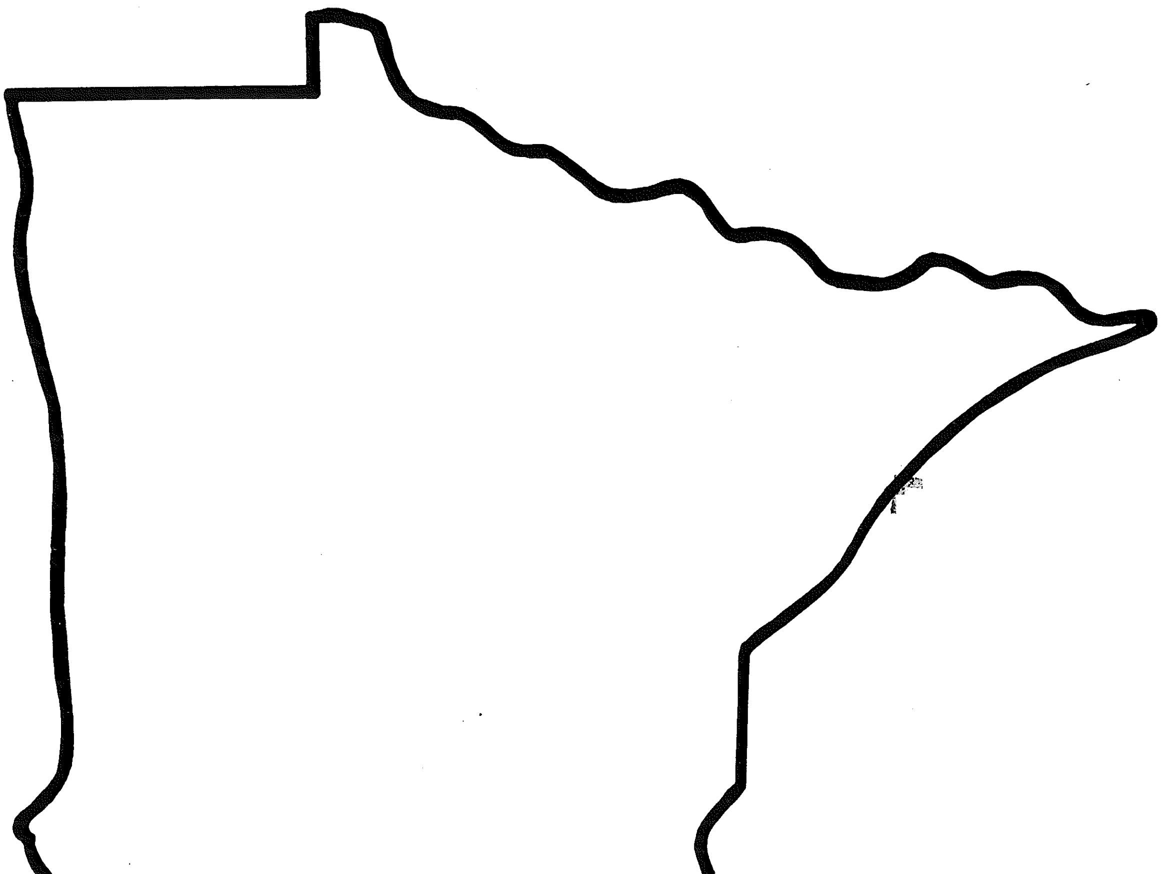
# MINNESOTA HORIZONS 1983

# PROCEEDINGS



# MINNESOTA IN THE EIGHTIES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Transcripts of Speeches
made to the Minnesota Legislature
January 18, 19, & 20, 1983

# MINNESOTA HORIZONS 1983

# PROCEEDINGS

**Minnesota State Documents Center**
117 University Avenue (Ford Building), St. Paul, Minnesota 55155

## PREFACE

Minnesota Horizons 1983 was a non-partisan seminar held in January, 1983 to consider a range of key issues expected to dominate state and national government debate during the 1980s. The symposium, although directed at the 1983 legislature, was broadcast live and by tape delay on Public Broadcasting Stations across the state for public viewing. A joint legislative task force, in cooperation with the Division of Planning of the Department of Energy, Planning & Development, sponsored the project. Financial assistance was received from private foundations.

### 1983 Minnesota Horizons
### Joint Legislative Task Force

Senator Don Moe, Co-chairman
Representative Irvin Anderson, Co-chairman
Senator John Bernhagen
Representative Todd Otis
Senator Tom Nelson
Representative Shirley Hokanson
Senator Randy Peterson
Representative Cal Ludeman
Senator Bill Luther
Representative Robert Haukoos

**Staff support to the Task Force provided by:**

Robert Benner, Department of Energy, Planning & Development
Bonnie Burt, Department of Energy, Planning & Development
Jim Waffler, House of Representatives
Vic Moore, Senate

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(AGENDA)

# INTRODUCTION

## Minnesota Horizons
## January 18, 19, 20, 1983*

Legislative leaders have set aside these three days to consider the fundamental implications of the many problems they are sure to face in the 1980s. Called "MINNESOTA HORIZONS 1983," and patterned after a similar session held in 1975, it is designed to take a fresh look at Minnesota's economy in order to sort out those factors most responsive to state initiatives. It is not designed to critique existing policies or to propose new ones, but rather to present challenging information and opinions on alternative futures for Minnesota. Presentations will include facts and opinions on a wide range of issues from potentials for economic recovery and development to state and local fiscal problems; from environmental concerns to opportunities for the development of our natural resources; from the changing nature of Minnesota's population to needs for human services and education.

The first day will open with a broad view of Minnesota's economy. This will form the basis for a discussion of Minnesota's economic future as a part of the national economy and in view of its own unique characteristics. Following the scheduled break, this session will continue with a general overview of Minnesota's historical development, a presentation of demographic trends (with emphasis on labor force projections), and will conclude by analyzing the effect of these trends on Minnesota.

The second day will shift to a discussion of more specific issues beginning with a review of the economic development and environmental aspects of our natural resources. This will be followed by specific presentations on key sectors: agriculture, energy, housing, and the public infrastructure.

The third and final day will begin with a look at Minnesota's human resource needs through presentations on education and human services. Emphasis will be on the extent to which our education and human services systems are compatible with the demands of the 1980s, drawing on the social and economic trends presented in previous presentations. We will then move to a presentation on the state and local fiscal issues associated with financing Minnesota's public services.

Horizons 1983 will conclude with a wrap-up presentation to summarize the three half-day sessions and to suggest implications for the Minnesota Legislature as it continues to confront the challenge of the 1980s.

Horizons 1983 is being telecast live on KTCA Channel 2. It is also being carried live by PBS stations in Duluth, Appleton, Austin (tape delay), Bemidji (tape delay) and Fargo/Moorhead (tape delay).

Moderators for the home viewing audience are Ted Kolderie from the Hubert H. Humphrey Institute and Jan Falstad from WCCO radio.

*Text of Minnesota Horizons program introduction.

# The U.S. Economic Outlook and Minnesota*

Walter W. Heller
*Regents' Professor of Economics*
*University of Minnesota*

**Walter W. Heller**

I feel privileged to be the lead-off speaker in this outstanding program arranged by the State Planning Division and the Minnesota Horizons Committee. It represents another of those many constructive initiatives that set Minnesota apart from other states and give us pride in being Minnesotans.

I hope and believe that this three-day program will prove helpful to legislators in sorting out those factors, economic and otherwise, that lie **beyond** their reach but still impact heavily on Minnesota's economic and fiscal fate from those factors that lie **within** their control and require action in 1983.

My assignment is to speak chiefly about the former, namely, the likely developments in the nation's economy and our national economic policies. The raw winds of recession have chilled Minnesota's economy to the bone. That recession traces largely to the tough tight-money policies of the Federal Reserve that were initiated in 1979 to battle inflation by taking the wind out of the sails of the economy and were then sharply intensified in 1981 when deep tax cuts, coupled with the biggest defense buildup in our peacetime history, generated mountainous federal deficits. The Fed became the only anti-inflation game in town, interest rates soared, and Minnesota, like other states, took it on the chin. Interest costs zoomed, while four years of recession and stagnation ate a big hole in the state's revenue base. At the same time, sharp cuts were made in federal grants as part of the Reagan program.

The net result? Four times in the past two years, the legislature had to go back to the fiscal well to avoid going to the fiscal wall — four times, we had to have a budget fix, boosting taxes, cutting spending, and using a few ingenious accounting devices. Is the recession going to push us into our fifth budget fix?

### Recession and Recovery

The answer is: "quite possibly," even if the recession ends this morning at 10:10 a.m.! Why? Because we have been mired in an economic swamp for four long years. Today, the great U.S. economy is producing no more goods and services than it was four years ago — by all odds the longest period of economic stagnation since the Great Depression. That's reflected in factories operating at only two-thirds of their rated capacity in the U.S. today. It's reflected in, not 12, but 15 or 16 million unemployed when we take into account discouraged workers — 1.8 million dropouts from the labor force — and part-timers — over 6 million — who want to work full time. And it's reflected in $300 to $350 billion a year in lost output — about 10% of our nation's productive potential is running to waste.

Why highlight these dismal numbers? Because they tell us several important things:

- First, that it's not just the **direction** of the U.S. economy — that is, whether it's still receding or starting to recover — that's going to decide Minnesota's fiscal fate, but the **level** of that economy, that is, 10 whole degrees below normal.
- Second, it tells us that if there is to be a 1983 recovery — and I believe there is, and Gerald Corrigan will cite chapter and verse on the factors that he and I agree will generate an upturn this year — it's not the fact of a turnaround but the speed of the recovery that will tell the tale. I'll come back to that in a moment.
- Third, the dismal numbers also tell us in no uncertain terms that this is no time to be timid in national recovery policy. There is so much slack in the economy that a further easing of money and interest rates, coupled with this year's tax cuts and federal deficits, will translate into more consumer demand, more output, more jobs, and more profits — **not** higher prices and more inflation. To be sure, any

*With addendum on economic recovery.

major increase in demand has some price effects. But under current conditions, these will be minor.

- Fourth, the numbers tell us that we can stand a good deal faster recovery than we are likely to get. Recovery since World War II came out of the starting gate at an average clip of about 6% in the first year after the end of the recession. The Reagan Administration, having taken off its rose-colored glasses and put on shades, tells us that we will grow at only a 3% clip between the end of 1982 and the end of 1983.

For the first time, the Reagan economists are below the private consensus, which is closer to 4%. Just so there's no confusion or illusion about this: a 3% rate of growth from year-end to year-end would mean that 1983 as a whole would weigh in at about 1½% above 1982. A 4% growth rate during the year would put 1983 at about 2½% above 1982. To the legislators here, let me say: Always insist that your advisers tell you whether they are talking about growth (or any other time series) **during** the year or about the **year-over-year** numbers.

In any event, the vast majority of forecasters are telling you that the 1983 recovery will be weak. In fact, I have been collecting adjectives as various forecasts cross my desk, and I now have 36 of them, 36 synonyms for "weak." Let me share them with you:

"Moderate, modest, mild, muted, and miserable; weak, wobbly, hesitant, and halting; slow, sickly, sluggish, sputtering, subdued, subpar, subnormal, uneven, and uncertain; dampened, downsized, and disappointing; listless, lethargic, lackluster, lukewarm, lopsided, and lead-footed; gradual, grudging, and anemic, feeble, fragile, and faltering; restrained, retarted, reluctant, and rickety."

Let me say this: Barring a string of financial failures or an international debt default crisis, I'm inclined to believe that the White House forecast is too bleak. Especially if the consumer regains his — I really should say her — confidence, the recovery could pick up more steam later in the year.

Please don't misunderstand me. Robust recovery is not in this year's card. There are too many drags:

- With the whole world in the economic doldrums and the dollar still too strong in world markets, our exports are taking a beating, and Minnesota's agricultural and industrial exporters are feeling the pain.
- With so much excess capacity, business investment in plant and equipment is still sliding. Minnesota's machinery industry and the Iron Range, for this and other reasons, are the victims.
- State-local spending is being reined in throughout the country. A recent news report shows that 41 states reported revenues for fiscal 1983, ending June 30th, that fell $8 billion below their projections just six months earlier.
- And so far, consumer confidence has been clobbered by the highest unemployment in 40 years. Surveys show that over 20% of the nation's families were impacted directly by unemployment during the year, and another 20% expressed fears that unemployment might hit their families. No wonder they have kept their purses zipped up. But if unemployment stops growing — even if it hovers at totally unacceptable rates of 10% — employed consumers may begin to come in from the cold and start spending a little more freely. Consumer debt is way down; liquidity is up; lower interest rates are making purchases of housing, autos, and other durables more affordable (even though real rates are still very high). If consumers respond to all this — and remember, consumers account for two-thirds of economic activity, or GNP — we could see a somewhat stronger recovery.

But even that leaves you with at least three questions: First, what's in it for Minnesota?; second, if recovery gets a little friskier, won't that arouse the sleeping dragon of inflation?; and third, how should the White House, the Congress, and the Federal Reserve behave to step up recovery without speeding up inflation?

On the first point, it's no longer news that Minnesota is not shielded or sheltered from national recessions. And what's worse, we will probably lag the national recovery:

- Our farm economy, like the nation's, simply can't generate a quick comeback in the face of huge grain surpluses, high debt, and high costs of production.
- The Iron Range is caught in the grip of the domestic recession, tough international competition in steel and autos, and high energy costs — no overnight relief is in sight even though some taconite operations are re-opening.
- And many of our manufacturers — heavy industry in particular — will be lagging the nation's recovery as investment lags.

True, recovery will help, and strong recovery would help more — but realism says that Minnesota will come into its own later, not earlier, in the recovery.

**Inflation**

Won't recovery send us off to the races on inflation again? Not the way it has in previous post-war recoveries. Just stop for a few moments to consider what it would take to get a sizable inflation going again. It would have to take one of three forms:

- Excess demand in the economy — too many dollars chasing too few goods.
- External shocks or special factors like run-ups in food, oil, and other raw materials prices and spurting interest rates.
- Cost-push, especially wage costs, surging again.

None of these is in prospect, even if the economy were to recover at a reasonable pace for two to three years.

First, consider demand inflation. Far from having too many dollars chasing too few goods, it's just the opposite: too few dollars chasing too many goods. Purchasing power or aggregate demand is running $300 to $350 billion below the supply potential of the economy, i.e., below the supply of goods and services that the productive capabilities of the U.S. economy could readily provide.

What of external-shock or special-factor inflation?

- On food, the news is painful for farmers, but pleasant for consumers. No early spurt in food prices is in sight.
- Oil: Oil prices have been easing and should continue to soften. Indeed, if OPEC were to fall apart, a big

drop in oil prices might well occur. Bad news for the oil industry, for the Mexicos of the world, and for oil-vulnerable banks. But good news for the American consumer — a $10 drop in the price of oil would put $50 billion a year in the pockets of American consumers — a great spur to economic recovery — and at the same time provide further relief from inflation.

- Other raw materials: The early stirrings in raw materials prices suggest that recovery is underway, but the muted pace of recovery should keep these prices in check.
- Interest costs: These are still falling and will fall farther — a weak economy, low loan demand, and fears of a financial crisis will keep the Fed's foot off the monetary brakes and help shave another 1½ to 2 points off of short-term interest rates, even as the economy begins to recover. I'll come to long-term rates in a moment.

That leaves us with the hard core of inflation, namely, cost-push. With wage increases finally catching up with price increases, with unemployment hanging high, and with labor productivity poised to increase briskly as the economy recovers, wage-push has been and will continue to moderate. That is, average wage increases will be in the 5% to 7% range while productivity per labor hour will step up as output rises and employers hold costs and new hiring in check. The bitter price we pay for this curbing of hard-core cost-push inflation will be continued double-digit unemployment through most or all of this year.

### scal and Monetary Policy

Where lies the greatest danger of renewed inflation? It's in those gargantuan $200 to $300 billion deficits projected for the so-called out-years, 1985-88, and the possibility that we'll get used to them instead of developing policies to stamp them out as the economy regains its health. After all, when a president who promised a balanced budget by 1984 now talks rather calmly about a $200 deficit, one can see how far we've come — or gone.

As to these huge deficits, one should be clear on three things:

- First, big as they are, we can stand them in 1983 and into 1984 because they are very largely absorbing credit that the private economy is **not** using in our weak economy.
- Second, the best bet for shrinking the **overall** deficit is recovery. And the best bet for promoting recovery is for Gerald Corrigan and his Federal Reserve colleagues not to spook at the first signs of recovery and start tightening money and reversing the downward course of interest rates.
- Third, what the Fed and the country will be looking for is evidence that the White House and Congress are tackling those out-year deficits. In particular, the structural deficit — the deficit that would still be there to haunt us when recovery brings unemployment down to about 6% — has to be cut to size, has to shrink, not rise, as the economy expands.

It will surprise many of you to hear me say that the prospects for some kind of accommodation or compromise that will accomplish this objective are improving. When you hear not just Democrats in Congress but worried Republicans sounding more like Tip O'Neill than Ronald Reagan, you know that for all the conflict and seeming stalemate that we'll see in the immediate future, compromise is not all that far off. How might the White House and Congress tackle those huge out-year deficits?

- First, by balancing the Social Security budget. A compromise program that would speed up payroll tax increases, delay some cost-of-living adjustments, and apply income taxes to half the benefits for middle and upper income taxpayers is already on the table. This would cut the basic deficit by some $25 to $30 billion a year.
- Second, dropping income tax indexing would pick up another $15 to $20 billion a year by 1986-87.
- Third, some tightening of the federal income tax could produce another $10 billion a year.
- Fourth, defense spending should do its part with a $25 billion per year cutback in the defense buildup by 1985.
- Fifth, entitlement programs other than Social Security can stand about a $10 billion trimming.

So without cutting further into the bone and marrow of other social programs, one could cut the **structural** deficit by about $100 billion. And if the Fed then cooperates, economic expansion will steadily cut the **overall** or **actual** federal deficits.

With plenty of slack in the economy in the next couple of years and with both the cyclical and the structural components of federal deficits shrinking as the economy expands, interest rates can continue to ease as the economy starts on the road to recovery — and that easing can occur without arousing the economic devil within us, namely, inflation.

In particular, if those out-year deficits are cut to size and the dangers of inflation in 1985-87 are kept in check, long-term rates will come down farther. An added drop of two to three points is in prospect under those circumstances, a move that would help housing and business investment and reduce Minnesota's borrowing costs.

It can be done with a combination of political courage, a spirit of compromise, and some straight thinking by the public and its political representatives.

And while we're thinking, let's keep in mind that as we tackle these tough economic and fiscal problems in America, we do so from what is still the strongest economic base in the world. We still have the highest standard of living in the world. When exchange rate distortions are stripped away to reveal the actual flow of goods and services per person in different countries, the U.S. still stands at the peak. Using our per capita output as the benchmark, we find that the closest competitors are Germany, France, and Japan, at 90%, 80%, and 70% of our living standard.

And contrary to public impression, U.S. workers, on the average, still produce more goods and services per labor hour than any other workers in the world. Others are gaining on us, but none have surpassed us. And our unit labor costs are rising more slowly in this country than they are abroad. In the decade of the seventies, our costs rose 6% a year compared with 12% or more in Germany, France and Britain.

But it is alleged that our spendthrift governments in the

U.S. foul the nest by spending more than our competitors do. That's wrong. The latest figures show total government spending in the U.S. — federal, state, and local — running at 32% of our total output, just 1/2% ahead of Japan and far behind Germany, France, and Britain whose governments spend roughly 45% of the nation's output.

But our deficits must be bigger than theirs, right? Wrong. In the late seventies, of the seven leading industrial countries the U.S. had the lowest ratio of overall government deficits to GNP. Even with the huge Reagan deficits in the eighties, we're still the lowest except for Canada.

Does this statistical barrage prove that we're in fine shape? Not at all. But it does tell our national policy makers to stop their hand wringing, to stop being so timid, and to start putting our great economic power to work in generating vigorous recovery.

*Script for the*
*"Nightly Business Report," PBS*
*January 26, 1983*

Recovery is underway. That's the hidden good news in the seemingly dismal GNP numbers released last week. Not only is recovery here, but this first quarter of 1983 could, by the numbers, show the biggest rather than the smallest GNP gain in 1983.

That may strike you as a strange conclusion to draw from numbers that show GNP at annual rates dropping 2½% last quarter to a level actually below our output level of four years ago. Nonetheless, it figures. How?

At the same time that output was falling 2½%, final sales to consumers and business were rising over 3%. In other words, businesses were satisfying a big chunk of final demand by drawing down inventories, by depleting the stocks of goods they already had on hand, rather than by stepping up output.

But this can't go on. Inventories are getting mighty lean. Rising sales can only be met out of rising production. Let's say that final sales rise at a 2% clip this quarter while inventoriew hold just about steady instead of dropping dramatically as they did last quarter.

That tells us that to satisfy even a modest rise in demand, the real rate of output, of GNP, would have to rise as much as 5-7% over last quarter. Does that portend a roaring recovery in the rest of 1983? No.

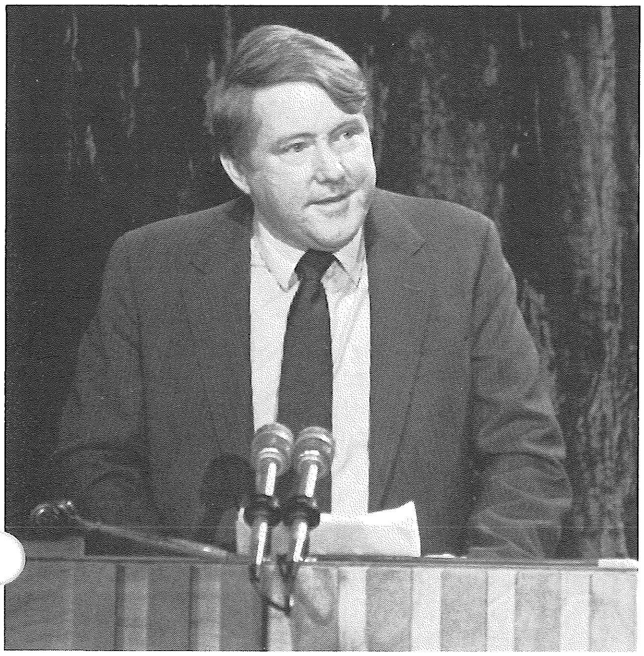
Just as last quarter's GNP numbers were not as bad as they looked, this quarter's won't be as good as they'll look. As Robert Ortner of the Commerce Department put it, "This is not the stuff that long-term recoveries are made of."

Keep your eye on those final sales numbers. Over the longer pull, GNP can't rise faster than they do. But this year, GNP growth will also reflect a swing from inventory downturn to inventory buildup. So if final sales for the year grow at 3% or so, as I expect, we can look for GNP to grow by over 4% from year-end to year-end — not great, but considerably faster than the White House forecast of only 3%.

# • THE ECONOMY

## The Minnesota Economy: A Historical Perspective and the Outlook

E. Gerald Corrigan
*President*
*Federal Reserve Bank of Minneapolis*



**E. Gerald Corrigan**

Mr. Speaker, Mr. President, Associate Justices, members of the 73rd State Legislature, Constitutional Officers, distinguished guests, and fellow Minnesotans.

I appreciate the opportunity to be with you today to examine the major economic trends which have and will have a bearing on Minnesota's economic future.

This is not any easy task, in part because the economy itself is so complex but also because it is very difficult to take what we can know and reasonably expect to understand about the national economy and break it down into digestible pieces that translate uniquely into implications for the Minnesota economy. Surely there are aspects of the state's economy which stand out: its diversity, both industrially and agriculturally; its strong resource base; its corporate base and culture, particularly here in the Twin Cities; its labor force; and its relative well-being compared to some other parts of the country. However advantageous these particular strengths may be, the hard fact is that Minnesota's economic well-being is inexorably tied to the economic well-being of the nation and indeed the world.

Elements of this interdependence were always present, but gains in technology, changing patterns of resource availability, and highly efficient worldwide financial markets have greatly increased that interdependence. Today, for example, wheat production levels in the Ukraine and the exchange value of the dollar in Tokyo have far greater implications for the Minnesota farmer and iron worker than they did a few short years ago.

In that setting, the current economic situation within the state can rightfully be viewed as an extension and a reflection of the more generalized difficulties we are facing around the country and around the world. The symptoms of those problems are all too familiar: sharply higher rates of unemployment, falling real incomes, financial strains, and perhaps most importantly, an apparent sense of skepticism about our ability or our willingness to deal with these problems in a meaningful way. I do not lightly refer to current rates of unemployment and current patterns of financial strain as "symptoms". They are surely problems of the first order in their own right, but in a more fundamental way they are symptoms growing out of earlier circumstances and earlier events. Thus, to gain a more appropriate perspective on the prospects for the future, I believe it is necessary that we pause for a moment to consider what it was in our past that produced the current and all too evident economic difficulties.

The answer to that question is at once simple and complex. It is complex because each of us can tick off a long and legitimate list of facts and circumstances that have helped to contribute to our current economic plight. Many of the events we would cite in this connection can be traced back a decade or more in time. They include the failure to face up to the need to finance the Vietnam War in a timely way; OPEC and the energy price/supply problems of the mid- and late 1970s; recurring and persistent problems with respect to deficits in our Federal fiscal affairs; intervals of excessive money and credit growth; and periodic episodes of rising interest rates sometimes associated with "credit crunches" in which the supply of credit — at any cost — virtually dried up in various sectors of the economy.

Most importantly of all, however, the decade of the 1970s witnessed a cumulative rise in the rate of inflation. Generally speaking, at each trough and peak of the business cycle the rate of inflation was higher than in the previous peak or trough. That process of accelerating inflation peaked in early 1980 when the headlines in our daily newspapers told of inflation rates running in excess of 15 percent in an environment of heavy speculation in precious metals, fine arts, wines, and other collectables.

In retrospect, it is not difficult to understand why that process of virulent inflation was associated with lower rates of savings and investment, lower — and at times —

negative rates of growth in productivity, and record high rates of interest. Nor, with the benefit of hindsight, is it difficult to see why that process of inflation was so conducive to patterns of excessive borrowing and leveraging. Taken by themselves any of these things would, at some point, have produced serious problems down the road. However, as with most economic phenomena, these elements had an interactive and cumulative effect which further complicated the situation and virtually assured that corrective actions would be difficult and painful.

What I am suggesting, of course, is that the fundamental error of our ways that most directly accounts for the severity of our current problems rests in the fact that we as a nation deluded ourselves into thinking that we could somehow live with a little more inflation. That statement, coming at this point in time and coming from a central banker, may, to some of you, strain the limits of credibility. However, and perhaps especially in the context of today's more moderate inflation, I believe it is very important that we not loose sight of that earlier experience. Indeed, I hope — and I believe — that we have now come to fully appreciate the hard fact that accelerating inflation and sustained economic growth are fundamentally in conflict. The transition from that inflationary environment has been long, difficult, and painful — in part because attitudes and expectations conditioned by ten or more years of experience do not change quickly or easily. However, failure to have made that transition would have only meant that we would again come eyeball-to-eyeball with these same hard choices a year, or two, or five from now. The difference would be that at that later date the choices would be harder and, I can guarantee you, the costs higher.

If that is a bit of an overview as to how we got where we are, what then about the outlook for economic activity in 1983 and beyond? In my judgment, the outlook for a modest economic recovery in 1983 is quite good. In the first instance, that recovery should be driven largely by consumer spending and a quickened pace of housing activity. Business spending — tempered by very low rates of capacity utilization — is not likely to provide much added thrust to the recovery for some time to come. Indeed, this is one of the reasons why the pace of expansion will be slower than experienced in the early phases of most periods of economic expansion. I also believe — very firmly — that we can achieve an expansion in economic activity in 1983 in a climate of further reductions in the rate of inflation — an outcome that is essential if we are to successfully chip away at the inflation premium built into the current structure of interest rates.

While I am guardedly optimistic about the outlook for 1983, the real issue is not the prospects for economic activity over the next few quarters; the real issue is creating and maintaining the conditions and the environment which will permit and encourage sustained noninflationary economic growth over time. On that score too, I believe there is room for some optimism.

Much has been accomplished in reestablishing those fundamentals that will permit the economy to work well over time. Inflation is down although not out; there are tentative signs that saving habits may be moving back toward more normal levels; consumer balance sheets have been strengthened; the prospects for at least near term gains in productivity are great; we have developed an appropriate sensitivity to the costs associated with excessive regulation; and, most importantly, we seem to have a clear view of the remaining problems that need to be dealt with if we are to bring or progress full circle. I spoke earlier of how the events of the 1970s interacted and cumulated to produce the subpar patterns of economic performance we are still witnessing today. The point I am suggesting here is that we are not that far from reversing that situation in such a way that events will interact and cumulate in the positive direction of lower inflation, higher savings and investment, higher productivity, and expanding real income growth. We are not yet at that point but it is, in my judgment, within reach.

Let me not deceive you, however. There are uncertainties and elements of downside risk in both the short-run and the longer run outlook. In the immediate setting, for example, consumers could retrench further as they react to high unemployment, recurring evidence of financial stress and still historically high levels of interest rates. Similarly, a financial shock here or abroad could further undermine business and consumer confidence. While these or other possibilities underscore the need for vigilance, the weight of evidence, in my judgment, solidly points in the positive direction I outlined earlier.

Longer term, it's a closer call. In that context, the potential array of problem areas is more formidable. Will we, for example, see business and labor build on the renewed sense of discipline in price and wage setting that has materialized in the past year or so? Similarly, will we see a worldwide pattern of economic growth that will support a much needed resumption in normal patterns of world trade and thereby suppress tendencies toward protectionism while helping developing countries to finance their large external debt burdens?

These and other questions are important but in a way are outside our direct and immediate control. Closer to home, the single most troubling cloud over the longer term economic outlook is the prospect of large, if not massive, structural deficits in our Federal fiscal affairs for years to come. Even assuming the best in terms of economic growth and performance between now and the 1985-1986 period, we still would be looking at the prospect of budget deficits of $100 billion or more at that time. In my judgment, this string of large structural deficits and the associated financing needs of the Treasury constitute a major impediment to achieving that pattern of sustained and balanced economic growth to which I referred earlier. The solution to the long-term structural deficit problem will not come easily for it will involve lower levels of government spending and/or higher taxes in a context in which every line in the budget has its own powerful constituent or interest group. Obviously, the Federal budget situation also has important implications for the budget problem here in Minnesota in that added Federal dollars simply will not be there to assist this or the other states in meeting their own fiscal problems.

Looking at the Minnesota economy more generally, I believe the prospects for the state's economy in 1983 are distinctly better than the performance experienced in 1982. Having said that, I will also confess that at this juncture it seems to me unlikely that Minnesota can expect to share fully in the early stages of economic recovery — primarily because it is difficult to foresee a near-term and generalized rebound of any size in farm prices and farm income.

While on the subject of the state's economy, let me digress a moment to touch on questions that have been raised regarding the future of basic industries in this country — and by implication their sources of raw material supply. Those questions reflect, among other things, the well-documented and interrelated trend toward a service-oriented economy and the intense degree of competition from abroad. While I am not willing to speculate that such basic industries as autos and steel will necessarily regain the peaks achieved in earlier years, neither am I among those who believe that our basic industries are doomed. I say that in part because our competitors abroad are not without their own problems and also because I believe that in a climate of higher savings and capital formation in this country, the needed adjustments in our basic industries can be forthcoming. I should add, however, that in these industries even more than in others, continued restraint on wages and prices must be an essential and ongoing part of the adjustment process.

An obvious implication of what I have said is, of course, that moderate economic growth here in the state will help with the budget problems, but in the near-term that help will be of modest proportions. Indeed, recent and near-term economic performance have produced two new realities for state government. The first and particularly painful reality is that state and local governments are near the short end of the financial stick. As we wind down inflation, for example, the ever present budgetary squeeze on state and local government mounts. On the expenditure side, a high percentage of your outlays are for health care, education, and services. These are precisely the areas in which achieving lower rates of inflation has proven most difficult. At the same time, relatively high interest rates and historically high levels of unemployment balloon other expenditure categories at the same time the recession — in combination with the tax structure — cuts into revenue flows. A second reality is that in these circumstances, it is my perception that the band within which you operate has been narrowed. Stated differently, if you sense that you have less freedom and fewer choices, it is my judgment you are right. Perhaps events will reverse that situation, but even if they do, it will take time. In the meanwhile, it seems to me that this situation requires that the options and choices that are left to you be exercised in a context that realistically takes into the account the "larger picture."

The reality of a narrower band of choices does not, of course, mean you are impotent. Quite to the contrary, the challenges remain, and while I have no particular insights or expertise as to how to best meet these challenges, I would offer a few brief observations:

1. Obviously, the state's budget must be balanced and it must be balanced in a setting in which — at best — added federal dollars will NOT be there and in a setting in which significant adjustments in tax and spending programs have already been made. In short, the choices will not become easier. Rather, the need for rigorous discipline will extend far into the future. To reinforce that discipline, it might be well to consider budget strategies not simply with a view toward achieving budgetary balance but also with a view toward regaining, in the shortest possible time frame, a Aaa rating for the state's bonds. This would provide a downside cushion in the budget itself and would also provide large and continuing savings in the state's interest expenses. Perhaps more importantly, it would provide both businesses and individuals with some assurances that they are not facing the prospects of recurring and unanticipated future increases in taxes.
2. Having referred earlier to the havoc that inflation has played with our national economy and the major progress that has been made in rolling back inflation, the point was made that the one area in which progress against inflation has been slowest has been in the service sector. To be more specific, the rise in prices and costs in such areas as medical care and education have hardly slowed in the past two years. Therefore, it strikes me that this is an area in which states have a particular interest and particular opportunity to help contain their own budgets while contributing to the goal of checking inflation more generally. Indeed, in the context of today's hard choices, we should not lose sight of the fact that an alternative to dismantling government or governmentally sponsored programs may be to place even greater emphasis on their cost effectiveness rather than their absolute cost.
3. If we are to have still greater success in managing our governmental affairs, it seems to me inevitable that we must be prepared to consider the possibility of paying higher salaries to **senior appointed** governmental officials. Stated more bluntly, can state government attract the "best and the brightest" — traits that are surely needed to manage large and complex institutions — when all too often the salaries paid to these individuals are, at best, comparable to middle management positions in private institutions of comparable size and complexity.
4. Last, and most importantly, it seems to me that as we consider the tough and politically charged questions of tax structure and spending program allocations, it must be recognized that the once perceived trade-offs between so-called "social programs" and "business programs" are increasingly illusionary. Do not mistake my point. Surely governments can and must provide a basic level of services and there can and should be dialogue and debate as to what constitutes that basic level. So too, the answers to that debate will differ from time to time and from place to place. However, in the final analysis, the way we tax and the way we spend must blend together to contribute to an environment that is conducive to economic growth and commercial vitality. Indeed, only in a setting of commercial vitality can we reasonably expect to provide the income growth and the tax base which will permit us to meet the social and environmental goals that have always been so closely associated with the legacy of the state of

Minnesota.

In concluding, allow me to emphasize one point. Any realistic assessment of current economic conditions must, of necessity, take account of the facts of economic and financial life. I am sensitive to the risks that in acknowledging those realities the thrust of my remarks can come across as more doom and gloom. I hope it is clear, however, that is not how I see things. To the contrary and to repeat something I said earlier, I believe that for the first time in many years, we are within reach of achieving those conditions which will permit the economy to truly work well again. Achieving the full measure of that vision will not be easy. It will take wisdom, leadership, and continued discipline. As a relative newcomer to the state of Minnesota, I can appreciate — perhaps in a different way than you — the capacity of this state and its leaders to be on the cutting edge of that process.

Thank you.

# • MINNESOTA'S PEOPLE

## Public Policy and Minnesota's Economy — A Historical View

Russell W. Fridley
*Director*
*Minnesota Historical Society*

**Russell W. Fridley**

In this brief overview of the interaction of state policy with Minnesota's economy, I begin with the great debate in the Constitutional Convention of 1857 over the configuration of the new state's boundaries. We take it for granted but party politics and public policy determined the size and shape of Minnesota. Which political party was to be the first to govern the state became an important question. The Democrats were in power in Washington, but the southern portion of Minnesota, which had by far the greater number of settlers, was dominated by Republicans. In general, they favored making the southern half of the Territory into a state, cutting off the northern half by an east-west line extending from the St. Croix River westward to the Missouri near such present-day communities as Hinckley, Little Falls and Elbow Lake. They hoped to build a railroad from Winona to St. Peter and then on to the Missouri River. They expected to make St. Peter the capital, and they probably had enough votes in the 1857 territorial legislature and a sympathetic governor to enact it. But their plans were frustrated, you may remember, by Democratic Representative Joe Rolette, a fur trader from Pembina, who disappeared with the en-[illegible]lled bill and saved the capital for St. Paul. While the [illegible]st-west faction was striving to gain its ends in Minnesota, Territorial Delegate to Congress Henry M. Rice, a Democrat, introduced a bill enabling Minnesota to adopt a constitution and become a state with longer north-south boundaries. The Rice position prevailed.

This public decision made 125 years ago profoundly influenced the course of Minnesota's economic history, for it determined the state's remarkable combination of natural resources – soil, timber, water and minerals. The outcome of that boundary battle made it possible for us to develop the increasingly diversified economy we now enjoy. It gave us iron mining, a big chunk of forest-related industries, the rich lands of the Red River Valley, and a good share of the more than 10,000 lakes so attractive to tourists. The state's location – at the center of the North American continent and at the crossroads of interconnecting rivers made Minnesota the hub of pioneer transportation, and these waterways continue to serve our economy to this day.

In rapid succession, here are a number of other examples of how state policy helped to shape the Minnesota economy:

1. Land was early viewed as a source of wealth if people would settle on it. Considerable sums were spent advertising cheap land, a "salubrious climate" and high culture. Later, Minnesota created an office of Immigration Commissioner, who recruited widely in Europe for families to settle in Minnesota.
2. Early state policy and public opinion encouraged the cutting of timber, especially the white pine of northeastern Minnesota. To the swift went the profits, and for many years people did not question that he who got there first deserved them. However, the tragic Hinckley Fire of 1894 and Christopher C. Andrews appeal for public control of forests, the perpetuation of forest growth, fire protection, state-owned forests and creating a forestry school began the impulse of conserving and taxing natural resources – an idea belonging largely to the 20th century.
3. That same Enabling Act that Henry Rice got through Congress laid a generous basis for public support of education by granting the state two sections out of every 36-section township for school lands, plus additional lands for public roads, a university and other internal improvements. Added later were state and federal forests and parks. Twenty percent of Minnesota's land area is in the public domain. For its relative age – 125 years – no state possesses so much public land. Unquestionably, this feature of the state patrimony has spurred the growth of our state as a haven for vacations, helping to promote the increasing prominence of the tourist industry in

today's economy.

4. The discovery of iron ore as early as the 1850s on the Vermilion Iron Range and the beginning of its extraction there in 1884 first led to efforts to attract "foreign" capital to mine the ore for use in eastern steel mills. A maze of tax legislation developed — first to encourage mining, later to tax ore removed on an **ad valorem** basis, still later to tax iron ore lands on a par with other properties; in 1913, tax policy was changed to an assessed valuation formula. Tonnage, royalty and occupation taxes followed as the search for an acceptable formula continued. State tax policy and eventually a constitutional amendment in 1964 wrote into the constitution protection for one industry in order to increase employment and economically revive the depressed Iron Range area.
5. Roads and railroads provide a further example. When Minnesota became a state in 1858, its principal roads were the rivers. On land, the famous Red River Trails linked the growing settlements near Fort Snelling with the British colonies in present-day Manitoba, and five so-called "military roads" were built by federal funds during the 1850s, laying the basis of our modern highway system. Though supposedly needed for "the defense of the frontier," their real purpose — much like our modern interstate system — was to foster commerce and settlement. The desire for railroads reached a fever pitch in Minnesota Territory. In an effort to capture the iron horse, territorial legislators floated a $5,000,000 loan for railroad construction. This initiative did not produce a single mile of track during the 1850s, although it was responsible for a cartoon that is the first known reference to Minnesota as "the Gopher State." It also waddled the young state with a burdensome debt — a problem not resolved until the 1870s by Governor John Pillsbury and the legislature.
6. A dramatic example of one of the state's first efforts at direct relief occurred when southern Minnesota farmers suffered recurring so-called grasshopper plagues (they were really locusts) during the summers of 1873, 1874 and 1976. It was the number one problem facing the 1877 legislature and was dealt with by identifying the affected counties, appropriating emergency relief funds and setting a precedent for a good many future relief measures providing relief from agricultural catastrophes.
7. Other state actions could be cited — checking the spread of wildcat banks that issued their own paper money, eventually leading to the establishment of the state banking department in 1909; correcting abuses in unfair grain grading, leading to the creation of the Railroad and Warehouse Commission in 1895; establishing the office of public examiner so that "Public funds were no longer available for the accommodation of treasurers and their friends having private notes to meet."

Although the foregoing examples constitute benchmarks in the evolution of public policy affecting Minnesota's economy, it was not until the devastating Great Depression of the 1930s, that large-scale relief efforts became widespread public policy. By and large, the 1930s were a period in which state governments tended to retreat from their traditional responsibilities in the field of economic policy and turn for aid and leadership to the national government. The decade saw an immense expansion in federal programs, power, and activity, and a corresponding decline in the state role in Minnesota and elsewhere.

The vital economic questions of the 1930s involved distribution, not production. The times were out of joint from a surplus of goods and services. Therefore, the important economic decisions were those which affected the distribution of income among the state's citizens and the protection through state action of groups like small family farmers and nonunion wage earners who were at a ruinous disadvantage in the marketplace.

Like that of other midwestern states, Minnesota's agricultural depression began in the 1920s. Then between mid-1931 and mid-1932 farm income dropped by half, mortgage foreclosures skyrocketed, and crops rotted in the fields because prices would not cover the cost of harvesting them. Desperate farmers, organized for direction action by the Farmers' Holiday Association, demanded that mid-eastern governors declare an embargo on all farm commodities selling below their cost of production and initiate an indefinite moratorium on farm mortgage foreclosures.

Farmer-Labor Governor, Floyd B. Olson, recognized the practical and constitutional impossibility of state action on farm prices, but he joined with other farm belt governors in pressuring the Roosevelt administration to adopt a mandatory rather than a voluntary system of price controls for farm products. The problem of farm mortgage foreclosures was also technically outside his power, but in February, 1933, the tide of mob action reached such heights that he issued an emergency proclamation suspending all foreclosures until the legislature could take action on a moratorium law. In April, the legislature extended the redemption period on past due mortgages for two years, thus intervening directly on behalf of the debt-ridden family farmer. Minnesota's action was challenged in the courts, and the U.S. Supreme Court's decision upholding the law became a nationwide landmark in the area of state powers.

The 1930s saw several other major turning points in state economic policy. One was the enactment of an income tax which laid the foundation for one of the most progressive state tax structures in the nation. Another was extension of the state's power to give disaster relief to include economic as well as natural disasters and the voting of massive relief funds. Thus, Minnesota recognized an obligation to its unemployed citizens. Another was the outlawing of "yellow dog" contracts and the use of injunctions in labor disputes. This was in line with national policy embodied in the Norris-LaGuardia and Wagner Acts, but Minnesota's changing attitude toward the bargaining rights of labor was also reflected in Governor Olson's unorthodox handling of several key labor disputes. Under the leadership of the Farmer-Labor party, Minnesota shifted from a traditional stronghold of anti-unionism and low wages to a state in which the economic influence of organized labor is greater than in most other heavily agricultural areas.

Worth noting, also, are some popular economic policies that Minnesota did not adopt. Unlike many states, Minnesota enacted no old age pension, nor, despite the socialist rhetoric of its political leaders, did it engage in any program of public ownership to stimulate employment or industrial expansion. Nevertheless, the decade of the 1930s saw a distinct change in the state's economic, as well as, its political climate. This was characterized by an attempt to redress in some measure the imbalance in economic forces that was seen to have produced the crisis, suffering, and stagnation of the Great Depression.

By the middle of the 20th century, Minnesotans long accustomed to thinking of their state as rural and agricultural awoke to find that several fundamental shifts had occurred in the state's economy. For the first time, 1950 census figures showed that the value of goods manufactured in Minnesota exceeded that of its agricultural products. The great extractive industries like lumber, mining, and to some extent agriculture, have been supplanted by manufacturing and service industries, and close to two-thirds of Minnesota's people now live in urban areas. The variety of industrial production is enormous, ranging from food processing and taconite pellets, to such "brain" industries as printing, electronics, and computer manufacture — all calling for a highly skilled work force that bears witness to Minnesota's commitment to a strong public education system dating back to its territorial period. The state has also been among the leaders of progressive taxation as well as in the first rank among states providing high quality public services — a combination of public policies that have helped to make possible the much-praised "quality of life" for which Minnesota is now known. Historians sometimes tend to isolate incidents and occurrences, and it is not always easy — even with the wide-angle lens of historical perspective — to see the interactions in economic development. We have tapped only a few of the rich veins in Minnesota's heritage to give you some examples of the impact of public policies upon the state's economy.

In looking back over this span of more than a century, it strikes me that the outstanding characteristic of such policies has been flexibility — the will to adapt to changing forces and circumstances. In the examples we have reviewed, the state's public policy toward natural resources, agriculture, transportation, banking — and the list might be expanded — was at the outset one of passive encouragement. It moved in the late years of the 19th century to a role of restraint and regulation. Perhaps it is fair to say that public policy then began to shift from reaction to action — from merely reacting to problems to attempting to change or ameliorate economic conditions. It seems to me that we are still witnessing a blend of those two public attitudes.

## Demographic Trends: 1970-1990

R. Thomas Gillaspy
*State Demographer*
*Minnesota Department of Energy, Planning & Development — Planning Division*

**R. Thomas Gillaspy**

During the past 125 years, and especially since the 1930's, Minnesota State Government has undergone major changes in its attitudes and approaches to dealing with economic and social change. To a degree, these changes result both from the greater numbers of people and from the rapidly changing characteristics of the population.

The 1980's will see some important changes in the population composition of Minnesota. Since these changes will have major impacts on the economic and social characteristics of Minnesota, we need to understand them when contemplating changes in the policies of state government.

To begin, I will discuss some past and expected future population trends in Minnesota. I will then describe some of the larger demographic characteristics of Minnesota and finally their implications for future change.

Between 1970 and 1980, the population of Minnesota increased by 7% while the U.S. increased by 11%. Much of the U.S. growth in population occurred in the "Sun Belt." Of the North Central states, including our four neighbors, Minnesota had the fastest rate of population growth.

Population change results from the interaction of three factors: migration, deaths and births. During the 1970's, more people moved into the state than moved out: the first time in several decades. Greater migration occurred in the newer suburbs, exurban fringe around the Twin Cities, and in some north central counties in the lakes region. While Minnesota loses young adults to migration, it receives substantial numbers of persons in their thirties. Some counties in the lakes areas of north central Minnesota also receive substantial numbers of older persons.

Death rates in Minnesota remain low and stable. The 1970's saw a substantial increase in longevity. For example, for women 65 years old, expected remaining years of life increased by approximately 1.5 years. The size of the increase in longevity is remarkable since Minnesota already had one of the longest lived populations in the world in 1970 and some experts believed substantial increases were unlikely.

The third component of population change, and probably the most significant for social and economic change in Minnesota, is births. During the 1920's and into the 1930's births declined to very low levels, and remained low during the early 1940's. In the late 1940's births began to rise rapidly, continued to rise during the 195( and peaked around 1960. This generation born largely during the 1950's is called the "Baby-Boom Generation." After 1960, births fell precipitously until 1973. The generation born during the 1960's and early 1970's is often referred to as the "Baby-Bust Generation." Since 1973, births have continued to increase, and should increase for a few more years and then decline again. The current increases in births are **not** due to a desire for larger families, but rather result from the large numbers of women in child-bearing years (the baby-boom generation is having children).

This boom-bust phenomenon of births results in an unusually large generation followed by a much smaller generation and is probably the most significant demographic characteristic for economic and social change. In 1980, almost one of three Minnesotans were between the ages of 18 and 34 years. Further, this characteristic is true not only for Minnesota but also for the nation. It has had a major impact on such areas as education, demand for housing, labor force and employment and politics. To examine the effects of this phenomenon, I will discuss three concepts: the life cycle, social change and expectations.

First, the life cycle describes the tendency of people to do approximately the same types of things at about the same point in their lives. People enter school at about the same age, progress through school and graduate, enter the labor force, look for housing, get married, have childr and so on, all at about the same age.

The baby-boom generation is now in its 20's and early

30's. In 1970, when the boom generation was in its teens and early twenties, secondary schools and higher education enrollments were exploding. Since then school enrollments plummeted, resulting in many school closings. At that time, the labor force began to grow rapidly as the boom generation left high school, and young people began to look for jobs in record numbers. Demand for housing rose sharply and increasing numbers of single adults entered the social scene.

The 1970's was a period characterized by the youth movement. Will the 1980's be a period of the mid-years movement?

Second, coupled with the life cycle effects of the boom generation during the 1970's, Minnesota (and the U.S. as a whole) saw major social changes. One of the most important of these was the sharp increase in participation of women in the labor force. In 1970, 43% of women 25 to 34 years old were in the labor force. In 1980, approximately 70% participated in the labor force. The result is a rapid growth of women in the labor force. Women are increasingly becoming partners in the work force; and with the increasing tendency to work away from home, comes a new sector of services to meet the needs of working women and two worker families, such as fast foods, daycare, etc.

The third major concept is expectations. What do people expect out of life? We all have a set of expectations in the back of our minds. If we do certain tasks then we expect certain rewards. Expectations are formed largely from examining the experiences of the previous generation.

The parents of the boom generation grew up mainly in the 1930's. They are products of the Great Depression. Understandably, their expectations were exceeded, while the economy of the 1950's and 1960's experienced strong growth. Their children, the boom generation, grew up expecting to get a good job, regular promotions, a nice three bedroom suburban house, country cottage, etc.

The expectations of the boom generation, I suggest, have been relatively unmet. I cannot argue whether or not their expectations were reasonable. I will argue, however, that their unmet expectations are at least partially the result of the very size of their generation. Because of their numbers, the baby-boomers have had to wait in line at almost every age.

In the 1970's, the economy strained to absorb their entry into the labor force. But to a large degree they have been absorbed in Minnesota. Between 1969 and 1981, total employment increased by almost 30%; faster than the nation and any of our neighboring states. Between 1975 and 1980, the number of business establishments increased by 11%; again faster than any of our neighbors. Per capita income increased by 83% between 1975 and 1981 and the number of families below poverty decreased by 5% during the 1970's. Average education rose sharply and the number of housing units increased by more than 26% during the decade. The boom generation has done reasonably well, but not as well as it expected.

The baby-bust generation, now largely in its teens, has seen the frustrations of the baby-boom generation and has adjusted its expectations to waiting in line longer.

What does the future look like? I do not have a crystal ball. However, we can examine some possibilities and their implications.

During the 1980's, the number of small children will increase, and the number of school age children will continue to decline. Young adults will increase, but at a much slower rate than during the 1970's. The number of persons in their middle years will increase at a faster rate largely due to the aging of the baby-boom. The number of people 65 and older will continue to increase, though at a slightly slower rate.

For state policy purposes, one of the more important departures from the past during the 1970's was the decline in school enrollments. The decline began sharply, following years of rapid increase, and resulted in such actions as school closings and reductions in teaching staffs.

The 1980's will see a continued decline in enrollments in secondary schools while primary school enrollments will begin to increase. Maintaining quality education, teaching staffs, and school buildings is always a difficult task. But in this era of sharp increases in enrollments, followed by sharp declines, followed by sharp increases, and so on, maintaining quality education becomes even more difficult. Preparing for and adjusting to such changes must remain a priority both for the state and for individual school districts.

Declines in secondary enrollments will also likely translate into declines in higher education enrollments by approximately mid-decade. The oldest members of the baby-bust generation are now entering our colleges, universities, and other institutions of higher education. These institutions have generally been geared to rapid increases in enrollments. Living in an era of declines will pose a totally new set of problems to solve.

In addition to education, changes in the labor force will be one of the most important areas of policy interest for the 1980's.

The 1970's was a period of an unusually rapidly growing labor force, exceeding 3% per year for much of the decade. These increases resulted from the aging of the baby-boom generation and the growing participation of women in the labor force. The rapid rate of labor force growth during the decade created a strain on the economy to absorb these new workers. Youth unemployment rose, workers accepted jobs at lower levels, productivity levels declined as young workers learned on the job, promotions came less often than expected, and real incomes did not rise as rapidly as expected.

We are now in a major recession and unemployment rates are very high. Under these circumstances, what I am about to say may seem unrealistic. It is difficult to forecast economic growth three or four years from now, but I do believe that we will return to a more normal economic growth pattern. As we do, we will begin to see a considerable slowing in the growth of the labor force, to approximately 1% per year by the end of the decade. This will represent a major break from past experience.

Some forecasters believe that by the end of the decade, national unemployment will be near zero. Lest you believe that this is impossible, consider West Germany's experience in the 1960's (they did not have a baby-boom). Until our economy can adjust to the slowing in labor force growth, labor shortages in some occupations and in some localities are possible.

Since we have no experience with such a situation, it is difficult to understand fully the policy effects. Certainly, we will need to be more efficient in placing workers into the most productive jobs. We will also need to be more flexible and efficient in training and retraining people for the jobs of the future, in a period of rapid technological change. We will not be able to afford workers trained for the jobs of the past. In this endeavor, education, business, labor and government must work closely together in a rapidly changing and radically new environment. We will need to tap non-traditional supplies of labor, engage in major retraining efforts to teach new occupations and skills, and encourage a geographically-spread growth to prevent new pockets of unemployment.

**A few of the other trends of policy interest include:**

1. Continued growth of the older population, especially of persons over 75 years old. For example, persons 85 and older will increase by almost 30% between 1980 and 1990, raising concerns about the living arrangements of older persons and their health and social needs.
2. Births will continue to increase until approximately 1985, a topic of interest to hospitals, day care facilities, primary schools and those supplying goods and services for children.
3. As interest rates fall and the economy returns to a more normal path, demand for housing should also begin to rise as the boom generation continues to form households. And
4. As growth continues in the north central lakes region of the state, increased competition between the population growth and the natural environment will require attention. Population change is a bit like an old-fashioned Minnesota thunderstorm. We cannot stop it, but with proper preparation we can benefit from the rain and maybe not get too wet. In the past, some population changes have caused problems for state policy because the changes were largely unanticipated. With proper foresight we should be able to accommodate and prosper from the coming population changes.

# • DEMOGRAPHIC IMPACTS

Hazel H. Reinhardt
*Vice President and Director of Human Resources*
*Cowles Media Company*

**Hazel H. Reinhardt**

Thank you for inviting me today. It is a privilege to be asked to speak for the third time at a Minnesota Horizons Program. As I reflected on my two previous presentations, I was struck by their consistency. Today's presentation is not substantively different from the previous ones, albeit the focus is narrower.

In the 1975 Minnesota Horizons program, I presented population projections and closed with a summary of some anticipated fundamental shifts in the age structure. A quick review of the population projections made in 1974 and those made in 1982 is instructive. The 1974 projection for the year 1980 was incredibly accurate. The 1974 projections for 1990 and the year 2000 have been modified downward only slightly by the 1982 projections. Over the eight years between projections, all evidence continues to point to relatively slow population growth for Minnesota. Minnesota grew by just over 7 percent during the 1970s and is projected to grow by 7 percent in the 1980s and just over 5 percent in the 1990s. These rates of growth are less than the national rates of growth. However, slower growth in this state than in the nation is not new, but a characteristic of the entire post World War II period. While these projections of relatively slow growth could be altered by changes in fertility levels, we have little reason to believe that migration will play a significant factor in the growth of this state in the remaining years of this century. Minnesota was a major exporter of people in the decades of the 40s and 50s; that trend modified in the decade of the 60s and finally in the 70s, the state experienced a slight net immigration.

The proportion of current residents who were born in this state is an indicator of our low level of net immigration. Minnesota is among the top 10 states in which 75 percent or more of current population is residing in the state of its birth.

Warning of coming changes in cohort sizes that result from past fluctuations in the numbers of births is the main contribution demographers can make to planning for changes in such areas as school enrollment, the labor market, housing, other public goods and services and ultimately to the estimation of revenues. We know that both the demands for public services and the revenues to support them grow and shrink in proportion to the population in specific age ranges.

The relatively slow growth rate in the 1970s (7 percent) conceals large variations among individual age groups. For example, during the 1970s:

- The student population (aged 5-14) declined by 23 percent.
- The college- and military-aged population (age 18-21) increased by 19 percent.
- Perspective home-buyers (aged 25-34) grew by 48 percent.
- The heaviest consumers of health care (aged 65 and older) increased by 19 percent.

The same age groups show further shifts in the decade of the 1980s. For example:

- The student population is projected to increase 3 percent.
- The college- and military-aged population is projected to decrease by 22 percent.
- Perspective home-buyers are projected to increase by a mere 14 percent, an indication of an end to the housing boom.
- And the elderly are projected to increase by 13 percent.

These shifts are no longer news to us, but their importance must not be underestimated. This demographic transition will compel a shift of societal resources away from the needs of the young and toward the needs of the elderly. As demographic change modifies whose wealth and income are redistributed to whom, it will alter the consequences of existing legislation.

At the core of societies resources is its labor force.

As we look at the labor force in the 1980s and early 1990s, what I say today may seem incongruous in the light of the current high unemployment and a mentality dominated by recession. However, the changes in the age composition of the population have the potential of creating radically different labor force issues from those of today or the recent past. Furthermore, these changes are not off in some distant future, but could appear within three to four years.

The rate of growth in the working population will slow. The 1970s saw very rapid growth in the labor force and in employment, 31 percent and 29 percent, respectively. However, the main bulge of the baby boom generation has entered the working ages (16 years and over). So the growth of the working population is expected to slow during the 1980s and early 1990s as the number of people reaching working ages each year actually decreases. Further, it is expected that women's participation in the labor force will continue to increase, but not at the revolutionary rate of the 1970s.

The magnitude of the slow down in labor force growth is best illustrated by the numbers. During the 1960s the average annual increase in the labor force was 25,000. The 1970s saw an annual average increase of 47,000, almost double that of the 1960s. Growth in the labor force was slower in the earlier part of the 1970s and very fast in the later part of the decade. In the 1980s the average annual increase will fall to the level of the 1960s, or the average annual increase will be cut nearly in half. As the far right of the (slide) graph shows, the decline will accelerate toward the end of the decade when the average annual increase will be 20,000.

This slowing of growth in the labor force will cause a tighter labor market. I hesitate to use the word scarcity although entry-level workers may indeed be in scarce supply.

A scarcity of entry-level workers may indeed bid the price of entry-level jobs up. If this happens, the job market may compete with post-secondary education for young adults, that is, high wages and good opportunities will beckon even more enticingly making the opportunity cost of staying in school rise.

A tighter labor market will result in higher real wages as employers compete for employees. Tighter labor markets will put downward pressure on unemployment, by removing the luxury of seeking and hiring the "perfect fit" for each job. I am not saying that unemployment will disappear, but in an era when labor is plentiful, employers can be more selective as to experience, credentials, and the like.

Perhaps the most important aspect of a slower rate of growth in the working population is that it so sharply contrasts with what our current experience and hence our perceptions of problems and workable solutions.

The tremendous growth in the labor force in the past decade also produced a growth in the number of taxpayers and hence revenue. Understanding the demographic factors contributing to revenue does not paint an optimistic picture for the future, but should not be ignored.

The changing age structure will also produce some very dramatic shifts in the age composition of the working population. In 1980 over half of the labor force was under the age of 35. By 1990 the labor force will be older which means it will have fewer inexperienced members. If the 1970s saw a demand for entry-level positions, the 1980s will see a demand for advancement. Competition for promotion is likely to be intense. The demand for advancement will undoubtedly produce frustration and could lead to more career changes.

The working population today and throughout this decade has and will have higher levels of educational attainment. In 1980 persons age 25 and over with college education comprised 17 percentof that age group, compared to 11 percent in 1970 and 8 percent in 1960. With a better-educated labor force the potential for large-scale under-employment and frustration increases. The potential for underemployment may warrant efforts toward targeted job creation to better utilize the labor force which was largely educated or trained with public dollars.

Today's labor force is composed of many more women than in any previous time. Forty-three percent of the labor force is comprised of women and 55 percent of all Minnesota women age 16 and over were in the labor force in 1980. Minnesota ranks among the top states in female labor force participation. With the majority of wives and mothers now holding paying jobs, the typical family is one in which both spouses are breadwinners. Labor force participation of women with children under 6 exceeded 51 percent; labor force participation of women with children 6-17 was 68 percent; and 62 percent of families had two or more workers. Perhaps no other single set of factors explain the social changes of the last decade better than these. The rapid growth and high level of women's labor force participation has impacted the family, the behavior of parents toward children, children toward parents and the behavior of men and women toward each other.

The labor force will be influenced by changes other than those in the age structure. The labor force is employed in a vast mix of occupations that together comprise the economy. In the national economy, the composition of employment has been shifting during the last 40 years from manufacturing and agriculture into service industries, a category that includes everything from auto repair and health services to hotel chains and education.

This shift toward services, while a continuous trend, has accelerated since 1970. This trend is attributed, among other things, to a demand for social services and other "human capital" industries, including education, and an increase in workers who tend to choose service-type careers, especially women, who have been entering the labor force in increasing numbers.

National data provide some examples of the impact of female labor force participation in the service industry. To cite some widely divergent occupations: 64 percent of computer and peripheral equipment operators were women as of 1981 compared to 38 percent in 1972. Fifty-eight percent of the insurance adjusters, examiners and investigators were women as of 1981, compared to 34 percent in 1972. And 14 percent of the lawyers and judges were women as of 1981, compared to 4 percent in 1972.

We have become painfully aware of the shift of our national economy away from steel and autos in the emergence of a truly competitive global economy. As Minnesotans we feel the psychological effects of these changes as do all Americans.

However, we are also experiencing the changes first hand as a large number of our fellow citizens are unemployed as a result of the decline of the U.S. steel and auto industries.

Today, on the threshold of the age of robotics, the application of technology takes on further meaning. But, perhaps, nothing symbolizes more fittingly the age we are entering than the naming of 1982 as the year of the computer. We have just begun to see the impact of computer and other information processing technology on white collar jobs and the office in particular.

The effects of the changing age structure interacting with a changing economy and a changing technology are not clear. Yet, we can say with certainty that tomorrow will be different from today. Our needs, concerns and priorities will change. The question is only how long before these changes are reflected in our collective will.

# • NATURAL RESOURCES

## The Environmental Effects of Economic Development of Natural Resources

John R. Borchert
*Regents' Professor of Geography*
*University of Minnesota*

**John R. Borchert**

Minnesota's boundaries contain important shares of the Midwest's great natural resource treasure – the flat or gently-rolling, deep, fertile soils of the western Corn Belt and Red River Valley; the commercial forests of the northern Great Lakes area; the metallic ores of the Lake Superior district; the area of relatively high water runoff from the land beneath the main storm track from the Border Lakes country to the Atlantic; the lake-studded, sandy, rough, wooded recent glacial deposits that have long provided rich scenic variety, solitude, and outdoor sport at the back door of the region's cities and workshops; and the millions of cubic miles of antiseptically clean air that flows from the Arctic after every passing cold front, in every season, year after year, to make the sun and the stars brighter.

The development of these resources has had two kinds of environmental effects. On the one hand, it has created the settlement pattern of the state; and it has contributed greatly to the quality of life in Minnesota and significantly to the quality of life in the rest of the United States and the world. At the same time, it has led to accelerated erosion, changes in the vegetation cover, depletion of soil and ore minerals, degradation of water and air, corruption of scenic panoramas, and inevitably covering some of the land with structures.

The first set of effects are benefits of development. The second set are costs. We can describe the development of the northeastern forest region of the state in terms of certain benefits and certain costs. We can do the same for the main farming region of the west and south. The transition zone of dairying, general farming, and lakes, and deep southeastern valleys has some of the benefits and costs of development found in both of the other regions. The Twin Cities metropolitan area, with the state's peak land-use intensity, maximizes both benefits and costs.

Our view of this balance sheet has evolved over four generations. From the first we knew that there are benefits. But at first it seemed that nature absorbs the costs by natural regrowth and purification. Then we began to see that the costs are really assessed against us; since the resources we deplete or degrade are the same ones that comprise part of our quality of living. So it became common for neighbors to play a game with one another – each try to find or perserve for himself a place where he has access to the pristine benefits and let undesirable costs flow to someone someplace else or to a later generation.

But as distance shrank and the scale of resource development grew, it became clear to most of us that we can't escape many of the costs of development; and we can't escape the wrath of our neighbors. For example, ask the Williams Pipe Line Company or the Metropolitan Waste Control Board. Costs must somehow be faced, toted up, and charged to the beneficiaries, which is **us**. The costs are a community problem. Then the questions are: What is the community? How do you keep the costs down? And how do you allocate them?

To think about those questions, let's go back and look at the map again. One community is the state of Minnesota. It has plenty of land. We rattle around. We are one of the relatively undeveloped parts of one of the most underdeveloped advanced nations in the world. That's another story. But if you have traveled in western Europe or Japan, you know what I mean. Not only is there plenty of room for us to do all that needs to be done, but there is a preferable place for every development. Farms, logging, resorts, power plants, dumps, suburbs, shopping centers, barge fleeting areas, coal docks, campgrounds, ski trails, mines, wildlife breeding areas and habitat – each has its own requirements in terms of site and location.

There are two main geographical concerns in resource development. One concern is to get each development into the preferable place, in terms of the resources and accessibility it needs. This means some kind of **zoning** – either spontaneous or governmental. A second concern is to be sure that the development, once in place and operating, has no spillover or discharge which damages its neighbors. That means some kind of **performance standards** for each zone, conceived and imposed by the community. And the community must be whatever one is large enough to include both the resource developer and the affected neighbors. The community might be local, regional, state, or national. The performance requirements might entail treatment, containment, or utilization of waste, or, for example, paying the costs and damages to widen an access road. Although zoning actions, based on plans, are nominally confined to local governments, the state also zones in many ways, in the absence of coordinated plans. When the state issues or denies a permit to build a power plant or fleet barges in a particular place, it is zoning. When the state puts a lake public access at one place and not another, it is zoning. When the state sets a maximum emission level for the power plant or requires that a public access be kept clean, it is setting performance standards for those zones.

In short, I have set out five basic principles: (1) We are stewards of a large share of Midwest and U.S. natural resources. (2) Development of those resources has overriding benefits and also costs. (3) Costs must eventually be charged to beneficiaries. (4) When the costs are faced by the community, there arises an obvious need for more efficiency in resource development. (5) Increased efficiency requires management to control the effects of resource development. That translates into zoning and performance standards, by whatever name we wish to call them, and organization to make wise decisions and act.

Let me speak in more detail about these management requirements as I see them in Minnesota. First, zoning. Most is done by the developers spontaneously, in response to economics of site and location. As a result, the land use map of the state shows a lot of order and always has. But there are some boundary areas where the same parcels of land or water are highly suitable for two or more conflicting or incompatible uses. That is especially likely in the transition zone between the forest and crop and at the developing edges of the main urban areas. Those are the places where the community has to lay down zoning rules and priorities simply for the sake of providing a stable framework in which investors can operate.

Second, performance standards. Beyond the boundaries of his appropriate zone and ownership, no one is free to cut costs by dumping his wastes in the laps of his neighbors. But he may well have to charge his customers part of the cost of managing the waste. And some of his customers may also be some of his neighbors. For many developments that is not a problem. For a few it is. In those cases, the community has to set performance standards for the particular zone, again simply for the sake of providing a stable framework in which both the investor and the neighbors can operate.

Finally, the matter of organization. For the community to have respectable zoning and performance standards in our system, there has to be ample, readily available information on land resources, use, ownership, and value. There have to be local community plans which synthesize the plans of the many people who own the land and hold the initiative to develop the resource, as they are constrained by their local neighbors. For some developments, there also have to be regional or state plans which synthesize the local plans. And for a few developments there have to be national plans which synthesize the state plans. A hierarchy of planning, by whatever name is acceptable, is both efficient and unavoidable, because many problems are local but some are not. The neighborhoods of different developments vary enourmously in extent – from a local gravel pit to the upper Mississippi 9-foot waterway to MX missle sites. If the neighborhood affected by a resource development is a region, the state, or the nation, then in one form or another the region, state, and nation must have zoning and performance standards which apply to the location of that development. Yet it is also clear that these plans cannot be made effectively from the top down in our system. They must evolve from the local level upward, starting with the millions of owners who hold both the development initiative and the basic responsibility to their neighbors.

Thus the effects of economic development on natural resources in general are obvious – both the benefits and the costs. The management task for the community requires zoning, performance standards, and enforcement, based on continuing resource inventories, monitoring, and evaluation. That task will become more important as the roles of new energy sources, new modes of transportation, new types of agriculture, and new types of construction become clear.

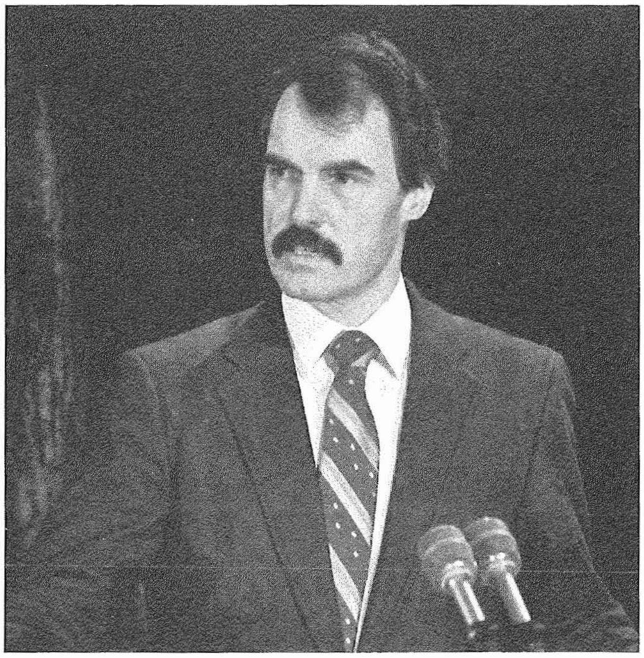
The legislature has created four state agencies which struggle with those management tasks on more than a dozen fronts. The agencies include the DNR, DOT, PCA, Energy, and the Geological Survey. The Legislative Commission on Minnesota Resources has worked to coordinate certain planning, monitoring, and evaluation programs of those agencies. The Land Management Information Center has served to coordinate data collection. Matching programs also have produced important Minnesota Inventory data from federal agencies. The legislature has also assigned parts of the job to local governments and regional commissions.

The problem continues to be to take the welter of approaches and laws and to coordinate and focus them on a few basic problems which run through the whole effort. In other words, a very major effect of economic development of natural resources is to add still more pressure on all concerned to improve the management of the public business.

# • NATURAL RESOURCES

## Economic Conditions and Prospects in Northeastern Minnesota

Jerrold Peterson
*Professor of Economics*
*Director-Bureau of Business and Economic Research*
*University of Minnesota-Duluth*



**Jerrold Peterson**

Minnesota has as unique an economy as any state in the Union. While the southern part of the state's economy is driven by agriculture, manufacturing, high technology, industry and various services, the northeast part of the state depends on taconite, timber, transportation and tourism. Unfortunately, several of these industries have undergone a severe recession during the last several years.

**• The importance of these industries, commonly referred to as the 4T's, to the regional and state economy can be shown by the impact they have on gross state and regional products.**

In 1980, Minnesota had a gross state product crudely estimated at $43 billion. Northeastern Minnesota contributed $3.4 billion to this output. Of this total, taconite accounted for $1.3 billion; timber, $.43 billion; transportation, $.4 billion; tourism, $.1 billion. All other activities accounted for $1.19 billion. As the results of the recession of 1981-82, Northeastern Minnesota economy has declined by $240 million or more than 7 percent in real output.

**• In more human terms, this $240 million loss in Gross Regional Product (GRP) has resulted in a loss of 11,000 jobs for the state and region.**

In 1980, the region employed 116,476 people who earned $1.6 billion in gross wage and salary income. By October 1982, employment in Northeastern Minnesota fell to a yearly average of only 105,000; the unemployment rate rose to 20 percent of the regional labor force. As terrifying as these economic statistics may appear, the future may hold even more frightening prospects.

The future recovery of Northeastern Minnesota depends on the recovery of the U.S. Steel industry. The recovery of the steel industry is by no means assured even if the U.S. economy were to improve in 1983.

Although world steel demand has more than doubled during the past two decades, domestic steel production has increased by only 20 percent during the same period, and actual domestic capacity has been decreasing recently. By comparison, the Japanese steel industry increased production sevenfold, and Common Market production went up by 70 percent. Substantially increased imports and constant levels of exports also testify to the declining role of the U.S. steel industry. In a recent report by the Congressional Office of Technology Assessment (OTA), three scenarios were outlined for possible steel industry growth over the next decade. The scenario most closely fitting the government policy and industry investment strategy observed by the study was referred to as the "liquidation" scenario and is one in which the declining role of the U.S. steel industry in world steel markets will continue.

Such a scenario is of particular concern to Northeastern Minnesota, which currently supplies 64 percent of the domestically mined iron ore. Iron mining is one of five major industries in Northeastern Minnesota and in 1980 directly provided 13,955 jobs out of a total employment of 116,476. The mining industry generated $294.171 million in wage and salary income. Since taconite ore production is directly dependent on steel production and demand, the current project of a declining steel industry is of vital concern to this region.

However, direct reduction of iron ore (DR) as a potential new local industrial development may dramatically alter the regional implications of these national trends. DR refers to a number of processes that are alternatives to the blast furnace and coke oven for the production of pig iron. These DR processes typically require many of the same raw materials but operate with less capital equipment and at lower temperatures than blast furnaces and can convert iron ore to iron without melting. In addition, the product, directly reduced iron (DRI), is compatible with other new technological developments and can be used as a substitute for scrap in electric furnace operation. Finally, DR is particularly applicable to Northeastern Minnesota since the process can be tied to current taconite production facilities and because the area has recently become a major transshipment point for western coal. As a result, Northeastern Minnesota may have the potential to develop and rapidly expand as a primary steel production area. Such development depends on many factors, including the technical and economic feasibility of different potential DR processes, transportation factors, etc.

If no changes occur in the U.S. steel technology the prospects for taconite production are bleak in Northeastern Minnesota. Taconite ore demanded from firms mining in Northeastern Minnesota is derived from the demand for raw steel produced primarily in the Lower Great Lakes area. Over the last twenty years the U.S. steel industry has faced increasingly stiff foreign competition both in markets at home and abroad.

- **In 1980, for example, raw steel demand was 101.0 million tons, with 84 million tons provided by domestic producers and 16.8 million tons provided by foreign companies.**

If the U.S. steel industry continues to perform as in recent years, the raw steel demand in the future will be increasingly satisfied by foreign producers. By the year 2000, total U.S. steel demand is forecast to be 151 million tons, with domestic shipments accounting for 105.7 million tons and imports of 45.3 million tons. Hence, domestic demand for ore will grow only slowly from 1980 to 2000.

Of equal importance for Northeastern Minnesota, the OTA liquidation scenario suggests that the domestic steel industry will use increasingly more foreign ores in producing domestic steel. This projection is based on the price competitive disadvantage that domestic ores have relative to foreign ores. Even though domestic shipments of steel are expected to increase from 84 million short tons in 1980 to 105.7 million short tons in the year 2000, U.S. mining production is forecast to decline from 48.52 million short tons of contained iron in 1980 to 44.1 million short tons by 2000. This decline will be accompanied by a dramatic increase in imported ore. Imported ore is forecast under the OTA liquidation scenario to rise from 14.08 million tons of ore to 34.66 million tons of ore by 2000.

- **As might be expected, shipments of taconite ore will follow a similar pattern.**

If Northeastern Minnesota maintains its domestic share of the taconite market, Minnesota taconite production will decline from 31.05 million short tons of contained iron (50.1 tons of pellets) in 1980 to 28.22 million short tons of contained iron (45.5 tons of pellets) by 2000, a 9.11 percent decline over the next two decades. Economic conditions in 1982 may have accelerated this decline and increased its magnitude.

This forecast is particularly gloomy for Northeastern Minnesota since iron ore mining has been this region's single most important industry for one-half a century. In addition, the mining industry indirectly provides employment for a large segment of workers in transportation and utilities, manufacturing, and wholesale.

If the forecasts of ore demanded by the U.S. steel industry are accurate, then taconite mining sales are forecast to be $1,170 million per annum by 2000. This represents a loss of $117 million per annum in taconite production. In addition, the region's rail transport system will experience a similar decline. Direct sales to the steel industry of moving taconite from the mine to the port is projected to decrease from $160.84 million to $146.19 million by 2000. The overall direct loss of taconite production and transportation sales forecast for the next twenty years amount to $131.83 million per annum by 2000.

This direct loss of taconite production will have ripple effects in Northeastern Minnesota, reaching many different businesses. A loss of one dollar in sales by the taconite industry will affect industries such as electrical power generation. In fact, the power industry will lose 4.5023 cents in sales to the taconite industry for every dollar decrease in taconite sales. By the year 2000, the power industry will lose $5.2758 million in sales as a result of the forecast decline in taconite production of $117.18 million. If indirect impacts are included, this loss rises to $6.4598 million per year by 2000. A number of other industries besides the electric power industry would be affected by the change in taconite production. These industries include maintenance industry, petroleum refineries, gas utilities, and wholesale trade, to mention a few.

- **The total direct and indirect impacts of the change in the taconite industry are estimated for the years 1980, 1985, 1990, and 2000.**

Continuing the example, the taconite industry's direct loss of $117.18 million in sales by 2000 will have a total effect on all industries in the area of $175.04 million. The total direct and indirect impact of taconite industry on the Northeastern Minnesota economy is shown as $1,922.44 million in 1980 and estimated to fall to $1,747.40 million by 2000, a decline of $175.04 million or 9.1 percent from current levels.

As indicated above, the decline in taconite production will also directly impact the regional rail transport industry. This industry activity will influence a number of other regional industries in a manner similar to the taconite industry. However, both the industries which are impacted and the size of the direct and indirect multiplier are different. The direct and indirect impacts of the decline in taconite sales are shown as a decline in rail transport to the port, ranging down from $160.81 million in 1980 to $146.19 million in 2000. The direct and indirect impacts of this level of activity are estimated to decline from $221.38 million to $201.22 million.

The Forecast of Total Impact of the OTA liquidation scenario on the Northeastern Minnesota Taconite Industry and Rail Transports Industry, as illustrated. The outlook is for declining production and sales, causing the direct and indirect impact of these two industries to decrease from $2,143.82 million in 1980 to $1,948.62 million in 2000. This decline will cause gross regional product to decline from $3,420.35 million to $3,108.92 million by 2000. In the absence of any changes in other industrial activity or regional, state, or national policies, Northeastern Minnesota regional products is forecast to decline by 9.10 percent, or $311.43 million per annum by 2000, as measured in 1977 prices. In common terms this forecast suggests fewer jobs, less taxes, economic decay and depression.

On the other hand, if a new technology of steel production proves to be economically feasible, the Northeast Minnesota economy may experience a far different economic future. The DR scenario continues to suppose that the steel industry follows the OTA liquidation scenario but that new investment in a DR industry occurs in Northeastern Minnesota. This investment couples DRI with electric furnace steel mills to make semi-finished steel billets and possibly finished steel products. Any number of other investment strategies might be examined, but this scenario appears to be the most likely one at the present time. The initial investment strategy suggests that a pilot plant with mini steel mills capable of producing 100,000 tons per annum could be ready by 1985. It is assumed that this plant would provide economic and technological information which would enable the steel industry to undertake a full-scale investment in DR facilities.

By 1990, five 400,000-ton per annum DR/mini steel mills could be in place and on line. These facilities would be built either in conjunction with existing taconite plants or as green field operations. The key ingredients in making the operation feasible are the availability of ore, coal, electricity, and a well-developed rail and water transport system. Northeast Minnesota now has the necessary ingredients through the development of western coal sources, to available peat and residual to make steel in the region.

- **The forecasts for the Northeastern Minnesota taconite industry coupled with a mini steel industry.**

If steel were produced in this region, the industry is forecast to increase output from zero to six million tons of product by 2000. This six million tons of product will require roughly nine million tons of taconite ore in addition to the expected output of 31 million tons. This ore is processed further into steel billets.

- **The value of billets from DRI.**

The total sales of the DRI industry could rise from zero in 1980 to $24.62 million in 1985 and to $1,476.9 million in 2000. These direct sales will have a direct and indirect impact on the regional economy, summarized as a rise from $47.15 million in 1985 to $2,828.96 million in 2000. The total impact of the introduction and development of DR for the region can be seen as the potential impact the industry would have on the regional economy. Mining and steel industry direct and indirect impacts increase from $2,143.82 million in 1980 to $2,225.66 million by 1985, or a growth of about .8 percent per year. From this miniscule amount, the growth of the industry would accelerate to 6.96 percent per year by 1990 when the value of the direct and indirect impacts are projected to rise to $2,999.93 million. The annual rate of growth of the industry would slow somewhat during the next decade, with the growth of the industry averaging 5.93 percent. By the year 2000, total mining and steel activity in the region would account for $4,777.58 million in direct and indirect impacts.

Unfortunately, this scenario is unlikely to occur without considerable additional research. At the present time, neither the private nor public sectors appears willing or able to carry the research necessary to establish a steel industry in Northeastern Minnesota.

- **To illustrate the importance of research in the establishment of any new industries, I will recap the research effort undertaken by government industries and the University of Minnesota to develop the taconite industry.**

Over the 45-year period from 1910 to 1955, industry, government and the University invested more than $3.2 million in seeking the taconite process. In aggregate dollars, this represented a research commitment of $3.25 million. This research eventually yielded a pay off of a new industry which now annually produces $1.3 billion in gross state output. Each year the rate of returns on this investment is 6,736 percent crudely estimated. Yet, to date the U.S. industry, State of Minnesota and University have spent less than $500,000 on investigating steel making potential for Northeastern Minnesota. I urge the Legislature, Governor, private industries and the University to carefully consider the potential of more fully exploiting our mineral wealth.

# • AGRICULTURE

## Minnesota Agriculture in the Eighties

Philip M. Raup
*Professor, Department of Agricultural and Applied Economics*
*University of Minnesota, St. Paul*

**Philip M. Raup**

We have just experienced the end of a land boom that I would characterize as a 100 year boom, in the same sense that hydrologists speak of a flood that has the probability of occurrence once in 100 years. After a flood of that magnitude you expect quite a clean up job and after a land boom of the magnitude we just had we do have quite a clean up job. The first reports of some of the magnitude of the declines are just now becoming available for Minnesota.

We had a July 1981 to July 1982 overall statewide decline in land values of about 10 percent in nominal terms. In a period in which the consumer price index went up 7.2 percent this is a real decline of over 17 percent. This is not easily assimilated and it is not uniformly distributed. By far the sharpest decline occurred in the counties to the east of the Red River Valley and strung up and down in a north-south axis towards St. Cloud, and in a group of counties on the southern border of the State where land values are the highest and where increases had been spectacular after 1972. In those two groups, we can note a decline of 20 to 25 percent in nominal terms. When adjusted for real purchasing power, this means in several of the counties on the south central border and in some of the counties in the area east of the Valley area we have had real purchasing power declines in the last year in the 30 percent range.

This is a wipe-out of equity of massive proportions. It is an impairment of the asset base of Minnesota agriculture and it will take some time to accommodate this kind of a decrease. Not only has the decline been sharp; but it has been all the more painful since about three-fourths of the level of land values that prevailed in 1981 represented increases that had occurred since 1972. In other words, it was a rapid loss of a recent gain.

The gain has been artifically stimulated by some policies, inadvertent but nonetheless powerful, that had the general effect of throwing gasoline on a fire. One of the most pronounced was the extent to which the combination of lending practices and inflation had rendered the rate of interest virtually useless as a guide to investment. In the eight years from 1973 through 1981, the real rate of interest on Federal Land Bank mortgage loans was negative in 18 of the 32 quarters. That is, in 18 of 32 quarters between 1973 and 1981 you made money by borrowing money. You could pay back at the end of the borrowing period with money that cost less in purchasing power than the land value had increased due to inflation. The loan in effect was a gift. This renders normal calculations of rates of return on investment or choices among investments meaningless.

A generation of farm land buyers was bred as a consequence that expected to make their rewards through capital gain. This has diverted attention from the more normal pursuit of profit with the result that we now have a majority of people in the United States: (a) who know only that land values go up since they have never gone down in their lifetime, and (b) who have been taught in the most recent past that you could be completely useless as a farm manager. You could do everything wrong and you could end the year richer than you began it. That is not the best training for wise use of agricultural resources.

While this was going on several other domestic changes were taking place within the state. Among them is the emergence of part-time farming and what amounts to a new life style. Minnesota farmers now get the majority of total family household income from nonfarm sources of employment, and this is widespread. This is not just a characteristic of the area around the Twin Cities or around Rochester, St. Cloud, or Mankato. Consequently, we have interspersed in the agricultural community a lot of people who are claimants for agricultural land and who are using it in agricultural pursuits in some cases. They can bring to bear on agricultural land purchases income earned from off-farm sources. This means that in effect agriculture now has to pay for an asset base that reflects a two-way use potential. It can be used for agriculture, or it can be used for nonagricultural pursuits, and nonagricultural demanders for land can generally win in a show down. We have to learn to live with a possible conflict in land use between rural nonfarm users and farm users. This has the overall effect of lifting the asset base of agriculture without increasing its profitability. This general situation is not peculiar to Minnesota but we have a very well developed case of it in Minnesota.

Now let me turn now to some lessons that we may have learned or could well learn from this land boom history. I believe that the overriding lesson is that we are not in a position to force other nations to buy our grains and soybeans. A corollary is that we can price ourselves out of world markets. Anyone who looks at what happened to the strength of the dollar in the last 18 or 24 months and observes what it did to our markets for grain exports can see clearly that we are not in the position of a monopolist able to demand a price for a scarce commodity that the world must have at all cost. Another lesson that is important is that the euphoria that led to this land boom included a belief in an ultimate demand for grains from the rest of the world that would bail us out of temporary difficulties. If there was a tough patch for a few years, just hang on and wait it out and those hungry millions would come pounding on our door eventually. This would bring our land values back up to what we considered to be a reasonable level again. I think the one lesson that should be clear now is that virtually all of the export expansion of the last decade was to countries who have among them the lowest rate of population growth in the world. About three-fourths of our total agricultural exports went to countries, specifically the European Common Market, the COMECON countries of East Europe and the Soviet Union, and Japan, which among them have a compound population growth rate of 0.67 percent per year. Whatever else is true, it is not true that the demand for American grains in the export market is a consequence of a population explosion. That is not where we have been selling our grains. That is not where we are likely to sell them in the future. A world population explosion is not going to bail us out of our present acute problem of overproduction.

Another lesson we can learn from this recent experience is that in our major agricultural countires about 70 to 80 percent of all of the farm land sales after 1975 have been for farm size enlargement. Most of these purchases were being added to farms that were on the upside of the average. In other words, bigger farms were being made bigger. In that circumstance your legislature may very well want to look carefully at proposals for farm debt relief and for moritoria on debt repayments. It is entirely possible that you could be harming people you wanted to help and that you could do more damage than good by general, sweeping debt moritoria. We have in place in Minnesota our Family Farm Security Program that has been well-administered, cautiously approached and carefully husbanded. I urge you to consider the continuation of that program and to avoid any temptation to try to make out of it a debt relief measure.

A related possible appeal may be made for the support of agricultural programs that depend on cost of production estimates that include in cost of production unrealistically high land values. There is a circular reasoning involved here. If you include over-priced land in calculating a rate of return on your assets then there is no solution to the question of what is a fair rate of return. This tendency is acute if it can be mobilized not only with the support of the farm community but of the financial community as well. There will be some tendency to want to do that and you may well want to be on your guard against it.

In another dimension you will almost certainly hear more about property tax relief. A notorious feature of the property tax is that it tends to lag behind real price movements. When prices have been going up assessments tend to lag behind the increases, which is nice for awhile. When there is a turn around, as we have had, the assessments also lag behind the decline and this period of most acute pressure is just ahead of us. If that coincides with some attempt to put still more local services on the property tax, that is, a stepping back on the part of the federal government and the state government in the provision of support for local services, then we can anticipate some real trouble in the fair apportionment of the burden of property taxation.

One final point has to do with possible expansion of further processing of Minnesota products in the state. I think we have forgotten one great truth in this state and that is, our most efficient processing takes place in the feeding of livestock. We have our poultry and our hogs and our cattle and dairy cows as our most efficient processors, and these will remain so. They probably are the only sectors in which we could really be efficient in an international dimension. For that reason we will want to be careful how we consider protectionist measures in Minnesota agriculture that could trigger international trade wars. There is no sector of the Minnesota economy more dependent on international trade than is agriculture. No sector has more to lose in an attempt to wrap up Minnesota or the United States in a fortress America mentality and practice protectionist economic policy.

# • ENERGY

Michael J. Murphy
*Former Assistant Commissioner of Energy*
*(Minnesota Department of Energy, Planning & Development);*
*As of June 1983 an executive with the*
*Wilson Learning Center, Eden Prairie, Minnesota*

**Michael J. Murphy**

In the past decade, no other issue or chain of events has had more impact on Minnesotans and on the state's economy than has energy. While inflation and unemployment dominate the scene, much of the economy's poor condition can be traced to events which began in 1973 with the oil embargo. While we have adjusted a great deal through energy conservation, we continue to face rising natural gas prices, and incomes have grown far more slowly than have energy costs. The dominant features in rising prices, as shown through monthly consumer price indicators, have been heating fuel and transportation energy price increases.

What I want to cover in this presentation are some of the critical impacts which have been felt; some of the alternative courses of action we have; the benefits of a changed energy course for Minnesota; and where, based on the work of the Energy Division, the focus of public policy should be in the next few years. I recognize, of course, the need both to resolve near-term problems and to set in motion those efforts which provide for improved energy and economic conditions and opqortunities for the longer-term.

In 1980, we spent about 18 percent of our primary state income on energy. As you can see, about 60 percent of those dollars leaves the state permanently, and are not available for reinvestment in new jobs and in economic improvement. Without major changes in this worsening condition, we can only expect poorer economic performance in the future. In but a decade, this problem has more than doubled.

Looking at actual state economic performance, higher energy prices have caused the Gross State Product to grow far less than it would have between 1978 and 1982. With economic recovery, we can expect petroleum prices to again rise in real terms; and we will again have to look for other ways to improve the economy to offset potential losses resulting from a new round of higher energy prices.

Employment, too, has suffered in the face of higher energy prices. Without rising prices during 1979 and 1980, dollars paid for employment would be about $60 million higher during 1982 than they actually were. Again, we see the decline beginning about the time of the Iranian Revolution in 1979, coincident with the last large jump in world oil prices. One way to avoid employment losses related to energy is to stimulate those jobs and businesses which can both save energy and produce energy in Minnesota.

Some Minnesotans have been hurt worse than others. Households with median income – $26,000 per year – paid about 9 percent of total income for energy just to heat and cool their home. At just 60 percent of median income – little more than $15,000 per year – many Minnesotans cannot keep pace with rising energy prices. A number of them have had to turn to federal fuel assistance payments, a program operated by the Department of Economic Security. These payments merely help those Minnesotans not to fall further in debt; yet their homes remain as inefficient as ever because of lack of weatherization funds.

Even worse is the situation for Minnesotans who live at the poverty level – abour $9,300 per year. Their household energy costs consume about 20 percent of their total annual income. This group of Minnesotans has access to weatherization funds; but the total amount available is insufficient to address all the needs; and the amount which can be spent on each household, by federal rules, is about one-half that needed to complete thorough weatherization of their homes.

This chart shows our projections of fuel assistance requirements for lower- and fixed-income people based upon projections for rising energy costs. In 1982, Economic Security paid out about $57 million for fuel assistance. This amount could more than double by 1990 if major investments are not made in weatherization. What we have here is a classic case of having to continually spend money when the solution actually requires permanent investments. While we need to maintain fuel assistance at current levels, at least, we also must markedly increase the dollars available — federal and state — for weatherization. There is no real return on fuel assistance; there can be through weatherization.

In order to evaluate which energy alternatives are most cost-effective, we just look at relative costs per million BTU's. As this table shows, natural gas remains the least costly; yet its cost is escalating rapidly through phased natural gas deregulation at the federal level. In the past two years, we have seen annual price increases well in excess of 20 percent. A just-announced federal order could raise current prices at least by that amount during 1983. Deregulation is expected to be completed by 1985, and future increases should begin to more-parallel inflation.

Comparing alternative fuels, you can see that those alternatives widely considered for use here in Minnesota continue to be more costly than traditional fuels. This will change, however, as we gain success in both resource and technology improvements, many which have been supported by both the general fund and the Legislative Commission on Minnesota's Resources in recent years. Passive solar and solar domestic hot water are gaining competitiveness; and peat, as a boiler fuel to replace coal, is nearing competive levels. Both wind and hydro, in some applications, can replace traditional ways to supply electric energy.

Our 1982 Biennial Energy Conservation and Policy Report, copies of which were made available to the Legislature in late-December, describes scenarios under which Minnesota can make substantial strides in changing the mix of energy supplies and uses and can improve the state's economy. As you can see from this chart, if we overcome major barriers caused by lack of information, poor financial incentives, complicated government regulations, and more, we will see major changes. In the 1980s, we can expect solar, district heating and wind to make major gains. By the turn of the century, we should see even more wind energy; but we also should see substantial gains in production and use of biomass fuels — wood, crops, peat, special energy crops — and methanol, a fuel with much versatility and a commodity with many alternatives in the petroleum industry.

Throughout this two-decade period, conservation remains our key energy strategy. In fact, it does no good to use alternative fuels unless we, first, make our using systems as efficient as possible. In other words, don't put solar systems in poorly-built or insulated homes.

Looking at the two more-progressive scenarios in our biennial report we can see that a vigorous statewide energy program in both energy conservation and in alternative energy development can contribute to increased employment. Energy conservation and most-all alternative energy production efforts are labor-intensive. They create local jobs for local people. We can, our analyses show, expect to see new businesses created to supply conservation technology, materials and installation services. Most all of these will be small businesses. We also should see, in the '80s, emergence of a number of small businesses which will produce fiber fuels, peat and other new energy sources; and we will see other companies and jobs created to harvest fuels, to transport them and to install equipment to use them.

Returning to energy conservation, all of the major energy conservation measures we should be emphasizing are less costly than acquiring and burning additional volumes of energy. Even an auto tuneup, something which many people avoid or put off, is far cheaper than inefficient use of gasoline.

We are working on a major superinsulated housing program, now constructing 25 demonstration homes throughout the state. We believe that future new homes in Minnesota should be superinsulated and the returns on superinsulation investments are attractive for new home owners. We also are evaluating superinsulation retrofits to see how cost-effective it is to improve the existing housing stock.

In determining the cost-effectiveness of weatherization, we need to look at the actual dollars compared with the accumulated energy cost savings over a period of a year. On a 15-year life-cycle basis, we can show that a near-$4,000 dollar weatherization investment in the average home heated by natural gas will yield $9,700 or more than double in dollar savings through less energy consumption. The savings are slightly higher for oil-heated homes.

Much is discussed these days about the role of government, in energy and in any number of critical public policy and issue areas. Our biennial report states firmly that government has and should play a strong role in energy. That role often costs money and, in many instances, the sums are large. Government, like any other institution, should seek to invest its capital in those areas where the returns are most attractive. For government, the returns come in two forms, generally. First, government financial investments generate what we call secondary economic benefits in the form of new jobs, new businesses, new private and public revenues and continued economic expansion. Second, we get other, indirect, returns through reductions in payments for unemployment, welfare and other subsistence; and, where possible, taxes can be reduced.

For the next four years, at least, we see four major areas where government can play a major, positive role through energy initiatives.

In areas of economic development, state government can stimulate those businesses and jobs which can supply and use alternative fuels and technologies. We have a base here with our indigenous fuels and our companies already producing energy savings and production technologies.

The energy problems of low income people represent a continued and growing drain on the public coffers and, of course, on the profits and the stability and growth of private businesses and individuals. You have, I am sure, heard much from lower-income people already. What is needed is a major effort to bring both public and private capital to bear on this problem. A major effort should be placed on developing ways to use private financing to solve this problem in that public funds are limited and stretched thin. This means finding ways to use public funds to leverage private money at lower interest rates; and it means finding ways to stimulate private property owners, particularly in the multi-family housing sector where many lower-income people live, to make the investments necessary to improve energy efficiency.

Our own public institutions have not received near the amount of effort needed to improve energy efficiency as both the costs and the savings would indicate should take place. A major effort to retrofit schools should be undertaken immediately in order to reduce operating costs and to make those dollars available to maintain the quality of education. Local and state government has done little to reduce energy costs. There are private companies which have expressed interest in financing and implementing major energy conservation programs in public buildings. We should work with these firms — they will hire local people and use local materials, too — to insure these investments are made. The combined energy savings and jobs created can have a major positive impact on the state's economy. One statistic is most-telling. In downtown St. Paul, including the Capitol complex, state government owns or leases about 40 percent of all available commercial office space. Yet, this space has had less energy efficiency improvements made in the past decade than has the totally private space.

Using energy efficiently means using our dollars efficiently. While state and federal funds have made substantial dents in our poor energy use conditions, much else needs to be done. State government has a large role to play through education and information, through providing financial incentives, and through leadership.

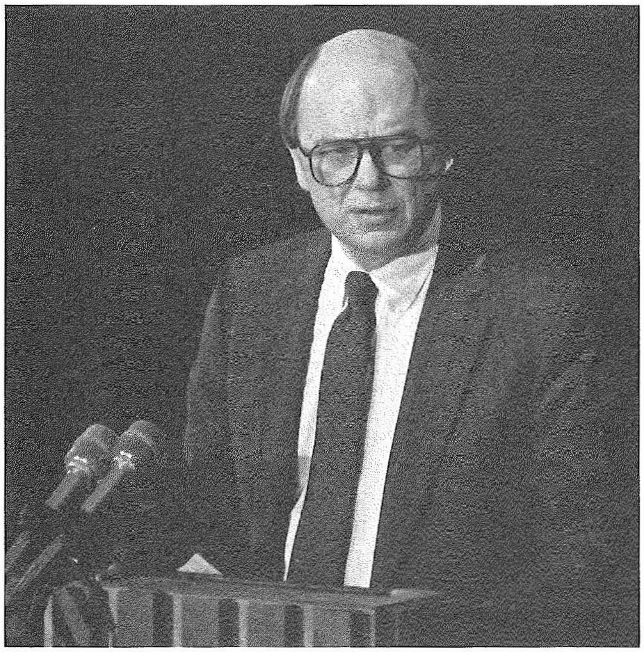
The 1980s represent a period of major challenge as we seek to move out of our poor economic environment into one of growth and improvement. Energy costs affect all parts of the state's economy — agriculture, mining, forestry, small businesses, homes and apartments, transportation, tourism and, even government.

Energy is an economic issue, not unlike any number of other economic issues we face. We have before us an opportunity to turn a problem into a solution. Rising energy prices are a problem for many sectors of the economy. Yet, those same rising prices, particularly for petroleum, natural gas and electric energy, provide real stimulus to the development of alternative fuels and to even more energy conservation. And, these more-attractive energy alternatives create jobs, cause existing businesses to grow and help create new businesses. Equally important, they reduce public and private costs and help to keep Minnesota dollars at home.

We have made a major investment in acquiring the knowledge and tools to better understand our energy problems and opportunities. The 1980s is the time to put those tools to work on behalf of our citizens and to advance the economy. Thank you.

# • HOUSING

James J. Solem
*Executive Director*
*Minnesota Housing Finance Agency*



**James J. Solem**

The first two years of the '80s have been the worst two years in new housing production since the depression of the '30s.

The late '70s, especially 1978, were some of the best years ever in new housing production.

Had this level of production been maintained in 1981-82 – and into 1983 – the impact on Minnesota's economy, jobs, and personal income would have been enormous.

Estimates, using the Department of Revenue's model of the State's economy, indicate the following losses to Minnesota's economy because of the major decline in housing production in the last two years:

- Minnesota in '81 lost $623 million in residential investment. This in turn resulted in the loss of 28,000 jobs, $458 million in personal income, and $21 million in taxes.
- Minnesota in '82 lost almost $673 million in residential investment. This resulted in the loss of 24,000 jobs, $427 million in personal income and almost $19 million in taxes.

This analysis shows the impact housing production can have on jobs, income, and taxes.

Today, I'll try to briefly describe why the '80s won't be like the '70s, and what this means for public policies which affect the affordability and availability of housing.

The '80s won't be the '70s because of:

- Inflation
- Demographic changes
- Federal deregulation of financial institutions
- Reduced dollars for or the actual stopping of important federal housing production programs

Let's start with inflation.

House prices have dramatically increased both nationwide and in Minnesota.

- The average sale price of a house in Minnesota nearly doubled from 1976 to 1981, increasing from $35,000 to $63,000.
- Nationwide the average price rose from $44,000 to over $77,000. By December of '82 the average sales price for a home in this country was $77,400.

Minnesota data shows that from the mid'70s to the early '80s, substantial increases in house prices occurred throughout the state.

Some of the biggest increases occurred in the more rural areas of the state.

These dramatic increases in house price, along with the equally dramatic increase in interest rates, have substantially reduced the ability of first-time homebuyers to buy a home.

1980 Renters Credit Data shows the income distribution of non-elderly renters in Minnesota. This is a good proxy for first-time homebuyers.

- Only 11% had incomes of over $20,000.
- Almost half had incomes of less than $10,000.

We've developed estimates of the percentage of first-time homebuyers who could afford a median priced home in Minnesota from 1979 through 1982.

Minnesota data shows that in the Twin Cities areas this percentage has remained at about 10%. But for the rest of the state, the percentage has declined from 25% to 18%.

In the '70s, first-time homebuyers were an important element in the housing market.

Demographic data you've already seen shows the importance of the baby boom in the housing market of the '80s.

There will be more potential first-time homebuyers in this decade than any other period in our history.

These potential first-time homebuyers will be less able to afford homeownership than any similar group in our history.

Another important piece of demographic data involves the impact of the change in family size – assume the 1980 population and the 1960 family size. Had family size remained at 1960 levels, Minnesota would have needed 270,000 fewer housing units for its 1980 population.

Inflation is one cause of the housing problems of the

'80s. Demographic changes have added to the demand problems.

Perhaps the most important fundamental change in the '80s is the way in which capital or money will be made available for financing housing.

In 1980 and 1982, Congress passed legislation which decontrolled the ways in which lending institutions get money from all of us and in turn lend it for a variety of uses, including housing.

These changes mean that savers won't finance housing in the '80s. Investors will finance housing.

What happened to all the passbook savings accounts as a source of affordable capital for housing?

Inflation happened.

Look at the ads in the paper for the new floating rate, short term deposits now offered by lenders.

These ads explain as effectively as anything else we could say why the '80's will be different for housing.

Lenders don't make long term fixed rate mortgages with short term, floating rate deposits.

The data shows that by 1980, only 20 percent of the deposits of thrift institutions were in passbook savings accounts. This is down from 88 percent in 1966.

So where will the lenders get dollars to use in housing loans?

A good share of these dollars will come from the contract thrift those institutions with forced savings, the pension funds, and insurance companies.

Lenders who make the loans won't be able to hold the loan in their institution's portfolio because the lender no longer has access to savings at a protected rate that allows holding a long term fixed rate loan. Inflation has made the holding of long term, fixed rate loans, by lenders, a bad investment.

This means local lenders will be sellers of big batches of mortgages to investors, through the secondary market institutions.

Those secondary market institutions, both public and private, will have a major role in determining the type of mortgage instrument available for the purchase of a home.

In the last few years, the change in types of mortgages has been phenomenal.

Most of you who purchased a home in the '60s and '70s used the 30 year fixed rate mortgage.

Last year, one secondary market institution for thrift institutions purchased over 100 different types of mortgages. These mortgage types weren't used or even heard of in the '70s.

One of the important housing issues for the '80s will be the determination of the six or eight standard mortgage types that are acceptable to investors; work well in the secondary market; and make homeownership affordable.

This issue is important because it affects the way in which capital will be made available to housing.

Estimates are that about $200 billion a year will be needed for housing in the '80s. There are real questions about the ability of the economy to generate this amount of capital, larger than anytime in history, at affordable rates.

The final element of change recognizes that the middle 80s will not be a period where federal housing programs act as a stimulus or incentive for the kind of creative state, local and private activity that took place in Minnesota in the '70s. For 1983, federal assistance for the new production of housing is limited to 14,000 units of elderly housing for the entire nation.

For at least the near term, federal housing programs as a source of new housing production, don't exist.

How then do we need to start to think about the problem?

Think about housing in the '80s for a minute:

- You've seen the demographic data — more households with fewer people in each. This means less space is needed per household.
- Money costs more and is harder to obtain for housing.
- The protection housing once had in federal legislation is gone, along with federal programs which stimulated production.

While the situation is different than the '70s, there are ways to adapt to the reality of the '80s. One of those ways is to adapt the existing housing stock.

The most important housing resource of the '80s is likely to be the 30 million plus units produced in this nation in the '60s and '70s.

In 1980, Minnesota had just over one and one-half million housing units. This was a 25% increase over 1970.

Of the units available in Minnesota in 1980, 69% were single unit, detached homes. About 30% of the housing units in Minnesota were less than 20 years old.

It is important to note, however, that almost one-third are at least 40 years old. This has significant implications for energy conservation, rehabilitation, and reuse of existing homes and neighborhoods. It's much more cost effective to save an existing home than finance the construction of a new home.

A large part of the existing stock of single family housing is underutilized in terms of the number of people living in the available space.

Creative ideas are needed to find ways to more effectively use the housing space that already exists in Minnesota.

One type of housing that might be reused is the home where elderly families or individuals now live. There are large numbers of elderly homeowners in all areas of the state.

Outside the Twin Cities, there is an especially high percentage of the elderly who own their own homes.

We need to combine creative elderly housing ideas with new approaches to health and social services. This must be a major task for the '80s.

For rental housing, a recent study done for the MHFA, concluded that there was significant potential to convert a large number of the existing single family units in the state to duplexes, and, thus, provide additional rental housing for a large number of families at cost savings of up to 60% of that for financing new rental units.

New rental housing isn't going to be produced in large numbers in the '80s. Without federal programs, current interest rates mean rents for a new one bedroom walk-up in the Twin Cities would be about $550 to $600 a month.

More intensive use of existing units, where the current occupants may not need all the space available, is a rental alternative that needs careful review.

Incentives for community and neighborhood acceptance and support for new approaches should be developed.

One of the important conclusions about housing in the '80s is that it won't be possible to house everyone in a single family, detached home, with white pillars and black shutters and a two car garage. Condos, quads, townhouses, and all other resources of the marketplace in the late '70s, will provide the majority of the new units produced in the '80s.

Housing programs in the '80s will be complex. Success will require the cooperation of state and local government working with the private sector. Dollars, public and private, will need to be combined. Resources must be targeted to those families and individuals that most need assistance.

No single piece of State legislation will be able to create a program that produces housing for the '80s. Tax policy, development policy, and housing policy must all work together.

Some actions are essential.

We must make certain that investors are willing to provide capital for housing in Minnesota.

We must make certain we don't add unnecessary costs to an already expensive housing unit with state and local requirements designed to build communities for the '60s and '70s, not the '80s.

Communities in all areas of the state must be open to creative ways to provide affordable housing to people of all incomes.

There must be opportunities for testing new approaches in affordability, energy efficiency, design, and reuse of existing housing.

All elements of the housing production system — government, developers, lenders, the building trades — have a responsibility and a role to play in making affordable housing available.

Inflation, federal deregulation, changes in the way we organize ourselves into households and the ending of federal housing production programs, have all combined to fundamentally alter the affordability and availability of housing in the '80s.

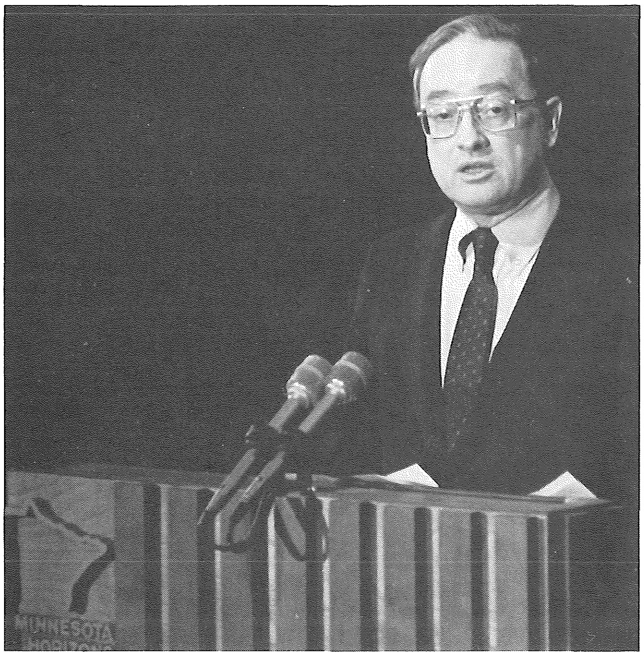
For housing, the '80s, which are almost one-third over, are already significantly different than the '70s.

For housing, the '80s are off to a bad start.

# • PUBLIC INFRASTRUCTURE

## Minnesota and Its Infrastructure

James A. Kelly
*President*
*Spring Hill Center*



**James A. Kelly**

Infrastructure has become America's latest buzz word. The term infrastructure was first used in England after World War II to describe airfields and other military facilities. After an incredulous and scornful salvo from Winston Churchill, the term went into temporary retirement until the Vietnam War. It has now emerged in full bloom and is used to describe roads, bridges, sewer and water systems, public buildings and transit systems, as well as rail systems, solid waste disposal facilities, prisons, hospitals, ports, and airports.

With talk of crumbling highways, teetering bridges and leaking sewers, experts and pundits predict the demise of our economy and even the American way of life, if our infrastructure needs are not made our top priority. Figures of over $3 trillion are bandied about as needed infrastructure investment over the next decade. Such estimates include over a trillion dollars for highways alone, $40 to $80 billion for transit, $50 billion for bridges and almost $300 billion for sewer and water systems. These are intimidating numbers, to say the least, even at the national level; what seems clear is that such investment will not be forthcoming.

But, one might ask, what about Minnesota? Minnesota's problems are not as bad as many states in the northeast and middle west. But our problems **are** serious, and neglect is expensive. Action is required now if Minnesota is to avoid the physical decay and costly repairs facing other areas.

For example:

- By 1990 Minnesota will have 7,850 miles of state highway more than 35 years old; 6,500 miles of it will require resurfacing.
- MnDOT has rated 4,500 of the state's bridges as deficient.
- Of the state's 110 solid waste disposal sites, 33 (30 percent) have less than five years capacity left.
- A new landfill costs $9 to $16 million, not including operating costs.
- MTC estimates it needs $100 million by 1986 to rehabilitate any buses in the fleet over 12 years of age. The alternative, replacement, would cost $143 million.
- Minnesota's rail system, a vital transportation service in rural areas, is shrinking rapidly. From 1976 to 1982 almost 20 percent of Minnesota's track mileage was abandoned.
- Federal water and sewer grants, the primary means used by local communities to comply with state and federal water standards, will dry to a trickle compared to the past decade. The standards remain, however.

Despite its good track record of investment, Minnesota will require a major investment in infrastructure over the next twenty years. The total need will be in the billions. That's the first reason infrastructure should be included on any list of major state priorities – it is an extremely costly item affecting all units of government and all residents of Minnesota.

The second reason infrastructure is important is its relationship to the economy and jobs, Minnesota's number one issue. Renewal and expansion of the state's economy require a viable public capital plant just as much as a renewed private capital in the form of plant and equipment. Grain and lumber must be moved, clean water must be available, products must be shipped to waiting consumers here and around the world, people most be mobile and information must flow. A healthy public infrastructure is a necessary, but not sufficient, condition for a strong economy. Without a strong economy, unemployment will persist, and the struggle to balance the state budget will become a permanent fixture of life in Minnesota.

The third reason infrastructure is a critical policy issue for Minnesota is that the rules of the game governing infrastructure are changing rapidly. The federal government can no longer be counted on to provide a large share of the costs of state and local capital projects. State policy must not be based on the assumption that the days of federal largesse will soon return, notwithstanding the recently adopted five cent federal gas tax, which will provide only a small fraction of funds needed for federal highways. Other developments include the shirnking fiscal capacity of state and local governments, the disenchantment of taxpayers and of financial markets with increased state and local debt offerings, and experimentation with an increased role for the private sector in financing and performing traditionally public functions. All of these combine to form a dramatically different political and economic environment for infrastructure than the one we knew even five years ago. Change is upon us.

So, to review quickly, there are three reasons why infrastructure must be an integral part of economic development strategies and governmental planning in Minnesota.

1. Renewal and expansion of the state's economy will require a viable public infrastructure plant.
2. Maintenance of a viable public infrastructure plant will require considerable investment.
3. The rules of the game governing infrastructure investments are dramatically changed, placing an increasing burden on state and local governments and the private sector.

I'd like now to outline four issues that should guide the state in establishing its infrastructure policy and program.

**1. Minnesota needs a comprehensive inventory of its existing infrastructure and impending investment needs.** There are currently wide variations in the extent and quality of information available to decision-makers regarding the state's infrastructure. We have, for example, a relatively good idea of the condition and life expectancy of state trunk and interstate highways. Our knowledge of local streets and roads is considerably less. Our knowledge of rural sewers is even worse.

The state should compile a complete inventory of all elements of infrastructure for which it is responsible. The state should likewise encourage local governments to compile similar inventories for elements of infracture for which they are responsible. These inventories could then serve as a baseline for subsequent planning and investment decisions.

**2. Minnesota needs a coordinated planning process pertaining to infracture** in order to make better choices among competing investments in the tough fiscal environment in which we now operate.

One of the primary effects of the budget decisions of the past few years has been the systematic dismantling of the state's planning mechanisms. Better planning is needed so that the far sighted decision-making that flows from it can occur. Local governments as well as the state must engage in this process.

The infrastructure planning processes at the state and local levels should have five elements. First, I have just described the need for an **inventory** of public facilities and assessment of their condition. Second, the state should establish clear **priorities** linked directly to the long-range economic needs of the state. Third, these priorities should lead to development of an explicit, long-term **financing strategy** for the most important investments. Fourth, an integrated state and local capital budget for infrastructure should be instituted. Fifth, the **legislature should examine its own decision-making process** so that coordinated state infrastructure policy can be adopted and implemented.

**3. State and federal design and construction standards should be examined for potential areas of cost savings.** The Urban Institute and others have conducted extensive work on the costs imposed by federal and state design and construction standards. They have found that with little or no loss of health or safety, or increase in risk, some standards can be relaxed, producing great savings. From bridge design criteria to water quality, revision of some standards could offer reduced costs at little or no risk. A similar examination of various process requirements could produce savings while maintaining the desired procedural protections for all concerned. This approach represents another means of lowering the monumental estimated cost of infrastructure in the years to come without major sacrifices in the quality of life.

**4. State and local governments should explore productive new relationships between the public and private sectors in the planning and implementation of infrastructure investments.** Throughout the nation the great potential of this approach is being proven. New cooperative arrangements are being tried. Minnesota's strong tradition of public-private collaboration suggests that we should be a leader in this regard.

Minnesota has a good record in building and maintaining its infrastructure. Recent history suggests, however, that Minnesota cannot stay on the same path and hope to prosper. New directions are needed, if we are to meet the dual challenge of severely limited fiscal capacity and mounting needs for investment. There is no easy answer. There is, however, great ferment throughout the nation, as individual states and communities develop new responses to ensure a healthy infrastructure. Without it, no state or community can hope to succeed in the competitive economy of the future. Minnesota must join in this collective innovation to keep its economy strong.

Spring Hill Center and the Urban Institute are co-sponsors of a major national three-year program to develop solutions to infrastructure problems. Ten major cities, from New York City to San Jose, are participating in the program. St. Paul is a leader in organizing the program; Minneapolis is also participating. Private and public leaders from each city will convene semi-annually at Spring Hill. The Urban Institute will conduct targeted research and provide technical assistance in each city.

One immediate step the governor and the legislature should undertake is to create a blue-ribbon task force of government leaders and private sector representatives to coordinate infrastructure planning in both legislative and executive branches of state and local governments. Minnesota needs an infrastructure plan, but won't get one unless it re-organizes its fragmented and uncoordinated planning process.

## "Human Services in Minnesota"

Earl Craig
*Former President*
*Urban Coalition of Minneapolis*
Jan Smaby
*Director*
*Hennepin County Economic Assistance Department*

Jan Smaby and Earl Craig

**Craig**: Good morning. During the next 30 minutes, Jan Smaby and I will attempt to describe the Human Services System in Minnesota — its programs, its users, its costs, some of the myths which surround it and some of the issues which will confront all of us in the coming decade.

**Smaby**: Today, more than $1.8 billion in federal, state and county revenue is spent for welfare, health, corrections and energy assistance programs in Minnesota.

Public welfare accounts for over 80% of all Human Service System expenditures. The welfare programs which we provide can be divided into four categories. First, there are the social service programs such as child day care, emergency food and shelter, homemaker services, or residential treatment programs for the mentally ill, the mentally retarded or the chemically dependent, a variety of counseling services and foster care for the emotionally disturbed, or abused or neglected and dependent child. Second, there are the income assistance programs for the poor be they young or old, singles or families. These programs are known as Aid to Families with Dependent Children, General Assistance, Supplemental Security Income, Minnesota Supplemental Aid, food stamps, and child support collections. Third, there are the state hospitals and institutions for the elderly or the physically and mentally disabled. And finally, in the welfare system, there is the medical assistance provided through such programs as General Assistance Medical Care and Medicaid, which includes payments to nursing homes and hospitals.

**Craig**: Other health programs represent nearly 7 percent of our annual human services budget. Programs provided include such things as community health programs, preventive health care and county hospitals.

Corrections represents another 6 percent of the annual Human Service System expenditures. The State of Minnesota operates eight adult prisons and juvenile correctional institutions. In addition, most of the State's counties operate jails. Corrections also includes, however, parole and probation services, residential treatment programs, restitution and victim services.

Finally, both individuals and communities are assisted through such programs as fuel assistance, weatherization and community action programs. These services account for 5 percent of the annual Human Service System expenditures in Minnesota.

**Smaby**: Clearly, the Human Service System touches the lives of thousands of Minnesotans each day. Who are they and how many do we serve? Here are but a few examples:

- Each month in Minnesota, there are **45,000 families** who receive AFDC grants. This represents nearly 8 percent of all families in Minnesota who have children under 18 years of age. But perhaps even more striking, **almost two-thirds of all families headed by women** are AFDC recipients. Most AFDC households consist of one adult and two children. The median age of the children is seven years. The vast majority of recipients (84 percent) are white; 8 percent are Black and 7 percent are American Indian. Forty percent of the recipients were required to seek assistance because of divorce; and another 40 percent of the recipients sought assistance because they were unmarried and without support for their children.
- Approximately 8,500 individuals depend upon General Assistance each month in Minnesota. The vast majority (89 percent) of General Assistance recipients, today, are individuals who cannot work due to physical or mental disabilities. Their average age is 35 years; 70 percent are male and 30 percent are female. Since 1981, General Assistance has provided only limited assistance — in the form of a once-a-year grant — to persons who are unemployed due

to no marketable job skills.

- **Craig**: Each month in Minnesota, there are approximately 80,000 households involving 200,000 individuals who receive food stamps. The average household size is 2.8 persons; the average monthly gross income for these households is $326. Over 80 percent of the recipients are unemployed.
- More than 104,000 households in Minnesota received fuel assistance this past year in order to pay their utility bills. And only last October, nearly 200,000 people stood in long lines to receive five pounds of cheese as part of our food surplus distribution program.
- By the way, less than 50 percent of the persons eligible for food stamps or fuel assistance actually apply for help.
- During 1982, we provided Medicaid payments to vendors on behalf of 135,000 persons each month. Twenty-eight percent of the Medicaid recipients are blind, disabled or over 65, yet they account for over 80 percent of all Medicaid dollars expended.
- **Smaby**: Our juvenile courts across this state will handle approximately 15,000 juvenile cases this year involving dependency, neglect, abuse or delinquency. Over 6,000 children will see the inside of a detention facility this year; another 1,200 will be confined in state or county juvenile correctional institutions; and a minimum of 6,300 children will be placed in foster homes, group homes or residential treatment facilities.
- Our adult criminal courts will process approximately 4,500 felons and nearly 25,000 misdemeanants. Nearly 1,200 men and women convicted of felonies are sentenced to one of our four state prisons each year. (Our prison capacity is either 2,000 or 2,400 beds depending upon whether Oak Park Heights is fully opened.) In addition, 79 counties operate jails or workhouses which have a total capacity of 2,800 beds. During an average year, nearly 50,000 people will pass through these county facilities.

**Craig**: The cost of this Human Service System is significant. As noted earlier, nearly $2 billion in combined federal, state and county revenue is spent annually on this system in Minnesota alone.

How does the State spend its share? What are the costly programs? And how rapidly and significantly are the costs for this system increasing? The answers to these questions may be surprising to many of you.

The State of Minnesota appropriates 20 percent of its total budget for health, welfare and corrections programs. Given the array of services provided and the thousands of persons served, it is perhaps surprising to realize that this Human Service System is not the first, but rather the third major expenditure of the State following tax relief and education. How is this money spent?

**Smaby**: As shown here, nearly half of all state welfare expenditures go for Medicaid payments to vendors of medical care. The next major welfare expenditure is for state hospitals and institutions for the mentally ill, mentally retarded, or chemically dependent. Only 18 percent of the State's $650 million welfare budget supports the income assistance programs and only 9 percent supports direct social services.

In Corrections, nearly two-thirds of the State's appropriation funds eight adult and juvenile correctional facilities. Over 80 percent of the State's professional correctional employees work in these institutions. Yet, these institutions serve less than 20 percent of all adult and juvenile criminal offenders.

**Craig**: The costliest program within the Human Services System is, however, welfare Medicaid. Medical assistance payments in Minnesota account for over 40 percent of the nearly $2 billion in federal, state and county funds spent for human services each year.

Persons aged 65 or older account for more than half of all Medicaid expenditures, yet they represent only 20 percent of all Medicaid recipients. A primary reason for this disproportionate cost is the type of services provided — nearly 48 percent of all Medicaid dollars go to nursing home care for the elderly. Our institutionalization rate is nearly double the national average. Minnesota ranks second nationally in the percentage of Medicaid dollars going to nursing homes.

And these costs are increasing.

In the last five years, MA payments have increased at a greater rate than the medical consumer price index. In fact, between 1976 and 1981, MA payments for persons in nursing homes have increased **twice as fast** as the medical consumer price index; and **three times as fast** as MA payments for low income families and children. Cash Assistance programs, such as AFDC, on the other hand, have not kept pace with the growth in the total consumer price index.

**Smaby**: Given the tremendous cost of medical services, it should not be surprising to find that the elderly and disabled use proportionately more public welfare dollars than do families or individuals. Approximately 39,000 elderly are served each month in Minnesota at an annual cost of $348 million. A similar ratio exists for the disabled. In contrast, we serve over 100,000 families (or three times the number of elderly or disabled) at an annual cost of $371 million.

**Craig**: Myths abound in the Human Service System and all too frequently guide public policy decisions. Hopefully, we have just corrected one prevalent public myth, namely, that most public welfare dollars go to AFDC families, when in fact most welfare funds support the elderly or disabled. But there are many more myths. We have time to touch upon just a few.

For example, the war on poverty has been won.

Martin Anderson, President Reagan's former chief domestic policy advisor, made that observation shortly before assuming his duties. It may help explain much of what has happened to human service funding during the past two years. Certainly the statement reflects the thinking of many people today.

Unfortunately, the statement is not true. In 1981, 31.8 million or 14 percent of all Americans lived below poverty. That equals the highest rate of poverty since 1967. Only two years earlier, the rate was almost two and one-half points lower. As tragic as that seems, as many as 4 million more people dropped below poverty during 1982. The rate of poverty in the year just completed will be even higher.

A lower percentage of Minnesotans live below poverty, but the recent "rising tide" of poverty affects this State as it does others.

Poverty statistics translate into needs for the entire gamit of human services. Children who are poor need nutrition programs. Unemployed families which are poor need help paying their energy bills. Single mothers who are poor need day care so they can work. Seniors who are poor need health care, disabled people who are poor need vocational rehabilitation, and on and on. As poverty rises, it's a safe bet that need for services which respond to manifestations of being poor rises as well.

**Smaby**: Within the welfare system, the prevalent myths are: (1) that people on welfare don't want to work; (2) that people stay on welfare forever; (3) that benefits are over generous; and (4) that fraud is great.

The facts, however, are quite to the contrary. In a recent survey of over 1,000 persons who sought emergency welfare aid in Hennepin County, 64 percent stated that providing job opportunities was the single most important thing which must be done by society; only 2 percent of these people felt that expansion of welfare was the most important thing to do.

Another example may be drawn from the results of a current study being conducted by the Center on Urban and Regional Affairs of AFDC recipients in Hennepin County. In February, 1982, new federal regulations were implemented which presented a majority of working AFDC recipients with a tough decision — in order to maintain their AFDC grants, they would have to either quit their jobs or reduce the number of hours they worked. Nearly 70 percent of the AFDC working recipients chose to maintain their jobs and, therefore, were terminated from the program in February. By July, 1982, 90 percent of these people remained off welfare. They lost real income and access to essential services. They've remained off welfare despite a loss in the quality and availability of day care, a loss in health care and a loss in income. Nearly 20 percent of these adults and 30 percent of their children are without health insurance. They must pay their medical expenses out-of-pocket and thus delay trips to the doctor and dentist. This should not be taken as an endorsement of the federal action for these families are living marginally — it is an example of people's desire to work, however.

**Craig**: Equally untrue is the belief that "once a welfare recipient, always a welfare recipient." Nearly 40 percent of all AFDC recipients are on the program for less than a year. Sixty-seven percent are on the program for less than three years.

There is also a public perception that welfare benefits are generous. The average AFDC grant each month is $349. The average General Assistance grant is $224 per month. The maximum monthly food stamp allotment is $125 a month. Poor people must spend a greater percentage of their income on basics like housing and energy and have less for food and medical care than the non-poor.

**Smaby**: Finally, there is the belief that fraud is great throughout the welfare programs.

*Reality:* When someone applies for welfare, outside proof is required and obtained about their:

Identity
Place of residence
Income
Cash assets
Vehicle and real estate ownership

As a further check, both county and state officials do quality control studies of the welfare case. Of the mistakes made, about 60 percent were made by the worker, and 40 percent by the clients. Mistakes involved both underpayments and overpayments.

Error and mispayment rates are often confused with fraud. Fraud, that is the intentional lying by people receiving AFDC, General Assistance or Food Stamps, was identified in only .01 percent of the cases in 1981, a typical year.

**Craig**: There are also myths in the corrections or Criminal Justice System as well.

For example, it is usually believed that most crimes committed are violent and that most criminals are repeaters. In Minnesota, only 5 percent of all crime is violent. And, only 15 percent of our criminal population have extensive criminal histories.

It is also believed that if an offender is not sent to prison, he/she is not being punished. Twenty percent of our adult offenders are sentenced to state prison. Another 40 percent are sentenced to serve time in county jails and workhouses and must abide for a period of years by a variety of rules or face state imprisonment.

And, it is almost universally believed that tougher sentencing laws will reduce crime. Virtually every study of this problem has shown that the severity of the criminal law has little or nothing to do with deterring lawlessness. Those committing street crimes act out of an utter irrationality often induced by drugs or alcohol. Furthermore, half of our felony offenders are juveniles and, therefore, would not be subject to the proposed tougher adult criminal laws. In order for deterrence to work through harsher criminal laws, we will first need to produce a criminal population that will act rationally and weigh the costs and benefits before committing a crime.

**Smaby**: Finally, within the health field there is a misconception of recent origin. Namely, that preventive health care will mean that people will no longer get sick — will no longer grow old. Preventive health care is essential but its value will be diminished if our expectations are that it is the answer to health care or soaring health care costs. As with so many of these myths, we tend to ignore facts in search of quick fixes to extraordinary complex problems.

**Craig**: What then are the issues, the complex problems which confront us in the 1980's.

## SAFETY NET

The State has a responsibility to provide an ultimate safety net for those in need. As you know, the changes made in General Assistance at the beginning of the current biennium removed the **last** source of public assistance for Minnesotans. As my good friend Don Fraser points out, in Minnesota for the first time in over 100 years, we offer no help for those who are reduced to utter poverty.

The "ultimate safety net" was dismantled not just for those made ineligible at the **time** of the change. It was also dismantled for those who, over the past two years, have had federal support withdrawn, or who have become victims of the economy, **families**, especially Southeast Asians, removed from AFDC; **disabled** people suddenly deemed "employable" and therefore, ineligible for SSI; and, of course, **workers** in economically depressed areas of the State like the Range, inner-city neighborhoods and hard-hit agricultural communities. General Assistance is gone for them as well. That safety net must be reestablished.

## RETARGET AND RESTRUCTURE RESOURCES

In the face of declining revenues yet ever increasing social needs, it is said that we must retarget our resources and restructure our services. We would agree, but exactly what does this mean?

Let us first address the issue of retargeting our resources.

In the last two years, many of the federal and state reductions in human services have run counter to our changing demographic trends.

We have reduced assistance to poor families at a time when the number of single parent families with low and marginal incomes have increased.

We have reduced work and training programs at a time of rising unemployment.

We have reduced the availability of child day care at a time when there has been both a dramatic increase in the number of two wage earner families and a termination in welfare assistance to thousands of single parents. We have reduced our funding for preventive or home-health services forcing even greater reliance on expensive institutionalization.

Our human services policy and our State's economic health must be evaluated in light of these and many other significant demographic trends. Those who are most needy today are not necessarily those who were most needy ten years ago.

When we speak of restructuring our services, there are many possibilities worth exploring.

Consideration should be given to modifying the budget-setting process to focus on the service continuum of each population in need rather than on single categorical programs. We must deregulate our income assistance programs. There are too many rules. We must finally tackle what has been documented to death – namely, the confusing, often duplicating and at times contradicting social services.

We presently have few mechanisms in place for cost containment. The development of reimbursement incentives to promote efficiency and contain costs in nursing homes and other institutional services is critical, as is continuation of the shift to less restrictive, less expensive levels of quality care. Institutionalization, be it in the health, welfare or corrections areas, is so expensive that we must reserve it for those who really need it.

We must explore ways to facilitate the assumption of a greater role on the part of employers in providing and financing day care services.

We must explore ways to use job training and job programs through such efforts as job subsidy programs to stimulate job creation and economic development in our communities and as an alternative to welfare assistance.

And, we must hold accountable both fiscally and programmatically all agencies involved in the delivery of human services – be they governmental, non-profit, or for-profit. This can be accomplished through stringent evaluation, competition among providers, and greater freedom of choice among the "buyers" or recipients of service.

As we move to "retarget" and "restructure" our Human Services System, we recognize that there will be a variety of competing public interests. For example, the closing of the hospital in Rochester last year was a decision which impacted the community, and the employees. It was an issue which could not be discussed in terms of client utilization rates alone.

Another and very recent example was an attempt by Hennepin County to participate in a national pilot project which would provide cash rather than food coupons to food stamp recipients in order to reduce the expense of administering the program. The Federal Government reversed its earlier support of this project as concerns were expressed that providing cash rather than food coupons could diminish economic support to the agricultural industry. Why? For fear that recipients might not spend their "cash" for food.

Thus our efforts to retarget and restructure our Human Services System in the face of declining revenues will not be easy. But such efforts will be no more difficult, and in the long run, more effective than our past experience of either cutting programs or raising taxes.

## SELF-SUFFICIENCY

While it is essential that the State make sure that there is a secure permanent safety net for those in need, it should also encourage increased self-sufficiency.

There has been a couple of tendencies that should be reexamined and, in our judgment, modified. One is the setting of formulas, eligibility guidelines, etc. If you fit the formula or are below the guideline, you receive the service or assistance. If only just above the cut-off point, you do not. And in times of declining fiscal resources, the guideline is moved down.

The other tendency is to remove people from their homes and give them total care. The philosophical approaches of the last 30 to 40 years and the funding incentives of the last 10 to 50 years has been to remove the young, the disabled, the elderly from the home and from a sense of self and/or family responsibility. Even when we have shifted to so-called community facilities, the size and location have been different but the expectations regarding assuming responsibility by the individual or family have still been abysmally low. Group homes for juveniles rather than Red Wing or Sauk Center often is not a move in the direction of self-sufficiency.

The choice for the State is not to opt out of its responsibilities for the young in need or the young offender; the elderly, the mentally ill or developmentally disabled. The choice for the State in income maintenance programs is not to just set **fiscally determined** eligibility guidelines.

The choice for the State, the responsibility of the State, the challenge for this legislature is to provide fundamental support: day care for working mothers or those in school; General Assistance and training or retraining for the unemployed; meals or other assistance for the basically able elderly, mentally disabled; etc.

But there must also be incentives for vendors, recipients and families of recipients to assume more responsibility coupled with the State support toward self-sufficiency. Your challenge is to resist both those who say that the family and church, non-profits and other parts of the private sector should and can meet the responsibility almost totally and those who say that the State can do it all. What the State can do is both support and build toward self-sufficiency.

## CONCLUSION

**Smaby**: In the last half hour, Earl and I have but scratched the surface in discussing our State's Human Service System. This $2 billion system serves thousands of people daily. It is not ineffective but it can be made more effective. This will involve: (1) basing decisions on current facts; and (2) challenging and permitting the public and private sectors to take risks, to compete, to produce results. Such efforts have begun in Minnesota: for example, we now offer pre-paid health plans to some welfare recipients — in the hopes of fostering cost containment, competition and freedom of choice. We are increasing our use of fees for certain public social services and we are just beginning to test such things as temporarily subsidizing jobs in the private sector or examining the use of direct cash payments to reimburse family members for in-home care of their elderly. These and many other creative ideas are worth demanding from all providers or producers of services. We thank you for your attention and for this Conference. And I thank you — Earl — .

# • EDUCATION

Rolland Dille
*President*
*Moorhead State University*

**Rolland Dille**

You have, or will shortly have, a report from the Higher Education Coordinating Board. It outlines, succinctly but fully, a number of issues that you will surely confront this year, as well as issues that you may not deal with directly at this time, but that will persist.

I will touch on only some of those issues.

It may be useful to begin with some history, for the challenges of the '80s spring from the past. In 1940, the Depression just about over, and the second World War about to involve us, public higher education in Minnesota was supplied by the University of Minnesota, enrolling about 12,000 students, many in graduate programs and professional schools; by the six teachers colleges, including Duluth, later to become a campus of the University of Minnesota, and by nine junior colleges, supported and governed by local school districts. Five of these were on the range, testimony to the benefits of local taxation of the iron ore industry.

With the end of the war came the G.I. Bill and thousands of young men who sought education as a means to make up for the lost years of the war. There was some building, but mostly there was over-crowding.

The building and a few new campuses came later, in the 'sixties, when the second result of the early years of peace, the baby boom, turned into a flood of post-adolescents.

The University of Minnesota showed dramatic growth, especially on the Minneapolis-St. Paul campus. Duluth was added in 1947, Morris in 1959, and then Crookston and Waseca.

It seems sometimes to be thought that the growth of our colleges and universities was entirely the result of the growing population of college-age young people. But as strong a reason for growth lay in the needs of the state — its society, its culture, and its economy — for men and women with college educations. Much of the growth of the University of Minnesota, indeed, has less to do with the need for greater numbers of educated people than with the increasing complexity of modern life. In its Institute of Technology, in its College of Agriculture, in its medical school, in its departments of natural and social science, scholars seek out the basic knowledge upon which rests the modern world and others build bridges between pure science and practical application. All of this has not only state, but world-wide effects.

Nor is it true to see the state universities as responding to sheer numbers. Winona, Mankato, St. Cloud, Moorhead, and Bemidji had started as teacher training institutions and that continued to be their central, even so purpose. But by 1957 when they were re-named sta colleges, it was clear that a great many students wh chose to attend them sought careers outside of education. The newer institutions, Southwest and Metropolitan, did not see teacher training as central to their mission. I remember a time, in rural Minnesota, when very few high school graduates went off to college. And little more than a generation before that, rural communities provided spaces and occupations for two-thirds of the young as they became adults. And to most of those, even a high school education seemed a luxury. But the needs of the state, clearly in 1957 and even more clearly in 1980, required many of these young people in its cities and it required that they be educated. Thus the widening array of programs that led to the name change — to universities.

As the state colleges grew, the junior colleges were joined in the community college system, increasing to 18 in number; a recent merger has reduced the number to 14. The six metropolitan colleges, created in the '60s, grew most rapidly of all. In a quarter of a century, and despite its own rapid growth, the University of Minnesota had become unable to cope with the numbers of metropolitan young people who wanted to attend college. Again, it was not simply the numbers of young people in the 18 to 24 year age group. Minnesota has a nearly universal high school education and an ever-larger percentage of high school graduates sought additional education. The community colleges, better than any other system, show th college is not just for the traditional college-age studen as an increasing number of people have asked the assis ance of our colleges in building new careers.

Finally, no picture of higher education in Minnesota is complete if only public education is described. Private colleges, some older than the state, have made and continue to make significant contributions not only to the lives of young people but to all aspects of the life of the state.

To these systems of higher education must be added the Area Vocational Technical Institutes, preparing people for many occupations, and reflecting, everywhere, the needs of a technological society.

Here then is higher education in Minnesota, the envy of the nation and the despair of appropriations committees.

Like every enterprise depending upon appropriation, higher education will be subject to your closest scrutiny. More than at any time in the past, basic questions will be asked.

Let me try to survey the principles that basic questions will ultimately bring us to, principles that have governed legislative action through the years that this great enterprise has been developed. I do not know that these principles have ever really been set down, and I will not myself put them into statements. Let me simply say that they have to do with serving the needs of the state, with providing broad opportunities, and with achieving high quality. Even in discussions necessarily dominated by economic considerations, attention must be paid to these principles.

"High tech" is the currently fashionable term. It is, of course, more than fashionable. The shape of the modern world is increasingly determined by technology; a state that wants a prosperous economy must have a piece of the action, and it will get its piece of the action not just from the entrepreneurship of business and industry but by having available the educated men and women who will create not only new technology but the science on which it depends. Even the simplest questions about these needs seem to require complicated answers. Such a simple question as this, how do we get enough science and math teachers into our high school classrooms? It may be that high school students deeply committed to science will find enough solid teaching, and will survive make-shift teaching. The real problem is that not enough students, of vague and unformed interests, are confronted with science, in either high school or college, to be seduced into usefulness by the excitements of the blackboard and the laboratory.

And a whole generation of scientists is lost. It is not, of course, only scientists who are lost. After a generation of providing technical-vocational education so that high school graduates can move directly into the labor market, we are now told that American industry is being severely undercut by the failure of the ability of young people to read, write, and handle mathematics at a useful level. These are very much issues for higher education.

At the same time, the needs of the state must not be too narrowly defined. A world of complex machines and high tech prosperity may nevertheless be a barren world. And not only barren, but a world in which even the machine and the prosperity are threatened.

Without a legislative commitment to the wide range of learning, the liberal arts will be lost and without the humanizing and spirit-raising impact of the liberal arts, much that has made us proud of Minnesota and happy to live here will be lost: the arts, civic responsibility, admiration for different cultures, a sense of history — these need your encouragement, as they have had it. It is not our relation to the machine but our kinship with humanity, whether we come to know it in Shakespeare's London or in the streets of Lake Wobegone, that will determine the quality of the life we lead, individually and together. This is, I assure you, not simply a sentimental notion. However dramatic a centerpiece the computer provides for future education, its potential is not unlimited, and we will, at great peril to our future, allow it to replace those disciplines that encourage reading and reflection and inspire the habit of profound, rigorous and original thought.

The question of opportunity, of access to education, has changed somewhat with the inevitable decline in the numbers of college-aged students. It was long ago decided by the legislature that the state should build institutions that would lend easy access to colleges for most people in the state. As you consider the prospect of declining enrollments and contemplate the pattern of institutional placement, and make tough fiscal decisions, you will need to keep in the backs of your minds the question of access, of educational opportunity.

The HECB projects a seven percent decline by the end of the 1983-85 biennium and a decline of 20-25 percent by the mid-1990s. I do not know if these figures are accurate since there are always factors hard to isolate but it would be foolhardy to act as though there would not be a considerable decline in enrollments overall. That will still leave both a great number of students and a continuing need for educated people. And it will still leave uncrossed the goal of offering wide, if not universal opportunities to those capable of profiting from a college education.

Central to the issue of opportunity is the principle of low-tuition public education, which, even in a period of generous federal student aid, has provided the best means for providing access to college for most Minnesotans. A substantial deviation from this policy would alter the expectations of a great many young people.

Low tuition is possible only if appropriations match needs or if quality is very much lowered.

The distribution of state funds to the several systems is generally based on formula, but that suggests a rather simpler process than the one that obtains. Not only the numbers of students, but the level of instruction, the differing costs among programs, the size of campuses, and tuition policies are factors in the distribution of funds.

For instance, tuition policy has required larger appropriations for students in the AVTIs. The level of instruction — large graduate programs and high cost professional programs — account for the larger appropriations per student at the University of Minnesota.

It is useful, I think, to point out, as does the HECB, that constant dollar appropriations per student have declined since 1979. This is partly due to the enrollment bulge policy that held systems to appropriations based on the number of students enrolled in 1977, despite large increases in enrollments since that time. It is further due to a reduction, during the 1981-83 biennium, of $40 million dollars from the original appropriation. Given the success of the institutions in dealing with this crisis, it is difficult to credit suggestions that new legislation is required to reduce inefficiency and increase productivity.

A further issue involving access has to do with programs for student assistance. Such scholarships and grants have grown steadily since 1970, during a period of the most generous federal student aid. As federal funds decline, the state will need to face a serious policy issue here. It should be pointed out that such state assistance is for Minnesota students only, in both public and private institutions.

Finally, there is the matter of quality. It is too simple to equate money and quality, but the relationship is real. It is certainly true that the period of our greatest prosperity was also the period of our greatest educational improvement. But the fact that improvement was not universally achieved indicates something of the complexity of the problem. Quality is, of course, difficult to measure; it is also difficult to achieve through state policy. In a time of austerity, it is, perhaps, the responsibility of the legislature to take such action as will assure that colleges do not bite off more than they can chew. House File 2 aims at just that. The curriculum review process of HECB has been an effective means of preventing costly duplication and of requiring institutions to produce evidence that they have the capabilities to do what the propose doing, but I think that it is a process that works best in a time of non-crisis. Increasingly I have come to believe that the best assurance of quality lies in a system board's understanding of and commitment to quality, and in it power to appoint chief administrators.

I do not have much faith in the panaceas of combining Boards and merging administrations, especially in a time of crisis, when the need for leadership is greater than ever. And leadership, if it is to be effective, must be supported. There are real problems if public employee legislation puts too many critical decisions into the hands of arbitrators who are indifferent to matters of quality and ignorant of the means by which high quality is achieved, or, more likely, destroyed.

As it makes decisions about higher education in a time when deepening fiscal problems conflict with a continuing need for an educated citizenry, the legislature will need much information and great wisdom. That the advice of chancellors, presidents, and faculty members often proceeds from self interest is unfortunately true, but the legislature is not thereby better served by the advice of those innocent of campus experience, generally indifferent and often hostile to the welfare of public education.

For education in Minnesota is still of central importance, it is a high enterprise, much is expected of it, and its problems, its health, and its future require the most thoughtful consideration by the legislators of this state.

## "Challenges in Education in the '80's"

Ruth E. Randall
*Former Superintendent of Schools*
*(Independent School District #196);*
*As of July 1, 1983, Commissioner of the*
*Minnesota Department of Education*

**Ruth E. Randall**

Governor Perpich, Senator Moe, Speaker Sieben, Senators, Representatives, and Invited Guests.

Thank you for the invitation to speak to you today about the challenges in eduction during the '80s. I see five primary challenges. Some are stressful. All are exciting.

### Greatest Challenge – Recognize the Trends

The greatest **challenge** is to recognize the **trends** which impact all of society, including education. As we move from the industrial era to the information era, schools are among the institutions which will have to change. I have spent a good part of my professional life in organization development, where change was affected **within** the organization. Attitudes were changed. Curriculum was changed. Teaching methodology was changed. Now change **within** the organization is no longer sufficient. The institution itself will have to change.

The **trends** suggest people want something quite different. We are in a "bottom-up" society in which the energy and initiative of individuals, groups, communities, and companies depart from traditional ways. New problem solving techniques are being developed. Real innovation is taking place at the bottom.

The **trend** toward decentralization is nationwide and present in all institutions. There is a growing desire for self-reliance and self-competence. People want to participate and to be involved. They want to have a part in decision making, if the decision affects them. Last spring when Independent School District 196 had to cut $2.3 million from its budget, the 1500 staff members brainstormed ideas. The 727 teachers held quality circles with the 13,000 students to get their suggestions about how we might save money. Over 2,000 parents came to our giant meeting on March 25. Over 4,000 written responses were received from the citizens.

The move toward greater accountability is another **trend** which directly affects us in schools. Parents, citizens, and those of you in the legislature want to know what elementary and secondary educators are accomplishing with the allocated dollars. Productivity, performance and quality are key demands.

The **trend** of high tech/high touch is changing education. Not only within the traditional institution, but in homes and in commercial enterprises. The electronic generation of children is different in how it thinks and learns. Many of us who are teachers came out of a religious or spiritual background and we have a sense of caring for one another. The high touch of a teacher, combined with the high tech of the computer, is a natural for education. Our teachers, our parents, and our Board of Education are cognizant of the great potential of the computer for teaching and learning. We believe that with the computer technology we can further develop the potential of the child. We can offer opportunity for the development of the potential of the teacher and other staff. And we will spend fewer general fund dollars in doing so.

The **trend** of multiple options is one to which we must respond. Every aspect of education may change: **who** we teach, **how** we teach, **what** we teach, **where** we teach, and **when** we teach. The learners want options for teacher styles, curriculum content, organization structure, delivery, time, timing, facilities, and space for learning. Public policy, rules, and regulations will have to change to accommodate the ideas we envision.

As these and other **trends** impact us, the institution will need to be restructured. The information society is based on knowledge. Since we all have intelligence, each of us can have a part in changing the institution.

### Second Greatest Challenge – Money

The second greatest **challenge** is money. Operating schools with fewer dollars is stressful. Providing exemplary academic and cocurricular programs is given A in the State of Minnesota. The increase in real dollars for a period of at least two decades has raised expectations and allowed for fantastic learning opportunities for our young people.

The **challenge** of competing for fewer dollars with other human needs and essential services is also stressful. When there are more successful surgical trnasplants and implantation of artificial organs, human beings who live longer will have different needs. It will be a challenge to help these people continue to value education so they will want to be supportive of schools with tax dollars.

The **trends** to which I have alluded make restructuring the schools necessary; the **lack of money** may hasten the restructuring. Most action taken to this time has been to reduce or eliminate programs and staff.

**Third Challenge — Curriculum Content — "World Citizens"**

The third **challenge** is determining the content of curriculum and the scope and sequence of it for the '80s and '90s. My youngest grandchild will graduate from high school in the year 2000, if we still have the traditional high school. As his grandmother and as a professional educator, I asked my daughter and son-in-law, "What do you want your child to learn in the next 17 years?" "Whose responsibility is it to see that he learns those skills, attitudes, and that knowledge?"

They answer that there is a dual responsibility; theirs as parents and that of the school. They want him to be knowledgeable of the humanities, of science and mathematics, to possess the functional skills (and they include computers as a functional skill), to possess coping skills and to have moral values. They further say that they want him to be "a citizen of the world." They have a desire for him to know the value of prevention, whether it be of conflict and war or of illness and accidents. The nuclear freeze, the peace movement, the health and wellness movements are important to them and they want "prevention of" for their child.

To function as world citizens, people will need to know Chinese, Japanese, Russian, and Spanish among the various languages. Students will need knowledge of the economics, politics, government, and geography of China, other Far Eastern countries, and the Third World countries as well as of the United States and Minnesota.

**Curriculum Content — Mathematics and Science.** The challenge of training students in mathematics and science throughout the country is well documented. We hear reports that mathematics and science courses in other countries are more rigorous. Math and science teachers are leaving teaching to accept positions in business and industry. Will we have the trained engineers, scientists, and technical experts needed in the future? One of our Board members believes we must address our part of this problem in our District.

**Computers — Learning and Management.** The computer and other technologies have great possibilities for teaching/learning and for instructional management. What an exciting **challenge**! Our teachers are providing drill and practice for students in grades 1-8 via the computer, but the electronic workbook or textbook page is capital expensive. Our teachers believe the greatest boon to learning, and an excellent use of capital dollars, is through computer **managed** instruction. The child can learn at his or her pace with the appropriate technological equipment in the classroom. For instance, the gifted child could be working on one lesson, the average student on another lesson and a slower student on a third lesson, all at the same time. The children could be "teacherless" for a portion of the time, then meet for the teacher assisted instruction.

Concepts can also be learned via the computer; I have observed this phenomenon in our eighth grade algebra classes. If the computer were interfaced with video, the same teacher's efforts could be repeated many times, thus, making learning less **labor intensive.**

**Computers — Operational Management.** Our directors and assistant superintendent tell me that through the use of available technology in monitoring and managing energy usage, general fund dollars can be saved. They have documented that general fund dollars can also be saved through the purchase of our own communications system and the establishment of a management information system using technology to a greater degree. An electronic office using computers, word processors, and a micrographic system will also be general fund dollar savers.

**Fourth Challenge — Teacher Tenure and Licensure**

The fourth challenge is with teacher tenure and licensure. The delivery of instruction will be a **challenge** in some schools. In some cases, recently trained teachers have been placed on unrequested leave or terminated.

Teachers who hold life licenses in several subjects have been transferred to subject areas where they **may** not have had recent training. Their **teaching skill** is not questionable. But **what** is their depth of knowledge in areas of genetic engineering, industrial robots and lasers, geriatrics, bionic medical electronics, aero astronautic engineering, computer data processing, systems analysis and programming?

Therefore, the **challenge.** Due to student decline and dollar shortages, we have recently trained teachers who cannot teach because of tenure and licensure laws. We have tenured teachers who may be less able **in knowledge of the content** who do teach because of tenure and licensure laws.

Presuming their willingness, do we retrain the older cadre of teachers? At whose expense? Or do we leave the content of the curriculum as it has been rather than offering those classes which are predicted as needs for employment for the future? What is the best use of the trained human resources? Dollar resources? What is "right" for teachers? "Right" for students? "Best" for Minnesota?

**Fifth Challenge — Unions and Employee Groups**

The fifth primary **challenge** is in working with the dozen or so unions and employee groups in a district. The trends indicate there are fewer unions nationwide; employees and employers are working together to solve the problems of the organization. A participatory management style provides for the building of advocacy relationships rather than adversarial relationships. In restructuring the institution, the bottom-up approach makes it possible for employees and management to use logical rational processes in a synergistic effort, which can benefit everyone. Emotional energy need not be consumed in attacks and counterattacks.

### Institutional Change

How can the institution be changed? It can be changed by using the creative and innovative abilities of the institution's employees and consumers. That's the bottom-up approach. I'll speak briefly about seven ways in which we've **begun** the change in our District.

**196 Foundation.** First, teachers in our district, through their exclusive representative, envision the establishment of an Independent School District 196 Foundation or corporation. The purpose of the Foundation would be to generate monies; provide employee entrepreneurial opportunities; manage employee/business partnerships; provide shared student/business partnerships; provide consulting and contracted services; and manage health care, investment, and retirement plans for employees.

Funds held by the Foundation would be used to maintain and improve quality programs and staff which may be reduced because of budget cuts. Equally important will be the opportunities provided for staff and students to use their unique potential to the limit each of them determines. The vision includes retraining staff members for other responsibilities in the restructured institution. Thus, if technology allows for teaching/learning to be less labor intensive, we create different jobs for those people through the Foundation.

**School/Business Partnerships.** Second, over the past several months, we have been working at the possibilities of developing school/business partnerships. Of the three businesses which have indicated an interest in working with us in a partnership, two would use the conceptual abilities and technical skills of our teaching staff in developing courseware for computers. The third business would use the conceptual and technical skill of our executives and secretaries in energy management and establishment of an electronic office. If these employees become entrepreneurial in their efforts, they could benefit, the school district could benefit, and the business could benefit.

**Citizen-Staff-Student Task Forces.** Third, we have 12 Citizen-Staff-Student Task Forces studying various issues. The Long Range Plan Task Force is dealing with the responses received in the district-wide survey carried out last spring by citizen volunteers and the district staff.

**Child in Today's Society.** The Citizen-Staff-Student Task Force entitled The Child In Today's Society, is working on a position paper regarding the school's role in dealing with the child today. We have begun dialogue with the leaders of the religious institutions in our area and on the "lifting up" of the family. Both preachers and teachers are advocates of the family as a primary institution. Both preachers and teachers have special concerns about the child in the one parent family, the two parent working family, and the general stresses of the world in which children live.

**School Based Management.** Fourth, principals are exploring the idea of school based management. They are attempting to determine how the parents, teachers and principal in a school attendance area can best make decisions on budget, staffing and curriculum. Parents know what they want for their children just as my daughter and her husband know what they want for their year old son. Parents should be encouraged to express their desires. They should be given choices. They should have some power in determining the kind of education their children receive. Decentralized, deregulated schools will need changes in public policy and regulations which would prohibit their development.

**Human Resources Development.** Fifth, we have a common mission of treating each child as a unique individual with unique potential, whose limits he or she will ultimately determine. Human resources development and teaching emphasis is on the higher level thinking skills; on the basics; on computers; and on character development. Monitoring pupil progress is a requirement in each of the 15 school buildings.

**Cities and Townships.** Sixth, we realize there are areas in which we might work in cooperative ventures with the chambers of commerce, service organizations and the cities and townships. We are willing to work with them and have offered the opportunity to meet with interested people to see how we might share our skills.

**Board of Education.** Seventh, we have a Board of Education, who as policy-makers, set yearly goals. They emphasize the development, supervision, and evaluation of the superintendent, principals, teachers and support staff. They hold strong convictions about the productivity of each employee, while encouraging development of the potential of each individual.

### Legislative Help

Without being presumptuous, I would ask you as legislators to help us meet the challenges of the '80s.

You can optimize the opportunity for creative problem solving by reducing statewide direction. If you believe in the grass roots, then you believe the people know best what they want in the school districts in Minnesota. Any parameters you set should be very general and very broad. Present duplication of services and unnecessary services should be terminated. Public policy must be changed. Deregulation is absolutely necessary. Let **us** restructure the institution according to **our** strategic vision.

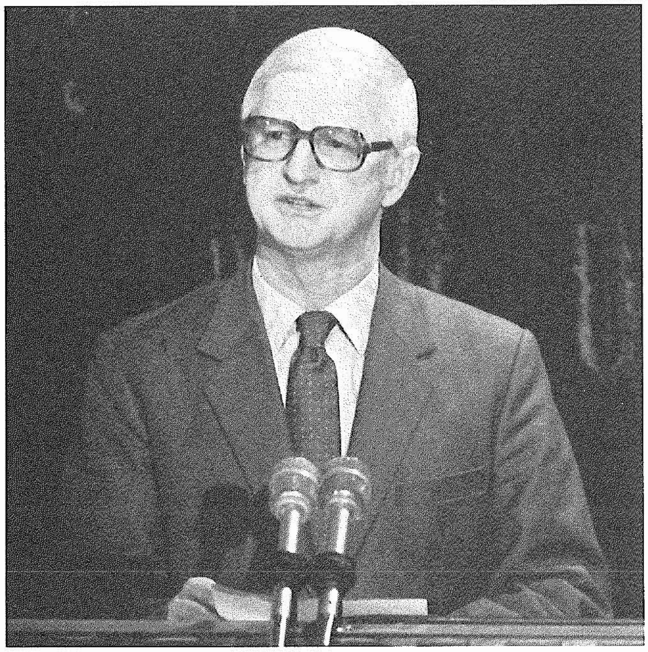
### Creating Our Own Destiny

If you agree, and act accordingly, you can help us meet the **challenge** of creating our own destiny!

# • FINANCING PUBLIC SERVICES

## Financing Minnesota's Public Services

Gerald W. Christenson
*Former Legislative Auditor*
*(Minnesota Office of the Legislative Auditor);*
*As of July, 1983, Chancellor of the*
[redacted]
**Minnesota Community College System**



**Gerald W. Christenson**

Deliberation over state and local government financing will dominate the 1983 Legislature.

- if Minnesota's triple A credit rating is to be restored;
- if we are going to eliminate the need for massive short-term borrowing;
- if we are going to reverse the undesirable impact of the large revenue and payment shifts that have been made;
- if we are going to establish an adequate budget reserve; and
- if we are going to restore a relationship of trust between the state and its local units of government;

then some tough decisions must be made.

Those of you who are veteran legislators know the painful choices that have confronted you the past two years. But you know, too, that the decisions made over the past two years have occurred in a crisis atmosphere with little opportunity to examine carefully basic state priorities or to chart a new, sound course for the state. Most of the spending cuts that have been made have been of the across-the-board variety, or have involved the elimination of relatively small programs that didn't have a broad constituency.

Most of you would agree that it is now time to step back, evaluate the entire taxing/spending pattern and then make the difficult decisions that will serve the people of this state well into the future.

As a small step in that direction, let's take a look at Minnesota's state and local taxing and spending situation. In a report issued last October, the Citizens League said,

> "Minnesotans pay more in taxes than citizens in most states, but not that much more and certainly not the most. Moreover, the trend is that taxation levels throughout the country seem to be drawing together, meaning the difference between what Minnesotans pay and what people pay elsewhere is growing smaller, not larger."

I agree with that assessment by the Citizens League.

But let's look specifically at how we rank among the fifty states and the District of Columbia in various types of taxes. Because state and local finances are so interrelated in Minnesota, it is important, in comparing us with other states, to examine taxes and spending on a combined state and local basis. For 1981, on a per capita basis:

- Minnesota ranked 11th overall for state and local tax collections;
- for individual income taxes, we ranked 7th;
- for corporate income taxes, 6th;
- for sales taxes, we ranked 37th; and
- for property taxes 22nd.

But, on an overall basis, taking into account all state and local taxes paid per capita, we ranked 11th among the states. So, while Minnesotans are not the highest taxed, we are above the national average.

What accounts for that? Where do we spend more in Minnesota than do people in most other states? Without getting into a lot of detail that time won't permit, let's look at some of the major factors in Minnesota spending more than most other states.

First, let's look at per capita expenditures of state and local governments for highways. Minnesota spends more than the national average. The reasons are obvious:

- we are a large state;
- we have a thinly-spread population;
- we have a high demand for roads; and
- we have an agriculture-based economy.

Because of these factors, Minnesota has the fifth largest highway system per capita in the country. In addition, our weather adds to construction costs. Commissioner of Transportation Dick Braun has said that, based on funding currently available, our 12,200 miles of trunk highways can be reconstructed on the basis of once every 372 years. It is clear that this legislature and those to come will have to make some hard choices in setting priorities for our state transportation system.

Another area in which Minnesota spends more than the national average is nursing home care:

- we have a higher proportion of elderly than most states;
- they live longer than just about anywhere else in the world; and
- we rely more heavily on nursing home care.

In Minnesota, we have 95 nursing home beds per 1,000 persons age 65 or older in our population. In that regard, we rank seventh in the nation. Our heavy reliance on nursing home care for the elderly is expensive and is reflected in our growing medical assistance expenditures. When the growing dependence on community-based facilities for mentally retarded persons is added, the legislature is faced with serious questions regarding the kind, the level and the cost of care into the future.

A third area where Minnesota spends more than the national average is in education:

- we have had a higher-than-average school age population;
- they have stayed in school longer; and
- they have had more options than in most other states.

I have said facetiously that one way for us to reduce our taxing and spending to the national average would be to begin counseling junior high students to drop out of school. Then we could reduce the need for high schools, vocational-technical institutes and colleges. Of course we shouldn't do that, but it makes the point that our fostering of educational opportunity costs money and is a significant factor in Minnesota being an above-average tax state.

There is another way of differentiating state and local expenditures. Because government is a service-type operation, the number of employees in state and local government and education is an important determinant in comparing costs among the various states. Each year, the United States Department of Commerce reports on the comparative number of public employees in the various states. It uses as a base, full time employees per 10,000 population. It will surprise some of you to learn that since 1970, Minnesota has never ranked higher than 36th in the number of state employees per 10,000 population. That is to say that at least 35 states have had more state government employees per 10,000 population than Minnesota has had over the past eleven years. And if one combines state and local government employment, **leaving out employment in education,** Minnesota has consistently, since 1970, had fewer state and local employees than the national average. The area in which we consistently **exceed** the national average is in education employment and the difference there has been reduced in the last few years.

What do these employment numbers mean? They mean that when compared with other states, Minnesota has a rather modest number of state and local employees, except in education, where we exceed the national average. And in education that reflects the longer time that Minnesotans spend in school and the additional options open to them.

So, let me summarize what I have said so far. Minnesota is a fairly high tax state. Most of the reason for that is that we spend more on highways, nursing home care and education. Those are all high expenditure areas and the 1983 Legislature will have to carefully consider new ways to meet needs in those areas with limited resources.

So far we have been focusing on combined state and local taxation and combined state and local expenditures. But let's shift now to a more direct discussion of the state budget.

The 1983 Legislature faces a tax-expenditure gap that ranges up to a billion dollars or more. How can that gap be closed without destroying services that have made Minnesota a good place to live, or without resorting to unfair or uncompetitive taxes that will hurt our state?

I don't have to tell you that there are no easy answers. Those were used up several budget crises ago. And the magnitude of the problem is such that it probably won't work, or at least it won't work successfully, to try to minimize the depth of the pain by sharing it on an across-the-board basis.

It is time for a fundamental sorting out of responsibilities. It is a time to recognize that we cannot continue to expand all of the programs now on the books. It is a time to recognize that state and local government in Minnesota must establish priorities based on sound principles. It is a time to take courageous action.

Let me give you a major example to make the point. A year ago, the Legislative Audit Commission charged the Office of the Legislative Auditor with responsibility for conducting an evaluation of our direct property tax relief programs. These include the homestead credit program, the agriculture credit, the renters credit and so on.

Some of our staff members have been working on that study over the past twelve months and we are now completing it. We will be releasing the report within the next two weeks and, at that time, we will be prepared to spend a good deal of time going over it in detail. But let me share with you today a few of our findings.

You'll remember I said earlier that, on a per capita basis, Minnesota ranks 22nd among the fifty states in property taxes. That's on all property including business and industry. Even though property taxes turned up sharply in 1982, indirect property tax relief programs such as school and local government aids, and direct property relief programs, chiefly the homestead and agriculture credit, have caused **net** taxes, in constant dollars, to decline about 24 percent between 1971 and 1982. In constant dollars, net property taxes in Minnesota were lower in 1982 than they were in 1965.

And then if we look only at property taxes paid by **homeowners,** Minnesotans do even better. In 1980, only eight states had lower taxes on homes, and Minnesota had the lowest property taxes on homes in this region of the country.

For example, if we examine property taxes on homes as a percentage of the market value of those homes, we find that, in Michigan, homeowners were paying 2.54 percent of the value of their homes; in South Dakota, it was 1.70 percent; in Wisconsin, 1.67 percent; in Iowa, 1.48 percent; and even North Dakota, with its ability to generate revenues from coal and oil, was at 1.00 percent.

Minnesota, at .93 percent, was the lowest in the entire region and well below the national average of 1.28 percent. Just a few days ago, we received information from the Advisory Commission on Intergovernmental Relations that shows that Minnesota ranked even better for 1981. The property tax on homes, as a percentage of the market value of those homes, declined for Minnesota homeowners from .93 percent in 1980 to .79 percent in 1981.

Now, property taxes are probably the least appealing of our major state and local taxes. And, from the very low level of 1981, property taxes have increased for many homeowners in the past year. There are projections that indicate that they may increase even more over the next few years.

In view of that, the danger is that we will adopt a blanket policy that property taxes can't increase or that they will be permitted to increase by only a small percentage each year.

The problem with that kind of policy is that it assumes that the property tax levels for homeowners that now exist, or that existed last year, are fair and appropriate.

Our study indicates that may not be the case. While there are instances of burdensome tax rates for particular homeowners in some areas of the state, we found that, overall, property taxes were not high in Minnesota when compared to the past, when compared to other states, or when compared to the market value of the property. But, we also found tremendous disparities in property taxes paid by homeowners in different areas of the state. Average property taxes in some locations were as much as five times as high as we found in the lowest tax areas.

Taking into account the financial problems of the state, we don't think that the existing disparate pattern of property taxes paid by homeowners across the state of Minnesota can, or should, be locked in as a base level for the future. That would be unfair and the cost would be prohibitive.

So, as an example of the need to establish clear priorities and to make difficult decisions, let's look at the homestead credit program.

The homestead credit program was first enacted in 1967 at the same time that the legislature approved a 3% general sales tax. It provided that the State of Minnesota would pay 35% of a homeowner's property tax bill up to a maximum of $250. The percentage and the maximum were increased over the years so that, today, the state pays 58% of a homeowner's tax bill up to a maximum of $650. These changes have resulted in huge increases in the cost of the homestead credit program and have been a significant factor in the state's continuing budget crisis of the past few years. The cost of the homestead credit program tripled between 1968 and 1979, from $79 million in 1968, to $242 million in 1979. And then, in just three years between 1979 and 1982, the cost nearly doubled to an annual cost of $479 million. Now, $479 million is a lot of money. It is equivalent to one-fourth of the total 1982 receipts from the state's income tax. It represents 12 percent of the annual general fund expenditures by the state. Or, put another way, it amounts to about $116 a year for every man, woman and child in the state. So, it is obviously a program of great magnitude that directly impacts most of us.

Because of that, it will be tough to change.

But I am convinced, as a result of our study, that you will have great difficulty solving the state's budget problems now and into the future, if you declare off limits a hard examination of the homestead credit and other direct tax relief programs.

There is no question that the homestead credit program was a significant factor in helping to hold down property taxes for homeowners during the 1970's. But the price has been high and it probably won't work into the future. What started as a program to pay 35% of a homeowner's property tax bill to a maximum of $250 was adjusted upward several times over the years to insulate homeowners from property tax increases. But now the state faces a dilemma. With limited financial resources and the soaring costs of the existing program, it is unlikely that the state can afford to further enrich the homestead formula. But if the formula remains unchanged, homeowners who are at the $650 maximum will bear the brunt of any tax increase. At the same time, the state will continue to pay 58 percent of the tax bill for many homeowners who already regard their property taxes as low. Put another way, if we continue reliance on the present formula, there will be a tendency to protect homeowners in low property tax areas from increases, while those in high tax areas will not be further helped. Continued reliance on the existing homestead credit formula will exacerbate the considerable disparities that already exist in property taxes paid by homeowners across the state.

In assessing a possible reform of the homestead credit program, we need to stop and consider the array of tax breaks that are currently provided to homeowners in Minnesota. A Minnesota homeowner is eligible for:

- reduced property taxes because of the various aids provided by the state to school districts and local units of government;
- reduced taxes because of the classification of the property;
- a homestead credit that pays 58% of the tax on the home up to a maximum of $650;
- additional state help in paying the home tax through the state's circuit breaker program if the owner qualifies on the basis of income and property tax level;
- deductions on the federal income tax for property tax paid as well as interest payments on a home loan;
- deductions on the state income tax for property tax paid as well as interest payments on a home loan; and
- in some cases, additional property tax relief based on geographic location or the special category of the homeowner.

Now, that brief listing only begins to describe the complexity and the uncoordinated nature of our various programs to limit the property taxes paid by homeowners.

But it does illustrate that loss of the homestead credit would, for most homeowners, be cushioned, principally, because of the ability to deduct property tax payments on federal and state income tax returns. Just on the basis of existing programs, if the homestead credit were dropped, the net dollar impact on many homeowners would be cut in half, or even more, and much of the cost would be picked up by the federal government.

Another aspect of the problem of coordinating the various property tax relief programs relates to school aids. Foundation aid is paid to school districts based, in good part, on the property wealth of the district. Now that includes, of course, the value of all property, not just homes. But there is a clear tendency for school districts with a high proportion of expensive homes to get less school aid while those with a high proportion of modest homes tend to get more.

Now, compare that to what happens with the homestead credit. It should be clear, of course, that the homestead credit program is designed to help individual homeowners, not school districts or other local units. But, an examination of where the homestead credit dollars go, will show that it tends to be a reversal of the school aid pattern. Generally speaking, the more expensive the homes in the district, the more homestead credit received per capita in that district. The homestead credit program results in the distribution of money in a pattern that tends to be counter to the school aid formula.

In addition to the problems of cost, complexity and coordination that I have just briefly discussed, it should also be pointed out that our study also found serious problems with the administration of the homestead credit program. We will document the specific administrative problems in our report, but let me just say now that those administrative problems are not readily solvable on a cost effective basis.

Let me summarize. If you do not change the existing homestead credit formula, the cost to the state of that program over the next biennium will be over one billion dollars. And even the expenditure of that one billion dollars will not protect homeowners who are at the $650 maximum from increases in their property taxes.

It is time for a fresh approach. If we continue to patch up the homestead credit program, it will be exceedingly costly and we will perpetuate and increase the inequities and the disparities that currently exist throughout the state.

So, repeating, it will cost over one billion dollars just to fund the existing homestead credit formula over the next biennium. We think that it is advisable to use that one billion dollars, or some portion of it, for a redesigned program that will more directly target property tax relief to those who really need it. In this time of financial crisis, we question whether state government can afford to provide homestead credit payments to those who are wealthy enough that they don't need it or to those whose property taxes are inordinately low. Rather, those funds that are available should be targeted to those that you determine need protection.

I believe that most legislators favor policies that will result in relatively low property taxes on homes; that will provide a stable system; that will help to assure that property taxes are fair and equitable across the state; and that will adequately protect senior citizens, the handicapped, the unemployed, those with low incomes and those who are subject to unfairly high property taxes.

Considering the financial condition of the state and the property tax information developed in our study, I am convinced that that will be better accomplished by a major redesign of the existing homestead credit program.

The State of Minnesota faces the most serious financial crisis in memory. It will not be solved by simply concentrating on adjusting or abolishing small programs. With over 70 percent of the state's budget going for aid to schools, aid to local government or to property tax relief in one form or another, it is clear that some major reordering must be accomplished in those areas.

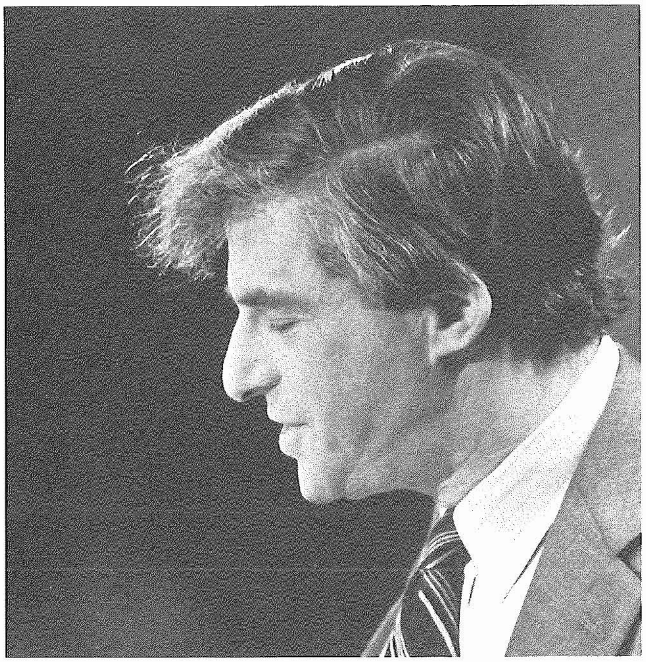
That will not be easy. It will require a careful analysis of where we have been, where we are now, and where we are heading. It will require that you avoid taking hard positions prematurely before needed information is developed and reviewed. And it will require a strong measure of bipartisan cooperation for the long-term, best interest of the state.

Your work in the 1983 Session may be the most difficult in history. But if you do it well, you will have earned the gratitude of Minnesotans for a long time to come.

# • SUMMARY AND CONCLUSIONS

## Minnesota Legislature Looks at the 1980s: Summary and Conclusions

Alan Rosenthal
*Professor of Political Science*
*Rutgers University*
*Director*
*Eagleton Institute of Politics, New Brunswick, New Jersey*



**Alan Rosenthal**

I am honored to have been invited here. And I am delighted to have this opportunity to visit with friends in Minnesota.

If the definition of an expert is someone who is from out of state, then by definition I **must** be an expert. I am from New Jersey and New Jersey is out of state, as least as far as Minnesota is concerned.

But I am really here because of my associations with state legislatures and legislators. I have been studying them and working with them since 1966, and that is quite a while. I have visited them in their natural habitats, listened to them speak their native tongues, and observed them practice their peculiar rituals. I have come to like them; more important, I have come to respect them. And there are not terribly many people, like me, who like and respect state legislatures and legislators.

The task assigned to me here is to provide a summary and conclusion for Minnesota Horizons 1983 – to bring everything together and knot every loose end, so to speak.

No way. There's not a chance that I can do that. It would be presumptuous even to try summarizing the excellent presentations made by such distinguished Minnesotans these past few days. In fact, I know of no other state that does what Minnesota does with its Horizons program – not at all, or not as intensively, or not as well.

If nothing else, Horizons already has two major accomplishments to its credit:

First, it has gotten legislators to show up on time and at 9:00 a.m., which seldom, if ever, happens in the capitol – an unparalled achievement.

Second, it has gotten experts and academicians (like me) to confine their remarks to fifteen minutes – which, while cruel and inhuman, is a substantial accomplishment.

This has been a unique learning experience for me. I have learned about the fine and enduring qualities of the state, as well as about its current and anticipated problems.

More important than my learning, however, is the learning of members of the legislature. Legislators have learned, and learned much, about problems and about possibilities – in the areas of natural resources and the environment, agriculture, energy, housing, human services, education, fiscal affairs, and infrastructure. (I have to express my admiration for Jim Kelly, who spoke yesterday and used the word "infrastructure" twenty-three times without stumbling once. I find it an awfully difficult word to handle. And I would suggest that the legislature ignore the infrastructure problem – no matter how serious it becomes – until you are sure you can master the word.)

Whether legislators agree specifically with Jerry Christenson's call for an overhaul of the Homestead Credit Program or not, they must take to heart his urging that "this is a time for courageous action." Rather unusual words for a Legislative Auditor to speak, but this is a rather unusual time in Minnesota's history.

### Where The Action's At

If courageous action – or even timid action – is to be taken, it will be up to the legislature to take it. The legislature is where it's at, and where it will continue to be. As posed in an earlier session of the Horizons programs by Gerald Corrigan, the question is: "Does the legislature have the capacity, knowledge, and will?" The answer to that question is "yes."

In the last twenty years we in the United States have witnessed the development, the modernization, and the strengthening of state legislatures throughout the country. More than any other American political institution, the state legislature has made progress, and great progress – in part because legislatures used to be pretty poor and had pretty far to go.

Minnesota's legislature has been good for some time, and in recent years it has been among the very best in the country. I say this not because I like the brisk winters in Minnesota. I say this because it is true; and anyone who pays attention to politics and government in the states and to state legislatures would have to agree.

Thanks to the outstanding leadership of Martin Sabo and Nick Coleman and others, all of you can be proud of the Minnesota Legislature.

Things would appear to look good, as far as legislatures are concerned. In view of the two-hundred year history of the institution, and given recent improvements in legislative structure and procedures, we might assume that legislatures will simply carry on. I expect so, but I'm not at all certain of what the future holds. I have no crystal ball and, in any case, those who do use crystal balls often wind up eating glass.

What I am sure of is that the legislature as an institution cannot be taken for granted. Therefore, on the basis of my experience and with Horizons 1983 specifically in mind, permit me to offer several observations' regarding the legislature.

### Matters of Choice

In the first place, the Minnesota Legislature – like other legislatures – will have to make choices in the years ahead. That is easy to understand, but it is difficult to put into practice.

Legislators like to say "yes;" they like to do good; they like to please everyone; they like to take on most everything. They can't; you can't. That is because to say "yes" to everything is really to say "yes" to nothing. That is because to try to do everything is to wind up doing nothing well.

You as legislators will have to say "no" to many things – and more now than before, and some that are worthwhile – in order to say "yes" to a few things. As has been pointed out again and again throughout these sessions, there are limits that restrict your action. You have "less freedom and fewer choices" now than previously. But choices you do have, and you will have to exercise them and set priorities. You must decide among alternative policies and programs and among various revenue measures. You must decide also where the legislature will focus its attention and spend its time – and where it will not.

### A Question of Size

In the second place, Minnesota legislators – like legislators elsewhere – will have to concern themselves with the health and welfare of their institution. Unfortunately, perhaps, nobody but its members will take care of and provide for the legislature. You as legislators are responsible not only for making policy, for raising and appropriating funds, for exercising oversight, and for providing service to constituents. You are also responsible for the maintenance of the legislature as an institution. Indeed, if the state and its people are to be served, then the institution has to be kept in good shape.

Nowadays the legislature is under heavy criticism and unrelenting pressure. Individual legislators may do well with the press and can wind up looking alright. But the legislature usually winds up suffering abuse and, for the most part, undeserved abuse.

Legislatures just do not look good, particularly in the eyes of the media. This is because legislatures are not neat and not very comprehensible. They are untidy, disorderly, sometimes chaotic, always difficult to grasp. That is the natural order of representative assemblies, the normal way when the business is negotiating settlements and trying to resolve disputes.

In looking after your institution, do not be deceived by simplistic prescriptions for reform. There have been many of them around. I refer to them as solutions in search of a problem or prescriptions unconnected to diagnosis.

Take the notion of smaller legislative bodies. I always favored smaller legislative bodies, but I thought smaller bodies meant restricting membership to people under 5'8". I am 5'10", and I am for little people, particularly people shorter than I am. In a similar vein, Jess Unruh, who as Speaker of the California Assembly was one of the most effective legislative leaders in the nation, came out in favor of unicameralism. Unruh thought unicameralism meant "one man." When he found out it meant "one chamber," his enthusiasm waned markedly.

I am not – I repeat, not – in favor of the reduction in the size of the Minnesota Legislature, as was suggested recently by Governor Perpich. Minnesota has 201 legislators. That's not too many. New Hampshire has twice as many, and in its House alone; and the New Hampshire House works fairly well.

The fact is that larger legislative bodies are as good as, and in some respects better than, smaller ones. As a rule, they are more tightly organized. Take the United States Congress. The House with 435 members is much more efficient (and effective, I believe) than the Senate with 100 members. Furthermore, there is the question of representation. In Minnesota members of the House represent 30,000 people and members of the Senate represent 60,000. Wouldn't the quality of representation diminish – at least to a degree – if each member represented more. Then, there is the matter of the geographical size of legislative districts in Minnesota. Some districts here are larger than the entire state of Rhode Island. A few, I suspect, probably approach the size of New Jersey.

What is the point of reducing the size of the Minnesota Senate and House? Yesterday the *Minneapolis Star and Tribune* editorialized: "If state government is going to trim its fat, where better to start than at the top?"

If that is so and you reduce your size, you will lose some good legislators – and not necessarily fat ones, but lean ones as well. No legislature can afford that. There would be greater justification for a reduction in size, if there was some assurance that it would get rid of the less competent members. But I am doubtful that we would all judge competence the same way and agree on who is less competent. And even if we did, our constituents might not. There are no guarantees as to who would stay and who would go.

Of course, there is always the bottom line – the money to be saved. If you go from 134 to 100 House members and from 67 to 50 Senators, Minnesota will save about \$3 million in the 1983-85 biennium. The state, I am told, faces a deficit of \$1.250 billion in 1983-85. I am afraid that the Governor and the Legislature would still have to look elsewhere to make up the additional $1.247 billion.

That is not to say there are no improvements to make in the Legislature and the legislative process. There are things to do. Certainly, the Minnesota Legislature needs better management of professional staff, better use of information, and more effective allocation of time — to mention a few items.

**The Legislative Perspective**

In the third place, the Minnesota Legislature — like many others — is in need of greater continuity and cohesion. The legislature suffers from discontinuity and fragmentation, which is not at all surprising given the centrifugal forces in our society today.

Yet, if there is any single message that comes through loud and clear from Horizons, it is that just the opposite is required in order to respond to the challenges ahead. In opening this program, Roger Moe, speaking on behalf of the Senate, indicated the need for planning and vision, a comprehensive view of the issues, an integrated approach, and predictability. Odd language for a legislator, odd indeed. It suggests "legislative planning," which is a contradiction in terms.

How can a legislature plan? A legislature finds it difficult, if not impossible, to plan. In part, it is because the legislature is constantly absorbing new members, as a consequence of relatively high turnover every two years. One out of three members in the Minnesota House is new to the job. In part, it is because the legislature suffers from the limits of a two-year perspective and a biennial discontinuity of focus and effort.

Legislators themselves plan only from one election to the next. In fact, legislators only live from one election to the next. For members of the House, legislative life is for a two-year duration; for members of the Senate, it is for a four-year duration.

Legislatures themselves come to a halt every two years, as representatives (and in places with staggered terms at least some senators) face the voters in primary and general elections. Such discontinuity is very disruptive to public policy making. Certainly, public policy requires thought and effort that run beyond the electoral cycle.

I would propose, therefore, lengthening the electoral cycle, by asking the electorate to amend the constitution so that members of the House in Minnesota (and elsewhere, too) would serve a four-year instead of a two-year term. There will be objections, of course. One is that legislators will lose touch and become less responsive. I am not worried about that happening. The current climate keeps legislators in touch with their constituents and the electoral process — with the press, the PACs, and the pressures — keeps them responsive. If anything, legislators nowadays are over-responsive. Even with a four-year term, people will be able to hold legislators accountable. And they will.

I recommend to you the example of the Maryland General Assembly. Here members of the House as well as of the Senate have four-year terms. Everyone — including the Governor, the Lieutenant Governor, and the Attorney General — runs at one time and every four years. Once elected, legislators and particularly legislative leaders can think ahead (at least somewhat further ahead) and govern more (at least somewhat more) effectively.

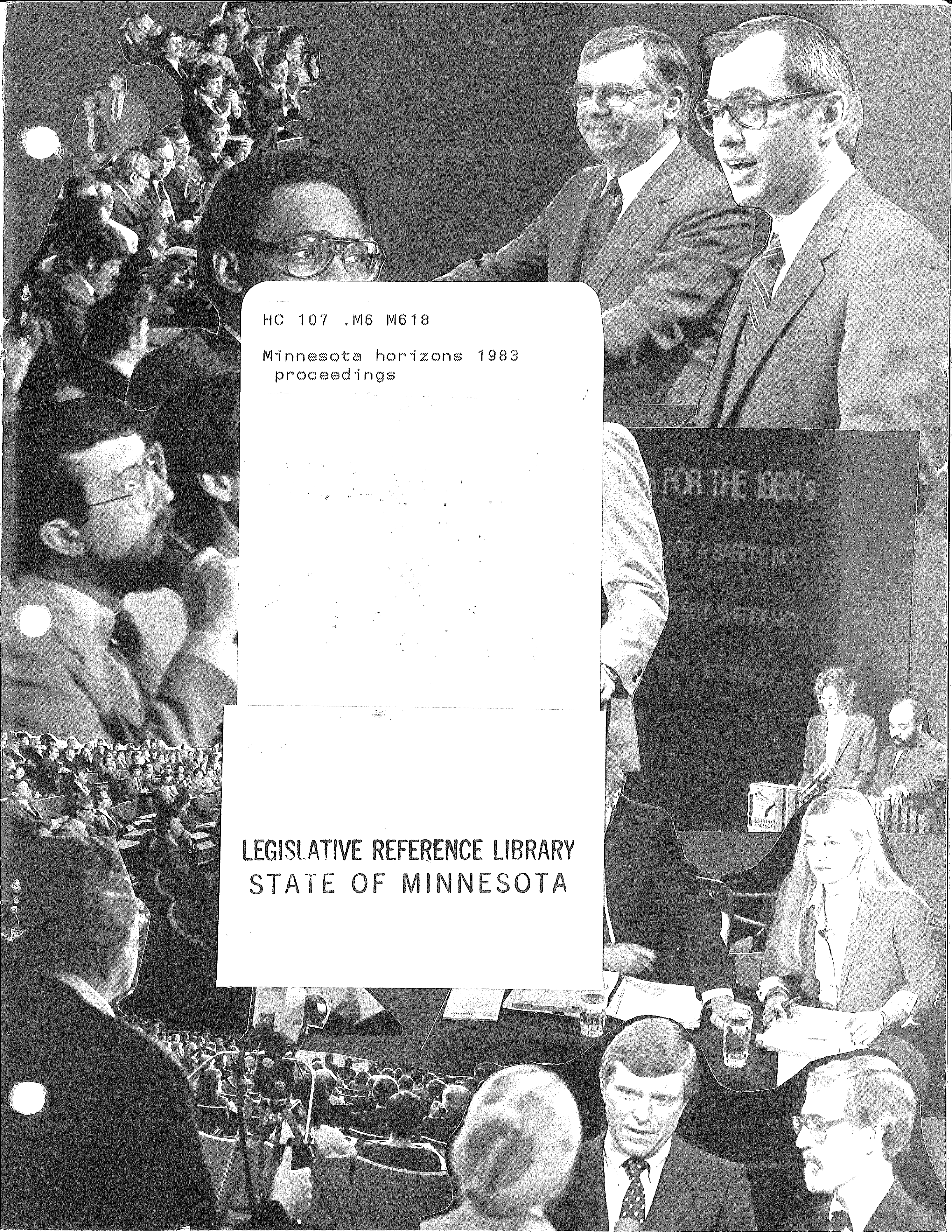
The opposition to a proposal for a four-year term should not be underestimated. At the outset, such a scheme is not likely to be very popular — with the press, with many citizens, and possibly even with members of the Senate. But I believe that it is a change worth discussing and worth working for.

**Concluding Comments**

Let me conclude this session and the Horizons discussions by saying to members of the Minnesota Legislature that you have a difficult job (as if you didn't know). I wouldn't want your job. Most normal people wouldn't want your job. But all of us can be thankful that some people — you out there — aren't normal, and thus are willing to take on burdens and responsibilities on behalf of the rest of us. You are in the front lines and I am way back in the rear. And that is what representative democracy is about — people like you representing people like me.

There is a new book out. Its title is *Megatrends*, and it is written by John Naisbitt, a futurist of sorts. It is a trendy, fashionable book. I recommend it to all of you — especially those of you who want to keep up with things — who are invited to cocktail parties. Among the megatrends (that is, big trends as opposed to itsy bitsy trends) transforming our lives, Naisbitt identifies one as the movement away from representative democracy and twoard direct democracy. According to him, "we have outlived the historical usefulness of representative democracy . . ."

I think Naisbitt is wrong. I hope Naisbitt is wrong. If Naisbitt is wrong, legislators in Minnesota — and state legislators throughout the nation — will have to be the ones to prove him wrong. Go to it. I have great confidence in you, and I am sure that there are many people in Minnesota who share my feelings and wish you well.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