

## **“Change Minnesota” Summary**

Minnesota’s state-local government relationship (“SLGR” – “Slugger”) and state-local fiscal system (“SLFS” - “Sluffis”) were last significantly redesigned 35-42 years ago, when dissatisfaction with high property taxes led to the 1967 enactment of the sales tax and the fast bounce back of property taxes led in the early 1970s to a much expanded state income tax, a higher sales tax, much greater state support for schools, and legislative involvement in keeping local property taxes “under control.”

Events have overtaken Slugger and Sluffis and each is now performing badly for Minnesotans, who want reasonable results at a reasonable price from their governments.

The Governor and Legislature should act in 2010-11 as described in the proposal to:

- Help balance the state general fund budget for FY 2010-11 and 2012-13
- Encourage local communities to reduce the cost and increase the quality of local government services, producing immediate results and steps along a path to greater future improvement
- Change systemic land use and development incentives to encourage better water and habitat quality, energy conservation and emissions reduction, protecting Minnesota’s iconic waters and working on climate change issues
- End Minnesotans’ risk of personal bankruptcy from health care financial catastrophe and begin reining in out of control health care spending
- End the need for referenda to raise the money to run the schools
- Engage citizens in communities across the state in reconfiguring their local governments to fit the times

The proposal is to implement a new Slugger operating system,<sup>1</sup> supported by the Sluffis redesign required to optimize Slugger performance to:

- Change Slugger strategy from state command and control to steering government service provision to improved results by:
  - Focusing governments on improving results at lower unit cost
  - Focusing state resources on investing in people by funding education and human services
  - Giving cities, counties and townships more autonomy on other functions
  - Ensuring that results are measured and accurately reported
  - Providing citizens opportunities to reconfigure their local governments based on knowledge of the true costs of the current configuration
- Change state-provided property tax aids and credits (“PTAC”) to maximize budget savings, support the Slugger strategic change, and focus property tax relief on individuals, not governments, until such relief can be eliminated

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<sup>1</sup> Readily extendable at Legislature’s option to the entire state budget and the Legislative-Executive Branch relationship. Readily extendable at local option to 3,000+ local government units.

- Make the Sluffis changes required to accomplish the foregoing and desired to make Sluffis more fair, reliable, efficient, understandable and competitive, in structure and in operation, than ever<sup>2</sup>

**What SLGR and SLFS Redesign Can Do for Minnesota**

<b>Characteristic</b>	<b>Present Crisis, Bleak Future</b>	<b>Redesign: Resolve Crisis, Bright Future</b>
General fund spending down property tax relief black hole	\$3.4 billion per biennium	0 within a couple of years
General fund savings	As agreed by Governor and Legislature	Same, but fewer service cuts & clear path to a brighter future
Land, water, energy, climate change	Inefficient land use + insufficient care of the land = dropping water & habitat quality, wasteful energy use, high emissions	Development channeled to cities, growth without trashing the place, energy conserved, emissions reduced. Taxes could further improve results.
Farm taxation	Property tax important, sales tax exemptions for environmentally harmful chemicals. Land as an economic commodity with no regard for the environment.	Exempt from property tax – honor the land. Exemption supports extending sales tax to food. Business activities tax like a severance tax. Stop subsidizing pollution.
Transportation funding	Gas tax, motor vehicle sales tax, license tabs, local sales & property tax	Don't need local sales tax. More from property tax. Consider green taxes. Consider some state highways to counties.
Health care	Some uninsured, most one or two events away from personal financial catastrophe, runaway costs	Cover all Minnesotans by ending current subsidies and risk of financial catastrophe, get started on cost reduction <sup>3</sup>
Schools	Near \$2 billion property tax per year, raise operating funds by referendum	No referenda, less property tax, none if use local income tax, measure and report results
Human services delivery	Organized through 87 counties, which levy hundreds of millions in property tax	9-14 regional boards, no more property tax dollars, counties can bid to produce services
Cities	Funding instability from LGA instability, levy limits,	Property tax opened up for cities, no levy limits, greater

<sup>2</sup> Criteria articulated by the Department of Revenue in its Model Revenue System in the early 1990s.

<sup>3</sup> Health care reform design beyond scope of this proposal, but potential use of SLFS in health care reform and contribution of health care reform to SLGR redesign are noted

	difficult access to crowded property tax	local autonomy, little or no LGA, measure & report results
Counties	Human services major part of budget, hands tied by maintenance of effort mandates, difficult access to crowded property tax	With schools (nearly) off & human services off property tax, access to property tax eased, end MOE mandates, measure and report results, maybe more roads responsibility
SLFS reliability	Unreliable – Budget Trends Study Commission report	Improved: state ptax reduces shortfalls, broader based lower rate sales tax, better budget reserve
Business location competitiveness	Governor and business community concerned – see 21 <sup>st</sup> Century Tax Reform Commission	Improved: eliminate giveaways and local negotiations, burdens more consistent across state, choice of burden shift to out of state businesses or continued high property & sales taxes
Tax System regressivity	Regressive and becoming more so	Governor and Legislature decide how regressive
State budget process and SLGR	Control inputs, command uses, provide property tax relief, results secondary	Results oriented, measure and report, state invests in human capital, more local autonomy
Measurement & reporting of results	Rare	The norm
Use service production alternatives for better, lower cost results	Comparatively rare	Common, but at local option
Local citizens decide to reconfigure local governments for better, lower cost results	Almost never	Opportunities abound
Twin Cities Metroplex	7 county statutory area plus Met Council, lots of governmental service producers per capita	Urban citizens decide whether to merge 7-17 county governments and Met Council into Metroplex Council; rural whether to attach to adjacent county or be in Metroplex rural division
Townships	Property tax reliant	Same, but can use money saving SLGR reform tools
Special Districts	Many levy property tax	No more – bill their local government customers

## Design Elements

1. Eliminate at least \$2.4 billion per biennium in property tax aids and credits
2. Change governmental property tax use
3. Change property tax incidence
4. Change property tax base from value to area
5. Redesign Slugger as described above, engaging local governments and citizens across the state in solving the budget crisis with minimal damage and reconfiguring local governments to fit the times
6. Broaden the consumer sales tax base and cut the rate
7. Broaden the individual income tax base, eliminate the AMT and fund health care reform by ending tax expenditures to protect Minnesotans from health care-related financial ruin.
8. Redesign business taxation to make Minnesota more competitive
9. Redesign farm taxation to honor the land
10. Interfere less in private and governmental decision making
11. Save on tax administration
12. Increase Sluffis reliability

## Political Feasibility

We are in the fiscal crisis of our lifetimes. The property tax system pours billions of dollars down the black hole of property tax relief.

Sluffis distributes money to cities all over the state with inaccurate regard for the ability of local homeowners to pay the property taxes that the cities would otherwise levy, even though the property tax refund programs exist to take ability to pay into account in relieving property tax burdens. Exhibit B and Attachments B-1 and B-2 shine some light on the murky property tax/local aids system interactions. Attachment B-2 shows 60 cities that receive more than \$400 per capita annually in state aids and what the total property taxes (for all local governments, not just the city) are for the average valued house in

each city. The high in aid per capita is \$881 (Mountain Iron). The low in average home value property tax is \$262 (Keewatin). The highest ratio of per capita aid from the state to average home value property tax is 2.6 (Eveleth).

Looking at three property tax relief programs – LGA, taconite aid and market value homestead credit - payable to cities for 494 Minnesota cities, arrayed in the Stinson/Gillaspy geographical groupings of five ruralplexes and one 17 county metroplex, shows the following average annual per capita city aids (dollars per each city resident) and the following 2007 county or “plex” populations:

Metro 7 outside Minneapolis and St. Paul – 135 cities	\$ 80	2,172,994
Metro 10 nonstatutory metroplex counties – 77 cities	\$139	<u>763,261</u>
Low subsidy areas population		2,936,255
Minneapolis-St. Paul - 2 cities	\$237	676,009
Central Lakes - 47 cities	244	<u>292,129</u>
Medium subsidy areas population		968,138
Northwest Valley – 43 cities	\$299	289,396
Southeast River Valley – 112 cities	301	549,035
Southwest Corn Belt – 41 cities	346	164,535
Up North – 37 cities	428	<u>356,134</u>
High subsidy areas population		1,359,100

There are wild variations among cities within each area except the two central cities.

Sluggo and Sluffis are performing badly for all 5.3 million Minnesotans. Under the redesigned Sluggo and Sluffis, cities would have greatly eased access to the property tax because schools and counties would levy less; no city or its residents would be punished; all cities would be treated similarly, which would greatly incentivize attempts to operate more efficiently, and all Minnesotans would be protected to the same degree against too high property taxes.

Four factors could make Sluggo and Sluffis redesign politically popular:

- Unhappiness with subsidy patterns of existing city aids
- Happiness at eliminating disputes over home property values, especially with outdated high values now affecting taxes currently payable
- Happiness at ending risk of personal bankruptcy from health care costs
- Happiness with emphasis on care for Minnesota’s water and land, channeling of development to cities and facilitation of energy conservation of the Best Property Tax System Redesign – the public voted in November to increase taxes to help the environment, and people increasingly recognize that we live in a “hot, flat and crowded” world.