



Mark Haveman, Executive Director, Minnesota Taxpayers Association

Interview with The Civic Caucus

8301 Creekside Circle #920, Bloomington, MN 55437

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Notes of the Discussion

Present : Mark Haveman, Verne Johnson, Dan Loritz, Paul Gilje, David Broden, Audrey Clay, Janis Clay, Sallie Kemper, Dana Schroeder, and Clarence Shallbetter

A. Summary —Mark Haveman asserts that any tax reform efforts should focus on structuring the revenue system to effectively deal with 21st century demographic and economic realities. He contends that two major themes currently surrounding tax reform - improving tax fairness and property tax relief - are both significantly overstated problems and should not be the focus of reform efforts. Rather, he believes that the combination of broader bases and lower rates through tax expenditure reform is an important strategy. He suggests that the thinking behind local aids and credits needs to be revisited, as does the state's rationale for taxing business. Any tax increase proposals should be conditioned, he asserts, on significant government reform and redesign to lower the rate of government cost increases and obtain greater return from the tax dollar.

B. Introduction of interviewee— Verne and Paul welcomed and introduced **Mark Haveman**, executive director, Minnesota Taxpayers Association. Haveman joined Minnesota Taxpayers Association (MTA) in 2002 as part of an effort to revitalize the Minnesota Center for Public Finance Research, the research and education arm of MTA. Haveman was vice president of a policy and technology consulting firm specializing in environmental protection and resource conservation issues. He has also served on policy and project advisory boards for the U.S. Environmental Protection Agency, the National Institute for Standards and Technology, as well as for several state agencies, academic institutions and private foundations. He received his B.A. from Calvin College and an MBA from the University of Michigan.

C. Discussion —Haveman was invited to discuss topics surrounding the tax reform debate expected in the 2013 legislative session. There has been considerable ongoing activity on this debate. Currently, Minnesota Commissioner of Revenue Myron Frans is holding events and town meetings

around the state to develop reform recommendations for Governor Mark Dayton. Separately, legislative study groups on property taxes and state aids to local governments will be offering recommendations. All of this is in addition to the recent work of former Governor Pawlenty's 21st Century Tax Reform Commission and a blue ribbon study on bringing tax expenditures into the budget process, both of which took place in the last few years.

THE PROBLEM: Minnesota's revenue system faces two primary challenges.

The first challenge: structuring the state revenue system to deal with 21st century demographics and economic realities . Haveman noted that the aging of the baby boomers has potentially significant implications for state revenue systems. According to the Department of Revenue income tax collections fall by 40 to 50 percent when people retire. Senior consumption patterns also shift with potential implication for sales tax collections.

Haveman cited other realities that have an impact on tax revenue: increasingly borderless commerce and the mobility of capital. Businesses can locate anywhere and profits can be sourced anywhere. Corporate income taxes, long derided as the most damaging form of business taxation on economic grounds, are, he contends, increasingly showing severe limitations as a practical part of a revenue system. Taxing corporate income is, he said, "highly volatile and 'leaky,'" and efforts to "fix" the tax immediately create new competitiveness problems and concerns for businesses.

The second challenge: continued use of the tax code to incentivize behaviors at the expense of funding government in the most effective, efficient and least distortive way possible. There is, Haveman believes, a growing recognition of the need to reexamine "tax expenditures" — the variety of exclusions, exemptions and credits embedded in the tax system to advance a variety of economic and social agendas. Broader bases and lower rates are, he contends, universally accepted as better tax policy. However, even with the heightened awareness of the potential revenue impacts and distortions they can create, legislators commonly propose new tax expenditures, and existing ones are difficult to dislodge.

THE "NON-PROBLEMS": Two commonly expressed concerns about Minnesota's tax system are overstated and should not be the focus for future tax reform.

The first overstated concern is greater tax fairness . Haveman argued Minnesota's tax system already strongly accommodates the principles of progressivity and ability to pay.

The data used to support the existence of a fairness problem lies in the Department of Revenue's tax incidence study, Haveman said. Every two years, the Department calculates the incidence-the final resting place-of taxes and examines effective tax rates by population and income deciles in the state. He pointed out that in this study the three primary taxes on individuals in Minnesota - income, sales, and property - actually show increasing progressivity through the 9th decile. The highest earning 10% of Minnesotans do pay a slightly lower proportion of their income than the 9th decile, but he said their burden relative to income is still equivalent to the middle class and well above lower income Minnesotans.

The appearance of a fairness problem only begins to emerge with the inclusion of other highly regressive and often discretionary forms of individual taxation ("the rich clearly do not do their fair share of smoking, drinking, and gambling" noted Haveman) and business taxes.

In the incidence study, taxes paid by business are passed along to households in the form of lower wages, higher prices, and lower returns on investment based on the principle that that "ultimately businesses don't pay taxes, people do." Business taxes are the primary source of regressivity in the state tax system, he said, a fact that gets practically no attention in tax fairness debates.

He noted Minnesota already does an excellent job of respecting the tax principle of "ability to pay". Minnesota's state income tax system is in the top five in the nation for structural progressivity. Among other features, the state has one of the most generous state-level earned-income tax-credit systems in the nation, and one of the most generous and broadly accessible property-tax refunds in the nation.

Haveman suggested Minnesota can have a good debate about revenue adequacy and whether or not the best way to raise new revenues, if needed, is by taxing higher income households. But he expressed concern about a tax adequacy argument masquerading as a fairness crisis. Such a representation not only distorts perspective on Minnesota's tax system but also "does a disservice and an injustice" to Minnesota's significant and successful efforts to address ability to pay concerns and build progressivity into the tax system, he said.

The second overstated problem is property taxation.

Haveman said there is little evidence to suggest Minnesota is facing a property tax crisis. In the aggregate, state property tax collections in Minnesota are below the national average on a per capita and per \$1000 income basis. Effective tax rates relative to home value are in the middle of the pack nationally. Tax rates as a percentage of homeowner income are, he said, modest across most of the state. And for those situations where ability to pay problems are very real, Minnesota has what he called "one of the best circuit breaker", or property-tax refund programs in the nation "targeting relief to those who need it," he added.

Structurally, property taxes are actually less regressive than sales taxes which are the most commonly sought after source of replacement income for local governments. This is true, he asserts, even before the inclusion of the property tax refund program designed to reduce the regressivity of the property tax.

In recent years, the "three legged stool" of the revenue system (income, sales, and property taxes) has appeared unbalanced with property taxation taking on a larger role. But, Haveman noted, in a "Great Recession" when sales and income taxes decline, the much more stable property tax will by its very nature pick up tax share, providing sorely needed stability to the fiscal system. He said it's ironic that the property tax is so frequently criticized for the very characteristic for which tax policy experts find it so valuable and indispensable.

GOALS FOR THE FUTURE REVENUE SYSTEM: In Haveman's view two goals are key: (1) get the tax system in synch with 21st century realities, and (2) balance Minnesota's long history of paying

attention to ability to pay with five other key and no less important principles: stability, competitiveness, visibility, administrative efficiency and economic efficiency.

Some specific reform issues and ideas are discussed.

Tax expenditures need greater scrutiny. Haveman asserts that tax expenditures deserve much closer examination, but cautions that care should be exercised since all tax expenditures aren't necessarily by definition bad public policy. The Minnesota Department of Revenue published a guide in early 2011 to introducing tax expenditure reform into the budget process. (<http://bit.ly/OAZsYZ>) It was, Haveman believes, a very careful and thoughtful piece of work done by well-respected public finance experts. However, Haveman said, as far as he knows, the report is gathering dust - in his mind, "a tragedy".

Re-examine priorities of business tax reform. Haveman believes both state property tax and corporate income tax probably deserve attention in the context of developing a much more coherent rationale for taxing Minnesota businesses other than "getting enough money." There are interesting approaches to consider - for example examining what New Hampshire has done, taxing all business uniformly, regardless of how the business is organized and basing business taxation levels on benefits received.

Broaden sales tax base. Stronger reliance on consumption-based taxes as opposed to taxes on income and capital is a worldwide trend. Haveman contends that concerns about regressivity can be addressed through income-based credits, an idea that can be traced back to Minnesota tax commissions from the 1950s.

Examine potential to tax online sales. Absent sorely needed federal action on this topic, state-by-state efforts to address this significant equity problem will increase. "Brick-and-mortar stores across the state are increasingly nothing more than a showroom service for consumers."

Prioritize state aids to local governments. Local government aid should prioritize capital needs essential to the safety, health, and welfare of Minnesota citizens over current operations expenses over which local officials can exercise more cost control. Haveman proposes also that government repurpose some aids to provide financial support to address the considerable costs often associated with shared service agreements/collaborations and government consolidation.

OTHER COMMENTS:

Stop attempts to demagogue the property tax . "It's the bedrock of local government finance for a very good reason." Fostering resentment for local property taxes is a dangerous thing to do, Haveman contends. "Lawmakers should help citizens channel frustration in more productive ways by improving transparency, citizen understanding, and engagement in local levy-setting processes."

Reform/redesign will likely be essential for any budget proposal in 2013 that includes tax increases. "If there's going to be some grand budget bargain that includes tax increases, it's going to

have to be handcuffed to major government reform/redesign proposals to demonstrate to those who are hit by higher taxes that government business is being done fundamentally differently and that they are getting more value for the dollar."

Will taxation of retirement income be a budget issue? Haveman said that Minnesota follows federal conformity on retirement taxation. However, a lot of other states are facing potentially more serious revenue implications in the future having stronger exclusions with respect to Social Security and/or pension or retirement income. "They could take a big revenue hit as time goes on," he said.

Explore "value capture" to help finance transportation . Haveman believes the concept of "value capture" deserves further exploration although "we've worked enough with developers to say there are many concerns and issues that merit caution in heading down that path," he said. Differential taxation of land value and improvement value (higher rate on land value, lower on improvement value) would be one way to approach this.

Does state tax policy have a negative effect on individuals and businesses locating in Minnesota? Business members of the Minnesota Taxpayers Association firmly believe that the Legislature underestimates the importance of the role of taxation, Haveman said.

Conclusion . The long-term budget picture is challenging, Haveman agrees. Any new revenues are already oversubscribed, demographics are pointing in the wrong direction and the general fund is going to be under long-term stress, he said. Growth in health and human services spending has placed stress on every other aspect of the general fund, including education, and will likely continue to do so. "Minnesota has historically spent 30 to 40% more per capita on health and human services than any other state," Haveman said, "going back to the 1970s. We have received many good returns from this spending but most other areas of government spending are now below the national average to preserve this 30 to 40% premium in health and human services."

"We need to have a serious conversation in this state about general fund priorities, where those dollars need to go and how we can get more value from the dollar."

The chair thanked Haveman for the discussion.