CITIZENS LEAGUE
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STATEMENT TO GOVERNOR AND LEGISLATURE CONCERNING EXPENDITURES/TAXATION FOR 1981-83

SUMMARY

- There is growing consternation and impatience with the way the legislative budgeting process is being conducted. And, at a time when most citizens are being forced to cut back their own spending and adjust their priorities, they are being asked to accept higher taxes.

- During the 1980s it will be necessary for policymakers to be more creative and forward-looking in balancing budgets with limited tax resources. The proposals being discussed in the late stages of the 1981 Legislature do not appear to be responding adequately to this challenge.

- Therefore, the Governor and Legislature should wait until the 1982 session to take final action on expenditure-tax decisions for the upcoming biennium. This means that no permanent tax increases—that is, those without expiration dates—should be considered before the 1982 session. This approach has the further advantage of the opportunity to relate to changes in economic conditions and to the final shape of changes in federal taxes, both of which have a powerful effect on state revenues.

- If permanent tax increases are to be adopted, they should be accompanied only by specific expenditure and tax policies looking toward the 1983-85 biennium and beyond, so that upcoming sessions won't be a repeat of the present one. Preparation of such policies should occur during the interim and be acted on in 1982. It is not likely that systematic attention to long-term tax/expenditure policies can be completed in the next two-and-a-half weeks.

- The committees of the House and Senate which are responsible for appropriations and tax legislation should meet intensively during the interim to prepare proposals for action in 1982 on (a) taxes and expenditures for the second year of the biennium, (b) targets for overall spending levels for the 1983-85 biennium and how these targets can be achieved, (c) the appropriate mix of sales, income and property taxes, and (d) mechanisms that would enable the Governor and Legislature to know more about the long-term impact of spending and tax legislation.

- If taxes must be increased, temporarily, in the next two-and-a-half weeks, we believe the sales tax should be picked. Minnesota ranks 36th in the nation in sales taxes per $1,000 of personal income, while it ranks third in individual income taxes.

- The 1981 Legislature should not grant further homestead property tax relief.

- The 1981 Legislature should not impose further state restrictions on local governments' authority to raise taxes on property or other means at their disposal such as licenses and user fees.

- Even though decisions on permanent tax increases should be delayed until 1982, it is clear that the Governor and Legislature have an enormous task of completing their current agenda by May 18. A short special session after May 18 would be far preferable to settling for an agreement which could contain serious flaws.

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This is not the time to make permanent increases in taxes – In the last several weeks the Governor and Legislature have been seeking a way to close a gap between desired expenditures and projected revenues for the next biennium. Over the last few days a sense of "relief" seems to have developed at the Capitol as bipartisan support has emerged for an increase in the sales tax. But we are extremely concerned over the basic decision, in light of current economic conditions, to increase taxes.

This state needs better long-range expenditures and tax policies or else the same sort of "crisis" will face the Governor and Legislature in succeeding bienniums.

If the people of this state are to be asked to accept a tax increase in the current environment, they need more assurance that the Governor and Legislature have a plan for influencing expenditures in upcoming bienniums. Such a plan could be ready in 1982. For example, specific expenditure increase (or decrease) goals for the following biennium could be set.

Consequently, we believe that the Governor and Legislature in this session should avoid actions that would lead to permanent tax increases. They must, of course, adopt the biennial budget. But there are several possible options they could adopt that would require their taking final action in 1982. For example, they could deliberately hold down appropriations for the second year of the biennium, with the specific understanding that the appropriations would be adjusted in 1982 when the final decision on a tax increase, if any, could be made. Or it is possible that certain tax increases could be imposed for one year only, expiring on June 30, 1982.

Do more to project what the decisions this year mean for the 1983 biennium and beyond.

Background – Much of the difficulty facing the Governor and Legislature in balancing the budget for 1981-83 relates to decisions made in previous sessions. For example, property tax relief provisions invariably have their greatest impact on the biennium following the immediately upcoming one.

The Governor is recommending several items which would affect the 1983-85 biennium, including shifts in dates of expenditures or collections of revenues. Some proposals, such as placing a "cap" on property tax relief provisions and increasing the mandatory school mill rate, reduce the claim on state revenues below what they otherwise would be.

Our Concerns – As we noted above, a better plan for expenditure levels in upcoming bienniums is needed. But even in the short time remaining before May 18, the Governor and Legislature can remind themselves, consciously, of the longer term impacts of all actions. We are here restating our recommendation, made last January, that the staff-prepared summaries of the differences in appropriations and tax bills, as submitted to conference committees, should contain projections of the impact of spending and tax decisions in the 1983-85 biennium, even though such information is not required for reaching agreement.

We are deeply concerned over the proposed shifts in dates of expenditures and collections of revenue. These actiohs further restrict the flexibility available in upcoming legislative sessions. Such shifts should be regarded as extreme measures, designed to meet emergencies. To reduce the temptation to resort to shifts, the Governor and Legislature could self-impose a requirement that for every dollar shifted they will find a way to improve or modify the delivery of services to save an equivalent amount in expenditures in upcoming bienniums. We have previously suggested, in the report of our Committee on the '80s, that the challenge in coming years will be to do more with less.

Use the sales tax, if taxes are to be increased, temporarily, this session.

Background – The Governor has recommended a temporary (expiring June 30, 1983) five per cent surtax on individual and corporate income, and a permanent decrease in deductible items (medical and gasoline tax) on the individual income tax.

Our Concerns – In our report, "A More Rational Discussion of Taxes and the Economy," issued in October 1979, we noted that the state's economy is growing in the business of selling know-how, such as servicing and managing things. Unlike agriculture, mining and, to a lesser extent, manufacturing, these activities are not tied to a geographic location. Thus, the Twin Cities area and Minnesota will be competing with other parts of the county for high-skilled people who make their living this way. We felt that the way the individual income tax is used will be critical for the development of our economy. We now repeat our recommendation from that report, that the state begin planning for use of some consumption-based tax, a sales tax, as the next additional source of revenue, particularly since our income tax is relatively high nationally, and our sales tax is relatively low. The Advisory Commission on Intergovernmental Relations, a national study group involving all governmental levels, has recommended that a good state-local tax system gives approximately equal weight to sales, income, property taxes, and other charges. For the fiscal year ending June 30, 1980, Minnesota's sales tax collections were about $657 million; individual income tax, $1.3 billion; corporate income, $345 million and property, $1.3 billion.

Don't further increase homestead credits in this session

Background – Some legislative proposals would increase the homestead credit on property taxes from $650 to $700 or $750. Other proposals would give homeowners state-paid relief for any property tax increases of five per cent or more over the previous year

Our Concerns – In our statement to the Governor and Legislature last month we questioned whether too much homestead credit already is being given. The state now is committed to pay substantially more than one-half (58 per cent to be exact) of homeowners' property taxes to a maximum of $650. Net homestead taxes, after deducting the homestead credit, but before the circuit-breaker, are less than $470 for two-thirds of the homeowners in Minneapolis, for one-half of the homeowners in suburban Hennepin and Ramsey Counties, for three-fourths of the home owners in Saint Paul, and for seven-eights of the homeowners in outstate Minnesota.

Property taxes are high for some metropolitan area home owners, particularly in homes valued in excess of $100,000.

Perhaps some imaginative way needs to be found to help those homeowners; but, in general, homestead property taxes in Minnesota today are very reasonable.

We have previously suggested a selected approach to ease the property tax burden in the metropolitan area, for all properties, not just homestead. That proposal is for a fraction-of-a-penny increase in the state sales tax in the metropolitan area, with revenues used to finance services that otherwise would be paid by the property tax, thereby providing relief for all property taxpayers located in the metropolitan area.

Don't further restrict the right of local governments to levy property taxes at a time when state aids are being restricted.

Background – The Governor has proposed that cities, counties and townships be prohibited from increasing their property taxes by more than eight per cent (in dollars) over 1981. Limits could be exceeded by referendum. These limits would apply to all levies; unlike existing levy limits, there would be no exceptions, such as for debt service. The proposed limits would restrict local government spending more than existing limits do. Existing limits are figured on a base that includes more than just property taxes levied. Some persons have asked whether the proposed limits would reduce bond ratings.

The Governor has also proposed that the state put a "cap" on the amount of additional homestead credit and other property tax relief payments that would be made each year to local governments. The "cap" would not deny full benefits to individual taxpayers; instead, local governments would not receive the full amount pledged by the state on behalf of the individual taxpayers.

Our Concerns – Clearly, the Governor and Legislature need to assure balance in the state-local fiscal system. (See chart at back of statement.) In the late 1970's the state became committed to ever-escalating payments to local governments, either directly in the form of aid or indirectly in the form of property tax relief payments. Much of the current fiscal problem has its roots in that action. Local governments were able to increase spending and let the state pay a large portion of the bill which would otherwise have fallen on local voters.

A cutback in the growth of property tax replacement payments to local governments is consistent with our previous positions. The tax burden on most homeowners (particularly those in medium-priced homes) has been reduced substantially. We have been concerned that local residents may lose some of their interest in controlling the level of the property tax if the state pays such a large portion of the total bill. Moreover, most state property tax replacement payments don't apply to non-homestead property. Owners and renters of such property become victims of higher taxes which are voted by residents who are unaffected, or slightly affected, by increases in taxes.

We have already made some suggestions for bringing the system back into balance, such as (a) denying additional homestead credit to homeowners when levies exceed a certain amount, and (b) making homeowners responsible for paying the gross amount of their bill, even though they receive a separate payment for the credit, or (c) withdrawing state aids, if local governments levy too much.

Our chief concern now, however, lies not in details, but in fundamental direction. We seriously question whether it is sound policy for the state to reduce local revenue raising authority at the same time it is cutting back aids. We have opposed the centralization of all revenue-raising and spending decisions at the level of state government. In the long run, the result may be higher spending, in total, than if local governments were given the right to decide, on their own. Centralization of decisions may produce a "leveling up" of service levels from community to community.

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This statement was prepared by the Tax and Finance Task Force of the Citizens League, which has been reviewing state budget-related issues since last fall. The task force previously issued three other statements on the budget. The statements are consistent with several reports of the Citizens League on tax and finance matters.

TRENDS IN MINNESOTA LOCAL GOVERNMENT FINANCE

Pre-1967. In these years, local governments were free to make their own spending decisions and were responsible for revenue-raising, without much state aid.

Spending decisions	Revenue-raising responsibilities
Locals, mainly	Locals, mainly
Locals and state jointly	Locals and state jointly
State, mainly	State, mainly

1967-71. The state provided more aid to local governments, indirectly through the homestead credit and exempt property reimbursements, and directly in new aid programs to cities and schools. Local governments were left free to make their own spending decisions.

Spending decisions	Revenue-raising responsibilities
Locals, mainly	Locals, mainly
Locals and state jointly	Locals and state jointly
State, mainly	State, mainly

Early 1970's. The state imposed stricter limits on local governments making their own spending decisions. This was accompanied by substantial state aid to local governments and to property taxpayers.

Spending decisions	Revenue-raising responsibilities
Locals, mainly	Locals, mainly
Locals and state jointly	Locals and state jointly
State, mainly	State, mainly

Late 1970's. The state further expanded its programs of aid to local governments and to property taxpayers, without further restrictions on local spending decisions.

Spending decisions	Revenue-raising responsibilities
Locals, mainly	Locals, mainly
Locals and state jointly	Locals and state jointly
State, mainly	State, mainly

Governor's proposal, 1981. The proposal would add further restrictions on local spending, accompanied by a reduction in the amount of state revenue-raising for local government.

Spending decisions	Revenue-raising responsibilities
Locals, mainly	Locals, mainly
Locals and state jointly	Locals and state jointly
State, mainly	State, mainly