

STATE BUDGET: REFORMING STATE AND LOCAL SPENDING

ISSUE

The state will face a \$1.2 billion budget shortfall for the remainder of the FY 2010-11 biennium and a \$5.4 billion shortfall in the FY 2012-13 biennium. How should the Legislature address the shortfall? Does it need to change the process it uses to budget? How should the Legislature reform state and local government spending and reduce its overhead expenses?

POLICY

The Governor and Legislature must address future shortfalls by reforming state and local spending systems rather than by increasing taxes. The state's demographics and revenue and expenditure trends dictate it.

The state's demographics are changing in a way that will slow the rate of state revenue growth in the future. According to a 2009 analysis by the State Budget Trends Commission, the rate of growth will slow from an average of 6.8 percent in 2001 to 3.9 percent in 2033. In addition, the commission estimated that between 2008 and 2033 the average annual rate of growth in state health care costs is expected to be 8.5 percent. If this trend materialized and the state lives within the 3.9 percent revenue growth, all other state spending (including education) can grow at 0.2 percent per year. Finally, the commission noted that the long run trend growth rate of the personal income tax and sales tax is 5.4 percent and 5.2 percent respectively – less than the growth rate of state health care expenditures. If the state does not significantly slow the rate of growth of health care expenditures, it will need to increase taxes on a regular basis which is not sustainable given Minnesota's already high business and personal tax burdens.

Given these trends, it is more important than ever to change the way state and local governments' budget, the way services are delivered, and reduce overhead expenses.

Budget Process Reform

The state needs to change the way it budgets to prioritize spending and reduce the likelihood that it over commits resources in good times. This can be accomplished by two reforms to the budget process.

- Adopt a "Priorities of Government" approach to budgeting: This form of budgeting evaluates each function or outcome of government by its results per dollar. Functions/outcomes can then be ranked from highest results per dollar to lowest within each budget category. With that information, the Governor and Legislature can determine which outcomes they want to "buy" each budget cycle. When the state faces a budget shortfall, the functions/outcomes that have the highest value (results per dollar) can be kept and the lowest value can be eliminated. When the state has surplus revenue, new programs should be evaluated based on their expected results per dollar. The Legislature will also be in a better position to determine if it makes more sense to add dollars to existing programs or create new ones because it can compare the value of each. The state of Washington uses this approach to budgeting.
- Change the way the state forecasts revenue growth: The Governor and Legislature should limit permanent spending and tax changes to the long run trend rate of growth in revenue or forecasted revenue whichever is less. Currently, Minnesota Management and Budget estimates the revenue that the state expects to collect over the budget cycle. For the most part, all of it is available for permanent tax and spending decisions. This results in over committing state resources, i.e. the Governor and Legislature make permanent commitments of spending increases and tax cuts that are not sustainable. Using the long run trend rate of growth in revenue as a limit for permanent spending and tax changes will make less money available for permanent commitments and more dollars available for one-time expenditures. This could help build up a budget reserve, reverse budget shifts, invest in infrastructure, etc. This was a recommendation of the State's Budget Trends Commission.

Increasing Productivity

The state needs to increase the productivity of existing state services by in many cases totally redesigning the way the services are delivered. The following are some examples of service redesigns that the Chamber supports.

- Redesigning state health care programs: The Minnesota's Bottom Line report from Public Strategies Group and five of the state's largest foundations suggests that by spending state dollars on health outcomes rather than fee for services, \$3.7 billion can be saved. (Recommendations on General Assistance Medical Care and other state health care programs are coming.)
- Long term care reform: Too many people that have the means to finance their own long term care, end up using the state's medical assistance programs instead. This is not sustainable. Individuals must begin to plan for their long term care needs and the state and federal governments need to provide more savings mechanisms and change incentives in the Medicaid system to allow this to occur. Employers should also publicize the availability of long term care insurance and savings options and encourage employees to enroll. (See separate policy on long term care.)
- Special education: It is often too easy to get a child classified as a special education student. With that designation comes increased costs. There are three ways to lower the price of special education. First, Minnesota could change its state-specific definition of special education. Second, it could eliminate state-specific paperwork requirements. Third, the state could provide a "flat grant" payment per Diagnostically Related Group (DRG) of children and allow parents, individually or in groups, to purchase services within a customized portfolio of services. The Public Strategies Group believes this could save \$645 million.
- County redesign: The Association of Minnesota Counties is working on redesign initiatives on human service delivery, children in need of protective services, and the court systems among other things. (Specific recommendations are coming.)
- Redefine role for local elected officials: The roles of county board members, city council members, school board members and other local officials could be changed so that their primary responsibility is to define results and outcomes they expect the unit of government to achieve. Then, their staff (e.g. county administrators, city managers and school superintendents) should be charged with competitively sourcing every function to non-profit organizations, for-profit businesses, or other entities. By minimizing its own in-house providers, the chief administrator will always be forced to shop for the best value.
- Shared services: School districts, cities and counties should share services to the greatest extent possible and where it is cost effective. There is no need for each local government to have human resource, purchasing, 911 dispatch, law enforcement, fire protection and other functions that could be done on a multi jurisdiction basis.
- Competitively sourcing services: Services where there are private sector providers should be competitively sourced, allowing public sector organizations and private businesses to compete for the provision of services. Barriers to competitive sourcing should be eliminated.

Reducing Overhead Costs

- Retirement plans: New state and local government hires should only be offered defined contribution retirement plans.
- Post retirement health benefits: New state and local government hires should not be eligible for post retirement health care benefits.
- Health Insurance: To help create affordability and stability, state and local governments should make better use of benefit designs that promote health/wellness and encourage wise use of health care resources. Examples include value-based benefit design, health savings accounts and tiered health insurance plans. In addition, the state and local governments should stop providing 100% of the

coverage for single people. Public employees should have to make some contribution towards their health insurance.

- Reform Minnesota's Public Employee Labor Relations Act: (Recommendations on PELRA reform are coming.)

Budget Reserve and Cash Flow Account

The state's bond rating depends on sound fiscal management. The budget reserve and cash flow account are important components of sound management. Accordingly, we support the following:

- Setting the budget reserve in relation to the volatility of state revenues. According to the Budget Trends Commission, that currently means the state should increase the budget reserve to \$2.3 billion.
- Increasing the cash flow account to a level the department determines is sufficient to eliminate borrowing from other state funds. At present, the state's cash flow account is \$350 million. According to the Management and Budget Department, that amount is not enough to manage the times of highest cash needs.

BUSINESS IMPACT

If the state does not fundamentally change how it budgets, how state and local government services are delivered, and its overhead costs, it will be forced to increase taxes on a regular basis to keep up with the cost pressures on existing programs.