

## How to Solve Minnesota's Budget Problem Framework

There are four approaches to solving the budget problem – redesign government, cut spending, raise taxes and wait for economic growth. This is an 11 element framework deploying each of those approaches.

The wait for economic growth is in part passive because the business cycle inevitably will turn around eventually, but active attempts to spur economic growth certainly should be undertaken. Described here are changes in the state-local fiscal system and state-local government relationships that would encourage economic growth. The emphasis here is on redesigning Minnesota government.

The 11 elements below redesign government to permit large spending cuts without significantly damaging services, allow tax increases to be less than otherwise likely, and encourage economic growth. They also allow for broad public and local government participation in solving the problem.

These elements form a framework for discussion on how to solve the budget problem. Practically any idea could be considered under this framework. Multiple comprehensive solutions from across the political spectrum could be drawn from the elements. Policy themes could include redesign of government for greater efficiency, citizen and local official empowerment, water and habitat quality improvement, positioning Minnesota to encourage jobs growth, and simplification (of taxes, tax forms and the state-local relationship), all while attaining the necessary goal of solving the budget problem.

Big political questions - cuts vs. taxes, and income vs. property vs. sales taxes – are not answered here, but what is here should help answer them. The emphasis here is to redesign more, so that you can do less harm with spending cuts than you will otherwise do, and can impose moderate tax increases in ways that not only do not harm, but in conjunction with the redesign, actually help Minnesota's economic prospects and improve the fairness of the tax system. Here is how to do it.

**1. Broaden the consumer sales tax base and cut the rate.** This would raise a little or a lot – up to well in excess of \$2 billion per year - of revenue, depending on how much the base is broadened and how much the rate is cut. It is the most important change to make in Minnesota's tax system.

**2. Repeal most or all property tax aids and credits, including city LGA and county program aid, but prevent unacceptable local property tax increases.** Property tax increase moderation comes through one or more of transition aid, the property tax refund program, health care reform (item 8), and property tax and state-local fiscal system reform (item 3). Allowing local property taxes to rise in modest amounts could solve a little (or a lot –up to \$1 billion plus per year) of the budget problem.

**3. Reform the property tax and state-local fiscal systems in three respects: (1) the state funds greater portion of education and human services costs; (2) local**

**property tax rates of businesses cut to same level as homes, and state business taxes increase to offset the local cuts and help fund state's greater responsibility for education and human services; and (3) developed property outside of cities taxed at rate no less than that in an appropriate city.** This would eliminate much of the risk of homeowner property tax increases from doing item 2, but more importantly would have a host of positive long term consequences, divorcing educational quality from local property wealth, making item 4 possible, saving on infrastructure costs and improving water and habitat quality, and laying the foundation for item 5.

**4. Shift the principal focus of business taxes from production in Minnesota to exploitation of the Minnesota market.** This would raise some revenue, but should produce a net tax reduction for businesses in Minnesota and a tax increase for businesses selling into Minnesota from out of state. It is crucial to making Minnesota as competitive as possible as a business location. See Minnesota Needs to Hit the Reset Button on Business Taxation. [need to cross ref this]

**5. Either implement or study other changes in the state-local fiscal system, state-local government relationship and local government operations that could make a major long term difference.** Numerous possibilities have been suggested by the Bridges to a Better Bottom Line project; the Association of Minnesota Counties in its Minnesota Redesign Project; and the Change MN proposal here. Some provide immediate budget help; most long term productivity improvements. Some would engage Minnesota citizens and local government leaders in deciding how much local government they want to buy; they are helped by items 2 and 3.

**6. Reform the budget process to eliminate the aid and payment deferrals over a reasonable number of years, and make other changes aimed at improving governmental efficiency or reducing the risk of serious future budget problems.** Only the aid and payment deferral elimination has immediate, quantifiable budget problem solution implications. But the other changes are needed to defer the next budget crisis and keep it from getting out of hand when it happens.

**7. Enact a major bonding bill.** Low interest rates and high infrastructure needs and unemployment combine to make construction projects highly desirable. While this would not contribute immediately to solving the budget problem, it would help grow the economy through the project spending and then the use of the infrastructure, producing more tax revenue in the long term.

**8. Get started on health care reform.** Health care spending is the biggest long term fiscal threat for the federal and Minnesota governments. Minnesota should lead in taking advantage of the opportunity to redesign health care. If major health care reform could be agreed upon and produce savings from day one, so much the better, but several small steps could make a difference. The important thing is to get started.

**9. Make the individual income tax more progressive.** This would raise a little or a lot of revenue, depending on whether middle as well as higher income Minnesotans

must pay more, and on the extent of rate increases and/or base broadening. Restoring the 1998 rates would bring in about \$800 million per year. Done badly, this would risk harming Minnesota's competitiveness as a business location and home for retirees.

**10. Increase existing and enact new taxes on undesirable behaviors.** The old reliables are the so-called "sin taxes" on alcohol and tobacco. Setting them as high as practicable without causing widespread bootlegging would help solve the budget problem. Less obviously, new taxes aimed at encouraging some behaviors and discouraging others could play significant roles in cleaning up Minnesota's waters, helping people avoid obesity, getting health care costs under control, and promoting a clean energy economy, while contributing to solving the budget problem.

**11. Cut spending and programs.** There are hard decisions to be made on shrinking or eliminating programs. Reasonable actions on all or most of the first 10 items will minimize the risk of damage from cuts.