FISCAL FOCUS

MINNESOTA CENTER for Fiscal Excellence

Sound tax policy. Efficient spending. Accountable government.

May – June 2015 Volume XXXVI No. 3

In This Issue:

The Tax Bill That Wasn't

No omnibus tax bill this session is a source of consternation and frustration for many. But there is a silver lining.

If Minnesota's 2015 legislative session is remembered for the absence of a tax bill, it may also be recalled for the pop culture references from House Tax Chair Greg Davids reflecting the emotional swings surrounding the tax bill's fate as the clock wound down. We heard pessimism from the Beatles ("Imagine There's No Tax Bill"), the ray of hope from Journey ("Don't Stop Believing") and a final plea for perseverance from Larry the Cable Guy ("Git-R-Done").

In the end, the exhortations proved to be for naught – primarily because the tax bill ended up handcuffed to the transportation finance stalemate. Legislators' failure to produce an omnibus tax bill in a budget session does truly appear to be a rare moment in state history. Having checked in with a couple of long time Capitol veterans, this seems to be a "first" in at least 40 years. There have been sessions with vetoed omnibus tax bills; there have been non-budget sessions without a tax bill; there have been budget years with a tax bill arising out of a special session; but no one can recall an odd-numbered year with no tax bill.

> One underappreciated fact: the state has a long ways to go to reach the budget reserve levels being recommended by MMB.

Even without the transportation roadblock, conferees still had their work cut out for them. The House and Senate tax bills reflected very different priorities, philosophies, and perhaps most importantly, numbers. The initial meeting of the tax conference committee probably best captured the magnitude of these differences. For the "walk through" of the 101-page side-by-side comparison of the House and Senate bills, non-partisan staff was asked to focus only on provisions that both bills addressed in some way. Staff provided that review and answered follow up questions from committee members in a very tidy 75 minutes.

A key theme of the House's tax bill was tax relief, to the tune of around $2 billion over the FY 16-17 biennium. A phaseout of the statewide business property tax, a phased-in exemption for Social Security income, and a two-year increase in the personal and dependent exemption amounts were among their relief initiatives. The House's tax bill also took on the state's transportation funding issues by dedicating sales tax revenues from certain auto-related sales to transportation, stripping them from the general fund. The House bill also promoted the idea of "property taxpayer empowerment", largely by requiring local government referenda to be held at a general election and by creating a process for voters to initiate a reverse referendum on property tax levy increases.

In contrast, the Senate bill spent far less money – $450 million over the biennium. The biggest piece of that pie came from shifting some aid payments to local governments forward – essentially putting another arrow in the state's budget balancing quiver by undoing a shift the state enacted in the 2000s. Additional support for the Local Government Aid and County Program Aid programs clearly demonstrated a desire to provide additional dollars for local governments. Finally, the Senate bill had a considerable "reform" ambience (whether such reforms were needed is of course, in the eye of the beholder) with changes proposed to the state's corporate tax regime, the assessment and taxation of railroad property, and the taxation of electric generating machinery.

Predicting what "would" have happened is a futile exercise because it's difficult to know which provisions are true legislative priorities and which are campaign literature bait or pure cannon fodder for negotiations. Based on bill introductions and the content and tenor of committee hearings in both bodies, however, we would not have been surprised to see some sort of reduction in the statewide business property tax and changes to the estate tax – especially in the areas of federal conformity and portability of unused exemptions between spouses – make their way into a final agreement.

Of course, the failure to launch a tax bill has created some collateral damage for changes that people generally agreed needed to happen. The city of Rochester had hoped for clarifying changes to the DMC financing statute to prevent some potential problems with the project in the near future. Housekeeping provisions in the Department's technical and policy bills fell by the wayside. The public finance bill and changes the League of Minnesota Cities

Minnesota Center for Fiscal Excellence

Susan Haffield, *President*
Aaron Twait, *Research Director*
Mark Haveman, *Executive Director*
Linda Edstrom, *Executive Secretary*

The Minnesota Center for Fiscal Excellence is a non-partisan, non-profit corporation founded in 1926 to advance economy and efficiency in government.

Fiscal Focus is published bimonthly for $150 per year by the Minnesota Center for Fiscal Excellence, 85 East Seventh Place, Suite 250, St. Paul, Minnesota 55101. ISSN # 1042-847X. UPS #519130. Periodical paid at St. Paul, MN 55101.

Postmaster, send address changes to:

Fiscal Focus
c/o Minnesota Center for Fiscal Excellence
85 East Seventh Place, Suite 250
St. Paul, Minnesota 55101

Phone: (651) 224-7477 or (800) 322-8297
Fax: (651) 224-1209

E-mail: question@fiscalexcellence.org
Web Site: www.fiscalexcellence.org

hoped to see in the tax increment financing area have gone for naught. And changes to how the state determines residency for tax purposes – provisions that were largely the same in both the Senate and House bills – will probably have to wait until next year, creating additional headaches for the state's business community.

Patience May Be A Virtue

All this suggests there will be considerable pent up demand for action next March when the legislature convenes. A major tax bill, even in a bonding year, is almost a certainty. A legislative session without a tax bill will be a source of frustration and disappointment for many. But it's not a completely bad thing.

One underappreciated fact surrounding the unused surplus and its "roll over" into next year is that the state has a long ways to go to reach the budget reserve levels being recommended by MMB per statute. We have reproduced information from MMB's most recent budget reserve report, from January, below. As the agency's accompanying narrative notes, "the current funded balance in Minnesota's budget reserve and cash flow accounts remains well below MMB's recommended level given the underlying volatility of Minnesota's tax structure." In fact, as **Table 1** indicates, the state's reserves sit $822 million below the level MMB is recommending for the upcoming FY 2016-17 biennium.

As MMB has noted, the "price" of a tax system more reliant on high income taxation and the accompanying higher growth rates of general fund tax receipts is a willingness to assume greater volatility. We are now experiencing the buzz of stronger revenue growth, but we have yet to experience the hangover of big revenue swings.

As a result, a sense of caution and conservatism is warranted. Adopting major tax or spending changes in the euphoria of a one-year surplus may quickly prove to be shortsighted. Even if this unused surplus is never rolled over into the budget reserve, another year's worth of economic performance and revenue collections that (hopefully) continue to exceed forecast expectations will provide the additional cushion necessary to embark on any tax and spending proposals next session with bit more confidence.

That's an idea that seems to resonate with several legislators on the record and likely a lot more off the record. It won't make editorials about "failed legislative sessions" go away, but this time next year it may prove to be smart fiscal policy. Between now and then, Chair Davids may well feel compelled to invoke Tom Petty and the Heartbreakers – "The Waiting is the Hardest Part." ■

Table 1: Summary of 2015 MMB Budget Reserve Report

	Level as of November 2014 Economic Forecast	% of FY 2014-15 Non-Dedicated Revenues	% of FY 2016-17 Non-Dedicated Revenues
Budget Reserve Account	$994 million	2.5%	2.4%
Cash Flow Account	$350 million	0.9%	0.8%
Total Current Reserves Balance	**$1.344 billion**	**3.4%**	**3.2%**
MMB Recommendation: FY 2014-15	**$1.990 billion**	**5.1%**	**--**
MMB Recommendation: FY 2016-17	**$2.166 billion**	**--**	**5.2%**

Source: Minnesota Management and Budget

When You Wish Upon a Star, Taxes Matter

A new research study concludes state taxes affect the location decisions of high-end scientific talent. It also shows Minnesota has a lot at stake – and potentially a lot to lose.

Do people move in response to taxes? It's a perpetual debate; pitting anecdotes from business, accountants, and financial planners against progressive interests backed by research that has generally found very modest – if any – causal relationships between taxes and migration. Now a new National Bureau of Economic Research working paper[1] sheds some interesting new light on this timeless topic. It finds that relative state taxes do affect the location decisions of some of the most important players in state competitiveness: the best and brightest in the scientific community.

> Overall, the researchers conclude, "state taxes have significant effect on the geographical location of star scientists and possibly other high skilled workers."

The paper, *The Effect of State Taxes on the Geographic Location of Top Earners: Evidence from Star Scientists*, is a joint investigation by two economists from the Federal Reserve Bank of San Francisco and the University of California, Berkeley. Noting that relatively little empirical work has been done on the "effects of taxation on the spatial mobility of individuals" the researchers sought to quantify the sensitivity of state-to-state migration by high skilled workers in response to personal and business tax differentials across the country.

The researchers focused their investigation on "star scientists," defined as scientists in the private sector, academia, and government with patent counts in the top 5% of the distribution – in other words, the most productive scientific minds in the country. These individuals are a prime study target for two reasons. First, by definition, such highly productive and sought after individuals are likely to be among the highest groups of income earners. Second, in the words of the authors, "their locational decisions have potentially large consequences for local job creation." Other studies have shown that the presence of "all star" scientists have implications for the establishment of research and development facilities and, in some cases, entire industries. Making this group even more interesting is that star scientists turn out to be a rather mobile bunch. According to the study, star scientists are almost four times as likely to migrate from one state to another as an aver-

1 Enrico Moretti and Daniel Wilson, *The Effect of State Taxes on the Geographic Location of Top Earners: Evidence from Star Scientists*" Working Paper 21120, National Bureau of Economic Research, Cambridge MA, April, 2015 http://www.nber.org/papers/w21120

age citizen and almost three times as likely to do so as someone with a professional or graduate degree.

The researchers created a unique data set combining information on top scientists based on patents issued between 1977 and 2010, their state of residence during those years, and changes in state-level individual and corporate taxation during this period. The result was over a quarter million "star-scientist year observations" which provided information on how many star scientists were "movers" and how many were "stayers." Importantly, the study's authors focused on state "pair effects" over time (e.g. the 30-plus-year history of star scientist migration between pairs of states, such as Minnesota and California). Incorporating this concept into the methodology controlled for "typical" migratory flow between states due to factors that are more or less permanent (e.g. nicer weather and the existence of Silicon Valley).

The result? In the words of the authors, "we uncover large, stable and precisely estimated effects of personal and corporate taxes on star scientists' migration patterns." Specifically, the investigators found that for taxpayers with incomes at the 99th percentile of their state, a one percentage point decline in a state's marginal tax rate is associated with a 1.7 percentage point change over the long-run in the out-migration and in-migration rates of star scientists. To illustrate, their estimates imply that the effect of New York's reduction in its marginal tax rate at the 99th percentile from 7.5% to 6.85% in 2006 (0.65 percentage points) was 12 fewer star scientists moving away and 12 additional star scientists moving into the state for a net increase of 24 stars. Overall, the researchers conclude, "state taxes have significant effect on the geographical location of star scientists and possibly other high skilled workers. While there are many other factors that drive when innovative individual and innovative companies decide to locate, there are enough firms and workers on the margin that relative taxes matter."

Corporate income tax changes also impacted star mobility. The reason: star scientists' salaries and those of R&D personnel associated with the star can influence corporate tax liability. The investigators found that corporate tax rate changes affected mobility only among private sector star scientists; academic and government star movements were unaffected. Moreover, corporate taxes only demonstrated a mobility effect in states where wages were included in the apportionment formula for multi-state income. Corporate taxes had no effect on migration where labor's location had little or no impact on the corporate tax bill.

Tests for validity and related topics offered other tidbits. For example:

- Are star scientists really among the top earners in a state? The study found star scientists' movements were sensitive to changes in the 99th percentile marginal tax rate (MTR) but insensitive to changes

From The Director:

Mark Haveman

Our latest edition of our 50 state property tax comparison study represents over twenty years of involvement in national property tax benchmarking and analysis. Over that time we have refined the study and added analytical features to improve the policy value of the report. We are proud to note that it is considered the gold standard of such property tax studies, having been incorporated in numerous tax and fiscal research studies around the country. We continue to be pleased about the attention the report receives on a national basis: the findings from this year's study were included in a news story last month on National Public Radio's *All Things Considered* about property taxation in Detroit. We are especially fortunate to partner with the Lincoln Institute of Land Policy in this endeavor. Their expertise is invaluable. But without their financial support a study like this would simply not be possible.

Many are surprised to learn MCFE membership dues account for only about two-thirds of our modest operating budget; the rest comes through annual contracts or charitable contributions to our 501c3 arm, the Minnesota Foundation for Fiscal Excellence. It is not hyperbole to say these non-dues revenues are the lifeblood for our special tax and fiscal policy investigations and no less essential to the fiscal health and sustainability of the organization.

If you appreciate the analysis and insight these studies offer and the voice we provide, please consider making a tax deductible donation to the Minnesota Foundation for Fiscal Excellence. Your contribution will support two major studies comprising part of our 2015 Foundation workplan:

- **Multistate Individual Income Tax Comparison Study (Payable 2013)** – Our other flagship effective tax rate study, we calculate effective tax rates and income tax burdens for 42 income/filer type combinations in every state with an individual income tax. Notably, this year's edition for the first time will capture the effects of the 2013 tax changes.

- **Minnesota State Competitiveness Study** – We are planning a reprise of our popular 2012 investigation on tax and foundational competitiveness issues and policy implications. We anticipate a special focus in this edition on areas of state performance where we are a standard deviation above/below national performance averages.

Please join us in advancing sound tax policy, efficient spending, and accountable, fiscally responsible government in Minnesota.

And thank you for your support!

— M. H.

to state tax rates affecting the 50th percentile MTR (i.e., middle incomes).

- What is the timing of these effects? The researchers found no evidence of pre trends – changes in mobility followed changes in taxes and did not precede them. In addition, mobility effects were small in the short run but grew over time, presumably because it takes time for firms and people to relocate.

- Should we understand the cause and effect relationship the other way around – i.e. do states raise and lower marginal tax rates in response to the economic situations faced by stars and their employers? The study found no evidence that changes in state taxes were correlated with the fortunes of the employers operating in the state.

Land of 600 Stars

What might this all mean for Minnesota? First, we have a lot at stake and potentially a lot to lose. According to the study, Minnesota was home to 593 star scientists in 2006, placing us 6th in the nation and trailing only states with far larger economies like California, Texas and New York. In fact, on a per capita basis, Minnesota has more star scientists than any of its high performing peers. It seems likely that these highly coveted individuals, with their rich professional networks and business relationships and their magnet-like ability to attract capital, are one of the unheralded factors of Minnesota's economic success.

The study also provides information on the bilateral relationship Minnesota has with nine of our primary competitor states. Looking more closely at that data, from 1997 to 2006 Minnesota was a net star scientist "exporter"; 32 stars left Minnesota to reside in one of these nine competitor states while 26 stars from those states came here. This was prior to the 4th tier creation which increased the state's top income tax rate from 7.85% to 9.85%. Increasing the marginal tax rate on top earners would seem to place Minnesota at even higher risk of being a net star scientist "exporter", with economic consequences that are not insubstantial given the jobs and other economic activity associated with these individuals.

> Rather than triggering "I told you so," headline-grabbing headquarters closures or mass relocations, any tax-induced effects will be hidden in the slow, imperceptible leakage of high-end talent over a period of many years.

With respect to corporate income taxes, this study casts additional light on how important single sales factor apportionment likely is to Minnesota's competitiveness. Economists generally regard state corporate income taxes as bad tax policy to begin with, and Minnesota's competitiveness is certainly not

Minnesota Findings from Our 2014 50-State Property Tax Comparison Study

The 2014 edition of *MCFE's 50-State Property Tax Comparison Study* has now been published by the Lincoln Institute of Land Policy. It's the fourteenth edition in the series and the fourth we have produced in conjunction with the Institute. The full report is available through the Lincoln Institute's "Significant Features of the Property Tax website (http://www.lincolninst.edu/subcenters/significant-features-property-tax/)

Each year we also publish our own issue-brief summarizing and highlighting key Minnesota-related findings. This year's highlights include:

- Burdens on Minneapolis homeowners are relatively average. When we set the home value for the largest city in each of the nation's 53 property tax systems at the median value – which allows for comparisons of homeowners in similar situations – the tax burden in Minneapolis is $2,905, $208 above the national average. However, the effective tax rate (taxes compared to home value) is 1.468%, about 4% below the national average. In other words, although property taxes on the median-valued home are higher, Minneapolis' relatively high home values result in a lower effective tax rate.

- Property taxes on commercial properties in Minnesota continue to rank high in both urban and rural settings. For $1 million- and $25 million-valued commercial parcels, taxes on Minneapolis properties ranked sixth, down one spot from last year, and were 20% to 25% above the national averages. In our rural city rankings, commercial property taxes in Glencoe ranked 2nd highest nationally at the $1 million and $25 million level – unchanged from last year – and were 85% to 95% above the national averages.

- Minnesota's statewide general property tax has significant implications for business property tax competitiveness. Its elimination would reduce the tax on $1 million and $25 million commercial parcels in Minneapolis from 60-65% to 20-25% above the national average. Similarly, eliminating the statewide general property tax would reduce burdens on $1 million and $25 million commercial properties in Glencoe from 85%-95% to 45%-50% above the average.

- Minnesota's business subsidization of local homeowner property taxes is 13th highest in the nation. A $1 million commercial property in Minneapolis paid 115.7% more in local property taxes on its share of property value than a homeowner in the median-valued home. This level of local property tax subsidization is the highest recorded in the study since payable 2002, before the effects of the 2001 property tax reforms were fully implemented.

The issue brief, *MCFE's Pay 2014 50-State Property Tax Comparison Study: Minnesota Results*, is now available on our own website under the "Studies" link.

enhanced by having the third highest rate in the nation. Experts have long recognized that single sales apportionment takes out some of the sting of this tax – particularly for our larger domiciled headquartered companies with a lot of physical presence in the state. This study finds an added benefit – by ensuring labor's location has no impact on the corporate tax bill, single sales apportionment also reduces any incentive corporate taxation might have on star scientists to migrate from Minnesota.

Perhaps most importantly, the study suggests that any negative impact from the fourth income tax tier will materialize very gradually over time. Rather than triggering "I told you so," headline-grabbing headquarters closures or mass relocations, any tax-induced effects will be hidden in the slow, imperceptible leakage of high-end talent over a period of many years. And even more hidden, but no less significant, is the potential in-migration of star talent that never materializes.

This lack of highly visible cause and effect relationships makes any push to reconsider past tax policy decisions much more difficult. This is especially true for Minnesota, which has one of best performing state economies in the nation by most any measure and which seems impervious to new tax burdens. Yet if these findings are true, Minnesota policymakers have some new things to think about with respect to the state's long-term economic interests.

Minnesota policymakers are keenly attuned to the vital importance of growing and developing a high quality workforce to ensure our future economic success. But the mobility of the workforce is another important factor to consider when developing policies to improve state competitiveness. Creating star scientists is a fantastic public policy objective. Retaining the ones we create and attracting more of them is no less important. ■

A Math Problem Called Education Finance

The balking and resistance to universal pre-K is symptomatic of a larger issue: the failure of state education aid to keep up with the rising costs of school district collective bargaining agreements.

For all the concern expressed over oil tanker cars and railroad crossings this session, education finance deserved to be policymakers' chief derailment worry. The House/Senate agreement that neglected to fund the Governor's top priority of universal pre-K sent the 2015 legislative session skidding off the tracks and helped trigger a mangled, ill-tempered mess that will require a special session to repair.

To some extent, this political drama over how to spend education money masked the bigger, never-ending debate about the adequacy of basic education funding. When each majority caucus (House GOP, Senate DFL) released their proposed increases in basic general education aid earlier in the year, school district officials expressed considerable frustration. News stories arose about the "fiscal cliff" looming for school districts and severe lay-offs already being implemented in spite of receiving a 3.5% increase in the per pupil formula this biennium. District officials' arguments clearly made an impact. The conference committee agreement included an increase of 1.5% in FY 2016 and 2% in FY 2017 – $87 and $118 per student, respectively.

Is this enough? Is 3% or more per year needed? Should 1% be able to suffice? Answering this question is difficult because the cost structure of K-12 education delivery is unique to each of Minnesota's 300+ school districts. State mandates and environmental factors have considerable influence over these cost structures. But so do decisions districts make themselves, especially with respect to what is by far their largest purchased expense – people. According to Department of Education data, nearly 80% of schools' general fund spending pays for compensation in some form or another – most of which they negotiate through collective bargaining agreements that almost always include some sort of inflationary increases in wages and/or benefits. Since each school district independently manages most of its inflationary destiny through the collective bargaining process, applying even the commonly used litmus test of adequacy – "keeping up with education inflation" – is complicated.

> Since each school district independently manages most of its inflationary destiny through the collective bargaining process, applying even the commonly used litmus test of adequacy – "keeping up with education inflation" – is complicated.

Since labor costs represent such a large piece of school budgets, the relationship between district labor cost trends and revenue availability is a key determinant of school finance adequacy. How this relationship evolves over time is a key determinant of school finance sustainability. As part of a forthcoming MCFE report on the evolution of school district cost structures and the implications for education finance, we have taken a closer look at how labor compensation trends have compared to the provision of state aids.

We began by obtaining Minnesota School Board Association (MSBA) data on the settlements districts negotiated with their teachers over the past ten years (FY 2006 – FY 2015). These self-reported financial summaries project the increases in salary and benefits costs that districts expect the new two-year contract to necessitate.[2] We converted these to per-full-time equivalent (FTE) costs using the employment counts provided with the contract data. It's important to note that actual compensation growth changes over a contract period will vary from these forward-looking projections due to retirements, new hires, layoffs, and related teaching staff adjustments taking place during that time. Moreover, since these financial summaries deal only with teacher contract settlements and do not include settlements with other district employee unions, these reports can only serve as a proxy for district labor cost trends. Nevertheless, they present the most accurate snapshot available of how individual districts expected their compensation costs to change over each two-year contract period, and for which they would need to plan accordingly.

MSBA provided complete data (i.e., including all five contract periods) for 252 districts.

[2] Settlement reports include districts' defined benefit retirement plan contributions even though they are set by the state and districts are prohibited by law from negotiating them.

Figure 1: Average Growth in Annual Average Contractual Compensation Costs per Teacher (FTE Basis), Contractual Periods From FY 2006 to FY 2015, by District

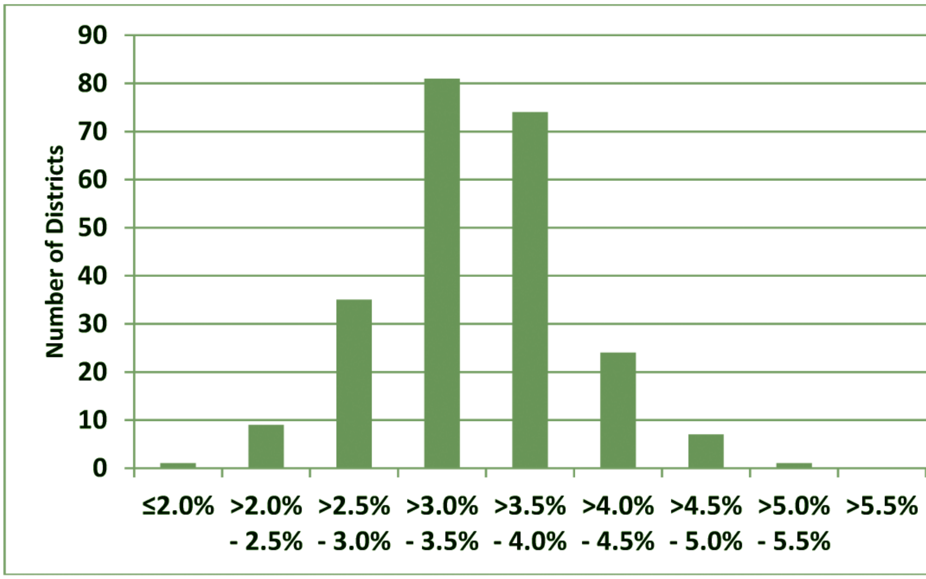

Figure 1 describes the distribution in the average annual growth, by district, in the average per teacher (FTE basis) compensation costs these districts negotiated over this ten-year period. As the figure shows, compensation growth resulting from contract settlements is far from homogenous across the state. However, the majority of districts negotiated teacher contracts that provided, on average, 3% to 4% per year growth per FTE in salaries plus benefits over this ten year period.

How do these district-level cost trends match up with state aid over this period? After adjusting for changes in the way the state weights pupils, basic per pupil formula aid (which constitutes 80% of all general education aid the state provides to districts) increased at an average annual rate of only 1.63% over this same period – or about half the rate of average projected district compensation expense. It's not difficult to understand the reports of staffing and education program cuts, growing classroom sizes, and the exceptionally well-documented rebound of school district property taxes in light of such numbers.

The challenge this presents to district finances can also be illustrated by examining the relationship between state aids and cost growth within a given contract period (**Table 2**). The median total compensation cost at the beginning of the most recent FY 2014-15 contract period for all districts for which MSBA provided data was $67,457. These districts projected a median per-FTE increase in compensation costs for the FY 2014-15 contract period of 3.77% per year – on the higher end of recent norms, but not particularly surprising coming out of the Great Recession. Columns 2 and 3 of the table highlight the resulting increase in district employment costs based on this median contract agreement and the median year on year change over the contract period.

Column 4 of the table shows the changes in the basic general education formula over the past two years, on a per pupil basis. Dividing the compensation cost change by the per pupil aid increase yields the number of students required to cover the additional compensation cost associated with one "median" teacher that these contracts impose (Column 5).

To put these 2014 and 2015 break-even totals in some perspective, data from the Minnesota Department of Education indicates that there are about 15.5 students per full-time equivalent teacher for 2014-15 school year – far fewer than would be needed to support this level of compensation growth.

Projecting forward using the K-12 education conference committee's proposed basic formula increase and an historical 3.5% annual growth in compensation cost per FTE, we see modest improvement in the pupil teacher "coverage ratio." But in the aggregate, these numbers suggest districts would continue to fall further behind.

Of course, schools' fiscal reality is much more challenging than these numbers suggest:

- School districts also use state aid to compensate management, administrative staff and support staff. Adding this population

Table 2: Changes in Median District Teacher Compensation Cost per FTE, Increases in the Basic General Education Formula, and Break-Even Analysis, FY 2014-15

Fiscal Year	Median District Teacher Compensation Cost Per FTE	Cost Change Over Previous Year	Increase in Basic General Ed Formula (per pupil)	# of Pupils per FTE Needed to Achieve Break-Even
End of FY 2013	$67,547	NA	NA	NA
2014	$70,094	$2,547	$78	32.6
2015	$72,736	$2,642	$105	25.2

Note: Assumes median compensation cost grows at median rate of 3.77% annually.

Table 3: Changes in Median District Teacher Compensation Cost per FTE, Increases in the Basic General Education Formula, and Break-Even Analysis, FY 2016-17 (projected)

Fiscal Year	Median District Teacher Compensation Cost Per FTE	Cost Change Over Previous Year	Increase in Basic General Ed Formula (per pupil)	# of Pupils per FTE Needed to Achieve Break-Even
End of FY 2015	$72,736	NA	NA	NA
2016	$75,282	$2,546	$87	29.2
2017	$77,917	$2,635	$118	22.3

Note: Assumes median compensation cost grows at median rate of 3.5% annually.
Note: Assumes 1.5% growth in formula in FY 2016 and 2.0% growth in FY 2017.

of district employees to the analysis only exacerbates the challenge.

- The approximately 20% of school general fund spending that is not compensation-related has its own inflationary pressures, much (if not all) of which the district has little ability to influence or control.

- In urban areas where costs of living are higher and compensation cost structures reflect that reality, the break-even ratio would be higher since most funding formulas provide the same per pupil funding to each district – putting even greater pressure on class sizes, program offerings, and property taxes.

Given all this, it's not difficult to understand why, for example, metropolitan-area school districts pushed to increase the basic formula allowance by at least 4% per year and index the formula to inflation moving forward.

> Basic per pupil formula aid increased at an average annual rate of only 1.63% over this same period – or about half the rate of average projected district compensation expense.

What do we take away from all this?

This helps explain why school district officials appear highly skeptical about universal pre-K. Putting aside the no less challenging questions of whether adequate supplies of space and teachers are available to fill this demand, if districts already have trouble sustaining their existing workforces, it's not difficult to understand why they might balk at compensating even more staff (potentially 2,500-plus teachers statewide). The proposed $173 million for statewide pre-K represents just the start of an expense that will compound over time at growth rates that have historically surpassed basic per pupil aid growth and will likely continue to trend that way given demographic realities. Dismissing administrators' objections as nothing more than generic resistance to change and rebutting their reservations about cost with claims of "we can afford it" based on a single biennial surplus demonstrates a remarkable willingness to ignore the long-term economics of such public spending.

This is why greater transparency on government cost structures matters so much. It takes two signatures to agree to a contract and districts are active participants in the cost structures they create. (Although school board members would undoubtedly question the negotiating leverage they actually have when an actual strike has such profound implications for their constituents.) This is why better and deeper access on public sector bargaining and contract details and their budget implications is so important.

Whether one agrees or disagrees with the concept of public sector unions, the use of collective bargaining constructs in the public sector presents some very unique and special challenges. At the top of the list is that it pits labor interests not against owners of capital but rather against the broader public interest as represented by government officials. Taxpayers have no chance to evaluate how well their government officials are respecting that balance of interests if they are working with partial understanding and incomplete information. ■

Thank you for your support!

For members who prefer to be invoiced mid-year, you will be receiving your dues renewal notice shortly. If possible, please consider upgrading your membership support. Thanks to a generous corporate member all new memberships and **membership upgrades will be matched dollar for dollar up to $25,000**. Help us take advantage of this special opportunity!

And a reminder to all members:

SAVE THE DATE

MCFE Annual Meeting of Members and Policy Forum

October 7, 2015
St. Paul RiverCentre

More Info to Come

MINNESOTA CENTER for
Fiscal Excellence

85 East Seventh Place
Suite 250
St. Paul, MN 55101
(651) 224-7477

Periodical
Postage
Paid
Twin Cities,
MN