

# A Tale of Two Visions: Comparing Governor Dayton's and the Legislature's FY 2012-13 Budgets

*2011 Legislative  
Session ends without a  
budget agreement*

*Policymakers agree to  
shift K-12 payments,  
but they do not agree  
on how to fund schools*

## **Governor Dayton's Budget Presents Balanced Approach, Legislature Focuses on Cuts**

The challenge before Minnesota policymakers is to shore up the state's economy, invest in its people and continue the state's move out of a deep recession. The Governor and legislature have put forward two very different plans for the state's next two-year budget.

The Governor has proposed a balanced approach that combines spending reductions and revenue increases to address the needs of Minnesotans struggling in tough times. It's a plan that restores balance to the state's tax system and improves the state's long-term fiscal health. According to polls and editorials from around the state, it is an approach favored by the majority of Minnesotans.<sup>1</sup>

The legislature has advanced a plan that relies heavily on spending cuts to services that are vital to a strong future economy. Their plan dramatically reduces the state's investments in the higher education and training that creates a competitive workforce, transit that gets people to work, and health care and other services that create safe and vibrant communities. Further, it cuts state aid to cities and counties, which will result in higher property taxes for businesses and residents alike.

Governor Dayton and the legislature were unable to arrive at a budget agreement before the end of the 2011 Legislative Session, leaving the state's \$5.0 billion revenue shortfall for FY 2012-13 unresolved. Negotiations continue, but if no budget deal is reached, a state government shutdown will occur on July 1.

This analysis examines the differences and similarities between the Governor's budget (as presented in March) and the legislature's budget bills (as approved in May and vetoed by the Governor).<sup>2</sup>

## **K-12 Education**

At first glance, Governor Dayton and the legislature are not very far apart on overall K-12 education funding. The Governor increases funding for education by \$36 million in FY 2012-13 compared to base funding, while the legislature proposes \$44 million in reductions – not a huge difference, since each would provide more than \$14 billion in funding for K-12 education in the next biennium.<sup>3</sup>

On closer examination, however, the two proposals present very different visions for K-12 education. The Governor's limited new investments focus on early childhood development and efforts to close the achievement gap. The legislature provides some additional funding for schools, but also shifts funding away from urban school districts and includes a number of controversial policy changes to how schools and teachers are evaluated. Resolving these policy differences will be

a critical piece to reaching agreement on education funding.

Areas of similarity or agreement between Governor Dayton and the legislature include:

- Continuing the shift in school aid payments passed in the 2010 Legislative Session, reducing state spending by more than \$1.4 billion in FY 2012-13.
- Reducing growth in Adult Basic Education (ABE). The Governor reduces growth in ABE from three percent to two percent in FY 2012-13; the legislative proposal reduces growth to one percent. ABE helps individuals enter and advance in the workforce by providing high school equivalency degrees, workplace literacy training, and English language and citizenship classes.
- Cutting administrative funding for the Department of Education by five percent in FY 2012-13. The department would also likely be impacted by \$95 million in overall state agency cuts included in the legislature's state government bill.
- Ending charter school start-up grants and magnet school grants.

Proposals unique to Governor Dayton's budget include:

- Increasing funding for optional all-day kindergarten programs by \$32 million in FY 2012-13. According to the Department of Education, all-day kindergarten has been shown to result in improved academic success in language, literacy and math skills.
- Providing \$2 million in one-time funds for a statewide early childhood quality rating and improvement system to assess program quality, support teacher improvement and better inform parents about their choices.
- Creating two grant programs to encourage better outcomes in schools: \$5 million for an Achievement Gap Innovation fund to support projects that develop innovative approaches for using technology to help close Minnesota's achievement gap and \$12 million for a Governor's Excellence in Education Award that would recognize schools with outstanding achievement growth.
- Capping funding for QComp, a voluntary alternative teacher compensation program, saving \$5 million in FY 2012-13.

Proposals unique to the legislature's budget include:

- Increasing the basic education formula by \$20 per pupil in FY 2012 and an additional \$21 per pupil in FY 2013, an increase of \$47 million in FY 2012-13.
- Increased funding for Minnesota Reading Corps of close to \$6 million in FY 2012-13. This is a statewide initiative that focuses on ensuring every child in Minnesota can read by third grade.
- Reducing growth in funding for special education, resulting in a one-time cut of \$48 million in base funding for FY 2012-13.
- Significantly reducing integration aid that goes to districts with high concentrations of children of color to promote integration in and between school districts. The savings are redirected to fund two new programs: innovation achievement transition aid that flows to the same districts as the current integration aid, but decreases over time, and literacy incentive aid that flows to all school districts based on literacy proficiency and improvement in literacy scores.

*Deep fiscal and philosophical differences separate policymakers on health and human services*

- Providing vouchers to low-income students living in Minneapolis, St. Paul or Duluth who attend persistently low-performing schools to allow them to switch to an out-of-district or a private school at a cost to the state of \$17 million in FY 2012-13.
- Policy changes such as developing an “A to F” grading system for schools and schools districts (with financial bonuses for successful schools), imposing a new performance-based evaluation system for teachers and principals, prohibiting strikes under some circumstances, proposing an alternative salary system based on student performance, and changing the teacher tenure process.

### **Health and Human Services**

In the Governor’s budget, health and human services contributes nearly \$852 million to solving the state’s general fund budget deficit. Elements of his proposal include \$495 million in general fund spending reductions and \$80 million in new investments. The Governor’s proposal also nets the state \$624 million in revenue by increasing surcharges on health care providers.

The legislature’s proposal cuts far deeper, reducing general fund spending for health and human services by \$1.6 billion in FY 2012-13.<sup>4</sup> The legislature’s budget includes not only spending cuts, but also dramatic changes to the state’s public health care programs which would result in more than 100,000 Minnesotans losing health care coverage.

Areas of similarity or agreement between Governor Dayton and the legislature include:

- Increasing funding for adoption and relative custody assistance, which provides financial assistance to families who have adopted or accepted permanent custody of children with special needs. The legislature includes an increase sufficient to cover the current caseload, while the Governor provides enough funding to cover the anticipated increase in caseload.
- Reducing funding for Children and Community Services Act (CSSA) grants to counties, which fund child protection and child and adult mental health services. The Governor reduces funding by \$5 million in FY 2012-13, a four percent reduction in state funding for these services. The legislature reduces funding by \$22 million in FY 2012-13, a 17 percent reduction. Mental health services for children and adults are most vulnerable to cuts as child protection services are likely to be considered the highest priority for the remaining funds.
- Reducing community-based services for individuals with disabilities and the elderly. The Governor continues restrictions on the number of individuals with disabilities that can access home-based Medicaid services, which help them avoid entering a more expensive and confining institutional setting. The Governor also reduces funding for the providers that serve these individuals. The legislature goes much further, proposing more than \$188 million in reductions in services for individuals with disabilities and the elderly, and for the institutions and community-based providers that serve them. These cuts would force more than 1,000 individuals with disabilities into more expensive institutional settings.

- Eliminating funding for Family Assets for Independence in Minnesota (FAIM) grants. Low-income participants get their own savings matched with state and federal funds to help obtain post-secondary education, purchase a home or start a new business. The loss of nearly \$500,000 in state funds in FY 2012-13 will mean the loss of a matching grant from the federal government.
- Changing the child care assistance system, removing some flexibility for families and creating \$7 million in savings in the FY 2012-13 biennium. Both proposals also capture \$5 million in child care assistance funds that were not spent in calendar year 2010 that would normally carry-over and fund child care assistance in the next year, meaning nearly 500 fewer working families would be helped. The legislature, however, goes further by reducing child care reimbursement rates by five percent and legally non-licensed child care rates by 16 percent, impacting approximately 22,000 Minnesota families who rely on these services. The legislature also reduces or eliminates grants that improve the child care system by funding training and capacity-building for child care providers, information for parents, and child care for migrant children.
- Cutting the Minnesota Family Investment Program (MFIP) Consolidated Fund, which could lead to longer wait times for families trying to access assistance, less support in finding work, and fewer families getting emergency assistance when facing homelessness. The Governor cuts funding by \$10 million in FY 2012-13, the legislature by \$20 million.
- Using federal funds for Temporary Assistance for Needy Families (TANF) to free up state dollars to help balance the state's budget (commonly known as "refinancing"). The Governor refinances \$28 million in FY 2012-13, the legislature refinances \$37 million.
- Cutting the Department of Human Services and Department of Health by five percent in FY 2012-13. In addition, the departments would also likely be impacted by \$95 million in overall state agency cuts included in the legislature's state government bill.

Proposals unique to Governor Dayton's budget:

- The Governor would increase surcharges that the state collects from all hospitals, nursing homes, Intermediate Care Facilities for persons with developmental disabilities (ICF/MRs) and managed care organizations, raising \$875 million in revenue in FY 2012-13. To partially offset the increased costs to these health care providers, the state would increase their Medical Assistance and MinnesotaCare reimbursement rates, at a cost to the state general fund of \$251 million. The federal government would match this additional state spending, with those federal dollars flowing to the health care providers. Some health care providers, particularly those that do not serve a large number of Medical Assistance clients, would not break even in this proposal. The result would be a \$624 million in net revenue for the state's general fund.

Proposals unique to the legislature's budget include:

- Including \$700,000 in one-time funding to help address long-term homelessness.
- Repealing Medical Assistance for extremely low-income adults. One of

Governor Dayton's first actions in office was to take advantage of the opportunity to cover extremely low-income adults without children through Medicaid (known as Medical Assistance in Minnesota). This turned an all-state funded program into a better health care option that receives matching federal funds. Reversing this action cuts general fund spending by \$921 million in FY 2012-13, but the state will also lose those federal matching dollars. To provide some minimal level of health care for these individuals, the legislature revives a limited state-funded General Assistance Medical Care (GAMC) program for those with incomes below 125 percent of poverty (an income of less than \$13,613 a year). However, spending on care for this population with significant health challenges is capped at just \$160 million a year, plus some additional funding for a prescription drug pool. Based on the state's previous experience with this limited GAMC program, there are concerns that it will be difficult for individuals to access care because health care providers will be reluctant to participate, particularly in Greater Minnesota.<sup>5</sup>

- Creating a Healthy Minnesota Contribution program that takes away MinnesotaCare coverage for adults without children with incomes over 125 percent of poverty and parents over 133 percent of poverty. This would impact individuals with incomes starting at just \$13,613 a year, or a family of three with an income of just \$24,645 a year. These Minnesotans would be given a subsidy that they could use to help purchase health insurance on the private market, but they are unlikely to find coverage options with a reasonable deductible and copayments at a premium they can afford. The proposal cuts \$276 million in spending in the Health Care Access Fund (HCAF) in FY 2012-13; this helps makes it possible to transfer \$116 million from the HCAF into the general fund to help resolve the state's budget deficit.
- Eliminating General Assistance and other emergency assistance programs and turning them into an optional Adult Assistance block grant to counties, reducing the resources that available to serve these individuals by \$20 million in FY 2012-13. This would dismantle a safety-net system for around 20,000 very low-income adult Minnesotans that provides them with a small monthly cash benefit, offers additional assistance for individuals who require a special diet for medical reasons or other special needs, and makes emergency funds available to prevent them from losing their housing or having their utilities turned off if they face a crisis.
- Increasing barriers for low-income families eligible for the Minnesota Family Investment Program (MFIP) to receive assistance in a timely way, get the training necessary to qualify for higher-paying jobs, and own a reliable car that can get them to work. And if there is a severely disabled adult living in their household, the family would see their cash assistance reduced by \$50 a month for each disabled individual.
- Increasing barriers to accessing health care, such reinstating some Medical Assistance copayments, increasing MinnesotaCare eligibility reviews to every six months and eliminating state-funded eligibility for legal noncitizens.
- Reducing funding for a number of mental health grants, including adult mental health, crisis services, children's mental health screening and culturally-specific services.

*Legislature would reduce funding for higher education to FY 2000-01 levels*

## Higher Education

To keep Minnesota's economy competitive, the state will need to produce more workers with degrees and credentials during the next decade. Unfortunately, both the Governor's and the legislature's higher education budget proposals would make it more challenging for students to increase their knowledge and skills. And while Governor Dayton's budget will create obstacles, the legislature's budget will create major road blocks.

The legislature proposes deep cuts to higher education, reducing funding by \$411 million in FY 2012-13, or 14 percent.<sup>6</sup> As a result, the state's investments in higher education would fall to FY 2000-01 levels (in actual dollars, not inflation-adjusted), even though our higher education institutions are serving tens of thousands of additional students. Cuts this deep would mean fewer Minnesotans would be able to access higher education as tuition increases, class offerings would be reduced and student support services would be slimmed down. Governor Dayton's budget also reduces higher education funding, cutting spending by \$171 million in FY 2012-13, or six percent. This would reduce state funding for higher education to FY 2002-03 levels.

The two largest elements of the higher education budget are funding for the University of Minnesota and Minnesota State Colleges and Universities (MnSCU). Although both Governor Dayton and the legislature reduce funding for these institutions, the legislature's cuts are far deeper.

- The Governor reduces funding for the University of Minnesota by \$77 million in FY 2012-13, a six percent cut. The legislature's funding cut to the University of Minnesota is three times larger: \$244 million in FY 2012-13, or 19 percent. The legislature also holds back about \$5 million, making the funds contingent on whether the University of Minnesota meets three of five goals: increasing institutional financial aid, producing at least 13,500 degrees, increasing graduation rates on the Twin Cities campus, maintaining spending on research and development, and maintaining sponsored research. The legislature "sets the expectation" that tuition increases will be limited to five percent in the first year and four percent in the second year, and that mandatory fees will not be increased by more than four percent, unless approved by student associations.
- The Governor's proposal cuts Minnesota State Colleges and Universities by \$76 million in FY 2012-13, or six percent. The legislature cuts MnSCU funding by over twice as much: \$180 million in FY 2012-13, or 14 percent. The legislature also holds back about \$5 million and makes the money contingent on whether MnSCU meets three of five goals: increasing the enrollment of students of color, increasing the number of students taking online courses, increasing the number of credentials earned, increasing completion rates and decreasing energy consumption. The legislature caps tuition increases at three percent each year for colleges and five percent in the first year and four percent in the second year for universities. Mandatory fees cannot be increased by more than four percent, unless approved by student associations.

Areas of similarity or agreement between Governor Dayton and the legislature

include:

- Eliminating the Achieve Scholarship, which was designed to help high-achieving, high-need students access higher education. Approximately 130 students will be impacted.
- Phasing out all general fund support for the Minnesota College Savings Program, which provides approximately 2,500 low-income families with a state match when they save for college.
- Reducing funding for the American Indian Scholarship program. The Governor proposes a five percent cut and the legislature proposes an eight percent cut. At least 32 fewer students would be able to access this financial assistance each year under these proposals.
- Reducing funding for the Office of Higher Education, which gathers data, provides information and manages financial aid programs. The Governor cuts funding by five percent in FY 2012-13, the legislature by 10 percent.
- Reducing state-funded work study, which pays 75 percent of wages for qualifying campus and community jobs. This is one area where the Governor proposes the deeper cut, reducing funding by 33 percent in FY 2012-13. This would mean 2,600 fewer students would have a work study opportunity in FY 2012. The legislature's budget cuts work study by three percent.

A proposal unique to Governor Dayton's budget is to reduce child care assistance grants for low-income students by five percent in FY 2012-13, resulting in 150 fewer students a year receiving help.

A proposal unique to the legislature is to increase funding for the State Grant program by \$21 million in FY 2012-13, or seven percent. The State Grant program provides financial aid for approximately 85,000 low- and moderate-income Minnesota students every year. The legislative proposal falls short of the \$35 million needed to fund financial aid for all qualifying students. The Governor's budget does not include any additional funding for the State Grant program. Under either budget proposal, the Office of Higher Education will have to ration funds, issuing smaller and/or fewer grants.

In his veto letter, Governor Dayton describes the legislature's deep cuts to higher education as "unacceptable." However, since the Governor's budget also reduces spending, it seems certain that the higher education compromise budget will cut funding, harming the state's ability to produce the workforce that is key to our future economic success.

### **Jobs and Economic Development**

Minnesota's recovery from the recession and our future economic success depends on many factors, including our ability to maintain a solid public infrastructure and replace an aging workforce. We need to train new workers and retrain current workers to respond to economic changes. Governor Dayton's economic development proposal, which reduces spending by \$3 million in FY 2012-13, would have a mixed impact on many investments, including funding for job training, affordable housing and cultural opportunities. The legislature's budget reduces general fund spending by \$30 million in FY 2012-13, or 18 percent, through both cuts and shifts that will impact funding for services that are

*Budget proposals will weaken the state's ability to train workers and rebuild the economy*

important to helping stabilize families and expand the state's economic recovery.<sup>7</sup>

Areas of similarity or agreement between Governor Dayton and the legislature's budget include:

- Increasing base funding for the Housing Trust Fund by \$2 million, preserving 150 rental assistance opportunities. However, both proposals include some reductions to the Minnesota Housing Finance Agency. The Governor's proposal includes a \$4 million cut in FY 2012-13, or five percent, while the legislature cuts funding by \$5 million, or seven percent. The reductions fall most heavily on housing rehabilitation and production, home ownership, and other housing supports.
- Increasing funding for Vocational Rehabilitation Services, which provide employment services for people with significant disabilities, and State Services for the Blind, which help Minnesotans who are blind, visually impaired or Deafblind with their employment skills. This increased funding would allow the state to draw down additional federal matching funds. The legislature only increases funding for one year in the FY 2012-13 biennium.
- Reducing funding for grants to several specified nonprofits for job training, career planning business development and financial education. These services benefit a variety of disadvantaged and disabled people, as well as young people just entering the job market. The legislature goes beyond just cutting funding, restructuring how most workforce development grants are awarded by merging them into competitive funding pools beginning in FY 2013.
- Reducing funding for the Jobs Skills Partnership, which supports job training or retraining partnerships between educational institutions and businesses. The Governor cuts funding by five percent, the legislature by 12 percent.
- Transferring available funds from other accounts to help resolve the general fund deficit. The Governor transfers \$6 million from the Unemployment Insurance Contingent Account. The legislature transfers \$16 million in available funds from various Unemployment Insurance accounts.

One proposal unique to Governor Dayton's budget is to allow the Department of Employment and Economic Development (DEED) to withhold up to five percent from pass-through grants to nonprofits to cover DEED's administrative costs.

The legislature reduces funding for Extended Employment by six percent in FY 2012-13. With this cut, approximately 600 fewer individuals with significant disabilities would be assisted in maintaining and advancing in their employment.

### **Public Safety**

Minnesota is projected to spend around \$1.8 billion on courts, prisons and other public safety services in the FY 2012-13 biennium. Given the amount of funding for this area, the level of changes proposed by Governor Dayton and the legislature are relatively small, but they are still significant.

The Governor proposes a \$39 million increase in public safety in FY 2012-13, or two percent, focusing additional funding on prisons, public defenders and the courts. The legislature cuts general fund spending by \$22 million in FY 2012-13, or one percent, focusing those reductions on services for some of society's most

*The Governor increases funding for public safety, while the legislature cuts services for the most vulnerable*



vulnerable people: low-income families needing legal assistance, crime victims, women in abusive relationships and Minnesotans facing discrimination.<sup>8</sup>

There are several areas where the Governor and legislature share similar goals, but there are sometimes important differences in the scale of the proposal:

- There is a slight increase in base funding for the Supreme Court, Court of Appeals and the Trial Courts in both proposals, with the additional resources going towards inflationary increases in employee health insurance and pension contributions.
- There is additional funding for public defenders, who represent low-income clients in criminal cases. Past budget cuts have taken a significant toll – in half of the state’s counties, there no longer are sufficient attorneys on staff to represent clients at their first court appearances. The Governor’s proposal increases funding for public defenders by more than \$6 million in FY 2012-13, or five percent. The legislature increases funding by \$1.5 million, or one percent.
- There is a \$27 million increase in both budgets for the Department of Corrections to make up for the loss of one-time federal economic recovery funds. However, the Governor proposes \$4 million in reductions to other areas of corrections, including community services and agency operations. The legislature proposes \$16 million in reductions that impact correctional institutions, community services and agency operations.
- Money is transferred from other funds to help resolve the general fund deficit. The Governor transfers \$400,000 from the Peace Officers Standards and Training (POST) Board to the general fund in FY 2012-13. The legislature goes much further, transferring \$18 million from various dedicated public safety accounts to the general fund in FY 2012-13, including nearly \$9 million from the Fire Safety Account, which is dedicated to training.

The Governor and legislature move in opposing directions when it comes to the Guardian ad Litem Board, which provides advocacy services for abused or neglected children, minor parents and incompetent adults in juvenile or family court cases. The Governor increases funding by \$329,000 in FY 2012-13, or one percent. The legislature cuts funding by \$1.5 million, or six percent.

A proposal unique to the Governor’s budget is a \$3 million increase for the Network for Better Future pilot program in FY 2012-13. This funding helps provide housing and employment support for men at high risk of prison or treatment needs.

Proposals unique to the legislature’s budget include:

- Reducing funding for Office of Justice programs by \$12 million in FY 2012-13, or 17 percent. Funding would be reduced for battered women programs, crime prevention services, crime victim assistance and justice system improvements.
- Reducing state funding by \$4 million, or 17 percent, for Legal Aid and others that provide free legal services to those who cannot afford an attorney to help resolve housing, credit, family matters and other civil issues. State funding for civil legal services has fallen below 2006 levels. The legislature would also

*The legislature cuts  
funding for transit by  
65 percent*

limit the ability of Legal Aid and similar state-funded programs to lobby the legislature and pursue legal actions against the state and federal government on behalf of their clients.

- Reducing funding for the Department of Human Rights by \$4 million in FY 2012-13, or 65 percent. This agency works to end discrimination in Minnesota by investigating complaints, mediating disputes and educating the public about human rights issues.

The legislature's spending reductions fall heavily on services for the most vulnerable, including legal services for low-income families and crime victim assistance. In his veto letter, the Governor strongly opposed many of the legislature's cuts, including those to Legal Aid, Office of Justice programs and the Department of Human Rights.

### **Transportation**

The visions presented by Governor Dayton and the legislature for transit in Minnesota could not be more different. The legislature cuts general fund support for transportation by \$118 million, or 65 percent, with nearly all of these cuts falling on transit services in both the metro area and Greater Minnesota.<sup>9</sup> The Governor does not propose any transit cuts, and labeled the legislative proposal as "draconian" in his veto letter.

Transit is a basic public service, getting people to work and school, and reducing congestion and pollution. Public transit helps the downtown office commuter avoid rush-hour headaches and high parking fees, but it is essential for those who either can't afford a car or who can't drive. More than 100,000 people – seniors, students and working adults – depend on transit every day just in the metro area.

The legislature reduces state support for Metro Transit by 84 percent in FY 2012-13. According to the Governor's veto letter, the reduced funding could mean an across-the-board fare hike of 50 cents and a 30 percent reduction in service. The combination of fare increases and service reductions could result in a 31 percent decline in ridership and the layoff of 610 Metro Transit employees. Many people would feel the impact of these cuts since sixty percent of metro area transit riders use the bus or rail to get to work. To reduce the impact of the cuts, the legislature allows the Metropolitan Council to transfer money from other funds, including the Livable Communities fund that supports affordable housing and economic development.

Several suburban areas have separate bus systems that have "opted-out" of the Metro Transit system. The legislature's budget keeps funding flat at 2011 levels for these transit systems.

The legislature cuts funding for transit in Greater Minnesota by more than \$7 million, or 23 percent. These cuts are expected to result in 101,000 fewer hours of service each year, a 10 percent reduction. Since there are usually few transportation alternatives for individuals living outside of the metro area, any reduction in service will have a significant impact. Although the legislature prohibits reductions in special transit services for the elderly and people with

*The legislative proposal counts on savings from controversial measures*

disabilities, the loss of mainstream services will still negatively impact these populations.

Department of Transportation funding for commuter and passenger rail is also eliminated in the legislature's budget, a loss of \$1 million in FY 2012-13. This will make it difficult to accept and manage federal funding for existing and future rail projects.

The Governor and legislature propose dramatically different visions for mass transit services in Minnesota. The final budget deal will have serious implications for tens of thousands of Minnesotans who depend on bus and rail for everyday activities like getting to work, attending school, accessing medical care or going grocery shopping.

### **State Government**

The state government area of the budget funds a variety of agencies, offices and boards responsible for the basic operations of state government, such as offices established by the state constitution, the Department of Revenue, Minnesota Management and Budget (MMB), and the departments of Military and Veterans Affairs. Many policy and budget decisions that affect all state agencies are also included in the state government budget bill – such as proposals that impact state employees and the way state government operates.

The Governor increases funding for state government operations by \$3 million and raises \$44 million in revenues in FY 2012-13. His budget proposal includes reductions for some state agencies, but also invests in initiatives to improve government efficiency and performance. The legislature takes a very different approach, reducing funding for state government operations by \$145 million and raising \$168 million in revenue in FY 2012-13, largely through stronger tax collections and enforcement. To achieve this level of spending cuts, the legislature makes deeper cuts to state agencies than the Governor proposes and includes several controversial initiatives to reduce the size of state government.<sup>10</sup>

There are several areas where Governor Dayton and the legislature share a similar goal, although their proposals have important differences:

- Both the Governor and the legislature plan to raise additional revenues by increasing tax compliance. Governor Dayton would raise \$32 million in net revenue for the state. The legislature goes much further, anticipating that the state would raise \$133 million in revenue in FY 2012-13 by employing analytic and intelligence tools to identify businesses and individuals that are not paying taxes they owe. This unprecedented tax compliance proposal requires the state to outsource the work to a private contractor and the Department of Revenue could not confirm the projected increase in revenue. However, the Governor stated in his veto letter that his administration is studying the concept. Both the Governor and the legislature cut the Department of Revenue's operating budget by five percent in FY 2012-13.
- Both proposals recommend reductions to some cultural opportunities that add to Minnesota's quality of life. The Governor recommends a five percent reduction to the Minnesota State Arts Board, the legislature makes a 15

percent reduction. The Minnesota Historical Society is cut by four percent in the Governor's budget and by 10 percent by the legislature. And the Science Museum of Minnesota is cut by three percent in the Governor's budget and by 15 percent by the legislature.

- Although the Governor and legislature both cut funding for the state legislature by five percent in FY 2012-13, the legislature cuts the Governor's office by 10 percent. The Governor cuts funding for his own office by five percent.
- Minnesota Management and Budget (MMB), which oversees the state's finances and employee relations, faces a five percent reduction from base funding in FY 2012-13 in the Governor's budget. The legislature cuts MMB's budget by 10 percent while requiring the agency to implement new initiatives like an agency sunset commission and a zero-based budgeting process.
- There is one area of complete agreement: educational programs for the military would get additional funding in both budget proposals. They propose a \$3 million increase for tuition reimbursement in the Military Affairs Department, enabling the continuation of 100 percent tuition reimbursement for members of the National Guard, and nearly \$2 million in additional funding for the Higher Education Veterans Programs, helping veterans access their educational benefits and make the difficult transition from the military to college.

One proposal unique to Governor Dayton's budget is funding for examining state government performance, including increased funding for the Small Agency Resource Team and new funding for a Results Management Initiative to evaluate whether some small agencies, boards and commissions can be merged or abolished.

Proposals unique to the legislature's budget include:

- Directing Minnesota Management and Budget to cut \$95 million from state agencies on top of reductions called for in other legislative budget bills. To reach this level of savings, the legislature requires that the state workforce be reduced by 15 percent by 2015, eliminates a number of deputy commissioner and assistant commissioner positions, proposes significant changes to health care for state employees, freezes state employee salaries for two years, and recommends various other changes in the way state government operates. The legislature largely shields the Minnesota State Colleges and Universities, the Department of Veterans Affairs and the Department of Military Affairs from these reductions.
- Entering into an agreement with the federal government to pursue debt collections, which the legislature asserts will raise \$37 million in FY 2012-13. The official fiscal note from Minnesota Management and Budget projects only \$4 million per year in additional revenue.
- Cutting funding for the state's Councils of Color, which advise policymakers on the issues facing their particular community. The legislature cuts funding by 13 percent for the Indian Affairs Council and by 20 percent for the Council on Black Minnesotans, Chicano Latino Affairs Council and Council on Asian-Pacific Minnesotans.
- Eliminating state funding for the Twin Cities Regional Cable Channel and

reducing funding for Minnesota Public Radio by 68 percent, only leaving money to cover an Emergency Alert and AMBER Alert system upgrade. Funding for public television is cut by 10 percent in FY 2012-13.

The state government budget isn't one that captures the headlines, but the funding in this area supports the backbone of state government operations. The deep cuts proposed by the legislature – such as the 15 percent reduction in the state workforce – would significantly hamper the ability of agencies to carry out their duties for the residents of Minnesota.

*The Governor focuses on tax fairness, while the legislature passes tax cuts*

## **Taxes**

Governor Dayton's budget takes a balanced approach of both service cuts and revenue increases to meet the state's needs. His proposal is also designed to reverse trends towards a more regressive tax system – one where low- and middle-income Minnesotans pay a higher share of their household incomes on total state and local taxes than the wealthiest Minnesotans. On average, Minnesotans pay 11.5 percent of their household incomes in total state and local taxes, while the wealthiest one percent of Minnesotans pay 9.7 percent.<sup>11</sup>

The Governor's proposal also responds to the fact that Minnesota's current tax revenues are a smaller share of the state's economy than a decade ago and are inadequate to fund current needs. The Governor's supplemental budget proposed \$2.7 billion in tax changes. In a May 16 offer to the legislature, he reduced his proposal to \$1.8 billion in tax increases.

The legislature has opposed increases in state taxes, and in fact include \$203 million in tax cuts in their budget. They make deep cuts to state aid to cities and counties and property tax refunds totaling \$925 million in FY 2012-13 and \$1.2 billion in FY 2014-15. This represents a 26 percent cut from base funding for the "property tax aids and credits" portion of the state budget. However, it clearly isn't an issue of whether revenues will be raised, but rather how. The legislature's tax bill is estimated to result in \$534 million increases in property taxes in FY 2012-13.<sup>12</sup> Governor Dayton proposes no cuts to local aids or property tax refunds, wanting to avoid state actions that lead to higher property taxes.

Areas of similarity or agreement between Governor Dayton and the legislature include:

- Transferring funds from the state's Cash Flow Account into the general fund. The legislature transfers \$166 million, the Governor recommends transferring \$171 million.
- Conforming to some federal tax changes. Minnesota uses federal law as the starting point for both the individual income tax and the corporate franchise tax, and so the state must decide whether to conform when changes are made to the federal tax code. In late March, the Governor signed House File 79, a bill addressing federal conformity for Tax Year 2010 only. The legislature includes \$122 million in additional tax reductions from federal conformity items for 2011 and 2012, including a larger standard deduction that the Governor had not included in his budget because he deemed it too costly.

Proposals unique to Governor Dayton's budget include:

- A new income tax bracket on the highest income Minnesotans. In his supplemental budget, a "fourth tier" of 10.95 percent on taxable income above \$150,000 for married filers was proposed, raising \$2.0 billion in FY 2012-13. In a May 16 offer to the legislature, this proposal was scaled back to apply to taxable income of \$250,000 for married filers, or about two percent of Minnesotans, raising \$1.5 billion.<sup>13</sup>
- Requiring more part-year residents to pay income taxes on a portion of their income, raising \$30 million in FY 2012-13. Currently, part-year residents who maintain a home in Minnesota need to be in the state for 183 days or more to be subject to the income tax. This proposal would drop that threshold to 60 days.
- Corporate tax changes, including revisions to the Foreign Royalty exclusion (which exempts from taxation any royalty payments a multinational corporation receives from its foreign subsidiaries) and the special tax treatment of Foreign Operating Corporations (FOCs), which are parts of a multinational corporation that are incorporated in the U.S. but at least 80 percent of their income is from foreign sources. The Governor's budget proposed eliminating these two provisions; he scaled back that proposal in his May 16 offer to the legislature.
- Sales and use tax changes that raise \$31 million. These proposals are often to update tax law to changes in technology. One proposal would require some remote sellers to collect sales taxes from Minnesota residents, just as retailers with a physical presence in the state do.

Proposals unique to the legislature's budget include:

- Gradually eliminating the state property tax paid by businesses and cabins. This proposal would cut those property taxes, and thereby state revenues, by \$50 million in FY 2012-13 and \$119 million in FY 2014-15. Fiscal estimates are not available for the cost when the state property tax is fully eliminated in 2025. However, if it were fully eliminated in FY 2012-13, the cost would be \$1.6 billion, about five percent of the state's general fund revenues.
- Accelerating the state's transition to Single Sales Factor apportionment, which determines the starting point for calculating corporate taxes for multistate corporations. The legislature would move the state to Single Sales Factor in 2012 instead of 2014, at an additional cost of \$18 million in FY 2012-13. In his veto letter, Governor Dayton mentioned this as one measure he would consider supporting if agreement could be reached on the "overall revenue target".
- Phasing in a new income tax exemption for military retirement pay, at a cost of \$24 million in FY 2014-15.
- Adding private school tuition to the set of allowable expenses for the state's K-12 education income tax credit.
- Cutting the Renters' Credit – the state's property tax refund for low- and moderate-income renters – by \$186 million, a 46 percent cut compared to base funding. About one in four currently-eligible households would no longer qualify for a property tax refund. Those remaining eligible face cuts to their credits that average \$190 for households including seniors and/or people with disabilities and \$335 for other households.

*A government shutdown looms as policymakers fail to reconcile their differences*

- Substantially reducing Local Government Aid to cities by \$310 million in FY 2012-13 and \$452 million in FY 2014-15. Duluth, St. Paul and Minneapolis are cut by 25 percent each year until they lose all aid in FY 2015. For other cities, the legislature essentially locks in the cuts that were made last year.
- Cutting County Program Aid, which is received by all counties, by \$73 million. This is in addition to cuts to specific funding streams in other budget bills that will impact counties' ability to provide services in their communities.
- Changing the Market Value Credit, which directly reduces homeowners' property taxes through a credit on their property tax statements. The state is supposed to reimburse local governments for the lost revenue, but has frequently cut the Market Value Credit reimbursement. The legislature cuts the reimbursement to local governments by \$104 million in FY 2012, and starting in FY 2013, replaces the Market Value Credit with a reduction in the tax capacity of homes, saving the state \$261 million from not paying any reimbursement to local governments.
- Eliminating the Political Contribution Refund. The PCR is part of the state's campaign finance system that reimburses Minnesotans for small donations to candidates and parties.
- Eliminating the Sustainable Forest Initiative, which reimburses landowners for sustainable forest practices.
- Transferring \$60 million from the Douglas J. Johnson Economic Development Fund into the general fund.

### **The Governor and Legislature Must Resolve Competing Visions**

The Governor has shared his vision of a balanced approach that includes a mix of revenues and cuts to services. The legislature's budget reflects the view that revenues should not be part of the approach, resulting in a budget that relies heavily on cuts to services. However, it's clear that both plans will raise revenues to meet the state's needs. The question is whether these revenues are raised at the state level transparently and based on ability to pay, or whether those revenues will come from higher local property taxes.

As the July 1 start to the FY 2012-13 budget draws nearer with no compromise, the possibility of a government shutdown grows. The issues at stake are serious. A shutdown would interrupt vital government services for days, possibly weeks. However, failure to raise new state revenues will mean deep, and likely permanent, cuts to services that build a healthy state economy. A balanced approach is needed to protect higher education, transit, health care and other public investments that are crucial to the state's ability to recover from the recession and create a more successful future.

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<sup>1</sup> Minnesota Budget Project, [A balanced approach to state budget winning hearts, minds and positive editorials](http://www.minnesotabudgetbites.org), www.minnesotabudgetbites.org, June 8, 2011.

<sup>2</sup> 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, and legislative research and fiscal departments. The opinions expressed are those of the authors.

<sup>3</sup> The K-12 education bill was passed as [House File 934](#) on May 19, 2011.

<sup>4</sup> The health and human services bill was passed as [Senate File 760](#) on May 18, 2011.

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<sup>5</sup> Minnesota Budget Project, [General Assistance Medical Care: Unique Program Serves a Unique Population](#), July 2010.

<sup>6</sup> The higher education bill was passed as [House File 1101](#) on May 20, 2011.

<sup>7</sup> The jobs and economic development bill was passed as [Senate File 887](#) on May 18, 2011.

<sup>8</sup> The public safety bill was passed as [Senate File 958](#) on May 18, 2011.

<sup>9</sup> The transportation bill was passed as [House File 1140](#) on May 20, 2011.

<sup>10</sup> The state government bill was passed as [Senate File 1047](#) on May 18, 2011.

<sup>11</sup> Minnesota Department of Revenue, [2011 Tax Incidence Study](#), March 2011.

<sup>12</sup> Department of Revenue estimate.

<sup>13</sup> The May 16 proposal would apply to taxable income above \$200,000 for head-of-household filers and \$150,000 for single filers.