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In This Issue:

The $100 Million Health and Human Service Savings Challenge

With nearly every new dollar of general fund tax revenue in the next biennium currently projected to be consumed by current law health and human service (HHS) spending, what should we expect from the cost-saving efforts of the Governor's Blue Ribbon Commission on Health and Human Services?

When the state's economic forecast is released, the bottom-line surplus or deficit figure gets the attention. But the forecast also provides pieces of information that when put together exposes the underlying challenges lawmakers face in their budget decision-making. The latest forecast provides such an example - and it's a head turner.

Minnesota Center for Fiscal Excellence

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According to the forecast, total general fund tax revenue growth in the forthcoming FY 22-23 biennium is projected to be $2.867 billion. Total health and human services (HHS) general fund spending growth for the coming biennium is expected to be $2.735 billion. Thus, 95 cents of every additional general fund tax dollar expected over the next two years is currently forecasted to be consumed by current law HHS spending. Looking further out, the claim on new tax revenue isn't quite as dramatic – about 44 cents for every dollar in FY 24-25. But that's in line with long term trends as HHS has grown over years to comprise nearly 30% of the general fund budget while consistently consuming 40-50% of all new general fund tax revenues.

This slow but steady general fund crowdout isn't a particular surprise having been long ago "foretold by the prophets" – namely the 2009 report of the Budget Trends Study Commission and prior to that the Brandl/Weber Agenda for Reform in the mid-nineties. But the relentless pressure explains the intense legislative scrutiny the Department of Human Services has been under and the creation of a Governor's Blue Ribbon Commission on Health and Human Services charged with delivering $100 million in savings.

Blue Ribbons in a Time of COVID

Absent several efforts undertaken by DHS in recent years, the HHS budget puzzle would be much more challenging. Over the past decade Minnesota embarked on several new human service delivery models that have adjusted cost curves and staved off some of the bleakest projections offered in the past. For example, according to the DHS, average managed care capitation rates increased 8.3% per year from 2000-2010 — part of the history that informed the Budget Trends Study Commission's findings. From 2011-2016, average managed care capitation rates *decreased* 5.7% per year.

Nevertheless, demographics and rising health care costs continue to exert significant pressure leading to one of the more unusual budget agreement provisions in state history. As part of the deal struck to resolve the FY20-21 state budget, the Governor and legislative leaders agreed to create a "Blue Ribbon Commission on Health and Human Services" charged with finding $100 million in cost savings for the FY 22-23 biennium. If those savings could not be found, $100 million would come out of the budget reserve (unless the next legislature would decide to do something different). Pursuant to the legislation the action plan was required to include strategies to increase administrative efficiencies and simplification, reduce health and human service expenditures, reduce fraud and improve program integrity, and address equity problems in HHS services. Importantly, no recommendation could result in the loss of benefits for eligible individuals or exacerbate inequities in HHS access.

The 17-member commission was comprised of the Commissioners from the Departments of Health and Human Services, four state lawmakers, and 11 HHS stakeholder organization representatives. The Commission had a year to assemble, discuss, and vet proposals with the assistance of staff and public input in making their recommendations. To count toward the savings goal, strategies had to directly impact the state HHS budget and have implementation timelines that facilitate changes in spending in the FY22-23 biennium.

According to the final report, the Commission received 200 unique strategy submissions, ultimately choosing 47 of them for closer review. However, the arrival of COVID had a major disruptive effect on the Commission's work and also short-circuited some of their bigger system transformation investigation ambitions. Commission staff and a supporting consultant were able to flesh out two dozen strategies for full consideration by the Commission. But due to the pandemic, the Commission was not able to undertake a final review of these strategies or "render a final judgement" and make actual recommendations based on their efficacy and merits. The 22 strategies included in the final report are presented "so that legislators may benefit from the policy analysis."

"One person's savings is another person's revenue loss"

For the deeply curious, the final report does a nice job of laying out for each strategy a concise problem statement; a description of the proposal; the existence, nature and degree of any supporting evidence; and a discussion of implementation matters including populations impacted and equity considerations. However, a layperson's grasp of the strategies is implicitly limited due to the highly technical details of the programs themselves and their complex administrative and regulatory features, formulas, and nuances. There is no easy transparency remedy for the inherent "inside baseball" characteristics of government human service delivery.

But perhaps the biggest hurdle in meeting the $100 million challenge will be overcoming organizational stakeholder opposition to these strategies that in many cases appears to be daunting.

The Commission report includes nine cost savings strategies in health care and six cost saving strategies focused on long term support services for older adults and people with disabilities. Three other strategies focused on reducing waste and fraud and improving program integrity — only one of which the Commission concluded offered potential near-term savings supporting the biennial cost reduction target. Initial estimates of the savings from these strategies totaled up to $106 million. Savings from other strategies included for further consideration totaled up to $98 million.

However, if legislators are hoping for discrete, detailed savings figures to plug into budget targets next year, they will likely be disappointed. Savings estimates in the report fell into one of three broad categories: up to $1 million, $1 million to $9,999,999, and greater than $10 million. Moreover, no information was presented on how these initial savings estimates were derived or what they actually were comprised of (e.g. direct labor, indirect labor, amounts of purchased services, price controls, etc.). In addition, some savings may require additional upfront spending such as hiring new investigators for DHS' Surveillance and Integrity Review Section.

But perhaps the biggest hurdle in meeting the $100 million challenge will be overcoming organizational stakeholder opposition to these strategies that in many cases appears to be daunting. The Commission solicited and included comments from a wide variety of governmental, non-profit, and for-profit advocacy and service delivery organizations, many of which expressly stated support or opposition to the strategies. For one strategy (modifying certain Medical Assistance durable equipment payment rates to match Medicare rates) all the public comments included in the report were in opposition. In others the number of organizational representatives opposing the strategy outnumbered those supporting it.

Even for strategies in which the majority of stakeholder organizations expressed support, politically the odds still often seem to be stacked against any change. For example, only three strategies fell into the Commission's "biggest ticket" category of cost saving opportunity— savings estimates in excess of $10 million for the coming biennium. One of those was the implementation of a uniform administration of non-emergency medical transportation. The majority of commenting stakeholder organizations expressed support for it. But among the five organizations expressing opposition were the Minnesota Hospital Association, the Minnesota Council of Health Plans, and the Association of Minnesota Counties. It's hard to imagine a more influential and formidable troika of organizations weighing in on this issue at the capitol.

Stated opposition to strategies were based on concerns about service access and quality impacts as well as unintended consequences of their implementation. But it would be naïve not to acknowledge that at least some degree of organizational self-interest — economic and otherwise — is inevitably at stake in these proposals. As Commissioner Harpstead observed in testimony to House Ways and Means, implementing program cost savings always represents some degree of challenge since "one person's savings is another person's revenue loss."

That Other Initiative

Process control problems leading to improper payments. Breaches of management responsibility with no satisfactory explanation. Resignations wrapped in mystery. Questions surrounding the actions of the Inspector General. Debate surrounding the rightsizing of a mammoth agency. An agency in a quiet state of turmoil and suffering from a damaged reputation with the public. This all may sound a little familiar but actually describes the Texas Health and Human Services agency several years ago and the circumstances leading to the creation of a Health and Human Services Strike Force by that state's governor.

Minnesota is not alone in taking a "blue ribbon" approach to dealing with a complex agency's complex problems. What makes this state's task force experience interesting is that although the Texas' governor made it clear that he set no limits on the scope of the strike force's work, the group refrained from reviewing individual programs and instead focused intensively on HHS management and organization. As their final report notes, the strike force concluded the high-profile problems afflicting some HHS programs "has as much to do with organizational structure and management relationships" as it did with specific agency processes and procedures.

Overlooked in the hunt for $100 million is a similar internal organizational effort now taking place within DHS. Upon her appointment, Commissioner Harpstead instituted operations "Stop Gap" and "Swiss Watch" to tighten and improve a wide variety of process controls within the agency. Organizational structures and reporting relationships have been changed, positions have been both added and eliminated, and some new talent has been secured. All this presumably has been influenced by the work of the DHS Commissioner's Advisory Panel (co-chaired by former Medtronic CEO Bill George) charged with reviewing progress and advising the commissioner on issues including organizational structure, management team development, and department culture.

It is not clear how this initiative may have influenced the Governor's Blue Ribbon Commission efforts, if at all. Nor is there any sense of whether unlocking the full benefits and potential of these management and organizational changes are being impeded by state human capital policies frozen in mid-twentieth century amber. As an organization which has been beating the drum of human capital reform for some time, we find it difficult to believe that cost effective, efficient, accountable human service delivery has not been affected by what the National Academy of Public Administration calls "human capital systems preoccupied with a process of internal compliance which force agency missions to fit personnel processes instead of the other way around." Parenthetically, we have observed with some amusement that it took an Emergency Executive Order (20-07) to provide state agencies "the flexibility to hire staff, schedule, assign, and reassign employees without adherence to existing limitations…that present barriers to the needs of state agencies to efficiently and effectively mobilize and deploy their workforce" — in short, the things most effective organizations do as a matter of course. (Perhaps one solution would be to declare the HHS' ever-growing resource demands a "peacetime budget emergency.")

Challenges of an Historical Commitment

Minnesota takes caring for the needs of its most vulnerable citizens seriously and makes it a government priority. The proof is in the numbers. We have tracked state and local health and human service spending for over 50 years in our publication How Does Minnesota Compare. State and local spending rankings in health and human services has never dropped out of the top ten nationally and seldom dropped out of the top 5. Based on latest available Census information, Minnesota health and human service spending per person at or below 150% of the federal poverty level (adjusted for state price differences) is 204.9% above the national average, second highest in the nation. State Medicaid spending appears to be the driving force behind this differential. According to the latest information from the Kaiser Family Foundation, Minnesota Medicaid spending per enrollee is 27% above the national average. Spending in every enrollment segment is above the national average (ranging from 9% for the aged to 64% for individuals with disabilities.) But there's more at work here than just Medicaid. Based on the latest information available (FY 2016) the 50-state average ratio of state Medicaid spending to total state and local "public welfare" spending as defined by the Census Bureau is 82%. In Minnesota it is just 70%.

That type of commitment to the quantity and quality of public services comes with a major responsibility: a relentless and aggressive pursuit of innovation, efficiency, and reimagination in their delivery. Otherwise, costs explode, taxes increase, other spending critical to the health and welfare of citizens and the state economy is crowded out, and the state economic climate deteriorates. It's a challenge especially relevant to DHS as its cost savings investigation explicitly excludes any recommendations that would result in the loss of benefits for eligible individuals or exacerbate inequities in HHS access.

For the reasons highlighted we are not particularly optimistic that $100 million in savings will materialize in the 2021 session out of the Commission's report. The strategies have not been fully reviewed, initial stakeholder skepticism and resistance appears stout, and questions remain on whether the current state of government's organizational and human capital systems are positioned to deliver on service delivery reform or anything resembling transformational change. But perhaps a biennial savings fix isn't the best way to think about this initiative. The Commission put a lot of hard work and thought into something that should have a life well beyond the biennial budget session and should continue to be built upon. In many ways it's the beginnings of a map for a much longer journey, one we absolutely can't afford not to take. ■

Clean Up on Aisle 2021

Federal COVID responses and the usual raft of end of year federal temporary tax provisions have again created a backlog of state tax conformity matters and the prospect of a yet more complicated and expensive tax system. There is an action we should consider to mitigate this recurring problem.

Between the start of the session and the release of the February forecast — when the budget goalposts are set and the session really gets cranking — tax committee hearings serve as a time to educate, cogitate, deliberate, pontificate, but seldom legislate. The exception is the occasional early federal conformity bill, an expedited effort to respond to the federal government's (often end of year) tax policy decisions in hopes the Department of Revenue can make necessary changes in time for tax filers. However, the political and budget implications of conformity are often too large, and the time constraints too great, to get a bill passed. The result is a potential accumulating layer of these issues over time generating filing complications, delays, cost, and administrative hassle.

Something Old, Something New

The layers are thickening these days. For starters, there is the usual inventory of temporary federal tax provisions scheduled to expire at the end of the 2020 calendar year. Many have been reauthorized before on a temporary basis (hence their nickname "extenders"). They are an affront to good tax policy since their uncertain staying power is antithetical to the stability and predictability a good tax system should strive for. In many cases the primary policy purpose of temporary provisions is to make tax cuts look cheaper in the context of the federal government's 10-year budget baseline and game federal budget rules in the process. Temporary tax provisions were the *sine qua non* of the TCJA's passage.

According to the Joint Committee on Taxation, 33 federal tax provisions were due to expire on December 31. Most all of these provisions were minor, narrowly targeted tax cuts for very specific activities and businesses. Many have been extended before. True to historical form, Congress let the shot clock run down to the very end before acting on these provisions. Their fate was part of the nearly 6000 page "Consolidated Appropriations Act, 2021" which included the latest COVID relief deal. According to the Tax Foundation, of the 33 temporary provisions, one was allowed to expire, six were made permanent, and eleven received a five-year extension to coincide with the scheduled expiration date of the TCJA's individual provisions in 2025 (making for a rather spirited tax debate heading into the 2024 elections). Shorter extensions were authorized for others.

However, this megabill comprises just part of Minnesota's current conformity decision-making landscape. Minnesota is already tardy in addressing provisions and extenders included in the "Further Consolidated Appropriations Act" from December of 2019. Some of the notable tax policy matters in that act dealt with permissible distributions from section 529 college savings accounts, “empowerment zone” incentives, and several tax policies to aid individuals affected by natural disasters.

Then there are the waves of temporary policies enacted in 2020 to address the significant health impacts and recessionary fallout of the COVID pandemic. These included substantial tax cuts in response to the recession. Conformity decisions on these tax matters offered the prospect of much larger state fiscal impacts than the usual slate of end of year extenders. The Families First Coronavirus Response Act and the CARES ACT included provisions affecting business deductions, charitable contributions, and early retirement distributions.

As opposed to a “rolling conformity” state which automatically conforms to relevant provisions of new federal law, Minnesota is a “static conformity” state requiring lawmakers to adopt, modify, or reject changes. Federal conformity offers several important benefits: [1]

- It allows state administrators and taxpayers alike to rely on federal statutes, rulings, and interpretations, which are generally more detailed and extensive than what any individual state could produce.
- It provides consistency of definitions for those filing in multiple states, and reduces duplication of effort in filing federal and state taxes.
- It permits substantial reliance on federal audits and enforcement, along with federal taxpayer data.
- It helps to curtail profiting just from differences in how activities are taxed and reduces double taxation.
- For the filer, it can make things easier by allowing the filer to copy lines directly from their federal tax forms.

It is quintessential “good government,” and history shows a reluctance for any of the three players in budget negotiations to be willing to step up and be the one to “pay for” conformity measures in negotiations and subordinate their other tax and spending priorities.

The tax compliance and administration benefits are especially crucial for businesses and individuals working and operating in multiple states and for tax-related situations and calculations that span multiple filing years. In short, although Minnesota might wish to have even greater flexibility to “go its own way” on taxation, it’s simply not realistic or practical for a state to require taxpayers to deviate too much from the federal system. The 2020 House omnibus tax bill included an article addressing these three federal tax acts, conforming to most but not all federal changes. However, the conformity provisions were ultimately left out in the end.

A Political Problem at its Core

It’s not surprising that federal conformity decision-making often gets left by the legislative roadside. Practically, the time crunch between federal action and state tax filing can be prohibitive. Substantively, tax administration and compliance benefits lack sex appeal and are not the stuff to woo voters in campaign literature. More significantly, conformity legislation is almost always revenue reducing. It competes against other budget priorities and makes balancing the budget more difficult, especially in tough economic times like today. Even if bipartisan consensus is that non-conformity has gone on too long and needs to be tackled, one really big conformity issue can suck up all the fiscal oxygen available for other conformity matters. Such was the case this year as the short-term price tag of full conformity with Section 179 expensing pushed all other conformity matters off the table.

But general attitudes toward taxation and politics also play an influential role in the failure to take action on conformity matters. We would likely see more timely action and greater prioritization of conformity efforts if offsetting rate, bracket, and other changes to pursue conformity on a revenue neutral basis would ever be considered a political option. This is especially true for dealing with bothersome end of year minor extenders whose costs are typically low and the needed revenue adjustments would often be imperceptible. But that is a tough sell among Republicans. Lower taxes have become the defining tax idea of the caucus, and it is too easy to have even small revenue neutral adjustments portrayed as tax increases. No less influential is the simple fact that better tax administration has no political home or natural advocate. It is quintessential “good government,” and history shows a reluctance for any of the three players in budget negotiations to be willing to step up and be the one to “pay for” conformity measures in negotiations and subordinate their other tax and spending priorities.

These factors have tended to overwhelm the ability of the Minnesota legislature to respond quickly on conformity matters. That is true for even minor federal tax bills, like extenders, for which conformity actions have sometimes been in limbo for one or two years. The result is an unnecessarily more complicated and expensive tax system for both government and taxpayers for no real tax policy reason.

A Modest Proposal for Modest Tax Changes

The barrage of federal tax actions in recent years have made life challenging for state tax policymakers, administrators, and taxpayers. For big federal tax reforms and changes like the TCJA and other major tax-related actions Congress enacts to deal with special circumstances like recessions (“Great” or otherwise), there is no mechanism or short cut for the hard work required to go through provisions systematically and determine what makes sense for the state both budgetarily and administratively. However, for the persistent congressional practice of tax extenders and the chronic disruption they cause the Department of Revenue, tax soft-

[1] “Toward a State of Conformity: State Tax Codes a Year After Federal Tax Reform” Walczak, Tax Foundation, January, 2019

From The Director: THANK YOU!

Mark Haveman

To all our members and readers who contributed to our end-of-year challenge grant for our Foundation arm, I want to convey my deepest appreciation for making the campaign such a success. We raised $28,300 all of which is matched dollar for dollar providing critical financial support for our programming.

These are obviously extraordinary times, and the MCFE has not been immune from the economic and financial fallout from the pandemic. However, we know there are so many deserving charitable organizations in need today, many of which provide critical assistance to those who have felt the greatest impacts. We are humbled by being able to benefit from your generosity in these difficult times.

We are enormously proud of our individual members who span the political spectrum but are united in support of sound tax and fiscal policy and the belief that good information and analysis remains a cornerstone of good government. We are equally proud of our business members, large and small, who support this mission even though the benefits of membership in an organization like ours can often be rather diffuse. It's a reflection of the type of business citizenship and civic engagement that has made this state so successful.

On behalf of Linda, Bob and our Board of Directors, thank you again and best wishes for a healthier and more prosperous 2021.

— M. H.

ware providers, and taxpayers, a remedy exists in a bill that was introduced a few years ago and is worth revisiting today: [2]

- Pass a law that conforms to extenders on a dynamic basis – i.e., specifically listing each extender and providing that it is in effect for Minnesota purposes, if it is also in effect for federal purposes.

- Establish a provision for a standing (ongoing statutory) appropriation to a dedicated account to fund the tax cut if congressional action triggered the contingent extenders. The account would address the resulting possibility/probability of an unfunded future tax cut and any state budget problems. (Federal extender conformity bills have historically had a budget impacts in the $10 - $40 million range.)

- Make conformity to each of the extenders subject to administrative approval by the commissioner of Department of Revenue to make sure the account balance is adequate

- Have the legislature specify exactly what order the commissioner would do this to prevent the commissioner's preferences from determining which provisions went into effect if the account's balance was too small.

The mechanics are straightforward. Legally, this would not violate Minnesota law prohibiting the delegation of legislative power to Congress. That's because the legislature itself would explicitly decide which provisions would apply for Minnesota tax purposes.

The problem, as often with specific conformity actions themselves, resides in the politics. A dedicated account requires the use of scare fiscal resources, and both sides are apt to have better ideas for how such resources should be used. The DFL could be expected to reflexively resist committing resources to ongoing tax cuts. Moreover, the prospects of defunding an account in a time of need that is dedicated to conforming to existing tax cuts would be fraught with public relations peril. Meanwhile, Republicans would be committing resources to funding tax cuts that already exist (if the federal government actually extends the provisions) rather than breaking new "tax cutting ground" with this money and currying favor with those beneficiaries in the process. Passage would require a shared belief that considerable simplification of state tax administration and compliance is an important policy objective and priority investment in and of itself, and a bipartisan "truce" not to leverage the effort for political advantage.

The resource problem might be addressed by a concurrent initiative we discussed in our last issue of *Fiscal Focus*: bringing tax expenditures back into the budget process. A formal, systematic review process evaluating whether tax expenditures are meeting their purpose and identifying changes that need to be made could be expected to identify opportunities that would be able to fund a relatively modest standing appropriation. Any revenue from implementing tax expenditure review findings could be dedicated to reducing filing complications, delays, cost, and headaches for taxpayers — a "twofer" for good state tax policy.

Current conformity challenges are a byproduct some very unusual circumstances combined with congressional dysfunction and Minnesota inattention. The first will go away, the second won't, and the third is in lawmakers' own hands. It remains to be seen to what extent elected officials will consider tax administration and compliance problems stemming from lack of conformity to be important enough to commit budget and political resources to address them. ■

[2] The proposal was introduced as H.F. No. 2875 in the 2016 session and received a hearing. In the 2017-18 session a revised version was introduced as H.F. No. 816 and was included in the House version of the omnibus tax bill. However, it did not survive the conference committee.

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