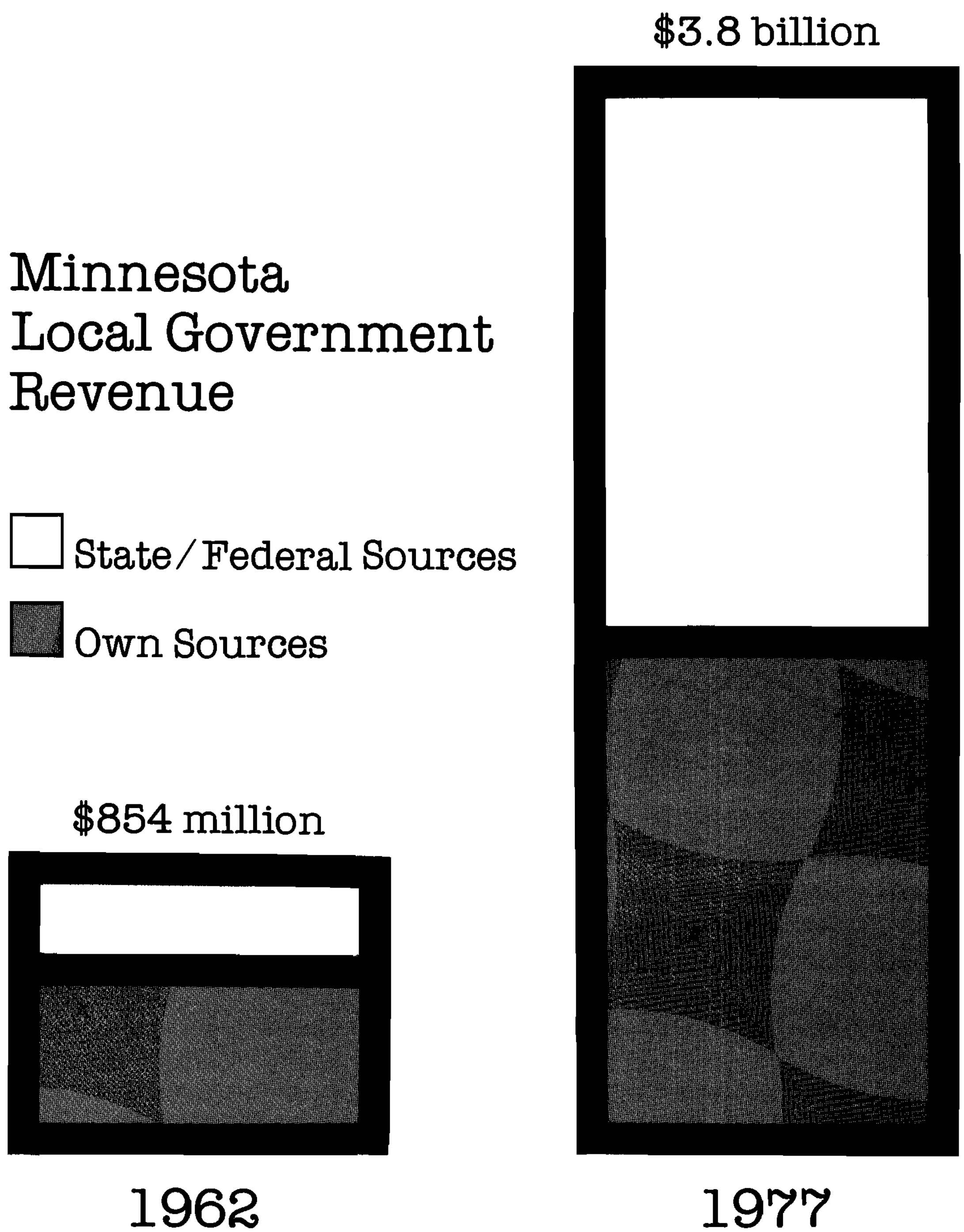
CITIZENS LEAGUE REPORT

Local Discipline, Not State Prohibition

A strategy for public expenditure control in Minnesota



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LOCAL DISCIPLINE, NOT STATE PROHIBITION

A Strategy for Public Expenditure Control in Minnesota.

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October 25, 1978

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TABLE OF CONTENTS

INTRODUCTION i

MAJOR IDEAS ii

FINDINGS, CONCLUSIONS AND RECOMMENDATIONS 1

Changes in Minnesota's Revenue System over the Past Decade 1

Program for Local Authority and Responsibility in Determining Local Spending Levels 7

BACKGROUND 21

APPENDICES 29

COMMITTEE ACTIVITY 33

ACTION BY THE BOARD 36

DISSENTING OPINIONS OF COMMITTEE MEMBERS 37

INTRODUCTION

This study was programmed by the Citizens League Board of Directors in the summer of 1977, when the widespread public interest in tax and finance issues that we see today was not present. The Legislature had shown its interest by programming a study of Minneapolis and St. Paul finances. But the public interest had not yet developed.

The Citizens League has dealt with tax and finance issues for many years. In 1970 we issued a report, "New Formulas for Revenue Sharing in Minnesota," which contributed to the discussion leading to major new state aid formulas for Minnesota's local governments. Since that time state and federal revenue sources combined for Minnesota local governments have passed the 50% mark. State revenues alone made up 44% of local government revenues in 1975/76. The property tax has also been significantly modified, with circuit breaker credits being extended to all residential properties and the benefits increased.

The League's Board felt that, after seven years of experience with a fundamentally changed system of local government finance, it was time to review and evaluate the changes. Midway through the study, California's Proposition 13 was passed, and national and local interest in tax and finance mushroomed. This report does speak to the issues raised by the California vote, but takes a decidedly different approach from that found in California.

Minnesota is approaching a legislative session where the revenues may be limited, but the demands for spending will be as large as ever. Debate will continue over the desirable mix of state vs. local revenues.

This report suggests that Minnesota's system of central revenue raising for local governments is desirable, and should be maintained...but that it can and should exist side by side with a program of *local* government accountability and responsibility for spending, and, to some extent, revenue-raising decisions.

Centralized and "absolute" controls are always tempting. They are simple, seemingly impossible to circumvent. But the fact is, no control is "absolute"--there is always a way around it, always the one or many exceptions to the rule. And these exceptions, created by complex formulas, or in the heat of legislative debate, cannot be responsive to unique local circumstances in the way that local elected officials, responding to their constituents, can. We cannot make rules that are impossible to break. And we cannot make rules that adequately address the variety of circumstances we find across the state. We have therefore recommended a strategy that relies on the political accountability of local elected officials who must rely on the most visible, and therefore probably least popular revenue source--the property tax.

MAJOR IDEAS . . . .

** Minnesota ought not take the route of tighter regulation of local government finance in order to achieve containment of government expenditures.* Needs vary a great deal across the state--a uniform regulation would almost certainly contain provisions inappropriate to many parts of the state. Further, there is no guarantee that absolute lids on spending will not be exceeded. Laws can be and are changed...or circumvented. The aid given to localities with attached machinery today is a good example of how an 'absolute' limit on spending by cities was circumvented.

Although the idea of a guaranteed and specific limit to government spending is attractive to some, we have concluded that it is extremely difficult to realize and undesirable should it be at all feasible.

** Instead, Minnesota should build on a system of financial incentives for local governments, giving local officials both the authority and the responsibility for financial decisions.*

The heart of a local fiscal incentive program must be an overall policy that provides for some increase in local residents' tax burdens when they or their elected officials decide to increase spending.

** The property tax, in our proposal, will be a major and appropriate feature of a local fiscal incentives program.* It is the major 'own' source of revenue available to local governments in Minnesota. It is the most visible tax, and so, often, the least liked. But we find its visibility a desirable feature in a fiscal incentive program. And we ourselves do not think it is at this time a severely unfair tax. Its worst features have been eliminated. through such things as the homestead credit and circuit breaker. Property tax as a per cent of valuation is not excessive in Minnesota. The tax also has some desirable features: it taxes a real form of wealth not otherwise subject to tax; it places a natural constraint on over-consumption of a valuable commodity; it is a fairly reliable source of income, not being mobile; and it places a natural restraint on spending because its base does not automatically grow as fast as other tax sources such as the income tax, and because it must be levied each year.

While some greater local discretion in levying property taxes will be desirable as part of a local incentive program, we would not support massive property tax increases. Property taxes at one time raised almost all the revenues for local governments. Today they raise less than half. We would like to keep the current proportion relatively constant--not returning to the system of ten years ago nor going much further towards state/federal financing of local governments.

** If local elected officials are to adequately respond to the wishes of their constituents then they must be freed from some of the regulations now confining them.* Specifically, local officials must have the ability to control their staff--their quality, their numbers and their salaries. Absolute seniority rules are a hindrance here, as is the requirement that employers' strategy sessions for collective bargaining be subject to the open meeting law.

Public officials must also have the independence to respond to constituents. So far as is possible, they should be free from the influence of special interests. To this end, individual contributions to candidates' campaigns should be limited to avoid undue influence by a few contributors. And steps should be taken to maximize voter turnout in the election of local officials.

* *An informed public will also be necessary so that local officials can know the wishes of their constituents.* Clear, concise information in a number of forms--through the media, the income tax booklet, the property tax statement--should inform persons about how their money is being spent, and fiscal decisions being made or soon to be made by government.

* *The recommended program above should correct the disincentives for expenditure containment that exist in some of our state funding formulas today.* Specifically, it should address those instances where local choices to increase spending or tax rates do not result in higher local tax burdens. In these cases, the incremental increase is passed on to the rest of the state...a case of "taxation without representation".

The manner in which certain parts of the circuit breaker work is an example of poor fiscal incentives. The particular formula governing the circuit breaker is such that, in low-tax communities, property taxes can be increased by several hundred dollars, with the entire increase passed along to the rest of the state.

Two other examples are the funding formulas for school transportation and for school declining enrollments. Both of these formulas provide money to local districts without requiring some local cost-sharing. The local districts have the authority to increase spending, but not the responsibility to pay for it. Any system of effective incentives must combine fiscal authority (that is authority to increase or decrease spending) with the responsibility to pay for at least part of the cost of those decisions.

FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

Minnesota's Revenue System for Local Governments has Undergone Major Changes in the Past Decade

FINDINGS

We have a local government finance *system* in this state composed of revenues and expenditures.

The revenues, in turn, are composed of local sources (mainly property tax and user fees) and state sources (mainly sales and income tax). What we mean by a "system" is that a change in one element will affect the others. For example, if local revenue sources were reduced and expenditures remained the same, then other revenue sources--state or federal--would have to increase. Or, if local revenues are reduced and expenditures decline proportionately, then state revenue sources can remain constant.

Over the past decade we have seen dramatic changes in this system. Through deliberate policy decisions, the legislature has altered the make-up of local government revenues.

Following is a list of major changes made in the local revenue system from 1967-1977:

YEAR	STATE TAXES	PROPERTY TAX	LOCAL GOVERNMENT AID-TAX AUTHORITY
1967	3% state sales tax adopted.	State withdraws from property tax, leaving tax exclusively for local governments; state partially exempts business personal property from taxation; state begins homestead credit payment, with modest rent credit supplement.	State shares one-quarter of sales tax receipts with municipalities and schools; distribution on per capita and per child basis.
1969		Green acres and open space property tax laws adopted.	Duluth adopts municipal sales tax.
1971	Major increase in state income tax rates; penny increase in state sales tax.	State imposes stiff limits on local property tax increases; metropolitan tax-base sharing law passed. Remaining business personal property tax made exempt from taxation, with business classification increased to 43%.	State prohibits additional local sales or income taxes; major new aid formulas for schools, municipalities adopted, including full equalization for schools, AFDC aid and replacement of per capita formula to municipalities with new formula related to local property tax level. Declining enrollment cushioned by counting pupil units equal to 6/10 the difference between the current and past year.

YEAR	STATE TAXES	PROPERTY TAX	LOCAL GOVERNMENT AID-TAX AUTHORITY
1973		Circuit-breaker introduced for low-income elderly and disabled.	Remaining state-shared taxes with municipalities eliminated and replaced by increase in state aids. Attached machinery made exempt. Declining enrollment aid option of three year pupil unit average offered.
1975		Circuit-breaker expanded to cover all taxpayers, with renter credit increased to same level as homeowner credit.	Municipal aid formula modified to reflect local mill rate.
1977	Income tax rates increased.	Circuit-breaker credits substantially increased; homestead classifications reduced. Two-year period allowed in which municipalities may exceed property tax limits without direct voter referendum.	
1978			Averaging for declining enrollment increased to 3¼ years.

These changes altered the source and types of revenues received by local governments:

- *In 1975/76 state aids represented 44% of all Minnesota local government revenues.* (Source: United States Department of Commerce "Governmental Finances.") In 1967 the state adopted a state sales tax. In 1971 this was increased by 1¢ while a major increase in income tax rates was enacted. These state revenues were used to reduce local property taxes.

- *Minnesota local governments now raise less than half their own revenues.* In 1967/68 Minnesota local governments raised 64% of their own revenue. This decreased to 45.5% in calendar year 1976 and fiscal year 1977. (Source: State Planning Agency, based on State Auditor's data.)

- *The nature of the Minnesota residential property tax has undergone fundamental changes in the last decade.* As a per cent of total Minnesota state/local revenues the property tax declined from 32.6% in 1967/68 to 18.6% (about equal with the income tax) in 1975/76. (Source: Advisory Commission on Intergovernmental Relations.) But perhaps more significant has been the change in the nature of the residential property tax: The classification ratios, homestead credit and circuit breaker have shifted the burden from residential to commercial/industrial properties and from lower income to higher income individuals. The circuit breaker has made property tax liability relate to individuals' income, thereby diminishing the alleged regressivity of the tax.

- *The Fiscal Disparities Law has lessened the disparity in property wealth within the metropolitan area.* The law provides that a portion of commercial/industrial growth in every locality will be shared with the region as a whole. While sharing wealth on a metropolitan basis, the law retains local decision-making on local tax rates. The idea has received a good deal of national attention, as one way to help reduce tax differences and to discourage the concentration of commercial-industrial properties in a few low tax communities. In the Twin Cities region the law has reduced the differences in per capita commercial/industrial valuation among municipalities from 10-1 to roughly 6-1. The law has also served to reduce the disparity in mill rates. A uniform area-wide mill rate is applied to the commercial-industrial tax base that is shared within the region. This has begun and will continue to reduce the difference in mill rates applied to commercial-industrial properties within the region. It thus reduces the mill rate level as a factor in a company's decision to locate in one locality versus another within the metropolitan area.

Changes in Minnesota's local government finance system were accomplished through direct state control of the mix of tax sources: property, sales and income tax.

The state has reserved for itself the right to levy income and sales taxes. And, to a large extent, the state also controls the property tax:

.*A minimum local property tax millage (28 mills) for schools is required by the state.* With a few exceptions, every district levies a minimum of 28 mills, and the state then pays the district the difference between the dollars raised by the local levy and an amount set by the state--currently $1,095 per pupil unit. For example, if a local levy of 28 mills produces $1,000 per pupil unit in the district, then the state will pay the district $95 per pupil unit. Outside of special cases, this 28 mill levy generally serves as the "maximum"--it cannot be exceeded except by local voter referendum or as provided by state law, based on levies prior to the creation of the formula.

.*Municipal property tax levies are controlled by levy limits which place a ceiling on property tax increases of 6% per capita per year.* These limits can be exceeded by voter referendum. In addition, some levies, such as those for pensions and debt, are not subject to the limit. Thus, a city's total levy may exceed the limit, while the portion of the levy subject to the limit is actually below the limit.

Today there is some debate about the desirable mix of revenue sources.

In 1976 Minnesota ranked 22nd in the nation in its use of property tax per $1,000 of personal income; 35th in use of the sales tax; 2nd in use of personal income tax; and 6th in use of the corporate income tax per $1,000 of personal income.* The state property tax was discontinued in 1967, although the state still controls property taxes as described above. However, although

*Preliminary figures for 1977 show Minnesota's rank for sales and income tax per $1,000 of personal income altered as follows: sales tax-36th; personal income tax-4th; and corporate income tax-3rd. (Source: Minnesota Taxpayers Association.) Figures for the property tax are not available.

It should be noted that there is a growing inaccuracy in the computation of Minnesotans' property tax burden. This is because the figures used for national comparisons do not account for the circuit breaker refund which homeowners receive. Thus, the figures include the amount Minnesotans pay in income tax which later goes to pay for the circuit breaker and the property tax paid before circuit breaker refund, resulting in a "double" counting of a portion of our taxes.

In 1976 Minnesotans actually paid $51.6 million less in property tax than the national comparisons would indicate. This represents approximately 4.7% of Minnesota property tax collections before circuit breaker refunds for the year. (Source: Minnesota Department of Finance.)

the state plays a significant role in determining property tax levies, those levies are thought of as exclusively local taxes. Therefore, as the legislature considers the merits of altering our present mix of revenue sources, it also finds itself in the midst of a debate about state-generated versus locally-generated revenues.

At the same time that the state was reducing reliance on property taxes and increasing reliance on the sales and income taxes, local and state government expenditures were rapidly increasing.

.*Minnesota local government expenditures increased 154% between 1967/68 and 1975/76, compared with a 150% increase in United States local government expenditures during the same period.* (Source: Governmental Finances) For Minnesota local governments, the most significant expenditure increases occurred between 1967/68 and 1971/72 (78%), while expenditure growth slowed after the enactment of the major state aid formulas for local government in 1971 (42% expenditure increase between 1971/72 and 1975/76). (Source: Governmental Finances)

.*Minnesota state government expenditures increased more rapidly in the 1971/72-1975/76 period (78%), as state aid formulas came into effect to reduce local property taxes.* During the same period growth in all United States state government expenditures was 54.4%. From 1967/68-1971/72 all United States state government expenditures increased 61.3%, compared with 51.9% for Minnesota state government. The overall increase in state government expenditures from 1967/68-1975/76 was 170.6% for Minnesota and 149.2% for the United States as a whole. (Source: Governmental Finances)

.*State/local expenditures combined increased 159.5% in Minnesota from 1967/68-1975/76, compared with 149.5% in the United States as a whole.* From 1967/68-1971/72 the increase was 69.5% in Minnesota and 62.9% in the United States. From 1971/72-1975/76 the increase was 53.1% in Minnesota and 53.1% in the United States as a whole. (Source: Governmental Finances)

The rapid growth in expenditures was made possible partly by the natural growth in revenue produced by a progressive income tax during periods of inflation.

Inflation places people in higher tax brackets, even though their "real income" may not increase. A larger portion of income is thereby taxed, making state revenues grow faster than inflation without an increase in tax rates.

For example, a person with $7,000 income in 1975 would pay state income tax at the rate of 10.2% of the last dollar earned. If inflation over the next year were 10% and his income increased 10%, up to $7,700, he would move into the next tax bracket, and pay state income tax at the rate of 11.5% on the last dollar. Thus, he would be taxed at a higher rate, even though his income, adjusted for inflation, did not increase. The opposite would also be true--in a time of deflation or depression, state revenues would decrease rapidly without a change in tax rates.

There is controversy today about whether the rapid growth in our finance system can continue.

Elsewhere in the nation proposals for spending and/or revenue lids are being made. In Minnesota reduced income tax rates are being proposed. Public pressure to reduce federal spending will also affect state and local revenues.

CONCLUSIONS

We should not turn back the clock on Minnesota's system of local government finance.

Although problems still remain, the shift towards increased state finance of local governments has had positive effects.

.*To a large extent, the shift has reduced wide differences in tax rates among communities caused by factors outside their control.* This is particularly true in the case of school mill rates. Both the school aid formula and the fiscal disparities law have made positive contributions towards fulfilling this goal.

.*However, the shift had an undesirable and unintended side-effect--it placed the two largest cities in the state--Minneapolis and St. Paul--among the highest in cumulative property tax rates.* While the core cities had tax rates below those of their neighbors before the major shift in revenue sources, they now have much higher mill rates.

Before the equalized school aids, many suburban communities had very high levies for schools. In contrast, the central cities, with proportionately less school age population and higher municipal expenditures, had lower levies for schools, but higher levies for municipal expenses. With the equalized school aid formula, the suburban school levies, and thus their overall property tax levies, decreased. Central city levies for municipal expenditures remained high, although they were reduced somewhat by the municipal aid formula. For example, the State Planning Agency, in its study of Minneapolis/St. Paul finances, estimated that Minneapolis received the equivalent of 24 mills in municipal aids in 1976, while St. Paul received the equivalent of 19 mills. In the same year, metropolitan area suburbs received the equivalent of 6 mills in municipal aids. This produced an estimated net reduction in mill rate disparity between central cities and suburbs of 18 mills for Minneapolis and 13 mills for St. Paul.

The property tax relief received by some cities through municipal aids has not been enough to offset the relief received by other cities through the school aid formula. The resulting disparity in central city/ suburban mill rates is undesirable. The legislature should continue its efforts to reduce tax rate differences which are caused by factors beyond the control of the localities involved.

.*The issues of tax mix and school funding are and should be separate.* The relative portion of state/local revenues that come from a particular tax source should not be determined inadvertently by a decision about school finance. In order to clearly separate the two issues--desirable mix of property, sales and income tax; and desirable mix of state vs. local funding for schools--the state should make explicit its control of the school property tax levy. The levy is already controlled by the state, but technically is levied by the local districts. This quirk creates the confusion of issues cited above. By making the levy a state levy in name as well as in fact, the issues should be clarified.

State revenues should not grow as fast in the future as they have in the past decade.

There is probably no need for growth to continue at so rapid a rate. Public pressure is demanding a reduced rate of growth. Our major concern is that tax rate increases for individual taxpayers not be imposed without explicit legislative decisions to increase rates. As it is today, rates increase automatically, even when real income does not increase, because of the combined effect of a progressive rate structure and inflation.

If the integrity of our finance system and public confidence in the fairness of that system are to be maintained then the automatic growth in progressive income tax rates during times of inflation will have to be stopped. The current automatic growth phenomenon not only hurts public confidence in a system that we would like to see maintained, it also goes contrary to the original intent of the progressive tax: to tax people at higher rates as their *real* incomes increase.

A reduction in state revenue growth should be accompanied by a decrease in local expenditure growth.

The two sides of our equation are revenues and expenditures. If one type of revenue decreases, either the other will increase, or the expenditures will also decrease. Either outcome is possible. A reduction in state revenue growth could result in more rapid property tax increases... but we do not think that alternative is necessary.

A reduced rate of growth in local expenditures should be possible today without severe dislocations. A compelling need doesn't seem to be present to continue the same rate of expansion as characterized the previous decade. In some cases, such as schools, the challenge is more that of coping with decline in numbers of persons being served rather than growth.

The other factor in determining the rate of expenditure increase, assuming no major additions to the system are made, is the cost of maintaining the current system. This will be determined primarily by such things as staffing levels and salary and benefit negotiations.

Local elected officials . . . and particularly municipal officials . . . should be given the authority and financial responsibility for deciding how to respond to a state revenue source that will not grow as rapidly as it has in the past.

We reject the idea of absolute lids on revenues or expenditures for Minnesota. This drastic step, under consideration in many other states, is not needed here. A uniform limitation on expenditures or revenues would not be responsive to the variety of needs throughout the state. And it could easily be avoided through special exceptions to the mandate. Uniformity might tend to level off at the highest level now found in any one unit--a practice which in the long run would be quite expensive.

A system of fiscal incentives...and municipal officials' partial reliance on the highly visible property tax... should provide a sound system for adjusting to a slower rate of increase in state revenues. A reliance on local decisions will not guarantee reductions in expenditures. Local officials will have the option to increase, retain or decrease their overall service levels. They might choose to increase property taxes to make up for lost revenue. While we do not advocate this result, we do accept it as a possibility, and we are willing to accept the consequences.

Today the property tax is both praised and criticized for its visibility. We think its visibility is a desirable aspect. The property tax also serves to tax wealth not otherwise subject to tax. And its worst features have been eliminated through such measures as the circuit breaker and homestead credit.

RECOMMENDATIONS

Make explicit the state's role in controlling the portion of property tax attributed to foundation aid for schools.

The state should replace the required local school district levy of 28 mills in the current aid formula with a direct state property tax for schools. The state would set a dollar amount to be raised from the property tax. The exact mill rate in each year would be derived by dividing that amount by the adjusted assessed valuation. The revenue from the tax should be dedicated to helping to pay for school foundation aids. The balance of foundation aids would come from the state general revenue fund. Each school district would then receive directly from the state its full foundation aid per pupil unit which would have been $1,095 for 1978-79. This would not alter funding of local districts' capital levies or operating levies above the state-set pupil-unit aids (such as a result of "grandfather" levies or local referenda). Such levies would still be imposed on the local property tax.

Adjust state income tax brackets and credits so that individuals will pay taxes at higher rates only when their real incomes increase . . . or when the legislature makes a deliberate decision to increase tax rates.

This will allow for tax increases, but will require that they be made through explicit legislative action rather than automatically through an unchanging rate structure. Care should be taken to see that adjusting the income tax for inflation does not alter the current distribution of income tax burden among taxpayers of different income levels.

Give local elected officials the authority and financial responsibility to reduce or increase the rate of growth in their expenditures.

Before giving local officials this authority, the following four major elements will be needed. These are explained in detail in the remainder of our report:

- Make local decisions to increase expenditures have an impact on *local* taxpayers; modify the aid formulas for schools and municipalities;
- Increase public understanding of the system so that voters can make their desires known to their elected officials;
- Increase independence and authority for elected officials over management and costs so that they can respond to voters; and
- Give local elected officials financial tools to respond to voters.

Establish a Program for Local Authority and Responsibility in Determining Local Spending Levels

Make Local Decisions to Increase Expenditures Have an Impact on Local Taxpayers

If local elected officials are to be responsible for expenditure increases, then their constituents must feel the impact of local expenditure decisions. Our system of state aids to individuals and local governments can reduce the local impact, removing it to the state as a whole. This has the potential for reducing local interest in and accountability for, local expenditure decisions--local officials make decisions, and the whole state pays, without having had a voice in the decision. Following are specific instances where we think that local responsibility for expenditure decisions should be improved.

FINDING

The Circuit Breaker provides a "free zone" wherein local taxpayers do not bear the burden for local property tax increases.

Depending upon household income and the level of tax, it is possible for some households to experience hundreds of dollars of increase in property tax and pass the entire amount of the increase on to the state, without feeling any of the burden themselves. For example, a household with a $15,000 income and a gross property tax of $400 (before homestead credit or circuit breaker payment) can have that tax grow to $700 before the household would pay any of the increase. When first enacted, the circuit breaker applied only to elderly and disabled homesteads. It now applies to all homestead properties, and renters.

CONCLUSION

Local taxpayers should not be permitted to pass along the entire burden for expenditure increases which they incur.

The "free zone" allows for local expenditure increases without local responsibility for those increases. It is, in a sense, "taxation without representation"...for the rest of the state.

RECOMMENDATION

Modify the Circuit Breaker so that local taxpayers share the burden for at least part of every local tax increase.

Require local taxpayers to bear some of the burden for future property tax increases which they or their elected officials choose. This would not have to reduce benefits now received, but should phase in with future tax increases. At the lowest income levels the taxpayers' share could be very small--perhaps $1 for every $10 of property tax increase. The share paid by the state through the circuit breaker could be gradually reduced as the property tax increased. putting more of a burden on local taxpayers for decisions to significantly increase local taxes.

FINDING

State transportation aids for school districts are based on districts' past expenditure levels.

The formula provides that every district contribute one mill from local property taxes. After that, the state reimburses the district for up to 127% of the district's 1975/76 per-pupil expenditures. This "base year" has been changed each biennium since the formula began in 1973. Beyond the maximum of 127%, the district pays the remainder out of its general fund.

CONCLUSION

The use of a base year, and the updating of that year does not give districts incentives to look for greater efficiencies.

Poor management practices in the past can be continued because state aids are based on past expenditure levels. And the updating of the base year encourages districts to spend as much as possible within the 127% maximum, so that their base year computation for the future will be increased.

RECOMMENDATION

Change the school transportation aid formula to provide incentives for efficient service delivery.

Some measure of need such as sparsity of population and desegregation orders might be used for determining state aids, rather than past expenditure patterns. Further, the costs should be shared between districts and the state for *every* dollar of expenditure, so that there is not a large portion of expenditures that are "free" to the district. To help districts with lower tax base, the state can provide additional assistance. For example, the state could provide funds so that every district would levy the same number of mills for a certain expenditure level. The mill rate would then increase as expenditures increased.

FINDING

The school foundation aid formula tries to ease the impact of declining enrollments on school district revenues.

The formula allows school districts to average their enrollments over the last 3¼ years in order to determine the number of pupil units on which state aids will be based. This declining enrollment formula, in effect, counts "phantom pupils" who are not really there. In 1978 the formula funded the equivalent of an additional school district the size of St. Paul that didn't exist. The declining enrollment issue will continue to be with us in future years. Enrollment is expected to decline at the rate of 25,000-30,000 pupils per year for the next five years. (Source: Senate Research.)

CONCLUSION

The current method of distributing aids to districts with declining enrollments does not provide the maximum incentive for interdistrict cooperation and other measures that could provide quality, cost-efficient educational opportunities as enrollment decreases.

It is impossible to set a uniform dollar level or number of years needed for every district to make the transition to smaller enrollments. By taking this decision away from local districts, the state is making that decision arbitrarily. It may be spending too much on some districts for too long, or too little on others for too short a time. Local responsibility for decisions on funding declining enrollments would be most responsive to local situations, and would provide the maximum incentive for efficiency.

RECOMMENDATION

Place a part of any additional declining enrollment aid on the local property tax levy, rather than keeping it totally a part of the state aid formula.

The state could match some portion of local levies for declining enrollment. To help districts with a low tax base, the state could provide some additional assistance, as suggested in number 2, above. A local levy above the levy limits could be permitted without voter referendum for a period of years coinciding with the enrollment decline. The extra levy would then be disallowed without referendum so that districts do not use the levy for purposes other than compensating for enrollment declines, without voter approval.

FINDING

A little-noticed change in state law in 1977 has given a windfall in state aid plus a major exemption from coverage by levy limits to a handful of cities and counties in the state.

In 1973 the state removed attached machinery from the property tax. In lieu of that lost revenue, the state reimbursed municipalities with state aid based on the locality's mill rate as applied to the machinery's value. That amount, calculated in 1973, was frozen at that level for subsequent years, through 1977. This was the practice followed in earlier years when other business personal property was exempted from taxation. The bulk of attached machinery is associated with oil refineries and paper companies, thereby giving the reimbursement to the few units of government where such facilities are located.

In 1977 two changes were made in the law which are in effect for 1978 and subsequent years:

The value of the attached machinery, for purposes of calculating state aids, was increased 25% over 1973; and the current mill rate, rather than the 1973 mill rate is applied to that value to determine the amount of state aids.

The amount received for attached machinery is not subject to the levy limits--this means that localities can levy up to their limits, plus get additional money above that amount for attached machinery. In the past, the levy limit was reduced by the amount received for attached machinery. In effect, the exemption from the limit allows some localities, because of the type of property within their borders, to exceed the limit without a voter referendum or penalty from the state, (or even a local tax increase) to which other localities are subject.

The 1977 changes apply only to cities, townships and counties--school districts receive aid on the same basis as in 1974. A list of major beneficiaries of attached machinery aid can be found in the appendix, page 30.

CONCLUSION

There is no justification for the large benefits received by a handful of cities.

The benefit is not based on need. In a finance system that has taken such care to limit cities' expenditures and to treat them equitably, it is particularly inappropriate to make such an exception, especially when that exception is not justified on the basis of need. This excess benefit should be removed.

RECOMMENDATION

Discontinue the special benefit received by some localities.

Phase out the attached machinery aids over a period of three years.

FINDINGS

The distribution of municipal aids by county produces unusual results.

Minnesota's local government aids are distributed in two parts:

- Part one is a per capita distribution by county, with the metropolitan area counted as one county. This spreads the dollars throughout the state.

- Part two, within each county, the county government itself first receives a flat grant, which is a grandfathered amount determined in a previous year. The remainder is distributed among the municipalities and townships in the county according to a formula which counts population and mill rate. These two factors are multiplied together to determine the dollar allocation. Township mill rates usually are a fraction of municipal mill rates. Consequently, municipalities are the principal beneficiaries of the formula. Sometimes there are only a few relatively small municipalities in a given county. When the Legislature approves an increase in the per capita amount to a county area (such as the $7 increase from $52 to $59 from 1978 to 1979), these municipalities receive the per capita increase attributable to the population in the townships, too. The total amount of aid received by some small municipalities in outstate Minnesota now exceeds $100 per capita. (See appendix, page 29, for a list of the 50 highest municipalities and townships in aid per capita for 1979.)

CONCLUSION

The county distribution aspect of the municipal aid formula results in unnecessarily high aids to some cities.

It does not affect the relative distribution of aids between outstate and the metropolitan area. This is exclusively an outstate issue.

RECOMMENDATION

Revise the outstate distribution of municipal aids by county so that municipalities are treated more equitably.

One possibility would be to treat the entire outstate area as one county, as is done for the counties within the metropolitan area. This would result in all outstate cities 'competing' with one another for aids, rather than just cities and towns within one county 'competing'.

FINDING

The measure of local 'effort' in the municipal aid formula counts property tax levies, but not fees and charges.

The measure of effort is criticized today because it does not recognize the taxpayer burden represented by fees and charges imposed by municipalities. To the extent that cities choose this form of finance, their municipal aids from the state are reduced relatively, as compared with what they would be had the same revenue been raised on the property tax.

CONCLUSION

The use of mill rates alone does not fully measure local 'effort'.

It is undesirable insofar as it may discourage local governments from financing services with fees and charges. Fees and charges may encourage efficient utilization of services, because they allow people to make a direct connection between the cost and provision of services. In contrast, the tax collection system is more abstract: one cannot make a direct connection between taxes paid and particular services provided.

While we realize that it may be difficult to determine what fees and charges should count towards state aid, we think it important that municipalities not be penalized for using revenue sources other than the property tax.

RECOMMENDATION

Make the 'local effort' measure in the municipal aid formula more accurate by including fees and charges along with mill rates as a measure of effort.

As a starting point, the federal definition of locally-raised revenue can be used. This includes some measure of fees and charges. Our goal is to put cities on as equal a footing as possible with respect to their eligibility for state aids.

FINDING

The use of property tax rates as a measure of 'need' has been criticized as a policy that rewards higher spending.

Heated debate is taking place over whether the mill rate measure 'rewards' cities for spending more, or 'penalizes' them for spending less. This has been highlighted by the State Planning Agency's study, which shows that St. Paul has held the line on spending, and thus has received less in state aids, while Minneapolis, with higher expenditures, has received more state aid. However, the argument that the aid formula encourages cities to increase mill rates is not borne out by an examination of the formula with actual dollar calculations. Holding population of all metropolitan cities constant, and mill rates of all cities except St. Paul constant, we found that if St. Paul wanted to increase its state aids by roughly $1 million over a 3-year period, it would have to increase local property taxes by roughly $6.6 million during the previous three years. The 'return' from the state represents 18% of the city's 'investment' in local property tax. And it must be remembered that this calculation assumes other cities' populations and mill rates are constant, which is not likely. St. Paul is actually losing population while other metropolitan cities are gaining. And other cities increase mill rates also. Because the distribution of state funds to St. Paul would depend on its population and mill rate *relative to that of other metropolitan cities*, it is likely that an even greater increase in St. Paul's property taxes would be necessary to produce the $1 million increase in state aids.

CONCLUSION

While it cannot be shown that the use of municipal mill rates as a measure of need in the aid formula has caused over-spending by local governments, it has created discomfort about the subject.

If another measure of need can be found which offers at least an equal degree of accuracy, it would be preferable. A formula that even gives the appearance of rewarding spending is not desirable, if a better substitute can be found.

RECOMMENDATION

Consider characteristics such as fiscal capacity, age of housing, poverty population and other factors beyond cities' control as possible substitutes for the 'need' measure in the municipal aid formula.

Some of the characteristics are used in federal need formulas for purposes of distributing federal aids. It is possible that they might also work in a state formula. (It is likely that alterations in this part of the formula would alter only the intrametropolitan distribution of aids--not the distribution within outstate areas, or the relative portions going to outstate vs. the metropolitan area.)

FINDING

Due to many factors, there is a large disparity in mill rates among municipalities in the Twin Cities region.

Controversy focuses on the disparity in municipal mill rates in particular. In 1976 municipal mill rates of metropolitan area cities with population over 10,000, as adjusted for differences in assessment practices, ranged from 7.821 in Edina to 38.728 in Minneapolis. St. Paul was second with a rate of 26.740. The median was roughly 14.378. (Source: State Planning Agency Minneapolis/St. Paul Study, "Municipal Revenues".)

However, the accomplishments of the legislature in reducing property tax burdens should also be noted. For example, the city of Minneapolis received 7% of its revenue from state aids in 1967, compared with 27% in 1976. For the city of St. Paul the growth in state revenues was from 8% in 1967 to 22% of total municipal revenues in 1976. In 1975 metropolitan municipalities received the following per capita amounts from the state aid formula: Minneapolis-$71.95; St. Paul-$60.23; other metropolitan cities over 10,000 population-$28.40. (All figures above from State Planning Agency Minneapolis/St. Paul Study).

A recent study by the State Planning Agency spent a good deal of effort in examining the finances of metropolitan area municipalities, and in identifying reasons for substantial mill rate differences. In part, the differences result from factors outside the municipalities' control. Aging physical plants in need of redevelopment are an example. Another is the introduction of equalized mill rates for schools in 1971. Mill rate differences may also result from differences in property tax wealth. Use of some city facilities such as parks by the entire region, with the financial burden resting solely on the city, affects mill rate disparity. Pension costs in the central cities are also high.

The Planning Agency also identified a set of factors within municipalities' control that contribute to mill rate disparities. The level of service desired is an example. Another is the government structure and decision process resulting in expenditures. Number of public employees, and their wages and benefits also affect mill rates.

The Planning Agency study suggested that mill rate differences cannot totally be accounted for by factors outside the control of cities. This is part of the reason, along with the "municipal taste" factors--those within control of the affected cities.

CONCLUSION

Substantial mill rate differentials among Twin Cities municipalities which result from factors beyond the control of cities should be reduced.

Efficient utilization of the cities' physical plant, a reduction in urban sprawl in order to maintain our green spaces, and simple energy usage considerations all call for efforts to make central city living...and tax rates...attractive to residents.

However, to the extent that mill rates differ because of local taste or other circumstances within the control of elected officials, the differences are acceptable. Local governments should be able to choose, and pay for different amounts and types of services. We would not want to see a uniform service level or package imposed on municipalities.

In attempting to alleviate mill rate differences caused by factors outside the control of cities, the legislature will also have to be cautious that it does not reduce incentives for local officials to correct those inefficiencies that are within their control.

RECOMMENDATION

To the extent that mill rate differences have been caused by factors outside the control of cities, the legislature should consider action to reduce the spread in mill rates within the metropolitan area.

We were unable to determine whether an entirely new approach to municipal aids is needed. We therefore recommend that the legislature study the appropriateness of distributing a portion of municipal aids on a basis similar to that used in the school aid formula--an equalized, uniform mill rate, for a basic level of service. We are not suggesting here that a new source of funds be used, but rather that a new way of distributing current funds be considered.

Municipal costs for parks and pensions have been of particular concern. Two Citizens League committee are now looking at these issues. Not having studied these subjects ourselves, we await the new reports for guidance on these matters.

FINDING

Pressures are increasing to have the state share in the expense of metropolitan area functions.

Among such functions likely to be seeking state funds in 1979 are (a) transit (because of a growing gap between fare box revenues and the actual expenses of the Metropolitan Transit Commission) (b) open space (because of the need to pay for acquisition and development and perhaps even operating and maintenance expense of large parks in the metropolitan area) and (c) urban development (because of the need to help pay for expenses of tearing down old buildings and making land suitable for rebuilding in urban centers). In recent years the Legislature frequently has adopted a statewide approach to both financing and delivery of such regional services. Usually separate legislation is passed for each function.

CONCLUSION

We see no compelling argument that the state general revenue fund is necessarily the best source of money for functions that are primarily benefitting the metropolitan area.

Clearly no part of the state has exclusive claim to a governmental function. But it is possible that the state general revenue fund might be thought of automatically as the source of funds, irrespective of the extent to which a function really should be delivered statewide. In fact, if the state general revenue fund is regarded as the only source, a temptation might exist to increase expenditures beyond what they would otherwise be, in order to spread the benefits statewide.

A function-by-function approach in which each has its own guaranteed revenue makes it extremely difficult to set priorities among functions.

RECOMMENDATION

The state legislature should now consider earmarking some funds for some parts of the state and not others, when appropriate.

This will be a cost-saving measure. If the legislature is not willing to allocate a portion of general fund revenues to one part of the state, then it should consider levying a tax on that area only, providing the area has sufficient wealth to pay the tax without hardship.

The legislature should require that the Metropolitan Council make a unified funding proposal for metropolitan functions each biennium. This will give the state a sense of how the region sees its priorities.

Improve Public Understanding for Communication with Local Elected Officials

A system of local responsibility and authority requires a strong representative system at the local level. Voters must understand the issues if they are to play an active part in informing their representatives of their desires. Today's system of revenue raising, revenue distribution and expenditure is complex. It is not likely to become less so. Following are three recommendations whose purpose is to make the finance system more understandable to the public. A fourth recommendation, from the League's 1978 report on public affairs information, is listed because of its relevance to this study.

Add pages to the income tax instruction booklet that would explain how state tax dollars are spent, including trends over the past few years.

In this way taxpayers will get some idea of what they are paying for, as they pay their bill. It will bring the revenue and expenditure sides closer together for the taxpayer.

In order to make property tax rates more understandable, express them as a per cent of real market value (as determined by the Assessor), as well as in mills, on property tax statements.

This figure would be arrived at by simply dividing the two figures which already appear on the property tax statement: the taxes in dollars, by the real market value of the property.

Publish local government budget information in the largest circulation daily or weekly newspapers prior to local government budget sessions.

The information should include summarized figures on expenditures and number of public employees in the current year, over the past several years, and as proposed in the budget document. This information should be published along with a notice of public hearings on the budget. In addition, the impact of the proposed budget on tax rates, assuming no change in tax base or state aids from the previous year; as well as the impact given estimated increases in tax base and aids, should be published. In order to avoid prohibitive costs for this information, it should be published instead of, rather than in addition to the detailed budget information which now appears in such publications as Finance and Commerce.

Improve media coverage of public affairs to help citizens better understand and participate in the decision process.

(Reference: 1978 Citizens League report on public affairs information). The newspapers should work towards a pattern of news coverage that provides citizens early notification about issues after problems are identified; helps citizens participate in discussions about the problems; and is continuous in the coverage of public issues, giving readers a sense of what came before, and what the next steps are likely to be.

This coverage will complement the mandated publishing of budget information by local governments in the daily papers, as recommended above.

Give Local Elected Officials Policy Tools to Respond to Voters

Once constituents are able to make their wishes known to their representatives, the elected officials must have the independence and authority to respond. This means more management and spending authority and freedom from interest control of campaign contributions and elections.

Independence to make decisions and control over major expenditure items such as salaries are indispensable tools for local government elected officials who have been given the authority and responsibility to control their own expenditures. Without these tools they will not have the ability, and therefore should not be given the responsibility to control expenditures. Instead, this job would have to be taken on by a higher unit of government.

We have spent the bulk of our time in studying the system of revenue raising and revenue distribution for Minnesota's local government. We have not given a great deal of attention to aspects of government structure and process which are such a crucial element of expenditure control. However, because our central conclusion that *local* government should be given control over expenditures rests on the ability of local officials to make decisions, we felt compelled to make some suggestions in this area. Below are suggestions arising out of this study, and out of earlier Citizens League reports (indicated by*). Recommendations from earlier committees are not stated as positions of our committee, but as relevant material which merits examination. We encourage readers to look back at the earlier reports mentioned, for the full background and reasoning behind those recommendations.

Give local elected officials more control over management and improve the public's representation in collective bargaining.

.*Make the order in which teachers are laid off a negotiable demand.* To the extent that seniority for lay-off is mandated by the state, local

*Recommendation from earlier Citizens League report.

authority over the mix of teaching staff and costs is diminished.

Repeal state legislation which mandates seniority as the order for lay-off in 1st class city school districts and which makes that the policy unless another is adopted for other school districts. In this way seniority for lay-offs will be a bargaining item--it may well be retained through the bargaining process--but it will be treated as a benefit to be considered like other benefits, and balanced in the negotiation process.

.*Conduct a legislative review to determine what modifications to the state collective bargaining law would strengthen the ability of elected officials to make expenditure decisions*. Today state law requires binding arbitration for "essential employees"--police, firemen and hospital workers. Their wage settlements are often achieved through binding arbitration--a labor mediator, rather than the elected officials, makes the decision. And these wage settlements make it difficult for elected officials to bargain with other public employees, tending to set a precedent for future wage negotiations.

Possible areas of study for the legislature would include "last best offer" arbitration and right to strike. Last best offer provides that the arbitrator's only choices are the last best offers made by each side. Right to strike would allow this option for essential employees, while eliminating the binding arbitration requirement.

A legislative review also should include the issue of what matters may be submitted to binding arbitration. In negotiations involving teachers, for example, controversy often arises over whether such matters as class size are negotiable.

.*Remove key managerial positions in local government from the classified service and place them in a new career executive service.** (Reference: 1973 Citizens League report on the career public service.) To the extent that elected officials' choice of top managers is limited, their ability to respond to constituents is also reduced. This will provide a system more flexible and responsive than the classified service, and should attract highly qualified managers into public service. It will allow incentives for top performance, a wider choice among candidates, and discretion of the appointing officials.

.*Substitute multi-year contracts for school administrators' tenure.** (Reference: 1972 Citizens League report on school accountability.) Retain tenure for administrative personnel within the school system, but not necessarily tenure as administrators with administrative salaries. This will give more flexibility in keeping a top quality administrative personnel system.

.*Provide a statutory exception to the requirements of the Minnesota open meeting law for meetings of local elected officials to discuss positions to be taken by their representatives in collective bargaining negotiations.** (Reference: 1977 Citizens League report on open meetings.) Given the current open meeting law requirements, local elected officials cannot privately agree on what their maximum limit will be in salary negotiations. That means that either this agreement is made public, in which case the employees are given an advantage in the bargaining session, or no such agreement is made, and more authority is given to the hired negotiator, taking authority away from the elected officials.

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*Recommendation from earlier Citizens League report.

Help local elected officials find new ways to provide services.

Create a foundation for local government performance. This could be funded by private and/or public dollars. It could provide analytical assistance to local governments and financial assistance in thinking through and trying new ways to deliver services or to organize local government for efficient operation.

Give local elected officials the independence to be accountable to the public.

.*Limit the amount of individual contributions to local government candidates.** To the extent that political campaigns are financed from only a few major sources, the independence of elected officials is also inhibited. (A 1974 Citizens League report on campaign finance called for the following limitations):

A $100 limit on contributions to the candidate by individuals other than himself, and by all organizations other than political parties;

A prohibition on transfers of campaign funds from one candidate to another; and

Restrictions limiting loans to political campaigns from sources other than financial institutions to $100 and a requirement that all loans be paid back within six months of the election and within the contribution limits on individuals and other sources as established above.

.*Create a uniform election day in November of the odd-number years for school, county board and municipal elections.** (Reference: 1974 Citizens League report on campaign finance.) To the extent that voter turnout is low due to elections at odd times of the year, the legitimacy and accountability of elected officials is reduced. This recommendation will increase voter awareness and participation in local elections.

.*Open up the opportunities for local governments to purchase services, rather than maintaining their own service delivery systems.** (Reference: 1972 Citizens League report, "Why Not Buy Service?") This idea is founded in a belief that a choice of service providers will enhance elected officials' ability to provide efficient, quality services. Without a choice, they are 'stuck' with a single vendor. With the choice they will have more control over the quality of service for which they are responsible.

Give Local Elected Officials the Ability to Use Local Revenues for Additional or Special Needs

Elected officials that have been made responsible and accountable for their expenditure decisions can then be given the financial tools to meet needs as they or their constituents identify them. Spending authority, however, cannot be given to officials without the above tools. Keeping this in mind, we identified the following areas where local authority should be increased.

Municipal property tax increases are limited to 6% above the levy in the previous year.

Municipal levy limits provide that if municipal property tax levies exceed 6% of the levy in the previous year (building on a 1971 base year), the state will reduce its aids for the *following* year by an amount equal to 1/3 of the amount by which the municipality exceeded the limit. In the following year, with a reduced

*Recommendation from earlier Citizens League report.

amount of state aid, the municipality is still confined to its levy limit. Therefore, unless it exceeds its limit again, by an even larger amount, the effect will be to reduce next year's revenue by $1 for every $3 it levied above the limit the year before. This cycle would continue, with state aids becoming a smaller and smaller part of local revenues, if the municipality did try to retain its level of revenue as found before it exceeded the levy limit.

The practical effect of levy limits is to keep almost all cities within those limits. The exceptions are cities with significant non-residential properties such as power plants, that will bear most of the burden of tax increases.

Because the base year is 1971, when many communities were much smaller than today, with much smaller expenditure needs, many of those communities are now at their limits, with significantly higher needs. Those that had fairly high expenditure levels in 1971 have not reached their levy limits, and are not likely to do so.

CONCLUSION

I he levy limit is too severe a penalty for municipal governments.

City councils are general purpose governments, which means they must make priority choices among services. And they are perhaps the most visible governments, often known on a first name basis by their constituents. If the measures outlined in previous sections of this report are followed, then municipal officials should have greater authority to determine their spending levels than they are now afforded by the levy limit law.

RECOMMENDATIONS

Modify the levy limit law to give elected municipal officials more choice in their spending levels.

To eliminate the "spiral effect" created by the current policy of implementing the state penalty in the following year, make that penalty fall in the same year that the limit is exceeded. There will then be no "catching up" to do. Secondly, instead of a 1/3 reduction on the first dollar exceeding the limit, make the penalty start at a very small percentage, and gradually increase as the amount exceeding the levy limit increases.

Municipalities are unable to tax their entire tax base, because portions of that base have been exempted from taxation by federal and state law.

Exempt properties include railroad and telephone property, property owned by non-profit organizations such as colleges and churches, and government property. The portion of property that is exempt from taxation within a community varies across the state. In urban settings, the property requires and receives services, which are paid for by the other properties within the community.

Data is not available on the amount of exempt acreage within different communities. A total value of buildings and land combined is assigned, although there is little confidence in the figures, because so few sales of exempt property take place.

CONCLUSION

Municipalities should have access to the tax exempt wealth within their borders.

This property tax wealth has been artificially limited, by powers outside the municipalities' control. The Legislature should take financial responsibility for decisions to limit local communities' wealth.

RECOMMENDATION

The 1979 Legislature should direct that data be compiled on the acreage and value of exempt properties.

The Legislature should then consider alternatives for making this wealth accessible to municipalities.

BACKGROUND

MINNESOTA STATE/LOCAL REVENUE SOURCES, PRELIMINARY 1976/77 FIGURES

Total state/local revenue equaled $4.6 billion. A breakdown of the revenue sources is listed below:

Revenue Source	Dollars (in millions)	Per Cent of Total*
Federal Government	$1,236.3	20.7%
State Income Tax	1,215.0	20.4
Charges & Miscellaneous General Revenue	1,113.6	18.7
Property Tax	1,077.3	18.1
General Sales Tax	469.6	7.8

Source: United States Department of Commerce, Bureau of the Census, "Governmental Finances"

*Does not add up to 100% due to other revenue not included.

MINNESOTA STATE/LOCAL GOVERNMENT EXPENDITURES, FISCAL YEAR 1977 & CALENDAR YEAR 1976

Total state/local expenditures equaled $5.2 billion. A breakdown of expenditures by government unit is listed below:

Government Unit	Expenditures	Per Cent of Total
State Government*	$1.6 billion	31.6%
School Districts	1.7 billion	33.3
Cities and Towns	950 million	18.3
Counties	854 million	16.5

Source: State figure from "A Fiscal Revenue of the 1977 Legislative Session" -- Minnesota State Senate.
Local government figures from "Report of the State Auditor of Minnesota on the Revenues, Expenditures, and Debt of the Local Governments in Minnesota, July 1, 1976-June 30, 1977"

*The state government expenditure figure does not include transfers to local governments. The figure was calculated by taking the state biennial expenditure for 1977/79, plus federal revenues, and dividing by two, to approximate an annual expenditure figure.

THE PROPERTY TAX

A property tax base, expressed in assessed valuation, is assigned to each unit of government -- Only a portion of property tax wealth may be subject to property taxes in Minnesota. Certain properties are entirely exempt from property taxes: railroad and telephone properties; business personal property, such as farm livestock and machinery; individuals' personal property, such as household goods, stocks, bonds, and insurance policies; attached machinery, such as commercial and industrial tools, implements, machinery and equipment; and those properties most often thought of as 'exempt' property -- schools and colleges, churches, hospitals, charitable institutions, forests, parks and wildlife refuges, etc.

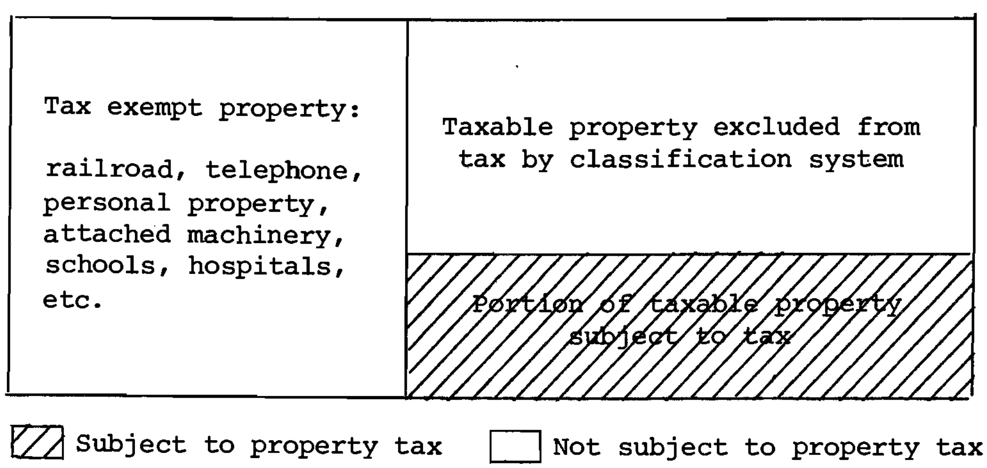
A statutory classification system in Minnesota provides that only a certain portion of taxable properties' value may be subject to property taxation. The statute sets the specific percentage of value for each type of property that may be taxed. For example, 40% of rental residential properties are subject to property taxation; 43% of commercial/industrial property; and 30% of agricultural non-homestead property is subject to tax.

In some cases the classification for a single property is split, based on property's value. For example, for taxes payable in 1979, 20% of the first $17,000 and 33.3% of the value above $17,000 for non-agricultural homestead properties will be subject to tax. (Source for classifications: "Minnesota Tax Guide 1978, Minnesota Department of Economic Development and Minnesota Department of Revenue.)

The net effect of the classification system and exemptions is that only a small portion of real and personal property value is subject to property taxation.

The total value ("market value") of the real and personal property that is taxable was $40.4 billion for assessment year 1976. Of this, the total assessed value -- i.e., the portion subject to taxation -- was $14.0 billion, or 34.7% of the total market value. (Source: Minnesota Department of Revenue, "Property Taxes Levied in Minnesota, 1976 Assessments, Taxes Payable in 1977.") We have an estimated additional $8.8 billion in tax-exempt property, not counting railroad, telephone, personal property and attached machinery, for which we do not know the value. (The estimated value of tax-exempt property is computed every six years. The $8.8 billion figure is for 1974.) (Source: Minnesota Department of Revenue.)

Below is a rough representation of the limits to Minnesota's property tax base:



When the value of property has been determined and the appropriate laws applied as described in the previous paragraphs, a unit of government is given an official tax base, against which it is allowed to levy property taxes. As permitted by law, a unit of government determines its levy of property taxes in dollars. This dollar amount is then divided by the tax base assigned to the unit of government. The resulting percentage is applied to each parcel of property individually to calculate the tax due from each parcel. That percentage is usually expressed as a mill rate. For example, if the result of dividing the levy by the tax base is 1.45%, that figure will normally be expressed as 14.5 mills. Therefore, any mill rate can be translated into a percentage by moving the decimal point one numeral to the left.

The metropolitan tax-base-sharing law redistributes a portion of the assessed valuation of commercial-industrial property -- After the application of the classification system, but before taxes are levied, a portion of the assessed valuation of commercial-industrial property is redistributed, in the metropolitan area only. The law gives every municipality and township in the seven-county Twin Cities metropolitan area a guaranteed share of commercial-industrial valuation, irrespective of where that valuation is located physically in the area. The amount of valuation which is shared is equal to 40% of the net growth in commercial-industrial valuation in each municipality and township since 1971. The shared amount is placed in a pool and redistributed throughout the metropolitan area on an adjusted per capita basis. If a municipality or township is below average in total valuation per capita, it receives more than a per capita share; if above average, it receives less than a per capita share.

For taxes payable in 1979, a total of $258 million in commercial-industrial valuation is being redistributed under the tax-base-sharing law. If the law were not in effect, the range in commercial-industrial valuation per capita among cities over 9,000 population in the metropolitan area would be about 10 to 1. The law has reduced that differential to about 5.7 to 1. A uniform areawide mill rate is applied to the commercial-industrial valuation which is subject to redistribution. As a result of this mill rate, which is a weighted average of all mill rates in the metropolitan area, taxes payable on commercial-industrial valuation are being brought closer together.

Units of government are constrained by law as to how much they can levy in dollars against their tax base -- A variety of contraints are in effect. Municipalities over 2,500 population, and county governments, may increase their tax levies for general operating purposes without a referendum, by roughly 6% annually, adjusted somewhat for population increases. Some levies are outside the limits, including levies for pensions and bonded debt retirement. If a municipality or county exceeds the limit, its state aids are reduced in the following year by an amount equal to one-third of the excess. The unit of government can't make up the loss in state aid by levying more property taxes, unless it wants to accept another loss in state aids in the third year. However, a municipality or county can exceed the limit without a loss in state aid if the excess levy is approved by voter referendum. From 1971 through October 12, 1978, eight such referenda were conducted, all successful. The locations: Faribault County, Brainerd (two referenda), Goodview, LaCrescent, Moorhead (two referenda), and Chanhassen. (Source: State Department of Revenue.)

During 1977 and 1978 counties and municipalities also were allowed a one-time opportunity to enlarge the base upon which the 6% limit is calculated through a process called a "reverse referendum." Under that procedure the increase can go into effect without a vote of the people unless petitions force a referendum. As of October 12, 1978, 25 municipalities attempted to use this provision. In four cases, the "reverse referendum" was called, and the increased levy was defeated. In 21 other cases, the levy was successful. For these, we do not know the number of cases in which a referendum was called and resulted in approval, and the number in which the measure was passed without a referendum being called. (Source: State Department of Revenue.)

School districts are treated differently. First, state law provides that every district exert a minimum local effort as a condition for receipt of state aids. That local effort is 27 mills for taxes payable in 1979. The 27 mills are imposed in such a way as to adjust for differences in assessment practices by local assessors. Consequently, it is not possible for a local assessor to deliberately undervalue property so that local taxpayers can evade the full impact of the 27 mills. The Department of Revenue conducts annual comparisons of assessors' values with selling prices of property. It then adjusts the actual amount of dollars to be raised from the property tax in each school district to correct for differences in assessment practices. Considerable controversy exists over the methods used in determining these adjustments.

State law contains restrictions which are designed to minimize the year-to-year increase in dollars to be raised from the required 27 mills in any given school district. The present restriction has the effect of insulating a district from increases that would be caused by growth in valuation above 8% a year. Currently, about three-fourths of the school districts in the state are growing faster than that. Consequently, the annual adjustments for those districts are made automatically by raising the previous year's valuation by 8%, which means the impact of adjustments for differences in assessment practices is largely moot.

Some school districts are allowed grandfather levies to compensate for higher expenditures which were in effect when the present form of school aid law was adopted in 1971. In addition, districts are allowed to levy additional taxes locally for capital outlay and debt service and, with voter approval in a referendum, for operating expense. From 1971 through October 9, 1978, 137 referenda have been held of which 92 were successful. Among metropolitan districts, the results were 8 approved and 8 defeated. Outstate, 84 were approved and 37 defeated. (Source: Minnesota School Boards Association.) As a result of spending for debt service and capital outlay, successful referenda for increased operating expenditures, and grandfather levies, the average mill rate in Minnesota's school districts in 1978 was 41 mills -- 14 mills higher than the state-mandated 27-mill levy payable in 1979.

The homestead credit provides a state payment of up to $325 to help pay property taxes of all homeowners in the state -- Since 1967 the state has paid a portion of all homeowners' property taxes. This is the homestead credit. For taxes payable in 1979, the payment is 45% of a homeowner's tax bill, or $325, whichever is less. The payment is made directly by the state to local units of government, with the homeowner then billed for the remainder of the property tax due.

Homesteads in certain Iron Range areas receive an additional taconite homestead credit of 57%, with a maximum of $330, or 66% with a maximum of $385, depending on location.

The state also makes a payment to reduce agricultural property owners' property taxes by 15 mills (for homestead property up to 160 acres) and by 10 mills for all other agricultural property and non-commercial seasonal recreational residential property.

The circuit-breaker credit, when combined with the homestead credit gives homeowners property tax reductions of up to $800 ($875 for elderly) and extends benefits to renters -- Beginning with taxes payable in 1976, the state provided a new kind of rebate to individuals called the "circuit-breaker." (Actually, a more limited form of the circuit-breaker had been available for elderly and disabled for the previous two years.) The amount of the rebate varies with household income and the size of the property tax. The term "circuit-breaker" is used because a householder becomes eligible for the rebate when property taxes exceed a certain percentage of household income, just as the circuit breaks in an electrical system when an overload occurs.

For households in the $12,000-$19,999 income category, the circuit-breaker payment begins when taxes exceed 1½% of income. This percentage declines for incomes below $12,000 and increases for incomes above $19,999. For a homeowner, the maximum rebate may not exceed $800, including the benefit from the homestead credit, except that the maximum is $875 for elderly and disabled. If a non-elderly, non-disabled homeowner's property taxes have been reduced by the full amount of the homestead credit ($325) then that homeowner may receive a rebate from the state of up to $475. A household must have less than $23,000 income to be eligible for the maximum rebate. The rebate maximum declines as incomes rise from $23,000 to $36,000, at which point eligibility for circuit-breaker rebate ceases.

For a renter, the law assumes that 22% of rent constitutes property tax. A renter's maximum rebate is $475 ($675 if elderly or disabled).

One issue of controversy in circuit-breaker laws concerns the impact on the householder of the marginal changes in the property tax from year to year. In this respect, Minnesota's law is divided in two parts. Part 1: For certain combinations of income and property tax, the householder will receive a 100% rebate from the state for any increase he pays in property tax. Part 2: The householder receives a 35% rebate for any increase in property tax. The 100% rebate applies in the middle-lower levels of property tax. The 35% rebate applies in the higher levels.

The chart on page 26 attempts to illustrate the impact of the circuit-breaker for different levels of income and property tax. The chart shows the impact of the circuit-breaker on persons with different incomes and different property tax liability. It is possible using this chart to estimate the combined homestead and circuit breaker credit for every combination of income and gross property tax and to see the extent the state will be helping to pay the next dollar of increase in property tax.

If the total amount of the tax falls within Zone A on the accompanying chart, only the homestead credit applies, with the state paying 45% of each dollar. In Zone B the state is paying 100% of each dollar of property tax (the 1975 circuit-breaker provision), and in Zone C 35% (the 1977 circuit-breaker provision). In Zone D, the state pays nothing and every dollar of increase falls on the taxpayer.

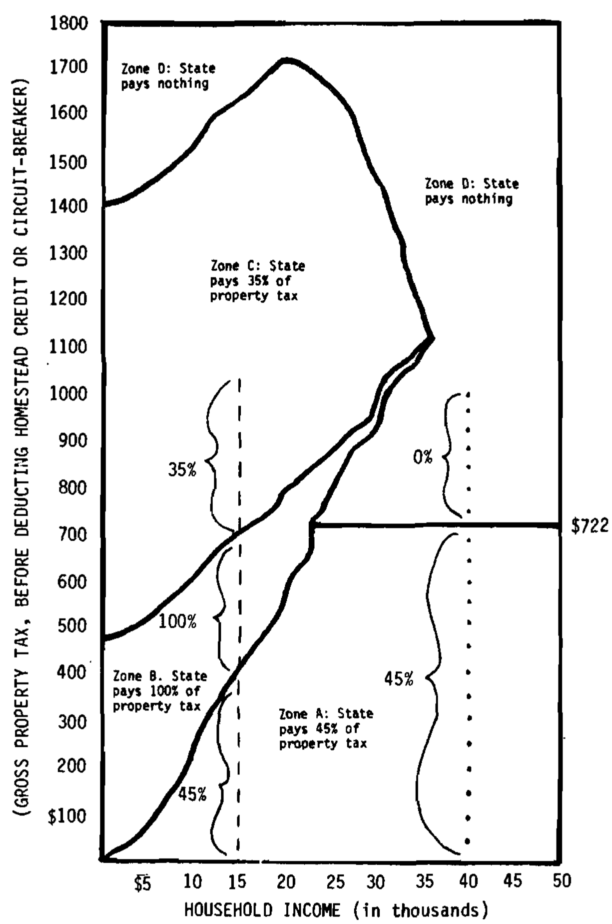
We have drawn two vertical lines on the chart to attempt to illustrate its impact. The first is a line of dashes at the $15,000 income level up to a gross tax of $1,000. For the first $400 of gross tax (until the taxpayer enters the free zone), the state pays 45%, or $180. From $400 to $700, the state pays the entire amount, or $300.

From $700 to $1,000, the state pays 35%, or $105. Thus, the total state credit is $585 ($180 + $300 + $105). If in coming years taxes for that household increase above $1,000, the state will pay 35¢ of each dollar of increase until the gross tax is slightly more than $1,600. Beyond that point, the taxpayer pays the entire amount of each dollar of increase.

For purposes of comparison we have drawn a dotted vertical line at the $40,000 income level up to $1,000 gross tax. At this income level, the taxpayer is ineligible for circuit-breaker credit.

Consequently, the state pays only the homestead credit, which is 45% of the first $722 of gross tax, or $325. Beyond this, the taxpayer pays the full amount. If in coming years taxes for this household increase above $1,000, the taxpayer will pay the full amount of each dollar of increase.

About 41% of the state's homeowners did not file for circuit-breaker credit in 1977, according to the Minnesota Department of Revenue. Department of Revenue records indicate about 972,000 homesteads, with 575,000 filing for circuit-breaker credit.



---- example of how $1,000 tax is paid if household income is $15,000

...... example of how $1,000 tax is paid if household income is $40,000

MUNICIPAL AIDS

The state's program of general aid to municipalities involves a two-step distribution process -- Since 1967 the state has been distributing general aid to municipalities. The current aid formula replaces a number of separate aid programs which had been added over the years. A municipality is guaranteed to receive its current entitlement under the formula or what it formerly received from the special aids, whichever is larger. The aid is tied to the levy limits under which the municipalities are covered. As state aid has been increased in recent years, the amount municipalities can levy from the property tax has been adjusted correspondingly.

In the two-step distribution process, the state first assigns a per capita share to the seven-county metropolitan area as one unit, and, separately, to each of the 80 counties outstate. For 1979, the share is $59 per capita.

Within the metropolitan area as one unit, and within each county outstate, the per capita amount is apportioned to municipalities according to a formula which assigns equal weight to two factors: (1) population and (2) mill rate, adjusted for differences in assessment practices. A municipality may use its 1970 population or an average of its 1970 and current population. The mill rate is an average of mill rates in the last three years, each adjusted for differences in assessment practices. In 1977 the Legislature modified the mill rate calculation for Minneapolis and St. Paul to reflect partially what mill rates would be if these cities were levying taxes at the maximum permitted by state law. Both now are below the maximum. The effect of that change is to give the two cities slightly higher shares than would be the case if their actual mill rates were used in the calculation.

The current formula is designed so that municipalities and townships share in the annual growth of the per capita amount. Counties are grandfathered in at amounts previously received, except that Hennepin, Ramsey and St. Louis County governments do not receive any aid. Removal of the three counties from even a grandfather share occurred at the same time the state took over a substantial welfare burden that had been heavier in these three counties than in other counties in the state.

SCHOOL AIDS

The state distributes aid to school districts on a pupil-unit basis -- The Legislature establishes each biennium a dollar amount per pupil unit which is intended to pay for the operating expenditures of the public schools. For the 1978-79 school year, the amount is $1,095. The state will pay to each district an amount equal to $1,095 per pupil-unit, minus the revenue which the district generates from a state-mandated mill rate. As was explained earlier, that mill rate, which is applied to a partially-equalized valuation, is 27 mills for taxes payable in 1979. The effect of this law is to remove local tax wealth as a factor in determining the number of dollars available to educate a child.

A key variable in determining the amount of aid a school district receives is the number of pupil-units. The number of pupil units is not the same as head-count enrollment. The Legislature has ordered several variations: (1) a kindergarten pupil counts one-half pupil unit, since kindergarten is held for half the day; (2) a pupil in grades 1-6 counts as 1 pupil unit; (3) a pupil in grades 7-12 counts as 1.4 pupil units. In addition, the state provides a minimum of one-half additional pupil unit for every pupil from an AFDC family, and, in school districts with a high concentration of AFDC pupils, an additional 1.1 pupil units is added for each AFDC pupil.

The pupil-unit factor is further adjusted for both growth and decline from previous years. If districts grow faster than 2% in pupil units from the previous year, an additional one-tenth pupil unit is given for each net increase in pupil units.

If districts are declining in pupil units, the aid is based on the average pupil units of the previous 3¼ years.

In addition to the major aid program outlined above, called "foundation aid," the Legislature has separate school aid programs for vocational-technical education, special education, transportation and community education. The vocational-technical and special education aid involves a percentage of salaries and equipment for these programs. The transportation aid pays for almost full cost, minus a required uniform local levy. For community education, districts which levy at least $1 per capita qualify for state aid of 50 cents per capita.

REGIONAL FINANCE

The state's role in financing regional services is expanding -- In the 1977-79 biennium, state grants to the Metropolitan Transit Commission (MTC) are about $33 million, which represents about 30 per cent of its revenues for the biennium. The property tax is about 23%; federal aid, 14%; and farebox and other earned income, 33%. Preliminary figures from the MTC indicate it will be seeking $45 million in state grants in the 1979-81 biennium, which would be about 33% of projected total revenues for that biennium of $137 million.

The state is heavily involved in financing the expense of acquiring and developing regional parks in the metropolitan area. In 1974 the Metropolitan Council was authorized to sell $40 million in bonds for regional parks. The original intent was that those bonds would be retired by a property tax levy in the metropolitan area. But in 1975 the state appropriated $20 million to the Council to finance principal and interest on regional park bonds. In addition, the Metropolitan Council receives $2 million annually from the Legislative Commission on Minnesota Resources to pay for debt retirement. In 1977 the state issued $61.5 million in state bonds for park and outdoor recreation purposes, of which $27.3 million was made available to the Metropolitan Council for acquisition and development in the metropolitan area. Because of the heavy state involvement, the actual levy within the metropolitan area for debt service for regional parks is only $603,000 in 1978.

Other proposals for increased state assistance are likely to be considered in 1979. The Metropolitan Parks and Open Space Commission may renew its request for state funds to pay for the expense of operation and maintenance of regional parks. The Metropolitan Council and perhaps other groups may seek state funds to pay for redevelopment of cities.

An exception to the growing state involvement in direct financing of regional functions is the special state-imposed on-sale liquor tax which is in effect only in the seven-county metropolitan area for the Metropolitan Sports Facilities Commission.

APPENDIX I

50 HIGHEST MUNICIPALITIES AND TOWNSHIPS IN THE STATE IN STATE AID PER CAPITA FOR 1979

City or Township	Aid/Capita 1979	Population	City or Township	Aid/Capita 1979	Population
Isanti	$220	727	Aitkin	$120	1815
Braham	185	744	Elysian	118	445
Staples (Wadena Co. portion)	168	98	Great Scott (town)	118	280
Bellingham	165	263	Cass Co. (unorg. ter.)	117	347
Leonidas	163	157	Cuyuna	117	118
Cass Lake	160	1317	Browns Valley	116	906
Hangaard (town)	160	21	Eagle Bend	115	557
McKinley	155	317	Mapleview	115	328
Calumet	155	460	Waverly	115	583
New York Mills	155	791	Clarissa	114	624
Bertha	153	512	Pennock	112	255
Nashwauk	153	1341	Dover	110	321
Marietta	144	264	Winsted	110	1451
Swanville	140	300	Keewatin	109	1424
Buhl	134	1303	Lakefield	109	1820
Greenbush	131	787	Chisholm	109	5999
Maynard	124	455	Badger	108	327
Bruno	126	130	Farwell	108	102
Ogilvie	126	362	Taconite	108	352
Nevis	125	308	Gilbert	108	2490
Sebeka	125	668	Parker (town)	107	72
Odessa	124	194	Mahnomen	107	1313
Milaca	122	1940	Beulah (town)	107	21
Viking	121	118	Foley	107	1388
Bovey	120	858	Breezy Point	106	233

SOURCE: Minnesota Department of Revenue

APPENDIX II

Between 1978 and 1979, the Legislature increased the total municipal aid package by $7 per capita, from $52 to $59. This amount is allocated to each county area in outstate Minnesota and to the Twin Cities metropolitan area as one unit.

After a reduction of amounts for units which are grandfathered at set amounts, the remaining dollars are apportioned among municipalities and townships on a basis which considers population and mill rate, adjusted for differences in assessment practices.

Within a given county area, the net impact can be a wide difference in the actual incremental growth in per capita aid attributable to a given municipality or township.

Following is a list of the municipalities which gained the most in per capita growth from 1978 to 1979.

31 HIGHEST MUNICIPALITIES IN PER CAPITA AID *GROWTH*, 1978-1979

Municipality	Population	Per Capita Aid Growth 1978-1979
Isanti	727	$131
Marietta	264	60
Lismore	323	57
Bena	169	51
Orr	315	47
Leonidas	157	46
Bruno	130	46
Cass Lake	1,317	46
Clearbrook	599	46
Cuyuna	118	45
Ironton	562	43
Badger	327	43
Lucan	271	42
Elysian	445	42
Greenbush	787	42
Maynard	455	41
Starbuck	1,172	41
Gary	265	41
Blackduck	645	40
Nevis	308	39
Zimmerman	668	39
Menahga	875	36
Mantorville	655	34
Henning	850	34
Graceville	735	34
Nashwauk	1,341	33
Walker	1,073	33
Kiester	681	31
Eagle Bend	557	31
Gonvick	344	30
Long Prairie	2,581	30

Of the highest 100 municipalities in per capita growth from 1978 to 1979, only one, Long Prairie, had a population in excess of 2,500.

The very high per capita gain in selected municipalities is exclusively an outstate phenomenon. The largest per capita gain in the metropolitan area is Minneapolis, $13, which is 251st.

It should be understood that a municipality with a very high per capita gain in one year is receiving its benefit only at the expense of other municipalities and townships in the same county. These high per capita gains do not change the fact that the total increase in per capita aids to each county area outstate and to the metropolitan area as a whole is $7 per capita.

Municipalities which are below 2,500 population are not governed by levy limits. Moreover, a municipality is guaranteed as much in one year as it received in the past year. Thus it would be possible for a small municipality to increase its mill rate substantially in one year, thereby capturing for itself a large amount of the per capita aid attributable to its county area. In the following year it could drop its mill rate and still be eligible, via the grandfather, for the higher amount received the previous year. Of course, this only is possible to the extent such a municipality follows a procedure which differs markedly from the practices of other municipalities in the same county. If other municipalities do the same, no change would occur.

APPENDIX III

1978 ATTACHED MACHINERY AID

CITY OR COUNTY	1978 ATTACHED MACHINERY AID	PER CAPITA
Wrenshall city	$23,729	$130
Taconite city	26,584	76
Rosemount city	334,390	74
International Falls city	471,878	73
Bovey city	47,493	55
Balkan Twp. (St. Louis County)	36,737	47
Grand Rapids	262,284	35
Cloquet	347,198	30
Koochiching County	528,750	30
Carlton County	457,466	16
Itasca County	510,514	14
St. Paul Park	74,870	13
Ramsey County	668,720	1.37
St. Paul	517,161	1.67
Hennepin County	424,558	.43
Minneapolis	302,591	.70

Fewer than 100 cities and counties in the state receive more than $10,000 in attached machinery aid in 1978.

SOURCE: Minnesota Department of Revenue

COMMITTEE ACTIVITY

COMMITTEE ASSIGNMENT

The Citizens League has had a keen interest in tax and finance issues over the years. We participated in the discussions which led to the major local government aid formulas in 1971. Among the recent reports we have done on these issues are:

"Reducing Property Tax Inequities Among Taxpayers and Cities," March 5, 1975, which proposed changes so that comparably-priced homes in Minnesota would not pay grossly unequal taxes for reasons beyond local discretion.

"State Fiscal 'Crises' Are Not Inevitable," June 26, 1972, which dealt with the need for better analysis of the long-term implications of present and proposed taxation and finance policies.

"New Formulas for Revenue Sharing in Minnesota," September 1, 1970, which called for major improvements in the state's formulas for distribution of non-property revenues to school districts and to cities.

"Breaking the Tyranny of the Local Property Tax," March 20, 1969, which dealt with local government problems arising from the distribution of property tax valuation in the Twin Cities area.

Having played an active role in the significant shift toward state financing for Minnesota's local governments, the League in 1977 felt a review of significant changes in local government finance over the past seven years would be appropriate. In June 1977 the Citizens League Board of Directors formulated the following charge for the study committee:

> *"The largest share of state appropriations is directed to the financing of cities, counties and school districts, either through aid formulas or through property tax relief payments to taxpayers. Over the last 10 years, several changes in the state-local fiscal system have occurred, including new formulas and more dollars of aid to schools and other local governments, homestead credit, circuit-breaker, tax-base sharing, tax-increment financing, levy limits, and changes in the assessment classification system. What, for example, is, or should be, the future of the property tax? How should localities and the state share responsibility for local government spending decisions? How does, or should, the state provide assistance to the financing of regional functions, such as open space and transit? The committee shall review current formulas for levy limits, state aid and property tax relief in terms of equity to units of government and taxpayers."*

COMMITTEE MEMBERSHIP

Seventy-five people initially signed up for the committee. A total of 25 persons participated actively in the deliberations. Committee co-chairmen were Lloyd L. Brandt, North Oaks, and William C. Johnson, Shoreview. Other active members were:

Dennis L. Alfton, Donald D. Anderson, Duane Bojack, Frances Boyden, Jim Bullock, Don Chemberlin, Wallace Dahl, Jean Heilman, Paul Hilstad, Richard Kiekow, Gene Knaff, Edward Knalson, Michael LaBrosse, Douglas LaChance, John Lilja, Van Mueller, John Myers, Tom Mulcahy, Arthur Naftalin, Richard D. Paulson, Kati Sasseville, Irma Sletten, and Steve Wellington.

The committee was assisted by Paul A. Gilje, Citizens League Associate Director, Margo Stark, Research Associate, and Paula Ballanger of the clerical staff.

COMMITTEE PROCEDURES

The committee met once each week from its first meeting, October 10, 1977, to its last meeting, October 16, 1978 -- a total of 46 meetings. All were 2¼-hour evening meetings, with the location alternating each week between Minneapolis and St. Paul. Detailed minutes of meetings were taken and distributed to non-members following committee activities, as well as members. A few extra copies of minutes are available on request.

Following is a list of resource persons who met with the committee:

Carol Alexander, Rosemount School Board
Kenneth Anderson, tax lawyer in Minneapolis
Robert O. Ashbach, state senator
Lyle Ask, director, property equalization division, Minnesota Revenue Department
Charles Backstrom, political science professor, University of Minnesota
Marcia Bennett, member, Metropolitan Council
Tom Berg, state representative
Francis M. Boddy, retired professor of economics, University of Minnesota
Allan Boyce, Citizens League board member and chairman of the 1975 Citizens League report, "Reducing Property Tax Inequities Among Taxpayers and Cities"
John Brandl, state representative
Richard Broeker, executive assistant to the mayor, St. Paul
Gerald Christenson, commissioner, Minnesota Department of Finance
Lorry Clugg, Hopkins School Board and vice chairman, Metropolitan Association of School Districts
Larry Cohen, member, Metropolitan Airports Commission
Nicholas Coleman, state senator
John Derus, chairman, Hennepin County Board of Commissioners
Robert Ehlers, local government department, Ehlers and Associates
Dennis Erno, assistant to the commissioner, Minneapolis Department of Revenue
Carol Flynn, member, Metropolitan Waste Control Commission
Ed Foster, professor of economics, University of Minnesota
Tom Fulton, State Planning Agency study on Minneapolis/St. Paul and municipal finance
Joe Graba, deputy commissioner, State Department of Education
Larry Harris, special assistant to the superintendent for school-community relations, Minneapolis Schools
Dave Hozza, council member of the City of St. Paul

Dennis Hron, commissioner, Scott County
LeRoy Johnson, commissioner, Anoka County
William Kelly, chairman, Minnesota House Tax Committee
Doug Kelm, chairman, Metropolitan Transit Commission
Stan Kehl, legislative liaison, City of Minneapolis
Eugene Knaff, economist, Metropolitan Council
Harvey Lange, Mayor of Robbinsdale
Carol Lind, chairman, Minneapolis School Board
Jim McComb, McComb and Associates, study of expenditures and community characteristics of Minneapolis/St. Paul and 18 suburbs
Bill McCutcheon, state senator, chairman, Senate Committee on Taxes and Tax Laws
Ralph McGinley, executive secretary, Anoka County
Peter Meintsma, mayor, City of Crystal
Michael Munson, research program manager, Metropolitan Council
Lloyd Neilsen, superintendent, Roseville Schools
Lyle Olson, director of staff services, City of Bloomington
Robert Orth, commissioner, Ramsey County
John Ostrem, administrative assistant for legislative affairs, Department of Education
Roger Peterson, League of Minnesota Cities and mayor of Cottage Grove
Robert Piram, member, Metropolitan Parks and Open Space Commission
Ron Rainey, Office of the Lieutenant Governor, former executive secretary, Minnesota Tax Study Commission
Jim Solem, State Planning Agency Study on Minneapolis/St. Paul and municipal finance
Chuck Weaver, Metropolitan Council member, author of fiscal disparities legislation
Jerry Weiszhaar, Hennepin County

ACTION BY THE BOARD

The Board met twice to consider the committee's report. The only major change in the committee's report made by the Board concerns treatment of tax-exempt property. The committee's recommendation called specifically for the Legislature to pay localities for exempt property within their borders. The committee suggested a possible way this could be carried out: A portion of the dollars already allocated for municipalities could be distributed on the basis of exempt property. The allocation could be determined by assigning the average land value in a municipality to the exempt acreage. The committee suggested that the Legislature consider limiting the use of exempt property as a basis for aid distribution to high mill rate areas, where some additional assistance might be needed.

In addition to legislative payment based on exempt properties, the committee recommended that the Legislature consider whether exempt properties should pay some fee in lieu of taxes for the municipal services they receive, such as police and fire. Three committee members dissented from this recommendation, which, along with the above recommendation, was deleted from the committee report. The recommendation which does remain simply calls for the 1979 Legislature to direct that data be compiled on the acreage and value of exempt properties, and then to consider alternatives for making this wealth available to municipalities. It is a more general recommendation than that recommended by the committee, the Board having felt that the committee's findings and conclusions did not support a more specific recommendation.

This report is unusual for the Citizens League, in that it incorporates recommendations from many earlier League reports which are germane to the subject of local government authority and accountability. The study committee called the Board's attention to the Citizens League reports which were of relevance, without itself endorsing those reports. However, those earlier reports remain as much a part of League policy positions as the report now being issued. The earlier recommendations are an inherent part of a program for local government accountability, which must accompany the local authority for decisions on revenues and expenditures recommended in this report.

DISSENTING OPINION OF COMMITTEE MEMBERS

Minority Report on the Fiscal Disparity Law

The report of the committee on State-Local Fiscal Relationships as submitted, condones the existence and continued operation of the so called "Fiscal Disparity" legislation as passed by the 1971 Minnesota Legislature. The proper title of the law is the "Metropolitan Revenue Distribution" law.

The undersigned dissents with the position that the "Fiscal Disparity" law should continue and be a part of the Minnesota taxing system for the following reasons.

1. Municipalities and school districts with low assessed valuations per pupil unit or per capita unit plus being in a low earning area can lose assessed valuations whereby municipalities and school districts with high valuations per pupil unit and a high earning capacity per capita can receive a higher portion of the assessed valuation, thereby discriminating against a governance unit with lower per unit valuations.

   Example 1: Let's take the City of Fridley first. Their original assessed valuation for 1978 was $152,553,962. After their contribution and the redistribution their valuation was reduced to $146,282,224 or a loss of $6,271,738.

   Example 2: Let's take Spring Lake Park School District 16 in Anoka County. Before the application of the Fiscal Disparity Law their assessed valuation was $78,189,883. After the application of the law it was $73,157,865, a loss of $4,932,018 for the year 1978.

   Example 3: The School District of Bloomington #271 before application of the law in 1977 had a valuation of $445,382,371. After the application of law it was $432,325,959 or a loss of $13,056,412.

   Example 4: Minneapolis School District has an EARC valuation per pupil unit of $25,845 in 1976 compared to the Spring Lake Park District 16 of $12,749 per pupil unit, yet District 16 lost in 1978 $4,932,018 in valuation compared to Minneapolis' gain of $35,000,000. Minneapolis didn't put any funds into the "Jackpot" in 1978.

2. Some municipalities and school districts with a high per pupil valuation do not contribute into the "Jackpot" at all. Minneapolis is an example. It is possible that it may have to contribute this year. As a result they are going to sue so the city may pay a smaller amount. This is not fair. Over the years they took all they could get, now they refuse to pay their share. What is good for the gander is not good for the goose.

3. The so called law "compounds" itself over the years. If for example, the Bloomington school district lost $13,000,000 in 1978, $12,000,000 in 1977, $11,000,000 in 1976 and $10,000,000 in 1975. It would make a total loss in assessed valuation for the district of Bloomington of $45,000,000. Applying this to a district that is calling for a referendum to increase their monies for school operation it would mean a decrease in mills to raise the same amount of money if they could have kept their original valuation.

4. This discrimination causes an anti-downtown attitude.

5. It exploits regionalism more than ever.

6. It does not do what the law intended to do:
   a. It does not stop competition between municipalities for industries.
   b. Does not equalize the tax ratio. This is influenced by too many other factors, as assessing. The manner in which the school district or city is managed, or the amount of service demanded or needed.

7. This law does not provide for efficiency in government. Example: Minneapolis has about 13 public employees per 1,000 residents, whereas most suburbs have about 4 public employees per 1,000 residents.

8. It does increase the mill levy in communities where the contribution is greater than the distribution.

9. If a city has created a condition that allows a lower tax rate on its original assessed valuation, it should not be the chore of the state legislature to increase the tax rate by decreasing its valuation to help out some other community. The local citizens didn't even have a voice in the increase. It is an erosion of local autonomy.

10. Since the state is moving toward a greater use of income tax for services, this law is becoming somewhat obsolete.

Edward H. Knalson

<u>Minority Report on Minnesota's Relative Reliance on Sales Vs. Income Tax Revenue</u>

Finding -- In 1977 Minnesota ranked 22nd in the nation in its use of property tax per $1,000 of personal income; 36th in use of the sales tax; 4th in use of personal income tax; and 3rd in use of the corporate income tax, according to preliminary estimates.

Conclusion -- These rankings indicate an apparently obvious overreliance on the income tax and underreliance on the sales tax as sources of state and local government revenue.

Recommendation -- The legislature should regularly study the "balance" among tax sources and make appropriate adjustments, giving particular emphasis immediately to increased reliance on the sales tax.

John B. Lilja

Dissent With Respect to Report's Reference to Earlier Citizens League Report Recommending a Uniform Election Day for Local Governments

I do not want to be associated with this report's reference to an earlier Citizens League recommendation that a uniform election day for school, county board and municipal elections be established.

Don N. Chemberlin

THE CITIZENS LEAGUE

. . . Formed in 1952, is an independent, nonpartisan, non-profit, educational corporation dedicated to improving local government and to providing leadership in solving the complex problems of our metropolitan area.

Volunteer research committees of the CITIZENS LEAGUE develop recommendations for solutions to public problems after months of intensive work.

Over the years, the League's research reports have been among the most helpful and reliable sources of information for governmental and civic leaders, and others concerned with the problems of our area.

The League is supported by membership dues of individual members and membership contributions from businesses, foundations, and other organizations throughout the metropolitan area.

You are invited to join the League or, if already a member, invite a friend to join. An application blank is provided for your convenience on the reverse side.

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Study Committees

- -- 6 major studies are in progress regularly.
- -- Additional studies will begin soon.
- -- Each committee works 2½ hours per week, normally for 6-10 months.
- -- Annually over 250 resource persons make presentations to an average of 25 members per session.
- -- A fulltime professional staff of 7 provides direct committee assistance.
- -- An average in excess of 100 persons follow committee hearings with summary minutes prepared by staff.
- -- Full reports (normally 40-75 pages) are distributed to 1,000-3,000 persons, in addition to 3,000 summaries provided through the CL NEWS.

Citizens League NEWS

- -- 6 pages; published twice monthly, except once a month in June, July, August and December; mailed to all members.
- -- Reports activities of the League, meetings, publications, studies in progress, pending appointments.
- -- Analysis, data and general background information on public affairs issues in the Twin Cities metropolitan area.

Public Affairs

- -- Members of League study committees have been called on frequently to pursue the work further with governmental or non-governmental agencies.

Community Leadership Breakfasts

- -- Held from September through June - 7:30-8:30 a.m.
- -- Minneapolis breakfasts are held each Tuesday at the Grain Exchange Cafeteria.
- -- St. Paul breakfasts are held on alternate Thursdays at the Pilot House Restaurant in the First National Bank Building.
- -- Suburban breakfasts are held the last Friday of each month at the Northwest Financial Center Cafeteria, Bloomington.
- -- An average of 35 persons attend the 64 breakfasts each year.
- -- The breakfast programs attract good news coverage in the daily press, television and radio.

Question-and-Answer Luncheons

- -- Feature national or local authorities, who respond to questions from a panel on key public policy issues.
- -- Each year several Q & A luncheons are held throughout the metropolitan area.

Public Affairs Directory

- -- A directory is prepared following even-year general elections, and distributed to the membership.

Information Assistance

- -- The League responds to many requests for information and provides speakers to community groups on topics studied.

Citizens League non-partisan public affairs research and education in the St. Paul-Minneapolis metropolitan area. **84 S. 6th St., Minneapolis, Mn. 55402 (612) 338-0791**

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