CENTER OF THE AMERICAN EXPERIMENT

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SMART BUDGETING FOR AN ERA OF LIMITS

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EXECUTIVE SUMMARY

THE MINNESOTA POLICY BLUE PRINT

PRESCRIPTION FOR PROSPERITY

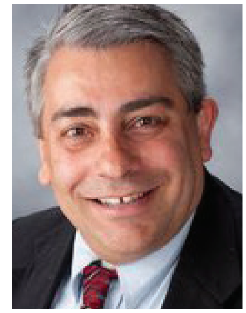
The Problem

Minnesota's state budget continues to grow and grow, even after adjusting for inflation and population. Total spending in Minnesota's current FY 2014-15 budget grew by 9.8 percent over the previous budget, which translates to a hefty $1,130 per Minnesotan. As spending grows, the state budget continues to face long-term challenges from an aging population, rising health care costs, unfunded pensions and uncertainty over federal spending.

Minnesota's competitiveness will suffer if we do not gain control of state spending. Because the state constitution requires a balanced budget, increased spending in one area must be offset either by higher taxes or lower spending in other areas. The spending required by an aging population and past promises threaten to crowd out spending in other, more economically productive areas such as education and transportation. Future budget challenges will almost certainly require higher, economically damaging taxes if nothing is done soon to control spending.

How we got here

Minnesota follows a *baseline budgeting* process. The process starts with the prior year's budget as a baseline and then adds or subtracts from the prior budget depending on available revenues. Thus, there is very little effort spent evaluating the rest of the budget and whether past spending decisions effectively deliver outcomes citizens value. Without a budget process that forces policymakers to evaluate the effectiveness of current programs, inertia carries current spending programs forward and allows programs to be expanded and new programs added when revenue permits. In effect, the baseline budget process sets the budget to grow on autopilot, which allows budgets to grow consistently faster than inflation plus population.



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The Solution

Proposals to correct the pro-spending, pro-status-quo biases in government budgeting should be based on a single principle: Spending should be evaluated based on the value of what it buys for the public.

Specific Recommendations

1. **Replace the baseline budget process with *budgeting for outcomes*.** The state budget should be determined by public priorities and evaluated based on results. In outcome budgeting, Legislators start by setting the price of government—the money available to be spent on public programs—and then establish priorities to guide spending decisions.

2. **Create a Legislative Budget Office.** An effective legislature requires a neutral arbiter of budget proposals. We propose that the Legislature create and fully fund a ***Legislative Budget Office*** (LBO) to estimate the spending and revenue impacts of proposed legislation, to prepare forecasts of budgets for upcoming sessions, and to evaluate public program performance or at least audit evaluations.

3. **Charge the Legislative Commission on Planning and Fiscal Policy (LCPFP) with taking a stronger leadership role in creating the state budget.** The executive branch has been given too much control over the budget process. It is the Legislature that provides the best forum to set priorities based on the diversity of views and values held by the citizens of Minnesota. To guarantee that future budgets best represent citizens' values and priorities, the Legislature through the LCPFP should take a stronger leadership role in setting the budget.

4. **Revive the Sunset Commission.** In 2011, the Minnesota lawmakers created a Sunset Commission to review the performance of state agencies and make recommendations for policy, organization, and structural changes. Unfortunately, the Legislature repealed the Sunset Commission in 2013. The Sunset Commission should be reinstated.

5. **Require public value impact statements**. New bills introduced to the legislature that increase spending, create new financial obligations, or impose new regulatory burdens on the private sector should be accompanied by a ***public value impact statement*** that states the chief author's intended outcomes and a means of measuring or evaluating those outcomes.

6. **Impose spending limits through statute or constitutional amendment.** To provide an anchor for the outcome budgeting process, the state should require that budgeted spending rise no faster than the average of inflation and

population growth in the prior biennium. Overriding this limitation should require supermajority support from the legislature.

How these recommendations can improve Medicaid

Nowhere is containing costs more important than in the health and human services budget and, in particular, Medicaid. Budgets for public health spending have consistently outstripped the growth of state income. How would the above recommendations apply to Medicaid, and what could be done to improve Medicaid within this framework?

1. **Start by setting the price of government and agreeing to fit Medicaid spending within that overall price.**

2. **Stop autopilot growth in the Medicaid budget.** With outcome budgeting, the Medicaid budget would not increase automatically simply because enrollment or health care costs went up. Eligibility criteria and the benefits purchased with increased per-beneficiary spending would be consciously considered against other priorities.

3. **Require Medicaid programs to accomplish specific outcomes and demonstrate progress.**

4. **Prioritize Medicaid spending based on the effectiveness of proposed programs.** With evaluations of the Medicaid program in hand, lawmakers and citizens could have a serious discussion about prioritizing funding.
5. **Gain control of the data necessary to measure Medicaid program performance.** These health plans consider certain Medicaid data to be proprietary information. As long as the information remains proprietary, policymakers cannot effectively evaluate performance.

6. **Work to gain greater freedom to prioritize and reallocate resources within Medicaid.** Medicaid is funded by both the state and federal governments, and federal funding comes with very stringent rules on how those funds are spent. Minnesota should pursue greater control over Medicaid spending to take maximum advantage of outcome budgeting.

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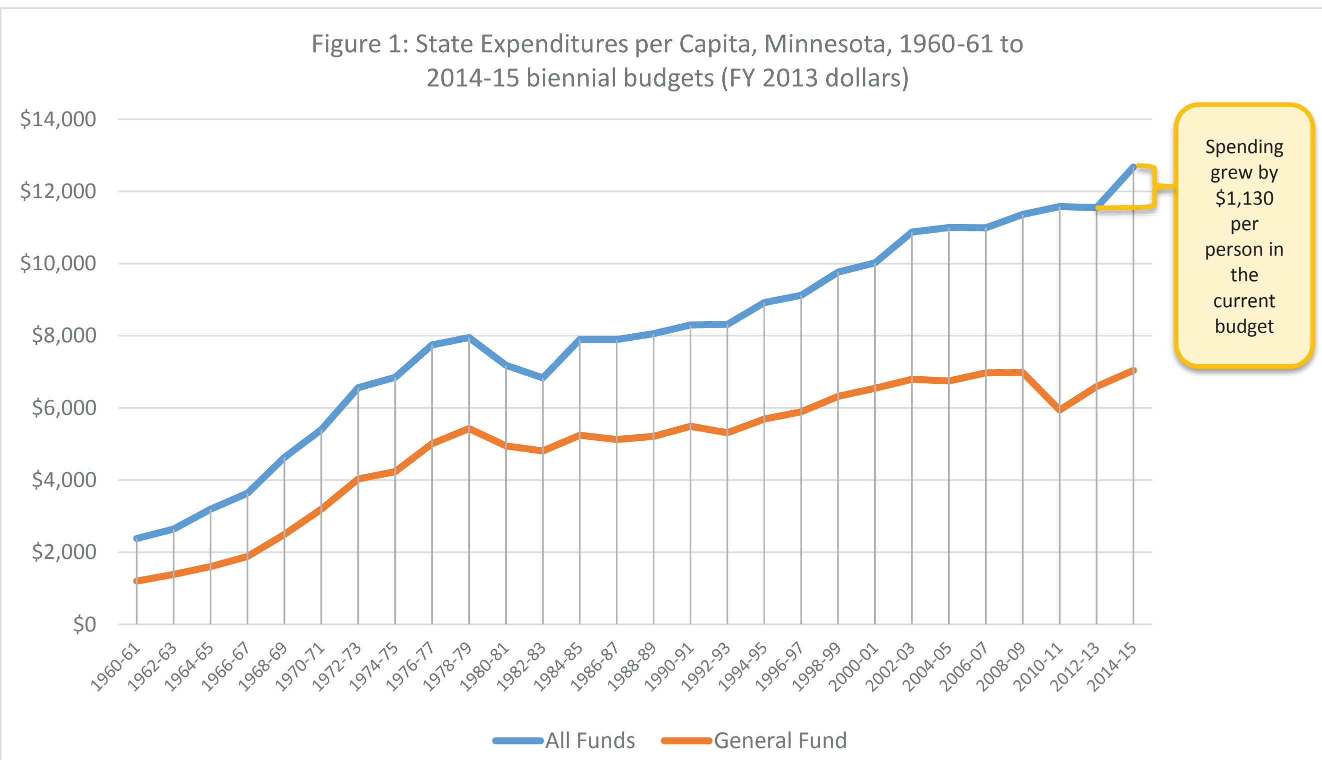
THE PROBLEM

Minnesota's state budget continues to grow and grow, even after adjusting for inflation and population. To fund this continued growth, the legislature adopted substantial, economically damaging tax increases in 2013. Despite this tax increase, Minnesota's budget still faces future challenges from health care cost increases, baby boomer retirements, unfunded pensions, and uncertainty over federal funding. The current budget process allows state spending to escalate on autopilot and fails to assess whether all this spending delivers good results. Minnesota can no longer afford to spend on autopilot.

Spending continues to grow unabated. As shown in Figure 1, state spending took an aggressive turn upward in the current budget as total spending from all funds grew by 9.8 percent, which translates to a hefty $1,130 per Minnesotan.[1] This is the largest percentage increase in total spending since the 1984-85 budget.

The main takeaway from Figure 1 is that state spending since 1960 (adjusted for both inflation and population growth) basically only goes up and up and up. The recession of



Source: Author calculations based on Minnesota Management and Budget, Spending History, 1960 to Present (May 2014), available at http://mn.gov/mmb/images/Spending_history_May2014.pdf; Minnesota Management and Budget, Minnesota Annual Forecast Data (February 2014), available at http://mn.gov/mmb/forecast/forecast/economic/; Massachusetts Institute of Technology, "Cost Indices," at http://web.mit.edu/ir/cost_indices/index.html; and U.S. Census Bureau, "Population Estimates," available at https://www.census.gov/popest/.

the early 1980s is the only exception. There are times when growth stalls, but the long-term trend clearly points up.

State spending as a portion of the state's economy is projected to set a new record in 2014. Between 1980 and 2013, state spending averaged 9.9 percent of the state's gross domestic product (GDP). Based on GDP projections in the February economic forecast, state spending will hit 11.2 percent in 2014. Because the state's GDP represents such a huge number, this small percentage difference represents a big change in the budget. Minnesota would be spending $6.8 billion less in the current budget if spending as a percent of GDP were 9.9 percent.

The budget still faces long-term challenges. Currently, the budget is balanced and projected to remain balanced into the 2016-17 budget cycle. Nonetheless, there are long-term challenges to future budgets that will be much more difficult to address if spending continues on its current trajectory.

- **Aging population.** Retiring boomers pose the most serious challenge because they have an impact on both the tax and spend sides of the ledger. On the tax side, the state will collect less revenue from boomers as their incomes decline during retirement. On the spending side, boomers will eventually increase demand for Medicaid long-term care services. Speeches by former state economist Tom Stinson and former state demographer Tom Gillaspy have warned repeatedly that rising health care costs are the natural outcome of the aging of the boomers.[2]
- **Health care costs.** Annual growth in health care costs has slowed since the start of the recent recession. However, growth is projected to accelerate as the economy improves. The most recent projections estimate public health care spending in Minnesota will increase 7.5 percent annually, on average, from 2012 to 2022 and private spending will increase 6.1 percent annually, on average.[3] These costs are driving the growth in health and human services spending. The financing for those costs has been made more uncertain by the recent, wrenching changes to federal programs for health care under the Affordable Care Act.
- **Pension liabilities.** The state's reported unfunded pension liabilities are estimated to be $17.3 billion.[4] If this liability is not managed properly, the state will need to fund costly pension bailouts. Accounting practices, though legal, permit the state to delay recognition of these liabilities. When finally recognized, they will either require massive tax increases or crowd out other budget items.
- **Uncertainty over federal funding.** Much of the state budget depends on federal matching funds and these funds—especially transportation and Medicaid—are increasingly at risk as pressure to cut the federal deficit grows.

The current budget substantially increased taxes to fund new spending. To fund spending increases, the Minnesota Legislature passed and governor Dayton signed $2.1

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billion in new taxes in 2013. At the time, the economic forecast projected a deficit of only $627 million. Thus, these new taxes went to support $1.5 billion in new spending. Since that time, revenues came in higher than projected; therefore, lawmakers were able to repeal about $500 million of taxes passed in 2013, including business-to-business taxes and the gift tax. Nonetheless, most of the 2013 tax increase was left in place, and the budget includes at least $1.5 billion in new spending.

Maintaining Minnesota's high tax rates is increasingly difficult as Minnesota businesses compete in a global market. Globalization puts pressure on government at all levels to reduce taxes on mobile resources, including labor and capital. One measure of the cost of our tax environment is when Minnesota businesses move or expand elsewhere. These costs are visible. It may be more damaging for the state to have businesses start elsewhere or not consider moving here. We cannot know how many there are, but it does long-term harm to the economic health of the state. Other states in our region have recognized this and have started to take substantial steps to control spending to remain competitive. Minnesota and Illinois, alone among Midwestern states, have failed to respond.

Minnesota's competitiveness will suffer if we do not gain control of state spending. Because the state constitution requires a balanced budget, increased spending in one area must be offset either by higher taxes or lower spending in other areas. The spending required by an aging population and past promises threaten to crowd out spending in other, more economically productive areas such as education and transportation. The budget challenges outlined above will almost certainly require higher taxes if nothing is done soon to control spending. And there certainly won't be room to lower taxes to make Minnesota more competitive with other states and countries. The resulting decline in economic growth will reduce revenue, creating a vicious cycle.

HOW WE GOT HERE

Why does the Minnesota state budget have an inflationary bias?

The baseline budget process fails to evaluate performance and value. Minnesota follows a *baseline budgeting* process. The process starts with the prior year's budget as a baseline and then adds or subtracts from the prior budget depending on available revenues. The process focuses on the margins of the budget—only the items subject to being cut or added. Thus, there is very little effort spent evaluating the rest of the budget and whether past spending decisions effectively deliver outcomes citizens value.

The baseline budget sets the budget to grow on autopilot. Without a budget process that forces policymakers to evaluate the effectiveness of current programs, inertia carries current spending programs forward and allows programs to be expanded and new programs added when revenue permits. In effect, the baseline budget process sets the budget to grow on autopilot, which allows budgets to grow consistently faster than inflation plus population. On autopilot, dysfunctional programs rarely go away, and mediocre programs never go away. New ideas also struggle for fair consideration in this process because the inertia of current spending programs shoves them aside.

There is no strong institutional barrier to spending growth. The only institutional barrier to autopilot spending growth is the state constitution's requirement of a balanced budget. State government cannot borrow money long term to finance current spending. While this keeps Minnesota's public debt low, it does not effectively contain spending. Instead, it produces "accounting ingenuity" when revenues fail to keep pace with spending. Be it school shifts, tobacco bonds (which pull forward a stream of dedicated revenue to the moment of crisis), or promises of revenue from unreliable sources, the state manages to squirm, wiggle, shift, and slide around periods when revenues fall short of spending, without actually cutting spending.

> "*Balanced budget requirements seem more likely to produce accounting ingenuity than genuinely balanced budgets.*"
>
> -- Thomas Sowell.

State agencies lead the process. Another issue with the budget process is that state agencies—the agencies asking for money—lead the budget process. The process starts with Minnesota Management and Budget (MMB)—the state's finance agency—preparing and providing budget instructions to state agencies in July. As a courtesy, MMB sends the instructions to legislative finance committees, but the committees are not charged with responding at this point in the process. State agencies work through October to prepare budget documents based on the governor's goals and priorities and then work with MMB to refine their budgets into December—again, all without input from the Legislature.

When the Legislature does become involved in the budget, it does not have great information. It must wait to receive the November economic forecast (usually released in December) and then receive the budget from the governor in January. Only then, with five and a half months to the end of the biennium, does the Legislature become actively involved in the process. And it still must depend on the agencies for the information to make budget decisions.

Fiscal notes present a particular information problem. State agencies develop fiscal notes to estimate the costs attached to bills, which is vital to understanding how a bill will affect future spending. Executive branch agencies under threat of reform have significant incentives to overstate the costs of reform and are not required to state the benefit envisioned. This has led to what is known in the Legislature as bills suffering "death by fiscal note."

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Past efforts at performance budgeting have failed. Because the baseline budget process fails to evaluate the performance of state programs in any meaningful way, Minnesota has tried to use some variation of performance budgeting since the mid-1970s.[5] Budget instructions to the agencies from the executive branch, however, have consistently changed how outcomes would be measured, how those measurements would be placed in budget documents, and how budgeting decisions would be affected by these measurements. In 1991, Governor Arne Carlson attempted to improve those efforts by creating Minnesota Milestones. The Milestones initiative had 5 themes, 20 goals, and 79 performance measures with 30-year targets for each. There were public hearings, and a citizen panel to create those themes, goals, and measures. However, a 1994 legislative audit report indicated that the agencies and the legislature found the Milestones "had a limited impact on the 1994-95 budget."[6] It was too difficult, they concluded, for committees and agencies to use the Milestones. The effort foundered and was abandoned.

For the current FY 2014-15 budget, state agencies were instructed to "focus on performance measures and how agency's strategies contribute toward high level outcomes for the state."[7] This is a positive development, but it remains to be seen whether these are serious efforts to evaluate performance or if they will be ignored and abandoned like past efforts. Furthermore, there is no requirement to prioritize spending items.

The high level of information necessary for performance evaluation remains the biggest impediment to implementing a budget process that regularly and systematically evaluates programs and then prioritizes spending based on value provided to citizens.

However, the executive branch poses another impediment. Because the agencies currently lead the budget process, and because the process provides the agencies with steadily increasing revenue regardless of performance, the agencies are largely satisfied with the status quo. Any change would likely mean giving up some control to the Legislature.

THE SOLUTION

Proposals to correct the pro-spending, pro-status-quo biases in government budgeting should be based on a single principle: Spending should be evaluated based on the value of what it buys for the public. Bringing that about will require a number of institutional changes.

1. **Objectively evaluate spending proposals.** There should be a neutral evaluator of the cost and effectiveness of programs. Using the agencies that will bear the reductions to evaluate potential savings leads to a systematic bias against spending reduction.

2. **Categorize spending by what we buy, not what we spend.** Many activities and programs in different agencies aim at the same goal, but their budgets remain in separate departments, with budgets determined by separate legislative committees. Silos abound in state budgeting. To evaluate what we spend on transportation, for instance, requires going through state, county, and local budgets with money coming from special funds as well as general revenues. A mechanism must be developed to evaluate these different programs and revenue sources together.

3. **State what an increase in taxes buys in very clear terms**. In 2011, we had a debate over the size of the state budget without a clear statement by those favoring higher spending of what it would buy for the public. In 2013, a new legislature enacted tax increases without specifying the public benefits to the state. There was no list of "if we have extra revenue, this is what we will do with it," or "if there is less revenue, here's what we would reduce." As a result, the public was under-informed about the costs and benefits of the higher spending and taxes.

Our proposal addresses these three institutional shortcomings.

Specific Recommendations

1. **Replace the baseline budget process with *budgeting for outcomes*.** The state budget should be determined by public priorities and evaluated based on results. Yet as discussed above, Minnesota uses prior budgets as a baseline and never intentionally or systematically reviews priorities. Rather than have a budget start with the amounts spent in the previous budget and propose changes, the state should change to an outcome-based budget process.

   In outcome budgeting, Legislators start by setting the price of government—the money available to be spent on public programs—and then establish priorities to guide spending decisions. When requesting funding, agencies must develop proposals linked to public priorities and demonstrate that the requests produce the best results for the money. Reducing cost and increasing effectiveness would make it more likely an agency's activity will be included in the budget. This would work only if managers of programs and activities—middle-level state employees—were convinced that leaders would not simply use their savings to reallocate money to pet projects. There must be commitment by a governor and legislative leaders to a rigorous, objective evaluation of the effectiveness of particular spending in meeting stated public priorities.[8]

   Outcome budgeting removes the concept of a "base" level of spending, which means prior spending programs are no longer presumed to have an entitlement for future spending. As a result, outcome budgeting turns off a key driver of autopilot spending growth. More importantly, removing the concept of base spending subjects public programs to regular assessments of whether they are actually achieving the results the public and policymakers expect.

There are a variety of outcome budgeting models available, such as public service agreements in the UK or the "priorities of government" program in Washington State.[9] As outlined by Marc Robinson and Duncan Last in a report for the International Monetary Fund, at a minimum the budgeting system should require these elements:

- A "strategic" priority-setting phase early in the budget cycle
- An expenditure review process
- Systematic scrutiny of new spending proposals
- Information on efficiency and effectiveness to support budget submissions
- Introduction of a program budget structure
- Increased managerial flexibility to meet priorities[10]

While to be sure linking performance to the budget is much more difficult than this list above, as Robinson and Last indicate, it should still be a goal to find links where feasible.

In addition to this list, it is also crucial that the process start with setting the price of government up front.[11] The budget is then set and prioritized to live within those means.

Why would this work, while Milestones failed? The model has worked in Washington in no small part by having themes or goals prioritized. Where the Milestones failed, in our view, is in its lack of agreement on priorities. Prioritization is necessary to inform budget decision-makers of which purchases are in and which are out.

Outcome budgeting offers tremendous advantages over the current budget process. The process would force leaders to state their priorities and periodically rethink the outcomes that matter most to the public. More importantly, this process would make public programs truly accountable for results because they would have to meet clear and objective performance measures. Finally, outcome budgeting would improve the public conversation. By starting with a focus on results that citizens value, the conversation would focus on what's working and on satisfying a stated set of public priorities.

2. **Create a Legislative Budget Office to manage and prepare the information necessary to create budgets.** An effective legislature requires a neutral arbiter of budget proposals. We propose that the Legislature create and fully fund a

Legislative Budget Office (LBO) to estimate the spending and revenue impacts of proposed legislation, to prepare forecasts of budgets for upcoming sessions, and to evaluate public program performance or at least audit evaluations.

The LBO should be run entirely by nonpartisan staff. Within government, it is our view that nonpartisan staff in the Legislature have proven to be the most reliable resource for fair and unbiased information. Therefore, it seems wise to take greater advantage of this valuable resource.

Moving in this direction would align Minnesota with the 31 states that rely primarily on the Legislature to estimate the budget impacts of proposed legislation.[12] This supplements rather than replaces MMB and other state agencies. The law must require state agencies to provide information to the Legislature in a timely fashion. The LBO would work in concert with the existing Legislative Commission on Planning and Fiscal Policy, which would conduct work in much the same way the federal Joint Committee on Taxation operates.

3. **Charge the Legislative Commission on Planning and Fiscal Policy (LCPFP) with taking a stronger leadership role in creating the state budget.** The executive branch has been given too much control over the budget process. Executive agencies are the "first mover" in setting budget targets and control the information. It is the Legislature that provides the best forum to set priorities based on the diversity of views and values held by the citizens of Minnesota. And that is why the state constitution gives the Legislature the exclusive power to enact laws, including taxing and spending policy. To guarantee that future budgets best represent citizens' values and priorities, the Legislature should take a stronger leadership role in setting the budget. Five state legislatures create budgets independently of their governors, and four of those five states depend on a joint budgeting committee much like the LCPFP.[13] For the LCPFP to create budgets independently of the governor, the resources of a Legislative Budget Office or something similar would be necessary. The Legislature should move in this direction.

   More immediately, the Legislature should charge the LCPFP with taking a stronger role in coordinating with the governor's office throughout the budget process. In fact, the LCPFP should lead process by holding budget hearings during non-budget sessions. These hearings could be used to start the outcome budgeting process and to develop budget instructions based on outcomes for agencies to follow. In this way, the non-budget session would become the program-evaluation session, and the LCPFP would gain a far more elevated and constructive role in the budget-setting process. After the session concluded, LCPFP should continue meeting to provide ongoing input and oversight.

State law already empowers the LCPFP to take a stronger leadership role. According to current law:

> All departments, agencies, and education institutions of the executive and judicial branches must comply with a request of the [LCPFP] for information, data, estimates, and statistics on the funding revenue operations and other affairs of the department, agency, or education institution. The commissioner of management and budget and the commissioner of revenue shall provide the commission with full and free access to information, data, estimates, and statistics in the possession of the Management and Budget and Revenue Departments on the state budget, revenue, expenditures, and tax expenditures.[14]

Thus, the LCPFP basically has the power to subpoena the information necessary to begin setting a new budget, either alongside or ahead of the governor. Moreover, state law specifically directs the LCPFP to provide the Legislature with budget information and oversee the governor's budget proposals. The major obstacle is funding. The LCPFP would work best in coordination with a fully funded Legislative Budget Office.

4. **Revive the Sunset Commission.** In 2011, the Minnesota lawmakers created a Sunset Commission to review the performance of state agencies and make recommendations for policy, organization, and structural changes. Instead of reviewing agencies all at once, it evaluated agencies one at a time on a schedule. This was the first time agencies were required to present anything looking like a priority/outcome-based budget.[15] Unfortunately, the Legislature repealed the Sunset Commission in 2013. The Sunset Commission should be reinstated. Any money saved could be freed to support higher priorities, which would certainly include lower taxes. If outcome budgeting were adopted, the Sunset Commission would be an important part of this process.

5. **Require public value impact statements**. New bills introduced to the legislature that increase spending, create new financial obligations, or impose new regulatory burdens on the private sector should be accompanied by a ***public value impact statement*** that states the chief author's intended outcomes and a means of measuring or evaluating those outcomes. Those would be used by the Sunset Commission, the Legislative Budget Office, and the Legislative Commission on Planning and Fiscal Policy (LCPFP), which collectively are charged with increasing legislative oversight and visioning of public spending in Minnesota.

6. **Impose spending limits through statute or constitutional amendment.** Thirty states operate under some type of tax or expenditure limitation. Minnesota does not. Decades of expenditure growth that consistently and substantially exceeded

inflation and population growth suggest that Minnesota lawmakers need help reigning in spending. To provide an anchor for the outcome budgeting process, the state should require that budgeted spending rise no faster than the average of inflation and population growth in the prior biennium. Overriding this limitation should require supermajority support from the legislature. Such expenditure limits have been used successfully in Alaska, Nevada, Ohio, Utah, and Washington. In Washington's case, we believe the spending cap has been vital in the success of the state's Priorities of Government program.

How these recommendations can improve Medicaid

Nowhere is containing costs more important than in the health and human services budget and, in particular, Medicaid. Budgets for public health spending have consistently outstripped the growth of state income and consumed a larger and larger share of the state budget. Looking to the FY 2016-17 biennial budget, health and human services spending is projected to grow $1.202 billion—10.6 percent more than current spending.[16] This represents 72 percent of the total projected growth in spending.

It bears repeating that the recommendations offered here are not only about saving money. All of these recommendations are aimed at providing better results for the people served by government programs and the taxpayers who fund them.

How would the above recommendations apply to Medicaid, and what could be done to improve Medicaid within this framework?

1. **Start by setting the price of government and agreeing to fit Medicaid spending within that overall price.** Instead of starting from the prior budget's baseline plus natural cost increases, future budgets should start by deciding how much money there is to spend, just as any family or business would do. The revenue forecast offers an ideal starting point, but lawmakers could decide to adjust the price of government up or down by increasing or reducing taxes. The amount of Medicaid spending would then have to fit within this aggregate price and compete with other government priorities.

2. **Stop autopilot growth in the Medicaid budget.** Baseline budgets assume current spending and planned increases will carry forward. In Medicaid, that means the budget assumes eligibility levels and benefit levels set in law carry forward into the new budget. It also assumes any increase in the cost of delivering services is a given. As discussed above, this baseline approach almost always leads to higher spending. For instance, current projections for the Medicaid Medical Assistance program estimate costs to the state's general fund will increase by $1.053 billion in the FY 2016-17 budget. Some of the factors driving this change include an estimated 254,673 more people would be eligible on an average monthly basis.[17] In addition, average payments per

person are projected to increase by $67 per month, or $804 per year. With outcome budgeting, the Medicaid budget would not increase automatically simply because enrollment or health care costs went up. Eligibility criteria and the benefits purchased with increased per-beneficiary spending would be consciously considered against other priorities.

3. **Require Medicaid programs to accomplish specific outcomes and demonstrate progress.** Outcome budgeting generally requires lawmakers to define five to ten high-level strategic outcomes and indicators to measure progress toward meeting those outcomes. The Medicaid program probably would focus on achieving outcomes based on the health of Minnesotans in the program. To that end, Medicaid would need to demonstrate whether the many programs and benefits actually improve the health of beneficiaries, and at what cost, and whether there were alternatives that could do a better job. This would give lawmakers and citizens information necessary to judge the effectiveness of various components of the Medicaid program

4. **Prioritize Medicaid spending based on the effectiveness of proposed programs.** With evaluations of the Medicaid program in hand, lawmakers and citizens could have a serious discussion about prioritizing funding. Importantly, this conversation could be about what the state can do to get the most from the money lawmakers decide to spend. The conversation should focus less on what is to be cut and more on whether the benefit of certain spending is a higher priority than the alternatives.

5. **Gain control of the data necessary to measure Medicaid program performance.** One of the main obstacles to adapting outcome budgeting to the state's Medicaid program would be collecting the data necessary to measure performance. Currently, much of the data necessary to measure performance is controlled by the managed care health plans that run Medicaid. These health plans consider this to be proprietary information and have fought hard in recent years not to give it up despite a congressional investigation into their practices. As long as the information remains proprietary, policymakers cannot evaluate performance. The state should require health plans to provide access to the data the state needs to judge the effectiveness of public health care programs. One way to get the data would be simply to stop contracting with managed care health plans and move to a self-insured model used by large corporations like Target and General Mills. These corporations know exactly what is happening with their health plans and can assess in great detail how various managed care tools save money or improve health. The state of Connecticut made this move in 2012, and it expected to save $80 million in 2013.[18]

6. **Work to gain greater freedom to prioritize and reallocate resources within Medicaid.** The benefit of outcome budgeting is that it would require lawmakers

to assess what programs deliver the most value for each dollar spent. This process would assume the state were free to redirect dollars to higher-value uses. Unfortunately, the state is not entirely free to redirect Medicaid spending. Medicaid is funded by both the state and federal governments, and federal funding comes with very stringent rules on how those funds are spent. To gain more control over Medicaid spending, states can apply for waivers from federal rules. These waivers are usually very narrow in scope and take years to get approved. The state of Rhode Island, however, received a global waiver, which gives it greater freedom over administering Medicaid. Even greater control could be achieved if federal Medicaid funding were converted to block grants. Through a block grant, a state would receive the entire block of Medicaid funding, free from the federal government's severe restrictions on how the program must be administered. Whether through a global waiver or a block grant, Minnesota should pursue greater control over Medicaid spending to take maximum advantage of outcome budgeting.

ENDNOTES

[1] We acknowledge that some observers believe government spending should be deflated by a different price index than the consumer price index. But in a state where budgets must balance, the burden of government is based on its cost to taxpayers, not its imposition on government agencies. Much of the cost of government is under the agencies' control, but without incentives to control the cost of their inputs, the price of government is simply permitted to rise faster than the price of goods in the private sector.

[2] *See, e.g.*, Tom Stinson and Tom Gillaspy, "Minnesota and the New Normal," Presentation to Parents United for Public Schools (April 2012), available at http://www.parentsunited.org/wp-content/uploads/2012/03/120416-gillaspy-stinson.pdf.

[3] Minnesota Department of Health, Minnesota Health Care Spending and Projections, 2012 (June 2014), available at http://www.health.state.mn.us/divs/hpsc/hep/publications/costs/healthspending2014.pdf.

[4] This unfunded liability represents the most recent actuarial estimates reported in January 2014. After Center of the American Experiment cited this number in a previous report, the Retirement Systems of Minnesota claim "preliminary numbers indicate that unfunded liabilities have dropped below $10 billion." However, the Retirement Systems of Minnesota admitted they were using a market valuation to estimate the unfunded liability, not an actuarial valuation, which helps explain the dramatic difference. Officials have not come forward with preliminary numbers estimating the unfunded liability based on actuarial values and so $17.3 billion remains the most recent data. See Retirement Systems of Minnesota, "CAE Response," July 16, 2014, available at https://www.minnesotatra.org/images/pdf/CAE%20response.pdf.

[5] Minn. Stat. § 16A.11, subd 3.

[6] For a description and evaluation of early efforts, see Minnesota Office of the Legislative Auditor, *Performance Budgeting* (February 1994), p. 66, available at http://

www.auditor.leg.state.mn.us/ped/1994/perform.htm.

[7] Marget Kelly, Memo, "Subject: 2014-15 Biennial Budget, Part A: Narrative Instructions," July 11, 2012, available at http://www.mn.gov/mmb/images/Part%2520A%2520memo%2520July%252012.pdf.

[8] The Legislature passed zero-based budgeting, HF 2, in 2011 as part of its comprehensive budget, but it was vetoed by Governor Dayton and was not included in the final compromise. The Sunset Commission mentioned later was part of the budget compromise passed in July that year.

[9] Washington's priorities of government approach was directly supported by the St. Paul-based Public Strategies Group (PSG). Current and former PSG consultants have generously offered advice and support to the authors in their ongoing efforts to advance outcome budgeting in Minnesota.

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[12] Minnesota Office of the Legislative Auditor, *Fiscal* Notes (February 2012), Table A.1. available at http://www.auditor.leg.state.mn.us/ped/pedrep/fiscal.pdf.

[13] Ronald Snell, The Power of the Purse: Legislatures that Write State Budgets Independently of the Governor (National Conference of State Legislatures March 2008), available at http://www.ncsl.org/research/fiscal-policy/the-power-of-the-purse-legislatures-that-write-st.aspx.

[14] Minn. Stat. § 3.3885, available at https://www.revisor.mn.gov/statutes/?id=3.885.

[15] Margaret Martin, "Requiem for the Sunset Commission," *Politics in Minnesota*, June 5, 2013, available at http://www.americanexperiment.org/publications/commentaries/requiem-for-the-sunset-commission

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[17] Minnesota Department of Human Services, Background Data Tables for February 2014 Forecast, available at http://www.dhs.statemnus/main/idcplg?IdcService=GET_DYNAMIC_CONVERSION&RevisionSelectionMethod=LatestReleased&dDocName=id_016358

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