
Spending Projections

CHAPTER 11

Most of this report has focused on past spending trends. Analyses of trends and national comparisons have provided useful insights into state and local government finance here in Minnesota and across the United States. It is also important to consider how future spending trends may differ from past trends and how future trends may be affected by demographic and economic changes.

It is equally important to recognize that forecasting future trends is extremely difficult and subject to considerable uncertainty. The future always has surprises that even the most astute analyst will not foresee. Few analysts in the late 1970s, for example, projected the significant increase in higher education enrollment which resulted from increased participation rates in higher education. Instead, most focused on the projected decreases in the number of high school graduates.

This chapter examines the future budget scenarios presented in two recent reports. One of these scenarios was largely prepared by Minnesota Planning and appeared in a January 1995 report entitled *Within Our Means*. The second scenario appeared in *An Agenda for Reform*, also known as the Brandl-Weber report.¹ The latter scenario was prepared by the Department of Finance at the direction of the report authors and with assistance from Minnesota Planning. In this chapter, we focus on the following questions:

- **What are the future spending and revenue scenarios developed for *Within Our Means* and the Brandl-Weber report?**
- **What future budget deficits are projected in these reports?**
- **What rates of growth in spending are projected?**
- **What factors are expected to contribute to future budget gaps?**
- **How much of the projected growth in spending must be avoided in order to avoid budget gaps and to keep revenue growth consistent with the Legislature's "price of government" resolution?**

¹ Minnesota Planning, *Within Our Means: Tough Choices for Government Spending* (January 1995); and John Brandl and Vin Weber, *An Agenda for Reform: Competition, Community, Concentration* (A Report to Governor Arne H. Carlson) (November 1995).

We first present and compare the future scenarios which appeared in these two reports. Second, we examine the sources of projected spending growth and the assumptions used to project future spending. Finally, we compare projected spending with revenue projections using the Legislature's targets for future revenue growth.

FUTURE BUDGET SCENARIOS

Within Our Means

Table 11.1 shows the scenario presented by Minnesota Planning in *Within Our Means* for the fiscal years 1996 through 2005. During the first biennium (1996-97), projected state and local spending of \$39.7 billion equals state and local revenues.² During fiscal year 1998, spending is expected to increase from \$20.3 billion to \$21.6 billion, while revenues grow to \$21.3 billion. The scenario assumes spending must be reduced to \$21.3 billion in order to balance the budget. In each subsequent year, the scenario similarly assumes the estimated budget shortfall must be eliminated by reducing spending. Despite these reductions in spending:

- **In *Within Our Means*, Minnesota Planning projected that cumulative budget deficits of \$2.5 billion would occur over an eight-year period from 1998 to 2005.**

Minnesota Planning has projected future budget deficits of \$2.5 billion through the year 2005.

Table 11.1: Future State and Local Government Budget Deficits (in Millions of Dollars) Estimated by Minnesota Planning in January 1995

<u>Fiscal Years</u>	<u>Revenues^a</u>	<u>Spending</u>	<u>Deficits^b</u>
1996	\$19,400	\$19,400	\$ 0
1997	20,300	20,300	0
1998	21,300	21,600	300
1999	22,500	22,800	300
2000	23,600	23,700	200
2001	24,800	25,100	300
2002	26,100	26,300	200
2003	27,400	27,800	400
2004	28,900	29,200	300
2005	30,400	30,900	500
Cumulative Deficits			\$2,500

Source: Minnesota Planning.

^aAssumes revenues are equal to 18.4 percent of personal income.

^bAssumes that the deficit is eliminated each fiscal year by reducing spending.

² Spending excludes expenditures financed by federal aid and expenditures from certain local enterprise funds. Revenues exclude similar categories of revenues and thus may be characterized as "own source" revenues.

These deficits represent about 1.2 percent of the projected "own source" revenues over the next four bienniums. Cumulatively, the deficits represent about a 10 percent cut in state and local spending phased in over eight years.

Brandl-Weber Report

The scenarios presented in the Brandl-Weber report are for a shorter period of time and include the impact of possible federal budget cuts. These cuts were passed by Congress but, for the most part, have been vetoed by the President.³ Table 11.2 shows that:

- The Brandl-Weber report projected cumulative budget gaps of \$5.1 billion through the year 2001 without reductions in federal aid and \$8.3 billion with federal aid reductions.

The Brandl-Weber estimate of future budget gaps appears larger than Planning's estimate.

Table 11.2: Future State and Local Government Budget Deficits (in Millions of Dollars) Estimated in the Brandl-Weber Report in November 1995

Fiscal Year	Without Federal Aid Reductions			With Federal Aid Reductions	
	Revenues	Spending	Deficits ^a	Estimated Aid Reductions	Deficits
1996	\$19,400	\$19,400	\$ 0	\$100	\$100
1997	20,100	20,200	100	300	400
1998	20,800	21,700	900	400	1,300
1999	21,600	22,800	1,200	600	1,800
2000	22,600	24,000	1,400	800	2,200
2001	23,700	25,200	1,500	1,000	2,500
Cumulative Deficits			\$5,100		\$8,300

Source: Department of Finance.

^aAssumes that the deficit is not eliminated and continues to grow.

Even without federal budget cuts, this scenario projects substantial gaps between expenditures and revenues for state and local governments in Minnesota. The projected deficit quickly grows from only \$0.1 billion in 1997 to \$0.9 billion in 1998. By 2001, the annual budget deficiency is \$1.5 billion, and the cumulative budget gaps are \$5.1 billion.

The difference in the two estimates in Table 11.2 reflects the projection that federal aid to state and local governments in Minnesota would be reduced by a total of \$3.2 billion during the six-year period. This is not an actual reduction in federal aid but rather a reduction in the expected rate of growth in federal aid. According to the projections used by the Department of Finance, federal aid

³ Planning did not include changes in federal aid in its scenario, since Congressional legislation had not yet been passed when Planning made its projections.

would still grow faster than state and local revenue from other sources. However, the reduction in the rate of growth in federal aid contributes to the budget gap, since spending on federally supported programs such as Medicaid is expected to grow faster than spending on other state and local programs. The budget gap created by federal budget cuts could be addressed with reduced spending on federally supported programs, reduced spending on other programs, increased state and local taxes or other revenues, or a combination of these options.

Comparison

The Brandl-Weber estimate of future budget gaps appears to be much larger than Planning's estimate. Through 2001, Minnesota Planning estimated a cumulative budget "deficit" of \$1.1 billion. The Brandl-Weber report showed a cumulative budget "gap" of \$5.1 billion, or almost five times as much as Planning's estimate, assuming no federal aid reductions.

These estimates were calculated, however, in significantly different ways. In estimating budget shortfalls, Minnesota Planning assumed that state and local budgets must be balanced each year. To the extent that spending tended to exceed revenues in any fiscal year, Planning assumed that spending would be reduced in order to balance the budget. Planning's estimate of budget shortfalls each year represents the amount of spending that state and local governments in Minnesota need to eliminate that year in order to balance state and local budgets.

In contrast, the Brandl-Weber projections did not assume that budgets would be balanced each fiscal year. Instead, it was assumed that spending would continue to grow faster than revenue and not be reduced. The Brandl-Weber estimate of future budget shortfalls represents the cumulative amount of deficit provided that state and local governments never address the deficits. As a result, the budget gaps calculated by Finance for the Brandl-Weber report grow much faster, and the cumulative deficits are much higher than Planning's estimates.

Table 11.3 examines how the Brandl-Weber estimate of future budget shortfalls would change, if we assumed, like Minnesota Planning, that budgets must be balanced every year by reducing expenditures. The table shows that:

- **The Brandl-Weber estimate of future budget deficits would be close to Planning's estimate if the same method of calculating deficits were used.**

This revised estimate shows cumulative deficits of \$1.3 billion for the years 1996 through 2001, compared with the \$1.1 billion estimate made by Minnesota Planning.⁴ The table also indicates that revised estimates of budget shortfalls expected

⁴ In deriving this estimate of cumulative deficits under the Brandl-Weber budget scenario we had to deviate from Planning's methodology in one respect. Planning projected future spending by functional category, such as higher education and criminal justice, and made explicit assumptions about how much of the spending in each category was available for budget cuts when spending exceeded revenues. In preparing the Brandl-Weber projections, the Department of Finance made spending estimates by jurisdiction (state, local schools, and local non-school), not by function. As a result, we could not use Planning's specific assumptions and instead assumed that all spending was equally subject to budget cuts.

The two estimates are similar if the same definition of "budget deficit" is used.

Federal aid changes would increase the size of the budget gaps.

Table 11.3: Brandl-Weber Projections of Future State and Local Government Budget Deficits (in Millions of Dollars), Using Minnesota Planning’s Definition of Cumulative Deficits

Fiscal Year	Without Federal Aid Reductions			With Federal Aid Reductions	
	Revenues	Spending	Deficits ^a	Federal Gap	Overall Deficits ^b
1996	\$19,400	\$19,400	\$ 0	\$100	\$100
1997	20,100	20,200	100	300	400
1998	20,800	21,600	800	100	900
1999	21,600	21,800	300	200	400
2000	22,600	22,700	100	100	300
2001	23,700	23,800	100	200	200
Cumulative Deficits			\$1,300		\$2,300

Source: Department of Finance.

^aAssumes that the deficit is eliminated each fiscal year by reducing spending.

^bSome totals do not sum due to rounding.

in the 2000-01 biennium are quite small. A significant shortfall of \$800 million is expected in 1998, but the shortfalls in 2000 and 2001 are only expected to be about \$100 million, absent federal budget reductions.

The additional budget gaps created by federal aid reductions must also be recalculated, since state and local government budgets are balanced each year. Table 11.3 shows that the estimated cumulative deficit grows from \$1.3 billion to \$2.3 billion using the Brandl-Weber budget scenario and \$3.2 billion in federal aid reductions over six years. Federal aid changes would account for about 42 percent of the projected shortfall.⁵

Table 11.4 compares the annual rates of growth in spending and revenues projected in the two reports over the next two bienniums.⁶ Both reports projected future budget shortfalls, since they both estimated that spending would grow at a faster rate than revenues. They differed, however, in how fast they expected spending and revenues to grow. From 1997 to 2001, the Brandl-Weber report projected average annual growth rates of 5.7 percent for spending and 4.2 percent for revenues. Planning estimated growth rates averaging 6.4 percent for spending and 5.1 percent for revenues.

⁵ At the time we prepared this report, the amount of federal aid reductions was not known, since the President and Congress had not yet agreed on federal budget legislation.

⁶ The growth rate for spending is the average annual rate at which spending is expected to grow absent any need to make budget cuts. If budgets are balanced each year, actual spending will grow at the same rate as revenues.

Table 11.4: Estimated Average Annual Growth Rates in Future Revenues and Spending, 1996-2001

Fiscal Year	Revenues ^a		Spending	
	Brandl-Weber Report	<i>Within Our Means</i> Report	Brandl-Weber Report	<i>Within Our Means</i> Report
1998-99	3.6%	5.3%	6.1%	6.7%
2000-01	4.8	5.0	5.3	6.1

Sources: Minnesota Planning and Department of Finance.

^aAssuming no federal aid reductions.

It is clear why Planning's estimated growth rate for revenue is higher than the Brandl-Weber estimate. Planning assumed that revenues would grow as fast as personal income and would remain a constant 18.4 percent of the state's personal income. The Brandl-Weber report generally assumed a continuation of current tax law and included inflationary increases for some categories of revenue. In addition to inflation, real growth was projected for certain types of revenue based on historical trends. The Brandl-Weber projections of future revenues are lower than those made by Planning and result in a declining share of personal income going to state and local government own source revenues.

The source of differences in spending growth is less clear. The two reports used significantly different methods of projecting future spending. While Finance projected spending by jurisdiction for the Brandl-Weber report, Planning estimated future spending by government function for *Within Our Means*. As a result, it is not possible to directly compare all of their assumptions. However, it does appear that the Brandl-Weber assumptions about spending growth were more modest in several areas. The Brandl-Weber report assumed no growth in higher education enrollment and no real growth in higher education spending per student, while Planning assumed that inflation-adjusted spending on higher education would increase about 1.6 percent per year. The Brandl-Weber report also assumed lower rates of growth in elementary-secondary education expenditures. Planning assumed that inflation-adjusted spending per student would increase about 1.5 percent per year, while the Brandl-Weber report assumed no real growth in spending per student. Finally, the Brandl-Weber report also appears to have used lower rates of growth for spending on Medical Assistance.

It is important to recognize that the two overall spending and revenue estimates are not much different from one another. Planning's revenue and spending estimates for 2001 are only about 5 percent higher than our revised estimates based on the Brandl-Weber budget scenario. These are relatively small differences, given the difficulty of accurate forecasting even a few years into the future. The recent change in the state's budget forecast for the 1996-97 biennium is testimony to the difficulty of projecting revenues and spending only a year or two ahead.⁷

⁷ See Department of Finance, *November Forecast*, November 1995.

SOURCES OF FUTURE BUDGET GAPS

The key factors behind these projected future budget gaps are that:

Revenue growth is expected to slow, while spending pressures continue in the future.

- **The growth rate for government revenues is expected to slow, as growth in personal income slows.**
- **Pressure to increase spending will come from increased caseloads in Medical Assistance, growth in elementary-secondary education enrollments, and population growth among those age groups most likely to be arrested.**
- **Spending is expected to continue to increase faster than inflation in elementary-secondary education, higher education, transportation, and some other areas.**
- **Sentencing policy, if unchanged, will continue to result in increased prison, jail, and probation populations.**
- **Possible cuts in federal aid for Medical Assistance, education, transportation, and other programs will create additional pressure on state and local government budgets.**

Even using Minnesota Planning's higher revenue projections, revenue growth is expected to slow down. Planning used revenue projections showing an annual rate of growth generally between about 4 percent and 5 percent. These rates of growth were based on similar expected growth rates for personal income. The rate of growth in personal income has typically been higher. The annual rate of growth was 9.2 percent from 1974 to 1984 and 6.6 percent from 1984 to 1994. Over the last five years, personal income in Minnesota grew at an annual rate of 6.0 percent. The decline in income growth is expected in part because of changing demographics, including growth in the share of the state's population that is elderly or in school.

Revenue growth in the next biennium may also be affected by the "price of government" resolution passed during the 1995 legislative session. This resolution calls for "own source" revenues of state and local governments to be reduced from 18.2 percent of personal income during the 1996-97 biennium to 17.8 percent during the 1998-99 biennium.⁸

Continued strong growth in spending is projected for Medical Assistance and criminal justice. The growth in Medical Assistance comes from several sources:

⁸ Neither of these reports used this "price of government" assumption. Planning's revenue estimate was completed before the 1995 legislative session and assumed that the percentage of personal income going to own source revenue would remain constant at 18.4 percent. For the most part the Brandl-Weber report projected revenues using current tax law and fee structures adjusted for inflation, demographic changes, and economic growth. Projections using the price of government resolution and the most current estimates of future personal income have revenues exceeding the Brandl-Weber estimates for 1996-2001 by only about \$650 million. These projections are about \$2.85 billion less than those used by Minnesota Planning.

1) increased caseloads particularly for the disabled and elderly, 2) growth in the average amount of services provided to a recipient, and 3) medical care inflation in excess of the general rate of inflation. The growth in corrections and police protection spending is likely to come from the continued impact of tougher sentencing policies and an increase in the number of Minnesotans between the ages of 10 and 24, the age group most likely to commit crimes.

Table 11.5 shows Minnesota Planning's assumptions about the growth rate for different types of spending from 2000 to 2005. The real growth rates represent the increase in spending over and above the general rate of inflation. The nominal growth rates also include the general rate of inflation. The fastest growth rates were projected for health care spending, which was expected to grow about 13 to 14 percent annually.⁹ Health care access funds such as MinnesotaCare were expected to increase about 7 percent annually. Planning also projected spending

Table 11.5: Assumed Growth Rates in State and Local Spending and Revenues, 2000-05

Nominal Growth Rates^a	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Higher Education	4.72%	4.82%	4.92%	5.02%	5.02%	5.02%
Elementary-Secondary Education	5.12	4.99	5.09	5.08	4.84	4.83
Criminal Justice	4.57	13.53	5.37	13.45	6.08	13.23
Family Support	5.04	5.14	5.24	5.34	5.34	5.34
Health Care	13.42	13.53	13.64	13.75	13.75	13.75
Residential Health Facilities	3.10	3.20	3.30	3.40	3.40	3.40
Transportation	4.37	4.47	4.57	4.67	4.67	4.67
Health Care Access	6.71	6.81	6.92	7.02	7.02	7.02
Other Trust Funds	4.03	4.13	4.23	4.33	4.33	4.33
All Else	4.03	4.13	4.23	4.33	4.33	4.33
Revenues	4.98	5.08	5.18	5.28	5.28	5.28
Real Growth Rates^b	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Higher Education	1.57%	1.57%	1.57%	1.57%	1.57%	1.57%
Elementary-Secondary Education	1.96	1.73	1.73	1.62	1.39	1.38
Criminal Justice	1.43	10.01	2.00	9.72	2.59	9.51
Family Support	1.88	1.88	1.88	1.88	1.88	1.88
Health Care	10.01	10.01	10.01	10.01	10.01	10.01
Residential Health Facilities	0.00	0.00	0.00	0.00	0.00	0.00
Transportation	1.23	1.23	1.23	1.23	1.23	1.23
Health Care Access	3.50	3.50	3.50	3.50	3.50	3.50
Other Trust Funds	0.90	0.90	0.90	0.90	0.90	0.90
All Else	0.90	0.90	0.90	0.90	0.90	0.90
Revenues	1.82	1.82	1.82	1.82	1.82	1.82

Source: Minnesota Planning.

^aIncludes general inflation rate which grows from 3.1 percent in 2000 to 3.4 percent in 2003-05.

^bDoes not include the general inflation rate.

⁹ Health care includes Medical Assistance, Alternative Care, General Assistance Medical Care and the Chemical Assistance Medical Care Entitlement.

increases averaging 9 to 10 percent annually for criminal justice activities, or about 6 percent after adjusting for inflation.¹⁰

Enrollment in elementary-secondary schools was forecast to increase modestly until 2003 before declining slightly. In addition, Planning assumed that higher education enrollments would increase about 0.8 percent per year from 1995 to 2005. Most of the real increase in elementary-secondary education spending, and about half of the increase in higher education spending, was expected to come from increased spending per student. Planning assumed that inflation-adjusted spending per student would grow about 1.5 percent annually in elementary-secondary education and 0.7 percent annually in higher education.

Growth in excess of inflation was also projected for transportation, family support, and other spending. Based on historical trends, Planning assumed transportation spending would grow 1.2 percent annually in addition to an inflationary increase. Spending on family support programs such as Aid to Families with Dependent Children was expected to grow 1.9 percent annually in addition to inflation, based on the projected increase in the number of single-parent families. Spending for most other areas was expected to grow at the rate of inflation, plus an annual increase of 0.9 percent, based on the expected growth in the number of Minnesota households.

The growth in overall spending is coming from a variety of sources, including:

- **Growth in caseloads and enrollment,**
- **Inflationary increases,**
- **Increases in spending beyond inflation, and**
- **Medical inflation in excess of the general inflation rate.**

It is difficult, however, to be more explicit about the relative contribution of each factor, since Planning's data are not specific enough about the relative contribution of some spending areas such as health care.¹¹

ANALYSIS

In this section, we examine the sensitivity of the two budget scenarios to alternative assumptions. In particular, we consider what sorts of budget cuts would be sufficient to eliminate any cumulative budget gaps in the foreseeable future. The

¹⁰ Within the criminal justice area, Planning assumed the following inflation-adjusted annual rates of growth: law enforcement (3.3 percent), judicial and legal (5.9 percent), local corrections (4.7 percent), and state corrections (11.1 percent). Specific allocations were also made for the costs of building facilities.

¹¹ It is even more difficult to sort out the factors contributing to spending growth in the Brantl-Weber projections. The Department of Finance was not able to provide us with detailed enough data to permit such an analysis.

current Department of Finance forecast indicates that no budget shortfall is expected for the 1996-97 biennium. As a result, we started our analysis with 1998 and examined the potential for budget deficits through 2003.

On the revenue side, we used Finance's most recent estimates of future personal income. In addition, we used the "price of government" targets set by the 1995 Legislature. These targets set the percentage of personal income which is to be raised through taxes and other "own source revenue."¹² Our revenue projections are consequently based on the expressed policy of the Legislature and estimates of future growth in personal income.

On the expenditure side, we used assumptions similar to those used by Planning and displayed earlier in Table 11.5. For example, like Planning, we assumed that any budgets would be balanced each year by reducing spending.¹³ Furthermore, we used Planning's assumptions about the portion of each type of spending which is available for budget reductions, when necessary. We used two different sets of assumptions about inflation rates. First, we used the projected increases in the PGSL, as provided to us by the Department of Finance. Using the PGSL resulted in lower rates of growth in spending than assumed in either of the two reports. However, since the PGSL is the deflator for all state and local government spending, we felt it was a more appropriate measure than the Consumer Price Index to use in projecting inflationary growth in Minnesota's state and local government spending. Second, we used Planning's assumptions about inflation rates to gauge the sensitivity of our results to different assumptions.

We examined three expenditure scenarios under each of the inflation rate assumptions. In the first scenario, the inflation-adjusted rates of growth in various spending categories were similar to those used by Planning. For example, we assumed health care spending would increase 10 percent annually in addition to the general rate of inflation.¹⁴ We also used Planning's assumptions about enrollment growth in elementary-secondary education and higher education.

The second scenario was identical to the first scenario except for lower growth rates in health care and criminal justice spending. In this scenario, we assumed that health care spending would grow 7.0 percent annually in addition to the general rate of inflation. We used a 4.5 percent real growth rate for criminal justice spending.

The third scenario is the same as the second scenario except for lower rates of spending growth for elementary-secondary education, higher education, and

¹² Although the price of government resolution covers revenues through 1999, we assumed that the price of government would remain unchanged in subsequent years from its level in 1998-99.

¹³ Unlike Planning, we also assumed that a budget surplus would be saved rather than spent.

¹⁴ We smoothed out the projected increases in criminal justice spending from those used by Planning. We assumed an annual growth rate of between 5.5 and 6.0 percent in addition to inflation.

transportation. Unlike Planning, in this scenario, we assumed no real growth in spending per student in education and a lower growth rate for transportation.¹⁵

The first budget scenario results in combined state and local government deficits which are similar in magnitude to those forecast in the two reports examined earlier in this chapter. Table 11.6 shows cumulative deficits of \$1.3 billion from 1998 to 2001 using our first scenario and the expected growth in the PGSL as an indicator of future inflation pressures affecting spending. These deficits are nearly identical to the estimated deficits we obtained when we adjusted the Brandl-Weber projections to reflect the assumption that budgets are balanced each year. Planning's estimate of future deficits was slightly lower primarily because, unlike the other two projections presented in Table 11.6, it assumed that revenues would remain a constant percentage of personal income.

We made similar projections using legislative targets for future revenues.

Table 11.6: Projected Deficits for Minnesota State and Local Governments (in Millions), 1998-2001

Year	<i>Within Our Means Report</i>	Brandl-Weber Report	Alternative Scenario Based on "Price of Government" Revenue Targets
1998	\$300	\$800	\$800
1999	300	300	300
2000	200	100	200
2001	300	100	100
Cumulative Deficits	\$1,100	\$1,300	\$1,300

Notes:

- (1) These projections do not include the impact of any federal aid changes.
- (2) Some totals do not add due to rounding.
- (3) We adjusted the original projections in the Brandl-Weber report so that all three sets of projections assumed that budgets must be balanced each year.

Table 11.7 displays the results of our three budget scenarios under the two different inflation assumptions. In general, we found that:

- **Even without federal aid reductions, eliminating future budget gaps appears likely to require significant constraints on state and local government spending and lower rates of spending growth than have been experienced in the past.**

Each of the scenarios would result in a substantial budget shortfall in 1998. The shortfalls would range from about \$550 million to a little more than \$800 million. The deficit is mostly due to the effect of the price of government resolution on revenues. From 1997 to 1998, the resolution suggests that state and local government revenues should be lowered from 18.2 percent to 17.8 percent of personal

¹⁵ We lowered the annual growth rate for transportation from 1.23 percent to 0.9 percent plus the general rate of inflation. The lower rate represents the projected annual rate of increase in the number of households in Minnesota.

Table 11.7: Projected Average Annual Surplus/Deficit in State and Local Governments (in Millions), 1999-2003^a

		General Inflation Rate	
		PGSL	CPI-U Used by Planning
Scenario 1:	Real Growth Rates per Minnesota Planning	\$(-160)	\$(-290)
Scenarios 2:	Slower Growth in Health Care and Criminal Justice Spending	(-10)	(-170)
Scenario 3:	Slower Spending Growth in Education and Transportation as well as Health Care and Criminal Justice	+200	(-10)

Source: Office of the Legislative Auditor.

^aThere is a deficit of between \$560 and \$810 in 1998 for each scenario.

income. This is a reduction of about \$470 million in revenues and accounts for more than half of the projected deficit for 1998.

The projected budget situation for subsequent years depends on spending and inflation assumptions. Using Planning's inflation assumptions, there are deficits under any of the three scenarios. However, if significant constraints are placed on spending growth (as under Scenario 3), the average annual deficit is only about \$10 million from 1999 through 2003. Using the PGSL as the inflation rate for government spending results in a more optimistic outlook. The average deficit is minimal from 1999 to 2003 under Scenario 2, and significant surpluses may be expected if spending is further constrained as under Scenario 3.

From 1977 to 1992, inflation-adjusted state and local expenditures grew at an annual rate of 3.0 percent in Minnesota. As Table 11.8 shows, each of the three scenarios has a lower projected growth rate for spending. The annual growth rate of

Table 11.8: Projected Annual Real Growth Rates in Spending Compared with Past Experience

	Annual Real Growth Rate	
	Projected (1997-2003)	Actual
Scenario 1	2.8%	NA
Scenario 2	2.3	NA
Scenario 3	1.7	NA
1977-92	NA	3.0%

Source: Office of the Legislative Auditor.

1.7 percent under Scenario 3 is significantly less than past experience. Only the growth rate under Scenario 1 is close to the historical average.

As a result, in the absence of faster revenue increases, it appears that eliminating future budget gaps will require a slowing of historical growth rates in spending. In addition, eliminating future deficits will also probably require some constraints on health care and criminal justice spending, which are likely to increase the fastest of all categories of spending over the next six years. Additional spending constraints may also be necessary, depending on the general inflation rate.

Any reductions in expected federal aid will create additional budget problems beyond those outlined above. The extent of the budget problem created by federal aid reductions will depend on the level of cuts eventually enacted into law. In addition, state and local governments will be affected by the degree to which the federal government gives them the freedom to make changes in federally supported programs in response to reduced aid. We did not attempt to analyze the impact of federal aid changes in detail, because the President and Congress had not agreed upon the level and the nature of federal aid reductions at the time this report was written.

SUMMARY

Two recent reports have projected future budget deficits for state and local governments in Minnesota. The deficits arise, in large part, because of an expected slowing of the growth in personal income and government revenues. Spending pressures are also significant, particularly for health care and criminal justice programs, but projected spending increases are not higher than the historical rate of growth.

In *Within Our Means*, Minnesota Planning projected a cumulative budget deficit of \$2.5 billion over a ten-year period (1996-2005). The Brandl-Weber report shows a \$5.1 billion budget gap over a six-year period (1996-2001), but the cumulative deficit would only be \$1.3 billion when calculated the same way as Planning's projected deficit. This adjusted figure is similar to the cumulative deficit of \$1.1 billion projected by Planning over the same period.

We also made projections of future budget gaps based on the most recent estimates of future personal income and the "price of government" targets for state and local revenues set by the 1995 Legislature. These projections suggest a significant shortfall in 1998, primarily due to the targeted reduction in state and local revenues as a percentage of personal income. Shortfalls over the next five years (1999-2003) can be avoided if spending constraints lower the growth rate in spending below historical levels. The extent of spending constraints needed depends on the general rate of inflation in spending, as well as other factors. Possible federal aid reductions pose an additional budget problem for state and local governments, but have not yet been agreed to by the President and Congress.