



# *Unbalanced Priorities*

*Dividing Up the Surplus  
in the 2001 Legislative Session*

The Minnesota Budget Project, an initiative of the Minnesota Council of Nonprofits, provides independent research, analysis, and outreach on state budget and tax policy issues, emphasizing their impact on low- and moderate-income persons and the organizations that serve them.

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## EXECUTIVE SUMMARY

One of the central points of disagreement in the 2001 Legislative Session was how to divide up the state's surplus. While the surplus is only a relatively small part of the total budget, how it is used puts priorities into sharp focus. Surplus funds are what can be used for new initiatives, to expand programs from existing levels, or to reduce taxes, without having to use dollars already committed to other needs.

Under the final budget agreement, 43% of the surplus went to tax cuts and 19% to new spending. This means that for every \$1 of the surplus that went to new spending, \$2.26 went to tax cuts. This may not be the right balance for Minnesota, as some critical needs were left unmet. Policy-makers may regret this lost opportunity since the economic slowdown makes future large surpluses unlikely.

<b>Where did the 2002-03 surplus go?</b>	<b>\$ in millions</b>	<b>% of Surplus</b>	<b>% of Surplus omitting endowments, reserves, and unallocated</b>
New spending (above inflation)	298	19%	31%
Tax changes (above inflation)	672	43%	69%
Tobacco endowments	343	22%	-
Budget reserve	31	2%	-
"Bottom line" (unallocated)	217	14%	-
<b>Total</b>	<b>\$ 1,561</b>	<b>100%</b>	<b>100%</b>

Source: Author's analysis of House Fiscal Analysis data

### ***Setting the Stage: The Ventura Budget***

When Governor Ventura presented his budget in January, there were more surplus dollars available to him than there were for the final budget agreement in June. The Department of Finance's November 2000 Forecast had estimated a surplus of \$924 million in the 2000-01 biennium and an additional \$2.086 billion for 2002-03.

In his 2002-03 biennial budget, Governor Ventura set out the principle that growth in government spending must be reined in. He expressed displeasure that general fund spending was 16.1% higher under the 2000-01 budget than in the previous biennium. Therefore, the Governor recommended that only 4% of the surplus would be used for new spending. New initiatives in his budget were offset by reduced spending in existing programs.

However, looking only at increases in general spending gives an incomplete picture of the growth in government. Looking at taxes or the more comprehensive Price of Government shows the burden of state government on Minnesotans has been gradually declining.

The Governor's top priority for the surplus was tax reform and relief, which used 78% of the 2002-03 surplus as measured in November. In addition, the Governor proposed to return the entire 2000-01 surplus as a rebate. Surplus dollars are an appropriate source of funding for tax cuts — without a surplus, tax relief must be offset by cuts in existing programs. Minnesota has devoted slightly over half of its total surpluses from 1997 to 2000 to tax cuts, and in fact led the country in tax cuts during this time.<sup>1</sup> However, the challenge is to find the appropriate balance between tax relief and spending.

<sup>1</sup> Children's Defense Fund – Minnesota, *Surplus Spending: Where has all the money gone?*

With the remainder of the surplus, Governor Ventura proposed putting 4% toward increasing the state's budget reserve and setting aside the 16% of the surplus that came from tobacco settlement funds into Medical Education and Healthy Kids endowments.

When the Department of Finance updated its figures in February 2001, the 2002-03 surplus had dropped by 25% to \$1.561 billion. The Governor maintained his commitment to augmenting the reserves and setting aside the tobacco settlement funds, but cut back his tax reform proposal. Nonetheless, tax changes still took up 68% of the 2002-03 surplus as measured in February.

### ***Legislative Responses: Senate Splits the Surplus Between Tax Relief and Spending, House Allocates Most of Surplus to Tax Cuts***

On both the 2001 rebate and the 2002-03 surplus, the two legislative bodies were in disagreement. Regarding the 2000-01 surplus, the House of Representatives agreed with the Governor's plan to use the entire amount for a rebate. The Senate, on the other hand, proposed using half of the available amount for a rebate, and the other half for one time investments in transportation, housing, and higher education.

For the 2002-03 surplus, the differences were even more dramatic. The Senate agreed with the Governor's proposal to divert the tobacco settlement funds into endowments, and divided the remaining surplus more evenly: 44% to new spending, 32% to tax cuts. The House proposal was similar to the Governor's in that only 5% surplus went to new spending. However, the House would leave the tobacco settlement in the general fund, allowing 93% of the surplus to be devoted to tax cuts.

### ***The Compromise: Some Additional Spending, But Tax Cuts Dominate***

As the legislative session progressed, the economic future was seen to be less rosy than previously thought, and it appeared that some of the surplus that policy-makers were depending on might not materialize. In the end, 14% of the 2002-03 surplus as measured in February was left unallocated, and 2% was dedicated to the state's budget reserve. Agreement was reached to put the tobacco settlement funds into the Medical Education Endowment to support the University of Minnesota's Academic Health Center.

Tax cut plans were scaled back, but nonetheless took up 43% of the 2002-03 surplus as measured in February. New spending received 19% of the available surplus. However, if the amounts that went to endowments, reserves, or were unallocated are set aside, 31% of the remaining surplus went to new spending and 69% to tax cuts. This is in addition to the rebate, which used the entire 2000-01 surplus balance.

Certain spending areas did not even keep up with inflation. Progress was made in reducing the waiting list for child care assistance only by using additional federal funds. Similarly, despite a severe housing shortage, the only significant investments in affordable housing were funded with federal welfare dollars. Even in areas that did receive increases, it's not clear that needs were adequately met. For example, despite a 6.6% increase in higher education funding, students at the University of Minnesota and the Minnesota State Colleges and Universities face double-digit tuition increases. Given the state's unwillingness to spend money to address the needs of Minnesota citizens during times of surplus, one can only wonder how well the state will do in meeting its obligations as economic times become more troubled.

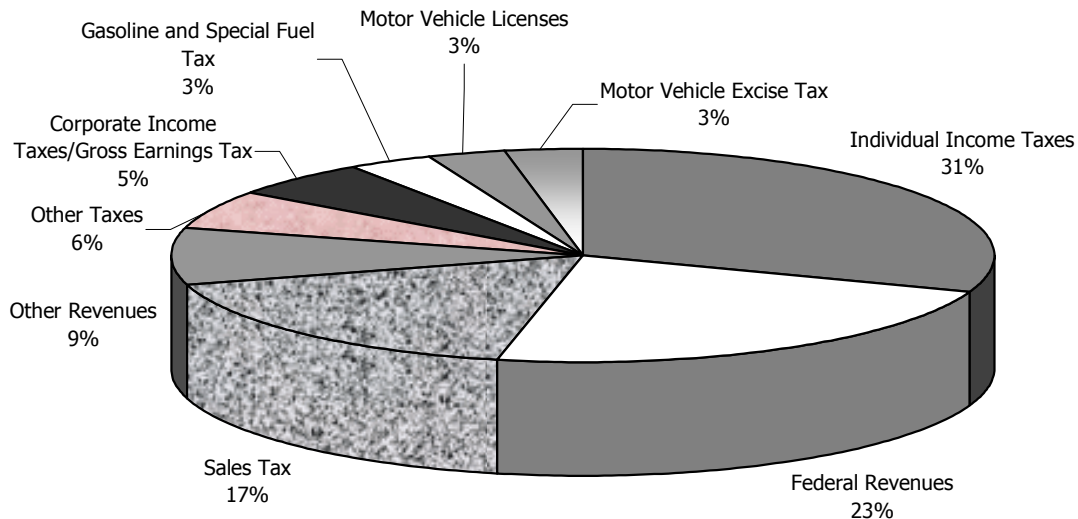
# BACKGROUND: AN INTRODUCTION TO THE MINNESOTA BUDGET

In January of each odd-numbered year, the Governor submits a two-year budget, called the **biennial budget**, to the state legislature.<sup>1</sup> The budget describes how state resources will be distributed among priorities such as education, health care, housing, economic development, transportation, public safety, agriculture, and state and local government operations. It also describes any proposed changes to the amount of state revenues to be collected.

In preparing the budget, the Governor needs to find a balance between state revenues and spending. State revenues are collected from a variety of sources, the largest of which is the individual income tax, which accounted for 31% of state revenues in FY 2000. The second largest source of revenue, accounting for 23% of the total, is the federal government.

## Where Does the Money Come From?

All Sources of State Revenues, FY 2000



Source: Department of Finance, 2000 Annual Comprehensive Financial Report

Once revenues have been received, the state divides these resources into separate funds. The **general fund** is the largest single fund, containing around 60% of total state revenue. Most of its money comes from the state's individual income tax, sales tax, and corporate income tax. Generally, resources in the general fund are not designated for any specific purpose.

The state's **special revenue funds** are used to dedicate individual revenue sources for particular purposes. For example, the vehicle registration tax and gas tax are dedicated to the Highway User Tax Distribution Fund, which can only be used for transportation.

Because general fund dollars are available for virtually any purpose, this funding source typically receives the most attention from the legislature and administration. The table below shows how the 2000 legislature allocated general fund dollars for the last biennium, divided into the

<sup>1</sup> The state's fiscal year runs from July 1 to June 30. For example, the 2000 fiscal year runs from July 1, 1999, to June 30, 2000, and is abbreviated FY 2000. A biennium covers two state fiscal years.

categories used by the legislature. The largest part of general fund spending goes to K-12 education, followed by health and human services, property tax aids and credits, and higher education. This distribution is not the same as looking at *all* government dollars spent in Minnesota. When looking at all funds, the largest portion of spending went to health and human services, followed by K-12 education and transportation. This reflects that health and human services and transportation rely heavily on funding sources outside the general fund, including federal funds and dedicated revenue sources.

<b>Expenditures - FY 2000-01</b>	General Fund	All Funds
K-12 Education	33%	24%
Health & Human Services	22%	31%
Property Tax Aids and Credits	14%	9%
Higher Education	11%	7%
Criminal Justice	5%	3%
State Government	3%	3%
Debt Service	2%	2%
Environment & Natural Resources	2%	3%
Transportation	2%	11%
Economic Development	2%	4%
Family & Early Childhood Education	2%	2%
Dedicated Expenditures	1%	-
Capital Projects (Bonding)	1%	-
Motor Vehicle Tab Replacement	1%	-
Transfers	-	1%

Source: Author's analysis of Department of Finance and House Fiscal Analysis data<sup>2</sup>

### ***Property Tax Aids and Credits: Spending or Tax Relief?***

One expenditure category that is somewhat different from the others is property tax aids and credits. This category includes state expenditures that reduce the property tax burden on Minnesotans, such as the Property Tax Refund (known popularly as the Circuit Breaker and Renter's Credit) and state aid programs to local governments, such as Homestead and Agricultural Credit Aid (HACA) and Local Government Aid (LGA). However, other actions that policy-makers take to reduce state tax burdens — income tax rate reductions and sales tax exemptions, for example — do not count as spending, but instead are accounted for as a reduction in state revenues. Without putting these two pieces together, it is difficult to get a full measure of the impact of tax proposals, which usually contain a combination of items measured on both the expenditure and revenue sides.

In addition, counting property tax aids and credits as expenditures can lead to misleading conclusions about total spending. Increases in spending over time are often cited as proof that the tax burden on Minnesotans is growing, although included in total spending are some of the legislative actions to ease that burden.

This analysis does not include property tax aids and credits in measures of total spending. All tax provisions — including property tax aids and credits — are combined into one item called tax changes to show the net impact of tax proposals on the state's general fund.

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<sup>2</sup> Department of Finance, *2000-01 Biennium, Where the General Fund Dollars Go*, House Fiscal Analysis, *Money Matters: State Expenditures – All Operating Funds*.

# THE NOVEMBER FORECAST: MEASURING THE STATE'S FINANCIAL STATUS

The Minnesota Department of Finance releases reports on the economic outlook for the state in November and February, which are simply called the *November Forecast* and *February Forecast*. The forecast estimates state revenues and expenditures for three two-year periods and are used to measure the state's financial status. The forecast numbers do not reflect any policy proposals by the Governor or legislature, but are used by policy-makers as a guide in making budget decisions.

<b>November 2000 Forecast General Fund Figures</b>	\$ in millions
2000-01 Surplus	\$924
2002-03 Available Balance	\$2,086
2005 Structural Balance	\$1,538

For the 2000-01 biennium, the November 2000 forecast estimated a **surplus** of \$924 million. The surplus is the difference between expected general fund revenues and forecasted expenditures at the end of the 2001 fiscal year. Only 40% of the surplus was currently on hand at the time of the forecast.

The forecast showed a projected **available balance** of \$2.086 billion for the 2002-03 biennium, which is the difference between forecasted revenues and expenditures, based on current law and adjustments in caseloads, expected costs, and inflation. The available balance is the total amount available for tax cuts and new spending above estimated inflation in the 2002-03 biennium, and it is this figure that is described as the 2002-03 surplus. It is in addition to the \$924 million surplus available at the end of the 2001 fiscal year. These surplus figures represent general fund dollars only — they do not include balances in reserves, special funds, or available federal revenues.

In determining the available balance, the November forecast estimated **inflation** of about 2% per year, or \$737 million. The estimated inflation amount does not have to be spent on inflation adjustments and is only spent when appropriated by the legislature for a specific purpose. Of this \$737 million, \$105 million is for estimated increases in property tax aids and credits, and the rest for inflationary increases in other spending. Because the estimated inflation is subtracted when calculating the surplus, that means that spending could be increased by \$632 million and property tax aids and credits by \$105 million in 2002-03 *without* taking money out of the surplus. It is only spending over the estimated inflation amounts (which in this analysis is called “new spending over inflation” or “tax changes above inflation”) that comes out of the surplus.

<b>FY 2002-03 Available Balance</b>	
(\$ in Millions)	
<b>Forecast Revenues</b>	<b>\$28,211</b>
Projected Spending:	
Current Law	25,388
Estimated Inflation	737
<b>Total Spending</b>	<b>26,125</b>
<b>Available Balance</b> (difference between revenues and spending)	<b>\$2,086</b>

Finally, the forecast provides planning estimates for 2004-05. The **structural balance**, estimated to be \$1.538 billion in Fiscal Year 2005, is the difference between expenses and revenue in a fiscal year, *excluding* all balances and one time expenses or revenues. Because it does not include time-limited resources, structural balance is used as a measurement of how much spending is sustainable into the future. It has been the policy of the Ventura administration not to accept total spending over the structural balance figure.

## GOVERNOR VENTURA'S BUDGET PROPOSAL

When Governor Ventura introduced his budget for the 2002-03 biennium in January, his priorities were to return the 2000-01 surplus to taxpayers, enact significant tax reform and relief, and limit the amount of new government spending. The Governor dedicated 78% of the available 2002-03 surplus to tax reform and relief above inflation, 4% to new spending above inflation, and 4% to the budget reserve. He also devoted the 16% of the surplus that came from the tobacco settlement to endowments. These budget decisions are described in more detail below.

<b>Governor Ventura's 2002-03 Surplus Proposal</b>	\$ in millions	% of Surplus
New spending (above inflation)	77	4%
Tax changes (above inflation)	1,634	78%
Tobacco endowments	334	16%
Budget reserve	78	4%
Unallocated and adjustments	-37	-2%
<b>Total</b>	<b>\$ 2,086</b>	<b>100%</b>

Source: Author's analysis of House Fiscal Analysis data

### ***2000-01 Surplus Returned in Rebate***

Under Minnesota law, when the November forecast in an even-numbered year or February forecast of an odd-numbered year shows a positive general fund balance over 0.5% of total biennial revenues, the Commissioner of Finance must designate the entire balance as "available for rebate." This was the case with the November 2000 forecast, which estimated a 2000-01 final balance of \$924 million. Under these circumstances, the Governor is required to present a plan to the Legislature for rebating the surplus. Although the legislature must make a decision about the amount designated as available for rebate, they are not required to rebate it — the funds can be used for other purposes. Governor Ventura proposed that the entire surplus be used for a sales tax rebate similar to those enacted in 1999 and 2000.

### ***Tax Reform and Relief***

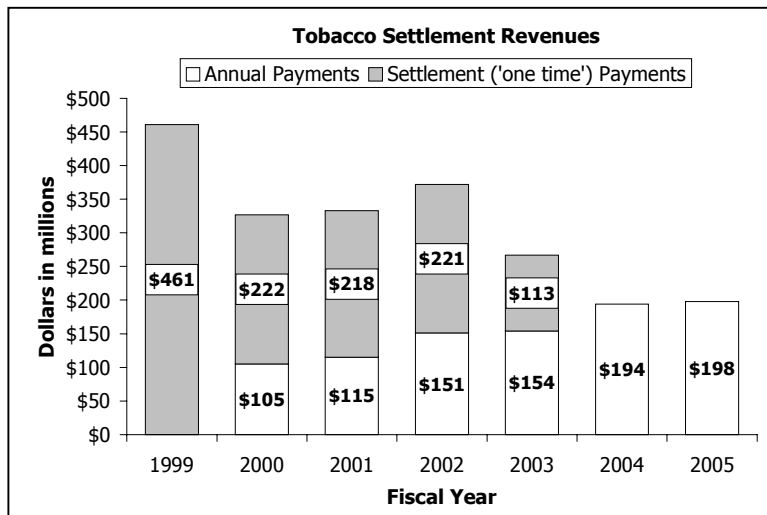
The primary emphasis of the Governor's budget was tax reform and relief. He proposed a fundamental restructuring of the property tax system, expanding the sales tax to services while lowering the rate, cutting income tax rates, and reducing the motor vehicle registration tax. The tax proposal would reduce the state's general fund by \$1.739 billion in 2002-03 and by \$2.7 billion in 2004-05, combining reduced revenues, collection of new revenue sources, and increased expenditures.<sup>3</sup>

<sup>3</sup> Of the \$1.739 billion cost for the 2002-03 biennium, \$105 million comes from the estimated inflation amount. This leaves \$1.634 billion to be funded by the surplus.

### ***Some Surplus Funds Taken “Off the Table”***

The surplus included \$334 million that came from the state’s tobacco settlement. Tobacco settlement revenue consists of “one time” payments received in 1999 through 2003, and ongoing annual payments. The one time payments received in 1999, 2000, and 2001 were dedicated to the Medical Education Endowment Fund and the Tobacco Prevention Endowment Fund.<sup>4</sup> The \$334 million in payments for 2002 and 2003 had not been dedicated, and therefore were included in the 2002-03 surplus total.

The Governor proposed putting the one time tobacco payments for 2002 and 2003 into two endowments. The Medical Education Endowment would receive \$160 million to support the University of Minnesota’s Academic Health Center. The remaining \$174 million would be used to create a Healthy Kids Endowment to improve health education in schools, strengthen partnerships between schools and local public health services, and develop a comprehensive program for immunizing children.



Source: November 2000 Forecast

A second dedication of general funds proposed by the Governor related to the state’s **budget reserve**, which is money that is held in an account in case of future budgetary shortfalls. The reserve is in addition to a **cash flow account** of \$350 million to cover potential imbalances in the timing of revenue collections and expenditure payments. The budget reserve contains \$622 million and the interest earned on it goes into the general fund. Citing a potential slowdown in the economy outlined in the November forecast, Governor Ventura proposed retaining the interest earned on the reserve in that account, thereby increasing it to \$700 million by the end of FY 2003.

### ***New General Fund Spending Limited***

Despite the surplus, Governor Ventura argued that it was necessary to rein in government spending. He expressed his displeasure that general fund spending (including property tax aids and credits) grew 16.1% under the 2000-01 budget compared to the previous biennium, and he noted that the forecast included a 3.2% increase in general fund spending for 2002-03 simply due to previously enacted decisions.

In his budget, Governor Ventura recommended \$709 million in new general fund spending, \$77 million over the inflationary increase assumed for non-tax spending in the November forecast, or 4% of the 2002-03 surplus.<sup>5</sup> Under his proposal, general fund spending for 2002-03 would increase by 5.4% over the previous biennium excluding the costs associated with tax reform and relief, or 11% when including property tax aids and credits.

<sup>4</sup> When money is set aside in an endowment, the funds are invested and only the earned interest is spent.

<sup>5</sup> Of the \$709 million in new spending, \$632 million comes from the estimated inflation amount. This leaves \$77 million to be funded by the surplus.

Governor Ventura asked state agencies to focus on shifting existing resources from lower priorities to higher ones when developing their budget requests, rather than asking for new money in anticipation of surpluses. To create an incentive to identify lower priorities, agencies were required to reduce their budgets by 2.5% before funding for any new initiatives would be considered. The savings were put into a “Challenge Pool” that was redistributed to agencies for new initiatives on a competitive basis.

The 2002-03 budget provided state agencies with a 3% per year increase for salary and compensation, of which health insurance cost increases were expected to take up at least half. For many agencies, this was the only increase in their operational budgets. Some investments were also made in Courts and Public Defenders to cover increased caseload costs, State Patrol training academies and trooper salaries, and security improvements in state prisons.

The Governor strongly expressed his belief that the state is a partner with state universities, local governments, schools, and other public systems, but would not be fully responsible for them. For example, only two-thirds of a 3% increase for higher education faculty and staff compensation was included in the budget, with the remainder expected to be made up by tuition. The Governor’s budget proposed that K-12 instructional staff and long-term care providers would receive a 2% cost of living adjustment in the second year of the biennium only, because there had been increases in these areas in the 2000 legislative session.

New initiatives were proposed for investments in health care and reducing disparities between whites and communities of color, technology projects, and workforce development. However, many of these initiatives used federal Temporary Assistance to Needy Families (TANF) dollars, transfers from the Health Care Access Fund, the tobacco settlement endowments, and tax reductions, rather than general fund investments.

<b>Governor Ventura’s 2002-03 Budget Proposal – New General Fund Spending</b>	<b>\$ in millions</b>	<b>Change from Current Law</b>
K-12 Education	105	1.2%
Family & Early Childhood Education	17	3.3%
Higher Education	99	3.7%
Health & Human Services	215	3.5%
Environment & Agriculture	16	3.0%
Economic Development	37	10.1%
Transportation	47	26.1%
Criminal Justice	91	7.4%
State Government	75	10.5%
Debt Service	22	3.5%
All Other	(15)	-5.4%
<b>Total</b>	<b>\$ 709</b>	<b>2.8%</b>

Source: Author’s analysis of Governor’s 2002-03 Budget

### ***How Fast Has Government Spending Been Growing?***

Despite its prevalence in budget discussions, growth in general fund spending is not the best figure for measuring the burden of government on Minnesotans. It can be misleading for several reasons:

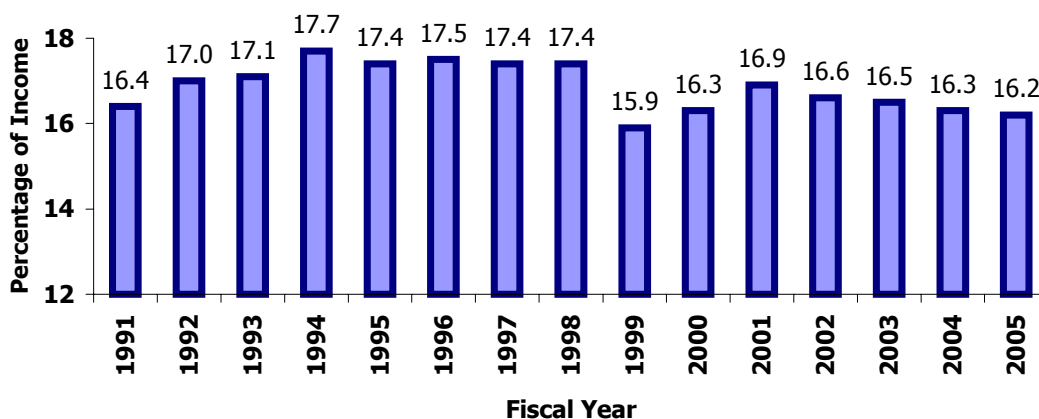
- The general fund makes up only 60% of total state resources.

- Property tax aids and credits are counted as general fund spending even though they reduce local taxes and thereby lower the tax burden on Minnesotans.
- Certain actions can reduce general fund spending without reducing government burden, such as replacing taxes with fees, lowering funding for higher education and making it up in higher tuition, transferring spending from the general fund to another fund, or moving funding responsibilities from the state to other levels of government.
- One time expenditures will contribute to an increase in general fund spending for a particular year, but do not necessarily indicate an ongoing commitment.

A common measure of the cost of government is taxes. State tax burdens have been declining over the past several years, thanks to several years of large tax cuts. In 1996, Minnesotans paid an average of 12.7% of their incomes in state and local taxes. In 1998, this amount dropped to 11.8%, and was predicted by the Department of Revenue to drop to 11.2% in 2003 even before any changes were made in the 2001 legislative session.<sup>6</sup>

However, tax information misses the cost of certain government services. When asking how big a piece government takes out of Minnesotans' budgets, a more comprehensive measure is the **price of government**. The price of government compares all state and local revenues (including taxes, fees, and tuition) except those transferred from the federal government, and measures the total as a percentage of personal income in the state. Calculating burden as a percentage of income compares government revenues to Minnesotans' ability to pay. The November forecast projected the price of government to be lower from 2000 through 2005 than it had been in the 1990s, and the trend was for a gradual decline, reaching 16.2% in 2005.<sup>7</sup> Although government revenues have been growing, Minnesotans' incomes have been growing even faster, so the price of government becomes a smaller part of their budgets.

### Minnesota's Price of Government



Source: Department of Finance, November 2000 Forecast supplement

While there are valid reasons to contain growth in spending, the data do not show that state spending is rapidly growing out of control.

<sup>6</sup> Minnesota Department of Revenue, *1999 Minnesota Tax Incidence Study* and *2001 Minnesota Tax Incidence Study*.

<sup>7</sup> In the February 2001 forecast, the price of government was even lower for years 2001 through 2005, reaching 16.0% in FY 2005.

## THE FEBRUARY FORECAST: REVISED ECONOMIC CONDITIONS INTENSIFIES BUDGET DEBATE

The February 2001 forecast predicted that the state's economy would grow less quickly than expected in November. It did not predict a recession, but rather expected a slowdown of short duration, with growth rates picking up again in the fall of 2001. Slower economic predictions meant the February forecast projected smaller surplus for both 2000-01 and 2002-03.<sup>8</sup>

<b>February 2001 Forecast General Fund Figures</b>	November 2000 (\$ in millions)	February 2001 (\$ in millions)	Percentage Change
2000-01 Surplus	924	856	-7.4%
2002-03 Available Balance	2,086	1,561	-25.2%
2005 Structural Balance	1,538	1,423	-7.5%

In addition to the general fund figures declining, the February forecast also warned that its predictions should be seen as being riskier than in November. Data Resources Inc., (DRI), the state's economic consultant, assigned a 50% probability that their scenario used to prepare the February forecast was correct. The likelihood of a recession during the forecast period increased from 25% in the November 2000 forecast to 40% in the February 2001 forecast.

### ***New Forecast Requires Adjustments to Governor's Budget***

The anticipated economic slowdown led Governor Ventura to make some adjustments to his budget in March, but it did not change his priorities. He continued to support rebating the entire 2000-01 surplus, enacting significant tax reforms and reductions, and keeping new government spending in check.

Regarding the 2002-03 biennium, given that the budget was already very lean in terms of new spending, the total spending amount was left relatively unchanged. Cutbacks mainly came in the tax area, although savings were found primarily by delaying certain tax cuts. The general fund impact of the tax proposal was reduced from \$1.739 billion in the original budget to \$1.16 billion.<sup>9</sup> The Governor also increased the amount to be dedicated to the reserves.

Overall, tax reform and relief was still the Governor's top priority, but its share of the surplus dropped from 78% in the original proposal to 68%. The tobacco settlement revenue grew slightly from the November forecast to \$343 million, and now comprised 22% of the surplus, up from 16% in January. The percentage of the surplus dedicated to new spending over inflation was up only slightly, from 4% in the original budget to 5% after the March revisions.

<b>Governor Ventura's 2002-03 Surplus Proposal – March adjustments</b>	\$ in millions	% of Surplus
New spending (above inflation)	84	5%
Tax changes (above inflation)	1,055	68%
Tobacco endowments	343	22%
Budget reserve	97	6%
Unallocated and adjustments	-17	-1%
<b>Total</b>	<b>\$1,561</b>	<b>100%</b>

Source: Author's analysis of House Fiscal Analysis data

<sup>8</sup> The estimated inflation amount was adjusted to \$735 million, with \$105 million for property tax aids and credits and \$630 million for other spending.

<sup>9</sup> Of the \$1.16 billion cost, \$105 million comes from the estimated inflation amount, leaving \$1.055 billion to be funded by the surplus.

## THE LEGISLATURE RESPONDS

### *The 2000-01 Surplus*

The Legislature had two main sums to work with in the legislative session: the 2000-01 surplus and the 2002-03 available balance. The February 2001 forecast stated that \$856 million was “available for rebate,” and the legislature had until April 15 to respond to the Governor’s proposal to return the entire amount as a sales tax rebate. The House agreed with the Governor’s rebate plan. The Senate, however, proposed using half of the surplus for a rebate, and using the rest for one time investments in transportation, housing, and higher education.

<b>2000-01 Surplus Proposals</b> (\$ in millions)	Governor	House	Senate
Rebate	856	856	425
Transportation	0	0	300
Housing	0	0	75
Higher Education	0	0	50
Unallocated	0	0	6
<b>Total</b>	<b>\$ 856</b>	<b>\$ 856</b>	<b>\$ 856</b>

Source: Senate Majority Research

### *Budget Resolutions Set the Big Picture*

In setting out their priorities for the 2001 session, both the House and Senate passed Budget Resolutions that established the total amount of general fund transfers and appropriations in the 2002-03 biennium. These resolutions also describe the impact on the price of government, which takes into account state revenues as a percentage of personal income in the state, and thereby measures the burden of government on Minnesotans. The House, Senate, and Governor all proposed to lower the price of government compared to existing law, although the Senate’s proposal would not lower it as much as the others.

<b>Price of Government</b> (percentage of personal income)	Current Law	Governor	House	Senate
2002-03	16.3%	15.9%	15.9%	16.2%
2004-05	16.1%	15.5%	15.5%	15.7%

Sources: House Fiscal Analysis, House and Senate Budget Resolutions

### *Targets Establish Spending Priorities*

Once they have determined the total amount of resources available, each legislative body sets **targets**, which distribute the available resources among the various legislative committees. Just as the Governor’s budget proposal indicates his priorities for the biennium, the targets reflect the budget priorities of the House and Senate. Committees cannot allocate more than their targeted share of resources.

The House dedicated 5% of the 2002-03 surplus to new spending over the estimated inflation amount and 93% to tax changes over inflation. The Senate, on the other hand, devoted 44% of the surplus to new spending and 32% to tax changes. The following table shows increases over current law. To determine how much of these target amounts comes from the surplus, \$630

million must be subtracted from total spending and \$105 million must be subtracted from tax changes.<sup>10</sup>

<b>2002-03 General Fund New Spending Targets</b> (\$ in millions)	<b>Governor</b>	<b>House</b>	<b>Senate</b>
Early Childhood/K-12 Education	114	355	500
Higher Education	99	165	233
Environment/Agriculture	16	16	46
Transportation	82	0	85
State Government/Judiciary/ Economic Development	144	45	111
Health & Human Services/Corrections	241	135	344
<b>Total Spending</b>	<b>\$696</b>	<b>\$716</b>	<b>\$1,319</b>
<b>Tax changes</b>	<b>\$1,160</b>	<b>\$1,555</b>	<b>\$601</b>

Source: Author's analysis of Senate and House Fiscal Analysis data.

House and Senate committee structures differ. Funding for Corrections is included in the Judiciary Finance target in the House and in the Health & Human Services target in the Senate. Department of Safety funding is included in the Judiciary Finance target in the House and in the Transportation target in the Senate.

### ***The House Proposal: Limited Spending, Larger Tax Cuts***

The House, with Republicans in the majority, shared many of the same budget priorities as Governor Ventura. They supported the Governor's emphasis on tax relief, although they did not agree wholeheartedly with his approach to tax reform; they particularly opposed the Governor's plan to expand the sales tax to services. The House reflected the same overall level of new spending for 2002-03 as the Governor, although the House placed greater emphasis on funding K-12 and higher education. The House made no new investments in transportation out of the general fund, proposing instead to increase funding by dedicating specific revenue sources to transportation.

### ***The Senate Proposal: Surplus Divided Between Tax Cuts and Spending***

The Senate, with Democrats in the majority, expressed very different priorities from Governor Ventura and the House. Although the Senate also supported tax relief and reform, they argued that it should be balanced with a similar amount of new investments in areas like education, transportation, and health and human services. They proposed new spending greater than proposed by the Governor or House in every category. Their overall target for new general fund spending in 2002-03 was nearly twice that proposed by the Governor or the House. However, this meant that the Senate was unable to offer sweeping tax reform in their omnibus tax bill, given their much smaller target.

<sup>10</sup> This table uses the Senate's method of categorizing spending. Available documents do not show some items, such as capital expenditures and debt service, that are included in spending totals elsewhere in this document, giving a slightly lower figure for spending for the Governor's plan than used elsewhere. The tax changes figures shown are the net general fund cost of the omnibus tax bills passed by each legislative body and the Governor's tax proposal as revised in March.

## **“Hands Off” the General Fund Means Seeking Other Funding Sources**

By agreeing to severely constrain growth in general fund spending and wanting to commit a significant amount of the surplus to tax relief, the House had little room to improve on the Governor’s spending targets. Devoting more funds to spending priorities meant finding resources outside of the general fund. The House proposed using \$73 million from the Workers Compensation Assigned Risk Plan for investments in the environment, judiciary, state government, and transportation. The House also did not agree with the Governor’s proposal to set aside the tobacco settlement money. This allowed them to propose a tax bill that was significantly larger than the Governor’s.

The House, Senate, and Governor all looked to the TANF reserve as a way to fund certain priorities without using general fund money. Temporary Assistance for Needy Families, or TANF, is a federal block grant that can only be used for welfare and family supports. TANF funds that are unused by the state in a given year are carried over to the next year and are accounted for in the TANF reserve.

The forecast is based on current law, and therefore probably overstates the size of the TANF reserve. The forecast had to assume that families who hit the 60-month time limit on assistance during the 2003 fiscal year would all leave the TANF program, even though the 2001 Legislature was expected to allow some families to continue to be eligible for assistance. Therefore, the forecast assumes an unrealistic caseload decline of around 12% due to time limits.

<b>Estimated TANF Reserve</b>	
FY 2001	\$147 million
FY 2002	\$125 million
FY 2003	\$139 million
FY 2004	\$216 million
FY 2005	\$294 million

Source: February 2001 Forecast

Another reason for caution regarding the TANF reserve is that the TANF block grant expires three months into FY 2003. It is uncertain at this point what decisions Congress will make about TANF in 2002 when the program comes up for reauthorization. The forecast assumes that Minnesota will continue to receive federal TANF dollars at the current rate. Because of these two uncertainties — time limits and reauthorization — TANF reserve estimates for FY 2003 and beyond should be approached cautiously.

Although TANF funds are only authorized for certain types of expenditures, they are sometimes made available for general purposes through a process called “refinancing” or “supplantation.” Under refinancing, TANF funds replace existing state funding for a TANF-eligible purpose, and the freed-up state funds are then available for general purposes. The Senate, Governor, and House all proposed using significant amounts of the TANF reserve, and some degree of refinancing. However, the Senate and Governor used refinanced dollars to fund self-sufficiency initiatives that do not meet TANF guidelines, while the House used refinanced dollars for purposes not directly related to family self-sufficiency.

## **THE COMPROMISE**

Reaching a compromise between the House, Senate, and the Governor proved to be challenging to say the least, requiring a special session that met up until the day before the new biennium began. Not only did the players need to overcome very different priorities for state resources, but as the session progressed, new financial reports came in that suggested that the resources all parties were counting on might be smaller than previously thought. The April *Economic Update*

from the Department of Finance reported that general fund revenues during February and March of 2001 were \$60 million less than forecast, a drop of 3.1%. Furthermore, Data Resources Inc. was predicting lower state revenues for FY 2002-03 than initially expected, due to a weakening U.S. economy.

The Governor and House prevailed in their desire to see the entire 2000-01 surplus refunded to taxpayers and the largest part of the 2002-03 surplus going to tax relief. Scaling back significantly from the House and Governor's original proposals, the omnibus tax bill made significant changes to Minnesota's property tax system and the way certain government services are funded, but made few significant changes to other kinds of taxes.

<b>Where did the 2002-03 surplus go?</b>	<b>\$ in millions</b>	<b>% of Surplus</b>	<b>% of Surplus omitting endowments, reserves, and unallocated</b>
New spending (above inflation)	298	19%	31%
Tax changes (above inflation)	672	43%	69%
Tobacco endowments	343	22%	-
Budget reserve	31	2%	-
"Bottom line" (unallocated)	217	14%	-
<b>Total</b>	<b>\$ 1,561</b>	<b>100%</b>	<b>100%</b>

Source: Author's analysis of House Fiscal Analysis data

There was a net increase in general fund spending of \$928 million in the final budget agreement. To determine how much of the surplus was used for new spending, it is necessary to subtract the \$630 million inflation adjustment assumed in the February forecast. This leaves \$298 million in new spending from the 2002-03 surplus, or 19% of the total as measured in February.

Revenues from the tobacco settlement were placed in the Medical Education Endowment to support the University of Minnesota's Academic Health Center. An additional \$31 million went into the budget reserve. Since there was uncertainty as to the actual size of the surplus by the end of the session, decision-makers left a portion of the surplus unallocated. If the amounts that went to endowments, reserves, or were unallocated are set aside, 31% of the remaining surplus went to new spending and 69% to tax cuts.

### ***Limited New Funding Leaves Important Needs Unmet***

With \$630 million assumed to cover inflationary increases and \$298 million in new spending, there were few major new spending initiatives. The House and Senate's emphasis on funding education prevailed: both K-12 and higher education received more new funding than the Governor had proposed, with an increase of 4.7% for K-12 and 6.6% for higher education. However, some have questioned whether the increase was sufficient. For example, students at the University of Minnesota and the Minnesota State Colleges and Universities face double-digit tuition increases.

Some areas of funding received little new investments, despite a clear need. The Family and Early Childhood Education and Jobs and Economic Development committees did not even receive an inflation adjustment. Progress on helping the nearly 3,000 families on the waiting list for child care assistance was only possible using \$9 million in TANF funds.

In economic development, several ongoing programs, such as the Displaced Homemaker program, had to rely on targeted funding sources, including TANF and workforce development

funds, to a greater extent than in the past. The overall replacement of general fund money with dedicated funding sources means a slight net decrease in general fund spending for economic development in the 2002-03 biennium. Another responsibility of the Jobs and Economic Development committee is addressing the state's affordable housing crisis. However, the only significant new investments in affordable housing were funded with \$24 million of TANF funds, which are one time in nature.

<b>2002-03 New General Fund Spending</b>	\$ in millions	Change from Current Law Spending
K-12 Education	393	4.7%
Family & Early Childhood	0	0%
Higher Education	176	6.6%
Health & Human Services/Corrections	215	3.1%
Transportation/Public Safety/Courts	130	21.5%
State Government	5	0.8%
Environment & Agriculture	16	3%
Economic Development	-1	-0.4%
Debt Service	9	
Other	-15	
<b>Total Expenditures</b>	<b>\$ 928</b>	

Source: Author's analysis of House Fiscal Analysis data

The TANF reserve was relied on heavily in the 2001 legislative session, with only \$13 million left at the end of FY 2003, although the reserve is expected to increase in the 2004-05 biennium if TANF is reauthorized at its current funding level. In addition to funding child care, economic development, and housing as described above, a significant portion of the TANF reserve went for ongoing features of the welfare program, such as extensions for families reaching the time limit, providing assistance to legal citizens, and preventing implementation of the "\$100 housing penalty," which would cut grants for families in subsidized housing. Future legislatures will have to deal with the consequences of using one time resources for ongoing financial commitments.

It does not appear that the right balance was struck in using surplus funds in the 2001 legislative session, as some critical needs were left unmet. The lack of investment was the result of policy decisions, not because of a shortage of funds. Given the state's unwillingness to spend money to address the needs of Minnesota citizens during times of surplus, one can only wonder how well the state will do in meeting its obligations as economic times become more troubled.

## **Sources**

Several primary data sources were used in the preparation of this analysis, including House Fiscal Analysis' *An Overview of Governor Jesse Ventura's FY 2002-03 Biennial Budget Recommendations* and spreadsheets, *Governor Ventura's 2002-03 Minnesota Biennial Budget* documents prepared by the Minnesota Department of Finance, as well as Finance's *November 2000 Forecast* and *February 2001 Forecast*. Other sources are noted in the text.



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