Minnesota Department of
Trade and Economic Development

500 Metro Square
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Saint Paul, Minnesota 55101-2146 USA

February 12, 1996

James R. Nobles
Legislative Auditor
Centennial Building
658 Cedar Street
St. Paul, MN 55155

Dear Jim:

Thank you for sending us your final report entitled "State Grant and Loan Programs for Business," which we received late Thursday afternoon. Thank you also for extending the deadline for responding to the report from Friday noon to noon today.

We would like to acknowledge that the version at hand is vastly improved from the draft report that we discussed on February 2, when we questioned your staff's objectivity and characterized their research methods and reporting skills as less rigorous than those one might expect to encounter in high-school term paper. To their great credit and yours, they have removed from the final report dozens of the inaccuracies, misunderstandings and mischaracterizations that we found in the version you showed us nine days ago.

To be sure, we could still a find nits to pick, but we are not very interested in doing so. Neither do we want here to challenge those policy recommendations of yours with which we disagree. We do, however, want to address your assertions that the average wage of the 8,300 jobs created with assistance of funds from the Economic Recovery Fund since 1991 has been $8.64 per hour and that the median wage has been $7.20 per hour.

We applaud that you have chosen to evaluate both average and median wage rates, and although you have not included the value of employee benefits in those figures, we appreciate that in the Executive Summary of you report you noted that "approximately 90 percent of the jobs created provided health care, 56 percent dental benefits, 85 percent life insurance, and 62 percent retirement benefits."

We also believe, however, that the methods by which you arrived at those two figures understates the effectiveness of that program and therefore understates the effectiveness of my two predecessors at the Department of Trade and Economic Development.

How? In two important ways, the first of which is by lumping job-expansion efforts funded with state funds together with similar efforts funded with federal Community Development Block Grants.

As you report, federal law requires that 51 percent of the jobs created with the help of block-grant assistance be filled by low- and moderate-income individuals, whose work experiences do not make them likely candidates for the best-paying jobs. That requirement pulls down the average and median and wages of federally funded jobs to levels much lower than comparable state-funded Economic Recovery Fund loans. In your Table Four, you report that the average wage for state-funded Economic Recovery Funds Loans is actually $8.87 per hour, and the median is actually $7.50 per hour. Both figures are significantly higher than the state/federal blended rates you have chosen to cite in your letter accompanying your report to the Legislative Audit Commission.

The other way in which your methodology understates the wages of jobs being created with Economic Recovery Fund loans has to do with the period covered by your study, from July 1990 through July 1995. (That is, during Fiscal Years 1991-1995.)

During roughly the first two years of that period, the United States and the Midwest were in recession and southern Minnesota was suffering the lingering effects of a farm crisis. Not surprisingly, incentives provided during the final months of the Perpich Administration and the early months of the Carlson Administration helped create jobs that might seem less attractive today than they did at the time. Indeed, your Table Three shows that the average wages of jobs created with Economic Recovery Fund loans in Minnesota's Fiscal 1991 and 1992 were $7.36 and $7.57 per hour, respectively, but that by Fiscal 1993, the average had risen to $9.22 per hour.

The chart also shows that the figure slipped to $8.31 in fiscal 1994, before rising to $9.36 is fiscal 1995, but both of those figures are misleading for this reason: When companies accept Economic Recovery Fund loans, they promise to create an-agreed-upon number of jobs at stipulated wage rates during a two-year period. For projects that originated in Fiscal 1994 (which began July 1, 1994), those companies must meet hiring deadlines that will occur at varying points of time between July 1996 to July 1997. For projects that originated in Fiscal 1995 (which began July 1, 1995), hiring deadlines will occur at varying points of time between July 1997 and July 1998.

Naturally, Jim, many of those jobs have been created and counted by your researchers. Others, however, have yet to be created-and, in fact, will be created in the present full-employment, high-wage environment. When they are tallied, they will raise the average and median wages of the jobs counted in your office's study. If your researchers had truly wanted to show the results of five years of loan originations, they would have had to go back to the start of Fiscal 1989. We predict that had they done so, they would have noted steady improvement in the quality of jobs being created with state assistance.

Wage levels of jobs created with the help of Economic Recovery Fund loans are likely to continue to rise. As you know and as your staff might have reported, the Department of Trade and Economic Development is considering requests for Economic Recovery Funds assistance that would result in the creation of significant numbers of jobs paying much more than averages of recent years. Additionally, I have made it clear that I do not expect in 1996 to approve any loan for the purpose of creating jobs paying less than $10 per hour in the Twin Cities metropolitan area of $8 per hour in Greater Minnesota. Through the Governor's Office, the department is also asking the Legislature this year to define in statute criteria for loanmaking through the Economic Recovery Fund.

We do have a second concern about the efforts of your office regarding your study. I am not referring here to the content of the final report, but about the dissemination of data and conclusions reached before anyone in the Department of Trade and Economic Development saw the first draft of the report.

As you have indicated, your office has briefed at least two legislators about your preliminary "discoveries" and answered questions from legislative staffers about your "findings." You and members of your staff have asserted that the rules under which you operate allow such briefings. If so, perhaps those rules should be scrutinized.

The extent to which the legislators shared information received from you with their peers is impossible for us to know, but it is clear that conclusions reached in your preliminary draft report have been treated less confidentially than you have asked me and my staff to treat them. Moreover, it is reasonable to assume that information from those briefings and your preliminary assessments of the Economic Recovery Fund were used to prepare legislation.

As I think you agree, those preliminary assessments were at best flawed-and that's the kindest word we can think to describe them. You will remember, for example that in your office's preliminary report, your staff asserted that:

1) **"Many loans [from the Economic Recovery Fund] were originally structured to begin repayment of principal and interest at some date between 5 and 25 years in the future."** You will remember, too, that when we asked your staff to name a single loans structured to begin repayment more than five years into the future, they couldn't name one. Normally, repayment begins within 30 days. If there has been an exception to that rule-and perhaps there has, though there haven't been "many"-we would be surprised to have it pointed out to us.

2) **In the decision to grant a loan, "DTED does not consider the wages, benefits, or type of jobs created."** We think your staff knew better, Jim, and we are pleased that you withdrew this ridiculous assertion from the final report. Someday perhaps you would explain how, after five months of study of our department, it ever got written.

3) **The Department's "Capital Access program is one of the best-received...of all of the programs we reviewed."** Well, thanks. But look at how your staff came to that conclusion. Although there are at present 543 commercial banks operating in Minnesota, and although (by your count and ours) only 17 of them (that's less that three tenths of 1 percent) have ever participated in the Capital Access program, your staff wanted to call it "one of the best-received." And how did they reach that conclusion? By contacting 12 of the 17 participants and none of the banks that decided not to participate. A similar survey of, say, owners of DeLorean automobiles might show the DeLorean to be the most popular car in America.

Is there more to complain about? Sure. (In the draft report, your staff was estimating in writing that we had 27 "full-time" staff operating the Economic Recovery Fund program, when in fact there are five.) But, as we've said, there is much less to complain about in the present version of your report than there was in the earlier version. You probably won't take it, but we believe you deserve credit for your staff's responsiveness to our concerns.

Sincerely,

Jay Novak
Commissioner

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JAMES R. NOBLES, LEGISLATIVE AUDITOR

February 13, 1996

Members of the Legislative Audit Commission:

Normally, I do not write a rejoinder to a commissioner's response letter. The letter from Commissioner Novak, however, requires some comment.

My staff and I expect to have differences and some conflicts with the agencies we audit and evaluate. There are even steps built into our audit and evaluation procedures to help resolve them. We went through those steps with Commissioner Novak, but unfortunately he is still dissatisfied with our work.

Department heads do, of course, have a different perspective from ours. Indeed, they have a different job--to promote and defend their programs. We respect that role. But, we think our role is important too--to objectively review the facts and report them accurately. In this case, that led us to write a different report than the one Commissioner Novak wanted us to write. I can understand his disappointment.

On the other hand, I do not think the differences between Commissioner Novak and my office are very great or unusual, which makes his letter all the more perplexing and inappropriate. His letter is also, I must say, quite intemperate and not altogether accurate. In my opinion, it is not a letter a commissioner in state government should write.

We commend our report to the Legislature, and to the commissioner. It contains data and analysis that will help the Legislature make policy decisions about loan and grant programs for businesses, and help the commissioner administer them better.

Sincerely,

Jim Nobles

James Nobles
Legislative Auditor