

Trends in Minnesota Government Spending

A Ten-Year Analysis



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Trends in Minnesota Government Spending

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The **Property Tax Study Project** is a collaboration of eight Minnesota local governments. The purpose of the Project is to identify common interests and to educate participating jurisdictions and others — including state policymakers, other local governments, and the public at large — regarding issues pertaining to government finance and property taxation. The local governments participating in the Project include the cities of Duluth, Minneapolis, and St. Paul, the counties of Hennepin, Ramsey, and St. Louis, and the school districts of Minneapolis and St. Paul.

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Executive Summary

Concerns over growth in government have taken a prominent place in Minnesota's political discourse in recent years. Some fear that the rate of growth in Minnesota government is unsustainable, while others are concerned that Minnesota will not be competitive in the global economy unless the state continues to commit to critical public investments.

To better understand trends in government growth in Minnesota and to get a sense of what these trends mean, this report looks at two questions:

- How much has government in Minnesota grown?
- Has a higher level of public investment in Minnesota resulted in a higher quality of life and a stronger economy?

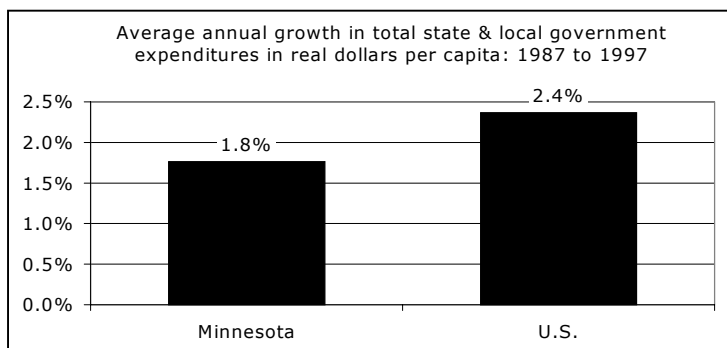
The report concludes with a consideration of how the answers to these questions can help guide future state and local government budget decisions.

Growth in Minnesota Government

In budget debates during the 2002 legislative session, Governor Ventura argued that government in Minnesota had doubled over the past decade. At first glance, this seems like a troubling statistic. However, this assertion is based on growth in the state's general fund from 1990-91 to 2002-03, which is actually a twelve-year period, not a decade. More significantly, the "doubling in a decade" claim is based on an incomplete measure of government revenue (the state's general fund). In fact, total state and local government revenues did not double over the last ten years.

Rather than limiting the analysis to the state's general fund, which includes only about two-thirds of state government revenues, this report focuses on *total state and local* government expenditures. In addition, this report also accounts for inflation and population growth. Using this approach, this report finds that:

- From 1987 to 1997, over two-thirds of the growth in Minnesota state and local government spending was necessary to keep up with inflation and population growth.
- As a percentage of Minnesota personal income, total state and local government expenditures in Minnesota declined slightly from 22.2 percent in 1987 to 21.9 percent in 1997.
- Government spending in Minnesota has grown less rapidly than the national average. From 1987 to 1997, state and local government spending for all fifty states and the District of Columbia in real dollars per capita grew by an average of 2.4 percent annually, significantly higher than Minnesota's annual average of 1.8 percent.



Measuring the Size of Government

This report measures growth in government by examining the change in government expenditures over time. This change in expenditures is measured in four ways:

- in simple nominal dollars (i.e., unadjusted for inflation or population growth),
- adjusted for inflation and population growth,
- as a percentage of total statewide personal income, and
- relative to the national average.

Combined, these measures provide a comprehensive picture of changes in the size of Minnesota government over time.

As population grows, public services must be provided to more people. In addition, because inflation erodes the purchasing power of the dollar over time, governments must increase spending in order to provide the same level of services. Examining expenditures in real (inflation-adjusted) dollars per capita allows us to measure the extent to which growth in government is due to inflation and population growth as opposed to other factors, such as the creation of new government programs.

For nearly a decade, lawmakers and business groups have argued in favor of measuring the size of government in relation to statewide personal income. Measuring expenditures as a percentage of statewide personal income helps to gauge growth in government in relation to growth in the state's economy and growth in taxpayers' ability to pay.

In addition, this report measures growth in Minnesota government relative to the national average. This comparison allows us to place Minnesota government growth in perspective by providing a national context.

Examining State and Local Government

As mentioned above, this report includes both state *and* local government. An examination of growth in state government spending that does not take into account growth in local government spending — or vice versa — can yield misleading conclusions. A comprehensive analysis of government growth needs to take into account both state and local government expenditures. There are two reasons why this provides a more meaningful picture.

First, spending responsibilities can shift from one level of government to another. For example, in the 2001 legislative session, policymakers agreed that the state would take over a significant portion of general education costs that had been funded through local property taxes. An analysis that includes only the state's general fund would conclude that this was growth in spending, when in fact it was merely a shift in funding responsibility from local property taxes to the state's general fund. Measuring the combined total of state and local government expenditures avoids this sort of error.

Second, states vary considerably in terms of which services are funded at the state level and which are funded at the local level. In some states, state government spending may appear high in relation to other states only because the state government is financing public services that are financed at the local level in other states. An examination of the combined expenditures of both state and local governments is necessary in order to make meaningful comparisons among states.

The primary source of expenditure data used in this report is the U.S. Census Bureau's *Census of Governments*, which contains data from all state and local governments. The disadvantage of the *Census of Governments* is that data for years after 1997 is not yet available.

In order to determine whether more recent data would yield different results, this report also looks at state and local revenue data up to 2002. The analysis of revenue data from 1990 to 2002 reveals a trend similar to the analysis of expenditure data: state and local government revenues in Minnesota grew less rapidly than the national average and declined as a share of Minnesota personal income.

Impact of Government Spending on Minnesota's Quality of Life

Even though government in Minnesota has grown less rapidly than the national average, total 1997 state and local spending per capita in Minnesota was 10.3 percent above the national average. To what extent has a higher level of public investment in Minnesota resulted in greater economic prosperity and a higher quality of life?

To answer this question, this report examines two policy areas: K-12 education and transportation. Within each policy area, this report examines Minnesota spending relative to the national average. In addition, this report attempts to determine whether a higher (or lower) level of public spending is accompanied by superior (or inferior) public outcomes.

In terms of current K-12 expenditures per pupil, Minnesota ranks 14th highest in the nation and is 6.6 percent above the national average based on the most current *Census of Governments*. There are strong indications that Minnesota has received ample return for greater investment in K-12 education. For example, Minnesota is at the top of the nation in terms of basic skills proficiency and other measurements of academic achievement.

In the area of transportation, the situation is mixed, with Minnesota spending above the per capita national average on highways but below average for transit. Minnesota's highway spending per capita was 42.2 percent above the national average in 1997, although Minnesota's high level of per capita spending on highways is to some extent driven by climate. A more meaningful comparison is between Minnesota and a similar northern state. In 1997, Minnesota spent 9.6 percent more per capita on highways than Wisconsin, which in part reflects the fact that Minnesota has more miles of road per capita than Wisconsin. In addition, roads and bridges in Minnesota are generally in better shape than in Wisconsin and traffic deaths per vehicle mile of travel in Minnesota are significantly lower. Once again, there is evidence that Minnesota is receiving a return on its higher level of government expenditures.

In terms of transit funding, Minnesota's spending per capita in 1997 was 64 percent below the U.S. average. Minnesota's low rate of public investment in transit has translated into low mass transit carrying capacity. Among the 18 states with metropolitan areas of more than two million people, Minnesota ranks last in terms of mass transit carrying capacity.

In general, Minnesota has a strong economy and a high quality of life as measured in terms of employment, wages, hourly earnings, business closings, child poverty, and a variety of other indicators. Various studies have ranked Minnesota at or near the top of the nation in terms of economic performance, development capacity, and quality of life. An examination of the *2001 Development Report Card for the States* indicates that public infrastructure and services have contributed to Minnesota's high rankings.

Planning for the Future

This report addresses growth of government in Minnesota and compares this growth to the national average. This is a relatively easy task. No attempt is made to predict future spending growth or determine which public investments are necessary to ensure Minnesota's future prosperity and quality of life and which are not.

This analysis indicates that state and local government investments in public services and infrastructure have contributed positively to Minnesota's economic health and quality of life. While policymakers need to be attentive to trends in government growth, they should also be mindful of the extent to which Minnesota's current prosperity is the result of wise public investments made in the past. Prudent use of public dollars in the present can reduce the need for government spending in the future. Conversely, the failure to make necessary

public investments now will only compound the severity of problems that the state will encounter in the future. Minnesota's experience provides a strong indication that public spending — even spending in excess of the national average — can produce positive public benefits.

Part 1: Introduction

In budget debates during the 2002 legislative session, Governor Ventura argued that government in Minnesota had doubled over the past decade. At first glance, this seems like a troubling statistic. However, this assertion is based on growth in the state's general fund from 1990-91 to 2002-03, which is actually a twelve-year period, not a decade. More significantly, the "doubling in a decade" claim is based on an incomplete measure of government revenue (the state's general fund). In fact, total state and local government revenues did not double over the last ten years.¹

How much has government in Minnesota grown? The answer depends on how government is defined, how the size of government is measured, and the time period that is examined. This report defines government to include both state and local levels, measures its size in terms of total expenditures, and examines a time frame of approximately ten years. This approach provides a comprehensive picture of government spending trends.

Defining Government

Broadly speaking, there are three levels of government: federal, state, and local.² This report defines government spending as both state and local government expenditures, including expenditures funded by federal aid. This measure of spending is chosen because it is comprehensive, it can distinguish actual growth from spending shifts, and it allows for more accurate comparison among states.

State and local spending that is funded with federal aid is included in this report's measures of state and local expenditures.³ However, direct federal expenditures are not included in this analysis because they do not fund state or local government services. For example, state health care expenditures paid for with federal Medicaid dollars are included in this analysis, whereas direct federal defense expenditures for military facilities in Minnesota are not included.

An analysis that is limited to only one level of government does not account for the fact that funding obligations are often shifted from one level of government to another over time. For example, in recent years the legislature and governor have reduced the share of K-12 education costs funded by local property taxes and increased the share funded from the state's general fund. This shift from the local level to the state resulted in an increase in state general fund spending, but did not in itself increase the total dollars spent on K-12 education. An analysis that focuses exclusively on state expenditures would show this as growth, when it is merely a shift of funding responsibilities from one level of government to another.

Another reason for focusing on combined state and local government spending is because the functions of state and local governments vary from state to state. For example, human service programs are funded almost exclusively by state government in some states, while

¹ Total state and local government revenue (including federal aid) increased 74 percent from Calendar Year 1991/Fiscal Year 1992 to CY 2001/FY 2002, based on the Minnesota Department of Finance's *Price of Government* report.

² Local governments include counties, cities, townships, school districts, and special taxing districts. Special taxing districts include entities such as the Metropolitan Council, watershed districts, and economic development districts.

³ Federal aid helps fund a wide array of programs, including environmental quality, agriculture, transportation, community development, education and training, health, income security, justice, and general government.

in other states much of this funding comes from local governments. An analysis that focuses exclusively on state government or exclusively on local government can lead to misleading comparisons among states, because it does not take into account differences in funding responsibilities between the levels of government from state to state.

Measuring the Size of Government

This report focuses on one of the most readily accessible and comprehensive measures of the size of government: total expenditures.⁴ Expenditure data used in this report comes from the *Census of Governments*, which is prepared by the U.S. Census Bureau every five years; the most current *Census* is from 1997.⁵ The *Census of Governments* is one of the few sources that reports combined state and local government expenditures. Because it is national in scope, the *Census of Governments* enables comparisons between Minnesota and other states.

The *Census of Governments* contains data from all state and local governments in the U.S., whereas other sources — while moderately more current — are based on only a sample of governments. This report relies on the *Census of Governments* because it is more complete.

Determining a Time Frame

There is a tension between choosing a time frame that is long enough to establish significant trends yet not so long so as to include the effects of trends or forces that no longer influence growth in government.

The forces that were influencing the rate of growth in government in the 1960s, 1970s, and 1980s are not the same forces at work today. For example, the “Great Society” programs of the 1960s caused a dramatic increase in the size of government. While many Great Society programs remain today, the rapid growth in the size of government resulting from Great Society initiatives is over. Similarly, the devolution of authority from the federal government to state government during the 1980s — sometimes referred to as “New Federalism” — also influenced the growth in government; however, New Federalism does not currently affect the rate of growth in government in the same way that it did in the 1980s.

Since our purpose is to assess forces that are currently influencing growth in government, it would be inappropriate to extend our analysis into the distant past. This report restricts the analysis to the most current ten-year period for which comparable data is available. Because the most current *Census of Governments* is for 1997, this report focuses on the period from 1987 to 1997. Such a period is long enough to establish significant trends of growth or decline in government, but not so long so as to incorporate trends that no longer have a major influence on government growth.

⁴ As defined by the Census Bureau, expenditures are “all amounts of money paid out by a government — net of recoveries and other correcting transactions — other than for retirement of debt, investment in securities, extension of credit, or as agency transactions.” Total expenditures include only external transactions of a government and exclude duplicative intergovernmental transactions. In general, this report uses total expenditures except where noted otherwise.

⁵ The next *Census of Governments* will include data for 2002; however, this information will not be available until approximately 2004.

From the perspective of this analysis, the period from 1987 to 1997 is appropriate also because it incorporates approximately one complete business cycle.⁶ Because the business cycle influences the rate of growth in government, it is useful to examine a complete cycle.

This analysis is limited by the availability of *Census of Governments* expenditure data. It is reasonable to ask whether more recent data would yield different results. Appendix B examines growth in government using revenue data from the *Price of Government* report prepared by the Minnesota Department of Finance, which includes estimated information from as recently as 2002.

Measuring Change

In this report, change in government expenditures over time is examined in four ways. The simplest way to measure growth in government expenditures over time is in **nominal dollars**. Nominal dollars are not adjusted for inflation.

However, inflation erodes the purchasing power of the dollar over time, causing governments to spend more in nominal dollars in order to provide the same level of services. In addition, because the need for government services increases as population increases, government expenditures tend to grow as population grows. Measuring government expenditures in **real dollars per capita**⁷ allows for an examination of growth in government over time after adjusting for the effects of inflation and population growth.

Political and business leaders in Minnesota have argued that the size of government should be measured as a **percentage of personal income**. Measuring the size of government in this way gives an approximation of the level of government expenditures relative to the wealth of the state and relative to taxpayers' ability to pay for these expenditures. If government expenditures grow less rapidly than personal income, the total cost of government as a percentage of total income will decline, even though expenditures in nominal dollars or real dollars per capita could increase.

Finally, this report measures growth in Minnesota government **relative to the national average**. This comparison places Minnesota government growth in perspective by providing a national context. In gauging Minnesota's position relative to the rest of the nation, this report compares Minnesota's per capita spending (or, in the case of K-12 education, per pupil spending) to national per capita (or per pupil) spending.⁸

⁶ 1987 preceded the recession of the early 1990s by a few years, whereas 1997 preceded the current recession by a few years. Thus, 1987 and 1997 occupy approximately comparable locations in the last two business cycles.

⁷ "Real dollars" are dollars that have been adjusted for inflation; real dollars are sometime referred to as "constant dollars" or "inflation-adjusted dollars." In this report, nominal dollars are converted to real dollars using the implicit price deflator (IPD) for state and local government purchases. The average annual rate of inflation over the time period examined in this report (1987 to 1997) as measured by the IPD is 3.0 percent. In addition to adjusting for inflation, this report also adjusts for the effects of population growth on government spending by examining expenditures on a per capita basis (that is, total spending divided by total population).

⁸ The national per capita average (total U.S. spending divided by total U.S. population) is a more meaningful measure of the "national average" than the per capita median among the fifty states. The per capita median of the fifty states weights all states the same (even though some states have much larger populations than others), which can produce skewed results that are not representative of the nation as a whole.

Examining the Effects of Government Expenditures

Are Minnesotans getting what they pay for in terms of government spending? In other words, have government expenditures in Minnesota contributed to economic growth and an improved quality of life? This report attempts to address these issues by examining two specific policy areas that have been the subject of debate in recent years: kindergarten through grade 12 (K-12) education and transportation (including both highways and transit). Within each policy area, the following questions are addressed:

- How much is Minnesota spending on a per capita (or per pupil) basis and how does this compare to other states?
- Is Minnesota spending growing more or less rapidly than the national average?
- To the extent that Minnesota is spending more or less than the national average, is Minnesota also receiving a higher or lower level of public benefit?

In addition to examining specific policy areas, this report also gauges the extent to which Minnesota's overall quality of life and economic health have been influenced by state and local government expenditures.

Planning for the Future

This report examines growth in Minnesota government over time, given the recent interest in this topic. However, no attempt is made to address the important issue of whether this growth has been too slow or too rapid. In short, this report examines how much Minnesota government has grown, but does not address how much government in Minnesota should grow or will grow.

No one knows how rapidly Minnesota government will grow in the future because no one can foresee future challenges and opportunities. This report avoids the use of extrapolation, which is the practice of anticipating future behavior based on past trends. Extrapolation can yield dramatically different conclusions, depending on the trends that are extrapolated and the time frame on which the extrapolation is based. In the past, the simplistic application of the extrapolation technique has led to unwarranted conclusions.⁹

Nonetheless, some trends will affect the ability of state government and the state economy to grow in the future. For example, the aging of Minnesota's population and the subsequent decline in per capita productivity will undoubtedly have an impact on Minnesota's economy. The final section of this paper will discuss the considerations that should guide our decisions regarding government growth in the future.

⁹ For a more detailed discussion of this topic, see Appendix C.

Part 2: Growth in Minnesota's Government Expenditures

The U.S. Census Bureau's *Census of Governments* is one of the few sources that reports combined state and local government expenditures for all fifty states and the District of Columbia. Based on total state and local government spending data, **just over two-thirds of the average annual growth in government spending in Minnesota from 1987 to 1997 was necessary to keep up with inflation and population growth.**¹⁰ In addition, total state and local government spending as a percentage of personal income in the state declined slightly over this period.

Specifically, total state and local government expenditures in Minnesota:

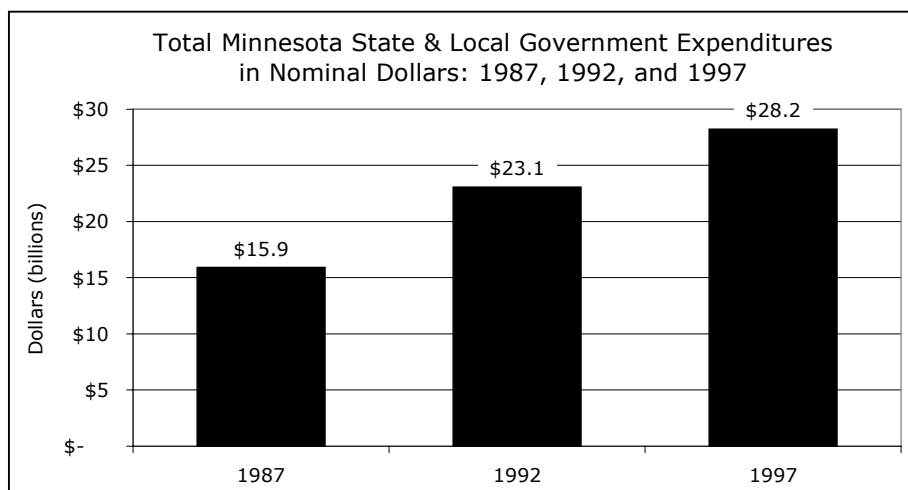
- Increased at an annual average rate of 5.9 percent from 1987 to 1997 in nominal dollars.
- Increased at an annual average rate of 1.8 percent from 1987 to 1997 in real (inflation-adjusted) dollars per capita.
- Declined slightly from 22.2 percent of Minnesota personal income in 1987 to 21.9 percent in 1997.
- Grew less rapidly than the national average. Among all fifty states, the annual average growth in total expenditures in real dollars per capita from 1987 to 1997 was 2.4 percent, compared to 1.8 percent in Minnesota.

While the rate of growth in Minnesota state and local government expenditures from 1987 to 1997 was below the national average, total 1997 Minnesota state and local government expenditures per capita were still 10.3 percent above the national average.

Expenditure Growth in Nominal Dollars

From 1987 to 1997, total state and local expenditures in Minnesota grew from \$15.9 billion to \$28.2 billion, an increase of 77.5 percent. The annual average rate of growth during this period was 5.9 percent (i.e., on average, expenditures in each year were 5.9 percent greater than the preceding year).

Expenditure growth was slower in the second five-year period than in the first. The annual average increase in total state and local government expenditures from 1992 to 1997 was 4.1 percent, down substantially from the 7.7 percent average annual growth from 1987 to 1992.

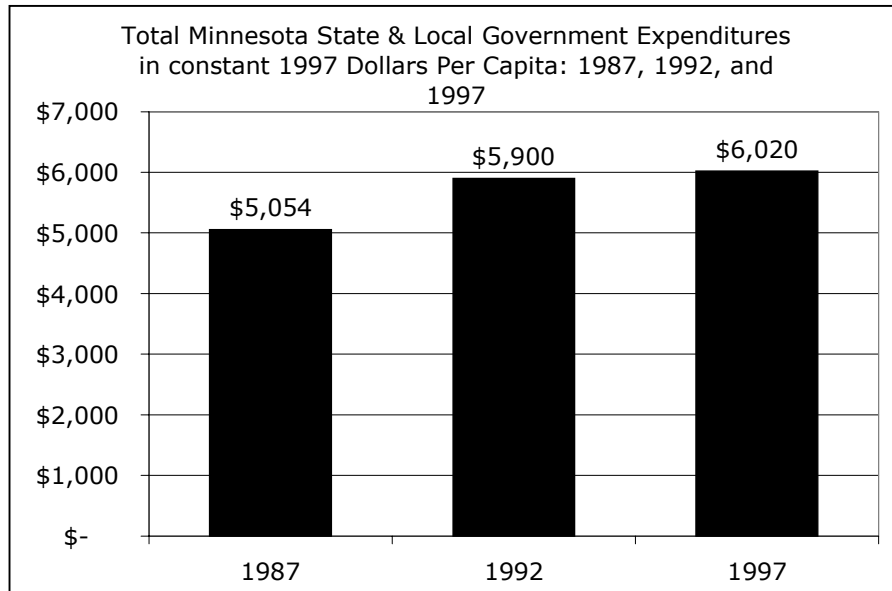


¹⁰ This report uses expenditure data from the 1987, 1992, and 1997 *Census of Governments*. The *Census of Governments* contains data from all state and local governments and thus is more complete than the Census Bureau's *Government Finances* report, which relies on a sample of governments. See Appendix A for details regarding the *Census of Governments* information used in this section.

Expenditure Growth in Real Dollars Per Capita

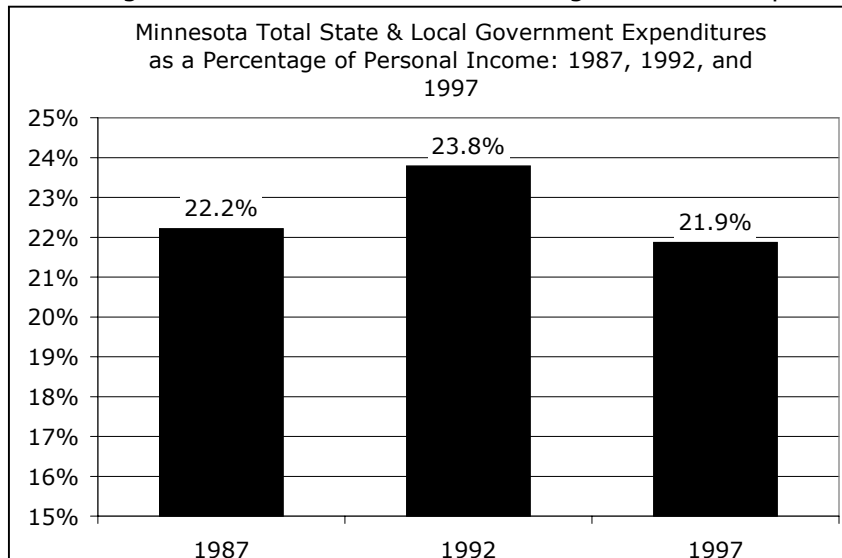
In order to gauge growth in government expenditures after controlling for the effects of inflation and population growth, it is necessary to examine expenditures in real dollars per capita. From 1987 to 1997, the per capita expenditures of state and local governments in Minnesota grew from \$5,054 to \$6,020 in constant 1997 dollars, an increase of 19.1 percent. This represents an average annual growth rate of 1.8 percent, which is less than one-third of the growth rate measured in nominal dollars. In other words, over two-thirds of state and local government spending growth from 1987 to 1997 can be attributed to inflation and population growth.

Most of the growth in government spending from 1987 to 1997 was concentrated in the first five years of this period. From 1987 to 1992, total Minnesota state and local government expenditures in real dollars per capita grew at an average annual rate of 3.1 percent, compared to only 0.4 percent average annual growth during the period from 1992 to 1997.



Expenditures as a Percentage of Minnesota Personal Income

Examining total Minnesota state and local government expenditures as a percentage of statewide personal income allows us to assess government spending relative to the size of the state's economy and the population's ability to pay. From 1987 to 1997, expenditures as a percentage of personal income declined slightly from 22.2 percent to 21.9 percent.¹¹



However, this decline was not steady. Total expenditures as a percentage of personal

¹¹ Readers familiar with the *Price of Government* report will note that these percentages differ from the commonly cited Price of Government percentages. There are two reasons for this difference. First, the *Price of Government* report measures revenues, while this report measures expenditures. Second, this report includes all expenditures, including those funded by federal intergovernmental transfers, whereas Price of Government percentages do not include federal revenues.

income actually grew during the first five-year period, but this growth was more than offset by a decline in the second five years.

Expenditure Growth in Minnesota Relative to the National Average

The rate of growth of government spending in Minnesota from 1987 to 1997 was below the national average. Total state and local government expenditures in Minnesota grew at an annual average rate of 1.8 percent in real dollars per capita from 1987 to 1997, compared to 2.4 percent for all state and local governments in the U.S.

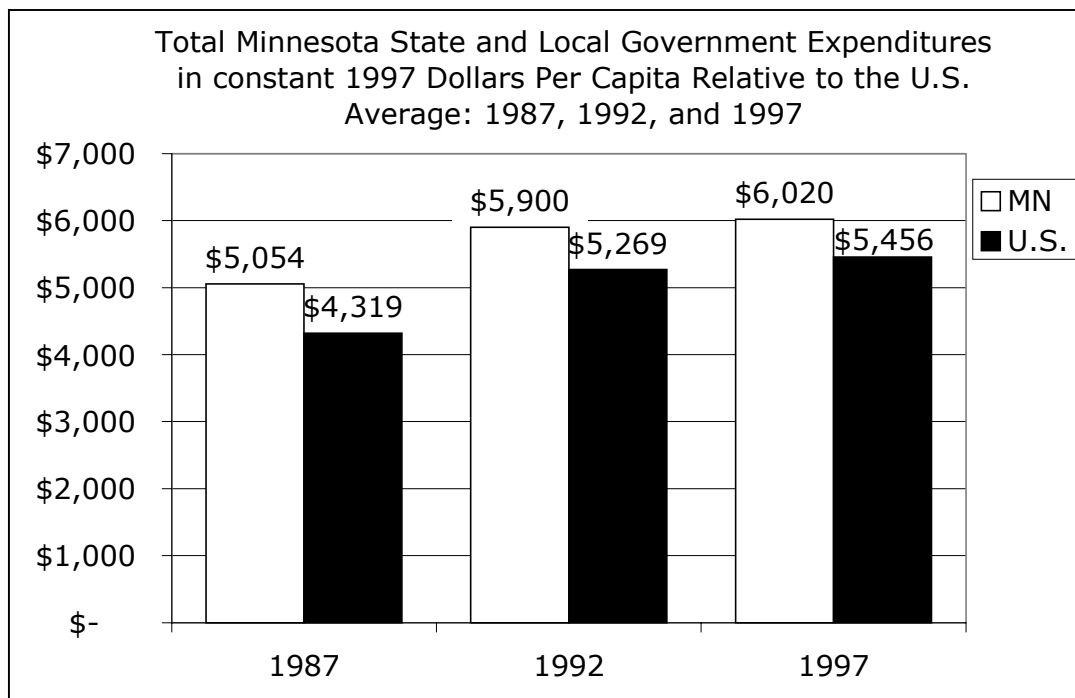
While government in Minnesota was growing less rapidly than the national average, Minnesota's economy was growing more rapidly. Minnesota personal income in real dollars per capita grew three percent more rapidly than the national average from 1987 to 1997. During the same period, Minnesota's Gross State Product grew four percent more rapidly than the national average.¹²

Both in an absolute sense and as a percentage of personal income, state and local government expenditures in Minnesota grew less rapidly than the national average during the period from 1987 to 1997.

Total Spending Per Capita Relative to the National Average

Thus far, this section has examined the *rate of growth* in Minnesota state and local government expenditures over time, but not the *absolute level* of Minnesota government spending per capita relative to other states at a single point in time. Such an examination is possible using information from the *Census of Governments*.

As might be expected, total state and local government expenditures in Minnesota are above the national average, as demonstrated in the following graph.



¹² Calculated based on information from the U.S. Department of Commerce Bureau of Economic Analysis website.

While government expenditures per capita in Minnesota are greater than the national average, the gap between Minnesota's per capita spending and the national average has gotten smaller. In 1987, total state and local government expenditures per capita in Minnesota were 17.0 percent above the national average. Minnesota had dropped to 12.0 percent above the national average by 1992 and to 10.3 above the national average by 1997.

In conclusion, total state and local government expenditures per capita in Minnesota are above the national average. However, the rate of growth in Minnesota state and local government has been below the national average since 1987. As a result of this trend, the extent to which Minnesota per capita government expenditures exceed the national average has declined since 1987.

Trends Since 1997

The most current *Census of Governments* is for 1997. To our knowledge, there is no single source that reports actual expenditures for *all* state and local governments in the U.S. after 1997. However, the *Price of Government* report from the Minnesota Department of Finance contains estimated revenue totals for both state and local governments in Minnesota. This data shows that total Minnesota state and local government revenues in real dollars per capita declined slightly from 1997 to 2002.¹³

Unfortunately, the *Price of Government* report covers only Minnesota and does not allow us to examine growth in Minnesota state and local revenues relative to other states since 1997. However, Minnesota's state-only revenue reductions can be compared to other states. The National Conference of State Legislatures' *State Tax Actions* reports find that Minnesota made the largest tax cuts in the nation as measured in terms of prior year tax collections in 1997, 1999, and 2001, as well as the 7th largest tax cut in 1998 and the second largest tax cut in 2000.¹⁴ Given the magnitude of these tax cuts, it seems unlikely that Minnesota's total state and local government revenues per capita increased relative to the national average.

¹³ This conclusion is based on information from the June 2002 *Price of Government* report adjusted for inflation and population growth. In constant 2002 dollars, combined state and local revenue was \$6,475 in CY 1997/FY 1998 and \$6,425 in CY 2002/FY 2003, a decline of 0.8 percent. See Appendix B for more information.

¹⁴ The years cited are those years in which the tax cuts were passed by the Legislature.

Part 3: Expenditure Growth in Two Policy Areas

Although Minnesota government spending has been growing less rapidly than the national average, total Minnesota state and local government expenditures per capita are nonetheless above the national average based on 1997 data. Are Minnesotans getting what they pay for from this higher level of government spending? In other words, have government expenditures in Minnesota contributed to economic growth and an improved quality of life? This section addresses this issue by examining two areas: kindergarten through grade 12 (K-12) public education and transportation. These areas were chosen because they have been subject to much debate in recent years and because they represent fundamental government functions.

Within each policy area, the following questions are addressed:

- How much is Minnesota spending on a per capita (or per pupil) basis and how does this compare to the national average?
- Is Minnesota spending growing more or less rapidly than the national average?
- To the extent that Minnesota is spending more or less than the national average, is Minnesota also receiving a higher or lower level of public benefit?
- What factors influence growth in spending?

The intent of this section is not to provide a comprehensive discussion of education and transportation finance, but rather to demonstrate that the task of gauging the appropriate level of spending or the appropriate level of spending growth is not as easy as simply examining the rate of growth over time.

As in the previous section of this report, this analysis relies on expenditure data from the *Census of Governments*.

K-12 Education

Total public elementary and secondary current expenditures per pupil in Minnesota grew less rapidly than the national average from 1987 to 1997.¹⁵ In constant 1997 dollars, elementary and secondary public school current spending per pupil in Minnesota grew from \$5,649 in 1987 to \$6,272 in 1997 — a growth of 11.0 percent. The growth nationally was 15.5 percent.

While the rate of growth in public school current spending per pupil in Minnesota is below the national average, it nonetheless exceeds the rate of inflation. What factors explain this growth?

¹⁵ As used by the *Census of Governments*, elementary and secondary education refers to regular, special, and vocational programs, summer school, food services, student activities, pre-kindergarten, transportation services, school health programs, and plant operation and maintenance. For shorthand purposes, elementary and secondary education is referred to herein as "K-12." In general, this report uses *total* expenditures from the *Census of Governments*. However, the *Census of Governments* does not report total K-12 education expenditures on a per pupil basis. Because it is important to show K-12 expenditures on a per pupil basis, the analysis of K-12 education in this report is based on *current* spending per pupil. Current spending "comprises current operation expenditures, payments made by the state government on behalf of school systems, and transfers made by school systems into their own retirement funds. This classification is used only in Census Bureau education reports in an effort to provide statistics for users who wish to make interstate comparisons."

Perhaps the most significant factor contributing to growth in school expenditures is special education. In recent decades, federal and state governments have decided that dramatic changes in public policy regarding special education were necessary to address the needs of disabled students. As a result of these changes in policy, special education spending has increased. In recent years, Minnesota special education expenditures have grown at twice the rate of total K-12 expenditures. Furthermore, on average Minnesota public schools are spending two times more per special education student than per regular education student. According to a 1997 report, special education costs accounted for 21 percent of total school district spending.¹⁶

Special education costs are growing for reasons beyond the control of school districts. In recent years, four trends have accelerated growth in the cost of special education services:

- Many disabled children of school age who were formerly cared for in institutional settings have been deinstitutionalized and returned to public schools due to federal requirements that disabled children be placed in the least restrictive educational environment. From FY 1991 to 1997, the number of special education students enrolled in Minnesota public schools grew by 28.8 percent.¹⁷
- Advances in medical technology have increased the number of medically fragile students who can be cared for in a public school setting.
- Court, state, and federal mandates continue to increase the level of service expected from school districts. For example, Supreme Court decisions have confirmed that school districts are responsible for all medical services for medically fragile students up to (but not including) medical services provided by a doctor.
- An increase in the incidence of high-cost disabilities — such as autism and deafness — and an increase in the number of students with multiple disabilities have resulted in further increases in the cost of providing special education services.

To a large extent, the provision of special educational services is not a discretionary item for school districts. Courts have consistently upheld the right of disabled students to receive services that are required under state and federal law. In short, school districts are not at liberty to refuse to deliver special education services.

These observations pertaining to special education should not be regarded as a criticism of special education spending. Indeed, the changes in special education policy were necessary in order to ensure that all students have equal educational opportunities. The reference to this information regarding special education costs is simply intended to underscore the impact of special education policy on total K-12 spending.

Other factors that contribute to growth in K-12 public education costs include:

- *Increases in the number of limited English proficiency (LEP) students.* Due largely to immigration, the number of LEP students has grown much more rapidly than total enrollment.
- *Increased health care costs.* All levels of government are affected by the rising cost of providing health care to employees. School districts are especially hard hit by health care costs because personnel expenses are an especially large percentage of school district budgets.
- *Technology.* In order to equip students for life in an information-based economy, school districts must provide students with access to computers and other forms of technology. This requires investments in computers and infrastructure that were not part of school budgets in the past.

¹⁶ Office of the Legislative Auditor, *Special Education: A Program Evaluation Report*, 1997.

¹⁷ 2000-2001 State of Minnesota Biennial Budget, p. A-111.

- *Performance standards.* In recent years, school districts have been asked to ensure that students are able to meet new performance standards. These new standards contribute to increased costs for testing and additional instruction for students who have not met the standards.

While K-12 spending per student in Minnesota has grown less rapidly than in other states, Minnesota current spending per student in 1997 was still 6.6 percent above the national average.¹⁸ Does Minnesota have anything to show for this higher rate of investment in public education? The answer would seem to be “yes.” While Minnesota ranks 14th in the nation in terms of current elementary and secondary spending per pupil, Minnesota ranks first in the nation in math proficiency, sixth in science proficiency, and sixth in reading proficiency.¹⁹ In addition, Minnesota ranks third in the percentage of adults over age 25 with a high school diploma.²⁰ In short, Minnesota appears to be getting a “bang for the buck” from its elementary and secondary public school investment.²¹

However, it remains to be seen whether Minnesota can maintain these superior academic outcomes if per pupil spending continues to decline relative to the national average.

Transportation

This report examines two primary types of transportation spending: highways and transit. The situation is quite different for these two types of expenditures. Minnesota’s highway spending per capita in 1997 was significantly above the national average, while its transit spending per capita was well below the national average. Evidence suggests that Minnesota gets what it pays for, with higher highway spending resulting in higher quality and safer highways and low transit funding resulting in low transit capacity.

According to the *Census of Governments*, highway spending²² per capita in Minnesota in constant 1997 dollars grew from \$424 per capita to \$436 per capita — an increase of 2.7

¹⁸ Based on information from the 1997 *Census of Governments*. Other more recent sources indicate that K-12 public school current expenditures in Minnesota are even closer to the national average. For example, the most recent *Digest of Education Statistics* from the U.S. Department of Education indicates that elementary and secondary public school current expenditures in Minnesota were only 2.1 percent above the national average in FY 1999. However, please note that “current expenditures” as used in the *Digest of Education Statistics* is not identical to “current spending” as used in the *Census of Governments*.

¹⁹ These results are based on an assessment of eighth grade students. The math and science results are based on information reported in the *2002 Congressional Quarterly State Fact Finder*. The *2002 CQ State Fact Finder* does not report reading scores. The reading score results cited here were compiled from *State Profiles* from the website of the U.S. Department of Education National Center for Education Statistics. (The most current reading scores for eighth grade students are from 1998.) For each category of scores, data is not available for some states. The math score ranking does not include 11 states, the science score ranking does not include 12 states, and the reading score ranking does not include 14 states.

²⁰ Congressional Quarterly, *2002 CQ State Fact Finder*.

²¹ This is not a scientific analysis of educational spending and educational outcomes, since it does not control for other factors — such as family characteristics and income — that could contribute to educational outcomes. However, there is a growing body of evidence that indicates that higher educational expenditures contributes to higher educational outcomes, particularly for low-income and minority students. This is the case even after controlling for the effects of family characteristics. For more information, see “Does Money Matter for Minority and Disadvantaged Students? Assessing the New Empirical Evidence,” in *Development in School Finances, 1997* from the National Center for Education Statistics.

²² Under definitions used in the *Census of Governments*, highway expenditures include construction, maintenance, and operation of highways, streets, and related structures, including bridges.

percent. The national rate of growth in highway expenditures over this same period was 5.3 percent.

Minnesota per capita highway spending in 1997 was 42.2 percent above the national average. To some extent, greater highway spending in Minnesota can be attributed to climate. Snow removal and damage to road infrastructure due to freeze and thaw cycles contributes significantly to the cost of maintaining the state's highway system.

However, Minnesota highway spending per capita is higher than in some other northern states. For example, Minnesota per capita highway spending is 9.6 percent greater than in Wisconsin.²³ Is there any indication that greater highway spending has produced superior highways in Minnesota relative to the Badger State?

While Minnesota is spending more per capita than Wisconsin on highways, Minnesota has more road mileage per capita to maintain.²⁴ In addition, Minnesota's highways are in better condition than Wisconsin's. Only 5.6 percent of highway miles in Minnesota are rated deficient by the U.S. Department of Transportation, compared to 16.0 percent in Wisconsin.²⁵ Furthermore, 22.1 percent of bridges in Wisconsin are rated deficient, compared to 17.9 percent in Minnesota.²⁶ Finally, traffic deaths per mile of vehicle travel are 15.0 percent less in Minnesota than in Wisconsin.²⁷

While highway spending per capita in Minnesota is above the national average, transit spending per capita is 64 percent below the national average.²⁸ In constant 1997 dollars, Minnesota's transit expenditures per capita were \$40.02 in 1987 and dropped to \$35.60 in 1997, a decline of 11.0 percent. During the same period, transit spending nationally grew by 9.7 percent in constant 1997 dollars per capita.

Minnesota ranks 25th among the 50 states in terms of the carrying capacity of urban public mass transit systems.²⁹ However, this ranking by itself is somewhat misleading, since the states that Minnesota surpasses in terms of mass transit carrying capacity are primarily rural states that have much less need of mass transit. Among the 18 states that contain metropolitan areas with populations in excess of two million, Minnesota ranks last in terms

²³ Based on the 1997 *Census of Governments*, Minnesota has lower per capita highway spending than the other three states adjacent to it (Iowa, North Dakota, and South Dakota). However, these three states each have lower population density than Minnesota, which should contribute to higher highway expenditures per capita. Of the four adjacent states, Wisconsin appears to be most comparable to Minnesota.

²⁴ Based on information from the 2002 *Congressional Quarterly State Fact Finder*, total road and street mileage per capita in Minnesota is 28.3 percent greater than in Wisconsin, while total state controlled road and street mileage per capita is 10.7 percent greater.

²⁵ Cited in Corporation for Enterprise Development, *2001 Development Report Card for the States*.

²⁶ Congressional Quarterly, *2002 CQ State Fact Finder*.

²⁷ Ibid.

²⁸ It should be noted that this information is from 1997 and therefore does not include expenditures on the Hiawatha Light Rail Transit (LRT) project. Even if LRT expenditures had been made in 1997, Minnesota's per capita transit spending would still be approximately 30 percent below the national average. This conclusion is based on the following calculations. The total cost of the Hiawatha LRT project is estimated to be \$675 million (estimate from House Fiscal Analysis staff). Assuming the cost of the project is spread evenly over four years, the annual cost would be \$169 million per year, or about \$34 per capita. A \$34 per capita increase in transit spending would raise Minnesota's total transit spending per capita from 64 percent below the national average to approximately 30 percent below the national average.

²⁹ Corporation for Enterprise Development, *2001 Development Report Card for the States*.

of mass transit carrying capacity. In short, Minnesota's low rate of investment in transit appears to manifest itself in low transit capacity.

As noted above, Minnesota highway spending has barely kept pace with inflation and population growth over the last ten years, while transit spending has not kept pace with inflation and population growth. The lack of public investment in transportation appears to be creating a strain on Minnesota's transportation infrastructure. According to a report from the Transportation Policy Institute, congestion on Twin Cities freeways has increased substantially in recent years. In 1990, 25 percent of the freeways in the seven-county metropolitan area were congested; by 1997, this had doubled to 50 percent.³⁰ According to the Transportation Policy Institute:

Changing demographics and land use development patterns in the state over the last 20 years have contributed substantially to increasing travel demands in Minnesota. These demands, measured in terms of automobile miles traveled, commercial vehicle miles traveled, number of licensed drivers, etc...have far outpaced population growth, and have led to a rapid depletion in the supply of roadway capacity.³¹

Growth in the number of economic centers in the Twin Cities area has contributed to a significant increase in travel demand.

Twenty years ago, the region's major employment centers were mostly located within the borders of the largest cities, Minneapolis, St. Paul, and Bloomington. Today, economic centers are located throughout the metropolitan area. Because these businesses are dispersed, the demands on the system's roadways have also become dispersed.³²

Growth in Minnesota's economy over the last decade has led to increased demands on transportation infrastructure as large commercial enterprises make increased use of Minnesota highways.³³ This is yet another reason why demands on Minnesota's transportation infrastructure are growing more rapidly than the state's population.

All indications are that transportation and congestion problems in Minnesota will grow more severe without significant new investment in highways and transit. Increased investment in the state's transportation infrastructure may be necessary to sustain Minnesota's economy and quality of life.

Conclusion

The examples in this section demonstrate that a simple comparison of government expenditures alone does not tell the whole story. An above average level public spending within a particular policy area does not necessarily indicate waste or inefficiency. Nor is growth in government spending a bad thing if it is responding to real needs. Government spending must be examined in light of the benefits received from that spending.

For example, Minnesota spending per pupil for K-12 public education is modestly above the national average. However, Minnesota is ranked at or near the top among the fifty states in academic performance. These superior academic outcomes are a good indication that Minnesota's investments in K-12 education are producing positive benefits.

³⁰ Transportation Policy Institute, *2001 Minnesota Road Transportation Needs Assessment Study*.

³¹ *Ibid.*

³² *Ibid.*

³³ *Ibid.*

Conversely, Minnesota is spending well below the national average in terms of transit, which no doubt contributes to the fact that Minnesota's transit carrying capacity is low relative to comparable states. The absence of an adequate transit system contributes to traffic congestion, a loss of productivity, and a reduction in quality of life.

The next section explores whether Minnesota's above average level of *total* state and local government spending has translated into tangible public benefits, such as a stronger economy and a more livable state.

Part 4: The Benefits of Public Investment

In previous sections, it has been demonstrated that state and local government expenditures in Minnesota have been growing less rapidly than the national average over the last decade. However, total 1997 state and local government spending per capita was still 10.3 percent above the national average. Has Minnesota's additional per capita public expenditure helped to produce a stronger economy and a higher quality of life? This section explores evidence that suggests that the answer to this question is "yes."

There are two schools of thought regarding the impact of government expenditures upon a state's economy and quality of life. The first is that government expenditures are necessary to provide the public services and infrastructure that are essential for a competitive economy and a high quality of life. The second school of thought is that government expenditures result in higher taxes, which harms economic competitiveness.

A number of national studies have ranked Minnesota the most livable state in the union.³⁴ In addition, the *2002 Kids Count Data Book* ranks Minnesota first in the nation in terms of overall child well-being.³⁵ In general, Minnesota ranks well relative to the rest of the nation on a range of indicators. For example, Minnesota ranks:

- 9th highest in per capita personal income
- 12th highest in average annual pay
- 12th highest in average annual pay growth
- 12th highest in average hourly earnings
- 9th lowest in unemployment rate
- Highest in labor force participation
- 4th lowest in the rate of business closings
- 3rd highest in the number of Fortune 500 companies per capita
- 6th lowest in percentage of children in poverty
- 14th lowest in infant mortality rates
- 2nd highest in homeownership rate³⁶

In the *2001 Development Report Card for the States*, Minnesota ranked 1st among the fifty states in performance, 8th in business vitality, and 1st in development capacity.³⁷ Minnesota was the only Midwestern state to rank in the top ten in more than one of the three categories examined in the *Development Report Card*. Over the years, the *Development Report Card* has been used by elected officials, business people, and policy analysts in Minnesota as a gauge of how well Minnesota's economy is performing relative to the rest of the nation.

³⁴ These include *State Rankings 2002* from Morgan Quitno Press and *The Camelot Index*, State Policy Reports, 2002.

³⁵ Annie E. Casey Foundation, *2002 Kids Count Data Book*.

³⁶ These rankings are from the *2001 Congressional Quarterly State Fact Finder*; U.S. Small Business Administration, *Small Business Economic Indicators 1999*; and U.S. Department of Labor, *Covered Employment and Wages*, 2001.

³⁷ Corporation for Enterprise Development, *2001 Development Report Card for the States*. The "performance" index looks at the overall quality of life that a state's economy is delivering for its citizens. The "business vitality" index gauges a state's economic dynamism by examining diversity in the state's economy, as well as the ability of the state's businesses to bring in income from outside the state and to create job and income growth. The "development capacity" index assesses the "building blocks for future development" such as a state's educational system, financial resources, and physical infrastructure.

A systematic cost-benefit analysis of all state and local government expenditures is beyond the scope of this study. However, it is possible to examine the factors used in the *Development Report Card* to determine the extent to which these factors are influenced by government expenditures. The *Report Card* is a particularly valuable resource when comparing states because it focuses primarily on outcomes (e.g., employment growth, poverty rate, creation of new companies, educational proficiency, crime rate, etc.), not inputs (i.e., the amount spent for particular public goods or the amount of taxes paid).

Looking more closely at these factors, it is clear that government investments have contributed to Minnesota's strong performance. The rankings in the *Report Card* are based on 70 different factors, each of which measures some dimension of the state's economy or quality of life. Nearly all of the factors used in the *Report Card* are either:

- Exclusively the result of state and local government investment (e.g., quality of highways and sewage treatment infrastructure).
- Partially the result of state and local government investment (e.g., basic academic skills proficiency and crime rate).
- Not directly the result of government expenditures, but affected by the quality of the education system, physical infrastructure, or services resulting from state and local government investments (e.g., average annual pay and employment growth).

Given the extent to which government investments influence a state's score on various factors that comprise the *2001 Development Report Card*, there can be little doubt that public investments in Minnesota contribute to the state's strong national ranking.

Minnesota's high ranking relative to other states on a number of important indicators is evidence that the higher level of per capita public expenditures in Minnesota has not undermined the state's economy. In fact, Minnesota's higher level of public spending appears to contribute to economic strength and quality of life by providing higher quality infrastructure and public services.

This should not be construed as a defense of all government spending. However, higher expenditures — and the taxes needed to fund them — are not harmful as long as these expenditures provide a positive net benefit in terms of economic health and quality of life. Minnesota's experience provides a strong indication that public spending — even spending in excess of the national average — can produce positive public benefits.

Part 5: Examining the Past, Preparing for the Future

This report has focused on measuring the growth of government in Minnesota. This is a relatively easy task. The more difficult task involves determining which public investments are necessary to ensure Minnesota's future prosperity and quality of life and which are not.

Currently, there are two barriers to sound budget decision-making in Minnesota. The first is a conviction among some that government must not grow or that government growth must not exceed some specified limit, such as the rate of inflation or the rate of growth in Minnesota personal income. The second obstacle is a budget structure that does not recognize the value of investments that reduce future costs or increase future revenues.

Limits to Government Growth

Many Minnesotans have expressed the concern that government in Minnesota has grown too rapidly. It is certainly true that total state and local government spending in Minnesota has grown in nominal dollars and in real dollars per capita. In addition, total state and local government spending per capita in Minnesota is above the national average.

However, neither of these facts constitutes proof that the rate of growth in government in Minnesota in recent years is unsustainable. Minnesota state and local government expenditures have been growing less rapidly than the national average, while total personal income in Minnesota has been growing more rapidly. Furthermore, government expenditures in Minnesota have declined as a percentage of total Minnesota personal income during the time frame examined in this report.

There are reasons to believe that Minnesota's economy and total personal income will not grow at the rate experienced at the end of the 1990s. The current recession has already curtailed economic expansion in the state. Other long-term factors — such as the aging of the state's population — could reduce the productivity of Minnesota's workforce and create additional demands on state and local government services.

The Value of Prevention

One strategy to respond to concerns about government growth is to use current resources to reduce future demands on government. For example, the Family Housing Fund compared the costs of two scenarios for a struggling family, one in which the family receives supportive housing services and one in which the family does not.³⁸ They found that under the supportive housing scenario, more is spent upfront on chemical dependency treatment and support, housing, child care, employment, mental health, and transportation. However, these investments lead to lower outlays down the road for out-of-home placement of children, criminal justice, medical care, case management, and remedial and special education services. Overall, the cost of public services under the scenario in which the family received supportive housing was 51 percent lower over a nine-year period than under the scenario in which the family did not receive such services.

In addition, some expenditures do not produce an immediate benefit to the state, but do create increased economic activity and higher wages down the road, which can in turn result in increased public revenues. For example, expenditures on K-12 education produce

³⁸ Family Housing Fund, *Financial Implications of Public Interventions on Behalf of a Chronically Homeless Family*, 2000.

little in terms of immediate economic benefits, since the students that benefit from these expenditures will not enter the workforce for several years. However, over the long-term, the state benefits from better educated workers who are equipped to compete in a global economy.

Unfortunately, current methods of budgeting do not provide incentives for prevention and investment strategies that have initial costs but produce positive net benefits in the future. There often is little incentive for these types of investments because savings will occur beyond the current budget cycle, in other parts of the budget, or for another level of government. Reforms that promote a more integrated and long-term and less parochial budget setting approach would seem to be in order.

Planning for the Future

In planning for the future, we should not forget the successes of the past. Prudent investment in education and other important public services is one way in which Minnesotans have created one of the most prosperous and livable states in the nation. Wise investment of public dollars can create growth and opportunities in Minnesota that could offset some of the negative effects of various demographic trends.

The wrong response to our current challenges would be to view either the rate of inflation, the current size of government, or some other measure as a limit above or below which future government revenues and expenditures must not rise or fall. State and local governments should make those expenditures that produce a positive net benefit for Minnesota residents, even if they cause the size of government to grow.

In short, negative economic or demographic trends or any other ominous portent should not be used as an excuse not to make necessary investments in schools, transportation, health care, and other essential components of public infrastructure. The failure to make necessary public investments now will only compound the severity of potential problems that Minnesota may encounter in the future.

Appendix A: Total Government Expenditures in Minnesota in 1987, 1992, and 1997

Year	Total Minnesota State & Local Government Expenditures		Total S&L Government Expenditures in Constant 1997 Dollars Per Capita		Total Minnesota Personal Income (thousands)	Total S&L Gov't Expenditures as a Percent of MN Personal Income
	Amount (thousands)	% Change since 1987	Amount	% Change since 1987		
1987	15,899,000	--	5,054	--	71,570,231	22.2%
1992	23,084,080	45.2%	5,900	16.7%	97,025,250	23.8%
1997	28,214,996	77.5%	6,020	19.1%	129,020,000	21.9%

1987, 1992, and 1997 total Minnesota state and local government expenditure amounts from the 1987, 1992, and 1997 *Census of Governments* (vol. 4, #5, table 34).

1987, 1992, and 1997 total Minnesota state and local government expenditures per capita from the 1987, 1992, and 1997 *Census of Governments* (vol. 4, #5, table 33). All per capita amounts adjusted to 1997 dollars using the implicit price deflator for state and local government purchases.

Total government expenditures as a percentage of Minnesota personal income is calculated using expenditure data from the *Census of Governments* report and Minnesota personal income amounts from the U.S. Department of Commerce Bureau of Economic Analysis.

Appendix B: Growth in Minnesota Government Revenues, 1990 to 2002

Change in total state and local government *expenditures* is one way to measure growth in government over time. An alternative approach is to examine total state and local government *revenues*. The most inclusive source of information on the total revenues of both state and local government in Minnesota is the *Price of Government* report prepared by the Minnesota Department of Finance.³⁹

Total state and local government revenues in Minnesota:

- Increased at an annual average rate of 5.3 percent in nominal dollars from 1990 to 2002.
- Increased at an annual average rate of 1.5 percent in real dollars per capita from 1990 to 2002. Revenues actually declined at an annual average rate of 0.2 percent from 1997 to 2002.
- Declined from 19.8 percent of Minnesota personal income in 1990 to 19.4 percent in 2002.⁴⁰
- Grew more slowly than the national average from 1987 to 1997.

³⁹ The *Price of Government (PoG)* information used in this report is from the 2002 End-of-Session update. The *PoG* report contains information on nearly all sources of Minnesota state and local government revenues, including intergovernmental revenues such as federal aid to state and local governments. However, adjustments are made to avoid double counting of intergovernmental transfers. The *PoG* information used in this section is presented in the following table:

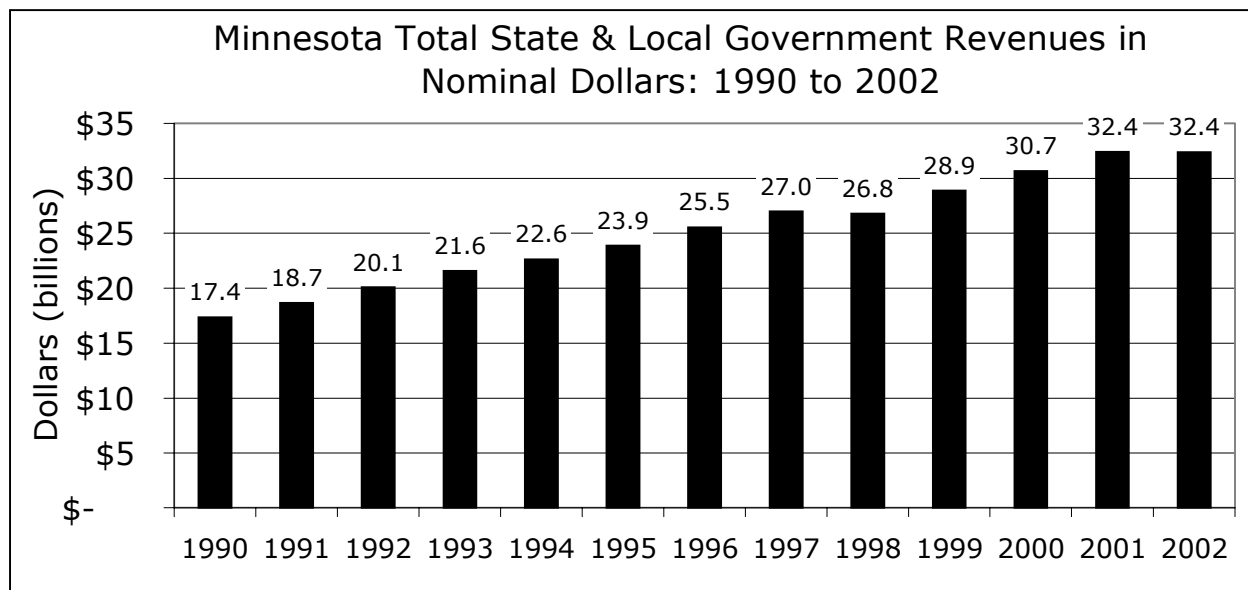
Year	Total MN State & Local Government Revenue in Nominal Dollars		Total S&L Gov't Revenue in Constant 2002 Dollars Per Capita		Total MN Personal Income (thousands)	Total S&L Gov't Revenue as a Percent of MN Personal Income
	Amount (thousands)	Percent Change since 1990	Amount	Percent Change since 1990		
1990	17,357,678	--	5,368	--	87,795,500	19.8%
1991	18,655,182	7.5%	5,556	3.5%	90,713,750	20.6%
1992	20,074,802	15.7%	5,801	8.1%	97,025,250	20.7%
1993	21,573,083	24.3%	6,016	12.1%	99,787,000	21.6%
1994	22,642,668	30.4%	6,078	13.2%	107,151,500	21.1%
1995	23,862,673	37.5%	6,152	14.6%	113,216,750	21.1%
1996	25,530,509	47.1%	6,355	18.4%	122,079,500	20.9%
1997	26,987,244	55.5%	6,475	20.6%	129,020,000	20.9%
1998	26,803,054	54.4%	6,262	16.7%	139,970,000	19.1%
1999	28,899,053	66.5%	6,487	20.8%	146,685,000	19.7%
2000	30,656,096	76.6%	6,488	20.9%	157,931,750	19.4%
2001	32,397,270	86.6%	6,597	22.9%	164,621,250	19.7%
2002	32,367,120	86.5%	6,425	19.7%	167,148,750	19.4%

Total government revenue in constant 2002 dollars per capita calculated using *PoG* revenue totals, population data from the U.S. Census Bureau and the State Demographer's Office, and the implicit price deflator for state and local government purchases. Total government revenue as a percentage of Minnesota personal income is calculated using revenue totals and Minnesota personal income amounts from the *PoG* report. Data for 2000, 2001, and 2002 are estimated by the Minnesota Department of Finance.

⁴⁰ These percentages are greater than the standard Price of Government percentages because they are calculated using total state and local government revenues, which includes federal aid. Because the focus of this analysis is on the total size of state and local government in Minnesota, total revenues are used in these calculations.

Revenue Growth in Nominal Dollars

From 1990 to 2002, total state and local government revenues in Minnesota grew from \$17.4 billion to \$32.4 billion in nominal dollars, a growth of 86.5 percent.⁴¹ The average annual rate of growth during this period was 5.3 percent (on average, revenues in each year were 5.3 percent greater than in the preceding year).

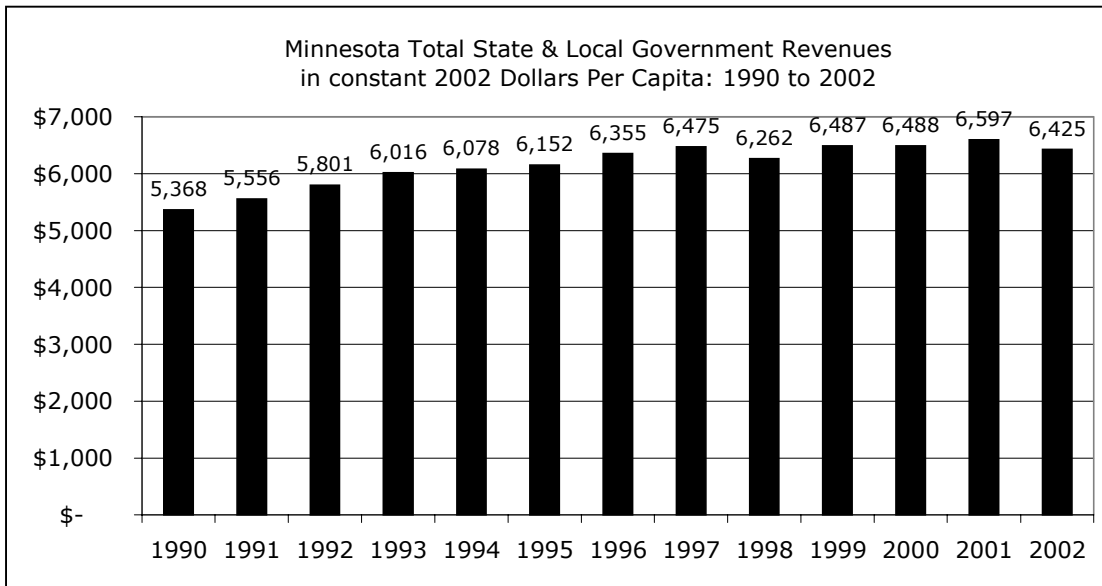


In order to gauge growth in government revenues after controlling for the effects of inflation and population growth, it is necessary to examine revenues in real (inflation adjusted) dollars per capita.

Revenue Growth in Real Dollars Per Capita

From 1990 to 2002, total Minnesota state and local government revenues per capita increased from \$5,368 to \$6,425 in constant 2002 dollars, an increase of 19.7 percent. The average annual rate of growth during this period was 1.5 percent. **Approximately three-quarters of the growth in state and local government revenue in Minnesota from 1990 to 2002 was necessary to keep pace with inflation and population growth.**

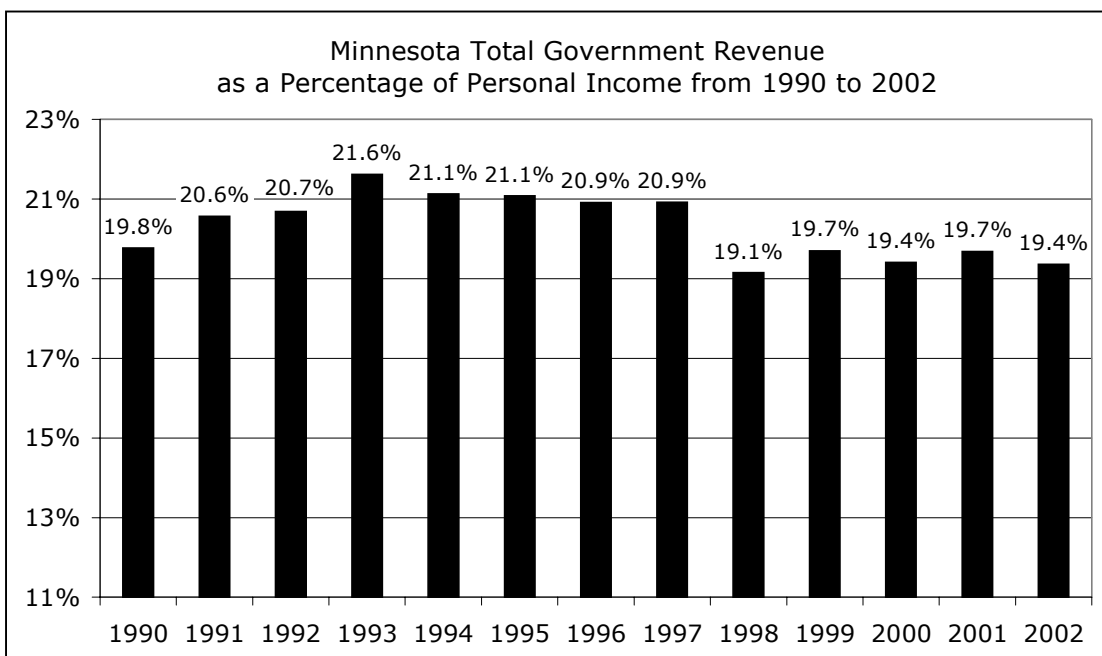
⁴¹ In the *Price of Government* report, fiscal year (FY) revenue data from some sources is grouped with revenue data from the previous calendar year (CY) from other sources. For presentation purposes, total state and local government revenue information will be identified by calendar year in this appendix. For example, data for 1990 includes revenue information for CY 1990 and FY 1991 (which began on July 1, 1990).



During the last five years of this period, total state and local government revenues declined slightly in real dollars per capita. From 1997 to 2002, total state and local government revenues in constant 2002 dollars dropped from \$6,475 to \$6,425, a decline of 0.8 percent. The average annual rate of decline during this period was 0.2 percent.

Revenue as a Percentage of Minnesota Personal Income

From 1990 to 2002, total Minnesota state and local government revenues as a percentage of statewide personal income declined modestly from 19.8 percent to 19.4 percent. However, there was not a steadily decline — revenue as a percentage of income was above 20 percent for most of the 1990s before dropping to 19.1 in 1998. Revenue as a percentage of Minnesota personal income has stayed below 20 percent since 1998.



The large decline in total government revenue as a percentage of Minnesota personal income from 1997 to 1998 is due primarily to a decline in state revenues due to tax rebates combined with above average growth in Minnesota personal income.

Based on this information, it is safe to conclude that total state and local government revenues in Minnesota have declined modestly relative to the size of the state's economy over the last twelve years.

Revenue Growth in Minnesota Relative to the National Average

The *Price of Government* report only contains information for Minnesota. Other sources must be relied upon in order to gauge growth in government revenues in Minnesota relative to other states. For this information, this report once again uses the *Census of Governments*.

From 1987 to 1997, total Minnesota state and local government revenues in real dollars per capita grew by 21.0 percent, compared to 26.1 percent for all state and local governments in the U.S.⁴² During the same period, Minnesota personal income in real dollars per capita grew more rapidly than the national average (19.8 percent in Minnesota versus 16.6 percent nationally).⁴³ Thus, while personal income in Minnesota was growing more rapidly than the national average from 1987 to 1997, government revenue was growing less rapidly.⁴⁴

Both in an absolute sense and as a percentage of personal income, state and local government revenue in Minnesota grew less rapidly than the national average during the period from 1987 to 1997.

Comparison to Expenditure Data

Because revenues and expenditures are closely linked (i.e., growth in expenditures are generally constrained by the amount of revenue available), we would expect trends in government revenue growth to resemble trends in expenditure growth. There is indeed a strong resemblance between the revenue trends presented in this appendix and the expenditure trends presented in Part 2. During the time periods examined in this report, Minnesota state and local government revenues and expenditures:

- Both grew in nominal dollars and in real dollars per capita.
- Both declined as a percentage of Minnesota personal income.
- Both grew less rapidly than the national average, while Minnesota personal income grew more rapidly than the national average.

⁴² Calculations are based on "per capita general revenue" data from the 1987 and 1997 *Census of Governments*, volume 4, #5 adjusted for inflation using the implicit price deflator for state and local governments.

⁴³ Calculations based on U.S. Department of Commerce Bureau of Economic Analysis.

⁴⁴ *Census of Governments* data for years after 1997 is not yet available. However, since 1997 Minnesota has been among the leading states in the nation in terms of cutting state taxes, according to the National Conference of State Legislatures' *State Tax Actions* reports.

Appendix C: Critique of Extrapolation as a Predictor of Future Spending

Occasionally attempts are made to project future government spending levels based upon past spending trends — an example of a method known as extrapolation. However, simplistic extrapolation of spending trends can lead to unwarranted conclusions. It is particularly risky to extrapolate spending funded from a single source — such as the state’s general fund — without taking into account funding from other sources.

Attempts have been made to project 2020 general fund spending levels based upon extrapolation of general fund spending from the 1990s.⁴⁵ This strategy is extremely risky and is not likely to produce meaningful results. For example, if 2000 general fund expenditures had been extrapolated by projecting general fund spending amounts from the 1970s, growth in the general fund from 1980 to 2000 would have been overstated by over 100 percent.

Growth in the state’s general fund in recent decades has been inflated by the state takeover of various functions. For example, during the 1990s, the state took over funding of county income maintenance programs and began paying for an increased share of general education costs. The increases in the state’s general fund resulting from these transfers do not represent increased spending, but rather a shift in how certain public functions are funded. Some attempts to extrapolate Minnesota general fund growth have not adequately adjusted for the transfer of expenditure items into the general fund.

Similarly, attempts have been made to extrapolate state aid to school districts based on growth during the 1990s. However, during the later portion of this period, the state was attempting to reduce school property taxes by increasing state aid to school districts. Thus, it is inappropriate to extrapolate the growth in state aid to school districts based on 1990s growth rates unless it is assumed that the state will continue to take over a larger share of education costs. Even under such a scenario, the rate of growth in state general fund aid to education would diminish as the state’s share of school funding approaches 100 percent.

The problem with extrapolation as the basis of a policy argument is that it is possible to support almost any position if the trends to be extrapolated are chosen carefully. Those who are concerned about growth in government spending often chose to extrapolate those trends that advance the argument they are trying to make.

However, extrapolation can also be used to make the opposite argument. Total state and local government expenditures have declined as a percentage of Minnesota personal income since 1990. If this trend is extrapolated into the future, the growth in expenditures during the 1990s could be sustained indefinitely, since these expenditures would be an ever-shrinking portion of the state’s economy.

This example underscores the problem with the selective use of extrapolation. Using the same data, completely different conclusions can be reached depending on how and what we choose to extrapolate. In short, simplistic extrapolation of state general fund spending can lead to misleading — and possibly contradictory — conclusions regarding growth in government.

⁴⁵ For example, see Minnesota Business Partnership, *Minnesota 1970-2020*, 2002.

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