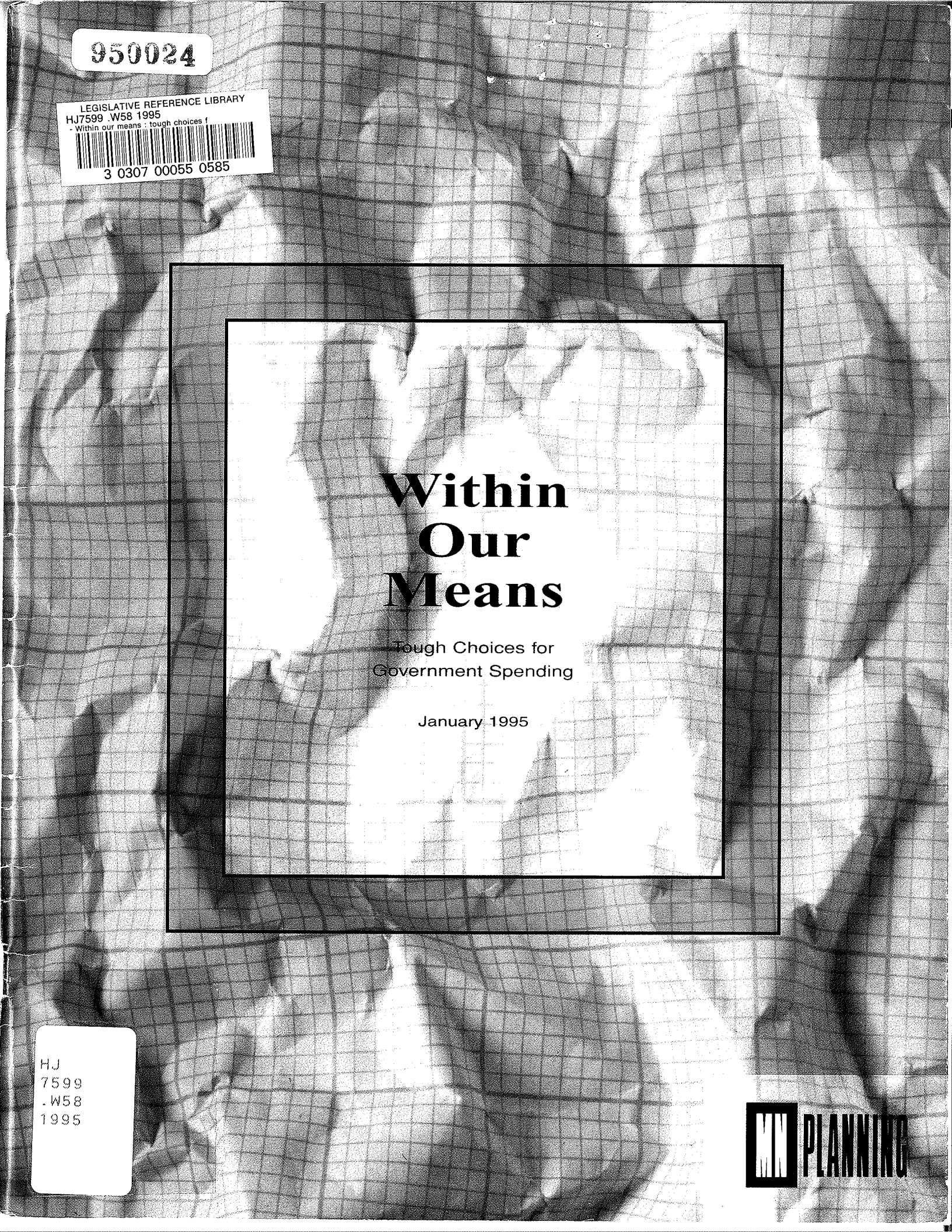


Within Our Means

Tough Choices for Government Spending

January 1995

MN PLANNING

To the People of Minnesota

In April 1994, I asked Minnesota Planning to conduct a comprehensive examination of the cost of government in Minnesota over the next 10 years.

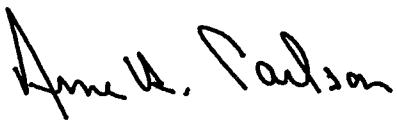
Minnesota must anticipate future spending trends while there is still time to make adjustments. Unless we understand and respond to the forces that will drive spending in the coming years, state and local governments are in danger of continuing to lurch from deficit to deficit.

Indeed, as *Within Our Means: Tough Choices for Government Spending* reveals, that danger is real and already upon us. If we continue spending as we have been, Minnesota's state and local governments will face a $2.5 billion cumulative budget gap or an average shortfall of $625 million between the bienniums ending in fiscal years 1999 and 2005.

We must begin now to respond to this reality because the gap will not disappear by itself. Correcting this problem will require making tough but smart choices about how to control spending.

If Minnesota is to reach the future called for by its citizens in *Minnesota Milestones*, the state's long-term strategic plan, action must not be delayed. To this end, I will be making several proposals to the 1995 Legislature aimed at closing the budget gap. Making such choices will require courage, vision and support from policy-makers, as well as every Minnesotan. The future demands no less.

Warmest regards,



ARNE H. CARLSON
Governor

Minnesota Planning is charged with developing a long-range plan for the state, stimulating public participation in Minnesota's future and coordinating public policy with state agencies, the Legislature and other units of government.

Authors of *Within Our Means* were Deborah Pile, J.H. Fonkert, Mark Larson, Steve Reckers, Ray Lewis and R. Thomas Gillaspy of Minnesota Planning and Liz Emerson of the Minnesota Department of Health. Additional assistance was provided by Dan Storkamp, Barbara Ronningen, Judy Johnson, Julie Gullickson and many others at Minnesota Planning, the Department of Finance and other state agencies and departments.

A panel of expert advisors made valuable contributions to *Within Our Means.* Members were Representative Jim Girard; Senator Gene Merriam; Samuel Meyers, Roy Wilkins Professor, Humphrey Institute of Public Affairs; Judy Pattison, Big Stone County auditor; Hazel Reinhardt, president of Hazel Reinhardt Consulting Services; Dan Salomone, executive director of the Minnesota Taxpayers Association; and Tom Stinson, Minnesota state economist.

January 1995

Within Our Means is the culmination of an eight-month Minnesota Planning study of government spending. During the course of the project, key findings were published in a series of *Line Item* reports covering government spending for welfare migrants, public payroll, education, justice and health. Working papers also were prepared on the following topics: revenue, justice, health, prekindergarten through 12th-grade education, higher education, transportation, environment and natural resources, and local government.

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Within Our Means

Summary

Minnesota's state and local governments face a cumulative budget gap of $2.5 billion between the bienniums ending in June 1999 and 2005, amounting to an average shortfall of $625 million each biennium. To close the gap will require a tax increase, spending cuts or some combination of both.

The gap between revenues and expenditures is not a cyclical problem that will disappear during economic good times. It is structural and will recur, unless corrected, for two reasons: demographics and other forces will cause personal income growth to slow, dampening state and local revenue growth; and the number of people served by government will continue to grow.

The time to act is now because Minnesota is experiencing economic conditions more favorable than can be expected for many years in the future. After 2010, the proportion of Minnesotans of working age will begin to decline, while the dependent population, children and elderly people, will proportionately increase.

Minnesota ranks high in revenue raising and spending compared to other states. In 1990, Minnesota ranked seventh among the states in revenue raised as a percent of personal income — 19 percent — and sixth in total general expenditures per capita, at $4,701.

Within Our Means examines spending trends of state and local governments, analyzes the forces driving spending and suggests options and recommendations for solving the state's budget problems. Seven major spending areas are analyzed: health care, elementary and secondary education, higher education, justice, transportation, environment and local government.

Major forces driving spending

Within Our Means identifies five key drivers of government spending.

- **Changing population characteristics.** Demographic changes are powerful forces driving both revenues and spending and contributing to the gap. For example, by 2020, the number of Minnesotans age 65 and older will grow by 348,000, increasing the need for Medical Assistance funding for nursing home care. Justice system costs are expected to escalate due to a rise in the number of 10- to 24-year-olds — the age group most likely to be arrested.
- **Eligibility and level of service provided.** Minnesota has enacted extensive policies aimed at ensuring health and long-term nursing home care for elderly people, the sick, people with disabilities and low- and limited-income citizens. Medical Assistance rosters have ballooned as a result. The number of special education students with emotional and other severe disabilities requiring high-cost services has also increased.
- **Standards, regulations and mandates.** Standards and regulations set by the federal and state governments to maintain quality public services are very costly. The 1989 law doubling sentences for the most serious crimes and the creation of new drug offenses contributed to a $225 million increase in justice system spending between 1984 and 1990.
- **Costs of labor, materials and other inputs.** Spending is directly affected by changes in salaries and benefits for government employees. Between 1987 and 1993, spending for medical and dental benefits for public school employees rose 58 percent. All benefits, including medical and dental, retirement and Social Security, now account for 14 percent of total elementary and secondary school spending.
- **Mounting infrastructure needs.** Parts of the state's public infrastructure systems will need major investments in the near future just to be maintained. If all deficiencies in public school buildings were corrected, it would cost $1.5 billion. Even after spending $80 to $100 million for a new 800-bed correctional facility opening in 1999, the state expects to be short 340 prison beds in 2002.

Choices

Within Our Means identifies a number of options for addressing the budget gap:

- **Change types, levels and delivery of service.** Possibilities include accelerating the use of alternative care for elderly people; stressing crime prevention and community corrections programs to help reduce future prison needs and justice system

costs; and replacing local government general purpose aid with funding for specific services that are crucial to the well-being of the state.

■ **Target eligibility for government services.** Some options are encouraging the use of long-term care insurance; tying special education funding to measurable outcomes, increasing the portion of higher education costs paid by students; and tying homestead, agricultural and other general purpose state aid to financial need of local governments and individuals.

■ **Redefine standards**. Choices include giving school districts more flexibility to meet personnel needs by changing teacher licensure requirements; placing a moratorium on further increases in criminal sentences and reevaluating current sentencing practices; and reducing right-of-way, lane width and other standards for highways.

■ **Control input costs and invest in technology**. Some possibilities are containing government employee health-care costs through purchasing pools and managed competition; overhauling elementary and secondary teacher salary schedules; and controlling public employer pension contributions and changing pensions from defined benefit plans to defined contribution plans.

■ **Target government infrastructure investments.** Alternatives include continuing to convert regional treatment centers to corrections facilities; developing alternative learning sites and enrollment options in lieu of building new schools; and reducing excess capacity in the higher education system.

Recommendations

Given these and other choices, Minnesota governments should take action in four areas to close the impending budget gap:

■ **Define the activities that are crucial to the future well-being of the state**. Efforts and funding should focus on core activities, including prekindergarten through secondary education and basic levels of critical local government operations.

■ **Build more flexibility into programs and requirements at all levels of government.** This includes giving school districts more latitude in deciding how students meet education standards and making it easier for local governments to obtain waivers from mandates.

■ **Focus on the most cost-effective approaches.** This includes promoting health intervention and other program efforts with low costs and high benefits and making greater use of community-based alternatives to prisons and nursing homes.

■ **Contain costs of government operations and programs.** Containment measures include controlling employee health care costs through managed competition, reducing costs of services through competitive bidding and placing a moratorium on further increases in criminal sentences, Medical Assistance eligibility and other programs.

If Minnesota is to reach the future called for by citizens in *Minnesota Milestones*, the state's 30-year plan, action must not be delayed. It is time to take the steps needed to bridge the gap.

Facing the Gap

Minnesota's state and local governments face a cumulative $2.5 billion gap amounting to an average shortfall of $625 million for each biennium ending between June 1999 and June 2005. This gap between spending and revenues is structural and recurring.

During this time, combined state and local spending is expected to rise more than 50 percent, from $39.7 billion to $60.1 billion, but revenues will fall short of projected spending and create the gap.

A portion of the gap will emerge during each successive biennium. The mismatch between revenues and expenditures is not a short-term cyclical problem that will evaporate during economic good times. The projected shortfalls are almost automatic for two reasons:

- Personal income growth will continue to slow, dampening state and local revenue growth; and
- The number of people served by government is expected to grow substantially. These demographic shifts will cause large spending increases for health care, corrections and other programs that are difficult to control.

Within Our Means analyzes Minnesota spending and revenue trends, assesses the forces that will drive spending over the next 10 to 20 years and discusses options for controlling spending. Minnesota Planning studied spending trends and issues in major program areas, including health care, elementary and secondary education, higher education, local government, criminal justice, transportation and the environment. A panel of expert advisers reviewed and commented on the agency's work in each area. A series of *Line Item* reports and working papers analyzing spending trends and issues are available upon request.

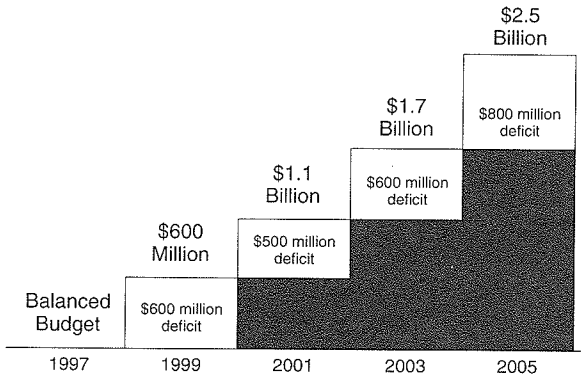
This report is composed of four parts:

- The first chapter, "Facing the Gap," describes the likely fiscal shortfalls confronting Minnesota over the next 10 years, explains their origins and provides an overview of state and local government spending.
- The second chapter, "Forces Driving Spending," describes the most important forces that will drive the need or demand for spending. Some of these spending "drivers" are external forces beyond Minnesota's direct control; others can be changed by deliberate policy choices.
- "Making Tough Choices," the third chapter, discusses options for reshaping Minnesota's public expenditures to conform with budget realities.
- "Closing the Gap" concludes the report with a series of steps that can be taken by government to close the gap and prepare for the future.

This report deals with combined state and local government spending. Many public services are financed and delivered by a combination of state and local governments. A large portion of state-raised revenues is used to make grants to cities, townships, counties or school districts, which in turn produce or purchase services locally. The state raises about 58 percent of all government revenues in Minnesota, but after intergovernmental transfers, local governments spend about 63 percent of the total.

Unless otherwise noted, all historical figures in this report have been adjusted for inflation to 1993 dollars. Federal transfers and payments are not included in revenue figures. All fiscal years are labeled by the year in which they ended. For state government, fiscal year 1993 refers to the budget period beginning in July 1992 and ending in June 1993.

Cumulative Fiscal Gap
for State and Local Governments



Projections show that there will be budget deficits of $500 million to $800 million every biennium, adding up to a cumulative $2.5 billion gap.

Source: Minnesota State Demographer

Cuts in sight

Shifting part of the gap into future bienniums, in hopes of an upturn in revenues, will not be a viable option because expenditures will continue to outpace revenues year after year. Delay in solving the problem will only make the problem worse, forcing huge cuts in spending or large tax increases.

The estimates presented in this report assume that both state and local governments will take action to balance revenues and expenditures each year. The Minnesota constitution requires the state to balance its budget every two years. The estimates balance expenditures and revenues each year by cutting back spending to match revenues. These cuts will keep the gap in subsequent years a bit smaller than it would otherwise be, but they will not reduce the cumulative budget pain.

The painful truth is that budget cuts and spending freezes will be necessary beginning in fiscal year 1998, and these cuts will not be available for fixing future budgets. The outlook for at least the next six years after 1999 is cut upon cut, upon cut.

Minnesota Planning estimated state and local government revenues and expenditures for future years to illustrate the structural problems that are built into the state's current fiscal system. The estimates are based on four assumptions:

- State and federal laws and policies governing taxes, fees and expenditure obligations will remain unchanged.
- Revenues will grow at the same rate as personal income; that is, revenues will remain constant at 18.4 percent of personal income.
- Spending will be cut enough at the beginning of each biennium to produce a balanced state and local budget.

Estimated Spending and Revenues by State and Local Government
Between 1997 and 2005 in Millions

Biennium Ending in	Estimated Revenues	Estimated Spending	Fiscal Gap	Cumulative Gap
1997	$39,700	$39,700	balanced	balanced
1999	$43,800	$44,400	-$600	-$600
2001	$48,300	$48,800	-$500	-$1,100
2003	$53,500	$54,100	-$600	-$1,700
2005	$59,300	$60,100	-$800	-$2,500

Notes: Revenues are assumed to be held at 18.4 percent of personal income and exclude federal transfer payments. These figures represent bienniums ending in fiscal years 1997 through 2005.

Source: Minnesota State Demographer

- Minnesota's economy will follow the same trends as the national economy, and there will be no recessions.

The estimates do not take into account possible major new initiatives, such as a new Twin Cities airport, light rail transit, expansion of MinnesotaCare eligibility beyond the 1994 level, longer prison sentences, higher water quality standards or year-round schools. Nor do they allow for unexpected costs associated with unpredictable events, such as natural disasters, major economic depressions, judicial rulings, new unfunded federal mandates or cuts in federal funding.

If these estimates are correct, no money will be left for major new initiatives unless large cuts are made in existing programs or revenues are increased.

Minnesota spends more than most states

Minnesota's state and local governments raise more revenue and spend more on public services than governments in most states. A strong revenue base has allowed Minnesota to offer more public services than other states, but with the prospect of fiscal shortfalls, all that might change.

In 1990, Minnesota state and local government revenues from taxes and other fees took 19 percent of personal income, according to the U.S. Census Bureau. Six other states registered greater revenue shares from personal income than Minnesota. Minnesota ranked sixth nationally in total general expenditures per capita, at $4,701.

The state ranked high both in taxes and other kinds of revenues in 1990. It was 12th in service charges and seventh in taxes as a percent of personal income. Taxes make up two-thirds of all revenues generated by state and local governments in Minnesota. As a percent of personal income, Minnesota's national ranking was eighth in income taxes, 26th in sales and gross-receipts taxes and 19th in property taxes.

Measured against personal income, Minnesota's state and local revenues were about the same as North Dakota's and 8 percent above Wisconsin's. Minnesota's revenue share of personal income was 14 percent greater than Iowa's and 30 percent greater than South Dakota's.

The state's relatively high overall level of taxation and other revenue-raising allows it to buy more services and facilities through government than

State Rankings

1990 State and Local General Revenues and per Capita Expenditures

Rank	General Revenue as Percent of Personal Income		Spending per Capita: Total General Expenditures		Highways		Higher Education		Elementary and Secondary Education		Health, Income Maintenance and Social Services	
1	Alaska (AK)	52.7%	AK	$10,969	AK	$1,115	DE	$593	AK	$1,877	NY	$1,735
2	Wyoming (WY)	26.1%	NY	6,064	WY	835	ND	563	WY	1,395	MA	1,419
3	New Mexico (NM)	21.0%	WY	5,602	SD	488	WY	550	NY	1,340	AK	1,250
4	Hawaii (HI)	20.0%	HI	5,096	DE	487	AK	546	NJ	1,196	**MN**	**1,192**
5	New York (NY)	19.8%	CT	4,915	MT	464	UT	503	CT	1,164	CA	1,120
6	North Dakota (ND)	19.0%	**MN**	**4,701**	VT	449	IA	498	VT	1,155	CT	1,088
7	**Minnesota (MN)**	**19.0%**	MA	4,566	IA	439	VT	491	WA	1,075	MI	1,031
8	Louisiana (LA)	18.5%	NJ	4,538	ND	432	NM	485	**MN**	**1,066**	GA	1,016
9	Arizona (AZ)	17.8%	DE	4,529	CT	432	WI	456	ME	1,065	RI	999
10	Utah (UT)	17.8%	CA	4,485	KS	416	HI	455	WI	1,058	SC	998
11	Oregon (OR)	17.7%	VT	4,295	**MN**	**414**	NE	453	MI	1,046	ME	990
12	West Virginia (WV)	17.6%	RI	4,292	NE	379	MI	447	MT	1,016	WY	953
13	Wisconsin (WI)	17.6%	WA	4,220	AZ	369	CO	444	NV	1,015	LA	944
14	Delaware (DE)	17.5%	NV	4,140	ME	366	AZ	439	OR	994	WI	929
15	Vermont (VT)	17.3%	MD	4,111	VA	360	MD	439	NE	984	OH	919
16	Washington (WA)	17.3%	WI	4,086	CO	360	KS	432	VA	982	IA	918
17	Montana (MT)	16.7%	ME	4,020	ID	345	OR	432	NH	978	AL	913
18	Iowa (IA)	16.7%	OR	4,017	NM	338	**MN**	**426**	MD	969	WA	879
19	Nebraska (NE)	16.5%	MI	3,995	NV	338	WA	423	CA	965	NJ	856
20	Michigan (MI)	16.5%	ND	3,917	HI	337	IN	409	PA	947	HI	838
21	Kentucky (KY)	16.5%	MT	3,876	WV	329	NC	403	CO	945	MS	830
22	Oklahoma (OK)	16.3%	IA	3,787	MD	326	AL	388	DE	935	KY	814
23	California (CA)	16.2%	AZ	3,785	NY	324	CA	388	RI	931	NC	809
24	Colorado (CO)	16.2%	CO	3,782	OK	322	ID	370	FL	923	VT	808
25	Mississippi (MS)	16.1%	FL	3,775	WI	320	SC	364	NM	920	IN	802
26	Idaho (ID)	16.1%	NM	3,715	IL	314	VA	363	IA	907	OK	772
27	Maine (ME)	16.0%	LA	3,707	OR	310	TX	353	IN	903	PA	768
28	Nevada (NV)	16.0%	VA	3,671	WA	307	MS	350	MA	893	NM	760
29	South Carolina (SC)	15.9%	IL	3,644	LA	304	KY	336	OH	890	FL	756
30	Georgia (GA)	15.7%	NE	3,617	NJ	292	TN	323	KS	889	DE	751
31	Florida (FL)	15.6%	GA	3,555	KY	286	OH	322	TX	888	TN	748
32	Texas (TX)	15.5%	KS	3,540	MS	284	WV	318	GA	887	NE	743
33	Kansas (KS)	15.4%	PA	3,540	NH	283	OK	317	SC	886	OR	734
34	Indiana (IN)	15.4%	OH	3,535	TN	273	IL	315	AZ	880	IL	713
35	Alabama (AL)	15.2%	SC	3,471	RI	271	AR	311	NC	860	MT	704
36	Rhode Island (RI)	15.0%	NH	3,382	MO	269	RI	307	SD	858	MD	692
37	Ohio (OH)	14.9%	NC	3,358	PA	263	LA	306	UT	855	KS	687
38	North Carolina (NC)	14.8%	UT	3,337	TX	258	NY	297	ND	853	VA	676
39	New Jersey (NJ)	14.7%	IN	3,315	GA	257	ME	297	MO	843	AR	675
40	Massachusetts (MA)	14.7%	SD	3,263	NC	255	MT	288	IL	841	CO	661
41	South Dakota (SD)	14.6%	KY	3,260	OH	253	NV	277	WV	835	MO	659
42	Virginia (VA)	14.4%	AL	3,255	AR	253	SD	270	OK	831	WV	659
43	Maryland (MD)	14.1%	OK	3,230	FL	250	MO	265	ID	804	ND	651
44	Pennsylvania (PA)	13.9%	TX	3,203	AL	243	NJ	263	LA	790	TX	642
45	Arkansas (AR)	13.9%	WV	3,170	UT	234	GA	260	HI	763	ID	606
46	Illinois (IL)	13.9%	ID	3,157	MI	230	FL	253	MS	701	NH	602
47	Tennessee (TN)	13.7%	TN	3,050	IN	225	NH	240	KY	689	UT	579
48	Connecticut (CT)	13.3%	MS	2,982	MA	203	CT	235	AR	685	AZ	579
49	Missouri (MO)	12.8%	MO	2,947	CA	201	MA	227	AL	681	NV	565
50	New Hampshire (NH)	12.7%	AR	2,700	SC	190	PA	197	TN	633	SD	534
	United States (US)	16.0%	US	3,983	US	285	US	345	US	955	US	928

Notes: Revenue data excludes federal grants. Alaska's unusually high revenues reflect large oil and mineral royalties and interest earnings.

Source: U.S. Census Bureau

most states. Per capita, Minnesota ranked eighth in operating expenditures and seventh in capital outlays for buildings, roads and other physical facilities in 1990.

Minnesota's per capita spending rank in 1990 was fourth in social services, health and income maintenance, sixth in parks and recreation, seventh in sewer systems, eighth in elementary and secondary education, 11th in highways and streets and 18th in higher education.

Spending in Minnesota was average or below in other areas, such as 26th in law enforcement services, 35th in fire protection and 38th in corrections.

Minnesota's total public debt ranked 16th at $4,265 per capita. In 1990, total interest payments on public debt were $269 per capita, 13th highest nationally.

Higher than average government salaries contributed to the state's high spending rankings. Overall, Minnesota ranked fourth in per capita state and local salaries and wages. The state had fewer government employees than most, ranking 28th in the total number of public employees per 1,000 population in 1991. Yet, it had more elected officials per capita than 42 other states and more governmental units per 1,000 people than 43 other states in 1992.

Minnesota spent 15 percent more per capita than Wisconsin, its most similar neighbor. The difference between Minnesota and its other neighbors was greater. Minnesota's per capita spending was 20 percent greater than North Dakota's, 24 percent greater than Iowa's and 44 percent greater than South Dakota's.

Four decades of growth

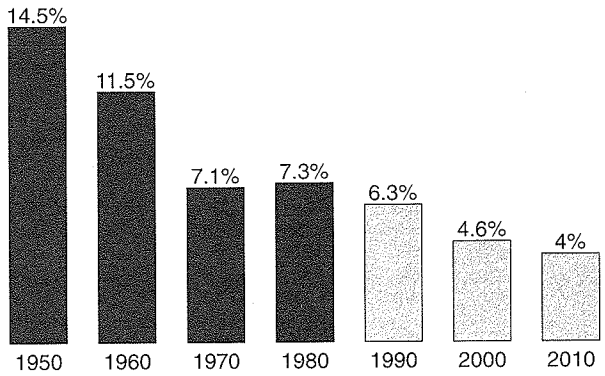
Over most of the last 40 years, the characteristics of Minnesota's population supported strong growth in government revenues. But all that has changed.

From 1950 to 1990, Minnesota's population increased by nearly 1.5 million people, or by more than 49 percent. Most of that growth, however, occurred between 1950 and 1970, when it was more than 1 percent annually. Population growth began to slow in the 1970s, but household formation rates picked up as baby boom children left home and pushed consumer spending up by buying big-ticket items, such as homes, appliances and furniture.

Now, population growth is at its lowest level since World War II. During the current decade, population growth is expected to be only six-tenths of a percent per year, and the rate will continue to fall through 2020. The aging of Minnesota's population and declining fertility rates virtually guarantee that this trend will continue.

In the last 40 years, the state's labor force increased rapidly, especially in the 1970s, when it rose almost 3 percent annually. Labor force growth during the 1970s was advanced by baby boomers entering the work force and the rapid increase in the percentage of female workers. The youngest of the baby boomers are now in their mid-30s and approaching their peak earning years. Female participation in the labor force cannot rise much more; 80 percent of women age 20 to 44 are already working outside the home.

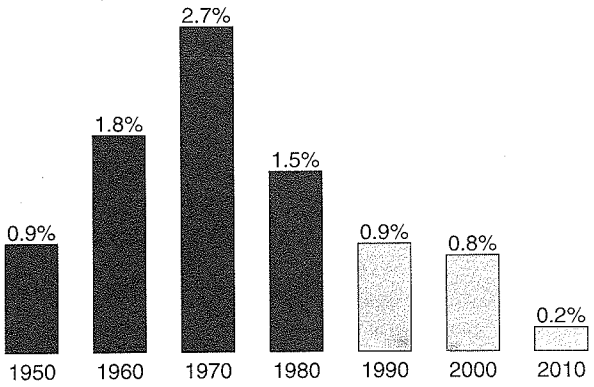
Minnesota's Population Growth Slowing
Percent Change for Each Decade



Note: The figures for 1990, 2000 and 2010 are projections. Each bar represents the rate for the decade.

Sources: U.S. Census Bureau and Minnesota State Demographer

Slow Growth Projected for Labor Force
Average Annual Percent Change for Each Decade



Note: The figures for 1990, 2000 and 2010 are projections. Each bar represents the rate for the decade.

Sources: U.S. Census Bureau and Minnesota State Demographer

During the 1990s, labor force growth slowed to about 1 percent per year. It will slip further in the next decade and approach zero by 2020.

Between 1950 and 1970, personal income rose about 5 percent per year. In the 1990s, personal income growth reached its postwar low point. This largely reflects the slowed rates of growth in population, household formation and labor force. The aging of the population also puts the brakes on many kinds of consumer spending. The percentage of Minnesotans older than 65 will go from less than 13 percent in 1995 to 18 percent in 2020.

Spending soared

Spending grew at a faster pace than the population between 1950 and 1990. Minnesota's state and local government spending per capita leaped 357 percent. This rising level of spending has contributed to the fiscal gap.

Spending also rose faster than personal income, which grew 143 percent between 1950 and 1990. Before 1960, revenues raised by state and local governments were about 12 percent of personal income. By the mid-1970s, the public-sector share went up to about 19 percent, where it has remained.

Data in this section on state and local spending includes spending financed with federal grants. Federal grants equaled 16 percent of total state and local spending in 1990. In 1950, they funded less than 10 percent of state and local spending and peaked at more than 20 percent in the 1970s.

The biggest rise in state and local spending over the last 40 years came during the 1950s and 1960s, when population was growing fastest. Per capita government spending grew 128 percent, or about 5 percent annually, between 1950 and 1967. The biggest increases were for schools and were paid for largely through property taxes.

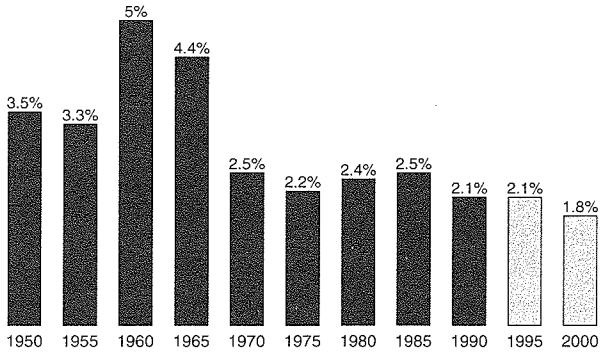
Spending growth slowed to about 3.5 percent annually between 1967 and 1978. During this period, Minnesota increasingly used state sales and income taxes to fund schools and local governments in an attempt to hold down property taxes.

After 1978, government spending growth slowed to about 2 percent annually. Revenue growth slowed after the Legislature indexed income tax brackets so that wage earners would not be pushed into higher tax brackets unless their incomes grew faster than inflation. A national recession also stalled economic growth.

Spending shifted toward social services

Since the late 1960s, the share of state and local government spending devoted to social services has grown the fastest, from 15 percent in 1967 to 25 percent in 1990. "Social services" refers to the Census Bureau's spending category that includes social services, income maintenance and health services. Shares devoted to such core areas as highways and education have declined.

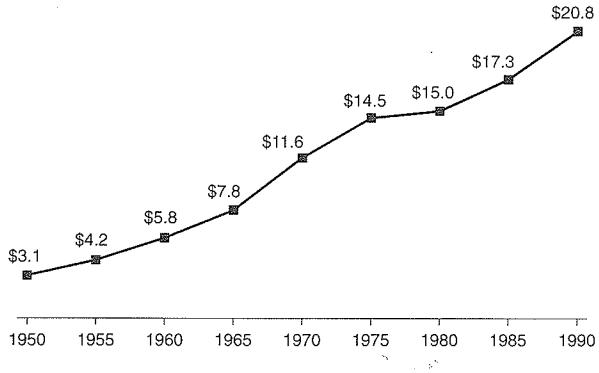
Sluggish Gains in Total Personal Income
Percent Increase — Five-Year Average



Notes: Each bar represents a five-year annual average for growth in personal income beginning with the stated year. The figures for 1995 and 2000 are projections.

Sources: U.S. Census Bureau and Minnesota State Demographer

State and Local Government Spending Climbs
In Billions of Dollars



Notes: All figures have been adjusted for inflation to 1993 dollars. Data from 1950 to 1960 is from the Minnesota Public Examiner and that from 1965 on is from the U.S. Census Bureau.

Sources: Minnesota Public Examiner, Office of the State Auditor and U.S. Census Bureau

On a per capita basis, spending for social services escalated 218 percent or $825 between 1967 and 1990.

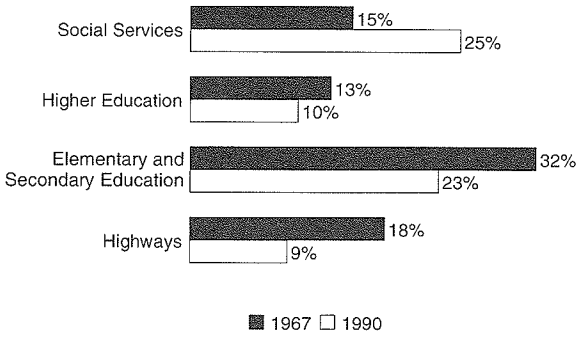
This shift toward social services spending was driven by demographic changes beyond Minnesota's control, along with broadened eligibility for services. The single most critical factor determining the cost of many health and income maintenance programs is the number of people who, by virtue of income, age or other characteristics, are eligible for assistance. Eligibility for these services is an "entitlement," meaning that anyone who is eligible is entitled to the assistance. Limiting eligibility to control spending becomes politically difficult.

The question of how to deal with rising entitlement costs is being debated nationally. Without commensurate growth in revenues, rising entitlement costs will consume an ever-increasing share of public spending.

Health, education and income maintenance now consume the most

Education, health, hospitals and income maintenance programs accounted for nearly 60 percent of all general expenditures by Minnesota state and local governments in 1990.

Budget Share Changes in Four Major Categories
Percent of Total Spending



Adjusted for inflation to 1993 dollars, total state and local spending in 1967 was $9 billion, and in 1990, it reached $20.8 billion.

Note: The social services category includes health services and income maintenance.

Source: U.S. Census Bureau

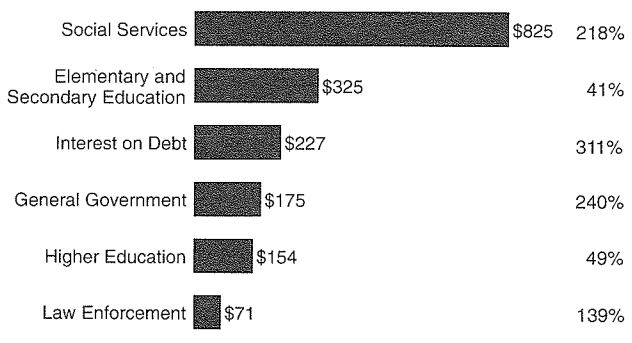
Some of the most highly visible services provided by government accounted for relatively small portions of total spending. Law enforcement, corrections and court-related services made up about 6 percent of state and local spending. All transportation spending, including streets and highways, consumed 10 percent of the total.

General government expenses, including financial administration and public buildings, claimed only 4 percent of total spending. Interest on debt made up 6 percent of the total.

Most social services spending is for health

The social services category includes a broad range of services aimed primarily at helping financially needy people, including elderly people with limited incomes. More than 70 percent of government expenditures in this category were related to health. Most went to health care providers, such as nursing homes, to purchase care for people with limited incomes. In 1990, Minnesota's state and local governments spent $1.8 billion for such services, mostly through the Medical Assistance program. About half of this amount was paid from federal grants. Minnesota ranks eighth highest nationally in per capita cash assistance payments to individuals and fourth highest in per capita payments to medical vendors.

Spending for Six Fastest Growing Areas
Change per Capita — 1967 to 1990



Total state and local spending per capita increased $2,289 between 1967 and 1990.

Notes: All figures have been adjusted for inflation. General government includes general and financial administration, government buildings and the judiciary.

Source: U.S. Census Bureau

Publicly owned hospitals and health facilities cost another $1.5 billion. Other public health and environmental health services accounted for $513 million of the total.

By comparison, cash assistance to individuals, at $614 million, was only 11 percent of the larger social services category. The largest cash assistance programs are Aid to Families with Dependent Children, General Assistance and Minnesota Supplemental Aid for people with disabilities. Federal grants cover more than half of AFDC expenditures.

Cash payments to individuals, commonly referred to as welfare payments, were less than 3 percent of total state and local general expenditures.

Action is needed now

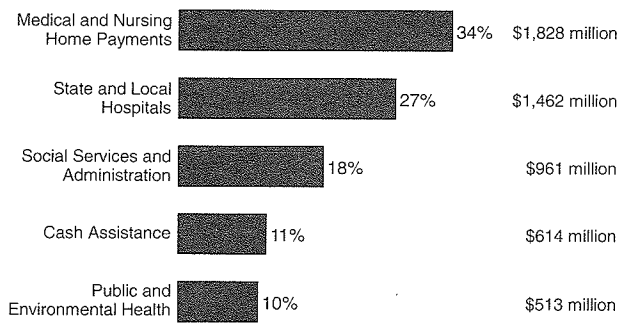
If there is a time to solve the state's fiscal problems, it is now. The economy has been strong. The percentage of Minnesotans of working age is still growing and will reach an all-time high in 2010, before beginning a long-term decline. Over the next 15 years, the combined proportion of children and elderly — the age groups most dependent on support from others — will be less than at any time since 1950. From now to the year 2010, the state will have a maximum percentage of people in their peak earning years. After 2010, solutions will be more difficult, as the percentage of Minnesotans of working age begins to decline.

Closing the gap might not seem so painful if a cut could be taken from every state and local program across the board. However, the problem is not that simple to solve. Some large programs, such as Medical Assistance, cannot be easily cut because certain basic services are required by the federal government. In other cases, taxes are dedicated to particular programs, such as highways, and cannot be used for other purposes.

Unless these spending restrictions are changed, a disproportionate share of cuts might have to be made in other programs — such as education, snowplowing, police and fire protection, natural resource management and parks. Unless Minnesota steps back from current spending commitments or finds radically different and cheaper ways of providing public services, less money will be available for basic services, such as public safety, education and transportation.

The state's 30-year plan, *Minnesota Milestones: A Report Card for the Future,* describes the people's priorities and can be used to make the tough budget choices ahead. Created with the help of more than 10,000 Minnesotans, *Minnesota Milestones* defines a shared vision for the future of the state and offers 20 goals with 79 milestones or ways to measure progress over time. It is a tool to help create the kind of future wanted by Minnesotans for themselves and their children.

Social Services Spending in 1990

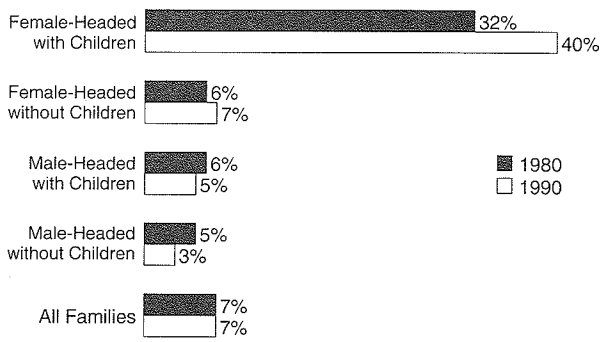


$5.4 billion was spent on health, income maintenance and social services in 1990.

Notes: Figures include expenditures paid with federal revenues. Cash assistance includes Aid to Families with Dependent Children, General Assistance and Minnesota Supplemental Aid.

Source: U.S. Census Bureau

Minnesota Families Living in Poverty



The 1990 federal poverty line for a family of four was $14,775 in 1993 dollars.

Source: U.S. Census Bureau

Forces Driving Spending

Social, economic and political forces drive government spending and cause it to change substantially over time. *Within Our Means* analyzes the influences on past spending and what is likely to affect future spending in seven major areas: elementary and secondary education; health, including Medical Assistance to needy people; higher education; transportation; criminal justice; environment; and local government.

Five key drivers of government spending emerged from this analysis:

- Changing population characteristics
- Eligibility and level of service
- Standards, regulations and mandates
- Costs of labor, materials and other inputs
- Mounting infrastructure needs

In this chapter, these drivers are discussed in terms of their effects in one or more of the seven spending areas.

While forces drive the demand for services, citizens' attitudes and expectations ultimately determine public spending choices. In addition, inflexible and outmoded methods can significantly inhibit cost-saving change in government.

Changing population characteristics

Minnesota's population and its changing characteristics are the most powerful forces driving both revenues and spending and contributing to the $2.5 billion fiscal gap. More people — more students to educate, more traffic on roadways, more elderly people needing long-term nursing home care — give rise to spending increases.

Changes in household characteristics, especially in income, significantly affect spending. Where Minnesotans choose to live also influences government budgets. The state's population is shifting from rural and central-city areas to suburbs and other growth centers. Population shifts affect local government budgets for roads, sewers, water facilities and other basic public services. In the Twin Cities and other growing areas, development continues to jump beyond communities with basic public services to more rural areas where services must be added. Old roads, sewers, public buildings and schools are underused as new ones are constructed.

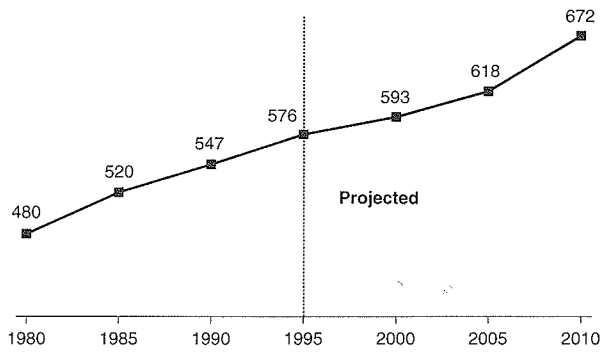
Aging population exerts pressure on health spending

Minnesota spent $947 million to provide medical care for low-income people through Medical Assistance in 1993, 64 percent of the state's total health spending. Of this amount, nearly half — 46 percent — was spent on people age 65 and older.

Between 1980 and 1993, Minnesota's population age 65 and older rose by 14 percent, or 70,000 people. This age group is projected to increase by another 348,000 by 2020. The number of elderly people enrolled in Medical Assistance is expected to go up 17 percent from 46,000 in 1993 to 54,000 in 1999. At the same time, state and federal Medical Assistance spending for this age group is estimated to grow by almost half, from $838 million to $1.2 billion.

The likelihood of living in a nursing home and receiving Medical Assistance increases with age. In 1993, more than 25 out of every 1,000 Minnesotans age 65 to 84 years and more than 190 out of every 1,000 age 85 and over lived in a nursing home and received Medical Assistance. Assuming these institutionalization rates continue, nearly 5,000 more elderly people will need nursing home care paid for by Medical Assistance in 2000 than in 1990.

Population Age 65 and Older
in Thousands



Source: Minnesota State Demographer

More elementary and secondary students drive up costs

The number of students in public elementary and secondary schools has grown by more than 120,000, from a low point at the end of the baby bust in 1985 to an estimated 817,000 in the current school year. Enrollment is projected to rise an additional 50,000 by 2001. This additional growth will cost $320 million per year by 2001 in state, local and federal funds, as well as parent fees, using the 1993 spending rate of $6,353 per student. General education formula funding will cover $210 million of the total at the current per pupil rate of $3,150.

Pressure to accommodate more students is concentrated in the Twin Cities. The Minnesota Department of Education expects the seven metropolitan counties to gain 54,000 students from 1995 to 2001, while the state's other counties may lose 4,000. Half of all growth from 1993 to 1999 is anticipated to occur in only 10 of the state's 379 school districts. The continuing decline in rural enrollment drives up the per student cost of educating children who remain in schools with excess capacity, as the Legislative Auditor found in the late 1980s.

Poverty, family changes stimulate education programs, spending

Increases in child poverty, single-parent and two-parent working families, and limited-English-speaking students have stimulated demand for more education spending and new programs. State funding formulas provide extra aid to school districts with concentrations of low-income students. State aid to school districts with concentrations of AFDC students is projected to grow from $84 million in 1993 to $129 million in 1997.

Over the 10-year period ending in 1993, spending for early childhood family education climbed from $2 million to $37 million and for adult and family literacy from $3 million to $21 million. Additional dollars went to drug prevention, AIDS prevention, limited-English programs, desegregation and multicultural initiatives. Parent fees and federal funds provided some of the revenue.

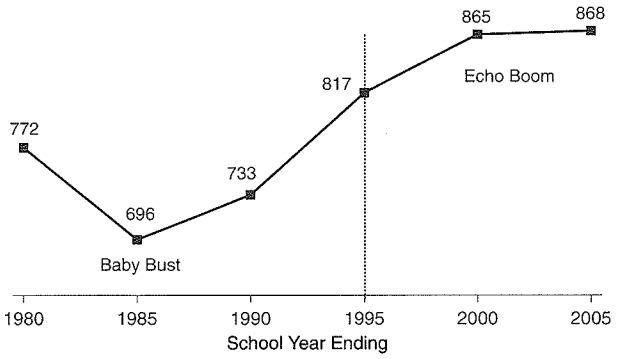
Justice costs will go up with rise in youth population

Minnesota's justice price tag climbed past $1 billion in 1990, a $225 million increase above 1984. The justice system includes law enforcement, court-related services and corrections. This spending trend is expected to escalate with the increase in the number of 10- to 24-year-olds, those most likely to be arrested. While this age group accounted for only 21 percent of Minnesota's population in 1990, it was 52 percent of people arrested for violent crimes and 57 percent of all arrests. The size of this group is expected to peak in 2005.

Pressures rise on highway and transit systems

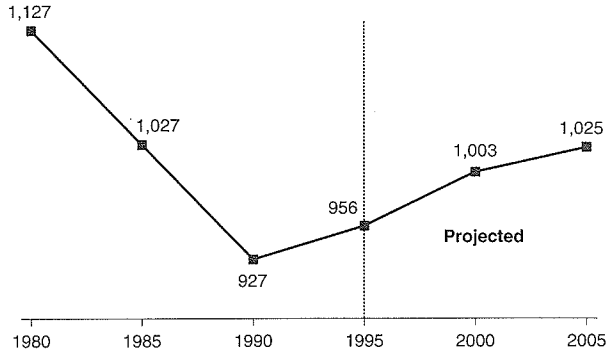
The volume of travel on Minnesota's highways has increased much faster than population. From 1970 to 1990, the Twin Cities population increased

Growing School Enrollment
Prekindergarten to 12th Grade in Thousands



Note: Data is projected for 1995 to 2005.
Source: Minnesota Department of Education

Number of Youth Age 10 to 24 Rising
in Thousands



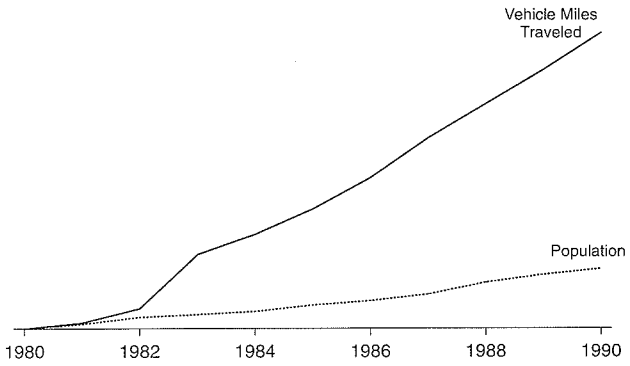
Note: Annual populations are based on the 1980 and 1990 census. The 1995, 2000, and 2005 population projections are estimates.
Source: Minnesota State Demographer

by 22 percent, while the vehicle-miles traveled increased 130 percent. Fewer people are using public transit or car pools. The resulting congestion will worsen as the population increases and concentrates in the state's metropolitan regions, accelerating demand for relief from gridlock.

The needs of people with disabilities and an increasing elderly population are stimulating demand for alternatives to the automobile. Metro Mobility, the Twin Cities system for providing transit service to people with restricted mobility, grew from giving 372,000 rides in 1980 to 1.1 million in 1993. Over the same period, total program costs rose from $3.7 million to $16 million. Metro Mobility ridership is expected to continue to rise as the number of elderly people increases. But many people with disabilities do not qualify for Metro Mobility, and federal and state laws require that transit systems be made accessible to all. Further costs are being incurred to meet this requirement and modify regular-route buses to accommodate disabled and elderly passengers.

Demands will be great outside the Twin Cities as well if people remain in rural areas and small towns as they age. A 1991 Minnesota Department of Transportation survey found that elderly people and people with disabilities accounted for more than 70 percent of transit riders in rural and small urban areas. Service-on-call systems in rural areas had a 53 percent increase in ridership from 1987 to 1992 and operating costs of $7 million in 1993. However, 19 counties outside the Twin Cities area have no transit service; six of these are projected to have elderly populations of more than 20 percent by 2010. Another 22 counties have service only in one or two cities. Current vehicle replacement needs for existing systems exceed $4 million per year, just to maintain 1992 service levels.

Traffic Increased Faster Than Population
Percent Increase Since 1980



Between 1980 and 1990, the number of vehicle miles traveled increased 36 percent, while population rose 7 percent in Minnesota.

Source: Minnesota Department of Transportation

Eligibility and level of service provided

The kinds of services available and criteria for eligibility are two great determinants of government spending. Changes in services and eligibility have caused tremendous spending increases for education and health care. Minnesota has enacted extensive policies aimed at ensuring health and nursing home care for elderly people, the sick, people with disabilities and low-income citizens.

Health care spending aims to ensure equal access

In 1993, 97 percent of state government health spending was for individuals with limited assets or low incomes who otherwise might not have access to health services. Service additions in recent years include the Children's Health Plan, MinnesotaCare, home care and expanded residential community care for elderly people and people with disabilities.

The number of people with disabilities receiving services has increased markedly. This growth is most apparent in the Medical Assistance program, where the number of enrollees with disabilities increased from 23,670 in 1980 to 49,874 in 1993.

In the late 1980s, total state and federal Medical Assistance dollars spent for people with disabilities surpassed the total spent for elderly people. By 1988, $472 million was spent on people with disabilities and $451 million for elderly people. However, this trend should reverse itself as the number of elderly people grows.

The increase was due to changes in eligibility and services, movement of people with disabilities from institutions to community care settings and changes in definitions. With few exceptions, such as cystic fibrosis and spina bifida, the increase does not reflect an actual increase in disabilities in the population.

Minnesota spends generously for the care of people with disabilities. In 1991, the state spent more than $14,000 per disabled person receiving services — the highest of all states and more than twice the national average.

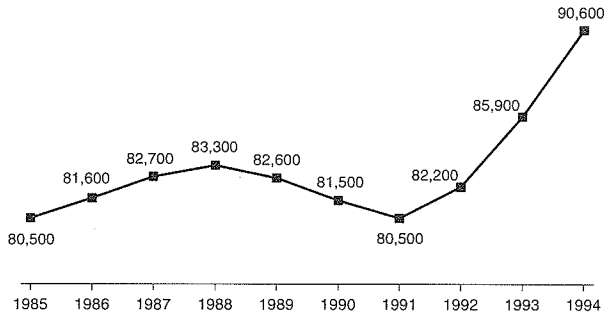
The total number of people enrolled in Medical Assistance increased by more than 190,000 from 1980 to 1993 — almost 15 times more than would be expected from the growth in the general population. At the same time, state spending for Medical Assistance more than doubled, from $449 million in 1980 to $947 million in 1993. Since 1988, the Legislature has expanded Medical Assistance eligibility on more than 10 occasions. Expansions included removing assets as a qualifying factor for all children under age 21 and for parents of Medical Assistance-eligible children, covering children's home-based mental health services and covering infants in families with incomes at or below 275 percent of the federal poverty level. In 1993, 275 percent of poverty for a family of four was $39,462.

Major spending increases are likely for veterans' care. The number of people in state veterans' homes could double within five years. Currently, 570 veterans are living in these homes. Veterans from World War II are entering their 70s and 80s, and the population of veterans age 85 and older is expected to more than triple by 2005 to 13,000. Based on current per capita rates, the $26 million now spent on veterans' homes could triple.

Special education costs are escalating

Special education spending from all sources increased 81 percent from 1982 through 1993, reaching $602 million. It was the fastest growing of the major program categories in education spending.

Special Education Enrollment Grew
Public and Private Schools



Special education students were 10 percent of the total enrollment in both 1985 and 1994.

Notes: Enrollment figures are based on the December 1 child count in school years ending in 1985 through 1994 and include students from birth to age 21.

Source: Minnesota Department of Education

In 1994, special education served 91,000 Minnesota children with a wide variety of needs, including those with physical limitations and learning, emotional and mental disabilities. Special education provides extra funding for specialized learning settings, instructors, equipment and materials, and support services to help students with disabilities function in regular classrooms. Some children are placed in special schools. Federal law obligates school districts to provide "free and appropriate education" in the "least restrictive environment."

National research has shown that educating children with disabilities on average costs 2.3 times the rate of other children. About 95 percent of special education is paid with state or local funds.

If spending increases for special education continue at the recent annual rate of about 7 percent, the total special education bill will reach $1 billion in the year 2001. Between fiscal years 1982 and 1993, more than 46 percent of the increase in special education spending was for children classified as emotionally disturbed or learning disabled.

Changes in public attitudes and federal and state policy over the last 20 years are major forces driving special education spending. Beginning in 1973, a series of federal laws was created that require public education to be provided to people with disabilities from birth to age 22. Under the new laws, schools must teach children with disabilities in regular classrooms whenever possible, and buildings must be made accessible. Before 1975, hundreds of children with special needs were in state institutions or at home, receiving little or no education.

More people, age groups are participating in education

The share of Minnesota's population completing high school and participating in postsecondary education is much higher today than it was 40 years ago. The percent of the population age 5 to 17 enrolled in school rose from almost 78 percent in 1950 to nearly 94 percent in 1990, while the percent of the population with at least some postsecondary education went from slightly more than 14 percent to nearly 50 percent.

Education systems have grown from public schools for grades one to 12 to include life-long services. In 1993, $1 billion from the state general fund was spent on higher education. More students, including working and unemployed adults of all ages, are attending college or adult education pro-

grams with public support. Services also have expanded to cover preschoolers.

Standards, regulations and mandates

Large numbers of standards and regulations set by the federal and state governments are driving spending for public services. These mandates cost state and local governments, as well as individuals. Sometimes, the costs of standards imposed by one jurisdiction end up being borne by another. A U.S. Conference of Mayors survey found, for example, that underfunded federal mandates cost St. Paul $20 million and Brooklyn Park $1 million in 1993.

Minnesota often has pioneered legislation setting standards higher and broader than other states in such areas as environmental regulation, long-term care, child care licensing and roads. The costs of these high standards also contribute to the spending gap. For example, Minnesota highway standards can increase project costs anywhere from one-half of 1 percent to 5 percent.

Graduation standards could lead to more spending

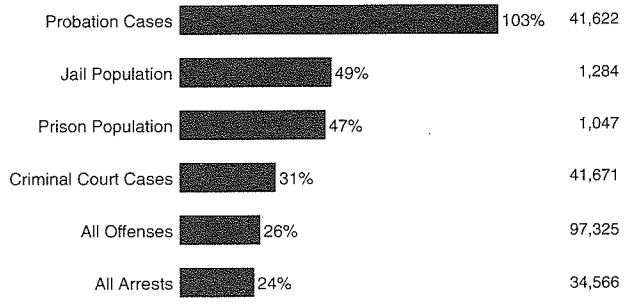
Cost implications of the state's proposed high school graduation standards will be outlined by the Minnesota Department of Education in a study to be released in March 1995. Competency standards for reading and math are expected in 1996. While such standards should make possible the elimination of many rules governing how schools operate and are organized, they could lead to more costs if they are introduced without eliminating rules and reorganizing schools. Additional costs might include programs to bring marginal students up to proficiency, assessment systems to measure student competence and training necessary to implement the new standards.

More law enforcement and tougher sentences add to bill

During the last decade, policy-makers created new criminal offenses and lengthened sentences, causing dramatic increases in justice system workloads. More arrests and cases prosecuted, compounded with longer sentences, have swelled the number of offenders on probation and in jails and prisons. Justice system spending climbed $225 million between 1984 and 1990.

Among the policy changes behind this spending growth were the 1989 laws doubling sentences for some of the most serious crimes and the expansion of drug offenses. Defendants incarcerated under these laws are not eligible for probation, parole, discharge or supervised release until they have served the minimum sentence ranging from six months to 30 years. Between 1990 and 1994, penalties also increased for driving while impaired, sexual assault, substance abuse, domestic abuse, firearm offenses, murder and arson. The full impact of these and other changes will not be felt until the next century.

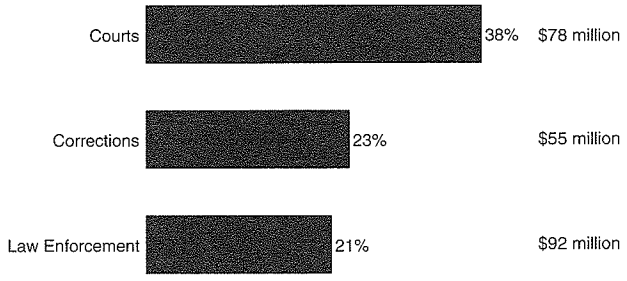
Justice Workload Growth
Percent and Actual Change — 1985 to 1991



Notes: Criminal court cases include all felonies, gross misdemeanors and nontraffic misdemeanors but not juvenile cases. All probation cases were as of December 31. Adult and juvenile jail populations are a daily average, while adult prison population is a yearly average.

Sources: Minnesota Department of Public Safety, Minnesota Supreme Court, Minnesota Department of Corrections

Justice Spending Increases
Percent and Actual Change — 1984 to 1990



Note: Courts spending includes the costs of both civil and criminal cases.

Source: U.S. Census Bureau

Judges have ordered more offenders to comply with the conditions of probation, such as completion of education or treatment programs, community service and victim restitution. Tougher sentencing options for juvenile offenders starting in 1995 will increase state and local costs for public defense and detention facilities.

Clean water costs rise for local and state governments

Minnesota cities spent $679 million on existing sewer and water utilities in 1992. The costs of meeting federal standards and requirements, however, continue to rise. Federal laws, for example, require the monitoring of more than 80 contaminants in public drinking-water supplies. A recent Minnesota Pollution Control Agency questionnaire completed by 543 cities identified more than $338 million worth of wastewater treatment needs over the next five years. The price tag for other water pollution control efforts could be high as well. Over the past five years, about $11 million in state money has been spent on agricultural and other land use pollution problems in the Minnesota River basin alone. Federal agencies, local governments and conservation groups have contributed additional funds.

Costs of labor, materials and other inputs

Two important components of government spending are the cost of labor and capital investments. Hence, spending is easily affected by changes in salaries, benefits and costs of materials. This is especially true for government administration, education and health care services. Total state and local government spending for salaries, wages and benefits was $8.5 billion in 1992.

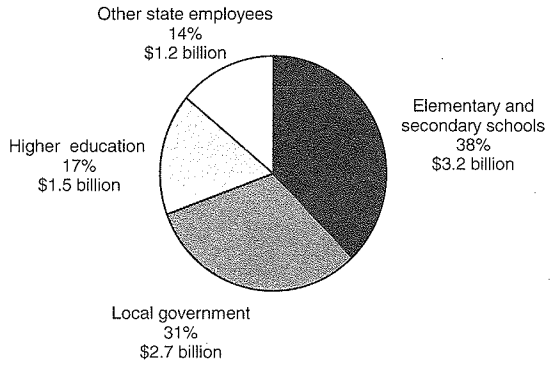
Payroll costs make up large share of government spending

Payroll costs made up 40 percent of all state and local government spending in 1991: 58 percent for school districts, 31 percent for counties, 32 percent for cities and 36 percent for the state. Payroll's share of total spending actually declined slightly between 1980 and 1991 for all jurisdictions but the state.

Payroll includes salaries, wages, fees, commissions and bonuses paid to employees but not benefits. Benefits, such as employer contributions to Social Security, health insurance and retirement, account for about 20 percent of total payroll and benefits. This does not include benefits associated with sick leave, vacation or worker's compensation.

Because salaries, wages and benefits account for such a large amount of government spending, small incremental changes can have significant financial impact over time. Adjusted for inflation, per capita public payrolls grew by 16 percent between 1980 and 1991. If the trend continues during the next 11 years, it would result in average annual increases of more than 1 percent. While this rate may seem small, the cumulative effect would be an increase in total payroll and benefits by 2005 of

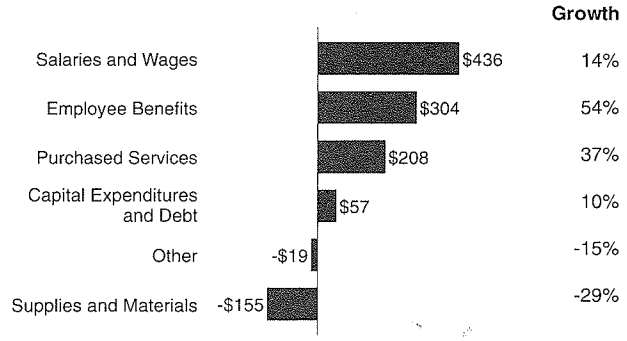
Public Employee Payroll and Benefits in 1992



Note: Benefits include employer contributions to Social Security, retirement funds and health insurance.

Source: Minnesota Department of Finance

Spending Changes per Elementary and Secondary Student by Budget Category — 1981 to 1993



Notes: Includes Social Security and teacher retirement for all years. Excludes construction fund. All figures have been adjusted for inflation to 1993 dollars.

Source: Minnesota Department of Education

about $1.4 billion, even after adjusting for inflation and population growth.

This assumes that benefits will grow at the same rate as payroll. Benefits actually grew faster than payrolls between 1980 and 1991.

Rising labor costs reflect salary increases, more expensive fringe benefits or more government employees. Labor agreements that contain salary and benefit increases above the rate of inflation and mandates for government services would contribute to growing labor costs.

Public employee salaries vary across jurisdictions

Almost 7 percent, or 17,000, of all public employees in Minnesota earned $50,000 or more a year in 1992. Ten percent of state employees earn more than $50,000. Five percent of county and 4 percent of school and city employees also fall in this group.

Some jurisdictions in 1994 had a higher percentage of their employees earning more than $50,000 a year than did the state. Matching or exceeding the state's 10 percent were Minnesota's two largest counties and cities: Hennepin County and Minneapolis, with almost 10 percent each, and Ramsey County and St. Paul, with nearly 12 percent each. About 8 percent of Rochester's workers made more than $50,000 in 1994.

This pattern also held for the number of employees earning more than $78,500, the top pay for state agency heads. In Minneapolis, St. Paul and Hennepin and Ramsey counties, the division directors, typically the next level below department heads, make about the same as state agency heads. Salaries of the top positions in these local governments exceed the salaries paid to state agency heads.

Though the pay for some top public-sector jobs may seem high, a 1991 State Auditor's study found that salaries for government's top managers were significantly less than those of their private-sector counterparts. This may be due in part to a salary cap enacted by the Legislature in 1983 that limits local government salaries to 95 percent of the Governor's salary; the cap in 1993 was $103,600.

The auditor's study also found that public employees in nonprofessional jobs paying less than $50,000 per year generally earned more than private-sector workers. Professional and middle management jobs paying more than $50,000 were about the same in both sectors.

Medical goods and services costs rise faster than others

Adding to government's growing bill for health care is the rise in the cost of medical goods and services. The medical consumer price index increased at twice the pace of the consumer price index from 1980 to 1990 — up by more than 117 percent, compared to almost 59 percent. Up to 80 percent of state government health spending is for medical goods and services.

The Minnesota Health Care Commission addressed this rapid cost increase by setting annual growth limits, beginning in 1994, for private and public spending on health care services. With legislative authority, the state monitors changes in fees charged by health care providers and premiums negotiated by employers and other payers. The state has the authority to enforce limits beginning in 1996.

Additional measures require pharmacists to substitute lower-cost generic drugs where appropriate, require review of certain new medical technologies, encourage competition and reduce administrative costs.

These actions are expected to lower the rate of growth by at least 10 percent annually. In 1993, for example, $309 million of the state's spending on Medical Assistance went for medical goods and services, including hospitals, prescribed drugs, phy-

1994 Salary Comparisons by Selected Jurisdictions

	Number of Employees	Earning More Than $50,000	Percent of Total	Earning More Than $78,500					Percent of Total
				Attorneys	Doctors	Higher Ed	Other	Total	
St. Paul	3,500	418	11.9%	11	0	0	32	43	1.2
Minneapolis	4,355	431	9.9%	15	0	0	16	31	0.7
Rochester	1,000	79	7.9%	0	0	0	3	3	0.3
Hennepin County	12,103	1,184	9.8%	41	11	0	49	101	0.8
Ramsey County	3,600	417	11.6%	16	0	0	18	34	0.9
State	42,043	3,978	9.5%	11	88	81	20	200	0.5

Note: "Other" includes department heads, assistant department heads, division directors and some top-level professional positions, such as engineers.

Source: Minnesota Department of Employee Relations

sicians, medical providers, ambulance service, lab and x-ray services, and medical supplies. Reducing the inflation rate of these costs by just 1 percent would save $3 million a year.

Benefit costs push up education's labor bill

Employee benefit costs in public schools rose from 10 percent to 14 percent of total spending from 1981 to 1993. Per student, the cost of employee benefits grew 54 percent, while salary costs went up 14 percent.

Increases in health insurance costs and in required employer Social Security contributions were the major causes of these gains. Medical and dental benefit costs increased 58 percent from 1987 to 1993, surging past retirement and Social Security to become the largest benefit expenditure for schools. In 1993, medical and dental benefits cost schools $215 million, while retirement cost $203 million and Social Security $195 million.

Schools have begun only recently to take advantage of managed care and pooled purchasing of health coverage.

Education technology needs are growing

To prepare students properly for the future, experts now suggest that schools should have one computer for every one to six students. In 1993, Minnesota's public schools had one for every 12 students, or about 70,000 computers. About three-quarters of these are outdated.

At current enrollment, the cost to provide a computer workstation for every student could reach $1.5 billion. The bill to furnish one workstation for every six students would be $230 million. Costs could be two to three times higher, however, when training, support, maintenance, software and connections to internal and external information sources are included. The new School for Environmental Studies in Apple Valley will be the first school in Minnesota to have a workstation for each student.

For Minnesota's public colleges and universities, technology investments also will be necessary simply to remain competitive with private colleges and schools in other states.

Selected Top Governmental Salaries As of December 1994

St. Paul

Attorney	$91,225
Chief accountant	88,627
Associate city engineer	88,627
Superintendent of parks and recreation	86,106
Library administrator	86,105
Mayor	77,947

Minneapolis

City coordinator	$96,257
City attorney	89,497
Assistant director, Public Works	86,861
Finance officer	85,712
Director, Human Resources	83,912
Mayor	71,879

Rochester

General manager, Utilities	$94,197
City administrator	91,046
Director, Public Works	81,000
Police chief	78,300
Director, Employee Relations	75,186
Mayor	25,626

Hennepin County

Physician (adult services)	$133,199
County administrator	103,596
Director, Community Corrections	97,392
Director, Public Works	97,392
Sheriff	93,612
Chair, county board	66,840

Ramsey County

County manager	$102,762
Director, Human Services	96,205
County attorney	93,321
Director, Taxation and Records Administration	90,240
Director, Community Corrections	87,012
Chair, county board	42,196

State

Medical director, state hospital	$156,892
Governor	109,056
Chancellor, Higher Education Board	103,607
State university president	103,600
Finance commissioner	78,509
Administration commissioner	67,505

Salaries for state department commissioners are typically lower than salaries for top administrative positions in large local government jurisdictions.

Note: Only the top paid position in a particular category was chosen. For example, even though several attorney or doctor positions may be paid more than any other position in another category, only one attorney or one doctor position was selected.

Source: Minnesota Department of Employee Relations

Mounting infrastructure needs

Many of the state's public roads, sewers, schools and other infrastructure systems will need major investments in the near future just to be maintained. In 1992, cities, counties and townships spent nearly $1.3 billion on capital expenditures, most of which went for infrastructure. Schools and interstate highways built during the 1950s and 1960s are aging and deteriorating.

Water supply and wastewater treatment systems, schools and highways must be upgraded to meet current standards and expanded to accommodate population growth and redistribution. Some facilities only require minor repairs; for others, years of deferred maintenance dictate the need for complete reconstruction.

School districts face crowding and aging buildings

Annual capital expenditures and debt payments on school construction and remodeling increased 10 percent per student from 1981 to 1993 and continue to make up 10 percent of total school spending. More students, aging buildings and numerous other factors will keep capital spending high through 2001. Minnesota's $10 billion worth of public school facilities are in better condition than those in many other states. Repair and maintenance needs are high, however. Schools deferred maintenance spending during the 1970s and 1980s. The Minnesota Department of Education estimated in 1993 that it would cost $1.5 billion to correct all deficiencies.

Schools spent $50 million in 1993 upgrading buildings to meet state fire and federal Occupational Safety and Health Administration requirements. New federal indoor air quality regulations may soon add more costs. Elevators, ramps and other accessibility features required by the federal Americans With Disabilities Act drew $32 million in property tax levies in 1994. ADA-related school spending is expected to total another $100 million by 1999.

Enhancing school programs for science, computers, special education and girls' athletics, increasing state standards for classroom square footage and wiring buildings for computer and telecommunications networks add to infrastructure needs. The Department of Education estimates that total spending through school bond issues will be $550 million per year for the next five years.

More offenders lead to need for more jails and prisons

More arrests, more convictions and longer sentences mean more inmates in Minnesota jails and prisons. Spending for the corrections system swelled by more than 20 percent between 1984 and 1990. The total bill in 1990, including the state prison system, local jails and probation, reached almost $296 million.

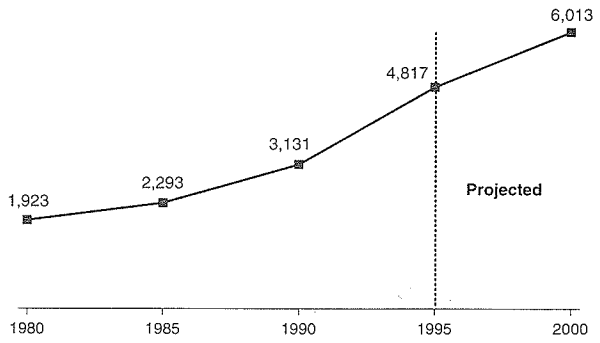
Based on the most recent prison population projections, the Department of Corrections anticipates a shortage of more than 380 beds by June 1997. Even after completion of an 800-bed facility in 1999, the state will be short about 340 beds in 2002. The new facility is expected to cost up to $100 million to build and about $30 million a year to operate. Converting regional treatment centers to prisons and expanding existing facilities will help hold down the cost of new space.

Local jail overcrowding has eased due to increasing statewide capacity, but some counties still do not have enough room. Hennepin County, for example, is planning a new jail with an additional 400 beds that is expected to cost about $160 million to build and $29 million to operate each year. Other counties also plan to build or expand jail space.

Aging roadways and congestion plague transportation systems

A recent study found that 35 percent of Minnesota's roads — typically designed to last 20 years — were more than 50 years old. The interstate system is 30 years old. More than 10 percent of the state's trunk highway system bridges over 20

Minnesota Adult Prison Population Climbs
Year-End Totals in Thousands



Note: Data does not include prisoners who are housed for other states.
Source: Minnesota Department of Corrections

feet long are deficient, and more than 20 percent of the system is restricted to less than 10 tons per axle in the spring. The Minnesota Department of Transportation says more than $28 billion will be needed to meet "full-service needs" for the next 20 years.

Investments in airports, highway and other transit systems further add to costs. In 1981, Minnesota had fewer miles of heavily congested roads than the national average. By 1992, it had more. More than 35 percent of its urban interstate and 40 percent of other urban freeways are heavily congested.

Extending transit services to 15 new counties per year to serve elderly people and people with disabilities would require an annual investment of $3.7 million. Annual service improvement needs, including increased security, for Twin Cities bus systems are estimated at $15.6 million. Minor capital improvement needs total $25 million. Costs of major transit projects are much higher — $682 million in capital costs and $18.3 million in annual costs for light rail in the central and south Interstate 35W corridors. A new Twin Cities airport could cost up to $4 billion.

Sewer and water needs require major government investments

From 1967 through the early 1990s, more than $1.2 billion in state and federal funds were granted to Minnesota communities for wastewater treatment projects needed to meet state and federal standards.

These grants have been replaced by loans. Current loan requests for such projects through the Minnesota Public Facilities Authority exceed $100 million. Requests for storm water project loans are estimated at $5 million to $10 million per year.

Debt and loan payments place greater financial burdens on communities than grants and can be particularly difficult to bear for communities with aging and dwindling populations. Of the 543 cities answering a recent Pollution Control Agency questionnaire, 151 identified a need for specific wastewater projects. The costs of these projects are more than these communities can reasonably be expected to afford.

Atwater's municipal wastewater needs are estimated at more than $2.5 million, for example, while its fiscal capacity is only $300,000. A 10-year, no-interest loan would require annual payments of $255,000 — nearly the equivalent of the city's current tax capacity. Issuing bonds to finance the improvement would further increase annual costs. Average per capita spending on interest for all cities, adjusted for inflation, increased 92 percent between 1970 and 1992, more than any other category of spending.

Making Tough Choices

Minnesota state and local governments must change the way they raise and spend money.

Taxpayer discontent already has forced government to scrutinize spending decisions. The 1994 Legislature passed a budgeting reform law designed to push governments to make spending decisions within the limits of what taxpayers are willing to spend. Often called the "price of government" law, it requires that each budget year, the Governor recommend the maximum percentage of personal income that should be collected over the next four years to pay for state and local government services. The Legislature must in turn adopt a targeted percentage of personal income to guide its expenditure and taxation decisions. The target must cover both tax revenues and revenues from fees.

If total government revenues and expenditures, as a percentage of personal income, are never allowed to rise, government spending can grow no faster than personal income. Government spending can grow faster only if the Governor and the Legislature agree to let taxes and fees rise to a higher percentage of personal income.

The need to choose

The growth in Minnesota state and local government spending will outpace the anticipated rise in personal income if current trends continue. Minnesota governments will have to aggressively restrain spending growth unless a larger share of taxpayers' income is devoted to public services.

Minnesotans already pay more taxes and fees than residents of most states. Excluding federal aid, Minnesota ranks sixth in the per capita amount of state and local revenue raised in 1990. Minnesota's revenue raising also is high compared to personal income. It ranks seventh in total state and locally raised revenues as a percentage of personal income.

The projected eight-year cumulative gap of $2.5 billion is equivalent to $1,000 for every working Minnesotan — $125 per worker per year. The gap is between 1 and 2 percent of total state and local government spending. However, much greater reductions than this will be necessary in some program areas because large parts of state and local government spending cannot be easily reduced under current federal and state laws.

No single program can supply the kind of savings needed. The $600 million gap expected for the biennium ending in 1999 is imposing when compared to current biennial state appropriations for several large programs:

- $200 million for the entire community college system
- $494 million for special education programs
- $303 million for Aid to Families with Dependent Children
- $277 million for operating correctional institutions

The causes of the expected cumulative gap are deep-seated and long-term. Good economic times in the short-term will not make it go away. Minnesota has a budget reserve fund to protect against cash-flow problems that has served its purpose well. According to the Department of Finance's November forecast, this reserve will be depleted by the biennium ending in fiscal year 1999.

Balancing goals and resolving issues

In responding to this looming gap, Minnesotans will have to decide how to balance a number of public policy goals and resolve some underlying issues, including:

Accountability — holding elected officials responsible for their taxing and spending decisions.

Equity — attempting to soften the effects of large economic disparities among individuals, households and communities.

Efficiency — producing services with minimum effort or use of resources.

Investment — incurring short-term expenses for long-term benefits.

Level of government — determining the level of government best suited to provide a service and make taxing and spending decisions.

Competitiveness — balancing taxes and services to maintain Minnesota's competitive edge.

Flexibility — designing governments and programs adaptable to a rapidly changing environment.

Options for bridging the gap

To bridge the gap, Minnesotans will have to make hard choices. Some specific options for closing the gap are outlined below. The list is not meant to be exhaustive and is not a set of recommendations. Instead, it illustrates possible directions Minnesotans could take.

Broadly, Minnesota's options include:

- Change types, levels and delivery of services
- Target eligibility for government services
- Redefine standards
- Control input costs and invest in technology
- Target government infrastructure investments

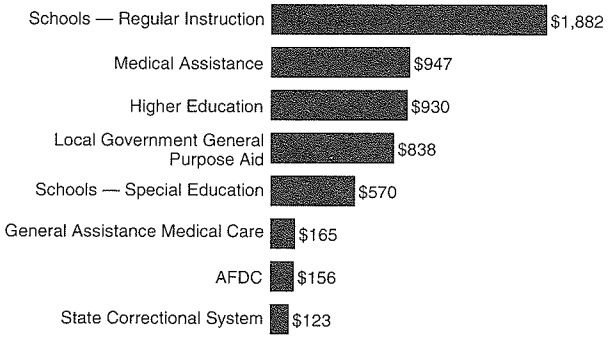
Each broad option for controlling spending includes specific examples. Under the option "target eligibility," examples include how money might be saved in health, elementary and secondary education, higher education and local government aid. The options are intended to spark debate and to generate more options and creative combinations.

Change types, levels and delivery of services

Government may not be able to afford to provide the same level of service or use the same methods it did five or 10 years ago if Minnesota expects to close the budget gap. Society is constantly changing, and government must adjust its mix of services and its ways of financing and delivering them to respond to these changes, just as successful businesses change their methods and offerings. Minnesota could:

- Reduce the types and numbers of services that government offers
- Provide financial assistance to citizens to choose their own services in lieu of funding expensive institutions, such as schools
- Limit state funding of local governments to specific priority functions, leaving remaining activities to local discretion or market forces

Comparison of Spending for Major Programs
State Funds in Millions in Fiscal Year 1993



Note: Spending for special education includes state and local funds; regular classroom instruction includes state, local and some federal funds.

Sources: Minnesota departments of Finance, Education and Human Services

Accelerate the use of alternative care for elderly people

In-home services can be much cheaper than institutional care. For example, the state's Medical Assistance costs for one nursing home patient average $10,753, compared to $3,240 for community-based care. Foster care, in-home services and other alternatives could meet the needs of some elderly people now living in nursing homes. In 1994, an estimated 17 percent of nursing home residents receiving Medical Assistance were capable of functioning in a setting other than a nursing home. Savings generated by accelerating the use of alternative care are estimated at $50 million over five years.

Drawbacks include limited availability of alternative care services and affordable and adequate housing for elderly people. Investments in these services and housing might be necessary. Also, people who would not want nursing-home services might seek alternative care, thus increasing the number of people served and pushing up overall costs.

Emphasize prevention and alternatives to incarceration

Preventing only five individuals from committing crimes that would send them to prison for 30 years would save nearly $4 million in prison costs — the amount appropriated by the 1992 Legislature to establish two of several crime and violence prevention programs. Keeping youth in school, reducing drug and alcohol abuse and creating jobs will go a long way in reducing crime and, ultimately, justice costs.

Using alternatives to prison for nonviolent offenders reduces prison needs and costs. These alternatives include electronic monitoring, community supervision, fines and restitution to victims. Such programs as Sentencing to Service put non-

violent offenders to work on community projects, saving both jail and labor costs while enhancing communities. Anoka County's program for repeat driving-while-impaired offenders sends offenders to jail but also requires them to deal with their substance abuse, perform community service and pay part of the program's cost. These alternatives are not only less expensive but also reinforce offenders' ties to the community.

Focus on cost-effective prevention programs

Spending on prevention often saves money in the long run by avoiding the need for more expensive treatments. A Harvard Center for Risk Analysis study shows that some prevention efforts are more cost-effective than others, while some, such as prenatal care, save more money than they cost. The cost of saving one year of life through influenza vaccinations, for example, is $141, compared with $470 by reducing emissions from coal-fired power plants. In comparison, the cost of saving one year of life by widening shoulders on rural roads to five feet from two is $125,000. Other preventive measures are enormously expensive, such as the $49 million it would cost for one year of life saved by banning asbestos in sealant tape.

Replace general purpose aid with funding for core services

In fiscal year 1994, state government spent $969 million on general purpose aid to local governments. However, it is unclear what results were achieved with this money. In the future, state government should define its core activities with measurable outcomes and focus funding accordingly. For those services that are not core to state government activities and therefore not funded, local governments could choose to raise taxes to pay for them.

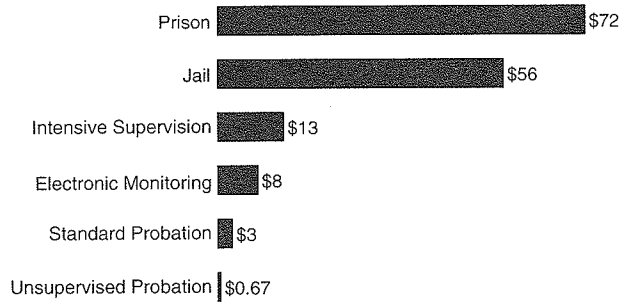
If revenues were raised at the same level of government at which they are spent, local officials would be more accountable for their actions. Equity would be maintained by ensuring that all residents receive a certain level of basic services.

Target eligibility for government services

Expanded eligibility and participation are two factors behind increased spending for public schools, higher education, health, nursing-home care and other programs. Much public support is targeted to low-income Minnesotans. But some is spread among citizens of all income levels. Thousands of middle-class citizens are taking advantage of higher education aid and subsidies, and early childhood and community education programs. Many are receiving medical assistance payments for elderly parents and catastrophic medical bills. Irrespective of need, most property tax relief is given broadly to all local governments and individuals through local government aid and homestead and agriculture credits.

Limiting eligibility is one approach to containing costs. However, some universal programs are more

Estimated Daily Cost per Person of Alternative Sentences



Sources: Minnesota Department of Corrections and Sentencing Guidelines Commission

Estimated Cost to Save One Year of Life

Influenza vaccination for all citizens	$141
Pneumonia vaccination for people age 65 and older	$2,236
Mammography every three years for women age 50 to 65	$2,706
Chlorination of drinking water	$3,082
Staff school buses with adult monitors	$4,878,228

Note: Cost per year of life saved is determined by dividing the cost of an intervention by the average number of years saved when death is averted.

Source: Harvard Center for Risk Analysis

cost-effective than targeting aid. For example, universal vision and hearing screening of children can prevent big, expensive problems later on. In considering the options, Minnesotans must ask who should be eligible for direct government assistance and indirect subsidies.

Promote personal responsibility for nursing home costs

The percentage of nursing home beds paid for by the state through Medical Assistance has been increasing as private-paying residents have been decreasing. The growth in the state's share of these costs from 1989 to 1992 raised the state's bill for nursing home care by more than $31 million. About 36 percent of nursing home residents paid their own way in 1988 compared to 29 percent in 1992. If the proportion of private-paying residents remained the same in 1992 as 1988, the state would have spent an estimated $16 million less for nursing home care in 1992.

Options for promoting personal responsibility for nursing home costs include requiring or encouraging long-term care insurance. Some states have considered providing tax deductions for premiums to encourage individuals to purchase policies. Long-term care insurance, however, is often not available to people age 85 and older, who tend to have the greatest need for this care.

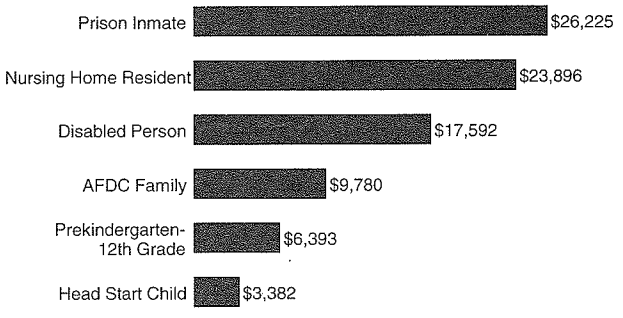
Another option is to tighten controls on asset transfers and boost their enforcement. Financial planners often advise elderly people to transfer assets to their heirs before they need nursing home care, thus avoiding the requirement to spend down their resources before becoming eligible for Medical Assistance. As a result of legislation passed in 1993, the state will not cover nursing home costs if assets have been transferred within 30 months for direct transfers and 60 months for transfers in trusts. While data on the expected savings from this legislation is not available, increasing the number of private payers by a mere 100 would cut more than $1 million from the state's annual $320 million bill for nursing home care.

Tie funding of special education to measurable outcomes

Minnesota has made a major commitment to fostering the development of children with disabilities and preschool children. Investments in preschool, special education, Head Start and other efforts have been significant. Spending on special education alone was $602 million in 1993. State government and local school districts provide 95 percent of this funding. However, little evaluation has been made of the effectiveness of these programs in improving children's self-sufficiency, learning and work force readiness. The state could tie funding for programs to measurable outcomes and results as a way of controlling spending. State government also could change state laws and request federal waivers to permit flexibility in addressing needs of children.

Beginning in fiscal year 1997, if the annual growth rate of special education spending were reduced from the recent rate of about 4 percent above inflation to 2 percent above inflation, an estimated $15 million could be saved in 1997, increasing to $76 million saved in 2001.

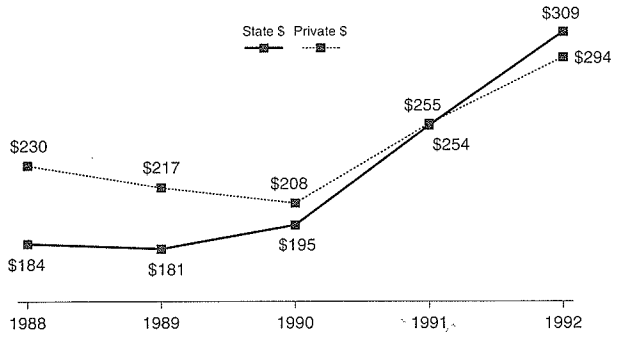
Comparison of Annual Spending
State, Local and Federal Revenues in Fiscal Year 1993



Notes: Annual per person spending for nursing homes and disabled people represents Medical Assistance costs. The AFDC figure includes Medical Assistance.

Sources: Minnesota departments of Corrections, Human Services, Health and Education

Private and State Payments for Nursing Homes in Millions



Note: Federal dollars not included.

Source: Minnesota Department of Human Services

To contain rapid increases in special education spending, options might include:

- Defining legislatively "appropriate education" for students with various disabilities
- Requiring outside assessment and classification of students
- Having parents or nonschool sources pay for noneducational support services

Increase students' share of higher education costs

Minnesota could reduce higher education spending by either raising tuition or lowering the income level above which students become ineligible for state financial assistance. Raising tuition would raise the student share of higher education costs. Making financial aid available only to lower-income students would raise costs for higher-income students. Targeting aid more heavily to lower-income students is consistent with recommendations recently adopted by the Higher Education Coordinating Board. Public costs also might be reduced by limiting the number of terms students can receive aid or raising tuition for such programs as applied graduate degrees. In 1994, the University of Minnesota estimated savings of $9.4 million per year by eliminating subsidies for applied graduate programs.

Tuition and fees for a liberal arts freshman at the University of Minnesota increased nearly 45 percent from 1982 to 1994. However, costs still remain below those of many comparable institutions in other states and significantly below those of private institutions. If the university raised its resident tuition of $3,391 by nearly one-third to match Michigan State's $4,470, students would pay about $30 million more of the cost, assuming an undergraduate student population of 32,400. However, if fewer students can afford postsecondary education, Minnesota will have a less educated populace.

Big 10 Universities
Undergraduate Annual Tuition and Fees for 1993 Residents

Michigan	$5,119	Indiana	$2,988
Penn State	4,822	Ohio State	2,940
Michigan State	4,470	Purdue	2,696
Illinois	3,506	Wisconsin	2,540
Minnesota	**3,391**	Iowa	2,352

The average tuition for private colleges in Minnesota was $12,919 in 1993.

Source: University of Missouri and Minnesota Higher Education Coordinating Board

Tie local aid to financial need and revenue-raising capacity

Tying homestead, agricultural and other general-purpose state aid to financial need would be more equitable and efficient than the current aid system, because it would base aid on ability to pay. It could lead, however, to increases in property taxes and local fees, if communities decide to provide more service.

Redefine standards

Many local and state government services are controlled by standards and regulations. Some come with funding, some do not. Some are mandatory, some voluntary. Most regulate processes rather than goals to be achieved.

Some services are tied to dedicated revenues and restrict government's ability to shift funds to more important needs. For example, part of automobile and gasoline taxes are dedicated to state, county and city roads, and the funds cannot be used for any other transit need.

Federal mandates also dictate spending by state and local governments. Such mandates too often are unfunded, inflexible or particularly onerous. Two such new federal mandates Minnesota faces are requirements to:

- Use "crumb rubber," made from shredded tires, in its asphalt mix for roads by 1997 or lose federal funding. Minnesota burns waste tires to generate power, so it may actually have to import old tires to comply. Using crumb rubber will at least double the cost of mix per ton and may reduce pavement performance and life. The cost to the state is estimated to be $8 million in 1996 and $10 million in 1997.
- Make 10 percent of all state correctional facility cells accessible by wheelchair. Doing this, however, is not cost-effective when less than 10 percent of all inmates in each facility are in wheelchairs. Without this proposed mandate, which will cost almost $24 million, accessibility efforts could be concentrated on facilities where changes are less costly.

Standards are intended to ensure equity, safety and other goals deemed necessary to promote the

public good. But they can become entrenched and go unchallenged, resulting in unnecessary expense. To reduce spending, Minnesota could:

- Eliminate or reduce certain standards and regulations
- Allow for flexibility in meeting requirements
- Shift from regulating inputs and processes to defining desired outcomes and results

For example, the Minnesota Long-term Care Commission made several recommendations to reduce regulations and save $35.7 million over the next four years. These savings would result by removing standards, including new food service regulations, and allowing such activities as non-nursing staff feeding patients and physicians visiting patients on flexible schedules.

Give schools more flexibility to meet personnel needs

A total of $1.9 billion was spent for licensed instructional staff salaries in fiscal year 1993. The state could make licensure requirements more flexible for teachers, administrators and other professionals. This would allow small schools to more efficiently use teachers across grade levels and subjects, along with having more college-level teachers, scientists, artists, writers and other professionals as visiting or permanent staff. This change also could make possible greater use in the schools of community social workers and counselors. In addition, the state should remove insurance and collective bargaining barriers that limit parents' participation and after-hours activity in schools.

Place a moratorium on further increases in criminal sentences and evaluate sentencing practices

Public pressure to get tough on crime and criminals has moved policy-makers to lengthen penalties and step up justice system activities at great cost over the last five years. This emphasis will continue to strain the corrections system. The Department of Corrections anticipates a shortage of 340 prison beds by 2002, a figure that assumes current laws and sentencing practices. If future policy changes occur to the extent they did in the last decade, Minnesota could need a new 500-bed prison every biennium after 1999. Each facility will cost about $50 million to build and up to $20 million a year to operate. Expanding existing correctional facilities will cost $20 million each biennium.

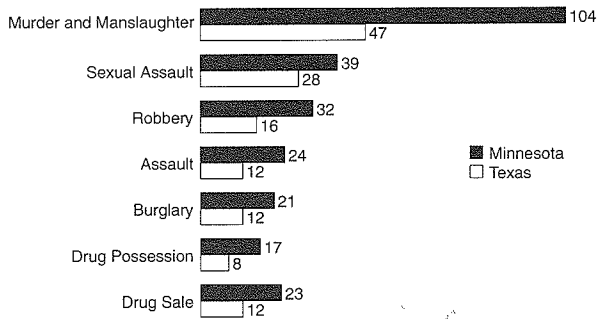
Contrary to the popular perception that Minnesota's justice system is lenient, offenders serve longer sentences here than in most other states. A national comparison compiled by the Sentencing Guidelines Commission shows that offenders in Minnesota serve more time in prison than they do in the 34 states responding to the survey. Texas is seen as a tough state on crime and criminals, for instance, but Minnesota criminals actually serve more time in prison than their Texas counterparts — in some cases, more than twice as long for the same crime.

Extensive policy changes have added expenses without reducing crime rates. As a result, the Sentencing Guidelines Commission will be recommending to the 1995 Legislature a proposal to increase sentences for violent crimes but cut them for more frequently occurring but less violent offenses, such as theft, burglary and some drug crimes. Long-term prison sentences would be limited to violent and repeat offenders; less expensive alternatives would be used for less violent criminals.

Reduce right-of-way, lane width and other highway standards

The $28 billion bill to meet "full-service needs" on Minnesota's roads could be lowered by reducing standards, particularly for lower-volume county, township and municipal roads. Minnesota's highway standards and procedures for determining needs are designed to bring all roads up to uniformly high standards.

Prison Months Served in Texas and Minnesota



Notes: Figures are the median prison time served in Texas in 1990 compared to the estimated 1991 median time served in Minnesota

Source: Minnesota Sentencing Guidelines Commission and Texas Criminal Justice Policy Council

Minnesota's approach is clearly illustrated by its collectors, those roads that collect and disperse traffic between residential areas and farms and highways used for long-distance travel. The state has less than half the percentage of miles of unpaved rural collectors as the average in other midwestern states — 21 percent unpaved compared to 49 percent. More than 85 percent of Minnesota's urban collector roads have lanes that are at least 12 feet wide, compared to 30 percent for other midwestern states.

An estimated 21,695 miles of the county state-aid highway system do not meet current state standards. Upgrading these roads will cost $5.3 billion. Studies show that reducing standards for specific projects could save from one-half of 1 percent to 5 percent, or between $26 million and $265 million, on county state-aid highways alone. In addition, low-volume roads that are not up to standards could be left with current dimensions, weight limits and surface materials. Nearly 66 percent of the state's rural collectors — totaling 27,406 miles of roadway — have traffic volumes of less than 500 vehicles per day.

High standards are partly motivated by safety concerns. However, vehicle safety features, reduced speed limits and other factors beyond road condition and design also influence safety.

Limit environmental standards and requirements

Minnesota has moved aggressively to identify and solve environmental problems and is ahead of many states in meeting and going beyond federal requirements. In the past year, the state committed $9 million to the Reinvest in Minnesota and wetland preservation programs and $20 million to nonpoint source pollution control loans. Some state actions, such as the Wetland Conservation and Shoreland Management acts, place requirements and costs on local governments as well. For example, Minnesota counties and cities spend an estimated $5 million annually to comply with state shoreland management regulations.

Minnesota could limit its efforts and seek waivers from federal requirements. This approach, however, has risks. The Institute for Southern Studies recently found that states with the best environmental records also offer the best job opportunities and climate for long-term economic growth. The study used 20 environmental and 20 economic indicators. Minnesota ranked seventh on the environmental list and second on the economic one.

Control input costs and invest in technology

Once governments decide what services will be provided and to whom, they must decide how they will be provided. Public agencies either assemble the labor, machinery, equipment, land, buildings and services they need to deliver the service, or they arrange to purchase the service and have it delivered by another organization.

The cost of providing public services is based on two factors:

- The cost of the labor (salaries and benefits), equipment and other inputs
- The productivity, or output, of the agency for each unit of resources put into the services

To control costs, governments can hold down or reduce the costs of public employee salaries and benefits and use market forces to buy products and services more cheaply. Collective bargaining agreements and state and federal requirements to pay prevailing wages, however, can inhibit change and savings.

Governments also can cut costs by adopting new technologies to increase productivity. New technologies require upfront investments but can yield substantial long-term savings. Investments could be made in such things as electronic surveillance systems that would allow offenders with a low security risk to be kept under house arrest; interactive televisions, computer networks and other learning technologies that would help schools increase offerings without adding staff; and technology that would permit specialists to evaluate medical needs without face-to-face contact with patients. A major study by the Arthur Little consulting firm recently projected national public and private savings from such medical technology at $36 billion annually, suggesting that savings for Minnesota might be in the hundreds of millions of dollars.

Contain public employee health-care costs through purchasing pools and managed care

Health-care costs are the largest employee benefit expense for schools and a major cost driver for other public agencies. To contain these rapidly escalating costs, all local governments and school districts could participate in purchasing pools, man-

aged care and managed competition. The state reduced the annual rate of increase for its employee health insurance premiums from 14 percent in 1990 to 6 percent in 1992 and 3 percent in 1994, in part through competitive bidding and employee incentives.

Pooled purchasing could be required legislatively or encouraged through financial incentives or penalties or through voluntary compacts. State aid payments could be capped for governmental units not participating in pooled plans and managed care or for units that exceed regional cost ceilings.

Overhaul teachers' salary schedules

School districts could eliminate or reduce the amount of teachers' salary increases that are based on training and experience alone. These increases could be replaced with salary incentives tied to student performance and specific responsibilities. These incentives could be renewable every several years. The state could gradually phase out aid and levies to schools for salary increases tied to training and experience, estimated to be $120 million in fiscal year 1994. A portion of these funds could be shifted to school-based staff development.

In fiscal year 1993, $1.9 billion was spent on salaries for licensed instructional staff in Minnesota. If a 5 percent reduction in pay were realized by 2001, it would yield nearly $100 million annually in savings, some of which would be absorbed by the new incentives. Tens of millions are being spent for regular salary step increases without any consideration of teaching competence or student outcomes. Another $30 million in state and local funds was spent directly by schools on staff development in 1993.

Many other licensed professions are required to engage in continuing education as a condition of certification, receiving a tax deduction but no additional compensation.

Explore changing public employee pension benefits

Total public employer contributions to employee pension funds were almost $514 million in 1992. During the same period, state and local governments contributed $480 million to Social Security for employees.

Career salaried Minnesota state employees retiring at age 65 with 30 years of service receive pensions equal to about 45 percent of their salary, along with Social Security. Both pensions and Social Security benefits are adjusted annually for inflation, with the adjustment to pensions based in part on investment returns on pension assets.

Governments could take a number of steps to control or reduce spending on employee retirement benefits. One action would be to raise the usual age of retirement.

Another would be to alter how pensions are funded by changing from a defined benefit to a defined contribution plan. Defined benefit plans place all the risk on the employer by guaranteeing a certain level of retirement benefit. Defined contribution plans place more of the risk on the employee because benefits are based on assets in the employee's account on retirement. A combination of these plans also could be used to share the risk between employer and employee.

Other issues that should be examined are fiduciary responsibilities to participants, financial implications of automatic cost-of-living adjustments and increases based on fund performance, effects of early retirement policies, and appropriate employer contribution levels.

Use competitive bidding and private-sector service providers

Cities and states across the nation are using competitive bidding to bring down costs. Unlike past movements to privatize, new approaches cover more services and bring public employees into the bidding. Governments are challenging union wage rates and are forcing public employees to bid against private firms to provide many basic services.

Public employees in Indianapolis won the contract to fill city potholes, with a bid of 27 percent less per ton of asphalt than the city's current costs. Philadelphia cut the costs of running its sludge treatment plant by one-third and New York City saves an estimated $500 million to $700 million a year through competitive bidding. Chicago estimates that in 1993, it saved $4.2 million by privatizing janitorial services and $2.5 million by privatizing parking at O'Hare Airport.

Capital-intensive projects, such as freeways and bridges, are particularly good candidates for privatization. Private investors can cover upfront costs and recoup them through tolls. Increasingly, governments do not have the funds for such investments.

Target government infrastructure investments

Investments in infrastructure — streets, schools, sewers, public buildings — will continue to exert major demands on Minnesota's governments. In the short run, delaying projects will enable a community to reduce expenditures, particularly in an environment of rising interest rates. Delaying too long, however, might result in the need for extensive rehabilitation when remedial measures might have been adequate.

Continue converting treatment centers to correctional facilities

The residents of Minnesota's eight residential treatment facilities could be housed in four. The four that could be closed have a total operating cost of $89 million — $80 million for salaries, $7 million for current expenses and $2 million for repairs, replacement and special equipment. However, these facilities employ many people in their communities, making elimination a difficult and costly choice. Converting these to correctional facilities, as is being done at two treatment centers, could save corrections and health care dollars and spare communities the loss of jobs.

Employees of state institutions have special legislative protection. If reductions in client populations lead to reduced staffing needs, an employee must be offered a comparable position elsewhere. If the position is accepted, the state pays relocation costs. If it is rejected, the employee receives $7,500 in addition to regular termination benefits. If comparable positions are not available, the employee retains the existing position, even though the institution may be overstaffed.

Expand school-choice options to foster learning opportunities

The state and local communities could further develop school-choice options to enhance learning opportunities and reduce costs for new buildings. The state also could make more use of its veto authority over building plans that create unneeded capacity. Possible actions include:

- Expanding postsecondary, interdistrict and charter school enrollment opportunities
- Leasing private buildings or buildings in neighboring districts
- Creating partnerships with businesses, museums and other institutions to establish work-based learning programs and apprenticeships
- Sharing facilities with cities, libraries, parks departments, social services agencies or colleges to take advantage of excess capacity
- Developing more multidistrict planning and rural magnet schools
- Wiring one-room school houses in isolated rural communities for interactive video and computer networks
- Promoting home-based learning, using computer and video networks to provide access to schools and other learning resources
- Contracting with private schools where there is a shortage of public school capacity
- Using facilities year-round, in split shifts, and in the evenings
- Expanding capacity through scheduling and use of work-based learning and other off-site learning for secondary students

Leasing, contracting and choice options are not necessarily cheaper in the short run. However, they can help districts manage enrollment growth and avoid 20-year commitments to bond payments for buildings that may not be needed when the child population drops.

Reduce capacity in the higher education system

Minnesota could reevaluate its policy of having higher education institutions within easy driving distance of all parts of the state. It could inventory all public campuses to identify excess capacity and merger possibilities. Distance learning via fiber optic networks and satellites now gives students access to high-quality college learning in small learning centers, local public schools or homes, providing an alternative to expensive or underused campuses. A college campus, however, may be key to an area's ongoing economic and cultural development and, therefore, to its population stability and tax base.

The combined state allocation for technical and community colleges and state universities is about $500 million per year. State allocations in fiscal year 1994 to each of its 18 technical colleges with 34 campuses ranged from $3 million to $28 million, with most getting from $9 million to $15 million. In the same year, the state's 21 community college campuses got from $2 million to $7 million each.

Seven state universities each received from $11 million to $42 million.

Net savings from closing or consolidating any of these campuses would be offset somewhat by shifting of students to other campuses and meeting ongoing contractual commitments to employees.

Government structures for the 21st century

Over the last few decades, dramatic changes have occurred in Minnesota's population distribution and its transportation and communication systems. The state's governmental and decision-making structures, however, have changed little. Much of Minnesota's state and local governmental structure dates from the 19th century. Many of its operations were established in the 1920s and 1930s.

About 3,600 general- and special-purpose governments place Minnesota sixth among the states in total number of local units of government. This number translates to one governmental unit for every 12,000 people in Minnesota — outnumbererd only by such sparsely populated states as North Dakota, South Dakota, Montana, Wyoming and Idaho. The number of school districts in Minnesota has declined dramatically — from 8,000 in 1900 to 379 today — due to a series of legislative actions and incentives. The number of counties, cities and townships, however, has remained virtually the same. Many of the state's towns, counties and cities have small and decreasing populations. Nearly two-thirds of all cities in the state have fewer than 1,000 people.

This large number of government units costs money. General government spending — the category most closely associated with the governing function — was one of the fastest growing areas of local government spending between 1970 and 1992. All levels of government had spending increases of 99 percent or more after adjusting for inflation. In 1992, cities spent $278 million, counties $435 million and townships $24 million.

The number of townships, cities and counties, and their current structures and responsibilities might not be appropriate or adequate to respond to the state's needs in the 21st century.

Minnesota also ranks high in number of state legislators and lobbyists. With 201 legislators, it ranks fifth among the states and is more than 25 percent above the median state. It ranks sixth in the number of lobbyists with 1,480. Lobbying, either by employees or by contract, cost local units of government more than $2.3 million in 1993. This was in addition to the estimated $1.1 million to $3.4 million spent by local units of government for lobbying services provided by some 30 government associations, such as the School Board Association, League of Cities and Association of Counties.

Closing the Gap

Minnesota's governments at all levels — the state, counties, cities, townships, school districts and special districts — should begin to work toward closing the budget gap by taking immediate steps in four broad areas.

Define activities crucial to the well-being of the state

State government should evaluate its roles and responsibilities to define the core activities needed to meet citizens' needs. Funding should be focused on providing basic services for these core activities. Counties, cities and special-purpose units of government should do similar evaluations. Specific areas for state action include:

Prekindergarten through secondary education — State responsibility and funding should focus on core activities necessary for students to achieve graduation standards. Schools should have discretion in funding facilities, administration and enrichment or extracurricular activities.

Local government aid — The state should identify core services and basic levels of service. These could include such things as essential police and fire protection services. Aid should be targeted to ensure equal access to these services.

Build more flexibility into programs and requirements

Traditionally, laws and regulations have dictated what state and local governments must do and how they must do it. This rigid approach can stifle efforts to find cheaper, more efficient ways of providing services and reaching objectives. It also can restrict governments' ability to meet the public's changing needs and circumstances. Flexibility is needed in:

Federal mandates — The state should aggressively pursue waivers from federal mandates affecting state and local governments.

Local government mandates — Costs of state-imposed mandates should be controlled by giving local governments greater flexibility in implementation. Laws should be changed to remove mandates or make it easier for local governments to obtain waivers and try innovative approaches.

Dedicated funds — All funds should be re-evaluated and modified, as necessary. Funds should focus on desired outcomes. For example, Minnesota's constitutional dedication of tax revenues from motor vehicles and fuels for highway purposes should be relaxed. This dedication and other restrictions on the use of revenues inhibit the state's ability to pursue the least costly transportation alternatives and adapt its transportation systems to changing needs.

Licensing requirements — Rigid requirements can stifle innovation and increase costs. Licensing standards in such fields as medicine, social services and education should be reviewed and changed as appropriate. For example, along with defining outcomes in education, the state should relax teacher licensure requirements. This will give school districts the ability to use staff more flexibly and use community resources and technology to meet needs.

Focus on the most cost-effective approaches

State and local governments should focus on preventing problems and future costs. They also should identify and emphasize the most cost-effective efforts and ways of meeting needs. Governments at all levels should concentrate investments in areas that will result in savings that are greater than program costs. These approaches are needed specifically in:

Alternative care for elderly people — Minnesota should aggressively pursue ways to reduce costly institutionalization of elderly people and explore new means for citizens to finance their own care when they become old.

Crime prevention and alternatives to prison — The state, counties and cities should focus on crime prevention and alternatives to prison for nonviolent offenders. These alternatives, such as restorative justice, are less expensive and require offenders to give something back to society through community service and restitution to victims.

Contain costs of government operations and programs

All governmental units should work to contain and reduce the costs of services they provide. Controlling the growth of public employee salaries and benefits will be important, as will evaluating the full costs and effects of laws. Approaches to containment should include:

Employee health care — All local governments and school districts should participate in purchasing pools and managed competition.

Salaries — All governmental units should take steps to hold total payroll and benefit cost increases to no greater than the rate of inflation and population growth. They further should limit automatic increases not based on outcomes. For example, school districts should eliminate or reduce the amount of teachers' salary increases that are based on training and experience alone.

Moratorium on program expansions — Minnesota governments should hold the line on eligibility and services. Specifically, the state should freeze further increases in sentences to control justice system costs.

Competitive bidding — All governments in Minnesota should expand the use of competitive bidding to contain and reduce the costs of services. More services, including those provided by government employees, should be subject to competitive bidding. Public employees should bid along with the private sector for service contracts.

Closing the gap will require citizens and policymakers to reconsider long-held beliefs about government's role and responsibilities and to work together to achieve the future envisioned in *Minnesota Milestones.*

Appendix

Glossary

Below are definitions of some terms used in this report.

Aid to Families with Dependent Children — Half-funded by the federal government, AFDC provides money to low-income families with children.

alternative care — home or community-based care to help elderly or disabled people live independently; an option to placement in institutions.

biennium — a two-year budget period for state government. Each biennium includes two fiscal years.

consumer price index — a measure of the average change in prices over time for goods and services; often used to measure and adjust for inflation.

criminal justice system — includes law enforcement agencies; judicial, prosecution, public defense and associated legal activities; and corrections.

defined benefit plan — a retirement plan that guarantees a certain benefit amount upon retirement. Both employee and employer contributions may vary from year to year.

defined contribution plan — a retirement plan based strictly on contributions that does not guarantee a specified amount at retirement. Employer contributions are usually a set percentage of salary or a match of the employee's contribution up to a certain level.

dependent population — people younger or older than the usual working age; for purposes of this report, people younger than 16 or 65 and older.

entitlements — programs, such as Social Security, AFDC and Medical Assistance, that provide benefits to people who meet eligibility criteria. Entitlement programs often have uncapped, open-ended budgets.

fiscal year — a 12-month budget period for governments. Most local governments have fiscal years beginning in January and ending in December, but state government and school districts have fiscal years beginning in July and ending in June.

General Assistance — GA is a state program that provides money to low-income people who are not employable.

General Assistance Medical Care — a state-funded program that pays for health care for low-income people who are not eligible for Medical Assistance.

general purpose aid — state grants to local governments that can be used for any purpose.

intergovernmental transfers — grants and aid paid by one level of government to another, such as state aid to local governments.

local government aid — now called aid to cities, LGA is general purpose aid that the state distributes to cities and townships.

long-term care — health care, personal care, social services and, sometimes, food and lodging provided to elderly or disabled people living in nursing homes, group homes, institutions or at home.

managed competition — the practice of purchasers of health care or government regulators requiring insurers and health care providers to compete for business based on price and quality.

managed care — an organization of medical care insurers or providers that sets standards for care and seeks to reduce costs by providing comprehensive services to prepaid members.

mandates — requirements in statutes, rules, policies or procedures applying to state and local governments that, if not complied with, can result in civil liability, criminal penalty, substantial economic sanctions such as loss of funding, or severe administrative sanctions such as closure or refusal to license a facility or program.

Medical Assistance — MA pays health care providers for care of elderly or disabled people or families with limited income and assets. The federal government pays 55 percent of the costs, while the state picks up the balance.

MinnesotaCare — a state program to provide subsidized basic health insurance coverage for otherwise uninsured Minnesotans.

property tax relief — state payments to local governments, in the form of local government aid and homestead and agricultural credit aid, or to individuals, as circuit breaker and targeted tax relief payments, to lower property tax burdens.

social services — a Census Bureau expenditure category that includes such programs as AFDC; payments to health care providers for people with low incomes or limited assets; and expendi-

tures for state and local hospitals and other services to support needy people; as well as expenditures for public and environmental health.

special education — a federally required program entitling people younger than age 22 with disabilities to appropriate education and related support services.

tax capacity — the dollar amount arrived at when a property's market value determined by the assessor is multiplied by the classification rate specified in statute for the property type.

Fiscal year technical note

All fiscal years in this report are designated by the year in which the fiscal year ended. For example, state government's fiscal year 1993 refers to the budget period beginning in July 1992 and ending in June 1993. School districts have similar fiscal years, but most local governments' fiscal years begin in January and end in December.

This difference in fiscal years makes difficult the tabulation of total state and local revenues or expenditures. This report generally uses the U.S. Census Bureau's *Government Finance* series for this purpose. The most recent final report in this series is *Government Finance: 1990-91*, which covers fiscal years ending between July 1990 and June 1991. Data from this Census Bureau report is called 1990 data in *Within Our Means.* Similarly, data from the 1967-68 report is referred to as 1967 data.

Estimating future revenues and expenditures

Within Our Means projects revenues and expenditures for each biennium through fiscal year 2005. The resulting gaps between revenues and expenditures are smaller than those included in the revenue and expenditure outlook released by the Department of Finance in December 1994. The major difference between this report's estimates and the Department of Finance outlook is this report's assumption that revenues will remain a constant percentage of personal income. The Finance Department forecast is based on current laws which would result in revenues declining slightly as a percentage of personal income.

The revenue projections are based on forecasts of Minnesota personal income. The expenditure projections are based on expected change in demand for state and local government services; these projections are largely the result of changing client populations. Projections of revenue assume constant effort relative to personal income, while projections of expenditures assume current law and programs.

At the end of each year projected, expenditures are reduced to bring them in balance with projected revenues. Trust funds, including health care access, are dedicated funds, which are not available for balancing the budget. Eighty percent of family support, 87 percent of health and 50 percent of transportation are not available for balancing. Reductions to balance the budget are taken across the board among the remaining funds, according to their relative share of the total budget subject to cuts.

Revenues include both state and local tax and nontax revenues. Transfer payments from the federal government to state and local governments are not included. Some local government enterprise activities, such as municipal golf courses, swimming pools and liquor stores, are not included. The definition of revenues in this report is consistent with that used by the Minnesota Department of Revenue, as reported in *Local Government Revenue Estimates, December 1994.*

Expenditures include direct general expenditures of state and local governments — the state, counties, cities, townships, school districts and special districts. Excluded from expenditures are intergovernmental transfers, such as state aid to local school districts, and spending for enterprise activities that also are excluded on the revenue side.

Projected revenues are assumed to be constant at 18.4 percent of Minnesota total personal income. This proportion is the 1995 percentage reported in the *December 1994 Forecast* by the Minnesota Department of Finance.

Minnesota personal income from 1995 through 1999 is from page 48 of the *December 1994 Forecast.* Minnesota personal income from 2000 through 2005 is projected from the DRI/McGraw-Hill long-term forecasts published in summer 1994. The average annual rate of change in the long-term projection for the cycle-long series of real total personal income for 1999 through 2018 was used. Since DRI/McGraw-Hill shows a declining rate of real national growth from 1999 through 2018, using

the average annual rate of change from that period for 1999 through 2005 for Minnesota implies a declining real share of national economic growth. This declining share reflects Minnesota's projected slower pace of population and labor force growth. The calculation results in a real growth rate for personal income of 1.82 percent per year.

DRI/McGraw-Hill forecasts project Minnesota's inflation-adjusted personal income to grow less than 2 percent annually after 2000, the slowest rate since 1950. State and local government revenue will rise about 4 percent annually between 1995 and 1999, compared to an annual growth rate of nearly 7 percent between 1991 and 1995.

Expenditure projections for 1996 through 1999 assume a constant relationship between state and local government spending. State government expenditure estimates from the *December 1994 Forecast* for the bienniums beginning in 1996 and in 1998 were adjusted by subtracting transfers to local governments. The resulting estimate of state government-only spending was divided by 0.31 to yield state and local government spending exclusive of transfers from the federal government for each of the two bienniums. The factor 0.31 was calculated from the 1992 U.S. Census Bureau estimate of Minnesota state and local government expenditures. The factor is the state portion of total state and local direct general expenditures minus transfers from the federal government, utilities and municipal liquor stores.

Expenditure projections for 2000 through 2005 were prepared for 10 specific categories of government spending, plus an "all other" category: higher education, elementary and secondary education, justice, family support, health care, residential health care facilities, transportation, health care access and other trust funds. The intent was to capture the effects of demographic and related changes on the demand for the specific categories. Constant laws and policies were assumed. For each category, annual real rates of change from 1999 through 2005 were applied to estimated 1999 levels.

Higher education estimates were based on the enrollment effects of an increasing number of high school graduates and young adults from 2000 through 2005, dampened by declines in numbers of people in their late 20s and early 30s. Population projections by age in 2000 and 2005 were applied to higher education participation rates for 1990 to project enrollments in 2000 and 2005. The average annual rate of change for this period was added to the annual average change in real expenditures per student from 1984 through 1992, yielding the assumed annual increase of 1.57 percent in higher education expenditures.

Rates of change for elementary and secondary education were based on projected changes in enrollments by year plus an additional increase of 1.5 percent per year in real spending per student. The rate of increase in real spending per student reflects the average from 1987 through 1993. Resulting real rates of change were 1.96 percent for 1999 to 2000, 1.73 percent for each year from 2000 through 2002, 1.62 percent in 2003, 1.39 percent in 2004 and 1.38 percent in 2005. The slowing rate of growth is due to declining rates of increase in enrollments through 2003 and actual declines in 2004 and 2005.

Justice system expenditures also assume current laws and their implications for facilities. The projection for justice spending was the sum of separate projections for law enforcement, judicial and legal services, local correctional facilities and state facilities. The projections indicate a real increase of 11.53 percent in the biennium beginning in fiscal year 2000, 11.92 percent in the biennium beginning in 2002 and 12.34 percent in the biennium beginning in 2004. Spending for courts is not broken down between civil and criminal cases; thus, an exact accounting of the cost of criminal cases cannot be made.

Family support includes the state and county components of Aid to Families with Dependent Children, Aid to Families with Dependent Children child care, Minnesota Family Investment, General Assistance, Work Readiness and Minnesota Supplemental Aid. An annual real growth of 1.88 percent in family support was assumed, based on the projected change in single-parent families from 2000 through 2005.

Health care includes Medical Assistance, Alternative Care, General Assistance Medical Care and the Chemical Assistance Medical Care Entitlement. The real rate of change for these programs was assumed at the real rate of change from 1994 through 1999 of 10.01 percent.

State residential health care facilities were projected separately, with a zero rate of real change assumed.

Transportation includes state highways, airports, water transport, transit subsidies, local streets and roads, and other related expenses. Transportation was assumed to grow at a real annual rate of 1.23 percent, based on analysis of historical trends from 1970 to 1992.

Health care access, such as MinnesotaCare, is a relatively new program that is growing rapidly. The projected real rate of growth from 2000 through

2005 is assumed to be at the 1998-through-1999 level of 3.5 percent per year. This subdued rate of growth assumes that the program will continue to serve only a limited proportion of the uninsured population. The program currently serves families with children below 275 percent of the federal poverty level plus other households below 125 percent of poverty.

The "other trust funds" category includes trust funds and special revenue funds not related to transportation and health. Those funds are specifically included in their functional category. This category encompasses such funds as the landfill cleanup, petroleum tank release, Minnesota Technology Inc. and game and fish funds. The other trust funds were assumed to grow at the rate of household growth, 0.9 percent per year.

"All other expenditures" includes all state and local expenditures, apart from the ones specifically identified above; for example, state and local government administration, parks and recreation, natural resources management and other similar activities. This category accounts for 24.5 percent of total government expenditures in 1994 and is assumed to grow only at the rate of household growth, 0.9 percent per year from 2000 to 2005.

DRI/McGraw-Hill projections of inflation, using the gross domestic product price deflator, were added to the projected real rates of growth to compute the nominal values. The inflation rates were 3.1 percent for 2000, 3.2 percent for 2001, 3.3 percent for 2002 and 3.4 percent for each year from 2003 through 2005. These rates are slightly higher than the 2.7 to 3.0 percent forecast for 1996 through 1999, reflecting DRI/McGraw-Hill's belief in a gradual revival in the inflation rate.

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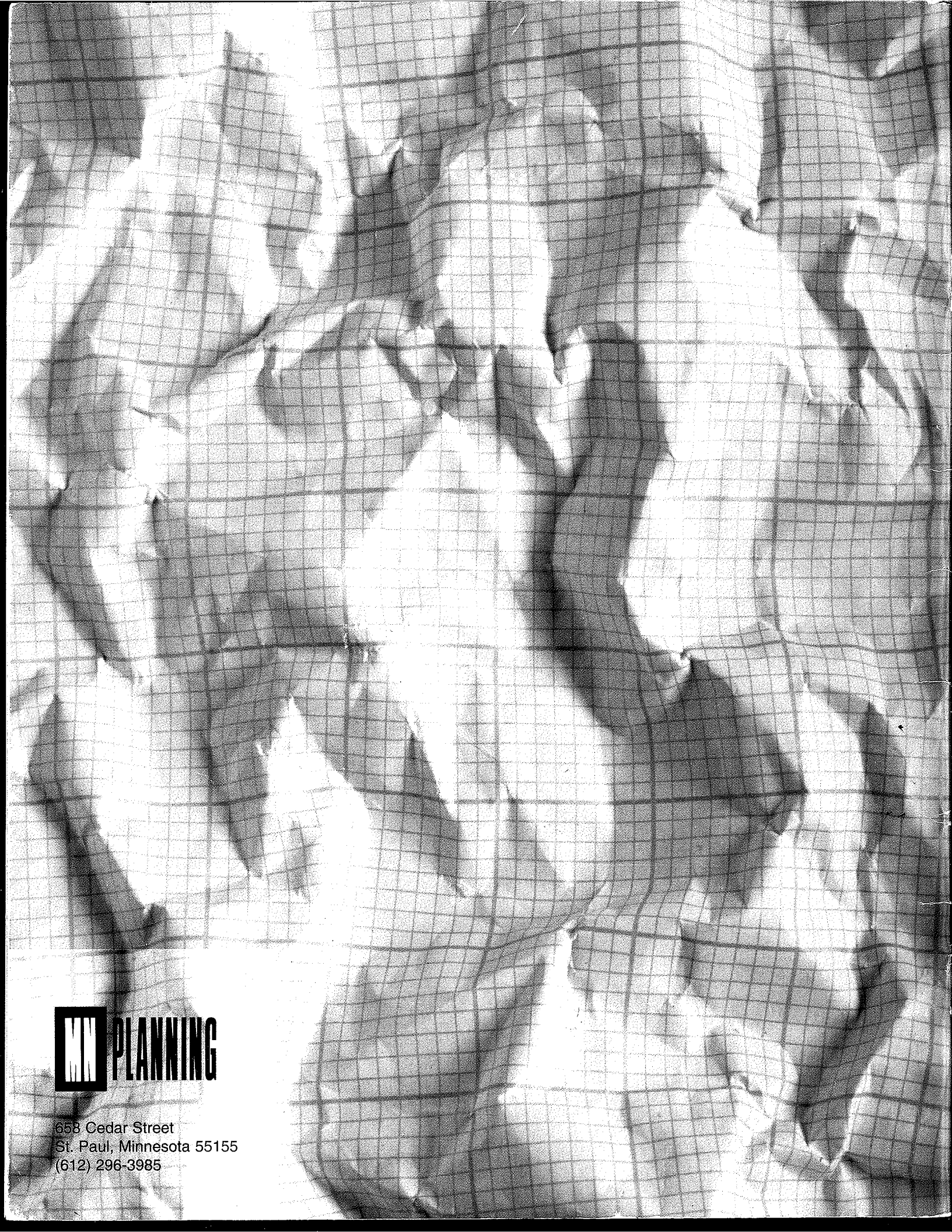

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