

Trends in State and Local Government Spending

EXECUTIVE SUMMARY

Government spending and taxes are the subjects of considerable discussion and debate. But past trends in state and local government spending have not been extensively examined. In addition, few analysts have comprehensively studied the reasons why government spending in Minnesota differs from spending in other states.

In this report, we examine in some detail the spending trends in Minnesota and other states since 1957. In particular, we address the following questions:

- **How has state and local government spending changed over time in Minnesota? How much has spending changed when adjusted for inflation and population growth or compared with increases in personal income?**
- **What types of government expenditures account for past growth in spending? What have been the major factors driving spending growth?**
- **How has growth in state and local government spending been financed?**
- **How do spending levels and spending trends in Minnesota compare with national averages for state and local governments?**
- **Are state and local governments in Minnesota facing future budget problems because of spending and revenue trends?**

This study relied extensively on data from the U.S. Census Bureau to analyze spending and personnel trends and to make comparisons with state and local governments nationwide. We also used data from a variety of state and national sources to analyze spending on particular government functions such as education.

TRENDS

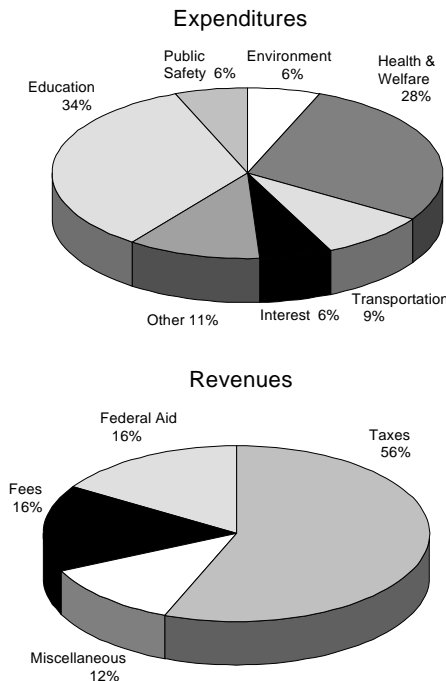
In 1992, state and local governments in Minnesota spent a total of \$20.1 billion, including \$3.1 billion in federal aid. State government directly spent \$7.6 billion, while local governments spent \$12.5 billion. Local government expenditures included \$4.7 billion in spending financed by state aid. Total state and local spending was \$4,500 per state resident.

Almost two-thirds of state and local government spending in Minnesota is for education, health, and welfare.

Education, health, and welfare accounted for a majority of state and local spending. About one-third of all expenditures were for education services, including 24 percent for elementary-secondary education and 8 percent for higher education. Another 28 percent of spending was for health and welfare, including expenditures on Medical Assistance, Aid for Families with Dependent Children (AFDC), various social service and safety net programs, and public hospitals. Other major areas of state and local spending included transportation (9 percent), environment and natural resources (6 percent), and public safety (6 percent).

About 46 percent of total spending funded employee compensation. In 1992, Minnesota state and local governments had about 240,000 full-time equivalent employees: 67,000 state employees (including higher education), 91,000 school district employees, and 82,000 other local government employees. Approximately 35 percent of spending went for non-personnel expenditures such as aid to individuals, purchased services, supplies, and rent. Capital spending (13 percent) and interest on public debt (6 percent) accounted for the remaining expenditures.

Minnesota State and Local Government Expenditures and Revenues, 1992



Source: U.S. Census Bureau.

Taxes paid for 56 percent of spending in 1992.

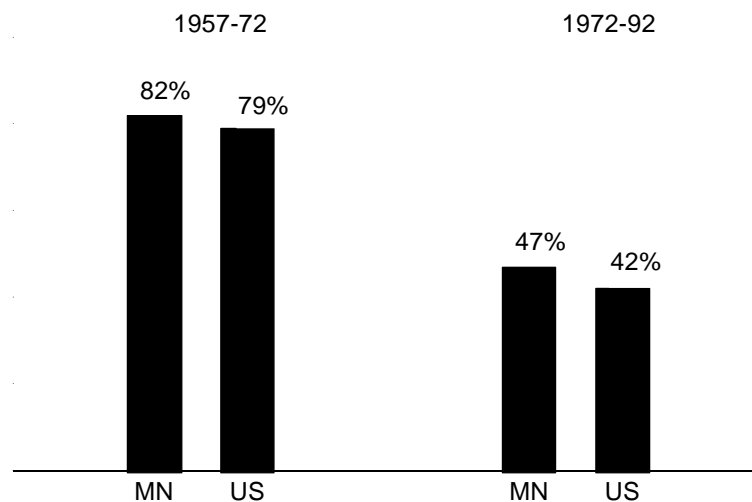
Taxes provided a little more than half of the revenues needed to pay for state and local government expenditures in Minnesota and throughout the nation. In Minnesota, 56 percent of state and local government revenues in 1992 came from taxes, while fees and federal aid each accounted for 16 percent of revenues. Other revenue sources such as interest earnings were responsible for 12 percent of all revenues.

Overall Spending Trends: 1957-92

State and local government spending per capita has increased significantly since 1957 in both Minnesota and other states. From 1957 to 1992, inflation-adjusted spending per capita grew from \$1,680 to \$4,500 in Minnesota, or 168 percent. Nationwide, there was a 153 percent increase.¹

The rate of growth in spending, however, has slowed significantly since the early 1970s. From 1957 to 1972, inflation-adjusted spending per capita rose 82 percent in Minnesota, or an average of about 4.1 percent annually. Since 1972, spending per capita has increased 47 percent, or just 1.9 percent annually.

Growth in State and Local Government Expenditures per Capita, 1957-92



Source: U.S. Census Bureau.

Spending growth slowed after the early 1970s.

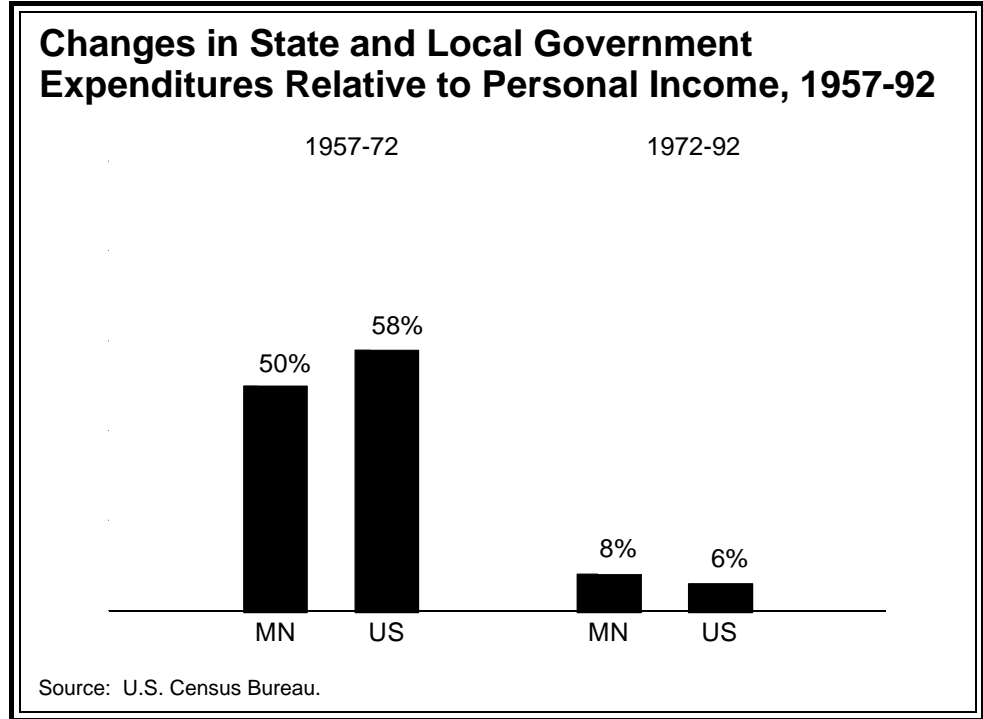
The growth in spending has been more modest when compared with increases in personal income. From 1957 to 1972, spending rose 50 percent in Minnesota relative to increases in personal income, compared with 58 percent nationally. Since 1972, expenditures have grown only slightly faster than personal income:

- Spending relative to personal income increased 8 percent in Minnesota and 6 percent nationwide from 1972 to 1992.

¹ All spending and revenue data presented in this summary are adjusted for inflation.

The slower growth in Minnesota's spending since 1972 is primarily the result of slower growth in education spending. From 1972 to 1985, enrollment in elementary-secondary education fell and caused education spending per capita to decline despite continued growth in spending per student. Spending per capita on higher education peaked in 1972, at the height of the building boom when college campuses were being built or expanded to accommodate growing numbers of students from the post-World War II "baby boom." While current operating expenditures for higher education have grown since 1972, capital expenditures have declined significantly.

Spending trends in Minnesota parallel national trends.



Significant growth in the number of public employees and their average compensation occurred between 1957 and 1972 in both Minnesota and other states. In Minnesota, the number of state and local government employees per capita increased 53 percent, and average salaries grew 70 percent in inflation-adjusted dollars. Nationally, employment growth was slightly higher (56 percent), while salary increases were lower (60 percent). However:

- **State and local government employment and average salaries have only increased modestly since 1972.**

The number of employees per capita grew 11 percent in Minnesota and 16 percent nationally between 1972 and 1992. Average salaries rose only 4 percent in Minnesota and 3 percent nationwide.

The fastest growing portion of personnel costs was fringe benefits, which grew 182 percent in Minnesota between 1967 and 1987. The growth in fringe benefits was largely due to rapidly increasing health insurance costs and mandated increases in employer contributions for Social Security.

Sources of Spending Growth

Minnesota's fastest growing major area of spending has been health and welfare. From 1957 to 1992, health and welfare spending per capita grew 4.2 percent annually and was responsible for 34 percent of the overall growth in spending per capita. Elementary-secondary education and higher education accounted for 19 percent and 9 percent respectively of the overall growth.

The primary source of spending growth has varied, however, over this 35-year period. Between 1957 and 1972, more than half of the growth in overall spending per capita was due to growth in education spending, as enrollments in elementary-secondary schools and higher education institutions grew significantly. Health and welfare spending was responsible for about 18 percent of the overall spending growth.

The primary source of spending growth changed after 1972, as enrollment in elementary-secondary schools declined and capital expenditures for higher education fell. Between 1972 and 1992, health and welfare accounted for nearly half of the overall growth in spending per capita. Education was responsible for only 9 percent of the growth.

Most of the pre-1972 spending growth was due to education, and much of the later growth has been in health and welfare spending.

Sources of Overall Growth in Minnesota's Spending per Capita, 1957-92

	<u>1957-72</u>	<u>1972-92</u>
Education	53%	9%
Health and Welfare	18	49
Environment/Housing	8	10
Interest on Debt	7	10
Public Safety	3	9
Government Administration	2	7
Transportation	4	0
Other	6	5

Source: U.S. Census Bureau.

Elementary-Secondary Education Trends

Expenditures per capita on elementary-secondary education doubled in Minnesota between 1957 and 1992. All of this growth resulted from increases in spending per student, since enrollment per capita declined about 8 percent. National spending and enrollment trends were similar, but spending per student grew faster nationally than in Minnesota.

From 1957 to the early 1970s, most of the growth in spending per student in Minnesota was due to increases in staffing levels and average salaries. From the early 1970s to the early 1980s, further increases in staffing levels as well as fringe benefit growth appear to explain the growth in spending per student. Since 1981, most

Fringe benefit costs and special education are responsible for much of the growth in elementary-secondary education spending per student since 1981.

of the growth has been due to increased fringe benefits and growth in exceptional education programs, particularly special education.

Growth in fringe benefits has included some increase in benefits provided to school staff, but much of the growth appears to be due to external factors such as rapid inflation in health insurance costs and mandated increases in Social Security.

Growth in special education since the early 1980s has been due to a number of factors. First, there has been significant growth in the number of emotionally or behaviorally disturbed students in special education programs. Second, school districts have hired an increased number of aides to enable more special education students to be educated in the regular classroom. Finally, new state mandates required the provision of services to handicapped individuals from birth.

Higher Education Trends

Higher education spending per capita went up 19 percent in Minnesota from 1978 to 1992. A little more than half of that growth was due to increased enrollment, while the remainder resulted from increased spending per student. The reasons for increased spending per student include growth in employee fringe benefits, administrative expenditures, student services, and non-instructional expenditures such as university research.

Student-paid tuition has financed an increasing share of spending in higher education. From 1978 to 1992, net tuition revenue per student grew 79 percent in Minnesota. State appropriations per student for instructional purposes declined 6 percent in constant dollars.

Nationally, spending has grown faster than in Minnesota. Spending per capita grew 24 percent nationally from 1978 to 1992. Spending per student increased 18 percent nationwide, compared with 8 percent in Minnesota. Tuition growth was slower nationally (57 percent), while state and local appropriations per student increased 3 percent.

Health and Welfare Trends

Health and welfare spending per capita increased 320 percent in Minnesota between 1957 and 1992. In part, this increase was in response to newly established federal programs and funding. For example, the federal government established the Medical Assistance program in the mid-1960s and has provided a little more than half of the funds for the program. In addition, the federal government has expanded the program over the years. Minnesota has also made choices within federal programs and other state programs that have affected the growth in health and welfare spending. Minnesota's spending growth since 1957 has exceeded the 280 percent growth nationwide.

Since 1980, there has been strong growth in spending on major human services programs except AFDC. From 1980 to 1995, spending per capita on those pro-

Tuition increases have financed an increased share of higher education spending.

Increases in caseloads and medical costs have caused growth in human services spending.

grams tracked by the Department of Human Services grew 95 percent in Minnesota. Spending per capita on each major program increased at least 65 percent except for AFDC, which declined by about 8 percent. Medical Assistance spending, which increased 118 percent, accounted for 70 percent of the overall growth in spending per capita among those programs examined.

Caseload increases were responsible for most of the growth in spending per capita for General Assistance/Work Readiness, General Assistance Medical Care, and Minnesota Supplemental Aid. Caseloads for AFDC also grew, but spending per capita decreased because of a 31 percent decrease in average program spending per recipient in constant dollars. Caseload increases also accounted for most of the increase in Medical Assistance spending, but a significant share of the growth in spending per capita was also due to higher costs per enrollee, particularly for elderly enrollees. Increased utilization of services and medical inflation in excess of the general inflation rate may explain the growth in Medical Assistance spending per enrollee.

Trends in Other Areas

State and local governments have three additional major functions: 1) transportation, 2) public safety, and 3) environmental and natural resource programs. These functions have experienced somewhat varied spending trends in the past.

Since 1957, spending per capita on highways and roads has been relatively constant. Spending per capita grew only 10 percent in Minnesota from 1957 to 1992, while it declined 11 percent nationally. With increases in productivity, state and local governments have been able to address growing automobile use and traffic congestion without increasing spending faster than inflation. Like highway spending, transit spending has also increased only slightly in Minnesota, but has grown much faster nationally.

Since 1972, spending on public safety programs in Minnesota has increased faster than most other state and local government spending in Minnesota. Spending per capita on corrections and police and fire protection grew 89 percent from 1972 to 1992. Strong growth in corrections spending occurred throughout this period, while police and fire protection grew faster than most state and local activities during the 1970s.

Since 1982, corrections has been one of the fastest growing areas of state and local spending. Correctional spending per capita increased 56 percent in Minnesota and 105 percent nationally. Increased spending has been due to a number of factors. Increased crime rates and tougher sentencing policies have both contributed to the growth in correctional spending. Between 1982 and 1992, the violent crime rate increased 60 percent in Minnesota. Tougher sentencing policies have lengthened prison sentences and resulted in more convicted individuals receiving time in jail or prison.

Since 1972, spending per capita on environmental and natural resource programs has grown 49 percent in Minnesota, or only a little faster than the overall growth

Growing crime rates and tougher sentencing policies have resulted in fast growth in corrections spending.

rate for state and local government spending. Parks and recreation spending, which grew strongly in the 1970s, accounted for half of the spending growth among environmental and natural resource programs. Most of the rest of the growth came from solid waste management, which increased 300 percent on a per capita basis. Growth in recycling, hazardous waste cleanup, and spending on waste incineration plants contributed to the increase in solid waste management expenditures.

Since 1977, much of the growth in parks, solid waste management, and sewerage spending has been financed by increased fees and charges. Overall, the share of environmental and natural resource spending financed by fees increased from 19 percent in 1977 to 42 percent in 1992.

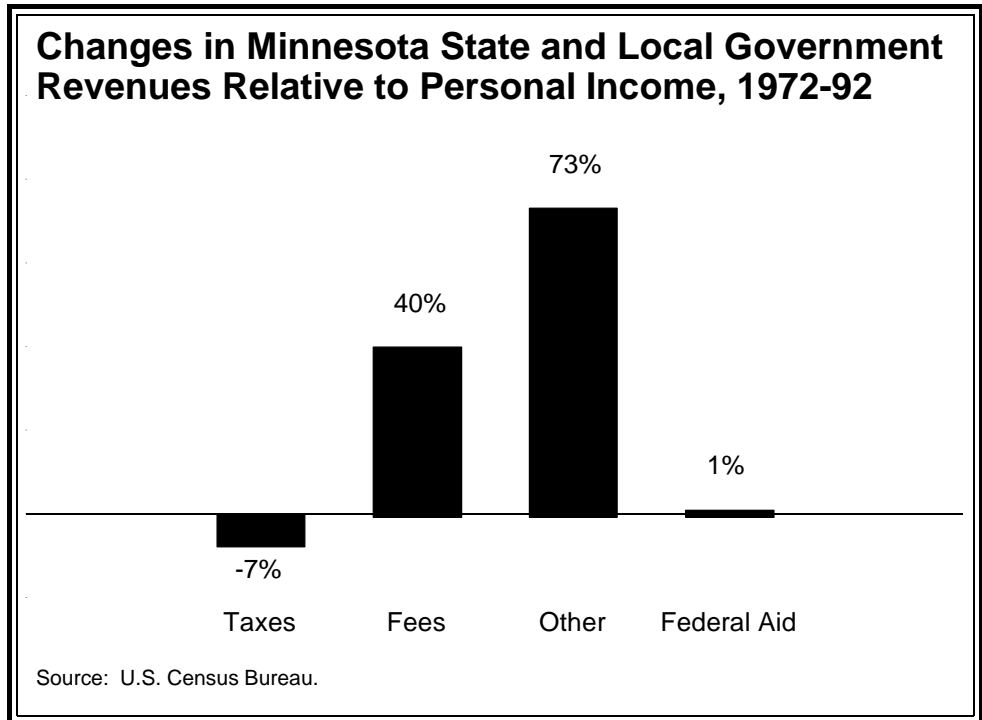
Revenue Trends

Revenues, like expenditures, grew strongly from 1957 to 1972 in Minnesota. Total state and local government revenues per capita increased 92 percent during that period. From 1972 to 1992, revenues per capita grew slower (45 percent), and revenues grew only 6 percent relative to personal income.

Revenue growth since 1972 has been dominated by increases in fees, interest earnings, and other non-tax revenues. Between 1972 and 1992, non-tax revenues per capita grew 108 percent, while federal aid per capita grew 37 percent. State and local tax revenue grew the slowest of the major types of revenues.

- **Between 1972 and 1992, state and local government tax revenues per capita grew 28 percent in Minnesota, but taxes declined 7 percent relative to personal income.**

Since 1972, tax revenues have increased 28 percent per capita but declined 7 percent relative to personal income.



Nationally, revenue trends since 1957 have been similar to those in Minnesota. Overall, revenues per capita grew only slightly slower nationally than in Minnesota. Growth in tax and non-tax revenues was slightly lower nationwide than in Minnesota, while growth in federal aid was a little faster nationally. Personal income taxes grew faster in other states and sales taxes grew faster in Minnesota, reflecting Minnesota's earlier reliance on income taxes than other states.

NATIONAL COMPARISONS

Minnesota state and local governments have generally spent more per capita than the national average. For example:

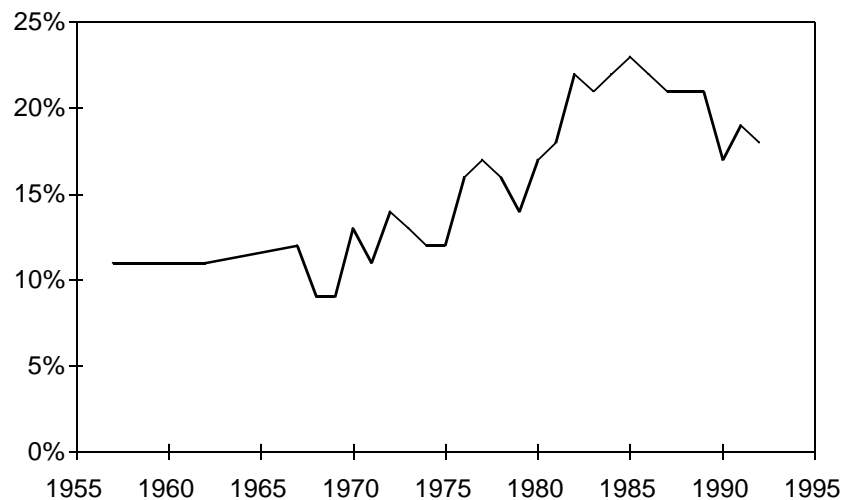
- **In 1992, spending per capita in Minnesota was 18 percent higher than the national average.**

Spending per capita was higher in Minnesota in most categories. Minnesota's spending was 45 percent higher than average for highways and roads, 40 percent higher for natural resources and parks and recreation, 29 percent higher for health and welfare programs, 16 percent higher for elementary-secondary education, and 12 percent above average for higher education. Minnesota spent less than the national average on corrections (41 percent), fire protection (32 percent), police protection (16 percent), and judicial and legal functions (6 percent).

Most of the difference in spending per capita between Minnesota and other states was due to spending on health and welfare programs, education, and highways. Health and welfare programs accounted for 41 percent of the overall spending

Minnesota spends more per capita than the national average for state and local governments.

Percent Difference in Per Capita Spending, Minnesota vs. the National Average, 1957-92



Source: U.S. Census Bureau.

A variety of factors explain Minnesota's above average spending.

difference, while education accounted for 32 percent and highways accounted for 17 percent of the difference.

Minnesota's higher than average spending on health and welfare programs appears to be largely due to welfare and social programs other than Medical Assistance and Aid to Families with Dependent Children (AFDC). These programs include a variety of safety net and social service programs. Minnesota's spending on Medical Assistance and AFDC has been close to the national average. Although Minnesota has fewer enrollees per capita in these programs, above average spending per enrollee brings overall spending per capita close to national averages. Higher than average spending per Medical Assistance enrollee was largely due to Minnesota's higher rate of institutionalization among the elderly and disabled.

Higher than average spending per capita in elementary-secondary education is due to a number of factors. Minnesota has more students per capita than the national average, and spends more than the national average on capital projects, special education, and transportation. Minnesota has fewer special education students per capita than average, but employs 47 percent more special education staff per special education student.

Higher education spending per capita exceeds the national average largely because public colleges and universities in Minnesota enroll more students per capita than their counterparts in other states. Minnesota has typically had a higher number of high school graduates per capita because of its lower than average dropout rates and higher than average number of school-age children per capita. In addition, Minnesota has a higher than average participation rate in higher education among its high school graduates. As a result, Minnesota's public college and university enrollment per capita exceeds the national average.

Spending on highways and roads is higher than the national average because Minnesota spends more per mile of road, particularly on state and municipal roads, and has a much more extensive system of rural roads. Climate and road standards such as road width may explain, in part, Minnesota's higher than average unit costs. The greater number of rural road miles is partially the result of Minnesota's higher than average number of farms, which also tend to be smaller in size than the national average. Spending on natural resources and parks exceeds the national average because of Minnesota's relatively large amount of park land and its citizens' high rates of participation in outdoor recreational activities.

Minnesota's lower than average spending per capita on corrections and police protection is partially related to differences in crime rates. In 1992, Minnesota's crime rate was 18 percent lower than the national average, while the violent crime rate was 54 percent lower in Minnesota than throughout the nation.

Minnesota state and local governments also pay higher salaries than their national counterparts. Average salaries in Minnesota were 5 percent above the national average in 1992, although it appears that fringe benefits were closer to the national average. Minnesota governments also employ 2 percent more staff per capita than

state and local governments nationwide. In 1992, staffing was well above the national average for public welfare, higher education, highways, and natural resource programs.

Minnesota's state and local government revenues must also be higher than the national average in order to finance higher than average expenditures. In 1992, Minnesota's tax revenues per capita were about 14 percent above average, while federal aid received by state and local governments was slightly below average. Other non-tax revenues such as fees and interest income were about 30 percent above the national average.

FUTURE BUDGET PROBLEMS

Two recent reports have projected future budget deficits for state and local governments in Minnesota. In *Within Our Means*, Minnesota Planning projected a cumulative budget deficit of \$2.5 billion over a 10-year period (1996-2005). *Agenda for Reform*, also known as the Brandl-Weber report, cited projections from the Department of Finance showing a \$5.1 billion gap between expenditures and revenues over a 6-year period (1996-2001). The report also suggested that reductions in expected federal aid might increase the gap to over \$8 billion.

The difference in the two estimates is a result of different methods. For *Within Our Means*, Planning assumed that state and local budgets would have to be balanced each year and calculated the amount of spending reductions needed to balance state and local budgets each year. In contrast, the Brandl-Weber report totaled the cumulative gaps between expenditures and revenues assuming expenditures grow as forecast without reduction. Using the same methods as Minnesota Planning, projections in the Brandl-Weber report would show cumulative budget deficits of about \$1.3 billion through the year 2001, or \$2.3 billion with federal aid reductions. The \$1.3 billion figure is similar to the \$1.1 billion projected by Planning for the same years.

Minnesota may face future budget problems even without changes in federal aid.

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

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

These projected deficits arise, in large part, because of an expected slowing of the growth in personal income and government revenues. At the same time, spending pressures are expected to be significant, particularly for health care and criminal justice programs, although projected spending increases are not higher than the historical rate of growth.

The projections in these two reports are consistent with results we obtained using the most recent forecasts of personal income and the targets set by the 1995 Legislature linking future revenue increases to personal income growth. Even absent federal aid changes, it appears that Minnesota faces budget problems. Slower than expected growth in spending will probably be needed in order to balance state and local budgets, unless state and local revenues are increased or grow faster than expected. Any reductions in the expected growth in federal aid will require additional budgetary adjustments.