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Tax Limitation: The Case of Missouri

Hancock Amendment Keeps Check on Government Tax Bite

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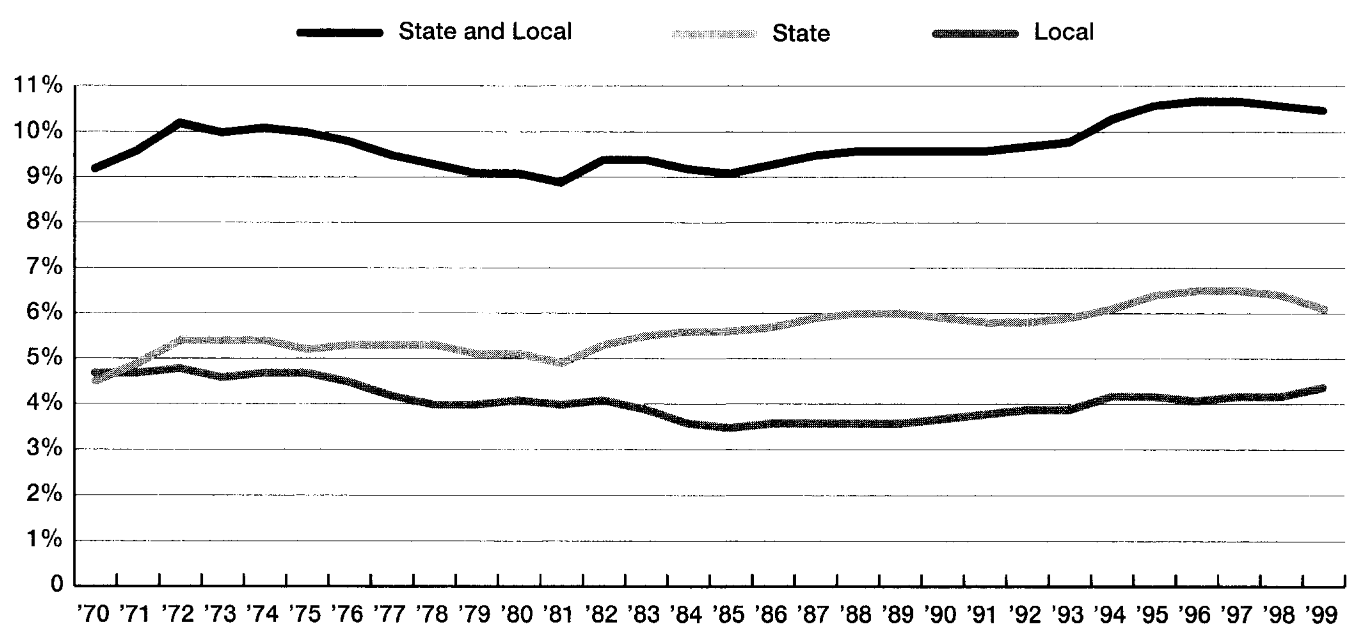
Since the end of the last recession in 1992, the U.S. economy has been growing steadily. The boom has caused state and local government tax collections to surge, and many states are now faced with large and growing budget surpluses. Policymakers must decide to pursue one of two general options—spend the surplus or return it to the taxpayers. Most states, to varying degrees, have chosen the latter option.

However, the methods used to return excess tax collections differ from state to state. Some states have simply enacted a temporary refund or lowered tax rates. Alternatively, six states have either a legislative or constitutional tax limitation provision—Arizona, Colorado, Ohio, Oregon, Massachusetts and Missouri. These limitations are automatically determined every year and if certain conditions are met (such as the growth in tax collection exceeding growth in personal income) the state is obligated to return the excess amount to the taxpayers.

This paper focuses on one such state,

Figure 1
Missouri's State and Local Taxes As a Percentage of Income
1970-1999



Source: Tax Foundation

Missouri. A 30-year period of Missouri's state and local tax burden is presented and compared with other states. The paper focuses on the current and expected fiscal effects of Missouri's constitutional provision limiting taxes—the Hancock Amendment.

State and Local Tax Burdens in Missouri

Propelled by a large increase in state taxes, as shown in *Table 1* and *Figure 1*, the early 1970s was a time of high state and local tax burdens for residents of Missouri. In fact, the state and local tax burden reached levels (over 10 percent of income) that would not be exceeded for another 20 years. However, after 1975, the total state and local tax burden fell back primarily as a result of a steep decline in local tax burdens.

During the early 1980s, Missouri's state tax burden grew rapidly as the overall U.S. economy recovered from recession and experienced an extended expansion. Economic growth raises state tax revenues faster than local revenue because state governments often rely more heavily on progressively designed income taxes. This type of tax pulls people quickly into higher tax brackets when economic growth raises personal income, while local government revenue sources such as property taxes are more stable. The state tax burden leveled off as a percentage of income in the latter half of the 1980s.

Table 1
Missouri's State and Local Taxes As a Percentage of Income
1970-1999

Year	State and Local	State	Local
1970	9.20%	4.51%	4.69%
1971	9.61	4.91	4.71
1972	10.23	5.45	4.79
1973	10.00	5.43	4.57
1974	10.12	5.38	4.74
1975	9.97	5.23	4.73
1976	9.77	5.26	4.51
1977	9.48	5.25	4.23
1978	9.32	5.28	4.04
1979	9.10	5.14	3.96
1980	9.13	5.08	4.05
1981	8.88	4.92	3.96
1982	9.39	5.29	4.10
1983	9.43	5.53	3.89
1984	9.17	5.56	3.60
1985	9.12	5.61	3.51
1986	9.27	5.72	3.55
1987	9.54	5.92	3.62
1988	9.60	5.98	3.62
1989	9.57	5.96	3.62
1990	9.61	5.90	3.70
1991	9.60	5.77	3.83
1992	9.68	5.77	3.90
1993	9.85	5.91	3.94
1994	10.29	6.12	4.17
1995	10.59	6.41	4.18
1996	10.67	6.53	4.14
1997	10.69	6.47	4.22
1998	10.60	6.35	4.24
1999	10.49	6.11	4.36

Source: Tax Foundation

As the economy entered a recession in 1991, the Missouri state tax burden receded. However, almost the entire decline in state tax burdens was offset by an increase in local tax burdens. The combination of a rebounding economy and state tax increases in 1992 and 1993 pushed the state tax burden to unprecedented levels in the following years. As a percentage of state income, state and local tax burdens hit an historical high (10.7 percent) in 1997.

In 1998, however, the tide turned, and Missouri's state tax burden has fallen slightly in the last two years. This dip is primarily attributable to refunds mandated by the Hancock Amendment that were issued in 1998. Recent cuts in the sales tax on food and in the personal income tax—via an increase in personal deductions and credits—also played a role.

State and Local Tax Rankings by State

Table 2 and *Figure 2* show how Missouri's state and local tax burden compares with the national average. Over most of the 30-year time span, Missouri's state and local tax burden has been well below the national average, and for the most part its fluctuations have tended to follow the national trend.

Between 1991 and 1997, however, Missouri's state and local tax burden grew rapidly—from 9.6 percent to 10.7 percent. Over the same time period, the nationwide state and local tax burden tapered off and hovered just below 11.5 percent of income. The surge in Missouri's state and local tax burden considerably narrowed the gap between the national average and Missouri's tax burden. Since 1997, this trend has been reversed by the Hancock refunds and other tax cuts.

The variation in state and local tax burdens around the nation is shown in *Table 3*. Although its state and local tax burden is at an all-time high, Missouri only ranks 39th highest of the 50 states. This means that 11 states have a lower state and local tax burden while 38 states have higher tax burdens.

Table 4 ranks Missouri's state and local tax burdens over the last 10 years. At the state level, Missouri's tax burden has been comparatively low. In 1989, Missouri had the 41st highest state tax burden, and since then the state tax ranking has changed very little. By 1998, Missouri's state tax ranking had climbed three places to the 38th highest in the nation, and in 1999, Missouri is projected to have the 40th highest state tax burden in the nation.

At the local level, Missouri ranks much higher. In 1989, Missouri's local tax burden was the 30th highest in the nation. In the decade since then, the local tax ranking has risen steadily, and in 1999, Missouri is projected to have the 23rd highest local tax burden in the nation.

It is important when looking at state rankings to note that the majority of states are clustered tightly in the middle, creating a bell-curve distribution (see *Figure 3*). Within this cluster, rankings change more dramatically when the tax burden rises or falls. For example, a hypothetical one percentage point increase in Virginia's combined state and local tax burdens in 1999 would propel it from the 40th highest tax burden to the 16th highest—a movement of 24 places.

Table 2
State and Local Taxes As a Percentage of Income: Missouri vs. the National Average
1970-1999

	Missouri	National Average		Missouri	National Average
1970	9.20%	10.79%	1985	9.12%	10.94%
1971	9.61	11.06	1986	9.27	11.13
1972	10.23	11.43	1987	9.54	11.23
1973	10.00	11.15	1988	9.60	11.04
1974	10.12	11.21	1989	9.57	11.09
1975	9.97	11.34	1990	9.61	11.09
1976	9.77	11.41	1991	9.60	11.35
1977	9.48	11.38	1992	9.68	11.42
1978	9.32	10.88	1993	9.85	11.42
1979	9.10	10.48	1994	10.29	11.42
1980	9.13	10.51	1995	10.59	11.38
1981	8.88	10.47	1996	10.67	11.32
1982	9.39	10.88	1997	10.69	11.23
1983	9.43	10.94	1998	10.60	11.32
1984	9.17	10.88	1999	10.49	11.33

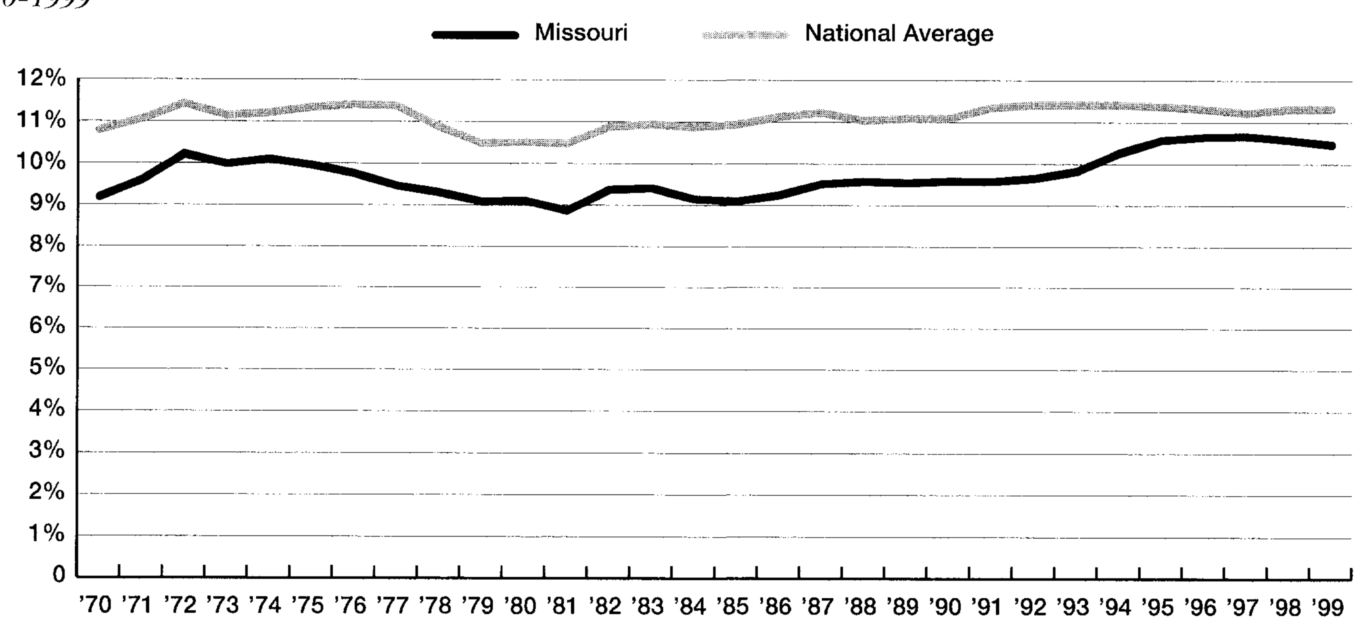
Source: Tax Foundation

The Hancock Amendment

The Hancock Amendment to the Missouri Constitution (Article X) was approved in 1980. The Amendment requires the state government each year to compare total state revenues with personal income.[1] If revenues exceed 5.6959 percent of personal income (one percent over the historical cap of 5.6395), then the state is obligated to refund any amount over the historical cap.

The tax revenue limit set by the Hancock

Figure 2
State and Local Taxes As a Percentage of Income: Missouri vs. the National Average
1970-1999



Source: Tax Foundation

[1] Exempts tax revenue earmarked for payment of principal and interest on bonds.

Amendment was first reached in 1995. The refund was calculated to be worth $147 million. However, court challenges to the Amendment delayed distributions until early 1998. By that time, two more years' worth of refunds had accumulated: $229 million in 1996 and $319 million in 1997.

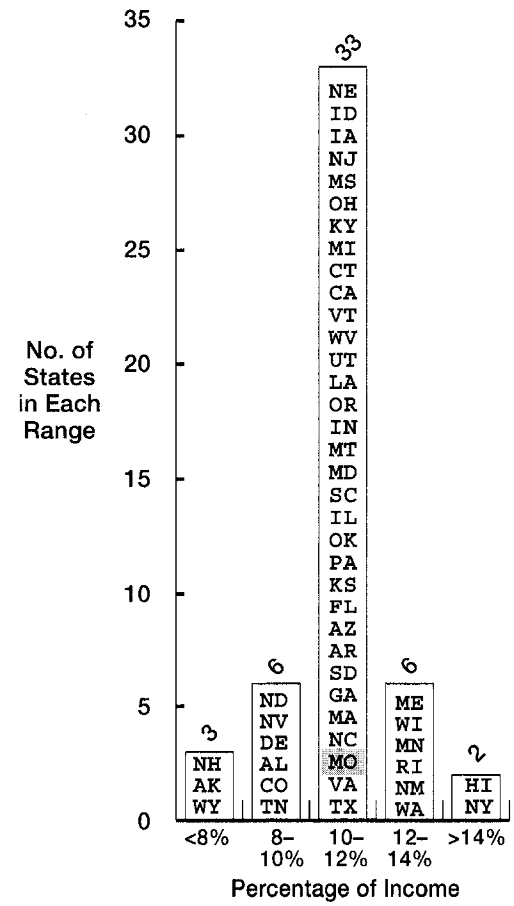
The first refund checks were issued in

Table 3
State and Local Tax Burdens As a Percentage of Income
1999

Rank	State	State/Local Tax Burden
	Total	11.33%
1	Hawaii	14.41
2	New York	14.15
3	Maine	13.84
4	Wisconsin	13.77
5	Minnesota	13.19
6	Rhode Island	12.51
7	New Mexico	12.19
8	Washington	12.06
9	Nebraska	11.71
10	Idaho	11.65
11	Iowa	11.61
12	New Jersey	11.59
13	Mississippi	11.55
14	Ohio	11.55
15	Kentucky	11.51
16	Michigan	11.43
17	Connecticut	11.36
18	California	11.31
19	Vermont	11.30
20	West Virginia	11.24
21	Utah	11.23
22	Louisiana	11.21
23	Oregon	11.16
24	Indiana	11.14
25	Montana	11.12
26	Maryland	11.09
27	South Carolina	11.06
28	Illinois	11.05
29	Oklahoma	11.04
30	Pennsylvania	11.01
31	Kansas	10.88
32	Florida	10.88
33	Arizona	10.83
34	Arkansas	10.75
35	South Dakota	10.74
36	Georgia	10.72
37	Massachusetts	10.63
38	North Carolina	10.58
39	Missouri	10.49
40	Virginia	10.43
41	Texas	10.27
42	North Dakota	9.92
43	Nevada	9.91
44	Delaware	9.91
45	Alabama	9.73
46	Colorado	9.65
47	Tennessee	9.45
48	New Hampshire	7.66
49	Alaska	7.61
50	Wyoming	7.29

Source: Tax Foundation

Figure 3
Distribution of State and Local Tax Burdens As a Percentage of Income
1999



Source: Tax Foundation

Table 4
Ranking of Missouri's State and Local Tax Burdens Compared to Other States
1989–1999

Year	State	Local	State and Local
1989	41	30	46
1990	41	31	46
1991	44	32	47
1992	44	29	47
1993	42	30	47
1994	41	24	45
1995	38	24	39
1996	35	25	36
1997	35	24	37
1998	38	25	39
1999	40	23	39

Source: Tax Foundation

early 1998, combining the 1995 and 1996 refunds. The 1997 refund was distributed in late 1998. The limit was also exceeded in 1998 triggering a $245 million refund due to be dispersed in the fall of 1999.

As shown in *Table 5* and *Figure 4*, the Hancock Amendment has worked to lower Missouri's state tax burden significantly since 1995, whether the refunds are counted in the years that the taxes were paid or in the years the refunds were finally paid out. The effects of other legislated tax cuts are included in all three lines of *Figure 4*, so the difference shown is entirely due to the refunds.

The 6.11 percent state tax burden in 1999 results from counting the Hancock refunds in the years they were actually paid out. This short-term drop is not indicative of a new, lower trend line for Missouri's state tax burden because the distribution of three years' worth of refunds in one year greatly exaggerated the magnitude of the drop (see Methodology). If the refunds had not been challenged in court and had instead been paid out on a timely basis, the trend line for Missouri's tax burden would have been flatter.

The uncertainty created by the Hancock Amendment manifests itself most dramatically in the state-by-state rankings of tax burdens. In 1999, Missouri is projected to have the 40th highest state tax burden and the 39th highest state/local tax burden. In the absence of the three Hancock refund distributions in 1998, Missouri's rank for state taxes alone would have risen to 23rd highest and the combined state/local burden would have been the 17th highest in the nation. Again, the actual trend line is somewhere in between.

Anticipating Missouri's Future Tax Burdens

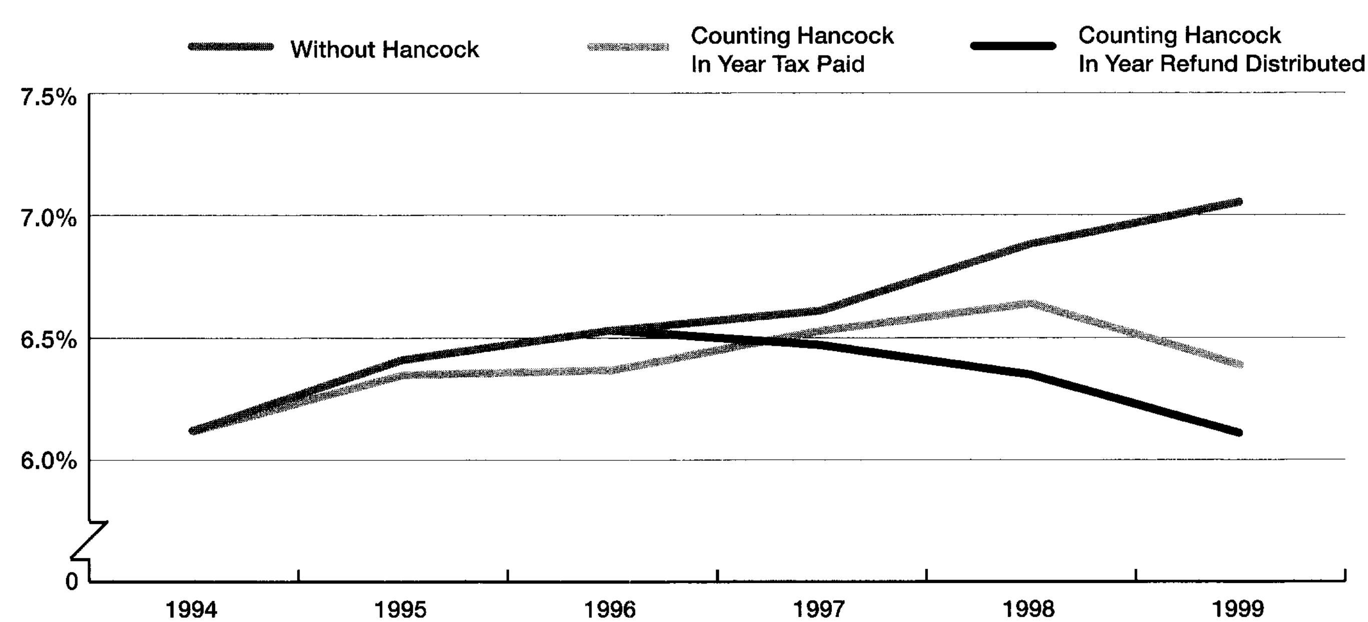
Even if no new tax cuts are legislated and Missouri's economy remains healthy, Missouri's residents can expect that their state tax burden beyond 1999 will be kept in check, even though almost 40 percent of Missouri's

Table 5
The Effect of the Hancock Amendment on Missouri's State Tax Burden 1994-1999

	Without Hancock Refunds	Counting Refunds in Year Tax Was Paid	Counting Refunds in Year Refund Distributed
1994	6.12%	6.12%	6.12%
1995	6.41	6.35	6.41
1996	6.53	6.37	6.53
1997	6.61	6.53	6.47
1998	6.88	6.64	6.35
1999	7.05	6.39	6.11

Source: Tax Foundation

Figure 4
The Effect of the Hancock Amendment on Missouri's State Tax Burden 1994-1999



Source: Tax Foundation

state tax collections come from its individual income tax, which has 10 rates that progress quickly from 1.5 percent to 6 percent as incomes rise. Without the Hancock Amendment, this progressive personal income tax rate structure, combined with a strong economy, would inevitably work to raise tax burdens as a percentage of income.

The Hancock Amendment effectively stems the increase in the state tax burden, leaving only Missouri's local taxes to push the combined state/local tax burden upward.

Methodology

The state and local tax burdens are derived from the Tax Foundation's annual Tax Freedom Day report published every April 15. The tax burden is determined by dividing per capita state and local tax burdens by per capita income. The following formula presents Missouri's total state and local calculation for 1999:

$$\frac{\text{Per capita state state \& local taxes}}{\text{Per capita income}} = \frac{\$2{,}835}{\$27{,}026} = 10.5\%$$

The income figure in this formula is Net National Product (NNP), a component of the National Income and Product Accounts (NIPA). These accounts are computed and compiled annually by the Commerce Department's Bureau of Economic Analysis. In order to maintain consistency, state and local tax collections totals are also based on NIPA definitions. The Tax Foundation has developed a state-by-state tax allocation model to distribute the national NIPA data.

Predicting Tax Burdens

Due to limitations in data availability, the Tax Foundation creates baseline forecasts to estimate state and local tax burdens for the most recent years. As a consequence, revisions in the data and unforeseen events that lead to changes in the baseline forecast can create relatively wide variations in reported state and local tax burdens between issued reports. This volatility is especially true for the sensitive state-by-state rankings where state and local tax burdens are often separated by only a tenth of a percentage point or less.

For example, in April 1998, the Tax Foundation's Tax Freedom Day® report estimated Missouri's 1998 state and local tax burden to be the 16th highest in the nation. A year later in April 1999 Missouri fell to 39th highest in our state-by-state ranking of state and local tax burdens. This discrepancy is primarily attributable to the incorporation of new data that now accounts for all three years' worth of Hancock refunds distributed in 1998. Neither NIPA data nor Census Bureau data record tax refunds until they are actually dispersed to the taxpayer, so even though Missouri's taxpayers and public officials may think of the refunds as counting for years 1995 through 1998, the government counts them all as 1998. Therefore, our early-1998 report did not count all of them, and incorporating all of them in the 1999 report caused a downward revision in the Tax Foundation's estimate.

In addition, the 1999 report used a 15-year trend line of tax collections to predict 1999's tax burden, while the 1998 report used a 5-year trendline. Therefore, the significant increases in state tax burdens that occurred between 1992 and 1995, prior to the Hancock refunds, affected our 1998 estimate more dramatically than they did our 1999 estimate. Both methods have their strengths. Sometimes using a shorter trend line can actually produce a more accurate estimate, but the Tax Foundation has made this change as part of a systematic effort to insure that the model's baseline assumptions are as conservative as possible.

After the baseline forecasts are made, the model utilizes more up-to-date data (provided by the National Conference of State Legislatures) to adjust the forecasts for recent legislative action.

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