



Nan Madden, director of the Minnesota Budget Project

An Interview with The Civic Caucus

2104 Girard Avenue South, Minneapolis, MN 55405

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Notes of the Discussion

Present : David Broden, Audrey Clay, Janis Clay, Pat Davies, Rick Dornfeld, Paul Gilje, (coordinator), Verne Johnson (chair), Sallie Kemper, Nan Madden, Dana Schroeder, Clarence Shallbetter.

Summary of Discussion: Nan Madden argued that Minnesota is not sustainably and fairly funding public investments that can make a big difference in the state's future. She cited as examples cuts in investment in higher education and in early childhood education. In addition, she argued that Minnesota's tax system is outdated and does not share the responsibility for paying for those public investments fairly. She proposed two strategies for improving Minnesota's tax and budget system: (1) Reform and modernize the tax system so that it can more adequately meet our needs as a state and share the responsibility more fairly; and (2) Adopt common-sense budget system reforms that encourage more responsible and sustainable budget choices.

Background.

Nan Madden has been director of the Minnesota Budget Project since 1999. The Minnesota Budget Project is an initiative of the Minnesota Council of Nonprofits that provides independent research, analysis and advocacy on budget and tax issues, emphasizing their impact on low- and moderate-income persons and the organizations that serve them. She is an active voice for tax fairness, a balanced approach to Minnesota's budget and adequate funding of public services. She is the author of numerous publications on fiscal issues, as well as economic self-sufficiency.

Madden serves on the Steering Committee of the Affirmative Options Coalition, a statewide coalition that promotes public policies that create opportunities for low-income Minnesotans to achieve economic security. She has a master's degree from the University of Denver and a bachelor's degree from Macalester College. The Minneapolis-St. Paul Business Journal named her as one of its 2006 "Forty Under 40" honorees.

Madden explained that the Minnesota Council of Nonprofits is a statewide organization with 2,000 nonprofit members. It's one of the largest such state organizations in the country. Its members are primarily charitable nonprofits. There is a separate group, the Minnesota Council on Foundations, for foundations.

The Minnesota Council of Nonprofits provides member services and training and does policy and tax and budget work. Madden noted that nonprofits employ 10 percent of the state's work force.

The problem.

Nan Madden asserted that one thing we need to do for a stronger and more prosperous Minnesota is to make sure we are sustainably and fairly funding our public services in Minnesota. The state benefits from public investments: infrastructure, education, safety, the way we care for each other to make sure all people can live in dignity, and cultural and environmental assets. She said we've gotten away from common-sense choices we've made in the past to finance public investments that make a big difference for our future.

She gave two examples of how we're not investing in our future:

1. Higher education. Minnesota will need more workers with higher education degrees and credentials to remain competitive in the economy, Madden said. But the state is paying less for public colleges and universities than it did 10 years ago, despite the fact that there are now 23,000 more students than a decade ago.

Tuition has increased substantially. That can prevent people from certain communities from accessing education and gaining the skills Minnesota needs to compete. She argued that we need everybody to reach his or her full potential if we're going to continue to have a competitive economy.

2. Early childhood education. More than 7,000 families are on waiting lists to get help in affording early childhood education that would help parents be successful at work and their kids to start school ready to achieve. This is a missed opportunity for the state, especially for high-risk kids, Madden said. It has implications for costs down the road.

In addition, we have an outdated tax system. Minnesota's outdated tax system is not meeting our needs. All Minnesotans benefit when we invest in our future prosperity, but we're not sharing the responsibility for funding public investments as fairly as we could.

Madden reported that in Minnesota, all state and local taxes put together amount to 9.7 percent of income for people with incomes more than \$429,000 a year and 12.1 percent for middle-income households earning around \$60,000. "This is something many people don't see as fair," she said. "It can contribute to more cynicism. We can narrow that gap."

These figures come from the state's tax incidence study, which includes estimates of how business taxes are passed on to people, whether as owners of capital, as consumers, or as employees.

The goals. Madden outlined two broad goals for Minnesota's tax and budget systems:

1. Reforming and modernizing our tax system so it more adequately meets our needs as a state and shares responsibility more fairly.
2. Making common-sense budget-process reforms that encourage more responsible and sustainable budget choices.

She predicted that tax reform will be a prominent issue in 2013. The administration is gathering input right now for a comprehensive tax reform package that the governor is planning to put forward in 2013.

The strategy.

Madden recommended three strategies for reaching those goals in Minnesota: using the income tax as the most direct and focused way to raise revenues based on ability to pay, updating the sales tax to reflect new economic realities and adopting common-sense budget process reforms.

Strategy 1: Raise additional revenue through the income tax. This could be by adding additional brackets or raising rates. She pointed out that the income tax is the only major revenue source based on income and ability to pay.

Strategy 2: Modernize the sales tax to make a level playing field for all retailers and to respond to new technologies.

For example, she said, music fans have more choices today. They can buy a CD at a store or online or download the album digitally. They would have to pay state sales tax on the store CD purchase, might or might not have to pay sales tax for the online CD purchase and would be exempt from paying sales tax for the digital download.

"It's not a level playing field among retailers selling essentially equivalent products," Madden said. The sales-tax base has been chipped away as people buy more products online and buy more services and fewer physical goods. "It's time to get into the 21st century with the sales tax," she said.

Strategy 3: Adopt common-sense budget process reforms.

- Include the impact of inflation in the state's budget forecast. State law currently does not allow the impact of inflation on spending to be taken into account in the state's economic forecasts. It's important to distinguish the measurement tool of the state's economic forecast from the actual budget choices. Madden said she is not advocating automatic spending increases in every part of budget. Instead, she argued, we need to acknowledge inflation when the state is putting together the economic forecast. Inflation creates a budgetary pressure, which is important to understand when we're making budget commitments. Without acknowledging inflation, we can make choices that aren't sustainable.
- Build up more robust budget reserves. The state's Council of Economic Advisers has long been recommending that the target for the state's reserves should be five percent of the state's biennial budget. The target in law currently is roughly half that. Adequate reserves are important under challenging circumstances and for managing risk and volatility.

- Don't budget through the state Constitution. Limiting taxes and expenditures to a formula in the Constitution has not been successful in other states. Such initiatives don't deliver on promises they make, have dangerous unintended consequences and tend to encourage budget gimmicks, which lead to looking for less transparent ways of raising revenue.

Madden noted that there were three such proposals in the last legislative session, including requiring a super majority vote by the Legislature for tax increases.

State faces a substantial shortfall. In response to a question, Madden said the state puts out quarterly economic updates, with the most recent an October update. That report showed that in the short term, revenues are coming in higher than expected. If that continues into November, \$444 million will go to fix part of the past school-funding shift, since surplus revenues are required to go to that payback.

Madden predicted the update will be less rosy for the next budget cycle, since national economic forecasters are downgrading forecasts for economic growth

She said a November forecast is due on Dec. 5 and that current projections forecast a \$1.1 billion budget shortfall for the upcoming 2013-2014 biennium. The forecasts are done by taking into account economic projections and current law. One difficulty in the coming projections is that the U.S. Supreme Court decision on the Affordable Care Act turned some state requirements into options. "There could be big changes based on that issue," she said.

Madden pointed out that the \$1.1 billion figure does not include inflation, which will cause the shortfall to grow by roughly another \$1 billion. And it will take another \$2.4 billion to completely pay back the past school-funding shift.

In response to a question about how we deal with fluctuations in the business cycle, Madden said some of the response is not on the tax side, but on the budgeting side, with things like more robust reserves.

A questioner asked what difference the state's sharper focus on outcomes in the next budget cycle will make. Madden responded that the outcomes approach may help focus thinking about the budget.

Minnesota's cost of government is average. An interviewer asked how Minnesota compares with other states. Madden replied that the best way to compare states is to measure taxes and spending as a percentage of income. On state and local taxes, Minnesota is about 14th or 15th as a percentage of income. We're about 25th on a more comprehensive measure similar to the state's Price of Government measure. We used to be higher and now we're about average.

Don't exempt retirement income for higher-income seniors. An interviewer asked how income tax revenues will be affected by so many people retiring in the next few years, thus pushing incomes down. Madden responded that we should not worsen the problem by further chipping away at the income-tax base through proposals to exempt certain retirement income from the income tax.

It makes more sense, she said, to look at people's incomes. If we need to help seniors with limited means, we should look at how to help that group.

Exemptions, deductions and broadening the tax base. An interviewer asked whether the Minnesota Budget Project had a position on broadening the base of the sales tax to include clothing and services. Madden expects there to be a big discussion in 2013 about including clothing in the sales tax and sales-tax base expansion. Her group would not support that as a stand-alone proposal. "We think that further shifts the responsibility more to low- and middle-income people," she said. Sales-tax changes could have a place in an overall package, paired with some income-tax changes, for example. And she argued that it would be a big mistake to extend the sales tax to groceries.

In response to a question on tax expenditures, Madden said a sales tax on services or clothing would be an example of ending a tax expenditure. There is a lot of attention to tax expenditures in general, but when people look at the specifics, finding agreement becomes more difficult. One important tax expenditure, for example, is tax incentives for charitable giving, which is of immense importance to the Council's nonprofit members.

The big income-tax expenditures at the federal level include the mortgage-interest deduction and not paying income tax on employer-based health care benefits. In response to a question on the mortgage interest deduction, Madden said itemized deductions tend to miss the mark and be upside down. People for whom the extra dollars might make a difference in their behavior tend not to itemize. "Maybe we should think about a tax credit and possibly capping the income level," she said. "We could spend less for incentives for home ownership, but we might be more effective."

She argues that over the last 10 to 15 years the state has gone too far on some budget cuts. For example, she said, "Minnesota has turned a corner where the ability of disabled people to live independently is at risk."

Waiting lists for early childhood education and rising college tuition are other examples showing the effect of budget cuts, she said. Those things must be addressed, since we need everyone to be at their full potential in the workforce.

Revenue sources for nonprofits. A questioner asked about revenue sources for nonprofits. According to 2010 information on the Council of Nonprofits' website (www.minnesotanonprofits.org), revenue to nonprofits in the seven-county Twin Cities area, for example, comes from the following sources:

- 85 percent from program services, which includes government fees and contracts;
- 10 percent from charitable contributions;
- Four percent from government grants;
- Less than one percent from investments and sales; and
- One percent from other revenue sources.

Redesign and reform. In response to a question about who is responsible for thinking about the larger questions of redesign and reform, Madden said it is the job of nongovernmental organizations—including public policy groups, organizations that deliver services and people who receive services—and members of the general public to be part of that discussion and raise ideas for new ways of doing things. That's also a message the governor has put out to state agencies: they should be rethinking what they're doing and consider doing things differently in certain areas.

"Service delivery reform is hard work," she said. "It takes time. It takes challenging thinking. Those things probably work best when there is a combination of people from the outside, who can question assumptions and ask if we can do things another way, and people who work in the field who have the on-the-ground experience. It's important to get a broad range of stakeholders, people who receive services and their family members." But no one particular group has the charge to promote innovation, she said.

A questioner asked where most of the new reform ideas are generated. Madden said the Minnesota Council of Nonprofits encourages nonprofit leaders and community leaders to be part of that public-policy discussion. There is no one place that is the center of gravity on reform. With nonprofits, the need for reform and doing things in a different way is a pretty constant message.

Nonprofits have seen their revenue from foundations and from charitable giving going down and cuts in government funding sources. "They know it's a new world and that things need to be done differently," she said. "They are asking those questions. They want to be part of designing the new way."

An interviewer commented that as people talk about redesign, they give the impression that it will save money. He asked if anybody is looking at whether changing things will save money or slow the growth of cost. Madden replied that there are many discussions that reform will cut costs or that cutting spending will induce reform. Sometimes that happens and sometimes it doesn't. Some things are not a reform, but just a cut.

Lack of convergence on tax reform. When asked about other organizations doing similar tax and budget work, Madden mentioned the Minnesota Taxpayers Association. She said the nonpartisan staff at the Legislature and the state Departments of Revenue and Management and Budget also do high-quality work and provide good information.

A questioner asked whether there is enough convergence of similar approaches to tax and budget reform that a consensus could be presented to the Legislature. Madden replied that on the tax side, there is not convergence, because there is not agreement about whether we need to raise more revenue, the same revenue or less revenue. The Minnesota Budget Project doesn't think it's worth substantially changing the system just to raise the same amount of revenue.

An interviewer asked whether there is more or less reason for optimism toward the possibility of convergence. Madden replied that we're living in a very polarized time where it's difficult to reach compromise, find middle ground and make things work.

"That is the side of things that makes me discouraged," she said. On the positive side, it's easier for people to be involved, to keep up on issues and to express their opinions than it was 15 years ago. There is more opportunity for people to be engaged.

Conclusion. Based on her 15 or 16 years of budget work, Madden feels where we are now is not sustainable. If we look only on the cutting side to solve budget shortfalls, the public won't stand for it.

"We think reform is part of that," she said, "but reform takes time. We think there does need to be more revenue as part of this. We have cut too deeply, so we're not making the investments that are

important to our future. And we should take the opportunity to close the gap between what low- and middle-income Minnesotans are paying and what the highest-income people are paying."