Summary of Meeting with Tom Stinson, Minnesota State Economist

Civic Caucus, 8301 Creekside Circle, Bloomington, MN 55437

Friday, October 16, 2009

Present: Verne C. Johnson, chair; David Broden, Janis Clay, Paul Gilje, Jim Hetland, Dwight and Lucas Johnson, Dan Loritz, Tim McDonald, Clarence Shallbeter (by phone), and Bob White

A. Context of the meeting —This is another in a number of meetings the Civic Caucus is conducting concerning information and issues in the upcoming Minnesota state elections.

B. Welcome and introduction —Verne and Paul welcomed and introduced Tom Stinson, Minnesota State Economist. Stinson, who also holds the position of professor of applied economics at the University of Minnesota, has been State Economist since 1987. In his role as state economist, Stinson is responsible for preparing revenue forecasts for the Governor and Legislature. His current research interests include the impact of Minnesota's changing age structure on the state's economic and financial outlook. He received his Ph.D. in economics from the University of Minnesota in 1973.

C. Comments and discussion —During Stinson's comments and in discussion with the Civic Caucus the following points were raised:

1. Stinson's close relationship with Tom Gillaspy, state demographer — Demographics and economics are very inter-related and he and Gillaspy, last week's Civic Caucus invitee, frequently make joint presentations including at recent legislative retreats.

2. A very sober economic outlook for the state and the state's budget —Looking toward the next biennium (July 1, 2011, to June 30, 2013), Stinson said the current planning estimates show the state's general fund budget more than $4 billion short of being in balance. That estimate, he said, is after revenue growth of more than 11 percent is factored in. State general fund revenues in the 2012-13 biennium are expected to total $34.3 billion.

He noted that revenue forecasts in advance of the current biennium (July 1, 2009, to June 30, 2011) showed a similar $4 billion gap. That gap was closed by a variety of adjustments, without raising taxes. All the easy solutions have been exhausted, he said. There's little "smoke and mirrors" left to use in the next biennium.

3. Drop in sales tax receipts— To illustrate the scope of the state's revenue slump, Stinson said that sales tax receipts for the third quarter of 2009 were 13.5 percent less than in the same quarter a year ago. That means, he said, that businesses dealing in taxable items experienced at 13.5 percent drop in sales during that 12-month period. Such a drop has not occurred before.

The drop in tax receipts is all the more sobering, he said, when you realize that it will take a great deal of growth simply to get state revenues back to where they were when the recession hit.

A member asked Stinson about the potential of making certain items that are now exempt, such as clothing and grocery food, subject to the sales tax. The sales tax is more volatile today than in the past, he said. Stinson suggested the group look again at the findings of the Minnesota Budget Trends Study Commission, (http://bit.ly/kGNm5) to which Stinson was a consultant. Key findings of the commission on the sales tax:

Replacing highly volatile tax base components with less volatile sources could reduce the volatility of the overall general fund tax system. However, such changes would also affect revenue growth rates and the distribution of the tax burden among taxpayers.

Adjusting the mix of state taxes, without changing the base for individual taxes or the overall growth rate of revenues, cannot significantly reduce revenue volatility without a radical change in tax rates and a dramatic re-weighting of tax revenue sources to the system.

Shifting consumption patterns have reduced Minnesota's sales tax base.

4. Decline in capital gains affecting income tax receipts —A major reason for the current drop in income tax receipts is thought to be a dramatic decline, year-to-year, in capital gains tax revenue, brought about by a significant decline in the value of assets such as real estate, stocks and bonds. Net capital gains are believed to have fallen by 36 percent in tax year 2008 and are forecast to fall by an additional 45 percent in 2009.

5. Income tax receipts becoming more volatile -For more than a decade high income workers have received a greater proportion of their compensation in the form of performance-based options and bonuses, rather than in base wages. Consequently, with the recession wiping out much income from such options and bonuses, the drop in income tax receipts was accentuated.

Another significant factor that will affect future income tax receipts is the higher number of retirees as baby boomers reach age 65 and retire. Retirees almost always have lower incomes than when they were working, so as the proportion of tax payers that are retired increases income tax receipts grow more slowly than in the past. The number of boomers reaching age 65 in 2011 will be 30 percent more than the previous year.

6. Parts of the state's economy affect volatility the most —Stinson said it's very difficult to pinpoint what parts of the state's economy are most affected by the recession and, therefore, have greater impact on volatility of the tax system. Minnesota's economy is very diversified and no sector has escaped damage. He said that construction was hit worse than other segments of the economy.

We're not very good at making guesses as to where economic growth will be concentrated, he said. We thought that investing in supercomputers was the wave of the future, but we were wrong. We didn't suggest investing in the internet, and we probably should have.

7. Where Minnesota should invest for purposes of productivity? —Continuing the discussion of priorities on the economy, a member asked Stinson if more investment is needed in the medical sciences. Stinson replied that the major question of investment relates to productivity. Some people are suspicious about productivity because they think that means making machines that will put people out of work.

Stinson cited two ways to improve productivity: (1) make things better, which is what Hutchinson Technologies has done with computer disk drives. (2) make better things, which has been a hallmark of 3M and Medtronic.

8. State isn't investing in research as it should —To increase prospects for more productivity, Stinson said the state needs to invest in human capital and research. He cited work by his colleague Phil Pardey and others (http://bit.ly/38DSEq), which illustrates that Minnesota ranked 20th among the 50 states in 1972 in academic research and development(R&D), and by 2004, the state had dropped to 40th. During the same time period the state dropped from 20th to 43rd in R&D per dollar of gross state product.

9. Productivity gain more difficult with services?— Responding to a question, Stinson said being in the service business doesn't change the opportunity to increase productivity. Just look at changes in telecommunications, he said.

10. Can productivity be measured in government? —We don't measure government productivity very well, because the output from government is difficult to define. A member commented that in the matter of vehicle license renewal, there's certainly been a great deal of productivity gain from renewing online rather than standing in line waiting at a renewal office.

11. Change in incomes and high school graduation rates —In the 1960s, Stinson said, per capita personal income in Minnesota was 95 percent of the U.S. average, and fewer than one-half of Minnesota workers had a high school diploma. These were people who grew up during the Depression and World War II. Today, per capital personal income in Minnesota is 108 percent of the U.S. average, and 91 percent of the work force has a high school diploma, highest in the nation.

But what is so tragic, he said, is that blacks and Hispanics are graduating at a 60 percent rate in Minnesota. We cannot permit such a difference to continue.

Stinson noted that Arthur Rolnick, senior vice president and director of research of the Federal Reserve Bank of Minneapolis, is a leading advocate for doing more for early childhood education. With the great problem facing youth who aren't getting a high school diploma, Stinson wishes there were a way to do something for the youth who already are beyond the age for early childhood education.

Continuing his discussion on education, Stinson said that as population ages it won't be as easy to raise revenue for schools. Stinson cited Nobel-prize-winning work by Franco Modigliani who demonstrated three main cycles in people's lives. The first cycle is when you are a net borrower, borrowing for your needs. The second cycle is when you are putting away funds for retirement. The third cycle is when you draw down the amounts you have saved. If population is distributed as a triangle, with fewer people in each older generation, life cycle considerations do not affect society's overall willingness to make public sector investments in human capital, infrastructure and research. But if there is a large cohort moving from the net saver phase to retirement, agreement to make such public sector investments is less likely since that cohort is more focused on building up retirement assets for use in the near future.

12. Change in support for the public sector —In the early 1990s, about 17.5 percent of personal income in Minnesota went to support state and local government, Stinson said. Today that percentage has dropped to 15.5 percent. Had the percentage remained at 17.5 percent, another $4.5 billion would have been available for state and local government in Minnesota annually.

13. No studies on whether Minnesota retirees have moved to other states because of tax levels— In response to a question about whether there are statistics on residents of Minnesota moving to other states to avoid Minnesota taxes, Stinson replied that there's a lot of anecdotal information but that isn't supported by data. Tax motivated movers appear to be a very small group of people.

Responding to a question about Minnesota's tax burden relative to that of other states, Stinson said that our state tax burden is below that of California and New York but above Wisconsin.

Stinson went on to discuss another aspect of older people and the income tax. When someone turns 65 and retires, income taxes are considerably reduced for that person, because of laws offering special treatment (such as not making all social security income subject to the income tax and increasing the state and federal exemption for persons over 65). Also, as people age, the mix of items purchased that are subject to the state sales tax changes, with fewer purchases by older persons subject to the sales tax. One study revealed the total tax bill falling by 60 percent for a hypothetical working couple with a $70,000 income before retiring and a $50,000 income afterwards.

14. Advice to candidates for office— In light of current budgetary shortfalls and likely reduced growth in the economy in coming years, Stinson advised that candidates for office should not promise what they can't pay for and that the Governor and Legislature must first find a way to close the income-spending gap in the upcoming biennial state budget before talking about spending increases. The size of the gap is about $4 billion, he said, which is more than 10 percent of the budget. But it could be even more if you include (a) inflationary increases in spending, (b) buying back the property tax recognition shift, and (c) reinstating General Assistance Medical Care. But no matter what you include in the calculation, the state has a big hole to fill before it will be possible to add more spending.

15. Possible redesign of state services —A member inquired whether you could redesign the way big service items in the budget, such as education and long term care, are delivered, so that more quality could be provided without increasing expenditures. Stinson replied that what really is needed is to re-examine what state government's role ought to be. Some state functions should be more appropriately financed by the federal government, some functions, more by local government and some are really individual responsibilities. The state-local relationship is more subject to direct state influence than is the state-federal relationship.

16. Possible impact on transportation —A member noted that—with state general fund dollars in such short supply for big ticket items like education and long term care—transportation financing appears more problematical. Where, for example, would one pay for subsidies for transit operating expense? Would options be considered, such as requiring more revenue from property owners who benefit from new roads or transit stations?

Stinson noted that some general fund revenues (sales taxes on new and used vehicles) were diverted to transportation by a constitutional amendment in 2006. The gasoline tax would need to be changed to make it more responsive, Stinson said.

But Stinson went on to say that the aging of the state's population will likely change the demand for transportation and infrastructure, but the actual impact of aging on transportation needs has not yet been thought through, nor has the impact of telecommuting, as that becomes more prevalent.

17. We're in a fiscal trap —Asked to sum up his comments for the day, Stinson harkened back to Tom Gillaspy's comments last week, that the state is in somewhat of a fiscal trap. To get more economic growth, the state needs to invest more in research and human capital, but we can't get those additional dollars to invest without first closing the existing budget gap. Closing the budget gap will require expenditures that aren't doing any more than holding things even and, therefore, won't do much for growth.

A member noted that candidates and office-holders of different parties hold widely differing views and aren't—today—working closely together to seek compromise.

18. Thanks —On behalf of the Civic Caucus, Verne thanked Stinson for meeting with us today.