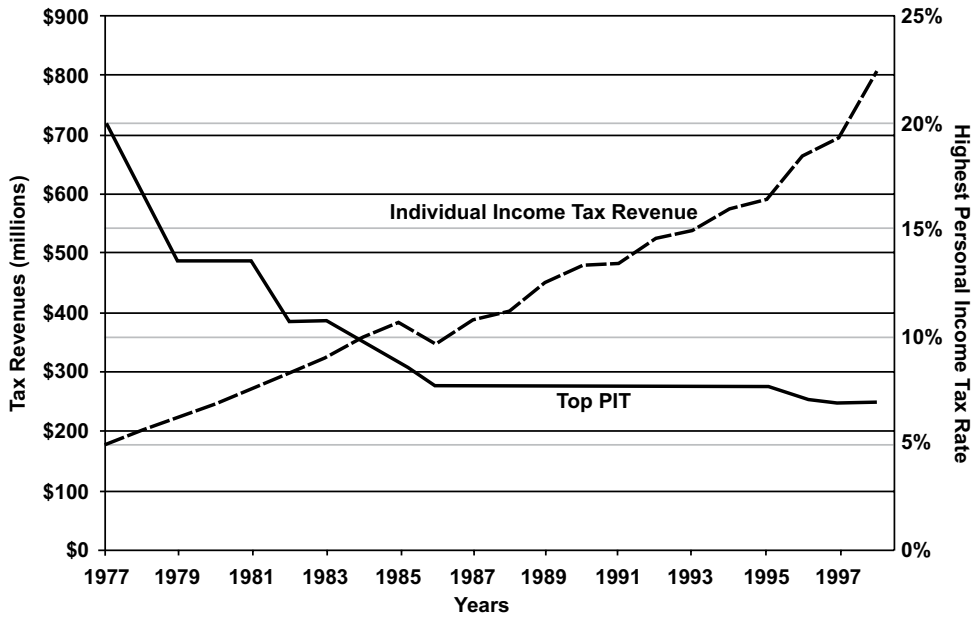
Figure 1: Delaware's Rate Cuts Enhanced State Revenues



determining good state economic policy, and especially relevant with respect to the tax proposal that Missouri is considering. Back in 1978, I, Arthur Laffer, was integrally involved with tax reform in Delaware when Pete DuPont was Delaware's governor. He sought to reduce the state's incredibly high top marginal income tax rate, which at the time was 19.8 percent. As it so happens, Gov. DuPont was successful beyond anyone's wildest imagination, and the top rate fell from 19.8 percent in 1978 to 6.9 percent in 1998. The rate currently stands at 5.95 percent.

When Gov. DuPont proposed his tax rate reduction plan, he was met with a chorus of criticism — much of which centered on the expected loss of tax revenues and the dire consequences that this revenue shortfall would have on the state's ability to help the state's poor, minorities, and the disadvantaged. He persevered, however, following in the footsteps of President John F. Kennedy, who famously said that the best form of welfare is still a good high-paying job.

Today, we know what actually happened as a result of this rate cut. The Delaware Laffer Curve figure reproduced in Figure 1 says it all.

When we compared Missouri over the past decade with Tennessee, which has no income tax (Table 1), the path of total tax receipts dramatically favored Tennessee. From 1998 through 2008, Tennessee's total tax revenues grew by 72.8 percent *versus* Missouri's 52.4 percent. If the mere existence of an income tax doesn't even provide more revenues, it does no good — either for individual wallets or government programs.

Earlier, we also provided a detailed comparison of the nine states without an income tax to the nine states with the highest income tax rates (Table 2). The last column of Table 2 looks at growth in total state tax receipts over the past decade. Average growth of tax receipts for the states without an income tax exceeded the average growth of tax receipts for both states with the highest income tax rates and the U.S. average by about 22 percent

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over the past decade. States without an income tax at all saw their total tax revenues grow by 40 percent more than Missouri's tax receipts grew — (96.12 percent vs. 52.38 percent).

States without an income tax economically outperform in every conceivable fashion their higher-taxed brethren, and also have more tax revenues.

Finally, Tables 5 and 6 show state and local tax revenues as a percentage of total U.S. tax revenues, and state tax revenues as a percentage of total U.S. revenues, respectively, in the 11 states that have adopted a state income tax during the last 50 years. In nine of the 11 states that have added an income tax,

Table 5: Tax Revenue as a % of Total U.S. (State and Local)

	PRIOR TO INCOME TAX	2007
Connecticut	1.72%	1.65%
New Jersey	3.80%	4.03%
Ohio	4.25%	3.61%
Rhode Island	0.45%	0.38%
Pennsylvania	5.30%	4.10%
Maine	0.43%	0.44%
Illinois	5.49%	4.32%
Nebraska	0.65%	0.56%
Michigan	4.69%	2.91%
Indiana	2.30%	1.66%
West Virginia	0.72%	0.48%

Table 6: Tax Revenue as a % of Total U.S. (State)

	PRIOR TO INCOME TAX	2007
Connecticut	1.72%	1.70%
New Jersey	3.62%	3.90%
Ohio	4.12%	3.43%
Rhode Island	0.45%	0.37%
Pennsylvania	5.38%	4.07%
Maine	0.43%	0.47%
Illinois	5.28%	3.97%
Nebraska	0.60%	0.54%
Michigan	4.75%	3.15%
Indiana	2.27%	1.85%
West Virginia	0.77%	0.61%

the percentage of that state's revenue as a percentage of total U.S. tax revenue in 2007 has fallen relative to where it was prior to adoption. Michigan's share of U.S. tax revenue fell precipitously from 4.69 percent prior to implementing an income tax to 2.91 percent in 2007.

VII. THE STABILITY OF TAX RECEIPTS

The previous sections of this essay focused extensively on measures of state prosperity, and, to a lesser extent, on overall tax receipts. State and local governments must also consider the stability of tax receipts. Volatile tax receipts usually entail a shortfall of revenues when times are tough and spending needs are the greatest, and excess revenues when times are good — leading to some superfluous government spending. Revenue fluctuations move counter to government spending needs.

During good times, state and local governments spend too much on marginal projects solely because they can. Then, when bad times arrive, officials are forced to raise taxes, cut back on desperately needed projects, or both. Volatility of revenues and spending needs is anathema to good governance. Therefore, decreasing revenue volatility allows a state to function more efficiently.

Table 7, reproduced from "The State Revenue Report" of the Rockefeller Institute, with slightly updated data, shows the annual percent change in the year-over-year numbers ending in June 2009 as compared to the same numbers ending in June 2008, for each state's personal income tax (PIT), corporate income tax (CIT), sales tax, and total tax revenues.

During good times, state and local governments spend too much on marginal projects solely because they can. Then, when bad times arrive, officials are forced to raise taxes, cut back on desperately needed projects, or both. Volatility of revenues and spending needs is anathema to good governance.

Table 7: Year-Over-Year Percent Change in State and Local Tax Revenue by Major Tax

STATE	PERSONAL INCOME TAX: CHANGE FROM JUL-07 THROUGH JUN-08 TO JUL-08 THROUGH JUN-09	CORPORATE INCOME TAX: CHANGE FROM JUL-07 THROUGH JUN-08 TO JUL-08 THROUGH JUN-09	SALES INCOME TAX: CHANGE FROM JUL-07 THROUGH JUN-08 TO JUL-08 THROUGH JUN-09	TOTAL TAX: CHANGE FROM JUL-07 THROUGH JUN-08 TO JUL-08 THROUGH JUN-09
Alabama	-6.03%	-6.80%	-5.24%	-3.77%
Alaska	NA	-51.11%	NA	-35.35%
Arizona	-27.99%	-24.52%	-15.39%	-15.41%
Arkansas	-4.52%	1.08%	-1.49%	-0.92%
California	-20.24%	21.09%	-8.83%	-10.75%
Colorado	-13.07%	-35.41%	-8.14%	-9.46%
Connecticut	-15.01%	-26.95%	-7.21%	-11.58%
Delaware	-9.55%	-32.40%	NA	-9.03%
Florida	NA	-16.95%	-8.29%	-9.31%
Georgia	-12.24%	-26.34%	-7.02%	-11.30%
Hawaii	-13.34%	-25.35%	-6.03%	-8.45%
Idaho	-18.28%	-25.21%	-10.48%	-13.14%
Illinois	-11.02%	-11.66%	-5.86%	-7.18%
Indiana	-10.83%	-7.75%	8.13%	-1.47%
Iowa	-4.95%	-28.48%	16.53%	0.17%
Kansas	-7.24%	-29.76%	-1.66%	-7.15%
Kentucky	-4.82%	-26.98%	-0.70%	-2.04%
Louisiana	-7.43%	-23.87%	-4.69%	-6.93%
Maine	-13.84%	-22.45%	-4.54%	-8.29%
Maryland	-12.37%	1.86%	2.73%	-4.74%
Massachusetts	-16.52%	-17.91%	-5.32%	-12.21%
Michigan	-10.73%	-56.84%	14.73%	-2.63%
Minnesota	-10.66%	-25.13%	-3.86%	-6.33%
Mississippi	-4.22%	-15.68%	-3.47%	-3.77%
Missouri	-6.78%	-27.43%	-6.13%	-5.65%
Montana	-4.93%	1.57%	NA	-2.06%
Nebraska	-7.19%	-14.78%	-1.95%	-5.92%
Nevada	NA	NA	-12.78%	-3.86%
New Hampshire*	-16.47%	-19.57%	NA	-8.21%
New Jersey	-15.40%	-14.98%	-8.15%	-11.20%
New Mexico	-41.81%	-27.25%	-2.15%	-9.76%
New York	-15.34%	-3.03%	-4.61%	-10.31%
North Carolina	-13.04%	-25.27%	-5.82%	-10.03%
North Dakota	16.65%	-19.86%	14.54%	4.44%
Ohio	-12.72%	-26.20%	-6.68%	-7.14%
Oklahoma	-9.05%	-4.88%	3.33%	-4.16%
Oregon	9.38%	-45.76%	NA	2.62%
Pennsylvania	-8.25%	-20.74%	-4.25%	-6.61%
Rhode Island	-11.98%	-25.62%	-3.82%	-6.80%
South Carolina	-16.40%	-25.39%	-9.92%	-11.66%
South Dakota	NA	-30.21%	3.30%	0.90%
Tennessee*	-23.82%	-18.85%	-6.81%	-8.44%
Texas	NA	NA	1.00%	-4.32%
Utah	-10.55%	-37.69%	-11.21%	-11.36%
Vermont	-14.46%	2.33%	-5.09%	-1.79%
Virginia	-9.10%	-19.53%	-5.56%	-10.08%
Washington	NA	NA	-8.10%	-6.49%
West Virginia	2.55%	-21.96%	0.02%	-1.90%
Wisconsin	-3.78%	-27.06%	-4.24%	-2.84%
Wyoming	NA	NA	-4.24%	-2.84%
U.S.**	**-13.37%**	**-11.70%**	**-4.63%**	**-8.09%**

* Although New Hampshire and Tennessee do not have a personal income tax, they do both tax interest and dividends, so they both show personal income tax revenues.
** Total tax revenues for all states, not including Washington, D.C.

A reliance on sales and corporate taxes (and property taxes on a local level) rather than on personal income taxes results in lower government revenue fluctuations over bad and good times. Simply put, revenues from sales and corporate taxes are more stable and reliable than are income taxes.

Personal income tax receipts for all states were down 13.6 percent for the 12-month period ending in June 2009 as compared to the same period ending in June 2008. Corporate income tax receipts

were down 10.9 percent, while sales tax receipts were down only 4.8 percent.

Meanwhile, of the 39 states with a personal income tax, corporate income tax, and sales tax, the sales tax component of total tax revenue experienced the smallest percentage decrease (or largest percentage increase) in 33 of those 39 states. In the other six states, the sales tax experienced the second-smallest decrease. Preliminary tax data for the third quarter tell much the same story.

VIII. Missouri's Sales Tax, Effectuating the Tax Swap

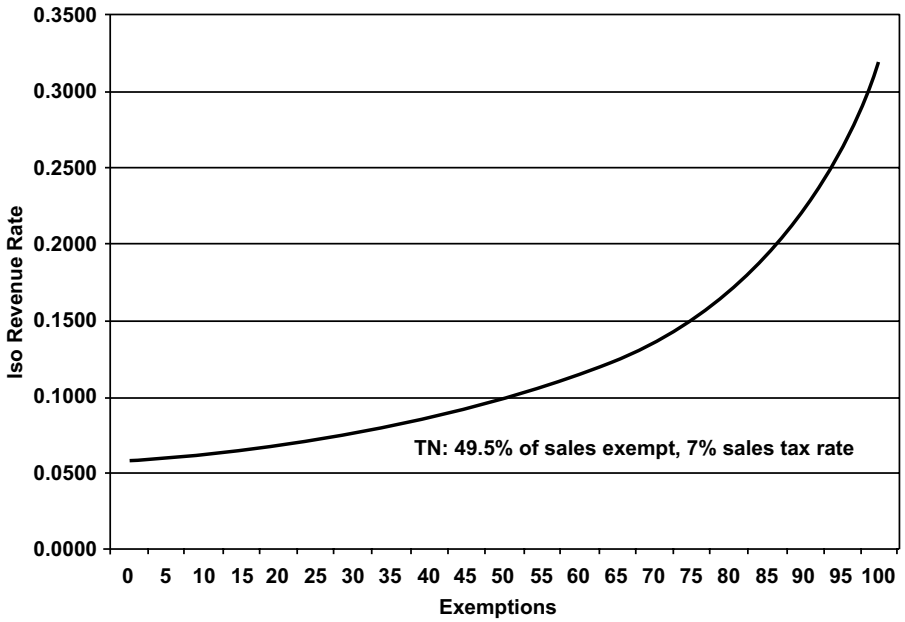
In order to gauge Missouri's ability to swap the state income tax for a state sales tax, let us continue comparing the tax structure in Missouri with that of Tennessee. Missouri levies a state personal income tax of 6.0 percent, beginning at $9,000 of income. The state also levies a state sales tax of 4.225 percent, 3 percent of which goes to general revenue. Counties and municipalities have the authority to levy additional sales taxes, and the large variation in this local portion of the sales tax results in the cumulative sales tax ranging from 4.73 percent in rural Ripley County to 8.24 percent in the city of Saint Louis.

Tennessee, on the other hand, has no state personal income tax but levies a state sales tax of 7 percent, all of which goes to general revenue. Counties and municipalities have the authority to levy an additional sales tax of up to 2.75 percent. There is thus less variability in the sales tax rate throughout Tennessee, ranging from 8.5 percent in Johnson County to 9.75 percent in Haywood County. The main difference in the structure of the sales tax in Tennessee *versus* the structure in Missouri, however, is that Tennessee has a larger sales tax base — some goods and services that are eligible for taxation in Tennessee are not in Missouri. In addition, Tennessee raises a significant amount of revenue through special categorical taxes, such as cigarette taxes and franchise taxes.

Eliminating the Missouri state income tax and replacing it with a sales tax would require raising an additional $5.6 billion via the state sales tax in order for the tax swap to be static revenue-neutral. The increase in revenues can be achieved by: a) increasing the sales tax rate; b) broadening the sales tax base; or, c) some combination of both a and b.

In Figure 2, we display an estimated iso-revenue line for the state of Missouri,

Figure 2: Iso-Revenue Line: Missouri Sales Tax Rate and Base Combinations



Source: Missouri Office of Administration, Bureau of Economic Analysis, Laffer Associates Calculations

A reliance on sales and corporate taxes (and property taxes on a local level) rather than on personal income taxes results in lower government revenue fluctuations over bad and good times. Simply put, revenues from sales and corporate taxes are more stable and reliable than are income taxes.

Table 8: Revenue Lost due to Sales Tax Exemption — Tennessee Actual and Missouri Estimate (Services)

SERVICES NOT SUBJECT TO SALES TAX TODAY	TENNESSEE TOTAL SIZE	*Source: Tn State Department Of Revenue* %	REVENUE LOST	TAX RATE	MISSOURI TOTAL SIZE	*Source: Modeling From Tn Base* %	REVENUE LOST	TAX RATE
State GDP	**$262,834,700,627.18**	**100%**		**7%**	**$242,278,390,389.08**	**100%**		**7%**
State Budget	$27,518,397,900.00	10.47%			$22,939,976,570.00	9.47%		
Health Care & Social Services (For-profit)	**$10,748,571,428.57**	**4.09%**	**$752,400,000.00**	**7%**	**$9,907,925,317.63**	**4.09%**	**$694,339,217.50**	**7%**
Physicians & Dentists	$6,212,857,142.86	2.36%	$434,900,000.00	7%	$5,726,949,389.47	2.36%	$401,339,879.97	7%
Other Health Practitioners	$735,714,285.71	0.28%	$51,500,000.00	7%	$678,174,048.19	0.28%	$47,525,876.80	7%
Hospitals	$1,240,000,000.00	0.47%	$86,800,000.00	7%	$1,143,019,560.83	0.47%	$80,101,866.13	7%
Nursing & Residential Care Facilities	$1,182,857,142.86	0.45%	$82,800,000.00	7%	$1,090,345,848.35	0.45%	$76,410,535.90	7%
Outpatient Care Centers	$451,428,571.43	0.17%	$31,600,000.00	7%	$416,122,328.60	0.17%	$29,161,508.87	7%
Medical and Diagnositic Laboratories	$354,285,714.29	0.13%	$24,800,000.00	7%	$326,577,017.38	0.13%	$22,886,247.47	7%
Other Selected Health Services	$150,000,000.00	0.06%	$10,500,000.00	7%	$138,268,495.26	0.06%	$9,689,741.87	7%
Social & Community Services	$421,428,571.43	0.16%	$29,500,000.00	7%	$388,468,629.55	0.16%	$27,223,560.49	7%
Construction Services	**$10,470,000,000.00**	**3.98%**	**$732,900,000.00**	**7%**	**$9,651,140,969.29**	**3.98%**	**$676,343,982.60**	**7%**
Construction of Buildings	$3,462,857,142.86	1.32%	$242,400,000.00	7%	$3,192,026,976.33	1.32%	$223,694,612.34	7%
Heavy and Civil Engineering Construction	$1,447,142,857.14	0.55%	$101,300,000.00	7%	$1,333,961,768.58	0.55%	$93,482,938.24	7%
Specialty Trade Contractors	$5,560,000,000.00	2.12%	$389,200,000.00	7%	$5,125,152,224.38	2.12%	$359,166,432.02	7%
Professional & Technical Services	**$10,075,714,285.71**	**3.83%**	**$705,300,000.00**	**7%**	**$9,287,692,353.17**	**3.83%**	**$650,873,803.97**	**7%**
Accounting, Tax Return Prep., & Payroll	$1,321,428,571.43	0.50%	$92,500,000.00	7%	$1,218,079,601.12	0.50%	$85,362,011.72	7%
Advertising & Public Relations	$454,285,714.29	0.17%	$31,800,000.00	7%	$418,756,014.22	0.17%	$29,346,075.38	7%
Architectural Studies	$347,142,857.14	0.13%	$24,300,000.00	7%	$319,992,803.32	0.13%	$22,424,831.19	7%
Engineering Services	$2,108,571,428.57	0.80%	$147,600,000.00	7%	$1,943,659,990.54	0.80%	$136,210,085.73	7%
All other Architectural, Engineering, & Related Services	$202,857,142.86	0.08%	$14,200,000.00	7%	$186,991,679.31	0.08%	$13,104,222.34	7%
Specialized Design Services	$241,428,571.43	0.09%	$16,900,000.00	7%	$222,546,435.23	0.09%	$15,595,870.25	7%
Computer Systems Design & Related Services	$667,142,857.14	0.25%	$46,700,000.00	7%	$614,965,593.21	0.25%	$43,096,280.51	7%
Legal Services (profit & non-profit)	$2,314,285,714.29	0.88%	$162,000,000.00	7%	$2,133,285,355.47	0.88%	$149,498,874.58	7%
Management, Scientific, & Technical Consulting	$2,130,000,000.00	0.81%	$149,100,000.00	7%	$1,963,412,632.72	0.81%	$137,594,334.57	7%
Scientific Research & Development (profit & non-profit)	$288,571,428.57	0.11%	$20,200,000.00	7%	$266,002,248.03	0.11%	$18,641,217.69	7%
Health Care & Social Services (Non-profit)	**$6,670,000,000.00**	**2.54%**	**$466,900,000.00**	**7%**	**$6,148,339,089.32**	**2.54%**	**$430,870,521.87**	**7%**
Hospitals	$5,534,285,714.29	2.11%	$387,400,000.00	7%	$5,101,449,053.76	2.11%	$357,505,333.41	7%
Nursing & Residential Care Facilities	$384,285,714.29	0.15%	$26,900,000.00	7%	$354,230,716.43	0.15%	$24,824,195.84	7%
Outpatient Care Centers	$372,857,142.86	0.14%	$26,100,000.00	7%	$343,695,973.94	0.14%	$24,085,929.79	7%
Other Selected Health Services	$94,285,714.29	0.04%	$6,600,000.00	7%	$86,911,625.59	0.04%	$6,090,694.89	7%
Social & Community Services	$284,285,714.29	0.11%	$19,900,000.00	7%	$262,051,719.59	0.11%	$18,364,367.93	7%
Administrative & Support Services	**$5,170,000,000.00**	**1.97%**	**$361,900,000.00**	**7%**	**$4,765,654,136.70**	**1.97%**	**$333,973,103.16**	**7%**
Collection Agencies & Credit Bureaus	$321,428,571.43	0.12%	$22,500,000.00	7%	$296,289,632.70	0.12%	$20,763,732.58	7%
Employment Services	$2,938,571,428.57	1.12%	$205,700,000.00	7%	$2,708,745,664.32	1.12%	$189,826,657.42	7%
Investigation & Security Services	$624,285,714.29	0.24%	$43,700,000.00	7%	$575,460,308.85	0.24%	$40,327,782.83	7%
Mail, Document Reproduction, & Call Centers	$228,571,428.57	0.09%	$16,000,000.00	7%	$210,694,849.92	0.09%	$14,765,320.95	7%
Services to Buildings & Dwellings	$1,057,142,857.14	0.40%	$74,000,000.00	7%	$974,463,680.89	0.40%	$68,289,609.38	7%
Finance, Insurance, & Real Estate	**$3,832,857,142.86**	**1.46%**	**$268,300,000.00**	**7%**	**$3,533,089,264.65**	**1.46%**	**$247,595,975.62**	**7%**
Investment Banking, Securities Brokerage, & Related	$1,277,142,857.14	0.49%	$89,400,000.00	7%	$1,177,257,473.95	0.49%	$82,501,230.79	7%
Insurance Agents & Related	$991,428,571.43	0.38%	$69,400,000.00	7%	$913,888,911.54	0.38%	$64,044,579.60	7%
Real Estate Agents & Brokers	$1,564,285,714.29	0.60%	$109,500,000.00	7%	$1,441,942,879.16	0.60%	$101,050,165.23	7%
Media Advertising Sales	**$1,891,428,571.43**	**0.72%**	**$132,400,000.00**	**7%**	**$1,743,499,883.11**	**0.72%**	**$122,183,030.83**	**7%**
Newspaper Advertising	$560,000,000.00	0.21%	$39,200,000.00	7%	$516,202,382.31	0.21%	$36,175,036.32	7%
Radio Advertising	$290,000,000.00	0.11%	$20,300,000.00	7%	$267,319,090.84	0.11%	$18,733,500.95	7%
Television Advertising (Broadcast & Cable)	$1,041,428,571.43	0.40%	$72,900,000.00	7%	$959,978,409.96	0.40%	$67,274,493.56	7%
Personal Services	**$1,220,000,000.00**	**0.46%**	**$85,400,000.00**	**7%**	**$1,124,583,761.46**	**0.46%**	**$78,809,900.55**	**7%**
Coin-operated Laundry	$40,000,000.00	0.02%	$2,800,000.00	7%	$36,871,598.74	0.02%	$2,583,931.17	7%
Death Care Services	$221,428,571.43	0.08%	$15,500,000.00	7%	$204,110,635.86	0.08%	$14,303,904.67	7%
Diet & Weight Loss	$24,285,714.29	0.01%	$1,700,000.00	7%	$22,386,327.80	0.01%	$1,568,815.35	7%
Hair, Nail, & Skin Care Services	$545,714,285.71	0.21%	$38,200,000.00	7%	$503,033,954.19	0.21%	$35,252,203.76	7%
Non-profit Amusement & Membership Organizations	$388,571,428.57	0.15%	$27,200,000.00	7%	$358,181,244.87	0.15%	$25,101,045.61	7%
Transportation Services (Local Trucking only)	**$840,000,000.00**	**0.32%**	**$58,800,000.00**	**7%**	**$774,303,573.47**	**0.32%**	**$54,262,554.48**	**7%**
Truck Transportation (Local)	$840,000,000.00	0.32%	$58,800,000.00	7%	$774,303,573.47	0.32%	$54,262,554.48	7%
Information Services	**$835,714,285.71**	**0.32%**	**$58,500,000.00**	**7%**	**$770,353,045.03**	**0.32%**	**$53,985,704.71**	**7%**
Data Processing Services	$337,142,857.14	0.13%	$23,600,000.00	7%	$310,774,903.64	0.13%	$21,778,848.40	7%
Movie Production & Sound Recording Studios	$95,714,285.71	0.04%	$6,700,000.00	7%	$88,228,468.41	0.04%	$6,182,978.15	7%
Cable TV Subscriptions (exempt amount)	$210,000,000.00	0.08%	$14,700,000.00	7%	$193,575,893.37	0.08%	$13,565,638.62	7%
Newspaper Subscriptions & Sales	$192,857,142.86	0.07%	$13,500,000.00	7%	$177,773,779.62	0.07%	$12,458,239.55	7%
Educational Services	**$634,285,714.29**	**0.24%**	**$44,400,000.00**	**7%**	**$584,678,208.54**	**0.24%**	**$40,973,765.63**	**7%**
Educational Services (for-profit)	$570,000,000.00	0.22%	$39,900,000.00	7%	$525,420,282.00	0.22%	$36,821,019.11	7%
Educational Services (non-profit)	$64,285,714.29	0.02%	$4,500,000.00	7%	$59,257,926.54	0.02%	$4,152,746.52	7%
Total	**$52,388,571,428.57**	**19.93%**	**$3,667,200,000.00**	**7%**	**$48,291,259,602.37**	**19.93%**	**$3,384,211,560.90**	**7%**

Table 9: Revenue Lost due to Sales Tax Exemption—Tennessee Actual and Missouri Estimate (Goods)

SERVICES NOT SUBJECT TO SALES TAX TODAY	TENNESSEE TOTAL SIZE	*Source: Tn State Department Of Revenue* %	REVENUE LOST	TAX RATE	MISSOURI TOTAL SIZE	*Source: Modeling From Tn Base* %	REVENUE LOST	TAX RATE
State GDP	**$262,834,700,627**	**100%**		**7%**	**$242,278,390,389**	**100%**		**7%**
State Budget	$27,518,397,900	10.47%			$22,939,976,570	9.47%		
Sales Taxes	**$27,486,942,857**	**10.46%**	**$1,924,086,000**	**7%**	**$25,337,188,188**	**10.46%**	**$1,775,609,207**	**7%**
Gasoline	$6,956,014,286	2.65%	$486,921,000	7%	$6,411,984,189	2.65%	$449,346,553	7%
Diesel fuel	$2,699,014,286	1.03%	$188,931,000	7%	$2,487,924,293	1.03%	$174,351,678	7%
Gasoline/diesel for agriculture	$188,485,714	0.07%	$13,194,000	7%	$173,744,241	0.07%	$12,175,853	7%
Prescription drugs, insulin, and related	$5,208,014,286	1.98%	$364,561,000	7%	$4,800,695,324	1.98%	$336,428,761	7%
Prescription drug samples	$651,071,429	0.25%	$45,575,000	7%	$600,151,112	0.25%	$42,058,094	7%
Energy fuels sold for residential use	$4,659,485,714	1.77%	$326,164,000	7%	$4,295,067,189	1.77%	$300,994,759	7%
Energy and water sales to man. for direct processing	$1,620,742,857	0.62%	$113,452,000	7%	$1,493,984,507	0.62%	$104,697,200	7%
Industrial and farm machinery and equipment	$2,626,314,286	1.00%	$183,842,000	7%	$2,420,910,162	1.00%	$169,655,383	7%
Packaging sold for resale or use	$1,469,857,143	0.56%	$102,890,000	7%	$1,354,899,569	0.56%	$94,950,242	7%
School books and lunches	$301,014,286	0.11%	$21,071,000	7%	$277,471,949	0.11%	$19,445,005	7%
Membership dues of civic organizations & associations	$294,614,286	0.11%	$20,623,000	7%	$271,572,493	0.11%	$19,031,576	7%
Prescription eyewear and optical goods	$241,642,857	0.09%	$16,915,000	7%	$222,743,962	0.09%	$15,609,713	7%
Newspaper periodicals	$192,585,714	0.07%	$13,481,000	7%	$177,523,579	0.07%	$12,440,706	7%
Motor vehicles sold to active-duty or non-resident military personnel	$115,585,714	0.04%	$8,091,000	7%	$106,545,752	0.04%	$7,466,638	7%
Physical fitness facility fees	$86,714,286	0.03%	$6,070,000	7%	$79,932,359	0.03%	$5,601,594	7%
Railroad rolling stock, materials and repairs	$69,557,143	0.03%	$4,869,000	7%	$64,117,077	0.03%	$4,493,272	7%
Film and transcription rentals	$61,942,857	0.02%	$4,336,000	7%	$57,098,304	0.02%	$4,001,402	7%
Fertilizers, pesticides, seeds, and related items	$44,285,714	0.02%	$3,100,000	7%	$40,822,127	0.02%	$2,860,781	7%
Total	**$27,486,942,857**	**10.46%**	**$1,924,086,000**	**7%**	**$25,337,188,188**	**10.46%**	**$1,775,609,207**	**7%**

depicting the different combinations of state sales tax rates and the percentage of all sales within the state that could be exempt from a sales tax that would otherwise generate the necessary sales tax revenues. To maintain revenue neutrality, the sales tax rate would need to be raised and the base would need to be broadened, but the locus of combinations is feasible.

Finally, the Tennessee Department of Revenue estimates revenue lost as a result of various sales tax exemptions. If we assume that the economic composition in the two states is similar, we can extrapolate the revenue that would be lost from those same exemptions in Missouri (Tables 8 and 9).

CONCLUSION

Missouri's proposal to eliminate the state income tax via a revenue-neutral increase in the state sales tax would represent a positive change for the state. First, the downside of the tax swap appears to be minimal, if not nonexistent — Tennessee currently has a tax structure very similar to the one being proposed in Missouri and has an economy that is performing better than Missouri's. Just as importantly, Missouri seems poised to experience significant gains if it were to eliminate the state income tax in favor of a broader and higher sales tax.

Missouri seems poised to experience significant gains if it were to eliminate the state income tax in favor of a broader and higher sales tax.

Appendix A

						TOP PIT	
CONNECTICUT	**1986-1990**	**1991-1995**	**1996-2000**	**2001-2005**	**2008**	**1991**	**CURRENT**
i.) GSP % of Total U.S. GSP	1.74%	1.67%	1.66%	1.59%	1.53%	1.50%	5.00%
ii.) PI per Capita relative to U.S.	134.86%	134.83%	136.45%	137.52%	140.75%		
iii.) Population as % of Total U.S.	1.33%	1.27%	1.22%	1.19%	1.15%		
iv.) Tax Revenues as % of Total U.S.	1.70%	1.80%	1.93%	1.74%	1.87%		
						TOP PIT	
NEW JERSEY	**1971-1975**	**1976-1980**	**1981-1985**	**1986-1990**	**2008**	**1976**	**CURRENT**
i.) GSP % of Total U.S. GSP	3.66%	3.33%	3.41%	3.79%	3.35%	2.50%	10.75%
ii.) PI per Capita relative to U.S.	115.67%	114.21%	118.63%	124.80%	126.82%		
iii.) Population as % of Total U.S.	3.47%	3.31%	3.20%	3.15%	2.86%		
iv.) Tax Revenues as % of Total U.S.	2.77%	2.95%	3.51%	3.68%	3.92%		
						TOP PIT	
OHIO	**1967-1971**	**1972-1976**	**1977-1981**	**1982-1986**	**2008**	**1972**	**CURRENT**
i.) GSP % of Total U.S. GSP	5.42%	5.04%	4.68%	4.24%	3.33%	3.50%	8.24%
ii.) PI per Capita relative to U.S.	100.94%	99.62%	99.58%	96.98%	88.79%		
iii.) Population as % of Total U.S.	5.25%	5.04%	4.81%	4.55%	3.78%		
iv.) Tax Revenues as % of Total U.S.	3.61%	3.77%	3.57%	3.91%	3.34%		
						TOP PIT	
RHODE ISLAND	**1966-1970**	**1971-1975**	**1976-1980**	**1981-1985**	**2008**	**1971**	**CURRENT**
i.) GSP % of Total U.S. GSP	0.44%	0.40%	0.36%	0.36%	0.33%	5.25%	6.50%
ii.) PI per Capita relative to U.S.	102.08%	95.88%	94.06%	97.96%	102.62%		
iii.) Population as % of Total U.S.	0.46%	0.46%	0.43%	0.41%	0.35%		
iv.) Tax Revenues as % of Total U.S.	0.47%	0.48%	0.42%	0.41%	0.35%		
						TOP PIT	
PENNSYLVANIA	**1966-1970**	**1971-1975**	**1976-1980**	**1981-1985**	**2008**	**1971**	**CURRENT**
i.) GSP % of Total U.S. GSP	5.72%	5.41%	4.98%	4.48%	3.91%	2.30%	7.05%
ii.) PI per Capita relative to U.S.	99.34%	99.35%	100.20%	98.56%	99.37%		
iii.) Population as % of Total U.S.	5.88%	5.63%	5.34%	5.06%	4.09%		
iv.) Tax Revenues as % of Total U.S.	5.59%	6.20%	5.50%	4.92%	4.11%		
						TOP PIT	
MAINE	**1964-1968**	**1969-1973**	**1974-1978**	**1979-1983**	**2008**	**1969**	**CURRENT**
i.) GSP % of Total U.S. GSP	0.39%	0.38%	0.38%	0.37%	0.35%	6.00%	6.85%
ii.) PI per Capita relative to U.S.	81.61%	82.44%	82.52%	82.59%	89.80%		
iii.) Population as % of Total U.S.	0.51%	0.49%	0.50%	0.49%	0.43%		
iv.) Tax Revenues as % of Total U.S.	0.43%	0.43%	0.49%	0.45%	0.48%		
						TOP PIT	
ILLINOIS	**1964-1968**	**1969-1973**	**1974-1978**	**1979-1983**	**2008**	**1969**	**CURRENT**
i.) GSP % of Total U.S. GSP	6.52%	6.16%	5.89%	5.28%	4.47%	2.50%	3.00%
ii.) PI per Capita relative to U.S.	115.10%	112.23%	112.78%	108.44%	106.10%		
iii.) Population as % of Total U.S.	5.53%	5.41%	5.22%	4.98%	4.24%		
iv.) Tax Revenues as % of Total U.S.	4.64%	5.55%	5.34%	4.80%	4.08%		
						TOP PIT	
NEBRASKA	**1963-1967**	**1968-1972**	**1973-1977**	**1978-1982**	**2008**	**1968**	**CURRENT**
i.) GSP % of Total U.S. GSP	0.67%	0.68%	0.72%	0.68%	0.59%	2.60%	6.85%
ii.) PI per Capita relative to U.S.	93.33%	93.62%	96.91%	94.44%	98.63%		
iii.) Population as % of Total U.S.	0.75%	0.73%	0.72%	0.69%	0.59%		
iv.) Tax Revenues as % of Total U.S.	0.45%	0.54%	0.56%	0.57%	0.54%		
						TOP PIT	
MICHIGAN	**1962-1966**	**1967-1971**	**1972-1976**	**1977-1981**	**2008**	**1967**	**CURRENT**
i.) GSP % of Total U.S. GSP*	5.08%	4.85%	4.44%	4.09%	2.70%	2.00%	4.30%
ii.) PI per Capita relative to U.S.	110.53%	106.73%	104.43%	103.61%	86.84%		
iii.) Population as % of Total U.S.	4.34%	4.36%	4.26%	4.10%	3.29%		
iv.) Tax Revenues as % of Total U.S.	5.03%	5.03%	3.86%	4.58%	3.17%		
						TOP PIT	
INDIANA	**1960-1963**	**1964-1968**	**1969-1973**	**1974-1978**	**2008**	**1964**	**CURRENT**
i.) GSP % of Total U.S. GSP*	2.61%	2.60%	2.48%	2.41%	1.80%	2.00%	4.30%
ii.) PI per Capita relative to U.S.	97.81%	97.76%	94.97%	95.92%	85.90%		
iii.) Population as % of Total U.S.	2.55%	2.55%	2.54%	2.47%	2.10%		
iv.) Tax Revenues as % of Total U.S.	2.09%	2.35%	2.01%	2.20%	1.93%		
						TOP PIT	
WEST VIRGINIA	**1960-1961**	**1962-1967**	**1968-1972**	**1973-1977**	**2008**	**1962**	**CURRENT**
i.) GSP % of Total U.S. GSP*	NA	0.60%	0.70%	0.73%	0.44%	6.00%	6.50%
ii.) PI per Capita relative to U.S.	73.75%	75.22%	75.19%	78.94%	77.48%	of U.S.	
iii.) Population as % of Total U.S.	0.97%	0.94%	0.87%	0.86%	0.60%	Tax Liability	
iv.) Tax Revenues as % of Total U.S.	1.01%	0.91%	0.84%	0.89%	0.62%		

* Gross state product (GSP) by state is available beginning in 1963; pre-income tax figures cover only periods where data is available.
** Taxes as a percentage of U.S. total are from 2007.

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