An Agenda for Reform

An Agenda for Reform: Competition, Community, Concentration proposes fundamental restructuring of Minnesota government to avoid a potential $8 billion financial crisis. At the request of Governor Arne H. Carlson, former state Senator John Brandl and former U.S. Representative Vin Weber, with assistance from many experts, offer major reforms for meeting government's responsibilities without raising taxes.

John Brandl, founder of and professor at the University of Minnesota's School of Public Affairs (now the Hubert H. Humphrey Institute of Public Affairs), served 12 years in the Minnesota House of Representatives and Minnesota Senate. He has served in the Office of the Secretary of Defense and as a Deputy Assistant Secretary of the U.S. Department of Health, Education and Welfare.

Vin Weber, a former six-term congressman who served on the House Appropriations Committee, is currently a partner in the Washington office of Clark and Weinstock Inc. He is vice chairman of Empower America and co-chair with former Congressman Tim Penny of the University of Minnesota's Humphrey Institute's Policy Forum.

November 1995

The cover contains an excerpt from *The Federalist* written in 1788 by Alexander Hamilton, James Madison and John Jay.

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Federal budget cuts, increased demand for services and slower economic growth are converging to produce a cumulative fiscal gap of more than $8 billion in Minnesota by 2001. By that year, state and local governments could face an annual shortfall of over $2.5 billion — a sum that far exceeds the combined current state spending on community colleges, prisons, nursing home care and special education.

A gap of this magnitude cannot be addressed merely through better management or belt tightening. It requires fundamental changes in the way Minnesota delivers taxpayers' services.

Report Summary

Prepared by former state legislator John Brandl and former Congressman Vin Weber at the request of Governor Arne H. Carlson, *An Agenda for Reform* offers an overall structure for change, plus specific approaches in each of the major government spending areas. Their central conclusion is that in the future, government in Minnesota cannot meet its responsibilities without reforms as sweeping as, and similar to, the "perestroika" that has been necessary in the formerly communist countries. Reforms are based on achieving results through competition, encouraging communities and concentrating spending on people most in need.

Competition in the private sector leads to improved services and reduced costs. But government responsibilities are usually carried out by monopoly government bureaus. In addition, where communities have been providing services, the results have usually been superior to government programs and the costs much lower. Government should institute reforms to offer consumers of government service choices and to carry out more of its work through families, churches and other voluntary organizations.

As budgets tighten, concentrating spending on areas and individuals most in need will become more critical. Currently, much government spending is distributed in an almost random fashion. For example, state spending for higher education lowers tuition for all, including the most wealthy. Focusing aid would permit the state to meet legitimate responsibilities fairly and with less money.

A new global budget framework is recommended to allow policy-makers and public administrators to set budgets based on realistic projections of available resources. Under the framework, overall spending targets would be set for each of the next four years based on projections of revenue growth. Spending estimates would be determined based on spending for each program area assuming current laws. Current policy choices reflected in adopted budgets are respected. Across-the-board cuts would be made in each program area to reach overall spending targets. Debate on priorities for funding among program areas should occur only after Minnesota institutes serious and far-reaching reform and restructuring.

An Agenda for Reform offers 39 specific recommendations.

General Principles

■ A target should be set for spending and targets should be established for all major expenditure areas.

■ Eligibility for government benefits should be limited to the most needy.

■ Funds should go to citizens, not bureaucracies.

■ Expand choices for government officials.

■ Enable families and communities to provide some services.

Global Budgeting

■ Minnesota should adopt a global approach to budgeting.

■ The state should establish the total spending targets for each of the next four years based on projected revenue growth without tax changes.

K-12 Education

■ Permit low-income parents to receive education vouchers that could be used at private and parochial schools.

■ Permit low-income parents to use education vouchers for independent learning or home schooling.

■ Do not allow school districts to deny use of facilities to nonpublic school students.

■ Allow students to enroll in any school district, with no restrictions on open enrollment.

■ Do not weaken or limit the post-secondary enrollment options program.

■ Remove the cap on the number of the charter schools and amend legislation to encourage development of charter schools.

■ Give credit to students who meet standards regardless of where learning takes place.

■ Allow low-income 11th-graders to establish accounts for career preparation programs.

■ Allow school sites to make decisions about management and funding.

■ Allow school boards to convert schools to charter schools.

■ Expand authority of school boards to purchase instructional services and authority of teachers to market services.

■ Establish a comprehensive, user-friendly program to provide information to students and parents about all the schools, programs and options available to them.

■ Establish a mechanism to monitor and report on school performance.

Post-Secondary Education

■ Radically change the way state funds for higher education are appropriated by giving more to students and less to institutions.

■ Governing boards should set standards for institutions.

■ Give college and university presidents more authority.

Criminal Justice

■ Keep the courts focused on necessary cases by using diversion, jail screening, an infractions bureau and victim-offender mediation.

■ Restore the independence of the Sentencing Guidelines Commission.

■ Incarcerate in county facilities those offenders with short sentences.

■ Authorize the Department of Corrections to contract with private vendors for incarceration and institutional programming for medium-security male inmates in nonpublic facilities.

■ Authorize the Department of Corrections to contract with private vendors for incarceration and institutional programming for low-security male inmates in public facilities.

■ Create mechanisms to lower prison per diem costs.

Property Taxes and Local Government Aid

■ Concentrate the state's property tax relief on needy people, not local governments.

■ Target aid to local governments at governments in need.

■ Require local governments to pass a referendum before increasing noneducation-related property taxes.

■ Require future property tax increases to be levied on market value.

■ Create a new form of government — the village — to foster local competitive contracting.

■ Establish deadlines for government to submit their services to competitive bid.

Health Care

■ Pool the state's buying power and require providers to bid to provide services to elderly people or people with disabilities.

■ Streamline regulations and focus instead on outcomes.

■ Give consumers incentives to pursue healthy conduct.

■ Take the consumers' ability to pay into account when providing services to elderly people or people with disabilities.

Elements of Reform

The policy challenges facing Minnesota are unprecedented. Beginning immediately and mounting over the next several years, Minnesota must cope with fiscal deficits of massive proportions.

To address this pending fiscal crisis, we have prepared an agenda for major reform at the request of Governor Arne H. Carlson. Fundamental changes are proposed in the way Minnesota delivers taxpayers' services. The key principles for reform are competition, community and concentration.

Government spending primarily benefits students, the elderly and the disabled. We will continue to see a bulge in these populations, which will put immense stress on our budget. Additionally, the Minnesota corrections budget has dramatically increased as incarceration rates have climbed. Prison construction costs are consuming an increasing portion of the state's capital budget.

The demographic problem is aggravated by the slowing growth of the economy. While Minnesota has enjoyed one of the highest rates of growth outside the Sun Belt for many years, spending demands on government are growing faster. Over the next six years expenditure demands exceed prospective state and local tax revenues by $5.1 billion.

This prospective shortfall would be sufficient to force a rethinking of public policy in Minnesota, but the coming cutback in federal aid will make the crisis even more acute. Preliminary analysis of federal plans adds $3.2 billion to the projected gap.

We believe that the current debate in Washington is qualitatively different than past debates, and that Minnesota would be foolish not to assume that federal funds to the states will be curtailed even further in the coming years.

In Washington, the debate has narrowed to the relative merits of balancing the budget in nine versus seven years. Both parties appear committed to budget balance and that forecloses the possibility of substantial increases in funds to the states for the foreseeable future. Minnesota should plan for an era of increased state responsibilities and decreased federal funds.

Over the next six years the anticipated federal cuts would add $3.2 billion to Minnesota state and local deficits. Not only will state and local governments have to contend with an aggregate shortfall of about $8 billion over the next six years, but by the year 2001, state and local governments in Minnesota could be facing an annual shortfall of $2.5 billion. This immense sum exceeds combined current annual state spending on community colleges, prisons, nursing home care and special education. Of course, abandoning such crucially important state responsibilities as these is no solution. In order to meet these responsibilities we must find ways of doing more for less.

In forecasting future revenues, we have assumed that current tax laws continue unchanged. Increases in sales and income tax revenues will occur as a result of economic growth just as property tax revenues change to reflect increases in valuations, but this report assumes that the option of raising tax rates is not available.

An assumption of no tax increases is the only possible way for Minnesota to approach its current crisis for two basic reasons.

First, any plan based on tax increases is almost sure to be frustrated by a tax-weary public. Legislators facing election are not likely to support large tax increases in this political climate. Virtually all recent political evidence concludes that the debate is between the current level of taxation and lower taxes. To bet Minnesota's future on any other calculation would be foolhardy.

Second, we are convinced that a tax-neutral approach is the only way the political will can be summoned to make the needed policy innovations.

This is no time for timidity in the public policy arena. The public is saying "no new taxes," but demanding improvements in the quality of services delivered by government at all levels. This apparent conflict between the public's unwillingness to pay higher taxes and their demand for improved services marks the central rationale for radical restructuring rather than a more traditional approach to budget management.

Both the political left and the right are challenged by the current environment. Traditional liberals wish for a return to a day when taxes could simply be raised and revenues spent and a grateful electorate would respond by re-electing the responsible public officials. Conservatives, on the other hand, would like to believe that the public's concern extends only to opposition to taxes, and that spending cuts can be enacted without regard to the quality of public services.

But the public is saying they want better and cheaper government.

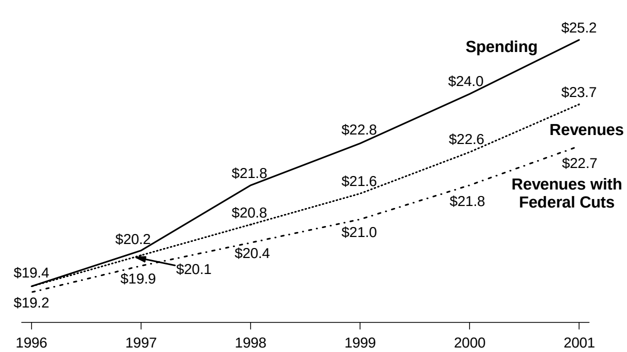
The Governor asked us to create a bipartisan agenda and we have done so. DFLers, who traditionally attribute major responsibilities to government and who want government to focus on the disadvantaged, will see those commitments reflected in our recommendations. Republicans, who have long wanted less government bureaucracy and more emphasis on individual choice, market forces, and voluntary institutions, will notice that our recommendations include those means of carrying out government's responsibilities.

The public understands that, when confronted with a problem of this magnitude, there are two paths available to policy makers: coping through better management of government's current programs or improving through fundamental restructuring.

The management approach is attractive, though in different ways, to both political parties. It is characterized by improved administration, better motivation of employees, reorganization of existing agencies, decentralization of functions and simple budget cuts.

Certainly there is much to be said for more efficient management. However, improved management of current arrangements will not generate the results we need.

Federal Cuts Will Increase State and Local Revenue-Spending Gap (in billions)



Source: Minnesota Department of Finance

The time has come to reconsider in the most fundamental ways how government in Minnesota meets its responsibilities to the people.

In discussing the necessary restructuring we have tried to use words that convey a true sense of the historic challenge and opportunity before us.

We have called our task Madisonian, because President James Madison, the principal designer of our federal system, addressed the basic relationship between the people and their government.

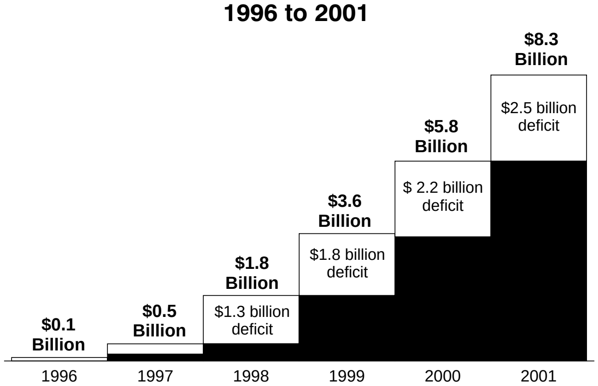
We have used the word "perestroika" because the restructuring of Eastern European economies shows the limitations of the "management" approach to reform. No one today would argue that any revolution in management could have made Eastern Europe competitive with the West.

Nothing in this report should be taken as an indictment of the motivations or competencies either of the people who have written public policy in Minnesota or of those who have administered it.

In fact, it is precisely Minnesota's tradition of excellence and innovation in public policy that make us optimistic that our state can look upon our current challenges as an opportunity. Just as Minnesota led the nation in building networks to provide services in such areas as vocational education and mental health, today we can lead the nation in restructuring public services to achieve superior results at reduced cost.

Minnesota is entering a period of serious fiscal difficulties. In this report we will explain why and recommend a course of action that we believe to be necessary if our state is to thrive in the future.

Cumulative Fiscal Gap including Federal Budget Cuts 1996 to 2001



By 2001, the annual gap is projected to be $2.5 billion with a cumulative gap of $8.3 billion over six years for state and local governments.

Source: Minnesota Department of Finance

The Problem

The coming challenge to government emerges from the following five facts, assumptions and projections:

■ The vast bulk of government spending in Minnesota goes to a handful of items widely regarded to be appropriate governmental responsibilities. Education, health and human services claim most of the money. Most of the rest is devoted to property tax relief (in the form of state aid to local governments and to property taxpayers) and criminal justice.

■ The economy of the state — from which tax revenues come — is growing more slowly than are the needs of people on whom some of the major state expenditures are focused. For example, spending for medical care is concentrated on elderly and disabled people, and the number of Minnesotans over age 85 is projected to grow five times as fast as the general population.

■ The people of Minnesota are not prepared to have a greater proportion of their income devoted to state and local taxes.

■ The federal government will cut back considerably in its aid to the state.

■ The results of government spending are not good enough. Despite large increases in state government spending in the past several decades — for example, inflation-adjusted spending per public school student nearly tripled between 1960 and 1990 — adult and youth literacy rates are dropping and juvenile crime rates are skyrocketing. Evidence suggests American young people are unprepared for the workforce and could be contributing to the slower economic growth we are now experiencing.

Minnesota, therefore, has a two-part budget problem:

■ For many years to come, state and local governments will face huge and growing imbalances between spending demands and available revenues.

■ The major programs to which government budgets are devoted produce unsatisfactory results.

In the past, Minnesota has often dealt with budget difficulties by raising taxes and reducing spending. This time the problem will not be solved by raising taxes; the citizenry has made it clear that government is to get by without taking a larger share of people's income. There is no practical possibility that the public sector will receive sizable budget increases in the foreseeable future.

The budget problem also will not be solved by merely cutting spending; the state's main services are of critical importance. Those advocating an increase for their favorite cause, whether it is education, health care, corrections or property tax relief, must know that more money can only come from other spending areas. Trading health for education will not solve Minnesota's problems.

The solution lies in finding ways to improve results while spending less. Americans, including Minnesotans, have come to see the government as unresponsive and inefficient in the extreme. Solving Minnesota's budget problems involves identifying and responding to the reasons for this situation.

Improving Government Management is Not the Answer

A management proponent would say the solution lies in finding successful "benchmark" solutions for government's tasks; stressing outcomes, not inputs; introducing total quality management; mandating higher standards; decentralizing authority; forming cooperative ventures with other units of government and the private sector; urging public employees to think of clients as customers; eliminating waste; and so on.

We do not claim these proposals are without value. But all come down to exhorting people in government to do things differently.

Exhortation is not policy. It is not systematic. It is ignored with impunity. Urging people in government to manage better will not work for the same reasons that management changes alone could not improve the East German automobile industry, the Soviet food delivery system, or steel-making in communist Poland.

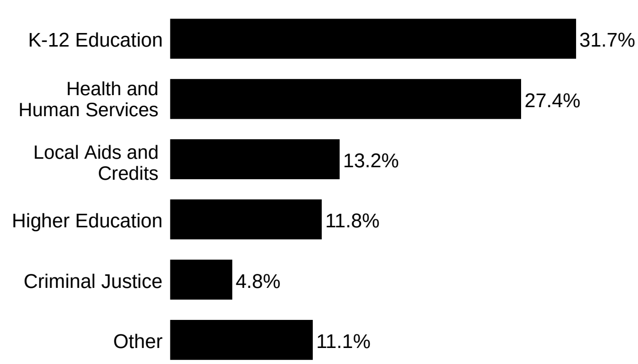
Could one of the management approaches just mentioned, *or any other attempt to improve management*, have turned around those hapless communist efforts? The answer is, no.

Countries behind the Iron Curtain attempted to produce goods and services in bureaus. A bureaucracy consists of government giving a franchise to an agency it owns, then bestowing money on it along with a set of rules the agency is to follow. Bureaus receive funding regardless of their effectiveness.

Recipients of a bureaucracy's services can do little to influence the quality of services. Bureaus lack built-in incentives to improve and lack penalties for failure. They are subject to no systematic discipline that would foster productivity.

Minnesota government tries to teach children, tend roads and heal people by means of the bureaucracies we know as school districts, the highway department and state hospitals. But the lesson of our time, from both the inadequate performance of government in this country and in more spectacular fashion from the colossal failure of the communist regimes, is the inherent inefficiency of bureaucracies.

State Government General Fund Spending Categories
Percent of Total — Fiscal Year 1996-97



Note: Other includes environment, natural resources, economic development, transportation and state government.

Source: Minnesota Department of Finance

Sheltered by its monopoly status, the East German bureaucracy that made Trabant automobiles could take its clientele for granted, secure in the knowledge that it would continue to receive its government appropriations. The cars were junk. Correspondingly, much of what American government does yields little in the way of results.

There is no more reason to expect monopoly bureaus to give rise to good education in Minnesota than there was to expect them to create good cars in East Germany. In bureaus the usual government policies — creating exclusive franchises, spending money, issuing mandates, exhorting people to work harder, installing the latest management fads — are condemned to have but fleeting effect.

Our point is not to criticize public servants. In fact, many government employees are well-motivated, highly competent people. However, like their counterparts in private employment, government employees often advance their own interests at the expense of the public good. Government employees are interested in their jobs, their incomes, their raises, their advancement, their pensions, their security in the workplace. These interests are represented at the Legislature, effectively, by wealthy and powerful organizations, which are themselves private. These interests are legitimate. But they are not public interests. It makes no difference that they do not take the form of a business corporation. They are private interests.

Private economic interests sometimes conflict with the public interest on matters of pay, accountability, assignment of personnel, on whether to introduce innovations that could accomplish more work at lower expense, and on whether the interests of the government employees themselves are to be put first, as opposed to the students, patients and citizens of the state.

It makes no more sense to expect that employees of state government or of school districts are always watching out for the public interest than it does to assume that those working at 3M or Cargill are doing so. Commercial organizations and the people in them can be selfishly devoted to their own advancement at the expense of those they are expected to serve.

They can also be conspicuously devoted to serving their customers' needs — if they are subject to competition that elicits such devotion.

Government organizations and the people in them can be entirely devoted to serving the public. They can also be self-serving, putting the convenience of the organization and its employees ahead of the interest and needs of the citizens. There are no dependable constraints preventing bureaucracies from satisfying the interests of their employees rather than those of their clients. When it comes to producing goods and services, government's failure and the source of Minnesota's budget problem lies in the attempt to turn over important societal responsibilities to bureaucracies.

Bureaucracies, whether Minnesota's school districts, highway department or state hospitals on the one hand, or the USSR's food delivery system on the other, cannot be managed to the point of regularly yielding innovations and efficiencies sufficient to accomplish better results at less cost. Likewise the solution does not lie in finding "smart" ways to root out waste, fraud and mismanagement.

Minnesota's budget problem is not a management problem in the sense that little can be expected from imposing a new management technique or from exhorting public managers to do better. Rather, the challenge is to devise arrangements within which people will dependably and consistently be inclined to seek efficiencies and management improvements.

The Need for Fundamental Reform

The only way to spend smarter is to get rid of the bureaucratic system, to undertake a "perestroika," a fundamental reform of government. The needed reform rests on a basic premise: while government has important responsibilities, they need not be carried out by monopoly government bureaus.

A service is public if it accomplishes a public purpose; whether those producing the service receive a paycheck from the government or not is irrelevant. When Minnesota state government helps a student get an education at Gustavus Adolphus College in St. Peter, or provides funding for a patient at the Mayo Clinic in Rochester, the public welfare is advanced as much as if the spending had gone to Worthington Community College or the Hennepin County Medical Center.

Elected bodies should concentrate on funding and arranging services, not on producing services exclusively through government-owned agencies.

The question of governance is, how can a free people regularly and dependably accomplish public purposes? If exhorting government to manage better cannot be counted on to have significant effect, how can public responsibilities be met?

In undertaking Minnesota's "perestroika," there are only two broadly effective instruments available to policy-makers wishing simultaneously to cut costs and improve quality. These instruments are competition and community.

Competition

Competition is the main way a free people hold one another accountable. As James Madison put it, "Ambition must be made to counter ambition. … This policy of supplying, by opposite and rival interests, the defect of better human motives, might be traced through the whole system of human affairs, private as well as public. … The constant aim is to divide and arrange the several offices in such a manner as that each may be a check on the other." The founders did not expect that government would one day come to consist largely of huge monopoly bureaus. Contemporary government bureaucracies do not reflect the admonition of the founders "to divide and arrange the several offices." They are not subject to competition; they are not arranged "in such a manner as though each may be a check on the other."

In government's production of services, the crucial element of competition is usually missing. The consumers of government services rarely have the option of choice and government bureaus lack both the incentive and the legal means to innovatively provide greater value to their "customers."

In American private business, competition is the indispensable engine of innovation, the instigator of efficiency, the main instrument by which society checks private interests.

In the private sector, reductions in cost are viewed as a sign of progress. In government, cutting costs is almost always viewed in negative terms, such as "Draconian," "hard-hearted" and "cruel."

But we make no particular claim for privatization. Private monopolies can be as self-serving as public monopolies. In both private and public realms, competition is fundamental. When citizen-consumers have the choice between competing suppliers, then those individuals possess the power that holds the suppliers accountable.

Suppliers, whether private firms or public schools, will try to attain monopoly status. When they succeed, accountability is lost; power flows from individual citizens to the monopoly suppliers.

A major responsibility of government is to ensure that private firms are subject to competition. But contemporary American government — national, state and local — lacks adequate institutionalized protection for the society from the self-interested behavior of the people who affect, make and carry out public policy. In present day Minnesota, most government money is spent on large monopoly bureaus that are not subject to competitive stimulation.

We propose to take away bureaus' monopolies and let people choose for themselves which service producers — starting with the schools, the largest spending item — are best for them. Competition puts power in the hands of individual citizens, not bureaucracies. The vast majority of government services could be improved by the use of competition.

It will take a sea change in the attitudes of even our best public officials to fully embrace competition because for so long the elimination of "wasteful competition" was viewed as one of the first principles of good public policy. In the future, competition must be viewed not as a problem, but as one of our most powerful tools.

Projected Growth in Population and Personal Income
Five-year average —1995 to 2000

Source: Minnesota Planning

Community

"Community" is a principle more difficult to use in public policy, but potentially even more powerful.

A community is an organization, membership in which ordinarily draws people to work for the welfare of others. Whether in a family, a religious organization, an ethnic affiliation or a civic association, the ties that bind a community together are usually far stronger than any that government engenders.

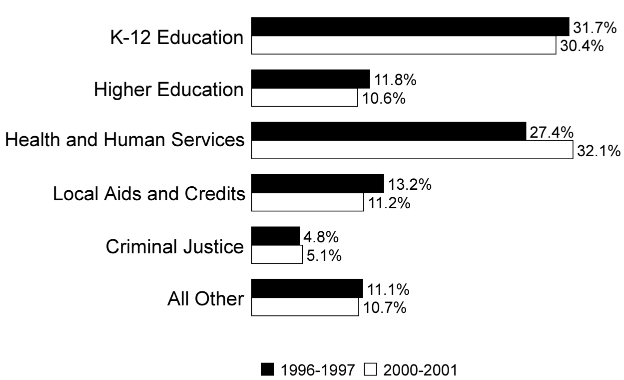
The key characteristics of communities are that they form voluntarily and are bound by common values. For this reason, communities can be thought of as potential resources at a time when additional public funding is not available.

Occasionally a government school or other bureau is a community, in the sense that those served feel at home there and workers spontaneously seek the benefit of their clients. But these cases are increasingly uncommon. For most of us, only family and religion hold our ultimate loyalties; few other affiliations consistently do so.

Where communities have been providing services, such as in education and health care, the results have usually been superior to government programs, and at lower cost.

Consequently, government should carry out much of its work through communities. For example, an existing Minnesota program provides public funds to families in order that their infirm loved ones can be cared for at home rather than in a government institution. We need more like it.

Health and Human Services Will Consume More of State Government Budget



Source: Minnesota Department of Finance

Families, churches and other voluntary organizations are the most vibrant communities and, although policymakers and public administrators will voice support and sympathy for these nongovernmental entities, public policy often has treated them with indifference at best and hostility at worst. In the future they must be viewed as indispensable allies. Communities inspire us to do good for others and it may be that no amount of government funding can make up for an absence of strong communities. It may also be that only in healthy communities can we grow to be concerned for the welfare of the greater society. If government helps citizens meet educational, health and social needs through communities, the communities themselves are strengthened. Thus a Minnesota, strapped for money, which turns to its natural communities may find both its spiritual and its fiscal health enhanced.

Competition and community are the elements of Minnesota's needed reform. They are the only dependable ways to accomplish public purposes. Government programs not embodying competition and community should be expected to fail.

Fully embracing competition and community will be difficult for the public policy world, because they require us to throw off the top-down command-and-control model that has dominated public policy for so long. Although competition will certainly result in lower costs and improved services, from a traditional public policy perspective the process is messy and unpredictable. And while communities offer tremendous untapped resources to apply to society's problems, they can never be quite as accountable as a government employee.

One philosopher wrote of America's quest for a "moral equivalent of war," a cause so compelling as to induce in us persistent motivation to work for the good of the whole of society. But in our rebellious times, even war is not the moral equivalent of war. Though we wish otherwise, only very rarely and fleetingly are we drawn to work for the benefit of all. For the production of goods and services, reforming government means meeting its responsibilities using competition and natural communities of mutual obligation.

Concentration

Finally, we believe that running through all our policy decisions should be a commitment to concentration of resources in areas of greatest need. This is not so much high principle as simple common sense, but common sense that has far too often not been applied in the allocation of dollars through public policy in Minnesota.

We propose that reform in Minnesota include the concentration of public spending on those people most in need. Much government spending is almost randomly distributed; some is even directed away from the disadvantaged.

For example, Minnesota's current aid to cities would be nearly as fairly distributed if it were strewn over the state from an airplane. As our local aid programs grew, something of a tradition arose in the Legislature, not to vote for a tax bill until cities in one's own district get additional funds. The current programs foster logrolling, which has contributed to wasteful expansion. Aid must be targeted to where it is needed.

Another example, state spending on higher education, is actually regressive, because it lowers tuition for all including the most wealthy (who attend college in higher numbers than the poor). Countless other programs are similarly haphazard.

In general, government should aid needy individuals directly rather than send money to an organization to help the individual.

For example, property tax relief is better granted directly to strapped taxpayers than to the cities in which they live. Assistance to higher education is better given to students directly than to the colleges and universities they attend.

There are two reasons for this: Individual recipients become monitors; they impose discipline on cities by deciding in referenda whether they wish to pay higher property taxes, and on higher education institutions by deciding whether this college or that better meets their needs. Also, money granted by the state to individuals can be focused better on those who need it, than can funds granted to bureaus, cities or colleges.

While public policy involves far more than the redistribution of resources, certainly in times of serious fiscal constraint the principle of concentration of resources where most needed should be applied more rigorously. Focusing aid would permit the state to meet legitimate responsibilities fairly and with less money.

General Principles

Meeting government's responsibilities by introducing competition, encouraging communities and concentrating public spending on the needy has clear implications for all government spending in Minnesota, whether financed locally, at the state level or by the federal government. The recommendations for reform contained in this report do not distinguish among sources of funds for state activities. The principles are germaine to all state services, regardless of source of funding. Following are some of the general policies that would result from a government intent on giving its citizens value for money.

Recommendation: A target should be set for spending and targets should be established for all major expenditure areas. The citizens, Governor and Legislature have already determined that taxes as a fraction of income will decline slightly in the coming years. Now we need to stipulate for each major spending area — K-12 education, higher education, health care, state aid to local government, prisons — how much of our tax revenues we will allocate to each.

Recommendation: Eligibility for government benefits should be limited to the most needy. Budgets will be extremely tight even if we undertake sweeping reforms. Rich people will have to pay higher college tuition if we are serious about providing financial aid to poor people. Only those cities that are especially needy should get aid from the state.

Recommendation: Funds should go to citizens, not bureaucracies. Parents, students, and patients would use the money at whichever school, college or hospital they choose. They would decide what is best for them, whether the institution is owned by government or not.

Recommendation: Expand choices for government officials. Where government officials, not individual citizens, make spending decisions, it is imperative that the officials have choices. The arrangement under which, for example, school boards buy services only from schools they own, is a conflict of interest. In general, public officials need choice as much as citizens do.

Recommendation: Enable families and communities to provide some services. Enabling, and where necessary, funding citizens to receive social and educational services from family members, churches and other communities is not only responsive to people's wishes, it is also cost-effective.

Government programs that do not embody the principles of competition, community and concentration are bound to fail. Conversely, a government which honors these principles will succeed. Such policies offer the best chance to balance the budget, improve the quality of public service and accomplish both in a just manner.

Global Budgeting

State governments often contrast themselves favorably with the federal government by noting that states do not engage in deficit spending. This is accurate as far as it goes but, in fact, the state of Minnesota has for decades engaged in a similar exercise which one might think of as "deficit committing." Policy commitments made in one year have carried budgetary "tails" that committed the state to increased expenditures in subsequent years.

In the 1960s and 1970s this practice caused few problems because Minnesota was experiencing a relatively high rate of economic growth. Revenue growth could be counted on to outpace growth in expenditures, except in times of recession, which the Legislature usually dealt with by raising taxes.

But in the 1980s the slowing of the national economy began to create chronic state deficit commitment problems as revenue growth failed to keep pace with spending growth. This problem reached serious proportions in 1991 when the Governor and Legislature were forced to enact a package of tax and spending changes totaling $2 billion.

In part, this situation arose because Minnesota's budget, like those of most other states and the federal government, was essentially "agency driven." Government agencies would base their requests on caseload changes, previously enacted policy changes and inflation and submit their recommendations to legislators accordingly. Legislators, in turn, would usually simply add to this "baseline" their own preferences and the result would be an increased appropriation. This was all made possible by a seemingly endless revenue stream.

As fiscal realities have tightened, governments across the country have tried to adjust their budget processes to these changing realities. In Minnesota, Governor Carlson has tried to change this process by seeking long term fiscal discipline. The Governor and Legislature also passed into law the Price of Government legislation which commits the state to a gradually declining share of total state income dedicated to taxes and effectively caps overall state revenues for the next four years.

Minnesota is facing a new era of constraints. Demographic and economic changes are overrunning the old way of budgeting. Deficit commitments must be replaced with a new system based on realistic projections of resource availability. Policy-makers and public administrators must have the means to plan ahead. Such a system of stipulating a spending plan ahead of time is usually referred to as "global budgeting."

Overall targets are meaningful only if accompanied by specific program-by-program targets that are both realistic and enforceable. We are convinced that to meet our twin goals of controlling cost and maintaining quality, it is imperative to enact such a system now.

Recommendation: Minnesota should adopt a global approach to budgeting. Minnesota's new budget framework should be based on the following principles:

■ The global budget should cover all general fund spending with program targets that balance the budget for the next two biennia.

■ Targets should be established for all major expenditure programs — K-12 education, post-secondary education,

The Magnitude of the Gap
(in billions)

	1996-97	1998-99	2000-01	Cumulative
Anticipated federal cuts	$0.4	$1.0	$1.8	$3.2
State shortfall	$0.0	$0.8	$1.1	$1.9
Local shortfall	$0.1	$1.3	$1.8	$3.2
Total				**$8.3**

Between now and 2001, federal, state and local revenues will fall $8.3 billion short of current spending demands.

Source: Minnesota Department of Finance

property tax aids and credits, health care and family support, criminal justice and all other general fund activities.

■ Program targets should be expressed as a percentage of available revenue.

■ The cash flow account and budget reserve should be fully funded.

The benefits of such an approach to citizens, elected officials, policy-makers and administrators in the months and years ahead are clear. We are entering an era marked by change, uncertainty and slower growth in resources. Global budgets will provide Minnesota a higher degree of public resources predictability. Long-term fiscal planning will facilitate the creativity and policy innovation necessary to maintain and enhance quality.

But the immediate challenge to our policy-makers in devising and implementing this structure should not be underestimated.

Continuing current laws and policies would require an 8.4 percent increase in revenues for the 1998-1999 biennium and another 10.1 percent increase in 2000-01. But the projected increase in revenues without a legislated tax increase during the same period is 3.9 percent and 8.8 percent respectively. This leaves the Legislature and the Governor with a gap of $1.9 billion.

If all state programs were growing at an even pace, this problem would be difficult, but at least straightforward. But the problem is complicated by the fact that spending is growing at dramatically different rates in different program areas.

Estimates of federal reductions have changed as the national debate advances. In July, the projection of $3.2 billion in reductions included $1.9 billion in Medicaid alone. The program implication for Medicaid is now estimated to range from $2 billion to $3 billion. The balance of state and local federal impact is still estimated to total $1.3 billion between 1996 and 2001.

The biggest part of the problem is health care spending. While overall spending is estimated to grow at a rate of 8.4 percent in 1998-99 and 10.1 percent in 2000-01, health care spending is projected to grow by 23 percent during the 1998-99 biennium and another 23 percent in 2000-01. During the same period of time, higher education is projected to grow by 0.8 and 6.9 percent respectively.

The projected federal changes in Medicaid will reduce, by more than half, the rate of increases in federal support. Establishment of block grants is intended to convert the individual entitlement into more flexible funds. Significant funding reductions will pose major program restructuring challenges at the same time state support must be constrained.

Clearly, trying to manage state spending increases within available revenues would be vastly more difficult in some areas (most notably health care) than in others. Equally clear, this problem will easily absorb our policy-makers in an intense debate over state priorities.

As we have tried to make clear in this report, we believe the federal and state fiscal challenge facing Minnesota citizens and lawmakers is of genuinely historic dimensions. Virtually every area of government policy must be reviewed and significant policy reforms enacted to assure that Minnesota can continue to perform its core functions with excellence in an era of resource constraints.

We cannot emphasize too strongly that it is to this task of reform and restructuring — perestroika — that we believe policy-makers must apply themselves most assiduously. It is highly desirable that the budgetary framework within which these policy changes take place be established as early as possible and that the debate over that framework be kept separate from the debate over the reforms themselves. Toward that end we recommend the following approach to Minnesota's first global budget.

Brandl-Weber Global Budget
Recommended Share of State Budget

	Actual Budget	Brandl-Weber Global Budget Recommendations	
	1996-1997	1998-99	2000-01
Education	31.7%	30.5%	30.4%
Property tax aids and credits	13.2	12.3	11.2
Higher education	11.8	10.9	10.6
Health care	18.2	20.6	22.6
Family support	2.8	3.1	3.1
Criminal justice	4.8	5.0	5.1
All other spending	17.5	17.6	17.0
	100%	100%	100%

Source: Minnesota Department of Finance

Recommendation: The state should establish the total spending targets for each of the next four years based on projected revenue growth without tax changes. Projected spending should be based on a calculation of what would be spent in each program area if current law and policies remain in place. Program targets should be established after across-the-board reductions to reach the overall spending target.

We believe Minnesotan's values are reflected in current program budgets. For that reason, in approaching the global budget framework, we have chosen to respect the priorities established by the Governor and Legislature

Our global budget recommendations envision cuts from current budget projections amounting to $811.5 million in 1998-99 and $1,156.8 million in 2000-01. The reductions affect every spending area, but take into account the demographic pressures that will be occurring over the next four years.

In future years, as reforms are enacted and their implications assessed, there will and should occur a lively debate in Minnesota over these priorities. That debate should occur within a global budgeting framework and after serious and far-reaching reform and restructuring of Minnesota government occurs.

We turn now to showing specifically how Minnesota government can live within its means and, in each of the major areas of expenditure, get more for the taxpayers' money.

Current Budget vs. Global Budget
(in millions)

	Actual Budget	Future Budget Based on Current Commitments		Brandl-Weber Global Budget Recommendation			
	1996-97	1998-99 Estimate	2000-01 Estimate	1998-99 Proposed Budget	1988-89 Reductions from Estimate	2000-01 Proposed Budget	2000-01 Reductions from Estimate
K-12 education	$5,777.9	$6,020.5	$6,606.9	$5,773.1	($247.4)	$6,255.6	($351.3)
Property tax aids and credits	2,406.9	2,430.4	2,428.6	2,330.5	(99.9)	2,299.5	(129.1)
Higher education	2,144.1	2,160.7	2,309.1	2,071.9	(88.8)	2,186.3	(122.8)
Health care	3,314.4	4,076.5	4,908.0	3,909.0	(167.5)	4,647.0	(261.0)
Family support	512.6	591.2	671.5	566.9	(24.3)	635.8	(35.7)
Criminal justice	869.2	991.8	1,107.5	951.1	(40.7)	1,048.5	(59.0)
All other spending	3,194.5	3,478.0	3,721.9	3,335.1	(142.9)	3,524.0	(197.9)
Total spending	**$18,219.6**	**$19,749.1**	**$21,753.5**	**$18,937.6**	**($811.5)**	**$20,596.7**	**($1,156.8)**
Available resources*	**18,219.6**	**18,937.6**	**20,596.7**	**18,937.6**		**20,596.7**	
Balance/(Deficit)	0.0	(811.5)	(1,156.8)				
Cumulative Gap	**0.0**	**($811.5)**	**($1,968.3)**	**0.0**		**0.0**	

*Resources shown exclude current $554 million budget reserve and cash flow account authorized in the 1996-97 budget. The global budget recommendation maintains this level of reserves.

Source: Minnesota Department of Finance

One of the greatest challenges facing Minnesota is to meet citizens' needs while living within our means as a state. If we do not take action, we will be left with an $8.3 billion gaping hole between government spending and tax revenues.

To live within these new fiscal realities, we cannot raise taxes or simply cut government spending. We must fundamentally reform the way government does business. Three systematic and broadly effective principles will make public policy work: competition, community and concentration.

Strategies for Change

Based on these three principles, the following recommendations address government reform in the areas of kindergarten through 12th-grade education, higher education, criminal justice, property tax reform and health care.

K-12 Education

K-12 education, by far the largest item of expenditure for state and local government in Minnesota, provides the best illustration of the impossibility of accomplishing vital public purposes by merely spending ever more money on the existing bureaucratic system. In this section, we will see how limited the financing for K-12 education will be in the coming years, consider why schools are not good enough, and recommend the most promising ways to improve the quality of schooling in the state when finances will be very tight.

In defining the challenges now facing K-12 education in Minnesota, it is useful to consider what the situation will be in the year 2001, given the budget constraint facing the state and the fact that the school-age population will increase by about 5,000 pupils per year from now to then. Under the global budget, per-student revenue from state and local sources would increase from $5,972 in the 1996-97 biennium to $6,404 in 2000-01, an increase of 7.2 percent, only half the estimated rate of inflation over the same period. There will not be more money available for K-12 education unless funds are diverted from higher education, local government aids, health care or corrections.

Educators are unaccustomed to slow growth in revenues over an extended period of time. From 1960 to 1990, the amount spent per public school student in Minnesota nearly tripled after adjusting for inflation. Almost three times the educational resources are spent on students today, compared to the amount spent on their parents when they were in school. Not only is it possible that real per student funding will drop in the coming years, but a larger fraction of the students now entering our schools come poorly prepared, with less educational assistance at home, and thus in greater need of the benefits of school.

Achievement gaps

Even though the education budget almost tripled from 1960 to 1990 on a per student basis, the system failed to achieve a corresponding improvement in educational outcomes. Minnesotans have long viewed our education system with smugness, pointing to our high graduation rates and to standardized test scores somewhat above the national average.

A closer look at how we are doing should give us pause. For example, two-thirds of Minneapolis students achieve at below national average rates. A survey this year of 10th- and 11th-graders in Minnesota found that 30 percent could not pass a basic reading test consisting of answering straightforward questions about newspaper articles the students had read.

In 1992, national tests found only 37 percent of Minnesota eighth-graders "proficient" in math operations with fractions, decimals, percents and basic geometry.

Improving performance

During the period in which educational expenditures were rising rapidly, much was learned about how to improve educational effectiveness. Educators and parents know, and researchers have corroborated, that successful schools are characterized by strong leadership, an orderly environment, the teaching of basic skills, high expectations of students, homework regularly assigned and accomplished, a substantial part of the students' day spent on academic work, systematic monitoring of students' progress, and a sense on the part of students, teachers and parents that their school is a community.

These findings are not surprising, and one might have thought that they would quickly have been adopted in schools as soon as administrators and teachers became aware of them. One might expect, for example, that school boards and principals would be creating more orderly environments and having teachers to assign homework and hold children to higher standards.

Unfortunately, evidence of their effectiveness and urging their use have not led to widespread adoption of those basic practices. Although many of them have even been partially implemented, obviously they have had inadequate effect.

By and large, the continually increasing funds being spent on education have not been dedicated to uses known to have beneficial effect. Rather, the money is mostly being devoted to higher teacher salaries and lower class sizes, neither of which has been found to be strongly related to student achievement. In the current arrangement, funding is in no way dependent on accomplishment of mission. The adults in the school bureaucracy receive their salaries and pensions (having lobbied the Legislature hard for them) regardless of what the children learn. In the school system it is only the children, not the adults, who are at risk when inadequate education occurs.

In the Post-World War II era, teachers have attained a comfortable standard of living (which could hardly be held against them) and the pupil-to-teacher ratio in Minnesota has dropped from 23.3 in 1966 to 17.3 in 1994. Meanwhile, the education level of Minnesota youngsters has become a matter of grave concern.

In recent decades, the schools have taken on a variety of functions not previously their responsibility — for example, social services and public safety. It might be argued that the costs of education are distorted and exaggerated by including money spent on those items. But those efforts and their contribution to the almost tripling of real per student expenditures in 30 years have not been sufficient to overcome the social problems at which they were directed. The efforts have not improved education outcomes. Current social, political and educational arrangements do not accomplish satisfactory education of our children.

Given the fiscal prospects of the state, there is no reasonable possibility for the foreseeable future that the schools as currently organized could receive enough additional money to produce substantial improvements. Even if schools were to maintain the modest 0.6 percent real per pupil spending growth rate of the early 1990s, they would face a $1.7 billion cumulative five-year deficit from 1997 to 2001 under current law revenues. Returning to the 1.8

percent annual real per pupil spending growth recorded from 1984 to 1994 would produce a five-year deficit of $3.9 billion.

Given the state's fiscal constraints, government must learn to do better with less. The education system has grown accustomed to large budget increases per student, but for a long while to come the state will have great difficulty merely keeping real expenditures per student constant.

Budget increases have not typically yielded corresponding improvements in elementary and secondary educational outcomes in the past. If education in Minnesota is to improve in the future, neither large amounts of additional money nor exhorting educators to do better will be what does it.

Effective approaches

Of course we wish Minnesota schools would use the most effective curricula and teaching techniques. But it is not for policy-makers in St. Paul to stipulate what those should be. The task of policy-making is to devise arrangements that allow and encourage teachers and administrators to adopt the most effective approaches.

That is why the most promising policy for improving schooling for all children in Minnesota is opening to families a broad range of educational choices. This would have the two-fold advantage of fostering the innovation and efficiency that comes with competition, and as well enabling families to find the educational community in which their children do well. While we believe that eventually such a policy should apply to all children, some of the recommendations we offer would apply only to children of low-income families; that is, those most in need of radical change in their schooling.

The very act of choosing a school heightens parent expectations and creates parental and school accountability. We are impressed with the evidence that where a school develops a sense of community, education improves. That is, where the children feel cherished, and the parents and teachers participate actively in the school's activities, the children tend to flourish educationally. And it appears that community-schools, particularly those operated by religious organizations, are often especially effective in educating disadvantaged youngsters, presumably providing support sometimes lacking at home. We think it prudent, where religious institutions accomplish public good — for example, providing better, cheaper education — that constitutional ways be sought for government to fund them.

Traditionally, constructing a budget for K-12 education, as in other areas, has begun by noting the number of students to be schooled, then estimating the cost of producing the schooling. As we have emphasized above, Minnesota is now in a position of having rather to start with a fixed amount of money available for the education of children. The new budgeting task is to find and implement policies that will foster quality education with that sum.

To help Minnesota meet the dual challenges of quality and cost, three major changes are needed: expanded choices for students; expanded choices for schools and districts; and an increased emphasis on useful information about schools and independent evaluation of school performance, both for parents and policy-makers.

Expanding choice for students

A decade ago, Minnesota became a leader among the states in education policy, challenging the traditional monopoly bureau model by opening up choice for students within the K-12 system. Session by session since then, the Legislature has been gradually expanding this policy of challenging the system by expanding choices. It is time now to extend this policy by offering students even more choices and expanding those choices beyond the traditional definition of public education.

Recommendation: Permit low-income parents to receive education vouchers that could be used at private and parochial schools. We propose a voucher program that would permit low-income parents to receive certificates that they could use for the education of their children at private and parochial schools. Minnesota has a long tradition of taking advantage of the strengths of private sector nonprofit organizations to accomplish public goals — we finance students to go to private colleges and we allow families to spend public dollars for church-operated child care, social services and nursing homes. Ten percent of Minnesota children already attend nonpublic schools. The question now is, why would we deny low-income students the same opportunity when so many are struggling and falling behind in public schools?

The Milwaukee voucher experiment has demonstrated that it is precisely the students who are having the greatest difficulty who are choosing nonpublic schools. Those who are doing well in public schools have no reason to change.

Private voucher schools may actually do the public system a favor by relieving then of some of their lowest achieving, most expensive students. In Minnesota, they can provide new capacity for fast-growing districts like Minneapolis and St. Paul that face space shortages.

Opponents are concerned that a voucher program drains money from the public schools. It is true that some may have to adjust staffing and programs because of lost revenue, but all enterprises in society must do this when their business drops, unless they redefine how they carry on business. The number of voucher students transferring out of the public schools in the near future is likely to range from a low of 2,000 to a high of 40,000. This is less than 5 percent of public enrollment, a drop far smaller than the 200,000 student loss school districts experienced at the end of the baby boom period. Total public enrollment is growing by 23,000 from this year to 2001. This growth may be greater than the number of students participating in the voucher program.

Many nonpublic schools are strong in nurturing character, discipline and values, above and beyond any particular religious doctrine. Parents need support in choosing that kind of education; perhaps as they do so, we will spend less later on drug abuse, dropout prevention and criminal justice programs.

We propose that Minnesota establish a statewide educational voucher program that gives every child eligible for a free or reduced-price school lunch the funding to choose a nonpublic school that meets their needs, providing the school joins the program and has space available.

The eligible group includes an estimated 230,000 public students and 20,000 nonpublic students from households with incomes below 185 percent of the poverty level. This is 28 percent of 831,000 public students and 21 percent of 95,000 nonpublic students. The upper-income limit is $28,028 for a family of four, and $18,556 for a single parent with one child.

The program will be fiscally neutral, and may generate savings in the long run. The commissioner of the Department of Children, Families and Learning would be given the authority to phase in the voucher amounts in the early years in order to guarantee fiscal neutrality. The voucher amounts would gradually be brought up to 90 percent of state average general education revenues per student.

The voucher could be used to cover the cost of tuition and fees at a private or parochial school. The maximum amount of the voucher would be adjusted for grade level, just as regular school funding is. For example, a voucher for a 12th-grader would be higher than the amount allowed

Brandl-Weber Voucher Proposal at a Glance

Who qualifies for education vouchers?	Low-income students. Generally, students who qualify for the free or reduced-price school lunch program also would qualify for the voucher program. For a family of four, the upper income limit would be about $28,000.
How many students qualify?	About 230,000 or 28 percent of public school students and 20,000 or 21 percent of nonpublic students would qualify, but it is likely that less than 40,000 of current public school students would actually use them to attend nonpublic schools.
How much will vouchers be in 1997?	Vouchers for new private school students will be about $940 for kindergarten, $1,900 for elementary grades and $2,300 for secondary grades. Vouchers for students currently enrolled in private schools will be $375 for elementary levels and $460 for secondary students.
What will happen in the future?	Over the next several years, voucher amounts will gradually increase until they reach 90 percent of the state's funding per student. At that level, vouchers for all private school students would then be about $1,700 for kindergarten, $3,400 for elementary grades and $4,150 for secondary levels.
Will home school students be eligible for vouchers?	Yes, if they meet income eligibility limits. New home school students could receive vouchers for $470 for kindergarten, $940 for elementary grades, and $1,150 for secondary levels. Children already in home schooling would get the same voucher amounts as students currently enrolled in private schools — $375 for elementary grades, $460 for secondary levels and $190 for kindergarten.

for a sixth-grader. A separate reimbursement mechanism would give families a choice of transportation.

In order to achieve fiscal neutrality from the outset, we expect the maximum voucher for students newly transferring into nonpublic schools initially to be set at 50 percent of state average general revenue per public school student — about $2,300 for secondary, $1,900 for elementary and $940 for kindergarten students. At this stage, scholarships or family support may often be needed as supplements to the voucher to cover the cost of tuition. It is important that the voucher amount be raised as quickly as possible to fully support tuition at average-priced private schools and to stimulate expansion of nonpublic schools. We propose that the maximum voucher eventually be raised to 90 percent of the state average per pupil general revenue amount — $4,150 for secondary students and $3,400 for elementary and $1,700 for kindergarten using fiscal 1997 formulas. Once the program is fully implemented, schools would have to accept the voucher as full payment; scholarships could still be used, but no charges could be made by schools to parents other than customary fees.

It is only fair to give low-income students already attending nonpublic schools the opportunity to be in the program. Unfortunately, the only way that fiscal neutrality can be achieved is by starting these students out with a lower voucher. We propose 10 percent of the state average general revenue per student — about $460 for secondary students and $375 for elementary students — gradually raising their voucher to the 90 percent level over a period of five to 10 years. Since the voucher cost and the average cost structure of nonpublic schools is lower than that of public schools, each student transferring to a nonpublic school generates savings. It is those savings that pay for the vouchers for existing nonpublic students. Thus, participating nonpublic schools will have a strong incentive to open up as many positions as possible for new voucher students.

All types of nonpublic schools could participate, providing they meet current state nonpublic school laws and several additional requirements. They would have to make a minimum number of positions available to new voucher students. Oversubscribed schools would have to select voucher students by lottery; they could not "cream" only the top applicants.

Under our proposal, special education students would have to be provided for and current discrimination laws would have to be met. These laws allow nonpublic schools to have admissions criteria, but not to discriminate based on disabilities. Participating schools would not be required to use any particular curriculum or instructional method, but would be expected to make a commitment to the state graduation standards when they go into effect. Like public schools, they would be expected to report to parents and the public on student achievement.

Vouchers would be issued by the state and financed within the present state general education revenue system, meaning that they would be funded almost exclusively with state dollars. No state categorical revenues, levy revenues or compensatory aids would go into the voucher formula.

Recommendation: Permit low-income parents to use an education voucher for independent learning or home schooling. We propose one additional type of voucher for independent learning. The rich array of educational resources available through computer networks, multimedia and distance learning technology will soon make it possible for children to learn as much or more at home as in school. Home school is the fastest growing educational option in Minnesota, increasing from 2,900 students in 1990 to 9,200 in 1994. Some parents are forming neighborhood clusters and support networks that provide training, technical assistance, evaluation and accreditation from certified teachers. This proposal is consistent with our commitment to invest more in families and less in costly institutions.

As a starting point for discussion, we propose that a voucher set at 25 percent of statewide average general revenue be made available to children from low-income families newly choosing independent learning. This would represent, in fiscal year 1997, about $1,150 for secondary students, $940 for elementary students and $470 for kindergarteners. Existing low-income home school families could receive a 10 percent voucher at the outset, which could be raised over time to the 25 percent maximum. The Commissioner of the Department of Children, Families and Learning would be given the authority to prorate vouchers or cap eligibility to keep the program fiscally neutral.

The child's home school would have to meet standards currently in state law for home schools, including annual standardized achievement testing in major subject areas arranged in cooperation with local school superintendents, unless the school is accredited or taught or supervised by a licensed teacher. The voucher would promote higher quality in independent learning, giving more families the ability to purchase learning technology and technical assistance from accrediting networks.

Recommendation: Do not allow school districts to deny use of facilities to nonpublic school students. We envision public school buildings being around-the-clock community learning centers open to a variety of learning and cultural activities and serving all kinds of people. Some already are. One implication is that it no longer makes sense for public schools to shut out nonpublic students who need particular classes, services or extracurricular activities.

Fortunately, cooperation is already a tradition in some parts of rural Minnesota. Small towns understand the reality of limited resources and the importance of a unified community. One hundred and seventy-seven districts already take some advantage of proportional "shared time" aid available under current law. To expand on this authority, we propose that public school districts no longer be permitted to deny timely and reasonable requests of parents of nonpublic school children for enrollment in classes or extracurricular activities not otherwise available.

Recommendation: Allow students to enroll in any school district, with no restrictions on open enrollment. Under Minnesota's pioneering open enrollment law, students are allowed to choose a school outside their district. Yet a number of districts are now closed to students from other districts; they cite a need to reserve available space for present and future students who reside in the district. To fully achieve the intent of open enrollment, students should be able to enroll in any district, taking to their school of choice the funds provided for them by local and state sources, including referendum income.

Recommendation: Do not weaken or limit the post-secondary enrollment options program. One of the most popular of Minnesota's choice programs allows the state's high school juniors and seniors to take courses at post-secondary institutions at taxpayer expense. Some districts that have lost students — and the financing that comes with them — to nearby colleges have urged the Legislature to place additional conditions on this choice option. These pressures to weaken or limit the post-secondary enrollment options program should be resisted and students should continue to be allowed to, in effect, finish high school while in college. We can no longer afford to keep students in high school who are ready to move on.

Recommendation: Remove the cap on the number of charter schools and amend legislation to encourage development of charter schools. Minnesota was the first state in the country to allow teachers, parents and others to start new public schools that are autonomous, site-managed and less regulated. Beyond having to attract students, these public schools offer a different form of accountability. In exchange for their independence and fewer regulations, they must agree to a term-specific performance contract with a sponsoring school district or the state board of education. To allow school choice to expand even further, the charter school law should be amended to remove the current cap on the number of schools that may be authorized; to permit additional types of organizations to sponsor schools; and to make the per-student financing for each charter school equal to what is available to a student in each student's resident district.

Recommendation: Give credit to students who meet standards regardless of where learning takes place. Expanded choices in Minnesota are taking place within a growing emphasis on results that students are expected to achieve as they progress toward graduation. Consistent with that policy change, all students who can meet the state-established outcomes should be provided credit, regardless of where or how their learning actually took place. For example, students who learn a language in a foreign country or a summer program should not be denied credit and be required to take courses in school. This is a wasteful use of limited resources.

Recommendation: Allow low-income 11th-graders to establish accounts for career preparation programs. We propose allowing low-income high school juniors preparing for technical careers to stretch their final two years of high school funding to one or two years beyond high school. Those meeting academic benchmarks and accepted into state-approved youth apprenticeship and work-based learning programs could receive an account from their school district valued at two years worth of educational funding.

Students could combine their education accounts with matching funds from employers, scholarships, training programs and job earnings to finance a three-year or four-year integrated program of academics, technical courses and part-time work with a participating employer in their chosen occupation. Based on an approved Individual Education/Training Plan developed with the help of parents, employers and school counselors, they could choose the best available courses and training from their local school, colleges, employers and other sources.

Several dozen youth apprenticeship and work-based learning programs are operating or being developed in Minnesota by local business-education partnerships, responding to Minnesota industries' need for more skilled employees, and to the need of young people for new options. Our proposal would motivate more low-income youth to participate by enabling them to shape their own program and guaranteeing them seamless financial support beyond high school. The program would be fiscally neutral for the state education budget.

Expanding choice for schools and districts

Beyond the benefits to students who choose another school, expanded choice offers both challenges and opportunities to all public schools. But to fully seize these opportunities, the state should allow both districts and schools the flexibility to adapt and improve to meet the challenges of expanded competition. School districts have asked for a level playing field. Our proposals give them several options to achieve just that.

Currently, schools and boards of education are limited by state and federal mandates. Districts are required to "purchase" learning services, in effect, only from the schools they own. To enable both school boards and individual schools to improve the learning program they offer, they need choice too.

Recommendation: Allow school sites to make decisions about management and funding. All individual public school sites should be given the authority, so long promised, to make their own decisions about how they will meet the state's outcome requirements; and to secure their noninstructional services, such as transportation, food services, accounting and so forth, from whatever source they decide will provide the best service for the money.

Recommendation: Allow school boards to convert schools to charter schools. All public school districts should have the authority to convert any existing school to charter status, with the resulting autonomy and flexibility to decide how to best meet the state's outcome requirements and other aspects of its operations. Finance formulas should be adjusted to make sure that schools do not lose ground when they convert.

Recommendation: Expand authority of school boards to purchase instructional services and authority of teachers to market services. School boards should be authorized to purchase both instructional and noninstructional services from whatever organization they choose and provide financial incentives aimed at achieving results. Groups of teachers and other professionals should be given clear authority to form learning enterprises and market their services to schools, and to reinvest savings in their classrooms. For example, a group of science teachers could form a cooperative and negotiate a performance contract with a school or a district. If they delivered under budget, they could put the savings into new lab equipment or other classroom needs. Furthermore, school boards should be authorized to develop and offer education programs in locations outside their traditional boundaries.

Providing information and monitoring perfomance

Recommendation: Establish a comprehensive, user-friendly program to provide information to students and parents about all the schools, programs and options available to them. Increased competition will offer schools a significant incentive for improving student performance. However, the state also has an obligation to make sure parents, schools and districts all have the information they need to make appropriate choices.

Recommendation: Establish a mechanism to monitor and report on school performance. The state's movement toward new forms of accountability based on outcomes will require increased monitoring and reporting on school performance. As the number and diversity of school choices grows, this information will be of importance not only to parents, but also to policy-makers. To ensure maximum objectivity and credibility, monitoring, evaluating and reporting on school performance should be transferred to an independent agency outside the K-12 system. This effort could be funded from the current state education budget or directly by schools.

The purpose is clear. The state is committed to making schools as well as students accountable for performance. This is essential if we are to have high standards. Only when schools are accountable for student performance will standards be taken seriously.

We must also commit ourselves to tying funding to performance. Public education in Minnesota is a $6 billion annual enterprise. We simply can no longer afford to put dollars into schools or classrooms that do not deliver the best possible results for the money.

Through choice and performance-based contracts, incentives can be created to save money and reinvest in improving our children's learning.

Post-Secondary Education

Minnesotans have a long tradition of supporting high quality colleges and universities and offering wide access to them. But both the quality and access to post-secondary education could now be in peril.

For nearly a decade, higher education's share of the state budget has been shrinking, while health care, K-12 education and corrections have claimed an increasing share of public resources. In 1987, the state spent about 50 percent more on post-secondary education than health care. In 1995, Minnesota will have spent almost 60 percent more on health care than on post-secondary education. Tuition rates at higher education institutions have risen faster than the rate of inflation.

Both of these trends — the intensifying competition for public resources and the increasing reliance on private resources to finance higher education — show no sign of abating. Our projection for the 2000-01 biennium shows post-secondary education receiving $2.19 billion, compared with the $2.14 billion it receives in the current biennium. This translates to an increase of 2 percent over four years. To educators anticipating an increase in high school graduates, this will come as shocking news, which is another reminder that Minnesotans have not yet absorbed the implications of the coming fiscal crisis. How then, under these conditions, can Minnesota sustain its historical commitment to quality and access?

From 1984 to 1994, total state appropriations to Minnesota's public post-secondary institutions grew by an inflation-adjusted 9 percent, while total student enrollment (in full-year-equivalents) grew by 6.5 percent. But real tuition income increased 46 percent, more than five times as fast as either appropriations or enrollment. Real tuition rates increased 41 percent at the University of Minnesota Twin Cities and 32 percent at state universities.

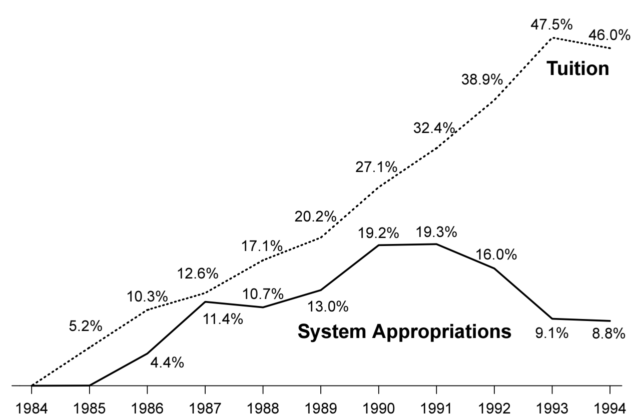
These tuition increases were partly the result of an explicit policy decision in the early 1980s. In 1983, the Governor and Legislature, faced with minor fiscal difficulty, chose to set tuition at 33 percent (on average) of the cost of public education. Tuition rose, but appropriations for student aid were increased and the state grants program was redesigned under a policy called "shared responsibility." Lawmakers set the expectation that all students shoulder 50 percent of their higher education costs; the state and federal governments would contribute up to 100 percent of the remaining share, according to the student's family financial situation.

Over the past decade, Minnesota has consistently supported financial assistance for needy students even when appropriations to public colleges and universities were cut during the recession of the early 1990s. In spite of this pattern of investment, the percentage of public resources targeted directly to students remains small. In the current biennium, 10 percent of the post-secondary budget supports grants and work-study for needy students, while 90 percent goes to the governing boards of the two public higher education systems. There is evidence that the cost of tuition is keeping some people from enrolling in post-secondary education.

Minnesota has more public institutions per capita than most states its size. Many of these institutions are inefficiently sized and located in geographic areas of the state that are facing declining or slow population growth. Nineteen of the state's 66 public campuses are located in the region stretching from St. Cloud through the Twin Cities to Rochester, a region that will produce 75 percent of all high school graduates by the year 2009.

The state's current pattern of investment in post-secondary education does not provide adequate incentives for colleges and universities to deliver education services in an efficient manner that responds effectively to the needs

Students Pay a Greater Share of Education Costs
Percent Change since 1984



Note: All figures have been adjusted for inflation to 1984 dollars.
Source: Minnesota Department of Finance

and demands of the citizen-consumers. The Governor's and Legislature's recent decision to tie a portion of colleges' and universities' appropriations to performance outcomes is a step in the right direction. But this kind of marginal change in budgeting practice is not radical enough. Nor does it concentrate public resources in the hands of citizens who are least able to afford an investment in post-secondary education from their own private resources.

A powerful answer to the twin challenges of providing quality post-secondary education and focusing public resources on needy citizens lies in creating a market for Minnesota's higher education institutions. Instead of letting legislative bodies or public system governing boards — government bureaus — make most of the decisions about how state funds are invested in post-secondary education, the majority of public funds should be put directly into the hands of citizens looking for education and training. This would shift the decision-making power about program needs and campus location from central bureaucracies to local campuses serving individual consumers, and thereby strengthen the ability of public colleges and universities to compete.

Recommendation: Radically change the way state funds for higher education are appropriated by giving more to students and less to institutions. Beginning with the 1998-99 biennial budget, we propose, as does the Citizens League, that the current practice of allocating 90 percent of the state's appropriation to institutions and 10 percent to students be nearly inverted. Specifically:

- Reserve 30 percent of appropriations for direct institutional support in the form of block grants to the two public higher education systems.

- Place 60 percent of appropriations directly in the hands of citizens seeking education and training. A portion of this amount would provide Minnesotans lifetime learning grants. Not limited to public institutions, these grants could be used to pay costs of post-secondary education or training. The rest of the appropriation would be budgeted for grants to needy students to help pay tuition and expenses. The two types of aid — learning grants and need-based grants — should be thought of as replacing the bulk of the current state appropriations to institutions.

- Allocate 10 percent of the post-secondary education budget for basic and applied research and for statewide programs such as the MINITEX interlibrary loan system and telecommunications grants.

The Minnesota State Colleges and Universities now derive 65 percent of their operating revenue from direct state appropriations, which the MnSCU board of trustees controls centrally; state appropriations make up 28 percent of the University of Minnesota's operating budget. With our recommendations, the total amount of public resources granted directly to the two governing boards would decline by two-thirds. This would radically affect the role of system governing boards and central administrations. The boards would need to continue to focus on quality assurance issues and may have to provide transitional assistance to some institutions. But, these recommendations would also remove colleges and universities, particularly Minnesota State Colleges and Universities, from the protection of a central administration that has been able to guarantee that sufficient funds go to sustain even the most inefficient campuses.

While there is no guarantee that all colleges and universities will survive in this new competitive post-secondary education marketplace, state institutions must be able to compete fairly with other providers by removing the handicaps of current state administrative and regulatory structures and policies. This is particularly true in the case of Minnesota State Colleges and Universities which, unlike the University of Minnesota, are not constitutionally independent of the state.

To ensure that public colleges and universities can respond to market forces while at the same time ensuring that statewide public interests are served, we recommend that the roles and responsibilities of governing boards and campus presidents be redesigned.

Recommendation: Governing boards should set standards for institutions. Governing boards should articulate statewide post-secondary education goals and objectives and set standards of academic and management performance for the institutions under their governance. The chancellor should exercise strong fiscal oversight through auditing and must be able to hold presidents accountable for their actions.

Recommendation: Give college and university presidents more authority. Presidents must have the authority to make and be accountable for management decisions affecting academic programs and financial operations, including the authority to set tuition rates and admissions standards.

The demand for post-secondary education is increasing at a time when the government is less able and the public less willing to fund it. Without radically changing the way in which it finances and delivers post-secondary education, Minnesota will end up with a weak and unresponsive system with too many campuses delivering insufficient programs to fewer and fewer students. By nurturing competition and targeting public resources to the most needy, Minnesota can create the conditions that will nurture a vital post-secondary education system ready to respond to the needs of its citizens, businesses and industries. Nothing less than an entrepreneurial spirit is required for our colleges and universities to compete with the growing number of private vendors delivering education using new electronic information technology. If traditional higher education does not provide what students need, it is clear that nontraditional providers will.

Criminal Justice

Criminal justice spending in Minnesota has been rising at the rate of 13 percent annually from fiscal years 1986 to 1996 and could reach $810 million by fiscal year 2001. At this rate, criminal justice spending threatens to crowd out other important programs in the state budget, assuming as we do, that we do not wish to raise taxes. If policies do not change, the funds projected to be available for criminal justice in 2000-01 will not be enough to cover the expense for future offenders.

Unless we find other ways to cope with about 750 additional future inmates, costs for imprisonment in 2000-01 would have to be taken from one or more of the other major spending areas. Likewise, if appropriate alternatives to prison can be found for nonviolent inmates, the state would be able to avoid building one of the two new prisons planned in the near future. The funds instead could be devoted to education, health and crime prevention and relieve the budget pressures accordingly.

Our recommendations aim to protect Minnesotans, punish violent criminals, concentrate funding on crime prevention programs and rein in escalating costs. We believe that the concepts of competition and community could further decrease costs for the criminal justice system.

Our proposals focus primarily on state expenditures for the criminal justice system, including public defender, courts, community services and corrections. We do not focus on spending at the local level, but the proposals will reduce costs at both state and local levels of government.

The forces driving budget increases include a growing population of potentially dangerous juveniles and public perception of worsening crime, translated into ever more stringent state crime laws, judicial rulings and local decisions.

Individuals in the 10- to 24-year-old age group accounted for only 20 percent of the population in 1990, but over 50 percent of total arrests and almost 70 percent of serious crime arrests. An already strained juvenile justice system faces a rising juvenile population in the next several years through the year 2000.

The public's decreasing tolerance for criminal behavior and the perception that crime has spun out of control led to development of a series of stringent crime bills. From 1965 to 1994, the state criminal code has increased from 32 pages to 156 pages. New policies, rulings and laws have broadened the list of behaviors defined as criminal, dramatically increased the amount of time offenders serve in prison and expanded the responsibilities of criminal justice professionals.

Minnesota actually has a relatively low rate of violent crime compared to other states, ranking 37th in the nation. We lock up our offenders for longer periods of time. A national comparison shows that offenders in Minnesota serve more time in prison than in 34 other states. The comparison includes sentences served for murder, manslaughter, rape, robbery, assault, burglary and drug offenses.

The state's criminal justice system is inefficiently organized. Funding for local entities is fragmented, making coordination and consistency nearly impossible. Today we have a distorted situation in which the locally funded components of the system — law enforcement and prosecution — determine what the state-funded components — courts, public defense, probation and corrections — are obligated to process and pay.

Once a prison or jail is built, recurring operating expenses are inevitable. Minnesota spends about $200 million each year to operate 4,600 prison beds. Local governments also spend large sums to operate the 5,200 jail beds in the state. Expanding the capacity of prisons or jails not only carries an enormous one-time capital expense, but also increases future recurring operating expenses. For example, the new 800-bed prison planned for Braham in the year

2000 is estimated to have a one-time capital expense of $100 million, plus the debt cost and recurring operating costs of at least $30 million per year. Jails face similar costs. All of Minnesota's prisons are over capacity, and future inmate projections show a budget shortfall that will continue well into the next century. Continuing to build prisons and jails will come at the expense of other government functions — educating youth or caring for the elderly — and is not an acceptable solution.

Alternatives to prisons and jails can reduce the number of inmates and the need to build additional institutions. These options can be accomplished at a lower cost without adversely affecting public safety. The following recommendations apply the ideas of competition, community and concentration to the criminal justice system. They range from the pretrial stage of the criminal justice process to sentencing policy and incarceration.

Recommendation: Keep the courts focused on necessary cases by using diversion, jail screening, an infractions bureau and victim-offender mediation.

■ Encourage the use and expansion of diversion programs for both adult and juvenile nonviolent offenders. Such programs allow for a contract between the offender and sanctioning entity for community service or payment of a fine. In particular, keeping juveniles out of the criminal justice system makes them less likely to be part of it as adults.

■ Use jail screening statewide to determine which offenders should be incarcerated prior to a pretrial hearing. This proposal would open up jail space for those offenders who should not be released.

■ Build on efforts in progress to create an infractions bureau that would use civil sanctions instead of incarceration for less serious offenses. This would save both time and administrative costs for the court system.

■ Introduce victim-offender mediation for cases involving nonviolent juvenile and adult offenders. For appropriate cases, mediation enables offenders to assume responsibility and make restitution for their offenses.

Recommendation: Restore independence of the Sentencing Guidelines Commission. The Sentencing Guidelines Commission is responsible for determining appropriate sanctions for criminal offenses. The commission is a group of experts who represent the entire criminal justice system. Since 1984, the commission has been required to submit proposed sentencing modifications to the Legislature for review prior to enactment. This has had the effect of curtailing the commission's independence from the political arena. The practical result has been that legislators, legitimately responding to their constituents concerns and fearing the "soft on crime" label, have ratcheted up prison time for criminal sentences. These increases often occur without due consideration of financial resources, the long-term cost of a rapidly growing prison system and the availability of less costly ways of punishing criminals.

Potential savings in this area are substantial. In 1995, the commission proposed modifications that, without compromising public safety, would modify the sentencing guidelines to further differentiate serious and violent offenders from nonviolent drug and property offenders. The commission also recommended that more nonviolent offenders be held accountable for their crimes through local punishments including jail and workhouse time. These proposals are designed to help ensure that prison space is available in the future to keep more violent offenders incarcerated in state institutions for their full term of imprisonment. These proposals are currently being modified and refined by the commission.

The commission acknowledges that its proposal will not succeed without adequate state funding to offset the additional local costs that will result as nonviolent offenders are supervised at the county level. If enacted, the commission's modifications would have a major cost impact, saving a total of $75 million by 2001.

Recommendation: Incarcerate in county facilities those offenders with short sentences. Under current law, offenders who are sentenced to less than one year serve their sentences in county jails. However, judges often give credit for time served in county jails while an offender is awaiting trial. The result is that many offenders actually serve less than one year in the state prison system.

It is estimated that the cost to the state prison system to house inmates serving less than one year would be $105 million from 1997 to 2001. It would cost counties $79 million to house these same offenders, assuming jail space for them is available. We recommend creating new state-funded jail alternatives using private and nonprofit community-based providers. Local officials would have the option of diverting nonfelony offenders to this alternative at no cost to them. If this option was applied to 30 percent of gross misdemeanor cases, and to 60 percent of misdemeanor cases, counties would save $11 million.

The result would be to use expensive, limited prison and jail space for felons to serve their sentences. Nonfelons would be subject to alternative community-based sanctions where private vendors would contract with the counties for the administration of the program. After paying the full cost of the jail alternative, the net savings to the state budget would amount to $72 million.

Recommendation: Authorize the Department of Corrections to contract with private vendors for incarceration and institutional programming for medium-security male inmates in nonpublic facilities. Under this proposal, the Legislature would authorize the commissioner of corrections to solicit competitive bids from private vendors to house and provide programming for inmates. Private vendors would have to ensure the cost to the state is less than it would be if the state directly provided the service. We recommend that the number of inmates to be served under the proposal not exceed 500; that participating inmates be selected by the commissioner; that inmates be housed in facilities provided or owned by the contractor, not the state; and that the corrections commissioner could impose additional conditions. Assuming a cost per day of $54 under competitive bids, savings from this proposal would total $25 million between 1997 and 2001.

Recommendation: Authorize the Department of Corrections to contract with private vendors for incarceration and institutional programming for low-security male inmates in public facilities. Similar to the proposal for medium-security inmates, this proposal would allow the commissioner of corrections to seek competitive bids from private vendors for the management and operation of a state-owned correctional facility for 300 low-security male inmates. Assuming a cost per day of $45, savings from this proposal would total $4.3 between 1997 and 2001.

Recommendation: Create mechanisms to lower prison per diem costs. Recognizing that lowering prison operating costs will require difficult policy choices, efforts must continue to reduce these costs. Reducing the per diem cost of managing 4,600 inmates by one dollar has the potential of saving $1.6 million annually.

Collectively, the recommendations add up to savings of about $177 million. If they were implemented beginning in the 1996 legislative session, we could avoid construction of a $100 million 800-bed close security corrections facility now on the drawing board. Adding the debt savings from such a decision, the savings grow to $214 million.

The alternative to fundamental reform in this area is that many court services will become unavailable, cases will become backlogged, probation caseloads will increase, offenders may not be adequately supervised and prisons will be overcrowded to potentially dangerous levels. In short, needed services will be substantially curtailed and public safety will be put at risk.

The reasonable conclusion is that the criminal justice system can and must change. While fundamental change must occur, we must assure that those persons who present the greatest threat to communities are strictly supervised and punished. We must reduce costs for both state and local governments or the growth of the criminal justice system will crowd out some of our most important prevention-related programs.

Property Taxes and Local Government Aid

The current fiscal arrangement between our state and local governments was put in place 25 years ago. At that time, property taxes paid to local governments were rising rapidly. Taxpayers and local governments banded together, seeking help from the state.

In response, state government instituted a sales tax and greatly increased the income tax. Much of the new revenue from those taxes was allocated as aid to local governments. Local aid was intended to make some property taxes unnecessary, and to provide individual homeowners relief from property taxes actually paid.

Known as the "Minnesota Miracle," Minnesota's local aid was acclaimed for meeting government's responsibilities without unduly burdening its citizens with property taxes, the most unpopular source of government revenues.

Now, the Minnesota Miracle has run its course and must be replaced with a different relationship between state and local governments. In 1995, these aids constitute 13 percent of the state's general fund budget and are the third largest expenditure, after education and health. Three problems exist with the current system.

First, the state cannot afford it. Over the past 25 years, the average annual increase in state aids for property tax relief has been 5 percent. Our projections indicate that by 2001, $100 million less than at present will be available from state government for relief of local property taxes. In the future, the state will not have the money to continue even current levels of relief for cities and property taxpayers.

The haphazard allocation of funds is a second failing of the current system. Money is spread across the state, not concentrated on those cities or taxpayers especially in need. As noted in the recent splendid Citizens League report, *Building a Legacy of Better Value,* of the billion dollars annually allocated in property tax relief, only $150 million goes to needy individuals through the so-called circuit breaker program. The program sends checks to people based on their income and the amount of property taxes they pay.

A few years ago, a distinguished group of national experts studied our state's system and concluded that the allocation to cities is almost random. That is, those cities most in need — with little property to tax, or with especially serious crime or poverty — were barely more likely to receive as much state aid as did many more prosperous cities. The current program is wasteful; a more fair distribution could be achieved with less money.

The third failing of the current arrangement is the perverse incentives it contains. Though designed to give relief from property taxes, it tends to push taxes upward. Local governments, finding some of their bills paid by the state, tend to spend more. This " flypaper effect" occurs when state aid sticks to local government rather than being passed on in the form of lower property taxes.

A more complex but equally perverse incentive is brought about by the property tax classification system under which different "classifications" of property — owner occupied, rental, farm, commercial-industrial — are taxed at widely different rates. Those paying low rates can support overall increases in property taxes knowing that others will bear the brunt of them.

Over the years, the distorted incentives have yielded rising income and sales taxes. These taxes have risen, in part to cover the cost of "property tax relief," but after adjusting for inflation, property taxes are higher now than they were 25 years ago.

The coming fiscal crisis provides an opportunity to make a virtue of necessity. A smaller property tax relief system will not only be more affordable but it can be designed to be fairer and to have more sensible incentives.

Recommendation: Concentrate the state's property tax relief on needy people, not local governments. A major share of the funds now devoted to local government aid and to the homestead and agricultural credit should be transferred into direct relief to needy property taxpayers through the circuit breaker program.

Recommendation: Target aid to local governments at governments in need. Almost all local governments now get aid. In the future, aid should be directed to a smaller number of cities, especially to those that are in need. Professor Helen Ladd's study of several years ago and the recent Commission on Reform and Efficiency have shown how to target local government aid.

Recommendation: Require local governments to pass a referendum before increasing noneducation-related property taxes. Minnesota is committed to collecting a fixed or declining fraction of personal income in state and local taxes. But, since the property tax is local, the total amount collected is determined not at the Capitol, but in hundreds of city council meetings all over the state. Thus, there is no guarantee that the overall tax limit for the state will be met.

To deal with this situation, we propose that local governments be required to pass a referendum before increasing noneducation-related property tax rates. An exception should be made in order to maintain a constant levy in municipalities where market values are declining.

Recommendation: Require future property tax increases to be levied on market value. Since the present classification system is both unfair and contains an incentive to push up property taxes, it should be replaced. The Governor and Legislature should consider requiring that any future property tax increases be levied on market value, rather than using present classifications.

Recommendation: Create a new form of government — the village — to foster local competitive contracting. Cities are the most efficient level of government; many already engage in much contracting for services. All local governments will need to become more efficient in the trying times ahead. To gain the efficiencies of local competitive contracting, we propose creation by the Legislature of a new form of government, to be called a village (since technically Minnesota no longer has any villages).

The new villages, to be formed by vote of the electorate of any municipality, would have no employees except those hired to administer elections and those hired to administer the contracts through which all of the services provided by the village would be delivered.

Recommendation: Establish deadlines for governments to submit their services to competitive bid. We also propose that the Governor and Legislature establish deadlines for governments to submit a set portion of their services and products to competitive bid. For example, the Metropolitan Council could be required by 1998 to have submitted 30 percent of its activities to competitive bidding. Public employees now producing public services should be welcome to submit bids. Given their expertise we expect that they would frequently win the contracts.

Ultimately, we want to shift the power from bureaucracies back to the people. Give the people the tools and they will be more creative and more effective than centralized government.

Health Care

The challenge facing Minnesota's publicly funded health care system is simple and dramatic. Without change, spending for health care would consume every additional dollar in the state's budget, eliminating increased financing for K-12 education, corrections, post-secondary education, local aid and other vital state programs. Health and human services funding is the fastest growing part of the budget now, and is second only to K-12 education in total funding.

If Minnesota is to live within its means, we recommend that the state raise the health care budget from $3.3 billion to $4.6 billion in 2000-01. An increase of $1.3 billion would seem to be immense, but meanwhile the numbers of people eligible for state-financed health care, especially the elderly and people with disabilities, are growing rapidly. The result is that the $4.6 billion available at the turn of the century would only be sufficient to cover the current levels of spending per person. In inflation-adjusted dollars, this is a huge cut.

In part, health care spending growth is being driven by larger demographic changes in the population. But spending also is being driven by Minnesota's generous eligibility and service standards. For example, Minnesota's spending on elderly people exceeds the national average by 59 percent. The state spends 63 percent more than the national average on people with disabilities. While this may speak well of our public mindedness, the state cannot afford to sustain such programs in their current form.

Moreover, federal support, which has long subsidized state efforts, is waning. While cost estimates are inexact until Congress acts, the state is likely to receive between $2 billion to $3 billion less health aid from the federal government during 1996-2001 than had been anticipated. This represents a potential reduction of at least 24 percent by 2000-2001 from current demands. The federal cuts make the need for reform more urgent. There is no alternative to comprehensive reform.

The challenge

The challenge facing Minnesota, then, is how to slow the growth of health care spending and yet provide improved services for those who need them most. As in other areas, we propose organizing public health care reforms around the three basic principles of competition, community, and concentration. Applying these principles would transform the way in which Minnesota tax dollars are spent through the state's three key health care programs, Medical Assistance (Minnesota's Medicaid program), General Assistance Medical Care and MinnesotaCare.

As in so many other areas, Minnesota's publicly funded health care system is driven largely by providers and institutions. That is, providers and health care institutions are reimbursed largely on a fee-for-service basis. The state sets prices for certain services and reimburses providers, as long as prices are within reasonable limits.

The state acts as the funder, the regulator, and often, for people with disabilities, is the service provider. In exchange for public health care money, private providers are required to undergo extensive licensing requirements and comprehensive, often prescriptive, regulatory oversight. In addition, because of the fee-for-service model, consumers largely do not have incentives to help reduce costs.

Revenue constraint

The first step to creating a new publicly funded health care service system is to begin budgeting with the assumption that revenues will be constrained. That is, the state should cap health care spending at a certain level.

This cap would determine how much money is available for services. Setting a limit on the amount to be spent would turn on its head the current system, which now guarantees that certain services are provided and then attempts to pay for them.

Recommendation: Pool the state's buying power and require providers to bid to provide services to people with disabilities and the elderly.

The best way to create greater competition in publicly funded health care services is to give individuals more choices and greater control. Under the new model, the state would give individuals greater choices by setting up a large buying pool of consumers. It would work not unlike the way in which state employees can now choose from a menu of health plans.

The state would use this large money pool to entice providers to bid plans to provide services to elderly people and people with disabilities. Consumers could choose from a range of options. For example, one plan might offer a better prescription drug benefit. Another plan might offer more in-home nursing services. A third plan might offer more day-training hours for the disabled. The plan a consumer would select would depend on his or her particular needs. The point is to use the purchasing power of the state to help reduce costs and expand the menu of choices. Both public and private providers would be required to bid competitively. In this new system, funding would follow individuals' choices, not institutions.

Further, the state would allocate resources based on the needs of groups of individuals. For example, elderly people who require only occasional in-home nursing care would be funded at one level. Another group, such as adults with developmental disabilities who require day-training services but not residence care, might be funded at another level. The idea is to assign a predetermined cost to consumers with similar health care concerns and then allow providers to bid on services they are best positioned to deliver. An emergency pool would be established for people whose care costs exceed those expected by the state.

Recommendation: Streamline regulations and focus instead on outcomes.

The state also would help control costs and encourage competition through some deregulation. Today, the choice of providers is limited in part because of the prescriptive licensing requirements and heavy regulation. Too often, the state regulates the procedures of providers but does little to ensure good results. For example, greater value is put on documentation of care than on client satisfaction. The new message to providers will be: we care less about the means by which you ensure good results and more about the results themselves. We will focus less on procedures and more on outcomes.

Recommendation: Give consumers incentives to pursue healthy conduct.

The other way to keep costs down is to give consumers a more direct financial stake in ensuring good health. One way, for example, is to give consumers a rebate check if they pursue healthy activities, like quitting smoking. Another option is to establish Medical Savings Accounts, which would allow consumers to retain a portion of their health care allocation if it were not spent during the year.

The overriding point is to make consumers partners in cost containment by offering incentives to pursue healthy conduct, whether through a cash rebate or a credit in a savings account. We strongly encourage the Legislature to experiment with Medical Savings Accounts by proposing a pilot program for Minnesotans.

We believe that, under this reformed model, new providers will emerge from the community. For example, the Veterans of Foreign Wars might decide to establish a health care network with area hospitals or nursing homes to provide care to elderly veterans. Lutheran Social Services or Catholic Charities might very well come forward to provide expanded services to people with disabilities. Once many of the excessive licensing and regulatory barriers are removed, communities will feel free to enter the market. Consequently, health care reform, we believe, will lead to a greater range and diversity of providers, creating more options for consumers and helping to ensure quality results.

Recommendation: Take the consumer's ability to pay into account when providing services to people with disabilities or elderly people.

The last principle shaping health care reform must be concentration: that is, targeting resources to those who need them most. Elsewhere the concept is known as means-testing. The days are over when the state can afford to finance those of means at the same rate as those without means.

MinnesotaCare, of course, is already income-sensitive. But we should begin to take the consumer's ability to pay into greater account when providing services to those with disabilities or the elderly. For example, some individuals have received extensive personal in-home care services, paid for entirely by the state, even though their families' health care insurance policies could have paid the cost. In short, the taxpayers are picking up the tab that could have been covered privately. Similarly, because of generous eligibility requirements, some affluent families pay little for the health care of a son or daughter with developmental disabilities.

While means-testing might be resisted initially by some, it is absolutely essential if Minnesota is to solve its long-term budget problems and to ensure adequate treatment for the most needy.

Conclusion

The state must change its role in health care. It must move from a model that chiefly reimburses providers to one that chiefly ensures greater consumer choice. It must concern itself with outcomes and results, not means and procedures. It must give consumers greater financial incentives to invest in their own good health. It should encourage the creation of more community-based providers and it should concentrate its resources on those who most need help.

It is imperative that the reforms we are recommending be implemented very soon. The best case would be if federal changes were of a magnitude that could be accommodated in Minnesota without substantial service changes because of the efficiencies resultant from our recommendations. But we must acknowledge the possibility that even after accomplishing efficiencies a shortfall could remain. Then Minnesota would be forced to cut back on eligibility for health care benefits. In either case, doing nothing is not an option. We must begin now to reform government health care programs.

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John Brandl and Vin Weber

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