

SOLVING MINNESOTA'S BUDGET PROBLEM

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Solving Minnesota's Budget Problem Topics

How Bad Is the Budget Problem?

How Did It Come to Be?

What's the Likely Impact on You and Me?

How to Solve the Budget Problem

Shortfalls in Governor Candidates' Proposals

We're All in This Together

Q&A

Intent of Presentation

Take a look at problem and solutions

Present technical realities and structural defects in state-local fiscal system

Identify, but not advocate for, political choices

Remind us all that we are all in this together

How Much Is Too Much Taxing and Spending?

Political question

But I will show you that spending is increasing more slowly than some claim

My main interest: Tax and spend no more than necessary to get the results we want

Getting to that level requires significant redesign of how government works

Redesign is difficult: “They all want to fix the problem, but none of them wants to change anything.”

Intended Take Aways

Minnesota: one Metroplex and five Ruralplexes

One community made up of spatially separated neighborhoods

Understand the spending growth bamboozle

The budget problem requires a balanced solution comprising multiple elements

We need to vastly broaden the sales tax base and slash the rate

None of the governor candidates has yet proposed a workable solution

We are all in this together

Minnesota's Spatially Separated Neighborhoods

Twin Cities Metroplex	17 counties
Ruralplexes	
Southeast River Valley	20
Southwest Corn Belt	14
Northwest Valley	15
Central Lakes	10
Up North	<u>11</u>
Total Counties	87

The Four Tools for Solving the Budget Problem

Grow the economy

Redesign government

Cut spending

Increase taxes

How Bad Is the Budget Problem?

First, understand the “budget's” place in the Minnesota state-local government enterprise

Second, look at the budget

- *Short term numbers*

- *Long term trends*

Dollar Size of the Minnesota Government Enterprise

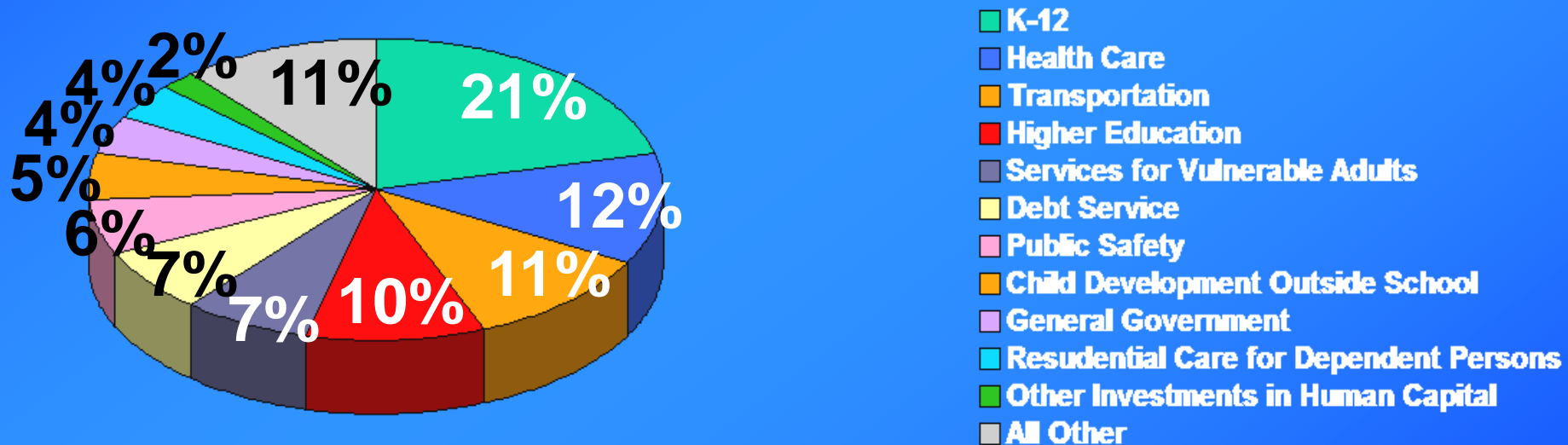
These numbers are annual and in \$ billions

Total state spending	28 billion
Local governments	14
School districts	<u>10</u>
Grand Total	<u>52</u>
Less state aids	<u>10</u>
Dollar size of the MGE	42 billion per year

State general fund at 17 is about 40% of total

Where the Money Goes

Sadly, no effort is made to report on this, so these are very rough estimates from 2008 and earlier



Health care understated because excludes health care costs of public employees, which is included in each of the other areas

Spending on Human Capital

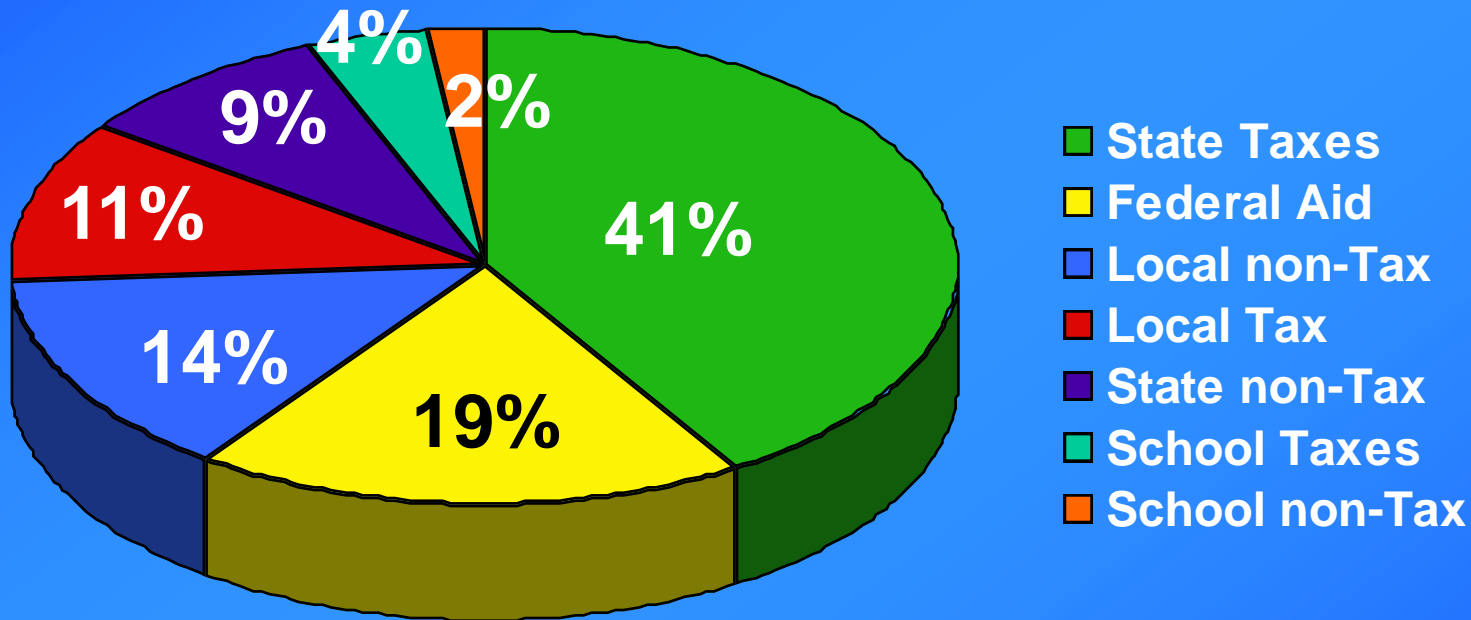
Info for fy 2009. Total state spending, not just general fund. Dollars in billions, % is the % of total state spending of \$28 billion, rank is rank among categories of state spending

Categories are created by jpj in attempt to generate meaningful information about where our tax dollars go. Broader than just health & human services spending

Health Care	\$5.5 billion	18.8%	2 nd
Services for vulnerable adults	\$2.4 billion	8.1%	3 rd
Residential care for dependent persons	\$1.7 billion	5.9%	6 th
Child development outside school	\$1.2 billion	4.3%	8 th
Other investments in human capital	\$0.5 billion	1.7%	11 th

Where the Money Comes From

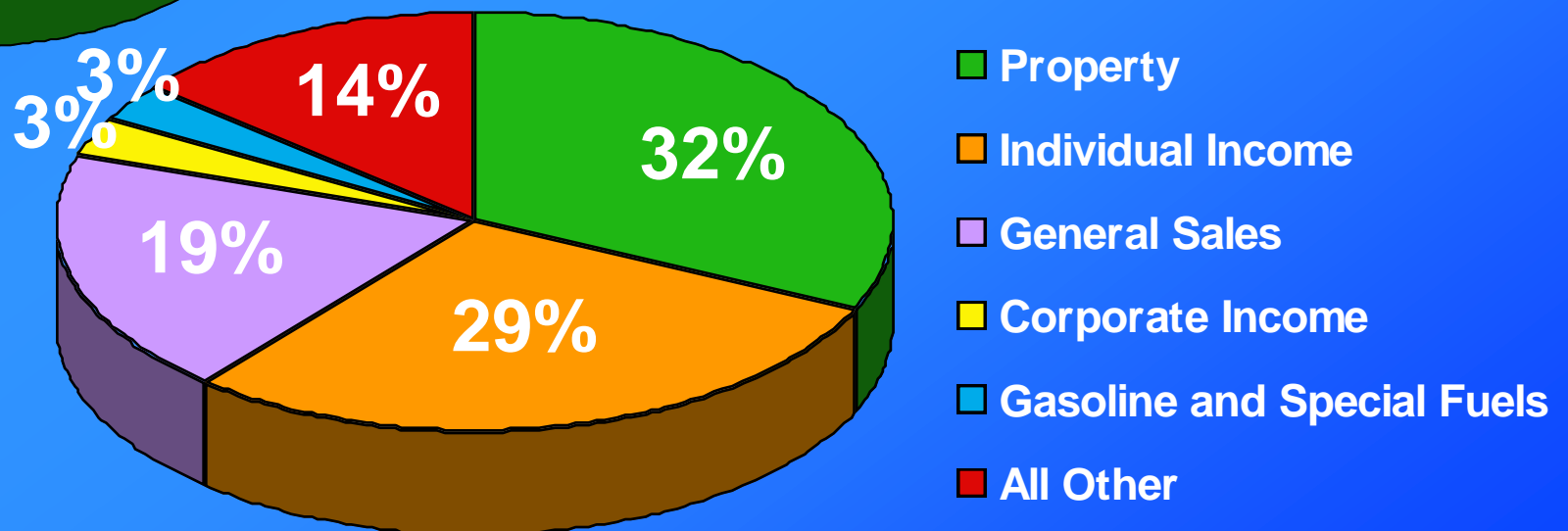
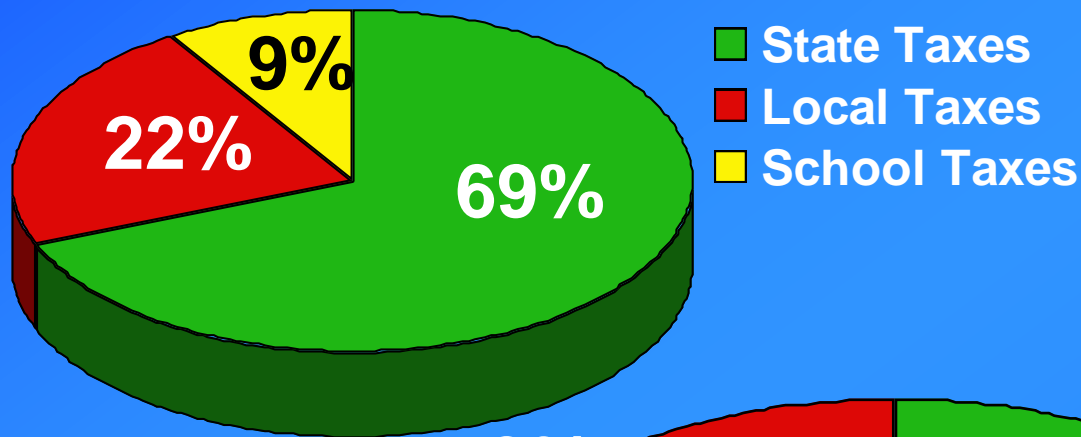
This is where the money comes from to fund the entire Minnesota Government Enterprise



State non-tax is largely college tuition
Most school funding comes from the state
Chart slightly out of date; now more local/school

Where Tax Revenue Comes From

This includes all state and local taxes for CY 2010/FY 2011



Big State-Local Numbers in Context

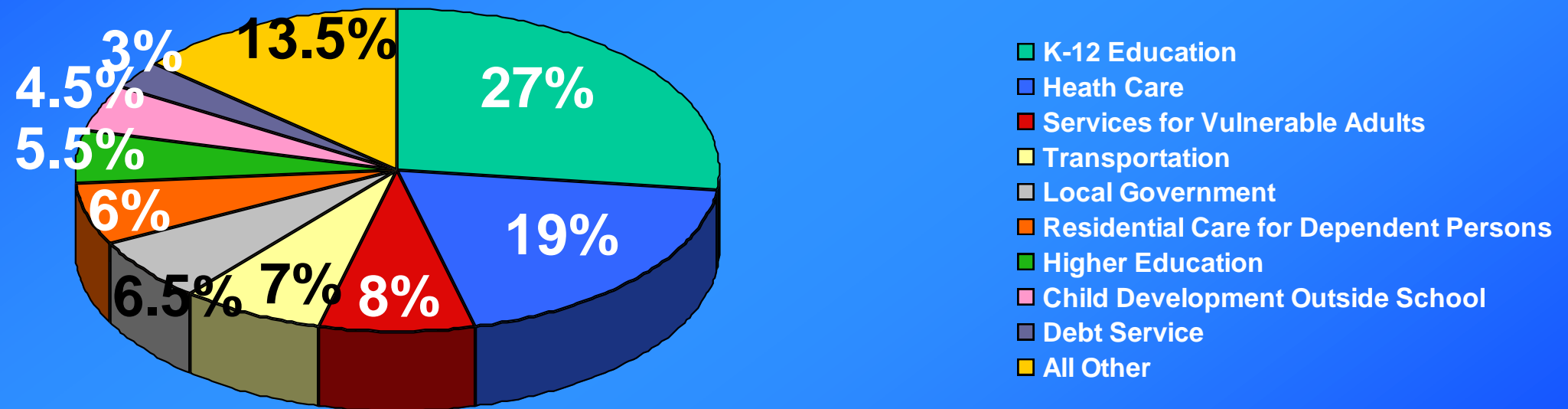
\$42 billion per year in total size of Minnesota Government Enterprise

Remember it includes state government, the U of M and MNSCU, school districts and all other local governments

With 5.3 million Minnesotans, the cost of the entire Minnesota Government Enterprise is about \$8,000 per person per year

Where State Money Goes

This includes all state spending, not just general fund, because of arbitrary nature of the divisions between funds and fact that federal aid, which comes through a separate fund, often is tied to general fund spending



Health care is understated because it does not include the health care costs of public employees

Transition to State General Fund

State budget problem centered on state general fund - roughly 40% of the entire MGE and 60% of total spending by the state

Budget problem affects entire MGE due to

- Distribution of money from the general fund*
- Choice of which revenue sources to include in the general fund*
- Need for schools and local governments to levy property taxes or increase other revenue sources if their distributions from the general fund are cut*

Transition from Annual to Biennial

Numbers so far have been annual numbers because all MN governments except the state use an annual budget and the year is the typical period used in dealing with financial information

The state budgets on a biennial – two year – basis

Next budget cycle is FY 2012-13, which runs from July 1, 2011 – June 30, 2013

Current budget cycle is FY 2010-11, which runs from July 1, 2009 – June 30, 2011 and which may still have a deficit to be closed in 2011

Remainder of presentation deals with FY 2012-13

Beware the Spending Increase Bamboozle

Almost all percentage change information is annual – one year to the next, so that's how our minds are framed to deal with percentage changes

Comparing one biennium to another compares two two year periods – years 3-4 vs. years 1-2

This makes percentage change more than double what it would be if comparing year to year

So if politician says spending growing at $x\%$, generally must cut it in half to be meaningful

See www.sensibletax.org, The Spending Increase Bamboozle for details

Be Aware of Price of Government

Price of government is percentage of state personal income spent by MN governments

State has kept track since FY 1991

From 1991-98 ranged from 17.1-18.3%

From 1999-2010 ranged from 15.0-16.2%

Projected at 16.0% for FY 2011 and 15.8 for FY 2012-13

Be Aware that Higher Tax States Generally Are More Prosperous than Lower Tax States

Historically, states with relatively high taxes as a percentage of personal income have higher personal income per capita than lower tax states

The poorest states generally have low taxes in relation to personal income

Does this mean higher taxes automatically mean higher incomes? No, but it does mean that lower taxes do not automatically mean higher incomes

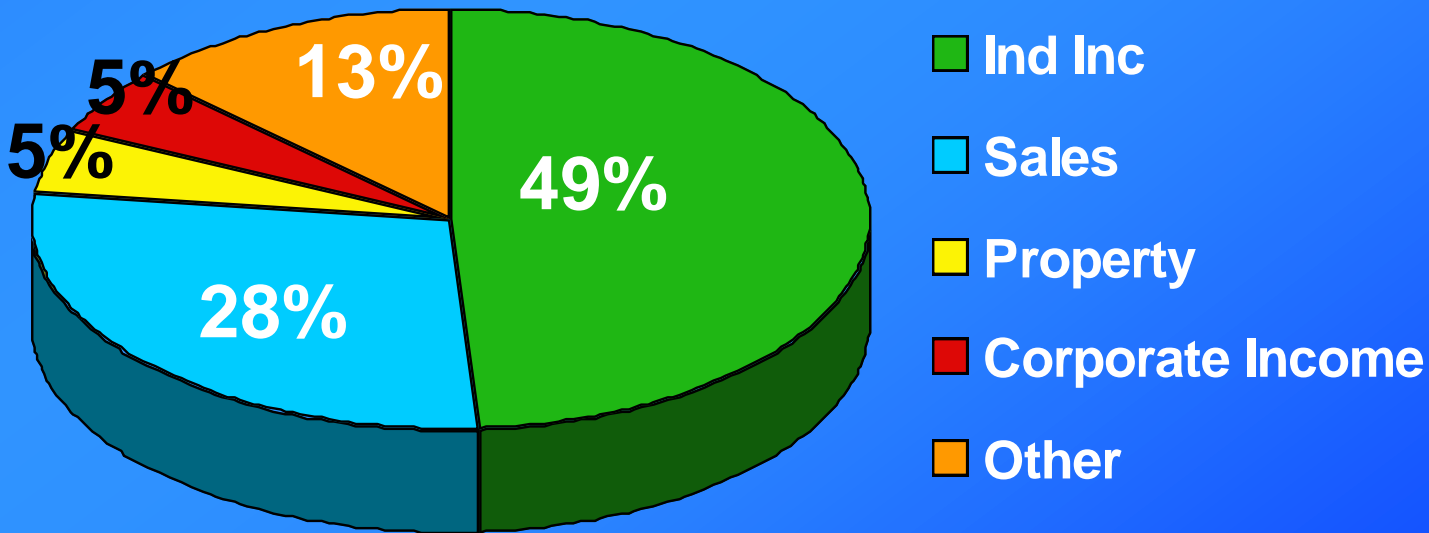
The 2011 Budget Nightmare

- FY 2010-11
 - Revenue 30.5
 - Spending 34.6
 - Deficit (4.1)
 - Solved by:
 - Fed Stimulus 2.1
 - K-12 Shift 2.0
 - Total 4.1
 - Revised Def. 0
- FY 2012-13
 - Revenue 32.9
 - Spending 37.3
 - Deficit (4.4)
 - Add shift repay 1.3
 - Rev. Problem (5.7)
 - Plus inflation (1.1)
 - Total Problem (6.8)

Where GF Money Is Projected to Come From FY 2012-13

Individual income tax	16,102
Sales tax	9,247
Corporate income tax	1,784
Property tax	1,562
Other	<u>4,212</u>

Total 32,907



Where the General Fund Money Is Projected to Go in FY 2012-13

Spending reductions from these projections, which do not include inflation, will come from some combination of these areas

K-12 education	14.361
Higher education	2.917
Health & human services	12.000
Property tax aids & credits	3.455
Agencies and other	<u>4.685</u>
Total	37.418

Long Term Trends Are Worse Says Budget Trends Study Commission

Today, as the first of Minnesota's 1.4 million baby-boomers begin to reach retirement age, the state has reached an inflection point – a moment of profound change that produces an immediate shift from recent trend. This milestone requires a complete reassessment of the way the state's economy is perceived. No longer can Minnesota sit by and watch as the crest of this giant aging wave grows larger.

BTSC Long Term View cont'd

As Minnesota's population begins to transform, new, long ranging factors will begin to weigh more and more heavily on the state's tax base, spending needs and overall economic progress. The wave is beginning to break and policymakers have not adequately prepared for the overwhelming implications this will have on state government finances.... If Minnesota wishes to have the prosperity it has had in past decades, the solutions will need to be robust, effective and immediate.

What the BTSC Report Means

The jig is up.

The party's over.

We're all in this together, and we had better figure that out fast.

Where to Find BTSC Report

Go to Minnesota Management and Budget
Website

Click on budget

Look on right side under Related Information

Click on BTSC

How Did the Budget Problem Come to Be?

Four self inflicted wounds 1999-2001 – two income tax cuts and state education funding takeover coupled with a property tax cut

Structural design flaws – narrow sales tax base, broad income tax exemptions, small budget reserve, weak budget process

Weak economy

Political gridlock

WITHWAGA – Wishful THinking WAiting GAME

Aging population and rising health care costs

What's the Likely Impact on You & Me?

BTSC: A serious decline in quality of life in Minnesota if the problem is not solved sensibly

A sensible solution likely means

- ***Somewhat higher taxes***
- ***Changing how governments operate***
- ***Fewer governmental units***

How to Solve the Budget Problem

The Four Basic Tools

Redesign government

Cut spending

Increase taxes

Grow the economy

11 Element Plan Using the Tools

For details of an 11 element budget problem solution plan using the four tools, email johnpjames46@comcast.net and check website www.sensibletax.org

Here just highlight some key elements

Key Simple Solution Elements

1. Broaden consumer sales tax base and cut rate
2. Repeal property tax aids and credits, but prevent unacceptable property tax increases

Each is a crucial redesign of Minnesota government. Item 1 can also be used to increase tax revenue if desired. Item 2 is also a state spending cut that will cause some local property tax increases, but can be used as a major impetus to redesign of local governments.

Sales Tax Redesign Elements

Broaden base to virtually all consumer purchases, including clothing, services, food, drugs, health care, or as close thereto as can come

Slash rate to 3-5% range, depending on how much broaden base and how much revenue want to raise – same or more than current law

Go after sales over Internet and TV and by catalogs

Sales Tax Redesign Outcomes-I

Stops erosion of base from economy's ever increasing shift from taxed goods to untaxed services

Stops erosion of base from economy's ever increasing shift from goods bought in local stores to sales over Internet, TV and catalogs

Keeps baby boomers paying reasonable amount of tax. This is the only way to do it. Boomer incomes and purchases are dropping and becoming more exempt.

Sales Tax Redesign Outcomes-II

Whole system less volatile because base of taxed purchases is more stable

Interfere less with buying decisions with lower rate

MN more competitive for business production
Lower rate on business inputs

Lower rate better in state comparisons

Property Tax Aids & Credits Repeal

This spending is poured into a black hole of property tax relief with no accountability for results whatsoever

System grossly subsidizes taxes in some communities, not others, with no defensible rationale

Most outrageous examples are subsidies greater than \$800 per capita to keep property taxes for all local governments below \$50 per month

Homeowners in Greater Minnesota pay 2.3% of income in property taxes; those in Metro area 3.17%

Advisable Complex Redesigns -I Property Tax Reform

Reform property tax & state-local fiscal system:

- *State funds more education & human services*
- *Local business property tax rates cut to same level as homes and state business taxes increase to offset local cuts and help fund state's increased role in education, human services*
- *Developed property outside cities taxed like in cities*

Advisable Complex Redesigns-II

Reform Business Taxation

1. Stop discriminating against Minnesota businesses
2. Shift emphasis from taxing production to market exploitation to shift burden on to those selling in from out of state. Enact business activities tax, repeal state business property tax, reduce sales tax on inputs
3. Fairly tax business income earned in Minnesota
4. Engage business leaders in redesigning government, funded by a corporate income tax credit

A Multitude of Redesign Options

Property tax aids & credits repeal + property tax reform + business tax reform = a multitude of opportunities for redesign of how Minnesota government works

Two common types of change:

- ***Mergers***

- ***Individual governmental units hiring outside contractors (other governments, nonprofits, businesses) to perform services now done by employees of those units***

Health care reform, the biggest need of all due to escalating costs, facilitated by changing state aid from property tax relief to paying a portion of local employee health care costs and creating a big market for testing of new approaches

What About Individual Income Tax?

Passions rage: Is it the fairest tax of all because those who benefit most from the civilization that taxes make possible and have the most ability to pay, pay higher rates than those who do less well, or is it an unfair burden on productive people which retards economic growth?

Undeniable fact: cutting the rates from 6-8-8.5% to 5.35-7.05-7.85% in 1999-2000 contributed enormously to today's budget problem

I see it as fairest of them all, so would use it to raise some revenue, but this is a political issue. Best way: broaden base so all rates except top end can be cut and top end minimized.

The Budget Problem and the Governor Candidates

Hats off to each for courage and passion

Each must cope with the worst budget problem ever and the nature of campaigns

What do we want? More and better services and lower taxes

Pogo: We have met the enemy and they is us

So now on to comparing proposals with reality

Shortfalls in Candidates' Proposals

In fairness: this is complex and hard to talk about in campaign mode, so we don't really know what whoever wins will actually end up proposing, or how he will react to legislators' reactions to his proposals

No candidate has come to grips with the magnitude of either the short or the long term problems, and no candidate has proposed the kind of fundamental redesign of Minnesota's state-local fiscal system that is needed.

Proposal Shortfalls: Sen. Dayton-I

1. No indication of willingness to dramatically broaden the base and drastically cut the rate of the consumer sales tax
2. Little indication of interest in government redesign
3. Unwisely seeks to soak rich with higher property tax on high value homes instead of eliminating classes and taxing based on area
4. Soak the rich is a divisive strategy and cannot possibly raise the money to solve the problem



Proposal Shortfalls: Sen. Dayton-II

5. Simply raising the top income tax rates is a bad way to get more money from the income tax. Better, broaden base and replace deductions with income-adjusted credits, to keep rates low. Top rate could be higher than now, but well under his proposal.
6. Overstates potential from tax compliance and loophole closing and misses the big developing loophole that requires sales tax base broadening
7. Failure to balance means no money for policy initiatives
8. Expands gambling (this criticism is political)

Proposal Shortfalls: Rep. Emmer-I

1. Explicit refusal to dramatically broaden the base and drastically cut the rate of the consumer sales tax.
2. Explicit refusal to consider any tax increase of any kind as part of the solution.



Proposal Shortfalls: Rep. Emmer-II

3. \$4.096 billion misstatement in his budget comparisons from disregarding federal stimulus funds and education shifts that filled 2010-11 general fund budget hole

2010-11 actual spending \$34.636 billion.

2012-13 projected \$37.294 billion without inflation

2012-13 Emmer budget \$32.281 billion

Emmer budget cuts \$2.355 billion from 2010-11 actual

Proposal Shortfalls: Rep. Emmer-III

4. Emmer budget means major service reductions because redesign and economic growth can't happen fast enough

2012-13 projected with inflation	\$38.4 billion
2012-13 Emmer budget	<u>32.3 billion</u>
Difference	\$ 6.1 billion

Major change with very little detail

Proposal Shortfalls: Rep. Emmer-IV

5. Inconsistent rhetoric and numbers on health and human services spending.

Claimed \$667 million increase really \$767 million cut because left out federal stimulus funds

He says: “Reprioritize unsustainable, runaway human services spending to focus on the most vulnerable. Refocus spending on programs for children and seniors which have been historically under funded. Work with the legislature to reform programs for adults.”

He does: Cuts affect those he says need more

Proposal Shortfalls: Rep. Emmer-V

6. Inconsistent rhetoric and numbers on education spending. Severely tightens education spending while contending that education is a key to the future.

K-12 \$525 million (3.6%, 1.8% per year) less than projected current program requirement without inflation; and less than 2011

Per pupil state aid certain to be cut

Higher ed \$417 million (14.3%, 7.1% per year) less than projected current program requirement without inflation

Proposal Shortfalls: Rep. Emmer-VI

7. Corporate income tax cut wastes money and has no immediate benefit. 80-90% of cut goes to giant corporations with less than 2% of their sales in Minnesota. Not good source for jobs.
8. Relying exclusively on spending cuts means no money for policy initiatives
9. Gets basic tax facts wrong and states that cutting taxes will automatically attract high income individuals and businesses, contrary to evidence

Proposal Shortfalls: Rep. Emmer-VII

Rep. Emmer's proposed budget raises these questions:

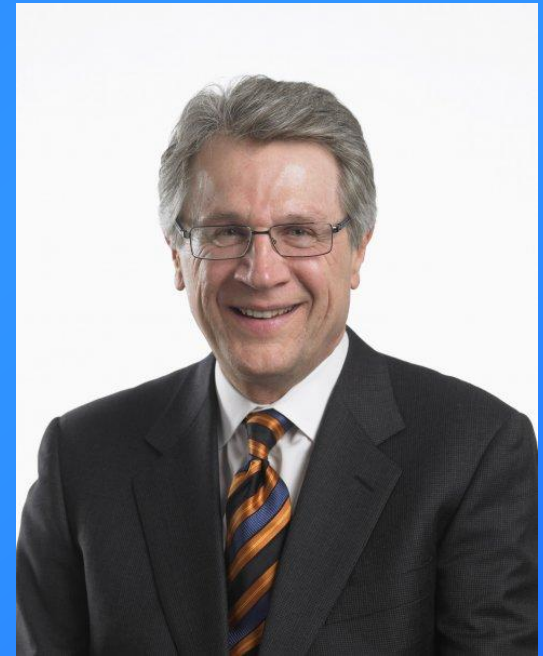
Does he realize the magnitude of the service reductions his budget would produce?

Is he trying to mislead the public on that?

Is he planning to compromise and raise taxes, but unwilling to admit up front that he will? If so, website suggests it will be the sales tax, with income tax cut or eliminated

Proposal Shortfalls: Mr. Horner-I

1. Sales tax base broadening and rate cutting do not go nearly far enough, but kudos for proposing modest changes, unlike his competitors



2. No explicit indication of willingness to raise some revenue with the income tax, but does hint at that.

3. Local government redesign with increased local sales taxes, on top of a still very high state rate, is a bad idea.

Proposal Shortfalls: Mr. Horner-II

4. Endorsement of corporate income tax repeal is a bad idea, but less bad than Rep. Emmer's proposal because it is postponed
5. Failure to balance means no \$ for his policy initiatives
6. Expands gambling (this criticism is political)

Proposal Shortfalls Summary

The bottom line is that Minnesota's next governor cannot succeed at solving the budget problem by being Mr. Income Tax, Mr. Soak the Rich, Mr. Sales Tax, or Mr. No Tax Increases Whatsoever.

Messrs. Emmer and Horner recognize need to redesign state-local government relationships, Sen. Dayton's website is silent

Messrs. Dayton and Horner propose efforts to control health care costs, Rep. Emmer seems to prefer government withdrawal from health care, a question of moral philosophy

We're All in This Together

Neither “soak the rich” nor “no tax increases of any kind, ever” is a viable strategy for Minnesota citizens

Pure reliance on either sales or income taxes to raise additional revenue undesirable

If we're willing to pay a little more in wisely redesigned taxes and pay some attention to redesigning how Minnesota governments operate, we can create a prosperous future

The business community could help drive change by investing in change opportunities through a corporate income tax credit

Reason for Hope

Redesign opportunities abound due to massive technological change since most Minnesota governmental structures and relationships were established

We have a large, deep talent pool in Minnesota, with people up to the job of redesigning

Citizens and businesses must pound on the politicians for change, and get engaged in making it happen