

Governor Closes \$160 Million Budget Deficit *Long-Term Budget Shortfall Remains*

The 2004 Legislative Session ended without completion of one of its primary tasks: balancing the state's budget. As measured in February, the state of Minnesota faced a \$160 million General Fund deficit in the 2004-05 biennium and a structural deficit of \$442 million in the 2006-07 biennium. If inflation were factored into the spending side of the forecast, the 2006-07 deficit would be \$1.1 billion.

During the 2004 session, the Governor, House, and Senate each proposed plans to address the 2004-05 deficit, which are summarized in Table 1. Sharp differences over the components of budget-balancing proposals — for instance, the Senate sought to raise revenues through tightening up corporate taxes, the House by slot machines at the Canterbury Downs horseracing track (the “racino”) — in addition to strong disagreement over other policy issues led to gridlock. Ultimately, the House and Senate failed to come to agreement on any major pieces of legislation, and the session ended without passage of a deficit solution.

	Gov.'s Budget	House	Senate	Gov.'s Actions
Size of Deficit	160	160	160	160
Reserves and Fund Transfers	-91	-68	-39	-110
Spending	-22	-10	4	-43
Revenues	-47	-86	-124	-6
Total	-160	-164	-159	-159
Ending Balance (Surplus/Deficit)	0	+4	0	0

Source: Author's analysis of House and Senate Fiscal Analysis data. “Gov.'s Budget” is the Governor's Supplemental Budget proposal released in March 2004, “Gov.'s Actions” are the administrative actions taken in June 2004. Columns may not add due to rounding.

Without a legislative agreement on the deficit, Governor Pawlenty chose to close the short-term budget gap through administrative action. The Governor's budget fix relies primarily on one-time measures and leaves a significant long-term deficit in place. Although this also characterizes the budget fixes seen in the last several legislative sessions, it should be noted that the Governor's authority limits him to only short-term budget adjustments.

How Was the 2004-05 Deficit Solved?

After the 2004 session ended in stalemate, there were several options available to the Governor:

- **Leave it to the Legislature, Part 1.** The Governor could call the Legislature into special session to try to balance the budget. Unlike recent years in which special sessions were used to finish the session's business, in 2004 it was not an issue of the Legislature running out of time, but rather of having seemingly irreconcilable differences. Efforts to negotiate a special session agenda have so far failed.
- **Leave it to the Legislature, Part 2.** The Governor could take no action and let the Legislature try to balance the budget in 2005, since the Constitution simply requires that the budget be balanced by the end of the biennium. Waiting until 2005 would present the Legislature with a significant challenge, as just six months of the biennium will remain when the 2005 Legislature convenes on January 4, 2005.
- **Budget Reserve.** The Governor could use a portion of the state's \$631 million Budget Reserve to solve the deficit. During the session, policymakers expressed reluctance to use

the Budget Reserve, often stating a concern that such action would further damage the state's credit rating. Generally accepted budget principles suggest that reserves should be built up during good economic times, rather than depleted.

- **Governor's Discretion.** The Governor could use his existing discretion to balance the budget.¹ This is the option he chose.

The Governor took five administrative actions to resolve the 2004-05 budget deficit, as shown in Table 2. The largest part of the deficit fix is the **reduction of a scheduled transfer to the Health Care Access Fund.**² This action does not trigger any immediate changes in health care programs, although it does cut off options for improvements in health care. It also increases the 2006-07 General Fund deficit.

A \$115 million transfer from the General Fund to the Health Care Access Fund has its origin in a temporary increase in federal Medicaid dollars that Minnesota received in a fiscal relief package authorized by Congress in May 2003. The fiscal relief freed up state General Fund resources, which were used to mitigate some of the cuts made to health care programs in the 2003 Legislative Session — the state was able to avoid some payment shifts, postpone certain eligibility reductions, and limit benefits less severely.³ Because some of the health care spending that the fiscal relief made possible would come out of the Health Care Access Fund (HCAF), the state planned to transfer \$115 million in General Fund savings into the HCAF.

As part of his solution to the 2004-05 budget deficit this year, the Governor reduced the scheduled \$115 million transfer to the HCAF to \$5 million. This does not have any immediate impact on health care programs: all of the scheduled health care spending that the federal funds made possible will still occur.

The Governor's action does have an impact on future HCAF transfers and the state's long-term deficit. Legislation passed last year scheduled transfers of certain amounts from the HCAF to the General Fund at the end of the 2005, 2006, and 2007 fiscal years.⁴ The Governor's action reduces the amounts available to be transferred. The net General Fund result is an increase of \$110 million in 2004-05 but a \$44 million reduction in 2006-07.

While the Governor's action results in a \$0 balance in the HCAF in FY 2006 and FY 2007, this does not trigger any changes in MinnesotaCare. In 2003, legislation made MinnesotaCare a "forecasted" program through FY 2007, meaning that if it appeared that the HCAF was going to

Size of Deficit	160
Reserves and Fund Transfers	-110
Reduce Health Care Access Fund transfer	-110
Spending	-43
Cut agency budgets by 3%	-17
Delay June bond sale	-18
Save debt service - no bonding bill	-8
Revenues	-6
Increase tax compliance	-6
Total	-159
Ending Balance (Surplus/Deficit)	0

Source: Author's analysis of House Fiscal Analysis data. Columns may not add due to rounding.

¹ The Governor used administrative tools that are regularly available to him, rather than the special powers available under unallotment that were used to balance the 2002-03 deficit in 2003.

² The Health Care Access Fund (HCAF) is primarily funded by the health care provider tax and MinnesotaCare premiums. It funds MinnesotaCare and certain other health care access activities. MinnesotaCare provides subsidized health insurance coverage to low- and moderate-income families and individuals.

³ See Minnesota Budget Project, *How Did Minnesota Use Its Federal Fiscal Relief?*, www.mncn.org/bp/fedfiscal.htm.

⁴ The original transfer amounts were up to \$192 million in FY 2005, up to \$53 million in FY 2006, and up to \$59 million in FY 2007.

run a deficit, the transfers described above would be reduced in order to fully fund MinnesotaCare under current program parameters. Previously (and starting again in FY 2008), if there was a deficit in the HCAF, the administration was required to make reductions in MinnesotaCare in order to accommodate the amount of resources available.

Even though there is no immediate impact on the state's health care programs, the Governor's action cuts off options to improve health care. As the Health Care Access Fund is dedicated to health care, many believe that any positive HCAF balances should be used directly for health care programs, perhaps by reversing past reductions in coverage or eligibility. There is also concern that some may see the zero balance in the Health Care Access Fund as evidence for a need for additional cuts in MinnesotaCare, although the zero balance is caused by transferring money out of the HCAF, not by growth in health care spending. And finally, the reduction of HCAF resources leaves little flexibility to respond to future increases in need, which could put health coverage at risk when MinnesotaCare is no longer forecasted starting in FY 2008.

The second largest part of the deficit solution is \$43 million in spending cuts. In his Supplemental Budget, the Governor proposed a **3% cut to state agencies' operating budgets**, with exceptions made for small agencies and the Department of Corrections. As part of his administrative budget fix, the Governor instructed state agencies to implement the proposed reductions, with additional exemptions for the Department of Military Affairs and Department of Veterans Affairs.⁵ These reductions cut FY 2005 spending by \$17 million. Because agencies have discretion as to how to implement the cuts, it is not known what the specific consequences of the reductions will be. The intent is to reduce operating costs through actions such as holding vacant positions open, travel restrictions, etc. But after cutting agency budgets three sessions in a row, one can expect there to be some impact on the quality of government services.

The other two spending reductions relate to debt service.⁶ The February Forecast anticipated that an average-sized bonding bill of \$530 million would be passed in the 2004 Legislative Session and included a corresponding amount of debt service. However, the Legislature was unable to come to agreement on bonding, and therefore the Governor's deficit fix includes **savings from no 2004 bonding bill** of \$8 million in 2004-05 and \$73 million in 2006-07. The inability to proceed on some bonding projects may mean a loss of other revenues. For example, the House, Senate, and Governor had all agreed to provide some funding for a wetlands restoration program in the 2004 bonding bill, which would leverage federal funds. But since no bonding bill was passed, at least some of the federal funds will be lost due to delays in implementing the program and the federal funding expiring in September 2007.⁷

Secondly, a **bond sale is delayed** from June to August 2004 for items approved in past bonding bills. This saves the state \$18 million in debt service in 2004-05, although these costs are shifted into the future. Previously-authorized bonding projects are affected by funding being delayed by a few months — no projects are cancelled by this action.

The Governor was not able to fund any of the spending initiatives he outlined in his Supplemental Budget, including his judiciary proposals relating to methamphetamine ("meth") and sex offenders.

⁵ For the amount of cut for specific state agencies, see House Fiscal Analysis, *Governor Pawlenty's Directives to Balance the FY 2004-05 General Fund Budget*, www.house.mn/fiscal/files/04gvbbal.pdf.

⁶ When the state borrows money for infrastructure projects, it does so by issuing bonds. The cost of paying back the principal and interest is called debt service.

⁷ AgriNews, *Wetlands program in limbo because of lawmakers' inaction*, May 26, 2004.

The Governor does not have the power to make tax changes administratively — legislative action is required — so his administrative budget actions do not include the \$47 million in additional revenues included in his Supplemental Budget proposal. However, the Governor’s budget fix does count on additional revenue expected from **increased tax compliance**. The Department of Revenue is directed to reallocate resources from other parts of their budget to compliance. Additional compliance efforts will focus on lawful gambling taxes, insurance taxes, corporate franchise taxes, and sales taxes; identifying non-filers of business taxes; and increasing collection of delinquent taxes.⁸ These activities are anticipated to increase General Fund resources in 2004-05 by \$6 million. The administration should be commended for the focus on compliance. When times are tight, it is more important than ever that the state collect the revenues it is legally owed.

No Progress Made on 2006-07 Deficit

Ongoing budget holes even in a good economy points to a disparity between the state’s system of raising revenues and the cost of meeting the state’s commitments. Unfortunately, once again a one-time solution has been implemented that leaves the long-term deficit in place.

None of the budget plans put forward in the 2004 session made a serious attempt to solve the 2006-07 deficit, as shown in Table 3. Spending cuts allowed the Governor’s Supplemental Budget proposal to shave \$108 million off the long-term deficit, while service cuts and projected racino revenues in the House’s plan would have eliminated over half of the \$442 million official deficit. Although the Senate’s budget plan would raise \$282 million in revenues, the funding was largely used to restore cuts made in 2003, and left the 2006-07 deficit largely unchanged.

	Gov.’s Budget	House	Senate	Gov.’s Actions
Size of Deficit	442	442	442	442
Reserves and Fund Transfers	0	0	39	44
Spending	-89	-60	230	-73
Revenues	-19	-121	-282	-16
Total	-108	-181	-13	-44
Ending Balance (Surplus/Deficit)	-335	-261	-429	-398

Source: Author’s analysis of House and Senate Fiscal Analysis data. “Gov.’s Budget” is the Governor’s Supplemental Budget proposal released in March 2004, “Gov.’s Actions” are the administrative actions taken in June 2004. Columns may not add due to rounding.

When he used his discretionary authority to solve the 2004-05 deficit, the Governor was unable to make much headway against the 2006-07 deficit. Reduced HCAF transfers increase the deficit, while debt service savings from the lack of a bonding bill and ongoing revenues from compliance measures improve the long-term fiscal picture. The net result is a \$44 million reduction in the 2006-07 deficit.

Opportunities Lost in 2004

The fact that policymakers could not come to a legislative deficit solution in the 2004 session means several opportunities were lost:

- Policymakers lost the opportunity **to address the 2006-07 deficit**. This means that the Legislature will convene in 2005 and face a budget deficit for the fourth year in a row.

⁸ This compliance initiative is similar to, but smaller than, proposals passed in 2004 by both the House and Senate.

- The lack of a 2004 bonding bill means a loss both of the opportunity **to make investments in Minnesota's future** and **to leverage other resources**, such as federal matching funds.
- The opportunity was lost to **reverse some of the worst cuts made in 2003**, such as dramatic fee increases for parents of disabled children, lost health care coverage, or benefit cuts to families making the transition from welfare to work who happen to live in public housing or that include disabled family members.⁹
- And once again, continued allegiance to the “no new taxes” pledge means that policymakers lost the opportunity **to use revenues to address the state's ongoing budget shortfalls**.

The lack of a legislated budget resolution is not all bad. Many undesirable ideas on the table were also avoided, such as cutting the Renter's Credit, reducing payments to nursing homes and other health care providers, or providing new corporate tax cuts.

What Happens Next?

Under current estimates, the 2004-05 budget has been balanced. However, in past years budget balance has proven ephemeral, with new deficits reappearing with the release of the November Forecast. While recent economic news has been positive, previous forecasts have already assumed the state's economy would see strong economic growth and found that a deficit would still exist under those conditions. It is possible that the November 2004 Forecast will show that some additional work will be needed to maintain budgetary balance in the current biennium.

Minnesotans are experiencing the consequences of deep service cuts made as part of past deficit solutions. We are also paying more for government services through increased fees, tuition, and copayments.

Minnesota faces a 2006-07 budget deficit that measures over \$1 billion when inflation is included. Policymakers will have to make a crucial decision: will they make the necessary reforms so that the state can fairly raise the funds needed to sustain government services and balance the budget in the long term? Or will they stick to the “no new taxes” pledge and put together yet another budget that relies on one-time measures and gimmicks to put off the hard choices and make the future problem even worse?

Sources: This document relies on data from House Fiscal Analysis.¹⁰ The opinions expressed in this document are those of the author.

⁹ For more on these issues, see Minnesota Budget Project, *Consequences: The Impact of Minnesota's Government Budget Cuts*, www.mncn.org/bp/consequences.htm and “Do-Nothing” Session Mixed Blessing for Health and Human Services, www.mncn.org/bp/2004hhs.htm.

¹⁰ House Fiscal Analysis, *Governor Pawlenty's Directives to Balance the FY 2004-05 General Fund Budget*, www.house.mn/fiscal/files/o4gvbbal.pdf and *Health Care Access Fund (HCAF) Transfer Issues*, www.house.leg.state.mn.us/fiscal/files/ibhctxfr.pdf.