How Does Minnesota's Fiscal Effort Compare?

Minnesota's reputation as a high tax state is a function of high rates and collections. Is our reputation still deserved when factoring in states' underlying ability to raise revenue?

With primaries in the rearview mirror and November looming, Minnesotans can expect to hear a lot about the state's tax environment in the next couple months. Minnesota's high tax reputation is heavily influenced by our comparative marginal rates and collections especially in personal and corporate income taxation where we are among the nation's leaders. According to the Pew State Fiscal Health Project, Minnesota is number one in the nation in the share of state revenue coming from taxation.[1] These are attention-getting facts and figures but an important piece of information providing additional perspective is missing: how big of a claim on resources in the state do these collections represent?

State fiscal effort is the extent to which state and local governments actually generate revenue from resources available to the state. It's measured by calculating total own source state revenue collections and dividing it into a measure of a state's capacity to raise revenue.

Measuring state fiscal capacity is done in a number of ways. Gross state product or state personal income (like the Minnesota Price of Government) are the most common measures but have some significant limitations. Our annual *How Does Minnesota Compare* publication employs a modified personal income approach we call "cash income" – removing some sources of personal income that can't be remitted to government to pay for services and including some other income sources than can. Perhaps surprising to many, Minnesota places a relatively modest 18th in national fiscal effort using our cash income measure – a result of Minnesota's higher and more visible individual and corporate income tax collections being somewhat offset by below average sales tax, property tax, and other non-tax own source revenues.

A more comprehensive and complete measure of fiscal capacity comes from the U.S. Treasury Department which each year calculates estimates of each states' fiscal capacity or "total taxable resources" (TTR).[2] It incorporates two important additional considerations – cross border effects (the ability of states to tax the earnings of nonresidents derived from the state and to tax out-of-state earnings of residents) and corporate earnings. The federal government uses TTR in various federal formulas to distribute a wide variety of state aids and grants.

As the accompanying table shows, Minnesota's fiscal effort (total own source revenues / TTR) is 12.3% or 9% higher than the national average placing us 15th in the nation. Of the 14 states demonstrating greater fiscal effort than Minnesota, 10 are states with less fiscal capacity, many substantially so. This includes states like Alabama, Mississippi, and West Virginia which are occasionally invoked during legislative sessions as the states "Minnesota doesn't want to become" even though they are making a greater fiscal effort to support their state and local governments.

State Fiscal Effort
(Total State and Local Own Source Revenues / State TTR, 2019)

	Fiscal Effort	Rank	TTR/Capita		Fiscal Effort	Rank	TTR/Capita
New Mexico	15.4%	1	$55,259	Pennsylvania	11.3%	26	$72,044
Hawaii	15.4%	2	$71,216	Ohio	11.2%	27	$65,055
North Dakota	14.7%	3	$81,403	Louisiana	11.1%	28	$59,064
Alaska	14.5%	4	$76,992	Wisconsin	11.1%	29	$67,999
Mississippi	14.4%	5	$44,373	North Carolina	11.0%	30	$61,830
Iowa	14.1%	6	$68,799	Virginia	11.0%	31	$75,599
Vermont	13.8%	7	$64,722	Colorado	11.0%	32	$76,477
Maine	13.7%	8	$57,541	Illinois	10.8%	33	$78,468
Oregon	13.6%	9	$66,780	Montana	10.8%	34	$58,584
Wyoming	13.2%	10	$82,997	Nebraska	10.7%	35	$74,042
West Virginia	12.9%	11	$51,119	Idaho	10.5%	36	$55,113
South Carolina	12.8%	12	$54,962	Maryland	10.4%	37	$84,179
New York	12.6%	13	$101,358	Missouri	10.3%	38	$61,194
Alabama	12.5%	14	$52,309	Washington	10.2%	39	$90,299
Minnesota	**12.3%**	**15**	**$75,024**	Texas	10.2%	40	$69,241
California	12.2%	16	$86,545	Connecticut	10.2%	41	$101,004
Utah	12.2%	17	$66,386	Nevada	10.0%	42	$67,147
Arkansas	12.1%	18	$51,530	Florida	9.9%	43	$65,133
Kansas	12.1%	19	$70,369	Massachusetts	9.9%	44	$98,433
Oklahoma	11.8%	20	$56,439	Arizona	9.9%	45	$56,924
Michigan	11.7%	21	$60,335	Delaware	9.8%	46	$90,231
Rhode Island	11.7%	22	$72,102	Georgia	9.4%	47	$64,368
Indiana	11.6%	23	$63,043	Tennessee	9.3%	48	$60,248
Kentucky	11.5%	24	$53,938	South Dakota	9.0%	49	$69,934
New Jersey	11.5%	25	$88,307	New Hampshire	8.8%	50	$80,646

This is not a surprising finding, since these states will have to exert much more fiscal effort to obtain an equivalent amount of revenue to support government services because they are poorer. The reality of fiscal effort has prompted the D.C. based Niskanen Center to observe that criticisms of poor states for being low tax and low service are "one of the enduring myths of American political discourse."[3]

For benchmarking purposes it's more illuminating to compare Minnesota fiscal effort to "peer" states with similar fiscal capacities. There are 22 states whose fiscal capacity per capita is within $10,000 of Minnesota, plus or minus. Only six employ greater fiscal effort. Of those six, three (Alaska, North Dakota and Wyoming) benefit from energy influenced tax bases insulating residents from the political pain of fiscal effort because of the ability to export burden. A fourth, Hawaii, likely benefits in a similar manner because of its tourism industry. That leaves Iowa and Oregon, both with less capacity, as the only peer states with a fiscal effort greater than Minnesota.

It's fair to conclude that the Minnesota's fiscal reputation is supported not just by relative tax collections themselves but by the relative fiscal effort generating these collections. There is now political consensus that Minnesota should, and has the ability, to reduce this effort. Based on what currently lies on the table, whether we will accomplish this in a fiscally responsible way that adheres to good principles and prioritizes the economic and competitive interests of the state rather than an influential voting bloc looks more doubtful.

Footnotes

[1] Where States Get Their Money, FY 2020, https://www.pewtrusts.org/en/research-and-analysis/data-visualizations/2022/where-states-get-their-money-fy-2020
[2] See https://home.treasury.gov/policy-issues/economic-policy/total-taxable-resources
[3] *Rich State, Poor State: The Case for Reforming Federal Grant*s, Niskanen Center, December 2019

85 E. 7th Place, Suite 250, St. Paul, MN 55101
(651) 224-7477
info@fiscalexcellence.org