



# Peter Nelson, Public Policy Director for the Center of the American Experiment

## No justification for new state spending

A Civic Caucus Focus on Competitiveness Interview

*April 19, 2013*

### Present

Dave Broden, Paul Gilje (coordinator), Randy Johnson, Dan Loritz (chair), Peter Nelson, Dana Schroeder, Clarence Shallbetter. By phone: Audrey Clay, Janis Clay, Pat Davies, Sallie Kemper.

### Summary of Discussion

Peter J. Nelson, director of public policy for the Minneapolis-based Center of the American Experiment, asserts that his March 2013 report, *Minnesota Spending 101: Smart Budgeting for an Era of Limits*, finds no justification for new state spending at this time. His report shows that all-fund state spending, adjusted for inflation, has increased from \$8.1 billion in 1960-1961 to \$61.9 billion in 2012-2013. Per capita spending, also adjusted for inflation, grew from \$2,341 in the 1960-1961 budget to \$11,433 in the current budget. Both measures have increased almost every biennium since 1960-1961. Nelson compares Minnesota's spending in various categories both nationally and with 10 peer states and finds that Minnesota's spending in almost every category ranks high in both comparisons. On the top end, Minnesota ranks second nationally in its state and local spending on public welfare per person under 200 percent of the federal poverty guideline and higher than all 10 of its peer states. On the bottom end, Minnesota ranks 48th in state spending, excluding local spending, on corrections per person in prison or under community supervision and lower than all 10 of its peer states. Nelson advises state policymakers, "We don't need to spend more. It's very clear that in comparison with other states, we're not spending too little."

### Introduction

Peter J. Nelson is director of public policy for the Minneapolis-based Center of the American Experiment. The Center is a local think tank, focusing on public policy issues. It emphasizes free market, conservative principles. Its mission is to build a culture of prosperity for Minnesota.

Nelson devotes most of his time researching and writing on a range of policy issues, including health care, energy, state budgets and state governance. He regularly consults with state policymakers on these issues and contributes commentaries to the StarTribune, Pioneer Press, and other local newspapers across Minnesota.

Nelson received a B.A. in economics from Wheaton College in Illinois and a law degree from the University of Minnesota, where he was a member of the Minnesota Law Review.

## Discussion

Peter J. Nelson, director of public policy for the Minneapolis-based Center of the American Experiment, authored the Center's March 2013 report on Minnesota state budgeting, *Minnesota Spending 101: Smart Budgeting for an Era of Limits*.

The study used Minnesota Department of Management and Budget (MMB) figures from 1960 to today on general-fund spending and all-funds spending to look at how that's changed over the years. He decided to focus on all-funds spending, because there are fluctuations through the years in what we spend or don't spend from the general fund. Also, federal funds are incorporated into all-funds spending figures.

Using a variety of data sources, the report also compares Minnesota's spending in various categories on a per capita or per-person-served basis with spending in 10 similar states, called "peer states." "That starts answering the question of how generous our state programs are relative to other states," Nelson said. In the report, Nelson draws a number of conclusions about Minnesota's state and, in some cases, local spending.

**Looking forward, there will be a lot of pressure on the state budget, coming from a number of sources.**

1. Baby boomers will start needing long-term care services in four or five years. They started retiring in 2008, but the real pressure will come from future needs for long-term care.
2. Globalization raises competitive issues. Decades ago, we were a much more localized economy, so we could get away with higher spending without facing competitive issues.
3. Growth in health care spending is outpacing growth in revenues. No one has figured out how to control health care costs. Health care spending is projected to increase by 8.5 percent annually, much faster than projected increases in revenues.
4. Pension fund liabilities may require dipping into the general fund. That leaves fewer funds for other priorities.
5. The federal debt could result in fewer grants to the state of Minnesota. Currently, the state counts on federal grants for about 20 percent of its total spending and 30 percent of its general fund spending.

**Minnesota must strike the right balance between spending and letting the private economy work in a way that lets us prosper as a state.** "We depend on the private economy for our future

prosperity," Nelson said. "Any time we have to raise taxes to fund more spending, it subtracts from the private economy, unless all that spending is going to productive things. We spend a lot of state money on very productive things that do promote growth in the economy, but we have to be careful."

**Inflation-adjusted spending has increased almost every biennium over the past 50 years.**

Spending from all funds, adjusted for inflation, increased from \$8.1 billion in 1960-1961 to \$61.9 billion in 2012-2013, a 667 percent increase, or 7.6 times. Per capita spending, adjusted for inflation, also increased almost every biennium. It grew from \$2,341 in the 1960-1961 budget to \$11,433 in the current budget, an increase of 388 percent, or 4.9 times.

**Total state spending as a proportion of the overall state economy has been pretty consistent at about 11 percent over the years.** In the past four years, however, it has registered closer to 12 percent, but that's to be expected during a recession, Nelson commented.

**State spending has grown at roughly the same rate as the private economy since 1985.** An interviewer commented that this shows that state spending is tracking with the economy. Nelson said that begs the question of whether state spending should be tracking with the economy. "Or should state government be becoming more efficient?" he asked. "I think growth in state spending should be something less than growth in the private economy."

**The proportion of general fund spending going to K-12 education and health and human services is much more now (73.6 percent) than 10 years ago (63.4 percent).** Both areas of spending as a proportion of general fund spending grew by about five percentage points over the past 10 years. Other priorities suffered some from this, like higher education, which fell from 10.1 percent of general fund spending in 2002-2003 to 7.3 percent of general fund spending in 2012-2013.

In response to a comment by an interviewer, Nelson said he plans to do more studies on health and human services and education. "That's where all the money is," he said.

**In 2010, total Minnesota state and local government spending per capita was \$10,534, 15th highest in the country.** Among 10 peer states (those 10 states with average state and local government salaries nearest to Minnesota's average) only Massachusetts had higher spending per capita. The peer states include Colorado, Illinois, Iowa, Maryland, Massachusetts, Michigan, Nevada, Oregon, Pennsylvania and Wisconsin.

**In 2008-2009, Minnesota spent \$11,098 per pupil on K-12 education, 15th highest in the country.** That amounted to \$599 more than the national average. Only three peer states, Maryland, Massachusetts and Pennsylvania, spent more per pupil than Minnesota. Nelson chose 2008-2009 data because of the K-12 education shifts in recent years, which would have made state-to-state comparisons difficult. (The education shifts, which happened over several years, involved the state delaying aid payments to school districts in order to try to balance the overall state budget.)

"Originally, I thought of the K-12 education shift as a gimmick," Nelson said. But he now believes the K-12 shift accomplished the same thing a budget reserve fund accomplishes. "The state should have a larger budget reserve fund; \$653 million is not enough," he said. "Many people, including the commissioner of Minnesota Management and Budget, say you need about five percent of the total budget, which is about what we used during those years with the K-12 shift."

An interviewer asked if we should spend more to get kids graduated from high school and to get them trained for jobs. "I don't think we need to spend more there; that's an area where we need to start spending differently," Nelson replied.

**In 2010, Minnesota state and local governments spent more on public welfare per person below 200 percent of the federal poverty guideline (FPG) than any other state besides Alaska.**

Minnesota's spending (\$8,680) was about twice the national average (\$4,389). (These numbers appear low because not every person below 200 percent of the FPG receives public welfare. Actual spending per person who actually receives public welfare would be much higher.)

An interviewer asked why Minnesota's spending on this measure is so high compared to other states and the national average. Nelson responded that we have one of the lowest poverty rates in the country and one of the lowest uninsured rates in the country, so those factors don't explain Minnesota's high spending. He said we have a lot more people using our public programs relative to our poverty rates and we have much more generous benefits. Minnesota, for example, provides Medicaid for single adults. Also, the state has made a decision to put much more money into disability and long-term care. "That's a value decision that we've made," he said.

**In 2010, Minnesota spent \$12,030 on public research universities per enrolled student, eighth highest in the nation and almost \$1,700 more than its closest peer state, Wisconsin.** Nelson commented that Minnesota's public university budgets are under scrutiny after reports of high spending on administrative expenses.

**In 2010-2011, Minnesota's spending on undergraduate student aid programs per student amounted to \$4,119, 14th in the nation.** But the state spent more per student than any of its 10 peer states. Nelson noted that Minnesota did cut spending on higher education over the past couple of years. However, the state continues to rank high because a number of other states cut higher education more deeply than Minnesota.

**Minnesota spends dramatically less than most states on corrections.** Minnesota's 2011 spending per person in prison and under community supervision was \$4,119 and ranked third lowest in the country. (It's important to note that this measure includes only state spending, not state and local spending, as some other measures do.)

An interviewer was surprised that Minnesota ranked so low on the corrections measure. Nelson responded that Minnesota has the fewest people in prison and "Minnesota clearly has different policies on whether people go to prison or are put in community supervision." He did say that some people have suggested his figures on corrections spending in Minnesota may be too low, because the counties do a lot of the spending on corrections and local spending is not included in the measure.

**Minnesota's spending per capita on interest on state general debt (\$111) ranked 35th in the nation.** Among the 10 peer states, only Iowa and Nevada ranked lower.

Following the meeting, an interviewer asked Nelson why he chose to leave out local spending in his analyses of corrections spending and spending on interest for general debt. The interviewer noted that Minnesota's spending per capita on interest for debt looks small when local debt is not included

and that counties run large parts of the corrections system here. Not including local spending in those areas may be missing a large part of spending, the interviewer said.

Nelson responded that he only used state spending in those two categories because he believed it would offer better comparisons with other states. He said he would go back and look at those analyses.

**The report doesn't offer enough information to judge whether Minnesota is spending too much or too little.** An interviewer asked why the report did not include more about outcomes. Nelson responded that measuring outcomes is very difficult. "This is a modest first step in that direction," he said. "Looking at state spending per person or per pupil or per low-income person gives us a little bit more information about how the state spends its money. But it doesn't give us enough information to know whether we're spending necessarily too much or too little. It does pull out certain issues and it begs us to ask some more questions."

**More care is given to spending outside the general fund.** An interviewer asked whether public programs funded through the general fund were run more carefully and more efficiently than programs with a more direct funding source. "This is just based on my theory, but I would say that programs with a direct funding source are generally run more carefully because their budgets are based on more fixed revenue sources," Nelson said. The Department of Natural Resources budget, for example, is largely set based on the fees they can get every year. "That fee is set in statute; it's a fixed fee. Raising these fees on hunters is not an easy job. Revenue supporting the general fund, however, comes from corporate taxes, income taxes and sales taxes which grow with the economy."

**Minnesota must self-finance, but we must guard against becoming a high-tax state.** In response to a question, Nelson said he agrees with Labor and Industry Commissioner **Ken Peterson, who spoke with the Civic Caucus on April 12, 2013**, that Minnesota must self-finance. "We're on our own up here," Nelson said. "We don't have the natural resources that other states have. The fact that we have to self-finance means we must be very careful about not being a high tax state. We depend on revenues from the jobs that come from private companies to support state spending, the good things that government does, and that will be compromised in the future if we become a high tax state."

**Advice to policymakers: "We don't need to spend more."** An interviewer asked what advice Nelson would give to Governor Mark Dayton and the Legislature. He replied his advice would be, "We don't need to spend more. Relative to other states we are comparatively spending more on all of these basic functions of government: education, public welfare, etc. It's very clear to me that in comparison with other states, we're not spending too little."

"We have a budget deficit of \$600 million," Nelson continued. "What the Governor and the DFLers in the Legislature have been proposing is to fix that \$600 million problem with \$1.8 billion to \$2.6 billion in tax increases. I think that's incredibly unwise to do, considering the competitiveness issues that presents for our businesses and for the people who live here. It doesn't recognize the fact that tax rates absolutely do matter. People do move away from Minnesota and, more importantly, people are dissuaded from moving to Minnesota. People and companies will choose not to move here."

"It's better to have some certainty over what our spending levels are going to be and what our taxes are going to be," he said. "Businesses don't like to see tax rates jumping up and down. We dealt with this recession without raising taxes and without cutting spending too much. Being able to do that has basically created the certainty that people want. If Democrats must raise taxes, I'd say fix the problem we have with \$600 million in higher taxes; don't add more spending."

**The state may need statutes or constitutional amendments to restrain spending.** Nelson said his ultimate conclusion is that it's not a time to raise spending. "We're clearly spending enough on our priorities relative to our peer states. I don't see any justification for new spending. I think maybe we could benefit from more institutionalized mechanisms to restrain spending, through statutes or constitutional amendments."