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In This Issue:

State Government's Human Capital Problem

Until Minnesota government takes other workforce issues as seriously as its fixation with internal equity, trying to get and retain necessary talent in government is doomed to be an increasingly expensive exercise in frustration while recent high-profile agency embarrassments become more common.

Following the MNsure and MN LARS controversies of past years, the problems engulfing the Department of Human Services have a lot of citizens wondering what is going on behind the scenes in state government. Another round of questionable decision-making, faulty internal process controls, and investigative hearings are causing taxpayers' faith in the state's good government reputation to be tested. Regardless of what happens this time around, it's long past due to consider whether these recurring events are symptoms of a much bigger and more fundamental problem – an increasingly anachronistic government human capital system unable to deliver the results citizens deserve and expect.

A Recurring and Increasingly Urgent Theme

For over 50 years the National Academy of Public Administration – a congressionally chartered non-partisan, non-profit academy based in Washington, D.C. — has provided expert advice to government leaders on building and managing more effective, efficient, accountable, and transparent organizations. Their 2017-2018 two-part report, No Time to Wait: Building a Public Service for the 21st Century, pulls zero punches on the urgent need to reform and transform civil service to address the needs and realities of modern government and the changing environment and nature of government work. "Government's human capital system is broken," it concludes, "hindering the ability to recruit, develop, and retain top talent while holding administrators and employees accountable for results." A core problem, NAPA argues, is government human capital systems are preoccupied with a process of internal compliance built, in part, on governments' instinct "to treat every person in a similar position in precisely the same way – which too often creates layers of regulations that advance neither mission or merit." The result is "a human capital system which forces agency missions to fit personnel processes instead of the other way around."

It's not just government human resource experts flagging these types of concerns. Those on today's front lines of government management are communicating similar themes, ideas, and urgency. A 2019 report from the National Association of State Chief Administrators (NASCA) entitled *Reimagine Today's State Government Workforce* concluded, "It's time for significant change and modernization at every phase of the government employment life cycle – from recruitment, hiring and onboarding to training, development and retention." In member polling that finds both a rapidly growing skills gap in the public sector and increasing difficulty in attracting new employees, NASCA argues, "it's time to rethink how states categorize and describe the work they do around talents and characteristics rather than focusing on titles, government scales, and jargon that will soon become obsolete."

Classification Calcification

"Over the years the basic purpose of civil service system has been forgotten: to recruit the most talented among our citizens in government, not to employ legions of classification experts and personnel administrators who spend days tracing bumping routes and rewriting job descriptions. State and local governments have a hard enough time as it is recruiting the best and brightest without actively discouraging them."

— *Hard Truth /Tough Choices — An Agenda for State and Local Reform*
Report of the National Commission on State and Local Public Service Presented to President Bill Clinton, 1993

It's difficult to overstate the disconnect between the prescriptions for reform contained in these reports and the reality of current government human resource practice. The foundation of our existing system – position classification – in many ways represents the antithesis of the ideas expressed by NAPA and others. We have a human capital system designed around discrete "jobs" rather than delivering government services efficiently and effectively. And as the quote above demonstrates, concerns about this foundation and its impact on filling governments' talent pipeline have existed for quite some time.

State law requires Minnesota Management and Budget (MMB) to maintain, revise, and administer a job classification plan. Job classes are a group of one or more positions with similar duties and responsibilities. Minnesota features "over 1500 such job classes in the executive branch"[1] all based on internal evaluations of individual job characteristics.

Identifying and evaluating the duties, responsibilities, tasks, and authority level of a job is common practice in any organization.

[1] *https://mn.gov/mmb/employee-relations/hiring-and-selection/*

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What makes government human capital systems increasingly unique is how it undertakes and uses this practice. Position classification is combined with job evaluations to determine the "comparative worth" of different jobs within government. This approach is needed to deliver on the human capital system's primary objective: internal compensation equity across completely unrelated types of government occupations. As MMB has said, "Evaluating job content (the kind and level of work assigned to a position) rather than individual qualifications or employee performance allows for quantitative comparison of one state job to another [emphasis ours]. Evaluation and comparison provides the foundation for consistent state-wide classification and compensation practices."[2]

This is accomplished by assigning "points" to each position based on specific job characteristics and factors like know-how, problem solving, and accountability. Summing the points quantifies each job's value to government, and the relative worth of all government occupations can be compared against each other. It's difficult to find a human resource practice more controversial than "point factor" job evaluation. Supporters say it's a respected job evaluation process used successfully for decades in the private, public and not-for-profit sectors. Detractors have described it as "a completely opaque, black box … the administration of which cannot be easily explained or defended because it is half voodoo." [3] Unfortunately, neither the results of Minnesota state job evaluations nor the recency of these evaluations is readily available to the public.[4]

Regardless of its merits — or lack thereof — this "blind pursuit of horizontal equity," as NAPA describes it, has significant implementation problems and consequences:

- **The timeliness of job evaluations is a chronic issue** – The federal government's Merit Systems Protection Board notes governments face enormous challenges in committing the time and financial resources needed to update these evaluations to reflect "new jobs" as well as the evolution of government work. For example, at the federal level, which employs a similar system, the Office of Personnel Management found 30% of white collar positions had not been updated since 1990 and some hadn't been updated since 1970. Here in Minnesota and according to the latest MMB job evaluation information, it appears several information technology job classes haven't been rerated in over twenty years. It's safe to say a few things may have evolved in the world of IT occupations, skills, knowledge, capabilities and responsibilities in the last couple of decades.

- **Incentives for title and grade inflation are created** – Facing this timeliness obstacle it becomes easier to get an existing job reclassified or create a new class – especially when there is a need to retain talent no longer eligible for tenure ("step") increases. As author and compensation expert Jim Brennan states, "The moment an evaluated job's internally equitable pay falls too far below the market-clearing rate, it generally gets re-evaluated upwards, reclassified by a content/title tweak or artificially promoted." [5] Tacking on another discrete job class (e.g. "Hydrologist 5"), adding discriminating qualifiers (e.g. "junior" "senior" "intermediate" "principal"), and employing such descriptors in combinations creates ever more finer distinctions between jobs resulting in what NAPA calls "bureausclerosis."

This approach is needed to deliver on the human capital system's primary objective: internal compensation equity across completely unrelated types of government occupations.

- **Government operations are handcuffed in the delivery of their mission** — As NAPA argues, "seeking fairness by addressing every single situation through an identical, uniform, strictly regulated path without consideration or pursuit of alternatives that can better address changing conditions is not effective human capital management." The "one size fits all" approach to government employment prevents government from accommodating unique circumstances surrounding an agency's mission, circumstances, and needs.

Once upon a time current practice didn't create as much potential for conflict with labor markets, especially when individuals were more likely to stay with the same employer for years if not their entire career. Today, government human resource experts note how technological advancement, automation, and the increasing complexity of issues in which government participates has — as in private industry — driven the demand for a wide variety of new professional talent and emerging skills sets, knowledge, and capabilities. "Government work" is very different than it was a half century ago.

Compensation Effects: Inequities From the Pursuit of Equity

In NASCA's 2019 survey of state chief administrators and human resource directors, respondents identified "the failure to offer competitive salaries when compared to the private sector" by far the greatest barrier to attracting high quality talent to state government. (In Minnesota, it's not just private sector competition. Over the years we have heard several examples of state government agencies losing talent to local governments due to compensation differences.) Although this finding is routinely chalked up to "not enough money," the design of the state's human capital system is a major contributor to non-competitiveness.

[2] This quote no longer appears on the MMB website because all content and information pertaining to the state's job evaluation process and results have been removed.

[3] "How to Be Both Transparent and Secretive at the Same Time" *Compensation Café* June 16, 2017

[4] MMB indicated to us the reason is that the state has an agreement with the state's job evaluation consultant that allows the state to use this information internally with the compensation team, but not distribute the information externally. While the proprietary nature of the job evaluation process, procedures manual, etc. makes sense to us, we do not understand how the output from applying the methodology to Minnesota occupational classifications – the bedrock of state compensation system design -- could in any way be considered proprietary. Since it's the basis for establishing internal equity in government compensation it seems to us to fairly and appropriately fall under the heading of basic government transparency. We received the latest information via a Data Practices Act request.

[5] "Point Factor Job Evaluation Concisely Summarized" *Compensation Café*, January 28, 2016

The rigidity and inflexibility of government pay scales and the resulting wage compression in the public sector have long been identified as a contributing factor to the hemorrhaging of talent. One academic study found that since 1970 high skill, private sector workers have become increasingly less likely to leave the private sector to serve in the public sector. At the same time high skill public sector workers have become increasingly more likely to exit to the private sector. Notably, within the public sector workforce, the top third of public sector wage earners featured quit rates far exceeding the lower two-thirds leading the researchers to conclude, "in determining the public sector's ability to attract and retain a high quality workforce … the analysis suggests future policy discussions of public sector wages need to pay a great deal more attention to the relative dispersion in the income opportunities afforded to government workers." [6] In other words, how you pay, not just what you pay, matters.

Questionable and outdated job evaluation findings, often tone deaf to labor market realities, make the problem worse. For example, the class description of the state government's mid-level information technology specialist (Information Technology Specialist 3) contains the following content:

- Differentiation from lower class levels – "Employees are responsible for independently completing projects or significant parts of large projects. They define what needs to be done rather than complete projects that are outlined for them by others … Participates in analyzing and designing systems, networks and applications rather than implementation only."

- Examples of work – "Examines the status and operation of existing systems and recommends or performs corrective measures. Coordinates work efforts so that standard methods and procedures are employed and time and cost commitments are achieved. Performs detailed analysis of modifications to existing systems."

- Abilities – "Project future MIS needs, analyze/develop alternatives, and recommend action sufficient to provide technical assistance to management in the long-range planning process. Assess operations (equipment, staff, training, etc.) needs sufficient to establish priorities and develop budget recommendations. Understand, evaluate, assess and implement complex data processing systems, software and equipment

[6] George J. Borjas, 2002. "The Wage Structure and the Sorting of Workers into the Public Sector," NBER Working Papers 9313, National Bureau of Economic Research, Inc.

"Mission First, Principles Always, Accountability for Both"

State efforts to reform their human capital systems differ in scope, scale, and approach. Incremental strategies often focus specifically on pay scales and structures. One common example is "broadbanding" in which the number of job classes are dramatically reduced but the associated pay scales are no less dramatically expanded to create greater internal compensation flexibility. Other tweaks include replacing tenure increases with some form of performance review linked to the acquisition of skills, knowledge and capabilities. On the other end of the spectrum are states that have essentially transitioned away from the traditional civil service structure — including potential protections from political influence — and adopted a largely "at will," performance-based workforce design akin to the private sector.

Perhaps the most radical reform vision to try to reconcile all these needs, demands, and expectations comes from the recommendations of the National Academy of Public Administration report *No Time to Wait: Building a Public Service for the 21st Century* highlighted in this issue. NAPA argues for a human capital system built on a three-legged stool of "Mission First, Principles Always, Accountability for Both":

- Mission First – Build a "federated" human capital framework allowing agencies the flexibility to develop customized human capital systems to meet the specific needs of their missions.

- Principles Always – Ensure these tailored human capital systems remain grounded in merit system principles[9] which has been at the core of public administration for well over a century. (NAPA argues merit principles are not the problem; how they have been brought to life by government laws, regulations, rules, process, and personnel authorities is the problem.)

- Accountability For Both – Ensure that the system focuses not on the devotion to process and regulations but on how its products – merit-based, agency-specific human capital policies and strategies — help agencies achieve their missions.

Key features of such a system include:

- A comprehensive human capital redesign oriented around talent management in particular "lines of work" (finance, IT, etc.) rather than specific jobs;

- A centralized executive agency supported by a cross agency advisory council dedicated to strategic workforce planning; continual monitoring of the skills, knowledge and capability needs across government and their evolution; and support in implementing agency human capital plans;

- Creation of agency "talent managers" to supervise and manage individual growth and development in concert with agency needs and mission

- Professional and career advancement through acquisition of credentials from mastering competencies and performance;

To be sure the visual description in the report (likened by NAPA to a "concept car") of what this model would actually look like in practice bears no resemblance whatsoever to the human capital system Minnesota now has in place. Whether this reform approach is "right" for Minnesota is an open question. But the challenges NAPA highlights prompting calls for reform should resonate. That's especially true for Minnesota which requires not just talent, but the continual pursuit of innovation, efficiency, and productivity improvement to keep costs from exploding and our "high tax / high service" competitiveness model working. ■

[9] The nine merit system principles applied to federal civil service are found in Title 5 of the United States Code — 5 U.S.C 2301(B)

sufficient to make recommendations for purchase and implementation."

State job evaluations deem this job of less value to government than, among many other occupations, a Zoo Guest Services Supervisor and a Central Mail Supervisor. It's circumstantial evidence of one of the common criticisms among human resource professionals of these types of evaluations — a bias of projecting greater value onto positions having responsibilities for managing people.

A further contributing factor to the state's competitiveness problem is the use of "steps" — which one human resource expert describes as the "quiet, automatic, uncontroversial, unnoticed, seniority-based progressions based on nothing but time." These annual adjustments are applied uniformly across the classified government workforce[7] and use tenure as a proxy for acquiring skills, knowledge, and capabilities. Steps have a significant compounding effect on compensation levels when combined with cost of living adjustments that are also employed uniformly across the workforce. For example, the new Minnesota Association of Professional Employees (MAPE) contract features step increases of 3.6% per year and cost of living increases of 2.25% and 2.5% over the next two years respectively. Thus, the total salary increase for step-eligible MAPE employees over the two year contract period is 12.5% (1.0225 x 1.036 x 1.025 x 1.036). According to the Subcommittee on Employee Relations, about 57% of MAPE members are eligible for these step increases.

Many MAPE employees may merit this increase (some perhaps more). Many may not. Many may deserve this increase but are unable to get it because they are no longer step-eligible. Some of the step-ineligible 43% may already be significantly undercompensated relative to the private sector or local governments. Absent a new job class or some other system manipulation, their continued service in state government may be at risk. Practically, the rigidity and inflexibility of millions of dollars in step compensation resources and the inability to repurpose them represents a significant opportunity cost with respect to attracting and retaining talent where it is needed.

Indirect effects also arise. The predominant focus on ensuring internal equity among all employees regardless of performance, learning curves, and professional development can backfire and appear highly unfair to employees. As one human resource expert has noted, "when salary compression and the policies that enable it are sustained over several years, it can be demoralizing and lead to widespread dissatisfaction. Employers should be concerned because salary compression transforms the organization's single largest cost (i.e., compensation) from a motivator into a "demotivator."

To offset salary disadvantages state government has historically relied on its comparatively more generous fringe benefit packages. In particular, the retirement security offered by defined benefit pension plans has been government's primary countermeasure for securing and retaining talent. However, in the effort to save these plans and restore them to health, potentially new talent-related problems have been created.

Dedicating more resources for larger and larger band aids to address the slow, steady talent bleed from current system design is an expensive proposition.

One cost saving tweak implemented in the last round of repairs was the elimination of "pension augmentation" in which future pension benefits for individuals who have left public employment are still increased by an established annual interest rate until the defined benefit is claimed. The elimination of pension augmentation keeps sorely-needed dollars in the pension system, but with a talent-related drawback. The way defined benefit pensions work, the economic benefit of working in the public sector is now even more conditioned on making government a lifelong career choice. Any public service-minded individuals interested in devoting anything less than a decade or more of their working career to government service would find their own retirement security and interests substantially harmed. Similarly, those already in government are incentivized to prolong their careers in government due to simple retirement economics. Without augmentation, defined benefit plans become as much a hostage situation as a retention tool. How this change impacts motivation, the quality of the public workforce, and the quest for talent remains to be seen.

Interestingly, the latest round of state employee contracts includes several new spending proposals to try to mitigate the talent access and retention problems stemming from current compensation system design. Upon ratification by the legislature:

- Agencies under a pilot program would be permitted to offer student loan reimbursements, up to $5,000 per calendar year or $25,000 over 5 years subject to some tenure related conditions.

- Agencies could offer a recurring incentive up to $5,000 to new employees who accept hard-to-fill positions. Agencies would also be able offer referral incentives up to $1,000 for hard to fill positions

- Upon request of an Appointing Authority, MMB would be permitted to grant equity adjustments to employees to maintain internal equity. The employee may advance within the salary range or receive up to $2,500 in a lump sum payment if they are at the top of their range.

Dedicating more resources for larger and larger band aids to address the slow, steady talent bleed from current system design is an expensive proposition. Perhaps that's why a management columnist for *Government Executive* argues "Position classification is an antiquated process that government can no longer afford" [8]

Implications for Government Accountability

A human capital system built around a culture of internal process compliance risks overlooking the bigger accountability issue of delivering results to taxpayers. Critics of traditional government human resource management point out accountability in a

[7] Collective bargaining units may differ in the magnitude of step increases within employment contracts but they all have them.

[8] "What's in a Name? Everything. That's Wrong With Job Classification" *Government Executive* June 2015

government human capital system should be determined by outcomes, not defined by adherence to human resource processes and rules. Or as NAPA states, "One of the problems crippling the current human capital system is the effort to force agency activities to fit personnel processes instead of the other way around."

With this in mind the recent troubles consuming the Department of Human Services on opioid payments is perhaps worth a closer look. The Office of Legislative Auditor's scathing Special Review concluded:

> *"The department did not have legal authority to make the payments; it did not document why, when, and who decided it was appropriate to make the payments; no one at DHS takes responsibility for the decision; and no one at DHS can provide a rationale for the payments. The overpayments continued over several years and did not stop until an outside inquiry brought them to light."*

In the organization chart presented in the OLA report, there are seven levels of management above the front-line State Opioid Treatment Authority Representative (position class: "Human Services Program Consultant") Three of those management levels are unclassified executive positions (assistant commissioner and higher). The four intermediate management levels are classified job positions – originating from four possible "Human Services Supervisor" job classes (numbered 1-4) and five possible "Human Services Manager" position classes (numbered 1-5). Reviewing the descriptions for these 9 different supervisory and middle management job classes it is often difficult to substantively distinguish skill and knowledge requirements and responsibilities. It's not a leap to consider duplication, overlap, and repetition might be a contributing factor to the problems at DHS.

According to the job class description for "Human Service Program Consultant" (the job class into which the State Opioid Treatment Authority Representative belongs) the section "distinguishing characteristics" (from other job classes) states, "Consultant scope of responsibilities extends across administrations and occasionally across agency lines with authority to develop legislation, policy, delivery systems and to ensure compliance with applicable laws and regulations." Similar language regarding involvement in and responsibilities for one or more of these activities can be found in all 9 possible supervisory and manager class descriptions that exist between this individual and the assistant commissioner level.

We have no way of judging whether or not the existence of nine different supervisory and management job classes in the delivery of human services have merit or if the four supervisory and middle management layers that exist in this particular situation is warranted. Program details, activities, and responsibilities may justify them. However, there is a familiar saying in college football: when a coach claims to have three potential starting quarterbacks, he doesn't have a starting quarterback. Similarly, when everyone is generically assigned responsibility for activities and obligations, no one has responsibility. In that respect, the OLA's "Sergeant Schultz-like" description of the situation in DHS may not be particularly surprising.

Reform with a Capital R

"One of the great failings of democracy is the tendency to take the path of least resistance and avoid controversy wherever possible."

— Eugene Patterson

In his book The Warping of Government Work, Harvard University public management professor John Donahue tracks the evolution and growing divide between public and private sector employment over the past several decades. He concludes talent deficits will increasingly define government as higher skilled workers spurn public sector jobs. At the same time government employment becomes a refuge from the higher risk and increasing uncertainty defining private sector employment making it rigid and more resistant to change. Both trends, he argues, are contributing to shortfalls in public sector performance.

Public workforce policies are now caught in a tug of war between the defense of middle class values and the urgent need to deliver on public sector imperatives of efficiency, innovation, flexibility, and performance. Despite the need to reconcile these objectives, there appears to be little appetite for grasping high voltage wires that connect them. But good government and fiscal excellence demands it.

In the aftermath of another and different DHS kerfuffle, MMB Commissioner Frans acknowledged it might be time to update state contracting laws, saying "We will recommend to the Legislature that it is time to fix the statute to make it more amenable to modern business practices."

That's not the only statute that deserves such an examination. ■

Greatest Research Hits of 2019

As is our custom in the year's last issue of Fiscal Focus, we take a moment to look back on "the year that was" in the National Bureau of Economic Research's Working Paper series. Once again we find that incomprehensible mathematics and turgid academic prose offers important information and useful insights on many issues and policies being debated at the state capitol.

Tax Incentives, Innovation, and Entrepreneurism

The devil is in the angel's details. That's the conclusion of a study examining the relationship between angel investor tax credits and entrepreneurship.[10] Examining angel investor credit programs across the country researchers found no measurable effect on local entrepreneurial activity or beneficiary company outcomes. The problem? State programs often failed to screen out financially unconstrained firms. Over 90% of beneficiary companies fell into one of three categories: 1) the company had previously raised external equity; 2) a corporate insider received the credit; or 3) the company was not in a high growth sector. One third of beneficiaries included an investor receiving a tax credit who was an executive at the company. Moral of the story is to manage eligibility carefully, otherwise it can become an angel tax arbitrage program.

Research and development credits received a fair share of attention this year. These have long been generally considered the most economically justifiable forms of favorable tax treatment because of positive spillover effects on the rest of the economy. Which raises the question, have these spillover effects changed over time? [11] Replicat-

[10] Howell and Mezzanotti, "Financing Entrepreneurship through the Tax Code: Angel Investor Tax Credits" NBER Working Paper No. 26468, November 2019

[11] Lucking, Bloom, Van Reenen, "Have R&D Spillovers Changed?" NBER Working Paper No. 24622, May, 2019

ing a previous analysis to include 15 years of additional data, researchers found the marginal social return to R&D now exceeds the marginal private return to R&D by a factor of four — compared to a factor of three in the original investigation.

How does corporate R&D impact labor? Does it increase worker retention by creating new internal job and career opportunities or does it lead to departures to new and growing firms? Does it create new marketable skills and job options for workers or lead to unemployment by making labor and skills obsolete? These questions were examined in a study of corporate R&D and labor mobility in 31 states.[12] Researchers found no effect on worker retention, employment loss, or movement to other companies. Researchers did find, however, that R&D increased employee departures to new start-ups that are venture capital backed, high tech, high wage, and in different sectors than the parent firm.

R&D credits have been strongly linked to innovation, but do state R&D credits effect the rate of formation and growth potential of new businesses? In a study of 25 states over a 20-year period researchers found "striking evidence" that state R&D credits have a long-term impact on the quantity and quality of entrepreneurship in a region.[13] Policy patience, however, is warranted. While state-level R&D credits have little to no effect on new firm formation in the first few years, researchers found these incentives led to a 20% increase in the quantity and quality-adjusted quantity of entrepreneurship over a ten-year period.

Taxes and Behavior

Determining if and how taxes make people behave differently has always been research catnip to academia. A couple of contributions caught our attention this year. The first, is an examination of the ultra-wealthy in response to estate taxes (that was also flagged by the Star Tribune in an editorial page commentary.)[14] Researchers looked at the mobility of the Forbes 400 richest Americans to examine their sensitivity to a change in federal estate tax law which made the existence of state-level estate taxes far more economically relevant.[15] Perhaps unsurprisingly, the number of Forbes 400 individuals in estate tax states fell by 35% compared to non-estate tax states. The fascinating part of the study examines the cost-benefit analysis for having an estate tax modeled on the current federal estate tax. With respect to Minnesota, researchers concluded the cost/benefit of having an estate tax depends on how sensitive the "very wealthy" are to estate taxes compared to the "ultra-wealthy." If we assume the very wealthy relocate at the same rates as Forbes 400 billionaires, the cost of having a Minnesota estate tax exceeds the benefits by 40% reflecting $4.2 billion in lost revenue (present value). On the other hand, if we assume the very wealthy relocate at only half the rates of the super-rich, the benefits of having the tax exceed the cost by 41% reflecting a $5.1 billion present value revenue gain.

The study suggests future behavioral responses to state estate taxation is an important question with potentially major state fiscal implications.

The analysis does come with two major caveats: 1) results do not factor in indirect effects like reduced in-state investment, charitable giving, etc.; and 2) the impacts on sales, property, and other tax revenues are not included. Nevertheless, the study suggests future behavioral responses to state estate taxation is an important question with potentially major state fiscal implications.

The behavioral impact of increasing the top rate of high-income earners was the focus of a study looking at the impacts of California's tax increase of up to 3 percentage points for high income households in 2012.[16] Researchers concluded an additional 0.8% of the residential filing base exposed to the new top bracket moved out of California in 2013 (above and beyond baseline departure rates). When combined with declines in reported income among top bracket "stayers," researchers concluded migration and other behavioral responses eroded 45.2% of the windfall tax revenues from the reform.

Those interested in expanding the universe of sin taxes for both revenue and public health purposes are now sticking a policy straw into sugar-sweetened beverages. A study examined the impact of Oakland's one cent per ounce tax on sugar-sweetened beverages on retail prices, product availability, purchases and consumption.[17] Researchers found about 60% of the tax was passed on to consumers in the form of higher prices. Researchers also found a small decline in the volume of beverages purchased, some evidence of an increase in purchases outside of the city limits and evidence of some increase in general shopping by Oakland residents outside of the city. With respect to health concerns, they found no substantial changes in consumption for either adults or kids.

Equity, Income Growth, and Income Inequality

A few interesting papers offered some bigger picture perspective and history on this influential set of issues surrounding state tax and fiscal policy. Research this year offered an important historical perspective on a topic that tends to get overlooked in income inequality debates—the considerable contributions government tax and redistributive policies have made in addressing these matters.[18] In the study, researchers from the U.S. Congress Joint Committee on Taxation, the Council of Economic Advisors, and Cornell University calculated and compared nearly 60-year trends using the most restrictive measure of income ("market income of individuals" which includes gross wages, salaries, farm income, self-employ-

[12] Lucking, Bloom, Van Reenen, "Have R&D Spillovers Changed?" NBER Working Paper No. 24622, May, 2019Babian and Howell, Entrepreneurial Spillovers from Corporate R&D: NBER Working Paper NO. 25360, July, 2019

[13] Fazio, Guzman, and Stern, "The Impact of State-Level R&D Tax Credits on the Quantity and Quality of Entrepreneurship" NBER Working Paper 26099, July, 2019

[14] "Taxing the rich pays — to a point, estate tax study shows" Doug Tice, Star Tribune, November 1, 2019

[15] Moretti and Wilson, "Taxing Billionaires: Estate Taxes and the Geographic Location of the Ultra-Wealthy" NBER Working Paper No. 26387, October, 2019

[16] Rauh and Shyu, "Behavioral Responses to State Income Taxation of High Earners," NBER Working Paper No. 26349, October, 2019

[17] Cawley, Frisvold, Hill, and Jones, "Oakland's Sugar-Sweetened Beverage Tax: Impacts on Prices, Purchases and Consumption by Adults and Children NBER Working Paper No. 26233 September, 2019

[18] Elwell, Corinth, and Burkhauser, "Income Growth and its Distribution from Eisenhower to Obama: The Growing Importance of In-Kind Transfers" NBER Working Paper No. 26439, November, 2019

ment, pensions, interest, rent, and alimony) with the most expansive measure of income (household size-adjusted, post-tax, post-transfer market income + in-kind income + the value of Medicare, Medicaid, and employer-sponsored insurance). The former is the basis for the oft-cited concerns over stagnating middle class and growing income inequality; the latter is a more complete perspective on economic well-being.

Using the market income measure, real median income growth since 1959 has increased 23%. The lowest population quintile has experienced a 75% decline in income growth while the top quintile experienced a 155% increase in income growth. In stark contrast, switching to the most expansive measure of income, median income growth since 1959 is 154%. The lowest quintile experienced a 262% increase income growth while the top quintile experienced a 187% increase.

Turning to measures of income inequality (Gini coefficients), similar results were found. Using a market income basis, income inequality in the U.S. has risen steadily at every business cycle peak over the last 60 years, increasing 22% over that period. But using the more all-encompassing income measure income inequality in the U.S. declined by 2.5% and is 42% less than the market income-based income inequality measure. The authors conclude that excluding the impact of government taxes and transfers "substantially understates the impact of government policies in offsetting stagnant median market income and the rise in market income inequality since 1969 . . . While over this period the rich got substantially richer, so did poor and middle class Americans." For a state like Minnesota, ranked second in the nation in health and human service spending and featuring some of the nation's most generous and broadly accessible income support programs, this is a finding worth keeping in mind the next time the fairness rhetoric heats up.

Which of these programs provide some of the biggest bang for the budget buck? That was the focus of a comparative welfare analysis of 133 U.S. policy changes pertaining to social insurance, education, job training, taxes, and cash and in-kind transfers over the past half century.[19] Researchers created a "marginal value of public funds" measure (MVPF) based on the ratio of benefits to

[19] Hendren and Sprung-Keyser, "A United Welfare Analysis of Government Policies," NBER Working Paper No. 26144, August, 2019

From The Director: DHS: Now Comes the Hard Part

Mark Haveman

Recently, new Department of Human Services Commissioner Jodi Harpstead testified before the House Health and Human Service Finance Committee on her "90 Day Review and Plan" for the beleaguered agency. As Chair Liebling noted, Commissioner Harpstead is believed to be the first commissioner in DHS history with a business background and private sector experience in managing large organizations. For an agency employing 7,300 people with an all funds budget of $36.9 billion, that observation is both welcoming and damning at the same time.

Commissioner Harpstead's testimony was designed to deliver two messages 1) provide assurances and supporting evidence that the department, contrary to a lot of public perception, is not on fire; and 2) offer an assessment of the problems that do exist and what DHS plans to do about them. With respect to the latter, the Commissioner described DHS as a "high-capacity agency which is soft around the edges," and defined the core problem as "soft interdepartmental process controls." As a result, an initiative entitled "Operation Swiss Watch" began on Day 91 of her tenure in which internal process improvement teams trained in quality control methods and tools will work to design and implement needed interdepartmental process controls. The objective: "get the Department's processes and systems humming like a Swiss watch."

Unsurprisingly, management and workforce considerations are an integral feature of "Operation Swiss Watch." The DHS organization chart has been revamped to improve lines of communication and accountability. New leadership positions have been created; some others have been eliminated. And, encouragingly, the kneejerk "it's too big, split it up" solution to what ails the agency was tempered by the Commissioner's observations that such actions often lead to the replication of infrastructure (a.k.a. cost), defeats the purpose of centralizing process controls, and can run counter to the intra-agency communication, coordination, and planning on which county agencies on the front lines of service delivery depend. In short, it was a thoughtful and encouraging plan of action from an experienced manager and leader.

So far, so good. Now come the implementation realities and challenges presented by the state's human capital system in delivering on the plan. Commissioner Harpstead noted the Department would like to hire additional experts. That should have prompted a question from committee members on what expertise is in short supply in an organization of over 7,000 employees containing nine different supervisory and management job classes, and most importantly, ***why*** it's in short supply. If we assume this needed expertise represents the creation of yet another job class, the demand for these skills and their labor market prices will do battle with the state's job evaluation process and the roulette wheel of pay equity with completely different government occupations.

DHS apparently has already experienced a talent attraction setback. In response to a committee member question about the ability to attract and retain talent, the Commissioner replied they had "swung for the fences" in trying to get three particular people. Two declined because of life circumstances, but the third declined because of the state salary structure. The state may have to eventually settle for a "double" in that important hire.

But the most interesting exchange originated from a committee member who noted getting a complex, mammoth operation like DHS running like a Swiss watch requires the right tools and the ability to move the gears around. He argued the accountability and process improvements described in the Commissioner's testimony demands the ability make appropriate human resource changes of all types. He asked the Commissioner if she needed any help from the legislature in increasing the ability to make these types of changes. "Those are good questions," she replied. "I don't know yet."

I suspect she will know the answer in the very near future. — M. H.

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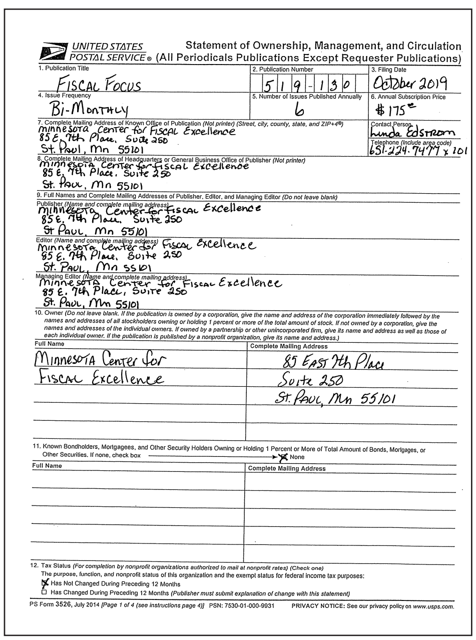

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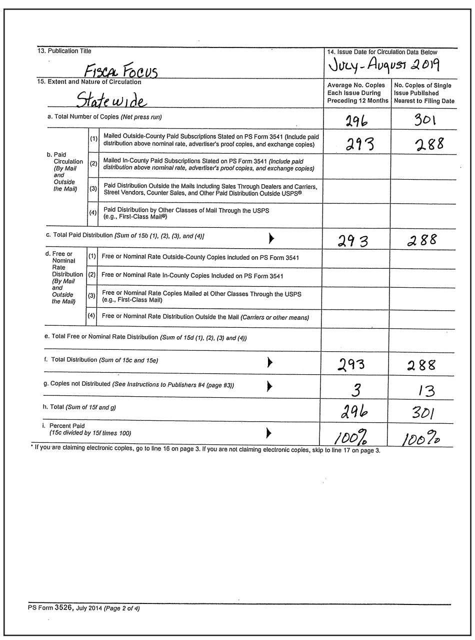

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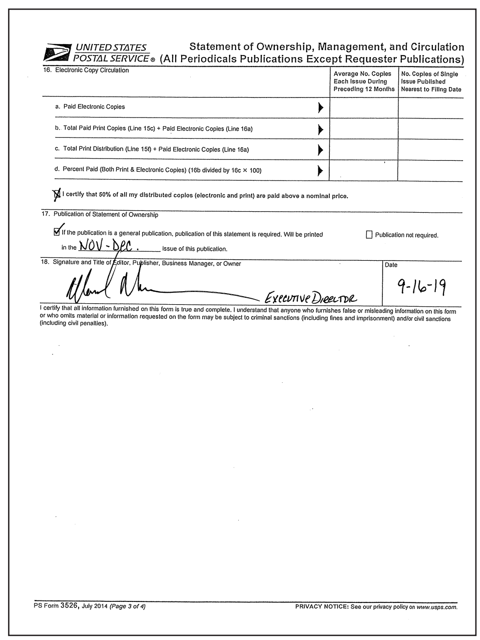

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net cost inclusive of long-term impacts to the government's budget. Echoing and confirming research findings and public testimony often heard here in the state, health and education programs targeting low-income children had the highest spending MVPF scores—some paying for themselves through additional tax collections and reduced transfers. Interestingly, the 1986 Tax Reform registered an MVPF of 44.3 far exceeding most spending programs.

How do people get rich in the 21st century? That was the focus of a study examining top earners and their characteristics.[20] Researchers concluded it's from human capital effort, rather than financial investment, primarily from owning/managing mid-size companies employing tax-advantaged pass through business structures. The increased use of pass through entities — in which business income gets disguised as labor income—has distorted understanding of how money is earned. Researchers found "wage" income dominates up to the 99th percentile of income distribution. More than 70 percent of the "human capital rich" are under 60 and typically own companies in skilled service industries. Interestingly, at the top 0.1 percent above the 99.9th percentile, the typical company is a large law firm, beverage distributor, or auto dealership. It's likely the one and only time such an eclectic trio of businesses will ever be grouped together. ■

[20] Smith, Yagan, Zidar, and Smith, "Capitalists in the 21st Century, NBER Working Paper No. 25442, June, 2019