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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 (TELs)
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
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-emption 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
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
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?


