BUDGET MESSAGE OF GOVERNOR ORVILLE L. FREEMAN

Delivered before a Joint Session of the Minnesota Legislature on Wednesday, January 19, 1955

Mr. Speaker, Mr. President, and Members of the 59th Session of the Minnesota Legislature:

Pursuant to the authority vested in me as Governor, I present herewith the biennial budget message. This message summarizes and amplifies the central recommendations contained in the biennial budget, copies of which were released today to all legislators.

I. Introduction

Our budgetary problems this year are unusually acute. We face extremely serious problems in developing a balanced budget that will provide adequately for necessary programs of human welfare and for essential services at minimum and efficient standards. Because of the size and complexity of our problems, it will be more necessary than ever for the executive and legislative branches of our government to maintain the most effective working relationship. I want you to know that I will do everything in my power to achieve such co-operation.

1. Complexity of Budget Process.

The budget process is inevitably a complex one. It involves not only hundreds of millions of dollars in annual appropriations and expenditures; it embraces a vast structure of dedicated and non-dedicated funds and involves many complicated and sometimes mystifying transfers of moneys among many different accounts.

While the process is a complex one, it is possible, I think, to acquaint a wide group of citizens with its central aspects. It is vital to do this, I feel, because broad public support is essential, if we are to develop reasonable and effective solutions for our pressing problems. With this in mind, I have taken special pains in preparing this message to focus attention, through such devices as simple tables and special appendices, on the critical points to be understood. The message is somewhat more detailed than has been customary and it includes basic explanatory and background data where I thought it would be especially helpful. I would like to thank both the House and Senate for their courtesy and co-operation in scheduling the time for this message. Technical problems made it impossible to televise it at a special night session as I had hoped and as you so graciously agreed originally. I would like to say to our radio audience, however, that a condensed version of this message will be televised over WTCN-TV Channel 11 at 10:00 tonight.

2. Seek Reasonable and Realistic Answers.

This message has not been easy to develop. We have had to make many decisions on subjects for which we would have preferred much more time for study. We have had to collate materials quickly in support of programs and operations involving the raising of many millions of dollars in additional income. Thanks to the excellent co-operation of the Department of Administration, the Department of Taxation, and my tax advisor, Mr. Walter Heller, I believe we have developed a sound budget proposal for the biennium.

This program represents on our part an honest search for reasonable and realistic answers in an area where there are all manner of sincere disagreements and differing points of view. I do not insist that my proposals are the only possible ones, but I do feel they represent a sound and reasonable program.

We have attempted to face our responsibilities forthrightly and honestly. I believe that the people of Minnesota want to maintain and strengthen the services provided by their state government and that it is our obligation to fashion the necessary ways and means to accomplish those goals. What in some instances may be painful in the short run, will, I believe, prove in the end to be preferable to a policy of drift and delay which only postpones the final day of reckoning.

3. General Economy of State Is Good.

While the problems we face are staggering in scope, there is no need for excessive alarm. We should be reassured by the knowledge that basically the economic health of our state is good. The people of Minnesota have shared in the continuous growth of our national economy. Our farms, mines, factories, professions, and businesses enjoy high levels of earnings, and, in general, the people of the state are experiencing a constantly improving standard of living.

We do note, however, with grave concern the drop in farm income and the persistence of a problem of unemployment, especially in the Iron Range area, but we are encouraged by the current reports that this year should see an upswing in basic industry, in particular iron and steel.

It is my general view that our total financial resources are strong enough to enable us to progress towards higher standards of service in education, public welfare, mental health, agriculture, conservation, and highways -- to mention only a few major areas. We, as a people, have the wealth to support these services; our problem is that we have not yet wholly convinced ourselves that governmental services -- like private services -- cost money, and that, if wisely conceived and properly administered, such services elevate our standard of living and actually improve our general financial situation. When our people have the facts, they support adequate financing of constructive governmental programs.

4. Budgeting Linked to Other Goals.

The preparation of this budget has been the most difficult task I have ever had to perform. In acting upon the department requests for appropriations, it was necessary to examine the purposes and objectives, the methods and operations of each agency and each service. I have been aware at each step that my decisions vitally affect the lives and welfare of thousands of people, and at times the decisions have been heart-rending to make. Regrettably, it was necessary to exclude from my recommendations many requests that I know have merit. At the same time many doubts were raised in my mind concerning the logic or necessity of some ongoing operations and administrative practices.

A sound budgeting process must be linked to the goals of greater economy and improved efficiency. I am certain that many economies can be made within the recommended budget, although these will require patient study and co-operative action with the operating departments. I am convinced, too, that we can improve our service and at the same time save tax dollars by further reorganization of the governmental machinery. Later in this message, I shall say a further word concerning the accomplishment of these related goals.

II. The General Revenue Fund

In considering the specific content of my recommendations, it is natural to turn first to the portion of the budget one hears most about and which, in many ways, is the most central in the operations of the state government. This is the General Revenue Fund.

1. <u>What the Fund Is.</u>

The General Revenue Fund receives all the revenue which is not ear-marked for specific purposes by legislation or by the Constitution. The fund supports the operations of some 75 or more state functions, including general overhead administration, the vast programs of public welfare, such as the state's share in Old Age Assistance and for mental health, the support of the University and the state teachers colleges, our civil service system, aid to veterans, the control of the liquor traffic, the operations of the Livestock Sanitary Board, the far-flung programs of the Conservation Department, the work of the Department of Business

Research and Development, the regulation of banking, insurance, and securities -- to mention only a few selected at random. (See Table I.)

TABLE I

Some Major Services Financed By General Revenue Fund

Mental Hospitals	Conservation	Courts
State Prison	Administration	Business Development
Old Age Assistance	Health	Crime Bureau
University	Agriculture	Liquor Control
Teachers Colleges	Veterans Affairs	Labor Conciliator

Into this fund comes the revenue produced by taxes and by charges for services that are not ear-marked for specific purposes. The fund receives, therefore, revenue produced by the gross earnings taxes on various utilities, 45 per cent of the occupational tax on iron ore, the tax on insurance gross premiums, the tax on beer, inheritance and gift taxes, the state's share in liquor and cigaret taxes, and, currently, a portion of the state property tax. (See Table II.)

TABLE II

General Revenue Fund Tax Sources

Gross Earnings	Cigaret
Insurance Premiums	Liquor and Beer
Iron Ore Occupational (45%)	Inheritance and Gift
Iron Ore Royalty	Grain Inspection

2. Situation One of Severe Stringency.

Two years ago, as we entered the current biennium, the General Revenue Fund had a carry-over working balance of $7,654,000. This year there will be no balance; in fact, the new administration inherits a situation in which it will be difficult to finance operations for the balance of this biennium out of current revenue.

The plight of the General Revenue Fund is further complicated by these additional factors:

(a) Two years ago the previous administration estimated that 80 million tons of iron ore would be shipped during the current biennium, producing a total revenue for the General Revenue Fund of $27,880,000. The national recession resulted in a smaller volume of shipments than had been anticipated, with the result that earnings, by the end of this biennium, will be an estimated $24,269,000, which is $3,611,000 less than originally anticipated. The gross earnings tax on railroads was also adversely affected, with receipts from this source producing an estimated $2,170,000 less than anticipated. (See Table III.)

TABLE III

Reduced Revenue Due to Lower Iron Ore Shipments 1953-55

	Iron Ore	Railroad Gross Earnings
Original Estimate	$27,880,000	$28,500,000
Revised Estimate	24,269,000	26,330,000
Decrease	$ 3,611,000	$ 2,170,000

(b) Another major factor affecting the General Revenue Fund is the necessity to absorb the automatic salary increases for all state employes included under the Economic Salary Adjustment program, which is tied to the cost of living index, and also to make provision for one merit increase for each eligible employe. Both of these were voted by the last legislative session.

These factors, added to the continued growth of our needs and the normal and natural expansion in service, help explain why the General Revenue Fund position is a severely stringent one.

3. Status Quo Policy Followed.

In the light of these factors, we found it necessary to follow a hold-the-line policy in making appropriation recommendations. It was necessary to deny all requests which, however worthwhile, could possibly be postponed without impairing vital services. It was necessary, too, to continue all present transfers from dedicated funds.

4. Total Appropriations Recommended.

We began our budgeting operations late in November, many weeks after the October 1 deadline set by law for the submission of departmental requests. It had been directed by the prior administration that each department should stay within its current level of financing in making appropriation requests. Despite this injunction, department after department found it impossible not to indicate, in one way or another, that the current level was insufficient to meet their minimum operating needs. As a result, the total of departmental requests -- even against the background of the hold-the-line order -- was $176,088,000. That this was not a padded figure is reflected in the fact that departmental requests two years ago totaled $177,100,000, -- $1,012,000 more than the present requests. (See Table IV.)

TABLE IV

General Revenue Fund
Departmental Requests by Bienniums

For current Biennium ('53 Session)	$177,100,000.
For next Biennium ('55 Session)	176,088,000.
Decrease	$ 1,012,000.

In the weeks since late November we have examined all departmental requests, line by line and item by item, and we have heard many departments present elaborations of their requests orally. In this exhaustive process we reduced the demands on the General Revenue Fund almost $10,000,000. (See Table V.)

TABLE V

General Revenue Fund

Departmental Requests	$176,088,000
Governor's Recommendations	166,166,000
Difference (Amount Cut)	$ 9,922,000

This reduction of almost $10,000,000 in total department requests, is, however, still $11,000,000 more than the $155,169,000 appropriated by the last legislature for the current biennium. This means that our recommendations, while following a status quo policy, do provide certain essential increases.

5. Additional Amount for Old Age Assistance.

The printed budget which you have before you is based entirely on present law and existing tax rates. Increased costs resulting from recommended changes in the law are not reflected in the document, yet we must so far as possible, plan for them. I wish, therefore, to lay before you a major appropriation recommendation which does not appear in the present budget. This is an additional $1,300,000 for Old Age Assistance.

In both my inaugural message and my detailed legislative program, I recommended two changes in laws governing Old Age Assistance. First, that the present monthly maximum of $60 for maintenance support be increased to $65. This would require an estimated $800,000 for the biennium. Second, that in determining the amount of aid an applicant may receive, the amount of his outside resources be deducted from his minimum subsistence budget total, which ordinarily runs between $80 and $90, rather than from the legal maximum of $60. This would require another $500,000 for the biennium, for a total of $1,300,000. (See Table VI.)

TABLE VI

**Recommended Changes
In Old Age Assistance**

Raising Monthly Maximum to $65	$ 800,000
Deducting "resources" from "needs" rather than maximum	500,000
Total	$1,300,000

The inclusion of this additional $1,300,000 in the total appropriations from the General Revenue Fund increases the total from $166,166,000 to $167,466,000, which is the gross figure for which provision should be made. (See Table VII.)

TABLE VII

**General Revenue Fund Total
Appropriations Including
Additional for O.A.A.**

Total as in Printed Budget	$166,166,000
Additional for O. A. A.	1,300,000
Total Gross Liability	$167,466,000

6. Income Available Under Present Rates.

As I have already indicated, there is no carryover balance in the General Revenue Fund. This means that the money to be available for the biennium is the total of what the various taxes, receipts from fees and charges, and transfers from other funds will produce. A complete schedule appears on Page 9 in the printed budget. The anticipated income under present rates totals $144,150,000.

This figure represents an increase of about $4,000,000 in tax revenue over the first estimates we were provided late in November and which were given wide publicity. The upward revision in the estimate is due to two main factors:

(a) the decision to request continuance of the present property tax millage now going into the General Revenue Fund, and (b) an increase from 60 to $62\frac{1}{2}$ million tons in the estimated amount of iron ore to be shipped during each of the next two years.

With our gross liability totaling $167,466,000, and our anticipated income totaling $144,150,000, we find that we have a gross need for additional revenue of $23,316,000. Allowing for a normal cancellation of 2 per cent,* we can reduce this need by $3,323,000 (2% of $166,166,000), for a net of $19,993,000,** which is the amount I am recommending that we raise by additional revenues and receipts. (See Table IX.)

TABLE IX

Additional Revenue Needs for General Revenue Fund

Gross Liability	$167,466,000
Anticipated Income	144,150,000
Gross Additional Need	23,316,000
Less 2% Cancellations	3,323,000
Net Additional Need	$ 19,993,000

7. Proposed Additional Receipts and Revenues.

The raising of the necessary additional money for the General Revenue Fund was extremely difficult. We have worked hard and earnestly to develop a balanced program, one that would spread the burden of taxation fairly among those best able to pay and on sources that, by sensible and reasonable standards, could best

* *This is the anticipated amount of appropriations that will be cancelled at the end of the biennium owing to the departments' inability to complete expenditures as the result of unforeseeable contingencies.*

** *The net liability given in the printed budget (p. 7) is a lower figure because it does not include the additional $1,300,000 for Old Age Assistance.*

afford to absorb increases. I early rejected the suggestion that we follow the easy course of loading the entire burden upon one or two industries. Instead we followed what I believe to be the sounder course of spreading the burden as broadly as possible.

I believe the program that I am recommending to you is a sound one and I want you to know that its spread took into account the financial and competitive position of the industries and economic groups affected.

Our first step, then, in considering ways and means for meeting our $19,993,000 deficit was to review present charges for State services that benefit particular groups or individuals based on costs of providing those services. At the same time we checked to determine whether administrative costs were being properly assigned to the respective funds.

As a result of our study, I am proposing that we obtain the needed $19,993,000 for the General Revenue Fund from five sources, as follows:

(1) The state government performs a great variety of services for various groups of individuals, for which fees are charged in accordance with law. Many of these fees, some as low as $1, were established a long time ago and were intended to cover the cost of a particular service or regulation. In other cases, services properly requiring fees are provided without charge.

Over the years, as costs have risen, the fees have remained the same, with the result that an additional burden has been absorbed by the General Revenue Fund. We have examined all fees and services and are recommending the establishment of several new fees and increases in existing fees. If adopted by the legislature, the new and increased fees will produce an estimated $3,259,000 for the biennium. A listing of the proposed increases is given in Appendix I.

(2) Several agencies of state government operating with dedicated tax receipts are provided overhead service by our general administration which is,

of course, financed by the General Revenue Fund. It is a well-established principle now that such agencies should pay an appropriate share of such administrative costs. This is the relationship that now exists with the Department of Highways and the Division of Game and Fish. Applying the same sound principle to other agencies and including all the various regulatory boards, which operate on licenses issued to those regulated but who pay no part of the support of general administration, we propose a schedule of charges that will yield, in all, a total of $262,011. Detail of this proposal is given in Appendix II.

In a somewhat similar category is the operation of the Lands and Minerals Division of the Conservation Department. Most of its administrative activity is devoted to the management of public lands, the revenue from which goes into the permanent trust funds. Under existing law the administrative costs of this division are borne by the General Revenue Fund. I am recommending that these costs be transferred from General Revenue to the Permanent Trust Fund, effecting a reduction in General Revenue needs of $636,635.

The combination of all items in this section will reduce General Revenue Fund needs from revenue sources by $898,646. (See Appendix II for further detail.)

(3) For many years the state government has paid rentals for the use by National Guard units of local armories. Such rental payments are, in turn, used by local armory commissions for the retirement of bonds issued for financing armory construction. These rentals have been paid for out of the General Revenue Fund. I propose that payment of these rentals be financed by borrowing the same as capital outlay for other buildings, thus relieving the General Revenue Fund of approximately $223,000 for the biennium.

(4) Each year the General Revenue Fund receives the earnings from the short-term investment of money collected by the state for current operating expenses which is not immediately needed. In the current year, we will receive an estimated

$1,135,000 from this source, and for the next biennium an estimated $1,875,000, if present policies are continued. I am advised by the new State Treasurer, that by a more judicious and alert investment policy than has been followed in recent years, we can realize, at a conservative estimate, an additional $750,000 for the biennium from this source.

(5) The four sources so far described will produce an estimated total of $5,130,000 in new receipts for the General Revenue Fund. From increased fees, $3,259,000; from attributable costs for administrative overhead expenses and by transfer out of costs not properly assignable to the General Revenue Fund, $898,000; by transferring armory rentals to the building fund, $223,000, and from a more alert investment policy, $750,000. (See Table IX.)

TABLE IX

New Proposed Receipts
for General Revenue Fund

Increased fees	$3,259,000
Attributable costs	898,000
Armory rental transfers	223,000
Increase from investments	750,000
Total	$5,130,000

If we apply these new receipts to our net additional need for new revenue of $19,993,000, we have a balance of $14,863,000 which it will be necessary to realize by means of increased taxes. (See Table X.)

TABLE X

Amount Needed from New
Taxes for General Revenue Fund

Total Additional Need	$19,993,000
New Proposed Receipts	5,130,000
Balance from Taxes	$14,863,000

8. The New Tax Program.

In developing our new tax program special attention was paid to the effects that new or increased taxes would have upon the general economy of Minnesota. Throughout, every effort has been made to spread the new load broadly and fairly. In addition to the general standards already outlined, we have judged each possible tax source by three criteria: (1) the ability to pay, (2) the impact of the tax on Minnesota's competitive position, and (3) how fairly and economically it can be administered. Measured in these terms, we have developed a tax program that is sound and fair.

Our proposals cover six sources. From occupational and royalty taxes on iron ore, an additional $8,000,000; by the modification of the labor credit in determining iron ore taxes, $750,000; from inheritance and gift taxes, $1,000,000 for the next biennium; the inclusion of annuities in the base of the 2 per cent insurance gross premiums tax, $600,000; from increases in the tax on beer, $2,100,000; by spreading the tobacco tax to other items than cigarets, $2,000,000; and by increasing from 4 to 7 per cent the gross earnings taxes on telephone companies in communities of less than 10,000 population, $1,500,000. These will provide a total of $15,950,000. (See Table XI.) Each tax is explained in detail below.

TABLE XI

New Tax Revenue

Iron Ore	$ 8,000,000
Modified Labor Credit	750,000
Gift and Inheritance	1,000,000
Insurance Annuities	600,000
Beer	2,100,000
Tobacco (non-cigaret)	2,000,000
Telephone Gross Earnings	1,500,000
Total	$15,950,000

It will be noted that the tax program here proposed actually exceeds by $1,087,000 the $14,863,000 additional amount needed beyond new non-tax sources. This, I feel, is a modest cushion in view of the fact that the entire program must necessarily be based on estimates which inevitably involve a certain margin of error. Further reference to this amount will be made in a later section of this message on unbudgeted items.

(1) Iron ore taxes. Iron ore is Minnesota's richest mineral resource. Taxes on this source financed about one-sixth of the General Revenue Fund this biennium. Because of the richness of this resource, many people have urged that it be made to support the entire additional amount of new taxation needed for the General Revenue Fund. There are persuasive arguments in favor of this, but I feel that no single source should assume the entire burden.

I am not unmindful of the claim that a sharp increase in the tax on iron ore will be harmful to the Minnesota iron mining industry. Therefore, in studying this tax, we asked ourselves this key question: At what level does the tax become so high that it will hurt Minnesota citizens by impairing the competitive position of Minnesota iron ore? We know, of course, that, while ore that is hoarded in the ground rather than being mined now is not lost, current employment and income is lost when the mines do not operate at capacity.

There is no hard and fast answer to this question. The evidence, however, that iron ore can absorb a substantial increase in taxation is conclusive. In this connection, I might point out that the last four Republican Governors have all recommended substantial increases in iron ore taxes.

At present, counting the one per cent surtax for the veterans bonus, occupation and royalty taxes on iron ore mined in Minnesota are levied at 12 per cent. The occupation tax is applied, not against the full $9.90 per ton Lake Erie price, but on a net amount of about $3.20 to $3.50 per ton after allowance for transportation and other costs. This tax is in lieu of the state corporation income tax, from which mining operations are exempt. The occupation and royalty taxes together come to about 40 cents per ton. This is the same amount as the Minnesota tax on one carton of cigarets. Because it is eventually absorbed in the price of finished steel, the burden of practically all of the iron ore tax falls outside of the State of Minnesota. It is well to note also that this tax represents only a little more than 1 per cent of the price of pig iron and less than 1/2 of 1 per cent of the price of finished steel. Even with ad valorem taxes added, all iron ore taxes represent only 6/10 of 1 per cent of the price of steel, which is less than it was in the 1930's and about the same as it was in 1941. This means, in relation to the price of finished steel products, Minnesota's iron ore taxes are not above their pre-war level, although taxes generally have increased very sharply since that time.

If we compare our iron ore taxes with the severance taxes of other states on their mineral resources, we find that they are not excessive but that they are actually modest. Texas, for example, has a severance tax of 13 cents per barrel of crude oil, which represents 5 per cent of the crude price and 2.3 per cent of the composite retail price (including all taxes) of products from the barrel of crude oil.

In the light of these facts, I recommend that the occupation and royalty tax rates on iron ore be raised from 11 per cent to 15 per cent, which, together with the one per cent for the bonus, will bring them to 16 per cent. These increases will yield an estimated $8,000,000 for the biennium for the General Revenue Fund and a roughly similar amount for the permanent education trust funds.

In addition, in line with the recommendations in the 1953 report of the Interim Commission on Iron Ore Taxation, I recommend that the labor credit provision of the occupation tax be restricted to underground mines and to mines producing concentrates by methods beyond ordinary washing and crushing. The purpose of this credit was to stimulate employment and the production of low grade ore. My proposed amendment would restrict the credit for the purpose intended. It will produce an estimated $750,000 per biennium.

It should be noted that these iron ore tax recommendations in no way disturb the tax-favored position for taconite development, which requires huge capital outlays and high costs. Its preferential treatment has my support as a justifiable investment in Minnesota's future.

(2) Inheritance and gift taxes. When the ability-to-pay criterion is applied, one of our best revenue measures is the tax on inheritances and gifts. It effectively differentiates those who do and those who do not enjoy inherited wealth. It bears lightly on the widow and children of the deceased but heavily on distant relatives. In comparison with other states, our tax imposes lower rates and contributes a smaller proportion of our total revenues. Therefore, I am recommending adjustments of deductions and increases in rates that will put the tax more in line with the national average. When fully operative, my proposed modifications will raise $2,000,000 in a biennium. Because of delays in the processing of estates, however, we estimate that only $1,000,000 of this increase would be realized during the 1955-57 biennium.

(3) Insurance taxes. Unlike the majority of the states, the Minnesota 2 per cent insurance gross premiums tax does not apply to annuities. In the view of tax authorities, there is no sound reason why annuities should escape this tax. They have just as much ability to pay and are fully as profitable a source of income to the insurance companies as are, for example, the premiums paid for protection at death. I recommend, therefore, that we follow the practice of 28 other states and bring annuities into the insurance tax base, thus realizing $600,000 of additional revenue each biennium.

In reviewing insurance taxation, we found that we differ from most states in that we exempt mutual casualty and certain other types of insurance companies which have their home office in Minnesota. Their inclusion under the 2 per cent tax merits serious study. Also, the possibility of increasing the rate beyond 2 per cent, as several states have done, regardless of the retaliatory provisions in most state insurance laws, should be investigated. Insurance companies are enjoying a prosperous period of rapid growth, and it is altogether likely that an increased tax on premiums would not adversely affect our insurance industry.

(4) Beer taxes. Taxes on Minnesota beer are $1.10 per barrel on 3.2 beer and $2.20 on strong beer, including the bonus surtaxes. A recent study by the State of California shows that, among 38 states surveyed, Minnesota and Missouri residents pay the lowest prices for national-brand beers. For local beers we are eighth from the bottom.

With respect to beer, we enjoy both a favorable price and a favorable tax position, compared with other states. I think it reasonable, therefore, to recommend that this commodity assume an additional tax. My proposal is for an increase of 50 cents per barrel for 3.2 beer and 75 cents per barrel for strong beer. This increase amounts to less than 1/5 of 1 cent per bottle. It will bring in about $2,100,000 in the next biennium.

In the past, people of Minnesota have made known their wish that beverages with a higher alcoholic content should be taxed more heavily than those with less alcoholic content. My tax proposal is consistent with this policy. One might ask why this consideration does not lead me to recommend an increase in taxes on wines and distilled spirits. The answer is simple. Our taxes and prices on these beverages are among the highest in the 48 states. Tax authorities fear that further increases might lead to a serious increase in tax evasion, resulting in less rather than more revenue. When federal liquor taxes are reduced, however, we should re-examine our own for possible increases.

(5) Tobacco Taxes. When we apply the criteria of balanced taxation and comparative tax rates to Minnesota's tobacco taxes, we arrive at a two-fold conclusion: (1) our 4 cent per-pack cigaret tax is exceeded by very few states and should not be increased except as a last resort; (2) tobacco products other than cigarets are escaping their fair share of state taxation. They bear no tax whatsoever under Minnesota law. Therefore, I recommend that a 20 per cent tax be placed on the retail price of tobacco products other than cigarets. It will raise an estimated $2,000,000 of additional revenue per biennium.

(6) Gross Earnings Taxes. After a careful examination of the entire Gross Earnings Tax picture, I wish to make these recommendations:

(1) That the legislature submit an amendment to repeal the present constitutional provision which requires a referendum before the gross earnings tax on railroads may be increased. There is no justification for the special and preferred position the railroads now enjoy. The legislature should have the same power to tax railroads as it has to tax other utilities and industry in general. Please do not construe this recommendation as a proposal for increasing gross earnings taxes on railroads by referendum at this time. Instead I urge on you careful study of the comparative taxes paid by forms of transportation which compete with our railroads. In this connection I commend to you the report of the Minnesota Tax Study Commission.

(2) In the light of the particularly serious financial problem confronting our municipalities, I recommend that the gross earnings tax on telephones be increased from 7 to 8 per cent and that the earnings from the additional one per cent be distributed to the cities having more than 10,000 population, as recommended by the Nine Cities Revenue Committee.

(3) I further recommend that the tax of 4 per cent on the earnings of telephone companies in communities of less than 10,000 be increased to 7 per cent, proceeds to go to the General Revenue Fund. This would produce an estimated additional $1,500,000. It involves no change for those small companies having gross revenues of $1,000 a year or less. They pay a tax of 30 cents per phone.

9. <u>Support for Unbudgeted Proposals.</u>

Beyond the General Revenue Fund recommendations already presented there is another major proposal which will require financing, that of bringing all state employes under the Old Age Survivors Insurance provisions of the federal Social Security Act. This would provide employes with extremely advantageous additional protection for their retirement. The nature of the federal act is such that adoption at this session will be of tremendous importance to employes by vastly accelerating the date at which retiring employes will be able to qualify for benefits.

It is estimated that the 2 per cent Social Security contribution of the state will require about $2,780,000 for the biennium, of which $1,850,000 would come from the General Revenue Fund. Delegations of employes have urged that the state's participation in this program be financed by absorbing the costs and that adoption of the program would provide an incentive to all employes to help the administration realize many economies that require employe cooperation.

Earlier I referred to the use of executive authority to improve our administrative procedures and thereby affect economies. I wish here to indicate that my experience to date suggests that substantial economies can be made, provided (a) that there is high employe morale and a determination on their part to co-operate in programs of economy, and (b) that the legislature extends to the executive certain authority for planning and executing economy measures. At an early date I plan to present you my specific proposals on this subject.

Under these circumstances and in view of the fact that my budgeted proposals, if adopted as recommended, will leave a balance of $1,~~148~~087,000, I believe the General Revenue Fund portion of the Social Security proposal can be absorbed without providing additional revenue. If this proposal is adopted, the executive departments will make every effort to absorb this additional cost. As a protection, however, against the possible failure of such a financing arrangement, we would plan, if necessary, to borrow against the property tax accrual at the end of the forthcoming biennium. The accrual is estimated at about $3,000,000.

III. Income Tax School Fund

I turn now to a consideration of the needs of our public school system, the financing of which comes entirely from the Income Tax School Fund. We face here an even more serious problem, in terms of the amount of additional revenue that will be required.

1. <u>Factors Affecting School Problem.</u>

Minnesota, like other states, is experiencing the impact now of the enormous increase in the birth-rate during World War II. During the next biennium the number of children of school age in the state will be more than 50,000 larger than during this biennium. Where now we have 587,248 there is an anticipated increase to 637,500 for the next biennium. (See Table XII.)

TABLE XII

Number of Children of School Age

Next biennium	(1955-57)	637,500
Current biennium	(1953-55)	587,248
Increase		50,252

This factor alone will place a tremendously increased burden upon the school fund because the major state aids are contingent upon the number of children of school age and the number of pupils in average daily attendance.

The growth in numbers also means a vastly increased demand for teachers and buildings, and school districts throughout the state must have still larger state assistance if we are to maintain present standards, which are by no means extravagant. I am on record and I wish to restate my position that I favor increasing the basic aid from $80 to $92.

2. Inequities in the System.

Our entire system of public education is still in need of further study. There are many inequities in our elaborate and complicated system of state aids. I commend for your careful study the analysis of the Equalization Aid Review Committee now being prepared and urge that you authorize the continuation of the important work being done by this Committee.

Since school districts depend so largely upon property tax revenues and property values serve as the basis for determining the amount of equalization school aid, there is an urgent need for a continuing careful review of assessment procedures as they relate to the administration of the property tax. In that connection, I urge you to give serious consideration also to the report of the Minnesota Tax Study Commission relating to assessment procedure.

I believe that the over-all administration of the school system can be improved. In 1954 we still had 1,531 school districts that maintain no schools. The cost of public education is too great to permit the continuation of inefficient operations.

3. Condition of Fund at Present Rates.

The printed budget presents the school fund on the basis of existing $80 basic aid, the continuation of existing transfers and anticipated earnings from the income tax at present rates, with the result that it shows a deficiency for the biennium of $12,207,000. (See Table XIII.)

TABLE XIII

Income Tax School Fund
On $80 Basic Aids
1955-57

Total Requirements	$158,050,000
Amount Available	145,843,000
Deficiency at $80	$ 12,207,000

This means that, even if no change is made in present law, it will be necessary to raise additional revenue in the amount of the deficiency in order to balance the budget.

The available amount of $145,843,000 includes a carry-over working balance from this biennium estimated at $29,593,000. The anticipated earnings from the income tax, at present rates, will be $116,250,000 for the next biennium. (See Appendix III for a detailed account of the fund.)

4. Requirements at $92 Basic Aid.

As I have indicated, however, to stand still at $80 state aid is to allow our educational system to slip back. There is no escaping the necessity of providing a substantial increase in the basic aid.

At $92 per pupil unit, the basic aid requirement will increase the total demands on the fund from $158,050,000 to $173,809,000, leaving a gross deficiency of $27,966,000. (See Table XIV.)

TABLE XIV

Income Tax School Fund
$92 Basic Aids
1955-57

Total Requirements	$173,809,000
Amount Available	145,843,000
Gross Deficiency at $92	$ 27,966,000

From this gross deficiency we deduct the amount of anticipated cancellations in the fund. Based on prior experience the cancellations can be expected to total $8,113,000, leaving a net deficiency at $92 basic state aid of $19,853,000. (See Table XV.)

TABLE XV

Income Tax School Fund
$92 Basic Aids
Net Deficiency

Gross Deficiency	$27,966,000
Less Cancellations	8,113,000
Net Deficiency	$19,853,000

5. Financing the 1955-57 Biennium.

The large new demand for school financing made necessary a most careful re-examination of the entire income tax structure, both corporate and individual. This was done not only from the point of view of prospective yield, but also in terms of the fairness and effectiveness of present administrative procedures and the collection system.

With the help of the tax department, I explored many recommendations for modifications, compared our rates and procedures with those of other states, and studied the likely effect of the introduction of new major proposals.

I now recommend a series of major modifications which will require your most earnest study and early action, if we are to enact the program which I regard as essential for the maintenance of our public school system.

My program will yield more than enough to meet the increased demands and will, at the same time, eliminate a number of inequities in the income tax system and will bring much-needed relief to individual income taxpayers by increasing credits for dependents.

In the aggregate my new proposals will raise $31,000,000, but offset against this will be a decrease of $5,000,000 resulting from increased credits for dependents.

The $31,000,000 additional income tax will come from three sources, each of which is explained in detail below: (1) by the introduction of a withholding system of payment, $25,000,000, resulting from the shift to a current payment basis; (2) the shifting of the second payment of the corporate income tax, providing an additional payment during this biennium, $4,000,000, and (3) by tightening the corporate income tax structure by the elimination of certain loopholes, $2,000,000. (See Table XVI.)

TABLE XVI

Additional Income Tax Yield
1955-57 Biennium

By Introduction of Withholding	$25,000,000
By Shifting Corporation Payment Dates	4,000,000
Eliminating Corporation Loopholes	2,000,000
Gross New Income	$31,000,000
Less Increased Individual Exemptions	5,000,000
Net New Income	$26,000,000

With this general summary of our proposals before you, I should like to proceed now to an item-by-item analysis of what I am recommending.

(1) <u>The Introduction of Withholding.</u> The successful experience of the federal government in shifting the payment of individual income taxes to a current basis has led six states to introduce a similar practice at the state level. This system makes payment easier and more convenient for the taxpayer. It provides a much more equitable application of the law, because it reduces the opportunities for tax evasion and results in substantially improved compliance.

Adoption of this system will mean that the tax will be collected currently through a system of payroll deductions, with the employer remitting collections quarterly, and through declarations and current payment of the tax by the self-employed.

It is my recommendation that the withholding system go into operation by July 1 of this year, in order that payments may be put on a current basis promptly. The Department of Taxation assures me that this can be done, if legislative action is taken early enough to enable the Department to install the necessary procedures. A bill specifying the essential installation details is now being drafted by the Department at my request.

In moving to the withholding system, the speeding up of tax payments will bring in an estimated $23,000,000 of additional revenue during the 1955-57 biennium. Better compliance on current collections, resulting from the introduction of the new system, will yield another estimated $2,000,000 for a total of $25,000,000.

The estimate of $23,000,000 assumes that no taxes will be forgiven in the process of moving from the old to the new system. It is true that the federal government, in the light of rates running to more than 90 per cent, saw fit to forgive part of the tax in 1943 when it introduced withholding. But the states, with their more moderate rates, have not found this necessary. None of the six states with withholding systems has forgiven any taxes in the process.

In following the lead of the states rather than the federal government, I want to make clear the nature of the overlapping of payments under the old and new systems of collection. First of all those who do not settle up their 1954 tax in full this March or April will experience some overlap in September; and almost all taxpayers will find that they have part of their 1955 tax to settle up in March or April 1956, at the same time that they are starting to pay their 1956 tax. I mention this in detail because I want the citizens of Minnesota to know exactly what we are proposing. The partial overlap of taxes is no different from settling up an installment debt, for example, on a refrigerator at the same time that one pays cash for a new stove. Payments are temporarily doubled up, but the taxpayer is better off from then on, because the introduction of withholding removes an overhanging tax liability when income declines or ceases because of illness, retirement, or death. In other words, by shifting to a current basis now, the taxpayer is saved one year's taxes at the end of his income life.

(2) Shifting of the corporation payment date. Under our income tax law corporations may pay their tax in two equal installments: one installment at the time of the filing and the second installment six months later.

In order to put corporations on a more current basis and to bring them more into line with the proposed payment system for individuals, I recommend that the second installment be made payable three months after the payment of the first installment. In effect, this change will adopt the so-called "Mills Plan" which provided for current payment of corporation income tax at the federal level.

The more prompt schedule would bring one additional payment amounting to about $4,000,000 into the coming biennium. The federal government has experienced the same type of speed-up revenue collections in shifting to the more current payment basis.

(3) Tightening the corporate income tax structure. Under existing income tax law, Minnesota corporations are permitted certain deductions which constitute large loopholes. For example, a corporation operating in a number of states may deduct from its Minnesota income certain charitable contributions made in other states. I propose that such deductions of contributions be limited to correspond to the percentage of the corporation's business performed in the state.

Another example is the use of out-of-state agents for the reduction of corporation sales which properly should be taxed in Minnesota.

I recommend also the elimination of the $500 exemption permitted each corporation. An exemption of this type is justified for individuals but not for corporations. It is employed, incidentally, in only one other state.

Finally, with respect to corporation tax loopholes, I recommend that the property-payroll credit be eliminated. This feature was intended to stimulate Minnesota employment by permitting a reduction in the taxable net income of corporations by granting a property-payroll credit, but it actually operates mainly to reduce corporation income tax collections. It means that while the corporation tax rate is 6 per cent, the effective rate for corporations operating entirely within the State of Minnesota is reduced to 5.4 per cent.

I should indicate here that, in a further section of this message, I deal with other needed changes in the tax structure -- both income and property -- which will provide the kind of business stimulation that was intended by the property-payroll credit. Such changes will effect some revenue loss.

These recommendations for tightening the tax structure will produce an estimated $2,500,000 in additional income. Offset against this, however, is the revenue loss resulting from modifications designed to stimulate business. The net additional income is, therefore, estimated at $2,000,000.

(4) Increasing credits for dependents. As I have already indicated, the credit for dependents which we allow individual taxpayers is much too low. Despite the extraordinary demands upon the income tax, I feel simple justice dictates the need for making a long overdue adjustment for the relief of the small taxpayer. I recommend, therefore, that the present credit of $10 for each dependent be increased to $15. This is still not as large an increase as I would prefer, but it is as much as I feel we can afford at this time.

6. Carry-over Balance Provided.

It will be noted that my proposals will yield an additional $26,000,000, which will more than cover the additional liability of $19,853,000 resulting from the increased enrollments and increased basic aids. In fact this will leave an estimated balance of $6,147,000 at the end of the 1955-57 biennium. (See Table XVII.)

TABLE XVII

Income Tax School Fund
Balance at end of 1955-57 Biennium

Proposed additional income	$26,000,000
Additional amount needed	19,853,000
Balance	$ 6,147,000

We have deliberately planned for a carry-over balance, recognizing that there will still be a serious financing problem for the public schools in future years. In years past we have always had a substantial carry-over balance, which will now be depleted because of the growth in enrollment. It is simply a prudent move to make provision for some carry-over, in order that we might have at least a small cushion for the biennium following.

7. Proposals for Future Bienniums.

We will not fully discharge our responsibilities with respect to the public schools and the income tax fund if we fail to make certain provisions for financing the program beyond the forthcoming biennium. Given the income tax as amended in accordance with my proposals, there will be a gap between expenditures and revenues of roughly $50,000,000 in the 1957-59 biennium, on the basis of $92 per pupil unit aid and present earning levels of the income tax.

We must, therefore, plan the necessary ways and means of closing the gap. Part of it will be taken up by growing income tax revenues as our economy expands.

Just as President Eisenhower is basing some of his hopes for tax reduction on an expanding economy, we can look forward to an easing of our revenue problems as a result of a growing income base. Federal tax reductions will aid this growth. They added more than $100,000,000 to Minnesota's taxable income in 1954 and could add many millions more in the next few years.

More positively, I recommend that we amend our Constitution to redirect the 50 per cent share of the occupation tax on iron ore from the Permanent Trust Funds into current operating education funds. This would not interfere with existing trust fund balances, nor with future trust fund revenues derived from sales of land, timber, and royalty on mined ore.

It would mean that, under present tax rates, the schools would receive an additional $16,000,000 for the biennium and the University an additional $4,000,000 which could be appropriated for current operations. If the iron ore tax increases I have recommended are adopted, it would mean a still further increase of $6,400,000 for the schools and $1,600,000 for the University.

To accomplish this will, of course, require the submission of a Constitutional amendment for action by the electorate in 1956.

With respect to the remainder of the gap, we should examine carefully the potential of our income taxes. One of the most promising possibilities is to restrict or eliminate the deductibility of federal income taxes in computing the state tax.

If this were done, the yield of the corporation income tax could be virtually doubled, bringing in about $25,000,000 more per biennium, while the yield of the individual income tax would be increased by as much as $30,000,000 to $45,000,000 biennially. In both cases, a large share of this additional revenue (upwards of 50 per cent) represents not a burden on the taxpayer, but a re-direction of revenues from the federal government to the state. The increased state tax becomes a deduction on the taxpayer's federal income tax returns and consequently reduces his federal tax liability.

This move has so much to recommend it from the standpoint of a more straightforward tax structure, that even if the revenue is not needed, there is much to be said for restricting deductibility and adjusting tax rates downward accordingly.

IV. The Building Fund

The third major segment of our financial structure which requires our attention is the building fund. This fund is financed by bond issues, the principal and interest of which are redeemed by the earnings of the state property tax. I am especially eager that the building fund be given more careful attention, and, in particular, that consideration be given to a long-range system of anticipating and planning for our physical plant needs.

1. Inadequacy of Past Policy.

We must face honestly the fact that our past policy in maintaining and developing our over-all physical plant has been inadequate. We are using buildings 75 and 85 years old, and many of them, notably certain mental hospitals, constitute alarming threats to the lives of patients and employees.

There is serious and unnecessary hardship and inefficiency resulting from insufficient space for the performance of essential functions. The efficiency of some agencies is greatly impaired because they are scattered over several different locations. This is especially the case of the Department of Taxation, which is located in five different buildings in the City of St. Paul. We pay large amounts of money for rentals and leases which, if our planning were intelligent and systematic, could be much more economically and efficiently spent in construction of buildings specifically designed for specialized governmental functions.

Previous legislatures have followed the policy of issuing bonds for relatively short periods. At present the periods of amortization are 8, 10, and 15 years. Short-term issues obviously impose a larger tax burden than is necessary during the early years of the useful life of the buildings. Modern buildings can be soundly amortized over a period as long as 30 years; in fact, from an investment point of view, it would be more economical to have a longer spread than a shorter one. Most of us have had this experience in the payment of mortgages on our own homes. I have a 20-year mortgage on my home, and I regard this as proper planning because I expect to live in my home for that period of time. Similarly, we should plan to spread the cost of public buildings over a reasonable period of the building's life.

2. Present Obligations.

Our building fund, in my view, is not overloaded. On December 31, 1954, there was a total of $29,147,900 in unpaid building fund debt. (See Appendix IV for detail.) For a physical plant the size of Minnesota's and for the volume of business performed by our state government, this is a relatively light burden. The 1954 tax levy for the building fund is 2.31 mills and the anticipated 1955 levy is 2.10 mills. I am convinced, therefore, that the building fund can absorb a fairly heavy new program. The time is overdue for us to consider certain essential needs already too long delayed.

3. Recommending Five-point Program.

The building requests for the next biennium are detailed in the printed budget on pages 22 through 25. They total $55,312,000. I am recommending the authorization of construction totaling $32,504,700, (See Table XVIII.) of which $29,404,700 would be financed by the property tax and the balance (82 per cent of a new state office building) from dedicated funds. All my recommendations are in the critical category. There are many other building projects that should be undertaken in the very near future. An extension of the recommendations I am making in this message would not, in my view, be unsound.

TABLE XVIII

Building Fund

Total Requests	$55,312,000
Recommended	32,504,700

My program includes five parts, as follows:

(1) Immediate action on an $8,022,000 emergency program for four mental hospitals and general fire protection work at nine others. I urge that this emergency program, as outlined on page 22 of the printed budget, be considered at the earliest possible moment. Each day these buildings are in operation places the lives of patients and employees in jeopardy. Of this amount, $7,022,000 is for the replacement of obsolescent and dangerous structures at Rochester State Hospital, Minnesota School and Colony at Faribault, Anoka State Hospital, and Hastings State Hospital, and the balance is for critical fire protection projects. I regard these projects as the first essential step in a long-range replacement program that will eventually remove all buildings condemned by our State Fire Marshal. I implore you not to delay on this matter, because, in the event of fire, we would be responsible for grave tragedy.

(2) Other critically needed buildings have been kept to a minimum. In the light of the emergency program, I felt it necessary to reduce or postpone wherever possible other building requests, although I am genuinely fearful that my actions here may have been too severe. I urge you, therefore, to examine most carefully all the building requests, in particular those presented by the University and the state teachers colleges, because these institutions are approaching the time when their enrollments will double and it would be wise to plan for such increase now.

(3) Immediate authorization for construction of a new state office building. Preliminary estimates indicate that the amount saved in rents and leases by the construction of such a building would, over a 30-year period, more than pay for it with a definite increase in efficiency. On the 30-year basis, the annual amortization cost would be $141,300. We would pay in rentals $143,900 for space that this building would provide or make available. Thus there would actually be a saving of $2,600 annually. (See Table XIX.) I see no reason why plans for this project should not begin immediately.

TABLE XIX

State Office Building
Amortization and Rentals
On 30-year Basis

Annual Rentals (now)	$143,900
Annual Amortization Cost	141,300
Actual Annual Saving	$ 2,600

(4) Construction of a new highway department central office building. The 1947 legislature authorized a three-man commission, consisting of the Commissioner of Highways, the Commissioner of Administration, and the Governor, to acquire land and prepare plans and specifications. The land has been acquired, preliminary plans drawn, and specifications are now in progress. I urge you to appropriate out of dedicated highway funds the amount needed for this building. Here again long-term economy and vastly improved service to the public will result if this project is completed. It will, of course, not affect the building fund.

(5) Creation of a permanent building commission. We should put an end to the haphazard and unsystematic manner with which we have handled our buulding problems. I urge that you create a permanent building commission with sufficient authority to develop a long-term planning program, subject to review each two years

but involving a 6 or 8 or 10-year planning base. I would further urge that you give consideration to the possibility of empowering the commission to launch individual projects, which have been approved as part of a long-range program, at such points in time when building activity would have the subsidiary value of stimulating the economy. In other words, a long-term building program might very wisely be related to the fluctuations in the employment index; when employment goes down, we would be prepared to undertake public works that would help create job opportunities.

I believe the importance of a commission of this type is so great that I would like to urge you to establish it immediately for the purpose of further reviewing the proposals I have submitted and perhaps reporting back to you before the end of the current session in time to provide you further information for use in the determination of your enactments for the next biennium.

4. Financing the Building Program

If my building recommendations were adopted in their entirety, this would mean the addition of $29,404,700 to the building fund debt, which added to the existing $29,147,900 debt would mean a total indebtedness of $58,552,600. (See Table XX.)

Table XX

Building Fund Debt

As of December 31, 1954	$29,147,900
Recommended new	29,404,700
	$58,552,600

The 1954 property tax levy, collectible this year, will retire $3,389,700 of this amount, leaving $55,162,900 to be financed by future levies. I see no reason why this entire amount could not be spread over a 20-year amortization base, which would require property tax millage of 1.93 annually, or over 25 years which would require 1.6 mills annually.

The 1955 property tax levy for buildings will be 2.10 mills. This means that, by refunding the present debt and spreading it over a longer period, there would actually be a modest bit of tax relief for property owners. I believe this course would be sound and wholly justified, and I commend it to you for your further study.

V. Improving the Tax Structure and Encouraging Business

Taxes are a concern of every citizen. Never neutral, they exert a powerful influence on the flow of income and the distribution of wealth. Because of their importance, it is essential that they be equitably levied and efficiently administered.

I cannot honestly ask Minnesotans to bear increased taxes without proposing certain improvements in our tax collection techniques and enforcement efforts as well as recommending certain essential readjustments of tax burdens.

In developing my program I have sought three objectives: (1) improving the convenience of payment and tightening the enforcement of tax laws, (2) removing certain inequities and complexities in our present tax laws, and (3) creating a more favorable tax climate for the economic development of our state. This is part of the program I have advocated for many years to Build Minnesota's Future.

1. Improved Convenience and Tighter Enforcement

Since we rely so heavily on income taxes in Minnesota, especially our individual income tax, it is extremely important that we make the tax as convenient and as easy to pay as possible. This is a well recognized principle of taxation. My recommendation of the withholding system is in line with this principle. It will provide both greater convenience and more complete enforcement and will, therefore, be welcomed by the great majority of Minnesota taxpayers. It should also improve taxpayer morale by assuring honest taxpayers that others having a tax liability are carrying their fair share.

The system of withholding and current payments offers still further opportunities for improving the tax system. Coordination with national withholding laws can then be sought as a means of minimizing additional burdens on the employer and reducing confusion among taxpayers.

Withholding should be extended to dividend and interest income. If the introduction of withholding in this area is to be delayed, I believe our income tax law should be amended to require that payors of interest report to the state all interest payments exceeding $100 annually (as dividend payors are already required to do). These reports should then be carefully matched against the taxpayers' state income tax returns to insure that this type of income is being fully declared and taxed.

So far as the income of self-employed persons is concerned, it is also important that we undertake a vigorous, hard-hitting program of intensive auditing, research, and the full use of federal tax returns as proposed by the Little Hoover Commission to reduce tax evasion to a minimum.

A program such as this will require added appropriations for the Department of Taxation, but I am sure that these outlays will come back to us many times in increased revenue, and the increase in tax fairness and improved taxpayer morale which will be derived from such a program cannot be counted in dollars and cents alone.

With respect to tax administration, I wish to underline my earlier reference to the property tax law, which produces more than half of the total state and local tax revenues in Minnesota. Although extremely difficult to administer, it is the backbone of local governmental finance and has a significance which goes beyond the production of revenue. It is essential that this tax be administered as efficiently and equitably as is humanly possible if a relative degree of justice is to be obtained between taxing districts and the many different types of property in the state.

While the drastic removal of all inequalities at one time is neither possible nor advisable, I do believe we should immediately undertake a long-range program for the gradual improvement of property tax administration. The first step should be a program of constructive co-operation and technical assistance to local assessing officials. In this connection, I recommend the expansion of the activities of the Department of Taxation in this area. A staff of professionally trained technicians should be available to assist local assessing officials in the valuation of particularly complex properties and businesses.

A companion step should be the continuation of the study of assessment standards now being done by the Equalization Aid Review Committee. This will provide us with objective guides as we work gradually toward the removal of inequalities.

2. Removal of Inequities.

There are certain inequities, loopholes, and unnecessary complexities in our income tax law which should be removed. At the top of the list for action, as I have already indicated, are the long overdue increase for credits for dependents and the plugging of loopholes in the corporation income tax. But further adjustments are needed not only in the interests of fairness but because they would stimulate agricultural and business development and would remove unnecessary differences between federal and Minnesota law.

Bills containing these adjustments are being drafted by the Department of Taxation on the basis of a careful analysis of our present law and of the new federal tax laws. Changes will be recommended wherever the provision is inconsistent with revenue needs and the improvement of Minnesota's income tax structure.

Let me mention a few of the proposed changes by way of illustration. To aid working parents in the lower income brackets, our law should provide an allowance for child care expenses on the pattern of the recently enacted federal provision. To aid agriculture, special allowances for soil conservation expenditure and outlays for grain storage facilities should be provided. To aid business, especially new and growing firms, we need more liberal deductions for research and development expenditures, longer carry-over of net business losses, and a series of other adjustments.

To aid all producing units, it would be desirable to incorporate into Minnesota law the new federal provisions for speedier tax write-offs of the cost of machinery, equipment, and buildings. However, a decision on this proposal can come only after careful appraisal of how much revenue it will cost the state and how this loss can be made up.

3. Building Minnesota's Future.

In the last analysis, the government services we want and need now and in the future can only be paid for out of an expanding tax base. This means we must have in Minnesota more production, more jobs with higher wages, more profits, and more dividends. In short, instead of fighting for a bigger piece of the present pie, we must all unite -- business, labor, and agriculture -- in producing a bigger pie with resulting bigger pieces for all.

For many years I have been vitally interested in industrial and business expansion and in resource development in Minnesota. We in this state are blessed with many resources. We have a wealth of mineral and water resources, a marvelous recreational area, able and experienced managerial talent, wonderful soil, an expanding network of natural gas and oil pipelines, good industrial relations, and an outstanding labor force. As an illustration of the efficiency of our labor force, the Wall Street Journal reported on August 19, 1954, that one firm found its production per man was 500 per cent higher after shifting to Minnesota.

If we are to be realistic, however, we must recognize our disadvantages. We are far from mass markets, which means transportation is a heavy cost item on products sold out of our natural trade area. Our climate is not favorable to many kinds of manufacturing, and our power costs are high compared to many parts of the country. Therefore, we must exert ourselves to the utmost, consistent with logic and fairness, to make sure that our state is attractive for new investors. Today there is much talk that our tax structure discourages the economic development so necessary to build Minnesota's future. Some of this talk has bordered on the irresponsible and has itself hampered our economic progress.

We should put an end to such destructive propaganda. The time is overdue for everyone dependent on our state's economy -- labor, management, farmers, co-operatives, the professions -- to join in an honest and realistic appraisal of our assets and liabilities. We must face the economic facts of life. Our task is not to protect powerful industry or special interest, nor is it to take advantage of any person or interest on an emotional basis. Our task is to determine our competitive position and the effects that each particular tax has upon our economy. When the facts show clearly that a tax is harmful to our economic position, we must courageously face up to our responsibilities and make the necessary modifications.

With respect to this point, I wish to discuss the personal property tax. This is a tax to which business is particularly sensitive. Certain personal property taxes are today a barrier to the economic development so vital to Minnesota's future. I believe the time has come to stop talking about this and to start acting.

Therefore, I recommend reducing the classification rate on manufacturers' tools and equipment from 33 1/3 per cent to 20 per cent and on manufacturers' inventory to 10 per cent. This is the rate recommended by the Minnesota Tax Study Commission and the Advisory Commission to the Department of Business Research and Development.

Because of the tight revenue situation in most localities in Minnesota, I recommend that this reduction be accomplished not all at once but rather in three steps over the next three years.

I further urge legislation to enable localities to raise needed revenue locally to meet their pressing needs. At the same time, I recommend the immediate adoption -- as a number of states have already done with favorable results -- of the optional inventory system for manufacturers, wholesalers, and retailers. This means that the property owner would be given an option of having this class of property assessed as of a given date or on an average basis. Other states which have adopted this plan have found it more equitable than the present somewhat arbitrary one date system, which is May 1 in Minnesota. The impact on revenues is difficult to estimate exactly, but experience in other states has shown that revenue loss is not as great as had been anticipated.

As I have indicated, I plan to create a Governor's Tax Study Commission, which will include representatives from business, agriculture, labor, the legislature, and professional groups. Its studies will be directed not to the question of who should pay taxes but rather to a specific examination of the competitive effect of different taxes on Minnesota's business, industry and agriculture. Today we desperately need the facts concerning the competitive position of Minnesota in the nationwide contest between states for new industry and business.

It is difficult at best to make recommendations concerning taxes, and, when emotion prevails over facts and reason, it becomes almost impossible to recommend wisely and with complete confidence.

VI. Conclusion

I wish to conclude this budget message by restating my desire to co-operate with the legislature in every way in developing mutually acceptable solutions for our problems.

I hope the length of this message has not been an undue burden on your time and patience. I thought it essential, in view of the seriousness and complexity of our problems, to support all major recommendations with full and detailed facts, because I believe we will arrive at sound and constructive decisions only by maintaining the fullest and frankest exchange of information. In this regard, I pledge on behalf of the executive branch our continuing effort.

Thank you for your courtesy and thoughtful attention. I face the future confident that we will work together in a spirit of trust and mutual respect and that we will evolve a sound and realistic financial program.

ANTICIPATED RECEIPTS FROM INCREASED AND NEW FEES

Department	1955-56	1956-57	Biennium	Grand Total
Agriculture				
Licenses:				
Egg - From $3 to $5	$ 8,000.00	$ 8,000.00	$ 16,000.00	
Babcock Test - From $1 to $3	5,800.00	5,800.00	11,600.00	
Creameries & Cream stations - From $1 to $25	24,000.00	24,000.00	48,000.00	
Ice Cream, In State - From $1 to $10	2,500.00	2,500.00	5,000.00	
Ice Cream, Out State - From $5 to $15	160.00	160.00	320.00	
Counter Type Freezers - From No License to $5	1,290.00	1,290.00	2,580.00	
Oleo Dealers - From $1 to $3	9,500.00	9,500.00	19,000.00	
Locker Plants - Up to 100 Lockers from $3 to $5, and each additional 100 Lockers, from $1 to $2	3,000.00	3,000.00	6,000.00	
Milk - From $1 to no charge	(14,000.00)	(14,000.00)	(28,000.00)	
Food - At present no license. Sales more than $150,000 @ $15; Sales more than $75,000 but less than $150,000 @ $10; Sales less than $75,000 @ $5 (New)	44,750.00	44,750.00	89,500.00	
Total - Agriculture				$170,000.00
Auditor				
Mortgage registration From 15¢ to 25¢ per $100	93,300.00	93,300.00	186,600.00	
Total - Auditor				$186,600.00
Banking				
Examination fees (graduated rates based on assets) for banks, trust companies	18,545.00	18,750.00	37,295.00	
Savings, bldg. & loan	2,000.00	2,000.00	4,000.00	
Credit unions	4,000.00	4,420.00	8,420.00	
Application fees for banks and trust companies from $200 to $220	40.00	40.00	80.00	
Savings, bldg. & loan from $200 to $220 and credit unions from $25 to $27.50	50.00	50.00	100.00	
Small loan companies from $50 to $55	20.00	20.00	40.00	
License fees for small loan co. from $100 to $110	95.00	95.00	190.00	
Small loan co. renewals from $100 to $110	1,200.00	1,275.00	2,475.00	
Licensing auto finance companies estimate ~~8,000~~ 800 companies @ $50 (New)	40,000.00	40,000.00	80,000.00	
Total - Banking				$132,600.00

APPENDIX I

Anticipated Receipts From Increased and New Fees - Continued

Department	1955-56	1956-57	Biennium	Grand Total
Education				
Teachers Certificates				
From .50 to 2.00 From 1.00 to 3.00 From 5.00 to 10.00	$ 23,353.00	$ 23,353.00	$ 46,706.00	
Trade School License From $50 to $100 Trade School Solicitors From $10 to $25 Correspondence School Solicitors From $2 to $25	3,900.00	3,900.00	7,800.00	
Teachers Employment Registration Charge $4 to $5	1,444.00	1,444.00	2,888.00	
Total - Education				$ 57,394.00
Governor				
Notarial fees from $3 to $5	8,750.00	8,750.00	17,500.00	
Total - Governor				$ 17,500.00
Insurance				
Twp. Mutual Companies' Fees				
For filing articles of incorporation and amendments from $2 to $5	1,540.00	1,540.00	3,080.00	
Filing annual statements from $1 to $10	1,386.00	1,386.00	2,772.00	
Certificate of authority from $1 to $10	1,386.00	1,386.00	2,772.00	
Filing amendments to by-laws $5 (New)	1,540.00	1,540.00	3,080.00	
Other Domestic Companies' fees				
For each company's certificate of authority from $1 to $10	766.00	766.00	1,532.00	
Foreign Companies' fees				
For filing annual statement from $20 to $30	4,000.00	4,000.00	8,000.00	
For filing certificate of authority from $2 to $10	12,000.00	12,000.00	24,000.00	
All companies except township mutuals				
Filing amendments to articles of incorporation from $10 to $20	1,900.00	1,900.00	3,800.00	
Abstracts of annual statements from $10 to $20	6,000.00	6,000.00	12,000.00	
Amendment to by-laws $5 (New)	2,200.00	2,200.00	4,400.00	
General Fees				
For each certificate from $1 to $2.50 and for each copy of paper on file in office 20¢ per folio to 25¢ and $1 to $2.50 for certifying	7,000.00	7,000.00	14,000.00	

Anticipated Receipts From Increased and New Fees - Continued

Department	1955-56	1956-57	Biennium	Grand Total
Insurance - Continued				
For receiving and forwarding service of process from $2 to $3	$ 400.00	$ 400.00	$ 800.00	
Agents Licenses				
2,000 additional agents annually	16,350.00	16,350.00	32,700.00	
18,000 domestic company agents from 50¢ to $2	27,000.00	27,000.00	54,000.00	
50,000 foreign company agents from $2 to $5	150,000.00	150,000.00	300,000.00	
Increased staff to make audits would net to the General Revenue Fund by transfer of surplus on June 30	6,600.00	6,600.00	13,200.00	
Total - Insurance				$480,136.00
Liquor Control				
Licenses:				
Mfgrs. & Wholesalers -				
Liquor - From $2,500 to $5,000	25,000.00	25,000.00	50,000.00	
Liquor Dupl. - From $1 to $1,000	5,994.00	5,994.00	11,988.00	
Mfgrs.				
Malt Bev. - From $500 to $1,000	7,000.00	7,000.00	14,000.00	
Wholesalers				
Malt Bev. - From $125 to $150	8,150.00	8,150.00	16,300.00	
Malt Bev. Dupl. - From $1 to $10	306.00	306.00	612.00	
Malt Bev. 3.2% - From $10 to $15	105.00	105.00	210.00	
Distillers Import - From $50 to $100	7,000.00	7,000.00	14,000.00	
Brewers Import - From $25 to $50	1,100.00	1,100.00	2,200.00	
Common Carrier, Liquor - From $25 to $50	275.00	275.00	550.00	
Common Carrier, Liquor, Dupl. - From $1 to $5	775.00	775.00	1,550.00	
Common Carrier, Malt Bev., Dupl. - From $.25 to $2.50	150.00	150.00	300.00	
Sacramental Wine - From $10 to $25	45.00	45.00	90.00	
Identification Cards & Permits:				
Distillery Representative - From $1 to $5	500.00	500.00	1,000.00	
The following from $1 to $2				
Liquor & Wine (Salesmen)	350.00	350.00	700.00	
Malt Beverage (Salesmen)	1,500.00	1,500.00	3,000.00	
Pharmacist	25.00	25.00	50.00	
Retailer	2,625.00	2,625.00	5,250.00	
Food Manufacturer	25.00	25.00	50.00	
Vehicle	3,325.00	3,325.00	6,650.00	
Total - Liquor Control				$128,500.00

Anticipated Receipts From Increased and New Fees - Continued

Department	1955-56	1956-57	Biennium	Grand Total
Board of Law Examiners				
Licensing attorneys (Present earnings of the board are $25 examination fee for bar examinations) (New)	$ 25,000.00	$ 25,000.00	$ 50,000.00	
Total - Board of Law Examiners				$ 50,000.00
Railroad and Warehouse Commission				
Bus & Truck Permit Fees, ATC License Plates - From $7.50 to $12.50	50,000.00	50,000.00	100,000.00	
Live Stock Buyers Licenses - From $7.50 to $10.00	8,000.00	8,000.00	16,000.00	
Weights & Measures, mandatory 3 yr. inspection - From no charge to actual cost fee (New)	100,000.00	100,000.00	200,000.00	
Total - Railroad & Warehouse Commission				$ 316,000.00
Secretary of State				
Domestic Corporation License - From $25 to $50	30,000.00	30,000.00	60,000.00	
Service Fees (various)	40,000.00	40,000.00	80,000.00	
Dealers License From $20 to $50	50,000.00	50,000.00	100,000.00	
Chauffeurs License From $1 to $2 From $1.50 to $3	181,500.00	181,500.00	363,000.00	
Charge for Transfer of Auto License Registration (New)	550,000.00	550,000.00	1,100,000.00	
Total - Secretary of State				$1,703,000.00
Securities				
Dealers' Licenses from $75 to $100	2,775.00	2,775.00	5,550.00	
Agents' Licenses from $5 to $7.50	1,660.00	1,660.00	3,320.00	
Investment Advisers' License from $50 to $75	425.00	425.00	850.00	
Registration of Coop. Securities from $5 each to $1 per thousand registered	550.00	550.00	1,100.00	
Registration of other Securities In addition to fee of $1 per thousand, propose $10 examination fee (New)	1,860.00	1,860.00	3,720.00	
Registration of Securities by Notification. In addition to fee of 50¢ per thousand, propose $5 examination fee (New)	1,630.00	1,630.00	3,260.00	
Total - Securities				$ 17,800.00
GRAND TOTAL				$3,259,530.00

General Revenue Costs Attributable to Dedicated Receipts and Trust Funds

MOTOR VEHICLE, PETROLEUM, EMPLOYMENT SECURITY, and EXAMINING BOARDS

MS 1953, Section 16.20 provides that several of the activities of the State of Minnesota which are financed by dedicated receipts should pay 5% of such receipts into the General Revenue Fund as the reasonable cost of the service rendered by the Governor, Secretary of State, State Treasurer, State Auditor, Attorney General, Department of Administration, Public Examiner, the Courts and the Legislature. However, in the case of Cory versus King, it was held that the constitutional dedication of all monies due the Trunk Highway Fund prevented the use of the arbitrary percentage figure and therefore under the provisions of the Laws of 1945, Chapter 609 a formula was worked out so as to charge the Highway Department for the cost of the State Auditor, State Treasurer, and the Departments of Civil Service, Administration and the Public Examiner.

In view of the foregoing, it is felt that the operation of the Motor Vehicle Division of the Secretary of State, the Petroleum Division of the Department of Taxation, the Department of Employment Security and the Examining Boards, all of whom operate from dedicated receipts, should likewise pay their share of the cost of the aforementioned activities. In view of the fact that Motor Vehicle, Petroleum, and Employment Security would meet with constitutional or federal restrictions if an arbitrary percentage were applied, the same formula used for the Highway Department has been applied to these activities, and, a 5% charge has been used in the case of the examining boards.

LANDS AND MINERALS

Laws of 1953, Chapter 741, Section 60 provides for a charge against trust fund receipts from State Forest Lands for the cost of the Division of Forestry that are applicable to the State Forest Trust Fund Land. In view of this, it seems reasonable that the cost of the operations of the Division of Lands and Minerals, insofar as they are incurred in the management of the mineral deposits on trust fund lands should likewise be charged against the trust fund receipts from mineral lands.

ADMINISTRATIVE COSTS ATTRIBUTABLE TO EMPLOYMENT SECURITY

Department	Basis	Cost	% Attributable	Annual Amount
Administration	Disbursements	$159,925.55	.00653	$ 1,044.31
Purchasing	Requisitions	159,016.64	.01019	1,620.38
Printer	Requisitions	16,059.24	.08169	1,311.88
Civil Service	Employees	215,031.38	.04870	10,472.03
Treasurer	Warrants	98,948.04	.02133	2,110.56
Public Examiner	Direct	30,500.00	1.00000	30,500.00
Auditor (Less Direct Highway)	Warrants	199,643.37	.02133	4,258.39
Other: Services of employee of Treasurer				1,510.86
TOTAL - Attributable to Employment Security				$52,828.41

ADMINISTRATIVE COSTS ATTRIBUTABLE TO PETROLEUM DIVISION

Department	Basis	Cost	% Attributable	Annual Amount
Administration	Disbursements	$159,925.55	.00092	$ 147.13
Purchasing	Requisitions	159,016.64	.00210	333.93
Printer	Requisitions	16,059.24	.00729	117.07
Civil Service	Employees	215,031.38	.00641	1,378.35
Treasurer	Warrants	98,948.04	.00285	282.00
Public Examiner *	Direct	900.00	1.00000	900.00
Auditor (Less Direct Highway)	Warrants	199,643.37	.00285	568.98
TOTAL - Attributable to Petroleum				$ 3,727.46

ADMINISTRATIVE COSTS ATTRIBUTABLE TO MOTOR VEHICLE

Department	Basis	Cost	% Attributable	Annual Amount
Administration	Disbursements	$159,925.55	.00222	355.03
Purchasing	Requisitions	159,016.64	.00494	785.54
Printer	Requisitions	16,059.24	.01263	202.83
Civil Service	Employees	215,031.38	.01703	3,661.98
Treasurer	Warrants	98,948.04	.00675	667.90
Public Examiner *	Direct	4,080.00	1.00000	4,080.00
Auditor (Less Direct Highway)	Warrants	199,643.37	.00675	1,347.59
TOTAL - Attributable to Motor Vehicle				$11,100.87

* As the audits of the Public Examiner are not on an annual basis the amounts are an average annual cost.

ESTIMATED COSTS OF LANDS AND MINERALS ATTRIBUTABLE TO STATE TRUST FUNDS

The Director of the Division of Lands and Minerals estimates that 95% of his costs are incurred in administering the mineral deposits on State Trust Fund Lands. Using this percentage, the attributable costs would be as follows:

	Recommended Appropriations	95% Attributable Costs
1956	335,716.00	318,930.20
1957	334,427.00	317,705.65

SUMMARY OF ATTRIBUTABLE COSTS

Attributable Costs	1 Year	Biennium
Motor Vehicle	11,100.87	22,201.74
Petroleum	3,727.46	7,454.92
Employment Security	52,828.41	105,656.82
Examining Boards	63,348.70	126,697.40
	131,005.44	262,016,88 *
Costs of Land & Minerals Attributable to Trust Funds (Average of two years)	318,317.92	636,635.85
Totals	449,323.36	898,646.73 *

* The attributable costs vary from year to year as the Public Examiner does not audit each year.

INCOME TAX SCHOOL FUND
On Basis of $80.00 Per Pupil Unit Basic Aid
And Present Tax Rates

	1953-55 Biennium	1955-57 Biennium
Income		
Balance Carried Over	$ 59,754,305.62	$ 29,593,579.90
Net Receipts at Present Tax Rates	112,199,901.76	116,000,000.00
Transfer IN (Administration of Veterans Adjusted Compensation Act)	250,000.00	250,000.00
Total Available	$172,204,207.38	$145,843,579.90
Outgo		
Basic Aid *	$ 84,604,517.00	$ 93,757,120.00
$10.00 Per Pupil Apportionment **	11,744,960.00	12,750,000.00
Equalization Aid	15,287,552.00	16,650,000.00
Transportation Aid	12,621,208.00	14,040,000.00
Other Aids	7,649,760.50	8,961,000.00
Income Tax Administration	2,991,099.43	3,412,454.20
Department of Education Administration	1,819,684.90	2,007,421.00
Transfer to Public Institutions	4,374,900.03	4,759,461.02
Transfer to Youth Conservation Commission	1,516,945.62	1,713,698.23
Total Outgo	$142,610,627.48	$158,051,154.45
Balance June 30, 1955	$ 29,593,579.90	
Deficiency June 30, 1957, on basis of Present Law		(12,207,574.55)
Deficiency June 30, 1957, on basis of $92 Per pupil unit in A.D.A.		(27,966,142.55)
* Average Pupil units in Average Daily Attendance	592,296	656,607
** Average Number of Children as base for distribution	587,248	637,500

CERTIFICATES OF INDEBTEDNESS
as of
December 31, 1954

Purpose & Legal Citation	Total C.I.'s Authorized	Total Issued to 12-31-54	Total Outstanding 12-31-54	Authorized but Unissued 12-31-54
Minn. State Bldg. Fund				
L. '47 - C. 636	4,200.00* $16,217,704.00	$16,171,904.00	$ 595,000.00	$ 50,000.00
L. '49 - C. 470	8,743,068.00	8,634,779.98	5,538,419.98	108,288.02
L. '49 - C. 742	17,146,000.00	16,435,887.72	9,977,485.72	710,112.28
L. '51X- C. 3	3,889,190.00	3,793,190.00	2,589,500.00	96,000.00
L. '53 - C. 758	10,278,350.00	6,382,387.30	5,587,100.00	3,895,962.70
Total Minn. State Bldg. Fund			$24,287,505.70	$4,860,363.00
Total Outstanding & Unissued as of Dec. 31, 1954			$29,147,868.70	
All Other				
State Veterans Serv. Bldg.	$ 3,000,000.00	$ 2,700,000.00	$ 455,000.00	$ 300,000.00
Mayo Memorial Bldg.	5,500,000.00	5,500,000.00	2,580,000.00	-0-
Military & Naval Land	700,000.00	700,000.00	515,000.00	-0-

Bldg. Fund Certificates of Indebtedness Redeemed July 1, 1954 to Dec. 31, 1954

L. '47 - C. 636	$ 1,294,538.00
L. '49 - C. 470	332,000.00
L. '49 - C. 742	743,067.00
L. '51X- C. 3	246,933.00
L. '53 - C. 758	570,287.30
	$ 3,186,825.30

Minn. State Bldg. Fund C.I.'s Outstanding & Unissued 6-30-54	$32,334,694.00
Less: Redemptions 7-1-54 to 12-31-54	(3,186,825.30)
C.I.'s Outstanding & Unissued 12-31-54	$29,147,868.70

* $75,000 authorized for Cottage at Home School for Girls, subsequently this full amount was cancelled by Laws 1949, Chapter 470, although a liability of $4,200 for architects fees was outstanding. This $4,200 was paid from borrowed funds.