

Summary of Meeting with Jay Kiedrowski and John Gunyou
Civic Caucus, 8301 Creekside Circle, Bloomington, MN 55437
Friday, November 21, 2008

Guest speakers: Jay Kiedrowski, co-chair, and John Gunyou, member, State Budget Trends Study Commission

Present: Verne Johnson, chair; David Broden, Marianne Curry, Bill Frenzel (by phone), Paul Gilje, Jim Hetland, and Wayne Popham (by phone)

A. Context of the meeting: As part of the Civic Caucus on-going work in areas affecting Minnesota and its governance, today we're looking at the state's fiscal outlook for the upcoming biennium.

B. Welcome and introductions--Verne and Paul welcomed and introduced our guests for today, Jay Kiedrowski, co-chair, and John Gunyou, member, State Budget Trends Study Commission.

Kiedrowski is a Senior Fellow in the Public and Nonprofit Leadership Center at the University of MN's Humphrey Institute of Public Affairs specializing in public finance, organizational development, and leadership. Kiedrowski retired from Wells Fargo in 2004 as the EVP of Institutional Investments after a 17 year career. Previously, he was MN Commissioner of Finance, Minneapolis Budget Director, and a MN Senate researcher. He has served on a dozen or more nonprofit boards over the last 25 years. He was the Treasurer of the Guthrie Theater, and is currently the Chair of the Greater Metropolitan Housing Corporation. Kiedrowski holds BSME and MA degrees from the U of MN, and an EdD from St. Mary's University of MN.

Gunyou is city manager of Minnetonka. He previously served as finance director for the City of Minneapolis; and was Minnesota's finance commissioner in the Carlson administration. He was also a partner with the largest economic consulting firm in the Rocky Mountains, ran Minnesota's original and largest Internet company, and was an executive with Minnesota Public Radio. Gunyou has taught at several universities, and has degrees in finance and economics from the U.S. Air Force Academy, UCLA and University of Colorado. He has authored numerous articles and books, and writes political commentary.

C. Comments and discussion--During Kiedrowski's and Gunyou's comments and in discussion with the Civic Caucus, the following points were raised:

1. Major revenue-spending gap imminent for 2009 Legislature--It is possible that the gap between projected spending under current law and revenues at present rates for the upcoming 2010-11 state general fund will be in the vicinity of \$4 billion to \$5 billion when official projections are announced by the State Department of Finance on December 4, Kiedrowski said. General fund spending for the current biennium is about \$35 billion.

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Kiedrowski said the spending-revenue gap has these elements:

--A \$1 billion shortfall that was built in to the 2010-11 biennium when the Governor and Legislature enacted the budget for 2008-09.

--A \$1 billion shortfall that would result if current law were unchanged for the upcoming biennium. This includes inflationary increases that do not need to be automatically included.

--Another \$2 billion to \$3 billion shortfall from the impact of the downturn in the national economy on state revenues and on state expenditures for counter-cyclical areas such as welfare programs.

Kiedrowski took note of an October 2008 update from the Minnesota Department of Finance that provided bleak economic news for the rest of 2008 and into 2009. See <http://www.finance.state.mn.us/> Global Insight, Inc., a firm that makes economic forecasts used by the state for its budget forecast, is now predicting a 3.3 percent decline in gross domestic product, for the fourth quarter of 2008, but that number could rise to 4 percent as conditions have continued to worsen, Kiedrowski said.

As part of preparation for presenting a budget to the 2009 Legislature, the Department of Finance has asked state agencies to present budget proposals that assume a 95 percent spending level from the current biennium, which could produce savings of about \$1.5 billion.

2. Commission seeking more stability in state budgeting--In light of the fact that Minnesota's budget system seems to have been on a rollercoaster for several years, leaders in the Minnesota House (Rep. Ann Lenczewski) and Senate (Sen. Richard Cohen)

led the way in establishing a bipartisan, statutory State Budget Trends Study Commission in 2007.

http://www.taxes.state.mn.us/mntaxreform/meetings/docs_071408/State_Budget_Trends_Study_Commission_PRELIM.pdf. Kiedrowski is co-chair with Kevin Goodno, and Gunyou is also a member.

The report of the commission probably will be completed before the end of 2008, Kiedrowski, said. The commission has yet to make its final recommendations. Therefore, he said, what he and Gunyou have to say today should be regarded as informal interpretation of the direction that the commission seems to be going.

The House, the Senate, and the Governor each made five appointments to the commission. Among its members are four former state commissioners of finance: Pam Wheelock, Peggy Ingison, Gunyou, and Kiedrowski.

3. Demographic changes--Kiedrowski outlined major changes in state demographics that will have a significant impact on state budgets in coming years:

a. Big growth in ages 55-74--The largest growth in state population is among the 55-74 age group, he said. Such a development has major budget implications because people in this age group tend to use more services, and they are leaving the tax-producing work force.

b. More elderly than school children--For the first time in the state's history, in the year 2020, Minnesota will have more persons over 65 than school children.

c. More elderly and school children than workers--By 2030, the state will have more persons in so-called dependency ages (persons over 65 and school children) than persons who are employed.

4. Shortage of educated workers--Even though the state is seeing a significant increase in immigration, the state always has had a problem attracting workers, because of our cold weather and distance from other population centers, Kiedrowski said. The problem is complicated by the fact that more students are leaving high school before graduating, which means that our work force is becoming less well educated.

5. Volatility in the revenue-expenditure system--The income tax is most volatile, Gunyou said, followed by the sales tax. The property tax is least volatile. Fixed tax rates apply to income and sales, he noted. Thus when people earn or spend less or more, the impact on tax revenues is immediate.

The property tax system is different, he noted. In good times property taxes don't go up as fast as sales and income taxes, and in bad times, they don't decrease as fast. Property taxes are paid yearly, and values are established not more than once a year. Unlike sales and income tax rates, property tax rates on a given parcel of property are not fixed in advance. The rates are derived according to how much local government decides to spend and by total property values in the community. As a result of a change in property values, taxes on a given home could rise or fall, depending upon how property values changed on all other properties in the community.

6. Gasoline taxes also volatile--In response to questions Kiedrowski and Gunyou noted that Minnesota gasoline tax revenues aren't growing as originally expected, despite a recent increase in state rates, because people are buying less gasoline.

7. Fees and charges less volatile--The portion of the state's budget that comes from various fees and charges, such as hunting and fishing licenses, is less volatile than the portion of the budget that comes from sales and income taxes, they said.

8. Broadening the sales tax base?--Broadening the sales tax base to include food and clothing wouldn't make as much a dent in volatility as might be expected, Gunyou said. True, the sales tax would be applied to necessities for which there is less volatility in purchasing, but much discretion is possible for bargain-seekers, who simply won't buy as many expensive items during hard times.

9. State revenue-expenditure gap is getting ever more challenging--Looking ahead to the next 25 years, Gunyou said that by extrapolating past trends, and taking into account changing demographics, one can expect that state revenues, at present tax rates, could grow about 3.9 percent year, with expenditures growing at 5.4 percent a year, a difference of 1.5 percent. Compounding that difference over 25 years produces a budget gap of astronomic proportions.

Public health expenditures in the state budget have been rising at 8.5 percent a year and would eat up the entire state budget by 2033, Gunyou said. In response to a question, Gunyou and Kiedrowski confirmed that the biggest growth in public health expenditures is occurring in long-term care, with the bulk of that expense in the last three months of life.

10. Proposals for special legislatively-ordered expenditures not included--In discussion it was noted that K-12 leaders are proposing a \$4 billion increase for the next biennium. Such an increase is outside--and would be in addition to--other projected increases.

11. Weber-Brandl report recalled--Kiedrowski noted that in November 1995 John Brandl, former dean of the U of M Humphrey Institute, and Vin Weber, former member of Congress from Minnesota, made major recommendations to improve the state's budgeting process. See: <http://www.gda.state.mn.us/pdf/agenda.pdf>. Major principles in that report:

- A target should be set for spending and targets should be established for all major expenditure areas.
- Eligibility for government benefits should be limited to the most needy.
- Funds should go to citizens, not bureaucracies.
- Expand choices for users and government officials.
- Enable families and communities to provide some services

12. Possible recommendations from current commission--The commission meets next Tuesday and hopes to complete its report by December 15, Kiedrowski said. He outlined several possible recommendations:

a. Re-establish a permanent long-range planning function in state government--The State Planning Agency, abolished a few years ago, should be re-established.

b. Make demographic data an integral part of budget data--The critical importance of accounting for changes in the nature of the state's population requires that demographic data be updated and accompany economic and budgetary forecasts every biennium.

c. Include inflationary factors in expenditure forecasts, but don't automatically include them in budget proposals--It is important for lawmakers to know the dollar impact of including or not including an inflation factor in forecasts of expenditures for upcoming bienniums. Such numbers should be included for information purposes only, not as providing any direction for lawmakers.

d. Stop overly-optimistic forecasting when times are good--Kiedrowski said all four former finance commissioners agree that during good times state forecasts should be related to average growth over a long period of time, rather than assuming continued high growth in the good times. If forecasts are "normalized", but above-average revenues are realized, those dollars can be placed in reserves, to be used when economic downturn occurs.

e. Don't balance the upcoming biennial budget by passing expenses on to the following biennial budget--In adopting the biennial budget, the Governor and Legislature should also demonstrate that the following biennial budget will also be balanced "structurally". That is, nothing is being postponed that would cause an automatic unbalanced budget in the following biennium.

f. Set realistic budgetary reserves--The state has had a goal for about 25 years of having a 5 percent budgetary reserve. The number was established more or less arbitrarily. The reserve amount needs to be determined as guaranteeing that any deficit will be covered--based on past experience--in 19 out of 20 years

g. Guard against short-term borrowing for cash flow purposes--The state always needs enough cash on hand to avoid short-term borrowing, because such borrowing represents an immediate signal to credit-rating agencies to reduce the state's credit rating.

h. Address the achievement gap in K-12 education--From a standpoint of assuring a good supply of workers in coming years, the state must increase high school graduation rates so that more students will go on to college and then become part of a well-trained work force.

i. Take action on health care--A permanent public-private group is needed to continually advise the Governor and Legislature on necessary steps to control increases in health expenditures.

Asked what steps are most urgent for the 2009 Legislature, Kiedrowski said (1) set the size of the budget reserve, (2) guarantee a structurally-balanced budget for the following biennium when adopting a budget for the immediately upcoming biennium, (c) adjust

budgetary forecasts during prosperous times to levels that would prevail in average, less prosperous, times.

13. Leadership on fiscal discipline--It was noted by a Civic Caucus member that both at the state and federal levels it is likely that the lawmaking body, whether a Legislature or Congress, is more likely to increase rather than decrease proposed budgets, even budgets submitted by the most profligate Governor or President. Thus strong executive leadership is essential in budget-making.

14. A "perfect storm" for more constitutional amendments on taxation?-- Kiedrowski said he is opposed to constitutional amendments that would give exclusive access from a part of the state's general revenue to some state services. Thus, he opposed the amendment adopted by the voters in November that gave 3/8 of a penny of the sales tax to outdoors, clean water and the arts.

A Civic Caucus member said it appears that the current fiscal situation, coupled with the precedent set in November, could produce another constitutional amendment in 2009. The fiscal gap will be enormous. Advocates for many services will be seeking significant increases. Resistance to tax increases will be high. The Legislature and Governor are likely to be at odds. A pressured Legislature might be tempted to acquiesce in to an influential group's urging, such as that of education, and submit a constitutional amendment for dedicated funds, which doesn't require approval by the Governor. Thus the state general fund would gradually be eaten up as taxes get dedicated to one function or another.

15. Thanks--At this stage in the meeting Verne thanked Kiedrowski, who had to leave early, for being with us today. Gunyou remained for additional discussion.

16. Difficulty in gaining state support for locally-initiated development-- Gunyou, city manager of the city of Minnetonka, said that United Health Care, in Minnetonka, at the intersection of Bren Road and Hwy 169, has been seeking the right to double its headquarters space. The city of Minnetonka supports the effort, as do state development officials, because it would add jobs. But Minnetonka is unable to convince the Minnesota Department of Transportation (MnDOT), to build a needed Bren-169 interchange because of lack of funding. MnDOT officials have suggested that if Minnetonka could build the interchange, MnDOT might be able to pay the city back over time, but cities do not have the tools necessary to front such a large project. Clearly the interchange would benefit many different commercial interests, depending upon their distance from the interchange, he said. Therefore, some kind of an assessment for benefiting property owners, based on distance from the interchange, might be considered, but Minnetonka doesn't have the authority for such an approach. Gunyou also supports an interchange at 169/494, which is off the table for lack of funds, too.

17. Question of relative need for light rail transit (LRT)--In response to a question, Gunyou said Minnetonka supports a new LRT line that would go from downtown Minneapolis to Eden Prairie. In light of the state's fiscal problems, the need

for major highway projects, and the fact that all LRT lines mainly serve downtown destinations, a Civic Caucus member wondered why officials would want to be attaching such high priority to LRT.

18. Thanks--On behalf of the Civic Caucus, Verne thanked Gunday for meeting with us today.

D. Upcoming meetings

Friday, November 28--Internal discussion on transportation

Friday, December 5--Officials of the Minnesota Association of Secondary School Principals

Friday, December 12--Joe Nathan, director, Center for School Change, University of Minnesota

Friday, December 19--Jim Bartholomew, Minnesota Business Partnership, on education

Friday, December 26--no meeting

Friday, January 2--Mark Ritchie, Minnesota Secretary of State, on election-related issues

Friday, January 9--Terry Stone, business owner, International Falls, MN

E. Recent website additions:

--**Comments on summary of meeting with Jeffrey Eppink, energy consultant:** <http://www.civiccaucus.org/RespSummEppinckJeffrey.html>

--**Comments on summary of meeting with Dee Long, former speaker, Minnesota House of Representatives:**
<http://www.civiccaucus.org/RespSummLongDee10-08.html>

--**Comments on summary of meeting with Peter Hutchinson, president, Bush Foundation :** <http://www.civiccaucus.org/RespSummHutchinsonPeter.html>

--**Comments on summary of internal discussion on future of Civic Caucus:** <http://www.civiccaucus.org/RespSummCivCaucInternalDisc10-08.html>

--**Comments on summary of meeting on education with State Rep. Mindy Greiling:** <http://www.civiccaucus.org/RespSummGreilingMindy.html>

