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A NEW TAX POLICY VISION FOR MISSOURI

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INTRODUCTION

Mark Twain, Missouri's unofficial state bard, was not terribly fond of paying taxes—who is?—and he opined about the subject often. In a speech to the Freundschaft Society in 1906, Twain complained about what came under the purview of the tax man. "We've got so much taxation," he told his guests, "I don't know of a single foreign product that enters this country untaxed except the answer to prayer."[1] Not just unhappy with the breadth of taxation, Twain also expressed his displeasure at the extent to which he was taxed. Writing in his notebook, he asked and answered, "What is the difference between a taxidermist and a tax collector? The taxidermist takes only your skin."[2]

Twain's humor gets at an unambiguous truth: Taxation requires a taking, with or without the consent of the individual. Because it is a taking, the debate about taxes—about how much money should be drawn from private enterprise, in what manner, and for what purpose—is among the most important debates in which policymakers engage. With that in mind, we must carefully consider what public goods are so vital that we must impose taxes to fund them. How much taxation is fair? And who is to pay it?

The need for this debate in Missouri has never been clearer. Since the late 1990s, Missouri has lagged behind her

ADVANCING LIBERTY WITH RESPONSIBILITY BY PROMOTING MARKET SOLUTIONS FOR MISSOURI PUBLIC POLICY peer states in economic growth according to a variety of indicators, including gross domestic product (GDP) and employment.[3] Population growth in the state has lagged[4] to such an extent that as a result of the 2010 census we lost a seat in the U.S. House of Representatives.[5]

No doubt, economic development and the policies that contribute to or detract from it are complicated. Population growth and GDP are driven by a variety of factors, including the preparedness of the state's workforce, the quality of the state's infrastructure, and a myriad of education variables. Nevertheless, the structure of a government's tax policy can have a significant impact on the economic prospects of its people. It was therefore encouraging to see the creation of the Committee for Simple, Fair and Low Taxes by Missouri Governor Eric Greitens, and its subsequent findings. The committee provided an important opportunity for policy leaders to reflect on the research regarding taxation and explore ways to put Missouri on a better economic footing going forward. That the Federal government pushed for tax reform of its own earlier this year brings added urgency to a reanalysis of Missouri's own tax situation.

Far from taxing prayers and taking hides, Missouri government at both the state and local levels should facilitate a level playing field for all taxpayers. In this essay we suggest reforms, supported by contemporary research (including our own), that we believe would improve Missouri's tax climate.

REDUCTION OR ELIMINATION OF INCOME TAXES

Researchers at the Show-Me Institute (SMI) have long supported the reduction—or better yet, elimination—of income taxes in the state. The very first policy study penned at SMI, written by Joe Haslag in 2006, focused on the negative impact of local earnings taxes on the cities of Kansas City and Saint Louis.[6] Taking a regression of 101 cities across the country, Haslag found that "a city with a one-percentage-point earnings tax rate will typically report per-capita income in the city part that is five percent less than per capita income in the MSA [metropolitan statistical area] when compared against a city with no earnings tax."

Those findings were buttressed in a 2010 study written by Grant Casteel and co-authored by Haslag.[7] There the authors compared state sales and income taxes and concluded that "by replacing the income tax with a revenue-neutral sales tax, the state economy realizes faster economic growth." The authors also noted that "overall, the model economy stresses the role played by the relationship between the income tax rate and economic growth in determining lifetime welfare."

Concerns about the negative impact of income taxes on growth are not restricted to findings from SMI research. As noted by Ishmael and Michael Rathbone in 2012,[8] a broad economic consensus exists on the detrimental effect of income taxes on economic development. In 2008, Jens Arnold of the Organization for Economic Cooperation and Development (OECD) wrote in his survey of the topic that

> *[a] stronger reliance on income taxes seems to be associated with significantly lower levels of GDP per capita than the use of taxes on consumption and property. Within income taxes, those on corporate income seem to be associated with lower levels of GDP per capita than personal income taxes. In fact, corporate income taxes appear to be the least attractive choice from the perspective of raising GDP per capita.*[9]

The research on the matter is more or less settled, or at least about as settled as any economic debate can be.

But the science surrounding the income tax and the economic growth question really just builds on our intuitive understanding of money. Every dollar taxed to fund the government is a dollar that cannot be spent or saved by private citizens. In the case of savings, it's a dollar that cannot accrue interest or draw additional capital into an investment—whether that investment is as simple as a savings account, as complex as an investment fund, or as tangible as a family restaurant that needs a new fryer to expand its operations.

In many respects, the discussion surrounding the income tax captures the debate about governing philosophies more broadly. If a policymaker believes that government is best equipped to spend a taxpayer's money to advance economic growth objectives, then reducing taxes to allow individuals to spend money as they see fit might not seem like an end worth pursuing. Yet aside from the morality of leaving people's earnings intact to the extent possible, the economic evidence is clear that individuals leveraging their resources in an open market make up the most powerful force for economic growth in the world. Ask Venezuelans what the top-down micromanaging of the economy through price controls and the nationalization of private industires has done to what was once one of the wealthiest countries in South America. On the other end of the spectrum, ask Indians whether free markets and free people have brought millions of its citizens out of poverty. While these examples are starker than the typical debate about domestic taxation levels, the difference is in scale, not in principle.

Of course, merely deciding to reduce the income tax is not the end of the discussion; implementation also matters. The wholesale elimination of an income tax without a compensating increase to, say, the sales tax, would likely result in a short term budgetary deficit.[10] Alternatively, fractional reductions in the income tax over the course of many years may lead to small increases in economic growth, but those small increases may not be enough to keep up with other, faster-growing states.

Still, there are ways forward. First, governments should review their state and local budgets for waste that may provide an opening for spending reductions—and parallel income tax revenue reductions. That includes not only looking for efficiencies in government operation, but also curbing economic development tax credits. Government should reassess the scope of its missions in general, particularly with respect to picking winners and losers in the tax code.

REDUCTION AND ELIMINATION OF ECONOMIC DEVELOPMENT TAX CREDITS AND ADVANCING TAX RELIEF

Norwood Hills Country Club in Saint Louis County is what it sounds like—a private golf club, with rolling hills and pristine facilities for its members. One might be surprised, therefore, to learn that it ever received financial assistance from the state. Yet, in 2006 it did—to the tune of over a million dollars in state tax credits.[11] Norwood Hills' tax credits came thanks to the state's Historic Preservation Tax Credit (HPTC), a program that regularly costs the state upwards of $100 million annually.

The fact that such a large credit was issued to a private country club is one thing, but that the tax credit was for historic "preservation" was perhaps even more extraordinary in light of the context. Around the time the credits were issued, an industry magazine covering the incentives wrote an article about the club, appropriately titled, "Norwood Hills CC: No Sweat and Plenty of Gain." In it, readers found out that the primary supporter of the country club's tax credit pursuit didn't see any structure as deserving preservation, but…

> "[The member] felt we could qualify not so much because of the club's history or architecture, but because of the distinction of our members in the St. Louis community through the years," [Norwood Hills GM/COO John] Wright says.[12]

Norwood Hills stands as an example of how easily the tax credit system can be gamed. The property gained historic landmark status just prior to receiving the tax credit, and the article suggests that landmark status was largely sought to gain access to public money—not because there was some communal recognition that the club itself was an asset that otherwise wouldn't be "preserved."

Many longtime tax policy observers are aware of the Norwood Hills situation, the HPTC itself, and the panoply of questionable tax incentive programs and projects facilitated by the state over the years. Certainly, the history of bad public policy regarding Missouri's tax incentives is a long one.

But even looking only at the past few years of tax credits and only at those purposed for "economic development" ends, the scope of the problem today is astounding. In 2016, the state of Missouri issued just over $380 million in economic development tax credits. In the last five years alone, the state has issued over $1.8 billion in these often-dubious incentives.[13]

We and others have suggested that the legislature and the state's Department of Economic Development (DED) do a better job of holding applicants responsible for their promises, including enhanced reporting and clawback provisions for many of the DED's existing tax credit programs.

But as Henry David Thoreau might suggest, the key here is "simplicity, simplicity, simplicity!"[14] Better reporting would increase transparency and potentially improve some of these programs, but it would still be papering over the larger problem. In most if not all cases, the state would be better served by wiping out the tax credit programs it presently offers—whether through outright elimination or hard sunsets—and assigning that money to broad-based tax relief.

For perspective, Missouri's corporate income tax revenues are regularly of the same, rough magnitude as the state's development tax credit spending.[15] During the last fiscal year, net corporate income tax revenue clocked in at $280 million—a full $100 million less than what the state issued in development tax credits during that same period.[16]

We are not suggesting today that every tax credit ought to be on the chopping block. While the discussion here focuses on development tax credits, in fact the total cost of tax credits to the state is approximately $700 million annually[17]—including millions of dollars in what many term "benevolent tax credits."

Nor are we opposed to every kind of tax credit. Specifically, a state-administered earned-income tax credit (EITC)—when combined with a reduction of the income tax and other welfare reforms—would be a substantial net benefit for the state's poor while also promoting and rewarding work for Missourians. A typical EITC provides a refundable tax credit to low- to moderate-income individuals and couples, providing workers with additional capital and empowering the poor to better care for themselves and their families.

That surgical policy tool stands in stark contrast to the blunt instrument of minimum wage hikes, which often raise the wages of those not living in poverty while limiting the availability of entry-level employment to those who need jobs the most. The EITC averts the negative consequences of the minimum wage and, in coordination with the reforms noted above, serves as a reasonable helping hand for Missourians towards the bottom of the income ladder.

In contrast, giving state money to, say, country clubs because of the "distinction" of their members? That does not advance good policy or the public interest. It enables the use of other people's money to aid the private economic interests of the well-heeled and well-connected.

Policymakers should pursue reforms that mitigate tax cronyism and maximize broad-based tax relief. Tax credit reform offers a pathway to achieving both.

REFORM OF LOCAL TAX INCENTIVES AT THE STATE LEVEL

While on the topic of using public funds to advance private economic interests, we should also consider tax incentive policy at the local level. Examples of local incentives susceptible to misuse include transportation development districts (TDDs), community improvement districts (CIDs), and tax-increment financing (TIF). These programs, in different ways, use tax dollars in order to subsidize local developments, and while each program has its specific applications, they are alike in that they steer public funds—or use public financing mechanisms—to support private projects that may not have a plausible public benefit.

Transparency and accountability are central to reforming these micro taxing districts. Missouri State Auditor Nicole Galloway recently called for reform of TDDs because they are often opaque to citizens—even though they raise and spend a great deal of money.[18] She has previously supported greater transparency for CIDs. Greater transparency is a necessary component of any potential reform proposal. Simply requiring these districts to publish their monthly financial statements would go a long way toward raising public awareness of the need for further reforms. While elected officials at the city and state levels are rightfully held accountable for tax policy, special taxing jurisdictions can often increase taxation without comparable checks.

TIF in particular could benefit from more transparency, but other reforms are necessary in this space as well. Although TIF was intended to be a tool for municipalities to spur development in economically challenged neighborhoods, in Kansas City and Saint Louis it has overwhelmingly been used to subsidize development in areas that are thriving economically. In Kansas City, TIF has been used to build world headquarters for successful global corporations such as H&R Block, JE Dunn, Burns & McDonnell, and Cerner.[19]

Not only do the TIF subsidies sometimes go to recipients who do not need them, but they do so at a cost to taxing jurisdictions that depend on property taxes—most notably school districts, counties, and library systems.

In urban settings, the result is often a diversion of money away from lower-income populations to fund projects enjoyed by the wealthy. For example, in Kansas City, TIF is used to subsidize high-rise luxury apartment buildings in a school district where 90 percent of children qualify for free or reduced-price lunch.

The reason these projects qualify for TIF is that the eligibility requirements hinge on two tests—a blight analysis and a but-for analysis—and both of those tests have been rendered effectively meaningless over the last few decades. Steve Potter, director of the Mid-Continent Public Library, has pointed out the standards for blight are so broad that under Missouri statute, the governor's mansion could be considered blighted.[20]

Across Missouri, findings of blight have been secured for all sorts of reasons—because of vacant buildings, tall grass, or cracked asphalt, or even because no development had happened there at all! The standards for receiving a TIF do not require commissions to take into account the parcels surrounding the one in question when determining blight—such that a vacant building in the trendy and economically thriving Crossroads district of downtown Kansas City can qualify for TIF. Similarly, the City of Saint Louis has employed TIF funds to build a parking garage in the well-to-do Central West End.[21]

And the but-for analysis, meant to address the need for a subsidy, is itself a porous barrier to subsidies. Often, an affidavit from the developer is sufficient evidence to justify taxpayer subsidies. But even lacking the request from a developer, TIF can proceed. In 2004, Joplin awarded TIF to a shopping center even though, according to the *Joplin Globe*, the developer "made it clear in a statement that it issued at the time that it did not ask for or even need the TIF designation, and that it was planning to come to Joplin regardless of whether the developer got a TIF designation."[22]

Nor does a TIF have to be premised on the notion that without it, the development won't make money. For one project in Kansas City's Crossroads district—specifically a vacant building at 1640 Baltimore Avenue—the but-for analysis concluded that without TIF, the unleveraged internal rate of return was calculated at 3.51 percent. TIF was projected to increase that rate to 8.11 percent. The argument for TIF was not that the project wasn't profitable—but that is wasn't profitable *enough*.[23]

While it seems that any reform would improve TIF, a simple and straightforward approach might be to bring the definition of blight into line with popular understanding. Restrict it mostly to structures, and use it only in areas with significant economic decay such as might be measurable by higher than normal poverty and unemployment.

FOR OUR ROADS AND BRIDGES, REVISIT TOLLING AND FUEL TAXES

In 2014, Missourians rejected a ballot initiative that would have imposed a new statewide three-quarter-cent sales tax to be used for transportation projects.[24] At the time, SMI analyst Joe Miller expressed his dismay at the structure of the proposal, not only for the dubious projects that would be funded as part of the plan but also because a sales tax falls on all Missourians—not just the users of the roadways.[25]

But despite the flawed design of Amendment 7 (the 2014 ballot item), the budgetary problems it was intended to address are legitimate and stem from long-standing policy debates. Missouri's gas tax is among the lowest in the country at 17 cents per gallon and hasn't risen since 1996.[26] Not only has the purchasing power of that revenue declined over twenty years of inflation, but today's more fuel-efficient cars use less gas per mile traveled than cars did two decades ago.

The result, broadly, is that the state has been forced to take in revenue at 1996 levels while paying for services at current prices. This isn't necessarily bad from a fiscal conservative's perspective—that is, forcing government to make better use of existing dollars rather than raising new revenue—but eventually this dynamic creates serious problems in terms of funding necessary fixes and improvements to the state's road system.

Modest increases to the gas tax, paired with responsible tolling along some of the state's most heavily-used highways, would help ensure that Missouri's roads are well maintained today and into the future.

And as a general matter, policymakers should reassess the systems by which certain goods and services are provided by the government to determine whether the systems are efficient and whether the costs of those goods and services are falling on the taxpayers who benefit from them. The debate over infrastructure and the taxes that fund it emphasizes the importance of that reassessment.

CONCLUSION

Tax reform offers an enormous opportunity to make Missouri a more hospitable place for families and businesses—whether they're already here or will come to the state in the future. Reducing income taxes, drawing down corporate welfare, and reorienting how the state raises and spends money on transportation priorities would help ensure that Missouri is not only empowering its residents, but also maximizing every taxpayer dollar that the state spends.

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