Crumbling Fiscal Foundation

A Decade of Decline in State Investment

Jeff Van Wychen, Fellow
Director of Tax Policy

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2324 University Avenue West,
Suite 204, Saint Paul, MN 55114
www.mn2020.org

Editing: Joe Sheeran
Design & Layout: Rachel Weeks

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There is no indication
that the decline in state general fund
spending over the last decade
has spurred growth
in Minnesota's economy.

EXECUTIVE SUMMARY

Adjusted for various accounting shifts and state takeovers, state general fund spending has declined by $5.2 billion over the last decade in constant FY 2012-13 dollars. If we further adjust general fund spending for population growth, annual per capita spending has declined by $730 or 18.3 percent.

When put in the proper context, the last ten years of state spending data reveal a much different pattern than anti-tax proponents would like Minnesotans to believe. State spending is not out of control. In fact, an apples-to-apples comparison of state general fund spending over the last decade reveals that state investment in public services, education, and local communities has significantly declined.

Governor Dayton's current budget proposal seeks to reverse this trend through a tax increase focused primarily on the wealthiest Minnesotans to invest in education, economic development, and property tax relief. Even if lawmakers fully implement Dayton's budget, the state of Minnesota would still spend about 12.6 percent less in adjusted per capita dollars by FY 2016-17 than we did a decade ago.

This report focuses on Dayton's proposed budget because details on the House and Senate alternatives were not available at the time of this report's publication.

Anti-tax proponents typically focus on nominal spending without accounting for the impact of inflation, population growth, shifts, and other short-term financial maneuvers. Such simplistic comparisons produce misleading conclusions regarding the change in state general fund spending over time.

To provide a more meaningful comparison of the change in general fund spending over time, this report adjusts for the following factors:

- ✓ Inflation
- ✓ Population growth
- ✓ K-12 funding shifts
- ✓ Federal recovery dollars
- ✓ Sale of tobacco bonds
- ✓ State takeover of general education costs.

The rationale for adjusting state general fund spending for these factors is described in the introduction section of this report. (see page 7)

Adjusted for all the above factors, annualized per capita general fund spending in FY 2002-03 was $4,008 in constant FY 2012-13 dollars. With the exception of a small increase from FY 2006-07 to FY 2008-09, adjusted per capita spending declined in each of the next five biennia, falling to $3,276 based on projections for the current biennium.

Adjusted General Fund Spending in Constant FY 2012-13 Dollars

Biennium	Total (in billions)	Annualized Per Capita
FY 2002-03	$40.561	$4,008
FY 2004-05	$38.037	$3,675
FY 2006-07	$37.233	$3,548
FY 2008-09	$37.804	$3,570
FY 2010-11	$36.402	$3,423
FY 2012-13 Projected	$35.377	$3,276
FY 2014-15 Projected	$35.698	$3,250
FY 2016-17 Planning Est.	$37.021	$3,313

In the absence of any changes to current law, adjusted general fund spending per capita is projected to drop by another 0.8 percent from the current biennium to the next biennium (FY 2014-15), before rebounding with a 1.9 percent increase in FY 2016-17 based on planning estimates. Adjusted general fund spending per capita in FY 2016-17 under current law is projected to be 17.3 percent less than it was in FY 2002-03.

The adjusted per capita general fund spending increase under the Dayton budget over the next two biennia is projected to be 6.9 percent; even after this growth, adjusted FY 2016-17 spending per capita is still projected to be $504 per capita less (constant FY 2012-13 dollars) than it was a decade ago. In total, Dayton's budget recaptures less than one-third (31 percent) of the total adjusted per capita spending decline over the last ten years.

There is no indication that the decline in state general fund spending over the last decade has spurred growth in Minnesota's economy. In fact, the percentage growth in personal income has lagged slightly behind the national average.

What the decline in public investment has produced is a sharp drop in state support for public education, with rising class sizes at the K-12 level and soaring tuition for state colleges and universities. Another consequence of the sharp decline is general fund spending is a 43 percent decline in real state-paid property tax aids and credits, thereby producing a rapid escalation in property taxes and a dramatic decline in resources for Minnesota local governments.

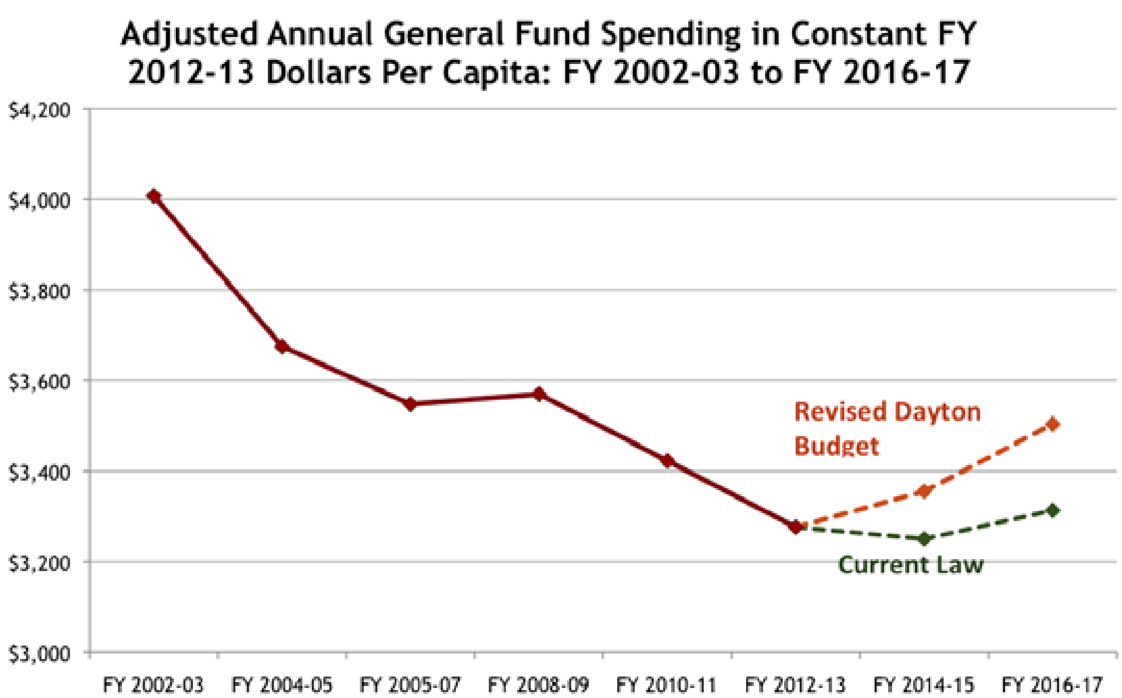
Dayton's budget would achieve a modest increase in adjusted general fund spending without increasing state and local government own-source revenue as a percentage of personal income—what is commonly referred to as the "Price of Government."[1] The Coalition of Minnesota Businesses has called the Price of Government an "index of what taxpayers can afford." This index is projected to decline over the next four years (FY 2014 to FY 2017) under the Dayton budget relative to what it was during the preceding four years (FY 2010 to FY 2013).

A half century ago, Minnesotans made critical investments in education, infrastructure, and public services.

These investments made Minnesota a relatively high tax state. It also made Minnesota a prosperous state. During the last four decades of the twentieth century, Minnesota per capita personal income rose steadily relative to the national average. Educational attainment was high. Roads were well paved and plowed. Time Magazine proclaimed "The Good Life in Minnesota" and most Minnesotans agreed.

The eighteen percent decline in adjusted general fund spending over the last decade has damaged the critical public investments that made the "Good Life in Minnesota" possible. A modest restoration of a portion of this reduction during the 2013 legislative session is both necessary and affordable.

1 "Price of Government Declines Under the Dayton Budget," January 28, 2013. http://www.mn2020.org/issues-that-matter/fiscal-policy/price-of-government-declines-under-the-dayton-budget .



FINDINGS:

- ✓ Adjusted for inflation, accounting shifts, state takeovers, and the tobacco bond sale, Minnesota is spending about $5.2 billion less (in 2012-13 dollars) than it was a decade ago. That's roughly $730 less per capita, or an 18 percent decline in state expenditures.

- ✓ Claims of rapid state spending growth are based on comparisons that fail to account for inflation, population, school funding shifts, and other one-time events that distort spending over time.

- ✓ If legislature implements Governor Dayton's current budget plan, by FY 2016-17 Minnesota's adjusted per capita spending would still be $500 less than it was a decade ago (FY 2002-03).

- ✓ Contrary to predictions, spending reductions and tax cuts have not brought economic prosperity to Minnesota. Relative to other states, Minnesota's percentage growth in personal income has lagged behind the national average over the last decade.

RECOMMENDATIONS:

- ✓ Legislature should adopt a budget that will enable the state to restore a portion of the spending reductions in K-12 and higher education, local services and infrastructure, and economic development that have occurred over the last decade.

- ✓ Minnesota should make structural revenue and budgeting reforms that minimize recurring deficits. State policymakers should enact reasonable revenue increases and spending reforms that will reduce the likelihood of future state budget deficits.

I. INTRODUCTION

A debate rages in Minnesota regarding perceived state general fund spending growth. Many conservatives argue that general fund spending has been spiraling uncontrollably and unsustainably upward, while progressives generally contend that state spending has been trending downward and is insufficient to meet current public needs.

This report is limited in the sense that it does not evaluate growth in general fund spending by category or attempt to determine the level of general fund spending that is "appropriate." The first question has been addressed elsewhere[2] and the second is highly subjective and beyond the scope of this report. This report will examine the more limited but nonetheless important issue regarding the rate of growth or decline in state government measured in terms of state general fund expenditures.

A debate rages in Minnesota regarding perceived state general fund spending growth.

According to Minnesota Management & Budget, "The general fund is the source of the state's main operating funding and is used to support activities outlined in statute. Major revenue streams into the general fund include state individual, corporate, and sales taxes among others. These are non-dedicated revenues and are available to be appropriated by the Legislature."[3]

During the current biennium, the state general fund comprises 58 percent of total state consolidated fund spending.[4] Apart from the general fund, the funds that comprise the consolidated fund fall into three major categories: special refund funds, permanent trust funds, and select debt service funds. These funds are generally constitutionally dedicated or are otherwise legally restricted for specific purposes.

This analysis focuses on the general fund because it includes the principal discretionary expenditures that are the focus of the state's biennial budget debate. The discussion of the state's long-term structural budget deficit or surplus is centered on the general fund, not the broader consolidated fund.

This analysis will focus on the last decade, beginning with the FY 2002-03 biennium and including projections for the current and subsequent biennia. Raw general fund expenditure data (i.e., prior to adjustments) used in this report are from Minnesota Management & Budget (MMB).[5]

2 For example, see slide 27 of the 2011 presentation by Scott Pattison, Executive Director of the National Association of State Budget Officers, entitled "The Economy and Budget: Minnesota and the Nation" at http://www.leg.state.mn.us/webcontent/leg/minnesota/2011/PattisonEconomyandBudget.ppt .

3 Minnesota Management & Budget (MMB) website: http://www.mmb.state.mn.us/citizen-glossary .

4 MMB February 2013 forecast consolidated fund spreadsheet: http://www.mmb.state.mn.us/doc/budget/report-cons/nov12/index.pdf .

5 The MMB February 2013 forecast spreadsheet is the source general fund spending information for FY 2012-13 through FY 2016-17. This document can be found at: http://www.mmb.state.mn.us/doc/budget/report-fba/feb13-detail.pdf . Information for preceding biennia is from archived forecast data, available at: http://www.mmb.state.mn.us/forecastarchives .

FY 2002-03 was the first biennium that major changes to Minnesota's tax system and general fund spending obligations enacted in 2001 were implemented.

Specifically, K-12 general education and operating transit costs were shifted into the state general fund; the resulting growth in general fund spending that occurred in FY 2002-03 was not the product of an expansion in government services, but merely the shift of funding for existing functions away from local property taxes and into the state general fund.

Other major changes that occurred during the FY 2002-03 biennium was the creation of a new state property tax, with proceeds going to the general fund.

By using FY 2002-03 as the baseline year, this analysis will be able to examine trends in general fund spending under the "no new tax" policies that prevailed during the tenure of Governor Tim Pawlenty.

The second section of this report will examine the growth in general fund spending in simple nominal dollars (i.e., not adjusted for inflation).

While nominal spending information is easy to present, it does not produce a meaningful analysis of the variation in state spending over time. In order to get a true "apples to apples" comparison of the change in spending over time, it is necessary to adjust for the effects of inflation, population growth, funding shifts, one-time federal recovery dollars, the sale of tobacco bonds, and the state takeover of K-12 general education costs.

The third section of this report will examine general fund spending adjusted for each of these factors. The rationale for each of these adjustments is described below.

Inflation. The purchasing power of the dollar erodes over time due to the effects of inflation. A meaningful comparison of general fund spending levels over time must adjust for the decline in the purchasing power of general fund dollars resulting from inflation. The inflation adjustment in this report will be based on the Implicit Price Deflator for State and Local Government Purchases (S&L IPD), which is the appropriate measure of inflation for state and local governments.[6]

6 For more on the appropriateness of the S&L IPD as an inflationary measure for state and local governments, see the 2008 Minnesota 2020 article, "Taking the Spin Out of Inflation Adjustments" at http://www.mn2020.org/issues-that-matter/fiscal-policy/taking-the-spin-out-of-inflation-estimates . Over the last decade, inflation as measured by the S&L IPD has been greater than inflation as measured by the Consumer Price Index (CPI). Some have argued that this is because state and local governments have provided lavish benefits to public employees, thereby pushing up public costs and leading to rapid growth in the S&L IPD. However, an examination of the Employment Cost Index (ECI) from the U.S. Bureau of Labor Statistics reveals that total wage and benefit compensation of state and local government employees over the last ten years is only slightly greater than that of private sector employees and somewhat less over the last four years. The ECI data rebuts the presumption that the growth in the S&L IPD is due to excessive benefits provided by state and local governments to their employees. The reason that the S&L IPD is running higher than the CPI is primarily because rapidly escalating benefit costs comprise a larger share of state and local government purchases (the basis for the S&L IPD) than of consumer purchases (the basis of the CPI).

This analysis will be able to examine trends in general fund spending during the "no new tax" policies that prevailed during the tenure of Governor Tim Pawlenty.

Population Growth. As the state's population increases, the demand for public services also increases. Furthermore, the number of taxpayers and the level of economic activity also increases as population grows. For this reason, it is appropriate to examine general fund spending in dollars per capita.

K-12 Funding Shifts. Several times over the last decade, the state has balanced its budget on a short-term basis by shifting state payments to school districts into the next biennium either through an aid payment delay or through a property tax recognition shift.[7] Most of these shifts have been repaid. The shift creates the false impression of a general fund spending decline in the biennium that it is first made and of a spending increase in the biennium that it is repaid. In order to correct for these artificial fluctuations in spending over time, it is necessary to make an adjustment for school aid payment delays and repayments.

Federal Recovery Dollars. During the Great Recession, state government revenues plummeted. In order to avoid a full scale economic depression, the federal government provided funds to states through the American Recovery and Reinvestment Act. The spending paid for with ARRA dollars was still occurring, it simply was not appearing as part of general fund expenditures during those years that it was being paid for with ARRA dollars. In order to adjust for the artificial dip in general fund spending due to the one-time ARRA dollars, the spending funded with these dollars should be added to general fund spending in the biennia in which it occurred.

Tobacco bonds. During the 2011 legislative session, state policymakers opted to generate a one-time up-front cash infusion through the sale of "tobacco settlement revenue bonds." Essentially, the state received up-front cash by selling bonds that would be paid off over time with revenue from the state's tobacco settlement. This revenue showed up in the general fund in the form of a one-time reduction in debt service payments. The debt service payments were still being made—they simply were not being paid for with general fund dollars. Again, to provide a more meaningful comparison of general fund spending levels over time, it is necessary to make an adjustment to reflect this one-time reduction in general fund spending.

7 For an explanation of K-12 funding shifts, see the House Fiscal Analysis Department document "State Education Funding Accounting Shifts" at http://www.house.leg.state.mn.us/fiscal/files/11edshifts.pdf .

State takeover of general education costs. The state takeover of general education costs created a large expansion in general fund spending not because of an actual growth in government, but because of a shift of existing costs away from local property taxes and into the state general fund. To allow for a more meaningful comparison over time, general fund spending is adjusted to reflect what spending would have been had general education costs been fully funded out of the state general fund in both years of each biennium.

During the last month of the 2013 legislative session, discussion at the State Capitol will focus on the biennial budget proposals put forth by the Governor, House, and Senate. While we do not currently have sufficient detail to do an analysis of general fund spending under the House and Senate proposals, we do have information on the Governor's revised budget. The fourth section of this report will examine general fund spending under Governor Dayton's revised budget for FY 2014-15 and FY 2016-17 based on projections and planning estimates from MMB.

The fifth and final section will examine the findings of this report in the context of the current debate over the level of state general fund expenditures and the need for public investment.

II. NOMINAL GENERAL FUND SPENDING

If we do not adjust for inflation, population growth, or any of the other factors listed in the preceding section that having an impact on state spending, total general fund expenditures have increased by nearly $9 billion or 33 percent from the FY 2002-03 biennium to the current FY 2012-13 biennium.

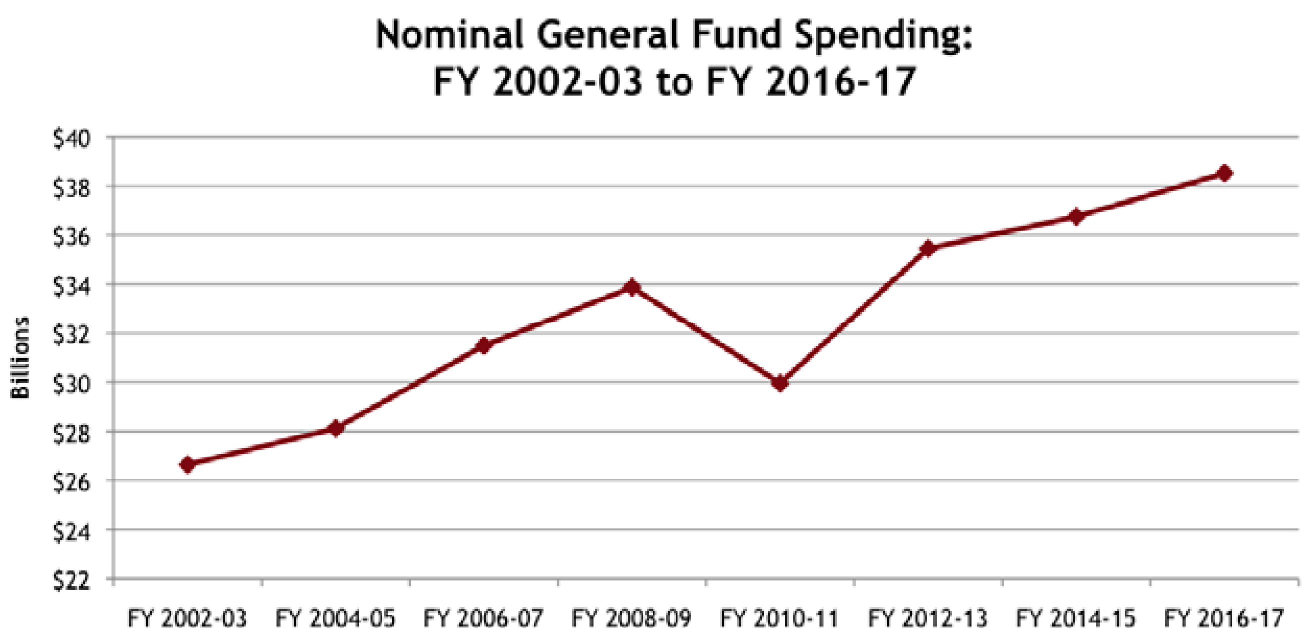
This nominal spending is projected to continue to grow by another $3 billion or 8.6 percent from FY 2012-13 to FY 2016-17.

The graph below shows total state general fund spending for each biennium from FY 2002-03 to FY 2016-17, with amounts for FY 2012-13, FY 2014-15, and FY 2016-17 based on MMB projections and planning estimates.

The most notable thing about this graph is the abrupt plunge in general fund spending in FY 2010-11. From FY 2008-09 to FY 2010-11, nominal general spending declined by nearly $4 billion or 12 percent. Conversely, general fund spending grew by nearly $5.5 billion or 18 percent from FY 2010-11 to FY 2012-13.

Nominal General Fund Spending (in billions)

Biennium	Amount
FY 2002-03	$26.648
FY 2004-05	$28.128
FY 2006-07	$31.490
FY 2008-09	$33.866
FY 2010-11	$29.962
FY 2012-13 Projected	$35.449
FY 2014-15 Projected	$36.744
FY 2016-17 Planning Estimate	$38.513



The spending valley in FY 2010-11 should serve as a caution regarding the interpretation of unadjusted general fund spending amounts. State spending did not actually decline by 12 percent from FY 2008-09 to FY 2010-11, nor did it grow by 18 percent from FY 2010-11 to FY 2012-13. Spending in FY 2010-11 was artificially deflated for two reasons:

- Federal recovery dollars had supplanted $2.3 billion dollars of K-12 education, medical assistance, and other general fund spending.[8] That spending was still occurring, but it was not being paid for with general fund dollars and thus did not appear in the state general fund.
- Approximately $1.9 billion in state funding for K-12 education was shifted forward into the subsequent FY 2012-13 biennium in order to balance the state budget in the FY 2010-11 biennium. Again, this $1.9 billion in K-12 spending was still occurring in FY 2010-11, but in the short-term the spending was paid for through use of school district reserves or short-term borrowing; the reserves were restored and the short-term borrowing was repaid in the subsequent biennium when the delayed state aid checks finally arrived.

Approximately $1.1 billion of the school funding shift was repaid during the FY 2012-13 biennium. Just as the initial shift of school spending artificially deflated state spending in FY 2010-11, the repayment of the shift in FY 2012-13 artificially inflated state spending to the tune of $1.1 billion, although the artificial increase in state spending due to the partial repayment of the K-12 shift was partially offset by the sale of tobacco bonds, which artificially deflated state spending in FY 2012-13 by $643 million.

Adjusted for the effects of the federal recovery dollars and the K-12 funding shift, spending actually declined by only about $200 million from FY 2008-09 to FY 2010-11, not $4 billion. Furthermore, after adjusting for federal recovery dollars, K-12 shifts, and the sale of tobacco bonds, general fund spending grew by less than $1 billion from FY 2010-11 to FY 2012-13, not $5.5 billion.

If we further adjust general fund spending for the effects of inflation and population growth, the actual per capita purchasing power of state general fund spending actually declined by over four percent from FY 2010-11 to FY 2012-13. Thus, what initially appeared as a sharp growth in spending based on an examination of unvarnished nominal general fund dollars is actually a modest decline in real (i.e., inflation-adjusted) per capita spending after all of the relevant factors are taken into account.

The next section of this report will examine state general fund spending adjusted for all the factors identified in section I. (see page 8) These adjustments will allow for a more apples-to-apples comparison of general fund spending over time.

8 As described in section 1, these federal dollars were provided through the American Recovery and Reinvestment Act, which was designed to shore up state and local government finances and prevent massive layoffs during the Great Recession.

III. ADJUSTED GENERAL FUND SPENDING

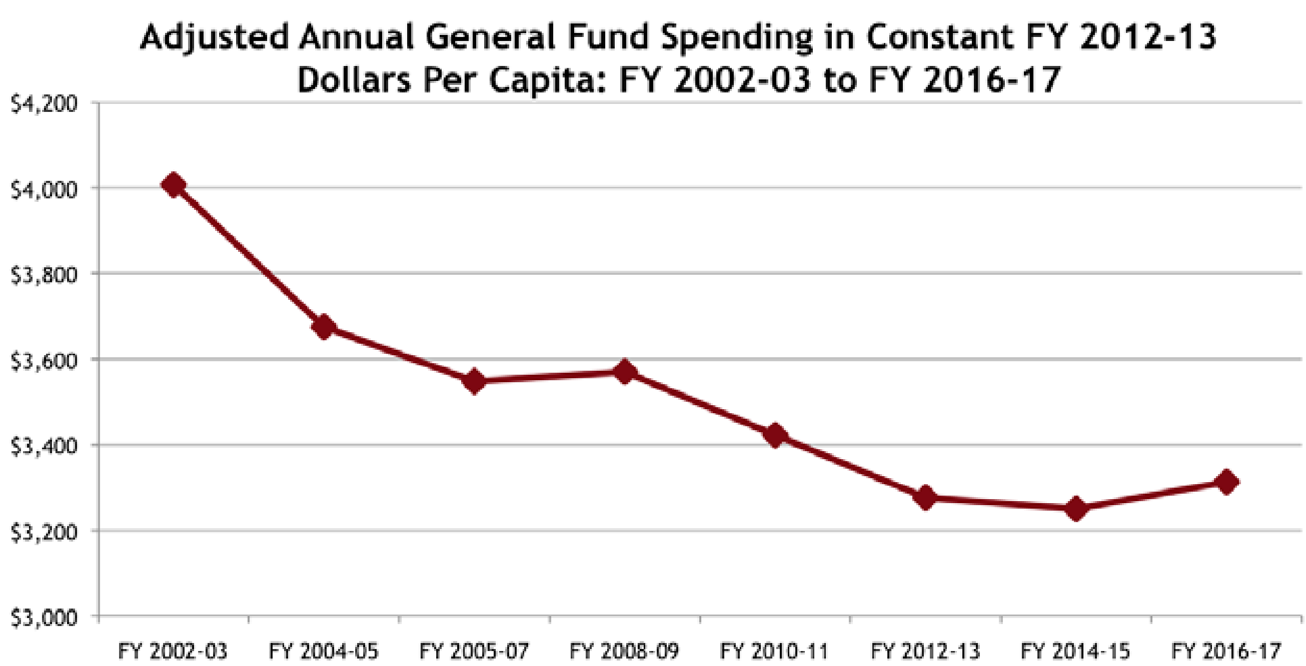
To achieve a meaningful comparison of the change in general fund spending over the last decade, it is necessary to adjust for the effects of inflation and population growth, as well as for K-12 funding shifts, one-time federal recovery dollars, the sale of tobacco bonds, and the state takeover of K-12 general education funding. The rationale for these adjustments is explained in section I. (see page 8)

The table on page 15 begins with nominal general fund spending for each biennium from FY 2002-03 to FY 2016-17 based on MMB planning estimates. Subsequent rows show the amounts that need to be added to or subtracted from this amount to adjust for K-12 funding shifts, federal recovery dollars, the state takeover of general education, and the sale of tobacco dollars.

The line "Adjusted Nominal General Fund Spending" shows general fund expenditures after these four adjustments but before the inflation and population growth adjustments. The following line entitled "Adjusted General Fund Spending in Constant FY 2012-13 Dollars" shows the amount from the preceding line adjusted for inflation.

The final line in the table shows total general fund spending after all adjustments, expressed in average annual dollars per capita. These amounts are illustrated in the graph below.

Adjusted general fund spending declined by 8.3 percent from FY 2002-03 to FY 2004-05, followed by a 3.5 percent drop by FY 2004-05 to FY 2006-07. Adjusted spending remained relatively flat from FY 2006-07 to FY 2008-09, increasing by less than one percent. Adjusted spending resumed its decline in FY 2010-11 and FY 2012-13, dropping by just over four percent in each biennium.



Based on current law projections and planning estimates, adjusted spending will remain relatively flat from FY 2012-13 to FY 2014-15, declining by less than one percent, and will grow by nearly two percent from FY 2014-15 to FY 2016-17.

After adjusting for K-12 funding shifts, one-time federal recovery dollars, the general education takeover, and the sale of tobacco bonds, real per capita general fund spending has fallen by 18.3 percent over the last decade (i.e., FY 2002-03 to FY 2012-13). Under current law, MMB anticipates that spending will rebound by 1.1 percent over the next two biennia, which translates to an average annual growth rate of less than 0.3 percent.

Even after this modest rebound, adjusted general fund spending in FY 2016-17 is projected to be 17.3 percent less than it was in FY 2002-03, with only about one in twenty dollars of the revenue decline from FY 2002-03 to FY 2012-13 having been recovered. This decline in adjusted general fund spending observed here corresponds with a double digit decline in real per capita state general fund revenue over the last decade.[9]

Claims of rapid growth in state government are often based on comparisons that fail to take into account inflation, population growth, school funding shifts, state takeovers, or other one-time events that distort the true level of change in spending over time. Properly adjusted for all of these, general fund revenue and expenditures have fallen dramatically over the last decade. Furthermore, projected revenue growth projected for the next two biennia under current law will only recover a negligible portion of this lost revenue. In light of this fact, some increase in state general fund revenues and expenditures in the upcoming biennia merits consideration.

9 "General Fund Revenue Near 20 Year Low," April 10, 2013. http://www.mn2020.org/issues-that-matter/fiscal-policy/general-fund-revenue-near-20-year-low

State General Fund Expenditures from FY 2002-03 to FY 2016-17: Current Law

Adjusted for Inflation, Population Growth, K-12 Funding Shifts, Federal Stimulus, General Education Takeover, and Tobacco Bonds

						Projected	Projected	Planning Est.	
	FY 2002-03	FY 2004-05	FY 2005-07	FY 2008-09	FY 2010-11	FY 2012-13	FY 2014-15	FY 2016-17	
Nominal Gen. Fund Spending (billions)	$26.648	$28.128	$31.490	$33.866	$29.962	$35.449	$36.744	$38.513	*All from MMB. Projections and planning estimates for FY 2012-13 through FY 2016-17 from Feb. 2013 forecast.*
K-12 Funding Shift Adjustment (billions)	$0.462	$0.189	-$0.652	$0.000	$1.890	-$1.095	$0.052	$0.052	*The state delays a percentage of school aid payments to the subsequent biennium. An increase in this percentage results in a one-time reduction in state spending and a decrease results in a one-time increase in spending, even though the same amount of aid is ultimately distributed.*
Federal Recovery Dollars (billions)				$0.500	$2.328				*Federal stimulus dollars were used to replace a portion of state general fund spending in FY 2008-09 and FY 2010-11. The spending was still occurring, but was not paid for out of the general fund in that biennium.*
Estimated State General Education Takeover Adjustment (billions)	$0.867	$0.062	$0.232	$0.369	$0.396	$0.380	$0.364	$0.362	*In FY 2003, general education property taxes were replaced with state general fund dollars, although in subsequent biennia a portion of general ed. costs was shifted back to local property taxes. This was not an increase in government spending, but a shift in how existing spending was paid for. Amounts here are added to simulate what general fund spending would have been had general ed. been fully funded from the general fund in both years of each biennium.*
Proceeds from Tobacco Bond Sale (billions)						$0.643	-$0.113		*Revenue from the sale of tobacco bonds was used to make a one-time reduction in general fund debt service payments in FY 2012-13. The debt service payments were still made, but they were paid for with proceeds from the tobacco bond sale instead of general fund dollars. Adjustment in FY 2014-15 is due to bond refinancing.*
Adjusted Nominal General Fund Spending (billions)	$27.977	$28.379	$31.070	$34.735	$34.576	$35.377	$37.047	$38.927	*Nominal general fund spending after adjustments for K-12 funding shifts, federal stimulus dollars, state takeover of general education costs, and tobacco bonds.*
Adjusted General Fund Spending in Constant FY 2012-13 Dollars (billions)	$40.561	$38.037	$37.233	$37.804	$36.402	$35.377	$35.698	$37.021	*Adjusted nominal general fund spending converted to constant FY 2012-13 dollars using the Implicit Price Deflator for State & Local Gov't purchases. The adjustment for FY 2016-17 is modified for the fact that inflation is not factored into projections of general fund spending, except for health care and debt service.*
Population	5,060,440	5,175,099	5,247,358	5,294,459	5,318,086	5,399,024	5,491,665	5,587,071	*Estimated & projected population averaged over both years of the biennium.*
Adj. Spending in Constant FY 2012-13 Dollars Per Capita (annualized)	$4,008	$3,675	$3,548	$3,570	$3,423	$3,276	$3,250	$3,313	*These amounts represent adjusted annual average general fund expenditures for both years of each biennium in constant FY 2012-13 dollars per capita. This affords a more "apples to apples" comparison of general fund spending over time than a simple nominal dollar comparison.*

IV. ADJUSTED GENERAL FUND SPENDING UNDER THE DAYTON BUDGET

Governor Mark Dayton's revised budget includes a projected increase in nominal general fund spending of $2.5 billion from FY 2012-13 to FY 2014-15 and a planning estimate increase of $2.8 billion from FY 2014-15 to FY 2016-17—an increase of just over seven percent in each of the next two biennia.

The growth in nominal general fund spending from FY 2012-13 to FY 2014-15 is somewhat understated due to the net effects of the K-12 funding shift and the tobacco bond sale; adjusted for these two factors, the growth in general fund spending from FY 2012-13 to FY 2014-15 is $2.8 billion or 8.1 percent. Shifts and takeovers do not significantly affect the growth rate in nominal general fund spending from FY 2014-15 to FY 2016-17 under the Governor's revised budget.

After adjusting for inflation and population growth, however, the growth in general fund spending over the next two biennia under Dayton's revised budget drops significantly. The table below shows general fund spending in FY 2012-13 under current law compared to spending in FY 2014-15 and FY 2016-17 under the Governor's revised budget in nominal unadjusted dollars and after adjustments for inflation, population growth, K-12 funding shifts, the tobacco bond sale, and the general education takeover.[10]

Adjusted general fund spending under the Governor's revised budget will increase by 2.4 percent from FY 2012-13 to FY 2014-15 and by 4.4 percent from FY 2014-15 to FY 2016-17.

10 The effect of the general education takeover on the growth in spending from FY 2012-13 to FY 2016-17 is minor, but its effect is nonetheless included in this table to maintain comparability to the table in the preceding section. There is no distribution of federal recovery dollars during the three biennia examined in this table, so the adjustment for federal recovery dollars is omitted.

State General Fund Expenditures: FY 2012-13 Based on Current Law; FY 2014-15 and FY 2016-17 Based on Governor's Revised Budget

Adjusted for Inflation, Population Growth, K-12 Funding Shifts, General Education Takeover, and Tobacco Bonds

See table on page 15 for notes corresponding to each row	Projected FY 2012-13	Projected FY 2014-15	Planning Est. FY 2016-17
Nominal Gen. Fund Spending (billions)	$35.449	$37.939	$40.752
K-12 Funding Shift Adjustment (billions)	-$1.095	$0.052	$0.052
Estimated State General Education Takeover Adjustment (billions)	$0.380	$0.365	$0.364
Proceeds from Tobacco Bond Sale (billions)	$0.643	-$0.113	$0.000
Adjusted Nominal General Fund Spending (billions)	$35.377	$38.243	$41.168
Adjusted General Fund Spending in Constant FY 2012-13 Dollars (billions)	$35.377	$36.851	$39.153
Population	5,399,024	5,491,665	5,587,071
Adjusted Spending in Constant FY 2012-13 Dollars Per Capita (annualized)	3,276	3,355	3,504

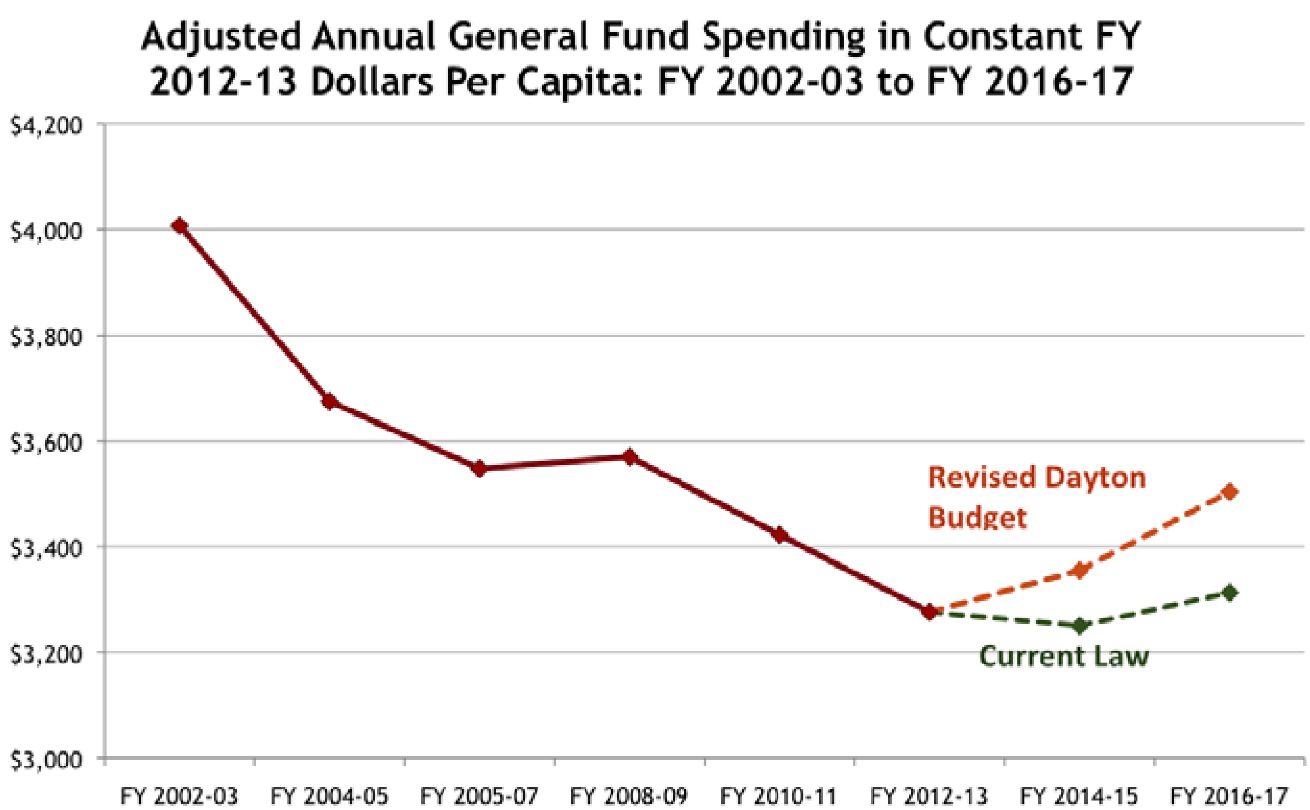
The aggregate growth over both biennia is 6.9 percent, which translates to an annual average growth rate of 1.7 percent.

The spending growth that occurs under Dayton's revised budget is quite modest relative to the revenue that has been lost over the last decade. The graph below shows the decline in adjusted per capita general fund revenue since FY 2002-03, including projected spending for FY 2014-15 and FY 2016-17 under both current law and the Governor's revised budget.

By FY 2016-17, adjusted state general fund spending under the Dayton budget would be nearly six percent greater than it would be under current law. However, it would still be 12.6 percent less than FY 2002-03 adjusted general fund spending. By FY 2016-17 the revised Dayton budget will have restored less than one-third of the adjusted spending decline since FY 2002-03.

Examined from different perspective, FY 2016-17 adjusted state general fund spending under the Dayton budget will still be less than in FY 2008-09—the biennium that encompassed the Great Recession. In addition, FY 2016-17 adjusted general fund spending under Dayton's budget will still be less than the average spending during the four biennia under the watch of conservative anti-tax Governor Tim Pawlenty.

The spending increases proposed by Governor Dayton in his 2013 budget are significant only in comparison to the spending level of the current biennium, which had been depleted by the Great Recession and a decade of "no new tax" policies. The level of general fund spending proposed by Dayton is actually low by the standards of recent history preceding the Great Recession.



CONCLUSION

The nominal dollars of general fund spending has increased over the last decade, but—as the name implies—nominal dollars are dollars in name only. Adjusted for inflation, the revenues going into the state general fund and the spending supported by that revenue has declined. In short, Minnesota general fund spending has increased, but only in the sense that median household income has increased: the number of dollars associated with each has grown over the last decade, but the purchasing power of those dollars has declined.

Inflation is not the only factor that needs to be taken into account when evaluating the change in general fund spending over time. Other factors—K-12 funding shifts, tobacco bond sales, the state takeover of K-12 general education, one-time federal recovery dollars, and population growth—all can cause short-term or long-term fluctuations in state spending that need to be accounted for in order to get a meaningful sense of the change in state general fund spending over time.

After adjusting for each of these, state general fund spending in Minnesota has dropped by 18.3 percent over the last decade. To a public that is continuously bombarded by rhetoric about "out-of-control" government spending, this finding may come as a surprise.

In one sense, Minnesota and every other state has a spending problem. But in the case of Minnesota, this spending problem is not borne of profligacy, but by demographics—most notably, a growing bubble of aging baby boomers—combined with spiraling health care costs. This trend has been examined at length in numerous forums and will not be revisited here. However, despite this spending pressure, Minnesota has made substantial cuts in adjusted general fund spending by cutting other areas of the budget, including K-12 education, higher education, and property tax relief programs.

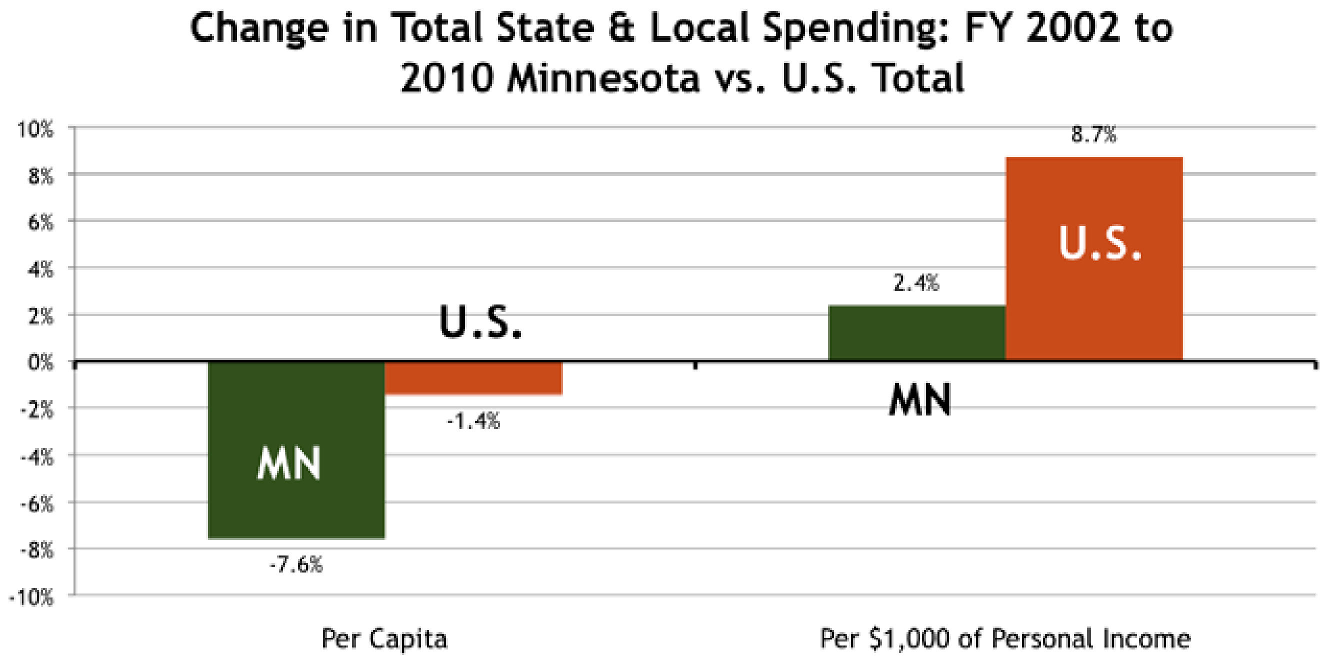
Upon closer scrutiny, there is nothing particularly shocking about the conclusion that adjusted state general fund spending has declined. After all, real per capita general fund revenue has declined by double digits over the last decade.[11] As general fund revenues decline, general fund spending must eventually follow.

General fund expenditure information for all fifty states which incorporates the adjustments described in this report is not available.[12] However, data on combined state and local spending for all fifty states is available from the U.S. Census Bureau. Both on a real per capita basis and as a percent of personal income, combined state and local government spending in Minnesota has either declined more rapidly (in the case of spending per capita) or grew less rapidly (in the case of spending per $1,000 of income) than the national average during the period from FY 2002 to FY 2010.[13]

11 "General Fund Revenue Near 20 Year Low," April 10, 2013. http://www.mn2020.org/issues-that-matter/fiscal-policy/general-fund-revenue-near-20-year-low

12 The Fall 2012 "Fiscal Survey of the States" from the National Governors Association (available at: http://www.nasbo.org/sites/default/files/Fall%202012%20Fiscal%20Survey.pdf) shows the annual percentage change in state general fund spending for all fifty states adjusted for inflation based on the Implicit Price Deflator for State and Local Government Purchases. By multiplying the percentage change over the last ten years (FY 2003 to FY 2013), it is possible to calculate the cumulative percent change in real state general fund spending for all fifty states over the decade, which turns out to be -4.6 percent. The comparable change for Minnesota real general fund spending over the same period is -5.4 percent. However, this adjusts general fund spending only for inflation and omits all other adjustments made in this report. If we further adjust Minnesota general fund spending for K-12 funding shifts, the state takeover of general education, and the sale of tobacco bonds, the percentage change from FY 2003 to FY 2013 is -11.9 percent.

13 FY 2010 is the most recent year for which U.S. Census state and local spending data for all fifty states is available.



The fact that adjusted general fund spending in Minnesota has declined over the last decade is undeniable. However, conservatives may argue that this decline has been a blessing for Minnesota. According to conventional right wing logic, a decline in public spending will lead to lower taxes, which will in turn lead to more private investment and job creation.

Unfortunately, Minnesota's decade of declining public expenditures does not appear to have led to much of a boom. Relative to other states, Minnesota percentage growth in personal income [14] and jobs[15] have both lagged slightly behind the national average over the last ten years. While Minnesota is by no means an economic basket case, there is no indication that the "no new tax" policies of the last ten years have done anything to improve Minnesota's economic performance relative to the rest of the nation.

In the absence of convincing evidence of job and income growth, Minnesota conservatives have touted the fact that state tax collections have exceeded projections in recent state budget forecasts. However, this trend is not unique to Minnesota. Fully two-thirds of states have experienced tax collections that have exceeded earlier projections. In fact, the extent to which Minnesota FY 2012 tax collections have exceeded projections is actually slightly less than the national average.[16]

The recent trend of revenue collections that exceed earlier projections is clearly the result of an improving national economy, not conservative fiscal policies adopted by state lawmakers.

14 Based on Bureau of Economic Analysis data, March 29, 2013.

15 Based on U.S. Bureau of Labor Statistics Local Area Unemployment Statistics, March 28, 2013.

16 For more on this, see the February 28, 2013 Minnesota 2020 Hindsight blog "Taking Credit Where None is Due on Budget" at http://www.mn2020hindsight.org/view/taking-credit-where-none-is-due-on-budget .

While the benefit of declining general fund expenditures is difficult to identify, the harms are apparent. For example:

- Real per pupil state aid to Minnesota school districts has fallen by 13 percent from FY 2003 to FY 2013 based on data from the Minnesota Department of Education.[17] The decline in state support has led to growing class sizes, reduced course offerings, and a scarcity of dollars for important public investments such as all-day kindergarten.
- State funding for higher education has fallen well short of what is needed to keep pace with inflation, leading to soaring tuition and a deterioration in the quality of Minnesota's state colleges and universities.
- Real state funding for property tax aids and credits has been cut by 43 percent, leading to property tax increases and declining investment in local services and infrastructure. Despite rapidly escalating property taxes, real per capita revenue for Minnesota counties and cities has fallen sharply over the last decade.

In the aftermath of the Great Recession, it is unlikely that Minnesota will be able to return to the adjusted general fund spending levels of FY 2002-03. Reforms and efficiencies in state spending must be pursued. Governor Dayton's proposed budget makes significant strides in this direction through cost savings and reductions and an emphasis on outcome-based performance measures. It is likely that the budgets proposed by the House and Senate will follow this lead.

However, it is a logical fallacy to conclude that the resolution to Minnesota's recurring budget problems must consist (1) entirely of budget reductions or (2) entirely of revenue increases. In reality, the Minnesota's fiscal strategy can and should involve a balance of both approaches. Governor Dayton's revised budget, for example, would restore less than a third of the decline in adjusted general fund spending that has occurred over the last decade; these assets are focused on strategic investments in education, infrastructure, and workforce development.[18] The rest of the savings needed to balance the state budget are achieved through smarter, leaner government.

The only alternative to the balanced approach is the "all-cut" approach. This is the path that Minnesota has gone down for the last biennium and has led to deteriorating investments in education and infrastructure, soaring property taxes (as state costs are shifted on to local governments), and recurring budget deficits. This is not a sustainable course.

Dayton's budget would achieve a modest level of investment in critical public assets without increasing state and local government own-source revenue as a percentage of personal income—what is commonly referred to as the "Price of Government."[19] The Coalition of Minnesota Businesses has called the Price of Government an "index of what taxpayers can afford." This index will decline over the next four years (FY 2014 to FY 2017) under the Dayton budget relative to what it was during the preceding four years (FY 2010 to FY 2013).

17 Based on the Minnesota Department of Education's eleven year revenue trends spreadsheet (inflation adjustment based on Implicit Price Deflator for State and Local Government Purchases), available at: http://education.state.mn.us/mdeprod/idcplg?IdcService=GET_FILE&RevisionSelectionMethod=latestReleased&Rendition=primary&dDocName=043203 .

18 An overview of the Governor's budget can be found at http://www.mmb.state.mn.us/doc/budget/bud-op/op14/gov-presentation.pdf .

19 "Price of Government Declines Under the Dayton Budget," January 28, 2013. http://www.mn2020.org/issues-that-matter/fiscal-policy/price-of-government-declines-under-the-dayton-budget .

The emphasis on the Governor's budget in this report should not be seen as a dismissal of the House and Senate budget plans. However, at this point the House and Senate plans lack the specificity needed for the type of analysis applied within this report; as a result, this report has focused on the only detailed budget plan currently on the table—the Dayton budget. There are promising signs that House and Senate leadership—like the Governor—recognize the need for a balanced approach to the state budget that involves both spending reforms and revenue increases.

Right wing groups are decrying Dayton's proposed budget, despite the fact that it is restoring less than a third of the adjusted general fund spending reductions that have occurred over the last decade and is accomplishing this without increasing the Price of Government. Such knee-jerk reactions in opposition to any and all tax increases is not fiscal conservatism, but anti-tax dogma run amuck.

A half century ago, Minnesotans made critical investments in education, infrastructure, and public services. These investments made Minnesota a relatively high tax state. It also made Minnesota a prosperous state. During the last four decades of the twentieth century, Minnesota personal income rose steadily relative to the national average. Educational attainment was high. Roads were well paved and plowed. Time Magazine proclaimed "The Good Life in Minnesota"[20] and most Minnesotans agreed.

The eighteen percent decline in adjusted general fund spending over the last decade has damaged the critical public investments that made the "Good Life in Minnesota" possible. A modest restoration of a portion of this reduction during the 2013 legislative session is both necessary and affordable.

20 http://news.minnesota.publicradio.org/play/slideshow.php?feature=2003%2f08%2f12_cunninghamg_timemag&slide=1

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2324 University Avenue West, Suite 204, Saint Paul, MN 55114
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