



Dan McElroy, Executive for Minnesota hospitality industry trade associations<

Provide good early education and a sense of opportunity to improve workforce preparation and region's competitiveness

A Civic Caucus Focus on Competitiveness Interview

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Present

John Adams, Dave Broden (vice chair), Janis Clay, Paul Gilje (coordinator), Sallie Kemper, Dan Loritz (chair), Dan McElroy, Paul Ostrow, Dana Schroeder, Fred Zimmerman.

Summary

According to Dan McElroy, president and CEO of Hospitality Minnesota and executive vice president of the Minnesota Restaurant, Lodging and Resort & Campground Associations, emphasizing early childhood education and creating a sense of opportunity that it's worth staying in school and going to college are the best ways to develop a highly qualified workforce. He also urges that we concentrate on helping immigrant, low-income families, who may have no college experience, to build up the cultural and financial capital and educational momentum to be successful.

Minnesota's leisure and hospitality industry has a large impact on the state's economy, McElroy says, accounting for 11 percent of the state's total private-sector employment and generating \$4.3 billion in wages. In 2012, the industry generated \$12.5 billion in gross sales and employed 245,411 people in private-sector jobs.

McElroy says the associations he represents are concerned about the recently enacted state minimum wage of \$9.50 an hour. They believe \$8.50 would have been more reasonable. He points out that some low-skilled hospitality workers earn more than the minimum wage already. He's concerned about the impact of the new wage on the jobs of people who get tips, since Minnesota is one of only seven states that don't count tips toward the minimum wage. He says the minimum wage system used in the United Kingdom has taken the politics out of the issue.

Besides competing to keep companies in the state, help companies grow and attract new companies, Minnesota also competes for people and cultural assets, McElroy points out. He believes the larger region, not just the artificial borders of individual states, is the proper context to think about competitiveness. Minnesota benefits when the rest of the region is doing well.

Issues to address

Prior to the meeting, Dan McElroy was asked to be prepared to discuss the following issues: the contribution of the hospitality industry to Minnesota's economy; how the hospitality industry feels about raising the minimum wage; where Minnesota is lacking and what it would take to make Minnesota more competitive; whether the concepts of foundational competitiveness and investment attractiveness make a reasonable model for looking at the state's economic competitiveness; and how the future evolution of the economy will impact the hospitality industry.

Biography

Dan McElroy is president and CEO of Hospitality Minnesota and executive vice president of the Minnesota Restaurant, Lodging and Resort & Campground Associations. He came to the associations in 2011 from Minnesota state government, where he served as commissioner of the Department of Employment and Economic Development (DEED), Gov. Tim Pawlenty's chief of staff and commissioner of the Department of Finance.

McElroy has years of experience as an elected official, including city council member (1983-1987) and mayor (1987-1995) in Burnsville, Minn., and Minnesota State Representative (IR-Burnsville) in District 36B, representing Dakota and Scott Counties, from 1995 to 2003. He served as House assistant majority leader from 2001 to 2002.

McElroy also has experience in the private sector, serving as CEO for Travel Agency Management Solutions, Inc.; president of Mainline Travel; and chief financial officer of Travel Professionals. He has a B.A. in history from the University of Notre Dame.

Background

The leisure and hospitality industry in Minnesota generated \$12.5 billion in gross sales in 2012 and employed 245,411 people in private-sector jobs. (This includes accommodations, food services and drinking places, arts, entertainment and recreation.)

- **The 10-county Twin Cities area generated \$8.4 billion (67.4%) of those sales and accounted for 156,742 (63.9%) of those jobs.**
- **Central Minnesota counties generated \$1.1 billion (9.0%) in sales and accounted for 26,350 (10.7%) jobs.**
- **Northwest Minnesota counties generated \$513 million (4.1%) in sales and accounted for 10,904 (4.4%) jobs.**

- **Southern Minnesota counties generated \$1.5 billion (11.9%) in sales and accounted for 34,024 (13.9%) jobs. Rochester and the rest of Olmsted County accounted for about one-quarter of these Southern Minnesota sales and jobs.**
- **Northeast Minnesota counties generated \$794 million (6.3%) in sales and accounted for 16,483 (6.7%) jobs.**

Sales at Minnesota leisure and hospitality businesses grew by 54 percent from 2000 to 2012, including five percent annual growth for 2012.

The leisure and hospitality industry accounts for 11 percent of the state's total private-sector employment and generates \$4.3 billion in wages.

Discussion

Some people say the way to be competitive is to have lower taxes, while others say to be competitive the state should put more money into foundational assets like schools, infrastructure, broadband, etc. These opinions, Dan McElroy said, reflect the two dimensions of competitiveness outlined by Prof. Michael Porter, head of the Institute for Strategy and Competitiveness at Harvard Business School. McElroy said he became familiar with Porter's work on competitiveness when he was commissioner of the Department of Employment and Economic Development (DEED).

Porter maintains these two dimensions are foundational competitiveness and investment attractiveness. Foundational competitiveness is the collection of core public goods (such as skilled employees, specialized infrastructure, technological knowledge, etc.) an economy has to have to grow and thrive. Investment attractiveness is businesses' perception of the cost and tax climate of a location relative to its foundational benefits.

Minnesota competes for people and cultural assets. McElroy said besides keeping companies in the state, helping companies grow and attracting new companies, investment and jobs, there are two other things Minnesota competes for:

1. People. McElroy said we compete to keep Minnesota high school and college graduates here. When high school graduates go out of state to college, they often don't return to Minnesota. About 83 percent of students who attend Minnesota State Colleges and University (MnSCU) institutions stay here. That percentage is smaller among University of Minnesota (U of M) graduates. "We also compete," he said, "for graduates of unique programs that are among the best in the country, like the watchmaking program at St. Paul College, the string instrument program at Red Wing or the gunsmithing program at Pine City. We don't keep many of those graduates."

"We also compete for our neighbors' people," he continued. "With financial services in South Dakota, oil in North Dakota and a wide variety of industrial efforts in Iowa, competing for other states' people is more difficult." He said we should also try to keep more of our older people here. Research shows that cold-climate states lose wealth faster than other states, as many people in their 60s leave. This is especially true for those states with high taxes.

2. Cultural assets . McElroy pointed out that we also compete to keep the Twins and the Vikings here, to attract a renowned new music director for the Minnesota Orchestra, to keep the best Orchestra musicians, to book popular Broadway plays in the Hennepin Theater District and to secure highly esteemed art exhibits.

The larger region, not individual states within artificial borders, is the right context to think about competitiveness. "I celebrate that North Dakota is doing well with oil and gas," McElroy said, "or that farm prices mean our surrounding agricultural states are doing well. It's good for the region." As a transportation center, with the Great Lakes, the Mississippi River and a strong rail network, we benefit from that regional economic activity.

Brand is an important part of competition. McElroy said the following questions can help define a metro area's brand: Is the area "cool"? Does it have opportunities? Do kids want to stay here for college or come back after college? What do external people making decisions think of the brand of the metro area, state and broader region? Do we have a great and vibrant art scene and music scene? Part of our brand should note that we have more live theater per capita than any other place besides New York City, McElroy said. And he acknowledged that the Twin Cities and the state do have a brand that is a little bit distinct from the larger region.

Communities have capital, just as individuals do. The national United Way has ranked Minnesota multiple times as the most caring community in America. "We have the most robust foundation activity for a community our size that I can imagine," McElroy said. "We have a high participation in faith communities, in youth sports, in Boy Scouts and Girl Scouts, and in Boys and Girls Clubs. All of that cultural capital contributes to the nongovernmental capacity to sustain a high quality of life, helps with brand and helps to sway the decisions people make about whether to stay here or not."

There are two concepts of equity in taxes: vertical and horizontal equity.

- A tax system achieves vertical equity when the taxes paid are progressive, that is, taxes increase with the amount of earned income. The driving principle behind vertical equity is the notion that those who are more able to pay taxes should contribute more than those who are not.
- Horizontal equity is an economic theory that individuals with similar income and assets should pay the same amount in taxes. Horizontal equity should apply to individuals considered equal, regardless of the tax system in place. The more neutral a tax system is, the more horizontally equitable it is considered to be.

"I have encouraged diagonal thinking that combines the fact that we must compete with the importance of helping families who may be immigrants, have low income, or have no college experience, to have the cultural and financial capital and the educational momentum to be successful," McElroy said. "That helps us compete on workforce issues and to be horizontally competitive."

Hospitality Minnesota and the Minnesota Restaurant, Lodging and Resort & Campground Associations are concerned about the minimum wage.

Note: The 2014 Legislature recently passed a law to increase Minnesota's minimum wage to \$9.50 an hour by 2016, with yearly increases (starting in 2018) tied to inflation (capped at 2.5 percent per year). The wage would increase in stages: up to \$8.00 in August 2014, followed by \$8.50 in 2015, and \$9.50 in 2016. With its current minimum of \$6.15, Minnesota is one of only four states beneath the federal minimum of \$7.25 an hour. When fully phased in, the state's new minimum wage could be in the nation's top five.

There will be certain exemptions from the new \$9.50 wage. Businesses with gross sales beneath \$500,000 will see the wage top out at \$7.75 in 2016. Companies could continue paying 16- and 17-year-olds less and 18- and 19-year-olds would be subject to a training wage of \$7.75 for 90 days.

"We don't object to the wage going up, but \$9.50 an hour will be among the highest minimums in the country," McElroy said. "There isn't much movement by states around us." He said his associations agree with the *StarTribune* that \$8.50 would have been more reasonable. It matches what's being done in South Dakota. The associations also care, he said, about trying to protect jobs for people who get tips. Minnesota is one of seven states that don't count tips toward the minimum wage. The groups tried to draft a compromise on the issue of tips, he said.

The wage system used in the United Kingdom has taken the minimum wage out of politics. He said the UK has created an appointed **Low Wage Commission** comprised of accountants and representatives of organized labor and business. The Commission sets the minimum wage through a process of public hearings. Young workers who are 16 or 17 work at 60 percent of the adult minimum wage and 18- or 19-year-olds work at 80 percent of the adult wage, which kicks in at age 20.

An interviewer asked whether the UK model could ever happen here. McElroy replied that it has gotten some publicity, such as an article in *The Economist*, but it doesn't have huge momentum here right now.

People work in the hospitality industry for different reasons and with different motivations.

McElroy said there are people in hospitality industry jobs who are transitional: they're finishing school, trying to find themselves, or putting a spouse through school. "Some others are careerists and some land there as a last resort," he said. "Some people love our industry because they have flexibility in their hours." He pointed out that the best opportunity for people wanting to make a career in the hospitality industry is entrepreneurship. "You can still start a coffee shop for not much money and with a lot of hard work," he said.

Some low-skilled hospitality workers earn more than the minimum wage. An interviewer asked how the hospitality industry thinks about the minimum wage issue related to those workers who are not transitional and have very few skills, but are attempting to support a family. McElroy replied that in many cases, these workers make more than the minimum wage because of their seniority or because they will work hours young people won't.

He said, for example, the prevailing wage in downtown hotels for housekeepers is also the union wage of \$12 or \$13 an hour, even though very few hotels are unionized. Some hotels have extra incentives if customer satisfaction scores are good. He said a typical housekeeper is expected to

clean 16 rooms per day. He noted that some aspects of the hotel business have become more efficient because of things like online reservations, but "there's really no way to automate housekeeping."

Quality of life is not just economic. An interviewer asked why communities strive to be competitive and what that means. McElroy responded that he believes competition is good because he cares about the quality of life for his family and his neighbors. "Quality of life is not just economic," he said, which is why cultural competitiveness and human capital competitiveness are also important. He views competition as the result of the choices people have. "We want to do those things that make us a good choice for people making those decisions," he said.

Ninety-nine percent of our companies are organized along old models. An interviewer asked whether Minnesota could look at its company organization options and treat the inheritance tax differently if the capital would remain employed versus being taken out and "blown." McElroy responded that in the early 2000s, Minnesota created a new way to organize business called the equity cooperative. In that model, farmers put in the majority of money for a business, but can have equity partners. It's been used mostly for ethanol or biodiesel plants, but it's been expanded into other types of businesses, as well.

Most hotel rooms being built in Minnesota will sell for a little over \$100 a night. An interviewer asked about the drivers behind hospitality industry growth in Minnesota and commented on the number of new upscale hotels. McElroy said upscale hotels get lots of publicity, but most of the rooms being built here are for brands like Holiday Inn Express, Hilton Garden Inn or Courtyard by Marriott, with rooms that sell for a little over \$100.

He said hotel occupancy has been very strong in the metro area. It was over 70 percent in Minneapolis last year, was extremely strong in the Rochester area, but was very weak along I-90 in the southern part of the state.

McElroy said the economic drivers behind the restaurant business are different from those in the hotel business. "There's a surprising amount of intellectual capital in the restaurant business, mainly with local owners and chef-driven concepts," he said. But Minnesota doesn't have a lot of national restaurant brands, because it doesn't allow recognition of tips as income.

It's important to take a regional approach to economic development. An interviewer asked why Minnesota should concentrate on taking a regional approach to economic development, when so much of that activity around the country is focused on providing financial incentives that fuel competition for businesses and jobs among communities and among states. "Incentive chasers do their customers some good and make a fair amount of money, but I don't know that they do the economy any good," McElroy replied. He said the oil and gas activity in North Dakota is good for the whole region and if Minnesota decides to allow copper-nickel mining in the northeastern part of the state, that will be good for the entire region.

"It would be a good thing if we could have a regional approach," he said. "If fresh water becomes the oil of the 22nd century, it should be thought of as a regional resource. Clean air may become a critical resource. The ability to create cellulose may be a new competitive structure. Those things are all regional."

States must invest in creativity. An interviewer pointed out the importance of using creativity to develop and then sell value-added products to increase an area's wealth. "What made wealth in this area early on was making flour, not growing wheat," he said and called for Minnesota to make investments in creativity.

McElroy responded that North Dakota is using its oil income to make investments in its higher education system "to catalyze future creativity, imagination, and intellectual-property-based development." He noted that the University of Minnesota's Natural Resources Research Institute invented taconite and has also been involved in developing the metallurgy process that would be used in processing copper-nickel in the state.

Emphasize early childhood education and a sense of opportunity to develop a highly qualified workforce. An interviewer asked where Minnesota should place its major emphasis in order to have a highly qualified workforce. McElroy replied the emphasis should be on early childhood education and preparation for kindergarten. When the interviewer asked what can be done for young people past that stage, McElroy said, "We must create a sense of opportunity, a sense that it's worth staying in school and going to college." He said a 16-year-old with a job is 50 percent more likely to graduate from high school than one without a job.

He said he worries that publicity about college debt might make college look unreachable. "To go to Normandale Community College is affordable and a Pell grant will cover it," he said. "There's not enough publicity about that. We don't do enough to connect opportunity with what's possible."