

Round Two: Governor Increases Use of One-Time Resources in Revised Budget

*February Forecast
shows deficit grows to
\$6.4 billion*

Governor's Revised Budget Proposal Offers Short-Term Fix for Long-Term Budget Problems

The real work of the 2009 Legislative Session – balancing the state's budget for FY 2010-11 – began in late January when Governor Pawlenty released his initial budget proposal. Since then, however, the passage of the American Recovery and Relief (ARRA) act by Congress and the release of the February Economic Forecast have resulted in some significant changes to the state's budget situation.

The passage of the ARRA, also known as the federal stimulus bill, was positive news for the state. It meant the federal government would provide approximately \$2.6 billion that can be used to help close Minnesota's budget deficit. Although the assistance is short-term, it will help to take the edge off of the current economic crisis.

The one-time infusion of federal money, however, will not cure the increasingly ailing state economy. The February Economic Forecast reveals just how bad the state's fiscal crisis is: Minnesota has underperformed the national economy for the last two years, the state's unemployment rate has reached the highest levels in 26 years and experts expect Minnesota will lose another 48,000 jobs before the recession ends.

As a result, the February Economic Forecast projects that the FY 2010-11 deficit is now \$6.4 billion – up from the \$4.8 billion reported in November. The deficit equals 17 percent of the general fund budget. The state, however, automatically qualifies for a portion of the federal stimulus dollars, reducing the size of the problem facing policymakers this session to \$4.6 billion.

Facing a substantially changed economic and state budget outlook, in mid-March Governor Pawlenty released a revised budget. One might have expected the Governor to significantly rework his budget proposal to reflect these major changes. Instead, the Governor recommended only a few noteworthy changes, leaving most of his original proposal intact.

The Governor's revised budget proposal includes these major components:

- Heavy use of one-time resources – including federal stimulus funds, a shift in education funding and a bonding proposal.
- Net spending increases in K-12 education and portions of public safety, but significant spending reductions in other areas of the budget.
- Use of federal stimulus funds to delay significant spending reductions in higher education.
- Delays in some cuts to health care and services for low-income families because of federal requirements, but significant reductions in health care for adults without children, individuals with disabilities and health care providers.

This report takes a close look at the Governor's revised budget proposal, highlighting the major components and providing a deeper look at proposed spending reductions.

Governor's revised budget increases deficit with business tax cuts and spending initiatives

Governor's First Step is to Increase Deficit

The Governor's revised budget keeps most of the major components of his original budget proposal intact, including two elements that would actually increase the size of the state's budget deficit:

- The Governor proposes several tax cuts, including \$254 million in tax cuts for businesses. The administration hopes these tax benefits will encourage businesses to create new jobs, while acknowledging that they will not produce short-term results.
- The Governor also proposes new spending initiatives, including \$186 million for K-12 education.

Governor's reliance on one-time resources only delays the problem

Governor's Solution Relies Heavily on One-Time Resources

When it comes to reducing the size of the state's deficit, the Governor and legislators have three tools at their disposal: spending reductions, revenue increases and one-time resources. The use of all three tools is a reasonable way to approach the state's budget problems. The Governor's revised proposal relies on just two of those tools: spending reductions and one-time resources. By taking revenue increases off the table, the Governor's budget must rely more heavily on one-time resources.

This is problematic because the state's budget deficits are large, and more significantly, persistent. Minnesota not only faces a deficit in the next biennium, but another \$5.1 billion deficit for FY 2012-13, or \$6.5 billion if you include inflation. Under these circumstances, using one-time resources effectively "kicks the can down the road," pushing the bulk of the state's fiscal problems into the future.

State benefits from \$2.6 billion in federal stimulus dollars

The most significant one-time element of the Governor's revised budget proposal is the federal stimulus. When the Governor released his initial budget in late January, Congress was still in the midst of putting together the economic recovery package. The Governor's original budget proposal conservatively estimated the state would receive \$920 million from the federal government.

Now that the American Recovery and Reinvestment Act of 2009 is law, Minnesota is anticipating around \$2.6 billion in federal funds that can be used to offset the state's budget deficit. These resources are insufficient to fix the state's entire budget problem, but they will help soften some proposed spending reductions.

There are two major elements of the federal stimulus package that have an impact the state's budget deficit:

- There is an increase in the Medicaid funds the state receives from the federal government. This money comes in the form of an increased match in Medicaid spending. Normally Minnesota pays 50 percent of Medicaid costs and the federal government covers the other half. Under the federal stimulus bill, states can qualify for an increased matching rate. For Minnesota, the federal government could cover just over 60 percent of our Medicaid costs, adding up to an extra \$1.8 billion in federal funds through FY 2011.
- Minnesota is also eligible for \$816 million in state fiscal stabilization funds. About 80 percent of the funds must be used for education. The rest of the funds, approximately \$149 million, can be used for any purpose.

These enhanced federal resources, however, are temporary and most must be spent by the end of 2011. In addition, the funds come with strings attached that serve to protect critical services at a time of budget deficits, but also limit state

Short-term budget gimmicks will cost the state in the future

Governor's recommendations would leave a deficit in FY 2012-13

Revised budget still contains significant cuts to health care and important services for low-income families

policymakers' flexibility in making budget decisions.

There are two other significant one-time elements to the Governor's revised budget proposal.

- The Governor employs a timing shift that saves close to \$1.3 billion in the FY 2010-11 biennium by shifting when the state makes aid payments to schools. Currently, the state pays schools 90 percent of aid in the current year and then follows up with 10 percent in the next year, once expenses have been finalized. The Governor proposes paying schools only 80 percent in the current year, shifting more than a billion dollars into a future biennium.
- His proposal also raises \$980 million by selling bonds the state would repay using future tobacco settlement payments. Instead of paying for capital projects, as bonds usually do, the funds raised from this bond sale would be used to cover the interest on bonds sold in previous years.

Between these two proposals and the federal stimulus funds, the Governor's revised budget utilizes approximately \$4.9 billion in one-time resources to solve the current deficit, or 70 percent of his deficit solution.

The Governor's reliance on one-time resources is particularly problematic in light of a new law passed this session. The law requires the Governor to propose, and the legislature to enact, a budget that is balanced not only in FY 2010-11 (as the constitution requires), but also in FY 2012-13. Meeting the requirements of that new law in a responsible way necessitates the use of more long-term solutions for solving the budget deficit. Alternatively, if policymakers make one-time resources a centerpiece of solving the budget deficit in FY 2010-11, it will be significantly more difficult to solve the deficit in FY 2012-13.

The Governor's revised budget proposal faces that problem. When the Governor released his revised proposal for FY 2010-11, he also presented a set of spending "targets" for balancing the state's budget in FY 2012-13. The targets would require some dramatic spending cuts in higher education and health and human services to achieve a balanced budget in the future biennium. The Governor, however, does not present any specific budget recommendations for achieving those additional spending cuts. As a result, there is still \$2.6 billion in reductions needed to balance the budget in FY 2012-13 that the Governor has not yet explained how he would achieve.

Spending Reductions are Second Major Component of the Governor's Budget

In addition to the one-time resources, the Governor's revised budget proposal also includes significant permanent spending cuts, including nearly \$1.6 billion in health and human services.

This rest of this analysis examines the Governor's budget in greater detail, focusing on spending reductions that would have the greatest impact on low- and moderate-income Minnesotans and other vulnerable populations.

Health and Human Services

An economic downturn increases the need for temporary public assistance to help stabilize struggling families. Employers cut back on health benefits, forcing those costs onto their workers. Under-employed and unemployed families turn to food shelves to help make ends meet. Unemployed Minnesotans may find themselves temporarily on Unemployment Insurance or the state's welfare-to-work program as they try to get back on their feet.

State spending generates economic activity that is particularly important in this economic downturn. For example, the health care industry spends billions of dollars within our borders, with hundreds of thousands of Minnesotans employed in the public, private and nonprofit health care sectors. These jobs are supported, in part, by state and federal spending on health care. Reductions in state funding, therefore, will have an impact far beyond just individuals losing access to health care.

The Governor's revised budget proposal still includes significant reductions to health care and important services for low-income families, nearly \$1.6 billion. The strings attached to the federal stimulus dollars, however, did necessitate some important modifications to his proposals.

More than 60,000 adults without children would lose access to public health care

The Governor still proposes to eliminate all access to public health insurance for almost all adults without children – over 60,000 people would lose access. The only childless adults who would still be covered under public programs are the elderly, people with disabilities and a small group of people in extreme poverty (below 75 percent of federal poverty guidelines, or \$10,830 annually for a single individual).¹ For everyone else, the only alternative would be private market insurance, although the existence of any preexisting conditions would make this an unlikely option.

On top of eliminating health care coverage for many adults, the Governor's revised budget includes a new proposal that drastically limits health care services to adults, effectively shifting millions of dollars of costs onto hospitals. His proposal would restructure the General Assistance Medical Care (GAMC) program so that it would not cover hospital visits. Instead, GAMC would only cover outpatient benefits (on a fee-for-service basis). Individuals that required inpatient services would not be covered by GAMC; instead, hospitals would seek reimbursement for their expenses from an uncompensated care pool. The pool is capped and the Minnesota Department of Human Services (DHS) acknowledges it would not be sufficient to meet all the costs incurred by GAMC enrollees. The unpaid costs would be shifted onto the hospitals themselves.

Revised budget delays reductions in health care for parents

In order to meet requirements for receiving federal stimulus funds, the Governor has delayed his proposals to:

- Take all parents off of MinnesotaCare, the state's subsidized health insurance program for low- and moderate-income working families.
- Make it more difficult for parents to qualify for Medical Assistance by lowering the amount of money someone can have in a retirement account, in the value of their car and in other assets in order to be eligible, and
- Eliminate funding for outreach efforts to ensure eligible parents are getting enrolled in public programs.

All of these proposals, however, would still take effect on January 1, 2011 after the federal requirements are lifted.

Beginning in 2011, working parents in Minnesota would have very limited access to affordable health care coverage through the state. Medical Assistance would be the only option for parents, but they would need to have income less than 100 percent of federal poverty guidelines (\$22,050 for a family of four), have a child under age 19 and have less than \$3,000 in assets for a single parent (\$6,000 if there are two parents). Working parents with income above the poverty line, but without access to employer-sponsored insurance, would have to turn to private market insurance.

Governor eliminates coverage for some health care services

For the few adults who would still remain eligible for public programs (including childless adults), the Governor's revised budget continues to eliminate coverage for the following services as of January 2010: dental (except emergency), chiropractic, podiatry, occupational therapy, speech-language therapy, physical therapy and audiology services.

Plan would delay some cuts to health care for children, other cuts go forward

Due to federal requirements, the Governor's revised budget delays some of his proposals that would have resulted in more than 25,000 children losing access to public health insurance by FY 2011. The revised budget delays proposals to eliminate outreach programs and stop premium reductions, both of which would result in fewer children being insured once implemented. The Governor's revised budget also recognizes that his proposal to repeal a reform that helps children transition seamlessly from Medical Assistance to MinnesotaCare as family income increases will not take effect as quickly as initially expected.

However, Governor does not delay the repeal of certain reforms in the health care enrollment process. The result is that more than 1,000 children will lose access to coverage under the Governor's budget proposal.

Revised budget places imitations on services for people with disabilities

Minnesotans with disabilities rely on a variety of services that allow them to lead a full life or avoid institutionalization. The Governor's revised budget still includes several proposals that would significantly limit these options.

The Governor's revised budget goes forward with his plan to make several negative modifications to Personal Care Assistance (PCA), which provides more than 18,000 Minnesotans with disabilities with in-home assistance. The changes include increasing the level of disability required in order to qualify for receiving services, reducing the hours available for some recipients, restricting the use of PCA services and instituting some provider standards, all for a \$45 million reduction in state funding in FY 2010-11. The loss in resources reaches \$85 million when lost federal matching funds are included. As a result, thousands of individuals who need assistance to manage the basics of life – such as dressing and feeding themselves – would lose access to PCA services. Some have raised concerns that this proposal might be in violation of federal maintenance of effort requirements, jeopardizing \$1.8 billion in federal funds. DHS, however, maintains that this proposal is in compliance with federal rules.

The Governor also maintains his proposal that would limit help for persons with disabilities, despite long waiting lists for help. The number of slots for waiver services would be capped. These waivers – including Community Alternatives for Disabled Individuals (CADI), Developmental Disabilities (DD) and Traumatic Brain Injury (TBI) – allow people to access home-based Medicaid services instead of being moved into a more expensive and confining institutionalized setting. Already thousands are on waiting lists for these essential supports and the lists would continue to grow under the Governor's budget. At the time of publication, DHS was still attempting to confirm with the federal government whether these reductions in waiver slots would violate the maintenance of effort requirements associated with the federal stimulus package.

The Governor's revised budget still reduces the personal needs allowance for the elderly and persons with disabilities living in a group residential housing situation. These are funds residents are allowed to use for discretionary spending, such as purchasing clothing. Some individuals would have their monthly allowance reduced from \$121 to \$89 per month, a drop of 26 percent.

Health care providers are targeted for cuts in payments

The Governor's revised budget maintains his reductions in state funding for most other health and human service providers, including inpatient hospitals, mental health inpatient hospitals, basic care, transportation providers, pharmacies, nursing homes, disability services and other long-term care providers. In fact, the Governor's revised budget accelerates the reduction to long-term care managed care rates and Medical Assistance and GAMC managed care contracts: they now would take effect in October 2009 instead of January 2010.

Revised budget eliminates the Health Care Access Fund

The Governor's revised budget continues to include his controversial proposal to merge the Health Care Access Fund (HCAF) into the state's general fund. Created in 1992 to provide a public health care option for working families, the fund largely pays for MinnesotaCare, a subsidized public health care program for low- to moderate-income working Minnesotans. Funds for the HCAF are raised through health care provider taxes and premiums paid by MinnesotaCare enrollees. The proposal to direct between \$500 and \$600 million per year in provider taxes and health care premiums straight into the general fund is extremely controversial, as the resources would no longer be dedicated to funding health care for working Minnesotans.

Governor's budget undoes reforms that move children and their families out of poverty and into self-sufficiency

The state's welfare-to-work program, the Minnesota Family Investment Program (MFIP), employs a number of strategies for people to raise themselves out of poverty, including limited access to education and training, counseling, job search assistance and child care assistance. The most common reason families in Minnesota apply for cash assistance is a job loss, a growing concern in today's declining economy.

The Governor's revised budget would undo many recent reforms that have helped move families out of poverty and into self-sufficiency. However, the Governor waits to repeal these reforms until 2010 in order to maximize the federal stimulus dollars the state is able to draw down:

- Families on MFIP who have at least one disabled person in their household who qualifies for Supplemental Security Income (SSI) would still see their MFIP cash grant reduced by \$125 per month, although the change wouldn't take effect until October 2010. This would impact approximately 7,700 families. Most of these families are headed by disabled parents unable to replace the lost assistance with earnings.
- Under the revised proposal, families who receive a housing subsidy would see their MFIP cash grant reduced by up to \$100 per month (under current law, the grant is reduced by up to \$50 per month) beginning in October 2010.
- The income at which families leave MFIP would be lowered from from 115 percent of federal poverty guidelines (FPG) to 110 percent of FPG. This reduction would be implemented in October 2010.
- The Governor's proposed cuts in funding that counties use to provide employment counseling for parents on assistance. This would now take effect in July 2010.

The Governor would not delay several proposed changes that would make it more difficult for families to achieve self-sufficiency:

- His proposal makes it much more difficult for parents to pursue education or training. Under the Governor's proposal, MFIP parents are required to be employed at least 20 hours per week in order to pursue post-secondary education. Parents are being required to find work at a time when there is only one job for every three unemployed workers.²
- The Governor also continues to reduce the Work Bonus for families who

have found employment and left MFIP for from \$75 per month to \$50 per month. This not only makes it more challenging for families to pay for essential needs on low wages, but also jeopardizes Minnesota's chances of reaching federal welfare-to-work performance targets, which could result in the loss of federal funds.

- His revised budget eliminates the Integrated Services Projects, regional projects using a multidisciplinary approach to serve the most challenged families on MFIP.

Most of these proposed cuts do not directly help reduce the state's general fund deficit because they reduce spending in the Temporary Assistance for Needy Families (TANF) fund, the federal block grant to the state that pays for MFIP and other related services for low-income families. However, the Governor then uses the freed up TANF funds to replace general fund spending, also known as "refinancing." In total, the Governor would refinance \$60 million in resources that could otherwise be used to help low-income families struggling through the current recession.

Federal stimulus bill offers some temporary resources for low-income families

The Governor's revised budget also includes a few new recommendations in direct response to the federal stimulus package. The federal stimulus bill makes additional resources available for short-term, one-time assistance for low-income families. As a result, the Governor's revised budget includes \$16 million for counties to provide emergency assistance (such as rental assistance, damage deposits, utility expenses and other financial issues) to families in crisis.

The Governor's revised budget, however, would cut state funding for community action agencies in half for the next two years, about \$4 million for the biennium. This means funds intended to get into the hands of low-income people would be used instead to fill the state's budget deficit. This reduction is offset by approximately \$12 million in federal stimulus funding for community action agencies in Minnesota. State funding is supposed to return to original levels in FY 2012-13 – approximately \$8 million for the biennium – once the temporary federal stimulus dollars expire.

Working families would see increased costs for child care

For most families, access to affordable child care is a key element of staying employed. The state child care assistance program, which helps low-income parents afford child care, is an important tool in keeping families in the workforce. Unfortunately, state general fund spending for child care assistance dropped by 26 percent between FY 2000 and FY 2009.³ More than 7,000 families remain on the waiting list for child care assistance.

The Governor's initial proposal added a further strain to the system, proposing a three percent reduction in the maximum rates paid to child care providers and a three percent increase in most parental copayments. The revised budget continues to include these reductions, but delays implementation until October 2010 in order to maximize federal stimulus funding.

Once these proposals are implemented, many parents will likely face a two-fold increase in costs. Not only will they have to pay more in copayments, but it is likely that child care providers will have no choice but to pass on the cost of the growing gap between the state's reimbursement rate and their actual rate, essentially resulting in a second copayment increase for families.

E-12 Education

Minnesota has work to do to ensure all that children have the opportunity to learn and succeed. There are large racial and income disparities in educational

achievement: low-income children are twice as likely to not be ready for kindergarten compared to children from families with the highest incomes. Business leaders recognize that closing this gap is not only the right thing to do, but the smart thing to do: the Itasca Project, a group of about 40 Minnesota CEOs, asserts that reducing racial and income disparities is critical to preserving a strong economy and business competitiveness.⁴

Yet schools across the state are simply in survival mode after years of budget austerity and cuts to programs and staff. State funding to schools has declined since 2003, after accounting for inflation. As a result, school district revenues are down and dependence on local property taxes is up.⁵

The Governor's recommendations for E-12 education, including delaying payments to schools, remain virtually unchanged from his January budget proposal. E-12 education continues to be one of the few areas to receive an increase in resources in the Governor's budget. However, the additional funding is focused solely on rewarding schools that are succeeding in making progress, rather than attempting to address serious educational disparities that persist in many schools.

Federal stimulus money used to backfill cuts to E-12 education

However, the Governor's revised budget proposal first cuts state funding for E-12 education by about \$320 million in FY 2010-11, but then replaces the lost dollars with federal money. The federal American Recovery and Reinvestment Act includes approximately \$668 million over the next two years for E-12 education and higher education in Minnesota.⁶ Similarly, his revised budget includes a new \$63 million cut in state funding for special education, which is again backfilled by one-time federal economic recovery funding for special education. This is an allowable use of the federal stimulus money, as long as state funding for education does not fall below FY 2006 spending levels.⁷

The net effect of state funding cuts and backfilling with federal stimulus funds is that K-12 education would see a \$186 million increase in funding for FY 2010-11.

Shift in education funding could force schools to borrow

The Governor's revised budget still includes one of the most significant E-12 education recommendations: to artificially lower the budget deficit for FY 2010-11 by delaying payment of \$1.3 billion in state aid to school districts to the FY 2012-12 biennium. Policymakers agreed to a similar shift in state aid when Minnesota last faced significant budget deficits in 2003.

This could force some districts into drawing down their cash reserves or short-term borrowing (made more expensive by tight credit markets, as the Governor's budget points out). This measure is a short-term fix for the state's budget woes, which simply delays the deficit problem to the next biennium.

Q-Comp program is expanded

The Governor also proposes spending increases in E-12 education, including expanding the Q-Comp program to all school districts. The Q-Comp program is a 2005 initiative from the Governor that restructures teacher pay and professional development. Currently, less than a quarter of all school districts participate in Q-Comp. The Governor would require all school districts to participate.

Funding to expand Q-Comp would come from higher property taxes and state coffers. Thirty-five percent of Q-Comp funding would come from an "optional" local levy, where the school district would be authorized to increase local property taxes to pay for a portion of Q-comp. The state would contribute \$42 million in FY 2011 and \$111 million in FY 2012-13.

Governor rewards schools that are succeeding

As before, the Governor's revised proposal also includes an additional \$91 million for schools that improve test scores as part of a new "pay for performance plan." The program would reward charter schools and school districts that have increases in certain standardized test scores with more general education revenue.

In a time of extremely limited resources, the Governor directs significant new resources to schools that are succeeding in making progress, but provides little help to schools that are struggling. This imbalance will not help Minnesota eliminate educational disparities. The Governor proposes just \$10 million for a new pilot program to set up an intensive summer school for 8th graders that are tested as not yet proficient in math or reading. This pilot program would reach 2,000 students in FY 2010 and 4,000 students in FY 2011.

Expiration of one-time resources forces a shift in priorities for affordable housing

Affordable Housing

The housing market meltdown and record number of foreclosures has put housing at the forefront of many policy discussions. A safe and affordable place to live is the foundation for strong families and a healthy economy. Under the Governor's proposal, the expiration of some one-time resources combined with additional budget cuts would mean that the state's investment in affordable housing would fall by 25 percent between FY 2008-09 and FY 2010-11.

The Governor did not include any changes to his proposals related to affordable housing in his revised budget recommendations. The Governor's budget proposal keeps his commitment to fully fund his plan to end long-term homelessness by increasing funding for the Housing Trust Fund by \$4 million. However, this increase is paid for by reducing funding for the Challenge Program, which funds grants and low-cost loans for the development of affordable housing opportunities. This redirection of funding, along with a significant cut to the base budget, results in a 44 percent cut in the Challenge Program from the FY 2010-11 base, or 69 percent from FY 2008-09 levels. The Governor's reduction would result in an estimated 1,200 fewer rental units and 500 fewer owner-occupied units being constructed.⁸

The Governor's proposal drains the Disaster Relief Contingency Fund, which helps victims after natural disasters, of its reserve dollars – \$1.5 million in all – and uses the funds for rental assistance for families living in shelters. Staff from Minnesota Housing supported this proposal, explaining that there has been a large increase in children in shelters, and the money should be shifted to address this need.⁹

Finally, state funding is reduced for housing and supportive service programs that serve the most vulnerable, including people with mental illness.

Workforce Development

Facing an unemployment rate at a 26-year high, the Governor announced in January that enhancing Minnesota's job climate was his top priority. His initial budget proposal relied almost entirely on business tax incentives to generate new jobs (see the Tax and Aids to Local Government section of this analysis). And his revised budget proposal includes only a few important changes in this area.

Overall, the Governor's revised budget would still reduce state funding for employment assistance and job training programs – cutting general fund spending for the Department of Employment and Economic Development by

Governor takes less money from existing job skills training programs, uses federal economic recovery money instead

10 percent, or nearly \$9 million for the FY 2010-11 biennium.

The Governor initially proposed using \$6 million from the Workforce Development Fund to hire new “re-employment specialists” who would be placed at WorkForce Centers to assist job seekers who don’t qualify for existing state and federal re-employment programs. This was not a new infusion of resources. Instead, the proposal directed funds away from existing job skills training programs and used the resources for supportive services, such as referring people to information and helping complete Unemployment Insurance applications.

In his revised budget, the Governor is able to use federal economic stimulus resources to partially fund these supportive services for the unemployed. Therefore, only \$1.5 million will be taken from the Workforce Development Fund. However, the federal funding is temporary, and the Governor’s FY 2012-13 budget would revert to redirecting \$6 million away from existing job skills training programs.

Most of Governor’s cuts to workforce development programs remain

The Governor revised budget still reduces or eliminates a variety of grants and programs serving for vulnerable populations, including:

- Reducing general fund support for the Minnesota Jobs Skills Partnership by one-third. This program partners with businesses and educational institutions to develop training programs that meet businesses’ current needs for employees.
- Reducing funding for services helping people with disabilities get job training and find work, including employment and interpreter services for the deaf.
- Reducing pass-through grants to nonprofits providing low-income, minority and other vulnerable populations with employment services, including Opportunities Industrialization Centers, WomenVenture, Metropolitan Economic Development Association and Lifetrack Resources.
- Significantly decreasing funding to several youth programs that help with job training and placement. For example, the St. Paul and Minneapolis Summer Youth programs, which support job placement and mentoring for youth, would be cut 17 percent and 25 percent, respectively. Youthbuild, a program for low-income young people to work toward their GEDs or high school diplomas, learn job skills and serve their communities by building affordable housing, would be cut \$150,000.
- Eliminating grants to the Minnesota Alliance of Boys and Girls Clubs, Rural Policy and Development Center, and Entrepreneurs and Small Business Grants.

Higher Education

An important element of success in today’s competitive job market is a person’s educational background. Many people take advantage of an economic downturn to return to school for vital retraining and skill development.

State investment in higher education already down

Higher education funding, however, has been under pressure in recent years. State general fund investment in higher education funding in FY 2009 was 16 percent lower than at the start of the decade. Colleges have turned to double-digit tuition increases to fill the resulting budget hole, which in turn has led to greater student debt loads.¹⁰

The Governor’s initial budget proposal would have further cut state investment in higher education. As part of the stimulus package, Minnesota is eligible for up to \$668 million over the next two years in state fiscal stabilization block

Governor cuts higher education by 10 percent in FY 2012-13

grant dollars for education.¹¹ The major string attached to this money is that the state must demonstrate “maintenance of effort.” At a minimum, the state must maintain funding for E-12 education and higher education at FY 2006 spending levels. Minnesota’s current spending levels are above FY 2006, so policymakers can cut state funding and replace it with federal dollars while still meeting the federal requirements. As a result, the Governor’s revised budget backfills his original \$313 million cut to higher education with the federal dollars. That would mean a net reduction of \$8 million for the University of Minnesota and \$31 million for Minnesota State Colleges and Universities (MnSCU) in FY 2010-11.

Although the one-time infusion of federal dollars enables the Governor to delay major cuts to higher education, the funding reductions in the following biennium would be considerable. The Governor’s revised budget would cut total higher education funding by 10 percent, or \$570 million, in the FY 2012-13 biennium.

The Governor’s revised proposal still includes other cuts to specific higher education programs, including:

- A 10 percent cut in state funding for technology programs that support bandwidth for internet at campuses and allow higher education libraries to share books and electronic resources.
- Eliminating the Office of Higher Education component of state funding for postsecondary enrollment for high school students at the University of Minnesota and Minnesota State Colleges and Universities. This does not necessarily eliminate the program, but postsecondary institutions and the Department of Education would have to fill in the funding gap to prevent reductions.
- Eliminating funding for the TEACH program, which improves the quality of child care by providing scholarships for child care providers to obtain a degree in early education.

The Governor does not propose cuts to the state grant program. However, he does recommend reductions to other state financial aid programs. State work study, which currently funds 75 percent of the wages of 11,900 work study students at colleges and universities, would be cut by five percent over the FY 2010-11 biennium, as would postsecondary child care grants and scholarships for low-income American Indian students.

On a more positive note, the federal economic recovery package includes an increase in federal Pell Grant funding. Without changes to the state grant program, the federal increase would automatically result in the Minnesota portion of the grant being reduced by the same amount to keep the total award constant. The Governor avoids this by adjusting the state grant formula to reflect a more realistic cost of higher education, resulting in a net increase in resources for students.

Public Safety

The Governor cites protecting state public safety programs as one of his top budget priorities. As a result, there were no significant budget cuts to the Department of Corrections and Department of Public Safety operations in his initial budget proposal.

The Governor has also not proposed any budget reductions to Office of Justice programs, which serve victims of crime and domestic abuse. The Governor’s revised budget includes a new proposal to repeal a requirement that short-term

Governor would cut state funding for already overwhelmed court systems

offenders serve their sentences at the local level, relieving some pressure on counties which have been paying most of the costs for their incarceration. These offenders would now serve their sentence at a Department of Corrections (DOC) facility.

The Governor proposes increases for the DOC and the Minnesota Sex Offender Program (located within the Department of Human Services) to cover deficiencies in their budgets. However, he partially offsets this increased spending by proposing controversial reductions to pension benefits for some DOC and DHS employees.

The state's court systems do not fare as well. The Governor's revised budget proposes a 3.3 percent reduction to the state's Supreme Court, Court of Appeals and Trial Courts, down from the five percent he recommended in January. This decreases the Governor's proposed cut to the court system from \$25 million to \$15 million for the FY 2010-11 biennium. The judicial branch, however, estimates that it needs a \$53 million increase in funding for the FY 2010-11 biennium to preserve core functions.

One area of need within the Supreme Court is civil legal services, which provides legal assistance to Minnesota's most vulnerable populations – low-income families, the elderly, people with disabilities and children. Currently, more than 20,000 people who are eligible for services are turned away each year due to lack of funding. Civil legal services received \$2 million above base funding in one-time resources during the FY 2008-09 biennium. Under the Governor's proposal, this one-time funding would not be renewed, plus civil legal services would likely receive an additional 3.3 percent reduction in its base budget. As a result, funding for these services would fall below FY 2006 levels and an estimated 5,000 additional families would go without needed legal assistance.

The Board of Public Defense continues to receive a five percent reduction under the Governor's revised budget proposal (nearly \$7 million for FY 2010-11). The Board had requested a nearly \$20 million increase for the biennium to maintain core services. Caseloads are already well above American Bar Association standards and the lack of public defenders is creating significant delays in the court system. The Board has already eliminated all non-mandated services, leaving few options for absorbing cuts without further reducing the number of public defenders.

Taxes and Aids to Local Governments

The Governor's revised budget makes very few policy changes to the taxes and aids to local governments portion of the budget. What has changed is the fiscal impact associated with many of his proposals, which have simply been updated to reflect the new February Forecast.

The Governor's tax proposal is made up of two main parts. First, there is a \$254 million package of tax cuts for businesses. Second, there is \$531 million in spending cuts, primarily in aids to local governments and various property tax credits.

Despite the fact that the state's current budget deficit is largely the result of a downturn in revenues, the Governor's budget does not contain any significant increases in revenues. Instead, the inclusion of the tax cut package means that the cuts to aids and credits only make a small dent in the state's overall budget deficit. In fact, 48 percent of the cuts in this portion of the budget made in FY

Governor's "economic stimulus" focuses on business tax cuts

2010-11 and 69 percent of the cuts made in FY 2012-13 pay for the new tax cuts, not for deficit reduction.

The Governor describes his tax cuts as an "economic stimulus" package. It includes:

- Gradually cutting the state's corporate tax rate in half over six years. This is by far the largest of the tax cuts, costing the state \$100 million in FY 2010-11, \$390 million in FY 2012-13 and more in future years.
- Changing the sales tax exemption for capital purchases so that businesses will get the exemption at the time of purchase, rather than applying for a refund. This is the second largest provision in FY 2010-11, with a cost of \$78 million. However, the cost drops to \$21 million in the next biennium.
- A new Green JOBZ initiative that provides twelve years of tax incentives for companies that "create renewable energy, represent manufacturing equipment or services used in renewable energy, or that create a product or service that lessens energy use or emissions."
- A few other credits for investments in small businesses.

This package of tax cuts would cost the state \$254 million in lost revenues in FY 2010-11, and the impact grows substantially to \$425 million in FY 2012-13. The ongoing cost is likely to be even higher, as some provisions don't have any impact until five years in the future, and the corporate tax cut is not fully in effect for six years.

The administration argues that these tax cuts will provide incentives for growth. However, it is not clear how much "bang for the buck" the state will get in the near term. In an analysis of several options to stimulate the economy, economist Mark Zandi found that small business expensing provisions and cuts in the corporate tax were among the least effective of the options studied.¹² Given the large cost, especially of the corporate tax reduction, policymakers will have to consider whether the state can afford to gamble on whether such provisions will pay off.

Governor conforms to federal changes

The one significant new tax item in the Governor's supplemental budget is to conform to a provision in the federal economic recovery legislation that exempts up to \$2,400 in unemployment compensation from income taxes in the 2009 calendar year. The Governor proposes to also exempt this income from the state income tax, with a one-time cost in FY 2010 of \$28 million.

Cuts to aids and credits for local governments

The Governor's budget includes deep cuts to the "aids and credits" portion of the tax budget, which includes aids to local governments as well as the state's Property Tax Refund, which provides refunds to Minnesotans whose property taxes are high in relation to their incomes.

There are cuts to four different ways the state provides aid to local governments in order to reduce property taxes and to ensure that even communities with low property wealth can provide a basic level of services:

- County Program Aid, which provides general purpose aid to counties, is cut by \$125 million in FY 2010-11 and \$132 million in FY 2012-13. This is a 27 percent cut compared to base funding.
- Local Government Aid, which provides similar state aid to cities, is cut by \$245 million in FY 2010-11 and \$259 million in FY 2012-13, a 23 percent cut compared to base.
- The Homestead Market Value Credit and Agricultural Market Value Credit, which are also paid by the state to lower local property taxes, are cut by 13 percent and eight percent, respectively.

*Proposal cuts
property tax credits
for renters*

The cuts to local governments raise real questions about their ability to provide continued services. The Governor's budget recognizes that some increase in local property taxes will likely result, and includes a line item of \$25 million in FY 2010-11 and \$31 million in the next biennium that represents the additional property tax refunds that the state will pay out and the reduced amount of income taxes that will be collected (because taxpayers can take their property taxes as a deduction on their income tax forms.)

The Governor's budget also includes a 27 percent cut to the Renters' Credit, which provides property tax refunds to nearly 274,000 low- and moderate-income households whose taxes are high in relation to their income. This provision is likely to have a detrimental impact on the economy, as it would mean \$51 million fewer dollars circulating in the local economy.

Finally, the Governor would eliminate the Political Contribution Refund, which provides a refund of up to \$50 for individuals and \$100 for married couples for contributions to political parties or candidates.

What Happens Next?

Policymakers are facing some very real deadlines: the 2009 Legislative Session officially ends on May 18 and the FY 2010-11 biennium begins on July 1, 2009. Now that the Governor has released his initial and revised budget proposals, the attention shifts to the House and Senate.

Legislative committees have their budget targets and are starting to assemble the omnibus budget and tax bills. All budget bills must be passed out of their budget committees and on the way to the House or Senate Finance committees by April 16. Then, by April 22, the House and Senate Finance committees (and the Ways and Means committee in the House) and the House and Senate Tax committees need to have processed the omnibus bills. In other words, by this date, all the omnibus budget and tax bills should be ready for action on the House and Senate floor.

By May 7, the House and Senate must have resolved their differences through conference committees and the omnibus bills must be back on the floor for final passage. The unofficial deadline for getting bills delivered to the Governor is May 12. If the Governor vetoes any of the bills, that deadline would leave the legislature with enough time to try an override or to work toward a compromise. If they wait too much past that date, the Governor has the ability to "veto" a bill just by doing nothing.

This timeline, however, is very tight and doesn't leave much time for negotiating a final agreement with the Governor. And most people anticipate that negotiations will be difficult with the Governor focusing on spending reductions and one-time resources to solve the budget deficit, and the House and Senate proposing significant revenue increases.

The people of Minnesota will be best served if this legislative session ends with a budget that:

- Resolves the deficit using a reasonable mix of revenue increases, spending reductions and one-time resources.
- Prioritizes spending increases to meet Minnesota's greatest needs and spending reductions to avoid harming Minnesota's most vulnerable populations.
- Balances the state budget not only in FY 2010-11, also in FY 2012-13.

The alternative would be a budget that could harm Minnesotans that are at-risk during this economic downturn and leave the state facing another significant budget deficit in the future.

Except where otherwise noted, the analysis in this report is based on data from budget documents prepared by Minnesota Management and Budget and the applicable state agency. However, special thanks to the Affirmative Options Coalition, Children's Defense Fund Minnesota, Legal Services Advocacy Project, Minnesota Community Action Partnership, Minnesota Disability Law Center, Minnesota Housing Partnership, Minnesota Workforce Council Association, Parents United and Ready 4 K for their invaluable contributions to this analysis.

¹ In 2009, the poverty line is \$10,830 for a single person, \$14,570 for a family of two, \$18,310 for a family of three and \$22,050 for a family of four.

² Department of Employment and Economic Development, *Minnesota Job Vacancy Survey*.

³ Minnesota Budget Project, *The Lost Decade*, December 2008. Adjusted for inflation in FY 2008 dollars.

⁴ More information about the Itasca Project is available at www.theitascaproject.com.

⁵ Minnesota Budget Project, *The Lost Decade*, December 2008. School district revenues per pupil adjusted for inflation in FY 2008 dollars.

⁶ Center on Budget and Policy Priorities, *American Recovery and Reinvestment Act of 2009: State-by-State Estimates of Key Provisions Affecting Low- and Moderate-Income Minnesotans*.

⁷ Note: at the time of this writing, it is not clear whether past or proposed accounting shifts of state funding to schools will be included in determining maintenance of effort.

⁸ Estimates from the Minnesota Housing Partnership.

⁹ Testimony in Housing Finance and Policy and Public Health Finance Division, January 28, 2009.

¹⁰ Minnesota Budget Project, *The Lost Decade*, December 2008. Adjusted for inflation in FY 2008 dollars.

¹¹ Center on Budget and Policy Priorities, *American Recovery and Reinvestment Act of 2009: State-by-State Estimates of Key Provisions Affecting Low- and Moderate-Income Minnesotans*.

¹² Mark Zandi, *Washington Throws the Economy a Rope*, January 22, 2008.