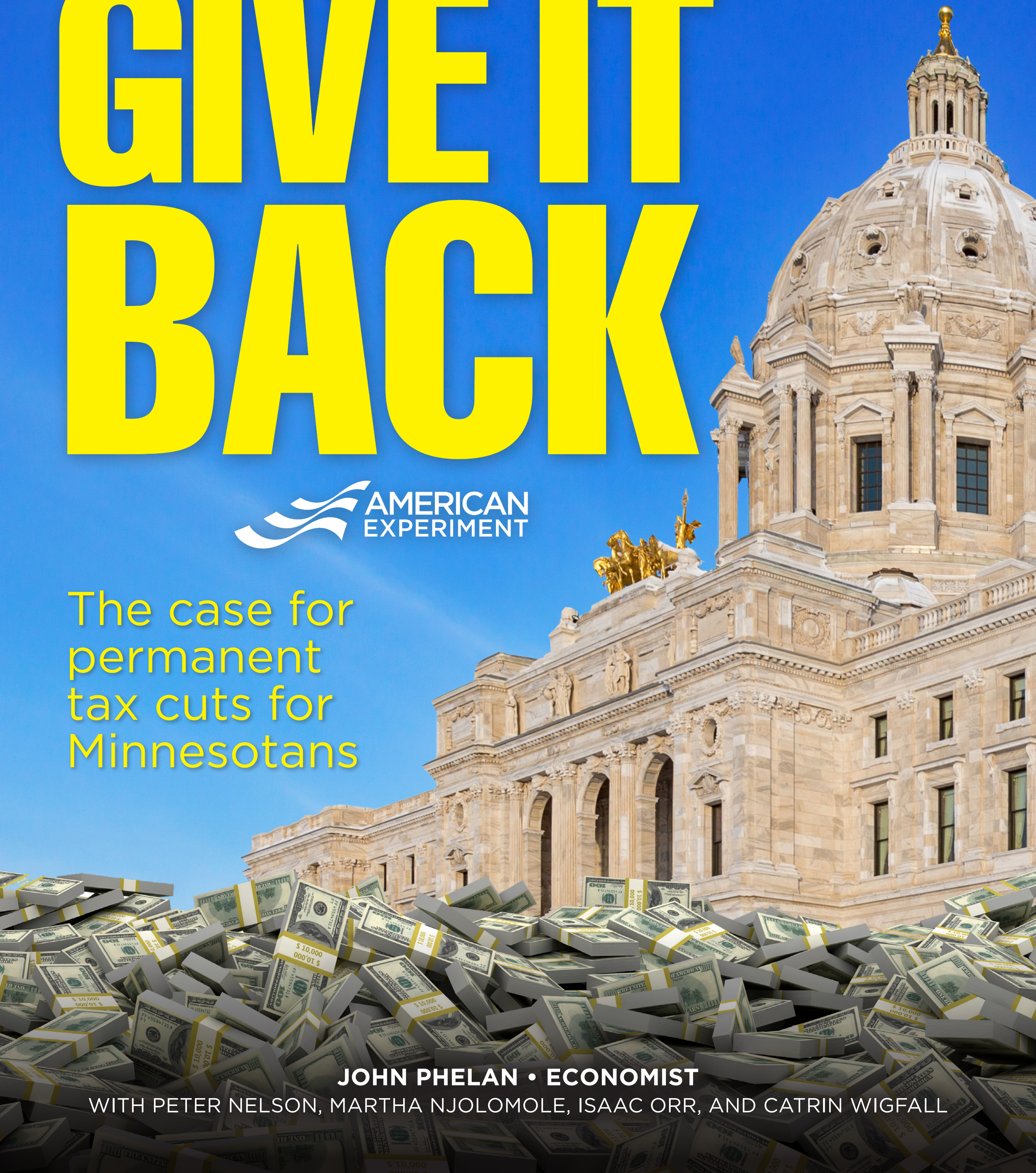
It's our surplus GIVE IT BACK

AMERICAN EXPERIMENT

The case for permanent tax cuts for Minnesotans



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FEBRUARY 2022

It's our surplus, give it back

The case for permanent tax cuts for Minnesotans

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Key findings

» Minnesota Management & Budget (MMB) forecasts a budget surplus of $7.7 billion for the FY 2022-23 biennium, the largest surplus in state history. Planning estimates for the General Fund budget show a surplus of forecast revenues over projected spending of $4.0 billion in FY 2022-23 and $5.9 billion in FY 2024-25.

» For a number of reasons, we believe that this money should be given back to – or, more accurately, left with – the people who earned it: ordinary, hardworking Minnesotans. And we believe this should be done in the form of permanent tax cuts.

» Minnesota's state government is already spending at historically high levels. In 2020, Minnesota's state government spent $4,348.20 for every state resident. This was the highest amount on record and was 5.9 percent higher than in 2016.

» Minnesota's state government spending is high compared to other states. In 2019, Minnesota ranked 14th in the United States in terms of direct state and local government expenditure per capita, 6.1 percent above the United States' average.

» These high levels of state government spending have not alleviated our social ills and spending more won't change that. There should be no surplus-funded increase in spending.

» Minnesota has some of the highest tax rates in the United States. Legislators should cut them.

» Minnesota has the sixth highest rate of state personal income tax in the United States. And, while the top rates for the District of Columbia (seventh highest), New Jersey, and California all kick in with incomes of $1 million annually and New York's at $25 million, Minnesota's starts at the relatively modest level of $166,040.

» Minnesota doesn't just tax "the rich" heavily. Our lowest personal income tax rate is higher than the top rate of 24 states.

» Our state ties for the third highest corporate income tax rate in the United States. While Minnesota's rate applies to the first dollar of taxable revenue, Iowa's rate, which also ranks third, only kicks in at taxable income over $250,000 annually.

» Minnesota is one of only twelve states and the District of Columbia to impose an estate tax.

» Our state's tax burden – state and local sales, property, and individual income tax rates as a share of Personal Income – ranked 6th highest in the United States in 2019.

» Minnesota's taxes are also needlessly complex. We are one of thirteen jurisdictions that don't fully conform to the federal depletion schedule, one of only six to impose an Alternative Minimum Tax (AMT) on corporations, one of just five to impose an AMT for individuals, and one of fifteen to have a "marriage tax penalty" written into our tax code.

» Research finds that high taxes, such as Minnesota's, restrain economic growth. This partly accounts for our state's below average economic performance in recent years.

» Studies also find that our state's high taxes push residents out of Minnesota and deter others from moving here.

» The surplus represents an opportunity to align taxes with economic growth.

» Minnesota should act to reduce the complexity of its tax system. This can be done with little cost of revenue.

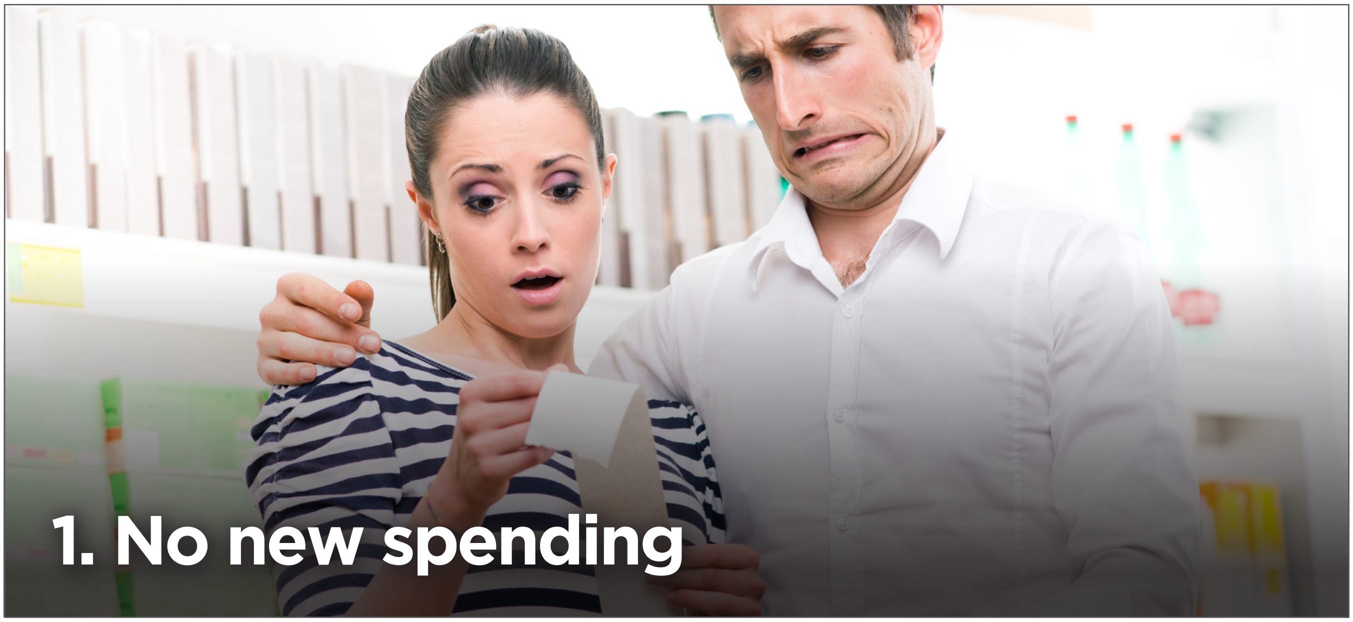
- Our state should also reduce its corporate income tax rate. A one percentage point cut would move Minnesota from third to seventh highest in the United States.
- Minnesota should also cut its personal income tax rates. A one percentage point cut in each tax bracket would move us from the sixth to seventh highest top rate in the United States with a lowest rate higher than the highest rate in thirteen states, as opposed to 24 currently. This would cost $2.1 billion in each of 2022 and 2023, accounting for the surplus.
- A two percentage point cut in each rate would move us from the sixth to tenth highest top rate in the United States with a lowest rate higher than the highest rate in eleven states, as opposed to 24 currently. This measure would cost $4.2 billion in each of 2022 and 2023, more than double the forecast surplus. Even so, if spending was cut as an offset, then General Fund spending would still be, in nominal terms, higher than in any year prior to 2019: in real terms, spending would be higher in 2022 and 2023 than in any year prior to 2014.

The surplus

In December, Minnesota Management & Budget (MMB) announced a forecast budget surplus of $7.7 billion for the FY 2022-23 biennium, the largest surplus in state history. These are only forecasts and significant downside risks remain, but MMB notes that "the improved outlook carries into FY 2024-25 planning estimates." Indeed, planning estimates for the General Fund budget show a surplus of forecast revenues over projected spending of $4.0 billion in FY 2022-23 and $5.9 billion in FY 2024-25.[1] The question of what to do with this money will dominate the forthcoming legislative session in Saint Paul.

We believe that this money should be given back to – or more accurately, left with – the people who earned it: ordinary, hardworking Minnesotans. We believe this should be done in the form of permanent tax cuts. And we believe that this surplus represents an opportunity to move our state's taxes in a decisively pro-growth direction.

There are a number of reasons for this. First, Minnesota's state government is already spending near record amounts, adjusted for inflation and in per capita terms. This should rule out using the surplus to fund even higher government spending. Second, Minnesotans are some of the most heavily taxed citizens in the United States. Third, needless complexities in Minnesota's tax system increase its burden. Fourth, this heavy tax burden slows economic growth in our state. Fifth, it leads to losses of residents to other states. For these reasons, the surplus should be taken as an opportunity to cut and simplify taxes on Minnesotans.



A number of proposals have been made to use the surplus to fund increased state government spending to alleviate a variety of perceived problems (see boxes). Two facts suggest that such increased spending will not have the effect its advocates suggest.

Minnesota's government spending is already high by historical standards

Minnesota's state government is already spending at historically high levels.

Figure 1 shows annual General Fund spending from 1960 to 2020 and forecasts for 2021 to 2025, adjusted for inflation in 2021 dollars.[2] In 2020, Minnesota's state government spent $4,348.20 for every state resident. This was the highest amount on record and was 5.9 percent higher than in 2016. There is a fall in real per capita state government spending of 4.7 percent from 2020 to 2021. However, that is driven less by declining nominal spending – forecast to fall by just 0.6 percent – than by surging inflation. The average of the monthly numbers for the Consumer Price Index for January to November 2021 is 4.4 percent higher than the average for all of 2020, a rate faster than the annual increase in any year since 1990. Even so, the per capita total for state government spending in 2021 – $4,143.15 – is still higher than in any year before 2015.

Looking beyond 2021, these elevated levels of per capita government spending will persist. From 2021's trough, there is a strong rebound to a new record high in 2023, followed by a decline which still leaves per capita government spending higher in real, inflation adjusted terms, than at any time before 2018.[3]

Minnesota's government spending is already high by national standards

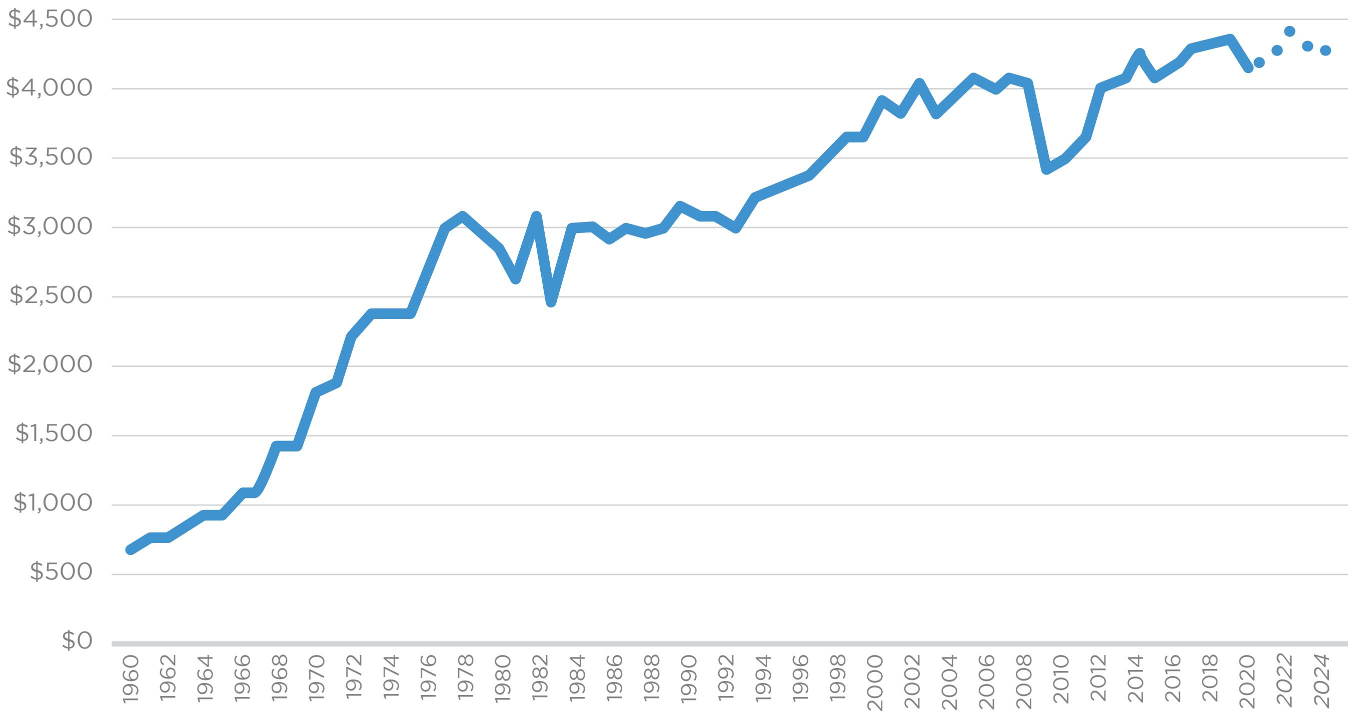
Not only is Minnesota's state government spending high compared to its own historical record, it is also high compared to other states.

Figure 2 shows direct state and local government expenditure for the fifty states and District of Columbia for 2019.[4] Minnesota ranked 14th in the United States on this measure, spending $12,814 per resident. This was 6.1 percent above the national average of $12,076. But this is nothing new: in the previous two years, Minnesota ranked 13th and 10th for direct state and local government expenditure per capita.

Other research confirms that Minnesota's state government spends an above average amount of

FIGURE 1

Per capita General Fund spending, 1960 to 2025



SOURCE: MINNESOTA MANAGEMENT AND BUDGET, CENSUS BUREAU, BUREAU OF LABOR STATISTICS, AND CENTER OF THE AMERICAN EXPERIMENT

money per resident. The Minnesota Center for Fiscal Excellence (MCFE) finds that in 2019 Minnesota ranked 11th among the fifty states and District of Columbia for Total Direct General Expenditures Spending per Household Adjusted for State Price Differences. Again, this was nothing new: MCFE raked Minnesota 10th in 2018, 11th in 2017, and 12th in 2016.[5]

High government spending has not solved our problems

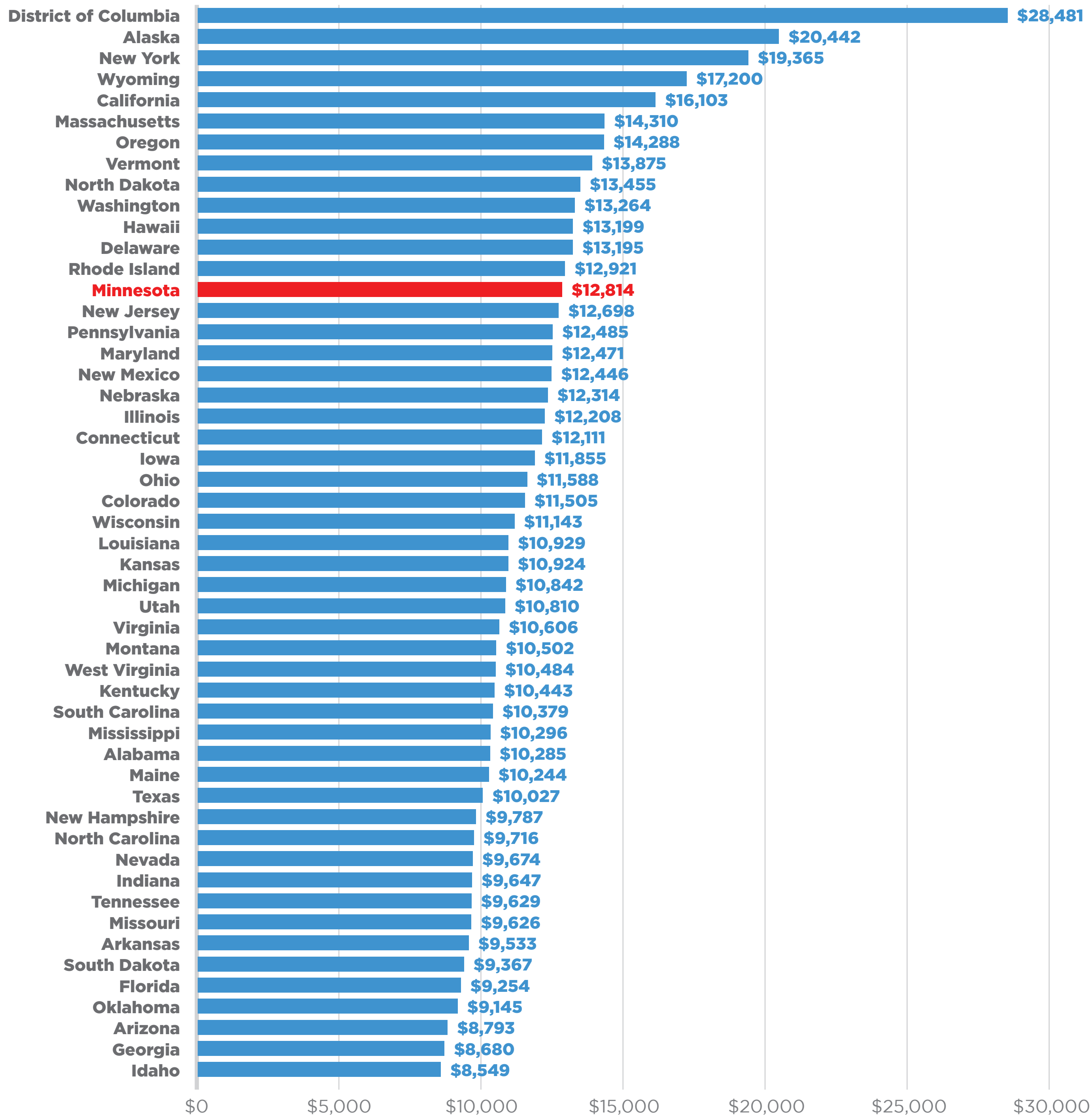
Minnesota's state government spending is high by both historical and national standards. Why, then, if elevated government spending can solve social problems, do we continue to have these problems in our state to the extent that we do?

Many of the spending proposals are sold as tackling various racial "inequities," for example, an issue that has been at the fore in Minnesota in the last two years. Our state purportedly has racial disparities in graduation rates, homeownership rates, loan denial rates, mortality rates, suspension rates, wage and salary incomes, unemployment rates, child abuse and neglect report rates, traffic stops and even drowning rates. Prof. Samuel L. Myers, Jr. of the University of Minnesota has said that "The coexistence in Minnesota of wealth and plenty for the majority group with wide racial gaps faced by minority groups has come to be known as the Minnesota Paradox."[6]

It gets worse. For black Minnesotans some of these outcomes, like home ownership rates, are not just low relative to white Minnesotans, but relative to black residents of other states. Black and Hispanic students in Mississippi outperform Minnesota's black and Hispanic students in both math

FIGURE 2

Direct state and local government expenditure per capita, 2019



SOURCE: CENSUS BUREAU, BUREAU OF ECONOMIC ANALYSIS, AND CENTER OF THE AMERICAN EXPERIMENT and reading, and tests scores for Mississippi's black students have been rising in recent years, compared to declining scores of our state's black students.[7]

These disparities coexist in spite of Minnesota's high levels of government spending. The data show that whatever problems currently afflict our state — from racial disparities to surging violent crime — they have either emerged while Minnesota has had high government spending or have proven resilient to remedy by high government spending. ■

More spending won't solve medical staffing shortages

As COVID-19 continues to impose substantial burden and strain on Minnesota's health care system, some people are calling on state lawmakers to use the surplus to help address worker shortages among nursing homes and disability service providers. COVID-19 nursing home data from the Centers for Medicare & Medicaid Services (CMS) do show over 50 percent of nursing homes in Minnesota report a shortage of nursing staff, the highest rate in the country. Yet, CMS data also show Minnesota spends $43,171 per Medicaid enrollee with disabilities. This is the highest spending level of any state in the country. Minnesota also spends $32,854 per aged Medicaid enrollee, the third highest behind Pennsylvania and North Dakota. Perched among the highest spending levels in the country, something else is clearly driving these staffing shortages.

- Peter Nelson, Senior Policy Fellow

No new education spending

During the 2021 legislative session, Minnesota leadership passed the largest student formula increase in 15 years — an increase of $1.1 billion over the next four years. Most of the money will be sent to local school districts, giving them the flexibility to spend it on their districts' specific needs. But even with such historic levels of funding, spending advocates and teachers' unions are already calling for more money.

Claims that Minnesota's education woes are caused by insufficient spending are not new. Policymakers and state leaders have a track record of dedicating billions of dollars to education with little to show for that investment. Before we pour more money into the education system, we need to ensure there is accountability with the current spending increases and that the dollars actually get to the students. Otherwise, Minnesota will continue to be known as a high spending state that can't make meaningful progress on closing its achievement gap and advancing student learning.

- Catrin Wigfall, Policy Fellow

Paid Family and medical leave will be a costly fiasco

A state-run Paid Family and Medical leave program would be costly, exert excessive bureaucratic burden on employers, and expand the size and scope of Minnesota's government.

Under a bill for a paid leave program passed by the Minnesota House last year, taxpayers would be expected to pay $2.1 billion over the program's first four years to fund startup costs. Besides this, the program includes numerous stipulations and provisions — dictating when employees can take leave and how businesses should and shouldn't treat employees who do — all of which will increase compliance costs for businesses. And while the bill allows employers to opt out, it requires that their private benefit programs closely mirror those of the state government. Moreover, the bill gives the Commissioner the power to terminate private programs for any businesses that violates the rules. Programs could be terminated for violations as minor as failure to provide reports.

More spending will not solve Minnesota's childcare shortage

Childcare is more expensive in Minnesota than most states because providers here are burdened with restrictive regulations that have no impact on quality but increase the cost of giving care and push small providers out of the market.

Stringent hiring requirements, strict child-staff ratios, training requirements, and other excessive licensing requirements make it hard for providers to find workers and raise the cost of providing child care. Removing these government imposed obstacles is the key to more affordable childcare, not more government spending.

Reduce taxes, fees, and regulations for more affordable housing, don't spend more money

As with childcare, the shortage of affordable housing is largely a creation of state and local government. Excessive taxes, fees, and regulations effectively make it illegal to build affordable housing. The solution to this problem is not to spend more money, but to reduce the burden of these taxes, fees, and regulations.[8]

Use federal money to pay back the Unemployment Insurance Trust Fund Debt

With $1.1 billion in unspent COVID-19 federal relief funds, legislators should not use Minnesota's surplus to pay back the federal government for covering deficits in the state's Unemployment Insurance Trust Fund. They need to do what most states have done — use the unspent American Rescue Plan (ARP) funds to cover the debt. This should have been done when the federal government ruled that states could use ARP funds to pay the federal government back.

Funds are already set aside for bonus pay for front-line workers

The legislature has already set aside $250 million to compensate those workers on the "front line" during the COVID-19 pandemic. No further money is necessary.

- Martha Njolomole, Economist

Energy bills are rising because of government action, the surplus should not be spent on treating the symptoms

For the last several years, Center of the American Experiment warned lawmakers about the rising energy costs that would result from mandating the use of wind and solar energy while intentionally making it more difficult to utilize fossil fuels and nuclear energy. Now, the high costs of these policies are making it more difficult for Minnesota families to put food on their tables.

Some groups are advocating using the budget surplus to help offset the rising cost of energy bills. Instead, we should stop making energy more expensive in the first place. Minnesota can make meaningful headway in this effort by repealing the wind and solar mandates that have caused Minnesota's electricity prices to increase 2.72 times faster than the national average since they were passed in 2007.

- Isaac Orr, Policy Fellow

2. Cut Minnesota's taxes

Minnesota should take the historic opportunity presented by this surplus to cut taxes. There are four main reasons for this. One, our state has some of the highest tax rates in the United States. Two, needless complexity in our state's tax code adds to the overall burden of taxes. Third, these high taxes restrain economic growth. And fourth, these high taxes push residents out of our state and discourage others from moving here, leading to a net domestic out-migration.

Minnesota has some of the highest tax rates in the United States

Minnesota has some of the highest tax rates in the United States.

Income tax

As Figure 3 shows, Minnesota has the sixth highest top rate of state personal income tax in the United States—9.85 percent. Only Oregon, New Jersey, New York, Hawaii, and California have higher top rates. Furthermore, while the top rates for the District of Columbia (seventh highest), New Jersey, and California all kick in at incomes of $1 million annually and New York's top rate kicks in at an annual income of $25 million, Minnesota's starts at the relatively low level of an annual income of $166,040.

Minnesota doesn't just tax "the rich" heavily. As Figure 3 shows, our state's lowest personal income tax rate—5.35 percent on the first dollar of taxable income—is higher than the highest rate in 24 states.[9]

Corporate tax

It is a similar story with state corporate income tax rates, as Figure 4 illustrates. At 9.80 percent on the first dollar of taxable revenue, our state ties for the third highest state corporate income tax rate in the United States: only Pennsylvania and New Jersey have higher rates. Furthermore, Iowa's rate of 9.80 percent only kicks in at taxable income above $250,000 annually.[10]

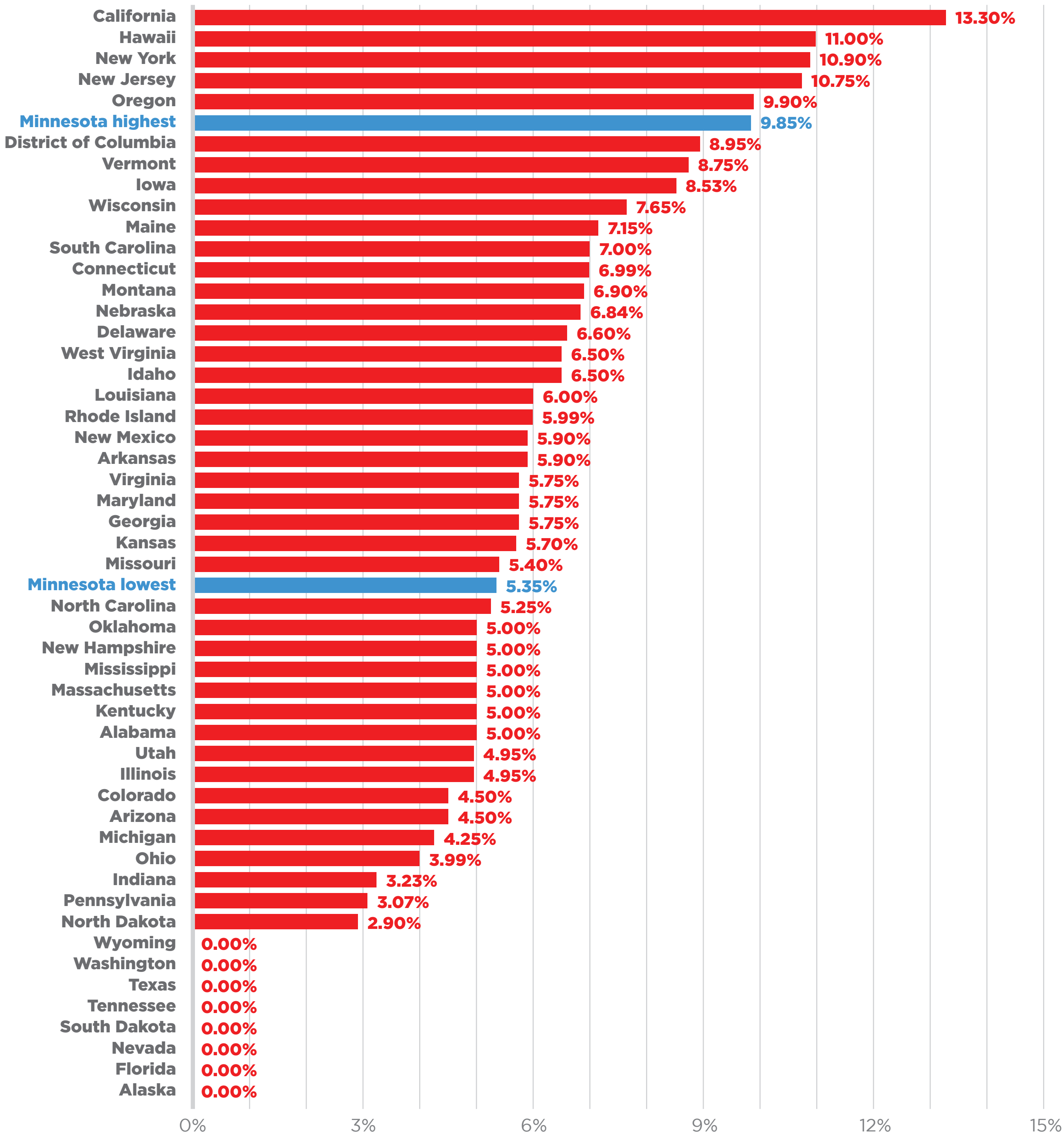
Estate tax

Minnesota is also one of only twelve states and the District of Columbia to impose an estate tax (six others impose inheritance taxes and Maryland imposes both), as Figure 5 shows.

Minnesota's estate tax burden is also one of the heaviest. Of the 13 jurisdictions imposing one, Minnesota's $3 million exemption is lower than that of eight. And at 13 percent, only Vermont has a higher minimum estate tax rate.[11]

FIGURE 3

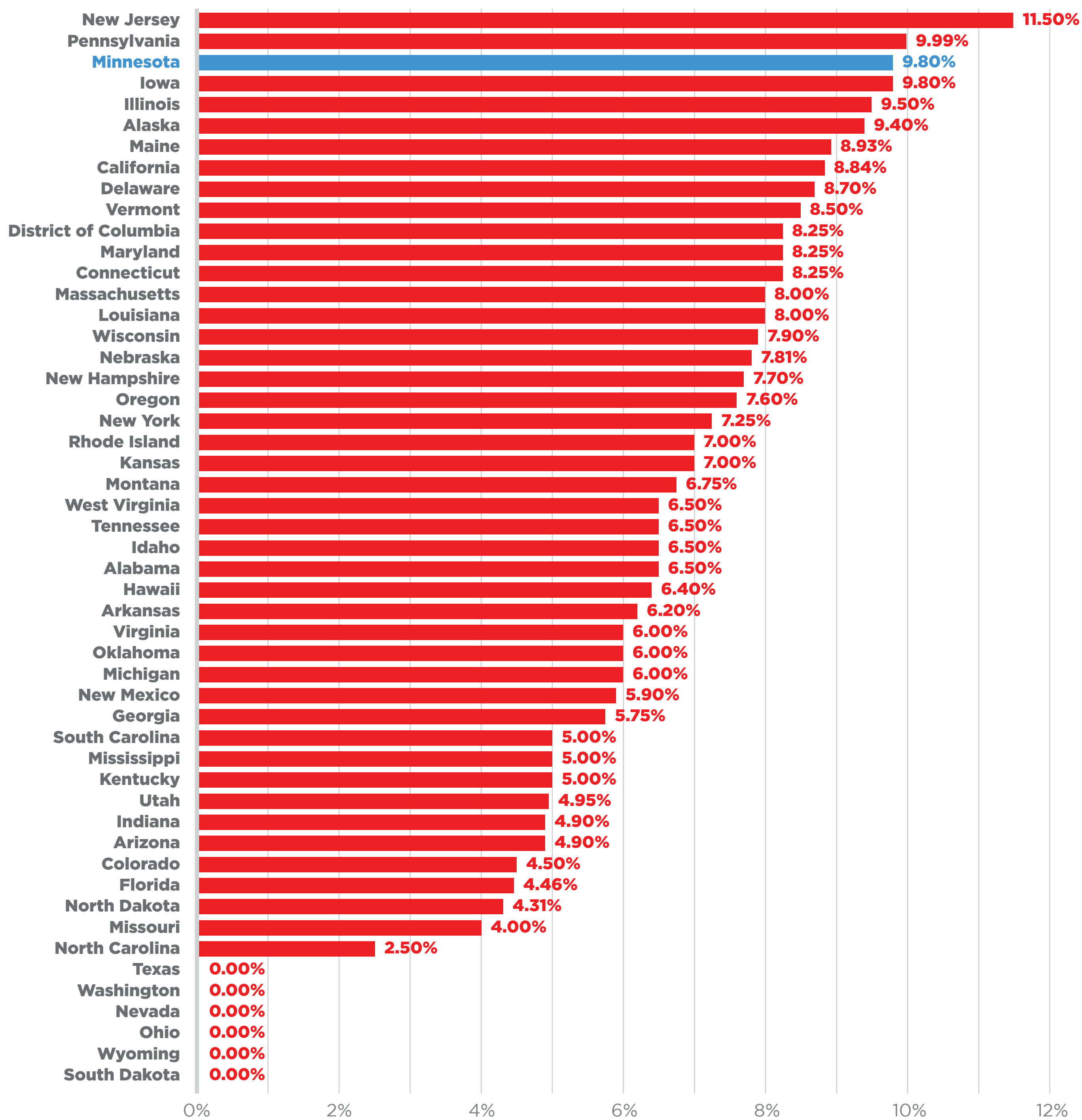
Top rate of state personal income tax and Minnesota's lowest rate, 2021



SOURCE: THE TAX FOUNDATION

FIGURE 4

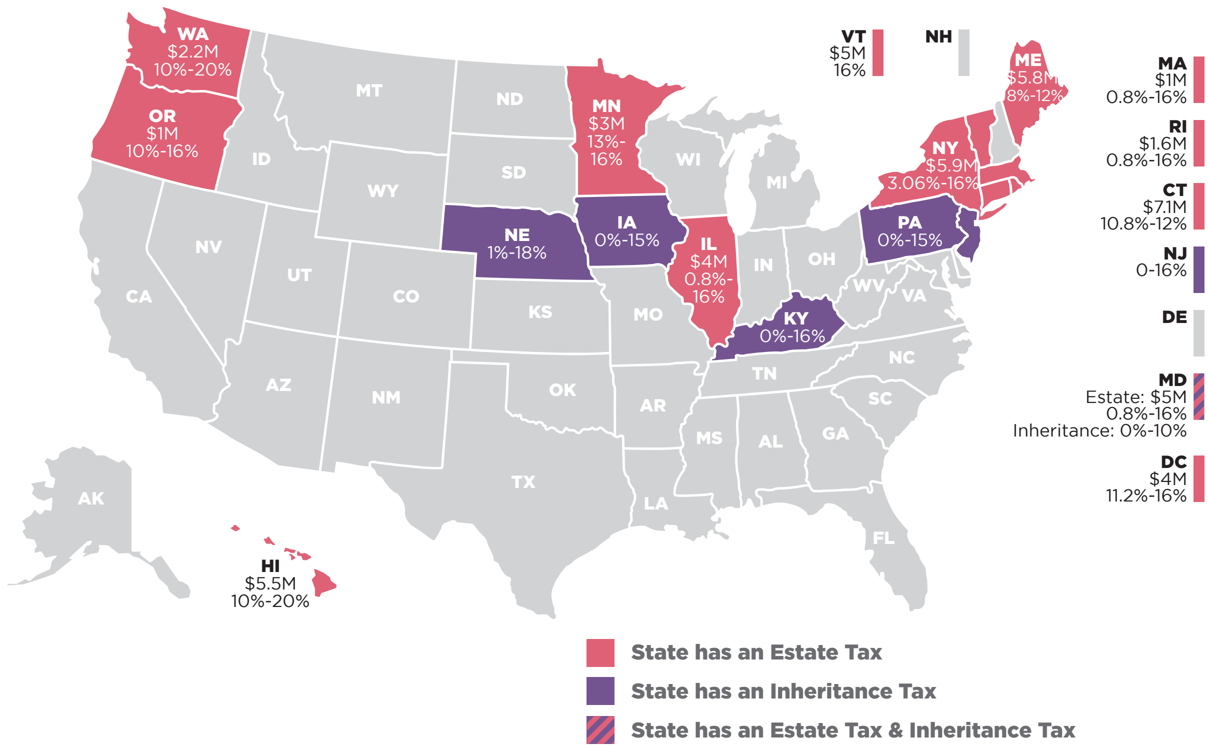
Top rate of state corporate income tax, 2021



SOURCE: THE TAX FOUNDATION

FIGURE 5

State estate & inheritance tax rate & exemptions in 2021



SOURCE: THE TAX FOUNDATION

Overall tax burden

These high tax rates contribute to one of the highest tax burdens in the United States.

As seen in Figure 6, at 10.2 percent in 2019, Minnesota had the 6th highest ratio of state and local sales, property, and individual income tax revenues to Personal Income out of the fifty states and District of Columbia. Our state's tax burden has ranked in the top ten on this measure in every year since at least 2009.

Minnesota's tax regime is complex

While the primary problem facing Minnesota in tax policy is excessive tax rates, our state also suffers from needless tax complexity. This complexity adds to the burden which Minnesota's tax system places on its residents and businesses.

Deductibility of depletion

Minnesota is one of 13 jurisdictions that don't fully conform to the federal system for the deduction for depletion. This works like depreciation but applies to natural resources. By imposing its own schedule, our state makes its tax system more complex than it needs to be.

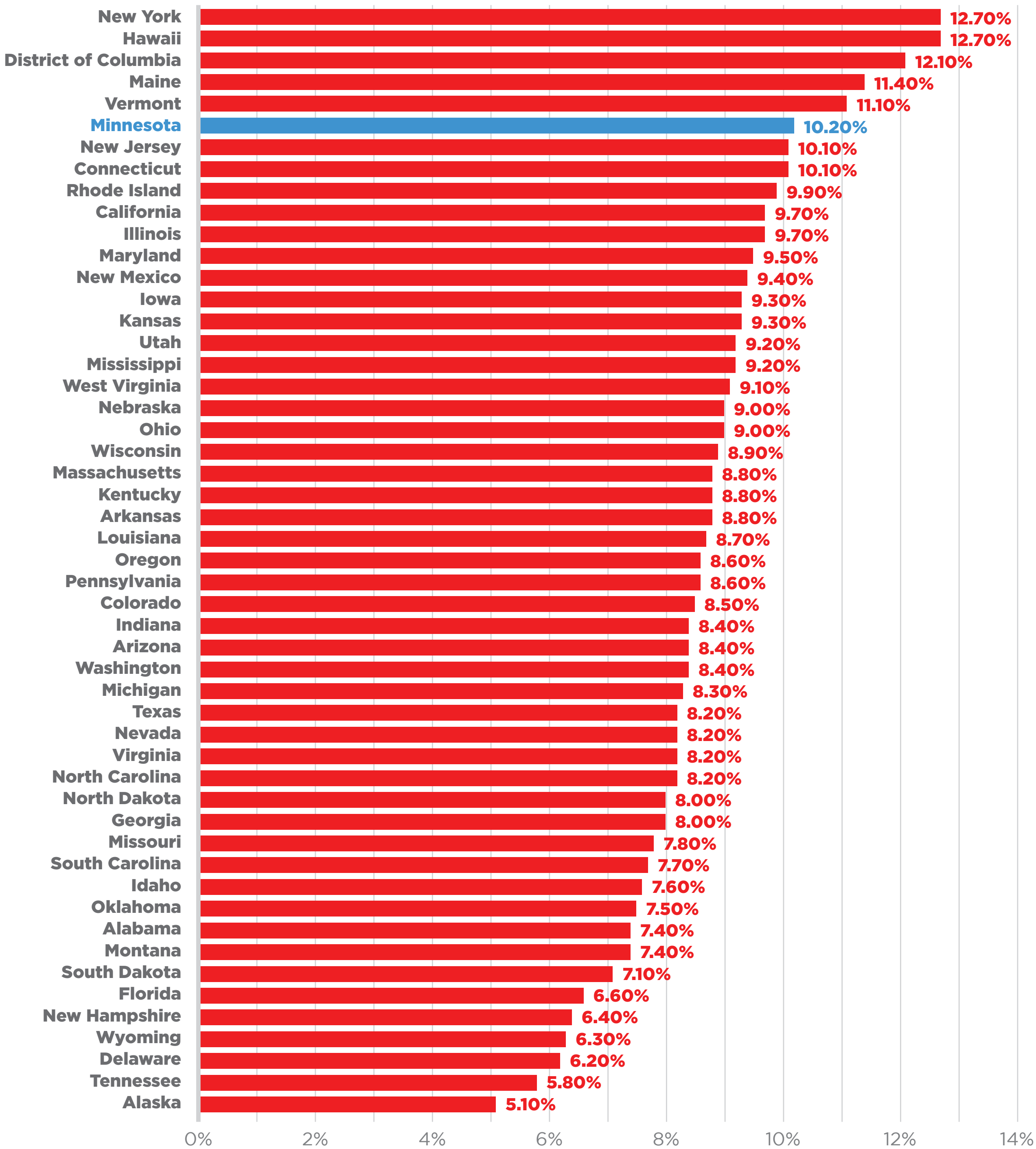
Alternative Minimum Tax for corporations

Minnesota is one of only six states which imposes an alternative minimum tax (AMT) for corporations, as Figure 7 shows.

Corporate AMTs exist to prevent corporations

FIGURE 6

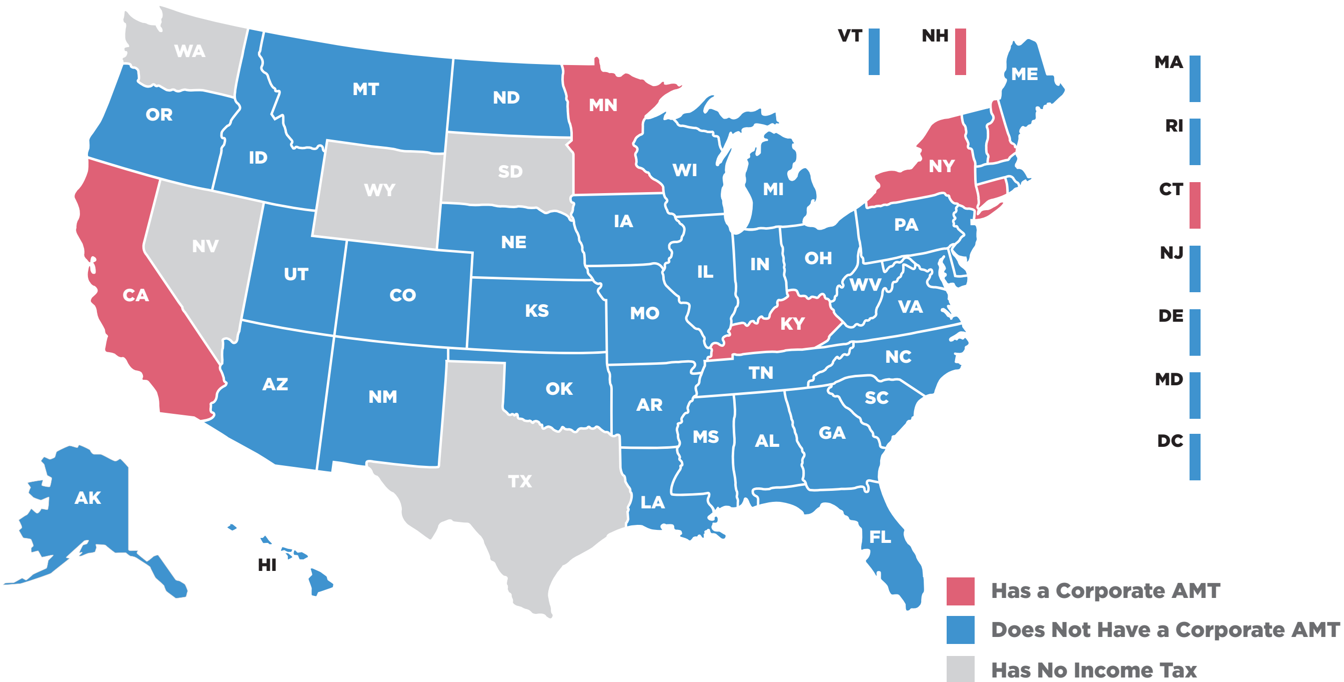
State and local sales, property, and individual income tax revenues as a share of Personal Income, 2019



SOURCE: CENSUS BUREAU AND BUREAU OF ECONOMIC ANALYSIS

FIGURE 7

Corporate alternative minimum taxes by state



SOURCES: THE TAX FOUNDATION, BLOOMBERG TAX, STATE STATUTES

from reducing their corporate income tax liability below a certain level, but they are an inefficient means of doing so. This contributed to their repeal in several states and at the federal level.

Minnesota's AMT requires corporations that meet certain requirements to compute their tax liability under two systems and to pay the higher amount. These requirements undermine structural elements of the tax code, like net operating loss provisions and deductions for business expenses, and, under the federal AMT, imposed steep compliance costs on businesses, which in some cases proved larger than collections.[12] With the repeal of the federal corporate AMT in 2017 and the various federal modifications located throughout the Internal Revenue Code, the Minnesota Center for Fiscal Excellence (MCFE) notes that:

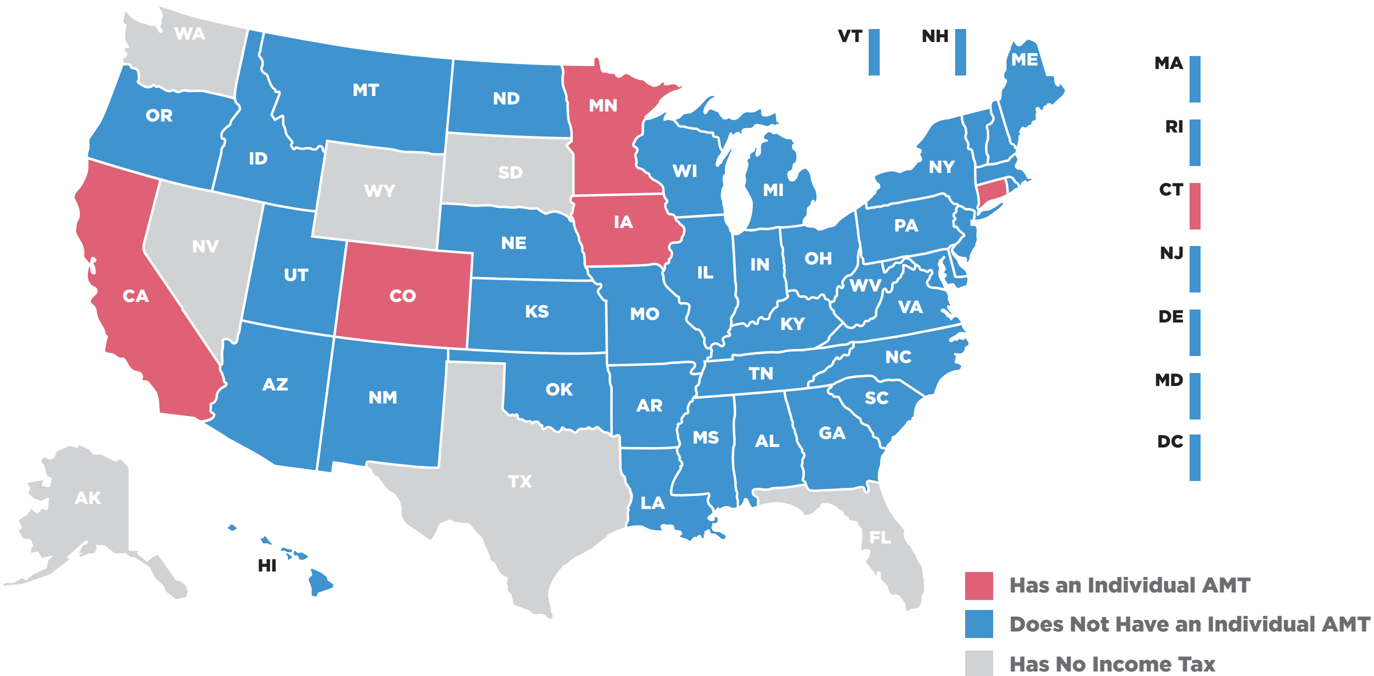
> *"…the Minnesota AMT calculation will likely be more complicated, confusing and burdensome (Is that even possible?) to taxpayers, if it remains. Practitioners are currently required to prepare additional forms calculating AMT, AMT credits, and AMT NOLs [Net operating losses], which also requires additional time and resources for the Department to audit."* [13]

Alternative Minimum Tax for individuals

Minnesota is one of just five states to impose an Alternative Minimum Tax for individuals, as shown in Figure 8.

The federal AMT was created in 1963 to prevent high-income taxpayers from reducing their tax burden below a certain limit. It did so by requiring certain individuals to calculate their taxes twice. Several states followed the federal lead and implemented their own AMTs which meant that some

FIGURE 8
Individual alternative minimum taxes by state



SOURCES: THE TAX FOUNDATION, BLOOMBERG TAX, STATE STATUTES

taxpayers had to calculate their tax liability four times: twice under the federal code and twice under their state's code.

The 2017 Tax Cuts and Jobs Act increased the federal AMT's exemption amounts and phaseout thresholds through 2025, so fewer taxpayers will be required to calculate and pay the federal AMT in the future. Minnesota's individual AMT does not conform exactly to the federal provision – it does not allow for the deduction of home mortgage interest and has one flat rate, while the federal AMT has two rates – so filers have to go through the process of calculating a state AMT even if they are no longer subject to a federal AMT.

Marriage tax penalty

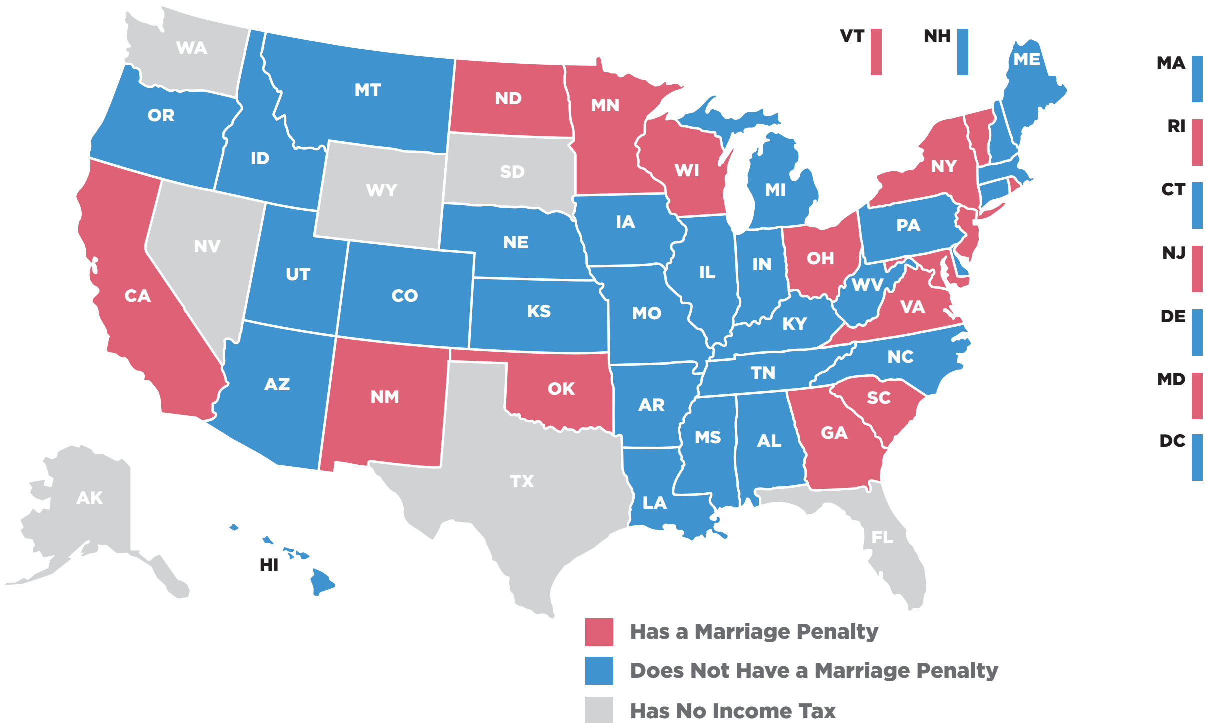
Minnesota is one of fifteen states to have a "marriage tax penalty" built into its tax code, as Figure 9 shows.

Under a graduated-rate income tax system such as Minnesota's, a taxpayer's marginal income is subject to progressively higher tax rates. When a state's standard deduction and tax brackets for married taxpayers filing jointly are less than double those for single filers, a "marriage tax penalty" is said to exist. In other words, married couples who file jointly under this scenario have a higher effective tax rate than they would if they filed as two single individuals with the same amount of combined income.

A marriage tax penalty is not only discriminatory by penalizing marriage in the tax code, it has negative economic consequences as well. Pass-through business owners pay taxes on their business income under the individual income tax system. With a marriage tax penalty in place, married business owners are subject to higher effective tax rates on their business income than they would be

FIGURE 9

Marriage penalty in state individual income taxes



SOURCES: THE TAX FOUNDATION, BLOOMBERG TAX, STATE STATUTES

otherwise. This is a real problem given that married couples dominate the top-earning 20 percent of taxpayers – they account for 85 percent of that category – and that same top-earning 20 percent also has the highest concentration of business owners of all income groups. Because of these concentrations, marriage penalties have the potential to affect a significant share of pass-through businesses.

High tax rates restrain economic growth

The balance of empirical research on the effects of state tax rates on economic growth is clear: high tax rates and tax hikes slow economic growth.

Empirical research has found that high taxes reduce economic growth generally,[14] and more specific impacts have been found within that. High taxes have been found to have a negative impact on business location,[15] business formation,[16] the location of foreign direct investment,[17] and job growth.[18] Corporate taxes have been found to be particularly harmful economically, with a large negative effect on employment,[19] aggregate investment and entrepreneurial activity, foreign direct investment decisions, entrepreneurship, firm and household location, and may also uniquely harm entrants over incumbent firms.[20]

In a review of the literature measuring the impact of taxes on economic growth, economist

William McBride concluded:

> *"...that there are not a lot of dissenting opinions coming from peer-reviewed academic journals. More and more, the consensus among experts is that taxes on corporate and personal income are particularly harmful to economic growth, with consumption and property taxes less so. This is because economic growth ultimately comes from production, innovation, and risk-taking."* [21]

Of the 26 papers reviewed by McBride, 23, or 88 percent, find a negative impact of higher tax rates on economic growth. The other three papers find no impact. Not one paper finds a positive impact. Of the six studies looking at state tax rates specifically, all six found a negative impact of high taxes on economic growth.

More recent research corroborates this conclusion. Of 12 papers looking at the impact of taxes on economic growth published since 2012, seven find negative effects, the other five find "mixed" or "unclear" effects, and none finds a positive effect. Furthermore, research suggests that the negative effects on economic growth from increased taxes are more pronounced when, as in Minnesota's case, taxes are already high.[22]

All of these make Minnesota's high tax burden problematic and suggest an explanation for several of Minnesota's recent economic ills including below average growth of per capita Gross Domestic Product (GDP), especially since 2014, GDP per worker and per hour, business formation,[23] and job growth.[24]

Minnesota's high taxes push residents out and keep others from moving here

There is also empirical evidence showing that Minnesota's high taxes push residents out of the state and deter non-residents from moving in.

A recent paper that "review[ed] what we know about mobility responses to personal taxation" found that:

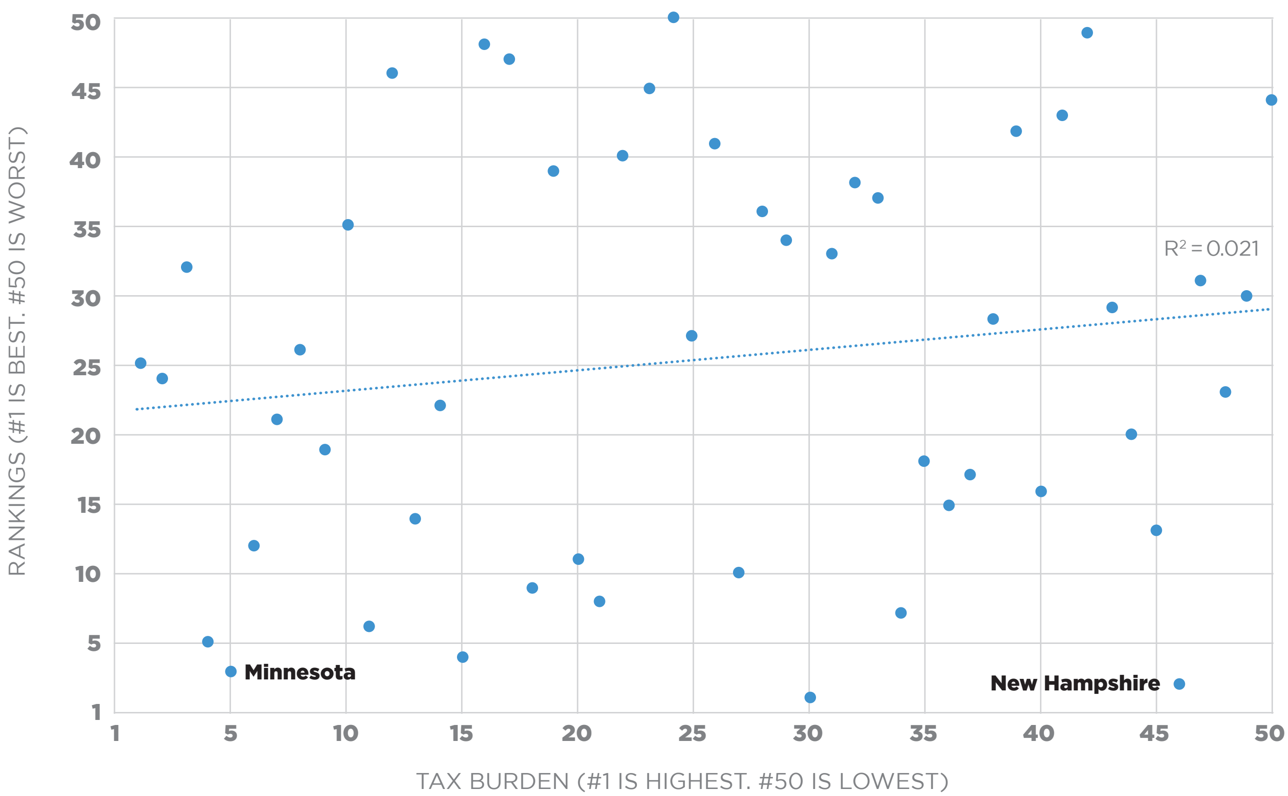
> *"There is growing evidence that taxes can affect the geographic location of people both within and across countries. This migration channel creates another efficiency cost of taxation with which policymakers need to contend when setting tax policy."* [25]

The authors look at papers estimating mobility responses to personal income taxes, but there is also evidence that taxes on wealth and capital income drive migration.[26]

Minnesota generally loses residents to other jurisdictions in the United States. A recent report looking specifically at the impact of Minnesota's tax burden on our state's pattern of net domestic migration found that our high taxes were responsible for some of that persistent outflow of residents. This could lead to lower productivity and lower state government revenues in years to come.[27]

Tax burdens and Best States Rankings

FIGURE 10



SOURCE: CENTER OF THE AMERICAN EXPERIMENT

Minnesota isn't a great place to live because of its high taxes

It is often argued that Minnesota's high taxes are the price we pay to make it a great place to live. Indeed, Minnesota's quality of life does rank highly. U.S. News & World Report's annual Best States Rankings typically have us up near the top: we ranked 2nd in 2021. But is that really because of Minnesota's high taxes or is something else responsible? If high taxes really make our state a great place to live, we would see a positive relationship between state tax burdens and quality of life rankings (assuming the latter are constructed sensibly).

The data do not support this. Figure 10 shows the relationship between a ranking of state tax burdens for 2019 and their ranking on that year's Best States Rankings. We see no statistically significant relationship. In other words, higher tax burdens do not improve your state's Best States ranking. (The p-values are a hefty 50 percent with the one-tail test and 100 percent with the two-tailed test. Any relationship with a p-value above 5 percent is seen as statistically insignificant).

This chart is a good advertisement for the use of data over anecdote. Minnesota for example, has both a high tax burden and a high Best States ranking. But New Hampshire has a much lower tax burden and a higher Best States ranking than we do. Which of these anecdotes tells us the truth about the relationship between tax

Tax burdens and net migration rates

FIGURE 11

SOURCE: CENTER OF THE AMERICAN EXPERIMENT

burdens and quality of life? The answer is neither; we must take them together. Doing so tells us that whatever Minnesotans might get for our high taxes, a better quality of life is not one of them.

And if you don't believe the p-values, believe the people themselves. Ask yourself, if high taxes are the price we pay for a high quality of life, why are people moving away from higher tax states to lower tax states?

Figure 11 shows the relationship between average tax burdens in the fifty states and District of Columbia over the period 2011 to 2018 and the ratio of domestic in-migrants to out-migrants from each of the fifty states and District of Columbia over the period 2011-2012 to 2018-2019. A ratio above 1.0 means that the state gained residents on net and a ratio below 1.0 means that the state lost residents on net. Consistent with the existing literature, we see a statistically significant negative relationship between the tax burden in a state and the ratio of in-migrants to out-migrants with a p-value of 0.000 percent (the R2 is 0.2581, meaning that 25.8 percent of the variation in migration ratios can be attributed to variations in state tax burdens.) Simply put, the higher the tax burden in the state the greater its migration loss.

There is no argument that Minnesota is a high tax state. The evidence shows that these high taxes are pushing residents out of our state and keeping others from moving here, and we don't even get a higher quality of life to compensate.

3. Policy proposals

It is easy to say “cut taxes;” it is less easy to articulate what that means. Exactly what would the tax reforms necessary to begin moving Minnesota significantly in a pro-growth direction look like?

Table 1 shows forecast spending over the next two bienniums, FY 2022-23 and FY 2024-25, and gives the estimated surplus in each calendar year.

The analysis in section 2 suggests seven possible policies, summarized in Table 2. These comprise two measures to simplify Minnesota’s corporate taxes, two to simplify our state’s individual income taxes, one to reduce the corporate tax rate, and two to reduce personal tax rates, for both the estate tax and the personal income tax.

1. Conform to the federal depletion schedule

This would remove a source of needless complexity, with likely very little - if any - loss, in terms of state government revenue.

2. Abolish the Alternative Minimum Tax for corporations

This, too, would make the taxes faced by businesses in Minnesota less onerous, and again, at little apparent revenue loss to the state government. MCFE points out that:

“...the last time [Minnesota Department of Revenue] published a corporate income tax bulletin (about a decade ago) the corporate AMT constituted about 1% of state corporate income tax collections. Given the current circumstances, that’s not worth retaining.”

With revenue from the Corporate Franchise Tax forecast to come in at $6.8 billion in each of 2022 and 2023, this measure would cost $68.0 million, or 3.4 percent of the surplus forecast for each year.

4. Abolish the Alternative Minimum Tax for individuals

Abolishing the AMT for individuals would reduce the needless complexity Minnesotans face. The loss to the state government is also small.

Our state’s AMT was estimated to raise about $23.6 million in tax year 2017, or 0.1 percent of total state tax collections.[28] With Total Tax Revenues for each of 2022 and 2023 forecast at $26.7 billion, this measure would cost an estimated $26.7 million, or 1.3 percent of the surplus forecast for each year.

5. Eliminate the marriage tax penalty

This measure would remove another burden-

TABLE 1

Spending and surplus, 2022 to 2025

	SPENDING		SURPLUS	
	Annual	Biennium (millions)	Surplus biennium (millions)	Surplus annual (millions)
2022	$25,129,609.00			$2,019.00
2023	$26,869,853.00	$51,999.50	$4,038.00	$2,019.00
2024	$26,868,333.00			$2,976.50
2025	$27,464,477.00	$54,332.80	$5,953.00	$2,976.50

SOURCE: MINNESOTA MANAGEMENT AND BUDGET

TABLE 2

Revenue effects of proposed tax measures, 2022 and 2023

	Revenue cost (millions)	% of surplus
Simplification measures	$94.80	4.7%
Abolition of estate tax	$374.10	18.5%
Corporate tax cut	$154.00	7.6%
Income tax cuts, 1 percentage point	$2,080.00	103.0%
Income tax cuts, 2 percentage points	$4,160.00	206.0%

SOURCE: CENTER OF THE AMERICAN EXPERIMENT

some source of tax complexity for Minnesotans. And, once again, the revenue loss to the state government is likely to be small.

6. Abolish the Estate Tax

Abolishing the estate tax is a measure which would reduce personal income tax burdens in Minnesota. Doing so may actually increase revenues for the state government.

Evidence shows that people leave our state to avoid paying the estate tax, and when they do they take future payments of other taxes with them. The net effect on state government tax revenues depends on whether the amount the estate tax brings in from those who stay is high enough to offset the lost revenues from these other taxes from those who go. In a previous report we estimated that they probably aren't. We estimated that, in 2015-2016 for example, the estate tax cost the state government $230.5 million in lost income and sales tax revenues set against estate tax collections of $183.2 million equaling a net loss to the state government of $47.3 million.[29] Subsequent research supports this. A recent study which investigated "the effect of state-level estate taxes on the geographical location of the Forbes 400 richest Americans" and "estimate(d) the effect of billionaire deaths on state tax revenues" concluded, "Surprisingly…that the benefit exceeds the cost for the vast majority of states." But not for Minnesota. We are one of four states identified where the costs in terms of lost revenues from other taxes outweigh the benefits in terms of estate tax revenues. Those states were the ones with the highest top rates of income tax: Hawaii, Minnesota, Oregon, and Vermont. This suggests that there is a tradeoff: a state can have either a high top rate of income tax or an estate tax but it cannot have both, as Minnesota currently does.

This research strongly suggests that Minnesota would see overall tax revenues increase if it abolished its estate tax. Even so, by conservative estimates, Minnesota's estate tax has contributed an average of 0.7 percent of Total State Tax Collections annually since 2000. If this continued into 2022 and 2023, this measure would cost $374.0 million, or 18.5 percent of the surplus forecast for each year. To see how conservative this estimate is, it is more than twice the average revenue, adjusted for inflation, that the tax has brought in since 2000.

7. Cut the corporate income tax rate

As research shows, Minnesota's high corporate taxes are among the most harmful aspects of our state's tax system. Cutting this rate is vital to strong and sustained economic growth.

A cut in the rate of the corporate income tax of one percentage point would move Minnesota from tying the third highest rate in the United States to having the eighth highest rate. This measure would, according to the Minnesota Department of Revenue, reduce state government revenues by $154.0 million in each of 2022 and 2023, or 7.6 percent of the surplus forecast for each year.[30]

8. Cut personal income tax rates

Minnesota's personal income tax rates are high across the board, so they should be cut across the board.

A one percentage point cut across the board

A cut in each of Minnesota's four rates of personal income tax of one percentage point would move our top rate from sixth to seventh highest in the United States. It would also mean that our lowest rate was now higher than the top rate in only thirteen states, as opposed to 24 at present. This measure would, according to the Minnesota Department of Revenue, reduce state government revenues by $2.1 billion in each of 2022 and 2023, or 103.0 percent of the surplus forecast for each year.

A two percentage point cut across the board

Cutting each of our state's four rates of personal income tax by two percentage points would move Minnesota's top rate from sixth to tenth highest in the United States. It would also mean that our lowest rate was now higher than the top rate in only eleven states, as opposed to 24 at present. This measure would, according to the Minnesota Department of Revenue, reduce revenues by $4.2 billion in each of 2022 and 2023, or 206.0 percent of the surplus forecast for each year.

Clearly, an across the board two percentage point cut in personal income tax rates would deplete the surplus and would need to be accompanied by spending cuts. But, thanks to the surplus, these spending cuts would be much smaller than they would need to be otherwise. If this measure was enacted with no others, it would open up a forecast deficit of $2.1 billion in each of 2022 and 2023. This would require nominal cuts in General Fund spending to $23.0 billion in 2022 and $24.7 billion in 2023, 8.5 percent and 8.0 percent respectively. Even so, nominal spending would remain higher than in any year before 2019. In real terms, this measure would require cuts in state government spending to $22.2 billion in 2022 and $23.3 billion in 2023, 8.8 percent and 8.4 percent respectively. This would leave General Fund spending still higher, in real terms, than in any year before 2014. Inflation is an issue, as noted in section 1, but it is a problem which the federal government has created[31] and which all of us are having to live with; Minnesota's state government should be no exception. ■

Conclusion

Back in 2015, President Barack Obama compared Minnesota favorably with Wisconsin, holding up our state's high, progressive taxes as the model for others to follow. Now, few would offer Minnesota as an example.

Our economic growth is lagging national averages, as is being widely noted.[32] Social spending, which is high by both historic and national standards, has failed to close various racial gaps. It is increasingly clear that our model of high, progressive taxes paired with high government spending, once praised by President Obama, is failing Minnesota.

Our state needs to change direction and the largest budget surplus in Minnesota's state history represents a golden opportunity to do it. The state government has the revenue to undertake reforms to reduce tax complexity resulting in an outsized benefit compared to revenue costs. These tax relief measures will not make Minnesota a low tax state, far from it. Cutting our corporate tax rate one percentage point will still leave us with the eighth highest rate in the United States. Cutting our top rate of personal income tax by one percentage point would leave Minnesota with the seventh highest top rate in the country, and a cut of two percentage points would still leave our state with the tenth highest. These measures would leave our state's lowest rate of income tax higher than the top rate in either thirteen or eleven states.

It is a measure of how highly taxed Minnesotans are that such apparently bold measures would still leave us so relatively highly taxed. These steps would not be the end of our journey to tax competitiveness, but they would represent an encouraging start. ■

Endnotes

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