

CITIZENS LEAGUE
530 Syndicate Building
Minneapolis, MN 55402

December 1, 1982

CITIZENS LEAGUE OPPOSES
UNFUNDED SHIFTS
TO BALANCE BUDGET

The Citizens League believes it would be fundamentally irresponsible for the Governor and Legislature to make unfunded shifts in state expenditures as a way to help erase a \$312 million state budget deficit.

The only conditions under which a shift can be considered is for the Legislature to put in place, right now, the way the shifts will be paid for. This means that if the lawmakers shift \$200 million of expenditure into the next biennium, to balance the current biennial budget, at the same time they would arrange for a \$200 million reduction in other expenditure commitments in the next biennium.

The state cannot afford to continue a credit-card approach to a long-term problem. It is unrealistic to expect that economic growth will generate enough revenues to pay for postponed, or "shifted", obligations in addition to current obligations.

A partial suspension of certain property tax relief payments in the next biennium, while keeping in place the circuit-breaker, which protects low and moderate income households, represents a responsible way for offsetting the shifts.

If lawmakers take such action now, then the Regular Session, convening in January, can evaluate whether to leave the suspension in place or raise taxes to remove it.

Because the Regular Session will need to look at overall tax policy, including the question of "temporary" taxes enacted earlier in this biennium, any taxes increased in the Special Session should also be placed in the same category, with a sunset provision of June 30, 1983.

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CITIZENS LEAGUE STATEMENT ON STATE BUDGET PROBLEMS

The Minnesota Department of Finance announced in mid-November that the state faces a \$312 million budget deficit by June 30, 1983. A special session of the Legislature is scheduled for December 7.

The current problem is immense and serious, much more so than the previous budget "crises" of this biennium, mainly because the time remaining to take corrective action is so short and the amount of the deficit is so large. Some legislators are urging that the corrective action assume a shortfall as high as \$400 million, to guard against further deterioration of the revenue picture.

As the Legislature now convenes, the following steps should be taken:

- * If further "shifts" are contemplated to help solve the current deficit, they should be undertaken only if, simultaneously, the Legislature takes action to offset the effect of the shifts. This current Governor and Legislature already have shifted -- without offsetting measures -- almost \$600 million in unfunded obligations to the next biennium. Shifts do nothing more than impose additional burdens on the next biennium. Legislators are seriously contemplating a shift which could take care of one-half to two-thirds of the deficit. Because the dollar magnitude of equivalent cuts in spending or increases in tax rates would be so huge in order to have any effect in the remaining months of the biennium, a new shift is being considered.

According to the shift under consideration, the state would suspend approximately \$200 million in school aid payments between now and June 30, 1983. To provide revenue to pay their bills for the rest of the current school year, school districts would be authorized to make use of property tax collections during the first five months of 1983 which would otherwise be held for use in the year beginning July 1. The effect is to make an additional \$200 million available during this current biennium. Supposedly, the state would find the money in the next biennium to repay the school districts. Those funds must be above and beyond the money that normally is used to finance whatever incremental growth occurs in spending. If the state chooses not to repay school districts, then these districts will have to find ways to trim \$200 million from their spending in 1983-85.

There is no way that "normal growth" in state revenues can handle such expenditures, even assuming a reasonable level of economic activity in state revenues in the 1983-85 biennium. The State Department of Finance's preliminary revenue estimates for that biennium indicate that clearly.

Such a shift should not be adopted unless the Legislature, during the Special Session, takes action to adjust expenditure commitments in the biennium beginning July 1 to offset the impact of the shift. That is the only responsible way to permit shifts. Further unfunded shifting could damage the state's credibility with bond rating firms, a Department of Finance official told a legislative committee.

In the absence of corrective action, the "shift" creates an illusion of a painless way of dealing with a serious problem. There is no painless way out of the current situation.

- * Any adjustment to offset the effect of a shift (a) should be sensitive to the impact of increases in tax rates on the development of the state's economy, (b) should not impose greater burden on low-income persons, who are the most severely affected by current economic conditions, (c) should be consistent with generally recognized areas where reform in the state-local fiscal system is needed, (d) should help place incentives on units of local government and state agencies to redesign services.

The Special Session of the Legislature has an opportunity to take courageous, even if highly controversial, action. It can do so with the full knowledge that the Regular Session, convening in January, will have the opportunity to review what has occurred and, if deemed desirable, make adjustments before the effective date. Thus the Special Session can avoid saddling the Regular Session with the necessity of finding a way to pay for the cost of the latest shifts, on top of everything else. Nevertheless, the Special Session would not be committing the state, irrevocably, to a certain direction. The Regular Session would have the full opportunity to make whatever modifications it desired.

One adjustment consistent with the above-mentioned criteria would be for the state to suspend some property tax relief payments. What this means, specifically, is that the Special Session -- at the same time it authorizes a shift -- could suspend an equivalent number of dollars in property tax relief payments which otherwise would be made after July 1, 1983. Thus, for every dollar shifted to the next biennium in order to balance the current biennium budget, the Legislature would be offsetting that shift with a dollar-for-dollar reduction in expenditure commitments in the upcoming biennium. Such an approach would not involve an increase in property taxes levied by local units of government nor in mill rates. It would affect certain taxpayers, depending upon which property tax relief payments would be selected. As a practical matter, the homestead credit, amounting to almost \$900 million in the current biennium, and the agricultural credit, almost \$150 million, would have to be selected, because of their size. Low-income farmers and other homeowners are protected through a separate property tax relief program known as the circuit-breaker, which should not be cut. Thus a loss in benefits from the homestead or agricultural credit could be picked up in circuit-breaker benefits. Circuit-breaker benefits are not available to households above certain income levels. They provide tax relief graduated on the basis of income.

Such an approach would be consistent with the overall direction which state policy should be taking. The homestead and agricultural credits essentially are part of a system of raising taxes (sales and income) to pay other taxes (property). For many homeowners that means taking money out of one pocket and putting it into another.

A reduction in the reliance on homestead and agricultural credits would have the effect of placing more responsibility for changes in property tax levels directly on the shoulders of elected officials of local government. Under existing provisions of the homestead credit, the state pays 58 per cent of the homeowner's property tax bill, to a maximum state payment of \$650. This means that for most homeowners in the state, for every dollar of additional taxes levied on their homes, they are responsible for only 42 cents. If more of the burden of the tax increase fell on the local homeowners, they would likely create more pressure on local officials who, in turn, would be inclined to seek more imaginative, efficient ways of delivering services. Such reform also would remove the Legislature from its responsibility for local property taxes. The agricultural credit provides that the state pays for 18 mills of the school levy on the first 320 acres of a farm homestead, 10 mills on the next 320 acres

and 8 mills on the balance. For non-homestead farms, the credit is 10 mills on the first 320 acres and 8 mills on the balance.

- * The Regular Session of the Legislature in 1983, not the Special Session beginning next week, should make the major decisions concerning the level of state taxes during the 1983-85 biennium.

The Special Session will consider a reduction in previously-authorized expenditures and increases in taxes to help erase the deficit. The Regular Session in 1983 will, of course, need to wrestle with the total tax picture, including whether to continue "temporary" increases in the sales and income tax voted last year and whether to impose tax increases to balance the budget for the biennium beginning July 1, 1983. It seems appropriate that any taxes increased in the Special Session should be made an automatic part of the overall tax discussions that will take place in the upcoming Regular Session. Consequently, the Special Session should place a sunset of June 30, 1983, on any taxes increased at this time. This doesn't mean that revenues from such increased taxes won't be needed after June 30. It just assures that the Regular Session, with more time available, will have to look at the entire tax picture, instead of having the opportunity to leave intact, without any further action, a tax package decided in the inevitable rush of this Special Session.

Increases in the state income tax are least attractive, because, as pointed out by the Citizens League in its report on the relationship between taxes and the economy, the direction of Minnesota's economy today -- high technology and services -- is dependent upon a tax system which is not far out of line with that of other states. Minnesota's income tax still is among the nation's highest. Moreover, other ways of taxing services, such as extending the sales tax to services, while tempting, present the same problems in terms of their impact on the economy. But some broadening of the sales tax to other tangible items or an increase in the sales tax rate may be appropriate.

- * The Regular Session in 1983 must come to grips firmly with the issues of service redesign. The Citizens League has pointed out in several reports that the ways out of a budget problem are not restricted to cutting services or raising taxes. Even in a time of revenue constraint, governments can improve programs and services by redesigning them. For example:

- The State of Minnesota, as the state's largest employer, should change its system of health care coverage for its employees and the indigent so that they have financial incentives to use cost-effective health care providers.
- More financing of post-secondary education should be directed to the students in financial aid instead of to the institutions as operating support. Thus the institutions will have incentives to attract students by providing high-quality, cost-effective education.
- The state should encourage ride-sharing, a do-it-yourself form of transit which can provide better, cheaper, service in some locations than publicly-owned bus systems.
- The state should modify pension plans for public employees so that higher-paid employees share some of the risk on payment of future benefits above a certain level.

-- The state should restructure elementary-secondary education to improve its performance but without necessarily a major addition of new money.

- * The Regular Session in 1983 should arrange for a major study of the state-local expenditure/taxation system. The Citizens League called for such a study in its latest report on expenditures and taxation, issued shortly before the announcement of the state budget deficit. The Regular Session in 1983 will have an extremely difficult task in simply balancing the biennial budget. A blue-ribbon study, involving the private sector and the public sector, also needs to be commissioned in 1983, to look at overall reform of the system.