



Gene Merriam, former State Senator, President of Freshwater Society

Civic Caucus, 8301 Creekside Cir. #920, Bloomington, MN 55437

August 12, 2010

Present : Verne Johnson (Chair); David Broden, Janis Clay, Bill Frenzel (phone), Paul Gilje, Jim Hetland (phone), Sallie Kemper, Dan Loritz, Joe Mansky, Tim McDonald, John Mooty (phone), Wayne Popham (phone), Clarence Shallbetter, Bob White

Summary of Merriam's comments : Don 't balance the budget by shifting obligations to the following biennium; some tax increases are essential in 2011; don't eliminate the corporate income tax; more attention is needed to find out what is driving higher expenses for post-secondary education; ideas for change must come from outside the Legislature; term limits should be enacted for the Legislature.

A. Context of the meeting - We are speaking today with a former leader of the legislature, with expertise in finance and more recently commissioner of the Department of Natural Resources (DNR). Merriam is presently president of the Freshwater Society; an organization devoted to protection of the natural resource.

Through 21 years in the Minnesota legislature Merriam became very well respected for balancing of the state budget. We have asked Merriam today to visit with us about the critical problem of how to balance budget, and any ideas he has for improving the situation beyond simply cutting and taxing.

B. Welcome and introductions - Gene Merriam is the president of the Freshwater Society, a non-profit. He was the commissioner of the Minnesota Department of Natural Resources from 2003 to 2007, and a state Senator from 1975 to 1997. While in the Legislature he served in the very influential position of chair of the Senate Finance Committee. Before serving in the Legislature, Merriam was a member of the Coon Rapids City Council. An accountant by trade, Merriam has B.S. and B.A. degrees from the University of Minnesota.

C. Comments and discussion - During Merriam's visit with the Civic Caucus, the following points were raised: "I get many invitations to talk about water," Merriam began, "but I don't get many opportunities to talk about handling of the budget." He thanked the caucus for the opportunity, and got to it straight away.

1. The legislature is 'operating on a myth' that they are balancing the budget — Merriam said

that the legislature is "operating on a myth" that they must, and that they are, balancing the state budget.

"Come the end of this fiscal year," Merriam said, "the certified financial statements will show the state budget is not balanced." The shifts are shown as liabilities. Legislators call him now saying, 'I know the constitution says the state needs to balance its budget, but where does it say that?' It doesn't, Merriam tells them. The budget must be balanced on a cash-basis but not an accrual accounting basis. (The state can borrow for operating purposes but that short term debt cannot go beyond the end of a biennium.)

2. The origins of the school aid shift — The shifts of spending from one year to the next are made possible because school districts have different fiscal calendars than the state. The mechanism is known formally as a school aid property tax recognition shift. Schools book the shifts as a payable, while the state books them as a receivable. "Kind of a crazy proposition, Merriam said," and he recalled when it first came up in the 1980's: "A superintendent came up to me and said he knew how the state could resolve its problems with cash flow." He laid it out. "I told him that's crazy and we're not going to do it," and the Senate didn't, but they went over to the House and got it started there.

Merriam remembered going to the Star Tribune editorial board at the time and they didn't think it was that bad of an idea. Merriam disagreed. "What a shift does is it allows you to mask the problem. Budget and cash flow streams are not static, so they should always be brought together (annually)...It is not a sound policy."

Further, the shifts also mask spending patterns. "It's indicative of a larger problem. Over the past biennium the allocation to education was decreased by \$2 billion."

3. Balancing the budget will require added taxes — In response to a question about the use of taxes to help fill the \$6 billion budget hole, Merriam said that he believes the consequences of resolving the deficit with no revenue increases "would be so dire most Minnesotans wouldn't want it."

"We can look for efficiencies," he said, "but we've wrung them out of all the systems."

4. The state needs to get a handle on what's driving higher education costs — "Many would say we see in higher education over the past 30 years a real decrease in productivity," a participant observed. Third party loans have enabled tuition to rise without putting pressure on the institutions. So it seems there must be opportunity to improve productivity?

"I'd like to understand what's contributing to these costs in higher ed," Merriam agreed. If you look at the cost for measure in higher education it's increased at a rate faster than inflation. "I've got a lot of conjecture, but don't know myself; I'd be interested to look at that. I think it's necessary to get a good handle on what's driving costs in higher education."

The need for something to change is going to become more apparent as students will not be able to continue to obtain more and more third party loans, Merriam said. The value of homes is going down affecting the capacity of parents to borrow against them. Students are getting 'gapped' more and

more-the void between cost and money in-hand-and students are turning more to personal loans. So what we've got is the worst possible model in business: premium pricing, deep discounting. The amount of debt students are taking on is postponing other things they would do in life.

5. The state should look to redesign first in the areas where it spends the most money — A participant said the caucus is wondering if over the long term there are ways to build into the budget new ways of doing things so they cost less-'redesign' as it is being called.

"Don't ask me to give you specifics on redesign," Merriam said, but: "We've got to look at the places where we spend the most money. K-12, higher ed, health and human services. Look at the fastest growing one-health and human services-particularly health care, the runaway middle class entitlement of nursing homes. I think those are the areas that are ripest."

6. The legislature has become more partisan— Merriam told the group that he thinks the Legislature and the legislative process has changed dramatically. He posits two reasons: More centralized caucus activity, and the influence of technology.

"It used to be that caucuses played the cards they were dealt," he observed. They are much more proactive now. Technology has further played into party activism, in the form of more thorough policing of the ranks. "When I first got (to the legislature) there may be whispers that a vote could mobilize an interest against you. But now technology has made it so that designated staff can keep the book on everybody, everywhere, always."

What about the role of lobbyists? "I don't think they've gotten to a place where they dominate the decision making. It's necessary for legislators to get input from many different places. And no matter how many lobbyists there are nobody can explain a bill better than constituents."

7. Ideas must come from the outside: 'Never forget that the legislature is a reactive institution' — A participant expressed concern that those talking about how to re-form the public sector and spending stay within the bounds of what they consider doable. Instead he said the state needs to ask what is possible-are we really doing these things as well as we think? We are seeing people accept things as they are, as a given. How do you break out of the given?

"Never forget that the Legislature is a reactive institution," Merriam cautioned. We need more long-term, big-picture thinking, both in the Legislature and the executive branch.

8. Support for term limits — "I do support term limits," Merriam said, "even though I served 22 years." He sees a lot of people becoming too insular, even though there are people who made great contributions for decades. "On whole we'd be a lot better off if there were some reasonable term limits."

9. No support for abolishing the corporate income tax— A participant mentioned Governor Pawlenty's 21st Century Tax Commission; the Civic Caucus had Mark Haveman in to talk about it. Their report recommended abolishing the corporate income tax, and balancing that out by broadening the base of the sales tax and reducing the rate. Has he looked at that report?

Merriam replied that he has not seen the report, but doesn't think the concept is a good one. He has a skepticism about the impact of tax incentives on corporate behavior: "I began my career in the public accounting business, in a time when many public tax incentives came up. Do those things affect behavior? Yes, but not much." He was convinced it didn't work. "The state should only be involved in deriving revenue in the fairest way possible-and not get involved with these sorts of active tax policies."

"I just don't think people will make a location decision based on that sort of a tax consideration," Merriam said. The state has to be mindful of a balance. The state corporate income taxes ought not be too high, but shouldn't be eliminated.

10. There is a strong likelihood the 'Legacy Amendment' funds may be squandered — Not wanting to conclude the meeting without taking some time to discuss water, Merriam told the group that he believes water quality in the state is a very serious issue for which there has been little attention. "Non-source point pollution is a major problem, and we're not going to be able to affect that without addressing what is being grown and where its being grown."

The state is on the verge of being able to address the problem, he said, now that there is dedicated sales tax money from the 'Legacy' constitutional amendment. But there are issues with the process. "From what I'm seeing today, there is a strong likelihood that we could squander those funds."

D. Closing — To close, Merriam reiterated that he is frustrated with the budgeting process, and that the legislature moves from one session to the next without balancing the budget.

A participant had one final question, shedding light on the difficulty of changing things in the public sector. As commissioner of the DNR, the participant asked, what made your job most difficult? "It is a huge bureaucracy," Merriam replied. "You're constantly in the position of telling people no, you can't do what you want to do. It's just a huge institution, in an environment where you don't get up in the morning and say, 'go do this.' Got to deal with highly unionized employees. It is a huge battleship you've got to try and turn."

Thank you to Mr. Merriam, for a good conversation.