

Minnesota governments get \$3.5 billion in federal grants annually

Line Item Line Item Line Item Line Item Line Item

Nearly one in every six dollars in government coffers comes from Washington. As Congress moves to balance the federal budget and change how federal money flows to the states, there could be profound effects on state and local government budgets.

March 1995

About 22 percent of state and 4 percent of local government revenues come directly from federal grants. Local governments and school districts actually depend more on federal grants than this figure suggests, because the state passes on a large share of federal grant revenue to pay for locally administered services.

This *Line Item* describes trends in the kind and size of federal grants that go to Minnesota state and local governments. It provides background information necessary for understanding the likely impact of federal budget cuts and grant reform on Minnesota.

In federal fiscal year 1993 the federal government collected \$20.5 billion in revenue from Minnesota. Minnesota received back only 82 percent of this amount or \$18 billion in the form of federal employee salaries, procurement, grants, loans, research contracts, farm subsidies and payments to individuals.

Of the \$18 billion Minnesota receives, it is the money from federal grants that most directly affects state and local government budgets. This report deals only with the \$3.9 billion in grants to Minnesota.

Federal grants are sometimes called “grants-in-aid” because they are outlays for specific programs operated by states, local governments or nongovernmental organizations. Most major federal grants require states or local governments to contribute matching funds.

\$3.9 billion to come from Washington

The federal government will distribute \$3.9 billion in grants to Minnesota recipients in federal

fiscal year 1995. Nearly 90 percent, or \$3.5 billion, will go to state and local governments. The remaining \$419 million will go directly to nongovernmental organizations and individuals. Most of the governmental share will be received by state agencies. Only \$404 million will go directly to local governments, although a portion of the state grant receipts is in turn passed through to local governments.

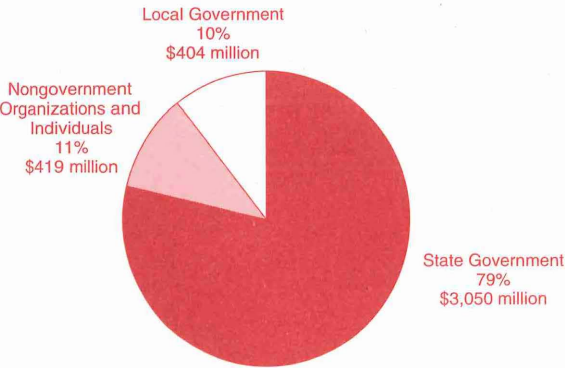
Of all local governments, special districts, such as the Metropolitan Waste Control Commission and other regional agencies, depend the most on federal grants. About 5 percent of county and city revenues come directly from federal grants, primarily for human services. Special district governments get 13 percent of their revenues from federal grants. School districts get about 4 percent of their revenue from federal funds, most of it indirectly from the State Department of Education.

Seven of every 10 federal dollars received by Minnesota provide medical care and income security for people with low- and limited-incomes. Federal programs for these purposes include Aid to Families with Dependent Children, food stamps and Medicaid, known in Minnesota as Medical Assistance. The state Department of Human Services manages these funds; county human services departments administer the programs and are reimbursed with federal and state funds.

Medicaid and AFDC services are called “entitlements” because the state must provide services to everyone who meets the eligibility standards. The federal commitment is open-ended in the sense that the total amount of federal aid received depends on the number of people served.

Minnesota supplements these federal programs with state-funded General Assistance Medical Care, General Assistance and Minnesota Supplemental Aid, which cover low-income people who are not eligible for the federal programs.

Minnesota to Receive \$3.9 Billion in Federal Grants in 1995



Notes: These figures are estimates of federal grants to Minnesota governments, organizations, and others during federal fiscal year 1995.
Sources: Minnesota Department of Finance

Minnesota's Federal Taxes High Compared to Return

Minnesota per capita tax burden	\$4,542
Minnesota ranking	15th highest
Minnesota return on federal dollar	82 cents
Minnesota ranking	45th

Compared to other states, Minnesota ranks high in the amount of federal taxes per person, and low in the return on the federal tax dollar.

Source: Northeast Midwest Institute

Medical Assistance draws more than half of all federal funds

More than half of the nearly \$3.1 billion in federal dollars Minnesota state government expects to receive in federal fiscal year 1995 will be in the form of reimbursements for the state's Medical Assistance program. The federal government picks up 54 percent of Minnesota's costs for these medical services. Nationally, the federal government reimburses from 50 to 83 percent of each state's costs for Medicaid, depending on the state's per capita income.

The federal government requires all states to provide medical coverage to all AFDC and most SSI recipients, as well as other groups, such as low-income pregnant women and children. Along with 40 other states, Minnesota has chosen to provide services to "medically needy" people who do not qualify for mandatory coverage. In state fiscal year 1995, the state expects to spend almost \$1.5 billion in federal and \$1.4 billion in state funds for Medical Assistance.

\$1.2 billion in federal grants will go to income security

Federal income security programs will account for nearly \$1.2 billion in federal grants to Minnesota in federal fiscal year 1995. The largest of these

programs and the approximate funds Minnesota receives annually are: \$252 million for Aid to Families with Dependent Children; \$244 million for food stamps; \$256 million for subsidized housing; \$163 million for child nutrition programs; \$52 million for low-income energy assistance; and \$44 million for child support enforcement administration. Food stamps are entirely federally funded, but the state must pay a share of the program's administrative costs. With AFDC, Minnesota sets the benefit levels and income limits for eligibility. The federal government paid 55 percent of Minnesota's AFDC benefit costs in 1994, based on state per capita income.

Some state agencies depend on federal money

Though the Department of Human Services gets more federal dollars than any other state agency, other agencies also rely heavily on federal grants. Federal funds make up half of the budget for the Department of Trade and Economic Development; most of these funds come in the form of community development block grants and are passed through to local governments. The Department of Economy Security depends on federal grants for 77 percent of its budget.

One of the largest areas of state spending, primary and secondary education receives relatively little federal aid — only \$297 million, or slightly more than 6 percent of total state appropriations for education. Most of this is for special education, certain programs for disadvantaged children, school lunches and child care meals. Some additional federal education aids flow directly to local school districts.

Federal Funding, Selected State Agencies
Estimated Fiscal Year 1995 (in millions)

	Federal Funds	Percent of Budget		Federal Funds	Percent of Budget
Human Services	\$2,080	42%	Economic Security	\$251	77%
Medical Assistance grants	1,496	52%	Vocational Rehabilitation	33	85%
General Assistance Medical Care	- 0 -	0%	Job Service/		
AFDC (Payments only)	166	43%	Re-employment Insurance	68	100%
General Assistance	- 0 -	0%	Community-based Services	127	70%
Minnesota Supplemental Aid	- 0 -	0%	Primary and Secondary Education	297	6%
Health	100	52%	Special Education	42	6%
Transportation	155	12%	Chapter 1	80	NA
Trade and Economic Development	251	49%	School Food Service	70	92%
			Child Care Food	56	NA

Note: Percentages cannot be calculated for some federally-aided education programs because data on total program cost is not available.
Source: Minnesota Department of Finance

Grants promote a variety of federal aims

Congress uses grants to serve a number of purposes. Overall, grants enable the national government to set policy while avoiding constitutional issues that might arise if it were to provide certain services directly. State and local government participation in federally aided programs is voluntary, but the lure of federal dollars is frequently too strong to resist.

Grant programs can have any of three general purposes:

■ **Stimulating state and local programs.** Grants-in-aid often are used to entice states and local governments to adopt new programs or increase their efforts with existing ones that Congress deems in the national interest. Many social programs of the 1960s were launched in this way, by offering grants with little or no matching requirement in support of specific state and local activities. Grant programs also are used to fund demonstration projects that may become models for new programs.

■ **Equalizing service levels or promoting minimum standards.** Grants can be used to equalize levels of service among states or localities. One approach is to use allocation formulas favoring jurisdictions that rank high on some objective measure of need, such as number of school-age children or acres of erodible cropland. Sometimes, more favorable matching requirements are offered to states or localities with high levels of program need.

■ **Equalizing fiscal capacity.** General purpose, no-strings-attached grants that are distributed according to fiscal capacity can help reduce fiscal disparities among states or localities. Such grant

programs can redistribute money from fiscally affluent states or local communities to less affluent ones. In some large grant programs, such as Medicaid, for example, the federal government picks up a larger share of costs for low-income states.

Grants come in three forms — most with strings

The federal government distributes more than \$200 billion in grants to state and local governments annually. While Congress has created nearly 600 separate grant programs, a handful of these — Medicaid, AFDC and other income security programs and highway programs — account for the lion's share of these dollars.

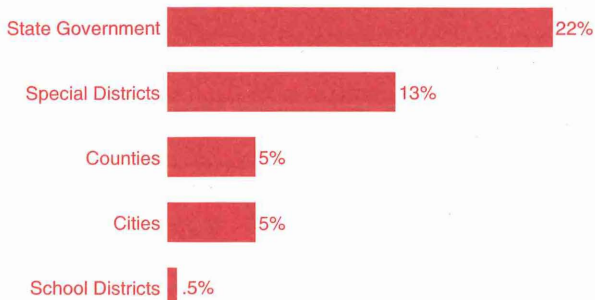
Federal dollars come in three basic forms: categorical grants, block grants and general purpose aid.

Categorical grants are the most basic kind. They make funds available for a specific program or set of activities. Examples include grants for maternal and child health services, rural fire prevention and control, asbestos school hazards abatement and urban transportation planning.

Block grants are created by consolidating, or "blocking," several related categorical grants into a single, broader grant in support of a group of programs. In contrast to categorical grants, block grants give states greater flexibility in deciding how to spend the money. In addition, the numerous requirements attached to categorical grants usually are simplified in block grants.

General purpose aid, which is now rarely used by the federal government, can be spent for anything the recipient chooses. Congress enacted a

Percentage of Government Revenues from Federal Grants — 1991 - 1992



Note: Local government figures include only grants received directly from federal government, excluding funds passed through from state government. The data is for fiscal years ending between July 1991 and June 1992.

Source: U.S. Census Bureau

Minnesota Federal Grant Revenue per Capita



Note: Dollars in this figure are adjusted for inflation to 1993 dollars and are for federal fiscal years.

Source: U.S. Census Bureau

general purpose aid program called general revenue sharing in 1972. The federal government used a fiscal need-based formula to distribute general purpose aid to state governments from 1972 to 1981 and to local governments from 1972 to 1986.

Grants distributed through formulas or specific projects

Federal grants are given out in one of two ways: through specific project grants awarded in a competitive application process or through allocation by formula. Most federal grant dollars are distributed to states and local governments by formulas based on population, number of children in poverty, per capita income or other indicators of need. One of the most difficult obstacles to creating block grants is agreement over distribution formulas.

Many federal grants require the recipient to make a matching financial contribution. States receive only partial reimbursement for several large programs, including Medicaid and AFDC. Reimbursement is based on a predetermined percentage of eligible program costs.

Federal grants barely keep pace with needs

Minnesota's dependence on federal grants has fluctuated over time. After growing during the early 1970s, it has generally declined since 1980. As a share of Minnesota state and local government

revenues, federal grants went from 16 percent in 1970 to 21 percent in 1976, before falling back to 16 percent by 1984. Adjusted for inflation, per capita federal grant revenues of Minnesota governments in the early 1990s were actually slightly lower than in the mid-1970s. Though per capita revenues from federal grants have grown since the early 1980s, they have barely kept pace with state and local revenue needs. As a result, the share of state and local revenues from federal grants has remained steady or dipped slightly.

The number of federal categorical grants grew rapidly during the 1960s and early 1970s. The U.S. Advisory Commission on Intergovernmental Relations counted 442 federal categorical grant-in-aid programs in 1975. During the late 1960s and early 1970s, state and local officials increasingly expressed frustration with the large number of grants, each with its own application and reporting requirements. Congress responded by creating four new block grants and general revenue sharing. Still, the number of categorical grants continued to grow to more than 530 by 1981. They then declined by about 25 percent with the enactment of a new round of block grants in the early 1980s, but began another steady rise in the late 1980s.

Categorical grants are the most common form of federal grants-in-aid. They accounted for 97 percent of all federal grant programs and 88 percent of all grant funds in 1993. At the same time, block grants were 11 percent and general purpose aids only 1 percent of federal grant funds.

Grant system becomes focus of reform efforts

Today, two decades after the enactment of the first federal block grants, Congress is again considering block grants as a way to simplify the federal grant system and expand state and local discretion. Pressures to curtail federal financial obligations are motivating this debate, along with changing philosophies about the proper relationship between the federal government and the states.

Numerous new block grants have been proposed, greatly reducing the number of narrow, categorical grants. Block grants are seen as a way to simplify the federal grant system, increase administrative efficiency and give states greater flexibility to direct federal dollars to state and local needs. Proponents argue that local officials know how to spend the money most productively.

However, new block grants could mean less money overall would be available to states than the categorical grants they would replace.

Federal Grants as a Percentage of State and Local Revenue



Note: Figures are for federal fiscal years.
Source: U.S. Census Bureau

Changes could have major impact for Minnesota

How such changes will affect Minnesota cannot yet be known, but the effects could be considerable. For example, one proposal would substitute a capped formula for current open-ended federal reimbursement for Medicaid. Depending on how much growth was allowed in the federal cap, within a few years Minnesota could lose millions annually in federal funding for Medical Assistance.

A similar proposal would cap the federal contribution for AFDC at the 1994 level, causing federal funding to fall 16 percent short of expected needs by 2000, based on Congressional Budget Office estimates. States would have to cut benefit levels or raise taxes to make up the difference.

Such entitlement programs are sensitive to economic cycles that cause demands for them to rise and fall sharply. Caps on block grant allocations could make states vulnerable to cost increases beyond their control.

In addition, states like Minnesota that have generous benefits may have trouble maintaining their traditional levels of service if less generous states take advantage of new spending flexibility to lower their benefits. Minnesota could become a magnet for people from other states seeking its higher benefits.

Minnesota clearly cannot look to growth in federal funding to solve its fiscal problems. A recent Minnesota Planning report, *Within Our Means: Tough Choices for Government Spending*, estimated that state and local governments face a combined \$2.5 billion gap between spending needs and revenues between 1997 and 2005. Much of the gap will result from spending growth in programs such as Medical Assistance that rely heavily on federal aid. With reductions in federal aid likely, Minnesota will have to make bold changes in the way it delivers and pays for many services if it wishes to avoid higher state and local taxes.

Technical notes

Data on Minnesota federal grant revenues is from the Department of Finance. Information on departmental budgets came from the 1996-97 Biennial Budget. Historical data on per capita federal grants and state and local dependence on federal grants was taken from the U.S. Census Bureau publication, *Government Finances*. Data on the composition of the federal grant system is from the U.S. Advisory Commission on Intergovernmental Relations, "Characteristics of Federal Grant-in-Aid Programs to State and Local Governments: Grants Funded FY 1993." Unless otherwise noted, references to fiscal years are to the state fiscal year running from July to June. The federal fiscal year runs from October through September. Fiscal years are designated by their ending date.

Line Item is a series of brief publications highlighting key facts and findings from Minnesota Planning's study, *Within Our Means: Tough Choices for Government Spending*. Published in January 1995, the study examined past local and state government spending and revenues, identified major driving forces and forecast what is expected to happen in the next five to 10 years.

Upon request, *Line Item* will be made available in an alternate format, such as Braille, large print or audio tape. For TDD, contact Minnesota Relay Service at (612) 297-5353 or (800) 627-3529 and ask for Minnesota Planning.

March 1995

For additional copies of *Line Item*, contact:



658 Cedar Street
St. Paul, Minnesota 55155
(612) 296-3985

Printed on recycled paper with at least 10 percent post-consumer waste.