FISCAL FOCUS

MINNESOTA CENTER for Fiscal Excellence

Sound tax policy. Efficient spending. Accountable government.

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In This Issue:

Session Breaks Bad, Better Call Saul

Our recap of a messy, confusing, and frustrating 2016 legislative session requires words of wisdom from a great negotiator and problem solver.

Minnesota's 2016 legislative session finished with its now-trademark blend of chaos, drama, finger pointing, and a real-life "Chariots of Fire" reenactment – a staffer sprint to beat a clock before it struck 12. In the end, even though there was strong agreement on top session priorities of transportation, bonding, and Real ID, the final gavels fell with no resolution on these topics.

Table 1: General Fund Impact of Tax and Supplemental Budget Bills

	Current Biennium (millions)	**FY 2018 -2019** (millions)
Tax Bill – Revenue Reduction	$178.8	$374.6
Tax Bill – Expenditure Increases	$78.6	$169.0
Supplemental Spending Bill– Net Change	$182.4	$233.3
Total General Fund Impact	**$439.8**	**$776.9**

Source: House Fiscal Staff
Note: Does not include impact of bingo hall tax break.

With these events undoubtedly triggering some level of disbelief among capitol watchers, it seems appropriate to turn to the world of fiction for some perspective. Fans of the television drama *Breaking Bad* and its prequel *Better Call Saul* know that ethically compromised attorney Jimmy McGill (a.k.a. Saul Goodman) has a special talent for negotiating impossible situations. We clearly could use some of that skill set. Fans also know Saul for his ultra-pragmatism – the ends don't justify the means; the ends make the means completely irrelevant. Observers could be forgiven for thinking this attitude has to some extent permeated the legislative process. And his ability to manage volatile circumstances certainly has parallels in the rough and tumble world of policy making. For these reasons, we frame our session summary using Saul Goodman's sage quotes and advice.

An undeniably promising future as a tax chair

"What good is money that doesn't spend?"

Who would have thought dealing with a $900 million surplus would prove to be as politically challenging as dealing with a multi-billion dollar deficit? About six hours before adjournment, House and Senate conferees approved a 600-page supplemental budget to complement the tax bill that conferees had adopted a comparatively leisurely 18 hours earlier.

Table 1 summarizes the net impact on the general fund of both these bills. As the bottom line suggests, lawmakers spent about half of the $900 million state surplus on new spending and tax relief – about a 60/40 split respectively. The $777 million impact on the out-biennium appears affordable – at least given current economic expectations – as current forecasted revenues less spending for FY 2018-19 is $1.2 billion.[1]

On the tax side, primary winners were college students and their parents, lower income households, farmers, and owners of rural business property. A trifecta of provisions specifically targeted would-be and indebted college students, including a new $36.5 million student loan debt credit and two new incentives for contributing to 529 college plans. One of the nation's most generous and accessible state earned income tax credits would have become even more so with an expanded phase out and a bigger credit for childless filers. Farmers would have seen major property tax relief with the state picking up some of their tab for school construction projects, which (conceptually) would have made it easier for rural districts to pass capital levies for school improvements. And excluding the first $100,000 of property value from the state general property tax levy – with a corresponding levy cut to avoid tax shifting – was a partial win for the business community, addressing one of their biggest tax peeves.

On the spending side, the strategy appeared to be to support as many spending interests as possible by providing supplemental resources short of everyone's ask but sufficient enough

[1] Incorporating MMB's unofficial inflation estimates into FY 2018-19 projected spending would make these decisions look fiscally irresponsible – increasing an existing projected structural deficit in the out biennium from $558 million to $1.33 billion. However, as we have argued on these pages many times before, applying the CPI to the entire general fund is a much more distorting and far less accurate planning exercise than ignoring inflation altogether.

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to keep most everyone satisfied until 2017. Legislators boosted general aid payments to cities (LGA) and counties (County Program Aid) for the upcoming FY 18-19 biennium; but in the case of LGA, most of that would have been "prepaid" in the current FY 16-17 budget period. The $35 million each for broadband expansion and equity programs may have been significantly less than what advocates were seeking and what Governor Dayton wanted to provide, but together they constitute 40% of all supplemental budget spending. Although $75 million was appropriated for Jobs, Energy and Equity (which includes broadband) only $16 million of fiscal impact exists in the out-biennium, suggesting most of this new spending is, at least for now, one-time money. E-12 Education received a $25 million injection to establish a pre-K grant program, $12 million for school support staff, and additional funding for other grants – many of which are also of a one-time nature. The one budget area that seemed to get relatively short shrift is Higher Education, which received only a $5 million bump in the supplemental budget.

Many inevitably will take issue with the priorities, targets, and deservedness of the various tax relief and spending measures the legislature chose to adopt. But from an overall budget perspective, the combination of relative restraint and emphasis on one-time money appears to be a rather fiscally responsible effort by the tax and supplemental budget conferees, especially in a non-budget year. In the end, the governor signed the supplemental budget bill, but a happy ending never materialized for the transportation, bonding, and tax bills.

"Did you not plan for this contingency? I mean the Starship Enterprise had a self-destruct button."

The fact that transportation and bonding bills never even made it out of the legislature was entirely predictable and arguably predestined. The immune response the words "transit" and "gas tax" trigger among many Republicans is equaled by the hives that break out among many DFLers exposed to the idea that road and bridge infrastructure be considered a public good worthy of ongoing general fund support. Last year's impasse provided all the evidence that some contingent "Plan B" would be necessary this time around.

The governor's pocket veto of the tax bill was a function of misfortune and miscommunication but with a whiff of political strategy wafting over the whole set of circumstances.

As the stalemate continued, legislators demonstrated several examples of Saul-like maneuvering to try to get results, even if the means weren't exactly according to legislative Hoyle. Both the House and Senate's bonding bills went down to defeat in their respective houses, which according to 8th grade civics classes and 1970's Schoolhouse Rock videos should be the end of things. To keep the bonding discussion alive, legislators put a disaster relief bill into conference committee to serve as the vehicle for a final bonding bill. And when it became clear the transportation funding plan was dead, legislators tried bolting an emergency one-year stopgap transportation spending measure onto a barely-breathing bonding bill.

Nevertheless, the clock expired on these contingency plans. Coincidentally, Captain Kirk used the Enterprise's self-destruct mechanism to settle a long-standing dispute between two warring parties with mere seconds to spare. In contrast, the legislature was too late to act and the session blew up.

The saga of the tax bill is a slightly different story but with the same ultimate ending. The governor's veto of the tax bill was a function of misfortune and miscommunication but with a whiff of political strategy wafting over the whole set of circumstances.

The relevant issues themselves were hardly the big buck, contentious topics one might expect to trigger a veto, but rather a bill drafting error and a curiously strident demand about a very minor tax expenditure. Before the drafting error came to light, the Governor insisted that a prerequisite for calling a special session was the extension of the sales tax expenditure for ticket sales to Minnesota State High School League events. After the drafting error came to light, which according to Administration officials triggers the need for legislative action to fix, the Governor stated he would have signed the tax bill as is if not for the drafting error – a tax bill that would not have included one of his essential demands for calling a special session. While the governor's commitment to resolving both issues shouldn't be questioned, it's difficult to look at this sequence of events and conclude special session leverage was not a consideration.

In any event, the tax bill joined transportation and bonding as session casualties. The final contingency option is another special session. As of this writing, it appears a lot of stakeholders want it, and the governor is very willing to consider it. However, it is also clear session content will not be something as simple as declaring a mulligan on the last 15 minutes and re-teeing the final proposal. Governor Dayton has made it clear a special session will have to address several new items with implications for both the size and scope of any bonding bill and the supplemental budget. Requiring even greater levels of compromise by clearly recalcitrant House and Senate Republicans does not appear to be a recipe for hope.

"Some people are immune to good advice"

When the bipartisan, local government-dominated 2012 Property Tax Reform Working Group recommended the elimination of the state general tax, they certainly did not do so out of some intense desire to give tax breaks to major corporations and skyscraper owners. Rather, it was motivated by principles of good tax policy and local governments' self interest – both based on the recognition that the state's considerable intrusion and footprint in the primary source of revenue for local government operations makes sound local government finance much more difficult.

Why does this tax exist in the first place? Many argue it was created to address political objections that business was getting "too good of a deal" out of sorely needed class rate compression. Others point out money was needed at the time to make the overall Ventura tax reform and budget package work and regardless of its political origins, the reality is that the business community signed off on the tax. But what does not get recognized is that the way policymakers treat the tax is a departure from what its policy architects originally envisioned.

According to then-Revenue Commissioner Matt Smith in an email exchange with us, a key idea behind having the state general tax was to make future policy discussions on interstate business property tax competitiveness a state policy (and budget) issue rather than a local government issue. The idea was if business property tax competitiveness were threatened (as the business community now argues vociferously), the governor and legislators could use the state general tax as a "relief valve" and dial down the levy accordingly. But in practice, the state general tax has never served in anything resembling that capacity. In fact, it has functioned in the opposite manner. Since its inception, the state general tax has been on inflation-indexed autopilot using an arguably "inflated" inflation measure[2] which explains why business is just as vocal about the indexing as it is about the tax itself.

Even if it never becomes politically feasible to adopt all of the 2012 working group's recommendations, progress on good tax policy can be achieved by eliminating the automatic inflator and making the legislature biennially establish a levy which balances budget needs and competitiveness concerns. Such a measure will likely prove to be tougher than enacting a value exclusion. A reliable and predictably growing general fund revenue stream will generate a lot of spending interest antibodies to protect it.

"Interstate commerce? It's a bh"***

Legislators took Minnesota's stance on taxation of remote sales to DEFCON 3 this year. Emboldened by Associate Justice Anthony Kennedy's comments on the U.S. Supreme Court's 1992 *Quill* decision, state governments are clearly looking to instigate a challenge to the case. South Dakota has taken the lead on the effort (perhaps not surprisingly, given that without an income tax it relies more heavily on sales tax revenues than most other states), enacting legislation designed to trigger a lawsuit.

Minnesota lawmakers have not been quite as aggressive as their South Dakota counterparts, but have still invested considerable time and energy into this topic. The conference committee's remote seller language:

- modifies and clarifies provisions related to marketplace providers;
- carves out an exemption to the definition of in-state retailers for any retailer with sales into the state of $10,000 or less over a 12-month period;
- expands the definition of "affiliated entities";
- imposes collection and remittance requirements for marketplace providers and marketplace sellers; and
- imposes an effective date of no later than either a reversal of the *Quill* decision or July 1, 2019.

It's clear a federal solution remains the preferred manner to address "marketplace fairness" but patience is plainly wearing thin. The graph on thenext page, which we stumbled across in a financial blog, suggests why that may be among states (and for that matter many retailers). It is just one very indirect data point pertaining to one year of financial results, but it conveys a rather loud message.

Lawmakers also tackled another longstanding concern tangentially related to interstate commerce: the use of Minnesota domiciled professional service firms as a factor in determining residency. In the 2015 session both the House and Senate had language in their respective omnibus tax bills prohibiting the location of someone's attorney, CPA, financial adviser, or financial institution from being factored into residency determinations. Legislators brought those ideas back this year with some additional definitional refinements and included them in the 2016 tax bill.

... the way policymakers treat the tax is a departure from what its policy architects originally envisioned.

This long simmering issue has reached full boil in recent years as out-of-state competitors targeted Minnesota retirees and part-time residents with marketing campaigns that essentially distilled down to "Move your business to us. Why take the chance?" Before the tax and conference committees, the Department of Revenue continued to emphasize its responsiveness to these concerns with their ongoing "clear language" efforts and informational products such as their recently issued *Revenue Notice #16-01: Income Tax – Domicile Consideration – Location of Attorneys, Certified Public Accountants, and Bank Accounts*". However, Minnesota's financial services firms were not taking any solace in the fact that ongoing uncertainty and ambiguity could be communicated plainly and simply. Tax conferees agreed, as one noted, information is nice, but a law is needed.

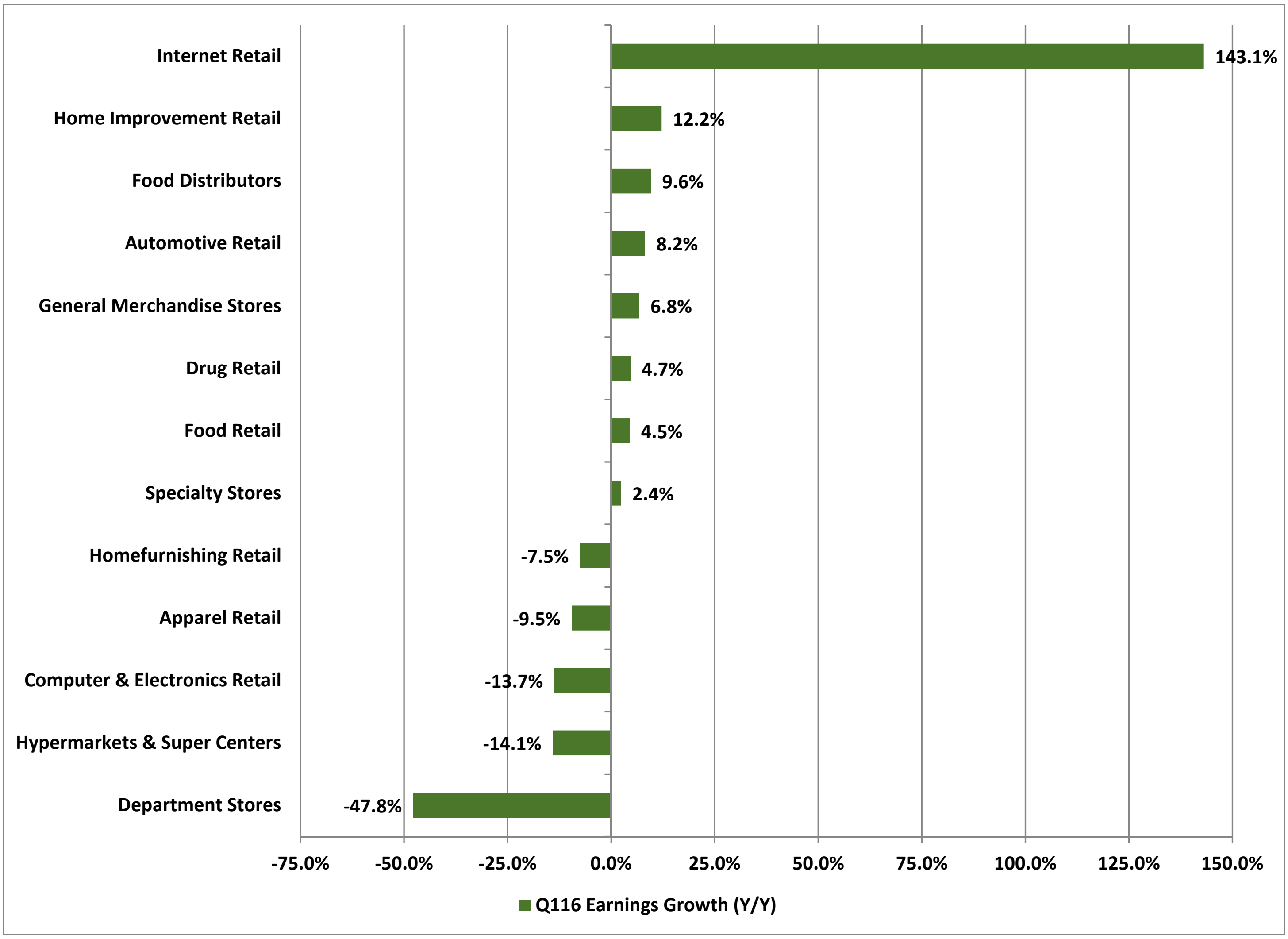
"If you're committed enough, you can make any story work."

Over the last decade, the messaging on Minnesota's public pension plans has been 1) there is nothing fundamentally wrong with the structure and design of the current system that a few benefit and contribution adjustments can't fix; and 2) adopting those tweaks will put us securely on a path to full funding. If the political press' failure to discuss this issue in all the session post-mortem reporting is any indication, this story has been tremendously successful.

Valuation reports this year, however, revealed a $15 billion shortfall in assets needed today just to pay for the retirement benefits already earned, let alone pay for new benefits earned this year and every year going forward. But that sum assumes the pension plans' investments can generate returns of 8% per year, even though their actuaries have determined earning even 7% per year is only a 50/50 proposition over the next two decades. Valuation reports also revealed state pension plans are now collectively "net sellers" – collectively $2 billion more money went out to pay benefits last year than came in through contributions. Assuming this trend continues (as the demographics suggest) and less capital is retained to in-

[2] See "The Big Divorce" *Fiscal Focus*, November-December, 2013; and "How Other States' Pension Crises Impact Minnesota's Own State and Local Budget Debates" *http://www.fiscalexcellence.org/blog/ipd.html*

Figure 1: S&P 500 Retail Sub-Industries: Q116 Earnings Growth (Y/Y)



Source: FactSet

vest, it will become more and more difficult to invest our way out of the existing hole.

Not only did these numbers fail to generate more aggressive reform discussions, even the sustainability repair proposals the pension plans themselves recommended faced internal resistance. And the source of the resistance was based on a commitment to a story of "fairness" that is so shortsighted in nature, so limited in scope, and so misguided in application, the idea ceases to have any meaning.

The contribution increases discussed this year would have been implemented a year from now (July 2017), giving school districts and state agencies time to plan for this additional expense. But school district officials were adamant they could not afford the contribution increases and insisted the state had to commit to increase school aid to cover the cost. MSRS, their stakeholders (and PERA and others) undoubtedly watched this development closely figuring what's good for the goose's budget would be good for the gander's. No commitment could be reached on new money now which derailed the contribution increases, but plan officials have made it very clear they will again be requesting them in the 2017 session.

When it became clear that contribution increases would not be enacted this year, retirees began barking about the unfairness of violating the spirit of "shared sacrifice". Remarkably, but perhaps not surprisingly, counter to the expressed recommendations of plans themselves, over 60 House members voted yes on a floor amendment to delay cost of living adjustment reductions. And citing this "fairness" concern, the governor vetoed the omnibus pension bill – which is all the more interesting since his proposed budget had no money to help school districts or state agencies actually share in the sacrifice.

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In summarizing what legislators attempted to accomplish this session with respect to pension repair, LCPR Chair Rep. Tim O'Driscoll employed an apt analogy which likened this year's attempted corrective actions as embarking on just the first leg of a very long flight. The problem is that we proposed to begin a grueling, multi-decade, around the world journey with a puddle jump from MSP to St. Cloud Regional with a 12-month layover. And now even that flight out of MSP has been delayed for another year.

Thus, under the increasingly distorted story of what "fairness" means, even exceptionally modest attempts to improve the health of Minnesota's public pensions have now been put on hold for another year. In the process, fairness to current public employees whose retirement future is placed at greater risk, fairness to future taxpayers saddled with the costs of both their own (future) public employees and the growing legacy costs of the current employee base, and fairness to Minnesotans facing a future of higher taxes and/or diminished public services gets thrown under the bus.

While many may view the last couple of months as another session of unfulfilled potential, it may be unrealistic to expect more in a year when decisions regarding budget matters weren't actually required and both houses are up for reelection. The currency of compromise has been devalued over time, but more so in an election year since campaign literature can so easily market compromise to voters as an electoral liability. Certainly, the election results this fall will eventually prove to be a more powerful influence on the state's fiscal future than all the developments of this session combined.

Or as Saul says, "It's the way of the world. You go with the winner." ■

Underfunded Pensions and Underfunded Infrastructure: A Match Made in Heaven?

Direct public pension fund investment in public infrastructure is gaining traction but requires a fundamental rethinking of how we conceptualize and manage public assets.

Drive east on the I-90 Indiana Tollway and you are not just escaping the road construction insanity of Chicago and the distinctive aroma of Gary. You are also paying for a California state public employee's retirement benefits. If you instead head west on that section of I-90 known as the Chicago Skyway to watch the now juggernaut Cubs, something no less strange is happening: a retired Toronto teacher is benefitting from your visit.

The 2016 legislative session affirmed two truths about public finance: 1) the demand for infrastructure capital far exceeds its supply; and 2) public pension plans need high and reliable returns. These truths are certainly not unique to Minnesota, or for that matter to the United States. But some countries and subnational governments are attempting to turn these fiscal lemons into lemonade by having public pension funds more actively invest in public infrastructure. Connecting these dots, many argue, creates a true win-win. From the standpoint of pension fund management, infrastructure investment offers the potential to yield predictable and stable cash flows that are far better matched with the duration of the funds' long-dated liabilities. From the standpoint of public infrastructure, pension assets offer a large source of supplemental capital and can play a major role in bridging governments' infrastructure funding gap.

Roots in an Old Idea: ETI

The idea of using pension assets to support objectives besides paying retirees is not something that has just popped into policymakers' heads. The hundreds of billions of pension assets under management nationwide have long been seen as a very enticing source of capital for any number of government policy initiatives. In the mid-nineties considerable effort and a large body of literature began to be developed around the idea of "economically targeted investments" or ETIs. ETIs are organized to yield market rates of return commensurate with risk, liquidity and transactional costs and are therefore often considered a subset of the "socially responsible investment" universe. A 2008 study found that U.S. public pension funds had invested $11 billion in ETIs.[3]

The most common ETI investment vehicles include housing finance agency bonds, real estate investments including mortgage backed securities, guaranteed SBA loans, private placements, and targeted venture capital. By all indications, to the extent they exist at all, ETIs remain a very small part of any public pension fund's asset allocation strategy – typically ranging around 2-3%.

But some have taken the concept of "investing in yourself" to completely different levels. The prime example is Retirement Systems of Alabama (RSA) which, according to one third-party analysis, invests 16% of its pension assets in the state and local economy. Its investments include a dizzying array of Alabama real estate holdings including premium office buildings, golf course properties, and hotels. Through its controlling interest in Raycom, a media empire comprised of 62 television stations and 130 local newspapers, RSA will offer free advertising for this real estate portfolio. The RSA org chart looks more like a Fortune 500 company than a sleepy state investment board.

State experiences with ETIs appear decidedly mixed, likely a function of the degree to which governments have access to the specialized management and analytical demands associated with this area of the investment universe. While some states report very positive results with respect to meeting investment performance benchmarks while also achieving desirable economic development/social outcomes, others have backed away from the idea and have repealed statutory in-state investment requirements. It is not difficult to find high profile venture capital failures and examples of companies declaring bankruptcy after receiving an infusion of pension-based capital, leading ETI critics like the CATO Institute to caustically comment "pension funds can ill afford philanthropy."

Eliminating the Middleman

If the general buzz surrounding ETI has diminished a bit, the same cannot be said for a very specific subset of this universe: public infrastructure. To be sure, meeting growing global energy, clean water, communication, and transportation needs has been a compelling investment theme for a very long time. It would be impossible to find a public pension fund that does not have large equity and debt holdings in manufacturing and service companies supporting public infrastructure maintenance and build out. But these generic positions are often augmented by targeted private equity positions addressing this specific investment theme. To provide an example of how this applies to Minnesota, Energy Capital Partners is a private equity firm which focuses specifically on North America's energy infrastructure including power generation, midstream oil and gas, electric transmission, environmental infrastructure, and energy services. According to

[3] Hagerman, Clark and Hebb, "Investment Intermediaries in Economic Development: Linking Public Pension Funds to Urban Revitalization," Federal Reserve Bank of San Francisco, 2008.

the Minnesota State Board of Investment's most recent annual report, its Energy Capital Partners holdings are currently worth $100 million, and the SBI has committed to an additional $230 million of investment with the firm in the future.

"It will be the biggest transit project since the Montreal metro, but this one will be built and mostly funded by a pension fund."

But what has now captured the attention of both the government and investment press is pension funds' growing involvement in the direct financing and management of infrastructure projects. In recent years, a handful of national governments, such as Australia, the U.K, and Switzerland, have led the way in developing this model. But perhaps the longest and most successful history of public pension fund involvement in infrastructure investment and management lies in Canada. In 1999, the Ontario Municipal Employees Retirement System (OMERS) established Borealis Infrastructure, an in-house arm devoted exclusively to direct investments in and management of public infrastructure. Compared to traditional private equity strategies, the "direct investment" model improves the economics by avoiding the "2 and 20" fee structure private equity firms commonly use (a 2% annual management fee on capital deployed plus 20% of profits). Beginning with four employees, Borealis has now expanded to over 85 employees with offices and projects around the globe.

Traditionally, investments have focused on upgrades, expansions, and improvements of existing infrastructure because of their more favorable risk profile. However, Canada's success has now emboldened a closer look at brand new "greenfield" infrastructure projects. For example, in April Quebec's public pension fund announced plans to build a fully automated 67 kilometer electric light rail train network in Montreal with the first stations coming on line in 2020. As the *Montreal Gazette* reported, "It will be the biggest transit project since the Montreal metro, but this one will be built and mostly funded by a pension fund."

Even in the United States, where public pensions' finance of infrastructure is far more embryonic, the "direct investment" concept is getting attention. Recently, the California Public Employee Retirement System (CalPERS) announced a $1 billion deal with an Australian pension fund to invest in Asian-Pacific infrastructure – a strategic departure from its historical practice of accessing these investment opportunities through private equity. One of CalPERS' objectives in this arrangement is to tap into the expertise and experience of those pension funds that have traveled the learning curve and begin to assemble their own internal capacity for becoming "investor managers" of public infrastructure.

Implementation Challenges as Great as the Need

Although this activity is spread across the globe, the roots are the same: cash-strapped governments, essential infrastructure in need of attention, high debt service payments with overcommitted bonding capacity, and a strong reluctance to raise taxes. But infrastructure's attraction as an investment class has also increased in the eyes of pension investment managers because of the ultra low interest rate environment which many financial experts believe is now the "new normal." The persistence of this environment has been the absolute bane of pension funds and their efforts to achieve their investment return objectives. In the eyes of many, long duration infrastructure assets are a substitute for bonds, offering a relatively safe yield between bond and equity returns, and are also are well-matched with the long duration nature of pension liabilities.

Given all this, why aren't more public pension funds pursuing this strategy? A 2011 global survey of institutional investors by the OECD [4] on pension fund infrastructure investing highlighted several major barriers affecting infrastructure investment opportunities, capabilities, and conditions. They include:

- Risk Perception – illiquidity, regulatory, and political. If investments include international infrastructure, currency risk exists as well;

- Scale problems – opportunities may be too small for large institutional investors;

- Due diligence demands – it is often difficult and very costly to identify, evaluate, and bid on potentially viable investment opportunities;

- Lack of transparency in the infrastructure sector including a shortage of data on investment performance benchmarking.

But two obstacles in particular stand out. The first is access to talent, which has both a substantive and a structural dimension. Global success stories demonstrate that it is absolutely vital to have access to deep operational experience in evaluating, setting up, and/or operating an infrastructure project. The pension funds that have had success in this asset class have also invested heavily in bringing that talent on-board or have gained access to that talent through strategic partnerships. Such success requires expertise beyond traditional pension investment manager/dealmaker skill sets.

The structural dimension of the talent issue revolves around conflict with pension governance and pay models employed here in the United States. As one Canadian analyst has noted, "in the United States, you don't have the right pension governance, which means you can't attract and retain qualified pension fund managers to bring assets internally to invest directly across public and private markets, as well as engage in internal absolute return strategies instead of farming them out and getting clobbered on fees." [5] Or as *The Economist* put it in infinitely less delicate terms, "they (Canadian pension plans) attract people with backgrounds in business and finance to sit on their boards, unlike American public pension funds, which are stuffed with politicians, cronies and union hacks." [6]

Of course in order to recruit the best talent and executives, Canadian pension funds offer far more competitive pay than U.S. public pension funds do. This typically includes

4 *Pension Funds Investment in Infrastructure: A Survey*, Organization for Economic Cooperation and Development, September 2011

5 "Fixing The U.S. Public Pension Crisis?" *Pension Pulse*, May 2, 2016

6 "Maple Revolutionaries" *The Economist*, March 3, 2012

From The Director: Two Transparency Initiatives We Really Need

Mark Haveman

Many years ago, when I hung around manufacturers for a living, "total quality management" was the rage. A focus for many firms was something called ISO 9000 – implementing management system standards that created rigorous processes, procedures, and documentation to assure quality. Many companies found ISO 9000 helpful in pursuing "zero defect" manufacturing practices. However, others questioned whether ISO 9000 distracted time and attention away from things that were arguably more important. Skeptics contended ISO 9000 focused energies on controls, procedures and paperwork, not product understanding and improvement, innovation, and customer responsiveness. One running joke was that ISO 9000 made you very, very good at making everything except money.

The post-session commentary about the need to reform our messy, dysfunctional legislative process brought me back to those days. The harsh criticism coming from legislators, the media, and the public is certainly understandable. Unsurprisingly, there is now a lot of talk about changing rules and procedures to improve the process, add transparency, and restore public confidence. Recommendations include longer advance notices before taking final votes on bills, prohibitions against post-midnight bill passage, restricting the subject scope of bills, and increasing public transparency of legislators' own activities, practices, and spending. There is certainly merit to these ideas. Policymaking will always be a very chaotic and volatile "manufacturing" process, and changes that better manage the volatility and chaos are worth exploring.

But just as ISO 9000 certification doesn't preclude manufacturing barbed wire toothbrushes, process improvements won't prevent policies that run counter to the pursuit of efficient, effective use of taxpayer dollars and results-oriented government. We'll never realize "good government" if we spend our transparency energies on process but ignore substance.

...just as ISO 9000 certification doesn't preclude manufacturing barbed wire toothbrushes, process improvements won't prevent policies that run counter to the pursuit of efficient, effective use of taxpayer dollars...

A transparency agenda that focuses on outcomes would allow citizens to evaluate whether their tax dollars are being used efficiently and productively and is very different from the inside baseball world of legislative rules and procedures. Here are two important initiatives that need to be part of that agenda:

A Big Budget Boost for the Office of the Legislative Auditor. Created in 1973, the OLA is the state version of the federal Government Accountability Office – the only entity within government specifically dedicated to promoting accountability, strengthening oversight, and enhancing government program effectiveness. The OLA's Program Evaluation Division has the authority to evaluate virtually any state funded program or study any topic that affects state government. Simply put, this office is the most indispensible tool in the government performance and accountability toolbox.

Current support for the OLA is, in a word, appalling. Since 2003, state spending from all government operating funds has increased nearly 60%, or over $13 billion. Meanwhile, the OLA's staffing has fallen 25% from 80 to 60. In FY 2015, state general fund spending was $20.3 billion, an increase of 4.9% over the previous fiscal year. The OLA's budget appropriation was $6.2 million – a slight *decrease* from FY 2014. And since the OLA has considerable financial auditing responsibilities like the use of the Legacy Fund and MNSure, only a fraction of that $6.2 million can go to program evaluation and special investigations.

Frankly, this should embarrass a state that prides itself on a good government ethic. As the size, scope, cost, and complexity of government programs escalate we should be aggressively building up our internal capacity to evaluate program performance and policy results.

Create a Tax Expenditure Commission. For a state that expresses so much doubt about the ability of taxes to influence behavior, Minnesota lawmakers have never shied away from tweaking the tax code to incentivize certain taxpayer behaviors, reward particular actions, treat certain taxpayers favorably, or advance some policy outcome. And there is absolutely no sign such interests are lessening. The number of new or expanded tax credits adopted in the conference committee bill is a small fraction of the number legislators introduced this year.

In 2010 lawmakers directed the Department of Revenue to recommend ways to improve the oversight of tax expenditures. The subsequent report[8] provided an excellent blueprint for systematically reviewing and evaluating tax expenditures via a new Tax Expenditure Commission and incorporating the resulting findings into ongoing budget and policy making. But like so many reports of this nature, the findings and recommendations sit untouched gathering dust in the Legislative Reference Library.

Current practice allows tax expenditures – largely spending in another form – to escape any semblance of normal budget discipline. A Commission would help ensure tax expenditures constitute sound public policy and meet their stated objectives.

Support for these two ideas would be a very good test of how serious lawmakers really are in their quest for making government more open to the public and improving the ability of legislators to craft sound public policy. Unlike procedural changes, these initiatives would cost money. That's asking a lot when every competing area of government spending now gets to label itself as "investment." Ironically, these two recommendations are examples of where that idea really applies. — M.H.

8 *Tax Expenditure Review Report: Bringing Tax Expenditures into the Budget Process,* Minnesota Revenue February , 2011

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a base salary, bonus, and long-term performance awards which together routinely can total seven figures annually. Public sector compensation of this nature would be a complete anathema to Minnesota taxpayers, but with billions of dollars and the retirement future of hundreds of thousands of individuals at stake, Canadian provinces do not believe in being pennywise and pound foolish. (It's worth noting most of this compensation package is based on performance, unlike certain multi-million dollar public sector salaries in Dinkytown.)

The Larger Framework: Reinventing State Asset Management

The second obstacle, and the greatest of all, is the sea change attitude required regarding the conceptualization and treatment of "public assets" in Minnesota. Direct infrastructure investment by pension plans is really only part of a much larger policy framework that has been described as "asset recycling" – managing legacy public assets in ways that generate capital to invest in new assets or refurbish existing infrastructure. A recent report from the University of Toronto describing the various policy dimensions of this idea noted, "traditional 20th century debates between public ownership and privatization are increasingly irrelevant to the real choices facing government… Too often the public debate devolves into a choice between public ownership or privatization when in fact the range of tools and approaches is far more sophisticated and diverse." [7]

This way of thinking is not completely foreign to Minnesota. Two years ago, a provocative article appeared in MinnPost with the title, "What If We Made Transportation Systems Regulated Public Utilities?" – essentially a textbook description of various principles and concepts associated with asset recycling. That article was based on an interview with Professor David Levinson of the University of Minnesota who himself authored a feature for The Atlantic magazine's "Citylab" website with the no less provocative title, "How to Make Mass Transit Financially Sustainable Once and For All." Both articles present an intriguing vision and argument for how adequate and sustainable investments in necessary infrastructure could be realized. But moving down such a path requires a radical departure from the entrenched governance models and mindsets that have calcified public debate on this topic.

Based on the results of the 2016 session, as bad as our infrastructure challenge may be, it's still not bad enough to discuss "outside the box" ideas, the risks that accompany them, and how to mitigate them. A strong case can be made that this issue is tailor-made for the convening of a blue ribbon commission that would kick the tires on the options and opportunities associated with new approaches to public asset management and investment and do so in a robust but politically safe way. Until the challenge gets bad enough, get used to bumpy roads, grumpy politicians, transit food fights, deteriorating parks, and political paralysis. ■

[7] *Recycling Ontario's Assets: A New Framework for Managing Public Finances,* Mowat Centre, University of Toronto, April 2014