

CITIZENS LEAGUE REPORT

**REMAKING THE MINNESOTA MIRACLE:
FACING NEW FISCAL REALITIES**

REPORT SUMMARY

Prepared by

Committee on Financing and Managing State and Local Programs

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Approved by the Citizens League Board of Directors
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REPORT SUMMARY

The state-local fiscal system in Minnesota is exceedingly complex. This complexity shrouds accountability of officials to their constituents.

A Citizens League committee was asked to study the fiscal system and determine what realigning of responsibilities and revenue raising authority would have to occur to finance the services at each level of government and increase the accountability of elected officials to voters.

Our recommendations are intended to provide a framework and a process for designing a future fiscal system. Because the committee's time was not unlimited, the recommendations do not present a finely detailed blueprint of the many facets of a restructured system. Instead, they provide a process for sorting out which government services should be the responsibility of the state and which of local governments, and who should finance those services. The committee left many public services undiscussed, which is a reflection of the committee's time constraints, not of those services' value.

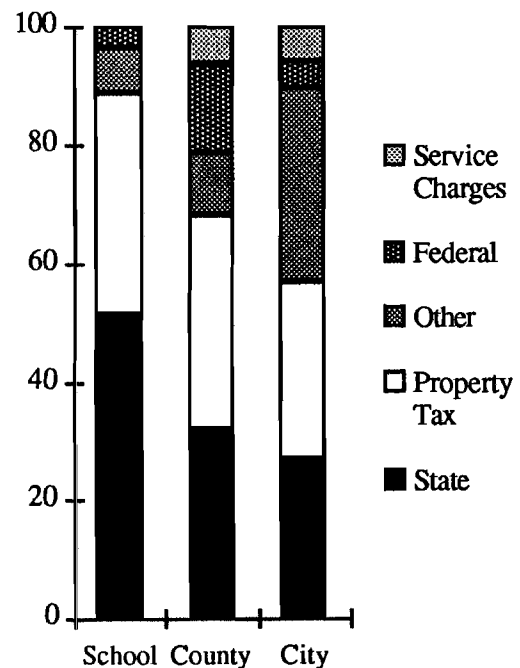
In addition, we do not expect major structural reforms to the fiscal system in one legislative session. Besides being politically unlikely, such a rapid changeover could create unacceptable shifts in financing, personnel, and administrative responsibilities. Although ultimately major restructuring is necessary, it would be imprudent to suggest that it occur all at once.

MINNESOTA'S FISCAL SYSTEM: WHAT'S WRONG?

For many services, revenues are raised by one level of government and spent by another. Nearly two-thirds of the state's general fund is sent back to local units of government for both property tax relief and direct spending for services. In fact, in 1988 Minnesota's direct distributions to cities, towns, counties, school districts, and special districts ranked third highest

in the country, exceeded only by California and Wisconsin.¹ Local units of government in Minnesota rely heavily on dollars from the state to provide their services. (See the following figure.)

PERCENTAGE OF REVENUES TO CITIES, COUNTIES AND SCHOOL DISTRICTS IN MINNESOTA BY SOURCE, 1988



However, few taxpayers understand the complexities of the state-local fiscal system. Even though state aid to local governments and

¹ Advisory Commission on Intergovernmental Relations, *Significant Features of Fiscal Federalism, Volume 2, Revenues and Expenditures, 1990*, p. 158-159.

property tax relief comprise large shares of the state budget, two-thirds of homeowners in a survey on taxes said the state does not pay any portion of their property tax bill. A plurality of the respondents (44 percent) said the *state legislature* is most responsible for increases in property taxes even though the property tax is considered the source of revenue for *local government*.²

Since the 1970s, the state has increasingly borne the revenue-raising burden for the state and local governments. Revenues from the state-collected income and sales taxes are used to reduce the amount of property taxes collected locally. This causes concern because although the revenue raising responsibility lies more and more with the state, the spending decisions remain local.

This fiscal arrangement created a cycle of increased local property taxes, followed by state legislative action to reduce property taxes with sales and income tax revenues. The pattern is problematic; it reduces local accountability and commits the state to spending its resources to hold down local property taxes. Although the relationship between the state and local units of government cemented in 1971 with the "Minnesota Miracle" may have been appropriate at the time, a new foundation is now necessary.

CHANGE IS NEEDED IN THE FISCAL SYSTEM

We concluded it is important to fix the way the money flows in the state-local fiscal system.³ Such a fix cannot be piecemeal; it demands major, systemic change. Although the state began taking steps in this direction in each of the last three legislative sessions, more progress is needed.

The current arrangement lessens the authority and autonomy of local units of government while heightening their dependence on the state. It encourages a trend of the state becoming the

primary focus of the revenue-raising system. As the state increased its role, the link in local decision-making between spending and taxing diminished and thus, the accountability of local units of government to their constituents suffered. In addition, the system is complex, confusing, and difficult for most taxpayers to understand. In such a system, it is not clear who to hold responsible for public policy, or how to enforce accountability.

It is important for the state on the one hand and local governments on the other to make their spending and taxing responsibility clear to taxpayers. Citizens need a clear understanding of who is responsible for financing, planning, and delivering public services. Public officials need input from citizens to understand the local needs and desires to determine appropriate levels of service and the resources to finance them.

How to change the fiscal system, however, is neither a simple nor automatic task. After studying a number of management principles to help guide program and finance decisions, we decided the fiscal system ought to optimize:

- accountability;
- effectiveness;
- economy; and
- equity.

Although these four principles seem integral to a successful fiscal system, all four cannot be equally achieved; they have to be balanced against one another. That is, a government might have to sacrifice some economy to ensure a service is provided equitably; to make a service effective, the government might have to spend more than lowest possible cost. Therefore, the goal is to structure a system that *optimizes* these four principles.

When the committee applied these principles to certain major functions, a picture began to emerge of how the state/local fiscal system might be restructured. We looked at the major spending items of state government today: elementary-secondary education, human services, higher education, transportation, property tax relief, solid waste management, and economic development. We did not apply the principles to all of the many services provided by each level of government. However, the principles and their

² Minnesota Department of Revenue, *Minnesota Tax Revenue and Policy Review*, May 1988, p. 3.

³ We did not take a position on the *amount* of money that flows in the state-local fiscal system. We did not try to determine whether the right amount of money is spent on public goods and services, but whether how and by whom it is spent makes sense.

PRINCIPLES TO GUIDE DECISIONS ABOUT FINANCING AND MANAGING STATE AND LOCAL PROGRAMS

Accountability: Responsibility for services should be assigned to the entity that is accountable to the electorate, the recipient of the service, and the governmental unit or persons paying for the service.

Effectiveness: Responsibility for services should be assigned to the entity, public or private, that gets the job done well and measures for results.

Economy: Responsibility for services should be assigned to the entity, public or private, that can supply the service at the lowest possible cost. For instance, in developed areas, water treatment and sewage facilities can be provided less expensively on a regional basis than on an individual city basis.

Equity: Responsibility for services should be assigned to the entities that can finance the service equitably, and ensure equity in the delivery of services to all persons.

applications could be used as a template to examine other functions.

ACCOUNTABILITY

We concluded that *accountability* needs the most work. Minnesota's fiscal system is composed of complex financing arrangements that involve multiple layers of government, and numerous units of general- and special-purpose local governments. As a result, few citizens understand which public officials are responsible for spending and taxing decisions. This weakens the ability of citizens to hold officials accountable. The system rarely sanctions poor performance or rewards the good.

To enhance accountability, local governments ought to be fully responsible for services that are truly local in nature. Local autonomy and authority should be reestablished at the local level of government. This is important to create genuine accountability of local officials to their residents and to avoid excessive state centralization of services. To do this, local units of government

have to be clearly responsible for both determining what services to provide and raising the revenues to pay for them.

To determine whether a given level of government can provide accountability for a service, we asked eight questions. In the table on the following page we apply these questions to Minnesota's district court system.⁴

Based on our analysis we concluded that, to maximize accountability, financing responsibility for the courts should be vested in the state. However, all four principles must be weighed against one another before making the decision about where the responsibility for courts should lie.

Recommended changes to enhance accountability

Some specific changes in the fiscal system are needed so that local units of government are clearly responsible for both setting services and raising revenues. To implement this goal we recommend the following changes:

- ☐ Eliminate local government aid (LGA) and other state-provided aid.

The state should no longer distribute general aid to general-purpose local governments.⁵ Local jurisdictions should rely on their own resources, from both tax and non-tax sources.

For services that are truly local in nature, in which the state has no compelling interest, it is legitimate for the level of service to vary from community to community, embodying local needs and preferences. Local tax rates will vary to reflect these local preferences. This process reinforces accountability of local officials by taxpayers.

Equally important, eliminating the aid is necessary to sever the dependency of local governments on the state. This dependency

⁴ We used two other measures of accountability not listed in the table for the sake of brevity: (1) Does the government ensure sufficient oversight on how the revenues are spent? (2) Does the government offer clients opportunity for individual choice?

⁵ A limited program of state aid for specific programs is described later in this report in the provisions under *equity*.

APPLYING THE ACCOUNTABILITY PRINCIPLE TO DISTRICT COURTS	
Question	Answer
<i>Is the service assigned to the government that can serve the "customer" (the recipient of the service)? Is the government equipped to understand the customers' needs and whether they are being met?</i>	The administration of justice in the courts follows the same basic process regardless of geographic location. The state is in a position of understanding what services are needed in the court system; justice needs do not vary by locale.
<i>Is the government that makes a spending decision on a service the same government that raises the dollars to pay for the expenditure? Alternatively, is the system structured such that those spending the dollars don't simply demand more and more resources for the service?</i>	The financing of the courts has traditionally been a county-state shared responsibility. County court expenditures have been in part controlled by spending decisions made by non-county officials.
<i>Is the service assigned to the level of government with a link to the electorate?</i>	Because responsibility for district courts' service is currently muddled, the link between the decisionmakers and the voters is weakened. The constituency is larger than that of a single county.
<i>Is the service assigned to the entity that provides services in a way that is understandable to the consumer and easy to use?</i>	There is some uniformity of district court service that could not be easily duplicated if lower levels of government were responsible. Complexity could increase if numerous local governments had authority for financing and administering courts.
<i>Is the service assigned to the entity with the greatest control over services that spill over to affect multiple jurisdictions?</i>	The effects of decisions by district courts can be felt statewide, and are not necessarily restricted to the region around the individual courthouse.
<i>Is the service assigned to the level of government with access to a financing base that is closely associated with the service?</i>	Because district courts have statewide impacts, statewide revenue sources ought to finance them.

serves to reduce the autonomy of local governments and abrogate their decision-making authority.

❑ Remove levy limits.

The Legislature should remove levy limits on local governments. Making local governments clearly responsible for providing local services requires breaking the fiscal ties that bind local units to the state. Although levy limits have been used by the Legislature to rein in local government spending and thereby property tax increases, they interfere in local officials' decisions regarding demand for local services. Removing the limits will support accountability by making it clear that local spending decisions determine the level of local taxation.

This change has already been approved in principle by earlier legislatures. However, the 1990 Legislature delayed the effective date of levy limit repeal to 1993 for both cities and counties.

Local governments ought to be able to increase their levies by an amount equivalent to what they had previously received in aid and credits from the state. Because there might be some services provided locally in which the state has a compelling and legitimate interest, we recommend some state aid for specific programs, as we note later in our discussion of equity.

To enhance accountability in the use of elementary-secondary school dollars, we recommend:

- ❑ The Legislature should eliminate the opportunity for school districts to**

seek additional state dollars to go beyond their budgeted expenditures.

If a district board decides to spend more than its available revenues, it should have to go to its voters to request additional dollars. In this way, district officials can be held accountable for their spending decisions.

The state's enrollment options policies further enhance accountability. These policies allow families to select the school that best meets their needs. If schools are not performing to families' expectations, students may go to other public schools better suited to their needs and desires.

EFFECTIVENESS

Effective provision of services also needs to be maximized. Effectiveness means the service is provided competently and the outcomes of the service are measured. In the context of sorting out program responsibilities, services should be the responsibility of the level of government that can provide them *effectively*.

We heard repeatedly from both private and public sector representatives of the importance of performance and measuring results. To be effective a provider must set standards of performance, measure the performance and

identify satisfactory/unsatisfactory results, and use these measures to redirect the delivery of the service.

Government agencies typically are not required to measure the results of the services they provide or assess their final product or service. According to testimony the committee received, the state may set appropriate goals for a program, but as they become embodied in rules, regulations and mandates, the goals can get lost; the focus shifts to the regulations and away from the performance of the service.

Effectiveness can be measured in several ways. These are illustrated in the following table where the *effectiveness* principle is applied to Minnesota's district courts.

Given our analysis of the effectiveness principle, the responsibility for delivering the services belongs at the district level, but the state has a role in defining the mission and setting overall objectives. This judgment must be balanced with the other principles before a final decision can be made.

Recommended changes to enhance effectiveness

Outcome measures are necessary for effective service, yet excessive regulation and rules can be

APPLYING THE <i>EFFECTIVENESS</i> PRINCIPLE TO DISTRICT COURTS	
Question	Answer
<i>Is the service assigned to the entity that knows who the customer is and has a vision of what the service is supposed to achieve?</i>	The judiciary is the third branch of state government. Its mission is defined by the state and does not have a local character.
<i>Is the service assigned to the provider that uses outcome measures?</i>	The state's caseload analysis determines the need for judgeships across districts. The state does not now, but should, set standards for performance and measure results.
<i>Is the service assigned to the entity that administers services proficiently?</i>	Each of the judicial districts can best administer its own services. State-level administration would be cumbersome and is unnecessary.
<i>Is the service assigned to the entity that is able to provide the service effectively over time, not just on a one time basis?</i>	The districts have proven to have the stability needed to provide services effectively. Lower levels of government would have more difficulty.

counterproductive. This is generally true for all functions. As an example, we focus here on elementary-secondary education and recommend:

- ❑ **The state ought to avoid centralized, micromanagement of elementary-secondary educational policy, even as it continues its substantial role in financing education.**

State policy responsibilities should be limited to setting overall standards for school districts, such as standards on educational outcomes and safety, and measuring statewide results. This is desirable even though the state's control over K-12 *financing* is (justifiably) considerable.

Persons at the school level should make the day-to-day educational and operational decisions in the schools. Local schools should have discretion over curriculum, how dollars are spent, and other operational decisions. The individual school is best equipped to know its "customers," their needs, and how to meet them. Decisions about how to spend money ought to be in the same hands as those who deliver the actual educational services--the schools themselves.

ECONOMY

Achieving economies will continue to be impor-

tant in the provision of public services.

However, while the public sector must always remain mindful of how public dollars are spent, it is as important to get the job done well the first time as it is to be concerned solely with low-cost. Furthermore, whether a service is provided at lowest cost is in part a result of accountability in the system: Public officials should be held responsible for wise use of public resources.

To determine whether a given level of government can maximize economies in delivering a service, we asked the questions used in the table below.⁶ The table illustrates how some of the questions apply to Minnesota's district courts.

Regarding the economy principle, district courts achieve some economies over courts organized on a county by county basis. Some economies may be lost on a statewide system if employee wages,

- ⁶ We used three other measures of economy not listed in the table for the sake of brevity: (1) Is the service assigned to the government that allows for competitive pressures in the delivery of the service, that is, the public body does not both set standards for the service and become the sole deliverer of the service? (2) Is the service assigned to the government that uses price as a mechanism to determine the level of service? (3) Is the service assigned to the government that directs resources to the clients who purchase services for themselves?

APPLYING THE *ECONOMY* PRINCIPLE TO DISTRICT COURTS

Question	Answer
<i>Is the service assigned to the government that can realize economies of scale?</i>	With the reorganization of courts from the counties to the district level, trial courts realized economies of scale not possible on a local level.
<i>Is the service assigned to the government that can take the least action needed to correct the identified problem?</i>	The state can better provide a statewide perspective on what judicial services are needed and direct action to that end. Many matters dealt with by the courts have no recourse elsewhere.
<i>Is the service assigned to the government that manages demand for the service as a means of controlling costs?</i>	The state should be in a position of offering other programs, such as alternative dispute resolution programs, that can lessen the demand for certain traditional district court services. Such dispute resolution programs have been generated locally around Minnesota.

for instance, are adjusted upward to a uniform level across the state.

There are many instances of organizational structures in the public sector that take advantage of economies. For instance, the regional transit system in the metropolitan area takes advantage of economies of scale that could not be achieved if each individual city operated its own transit system.

However, not all governmental services are provided in the most economic way. Among local governments, fiscal constraints, population shifts, rapidly changing needs, and uncontrollable market forces have, in some cases, proven debilitating. Many Minnesota farming communities, for instance, felt severe economic consequences during the 1980s as reverberations from farm foreclosures and the decline of the agricultural economy affected communities' ability to afford public services.

In these instances, some areas of the state would benefit from a restructuring of the local jurisdictions. Restructuring may be called for when the existing political subdivisions fail to provide public services in the most effective and economic way.

Restructuring could take one of several forms, and would vary around the state as needs and political and social conditions vary. Forms of restructuring include: intergovernmental service agreements, annexation, city-county or city-city consolidations, regionalism, and transfers of functions from one level of government to another.

Recommended changes to enhance economy

It became clear as our work progressed that effective, efficient service delivery is highly dependent upon the structure and fiscal power of the local governments.

To facilitate economic as well as effective service delivery we recommend:

- ☐ **Local governments should make efforts toward, and the state should facilitate, restructuring local governments where necessary.**

Municipalities, counties, school districts, and special taxing jurisdictions should reexamine the services they provide and the populations they serve in an effort to adopt cooperative service arrangements with neighboring communities or other levels of government. This examination should be done with an eye toward: consolidating services, determining opportunities for mutual cooperation with other units, transferring functions to more appropriate levels of government, such as regionwide levels, merging with other units, or dissolving unnecessary units.

The state and its agencies should be willing to alter regulations in ways that are conducive to any restructuring contemplated at the local level.

However, the committee believed it should be up to the local units of government themselves to identify those areas that are ripe for restructuring. In concert with other recommendations in this report, the restructuring should be a way for local governments to regain control over providing their services effectively and economically.

EQUITY

Relative to the other principles, equity has received greater attention in Minnesota over the past several decades. This is evidenced by several state policies, such as the equalized school financing formula, tax-base sharing in the metropolitan area, and numerous property tax relief measures. Even though equity concerns must remain, Minnesota needs to bring accountability, effectiveness, and economy into better balance with equity.

We believe that today's fiscal system has reduced the meaningful role of many local governments because they depend increasingly on state aid. The growing tendency for the state to step in to abate local problems diminishes the autonomy of local units. It also predisposes the Legislature to micromanage local issues and the accompanying problems of a statewide policy-making, legislative body attempting to mitigate local concerns.

Nonetheless, although the committee felt strongly that local governments ought to be responsible for the services that are truly local in nature, it became clear that state aid may be necessary in some circumstances for equity reasons.

It is important that state-provided aid be directed only toward specific local services and provided only when there is a compelling state interest in doing so. The state's role in providing tax relief should be minimized to keep the responsibility for levying local taxes and providing local services focused on locally elected officials. Therefore, the justification for state aid should be limited to two circumstances:

- when low-income/wealth persons have relatively high property tax burdens; or
- when a local unit of government experiences an extraordinary need.

We talked about equity in terms of both financing and delivering services. To determine whether a given level of government can maximize equity for a service, we asked three questions. To illustrate the equity principle, the questions are applied to the example of Minnesota's district courts in the table below.

Given our analysis of the equity principle, coupled with the answers regarding the three other principles, it is reasonable to suggest that the state assume fuller responsibility for financing district courts.

Recommended changes to enhance equity

To enhance equity in the fiscal system some services now provided by local governments ought to be financed by the state. We recommend:

□ The state ought to be fully responsible for financing:

- courts and public defense costs; and
- income maintenance programs and a base level of social services.

In 1990, the state began assuming responsibility in the courts area with a phased transfer of certain components of the judicial district budgets and a pilot project takeover of finances for all court operations in the Eighth judicial district. In addition, in 1991 the state will relieve counties of most of the property tax burden for income maintenance programs. We commend these initial efforts and believe the state should expand them.

Without state financing, these services would lack equity in both financing and service delivery. It is in the state's interest to finance the services because the variation in the local units' abilities to finance them can cause unacceptable differences in the level or quality of service. Unlike some other local services, differential service levels are unacceptable for these functions. And to the degree the amount of financing determines the amount of the service available, these functions should not depend on an area's property tax capacity.

The effect on local property taxes of eliminating state credits and aid, combined with shifts to state financing of courts and human services, will differ around the state. Part of this disparity can

APPLYING THE EQUITY PRINCIPLE TO DISTRICT COURTS

Question

Answer

Is the service assigned to the government that ensures persons with similar income and assets pay similar amounts for -- and have equal access to the delivery of -- like services.

Use of the district courts does not depend on a person's income level. The state is in the best position to ensure that the service is available to all regardless of income.

Is the service assigned to the government with the capacity to raise the same amount of dollars to provide similar services regardless of location?

As a result of the difference in property tax bases among counties, the level of some services varies from district to district.

Is the service assigned to the government that can reduce the tension that results when the recipients of a service and the people who pay for it are different persons?

The courts are seen as a public good for which all of society is in part responsible. Consequently, the state is the best mechanism for equitable financing.

be rectified by modifying the "circuit breaker" property tax refund. We recommend:

- ❑ **The state should modify the property tax refund (or "circuit-breaker") to individuals to ensure progressivity among local tax burdens, relative to persons' income *and* wealth.**

A circuit-breaker is necessary to make up for disparities in property tax burdens among those with less ability to pay. The circuit-breaker should be inversely related to both income and wealth. When two homeowners have the same income, the one with the lower-valued home would get a larger fraction of relief. When two owners have the same value home, the one with the lower income would get a larger fraction of relief. It should be structured such that it does not encourage turning to the Legislature for relief from locally imposed taxes.

Further:

- ❑ **If the realignment of services and financing widens a gap in property taxation among local governments to unacceptable levels, the state could use one or some combination of the following strategies as possible tools for controlling the disparity.**

Categorical Aid: The state should provide categorical aid to local governments only for those needs in which the state determines it has an interest. That is, the services that are local in nature should remain locally financed. However, from time to time the Legislature may determine that it is in the state's interest to appropriate dollars for a function for which it would be unfair and unreasonable to rely solely on local resources. Controlling excessive crime is an example of a need of this type.

Categorical aid should be distributed only on the basis of explicitly defined needs. It should not be distributed based on past spending practices of the local governments. Needs should be defined by the severity of certain conditions that define the need, such as the extent of deteriorated housing stock and rates of homelessness. Further, the state should set thresholds of eligibility for the aid. Not every city would receive the aid; only those that met the eligibility standards would be assisted.

User Fees: A second option is increased reliance on user fees and service charges to the

extent practicable. Public opinion surveys indicate the preferred method of generating additional revenues to help meet costs is charges for specific services. Although many cities charge users for services such as water, user fees are not employed universally nor for every applicable function.

Sales Taxes: A third option is the Legislature making additional taxing authority available to a limited number of eligible cities. With a local sales tax, cities that need to supplement their local property tax revenues could do so while continuing to rely on their own resources (from retail sales).

However, only cities that met some threshold of eligibility should be allowed to use a local sales tax. For instance, the cities with some combination of a lower than average property tax capacity (tax base) and greater than average need could be designated eligible. In this case, cities with tax capacity per household below the area median and tax burdens on similarly-priced homes above the area median would have the authority to use a sales tax.

Another possibility is designating as eligible one city in each county that both has substantial retail activity and provides a significant amount of services to non-residents of the city. The local tax would be a "piggyback" sales tax in that it would apply only to those goods and services now taxed by the state.

Statewide Property Tax: A fourth option is a statewide property tax to pay for some or all of the costs involved with the recommended realignment of services.

A statewide property tax could be phased in, and accomplished most easily with a modification to the existing school financing arrangements. Local school districts would no longer levy an amount established by the state, as they do today. Instead, the state would set and collect property taxes in an amount equivalent to what is currently generated locally.

Tax-Base Sharing: A fifth tool would involve pooling and redistributing the property tax base to make local governments' ability to raise revenues less disparate. It would be an extension of the current tax-base sharing program in the Twin Cities, wherein 40 percent of the increased value of commercial-industrial tax capacity since 1971 is shared.

Because of the tremendous variation in tax bases around the state, the sharing should be done within discrete regions, for instance, the 13 economic development regions as defined by the state. Tax-base sharing may not be necessary in those regions where the disparity among tax bases is not large.

To achieve a significant reduction in the disparity among cities' tax rates, a substantial amount of tax-base sharing is necessary. That would likely mean contributing some portion of all types of property -- residential as well as commercial-industrial. Sharing 40 percent, for example, of the existing property tax base within each economic region would reduce disparities in tax rates, yet minimize the incentive to raise taxes on non-city property.

Restructuring Local Governments:

Appropriate restructuring of local government units could reduce the disparities in fiscal capacity among communities. Local units should reexamine the services they provide and the populations they serve in an effort to adopt cooperative service arrangements with neighboring communities or other levels of government. This examination can lead to consolidations or other restructuring that evens out financing capabilities.

To enhance equity in elementary-secondary education, we recommend:

- ☐ **The Legislature should take action if the non-equalized portions of K-12 school financing produce unacceptable disparities.**

Over time, the state has increased its direct share of basic education monies to nearly two-thirds of the total. However, as a result of the state appropriation for the equalized school financing formula, the state also determines the tax rate to be applied against the local property tax base. In effect, the local portion of the general education levy is a state-set property tax that is collected locally. In this way the state controls 94 percent of K-12 education financing today. The exceptions are the excess levy referenda and debt service levies, over which local districts, and their voters, have complete authority. Excess levy referenda allow districts to exercise reasonable discretion over the services they deliver. However, because of low property wealth, some districts cannot raise the same amount of dollars with equivalent taxing efforts as other, wealthier districts.

If the Legislature is concerned about the resulting disparities, it might consider mitigating them in the following way: Among the districts with approved referenda, the wealthier districts would subsidize the lower-wealth districts through "power equalization." The wealthier districts would not keep all that they raise; part of what they raise would go to lower-wealth districts. A system such as this would permit an equalized system of local referenda without making the state susceptible to additional uncontrolled expenditures.

BALANCING PRINCIPLES OF ACCOUNTABILITY, EFFECTIVENESS, ECONOMY, AND EQUITY

We emphasize the importance of balancing accountability, equity, effectiveness and economy. In some services, more priority will have to go to improving accountability; in others, the priority will be on enhancing effectiveness. Most important is optimizing the four principles so that none of the four is neglected.

This can result in distinctions among the responsibilities for providing, controlling, and paying for a service.

Therefore, although we believe the state should assume *financial* responsibility for courts, income maintenance services, and a base level of social services, levels of government below the state should have the responsibility for management and administration of these services. The administration of the courts, for instance, should remain with the Chief Judge of the judicial district under the general supervision of the Chief Justice at the state level. Each of the judicial districts can best administer its own services which can vary in scope around the state.

Administering human services is more logical on a sub-state level, for best service to the clients. Economies can be realized by administering these services on a sub-state level. Although the state should be responsible for how much public money is spent on income maintenance services and the base level of social services, the state should not actually deliver the services. Existing vendors, both public and private, should be retained.

The need to balance the principles of accountability, effectiveness, economy, and equity are also evident with elementary-secondary education. The need for equity is great: The effect of our public schools is statewide, not limited to an individual district. School financing should not be a function solely of an area's property tax capacity. Consequently, it is desirable that the state effectively controls the bulk of K-12 education financing today.

However, the need for equity cannot overshadow the need for *effective* education, and the need for *accountability* in each of the K-12 school districts. This is why we feel strongly that state policy responsibilities should be limited to setting overall standards for school districts, and that the schools themselves should make the decisions about how to spend their educational dollars.

Furthermore, school boards should be held accountable for their spending decisions, such as in cases when they exceed their budgets with larger than expected employee contract settlements.

In our discussion of optimizing these principles for the state/local fiscal system, we acknowledged the need for reform of the property tax system.

We refer readers to an earlier Citizens League report for a discussion of the needed reforms.⁷

What is the fiscal impact?

We estimated the shift in costs resulting from the recommendations. In 1990, the additional cost to the state for assuming financing responsibility of the remainder of income maintenance programs, approximately half of social service expenditures, and the remainder of courts and public defense would be about \$266 million (net of the amount the state now provides in credits and aid for these service expenditures).

However, the state would reduce its expenditures by \$716 million by eliminating local government aid and homestead and agricultural credit aid. (Other state aid programs of smaller dimensions are not included in this particular calculation.) Therefore, the net reduction of state expenditures would be roughly \$450 million.

That net reduction in state expenditures could be used to pay for an additional share of the property tax now collected locally for elementary-secondary education.

⁷ See Citizens League, *A First Class Property Tax System*, March 24, 1987.

COPIES OF THE FULL REPORT

We hope that you find this report summary useful. Copies of the full report are available from the Citizens League office. To request a copy, please call 612/338-0791 or use the publication order form included in this booklet.

WORK OF THE COMMITTEE

CHARGE TO THE COMMITTEE

The Citizens League Board of Directors adopted the following charge for the research committee:

Financing and Managing State and Local Programs: Redefining the Relationship

Under Minnesota's complex fiscal system, approximately 65 percent of the monies collected by state government are redistributed to local units of government in the form of aid and property tax relief. And state officials say the local government pieces of the state budget have been growing much faster than state government's. When state government raises the revenue and local governments spend, concerns arise about accountability and efficiency. State taxes, in effect, pay for the amount, type, and quality of services substantially determined by locally-elected officials.

Furthermore, some legislative leaders suggest that spending is out of control. In 1988, the Legislature changed the property tax system to sever the link between local government tax levies and state-paid homestead and agricultural credits. The goal was to exert more state control over payments to local governments and to increase the accountability of locally-elected officials to their constituents.

Despite the changes, the 1989 Legislature is debating the size of increased payments to local governments. Little debate is heard about which level of government should raise the revenue for different services.

Legislative leaders say we are running out of public support for higher taxes. For the last several years, new spending has been partly paid for by economic growth -- growth which may not continue at the same rate in the future. Future financing of the needs and expectations of Minnesotans may now exceed the capacity of the current fiscal system. It is time to consider changing the system.

The committee should study which government services should be the responsibility of the state and which of local governments, and who should finance those services. For which services should state government be solely responsible? Which services should be shared and jointly financed by state and various local governments? And which services should be provided and financed solely by local governments? (Local governments include school districts, counties, cities, and townships.)

The committee should address the following questions:

- Which government services are considered to be essential, regardless of where citizens live or what a local community's financial capacity may be? Which government services are essential, but with varying degrees of need around the state?
- Which services are those in which local differences can be tolerated or even encouraged? Which services should be financed by which local units of government?

- What realigning of responsibilities and revenue raising authority needs to occur to finance the services at each level of government and increase the accountability of elected officials to voters?
- Should the state reduce or eliminate disparities in local "tax capacity" in order to ensure provision of government services? If so, how might this be done without reducing accountability or efficiency?

COMMITTEE MEMBERSHIP

Under the leadership of the committee chair, Jay Kiedrowski, 27 Citizens League members participated actively in the deliberations. They are:

William Batchner	John Karr
David Black	Edward Knalson
Luci Botzek	Ted Kolderie
Pauline Bouchard	A. Scheffer Lang
Curtis Carlson	Tom Lehman
Charles Darth	Van Mueller
Jagadish Desai	James Myott
Bright Domblaser	Florence Myslajek
Clifton French	Donald Priebe
Craig Gordon	Lyall Schwarzkopf
Don Grande	Norman Werner
Virginia Greenman	Kevin Wilkins
Ronald Johnson	Lyle Wray
William Johnstone	

COMMITTEE MEETINGS

The committee met for the first time on October 30, 1989 and concluded its work on September 17, 1990. It held 34 meetings, with each meeting averaging two hours.

During the first stage of the committee's work, it heard presentations from some of the resource speakers listed below. It discussed and developed a list of principles that could be used to help make program and financing decisions. It also discussed how those principles differed for private and public sector services. For the initial discussions, the committee relied on work done by the Advisory Commission on Intergovernmental Relations in 1974 on criteria to evaluate whether governmental functions are better performed on a local, areawide, or statewide basis. The committee supplemented that work with its own deliberations and input from resource speakers to arrive at the principles it used to develop the recommendations in this report.

During the second phase of the committee's work, it tried to apply theory to practice. After developing the principles, the committee spent time with other resource persons learning about the functions that represent the largest components of state spending, as well as a number of locally-provided functions. It applied the principles to several of these functions to test their usefulness in helping decide who should be responsible for providing and financing the services.

In the last half of its work, the committee developed recommendations to change the fiscal system in ways that reflected its principles. It then discussed how to change the financing of services to mitigate inequities that could result from realigning function responsibilities.

RESOURCE SPEAKERS

The Citizens League would like to thank these resource people for the assistance they provided to the study committee. (Titles reflect the position held by the speaker at the time of the presentation.)

Mary Anderson, mayor, city of Golden Valley and immediate past chair of the Governor's Advisory Council on State-Local Relations
John Brandl, vice-chair, Senate Tax Committee, and professor, Humphrey Institute of Public Affairs, University of Minnesota
Dick Braun, director, Center for Transportation Studies, University of Minnesota
Howard Davies, controller, The Audit Commission for Local Authorities in England and Wales
Gus Donhowe, senior vice president of finance & operations, University of Minnesota
Sue Dosal, State Court Administrator
John Ellwood, professor, Humphrey Institute of Public Affairs, University of Minnesota
Jim Gelbmann, State Planning Agency, former staff to the Governor's Advisory Council on State-Local Relations
Steve Keefe, chair, Metropolitan Council
Ted Kolderie, senior associate, Center for Policy Studies and committee member
George Latimer, dean, Hamline Law School
Jack Militello, professor of management, College of St. Thomas
Jim Mulder, executive director, Association of Minnesota Counties
Arthur Naftalin, professor emeritus, Humphrey Institute of Public Affairs, University of Minnesota
Karl Nollenberger, county administrator, St. Louis County
Bob Orth, executive director, Metropolitan Inter-County Association
Randy Peterson, state senator, DFL-Wyoming, and chair, Education Funding Division of Senate Education Committee
Peter Ring, professor, Carlson School of Management, University of Minnesota
Michael Robertson, director, Office of Waste Management
Duane Scribner, member, Higher Education Coordinating Board
John Tomlinson, assistant commissioner, tax policy program, Minnesota Department of Revenue
Tom Triplett, commissioner, Minnesota Department of Finance
Michael Weber, director, Hennepin County Department of Community Services
Ann Wynia, commissioner, Minnesota Department of Human Services

ASSISTANCE TO THE COMMITTEE

Research Associate Jody Hauer worked with the committee to prepare the report and this report summary. Staff assistance for the committee's work was provided by Allan Baumgarten, Joann Latulippe, and Dawn Westerman.

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For the first time, Minnesota parents who are selecting schools will have a concise source of comparative information. *The School Book, A Comprehensive Guide to Elementary Schools in the Twin Cities*, a new publication from the Citizens League, is now available. The book profiles 449 public and private elementary schools.

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Also included in the book is information about what to consider when choosing a school, an explanation of Minnesota's school choice law, an application for the open enrollment program, and a Metropolitan Council map of public schools and districts in the region.

You can get a copy of *The School Book* by calling the Citizens League at 612/338-0791 or by using the enclosed order form. League members can buy the book for \$10.00; the nonmember price is \$12.95.

New report highlights Minnesota health care marketplace:

Minnesota HMO Review 1989

After three consecutive years of losses, Minnesota's health maintenance organization (HMO) industry returned to profitability in 1989. Nevertheless, concerns remain over HMOs' finances and their increasing use of hospital care.

A new report by the Citizens League provides valuable information about Minnesota's HMO industry. The report, *Minnesota HMO Review 1989*, also analyzes key trends in enrollment, hospital utilization, and management arrangements and costs. With 1.1 million Minnesotans enrolled, HMOs affect most businesses, medical providers and families in the state. Besides losing \$26 million in the late 1980s, HMOs faced widely publicized provider revolts, a 9percent enrollment decrease and increasingly tough state rules.

The report analyzes the improved finances of Minnesota's 10 active HMOs and points out areas of continuing concern. For example, four HMOs still lost money in 1989, and several cannot, on their own, meet new state minimums for net worth and working capital. Most will have to continue double-digit premium increases to raise their net worth to state standards. Furthermore, although HMOs have reduced inpatient hospital use in the past, their use has increased steadily in recent years, particularly for older enrollees.

Minnesota HMO Review 1989 is a valuable reference for people who need to keep up with Minnesota's dynamic health care marketplace. League members can buy the report for \$5.00; nonmember price is \$10.00. To order your copy, please use the enclosed form or call the League at 612/338-0791.

The data set developed by the League staff in preparing its analysis is also available. Call for details.

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The Citizens League has been an active and effective public affairs research and education organization in the Twin Cities metropolitan area since 1952.

Volunteer research committees of League members study policy issues in depth and develop informational reports that propose specific workable solutions to public issues. Recommendations in these reports often become law.

Over the years, League reports have been a reliable source of information for governmental officials, community leaders, and citizens concerned with public policy issues of our area.

The League depends upon the support of individual members and contributions from businesses, foundations, and other organizations throughout the metropolitan area. *For membership information, please call 612/338-0791.*

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