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## Jay Kiedrowski: The awful, lawful joyride

Whipping wildly from deficit to surplus isn't good for Minnesota. Let's smooth our system.

### Jay Kiedrowski

In 2002, the state of Minnesota budget had a \$4.5 billion deficit. Now, the state budget has a \$2.2 billion surplus. How can this happen in just four years?

Minnesota has one of the most volatile revenue systems in the United States. Think of the rollercoaster at Valleyfair. That up, down and twisting ride is a good visual picture of our state revenue system. Minnesota public officials feel like they're in the front row of the first car with their arms high in the air.

This volatility in Minnesota's revenue system causes more problems than simply headlines in the paper and additional work for our public officials. When revenues slow, spending cuts are made that result in public employees losing their jobs; key services like policing and schooling are reduced, and fees and taxes increase. When revenues swell, police officers and teachers are rehired, services such as health care for children are expanded and taxes are lowered.

Minnesota government is less efficient because of the "now we have some, now we don't" financing system. With steadier revenues, our government units would spend less time solving crises and more time improving and delivering public services.

Minnesota's revenue volatility is not new. The years of 1982, 1991 and 2001 produced economic slowdowns that dropped revenues below forecasted levels, causing deficits. These were followed by the years of 1985, 1996 and 2005, which produced revenue increases beyond the most optimistic forecast, resulting in surpluses.

Minnesota's imbalance in its revenue system needs to be corrected. In 2003, our income tax ranked seventh; our sales tax 34th; and, our property taxes 26th, all per \$1,000 of personal income. Because the Minnesota income tax is used disproportionately more and is much more volatile than the other state taxes, we get rollercoaster results.

A special 1985 Minnesota Tax Study Commission noted this revenue volatility problem and proposed a more balanced revenue system that included including the following key recommendations:

- "Reduce the level of the income tax and lower the effective tax rates on all income classes ... ."
- "Broaden the sales tax (now among the nation's most narrowly based) to personal services and new clothing."

In essence, the Minnesota tax system should be balanced like a three-legged stool with income-, sales- and property-tax legs all contributing similar amounts. These changes could be enacted in a way that does not increase taxes overall and still preserves the individual progressivism of Minnesota taxes.

Now is the time to make the change. Too many years have passed with governors and legislators arguing that the reforms should occur, but "in the future." With Gov. Tim Pawlenty and the Legislature starting new terms, they could make the change now and avoid a likely deficit by the end of their terms.

If the governor and Legislature refuse again to solve the long-term problem, then the state must undertake difficult budget reforms now. First, Pawlenty and lawmakers should increase the size of the budget reserve. The 1985 tax study commission and other studies have suggested a budget reserve of at least 10 percent (more than \$3 billion for today's budget) to avoid emergency cuts when the next recession reduces Minnesota's forecasted revenue.

The state will have a \$1 billion surplus by June 30, 2007. This surplus should be put in the budget reserve as protection against the next recession. Also, a "trigger tax" should be enacted to provide emergency revenues to get to the 10 percent reserve level if forecasted revenues fall short.

Second, the governor and Legislature should require an inflation adjustment in Minnesota's budget forecast. To forecast inflation in revenues and not in expenditures is very misleading and can result in excessive spending or tax reductions. Case in point: There is no additional surplus for 2007-08 because expenditure inflation of \$1.2 billion will offset the rest of the forecasted surplus.

Third, as the 2020 Caucus has argued, the governor and Legislature should not only balance the upcoming biennial budget for 2007-08, but also ensure that the following biennial budget for 2009-10 is balanced as well. This avoids spending and tax reductions that have larger future impacts.

Minnesota has a choice: Undertake the necessary tax and budget reforms now or let the state continue to be known for having the worst rollercoaster revenue system in the country. Urge the governor and Legislature to fix it so that Minnesota has no more embarrassing surpluses or deficits.

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