

The Changing Picture of Minnesota Finance

How Local Government and School District finances
are being undermined by bad state fiscal policy

A Graphic Overview

September, 2006

By State Auditor Candidate Rebecca Otto

Update based on June 2006 Price of Government report issued by MN Dept of Finance

Purpose of this report

The purpose of this report is to provide credible, fact-based illustrations of the effect "no new taxes" policies have had on Minnesota state finances between 2002 and 2006. All financial information in this report is based on numbers provided by the Minnesota Department of Finance's "Price of Government" report.

The "Price of Government" report was developed to give Minnesota citizens a sense of how much of their personal income was going to fund the various aspects of government in Minnesota.

It is available online from the Minnesota Department of Finance web site.

The primary responsibility of the State Auditor is to ensure the financial integrity, accountability, and cost-effectiveness of Minnesota's local governmental entities, including all counties, cities, townships, school districts, police and volunteer fire relief association pension funds, housing and redevelopment authorities, port authorities, soil and water conservation districts, and approximately 150 other special districts in the State of Minnesota.

2002: A special interest group takes control of Minnesota fiscal policy

In 2002, Governor Tim Pawlenty, State Auditor Patricia Anderson, and several legislative candidates sign a "no new taxes" pledge. The pledge is controversial because it caters to a special interest group funded by wealthy conservatives rather than to the best interests of the citizens of Minnesota.*

It was to change finance throughout the state of Minnesota in a variety of unanticipated – and negative – ways.

*The idea behind the "no new taxes" pledge has been shown to be flawed. It was assumed that one could encourage fiscal restraint by "starving the beast," but the notion has since been discredited by the Cato Institute and others, who show that there is a negative relationship between lower taxes and increased spending; ie lowering taxes tends to encourage spending, while raising taxes increases the clamor for spending restraint and does more to hold spending in check. What is needed is accountability and discipline in spending, not in taxation. Read the Cato Institute's piece discrediting the thinking behind "no new taxes" at <http://www.rebeccaotto.com/downloads.cato.pdf>

2003: State Auditor Patricia Anderson sets up the Governor's "no new taxes" agenda.

A month after taking office, State Auditor Patricia Anderson issues a report recommending historic cuts to local government aid, "softening up the opposition" for the Governor's controversial 2003 "no new taxes" budget proposal. Pawlenty spokeswoman Leslie Kupchella says that the governor "agrees overall with the results he's seeing in the report."

Minnesota Public Radio says "A report from Republican State Auditor Pat Awada (Anderson) concluded that local government aid could be trimmed by 43 percent without affecting essential programs or prompting local property tax increases."

Not included in Patricia Anderson's "essential programs" are things like public health, parks, and libraries.

The League of Minnesota Cities is harshly critical of the report, testifying that it uses "faulty methodology and suspect data to reach sweeping conclusions."

Nevertheless, the "no new taxes" agenda is largely implemented with the help of a wide Republican majority in the state House of Representatives, most of whom are also pledge signers who refuse to compromise. The Governor dismisses critics as "victims du jour."

Unprecedented financial shifts, gimmicks, and other questionable money maneuvers are implemented

The shifts and gimmicks undermine financial stability as the administration struggles to meet the demands of the special interest pledge:

- relabeling taxes as fees
- spending the \$1.2 billion tobacco fund
- borrowing heavily from future taxpayers (bonding)
- shifting revenues and expenses from one year to the next

The bond rating house Moody's raises concerns at these questionable maneuvers. Minnesota loses its AAA bond rating and property taxes, fees, and tuition begin to soar.

The question:

Is this sound fiscal policy?

This is an important discussion, because as you'll see in a moment, Minnesota finances have been weakened as a result.

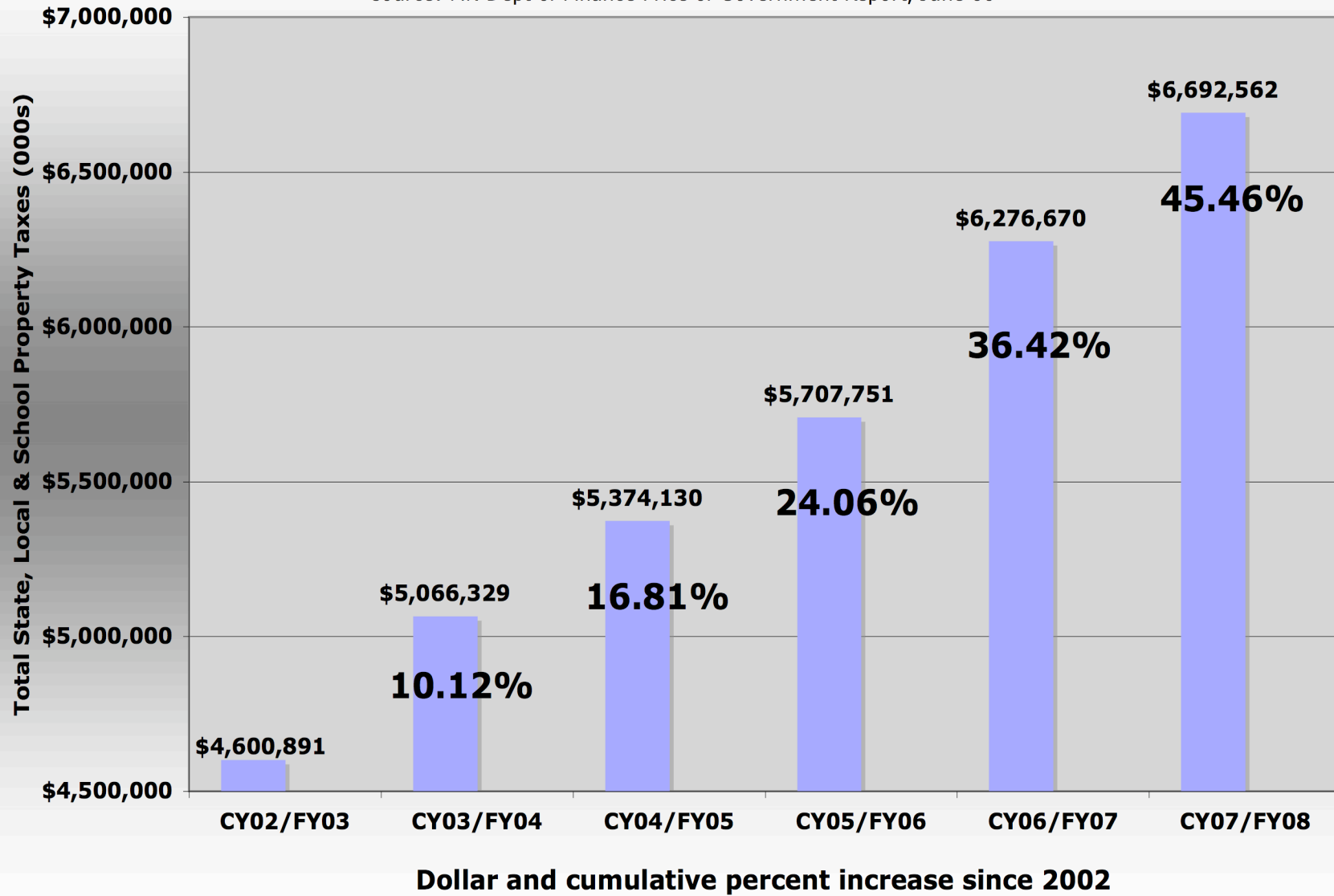
Charting the effects of "no new taxes"

The most noticed and wide-spread effect of giving state fiscal policy over to the dictates of a special interest group, largely placing political expediency ahead of substantive leadership, has been an explosion in property taxes.

There are several reasons this is not smart fiscal policy. It tends to ignore disparities in income and economic capacity, so it unfairly burdens seniors, people on fixed incomes, young families, and people living in smaller, less developed communities with lower tax bases.

Property Taxes up \$2.1 Billion

source: MN Dept of Finance Price of Government Report, June 06



What is driving property taxes up so steeply?

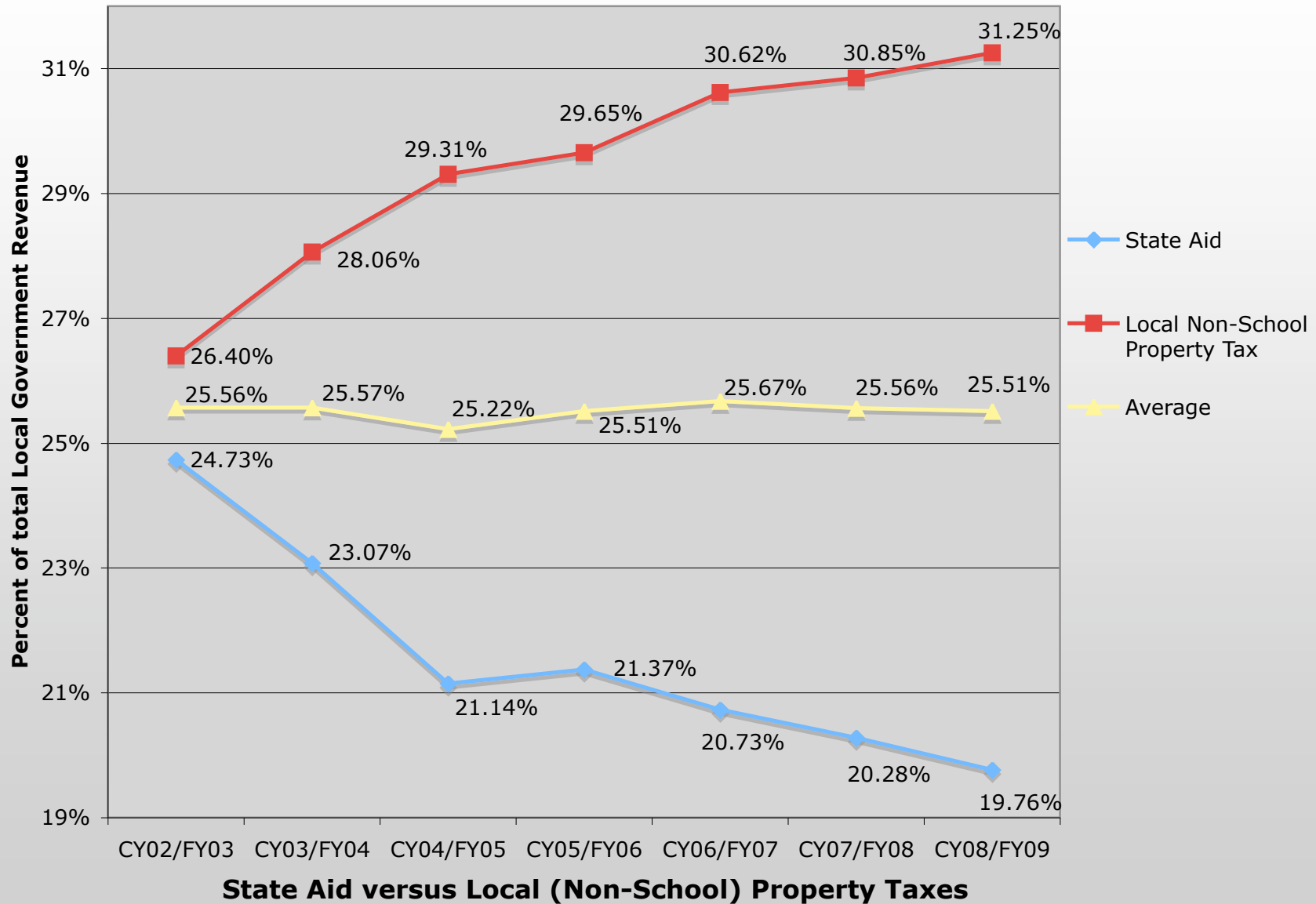
The cuts to Local Government Aid recommended in early 2003 by State Auditor Patricia Anderson were indeed "sweeping." Using "faulty methodology and suspect data," she advocated for cuts of 43%, much larger than those eventually enacted. Her recommendations included classifying such things as libraries, parks, and public health as "non-essential" and targeting them for large aid cuts, arguing that this would not prompt local property tax increases.

However those cuts, combined with large cuts in block grants to counties for implementing state programs, caused large increases in property taxes.

State Aid cuts drive Property Tax Hikes

Cuts to Local Government funding have driven up property taxes

Source: MN Dept of Finance Price of Government Report, June 06



As you can see from the above chart, in 2002 state aid and property taxes made up roughly equal shares of local government revenue, but that is no longer the case. As state aid was cut, taxes began to rise. Local government costs have been shifted onto property tax. The average of total revenue from state aid and property taxes has remained remarkably constant - within 1/100th of 1% over 5 years.

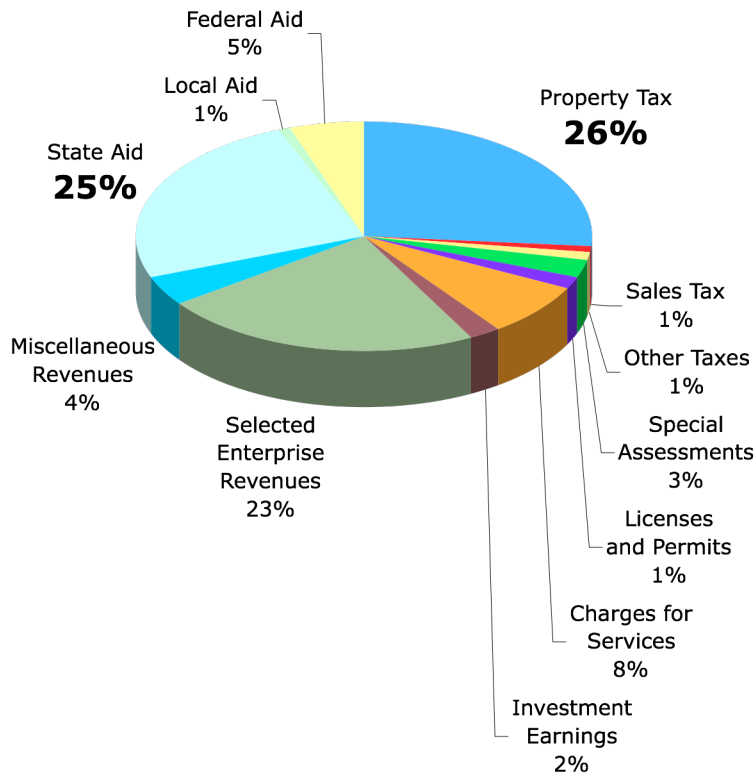
Picturing it then and now

The relationship between state aid cuts and property tax increases can also be illustrated by looking at how local governments got their revenues in 2002, and how they are getting them in 2006, as the following comparison chart shows.

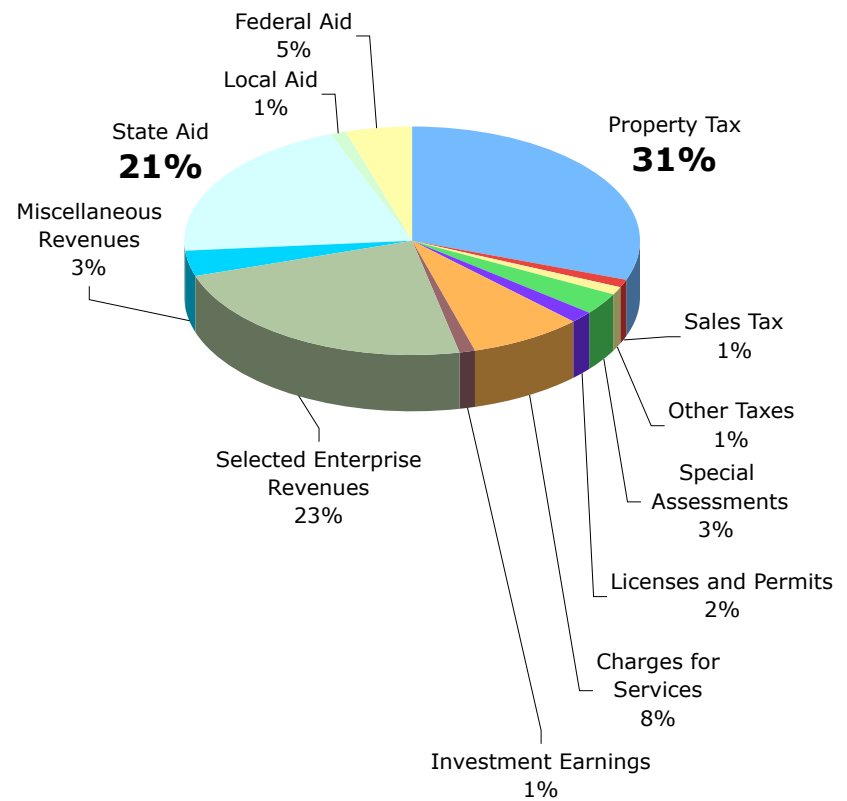
Where Local Government Revenues come from

Source: MN Dept of Finance Price of Government Report, June 06

CY 2002



CY 2006



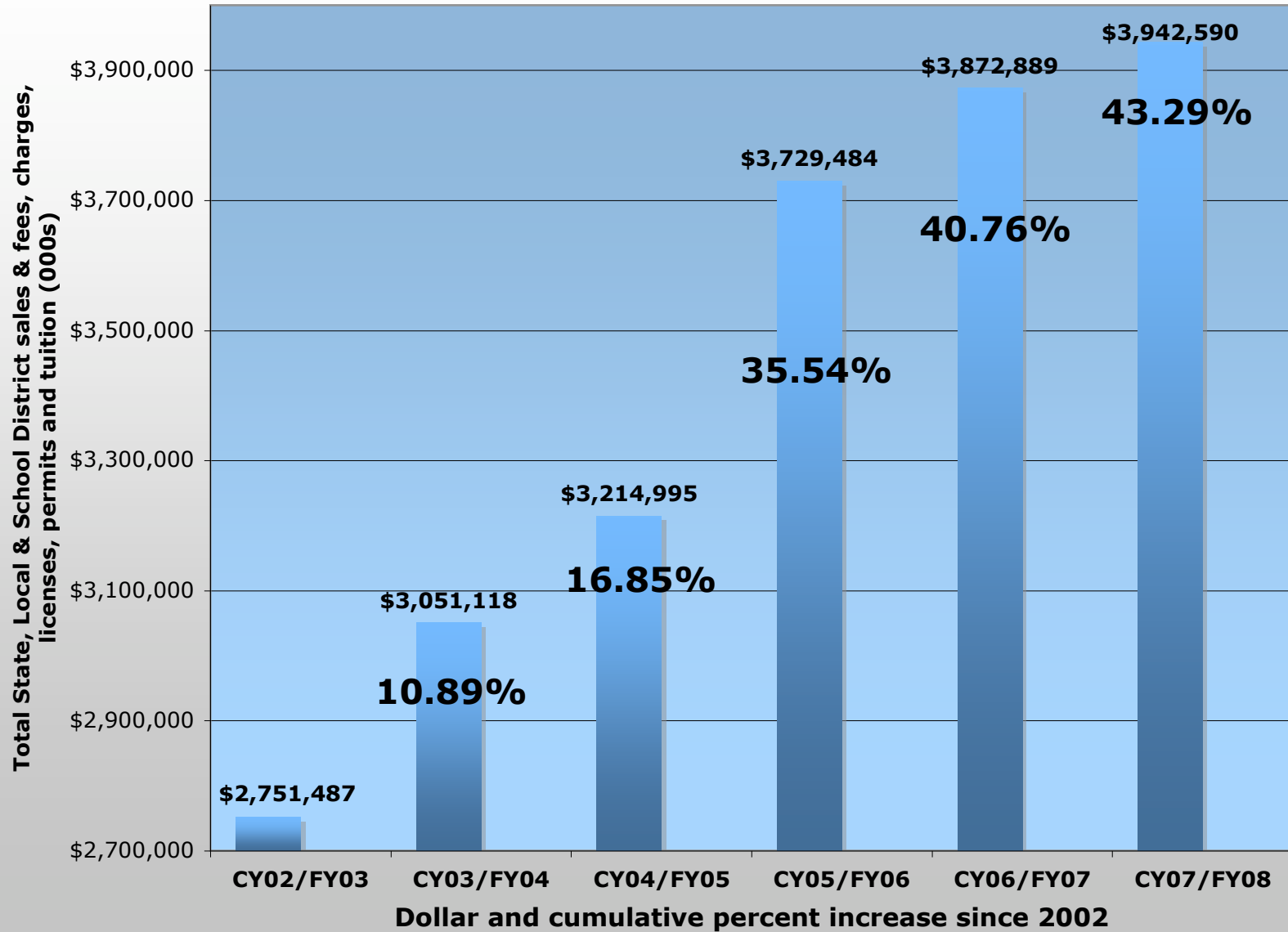
"No new tax" rhetoric drives massive fee increases

In the drive to adhere to the rhetoric of the no-new-taxes pledge, revenue has also been shifted onto other forms, such as "fees." Ronald Reagan once said that another way to spell "fee" is T-A-X. Nearly every fee you can imagine has been increased - some extremely.

Once again, the problem is that this is regressive - meaning it is unrelated to a person's ability to pay. Regressive taxes and fees are also less efficient means of generating revenue - and much less transparent.

Nearly \$1.2 Billion in New Fees

source: MN Dept of Finance Price of Government Report, June 06



Family pocketbooks hit hard by "no new taxes" tuition hikes

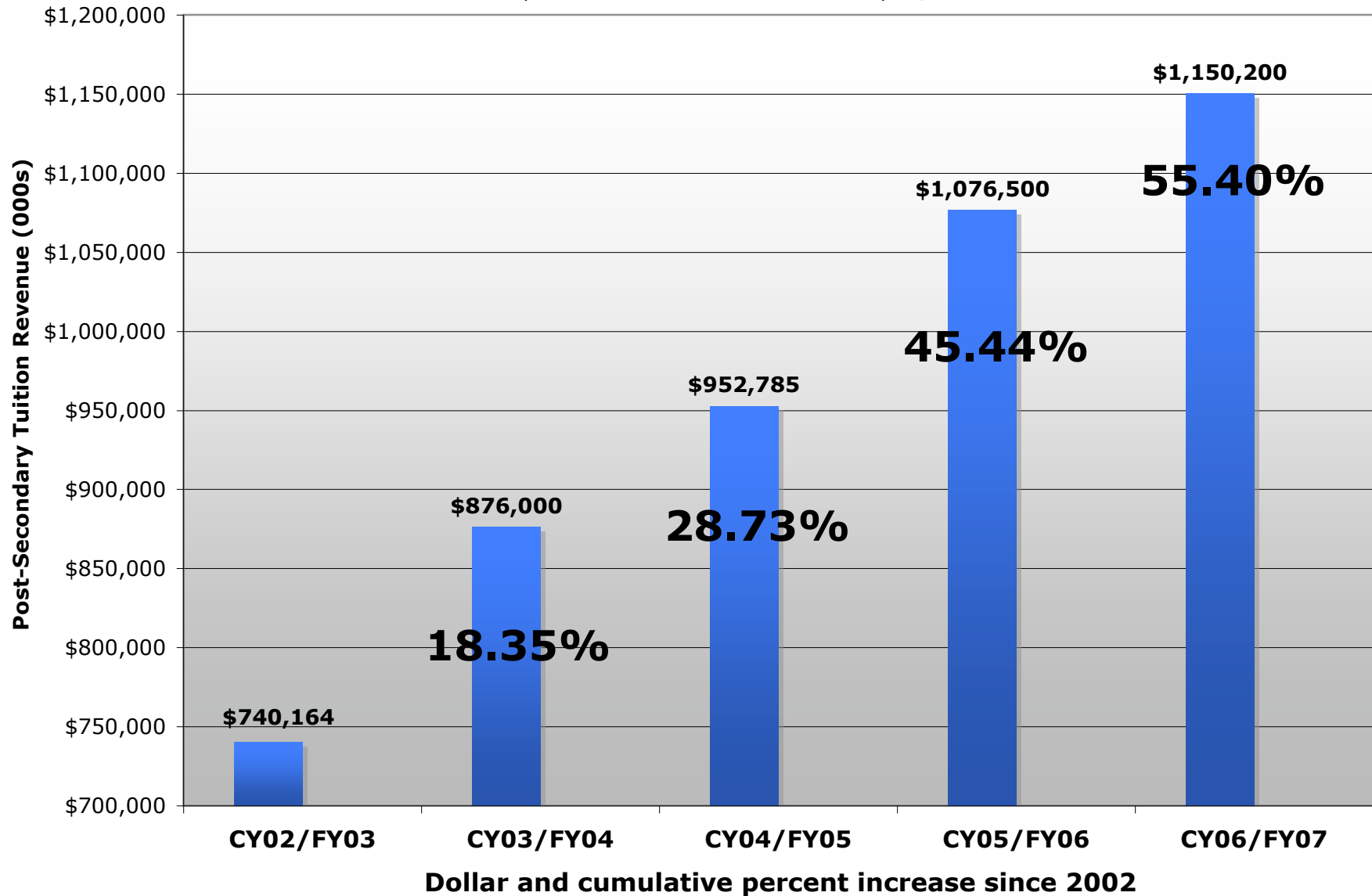
In addition to a wide variety of substantial fee increases under the no-new-tax policies, families are spending 55% more to send their children (or job-changing mom and dad) to Minnesota 's public colleges and universities.

Making college less affordable expands the achievement and economic gap between the haves and have-nots, and makes Minnesota less competitive both economically and culturally.

Tuition soars 55% to \$1.15 Billion

at Minnesota Public Colleges & Universities

source: MN Dept of Finance Price of Government Report, June 06



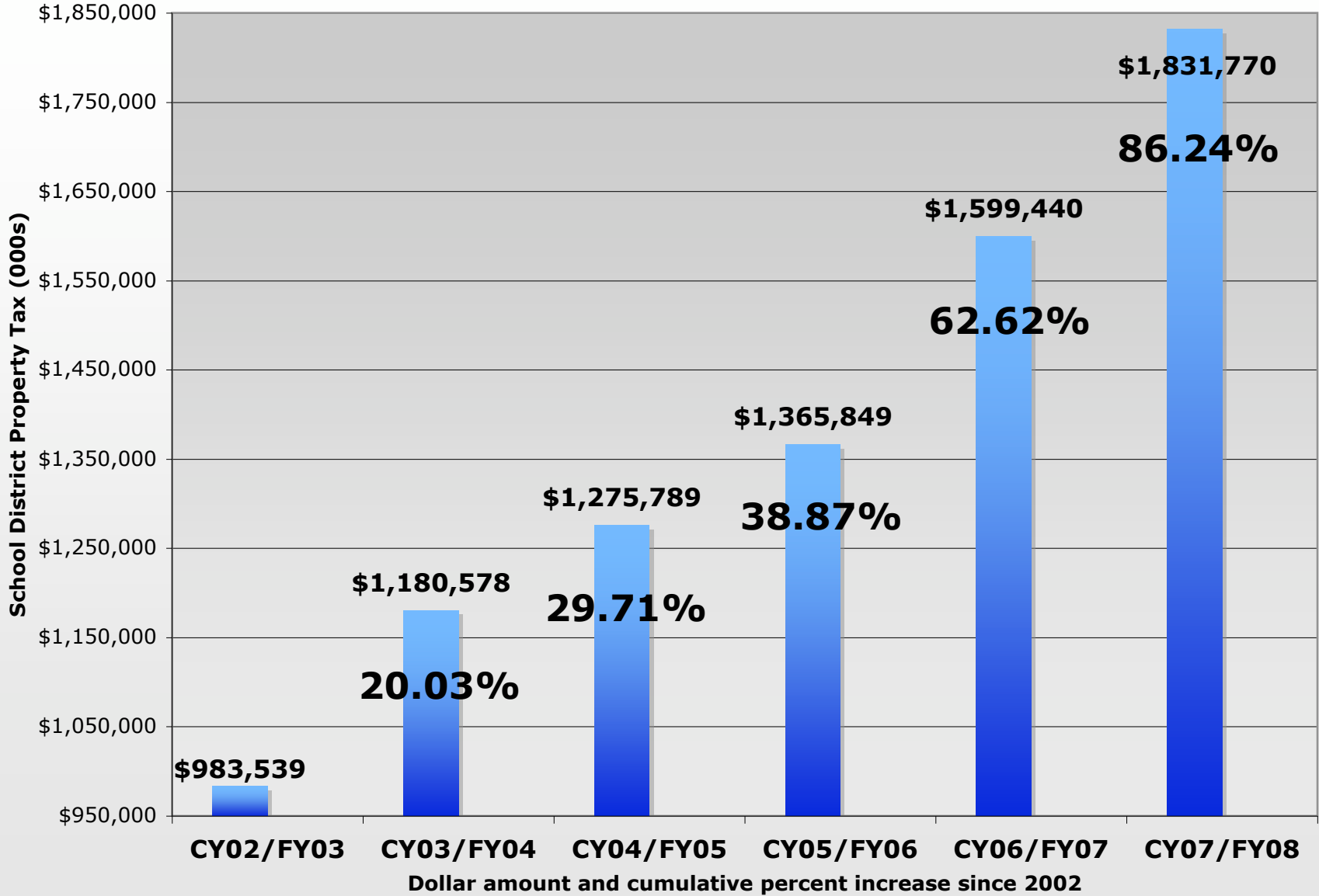
School Property taxes nearly double

Aside from the financial problems of local governments, the "no-new-taxes" policies have caused large increases in school property taxes.

Like increasing tuition, increasing school property taxes tend to be unrelated to the ability to pay. People who live in a community with a low tax base that does not have a lot of high-value commercial property will be hit harder by this shift of education funding onto local property taxes. This disparity is exactly why the legislature moved in 2001 to reform property taxes. That reform has been largely undone by "no-new-taxes".

Minnesota school property taxes nearly double

source: MN Dept of Finance Price of Government Report, June 06



The other problem with this shift is that it relies heavily on schools going out for voter-approved levies, a funding mechanism that is highly inefficient because it involves a school district spending time and resources trying to pass levies to fund basic needs instead of directing those same energies to educating our children. This is combined with thousands of hours of community volunteer time raising tens of thousands of dollars to promote a levy - time that should be spent on other community needs - just to pass basic education funding. This inefficient cycle must be repeated sometimes annually.

Finally, this approach tends to divide communities, as seniors cannot afford and tend to oppose property tax increases, while younger families need basic education for their children.

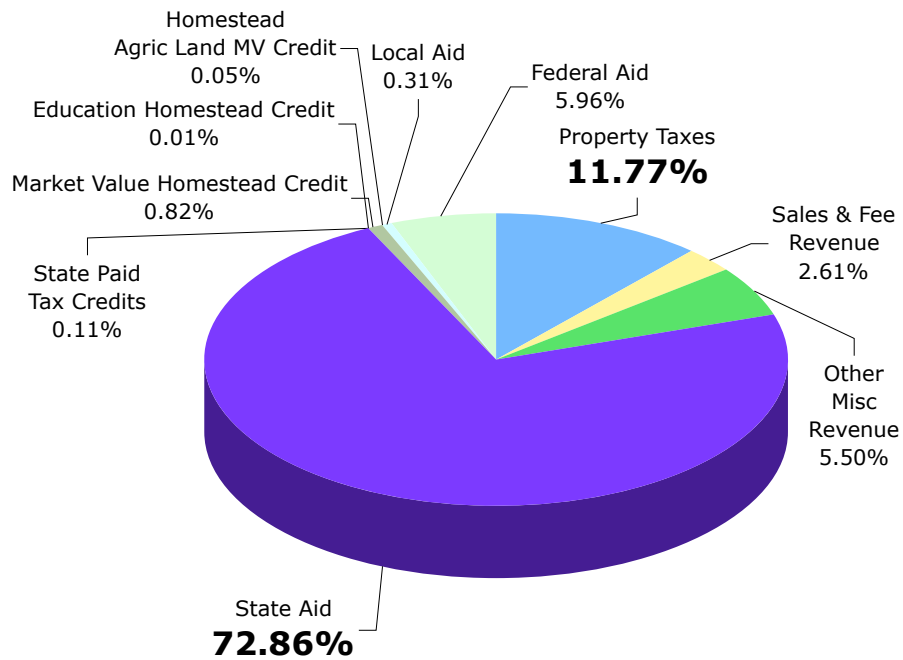
Picturing it then and now

As in local government, the relationship between aid cuts and school property tax increases can be illustrated by comparing where schools got their revenues in 2002 to where they get them now.

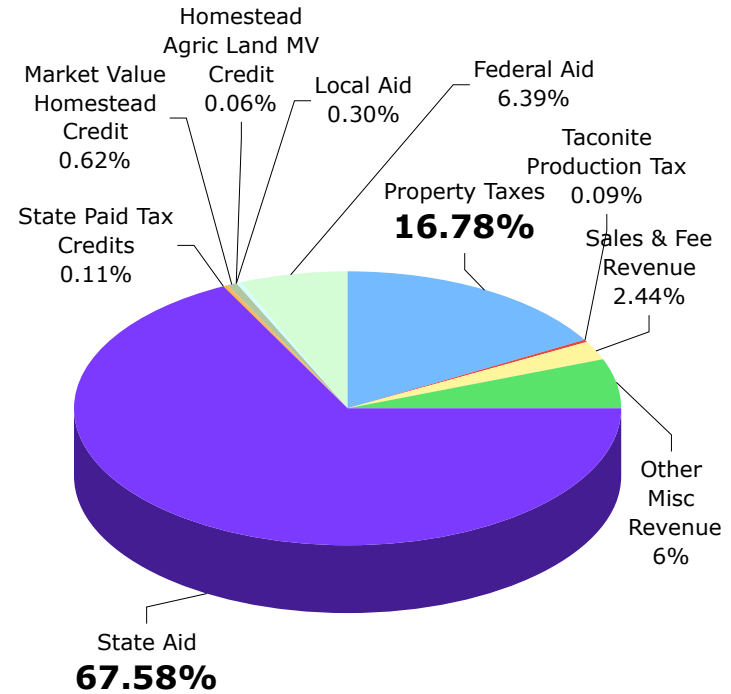
Where School District Revenues come from

Source: MN Dept of Finance Price of Government Report, June 06

CY 2002



CY 2006



A "property tax grab"?

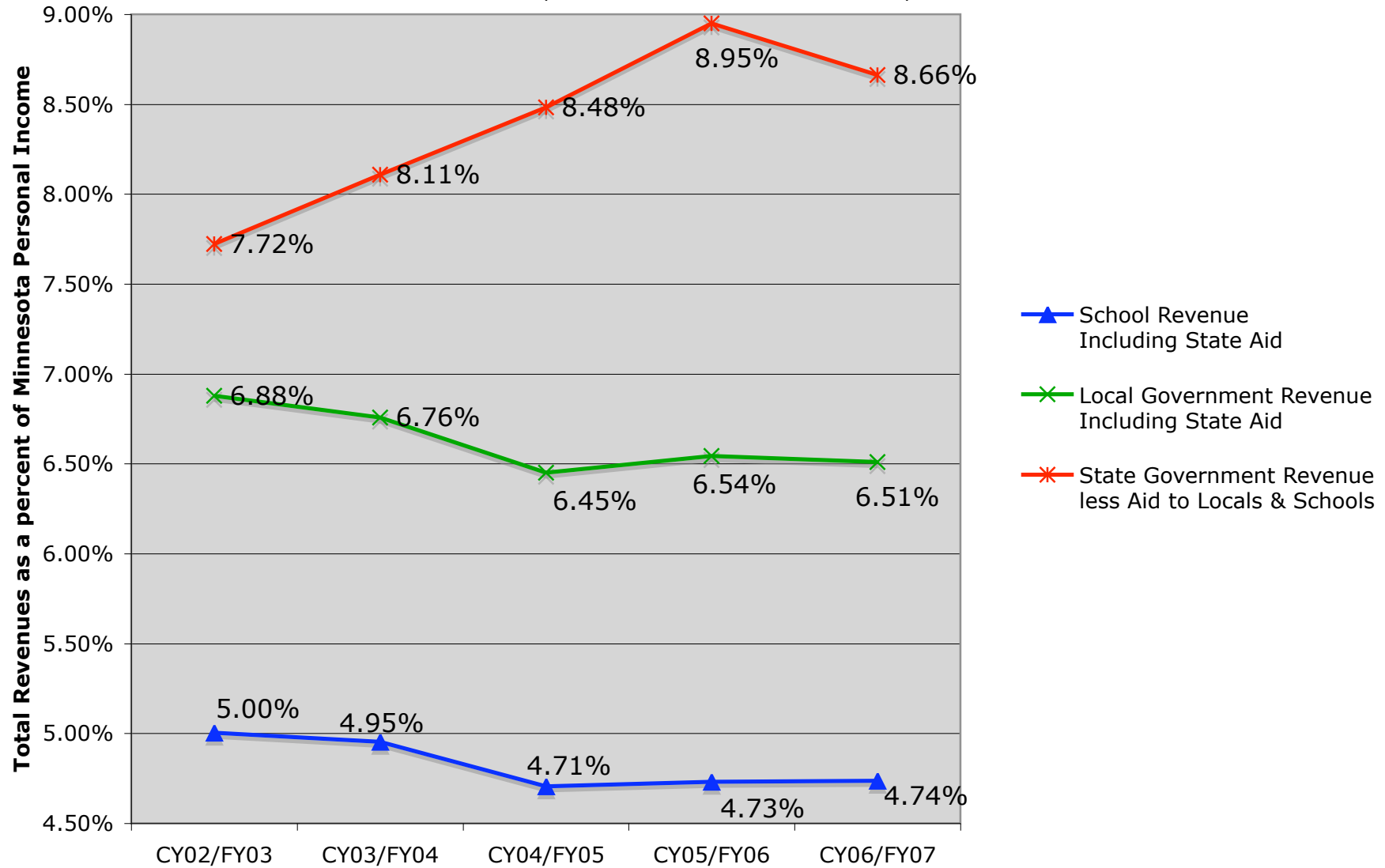
Advocates of the no-new-taxes policies embraced by State Auditor Patricia Anderson and Governor Tim Pawlenty have argued that spendthrift local governments and school districts are refusing to live within their means after the state tightened their belts for them, and that there is a consequent "property tax grab."

But as the following chart shows, even after historic property tax increases, both local government and school district revenues have actually fallen as a percent of personal income, while state revenues have grown.

There is no "property tax grab"

Total price of state, local, and school district government

Source: MN Dept of Finance Price of Government Report June 06



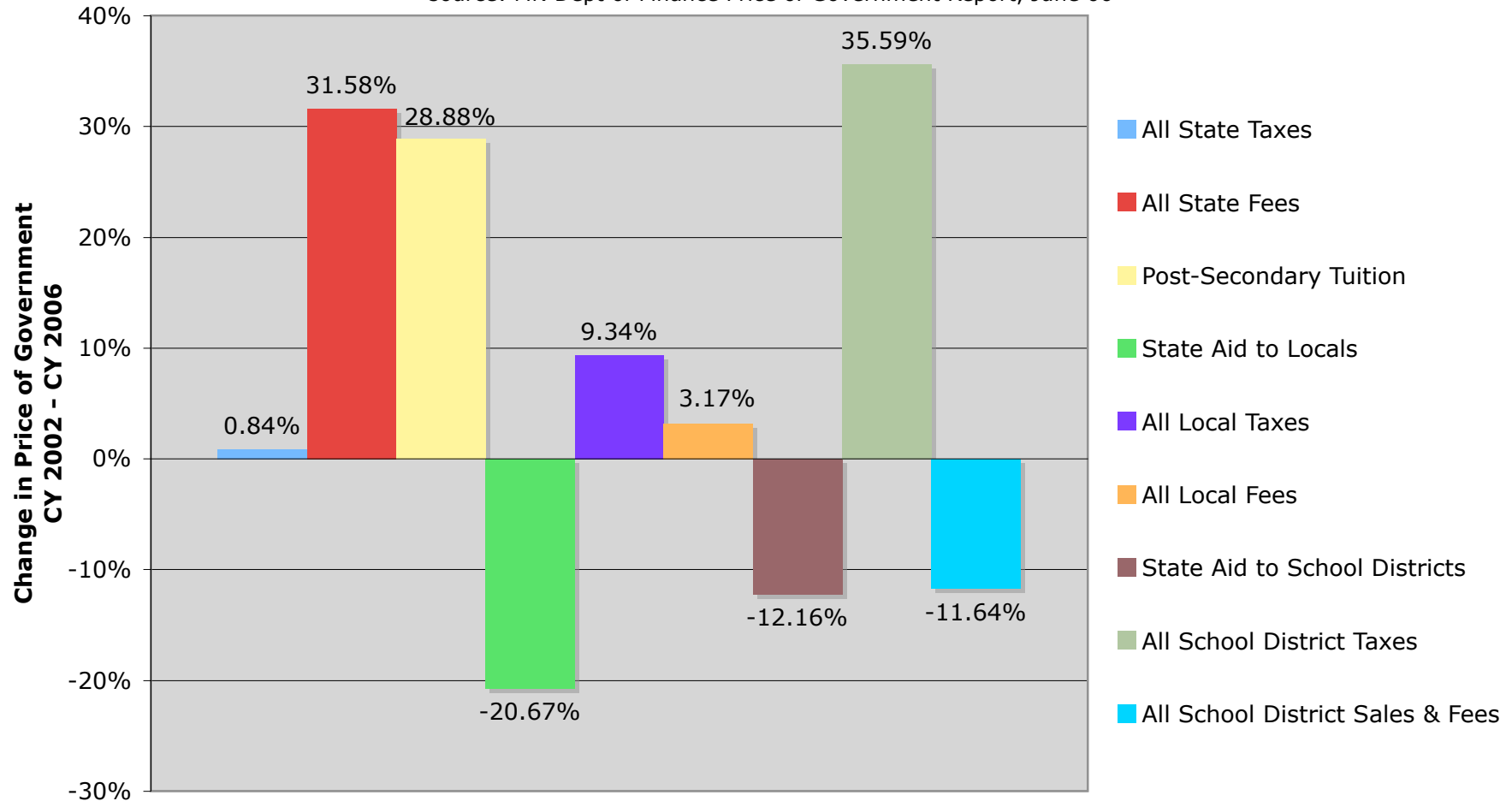
What is wrong with this picture?

Overall, the effect of the "no-new-taxes" policies of Governor Tim Pawlenty and State Auditor Patricia Anderson has been to make Minnesota a more regressive state. The following chart shows in a single compelling image how our state and local finances have shifted since they took office.

The Changing Picture of Minnesota Finances

How "no new taxes" has made Minnesota finances more regressive

source: MN Dept of Finance Price of Government Report, June 06



Local Government and School District finances have been undermined by bad state fiscal policy

Rebecca Otto, Sep 06

As you can see, state taxes have indeed remained relatively flat. To achieve this, aid to schools and local governments has been cut significantly. Fees, tuition, local taxes, local fees, and school property taxes have all increased.

Conclusion

Bad fiscal policy by the adherents of "no-new-taxes" at the state capitol has simply shifted revenue generation onto other forms and made state and local finances far more regressive. Because of this, state and local governments are less able to respond quickly to changing economic conditions, and so are financially weaker. Overall, Minnesota finances have moved away from a "One Minnesota" approach and toward an "every man, woman and child for him or herself" philosophy that will have negative long-term economic and quality of life impacts across Minnesota.

This report has been prepared by the Rebecca Otto campaign for State Auditor, www.rebeccaotto.com

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