Staff Report SR-7

FISCAL DEADLOCK IN MINNESOTA

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This paper will discuss the current fiscal deadlock in Minnesota. It will be organized as follows:

1. The opponents in this controversy will be portrayed.
2. The background leading to this controversy will be described.
3. The 10-week extra session of legislature and the Governor's veto of its tax bill will be discussed.
4. Some observations on the current status of the deadlock will be made.

In order to understand this dispute, the individuals and groups involved must first be presented. These can be divided into three groups.

1. Governor -- The Governor last fall campaigned for and subsequently proposed to the legislature a program that would substantially reduce and equalize property tax burdens. He hoped to accomplish this by having the state assume 70 percent of operating costs for school districts and planned to finance this larger state involvement primarily through increased individual and corporate income taxes. In the last biennium, the state paid 43 percent of school district operating costs. He opposed any increase in the state sales tax.
2. House Conservatives -- Their spokesman is House Majority Leader Ernest Lindstrom. They are the Governor's major opponents, and their program for property tax relief was much less ambitious than his. Also, they supported increasing the sales tax and feared that increased income taxes would hurt the Minnesota business climate.

3. Senate Conservatives -- They occupy a middle ground somewhere between the House Conservatives and the Governor. They have been willing to work with their DFL counterparts and did produce a tax bill acceptable to the Governor in the special session.

Before discussing this year's regular legislative session, the following comments are made about public finance and politics in Minnesota.

1. The DFL has always strongly opposed the use of a sales tax in Minnesota, while the Conservatives have favored the sales tax and successfully enacted it in 1967.
2. The sales tax was enacted to provide property tax relief in 1967, but property tax rates quickly rebounded to their former levels and beyond. Consequently, the public was demanding property tax relief this year.
3. Local units of government -- particularly school districts -- differ greatly in their ability to finance expenditures. In 1970, for example, the Anoka school district had to levy a tax of $581 on a $20,000 home to spend $536 per pupil for school costs, while the nearby Golden Valley school district levied only $369 on a similar home in order to spend $837 per pupil. Given the rapid increase in school costs, this problem has become more acute in recent years. Minnesota school districts currently can choose between two state aid formulas, one attempting to equalize property tax burdens and the other benefiting school districts with large property tax bases, like Minneapolis and St. Paul.

Given these particular biases and problems, it was inevitable that taxation and related issues would be very controversial in 1971. The Governor proposed a tax package which called for $762 million in new state taxes, mainly through increased income taxes, and which would substantially raise the state share of local school district operating costs. Both the Senate and House rejected the Governor's proposal. The Senate reacted by enacting a bill calling for $600 million in new taxes primarily by imposing a 1 percent value-added and gross earnings tax; this plan provided substantial property tax reductions. The House passed legislation calling for about $478 million in new taxes to be raised from income tax increases, a 1 percent increase in the sales tax, and raises in several excise taxes. It proposed less property tax relief than either the Senate or Governor's plans. The House and Senate Conference Committee on Taxes was not able to arrive at a compromise between the two bills, and the legislature adjourned on May 24 with no taxation legislation enacted.

On May 25 a special session of the legislature was convened to deal with unsolved state finance problems. The debate in this session, as in the regular session, centered on two highly interrelated issues: (1) the amount and type of property tax relief and (2) the type of taxes needed to defray such relief. During this session, the House repassed its earlier tax bill from the regular session. The Senate, due to DFL opposition, dropped its support of a 1 percent value-added tax and a gross earnings tax and passed an alternative bill which was acceptable to the Governor. Subsequently, a House-Senate conference committee, dominated by Conservatives, wrote another tax bill, which was enacted by the legislature. The Governor, however, vetoed it.

In order to understand why the Governor vetoed the conference bill, a detailed examination of the various property tax relief measures advocated in the special session in comparison to the Governor's original proposal is in order. The major property tax relief proposals are listed in Table I. The Governor hoped to obtain local property tax relief by having the state pay 70 percent of school operating costs. The House Conservatives, meanwhile, wanted the state to pay only 50 percent of school operating costs and to provide additional tax relief in the form of state assumption of local welfare costs. Every additional percentage point of school district operating costs that the state assumes is equivalent to approximately one half of a percentage point reduction in a homeowner's current property tax. The House proposal would have cost an estimated $276 million versus $390 million for the Governor's plan. In addition to providing more property tax relief, the Governor's proposal would have been more effective in equalizing property tax burdens. Because welfare programs are primarily a county function, a state takeover of local welfare costs would not have eliminated fiscal disparities between school districts and municipalities.

The Senate proposal would have raised the state share of school district operating costs to 63 percent and allowed property owners of residential property and agricultural land to subtract 20 percent of their property taxes from their state income tax liability. The conference bill provided that the state would pay 60 percent of school district operating costs and would permit taxpayers to deduct 10 percent of their property taxes from the state income tax. In terms of total property relief to homeowners, the Senate bill would have achieved a 30 percent reduction in current property taxes as compared to an 18 percent reduction provided by the conference bill.

The conference bill increased property tax relief for senior citizens and renters and contained some property tax relief to businesses by exempting them from personal property taxes. The Senate proposal to set property tax levy limits on local units of government was incorporated into the conference bill. The school aid formula sponsored by the Governor and the Senate was more equalizing among school districts, however, than the one used by the House and finally adopted in the conference bill. The Senate bill provision for additional school aid based on the number of AFDC parents in the school district was incorporated into the conference bill.

The Governor in his veto message objected to the bill on the grounds that (1) the school aid formula to school districts was not equalizing enough and (2) it provided property tax relief to business at the expense of individuals.

Table II contains the major tax proposals advocated by the parties in this controversy. The Governor originally wanted to eliminate federal income tax deductibility from the state personal income tax and increase rates. The Senate went along with the federal income tax deductibility while House Conservatives wanted a surtax on the Minnesota personal income tax. In the next biennium, the Governor's proposal would have increased personal income taxes 49 percent, while the House and Senate provisions would have raised them 29 and 41 percent, respectively. The House version is considered less progressive than the measure passed in the Senate. The conference bill contained a provision for increasing state personal income tax rates 23 percent, which would have increased state personal income taxes 26 percent in the next two years. In addition, the Governor wanted to eliminate federal deductibility on the state corporate income tax, which would have increased this revenue source by 77 percent, and to raise the state corporate tax rate 1 percent. The House Conservatives opposed this, but the Senate went along with eliminating federal deductibility, and it was contained in the conference bill.

As for the sales tax, the Governor originally opposed it, but a provision to increase the state tax from 3 to 4 percent was contained in the House, Senate, and conference bills. The sales and income tax proposals in all four versions account for a major portion of the new revenue to be raised in all the tax plans. Also, all parties agreed to increasing the cigarette tax. The Governor objected to other tax proposals in the conference bill because they favored certain industries. Liquor taxes, for example, were not increased, and the increase in the taconite production tax was not large enough to suit the Governor.

The main areas of contention appear to be the following:

1. The Governor wants any increase in the state income tax to be more progressive than the provision in the conference bill proposal.
2. Any provision that hints at favoritism to business, such as no increase in the liquor tax, would have to be removed.

The above discussion describes the Minnesota fiscal situation up to the time that the Governor vetoed the conference bill on August 3. The legislature is not scheduled to reconvene until October 12, and the Governor has stated he will not call it back into session before then unless an informal legislative conference committee draws up a favorable tax bill which can be passed in one day. The Conservatives balked at the Governor dictating terms to the legislature. Local government officials, however, are pressuring the Governor and legislature to do something, for the amount of state aid they will receive has not yet been determined. The newspapers have indicated that some legislative tax meetings may be held around the first of September. The current positions of the opponents are as follows:

1. Governor -- The Governor has stated that the Senate bill passed in the special session would be a good starting point for legislative action. He has compromised and agreed to exempt business from personal property taxes if the local unit of government is reimbursed for the revenue loss and business is paid for the reimbursement. He hopes that Minneapolis and St. Paul House Conservatives defect and support a tax bill he favors. The conference bill in the special session was not favorable to the central cities.
2. House Conservatives -- House Conservative Majority Leader Ernest Lindstrom, the Governor's major opponent, has gone back to advocating proposals similar to those in the House-passed bill in the special session, although he has made some concessions. He agreed to increases in the liquor and taconite production taxes suggested by the Governor and has also proposed increasing the state share of state school operating costs to 57 percent.
3. Senate Conservatives -- They continue to seek a compromise bill acceptable to the House Conservatives and the Governor.

Two major issues remain unresolved:

1. The amount of state support for school district operating costs. The settlement of this issue would be an important

factor in determining the amount of new tax revenue needed. The degree of equalization in the school aid formula also continues to be a bone of contention.

2. The amount of progressivity built into any increase in the personal income tax. The Governor continues to push for federal deductibility while the House Conservatives want a surtax.

Table I

Major Property Tax Relief Provisions

	School Aids	Welfare Aid	Direct Relief	Levy Limitations
Proposals in Governor's Budget Message	State assume 70 percent of school district operating costs. Built in greater equalization in distribution formula.		Allow property tax levies to repay bonded indebtedness to be eligible for the 35 percent Homestead Tax Credit.	
House-passed bill in the Special Session	State assume 50 percent of school district operating costs. Did not significantly increase equalization in school aid formula.	State take over all local welfare costs.		
Senate-passed bill in the Special Session	State assume 63 percent of school district operating costs. Built greater equalization in distribution formula. Provided additional aid based on number of parents on AFDC in school district.		Owners of residential property and agricultural land could subtract 20 percent of their property taxes from their state income taxes.	Set limits on property tax levies.
Conference bill passed in the Special Session	State assume 60 percent of school district operating costs. Did not significantly increase equalization in school aid formula. Provided additional aid which is based on number of parents on AFDC in school district.		Owners of residential property and agricultural land could subtract 10 percent of their property taxes from their state income taxes.	Set limits on property tax levies.

Table II

Major Tax Provisions

	Individual Income Tax	Corporate Income Tax	Sales Tax	Total New Taxes Proposed
Proposals in the Governor's Budget Message	Eliminate the deduction of federal personal income taxes from state personal income tax returns. $360 million new revenue by increasing personal income taxes 41 percent in the next biennium.	Eliminate the deduction of federal corporate income taxes from state corporate income tax returns. $126 million new revenue by increasing state corporate income taxes 77 percent in the next biennium.	Extend the sales tax to those industries now exempt. $13 million new revenue by increasing state sales tax receipts 3 percent in next biennium.	$762 million
	Add 1 to 3 percent to state income tax rates of individuals with net incomes above $10,000. $73 million new revenue by increasing personal income taxes 8 percent in the next biennium.	Increase state corporate income tax rate 1 percent. $26.9 million new revenue by increasing state corporate income taxes 16 percent in the next biennium.		
House-passed bill in the Special Session	A 25 percent surtax on state personal income tax liability instead of eliminating deduction of federal income taxes. $256 million new revenue by increasing personal income taxes 29 percent in the next biennium.		Raise state sales tax 1 percent. $146 million new revenue by increasing state sales tax receipts 36 percent in the next biennium.	$478 million
Senate-passed bill in the Special Session	Eliminate the deduction of federal income taxes from state personal income tax returns. $360 million new revenue by increasing personal income taxes 41 percent in the next biennium.	Eliminate the deduction of federal corporate income taxes from state corporate income tax returns. $126 million new revenue by increasing state corporate income taxes 77 percent in the next biennium.	Raise state sales tax 1 percent. $146 million new revenue by increasing state sales tax receipts 36 percent in the next biennium.	$672 million
Conference bill passed in the Special Session	A 23 percent increase in state personal income tax rates instead of eliminating deduction of federal income taxes. $231 million new revenue by increasing personal income taxes 26 percent in the next biennium.	Eliminate the deduction of federal corporate income taxes from state corporate income tax returns. $126 million new revenue by increasing state corporate income taxes 77 percent in the biennium.	Raise state sales tax 1 percent. $146 million new revenue by increasing state sales tax receipts 36 percent in the next biennium.	$599 million