AMERICAN EXPERIMENT

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Dear Members of the House Taxes Committee:

My name is Martha Njolomole, and I am an Economist at the Center of the American Experiment. I thank you for the opportunity to provide comments on HF 1938. I specifically oppose provisions in the tax Omnibus bill to create a fifth-tier income tax credit as well as expand the Minnesota Working Family Credit.

Minnesota already has some of the country's highest income tax rates as well as one of the most progressive income tax systems. Creating a fifth-tier income tax bracket would make us even less competitive and depress economic growth. Additionally, the proposal to expand the working family credit will narrow the tax base, making us even more reliant on a small population of taxpayers. This is unsustainable for the state budget, especially considering our growing government.

Minnesota already relies heavily on the rich

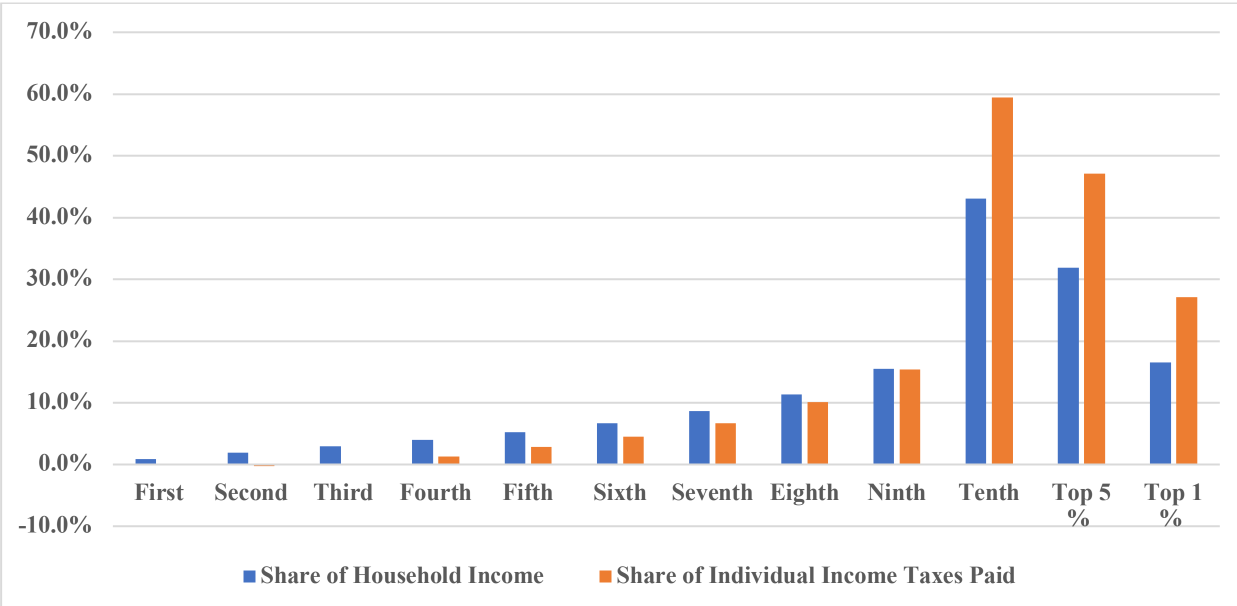
According to the Minnesota Department of Revenue's 2021 Tax Incidence Study, the bottom 30 percent of Minnesota households earned 5.8 percent of all state income. However, not only did they not pay any individual income taxes, but they also received money back from the state.

On the other hand, the top 10 percent of Minnesota households — those earning over $164,000 — received 43 percent of state household income. However, they paid nearly 60 percent of all individual income taxes in the state. Rich Minnesotans contribute a disproportionate share of Minnesota's individual income tax revenues, and they also pay a disproportionate share of income taxes commensurate with their income.

In fact, the share of income taxes paid by the rich has grown more than their share of household income. In 2000, for example, the top 10 percent of Minnesota Households earned 42 percent of all household income. That number has only grown by 1 percentage point as of 2018. However, the share of taxes paid by the top 10 percent has grown by over 4 percentage points between 2000 and 2018.

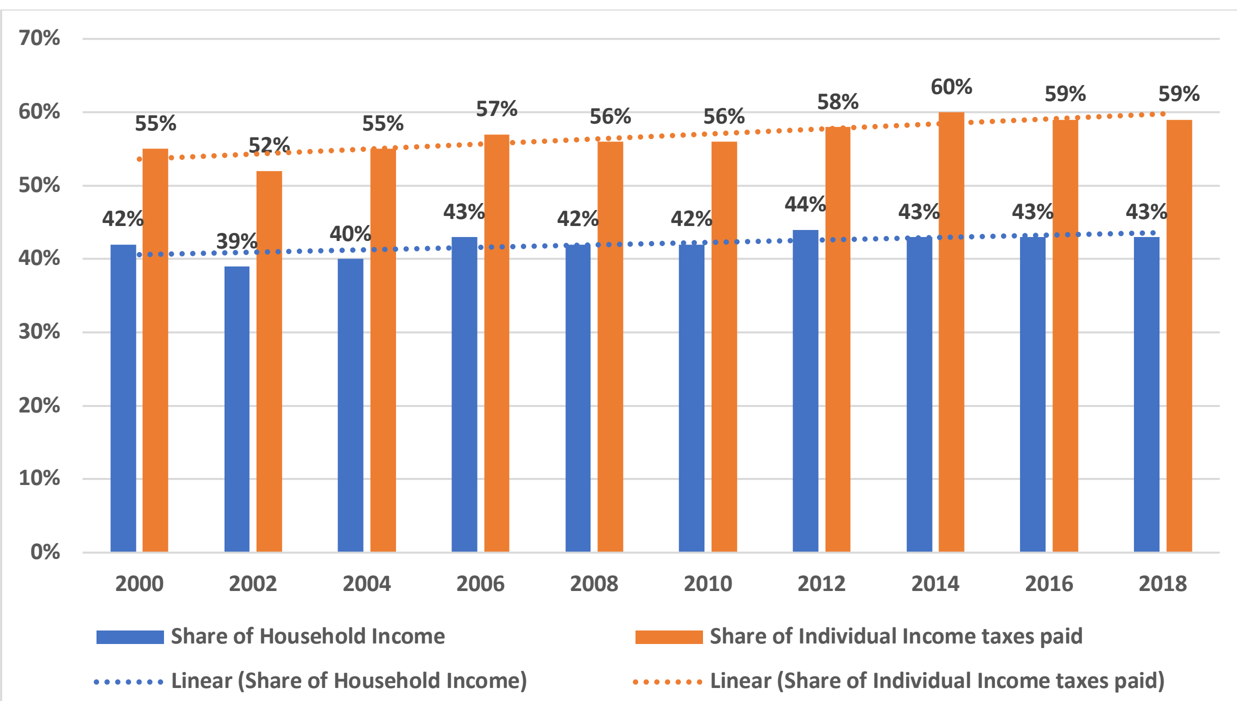
Minnesota's individual income tax system is highly progressive, with income tax rates ranging from -0.7 percent for the bottom two deciles, to 6.4 percent for the top decile. For the top 5 and top 1 percent, these tax rates are even higher at 6.9 percent and 7.7 percent respectively. Creating a fifth-tier income tax rate will make our individual income tax system even more progressive. At the same time, the proposal to expand the working family credit will further reduce tax liabilities for those Minnesotans at the bottom of the income ladder, making Minnesota even more reliant on a tiny segment of taxpayers who already pay most individual income taxes.

Figure 1: Share of state household Income earned and share of state individual income taxes paid by income decile, 2018

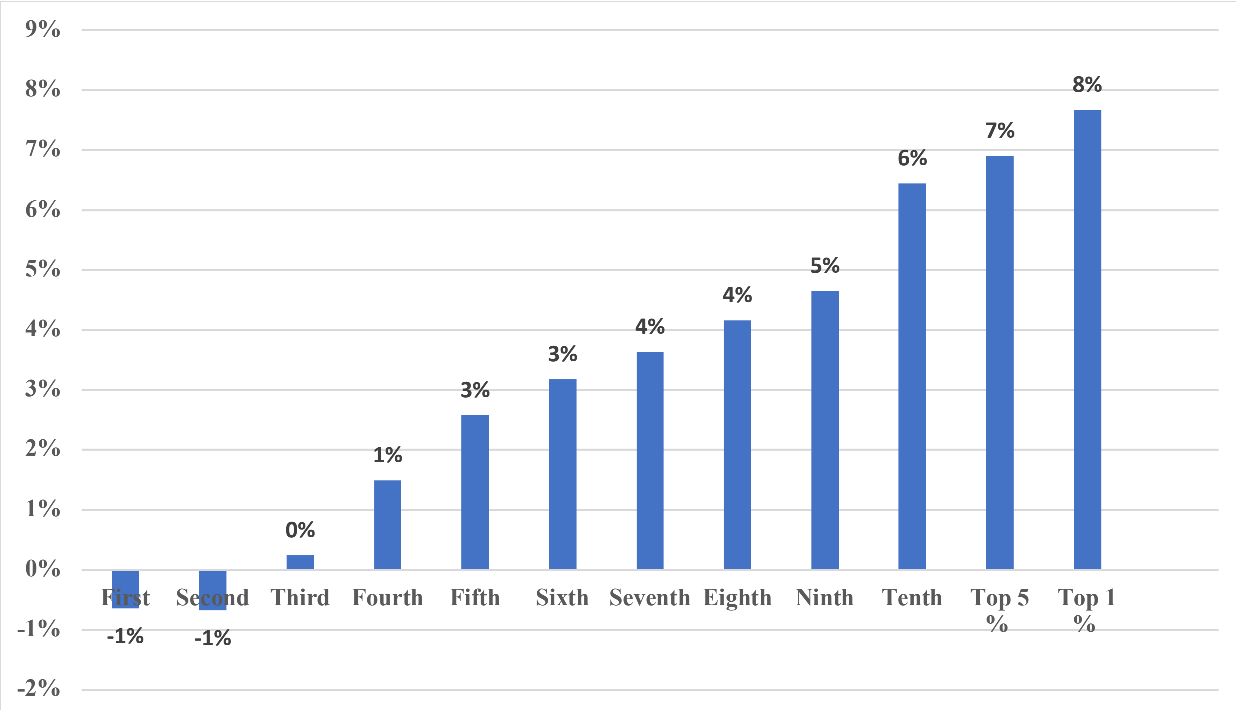


Source: Minnesota Department of Revenue

Figure 2: Share of state household income and income taxes paid by the top 10% of Minnesota households by income



Source: Minnesota Department of Revenue
Figure 3: Effective income tax rates by income decile, 2018



Source: Minnesota Department of Revenue

High taxes are bad for economic growth, and progressive income taxes are even more so

Minnesota already has some of the highest tax rates in the country. According to data from the Tax Foundation, this year, Minnesota's top income tax rate is the seventh highest in the country. If created, a 10.85 percent top income tax bracket will be the fourth highest in the country, only behind California, New York, and Hawaii.

High taxes are, however, bad for economic growth. In a review of the literature measuring the impact of taxes on economic growth, economist William McBride concluded:

> "that there are not a lot of dissenting opinions coming from peer-reviewed academic journals. More and more, the consensus among experts is that taxes on corporate and personal income are particularly harmful to economic growth, with consumption and property taxes less so. This is because economic growth ultimately comes from production, innovation, and risk-taking."[1]

Of the 26 papers reviewed by McBride, 23—88 percent—find a negative impact of higher tax rates on economic growth. The other three papers find no impact. Not one paper finds a positive impact. Of the six studies looking at state tax rates specifically, everyone found a negative impact of high

[1] William McBride, "What Is the Evidence on Taxes and Growth?" The Tax Foundation, Washington, D.C., 2012.

taxes on economic growth. More recent research corroborates this conclusion. Of 12 papers looking at the impact of taxes on economic growth published since 2012, seven find negative effects, the other five find "mixed" or "unclear" effects, and none finds a positive effect.5 Furthermore, research suggests that the negative effects on economic growth from increased taxes are more pronounced when, as in Minnesota's case, taxes are already high

What's worse, research from the Congressional Budget Office (CBO) has found that progressive income tax hikes are even more damaging to economic growth compared to flatter income tax hikes.[2] This is because progressive taxes either on income or labor reduce the incentive for work for high-productive workers as well as the incentive to save and invest relatively more than under a flat income tax system. Making Minnesota's already progressive tax system even more progressive is bound to have a significant effect on the state's already mediocre economic performance

Minnesota is losing middle- and high-income residents to other states, and tax hikes will worsen that trend

Data from the US Census Bureau show that Minnesotans lose residents to other mainly low-tax states. Between 2011-2012 to 2019- 2020, for example, Minnesota on net lost nearly 30,000 residents to other states. From mid-2021 to mid-2022, Minnesota lost nearly 20,000 residents to other states.

While Minnesota loses residents in nearly every income bracket, that trend is more pronounced among high-income taxpayers. From 2011-2012 to 2019-2020, Minnesota, on average, lost residents in every income bracket over $50,000. Minnesota lost the most residents for income brackets between $100,000 to $200,000.

For every income tax bracket under $50,000, Minnesota gained residents during that same period. However, this was still not enough to offset total outward migration, as Minnesota still on net lost nearly 30,000 residents to other states.

Minnesota's income tax system is heavily reliant on the rich. This tax proposal will make it even more so. But with the rich leaving Minnesota at higher rates than other groups, making it more expensive for the rich to stay by creating a fifth-tier income tax rate will worsen this trend threatening the sustainability of the state budget. This is especially so since Minnesota is attracting lower-income residents, who are likely to be an expense to the state and won't pay into the system.

Our socio-economic woes are government made, higher taxes and more spending won't fix them

Certainly, it is noble to try to lower costs for Minnesotans. On housing and childcare, Minnesotans especially face higher costs than many other Americans.

[2] Jaeger Nelson and Kerk Phillips, "The economic effects of financing a large and permanent increase in government spending: Working paper 2021-03," Congressional Budget Office, March 2021.

More taxes and spending, however, won't lower costs. This is mainly because the causes of these relatively high costs have nothing to do with the lack of public spending. Instead, these high costs are largely caused by excessive taxes, fees, and regulations imposed by state and local government, which make it effectively illegal to supply housing and childcare at an affordable price in Minnesota.

Compare Minnesota to South Dakota, for example. While Minnesota requires daycare centers to have 1 teacher per 4 infants and limits group sizes to 8, in South Dakota centers can have 1 teacher per 5 infants with no limits on group sizes. Moreover, in South Dakota, center teachers are only required to be 18, while in Minnesota, they must have a bachelor's degree or equivalent. But even with a bachelor's degree, they must have over a thousand hours of experience in childcare work.

Result? While Minnesota households state median income pay about 22 percent of their income to keep their infant in a licensed center, North Dakota Households with state median income only pay about 12.5 percent of their income.

In housing, again for example, Minnesota's requirement for a passive radon mitigation system to be installed in new homes adds $1,500 to the cost of foundation excavation and reparation relative to nearby states like Wisconsin. Its requirement for sealing of air ducts and its balanced ventilation requirement adds another $2,060 to the cost of a heating/air conditioning system.

Propositions to raise taxes and instead increase spending (either through tax credits, or rental assistance won't bring costs down. These proposals will simply pass high costs on to the taxpayer. These are demand-side measures to fix a supply-side problem. Even worse, by pumping money into markets where supply is constricted, we can expect to cause costs to increase. This will, no doubt, lead to further demands for the various credits and subsidies to be expanded, and for taxes on the rich to be raised even further.

Sincerely,
Martha Njolomole

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