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ECONOMIC ANALYSIS
of the
STATE OF MINNESOTA

Report to
THE MINNESOTA RESOURCES COMMISSION
1945

IN THREE VOLUMES
Volume III



THE J. G. WHITE ENGINEERING CORPORATION
NEW YORK

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Table of Contents

FOREWORD

RECOMMENDATIONS

Iron Ore Industry

Forestry

Manufacturing

Agriculture

Taxation

State and Local Government Expenditures

CONCLUSION



FOREWORD

The submission of this Report in three separate volumes, as requested by the Minnesota Resources Commission, with the Exhibits separately bound, unavoidably produces some repetition and overlapping of subject matter. The findings and conclusions of the Report with a minimum of necessary foundation data have been assembled to form Volume I. Statistical and factual data compose Volume II with illustrative graphs and other matter separately bound. Volume III, (the present volume) which is necessarily brief, contains suggestions for remedial action relating to the findings and conclusions set forth in Volume I. Of necessity, much of the remedial action is implied in connection with the findings. Therefore, it is apparent that Volume III should be read as a normal continuation of Volume I, while Volume II can be regarded largely in the nature of a book of reference.

As expressed in Volume I, the unsatisfactory trends in important elements of the State's economy which have been progressing intermittently but unmistakably for a generation, have been accentuated by developments outside the State, but they also have been fostered by actions, omissions or failures within the State.

Apparently these actions, omissions or failures have been oversights caused by lack of realization of the State's actual competitive position and lack of comprehension of their influences on the State's own best interests. It is apparent that the adverse effects of these can be corrected only by the State itself, if after due consideration, it should decide to take the action necessary in order to improve in the future the unimpressive record of the past.

In this Volume III, which, as stated, can be read intelligently only as a part of Volume I, this Report offers the following recommendations for remedial action, believed to be potentially helpful for this accomplishment.



RECOMMENDATIONS

Iron Ore Industry

1. *The State should continue to encourage the mining of high cost ores and the mining and beneficiation of low grade ores.*

Extension of the policy, evidenced by the enactment of such laws as the Labor Credit Bill, the Taconite Bill and the bill providing a sliding scale for royalties on State owned properties, should make it possible better to meet competition that is presently increasing with Minnesota ores.

2. *The State should foster a constitutional amendment in regard to the policy of taxation of taconite.*

Taconite concentration must ultimately become a reality if Minnesota is to retain an iron ore industry for succeeding generations. The processes involved in taconite concentration are costly and require large capital expenditures in plant and equipment. This capital expenditure must be amortized over a long period of years and could not tolerate a large tax burden and in addition produce concentrated ore in competition with ore from other sources. The Taconite Bill in the form of a constitutional amendment would give assurance to the operating companies of the permanence of the State's taxing policy.

3. *The State should place a mill rate tax limit on the local taxing districts in the iron ranges.*

There are per capita tax limitations imposed by the State on the various taxing districts, and mill rate limitations on all but Independent School Districts and Home Rule Charter Cities. Some Home Rule Charter Cities have mill rate limitations in their charters, but others do not. The Independent School Districts and Home Rule Charter Cities may raise their mill rate levy without limitation as long as they do not exceed the total amount of taxes permitted by per capita limitations. This is possible regardless of decreasing assessed values and places a higher tax burden per ton of ore remaining in the ground as the reserves are depleted.

4. *The State should reduce the ad valorem taxes on iron ore.*

Under the present ad valorem taxes, the mining industry will remove high grade, high tax cost ores first. As the ad valorem tax is reduced, the mining companies can disregard the effect of the tax, and plan operations from viewpoints of economy and conservation rather than of tax saving.

A lowering of the assessment rate below the present 50% of the "full and true" value would place more of the tax burden in the Range communities on the general public, which derives the most benefit from such taxes.

5. *The State should establish a single State agency charged with the responsibility of research in connection with the iron ore industry.*

There are now several State agencies which devote some time to research and similar work, many with insufficient funds. They are all doing good work which includes exploratory, laboratory and pilot plant experiments, interpretation of drill records and determination of quantities. However, there are bound to be duplications and over-lapping. Often these agencies are not assured of adequate and continued appropriations.

A single agency with necessary appropriations should direct and divide the work.

Forestry

1. *The State should establish a uniform and mandatory forestry tax law having the same general characteristics as the Auxiliary Forest Law.*

The discussion in the earlier volumes of this Report has indicated the effect of the present ad valorem tax in bringing about the transfer of forest lands from private to State and County ownership by causing tax forfeiture. The establishment of a sound tax policy and procedure that would counteract this trend is an essential first step in the encouragement of the development of the State's forest lands under private ownership.

2. *The State and private ownership should join forces in endeavoring to reduce losses by fire.*

Relatively speaking, fire losses within the State of Minnesota far exceed the losses in other neighboring states. It appears to be economically sound and practicable to take steps to reduce these losses to a degree comparable to that of an ordinary insurable risk. This will entail materially better protection by the State and a program of cooperation with owners in the education of the public who make use of the forests.

3. *In cooperation with the Federal government the State should maintain a continuing study of and guard against injury to forests by insects and fungi.*

The extent to which expenditures for this service need be developed is largely dependent upon administrative procedure in encouraging cooperative efforts by private ownership.

4. *A properly qualified State authority should undertake a thorough study of forest trespass with the objective of guarding the rights and benefits of private ownership with due appreciation of public interest.*

If the State would encourage private owners in the development and use of their forests, it would be logical to transfer as much as possible of the burden

of forest care to the private owners. On the other hand, appreciable public interest will continue even with respect to privately owned forests, particularly in the matter of fish and game, the protection and propagation of which has been almost wholly a State function.

In order that no conflict may occur between the interests of private ownership and the public, the problem of maintaining the situation on a mutually satisfactory basis is a State responsibility which should be administered with the greatest possible care.

5. The State should encourage forest regeneration.

With the goal of insuring continuity and welfare of Minnesota's forests as the source of substantial income and employment, the State should encourage a continuing program of forest regeneration within the State-owned forests and those privately owned. The nature of such regeneration must necessarily recognize the respective needs and interests of both the owners and the public, particularly in its long range effect. Accordingly, in certain areas a high rate of production of pulpwood might well justify one form of regeneration, yet, under another set of conditions or in other areas, it might be more desirable to regenerate with the ultimate objective of increasing the extent of timber stands for the future production of lumber. No universally applicable program of regeneration can be laid down. However, it should be accomplished at a minimum of initial cost and with a minimum of capital tied up in growing stock.

Exhibits III-A-5 and III-A-6 were prepared to illustrate the procedure which should be followed if these objectives are to be accomplished. One hundred years has been arbitrarily selected as the period of maturity in these exhibits, as it is understood that other periods of time should apply depending upon the type of forest products.

The first of these exhibits is intended to illustrate the theoretically ideal program of forest production with the rate of development of products as indicated in the various growth periods.

The second exhibit illustrates a condition that might be said to apply to the forest areas of the State at the present time, showing the deficit resulting

from overcutting and the neglect of thinning. In the blocks below the triangular diagram, with growth indicated from left to right, is shown the potential yield assuming a suitable program of thinning.

The establishment of an orderly process of regeneration should originate with the State but be developed in close cooperation with private owners.

6. *The State should encourage the return of State and County-held forest land to private ownership.*

Such a program should be initiated if the State as a whole is to derive the advantages that can be secured through the stimulation of industrial activity with the advantage of private ownership.

7. *The State should charge some properly qualified agencies with maintaining a continuing record of all components as to cost, income and expense incidental to the promotion of recreational use of its forests, lakes and streams.*

These agencies should either be identical with or closely coordinated with those charged with other duties materially affecting the conservation of the forest areas within the State.

Manufacturing

1. *Representatives of industry within the State—primarily of manufacturing—should organize a State Industrial Association which would undertake such matters as the following:*
 - a. *In association with representatives of agriculture, forestry, mining and other sources of raw material, to study the production and adaptation of these raw materials to processing and manufacturing within the State, and all related costs.*
 - b. *Concurrently with the foregoing, to maintain continuing study as to market outlets.*
 - c. *To investigate the availability of raw materials from outside the State susceptible to manufacture within Minnesota.*

2. *Manufacturers should make every effort to improve the competitive position of their products.*

In appreciation of the fact that Minnesota's geographical location is disadvantageous for products in the field of "pure" competition, manufacturers should study means of adapting to their existing facilities, production of products in classes more nearly within the field of "imperfect" competition. The Report has indicated the large percentage of manufacturing in the State which is in "pure" and "advanced" competition. Compared to the total value of products manufactured in Minnesota the "value added by manufacture" is relatively small. The advantages of products in the "imperfect" class of competition are so great as to warrant every effort to enlarge this class.

3. *The State should encourage the establishment of industries within the State whose products are in the "imperfect" competitive class.*

The readiness of manufacturers to establish themselves within any given area is affected by the extent to which conditions within that area are favorable. Even though many of the conditions now adverse to manufacturing within Minnesota may be corrected, and excepting those using raw materials obtainable within the State or in nearby areas, Minnesota has little to offer those concerns which might be inclined to locate in Minnesota, unless they manufacture products in the field of "imperfect" competition. The problem of arousing the interest of such prospective industrial "settlers" is a State problem, as is also the interest of holding manufacturers now located in the State.

The State can and should organize to go after new business. In doing so, it should use means which are not inimical to the interests of concerns already established in the State.

4. *The State should stabilize its policy on a long term basis with regard to manufacturing.*

The economic conditions which, in the past, made Minnesota a natural location for a variety of industries either have been greatly changed, or have

completely vanished. The causes of this reverse have been rooted in the shifts and changes in the national economy, rather than those within the State itself, but their long term influences which are beyond the control of the State, have dissipated most of the Minnesota manufacturers' former advantages. Hence, if the State expects even to maintain its present position, it will be well advised to adopt a policy of encouragement for both old and new business concerns.

As management can plan on a basis of fact but not on uncertainties, the State should set forth in positive terms that would stabilize its policy, its general attitude toward business and industry, particularly with regard to taxation.

Agriculture

1. *Minnesota's farm organizations should plan for the long range development of the market for their products in a fashion which will serve both the State's and their own interests better than is at present the case.*

Findings of the Report show that if prewar trends in agriculture persist, the outlook for the future is not promising, although agriculture within the State apparently has made economic progress in the last thirty years, and the present rate of income is high as the result of Federal subsidies and war needs.

Seemingly agriculture has tried to expand the direct market of the Minnesota farmer to points outside of the State for products in the class of "pure" competition rather than to find, or even by stimulation to create, a better market within the State for such products. Such outside-the-state expansion of market tends increasingly to identify Minnesota's farm income with that of the national farm income to the greater disadvantage of the former in respect to periods of low income, and with no offsetting advantage in periods of high income.

With the use of farm products as raw materials, if processing and manufacturing can be stimulated within the State, not only will the farmer's market for such products be increased but he should derive other benefits. With the increase of manufacturing, greater opportunity will be afforded within the State for those members of the farmer's family for whom opportunity is lacking on

the farm. Increasing population in urban manufacturing areas should supply a relatively increasing market for farm products in the class of "pure" competition, with transportation costs at a minimum.

Increased activity in manufacturing and processing within the State will serve to supply another and constantly strengthening means of carrying the tax burden which would otherwise be gradually transferred to agriculture.

Taxation

1. The State should impose a Sales Tax in some form and correspondingly reduce Property and Income Taxes.

It has been pointed out that the "Sales Tax" is collecting 15%, on the average, of the tax revenue of all the states. Minnesota lacks this tax in its tax structure and is collecting revenue from two other taxes, namely, the Property Tax and the Income Tax, in excess of the national average. It has been repeatedly stated throughout the Report that from a competitive standpoint, manufacturing should be relieved of some of its tax burden. As imposed in Minnesota, the Property Tax under the classification system, which discriminates between different types of property, falls more heavily on manufacturing and mining than on the other enterprises within the State. As related to manufacturing, this is also true of the Income Tax.

The Sales Tax would distribute this excess tax burden among all groups of the population and place the manufacturing industry in a position to compete better in the national market. The Sales Tax may take several forms, such as, Retail Sales Tax, or Gross Income Tax.

This recommendation of a Sales Tax is based solely upon the desirability for the State to improve its relative position in respect to the average tax structure of the 48 states. It in no way reflects a general preference for this type of tax as such, upon the part of the authors of this Report.

2. The State should reduce the Property Tax (State and Local).

Property taxation as applied in Minnesota through the Classification System is placing a burden on manufacturing and mining considerably in excess

of that imposed on other industries. Manufacturing cannot stand this excess burden and at the same time compete in the national market. It is, therefore, desirable to spread this excess burden over the population and other industries of the State more evenly. Revenue that is lost by this reduction may be compensated for if a Sales Tax, as previously recommended, is enacted.

3. *The State should reduce the Income Tax.*

Minnesota levies one of the highest Income Taxes compared with other states. The Income Tax, like the Property Tax, places an excess burden on the manufacturing industry, and prevents Minnesota manufacturers' products from entering the national market on an equal basis with other states whose tax burden on manufacturing is not so great. Revenue that is lost by this reduction may likewise be compensated for by a Sales Tax, as previously recommended.

4. *The State should enact into the Auxiliary Forest Law a provision that makes application of the tax provided therein mandatory upon the local taxing units.*

Realization of the inability of the forests to withstand the burden of taxation as presently imposed has been manifested by the enactment of the Auxiliary Forest Law, but the purpose of this legislation has largely been defeated by the failure of local taxing units to grant auxiliary forest status to a large majority of the forests in the State. This inability to carry a tax levied on the same basis as agricultural land is discussed more fully in the Forestry Section of this Report.

5. *The State should abolish the "Money and Credits" and "Mortgage Registry" taxes and enact a provision in the "Income Tax" law to the effect that taxes collected upon the income of mortgages and moneys and credits should be "in lieu of" the Property taxes now levied on this type of property.*

The "Money and Credits" tax has been largely evaded in its application throughout the State. Therefore, the distribution of its burden has been inequitable. It is a tax on evidence of wealth, rather than on wealth itself and

where the wealth itself is in the form of property that has been taxed, it represents double taxation. The "Mortgage Registry Tax" should be treated in the same manner.

6. The State should inaugurate a County Assessor System and place the assessors under the supervision of the State Tax Commissioner.

Assessments made by the approximately three thousand different part-time assessors that are now employed throughout the State of Minnesota can not be uniform. This is particularly true when there is no uniform method of approach. The State Tax Commissioner should be empowered to determine and furnish to the assessors a uniform method of assessment. The number of assessors would be greatly reduced by the employment of full time personnel. A County Assessor System would accomplish this result.

7. The State should change the assessment classification of inventory and fixtures of the Manufacturing and Trade Industries.

Reduction of the Property Tax could be put into effect largely by a change of assessment classification for inventory and fixtures in the manufacturing and trade industries now assessed at 33-1/3%, and transferring them to the same classification as agricultural inventory and fixtures, namely, 10% and 20% respectively.

State and Local Government Expenditures

1. The State should strive toward overall economy in expenditures and should endeavor to reduce the number of minor civil divisions and the volume of their expenditures.

Expenditures beyond state and local government minimum costs impose a handicap on the people because such expenses reduce the funds available for competitive productive enterprise. The actual burden must be adjusted to the ability of the people to carry it. Before individual "Incomes" became increased by the war and deficit financing, Minnesota had been spending for the operation of all combined state and local government activities, including

current operating expenses, capital outlays and interest payments, about 15% of the income payments to individuals.

Current operating expenses of the State alone (including State aid), capital outlays and interest payments have taken about 8% of these income payments. For the years 1939 through 1943 in Minnesota, these latter expenditures, computed on a per capita basis, have exceeded corresponding expenditures averaged among the 48 states by from \$3 to \$12 annually. As these annual per capita expenditures in Minnesota ranged from about \$39 to \$44, the excesses, percentagewise, have ranged between 7.5% and 30%.

In 1941, the number of administrative units in Minnesota, including counties, incorporated places, towns, school and other districts, was more than three times the corresponding average for the 48 states. The same was true of the number of school districts alone. The large number of administrative government units in Minnesota can only increase government costs, especially if the 2,729 state and local highway administrative agencies are taken into consideration. An effort by the State toward the consolidation or elimination of some of these units, with the object of overall economy, is recommended.

2. *The State should revise and simplify the State-Aid Systems especially as to the allocation of State funds for education, highways and charities. It should strive toward uniformity in the public school system, consolidation of school districts with elimination of small rural schools; also the simplification of highway administration.*

Three large groups of expenditures in Minnesota are schools, highways and charities. The administration of all these departments requires state-wide organizations, supervised by central-office staffs. The State has realized the seriousness of the shortcomings of these large and overlapping organizations and numerous reports have been published, many of them thoroughly covering the subjects. Educational problems have received marked attention and plans have been prepared leading toward improvement by simplifying the whole school and school aid system, including a reduction in the number of school districts

and rural schools. The State should act promptly in promoting uniformity in the public school system and improving the administration of State aid.

Administration of highway construction and maintenance has become unwieldy with overlapping jurisdictions. In planning for post war construction and maintenance the highway systems should be coordinated, and the State should promote reduction in number of agencies. The same situation and recommendations apply to the administration of the laws relating to care and maintenance of the needy and handicapped.

3. The State should extend the mandatory domain of the Public Examiner to levels of government below counties and cities of the first class.

In Minnesota the Public Examiner occupies a strategic position as an agency for influencing the local units to improve their procedures in handling government expenditures, and for planning improvements and economies in fiscal departments. The State should extend his mandatory jurisdiction to all levels of government.

4. The State should revise the limitation of the debt of communities by a method that will not tend to freeze high assessment valuations.

As has been noted in both the tax and expenditures sections in Volumes I and II of this Report, the policy of limiting the amount of debt to be incurred by local units to a relatively small proportion of total assessed valuations in such local areas has tended to keep these valuations high in those civil units in which the outstanding debt is at or near the maximum. This condition promotes inequalities among the communities.

CONCLUSION

As this Report is submitted the end of organized fighting by the Germans appears soon to be expectable, and the end of the Japanese war more remote. The clean up job probably will take longer than present appearances would indicate as the economic and industrial character of a large portion of the world will be changed. The United States has had a long period of peace time deficits followed by an expensive war. It will emerge victor from this but with a debt of well over 300 billions of dollars and a serious employment problem; hence, thoughts of an easy or normal post-war period might just as well be dismissed.

Such an unpleasant prospect, coolly appraised, appears to offer to Minnesota an opportunity to take advantage of its remoteness from the more densely populated regions, and regain much lost ground. This it can do by providing conditions and opportunities that will attract venture capital, foster industrial initiative, protect both old and new investments and generally make the State a more desirable place for ambitious and energetic people to settle in and strive for economic independence.

Any substantial benefit to the State from this Report must come through political action; hence, the best service that it can render may be to provoke discussion, comment and criticism, deserved or undeserved, which will arouse in the citizens of Minnesota an increased interest in the things which affect their welfare. It also can render service in bringing about an appreciation of the fundamental necessity for prompt and permanent correction of conditions, which judged by their effects on the State's economy, are unsatisfactory.