



## MINNESOTA BUDGET PROJECT

An initiative of  
the Minnesota Council  
of Nonprofits

# '98 Percent' Constitutional Amendment Creates Barriers to Common-Sense Budgeting

A constitutional amendment proposed in the Minnesota Legislature would place strict limits on the ability of lawmakers to craft a budget that meets the state's needs. The amendment would lead to more budget gridlock and gimmicks, hinder a quick response to a crisis, threaten the state's credit rating, jeopardize the state's economic health and trigger tax cuts that could deepen budget deficits. It would be short-sighted to interfere with the ability of future policymakers to make common-sense decisions in response to changing circumstances.

### **The Basics of the Amendment**

Introduced as Senate File 1378 and House File 1661, this amendment includes several significant restrictions on the ability of policymakers to make budget decisions.<sup>1</sup>

- General fund appropriations for a biennium would be limited to 98 percent of forecasted general fund revenues for that biennium.<sup>2</sup>
- Any spending above the 98 percent could only be used to respond to emergencies "involving the health, safety, or welfare of the citizens of the state of Minnesota," and would require a three-fifths (60 percent) supermajority vote of the Legislature.
- The unused revenues would be placed into a reserve account. The reserve account could only be accessed in an emergency "involving the health, safety, or welfare of the citizens of the state of Minnesota" and would require a three-fifths supermajority vote of the Legislature.
- An automatic reduction in the state sales tax would be triggered when the reserve account reaches five percent of state revenues. The size of the tax cut would equal at least three percent of state revenues, or \$1 billion in the current biennium. The Legislature could pass an alternative temporary or permanent tax cut, but some type of tax reduction is required.

If this constitutional amendment is approved by a majority in both houses of the Legislature in the 2012 Legislative Session, it would be placed on the ballot in the November 2012 general election. It would then take effect if approved by a majority of voters.

### **The Amendment Would Lead to More Gridlock and Gimmicks at the Capitol**

Minnesota's constitution requires a balanced budget, meaning that our spending in a two-year budget cycle must match up with our revenues. This amendment would make it even more difficult for policymakers to fulfill their duty to their constituents by artificially preventing them from using available revenues, leading to more gridlock and gimmicks as they struggle to create a balanced budget.

To better understand how the proposed amendment would interfere with the ability of policymakers to pass a budget, we can examine what would have happened if it had been in place during the 2011 Legislative Session. It took Governor Dayton and the Legislature more than six months of debate and a 20-day state government shutdown to reach a budget agreement for the FY 2012-13 biennium. The final budget included over \$2 billion in cuts to services, as well as \$2.2 billion in school funding shifts and \$640 million raised by selling future tobacco settlement revenues (a decision that will cost taxpayers an estimated \$1.2 billion over the next 20 years.)<sup>3</sup> Had this constitutional amendment been in place, policymakers would have faced an even greater challenge – reducing net general fund spending by an additional \$1.3 billion. That would have meant an additional \$1.3 billion in service cuts or other timing shifts and gimmicks on top of what was in the agreement they did reach.

This amendment would make it challenging for policymakers to fund services that their constituents want and value, encouraging them to look for funding sources that are exempt from the 98 percent restriction on the general fund. This would include greater use of dedicated funding sources, tuition and fees, as well as turning to more gimmicks like delaying payments to our schools.

Under this amendment, the state would also be more likely to take actions that create pressure to increase local property taxes. The 98 percent restriction would have a “ratchet effect” of eroding state funding over time, making it more likely that state policymakers would cut funding to local units of government or pass responsibility for providing services down to the local level, both of which create pressure on local property taxes.

### **The Amendment’s Supermajority Requirements Hinder Quick Response to a Crisis**

The amendment would create new supermajority vote requirements to take responsible actions during a budget crisis: accessing the budget reserve or spending beyond the 98 percent cap.

Under this amendment, policymakers would only be allowed to spend above the 98 percent cap if the state faces an emergency “involving the health, safety, or welfare of the citizens of the state of Minnesota.” However, even under emergency circumstances, the amendment requires a three-fifths (60 percent) supermajority vote to approve spending beyond the constitutional limit. The amendment also applies these same extraordinary hurdles to accessing the budget reserve. These restrictions would make it challenging for policymakers to respond quickly and responsibly to a budget crisis in the state.

Minnesotans are very familiar with the gridlock that has gripped the State Capitol year after year with only a simple majority vote required to pass a budget. Raising the bar to require a supermajority to respond to an emergency would only increase the level of gridlock and empower a small number of legislators to block action on important priorities while trying to gain concessions on unrelated issues.

### **The Amendment’s Inflexible Restrictions Could Threaten the State’s Credit Rating**

The severe restrictions in this amendment, particularly the supermajority requirement to access our budget reserve or spend above the 98 percent restriction, are likely to affect the state’s credit scores and thereby increase costs when the state issues bonds to pay for infrastructure projects such as building and repairing roads, bridges and public buildings.

The major national credit rating agencies do not see constitutional restrictions that make it harder for policymakers to manage the state’s budget as a sign of fiscal responsibility. They evaluate a state’s creditworthiness in part by how much flexibility policymakers have to respond quickly to changing budget conditions. For example, Standard & Poor’s states that a “key factor” in determining a state’s credit quality is “a government’s ability to implement timely and sound financial and operational decisions in response to economic and fiscal demands.”<sup>4</sup> The proposed amendment requires there to be an “emergency” and a supermajority vote before policymakers could access our budget reserve or spend above the 98 percent restriction.

Minnesota’s credit rating is already on shaky ground. After last year’s failure to pass a state budget on time, Minnesota’s credit rating was downgraded by two agencies – Fitch and Standard & Poor’s – and Moody’s changed our credit outlook from stable to negative.<sup>5</sup> If Minnesota passes an amendment that would place even more restrictions on the ability of policymakers to respond quickly to changing economic circumstances, it could further threaten our credit rating and lead to increased borrowing costs.

## **The Amendment Creates a Tax Cut Account, Not a Budget Reserve**

Under the amendment, the state would put two percent of state general fund revenues into a reserve account each biennium. Building up our budget reserves when the state is enjoying strong economic growth is a smart decision. A healthy level of reserves allows policymakers time to make good budget decisions in the face of challenging economic circumstances. Adequate reserves allow states to maintain health care, education, job training and other services needed in tough times. They also protect long-term investments from cuts during a short-term economic downturn. Instead of making drastic choices to balance the state's budget, policymakers can use reserves to take time to respond to a situation in a more thoughtful and deliberative way.

However, this amendment forces the state to put hundreds of millions of dollars into a budget reserve every biennium, even if the state is facing a devastating recession. This would take resources off the table in times of economic crisis, increasing the size of the deficit and forcing policymakers to make deeper spending cuts that would hurt struggling families and undermine our future economic growth – or rely heavily on unsustainable one-time budget gimmicks. Because the amendment only allows policymakers to use reserve funds if there is an emergency and only with a three-fifths supermajority approval, this amendment would make it difficult for policymakers to use the reserves as part of a budget agreement that is in the best interests of the state.

In reality, this budget reserve functions more as a tax cut account. With the state placing two percent of revenues in the reserve each biennium, it would only take a few years for the reserve to reach the five percent of revenues threshold and trigger an automatic reduction in the state sales tax.

Although legislators can propose an alternative temporary or permanent tax cut, they are not given the authority to avoid the reduction in taxes altogether. The tax cut must happen regardless of the current economic situation, leading to the perverse possibility that a tax cut would be triggered that would tip the state into deficit or deepen an existing revenue shortfall.

For example, if the budget reserve had hit five percent of state general fund revenues during the 2011 Legislative Session, the amendment would have required a \$1 billion tax cut, even though policymakers were already struggling to address a \$5 billion revenue shortfall. Clearly, it doesn't make sense to dig the budget hole deeper in such circumstances. Even more troubling is that the default tax cut required by the amendment is a permanent one, reducing state revenues far into the future.

## **The Amendment Interferes with Investments in the State's Future**

This amendment would interfere with Minnesota's ability to recover from a recession and invest in our future. Putting two percent of forecast revenues off limits would prevent Minnesota from taking full advantage of economic growth coming out of a recession. Other states could use all available resources to start rebuilding their economies, while Minnesota might be forced to make additional cuts to vital building blocks of the economy such as education, job training and infrastructure.

The amendment also makes it very difficult to use the budget reserve to help stabilize the budget during challenging economic times. States build up reserve funds so that they can respond to unanticipated circumstances and smooth over changes in the economic landscape. Putting additional restrictions on the use of the reserve would severely constrain Minnesota's ability to act wisely during tough economic times.

And if policymakers agreed it would be wise to raise revenues in response to the public will, this amendment is unclear on when the state could actually use those additional resources. The restrictions in the amendment are based on forecasted revenues. Policymakers could pass a tax increase but might be unable to appropriate those funds until after the revenues had been included in the next economic forecast – they might even have

to wait until the next legislative session. This would result in an unnecessary delay in the ability of policymakers to respond to the needs of their constituents.

### **98 Percent Amendment is Wrong for Minnesota**

This amendment would increase gridlock at the Capitol and place the state on shaky financial footing. The restrictions in the amendment are so severe, there are few options for policymakers to pursue as they try to create a budget that is in the best interest of the state. The amendment takes resources off the table – unless an emergency exists and a supermajority approves – encouraging policymakers to turn to less transparent means to fund services their constituents want and value. The amendment also hampers their ability to raise revenues to respond to the public will. And it can even force tax cuts at times that would create deep budget challenges. The result is likely a future where Minnesota’s financial reputation is damaged, gridlock and gimmicks are commonplace, and policymakers struggle to maintain investments that are essential for economic growth.

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<sup>1</sup> The Senate only allows a maximum of five authors on a bill, so it is common practice for multiple versions of the same bill to be introduced in order to accommodate all the senators who wish to sign on. This bill has been introduced as Senate Files 1378, 1379, 1380, 1381, 1382, 1383 and 1401.

<sup>2</sup> Bonds issued by the state are exempt from this limitation.

<sup>3</sup> Star Tribune, [Tobacco bonds: A high-priced revenue alternative](#), November 19, 2011.

<sup>4</sup> Standard & Poor’s, [U.S. Public Finance: U.S. State Ratings Methodology](#), January 3, 2011.

<sup>5</sup> Fitch Ratings, [Fitch downgrades Minnesota GOs to ‘AA+’; Outlook stable](#), July 7, 2011, and Standard & Poor’s, [Minnesota; General Obligation](#), September 23, 2011.