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 and business climate create 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.

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 43rd out of the 50 states in the Tax Foundation's State Business Tax Climate Index. As Minnesota competes with other states and countries for future investment and job growth, lawmakers should be mindful of how Minnesota's tax and business climate compares to our competitors.

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Minnesota's tax code was developed to meet the needs of the 20th century's goods-based economy, but our outdated tax system now creates barriers to business investment and job creation in our mobile, global, knowledge-based economy.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 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 HHS 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.

GUIDING PRINCIPLE

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.

Personal Income Taxes

Minnesota has the nation's 2nd highest income tax rate for joint filers at the $267,000 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. Recent federal changes to the State and Local Tax (SALT) deduction will only exacerbate this competitive disadvantage.

2nd
highest personal income tax rate*

Corporate Taxes

Minnesota's high corporate income tax rate is a substantial barrier to attracting new business investment to the state. The 9.8% "billboard rate" is the 3rd highest in the nation, and contributes to the state's reputation for having an unfavorable business climate. Furthermore, the corporate tax is regressive, volatile, expensive to administer, and leads to higher prices and lower wages.

One bright spot related to the state's corporate income tax is that lawmakers, on a bipartisan basis, enacted single sales apportionment. Prior to 2014, the state apportioned corporate income using the Minnesota proportions of a business's sales, payroll, and property. This created a disincentive to expand operations or hire more employees in Minnesota. Under current law, the state now apportions income based on sales only ("single sales").

3rd
highest corporate income tax rate

Policymakers should consider several reforms related to the corporate tax, including reducing the rate, increasing the research and development tax credit, and targeting corporate tax relief to Minnesota-based companies and those with a significant presence in the state. In a highly competitive global economy, it is counterproductive to penalize companies for competing and succeeding in international markets. International success creates good-paying jobs at Minnesota headquarters, and strengthens Minnesota's standing as a "headquarters state".

Property Taxes

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 property tax burden for two reasons: because businesses pay higher local tax rates than other property types and because of a separate statewide business property tax.

8th
highest business property tax burden (metro)

The statewide business property tax is a burden on businesses of all sizes, including those that do not own property but pay the tax through their lease. It is more regressive than overall Minnesota state and local taxes. Until 2017, the tax also had an auto-inflator that increased the levy each year. The levy is currently $787 million.

2nd
highest business property tax burden (rural)

Sales Taxes

The composition of Minnesota's economy has changed dramatically over the past 50 years. In 1963, the goods-producing sectors of the economy, like manufacturing, construction, and mining, comprised 41 percent of the state's economy. That share of the economy has shrunk to just 24 percent, while the services-producing sectors have increased from 59 percent to 76 percent of Minnesota's economy.

The sales tax is among the most stable sources of revenue for the state. But Minnesota's sales tax is increasingly top heavy. At 6.875%, Minnesota's state sales tax rate is the sixth highest in the nation. But the tax falls on a narrow base. Minnesota's sales tax should be updated by moving to a lower tax rate and broadening the tax base to include additional consumer goods and services, without taxing business inputs or business-to-business services, which results in "tax pyramiding."

6th
highest state sales tax rate

Tax Structure and Revenue Volatility

One of the state's greatest fiscal challenges is its existing tax structure that contributes to budget volatility and is misaligned with the modern economy. Minnesota's corporate income tax revenue has varied by as much as 42% year-over-year, making it difficult to properly budget when revenues are unpredictable. And compared to other states, Minnesota is heavily reliant upon relatively volatile individual income tax revenue, accounting for 18.5% of state and local revenues compared to 12.5% for all other states. In contrast, sales tax revenue is more reliable since consumption stays relatively steady even during economic downturns. Policymakers should 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.

Regulations and Mandates

Excessive state and local regulations and mandates substantially increase business costs and complexity, and create a perception that Minnesota is hostile to business. In recent years, a proliferation of onerous local workplace mandates has created a regulatory patchwork that imposes substantial legal, administrative, operational, and financial burdens on businesses of all sizes.

In an increasingly competitive and mobile economy that offers businesses an unprecedented level of choice in where to locate and grow, Minnesota simply cannot afford to be a regulatory outlier. State policymakers can help unwind the regulatory maze by preempting local government mandates and eschewing rigid one-size-fits-all mandates that fail to take into account existing employer-provided benefits, discourage job growth, create uncertainty, and inhibit business investment.

GUIDING PRINCIPLE

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

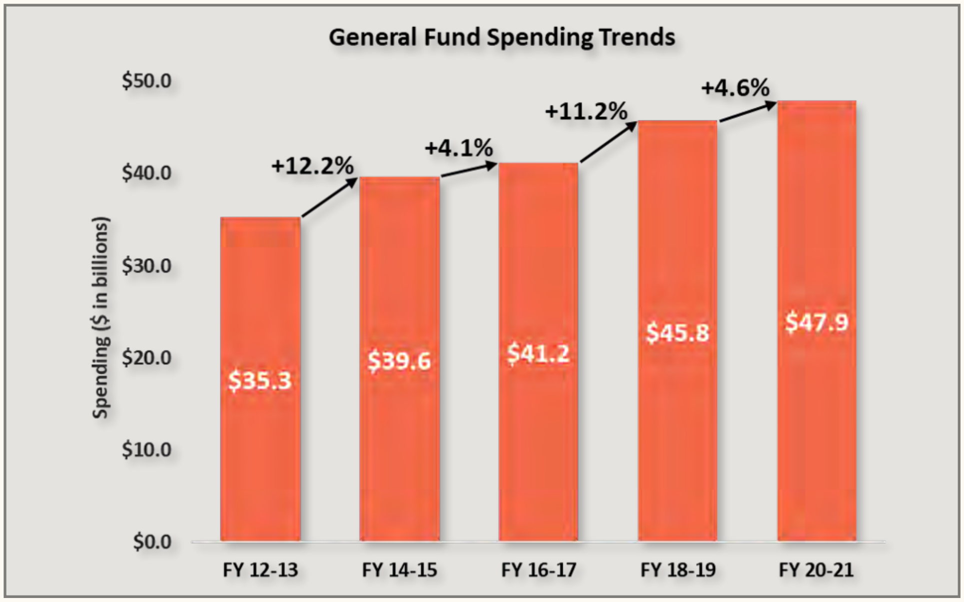
Priority-Based Budgeting and Sustainable Spending

Long-term budget stability requires that state spending be aligned with long-term economic growth. However, with few exceptions, spending growth in Minnesota's recent state budgets has substantially outpaced economic growth. This imbalance has been sustained only through budget shifts and tax increases on individuals and businesses. Tax increases offer only temporary relief because the major government spending areas continue to grow faster than the state's economy.

12th
highest total spending per household

State lawmakers should utilize priority-based budgeting to set clear and specific priorities, identify indicators to monitor progress, and purchase services to achieve desired outcomes. Lawmakers should also consider the impact of funding proposals on Minnesota's competitiveness and overall tax burden. For example, policymakers should make transportation a high priority when setting the state's general fund budget by dedicating all transportation-related general fund revenues to transportation, and prioritize targeted scholarships to expand access to early childhood education for low income families.

2nd
highest public welfare spending



Innovation and Partnerships

State government should leverage private-sector expertise and innovations to increase efficiency, productivity, and quality in areas including strategic sourcing, information technology, health care, transportation, and economic development. Examples include streamlining administration, using competitive bidding and strategic sourcing to deliver government services, and aligning public sector compensation with the private sector.