CITIZENS LEAGUE
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STATEMENT TO THE GOVERNOR'S TAX STUDY COMMISSION

At this stage in its work, the Tax Study Commission is defining which questions will be central to its work. As one of the groups calling for the creation of a tax study group, the Citizens League hopes to come to the commission later with specific proposals for change, but at this point would like to identify three areas to which we think the commission must direct its attention to fulfill its responsibility:

* Developing a tax system that will support and encourage economic growth.
* Creating an efficient and coherent intergovernmental tax and revenue system.
* Building a tax system which is responsive to policy and service redesign incentives.

TAXES AND THE ECONOMY

Before the commission can design a tax system which supports economic growth, it will need to understand which economic sectors are likely to grow in Minnesota. It must strive to create an environment which does not hamper the success of new and existing businesses.

Although the commission must consider this question independently and come to its own conclusions, the League and others have identified several key variables in the equation.

First, there is the continuing shift towards increasing employment in the services sector. This trend is apparent here and nationally. The commission should ask itself if the larger shape of the tax structure -- with its relative over-reliance on personal income taxes -- helps or hinders service industries. Our 1979 study committee said the state should shift more to consumption taxes like the sales tax to help the service sector.

Many economists have observed the importance of entrepreneurship in the development of Minnesota's economy. Others have pointed to the strong role of small business in job growth. How does the existing tax system affect the opportunities for job growth and new business development? Does Minnesota's tax system allow successful small business to grow rapidly? Past experience suggests that small companies have not found it difficult to grow here, but understanding this dynamic relationship is critical.

Relating to both the entrepreneurship and service economy issue is the question of the tax burden on key personnel who drive both of these sectors. The talented engineer critical to the growth of a word-processing firm, the creative director of an advertising agency, or the financial manager able to make a small company grow are persons likely to have many choices about where they will live. Overall, does Minnesota's tax system work to keep these people here or to encourage them to move to California, Massachusetts, New York, Texas or Florida?

The economic experience of the 1970s in Minnesota was tied strongly to the performance of the agricultural sector. Tax policy is of major importance to agriculture. Does Minnesota's tax system encourage a centralization of farm properties, making difficult the maintenance of family farms? Is this good or bad? Is Minnesota losing an opportunity to have value-added farm processing take place here as opposed to elsewhere as a result of tax policy?

We hope the commission will try to understand these relationships and keep them in mind while fashioning a new tax system.

AN EFFICIENT AND COHERENT INTERGOVERNMENTAL SYSTEM

Our 1982 study committee on taxes and spending concluded there are significnat problems in Minnesota's state-local fiscal system. The system is not policy responsive, does not allow sufficient local autonomy or authority, and cannot be understood by voters. The League is not alone in pointing to problems here. Legislative Auditors' reports on the homestead credit and the circuit breaker have identified major problems.

Starting in the late 1960s and continuing since then, the trend in the state-local fiscal system has been toward more state-collected revenues being used to pay for local government services. Nothing is wrong with this overall framework. The state should be the unit to levy sales and income taxes, and distribute revenues to cities, counties and school districts. Cities, counties, and school districts should be the ones making decisions about how to spend, not the state.

The problem stems from the collection of ad hoc, piecemeal measures which make up the system as a whole. School aids, local government aid, homestead credits, circuit breaker rebates, and property tax classifications have been changed frequently in the past decade and a half, usually with only the immediate, short-term impact in focus. The commission should ask itself about the net impact of all of these measures. Does it channel state resources to those local units which it should? Is the tax burden distributed around the state fairly? Is it distributed among individuals fairly? Is it distributed fairly between business and individuals? Does it allow local officials too light a burden of responsibility for spending decisions? Does it allow sufficient local autonomy and flexibility?

Overall, the commission should try to bring to bear the same degree of clarity for the system as a whole as is the case in the school aids system. There, the state puts forth a clear position: $1,475 will be available for per-pupil unit spending in each district regardless of tax base. Additional spending is allowed at local discretion with the state's commitment to support that spending gradually phasing out.

The state limits its commitment. The budget implications of both state and local decisions are clear to voters and policy makers. School districts have the ability to raise as much money as they want, but above a certain level of spending, it becomes a purely local tax matter. The school aids system is not perfect and is not a perfect example. The commission may recommend significant changes in school finance as part of overall reform of the fiscal system. The school aids system does, however, illustrate a clear, policy-responsive mechanism for sharing the revenue burden in financing schools.

The largest source of income for Minnesota cities, counties, school districts, and townships is the state government. The largest budget item for the state is financing local government spending. We think the commission must address the issues of policy clarification and efficiency in the state-local fiscal system in order to issue a complete report. We doubt it will be possible to address many of the other issues of revenue raising without a fundamental solution to the larger question of state-to-local transfers of money.

A TAX SYSTEM RESPONSIVE TO POLICY: SERVICE REDESIGN INCENTIVES

At some point in the commission's work, it will inevitably come face-to-face with the question of the overall level of state-local spending. Simply put, what percentage of the state's income should go to the public sector? This is the basic revenue question which the commission faces. In public decision making typically, the question is asked after the fact and answered comparatively. The commission has already heard from John Shannon of the Advisory Commission on Intergovernmental Relations who discussed what Minnesota's state-local government spent in past years, as a percent of total state income, and how Minnesota compared to other states.

The commission must come to grips with this issue because any realistic assessment of governmental performance must take into account the resources available.

The current national and local debate over education illustrates this point. Many people are saying that American and Minnesota schools are not doing the job. We need increased quality from primary-secondary education, the reports say. A simple answer to the problem is to increase the amount of money being spent on education. Increase direct financial resources and you'll get better quality, the argument goes.

But what if no more money is available? The national economy is a finite sum, as is the Minnesota economy. How much of that are we willing to put into schools--or roads, or health care? Past experience shows adding more money does not necessarily increase service quality. To grant service system requests without new assurances of quality would at this point be a mistake.

If the commission fails to shed some light on this question, Minnesota could soon find itself in serious trouble. If the percentage of income going into the public sector gets too far out of line in Minnesota compared to other states, a Proposition 13-type mentality may set in. Voters will ask for absolute, inflexible tax caps without regard to public needs.

Alternatively, if the public is not satisfied that it is getting high quality public services, the general agreement to support those services may erode. Minnesotans have traditionally supported high quality public services and have been willing to pay for them. Risking this social consensus is dangerous.

The League's position on how to resolve this dilemma has been to support changing the way public services are delivered before adding new money. In our statement to the 1983 Legislature, we said the state should not solve its budget problems by simply adding more money. In education, for example, we support giving families and children the ability to choose schools as a means to increase educational quality. Over time, it may become clear that to increase quality--even with user choice--more money is needed. We say that if the public knows that more money is needed, it will be willing to pay the price. But first, the public as a whole deserves the opportunity to find that out for themselves.

Public service delivery systems in Minnesota are beginning to change. The changing circumstances represent an important opportunity which the commission should not miss. Revenue raising decisions made by the commission will shape the way services are delivered. The commission should not give the wrong signal to local units of government and service providers. If the general impression is that budget discipline is no longer required, it is unlikely service delivery changes will continue. The long-term quality of services will be imperiled.