NEW FEES
IN THE ERA OF
“NO NEW TAXES”

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Key Findings & Recommendations

During the era of “no new taxes,” Minnesota is primarily addressing rising budget shortfalls by cutting much-needed aid to local governments and jacking up regressive fees on Minnesota families. Relying on these policies alone to resolve the $5.5 billion deficit would have disastrous repercussions for our state.

Minnesota Fees Jump During Past Five Years
A fee is a payment to use a particular good or service. While the difference between a fee and a tax is not always clear, one distinction between the two is that a person opts to pay a fee, but must pay a tax. As used in this report, “fees” include fees, charges, and post-secondary tuition.

From fiscal year (FY) 2003 to FY 2008, real (i.e. inflation-adjusted) per capita state fees increased by 20.8 percent. In other words, growth in state fees has exceeded both inflation and population growth by nearly 21 percent.

Percent Change in Real Per Capita State Fees, Taxes, and Own-Source Revenue Since FY 2003

<table>
<thead>
<tr>
<th>Year</th>
<th>Fees*</th>
<th>Own-Source Revenue</th>
<th>Taxes</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
</tr>
<tr>
<td>2004</td>
<td>0.7%</td>
<td>0.2%</td>
<td>-1.3%</td>
</tr>
<tr>
<td>2005</td>
<td>1.3%</td>
<td>1.0%</td>
<td>-1.5%</td>
</tr>
<tr>
<td>2006</td>
<td>2.6%</td>
<td>-0.7%</td>
<td>3.7%</td>
</tr>
<tr>
<td>2007</td>
<td>10.1%</td>
<td>-5.2%</td>
<td>-9.0%</td>
</tr>
<tr>
<td>2008</td>
<td>10.7%</td>
<td>20.8%</td>
<td>19.1%</td>
</tr>
<tr>
<td>2009</td>
<td>29.0%</td>
<td>22.7%</td>
<td>19.1%</td>
</tr>
</tbody>
</table>

Statewide fee totals in this report are taken from the November forecast “Price of Government” report, as used here, “fees” will refer to the combined total of “fees and charges” and “post-secondary tuition.

Based on projections for FY 2009, real per capita state fees have increased by 19.1% from FY 2003 to FY 2009. Because state tax revenue is more than seven times greater than state fee revenue, a 19.1 percent increase in fees is nowhere near enough to make up for a 13.0 percent decline in taxes, so total state own-source revenue (i.e., all state revenue generated by the state excluding federal aid) is down 9 percent.

Most importantly, the increase in state fees has financial implications for the typical Minnesotan.
Getting married? Congratulations. That marriage license will cost you $110—$40 (57 percent) more than six years ago.

Lose that birth record? In 2003 it would have cost you $20 to get it replaced. Today it will cost you double.

Going pheasant hunting? Good luck. Your pheasant stamp will cost $7.50—50 percent more than six years ago.

Each of these fees has one thing in common: the increase is much higher than inflation. While some fee increases may be necessary to pay for increased costs, it is clear that fee increases are also being used to backfill a hole in the state budget.

Fees are Regressive
Minnesota’s revenue system has become regressive, meaning lower-income households pay a larger percentage of their income in taxes than do higher income households. Regressivity in Minnesota’s tax system increased from 2002 to 2004 and is projected to increase again by 2009.

According to the Internal Revenue Service, fees are “considered regressive because they take a larger percentage of income from low-income groups than from high-income groups.” There can be no doubt that Minnesota’s increased dependence on fees has shifted more costs to those with the least ability to pay.

Projected FY 2008 State Revenue

<table>
<thead>
<tr>
<th>Revenue Source</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>State Taxes</td>
<td>63.3%</td>
</tr>
<tr>
<td>Federal Aid</td>
<td>24.5%</td>
</tr>
<tr>
<td>Fees</td>
<td>8.8%</td>
</tr>
<tr>
<td>All Other</td>
<td>3.4%</td>
</tr>
</tbody>
</table>

(Total = $27.7 billion)

Fees Can’t Replace Tax Revenue
Total FY 2008 state fee revenue—including post secondary tuition—was $2.44 billion. The state is projected to collect $17.5 billion in taxes, seven times greater than fee revenue.

Since fees are a smaller revenue source, fee increases cannot replace massive drops in tax revenue. This is one of the reasons why total real per capita state revenue declined by 5.9 percent from FY 2003 to FY 2008, with another large reduction anticipated for FY 2009.

Over-reliance on fees is a recipe for large scale decline in public investment, which is precisely what we have seen over the last six years.
Discouraging Higher Education

Fees can be attractive because they tend to discourage consumption of public services. However, there is one public good that we do not want to discourage: higher education.

Post-secondary tuition is one type of fee that has grown rapidly in recent years. State revenue generated from tuition has increased by 22.3 percent from FY 2003 to FY 2008 in inflation-adjusted dollars per capita.

A recent Growth & Justice report notes, “At the current rate we are producing students with post-secondary degrees, within two decades Minnesota will not have enough skilled working adults to sustain our economy or quality of life at the levels most of us have enjoyed.” The National Center for Public Policy and Higher Education concludes that “colleges and universities in Minnesota have become less affordable for students and their families. If the state’s downward trends are not addressed, they could limit its access to a competitive workforce and weaken its economy over time.”

The recent trend toward escalating tuition is likely undermining the Minnesota’s long-term economic vitality and competitiveness.

A Balanced Approach

Fees play an important role in financing government. There is something intuitively appealing about requiring those who benefit from particular public goods and services to cover the costs through a fee. However, Minnesota’s recent fee increases frequently have fallen outside of what would be considered good public policy.

Ronald Reagan once said that another way to spell fee is “T-A-X.” While the 40th president was oversimplifying, this comment is apropos in Minnesota today. In order to satisfy political objectives, revenue enhancements that would ordinarily have been considered a “tax increase” have been reframed as a “fee increase.” A prime example was the 2005 “health impact fee,” which is broadly considered to be a defacto tax.

During the 2009 legislative session, the state will be confronting a massive $5.5 billion dollar deficit for FY 2010 through FY 2011. In dealing with this revenue shortfall, state policymakers have two options. Continuing policies of the last six years, balancing the state budget through a combination of painful budget cuts and fee increases, would be a recipe for disaster. A more progressive approach would be to rely on a balanced mix of spending reductions, revenue increases, and—where appropriate—fee increases.

Any new fee increases in this year’s budget solution must be implemented with transparency, with the goal of mitigating their regressivity and other harmful side effects.
Fees vs. Taxes

In the “Price of Government” report from Minnesota Management and Budget, own-source revenues are neatly divided between several categories, the largest of which are taxes, fees, and post-secondary tuition. However, in practice the dividing line between these revenue categories is not always clear. The distinction between taxes and fees can be particularly blurry.

Distinguishing Between a Fee and a Tax

In theory, fees are voluntary payments, while taxes are involuntary. For example, you chose whether you want to buy a fishing license; thus, purchasing a fishing license can be categorized as a fee. On the other hand, you do not choose whether or not to pay income taxes. A person opts to pay a fee, but must pay a tax.

Another distinction between fees and taxes relates to the government service being paid for. In general, a fee is a payment for the privilege utilizing or receiving a particular good or service. An example would be the charge for a state trail cross-county ski pass. The beneficiaries of cross-county ski trails can be easily identified (these are usually the people with long boards attached to their feet), so skiers pay for the privilege of using state trails and help fund trail maintenance and improvement.

Post-secondary tuition resembles a fee insofar as admission to an educational institution is contingent upon payment of the tuition. Payment of fees or tuition is generally accompanied by a privilege not available to those who did not pay.

Taxes, on the other hand, are usually not tied to direct receipt of a particular good or service. Paying income or sales taxes does not impart any privilege to a taxpayer that is not available to a non-taxpayer or to someone who pays these taxes at a lower level.

For this reason, taxes are generally used to pay for public goods. For example, society benefits from the criminal justice and correction systems. It would be difficult to quantify how much any one citizen benefits from keeping criminal offenders behind bars, so society pays for these systems through general taxes.

Ultimately, it is important to recognize the subjectivity involved in the distinguishing fees and taxes. In an analysis of state fees, the best that a researcher can do is to be clear about which categories of revenue are being treated as fees.

“Fees” for purposes of this report will include “fees and charges” as well as “post-secondary tuition.” Post-secondary tuition is included with fees in this report because it is a payment received for a particular service. All data will be derived from the November 2008 forecast “Price of Government” report prepared by Minnesota Management & Budget.
In 2002, Tim Pawlenty was elected governor on a platform of “no new taxes.” As the pledge was implemented, it was clear that it applied only to state taxes, not local taxes. (For example, as noted in previous Minnesota 2020 reports, the state solved a disproportionate share of its budget problems by cutting aid to local governments, essentially forcing local governments to increase property taxes at the same time that they were cutting local services.) In addition, it became equally clear that the “no new tax” pledge did not apply to state fees and charges.

Using data from the Minnesota Management and Budget’s “Price of Government” report, it is possible to examine the change over time in state fees and taxes. In this analysis, fiscal year (FY) 2003 will be the baseline year. FY 2003 was the last year under a budget set by Governor Ventura; thus, it is a good starting point for analyzing the changes that occurred under the “no new tax” policies of Governor Pawlenty.

Nearly all budgets—public and private—increase over time due to erosion in the purchasing power of the dollar. Population growth also contributes to the need for more public expenditures and growth in public revenues. For this reason, fee, tax, and other revenue amounts will be expressed in real (i.e., inflation-adjusted) dollars per capita, thereby adjusting for the effects of inflation and population growth. The inflation adjustment in this report will be based on the implicit price deflator for state and local government purchases, which is the most appropriate measure of inflation for state government.

State Tax Revenue Declines

As a prelude to a discussion on growth in state fees, it is useful to consider change in state taxes. Statutory increases in state taxes have been rare under the Pawlenty administration. One of the few exceptions occurred during the 2008 legislative session, when statutory changes were made which closed loopholes in the corporate income tax, effectively resulting in a tax increase. However, it should be noted that these changes were a legislative initiative that Governor Pawlenty opposed but ultimately acquiesced to as part of a compromise with the legislature. In addition, the state’s gas tax was increased in 2008 after Pawlenty’s veto of the legislation was overridden.

However, taxes can increase in the absence of statutory changes. For example, income and sales tax revenues can increase as a result of increased economic activity, even if no statutory change in tax rates has occurred. State tax increases driven by economic growth have not occurred during the Pawlenty administration. In real (i.e., inflation-adjusted) dollars per capita, state taxes have declined since FY 2003.

While state tax revenue kept pace with inflation and population growth from FY 2003 to FY 2006, it declined sharply after 2006. Despite complaints about growing taxes from anti-tax advocates, per capita state tax
revenues are projected to decline by slightly more than $181 or 5.2 percent from FY 2003 to FY 2008 in constant FY 2008 dollars.

The ongoing economic collapse is expected to severely affect state tax revenue. Based on November 2008 forecast, real per capita state tax revenue will fall by another 8.2 percent from FY 2008 to FY 2009. The aggregate real per capita decline in tax revenue from FY 2003 to FY 2009 is expected to be $455 or 13.0 percent.

Growth in State Fees
While state taxes have declined during the era of “no new taxes,” state fee revenue has not. As noted in the introduction, fee revenue as used here will include “fees and charges” and “post-secondary tuition,” both from the “Price of Government” report. Growth in state fee revenue has outpaced both inflation and Minnesota population growth.

Real per capita fee revenue increased by 10.1 percent from FY 2003 to FY 2005. From FY 2005 to FY 2006, real per capita fees increased by 17.2 percent largely due to the imposition of the health impact fee (HIF). However, even if HIF revenue is excluded from the fee total, real per capita fee revenue still increased by approximately seven percent from FY 2005 to FY 2006.

Fee revenue declined modestly since FY 2006 for reasons that are not apparent based on data from the “Price of Government” report. However, even with the dip real per capita fee revenue in FY 2007 was significantly greater than in FY 2003—the last year under Governor Ventura. Based on “Price of Government” projections, real per capita state fees will be 20.8 percent higher in FY 2008 than in FY 2003.

While state taxes have declined during the years of the Pawlenty administration after adjusting for inflation and population growth, fees have increased.

If post-secondary tuition is excluded from fees, real per capita fee growth from FY 2003 to FY 2008 is 19.3 percent. Over the same period, post-secondary tuition increased by 22.3 percent.

State Own-source and Total Revenue
While real per capita fee revenue collected by the state increased significantly since FY 2003, these increases were no where near sufficient to offset the decline in real per capita state taxes. Total state own-source revenue—which includes taxes, fees, and tuition, as well as the much smaller revenue categories of investment earnings, tobacco settlements, and “all other resources”—has declined sharply during the era of “no new taxes.”
State own-source revenue kept pace with inflation and population growth and even increased slightly from FY 2003 to FY 2006, as increases in real per capita fee revenue were sufficient to push total own-source revenue higher despite essentially flat real per capita taxes. However, since FY 2006 real per capita own-source revenue has declined. During the five year period from FY 2003 to FY 2008, per capita state own-source revenue is projected to decline by $151 or 3.7 percent in constant FY 2008 dollars.

Based on the November 2008 forecast, the national economic collapse will cause a sharp decline in state own-source revenue in FY 2009. From FY 2008 to FY 2009, per capita own-source revenue is expected to decline by another $219 or 5.5 percent in constant FY 2008 dollars. The aggregate real per capita decline in own-source revenue from FY 2003 to FY 2009 is expected to be $370 or 9.0 percent.

Own-source revenue excludes one major category of dollars received by the state: federal aid. After factoring in federal dollars, total per capita state revenue is projected to decline by $331 or 5.9 percent in constant FY 2008 dollars from FY 2003 to FY 2008, with an additional $116 or 2.2 percent decline anticipated from FY 2008 to FY 2009.

While state fee revenue has increased sharply over the last six years, it would be a mistake to conclude that increases were sufficient to replace the decline in real per capita taxes.

Postscript to State Revenue Decline
Real per capita state government revenue certainly has shrunk during the era of “no new taxes.” While fee revenue has increased, this growth was more than offset by a decline in real per capita state taxes. However, the decline in state revenue should not be interpreted as a sign of frugality and exemplary fiscal management on the part of the state.

Total per capita state revenue from FY 2003 to FY 2009 is projected to decline by $448 in constant FY 2008 dollars. However, the total per capita aid that the state shares with local governments is projected to decline by $553. Because the cut in state aid to local governments exceeds the total decline in state revenue, the total per capita revenue retained by the state (i.e., total state revenue minus the dollars shared with local governments) is projected to increase by $105 in constant FY 2008 dollars.

Thus, while real per capita state revenue has fallen, the state has managed to shift the burden of this revenue loss on to local governments through cuts in state aid. From FY 2003 to FY 2009, total local government revenue will decline much more rapidly than state government revenue. Clearly, local governments have been more frugal than state government during the era of “no new taxes.”
The Health Impact “Fee”
In practice, the distinction between a fee and a tax is not always clear. A prime example of the confusion over what constitutes a tax and what constitutes a fee is the “health impact fee,” enacted during the 2005 legislative session.

In 2005, Minnesota was anticipating a budget shortfall for the approaching FY 2006-07 biennium. Historically, policymakers would deal with a shortfall through a combination of spending cuts and tax increases. However, in 2005 Governor Pawlenty was bound by a “no new tax” pledge. Thus, state leaders felt compelled to find ways to increase state revenue in a way that did not increase taxes—or at least in a way that would not be identified as a tax increase.

The ultimate comprise reached between the Governor and the legislature was the “health impact fee” (HIF), which was a 75 cent per cigarette pack charge that generated approximately $200 million in fiscal year 2006. From the outset, there was a debate whether the HIF was a fee or a tax.

As stated in law, the purpose of the HIF was to “recover for the state health costs related to or caused by tobacco use and to reduce tobacco use, particularly by youths” (Laws 2005, First Special Session, Chapter 4, Article 4, Section 2, subdivision 1). Because the revenue was dedicated to a particular purpose, Governor Pawlenty argued that the HIF was in fact a fee and not a tax.

However, in other regards the HIF did not pass the “smell test” for a fee. In the debate over the HIF, it was noted that:

• The HIF was collected in the same manner as the existing 49 cent per pack cigarette tax. As stated in law, “A distributor must pay the fee at the same time and in the same manner as provided for payment of tax under chapter 297F [i.e., the existing cigarette tax]” (Laws 2005, First Special Session, Chapter 4, Article 4, Section 2, subdivision 4).

• Those who pay the HIF were not receiving any specific benefit or privilege that was not available to those who did not pay the HIF. In fact, insofar as the proceeds of the HIF were successful in preventing smoking among youth, the beneficiaries would, by definition, not be paying the HIF.

• While the stated purpose of the HIF was to recoup costs associated with tobacco use, proceeds from the HIF were largely supplanting general fund dollars that could then be freed up to pay for other functions, such as K-12 public education. By shifting and replacing existing funds, it could be argued that the HIF was in fact funding other government functions unrelated to public health.

The creative attempts to spin the HIF as a fee instead of a tax were not lost on the media. In his blog from May 2005, Minnesota Public Radio Political Editor Mike Mulcahy noted that “Most of the people who work on tax policy at the Capitol say the governor’s proposal is a tax, even though Pawlenty insists it’s a fee. So we’ve made a decision at MPR that we will generally refer to it as a tax and do our best to put it in context.”

By linking the HIF to “costs related to or caused by tobacco use,” the state opened itself up to a lawsuit from the tobacco industry on the grounds that the state was violating conditions of a 1998 settlement with the tobacco industry. In exchange for a multi-billion dollar settlement payment from the industry, the State of Minnesota agreed to release the industry from future costs related to tobacco usage. The industry argued the imposition of the HIF violated this settlement.
A Ramsey County District Court agreed with the tobacco industry. The District Court concluded, “That the state sought reimbursement of tobacco-related health care costs clearly violates the Settlement Agreement.” A portion of the District Court’s decision to side with the tobacco industry rested on the fact that the HIF was a fee, not a tax. Citing a Minnesota Department of Revenue publication which characterizes a fee as “approximating the costs incurred by, or imposed upon government,” the District Court concluded:

The inclusion of the [HIF] bill within an “Omnibus Health and Human Services Bill” providing policy and funding, establishing the health impact fee and appropriating money clearly indicates that the $.75 per pack was not a tax. Had it been a tax it would have been likely included in the “Omnibus Tax Bill” passed the same day, which had provisions related to the collection of excise and sales taxes on tobacco products.

In part, the District Court’s conclusion that the HIF was a fee and not a tax had to do with the fact that the measure was contained in a health and human services bill and not a tax bill.

Ultimately, the Minnesota Supreme Court overturned the District Court’s decision. The Supreme Court concluded that “the settlement agreement [did] not waive the legislature’s authority to enact future legislative revenue measures to recover healthcare costs.” The Court’s decision did not definitively resolve the question of whether the HIF was a tax or a fee; in fact, both plaintiffs and defendants appeared to agree that whether the HIF was a tax or a fee ultimately made no difference to the resolution of the lawsuit.

Nonetheless, it is clear that had the HIF been characterized as a simple addition to the existing cigarette tax, instead of as a fee to pay for health care costs related to tobacco usage, litigation over the HIF never would have arose. Furthermore, the whole issue could have been resolved if the state had agreed to identify the HIF as a tax. As one health policy think tank observed, “One possible solution would be to convert the ‘fee’ into a tax, but both lawmakers and Gov. Tim Pawlenty have been averse to raising taxes, even if it is just a matter of semantics in this case.”

State policymakers attempted to statutorily define “tax” in legislation passed in 2006.

(a) “Tax” means any fee, charge, exaction, or assessment imposed by a governmental entity on an individual, person, entity, transaction, good, service, or other thing. It excludes a price that an individual or entity chooses voluntarily to pay in return for receipt of goods or services provided by the governmental entity. A government good or service does not include access to or the authority to engage in private market transactions with a nongovernmental party, such as licenses to engage in a trade, profession, or business or to improve private property.

(b) For purposes of applying the laws of this state, a “fee,” “charge,” or other similar term that satisfies the functional requirements of paragraph (a) must be treated as a tax for all purposes, regardless of whether the statute or law names or describes it as a tax. (Laws 2006, Regular Session, Chapter 259, Article 13, Section 15, subdivision 19)

By this definition, the HIF can be both a tax and a fee, since “fees” are a subcategory of “taxes.” However, this resolution is not entirely satisfactory to policy wonks. Constructive policy outcomes are best served when there is a reasonable delineation between fees and taxes and some consensus regarding the appropriate use of each.

The entire controversy regarding the HIF underscores the problems that can arise when state leaders, in
order to satisfy political objectives, attempt to make revenue measures that would ordinarily be considered a tax appear to be a fee. Attempts to spin the HIF as a fee, instead of the more direct route of simply adding the 75 cent per pack charge to the existing cigarette tax, resulted in unnecessary and costly litigation, a loss of financial transparency as public dollars were shifted among various state funds, and an increase in public cynicism.

Perhaps the only beneficiaries of the shenanigans surrounding the HIF were Governor Pawlenty and anti-tax legislators, who were able to claim that they did not increase taxes. However, even this “benefit” was somewhat illusory for anti-tax politicians. The Taxpayers’ League of Minnesota contemptuously dismissed the HIF as a tax increase and blasted lawmakers who supported it. Ultimately, few were fooled.
State Fees in Minnesota

The state charges fees for a wide variety of services. The individual fees and charges from which the State of Minnesota draws revenue are not listed individually in the “Price of Government” report. However, information on the composition of state fees is contained in a 2006 report from the Minnesota Department of Revenue. While the state fee revenue shown in the Revenue Department report does not precisely match the fee revenue shown in the “Price of Government” report, the statewide totals are similar.

**Diagram: Distribution of State Fee Revenue in FY 2005**

- Court penalties and fines, 6.0%
- Departmental penalties, 0.6%
- Departmental sales, 4.1%
- Departmental services net of refunds, 20.7%
- Licenses, 55.9%
- Other court revenue, 6.5%
- Care and hospitalization fees, 6.2%

**Composition of State Fees**

The distribution of state fee revenues based on the 2006 Revenue Department report for FY 2005 is shown on the left.

The distribution of fees for FY 2005 shown in the left-hand chart does not take into account the health impact fee (HIF), which was not imposed until FY 2006. However, based on FY 2007 HIF revenue and assuming that the distribution of the remaining fee revenue remains the same as in FY 2005, it is possible to approximate the distribution of state fee revenue in FY 2007 after the introduction of the HIF.

With the addition of the HIF, the approximate share of total fee revenue derived from the other fee categories shrinks relative to FY 2005.

**Examples of Specific Fees**

Several fees that are collected by the State of Minnesota are listed in the following section. This list is not exhaustive, but does provide examples of some of the fees collected by the state and, where available, information on the amount of revenue generated. The fee categories listed below may not correspond with categories used in the 2006 fee report prepared by the Minnesota Department of Revenue.

- **Health Impact Fee**
  
  Among the largest single state “fees” is the health impact fee (HIF), which—as noted in the previous section—some

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\*For each year from FY 2003 to 2005, total fee revenue from the Price of Government report is within three percent of total fee revenue from the 2006 Revenue Department report. Differences between the two reports are likely due to (1) modest differences in which revenues are classified as “fees” and (2) differences in the timing of the data. (The November 2008 Price of Government report could contain final data that was not available when the 2006 Revenue Department report was released.)
consider to be a tax. In the 2008 end-of-session consolidated fund statement, the HIF is described as “cigarette and tobacco fees.” The first year that the state collected revenues from the HIF is FY 2006. The amount of revenue generated by the HIF in FY 2006 was $208 million.

HIF revenue peaked in FY 2007 at $225 million, before falling to a projected $219 million and $217 million in FY 2008 and 2009 respectively. HIF revenue is projected to continue to decline in the next biennium; by FY 2011, the Minnesota Management and Budget anticipates that HIF collections will be $25 million less than in the peak year of FY 2007. According to the consolidated fund statement, all of the revenue generated by the HIF goes to the “health impact fund,” but is then transferred to the state’s general fund.

Petroleum Tank Release Fee

The “petroleum tank release fee” provides most of the revenue for the State’s Petroleum Tank Release Cleanup Fund, also known as the Petrofund. According to a Minnesota House Research Department memo, the Petrofund was enacted in 1987 in response to Congressional action. Petrofund dollars are used to address contamination of soil and groundwater resulting from leaking petroleum tanks. According to the House Research memo, “A fee of 2 cents per gallon is imposed on the use of tanks that contain petroleum products. Whenever the balance of the fund falls below $4 million, the fee is activated by the commissioner of revenue for a period of four months.”

According to the state’s consolidated fund statement, the petroleum tank release fee has generated approximately $26 to $27 million annually in recent years. Unlike the HIF, fee revenue is not transferred to the general fund, but goes primarily to the Commerce Department to pay for cleanup of contaminated sites.

Supervision Fee

In addition to large fees like the HIF and petroleum tank release fee, the state also imposes a number of smaller fees. One such small fee is the “supervision fee.” According to a Minnesota Department of Corrections report, in 1999 the legislature authorized the Department of Corrections to collect “fees from offenders on probation and supervised release… to help offset costs related to correctional services.”

Offenders subject to this policy are required to pay an annual fee of $120. According to the report, approximately $1.5 million in supervision fees were imposed in each FY 2004 and 2005, although actual collections were about half this amount. Of the $783,000 collected by the state in FY 2005, $219,000 was distributed to Minnesota counties, with the balance going to the state’s general fund.

Hunting and Fishing Licenses

The revenue from the sale of hunting and fishing licenses is included within total “fees and charges” listed in the “Price of Government” report. Revenue from the sale of hunting and fishing licenses—as well as from the sale of “stamps” needed to take selected species of fish and game—go to the Game and Fish Fund and are used to support activities related to the management and enhancement of these sports, such as habitat preservation and improvement.

Based on information from the Department of Natural Resources, revenue from the sale of hunting and fishing licenses has totaled approximately $45 million to $47 million annually each year from FY 2005 to 2007, with similar collections projected for FY 2008 to 2011.

While sportsmen may assume that revenue from the sale of hunting licenses is used to support hunting related activities and revenue from the sale of fishing licenses is used to support fishing related activities, this is not entirely true. A 2006 memo from the Game and Fish Fund Budgetary Oversight Committee reveals
that revenue from the sale of hunting licenses is greater than expenditures for hunting related activities, while revenue from the sale of fishing licenses is less than expenditures on fishing related activities. In short, a portion of the revenue from the sale of fishing licenses is being used to support hunting related activities. (State law does not explicitly require that hunting license revenue be used exclusively for hunting related activities or that fishing license revenue be used exclusively for fishing related activities.)

The extent to which fee revenue is used to pay for expenditures not directly related to the perceived purpose of the fee is not clear. However, the example of subsidization of hunting related expenditures with fishing license revenue indicates that this does occur to some extent.

**Fines and Forfeitures**
Fines and forfeitures are included among “fees and charges” in the Price of Government Report. Among the fine revenue included in Revenue Department’s 2006 fee report are court penalties and fines, late license renewal fines, administrative penalty orders, seat belt fines, controlled substance fines, and civil penalties.

According to a Minnesota House Research Department information brief, general forfeiture laws allow for the seizure of property associated with a long list of “designated offenses.” In addition, administrative forfeiture law allows for the seizure of “all money, precious metals, and precious stones found in proximity to controlled substances” or “drug manufacturing and distribution equipment.” In certain instances, general forfeiture law allows for the sale of seized property. After liens and sale expenses have been satisfied, a portion of proceeds from the sale of foreclosed property is distributed to the state general fund.

There is a vast body of state law pertaining to fines and forfeitures. The preceding discussion only scratches the surface of these laws.

According to State of Minnesota consolidated fund statement, “fine and surcharge” revenue going to the state’s general fund was $85 million in FY 2005, $131 million in FY 2006, and $106 million in FY 2007. Fine and surcharge revenue is projected to dip to $95 million in FY 2009. In addition to the general fund, several other state funds receive fine revenue.
Fee Increases, Minnesota Style

As noted earlier, real per capita state fees—including post-secondary tuition—in Minnesota have increased by 20.8 percent from FY 2003 to FY 2008. If we do not adjust for inflation and population growth, the state fee increase over this period are 63.0 percent.

Fee increases are not inherently bad. Fees definitely have a role to play in financing government services. For certain government services, fees help to direct the cost of those services to those members of the public that benefit from them. Used appropriately, fees can control the demand for public services and help hold down government costs.

However, increases in state fees as implemented in Minnesota in recent years have had negative consequences that need to be explored.

Obfuscation in Public Finance

Ideally, fees should be used to pay for the cost of services for which the fee is imposed. However, some of the fee increases in Minnesota in recent years have been part of an elaborate ruse to generate general purpose public revenue under the guise of a fee increase.

An example of this is the health impact fee (HIF) discussed earlier in this report. The stated purpose of this fee was to cover “costs related to or caused by tobacco use;” furthermore, the dollars generated by the fee were deposited into a “health impact fund.” However, while the disposition of HIF revenue is on the surface related to its stated purpose, the truth is more complicated.

During the legislative debate on the HIF, Minnesota Public Radio reported that:

[Gov. Pawlenty] says he would dedicate the entire $380 million [from the HIF] to treat smoking-related diseases. What troubles health care advocates is that Pawlenty also wants to shift $280 million from his original health care budget proposal and dedicate that money to public education. Minnesota Human Services Commissioner Kevin Goodno says the proposal should satisfy Senate DFLers who want increases for schools and health care... But others argue that Pawlenty is relying on accounting shifts in an attempt to dodge the charge he’s breaking his no-new-tax pledge. Pawlenty calls the proposed charge on cigarettes a “health impact fee.” Critics say he should be calling his proposal a tax since the money isn’t all being spent on health care programs. Sen. Becky Lourey, DFL-Kerrick, says Pawlenty and House Republicans should find another revenue source if they want to provide more money for public education. “If you’re going to do a fee, it should be directly related to the reason it’s raised,” said Lourey. “This is a health impact fee. I think the regular citizen would say ‘well then it should be going to the things in health care budget.’”

From the outset of the public debate on the HIF, it was clear that a large portion of the revenue from the HIF was being used not to provide an increase in public funding for costs related to tobacco use, but to free up general fund revenue that could then be diverted to other public purposes. A more transparent approach would have been to directly increase general fund revenue by simply increasing the existing cigarette tax.

However, this approach would not have allowed anti-tax politicians to claim that they had not increased taxes. In the creation of the HIF, transparent public policy took a back seat to politically motivated obfuscation. Fee increases should not be used as a backdoor way of generating additional general purpose public revenue when politicians are too timid to accept responsibility for increasing taxes.
Inadequacy of Fees as a Replacement for Large Tax Cuts

According to the “Price of Government” report, total FY 2008 state fee revenue—including post secondary tuition—was $2.44 billion. The amount that the State is projected to collect in taxes is $17.5 billion, more than seven times greater than fee revenue.

In FY 2008, fees comprise 8.8 percent of total state government revenue, up from 6.9 percent in FY 2003. However, even with the growth in state fees and the decline in state taxes, taxes are still comprise 63.3 percent of total state revenue in FY 2008.

If the state had attempted to replace the entire real per capita decline in state tax revenue from FY 2003 to FY 2008 with fee increases, the growth in fees would have been 47.2 percent in real per capita dollars—more than double the actual real per capita fee increase over this period. In nominal dollars, this would translate to a total fee increase of nearly 100 percent over the five year period.

Because fees are a relatively small revenue category, fee increases will never be able to replace massive cuts in state taxes. This is one of the reasons why total real per capita state revenue is declining by 5.9 percent from FY 2003 to FY 2008, with another large reduction anticipated for FY 2009. Over-reliance on fees as a replacement for large reductions in state taxes is a recipe for large scale decline in public investment, which is precisely what we have seen.

Fee Increases Make the Revenue System More Regressive

Based on information from the 2007 Tax Incidence Study from the Minnesota Department of Revenue, Minnesota’s tax system is regressive, which means that low-income households pay a larger percentage of their income in taxes than do high income households. In 2004, state and local taxes paid for each dollar of income was 18 percent higher among low-income Minnesota households than among the wealthiest one percent of households. Regressivity in Minnesota’s tax system increased from 2002 to 2004 and is projected to increase again by 2009.

*This statistic is based on a comparison of the effective tax rate (i.e., taxes as a percent of income) for households in the second lowest income decile to the effective tax rate for the wealthiest one percent of households. The effective tax rate for households in the lowest income decile is artificially high because of negative business income reported by some households; for this reason, effective tax rates for the lowest income decile are frequently ignored or downplayed when comparing effective tax rates among deciles. In 2004, state and local taxes paid for each dollar of income was 97 percent higher among households in the lowest income decile relative to wealthiest one percent of households.*
The growth in regressivity has been a concern of advocates for a fair revenue system in which the cost of public services is distributed among citizens based on their ability to pay.

For this reason, progressives generally oppose over-reliance on fees as a way of financing public services. According to the U.S. Internal Revenue Service, fees are “considered regressive because they take a larger percentage of income from low-income groups than from high-income groups.”

There is little quantitative information available as to precisely how regressive fees are. However, the 2007 Tax Incidence Study does contain information on the regressivity of the health impact fee. Even though the HIF is officially a fee, legislators who felt that the HIF was a de facto tax insisted that an analysis of the HIF be included in the tax incidence study.

The suits index is a measure of tax regressivity. A suits index of zero indicates a proportional tax (i.e., taxes as a percent of income is uniform for households of differing income). A negative suits index indicates regressivity; the larger the negative value, the more regressive the tax.

According to the 2007 Tax Incidence Study, the projected 2009 suits index for Minnesota’s state and local tax system is -0.032, which indicates modest regressivity. The suits index for the HIF is -0.501, which indicates extreme regressivity. The only existing tax that approaches the HIF in terms of regressivity is the cigarette and tobacco excise tax. The fact that the regressivity of the HIF resembles that of the cigarette and tobacco tax should not be surprising, since the two are nearly identical.

The HIF is so regressive that its inclusion in the tax system results in a noticeable decline in Minnesota’s suits index and a noticeable increase in regressivity. If the HIF is included, Minnesota’s suits index falls to -0.038, significantly more regressive than the -0.032 calculated without the suits index.

There can be no doubt that Minnesota’s increased dependence on fees has made the state’s revenue system more regressive, shifting more of the cost of government on to those with the least ability to pay.

**Tuition Increases as an Impediment to Higher Education**

One of the features of fees that make them attractive is that they tend to discourage consumption of public services. However, there is one public good that we should not want to discourage: higher education.

Post-secondary tuition has grown rapidly in recent years. As noted in the previous section, state revenue generated from post-secondary tuition has increased by 22.3 percent from FY 2003 to FY 2008 in inflation-adjusted dollars per capita. Without adjusting for inflation or population growth, the increase in state post-secondary tuition over this period is 65.0 percent.
The 2008 National Report Card on Higher Education from the National Center for Public Policy and Higher Education notes that tuition cost as a percent of family income at public two-year and four-year colleges in Minnesota is above the national average in 2007-08. In 1999-2000, before the rapid growth in tuition costs, the opposite was true. In a recent Star Tribune article, a spokesperson for the Minnesota State Colleges and Universities system confirmed that “tuition at our colleges is high compared to other states.”

A 2008 Growth & Justice report notes, “At the current rate we are producing students with post-secondary degrees, within two decades Minnesota will not have enough skilled working adults to sustain our economy or quality of life at the levels most of us have enjoyed.” The National Center for Public Policy and Higher Education concludes that “colleges and universities in Minnesota have become less affordable for students and their families. If the state’s downward trends are not addressed, they could limit its access to a competitive workforce and weaken its economy over time.”

The Growth & Justice report goes on to note that increasing the percentage of the state’s population with post-secondary degrees will have a positive net impact not only for the individual graduates, but for the state as a whole through increased tax revenue and reduced spending on crime, health, and welfare.

The recent trend toward escalating tuition is likely undermining Minnesota’s long-term economic vitality and competitiveness with other states by reducing the percentage of the state’s population with a post-secondary degree. This being the case, lawmakers should consider halting—if not reversing—the pattern of perennial tuition increases at state institutions of higher learning.
Conclusion: A Balanced Approach

Fees play an important role in financing government. There is something intuitively appealing about requiring those who benefit from particular public goods and services to cover the costs of these goods and services through payment of a fee. However, fees have their limitations. State fee increases as implemented in Minnesota in recent years frequently have fallen outside the realm of what would be considered good public policy.

Ronald Reagan once said that another way to spell fee is “T-A-X.” While the fortieth president was oversimplifying, his remark regarding the distinction between taxes and fees would have been apropos in Minnesota in recent years. In order to satisfy political objectives, revenue enhancements that would ordinarily have been considered a “tax increase” have been reframed as a “fee increase.” The subterfuge in the use of fees has resulted in increased public cynicism regarding how state government is financed.

During the 2009 legislative session, the state will be confronting a massive $5.5 billion dollar deficit for FY 2009 through FY 2011.* While fee increases need to be on the table, they should be implemented responsibly and with an eye toward the large increases that have already occurred.

State policymakers and the Minnesota public have an important decision before them. One option is to continue to do as we have done over the last six years: that is to say, balance the state budget through a combination state spending reductions (which have been primarily in the form of cuts in state assistance to schools and local governments) and fee increases, which shift a disproportionate share of public costs on to the backs of low-income households.

A more progressive approach to the state’s budget problems would be to rely on a balanced mix of spending reductions, tax increases, and—where appropriate—fee increases. To the extent that fees are part of the budget solution, they should be implemented with transparency and with the goal of mitigating their regressivity and other harmful side effects.

*Inflation-adjusted
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