House and Senate Phase 2 Budget-Balancing Proposals: Comparison and Analysis

General Fund Changes – Phase 1 ($ in millions)	FY 02-03	FY 04-05
One-Time Resources	1,345	0
One-Time Spending Reductions	131	0
Permanent Spending Reductions	374	721
Additional Spending Reductions (inflation)	0	1,127
TOTAL:	**1,850**	**1,848**
Remaining Problem:	**-439**	**-1,369**

On February 21, the House and Senate passed an agreement that addressed Minnesota's 2002-03 budget deficit and made a dent in the deficit in 2004-05. This "Phase 1" proposal relied largely on one-time resources in the current biennium and on spending reductions in the next biennium.[1] However, the February Forecast showed that the deficit has grown, and additional work is needed to balance the budget in what is being called Phase 2. The House and Senate Phase 2 plans are very different both in approach and size. The two plans are described in more detail below and measured against our principles for fiscal decisions.[2]

General Fund Changes – Phase 2 **($ in millions)** Parentheses indicate an *increase* in general fund spending.	Senate		House	
	FY 02-03	FY 04-05	FY 02-03	FY 04-05
One-Time Resources	**801.7**	**140.9**	**325**	**0**
Cash Flow Account	155			
Workers Compensation Special Fund	52			
Tobacco Endowments			325	
Transportation refinancing	245.2			
K-12 timing shift	312.5	3.9		
County Social Services shift	36.9			
Delay June Accelerated Sales Tax Repeal to 2006		137		
Permanent Spending Reductions	**(30.1)**	**(242.3)**	**119.7**	**312.1**
K-12 Education	(16.2)	(3.2)	(0.2)	
Family & Early Childhood Education			6	15.2
Higher Education	(5)			
Education Reserve Account*		(209)		
Human Services	(0.4)	0.2	57	242
Environment			10	20
Judiciary/Corrections	(0.9)	15.2	1.7	5.3
Economic Development			8	6
State Government		0.3	17.2	23.6
Hiring Freeze & Contracts Moratorium	(7.7)	(15.4)	20	
Revenue Increases	**222.5**	**507.9**	**0**	**0**
Cigarette and Tobacco Taxes	174.4	375.9		
Other Tax Changes	48.1	132		
TOTAL:	**994**	**406.5**	**442.7**	**312.1**
Size of Problem:	**-439**	**-1,369**	**-439**	**-1,369**
Bottom line:	**+555**	**-963**	**+5**	**-1,057**

* Can be used for K-12 education aid or higher education funding.

[1] See Minnesota Budget Project, *Analysis of the House-Senate Budget Agreement*.
[2] The Senate plan is as passed the Senate Floor and amended to HF 3270. The House plan is made up of HF 766 (Environment & Natural Resources), HF 2515 (Health & Human Services), HF 2902 (Family & Early Childhood Education), HF 3011 (Jobs & Economic Development), and HF 3270 (State Government).

Revised April 10, 2002

The Senate uses a combination of one-time resources and revenue increases to address the remaining 2002-03 deficit. These mechanisms provide sufficient resources to restore $30 million of spending cuts and to leave a positive balance of $555 million, $538 million of which would be used to partially restore the state's Budget Reserve.[3] The House uses $325 million from the tobacco endowment and $120 million in additional spending cuts to reach a positive balance of $5 million, with no provisions for restoring the Budget Reserve. For 2004-05, the Senate restores $242 million in funding while the House makes an additional $312 million in cuts, with both proposals leaving a negative biennial balance close to $1 billion.

Reserves and One-Time Resources

The Senate plan draws on a number of one-time funding sources:

- $155 million of the Cash Flow Account, which normally is used to address short-term cash flow problems during the year. This leaves the account empty, as $195 million was used in Phase 1.[4]
- $52 million from the Workers Compensation Special Fund.[5]
- $245 million in previously authorized transportation projects would be funded by bonding, rather than general fund dollars.

The Senate plan makes additional revenues available in 2002-03 by changing when payments are made to local units of government. Currently, major appropriations to schools are made with 90% of the appropriation coming in the current fiscal year and 10% in the next fiscal year. Under the Senate plan, 85% would be paid in the current fiscal year and 15% in the next. Changes would also be made to the way in which counties receive community social services funding. These payments currently are paid to counties in four installments. Under the Senate proposal, counties would receive these funds in one payment on or before July 10. It is not yet clear what the impact of these funding delays will be on local governments. A final shift of $137 million occurs in the 2004-05 biennium by further delaying the repeal of the June Accelerated Sales Tax Payment until 2006.[6]

The House does not draw on the resources mentioned above, but instead would use $325 million from the state's tobacco use prevention and local public endowment to address the 2002-03 deficit. This is estimated to reduce the amount of funding for statewide tobacco prevention grants from $17.8 million to $1.5 million, but maintain the approximately $4.4 million per year for local tobacco prevention grants and local health promotion.[7]

Expenditure Changes

In Phase 1, $374 million in permanent spending cuts were made in 2002-03 and $1.8 billion in 2004-05.[8] The Phase 2 plans take different directions. The Senate plan restores $30 million of cuts in 2002-03 and $242 million in 2004-05. In contrast, the House cuts an additional $120 million in 2002-03 and $312 million in 2004-05.

---

[3] This balance does not take into account the fiscal impact of other proposed legislation, such as debt service for bonding or anti-terrorism initiatives.

[4] Phase 1 allowed for access to the state's tobacco endowments for cash flow purposes.

[5] The Workers Compensation Special Fund was created in the 2000 legislative session when $325 million was transferred out of the Assigned Risk Plan (which provides workers' compensation coverage to employers who are unable to purchase coverage in the private insurance market). Phase 1 drew upon $95 million from the Assigned Risk Plan and $230 million from the Workers Compensation Special Fund to address the 2002-03 general fund deficit.

[6] Currently merchants must remit a portion of their estimated sales tax collections for June in advance, which moves some sales tax revenues into the prior fiscal year. Under existing law, this provision will be repealed in 2004.

[7] House Research, HF *2515 Bill Summary*.

[8] Of the $1.8 billion in cuts for 2004-05, $721 million comes from targeted reductions, a hiring freeze, and contracts moratorium, and $1.1 billion from eliminating discretionary inflation.

The House makes the bulk of its cuts in the Health and Human Services area, with a $57 million general fund reduction in 2002-03 and a $242 million cut in 2004-05. The reductions include:

- Consolidating the General Assistance Medical Care (GAMC) and MinnesotaCare programs, which would mean loss of health care coverage for some people currently on GAMC and more expensive coverage for some making the transition to MinnesotaCare
- Reducing the "covering all kids" health insurance expansion
- Limiting access to General Assistance to 6 months out of a 24-month period
- Limiting access to Emergency General Assistance to one month in an 18-month period
- Limiting access to Emergency Assistance to one month in an 18-month period
- Lowering the income level at which families leave the Minnesota Family Investment Program (MFIP) and limiting access to a second year of education and training for MFIP participants

The impact of these changes go beyond the general fund reductions, and involve cuts in federal Temporary Assistance for Needy Families (TANF) and state Health Care Access Fund (HCAF) dollars. For example, the limitations on Emergency Assistance save only $98,000 in general fund dollars in 2004-05, while cutting $9.7 million in TANF funding for the program. Cuts in these funding streams do not help address the general fund deficit.

In the Senate plan, the largest changes are made to education. The Senate transfers $209 million in the 2004-05 biennium from the general fund to the education reserve account, which can be used for both K-12 education aid and Higher Education.

In Jobs and Economic Development, the Senate makes no changes. The House cuts an additional $8 million in 2002-03 and $6 million in 2004-05. Much of the reduction comes from transferring the interest on the 21st Century Fund into the general fund, but cuts are also made to such programs as the Jobs Skills Partnership, Youth Intervention Program, Minnesota Youth Program, three housing programs, and the Historical Society.[9]

In Family and Early Childhood Education, the House makes an additional $6 million in cuts in 2002-03 and $15 million in 2004-05. These reductions come from limiting the size of reserve accounts that Early Childhood Family Education (ECFE) programs may have, and making cuts to Basic Sliding Fee child care, child care service grants, and Adult Basic Education. The Senate makes no changes.

For 2002-03, the Senate plan restores $5 million of funding to in Higher Education for State Grants and $1 million in Corrections for the Crime Victims Ombudsman and Battered Women Shelters per diems.

Phase 1 contained a $35 million reduction in contract expenditures and a $40 million hiring freeze in 2002-03. The Senate plan reduces the contracts reductions to $27.3 million and excludes the following agencies from the moratorium: Minnesota State Colleges and Universities (MnSCU), the Higher Education Services Office, Department of Corrections, and Department of Human Services with respect to contracts for state operated services. The Senate further exempts employees of state correctional facilities and employees of state operated services under the Department of Human Services from the hiring freeze. The House increases the contracts moratorium and hiring freeze by an additional $10 million each in 2002-03. New

[9] Cuts are in 2004-05 only for the Youth Intervention Program, Minnesota Youth Program, Historical Society, and two of the housing programs.

exemptions from the moratorium are made for contracts needed to avoid a disruption of essential state functions or to avoid a legal liability, and contracts paid for entirely with federal or certain highway funds. In terms of the hiring freeze, the exemption for work-study students is expanded to include all student workers, and would include positions that are entirely paid for by federal funds or non-state entities.

The State Government portion of the House plan makes additional cuts to the legislature, Attorney General, Secretary of State, Department of Administration, State Arts Board, and Humanities Commission. It also assumes $2 million in savings in 2002-03 and $10 million in 2004-05 by reorganizing the structure of state agencies, although these numbers are somewhat in question.

Revenue Increases

The Senate plan raises $223 million of revenue in 2002-03 and $508 million in 2004-05. The largest portion of the revenue comes from increasing cigarette taxes by 30¢ per pack on May 1, 2002, and by an additional 30¢ on January 1, 2003, for a total of $1.08 per pack. The taxes would be then indexed for inflation starting June 1, 2004. Taxes on tobacco products are also increased. This raises $174 million in 2002-03 and $376 million in 2004-05.

The tax bill would also end income tax reciprocity with Wisconsin and would partially restore the 4D program, which provides property tax reductions for affordable rental housing. The House plan has no tax provisions.

How Do These Plans Measure Up?

We have argued that tough choices are needed to address the state's budget deficit, but they can be smart choices. Under Phase 1, the use of reserves in the current biennium lessens the blow from the expenditure cuts, but the impact of those cuts will be serious, and in 2004-05, the reductions are even more severe. The task in Phase 2 is to bring the budget back into balance without further harming vulnerable Minnesotans.

The state's budget-balancing decisions should not make the recession worse for those Minnesotans least able to weather the downturn, including low-income families, laid-off workers, and other vulnerable populations.

Phase 1 mainly avoided serious reductions in 2002-03 in programs helping low-income families, laid-off workers, and other vulnerable populations, although it is not yet clear what impact the large cuts in state government will have for the provision of services. Given that the cuts for 2004-05 are larger but even less well-defined, we cannot say at this point whether the goals of not harming low-income and other vulnerable populations will be achieved in the next biennium.

The House Phase 2 plan makes deep cuts in safety net programs for the most vulnerable Minnesotans, including the disabled, welfare recipients, and children without health insurance. It clearly violates the principle that state budget-balancing decisions should not increase the burden on vulnerable Minnesotans.

The state should use a combination of the three primary budget-balancing tools available: raising revenue, using reserves, and cutting spending.

In Phase 1, only two of the three available tools are used. The House Plan continues to use only one-time revenue sources and painful spending cuts to deal with the 2002-03 deficit. The

Senate Plan takes a positive step by using revenues to address the deficit and by providing resources to start rebuilding the reserves.

However, not making the recession worse for vulnerable Minnesotans also means paying attention to tax fairness. A large portion of the revenue raised under the Senate plan comes from regressive cigarette and tobacco taxes, which will hit low-income taxpayers the hardest. As policy-makers work towards a compromise solution, they should consider softening the blow on low-income taxpayers. If the cigarette tax proposal is enacted, it should be coupled with an expansion of one of the state's existing refundable tax credits for low-income families, such as the Working Family Credit. Policy-makers should also consider other options, such as an income tax surcharge, that could raise needed revenue without disproportionately burdening low-income taxpayers.[10]

Budget-balancing should be informed by past budget decisions, including how surpluses were divided between tax cuts and new spending, who benefited from recent tax cuts, and how certain programs were underfunded even in times of surplus.

During last five legislative sessions, almost no surplus dollars went to areas critical to Minnesota's struggling families. In many years, the Health and Human Services and Children and Families areas contributed more to the surplus than they received: existing state funding for family support programs was replaced by federal TANF dollars, and the resulting state savings was added to the already substantial surplus.[11] Yet these two funding areas receive large cuts under the House Phase 2 plan. These crucial supports for Minnesota's families did not benefit during the years of surplus, were significantly cut in Phase 1, and should not be cut further.

Of over $13 billion in surpluses allocated during the last five legislative sessions, the majority (53%) went for rebates and permanent tax reductions. A large part of the tax reductions were in Minnesota's progressive income tax. Unfortunately, now that tax increases are needed, policy-makers have been looking to our more regressive taxes, including tobacco taxes, and in other legislation, the gas tax. While we have strongly supported the use of revenue raisers to balance the budget, we encourage closer attention to tax fairness.

Next Steps

Between the two choices currently available, the Senate Phase 2 plan is more in tune with the fiscal principles we have suggested. However, policy-makers should look beyond the plans as they currently exist and reach a budget solution that does not disproportionately affect vulnerable Minnesotans. We encourage a second look at progressive revenue options.

There is no question that difficult choices are ahead. However, by looking at the full range of options available, and considering the impact on vulnerable Minnesotans, policy-makers can make budget-balancing decisions that put the state on the right track while not increasing the recession's burden on those who are hurting most.

[10] See Minnesota Budget Project, *Options to Address Minnesota's Budget Deficit*.
[11] Children's Defense Fund-Minnesota and Minnesota Budget Project, *Wasted Opportunities: How We Used Our Surpluses 1997-2001*.