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MINNESOTA CENTER for Fiscal Excellence

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In This Issue:

Budgeting in a Sea of Federal Uncertainty

Federal tax and spending reform proposals present a challenging and volatile environment for state budget development. But Minnesota lawmakers can be guaranteed of two things.

The old Sunday school song goes "the foolish man builds his house upon the sand," but sometimes the "man" has really no choice in the matter. Such is the case for state lawmakers tasked with constructing a biennial state budget while facing a potential wave of federal reform efforts in individual and corporate income taxation, ACA repeal, infrastructure spending, and K-12 education – just to name a few areas. Adding to the challenge, there appear to be some differences of opinion on these matters between the Trump administration and the Republican-controlled Congress. So the "hurricane watch" is not just a matter of intensity; it's also a function of where the storm may be coming from.

Individual Income Tax Collections: A Windfall in the Offing?

Both the House and Trump individual income tax plans are based on similar themes of dramatic simplification, rate reduction, and expanded bases. Both reduce the number of income tax brackets from 7 to 3 (with identical rates of 12%, 25%, and 33%), although the Trump plan implements the top bracket for single filers at a much lower rate and eliminates the "head of household" filing status. Both increase standard deductions, both eliminate personal exemptions, and both eliminate the Alternative Minimum Tax. Perhaps the most notable difference regards the treatment of itemized deductions. The Trump plan caps them – albeit at high levels (e.g. $200,000 for married-joint filers) – while the House plan eliminates them entirely except for mortgage interest and charitable contributions.

If some version of this structural reform comes to pass, many tax policy experts predict potentially sizeable income tax revenue gains for states that conform with the federal code for a simple reason: states' existing tax rates would now apply to broader tax bases. History suggests the revenue gains could be substantial. In the aftermath of the 1986 federal tax reform premised on base broadening, state income tax revenue grew by an estimated 20% or more in 19 states.[1]

[1] "State Responses to the TRA86 Revenue Windfalls: A New Test of the Flypaper Effect," Helen Ladd, *Journal of Policy Analysis and Management* 12, 1993

Table 1: Potential Implications of House and Trump Tax Plans on Minnesota Income Tax Burdens, Selected Taxpayers

Filer Type/Income	Federal/ State	Baseline	House Tax Plan	Trump Tax Plan	State Change conforming to House	State Change conforming to Trump
Married-Joint, 2 children/$100K	Federal	$6,787	$5,527	$5,807		
	Minnesota	$4,066	$4,387	$4,246	7.9%	4.4%
Total Income Taxes Payable		**$10,853**	**$9,914**	**$10,053**		
Married-Joint, 2 children/$500K	Federal	$113,052	$114,924	$95,494		
	Minnesota	$36,243	$37,057	$36,445	2.2%	0.6%
Total Income Taxes Payable		**$149,295**	**$151,981**	**$131,939**		
Single/$100K	Federal	$14,853	$15,584	$14,236		
	Minnesota	$5,309	$5,383	$5,563	1.4%	4.8%
Total Income Taxes Payable		**$20,162**	**$20,967**	**$19,799**		
Married-Joint, 2 children/$50K	Federal	$325	$30	$310		
	Minnesota	$1,257	$1,458	$1,137	16.0%	-9.5%
Total Income Taxes Payable		**$1,582**	**$1,488**	**$1,447**		
Head of Household, 1 child/$50K	Federal	$3,162	$2,190	$3,050		
	Minnesota	$1,748	$1,660	$1,871	-5.0%	7.0%
Total Income Taxes Payable		**$4,910**	**$3,850**	**$4,921**		

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To examine how such reform might play out here, we modeled the effects the House and Trump plans would have on state income tax burdens for income tax filers at selected incomes and filing statuses. We based our modeling on the representative taxpayers the Department of Revenue created for us to use in our latest *Multistate Individual Income Tax Comparison Study*. The findings from that study establish our comparative baseline, and we modeled tax returns for these filers under both reform proposals. It's important to recognize while our modeling assumes the tax plans create no changes in taxpayer behaviors, it's very likely that taxpayer behaviors would change under such significant federal reform, with corresponding changes in tax burdens. In addition, changing the number of dependents filers claim could have big effects on the comparative differences. Nevertheless, **Table 1** offers some perspective into how burdens may change and what the resulting implications might be for state income tax revenue collections.

As the table shows, we project state income tax collections from conforming to the House plan would increase for all the married and single filers we modeled, ranging from a modest 1.4% for our single filer to 16.0% for our married filer with $50,000 in income. Similar, albeit less variable, results exist in conforming to the Trump plan, although its significantly more generous standard deduction for married filers compared to the House proposal results in a $120 state income tax cut for the $50,000 married filer rather than a $201 increase.

Such an approach would "result in a seismic redistribution of federal spending."

In most cases, higher state income taxes would be more than offset by lower federal income taxes lowering the total combined income tax burden. The big exception lies with our wealthiest example – the $500,000 married joint filer. Under the House tax plan, federal income taxes would increase as well as state taxes because the loss of state income tax deductibility overwhelms any benefits the adjustments to the federal rates and brackets provide. Currently, high-income filers in states like Minnesota that rely heavily on progressive state income tax systems benefit greatly from state income tax deductibility as the federal government effectively subsidizes higher state-level marginal tax rates. With competitiveness concerns and incentives to relocate already a prominent fixture of Minnesota's individual income tax debates, this type of federal reform would take these discussions to a completely new level.

Corporate Income Tax: Even More Money?

The history of tax reform is littered with ideas that make economists and tax wonks swoon but fail to get any public or political traction. Such seems to be the case with the Republican "destination-based cash flow tax"(DBCFT) – which would abolish the federal corporate income tax and replace it with a border adjusted, more progressive form of a value-added-like tax on goods sold in this country. Although it's garnered a lot of interest and received some positive reviews from across the political spectrum, it would be truly significant reform creating major winners and losers in the business community and would demand a lot of leadership and political capital to make it happen. President Trump has declared the tax "too complicated," and has demonstrated an interest in taking a mercantilist approach by addressing competitiveness concerns through tariffs. Any near-term reform effort will likely turn to less ambitious but familiar ideas along the lines of individual income tax changes – lower corporate rates paired with base expansion through elimination of or caps on various tax expenditures.

The Trump proposal cuts the corporate income tax rate from 35% to 15% while creating a new 15% rate for pass-through business income. As part of its DBCFT, House Republicans envision a 20% tax rate, 100% expensing on all tangible and intangible capital assets, and the elimination of various tax expenditures. It would seem likely those ideas would try to find their way into a federal corporate income tax reform proposal.

Revenue impacts aside, a federal rate reduction of this magnitude would almost assuredly trigger an immediate call to dramatically reduce Minnesota's corporate income tax rate over competitiveness concerns. Although Minnesota's 9.8% rate is second highest in the nation, the current top federal rate of 35% has a much larger relative influence with respect to competitiveness issues. Under federal reform state taxes would suddenly represent 50% or more of all corporate income tax exposure on Minnesota-sourced revenues.

The other potential budgetary curve ball lies in federal policy changes regarding the repatriation of foreign earnings. Both the president's and the House's tax plans have called for a deemed repatriation of corporate profits (Trump at 10%, the House at a rate of 8.75% percent for cash and cash-equivalent profits and 3.5% on other profits.) Both rates are likely low enough to have the policy feel and implications of a voluntary repatriation holiday like that which occurred in 2004. Back then, the state's economic forecast projected higher near-term corporate income tax collections offset by a loss of revenues in future years. While the ongoing compulsory nature of deemed repatriation may mitigate some of the "espresso effect" on corporate income tax collections, it seems likely any movement on foreign earnings repatriation would give a boost to projected revenues.

Medicaid: Sticking it to Minnesota?

For two-thirds of the federal safety net's Big Three – Social Security and Medicare – it's not clear whether congressional Republicans and the president are on the same page. But for the third program, Medicaid, a shared sense of policy direction exists with potentially major ramifications for the state budget.

Our national health insurance program for the poor ("Medical Assistance" in Minnesota) is funded jointly by the federal government and the states. Currently, the federal government pays states at least 50% of Medicaid program expenditures based on certain criteria. As states increase the generosity and scope of their Medicaid programs, the federal government pays its portion of the increased costs. Both the president and the congressional majority have expressed concerns about the incentives this creates and have stated an interest in converting Medicaid into a block grant program.

This seemingly straightforward idea masks a really challenging question: how would you determine each state's grant? One option would be to use existing Medicaid spending as a base and issue the block grants on a per capita or per enrollee basis. But an analysis by the Urban Institute showed that current spending per low income person varies by a factor of 5:1 across the states and spending per enrollee varies by a factor of at least 2:1.[2] Block grants based on current spending would lock in these disparities, turning state policy decisions into federal ones.

As an alternative, the block grants might be determined using some need based calculations independent of state Medicaid decisions like per capita income, which is already used to determine the federal government's share of each state's spending. But an analysis by researchers at the American Enterprise Institute concluded such an approach would "result in a seismic redistribution of federal spending." [3] According to the analysis, under a personal income-adjusted block grant program Minnesota would stand to lose $1.07 billion per year in federal Medicaid support.

The potential general fund budget considerations regarding Medicaid reform don't stop there. What would be the financial implications of all the new administrative responsibilities now delegated to Minnesota? Since demand for Medicaid is countercyclical and increases in difficult economic times, would we need to strengthen our existing budget reserve even further on the expectation that federal contributions would not increase during recessions? And if the federal government's block grant appropriations fail to keep up with demand, what are the contingency plans (and the general fund implications) for more uninsured and underinsured residents?

Two Things States Can Count On

These three areas are just the tip of the iceberg. On the revenue side, any state gains that may materialize from federal individual and corporate income tax reform could be offset by other reforms which make retaining other state collections much more challenging. For example, expressed interest in abolishing the federal estate tax would make it even more difficult for the handful of states like Minnesota that have this tax to keep it. On the spending side, all other discretionary spending areas – transportation, higher education, K-12 education, non-Medicaid human service programs, etc. – will be exposed because of the likely transformation in the federal-state relationship specifically and in the concept of fiscal federalism generally.

Amidst all this uncertainty, state lawmakers can be guaranteed of two things. First, whatever revenue gains federal tax reform might generate for states will be counterbalanced by significantly greater responsibility in financing public goods and services. This will come with greater pressure to ensure state tax systems do not get out of line with the rest of the country because of the much larger role state tax systems will have with respect to tax competitiveness.

Second, competition for resources within state budgets is only going to intensify. Politically unpopular and dangerous topics that tend to keep government redesign ideas in filing cabinets will have to be discussed. Some of the most sacrosanct ideas about organizing, managing and delivering government services are going to have to be rethought. We will once again have to embrace the idea of the states as laboratories of democracy, and Minnesota is going to need all the mad scientists we can find. ■

[2] "Block Grants and Per Capita Caps," Urban Institute Health Policy Center, September, 2016

[3] "Medicaid Reform: The Elephant in the Room" Real Clear Health, January 4, 2017

"Levyphobia" and the Minnesota Homeowner

The latest edition of the routinely overlooked but indispensible Department of Revenue "Voss Report" shows that the average homeowners' property tax effort over the last decade is feebler than whatever the state is (or is not) doing.

Totaling $3.34 billion in current biennium, property tax aids and credits is the 3rd largest spending area in the state general fund, trailing only the two behemoths – E-12 education and health and human services. Spending to keep property taxes down exceeds state higher education spending by 8%. It exceeds the ***combined*** general fund spending on public safety, judiciary, environment, agriculture, jobs, economic development, housing, and commerce. In short, in the grand scheme of state government budgeting, Minnesota policymakers have made helping to pay for the costs of citizens' own local governments a very high priority.

If some might use the term "anemic" to describe how state support for local governments has grown over the past decade, growth in median homeowner property taxes could be described as "comatose"

It's not working. Or at least that's the message being communicated as the 2017 legislative session began. In the most recently released city finances report from the State Auditor, property taxes were 39.4% of total city revenues in 2015, up from 30.8% in 2006. The same report also finds that total property tax collections grew 49.4% over this 10-year period, compared to an increase of only 6.0% for intergovernmental revenues (mostly state and federal aid payments). Local government stakeholders have echoed this message in their commentary on the state of local finances. City officials have highlighted a decade of unfilled positions, program cuts, and delayed capital spending – presumably because local property taxation reached unacceptable levels. Editorial pages and advocacy groups have renewed appeals for more state aid to cities and counties. Governor Dayton's budget proposes $30 million of additional general purpose aids to "relieve the burden on Minnesota property owners".

Has $3.34 billion of spending ever had less to show for it? That's a reasonable question to contemplate in light of the current portrayal of local finance conditions. Fortunately, there is a routinely overlooked, but absolutely indispensible research report published by the Department of Revenue which helps make sense of what is going on while cutting through the rhetoric to reveal important truths about the state of local property taxation. It's the *Residential Homestead Property Tax Burden Report* (a.k.a "Voss Report").

"Here Comes da Voss"

The Voss Report matches each homeowner's property tax burden with their household income across all parts of Minnesota to determine how big a claim on income homeowner property taxes really are. To protect taxpayers' privacy, the report summarizes results at the regional level. What makes the Voss Report so unique and important is the power of its simplicity. It drills down from aggregate collections, which can mask a multitude of issues and relationships, to capture what an individual taxpayer's world actually looks like.

The just-released report for taxes payable 2015 is interesting in and of itself, but the real attention-grabbing findings come from comparing it to the first-ever Voss Report for taxes payable 2007. Conveniently, this 9-year period matches up closely with the 10-year analysis in the State Auditor's city finance report. **Table 2** compares the median net property taxes (taxes minus any property tax refund, to give a sense of the true homeowner cost) and the median incomes, by region, from the 2007 and 2015 Voss Reports.

The data shows something quite remarkable: median net homeowner burdens have changed very little over the last 9 years in the vast majority of the state. In six regions, it actually declined. In Greater Minnesota, the 6.1% median change translates to an annual growth rate of 0.66%. But the median net homeowner property tax price for all local government services – K-12 education delivery, city services, county functions, and anything else – is still a bargain by any definition at about $3.50 a day (essentially a McDonald's Happy Meal or a Starbucks cappuccino – take your pick).

Over this same period, Local Government Aid grew from $484.5 million to $516.9 million – an increase of 6.7% that outpaces growth in median net homestead taxes in 14 of the 20 individual regions and in both the metro area and Greater Minnesota as a whole. If some might use the term "anemic" to describe how state support for local governments has grown over the past decade, growth in median homeowner property taxes could be described as "comatose" by comparison.

All this is on a nominal basis. We could show changes in homeowner effort between 2007 and 2015 on a "real" or inflation-adjusted basis as the State Auditor's report does with state aid support. Such an adjustment would clearly show a decided decline in the median net homeowner property tax effort in nearly every, if not each, state region.

The curiosities don't stop there. Affordability needs to be judged relative to income, and even small property tax increases could be an undue burden if household incomes are stagnant or declining. But they are not. Median homestead incomes grew consistently across each region of the state, ranging from 19.6% in Anoka County to 34.5% in Minneapolis. Contrary to the conventional thinking informing "One Minnesota" debates, median homeowner incomes in Greater Minnesota grew slightly faster than in the metro area (24.7% vs. 23.7%).

Looking at the change in the net median homeowner property tax over this period gives a good idea of how the affordability of homeowner property taxes has changed over this time. As **Table 3** illustrates, taxes relative to income have fallen in every region except one (the Arrowhead), and generally property taxes are eating up about 15%-20% less of the median homeowners' income.

Table 2: Changes in Median Net Homeowner Property Taxes and Median Homeowner Income, By Region, 2007-2015

	Median Net Tax 2007	Median Net Tax 2015	Median Dollar change	Median % change	Median Income 2007	Median Income 2015	Median Dollar change	Median % change
Arrowhead	$816	$1,085	$269	33.0%	$49,292	$62,150	$12,858	26.1%
Central	$1,720	$1,694	($26)	-1.5%	$63,781	$77,959	$14,178	22.2%
East Central	$1,580	$1,551	($29)	-1.8%	$54,948	$66,218	$11,270	20.5%
MN Valley	$1,076	$1,026	($50)	-4.6%	$51,475	$64,029	$12,554	24.4%
North Central	$946	$1,013	$67	7.1%	$45,824	$56,663	$10,839	23.7%
NW/ Headwaters	$944	$992	$48	5.1%	$47,560	$61,864	$14,304	30.1%
South Central	$1,087	$1,206	$119	10.9%	$52,002	$66,134	$14,132	27.2%
Southeast	$1,393	$1,462	$69	5.0%	$59,232	$72,858	$13,626	23.0%
Southwest	$726	$756	$30	4.1%	$46,171	$59,099	$12,928	28.0%
West Central	$1,009	$1,209	$200	19.8%	$51,468	$66,561	$15,093	29.3%
Greater MN	**$1,210**	**$1,284**	**$74**	**6.1%**	**$54,027**	**$67,346**	**$13,319**	**24.7%**
Anoka	$1,936	$1,881	($55)	-2.8%	$68,825	$82,300	$13,475	19.6%
Carver Scott	$2,612	$2,639	$27	1.0%	$82,655	$103,048	$20,393	24.7%
Dakota	$2,276	$2,241	($35)	-1.5%	$77,050	$93,656	$16,606	21.6%
Mpls	$2,191	$2,334	$143	6.5%	$57,877	$77,864	$19,987	34.5%
No. Hennepin	$2,358	$2,209	($149)	-6.3%	$69,729	$85,617	$15,888	22.8%
Saint Paul	$1,747	$1,781	$34	1.9%	$56,762	$71,552	$14,790	26.1%
SE Hennepin	$2,434	$2,501	$67	2.8%	$72,159	$89,591	$17,432	24.2%
SW Hennepin	$3,257	$3,546	$289	8.9%	$96,414	$116,812	$20,398	21.2%
Sub Ramsey	$2,270	$2,293	$23	1.0%	$72,922	$87,318	$14,396	19.7%
Washngton	$2,261	$2,420	$159	7.0%	$80,677	$98,090	$17,413	21.6%
Metro	**$2,279**	**$2,293**	**$14**	**0.6%**	**$72,779**	**$90,006**	**$17,227**	**23.7%**
Statewide	**$1,810**	**$1,777**	**($33)**	**-1.8%**	**$63,551**	**$78,346**	**$14,795**	**23.3%**

2007 and 2015 Voss Report, MN Department of Revenue

Note: Median net property taxes equal taxes minus any property tax refund.

Table 3: Change in Net Median Homeowner Property Taxes' Share of Income, by Region, 2007-2015

Region	Median Net Homeowner Property Tax As Share of Household Income		Percentage Point Change 2007-2015
	Payable 2007	Payable 2015	
Arrowhead	1.8%	1.9%	0.1
Central	2.8%	2.2%	(0.6)
East Central	2.9%	2.4%	(0.5)
Minnesota Valley	2.2%	1.7%	(0.5)
North Central	2.1%	1.9%	(0.2)
Northwest/Headwaters	2.1%	1.7%	(0.4)
South Central	2.2%	1.9%	(0.3)
Southeast	2.4%	2.1%	(0.3)
Southwest	1.7%	1.4%	(0.3)
West Central	2.0%	1.9%	(0.1)
Greater Minnesota	**2.3%**	**2.0%**	**(0.3)**
Anoka	2.9%	2.4%	(0.5)
Carver/Scott	3.3%	2.6%	(0.7)
Dakota	3.0%	2.4%	(0.6)
Minneapolis	3.6%	2.9%	(0.7)
North Hennepin	3.4%	2.6%	(0.8)
Saint Paul	3.1%	2.6%	(0.5)
Southeast Hennepin	3.3%	2.7%	(0.6)
Southwest Hennepin	3.3%	2.8%	(0.5)
Suburban Ramsey	3.2%	2.6%	(0.6)
Washington	2.9%	2.5%	(0.4)
Seven-County Metro	**3.2%**	**2.6%**	**(0.6)**
Statewide	**2.8%**	**2.3%**	**(0.5)**

2007 and 2015 Voss Report, MN Department of Revenue
Note: Median net property taxes equal taxes minus any property tax refund.
Note: 2007 figures rounded to tenths of a percent to match the data presented in the 2015 report

Frankly, its tough to see where homeowners should be experiencing large-scale property tax annoyance and frustration.

"Much (local) effort, much prosperity"
— Euripides (adapted)

While these findings may be surprising to many at first glance, they actually make a lot of sense when considering the nature of Minnesota's property tax policy decisions over the past decade. We made the nation's most accessible and generous homeowner property tax refund program even more accessible and even more generous. On top of that, we also have the homestead exclusion exempting significant chunks of home value from the tax. And our classification system continues to effectively subsidize homeowners, especially in times of rising commercial real estate values.

The bigger mystery and concern is why, in light of these findings, local governments are so reluctant to simply pass higher levies to address all the unfilled positions, program cuts, and capital needs their officials highlight. Is Minnesota's classification system and homestead exclusion shifting so much tax burden onto higher value homesteads and business property that these property owners have become much more vocal and active in their local levy setting discussions? Does the state's own huge footprint in business property taxation make the prospect of raising local levies further a non-starter because of the resulting impact on small business' property taxes? Are homeowner perspectives framed exclusively by the "MSRP" sticker price of local government and ignore the generous rebates the state provides? Have homeowners just been conditioned over 40-plus years to expect other citizens to pay for the local government services they receive? Or is it simply that the unique visibility of this tax and the political opportunity that represents will forever trump principles of good tax policy and public finance?

We don't know the answer, but it's a problem if for no other reason than property tax policy will continue to devolve into an expensive game of three card monte in which every legislative session targets the latest aggrieved property owner. That will score votes but it will not address the fundamental problems: growing opportunity costs for all other state government-provided services and responsibilities, and a local finance system in which responsibility for spending is increasingly disconnected from the responsibility of paying for it. ■

How Would a Pay Raise Affect Lawmaker Performance and Legislature Diversity?

If academic research findings apply here, any decision to give our lawmakers a raise is best based on recognition of their hard work in the service of Minnesota citizens rather than on an expectation that our legislature would look or perform differently.

Last November, by over a 4 to 1 margin, Minnesota citizens stripped lawmakers of their authority to establish their own compensation levels and passed that responsibility on to a new Legislative Salary Council. The 16-member council has two members from each of the state's congressional districts, with representation split evenly between the DFL and GOP, and the governor and chief justice of the state supreme court each appoint 8 of the members. The council must prescribe salaries for legislators by March 31st which will then take effect at the beginning of the new fiscal year.

State legislator compensation levels differ dramatically around the country ranging from essentially volunteer work to salaries resembling what full-time white collar professionals would expect. Such diversity begs the question of whether or not legislative compensation levels influence various legislative outcomes, overall productivity, or perhaps the actual make up of state legislative bodies. In preparation for a recent presentation to the Legislative Salary Council, we took a look at what scholars have concluded on the relationship between legislative pay and these issues.

Getting What You Pay For

The composition and performance of legislative bodies has been an irresistible topic for political science researchers for many decades, so it's not surprising compensation and its influence has been part of this growing body of empirical research. Studies have found associations between legislative compensation and a wide variety of issues. Some findings are quite intuitive: when legislators are paid more they are less likely to pursue outside employment when in office[4] and more likely to run for reelection.[5] Other studies have found that higher pay is associated greater electoral competition,[6] more party involvement in recruiting candidates,[7] and even a greater tendency to favor citizen interests over business interests.[8]

With respect to the legislative process itself, one interesting study found that higher pay reduced the rate of delegation of policy making to state agency staff.[9] Lawmaking comes in a continuum of forms ranging from broad language conveying general legislative intent to highly detailed and prescriptive language attempting to address most every possible administrative detail and enforcement circumstance. In the former case, states must rely more on administrative rulemaking processes and experts in executive branch agencies to put "meat on the bones" with respect to interpreting, administering, and enforcing the law itself. This study found that the more legislators are paid, the less reliance there is on administrative rulemaking and experts in the state bureaucracy to interpret and apply the law.

All of these findings suggest there are important relationships between how much we pay legislators and the kind of government we get in return. But some new studies have taken the next step to focus specifically on what compensation does or does not accomplish regarding individual legislator performance and whether greater economic diversity among lawmakers can be supported by higher pay.

Pay for Performance?

Legislator performance can be evaluated with respect to both productivity and behaviors. An exceptionally ambitious 2013 study took on both these performance dimensions using 60 years of data on state legislators.[10] With respect to productivity, the researchers examined both bills passed and participation in roll call voting. (Fun fact: failing to show up for roll call votes is called "participatory shirking" in political science literature.) In both cases, researchers found statistically significant results linking increasing legislator pay to improved rates of bill passage and decreased numbers of missed votes. However, in each case the actual impact itself was extremely small. For example, a 100% increase in salary increased the share of bills passed by only 1%, and decreased the probability of a missed vote by just 2%.

With respect to legislative behavior, researchers found that higher pay caused legislators to increase the time spent on both fundraising and constituent services. Why? Because the study also found that higher pay was likely to cause legislative candidates to face more competition. And notably, the time devoted to these activities seems to come at the expense of some other important legislative work. The study found a negative relationship between pay levels and time spent studying proposed legislation, building coalitions within a party and a highly significant but negative relationship between pay and efforts to build coalitions across parties.

The link between pay and legislator characteristics and outcomes was also very weak. The same study found no discernible effect from pay levels on state legislators' gender, race, age, education, or experience. Higher pay did not reduce levels of political corruption. And there were no apparent impacts on the actual fiscal outcomes. Neither state expenditures nor taxes per capita nor income per capita demonstrated a statistically significant relationship with pay levels, leading researchers to conclude, "there is no evidence that paying higher salary helps improve fiscal discipline." All in all the researchers question the role of salaries as a meaningful influence on legislative performance and conclude, "Our results lend caution to common claims that increasing politician salary would significantly increase the quality of U.S state government."

A More Representative Legislature?

An alternative reason often cited for increasing legislator pay is to improve the economic diversity and barrier for middle- and working-class individuals to serve as legislators. Less flexible work schedules and less savings can make serving in office simply unaffordable. The previous study offers a potential counterpoint to this argument: higher pay makes legislative office more competitive. As a result, higher pay may attract an even larger number of individuals from higher wealth, white-collar professional demographics.

A 2016 study by scholars from Duke University and the University of North Carolina examined whether legislative pay levels have an impact on the economic diversity of state legislatures.[11] Their findings and conclusions are in stark contrast to much of the conventional wisdom surrounding this topic:

- In states that pay legislators higher salaries, working class citizens make up smaller shares of the state legislature, not larger ones. Political representation of workers is worst in states with salaries over $75,000 (about 2% of all legislators) and best in state that pay legislators next to nothing (about 7% of all legislators). For reference, working class (defined as manual labor, service industry, clerical, and union jobs) represents about 52% of the general public.

- Simple findings like these can hide or distort deeper relationships that may exist. As a result, the researchers conducted numerous statistical tests to see if various factors influenced the findings. These included state demographic features (e.g., measures of state economic inequality, poverty rates, degree of urbanization, unionization rates, etc.) political characteristics (e.g. cost of state campaigns, existence of term limits, distance to state capitol, partisan composition of legislature, competitiveness of state parties, etc.) and economic considerations (e.g. per capita income, size of state budget, average per capita income, etc). After examining and controlling for these variables, their original findings remained unchanged – and in many cases were strengthened. The researchers con-

4 "Working Outside of the House (and Senate): Opportunity Costs and Outside Careers in U.S. State Legislatures," Maddox, Legislative Studies Quarterly 29, 2004

5 "A Political Economy Model of Congressional Careers," Diermeier, Keane and Merlo, American Economic Review, 2005

6 "Do Higher Salaries Lead to Higher Performance? Evidence From State Politicians" Hoffman and Lyons, October 2015

7 "Where Women Run: Gender and Party in the American States" Sanbonmatsu, University oif Michigan Press, 2006

8 "The Voter's Blunt Tool" Bowen and Mo, Journal of Theoretical Politics, 2016

9 "Experts, Amateurs, and Bureaucratic Influence in the American States", Boushey and McGrath, 2015

10 Do Higher Salaries Lead to Higher Performance? Evidence From State Politicians" Hoffman and Lyons, University of Toronto, October 2015

11 "Does Paying Politicians More Promote Economic Diversity in Legislatures?" Carnes and Hansen, American Political Science Review, November, 2016

From The Director: Government Budgets, Scarcity and Our Lizard Brains

Mark Haveman

One of my favorite authors is Michael Lewis, the bond trader-turned-non-fiction author who has entertained his readers with behind the scenes looks at such topics as the subprime mortgage debacle, front-running stock traders, and the use of advanced statistics in baseball to gain competitive advantage.

One of his lesser known books is Boomerang: Travels in the New Third World – a guided tour of places around the world where individuals, institutions and entire nations have embraced instant gratification over fiscal responsibility and are now paying the price. One stop is California, where he documents that state's financial problems and increasing amounts of service level insolvency in government. Figuring out how California got to this point takes Lewis to former Governor Schwarzenegger, numerous state and city officials, municipal bond gurus, citizens, and even neuroscientist Dr. Peter Whybrow, who provides this take:

> *Whybrow argues, in effect, that human beings are neurologically ill-designed to be modern Americans. The human brain evolved over hundreds of thousands of years in an environment defined by scarcity. It was not designed, at least originally, for an environment of extreme abundance. "Human beings are wandering around with brains that are fabulously limited," he says cheerfully. "We've got the core of the average lizard." Wrapped around this reptilian core, he explains, is a mammalian layer (associated with maternal concern and social interaction), and around that is wrapped a third layer, which enables feats of memory and the capacity for abstract thought. "The only problem," he says, "is our passions are still driven by the lizard core.*
>
> *When faced with abundance, the brain's ancient reward pathways are difficult to suppress," says Whybrow….The richest society the world has ever seen has grown rich by devising better and better ways to give people what they want. The effect on the brain of lots of instant gratification is something like the effect on the right hand of cutting off the left: the more the lizard core is used the more dominant it becomes.*

As a successful, wealthy, high income state, Minnesota wants it all, and that's not bad. For much of the last half century, scarcity has intruded on these ambitions only episodically – in recessions both great and small. But demographic trends portend a future in which the concept of scarcity will play a much larger role compounded by a federal government less willing and able to lend a hand.

Entering an era of greater scarcity, what have become the "better and better ways" to give people what they want from government? The cautionary lesson from California comes from a public policy scholar in Lewis' book, "The system is actually very good at giving Californians what they want. People want services and not to pay for them."

Thankfully, we are nowhere near California in this regard with respect to our tax and fiscal system. But it's not difficult to find symptoms – the merits of tax policy evaluated exclusively on ability to pay, an increasing fixation on using tax credits to tackle what should be matters of appropriation, an unhesitant willingness to saddle future taxpayers with current public pension financing obligations, resistance to new user revenues for transportation funding, and as this issue highlights, objection to levels of property taxation that are still a bargain by most any objective definition.

This organization was founded 90 years ago on the idea that accurate tax pricing is a key to ensuring that the levels of service citizens demand of government are calibrated with their desire to pay for them. As revenue growth weakens with demographics and the state and federal aid spigot slows making government resources more scarce, it will be interesting to see if our expectations, demands and priorities adjust accordingly, or if a have it all mentality wins out – with potential long range consequences.

— M.H.

cluded, "Regardless of how we analyzed the data, we consistently found states that offer higher salaries to their legislators have fewer working class politicians, not more."

- Higher pay does do one thing – attract career politicians. States that pay more to legislators are more likely to attract people that work exclusively in politics. And although this "career politician" path might be considered an avenue to increased economic diversity, the researchers found "career politicians with working class backgrounds are no more likely to run, win and run again in states that pay more."

The conclusion of this investigation throws a rather large wet blanket on the idea legislative pay has potentially transformative power on legislative representation. As the authors rather bluntly state regarding the lesson of this study, "Activists and political observers should stop saying that raising legislative salaries would make holding office more accessible for middle- and working-class Americans or that it would reduces class–based political inequities. It probably wouldn't."

What does all this mean for Minnesota's legislative salary decision-making? Studies like these are not last word on this topic but they do suggest that any big expectations about different legislative results or a different composition of legislators resulting from higher legislative pay need to be ratcheted back. The decision to give our lawmakers a raise is best based on recognition of their hard work and dedication in the service of Minnesota citizens rather than on an expectation that our government will look or act differently. ■

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