Dollars and Sense: Maine State Budgeting at a Crossroads

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Dollars and Sense: Maine State Budgeting at a Crossroads

By
Josephine M. LaPlante

with the assistance of
Robert G. Devlin
Edmund S. Muskie Institute of Public Affairs

State and Local Finance Program

The Muskie Institute's new State and Local Finance Program provides non-partisan research and analysis of state and local finance policies, practices, and issues for citizens and policymakers, alike. Its intended scope extends to data reporting and analysis regarding state and local revenues and expenditures; identification of emerging issues and alternative strategies for addressing them; review and analysis of the biennial state budget; tracking the fiscal health of Maine's local governments; and in-depth, applied research on selected state and local finance topics. The Program will also maintain a continuing public education effort to make public budgeting and finance understandable and accessible to Maine citizens, opinion leaders, and policymakers.

Dollars and Sense is the first publication of the State & Local Finance Program. The second, soon to be released, is the Fiscal Crisis in the States: Lessons from the Northeast, edited by Charles S. Colgan and Joseph G. Slavet. This is the proceedings of the conference, "The Fiscal Crisis in the Northeast: Causes, Consequences and Lessons," held at the Federal Reserve Bank of Boston in April 1992 and cosponsored by the Muskie Institute, the John W. McCormack Institute of Public Affairs at the University of Massachusetts at Boston, and the Federal Reserve Bank of Boston.
DOLLARS AND SENSE:
MAINE STATE BUDGETING AT A CROSSROADS

by

Josephine M. LaPlante
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with the assistance of

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Research Associate

The Edmund S. Muskie Institute of Public Affairs
THE UNIVERSITY OF SOUTHERN MAINE
January, 1993
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Numerous Maine state government officials and their staffs facilitated our efforts by giving generously of their time and expertise. While we cannot mention each person who has supplied us with needed data or helped us to sort out the "whys" and "whens," we especially would like to acknowledge several individuals. Governor John R. McKernan, Jr. and H. Sawin Millet, State Finance Commissioner, deserve a special word of thanks for supporting the idea of an "outside look" at state budgeting. Victor Fleury, Deputy State Controller, helped us to unravel the state’s budget history with patience and unfailing good cheer. State Treasurer Sam Shapiro and Marc Cyr, Fiscal Analyst in the State Treasurer’s Office, Kent Price of the University of Maine System Office, and Jim Watkins, Director of Management Information Systems for the Maine Department of Education provided prompt and helpful responses to our many questions and requests for information.

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While this report would have been impossible without the assistance of these people and others unnamed, responsibility for any errors, omissions, and opinions expressed remains fully our own.

Josephine M. LaPlante, Ph.D.
Robert G. Devlin, M.A.
1. INTRODUCTION

Although choices made as part of the process of budgeting public funds often seem distant and removed from our daily lives, whether in crisis, or not, the state budget touches each one of us. Decisions that shape the budget determine the level of income we have after taxes, the potential effectiveness of our schools, and the quality of the environment. Government’s budgets are even more fundamental for some, because funding choices define essential aspects of people’s lives, including whether there is food on the table and a roof overhead at night. Less obvious, but no less vital, is the effect of budget choices upon the state’s fiscal prospects: the combination of the mix and quantity of public services and the level and distribution of taxes used to finance them are crucial determinants of a state’s ability to nurture and sustain economic health.

Despite the complexity of Maine’s new budgetary environment, a reasoned and strategic response to scarcity can minimize real losses today and turn the balance to wins for the future. The onset of recession, coupled with significant change in the composition of the state’s legislature, provides a fortuitous opportunity for policy makers to step back from the legacy of choices that have shaped the content and scope of Maine’s state budget and to affect meaningful reform.

Even in the best of times, budgeting in the public sector is never an uncomplicated process, with clearly defined goals, a "bottom line," and complete information. However, in the "good" times, the complexity of choices and the need for sound information to support difficult decisions often is obscured by revenue growth. By permitting both the sustenance of ongoing programs and the initiation of new endeavors, increasing resources create the illusion that government budgeting is a "win-win" endeavor. As a result, debate tends to become focused upon the short term distribution of increased shares of resources, often to the exclusion of considerations of the "big picture."

In times of fiscal crisis, the need to consider tradeoffs, probable long term consequences of budgetary choices, and how much government a state can afford are not as easily dismissed, because retrenchment of necessity designates more "losers" than "winners." Yet, by its very nature crisis demands action, so swift response may deftly displace favorable outcomes as the short term objective of public budgeting.
Maine's policy makers stand today at a critical juncture in state budgeting. Although the fiscal crisis has been treated by many as a temporary, albeit prolonged, suspension of "business as usual," our elected officials may expect to confront intense budgetary pressures throughout the 1990's. The fiscal tensions of the 1980's- Medicaid and environmental mandates, education reform, and spiralling health care costs- continue unabated in this decade, compounded by a prolonged recession, new and expanded federal mandates, a deteriorating public infrastructure, and intensified competition among the states for jobs.

Even after the national economy moves fully into a period of recovery, economists agree that the United States will face a period of slow growth while we strive to regain technological prominence in the world market. Many experts expect economic growth in New England to lag behind the U.S., at least for awhile. In Maine, the budgetary challenges that are likely to affect all states in the 1990's will be exacerbated by tax levels that are among the very highest in the U.S. There can be little doubt that profound budgetary choices will be forced upon us, with decisions potentially made more difficult by short term and possibly short sighted responses to recession.

Despite the complexity of Maine's new budgetary environment, a reasoned and strategic response to scarcity can minimize real losses today and turn the balance to wins for the future. The continuing revenue effects of recession are forcing not only a new, lower spending level, but also more realistic expectations about the extent of services that state government should provide. When coupled with a significant change in the composition of the state's legislature, the new economic reality offers a fortuitous opportunity for policy makers to step back from the legacy of choices that have shaped the content and scope of Maine's state budget and to effect meaningful reform.

Skillfully guiding Maine's fiscal course will be aided by knowledge and a shared understanding of the extent and nature of the fiscal challenges and opportunities that face Maine. Dollars and Sense: Maine State Budgeting at a Crossroads has been developed to equip policy makers, public managers and citizens with an evaluation of where we are, how we got here, and how that fiscal legacy may shape issues, constrain options, and offer opportunities in this decade. Although the focus of the study is on state policy, the report provides a broad examination of Maine's finances, including the important financial linkages between the state and local governments.

Dollars and Sense: Maine State Budgeting at a Crossroads provides a "bird's eye" view and analysis. The value of this approach is the capacity to take an "arm's length" look at state finances. We hope that the broader perspective will promote viewing expenditure and tax policy issues comprehensively, not as isolated slices of the state budget pie, but rather, as interdependent building blocks of a healthy fiscal system. There is an important limitation to an "outside" study, however, which is actually the same as its strength: distance from the "whys" and "whens." We do not pretend to understand every policy area as fully as specialists within government, nor to be privy to the same information. Thus, this report will be best used as a working document, to encourage and facilitate directed inquiry, open and thoughtful discussion of issues, and hopefully, decisions that can place Maine on a sound fiscal footing for the 1990's.
2. REVIEW OF SPENDING TRENDS

In this section, we trace ten years of state expenditure history in an effort to determine where and when major increases in expenditure occurred, how much of the increase in state spending during the 1980's was attributable to erosion of purchasing power due to inflation and how much was "real," and whether expenditure expansion was in line with increases that might be expected, given new budget pressures associated with rapid economic expansion.

2.1 OVERVIEW

The activities of state government are financed through and accounted for within "funds." Funds are like "separate pockets" within which the financial transactions of groups of programs are recorded. Typically, the categorization of programs into particular funds depends upon their sources of finance.

The general purpose activities of government are contained within a set of "governmental" funds, which includes the highways, special revenue, and general funds. Figure 1 provides an overview of governmental funds spending trends from 1980 and 1990.

- Spending from all of the governmental funds was characterized by rapid increase during the 1980's, averaging 13.2% annually between 1980 and 1990.
As is often the case, however, the overall trend is not indicative of trends of the components. Let’s consider the funds that comprise "governmental" spending individually. The highways fund, which derives its revenue largely from user fees on roads and gasoline, finances the state’s department of transportation, portions of other agencies’ budgets, and road assistance for local governments.

- Although spending nearly doubled between 1980 and 1990, the highway fund was responsible for only 8% of governmental funds spending in 1990, which represents a slight decrease from its 1980 share of 9%.

The special revenue fund is financed through a variety of revenue sources. Federal aid has traditionally been, and continues to be, the most important source of finance for this fund. In addition, "dedicated" revenues from fees enacted with a specific program in mind, and similarly, taxes that have been earmarked for special purposes are also accounted for through this fund.

- Expenditures from the special revenue fund increased by $348 million between 1980 and 1990. Yet, by 1990, spending from this fund had declined to 32% of combined governmental funds expenditure, from its 1980 share of 43%.

Public programs that are financed with "own source" revenues tend to be of particular interest to citizens because these funds largely are raised within Maine, through taxes and fees. Although own source revenues are expended through both the general and highway funds, the general fund is by far the largest and most important, in terms of both its size and claim on "own source" resources. The most important growth in state spending during the 1980’s was in the general fund.

- General fund expenditures nearly tripled between 1980 and 1990, increasing from $524.7 million to $1,546.9 billion. Even considered net of inflation, expenditures still doubled in ten years.
Both the very high rate of growth in the general fund and the claim these programs place upon "own source" revenues makes this fund a priority for further analysis. Table 1 presents an overview of pertinent trend data for the latter part of the decade.

2.2 TRENDS IN GENERAL FUND EXPENDITURE

Figure 3 and Table 1 display rates of increase in general fund expenditures for major state programs for the high rapid growth period 1985 through 1990.

While state employees retirement contributions stand out as having increased at a particularly rapid rate, examination of Table 1 and Figure 3 reveals that all of the general fund budgets were growing very rapidly.

- Between 1985 and 1990, annual increases in the Consumer Price Index averaged approximately 3.4%. Thus, all of the general fund policy areas displayed in Figure 3 were increasing at rates that were at least four times the rate of inflation.

The expenditure categories "all other" and "environment" both exhibited average increases in excess of 20% annually from 1985 through 1990. These rates of increase were exceeded only by growth in the state's contributions to the retirement system, which included "catch up" for previous underfunding.

Although a high percentage increase is always a reason to examine a budget carefully, a large percentage increase in a comparatively small budget typically adds fewer dollars to the total budget than a smaller percentage increase in a large budget. Multiple increases in small budgets can
<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>HUMAN SERVICES DEPT.</td>
<td>$156,246</td>
<td>+15.2%</td>
<td>16.6%</td>
</tr>
<tr>
<td>MENTAL HEALTH DEPT.</td>
<td>$275,320</td>
<td>+16.9%</td>
<td>8.4%</td>
</tr>
<tr>
<td>ENVIRONMENT</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Marine Resources</td>
<td>$156,246</td>
<td>+16.9%</td>
<td>8.4%</td>
</tr>
<tr>
<td>Conservation</td>
<td>$275,320</td>
<td>+16.9%</td>
<td>8.4%</td>
</tr>
<tr>
<td>Environmental Prot.</td>
<td>$3,307</td>
<td>+21.6%</td>
<td>0.5%</td>
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<tr>
<td>CORRECTIONS SYSTEM</td>
<td></td>
<td></td>
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<td>Corrections</td>
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<td>3.8%</td>
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<tr>
<td>Judicial</td>
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<td>+8.2%</td>
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<tr>
<td>TRANSPORTATION</td>
<td>$70,937</td>
<td>+19.4%</td>
<td>9.6%</td>
</tr>
<tr>
<td>UMAINE SYSTEM</td>
<td>$255,489</td>
<td>+17.9%</td>
<td>32.0%</td>
</tr>
<tr>
<td>RETIREMENT</td>
<td>$2,999</td>
<td>+68.1%</td>
<td>1.1%</td>
</tr>
<tr>
<td>Teachers</td>
<td>$10,130</td>
<td>+19.4%</td>
<td>9.6%</td>
</tr>
<tr>
<td>State Employees</td>
<td>$484,727</td>
<td>+22.3%</td>
<td>8.7%</td>
</tr>
<tr>
<td>ALL OTHER SPENDING</td>
<td>$829,617</td>
<td>+17.3%</td>
<td>100.0%</td>
</tr>
</tbody>
</table>


sum to an appreciable total, but controlling the addition of major dollar gains requires the determination of the sources of the largest increases. To assess the contribution of individual budgetary categories to overall spending growth, we may express the change in each budget area as a percentage of total expenditure change. Figure 4 displays the percentage of overall budgetary growth attributable to each policy area.
Figure 4

PERCENT OF BUDGET GROWTH ATTRIBUTABLE TO MAJOR POLICY AREAS, 1985-90

State Employees Retirement (7.5%)
Univ. of Maine (9.7%)
Human Svcs. Dpt. (16.8%)
Criminal Justice (6.7%)
Mental Health Dpt. (6.5%)
Teachers' Retirement (8.1%)
Local Schools (32.4%)
Other (8.8%)
Environment (1.5%)

Percent of General Fund Expenditure Increase


• Over 80% of the total increase in spending from the general fund between 1985 and 1990 may be attributed to six programmatic areas:

1) State aid for local schools (32%)
2) The Department of Human Services (16.6%)
3) The Maine State Retirement System (15.4%)
4) The University of Maine System (9.6%)
5) The Department of Mental Health (8.4%)
6) Criminal justice programs (6.6%)

The single largest "budget driver" is the state's contribution toward local school programs, which alone accounted for 32% of all of the growth in general fund spending between 1985 and 1990. Including the state's payment of the full employer share of the retirement system for teachers increases the explanatory power of education aid to 40.5% of overall budgetary growth.

Other important explanations for general fund budget growth during the second half of the last decade include:

• An annualized rate of increase in D.H.S. spending of 15.2% added nearly $120 million to the general fund between 1985 and 1990 and explained 16.6% of overall expenditure growth.

• Spending by the Department of Mental Health increased at an annual average rate of nearly 17% over the five year period and accounted for 8.4% of the total increase in general fund expenditure between 1985 and 1990.

• Growth in spending for the University of Maine system explained 9% of the total increase in general fund expenditure from 1985 through 1990.
Required contributions to the state retirement system for both teachers and state employees have been an increasing source of budget pressure.

- Taken together, the state's annual contribution towards retirement for state employees and for teachers explained 15.6% of the expenditure growth in the general fund between 1985 and 1990.

**Impacts of Trends on the Composition of the General Fund**

The analysis up to this point has enabled us to identify the major contributors to budget growth, to isolate the magnitude of their budgetary impact, and to get a better sense of which budgets have "driven" spending, to what extent. It is likely that the budget "drivers" that have been identified, including local schools, human services programs, corrections, higher education, and particularly, the state retirement system, will continue to push state spending, even though the rate of increase may wane due to policy intervention.

![Figure 5: Comparison of Budget Shares General Fund, 1980, 1985, and 1990](image)


At this point, we need to gain an added perspective on budget growth to permit us to make useful comparisons of differential changes in budgets of various sizes. Why? Even before undertaking any calculations, we could have predicted the drivers: they almost always are the largest budgets. The reason is straightforward: even moderate percentage increases in large budgets result in many additional dollars of expenditure.

To facilitate further understanding of budget growth, we may compare the percentage of total resources devoted to each component of spending at two, or even three points in time, as shown in Figure 5. We shall be looking for are changes in
"shares" of total spending: if each budget category increased at a rate that proportionate to growth in the other areas, the percentage of total budget would remain constant over time. In contrast, if indeed a budget category is growing more rapidly, we would expect there to be a "gain" in terms of the percentage of resources devoted to that area. Over time, more rapid rates of increase and intentional "injections" of funding should result in a reordering or at least demonstrable change in the portion of funds devoted to each component. Let's consider education, the most important component of general fund spending, first.

During the latter part of the 1980's, elementary and secondary education was frequently cited as a key priority of the state. As we already have seen, the state increased its contribution to public education markedly during the decade, with major injections of funding in fiscal years 1987, 1988 and particularly, 1989.

Based upon the heightened priority apparently being afforded education, we would expect to see that its claim on the general fund had increased as a result. However, as both Figures 5 and 6 (which traces education as a percentage of general fund spending) reveal:

- Both the 1985 and the 1990 shares of total expenditure from the general fund are lower than the 1980 percentage of 35%.

An important conclusion emerges:

- Despite the important contribution of increases in education funding to the total growth in spending, education has not achieved the anticipated "gain" in its share of the general fund expected to accompany its late 1980's "targeted priority" status.
In fact, the decrease in education's share of state general fund spending between 1980 and 1990 reveals that this policy area actually "lost ground" as a state fund priority over the decade of the 1980's, in spite of a substantial real dollar increase in funding.

For some years, human services has been an important state policy area, both in terms of the functional roles of states versus local governments nationally and the required outlay of funds. In recent years, the federal government has transferred both administrative and financial responsibility for human services "transfer" programs to the states. Although the rate of increase in spending in the Department of Human Services has been rapid:

- The claim of the Department of Human Services on general fund resources actually declined from 18.5% in 1985 to 17.8% by 1990.

- The fact that despite large annual increases in spending between 1985 and 1990, the percentage of the general budget devoted to this department did not decline, during a period when most states were seeing social services spending become more dominant within their budgets, is suggestive of even more rapid budget growth in other general fund areas.¹

We shall return to human services spending for transfer programs later in this section and in Chapter 4.

Higher education is another important state government role in both Maine and nationally. Maine state government appropriates a significant level of funds to three separate higher education institutions: the University of Maine System, the Maine Maritime Academy, and the state's Technical College System. The University of Maine System is the primary recipient of state support for higher education.

As we saw earlier, increases in funding for the University of Maine System was an important source of general fund budget growth between 1985 and 1990. In 1986 a visiting committee to the university determined that funding for the system was inadequate to support quality programming. In 1987, new state resources were targeted to the university, as Figure 7 reveals. However, also apparent is that almost as soon as the university system had been cited as a high priority for state funds, it began "losing ground" in terms of its claim on general funds resources. The other higher education institutions also lost ground between 1980 and 1988, but then remained constant through 1990.

- As shown in Figure 7, funding for higher education declined in total between 1980 and 1991, despite a large increase in budget share in 1987.

¹ More recently, when coupled with reduced spending in policy other areas, the combination of increased spending for safety net programs and a reduced federal reimbursement rate (which raises the state share) has thrust the department of human services into a more prominent position in the state budget.
Figure 7
HIGHER EDUCATION SPENDING TRENDS
PERCENT OF GENERAL FUND, 1980-91

The state's annual contributions toward retirement for state employees and teachers was one budget area where a notable gain in the share of funding was achieved.

- As a claim on general fund resources, retirement contributions for teachers and state employees have gained more than any other area, from a 1980 share of 7.9% to 10.9% by 1990.

The share of budget devoted to "all other" state purposes and environment experienced a barely perceptible decline between 1980 and 1990.

- Although the high rates of growth in some smaller budget areas did not contribute as many dollars to overall growth as did the larger components of state spending, their ability to "hold their own" as a percent of spending is evidence that they were growing just as rapidly as other, more visible, areas of the budget.

An obvious question that emerges at this point: if the areas of the budget that received injections of funds during the 1980's did not gain on other expenditure areas, what was going on? The finding that the balance among expenditure components of the state budget did not change notably between 1980 and 1990 leads to a key conclusion:

- This display further reveals a strong, downward trend in general fund support of higher education after 1987.

In 1991, the share of the general fund directed to these institutions again declined. As a result, the portion of general fund resources targeted to higher education in Maine has slipped appreciably since 1987. A conclusion emerges:

* The anticipated "heightened priority" of the higher education expenditure area during the 1980's is not supported by the data.
The lack of significant increase in the share of the general fund devoted to newly designated "priorities" during the 1980's provides important evidence that "high profile" funding targeted to selected policy areas was uniformly matched by less renowned, yet nonetheless significant, increases in other budget areas.

Although debate during the latter half of the past decade often focused upon "setting expenditure priorities," prioritization appears to have been limited to the allocation of increases in funds.

In effect, there is little evidence that any meaningful prioritization, where new initiatives displace old, accompanied expenditure decisions during the 1980's.

General fund expenditure increases may occur simply as the result of higher spending, but they may also reflect the impact of transfers of financial responsibility between governmental funds. Although budget debate often focuses exclusively on the general fund, shifts in financial responsibility between funds can significantly change the balance of financing responsibility.

Shifts in Financial Responsibility

A greater increase in general fund spending relative to growth in the other funds may occur due to a real decline in federal aid dollars or because aid does not keep abreast of increases in state expenditures, which may reflect the impact of unfunded mandates or simply state choices. In the Department of Human Services, changes in federal reimbursement rates can have sudden and severe impacts on general fund expenditures. Table 2 provides expenditure information by policy area for 1980 and 1990 in terms of how much of the total governmental funds expenditure was financed by the state's General Fund. The comparatively higher utilization of the general fund explains part of the increased pressure on the state budget in recent years, with the 1990 impact estimated at $326.8 million (as shown in Table 2.)

- In 1980, 47% of all governmental funds expenditure was made from the general fund; by 1990 the general fund’s share of total spending had reached 58%. The increase in financial responsibility that has accompanied the more pronounced general fund role is estimated at close to $327 million for 1990.

One budget area that does show a substantial shift in financial responsibility is the retirement system.

- Both the state employees and the teachers retirement contribution were financed with significant levels of non-general fund resources in 1980, but had become fully dependent on the general fund by 1990. The added cost to the
Table 2

Financing State Expenditures in
Selected Policy Areas
Comparison of General Fund Responsibility
1980 and 1990

<table>
<thead>
<tr>
<th>POLICY AREA</th>
<th>Percent Financed by General Fund Revenues</th>
<th>Impact of Financing Shift on 1990 General Fund</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1980</td>
<td>1990</td>
</tr>
<tr>
<td>HUMAN SERVICES</td>
<td>27%</td>
<td>37%</td>
</tr>
<tr>
<td>MENTAL HEALTH/ CORRECTIONS</td>
<td>73%</td>
<td>93%</td>
</tr>
<tr>
<td>ENVIRONMENT</td>
<td>69%</td>
<td>82%</td>
</tr>
<tr>
<td>Marine Resources</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Conservation</td>
<td>56%</td>
<td>78%</td>
</tr>
<tr>
<td>Dept. Envir. Prot.</td>
<td>18%</td>
<td>22%</td>
</tr>
<tr>
<td>JUDICIAL</td>
<td>99%</td>
<td>99%</td>
</tr>
<tr>
<td>TRANSPORTATION</td>
<td>2%</td>
<td>4%</td>
</tr>
<tr>
<td>UMAINE SYSTEM</td>
<td>100%</td>
<td>100%</td>
</tr>
<tr>
<td>GEN. PURP. EDUC. AID</td>
<td>100%</td>
<td>100%</td>
</tr>
<tr>
<td>RETIREMENT</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Teachers</td>
<td>47%</td>
<td>100%</td>
</tr>
<tr>
<td>State Employees</td>
<td>47%</td>
<td>100%</td>
</tr>
<tr>
<td>TOTAL</td>
<td>46%</td>
<td>58%</td>
</tr>
</tbody>
</table>

general fund is estimated at almost $103 million.

Although part of the explanation for the notable "gain" in the share of general fund resources devoted to the retirement system that we saw in the previous section stems from a combination of an intentionally "stepped up" contribution coupled with employment trends, as we shall discuss further in Chapter 4. However, as this display reveals, an important factor that has contributed to the increased percentage of general fund revenues used for funding the retirement system was the shift of financial responsibility from other governmental funds to the general fund.²

- General Fund support of the Department of Human Services increased from 27% of their total spending in 1980 to 37% in 1990. The dollar impact of the shift in financial responsibility is estimated at nearly $76 million.

Part of the increase in general fund responsibility for human services finance stems from the transfer of some costs from Mental Health, in order to obtain federal Medicaid reimbursements, part from a reduced federal reimbursement rate, and part from growth in discretionary state spending, such as for the Supplemental Security Income (S.S.I.) state addition and general assistance (neither of which receive any federal aid.)

Interestingly, this finding of an increased general fund share would be expected to be accompanied by a higher percentage of general fund resources targeted to this policy area. As we saw in the previous section, however, in 1990 the share of general fund resources used for human services had declined, not increased.

Funding for Mental Health and Corrections (which were a combined department in 1980 and must thus be considered together) has similarly become more dependent upon the general fund, increasing from a general fund share of financial responsibility of 73% in 1980 to 93% in 1990. The increased share is largely explained by more rapid increases in the use of general fund resources than in the receipt of other revenues.

2.3 TRENDS BY THE TYPE OF EXPENDITURE

Thus far, we have studied state spending within the framework of policy or departmental funding areas. Viewing state spending solely within those categorizations may disguise government wide "budget drivers," such as increases in employee benefit costs. Consideration of state expenditures from another perspective, that of commodities, goods or services purchased, may provide additional insights into budgetary "pushes" that may have been driving spending growth in the 1980's, such as the identification of common areas of budgetary increase across policy areas, such as wages. In addition, this perspective permits a separation of spending for programs operated

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² It is unclear what other funding sources were used in 1980.
Figure 8

PERCENT OF BUDGET GROWTH ATTRIBUTABLE
TO EACH CATEGORY OF EXPENDITURE, 80-90

All Governmental Funds (includes federal aid)


indirectly, through payment for services provided to individuals.

- Increased spending for grants and subsidies accounted for more than
62% of the growth in governmental funds spending during the 1980’s.

The impact of these important increases on the share of total state expenditure devoted to
grants and subsidies has been appreciable:

- In 1980, 62% of all governmental funds were used to provide grants
and subsidies. By 1990, the share of resources directed to grants and subsidies
had reached 66%.

The higher share of governmental funds spending reflects increased federal aid. If we
compare only general fund resources used to provide grants and subsidies at the beginning and end
of the decade, we find a slight decline in the percentage.

- In 1980, 64.3% of general fund spending was for grants and subsidies.
By 1990, this figure had decreased slightly, to 63.0%.
**Table 3**

Trends in Governmental Funds Spending  
by Object of Expenditure, 1980 - 1990

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1980</td>
<td>1990</td>
<td></td>
</tr>
<tr>
<td>PERSONAL SERVICES</td>
<td>$199,200</td>
<td>$469,186</td>
<td>+13.6%</td>
</tr>
<tr>
<td>Salaries and Wages</td>
<td>168,088</td>
<td>355,415</td>
<td>+11.1%</td>
</tr>
<tr>
<td>State Emp. Retirement</td>
<td>25,729</td>
<td>77,098</td>
<td>+20.0%</td>
</tr>
<tr>
<td>Health Ins/Oth. Benefits</td>
<td>5,383</td>
<td>36,071</td>
<td>+57.0%</td>
</tr>
<tr>
<td>CONTRACTUAL SERVICES</td>
<td>$ 89,945</td>
<td>$186,261</td>
<td>+10.7%</td>
</tr>
<tr>
<td>Professional Services</td>
<td>27,210</td>
<td>74,144</td>
<td>+17.2%</td>
</tr>
<tr>
<td>Rents</td>
<td>20,567</td>
<td>39,438</td>
<td>+9.2%</td>
</tr>
<tr>
<td>General Operations</td>
<td>21,305</td>
<td>31,283</td>
<td>+4.7%</td>
</tr>
<tr>
<td>COMMODITIES</td>
<td>$ 24,292</td>
<td>$ 33,464</td>
<td>+ 3.8%</td>
</tr>
<tr>
<td>GRANTS AND SUBSIDIES</td>
<td>$681,652</td>
<td>$1,630,267</td>
<td>+13.9%</td>
</tr>
<tr>
<td>To Other Governments</td>
<td>266,067</td>
<td>638,053</td>
<td>+14.0%</td>
</tr>
<tr>
<td>To Public and Private Organizations</td>
<td>120,102</td>
<td>388,984</td>
<td>+22.4%</td>
</tr>
<tr>
<td>Social Services Transfers</td>
<td>228,118</td>
<td>590,059</td>
<td>+15.9%</td>
</tr>
<tr>
<td>CAPITAL OUTLAY</td>
<td>$ 72,255</td>
<td>$132,643</td>
<td>+ 8.4%</td>
</tr>
<tr>
<td>DEBT SERVICE</td>
<td>$ 35,451</td>
<td>$ 70,343</td>
<td>+ 9.8%</td>
</tr>
<tr>
<td>TEACHERS RETIREMENT</td>
<td>$ 29,366</td>
<td>$116,934</td>
<td>+29.8%</td>
</tr>
<tr>
<td>TOTAL</td>
<td>$1,139,884</td>
<td>$2,650,212</td>
<td>+13.2%</td>
</tr>
</tbody>
</table>


As we have already seen, spending for teachers retirement, which is actually an indirect subsidy of local schools, was a primary general fund budget driver. (State employee retirement is included with personal services.)

- When teachers’ retirement is included with grants and subsidies, the percentage of the general fund used for this purpose increased slightly over the decade, from 69.9% of the total in 1980 to 70.6% in 1990.
Figure 9 compares the percentage of general fund resources that were used for different types of grants and subsidies in 1980 and in 1990. This graph reveals some very important impacts of different growth trends among the funding categories.

Although Medicaid, AFDC and local education aid have been the focus of much attention since the recession began taking its toll on state revenues, the comparison of shares of grants and subsidies directed to these budget components reveals that each decreased between 1980 and 1990, which was actually the first year that the recession began effecting spending for safety net programs.

- Grants and subsidies to other governments (which is predominantly general purpose school aid but includes some funding of county government), declined markedly, from 57.3% of total subsidies in 1980 to 50.9 in 1990.

We have looked at education previously, as one of the policy areas, but the importance of this expenditure area within grants and subsidies to other governments warrants another look. If we consider general purpose education as a percentage of the general fund, we find a similar pattern of decrease:

- General purpose education aid declined from 35% of the general fund in 1980 to 30.8% in 1990.

The component of grants and subsidies that stands out as having gained on other categories is assistance to "public and private agencies and organizations." The state’s allocation to higher education comprises the major portion of this component of grants and subsidies.
• In 1980, grants and subsidies to public and private organization comprised 11.5% of all general fund expenditure; by 1990, the percentage had increased to 16.8% of the total.

The gain in general fund budget share is not attributable to higher education funding. As we saw earlier, percentage of total has declined dramatically since 1980, as shown in Figure 7.

• In 1980, higher education comprised 87% of general fund spending for grants and subsidies to public and private organizations. By 1990, the share directed to higher education had declined to only 59.5%, with the difference deftly displaced by the far more vigorous growth in grants and subsidies to other types of public and private organizations.

Since the onset of the recession, this category of state spending was down only very slightly—despite cuts to higher education—to 16.4% in 1990 from its 1990 share of 16.8%.

• Analysis of what besides higher education is being funded through "grants and subsidies to public and private organizations" should be undertaken without delay, the resultant list reviewed, and the priority of each allocation determined.

Three other components of state spending, also contributed importantly to budget growth in the 80’s: personal services, debt service and contracts.

Personal services includes all of the costs associated with the employment and compensation of state personnel. Thus, in addition to salaries and wages, the cost of the state employees’ retirement and health benefits are included in this budget account.
Between 1980 and 1990, average annual spending increases for personal services exceeded 13.6%.

Over the decade, increases in spending for personal services explained 18% of the total growth in state governmental funds expenditure. However, even more importantly, 79% of the real growth in governmental funds spending for personal services occurred within the general fund.

The most rapid area of increase within personal services was for health and related benefits, at an average annual rate of growth of 57%, compared to the +11.1% per year for salaries and +19% for retirement benefits.

However, the dollar contribution of increased salaries and wages was by far the most important source of growth in spending for personal services.

Between 1980 and 1990, increases in spending for salaries and wages totalled $187 million and explained 69.4% of all expenditure growth for personal services.

Since governmental funds spending includes federal funding that may fully cover the cost of employment, looking at the general fund impact of personnel increases separately enables us to better isolate the significance of the budgetary impact upon own source revenues.

General fund spending for personal services increased by more than $100 million real dollars between 1980 and 1990.

The size of this increase in general fund financing burden as well as the broad, government wide impacts that may accompany personal services cost growth make this area a high priority for further analysis. We return to both state employment and personnel compensation in Chapter 4.

Contracts for service are another important area of state spending. While as a whole, expenditures for contractual services increased steadily between 1980 and 1990, there was a diversity of trends within this category. Figure 11 shows deflated trends for contractual expenditure for different types of contract.

Several contract areas, including vehicles, utilities and travel, saw little or no real growth over the decade.

In contrast, spending for professional contracts showed exceptionally high growth, with annualized increases between 1980 and 1990 of 18%. Rents evidenced strong growth, at 9.2% on an average annual basis over the decade.

One area of governmental funds expenditure that did not show significant increase in expenditure during the 1980's is capital outlay. An examination of capital spending trends shown in Figure 12 provides a sense of potential underinvestment in infrastructure.
A comparison of real capital outlay in 1980 and in 1989 shows little discernable difference.

During the period of time between those two years, real spending dipped below the 1980 level several times, reaching a critical low point in 1984.

The potential for sudden budgetary pressure to emerge from postponed or an unrecognized need for capital reinvestment, coupled with the importance of infrastructure for economic growth and sustained vitality make this area a priority for further study. Although there is no generally accepted, "ideal" level of capital investment, we shall employ infrastructure ratings done by the federal Department of Transportation and comparative data on state and local capital investment and public capital stock to evaluate Maine's capital spending during the 1980's in Chapter 4.

Finance Shifts by Expenditure Type

In the same way that we considered the changing balance of financing public services between the general fund and other governmental funds revenues by policy areas, we may consider shifts by expenditure type. Table 4 shows this information. The most significant dollar shift in responsibility occurred in the category grants and subsidies.

- Although the portion of governmental funds spending for grants and subsidies financed through the general fund only increased from roughly 50% to 60%, the dominance of this expenditure area in the state budget resulted in many extra dollars of financial responsibility.
Table 4

Shares of Financing Responsibility by Object of Expenditure
Comparison of the General Fund Share, 1980 and 1990

<table>
<thead>
<tr>
<th>Object of Expenditure</th>
<th>Percentage Financed by General Fund</th>
<th>Estimated Impact on 1990 General Fund</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1980</td>
<td>1990</td>
</tr>
<tr>
<td>PERSONAL SERVICES</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Salaries and Wages</td>
<td>48.7%</td>
<td>59.6%</td>
</tr>
<tr>
<td>St. Emp. Retir. Sys.</td>
<td>49.1%</td>
<td>59.2%</td>
</tr>
<tr>
<td>Health/Oth. Emp. Ben.</td>
<td>46.5%</td>
<td>63.1%</td>
</tr>
<tr>
<td></td>
<td>48.4%</td>
<td>57.0%</td>
</tr>
<tr>
<td>CONTRACTS</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Professional Services</td>
<td>38.7%</td>
<td>47.4%</td>
</tr>
<tr>
<td>Rents</td>
<td>51.3%</td>
<td>52.4%</td>
</tr>
<tr>
<td>General Operations</td>
<td>8.3%</td>
<td>18.2%</td>
</tr>
<tr>
<td></td>
<td>41.7%</td>
<td>68.4%</td>
</tr>
<tr>
<td>COMMODITIES</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>37.9%</td>
<td>40.2%</td>
</tr>
<tr>
<td>GRANTS/SUBSIDIES</td>
<td></td>
<td></td>
</tr>
<tr>
<td>To Other Governments</td>
<td>49.5%</td>
<td>59.8%</td>
</tr>
<tr>
<td>Public and Private Organizations</td>
<td>72.8%</td>
<td>77.7%</td>
</tr>
<tr>
<td>Social Services Transfers</td>
<td>50.5%</td>
<td>66.8%</td>
</tr>
<tr>
<td></td>
<td>29.1%</td>
<td>35.9%</td>
</tr>
<tr>
<td>CAPITAL</td>
<td>5.9%</td>
<td>14.3%</td>
</tr>
<tr>
<td>DEBT SERVICE</td>
<td>74.7%</td>
<td>73.8%</td>
</tr>
<tr>
<td>TEACHERS’ RETIREMENT</td>
<td>46.7%</td>
<td>100.0%</td>
</tr>
<tr>
<td>TOTAL BUDGET</td>
<td>46.0%</td>
<td>58.3%</td>
</tr>
</tbody>
</table>


An examination of shifts within the components of grants and subsidies is revealing. Although we considered the Department of Human Services in the previous section, Table 3 provides information on social services transfers alone, that is, net of any administrative costs or other D.H.S. programs. This table shows that in 1980, 29.1% of all social services transfers were financed through the general fund, by 1990 the share had increased, but not as much as might be expected, to roughly 36%. We shall look at the programs that comprise social services transfers separately in Chapter 4.
• The 1990 impact of the shift of financial responsibility for human services transfer programs to the general fund is estimated at $40 million.

While not an insignificant amount, these additional dollars of financial responsibility fall far short of explaining the massive increase ($168 million) in state general fund support for grants and subsidies. Increased expenditures for grants and subsidies "to public and private organizations" is the primary cause of growth in the general fund share.

• In 1980, the general fund paid 50.5% of the total outlay of funds for grants and subsidies to public and private organizations. By 1990, the share had increased to 66.8%, with an estimated impact in that year on general fund financing requirements of $63.5 million.

Some of the shift to the general fund may reflect reduced federal funding that had formerly been channelled through the state to local government agencies and private or non-profit organizations. An additional portion of the shift may be explained by "privatization," the state’s purchase of services from private and non-profit agencies to replace services previously delivered in house or to implement new programs. As noted earlier, delving further into this rather amorphous category of expenditure to determine how funds are being spent should be a top priority in this time of budget retrenchment.

The shift in responsibility for funding personal services has been a critical change, that appears to have stemmed from very rapid growth in general fund expenditure (as discussed earlier in this section), rather than from a transfer of responsibility from one fund to another.

• In 1980, $97.1 million, or 49% of the total personal services expenditure was financed by the general fund, but by 1990, $279.5 million, or 60% of the total was paid from the general fund.

• The increased costs of personal service added $50.8 million to general fund spending in 1990.

Both the rate of increase and budgetary impact on the general fund make personal services a priority for further study.

2.4 ADJUSTMENTS FOR MAJOR COST FACTORS

It is generally recognized that inflation affects public spending, and consequently, expenditure trends are usually adjusted for cost increases that accompany inflation. However, too often increases in spending that exceed the rate of inflation are viewed as "bad" and slow growth as "good," with little comprehension of how those budgets should have been changing, given changes in the need for, and cost of, producing public services.
Figure 13
PER CAPITA GENERAL FUND EXPENDITURES
1980-1990


As we have seen, spending for capital outlay clearly lagged behind increases in other areas of the state budget, during a period of rapid economic and population expansion. Both of these factors would be expected to have placed substantial pressure on existing infrastructure, and in many cases, contributed to the need for expansion or new construction because both population increases and economic development place pressure on government to provide additional physical infrastructure. In addition, services would in all likelihood need to be increased to serve more people.

To determine whether spending increases that exceeded inflation are attributable to these forces, we must "net out" their impact. Although more elaborate methods are available, at least a rough gauge of the "expected" level of expenditure can be obtained by making two adjustments. First, we may express spending on a per capita basis to adjust for the larger population receiving services. If expenditure growth was simply a response to an increased population, per capita expenditure figures would not change. However, even a cursory examination of Figure 13 shows that significant growth in expenditure occurred beyond that which would be explained by increased population.

- Per capita general fund spending increased steadily over the decade, from a level just under $500 in 1980 to over $1200 per person in 1990. In deflated dollars, there was an increase of more than $300 per person.

Second, we may adjust spending for economic change by expressing expenditures as a percentage of personal income. If spending increases were simply keeping pace with economic growth, the percentage of personal income "claimed" by the general fund would be relatively constant. Figure 14 displays general fund spending as a percent of personal income.

- In 1980, state general fund spending was equal to 5.7% of personal income. By 1990, spending as a percent of income had increased to 7.4%.
After making both income and population based adjustments to general fund spending, two important conclusions emerge:

♦ Neither inflation nor population growth are able to "explain away" increases in state spending. Moreover, even during this period of very rapid income growth, the claim of the general fund on personal income increased.

Although the adjustments to spending used in this section at least partially correct for key budgetary forces, there were undoubtedly other influences on spending. Federal retrenchment, "catch up" or other influences upon budget growth may further explain why there was rapid growth in one or more of the policy areas or object of expenditure categories. However, aggregate adjustments are not indicated, because the impact upon expenditures is likely to have varied greatly.

In Chapter 4, we shall take a "closer look" at state spending in a number of key budget areas. In an effort to better understand Maine's spending trends, we shall use a set of specially selected states as a "reference" group, to help us assess whether Maine's rate of increase in expenditure was unusual among the states and how our level of spending for individual programs and components of expenditure (such as salaries) compares to other states.

Although comparative analysis may reveal that in select areas of the budget rapid increase has been the "norm" among states, it is unlikely that the brisk, across the board increases seen throughout Maine's general fund in the latter part of the decade will be "explained away" by uncontrollable forces.

♦ Every indication thus far points to a failure to adequately offset new spending in explicitly acknowledged high priority budget areas with reductions in other, less important budget areas.

Given that income was growing quickly during the 1980's, the increasing "bite" of state spending provides significant evidence that growth in spending may have been outpacing Maine's ability to pay for services. At this point, then, it may be most productive to consider trends in state revenues, how our reliance upon various financing sources changed, and whether tax burden actually increased during the 1980's.
3. REVIEW OF REVENUE TRENDS

Two important questions are raised by the increased bite of the general fund on the state’s major resource base. First, since the state uses a variety of tax instruments to raise revenues, each of which effects various groups of taxpayers differently, how was the increased burden of government finance distributed among tax types, and consequently, among taxpayers? Second, given that nationally states were accepting more financing responsibility during the 1980’s, how does Maine’s new, higher, aggregate tax burden compare to other states?

In this section, we first explore revenue trends to determine the financing sources for increased spending. We then turn our attention to tax burden: how the overall burden of taxation in Maine has changed, how the distribution of burden among the tax types- and hence, among taxpayers- has been modified, and finally, how Maine’s burden compares to other states. Finally, we consider the impacts of the altered tax structure upon the stability of revenues.

3.1 OVERVIEW

Figure 15 compares the financing share of each of the major revenue sources in 1980 and 1989. The diminished role of federal aid immediately draws attention. The upper portion of Figure 16 shows trends in the state’s annual receipts of federal aid.

- Despite a substantial increase in dollar terms, from $380 million to $656 million, federal funding declined significantly in importance as a financing source, from a 1980 level of 34.2% of revenues to only 26.9% in 1989.

Figure 16
TRENDS IN FEDERAL AID
CURRENT AND DEFLATED, 1979-90

Trends in Federal Aid for
State Programs, Excluding Human Svcs.

Once the influence of inflation is removed, we see that in 1989 real federal aid was nearly identical to the 1980 level.

In 1990, federal aid showed a real and significant increase, due to the state's recession induced higher expenditure level, which leveraged additional dollars of federal reimbursement. Trends in aggregate yearly federal aid allocations disguise important changes in allocations to various policy areas. As shown in the lower portion Figure 16:

- In real dollars, aid for state purposes other than human services decreased steadily over the entire decade, for a total loss of over $100 million.

Figure 17 displays rates of increase for the major "own source" revenues between 1980 and 1989.

- Collections from the personal income tax averaged increases of 35%, far outpacing the growth of all other revenue sources.

While far less significant than increases in personal income tax collections, several other revenue sources did evidence strong growth in the 1980's, especially the general sales tax.

- General sales tax collections averaged increases of nearly 16% annually over the nine year period of 1980 through 1989.

Although the growth in the corporate income tax collections lagged significantly behind those from the personal income tax, the yield was nonetheless characterized by healthy increases during the 1980's.

- Corporate income tax collections increased by 12.6% on average annually between 1980 and 1990.
During the 1980's, selective sales or "excise" tax collections from cigarettes, alcohol and gasoline increased appreciably, due in large part to a number of rate increases. Nonetheless, as a proportion of total revenues, each declined between 1980 and 1989.

Responsibility for total revenue growth over the period 1980-1989 may be apportioned to the different revenue types by expressing the increase in each of the individual revenue sources as a percentage of the total difference in collections. The results are shown graphically in Figure 18.

- Between 1980 and 1989, growth in personal income tax collections accounted for 47.3% of the total increase in yield from the major own source revenues.

- Sales taxes contributed 31.8% to the total increase in revenues.

Thus, close to 80% of all growth in collections from the state's major tax types was attributable to just two revenue types, the personal income tax and the general sales tax.

The very rapid increases in revenue from these two taxes and the significance of their contribution to overall revenue growth raises three questions. First, how did the relative shares of financing burden among the tax types change during the 1980's? Second, what are the implications of a changed revenue reliance pattern? Third, are the increases in tax collections evidence that the burden of state taxes grew during the 1980's?

3.2 REVENUE STRUCTURE: TRENDS AND IMPACTS

The relatively more rapid growth of personal income tax collections is underscored by its changed importance as a financing source.
• In 1989, personal income tax collections accounted for 24% of all governmental funds revenues, compared to only 13% of the total in 1980.

• As a percent of own source revenues, the personal income tax increased from 21% to 33%.

• The corporate income tax declined from 7.8% of the state's total own source revenue collections in 1980 to only 6.1% by 1989.

The effect of the far higher rate of growth of personal income tax collections on the relative balance between the two income tax types is displayed in Figure 19.

• While corporate income tax collections were equal to about one-third of personal income tax collections in 1980, by 1989, they had declined to only 17%.

Although in 1980 the general sales tax was Maine’s most important own source revenue, by 1989 the balance had changed appreciably.

• Despite strong growth, the sales tax declined from 32.2% of own source revenue to 28.5% of the total by 1989 and moved from first to second place in importance as a financing source.

Revenue Reliance
and the Stability of Tax Collections

Changed patterns of reliance on various revenue instruments resulted from policy choices (such as changes in rates), national trends (less smoking), reactions to national tax policy, and an
Figure 20
THE REVENUE EFFECTS OF RECESSION: COMPARISON OF RATES OF BUDGETARY CHANGE


over effort to reduce local reliance on property taxes. However, other differences in the rates of change are reflective of the degree of responsiveness (elasticity) of each revenue instrument to the economy.

Whether through tax policy design or as a result of the inherent sensitivity of different taxes, by the end of the decade Maine's pattern of revenue reliance had shifted the balance of Maine's revenue structure towards a much heavier reliance upon the sensitive or "elastic" tax types.

- By 1989, the state had come to depend far more heavily upon the two most elastic tax types, the corporate and personal income tax, with their sum comprising 39% of "own source" revenues compared to only 29% in 1980.

Figure 20 compares pre-recession rates of increase in major tax sources to changes between 1989 and 1991. The contrast in the rates of growth under disparate economic conditions is startling.

- The sharp decline in the growth of state revenues that followed the onset of the recession provides important evidence that the relative utilization of the various tax types within our overall revenue system is not conducive to the collection of a reasonably stable level of taxes.

A comparative study of state tax collections by Robert Tannenwald (1990) for the Federal Reserve Bank of Boston, which covered the period 1974 through 1989, developed an index of tax volatility (which measures the responsiveness of tax collections to economic changes) for each of the New England states and for the U.S.

- Maine's tax volatility score for the period 1974 through 1989 of 191 was nearly five times the U.S. average of 42 and exceeded all of the New England states by a significant margin.
Figure 21 reveals that between 1989 and 1991 the percentage of personal income collected as tax declined more in Maine than in any other state. The reduction of the percentage of income raised as tax or the effective rate of that tax has been a major cause of Maine’s revenue shortfall.

- The "effective" or average rate of taxation of personal income declined from 3.1% in 1989 to 2.6% in 1991.

Although the change in the average rate at which personal income is taxed many not appear to be great, the revenue impact has been severe.

- The decline in the average rate of taxation of personal income the accompanied the onset of recession resulted in $212 million of lost tax revenues in Fiscal Years 1991 and 1992.

To make matters worse, Maine’s sales tax collections have been responded sharply to the economic downturn.

- The sharp decline in Maine’s general sales tax collections relative to personal income, and the contrast to the general U.S. experience, provides evidence of an underlying, and problematic, volatility in this tax.

Review of Figure 21 verifies a judgement of magnified tax volatility in Maine. In addition, while progressive personal income taxes are always sensitive to economic change, many states use progressive income taxes and did not see the response to economic downturn that we witnessed in Maine. This suggests that our high reliance upon elastic tax types does not fully explain the overall volatility of our tax system. Important conclusions emerge:

- Personal income taxes and general sales taxes are particularly problematic sources of volatility in Maine’s system of revenues, as evidenced by
(1) the magnitude of their response to the recession and (2) the difference in the
degree of response relative to the U.S.

The dominance of two highly volatile revenue types within our overall tax structure
makes state programs far too susceptible to the "bungee cord" effect: spiralling increases in
funding followed by sharp and potentially severe cutbacks.

responded to changes in personal income far more than would be expected? For both of these
revenue types, the answer lies in part in the structure of the tax. However, other, differing factors
have contributed to the sensitivity of each.

Before considering the causes of volatility in these tax types, another aspect of revenue
stability must be considered. The tremendous volatility of Maine’s revenue structure has
exacerbated by federal aid policies. First, the reduction in federal aid in areas other than social
services caused state programs and capital investment to be more dependent upon "own source"
revenues. The heightened dependency upon general fund and other own source revenues make
programs more vulnerable to cutbacks in recessionary periods. Second, just as the recession
descended upon us, Maine’s Medicaid and A.F.D.C. reimbursement rates were reduced. The
seemingly perversity of this federal action is explained by the lag between economic change and
updating the formulae. Maine’s economic renaissance of the late 1980’s had improved our
comparative position among the states. The formulae were thus updated, eventually, to reflect our
improved status. The fact that our position deteriorated as a result of the recession will be built into
the federal formula, eventually.

CAUSES OF SENSITIVITY: THE PERSONAL INCOME TAX

It is important to recognize that the effective rate of income taxation simply expresses
collections as a percentage of income. Thus, a decline in personal income, in and of itself, will not
effect the rate.

- The magnitude of the portion of Maine’s revenue shortfall that is
attributable to the personal income tax reflects the dual impact of stagnant
personal income and the structure of our personal income tax.
A number of structural features of our income increase its sensitivity to changes in personal income.

- By the end of the 1980's, Maine's income tax had one of the highest maximum marginal rates in the U.S. The increase of the top bracket rate to 10% will exacerbate the elasticity of the tax.

- The top marginal rate "kicks in" at a relatively low level of income, with all income above that threshold amount taxed at the top rate.

- The responsiveness of the personal income tax is heightened by the steep structure of the marginal brackets, which concentrate all increases within a narrow range of incomes.

- The large number and value of deductions from income permitted and the high personal exemption amount exacerbate the volatility of the personal income tax by reducing the "stable core" of income subject to taxation.

Under a progressive tax structure, the reduction of taxable income reduces the tax liability more than the household's average tax rate would predict, because that income was taxed at their highest marginal rate.

In addition to these structural features, workforce trends have effected the average rate of tax collections.

- The structural sensitivity of the personal income tax became exaggerated during the 1980's by a growth in second wage earner households.

The linkages between second wage earners and responsiveness of the income tax warrants elaboration, because the connections are not necessarily intuitively obvious and the impact on tax collections, whether in "good" times or "bad," is substantial.

The increase in household income that results from the addition of a second wage earner is taxed differently than the first income producer's wages. The deductions and exemptions permitted a family usually do not change when a second worker becomes employed. Thus, the deductions and exemptions reduce the first wage earner's taxable income, leaving the second wage earner's income fully taxable. In addition, the second earner's income is not only fully taxed, it is taxed at the family's highest marginal rate(s). During periods of income growth, the state's income tax collections benefit dramatically from these structural aspects of our system.

The impact of job loss or a reduction in pay in a dual earner family is far more detrimental for state tax collections than when a single person or single head of household faces similar employment difficulties, because in the two wage earner family, more of the second wage earner's income would have been subject to tax. Most (or all) of the loss of earnings represents a reduction
in taxable income. Thus, revenues decline far faster than the size of the economic change would predict.

In sum, the combined effect of a progressive personal income tax structure, a steep progression of marginal bracket rates, and an increased number of two income households is that more income is taxed at higher levels than under another structure, which substantially increases tax yield during expansionary periods but just as quickly sends receipts into a downslide when the economy falters. Consequently, the state's capacity to sustain funding for priority purposes across economic cycles is profoundly diminished.

**CAUSES OF SENSITIVITY: THE GENERAL SALES TAX**

The instability of this tax stems from both structural characteristics and consumption patterns. First, in an effort to reduce the inherent regressivity of the general sales tax and to mitigate its burden on very low income residents, Maine exempts goods such as most foods and home heating fuel from taxation. The exclusion of these commodities, which form a stable component of consumer spending across business cycles, has been granted for understandable reasons, but the effect is to increase appreciably the sensitivity of this tax to economic change.

In addition to tax equity considerations, issues of interstate tax competitiveness often enters into decisions about the structure of the sales tax. Like many states, Maine does not apply the sales tax to the purchase of equipment for manufacturing and other business purchases likely to cause a problem known as "pyramiding," which is price escalation due to the sales tax being applied at multiple points in the production of goods. Finally, Maine taxes almost no services and has granted exemptions from sales tax to many special interest groups. For example, although the purchase of a book is taxed, the sale of a magazine is not. At least one observer has noted correctly that Playboy magazine is not taxed while the Bible is!

- The structural instability of the general sales tax in Maine arises from (1) the extent of exemptions from taxation (narrowness of the tax base) and (2) the exclusion from taxation of items whose purchase is not easily postponed with an economic downturn.

As a result of diverse trends, during the 1980's our sales tax became more reliant upon commodities within the taxable base whose purchase is easily deferred until better times.

- The responsiveness of the general sales tax to economic cycles increased during the 1980's because tax collections became more dependent upon purchases of building materials and automobiles.

The growth of tourism has exacerbated that the trend towards taxation of postponable purchases.
Increased dependence upon sales of taxable goods to tourists effects both the level and composition of retail sales: (1) the purchase of non-necessities tends gains in importance relative to other taxable sales, and (2) sales tax collections become linked to the regional economy.

On the positive side, tourism has diversified our base of consumers, so that sales to tourists may bolster revenues, as strong consumption of taxable goods by Canadians has done.

A final variable that has played a role in the sensitivity of our sales tax collections is the expanded use of credit during the latter 1980’s. There are two important consequences of credit finance of purchases for tax collections.

- Consumer expenditure patterns that helped fuel increases in the state’s collections from the sales tax during the 1980’s were leveraged with borrowed dollars, rather than income that could sustain spending over time and across diverse economic cycles.

- As the economy deteriorated, many households began paying off consumer debt, rather than incurring new debt or maintaining the former level. This trend heightened the impact of the economic slide, because fewer dollars of disposable income are being directed at consumption.

The trends in tax collections that brought about a major restructuring of Maine’s revenue system can be expected to have changed the distribution of tax shares among households and between businesses and households. In addition, data considered thus far suggests that an increase in tax burden may have accompanied Maine’s economic renaissance, because of the heightened responsiveness to economic change of not only the traditionally elastic tax types but also the typically more stable general sales tax. Let’s explore these issues.

3.3 THE BURDEN OF STATE TAXES

Maintaining spending at a "steady state" during the 1980’s would have reduced the percentage of the state’s revenue bases that needed to be raised to finance programs. A decrease might have be possible, if economic growth was "more than paying its way." In contrast, an increased bite will provide evidence that government spending was expanding more rapidly than

---

3 A study by the Federal Reserve Bank of Boston found that New Englanders incurred more debt than their counterparts in other regions of the country in response to gains in home equity that accompanied the regional economic resurgence.
resources. Let us consider the claim of taxes on the state's major resources bases, personal income and gross state product, to evaluate whether "tax bite" changed.

Figure 22 compares the "bite" of Maine's major own source revenues on the state's two key resource bases, gross state product and personal income, in 1980 and 1990.

- As a percent of personal income, own source state revenues increased from 8% in 1980 to 8.5% in 1990.

- As a percent of gross state product, own source revenues increased from 6.3% to 7.4% of that base.

The implication of these trends is straightforward:

- During the 1980's, Maine state government increased spending at a rate that exceeded natural growth in the economy.

Figure 23 shows per capita governmental funds revenues in 1980, 1985 and 1990, in current and real dollars.

- There was a real increase of about $330 per person from 1980 through 1990 in the burden of government finance in Maine. Much of the growth was confined to the period between 1985 and 1990, when the real increase exceeded $300 per capita.

Although we now know that the burden of state taxation increased in Maine during the 1980's, we can not immediately conclude that taxes are "high." Although change in tax burden is keenly felt by individual taxpayers and can lead to a sense of "high" taxes, even when tax burden is comparatively low relative to other states, locational decisions of firms and households, disposable income, and business profitability are sensitive to interstate differences in both the level of taxation and the distribution of burden among taxpayers. Let's take a look at how Maine
If Maine's taxes are heavier than desirable from a long term fiscal health perspective, we need to know that now, so that we do not exacerbate our position in attempting to resolve the current budget crisis. On the other hand, if taxes are high in selected areas but low or average in others, there may be opportunities at hand to both increase revenues from some sources and adjust others. Interstate comparison is often used to provide a "yardstick" with which to evaluate one state's taxation position relative to those of one or more other states. A state's comparative position can provide an important gauge of whether any flexibility exists to raise the overall level of taxes, whether a redistribution of existing burden appears warranted, and whether any individual tax types are overutilized.

We now shall attempt to answer three questions. First, how did the comparative burdens of the major tax types change during the 1980's? Second, by the end of the decade, how did Maine's burden of taxation compare to other states, in both the aggregate and for individual tax types? Finally, how has the combination of the recession's influence upon tax collections and tax policy changes taken in response to the state's economic slide effected our comparative position?
Comparative Tax Burden

Figure 24 compares Maine's total per capita state tax burden and the per capita burden of some of the major components of state taxes to the U.S. average levels.

Figure 24
COMPARISON OF PER CAPITA TAXES
MAINE AND THE UNITED STATES, 1989

<table>
<thead>
<tr>
<th>Component</th>
<th>1989 Per Capita Tax Collections</th>
</tr>
</thead>
<tbody>
<tr>
<td>TOTAL</td>
<td></td>
</tr>
<tr>
<td>OTHER</td>
<td></td>
</tr>
<tr>
<td>MOTOR FUEL</td>
<td></td>
</tr>
<tr>
<td>SALES</td>
<td></td>
</tr>
<tr>
<td>INCOME</td>
<td></td>
</tr>
</tbody>
</table>


- Maine's per capita burden for state taxes was $1301 in 1989. This amount exceeded the U.S. average of $1147 by more than $150 per person.

The margin between Maine's per capita burden and the U.S. is particularly noteworthy for the personal income tax, which differ by more than $100 per person. In addition, sales, personal income and gasoline taxes per capita each exceeded the U.S. average.

Figure 25 compares the claim of different state taxes on Maine personal income. In this display, some additional taxes as well as the impact of charges and fees for services have been
**Figure 25**

**COMPARISON OF TAX "BITE" ON INCOME**

**MAINE, THE U.S. AND NEW ENGLAND, 1989**

<table>
<thead>
<tr>
<th>Category</th>
<th>Maine</th>
<th>U.S. Average</th>
<th>New England Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>CHARGES/FEES</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ALCOHOL</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GASOLINE</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CORP. INC.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>PERS. INC.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SALES</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>TOTAL</td>
<td>$32</td>
<td>$24</td>
<td>$12</td>
</tr>
</tbody>
</table>


- In 1989, Maine's "bite" on personal income from the personal income tax, the general sales tax, each of the excise tax types and charges/fees at $32 per $1000 of personal income significantly exceeded the U.S. average of $24, ranking Maine's taxation level 7th highest in the U.S.

- The effect of charges and fees are noticeably high, with the "bite" on personal income exceeding the U.S. average by $12 per $1000 of income.

In addition to these common methods of interstate comparison, the U.S. Advisory Commission on Intergovernmental Relations (A.C.I.R.) has developed an approach that permits direct comparison of states, despite differing utilization of tax types, tax bases sizes, and rate structures. A.C.I.R. derives estimates of comparative tax effort that can provide a useful gauge of our relative position among the states.

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4 The following data on Maine's comparative position on the various taxes was obtained from the U.S. Bureau of the Census report *State Government Taxes in 1989.*
The A.C.I.R.'s estimate of tax effort is calculated by expressing each state's actual revenue collections from each tax type as a percentage of what that state could collect if the national average rate of utilization of that tax were applied to the state's own tax base. For ease of display, the resulting percentage is shown without the percent sign, or as an "index." A tax effort index of 100 means that taxes raised in Maine were equivalent to the amount that could be raised using the U.S. average effort, an index of 150 tells us the state under study exceeds the U.S. average by 50%, and an index of 50 means the state is exerting only one half the U.S. average tax effort. Figure 26 compares Maine's tax effort for major tax types to that of the U.S. and the other New England states in 1988. Figure 27 shows trends in effort for the three major state sources between 1981 and 1988.

![Figure 26: 1988 Tax Effort Comparison, Major Taxes](image)


Although tax policy design must consider how a state compares to national "norms," or typically, the national average, to ensure that the state is attractive to prospective residents and businesses and that income flows within the state are adequate, research shows that regional comparisons may be even more crucial for two reasons. First, businesses often select a region of the country for a variety of non-tax reasons and then determine the exact locational choice. Although taxes may not effect the first decision appreciably, taxes have been shown to be an important "marginal" factor when companies are narrowing their locational choices. Second, many
of state's important tax types are susceptible to "border hopping," such as travelling to New Hampshire to avoid Maine's sales tax on purchases.\(^5\)

While it is difficult to avoid personal income taxes, lost sales of items subject to either the general sales tax or one of the excise (selective) sales tax types reduces the income of Maine businesses, and eventually, employees. This crucial, yet frequently neglected, aspect of effective tax policy design and evaluation is called the interaction of tax bases, a dynamic wherein a tax policy action in relation to one tax type either immediately or eventually effects collections from one or more other taxes. Regional comparisons facilitate the identification of potential pitfalls from tax base interactions.

**THE PERSONAL INCOME TAX**

An examination of Figure 26 quickly reveals a crucial aspect of Maine’s personal income tax burden:

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\(^5\) Although Maine residents are required to pay sales taxes to Maine for items purchased out of state but used in Maine (the "use" tax), compliance with the law has been low and enforcement difficult.
• At 160% of the national average in 1988, Maine’s use of the personal income tax was considerably above that of most states.

• Perhaps even more importantly than our national position, Maine’s personal income tax effort was double that of the average for the New England states, which in 1988 was only 76% of the national average.

Our tax effort with regard to personal income far exceeds the effort in the other major tax areas: personal income tax effort is more than double corporate tax effort and approximately double sales tax effort.

• Maine’s use of the income tax was above average, but not exceedingly, through 1984. Between 1984 and 1988, the tax effort increased sharply to propel us to 160% of the U.S. use of this tax.

Earlier we also saw that Maine’s effective rate of taxation of personal income (percent of base raised as taxes) had doubled between 1980 and 1989. However, the question of whether this new, higher rate might be considered reasonable or excessive remained open. Figure 28 shows Maine’s major taxes expressed as percentages of the U.S. average for 1989 and 1991.

• As of 1989, our effective rate of taxation of this base, at 3.1%, exceeded both the national average of 2.2%, and particularly the New England average of 1.5% by appreciable margins. Our rank among the states for personal income taxes was 7th at that time.

• Since the onset of the recession, Maine’s effective rate of income taxation has declined from our 1989 average percentage of income paid as tax of 3.1% to only 2.5%.

• In 1991 our effective rate of taxation of income comprised only 122% of the U.S. average,
compared to the far higher 1989 level of close to 160%. Our rank has declined to 14th in the U.S., from our more visible position of 7th in 1989.

Thus, we now compare more favorably, although we are still a bit high. Yet, despite the aggregate picture portrayed by the overall effective rate of personal income taxation, if we consider taxes on households at various taxable income levels, we find that Maine's comparative position has seriously deteriorated since 1989.

- Maine's new top marginal rate of 10% is one of the highest is among the top four in the United States.

Even an unsophisticated citizen or business considering relocation can easily compare the top marginal rate in Maine to other states.

A full analysis of comparative income taxes requires the calculation of tax due at specific income levels, because exemptions, deductions and the structure of the progression of tax rates varies greatly among states. Such calculations are laborious, and as such, infrequently done by those considering moves, nor are they reported by governmental and private agencies who routinely compile tax data. The staff of Money magazine, however, initiated a series of interstate comparisons of taxes in 1989 aimed at saving their readers money. Regardless of purpose, the compilations provide highly useful comparative information.6

Unfortunately, using the more accurate method of gauging relative tax burden does not improve the assessment of Maine's comparative position.

- In 1992, Maine's personal income tax bill for a two income, married couple earning $100,000 was 4th highest among the states. Although faring slightly better, the tax on households with incomes of $75,000 nonetheless ranked 7th in the U.S.7

- Despite our improved effective rate of tax collections, our comparative position has worsened significantly, to the point that no one could reasonably argue that Maine's long term fiscal prospects are not seriously compromised by our high personal income tax.

THE CORPORATION INCOME TAX

Several important points emerge from an examination of corporate income tax effort shown earlier in Figure 26:

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6 When Money presented their first comparisons, they were roundly criticized in some states for listing certain states (including Maine) as "tax hells," without including property tax burden in the comparison. That oversight has now been rectified.

7 Money, January 1993, pp. 90-9.
Despite a widespread sense in Maine that "business" taxes are high, our use of the corporate income tax, at 67% of the national average, is comparatively low.

While many states have reduced their corporate tax bite in recent years, comparative data shown earlier in Figure 27 reveals that Maine's effort was somewhat low relative to other states and has reduced use of this tax to a level even further below the U.S. average.

- Between 1981 and 1988, corporate tax effort declined from approximately 80% of the national average to 67%.

- Compared to the New England states, whose average use was 110% of the national average in 1988, Maine's corporation income tax effort index of 67% may be considered very low.

The results of this analysis show that there is a significant difference between the amount that Maine actually collects from the corporation income tax, and what ACIR estimates could be collected if a national average effort were assessed against this base. Yet, Maine's top marginal rate in 1988 was very high and takes effect at a relatively low level of taxable income. Gaps between the ACIR estimate of what could be collected and a state's actual collections typically emerges because of a narrowly defined tax base. Low tax effort coupled with a high rate structure suggest a narrow tax base in Maine.

- Given our comparatively high corporate tax rate, the discrepancy between our collections and the ACIR estimate requires careful analysis.

THE GENERAL SALES TAX

Figures 26 and 27 (shown previously) compare Maine's tax effort for the general sales tax to other states and trace trends in effort.

- At 80% of the national tax effort level, Maine's use of the sales tax was below average in 1988.


At the time of these comparisons, Maine had a narrow general sales tax base, which means that many items (such as food, magazines and services) are not taxed. Thus, although our sales tax rate at 5% was about average for the U.S., when applied to a constrained base of sales it raised less revenue than other states could acquire with the same or even a lower rate. However, recent budget balancing actions, which included an increase in the sales tax rate to 6% and the addition of "snacks" and miscellaneous other items to the taxable retail base, will have the effect of boosting
Figure 29
EXCISE TAX EFFORT COMPARISON, 1988

TRENDS IN EXCISE TAX EFFORT

our tax effort level and should bring Maine closer to the national average.

Our position relative to the United States may give a misleading perspective on the efficacy of increases in the general sales tax. Our 6% rate is above the national average of 5%, and although application to a narrow base of retail sales taxation yields fewer dollars than some states with lower rates but narrower bases, the public perception is nonetheless one of comparatively "high" sales taxes in Maine.

Comparison of Maine's sales tax effort to the New England states, and particularly to New Hampshire, shows a disparity that suggests we were high, not low, relative to our competitors for retail sales at the end of the 1980's. Even with the economic problems Massachusetts has faced, their sales tax remains at 5%. Recent policy action in Maine that raised the sales tax rate to 6% has exacerbated the difference between Maine and our competitors for retail sales. Not only shoppers, but perhaps even more importantly, retail businesses are sensitive to differences in rates, because the sales tax amounts to a price increase they may not be able to afford in today's highly competitive marketplace.

SELECTIVE OR "EXCISE" SALES TAXES

The upper portion of Figure 29 shows comparative tax effort for the major types of excise taxes and the lower portion traces changes in effort over the period 1981 through 1988.

- Our use of excise tax bases is far in excess of the U.S. average, as well as that of the other New England states. The tax on beer, at 250% of the U.S. average, is the highest, with the tax on wine following at 200% of the U.S. average.

The contrast between Maine's excise tax levels and the New England average is sizable.

- Each of the excise tax effort indexes increased in Maine from a level in 1981 that was not appreciably above the U.S. average to substantially above by 1988.

"Sin" taxes, as many of the excise taxes are sometimes called, generally garner easy legislative support because of the nature of the commodities taxed. Cigarettes and alcohol are not only known to be "bad" for us, there use is perceived as a choice. As a result, the national pattern of use of these taxes is undoubtedly high. Our very high utilization compared to other states may arguably be far higher than fair tax policy would dictate, since selective sales taxes are the most regressive of all tax types.

The finding of a far heavier and increasing reliance upon these tax types in Maine presents another issue of some concern: excise taxes are particularly vulnerable to regional discrepancies that encourage consumers to "border hop" to shop.
Several crucial findings relating to the stability of our tax system and the burden of taxation emerge from this analysis:

- Our revenue structure is highly unstable, producing very high rates of collection during good times but then failing to yield sufficient revenues during "bad" times to sustain priority public purposes.

- The primary source of instability in our revenue system may be traced to the design of our personal income tax, which is steeply progressive and grants large personal exemptions and many deductions from income.

- The method of taxing of personal income in two earner households, which during the 1980's became an increasingly important component of Maine's workforce, exacerbates the "bungee cord" effect of our revenue collections, and hence, spending responses.

- The instability of our revenue structure is exacerbated by a highly sensitive sales tax.

- The instability of the sales tax may be traced to its narrow base of taxation and the increased importance of sales of automobiles and building materials within taxable sales during the 1980's. In addition, the growth in significance of sales to tourism increased the importance within our taxable sales of items easily postponed during an economic downturn and tied us to the regional economy.

- As a result of the design of our tax system and tax policy changes enacted during the 1980's, the overall burden of Maine's tax system increased appreciably- despite rapid economic growth during the 1980's.

- Today, our total tax burden is quite high relative to national standards, even though the responsiveness of Maine's tax structure has resulted in a diminution in the effective rate at which major bases are tapped.

- The personal income tax is exceedingly high in Maine, whether compared to national averages and the New England states.

- Although Maine's policy makers often pride themselves on what is perceived as a progressive tax system, Maine's burden of taxation avoids overall regressivity through the imposition of an extremely burdensome progressive
personal income tax in addition to extensive and heavy utilization of regressive tax types.

Select sales or "excise" taxes are used excessively in Maine, and their utilization has increased dramatically during the past decade. As a result, (1) the tax burden imposed upon the poor through these taxes is extremely high and (2) we are unquestionably jeopardizing the profitability of Maine businesses, particularly those located within proximity to the New Hampshire border.

In the 1990's, the increased competition among states for job location and retention will force many states to think more strategically about tax policies. Unlike the revenue driven spending of the 1980's, both tax and spending policies in the 1990's will need to reflect that new economic reality.
4. A CLOSER LOOK AT EXPENDITURES

The comparative analysis of Maine's taxation position suggests that spending in Maine was higher than we could comfortably sustain even before the onset of the recession. Budgetary cutbacks being taken today, to bring spending for the upcoming biennium into line with the expected slow growth in revenues, may be used to begin establishing a more realistic target expenditure level that can be supported for the longer term, across various economic cycles.

As citizens and policy makers consider the composition of state spending and seek retrenchment opportunities, many questions will certainly arise. In this section, we take a "closer look" at a number of key areas of state finances, in an effort to provide information and added perspective.

Interstate comparison may be used to provide a "yardstick" of our state's relative expenditure position. Information about how we compare to other states:

- Enables preliminary judgements about budgetary flexibility and constraints,
- Assists with the identification of areas in the budget where efficiency gains may yield cost savings or at least constrain future increases,
- Helps policy makers to pinpoint issues that require further study,
- Assists in the identification of potential "timebombs," that is, areas of underfunding that may crop up unexpectedly and crowd out other priorities of government, and
- Encourages candid discussion and informed choices about whether Maine should spend less, more or about the same as the comparison states.

We shall begin this chapter by examining how Maine's spending within a number of areas compared to other states in 1989, just before the onset of the recession, and in 1991, after the recession's effects on welfare spending had become visible and states had taken actions to cut spending.

Based upon insights gleaned from both the overview and the earlier identification of budget drivers, we shall select areas of the state budget for more detailed analysis in the remainder of this chapter.
Figure 30 shows Maine's per capita spending as a percent of the national average for 1989 and 1991 for several key expenditure areas and Figure 31 shows Maine's changes in spending between 1989 and 1991 in comparison to the U.S. average.

Public Welfare

Public welfare programs have been a source of significant budget pressure in Maine, as for all other states. However, comparative data reveals that as of 1989, we were outspending most states:

- At $498 per capita in 1989, Maine's spending for public welfare ranked 6th among the states and exceeded the U.S. average per capita expenditure of $375 by one third.

- Maine's per capita expenditure for public welfare increased by 43% to $710 in 1991. Applied against a larger initial per capita expenditure, Maine's more rapid rate of increase (U.S. average equalled +32%) thrust our welfare spending to 4th place in the U.S. and 145% of the U.S. average.

The pronounced difference in spending for public welfare between Maine and the U.S. average shown in Figure 30 for both 1989 and 1991 raises a crucial question: what factors explain...
the difference? We shall return to this query shortly, by examining individual human services transfer programs.

Even a cursory look at Figure 31, which shows the percentage change in per capita expenditures for Maine and the U.S., reveals that nationally public welfare expenditures has been the major "budget driver" during the recession, rapidly increasing spending despite efforts to reduce the size of the budget. In Maine, growth in expenditures has outpaced the national average. Applied against a base of spending that was relatively high prior to the recession, the faster rate of increase has resulted in very high expenditure levels. Maine's average per capita personal income is lower than the U.S. average, so that as a result, our high level of public welfare spending produces a heavier burden of finance:

- In 1989, Maine's public welfare spending, $33 per $1000 of personal income, was 145% of the national average and ranked fourth in the U.S.

- In 1991, despite reductions in eligibility for some social services and cutbacks in personnel, Maine's welfare spending increased to $42 per $1000 of personal income, which boosted Maine to 155% of the national average and a position of 3rd highest in the U.S.

**Higher Education**

Higher education spending in Maine, measured on a per capita basis, resembled the U.S. average in 1989.

- Maine's 1989 per capita expenditure of $262 in 1989 was very close to the national average (mean) of $260 and ranked 24th in the U.S.

- By 1991, Maine had slipped below the national average, spending $270 per capita for higher education, compared to a national mean of $285 and median of $306.

- In real dollars, there was a decline in the expenditure for higher education in Maine of roughly $13 per capita between 1989 and 1991.

Maine's significant withdrawal of funding from this budget category since the onset of the recession had eroded our spending rank by 1991:

- Maine's national rank for per capita higher education spending dropped from 24th in the U.S. in 1989 to 36th in 1991.
Maine’s fiscal effort to fund higher education, defined as dollars per $1000 of personal income, had exceeded the U.S. average in 1989, but by 1991 investment in higher education declined to "average."

- In 1989, Maine spent $18 per $1000 of personal income for higher education, compared to $15 nationally.

- By 1991, our fiscal effort in this area had declined to $15 per $1000 of personal income, which was equal to the U.S. average.

- In 1991 only 11 states spent less of their personal income on higher education than did Maine.

Thus, despite its importance in terms of share of the general fund, these comparative figures reveal that Maine is not "overfunding" higher education. In fact, the opposite conclusion could be reached.

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State Employee Salaries

Citizens often expect salaries to be an important budget driver.

- In 1989, Maine’s per capita expenditure for salaries ($393) was almost equal to the U.S. average ($387).

Since the onset of the recession, state employment has been a target for cutbacks. However, the bulk of savings was achieved through employee furlough days. The reduction in employment in fiscal year 1991 was only 2.9%. In addition, the state’s expenditure for salaries has actually increased.
Between 1989 and 1991, Maine's per capita expenditure for state employee salaries increased by 16%. Nationally, the average percentage gain was 11%.

As a result of a combination of a higher rate of increase in Maine and retrenchment of staff in other states, Maine's per capita state employee salaries grew from 102% of the national average to 106% in a two year period.

Among states facing severe fiscal situations, Maine was not alone in increasing this expenditure. Massachusetts government salaries increased by $70 per capita and New York by $20. On the other hand, some states accomplished significant reductions in their per capita expenditure between 1989 and 1991: California's per capita spending for salaries declined by $50 and Vermont by $85. Part of California's decrease is reflective of a population increase rather than expenditure reductions; however, Vermont saw no increase in population during the period 1989 through 1991.

Since spending for salaries may increase as a result of either growth in the level of salaries or the number of employees, or both, understanding why Maine’s level of spending in this area has increased so much- despite efforts to reduce costs- requires a separation of the forces that influence spending. We shall consider state employment further in the next section to attempt to isolate the causes for increases in Maine and to assess whether salaries and employment levels are also high.

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**Corrections**

Earlier trend analysis revealed that corrections spending has been a source of substantial budgetary pressure in Maine, at both the state and county levels of government. When compared to the U.S. as a whole however, spending for corrections in Maine turns out to be rather modest.

- In 1989, compared to a U.S. average of $61 per capita, Maine expended only $40 per capita on corrections or 66% of the national average.

However, the rate of increase in corrections spending over the period 1989 through 1991 has been far more rapid in Maine than has generally been the U.S. experience.

- Maine’s spending for corrections increased by 38% between 1989 and 1991, while the U.S. as a whole increased by 25%.

Maine’s faster growth in corrections spending has narrowed the difference between out spending and the U.S. average:

- Between 1989 and 1991 reduced the expenditure gap between Maine and the nation in 1991, when Maine reached 72% of the national level.
Maine's relatively low crime rate, and changes in crime during the 1980's would be expected to be accompanied by lower than average spending, as they have been. However, the rate of increase in the past few years, which was exceeded only by public welfare, signals the need to gain greater control over this area of the state budget. We shall look at corrections more closely later in this chapter.

State Direct and Indirect Debt

While debt is not an expenditure item per se, the level of debt in a state affects expenditure flexibility and the cost of borrowing. Although general obligation debt tends to be the focus of policy attention, states provide direct and indirect backing to a variety of types of other debt. Throughout the U.S., the use of debt diversified during the 1980's and became more inclusive of issues to further economic development. The U.S. Census Bureau tracks not only general debt, but all debt for which a state may ultimately become responsible. Total long term per capita debt, which includes state guaranteed, contingent and non-guaranteed debt are expressed as percentages of the national average level for 1989 and 1991 in Figure 30 (shown previously.)

- In 1989, Maine's total debt burden, which includes non-guaranteed debt issued by state authorities for which the state is not directly responsible, was at 140% of the national level.

- Although the nation's use of debt increased by 16% between 1989 and 1991, Maine increased more rapidly, +26%. As a result of a higher initial per capita debt burden coupled with faster growth, Maine increased to 152% of the national average in 1991.

The annual per capita expenditure for interest on the general debt (guaranteed) is an important component of annual state spending.

- In 1989, Maine's annual debt service, when adjusted for population size ($111 per capita), was 135% of the national average ($82.)

- Due to more rapid growth in per capita interest payments between 1989 and 1991 (+25% in Maine compared to +13% nationally), by 1991 Maine had reached 151% of the national average.

The conventional wisdom that Maine is a conservative user of debt is challenged by the comparative data. In addition, since 1991, significant amounts of new debt have been approved by voters and some has already been issued. These factors combine to make this area a priority for further analysis later in this chapter.
State Aid to Local Government

States provide varying levels of support to their localities and school districts, depending upon the division of responsibility between the state and local government for providing services, the fiscal needs of local government, and the fiscal capacity of the state to assist them.

State aid for schools is the primary component of local assistance in Maine.

- In 1989, Maine state government provided school districts with funding equivalent to $473 per capita, compared to $450 per capita on average nationally. Our spending in 1989 was equal to 105% of the national average.

- In 1991, despite increases in the per capita expenditure over the 1989 level, Maine’s position relative to other states declined very slightly, to 103% of the national average.

Although the per capita expenditure is always an indicator of the level of investment in public elementary and secondary education, per pupil expenditures provide an enhanced perspective upon resources directed at the child. We shall explore education funding further, later in this chapter.

Some difference between Maine and the U.S. average expenditure for local aid will emerge as a result of differences in the assignment of functions. Since Maine state government takes responsibility for two costly functions, public welfare and corrections, that are partially local responsibilities in other states, we shall focus upon financial assistance for general support to make the comparison more relevant.

In many states, either sales or income taxes, and in a few instances both are levied at the local level. State financial assistance to local government for general government support in Maine serves a more important fiscal role than in many states, because Maine’s local governments are not permitted to use any major tax instrument other than the property tax. Nonetheless:

- In 1989, Maine state government transferred $53 per capita to local government for general support, compared to a U.S. average of $64.

- In 1991, although Maine’s support of local government had grown slightly more quickly than the U.S. (+8% compared to +5%) since 1989, Maine continued to lag behind the U.S. average at only 85% of the national level.

These figures, which suggest a continuing paucity of state resources for local government support in Maine, may be indicative of long term problems. The economic expansion of the 1980’s would have had a more significant impact upon local government spending than state, because primary responsibility for direct services rests with municipal government in Maine. On the other
hand, the property tax is a comparatively unresponsive tax type, and thus would not experience the natural growth in yield characteristic of the state’s more elastic revenue sources. As a result, under growth conditions, there would be an increasing gap between needed expenditure and the capacity of the property tax to finance those spending. In the absence of sufficient state aid to offset the gap between spending needs and revenues, services and infrastructure requirements would be underfunded.

From a perspective of the long term health of Maine’s state-local fiscal system, a deficiency in funding of local services would be problematic. We shall explore various dimensions of the state-local fiscal partnership in the Chapter 6.

Discussion

On the basis of these comparisons, the earlier identification of “budget drivers,” the availability of additional comparative data, and the importance of expenditure areas with long term expenditure impacts, we have now identified a number of spending areas for further analysis:

(1) State employment and compensation,
(2) The state retirement system,
(3) Human services transfer programs,
(4) Corrections,
(5) Capital investment,
(6) The use and management of public debt, and
(7) State aid for education and non-school general government support.

Before moving ahead with the analysis, however, we’d like first to return to the concept of a "reference set" of states and explain how and why we’ve selected Maine’s comparison states.

4.2 THE "REFERENCE SET" COMPARISON APPROACH

Within the context of a recessionary environment, when many states are grappling with revenue shortfalls, comparison of how spending in one state is changing relative to other states additionally may provide insights into both expenditure reduction opportunities that otherwise might have been overlooked and possible pitfalls of cutback actions.
Although interstate comparison sounds easy, and is often practiced as though it were, expenditure comparison is troubled by data limitations and potential pitfalls. First, although ideally service cost data should be considered on a unit basis, such as cost per mile or per recipient, programmatic and performance data are not routinely compiled and reported.

Second, a frequently overlooked problems that can jeopardize the reliability of comparative analyses is that the assignment of functions differs among states. For example, in some states, the state is fully responsible for welfare while in others counties may deliver the service and assist with the financing of costs. In the states where local governments deliver welfare, the state’s welfare expenditure will appear low relative to other states while the expenditure for state aid to local government will appear to be high.

Third, to further complicate analysis, the composition or sub-categories of functions typically also varies among the states. States include youth services in the departments of human services or mental health, or may have a free standing agency for that purpose. Improved comparability may be achieved by comparing programs, such as Medicaid, rather than the total expenditure for a function, such as public welfare, but disaggregated data is not available annually for all activities. We shall attempt to do this, where data is available, throughout this section.

Finally, although we shall rely in part upon the national averages as a basis of comparison, the usefulness of aggregate comparative data wanes when the costs associated with delivery of a particular service are likely to be affected by conditions such as cold weather or low population density that vary among states, using the average of all states cancels out differences at the high end or the low end, in effect removing the influence of the characteristics that require some states to spend more (or less) to achieve an equivalent level of service quality.

A more precise "yardstick" with which to assess a state’s relative expenditure position may be fashioned by carefully selecting a comparison set of states that are similarly situated relative to conditions known to affect the cost of service delivery. These states may then be used as a "reference" point for assessing whether spending in the study state appears "high," "low," or "about average"- given conditions known to affect the cost of service production. Needless to say, the "reference set" methodology requires far more data and time for analysis than simpler methods, and can not easily be used to study every area of state expenditure. In the remainder of the chapter, however, we shall employ a reference set of states for comparison when sufficient and meaningful interstate data is available.

The basis for selecting the reference sets of states is their similarity to the state under study in terms of both cost of service provision and revenue capacity characteristics. This method relies upon comparison of the financial position and trends of the state under study to the average behavior or "response" of a group of specially chosen states. For comparative analysis to be useful, and to avoid erroneous conclusions, as relevant a comparison group as possible is required. A quick review of major factors that influence state (and local) spending should help to clarify both the
application of this technique and the variables that we must consider in selecting a relevant reference group.  

Cost Differences and Budget Levels

State and local governments spend in accordance with perceived demands of citizens and businesses and the needs of their population. The cost of producing a service is the combination of the extent of need or demand and the influence of a variety of production characteristics that make it more (or less) expensive to deliver services. For example, the unit or "per pupil" cost of education is higher in areas where only a few children are served but a school building and teachers must nonetheless be provided.

Public finance experts have coined the term "cost differences" to describe demands, needs and production characteristics that influence the required level and cost of public services. Cost differences exclude tastes, that is, citizens preferences for different levels of quality. Needs of the population are separated from tastes by the urgency of the requirement for service provision or the necessity for compensatory service, that is, in order to achieve an acceptable level of well-being, some additional care or service must be provided to an individual or groups of individuals. An example may help to distinguish the two terms. Citizens may desire, or have a taste for, high quality education, but bilingual or handicapped children need more academic assistance in order to have a "level playing field"- the same chance to achieve as their English speaking peers.

Some of the "cost differences" that occur among states, or among communities within states, are easily identified. The prices of inputs such as labor will vary, sometimes dramatically, in different areas of the country and to some extent even within states. The prices of supplies, materials and equipment will be somewhat more uniform, but will be influenced by transportation costs, proximity of the supplier and regional price differences. Labor costs tend to be lower than average in Maine, but other prices, particularly those that reflect transportation of goods, often are higher.

The severity of weather conditions is another important cost difference that makes it more or less expensive for different states to provide public services. For example, very cold weather means that more heating oil will be required to bring a room to a comfortable level than would be the case in a milder climate; roads will require more repair after a winter of heavy snowfall. This cost factor substantially effects Maine state and local government spending.

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8 Practical applications of these studies include interstate comparison and intergovernmental grants formula design. See Bradbury, et. al. (1984) for a discussion of how cost differences were used in the design of Massachusetts' local aid formula. In addition, knowledge of these variables can greatly improve budget planning.
Population density is an important factor that influences the cost of producing a service. In rural states like Maine, low density raises the cost per user of many public services such as transportation. Very low population density in many parts of Maine actually precludes provision of some public services like sewers because the unit cost, and the resultant unit "tax price," would be extremely high. On the other hand, high population density raises the demand for spending on many public services such as garbage pickup and police services.

The composition of a state's population including their ages, educational levels, income, and other social and demographic characteristics contribute to the needs of the citizenry for many public services. A state with a higher proportion of needy citizens will face a higher cost of providing a service such as public welfare than a state with fewer needy citizens.

The economy is an important determinant of both public spending and revenues. During a recession, caseloads for social service "safety net" programs swell when a state's residents find their circumstances dramatically altered. In addition, as a major tax base in many states, the level of personal income influences the ability to secure financing to pay for service provision. Maine's increase in social services "safety net" program that accompanied the onset of recession is reflective of the impact of the economy on those budgets. However, the extent of spending is also determined by policy choices.

The composition of the economic base of a state also produces cost differences. Maine draws a goodly portion of state revenues from tourism, but can also expect it to be more costly to achieve traffic control during heavy weekend and summer influxes of tourists. Similarly, a town that employs many workers faces a daily influx of users of public services. Even in a large city, the infrastructure such as sewers can be quickly overburdened, leading to a need to provide additional facilities. In Maine, because of the division of taxation authority between that state and municipal governments, the expenditure impacts of the economic base largely fall to local government, while the largest portion of the revenues generated (sales, personal and corporate income taxes) flow to the state level.

One important aspect of some of the cost factors is that in addition to determining the need for services, they additionally establish the ability to pay for those services. Thus, a state with a higher than average proportion of non-working age citizens will tend to have lower ability to pay.
Similarly, high proportions of poor tend to lower total resources. Thus, cost differences establish the potential scope of government services by defining both the need for spending and the availability of revenues.

While there will be no single state whose cost differences and budgetary response to those factors will be identical to Maine’s, a reference set of states with small populations, strong population growth in the past decade; low density; cold weather; and social, demographic, income, and economic base characteristics as much like Maine’s as possible needs to be selected. For this analysis, we have used Vermont, Rhode Island, Oregon, Nebraska, New Mexico, Wisconsin, Kansas, Minnesota, and Idaho as Maine’s reference group, as shown in Table 5.

<table>
<thead>
<tr>
<th>State</th>
<th>1986 Popul. (thous.)</th>
<th>Pop. Change 80-87</th>
<th>1986 Per Capita Income</th>
<th>% Pop. in Metro Areas</th>
<th>% Pop. Over 65 Years</th>
<th>% Pop. Below 150% of Pov. Line</th>
<th>% Pop. 5-17 Years</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rhode Island</td>
<td>975</td>
<td>+3.6%</td>
<td>$16,892</td>
<td>92.5%</td>
<td>14.6%</td>
<td>16.8%</td>
<td>16.8%</td>
</tr>
<tr>
<td>Vermont</td>
<td>541</td>
<td>+9.8%</td>
<td>15,302</td>
<td>23.1%</td>
<td>11.8%</td>
<td>19.5%</td>
<td>18.5%</td>
</tr>
<tr>
<td>Wisconsin</td>
<td>4,783</td>
<td>+3.5%</td>
<td>15,524</td>
<td>66.5%</td>
<td>13.0%</td>
<td>17.6%</td>
<td>19.1%</td>
</tr>
<tr>
<td>Kansas</td>
<td>2,459</td>
<td>+6.0%</td>
<td>15,759</td>
<td>52.0%</td>
<td>13.4%</td>
<td>20.4%</td>
<td>18.4%</td>
</tr>
<tr>
<td>Minnesota</td>
<td>4,213</td>
<td>+5.7%</td>
<td>16,674</td>
<td>65.8%</td>
<td>12.5%</td>
<td>19.2%</td>
<td>18.7%</td>
</tr>
<tr>
<td>Nebraska</td>
<td>1,598</td>
<td>+1.9%</td>
<td>14,774</td>
<td>46.9%</td>
<td>13.6%</td>
<td>21.7%</td>
<td>18.9%</td>
</tr>
<tr>
<td>Idaho</td>
<td>1,002</td>
<td>+9.8%</td>
<td>12,665</td>
<td>19.4%</td>
<td>11.2%</td>
<td>24.7%</td>
<td>22.3%</td>
</tr>
<tr>
<td>Oregon</td>
<td>2,702</td>
<td>+8.1%</td>
<td>14,885</td>
<td>67.4%</td>
<td>13.4%</td>
<td>20.8%</td>
<td>18.3%</td>
</tr>
<tr>
<td>New Mexico</td>
<td>1,479</td>
<td>+20.8%</td>
<td>12,488</td>
<td>47.6%</td>
<td>9.7%</td>
<td>34.5%</td>
<td>20.9%</td>
</tr>
<tr>
<td>Reference Set</td>
<td>Averages:</td>
<td>+7.7%</td>
<td>$14,996</td>
<td>46.8%</td>
<td>12.6%</td>
<td>21.7%</td>
<td>19.1%</td>
</tr>
<tr>
<td>Maine:</td>
<td>1,172</td>
<td>+6.5%</td>
<td>$15,106</td>
<td>36.1%</td>
<td>13.3%</td>
<td>21.2%</td>
<td>18.8%</td>
</tr>
</tbody>
</table>

Although none of these states viewed individually can provide a useful basis for delineating "high" from "low" responses to budgetary demands and constraints, the underlying premise of the reference group method is that the average (median or mean) for a group of generally comparable states provides a "typical," and presumably, reasonable proxy of an efficient level of response. The expenditures or revenues of the state being analyzed may then be compared to this "typical" level. Key variables used in selecting this particular set of states are shown in Table 5. It is important to note that the group average for each variable resembles Maine's actual values.

We would like to underscore an important caveat: a determination that spending in a particular policy area appears to be "high" should never be equated automatically with waste, or for that matter, higher quality. A higher than average level of spending may reflect increased or improved services, inefficiencies, or a policy choice to spend more in some areas than other states have opted for. Yet, even when there is a willingness to spend at a higher level, we want to be sure dollars are being used efficiently- in other words, could the same outcome be achieved at lower cost?

An idea long influential in budgeting is that "what is being spent should be distinguished from what is being accomplished and the nature and the size of the problem(s) being faced." The use of the reference group approach to study state spending permits us to partially control for the extent of problems being faced. By permitting the direct comparison of apples and apples, rather than apples, oranges and grapefruit, the use of a reference set of states for interstate comparison:

(1) Enables us to separate out at least some of the influences on spending that lie beyond the control of policy makers.

(2) Implicitly acknowledges constraints placed upon policy makers by their state's relative ability to pay.

Despite the usefulness of the reference set comparison method, it is important to keep in mind that the approach facilitates the financial analysis of programs. Neither the method, nor in fact this study, evaluate the effectiveness of programs. Thus, a determination that expenditures are "higher" or "lower" compared to the reference states does not translate to services that are better or worse. We do, however, attempt to identifying areas where possible inefficiencies in service provision exist or inequities in the allocation of appear to be problematic, for further investigation by managers and policy makers.

Comparative analysis of state finances requires programmatic and financial information for other states. The organization and presentation of financial data in audited financial reports that might be obtained from other states often differs significantly from not only Maine's but from each other because of accounting basis choices, among others. Fortunately, the U.S. Bureau of the Census collects financial information for all states and takes great pains to standardize the groupings

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of expenditure categories. The U.S. Advisory Commission on Intergovernmental Relations also compiles and reports a great deal of fiscal data, within standard classifications. Several federal agencies including the Departments of Education and Justice and the Health Care Finance Administration collect, tabulate and report extensive programmatic and policy data for their areas of coverage. Reports of these various agencies have provided important data for the comparative analysis of Maine's spending and tax policies. However, there is usually a considerable lag between compilation and publication so data is rarely up to the minute.

Although the degree of comparability, and undoubtedly accuracy, varies across the numerous specialized studies of government spending and taxation reported by public and private organizations, the need to move beyond aggregate financial data to client or spending category specific information has required us to tap into these other sources of data. To the greatest extent possible, we have taken steps to ensure reasonable comparability to Maine and to evaluate the quality and integrity of all data prior to use in this analysis.

4.3 STATE EMPLOYMENT AND COMPENSATION

One of the most costly aspects of meeting public purposes is the cost of human resource inputs: wages and salaries paid to employees, contributions to the retirement system, health coverage and other fringe benefits. In 1990, at $279 million, expenditures for personal services amounted to 18% of all governmental funds spending.

Whenever personal services costs increase, a natural assumption is that salaries have increased. Yet, rising costs of employee benefits may have important effects upon total spending and trends.

Even if growth in spending for personal
services is attributable largely to wages and salaries, the growth may have resulted from increased pay for existing positions, the addition of positions, a changing complement of positions (e.g. more managers relative to other types of employment), or some combination.

Figure 32 displays expenditure trends by components of personal services expense.

- Increases in salaries and wages were equal to $187.3 million in current dollars or $76.4 million in real terms and explained 69.4% of the growth in personal services spending over the decade.

![Figure 32]

Figure 33 displays expenditure trends by components of personal services expense.

- Increases in salaries and wages were equal to $187.3 million in current dollars or $76.4 million in real terms and explained 69.4% of the growth in personal services spending over the decade.

![Figure 33]

Figure 33 shows trends in state employment.

- Following a slight decline in employment between 1980 and 1983, approximately 2400 positions were added in state government over the remainder of the decade, for an increase in the total complement of positions of 18%.

Comparison of population adjusted figures for Maine, the nation and the reference states provides several important insights:

- Maine state government employment, at 13.03 state employees per 1000 residents in 1991, is quite high relative to both the nation (10.4 per 1000 residents) and the reference set of states (10.03 per 1000).10

- Maine ranks 10th in the U.S. for the number of state government employees per 1000 state residents.

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• Maine added personnel in 1988, 1989 and 1990, while the reference
group average employment level declined.

• Between 1990 and 1991, Maine state employment was reduced, from
15,940 to 15,336 positions, for a decrease 3.8%.\(^{11}\)

An examination of contractual increases in wages reveals that these have contributed
substantially to the growth in spending for personal services. While we were unable to obtain a
1980 pay schedule for comparison to 1990 wages, we did obtain data on the negotiated increases
for MSEA covered employment.

• Applied to a salary which was at $20,000 in 1980, these wage
settlements yield a 1990 salary of approximately $34,000, an increase of 70%.

• The sum of increases exceeds both inflation during the period of
approximately 58% and private sector increases which averaged 5.3% from 1980
through 1988.

Although this change may seem high, given the sum of increases, the explanation lies in
the fact that wage settlements "compound" in much the same way as interest on a bank account.
After the percentage increase is applied, the new salary level becomes the base for the next
percentage increase. Thus, over time the real gain in salary exceeds the simple percent increases.
This compounding effect can also escalate spending for any programs that have automatic cost of
living adjustments (COLA's). However, before we may conclude that the wage settlements have
been overly generous, we must first determine if "catch up" was involved, that is, whether
increases were given to leverage low salaries.\(^{12}\)

• The 1989 average monthly Maine state government salary ($1860) is
well below both the U.S. average of $2,161 and the New England average of
$2,209.

• The average salary for the reference set of states, at $2030, was 9%
above Maine's in 1989.

Two conclusions are possible at this point:

♦ Despite increases in state employee salaries which exceeded the rate
of inflation, current salaries are still lower than the reference states and
particularly low when compared to other New England states.


\(^{12}\) Source of comparative wage data is the U.S. Department of Commerce, Bureau of the Census, Statistical
The level of employment in Maine state government appears to be higher than necessary.

Although Maine's lower population density would result in a higher number of employees than in the reference states, the extent of difference provides an indication that we may be overstaffed. A reduction of state employment of approximately 3.8% in 1991 has not appreciably changed our comparatively high position. In addition, it is unclear how much impact these reductions have had on general fund expenditure requirements, since some of the positions deleted were funded in whole or in part with federal dollars.

Steve Gold, who has tracked comparative state spending for a number of years, notes an interesting relationship between employment and salary levels: states with low salaries tend to hire substantially more personnel than those with higher costs of employment. The end result of course was similar total expenditures despite lower salaries.

During the 1980's, Maine clearly fit the pattern Gold observed. However, by the end of the decade the total cost of employing one individual had escalated substantially, due to salary increases and particularly, the far higher costs of employee benefits. Inclusion of the "hidden" costs of providing a pension and health benefits to retirees would dramatically increase the "price" of employment. Let's turn to trends in benefits, so that we may consider the cost of the combined "employment package" in state government.

Employee Benefits

In this section, we shall consider the two primary benefits, from a cost perspective, of state employment: health care and retirement. However, other benefits including the number of paid vacation days, the association between the length of employment and the number of vacation days, personal leave policies, tuition reimbursement, and eligibility for each type of benefit are critical determinants of the overall cost of compensation. Leave policies, whether for vacation or other purposes, can have a resounding impact upon the level of employment in many positions, because of the need to provide coverage of priority tasks.

Although a full analysis of all aspects of employee benefits was beyond the scope of this study, detailed comparison of policies in Maine to those of other states and also the private sector may provide important strategies for reducing public personnel costs in Maine, and should become an on-going aspect of monitoring state government costs in the future.

HEALTH BENEFITS

The range and composition of employee health benefits, deductible levels, dependent coverage, arrangements with service providers and who actually insures the employee (HMO type organization, major insurer, or the state itself) will all influence the cost of health benefits. In addition, overall trends in health care costs influence spending for this benefit.

Figure 34 presents trend data for health and miscellaneous other benefits for state employees.

- Growth in health benefits expenditures have added $30.6 million in current dollars to the governmental funds budget, with a real dollar increase of close to $21 million.

- Between 1980 and 1990, Maine's rate of increase in health care benefits costs averaged 57% annually. A study of state costs for employees' healthcare found that during the same period increases averaged approximately 11% for all states.°° Maine's annualized increases were more than four times the national average.

A comparison of Figures 33 and 34 shows that the sudden growth in spending for health benefits paralleled the addition of a substantial number of personnel. However, the cost increases have been more significant than the extension of coverage to additional employees explains.

The U.S. Health Care Finance Administration maintains a special price index for personal health care expenditures. They report that between 1982 and 1989 the cost of care increased at an

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average annual rate of 9.2%. Estimates of private sector costs for group insurance indicate an annualized growth rate of 16% from 1980 through 1989, followed by a jump of 25% between 1989 and 1990.

- In 1988, health insurance coverage for state employees nationally averaged 2.9% of payroll. At that time, Maine state government was at 4.8% of payroll.

While Maine’s percentage is substantially above the average level, Maine’s wage scale has already been determined to be below average. Thus, a standard health insurance package would comprise a higher percentage of salary in Maine than in a state with above average salary levels.

* The comparatively greater claim of health benefits in Maine join with other indicators reviewed to signal a need for review of the benefit package and a strategy for controlling rising benefits costs.

Interestingly, University of Maine employees have a wholly different health benefit plan. In addition, unlike the state who purchases insurance through Blue Cross/Blue Shield, the university

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16 Yolanda K. Henderson, "Government Employment and Compensation" in Munnell and Browne (eds.) Massachusetts in the 1990's: The Role of State Government. Boston: Federal Reserve Bank of Boston. Although the more recent national pattern is resembles Maine’s trend, the organizations may be largely noncomparable because businesses had begun accruing retiree health benefits and amortizing unfunded liabilities in response to revisions to accounting standards scheduled for full implementation this year. (Wall Street Journal, p. C1-2, 4/22/92.)

is self-insured. The University of Maine System's costs for employee health benefits increased by 10.4% between 1990 and 1991.\textsuperscript{18} During the same period state government's expenditures increased by 23.9%.\textsuperscript{19}

\textbullet Although many factors influence health care costs and the rate of change in health benefits costs, the differing experiences of state government and the university nonetheless suggest that careful comparison of the health coverage and methods of finance may yield insights and alternatives that may help stem the rapid increase in benefit costs in state government.

\textbf{RETIREMENT BENEFITS}

Increases in the state's contributions to the state employees retirement system has been one of the major state "budget drivers," and thus not unexpectedly, has had a significant effect upon personal services spending.

\begin{itemize}
\item Increases in the state's contribution to the pension system for state employees averaged 19.3\% per year between 1985 and 1990.
\item Increased contributions for state employee retirement accounted for 7.4\% of all general fund budget growth between 1985 and 1990.
\item During that five year period, the state's annual contribution increased by $20 million \textit{in real dollars}.
\end{itemize}

Not only state government employees, but also school district personnel, other local government employees, and some university employees are covered by the state retirement system. Therefore, in order to consider the financial condition of the system further in a later section. At this point, however, consideration of the impact of the components of benefits on total personal services expenditure facilitates understanding the rising cost of employing state workers.

\textbf{BENEFITS COMPARED TO SALARIES}

An important means for monitoring the growth of benefits is to track the percentage of payroll they comprise. Figure 36 displays employee benefits as a percent of payroll for 1980 through 1990.

\begin{itemize}
\item In 1980, employee benefit costs were equal to 18.5\% of total payroll; by 1990, this percentage had climbed to 31.8\%.
\end{itemize}

\textsuperscript{18} Source: Chancellor's Newsletter Vol. XVI (3), University of Maine System, 12/91.

\textsuperscript{19} Maine Financial Report, annual.
- Health and "other" benefits increased from 3.2% of payroll in 1980 to over 10% by 1990.

- Between 1980 and 1990, retirement contributions increased from 15.3% of payroll to 21.7%.

Between 1980 and 1990, the price of employing one individual in state government rose from 118.5% to 131.8% of base salary. By 1991, the price had risen again, to 135% of salary.

- Although the rate of growth in retirement costs can be seen to have declined between 1990 and 1991, health (and other, miscellaneous) benefits "took off," propelling employee benefits as a percent of payroll to 35%.

We shall turn now to examination of the full retirement system.

### 4.4 THE STATE RETIREMENT SYSTEM

Between 1985 and 1990, the state’s contributions to the teachers’ component of the retirement system (which are made on behalf of local school districts) grew at an annualized rate equal to 19.3% and explained 8.0% of the total growth in general fund spending during the latter part of the decade. Contributions for state employees, which averaged an astonishing 44.8% average annual increase between 1985 and 1990, explained 7.4% of the total expenditure growth in the general fund during the same period.

Figure 37 compares trend data for the teachers’ and state employees’ portions of the state retirement system.
At the beginning of the decade, annual contributions for teachers and state employees were roughly equivalent. In 1982, the teachers' contribution pulled ahead, and then surged upward in both 1988 and 1990. The state's annual employer contributions to the system for state employees also increased rapidly after 1985.

There can be little debate that annual increases in the state's cost of funding the retirement system have become a substantial source of pressure on general fund resources. However, determining whether cost control, and perhaps even reductions in state spending, are feasible requires knowledge of the source(s) of spending increases, and the adequacy of current funding of the system, to include the adequacy of benefit levels paid to retirees. In addition, although we shall not explore this question until later in the report, policy makers must determine the appropriateness of the current cost sharing arrangement between the state and school districts and the financing implications of shifting some or all of the cost of retirement to school districts.

Sources of Expenditure Pressure

Increases in the state's annual contribution to the retirement system exceed the impact of inflation can be traced to seven areas.

(1) As discussed earlier, state employment grew rapidly during the 1980’s, increasing by 2200 positions over the decade, with 1900 of those added during Maine’s economic resurgence from 1985 through 1990.
It is important to recall that interstate comparison suggested that as of 1991, state government was heavily staffed relative to other states, with 13 employees per 1,000 residents, compared to a national average of 10 per 1,000. Nonetheless, during the budget crises of fiscal year 1991, state employment was reduced by a mere 2.6%.

(2) Although as we also saw earlier in the study, Maine state employee salaries continue to lag below the national average level ($1,860 monthly in Maine in 1989 compared to $2,161 nationally and $2,209 in New England), negotiated wage increases during the latter part of the 1980's were generous. Increases in wages required a matching increases in the employer's annual pension contributions.

Both employment and salary increases are important explanations for the state's increased costs of providing retirement benefits, but it is important to note that increases in contributions for state employees has substantially outpaced salary increases: between 1980 and 1990, retirement costs as a percentage of payroll increased from 15% to 22%.

(3) The third source of spending increase was the intentional acceleration of the state's annual contribution to the pension fund (for both state employees and teaching professionals), in an effort to reduce the system's unfunded liability.

Like many states, Maine had historically financed the pension system on a "pay-as-you-go" basis, that is, annual employer contributions just covered retirees' benefits. As the accumulating amount of benefits due future retirees began to mount in the 1970's, states moved toward a system of financing all retirement benefits during the lifetime of employees.

Despite gains during the 1980's, Maine has not "caught up;" as of 1990, the unfunded liability hovered above $1.3 billion, an increase from a level of $1.2 million two years before. Deferments of required contributions of more than $73 million during fiscal years 1991 and 1992 have further boosted the long term liability, and additionally, have served to increase the annual cost for years into the future, because not only the current dollars deferred but the interest earnings that would have accrued on that investment will need to be made up.

(4) Another cause of higher state costs lies in a budget balancing action, taken in the early 1980's, under which the state assumed the full cost of required employee contributions for selected job classifications for state employees who agreed to temporarily forego salary increases. In addition, during the 1980's some part time state employees were made eligible for full pension benefits and the state assumed the cost.

The assumption of these costs by the state has increased the employer share of payments relative to the employee share. Thus, not all of the increase in spending is due to higher system costs; rather, part of the state's higher expenditure rests in a changed cost sharing arrangement.

* While in 1980 employees contributed 31.7% of the total annual investment in the retirement system, by 1990 the portion of system finance contributed by
employees had declined to 24.3%. This share is low compared to a national contribution rate of 30.9%.\textsuperscript{20}

In addition to the state’s assumption of the full contribution for some employees, these figures reflect the stepped up contribution rate to finance the unfunded liability. Nonetheless, the difference between Maine and the nation is notable and signals a need for further analysis.

(5) Following enactment of the School Finance Reform Act in 1985, teacher salary levels were increased each year for three years \textit{in response to state mandates}.

During that period, state block grant funds were made available to help districts reach mandated levels. Not only entry level teachers, but teachers throughout the employment ranks saw their wages increase as salary schedules were updated to reflect the mandated minimums.

Interestingly, despite these increases, by 1991 Maine’s average teacher salary of $28,700 still ranked only 35th in the U.S. and comprised less than 87% of the U.S. average salary.

(6) There was a large increase in the employment of personnel covered under the teachers’ portion of the retirement system between 1986 and 1990.

Some of the increase in employment simply recovered “lost ground,” because the number of personnel had declined in 1982 and 1983, during a recessionary period. Interestingly, the beginnings of the rise in employment \textit{preceded} the implementation of 1985’s school reform act. However, between the school years 1984-85 and 1989-90, professional employment in Maine’s

\textsuperscript{20} The balance was contributed by local governments.
schools increased by more than 1900 positions, indicating the catalytic nature of that legislation on employment.

In addition to adding new positions, a professionalization of previously employed school staff occurred, again, at least in part as a response to state mandates. As a result, some employees previously not eligible for the state retirement system have come under the plan in recent years, increasing the amount of the retirement contribution the state must pay, but also saving the slightly more expensive cost of social security coverage.

(7) The comparatively higher salaries of school district professionals has contributed to the rapid increase in the state’s annual contribution for teachers.

The preponderance of teachers and other education professionals in schools, who tend to have higher educational levels, increases the average salary level for the teachers’ system above that of the more heterogenous group of state government employees. In addition, identical percentage increases in higher salaries yield greater dollar increments to the higher salary, so the dollar value of contributions for teachers grows by more each year.

- In 1987-88, the average October salary of non-instructional state and local employees in Maine was $1,789 compared to $2,953 for instructional employees (including both teachers and university faculty.)

---

The Financial Condition of the State Retirement System

The question of adequacy of current state contributions to the retirement system must be considered from the perspectives of the financial condition of the system and whether retirement benefits are sufficient. An important aspect of the state retirement system is the accrued, long-term financial obligation it represents for the state. The significance of these long term liabilities is underscored by the views of bond rating agencies. Standard and Poor’s debt rating criteria manual for municipal bonds (all state and local issues of debt are called "municipal" bonds) states that pensions are one of several factors which they view as increasingly important in judging the financial condition of a debt issuer. Standard and Poor’s rating manual notes:

Pension liabilities are critical; their funding should be adequate and on schedule...Pension fund position, other long-term liabilities and risk management have significant impact on financial performance. While all areas of expenditure

---

growth are important indicators, pension fund requirements are particularly noteworthy.\textsuperscript{22}

While pension analysis forms an important component of a budgetary study, it is not yet an exact science in finance because of a lack of standardization in pension fund financial reporting for the public sector. However, recent rulings by the Government Accounting Standards Board (GASB) regarding computation methods are beginning to improve the comparability of financial data across systems. Currently, most analyses rely on comparison between one state system and aggregate, national data on cash inflows, outflows and assets for all pension systems. Since there are both strong and weak systems nationally, the expectation is that the United States average is a realistic target for "acceptable" performance.

Three measures of pension system performance ratios are commonly employed to judge the relative strength of a state's system. The first ratio, cash receipts as a proportion of cash disbursements, measures the degree to which cash inflows from contributions and investment earnings exceeded cash outflows. Figure 39 displays Maine's ratios for each, relative to the U.S., for 1980 and 1989.

In 1980, Maine's receipts were more than one and a half times the disbursements made. The nation, however, showed a much higher level of cash accumulation, with inflows constituting 278.3\% of outflows. Maine's performance as a proportion of the U.S. performance was only .59, or 59\% of the U.S. average (which would be represented by a ratio of 1.00 or 100\%). By 1989, Maine had improved the cash receipts to cash disbursements ratio substantially, with inflows now exceeding outflows by a much higher margin, at 246\%. This higher accumulation rate reflects an effort by the state during the 1980's to reduce an unfunded liability. However, national performance also improved during this period, with an aggregate ratio for all state systems combined of 2.99, or inflows equal to 300\% of outflows.

- While Maine's cash receipts to cash disbursements ratio is low at 82.3\% of the national average, Maine's stronger performance during the decade of the 1980's improved our position relative to the U.S. from the 1980 level of only 59\%.

The second measure of pension condition is investment earnings as a percent of benefits and withdrawals (disbursements). This measure assesses the degree to which the earnings from previously accumulated and currently held assets are by themselves sufficient to pay current benefits.

In 1980, Maine's earnings as a percent of benefits were only 40.5\%, indicating a significantly underfunded system at that point in time. The national ratio for 1980 was close to one for one, at 99.3\%. As a proportion of the U.S., Maine's investment earnings to benefits and withdrawals ratio was far below average, at only 41\% of the U.S. average. By 1989, Maine's

\textsuperscript{22} Debt Ratings Criteria, Standard and Poor's, New York, 1988, p. 31.
**Figure 39**

**COMPARISON OF PENSION FINANCE TRENDS**

**MAINE COMPARED TO U.S. AVERAGE**

**RATIO OF RECEIPTS TO DISBURSEMENTS**

<table>
<thead>
<tr>
<th>Year</th>
<th>Maine</th>
<th>U.S. Average</th>
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<tbody>
<tr>
<td>1980</td>
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<tr>
<td>1989</td>
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**EARNINGS AS A PERCENT OF BENEFITS**

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<tr>
<th>Year</th>
<th>Maine</th>
<th>U.S. Average</th>
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<tr>
<td>1980</td>
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<tr>
<td>1989</td>
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</table>

**RATIO OF CASH/SECURITY TO BENEFITS**

<table>
<thead>
<tr>
<th>Year</th>
<th>Maine</th>
<th>U.S. Average</th>
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<tr>
<td>1980</td>
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<tr>
<td>1989</td>
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</tbody>
</table>

**Source:** U.S. Bureau of the Census,
*State Finances in 1980, State Finances in 1989.*
investment earnings to benefits and withdrawals ratio had improved significantly, with earnings constituting 88.8% of benefits compared to only 40.5% in 1980. Nonetheless, the fact that this ratio is less than 100% indicates that earnings on accumulated and currently held assets are not sufficient to finance current benefit demands.

- Maine’s ratio of earnings to benefits paid in 1989 was the worst in the U.S., with only New Hampshire, at 96%, paying out more benefits than earnings.

- While very slightly improved from the 1980 position relative to the U.S., Maine is still shaky at only 52.2% of the national average.

The third measure used to study pension condition is the degree to which currently held assets (cash and securities) exceed current benefit payments. In 1980, assets exceeded current payments by only 3.676, versus a national ratio of 14.11. Maine as a proportion of the U.S. ratio was just .26, or 26%. By 1989, Maine’s cash and security holdings exceeded benefits by a much larger margin, with a ratio of 9.637. Although this figure evidences strong improvement, the performance of the nation during the same period, with cash and security holdings exceeding benefits at a ratio of 18.75, Maine’s position- 51.4% of the national average- remains quite weak.

- In 1989, only three states, Louisiana, Oklahoma and West Virginia had worse performance on the assets to payment ratio than did Maine.

To complement information on the financial condition of the system, some assessment of Maine’s system relative to other states may assist policy makers to determine whether any funding flexibility exists. One of the more important aspects of Maine’s retirement system is the fact that the retirement benefits paid through the state system are not supplements to social security, as retirement, as they often are in other states.

- Maine currently is one of only 7 states nationally offering little or no social security coverage.

- In 1989, less than 5% of Maine state government employees were covered by social security, compared to the U.S. average of 74%.

- In 1989, only 18.7% of school district personnel were covered under social security, compared to 54% nationally.

- Only three of those states cover as small a percentage of employees with social security as Maine.

Figure 40 compares Maine’s median annual pension benefit to that of the group of seven states with little or no social security coverage. Although Maine state government is spared the annual expense of social security coverage for state employees, comparative data reveals that the state retirement system is far from lucrative for retirees:
Of the seven states whose employees have little or no social security insurance coverage, Maine's median annual benefit of $6,000 in 1989 was the second lowest and fell nearly $4,000 below the group's average annual benefit of $9,958.

In 1989, Maine's average monthly benefit was only 83% of the national average, even though we are only one of seven states whose retirees will not receive social security in addition to state retirement benefits.

Maine's poor comparative position with regard to average pension benefit level raises serious questions about the adequacy of the retirement system. Since housing and utility costs have increased appreciably and more rapidly in Maine than for the U.S. as a whole in recent years, these comparative figures may be more problematic than they seem at first glance. This is clearly a priority area for further investigation.

Despite debate here in Maine and the oft-professed strength of Maine's pension system, financial experts outside of state government observe significant problems. City and State, a public finance weekly, now tracks pension funding as one of 7 elements of financial performance for their annual report on the states. City and State recently joined other studies in citing poor funding of the pension system as an important and negative factor in Maine's financial health, estimating that the system's liability is funded at only 59%, the 7th lowest in the U.S.23 A comparative study of state pension systems undertaken by Wilshire Associates concluded in late 1989 that Maine's system was the second most underfunded of the eighty-two analyzed.

The results of this analysis are consistent with the findings of several other "outside" studies of Maine's state retirement system: the system is seriously underfunded relative to other states.

As of 1990, the unfunded liability hovered above $1.3 billion. Deferments of required contributions of more than $73 million during fiscal years 1991 and 1992 have boosted the long term liability of the retirement system. Deferments of contributions increase the annual cost for years into the future, because not only the current dollars deferred but the interest earnings that would have accrued on that investment will need to be made up.

As the result of a lack of fiscal discipline, financing the state retirement system is nearing a crisis stage that extends well beyond the funding deficit projected for the current budget. Any further deferment or slowdown in amortizing the unfunded liability will worsen our already inferior relative standing among the states and add millions of dollars to the annual cost of the system. Unless a concerted effort is made to pay off what we must in a timely way, our grandchildren could end up paying for benefits that accrued to our parents.

4.5 HUMAN SERVICES TRANSFER PROGRAMS

Human services transfer programs span a broad range of services and have been significant sources of budgetary pressure in recent years. As discussed earlier (under federal aid trends), the federal government has transferred significant programmatic responsibility to states for these programs. The state currently provides income assistance and medical care to Maine's poor primarily through four programs: Aid to Families with Dependent Children (AFDC), Supplemental Security Income (SSI), and Medical Assistance (Medicaid), administered by the Department of Human Services, and General Assistance, administered by local governments, with a portion of spending reimbursed by the state.

Figure 41

RATES OF CHANGE IN GENERAL FUND OUTLAY FOR MEDICAID AND AFDC BY TIME PERIOD

<table>
<thead>
<tr>
<th>Time Period</th>
<th>Medicaid</th>
<th>AFDC</th>
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<tbody>
<tr>
<td>1990 - 1991</td>
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<td></td>
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<tr>
<td>1989 - 1990</td>
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<tr>
<td>Average Annual, 1985 - 1989</td>
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<tr>
<td>Average Annual, 1980 - 1985</td>
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Percent Increase in General Fund Outlay

The major social services aid program are entitlement based, which means that anyone who meets eligibility standards are established by the state is "entitled" to services. These programs used to be called "automatic stabilizers" when the federal government was largely responsible for their funding, because any downturn in the economy would be accompanied by increases in eligibility, and hence, a flow of funds into the economy to replace a portion of lost income.

Now that the states are more responsible for funding these programs than they once were, the stabilization benefits are incidental to the need to balance budgets. In Maine, where the impact of the recession has been more severe than in many states, increased eligibility for "safety net" services has had a tremendous effect on the state budget, as shown in Figure 41.

Medicaid is the state's largest and most expensive social services program. The onset of the recession sent the Medicaid budget soaring. The more than 25% increase in spending between 1990 and 1991 is immediately noteworthy (see Figure 41.) That single year's increase doubled the average increase of the 1985-1989 period, which had been a "stepped up" rate over the early 1980's.

Figure 42 shows trends in Medicaid expenditures from the general fund in current and deflated dollars. The flat pattern of real funding between 1980 and 1985 stands in stark contrast to the sharp upward trend from that point forward.

Although the economy was strong in Maine during the latter part of the decade, state policy changes to the Medicaid program in 1985 expanded eligibility for the program and the coverage of medical services. The combined impact of broader eligibility and changed economic conditions became apparent between 1990 and 1991, when the rate of real growth in spending may be seen to have taken a more sharply upward direction.
It is important to recognize that since the highest percentage of state reimbursements are not triggered until local governments exceed a specified level of spending, this increase provides important evidence that the impact of the recession on local governments, and in particular the urban communities that house many of Maine’s poor and homeless, undoubtedly has been significant.

Aid to Families with Dependent Children (A.F.D.C.) is a program of income assistance for low income households with children. States set A.F.D.C. eligibility levels.

Figure 43 shows general fund spending for the A.F.D.C. program in current and real (deflated) dollars.

- Real spending from the general fund for the AFDC program was nearly identical in 1980 and 1989.

Then, in 1990 and again in 1991, eligibility for AFDC increased in response to the recession, and as a result the general fund expenditure grew markedly.

- Despite cuts in eligibility for services in 1991, AFDC spending increased by 38% between 1990 and 1991 (as shown earlier in Figure 41.)

All of the New England states except Massachusetts saw increases in AFDC payments between 1990 and 1991 that equalled or exceeded Maine’s: New Hampshire’s expenditure grew by 98.1%, Connecticut’s by 46.4%, Vermont’s by 44.3% and Rhode Island’s by 38.2%.

Part of the explanation for slow growth in spending that characterized the latter part of the 1980’s, despite policy actions that broadened eligibility for services, lays in the strength of the economy. The number of A.F.D.C. recipients declined over the period of 1980 through 1988, from
a level of 58,000 recipients in 1980 to 49,000 in 1988, despite the fact that Maine expanded eligibility for services in 1985 by raising the family income permitted for program recipients.

- While average yearly spending per recipient increased by 82% over the eight years (from $1,034 per year in 1980 to $1,892 in 1990 in current dollars); however, real growth over the period was only 18% (less than 2% per year).

In addition to AFDC and Medicaid, like many states, Maine also provides cash support to individuals who are in need but do not qualify for one of the national programs through the general assistance program. Assistance actually is provided by local governments, and then after a threshold level of expenditure is reached, the state reimburses local governments for general assistance payments.

**Figure 44** traces the growth in spending for the state’s share of local costs of the general assistance program. Although reimbursements to local governments for general assistance payments had declined slightly between 1985 and 1989, as the first evidence of the recession began to register, the payments under this program escalated, dramatically increasing the level of state reimbursement. The state receives no federal aid for the general assistance program.

- State spending for reimbursements to local governments for the general assistance program more than doubled between 1989 and 1990, from $7 million to $15 million.

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The Supplemental Security Income program (SSI), which consolidated the old aid to the aged, blind and disabled programs, is another program of income assistance. This program originates at the federal level, where eligibility for S.S.I. is determined. The federal government pays a monthly benefit to individuals with limited income who are blind, 65 years or older or who have a disability. States may elect to supplement the federal SSI payment, as Maine elects to do. All SSI recipients in Maine are eligible for Medicaid.

Although the Supplemental Security Income program is not an extremely expensive program, it is funded entirely with state resources. The fact that Maine offers the program while some of the other states do not contributes to our higher than average per capita public welfare expenditure. Real increases in spending for SSI were strong during the 1980’s.

- In 1980, the state’s SSI caseload numbered 21,600, and spending totalled $4.7 million; By 1989 there were 22,900 recipients with expenditures of $14.3 million. In real dollars, this represents an increase of more than 100% over the nine year period.

- In fiscal year 1991, the state expended $15 million for SSI, which represented "flat funding" from the 1990 level of spending and only a modest increase over 1989.

Thus, with the exception of the AFDC program, all of the social services transfer programs were seeing strong growth even before the onset of recession. However, state resources were also increasing during this period. Let’s consider how the claim of these programs on resources has changed.

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**The Claim of Safety Net Programs on the General Fund**

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A major factor influencing the general fund "claim" of spending for Medicaid and AFDC is the annual rate of federal reimbursement for state expenditures made under these programs (the total expenditure is shown under the Governmental Funds.) As Figure 45 shows:

- Federal aid provides a significant percentage of all dollars spent for income and medical assistance to Maine’s low income.

- In 1990, only 22.2% of the total AFDC budget was financed through the General Fund ($27.5 million out of the total $123.6 million of AFDC spending.) Thus, for every dollar spent on AFDC in Maine in 1990, the federal government paid close to 88¢, leaving a rather paltry 22¢ to be financed in state.
• In 1991 the federal reimbursement rate for AFDC declined, as a result of an update of the personal income used in the distribution formula to the 1989 level. As a result, the state became responsible for financing a higher level of costs, 27%. However, this percentage was less than the share of spending the state bore in 1980 and 1981.

• The federal rate of Medicaid reimbursement has been declining steadily since 1986. As a result, the state share of rapidly rising Medicaid costs rose from 30% of the total in 1986 to close to 40% in 1991. 26

Although social services transfer spending has been an increasing source of budget pressure for all states, including Maine, interestingly, in Maine the pattern of increasing general fund share of resources devoted to these outlays that has been seen nationally was not the pattern in Maine prior to the recession.

Analyses of the claim of Medicaid and AFDC on the general fund have typically looked at a comparatively short time span for example, the changed share of general fund in 1989 versus 1991. These kinds of comparisons can be grossly misleading in the case of transfer spending, because we are looking at “before” and “after” effects of the economy on expenditure responses built into these “safety net” programs. Some studies have gone back a bit further, for example to 1985. 27 Although the longer time frame provides improved information, because the period of 1985 through 1989 marked a low point in spending for transfers we really need to go back further for a meaningful point of reference.

26 These figures are based upon actual expenditures and actual federal revenues reported in the state’s annual publication of audited finances, the Maine Financial Report. A small percentage of total federal aid for Medicaid comes directly into the general fund and is not easily tracked. Thus, the Medicaid reimbursement slightly understates federal aid receipts.

27 For example, see Saucier (1992.)
Figure 46 reveals that the percentage of the general fund devoted to social services transfer programs declined over the decade, with steady decreases annually after 1983 until the onset of recession.

* In 1980, 15% of the state's general fund was devoted to social services transfer payments. The percentage increased to 16% from 1981 through 1983, while the economy was in a "trough." Between 1986 and 1989, the share of general fund resources used for transfer payments was at a low point of only 13%.

The declining share devoted to these programs reflects first, the strength of the economy in Maine between 1983 and early 1990, and second, the very rapid growth of other policy areas. The effect was a displacement of social services transfer spending in terms of its priority in the state budget. By late 1990 and 1991, social services transfer payments had grown to comprise a more important portion of total state spending, which had itself gone "flat," reflecting level funding, between 1990 and 1991.

* In 1991, the percentage of total general fund expenditure used for social services transfer payments reached 17%, which seems very high relative to the lower 13% of 1989. However, this claim on general fund resources is not out of line with the 16% share of budget devoted to these programs during the recessionary period of the early 1980's, particularly when the severity of the current recession is considered.

The various programs that comprise social services transfer spending have fared differently in terms of the share of resources each has garnered over time, as shown in Figure 47.

* In 1980, 11.3% of all general fund expenditures were for transfer payments under the Medicaid program. By 1990, the percentage of the general fund used for this purpose had declined to 10.2%.
The decline in share of general fund resources used for Medicaid occurred despite the transfer of some previously state funded Mental Health institutional services into this account (an action taken to maximize federal reimbursements on state expenditures) and a declining federal reimbursement rate.

- The share of the general fund expended for Aid to Families with Dependent Children declined from 3.8% of the total in 1980 to only 1.8% in 1990.

- Even with though the recession had a resounding impact on the number of persons eligible for both AFDC and Medicaid and general fund spending was maintained at a nearly level total between 1990 and 1991, the shares of that these two transfer programs claimed increased to only 2.4% and 12.8% respectively.

- In the case of AFDC, the 1991 percentage of general fund resources was less than the 1980 share, while Medicaid increased by only 1.5 percentage points.

Despite the extraordinary rate of increase in state spending for reimbursements to local governments under the general assistance program, this important "safety net" program utilizes only a truly small percentage of state resources.

- In 1980 General Assistance claimed only .2% of the general fund. In 1990, the share increased to .7%, then to 1.0% in 1991.

These comparisons give a very different perspective on the relative claim of social services transfer spending on the state budget. The historical perspective is important, because it takes us back before rapid growth in state revenues had whetted appetites for spending.
of 7.3% in 1988, despite policy actions taken in 1985 that expanded eligibility for services by lowering income requirements and extended Medicaid coverage to a broad range of medical services.

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**Comparative Analysis:**
**AFDC and Medicaid**

In this section, we shall consider both Maine's comparative expenditure for ADFC and Medicaid and the burden of finance.

**AID TO FAMILIES WITH DEPENDENT CHILDREN**

States have a great deal of discretion in setting A.F.D.C. payment levels; as a result, payments vary sharply among them.

- In 1990, Maine's average grant for a single parent family of three was $453 ($1892 per recipient yearly), compared to a U.S. median payment of $364 and a reference group payment of $377.\(^{28}\)

Eligibility for services is also established by the states, within federal guidelines.

- In 1989, Maine's income standard for a family of three was 75.4% of the federal poverty level, compared to a national average of 47.1%.\(^{29}\)

Comparison to the other New England states, in addition to the reference set is appropriate for assessing whether income support is "high," because New England shares cost of living characteristics facing Maine's AFDC population, whereas the reference set was selected on the basis of cost factors that might effect not only spending but also revenue capacity.

- Maine's A.F.D.C. grant amount lagged behind the payment of the next lowest state (New Hampshire) by more than $50 per month and behind the average of the other New England states by $127.

Thus, the negligible real growth in AFDC funding seen earlier did not reflect a slowed expenditure due to higher than necessary payments. Rather, Maine appears to have followed many

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\(^{28}\) Comparative data in this section was obtained from the U.S. Bureau of the Census, *1990 Statistical Abstract* and Yolanda K. Henderson (November, 1990), "Income Support and Social Services Programs" in Munnell and Brown (eds.) *Massachusetts in the 1990's: The Role of State Government*.

\(^{29}\) Maine Department of Human Services, *1989 Medicaid Annual Report*. 

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Thus, the negligible real growth in AFDC funding seen earlier did not reflect a slowed expenditure due to higher than necessary payments. Rather, Maine appears to have followed many other states in providing little or no real increase in A.F.D.C. payments. Maine's minor increase was actually noteworthy for increasing the payment at all, because most other states did not.

- In New England, Maine was the only state to increase real spending per recipient; nationally, the median change was a real decrease in income support of 36%.

Despite a minor increase in the per recipient grant:

- As of 1990 Maine's monthly AFDC allocation remains the lowest in New England, lagging behind the New England average by $127 monthly and even behind New Hampshire by $50 per month.

AFDC recipients receive food stamps in addition to monthly income assistance. (The food stamp program is fully funded by the federal government.)

- The combination of income support and food stamps brings AFDC recipients to 80% of the poverty level; this compares to a U.S. median of 73% and a New England average of 92%.

MEDICAID

Medicaid is an assistance program designed to provide medical care to people who are eligible for cash assistance under one of the existing welfare programs established under the Social Security Act: Title IV-A, the Program of Aid to Families with Dependent Children, or Title XVI, the Supplemental Security Income program for the Aged, Blind, and Disabled. In most cases, qualification for one of the several welfare programs (e.g., A.F.D.C.) means automatic, "categorical" eligibility for Medicaid, in other words, mandated service provision. In addition to those citizens the state must serve through the Medicaid program, the federal government reimburses states for certain other groups who states may choose to include in their Medicaid program. Maine opts to extend Medicaid coverage to the "medically needy," citizens with high medical need and relatively low income.

The federal government additionally mandates that certain types of medical services be covered as part of a state's Medicaid program. States additionally may elect to cover other services, with federal reimbursement for most services. Maine has chosen to cover the majority of optional services, and to make the full range available to all persons covered through state option.

Although we know that Maine's Medicaid spending increased significantly during the 1980's, trend data affords little insight into how our spending level and the burden of financing the Medicaid program compares to other states, nor why differences may exist. In the next part of this section we consider a variety of indicators in an effort to answer these questions.
To assess the burden of financing Medicaid in Maine relative to other states, we may consider the per capita cost of the program and the relative claim on personal income.30

- Maine's 1989 per capita Medicaid payments of $304 exceeded the U.S. average of $220 by one half.

- At $19.41 per $1,000 of income, Maine's 1989 expenditure for Medicaid exceeded the U.S. average by 50%.

While falling approximately in the middle of the New England states in terms of per capita financing burden, Maine's Medicaid program's claim on personal income is exceeded only by that of Rhode Island. Why is the burden of financing Maine's program so high relative to other states? Part of the answer lies in Maine's slightly lower than average income. Nonetheless, per capita payments also exhibit a similarly "high" pattern. An important difference between Maine and national patterns lies in how we define eligibility for Medicaid.

- In 1989, the average income eligibility threshold for optional coverage was 70.5% of the federal poverty level, compared to a national average of 60.1% for the 35 states who elect to cover this non-mandatory group.31

More detail on our income requirements compared to federal minimum requirements appears in Figure 48. As a result of our less restrictive eligibility guidelines:

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In 1989, 90.5% of Maine residents living in poverty received Medicaid coverage, compared to a national average coverage rate of 67.8%.\textsuperscript{32}

It is important to recognize that neither the federally minimum nor the national average represent an "ideal" coverage level. Even though Maine extends the program to more of the poverty population than some states, as of 1989 nearly 10% of people living in poverty in this state did not qualify for service, as shown in Table 6.

<table>
<thead>
<tr>
<th>Medicaid Recipients As a Percent of State's Population</th>
<th>Percent of Poverty Population Aided Categorically Needy</th>
<th>All Households</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maine</td>
<td>10.0%</td>
<td>83.2%</td>
</tr>
<tr>
<td>United States</td>
<td>9.5%</td>
<td>56.4%</td>
</tr>
<tr>
<td>Connecticut</td>
<td>7.0%</td>
<td>73.0%</td>
</tr>
<tr>
<td>Massachusetts</td>
<td>9.8%</td>
<td>81.1%</td>
</tr>
<tr>
<td>New Hampshire</td>
<td>3.3%</td>
<td>46.5%</td>
</tr>
<tr>
<td>Rhode Island</td>
<td>10.3%</td>
<td>81.3%</td>
</tr>
<tr>
<td>Vermont</td>
<td>9.4%</td>
<td>84.6%</td>
</tr>
<tr>
<td>New York</td>
<td>12.6%</td>
<td>60.5%</td>
</tr>
<tr>
<td>New Jersey</td>
<td>6.9%</td>
<td>67.8%</td>
</tr>
</tbody>
</table>


A second explanation for the comparatively higher cost of Maine's Medicaid program lies in the comprehensive range of medical services covered. As noted at the beginning of this section, Maine has chosen to cover the majority of services the federal government leaves to state option, and to make the full range available to all persons covered through state option. Although per capita figures on spending adjust programmatic costs so that we may make comparisons among states of

\textsuperscript{32} U.S. Health Care Financing Administration, State Medicaid Data Tables, 1990.
differing sizes, per recipient expenditures provide an improved sense of resources directed towards a program’s clients.33

- Maine’s per recipient expenditure of $3,026 in 1989 was $700 higher than the national average of $2,318 and ranked 13th in the U.S. in 1989.

- Maine’s 1989 per recipient expenditure exceeded the reference group average by $700.

A key explanation for Maine’s higher expenditure lies in the composition of the population served. A 1986 study of medical care payments by case type provided data on our caseload relative to other states.34

- In 1986, the elderly comprised 16.5% of the total Medicaid caseload in Maine, compared to a national average of 14.0%.

- In 1986, the disabled comprised 15.2%, compared to a national figure of 13.5%.

Thus, both the elderly and the disabled are larger relative to Maine’s Medicaid recipient group than they are to the nation. The higher proportion of the recipients serve that the elderly and disabled comprise is due in part to the extension of the program to the medically needy. An important, and related, explanation for the high cost of Maine’s Medicaid program lies in the coverage of persons in institutions, including mental health facilities and nursing homes. Although the full cost of medical care for mental health patients in state institutions would fall to the state in the absence of Medicaid, increased coverage of other populations during the 1980’s comprises an important element of increased state spending.35

- Three out of four of Maine’s nursing home residents are covered by Medicaid.

- As shown in Figure 48, Maine’s income limitation for Medicaid for nursing home residents, some of whom are the optionally covered elderly medically needy, is more than double the federally specified minimum.

The daily payment for institutional care is another important factor that influences the overall cost of providing Medicaid. Comparative data reveals that Maine’s high daily payment, when combined with a large number of Medicaid patients in nursing homes, produces an expensive result.

33 U.S. Health Care Financing Administration, State Medicaid Data Tables, 1990.

34 U.S. Healthcare Finance Administration, Office of the Actuary.

In 1988, Maine’s daily expenditure for skilled nursing facilities (SNF) averaged $85.45, ranked 5th in the U.S., and exceeded the U.S. average of $60.65 by roughly $25 per day.

Maine’s average daily payment for intermediate care facilities $56.74 ranked 8th in the U.S. and exceeded the national average of $46.03 by 23%.

In sum, Maine’s Medicaid program is expensive both in terms of the "bite" on taxpayers and relative to other states.

The comparatively higher cost of Maine’s program stems from (1) our more liberal eligibility standards, particularly for nursing home care, (2) coverage of optional groups of recipients, (3) coverage of the costs of many optional medical services, and (4) higher vendor payments for nursing home care.

Although cutting back in one or more of these areas appears at first glance to be a clear and easy method of trimming the state budget, the pros and cons of different options are highly complex. Experiences of other states have been mixed, sometimes including higher costs rather than lower.36

Discussion

An important finding from this historical look at the financing of safety net programs is that the portion of the general fund devoted to these programs in total is only slightly higher than during the recessionary period of 1981-83 (17% in 1991 compared to 16% in the earlier period.) When we consider the programs individually, we find that AFDC received less of the general fund outlay in 1991 than in 1980, while Medicaid increased by only 1.5 percentage points. Like the other "safety net" programs, general assistance has grown rapidly, but in 1991 comprised only 1% of general fund spending.

Values have played an unusually strong role in Maine in shaping the allocational of resources within the sum of state social services programs over time. The elderly have fared well in Maine, receiving state supplements to the federal SSI payment and facing far less stringent

36 See Paul Saucier Medicaid Cost Containment: Issues and Options (Maine Legislature, Office of Legal and Policy Analysis) for a valuable discussion of the cost containment options tried in other states.

The University of Southern Maine’s Muskie Institute has been working with the state’s Department of Human Services (under a multiyear grant from the Robert Wood Foundation) to develop a new, case mix based method of reimbursement for nursing homes.
standards of need for Medicaid than in many other states. Poor families, in contrast, have seen the state’s response to them deteriorate.

The meager increase in AFDC payments over the decade is a cause for concern. Our monthly payment is the lowest in New England. Given the higher cost of housing and fuel costs in Maine compared to many parts of the U.S., 80% of the national average suggests that A.F.D.C. families may face some difficulty meeting basic needs. In addition, the rapid increase of housing costs, and in particular rental costs in urban areas, during the 1980’s has undoubtedly meant a reduced standard of living for many AFDC recipients. Yet, AFDC is a comparatively "cheap" program for the state to participate in because of (1) the high rate of federal reimbursement (more than 70% of the total program’s costs), (2) the low Medicaid costs associated with this service population, and (3) the long term health and welfare benefits of good food and housing for not only the children assisted, but also the state.

Some local officials in the urban centers of the state have argued that general assistance frequently is requested by AFDC recipients to supplement state support because housing costs consume a large share of monthly allocations. Since AFDC is federally reimbursable while general assistance is not, an investigation is warranted of who receives general assistance and whether an increase in the monthly allowance, in urban areas particularly, might not more than pay for itself.

It bears noting that although the cost of social services in Maine is high relative to personal income, expenditures by all of the transfer programs are made directly to or on behalf of clients. This is noteworthy, because their is no "efficiency loss": what we spend purchases an improved quality of life for Maine’s poorest citizens. Yet, despite the strong growth in state spending for social services in the 1980’s, poverty researchers estimate that only 55% of the persons living in poverty in Maine are covered under the two major income supports programs, Aid to Families with Dependent Children and Supplemental Security Income programs. Nationally, roughly 45% of the poverty population receives assistance through these programs.37

A piece of the current budget crisis in Maine results from a reduction in the percentage of state costs the federal government would reimburse under both Medicaid and AFDC. Each rate actually declined in 1991, just as the economy was turning downward and our costs of financing "safety net" programs were escalating. (The formula change occurred at the time it did because there are lags in recognition of economic change of almost two years. Thus, our good fortune of the late 80’s was just being recognized in the reimbursement method.)

One area that requires additional research is the question of how Medicaid eligibility differences may influence behavior. There appears to be an incentive built into the eligibility criterion that would encourage people to enter nursing homes, rather than to stay in their homes and receive nursing or other health care assistance.

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State policy makers may wish to strive for the adoption and implementation of improvements to current federal aid policies that will promote equity and enhance Maine's capacity to meet citizen's needs, particularly during periods of economic stress. Seeking a change in the Medicaid formula to recognize sudden changes in state financial circumstances that accompany severe economic downturns and some type of emergency fiscal assistance from the federal government during periods of recession has been suggested in Washington.

A complementary avenue of state action which may offer important long term returns is for Maine to work for a Medicaid formula change that would more equitably distribute federal assistance. Under the current Medicaid formula, all states are guaranteed a minimum federal reimbursement equal to 50% of their Medicaid spending, regardless of their own abilities to finance program costs. This "floor," or minimum funding level, reduces the ability of the Medicaid formula to target funds to needy states because a large portion of the available funding available is used to meet the requirements of the "floor."

The U.S. General Accounting Office (GAO) has been pursuing legislation which would redirect Medicaid funding to the states with high need and lower than average ability to pay, like Maine, but have been unable to rally sufficient support among the states. The General Accounting Office has suggested that the floor should be reduced to 40%, or even lower. Under GAO's 40% floor proposal, even with no increase in the amount of federal funds available, Maine would receive an increase of 6.25% in federal funding. GAO estimates that only 14 states- including Maine- would receive more than an additional 5% in funding; 16 would lose more than 5%. Both the General Accounting Office and, more recently, the U.S. Advisory Commission on Intergovernmental Relations (A.C.I.R.) have argued that the Medicaid formula should be revised to include a better measure of a state's fiscal capacity. Currently, per capita personal income is the only measure, which neglects other, potentially lucrative, tax bases of some states. It would be a simple matter to include both a revised indicator of fiscal capacity such as the representative tax system (R.T.S.) measure that A.C.I.R. compiles. However, fiscal capacity is only part of the issue, because the proportion of a state's population that has need for services also varies. A need index, such as the percentage of the state's population that is below poverty, would improve the targeting of funds.

4.6 CORRECTIONS

The criminal justice system in Maine is a shared responsibility of local police, county level courts, prosecutors and jails, and state agencies including the Judicial Department and the Departments of Corrections, Attorney General and Public Safety. In this analysis we focus upon

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The Department of Corrections, with a minor detour to consider trends in county jail populations. However, it is important to recognize that corrections policies have significant impacts on court and prosecution costs.

Responsibilities of the Department of Corrections for correctional programming extend to both adults and juveniles. Growth in spending by the Department of Corrections was identified in the preliminary analysis of trends as a significant source of budgetary pressure during the latter part of the decade of the 1980's.

Figure 49 compares spending for the major correctional programs in 1985 and 1990.

- Expenditures for the state's largest correctional facility, the Maine State Prison, nearly doubled in five years.

- Increases in spending for other institutions multiplied dramatically.

- The Maine Youth Center, the apparent focus of the state's expenditure reduction efforts, is neither the most costly nor the fastest growing budget area.

- Increased spending for correctional institutions explained 70% of budget growth between 1985 and 1990.

Increased populations at state facilities provide an important explanation for rising costs. As shown in Figure 50:

- The number of prisoners incarcerated at the various state facilities doubled between 1981 and 1990.
Overcrowded conditions escalate expenditures because added security is required and control of prison populations becomes more difficult. Both full time employment and overtime wages grow more rapidly than generalized trends under less crowded conditions.

Employment in the Department of Corrections escalated between 1984 and 1990, increasing from approximately 900 positions to 1300.39

- At the 1990 state average annual pay rate of $24,778 ($476.50 per week), plus fringe benefits at 31% of salary, the cost of roughly 400 corrections positions added between 1984 and 1990 would exceed $13 million in that year alone.40

Populations housed in county jails have also risen during the past decade. Figure 51 shows trends in populations over the past decade. Examination of this figure reveals that during the early part of the 1980's, the number of offenders sentenced to county jails first declined and then increased slowly.

- Between 1987 and 1989, county jail populations escalated, and then, a sharp upward jump in the number of incarcerated offenders occurred, adding over 200 prisoners by 1990.

Juveniles are still being held in jails in Maine, despite more than a decade of federal mandates (Maine has had several extensions for full removal of youths from jails.)

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39 Maine Annual Report, various years.

40 Weekly wage data for 1990 was obtained from Maine State Controller's report entitled "State of Maine Financial Highlights."
Although the costs of county jails is paid for locally through property taxes, and is not therefore the focus of state debate, the state legislature approves county budgets. The costs of incarcerating prisoners in county jails, as well as jail construction and maintenance have been a continuing and significant source of added property tax pressure. The new Cumberland County facility recently has added more than 170 beds to the statewide system, for an additional annual operating cost in excess of $3 million, based upon an average of $22,000 per bed.

**Comparative Analysis**

A key factor that influences corrections spending is the number of individuals housed in prisons. A primary determinant of the number of persons in prison is the number of convictions for serious crimes. However, the incarceration rate varies widely among states and is a primary influence on spending, because prison, and particularly secure facilities, are the most costly sentencing options. Thus, the percentage of convicted offenders who are sent to prison rather than sentenced to alternatives has a resounding impacts on corrections spending.
Figure 52 compares Maine’s prison admission rate to both the New England and reference group averages. The rate of admissions is expressed as the number of incarcerations per 1000 convictions for serious offenses, an adjustment that permits comparison over time without regard to crime rates.

Although the rate of sentencing offenders to prison was higher in Maine than for either the New England states or reference group averages in 1980, by 1988 Maine’s rate had nearly doubled in eight years, while the others grew more slowly.

While many states adopted a "tough on crime" stance during the 1980’s, these figures disclose that Maine’s use of prison, the most costly sentence, was high to begin with, increased more rapidly, and as a result, now surpasses most other states. In addition, the increase in costs associated with a higher incarceration rate in Maine tends to be compounded by longer stays in prison.

Maine is currently the only state in the nation that does not permit parole. In addition, use of less costly alternatives to secure confinement is significantly below both the national and the northeastern states’ averages. Although an "intensive supervision" probation status was enacted as an alternative to prison, it has rarely been used.

- In 1987, Maine had 521 adults on probation per 100,000 adult residents, compared to the national average of 1,247, a northeastern average of 1046 per 100,000, and a reference states’ average of 966 per 100,000 residents.

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41 Although Maine does use a what we call a "good time" system that can lead to early release, the federal Department of Justice does not equate this option with parole.

Our use of probation is only 41.8% of the national average and 54% of the reference group's average. Only seven states had fewer on probation per 100,000 residents in 1987 than Maine.

Discussion

The overview of comparative spending in the previous section revealed that Maine does not spend as much as average state for corrections, but our expenditures have been increasing far more rapidly. Between 1989 and 1991, while the average state increased corrections spending by 25%, Maine increased by 38%.

Coupled with the knowledge that our prison admission rate is higher than the norm and that admissions are growing more rapidly, the comparative trends suggest a significant capacity for Maine to achieve short term cost savings and long term cost control by placing less emphasis on institutional placement of convicted offenders.

A recent report notes that corrections spending is not "uncontrollable" and offers several strategies for cost control, including increased use of community sanctions such as probation and parole, moderating prison lengths of stay, coordinating state and local funding for corrections, careful preparation and use of fiscal impact studies to encourage "pay as you go" funding of bills with cost impacts, and prison construction cost containment. Although a sudden shift away from the institutional focus in Maine may be politically difficult, the spiralling costs of confinement make the development and utilization of alternatives to incarceration a pivotal long term budget control strategy.

Public education regarding the comparative costs and benefits of alternatives to incarceration and prison may be helpful.

Similarly, moving towards an emphasis on early intervention in the lives of juveniles who are at risk of being swept into the juvenile justice system will be expensive in the near term, but should prove to be highly cost effective in the longer run. First, diversion programming is less expensive than incarceration, and successful intervention is a powerful means of controlling the long

term costs of juvenile and adult corrections. Second, citizens want adult offenders locked up to prevent them from committing additional crimes. Preventing criminal activity before its first incidence is obviously a happier situation for everyone concerned. Finally, intervening when the first "help" is heard, whether through a juvenile's encounter with the law or school authorities, or a report of child abuse, stands a far better chance of seeing that young person become a productive citizen. Efforts are already underway to study the child welfare system with consideration of organizational placement of juvenile corrections. Additional analysis of needs for juvenile justice and delinquency prevention programming may prove beneficial.44

4.7 CAPITAL INVESTMENT

In Maine, the state, local governments, and public authorities such as the Maine Turnpike Authority share responsibility for roads and bridges, schools and other public buildings, sewerage treatment plants, storm water and drinking water systems. Responsibility for financing infrastructure provision, maintenance and reinvestment often involves combinations of federal, state and local funds, including both taxes and user fees; and debt finance.

In this section, we consider trends in state capital investment over the decade. In addition, where pertinent, we include local

Figure 53
Comparison of Per Capita Capital Spending, Maine and U.S.


44 A number of state commissions over the years have noted the absence of juvenile delinquency prevention services and justice system diversion programming in Maine. See particularly the report of the Commission on Children in Need of Supervision and Treatment (March, 1989); also the report of the Governor's Task Force to Improve Services for Maine's Children, Youth and Families (May, 1991) and "A New Vision: Empowering People for Change," the Final Report of the President's and Speaker's Blue Ribbon Commission on Children and Families (August, 1991).
government capital expenditures. The objective of this section is not to examine every aspect of infrastructure provision and need in detail, but rather to assess Maine's spending trends and progress toward meeting infrastructure needs in comparison to other states. Comparative data on per capita capital outlay, shown in Figure 53, reveals that Maine's expenditures lagged seriously behind U.S.

- In per capita terms, despite a stepped up level state capital outlay in 1988 and 1989, the difference between Maine and the nation persists, with Maine spending $396 per capita in 1989, versus a national average of $450.

- On a more positive note, the size of the gap between Maine and the U.S. has narrowed steadily from 1986 through 1989.

Recent "jobs bonds" and other capital programming initiatives should improve our position relative to the nation, but may not be sufficient to fully close the gap.

Trends in Maine's total state and local government capital outlay as a percent of gross state product are compared to the national average from 1970 through 1989 in Figure 54.

- While throughout the 1970's Maine's spending for capital outlay as a percent of gross state product paralleled or exceeded the national average, in 1980 we fell substantially beneath and then continued well below until 1988 and 1989.

Comparative data which includes local governments disguises key facets of state capital investment during the 1980's:

- Expenditures for major capital projects were largely attributable to municipalities and school districts, who spent $207.7 million in 1989.
The state spent only $58.4 million for capital purposes that the U.S. Census Bureau classifies as major projects.

These figures somewhat understate the role of the state in financing infrastructure, because the state finances local government capital spending through programs such as the local roads program and the school debt subsidy. Total aid to localities from the highways fund increased from $4.9 million in 1980 (4.4% of the highways fund) to $20.7 million (10.9%) in 1989.

Local governments spent approximately 71% of all capital funds on major projects, while the state spends 72% on "other purposes."

In 1989, $65.6 million, or 31.3%, of the total state capital expenditure was for the purchase of equipment.45

Figure 55 presents data on Maine’s per capita capital stock, in comparison to the other New England states and the U.S. average. This indicator is often considered as a gauge of extent and value of infrastructure, as well as the attractiveness of a state for business location. While extensive infrastructure by itself is not...

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necessarily sufficient to attract business, experts agree that the absence of adequate infrastructure is a significant barrier.

- Maine’s per capita public capital stock is low relative to the rest of New England and the U.S. average.
- Vermont, another New England state which faces high unit costs of infrastructure because of low population density, shows a much higher population adjusted level of public capital stock ($6706 per capita in 1989) than does Maine ($5094).

Although Figure 55 readily reveals the difference between Maine and the other states, the relatively flat level of Maine’s per capita capital stock actually understates a lack of capital investment. When inflation adjusted values of stock are considered, a far bleaker picture emerges:

- During a decade of unprecedented income growth Maine’s capital assets declined in value by more than $2000 per person.

In addition to the extent of infrastructure, the quality of existing capital stock is important. Although a full inventory and condition rating for Maine’s capital stock is not currently available, the U.S. Department of Transportation rated major U.S. highways in 1989 and bridges in 1988.

Figure 56 presents comparative data on ratings of bridge and highways quality, while Figure 57 shows changes in the quality ratings. For these displays, we are comparing Maine to both the U.S. average and a set of "high tech" states. The "high tech" states include Massachusetts, Connecticut, New York, New Jersey, Arizona, and Pennsylvania. Although the "high tech" states are wealthier than Maine, and thus are able to invest more in infrastructure, the comparison provides a useful

<table>
<thead>
<tr>
<th>Type of Infrastructure</th>
<th>BRIDGES 1988</th>
<th>HIGHWAYS 1989</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percent Rated Deficient by USDOT</td>
<td></td>
<td></td>
</tr>
<tr>
<td>0%</td>
<td>5%</td>
<td>10%</td>
</tr>
</tbody>
</table>

gauge of how we compare with states have vigorously pursued economic development of the sort Maine hopes to attract.

- In 1988, Maine enjoyed a comparative advantage over all of the comparison groups in terms of the percentage of bridges deficient.

- In terms of highway miles rated deficient, Maine compared favorably to New England average in 1989 but had a higher percentage than either the U.S. average or the high tech states.

Despite the comparatively strong condition of bridges in Maine, as Figure 57 reveals, between 1980 and 1988 the number of bridges rated deficient increased notably.

- Between 1980 and 1988, Maine's bridge deficiencies increased by more than 62%, compared to a U.S. average that was close to no change and a decrease in deficiencies in the high tech states.

Maine's performance with regard to highways was better than for bridges, yet nevertheless lagged behind the comparison states.

- Between 1982 and 1989, Maine's highways rated deficient increased by 18%, while the U.S. as a whole and the high tech states saw sizable reductions in deficiency ratings.

Thus, in the cases of both highway mileage and bridges rated deficient, Maine's deficiencies have increased over the decade and increased more rapidly than the rest of the New England states and the average for the U.S. This finding, when added to a number of other important indicators of infrastructure investment sufficiency and quality, raise concerns.
Discussion

A state’s public infrastructure is one of the most important, and expensive, financial assets for which state government is responsible. Public infrastructure is viewed by most economists as far more important to a state than the simple dollar value of the physical assets. Numerous studies have linked the extent and quality of the public capital stock with economic growth and sustained vitality. Researchers have also argued that investment in public capital increases the rate of return to private capital and investment, and enhances productivity growth. Although recent "jobs bond" proceeds and other debt issues should permit a significant step forward in meeting the state’s infrastructure need, it is important to note that the state persists in a haphazard approach to assessing infrastructure needs and scheduling capital investments.

Despite efforts over the years to initiate a statewide capital planning and programming process, Maine state government continues to develop capital plans at the departmental level only and does not prepare a capital budget.

- The findings of this section underscore the need for the state of Maine to develop and implement a capital planning process and a systematic approach to prioritizing and programming expenditures within a government wide capital budget.

Regardless of which level of government claims ownership over a particular area of infrastructure, the provision of an adequate infrastructure is a shared responsibility of both the state and the local governments. Many of the most costly infrastructure needs of the 1990’s are likely to occur at the local level, as municipalities attempt to respond to state and federal clean water and other environmental mandates. Solid waste disposal is already an problem in many towns, with landfills nearing capacity and in some cases contaminating groundwater.

The division of capital investment responsibilities between the state and local governments derives from the assignment of functions to the respective levels, not from any reasoned distribution. As a result, responsibility may not correspond to the relative priority of the capital needs in the overall fiscal system, the dispersion of benefits, nor the financial capacity of the "home" unit of government to undertake sizable projects.

4.8 THE USE AND MANAGEMENT OF PUBLIC DEBT

The decision to proceed with capital investments usually hinges upon the availability of financing. Although pay-as-you-go financing is sometimes used to fund capital projects and the
acquisition of major assets, often debt or a debt-like long term financing arrangement is used to spread the costs over a number of years. While debt incurred through the issuance of general obligation bonds was once the primary long term financial obligation of government, in recent years other debt types and debt like liabilities have become increasingly important in many states including Maine.46

Like most states, Maine’s use of debt has diversified. Today, authorities of state government issue significant amounts of debt that is not "guaranteed" by the state, which means the state is not directly obligated to pay the debt. However, some of the non-guaranteed debt is a contingent liability of the state (the state is like a co-signer); any of it could potentially become a liability of the state because of the agencies are arms of state government. In addition to diversifying among debt instruments, long term financial obligations of government today include new debt-like liabilities, such as lease purchase agreements. These long term liabilities differ from debt more in language than in their claim on the state’s annual financial resources. Finally, the state has assumed a statutory responsibility for paying all or some of the annual principal and interest on debts of school districts and the Maine Court Facilities Authority.

Two fundamental questions that relate to debt face governments when they must determine whether debt should be undertaken to finance needed capital improvements. First, to what extent should current revenues finance the undertaking versus longer term revenues? Second, how will the proposed obligation effect the government’s financial position? The answers to both questions depend in part upon the government’s current long term liabilities and how the proposed addition to those obligations will change the claim on current and future financial resources. As we have seen, significant long term liabilities exist for employee pensions; the addition of accrued health benefits due future retirees would escalate the unfunded liability.

In this section, we first consider the state’s general long term debt position and how it has changed since 1980. Then, we examine other long term debt and debt-like liabilities for which the state has either a current or potential repayment obligation.

General Long Term Debt

Data on Maine’s direct, general obligation debt outstanding shown in the state’s financial statements includes both principal and the interest, in order to reflect the total liability that is scheduled to be financed through yearly appropriations.

46 Municipal bonds fall into two debt categories determined by the security behind the debt. General obligation bonds, often called "full faith and credit" debt, carry an unconditional promise that the principal and interest will be repaid. In state financial reports, these are shown under the heading "general long term debt." Limited liability bonds, or revenue bonds as they are often called, are secured by a pledge of specific revenues, such as user fees or rents. Although Maine state government is not currently authorized to issue revenue bonds, authorities and other entities of state government do utilize them.
• Long term, outstanding, full faith and credit debt increased very slowly over the decade, from $254 million in 1980 to $306 million in 1990. Recent debt issues, however, have raised the debt level significantly: by January, 1992 the state’s total, outstanding, long term debt had risen to $395,420,000, an increase of 29.2%.

Two additional debt issues were recently approved by voters (November, 1991 and June, 1992) that may potentially boost the total to over $540 million during Fiscal Year 1993.

The percentage of annual state revenues that outstanding debt potentially "claims" (since state revenue flows provide the assurance of repayment for debt issues) is monitored to assess the degree to which that obligation may potentially crowd out other priorities or become vulnerable to default if emergencies arise.

Figure 58
TRENDS IN ANNUAL DEBT SERVICE
CURRENT AND DEFLATED, 1980-1992


a modest 2.9% in 1990.

However, although debt service declined further in 1991, payments on new debt issues had not yet commenced and some debt had been refinanced (an action which may reduce interest rates, but postpones payments and may increase total interest.)

• Long term debt declined as a percent of governmental revenues from 24.1% in 1980 to 12.6% in 1990. In 1991, the ratio increased to 15.6%.

The state’s debt burden may be examined further by tracing trends in the amount of yearly principal and interest payments required to "retire" (pay off) debt and their "claim" on resources. Figure 58 traces annual debt service.

• Annual payments for debt service have increased over time, although as a percentage of governmental revenues debt’s "claim" declined to
Financial analysts measure the "burden" that the government's debt places on the current revenues and the revenue bases of government using several ratios that adjust debt figures for ready comparison over time and among comparable jurisdictions. The bond raters use the median value for all states for each ratio as a basis of comparison among states.

**Maine's Comparative Debt Position**

The first debt ratio, long-term debt per capita, is calculated because it is assumed that the need to provide capital facilities will increase as population increases. In addition, population growth means that the debt service requirements will be spread out over more citizens, thereby reducing the burden on any one individual. Per capita long term debt outstanding decreased steadily during the 1980's, due to both declining debt and increasing population.

Moody's (one of the two major bond rating agencies) shows Maine's net direct debt in their 1992 listing of state medians as slightly higher than does the recent state bond prospectus. The bond raters have some discretion in what they count as direct debt versus other debt. To facilitate comparison of Maine's debt position with other states, Moody's numbers are used. Figure 59 shows Maine's current and FY93 projected debt per capita ratios compared to the 1991 Moody's medians.

- Maine's 1991 net direct debt per capita of $373 was slightly above the U.S. median of $364, and ranked 25th in the U.S.
• Newly approved debt likely to be issued in FY93 would increase the net debt per capita to $491 per capita. A per capita debt of $500 currently ranks 16th among the states, according to Moody’s ratings.

The second debt ratio is debt as a percentage of personal income. This measure is used to adjust the claim of debt for changes in the state’s ability to pay with one of its major revenue bases. Figure 60 shows Maine’s current ratio and projected 1993 ratio (assuming full issuance of recently approved debt) compared to Moody’s median.

• As a percent of personal income, long term debt outstanding decreased steadily through 1990, then increased in 1991 to 2.2% of personal income.

• Debt as a percent of personal income was equal to the U.S. median for states in 1991 and ranked 23rd. The additional debt that may be issued in FY93 would boost this ratio to 2.8%, which currently would rank 13th in the U.S.

The bond raters also consider debt as a percentage of full (state equalized) property value. Although the state chooses not to tap the property tax base to support state programs, property valuation increases augment the fiscal capability of the state.
In 1991, Maine’s debt as a percentage of full property valuation was less than 1% and ranked 33rd in the U.S.

The very strong growth of property values in Maine in the 1980’s was not experienced by all states. Maine improved quite markedly on this measure since the mid-1970’s when our debt to full value ratio was 3.2% and relative to other states. The contrast between our position on this measure and on the other two, where we are quite average, underscores the importance of this tax base to the state.

Other Debt and "Debt Like" Obligations

As discussed at the beginning of this section, the use of debt and debt-like instruments changed during the 1980’s. In Maine, some of the trends have resulted in direct, annual repayment obligations for the state. It is important that these be identified in order to obtain a complete picture of long term claims on financial resources. In addition, authorities and other quasi-governmental agencies have greatly increased debt issuance. Although much of their debt is non-guaranteed, some could potentially become a responsibility of the state. We begin with a review of repayment obligations that currently reside with state government, then consider non-guaranteed debt.

CERTIFICATES OF PARTICIPATION

In the early 1980’s, following the constraints of Proposition 13 on local government debt and taxes, a number of alternatives to general obligation and limited liability debt were introduced nationally. One of these "creative" financing approaches, private equity arrangements known as lease-purchase agreements, have become an important aspect of capital finance in many states. In Maine, the financing of both equipment purchases and capital construction have been undertaken through a lease-purchase approach called "certificates of participation." Certificates of participation are debt instruments similar to a bond, but the debt is not incurred directly by the state. Instead, the state agrees to pay off the debt through annual lease payments to a bank (or other financial intermediary.)

Maine has used certificates of participation increasingly in recent years to obtain funds for a variety of purposes including the purchase of highway equipment and construction of facilities. Generally, the interest rate paid by the state for these funds is higher than it would be for general

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47 Despite arguments that COP’s are not a "debt" of the state, late payments on COP’s were a primary reason cited for the downgrade of Massachusetts’ bond rating in 1990.
obligation debt, because the requirement of an annual legislative appropriation of money to pay the "lease" increases the risk to investors.  

- Certificates of participation in the amount of $40.5 million currently are outstanding.

- When C.O.P.'s are included in the calculation of general long term debt, Maine's liability in 1992 climbs from $395 million to $435 million.

**DEBT SERVICE FOR LOCAL SCHOOLS**

Another significant area of long term financial obligation is debt service payments Maine has assumed on behalf of school districts. The Maine Legislature establishes in law not only debt ceilings for school bonds, but also a percentage of total debt service that will be paid on behalf of the school districts.

In an effort to deal with a backlog problem, the State Legislature has raised the debt ceiling for school construction several times in recent years, from $38.5 million in the mid-eighties to $67 million for 1992.

The debt service costs paid by the state for school districts do not show up as part of the debt section of the state budget nor on state financial statements, but instead appear as a line item in the Department of Education's budget. The state's portion of school debt service for 1992, which is based upon construction already approved by the state, 

48 Interest rates derive from a variety of factors, including the quality of competing debt issues. Nonetheless, on a given day, if a government has the choice of issuing general obligation bonds or C.O.P.'s, it can expect a more favorable interest rate on the general obligation debt.
state Department of Education and a resultant total outstanding debt level of $61 million, is approximately $43.4 million.

DEBT OF THE MAINE COURT FACILITIES AUTHORITY

The state has agreed to retire debt incurred through the Maine Court Facilities Authority by making annual rental payments.

- As of June 30, 1991, the state is obligated to repay $14.8 million of principal owed by the Maine Court Facilities Authority.49

- Annual debt service on these bonds is estimated at $1.4 million.

Although the cost of paying the debt of the Maine Court Facilities Authority is relatively small compared to other state obligations, the amortization of this debt is another little known, and arguably easily overlooked, component of annual spending and long term liabilities. Increased visibility of this type of obligation would enhance both financial management practices and public accountability.

NON-GUARANTEED DEBT

Like many states, Maine has aggressively sought business location. In recent years, authorities and other quasi-governmental agencies have been issuing debt to finance private purposes. In addition, a significant amount of debt has been issued to support endeavors such as subsidized mortgages, student loans and health care facilities. Some of the non-guaranteed debt issues are more important from a debt management perspective than others because the state has promised either to pay any money necessary to replenish a debt service reserve fund or to assume the debt in the case of default. These "moral obligation" agreements make the debt issued a contingent debt of the state.

Although debate often surrounds the question of who is ultimately responsible for non-guaranteed debt, the bond raters consider all of the debt of authorities and other arms of government to be potential obligations of the state. Since the state may be called upon to meet debt obligations if a financial emergency occurs, even when moral obligation backing has not been promised, the level of this debt and whether the state has been asked to pay is scrutinized as part of the bond rating process. In the case of both moral obligation and other non-guaranteed debt, the existence of the debt is typically treated as "neutral," i.e. it does not affect the rating, unless the state has been asked to step in with some frequency in the past. To date, Maine has not faced defaults or other problems with this class of debt.

49 Source of data is the official disclosure statement of public offering of certificates of participation dated March 12, 1992.
Public authorities created by the Maine state legislature currently have outstanding long term principal obligations owed in the amount of $2.8 billion.\(^{50}\)

The cumulative debt load of these authorities and agencies currently is seven times greater than the state’s full faith and credit obligation.

In 1991, $105,000,000 of non-guaranteed debt was considered a contingent liability of the state.\(^{51}\)

Maine’s 1989 per capita non-guaranteed debt of $1,397 substantially exceeded the U.S. average of $899 and ranked 13th among the states.

Maine’s high level of non-guaranteed debt closely parallels the pattern of other New England states, whose rankings all fall in the top ten nationally (Rhode Island, 3th, Connecticut, 7th, New Hampshire, 5th, Massachusetts 8th, and Vermont 9th.) In Maine, the impact of non-guaranteed debt upon personal income (used to adjust for differing tax base sizes) was substantial.

While lower than the New England average (14.6%), Maine’s total debt, with non-guaranteed included, was 11.2% of personal income in 1989, well above both the U.S. average of 7.3% and the reference group average of 9.5%.

The dramatic impact of the high level of non-guaranteed debt upon per capita long term debt is shown in Figure 62. If "hidden" debt such as obligations for repaying school debt, certificates of participation and other debt-like liabilities were included, the increase since 1980 and the level

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\(^{50}\) Source of data is the official statement of public offering of certificates of participation, March 12, 1992.

of total obligation would be even more striking.

Discussion

Although Maine has traditionally been a conservative user of long term debt, this analysis shows that actual and planned debt issues are thrusting us to a level of debt burden that will place us among the top one-third of states in the nation. Once debt commitments are made, they become an "uncontrollable" aspect of annual budgets because the repayment schedule must be met.

- When coupled with Maine's lower than average ability to pay, our new and far higher dependence upon debt finance suggests that we have relinquished important future budgetary flexibility to respond to continuing and emerging needs.

Despite the issue of whether we really could afford to take on a great deal of new debt, largely in the pursuit of short term economic objectives, is balanced by the use of recent debt issues for major, and in many cases pressing, capital reinvestment projects. The analysis of capital investment over the past decade suggests that we failed to adequately invest in infrastructure during a period of our fiscal history when rapid resource growth would have enabled Maine to achieve important, and much needed, gains in the extent and condition of our public capital stock. However, the magnitude of our capital needs argues for a systematic approach to funding capital projects, particularly when debt finance is utilized, rather than a prioritization based upon how quickly the project could be mounted.

- The knowledge that there is a backlog of capital projects facing both the state and local governments that will be exacerbated by new and continuing environmental mandates makes Maine's new debt level more problematic than it may seem, because there is little residual debt capacity to be tapped. In the absence of major gains in the state's economic position, the outlook is for fierce competition among projects for scarce debt finance dollars during the 1990's.

If "hidden" debt obligations such as the state's statutory responsibility for repaying school debt, required funding for annual payments on certificates of participation and other debt-like liabilities, and the arrangement for paying debt of the Maine Court Facilities Authority were all included with general obligation debt, the sum of annual debt service requirements would appear more dramatic than when viewed individually. An assessment of the state's debt position without these obligations factored presents an inaccurate portrayal of continued flexibility to secure and repay new debt.

- Maine's general obligation debt position is only a piece, and in fact a small piece, of a larger set of long term liabilities that have eroded the
"controllable" portion of the state budget and diminish our capacity to take on additional obligations.

The extent of use of non-guaranteed debt by public authorities, which are quasi-governmental agencies created by the state, raises serious concerns about the potential budgetary impact of a default.

- Maine’s very high non-guaranteed debt level indicates an acute need for a broader definition of debt and closer attention to managing these obligations.

- Development of more rigorous and comprehensive debt policies and procedures for monitoring and managing the level and use of debt and debt-like long term commitments of public resources should be a high priority of state government.

Finally, the state has made other financial commitments that are not debt, per se, yet nonetheless place significant, long term claims on state resources. The unfunded liability of the state retirement system represents a sizable financial obligation that in combination with escalating current costs of retirement contributions has been placing an increasing burden on the state’s general fund. Another long term cost of employment is the accruing health care benefits due to state employees during their retirement years. The Financial Accounting Standards Board (F.A.S.B.), which oversees private sector accounting, has begun requiring businesses to begin accruing this liability and to include unfunded, previously amassed obligations in their statements of liabilities. A similar ruling for government from the sister Government Accounting Standards Board (G.A.S.B.) would reveal massive, and heretofore hidden, liability.
5. STATE-LOCAL FINANCIAL LINKAGES

As Maine's policy makers have struggled to bring the unwieldy state budget into balance with available revenues, aid to local government has become an easy target for cutbacks. Despite the prominence of local financial assistance as a component of state spending, the appropriateness of the level of funds redirected to localities and school districts is a complex question. Shaping sound policy will be aided by early determination of the answer to the following: how much can the state afford to spend for local aid?

The question of affordability is partly an issue of how much revenue is available. As most Mainers are already painfully aware, revenue availability is a yearly issue, dependent upon actual collections. More importantly, however, in the longer term, revenue availability depends upon whether state tax collections are below, above, or at a level likely to sustain statewide fiscal health. As we now know, Maine's state taxes are among the heaviest in the nation. Yet affordability is far more complicated than the state's short term ability to pay. It is also an issue of what economists call "opportunity cost": what tradeoffs must be made to enable the state to redirect scarce resources to local government instead of using the revenues for state level services or reducing taxes? Conversely, what opportunities are foregone when local governments are unable to mount programs or adequately fund existing services without state aid?

Although state programmatic endeavors that must be funded through the state budget are often viewed as cleanly separable from local functions, Maine's state and local governments are not autonomous entities, but instead, partners in the provision and financing of important public purposes. A fundamental, yet frequently overlooked, dimension of this fiscal partnership is the singular interdependency of state and local policy choices and the ultimate determination of the maximum size of the "public pie."

Whether state and local tax bases grow over time is integrally related to four forces that are shaped by state and local fiscal policies: the types of revenue collected, how hard each base must work to produce that revenue, whether citizens and businesses believe they are receiving something of value in exchange for at least a portion of the taxes and fees they are asked to pay, and finally, whether government expenditures adequately prepare a state to attract and retain jobs. The combination of the mix and quality of state and local programs with the sum of tax burdens imposed to finance those endeavors shall determine Maine's fiscal fortunes in the next decade.

The combination of the mix and the quality of state and local programs with the sum of tax burdens imposed to finance those endeavors shall determine Maine's fiscal fortunes in the next decade.
The seeming autonomy of state and local governments is also something of an illusion from the perspective of local spending and taxation, because several types of state policies affect local spending, and as a result, local tax levels. The most obvious state impacts on local budgets occur through state aid policies. By specifying a state funding level, a residual local funding amount is established. In recent years, state mandates and regulations have become increasingly important influences upon local spending. State policies also affect local spending through a variety of expenditure incentives and disincentives that may be part, implicitly or explicitly, of distribution formulae. In the school finance area particularly, the state can influence local programmatic and budgetary choices either intentionally through incentives and rewards, or unintentionally, when aid policies subtly influence spending decisions and behavior. Finally, the state establishes in statute financial constraints and opportunities that affect local expenditure decisions. Current law stipulates what revenue instruments localities may use, permissible financing strategies for economic development, and debt ceilings, to name a few.

As the federal role in financing state and local initiatives has dwindled and changed over the past fifteen years, the fiscal relationship between the states and localities has become more complex, and as a result, more crucial to a state’s long term fiscal health. As a result, the determination of how much state level revenue should be redistributed to local governments in Maine has evolved into not only the single most expensive, but potentially the most important expenditure decision facing state budget makers.

5.1 PROPERTY TAX TRENDS

Property taxes remain the primary source of local government revenue in Maine.

- In 1980, statewide property tax collections totalled $348 million dollars. By 1989, this figure had increased on average by nearly 14% per year, to $780.8 million.

- Property taxes per capita increased from $319 in 1980 to $666 per capita in 1989, more than doubling in the nine year period. However, when this current dollar increase is adjusted for inflation, we find that property taxes saw
slower real growth of approximately 55%, or about 6% per year above the rate of inflation.

Although property taxes accounted for 99% of tax revenues collected by local governments in Maine in 1989, they contributed only 42% of total local revenues. The dichotomy between property taxes as a percent of local taxes and property taxes as a percent of local revenues reflects the important role of state aid in financing local service provision in Maine.

Figure 63 shows changes in state aid payments to municipalities and school districts between 1980 and 1989 by the type of financial assistance. The first impression gleaned from this display is that there was a significant increase in state aid during the 1980's.

- In fiscal year 1990, the state paid $475.8 million in direct, general purpose aid directly to school districts and subsidized local education indirectly by an additional $116.9 million through the full assumption of the employing school districts' shares of the teachers' retirement system contribution.

Together, these two categories of state education aid in FY90 1990 claimed more than 30% of the general fund. In addition, the state paid more than $90 million to local governments through the municipal revenue sharing, the local road assistance programs and as reimbursement for a portion of local expenditures for general assistance.

Although not paid directly to local government, most experts agree that the state financed circuit breaker is also an important mechanism for providing local fiscal relief. In 1990, the property tax circuit breaker reimbursed Maine citizens for approximately $20 million of local property tax payments.
In 1990, nearly $700 million dollars, almost one half of the general fund, were redirected as "fiscal relief" for local governments.

The sum of state revenues redirected to local governments increased by 156% over the decade, for real annualized growth of 8.6% per year.

Another aspect of Figure 63 that warrants notice is that aid grew at different rates for each of the program areas, with education aid, surprisingly, notably lagging behind the others. Of course, education is by far the largest component of local aid, and the smaller percentage increases were accompanied by large dollar increases in aid. Nonetheless, the higher rates of growth in the other aid programs raise an important question: what effect have the differential growth patterns had upon the relative priority among these programs?

We shall address this question by expressing each of the individual aid programs as a percent of collections from major state taxes in 1980 and 1989. This will permit us to compare both the local share of state tax revenues and the allocation of that share among programs of assistance in 1980 and 1989. As shown in Figure 64:

- Despite rapid increases, as a percentage of total collections from the state's major tax sources, revenues shared with local government actually declined between 1980 and 1989, from 60% of the total to only 50.4%.

Within a decreased share of state resources redirected to local government, all of the state aid programs except general purpose education assistance now garner a larger portion than in earlier years.

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52 We use FY 1989 rather than FY 1990 because some state revenues in 1990, so that 1989 more accurately represents the peak of prosperity.
Despite significant growth in dollar allocations, education aid as a claim on collections from major state tax sources declined markedly, from a 1980 level of 45.9% of the total to only 35.5% by 1990.

However, the state's contribution to teachers' retirement did increase.

As a share of major state tax collections, teachers' retirement received 7.3% in 1980 but increased to 7.9% by 1989.

Yet, even with teachers' retirement included, education has "lost ground" as a claim on state resources.

The sum of the direct and indirect education aid declined from 53.2% of major state tax collections in 1980 to only 43.3% by 1989.

Municipal revenue sharing increased its share of state tax revenues from major sources, from 4.6% in 1980 to 5.4% in 1989.

Municipal revenue sharing kept pace with increases in state tax collections because the allocation to municipal governments is based upon a fixed amount, $237,000 per month, plus a percentage of tax collections. In addition, while the percentage of total collections dedicated to local government was 4% at the beginning of the decade, that share was increased to 4.75% in 1984, and again in 1985, to 5.1%.

While road assistance is paid to municipal governments from the Highways Fund, which does not draw upon the major state revenue sources, it is an important form of state shared revenue. We may trace the priority afforded this program of aid by expressing it as a percentage of major revenues.

In 1980, road assistance comprised 1.2% of the major state tax collections. By 1989 this share had increased to 1.7%.

Whether the percentage of tax receipts shared with local government is "appropriate" may not be answered as part of a financial analysis, as we discussed at the beginning of this chapter. However, evaluating the adequacy of shared state revenues as well as the efficiency of their distribution may be facilitated by examining the "tax balance" or the portion of total state-local financing contributed by each of the major tax types, trends in property tax effort and the interjurisdictional distribution of property tax burdens.
The Balance of State and Local Tax Shares

Public finance specialists argue that to meet the diverse, and at times conflicting, tax system goals of revenue adequacy and equity, the relative shares contributed by each of the "big three" tax bases- income, sales and property- to financing the services of the combined state-local fiscal system should not be unduly disproportionate. Generally, if each of the major three taxes finances about one-third of the total, then the system is called "balanced." In the mid-1980's, Maine's tax structure was classified as relatively balanced, although property taxes contributed 43% of the total; during the latter part of the 1980's the property tax decreased relative to the other tax types.

- Property taxes declined as a share of the "big three," from 46% of the total in 1980 to 39% in 1989.

Recent increases in property taxes and very slow state revenue growth will have the effect of tilting the balance between state and local taxes back toward the property tax. This effect is not unexpected in a recessionary period. One of the reasons for seeking balance in the tax system's structure is to have an adequate base of the less sensitive tax types, like the property tax, so they may bolster the more elastic revenue sources during an economic slide. However, from the perspective of an "optimal" or ideal balance of taxes, Maine's reliance upon property taxes within the overall state-local fiscal system was a bit higher than desirable in 1989 and further shifts in financing responsibility toward the property tax will worsen the balance of taxes.

When using the standard definition of "balance," the legal division of tax authority is the focus of attention. Important perspective may be gained by distinguishing between the level of governments that collects the taxes and who actually spends the proceeds.

- After intergovernmental transfers, the percentage of total collections from sales, income and property taxes expended by local governments and schools in Maine was 69.9% in 1989, compared to 88.0% in 1980.

Another way to consider this relationship is that after the state had turned over all financial assistance to local governments, in 1989 the percentage of major state tax revenues used for state purposes was 30.1% of the total. Compared to the share retained for state purposes in 1980 of only 22.0%, this change represents a significant shift in the state-local financing partnership.

- Despite rapidly increasing state level revenues, between 1980 and 1989, state government expanded their own use of those resources and reduced the portion of the total shared with local governments and schools.

- Thus, the reduced percentage the property tax comprised of the far larger sum of major state and local taxes in 1989 was more the result of slower growth of property tax collections relative to increases in the state's elastic...
sources rather than from an increase in the share of state revenues redirected to local governments and schools.

Although there is clear evidence that state government began diverting revenues for its own use that had previously gone to local government and schools, we can not say whether this was a "good" or "bad" choice. However, the issues of the adequacy of shared state revenues and the efficiency of their distribution may be explored further by examining property tax effort, its burden in Maine, and school funding.

5.2 TRENDS IN PROPERTY TAX BURDEN

Although it has been argued that property taxes are too high in Maine and much legislative activity in recent years has focused upon property tax relief, the contention of the high burden of this tax type has been subjected to little close scrutiny. Property taxes are like the proverbial elephant—depending upon each individual’s particular vantage point, the description of the elephant can vary dramatically. Describing the elephant, rather than detached parts of the animal, requires a comprehensive examination of property tax effort and burden. We therefore shall consider a number of indicators in this section, in an effort to gain a comprehensive perspective on property tax burden in Maine.

Per Capita Property Taxes

- Per capita property taxes grew from $319 in 1980 to $722 in 1990. In real dollars, this amounts to an increase of $176 per person.

- At 115% of the national average of $626 in 1990, per capita property taxes ranked 17th in the U.S.

- Between 1980 and 1990 per capita property taxes in Maine increased by 126%, compared to a national average rate of increase of 107%.

The more rapid increase in Maine meant that by 1990 per capita property tax burden had increased relative to the national average, both in terms of rank (we were 23rd in 1980) and tax as a percentage of the U.S. average, which had been only 106% of the national average in 1980. More recent comparative data is not available, so we can not determine how recent tax increases have affected our relative position. Our comparative position may not change appreciably because
many states are drawing more heavily upon this more stable tax base, to counter the loss of revenues from the more elastic personal and corporation income taxes.

Comparative Property Tax Effort

Figure 65 traces trends in property tax effort in Maine, relative to the U.S. average level of effort.

- At 106% of the national average, Maine's use of the property tax base in 1988 compared well and would not have been considered "high" relative to other states.

- Maine's property tax effort declined steadily during the 1980's, from a level that was 140% of the national in 1981.

The difference between Maine and the U.S. emerges because Maine, like the other New England states and California, experienced important increases in property valuation.

Effective Rate of Property Taxation

Another important means for evaluating the burden of the property tax is to determine the percentage of the tax base raised as tax, which is known as the average or "effective" rate of property taxation. Property taxes are expressed as a percentage of state equalized or "full value" property value in each community to ascertain the effective rate of taxation.
Figure 66 displays trends in effective rates of property taxation in Maine.

- In 1970, Maine municipalities raised 2.4% of the value of their property tax bases as property taxes.

- By 1980, the effective rate had declined to 1.8%, and by 1989 to only 1.3%.

- In 1989, Maine’s effective rate of property taxation was 87% of the U.S. average.

The decrease in effective rate, like the decline in property tax effort, reflects the important gains in home values in Maine during the 1980’s.

Property Taxes as a Claim on Income

Although property taxes are a tax on wealth (property value) rather than on income, we may examine the changing burden of this tax as we did for state tax sources by expressing collections relative to income.

- As a claim on personal income, property taxes have declined over the past two decades, from $58 per $1000 of personal income in 1970, to $47 per $1000 in 1980, to $39 in 1989.

- However, in 1990, with stagnant personal income but increasing property taxes, the ratio reached $45 per $1000 of income.

- Maine’s property taxes per $1000 of income ranked 14th in the U.S. in 1990 and stood at 125% of the national average level of $36 per $1000 of income.
Thus, although the claim of property taxes on personal income has declined in Maine since 1980, and particularly since earlier periods, our burden remains noticeably high relative to the national average.

Although total taxes compared to total income provides an important and useful gauge of overall burden, an important limitation of this aggregate measure is that it tells us nothing about whether and how the distribution of that burden among households has changed. Thus, the conclusion that relative to income the burden of property taxes has declined should not be interpreted to mean either that no one is burdened more today nor that the burden is less for everyone. The 1990 Census has revealed that (1) all Mainers did not share in the 1980's economic resurgence and (2) renters are paying a significant portion of their income for housing, which includes property taxes.

We must also remember that businesses and out of state vacation property owners pay taxes as well as Maine residents. This fact is relevant for two reasons. First, business equipment and machinery is taxed as property in Maine, which is not the case in all states. The huge equipment investment of the paper industry, for example, makes a significant difference in the level of property taxes collected. Second, there is a significant amount of valuable waterfront and recreational property in Maine that is owned by out of state residents. Thus, comparing property taxes to resident personal income may tend to overstate the burden of property taxes in Maine.

The Interjurisdictional Distribution of Property Tax Burdens

Although the mil rate quoted by towns is not a reliable indicator of interjurisdictional tax effort because of lags in assessing property, the state "equalizes" values to a common, market value basis for the purpose of distributing school aid. The adjusted or equalized mil rates may be directly compared across jurisdictions.53

Differences in property tax rates are expected to occur among towns in response to different sets of citizen preferences for services. However, public finance experts generally agree that tax burdens should not vary too widely among communities, because towns with high rates will find that their tax bases erode over time. This occurs because (1) prospective home buyers will offer less for a home in a high tax community to offset the higher tax and (2) businesses that may relocate easily can reduce their costs. From a state policy perspective, promoting an equitable

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53 Field personnel from the state's property tax division take a sample of recent sales of each class of property (e.g., residential, business, industrial) in each town to determine how close the town's estimate of each parcel's value comes to the sales price. The ratio of the town's assessed value to actual sales price is calculated for each parcel, then an average ratio derived for each property classification. The averages from the sample of sales are used to adjust the town's estimated valuation to reflect "full" or market value.
distribution of local tax burdens helps to nurture a healthy state-local fiscal system by avoiding tax induced base erosion and interjurisdictional competition.

Historical property tax data reveals that disparities in tax rates among counties, and particularly among municipalities have widened since the latter part of the 1970's.

- In 1977, all counties with the exception of Lincoln (at 1.6%) were between 1.9% and 2.5%. By 1990, county averages in 1990 ranged from a low of 1.0% in Hancock County to a high of 2.0% in Aroostook.

- By 1991 there was a difference that exceeded 27 mils per thousand dollars of property value between the lowest mil rate and highest mil rate towns, compared to a range of roughly 20 mils in 1978.

- The number of very low tax rate towns has multiplied significantly since the late 1970's, when a statewide "uniform" property tax rate was used to partially finance local schools.

Widely differing total tax rates among Maine’s towns result disparities in the level of tax effort required to support municipal services, and somewhat more surprisingly, given the equalizing objectives of Maine’s school finance law, local education. Examining mils raised for non-school purposes and for school separately provides important insights. We shall look at mils raised for non-school purposes in this section, then turn to consideration of school taxes in the next, within the broader context of the state-local relationship for providing and financing a system of public schools in Maine.

5.3 FINANCING MUNICIPAL SERVICES

Some municipal governments in Maine provide a broad range of public services, while others have a small number of administrative responsibilities that may be handled entirely by elected boards of selectman without professional staff. Figure 67 displays full value, non-school mil rates (based upon taxes levied for all purposes other than schools) expressed as a percent of the state average for a sample of towns raising a very high level of taxes.

- A relatively small set of communities are raising far more than the state average of $5 per $1000 of valuation for the support of municipal and county government functions.

54 For a closer look at spending patterns in Maine local governments, see LaPlante (1990), "Financing Local Public Services in Maine: An Analysis of Patterns and Trends, 1984 - 1989." (Edmund S. Muskie Institute of Public Affairs).
Research on property tax patterns in Maine has revealed that four primary factors explain much of the disparity in tax rates levied for municipal purposes.55

(1) In some cases, high municipal mil rates are caused by low property wealth: it simply requires more effort to finance services in property poor towns than in communities with high property wealth. The provision of an equal dollar amount of service requires a higher tax rate in a low wealth town than in a property rich community— in the absence of state aid designed to reduce disparities in ability to pay.

(2) Another important factor that often explains both unusually high tax rates and fluctuating tax rates is the high, "up front" cost of infrastructure investment and reinvestment.

The remaining explanation for high non-school taxes applies to only a subset of municipalities that serve as regional and/or tourism "hubs."

(3) Significant disparities in tax effort arise from Maine's "economic geography": economic, and also political and social activities tend to be concentrated in a small number of central communities.

A review of a list of towns in Figure 67 with high mil rates quickly reveals that a number of them are the regional and tourism centers: the "hub" communities of the state. It is important to note that the high tax rate, central communities are located throughout Maine. Thus, these are not exclusively southern or coastal Maine communities, but rather towns throughout the state that support economic, political and social functioning. Since many of these central communities are

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55 These factors have been summarized from an continuing analysis of local fiscal trends by Professor LaPlante. Additional explanation is provided in LaPlante (1989) and LaPlante (1990). Results of regression analyses of the determinants of local spending are available from Professor LaPlante.
among the "wealthiest" municipalities, as measured by the size of their tax bases, why are their taxes so high?

The answer lies in the demand for public services that originates from the daily use of the community, rather than from the desires or needs of residents. The hub towns must purchase police protection, sewerage, sanitation, capital projects and debt service that are far in excess of the needs of their resident populations. In many of the hub towns, the size of the population receiving services far exceeds that of the resident population. Tourism exacerbates the inflow of people into the community during certain seasons.

It is noteworthy that several of the hub communities, including Bath and Bangor, do not register mil rates at as high a level. However, there has been little or no real growth in some of the urban budgets since the 1988 round of expenditure and tax limitations either imposed, or nearly imposed, tax and spending limitations. The mil rate thus may understate the true demand for spending and hint at deferred obligations.

The state’s hub communities face what may be termed a "structural mismatch" between available revenues and the expenditure requirements of serving a regional population. This structural difference occurs, and persists, because the size of the service user population greatly exceeds the size of the taxpayer population.

(4) The county tax exacerbates tax rates in the hubs particularly because of the comparatively higher tax bill they must pay.

Since the county levy is based upon valuation, the larger, central towns pay a larger portion of the county budget. In many cases in the more urbanized parts of the state, these communities are paying for services, in particular public safety, that duplicate their own.

5.4 EDUCATION FINANCE IN MAINE

Although increases in state education aid have been curtailed and contributions to the teachers' retirement system postponed as part of the state’s budget balancing strategy during the fiscal crisis, most policy makers and citizens agree that in the longer term, ensuring Maine's economic future will require adequate investment in education. Any assessment of whether state spending for local education can be reduced or the rate of future increases curtailed without jeopardizing quality depends upon the adequacy of current spending.

The assessment of fiscal adequacy, from a state policy perspective, encompasses each of the following objectives:

- The assurance of enough funds to mount a school program in each district,
- A fair distribution of financing shares among taxpayers,
○ Equitable distribution of educational resources among Maine’s pupils,
○ Efficiency of both state aid allocations and the utilization of those scarce state resources,
○ The desired quality of educational outcomes, and
○ The respective abilities of the state and the local governments to finance education.

Although consideration of all of these issues would be substantially beyond the scope of this study, some preliminary analysis of issues of equity and efficiency may provide useful insights and help to identify priorities for further study.56 We shall begin by examining trends in state aid to education, then move to consideration of taxpayer and student equity, efficiency and the comparative cost of education in Maine.

Maine’s school finance law has two broad objectives: (1) student equity, which the courts have consistently viewed as relatively comparable educational quality across school districts as measured by resource input indicators, and (2) taxpayer equity, which seeks to achieve comparable tax effort from all taxpayers, regardless of where they live. Efficiency relates to both the broad dissemination of an adequate education, which is a constitutional requirement, and the definition with which most of us are more familiar, cost-efficient use of resources.

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**Trends in State Aid for Education**

The state distributes a substantial amount of direct aid to school districts, primarily for the purpose of offsetting wealth disparities. In addition to state aid distributed for "wealth equalization" purposes, other aid that is not designed to equalize ability to pay is channelled to school districts directly, through a minimum subsidy provision and other direct funding mechanisms, and indirectly, through the state’s assumption, on behalf of school districts, of the full cost of the teachers’ retirement system.

Figure 68 presents the annual increases between 1980 and 1990.

- **Between 1980 and 1986**, the annual state aid for local education allocation increased from $184 million to just under $300 million, for a total increase of roughly $115 million. After slow growth in the allocation during the early part of the decade (roughly 8% per year), the rate of increase literally "took off" in 1986.

The Educational Reform Act of 1985 was a major policy initiative that increased teachers’ salaries, expanded special education programming, and required establishment of gifted and talented

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56 Professor LaPlante and Dr. Robert Goettel of USM have been assisting the school funding task force and shall be exploring further some of the issues surrounding a new formula.
Figure 68
ANNUAL CHANGES IN THE EDUCATION SUBSIDY
FISCAL YEARS 1980/81 THROUGH 1990/91

<table>
<thead>
<tr>
<th>Fiscal Year Range</th>
<th>Percentage Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY90 to FY91</td>
<td></td>
</tr>
<tr>
<td>FY89 to FY90</td>
<td></td>
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<tr>
<td>FY88 to FY89</td>
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<tr>
<td>FY87 to FY88</td>
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<td>FY86 to FY87</td>
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<td>FY85 to FY86</td>
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<td>FY84 to FY85</td>
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<td>FY83 to FY84</td>
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<tr>
<td>FY82 to FY83</td>
<td></td>
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<tr>
<td>FY81 to FY82</td>
<td></td>
</tr>
<tr>
<td>FY80 to FY81</td>
<td></td>
</tr>
</tbody>
</table>

Source: Calculated by authors from data in the Maine Financial Report, annual.

programs, among other mandates. One objective of the new school finance act was to transfer more of the responsibility for financing education to the state, in the expectation that student and taxpayer equity would both be enhanced if less of the responsibility for financing education fell to the property tax.

- Between 1986 and 1990, yearly increases in the school subsidy averaged 17%, with the largest single increase, 23%, seen in 1989.

- The average annual increment in state spending for local public education was less than $20 million per year between 1980 and 1986; from 1987 through 1990 the average increase topped $80 million annually.

The state's enactment of school reform legislation placed new, significant spending requirements upon school districts. As a result, local spending for education grew as rapidly as the state's. By the close of the decade of the 1980's, when state, local and federal funding shares are considered, we find that the balance between state and local funding sources had changed little.

- In 1980, the state financed 42.8% of total education expenditures. By 1990, the state's share of total local spending had increased by less than one percentage point to 43.3%.

When the state largely abandoned the formula for aid distribution in fiscal year 1991, the cutbacks in funding translated into small numbers of mils for property rich districts and much larger numbers of mils for property poor districts. Citizens became aware that the goals of school finance were in jeopardy, perhaps particularly as related to taxpayer equity, but also in reference to pupil equity, since some districts are more fiscally able to weather reductions in state funding than others.

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57 Source of data on funding was the Maine Department of Education's Maine Education Facts.
Other policy actions and differing growth trends in the various components of state aid had begun undermining the ability of state financial assistance to ensure student and taxpayer equity. Let's explore these problems.

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**Equity and Efficiency in School Finance**

Issues of efficiency and equity arise with regard to both the content and distribution of state aid and the cost-efficiency of resource use within districts.

The teachers' retirement contribution is made by the state on behalf of all districts, regardless of their ability to finance the costs locally (non-equalizing), whereas the majority of general purpose aid distributed ensure a foundation level of support for each pupil (equalizing aid.)

The state's annual contributions to the teachers' retirement system were identified earlier as one of only a few areas in the state budget that saw any appreciable "gain" in terms of the claim on general fund resources. We also learned that general purpose, equalizing education aid lost ground, declining from 35% of the general fund in 1980 to only 32% by 1990. As a result of the more rapid growth of the teachers' retirement component of the state's annual outlay for the support
of local public education, equalizing aid is being "crowded out" by non-equating assistance, as shown in Figure 70.

- In 1980, the teachers' retirement contribution was equal to 13.5% of the combined state allocation for education. By 1990, the annual payment to the teachers' retirement was claiming close to 20% of all local education aid.

Nationally, in addition to Maine, 30 states currently contribute towards teachers' retirement costs for school district employees. However, only 17 of those states pay the full employer share. However, in 1993-94, retirement costs in New Jersey are scheduled to shift to local districts, which will reduce that number of states paying the full cost to 16.

- Although a large number of states subsidize public education through payment of some or all of the costs of teachers' retirement systems, Maine's contribution as a percentage of total school aid (19.6%) is currently the highest in the United States and is more than double the average for the group of states who use this subsidy method (9.2%).

Under level or diminished state funding for general purpose state aid, the indirect subsidy provided through the retirement system contribution will continue to grow as a percentage of total education funding.

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**Figure 70**

Comparison of Claim of Retirement Contribution on Total Aid for Education

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Retirement as % of Education Aid</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>10.0%</td>
</tr>
<tr>
<td>1990</td>
<td>20.0%</td>
</tr>
</tbody>
</table>


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58 A recent report on school finance in the U.S. and Canada (American Education Finance Association and Center for the Study of the States, 1992) reports Maine's FY91 actual retirement system contribution of $76 million, which represents a reduction of 50% from the budgeted amount. Although government is able to underpay outstanding liabilities in a given fiscal year by exploiting government accounting rules, the required pension contribution for the fiscal year—whether paid or deferred to the future—is the appropriate measure of financial commitment.
• The state has estimated that their required retirement contribution for the teachers portion of the state retirement system will reach $220 million in FY95. With continued level funding of general purpose aid at approximately $520 million, teachers retirement will increase to 29.7% of total state aid for education.

Even within the general purpose aid appropriation, not all of the financial assistance to school districts is for wealth equalization. Other provisions of the state’s education aid program introduce further equity issues. The state legislature establishes in statute a percentage of total debt service (including a "circuit breaker" to help with the expense of capital leases and debt service costs which exceed the maximum mil rate established by the legislature) that will be paid on behalf of the school districts. The percentage of approved school debt service paid by the state has increased substantially over the past decade, from approximately fifty percent of school’s principal and interest payments, to the current level of approximately 68 percent. "Need" for assistance is established by the priority of the capital project.

State aid is provided for approved projects under a cost sharing arrangement that establishes a maximum mil rate for debt service. Once a district reaches the statutorily defined level, "circuit breaker" state aid assumes the remaining costs. The circuit breaker for debt is applied to the debt portion of school costs only, so that a district with a low overall mil rate but high debt service expense qualifies for assistance. This has the effect of being non-equalizing.

While not as dramatically as the retirement system payment, this category of state financial assistance also has been increasing as a component of state aid for education.

• Maine’s debt subsidy as a percentage of general purpose education aid was 6.8% in 1991, which ranked fifth highest in the U.S. 59

As with the teachers’ retirement contribution, the debt subsidy will continue to increase as a percentage of general purpose aid under level state funding.

Taxpayer equity has become a hot topic in Maine of late, because many people have argued that property value does not adequately measure ability to pay property taxes. Regardless of where a person stands on this particular issue, two decades of case law surrounding school finance systems makes it quite clear that the courts view school district’s property values as a legitimate basis for differentiating ability to pay. Most school finance experts agree that in a completely equitable financing scheme, from a taxpayer’s perspective, each district would raise the same number of mils.

Maine’s school finance system has been highly successful at equalizing tax burden across the majority of communities. However:

59 Source: School Finance Programs in the U.S. and Canada, American Education Finance Association and Center for the Study of the States, 1992
There are significant disparity in the extent to which "high effort" and "low effort" communities tap into their property value for the support of local schools, with a $20 per $1000 of valuation difference between the most heavily and most lightly taxed districts.

As shown in Figure 71, there are a number of districts that raise far more than the state average. There also are a number of districts that raise far less than the average amount would lead one to expect. These disparities in effort clearly demonstrate that taxpayer equity is not being achieved fully through the current funding method.

Two questions emerge: first, what factors account for the disparities in tax effort, and second, are there any implications for student equity?

Unlike many states that utilize a "foundation" funding approach, Maine law does not require school districts to make a minimum tax effort. Thus, districts with high property tax wealth may raise sufficient revenues to finance school with a low mil rate.

Maine's school finance approach also makes each district responsible for their own children. Thus, towns that have only a few students to educate but have high wealth can tax lightly and still raise sufficient funds. High wealth districts that "tuition" their students to other districts often pay the required tuition with a comparatively low tax effort.

The reasons for the very high tax effort borne by some Maine districts is less clearcut, but there are some common explanations. One important answer lies in the state's method for determining the portion of total local spending that is eligible for subsidization by the state. Operating costs, debt service, transportation and program costs such as special education are budgeted separately. The operating budget estimate is derived by updating the previous year's statewide, average per pupil operating cost for inflation, then multiplying the updated per pupil cost
by the current enrollment of each district (updated per pupil expenditure * # of pupils).\textsuperscript{60} The result is assumed to represent the budgetary need of a district, without frills, but ensuring an adequate "foundation" expenditure behind each child.

It is important to recognize that the per pupil expenditure is not an "ideal," for by definition, it is the arithmetic mean, and as such, simply representative of the middle of a distribution of spending. The amount could easily be too little, if many of the districts spent on the low side or if some very low spenders pulled the average down. Similarly, the reverse is true: the mean could be higher than desirable from an efficiency perspective. Many people have identified that Maine's education formula is "spending driven;" the use of the mean of actual spending ties the state subsidy to local spending behavior rather than an independently derived standard of dollar inputs required to achieve a specified quality (or at least quantity) or output.

Other than that problem, the approach to determining the subsidizable budget sounds alright, unless one is familiar with the structure of costs in school systems. Before explaining this statement, let's take a look at Figure 72, which shows the composition of mils raised within the formula (foundation funds) and outside of the formula.

\textbullet\ Comparison of Figures 71 and 72 make it immediately clear that all of the districts exerting very high tax effort for schools are raising significant revenues above and beyond what the state's budget estimation approach projects as their expenditure need.

These districts have high per pupil expenditures, but the tax rates are too high to simply reflect a "taste" for a cadillac education. Vanceboro, Alton and many of the others shown in Figure

\textsuperscript{60} This is done separately for elementary and high school students.
71 not only are not wealthy communities, they do not spend a lot of money on frills. A "threshold" or minimum expenditure that must occur if any school program is to be undertaken turns out to be the culprit: the districts have a small number of pupils to educate but must nonetheless must provide a school program.

Education is a service that is particularly burdened by what is known as the "high fixed cost problem" of the public sector, which arises because whole increments of inputs must be provided, whether the service is offered to one student or twenty. An entire building, rooms with chairs and blackboards, and teachers must be in place if any students are to be educated.

- The fixed costs associated with educational delivery translate into a minimum or "threshold" expenditure that is independent of the number of students.

The current funding approach does not recognize the need for a minimum outlay of funds to mount a school program. As a result, the effected districts are "on their own" for a sizable portion of school funding, as we saw in Figure 71. Luckily for the students in those districts, the taxpayers in their wisdom have raised the needed revenue. In the face of continuing recession, it is difficult to predict how these districts will fare.

- Problems related to the adequacy of state resources and resultant taxpayer and pupil inequities in Maine's geographically isolated districts require prompt, effective policy action.

The formula's assumption that spending is linear, rather than following a "step" pattern as it actually does, raises other issues that are becoming more pressing in these times of fiscal exigency.

Under the education finance current approach in Maine, when districts are compared, it is usually on the basis of per pupil expenditures rather than any analysis of resources available to students, quality of staff, and so on. Two districts with roughly equivalent expenditure levels would be viewed as having equivalent educational programs. On the other hand, when two districts with very different per pupil expenditures are compared, the assumption is that the high spending district provides more resources to the average child in the classroom. This rationale unfortunately has led to some unwarranted jealousy about the high spenders, particularly when they are also "high receivers," that is, receive state funds for a sizable portion of their budget.

- Although one or two of the high per pupil expenditure districts shown in Figure 73 have school programs that are renowned for their plentiful resources, many of the apparently

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61 Although a geographic isolation factor is employed to channel more funding to very low population districts, the adjustment is inadequate to compensate for the very high unit cost of educating a small number of pupils.

62 In fact, the comparison of per pupil expenditures as the basis for assessments of adequacy of expenditure as well as quality is widely employed.
"high" spending districts are simply meeting the minimum or threshold level and lack some of the "normal" features of schools in more populous areas of the state: well equipped science labs, calculus and advanced placement courses, and so forth.

Regardless of their position on the expenditure distribution, two districts with similar per pupil levels may be providing quite different combinations of resources to their students. As we have discussed, the level of per pupil expenditure in a district is influenced dramatically by two variables: (1) the efficiency with which they utilize their available physical and teaching capacity, that is, how close classrooms come to achieving maximum occupancy; and (2) whether the school buildings and district are large enough to achieve economies of scale.

Longevity of teachers employed within districts also effects total spending, and hence, per pupil costs. If a district has a large percentage of its teachers nearing retirement age, the per pupil expenditure in the district will be higher than that of a district with a younger group of teachers. Although some qualitative differences may come into play, we can not simply assume the older teachers are better teachers.

Salaries are another important determinant of districts' expenditures, although the commonly employed indicator of district spending, average salary, may be misleading. This occurs because longevity effects the average for the district. Comparing actual salary schedules for districts provides far more definitive information about remuneration of personnel. Figure 74 shows a sampling of high and low beginning salaries, while Figure 75 shows a sample of salaries for experienced teachers.

* A number of districts in Maine pay salaries that are quite high, relative to other districts, while a few districts are extremely low and as of 1991 were not yet meet the salary targets in the 1985 education reform act.
Some districts’ entry level salaries are as high as other districts salaries for highly experienced personnel.

For example, Cumberland pays beginning teachers the same amount as Pembrooke pays teachers with fifteen years of experience.

There was a gap of $7,000 between the lowest and the highest starting salaries in Maine in 1991.

Although the disparity in salaries is large and problematic at the entry level, the gap widens dramatically among districts when salaries paid to more experienced teachers are considered.

There was a difference of $14,500 between the highest salary paid in Maine for a teacher with a bachelor’s degree and 15 years of experience and the lowest in 1991.

These disparities raise serious issues with relation to student equity. The state is constitutionally required to ensure equal educational opportunity. Yet, interdistrict variations in salaries do not follow a geographic pattern and even if one were in evidence, such large discrepancies are hardly defensible from the perspective of labor market differences. Two neighboring districts may pay grossly dissimilar salaries for teachers with the same experience level. In such cases, particularly with experienced teachers, it is unlikely that wage differences do not effect the respective ability of districts to compete for the best available personnel.

The state’s full payment of the retirement contribution exacerbates the equity problem, because the retirement benefit is based upon salary. Districts with high salaries are able to increment the attractiveness of their employment offers well beyond those of lower paying districts who may be competing for the same teachers, by offering a lucrative package of a high salary and promised high retirement income- at the state’s expense.
The combination of large salary differentials among districts and full state payment of the teachers retirement contribution, which increases as salaries increase, without regard to the ability to pay of the community is exacerbating the differences between the "haves" and the "have nots" in Maine and leaves the state wide open to a court challenge on the basis of equal educational opportunity.

Courts have consistently ruled that large differentials in salaries among districts are evidence of the failure of the state to ensure equal educational opportunity. In addition, recent rulings have specifically identified non-equalizing retirement system aid as unconstitutional.

**ISSUES RELATED TO EDUCATIONAL EFFICIENCY**

Efficiency in educational programming is also an issue under the current state funding approach. Although it is generally assumed that per pupil expenditures that resemble the state average provide efficient programming without "frills," there is currently no clear understanding of the linkages between per pupil expenditures and the actual resources directed at the average child in the average school in any given district. Interestingly, Cumberland achieves a per pupil expenditure that is quite close to the state mean and at the median, despite its superior starting pay.

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64 For example, in Abbot v. Burke (New Jersey, 1990) pension aid was noted as counter-equalizing, as was the provision of a minimum funding amount. Both state funding practices are being suspended in response to the court finding for the plaintiffs. The retirement system is scheduled to become fully a local responsibility in 1993.
It is important to recognize that the fixed cost component of educational delivery does not necessarily change when one child is added to a class or one child leaves. Yet, the state's budget approval model assumes that when a district gains one pupil an additional amount of spending equal to the state wide per pupil average will be required, and that amount becomes eligible for subsidy. In fact, there may be no additional expenditure required if the child can be accommodated within existing space. Conversely, when a district loses a pupil, the model assumes that savings equivalent to the state average per pupil expenditure will be achieved.

In essence, the addition of a pupil means that more of a district's budget is subsidizable (if they already spend above the average per pupil rate) or additional dollars of spending can be subsidized. The funding method is likely to stimulate spending in districts where the number of pupils is increasing, especially in districts where the state percentage is large, because of the "match" offered for new spending. Although stimulating the very low spenders may be a laudable objective, the formula does not differentiate. At the very least, some districts will have some degree of "slack" built into their budgets by the state's assumption that every new pupil added at the margin.

The state uses per pupil valuation to determine a district's ability to pay, rather than simply using the value of the tax base. Thus, when a pupil is added, the per pupil valuation declines, and hence, the state's estimate of a district's ability to pay, even though there is no change in the number of dollars one mil raises from the tax base. The adjustment to wealth that occurs when valuation is divided by the number of pupils may exacerbate the stimulative tendency, because often at the same time more spending is approved a higher portion of spending also may be covered (increased state share.) In addition, the use of per pupil valuation may contribute to tax differences among communities. Assume two towns with identically valued tax bases, but one town has more pupils. The town with fewer pupils will be treated in the formula as having more ability to pay because the per pupil valuation will be higher than that of the town with more students. Towns that are gaining pupils could be fiscal "winners," while those who are experiencing a decline in enrollment may be fiscal "losers."

We emphasize "may be" because due to the complexity of Maine's formula, however, the actual effect of using per pupil valuation rather than full valuation is uncertain. This issue needs to be explored further, in an effort to determine the true impacts of alternative approaches on taxpayer equity and spending responses.65

THE PROBLEM OF MUNICIPAL OVERBURDEN

For many years, education finance specialists have speculated, and education officials have argued, that not only major but also smaller cities who find themselves in the position of providing a higher than average level of municipal government services will have less dollars available for

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65 Dr. James Watkins of the state's Department of Education has argued that the formula eventually adjusts the local share so that mil rates in two towns with equivalent wealth will be similar. This, however, is not the case in other states that use this method.
school funding. School finance researchers have tried to prove statistically the existence of municipal overburden for many years and have been unable to unequivocally demonstrate that school spending suffers when multiple and costly municipal functions must be provided.

Some of the difficulty surrounding the "proof" of municipal overburden derives from measurement problems: researchers often use per pupil expenditure as the means for operationalizing "adequate" spending. Yet, on a per pupil basis urban communities may spend at least at the state average level, due to the higher need population they generally serve (e.g. bilingual students, students with multiple disabilities, and of course, a higher proportion of lower academic advantage). Thus, without an examination of the quality of education and the allocation of resources among various purposes in each school district, it may be difficult to make a case that resources directed toward pupils suffer.

Another important factor that makes municipal overburden hard to "pin down" is that most cities recognize the fundamental link between the perceived quality of schools and maintenance of the tax base. Most will fight to keep school funding at an adequate level to ensure that too many homeowners do not flee to lower tax rate towns with better schools. As a result, however, the total tax effort and pent up demands for services mount—particularly if state aid for education is insufficient to offset some of the higher municipal claim on the tax base.

Interestingly, and to the dismay of vocal detractors of the municipal overburden hypothesis, the courts have routinely either found in favor of plaintiffs who have argued their cases partly on the basis of overburden or at least have acknowledged the existence of municipal overburden in opinions. In New Jersey's Robinson IV,

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66 See, for example, H.E. Brazer and T.A. McCarty, "Interaction Between Demand for Education and for Municipal Services," National Tax Journal XL, pp. 555-566.
Justice Pashman (in a dissenting opinion) suggested measures of "relative degree of municipal overburden" that included the ratio of the proportion of local revenues used for non-school purposes to the statewide average ratio, the ratio of the proportion of local revenues used for school purposes to the statewide average ratio, and the ratio of local non-school tax rate to the state average rate. Justice Pashman's conceptualization of municipal overburden as a non-school tax rate disparity issue, rather than simply the "crowding out" of educational expenditures, permits easy evaluation of whether municipal overburden is a problem in Maine.

Although most communities do fall within a reasonable distance from the statewide average, a select set of municipalities have mil rates that exceed 150% of the state average, as shown in Figure 76. Issues related to the current educational finance system and municipal overburden may be identified.

First, the school funding formula implicitly assumes that the property tax bases of various communities are equally available to finance schools. In those towns where the tax base has significant non-school claims upon it, this method may seriously overestimate the overburden town's wealth relative to that of other towns. An average tax effort for schools added to high tax effort for municipal functions produces high totals.

Second, as just discussed, the state uses per pupil valuation as the basis for determining the cost sharing arrangement, that is, the percentage of state education aid. If the approach works as it is intended, it will have the effect of biasing the formula in favor of communities that are gaining pupils, because using per pupil valuation rather than the full valuation of the town has the effect of deflating or reducing the wealth of towns with more pupils. The approach may seriously disadvantage communities that have large non-residential portions of their tax base and actually provides a powerful disincentive to economic development.

In addition, districts who find themselves faced with declining enrollments see the state's estimate of their ability to pay increase, even in the absence of any change in valuation. The impact of the loss of enrollment on the revenue side of the equation is compounded by a reduction in the portion of total local spending subject to subsidy. The potential for a "double whammy" of this sort to jeopardize the quality of education in our urban centers makes the investigation of the true effects of using per pupil valuation in the formula a high priority.

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Maine's Comparative Cost of Education

Per pupil expenditures are one of the primary indicators used to compare states' educational policies. Although serious limitations emerge when trying to use per pupil expenditures at the school district level to assess relative quantity or to derive an estimated budget, at the state level the average expenditure provides a useful gauge of resources directed at the average pupil.
Comparative data indicates that Maine's schools are expensive compared to the U.S. average and the reference set of states.

- Maine's 1990 per pupil expenditure of $5,577 ranked 10th in the U.S., exceeding both the U.S. average and the reference group average. When adjusted for cost of living, Maine's per pupil expenditure ranked 5th in the U.S. in 1990.

- The state subsidy expressed on a per pupil basis is somewhat higher than the national average, $3,039 in Maine compared to $2,849 in the U.S. in 1991.

Often, the assumption is made that a higher level of resources used to purchase educational inputs equates with a higher quality system. However, such a conclusion may not be wholly accurate. From the perspective of cost control, it important to realize that a high expenditure level may be associated with inefficiencies in educational delivery rather than the purchase of inputs that improve educational programming. An examination of factors known to influence spending for education may help to shed light on why Maine differs from the U.S. Teachers' salaries are typically the first factor that comes to mind when questioning "why" costs appear high. In fact, when states have sought to improve educational quality, one of the first actions typically taken has been to upgrade salaries. In Maine this was a strategy of the School Finance Reform Act of 1985. As Figure 77 shows:

- Maine's average 1989 salary, at $24,938, was only 76% of the national average and ranked 39th in the U.S. Maine's salaries were also lower than the reference group's average, constituting 89% of their salary level.
• By 1991, Maine’s average salary had increased substantially to $28,700 and our rank improved to 35th in the U.S. Despite these gains, average teacher salaries in Maine still comprised only 87% of the U.S. average of $33,015.\textsuperscript{67}

• However, growth in the state average has been influenced by more rapid growth of salaries at the high end of the distribution, that is, among experienced teachers.\textsuperscript{68}

![Figure 78](image)

**Figure 78**

**COMPARISON OF PUPIL-TEACHER RATIOS**

**BY LEVEL, MAINE AND U.S., 1989**

SECONDARY CLASSROOM

ELEMENTARY CLASSROOM

ALL TEACHERS

<table>
<thead>
<tr>
<th>Number of Students Per Teacher</th>
<th>Maine</th>
<th>U.S. Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>0.0</td>
<td></td>
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<tr>
<td>5.0</td>
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<td>25.0</td>
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</tbody>
</table>


If a high average salary does not fully explain Maine’s comparatively high level of expenditure, what does?

An important explanation for our comparatively higher level of spending may be found in Maine’s low utilization of teaching capacity, that is, number of children each teacher has in each class taught is low on average.

An examination of Figure 78 reveals that Maine has an overall low pupil teacher ratio, but the overall ratio masks important, and divergent, situations at the elementary and secondary levels. The pupil teacher ratio at the elementary level is very low in Maine by national standards, while the high school ratio exceeds the national average.

\textsuperscript{67} Interestingly, two states with per pupil expenditures very close to Maine’s, Delaware and Maryland, have average teachers’ salaries significantly above ours. During the school year 1990, Delaware’s average salary was $34,700, Maryland’s was $37,515, while Maine’s was only $27,829.

\textsuperscript{68} This determination is based upon a comparison of rates of increase for different parts of the salary distribution reported in the U.S. Department of Education, National Center for Education Statistics, Dicest of Education Statistics 1991.
Figure 79 compares Maine’s rates of educational support staffing to the U.S. average. The ratios reflect Maine’s number of pupils for each support staff member expressed as a percent of the national average.

Instructional aides stand out as one area where our ratio of pupils to support staff is far lower than national patterns. Given the high pupil teacher ratio in Maine and the resultant small average class size, this finding suggests the need for further analysis, to determine where and how aides are utilized. The ratio of students to guidance personnel in Maine is also low relative to the U.S., at only 80% of the national average. The use of library personnel, on the other hand, appears to be significantly below national levels.

Another important reason for the comparatively high cost of educational delivery in Maine is the large number of school districts.

- On average, Maine has 689 children in each school district, compared to a national average of 2,426 per district.

A small number of pupils spread over a large geographic area like Maine’s requires more schools, than more densely populated states, and perhaps more school districts. However, the total cost of educational delivery increases when district level bureaucracies are added. Some states with fewer pupils than Maine use fewer districts. For example, New Hampshire, with average daily attendance of 152,536 (compared to Maine’s 194,350) has 897 children per district and averages only 7 district administrative staff persons per 100 teachers. Maine, on the other hand, averages 14 staff people per district.69

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There are also states with far more districts per pupil than Maine. Nebraska, one of the reference group of states, in 1990 averaged only 302 pupils per district level administrative staff person. A study of school organization in Nebraska conducted in 1989 concluded that significant savings in educational costs could be achieved by consolidating districts. Although Maine's district level staffing is not as extreme as Nebraska's, this clearly is an area for further analysis.

Comparative data on the number of pupils per school reveal that Maine has a very low number relative to national patterns.

- Maine's schools house an average of 259 students compared to a national average of 448 and a reference set of states average of 376.

- The notable margin between the number of students housed in one facility in Maine and both the U.S. average and the reference set of states is an important explanation for both the relatively higher per pupil cost of education in Maine.

We had indicated earlier, in the discussion of the structure of education costs, that both geographic isolation, which prevents efficient use of available capacity, and the failure to achieve economies of scale as reasons why unit costs of education may be high in the absence of quality differentials. The number of schools in use in Maine at the elementary level also appears to be an area for further investigation for possible cost savings.

- Maine's 600 elementary schools on average house 243 pupils compared to a national average of 441 and a reference group average of 322. This places Maine's utilization of elementary school capacity (pupils per school) at only 56% of the national average.

Interestingly, despite higher than average class sizes at the secondary level in Maine, the utilization of secondary school facilities in Maine is below average:

- Maine's 135 secondary school serve an average of 495 pupils per day, compared to a national average of 670 and a reference state average of 605. Maine's utilization of secondary school capacity (pupils per school) is 74% of the national average.

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70 Radcliffe, Kerri et. al. (1990).


5.5 IDENTITYIFICATION OF KEY ISSUES

A number of significant issues with regard to the allocation of both direct and indirect state aid arise from the analysis.

At the outset of this section, we noted that the respective abilities of the state and local governments to pay for services was a crucial issue to be resolved before sound intergovernmental financial aid policies could be developed. In Chapter 3, we learned that Maine state taxes are among the highest in the United States. Somewhat surprisingly, therefore, although reliance upon property taxes as one of the "big three" tax types had declined by 1989, the percentage contributed by that tax was nonetheless higher than desirable at 39%.

With the economic downturn, state revenue growth has levelled off, and both as the result of the natural stability of the property tax base and state budget balancing actions that have shifted financial responsibility to local governments and schools, the property tax is becoming a larger part of the total.

♦ Although an increased reliance on the property tax is not normally problematic during an economic downturn, and in fact, is usually an appropriate and complementary role for the less elastic tax types to play, the share of total spending being borne by the property tax is growing to a point that the state-local revenue system is becoming grossly unbalanced.

The implication is clear:

♦ In the absence of an economic upswing that increases home values and incomes, the aggregate level of property taxes in Maine should not be increased.

The large disparity in mil rates among both municipalities and school districts stands out as highly problematic.

♦ There is a significant opportunity to redistribute tax burdens within the current aggregate level, to promote equity and to mitigate the most pressing problems associated with the state's current incapacity to increase spending to assist localities and school districts.

We shall offer some specific proposals for accomplishing the redistribution in the final chapter. At this point, however, some discussion of the perception of a greater, and different, "property tax problem" than apparently exists may be helpful.

Although a perception of a widespread "property tax problem" generated much debate during the 1980's and state level policies directed toward reducing the burden of this tax were
developed, the analysis of indicators of burden reveals that as of the end of the 1980’s, there is little evidence of a generalized "problem" with the property tax in Maine:

- The A.C.I.R. index of tax effort, which considers property taxes raised in Maine, from our total valuation base, relative to the utilization of this tax nationally, reflects both very "average" use of the property tax in Maine and a steady decline in effort over the past decade.

- Property tax burden, when considered relative to the true base of taxation, home value or asset wealth, declined over the decade to the point that by 1989 closely resemble the average for all of the states.

- Relative to personal income, property tax burden also declined during the 1980’s, but remains relatively high at 125% of the national average and with a rank among the states of 14th in 1990.

Although the sum of these indicators says that there is not a significant, overall, property tax problem, there is a discrepancy between burden measured from the perspective of home values versus from the perspective of the claim of property taxes on income. It may be worth considering this apparent dichotomy.

Many have argued that home value does not measure ability to pay. This assumption needs to be carefully examined. As we mentioned earlier, property values in Maine increased during the 1980’s at a rate that significantly exceed the U.S. average. Was this a "good" or "bad" trend?

Although many citizens in Maine have complained about increases in their home’s value because the increase was accompanied by an increase in property taxes, in many parts of the country (and even in some parts of Maine) stagnation and depreciation of property values were far more common. For example, between 1981 and 1987, Minnesotans experienced a loss of $20 to $40 billion dollars when the per acre price of land declined from $1947 to $628. (Real dollar declines were even greater.)

If everyone in Maine had seen an increase in their home’s value that was proportionate to everyone else’s increase, there would have been no redistribution of tax burdens. During the 1980’s, some homes gained dramatically in value, while others grew some, and yet others lagged behind inflation. Who were the winners? The conventional wisdom that has evolved in Maine is that those homeowners who "made a killing in real estate" in the 1980’s were the losers. They may have "lost" in one respect, if their property taxes became a larger portion of their income. However, they are clearly the winners, for even if they have not "cashed in" as yet on their capital

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74 See Kevin Phillips, The Politics of Rich and Poor: Wealth and the American Electorate in the Reagan Aftermath (Harper Collins Publishers, 1991) for an excellent analysis of changes in wealth shares during the Reagan era and a discussion of the implications for who are today’s "have" and the "have nots" as a result.
gain, they increased their wealth holdings through no effort on their part. The added value in homes in New England provided a ready source of cash to many through home equity loans.\textsuperscript{75}

Gains in property equity are assets that add to an individual's wealth, regardless of their current income level. The "inability" to pay property taxes emerges not from the lack of measurable value of real estate, but from the non-liquid nature of the asset. In recent years, both Maine and the federal government have adopted and expanded tax deferral and equity buy down programs designed to ease the "cash flow" problems that often emerge for the elderly.\textsuperscript{76}

\begin{itemize}
  \item Disparities in tax rates among municipalities for financing non-school governmental functions are large.
  \item In some municipalities, the combination of average school tax effort and high effort for municipal services results in very high taxes relative to the rest of the state.
  \item Vast differences in the numbers of mils raised for school purposes is highly problematic, not only because of the inherent unfairness to taxpayers and students, but also the likelihood that it is unconstitutional in Maine.
\end{itemize}

Many states use revenue sharing and school aid to offset wealth disparities and to equalize tax burdens across local governments. Although Maine's municipal revenue sharing statute does note a desire to reduce tax burdens, the formula primarily serves to distribute aid on a per capita basis. In addition, all municipalities are eligible for aid, regardless of their ability to pay for services or tax effort. Unlike the design of some state's programs, wealth disparities are not explicitly addressed by the revenue sharing formula.

\begin{itemize}
  \item Guaranteeing every town an allocation from the municipal revenue sharing "pot" reduces the amount of funds available to address tax burden disparities and wealth differences.
  \item Among the causes of disparities in school mil rates are the absence of a state mandated minimum effort, a school budget approval process that does not consider the relationship between fixed costs and variable costs, and local financing responsibility that is tied to the number of pupils to be educated.
\end{itemize}

\textsuperscript{75} As we discussed in Chapter 3, one of the reasons sales tax collections literally took a nose dive in Maine was because of the heavy use of credit from home equity loans in the 1980's.

\textsuperscript{76} Equity buy down programs are not unlike home equity lines of credit, with the exception that no payment is required until the householder dies or transfers the property. These programs permit the elderly to draw a monthly payment with the value of their homes as collateral for any purpose that they choose. This arrangement also places a lien against the property that includes interest on the funds "borrowed." Tax deferral programs are similar, in that interest accrues and the debt is repaid when the home is transferred. However, only the value of taxes is "borrowed."
Movement away from the provisions of the school finance law of 1985 through the adoption of "pacifiers" for vocal minorities, such as minimum funding provisions, combined with more rapid growth of other non-equalizing aid relative to assistance designed to ensure an ability to finance education in every town have seriously eroded the ability of state aid to meet the constitutional mandate for equal educational opportunity.77

Although teachers' salaries are now closer to the national average, they continued to lag behind even before the enactment of reductions to planned state spending for elementary and secondary education. The gain in the statewide average appears to have been achieved more through increases in salaries in high paying districts.

Although raises given to teachers over the past year have recently become the target of proposed state funding cuts, salary disparities across districts should be of far more concern, because of the significance of the costs involved and the seriousness of the student equity implications.

Maine's per pupil expenditures are among the highest in the U.S. The results of this analysis strongly suggest that all of the increased funding is not being used efficiently, to purchase additional quality.

The utilization of capacity, that is, how many pupils are served by each school building and how many pupils each teacher instructs, are always major factors affecting education costs. Although small class sizes are virtually unavoidable in very low population parts of the state, this analysis suggests that consolidation at both the school district level and of schools within districts promise significant cost savings.

Although some long needed attention has begun to focus on regional solutions to educational resource constraints, it is important to understand that both of these factors are often beyond the short term control of districts and may not be amenable to improved efficiency even in the longer term. In isolated regions of the state, it is unlikely that economies of scale can be achieved.

From a quality of education perspective, although very small class sizes have been found to correlate with improved student performance, the difference between a class of 15 and a class of 20 has never been shown to be statistically significant. Thus, it is difficult to argue that our low pupil-teacher ratio is an effort to enhance the quality of education. Since the class sizes at the secondary level in Maine are higher than the national average, the quality motive would quickly become suspect.

77 In Abbott v. Burke (New Jersey, 1990) pension aid was found to be non-equalizing, as was the provision for a minimum funding amount. Both policies have been revised and responsibility for financing retirement is being returned to local governments in 1993, in response to the courts finding for the plaintiffs.
Most experts do agree, however, that very small school sizes preclude important educational programming such as specialized courses. Former Commissioner Bither has suggested that an important school improvement strategy for Maine to pursue is secondary school consolidation, to permit all students access to advanced mathematics and other specialized offerings now only available in some schools. Interestingly, a quality objective leads to a similar conclusion as a cost efficiency objective.

Increasingly in the future we can expect the linkages between levels of government to expand, as the state seeks to promote statewide objectives in various policy areas and local governments strive to respond to costly state and federal mandates while continuing other services. In the face of continued resource scarcity, there is little doubt that sorting out Maine's intergovernmental system, including determining where economies may achieved and who can, and should, pay for public services will be a predominant challenge of the 1990's. These issues raised by this analysis should prove fertile ground for further study and discussion.
When recession struck in late 1989, Maine’s policy makers were unprepared for the sharp about face in revenue growth and the massive deficit that ensued. Citizens were confused, because reports of increased spending in the face of an economic downturn seemed irrational and perhaps irresponsible. In searching for revenue enhancement alternatives, it quickly became apparent that, at a minimum, we had less flexibility to raise taxes than would be needed to close the budget gap.

As the first weeks of grappling with the unwieldy state budget turned into months and then years, more questions have surfaced than answers. Why is Maine’s budget so seriously out of balance? Why have state forecasters had such a difficult time getting a handle on likely revenue receipts? Why has the deficit not only persisted, but worsened? And why have lawmakers relied so heavily on postponed obligations, accounting gimmicks, and employee sacrifices to close the budget gap, rather than effecting meaningful reforms in spending?

Much of the explanation can be summed up as "the fiscal legacy of the 1980’s."

The decade of the 1980’s was a period of great change for all states. The complex partnership between federal, state and local governments for implementing public programs had begun a metamorphosis during the 1970’s that by the mid-1980’s had significantly reduced the federal role in most domestic policy areas. Tax reforms enacted by Congress in 1986 profoundly altered the structure of federal taxation, and many states, including Maine, adjusted their tax codes to reflect the broadened base of taxable income and to remain competitive with other states for business location and retention.

Within the broader context of national trends, Maine had entered an era of unprecedented economic growth that presented not only new opportunities for citizens, but also extraordinary public policy and management challenges. Rapid economic expansion placed substantial stress on state and local infrastructure and the environment. At the same time, a growing dissatisfaction with the property tax intensified in many parts of Maine when tax shares began shifting among and within communities in response to market forces that escalated the value of coastal, waterfront and recreational properties.

To say that Maine’s budgeting environment was characterized by complexity during the 1980’s understates the aggregate influence of diverse and at times opposing fiscal forces. By 1989, policy responses to multiple and often competing demands had shaped a state budget that was significantly larger, more complex, and perhaps surprisingly to some, far more burdensome for Maine’s citizens and businesses to finance.
Understanding why we are where we are today, fiscally speaking, is the first step toward gaining control over the situation. In this chapter, we first synthesize the major findings of this study into an overview of "where we are and how we got here." In the final section, we offer strategies for strengthening Maine's capacity to manage, rather than to be managed by, the state's fiscal fortunes.

6.1 THE FISCAL LEGACY OF THE 80'S

INCREASED RESPONSIVENESS OF STATE SPENDING TO THE ECONOMY

Federal aid to states and local government declined in most policy areas, which has made state programs more dependent upon general fund revenue.

On the expenditure side of the state budget, the sensitivity of spending to economic change was increased through federal actions which in turn became amplified by state policy responses.

As a result of federal retrenchment in a number of important policy areas, state programs and capital investment became more dependent upon "own source" revenues, which has made them more vulnerable to cutbacks in recessionary periods.

Federal retrenchment also hurt local governments. Local governments in Maine, like their counterparts in many states, turned to the state capital to replace needed revenues lost with the end of the federal revenue sharing program.

The design of safety net social services programs is "entitlement" based, which means that anyone who meets eligibility requirements is entitled to those benefits. For years at the federal level social services safety net programs were called "automatic stabilizers," because even before an economic downturn could be identified, benefits would begin flowing to newly eligible citizens. The influx of transfer funds into the economy helps to offset the loss of income. As a result of the transfer of substantial responsibility for funding these programs to the states, an important component of Maine's state expenditures now responds to economic change quickly, and in a direction opposite to that of revenues.

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In Maine, just as growth in state revenues began to wane, escalating caseloads were catapulting state spending for Aid to Families with Dependent Children (A.F.D.C.), Medicaid, and subsidization of the local general assistance program. This effect should not have been unexpected, because safety net programs are intended to be countercyclical: spending is highest in periods of recession and lowest in good economic times. Nonetheless, the sudden surge in spending widened the growing budget gap.

Federal retrenchment during the early 1980's had left some low income and disabled citizens "at risk." Maine, unlike some states, responded by expanding safety net programs. The effect of the policy decisions that extended more services to more people lay dormant while the economy was strong and growing, and as a result, the budgetary implications were not realized until late 1989. The acceleration of welfare "safety net" spending that has accompanied the recession in part reflects the severity of the economic downturn, but additionally, is indicative of the greater extent of responsiveness that has been built into our eligibility standards and coverage of services.

The magnitude of Maine’s budget problem is only partly the result of recession induced expenditure increases, however. As most people realize, revenues fell far short of projections for the biennium that is ending. What most people do not realize is that our revenue problem is far more severe than that of most of the states, and it is worse than it should be given economic conditions. Why? As discussed in Chapter 3, the sensitivity of Maine’s revenue structure to economic change increased significantly during the 1980’s.

Both the rapid and unpredictable decline in revenues that accompanied the onset of recession and the accelerating growth that had characterized the latter part of the 1980’s rest in the sensitivity imbedded in the structure and composition of Maine’s tax system.

Differential growth of the various revenue sources in the 1980’s shifted the balance of Maine’s revenue structure towards a heavier reliance upon the sensitive or "elastic" tax types. In addition, the general sales tax,
The sales tax is made more volatile by exemptions of "staples" from taxation.

In the 1980's, consumption tilted toward items whose purchase may be easily postponed with a change in circumstance.

An increased use of credit, obtained in many cases by tapping into sizable gains in home equity, permitted more purchases...

...the use of credit created an illusion of long term revenue base growth that was unsustainable.

An emphasis on debt repayment by many households since the beginning of the recession has compounded the decline in disposable income.

which is normally considered a relatively stable tax source, responded strongly to the economic downturn, reflecting a much higher than expected sensitivity.

Maine's general sales tax collections continued during the 1980's to be more sensitive to economic change than did sales taxes in some other states, because we exempt "staple" items such as food and heating fuel from taxation that comprise a stable core of buying.

The responsiveness of the general sales tax to economic cycles also increased during the 1980's, because tax collections became more dependent upon discretionary purchases of goods. Sales of both automobiles and building materials were primary components of the growth in sales tax collections. The growing dominance of "big ticket" items within the overall range of taxable sales exacerbated the sensitivity inherent in our narrow base of taxation. The virtual halt in purchase of these items since the onset of the recession has been a major contributor to sales tax revenue stagnation.

During the latter part of the 1980's, New Englanders used a higher level of consumer credit to finance purchases than residents of other parts of the nation. As a result, the consumer expenditure patterns that helped fuel increases in the state's collections from the sales tax were leveraged with borrowed dollars, rather than income that could sustain spending over time and across diverse economic cycles.

In addition, the use of the borrowed dollars appears to have been weighted toward "big ticket" purchases like boats, cars and home improvement projects, which are cyclical purchases at best.

As the economy deteriorated, many households began paying off consumer debt, rather than incurring new debt or maintaining the former level. As a result, fewer dollars of disposable income are being directed at consumption. For those households where income has reduced due to shortened work days or layoffs, repayment of consumer debt represents a fixed obligation, and thus a higher percentage of disposable income- which leaves less for purchases.
The excessive sensitivity of Maine's personal income tax causes "bungee cord" budgeting.

The structure of our personal income tax is the primary "culprit."

The sensitivity of the personal income tax became exaggerated by an increase in households with second wage earners.

THE 80'S BROUGHT HIGHER TAX BURDENS DESPITE RAPID INCOME GROWTH

Increased personal income taxes led the way to a far heavier burden of taxation.

Given the continuing need to support public programs during varying business cycles, a highly sensitive income tax is problematic during growth periods as well as in a recession, because programs tend to get built around available resources. The end result is "bungee cord" budgeting: rapid escalation of spending followed by sudden and often severe cutbacks.

The sharp halt in the growth of income tax revenues resulted not only from lack of personal income growth, but even more importantly, from an appreciable reduction in the average or "effective" rate at which we tax income. The increase in effective rate that accompanied personal income growth during the latter part of the 1980's was an important ingredient in the acceleration of state tax collections. Income was increasing, which would have yielded additional revenues even if our income tax was based upon a "flat," or equal percentage tax at all income levels. However, since the structure is steeply progressive, as a household's income increased they quickly moved into higher and higher tax brackets.

The personal income tax yield impact of income increases or decreases in dual wage earner households is exaggerated for two reasons. First, the second earner usually has no additional deductions or exemptions available beyond those already taken by the first wage earner. Thus, all income earned is subject to tax. Second, the first dollar of income is taxed at the household's highest marginal rate.

One important side effect of our personal income tax structure is that as income increases, we tax more heavily. By the end of the 1980's, the effective rate of personal income tax in Maine had increased substantially, thrusting us to near the top of all states in the United States.

The growth in personal income was accompanied by increases in the effective rate of taxation of personal income in the absence of any policy changes. Responsive or "elastic" taxes usually are progressive taxes, which means that as personal income increases, the average or
High income taxes have been made even higher...

Our taste for spending increased even faster than natural growth in revenues.

effective rate of taxation increases. By 1989, the effective rate of personal income taxation had increased from 2.5% to 3.1%, propelling us to a level of taxation that ranked 7th in the United States. The U.S. Advisory Commission on Intergovernmental Relations estimated in 1988 that our use of the personal income tax was at 160% of the national average.

Budget balancing tax actions have exacerbated the problem by increasing our top marginal rate to a highly visible 10% and enacting surcharges. A recent compilation by Money magazine places our tax on a household earning $100,000 as the fourth highest in the U.S.

Although revenues were growing by leaps and bounds during the 1980’s, policy makers nonetheless found it necessary to raise taxes to support approved expenditures.

During the years of strongest state revenue growth excise taxes in Maine grew to among the heaviest in the country. Comparative analysis revealed that by the end of the decade of the 1980’s, we were tapping this revenue base far more than the majority of states. In fact, the Advisory Commission on Intergovernmental Relations estimated that in 1988 our excise tax on beer was at 250% of the U.S. average use of this tax.

Since all states find it easy to rationalize increasing the use of these "sin" taxes, our comparative position understates the heavy burden these taxes are likely to be placing on Maine’s poor and lower middle income families. The contrast in tax policies between Maine and New Hampshire makes it unlikely that Maine businesses in proximity to the border do not suffer.

Whether viewed on a per capita basis or per $1000 of personal income, Maine’s state taxes were among the highest in the U.S. prior to the recession. Unlike some states who use one or two tax types heavily but others very lightly, our taxes were high across the board. This analysis reveals that by the time the recession struck, only the corporation income tax offered any hope of absorbing an increase without significantly eroding our ability to
Hindsight reveals an historic incapacity to say "no" to spending requests.

The decline in social services spending during the "good" years left a gap that was quickly filled by new initiatives and expanded programs.

Attract and retain jobs in Maine. Yet, the consensus among businesses is that their taxes are too high.

Several expenditure areas in the state budget including aid for local education and the University of Maine System were "targeted" for injections of funds during the 1980's. In addition, the Medicaid program was blamed for the rapid growth of the state budget before the recession mandates. One would expect to find that these expenditure categories had increased as shares of spending. Although the University of Maine's share increased, the gain was minimal. More surprising, and sobering, is the finding that spending for general purpose education aid and social services transfer program declined as a percentage of the state's general fund between 1980 and 1990! So what does this mean? It tells us that spending for everything else was increasing even more rapidly than the usual scapegoats for budget growth.

Despite discussion of "priorities" and accompanying major injections of funds, the high visibility new funding initiatives were matched and in some cases exceeded, by increases in other policy areas. In effect, there was no displacement of old programs, new was simply added to old. The budgetary impact of not offsetting areas of purposefully higher spending with reductions in others is a far larger and more expensive financing responsibility. The comparison of Maine's spending to other states reveals several areas that are notably higher, growing more rapidly, or both.

During the "quiet years" after enactment of programmatic and eligibility changes, both the gubernatorial administration and the composition of the legislature changed. It is likely, and perhaps even understandable, that the responsiveness of the costs of the expanded social programs to economic change was forgotten as other demands for spending became known and it seemed that increasing resources were available for other new initiatives. The onset of the recession confronted policy makers with the sum of their 1980's expenditure choices: they had approved more spending than revenues could sustain across disparate business cycles.

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The promised safety net started to disappear in Maine just when it was really needed.

We face a structural mismatch between spending trends and long term revenue availability.

The major effect of the fiscal legacy of the 80’s is either ever higher tax rates, an increasing gap between budgeted expenditures and the capacity of the state to finance them, or both.

To make matters worse, we failed to spend on things we should have during the good years.

Although policy actions of the mid-1980’s had provided testament to maintaining social services programs as a high funding priority, Maine’s most vulnerable citizens are now being forced to compete for scarce state funds with programs that quietly swelled while they were being assured the "safety net" would be there when the rainy day came.

Although much attention has focused upon the current cyclical mismatch between state spending and available revenues, the growth rate of state spending in the 1980’s was far higher than the path that state revenues reasonably could be expected to follow in the long run. The rate of increase in spending in each year reflected, and then built upon, increases in revenues in the previous year. It can be argued with some conviction that even before the onset of the recession, we were following a path of expenditure increase that had begun diverging from revenue growth. In fact, in fiscal year 1990 the state’s general fund expenditures actually exceeded revenues; a deficit was prevented through the use of carryover funds from previous years.

In the face of flat or slowly growing state revenues, the long term fiscal impacts of the expenditure initiatives of the 1980’s must be either ever higher tax rates or an increasing gap between budgeted expenditures and the capacity of the state to finance them, or both. New federal mandates that affect both the state and local governments in Maine, spiralling health care costs, and other emerging budgetary pressures promise to combine with the fiscal legacy of the 1980’s to create a structural gap between revenues and needed expenditures for the foreseeable future.

This analysis reveals that important expenditures were deferred while long term debt was used to finance equipment and other purchases of assets with short lives that ordinarily would have been financed on an annual basis. In addition, despite the pressures on infrastructure associated with economic and population growth, Maine’s investment in infrastructure during the 1980’s was quite low relative to other states, with the major portion occurring at the local level.
During the past decade and as the result of budget balancing actions our long term financial liabilities have mounted to the danger level. The state retirement system remains seriously underfunded, yet continues to be a primary lynchpin in efforts to bring the unwieldy state budget under control. Previous budget balancing actions, although perhaps justifiable as a short term strategy, have aggravated our pension financing problems by further increasing the system's unfunded liability and the cost of reducing it. Any further failure to meet this financial responsibility will jeopardize the state's fiscal health. In addition, the approval and issuance of a large amount of new public debt during the recession is pushing Maine to a level of long term obligation that places among the top one-third of debt users nationally.

The increases in the state's own spending only tells part of the story, for mandates placed upon local government during that time period fueled both local spending and state spending. The magnitude of the spending impacts one major initiative, education reform, was seriously underestimated in terms of required school district expenditures and the impact on the state retirement system.

### 6.2 THE PATH TO FISCAL CRISIS

At this point, a question that naturally emerges is why no one seemed to realize that our expenditures were propelling not only spending but also our taxes to among the highest in the United States. We would like to take a moment to reflect upon this question, because it is far too easy to place blame in such a situation and fail to recognize the lessons that come with mistakes.

It is important to remember that the high sensitivity of our tax system to economic change was causing revenues to increase swiftly, and for an extended period of time. Although hindsight permits us to recognize that part of the growth in personal income tax collections was due to tapping that base harder and harder, at the time, most people assumed the increases in revenues were a natural outgrowth of economic vitality.

Perhaps even more importantly, Maine's personal income growth during the latter part of the decade was among the most rapid in the U.S. Yet, despite the high rate of increase, Maine's per capita income continued to be lower than both the U.S. average and particularly the New
Another factor that may have contributed to a conventional wisdom that economic expansion was financing new and expanded programs is the mismatch that often occurs between the level of government who feels the expenditure pressures associated with growth and the level that receives the revenues. This occurs because there is a difference between the economic base of a state or local government, and the revenue base it is able to tap for funds.

During Maine's period of rapid economic growth in the 1980's, the cost pressures placed upon some municipalities escalated tremendously, as the need to provide physical and service infrastructure multiplied with population, employment and tourism growth. While in many towns the property tax base expanded, the increases were not sufficient to pay for the level of service expansion required to serve large volumes of tourists and other non-residents. Conversely, the state's revenues increased dramatically, as both personal income and sales tax collections responded to the expanding economic base. The unrecognized mismatch between the distribution of spending factors and revenue flows may have fostered an inaccurate assessment that new, "extra" resources were available to fund programs.

The nature of public budgeting itself fosters revenue driven expenditure policies. Textbooks tell us that public budgeting is clash of perspectives, and of values, with tradeoffs known and debated that culminates with the allocation of scarce resources to priority public purposes. Yet, while the textbook model holds great allure for students and practitioners alike, particularly in times of budget crisis, rarely does the process achieve its promise of forcing government wide priority setting. A number of factors impede comprehensive examination and clear delineation of public priorities during the "good times." These factors are worth thinking about, because in times of fiscal crisis, when we most need to consider consequences and tradeoffs rationally, they may erect seemingly insurmountable barriers to effective budgetary change.
The formulation of the budget is a political process that brings together elected officials with diverse values, constituencies, and agenda and asks them to determine what public programs will be funded and how. Elected decision makers tend to be reluctant to state publicly that they view one program- and hence one segment of their constituency- as a priority over another. In the good times, they can often escape doing so, because there may enough funding available for the sustenance of on-going programs and the initiation of new endeavors. Hope does spring eternal and in the absence of sound, reliable data to show otherwise, current revenue receipts typically provide a good gauge of what's "affordable."

Overwhelming is not too strong a word to describe budgeting for an organization as large as Maine state government. The sheer size, scope and complexity of the Maine state budget mean that it would take an extraordinary amount of time, effort and understanding to adequately delve into its content and affect fundamental change. Consequently, the full range of policy issues seldom is placed "on the table" at one time for identification of tradeoffs and prioritization across areas. Although elected officials technically make policy, realistically many important choices occur at the departmental level before policy makers even see the budget document.

The "slice of the pie" approach to budget review is exacerbated at budget time, because to make the tasks manageable, committees often review pieces of the budget within their areas of expertise. While the Appropriations Committee serves in Maine as the locus of decision making on expenditures, they do not have access to all of the information that flows through specialized committees. In addition, the Maine state budget is approved in two stages, with current or on-going programs reviewed and budgeted first, and then all requests for new or expanded funding considered. This approach builds in a strong bias in favor of the existing budget base and discourages the replacement of old programs with new- and potentially more cost efficient-approaches.

The end result of these diverse forces is that the great bulk of programs, and the range of revenues used to finance them, remain in place from one year to another- even when a concerted effort is made to affect meaningful change. In times of fiscal constraint the same forces that work against comprehensive examination of budgetary options, the explicit identification of tradeoffs, and meaningful prioritization of governmental purposes during the good times intensify, because the stakes increase when there are fewer dollars to go around. Today, the stakes are about as high as they could possibly get.

Taking Charge of Maine’s Fiscal Fortunes

Like many states, Maine’s policy makers are looking beyond merely surviving the current budget crisis, to longer term goals of job creation and restoring Maine’s economic vigor. Renewing and then sustaining economic vitality in Maine requires a deliberate, multifaceted plan that is capable of overcoming significant obstacles presented by the "fiscal legacy of the 1980’s."
First, greater stability of tax collections must be achieved.

Second, the effective rate of personal income tax collections should not be permitted to increase to the formerly high percentage.

Third, spending must be carefully and efficiently directed, to ensure a "steady state" budget that targets and consistently supports crucial state purposes, while nonetheless remaining prepared to increase spending for vital safety net programs when the economy falters.

Lastly, there must be a commitment to more analysis in budgeting. Too much of the explanation for "where we are today" lies in not really knowing where we were as we made all of those choices during the 1980's. Maine needs to build greater capacity to manage, rather than to be managed by, our fiscal fortunes.

These four points may not seem to present an insurmountable agenda. Nonetheless, they will not be achieved without concessions, without pain, nor without strong leadership and the political will to tally the wins for the long haul, rather than at the end of each day. Stabilizing tax collections and preventing the rate of taxation of personal income tax level from reaching the exceedingly high level of the late 1980's will require expenditure reductions in the short term and control of the rate of increase in the longer run. However, nurturing and maintaining healthy tax bases requires investment in expenditure areas of the budget that prepare citizens for jobs.

Throughout this report, issues and problems have been identified. There are a variety of choices that must be made, which shall require further analysis beyond our work. Work is already under way to consider ways to restructure state government for increased efficiency and economy. Thus, in this final section, we shall concentrate on recommending some primary strategies for increasing the state's capacity to effectively steer its fiscal ship.

6.3 A FISCAL AGENDA FOR THE 90'S

Strive for a level of taxation that Maine can afford for the long term.

The impact of the recession on state tax collections offers policy makers a "window of opportunity" to reduce our overall level of taxes and to redistribute tax burdens among the different instruments, to enhance both the stability and equity of the state's revenue system. The decline in our effective rate of taxation of personal income (2.5% in 1991 compared to 1989's 3.2%) places us much closer to the national average (2.1%) and
Enhance the stability of Maine’s tax structure.

provides a significant opportunity, because we are being forced to adjust our "appetites" to fewer calories.

It is important to recognize, however, that economic recovery will increase the effective tax rate just as quickly as the recession reduced it. The current elastic structure of Maine’s personal income tax will begin propelling collections and increase the effective rate of tax as the economy improves. In the absence of any policy change, we could be right back where we were relative to other states. Thus, the chance to capitalize upon the fiscal crisis to improve Maine’s comparative taxation for the longer term is time limited.

Implementing structural changes to the personal income tax now will permit Maine to build in a more stable core of taxable income and to maintain our reliance upon that tax at a level that is not grossly out of line with other states.

The very tight budget required by the recession is not simply the effect of lagging revenues, it is the result of escalating social services expenditures. As economy recovers, social services spending will decline, freeing up a reasonably large amount of resources. However, if we are to avoid the catapulting expenditure phenomenon that characterized the late 1980’s, we must carefully target any excess revenues to the highest priority needs.

In adjusting the tax schedule to reduce volatility, the top rate must be considered carefully. Not only is our current maximum rate among the very highest in the United States, it contributes to the elasticity or responsiveness of the tax structure. In addition, even when our effective rate of taxation is comparatively low—as it is now—the high top marginal rate continues to give the impression that we are one of the heaviest taxers. Recently enacted personal income tax rate increases have elevated the system’s progressivity and will augment its sensitivity to income change.

Last year’s budget balancing strategies included an increase in the rate of the sales tax to 6% and a broadening of the base to include non-basic foods and
amusements. The extension of the tax to additional food items is sound tax policy for several reasons.

First, the inclusion of food in the taxable base enhances the stability of the sales tax over economic cycles, because people always buy food. Second, tourists buy convenience foods and snacks, and can be asked to contribute toward the costs of state and local public services they use through this tax. Finally, the tax eliminates an exemption which benefitted high income households more, in actual dollars, than low income households because the revenue foregone through not taxing food increases with family income.

Given the volatility of the sales tax, extension of this tax to additional food items should at least be considered. The National Conference of State Legislatures estimated recently that Maine’s potential collections from a sales tax on food would exceed $100 million. However, it must be kept in mind that revenue enhancement through taxation of items purchased frequently by the low income imposes a serious burden that may be excessive. Reducing the rate with a base expansion to additional food items would help to mitigate the additional burden imposed, and furthermore, would reduce the sensitivity of the tax.

While on balance Maine’s tax system provides a higher degree of equity than the structures of many states, its comparative fairness is not achieved through avoidance of regressive tax types, but rather, through a heavy reliance upon the progressive personal income tax within an overall taxation level that is very burdensome.

Seven states currently use a low income rebate to offset the burden of the sales tax. Maine’s extension of the tax to some additional foods could be a reasonable compromise between the need for increased revenue stability and equity objectives if a rebate or credit program was also implemented.

Since food stamp purchases are not taxable, an option worth considering would be the adoption of an earned income credit in Maine, so that low income families with an employed head of household would receive an income supplement.
A thorough evaluation of the "tax climate" for business should be given high priority.

As part of a comprehensive look at these issues, analyze the effects of specific taxes and fees on individual business sectors.

Foster a "steady state" budget through strategic use of revenues during "ups wings."

Despite corporate taxes that are estimated to be well below the national average by the Advisory Commission on Intergovernmental Relations and an increasing gap between personal income and corporate income tax collections, many businesses argue that Maine is not "friendly" to business. In all likelihood, there is more basis to this concern than just corporate income tax, as the recent rounds of attempting to streamline Maine’s workers’ compensation system have demonstrated. However, a pervasive sense of high burden may be accompanied by a "hands off" policy that is unjustified. More importantly, there may be particular taxes or fee systems in place that unduly disadvantage specific industries or employment sectors. We need to understand a great deal more about the dimensions of the business tax issue.

Maine must determine how to best position itself to attract and retain jobs in the 1990’s, while nonetheless striving to distribute the burden of government finance between businesses and households equitably. Our "tax climate" must be carefully scrutinized, to include an evaluation of the impact of state and local taxes as well as the imposition of fees and charges on businesses as a group and on specific sectors, such as the paper industry, retail establishments and other important components of our economy. In addition, "tax expenditures" (exemptions from paying tax) should be catalogued and their value calculated to obtain a full picture of the tax position of businesses.

Whenever the economy slides, talk of budget stabilization funds abound. The problem is, there is rarely enough fiscal discipline to put the money away and then leave it there. Although it is simply good financial practice to always have a reserve fund on hand, keeping too much money tucked away "for a rainy day" may not be fair to taxpayers or for that matter the best use of the resources: might not the funds be left in private hands, to be used and to grow, until needed? Any budget stabilization fund should have realistic, equitable policies to govern when deposits occur, how much should be permitted to
Enhance the capacity to more effectively acquire and allocate scarce financial resources by building timely, relevant and longer term information into budget development and review.

Restructure the budget document to facilitate decisions and enhance accountability.

accumulate, and how and when resources may be used.

Targeting the use of a portion of "excess" revenues during economic upswings permits the reduction of long term liabilities, ensures that new or expanded programs do not become dependent upon serendipitous resources, and can provide needed flexibility to defer expenditures during downswings. If we had gotten ahead on debt service or pension payments during the 1980's, deferring payment now or refinancing would not be an issue.

The state budget must support priority public purposes through "thick and thin." Cutting local education, the university, capital outlay or other important areas of the budget may be required, but a commitment to hold key purposes of government in abeyance- to only be cut as a last resort- will preserve the fiscal health of the state for the long term.

Effective management of financial resources must begin with timely, reliable and consistent information. Although a significant volume of data is tabulated, computerized and stored by many state agencies, rarely are the myriad pieces integrated into usable information in the policy and budget processes. State government systems must be designed to produce information, not to simply store data. In addition, a variety of data that are not currently compiled must be added.

The budget document is the primary presentation on government services and finances that a citizen or even a state representative is likely to see. Increasingly, as computers have taken hold in government, budgets have become communication tools. Yet, the budget must serve other users as well. The budget should provide a summary of important information for planning expenditures for the fiscal period ahead. The budget is the basic policy tool of government, because it defines who will benefit from government services, who will pay and how much. Currently, the Maine state budget is close to being unreadable, even by experts. The Commission on Restructuring has made some useful recommendations, so
we shall only add emphasis. In times of cutback, decision makers must be able to judge the effects of their actions on programs and people. The budget document needs to provide the essential base of information about who does what in government, how much it costs, and how those dollars are used to implement programs.

Effective management of financial resources requires the examination of the results of government activities as well as their costs. As the Special Commission on Government Restructuring has already recommended, performance measures should be developed and included in the budget document. In addition, an integrated and disciplined financial management information system that can provide consistent, reliable and timely data on the cost, demand, workload and performance of public programs should be developed to assist managers and policy makers with the assessment of budgetary need, program effectiveness, and the efficiency of resource allocation and use. This type of data is fundamental to making sound decisions on programmatic cutbacks or expansion.

Many of the pressing public policy problems that face Maine today, and are likely to confront the state over the next decade, can not be adequately considered from a policy or budget perspective using a narrow, short-term focus. The capacity to identify and delineate problems, outline and evaluate alternatives, project costs- including any likely negative consequences, and track progress is an essential capacity for managing- rather than being managed by- change.

These activities would seem to fall squarely within the role and expertise of the State Planning Office. Charging the State Planning Office with a clear responsibility for strategic policy analysis within a longer term planning framework, in continuing, defined areas that may be supplemented as needs arise by either the Governor or Legislative leadership, would be a giant step toward getting on top of our budget problems.
Develop a fiscal forecasting capability, rather than focusing exclusively on revenues.

Build regular research into both revenue and expenditure forecasting.

Improve the quality and utilization of "fiscal notes."

Although much discussion has focused on the need to improve revenue forecasting in state government, little attention has been paid to expenditure forecasts. The interrelationships between expenditure and revenue choices, and the duality of the effects of economic change, require projections for both areas of the state budget and for several years into the future, under varying economic assumptions. Projections of demographic trends should be incorporated into expenditure estimates, so that fiscal impacts assessments are based upon the best possible information about the likely extent of needs among citizens.

On-going research on taxes, demographics and other fiscal trends should be combined with careful monitoring of real (deflated) tax collections to understand past behavior as a step toward better predicting and interpreting the direction of future trends. A better understanding of who pays income taxes, how much credit is or is not in use for retail purchases, what items are being purchased and so forth is information that permits forecasters to estimate the likely effects of major economic change. Consumer surveys are used in several states, and may be supplemented with expert judgements of people like the president of the Chamber of Commerce, to improve forecasts and to help predict the seemingly unpredictable: economic "turning points." Early signals of turning points in the economy always show up in the social services department, because food stamp applications increase.

Some of the more problematic aspects of budget balancing in Maine have evolved from poorly informed policy actions. For example, it is doubtful that the probable impact of state educational mandates on the retirement system was factored into decisions about affordability of reforms. Similarly, the employment effects of mandates in small school districts—where a special education teacher may serve a only a few children—have been far more costly than expected.

The current "fiscal note" process, whereby estimates of program costs are prepared for bills that require funds, is an important means of identifying operating budget impacts. This is an area where some
additional attention to the quality of estimates and the sensitivity of projections to the economy and demographic assumptions could yield important gains in our ability to foresee, and potentially manage, budget impacts.

The development of an estimation process for fiscal effects of mandates is a high priority for Maine. In addition, the ability to better assess "who can afford to pay," "how much" and "who needs state resources the most" will become pressing issues as resource scarcity persists, and whose equitable resolution will depend upon sound data.

Although the yearly allocation of dollars to public purposes tends to be the primary focus of policy attention and budget deliberations, looking beyond the near term to consider both the long term impacts of current policies and the effect of pending decisions upon future budget requirements are essential ingredients of maintaining a state's financial health and budgetary flexibility.

One of the major problems facing Maine's budget makers today are commitments, made in times of plenty, which now comprise a heftier portion of the total revenues available and as a result leave much less of the budget "controllable." Long term financial commitments often seem less significant than operating budget items, because the costs extend far into the future. Nevertheless, the future costs of yesterday's and today's obligations will combine with future liabilities to create a significant claim on the state's financial resources well into this decade and beyond.

Maine, like many states, has witnessed the rapid evolution of a new and far more complex definition of budgeting and public financial management. While strides have been made to keep abreast of needed improvements in practice, the analyses of three major components of long term state liabilities- capital assets, debt and the state retirement system- suggests that current policies are not wholly adequate to oversee financial commitments that extend beyond the biennium. Let us look briefly at each of the three areas.
It is imperative for the state to develop a capital budget...

A state's public infrastructure is one of the most important, and expensive, financial assets for which state government is responsible. Public infrastructure is viewed by most economists as far more important to a state than the simple dollar value of the physical assets. Numerous studies have linked the extent and quality of the public capital stock with economic growth and sustained vitality. Researchers have also argued that investment in public capital increases the rate of return to private capital and investment, and enhances productivity growth. Meeting Maine's infrastructure and economic goals in the 1990's will be aided by a state level capital budget that encompasses all priority statewide needs—regardless of which level of government claims ownership of the capital asset—and candidly assesses who should pay.

Regardless of which level of government claims ownership over a particular area of infrastructure, the provision of an adequate infrastructure is a shared responsibility of both the state and the local governments. However, as the senior partner in the state-local fiscal system, the state has a fundamental oversight role in ensuring the provision and maintenance of facilities which are essential to the health of the citizenry, bear upon progress toward meeting state or federal environmental goals or mandates, or provide the basis for meeting statewide economic development objectives.

Many of the most costly infrastructure needs of the 1990's are likely to occur at the local level, as municipalities attempt to respond to state and federal clean water and other environmental mandates. Solid waste disposal is already an problem in many towns, with landfills nearing capacity and in some cases contaminating groundwater. The division of capital investment responsibilities between the state and local governments derives from the assignment of functions to the respective levels, not from any reasoned distribution. As a result, responsibility may not correspond to the relative priority of the capital needs in the overall fiscal system, the dispersion of benefits, nor the financial capacity of the "home" unit of government to undertake sizable projects.

The New Jersey Capital Planning Commission may provide a useful model for Maine. The commission
Review state debt policies, reshaping and strengthening them as needed for greater oversight and control.

consists of four legislators (ranking members of finance and appropriations committees of both houses), the state Budget Director, the Treasurer, two gubernatorial appointments from within government, and four private sector members confirmed by the Senate. New Jersey’s Capital Planning Commission has a small staff, receives all capital plans, holds meetings on the plans followed by formal hearings, and compiles a list of recommendations which become the basis for the governor’s capital budget. Although this approach does not directly include the authorities in New Jersey, the governor may (and does) request information on all planned projects of authorities, and may also veto projects they propose.

The New Jersey Commission approach has been highly successful because it has involved the public, executive department staff and legislators; it has provided detailed and consistent information about proposed state projects; it has carefully sought information on alternative approaches to achieving goals; and it has brought together capital and operating budget considerations. In addition, New Jersey’s capital planning process includes a coordinating committee of all agencies and authorities involved in transportation, so that their individual plans can be designed to best meet statewide needs. A similar approach could be implemented in the environmental area.

A bipartisan commission, structured after New Jersey’s creation, to oversee capital planning, priority setting, and capital allocation is a model worth exploring for implementation in Maine. Addition of a local government representative and a university finance specialist to the commission might broaden the perspective of the group.

Debt is frequently viewed by elected officials and the public as an area of substantial mystery, because it has a specialized vocabulary and a mathematical basis. As a result, a government’s debt position and practices are often ignored by elected officials and citizens, unless a revision in debt rating occurs or is threatened. Yet, the decision to finance the public purpose with debt should never be made lightly, nor ratified without careful
Develop policies to ensure that retirement system obligations are met fully and in a timely manner.

consideration of the purpose of the debt, the costs involved, and the impact a proposed debt issue is likely to have on other areas of government operations.

Projects, and any debt financing required, should never be considered in a vacuum. Debt issuance should be carefully scrutinized within the context of all known, and potential demands, from the operating and capital budgets, and any local infrastructure needs which bear upon progress toward meeting state environmental goals or federal mandates, or economic development objectives. Changing federal environmental mandates, the condition of infrastructure, and growth pressures are but a few of the factors which can influence what other projects may need to be funded, and whether they must be given priority over the particular project under review.

At a minimum, the state's debt policy should define parameters for borrowing, including when debt finance is not suitable. Options for controlling and monitoring nonguaranteed and moral obligation debt as well as leases and lease purchase arrangement that are currently used by New York and other states should be evaluated for adoption in Maine.

Although for the average person the actuarial assumptions behind retirement system contributions may as well be written in Greek, the state retirement system is a significant component of the state's long term financial health and has been the most rapidly growing category of annual expenditure. From both a budgetary and an ethical perspective, given the dependence upon this system of both state and local government employees, proper annual investments are central to accountability.

Maine's state retirement system is currently one of the most underfunded in the country, based upon our assessment and those of other "outside" observers. Deferments of obligations during the preceding two years have significantly boosted our unfunded liability, which already exceeds $1.4 billion dollars, and will increase the annual costs of retiring this "debt" to current and former state workers and teachers for years to come. Any further efforts to postpone paying for these increasingly stale obligations through extended financing arrangements
should be resisted. Aren't we already saddling our children and their children with enough "clean up" costs? Adopting a policy of paying for employee benefits as they accrue would make the full cost of employment more visible and may provide a catalyst for more careful evaluation of personnel needs.

Budget decisions are improved when discussion of new program initiatives and expansion of current activities is conducted within the context of known and potential competing claims on the resource bases of the state. Currently, scant attention is given to long term liabilities beyond their direct claim on the biennial budget under review. Since government accounting requirements do not stipulate that currently accruing liabilities be shown "on the books," it is very easy to overlook future budgetary claims. In addition, as discussed earlier in the report, the hidden costs of employment (pension and retirement health benefits) can give a mistakenly cheap appearance to the cost of adding personnel.

The results of this study provide several pieces of information about property taxation in Maine. First, most communities in Maine do not face property taxes that may be termed excessive by national, comparative standards. However, some communities face property taxes for either schools or non-school purposes or both that are exceedingly high relative to neighboring jurisdictions and the state wide average.

The National Conference of State Legislatures has suggested that states interested in meeting the fiscal challenges of this decade adopt a strategy called "targeting," wherein resources are carefully used to address specific state priorities, rather than being broadly distributed as has often been done in the past. This analysis reveals opportunities to target both municipal revenue sharing and school aid to enhance taxpayer equity, promote equal educational opportunity, and enhance the ability of local governments to provide much needed services.

The very low tax effort for schools of some Maine communities goes beyond the issue of targeting, however.
The issue is not simply redirecting resources to someone else that would otherwise have gone to them, but additionally, requiring them to pay their fair share towards educating Maine children. The growing reluctance of some Maine communities to meet reasonable financing obligations for schools— even when their mil rate is no higher than average— raises a serious concern, particularly in these times of state funding retrenchment.

The Maine Constitution is very specific in stating that state government must require the towns to pay for the broad diffusion of education. The time may be here for Maine to once again consider a state levied property tax for schools that will require a minimum effort of everyone, regardless of the number of children to be educated in their particular community, to share in financing Maine’s schools.

The current teachers’ retirement system financing arrangement, under which the state pays the entire employer’s share regardless of a school district’s own capacity to finance the expense, helps to perpetuate low tax effort of some districts, while also denying sorely needed aid to the high tax effort districts. Including funds currently allocated for the teachers’ retirement system with general purpose education aid would greatly enhance the opportunity to achieve equity gains, as some other states have already learned.

The magnitude of salary differences among school districts discussed in Chapter 5 raises at least two issues. First, higher salaries mean that the state must make a larger retirement contribution on behalf of teachers in those districts. Second, resources are used differently in various districts. Although there is much to be said for "local control," when state aid dollars are going to one district to subsidize what may be the highest salaries in the state while another district has very low salaries and high tax effort, something is out of kilter.

From the perspectives of both educational quality and cost efficiency, we need to get inside Maine’s schools and see how they use resources. The simplistic "per pupil expenditure" approach to budgeting for education at the state level and assessing sufficiency of resources is
inadequate and also expensive, because it ties state budgets to aggregate spending behavior.

In the short term, it would not be difficult to build some "cost checks" into the state's process of approving school district budgets for subsidy. Currently, administrative costs are capped at a percentage of budget, which is a step in the right direction. However, that method allows high spending districts to spend more on administration. An alternative that would foster school and potentially district consolidation would be to establish a maximum number of administrators per some specified number of teachers. Capping salaries would also be a straightforward step, for administrators, teachers, and staff. For each experience level, the state could establish a maximum salary that will be subject to subsidy. Such a step would not preclude a district from paying more, it would simply put them "on their own" for the excess.

Moving in the direction of establishing maximum levels for reimbursement of spending on various resource inputs in schools would foster accountability, because then the "local appropriation without subsidy" that districts raise would be for "extras." Currently, the unsubsidizable portion of spending may reflect amenities or high unit costs due to isolation, among other possibilities. In addition, and most importantly, it would permit the state to direct increasingly scarce resources at meeting pressing needs.

A responsive partnership means more than paternalism. It is a fair sharing of resources, at a level that matches measured needs and recognizes the strengths and limitations of the inelastic property tax. Not only today, as the state seeks to reduce state level expenditure, but in the future, when many costly infrastructure investments must occur at the local level, answering the question of "who can afford to pay and how much" promises to be a crucial element of efficient and equitable state aid decisions.

Although a significant amount of detailed school district budget data is collected by the state Department of Education, no other local fiscal data is systematically collected. Tracking local finances and developing

*Develop a local government financial monitoring system.*
estimation models that are able to differentiate necessary from amenity expenditures will provide fundamental building blocks for shaping sound intergovernmental fiscal policies. It would be expensive to fully develop a full scale capacity in-house. However, it is possible to enhance state legislature’s capacity by joining forces with the University of Maine system for training and technical assistance. An arrangement wherein part of one or more faculty persons’ time could be divided between teaching and other university responsibilities and state government duties may be worth exploring in not only this area, but others such as forecasting, budget development and special projects.

In closing, we would like to say that there is a lot of work ahead, but we saw evidence throughout Maine state government of people who are ready and willing to do what needs to be done. We look forward to the opportunity to dig in and help!
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