

LOCAL GOVERNMENT FISCAL AUTONOMY IN MINNESOTA

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MINNESOTA · REVENUE

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OUTLINE

- 1. Local Fiscal Autonomy Framework**
- 2. State Motivations for Changing the State/Local Fiscal Relationship**
- 3. Evolution of Minnesota's Local Fiscal Autonomy**
- 4. Focus on De Facto Devolution**
- 5. Conclusions**

1. LOCAL FISCAL AUTONOMY

- **Local flexibility yields superior fiscal policy because policy tailored to local economic variations can result in efficiency (Hoene and Pagano)**
 - **Counter argument: local flexibility can maximize exporting (including to nonresident property owners) and create economic inefficiencies for taxpayers with presence in multiple jurisdictions**
- **Dimensions of autonomy include: (Wolman et al.)**
 - **local government importance**
 - **local government discretion**
 - **local government capacity**
- **State systems conducive to economic vitality provide local fiscal autonomy and address local fiscal inequalities (McFarland and Hoene)**

2. WHY DO STATES ALTER THE STATE/ LOCAL FISCAL RELATIONSHIP?

Policy-oriented reasons

- Tax reform
 - Education funding goals
 - Taxpayer equity goals
 - Tax relief
- Pre-emption: preference for uniformity or local policy boundaries
 - Prohibition from specific revenue sources
 - Tax and Expenditure Limits (TEs)

2. WHY DO STATES ALTER THE STATE/ LOCAL FISCAL RELATIONSHIP?

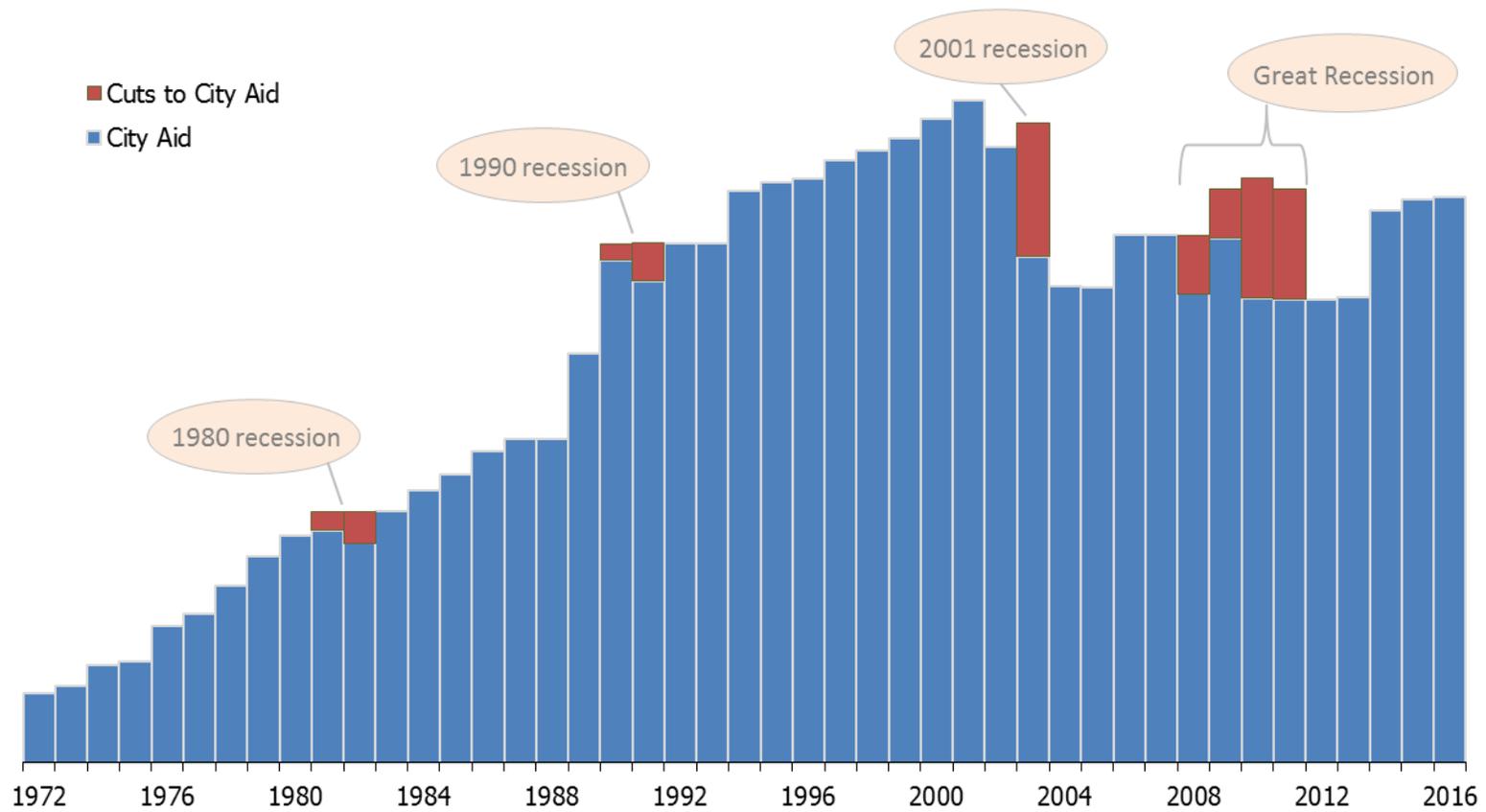
- **Formal devolution: potential advantages (Kincaid)**
 - more efficient provision and production of public services
 - better alignment of the costs and benefits of government for a diverse citizenry
 - better fits between public goods and their spatial characteristics;
 - increased competition, experimentation, and innovation in the public sector
 - greater responsiveness to citizen preferences;
 - more transparent accountability in policymaking

2. WHY DO STATES ALTER THE STATE/ LOCAL FISCAL RELATIONSHIP?

Other-than-policy-oriented reasons

- Tax reform ‘side effects’
 - Tax reform often focuses on taxpayers or education funding but changes impacting counties and cities may be included as means to main goals.
 - Maintaining outcomes of reform in later years can require systems tinkering
- De facto devolution
 - More on this shortly
- Budget shocks
 - Recessions and expansions

CITY AID CUTS AND RECESSIONS



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3. MINNESOTA'S EVOLUTION

- **Pre-1967**
 - Limited state and local fiscal relationship
- **Minnesota Miracle 1967-1975**
 - Centralized revenue collection with decentralized spending
 - Aids to local governments in exchange for state pre-emptions and limitations; schools especially controlled
- **Tax Burden Management 1976-2001**
 - Annual state adjustments to classification and levy limitations, increased funding for aids, credits and refunds in an attempt to manage taxpayer burdens via state policy
 - On-again/off-again levy limits based on magnitude of other changes
 - Local Government Trust Fund experiment
 - Complexity begets complexity

3. MINNESOTA'S EVOLUTION

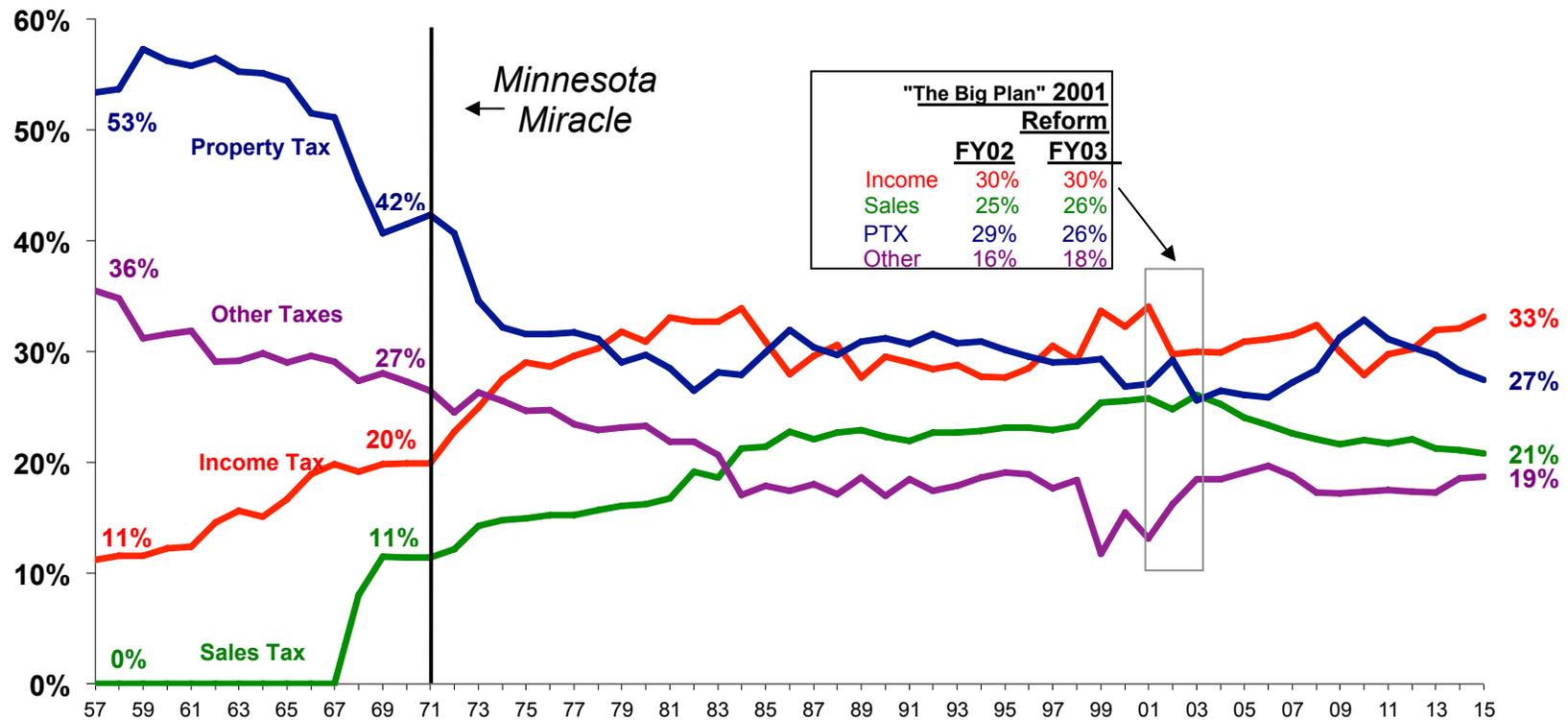
- **Big Plan reforms 2002-2008**
 - Property tax relief
 - 'Right-size' education and local aids
 - Recalibrate classification system
 - State takeover of transit levies
 - Attempt to incentivize responsible city and county levy decisions by increasing marginal tax price on homesteads (instead of levy limits)
- **Post Great Recession 2009-2016**
 - Shift from state aids and credits to means-tested refunds
 - Local revenue diversification for dedicated purposes
 - Increase in de facto devolution

3. MINNESOTA'S EVOLUTION

- State and Local government revenues in MN grew faster than national average as Minnesota Miracle evolved, then fell back to the average in recent years
- Minnesota Miracle centralized tax revenue collection with decentralized spending

3. MINNESOTA'S EVOLUTION

History of Major Taxes Percent Share FY 1957 - 2015



Source: Minnesota Department of Revenue and
Price of Government, February 2016
Includes sales tax rebates FY 1999-2001

4. DE FACTO DEVOLUTION

- Two facets of de facto devolution:
 - Inaction by the state that results in local governments using existing authority to step into traditional state policy space
 - State grant of new fiscal authority to local governments or citizens for traditional state policy issue when state consensus fails
- Examples
 - Transit funding
 - County sales and wheelage taxes for transportation
 - Local Government Trust Fund
 - Clean Water Legacy amendment
 - School levy responsibility from state to voters to school boards

5. CONCLUSIONS AND QUESTIONS

- Political polarization, especially around taxes, can lead to de facto devolution.
- Metropolitan regions are growing in importance for economic development, requiring new partnerships of local public and private leaders (Katz and Bradley)
- De facto devolution is less likely than formal devolution to include the necessary local government discretion and fiscal capacity or to maximize efficiency
- Question: Do you see growth of de facto devolution in your states?

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