BUDGET MESSAGE

of

Governor Orville L. Freeman

1959 - 1961

Deliver   ssion of the

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January 14,

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GOVERNOR ORVILLE L. FREEMAN

Delivered at a Joint Session of the Minnesota Legislature
Wednesday, January 14, 1959

Mr. Speaker, Mr. President, and Members of the 61st
Session of the Legislature of the State of Minnesota:

Pursuant to the authority vested in me as Governor, I present to you herewith the biennial budget message. This message supplements the other materials, released today, that contain my detailed recommendations.

This budget message is necessarily long, but its importance warrants all the time and study we can give it. Hundreds of hours have been devoted to its careful preparation. We, in the executive branch, have done our utmost to present to you, the legislative branch, as complete a picture of our proposed program as possible.

In the message itself and in the extensive supplementary materials, which includes the basic budget document, the guide to state agencies, and the drafted legislation covering my financial recommendation, we have attempted to present as conscientiously and as comprehensively as possible our recommendations and their justification. Although the message is long, it is as concise as we could make it without sacrificing the essential information.

I. Introduction

In my inaugural message last week I presented in broad context the challenge that we, as a free and democratic people, face in this period of fundamental change amid world turmoil. I sought to describe the challenge of this time of crisis as it relates to the work of state government -- a challenge that imposes on us even greater responsibility to make our government a symbol of inspiration and confidence for the entire world. It is a challenge that requires thoughtful planning, skillful direction and courageous action.

1. Programs to Meet the Challenge.

Two years ago, in 1957, the 60th session of the Minnesota Legislature launched our state on programs designed not only to serve the needs of today but to meet the challenge of the years just ahead. That session has been justly hailed as one of the most constructive in Minnesota's century as a state.

We are justifiably proud of this record. We take pride in noting that, even before Sputnik, Minnesota saw the need and met the challenge for improved educational programs on all levels. By increasing services for rehabilitation, for adequate care and special training for the ill, the retarded, and the handicapped, we set in motion programs designed to make Minnesota a happier and a more prosperous place in which to live and make a living. By programs to promote the wisest possible use of both human and natural resources and to encourage economic growth and development, we set our state well on the road to leadership in economic progress in this great mid-continent area. By adopting a long-term building program, as the result of the Legislative Building Commission's work, we took action to make up for long years of deferred needs and to set in motion a sound program of capital investment in the future.

The most constructive aspect of this record of the 60th Legislature is that we have looked ahead to launch ongoing programs to meet the challenge of the future. We have set policies for progress. The most important task facing this session is to continue these policies and to maintain these increased services and forward-looking programs. The budget that I present to you today is directed primarily toward that goal.

2. Minnesotans Need and Want These Services.

The people of Minnesota have amply voiced their approval of the programs and policies we have been getting so well under way. And conditions in the state, the nation, and the world emphasize the necessity of maintaining them. We cannot retreat from our determination to go forward. We cannot set back our progress by halting this splendid beginning. If temporary financial problems and the nationwide recession impel us to defer new programs that would have accelerated our rate of progress, we must not permit them to slow down the rate we have already set. Minnesotans need not -- must not -- and I am convinced they will not -- retreat from programs to achieve our goal.

3. Guide Lines Followed in Budgeting.

It is on the basis of this faith in the future of Minnesota and this confidence in the soundness of the programs and policies we have already launched that I have prepared the budget I present today. In making my recommendations I have followed four major guide lines: (1) the maintenance of present levels of services to the people; (2) the protection of improvements we have made in employee services and benefits; (3) the acquisition of equipment and new facilities only in cases of most urgent need or where savings would clearly result; and (4) the postponement of virtually all new programs.

The budgeting process this time has been the most difficult of the three budgets that I have prepared. I have personally examined every account, item by item, and have raised questions concerning the necessity of each program and each expenditure. I believe that the recommendations I now make for appropriations are the absolute minimum to meet human needs and our program for progress.

I turn now to a summary review of my recommendations for appropriations and for needed financing. I will deal first with the recommended appropriations from the General Revenue Fund, after which I will review my recommendations for appropriations from the Income Tax School Fund. I will then present my financing proposals.

II. The General Revenue Fund

The General Revenue Fund receives all revenues not earmarked by law for specific purposes. It finances some 75 different functions, of which the major ones are shown in Table I. The relative shares of General Revenue Fund money, by functions, is shown in Chart 1. You will note that about three-fourths of the expenditures from this fund go to support welfare programs and higher education -- two functions that are significantly affected by the increasing proportion of the aging and of young people in our population.

TABLE I

General Revenue Fund
Major Services Financed

Mental Hospitals	Children's Welfare	Youth Conservation Commission
State Prison	Conservation	Courts
Old Age Assistance	Administration	Business Development
University	Health	Crime Bureau
State Colleges	Agriculture	Liquor Control
Railroad and Warehouse Commission	Veterans Affairs	Labor Conciliator
	Taxation	
	Military Affairs	

1. Total of $253,222,000 Requested From Fund.

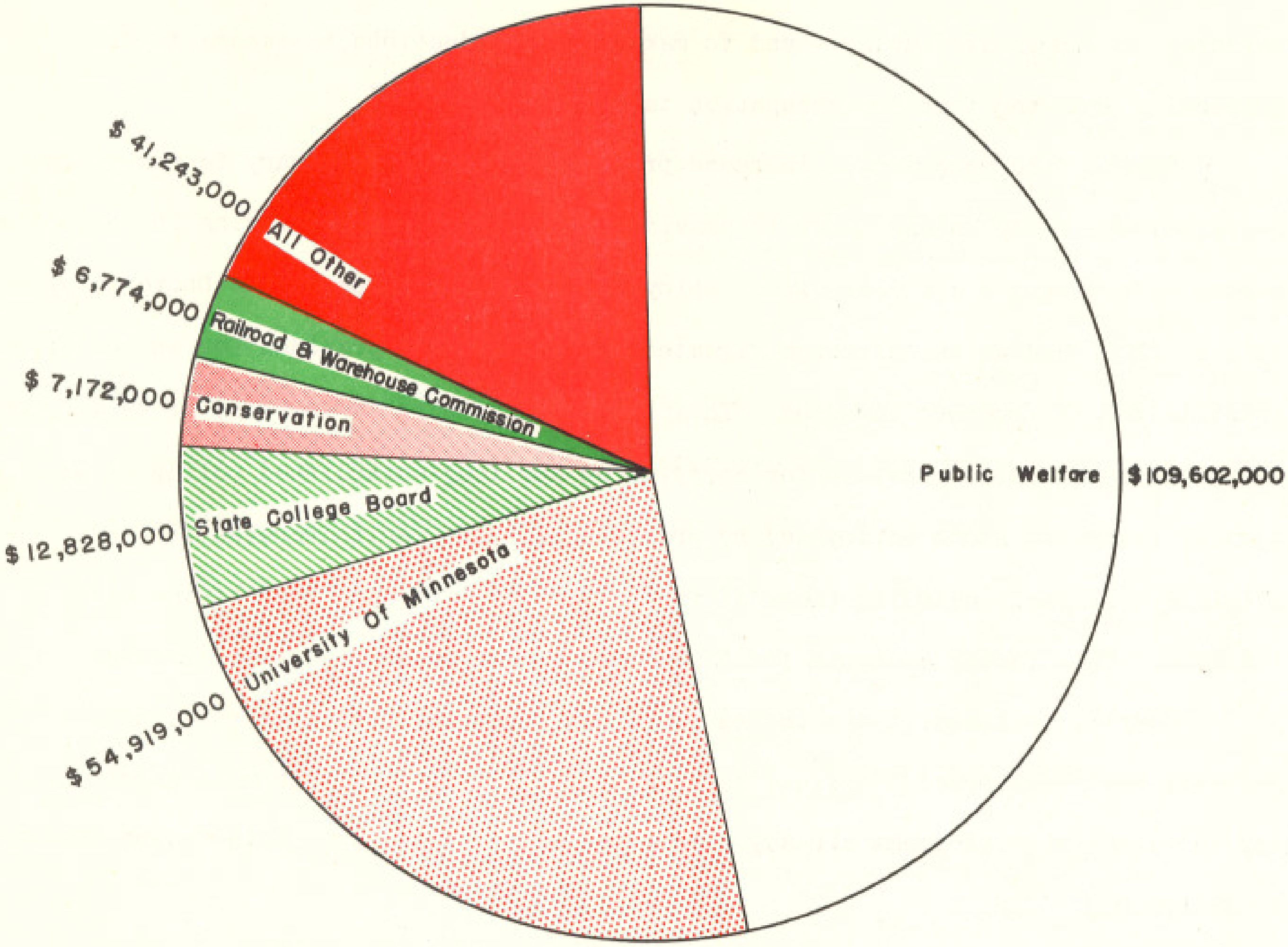
During the current biennium we are expending $201,294,000 from the General Revenue Fund, the total of all appropriations from this fund voted by the 1957 session. As we began our budgeting we had before us requested increases totalling $51,928,000 which, if approved, would require total General Revenue Fund appropriations of $253,222,000 for the forthcoming biennium.

Chart I

GENERAL REVENUE FUND OPERATIONS

1959 - 1961

GOVERNOR'S RECOMMENDATIONS



TOTAL $ 232,538,000

Source: Department of Administration

After carefully evaluating all requests, I have reduced the requested increase of $51,928,000 by $20,684,000 for a net of $232,538,000. An examination of the recommended increase shows that it substantially meets the criterion of what is absolutely necessary to carry out the programs, policies and increased services already enacted into law by previous legislatures.

2. <u>Increases Recommended to Continue Established Programs</u>.

First, the recommended increase includes $8,556,000 to support activities presently financed by the Game and Fish Fund, by the Prison Revolving Fund, and by the Iron Range Resources and Rehabilitation Fund -- all financed in the past by balances no longer available -- and to make up for reductions in income to the University from the iron ore occupation tax.

Second, the recommended increase provides financing necessary to carry out legislation already on our books to provide the one-step cost-of-living increase that became effective for all classified employees, including those at the University, on July 1, 1958, and which, although directed by law, was not provided for in the appropriation for the current biennium. This factor represents an increase of $3,420,000.

Third, it also provides for carrying on our long-established policy of adequately rewarding state employees, by providing for one merit increase for each eligible employee, including those at the University, for each year of the next biennium. This factor accounts for $2,784,000 of the total requested increase.

Fourth, included in the increase are new personnel needed to staff and maintain newly constructed welfare department facilities, built to meet urgent needs and in accord with programs already authorized and established. This factor amounts to $2,283,000.

Fifth, $2,555,000 of this increase is necessary to cover the anticipated growth in number of students at the University and the five state colleges while maintaining present faculty-student ratios.

These five factors total $19,598,000 (Table II). Thus, nearly two-thirds of the $31,244,000 increase represents expenditures to which we are committed by existing legislation. The remaining one-third -- $11,650,000 -- which represents essential improvements and increases due to rising costs actually amounts to only

5.51 per cent of the appropriations for the present biennium (Table III).

TABLE II

General Revenue Fund
Analysis of Recommended Increases

Activities presently financed by Other Funds	$ 8,556,000
July 1, 1958, Cost-of-Living Increase	3,420,000
Merit Increases for 1959-1961	2,784,000
Staffing of New Facilities	2,283,000
Expanded Enrollments in Higher Education	2,555,000
Increases Required to Meet Existing Commitments	$19,598,000

3. Essential Improvements Recommended.

Our budgeting has been austere, and we are recommending only the most essential improvements. In addition to the increases to continue programs already established, we provide for a general strengthening of faculty salaries at both the University and the state colleges and for a substantial increase in the number

TABLE III

General Revenue Fund
Per Cent Increase Recommended Over 1957-1959 Appropriations
Exclusive of Present Commitments

Total Recommended Increases for 1959-61	$ 31,244,000
Needed for Present Commitments	19,598,000
Net Recommended for Expanded or Increased Activities	$ 11,656,000
1957-1959 Appropriations	$201,294,000
Percentage Increase 1959-61 Over 1957-59 for Expanded or Increased Programs	5.51%

of junior college students to be supported on the basis of $200 per student per year. We cannot afford to fail to strengthen this critical progress in higher education, on which our economic progress and our national security must depend.

We also provide for essential improvements in various welfare programs, including mental health, children's institutions, the correctional system, assistance programs, and for major increases for the Youth Conservation Commission and the Board of Probation and Parole.

Similarly, essential support is provided the many other ongoing activities financed by the General Revenue Fund, including improved operations for the Department of Administration, an expansion of the tree nursery and reforestation program of the Department of Conservation, the strengthening of programs administered by the Board of Health including the new program for research and study of radiation hazards, and improvement in the benefits under disabled veterans' relief.

4. <u>Recommended Unbudgeted Items.</u>

The total General Revenue Fund recommendations of $232,538,000 cover all accounts included in the printed budget document. They are all authorized by existing legislation.

There are, however, in addition to these established accounts, certain new or modified activities that are not included in the printed budget but which have my support and will require financing. These items (Table IV) total $2,089,000 and include:

(1) <u>The Removal of OAA and AD Ceilings.</u> Recipients of Old Age Assistance and Aid to the Disabled have needs that are determined in accord with a standard budget.

TABLE IV

General Revenue Fund
Recommended Unbudgeted Items

Removal of OAA Ceiling	$ 746,000
Removal of Aid to Disabled Ceiling	608,000
Services for Crippled Children	175,000
Aiding Counties for Welfare Administration	500,000
Office of Consumer Counsel	40,000
Minnesota Society of Art	20,000
	$ 2,089,000

It is only humane and proper to remove present ceilings that prevent recipients from receiving the minimum essential budgeted assistance.

(2) Services for Crippled Children. Many children treated at Gillette Crippled Children's Hospital require service and treatment outside the hospital. Federal funds are no longer sufficient for such treatment, and I support an appropriation for this purpose.

(3) State Aid to Counties for Administrative Costs. Counties have been assuming greater responsibility for administering welfare functions. It is only fair that the state should assume a share in such costs.

(4) Consumer Counsel. Establishment of the Office of Consumer Counsel would provide an office charged with advisory and coordinating functions relating to state activities to protect the interests of consumers.

(5) State Art Society. This organization, established in 1947 by state action, is deserving of recognition and support similar to that provided other groups devoted to the enrichment of our cultural life. I therefore urge an appropriation to assist the society in its program.

I should also like to note at this point my endorsement of the recommendation of the Minnesota Statehood Centennial Commission that $100,000 of its unexpended balance be appropriated for assisting educational television station, KTCA-TV, in erecting a Centennial Memorial Educational Television Building. This does not represent a new liability for the next biennium inasmuch as the appropriation can be made from the balance remaining in the Centennial account.

5. Total Appropriation of $234,627,000 Required.

Including all unbudgeted items, my recommendations for General Revenue Fund appropriations total $234,627,000. In a later section of this message, I will present my proposals for financing the recommended appropriations.

III. The Income Tax School Fund

I turn now to the Income Tax School Fund, and I should like to recommend again that this fund be redesignated the Education Fund in recognition of the fact that it now receives, in addition to income tax receipts, 40 per cent of the iron ore occupation tax. A more general designation would add clarity to our accounting system.

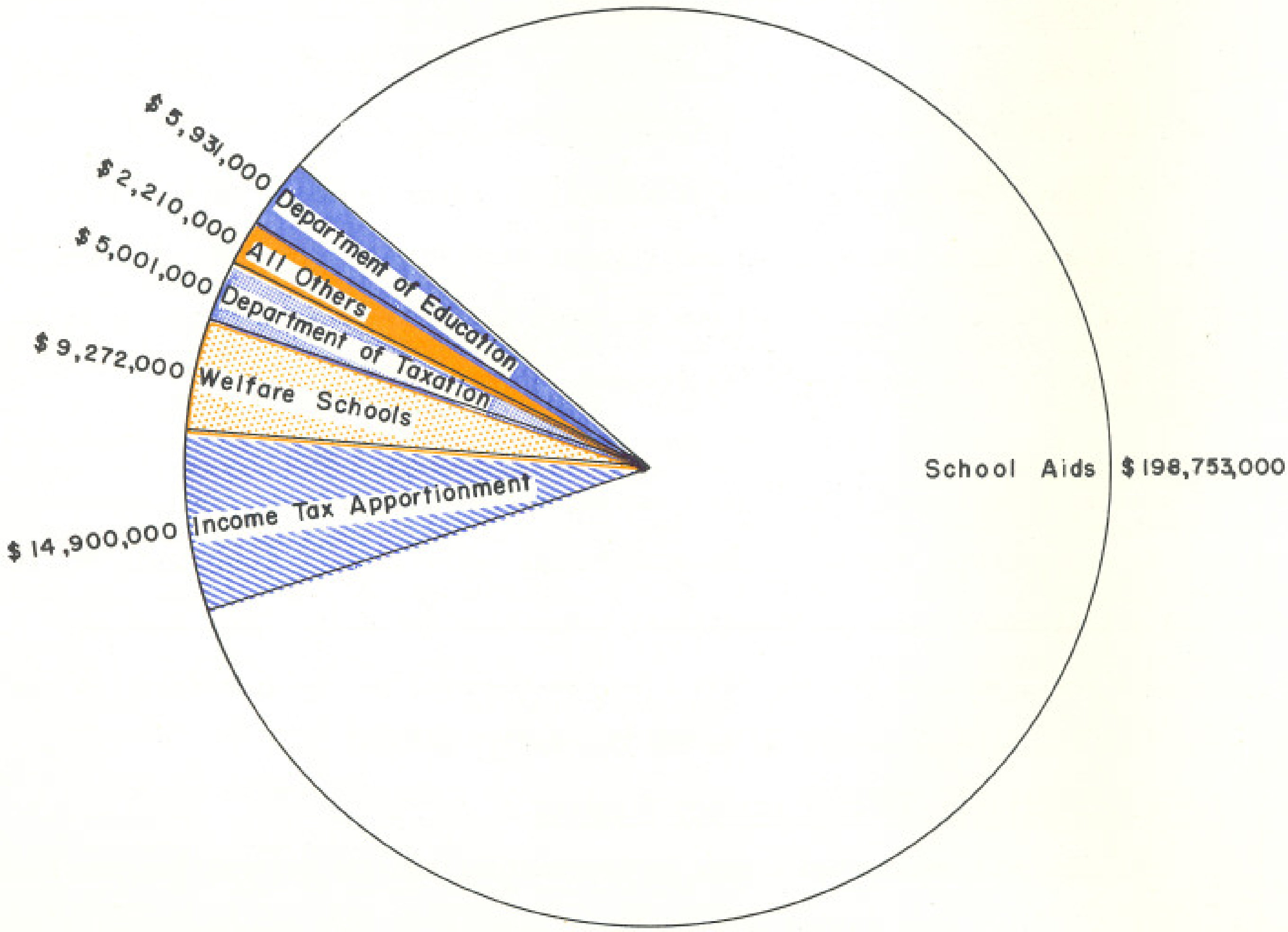
This fund supports all state aids to public schools. It finances the Department of Education and those functions of the Department of Taxation that relate to income tax collection. It also supports certain educational activities of the Department of Public Welfare and the Youth Conservation Commission. The fund is used preponderantly for school aids (Chart II), more than 80 per cent going for that purpose.

Chart II

INCOME TAX FUND OPERATIONS

1959 - 1961

GOVERNOR'S RECOMMENDATIONS



TOTAL $ 236,066,000.00

Source: Department of Administration

1. Current Appropriations Will Total $218,157,000.

During the current biennium appropriations from the Income Tax School Fund will total $218,157,000. This figure covers the sums appropriated for the various school aids by the 1957 session, and includes a deficiency appropriation of $17,794,000 which is being requested in order to complete all payments as provided for in the state aid formula adopted in 1957. This large deficiency appropriation is necessary because the 60th Legislature undercalculated by that amount what was actually needed to pay in full the school aids it voted in the basic legislation. I might note at this point that, if it were not for this deficiency, the Income Tax Fund would have had a balance of $12,567,000 at the end of this biennium; but because it is necessary to cover this deficiency, we will enter the new biennium with a deficit of $5,227,000 in that fund.

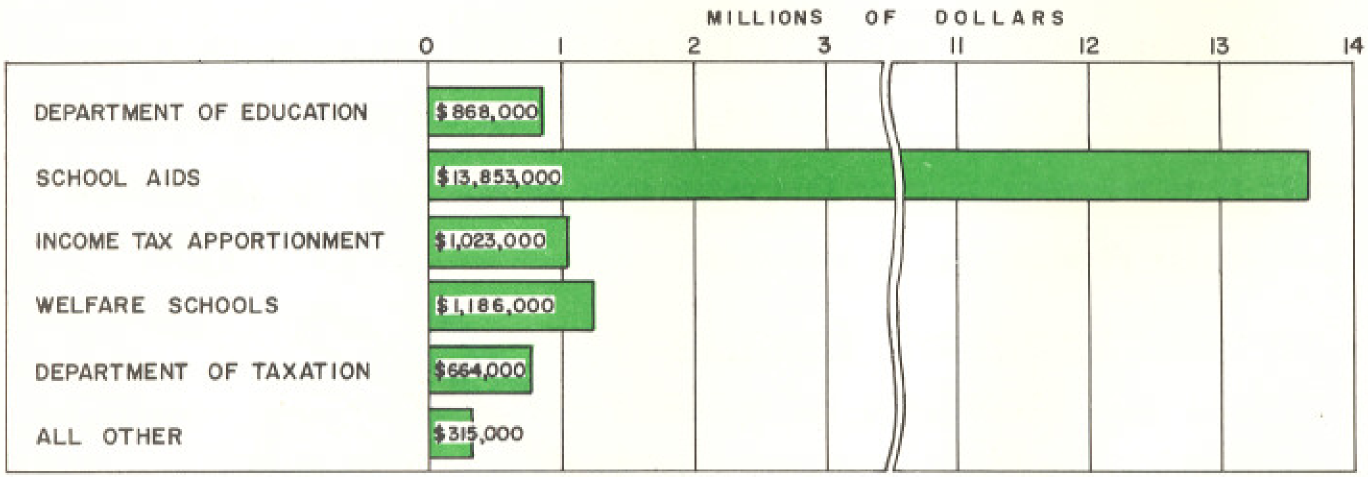
2. Recommended Increases Total $17,514,167.

As we began our budgeting for the school fund we had before us requests for increases totalling $20,499,000, of which $14,876,000 is the additional amount needed to provide state aid under the existing formula for the increased number of pupils anticipated in the next biennium. This represents simply a population projection and involves no increase in the basic formula. I am recommending the increased amount for school aids as requested. However, with respect to the remaining $5,623,000 of requested increases, I have reduced them by $2,590,000 leaving a recommended increase from this fund of $17,909,000 (Chart III).

The recommended increase, when added to the present appropriation, results in a total need from the Income Tax School Fund for 1959-61 of $236,066,000. The financing of this fund will be dealt with as part of my overall fiscal program later in this message.

Chart III

INCOME TAX FUND
RECOMMENDED INCREASES
1959-1961



TOTAL $17,909,000

Source: Department of Administration

IV. Building Fund

I turn now to a brief discussion of the State Building Fund. You have before you, as a companion document to the budget, the second excellent report of your Legislative Building Commission. This Commission, continuing the work of the earlier Legislative Commission to Study State Building Needs, has made an even more intensive and more thorough examination of state building needs and has presented a second report that updates the state's ten-year building program.

The contribution of the legislators who participated in the activity of this Commission is especially noteworthy, and I should like to extend my personal thanks to them for the devoted manner in which they have completed a most difficult assignment. They spent an aggregate of 88 days in full session, toured all of the state's many installations and spent hundreds of hours in intensive analysis to make certain that priorities were properly assigned.

The Building Commission's report, in which I have formally concurred, contains what is in effect the state's capital outlay budget. You will recall that two years ago you had before you the first capital outlay budget in the state's history, and I am most gratified to take note of the continuation of this important procedure.

The Commission's report presents detailed findings and recommendations concerning the state's entire physical plant. Because these recommendations are so fully documented by the Commission's report, I see no need in this message to amplify further these recommendations. They have my full support and I am confident that they will serve as a proper base for your review and analysis.

You will find that the recommendations for the next biennium total $53,330,000, covering all institutions and agencies maintaining physical plants. I support the Commission's recommendation that these projects be approved and that money for them be appropriated and that these appropriations be financed on a twenty year basis. While the amount of recommended appropriations is substantial, I am convinced that all recommended projects are essential and that it would be a mistake to delay them further.

The Commission followed again the same criteria that was employed by the Commission in its report two years ago. These criteria call for the rehabilitation and prevention of further deterioration in our state physical plant, the providing of essential new buildings for state programs, in particular in the fields of welfare and higher education, and the further development of a program of systematic and long-term planning.

V. Non-Recurring Activities

Later in this message I will recommend the adoption of the current payment system for the collection of personal income tax. By shifting to the pay-as-you-go basis we will receive about $36,000,000 in non-recurring income.

I propose that a portion of this non-recurring income be used to finance several non-recurring activities, as follows:

1. Opening deficit in the Income Tax School Fund. As I explained earlier, if the deficiency appropriation is voted to complete payments of all school aids authorized by the 1957 session, the Income Tax School Fund will end the biennium with a deficit of $5,227,000, which amount should be financed from the non-recurring gain resulting from the shift to pay-as-you-go.

2. School Construction Revolving Fund. The need for capital outlay for school construction remains urgent. I propose, as I did two years ago, that a school construction revolving fund be created, capitalized at $1,000,000.

3. Aid for Distressed School Districts. For this purpose I recommend an appropriation of $2,500,000.

4. Assistance for Junior College Construction. If we are to expand the opportunities offered by junior colleges, it will be necessary for the ssate to participate in financing of physical plant expansion. For this purpose I recommend that $6,000,000 be earmarked.

5. Aid for Nursing Home Construction. To help alleviate the problem of providing adequate nursing home facilities, I recommend a program under which the State would match on a fifty-fifty basis the cost of constructing nursing homes. I propose the establishment of a construction revolving fund of $1,000,000.

6. Student Loan and Scholarship Program. We face a continuing need to assist our young people who would otherwise be unable to continue their education. For this purpose I recommend the establishment of a revolving fund of $1,000,000.

7. Administration of Withholding. The installation and initial administration of the withholding system will require an additional appropriation for the Department of Taxation of $750,000 most of which is non-recurring.

8. Electronic Computer Center. You have before you the special report of the Department of Administration detailing the recommendation for the establishment of an electronic data processing center. This recommendation is based on the findings of the feasibility study authorized by the 1957 session. The substantial portion of $500,000 required appropriation for this activity will be more than offset by the savings in operations that will be realized during the biennium.

These programs appregate $17,977,000. (Table V).

VI. Other Financing Needs

Two other financing needs that do not involve the General Revenue Fund or the Income Tax School Fund should be mentioned briefly.

First, I am recommending that the special revenue measures that finance the War Veterans Compensation Fund be continued in order to fulfill the remaining obligation to veterans of the Korean conflict.

Table V

Non-Recurring Activities

Opening Income Tax Deficit		$ 5,227,000
School Construction Revolving Fund		1,000,000
Aid for Distressed School Districts		2,500,000
Junior College Construction		6,000,000
Nursing Home Construction		1,000,000
Student Loans and Scholarships		1,000,000
Administration of Withholding		750,000
Computer Center		500,000
	Total	$ 17,977,000

Second, I intend to prepare a separate analysis of the serious problem we face concerning the financing of retirement programs for state and public employees and for teachers. The gravity of this problem is of such dimensions I believe it justifies a special message, which I will submit at an early date.

VIII. The Financing Program

I now turn to the problem of financing. The need for increases in the General Revenue and income Tax Funds for 1959-61, even after sharp pruning of departmental requests, confronts us with a major revenue-raising task.

1. Increases Due to Several Factors.

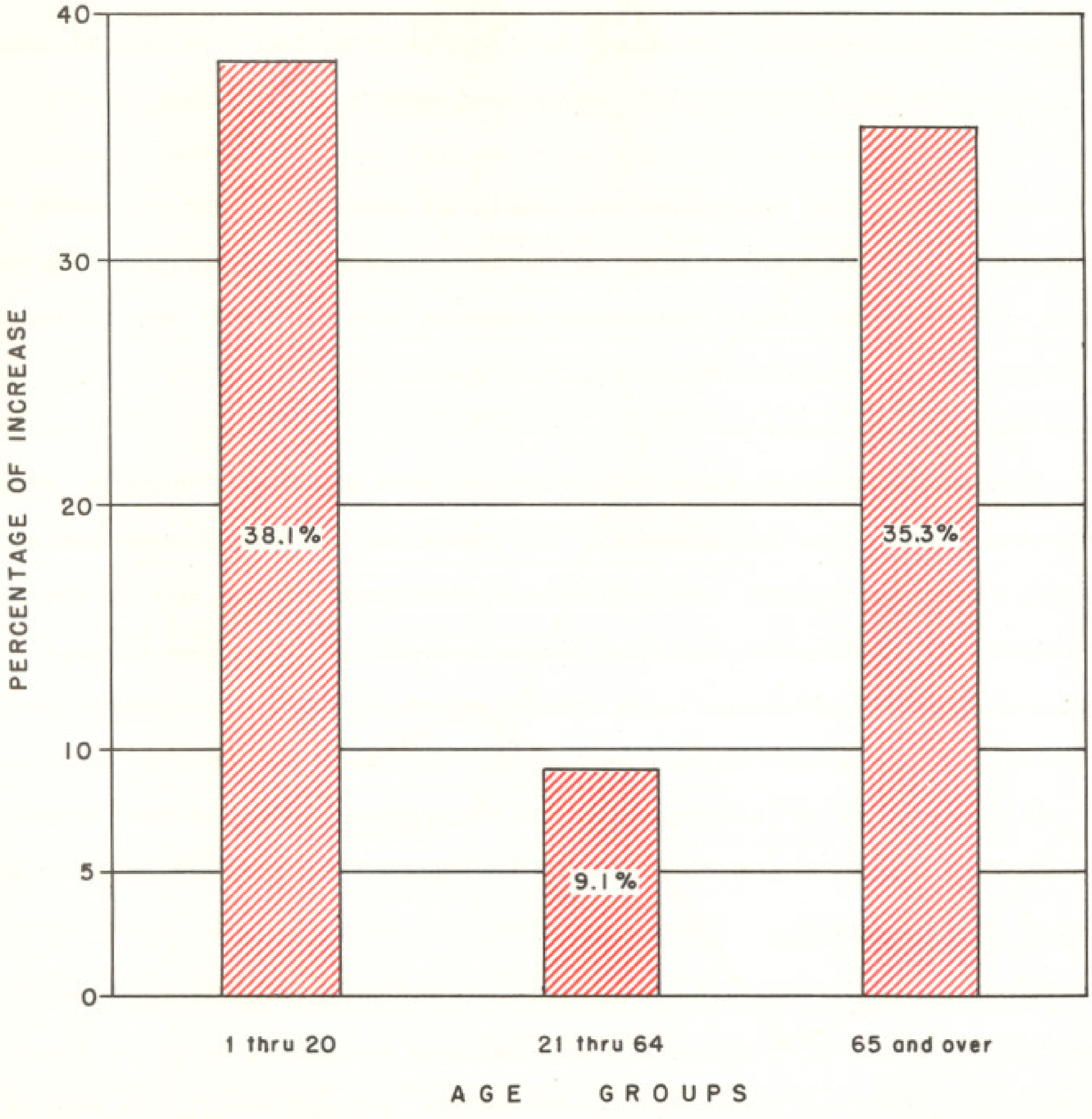
The increases are occasioned by several factors. In part they are necessary to meet increased costs due to inflation. In part they are due to technological and scientific progress that makes available new techniques, new methods, new miracle drugs, new educational needs, of which we must take advantage if we are to continue our progress. In a large measure they are due to increased population and to a disproportionately large increase at both ends of the population scale -- the young and the old -- for whom greater expenditures are necessary. (Chart IV).

A study of the probable population growth in Minnesota during the period from 1950 to 1965 shows that our overall population is likely to increase a total of 22 per cent during that period. The numbers under 21 years of age will probably increase by 38 per cent and those over 65 will increase by 35 per cent, while those in the productive years between 21 and 65 will increase only 9 per cent.

The severity of the impact of the age distribution within our population is in one respect temporary. The number of young adults in their twenties is disproportionately low today, as the result of the low birth rates in the depression years of the thirties. Thus, although we can anticipate increased longevity, we know that when the larger numbers born during the forties and fifties reach the productive years,

Chart IV

MINNESOTA POPULATION DISTRIBUTION
INCREASES BY GROUPS FROM 1950 TO 1965



Source: Department of Public Welfare, June 1955 the proportion in the non-productive years of childhood and old age will decline.

Another aspect of our financial problem is likewise temporary -- and that is the impact of the recession. During the last four years we have been able to make good progress in meeting our problems because our economy was expanding rapidly enough to provide additional resources needed to meet increasing costs. However, the recession of 1957-58 interrupted this growth and abruptly reduced government revenues. Costs continued to increase while the economy declined, resulting in the loss of millions of dollars of revenue for Minnesota. On a national basis (Chart V) the costs of state services moved dramatically upwards while the gross national product was falling sharply.

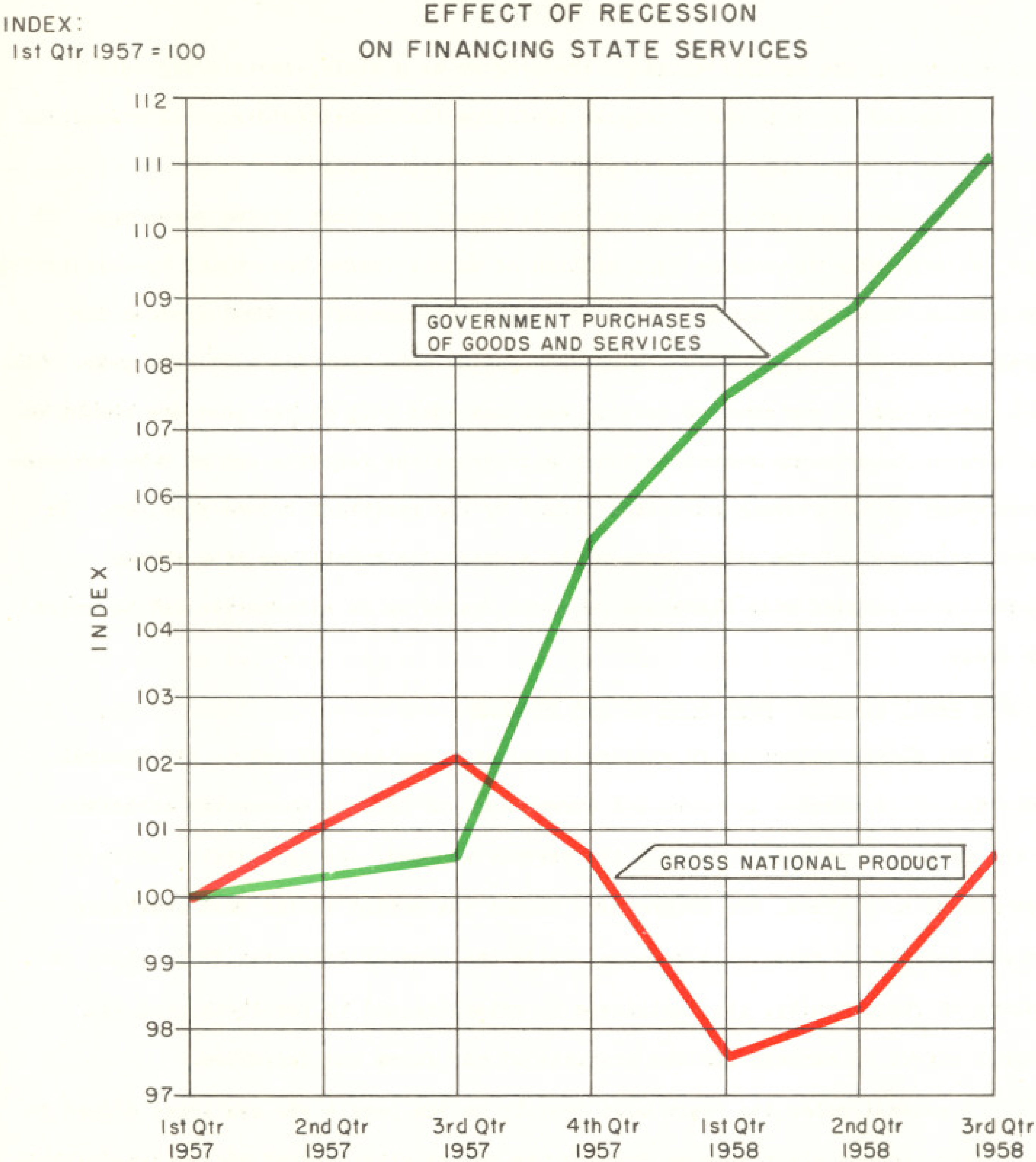
Minnesota is thus not alone in facing these twin problems of increased costs and lower revenues due to the recession. All states and the Federal government must face this situation, and many have much more critical problems than we. In Minnesota we can face this problem with optimism, because recently we have shown economic growth at a rate of increase far higher than the average. We have confidence that the national economy is on its way upward again. This being the case, we would be cheating our future if we halted our programs for progress, if we cut back on essential services, because we lacked the courage to finance these programs and services.

2. Taxes Must be Increased.

Two years ago, I came before you with the broad program of tax revision, reduction, and reform which represented the unanimous recommendation of the Minnesota Governor's Tax Study Committee. This Committee, you will recall, was made up of leaders from business, labor, agriculture and the University, and was generously financed by the constituent private organizations. It made an exhaustive study which will long stand as a landmark in the field of state taxation. Although the

Chart V

EFFECT OF RECESSION ON FINANCING STATE SERVICES



SOURCE:
ECONOMIC INDICATORS, DECEMBER 1958
JOINT ECONOMIC COMMITTEE OF CONGRESS

Legislature did not see fit to adopt the program as a whole, certain segments of it were enacted in 1957, and I propose to follow the Committee's general principles and many of its specific recommendations in my revenue program.

Our fiscal situation today is far different from that of two years ago. In 1957, we were able to provide $6.5 million of annual income tax relief by eliminating the onerous "head tax" and providing for full allowance of personal credits for surtax purposes. Today, we face a revenue gap of more than $40 million a year. The full dimensions of our revenue-raising task unfolded only in the past few months as our various departments submitted their appropriations requests and as more accurate measurement of the revenue shrinkage caused by the recession became possible. In common with most of the other forty-eight states, the relentless rise of our expenditures coupled with slackened revenues leaves us no alternative but to raise tax rates.

3. The Basic Choice: What Kind of Tax Program?

The choice before us is whether to adopt a new kind of tax -- the general sales tax -- or whether to raise and strengthen our present income tax structure as the principal method of raising the revenue we need. In my opinion, which I have stated many times, the progressive income tax method is the most equitable one yet devised to raise this revenue, while the general sales tax falls short on grounds of its inequity, its costliness to retailers and to the state, and its adverse effect on markets for the products of our farms and factories.

A general sales tax bears most heavily on the people who can least afford to pay. This becomes clear when we compare its impact with that of an increased income tax (Table VI and accompanying chart). Its impact is like that of an income tax which would assess a smaller percentage tax on larger incomes and a larger percentage tax on

Table 6: Comparative Impact of Income Tax Increase and 1 % General Sales Tax [1]

SIZE OF FAMILY	INCOME GROUP	INCREASED LIABILITY UNDER: Income Tax (2)	Sales Tax (3)
Married Couple With Three Children	$ 2,000	$ 0.00	$ 22.00
	3,000	0.00	30.00
	4,000	16.57	38.00
	5,000	24.53	44.00
	7,500	44.83	57.00
	10,000	64.72	70.00
	15,000	103.44	89.00
	25,000	174.91	127.00
	50,000	315.39	160.00
Married Couple With Two Children	2,000	0.00	21.00
	3,000	11.73	28.00
	4,000	20.68	36.00
	5,000	28.84	42.00
	7,500	49.08	55.00
	10,000	68.92	67.00
	15,000	107.38	85.00
	25,000	178.36	121.00
	50,000	317.57	155.00
Married Couple With One Child	2,000	0.00	20.00
	3,000	16.86	27.00
	4,000	24.99	35.00
	5,000	33.05	41.00
	7,500	53.26	53.00
	10,000	73.10	64.00
	15,000	111.34	81.00
	25,000	181.60	114.00
	50,000	319.74	150.00
Married Couple With No Children	$ 2,000	$ 6.28	$ 18.00
	3,000	21.17	25.00
	4,000	29.31	32.00
	5,000	37.47	38.00
	7,500	57.45	48.00
	10,000	77.31	58.00
	15,000	115.18	73.00
	25,000	184.83	100.00
	50,000	321.82	130.00
Single Person	2,000	11.92	13.00
	3,000	19.97	20.00
	4,000	27.92	26.00
	5,000	35.90	32.00
	7,500	54.85	41.00
	10,000	72.75	50.00
	15,000	105.51	62.00
	25,000	156.58	85.00
	50,000	260.34	100.00

(1) The general sales tax rate of 1 per cent is used to serve as a basis for comparing the impact of a sales tax on various sizes of family units at various income levels. Different percentages would result in different amounts, and various exemptions might alter the nature of the impact. A general sales tax of 1 per cent in Minnesota would, if levied against all principal expenditures except housing, bring in an amount of revenue somewhat greater than that contemplated by the recommended increase in income tax rates.

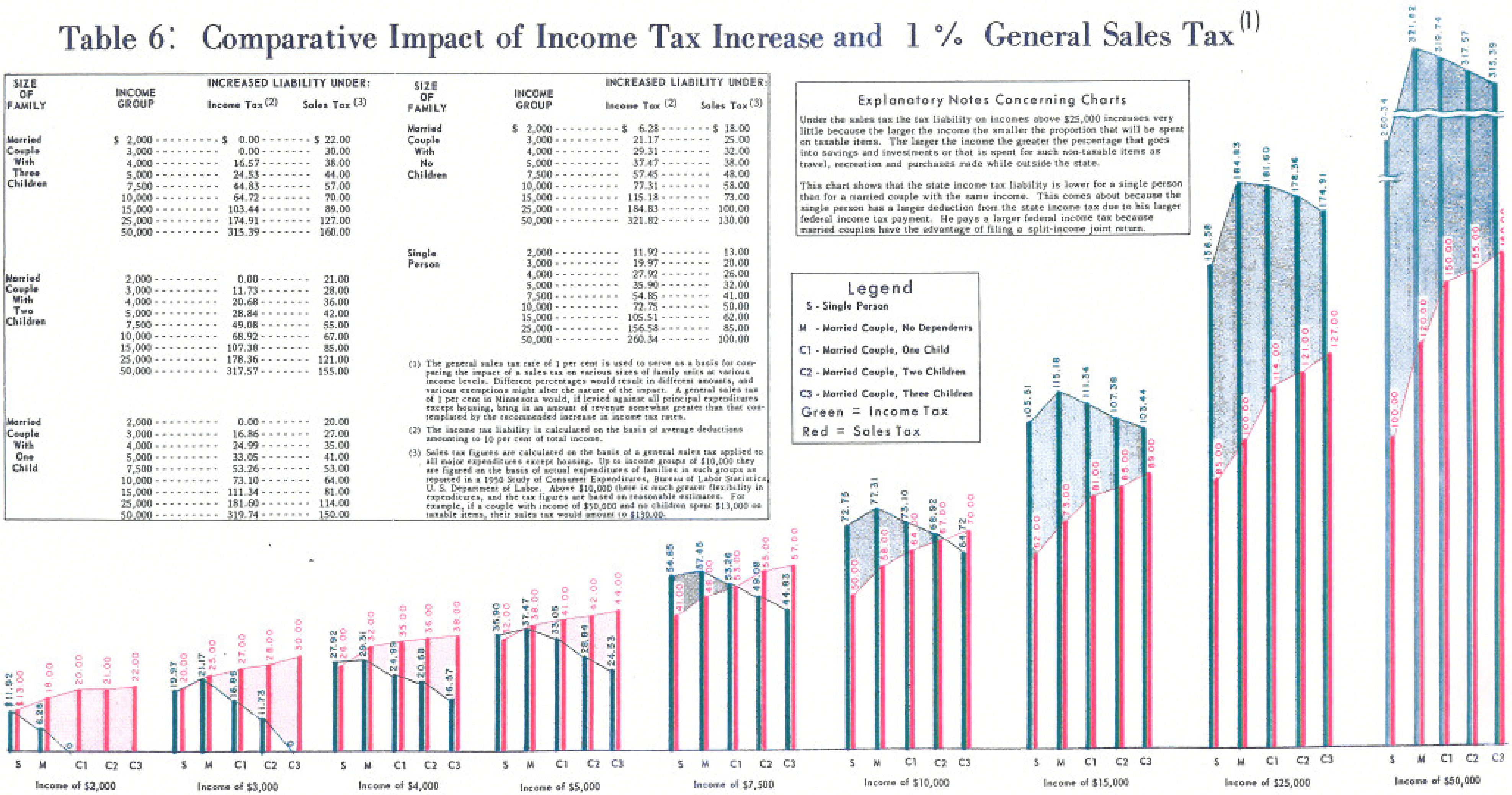
(2) The income tax liability is calculated on the basis of average deductions amounting to 10 per cent of total income.

(3) Sales tax figures are calculated on the basis of a general sales tax applied to all major expenditures except housing. Up to income groups of $10,000 they are figured on the basis of actual expenditures of families in such groups as reported in a 1950 Study of Consumer Expenditures, Bureau of Labor Statistics, U. S. Department of Labor. Above $10,000 there is much greater flexibility in expenditures, and the tax figures are based on reasonable estimates. For example, if a couple with income of $50,000 and no children spent $13,000 on taxable items, their sales tax would amount to $130.00.

Explanatory Notes Concerning Charts

Under the sales tax the tax liability on incomes above $25,000 increases very little because the larger the income the smaller the proportion that will be spent on taxable items. The larger the income the greater the percentage that goes into savings and investments or that is spent for such non-taxable items as travel, recreation and purchases made while outside the state.

This chart shows that the state income tax liability is lower for a single person than for a married couple with the same income. This comes about because the single person has a larger deduction from the state income tax due to his larger federal income tax payment. He pays a larger federal income tax because married couples have the advantage of filing a split-income joint return.



smaller incomes; one that would assess a larger percentage tax the bigger one's family; one that would exempt all savings and that would allow deductions for luxury expenditures on such things as traveling, household servants, and gambling; one that would put an especially heavy penalty rate on newlyweds, on victims of fire and other casualty losses, and on others who must undertake heavy expenditures to equip or re-equip their households.

Thus, in reaffirming my opposition to the general sales tax and in choosing the income tax way as the fairest approach to raising the bulk of our needed revenue, I am choosing the way that is vastly superior in terms of fairness and equity, cost of administration, and burden on consumers. I am also following the guide lines laid down by the Governor's Tax Study Committee two years ago, when it concluded: "Our principal reliance should continue to be on a truly progressive personal income tax and a well-balanced corporate income tax, keeping in mind that a reasonable share of increased burdens should be assigned to the iron ore, gross earnings, selective excises, and other existing taxes."

The program that I am recommending follows the broad patterns laid down by the committee. It relies chiefly on substantial increases in the individual and corporate income taxes, but draws also on the excise taxes on liquor and tobacco, the iron ore tax, and the inheritance tax. Coupled with this program are numerous recommendations to carry out committee proposals to promote tax equity, strengthen enforcement, and improve Minnesota's tax climate by a variety of specific tax adjustments.

4. Recommended Changes in the Individual Income Tax.

To raise the needed additional revenue, I propose, first, the following adjustments in the individual income tax, effective July 1, 1959:

(1) Adoption of withholding and current quarterly payment.

(2) Increase rates in each income bracket by one percentage point on all taxable income above $500 and reenact the present 10 per cent surtax.

(3) Increase the dependency credit from $10 to $15 per dependent. The credit of $10 for single persons and $30 for married couples would remain unchanged.

(4) The change over to current payment will produce non-recurring revenues of $36 million at the new rates. I propose that half of this revenue be used to cover certain non-recurring activities and that the other half be "forgiven."

In drawing up the proposed modifications, I have been guided by three major principles:

(1) It would be irresponsible, on one hand, to oppose a sales tax and, on the other hand, to propose no alternative way of reaching the tax-paying ability of the mass of our citizens. We are no longer simply providing services to the poor and underprivileged, to be paid for by the rich. Rather, we are providing essential services that we have decided to buy collectively through government. To pay for them collectively requires contributions not only from the top income groups, but from the middle and lower-middle groups, as well.

(2) At the same time, we must protect our least fortunate citizens by continuing to relieve them entirely from income tax liability. In spite of some lowering of exempt limits under my recommendations, single individuals with incomes of less than $750 and married couples with less than $1,500 will continue to be entirely free from state income tax (as compared with exemptions of $600 and $1,200 under the federal income tax). Also, we will continue to hold the starting rate on the first $500 of taxable income at one per cent in contrast with the starting rates of 1½ per cent, 2 per cent, and 3 per cent that prevail in fifteen income tax states.

(3) By increasing the dependency credit from $10 to $15 we make more adequate provision for families with dependents, thus correcting an inequity in the present law and giving tax relief where most needed.

By broadening and deepening the individual income tax in this way we can meet our additional tax needs fairly and rationally without erecting a costly new tax superstructure like that of the sales tax. At the same time, it becomes imperative to put the income tax on a pay-as-you-go basis by withholding and by current quarterly payments as now done by the Federal government and by a growing number of sister states. The Governor's Tax Study Committee unanimously recommended this step, even in the absence of tax increases. I cannot ask the honest and conscientious taxpayers of this state to assume substantial additional burdens when tax slackers are escaping millions of dollars of taxes already on the statute books.

We have already taken action to get the fullest possible benefits of Federal auditing and enforcement activities through the most advanced program of exchange of income tax information that exists in any state today. This program will be especially effective in reaching business, professional and other self-employed taxpayers. But, if we wish to collect all the estimated $3,500,000 of tax being evaded each year, the only effective method open to us is to withhold the tax at the source.

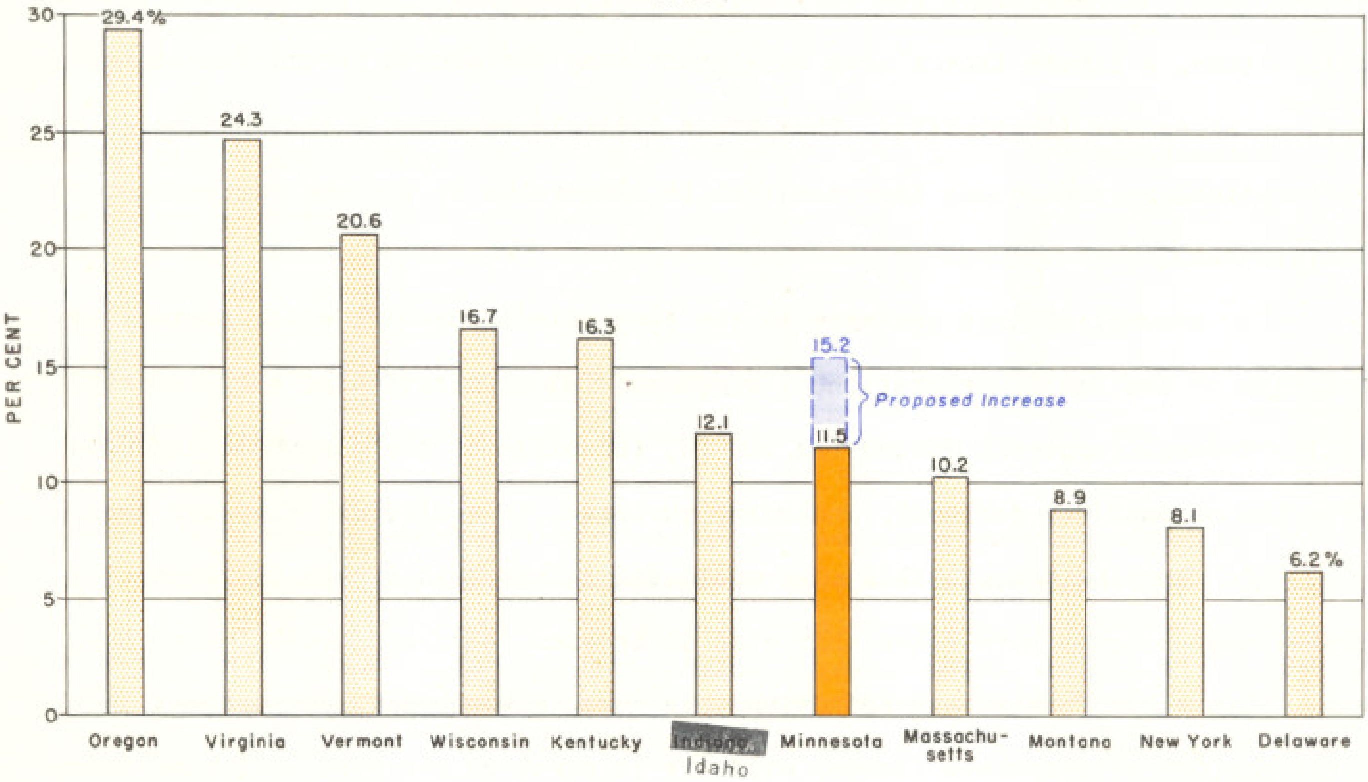
As the tax burden rises, it also becomes increasingly important to break income tax payments into small pieces which are payable automatically with the receipt of one's paycheck thus building into our income tax the chief advantage of a sales tax. By this method, our income tax is put on a par with other payments that we budget week-by-week and month-by-month. Yet, unlike the sales tax, we know how much tax is being taken out of each paycheck and how much the total is when we settle up our tax liability in April each year.

5. <u>Minnesota's Comparative Position.</u>

Where would the proposed program place our individual income tax in relation to other states? Perhaps the best basis for comparison is the ratio of state to federal income tax collections in the various states, since this automatically takes into account all features of the income tax law. Of the thirty states with income taxes, nineteen also have sales taxes. If we eliminate these from the comparison in order to bring together the eleven states which are on a comparable tax footing, we find that Minnesota's present income tax burden ranks seventh among the eleven states (Chart VI).

Chart VI

MINNESOTA INDIVIDUAL INCOME TAX
COMPARED WITH ALL STATES HAVING
INCOME TAX BUT NO SALES TAX*
- 1957 -



* Standard of comparison: ratio of state to federal individual income tax collections.

** Virginia collections include more than one year's liabilities because of an advancement of due dates. Removing this factor, the Virginia figure would be between 12 and 15 per cent.

This chart does not take into account possible tax increases in other states.

SOURCE: Annual Reports, Commissioner of Internal Revenue; and annual Summaries of Governmental Finances, Government Division, United States Bureau of the Census.

Our income tax collections represent 11.5 per cent of the federal collections, as against percentages ranging from 12.1 to 29.4 per cent in the six states with heavier income taxes than ours. The recommended program would bring our ratio to 15.2 per cent, somewhat below Kentucky and Wisconsin and substantially below Vermont and Oregon. This does not consider the inevitable tax increases in other states.

6. Recommended Changes in Corporation Income Tax.

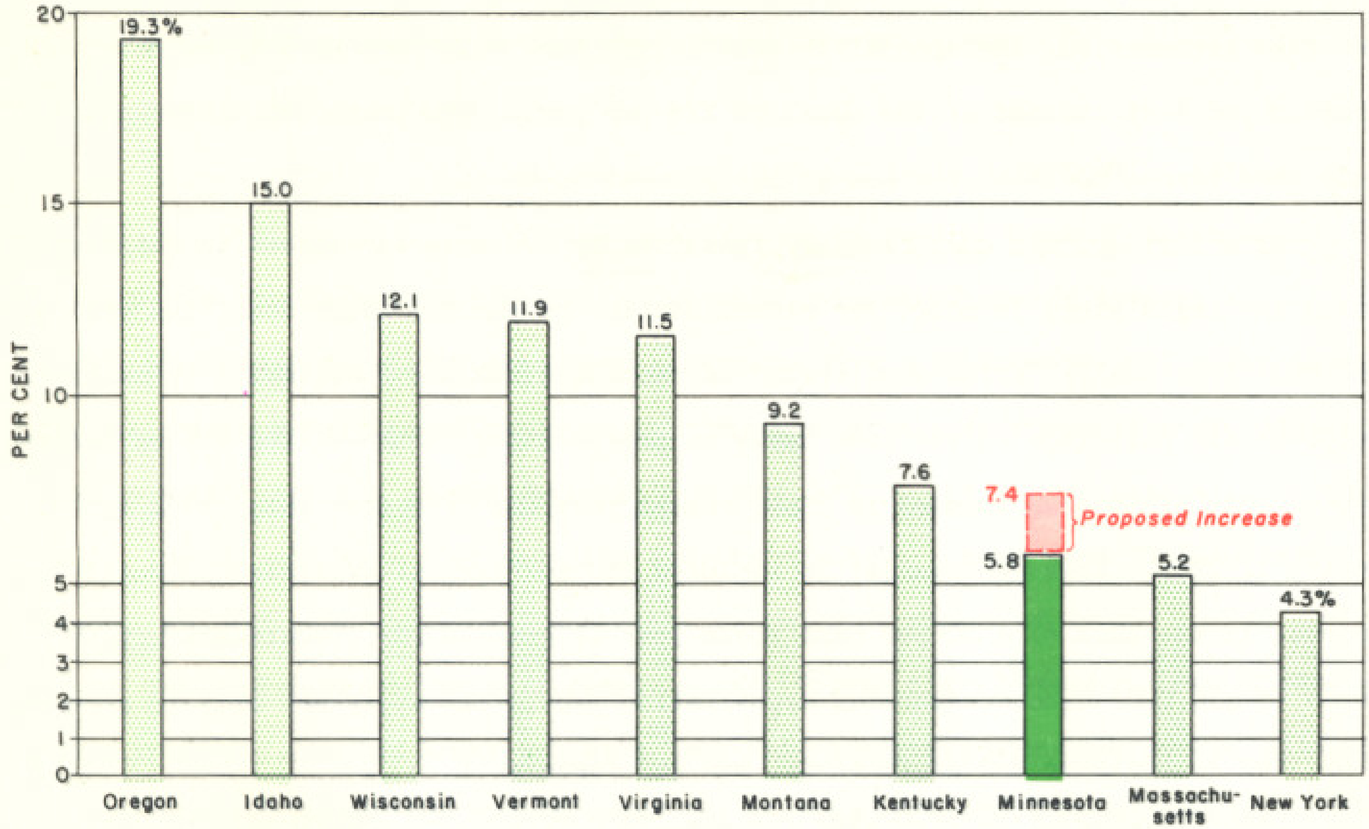
Our present revenue situation also calls for an increase in the corporate income tax. Our corporate tax collections represent only 5.8 per cent of federal collections, a figure that places us eighth among the eleven income tax states that have no sales tax (Chart VII). Thus it is entirely reasonable that we impose on corporations an income tax increase that is comparable to the one recommended for individuals.

To accomplish this increase in the corporate income tax while protecting the position of the small corporation, I recommend (a) elimination of the deductibility of the federal corporate income tax and (b) reduction of the corporate tax rate from the present 7.3 per cent, including surtaxes, to a straight five per cent.

In removing deductibility, we would follow the lead of the 21 income tax states that already have taken this step to broaden their corporate income tax base. Since the federal tax deduction privilege is worth only 30 per cent on the first $25,000 of corporate income, while it is worth 52 per cent on income above $25,000, the recommended change will actually reduce slightly the tax burdens of small corporations. Since they currently realize only 30 cents on the dollar from this deduction, they will gain more from the reduction in the state tax rate than they will lose from the withdrawal of federal deductibility. Even for the larger corporations, the net cost of the corporate income tax (after taking account of the fact that the state income tax will still be deductible for federal income tax purposes) will be very modest: Less than 2½ cents on each dollar of Minnesota income.

Chart VII

MINNESOTA CORPORATION INCOME TAX
COMPARED WITH ALL STATES HAVING
INCOME TAX BUT NO SALES TAX *
1953-57 (5 YEAR AVERAGE)



* Standard of comparison: ratio of state to federal corporation income tax collections.

This chart does not take into account possible tax increases in other states.

Delaware, which appears on Chart VI, is not shown because it has no corporate income tax.

SOURCE: Annual Reports, Commissioner of Internal Revenue; and annual Summaries of Governmental Finances, Government Division, United States Bureau of the Census.

7. Recommended Structural Changes.

Side by side with these tax increases, I wish to urge the adoption of changes in the business income tax base, recommended by the Tax Study Committee, to improve the equity of the income tax and increase the incentive to invest in Minnesota. The Committee recommended abolition of the special "alternative allocation formula." At present, this formula permits the state manufacturer for out-of-state markets to put a weight of 70 per cent on sales and only 15 per cent each on payroll and property, as against the usual formula of 33 1/3 per cent for each. As a result, some manufacturers are escaping large amounts of tax that would otherwise be due. At the same time, we wish to continue to encourage manufacturers in Minnesota who are producing for out-of-state markets to expand their operations here. This consideration leads me to suggest that, rather than eliminate this tax incentive entirely, as the Committee recommended, the special formula be cut back only part way, to weight sales 50 per cent instead of the usual 33 1/3 per cent. The preferential formula would then become 50-25-25 instead of the present 70-15-15.

As a further, and much broader, incentive to business investment in Minnesota, I urge the Legislature to adopt the recommendation of the Tax Study Committee that I have made previously: allow accelerated depreciation for new investments in machinery, equipment and buildings on the same basis as provided for in the United States Internal Revenue Code of 1954 as amended in 1958, except that the effective date shall be January 1, 1959. This recommendation includes the new special incentive to small business in the form of a 20 per cent first year allowances for investments not in excess of $10,000. The accelerated depreciation provisions apply not only to cooperations, but to business and professional men and farmers.

Other changes to conform with new federal provisions and to improve the climate for investment will be proposed in due course. I do not, however, recommend that Minnesota blindly follow the federal government in all its income tax changes. As the Governor's Tax Study Committee recommended, the Minnesota provisions should "be brought into conformity with the federal law in all cases where the differences are purely technical and/or where the policies involved are acceptable to the people of Minnesota." But the Committee recognized the values of freedom of choice at the state and local level and felt that Minnesota should feel free to differ in such matters as taxation of dividends and other areas "where there is room for real differences in value preferences." In addition to exercising this right of free choice which is one of the prerogatives of self-government at the state level, we must be careful not to adopt new federal provisions which have opened up unintended loopholes. A series of technical and conformity changes will be submitted to the legislature after the Tax Department staff has completed revisions designed to prevent unwarranted tax avoidance and unnecessary loss of revenue.

8. Increases In Other Taxes.

In keeping with the principle of the most equitable distribution of the burden of increased taxes, I believe it is proper to assign a share of the needed increase to other existing taxes. I, therefore, recommend the following:

(1) Cigaret and Tobacco taxes. Increase from 4 to 5 cents per pack; eliminate tax stamps and dealer discounts; and increase tax on the other tobacco products from 15 to 20 per cent of manufacturer's price.

(2) Liquor tax. Increase the surtax from 10 to 20 per cent on distilled spirits and wine and continue the present 10 per cent surtax on beer.

(3) Inheritance and Gift taxes. Simplify the classification system; increase rates in the middle and lower brackets, and reduce certain excessive rates; eliminate certain special exemptions and increase the general exemption levels; and raise the gift tax rates and exemptions to the level of the inheritance tax rates and exemptions, instead of three-fourths as at present.

(4) Iron ore tax. Increase the rate of the occupation and royalty taxes (except on taconite) by one percentage point; extend labor credits to the royalty tax, and extend special tax benefits to new beneficiation facilities for low-grade ores.

The foregoing adjustments in general follow the principle of combining revenue increases with improvements in tax structure recommended by the Governor's Tax Study Committee. For example, the Committee recommended elimination of tax stamps and discounts and closer alignment of the tobacco products tax with the cigaret tax. Similarly, I have followed the Committee's proposals to produce a more balanced inheritance tax structure with rates and exemptions that are in considerably better conformity with those of other states. Although the Committee was silent on the question of the gift tax, my proposals would simplify gift tax compliance and administration and would follow prevailing practice in other states to coordinate gift and inheritance tax rates.

Concerning iron ore, the Committee recommended that "the present effective levels of burden of occupation and royalty taxes including all present surtaxes should not be increased, except as a part of a tax increase program affecting business generally." However, in light of the impact of recession and foreign ores on the position of Minnesota iron ore, I do not feel that it would be wise to advocate an increase in the iron ore tax corresponding to the increase in the corporation income tax. Such an increase would mean an addition of approximately four percentage points to the present combined severance tax rate of 13.65 per cent on iron ore.

Instead, I recommend that the iron ore occupation and royalty taxes be increased by only one percentage point, with one-half of the proceeds being used to give additional benefits to low-grade, high-cost ore operations, and particularly to the small mining operators. These benefits will be worked out in accordance with the recommendations of the Tax Study Committee to extend credits to the royalty tax and extend additional tax benefits in connection with beneficiation of low-grade iron ores. As the Committee also recommended, I urge that the present special tax on taconite operations be maintained in its present form and at current levels, thus assuring our iron mining industry, as it moves increasingly from the low-cost direct shipping ores to the high-cost beneficiated ores, of a friendly tax climate for its heavy investments in new facilities.

9. <u>Improving the Tax Climate for Investment.</u>

Two years ago, in a position of relative revenue ease, a golden opportunity to implement the Tax Study Committee's recommendation for a drastic reduction of personal property taxes on business and farm inventories was lost. This program, which I fully endorsed, went well beyond the recommendation for personal property tax relief for manufacturers which I had made in 1955. Although it is extremely difficult to determine the exact impact of taxes on the location of industry, most studies indicate that taxes are much less important in determining business location than such factors as the cost and quality of labor, transportation costs, power costs, the availability of water and natural resources, the level of public services, and the like. Nevertheless, if there is any feature of the Minnesota tax structure that imposes an undue burden on industry, it is the personal property tax, and it is our goal to reduce this burden. But given the magnitude of our present fund-raising requirements, and the need to recommend tax increases on individuals, I cannot in good conscience recommend that the legislature provide this relief during the current biennium. We must, therefore, postpone action on this highly desirable tax adjustment for the time being. But when vigorous economic growth restores our revenue flow, as I am confident it will, we shall again be in a position to move ahead on tax relief for business and farm inventories, as well as on removal of the household goods tax.

Although we cannot take this major step at the present time, I wish to point out that a number of changes are being made to improve the tax environment for investment in Minnesota: (1) The introduction of accelerated depreciation and the special 20 per cent first-year allowance on investments up to $10,000 will provide a tax stimulus which is directly related to capital investment; (2) the additional tax benefits for high-cost iron ore operations will encourage investment in new beneficiating facilities; (3) in the small business area, which is so vital to vigorous economic growth and competition, the proposed changes in the corporate income tax will reduce burdens on corporations with incomes below $25,000, and (4) other small business tax relief, in addition to accelerated depreciation, will be provided in the technical and conforming legislation which will be submitted later in the session. Even in the face of our heavy revenue needs, therefore, we will continue to adjust our tax structure so as to stimulate industrial and agricultural investment in Minnesota.

10. Property Tax Reform.

The property tax is another area in which reform is long overdue. This tax is the fiscal backbone of local government; whatever weakens it weakens self-government at the county, township, school district and city and village level. Experience in many other states has shown that, while we cannot hope to reform property tax administration over night, progress toward a more equitable property tax administration should be pushed on many fronts. I am proposing a six-point program to continue our progress toward more uniform property tax administration:

1. Strengthen the recently established Property Tax Division in the State Tax Department by making budgetary provision for establishment of additional positions. With added personnel, this Division can enlarge its program of constructive cooperation with local and county assessing officials in the interest of improved assessment procedures and better appraisals of large and complex properties.

2. Spread the state property tax levy on an equalized basis. Under the present system of spreading an equal state millage levy throughout all counties, those that under-assess their property do not pay their fair share of the state property tax. This proposal of spreading the state levy on an equalized basis will assure that each county will make its proportionate contribution to the state levy. Owing to certain highly technical legal problems, the precise method of carrying out this recommendation must be worked out with great care.

3. As an extension of the philosophy of home rule which is so highly cherished here in Minnesota, I recommend that County Boards of Commissioners be given the authority to consolidate the assessment function at the county level under one assessor for the entire county by resolution of the board. This would simply mean that in those counties where the elected representatives of the people desire to make this change, it would be legally possible for them to do so.

4. Set up realistic modern training and experience standards for eligibility to appointment in filling vacancies as County Assessor and Supervisor of Assessments to assure a continuing development of expertness in these important positions.

5. Provide for the assessment of large industrial and commercial properties by the State Department of Taxation, on behalf of local governmental units. A number of states have extensive programs of assistance of this general type at the present time, and this step would relieve the local assessing officials of the excessive burden involved in appraising highly complex properties for which no sales figures are readily available.

6. Provide for equalization of individual assessments within classes of property and provide that taxpayers whose individual assessments are out of line with the general level of assessments within the respective classes within districts will have a simple means of securing relief.

11. Effect of Increases on Financing.

The effect of the proposals for new revenue are summarized in the large fold-out chart. You will note that, by assigning all collections from the individual income tax to the Income Tax School Fund, together with its constitutional share of the iron ore occupation tax, the entire appropriation recommendation of $236,066,000 is covered, leaving a balance of $1,895,000.

Similarly, by assigning all collections from the corporate income tax, together with other recommended increases, to the General Revenue Fund, the entire appropriation of $234,500,000 is covered.

It will be further noted that the program anticipates the use of 50 per cent of the gain from moving to current payment of the income tax for certain non-recurring activities.

VII. Conclusion

The foregoing program would raise the required revenues in a balanced and equitable manner that will not bear unduly hard on any one group of our citizens or any one type of economic activity.

It follows the guide lines laid down by the Governor's Tax Study Committee, not only in the broad approach to raising added revenues, but also in pushing ahead on revisions and reforms to improve tax equity, stimulate economic growth, and strengthen tax compliance and administration.

As I reflect on our fiscal problem in its broadest perspective, I am struck with the critical importance of doing a courageous and responsible revenue-raising job. In our emerging society of abundance, the people can and will demand a high level and quality of services from government. If we are to be worthy of the privilege of self-government, we must be willing to provide and pay for essential services at the state and local level. I am confident that the people of Minnesota, recognizing the need for the services provided for in this budget, will approve a responsible program of taxation to pay for them.