

## “High Tax” State is Only Average

Minnesotans face a puzzle when thinking about the size of government in our state. They hear regularly that Minnesota is a high tax place, and it is true that Minnesota’s state taxes per person are the 2<sup>nd</sup> highest among the 50 states. But it’s also true that Minnesota ranks a more modest 24<sup>th</sup> in the total size of government.

How can both be true? The 2<sup>nd</sup> place ranking is based on just one piece of the puzzle. If you add more pieces of the puzzle, you see that the 24<sup>th</sup> place ranking is a more accurate representation of the size of government in Minnesota.

The first piece of the puzzle is state taxes. But rankings based only on *state* taxes are incomplete: they ignore two-thirds of the total revenue collected by state and local governments in Minnesota, which also include property taxes, license fees, permit charges, special assessments, and funds received from the federal government.

So the second piece of the puzzle is taxes collected by local governments, including counties, cities, townships, and school districts. Minnesota’s local taxes are lower than in most other states — in fact, Minnesota ranks 32<sup>nd</sup> in local taxes per capita — partly because Minnesota has chosen to use state taxes to help pay for many local functions, such as K-12 education and courts. The main state tax is the income tax, which is based on ability to pay, so that those with higher incomes pay more. In contrast, the primary local tax, the property tax, falls more heavily on those with lower incomes. The decision to rely more on state income taxes and less on local property taxes helps to ensure that total taxes in Minnesota are spread relatively evenly among all income levels. This is not the case in most other states, where low- and middle-income people pay a larger percentage of their income in state and local taxes than do people with higher incomes.

Federal aid is the next piece of the puzzle. Nationwide, federal dollars make up 20% of all state and local government revenues because Washington helps pay for programs such as Medicaid and highway construction. Federal aid per capita tends to be higher in low-income states, such as Mississippi, and lower in high-income states, such as Minnesota. In fact, Minnesota ranks 29<sup>th</sup> among the 50 states in federal aid per capita.

While it is a good thing to be a high-income state, it also means that Minnesota gets less help from Washington and has to raise more revenue on its own just to deliver the same services that in another state may be more heavily subsidized with federal dollars.

Other sources of government revenue — such as license fees, park and recreation charges, tuition at public colleges and universities, and special assessments — make up the next piece of the puzzle. Since these charges represent dollars that state and local governments collect from their citizens, they should definitely be included when measuring the size of government. Here again, Minnesota ranks relatively low compared with other states because it has chosen to rely on taxes rather than fees, charges, and special assessments.

There is one last piece to our puzzle. Per capita rankings — such as Minnesota’s 2<sup>nd</sup> place ranking in state taxes — simply take revenue and divide by the number of people in the state. But per capita measures have two flaws:

- Per capita rankings do not recognize that states with high incomes, such as Minnesota, tend to have higher labor costs. For example, Minnesota cannot hire a teacher for the same salary as Arkansas, nor can it hope to retain quality teachers if wages are significantly less than could be earned in the private sector.
- Per capita rankings do not take into account the fact that states have different average incomes. A \$500 tax is a bigger slice of the household budget for a family making \$30,000 than for a family making \$60,000.

The shortcomings of per capita rankings can be overcome by measuring revenues as a percentage of statewide income.

When all the sources of revenue are put together and measured as a percentage of income, all the puzzle pieces are in place. The completed picture shows that Minnesota ranked 24<sup>th</sup> among the 50 states in the size of government in 2002, the most current year for which data are available. Interestingly, our rank on this measure has been falling: Minnesota ranked 9<sup>th</sup> in 1992 and 18<sup>th</sup> in 2000. In all likelihood, Minnesota's ranking will continue to slide given that government revenues in Minnesota are expected to grow less rapidly than in most other states.

Tax rankings are popular because they compress complex issues into a single number. But Minnesotans need to be particularly cautious of claims about the size of government that focus on only one piece of the puzzle, especially when those claims are used to justify the sort of tough belt-tightening measures that Minnesota has gone through for the last two years. State comparisons should include all government revenues — not just state taxes — and should also take into account variations in incomes among states. Based on this more meaningful and complete measure, Minnesota ranks in the middle of the fifty states.