Blueprint for Fiscal Policy Reform

Innovative and diverse Minnesota businesses are the backbone of the state's economy. But past success does not guarantee future prosperity, and Minnesota's tax code creates burdens that may hinder long-term economic growth. Lawmakers should evaluate policy decisions with a global view, and address present-day challenges with solutions that will enhance Minnesota's future competitiveness in the global economy.

Globalization, technological advances, demographic changes, and other forces are causing fundamental changes to the economy that make existing state spending trends unsustainable. In addition to unsustainable spending trends, Minnesota has an antiquated and burdensome tax structure that forces Minnesota-based businesses to shoulder a heavy and growing load while they compete in a dynamic worldwide economy. Reforms are necessary to position the state for greater economic growth and reduce the effect of economic shocks on the state budget.

Minnesota's Fiscal Challenges

1. Spending trends that exceed projections for economic growth.
2. A tax structure that contributes to budget volatility and isn't aligned with the modern economy.
3. High taxes that disproportionately burden Minnesota-based businesses, hinder growth, and make it more difficult to attract top talent.

The Spending Challenge

It will take more than belt-tightening to create sustainable budgets. The public sector must innovate to maintain essential services and a high quality of life. Developing new and better ways to set budgets, deliver services, and meet public needs will improve the business climate.

Spending growth in the largest areas of Minnesota's general fund budget, including health and human services (HHS), is accelerating far faster than the economy. Although spending growth has been mitigated somewhat through recent reforms, the state is expected to continue to see double-digit increases in the near future. Spending restraint and further reforms will be necessary to address this issue.

The Structural Challenge

Minnesota's tax code was developed to meet the needs of the 20th century's goods-based economy, but our outdated tax system now creates barriers to business investment and job creation in our mobile, global, knowledge-based economy. In addition, Minnesota relies disproportionately on volatile revenue sources like high personal and corporate income taxes, which has contributed to the unpredictable fiscal forecasts that we've seen in recent years. Reforms are needed to construct a simplified, streamlined, 21st century tax system that will generate job growth, promote private-sector investment, and create stable and sustainable budgets.

The Competitiveness Challenge

Minnesota businesses and entrepreneurs are faced with some of the nation's highest tax burdens. The state's tax structure deters business expansion and relocation in Minnesota and discourages companies from locating high-skill, high paying jobs here. Our anti-competitive tax code contributed to Minnesota ranking 46th out of the 50 states in the Tax Foundation's State Business Tax Climate Index.

4th
highest personal income tax rate

3rd
highest corporate income tax rate

5th
highest per capita income tax burden

9th
heaviest business property tax burden

7th
highest state sales tax rate

Principle 1

The state should foster private-sector investment and job creation, reduce revenue volatility, strengthen Minnesota's global competitiveness, and ensure that businesses are not penalized for locating, investing, or growing in Minnesota.

Use federal tax reform as an opportunity to improve Minnesota's tax competitiveness.

- Apply state revenue gains from federal tax reform toward improving Minnesota's tax climate.

Reduce employers' property tax burdens. Minnesota's high business property taxes are a competitive disadvantage for Minnesota-based employers, and are a barrier to investment in the state. Minnesota businesses bear a disproportionate burden because they pay higher local rates than other property types and also pay a state property tax.

- Maintain the repeal of the state business property tax auto-inflator.
- Provide direct tax relief to businesses by reducing the state business property tax levy.
- Do not shift larger portions of local property taxes onto employers.

Reform corporate taxes. Minnesota's high corporate tax rate is a barrier to attracting new business investment and should be reduced. It is regressive, volatile, expensive to administer, and leads to higher prices and lower wages.

- Increase the research and development tax credit to encourage investment and high-paying jobs in Minnesota.
- Maintain sales-only apportionment to encourage businesses to keep and grow jobs in Minnesota.
- Don't penalize Minnesota companies for competing and succeeding in international markets. International success creates good-paying jobs at Minnesota headquarters.

Reduce personal income taxes. Minnesota has the nation's second highest income tax rate for joint filers at the $260,000 income level and the fourth highest rate overall. These extraordinarily high rates suppress business expansion because business income often flows through personal income tax returns. High rates also make it difficult to attract top talent to the state and make it more expensive for businesses to locate high paying jobs in Minnesota.

- Reduce Minnesota's reliance on volatile income taxes and reduce personal income tax rates.

Ease regulatory burdens and workplace mandates. State and local regulations and mandates substantially increase business costs and complexity, and create a perception that Minnesota is hostile to business.

- Do not impose rigid workplace mandates that discourage job growth and limit flexibility.
- Support uniform labor standards by explicitly preempting local governments from enacting workplace mandates.
- Do not make Minnesota's regulatory burden an outlier compared to other states.
- Provide administrative relief to businesses burdened by a growing patchwork of local workplace mandates.

Focus on the big picture. Tax incentives or subsidies for particular businesses may occasionally help attract and retain jobs, but policymakers should focus on improving the overall business tax climate and promoting broad-based economic vitality.

Principle 2

State budget reforms should focus on outcomes and priorities, encourage fiscal restraint, improve service delivery, and produce desired results.

Build sustainable budgets based on priorities and outcomes.

- Base spending priorities on whether expenditures are achieving expected outcomes and supporting long-term economic competitiveness.
- Align state spending with long-term economic growth.
- Reduce reliance on highly volatile personal and corporate income taxes and move toward a broader, consumption-based sales tax on final retail purchases, without taxing business-to-business services.

Emphasize efficiency and economic growth when evaluating transportation infrastructure spending. Efficient movement of people, goods, and services is critical to Minnesota's economic competitiveness, but according to MnDOT, current projected revenues will be insufficient to meet the needs of our transportation system.

- Make transportation a high priority when setting the general fund budget by dedicating all transportation-related general fund revenues to transportation.
- Address transportation funding on a longer-term, consistent basis, including the metro-area bus transit system.
- Identify and implement efficiencies to help fund additional transportation investments.
- Consider the impact of funding proposals on Minnesota's competitiveness and overall tax burden.
- Direct additional transportation investments to projects with the highest return on investment and the greatest positive impact on economic growth.
- Explore alternative funding sources and models, such as value/benefit capture and public-private partnerships.

Leverage public-private partnerships. Policymakers should leverage private-sector expertise and innovations to increase efficiency and quality in areas such as strategic sourcing, information technology, health care, transportation, and economic development.

Promote productivity and efficiency in government programs and services to provide greater value for tax dollars. Pursue innovative approaches that focus on saving time, effort, and resources.

- Encourage local governments and state agencies to collaborate, consolidate, share services, and streamline administration.
- Use competitive bidding and strategic sourcing to deliver state and local services.
- Compare Minnesota's health care program benefits to national benchmarks and consider aligning Minnesota to high performing states.
- Evaluate and compare economic development programs and prioritize funding for the most effective programs.
- Align public sector compensation with the private sector.

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