



# Summary of Discussion with John James, Lawyer and former Commissioner of Revenue Civic Caucus

8301 Creekside Circle #920, Bloomington, MN 55437

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**Present:** Verne Johnson (Chair); Marianne Curry, Paul Gilje, Jan Hively, Dan Loritz, Joe Mansky, Tim McDonald, Wayne Popham (phone)

**A. Welcome and introductions** - John James is a lawyer and public policy consultant with deep background in taxation and a history of developing proposals for change in law.

A native of Iowa, James came to Minneapolis in 1974 from Harvard Law School and has lived and worked in the Twin Cities ever since. As James describes it, he got the public policy bug in the early 1980's when he got active in the Minnesota State Bar Association Tax Section. He joined the Minnesota Department of Revenue as Assistant Commissioner for Compliance under Commissioner Tom Triplett in early 1986. A two-year commitment turned into five years when he was named Commissioner of Revenue in late 1987 and stayed in state government until 1991.

James co-founded the Public Strategies Group with Peter Hutchinson and Babak Armajani. He ran for Attorney General on Hutchinson's Team Minnesota ticket for the Independence Party in 2006.

James has produced numerous governmental reform proposals, some of which have been enacted. The most recent success came in 2009 with passage of a bill that ended a gross unfairness in the Department of Revenue's approach to officer liability cases.


James chairs the board of 1000 Friends of Minnesota, and volunteers legal counsel to Karen Organization of Minnesota.

**C. Comments and discussion** -

First, an editor's note: These notes reflect the conversation had around the table with some additional details pulled from two important documents provided by James. One is a proposal for reforms James has prepared for the Governor, and certain state officials and legislators. The second include points taken from a sort of diagnostics test that James ran on state services and finances, in preparation for today's meeting. He put those together in a memo titled, "Minnesota's Fiscal Situation."

His thorough and detailed recommendations are truncated here, for consideration of space and accessibility of these notes.

You can read his proposals, "Finding a Way Forward," at:  <http://pages.google.com/edit/thewrittenleague/FindingAWayForwardJohnJamesJan2010.pdf> .

See his memo to the Civic Caucus, complete with detailed analysis of the budget and titled "Minnesota's Fiscal Situation: Problems and Solutions," at:  <http://pages.google.com/edit/thewrittenleague/MinnesotasFiscalSituationJohnJamesJa.pdf> .

During James' visit with the Civic Caucus, the following points were raised:

### **The future trends are clear: there is a structural imbalance in the state budget**


Revenues are projected to grow at 3.9 percent compounded, through 2033, while expenditures are projected to grow at 5.4 percent, over that same period.

Projections from the state economist and state demographer are that the demands on state services will grow. Baby boomer retirement and health care costs are contributing to what former governor Carlson calls an 'economic tsunami' ( <http://minnesota.publicradio.org/display/web/2010/01/26/midday1/> ), as their retirement and health care costs will grow while taxable income and spending on consumer goods drop.

Meanwhile the 2010 legislative session is beginning from a deep hole, with the cost of the status quo at 15-20 percent higher than currently projected revenues.

James ran out two possible scenarios, to help illustrate. "Assume that revenue and health care projections hold," he said. "Then K-12 and all other areas of spending are limited to .2 percent." But "if K-12 gets a 2 percent increase, then all other areas of spending outside of health care must drop at 3.9 percent.

### **It is also clear that taxing and cutting are not sufficient to resolve this imbalance**


"Ted Kolderie has gotten it right," James said, referencing a talk Kolderie gave to the Minnesota Taxpayers Association last September (  <http://pages.google.com/edit/thewrittenleague/KolderietoMTA9162009.pdf> ). In it he said, "We've got four ways to handle this. We can tax more, we can spend less, we can grow the economy, or we can redesign." Doing things differently is the only way to resolve the long-term imbalance.

A member observed that we are seeing all sorts of activity to reduce costs by finding new ways to accomplish tasks in the private sector. "There is too much focus in the public side on revenue, and not on doing things differently."

"The goal," James put it, "is to temper an increase in taxes while permanently cutting state spending." The goal here is not as simple as a focus on higher or lower taxes, or larger or smaller government. Some people may want to grow government; others shrink it. Those are separate questions. We need to make sure that the government we do have is as much of a value as we can make it. If we are not always looking for ways to better deliver services, we are sliding.

### **Health care and education are the two biggest cost drivers**

"Expenditures are expected to grow at 5.4 percent annually, compounded, in the coming two decades. They break down to Health care at 8.5 percent, K-12 at 4.8 percent, and all other areas at 2.7 percent.

Together health and human services, K-12, and higher education assume approximately 70 percent of the state budget (  <http://www.mmb.state.mn.us/doc/budget/report-pie/all-nov09.pdf> ).

Something must be done differently.

### **Redirect property aids and credits to the individual, not to municipalities**

"The Minnesota Miracle has become the Minnesota Debacle," James declared, referencing the 1971 effort that re-organized the fiscal policies of the state ( [http://www.mnhs.org/library/tips/history\\_topics/18public.html](http://www.mnhs.org/library/tips/history_topics/18public.html) ). "What I'm doing is proposing a new Miracle," he said, noting that "the problem is around the property tax, and changes in conditions that have resulted in a myriad of perverse incentives" and other side-effects not intended or created by the original policy.

To James this is a question of wise use of taxpayer money. "Part of this is getting better value. We should be budgeting for effectiveness and results, but the local assistance at \$2 billion is a black hole for the state."

The method for this is to wipe clean our practice of sending money to the state, only to turn it back around to municipalities. In its place James would allow decisions on taxation to be made at the local level, protecting individuals through an expansion of the 'circuit breaker': If property taxes rise above a person's income, they receive a credit to set the balance.

### **Resolve the partisan deadlock by finding the win-wins that do exist**

"Governor Pawlenty and the legislature are at loggerheads, and so need to expand the scope of negotiations," James said.

"We have a high sales tax rate and a narrow base-that doesn't make sense. Broaden the base, and cut the rate. This could drop rates to below 5 percent, ...yet increase the amount of revenue. And write into law that when the economy comes back, drop rates further."

### **Target reform at health care provided to state and local employees**

There are about 338,000 employees in state and local government in Minnesota, with a host of different health care plans, James said. "If you add together all the state and local employees, the amount we spend on their health care premiums is the biggest investment of state and local government." He suggested the state could experience significant savings if it were to buy health insurance for all state and local employees in one plan.

### **Reform the budget reserve**

"I've got legislation already drafted on this," James said. Recalling when he first came in to state government, he told a story that "I was simply a lawyer; came in and saw a \$10.9 billion budget, and asked, 'What happens if we have a recession? If the economist blows the forecast?' Minnesota needs a healthier reserve, as a matter of good governance.

In James' view, budget reserve reform, coupled with the switch of state effort from general property tax relief to investment in human capital, with rate cuts enacted now to take effect when the economy recovers in a few years, with broadening of the sales tax base, and with positioning Minnesota to be a leader in health care reform, could be a powerful legacy of sound fiscal management for Governor Pawlenty to leave the state, and unleash a torrent of creative effort to make Minnesota's state and local governments more efficient.

### **Consolidate the purchasing of services**

"Buy the services together. There are too many little service buyers. This is a big redesign area. It can be done already by the joint powers act. Armi Armajani (of Public Strategies Group) likes to say that people all want to fix the problem, but nobody wants to change anything. Don't force consolidation, but align incentives so that people see its value and elect to do it. The problem here is not just the number of service buyers, but the transaction costs."

Ted Kolderie cites the joint powers act often, when illustrating the law's capacity for service sharing. Fire and police are commonly shared amongst municipalities. What about other services?

### **Change the way we treat business**

"In Minnesota we need to change our attitude toward businesses, by stopping the clobbering of production in Minnesota," James remarked.

It is possible, James argues, to increase the amount of tax revenue from businesses while decreasing the share paid by those located in the state, by targeting companies located elsewhere that exploit the Minnesota market. "The corporate income tax should be harmonized with the individual tax. The corporate rate (now 9.8 percent) and the top individual rate (now 7.85 percent) should be the same," he argues. Broadening the base in each area of tax could both drop the rates and increase revenue.

He advocates creating either a common state wide business property tax, or, better in his view, repealing the existing state business property tax and enacting instead a state wide tax based on business activity. James notes that taxing businesses the same as homes at the local level would more fully engage citizens in their local governments' spending decisions, while also automatically reducing the gap that now exists in business tax rates around the state. Businesses would pay less

tax to local governments and more to the state. The business activities tax would be better for Minnesota businesses than a bigger state wide property tax because it would shift tax burden from businesses producing in Minnesota to businesses exploiting the Minnesota market from out of state. The existing state property tax on business would be repealed and sales taxes on business capital spending eliminated. The clobbering of production in Minnesota would be a thing of the past.

But if a new tax is too scary to contemplate even though businesses producing in Minnesota would collectively pay less than they do now, increasing the state business property tax and reducing the local business property tax would still be a big improvement over the current system for three reasons. First, it would support the new Minnesota Miracle described above, in which the state would invest more in human capital, local citizens and governments would decide how much they wanted to spend on other services, and there would be stronger incentives to operate more efficiently.

Second, the disparity in taxes paid by businesses from one community to the next would be significantly reduced. Now, for example, a business located in a property rich community like Edina has a local property tax rate about 1/3 that of a business located in a property poor community like Brown's Valley. This perverse feature of the current system makes it harder to get businesses to invest where investment is most needed.

Third, because individual businesses' property tax burdens would be more related to how much property they have and less to what community the property is in, the business property tax would be better correlated with ability to pay.

#### **D. Closing**

James had some comments, to close with. "We have got to find a place where ideas can be heard. "That's why you have the Civic Caucus," he noted. More, though. Venues close to government, among other non-profits, and by those interested in this.

That raises an interesting question for the Civic Caucus: What is our role in this? Communicating the ideas of speakers, as we do now, is one piece. What about acting on ideas? Our capacity for the latter is limited, the members agreed, but that does not mean the Caucus cannot make a significant contribution.

The group asked James, who departs for his residence in Hawaii this month, how he plans to stay involved. "If I got some encouragement I'd put in a lot more time."

Indications seem to be that the knowledge and creativity to solve the state's problems are out there. What is missing is the capability to capture and apply it. Something to think about.

Thank you to Mr. James, for a very important contribution to this ongoing topic.