



AMERICANS
for TAX REFORM

Statement of Kelly William Cobb
State Affairs Manager, Americans for Tax Reform

Hearing on
“Spending Accountability Amendment”

Minnesota Senate Taxes Committee
December 7, 2009

722 12th Street N.W.

Fourth Floor

Washington, D.C.

20005

T: (202) 785-0266

F: (202) 785-0261

www.atr.org

Good morning, my name is Kelly William Cobb and I serve as state affairs manager for Americans for Tax Reform, a non-profit taxpayer advocacy organization. I would like to thank the Senate Taxes Committee for the opportunity to comment in strong support of Governor Pawlenty’s proposed “Spending Accountability Amendment.”

This past year, the state struggled to rectify billions in overspending, and last week we learned Minnesota now faces another \$1.2 billion in overspending – a number that could grow to as high as \$5.4 billion over the coming years.

It goes without saying that Minnesota must reform the way it does business – in prioritizing expenditures and reforming its tax code. The proposed “Spending Accountability Amendment,” which simply restrains general fund spending to the amount of revenue received during the previous biennium, is a great step forward in restoring Minnesota’s fiscal and economic health.

Minnesota’s Spending History

Ideally, state spending should match tax revenue. Tax collection correlates greatly with economic growth – state coffers get fatter during good years and leaner during bad years. Yet spending growth tends to rise faster during years of economic downturn, resulting in tax revenue being overspent. This leads to calls for higher taxes or spending cuts – the likes of which Minnesota saw this year – that too often come in the middle of recessions.

In 2000, for example, Minnesota gross state product (or GSP) grew by 5%, while spending increased by 4.86%.¹ This meant expenditure baselines grew at a rate that could generally be sustained by the economy. Then in 2001, as the recession hit, spending jumped by over 12% while the economy grew only 0.7%. This caused large budget gaps in years that followed.

The massive hike in total expenditures in 2001 pushed the state’s spending baseline well beyond gross state product. Even as GSP growth had begun to decline in 2004, Minnesota continued to increase total spending, building the foundation for an even more severe crisis with frequent revenue shortfalls. In 2006 – before the official recession hit – total state expenditures, which include both the general fund and all capital expenditures, had hit 4.9% growth, while GSP growth tumbled to a mere 0.5%.²

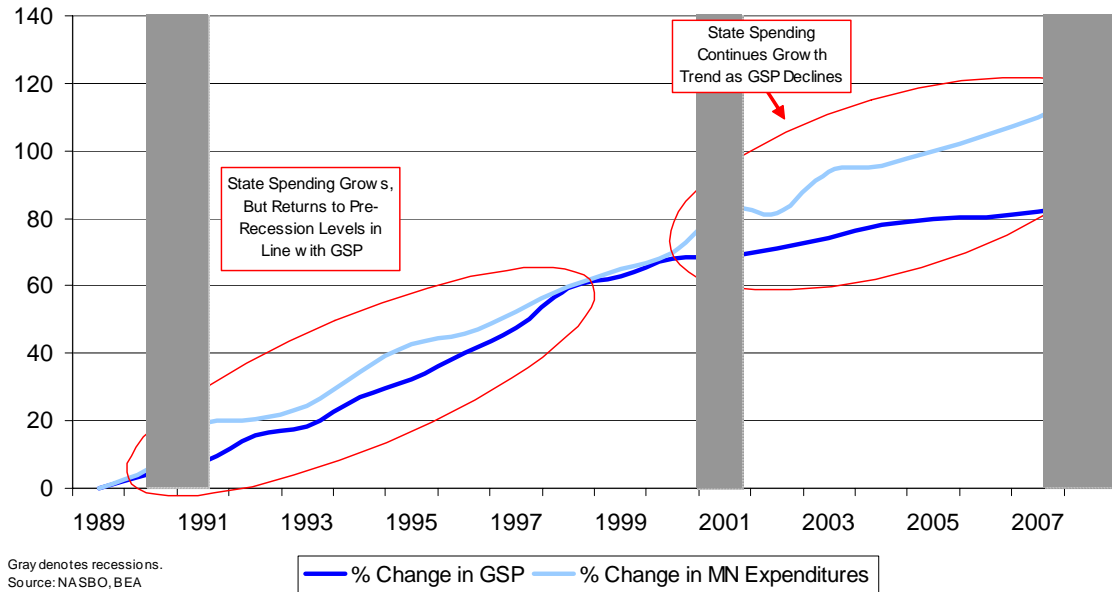
Governor Pawlenty and the legislature rightly restrained general fund spending to roughly 2% each year over this time period, but the higher spending baseline that begun in 2001 was already set in place as the economy began to slow.

Looking at it another way, in 1999 spending and GSP growth chained to 1989 levels were at 65% and 63% respectively – nearly equal.³ In 2008, just a decade later, chained state spending was at 117%, while gross state product was at only 84%.

Simply put, growth in Minnesota’s spending – well above the state’s economic growth – is completely unsustainable. Governor Pawlenty’s “Spending Accountability Amendment” will tie spending growth to tax revenue and the economy, helping to prevent the sort of budget gaps we saw this year, while simultaneously protecting taxpayers from shouldering the burden of a larger government.

Minnesota Spending Outpaces GSP Growth

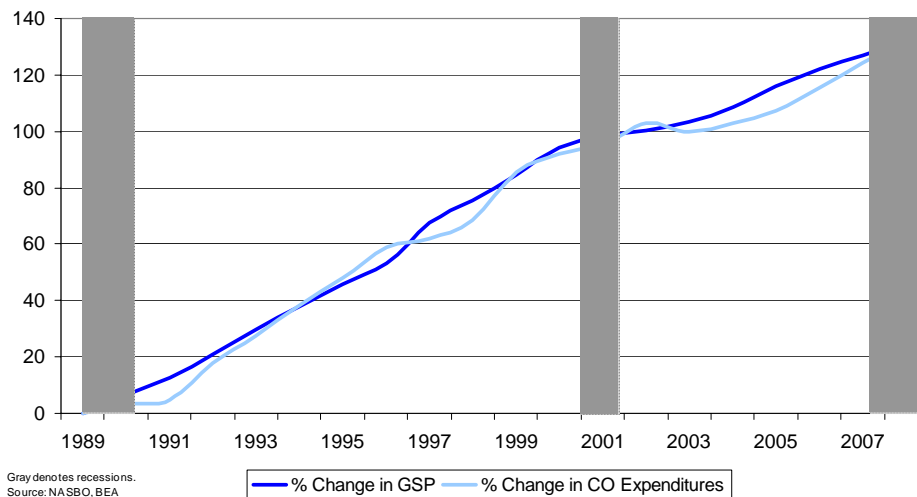
Spending Chained to 1989 Levels Shows Spending Grew as Economy Flatlined



Compare these numbers in Minnesota with Colorado, which constitutionally limits spending to population plus inflation growth. This spending cap, enacted by voters on the ballot in 1992, is currently the strongest tax and expenditure limit in the nation. Chained to 1989 levels, spending in Colorado has grown by 132%. This is the exact same percentage that Colorado’s economy has grown.⁴ The spending restraint has allowed Colorado’s expenditures to grow – albeit at a sustainable rate – while also maintaining a lower tax rate structure with high incomes and strong economic growth.

Colorado Spending Under TABOR Matches GSP Growth

Spending Chained to 1989 Levels Grows Sustainably with GSP



Higher Spending or Lower Taxes?

Minnesota's balanced budget requirement means higher spending is typically accompanied by higher taxes. It is no wonder why Minnesota's spending habit has given it the 12th highest state and local tax burden on individuals in the nation.⁵ Minnesota also has the 3rd highest business tax – not only in the U.S, but when combined with the federal tax rate, in the entire developed world.⁶

Last year we saw the largest drop in state tax revenue across the country in over 50 years, where only five states had a surplus.⁷ Interestingly, these five surplus states actually cut taxes by over \$105 million during the prior two fiscal years.⁸ In contrast, the five states with the largest gaps as a percentage of their budgets actually raised taxes during the prior two years by over \$370 million – well beyond the national average of nearly \$8 million. Clearly higher taxes and higher spending do not guarantee a healthy budget.

Furthermore, a recent comprehensive study by the Federal Reserve Bank of San Francisco found that a dollar of government spending results in 70 cents of job-creating activity after two years.⁹ However, a dollar in tax cuts results in \$1.30 to \$3 of job-creating activity after two years. According to Governor Pawlenty's office, had the Spending Accountability Amendment been in place, taxpayers would have saved over \$22 billion. That's \$22 billion that could have been kept in the private economy to realize this type of job creating activity and economic growth.

Concluding Thoughts

Spending in Minnesota has grown out of hand. Governor Pawlenty is correct that between 1960 and 2003 government spending increased by more than 20% on average in each biennial budget.¹⁰ This should be a sobering statistic.

True governing means prioritizing spending, not continuing to simply raise taxes to cover reckless spending habits. The "Spending Accountability Amendment" requires Minnesota to do exactly that. Just as a family cannot spend frivolously and assume a pay raise will naturally come to cover it, neither should the state. And just as a family or business cuts back their budget during an economic downturn, so should the state.

As legislators, you may or may not agree on whether this spending restraint should be enacted. But I urge you to give Minnesota residents – your constituents who must shoulder the costs of increased spending – the opportunity to vote on it. Thank you.

¹ U.S. Department of Commerce Bureau of Economic Analysis, National Association of State Budget Officers

² Ibid.

³ Data from National Association of State Budget Officers compiled by Americans for Tax Reform Foundation.

⁴ Ibid.

⁵ Tax Foundation, *State/Local Tax Burden*

⁶ Tax Foundation

⁷ Americans for Tax Reform Foundation, *2009 State Tax Trends*

⁸ Americans for Tax Reform Foundation, *2009 State Tax Trends*; National Association of State Budget Officers, *State Expenditure Reports*

⁹ FRBSF Economic Letter, *Fighting Downturns with Fiscal Policy*,

<http://www.frbsf.org/publications/economics/letter/2009/el2009-20.pdf>

¹⁰ "Finally – see spending match with revenue", Star Tribute Commentary.