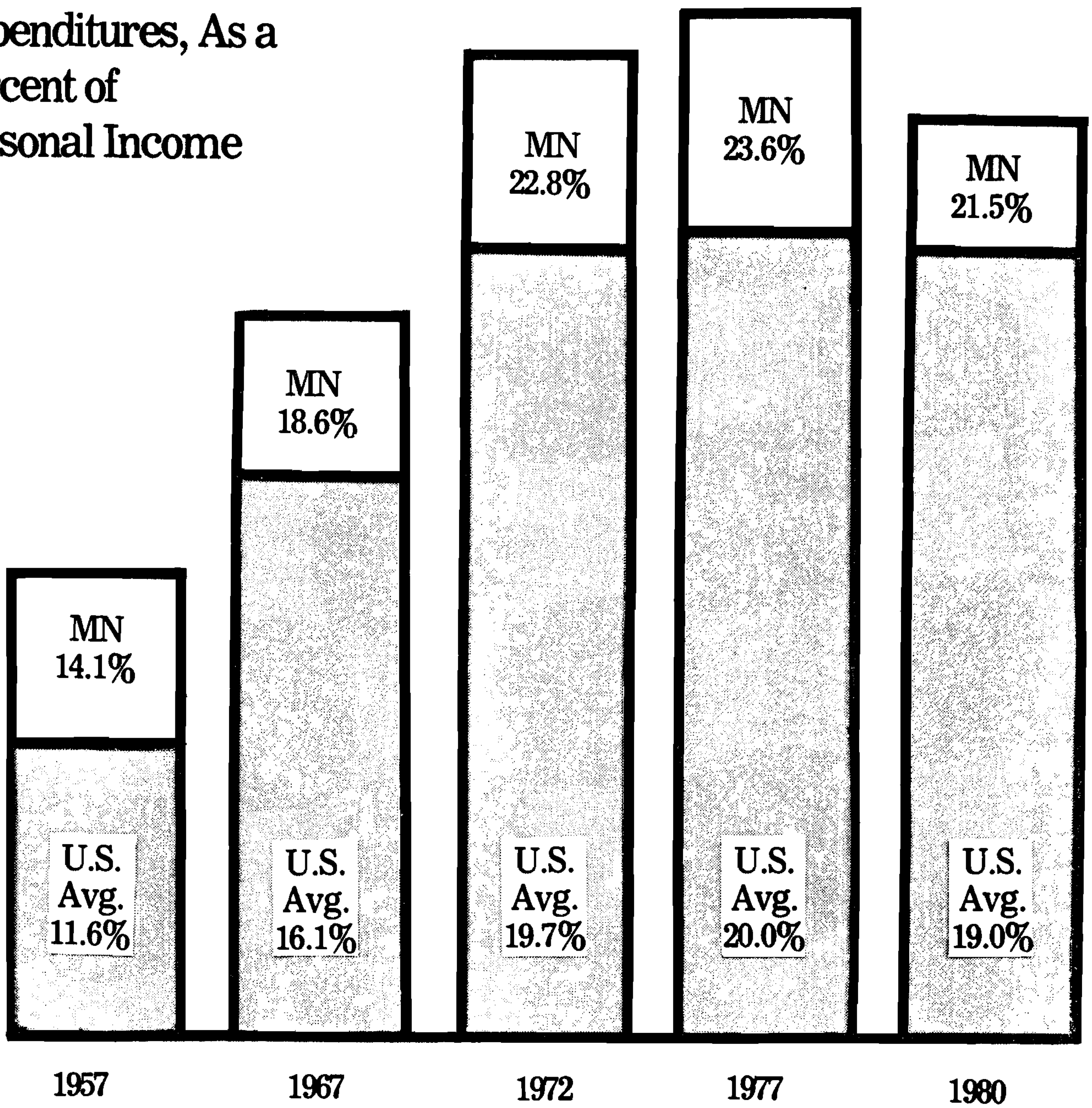
Citizens League Report

Thought Before Action: Understanding and Reforming Minnesota's Fiscal System

Total State-Local Direct General Expenditures, As a Percent of Personal Income



CITIZENS LEAGUE REPORT

THOUGHT BEFORE ACTION:

Understanding and Reforming Minnesota's Fiscal System

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MAJOR IDEAS IN OUR REPORT

I. A central element of our research was to find out how Minnesota compared to other states, both in taxes and spending. We discovered two main things: First, Minnesotans pay more in taxes than citizens in most states, but not that much more and certainly not the most. Moreover, the trend is that taxation levels throughout the country seem to be drawing together, meaning the difference between what Minnesotans pay and what people pay elsewhere is growing smaller, not larger.

Second, we discovered a broad pattern of extensive delivery of government services. State-local government in Minnesota spends more–but again not the most–in the major areas of public service: education, health-welfare, and highways. There are specific reasons which account for some of the higher level of spending in these areas, but questions remain about the effectiveness of the spending. We found out that Minnesotans spend more time in schools and nursing homes, for example, but that does not automatically insure people are better educated or better cared for. Certainly, we were not able to establish a casual relationship between the higher spending and any presumed outcome.

This led us to conclude that there is a greater need for understanding about public spending–what it goes for and greater need for evaluation of how effective spending is. Minnesotans have historically supported public services, whether in education, health, or roads. If the public knew spending was achieving specific, verifiable results, we felt it would be likely they would be willing to pay for public services. If the results of public spending cannot be demonstrated, it is difficult to understand why people should put up with a higher level of taxation.

II. This leads directly to a second major point: the need for substantial change in the state-local fiscal system so that it will be more policy responsive and so that people will understand it better. Minnesotans do not know to any great degree how the current system functions, since it is so complicated and intertwined. In the following pages, a reader will learn about how it works, and how fiscal transfers occur between levels of government, and the overlapping levels of decision making.

This convoluted system has grown up over the years in response to real needs and pressures. Public officials did not set out to create a system which is nearly impossible to comprehend. As it now stands, however, the system is too complicated to allow adequate comprehension or accountability. It allows public officials to avoid responsibility for their actions, and to seek indirect, backdoor solutions to problems, not simple and direct ones. The complexity adds significant administrative costs, as well as undermining accountability and understanding.

Against this backdrop, we felt a substantial reform is needed.

III. That having been said, it needs to be understood that we do not favor a return to the type of simple system which used to exist when government relied heavily on the local property tax. The state should maintain its central role as collector of sales and income taxes. Local governments should retain their responsibility to administer programs and, for example, make choices about the type of education children receive, which streets should be repaired first and how many policemen to hire.

What is needed is a simpler, clearer delineation of taxing and spending authority, one that retains the progressive elements of centrally collected sales and income taxes, but also creates incentives to control spending by making local units face the political consequences of spending decisions.

Central to any rational reform is a change in the property tax system. We have focused on this element of the system because a lot of the distressing elements surround this tax. (This is not surprising if one considers the history of the system. For two decades, Minnesota has been moving away from over-reliance on property taxes. As a result, each biennium new wrinkles have been added to its administration to make it conform to new policy direction. After many years, it has become a mass of ad hoc measures heaped upon each other.)

A reader will find out more within about what we have in mind in this area. Suffice it to say here that what is needed is a property tax which does not allow the significant portion of society's wealth represented by homes, farms, and businesses to escape taxation, but which also does not unfairly burden those property holders with low incomes.

IV. The right role for the property tax is but one element in the overall tax system, and it is our view that the tax system must be viewed as a whole, as a *system*. To say the property tax—or any other tax—is regressive is an oversimplification if the tax's administration is not considered, as well as the role of the individual tax as part of the overall system. Minnesota's property tax, with the effects of the various property tax relief measures and the classification system taken into account, results in a system which taxes higher-priced homes at a higher rate than lower-valued homes, and taxes businesses significantly more than homes or farms.

The effect of the *overall* tax system—including sales, income, property taxes and user fees—is what should be measured when judging how fairly Minnesota's tax burden is apportioned. Measuring the effect of only one tax is looking at less than the whole picture.

V. Because it is not an easy task to understand the interplay of all of the elements of the state-local fiscal system, we have recommended that a major, formal study be undertaken, along the lines of the J. Cameron Thomson study of the mid-1950s, to deal with problems in the present system. Right now, much of tax policy is based on assumptions, and not verifiable facts. There are many unresolved questions about tax incidence in general, and many more unresolved issues in the Minnesota state-local system.

To call for a sweeping change in the internal mechanisms of transfer between state government and the local units without rationally analyzing and discussing the system would be folly.

We know the Legislature and Governor in 1983 will pass a major budget bill, a bill which may even contain major revisions of the state-local system, along the quadrennial pattern which can be counted back through 1979 (indexing), 1975 (expansion of property tax relief), 1971 (state takeover of substantial financial responsibility for schools and other local units), and 1967 (the sales tax).

Whether or not another major reform passes, setting in motion now a mechanism to understand and analyze the effects of the tax and spending system is imperative. Such action should have been taken in 1979. We do not think the state-local system will get out of its current crisis-to-crisis bind without some changes in the process of decision making which will allow more consideration of the overall effects of the system.

Although it may seem that we are recommending the automatic solution to any complicated problem—appoint a committee to study it—we hope a thoughtful understanding of the scale of the issues at hand will lead to the position we hold, which is that constant monitoring and evaluation are needed by some body other than a Legislature which meets for a few months each year.

INTRODUCTION

When this committee began its work in studying taxing and spending practices in Minnesota and other states, it first sought to understand how things work here and then moved to compare our system with practices elsewhere.

The first thing we realized—and this point is stated frequently in the report—is that the state and local levels of government are totally intermixed, in finances and function. They can barely be separated and should be considered together as one unit, not as separate entities. This point can be clearly understood in considering a state-to-state comparison of property tax levels. Minnesota does not levy a property tax at the state level. Some states do. To compare *just* the state's taxation of property or sales or income would reveal little. State and local taxation must be studied in tandem since both levels may levy the tax. The same goes with any comparison of expenditures, since different states are likely to use different levels of government to perform any given function.

In making comparisons and understanding our system we followed several other guidelines. We found that taxing and spending data are commonly reported in three forms: raw dollars, collections per capita, and collections per $1,000 of personal income. Clearly, the raw dollars figure is not too useful. There are advantages and disadvantages to the use of the other figures as well.

In comparing taxes, we more frequently use the per $1,000 of personal income figure. Several of our resource persons suggested it is the more relevant measure, mainly because taxes are levied on income, wealth, and sales, not on a per capita basis. The larger an economy, the more tax revenue it can support. In comparing Minnesota to a poorer or richer state, to consider simply per capita collections might be as misleading as comparing total collections here to total collections in a less populated state. In all of these comparisons we felt it is best to consider several measures and pick the appropriate one which best fits the comparison being made.

We use the per capita figure more frequently when comparing spending because spending goes to people. It is helpful in understanding what a citizen is "buying" from state-local government. We know, for example, that each person in Minnesota paid an average $219 for highways in 1980. Most people have a good idea of what $219 will buy, and therefore can roughly gauge whether or not they have made a good deal on their "purchase" of highways and roads. To look at highway spending per $1,000 of personal income is less revealing, on this level.

Another important factor to keep in mind is the picture over a multi-year period. Governmental budget periods do not match among states. Some states have a biennial budget, others annual, and with different fiscal years. A figure for any one reporting period might be distorted or unrepresentative. Tax collections for a year may represent, say, the effects of a tax rate increase in the second half of the year.

So, rather than trying to choose a sample year and make comparisons, we looked at the shifting picture over several years.

The relevant measure is the tax level over a multi-year period. Not only might a one-year comparison be misleading by itself, but it would not consider the pattern. The trend of a given tax or expenditure is just as important, in many cases, as the level itself.

If Minnesota's total taxes were high, but other states catching up, that might be of less concern than if we were average, but pulling rapidly away from the pack. Knowing which expenditures are rising and which are falling is just as important as knowing their relative share of total spending.

Most of the data which we used in making comparisons came, one way or another, from the U.S. Government's Department of Commerce. We looked at reports from several other groups—notably the Advisory Commission on Intergovernmental Relations, a group which does a great deal of analysis of practices in different states—but most of the data could be traced back to the Department of Commerce. In a few cases, the manner in which the Department of Commerce categorizes taxing and spending is open to question, as in the example contained in the report on circuit breaker payments to the elderly. Nonetheless, the department is at least consistent, and is the source of the information used by virtually everyone in making comparisons.

A reader should be careful in reading this report, because there are figures from many years mixed in. Reports from varying years were included in an effort to use the most up-to-date figures whenever possible. While we were forced to work, in some cases, with data which was not as current as we would have liked, we have seen no evidence to make us fear that the overall analysis and understanding we have gained is flawed by the age of the statistics.

BACKGROUND

Readers of this report will find many references to features of the Minnesota property tax system. This section is intended to build familiarity with the system. It does not include a discussion of several features of the system, including the fiscal disparities law, tax increment financing, rent capitalization (discussed in an appendix to the report), sales ratios, the system of taxation for mobile homes, and the "targeting" property tax relief program.

DETERMINING THE TAXABLE VALUE OF A PIECE OF PROPERTY.

The first step in the process is determining the value of any given parcel of property for tax purposes.

1. The assessor assigns a value to each parcel of land in the community. The value is supposed to represent, in most cases, the price a willing buyer would pay a willing seller in an arms-length transaction.[1] The value of the property on January 2 is used for determining the taxes in the following year. For example, the value of the property on January 2, 1982 will be used to determine taxes payable in 1983.

2. Any person who thinks the value of his property is lower than the value picked by the assessor can challenge the value in city or county boards of review. The Commissioner of Revenue also hears appeals, and anyone still unsatisfied can bring the matter to the Tax Court.

3. The value of the property assigned by the assessor is called "estimated market value." The estimated market value is then modified by the classification system determined by the state Legislature to arrive at the taxable value for the property.[2] There are more than thirty separate classifications, shown on the chart on the next page.

No piece of property has its market value equal its taxable value, with the highest rate paid by iron ore property at 50 percent, as shown in the table.

DETERMINING THE LEVY AGAINST EACH PARCEL OF PROPERTY.

Now we have determined the taxable value of a piece of property in the community. How is the property tax levied on this parcel determined?

1. Each taxing district determines how much it will levy in dollars (as opposed to mill rate) for the tax year. The main taxing districts in most communities are the school district, the county, and the city or township. Special taxing districts include watershed districts, regional rail authorities, metropolitan agencies, and other units.

For the moment, let's stick to the city. The city council determines a budget for the year, and estimates revenues from different sources. Property taxes make up just one portion of the city's revenue stream. The amount of money the city can raise through the property tax is limited by the state through levy limits. Through that law, the city can increase its dollar property tax levy (not the rate) by a certain percentage each year, taking into account property valuation increases. The state also regulates county levies, township levies, and school district levies, with a substantially different system of levy limits for schools.

2. The city council then informs the county auditor (the office that actually administers the property tax collections) of the tax levy for the year. The city council stipulates it will levy a certain number of dollars, which is apportioned evenly on all taxable property in the city, with a certain amount of money to be raised from each dollar of taxable value. This figure is arrived at by dividing the total levy by the total taxable value.

The county auditor expresses this levy in mills. Mills are simply a different way of expressing percentages. One mill is one thousandth, or .1 percent. Ten mills is the same as one percent. So, if a city council levied 20 mills against all property in the district, it is the same as two percent of all taxable value in the city.

3. Since the city, the county, the school district, and other taxing districts are all levying taxes on any given parcel

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[1] An exception to this is the aforementioned rent capitalization feature, discussed in Appendix Three.

[2] The technical term for taxable value is "assessed value," even though the value assigned to a parcel of property by the assessor is called the estimated market value. There is an additional more technical meaning for "taxable value" used by county auditors in relating assessed value to the value available for taxation after taking into account the fiscal disparities law, but we will not use the term in this meaning.

REAL PROPERTY

Class	Description	Percent of Market Value
1	Unmined Iron Ore	50%
1a	"Low Recovery" Iron Ore	30 to 48½%
1b	Severed mineral interests tax	*
3	Agricultural non-homestead	19%
3	Seasonal residential for recreational purposes:	
	a. Commercial, but not used for more than 200 days per year (example: resort). See also Class 3b below.	21%
	b. Non-commercial (example: cabin)	21%
3	Tools, implements and machinery of an electric generating, transmission or distribution system or a pipeline system transporting or distributing water, gas or petroleum products which are fixtures to real property	33-1/3%
3a	Commercial seasonal recreational residential not used for more than 200 days per year which includes a portion used as a homestead by the owner	12%
3b	Agricultural homestead	
	1st $50,000 market value	14%
	Excess of market value over $50,000	19%
3c	All other homestead**	
	1st $27,000 market value	16%
	2nd $27,000 market value	22%
	Excess of market value over $50,000	28%
3cc	Paraplegic veterans, homesteads of blind and permanently and totally disabled persons	
	1st $33,000 market value***	5%
	$33,000 to $50,000 market value: agricultural	14%
	Excess of market value over $50,000: agricultural	19%
	$33,000 to $50,000 market value: all other	22%
	Excess of market value over $50,000: all other	28%
3d	Non-homestead residential	
	a. Apartments with four or more units that do not qualify as Title II National Housing	38%
	b. Land of Title II National Housing	38%
3dd	Non-homestead residential one, two or three units	28%
3e	Timberland	19%

REAL PROPERTY

Class	Description	Percent of Market Value
4	All other real property (examples: a. Commercial, including parking ramps, industrial including petroleum refineries and public utility land and buildings	43%
	b. Vacant land	40%
None	Type I and II Apartments	
	Five or more stories (structures only)	25%
	Four or less stories (structures only)	33-1/3%
None	Housing for elderly or for low and moderate income families financed by direct federal loan or federally insured loan pursuant to Title II of the National Housing Act or the Minnesota Housing Act. Structures only.***	20%
None	Housing for elderly or for low and moderate income families financed by a direct loan or insured loan from the Farmer's Home Administration and is located in a municipality under 10,000 population. Structures only.***	5%

* $ .25 per acre annually (tax effective January 1, 1975). Each parcel is subject to minimum annual tax of $2.00.

** Townhouse property is classified and valued as all other homestead real estate. Value is added for each unit's share of the development's common areas.

*** The assessed value resulting from this classification is used to determine a property tax credit (reduced assessment credit) extended to this type of property. The regular classification that applies for this property is used to determine the assessed value which is used for mill rate and tax extension purposes.

of land, the county auditor adds up all the levies on each parcel, and figures out the bill. To visualize how this works, imagine a giant overlay map of the county. The city will tax only a part of the area in the county, as will the school district and the other taxing districts. Each taxing unit has different boundaries, so a series of "map overlays" are dropped on the whole area, and each parcel is taxed by each taxing district.

For a house in the city of Saint Paul in 1982, for example, the following taxes were levied: city, 26.561 mills; county, 27.319 mills; school district, 45.697 mills; Metropolitan Council, .492 mills; Metropolitan Transit Commission, 2.863 mills; Mosquito Control District, .242 mills; Minnehaha Creek Watershed District, .109 mills; Port Authority, 1.202 mills; and Saint Paul Housing and Redevelopment Authority, .536 mills. The total for all districts was 105.021 mills.

4. So, a house which the assessor said was worth $75,000 in market value would have a taxable value of $16,140[3] which would be multiplied times the mill rate of 105.021 (about ten percent) to have a tax bill of $1,695. (This is not the actual net tax which the homeowner must pay, though. The state pays part of the bill, as we will discuss in the next section.)

Each parcel of property pays a total bill which represents the sum of levies against the property. This money is then divided up among the taxing units.

DETERMINING THE LIABILITY OF EACH PROPERTY HOLDER.

State government has established a series of measures to help individual property taxpayers to pay part of their bill. Different mechanisms are in place to pay part of the bills of different groups of taxpayers. We will discuss some of the major mechanisms here.

1. The homestead credit commits the state to paying 58 percent of a homeowner's property tax bill, with the maximum credit fixed at $650. Under the example given above, the state would pay the full $650 credit, reducing the homeowner's tax liability from $1,696 to $1,046. (There is an additional property tax relief program which is tied to income and age, known as the circuit breaker. We will discuss this later.) The homestead credit is the largest of the state programs under which the state pays a portion of the bill for taxes on a parcel of property.

2. The second largest credit—in terms of dollars paid out by the state—is the agricultural aid credit. This credit is limited to agricultural, non-commercial seasonal recreational residential, and timberland property. Credit for agricultural homestead property is equal to the sum of 18 mills times the taxable value of the first 320 acres, 10 mills times the taxable value of the next 320 acres, and 8 mills times the taxable value over 640 acres. Credit for non-homestead agricultural property is the sum of 10 mills times the taxable value of the first 320 acres plus 8 mills times the taxable value over 320 acres. Credit for timberland property equal 8 mills times the taxable value of qualifying property. Credit for non-commercial seasonal recreational residential property equals 10 mills times the assessed value of the qualifying property.

3. Other credits are the wetland, native prairie, and reduced assessment credit. These credits work in similar fashion to the homestead and agricultural credits, and commit the state government to paying a certain portion of the property tax bill for certain parcels of land.

Through this system of credits, the state acts to reduce the net tax on certain property owners. The use of the credit system in effect substitutes the state for the local taxpayer in determining tax liability for a portion of the bill.

REBATES TO TAXPAYERS FOR CERTAIN PROPERTY TAXES PAID.

We have seen the state acts to pay part of the tax levied on a certain parcel of property through the various credits. In these cases, the state actually receives a portion of the bill, as if it were a property owner. The state also commits itself to pay an additional part of the property tax bill through a rebate system.

1. The circuit breaker payment is a rebate which the state will pay to a homeowner who made less than $36,000 or who is over 65 years of age.

Under this program, qualifying individuals file for a rebate of a portion of taxes paid based on a sliding scale which takes into account property taxes paid and income. The maximum rebate is $1,000, with the homestead credit deducted from the credit due.

Under our example of the house in Saint Paul, a homeowner could receive no more than $350, since the homeowner had

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[3] If the market value is $75,000, why is the taxable value only $16,140? Remember the classification system. For urban residential property, the first $27,000 of valuation is classified at 16 percent, the second $27,000 of value at 22 percent, and the rest at 28 percent. So, the equation is 16 percent times $27,000 or $4,320; 22 percent times $27,000, or $5,940; and 28 percent times the balance of $21,000, or $5,880, for a total of $16,140.

already received the maximum homestead credit of $650. This would have reduced the total property tax paid by the homeowner from a gross tax of $1,696 to $696.

* * * * * *

Most people carry around with them the image of a layered government: each level providing certain services, supported by taxes levied by that level of government. Many years ago, this was basically the case. State and local government depended heavily on the property tax, and most of the functions were fairly well divided between levels of government. Since the end of the Second World War, most states have imposed sales and income taxes. Minnesota was early with the imposition of the income tax, coming in 1933, and later with the sales tax, which was imposed in 1967.

In the past 25 years, major shifts have occurred in Minnesota's tax and spending system. One major change has been to move from the property tax. That tax source is still a major source of revenue for local government, but not the central revenue raiser it once was. By policy, Minnesota has increased its reliance on income taxes, and at the same time federal assistance has become a major factor.

The state itself is not now a primary deliverer of services. The state acts as a central tax collector and passes much of the money along to local government which does the actual spending. At least two-thirds and as much as three-quarters of the state's budget can be viewed as transfers to local units or individuals.

There are many mechanisms which the state uses to accomplish this massive transfer of money, which totalled $2.4 billion in 1980, out of a state general fund of $3.6 billion. The state pays direct aids to cities, counties, and school districts, which are then available to those units for spending, lessening the need to levy property taxes. In 1980, local government and school aids totalled about $1.5 billion.

Besides direct aids the state paid out $424 million in property tax credits discussed in preceeding paragraphs. These credits represent payments made to local governments on behalf of local property taxpayers. The largest credit is the homestead credit, under which the state commits itself to pay 58 percent of a homeowner's property tax bill, up to a maximum of $650. Other credits are the agricultural, wetlands, native prairie, reduced assessment, powerline, and taconite credits.

Senior citizens, renters, and others received an additional $219 million through the circuit breaker and rent credit mechanisms to reduce their burdens. These payments go directly to individuals, unlike the other assistance, which is paid to local governments.

The result is the following breakdown of revenues for local units in Minnesota in 1980 shown on the chart below.

One feature of the property tax system is that Minnesota, a high tax state, has a relatively low tax rate on many properties, and also has a system in which higher-priced homes pay at a higher effective rate. The effective rate of taxation on a median-priced home (*not* on business property) in the state is less than one percent of valuation. The percentage of valuation which is paid in property taxes rises as the value of

PERCENT OF TOTAL REVENUES FOR MINNESOTA LOCAL UNITS OF GOVERNMENT, 1980

	State Aid	Taxes	Fees[1]	Other[2]
Counties	49.2	30.5	4.0	16.3
Cities	29.0	21.1	20.6	29.3
School Districts	53.7	27.3	---	19.0

[1] Includes special assessments.

[2] Includes federal aid. This year's Auditor's reports did not contain a breakdown for state versus federal aid for the counties, so the figures represent an extrapolation from the previous year.

SOURCE: Report of the State Auditor, Revenues, Expenditures, and Debt of the Local Governments in Minnesota for the fiscal years ended during the period July 1, 1980 to June 30, 1981.

the home rises, but few homes pay more than two percent of their market value in taxes. By way of comparison, Massachusetts' recent property tax limitation measure holds property taxes there to a maximum of 2.5 percent of value.

The state itself no longer levies a property tax. It does, however, stipulate the levy of 26 mills to finance local schools' operation and transportation budgets. The money is not counted as a state property tax because it flows directly to the local school districts. It does have the effect of leveling out property taxes across the state, since the 26 mills is levied on just about all parcels of property in the state.

If property taxes no longer are the central revenue raising feature of the state-local system, what is? As has been said, the state was early in imposing an income tax, and in 1980 27.3 percent of state-local general revenues came from income taxes. Sales taxes accounted for 10.4 percent, fees and other income for 24.6 percent, miscellaneous taxes for 16.3 percent, and property taxes for 21.4 percent. (This does not take into account federal assistance.) State-local revenues and spending are discussed more fully in the Findings section of this report.

Minnesota's sales tax rate of five percent (including a penny which is due to expire next year) is about average for states with sales taxes, but because Minnesota exempts food, clothing, and drugs from the tax, actual collections run much lower than the national averages. Minnesota collects about three-quarters of the national average in sales taxes.

In regards to the relative shares of the different revenue sources, Minnesota is higher on income taxes, lower on sales taxes, slightly lower on property taxes, and about average in other taxes, fees, and other revenues.

What is this money spent on? Education remains the largest single expenditure of state-local government in Minnesota as elsewhere. While the relative expenditure for education in Minnesota's state-local system is now declining somewhat, it accounted for $653 of the $1,894 spent per capita in 1980. Health-welfare ranked second at $411 per capita, and highways, at $219 per capita, ranked third.

In setting up a delivery system for a governmental service, any number of options are available to state-local government. The state first decides what service is to be delivered, and then figures out a way to pay for it. It then determines a mechanism for the provision of the service. The service can be provided directly, in combination with another level of government or with a private agency, or delegated to another level of government, with or without financial assistance. The state can also give the money to individuals and let them decide how to spend it on a certain service.

Leaving aside for the moment the question of financial responsibility, here are some examples of how the state arranges service delivery.

Pollution control–state.

Health care to the indigent–direct state provision, and state delegation to counties.

Vocational-technical education–state, school board partnership.

Sewers–local matter.

Police–state, county, cities.

In terms of financing, aside from the provision of aids and credits described above, the state may substantially undertake the financing of a service, as it does in income support, but have another level of government supply it, in this case, the counties. It may set up a dedicated fund, like the highway trust fund, to finance a state service (trunk highways) and a local service (streets). It may stipulate the levy of a certain tax for a certain purpose, as with the school mill levy.

In addition, the state controls the financial tools available to local units. Levy limits, laws allowing discretionary and referendum school levies, and the prohibition of local sales and income taxes are examples.

FINDINGS

I. The State of Minnesota occupies a central position in state-local revenue raising, with the bulk of revenue raising decisions being made or controlled by the state. The mix of revenues raised in Minnesota is different from the national profile, with Minnesota having a greater reliance on income taxes, and less on sales taxes.

Total state-local-federal tax collections in Minnesota in 1980 were $3,665 per capita, $137 more than the national average of $3,528, or 104 percent of the national average for a ranking of sixteenth. Of the $3,665, $1,124 was state-local taxation, and $2,541 federal taxation. When federal taxes are excluded, Minnesota ranked ninth in state-local taxes per thousand dollars of personal income in 1980, or 110 percent of the national average.

Minnesota ranked seventh in individual income tax collections, third in corporate income tax collections, twenty-second in property tax collections, and thirty-seventh in sales tax collections, per thousand dollars of personal income.

All state-local taxes in Minnesota in 1980 totalled $127.41 per thousand dollars of personal income. Of this, $36.72 came from property taxes, $45.67 from personal and corporate income taxes, $18.06 from sales taxes, and $26.96 from miscellaneous taxes.

Minnesota received $44.04 per thousand dollars of personal income from the federal government in 1980. A total of $51.82 per thousand dollars of personal income was raised from charges and other income.

MINNESOTA STATE-LOCAL GOVERNMENT REVENUES, 1980 (per $1,000 of personal income)

Property Taxes	$ 36.72
Income Taxes	45.67
Sales Taxes	18.06
Miscellaneous Taxes	26.96
Total Taxes	$127.41
Federal Aid	44.04
Charges and Other	51.82
Total Revenues	$233.27

SOURCE: U. S. Department of Commerce, *State and Local Finances*, 1981.

Over time, Minnesota's reliance on income taxes has been increasing, and that of the property tax decreasing. The reliance on fees and charges and "other" income has been increasing.

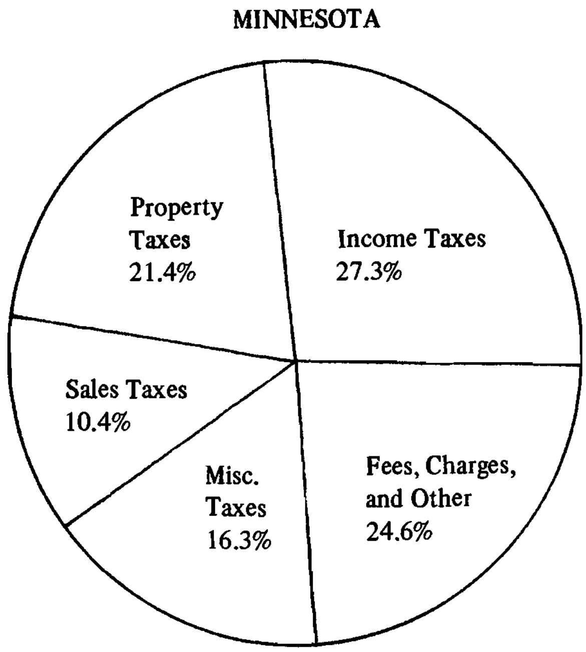
Minnesota in 1979 got 27.3 percent of its income (not counting federal aid) from state-local government income

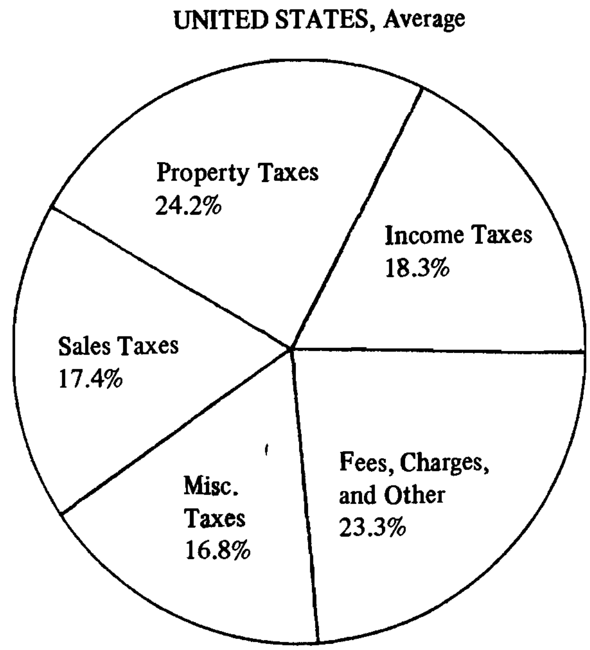
STATE-LOCAL REVENUES IN MINNESOTA AS A PERCENT OF PERSONAL INCOME

	1980	1977	1972	1967	1957	1942
Property taxes	3.7	4.4	5.8	6.0	5.0	5.2
Income taxes	4.6	5.0	3.8	3.1	1.4	0.8
Sales taxes	1.8	1.9	1.7	-----	-----	----
Miscellaneous Taxes	2.7	3.4	3.1	3.1	3.3	3.2
Charges, fees and other	5.2	4.5	4.3	3.3	2.1	1.8
TOTAL	18.0	19.2	18.7	15.5	11.8	11.0

SOURCE: Advisory Commission on Intergovernmental Relations, *Significant Features of Fiscal Federalism, 1980-81.*

REVENUE SOURCES FOR STATE-LOCAL GOVERNMENT, 1979
(Federal Assistance Excluded)





SOURCE: U. S. Department of Commerce, *State and Local Finances*, 1981.

taxes, 21.4 percent from property taxes, 10.4 percent from sales taxes, 16.3 percent from miscellaneous taxes, and 24.6 percent from fees, charges, and "other" income.

The comparable national figures were: 18.3 percent from income taxes, 24.2 percent from property taxes, 17.4 percent from sales taxes, 16.8 percent from miscellaneous taxes, and 23.3 percent from fees and charges.

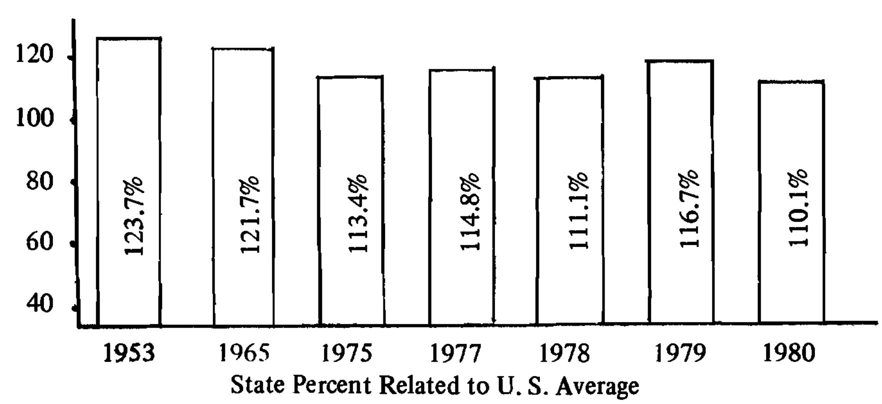
Minnesota's total state-local taxes as a percent of personal income ranked ninth in 1980, eighth in 1978, and sixth in 1975.

Minnesota's total state-local tax revenues, in relation to state personal income as a percent of the national average, stood at 110.1 in 1980, 116.7 in 1979, 121.7 in 1965, and 123.7 in 1953.

The percentage of the state's economy going into state-local government now is smaller than it was in the 1970s.

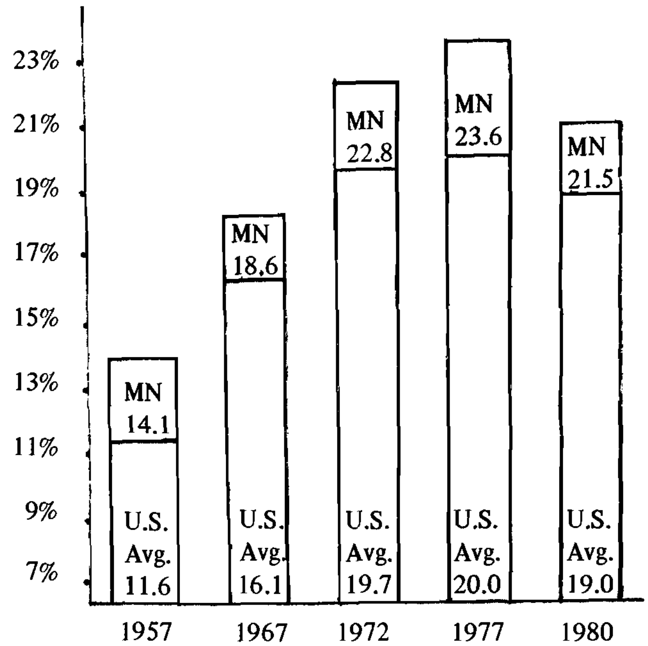
Minnesota state-local government accounted for 22.8 percent of total personal income on state-local government in 1972, 23.6 percent in 1977, and 21.5 percent in 1980. This is part of a national trend. The nation as a whole is currently

STATE-LOCAL TAX REVENUE IN RELATION TO STATE PERSONAL INCOME



SOURCE: ACIR, *Significant Features of Fiscal Federalism*, 1980-81.

PERCENT OF PERSONAL INCOME DEVOTED TO STATE-LOCAL GOVERNMENT



SOURCE: ACIR, *Significant Features of Federalism,* 1980-81.

putting less of a percentage of personal income into state-local government than it was in the 1970s.

Roughly two- thirds of the state's budget is money collected by the state, and passed along to local units for spending. The state raises a large proportion of total state-local revenues, but directly spends a smaller proportion.

II. Minnesota has been and continues to be a high spending state, outspending most states in most major categories of state-local spending. State government makes most of the decisions about the total level of spending in the major areas of state-local government: education, health-welfare, and highways.

The following table shows Minnesota's 1980 spending per capita in major areas of spending and the percentage of national average for each function.

Education is the single largest component of state-local spending, accounting for $653 of the $1,894 spent per capita in Minnesota in 1980, or 34 percent.

Health-welfare ranked second at $411, (22 percent) and highways third at $219 per capita (about 12 percent) of total spending. Many people equate welfare spending with direct cash assistance, but in the current biennium, only about 12 percent of the state Department of Welfare's budget is income transfers. Seventy percent is medical assistance, general assistance medical care, and the state hospitals. Medical costs are rising faster than income support costs.

Together, these three functions accounted for roughly two-thirds of all state-local spending. The percentage of spending for these three functions is similar in most other states.

Over time, the mix of spending has been changing. In 1954, education accounted for 40.6 percent of total spending,

MINNESOTA 1980 PER CAPITA EXPENDITURES FOR MAJOR STATE-LOCAL FUNCTIONS

	MN	% of U. S. Avg.
TOTAL	$ 1,894	117
Education	653	111
Health/Welfare	411	120
Highway	219	149
Police/Fire/ Corrections	93	82

SOURCE: Minnesota Taxpayers Association, *How Does Minnesota Compare?* 1982.

and in 1979, it was 35.8 percent. Health-welfare has been increasing, from 15.6 percent in 1954 to 21.8 in 1979. Minnesota has a smaller poverty population than the national average, and the percentage has not increased significantly in the last few years.

The state has a central role in deciding the overall level of spending. In primary-secondary education, the state determines the basic spending level per pupil. The state controls public institutions of post-secondary education.

While Minnesota's health-welfare system relies strongly on the counties for administration, most rules and spending formulas are state-determined, and the bulk of the money is state raised.

In highway spending, the state determines the total spending level to a certain degree by determining the gas tax and other fees and taxes dedicated for highway spending and through the Department of Transportation's planning. There is more local discretion in road and highway spending than in the other major expenditure areas.

III. There are many different ways to compare Minnesota with other states. Minnesota does not compare unfavorably to similar states.

While comparing Minnesota to all states would seem logical, such a comparison would compare Minnesota to states receiving large sums from severance taxes, as well as states which are significantly poorer, larger or smaller in population or physical size, or have significantly different populations. Any of these factors could limit the validity of the comparison.

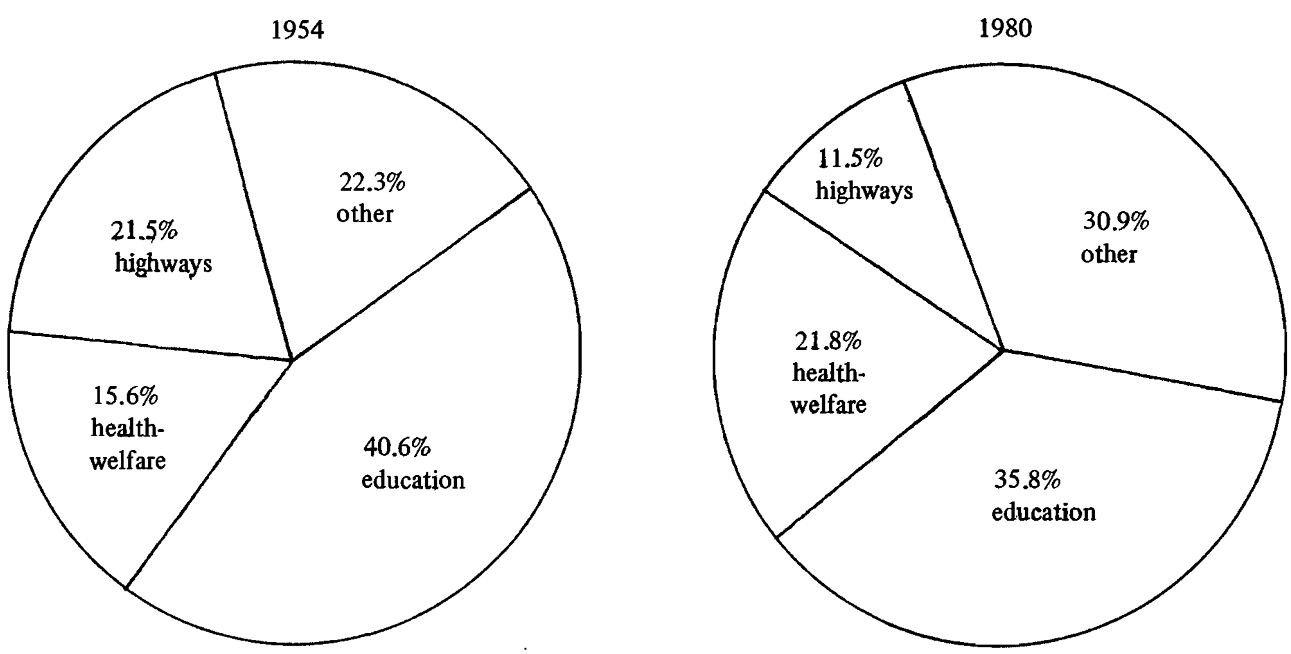
For example, it would not seem logical to match Minnesota's road expenditures to those of Hawaii, Rhode Island, Connecticut, or the District of Columbia, but a fifty state sample would include them. (Note: The District of Columbia is usually included as a "state" in national data on taxes and spending.)

Comparisons to neighboring states are inevitable, but fail to take into account the significant differences between states.

Comparing Minnesota to Wisconsin is reasonable, given the similarities in population size, wealth, and population characteristics.

Comparing Minnesota to a low-spending, non-severance tax state may be revealing. It is reasonable to ask why another midwestern state, such as Indiana, has drastically lower spending levels than Minnesota. What is the difference in the

MINNESOTA SPENDING PER CAPITA
PERCENTAGE DISTRIBUTION



SOURCE: ACIR, *Significant Features of Fiscal Federalism*, 1980-81.
Report of the Governor's Minnesota Tax Study Committee, 1956.

public service level between the two states? What is the result of the different level of taxations?

Comparisons based simply on rankings are misleading. Rankings do not take into account the difference and scale of spending or taxing differences.

A ranking does not reveal the amount of difference between one rank and another, or the amount of difference from the national average. It also does not reveal the spread of all states, from high to low.

For purposes of comparison our committee studied an eight state sample of Minnesota, Wisconsin, Iowa, Indiana, Vermont, Oregon, Tennessee, and Maryland. Also included was the national average figure for the respective spending categories.

We looked at spending in education, health-welfare, and highways.

Of twelve measures of spending, Minnesota topped the list only once. The overall pattern of spending could be largely explained by the variables involved. Spending patterns are being determined by structural arrangements, demand for service, and demographic factors.

- Because of its large size, thinly-spread population, high demand for roads, and agriculture-based economy, Minnesota has the third largest highway system per capita in the eight state sample. (Minnesota has the fifth largest system overall in the nation.) Climate-determined high construction costs also add to the size.

- Because Minnesota has more people in nursing homes, and because we provide a broad spectrum of health benefits and support services, Minnesota has high health-welfare costs.

- Because of higher-than-average school age population (now declining), and more years of schooling, on the average, Minnesota has high education costs.

IV. There is a weak link between revenue raising and spending decision-making, both between and within levels of government. Local units of government determine how money is spent, but do not have as much authority about how much is raised in taxes.

The state's major function is to raise revenues through income and sales taxes, and distribute it to cities, counties, townships, school districts, and other units of government for actual spending.

Local units of government raise directly through their own initiative only a small portion of the money they actually spend. The bulk of the money they spend is received through state aid or federal assistance. This is not to say local units are not totally without influence in determining the overall levels of spending. Local units do have available to them important non-tax revenue sources such as fees, charges, licenses, and special assessments. Cities have a greater ability to tap these sources than do the other local units. Local units also lobby the Legislature to get spending formulas which are favorable to them.

The *taxes* which are available to local units are strongly affected by state policies. The state controls the property tax levies allowed by cities and counties through levy limits, although local units may exceed these limits through a local referendum.

School district levies beyond the basic levy are controlled by the state. There are several levies available to local school districts, but the rules governing their use are determined by the Legislature.

The state controls the relative share of burden each parcel of property in a community bears through the classification system.

The state determines the net property tax bill to a property owner through credits and income-based property tax relief.

The state maintains a monopoly on sales and income taxes, with the exception of Duluth's sales tax.

Because the state controls the revenue sources, it strongly affects the spending level of local units. On the other hand, the spending content is strongly determined at the local level. Schools can choose to emphasize science instruction, or a city may choose to develop first class parks.

V. Significant segments of the property, sales, and income tax systems are designed to provide tax relief to groups of individuals in need of assistance. The classification system, sales and income tax exemptions, income tax deductions, the various property tax credits are in the system to address social policy goals, not revenue raising, goals.

Little attention has been paid to cumulative effect of all of the provisions put into the total tax system. It is sometimes possible to determine the effect on any given individual (within certain limits and making certain assumptions), but it is difficult to generalize the effect on a group or category of individuals.

There are some difficult questions about the real incidence of taxation which are hard to resolve, especially in the case of business taxation. Some people hold that any tax on business is passed along to the people who buy from that business.

In a suburban community with only a few small businesses, shifting the property tax burden onto business property will have consequences which are difficult to determine. The property tax may be passed along to the people who shop in the stores in the community, and those people are likely to be the ones who have had the property tax burden on their homes lowered through the shift of burden to the business property.

Tax policy is frequently made on the basis of assumptions in this regard, as opposed to verifiable fact.

There are significant administrative costs both to taxpayers and tax collectors because of the complexity of the system, especially in the income and property taxes.

If each family in Minnesota needed to spend an extra $10 a year for professional assistance in figuring out and filling out their income tax form, this would represent an annual expense of millions of dollars. Businesses also must hire professionals to assist them in the actual paying of income taxes, and the state must employ people to keep tabs on the taxpayers. It is not clear there are enough benefits from the current system to justify the extra effort required by its complexity.

It is frequently more difficult to determine the effect of a tax expenditure[4] than a direct appropriation. A tax break in the property tax system designed to help farmers may help rich and poor farmers, family and corporate land owners, Minnesotans and non-Minnesotans. An income tax deduction may be available only to those with enough professional advice to know the tax break is in the code.

By their very nature, tax expenditures are more difficult for legislative bodies to manage than direct appropriations. In the first place, it is rare for the budgetary implications of a tax expenditure to be as clear as those of a direct appropriation because the proper research is rarely done. Secondly, features of the tax code are not as frequently scrutinized as are spending features.

VI. The basic overall taxation and state-local fiscal system, in which the state collects revenues and passes them along to the local units, can be made to serve the interests of stability, accountability, fairness, and efficiency.

The state is the most logical level of government to collect income and sales taxes. It most closely approximates the relevant economic units being taxed.

To allow cities, counties, townships, and school districts to collect sales or income taxes would disrupt commerce and add administrative expenses.

The property tax lends itself easily to local taxation and is the traditional source of local government revenue. The problem with undue reliance on the property tax is that property wealth is unevenly distributed among communities, and thus if left to shoulder a disproprotionate share of the burden would create vast disparities in the availability of public services. In addition, property represents wealth, only one of the three easily taxable main currents of economic activity, the others being consumption and income.

The property tax can be understood as a tax on a form of wealth–as distinct from income–or as a charge for services rendered to property. Roads, police, fire protection and other similar services are assumed to directly enhance the value of a piece of property, and many people feel property taxes should be used only to finance these direct property services. Others say that many government services–education or parks for example–may also be important in enhancing the values of business or residential property.

VII. Higher levels of revenue raising and spending in the 1970s did not limit Minnesota's economic growth. The perceptions of business leaders and a changing economy remain as problems to be resolved.

Personal income and manufacturing job opportunities increased at a more rapid rate in Minnesota during the 1970s than in the nation as a whole. During this time, Minnesota maintained its position as a high taxing and spending state.

Representatives of the business community say they are as concerned about workers' compensation and unemployment insurance as they are about the level of taxation.

They say the problem does not lie with the overall level of taxing and spending as much as with a perception that business is taken for granted by policy makers.

[4] For those unfamiliar with this term, a tax expenditure refers to revenue foregone by a taxing district because of a tax exemption or credit. If the state exempts from taxation income which is used to buy insulation, and 10,000 families claim $100 each worth of insulation purchases, a total of $1,000,000 in income would have been exempted. If the prevailing tax rate on that income were five percent, the state would have foregone $50,000 in taxes. It may in fact be cheaper for the state to encourage people to insulate their homes in this fashion, but the point is the loss of $50,000 though the provision represents the same strain on the public treasury as a direct expenditure of $50,000.

There are specific and well-founded complaints about the complexity of Minnesota's tax system.

Business property pays property taxes in Minnesota at a higher rate than homestead property, because of policy choices by the Legislature.

Instability in tax rules is also of concern.

Negative perceptions in the business community can affect locational decisions.

While Minnesota's economy grew quickly during the 60s and 70s, there is no assurance this will continue to happen during the 1980s. While Minnesota was not hard hit by the recessions of the 1970s, the current recession has seriously injured the state's economy.

CONCLUSIONS

I. While there are problems in the revenue raising and expenditure system, Minnesota's true position compared to other states, is generally misunderstood. Minnesota spends and taxes more than most other states but is closer to the national averages than is often claimed. Tax and spending levels in dollars are rising in Minnesota but not as rapidly as the national averages. As a result, Minnesota is moving closer to, not farther from, national norms. The total portion of the state's economy going into state-local government is declining, not rising.

While public and legislative debates frequently center on Minnesota's ranking in a given category, the ranking measure is, by itself, of extremely limited value for comparison purposes.

For example, Minnesota ranks twenty-first on highway spending, yet spends 47 percent more per capita than the national average in that category. In education, Minnesota ranks twenty-second in spending per capita, but spends 11 percent more than the national average. Rankings do not explain how large the gap is between one state and another.

A major problem of rankings is that there is little consensus as to how the state ought to rank. A high ranking in a given tax category is seen as a negative factor, but considering only one factor in isolation does not aid in the understanding of the total picture. Overreliance on rankings has frequently distorted the debate.

Because of the way in which the Department of Commerce tabulates tax and spending statistics, Minnesota's taxes are overstated. In changing the payment dates for rent credit and some circuit breaker payments, the 1982 Legislature also changed the way in which the Department of Commerce will tabulate them. The Department will count them as direct expenditures–Not as tax funds–as had been past practice because of the change in payment dates. The effect of the change will be to show Minnesota to have had a tax "increase" of $187 million, even though the amount of money going into and out of state government through this program has not changed.

Statistical and data collection practices can have an impact on certain aspects of public finance which cloud accurate comparisons.

Workers' compensation and unemployment compensation, important public issues for the business community, were not part of our study. Except to the extent they affect public sector costs, they do not figure into state-local tax and spending policy as this committee has defined it. Another CL committee is currently studying the state's workers' compensation insurance system.

Comparisons of Minnesota to other states have to be rigorous in their analysis of Minnesota's real status. The use of piecemeal or partial data reveals less than the whole picture and can misrepresent Minnesota's real status.

For example, it is frequently said that Minnesota's taxes are among the highest in the nation, which is not the case. Minnesota's total state-local federal taxes in 1980 were 16th in the nation, per $1,000 of personal income, moreover, Minnesota is moving towards the national average, not away from it.

II. It is not totally clear what Minnesotans are getting for the extra public spending.

Minnesota is higher in spending and taxing than most states, a fact which in many areas has been looked upon with pride. Nonetheless, it is frequently difficult to understand precisely what the public is getting for the extra spending. Minnesota supports a larger-than-average road system, uses nursing homes to a greater degree, pays higher teacher salaries, and keeps children in school for more years than most states. The extent to which Minnesota's population is better educated or healthier as a result is unclear.

Pressure from public service providers was frequently cited by those who spoke to us as a reason for increased public spending. Lobbyists for groups frequently seek reimbursement formulas and funding systems which will maximize benefits to their clients, not necessarily the needs of service recipients. Policy makers in Minnesota have sought adequately to finance needed public services and Minnesotans have sought high quality, rather than merely adequate, public services.

The public will be less willing to commit resources to a system which does not appear to be responsive and efficient. Better techniques of evaluation and consequent increases in understanding are likely to generate clearer decision making about what the public is getting and should expect to get from public spending. Clearer definition of policy goals when a program is started would make evaluation more precise and increase needed public understanding.

Comparisons of overall or aggregate spending in other states can provide a useful framework for understanding, but have limited policy application. For example, it is unlikely a company will locate a factory on one site rather than another on the basis of an overall tax differential between states. The decision may, however, be made on the basis of a sharp disparity in property taxes on the factory. In the same vein, health-welfare policy makers should be concerned if they are facing per-patient bills for nursing homes which far outstrip nursing home bills in other states. Aggregate health-welfare spending level comparisons may be less important in making policy choices about health-welfare services than specific comparisons.

III. Successful policy making has become difficult in the existing system. Complexity, lack of clarity, lack of accountability, and lack of direct contact by elected officials all hinder successful policy making.

Accomplishing any policy objective is made more difficult because of the complexity of the current system. Making a change in the tax code or in an expenditure program may or may not achieve the desired end and is likely to have some unexpected consequences.

Some of these sorts of problems are inherent to any complicated system, and some are specific to the Minnesota system. To begin with, any large-scale transfer of resources creates problems in measuring results.

The homestead credit is a good example. In this program, sales and income tax revenues are used to pay part of a local property tax bill. The idea is to grant tax relief to homeowners, and encourage homeownership.

The money used to achieve these goals is raised by taxing most of the same people who otherwise would have had higher property tax bills, as well as taxing non-homeowners. Some of the people getting $650 in homestead credit (the maximum allowed) probably paid $650 in income and sales taxes to support the program.

This is not to say that the simplest system would be the best or that the homestead credit is useless. The point is that in trying to evaluate a program like the homestead credit, the total, systemwide impact of the program should be evaluated, and analysis should not be limited to the easily measurable phenomenon of who first receives the dollars from a spending program.

Each layer added to the system (e.g., property classifications, credits, income tax deductions, circuit breakers, direct transfers between levels of government) creates problems in measuring the effectiveness of any single feature of this system.

The multi-layered system which we now have is not clearly organized on the basis of function or of taxation.

Many of the various services are now supplied at the same location by different levels of government. In western Hennepin County, it is possible to receive police services from state, county, park, and municipal police forces. County government is involved in waste disposal, and cities are responsible for waste collection.

It is probable that a coherent system would involve some intermingling of service provisions from different levels of government. In addition, policy responsibility may be vested at one level, and service provision responsibility at another. Under the current system, the degree of overlap is too great, and puts undue strain on the officials charged with running the various units of government.

The nature of the system makes it easy for policy makers to address social concerns through tax measures, a practice which generally leads to a large use of resources to accomplish any given goal. For example, when the state provides a tax break or credit in the sales, income, or property tax, it by necessity spreads the benefit broadly and includes people who may not need help, or may not be the intended recipients at all.

Exempting clothing sales from sales taxes removes the burden for this tax from poor and rich alike. A lower value on homesteads helps people who own modest homes and people who own expensive homes.

The cost of revenue foregone through these sorts of measures is rarely charted as carefully as expenditures through direct appropriations, and systematic checking to determine if the targeted groups are the actual real beneficiaries rarely occurs.

In the income tax system, however, it is more easily possible to achieve social ends, because the benefits can be clearly linked to income, allowing the system to respond to at least that variable.

Complicated systems create incentives to address problems indirectly and are bound to have unintended side effects. There are many examples of tax laws being passed which did not have the effect the authors wanted them to have. In many cases, key issues in tax laws are resolved in court or through administrative channels, which means the people who are supposed to be making the policy decisions are not the ones actually determining how the law functions.

Perhaps the most prominent recent example is the unitary tax, which, several months after its passage, remains partially obscure as to its effects. The unitary tax was designed to tax multi-state corporations on the basis of sales and income in all states, with the Minnesota tax liability determined on the basis of a proportionate fraction of total national or international sales and other factors. Lawyers, accountants, civil servants, and others have spent many hours trying to figure out how the law is supposed to work, making it possible that the total real cost of administering the tax may exceed the amount ever raised through its imposition.

A complex system of state-local transfers is more expensive to administer, sometimes significantly more expensive than a simple one.

For example, the state sends a great deal of money to school districts, cities, counties, and townships. This creates an incentive for each of these local units to have a lobbyist in Saint Paul to watch out for the interests of the various units. If each local unit of government had to pay for one fulltime salary just to keep tabs on what was going on in Saint Paul, it would represent an enormous expense.

This is not to say that if the system were slightly less complicated, there would be fewer lobbyists. It is to say that in the current system, a vast amount of money is spent by all parties—the Legislature, the people who administer the money transfers, and the recipients—just to support the system, leaving aside the question of whether or not the money is having its intended effects or reaching those who need it most.

Besides the total, direct costs of such a complicated system and its inherent unmanagability, the current system is so obscure as to defy comprehension by all but the most persistent and tenacious citizens. Although some would hold that a few key people are the only ones who fully understand how any large organization—public or private—works, the goal in the public sector should be clarity.

In the present system, it is not clear who has spending responsibility for any given service or responsibility for any given tax. A system which is confusing to the public and to the people running it is not likely to function well.

A system which posits discussion by an informed public as a necessary element for success should be easier to comprehend than Minnesota's current system.

The system is not now internally consistent, and does not function as intended or as most people assume. For example, the local property tax is assumed to be visible and relatively painful tax which therefore acts as a check on spending. Because the property tax burden is substantially deflected through property tax relief, and because most of the local money is state-generated, local officials have less say about the final impact of the tax than state officials.

IV. The fundamental outline of Minnesota's state-local tax and spending system in which sales and income taxes generated by the state are spent by local units is not the problem. The problem lies in the internal mechanisms of transfer, taxation, and accountability which have accumulated over the years. A return to an over reliance on the local property tax is not the answer.

There is broad public consensus that the level of service in certain functions should be fairly uniform around the state. Primary-secondary education is the most prominent example of this. To a large degree, the same is true of health care, income support, and highways. Together these functions account for the bulk of state-local government's activities.

The system of local units actually spending the money in response to local conditions and needs also makes sense. Few people are willing to try to make a case for one statewide school board, or health care agency, or transportation agency which would administer these services from a central office.

Less complicated, more direct mechanisms of revenue transfer would make the system more policy responsive. A clearer system of accountability would help build public confidence in the system, and generate public understanding about what tax money is being used for. This understanding is critical if Minnesotans are to continue being asked to support more-expensive-than-average public services.

RECOMMENDATIONS

I. The Governor and Legislature should undertake actions leading to a complete reform of the internal mechanisms of state-local tax and spending system. The goal should be an integrated system which enhances accountability and stability at all levels, and clarifies the responsibilities of the different levels of government.

Any attempts taken now at changing the system should be part of an overall, integrated reform. Piecemeal changes lead to unintended consequences and additional complexity, and should therefore be avoided.

Any attempt to address any specific portion of the existing system would necessarily affect the system as a whole because of the interrelated nature of the whole structure.

The current decision making apparatus does not function in an integrated fashion and probably will have to be changed to do so. Strengthening the mechanisms in the current system which help the state-local fiscal system function comprehensively is also important.

II. The first step towards comprehensive reform should be a major, formal study of the system. The Governor and Legislature will pass a new budget in 1983. They should not do so without also passing a measure creating a study group.

The goal of the study should be to develop a set of principles for the system as a whole, and a set of policies and processes for accomplishing the goals of the new system.

Some of the principles which should guide the reform of the state-local system should include but not be limited to:

- Social concerns should be addressed directly through direct appropriations or income tax-related measures, and not through property or sales tax mechanisms.

- Geographic imbalances in tax capacity should not be allowed to create dramatic disparities in the governmental services such as education in which there is a statewide interest.

- Some levels of government can respond more efficiently and effectively in the provision of certain services than can other levels. Some levels of government can levy different taxes more efficiently and fairly than others. A clear system of responsibility and authority for the various governmental services and taxing authorities should be pursued.

- It is appropriate to finance government services by taxing income, wealth, and consumption, and through the use of service-related fees. The overall effect of the total system should be to tax on the basis of ability to pay.

- Taxpayers and voters should be sufficiently informed about the tax consequences of spending decisions to be able to fix political responsibility for the decisions.

Some of the policy formulations which would extend from these principles include:

- Whether appropriations should be used when the state acts to adjust local revenue raising capacity to finance services of a statewide interest.

- Whether the arrangement should be changed to delegate service delivery responsibilities to different levels of government, because the complex nature of the current state-local system makes it unclear who is paying for what service and who is responsible for providing it.

- Whether the property tax system should be viewed as a charge for services received *and* as a tax on wealth.

- Whether the last dollar spent should be spent at the discretion of local authorities and come totally from local tax sources, unassisted by the state, although the state may provide assistance to local governments to pay for a basic level of local services.

- Whether greater attention should be given to new non-tax sources for local governments. New fee sources, where applicable, can supplement the already significant portion of local revenues derived from fees. The possibilities of revenue generation through public enterprise should be explored.

- Should property tax relief be granted through one mechanism, preferably a direct expenditure which is appropriated yearly, and targeted specifically to those in need, instead of the current system in which the state intervenes at several points and spreads benefits broadly.

- Whether income and property taxes should be significantly simplified to achieve the following two goals: savings to both payers and collectors; and increased accountability and understanding.

III. The study should be conducted by an independent, broad-based task force, including representatives of the legislative and executive branches of state government, local government, business, labor and the academic and non-profit communities. It should make recommendations on how to implement the new system, and develop a mechanism for monitoring the effects of the new system, and for re-evaluation of the long-term goals.

The study should have its own staff, and not be dominated by any one group.

Among the specific items the study should evaluate are:

- The cost and consequences of more complete financial responsibility by the state for health-welfare and primary-secondary education, with an eye towards moving those costs to the state level, leaving the property tax base for municipal and county services.

- The consequences of the elimination of the property tax classification system.

- The consequences of removal of the 26 mill basic school levy and the potential property tax disparities which would result.

- The best mechanism for providing aids to local governments to reduce or eliminate major disparities in property tax resources.

- A statewide equalization of property taxes.

- The elimination of levy limits.

- The development of mechanisms to inform taxpayers about the property tax implications of local spending decisions.

- The elimination of the sales tax exemptions.

- The use of refundable credits for those who are eligible for tax credits but do not pay the basic tax.

- The simplification of the method of calculating the personal income tax, including the possibility of linking state income taxes to federal definitions of tax deductions and income.

- The effects of excluding some income from current state tax liability.

- The removal of federal income tax deductability.

- Reduction of the number of deductions in the state income tax.

In addition, the study group should assure that the new tax system is implemented in a manner that produces fair and acceptable results.

IV. In discussing comparisons between Minnesota and other states, all parties—whether candidates, interested groups like the Citizens League, or members of the press—should refrain from using the partial data which has muddied the discussion in past years.

In making state-to-state comparisons, total state-local spending or taxing should be looked at. As has been pointed out, perhaps the most common oversight is to consider state government in isolation. Comparing Minnesota's rising state expenditures to a state in which state spending has not risen is an invalid comparison, unless the analysis also considers local spending. Because so much of Minnesota's state spending finances local activities, it is a mistake to try and compare Minnesota state government to state government elsewhere, yet many people continually do so.

In looking at taxing levels on a state-to-state basis, it is best to look at all taxes and revenues, not just at one tax. Minnesota has followed a policy of reliance on income taxes and thereby avoided some of the property tax problems which in other states have led to taxpayer revolts.

There are areas in which state-to-state comparisons can be extremely useful in determining if public spending decisions are being carried out properly. If Minnesota spent twice as much to salt a mile of road as Wisconsin did, there would be clear cause for concern. If teacher salaries in Minnesota were twice the average for neighboring states—or half as much—the information would be useful in determining public policy. Right now, much of the public discussion in which Minnesota is compared to other states focuses on the superficial or misleading factors, and does not consider the useful comparisons.

Clearly there are areas in the Minnesota system that can use changing, but to make invalid comparisons merely focuses attention on misleading points. No one should try to hide Minnesota's true position, but no one should present things in a way that makes things seem worse than they are, either.

V. The Legislature should routinely include clear statements of the intended goals of spending bills, making the goals quantifiable wherever possible. Evaluation of the spending should follow.

As has been pointed out, Minnesota's state-local government spends more than the national averages on a broad variety of public services. The *public* may or may not accept the validity of this spending, but deserves to have a better idea about what it is getting for the money.

Evaluation need not increase the cost of government. Vast amounts of data are not routinely collected as part of the everyday operation of government. As a rule, however, the data gathered is not related to any objectives and has little utility for evaluation. With clearly stated goals it should be possible to collect data in a way that lends itself to measuring the effectiveness of government operations at little or no increase in cost. Specifying goals in advance will also allow evaluation of choices before policy decisions are made.

Clear statements of goals and refined techniques of evaluation are bound to be difficult to achieve. We know there has been a great deal of work in the area of monitoring public programs, with varying degrees of success. It is impossible to envision a perfect system of evaluation, or a legislative process guaranteed to attain total clarity in the goals of a new program. What is needed, though, is a *better* accounting for what we are getting than now occurs. In the absence of new efforts towards achievement of clearer goals and better evaluation, public skepticism about higher levels of spending will persist.

DISCUSSION OF RECOMMENDATIONS

The recommendations of this committee address three main subjects: the need for and nature of comprehensive reform of the system; the quality of the debate about taxes and spending; and the need for more and better evaluation of the results of public spending.

We have come to see there is a need for a comprehensive, integrated reform. The tax and spending system is never static, but it appears we are likely to see significant changes in 1983. There will soon be a new Legislature and Governor, and virtually every interest group is gearing up to propose changes in taxes, spending, and the state-local system. The emergence of widespread interest in overall reform strengthens the case for it as does the long-term nature of current financial problems.

Policy makers should insist on balancing all needs considering all elements of the tax system, and all elements of the state-local system. We have attempted to formulate some guidelines in this report about what such a system should and should not include. Our agenda is not complete, but it has been developed with all elements of the system in mind.

State and local government at one time was primarily financed by property taxes. That situation has changed here and nationally. Because the changes in Minnesota have proceeded in an incremental fashion, responding to different circumstances and needs, the state has ended up with a system that lacks coherence and balance. The property tax has been around the longest and lends itself easily to intricacy and complexity. Our view is that thoroughgoing reform should begin with this tax, with lawmakers moving towards a radically simplified system of property tax collection, addressing social and equity concerns elswhere in the tax and spending system, through direct, budgeted spending wherever possible.

We came to view the property tax as having a dual purpose. We do not see it only as a tax for property services received. Property represents a form of wealth, and therefore is subject to fair and equitable taxation in much the same way that income or consumption is. Because some forms of property—homes and farms notably—occupy a special place in our social structure, laws are in place to reduce substantially the incidence of property taxes on them.

Our committee does not disagree with the government's offering special protection for certain property owners. What we think is mistaken is the methodology used. All property should be taxed on roughly the same basis, with assistance targeted through expenditures to those explicitly in need. The state has a good model for this method of assistance in the income tax-related relief granted to senior citizens, renters, and low-income people.

The benefits of this approach are twofold: first, assistance is targeted where it is needed, reserving assistance for those intended to receive it and not spread to all owners of the property class; second, assistance, because of its overt and explicit nature, is reviewed periodically by lawmakers. A tax break is rarely scrutinized, but an expenditure frequently is. Especially at the time when public sector resources are strained, all public costs should be examined by lawmakers.

Besides the way in which the property tax is administered, there is also the issue of the relative role it should play in the overall revenue raising system. Because wealth is an important factor in the economic system, and because revenues deriving from the property tax are stable, the tax is an important feature in any coherent tax structure.

Property taxes also are used to support property services, and, when fulfilling this function, should be viewed almost as a user fee rather than a general tax.

A final distinguishing feature of the property tax is its ability to supply accountability. Current theory holds that the local property tax provides the most accountability of any tax source because it is so visible. In the existing Minnesota system, much of the accountability is wasted. Because the state has local school districts levy 26 mills to finance school operations, the levy is automatic, not discretionary. Because the state pays 58 percent of a homeowner's tax bill, up to a maximum of $650, much of the impact is deflected. This is not to say that Minnesota should return to a system of strict reliance on local property taxes; it should not. A reformed state-local system should seek to harness the accountability of the property tax, and use it to the advantage of the overall system.

We strongly support the principle behind the tax reform of 1971, known as the Minnesota Miracle. Services in which there is a strong statewide interest should be supported financially by everyone in the state.

Many groups are now in the process of studying pieces of the tax-spending puzzle, but what we think is needed is a comprehensive look at the system and its overall effects. While the 1983 Legislature develops a new state budget, it must also take steps to move towards a simpler, more understandable, more responsive system. Much of the current short-term difficulty could have been avoided if the state had continually evaluated and monitored the state-local fiscal system and the effects of tax law changes. In much the same way that maintaining highways and the physical infrastructure is more efficient than waiting for it to fall into disrepair and then rebuilding, the state-local tax and spending system should be analyzed and kept in top form. Right now, we are in need of total rebuilding. Once that has been accomplished, the system should not be allowed to slide into disrepair through neglect.

The study we have in mind would include representatives of government, labor, business and other groups. It should have enough independence from government to take a critical view, but not so distant as to lose contact with the realities of the system. It should make recommendations for the needed overhaul and for continually updating and measuring the effects of the system.

We have listed elsewhere several specific elements for study and evaluation. Overall, the goal is to determine how the state-local tax and spending system should work, and how what we have now compares to what we want. Then, a plan for moving towards the new system and maintaining it should be developed. This approach does not require a dramatic shift in the relative reliance on income, sales, or property taxes. It does require a clearer accounting of their use.

While this study is going on, the Legislature and Governor will be wrestling with vast budget problems. The presence of these problems proves the need for careful study and overall reform. For the present, piecemeal solutions which paper over the real problems should be avoided. Any changes which are made should help move state-local government towards a new, integrated system, or at least not aggravate the problems already present. If after all avenues of expenditure reduction are exhausted more money is needed, straightforward action, such as a change in rates, should be undertaken.

In making a recommendation about how to improve the quality of public debate, we found ourselves in a quandary. It is hard to tell others how to go about discussing a central issue of public policy. Nonetheless, the need remains for a clearer, more precise discussion of the issues of taxes and spending, or else there can be little improvement in the policies.

Taxes are at the same time technical and simple. People know what they are paying, but do not know with any great precision exactly which government is levying the tax, how the figure is determined, or what it is going to support. Our view is that Minnesotans are willing to pay to support public services. There is a tradition of high quality public service in this state, and people know education, highways, health-welfare and the like cost money. It seems to us they are likely to make wise choices if they know what is happening to their tax dollars.

Right now, people do not really know. If local property taxes go up, people commonly look to City Hall for the answer, even though city government ironically may have the least impact of any level of government on just what the tax is on any given parcel of property.

As noted elsewhere, because of the nature of public spending, it is difficult to determine with precision the effects of spending. There is widespread feeling that we are not getting what we should for our public dollar spent. We have found that state-local public spending is not taking up an increasing share of the state's economy, but most people probably feel they are paying more, not less.

The sheer complexity of the system accounts for much of the misperception. Additionally, it seems to us that many of the problems of perception are based in incorrect information, partial facts, and slipshod interpretation of facts.

It is clear that many people have chosen to discuss a particular element of the system in isolation, which is always an easy way to end up with a misleading analysis. One thing we have learned in this study is that the state-local taxing and spending system is mixed up like scrambled eggs, and bits of it cannot be considered in isolation. In discussing an increase in someone's property tax bill, it is rare to hear about income taxes. Those who seek to engage in the public debate on taxes and spending, however, have a responsibility to look at the whole picture.

Understanding that we are dealing with an interrelated system of state-local government and intertwined revenue sources is especially important in making comparisons between Minnesota and other states. Other states use different taxes to finance different levels of government. Responsibility to accomplish certain functions may reside with a different level of government.

Isolating one element in the system for comparison should be done with extreme care. Some comparisons are useful; we have previously used the example of comparing the cost to salt a mile of highway or comparing average teacher salaries. Comparing property taxes on businesses or homes is not revealing, unless the impact of other taxes is also taken into account.

Some state officials tend to address themselves only to state taxation, and some local officials only to local taxation. An observer would be hard put to fairly isolate exactly what constitutes a purely "state" or "local" tax in our current system. Many people assume the property tax is a local matter, but the state determines what percentages of valuation will be taxed, limits the total amount that can be levied, pays a portion of the bill, rebates another portion to renters, the elderly, and those with low incomes, and directly aids local government. In addition, the state requires the levy of 26 mills statewide to help finance local public schools. Under these circumstances, should the property tax be seen as a local tax source?

Our final main point concerns the need for greater understanding about what is desired of public spending, and greater measurement of how successful programs have been in achieving their goals.

Clearer definitions of what is expected of a given program—in taxing or spending—must become routine. We make this recommendation with an understanding that the legislative process as it now exists avoids a clear accounting of goals in order to facilitate political compromise. In the changed circumstances in which the public sector now finds itself, the comparative luxury of ill-deferred programs—especially tax relief-measures—must come to an end.

As has been said, many of the problems stem from misunderstandings, or partial representations of fact. People should not be expected to pay taxes if they do not know what they are getting in return. Minnesotans right now are paying about the same percentage of their income in taxes as they did a decade ago, but probably most people are more dissatisfied with the results of public spending. Part of the problem stems from a poor accounting by the taxing and spending units of what the money supports.

Besides the public, policy makers cannot be expected to assess the relative worth of public programs without knowing what the programs are supposed to achieve, and measurements on how effective they are in achieving their goals. Difficult decisions about paring away public spending will not become easy by better evaluation, but they will become less difficult.

WORK OF THE COMMITTEE

As part of the Citizens League's 1981-82 work program, the Board of Directors adopted the following charge for the tax and expenditure study committee.

Over the last 15 years, major changes have been made in Minnesota's state-local fiscal system almost every biennium. Even today, the system is highly controversial with conflicting evidence about the overall "health" of the system and with conflicting notions about what it is supposed to be doing. In this assignment we will attempt to develop a comprehensive tax and spending policy, in the following fashion:

Identify what the higher taxing and spending policies of the State of Minnesota support; i.e., what are Minnesotans spending public funds for that exceeds the practice of other states with which it is legitimate to make comparisons?

Establishing a framework for political debate through interpretive analysis of the findings in the first step.

- Testimony on historical explanation.
- Impartial "best case" summary for and against present fiscal practice as identified in the findings.

Making suggestions for improvement, including:

- Guide to evaluating the appropriateness of changes in level of spending.
- Preferred balance between state and local government in the mix of responsibility to collect revenue and authority to spend.
- Criteria for altering the mix either when emergencies necessitate additional spending or when opportunities emerge to spend less.
- Changes in classifications, valuations, millages, homestead and income-related relief.

COMMITTEE PROCEDURES

The committee held its first meeting on November 11, 1981, and held a total of 25 meetings, with the last coming on September 8, 1982.

The committee heard testimony from many individuals, including the following:

Clyde Allen, commissioner, Minnesota Department of Revenue

Stephen Alnes, executive director, Upper Midwest Council

Francis Boddy, professor emeritus, University of Minnesota

Winston Borden, president, Minnesota Association of Commerce and Industry

John Brandl, representative, State of Minnesota

Arne Carlson, auditor, State of Minnesota

Earl Craig, president, Urban Coalition

Dennis Erno, assistant commissioner, Minnesota Department of Revenue

John Helmberger, professor, University of Minnesota

Kevin Kenney, director, Policy Analysis, Minnesota Department of Public Welfare

Mike Lovett, supervisor, Education Program, Minnesota Department of Education

Joel Sutter, senior research analyst, Minnesota Department of Education

Pat Westhoff, research director, Minnesota Taxpayers Association

John Williams, legislative analyst, House Research Department

More than 100 people signed up for the committee and 34 remained active throughout the duration of the study. Their names are listed below.

Earl F. Colborn, Jr., Chairman	**Doug LaChance**
Monte Aaker	**Helmer Larson**
Fred Cady	**John Leddy**
James Christensen	**Mary Levitt**
Richard Cox	**Margaret Lulic**
Robert Dildine	**Sheldon Mains**
Dianne Ekhaml	**David McElroy, Jr.**
Robert Erickson	**John Mullen**
Marsha Freeman	**Florence Myslajek**
Sally Graven	**Iric Nathanson**
Joseph Hamilton	**David Rodbourne**
Milda Hedblom	**John Rukavina**
Jean Heilman	**Patricia Ryan**
Helen Holmes	**Claricy Smith**
Roger Hughes	**Irma Sletten**
Eva Ingle	**Larry Sundberg**
Edward Knalson	**Evelyn Van Allen**

The committee was assisted by **Robert de la Vega** and **Paula Ballanger** of the League's staff. This report was printed by **Joann Latiluppe.**

APPENDIX I

COMPARATIVE SPENDING LEVELS AMONG STATES

In choosing states for comparison, both distant and neighboring states with similar demographics and variables which ought to affect spending levels have been chosen. Also included are two states with similar demographics (Maryland and Tennessee) but sharply different histories. The neighboring states (Wisconsin and Iowa) seem like logical choices for comparison, in that they have similar types of people, compared to, say, a southern state, and similar history. The distant states of Vermont, Oregon and Indiana represent areas with divergent histories and values, but roughly similar demographic characteristics which should affect public spending.

States which are dramatically different from Minnesota in population or climate were not chosen, because of the difficulty of drawing any conclusions from comparisons that would not directly relate to the obvious difference in population and needs. In comparing Minnesota's schools to California's, it would be easy to find reasons to account for different spending levels, but difficult to judge whether the differences could be accounted for by inefficiency, social values or quality of service rendered.

Also, because a state which, for demographic or geographic reasons, did not have to face high spending choices for highways or welfare might be more willing to spend more on other necessities or even amenities, comparisons would likely result in obvious or insignificant conclusions.

Two states, Tennessee and Maryland, have been included for comparison because they are somewhat different demographically from Minnesota, but not so different that changes in expenditures cannot be illustrative. Both have similar sized populations and, in different categories, other similar characteristics.

The idea here is to understand how different policy choices and social values might result in different spending levels. For example, we might find a different level of educational spending in Maryland that resulted from different teacher salaries and less emphasis on public (as opposed to private) education. This could be seen as a value difference, and not a quality or efficiency difference.

The charts are designed to help understanding of the differences in spending among states, and to understand what sort of physical, demographic or other tangible variables could account for different spending levels. In this way, it is hoped we can understand what policy, value and efficiency questions determine spending levels.

The first chart shows some general spending and demographic facts about the various states. All of the figures are for 1979 on this chart, but not on all other charts. As can be seen, Minnesota is above the national averages in spending and income. Also, public salaries here tend to be at the high end.

The second chart contains information about highway spending, and we can see there is a clear connection between the number of highway miles per capita and the spending level.

In looking at the national average in per capita highway spending, it becomes apparent that almost all of the states (Indiana is the exception) in our sample spend significantly more than the national average. Most states, including low-spending southern states like Tennessee, spend more than the national average on highways.

The reason for this is that the major industrial states (California, New York, Michigan, Massachusetts, Ohio, Pennsylvania, Connecticut and Rhode Island) all spend relatively low amounts per capita on highways. These low levels in the highly-populated areas drag the national average way down. As a result, midwestern and southern states appear to be spending a lot more than the national average, but not a lot more than similar states.

Since the areas of welfare and health and hospital spending are closely related, it should be easier to consider them together. Since publicly supported medical care programs for those who otherwise cannot afford to pay for health care is the main item here, it should not matter whether the care is provided in a state-owned and run facility, or contracted for, through Medicare. As the chart shows, Minnesota is a fairly high spender here. There is some correlation between the AFDC benefit level and the overall spending figure, but the "medical infrastructure" (nursing homes, hospital beds, and doctors) must account for a major part of the higher level of spending.

Comparing Minnesota to the national average, we see the state is lower in its poverty population, slightly higher in the AFDC benefit, and sharply higher in nursing home and hospital bed categories. The separate chart on nursing home utilization shows Minnesota's relatively high rate of use.

In education spending, we see Minnesota is in the middle in spending, with a fairly large group of people to educate, fairly high teacher salaries, and about middling pupil-teacher ratios. What this chart probably does not adequately address is the public-private issue. It is possible that some states have higher proportions of their K-12 populations in private schools, which would translate into lower public spending on education, but, perhaps, similar overall public-private spending to accomplish the same goal of educating children.

SELECTED FEATURES OF STATE-LOCAL FINANCE, EIGHT STATE SAMPLE

	1979 POPULATION (IN THOUS.)	1979 PER CAPITA PERSONAL INCOME	1979 TOTAL STATE-LOCAL GOVT. SAL. % OF PER. INC.	1979 STATE-LOCAL AVERAGE SALARY FULL-TIME	1979 TOTAL STATE-LOCAL SPENDING PER CAPITA (% OF US AVG. SHOWN IN PAR.)	1979 STATE-LOCAL SPEND. PER. $1,000 OF PER. INC. (% OF US AVG. SHOWN IN PAR.)
MN	3,980	$8,865	9.9%	$17,376	$1,894 (117%)	$215 (113%)
WI	4,644	$8,484	9.8%	$17,364	$1,799 (111%)	$211 (111%)
IA	2,888	$8,772	8.9%	$15,180	$1,686 (104%)	$193 (102%)
IN	5,350	$8,570	7.7%	$14,316	$1,243 (76%)	$148 (78%)
VT	482	$7,329	9.3%	$13,776	$1,600 (99%)	$226 (119%)
OR	2,385	$8,938	10.1%	$16,812	$1,899 (117%)	$211 (116%)
TN	4,292	$7,343	9.3%	$13,308	$1,291 (80%)	$184 (97%)
MD	4,137	$9,331	9.9%	$16,632	$1,809 (112%)	$198 (104%)
USA	216,383	$8,772		$16,044	$1,622 (100%)	$190 (100%)

SOURCE: U.S. Census, Advisory Commission on Intergovernmental Relations, The Tax Foundation.

SELECTED STATISTICS, HIGHWAY SPENDING

	1979 POPULATION DENSITY SQ. MILES PER CAPITA	1979 MOTOR VEHICLE REGISTRATION, PER CAPITA	1979 HIGHWAY MILES, PER CAPITA	1979 HIGHWAY EXPENSE, PER CAPITA
USA	16.4	.7252	17.80	$129
MN	20.7	.8808	31.81	$190
WI	11.9	.7019	22.60	$162
IA	19.4	.8684	38.56	$227
IN	6.7	.7326	16.87	$112
VT	19.5	.7140	28.46	$180
OR	38.4	.8267	48.78	$148
TN	9.6	.7034	18.87	$136
MD	2.5	.6856	6.55	$132

SOURCE: U.S. Census, Advisory Commission on Intergovernmental Relations, The Tax Foundation.

SELECTED STATISTICS, HEALTH/WELFARE SPENDING

	1977 NURSING HOME BEDS PER 100,000	1977 DOCTORS PER 100,000	1977 HOSPITAL BEDS PER 100,000	1979 AFDC AS % POPULATION	1975 PERCENT BELOW POVERTY LINE	1978 AVERAGE AFDC PAYMENT	STATE-LOCAL WELFARE/HEALTH/HOSPITAL SPENDING	
							PER CAPITA	PER $1,000 PERSONAL INCOME
MN	1,080.4	172.1	782.4	3.2%	8.3%	$299	$360	$46.12
WI	1,133.3	140.2	640.8	4.3	7.7	319	364	48.71
IA	1,173.8	112.8	746.2	3.4	7.9	284	283	35.50
IN	702.8	117.5	644.1	2.8	8.1	190	223	29.04
VT	1,058.1	193.8	638.0	4.3	13.4	293	265	40.85
OR	721.2	168.3	504.4	3.9	8.9	279	287	36.65
TN	468.3	142.1	727.7	3.6	15.8	110	252	38.80
MD	464.1	222.7	601.0	5.1	7.7	195	277	33.19
USA	653.9	165.7	650.3	4.6	11.4	254	312	40.17

SOURCE: U.S. Census, Advisory Commission on Intergovernmental Relations, The Tax Foundation.

SELECTED STATISTICS, EDUCATION SPENDING

	PUBLIC K-12 ENROLLMENT % POP. 1978	AVG. TEACHER SALARY 1978	PUBLIC STUDENT TEACHER RATIO 1978	TOTAL HIGHER ED. % OF POP. FALL 1978	HIGHER EDUC. PERCENT PUBLIC FALL 1978	PUBLIC SPENDING, ALL EDUCATION	
						PER CAPITA	PER $1,000 PERSONAL INCOME
MN	21.13%	$14,167	19.15	4.7%	79%	$591	$75.63
WI	19.92	14,053	16.97	5.1	87	634	84.93
IA	20.64	13,402	17.99	4.4	69	619	77.51
IN	21.30	13,408	21.54	4.1	76	491	64.09
VT	20.89	11,305	16.61	6.1	59	611	94.19
OR	23.35	13,832	19.79	5.8	89	663	84.66
TN	19.95	11,919	21.63	4.5	76	428	65.73
MD	20.78	15,808	19.95	5.2	87	613	73.36
USA	19.86	14,247	20.08	5.1	78	543	69.91

SOURCE: U.S. Census, Advisory Commission on Intergovernmental Relations, The Tax Foundation.

NURSING HOME USE

	1978 NURSING HOME RESIDENTS 1978 ELDERLY POPULATION	1978 PERCENT OF POPULATION OVER 65	1979 NURSING HOME BEDS PER 100,000
USA	5.2%	11.0%	653.9
MN	9.2%	11.6%	1,080.4
WI	8.7%	11.7%	1,133.3
IA	8.3%	13.1%	1,173.8
IN	6.5%	10.5%	702.8
OR	3.8%	11.7%	721.2
TN	3.7%	11.0%	468.3
MD	4.9%	8.9%	464.1
VT	8.4%	11.3%	1,058.1

SOURCE: U.S. Department of Commerce, State Department of Welfare.

APPENDIX II

PER CAPITA TAX COLLECTIONS–BY STATE*

FEDERAL		STATE		LOCAL		TOTAL	
1. Alaska	3670.00	1. Alaska	3594.02	1. D.C.	1474.71	1. Alaska	7858.68
2. D.C.	3373.00	2. Hawaii	1034.59	2. New York	770.56	2. D.C.	4847.71
3. Connecticut	3267.00	3. Delaware	866.75	3. Alaska	594.66	3. Connecticut	4337.27
4. New Jersey	3038.00	4. Wyoming	824.04	4. Wyoming	575.32	4. Wyoming	4289.36
5. Illinois	3026.00	5. California	818.23	5. Massachusetts	558.81	5. New York	4218.87
6. Wyoming	2890.00	6. Minnesota	785.52	6. New Jersey	558.21	6. New Jersey	4175.49
7. California	2859.00	7. New York	724.31	7. Connecticut	478.35	7. Illinois	4109.83
8. Maryland	2854.00	8. Wisconsin	715.48	8. Colorado	473.64	8. California	4031.23
9. Michigan	2842.00	9. New Mexico	712.34	9. Illinois	464.36	9. Maryland	3958.23
10. Washington	2827.00	10. Washington	706.40	10. New Hampshire	449.54	10. Michigan	3917.44
11. Nevada	2820.00	11. Massachusetts	684.56	11. Maryland	449.39	11. Hawaii	3886.52
12. Delaware	2802.00	12. Maryland	654.84	12. Montana	446.00	12. Massachusetts	3881.37
13. New York	2724.00	13. Michigan	642.43	13. Nebraska	443.02	13. Delaware	3860.67
14. Kansas	2711.00	14. West Virginia	625.38	14. Michigan	433.01	14. Washington	3815.85
15. Massachusetts	2638.00	15. Arizona	619.72	15. Oregon	425.80	15. Nevada	3792.17
16. Ohio	2627.00	16. Illinois	619.47	16. Rhode Island	410.85	16. Minnesota	3665.73
17. Hawaii	2609.00	17. Pennsylvania	610.16	17. South Dakota	396.49	17. Kansas	3637.12
18. Colorado	2577.00	18. Iowa	599.67	18. Kansas	388.81	18. Colorado	3566.70
19. Indiana	2551.00	19. Nevada	596.50	19. Arizona	387.70	19. Wisconsin	3550.40
20. Pennsylvania	2543.00	20. Connecticut	591.92	20. Vermont	378.85	20. Pennsylvania	3521.00
21. Minnesota	2541.00	21. Oklahoma	587.12	21. Nevada	375.67	21. Oregon	3515.54
22. Oregon	2537.00	22. Kentucky	585.89	22. Ohio	368.72	22. Rhode Island	3492.46
23. Iowa	2524.00	23. Rhode Island	581.61	23. Pennsylvania	367.84	23. Iowa	3491.24
24. Texas	2510.00	24. New Jersey	579.28	24. Iowa	367.57	24. Nebraska	3468.25
25. Nebraska	2505.00	25. Louisiana	570.22	25. California	354.00	25. Ohio	3437.20

26. Rhode Island	2500.00	26. North Dakota	569.47	26. Wisconsin	345.92	26. Virginia	3346.61
27. Virginia	2491.00	27. Montana	553.69	27. Virginia	342.46	27. Texas	3315.90
28. Wisconsin	2489.00	28. Oregon	552.74	28. Minnesota	339.21	28. Indiana	3294.73
29. New Hampshire	2488.00	29. Maine	550.36	29. Missouri	333.48	29. Montana	3267.69
30. Missouri	2458.00	30. North Carolina	547.39	30. Texas	330.87	30. New Hampshire	3227.98
31. Oklahoma	2372.00	31. South Carolina	538.01	31. Maine	307.90	31. Missouri	3217.46
32. Florida	2311.00	32. Utah	537.82	32. Utah	301.89	32. Arizona	3207.42
33. North Dakota	2302.00	33. Kansas	537.31	33. Washington	282.45	33. Oklahoma	3198.66
34. Montana	2268.00	34. Vermont	521.17	34. North Dakota	277.34	34. North Dakota	3148.81
35. Arizona	2200.00	35. Nebraska	520.23	35. Georgia	270.50	35. Florida	3068.86
36. Louisiana	2188.00	36. Idaho	519.43	36. Louisiana	270.40	36. Louisiana	3028.62
37. New Mexico	2074.00	37. Colorado	516.06	37. Florida	264.61	37. New Mexico	2953.24
38. Tennessee	2047.00	38. Virginia	513.15	38. Indiana	252.70	38. Vermont	2925.02
39. Vermont	2025.00	39. Arkansas	507.99	39. Tennessee	245.10	39. South Dakota	2799.55
40. Kentucky	2022.00	40. Georgia	499.44	40. Hawaii	242.93	40. West Virginia	2795.75
41. Georgia	2022.00	41. Mississippi	498.98	41. Oklahoma	239.54	41. Georgia	2791.94
42. South Dakota	2011.00	42. Florida	493.25	42. Idaho	234.85	42. Kentucky	2762.06
43. Idaho	2003.00	43. Indiana	491.03	43. North Carolina	200.86	43. Idaho	2757.28
44. West Virginia	2000.00	44. Alabama	477.32	44. Delaware	191.92	44. Maine	2754.26
45. North Carolina	1957.00	45. Texas	475.03	45. Alabama	172.64	45. Utah	2750.71
46. Utah	1911.00	46. Ohio	441.48	46. West Virginia	170.37	46. North Carolina	2705.25
47. Alabama	1898.00	47. Missouri	425.98	47. South Carolina	170.26	47. Tennessee	2703.12
48. Maine	1896.00	48. Tennessee	411.02	48. New Mexico	166.90	48. Alabama	2547.96
49. South Carolina	1826.00	49. South Dakota	392.06	49. Kentucky	154.17	49. South Carolina	2534.27
50. Arkansas	1792.00	50. New Hampshire	290.44	50. Mississippi	147.44	50. Arkansas	2446.38
51. Mississippi	1619.00	51. D.C.	0.00	51. Arkansas	146.39	51. Mississippi	2265.42
U.S. Average	**2542.00**		**606.88**		**379.69**		**3528.57**

* Federal tax burden figures are estimates compiled by Tax Foundation, Inc., for the fiscal year ended September 30, 1981. State and local data is for taxes collected for the fiscal year ended June 30, 1980, which is the most current data published by the U.S. Department of Commerce, Bureau of the Census.

SOURCE: Minnesota Taxpayers Association.

STATE OF MINNESOTA MAJOR TAX REVENUE SOURCES
(1978-1984)
(ALL AMOUNTS IN THOUSANDS)

	CALENDAR YEAR COLLECTIONS									FISCAL YEAR ESTIMATES			
	1978	1979	% Change 1979/1978	1980	% Change 1980/1979	1981	% Change 1981/1980	Fiscal Year 1982 (Preliminary Actual)	Fiscal Year % Change 1982/1981	1983	% Change 1983/1982	1984(A) (Unofficial)	% Change 1984/1983 (Planning Assumption)
General Fund Net Collections													
Individual Income	$1,213,827	$1,343,991	10.72%	$1,283,609	-4.49%	$1,494,720	16.45%	$1,558,954	10.90%	$2,088,556	33.97%(B)	$2,214,000	6.00%
Corporation and Bank	318,978	390,320	22.37	363,428	-6.89	329,708	-9.28	334,925	.97	395,672	18.14	419,000	6.00
Sales	583,255	636,349	9.10	667,469	4.89	754,452	13.03	876,216	27.62	1,052,001	20.06	1,115,000	6.00
Motor Vehicle Excise	90,539	97,770	7.99	82,519	-15.60	93,371	13.15	103,067	18.44	141,342	37.14	150,000	6.00
Insurance Gross Premiums	55,196	61,126	10.74	64,687	5.83	54,520	-15.72	74,159	18.64	66,028	-10.96	70,000	6.00
Other Gross Earnings	67,120	71,461	6.47	71,159	-.42	66,192	-6.98	73,519	12.74	110,650	50.51	118,000	6.00
Cigarette and Tobacco	85,575	86,490	1.07	87,410	1.06	89,505	2.40	88,959	.37	91,847	3.25	98,000	6.00
Alcoholic Beverages	53,171	54,029	1.61	55,302	2.36	55,919	1.12	55,465	-.61	58,104	4.76	61,000	6.00
General Fund Mining	11,007	36,165	228.56	32,538	-10.03	20,701	-36.38	20,109	-4.92	16,099	-19.94	17,000	6.00
Other General Fund	56,669	62,657	10.57	50,713	-19.06	45,706	-9.87	42,170	-19.42	39,614	-6.06	42,000	6.00
Total General Fund Net Tax Collections	$2,535,337	$2,840,358	12.03%	$2,758,834	-2.87%	$3,004,794	8.91%	$3,227,543	13.06%	$4,059,913	25.79%	$4,304,000	6.00%
Non General Fund Taxes													
Highway Fuel	$206,500	$208,872	1.15%	$217,503	4.13%	$244,630	12.47%	$259,090	15.96%	$249,076	-3.87%	$244,000	-2.20%
Motor Vehicle Licenses	119,019	121,227	1.86	129,718	7.00	133,919	3.24	153,005	12.08	185,216	21.05	196,000	6.00
Taconite Production	48,321	68,529	41.82	87,599	27.83	86,313	-1.47	98,501	14.12	94,111	-4.46	94,000	.00
Other Non General Fund	6,809	10,404	52.80	9,152	-12.03	8,545	-6.63	5,900	-36.76	4,014	-31.97	4,000	.00
Total Non General Fund Taxes	$380,649	$409,032	7.46%	$443,972	8.54%	473,407	6.63%	$516,494	11.98%	$532,417	3.08%	$538,000	1.13%
Total Net Tax Collections (State)	$2,915,986	$3,249,390	11.43%	$3,202,806	-1.43%	$3,478,201	8.60%	$3,744,039	12.91%	$4,592,330	22.66%	$4,842,000	5.44%

PROPERTY TAX LEVIES AND CREDITS TAXES PAYABLE 1978-1984

	1978 Actual (000)	1979 Actual (000)		1980 Actual (000)		1981 Actual (000)		1982 Actual (000)		1983 Estimate* (000)		1984 Estimate* (000)	
Gross Tax Levies													
County	$408,628	$440,659	7.84%	$495,585	12.46%	$562,404	13.48%	$636,084	13.10%	$719,000	13.04%	$813,000	13.07%
City	279,032	285,996	2.50	305,909	6.96	353,315	15.50	396,711	12.28	446,000	12.42	501,000	12.33
Town	24,359	27,396	12.47	33,811	23.42	41,266	22.05	46,865	13.57	53,000	13.09	60,000	13.21
School District	789,476	832,324	5.43	872,727	4.85	872,054	-0.08	1,128,362	29.39	1,298,000	15.03	1,402,000	8.01
Special District	31,895	34,520	8.23	39,502	14.43	52,610	33.18	61,919	17.69	73,000	17.90	86,000	17.81
Tax Increment	5,307	7,418	39.78	11,305	52.40	22,489	98.93	35,141	56.26	40,000	13.83	45,000	12.50
Total	$1,538,697	$1,628,313	5.82%	$1,758,838	8.02%	$1,904,138	8.26%	$2,305,082	21.06%	$2,629,000	14.05%	$2,907,000	10.57%
Credits													
Agricultural	$35,165	41,634	18.40%	$52,187	25.35%	$70,456	35.01%	$86,946	23.40%	$98,000	12.71%	$108,000	10.20%
Wetlands						2,307		2,799	21.33	3,200	14.33	3,600	12.50
Native Prairie						83		102	22.89	120	17.65	135	12.50
Reduced Assessment						11,537		14,027	21.58	15,400	9.79	17,000	10.39
Power Line								136		150	10.29	160	6.67
Agricultural Preserve										**		**	
Disaster										**		**	
Taconite Homestead	9,525	11,749	23.35	13,006	10.70	13,976	7.46	15,947	14.10	17,700	10.99	19,300	9.04
Supplemental Homestead						422		465	10.19	500	7.53	500	10.00
State Paid Homestead	234,439	242,340	3.37	358,307	47.85	432,835	20.80	479,293	10.73	513,000	7.03	532,000	3.70
Total	$279,130	$295,723	5.94%	$423,500	$43.21%	$531,616	25.53%	$599,715	12.81%	$648,070	8.06%	$680,745	5.04%
Net Tax Payable	$1,259,567	$1,332,590	5.80%	$1,335,338	0.21%	$1,372,521	2.78%	$1,705,367	24.25%	$1,980,930	16.16%	$2,226,255	12.38%
Total Net State and Local Taxes	$4,175,153	$4,581,890	9.74%	$4,541,144	-9.89%	$4,850,722	6.82%	$5,449,406	16.22%	$6,573,260	20.62%	$7,068,255	7.53%

(A) 1984 estimates are unofficial using the average growth rate for planning purposes from the Department of Finance Memo of July 16, 1982.

(B) The large individual income tax percent change is due to the rescheduling of the property tax credits paid to renters and senior citizens to October 1983. This change removes the credit from the Individual Income Tax structure.

* The 1983 and 1984 estimate for county, city, town and special district levies reflect the same annual percentage increase that existed between 1981 and 1982. These percentages are: county 13.1%; city 12.3%; town 13.6%; special district 17.7%. School district levies are estimated to increase by 15% in 1983 and 8% in 1984. Tax increment taxes are estimated to increase by $5,000,000 per year. The total levy increase between 1981 and 1982 was 21.1%. It is estimated to be 14.1% between 1982 and 1983 and 10.6% between 1983 and 1984.

** No estimate has been made for this credit.

NOTE: Detail may not add to totals because of rounding.

SOURCE: Research Office, Minnesota Department of Revenue
Local Government Aids and Analysis Division Department of Revenue
August 10, 1982

APPENDIX IV

Our committee heard many examples of tax policies which did not accomplish their desired goals, or had significant negative side effects which were unexpected. In the text of the report, we did not refer specifically to any of them, because we did not want to single out any features of the tax system as being in need of change without researching each of the examples.

The unitary tax, the imposition of a sales tax on candy and pop, the rent capitalization method of determining farm property and many other items were brought to us as examples of mistakes in tax policy. One of our committee members, Robert Dildine, has done some independent research about rent capitalization, which was published as part of another paper on tax policy. His section on rent capitalization follows.

An example, the Rental Rate Treatment of Farmland.

Beginning with the 1977 Equalization Aid Review Committee (EARC) certified adjustment assessed values (for the FY 1980 school aids and basic levies), Minnesota statutes require that farm rental rates capitalized at nine percent be used in the determination of the school district values. Beginning with the 1981 assessment, statute requires that farm rental rates capitalized at 5.6 percent be used in determining assessors' market values for the spreading of all tax levies. These obscure references are a major change in property tax practice and administration. They became law with little discussion or controversy. It is instructive to examine the history and effects of this use of capitalized rental rates in the property tax system.

The first observation is that this change makes the assessment process more complex and more expensive to administer. Further examination reveals that it also makes the results less reliable, consistent or defensible. Estimation of market value is a long established practice with an accepted methodology and a standard of comparison: actual registered sales prices. None of this exists for the determination of rental rates. Five years of experience with the use of rental rates in the EARC procedure reveals a significant increase in the coefficient of variation of the resulting values from the use of rental rates. Since under statute both market value and rental rate must be determined, it would seem that to do an equivalent job of assessment the administrative cost of farm assessment would have to more than double. The problem for the state's review process would seem likely to increase more than proportionally due to the additional factor in appeals.

Given all these strikes against the use of rental rates one would expect to find some compelling reason for their use. No such compelling reason is to be found.

The use of rental rates along with the artificial capitalization percentage of nine percent has given large, hidden tax relief credits to school districts containing significant portions of farm property. The use of rental rates capitalized at an arbitrary 5.6 percent will give lesser tax breaks to specific farms (which ones being unknown at this time), beginning with taxes payable in 1984.

The magnitude and distribution of the school tax relief given through the use of farm rental rates is examined in the following table. As shown, the use of the rental rates reduced statewide adjusted assessed values by \$2.4-2.8 billion for the three years it has been fully effective. (The use of the rental ratios was phased in over a three-year period. It may also be noted that the rental rate method is averaged with the sales price method in determining the adjusted values. The discrepancy between the rental method and the sales price method is roughly twice that shown by the average.) The amount of tax relief represented by this method ranges from \$50.1 million for 1981 taxes to \$71.4 million for 1983 taxes.

(There is a limitation provision that phases in changes in the adjusted assessed value. The analysis in the table is based on an assumption that the adjusted assessed values would have fully reflected actual market values. It is likely that the limitation would have had some interaction with the phasing in of the adjusted value increases without the use of the rental rates. However, since the limitations would have been applied to a higher base, and since the limitation is set at 19 percent, a higher rate than the average rate of property value inflation, the limitation would not have had a great effect. If the use of rental rates were suddenly ended, the limitation would go into effect, e.g., limiting the recovery of the tax loss in 1983 to about \$36 million.)

The tax relief involved in the use of rental rates capitalized at nine percent could have been put directly into the school aid formulas. The use of the rental rates only serves to reduce the total school levy in the affected districts; it does not affect the spreading of the levy, i.e., it gives the same relief to commercial, industrial and residential property within the affected districts. One problem with this form of tax relief is that since it is not an appropriated budget item it is not subject to the scrutiny and analysis of the budget process.

As shown on the lower portion of the table, the effect of using rental rates only on farm land is not uniform between the metro and non-metro regions. The rental rates are a form of tax relief that increases the metro share of the net property tax burden.

Two alleged justifications for the use of rental rates are that they compensate for inflated sales prices due to contract for deed sales at lower than market interest rates, and that they make the property tax more income sensitive. There are three answers to the contract for deed issue. One is that it applies to all property types, not only farms. Applying a remedy only on farm land only exacerbates the metro-non-metro disparity found in the previous analysis. Second, it can be argued that using the contract prices is valid because a low interest rate is an asset against which it is legitimate to apply a wealth tax. The person paying the contract price is assumed to be receiving something of equal worth in return. Third, a more direct means of providing remedy, if so desired, is available: direct discounting of the contract price by comparing the contract interest rate to the prevailing market rate at the time of sale. (This could be done as part of the sales ratio study.) The notion of making the property tax more income sensitive is contrary to the notion of a broad, diversified tax base, the goal of which is to achieve a balance between taxes on income, taxes on consumption, and taxes on wealth.

The use of rental rates has provided what is probably a temporary windfall for farm school districts. If the use of rental rates prevails, the use will probably have to be expanded in the name of fairness to the other poverty types. Then, to bring in the desired levels of revenue, mill rates will have to be raised, and, except for random differences, we will be back where we started, except that we will have a more complex and expensive system to understand and administer.

A similar statement could be made about the use of rental rates (capitalized at the more realistic, but still arbitrary 5.6 percent) for 1983 farm assessments. County assessors are already complaining about the administrative problems and costs. The real question is of what benefit is the procedure?

THE EFFECT OF THE USE OF FARM RENTAL RATES CAPITALIZED AT 9% ON SCHOOL TAXES AND STATE SCHOOL AIDS

Change in Equalization Aid Review Committee adjusted assessed values resulting from the use of estimated rental rates capitalized at 9%.

1979	E.A.R.C. value change for 1981 taxes:	$-2.786 billion
1980	E.A.R.C. value change for 1982 taxes:	-2.413 billion
1981	E.A.R.C. value change for 1983 taxes:	-2.747 billion

TAX YEAR	(1) E.A.R.C. MILLS	(2) RENTAL REDUCTION IN E.A.R.C. VALUE	(3) LEVY REDUCTION* (1) X (2)
1981	22 mills	$-2.786 billion	$-50.1 million
1982	26 mills	-2.413 billion	-62.7 million
1983	26 mills	-2.747 billion	-71.4 million

Dividing the levy reduction 4.6%/95.4% to approximate the division of farm values between the Metropolitan and Nonmetropolitan counties yield:

LEVY REDUCTION

TAX YEAR	METROPOLITAN 4.6%	NONMETROPOLITAN 95.4%
1981	$ 2.3 million	$47.8 million
1982	2.9 million	59.8 million
1983	3.3 million	68.1 million

*Recovery of the full amount of these reductions would require that the E.A.R.C. values be fully phased in under the 19 percent limitation on annual E.A.R.C. value increases, and that the school aid formulas reflect the value changes so as to keep school districts on the school aid formulas.

DATA SOURCE: Minnesota Department of Revenue, Property Tax Equalization; Department of Education, State Aids Section.

WHAT THE CITIZENS LEAGUE IS

Formed in 1952, the Citizens League is an independent, nonpartisan, nonprofit, educational corporation dedicated to understanding and helping to solve complex public problems of our metropolitan area.

Volunteer research committees of the Citizens League develop recommendations for solutions 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.

WHAT THE CITIZENS LEAGUE DOES

RESEARCH PROGRAM

- Four major studies are in progress regularly.
- Each committee works 2½ hours every other week, normally for 6-10 months.
- Annually over 250 resource persons made presentations to an average of 25 members per session.
- A fulltime professional staff of eight 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.

CL NEWS

- Four pages; published every two weeks; mailed to all members.
- Reports activities of the Citizens 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 ACTION PROGRAM

- Members of League study committees have been called on frequently to pursue the work further with governmental or nongovernmental agencies.
- The League routinely follows up on its reports to transfer, out to the larger group of persons involved in public life, an understanding of current community problems and League solutions.

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- A 40-page directory containing listings of Twin Cities area agencies, organizations and public officials.

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- Opportunity for individuals to participate in background presentations and discussions on major public policy issues.
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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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