

# MONEY MATTERS...\$...\$...\$

FOR KIDS, FOR COMMUNITIES, FOR KENTUCKY

A Fiscal and Budget Policy  
Research Brief

Author: Rick Graycarek  
Director, State Fiscal  
Analysis

Why use personal income and gross state product as units of comparison? Both broadly measure the economic health of the state. Many economists agree that state government spending should closely follow these measures. Using inflation and population growth are less meaningful measures.



*This KYA report is funded through the Ammie E. Casey Foundation, Open Society Institute, Stoneman Family Foundation, and the generous support of local benefactors. Contents of this report are the sole responsibility of Kentucky Youth Advocates.*

## KENTUCKY GOVERNMENT GROWING SLOWER THAN THE STATE ECONOMY

- Purpose** To clarify incomplete statements that suggest Kentucky state government spending has grown excessively in recent years.
- Kids Matter** Efforts to cut programs and services, even those for children, are sometimes justified by the erroneous notion that government spending (executive, legislative, and judicial branches) has grown excessively.
- Summary** Since 1991, Kentucky state government spending has grown more slowly than the state's economy. Measured by comparing state general fund expenditures to personal income and gross state product growth, state government spending has not out-paced the economy. It grew more slowly.

According to some, Kentucky's state government spending has grown without restraint. To support their claim they report that state government spending has more than doubled over the past ten or so years. While this figure may be true, it only tells part of the story.

Here's an example of how this type of "analysis" works. Assume I tell you that power plants are raking in money hand-over-fist. As evidence I point to the fact that my electricity bills doubled over the past year. What does that tell you? On the surface it says that I pay a lot more for my electricity now than I did last year. It says nothing, however, about whether power plants are the cause or not. My electricity bills *could* have increased because of higher prices, but it could also be due to other factors.

As Paul Harvey says, "here's the rest of the story." Suppose now I tell you that I bought a house this year. I explain that I lived in a one-bedroom apartment

the prior year. That means my electricity bills rose, in large part, because I moved from a small apartment to a house. Consequently, I had more living space to heat and cool. Power plants, in this instance, were not charging me excessive rates—I simply purchased more electricity because the size of my residence grew.

### Analysis

Reports that state government spending have grown excessively are similarly one-dimensional and, as a result, misleading. Here are the details.

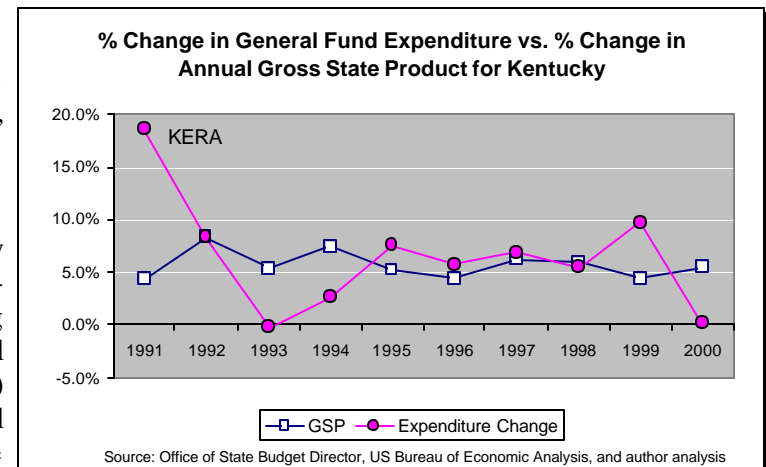
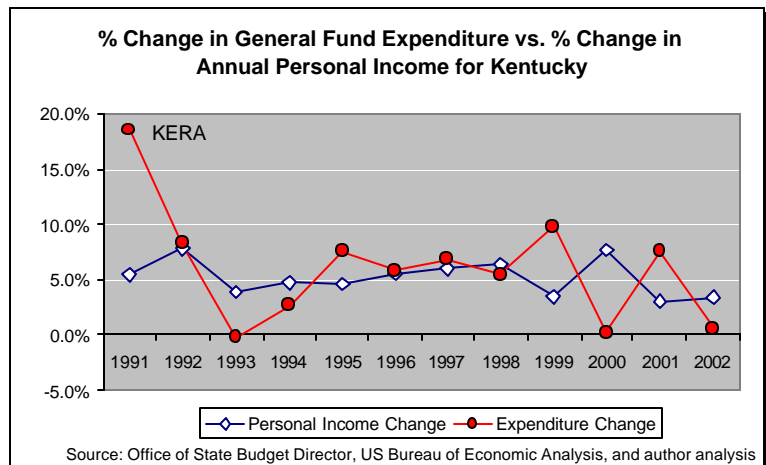
In order to determine whether state government spending has outpaced the economy, we need to know two things: 1) how much expenditures have grown; and 2) [the part others frequently leave out] how fast expenditures should grow. Comparing how fast government grew to how fast government should grow allows us to objectively analyze the growth of state government.

To do this, economists often compare state expenditure growth to personal income or gross state product growth. Why? Both measures place government spending within the context of economic activity. By comparing state government spending versus personal income and gross state product changes we can determine if state government has grown faster, slower, or at the same rate as the economy.

Let's start by looking at state government spending (measured as general fund expenditures) compared to annual personal income. (See Graph 1.) We find that changes in state government spending frequently followed annual personal income changes. The notable exception was 1991. That is the year education reform was enacted in Kentucky, along with a corresponding tax increase to pay for it. Looking at the entire 1991-2002 period we find that personal income grew by 73.5 percent, while state government spending grew by 69.1 percent. That means personal income grew 4.4 percentage points faster than state government spending.

Next, let's look at gross state product. (See Graph 2.) We find a similar pattern. The exception again was 1991. When looking at the 1991-2000 period (the latest year data was available), gross state product grew by 67.3 percent, while state government spending grew by just 56.4 per-

Graphs 1 and 2



cent. That means state government spending grew more slowly than gross state product over this time period. (The graphs show annual changes.)

**Conclusion**

State government spending has not grown without restraint since 1991. In fact, growth has been limited to less than the growth in the state's economy as measured by personal income and gross state product. Comparing the change in state general fund expenditures to the change in annual personal income shows that state government spending grew 4.4 percentage points more slowly than personal income. Comparing the change in state general fund expenditures to the change in gross state product shows that state government spending grew 10.9 percentage points more slowly.



**Personal income** represents the "pocketbook" measure of a state's well-being. That is, the amount of income an individual or household earns.

**Gross state product (GSP)** measures the value added in production by labor and property located in a state. For example, the value of a Ford Explorer built in Louisville (less any parts built outside of Kentucky) would be included in GSP.