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Sound tax policy. Efficient spending. Accountable government.

March – April 2022 Volume XLIII No. 2

In This Issue:

- Four Questions Regarding the Homestretch
- Money Well Spent
- Revisiting "How Much is Enough?"

Four Questions Regarding the Homestretch

With a month to go, we look at some questions surrounding 2022 budgeting, tax relief, and spending priorities.

Having returned from their Passover/Easter break, lawmakers begin the arduous process of trying to find areas of compromise and reconcile two very different perspectives on state government. A look at some questions we have been asking ourselves:

How Much "Triennial Budgeting" Will Be Enacted?

Once upon a time, according to the 1972 State Joint Committee on Flexible Sessions Report, lawmakers concluded the first year of the biennium should be used for the "major financial planning of the State" and base the second session of the biennium on "the experiences and an evaluation of the needs of the State" which would include "budget review, action on the results of interim studies, and consideration of emergency measures." Those lawmakers probably never imagined a budget surplus well over 15% of the biennial budget and a projected structural balance (revenues in excess of spending) of over $6 billion in the out-biennium. As a result, neither party has shown much interest in waiting around for the 2023 budget session to engage in "major financial planning" for the state, preferring instead to strike while the forecast is hot.

The result has been what might be called "triennial budgeting" — budget proposals that have just as much influence on the next biennium — and for that matter beyond — as they do for addressing the needs of the current biennium. Another Senate tax bill is forthcoming, (and the different committee structures and spreadsheet updates and layouts require an asterisk accompany this attempt) but the accompanying table offers our best take on what everyone's "triennial budget" proposals going forward look like at this time.

Unsurprisingly, the different emphasis placed on tax relief versus new spending/investment makes a "triennial agreement" difficult. But even if that gulf could somehow be bridged, huge differences also exist regarding where any additional budget resources should be deployed. The House is proposing supplemental FY 22-23 spending increases of $100 million or more in twelve different program areas. In contrast the Senate concentrates new spending almost exclusively in the public safety, transportation, and health and human service areas. The discrepancy is especially stark in proposed E-12 education spending: the House is proposing an additional $3.275 billion for FY 23-25; the Senate $32.1 million.

"Triennial" General Fund Impact (billions)

	FY 23	FY 24-25	Total
HOUSE			
Tax Relief/Aids/GF Tax Reductions	$1.645	$1.600	$3.245
GF Spending Increases	$5.719	$5.582	$11.301
Triennial General Fund Impact	**$7.364**	**$7.182**	**$14.546**
SENATE			
Tax Relief/Aids/GF Tax Reductions	$3.385	$5.045	$8.430
GF Spending Increases	$1.452	$2.196	$3.648
Triennial General Fund Impact	**$4.837**	**$7.241**	**$12.078**
GOVERNOR			
Tax Relief/Aids/GF Tax Reductions	$2.366	$0.436	$2.802
GF Spending Increases	$6.887	$5.592	$12.479
Triennial General Fund Impact	**$9.253**	**$6.028**	**$15.281**

Triennial Resources

Surplus			$9.253
ARPA			$1.150
FY 24-25 Forecast Structural Balance			$6.289
Total Triennial Resources			**$16.692**

Source: House Budget Resolution, MMB, and Senate Fiscal Spreadsheets

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Fiscal Focus (USPS 519130) (ISSN 1042847X) published Bi-monthly in February, April, June, August, October & December by the Minnesota Center for Fiscal Excellenece, 85 East Seventh Place, Suite 250, St Paul, MN 55101. Periodicals postage paid at St Paul, MN. Postmaster: Send address changes to Fiscal Focus, c/o Minnesota Center for Fiscal Excellence, 85 East Seventh Place, Suite 250, St Paul, MN 55101.

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This is not a promising landscape for a meeting of the minds on a three-year budget plan. When all is said and done, outcomes reflecting the intent and purpose of an even-numbered year session as envisioned by lawmakers 50 years ago are much more likely…although there is certainly no guarantee of that either.

What (If Any) Tax Relief Will Business Get This Year?

It's too early to declare session "winners and losers" but the tea leaves don't look promising for the general business community. Several provisions are in play that certainly are important to and benefit business but are mostly one-time measures that likely fall short of business' idea of relief. These include federal conformity (included in all three tax bills), exclusion of COVID recovery grant income from taxation, and administrative benefits like reducing June accelerated tax payments for mortgage, deed, tobacco and liquor taxes. Unemployment Insurance Trust Fund replenishment from one-time ARPA funds and some surplus would be a tremendous assist to business, but this fix is functionally negating a required tax increase created by government actions in response to a pandemic rather than providing relief for business. As of this writing, the nature and extent of trust fund replenishment remains in limbo as negotiations with respect to frontline worker payments remain at a stalemate. However, the current surplus minus the House's FY 23 general fund targets still leaves about 1.88 billion of negotiation capacity.

A second Senate tax bill expected to be unveiled this week is likely to include a bill to reduce or eliminate the state general levy. This may become an area of negotiation as there is some bipartisan interest in using the surplus to address this tax to put Minnesota's business property taxes more in line with neighboring states. But the relief priorities among all the principals clearly lie elsewhere.

How Will the Wooing of Senior Hearts and Votes Turn Out?

"Targeted" has been a theme in both parties' tax relief messages, and in 2022 seniors and their Social Security income are the bullseye. The 1993 House Ways and Means recommendations underlying the federal government's 1993 Social Security tax reform, under which Minnesota largely operates today, was justified by "enhancing both the horizontal and vertical equity of the individual income tax system by treating all income in a more similar manner." The existence of *social* insurance benefits may still be a policy anathema to some (one legislator this year called it a Ponzi scheme and a casualty for most people) and the program itself is certainly in need of some serious attention. But it is not double taxation as the withholding tax acts ***economically*** as a pre-tax 6.2% employee contribution to something roughly analogous to a collective defined benefit plan, with taxes only paid based on the difference between what employee contributes and the benefits received as determined by actuaries. These policy arguments may carry weight in tax journals and public finance courses but hold no currency with senior constituents at the local coffee shop.

A closer look at household income trends indicates a third equity-related issue — generational fairness — deserves at least a little consideration in constructing state tax treatment of seniors:

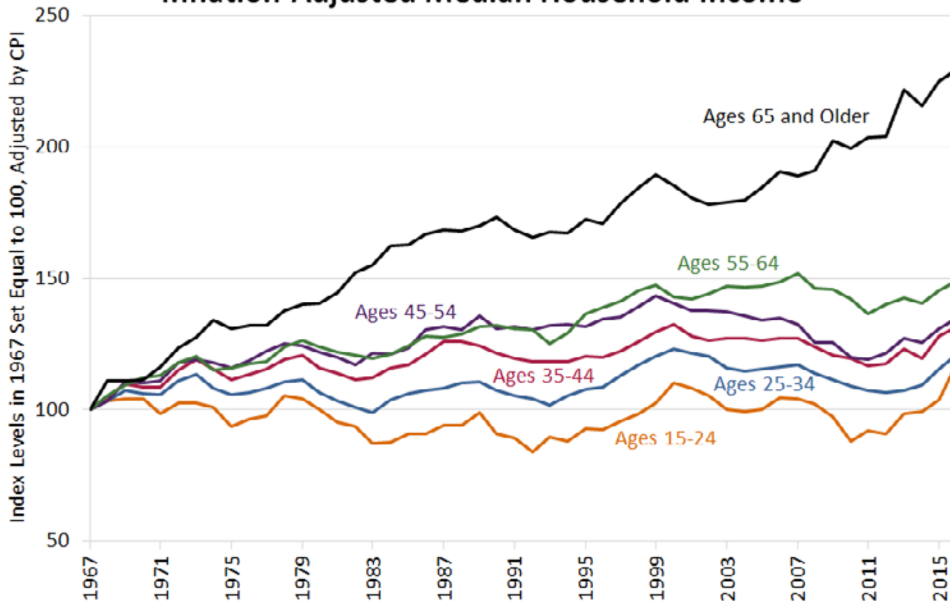
Seniors have been the undisputed heavyweight champion in improving their income status over the last two decades. From 2000 -2017, change in real median household income for the 65 and over demographic was 24%, or 6 times greater than the 55-64 age group.

- As the accompanying chart from the St. Louis Federal Reserve illustrates, seniors have been the undisputed heavyweight champion in improving their income status over the last two decades. From 2000 -2017, change in real median household income for the 65 and over demographic was 24%, or 6 times greater than the 55-64 age group. During this period real median income growth was negative for the prime working age group (25-54).
- *The Wall Street Journal* reports, "baby boomers and older Americans have spent decades accumulating an enormous stockpile of money. At the end of this first quarter of 2021, Americans age 70 and above had a net worth of nearly $35 trillion, according to Federal Reserve data. That amounts to 27% of all U.S. wealth, up from 20% three decades ago. Their wealth is equal to 157% of U.S. gross domestic product, more than double the proportion 30 years ago." [1]
- A recent report by the Social Security Administration[2] has confirmed earlier research that "underreporting of retirement income continues to be an issue with public-use data" and that "retirement income from sources other than Social Security to be significantly underreported in the Current Population Survey (CPS)." It found pensions (including IRA withdrawals) rather than Social Security are the largest source of aggregate income among those aged 65 or older, and the proportion persons aged 65 or older relying on Social Security for 90 percent or more of their income is half that reported in the public-use CPS.

The Senate has declared full exclusion of Social Security benefits its top tax priority. The House has adopted a partial enhanced benefit allowing a 100 percent Social Security benefit subtraction for taxpayers under a new income threshold: adjusted gross income rather than provisional income. For married joint filers and surviving spouses, the threshold would be $75,000 of AGI. For single and head of household filers, the threshold would be $58,600. The subtraction would be reduced by ten percent for

1 "Older Americans Stockpiled a Record $35 Trillion. The Time Has Come to Give It Away." *Wall Street Journal*, July 2, 2021

2 "Improving the Measurement of Retirement Income of the Aged Population," ORES Working Paper No. 116, January 2021



each $4,000 of AGI above the phaseout threshold. It reduces the general fund impact by nearly 80% compared to a full exclusion, but would eliminate taxation of all social security benefits for all senior filers at or below the state's latest estimate of median senior household income while making the taxation of social security income much simpler for taxpayers to grasp (e.g. "for a married joint filing retiree with less than $75,000 in AGI, Minnesota will not tax your Social Security income.")

The influence of enhanced transparency should not be underestimated. One of the questions surrounding a full exclusion is: what explains its apparently significant popularity given the fact that a lot of beneficiaries are not currently taxed on this income and the benefit of a full exclusion would be heavily skewed towards higher income earners? A possible answer comes from a 2014 National Tax Association journal article examining the effects taxation of Social Security benefits had on older workers' income and claiming decisions.[3] Noting the complexity of Social Security taxation and seniors' unresponsiveness to the incentives/disincentives created, the authors concluded "overall, the findings suggest that older taxpayers have little understanding of the rules governing Social Security benefit taxation." A shift from provisional income to AGI makes the existence of any taxation of Social Security benefits much more transparent, and might influence the politics surrounding it.

The Governor's tax bill includes no Social Security tax changes and is proposing a more "generationally agnostic" tax relief package, albeit with more of a targeting emphasis on low to middle income working families via various income tax credits. An enhanced exclusion of some sort would seem the likeliest outcome, but implementing another incremental measure may make the Senate's interest in a full exclusion more difficult going forward.

This is an issue that is not going to go away, but neither will the long-term fiscal implications nor the opportunity cost imposed on alternative tax actions that could improve Minnesota's economic climate. According to IRS statistics of income, taxable social security income in Minnesota grew at an average annual rate of 7.1% per year over the past 5 years. The Department of Revenue's current forecast projects the total Social Security income of Minnesota income tax filers to grow by 22% over the next three years. With "peak boomer" levels still several years away and the number of retirees aged 65 and over expected to increase by 370,000 in the next twenty years accompanied by the government spending this demographic typically demands, the budget implications reach far beyond the next biennium.

What May Not Get Done that Should Get Done?

Even-year sessions are an opportunity for mid-course adjustments to appropriations and other measures to reflect developments and special circumstances. Although beliefs concerning the nature and extent of any needed adjustments will always be in the eye of the beholder, some issues deserve to be at the top of the list. They include spending needed for well-functioning government operations that voters don't know about, don't benefit from, and don't care about … unless something goes wrong.

That includes mission critical government infrastructure. For example, in the state government finance area, Minnesota Management and Budget has requested $24.2 million of one-time funds over three years to provide the necessary maintenance and upgrades to the state's Enterprise Resource Planning Systems (ERP) which support essential human resource functions like payroll, benefits, recruiting, and training; procurement/vendor transactions, and the state's data warehouse. According to MMB testimony, maintenance deficits and inadequate updates due to lack of funds are now resulting in performance and security risks and higher costs. The reserves in the account used to pay for this have been used up and the account is projected to have a deficit next year. The annual cost to run these systems is $22 million per year. MMB has submitted four budget requests since 2015 to address this issue; the amount of funding provided over this period has totaled $13.5 million. Similarly, MN IT has requested $18 million in one-time funds in order to match available federal funds to mitigate city and county cybersecurity risks.

Yet, the prospect for tackling these system needs is in some doubt. The Senate State Government Finance Committee was only given a $10 million budget to spend (which it did on election security). In the House these proposals were lumped into a much larger ($76 million) state government omnibus finance bill which include several initiatives which several committee members objected to as unnecessary bloat and government growth - a perspective likely shared in the Senate. That bill passed the committee, but whether agreement can be reached on a stripped-down conference committee bill to focus on these essentials remains to be seen. One thing is certain: should breaches of security or system failures occur causing a ma-

[3] The Effects of the Taxation of Social Security Benefits on Older Workers' Income and Claiming Decisions" Burman, Coe, Pierce, and Tian, *National Tax Journal*, June 2014, 67 (2), 459–486

jor disruption to government operations and trigger a big expense, there will be bipartisan demands for investigations and hearings and a lot of sudden indignation expressed as to how such a thing could happen in a state that prides itself on good government.

As many legislators have observed, a time of abundance often makes finding compromise more challenging, not less. With a month to go, that observation certainly appears to be holding true. The X factor heading into final month is the political calculus of weighing action against inaction. Stalemates, especially when public expectations are so high, could be harmful to electoral health. As a recent MinnPost article succinctly put it, "the politics of the session are a choice between whether doing nothing and waiting for the election is more advantageous than getting something to talk about during the campaign." ■

Money Well Spent

The work of Office of the Legislative Auditor commands the attention and respect of lawmakers across the political spectrum. But that high regard has not translated into a level of financial support reflecting the size, scope, and complexity of state government today.

According to news reports, the Office of the Legislative Auditor (OLA) — the state's version of the federal Government Accountability Office – has been besieged this year with requests for audits and investigations beyond its capacity. Having experienced a $70-plus billion injection of federal support over the last few years to deal with the pandemic and its economic impacts, we might expect some heightened interest in how well Minnesota is spending this money and what it has accomplished.

But even if the federal government hadn't participated in our recent fiscal affairs in such a unique and potent way, there is no lack of policy and program topics worthy of OLA study. The growth of government spending to advance the health, social, and economic welfare of Minnesotans requires a concomitant effort to "promote accountability, strengthen legislative oversight, support good management, and enhance program effectiveness." That is the OLA's stated mission. Their audits, reviews, and evaluations are recognized for their high quality, reliability, and non-partisanship by lawmakers of all stripes. However, the respect the Office receives has not translated into a level of investment that the size and complexity state government today demands.

OLA "101"

Created in 1973, the work of the Office is organized into three divisions:

- **Financial audits** ensure programs are safeguarding public resources from fraud and complying with laws that govern their financial and program operations. OLA audits organizations and programs in the state's executive and judicial branches, metropolitan agencies, several "semi-state" organizations, state-funded higher education institutions, and state-funded programs operated by private organizations.

- **Program evaluations** are detailed analyses of spending program goals and objectives, performance and results, and operating efficiencies that are typically done over a 6-9 month period.

- **Special reviews** are narrower investigations that typically address specific concerns or allegations about spending programs.

Since 2003, total state spending per year from all government operating funds has increased 147%, or over $33 billion. Over that period, OLA's staffing has declined from 80 to 56 full time equivalent employees. That translates into one person providing auditing and program evaluation oversight for every $1 billion the state spends annually, compared to $282 million in 2003.

The Office itself has authority to select special reviews and financial audits, but the Legislative Audit Commission, comprised of 6 members from the House and 6 from the Senate (equally divided between the majority and minority parties) must approve the program evaluation agenda. In addition, lawmakers will occasionally pass laws requiring the OLA to conduct a specific audit or investigation.

Financial audits understandably consume most (about 60%) of the Office's resources given the importance of ensuring proper internal controls and legal compliance exists in state financial affairs. Special reviews are frequently public attention-getters ascertaining the facts behind a specific complaint or concern about government actions or operations. But program evaluations — which tackle issues like the performance, management, efficiency and cost effectiveness of government programs — fill a crucial role in providing information and analysis on how "well" the state spends its resources. It should not be surprising this is where the greatest competition for OLA's limited resources appears to exist. This year alone, 67 potential program evaluation topics were submitted by lawmakers, organizations, and citizens which the Audit Commission needed to winnow down to just 5 for inclusion in this year's workplan. The Audit Commission's Program Evaluation Subcommittee employs a multistep process which includes topic background reviews by OLA staff, a survey of legislators, and meetings of the Subcommittee to identify the "final five" for full Audit Commission ratification. The staff background reviews employ six criteria to rank topics by how promising they are in

delivering value to policy makers and findings that are useful and actionable:

- State Resources — What state government resources are involved? (e.g., how much state money goes to this program?)
- State Control — How much control does the state have over this program or activity? (e.g., do state, federal, or local laws regulate this program?)
- Impact — Are significant social and/or economic impacts involved? (e.g., how many people are affected by this program?)
- Timeliness — Is this an appropriate time for an evaluation? (e.g., is this program changing or have new procedures recently been implemented?)
- Feasibility — Are data and resources available for an evaluation?
- Balance — Would the topic contribute to a balanced work agenda? (e.g., has the office recently conducted an evaluation of this program?)

Although members of the Program Evaluation Subcommittee and Legislative Audit Commission show considerable deference to these staff assessments, the five most promising topics identified by OLA staff are not guaranteed to be the five constituting the final workplan.

Numbers Tell the Story

Because the demand for OLA involvement far exceeds its capacity, lawmakers have had to urge colleagues not to overload the Office by writing investigations into statute. It might be argued limited resources is a positive by requiring attention and resources to be focused on the most important and valuable investigations with the biggest program and policy payoffs. On the other hand, the capacity and productivity of the Office must also be evaluated in light of growth in the size and scope of government over time. When viewed through this lens, there's a strong argument to be made that additional investment in the Office should be a top priority.

A striking statistic: since 2003, total state spending per year from all government operating funds has increased 147%, or over $33 billion. Over that period, OLA's staffing has declined from 80 to 56 full time equivalent employees. That translates into one person providing auditing and program evaluation oversight for every $1 billion the state spends annually, compared to $282 million in 2003. Over the last ten years, as new state programs have been created, others expanded, and total state government employment has increased by over 4,600 full time equivalent employees in the process, OLA staffing has been essentially flatline.[4]

Digging a little deeper into the OLA's legislative history and historical budget data offers more color and context on the fiscal constraints affecting the Office's capacity. For example, in a OLA FY22 base budget appropriation of $7.69 million about 25% is allocated to program evaluation. In other words, for an annual all-funds budget totaling about $53.9 billion, the OLA has about $2 million to fulfill the statutory purpose of program evaluation: "to determine the degree to which the activities and programs entered into or funded by the state are accomplishing their goals and objectives, including a critical analysis of goals and objectives, measurement of program results and effectiveness, alternative means of achieving the same results, and efficiency in the allocation of resources." [5]

Over the past ten years, OLA funding has followed a pattern of flat to very modest base appropriation increases, enhanced by some sizeable appropriations for legislatively mandated activities. Over the 5 years between FY 14-19, OLA's base budget allocation increased by $281,000, an annual growth rate of 0.89%. Budget conditions have improved a bit recently with larger base appropriation increases combined with the supplemental statutory appropriations to perform these legislature-mandated financial audits. However, these supplemental appropriations functionally require the Office to staff using one time money. While the Office was permitted to carryover any excess from these special appropriations into the current biennium, such resources can only be used for one-time expenses.

To add a bit of budget insult, this year the responsibility for the federally-required state "single audit" was transferred from the OLA to Minnesota Management and Budget (a move which made both practical and administrative sense.) However, instead of the Office being able to repurpose the resulting freed-up resources to better deliver on its existing auditing and program evaluation responsibilities, the Governor's FY 22-23 budget recommendations stripped $1.2 million from the OLA base budget.[6] In the end, the Legislature looked after the Office by working to restore half of that appropriation while also permitting additional carryover from statutory appropriations to essentially make the office whole. But going forward the Office still faces the prospect of delivering on its "regular" auditing and program evaluation responsibilities without this one-time project money made available to it in recent years.

What explains the rather parsimonious budget treatment of the Office over its long history? Much of the answer undoubtedly lies in the reality that spending programs out of sight to the public, that have no groups repeatedly advocating their interests, and do not benefit constituents are always at a major disadvantage come appropriations time (and are also easier to cut in times of budget stress as occurred in 2003). But another reality is that OLA investigation findings – even though they are strictly non-partisan – are often leveraged for political purposes. Fundamentally, OLA investigations critique programs under the watch of the executive branch at that time, so whatever party holds the governor's office can have political exposure to whatever concerns and criticisms may arise from those investigations.

Getting the Biggest Evaluation Bang for the Dollar

Careful scoping of projects and finding project synergies/areas of overlap between the work of OLA divisions are two ways the Office works to provide greater value-added for its investment of time and resources. Another strategy is to aim for economies of scope by combining similar or related topics into one investigation. It's a logical strategy, but there are potential drawbacks in trying to accommodate a bigger agenda in this manner.

For example, based on this year's OLA staff assessments, three of the top seven most

[4] Full Time Equivalent Reports, Second Quarter FY 2022 vs. Second Quarter 2012, MMB

[5] Minnesota Statutes, Sec 3.971, subd. 7

[6] MMB Program Expenditure Overview, Legislative Audit Commission, Revised Biennial Budget, March 2021

promising program evaluation topics dealt with grants management and oversight. Number one on the OLA's "most promising" list was Minnesota Department of Education grants oversight which would include the now notorious Child and Adult Care Food Program (CACFP). After considerable discussion, the Program Evaluation Subcommittee chose to combine these three grant related investigations together into a more generic "grants to non-profit organizations" evaluation which will place a primary emphasis on how well state agencies are complying with the state's Office of Grants Management policies. MDE grant management activity is expected to be folded into a larger set of agency case studies.

The potential problem is that there is tremendous variety in "grants." CACFP, for example, is a federal-state program that is enormously regulated and is very different from state financed grant programs that benefit homeless shelters or family planning education. The relevant issues for a grants program like CACFP are:

- Did MDE adhere to federal guidelines and requirements?
- Did they have the requisite policies, processes, and procedures in place to meet these obligations?
- Were those policies, processes, and procedures followed?
- Did the extent to which any policies, processes, and procedures were not followed result in disparate treatment among grantees?
- Did they provide necessary and timely assistance for grantees?

All these issues are independent from any ongoing criminal investigation that the OLA would obviously not want to interfere with. The concern is that a wide-ranging "grants to non-profits" program evaluation focused on compliance with state policies will not provide answers to these critical questions — assuming the CACFP grant program is even included as part of the MDE evaluation.

Enabling citizens to evaluate whether their tax dollars are being used efficiently and productively is a cornerstone of good government and the critical means of building and restoring citizen faith in their government. For a state that prides itself on a good government ethic, and which has invested heavily in the high cost/high service government model, the OLA's share of the state budget leaves a lot to be desired. As the size, scope, cost, and complexity of government programs only escalates, our need to determine whether and how these programs are achieving their goals is greater than ever. ■

Revisiting "How Much is Enough?"

The adequacy of education aid is once again a major issue in the 2022 session. A look back at our 2015 report on education finance labor costs and its relevance for today's debate.

Despite last year's bump in the state's Basic Education Aid formula – the largest in 15 years – plus the roughly $2.1 billion in one time money from waves of federal COVID and ARPA support over the past couple of years, many school districts are again looking at the prospect of budget cuts in 2022-2023. For example, a survey by the Association of Metropolitan School Districts found their membership collectively face a $230 million budget shortfall for the next school year if no additional funding is provided in the 2022 legislative session.

Providing a uniform amount of per pupil formula aid to all districts did not result in anything resembling similar district compensation trends or patterns.

The roots of the problem appear to be a combination of something old and something new. Something old is the chronic challenge of general education resources needing to be diverted to support special education program needs like special education and English learners. The "something new" is the accelerated declines in enrollment during COVID and its aftermath. When a system built on pupil counts collides with the relatively fixed cost structures of educational delivery, funding challenges materialize. A loss, for example, of 50 pupils spread equally over 13 grade levels translates into slightly less than four fewer children per grade – unlikely to trigger restructuring. Yet those lost pupils translate into a $336,000 financial hit for a district.

As a result, the sufficiency of state support for public schools is again in the spotlight. The most commonly offered analysis looks at trends in school resources adjusted for inflation. However, such an analysis can communicate pretty much any message based on the starting point for analysis, the inflation measure used, and what revenues are included. For example, according to data published by the Minnesota Department of Education, using a starting date of 2003, adjusting revenues using the Implicit Price Deflator for State and Local Government, and focusing solely on state aid, the percent change in real revenue per pupil has declined by 16.8%. However, choosing 2006 as the starting date, adjusting revenues with the Consumer Price Index, and including all school revenues (not just state aid) the percent change in real revenue per pupil *increased* by nearly 20% – prior to COVID. Keeping up with inflation is in the eye of the beholder.

A better understanding comes from examining the relationship between revenues and the costs districts incur in delivering educational services. This requires a focus on the relationship between trends in revenues and trends in labor costs for several reasons. School spending on compensation and benefits comprises just under 80% of all school district general fund spending (which finances most day-to-day school operations). Decisions around collective bargaining agreements give districts some ability to manage inflationary pressures in what is by

[7] "How Much is Enough? The Implications of School District Labor Cost Trends for State Education Aid" MCFE 2015

far their largest purchased input. And all our current educational spending and support debates – eliminating cross subsidies, mental health and counseling supports, in-classroom supports, class sizes, etc. – are at their core labor expenditures.

Findings on the Implications of Labor Cost Trends for State Education Aid

In 2015 we took a close look at how district labor cost trends over time matched up with state support for K-12 education.[7] We focused primarily on Basic Education revenue (now $6,728 per pupil in FY 22) which constitutes about 78% of total state general education revenue.

What we found, unsurprisingly, was tremendous diversity among school districts. Providing a uniform amount of per pupil formula aid to all districts did not result in anything resembling similar district compensation trends or patterns. The relationship between a district's employment changes (driving costs) and its enrollment changes (driving revenue) was highly variable and, in a quarter of school districts, counterintuitive (increasing student counts with declining staff or in rare cases declining student counts with growing staff). Most notably, the labor purchasing power of new basic education revenue varied tremendously from district to district. We compared the revenue growth from the 2% per year increase in Basic Revenue enacted in the 2015 session with projected per pupil district labor cost increases over the coming biennium based a continuation of multi-year trends in district compensation costs. We found in 3 out of 4 districts the projected growth in per pupil compensation costs would exceed the per pupil increase in Basic Education Aid with a median shortfall of $225 per pupil.

We also estimated how large the annual growth in the Basic Education formula would have to be to fund projected compensation growth into future years. (Historical trends have proven, at least so far, to be remarkably reliable in determining future compensation cost – our statewide projection back then for FY2019 was off by only $170 million.) We concluded that, if recent trends continued and the system remained otherwise unchanged, an average formula increase of around 4% per year would be required to finance 100% of expected compensation growth. Some of that increase could, of course, be paid for by other state education revenue programs or additional local property tax effort. On the other hand, our 4% annual estimate did not account for price inflation in the approximately 20% of non-labor school general fund spending, various reserve requirements, or potential future district contributions for underfunded pensions.

What do these findings mean for today? For starters, sufficiency of state support for education needs to be recognized as an intensely district specific condition. K-12 funding acknowledges this which is why we have 13 other general education aid programs as well as special education revenue to compensate for factors that are largely outside of a district's control but which also create higher costs for educational services. Higher cost educational environments are typically higher labor cost environments. The state needs to more effectively distribute these aids to districts based on an empirically rigorous understanding of how these factors and conditions influence direct labor costs through staffing needs and prices paid. Adjustments to declining enrollment aid in particular continues to be topic worthy of investigation.

At the same time, it's no less essential to recognize sufficiency of state support for education is also an intensely district influenced condition. Whether the state provides "enough" additional money each year depends in no small part on the outcomes of the agreements districts collectively bargain with their employees. Even modest increases in wages or fringe benefits can appropriate most if not all (and then some) of the new resources the state makes available to districts. This is not a criticism of collective bargaining in the public sector; but is simply a result of how that process works.

That being said, this indicates an urgent need for far greater public transparency of the financial impacts of school districts' collective bargaining agreements. For example, upon the ratification of a collective bargaining agreement, districts should provide the estimated increase in the total labor cost on a per pupil basis, and for each individual negotiated labor cost component – COLAs, steps, lanes, and fringe benefits, so that taxpayers can have a better sense of what drives cost increases. All this should then be reported alongside the estimated general and special education revenue per pupil the district projects to receive from the state over the life of the contract.

The traditional unified salary schedule has been the staple of education compensation for decades. Teachers appreciate its simplicity and understandability. Administrators appreciate the fact it is easy to administer. Although many interpret proposals to move away from the traditional unified salary schedule as a thinly-disguised attack on teachers and teacher unions, support for this idea can be found within the educational profession, progressive interests, and even union membership. Many intriguing models exist which redesign compensation and repurpose existing compensation resources for greater effect and professional satisfaction. In our report we generated a rough estimate that $1.3 billion in current compensation elements could be repurposed for a career-oriented compensation system built on the acquisition of knowledge, skills, and development of human capital.

These efforts are becoming increasingly urgent to complement state per pupil aid to ensure sustainability of state education finance. Demographics alone will make it increasingly difficult for education appropriations to generate the type of per pupil formula increases our estimates suggest. In addition, as the number of empty nester households grow, support for operating referenda may become even more challenging.

Alternative strategies are politically contentious and can be challenging to design responsibly without creating other unintended consequences. But as we concluded several years ago, the push for alternative compensation design is rapidly evolving from a debatable policy discussion to an undebatable fiscal necessity. ■

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