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MAINE'S LEVELS OF GOVERNMENT SPENDING AND TAX BURDEN

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With Maine facing a projected $95 million budget shortfall through fiscal year 2009—a figure that may grow in coming months—it is not surprising that legislators, the media, and Mainers are focused even more intently than usual on levels of state spending and taxation.

During recent remarks to her fellow senators, Senate President Beth Edmonds offered the following observation:

"Maine has spent the last 7 years trimming much of the state budget… Just last year, we all sat here together and cut over $100 million in order to avoid a tax increase… After seven years we have cut all the fat. Now we are down to muscle and bone."

Others, of course, suggest that Maine state spending remains too high and should be easy to cut. This paper examines how Maine compares to other states and what some of the impacts we might expect from altering current spending patterns are likely to be.

Maine's rates of growth in spending and taxation are stable or falling

Analysis by the Maine State Planning Office, the Maine Office of Fiscal and Program Review, and the Federal Reserve Bank of Boston all support the conclusions that Maine's overall rate of spending and taxation have actually been falling in relation to personal incomes over the past several years.

Looking first at longer-term trends, Maine's levels of *total* state expenditure relative to the incomes of Mainers' has grown from 14.2 percent to 15.8 percent since 1996. When this increase is broken down, however, we see that virtually *all* of the spending growth in the last five years has occurred in Maine's federal funds accounts.[1] This means that while state government is spending more on services, the additional cost for these increases is not falling principally on the shoulders of Maine's resident.

If we look at long-term trends in combined state and local tax growth, we see a similarly restrained rate of growth. Since 1986, taxes as a percent of personal income have grown from 11.3 percent to a projected 12.3

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percent in 2009, and have been falling for the last five years.[2] The likelihood that that downward trend will continue is given substance by the 2005 passage and implementation of LD1.

In January 2007, the Maine State Planning Office released its progress report on LD1. This bill sought both to limit growth in taxes and state spending over the next decade (and to increase the percentage of K-12 education funding supplied by the state to municipalities). The more specific cost containment goal of LD1 was to reduce state spending as a percent of Mainers personal incomes to the point where Maine would fall within *the middle third of all states by the year 2015.*

The details of how the annual limits are calculated are complex, but the end result is that current LD1 limits hold spending growth essentially to the rate of inflation, and tax growth to somewhat higher limits. Even as Maine's economy expands over the coming decade and people's incomes and purchasing power increase, the purchasing power of *government* will remain flat, and tax growth will slow. Following this prescription, over time the cost of government will decline steadily relative to Mainers' incomes, pushing Maine toward the middle third of all states.

In fact, Maine is not only meeting, it is exceeding many of these goals, and by very significant amounts.[3] LD1 set an annual limit for growth in General Fund appropriations of 3.11 percent for fiscal years 2006 and 2007. In its 2007 report, the Maine State Planning Office found that total General Fund appropriations grew at just 1.6 percent in 2007, or roughly half the rate set by LD1, down from 3 percent growth in 2006 and far below the 5.4 percent average annual growth of the last decade. Excluding new appropriations needed to cover voter-approved increases in K-12 spending, General Fund appropriations actually declined by 1.2 percent in 2007, after declining by 0.5 percent the year before.[4] Growth in both municipal property taxes and county assessments fell below set limits, with growth rates hovering at or below the rate of inflation.[5]

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The one important area where Maine did not meet LD1 limits was in expenditures on K-12 education. Eighty-one percent of School Administrative Units exceeded their LD1 limits for a combined total of $132 million in "over-limit" spending, despite an increase of $78 million in state-level school aid.[6] A better understanding of how the "essential programs and services" limits affect different districts will be a necessary step toward controlling education costs in Maine without sacrificing quality. In the years ahead, cost-effective, top-quality education will become still more critical to the long term health and growth of Maine's economy.

Given current trends, it is very likely Maine in fact will come to fall within the designated "middle third" of states in terms of government cost compared to personal income. Interestingly—and contrary to commonplace misconceptions—other measures indicate that Maine already may not be so far from entering this "middle third" grouping of states.

Maine compares favorably to other states, particularly those with similar challenges

While Maine collects the overwhelming majority of its in-state revenues through taxes, many other states have artificially low taxes that they augment through fees and other mechanisms. Therefore, a more appropriate comparison among states—one that includes all the different forms of in-state collections and thus offers a more accurate figure for the true cost of government—is "own source revenue". Two related measures—own source revenue *as a percent of total personal income*, and own source revenue *per capita*—are better still. These allow researchers to compare not simply the absolute dollar cost of government (own source revenue), but how those costs compare to the population size of the state (own source revenue per capita), and how heavy a burden those dollar figures really are for states' citizens and economy (own source revenue as a percent of total personal income).

Using own source state and local revenue as a percent of total personal income, Maine ranks ninth among all states at 18.2 percent compared to the US average of 16.3 percent.[7] While this places Maine squarely in the middle of the top third of all states, it is quite different from widely-covered Tax Foundation analysis that incorrectly places Maine second among states by this measure.[8]

Using own source revenue *per capita*, Maine ranks still lower: fifteenth among all states, or just two slots shy of the middle third grouping of states.[9] With a per capita burden of $5467 annually, Maine exceeds the US average by just $129 per person, an arguably modest sum, and one that makes more sense when placed in the context of Maine's unique geographic and economic challenges (as discussed below). Though recent analysis—again, based on Tax Foundation data—suggests that Maine's tax burden exceeds the US average by over $700 million annually, calculations using US Census Bureau data clearly show this figure to be greatly inflated. Applying the same back-of-the-envelope methodology but using accurate US Census Bureau data, the number drops to roughly $170 million in "above average" collections.[10] Research by the Maine Municipal Association indicates that errors by local officials in reporting property tax collection totals likely inflated Census Bureau figures by over $200 million. Maine in fact may be collecting fewer taxes *per capita* than the US average.[11]

While even accepting that Maine collects $129 more per person than the US average state, this information is only useful up to a point. The implication is that all states can and should "be average", that all states have the same expenditure requirements, and that all states' citizens share the same preferences for government services. Clearly, none of these assumptions hold true.

Like all northern states Maine has high energy requirements, and like all rural states with highly dispersed populations, ME has relatively higher infrastructure needs (Maine is the second most rural state in the nation).[12] In terms of healthcare, Maine also has higher than average needs: Maine has the oldest population in the nation, exceeding the national median by 5 years.[13] Moreover, Maine has a higher percentage of citizens with severe and chronic illnesses than is average among the states.[14]

Maine faces a unique set of challenges, challenges that would tend to push Maine toward higher levels of spending relative to personal incomes than many other states even were Maine a wealthy state with incomes comparable to Connecticut or Massachusetts. Unfortunately, Maine's economy does not yet provide those levels of income for most of its citizens. The result is that—given Maine's high spending requirements and low incomes—if Maine were to spend at levels close to the national average as a percent of personal income, the quality of government services provided would be well below the national average. This is because the cost drivers for many government services remain essentially constant (on a per unit basis) throughout the country (energy costs, equipment costs, pharmaceutical costs). A state with low personal incomes pays just as much as a high income state for a gallon of gas—or a snow plow, a computer system, or a course of antibiotics.

It is also true that Maine is a New England state, and as is the case throughout most of the Northeast, Maine's citizens have chosen and have come to expect a higher level of government services.[15] From educating our children, to building roads, to caring for elderly parents and sick relatives, life presents innumerable challenges that are most effectively and economically met through collective action. There is passionate debate about whether such action should be organized by markets (think Verizon), charitable organizations (think The United Way), or by the public sector (think Transportation Department). Creating agencies and programs within our government is simply one form of organized, collective response. It is one of several rational options, and is the path that most of our New England neighbors also have chosen.

Analysis by the Federal Reserve Bank of Boston provides a comparison of Maine to its New England neighbors, and to other similarly rural, northern, low-income states throughout the country (Iowa, Nebraska, and Wisconsin).[16] Among this study's comparison group, Maine has both relatively low expenditures per capita (only two of the nine states in the comparison group are lower), and only slightly higher-than-average government spending on payroll as a percent of total personal income (with three states in the comparison group spending more, two spending essentially the same amount, and three spending less). In other words, far from having particularly high levels of state spending, these findings demonstrate that Maine differs very little when compared to its social and geographic peers.

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The push to "become average" is likely to have substantial negative effects for Mainers and the Maine economy

Recently, a good deal of press has been given to the idea that Maine should "become average" through immediate reduction in state spending.

One area on which proponents of state spending cuts perennially train their focus is the portion of the state budget devoted to Medicaid. As an example, two-thirds of the cuts suggested by the Maine Public Spending Research Group are to come from Medicaid spending, or some $470 million annually. At first blush, this may seem reasonable; after all, in 2006 the combined state and federal Medicaid spending approached $2.2 billion out of a $6.3 billion total budget. If one is looking for places to cut, Medicaid is a big slice of the overall spending pie.

On closer examination, however, the obvious downside to this approach becomes immediately apparent: of that $2.2 billion, the federal government supplied $1.4 billion—or two-thirds of the total—in matching assistance. Due to its lower incomes, Maine has an unusually high Medicaid matching rate; for every dollar the state invests through Medicaid in healthcare for its elderly, low income, and disabled citizens, almost two additional dollars of federal money enters the Maine economy. This $1.4 billion of federal money is a huge stimulus, arriving from a source external to Maine's economy. Much of it is used to pay wages and salaries within Maine's workforce, seventeen percent of whom are employed in the health care sector.[17]

Thus, if $470 million were cut from the state Medicaid budget, roughly $315 million in federal dollars would be removed from Maine's economy. Absent further detrimental ripple-effects, this would represent a 4 percent decline in health care sector spending, and close to a 1 percent decline in the total Gross State Product.[18] Compounding the negative economic and fiscal repercussions resulting from such cuts, reductions in healthcare services to Medicaid recipients would lead to higher costs in other areas for state government and for non-Medicaid citizens.

Contrary to the message delivered by the most devoted proponents of market-based solutions, money that is spent in the public sector does not simply "disappear into the bureaucracy", but instead is used to purchase specific goods and services, commonly at significant overall savings to the public. Cuts in Medicaid spending would lead to lower levels of service, a decline in preventive care, and ultimately to more severe and thus more costly illness.

Reduced preventive care leads to greater use of mental health and substance abuse services, higher levels of incarceration among adults with untreated mental illness, and increased visits to emergency rooms.

All of these negative outcomes only would serve to shift now much higher costs onto other government programs that are not supported by federal dollars, or onto the private sector, for example in the form of higher insurance premiums to offset more frequent emergency room use. A decline in the overall health of Maine's population likewise negatively affects the productive capacity of both the unhealthy individuals themselves and the family members that must care for them. All of this in turn reduces the size and efficiency of Maine's workforce.

Cutting Medicaid spending thus undermines not only the health and well-being of Maine's vulnerable populations; it also pulls hundreds of millions of federal dollars out of Maine's struggling economy, and transfers costs into areas that do not enjoy federal matching support. By any measure, such cuts clearly are penny-wise and pound-foolish.

By and large, spending and taxation in Maine are not anomalously high. While K-12 spending has grown faster than other areas of state spending, overall state spending from state tax collections has actually fallen over the past five years. Success in meeting LD1 limits means shrinking Maine government relative to the state's economy, and thus will require decreases over time in the value of services delivered. We question the value of making this trade-off. Neverthless, Maine is reducing the costs of government more quickly than required or expected. Adopting deeper cuts would undermine the state's economic security and potential, and condemn Maine residents to below-average services.

[1] Darcy Saas, Deputy Director, New England Public Policy Center, Federal Reserve Bank of Boston, PowerPoint presentation made to the MECEP 2008 Annual Tax and Budget Conference. Please link through the MECEP website: http://www.mecep.org/MECEP2008TaxandBudgetConference.asp

[2] Maine Office of Program and Fiscal Review: http://www.maine.gov/legis/ofpr/Tax%20Info/Tax%20Burden%20-%20Graph%20A%20-%20March%202006.pdf

[3] Maine State Planning Office, "LD1 Progress Report 2006", January 2007: http://www.maine.gov/spo/economics/ld1/index.php

[4] Ibid

[5] Ibid

[6] Ibid

[7] MN Department of Revenue, December 2007 report (data from US Census and US Bureau of Economic Analysis): http://www.taxes.state.mn.us/legal_policy/research_reports/content/06_Table_National_Own_Source_SL_FY05.pdf

[8] For a more complete treatment of the inherent problems with Tax Foundation analyses, please see the write-up at the Center for Budget and Policy Priorities website: http://www.cbpp.org/3-27-07sfp2.htm

[9] MN Department of Revenue, December 2007 report (data from US Census and US Bureau of Economic Analysis): http://www.taxes.state.mn.us/legal_policy/research_reports/content/06_Table_National_Own_Source_SL_FY05.pdf

[10] Calculation: $129/person * 1.3 million Mainers = $170 million

[11] Kennebec Journal, "Double Counting Glitch," Gary Remal, 02-03-2008

[12] Brookings Institution, "Charting Maine's Future", 2006

[13] Ibid

[14] Anna S. Sommers and Mindy Cohen, "Medicaid's High Cost Enrollees: How Much Do They Drive Program Spending?", The Henry J. Kaiser Family Foundation, March 2006.

[15] An example of which is the recent state referendum mandating a $100 million increase in state K-12 spending.

[16] Darcy Saas, Deputy Director, New England Public Policy Center, Federal Reserve Bank of Boston, PowerPoint presentation made to the MECEP 2008 Annual Tax and Budget Conference. Please link through the MECEP website: http://www.mecep.org/MECEP2008TaxandBudgetConference.asp

[17] While the health care sector itself represents roughly 18 percent of Maine's $44.8 billion Gross State Product: Dirigo Health Agency, "Maine's State Health Plan 2007", pg 120 http://www.dirigohealth.maine.gov/2007%20State%20Health%20Plan.pdf

[18] Ibid

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