

STATE AND LOCAL FEES BACKGROUND

Minnesota uses many fees to finance the delivery of state and local government services. Fees can be special assessments, charges for licenses and permits, and enterprise revenue. For example, the Minnesota Pollution Control Agency assesses fees to implement permitting programs, and the Department of Commerce charges for licensing barbers.

Fees are becoming a larger source of revenue at the state and local levels. State fees and charges have grown from \$249 million in FY 1991 to \$1.2 billion in FY 2007. That equates to a 10.3-percent annual rate of growth. State fees and charges represent 5.9 percent of state own source revenue. At the local level, revenues collected from license and permit fees and charges for services have grown from \$447 million in FY 1991 to \$1.3 billion in FY 2007 – a 6.8-percent annual increase. In addition, local enterprise revenues (i.e. golf courses, water and sewer) have grown from \$1.2 billion to \$3.0 billion during that same period – a 5.9-percent annual increase. Local license and permit fees and charges for services represent 13.3 percent of local own source revenue while local enterprise revenue represents another 31.6 percent of the revenue raised by local governments.

Many in the business community are concerned that there is no relationship between the fee that is charged and the cost of providing the service. For example, local fees significantly vary from city to city and from county to county. It is unlikely that the cost of providing the services varies to that extent. The state mutual fund registration fee is capped at \$25 million per year; however, it costs the Department of Commerce less than \$1 million per year to regulate this activity.

In 1999, the Legislature passed a provision that requires legislative approval of any new state fee or an increase in existing state fees as part of the omnibus state departments' finance bill. The provision took effect July 1, 2001, and is designed to address the lack of accountability and oversight the public and legislators have in setting fees. In addition, requiring legislative approval may improve efficiency if state agencies try to find alternatives to raising fees, such as controlling costs.

During the 2001 session, the Legislature passed industry-specific provisions that limit local fees. The residential building construction and grocery and convenience store industries will be treated more fairly because these provisions require local fees to be proportionate to the actual cost of the service.

During the 2003 session, the Legislature increased a variety of state fees. For example, fees were increased for court administration, fire marshal inspections, water use permits, food handler reinspections, state park admissions, motor vehicle transfers and a variety of licenses. In total, the FY 2004-2005 budget contains \$395 million of fee, surcharge and co-pay increases.

In 2005, the budget was balanced in large part by the imposition of a "health impact fee" or a 75-cent per-pack cigarette fee levied at the wholesale level. The health impact fee is expected to raise about \$400 million during the FY 2006-2007 biennium. Tobacco companies sued the state over the imposition of this fee, alleging that the state is not allowed to impose a fee that seeks to recover health costs related to tobacco use. The Ramsey County District Court agreed and ruled that the health impact fee was unconstitutional; however, the Minnesota Supreme Court upheld the fee.

Local franchise fees. In theory, local franchise fees are taxes levied by municipalities for use of public property for private gain. At present, local governments charge franchise fees to cable television providers, electric utilities and natural gas utilities. Franchise fees are generally based on a percentage of gross revenue. According to the 1996 report by the Department of Public Service (DPS), now the Department of Commerce, franchise fees for electric utilities ranged from 1 percent to 8 percent of gross revenues. Franchise fees varied from 3 percent to 8 percent of gross revenue for natural gas utilities while fees for cable companies ranged from 1 percent to 5 percent of gross revenue. The DPS reported that municipalities used franchise fee revenue for a variety of purposes including street improvements, rights of way, offsetting the cost of regulation and relocation of power lines. However, the DPS also reported that municipalities also believe "it is proper for franchise fee revenues to go into the general

fund.” Cable providers used a portion of franchise fee revenue for public, educational and government cable access.

The DPS report recommended, among other things, that:

“Franchise fees received by a municipality should only be used for franchise-related activities. Such fees should be separately tracked to ensure that they are not used for other purposes. Since many municipalities currently assess fees beyond that required to support cable-related activities, with the revenues being placed into the general fund, it is important that franchise fees be reduced to a level that covers the cost imposed on the municipality. Further, municipalities should not expand their costs to use all of the revenue currently collected. The goal should be to convert this hidden tax into a cost-based fee.”

This recommendation specified “cable-related activities,” but we believe it also should be used with respect to electric and natural gas utilities.

In 2003, several local governments proposed and adopted new local electricity and natural gas franchise fees. Most proposals came from metropolitan cities. It appears that these fees were not used to recover costs associated with the respective franchise, but rather to raise general fund revenue. Cities chose to impose new fees to make up for state aid reductions and because they did not want to make the more difficult choice of restructuring or reducing spending programs. In some cases, cities that adopted franchise fees will receive more revenue in 2004 than they did in 2003. Cities also have proposed other fees such as street light utility and storm water utility fees.