



Jay Kiedrowski, University of Minnesota's Humphrey School of Public Affairs

Focus on state economic fundamentals to grow, compete

A Civic Caucus Focus on Competitiveness Interview

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Present

Dave Broden, Pat Davies, Paul Gilje (coordinator), Randy Johnson, Sallie Kemper, Jay Kiedrowski, Dan Loritz (chair), Tim McDonald, Paul Ostrow, Dana Schroeder, Clarence Shallbetter; by phone: Audrey Clay, Fred Zimmerman.

Summary of Discussion

Focus on the fundamentals to keep Minnesota's economy successful and competitive, says Jay Kiedrowski, senior fellow at the University of Minnesota's Humphrey School of Public Affairs. Focusing on the fundamentals means spending money on developing human capital and infrastructure, rather than on the gimmicks of economic development that provide inducements to specific businesses. Further, he contends that economic development activities are better suited to a regional approach, rather than limited specifically to state concerns.

Many comparisons of states illustrate that Minnesota has done quite well in national economic competition, but still has problems to address. He cites Minnesota's many strengths, such as productivity and human capital, and lays out his concerns about the state's weaknesses, such as lack of business incubation and some particular challenges in the area of human capital.

He believes use of tax-increment financing and tax abatements by cities should be capped and that dipping into the region's fiscal disparities pool to help pay for the expansion of the Mall of America was "terrible." He says we must be careful about funding things like the Mayo Clinic expansion in Rochester, so we don't set a precedent encouraging others, who might be planning expansions independently, to seek public subsidies. On the other hand, he says there is no excuse for

government not to be more efficient in the processes where it interacts with business, such as zoning and environmental impact statements.

Background

Jay Kiedrowski is a senior fellow in the Public and Nonprofit Leadership Center at the University of Minnesota's Humphrey School of Public Affairs. Before coming to the University in 2004, Kiedrowski was executive vice president at Wells Fargo and Company. He served as Minnesota Deputy Commissioner and Commissioner of Finance from 1983 to 1987 and budget director for the City of Minneapolis from 1978 to 1982. He also served as a researcher and committee administrator with the Minnesota State Senate between 1973 and 1977, specializing in tax and urban policy analysis.

Kiedrowski's board service includes the State of Minnesota Investment Advisory Council, UCare Minnesota & Wisconsin Health Care Insurance Board, Humphrey School of Public Affairs, Carlson School of Management, Greater Metropolitan Housing Corporation, Guthrie Theater and Minneapolis Schools Referendum Oversight Committee.

Kiedrowski earned a B.S.M.E. in industrial engineering from the University of Minnesota and an M.A. from the University's School of Public Affairs. He also earned an Ed.D. from St. Mary's University of Minnesota.

Discussion:

Many state comparisons illustrate that Minnesota has done quite well in national economic competition, but we still have problems to address. Jay Kiedrowski, senior fellow at the University of Minnesota's Humphrey School of Public Affairs, laid out rankings of Minnesota vs. other states on a number of economic factors from different sources, indicating many strengths and things needing improvement as well.

- **Productivity.** "One word to describe Minnesota's economy is productivity," he said. "Minnesota is more productive than other state economies across the country." Comparisons indicate that Minnesota:

...ranked sixth in GDP per capita growth in 2012/2011 (Bureau of Business and Economic Research, 2013).

...scored "A" for productivity and innovation (Ball State, 2013).

...had the fifth fastest-growing economy in the nation in 2012, with the state's GDP growing by 3.5 percent vs. 2.2 percent for the U.S. (USgovernmentspending.com, 2013).

...ranked 13th in State New Economy Index (Information Technology and Innovation Foundation, 2012).

...ranked 20th in annual Best States for Business survey (Forbes magazine, 2012)

- **Human capital.** Kiedrowski noted that Minnesota is strong in human capital. He contended that the first thing companies think about when they think about locating is the quality of the workforce. Rankings show that Minnesota:

...scored "A" for human capital (Ball State, 2013).

...is one of the nation's leaders in high school graduates. 91.5 percent of Minnesotans are high school graduates vs. 85.3 percent for the U.S.; 31.5 percent of Minnesotans are college graduates vs. 27.9 percent for the U.S. (U.S. Census Bureau, 2012). Kiedrowski pointed out that Minnesota is not a leader in people with advanced degrees, but competitive.

...excels in ACT scores, with an average of 22.8 vs. 21.1 for the U.S. (ACT, Inc., 2013). He noted that 70 percent of Minnesota kids take the ACT test, so the scores represent a broad cross-section of students.

Kiedrowski said we can never rest on our laurels in the area of human capital, but indeed must meet several human capital challenges:

(1) Diverse students are a greater percentage of our students and they are lagging.

(2) We need to expand apprenticeships and non-degree training.

(3) We need to resurrect the idea of vocational education. We shouldn't go to the European two-prong approach, but we should strengthen vocational schools for those who learn by doing.

(4) We need to improve learning and outcomes for college students. "We have an excellent college system, but we clearly can make it better," Kiedrowski said.

(5) We're going to need more workers in the future. They're likely to be more diverse than our current population in Minnesota. We need those workers to keep our human capital strong.

(6) We need immigration reform, in part because we need additional foreign high-tech workers for the industries we have in Minnesota. We're being hurt by not having enough Green Cards to offer them.

- **Women in the workforce.** In Minnesota, 67 percent of women are in the workforce, compared to 58 percent across country. (U.S. Census, 2010). "That's been one of the reasons behind our strong human capital," Kiedrowski said.
- **Creative Environment.** Minnesota ranked sixth as a 2010 magnet city for young and talented workers (Rebecca Ryan, 2012). Kiedrowski said this ranking reflects quality of life factors: approval of gay marriage, support for the arts, major league sports, healthy environment, recreational opportunities, safety, easy access and educational opportunities.

- **Community.** "There's something special about the broader Minnesota community," Kiedrowski said. Studies indicate that Minnesota:
 - Ranks fourth in volunteerism, with Utah ranked first. The Twin Cities ranks first in volunteerism among major metropolitan areas. (National and Community Service, 2012.)
 - Ranks first in voter participation.
 - Has strong philanthropic and nonprofit sectors.
 - Has a strong work ethic and low poverty. "We want to take care of everybody in our community, which is not true everywhere," Kiedrowski said. "It adds to our humaneness and quality of life."
- **Research and innovation.** Minnesota ranked 12th in inventor patents (Information Technology and Innovation Foundation, 2012). Kiedrowski said we need the University of Minnesota to be stronger in research. He noted that the University's share of federal research dollars has grown dramatically over the last five years. Because of sequestration, the federal money will be drying up, so the University must work with the private sector on research. The private sector also must pursue research and development.
- **Business incubation.** Kiedrowski said Minnesota has a problem in the area of business incubation. Minnesota:
 - Ranked 35th in business incubation (Beacon Hill Institute, 2012)
 - Ranked 44th in entrepreneurial activity (Information Technology and Innovation Foundation, 2012).
 - Ranked 40th in business creation rate (Corporation for Enterprise Development, 2013).
 - Receives less than two percent of the venture capital funds invested in the U.S., even though the state was once a national center for venture capital. (Caux Roundtable, 2013)
 - In contrary evidence, had one of the highest years on record in 2012 for new business filings. (Minnesota Secretary of State Mark Ritchie, 2013)

"We do need to worry about business incubation," Kiedrowski said. "We need capital access, reduced regulation and research transfer-transferring the research at the University of Minnesota easily and economically so that it can be used to develop new businesses."

Infrastructure. Minnesota ranks 10th in infrastructure (Beacon Hill Institute, 2012). Kiedrowski said the state needs:

- (1) Transportation funding, because we will be behind soon in the quality of our roads and bridges. Minnesota is getting less from its per-gallon gas tax with increasingly fuel-efficient cars.
- (2) Better broadband access across the state.
- (3) A productive capital budget. As an example, he pointed to state funding for building regional convention centers in St. Cloud, Mankato, Rochester, and elsewhere. "All they're doing is competing with each other for regional conferences," Kiedrowski said. "We need to be putting the capital budget where it's going to improve the infrastructure needed for a productive economy, not into things that allow us to compete with one another."

- **Electricity cost.** Minnesota used to be one of the leaders in low electricity costs in the country, Kiedrowski said. "Now we're back with the pack." Minnesota does continue to compare favorably in commercial electricity costs at \$9.18/ kilowatt-hour compared to \$9.67 nationally.
- **Health.** Kiedrowski said Minnesota ranks as healthy, but costly in the health care area. Minnesota:
 - Ranked fifth in overall healthiness in 2012 and first for seniors.
 - Had health care costs in 2009 of \$7,409 per capita vs. \$6,815 per capita nationally. Kiedrowski thinks our costs may be higher because we provide more care for the indigent than other states, but that our costs per medical procedure are competitive, if not low.
 - Has a high percentage of volunteerism, a high percentage of creditable drug coverage and ready availability of home health care workers (United Health Foundation, 2013).
 - Has a history of health care reform success.
 - Has more capitated care. "That's the future, whether we like it or not," Kiedrowski said. "The only way to control costs is to put someone in charge of trying to manage the cost for a given client."
 - Has both the University of Minnesota medical complex and the Mayo Clinic.
- **Effective government.** Minnesota has low corruption, active citizen participation, good basic services, more services and more taxes. But Minnesota received an "F" for tax climate for business (Ball State, 2013). Kiedrowski said that was not surprising, because we've always been a high-tax state.

We have an upcoming dependency problem: There will be fewer people working than people not working by 2020. "That's the challenge of being an older state," Kiedrowski said. We are adding young people and still growing in population, though. Iowa, in comparison, is actually losing population.

Minnesota needs more professionalism in government, bipartisan support for good management, more focus on outcomes and more tax balance. "We're over-dependent on the income tax," he said. "We need to use the sales tax more."

Kiedrowski said the state desperately needs a state planning function again. He noted that Rep. Paul Marquart had an excellent bill three years ago, The Minnesota Civic Compact: Planning, Innovation, and Results Act, which would create a North Star Council, made up of 17 people who would oversee the state planning effort, data collection and performance measurement.

During the rest of the discussion, prompted by questions, Kiedrowski made the following points:

State funding for the Mayo Clinic's expansion in Rochester is a complicated issue. "We clearly want the Mayo Clinic and the medical industry to grow in Minnesota," Kiedrowski said. "It's been very good for us, but we need to be really careful. Now that we've done it for Mayo, what's to say if Target wants to expand, they shouldn't get additional dollars? Or General Mills? Where does it stop?" He

said the University of Minnesota or Fairview Hospitals might expect a public subsidy for an expansion they would have otherwise done naturally. "It's a tricky question; I'm not sure if it was a good or bad decision," he concluded.

Clustering, that is, development of a critical mass of similar industries in an area or region, is good, but it must be balanced by a diversified economy. "I don't think we'd want to be centralized or clustered to the extent of Rte. 128 in Boston or the Silicon Valley in California," Kiedrowski said. "If we have a tech bust as we had in 2000, then we're in trouble. Minnesota has traditionally had a very diversified economy, which is a strength for our economy."

"Clustering is a great idea, but how do you pick the cluster?" Kiedrowski asked. "Which cluster is going to be hot in the future? Did we know in advance that medical technology would be where we wanted to be as medical spending grew faster than at any point in our history? I don't think we knew that. I don't think we were that smart." He said it's even hard for the University of Minnesota to know where to put its research dollars, because it's betting on what the future is going to hold.

We should spend money on developing human capital and infrastructure, rather than on the gimmicks of economic development that provide inducements to specific businesses.

Kiedrowski recommended capping the amount of tax-increment financing (TIF) that communities are allowed to use and doing the same with tax abatements. "We should have some economic development tools when we do get into competition, when a major employer is thinking about possibly moving," he said. "But we have to be responsible and we have to be really smart about that."

The state is probably not the appropriate economic development entity; the region is more logical, because we really are part of a region. Kiedrowski noted that the Twin Cities is the hub of a region that includes South Dakota, eastern North Dakota, northern Iowa and western Wisconsin. He said, for example, that the oil industry in North Dakota is good for the Twin Cities and that, in the broader scheme of things, it's good for Minnesota to have Fargo growing.

Looking at a number of factors indicating a strong, growing economy (Ball State, 2013), four states that are doing well are Utah, Texas, Washington and Indiana. "Some states I would have thought would look better didn't, like North Carolina, Wisconsin, Oregon and Massachusetts," Kiedrowski pointed out.

It's important to work on the fundamentals. Kiedrowski said in many ways, the answer to the question of what makes for a healthy economy and business growth remains a relative mystery. "Minnesota seems to grow in spite of surveys that say we shouldn't," he said.

For example, he noted that when Norwest Bank merged with Wells Fargo, Wells Fargo had 12,000 employees in Minnesota and people were worried about what would happen. Today there are 20,000 Wells Fargo employees in Minnesota. "In spite of our taxes and in spite of all the negatives we sometimes think about, 8,000 employees were added in Minnesota," he said.

"We have some things to work on and we should continue to be good at the things we've been good at. In the long term, the fundamentals really matter. I'm a fundamentalist. I think over time we'll do just fine focusing on the fundamentals."

Minnesota's weather has done us a favor, because we've never had a period of extremely rapid growth. Kiedrowski said the Twin Cities have never been viewed as a Mecca like Chicago was or New York or the Silicon Valley or Austin, Texas. "The weather has given people pause," he claimed. "To come here you have to want to be here. From my experience at Wells Fargo, it's hard to get people here, but once you get them here, they don't want to leave the Twin Cities."

Minnesota has traditionally had a progressive tax system, but we should be concerned that we not reach the tipping point on taxes for the wealthy, so companies decide to expand elsewhere.

Kiedrowski doesn't think we've reached that point. "This year's income tax increase puts us back to where we were for the wealthy in 1998, but it's worrisome," he said. "We need to think practically about that, as opposed to thinking emotionally or, in an equity sense, that it's not fair. You're right, it's not fair, but you have to be practical about growing the economy."

It'd be useful to get some data on what industry clusters we have. Kiedrowski agreed with an interviewer that we could try to strengthen the weak spots in the supply chains of major companies as a way of beefing up the clusters that we now have.

State efforts at economic development should provide information, help displaced workers find re-employment or job training and provide emergency assistance to try to keep companies that might be thinking about leaving.

Using tax-increment financing for the Mall of America expansion is not a good investment and dipping into the region's tax-base sharing pool (fiscal disparities) for the same project is "terrible."

Former Minnesota Governor Rudy Perpich had a real vision for Minnesota's economic success. According to Kiedrowski, Perpich was clear about the importance of human capital and the need for a competitive tax structure. "He really did believe in fundamentals," Kiedrowski said. "But there was another part of Rudy that tried to do deals. [Now-Governor] Mark Dayton was Commissioner of Economic Development at that time doing the deals. I'm afraid Mark learned too much about doing deals, as opposed to focusing on the fundamentals."

The University of Minnesota has spent money on key developments, such as the research centers on University Avenue, that have been very solid, and has also attracted increased research funding. The University looks at demand, Kiedrowski argued, so the business community must speak up about what their needs are. "It's unfortunate that the business community is so loud on the tax issue that their other advice gets drowned out," he said. "We need a more civil discord among all of the parties to make that kind of progress."

Any strategy to improve business incubation in Minnesota must include looking at regulation.

"There's no excuse for us not to be more efficient in the processes where we interact with business, such as zoning and environmental impact statements," Kiedrowski stated. "We just need to be better and work for continuous improvement."

It's good that the Civic Caucus is broadening its focus from looking at redesign of government to thinking about competitiveness. Civic Caucus chair Dan Loritz said that we're now thinking about competitiveness because we've decided that redesign is important, critical, but insufficient by itself. "I'm pleased that you're not just focusing on government," Kiedrowski said. "We must work on government, but it's not the most important factor." Companies making decisions on location look at the quality of the workforce and access to suppliers, before looking at taxes. "Taxes are often third, fourth or fifth on the list, but not first," he said.