MINNESOTA BUDGET PROJECT
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2012 Legislative Session: Modest Budget Changes, Little Progress on Sustainably Funding Our Future

Following a long and contentious budget debate in 2011 that included a three-week state government shutdown, the 2012 Legislative Session was a relatively normal year. The 2011 Legislative Session was characterized by a debate between Governor Dayton, who promoted a balanced approach, including raising revenues, to meet the state's needs; and the Legislature's use of cuts in services in response to the economic downturn and resulting state revenue shortfall. The two-year budget that did pass reflected an uneasy compromise that combined substantial service cuts with several one-time measures, including shifting state payments to school districts and issuing bonds backed by future tobacco settlement revenues.

In 2012, Minnesota's policymakers made only modest budget changes as the state slowly emerged from the most recent recession. Passing a bonding bill to fund infrastructure improvements took the spotlight, as it normally does in an even-numbered year. Building a Vikings football stadium was another high-profile issue. And policymakers considered, but did not pass, constitutional budget amendments that posed the most serious threat in decades to the Minnesota's ability to make common-sense budget decisions and fund services valued by residents.

The state's improving short-term financial situation was a significant reason why there were few showdowns over state funding in the 2012 Legislative Session. The February 2012 Economic Forecast revealed that Minnesota had a positive balance of $323 million for the current two-year budget cycle (FY 2012-13).[1] State law determined that these surplus dollars would be used to rebuild the state's reserves and start to reverse the school funding shift. That left policymakers with no surplus dollars for other needs, but also no significant short-term deficit requiring their action for the first time since 2007.

However, the lack of a deficit was not going to last long. The February forecast projected a $1.1 billion revenue shortfall in the next budget cycle, FY 2014-15. An ongoing point of debate during the session was Governor Dayton's insistence that no laws passed in 2012 would make that future challenge larger. Legislative leaders made a different case, arguing that tax cuts for businesses and investors would help stimulate economic growth and should be a priority, even if they added to the state's budget deficits.

This analysis looks at some of the major budget issues raised during the session, as well as the three budget areas that saw any significant debate during the session – K-12 education, health and human services, and taxes. Although policymakers approved several other omnibus finance bills, they will have a very minor impact on the state budget. The final agreement left the state with a positive balance of $26 million for FY 2012-13, and reduced the FY 2014-15 general fund shortfall by $56 million.[2]

Governor Rejects Proposal to Use Reserve Funds to Reverse School Shift More Quickly

In recent years, policymakers have opted to delay $2.7 billion in payments to school districts, using those funds as a short-term fix for budget deficits. Following state law, $9 million of the surplus reported in the February forecast refilled the state's budget reserve to its target of $658 million and the remaining $315 million was used to begin to reverse the school payment shift. Any future surpluses will continue to restore the shifted school payments. According to current projections, it will take an additional $2.4 billion to return the school payment schedule to normal.

During the 2012 Legislative Session, the House and Senate passed a K-12 education omnibus finance bill (House File 2083) that included just one provision – using $430 million of the $658 million state budget reserve to buy back more of the school payment shift. Governor Dayton vetoed the bill, citing concerns that using two-thirds of the state's budget reserve to pay back schools would undermine the state's "newly achieved fiscal stability."[3] The Governor did approve other education bills that focused primarily on policy changes.

Policymakers Reject Constitutional Budget Amendments That Threatened State's Future

Three constitutional amendments introduced in 2011 and under consideration in 2012 posed one of the most serious threats in decades to the state's ability to fund public services and invest in the future.[4]

The amendment that got the most attention would have required a three-fifths (60 percent) supermajority vote in each body of the Legislature to pass tax increases. It would have applied to the state income tax, sales tax, or a new statewide tax, as well as increases in local governments' authority to raise property taxes.

Another proposed amendment would have created other barriers to common-sense budgeting by putting a portion of state revenues in a separate account that could only be used for emergencies and could only be accessed with a supermajority vote. It would also have triggered an automatic cut in the state's sales tax – even if such an action created a budget deficit.

These amendments would have led to more government shutdowns and gridlock, more cost-shifting to local governments, created pressure to increase property taxes, impeded tax reform, and threatened the state's credit rating.

These constitutional budget amendments could have been put on the November 2012 ballot with only a simple majority vote of the Legislature. The Governor has no role in the constitutional amendment process. Despite such amendments being named as a priority coming into session, the Legislature chose not to vote during the session to move any of the proposed amendments to the ballot.

Governor Vetoes Legislature's Business Tax Cuts that Add to Future Deficits

The legislative majorities made tax cuts, primarily for businesses and investors, a top priority. They argued that such cuts would stimulate economic growth. Such an approach can have a low return on its investment, however. In some cases, the state could be providing a tax benefit for behavior that would have occurred anyway. With narrow exceptions, there were no requirements that tax cuts be spent on new hiring in Minnesota, or spur new investments that would not have occurred in the absence of the tax benefit. It's more likely that businesses will create jobs when there is more demand for the goods and services they produce, not simply in response to a tax cut.

The centerpiece of the House omnibus tax bill (House File 2337) was the gradual elimination of the statewide property tax paid by businesses and cabins. This had a cost of $40 million in lost revenues in FY 2012-13 and $310 million in FY 2014-15, and the cost grew each year until the tax was completely eliminated in 2025.

Some of the other tax cuts in the bill included increasing the Angel Tax Credit for investors in certain start-up businesses; increasing the Research and Development Credit for businesses with certain research and development expenditures; creating a jobs tax credit for employers who hire qualified veterans; and allowing businesses that make capital purchases to receive a sales tax exemption at the time of purchase, instead of the current practice of requiring them to apply for a refund.

In the current budget cycle, the House bill would have paid for these tax cuts primarily through a dramatic 38 percent cut in the Property Tax Refund for renters, commonly called the Renters' Credit. The Renters' Credit recognizes the property taxes that renters pay through their rents, and is a critical tool for ensuring that these low-and moderate-income Minnesotans don't pay more than their fair share of income. Under the House proposal, the average refund would have been cut by $213 and 66,200 Minnesota households would have become ineligible – one of five currently eligible households.[5]

And even after these deep cuts to the Renters' Credit, the House omnibus tax bill did not have a sustainable long-term funding source, and added $228 million to the FY 2014-15 deficit.

The Senate omnibus tax bill had similar priorities. Senate File 1972 included an analogous package of tax cuts for businesses and investors. The Senate bill had more tax cuts for individuals than the House bill, including a one-time $62 million income tax cut for married couples in 2012 and an increased tax benefit for people with military retirement pay.

The Senate did not make cuts to the Renters' Credit, but it still failed to find a sustainable funding source. In the near term, it offset the tax cuts through a $100 million transfer from the state's budget reserve, although the bill gave the Dayton administration the option to reduce that transfer by identifying savings or cuts elsewhere in the budget. But in the long term, it added $194 million to the deficit in FY 2014-15.

The Legislature passed several tax bills that followed these priorities. As the session went on, the Legislature scaled back the size and scope of the tax cuts in these bills, but kept the focus on tax cuts for businesses and investors. The bills continued to lack a sound funding source. For example, the cumulative loss of revenue from the tax conference report's freeze on the state business tax was estimated to be $2.3 billion.[6] Governor Dayton vetoed several such tax bills, noting he would not support legislation that used reserves to pay for tax cuts, were unfair in their impact (by cutting the Renters' Credit or by not providing tax reductions for a broader set of Minnesotans), or increased future deficits.

One of the few provisions from the omnibus bills that did become law was a one-time $4 million increase in the targeted Property Tax Refund.[7] This refund is available to homeowners without any income restrictions whose property taxes increase by at least 12 percent and at least $100 over the previous year.

Minnesota ended the session much where it started: with some of the most dangerous tax proposals rejected, but also little progress made in reforming the tax system so that it adequately funds the state's priorities and fairly distributes the responsibility for funding those services. Governor Dayton's vetoes prevented proposals that would have moved Minnesota in the opposite direction by making our revenue shortfalls even worse.

Policymakers Focus on Fixes in Health and Human Services

The final health and human services omnibus finance bill (House File 2294) focused on addressing some of the most pressing challenges facing vulnerable Minnesotans. While the bill did not offer complete solutions to these issues, it did move the state in the right direction in a session where substantial budget changes were unlikely.

The Governor and Legislature agreed to an omnibus bill that reduces net general fund spending for health and human services by $24 million in the current biennium, and increases spending by less than $1 million in FY 2014-15. There is a savings in the FY 2012-13 biennium because the additional spending in the bill was offset by $35 million in payments from HMOs that had agreed to reimburse the state for any excess profits from their public health care program contracts.

Although the final health and human services omnibus finance bill does take a few important steps forward, such as allowing individuals in the Medical Assistance-Employed Persons with Disabilities program to work past the age of 65 and maintain more of their assets, it focuses mostly on reversing or modifying decisions made during last year's turbulent special session.

Emergency Medical Assistance, which provides health care coverage for qualifying non-citizens who face a medical emergency or suffer from a serious chronic health condition, was one area where policymakers made significant reductions in 2011. Coverage for most non-emergency services was eliminated. The final omnibus 2012 bill restores coverage for kidney dialysis and cancer treatment, but only for the FY 2012-13 biennium. A recent legal settlement between the Minnesota Department of Human Services and immigration advocates requires the state to provide health care services in situations where failure to provide treatment would result in a medical emergency within 48 hours.

Personal care attendants (PCAs) enable individuals who need assistance with the activities of daily life to remain in their communities and avoid institutional care. The final omnibus bill delays the implementation of a 20 percent cut made last year in payments to people who work as personal care attendants for disabled family members. This cut raised the concern that relative caregivers, especially those in rural areas, would have to find different jobs to support themselves, leaving their relatives with no options for at-home care.

Continuing care services help Minnesotans live independently in the community and avoid institutionalized care. The final omnibus bill delays a 1.67 percent cut in payment rates for continuing care providers until FY 2014 (when an anticipated federal waiver will make the cut unnecessary). However, the payments that are restored for FY 2013 will not actually be paid to providers until FY 2014, an accounting move that will push most of the $21 million cost into the next biennium.

In 2011, lawmakers reduced the number of absent days that the state's child care assistance program would reimburse providers from 25 to 10. The reduction makes it challenging for families to maintain child care if illnesses or emergencies result in too many absences. The final omnibus bill eliminates the 10-day limit, but only for families where at least one of the parents is under 21 and attending school.

When they passed the budget in 2011, policymakers eliminated state funds for Family Assets for Independence in Minnesota (FAIM) grants, which match savings by low-income participants who are seeking post-secondary education, purchase a home or start a new business. The final omnibus bill uses $250,000 in federal Temporary Assistance for Needy Families (TANF) dollars to provide one-time funding for FAIM. While it is a step forward to have restored the state match, using federal funds to pay for the state match means that participants are not eligible for an additional federal match on their savings.

Stadium and Bonding Debates Grab Most of the Attention

Even-numbered legislative sessions in Minnesota have traditionally focused on passing the capital budget, commonly referred to as the bonding bill, which funds infrastructure investments in the state. The Legislature and Governor agreed to a $496 million bonding bill that includes funds for affordable housing, economic development, flood control, renovating and repairing buildings at Minnesota's state colleges and universities, Capitol building renovations and other projects.

Policymakers also spent a significant amount of time considering proposals for a new Minnesota Vikings football stadium. The question wasn't resolved until the final day of the session, when policymakers approved legislation supporting a $975 million facility in downtown Minneapolis.[8] The state will contribute $348 million to this project, funded primarily by the expansion of gambling to include electronic pulltabs and bingo. The City of Minneapolis is contributing $150 million of local taxes for the project.

2013 Legislative Session is Opportunity to Sustainably Fund Priorities

The 2012 Legislative Session could have fundamentally changed the state, had the constitutional budget amendments under consideration been passed. Ultimately, modest changes were made during the 2012

Legislative Session. The state's fiscal situation was improved by rebuilding reserves and beginning to reverse the school funding shift as required by law. This puts Minnesota on stronger footing to address unforeseen short-term challenges the state may face in the future. Laying this groundwork is wise in light of the fact that the state had previously spent down most of its reserves, still has a substantial way to go before fully reversing the school funding shift, and faces a substantial revenue shortfall in the FY 2014-15 biennium.

However, policymakers did not make much progress on the state's ongoing challenge to find sustainable funding for the state's priorities. The state started the session with a projected $1.1 billion shortfall for the FY 2014-15 biennium, and this session's work shaved a scant $56 million off that figure. The challenge before policymakers in 2013 is to return to the sound budgeting principles that served Minnesota well in the past, and find sustainable and fair ways to fund the state's needs.

By Christina Wessel and Nan Madden

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[1] Minnesota Management and Budget, *February 2012 Economic Forecast*.

[2] 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.

[3] Governor Mark Dayton veto letter, April 5, 2012.

[4] The proposed amendments were House File 1598/Senate File 1384, House File 1661/Senate File 1378 and House File 1612/Senate File 1364. For more information, see Minnesota Budget Project, Supermajority Amendment is Wrong for Minnesota and '98 Percent' Constitutional Amendment Creates Barriers to Common-Sense Budgeting.

[5] Minnesota Department of Revenue, Property Tax Division. For more information, see Minnesota Budget Project, 2012 House Tax Bill Would Severely Cut Renters' Property Tax Refunds.

[6] Tax Conference Report on House File 2337.

[7] This was included in House File 2690.

[8] House File 2958.