# Summary of the Fiscal Actions of the 2002 Legislature

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June 2002

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**Fiscal Analysis Department**
Minnesota House of Representatives

# 2002 Session Budget Actions - Overview

The Legislature balanced the FY 2002-03 budget in two steps during the 2002 legislative session. The first actions in February, Chapter 220, resolved the $1.953 billion general fund budget shortfall that was projected by the November 2001 budget forecast.[1]

The first budget bill, Chapter 220, was enacted by the Legislature by over-riding the Governor's veto. Final action on that bill occurred about the same time the February budget forecast was released by the Department of Finance. The results of that forecast and Chapter 220 left an additional $439 million general fund shortfall for the FY 2002-03 biennium. That problem was resolved by the Legislature in laws enacted in mid-May.

As with Chapter 220, the second budget balancing bill was enacted into law over the Governor's veto. The second bill, Chapter 374, contained most of the "Phase II" budget measures. However, some provisions were contained in a separate Tax bill, Chapter 377. Other major bills making appropriations were the Capital Expenditure bill, Chapter 393, and an Anti-Terrorism bill, Chapter 401.

| **2002 Session Budget Bills** | |
|---|---|
| Budget Balancing – Phase I | Chapter 220 |
| Budget Balancing – Phase II | Chapter 374 |
| Tax Bill | Chapter 377 |
| Capital Expenditure Bill | Chapter 393 |
| Anti-Terrorism Bill | Chapter 401 |

The budget changes enacted during the 2002 session resolved the $2.290 billion deficit for the FY 2002-03 biennium. The changes are a combination of spending reductions, use of several reserve accounts, transfers from other state funds and changes in aid payments that resulted in one-time savings to the state in FY 2003. Changes made in the 2002 session reduce the projected deficit for FY 2004-05 but do not eliminate it.

**Budget Changes Compared to Budget Problem**

*(Dollars in millions)*

*These numbers are presented from a general fund balance perspective; a positive number shows a positive impact to the general fund, a negative number shows a negative impact to the general fund.*

| | **FY 2002-03** | **FY 2004-05** |
|---|---|---|
| Budget Problem – February Forecast | $ (2,289.7) | $ (3,213.4) |
| Total Changes | $ 2,605.4 | $ 1,765.8 |
| **Difference:** | **$315.7** | **$ (1,447.6)** |

[1] *Those actions were summarized in detail in a previous Money Matters published by the Fiscal Analysis Department in March and are included in the total actions summarized in this document.*

For FY 2002-03, the budget balancing bills use the budget reserve of $653 million, the local government aid reserve of $14 million, and the cash flow account of $350 million for general fund purposes. The bills also transfer to the general fund the following amounts: (1) $108.9 million from the worker's compensation assigned risk plan, (2) $250 million from the worker's compensation excess surplus account, and (3) $158.1 million from the tax relief account.

**2002 Session Budget Changes**

*Dollars in millions*

*These numbers are presented from a general fund balance perspective; a positive number shows a positive impact to the general fund, a negative number shows a negative impact to the general fund.*

| | FY 2002-03 | FY 2004-05 |
|---|---|---|
| Expenditure Changes (Net) | $487.3 | $659.0 |
| Expenditure Changes - One-time Payment Shifts | $483.4 | $5.0 |
| Budget Reserve | $653.0 | |
| Cash Flow Account | $350.0 | |
| LGA Reserve | $14.0 | |
| Tax Relief Account | $158.1 | |
| Assigned Risk Plan Transfer | $108.9 | |
| Worker's Compensation Fund Transfer | $250.0 | |
| June Sales Tax Acceleration Change | $25.5 | $ (25.5) |
| Bonding for Capital Projects | $75.0 | |
| Planning Estimate Inflation | | $1,127.3 |
| **Total Changes:** | **$2,605.4** | **$1,765.8** |

Chapter 220 specifies that inflation cannot be included in the planning estimate expenditures for FY 2004-05.[2] Inflation had been added to all expenditures except debt service. Inflation for FY 2004-05 had been set at 2.5 percent per year and had equaled $1,127.3 million. This inflation had been in addition to the level of expenditures set in current law. This inflation had recognized the cost of inflation on the provision of state services but was not part of any base level budget or statutory funding formula.

Net expenditure reductions make up $487.3 million of the FY 2002-03 the budget changes (Net means that expenditure increases are subtracted from expenditure reductions to obtain this number.) Some of these reductions are permanent and result in net reductions of $659 million in FY 2004 and FY 2005.

Another $483.4 million of expenditure reductions result in one-time savings in FY 2003 for the state. These are delays in state aid payments to school districts and counties. The payment is delayed until the next state fiscal year but the payments will continue to be made at the same level, only later.

[2] See Issue Brief, "Planning Estimate Inflation in State Budgets" for additional information on the use of planning estimate inflation in state forecasts. www.house.leg.state.mn.us/fiscal/files/ibinflate.pdf

Expenditure changes were concentrated in state agency operations. Expenditures for K-12 education and local government aids were largely protected from permanent reductions. The expenditure reductions include a hiring freeze on state employees and a moratorium on state agency consultant contracts. (*See the State Government Finance section for more discussion of these items*.)

**2002 Session Expenditure Changes by Committee**
*Dollars are in millions*
*These numbers are presented from a general fund expenditure perspective, a negative number is a reduction in spending, a positive number is an increase in spending.*

| **Net Expenditure Changes** | **FY 2002-03** | **FY 2004-05** |
|---|---|---|
| K-12 Education | ($12.8) | ($21.3) |
| Family & Early Childhood Education | ($4.0) | ($8.0) |
| Higher Education | ($45.0) | ($100.0) |
| Health & Human Services | ($106.2) | ($184.6) |
| Environment & Natural Resources | ($23.3) | ($28.7) |
| Agriculture | ($2.7) | ($5.4) |
| Economic Development | ($7.1) | ($14.1) |
| Transportation | ($3.9) | ($7.9) |
| Judiciary/Crime Prevention | ($26.3) | ($52.5) |
| Anti-Terrorism | $13.0 | $0 |
| State Government | ($48.7) | ($77.5) |
| Hiring Freeze | ($29.7) | ($80.0) |
| Professional & Technical Contract Moratorium | ($28.3) | ($56.6) |
| Taxes | ($127.7) | ($65.8) |
| St. Paul Busways Grant | ($40.0) | $0 |
| Debt Service/Capital Bill | $5.4 | $43.4 |
| **Subtotal** | **$ (487.3)** | **($659.0)** |
| Planning Estimate Inflation eliminated (2.5%) | | ($1,127.3) |
| **Total – Expenditure Changes** | **($487.3)** | **($1,786.3)** |

*Note: For specific details on changes in each area, see the following summaries by area and the individual committee tracking documents at the following address (www.house.leg.state.mn.us/fiscal/tracking.htm)*

The charts and discussion above show the combined effects of all budget changes made during the 2002 session. The following information breaks the budget changes down according to Phase I and Phase II.

For FY 2002-03, Chapter 220 (Phase I) uses the budget reserve of $653 million, the local government aid reserve of $14 million, and $195 million from the cash flow account for general fund purposes. It also transfers to the general fund the following amounts: (1) $94.9 million from the worker's compensation assigned risk plan, (2) $230 million from the worker's compensation excess surplus account, and (3) $158 million from the tax relief account.

As noted previously, Chapter 220 specifies that inflation cannot be included in the planning estimate expenditures for FY 2004-05. Inflation (2.5 percent per year) had been added to on all expenditures except debt service. This inflation was in addition to the level of expenditures set in current law.

Spending reductions make up $505 million of the FY 2002-03 changes in Chapter 220. Of these reductions, $358 million are permanent and result in reductions in FY 2004 and FY 2005.

**Phase I (Chapter 220) – Budget Changes**
*Dollars in millions*

| | FY 2002-03 | FY 2004-05 |
|---|---|---|
| Expenditure Changes | $505.2 | $1,843.9 |
| Budget Reserve | $653.0 | |
| Cash Flow Account | $195.0 | |
| LGA Reserve | $14.0 | $28.0 |
| Tax Relief Account | $158.1 | |
| Assigned Risk Plan Transfer | $94.9 | |
| Worker's Compensation Fund Transfer | $230.0 | |
| June Sales Tax Acceleration Forecast Change | $118.6 | ($118.6) |
| **Total Changes:** | **$1,968.8** | **$1,753.3** |

The second part of the budget process, Phase II, took the most time and was the subject of discussions for March, April and half of May. The Phase II bills resolved the $439 million budget shortfall remaining after the February forecast and also provided for about a $300 million budget balance that will become a budget reserve. Most of the Phase II changes were one-time shifts in state aid payments to school districts and counties.

The chart on the following page shows the Phase II changes only.

| **Phase II Budget Agreement**<br>Dollars in millions<br>*These numbers are presented from a general fund balance perspective; a positive number shows a positive impact to the general fund, a negative number shows a negative impact to the general fund.* | | |
|---|---|---|
| | **FY 2002-03** | **FY 2004-05** |
| K-12 Aid Payment Shift to 83/17 | $437.5 | $5.4 |
| K-12 Cash Flow Appropriation | ($17.5) | |
| K-12 Special Education Payment Shift | $26.5 | ($.4) |
| HHS Payment Shift | $36.9 | |
| Cash Flow Account | $155.0 | |
| Assigned Risk Plan Transfer | $14.0 | |
| Worker's Compensation Fund Transfer | $20.0 | |
| June Sales Tax Acceleration Change | $25.5 | ($25.5) |
| Bonding for Capital Projects | $75.0 | |
| Building Codes Account Transfer | $2.0 | |
| Capital Bill | ($5.4) | ($43.4) |
| Anti-Terrorism | ($13.0) | |
| School Employees Health Insurance Study | ($.7) | ($.7) |
| Dept. of Revenue for Compliance | ($7.6) | ($9.5) |
| Additional DOR Compliance Revenue | $7.6 | $25.6 |
| Governor's Mansion | ($.4) | ($.8) |
| Higher Education | ($11.7) | ($13.4) |
| K-12 Education | ($1.6) | ($2.2) |
| Legislative Budget Reduction | $5.0 | $4.0 |
| Solid Waste Fund for SCORE Grants | $9.0 | |
| Health & Human Services | | ($1.7) |
| Taxes | | ($1.8) |
| **Total Changes:** | **$756.3** | **($64.3)** |

The Phase II changes resolved the remaining $439.3 million and left a bottom line balance of over $300 million. Any portion of that balance that remains on June 30, 2003, is transferred to the budget reserve.

***For more information on the overall budget, contact Bill Marx, Chief Fiscal Analyst, at 651-296-7176 or at bill.marx@house.leg.state.mn.us.***

# Family and Early Childhood Education Finance

For budget activities overseen by the Family and Early Childhood Education Finance Committee, budget adjustments (Phases I and II combined) include general fund spending reductions of $10.3 million in FY 2002-03 and $10.2 million in FY 2004-05. Total proposed spending would be $494.2 million in FY 2002-03 and $502.6 million in FY 2004-05, a two percent decrease in each biennium from February 2002 forecast levels.

Since general fund revenues comprise approximately 65 percent of all funding sources for Family and Early Childhood Education activities, non-general fund sources were also reviewed. While general fund spending is reduced, appropriations in non-general fund accounts are increased by $3.5 million in each FY 2003, FY 2004 and FY 2005 to continue with program services. In addition, $10.1 million is returned to the TANF reserve.

## Summary of Budget Adjustments for FY 2002-2003

**Phase I Changes:** Chapter 220 includes funding changes for four general fund budget activities and four non-general fund activities as follows:

**FY 2002-2003 F&ECEF Budget Adjustments**

| Budget Activity | Conference Agreement FY 2003 | Amount of Adjustment | % Reduced from Nov Forecast |
|---|---|---|---|
| General Fund | | | |
| 1. Basic Sliding Fee Child Care | $48,499,000 | ($3,500,000) | - 6.7% |
| 2. Child Care Development | $ 1,365,000 | ($ 500,000) | -26.8% |
| 3. ABE Administration | $ 175,000 | ($ 200,000) | -53.3% |
| 4. Regional Library Telecommunications | $ 2,600,000 | +$ 200,000 | + 8.3% |
| **Total General Fund Change** | | **($ 4,000,000)** | **- 1.4%** |
| **Federal Fund Redistribution** | | | |
| 5. Social Services Child Care | $ 1,970,000 | ($ 4,192,000) | -32.0% |
| plus FY 2001 carry forward | | ($ 3,009,000) | |
| 6. Transition Year Child Care | $ 2,761,000 | ($ 4,899,000) | -64.0% |
| plus FY 2001 carry forward | | ($ 1,000,000) | |
| 7. Basic Sliding Fee Child Care | $44,356,000 | +$ 3,000,000 | + 7.3% |
| **Total Federal TANF Redistribution** | | **($10,100,000)** | **-14.8%** |
| State Special Revenue | | | |
| 8. Child Care Assistance | $ 2,840,000 | +$ 500,000 | +10.4% |
| **Total State Special Revenue Change** | | **+$ 500,000** | **+10.4%** |

**Phase II Changes:** Chapter 347 shifts state aid payments to school districts for certain early childhood and adult education programs. Currently, state aid for many education programs is paid over the course of two years, with districts receiving 90 percent of their entitled amount in the fiscal year in which the funding is due, and the balance, approximately 10 percent, adjusted for corrected enrollment data, in the subsequent fiscal year. Chapter 347 changes that breakdown, beginning in FY 2003, to 83 percent in the current fiscal year and 17 percent in the subsequent fiscal year. The timing of payments made to school districts during the course is also adjusted, speeding up those payments to come more in the beginning of the year, in order to minimize the cash flow impact of the payment schedule conversion. The anticipated savings of this shift in state aid is $6.3 million in FY 2003.

**Family & Early Childhood Education**
**FY 2003 Summary of 83/17 Payment Shift**

| Budget Activity | FY 2003 Cost Savings |
|---|---|
| General Fund | |
| 1. School Readiness | ($ 728,000) |
| 2. Early Childhood Education | ($1,443,000) |
| 3. Health & Developmental Screening | ($ 186,000) |
| 4. School Age Care | ($ 6,000) |
| 5. Community Education | ($ 527,000) |
| 6. Adults With Disabilities | ($ 49,000) |
| 7. Violence Prevention Grants | ($ 101,000) |
| 8. Adult Basic Education | ($2,450,000) |
| 9. Adult Graduation Aid | ($ 177,000) |
| 10. Library Basic Support Grants | ($ 599,000) |
| 11. Multicounty, Multitype Libraries | ($ 63,000) |
| **Total General Fund Change** | |
| **FY 2003 Family & Early Childhood Education** | **($6,329,000)** |

In addition, minor adjustments to existing levies that support family and early childhood education activities will be made in FY 2003 to reflect the impact of the 83 /17 payment policy on state aid receipts.

## Biennial Summary of Changes FY 2004-2005

**Phase I Changes:** Budget adjustments for FYs 2004-2005 include funding changes for four general fund budget activities and two non-general fund activities as follows:

**FY 2004-2005 F&ECEF Budget Adjustments**

| Budget Activity | Conference Agreement FY 2004-05 | Amount of Adjustment | % Reduced from Nov Forecast |
|---|---|---|---|
| General Fund | | | |
| 1. Basic Sliding Fee Child Care | $96,998,000 | ($7,000,000) | - 6.7% |
| 2. Child Care Development | $ 2,730,000 | ($1,000,000) | -26.8% |
| 3. ABE Administration | $ 245,000 | ($ 200,000) | -44.9% |
| 4. Library Basic Support Services | $19,645,000 | +$ 200,000 | + 1.0% |
| **Total FY 2004-05 General Fund Change** | | **($8,000,000)** | |
| Federal Fund Allocation | | | |
| 5. Basic Sliding Fee Child Care | $35,386,000 | +$ 6,000,000 | +20.4% |
| **Total Federal TANF Change** | | **+$ 6,000,000** | **+20.4%** |
| State Special Revenue | | | |
| 6. Child Care Assistance | $ 5,496,000 | +$ 1,000,000 | +22.4%* |
| **Total State Special Revenue Change** | | **+$ 1,000,000** | **+22.4%*** |

*This increase is calculated above end of 2001 session appropriations.

**Phase II Changes:** Again, there is a residual impact attributable to the Chapter 347 shifts in state aid payments to school districts for certain early childhood and adult education programs. The budget activities affected are Health and Developmental Screening (-$125,000), Community Education (-$95,000), Adult Basic Education (-$897,000) and Library Basic Support (-$1,250,000). The estimated cost savings of this shift is $2.2 million for the biennium.

For all agencies, sections of Chapter 220, modified by Chapter 347, placed a moratorium on professional service contracts and imposed a hiring freeze on state agency personnel. While the full impact of these provisions are yet to be determined, further discussion can be found in the fiscal analysis for State Government Finance.

***For additional information on Family and Early Childhood Education finance issues, contact Katherine Schill at 651- 296-5384 or Katherine.Schill@house.leg.state.mn.us.***

# K-12 Education

The total K-12 education changes in Phase I and Phase II include a net reduction of $459.4 million in FY 2002/03 and $26.9 million in FY 2004-05. In addition, there is a net increase of $46.2 million in local property tax levies in FY 2004-05.

The K-12 education article in Chapter 220 (phase I) includes a net reduction of $3.8 million (or 0.1 percent from the forecast base for FY 2002) in FY 2002, $11.2 million (0.2 percent) in FY 2003, $8.7 million (0.1 percent) in FY 2004 and $15.5 million (0.3 percent) in FY 2005. Offsetting these reductions are increases in local levies of $12.6 million in FY 2004 and $5.9 million in FY 2005. All changes are expressed relative to the February 2002 forecast appropriation levels, and are general fund, unless otherwise noted.

The total Phase II (Chapter 374 and Chapter 377) change for K-12 education in the FY 2002-03 biennium is a net reduction of $444.3 million. For FY 2004-05, the total change is increases of $44.1 million, including reductions of $2.2 million in general fund spending, and an increase of $46.2 million in local property tax levies.

**K-12 Education – General Fund Changes**
*(dollars in thousands)*

| | FY 2002/03 Change | FY 2004/05 Change |
|---|---|---|
| ***PHASE I CHANGES*** | | |
| **General Education Program** | | |
| Limit Learning Year ADM to 1.5 | (1,957) | (4,861) |
| **Education Excellence** | | |
| Adv. Placement / International Baccalaureate Program | (1,000) | (2,000) |
| Best Practices Grants | (1,300) | (2,600) |
| Integration Revenue | 0 | (5,302) |
| Youth Apprenticeship | (450) | (900) |
| Junior Achievement | (75) | (150) |
| ISEEK Solutions | (250) | (500) |
| Work-Study Student Compensation | (89) | 0 |
| Alternative Compensation / Performance Incentive Pool | (1,300) | (600) |
| Education Accountability Audits | (1,000) | 1,500 |
| **Education Excellence Total:** | **(5,464)** | **(10,552)** |
| **Special Education** | | |
| Web Based Individual Interagency Intervention | (250) | (500) |
| **Department of Children, Families & Learning** | (6,650) | (7,842) |
| **Perpich Center for Arts Education** | (750) | (1,000) |
| ***PHASE I CHANGES subtotal*** | **(15,071)** | **(24,755)** |

| K-12 Education – General Fund Changes *(dollars in thousands)* | | |
|---|---|---|
| | **FY 2002/03 Change** | **FY 2004/05 Change** |
| ***PHASE II CHANGES*** | | |
| **Payment Shift Changes** | | |
| Convert Payment Schedule to 83/17 | (437,500) | (5,448) |
| Special Education Excess Cost Payment Shift | (26,520) | 428 |
| Payment Schedule Change Impact Adjustment | 17,500 | 0 |
| **Payment Shift Changes Total:** | **(446,520)** | **(5,020)** |
| **Appropriations** | | |
| Perpich Center for Arts Education | 750 | 1,000 |
| Duluth (709) Referendum Increase | 295 | 569 |
| Albert Lea (241) Declining Enrollment Aid | 300 | 375 |
| Mesabi East (2711) Declining Enrollment Aid | 200 | 250 |
| **Appropriations Total:** | **1,545** | **2,194** |
| Statewide School District Employee Health Ins. Study | 670 | 670 |
| ***PHASE II CHANGES subtotal*** | **(444,305)** | **(2,156)** |
| **Total K-12 Changes** | **(459,376)** | **(26,911)** |

## General Education Program

- Learning Year Pupils: Beginning in FY 2003, cap the average daily membership that a pupil can generate at 1.5 per fiscal year. Currently, there is no limit for non-kindergarten pupils. This change was part of the Governor's supplemental budget recommendations. *Savings: FY 2003, $1.9 million, FY 2004 and FY 2005, $2.1million per year.*

- Payment Schedule Conversion: Currently, state aid for many education programs is paid over the course of two years, with districts receiving 90 percent of their entitled amount in the fiscal year in which the funding is due, and the balance, approximately 10 percent, adjusted for corrected enrollment data, in the subsequent fiscal year. This bill will change that breakdown to 83 percent in the current fiscal year and 17 percent in the subsequent fiscal year. The bill also changes the timing of payments made during the course of the fiscal year to school districts, speeding up those payments to come more in the beginning of the year, in order to minimize the cash flow impact to school districts of the payment schedule conversion. *Savings: $437.5 million in FY 2003.*

- Payment Schedule Change Impact Adjustment Pool: Districts that have fund balances which amount to less than 2.5 percent of their general fund expenditures are said to be in statutory operating debt. To reduce the impact of the payment schedule change on districts that are in statutory operating debt, each year those districts can apply to receive an advanced payment equal to the amount the district's expenditures are over the 2.5 percent limit or 7 percent of their general education aid, whichever is less. *Cost: $17.5 million in FY 03.*

- Duluth (709) Referendum increase: Increases the Duluth school district's referendum amount by $500,000 per year, starting in FY 2003. *Cost: $295,000 in aid in FY 2003, $296,000 in aid in FY 2004, $273,000 in aid in FY 2005, $478,000 in levy in FY 2004 and $260,000 in levy in FY 2005.*

- Albert Lea (241) Declining Pupil aid: Provides the Albert Lea school district with $300,000 in general fund aid in FY 2003 to compensate for pupils lost due to the fire and closure of Farmland Foods. Aid is phased out over a four-year period. *Cost: $300,000 in FY 2003 and $375,000 in FY 2004-05.*

- Mesabi East (2711) Declining Pupil aid: Provides the Mesabi East school district with $200,000 in general fund aid in FY 2003 to compensate for pupils lost due to the closure of the LTV plant. Aid is phased out over a four-year period. *Cost: $200,000 in FY 2003 and $250,000 in FY 2004-05.*

**Education Excellence Program**

- Advanced Placement / International Baccalaureate Aid: Beginning in FY 2003, require means testing for reimbursement of test-taking costs. This change was part of the Governor's supplemental budget recommendations, with a larger reduction. *Savings: FY 2003 – FY 2005, $1 million per year, 50 percent of the annual appropriation for this program.*

- Best Practices Grants: Beginning in FY 2003, reduce the annual appropriation for best practices grants from $3.5 million to $2.2 million. This change was part of the Governor's supplemental budget recommendations, with a larger recommended reduction. *Savings: FY 2003 – FY 2005, $1.3 million per year, 37.4 percent of the annual appropriation for this program.*

- Advanced Placement / International Baccalaureate Aid: Beginning in FY 2003, require means testing for reimbursement of test-taking costs. This change was part of the Governor's supplemental budget recommendations, with a larger recommended reduction. *Savings: FY 2003 – FY 2005, $1 million per year, 50 percent of the annual appropriation for this program*.

- Integration Revenue: In FY 2005, change the aid / levy ratio for Integration Revenue to 71 percent aid, 29 percent levy. This does not result in a reduction of revenue to an individual school district. Current law calls for the ratio to be 78 percent aid and 22 percent levy in FY 2004 and later. The Governor's budget recommendations included a similar change, but the aid / levy ratio was 67 percent aid and 33 percent levy, with the change starting in FY 2004**.** *Savings: FY 2005, $5.3 million. Local levy cost: FY 2005, $5.9 million*

- Education and Employment Transitions: Beginning in FY 2003, eliminate state funding for the Youth Apprenticeship and Junior Achievement programs, and transfer funding for ISEEK solutions to the Department of Trade & Economic Development. This change was part of the

Governor's supplemental budget recommendations. *Savings: FY 2003 and later, $775,000 per year.*

- Work-Study Student Compensation: Eliminate the carryforward from the FY 1998 and FY 1999 appropriations for this program. *Savings: FY 2002, $89,000.*

- Performance Incentive Pool: For FY 2002, the appropriation for the program is reduced by $1.0 million, which leaves enough funding for the current grant applicants, as well as the potential for 2-3 more school districts. For FY 2003 and later, the appropriation for the program is reduced by $300,000. This change was part of the Governor's supplemental budget recommendations, with a larger recommended reduction. *Savings: FY 2002, $1.0 million, or 25 percent of the current budget, FY 2003 – FY 2005, $300,000 per year, 7.5 percent of the annual appropriation for this program.*

- Education Accountability Audits: The appropriation for this grant was $2.5 million for the FY 2002-03 biennium. The bill changes the appropriation to $1.5 million in FY 2002 and $1.5 million 2004. The net result is a $1.0 million reduction in the FY 2002-03 biennium and a $1.5 million increase in the FY 2004-05 biennium.

- Career and Technical Education Levy: Allows districts, for revenue for FY 2003 only, to levy for the costs of their Career and Technical Education Levy program at the FY 2001 level, or $10,000, whichever is greater. *Local Levy Cost: $12.6 million in FY 2003 only.*

- Statewide School District Employee Health Insurance Study: A separate act (Chapter 380) appropriates general fund money to study and implement a statewide health insurance program for public school employees. *Cost: $670,000 in FY 2003 and $670,000 in FY 2004.*

## Special Education

- Web-based Individual Interagency Intervention: Beginning in FY 2003, eliminate funding for this program. *Savings: FY 2003 and later, $250,000 per year.*

- Special Education Excess Cost Payment Shift: Under current law, special education excess cost aid is paid out on estimated payments, with the final special education payments made in January of the fiscal year following the fiscal year for which the appropriation has been made. The bill converts the final payment from being accounted for in the fiscal year prior to which it is paid to being accounted for in the fiscal year for which it is being paid. *Savings: $26.5 million in FY 03.*

## Department of Children, Families and Learning

- Base Agency Budget: Reduce the agency's operating budget by 10 percent. This change was part of the Governor's supplemental budget recommendations, with a smaller recommended reduction. *Savings: FY 2002, $2.7 million, FY 2003, $3.7 million, FY 2004 and later, $3.7 million per year.*

- Ancillary Agency Boards: Beginning FY 2003, eliminate funding for the Minnesota Academic Excellence Foundation. *Savings: FY 2003 – FY 2005, $250,000 per year.*

## Perpich Center for Arts Education

- Base Agency Budget: Phase I reduced the agency's operating budget by 5 percent for the biennium. This change was part of the Governor's supplemental budget recommendations, with a larger recommended reduction. Phase II restored the cut to the agency's operating budget. *No net general fund change.*

## Property Tax Levy Increases (Chapter 377)

- Minneapolis (1) Integration Levy: The bill allows the Minneapolis school district to levy for integration costs. Integration aid and levy for Minneapolis was reduced during the 2001 legislative session. This provision would restore the levy part of what Minneapolis lost. *Cost: $3.8 million in local levy in FY 2004-05.*

- Crime / Safe Schools Levy: The $11 per pupil Crime levy is changed to a $30 per pupil Safe Schools levy. The levy amount is the maximum that a district can levy. *Cost: $33.5 million in local levy in FY 2004-05.*

- Judgment Levy: School districts will now be able to use their judgment levy authority to levy for court judgments against intermediate school districts of which they are members. *Cost: $21,000 in local levy in FY 2004-05.*

- Disabled Access Levy Extensions: Two school districts (Pine City (578) and Westbrook-Walnut Grove (2898)) received extensions of their ability to levy for making improvement for disability access. *Cost: $253,000 in local levy in FY 2004-05.*

- TIES Building Lease Levy: Allows groups of districts within the "Technology and Information Education Systems" data processing joint board to lease a building for staff development purposes. *Cost: $1.3 million in local levy in FY 2004-05.*

- Tree Growth Revenue: Allows districts that received tree growth revenue prior to FY 2001 to levy an amount equal to what they received in tree growth revenue in FY 2001. *Cost: $373,000 per year in local levy starting in FY 04.*

- Interest Income Loss from General Education Levy Conversion Levy: Allows districts to levy to restore lost interest income from the loss of general education levy revenue. Districts received general education levy revenue at two times during the year, in June and in October. When the general education levy was eliminated, that revenue became state aid, which is paid out in smaller payments over the course of the entire year. Because of the elimination of the general education levy, districts lost interest income from the investment of their property tax receipts during the year. The total interest lost is estimated to be approximately $6.4 million. The levy authority would be capped at $3.0 million, resulting in slightly more than 50 percent proration of levy authority. *Cost: $6.0 million per year in local levy in FY 2004, $3.0 million per year in local levy in FY 2 05 and later.*

***For additional information on K-12 education issues, contact Greg Crowe at 651-296-7165 or [greg.crowe@house.leg.state.mn.us](mailto:greg.crowe@house.leg.state.mn.us)***

# Higher Education Finance

For FY 2002-03 there is a total reduction to higher education of $45 million. For FY 2004-05 there is a total reduction of $100 million.

| Higher Education Reductions *(dollars in thousands)* | | | | | | |
|---|---|---|---|---|---|---|
| | **FY02** | **FY03** | **02 & 03** | **FY04** | **FY05** | **04 & 05** |
| Base | $1,380,039 | $1,464,114 | **$2,844,153** | $1,477,496 | $1,477,496 | **$2,954,992** |
| Conference Reductions | $2,256 | ($47,256) | **($45,000)** | ($50,000) | ($50,000) | **($100,000)** |
| **% Reduction** | **+0.2%** | **-3.2%** | **-1.58%** | **-3.4%** | **-3.4%** | **-3.4%** |

## Higher Education Services Office (HESO)

For FY 2002-03 there is a total increase to HESO of $1.325 million. This reflects increases to the State Grant program of $10.14 million for FY 2002 and $6.44 million for FY 2003 to recognize greater than anticipated tuition and enrollment. Phase I of the budget solution (Ch. 220) provided for $6.44 million in recurring State Grant funds for FY 2003 and both phases I and II (Ch. 374) provided one-time funding for State Grants in FY 2002. However, these amounts are not sufficient to fully fund projected demand for State Grants in FY 2002-2003. Chapter 374 also directs HESO to transfer any amounts needed to make full State Grant awards in FY 2003 from the Child Care and/or Work Study accounts. New State Grant appropriations are offset by $6.44 million in increased federal PELL grant funding which covers a portion of the unexpected demand.

In combination, the appropriations and language of Chapter 220 and Chapter 374 should ensure that student awards are not prorated during the current biennium. However, it is highly likely that the FY 2004-05 base for the State Grant Program is substantially lower than what will be needed to meet demand during that biennium. As a result of changes made in both Chapter 220 and Chapter 374, the base of the State Grant program increases by $6.54 million in FY 2004-05 while HESO's total agency base is reduced by $62 thousand for FY 2004-05.

In addition to increases in the State Grant program, $8.605 million in reductions are made to the HESO administration, Learning Network of Minnesota grants, Minnesota College savings plan matching grants, the Advanced Placement Scholarship program, Summer Scholarships, the MINITEX inter-library loan system and the Mnlink electronic library project. Also, the National Service Scholars program is eliminated and carryforward funds in the Youthworks program are rescinded. The State Government section of Chapter 374 also exempts HESO from the Professional/Technical contracts moratorium and reduces the savings for that item by $600,000.

| HESO Reductions *(dollars in thousands)* | | | | | | |
|---|---|---|---|---|---|---|
| | **FY02** | **FY03** | **02 & 03** | **FY04** | **FY05** | **04 & 05** |
| Base | $148,699 | $157,650 | **$306,349** | $157,533 | $157,533 | **$315,066** |
| Conference Reductions | ($2,256) | ($931) | **($3,675)** | ($31) | ($31) | **($62)** |
| **% Reduction** | **-1.8%** | **-.6%** | **-1.2%** | **-.02%** | **-.02%** | **-.02%** |

## Minnesota State Colleges and Universities

For FY 2003, the Minnesota State Colleges and Universities receive a cut of $22.69 million. The base is reduced a further $1.786 million in each year of the FY 2004-05 biennium. The Board of Trustees is directed to look to administrative reductions, reserve funds and programmatic changes as much as possible prior to raising tuition. The State Government section of Chapter 374 (Article 7) also exempts MnSCU from the Professional/Technical contracts moratorium and reduces the savings for that item by $6.1 million.

| MNSCU Reductions *(dollars in thousands)* | | | | | | |
|---|---|---|---|---|---|---|
| | **FY02** | **FY03** | **02 & 03** | **FY04** | **FY05** | **04 & 05** |
| Base | $601,583 | $639,984 | **$1,241,567** | $653,483 | $653,483 | **$1,306,966** |
| Conference Reductions | ($0) | ($22,692) | **($22,692)** | ($24,478) | ($24,478) | **($48,956)** |
| **% Reduction** | **0%** | **-3.6%** | **-1.8%** | **-3.7%** | **-3.7%** | **-3.7%** |

## University of Minnesota

For FY 2003, the University of Minnesota receives a cut of $23.633 million. The base is reduced a further $1.858 million in each year of the FY 2004-05 biennium. Cuts may not be taken from the Agricultural Special funds appropriated to the University for the FY 2002-03 biennium. The University is directed to look to administrative reductions, reserve funds and programmatic changes as much as possible prior to raising tuition.

| University of Minnesota Reductions *(dollars in thousands)* | | | | | | |
|---|---|---|---|---|---|---|
| | **FY02** | **FY03** | **02 & 03** | **FY04** | **FY05** | **04 & 05** |
| Base | $628,120 | $664,843 | **$1,292,963** | $664,843 | $664,843 | **$1,329,686** |
| Conference Reductions | ($0) | ($23,633) | **($23,633)** | ($25,491) | ($25,491) | **($50,982)** |
| **% Reduction** | **0%** | **-3.6%** | **-1.8%** | **-3.8%** | **-3.8%** | **-3.8 %** |

***For additional information on higher education issues, contact Doug Berg at 651-296-5346 or doug.berg@house.leg.state.mn.us***

# Health and Human Services

## Forecast spending

Prior to any decisions being made by the 2002 legislature, spending on Health and Human Services (H&HS) programs was projected to be $6.546 billion in FY 2002-03 and $7.371 billion in FY 2004-05, based on estimates from the February 2002 forecast. Since July 2001 (end of 2001 session), projected general fund spending has risen by $123.1 million (1.1 percent) in FY 2002-03 and $98.7 million (1.5 percent) in FY 2004-05 compared to previous biennial estimates (see table 1 below). During the same time period, federal TANF spending has increased by $22.1 million (3.3 percent) and $31.2 million (6.9 percent). Spending from the Health Care Access fund, primarily related to the MinnesotaCare program, rose by $15.6 million (2.7 percent) in FY 2002-03 and $120.1 million (16.2 percent) in FY 2004-05.

It is important to remember that these funding changes -- those related to the forecast -- reflect revised estimates of biennial spending based on current law. In other words, it is the level of funding that is necessary to fully-fund the anticipated caseload of programs such as Medical Assistance (general fund), MinnesotaCare (health care access fund), and the Minnesota Family Investment program (general fund and federal TANF). All of these projected funding changes were approved by the 2002 legislature.

**Table 1: Forecast-related H&HS spending by fund**
(November 2001 and February 2002)

| | FY 2002-03 | Percent Change | FY 2004-05 | Percent Change |
|---|---|---|---|---|
| **General fund** | | | | |
| November 2001 | $50.0 million | | $40.0 million | |
| February 2002 | $73.1 million | | $58.7 million | |
| **Total, general fund** | **$123.1 million** | **1.1%** | **$98.7 million** | **1.5%** |
| **Federal TANF** | | | | |
| November 2001 | $20.9 million | | $31.9 million | |
| February 2002 | $1.3 million | | ($0.6 million) | |
| **Total, federal TANF** | **$22.1 million** | **3.3%** | **$31.2 million** | **6.9%** |
| **Health care access fund** | | | | |
| November 2001 | $23.0 million | | $122.8 million | |
| February 2002 | ($7.4 million) | | ($2.6 million) | |
| **Total, health care access fund** | **$15.6 million** | **2.7%** | **$120.1 million** | **16.2%** |

*NOTE: Numbers may not add due to rounding.*

## Legislative action

As a result of the enactment of Phase I (Chapter 220) and Phase II (Chapter 374), projected general fund spending on H&HS programs, compared to the February 2002 forecast, is expected to decline by $143.1 million (-2.2 percent) in FY 2002-03 and $184.6 million (-2.5 percent) in

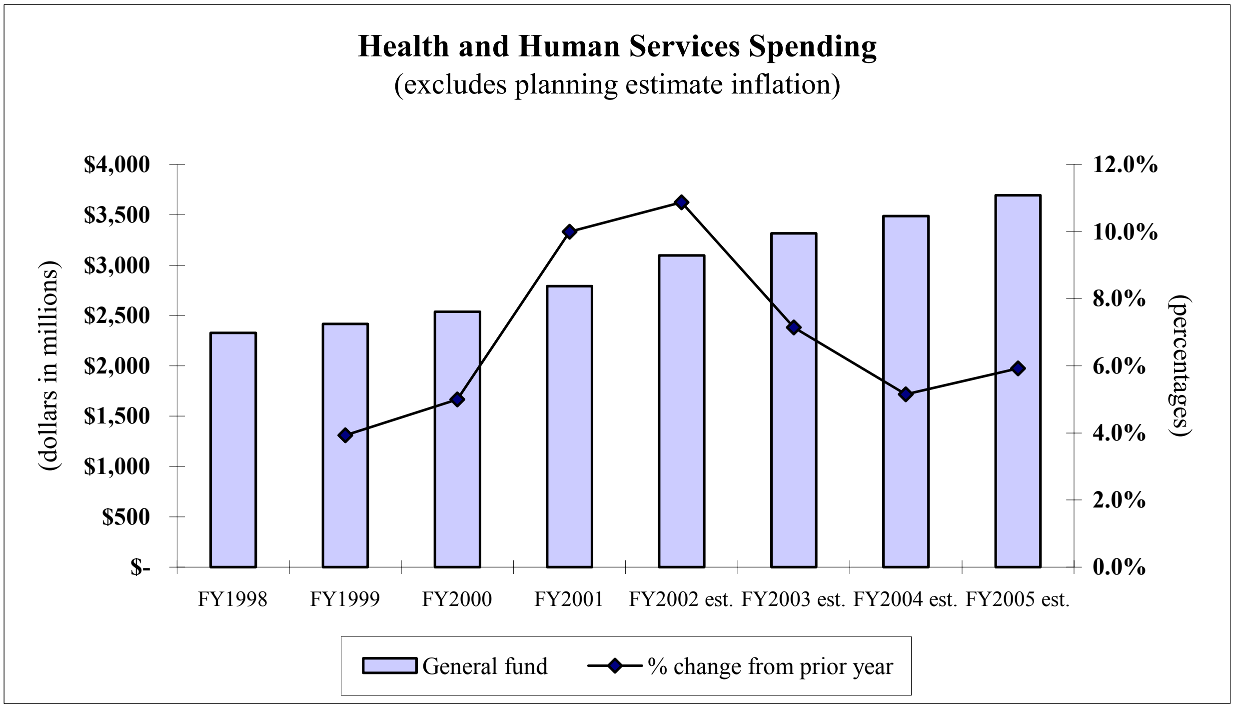
FY 2004-05 (see table 2 below). Of the general fund reductions for FY 2002-03, $96.0 million was adopted in Phase I and $47.2 million in Phase II. Of the net reduction to spending in Phase II, $36.9 million is actually an accounting shift, permanently delaying one-quarter of annual payments to counties for social services from one fiscal year to the next; this funding change should have no impact on county-funded social services. The Ventura Administration had proposed to reduce state general fund spending, through a combination of revenue increases and spending reductions, by $127.7 million (-2.0 percent) and $283.5 million (-3.8 percent), in FY 2002-03 and FY 2004-05, respectively.

**Table 2: Non-forecast related H&HS spending by fund (Phase I* and Phase II)**

| | FY 2002-03 | FY 2004-05 |
|---|---|---|
| **General fund** | | |
| Phase I | ($96.0 million) | ($186.4 million) |
| Phase II | ($47.2 million) | $1.7 million |
| **TOTAL, general fund** | **($143.1 million)** | **($184.6 million)** |
| | | |
| **Federal TANF** | | |
| Phase I | ($4.0 million) | $23.8 million |
| Phase II | $259,000 | $1.4 million |
| **TOTAL, federal TANF** | **($3.7 million)** | **$25.2 million** |
| | | |
| **Health care access fund** | | |
| Phase I | ($716,000) | ($9.2 million) |
| Phase II | $486,000 | $2.5 million |
| **TOTAL, health care access fund** | **($230,000)** | **($6.7 million)** |
| | | |
| **State gov't special revenue fund** | | |
| Phase I | $75,000 | -0- |
| Phase II | $4,000 | $8,000 |
| **TOTAL, state gov't special revenue fund** | **$79,000** | **$8,000** |

* *Adjusted for changes in the February 2002 forecast*
*NOTE: Numbers may not add due to rounding.*

With the passage of Phase I and II, general fund spending on H&HS programs is expected to experience annual growth in the range of five to seven percent in fiscal years 2003, 2004, and 2005, approximately $200.0 million each year (see graph on next page). These projected increases do not include planning estimate inflation, which was removed in Phase I. Projected spending in health and human services is down from approximate annual growth of 10.0 percent in FY 2001 and 10.9 percent in FY 2002 (estimated). For more on inflation see Health and Human Services Inflation on the following page.




## Non-general fund

With the focus of the 2002 legislature on the projected general fund deficit, non-general fund spending was held to a minimum. As a consequence, H&HS spending from non-general fund accounts was virtually unchanged, with the exception of efforts to use non-general fund spending to offset spending from the general fund or to account for forecasted-related changes.

**Health and Human Services Inflation**

Despite the removal of planning estimate inflation from state spending in Phase 1, inflationary increases continue to be reflected in figures reported for DHS' forecasted programs (e.g., Medical Assistance (MA), General Assistance Medical Care (GAMC)). Based on the February 2002 forecast, DHS' projected state general fund spending in MA programs included inflationary increases of $251 million for the FY2004-05 biennium. Put another way, the DHS forecast of MA spending assumes the cost of providing medical assistance services will increase in FY2004 and FY2005, based on historical trend data, as well as the case-mix of the clients being served and the intensity of the use of services. The recognition of inflationary pressures based on cost is unique to DHS' forecasted accounts.

### Federal TANF

Net spending from the federal Temporary Assistance for Needy Families (TANF) block grant in Phase I and Phase II will decline by $3.7 million in FY 2002-03 but rise by $25.2 million in FY 2004-05 (see table 2 on Page 20). Of the reduction in FY 2002-03, $4.0 million is made possible by changes in federal reimbursement claims related to the MAXIS (eligibility determination) system. The remaining federal TANF spending provisions relate to additional MFIP extensions. Four new MFIP extensions to the 60-month time limit were enacted into law in Phase 2, but only two involve costs. In the aggregate, these additional extensions will result in federal TANF expenditures of $259,000 in FY 2002-03 and $1.4 million in FY 2004-05.

The remainder of the projected increase in federal TANF spending recognizes that the state will likely meet its TANF work participation rates in future years. As an incentive to meet the work participation goals, the federal government allows states to reduce their general fund commitment or maintenance of effort (MOE) to their TANF program by five percentage points, or $11.9 million, each fiscal year in Minnesota. As the general fund amount is reduced by $23.8 million in FY 2004-05, an equal amount of federal TANF dollars is allocated to the MFIP program in order to fully fund the program's projected need.

**Health care access fund**
Similar to TANF spending, health care access fund spending was held to a minimum in both Phase I and II of the budget reduction acts (see table 2 on page 20). Two initiatives expand eligibility for the MinnesotaCare program. The first expansion repeals the "bridge kids" initiative adopted in last year's budget bill and replaces it with an expansion for children in families with income under 175 percent of poverty. [Under current law, eligibility is set at 150 percent of poverty.] The Department of Human Services deemed the proposal to allow one year of premium-free enrollment in MinnesotaCare for children transitioning into the program from Medical Assistance to be too difficult to implement in a timely manner. This initiative will be implemented July 1, 2003 (FY 2004).

A separate provision expands coverage in MinnesotaCare by allowing self-employed farmers to add back to their federal adjusted gross income only depreciation expenses, resulting in more farmers being eligible for the program. [Under current law, farmers must add back carryover loss, net operating losses, and depreciation expenses.] This expansion involves costs to the health care access fund of $475,000 in FY 2002-03 and $2.5 million in FY 2004-05.

**State government special revenue fund**
From the state government special revenue fund, $79,000 in FY 2002-03 was appropriated to the Board of Chiropractic Examiners and the Department of Health (see table 2 on page 20). In FY 2003, a one-time appropriation of $75,000 was made available from the state government special revenue fund to the Board of Chiropractic Examiners to cover extraordinary legal costs. In addition, an appropriation of $4,000 each year will be made to the Department of Health to administer voluntary registration of housing with services establishments.

## Endowment funds
Phase I and Phase II of the budget reduction effort affected the endowments in two ways. Initially, the budget agreement only required the use of the Tobacco Use Prevention and Local Public health endowment for cash flow purposes beginning July 1, 2003. Ultimately a decision was made to use all of the endowments created with proceeds from the 1998 tobacco settlement agreement for cash flow purposes. Use of the endowment's principle was prioritized in the following order should the need arise:

1) Tobacco Use Endowment (statewide tobacco grants)
2) Tobacco Use Endowment (local tobacco grants)
3) Tobacco Use Endowment (local public health grants)
4) Medical Education Endowment (Medical Education and Research Costs)
5) Medical Education Endowment (Academic Health Center)
6) Medical Education Endowment (Academic Health Center Account)

While the corpus of the endowments may be used for cash flow purposes, the appropriations for the activities funded from the endowments will not be affected by this funding mechanism. When sufficient general fund dollars are made available during the FY2004-05 biennium, the principle, with interest, will be repaid to the respective endowment fund.

The second way in which the endowments were changed was to require the University of Minnesota's Academic Health Center to transfer funding to the Department of Health to leverage federal funds for the Medical Education and Research Costs trust fund. The amount transferred, including interest, will be returned to the Academic Health Center.

## Department of Human Services

Phase I of the budget reconciliation act reduced net general fund spending at the Department of Human Services by $81.5 million in FY 2002-03 and $172.1 million in FY 2004-05, adjusted for the February 2002 forecast.[3] Phase II reduced spending at DHS by an additional $47.2 million in FY 2002-03 and $1.7 million in FY 2004-05. Of the Phase II reduction in FY 2002-03, $36.9 million delays a payment to counties for social services activities. The remaining savings of $10.3 million, in FY 2003 only, will be used to restore anticipated reductions to the state operated services division within the Department of Human Services and the Department of Corrections due to the state's hiring freeze as a result of Phase I budget reductions.

Highlights of specific reductions to the general fund, net of revenue changes and federal reimbursements, are reflected below.[4] Unless otherwise noted, these budget reductions are permanent, beginning in FY 2003.

**Specific initiatives include:**

- $350,000 by reducing the appropriation to the level of actual spending for grants to private adoption agencies to recruit adoptive families;

- $320,000 by maintaining funding for electronic government services at the FY 2002 appropriation and not providing an increase slated for FY2003;

- $3.750 million by reducing funding for the state operated services system by 2.5 percent. This action reduces the Department's appropriation by approximately one-half the amount the state operated services system has carried forward from the first to the second year of the biennium during each of the last two biennia. *Of this reduction, $3.0 million was restored in subsequent action in Phase 2;*

[3] These estimates do not include the effect of the hiring freeze or reduction in professional and consulting contracts contained elsewhere in Chapter 220. See the state government section of this document for more detail.

[4] For a complete list of items contained within Phase I (Chapter 220) and Phase II (Chapter 374), see the 2002 Health and Human Services Finance tracking documents at the following addresses (http://www.house.leg.state.mn.us/fiscal/tracking.htm) or contact Joe Flores at 651-296-5483.

- $2.2 million by eliminating start-up costs and wrap-around services for children's mental health collaboratives. While this eliminates the Department's general fund base for these activities, local collaboratives have been able to generate upwards of $40.0 million annually in new federal revenues for collaborative-funded initiatives since this revenue enhancement project began in the late 1990s. *Of this reduction, $1.8 million was restored in Phase 2;*

- $1.5 million in FY 2003 and $768,000 in FY 2004 in one-time reductions for grants to spur the development of community-based services for elderly Minnesotans;

- $4.7 million by reducing by ten percent a grant to counties for a broad range of social service activities under the community social services act;

- $2.6 million in FY 2002-03 and $11.4 million in FY 2004-05 by vacating the Kirkbride building at Fergus Falls and moving into a more efficient facility on the campus, consolidating business functions among the state operated services' campus-based programs, and making improvements in the Department's ability to bill for services;

**Additional federal funds**
Four provisions in Phase I and II leverage additional federal dollars that will result in savings to the general fund of $38.3 million in FY2002-03 and $70.8 million in FY2004-05. One provision recognizes that the State will meet its work participation rates under the Minnesota Family Investment Program (MFIP) in FY2004 and FY2005. As a result, Minnesota can reduce its commitment of general fund resources to the MFIP program by $23.9 million in FY2004-05, instead committing federal TANF resources. Services to MFIP clients will not be affected by this change.

Another provision transfers $4.9 million annually from the proceeds of the Academic Health Center (AHC) account within the Medical Education Endowment fund to the Commissioner of Health for distribution under the medical education formula of the Medical Education and Research Costs or MERC fund. The amount transferred and distributed under the MERC formula will earn federal revenue of approximately $4.9 million annually, while the amount transferred by the University's AHC will be returned with interest.

Yet another provision in Phase 1 leverages federal dollars through a transfer from the University of Minnesota's appropriation. One-half of the transfer will be deposited into the general fund, while one-half will be used to increase the medical education payments to the University of Minnesota. The payments to the University for medical education will generate federal matching dollars that offset the transfer to the general fund. This mechanism allows the state to save $6.4 million in FY 2003 and $17.4 million in FY 2004-05.

Finally, revenues generated from an increase in the per bed transfer from county-operated nursing facilities as well as an additional surcharge of $1.00 per bed per day on all nursing facility beds will be deposited into the general fund beginning July 1, 2002. At the same time, Medical Assistance rates paid to nursing facilities will be increased, paid for partially with these new revenues and federal dollars, resulting in net savings to the general fund of $22.2 million in FY 2002-03 and $19.9 million in FY 2004-05. [NOTE: Phase 2 of the budget reconciliation effort accelerated the implementation of the additional MA surcharge by one year, from July 1, 2003 to July 1, 2002.]

- $7.0 million in FY 2002-03 and $7.2 million in FY 2004-05 by reducing the Department's central office administrative expenses. The estimated savings result from the elimination of the Public Policy Graduate Program and the DT&H task force. In addition, there are reductions for one-time salary savings in FY 2002-03 and ongoing central office costs by 3.7 percent in FY 2004-05. Finally, savings are generated through the delay of several long-term care administrative initiatives funded by the 2001 legislature;

- $4.1 million in FY 2003 and $4.6 million in FY 2004-05 by curtailing rate exceptions for ICFs/MRs, modifying, by one year, the schedule for planning and development for aging services, and eliminating one year of funding for the supportive housing and managed care pilot. *Of the amount reduced in FY 2003, $175,000 was restored in Phase II by delaying by one-year the imposition of a rate limitation for homes with rates above the average for all ICFs/MRs;*

- $5.1 million in FY 2002-03 and $10.9 million in FY 2004-05 to delay by 180 days the allocation of MR/RC or Developmental Disabilities (DD) waiver slots for community-based waiver services for people with disabilities for new recipients;

- $8.5 million in FY 2003 only by transferring surplus funds from the reserve account within the consolidated chemical dependency treatment fund to the general fund. Tier II services for individuals with income up to 215 of the federal poverty guidelines will continue to receive CD treatment. *An additional $7.0 million in excess funding will be transferred to the general fund in FY 2003 as a result of Phase 2 actions;*

- $12.3 million in FY 2003 and $20.4 million in FY 2004-05 by withholding five percent of the monthly, prepaid Medical Assistance payments (PMAP) made to managed care companies beginning January 1, 2003. Provided health plans comply with performance outcomes, the amount withheld will be returned within 12 to 18 months. Initially, the health plans are expected to meet all performance outcomes, resulting in no net loss to providers. Health plan companies serving MinnesotaCare clients will only have 0.5 percent of their monthly payments withheld, resulting in savings to the Health Care Access fund of $596,000 in FY 2003 and $1.3 million in FY 2004-05;

- $1.3 million in FY 2003 and $5.7 million in FY 2004-05 by reducing by 2.0 percent an adjustment made to non-metro PMAP counties, effective January 1, 2003. A

**Prescription Drug Program Expansions**
Chapter 220 proceeds with the expansion of the Prescription Drug Program to the disabled up to 120 percent of the federal poverty guidelines (FPG) on July 1, 2002 and seniors with income between 120 percent and 135 percent of FPG effective July 1, 2003. Under current law, seniors were to be enrolled on January 1, 2002, but the Commissioner of Human Services forestalled expansion of the program in December 2001, citing statutory authority to manage anticipated spending within the current appropriation. Subsequent to the Commissioner's decision, the Governor recommended repealing the scheduled expansions to the disabled and seniors. The expansions will go ahead at a cost of $1.2 million in FY 2002-03 and $4.8 million in FY 2004-05.

provision was added to this Governor's recommendation to inhibit health plans from passing on this reduction to health care providers;

- $2.1 million in FY 2003 and $9.3 million in FY 2004-05 as a result of reducing by 0.5 percent the rate of growth paid for inpatient and outpatient hospital services in MA and GAMC. Rates paid to fee-for-service providers will be reduced on July 1, 2002 and prepaid health plans on January 1, 2003. Rates paid to MinnesotaCare providers are not reduced from its rate of growth;

- $290,000 by reducing, by approximately one-half, the community social services supplemental grants;

- $1.9 million in FY 2003 and $7.3 million in FY 2004-05 by imposing limits on the use of annuities and sole benefit trusts to shelter assets. As a result of this change, recipients of long-term care services will pay more of their assets toward their cost of care;

- $3.1 million in FY 2002-03 and $11.5 million in FY 2004-05 through the imposition on counties of a ten percent cost-sharing arrangement for individuals under age 65 with disabilities who continue in nursing home placements after 90 days;

- $158,000 in FY 2002-03 and $3.0 million in FY 2004-05 in net revenue by establishing a preferred drug/supplemental rebate program. This program will require drug manufacturers to provide additional rebates on prescriptions with similar properties but higher costs. While the program will be voluntary, the drug products of manufacturers who refuse to participate in the program will be subject to prior authorization;

- an increase of $350,000 in FY 2002 only to the University of Minnesota for the U special kids program to provide physician-supervised case management services for children eligible for medical assistance;

- $36.9 million in FY 2003 only by shifting a payment to counties for social services grants from FY 2003 to FY 2004. Payments to counties that are affected by this change include the following:
    - community social services grants ($13.730 million)
    - family preservation grants ($2.702 million)
    - developmental disability semi-independent living services ($1.766 million)
    - developmental disability family support ($1.237 million)
    - adult mental health grants ($13.635 million)
    - children's mental health grants ($3.846 million)
    
    TOTAL: $36.916 million

- $564,000 in FY 2003 only from excess revenues in several state-operated services, dedicated revenue accounts within the special revenue fund.

## Department of Health

Phase I and II reduce general fund spending at the Department of Health by $14.5 million in FY 2002-03 and $14.3 million in FY 2004-05. Unless otherwise noted, the proposals involve ongoing, general fund reductions beginning on July 1, 2002.[5]

**Specific initiatives include:**

- $9.7 million in FY 2002-03 and FY 2004-05 by eliminating the general fund base for the Medical Education and Research Costs (MERC) trust fund. The actual reduction to the MERC fund is twice the general fund amount, because federal matching funds will be lost, as a result of this reduction. One-half of this reduction ($4.85 million annually) is replaced by transferring existing funding from the University of Minnesota's Academic Health Center to the MERC fund where it is matched with federal dollars. The federal match will be retained within the MERC fund, while the amount transferred from the University of Minnesota will be returned with interest;

- $400,000 in FY 2002-03 and FY 2004-05, and $294,000 in FY 2002-03 and FY 2004-05 by shifting the financing of the summer health care internship program and the health and long-term care career promotion grants program passed by the 2001 legislature to the Health Care Access fund. Administrative funding within the Department of Health will be reduced to offset the increase to the Health Care Access fund. The governor proposed eliminating funding for these programs;

- $1.3 million in FY 2002-03 and FY 2004-05 by eliminating grant funding for Juvenile Assessment Center Grants;

- $100,000 by reducing the department's funding for curriculum development of fetal alcohol syndrome activities;

- $650,000 in FY 2002 only to reduce unused appropriations for two recent initiatives – suicide prevention and eliminating health disparities;

- $400,000 by not providing an increase in funding for emerging health threats that was slated to take effect in FY2003; and

- $800,000 in FY 2002-03 and $850,000 in FY 2004-05 to reduce the Department's administrative funding.

[5] These estimates do not include the effect of the hiring freeze or reduction in professional and consulting contracts contained elsewhere in Chapter 220. See the state government section of this document for more detail.

**Veterans Homes Board**

In order to fund a projected funding deficiency, a one-time appropriation of $900,000 in FY 2003 from the general fund was made to the Minnesota Veterans Homes Board. In addition to this one-time appropriation, the Department of Administration will transfer to the Board up to $500,000 of any payments made by contractors for mold damage at the Luverne Veterans Home.

## *Implications*

**General fund**

As noted earlier, general fund spending within the Health and Human Services budget is expected to increase by approximately $200.0 million each year between fiscal years 2003 and 2005, an average of 6.1 percent each year. However, few proposals in Phase I and Phase II address the underlying issues behind these escalating costs (i.e., enrollment, price per unit of service, utilization) within the H&HS budget, particularly within the Medicaid budget, an issue that looms in the future.

On its face, the H&HS budget will experience the largest permanent reduction in general fund spending in Phases I and II. A closer examination of the numbers reveals that 78.4 percent of the reductions in FY 2002-03 ($112.4 million) result from shifting costs to other entities. For example, 26.8 percent of the reductions or $38.3 million in the current biennium are made possible by replacing general fund spending with federal dollars (see Additional Federal Funds on page 24). An additional reduction of $7.8 million during the current biennium shifts costs to counties (e.g., reduction to the CSSA grant and imposition of a 10 percent county share on extended stays in nursing facilities).[6] Finally, one-time spending reductions or cost-shifting maneuvers result in $66.1 million in savings, 46.2 percent of the total reductions, in FY 2002-03.

That is not to suggest that shifting costs to other entities is necessarily a bad thing, especially if there is a good policy reason for doing so (e.g., withhold of prepaid Medical Assistance payments to encourage certain behaviors). However, it does highlight the fact that in future budget discussions, should additional budget reductions become necessary, these options may not be available or simply exhausted.

***Federal TANF reserve***

With the exception of the forecast changes in the Minnesota Family Investment Program (MFIP) and a recognition of Minnesota's progress in meetings its work participation requirements, few changes were made in federal TANF funding.

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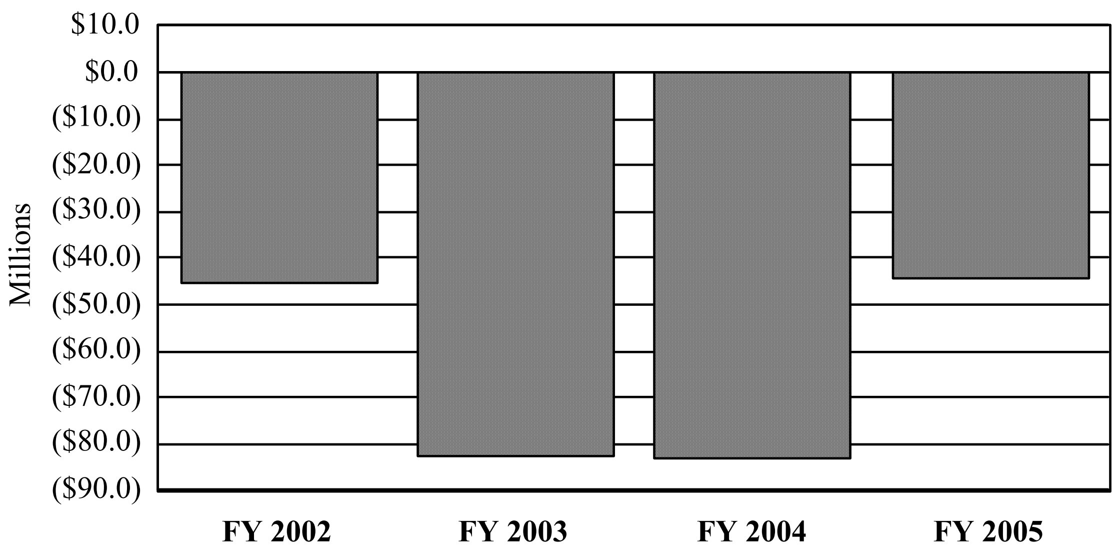
[6] It should be noted that county commitments to human services have declined significantly during the past biennium with the expansion of the Adoption Assistance (AA) and Relative Custody Assistance (RCA) programs and the Department of Human Services "open enrollment" onto the waiver program for people with mental retardation and related conditions (MR/RC waiver), better known as the DD waiver. The expansion of AA and RCA has removed counties' foster care obligations to the state, to the tune of approximately $10.0 million in annualized savings. The expansion of the DD waiver program has relieved counties from providing day training and habilitation services as well as case management, reducing counties' annual obligations by an estimated $18.0 million.

***Health Care Access fund***

Policymakers, including the Governor, delayed addressing the impending funding crisis facing the Health Care Access fund during the 2002 legislative session, meaning the annual structural deficits (revenues minus expenditures) that exist in each fiscal year from FY 2002 through FY 2005 will persist. Based on current projections, the fund is not expected to run out of money through FY 2005. However, it is very likely that the fund will become insolvent in FY 2006. Solving the funding crisis will involve a myriad of difficult choices including curtailing MinnesotaCare enrollment, reducing benefits, paring back grants to improve health care access, or raising taxes.

**Projected Health Care Access Fund structural deficits**
**(revenues less expenditures)**




Source: Health Care Access fund tracking document, May 2002.

***For additional information on health and human services finance issues, contact Joe Flores at 296-5483 or joe.flores@house.leg.state.mn.us***

# Environment and Natural Resources Finance

For budget activities overseen by the Environment and Natural Resources Finance Committee, budget adjustments (including Phase I, Phase II and the Consolidated Conservation Land Act) include total general fund spending reductions of $23.2 million in FY 2002-03 and $28.6 million in FY 2004-05. Total proposed general fund spending would be $386.1 million in FYs 2002-03 and $384.9 million in FY 2004-05, a 5.7 percent and a 6.9 percent decrease from February 2002 forecast levels, respectively.

Since general fund revenues comprise approximately 42% of all funding sources for Environment and Natural Resources activities, non-general fund sources were reviewed. While general fund spending is reduced, appropriations in non-general fund accounts are increased by $13.6 million to continue to support certain program services.

For all agencies, sections of Chapter 220, modified by Chapter 347, placed a moratorium on professional service contracts and imposed a hiring freeze on state agency personnel. While the full impact of these provisions are yet to be determined, further discussion can be found in the fiscal analysis for State Government Finance.

**Environment & Natural Resources – 2002 Session Summary**
**FY 2002-2005 General Fund Budget Adjustments**
*(dollars in thousands)*

| | FY02 | FY03 | 02 & 03 | FY04 | FY05 | 04 & 05 |
|---|---|---|---|---|---|---|
| Base (February 2002 forecast) | $177,202 | $179,633 | $356,835 | $179,133 | $179,133 | $358,266 |
| Open Appropriations | $25,391 | $27,046 | $52,437 | $27,422 | $27,869 | $55,291 |
| Chapter 220 Reductions | ($ 103) | ($12,797) | ($12,900) | ($14,300) | ($14,300) | ($28,600) |
| Chapter 220 GF cancellations | 0 | (1,300) | (1,300) | 0 | 0 | 0 |
| Chapter 347 Reductions | 0 | (9,000) | (9,000) | 0 | 0 | 0 |
| Chapter 353 (Con Con Lands) | 0 | 0 | 0 | (30) | (20) | (50) |
| Adjusted Base Appropriations | 177,099 | 156,536 | 333,635 | 164,833 | 164,833 | 329,666 |
| Adjusted Open Appropriations | 25,391 | 27,046 | 52,437 | 27,392 | 27,849 | 55,241 |
| % Reduction (Direct) | -0.1% | -12.9% | -6.5% | -8.0% | -8.0% | -8.0% |
| **% Reduction (Direct & Open)** | **-0.1%** | **-11.2%** | **-5.7%** | **-6.9%** | **-6.9%** | **-6.9%** |

# Detail by Agency – FYs 2002-2005

## Pollution Control Agency (PCA)

| all numbers in thousands | FY02 | FY03 | **02 & 03** | FY04 | FY05 | **04 & 05** |
|---|---|---|---|---|---|---|
| Base (Feb 2002 forecast) | $18,409 | $18,706 | **$37,115** | $18,206 | $18,206 | **$36,412** |
| Chapter 220 Reductions | ($103) | ($3,161) | **($3,264)** | ($1,821) | ($1,821) | **($3,642)** |
| **% Reduction** | **-0.6%** | **-16.9%** | **-8.8%** | **-10.0%** | **-10.0%** | **-10.0%** |

Starting in FY03 $683,000 per year of General Funds will be removed from the Water Quality budget. This will be replaced by a 25% Water Quality Fee increase (Environmental Fund).

Starting in FY 2002, the Household Hazardous Waste program will be funded by the Solid Waste Fund. Currently the program is funded with General Fund dollars with a continuing base of $1.041 million.

Chapter 220 budget adjustments make $1,300,000 of existing FY 2003 appropriations for Clean Water Partnership grants available for use in FY02.

A one-time cost savings of $236,000 due the state employees strike will be canceled back to the general fund. Non-general fund strike savings of $664,000 will be canceled to the Environmental Fund, Solid Waste Fund, Petro Fund and the Public Facilities Authority proprietary Fund.

The PCA will save $137,000 per fiscal year in lease expenses due to the conclusion of the negotiated lease arrangements. This amount will be canceled from the agency budget back to the General Fund. Similarly, non-general fund rent savings of $363,000 will be canceled to the Environmental Fund, Solid Waste Fund, and the Petro Fund.

## Office of Environmental Assistance (OEA)

| all numbers in thousands | FY02 | FY03 | **02 & 03** | FY04 | FY05 | **04 & 05** |
|---|---|---|---|---|---|---|
| Base (Feb 2002 forecast) | $20,354 | $20,480 | **$40,834** | $20,480 | $20,480 | **$40,960** |
| Chapter 220 Reductions | ($0) | ($2,049) | **($2,049)** | ($2,049) | ($2,049) | **($4,098)** |
| Chapter 347 Reductions | 0 | ($9,000) | **($9,000)** | 0 | 0 | **0** |
| **% Reduction** | **0%** | **-54.0%** | **-27.1%** | **-10.0%** | **-10.0%** | **-10.0%** |

Starting in FY 2003, budget adjustments include 1) a $10.4 million reduction in Select Committee on Recycling and the Environment (SCORE) block grants to counties, and 2) an expansion of the solid waste processing credit to include certain municipal solid waste processing facilities and county consortiums that operate under a solid waste management joint powers agreement. The reduction in SCORE funding is mitigated with a $9 million, one-time appropriation in FY 2003 from the Solid Waste Fund. The processing credit expansion, effective March 30, 2002, is funded with a $1.5 million appropriation from the Solid Waste Fund.

Additional budget adjustments include a $208,000 reduction (10 percent) to base funding in FY 2003 reduction for competitive grants and loans, and a $440,000 reduction (10 percent) to base funding in FY 2003 for OEA operations.

### Minnesota Zoological Gardens

Appropriations for the Minnesota Zoo are reduced by $383,000 (10%) in each FY 2003, FY 2004 and FY 2005.

| all numbers in thousands | FY02 | FY03 | **02 & 03** | FY04 | FY05 | **04 & 05** |
|---|---|---|---|---|---|---|
| Base (Feb 2002 forecast) | $7,445 | $7,668 | **$15,113** | $7,668 | $7,668 | **$15,336** |
| Chapter 220 Reductions | 0 | ($383) | **($383)** | ($383) | ($383) | **($766)** |
| **% Reduction** | **0%** | **-5.0%** | **-2.5%** | **-5.0%** | **-5.0%** | **-5.0%** |

### Department of Natural Resources (DNR)

| all numbers in thousands | FY02 | FY03 | **02 & 03** | FY04 | FY05 | **04 & 05** |
|---|---|---|---|---|---|---|
| Base (Feb 2002 forecast) | $110,640 | $112,543 | **$223,183** | $112,543 | $112,543 | **$225,086** |
| Open Appropriations | $25,391 | $27,046 | **$52,437** | $27,422 | $27,869 | **$55,291** |
| Chapter 220 Reductions | ($0) | ($5,385) | **($5,385)** | ($8,088) | ($8,088) | **($16,176)** |
| Chapter 220 GF cancellations | 0 | (1,300) | **(1,300)** | 0 | 0 | **0** |
| Chapter 353 (Con Con Lands) | 0 | 0 | **0** | (30) | (20) | **(50)** |
| % Reduction (Direct) | 0% | -5.9% | **-3.0%** | -7.2% | -7.2% | **-7.2%** |
| **% Reduction (Dir & Open)** | **0%** | **-4.8%** | **-2.4%** | **-5.8%** | **-5.8%** | **-5.8%** |

Budget adjustments for DNR include a $1.052 million reduction (50 percent) in FY 2003 for the MN Conservation Corps program. In FY 2004, a reduction of $2.104 million eliminates the program.

Starting in FY 2003, base funding for the Forest Resource Council is $700,000, a reduction of $200,000 per year.

Department-wide reductions (called "Division Service Reductions") originally proposed by the Governor, were enhanced by legislative action. This is the single largest reduction in the DNR, equaling over $4.0 million in FY 2003, and $5.2 million thereafter. It includes the following cuts, detailed in the chart on the following page:

**Summary: DNR Division Service Reductions - FY 2002-2005**
*(dollars in thousands)*

| Appropriation Name | FY02 Cuts | FY 03 Cuts | FY 04 Cuts | FY 05 Cuts |
|---|---|---|---|---|
| Lands & Minerals | 0 | (11) | (11) | (11) |
| Water Resources Management | 0 | (563) | (563) | (563) |
| Forest Management | 0 | (99) | (99) | (99) |
| White Pine Restoration | 0 | (300) | (300) | (300) |
| Parks And Recreation | 0 | (317) | (567) | (567) |
| Trails And Waterways Gen | 0 | (177) | (177) | (177) |
| Enforcement | 0 | (349) | (349) | (349) |
| General Operations Support | 0 | (1,931) | (2,832) | (2,832) |
| Wildlife Management | 0 | (110) | (110) | (110) |
| Lake Ecosystems Monitoring | 0 | (44) | (44) | (44) |
| Fish Management | 0 | (134) | (134) | (134) |
| **TOTAL** | **0** | **-$4,035** | **-$5,186** | **-$5,186** |

In addition, reductions of $198,000 in FY 2003 and $598,000 in FY 2004 and thereafter were made to grants and grant programs. They include:

**Summary : DNR Adjustments to Grants and Grant Programs – FY 2002-2005**

| Appropriation Name | FY 02 Cuts | FY 03 Cuts | FY 04 Cuts | FY 05 Cuts |
|---|---|---|---|---|
| Mineral Cooperative Programs | 0 | (78) | (78) | (78) |
| Taconite Mining Grants | 0 | (100) | (100) | (100) |
| Metro Parks Grants | 0 | 0 | (400) | (400) |
| Aquatic Plant Restoration | 0 | (20) | (20) | (20) |
| **TOTAL** | **0** | **-$198** | **-$598** | **-$598** |

Chapter 220 also includes a one-time transfer of $1.3 million from the Minnesota Future Resource Fund to the general fund.

## Board of Water and Soil Resources (BWSR)

| all numbers in thousands | FY02 | FY03 | **02 & 03** | FY04 | FY05 | **04 & 05** |
|---|---|---|---|---|---|---|
| Base (Feb 2002 forecast) | 19,054 | 18,936 | **37,990** | 18,936 | 18,936 | **37,872** |
| Chapter 220 Reductions | 0 | -1,754 | **-1,754** | -1,894 | -1,894 | **-3,788** |
| **% Reduction** | **0.0%** | **-9.3%** | **-4.6%** | **-10.0%** | **-10.0%** | **-10.0%** |

Budget adjustment for BWSR include a $523,000 reduction in operating expenses, effective in FY03.

Also beginning in FY 03, base funding for grants in the BWSR budget include a decrease of $800,000 for Cost Share grants and a $382,000 decrease for Natural Resource Block grants. The Area II MN River grant is reduced by $49,000 in FY 2003 and then by $189,000 in each FY 2004 and FY 05.

### Science Museum of Minnesota

| all numbers in thousands | FY02 | FY03 | **02 & 03** | FY04 | FY05 | **04 & 05** |
|---|---|---|---|---|---|---|
| Base (Feb 2002 forecast) | $1,300 | $1,300 | **$2,600** | $1,300 | $1,300 | **$2,600** |
| Chapter 220 Reductions | $0 | ($65) | **($65)** | ($65) | ($65) | **($130)** |
| **% Reduction** | **0.0%** | **-5.0%** | **-2.5%** | **-5.0%** | **-5.0%** | **-5.0%** |

Beginning in FY 2003, base appropriations of $1.3 million are reduced by $65,000, reflecting a 5% reduction.

***For additional information on Environment & Natural Resources finance issues, contact Katherine Schill at 651- 296-5384 or Katherine.Schill@house.leg.state.mn.us***

# Agriculture and Rural Development Finance

Chapter 220 makes General Fund reductions of $1.7 million for the Agriculture Finance area in FY 2002-03. Expenditure reductions for FY 2004-05 total $4.1 million. Transfers from special revenue accounts to the general fund are $1 million in FY 2002-03, and $1.3 million in FY 2004-05. No general fund changes to Agriculture Finance programs occurred in subsequent budget bills.

**Agriculture: Chapter 220 reductions**
(dollars in thousands)

| | FY 2002 | FY 2003 | 02 & 03 | FY 2004 | FY 2005 | 04 & 05 |
|---|---|---|---|---|---|---|
| Direct Appropriations Base | $28,986 | $29,174 | **$58,160** | $29,174 | $29,174 | **$58,348** |
| Open Appropriations Base | $35,436 | $35,456 | **$70,892** | $35,327 | $32,968 | **$68,295** |
| Chapter 220 Direct App Reductions | ($469) | ($1,227) | **($1,696)** | ($1,246) | ($1,247) | **($2,493)** |
| Open Appropriation Reductions | $0 | $0 | **$0** | $0 | ($1,648) | **($1,648)** |
| % Reduction (Direct) | -1.6% | -4.2% | **-2.9%** | -4.3% | -4.3% | **-4.3%** |
| % Reduction (Open) | 0.0% | 0.0% | **0.0%** | 0.0% | -5.0% | **-2.4%** |
| **% Reduction (Dir & Open)** | **-0.7%** | **-1.9%** | **-1.3%** | **-1.9%** | **-4.7%** | **-3.3%** |

### Minnesota Department of Agriculture (MDA)

Chapter 220 reduced General Fund appropriations for the Department of Agriculture by $879,000 in FY 2002-03, and $3.3 million in FY 2004-05.

**MN Department of Agriculture: Chapter 220 Reductions**
*(dollars in thousands)*

| | FY 2002 | FY 2003 | 02 & 03 | FY 2004 | FY 2005 | 04 & 05 |
|---|---|---|---|---|---|---|
| Base | $21,991 | $22,159 | **$44,150** | $22,159 | $22,159 | **$44,318** |
| Open Appropriations | $35,436 | $35,456 | **$70,892** | $35,327 | $32,968 | **$68,295** |
| Reductions | ($69) | ($810) | **($879)** | ($833) | ($834) | **($1,667)** |
| Open Appropriations Reductions | $0 | $0 | **$0** | $0 | ($1,648) | **($1,648)** |
| % Reduction (Direct) | -0.3% | -3.7% | **-2.0%** | -3.8% | -3.8% | **-3.8%** |
| % Reduction (Open) | 0% | 0% | **0%** | 0% | -5.0% | **-2.4%** |
| **% Reduction (Dir & Open)** | **-0.1%** | **-1.4%** | **-0.8%** | **-1.5%** | **-4.5%** | **-2.9%** |

The ethanol producer payment subsidy program will be reduced one cent per gallon or 5 percent beginning in fiscal year 2005. This reduction reduces total producer payments by $1.648 million in FY 2005.

| Department of Agriculture: Chapter 220 in Detail (dollars in thousands) | | | | | | |
|---|---|---|---|---|---|---|
| **Program** | **FY 02** | **FY 03** | **02 & 03** | **FY04** | **FY05** | **04 & 05** |
| Protection Services Reductions | 0 | (250) | **(250)** | (250) | (250) | **(500)** |
| Ag Marketing and Development Reductions | (21) | (71) | **(92)** | (92) | (92) | **(184)** |
| Administration and Financial Assistance Reductions | (5) | (489) | **(494)** | (491) | (492) | **(983)** |

Two reductions are specified in the bill. These reductions begin in FY 2003.

- Duluth Seaway Port Authority ($11,500 of a $115,000/yr base, or 10%)
- Elimination of grants to Ag Information Centers ($175,000/yr)

Balances from three accounts in the Special Revenue Fund were transferred to the General Fund: the Family Farm Administrative Account ($106,000 in FY 2002 and $50,000 in FY 2004), the Ethanol Development Loan Administrative Account ($8,000) and the Family Farm Bond Principal Account ($890,000 in FY 2002, $800,000 in FY 2004 and $410,000 in FY 2005.)

Balances in two special revenue fund accounts are transferred to a new methane digester loan program to be operated under the Rural Finance Authority in Chapter 373, the Agriculture Policy Bill. The remaining balance of $572,000 in a disaster recovery account funded in 1998 and a balance of $88,000 in an existing manure digester loan program are transferred to the new program. Loans are available at rates not exceed four percent (any loan made prior to July 1, 2003 must be at no interest) to purchase equipment and finance construction of systems that use manure to produce electricity.

## Board of Animal Health

Chapter 220 made no reductions to the Board of Animal Health budget.

## Minnesota Horticulture Society

Chapter 220 made a one-time reduction in the Minnesota Horticulture Society's $82,000 state appropriation by $16,000 (or 19.5%) in FY 2003.

## Agricultural Utilization Research Institute (AURI)

Chapter 220 makes reductions of $400,000 in FY 2002 (out of $3.88 million, or 10.3%), $401,000 in FY 2003 (out of $4.130 million, or 9.7%), $413,000 in FY 2004 and FY 2005 (or 10%). A reduction of $20,000 hybrid tree research and development out of a $200,000 base is included in the AURI reductions. (see chart on next page for further details).

| Agricultural Utilization Research Institute: Chapter 220 Reductions (dollars in thousands) | | | | | | |
|---|---|---|---|---|---|---|
| | **FY 2002** | **FY 2003** | **02 & 03** | FY 2004 | **FY 2005** | **04 & 05** |
| Base | $3,880 | $4,130 | $8,010 | $4,130 | $4,130 | $8,260 |
| Reductions | ($400) | ($401) | ($801) | ($413) | ($413) | ($826) |
| **% Reduction** | **-10.3%** | **-9.7%** | **-10.0%** | **-10.0%** | **-10.0%** | **-10.0%** |

***For additional information on agriculture finance issues, contact Bill Marx, Chief Fiscal Analyst, at 651-296-7176 or bill.marx@house.leg.state.mn.us***

# Jobs & Economic Development Finance

The 2002 Legislature reduced the General Fund appropriations for the agencies under the jurisdiction of the Jobs and Economic Development Finance Committee by $5.493 million in the FY 2002-03 Biennium. New General Fund revenues will increase by $1.756 million.

**Jobs & Economic Development Budget Reductions**
*(dollars in thousands)*

| Agency | FY 2002 | FY 2003 | FY 2004 | FY 2005 |
|---|---|---|---|---|
| Trade & Economic Development | 559 | 761 | 1,870 | 1,870 |
| Minnesota Technology | | 750 | 750 | 750 |
| Economic Security | 80 | 559 | 1,459 | 1,859 |
| Housing Finance Agency | | 216 | 673 | 673 |
| Commerce | 506 | 376 | 401 | 401 |
| Labor & Industry | 324 | 502 | 502 | 502 |
| Mediation Services | 30 | 30 | 50 | 50 |
| Historical Society | 400 | 400 | 650 | 650 |
| ***TOTAL:*** | **1,899** | **3,594** | **6,355** | **6,755** |

**Department of Trade & Economic Development**

The Department's General Fund budget is reduced by $559,000 in FY 2002, and $761,000 in FY 2003. The out-biennium reductions are $1.87 million each year in the 2004-05 biennium.

- $146,000 one-time reduction in the Department's FY 2002 funding to reflect salary savings from the state employee strike.
- $70,000 in FY 2002 and $111,000 in FY 2003 is saved through Department-wide cost reductions. These reductions are ongoing.
- $20,000 in FY 2003 and $50,000 each year going forward is saved by reducing the Film Board's "Snowbate" grant program.
- $43,000 in FY 2002 and $270,000 in FY 2003 is saved through cost reductions in the Trade Office. The FY 2004-05 biennium savings are $320,000 per year.
- $120,000 in FY 2002 and $320,000 in FY 2003 are saved in the Minnesota Tourism Office. The FY 2004-05 biennium savings are $770,000 per year.
- $100,000 in savings in both FY 2002 and FY 2003 in the Information and Analysis Division. The FY 2004 and FY 2005 reductions are $179,000 each year.

- $500,000 per year in reduced funding for the Minnesota Investment Fund program. The reductions begin in FY 2004.

- $250,000 in increased General Fund funding in FY 2003 for the ISEEK (Internet System for Education and Employment Knowledge) program. This funding is one-time.

- $150,000 in increased funding for the Rural Policy Center beginning in FY 2004.

The Legislature **did not** enact several of the Governor's budget reduction proposals, including:

- $850,000 in reduced funding to the Job Skills Partnership Board.

- $13,000 reduction in the one-time grant to the Mississippi Parkway Commission.

- $35,000 one-time grant to the Blue Earth County Business Facilitation Program.

- $75,000 one-time grant to the West Central Growth Alliance

- $150,000 one-time grant to the Cuyuna Range Technology Center

- $500,000 one-time grant to the Duluth Technology Center

- $750,000 per year in TANF funding for the Healthcare Workers Job Training program that is administered by the Job Skills Partnership Board.

The Governor's proposal to make the Minnesota Investment Fund into a revolving loan program was **not enacted**.

The Legislature also enacted several General Fund revenue transfers and cancellations, to include:

- $1 million from the balance in the Rural Policy Center Development Center Account is transferred to the General Fund in FY 2004. A second transfer of $1 million will occur in FY 2005

- $30,000 in various Special Revenue account balances in the Trade Office is transferred.

- $426,000 is canceled from the 1999 appropriation to the Journey Travel Information System.

The Legislature **did not** enact the Governor's recommendation for transferring the accumulated and ongoing interest receipts of the Minerals 21st Century Fund to the General Fund.

### Dislocated Worker Program Funding

The 2002 Legislature increased funding to the Workforce Development Fund for the Dislocated Worker Program by $30.277. The money is derived from three sources. First, $15.027 million is transferred from the General Fund; second, $3.2 million is transferred from the balance of the Realtor Education, Research and Recovery Fund; and third, the funds collected in CY 2002 and 2003 from the .02 percent Unemployment Insurance Technology Enhancement assessment will be reallocated to the Workforce Development Fund for the Dislocated Worker Program. This assessment is expected to raise $12 million for the program between FY 2002-04.

### Minnesota Technology

The state's General Fund grant to Minnesota Technology will be permanently reduced by $750,000 per year. The Legislature **did not** approve the Governor's recommendation that state financial support for Minnesota Technology end completely effective January 1, 2003.

### Department of Economic Security

The Department's General Fund appropriations are reduced by $80,000 FY 2002, and by $559,0000 in FY 2003. The enacted ongoing reductions are $1.459 million in FY 2004 and $1.859 million in FY 2005.

- $80,000 one-time reduction in the Department's FY 2002 budget to reflect salary savings from the state employees strike.

- $228,000 year is a base reduction for the Agency's Workforce Services Division. The Division base funding is reduced by an additional $700,000 each year in the 2004-2005 biennium. The reduction includes a $ 500,000 per year reduction in funding for the Minnesota Youth Program.

- $204,000 each year is a base reduction for the Agency's Workforce Rehabilitation Services Division. The reduction is ongoing.

- $127,000 each year is a base reduction for the Agency's Workforce Rehabilitation Services Division. This reduction is also ongoing

- $200,000 in FY 2004 reductions and $600,000 in FY 2005 reductions result from the savings owing to the merger of the Departments of Economic Security and the Department of Trade & Economic Development. The Legislature delayed the merger of the two agencies for one year to July 1, 2003.

The Legislature **did not** enact several of the Governor's budget reduction proposals within the Department:

- Funding for the Youth Intervention Program is continued. The Governor recommended that funding for this program be eliminated.

- Funding for the Minnesota Youth Program will continue in FY 2003 as provided in current law. The Governor recommended a $2.422 million reduction. The program's FY 2004 and FY 2005 funding is reduced by $500,000 each year. This is less than half of the Governor's recommended $1.213 million yearly reduction.

- State funding for the Displaced Homemaker Program is continued at current law levels. The Governor recommended that funding for this program be eliminated.

- Funding for the one-time grant to the HIV Workplace Education program is continued. The Governor recommended that the grant be eliminated.

## Unemployment Insurance

The Legislature enacted several measures regarding the state's unemployment insurance program.

- Benefits extension are provided to Fingerhut workers in St. Cloud, Eveleth and Mora areas; several airline and LSG Sky Chefs employees; Farmland Foods workers in Albert Lea; and certain employees who qualify for state unemployment benefits but were not covered by the recent Federal unemployment insurance extension. The maximum amount of extra benefits available is 13 weeks. The estimated cost of these extensions is $22.6 million over the three fiscal years, 2002 through 2004.

- The current law provision allowing employees of private employers performing work related to food service for an elementary or secondary school is extended to December 31, 2004. The cost is estimated at $4.5 million over the four fiscal years 2002 through 2005.

- The Special Assessment to repay the interest on any loans to the UI fund from the Federal government is changed to a range from 2 to 8 percent. A second change is to allow the Commissioner of Economic Security in consultation with Commissioner of Finance to determine the assessment rate and when the special assessment is implemented based on their estimate that an interest payment will be due during the following calendar year. Prior law had a flat 10 percent special assessment rate that was implemented anytime the fund balance was less than $150 million on June 30.

- The unemployment insurance base tax rate for employers is increased to 0.38 percent for calendar year 2003. The increase is estimated to raise $122.1 million more that the current base tax rate.

- $12 million is appropriated from the $163 million in Federal Reed Act funds. The money will fund the Technology Enhancement initiative.

## Minnesota Housing Finance

The General Fund reduction to Minnesota Housing Finance Authority's 2002-03 biennial appropriations is $216,000. The FY 2004-05 biennial reductions are $673,000 per year.

The Legislature **did not** adopt the following funding recommendations put forth by the Governor.

- $496,000 reduction in FY 2002 and FY 2003 for the Housing Rehabilitation & Accessibility program. These reductions would have been ongoing.

- $900,000 per year reduction in the Home Ownership Assistance Program. The reduction would be reduced to $325,000 per year in the FY 2004-05 biennium.

- $2.1 million reduction in FY 2002 and $3.04 million reduction in FY 2003 funding to the Challenge Program. Program funding would have been reduced by $2.2 million per year in the FY 2004-05 biennium. The proposed current biennial budget cuts included eliminating a one-time $400,000 grant for lead abatement.

- $400,000 reduction for the Manufactured Housing Pilot Program. The reduction would eliminate this Program.

- $250,000 reduction in administrative funding for the Section 8 Homeownership Program.

## Department of Commerce

The Department's current budget is reduced by $506,000 in FY 2002 and $376,000 in FY 2003. The 2004-2005 biennium reductions are $401,000 per year.

- $353,000 reduction in FY 2002 is for the Department's one-time savings from the state employee's strike.

- $50,000 in FY 2002 and $125,000 in FY 2003 are for reductions in Department administrative costs. The 2004-2005 biennium reductions are $150,000 each year.

- $44,000 in FY 2002, and $104,000 in FY 2003 and beyond is saved through staff reductions in the Department's Administration Division.

- $59,000 in FY 2002, and $147,000 in FY 2003 and beyond is saved through improved gasoline pump inspection efficiencies. The Department expects the improvements to allow reducing inspection staffing by 2.5 FTE. The staffing reductions will be accomplished through attrition, so no layoffs are expected.

The Legislature **did not** eliminate cosmetology industry enforcement as the Governor recommended.

Two new appropriations were made to Commerce in the 2002 Legislative Session:

- $482,000 is appropriated from the General Fund in FY 2003 to administer the "no call list" telephone solicitation bill. The FY 2004 and FY 2005 appropriations are $349,000 and $299,000 respectively. A new "no call list" acquisition fee is established to offset the cost of these appropriations

- $30,000 is appropriated from the General Fund in FY 2003 to administer the "agents of student athletes" registration bill. The FY 2004 and FY 2005 appropriations are $21,000 and $22,000 respectively. A new agent registration fee is established to offset the cost of these appropriations.

## Assigned Risk Plan Lawsuit Settlement

The Legislature appropriated $25.1 million to fund the settlement for the lawsuit entitled Danny's Trannys, Inc. et al. The funding source for this appropriation was a transfer to the General Fund from the surplus assets of the Assigned Risk Plan.

## Department of Labor & Industry

The Legislature enacted budget reductions totaling $324,000 in FY 2002 and $502,000 in FY 2003 within the Department. The $502,000 reduction would be ongoing.

- $53,000 in FY 2002 is one-time savings from the state employee strike. An additional $5,000 saving comes from eliminating a one-time appropriation to conduct a wage disparity study. The study was done with current resources.

- $70,000 in FY 2002 savings is achieved through eliminating three staff positions (boiler inspector, management analyst and administrative support) within the agency. The FY 2003 and permanent savings are $141,000 per year.

- $100,000 in FY 2003 General Fund savings is achieved through charging the Workforce Development Fund for the agency's indirect costs occurring from the Apprenticeship program. The $100,000 per year savings from this change is ongoing.

- $196,000 in FY 2002 General Fund savings is achieved through redirecting administration savings in the Workers Compensation fund to cover agency General Fund costs. The FY 2003 and beyond General Fund savings from this change is $261,000 per year.

## Bureau of Mediation Services

Funding for the Bureau's Labor-Management Cooperation Grants program is reduced by $30,000 each year in the 2002-03 biennium. The out-biennium reduction is $50,000 each year.

## Minnesota Historical Society

The Legislature reduced the FY 2002-03 General Fund appropriation to the Minnesota Historical Society by $400,000 each year. The reduction in the 2004-05 biennium is $650,000 per year. The Governor had recommended much more drastic reductions of $793,000 in FY 2002, and a permanent $2.053 million yearly reduction beginning in FY 2003.

## FY 2004-05 Biennium

The net General Fund impact of the actions of the 2002 Legislature on the agencies under the jurisdiction of the Jobs & Economic Development Finance Committee is $14.1 million less than previous law for the FY 2004-05 biennium. The Legislature reduced ongoing General Fund appropriations to the agencies by a total of $13 million. General Fund revenues are increased by $1.1 million.

***For additional information on job and economic development finance issues, contact Ron Soderberg, Fiscal Analyst, at 651-296-4162 or ron.soderberg@house.leg.state.mn.us***

# Judiciary Finance

The Legislature's supplemental budget includes an overall reduction in criminal justice spending of $26.3 million for FY 2002-03, and $52.5 million for FY 2004-05. General fund expenditure reductions total $23.275 million in FY 2002-03, and $51.23 million in FY 2004-05. Net revenue changes are $3 million in FY 2002-03, and $1.27 million in FY 2004-05. In addition, a separate anti-terrorism bill appropriated $13 million. The following tables show the reductions, transfers and fees that were passed by the Legislature.

**Judiciary Finance Reductions**
*(dollars in thousands)*

| Agency | FY 02-03 | % Cut | FY 04-05 | % Cut |
|---|---|---|---|---|
| Courts | ($1,385) | .4% | ($2,218) | .5% |
| Public Defense Board | ($1,153) | 1.1% | ($2,236) | 2% |
| Human Rights | ($207) | 2.5% | ($414) | 5% |
| Corrections | ($15,278) | 2.1% | ($30,616) | 3.9% |
| Ombudsman for Corrections | ($168) | 25% | ($336) | 50% |
| Sentencing Guidelines | ($55) | 5.1% | ($120) | 10.9% |
| Public Safety | ($4,439) | 2.7% | ($14,288) | 8.6% |
| POST Bd. | ($179) | 1.9% | ($182) | 1.9% |
| Crime Victim Ombudsman | ($411) | 50% | ($822) | 100% |
| **Total Reductions:** | **($23,275)** | | **($51,232)** | |

**Judiciary Finance: Transfers & Fee Increases**
*(dollars in thousands)*

| | FY 2002-03 | FY 04-05 |
|---|---|---|
| POST Bd Transfer from special revenue to general fund | $179 | $182 |
| 12% of DWI reinstatement fee transferred from special revenue to general fund | $605 | $1,210 |
| Auto theft carry-forward balance transfer to general fund | $1,317 | |
| Auto theft balance (above $1.7 million) transfer to general fund | $2,600 | $2,600 |
| Fee increase-hazardous installation plan review | $12 | $24 |
| Fee increase for gambling background checks | $150 | $300 |
| Civil filing fee increase from $122 to $135 | $1,286 | $2,940 |
| Conciliation court fee increase by $10 | $638 | $1,460 |
| Public Defender co-pay of $28 | $215 | $250 |

## Department of Corrections

The Legislature decreased funding by $15.1 million for FY 2002-03, and $19.8 million for FY 2004-05. Reductions include:

- A one-time reduction of $5.2 million in FY 2002. This includes savings from the fuel reserve account, and savings at the Rush City prison.

- A department wide reduction of $6.395 million per year beginning in FY 2004.

- A $1.6 million reduction beginning in FY 2003 to reflect revised felony DWI bed impact estimates.

- The $8 million in juvenile residential treatment grants that go to counties will be reduced by $5 million (beginning in FY 2003), with $1.1 million going to the general fund and $3.9 million used to offset the costs for counties to make permanent the cost sharing arrangement at the Red Wing juvenile facility. This means that counties will pay 65 per cent of the per diem costs and the other 35 percent will be offset with the $3.9 million reduction in juvenile treatment grants.

- $ 7.913 million savings in community services that will be begin in FY 2003. The reductions are as follows:
  - $100,000/year for eliminating funding for the remote alcohol monitoring grants.
  - $322,000 for eliminating pre-trial bail evaluation grants.
  - $200,000 for the elimination of the community re-entry program.
  - $1.2 million for reducing the extended juvenile jurisdiction grants.
  - $800,000 reduction for FY 2003 only in community corrections grants.
  - $80,000 reduction for FY 2003 only for Country Probation Officer counties.
  - $320,000 reduction for FY 2003 only for Department of Correction field services.

- $300,000 savings each year beginning in FY 2003 for a reduction in management services.

- $115,000 savings in juvenile services each year beginning in FY 2003 as a result of per diem savings.

- The State Government section of Chapter 374 also exempts the institutional side of the DOC from the hiring freeze.

## Ombudsman for Corrections

$168,000 reduction each year beginning in FY 2003.

## Sentencing Guidelines Commission

$55,000 reduction each year beginning in FY 2003.

**Department of Public Safety**
A reduction of $4.439 million this biennium and $14.288 million in the next biennium.

- $1.317 million carry forward from FY 2001 to FY 2002 in the auto theft prevention program special revenue fund is transferred to the general fund. This is a one-time change.
- $1.3 million each year from the auto theft prevention program special revenue fund is transferred to the general fund. This leaves $1.7 million each year in the auto theft prevention program to be used for auto theft prevention activities.
- $1.15 million is saved in FY 2002 by an accounting adjustment in the drug policy and violence prevention area.
- $142,000 each year is reduced from the drug policy and violence prevention reduction grants.
- The model-policing program is reduced by $150,000 in FY 2002.
- The funding for the Camp Ripley weekend camp for troubled youth is eliminated. This will save $175,000 each year.
- The funding for the violence prevention council grants ($75,000 each year) is eliminated
- The crime victim service grants and staffing are reduced by $1.152 million this biennium and by $4 million for the next biennium.
- The shelter per diems are reduced by $600,000 beginning in FY 2003.
- The gang strike force grants are reduced by 5 percent each year.
- The Fire Marshall Division and the Gambling Enforcement Division are reduced by $84,000 each beginning in FY 2003.
- The base funding for the state match for disasters is reduced by $200,000 for FY 2003 and by $3.627 million beginning in FY 2004.
- Staff reductions in the office of drug policy and violence prevention resulting in savings of $176,000 beginning in FY 2003.
- A fee increase is imposed for plan reviews for above ground fuel storage and liquid petroleum storage. This is anticipated to bring in $12,000 per year.

- A fee increase is imposed for an increase in the cost of doing background checks for the Alcohol and Gambling Enforcement Division. This is expected to raise $150,000 per year.

- The $605,000 per year from the DWI reinstatement fee that goes to the Department of Public Safety in a special revenue fund is transferred to the general fund.

**Courts (Supreme Court, Court of Appeals, and District Courts)**
The courts receive a $1.385 million reduction in FY 2003, and a $2.218 million reduction in FY 2004-05.

**Public Defense Board**
The Board receives a $1.153 million reduction for FY 2003 and a $2.236 million reduction for FY 2004-05

**Peace Officers Standards and Training Board (POST)**
This special revenue fund appropriation is reduced by $179,000 for this biennium and by $182,000 for the next biennium.

**Human Rights Department**
The budget is reduced by 2.5 percent this biennium and 5 percent next biennium. This results in a savings of $207,000 each year beginning in FY 2003.

**Crime Victim Ombudsman**
This office is abolished with the duties transferred to the Public Safety Department. This results in a savings of $411,000 beginning in FY 2003.

**Uniform Laws Commission**
In Phase II, $5,000 each year is appropriated for an increase in dues.

## Anti-Terrorism Bill: Chapter 401

The anti-terrorism bill contains $13 million dollars in general fund money (all one-time appropriations) and $6.025 million in special revenue from a six-cent increase in the telephone 911 surcharge. The following table summarizes the general fund appropriations:

**2002 Anti-Terrorism Legislation (Chapter 401)**
**General Fund Appropriations**
*(dollars in thousands)*

| | FY 2002-03 |
|---|---|
| Grants for terrorism response related equipment | $3,750 |
| Terrorism response-related training | $7,500 |
| Bomb disposal squads | $250 |
| Hazardous materials emergency response teams | $240 |
| Chemical assessment teams | $105 |
| Capitol security | $600 |
| DNA expansion | $150 |
| 800 megahertz plan | $5 |
| Medical resources control centers | $400 |
| **Total:** | **$ 13,000** |

The anti-terrorism legislation provides the following:

- $3.75 million for the purchase of terrorism response-related equipment.
- $7.5 million for terrorism response-related training.
- $250,000 to reimburse bomb disposal units.
- $240,000 to increase the number of hazardous materials emergency response teams from one to four. The new teams will be located in Rochester, Moorhead, and Duluth.
- $105,000 to provide funding for up to five members for each chemical assessment team.
- $600,000 to fund the increased security for the capitol complex. This funding is for additional two state troopers and for overtime for two state troopers for the session, and for additional capitol security guards.
- $5,000 to update and modify the 800 Megahertz report.
- $150,000 for the costs associated for the collection of biological specimens for DNA testing.
- $400,000 for medical resource control centers.

**911 Special Revenue Funds:**
The 911 emergency telephone fee was increased by 6 cents, bringing the total 911 fee on each subscriber line (both wired and wireless) to 33 cents. This fee increase is projected to raise $6.025 million FY 2002-03, and $10.4 million in FY 2004-05.

Chapter 401 returned the authority to change the 911 fee to the commissioner of administration. The commissioner may set the fee within the range of 8 cents to 33 cents without legislative approval. This action reversed a policy change made by the 2001 legislature, which had established the fee at 27 cents in law, and required legislative approval for any increase above this level.

Chapter 401 also modified the 911 statutes to allow the Metropolitan Radio Board to use its share of the 911 fee (currently set at 4 cents of the fee) to provide aid to local units of government for sites and equipment in support of emergency medical communications services.

**2002 Anti-Terrorism Legislation (Chapter 401)**
**Special Revenue Fund Appropriations – 911 Fee increase**
*(dollars in thousands)*

| | FY 02 | FY 03 | FY 04 | FY 05 |
|---|---|---|---|---|
| Allows current unappropriated funds in account to be used | $1,781 | | | |
| Supports current obligations and provides enhancements to the 9-1-1 emergency telephone service (6-cents in FY 2003 and FY 2004, then drops to 3-cents in FY 2005). | | $4,244 | $4,848 | $2,796 |
| Supports additional revenue bonds for expansion of the metro radio subsystems (11/2-cents beginning in FY 2005) | | | | $1,398 |
| Increased funding for public safety answering points (PSAPs) (11/2-cents beginning in FY 2005) | | | | $1,398 |
| **Total 911 Special Revenue:** | **$1,781** | **$4,244** | **$4,848** | **$5,592** |

***For additional information on Judiciary Finance, contact Gary Karger, at 651-296-4181 or gary.karger@house.leg.state.mn.us***

# State Government Finance

The 2002 Legislature reduced net spending in the State Government Finance area by $48.7 million in FY 2002-03. Recommended net reductions for FY 2004-05 total $67.1 million.

| **State Government Budget Reductions: Phase I & II** *(dollars in thousands)* | | | | |
|---|---|---|---|---|
| | **FY 02/03 Cuts** | **FY02/03 Percent cut** | **FY 04/05 Cuts** | **FY 04/05 Percent cut** |
| Legislature | (7,245) | -4.9% | (8,490) | -6.2% |
| Secretary of State | (199) | -1.3% | (398) | -2.8% |
| Governor's Office | (962) | -10.3% | (1,404) | -10.6% |
| State Auditor | (1,043) | -5.1% | (1,080) | -5.2% |
| State Treasurer | (30) | -0.5% | (60) | -1.3% |
| Attorney General | (900) | -1.7% | (1,800) | -3.3% |
| Campaign Finance & Public Disc Board | (35) | -2.5% | (70) | -5.0% |
| Investment Board | (127) | -2.5% | (254) | -5.0% |
| Gov't Innovation & Cooperation Board | (793) | -77.0% | (1,036) | -100.0% |
| Minnesota Planning | (1,160) | -10.9% | (1,120) | -11.2% |
| Department of Administration | (3,991) | -6.6% | (5,258) | -10.9% |
| Public Broadcasting | (67) | -0.5% | (266) | -4.0% |
| Capitol Area Arch & Plan Board | (16) | -2.0% | (32) | -5.0% |
| Department of Finance | (5,382) | -13.8% | (5,898) | -15.8% |
| Department Employee Relations | (1,929) | -11.5% | (2,538) | -15.0% |
| Department of Revenue | (6,400) | -3.4% | (4,500) | -2.4% |
| Humanities Commission | (41) | -2.0% | (82) | -4.0% |
| Arts Board | (526) | -2.0% | (1,052) | -4.0% |
| Military Affairs | (2,851) | -10.0% | (3,098) | -11.0% |
| Veterans Affairs | (180) | -1.9% | (360) | -4.0% |
| Amateur Sports Commission | (120) | -9.0% | (120) | -8.9% |
| Lawful Gambling Control Board | (126) | -2.6% | (252) | -5.0% |
| Minnesota Racing Commission | (21) | -2.5% | (42) | -4.9% |
| Contingent Account | (5,638) | -100.0% | (6,000) | -100.0% |
| Tort Claims | (114) | -20.7% | (228) | -41.5% |
| MN State Retirement System (Judges) | (2,004) | -10.7% | (4,375) | -20.8% |
| Transfer to Dislocated Workers Fund | 2,800 | | 0 | |
| **Total reductions:** | **(39,100)** | | **(49,413)** | |
| Revenues Changes: GF (gain) / loss | (9,600) | | (17,700) | |
| **Net General Fund Changes:** | **(48,700)** | **-6.2%** | **(67,113)** | **-9.0%** |

**Legislature:** *$7.2 million in FY 2003, $8.5 million in FY 2004-05.*
Phase I included a 3 percent base reduction to the operating budgets of the House and Senate. The Legislative Coordinating Commission's base budget was reduced by 5 percent.

Phase II reduced the House and Senate operating budgets by an additional $1 million per year for each chamber. $1 million was cancelled from the House carryforward balance.

| | FY 02/03 Reductions | FY02/03 Percent cut | FY 04/05 Reductions | FY 04/05 Percent cut |
|---|---|---|---|---|
| **Legislature Operating Budgets** | | | | |
| Senate | (2,688) | -5.7% | (3,376) | -7.4% |
| House of Representatives | (2,910) | -5.0% | (3,820) | -6.3% |
| Legislative Coordinating Cmsn. | (483) | -2.4% | (966) | -4.9% |
| Legislative Auditor | (164) | -1.5% | (328) | -3.0% |
| House Carryforward | (1,000) | -8.3% | 0 | 0% |
| **Total Legislature:** | **(7,245)** | **-4.9%** | **(8,490)** | **-6.2%** |

## *Constitutional Offices*

**Governor's Office:** *$962,000 in FY 2002-03, $1 million in FY 2004-05*

- The Minnesota Office of Volunteer Services (MOCVS) was eliminated at the end of January, saving $141,000 in FY 2002 and $339,000 each following year. This reduction accounts for almost 50 percent of the reduction to the Governor's office in FY 2002-03.

- In Phase I, the Governor's Washington DC office was eliminated, for a savings of $206,000 each year, beginning in FY 2003. In Phase II, the language forbidding the use of state funds for a Washington DC office was repealed, but the appropriation was not restored.

- $375,000 in funding was provided in Phase II to ensure that the Governor's residence in Saint Paul will remain open to the public. The Governor closed the residence in May in response to the Phase I cuts to his office's budget and to his executive protection budget (funded through the Department of Public Safety). The funding provided to the Governor's office is for the residence staff and operational costs only. Maintenance and utilities for the residence are funded through the In-Lieu-of-Rent program in the Department of Administration, and were not impacted by the Phase I reductions.

| **Governor's Residence: Phase II Funding** | |
|---|---|
| Governor's Office | $ 200,000 |
| Dept. of Public Safety - Executive Protection | $ 175,000 |
| **Total Governor's Residence:** | **$ 375,000** |

**Secretary of State**: *$199,000 each year, beginning in FY 2003*
Chapter 220 directs that these reductions may not be made in either the elections division or in programs that produce general fund revenues.

**State Auditor**: *$1 million in FY 2002-03, $1.1 million in FY 2004-05.*
This reduction equals 5 percent of the office's general fund budget.

**State Treasurer** – *$30,000 each year, beginning in FY 2003*
- $30,000 per year in savings result from the closure of 130 local bank accounts maintained for the benefit of Deputy Registrars.

- The State Treasurer's office will be abolished in January 2003, and its staff and functions transferred to a yet undetermined agency or office. The 2001 Legislature reduced the Treasurer's budget in FY 2003 to reflect this change, since the position of State Treasurer will no longer be needed.

The 2002 Legislature failed to pass legislation transferring the duties of the Treasurer. The Governor will have the responsibility for determining where these duties will be transferred.

**Attorney General**: *$900,000 each year, beginning in FY 2003*
This represents a 3.3 percent reduction to the office's general fund base.

## *State Agencies*

**Campaign Finance Board:** *$35,000 each year, beginning in FY 2003.*
This reduction is a 5 percent cut to the Board's annual general fund base.

**Investment Board:** *$127,000 each year, beginning in FY 2003*
This is a 5 percent reduction to the Investment Board's general fund base.

**Minnesota Planning**: *$1.2 million in FY 2002-03, $1.1 million in FY 2004-05.* Reductions consist of:

- Eliminate of Local Planning Assistance Grants ($600,000 one-time reduction)
  $500,000 for grants to regional planning groups, and $100,000 for a grant to the
  I-35 Corridor Coalition was eliminated.

- FTE Reductions ($360,000) in FY 2002-03, ($800,000 in FY 2004-05): The agency estimates that there will be eight FTE reductions, spread among both program and administrative functions.

- General Base Reduction of $200,000 each year.

**Department of Administration:** *$4.1 million in FY 2002-03, $5.5 million in FY 2004-05.* The department's overall general fund budget (excluding public broadcasting) was reduced by 6.6 percent in FY 2002-03 and 10.9 percent in FY 2004-05. However, these percentages are skewed because the In-Lieu-of-Rent program, which funds space costs for the Legislature and the Governor's residence, were not subject to cuts. The actual percentage reductions to the department's *operating* budget are higher – 9.0 percent in FY 2002-03, and 16.2 percent in FY 2004-05.

In addition to including all of the Governor's recommended cuts to agency operations, and additional general base reductions to all divisions, specific cuts include:

- $200,000 from the Technology Enterprise Fund

- $74,000 in FY 2002 from the $1.9 million appropriation for local government voting equipment upgrades.

- $2 million additional reduction spread across all programs, except for Public Broadcasting and the In-Lieu-of-Rent program.

- Chapter 220 specified that no reductions may be made to the Information Policy Analysis division, the program that is responsible for data privacy concerns.

*Building Codes and Standards: $2 million one-time transfer to the general fund in FY 2002*

- Chapter 374 cancels $2 million of the balance in the Building Codes special revenue account to the general fund, leaving $4 million in the fund. This one-time reduction will take the place of a proposed 20 percent reduction in the state surcharge. A twenty percent reduction equates to an approximately $1 million reduction in fees.

*Public Broadcasting**:*** $67,000 each year in a general base cut to be distributed equally among public radio, public television, and legislative television.

The Legislature re-appropriated (over the Governor's veto) $7.8 million in funding for public television's digital conversion. The earlier appropriation made by the 2001 Legislature had cancelled when the commissioner of administration did not sign an agreement with the Minnesota Association of Public Television Stations.

**Capitol Area Architecture Board**: $16,000 each year, beginning in FY 2003. This is a 5 percent reduction to the Board's general fund base.

**Department of Finance:** *$5.4 million in FY 2002-03, $5.9 million in FY 2004-05*
The department's overall general fund operating budget was reduced by 13.8 percent in FY 2002-03 and 15.8 percent in FY 2004-05. This reduction includes all of the Governor's recommended $4 million in cuts to agency operations, plus an additional $1.4 million in general base reductions.

**Department of Revenue:** *$6.4 million in FY 2002-03, $4.5 million in FY 2004-05*
In Phase I, the Department received a general reduction of $7 million each year, beginning in FY 2002. This reduction represents 7.4 percent of the agency's general fund base for FY 2002-03, and 7.6 percent for FY 2004-05.

*Phase II Compliance Initiative:* The 2002 Tax bill (Chapter 377) appropriated to the Department an additional $7.6 million in FY 2002-03 for tax compliance activities. These activities include identification and collection of tax liabilities from individuals and businesses that currently do not pay all taxes owed, and audit and collection activity in the income tax, sales tax, lawful gambling, insurance, and corporate areas.

This funding was provided to offset potential revenue losses from the impact of the Phase I reductions to the department's compliance activities. The Department projected that its share of the reductions from the hiring freeze and contract moratorium – estimated at $5 million - would force the agency to reduce personnel in the compliance area. Because compliance activities bring in revenues to the general fund, the proposed reductions would have resulted in a loss of $14 million in revenues in FY 2002-03.

The funding level is intended to fill the $5 million "hole" in the agency's compliance budget, thus restoring the $14 million in projected lost revenues. An additional $2.6 million in funding for new compliance activities was provided to generate enough new revenues to cover the full $7.6 million appropriation. In other words, the initiative had a zero net cost because the projected revenues (from both the restored compliance activities and the new activities) offset the appropriation.

**Department of Revenue Compliance Initiative**
(dollars in thousands)

| | FY 02-04 | FY 04-05 |
|---|---|---|
| **Expenditures** | | |
| Phase I: General reduction impact | (5,000) | |
| Phase II: General reduction buyback | 5,000 | |
| Phase II: New funding | 2,600 | 9,500 |
| | **7,600** | **9,500** |
| **Revenues** | | |
| Phase I: Projected revenue loss | 14,000 | |
| Phase II: Restore revenues | (14,000) | |
| Phase II: New revenues | (7,600) | (15,200) |
| | **(7,600)** | **(15,200)** |
| **Net General Fund impact:** | **0** | **(5,700)** |

Language was also included to protect the general fund if the actual revenues from the initiative do not match projections. The legislative auditor is required to determine if actual revenue collections generated from new tax compliance activities will generate at least $7.6 million in additional general fund revenue for the biennium ending June 30, 2003[7]. If not, then the commissioner of finance must cancel from the budget reserve account to the general fund the difference between the $7.6 million and the actual additional general fund revenue.

**Department of Employee Relations:** *$1.9 million in FY 2002-03, $2.5 million in FY 2004-05*. The department's general fund operating budget was reduced by 11.5 percent in FY 2002-03 and 15 percent in FY 2004-05.

**Military Affairs:** *$2.85 million in FY 2002-03, $3.1 million in FY 2004-05.*

- Custodial positions at the TACCs have been eliminated. Other staff and Guard members will handle routine cleaning and small maintenance projects.
- The TACC maintenance and repair budget will be temporarily reduced by 13 percent in FY 2002-03. Some routine and preventative maintenance projects would be delayed.
- The utility budgets for TACCs will be temporarily reduced by three percent in FY 2002-03. Facilities may be required to limit some hours of operations and modify heating and air conditioning use.
- Funding for the Guard Our Youth program and the two associated positions was eliminated, effective FY 2002.

**Veterans Affairs:** *$180,000 each year, beginning in FY 2003*
This represents a 4 percent reduction in the agency's general fund base.

**Minnesota Amateur Sports Commission:** *$60,000 each year, beginning in FY 2002.*
1.5 vacant staff positions related to administration of grants would be eliminated, for a total of $30,000 each year. When the Mighty Ducks ice arena grant program was begun in 1995, the Legislature increased the agency's budget to hire additional staff to handle the grant process. However, in both the 1999 and 2001 sessions, the Governor vetoed all grant funds appropriated to the agency, so the workload related to these grant programs has decreased.

**Humanities Commission:** *$41,000 each year, beginning in FY 2003*.
This is a 4 percent reduction in the Commission's state funding.

**State Arts Board:** *$526,000 each year, beginning in FY 2003.*
This is a 4 percent cut to the Board's two grant areas, as well as to the administrative budget.

**Lawful Gambling Control Board:** *$126,000 each year, beginning in FY 2003.*
This is a 4 percent reduction to the Control Board's general fund base.

**MN Racing Commission:** *$21,000 each year, beginning in FY 2003.*
This is a 4 percent reduction to the Commission's general fund base.

[7] *The legislative auditor's determination must be made in the February 1, 2003, report to the legislature required by Laws 2001, First Special Session chapter 10, article 1, section 16.*

**Board of Government Innovation & Cooperation:** *$275,000 in FY 2002 $518,000 each year after.*
Chapter 220 cut 75 percent of the Board's remaining grant funds for FY 2002, and eliminated the Board beginning in FY 2003

**Contingent Accounts:** *$5.6 million in FY 2002-03, $6 million in FY 2004-05.*
This cut is a 100 percent reduction in the remaining general fund appropriation to the contingent account.

**Pension Changes**
*Minnesota State Retirement System: $2 million in FY 2002, $4.4 million in FY 04-05*
The Legislature eliminated the open appropriation for judges not participating in the post-retirement fund. At this time, the judges' retirement fund has a sufficiency and is on track to be fully funded by the statutory amortization date, so the open appropriation is no longer needed.

## *General Reductions*

In addition to the specific reductions to the agencies in the state government area, the Legislature applied general reductions across all executive branch agencies through a hiring freeze and a moratorium on professional / technical contracts. These two reductions are expected to save an additional $58 million each year, beginning in FY 2003.

These general reductions will be allocated to each state agency by the Department of Finance. Specific allocations for each agency have not yet been determined, but further detail is expected in early June.

**Hiring freeze:** ***$29.7 million each year, beginning in FY 2003***
Both Chapter 220 and Chapters 374 provide that an executive or legislative branch employer may not hire any permanent or temporary employees before July 1, 2003. The Legislature anticipates that the hiring freeze will result in general fund savings of $29.7 million (within the executive branch) during the biennium. If the governor determines that the freeze will not save $29.7 million, the governor must make proportional reductions in executive agency operating budgets to achieve these savings.

*Exemptions*: The freeze does not apply to MnSCU, or to a student in a work-study position. The provision also does not apply to a position that is necessary to perform essential services, as determined by leadership in the legislative branch, by a constitutional officer with respect to their employees, or by the governor with respect to another executive employee.

Phase II further modified the hiring freeze provision to exclude employees at a state correctional facility; employees of the department of corrections who provides direct services to offenders, and employees of state operated services under the department of human services. In addition, portions of the department of corrections and department of human services were excluded from the general reductions associated with the hiring freeze.

Because these exclusions would have the effect of pushing more of the reductions onto other state agencies, the Legislature made an effort to "buy back" a portion of the reduction to reduce this impact. Phase II reduced the overall general reduction by $10.3 million, which represents about 58 percent of the expected allocations for Corrections and Human Services (see table on following page). Because the Legislature did not buy-back the entire allocation, reductions to other state agencies will be increased.

| **Hiring Freeze General Reductions**<br>(dollars in thousands) | |
|---|---|
| **Hiring Freeze: Phase I** | **(40,000)** |
| **Phase II: "Buyback" of excluded programs** | |
| DHS - SOS division | 5,440 |
| Corrections | 4,824 |
| **Total Buybacks:** | **10,264** |
| **Total Hiring Freeze General Reduction** | **(29,736)** |

Additional exemptions included in Phase II are student workers (current law exempts only students in work-study positions); employees paid entirely with federal funds or a special revenue fund, or employees whose costs are entirely recovered from non-state entities. These exemptions are not expected to shift additional costs onto the remaining agencies and programs, so no additional funding was provided.

## Professional / Technical Contract Moratorium: *$28.3 million each year*

Chapter 374 (modifying Chapter 220) requires the governor to reduce planned agency general fund expenditures on professional or technical service contracts by at least $28.3 million during the current biennium. The governor must allocate this reduction among executive agencies.

Chapters 220 and 374 also provide that an entity in the executive branch may not enter into a new contract or renew an existing contract for professional or technical services before July 1, 2003. An entity may apply for a waiver, which the governor may grant upon a finding that the contract is necessary. Monthly reporting of all exceptions and waivers is required.[8]

*Exceptions to the Moratorium:* Phase I (Chapter 220) exempted contracts that relate to a threat to public health, welfare or safety. The capital investment bill (Chapter 393) also exempted all projects authorized in that act, and in the 1999, 2000, and 2001 bonding laws, from the moratorium.

Phase II (Chapter 374) clarified other exemptions to the moratorium. The moratorium does not apply to contracts for which the cost of which is entirely recovered from nonstate sources, or to a contract that is necessary to avoid a disruption of essential state functions, will reduce state costs, or is necessary to avoid a legal liability.

[8] The monthly waiver report can be found on the Department of Administration's website at www.mmd.admin.state.mn.us/pdf/PTWaiverMonthlyReport.pdf

Phase II also modified the moratorium provision to provide that the moratorium does not apply to MNSCU and the higher education services office. As with the hiring freeze, the Legislature "bought-back" a portion of the general reduction to lessen the impact on the remaining agencies (see table on next page).

| **Professional / Technical Contract Reductions** *(dollars in thousands)* | |
|---|---|
| **Contract Reductions: Phase I** | **(35,000)** |
| **Phase II: "Buyback" of excluded programs** | |
| MNSCU | 6,100 |
| Higher Education Services Office (HESO) | 600 |
| **Total Buybacks:** | **6,700** |
| **Total P/T Contract General Reduction** | **(28,300)** |

**Other fiscal issues:**
Chapter 374 included a provision intended to expedite payments of certain grants that were "frozen" by the Department of Finance after the November forecast was released. An agency must process the grants and contracts and issue payments by June 4, 2002. This provision applies only where a state agency delayed a decision on entering into a grant or contract with a nonprofit corporation for FY 2002 pending budget decisions, and where the nonprofit has provided services based on an appropriation that names the nonprofit or based on a grant award letter from a state agency.

***For additional information on state government finance issues, contact Helen Roberts at 651-296-4117 or Helen.Roberts@house.leg.state.mn.us***

# Transportation

Cuts for the area of Transportation were relatively small, but may have an impact on services. Annual reductions for the Departments of Transportation, Public Safety and Metropolitan Council Transit totaled $4.1 million.

The second phase required to balance the budget had little impact on the area of Transportation. No further cuts were made to the transportation related agencies. The prior cut of $175,000 for Executive Protection, was restored (*see state government finance summary*).

**Transportation: General Fund Reductions**
*(dollars in thousands)*

| | FY 2003 | FY 2004 | FY 2005 | FY 04-05 |
|---|---|---|---|---|
| MNDOT | (510) | (510) | (510) | **(1,020)** |
| Met Council | (2,715) | (2,715) | (2,715) | **(5,430)** |
| Public Safety: Phase I | (875) | (875) | (875) | **(1,750)** |
| Public Safety: Phase II | 175 | 175 | 175 | **350** |
| **Total:** | **(3,925)** | **(3,925)** | **(3,925)** | **(7,850)** |

## Department of Transportation

The Department of Transportation had a total of $510,000 in annual general fund reductions from an annual level of $18.5 million. The Office of Aeronautics was reduced by $50,000 per year. The dollars were used for pilot salaries, but will be replaced by unused balances in the state airports fund. Administrative dollars within the Office of Transit were reduced by $400,000, but language allowing the department to use un-appropriated fund balances within the 1.25% of MVST dedicated for rural transit property tax replacement will fill in the reduction. The Office of Railroads and Waterways was reduced by $60,000 annually.

## Metropolitan Council

Metropolitan Council Transit Operations was reduced by $2.7 million dollars per year. The Governor and the Metropolitan Council had proposed reductions of $1.1 million for the current biennium, and an annual reduction of $885,000 beginning in state fiscal 2005. Language in the bill directs the Met Council to reduce expenditures further, raise revenues (fare increase), or cut non-peak service or routes with less than 10% fare box recovery at their discretion. None of the options may be necessary, however, because under current law the Met Council was given a portion of motor vehicle sales tax to replace local property tax. Since car sales have been much stronger than expected, the Met Council is receiving more dollars from the general fund than projected last session, even after the cuts are enacted.

## Department of Public Safety

The Department of Public Safety's general fund budget was reduced by $875,000 annually. A transfer from the general fund to the trunk highway fund was reduced by $500,000 saving dollars for the general fund, but in essence costing the trunk highway fund. Executive Protection was cut by $175,000, reducing the budget for protecting the governor. Driver and Vehicle Services was also reduced by $200,000 per year. The cut of $175,000 for executive protection was restored in a later budget bill.

## Other Issues:

Also at issue was $245 million of general fund cash that had been appropriated in the 2000 legislative session for highway construction. These dollars had been used in the Governor's plan to balance the budget, but were left un-touched by the legislature and will continue to be used for highway projects.

A separate transportation finance bill passed both legislative bodies and went to a conference committee. No compromise was reached, and no funding bill was adopted this session. The House proposal was to issue $750 million in trunk highway bonds and pledge future revenues to fast track the current backlog of projects. The Senate proposal increased gas taxes by six cents, indexed the gas tax, proposed a metro referendum for a seven county metro sales tax increase, and provided dollars for highways, transit, and a "multi-model" fund. The issue will most likely be re-visited next session.

***For further information on Transportation related issues, contact John Walz at 651-296-8236 or John.Walz@house.leg.state.mn.us***

# Taxes, Local Aids and Credits

Chapter 377, Minnesota Laws of 2002, (the 2002 Omnibus Tax Act) consists primarily of adjustments to changes enacted in 2001 and partial conformity to federal income tax law changes. As summarized in Table 1, the tax changes are largely revenue neutral to the general fund with revenue increases for certain federal update provisions offset revenue reductions for other provisions. Further, a net increase in income and sales tax revenues offset expenditure increases due to changes in property tax aids and credit.

**Table 1**
**2002 Omnibus Tax Act**
**General Fund Revenue and Expenditure Changes**
*(dollars in thousands)*

| Tax Type | FY 2002-03 | FY 2004-05 |
|---|---|---|
| **Income Tax** | | |
| Revenue increases | 2,990 | 36,160 |
| Revenue losses | (600) | (4,300) |
| Transfers to reserves—expenditure | (3,900) | (24,300) |
| **Net Income Tax Change** | **(1,510)** | **7,560** |
| **Sales Tax (excl. June accelerated)** | | |
| Revenue increases | 12,926 | 31,649 |
| Revenue reductions | (9,321) | (17,739) |
| **Net Sales Tax Change** | **3,605** | **13,910** |
| **Property Tax, Aids and Credits** | | |
| Expenditure increases | (2,600) | (23,127) |
| Expenditure decreases | 0 | 506 |
| **Net Property Tax, Aids and Credits** | **(2,600)** | **(22,621)** |
| Miscellaneous-Net Revenue Change | 385 | (290) |
| **Net general fund impact*** | **(120)** | **(1,441)** |

** Does not include $25.5 million increase in FY 2002-03 collections or the $25.5 million decrease in FY 2004 collections for June-accelerated sales tax.*

In addition, as part of Phase II budget deficit reductions, chapter 377 appropriates funds to the Department of Revenue to induce higher revenue collections achieved through increased compliance efforts and retreats from a previously enacted partial buy-back of June accelerated sales tax collections in 2002 and 2003. Phase I budget reductions included one tax provision; the elimination of tax increment finance (TIF) grant fund appropriations of $91.0 million in FY 2002 and $38.0 million annually thereafter.

## Income Taxes

**Table 2. Individual Income Tax and Corporate Franchise Tax**
*(dollars in thousands)*

| | Effective Date | FY 02 | FY03 | **FY 02-03 Biennium** | FY 04 | FY 05 | **FY 04-05 Biennium** |
|---|---|---|---|---|---|---|---|
| **Federal Provisions** | | | | | | | |
| 2002 Tax Act: All except bonus depreciation and Subpart F exclusions | TY 2001 | ($2,660) | ($4,050) | **($6,710)** | ($320) | $1,480 | **$1,160** |
| 2002 Tax Act: Add-back 80% of "bonus depreciation;" subtract same total over 5 yrs | TY 2001 | (1,800) | 5,700 | **3,900** | 12,300 | 12,000 | **24,300** |
| **Other Provisions** | | | | | | | |
| Require Wisconsin to pay interest on annual reciprocity payments | 12/02 | 0 | 5,500 | **$5,500** | 4,600 | 5,300 | **9,900** |
| Allow deduction for certain dividends paid by property casualty insurance companies | 1/1/03 | 0 | (600) | **(600)** | (2,100) | (2,200) | **(4,300)** |
| Limit special mail order apportionment rule to retailers | 1/1/02 | 0 | 300 | **300** | 400 | 400 | **800** |
| **Subtotal: Income Taxes** | | **($4,460)** | **$6,850** | **$2,390** | **$14,880** | **$16,980** | **$31,860** |
| Transfer net revenue from bonus depreciation to Reserve Fund | FY 2003 to FY 2005 | 0 | (3,900) | **(3,900)** | (12,300) | (12,000) | **(24,300)** |
| ***Total: Income Taxes after Transfer to Reserve Fund*** | | ***($4,460)*** | ***$2,950*** | ***($1,510)*** | ***$2,580*** | ***$4,980*** | ***$7,560*** |

*Positive numbers represent an increase in General Fund revenue; negative numbers represent a decrease in General Fund revenue.*

### Update to Federal Tax Law Changes

The Job Creation and Worker Assistance Act of 2002 (JCWAA) changed the definition of federal taxable income. Federal taxable income is the starting point in calculating Minnesota taxable income – the first line on the Minnesota tax return. Therefore, changes in the definition of federal taxable income require Minnesota to do one of two things: (1) fully conform to those changes; or (2) enact new additions and/or subtractions to use in calculating Minnesota taxable income, thereby adding lines to the Minnesota tax return.[9]

[9] The 2002 Tax Act also conforms to all provisions of the Victims of Terrorism Tax Relief Act, exempting from tax certain income received by victims of the September 11 terrorist attack, the subsequent anthrax mailings, or the Oklahoma City bombing, and their survivors. Conforming to those federal provisions has a zero cost because no Minnesota taxpayers are expected to benefit from them.

The 2002 Tax Act also updates the deemed childcare expenses eligible parents can claim for the "young child credit" (child under one year for married couples with income under $33,500) to match the new federal maximum of $3000, effective in 2003. Conforming will simplify tax returns, but it will not change any taxpayer's tax liability because the maximum credit is still capped at $720.

The 2002 Tax Act conforms Minnesota law to the provisions of the Job Creation and Worker Assistance Act of 2002 listed in Table 3. The only income tax provision to which Minnesota did not conform – other than bonus depreciation (discussed below) – was the tax exclusion for the foreign earnings of some financial companies. Minnesota chose not to conform to this provision because it will affect few Minnesota taxpayers and the cost of conformity, estimated to be $2 and $3 million per year, was believed to exceed its value.

**Table 3. Cost of Conforming to Provisions of the Federal Job Creation and Worker Assistance Act of 2002**
*(dollars in thousands)*

| **Federal Tax Provision** | FY 02 | FY03 | **FY 02-03 Biennium** | FY 04 | FY 05 | **FY 04-05 Biennium** |
|---|---|---|---|---|---|---|
| Allow $250 deduction for teacher expenses (TY2002 and TY2003) | $0 | ($1,000) | **($1,000)** | ($1,050) | 0 | **($1,050)** |
| Expand deduction for foster care payments | 0 | (200) | **(200)** | (200) | (200) | **(400)** |
| Allow 5-year carry-back of net operating losses | (2,700) | (3,100) | **(5,800)** | 700 | 1,400 | **2,100** |
| Modify tax treatment of S-corp. discharge of indebtedness | 100 | 400 | **500** | 500 | 500 | **1,000** |
| Limit non-accrual experience accounting | 20 | 200 | **220** | 200 | 200 | **400** |
| Extend sunset for deduction for clean-fuel vehicles | (80) | (350) | **(430)** | (470) | (420) | **(890)** |
| ***Total*** | ***($2,660)*** | ***($4,050)*** | ***($6,710)*** | ***($320)*** | ***$1,480*** | ***$1,160*** |

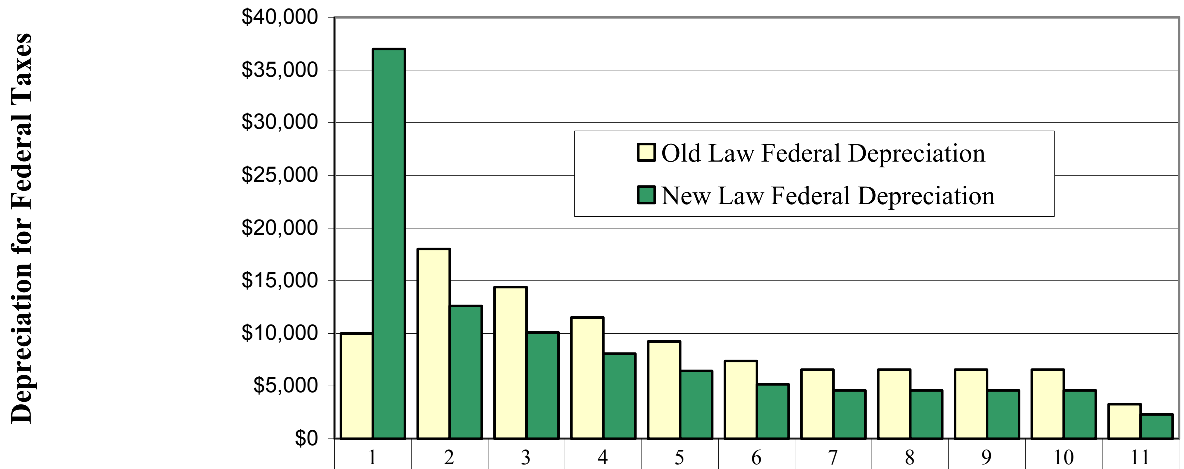
*Provisions with negligible cost are omitted from the table. Positive numbers represent an increase in tax revenue; negative numbers represent a loss in tax revenue.*

**Bonus Depreciation:** Federal law allows taxpayers to accelerate their depreciation for most machinery, equipment, and structures placed in service between September 11, 2001 and September 10, 2004. For qualifying assets, taxpayers can claim a first-year "bonus depreciation" equal to 30 percent of asset cost. The remaining 70 percent of the cost is then depreciated over the life of the asset. Accelerating depreciation in this way reduces federal taxable income in the first year and raises it (by an equal amount) in later years.

Figure 1 on the next page illustrates federal depreciation under the old and new federal law for a qualifying asset with a 10-year life. By shifting depreciation from later years to the first year, the federal law change reduces taxes in the year the asset is purchased but raises taxes – by an equal amount – in later years. This provides a clear benefit to the taxpayer because of the time value of money. A dollar saved today is worth more than a dollar saved in a future year.

Fully conforming to the federal bonus depreciation provision would reduce Minnesota's tax revenue by an estimated $233.5 million in the FY2003-04 biennium and $145.6 million in the FY2005-06 biennium. Although tax revenue would have increased in later years, the revenue loss within the budget window made full conformity a politically unacceptable option given the forecast budget deficits.

**Figure 1. Depreciation Under Old and New Federal Law**
**10-year $100,000 asset qualifying for bonus depreciation**




| | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Old Law Federal Depreciation | 10,000 | 18,000 | 14,400 | 11,520 | 9,220 | 7,370 | 6,550 | 6,550 | 6,560 | 6,550 | 3,280 |
| New Law Federal Depreciation | 37,000 | 12,600 | 10,080 | 8,064 | 6,454 | 5,159 | 4,585 | 4,585 | 4,592 | 4,585 | 2,296 |

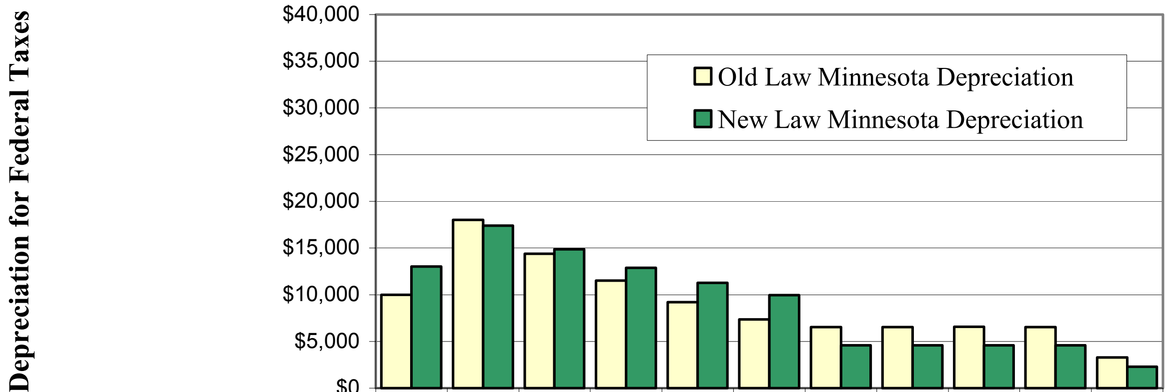
Year

However, simply ignoring the federal change would have required taxpayers to keep two sets of depreciation records for each qualifying asset – one for federal taxes and one for Minnesota taxes – over the entire life of the asset (up to 20 years). Tax preparers and certified public accountants warned that tax compliance would likely have declined due to the increased complexity in record keeping and audit difficulties.

The 2002 Tax Act simplified tax filing while avoiding any large changes in revenue. In the year a qualifying asset is placed in service (2001 through 2004), taxpayers must add back 80 percent of the "bonus depreciation" claimed on the federal return. The taxpayer will then subtract one-fifth of this add-back during each of the following five years. Rather than getting all of the bonus depreciation in the first year (as on the federal return), the taxpayer will receive 20 percent in year one and 16 percent in each of the next five years.

Figure 2 compares depreciation allowed under old and new Minnesota law, for a qualifying 10-year $100,000 asset. As is clear by comparing Figure 2 to Figure 1, Minnesota's new law is far less generous than the federal law. For this 10-year asset, however, the Minnesota change does benefit the taxpayer. Under the new law, depreciation is shifted forward with allowable depreciation being higher in years 1, 3, 4, 5, and 6. Taking account of the time value money, the Minnesota tax change increases the rate of return on this investment.

**Figure 2. Depreciation Under Old and New Minnesota Law**
**10-year $100,000 asset qualifying for bonus depreciation**



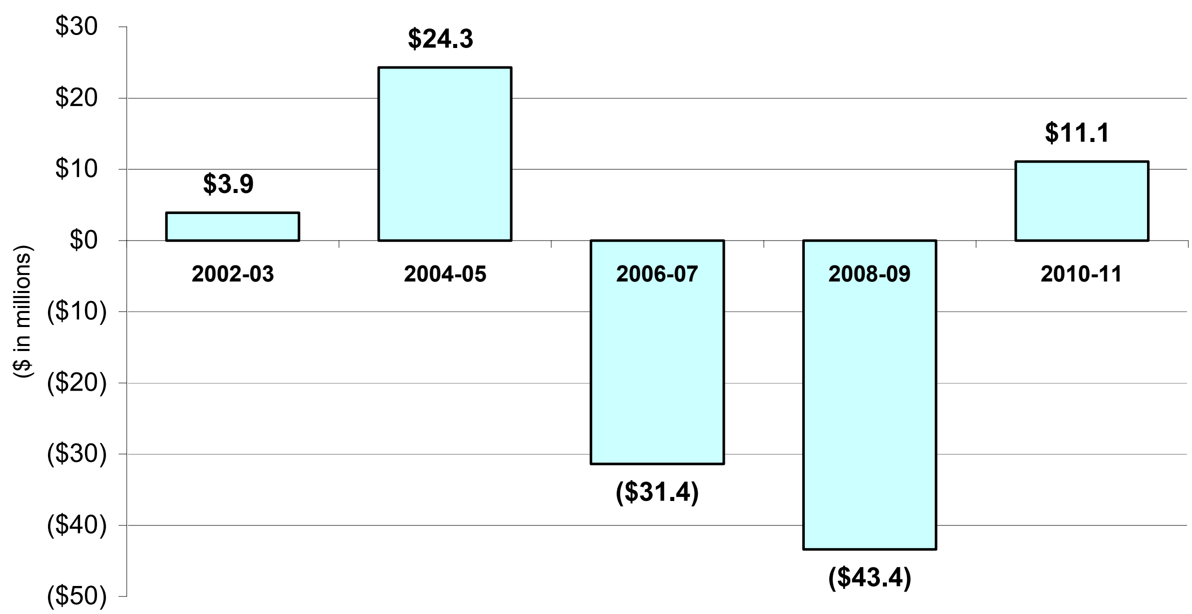

| | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Old Law Minnesota Depreciation | 10,000 | 18,000 | 14,400 | 11,520 | 9,220 | 7,370 | 6,550 | 6,550 | 6,560 | 6,550 | 3,280 |
| New Law Minnesota Depreciation | 13,000 | 17,400 | 14,880 | 12,864 | 11,254 | 9,959 | 4,585 | 4,585 | 4,592 | 4,585 | 2,296 |

Year

The change is clearly beneficial for assets with lives of 10, 15, or 20 years. For some shorter-life assets, however, the resulting depreciation shifts may be less desirable. For business as a whole – taking into account the actual mix of assets that will qualify for bonus depreciation – the 80 percent add-back subtracted in equal parts over five years will increase the after-tax rate of return on investment.

***Can It Be a Tax Cut If It Raises Revenue?*** The Minnesota provision regarding bonus depreciation helps Minnesota businesses even though it increases tax revenue by a total of $28.1 million in the first four years (FY 2002 to FY 2005). As shown in Figure 3, the net revenue gain in FY 2002-05 is much smaller than the revenue loss in the following two biennia. Over the lifetime of the assets, the law change will increase the average rate of return on the qualifying business investments. The 2002 Tax Act requires that the revenue gains in the first four years be transferred to the Budget Reserve, to help finance the revenue losses in FY 2006 through FY 2009.

**Figure 3: Revenue Impact of 80% Add-back and 5-Year Subtraction by Biennium**




## Other Income Tax Changes

**Modify income tax reciprocity with Wisconsin:** Since 1968, Minnesota residents working in Wisconsin (now about 25,000) have not been required to file tax returns in Wisconsin. Similarly, Wisconsin residents working in Minnesota (about 50,000) have not been required to file Minnesota tax returns. Instead, these taxpayers pay tax on their wage or personal services income in the state in which they live. As part of the agreement the state that collects more revenue than it would otherwise collect reimburses the state that collects less revenue than it would otherwise collect. Since 1973, Wisconsin has reimbursed Minnesota for the net loss Minnesota incurs from reciprocity because Wisconsin residents working in Minnesota outnumber Minnesotans working in Wisconsin, and have higher incomes as well.[10]

However, the annual reimbursement payment from Wisconsin is delayed until December 15 of the year following the end of the tax year. In the past, no interest was paid during the delay. The 2002 Tax Act requires that Wisconsin pay interest – at the rate generally charged taxpayers on late payments – starting July 1 of the tax year (when roughly half of a year's income tax payments have been received). If Wisconsin does not agree in writing by October 2002, income tax reciprocity with Wisconsin will be repealed.[11]

[10] The Governor's January 2002 budget proposed to repeal the income tax reciprocity agreement with Wisconsin. For an analysis of that proposal, see the House Fiscal Issue Brief "Proposed Repeal of Income Tax Reciprocity with Wisconsin" (January 2002) at http://www.house.leg.state.mn.us/fiscal/files/ibwimntx.pdf .

[11] The statutory language that makes tuition reciprocity payments to Wisconsin contingent on the existence of an income tax reciprocity agreement would be suspended for one year if income tax reciprocity is repealed for this reason. This would allow time for legislative action during the next session.

Table 4 summarizes the magnitude of the next three years of reciprocity payments.

**Table 4. Wisconsin Income Tax Reciprocity Payments**
*(dollars in thousands)*

| Tax Year | Payment Date | Payment Amount* (without interest) | Interest Rates* (tax year/ succeeding year) | Interest to be Paid |
|---|---|---|---|---|
| 2001 | Dec. 2002 | $49,345 | 9 % / 7 % | $5,500 |
| 2002 | Dec. 2003 | $54,981 | 7 % / 5 % | $4,600 |
| 2003 | Dec. 2004 | $57,889 | 5 % / 7 % | $5,300 |

**Reciprocity payments and interest rates from February forecast. Tax year rate of interest applies for 6 months, succeeding year rate of interest for 11.5 months.*

**Allow 100% deduction for certain dividends paid by property casualty insurance companies:** The 2001 Tax Act exempted insurance companies from the corporate franchise tax. Some insurers will not receive the benefit of this exemption unless the dividends they pay to a subsidiary can be fully deducted by that subsidiary (as they were before the 2001 change). The effective date was delayed to 2003 to eliminate any cost in the current biennium.

**Limit special mail order apportionment rule to retailers:** To curtail reported abuses, the 2002 Tax Act ensures that the special apportionment rule for mail order companies (single sales apportionment) is limited to the intended beneficiaries.

## *Estate Tax*

**Clarify Minnesota estate tax filing requirements:** Minnesota has not conformed to the federal estate tax changes enacted as part of the Economic Growth and Tax Relief Act of 2001 (EGTRRA). The 2002 Tax Act clarifies that the filing requirements for the Minnesota estate tax follow the law prior to EGTRRA. Filing a Minnesota estate tax return is required if the gross value of the estate is at least:

- $700,000 for deaths in 2002 and 2003;
- $850,000 for deaths in 2004;
- $950,000 for deaths in 2005; and
- $1,000,000 for deaths in 2006 and following years.

These filing requirements are lower than those for the federal estate tax. Some estates that are not required to file a federal estate tax return will be required to file a Minnesota return and, in many cases, pay Minnesota tax.[12]

[12] For more information on the impact of the federal tax changes and their implications for Minnesota, see Joel Michael, *The Minnesota's Estate Tax After the 2001 Federal Tax Act* at www.house.leg.state.mn.us/hrd/pubs/estatetx.pdf .

## *Sales and Use Taxes*

**Definition of Prepared Food:** The 2002 Tax Act modifies the definition of prepared food" adopted in 2001 as part of the uniform definitions proposed by the Streamlined Sales Tax Project (SSTP).

- Exempt bakery products made by the seller (unless served with eating utensils). At the time the 2001 Tax Act was enacted, SSTP's approved definitions did not allow an exemption for bakery products. As a result, under the provisions of the 2001 Tax Act, bread baked by the seller was taxable as "prepared food," while identical bread baked by someone else was exempt from tax. The SSTP now allows such an exemption.[13]
- Exempt unheated ready-to-eat meat and seafood prepared by the seller (unless served with eating utensils). This exemption is not permitted under the approved SSTP definitions, so it is scheduled to sunset at the end of 2005. Participating states are required to be in conformity with the SSTP definitions at that time, but modifications in the approved definitions are still possible.
- Exempt foods containing raw eggs, meat, fish, or poultry that require cooking by the consumer to prevent food borne illnesses. As a clarification of the existing definition (consistent with SSTP), this provision is assumed to have no impact on revenue.

Although the original bills would have made these changes to be effective the day after enactment, the effective date was moved to July 1, 2002 to reduce the current-year cost.

**Installation and Delivery Charges**: The 2001 Tax Act defined a product's price to include installation or delivery charges by the seller. So installation and delivery services provided by the seller are subject to tax. Installation and delivery services provided by third parties, however, remained exempt from tax. The 2002 Tax Act dealt with this problem by making the following changes:

- Tax installation services by third parties if installation by seller would be taxable.
- Tax delivery charges for concrete block and aggregate materials (now a taxable service).

These are permanent changes and are consistent with SSTP.

Because contracts for concrete block and aggregate materials are often several years in length, the effective date for making delivery charges taxable was delayed for three years (until January 1, 2005) for existing contracts signed by January 1, 2002.

Charges for postage are included as delivery charges, so the 2001 Tax Act made such charges subject to tax. At the time the 2001 Tax Act was enacted, it was not anticipated that direct mail companies would charge tax on postage. The 2002 Tax Act specifically exempts such postage from tax, with a retroactive effective date, but the exemption will sunset at the end of 2005 (the date by which states must fully conform to SSTP definitions). This will give SSTP time to address this issue at the national level. This exemption had no cost because it codified the way the Department of Revenue has been administering the law.

[13] This provision will exempt some bakery products that were taxable under pre-2001 law.

## Table 5. Sales & Use Taxes

*(dollars in thousands)*

| | Effective Date | FY 2002 | FY2003 | **FY 02-03 Biennium** | FY 2004 | FY2005 | **FY 04-05 Biennium** |
|---|---|---|---|---|---|---|---|
| **Sales Tax Provisions** | | | | | | | |
| Exempt certain bakery products | 7/1/02 | $0 | ($6,385) | **($6,385)** | ($7,317) | ($7,663) | **($14,980)** |
| Exempt cold meat and seafood | 7/1/02 to 12/31/05 | 0 | (594) | **(594)** | (657) | (657) | **(1,314)** |
| Tax third-party installation charges | 7/1/02 | 0 | 3,178 | **3,178** | 3,606 | 3,754 | **7,360** |
| Tax third-party delivery charges for aggregate materials and concrete block | 7/1/02 (transition rule) | 0 | 4 | **4** | 43 | 83 | **126** |
| **Other Provisions** | | | | | | | |
| Tax interstate WATS telephone service | 7/1/02 | $0 | $6,530 | **$6,530** | $7,550 | $8,000 | **$15,550** |
| Tax on-campus meals if not part of a board contract; vending machine sales at educational institutions | 7/1/02 (or 7/1/03 for vend. machine contracts) | 0 | 2,345 | **2,345** | 3,359 | 3,457 | **6,816** |
| Restrict construction material exemption for low-income housing | 7/1/02 | 0 | 869 | **869** | 889 | 908 | **1,797** |
| Exempt post-secondary instructional materials | 7/1/03 | 0 | 0 | **0** | (170) | (195) | **(365)** |
| Exempt admissions to arts events at Univ. of Minnesota | 8/1/01 | 0 | (202) | **(202)** | (167) | (172) | **(339)** |
| Expand exemption for energy-efficient appliances | Date of enactment to 7/31/05 | 0 | (40) | **(40)** | (40) | (41) | **(81)** |
| **Construction Material Exemptions** | | | | | | | |
| Meat packing facility destroyed by fire (Albert Lea) | 4/1/02 to 12/31/04 | 0 | (1,200) | **(1,200)** | (300) | 0 | **(300)** |
| Hydroelectric genera-ting facility (Mpls) | 9/1/02 to 12/31/03 | 0 | (94) | **(94)** | (10) | 0 | **(10)** |
| River Centre (extend) | 7/1/01 to 12/31/02 | (59) | (214) | **(273)** | 0 | 0 | **0** |
| Low-income housing built by certain for-profit companies (Holman Proj., Mpls) | 8/1/01 | (180) | (353) | **(533)** | (350) | 0 | **(350)** |
| **Subtotal All Provisions:** | | **($239)** | **$3,844** | **$3,605** | **$6,436** | **$7,474** | **$13,910** |
| Maintain accelerated payment at 75% of June liability | June 2002 and June 2003 | 24,500 | 1,000 | **25,500** | (25,500) | 0 | **(25,500)** |
| **Total: Sales & Use Taxes** | | **$24,261** | **$4,844** | **$29,105** | **($19,064)** | **$7,474** | **($11,590)** |

*Positive numbers represent an increase in revenue; negative numbers represent a reduction in revenue.*

**The Simplified Sales Tax Project:** The goal of this national project, supported by the National Conference of State Legislators and the National Governors Association, is to simplify the administration of state and local sales taxes. If compliance costs for multi-state businesses are substantially reduced, states may be able to overcome federal restrictions on their ability to require most remote sellers (internet as well as catalog) to charge tax on their sales. The growth of e-commerce otherwise threatens to erode the sales tax base and put main street businesses at a competitive disadvantage.

Adoption of uniform definitions will require each state to change the base of its sales tax, sometimes by exempting a currently-taxed item and sometimes by taxing a currently-exempt item. The intention of SSTP is neither to broaden nor narrow the tax base overall.

In response to the controversy surrounding the definition of prepared foods (the "bread tax"), the 2002 Tax Act added the chairs of the Senate and House tax committees as voting members (in addition to the Commissioner of Revenue) at future meetings of the Sales Tax Simplification Implementing States. The Commissioner is also instructed to negotiate with the goal of ensuring that similar transactions are taxed uniformly.

**Nexus rules for dot.com affiliates**: Some bricks-and-mortar retailers have established wholly-owned subsidiaries for their e-commerce business. They claim these affiliates have no obligation to remit tax because they have no "physical presence" in the state. The 2002 Tax Act tries to tighten the rules by defining a "retailer maintaining a place of business in the state" to include affiliates of companies with a place of business in the state. An e-commerce business has an obligation to remit tax if (1) it is related to the retailer, (2) it sells basically the same products under basically the same name, and (3) it promotes the retailer's business or provides services to the retailer's customers. To encourage voluntary compliance with the new definition, businesses that apply for a sales tax permit by August 15, 2002 cannot be prosecuted for non-collection of taxes in prior years. Although this provision would strengthen the state's case in court, the Department of Revenue did not credit the new rules with any increase in revenue.

**Other Sales Tax Provisions that Increase Revenue:**

- **Repeal exclusion for interstate WATS phone service**: Conforms the tax treatment of WATS calls to the telecommunications sales tax reforms enacted in the 2001 Tax Act.
- **Make on-campus meals taxable unless they are part of a board contract**: Narrows the exclusion for meals served at colleges, universities, and private career schools. Also clarifies that food sold from vending machines does not qualify as exempt meals, whether at elementary, secondary, or higher education facilities. (The vending machine change is delayed one year for existing contracts with K-12 schools.)
- **Restrict construction materials exemption for low-income housing**: Allow exemption only for materials used in low-income units, not entire housing project. This matches the original intent of the exemption enacted in 2001.

**Other Sales Tax Provisions that Reduce Revenue**:

- **Exempt required instructional materials for post-secondary students**: Includes interactive tapes, CDs, and computer software, but not pens, paper, or computers.
- **Exempt admissions to arts events at University of Minnesota**: Events must be sponsored by the university and held in a university-owned facility.
- **Expand exemption for energy efficient appliances**: The 2001 Tax Act restricted the exemption to furnaces and hot water heaters that used natural gas. The 2002 Act allows those fueled with propane and fuel oil to qualify as well. The exemption (regardless of fuel) sunsets on August 1, 2005.
- **Exempt construction materials for the following**:
    - Meat packing facility to replace the one destroyed by fire in Albert Lea.
    - Hydroelectric generating facility in Minneapolis (Crown Hydro).
    - River Centre – Delay repeal by one year (through December 31, 2002) the sunset date enacted in 2001, to include materials used in the final phase of construction (the tunnel).
    - Low-income housing (Holman project in Minneapolis) – Expand exemption to include low-income housing units built by some for-profit owners. When enacted in 2001, the exemption was expected to apply to this project.

**Repeal Cap on Total State Payments to Counties with Casinos**: Counties with casinos receive payments equal to ten percent of sales and use tax revenue generated by activities on reservations and collected under a tax agreement with a tribal government. Currently 11 counties receive payments. Total payments were capped at $1.1 million under prior law. If the cap were reached, payments would be reduced first for counties with per capita income exceeding 80 percent of state per capita income (Scott, Cook, and St. Louis counties). Repealing the cap has no cost within the budget window (FY 2002 to FY 2005), because payment totals are forecast to be below the cap.

**Maintain June accelerated payments at 75 percent for June 2002 and June 2003**: Since 1983, venders with over $120,000 of annual sales and use tax liability have been required to make an accelerated payment of a portion of their June tax liability – paying that portion of the tax two business days before June 30 rather than on July 20. By shifting the payment forward by about three weeks, this shifts the revenues to an earlier fiscal year. This “fiscal year shift” was originally used to balance the state budget by creating a large one-time gain in revenue.

The 2001 Tax Act repealed June accelerated payments, effective in June 2004.[14] The 2002 Tax Act does not change this; businesses will still make their final June accelerated payments in June 2003.

However, the 2002 Tax Act does reverse a change enacted in 2000. The 2000 Tax Act reduced the portion of the June tax liability that venders must accelerate from 75 percent to 62 percent,

[14] The intent was for repeal to be effective for June 2003, but a drafting error pushed the effective date back one year. The November 2001 forecast assumed the change was effective in June 2003; the February 2002 forecast pushed the effective date back to June 2004, increasing FY 2003 revenue by $122 million (and reducing FY 2004 revenue by $130 million). Although Finance showed this as a forecast adjustment, the $122 million gain in FY 2003 was also counted – creating some confusion – as revenue gained in the Phase I Budget Act (Chapter 220).

effective for June 2002. The 2002 Tax Act repeals that change. Maintaining the 75 percent requirement for the next two years (followed by repeal) simply shifts $25.5 million from the FY 2004-05 biennium to the current biennium.[15]

## Appropriations

**Appropriation to Department of Revenue for Compliance**: Certain budget cuts enacted in the Phase I Budget Bill (Chapter 220) were projected to reduce funding for tax auditors by $5 million in FY 2002-03, and the Department of Finance estimated that the resulting decline in tax compliance would reduce tax revenue by $14 million for the biennium. The 2002 Tax Act increases compliance funding by more than it was cut in Phase I – increases of $7.6 million in FY 2002-03 and $9.5 million in FY 2004-05. Table 6 summarizes the fiscal impact. (*See the state government section for a more detailed description of this appropriation*.)

**Table 6. Net Fiscal Impact of Compliance Appropriation to Department of Revenue**
*(dollars in thousands)*

| **Tax Provision** | FY2002 | FY2003 | **FY02-03** | FY 2004 | FY 2005 | **FY 04-05** |
|---|---|---|---|---|---|---|
| Appropriation to Revenue | ($585) | ($7,015) | **($7,600)** | ($4,750) | ($4,750) | **($9,500)** |
| Added revenues due to greater compliance* | 585 | 7,015 | **7,600** | 7,600 | 7,600 | **15,200** |
| **Net impact on General Fund** | **$0** | **$0** | **$0** | **$2,850** | **$2,850** | **$5,700** |

**This is the gain in addition to the revenue needed to offset the estimated $14 million revenue loss in FY 2002-03. See state government section above for more information.*
*Positive numbers represent increased revenue or reduced expenditures; negative numbers represent reduced revenue or increased expenditures.*

[15] Maintaining the higher payment requirement in June 2002 shifts $24.5 million in to FY 2002. That $24.5 million gain in FY 2002 is, of course, a loss of $24.5 million in FY 2003. But a year later – June 2003 – the accelerated payment shifts $25.5 million from FY 2004 to FY 2003. This results in a net gain of $1million in FY 2003 as well, reflecting the annual growth in sales tax revenues. Because the June accelerated payments are repealed effective June 2004, however, no revenue gain is created in June 2004 to offset the FY 2004 loss of $25.5 million created in June 2003. [See the table below.]

*(dollars in thousands)*

| **Month of Accelerated Payment** | FY 2002 | FY2003 | FY 2004 | FY 2005 |
|---|---|---|---|---|
| June 2002 | 24,500 | (24,500) | | |
| June 2003 | | 25,500 | (25,500) | |
| June 2004 | | | 0 | 0 |
| Total | 24,500 | 1,100 | (25,500) | 0 |

## *Local Sales Taxes*

**St. Cloud Area Local Sales Tax:** Authorized six cities in the St. Cloud area (St. Cloud, Sartell, Sauk Rapids, Waite Park, St. Joseph, and St. Augusta) to levy a local sales tax at a ½ percent rate for three years from January 1, 2003 to December 31, 2005. St. Cloud and Sartell are permitted to levy the tax based on referendums passed in 2000 and 1999 respectively. An authorizing referendum will be required in the other cities. Funds will be used first for expansion and improvement of the St. Cloud regional airport, with excess funds available for authorized local projects, such as:

- in St. Cloud – road improvements of regional significance; specified park and trail improvements.
- in Sartell – community center; park land acquisition and improvement.
- in Other cities – park land acquisition and improvement; arts, libraries, community centers; major road improvements.

**Local Sales Tax History:** This is the first local sales tax authorized since the 1999 legislative session, which authorized new taxes in Proctor and New Ulm. In 1998, new taxes were authorized in 12 cities (including five St. Cloud area cities) but only two were successfully enacted (Two Harbors and Winona). The 1999 referenda only passed in one of the St. Cloud cities (Sartell), so no St. Cloud area sales tax was levied.[16]

**Delay state administration for Duluth local sales tax until December 31, 2005:** State administration is required by this date under the Streamline Sales Tax agreement. The 2001 Tax Act required state administration by January 1, 2003.

**Local Lodging Taxes**: Authorized both Bloomington and Rochester to increase their local lodging tax rates by one percent.[17]

## *Property Taxes, Local Aids and Credits*

As summarized in Table 7 on the next page, the 2002 Omnibus Tax Act will increase general fund expenditures for property tax aids and credits by an estimated $10.5 million in FY 2004 and $13.1 million in FY 2005. Those costs are largely attributable to adjustments to changes enacted in the 2001 Omnibus Tax Act. In addition, Phase I budget reductions eliminated tax increment finance (TIF) grant fund appropriations made in the 2001 Tax Act.

[16] For more information, see Pat Dalton, *Local Sales Taxes in Minnesota* at www.house.leg.state.mn.us/hrd/pubs/localsal.pdf.
[17] Total tax on lodging – including the 6.5 percent state sales tax – was 12.5 percent in Bloomington and 9.5 percent in Rochester prior to this change.

**Table 7: Property Taxes, Local Aids and Credits**
**General Fund Revenue and Expenditure Changes**
*(dollars in thousands)*

| | FY 2002 | FY 2003 | FY 2004 | FY 2005 |
|---|---|---|---|---|
| **Phase I Budget Provisions** | | | | |
| Eliminate TIF grant fund appropriations | 91,000 | 38,000 | 38,000 | 38,000 |
| **2002 Omnibus Tax Act** | | | | |
| Agricultural market value credit for low-tier | 0 | 0 | ($5,000) | ($5,600) |
| Pipeline Aid (Kittson, Clearwater, and Red Lake) | 0 | 0 | (1,408) | (1,408) |
| Disparity Reduction Aid | 0 | 0 | (1,214) | (1,936) |
| Disparity Reduction Aid Forecast Correction | 0 | 0 | (1,771) | (2,135) |
| Split-class parcels--reinstate "borrowing" | | | (522) | (332) |
| ***Provisions Affecting Property Tax Refunds:*** | | | | |
| Pipeline Aid, Disparity Reduction Aid, and K-12 property tax levies | 0 | 0 | (95) | (95) |
| Split-class—reinstate borrowing | 0 | 0 | (38) | (24) |
| Levy-back for lost tree growth tax revenues | 0 | 0 | (16) | (7) |
| Personal property tax exemptions | 0 | 0 | (8) | (8) |
| Met. Council Transit bonding authority* | 0 | 0 | 0 | (156) |
| Anoka County public safety facility bonding* | 0 | 0 | 0 | (9) |
| ***Net Change, Property Tax Refunds:*** | **0** | **0** | **(157)** | **(299)** |
| Appropriation: Washburn Crosby Mills City Museum TIF project | 0 | (2,600) | 0 | 0 |
| Border City Credit Aid—Moorhead TIF Levy Authority | 0 | 0 | (436) | (799) |
| Taconite Aid Reimbursement Revenue (Deer River School District) | 0 | 0 | 506 | 0 |
| General Education aid increase for taconite distribution reduction | 0 | 0 | 0 | (110) |
| Income tax offsets due to property tax changes | 0 | 0 | (480) | (500) |
| **Total: Property Taxes, Local Aids and Credits** | **0** | **(2,600)** | **(10,482)** | **(13,119)** |

**Language for these provisions carried in Chapter 390, 2002 Laws of Minnesota, the Omnibus Public Finance Act.*
*Positive numbers represent a reduction in expenditures; negative numbers represent an increase in expenditures.*

**Increased Agricultural Homestead Market Value Credit:** Chapter 377 increases agricultural homestead market value credit aid by $5.0 million beginning in CY 2003 and $5.6 million thereafter[18]. The credit rate is increased from 0.2 to 0.3 percent of agricultural homestead market value and the maximum credit amount is increased from $230 to $345. However, the additional credit is targeted toward low-valued farmland by phasing-out the increase in the credit maximum at a rate of 0.05 percent of market value above $115,000. As a result, the maximum credit amount will phase-down to the current law maximum of $230 for farms valued at about $350,000 and above.

The increase in agricultural market value credit is intended to offset shifts onto low-valued farmland resulting from changes made in the 2001 Omnibus Tax Act. Specifically, two changes in the 2001 Tax Act resulted in shifts onto low-valued farmland: First, class rates for most other classes of property were reduced while no reduction occurred for low-valued farmland. Second, the class rate on low-valued farmland was increased from 0.35 percent to 0.55 percent. In addition, property taxes paid on homesteaded farmland were eliminated from eligibility for property tax refunds; taxes paid on the house, garage and one acre remain eligible.

The 2001 tax act intended to simplify the taxation of farmland by reducing the number of tiers for farmland and by focusing the property tax refund program on residential property. To that end, House proposals leading up to adoption of the 2001 Omnibus Tax Act contained varying combinations of tier changes, class rate changes, and PTR eligibility, along with varying levels agricultural market value credit to offset the tax shifts that were expected to result from those changes. While the amount of credit needed to offset tax shifts due to class rate and other changes always involves a fair amount of subjectivity, the level of agricultural market value credit enacted in the final 2001 tax bill was lower than the amount which had typically been discussed in relation to the combination of class rate and PTR changes included in the final bill.

**Increased Homestead and Agricultural Credit Aid (HACA) for Pipeline Aid:** The 2002 Tax Act increases HACA by $1.4 million beginning in CY 2003 for three counties, including Clearwater ($884,000), Kittson ($393,000), and Red Lake ($213,000). The increased aid is intended to offset tax shifts from public utility property on to other classes of property in counties for which public utility real and personal property accounted for over 40 percent of the net tax capacity in assessment year 2000 (taxes payable 2001). The 2001 Omnibus Tax Act reduced class rates for public utility real property over $150,000, and for personal property, from 3.4 to 2.0 percent. The amount of aid for each jurisdiction is equal to 83 percent of county tax revenues attributable to the tax base reductions for these classes of property in CY 2002.[19]

**Increased Disparity Aid:** Disparity reduction aid increases by $1.2 million in FY 2004[20] and $1.9 million in FY 2005 to partially restore aid reductions resulting from class rate reductions in the 2001 Tax Act. Aid is restored up to 87 percent of the 2001 disparity reduction aid payment

[18] Credit amounts will actually increase by $5.4 million in FY 2004 but the impact on the general fund is only $5.0 million due to school-aid payment schedule, which pays 83 percent of school district amounts in the first FY and shifts 17 percent in the subsequent FY.

[19] Note that statutory language simply expresses as a percentage of tax capacity, a mathematical equivalent.

[20] Net cost after accounting for school-aid payment shift which pays any aids to school districts 83 percent in the first year and 17 percent in the subsequent year.

for jurisdictions having a total tax rate greater than 135 percent. Aid payments declined in 2002 because of a mechanism in the disparity reduction aid formula that reduces aid when class rates are reduced. Because that provision is maintained in law, disparity reduction aid amounts will still decline with subsequent class rate reductions. In addition, as also shown in Table 7, Chapter 377 also accounts for higher than forecast general fund expenditures for disparity reduction aid —amounting to $2.0 million in FY 2004 and $2.4 million higher in FY 2005— due to an error in the February 2002 forecast.

**Preferential Treatment for Split-Class Parcels:** The 2002 Tax Act will also increase general fund expenditures for the homestead market value credit by $854,000 in FY 2004-05 to temporarily reinstate preferential tax treatment for property parcels that are partially classified as residential homestead and partially classified as something else, such as commercial or apartment property. In pay 2003, the first $60,000 in market value for these split class parcels will be classified as residential homestead even if the actual value of the residential homestead portion of the is less. As a result, the difference between the actual value of the homestead portion and $60,000, which is referred to as the "borrowed" amount, will be taxed at a lower tax rate than if it were taxed in its true class, such as commercial or apartment. The cap on the borrowing amount will be $60,000 for pay 2003, $45,000 in pay 2004, $30,000 in pay 2005, and the benefit will be eliminated in pay 2006.

This provision increases market value credit costs for the general fund because owners of split class parcels will be eligible for larger homestead market value credit on the additional value classified as residential homestead. In addition, property tax refunds for other homeowners will increase because the taxes not levied on split-class parcels will shift to other classes of property, including homeowners (see property tax refunds below). Further, any state property tax that would have been paid on the commercial value of split-class parcels that is instead taxes as residential homestead will shift to other state property taxpayers.

Under prior law, homesteaded split-class parcels were allowed to borrow up to $76,000, i.e. the market value break-point between the first and second tiers for residential homestead property. The 2001 Tax Act increased the tier break-point from $76,000 to $500,000 in market value for pay 2002 and rather than increase the borrowing amount up to $500,000, the tax benefit for split-class parcels was eliminated.

**Provisions Affecting of Property Tax Refunds:** Because property tax refund payment amounts are based on the amount of residential homestead property taxes owed relative to the property owner's household income, changes that increase or decrease property taxes on residential homestead property also affect property tax refund payments. As shown in Table 7, general fund expenditures for property tax refunds will increase by $456,000 in FY 2004-05 due to the following changes in Chapter 377:

- the net increase in homeowner property taxes resulting from higher K-12 tax levies (see summary of K-12 provisions) and lower levies due to pipeline aid and disparity reduction[21] aid will increase property tax refunds by $190,000;

[21] Assumes local levies will decline by the same amount that aid increases.

- reinstatement of preferential treatment for split-class parcels will shift taxes off of split class parcels and onto all other classes of property, including homeowners, which will increase refunds by 62,000;

- exemptions from the personal property tax on electric generation equipment for five proposed power plants —including a combined-cycle natural gas facility in Waseca County, a simple-cycle combustion-turbine facility in Beltrami County, a biomass facility in Shakopee, a run-of-the-river hydroelectric facility (Crown Hydro) in Minneapolis, and a facility located on an energy park (former LTV plant)— will increase refunds by $16,000;

- authority for local governments to increase property tax levies to replace tree growth tax revenues —the tree growth tax was eliminated in 2001 and replaced by a forest land tax credit program— will increase refunds by $23,000;

- a $54 million increase in bonding authority for the Metropolitan Transit will be repaid by property tax levies in the metropolitan area, including levies on homeowners, which will increase refunds by $156,000 in FY 2005[22];

- authority for Anoka County to issue $12.5 million in bonds for public safety, is expected to increase refunds by $9,000 in FY 2005[23].

Three other provisions in the 2002 Tax Act may result in property tax increases in certain taxing districts but will have only a negligible impact on property tax refunds, including: preferential treatment for homesteaded bed and breakfasts that will allow up to 5 units to classified at a reduced class rate of 1.25, as well as reduce the state property tax for these parcels; authority for local governments to increase levies to replace reductions in mobile home HACA enacted in 2001; and authority for the Southwest Regional Development Commission (SWRDC) to bond and levy to repay Prairie Expo debt[24].

## *Tax Increment Financing (TIF) and Economic Development Provisions*

The 2002 Tax Act contains two TIF provisions that will increase general fund expenditures, including:

- A direct appropriation of $2.6 million in FY 2003 for the Washburn Crosby Mills City Historical Society tax increment finance project in Minneapolis; and

- Authority for the City of Moorhead to increase its levy on commercial and industrial property to repay certain preexisting TIF obligations. While the additional taxes will be levied and collected locally, general fund expenditures for border city disparity credits will increase by the amount levied, or about $1.2 million in FY 2004-05, because

[22] Language carried in Chapter 390, 2002 Laws of Minnesota, the Omnibus Public Finance Act.
[23] Language carried in Chapter 390, 2002 Laws of Minnesota, the Omnibus Public Finance Act.
[24] Language carried in Chapter 390, 2002 Laws of Minnesota, the Omnibus Public Finance Act.

Moorhead's designation as a border city qualifies the commercial industrial property in that city for a state-paid credit sufficient to reduce the tax to an effective tax rate of 2.3 percent (i.e. 2.3 percent of the properties market value).

The Phase I budget agreement also reduced general fund expenditures by $91 million in FY 2002 and by $38 million each year thereafter by eliminating appropriations to the TIF grant fund. The grant fund appropriation was established to provide grants to tax increment authorities to replace lost TIF revenues attributable to class rate reductions contained in the 2001 Omnibus tax act provided certain local efforts were made to offset those losses.

In addition, the 2002 Act:

- Expands the types of properties that qualify for exemption under border city development zone law to include housing;

- Authorizes border city development zone allocations to be used to grant sales tax exemptions to building materials for housing construction; and

- Creates special law TIF exemptions for Albert Lea, Rushford, Dakota County, and East Hennepin, University, and Southeast Industrial Area districts in Minneapolis.

### *Provisions Having No State Fiscal Impact*

Chapter 377 also contained a variety of provisions having a statewide impact but no state fiscal impact, including provisions that:

- Prevent the sale of manufactured homes for which there are outstanding property tax liabilities by prohibiting the issuance of titles for manufactured homes unless applications for title are accompanied by a statement from the county auditor or treasurer stating that all personal property taxes have been paid;

- Clarify that the utility rate reductions mandated by the 2001 Omnibus Tax Act, which required that tax savings due to changes in the treatment of public utility generation machinery be passed along to consumers through rate reductions, are to be permanent reductions and that a utility may voluntarily reduce rates by more than the mandated amount;

- Exempt wind energy conversion systems from the personal property tax and instead impose a graduated production tax based on the scale of the wind energy conversion system. A payment-in-lieu of property tax may be negotiated for systems in place prior to January 1, 2002.

- Provide that county levies for lake improvement districts must be stated separate from other county levies on truth-in-taxation statements.

## *Taconite Production Tax*

The 2002 Tax Act made the following changes to the distributions of taconite production tax revenue:

- Restores 77 percent (about $8 million) of the taconite aid payments to school districts that were shifted to cities and towns in 2001. The 2001 shift was in response to concerns that taconite production tax distributions to school districts would be used to buy-down voter approved levies when the general education levy was eliminated in pay 2002. Therefore, the revenues were diverted to municipalities in the same school districts to ensure the benefits accrued to the same taxpayers. Under the new law, distributions of taconite tax revenues to school districts could be used to reduce voter-approved referendum, facilities down payment, and debt levies by up to 50 percent, but if taconite revenues exceed the 50 percent buy-down, those revenues would continue to be diverted to the relevant municipalities.

- Distributes the remaining 23 percent (about $2.5 million) two-thirds to the Northeast Minnesota Economic Trust Fund and one-third to the Environmental Protection Trust Fund.

- Due to differences in the timing of aid payments to school districts versus municipalities, the distribution change results in one-time availability of about $10 million in 2002 and that money is directed to the Northeast Minnesota Economic Trust Fund. Authorizes the expenditure of that one-time allocation.

- Authorizes expenditures of up to 20 percent of the corpus of the Northeast Minnesota Economic Protection Trust Fund by a vote of at least 10 members the IRRRB provided that the fund cannot be used for administration or operating expenses of the board or any facility currently owned or operated by the board; and

- Makes a corresponding restoration of taconite replacement aid payments for the Deer River school district, which are funded by the general fund rather than from taconite revenues. As summarized in Table 7, these changes result in a one-time savings for the general fund of $506,000 in FY 2003 and an on-going cost of $110,000 beginning in FY 2005.

In addition, Chapter 377 extends the Northeast Minnesota Economic Protection Trust Fund Act by 25 years, from 2003 to 2028, and renames the fund the Douglas J. Johnson Economic Protection Trust Fund Act.

### Mortgage Registry and Deed Taxes— MN Conservation Fund

General fund revenues will increase by an estimated $400,000 annually beginning in FY 2003 due to enactment of a recommendation by the Governor to deposit 50 percent of the state share of collections from a $5 surcharge on mortgage and deed registrations in the seven-county metropolitan area. The remaining 50 percent would continue to be deposited into the Minnesota conservation fund.

Under current law, a $5 surcharge is collected on the filing of mortgage and deed registrations in the seven-county metropolitan area with $2.50 being retained by the county and $2.50 being transferred to the state. The surcharge revenues collected by the county —and when necessary the revenues transferred to the state— are then used to replace lost property tax revenues for properties enrolled in the metropolitan agricultural land preserve program. These properties are assessed and taxed as agricultural land rather than at the highest and best use of the land. However, the amounts collected by the state have consistently been greater than the amounts needed to reimburse local governments.

**Table 8: Reallocation of Mortgage and Deed Tax Surcharge**
*(dollars in thousands)*

| | FY 02 | FY 03 | **FY 02-03** | FY 04 | FY 05 | **FY 04-05** |
|---|---|---|---|---|---|---|
| General Fund | 0 | 400 | **400** | 400 | 400 | **800** |
| Conservation Fund | 0 | (400) | **(400)** | (400) | (400) | **(800)** |

*Positive numbers represent increased revenue or reduced expenditures; negative numbers represent reduced revenue or increased expenditures.*

## Solid Waste Management Tax
Chapter 377 permanently exempts source-separated compostable waste from the solid waste management tax if delivered to qualifying facility by eliminating the sunset for the tax exemption. Under current law, the exemption expired December 31, 2001. As summarized in Table 8, because solid waste management tax revenues are split between the general fund and the solid waste fund, permanent extension of the exemption will reduce forecasted revenues for both funds by $15,000 in FY 2003 and $110,000 in FY 2004-05.

**Table 8: Solid Waste Management Tax**
Permanent extension of exemption for compostable waste
*(dollars in thousands)*

| | FY 02 | FY 03 | **FY 02-03 Biennium** | FY 04 | FY 05 | **FY 04-05 Biennium** |
|---|---|---|---|---|---|---|
| General Fund Impact | | (15) | **(15)** | (45) | (65) | **(110)** |
| Solid Waste Fund Impact | | (15) | **(15)** | (45) | (65) | **(110)** |

* *Positive numbers represent increased revenue or reduced expenditures; negative numbers represent reduced revenue or increased expenditures.*

## Health Care Access Fund
The 2002 Tax Act made a technical change in the way some providers calculate a deduction in calculating revenues subject to the provider tax.

**Health Care Access Fund: Change in Deduction Calculation**
*(dollars in thousands)*

| | FY 02 | FY03 | **FY 02-03** | FY 04 | FY 05 | **FY 04-05** |
|---|---|---|---|---|---|---|
| Modify legend drug deduction | $15 | $35 | **$50** | $35 | $35 | **$70** |

*Positive numbers represent increased revenue or reduced expenditures; negative numbers represent reduced revenue or increased expenditures*

## *Other Acts with Tax Provisions*

**Stadium Act (Chapter 397):** The only General Fund cost included in the stadium finance plan is a sales tax exemption for stadium construction materials.[25] The $10.7 million General Fund cost of that exemption is spread over the three years of estimated construction.

**Stadium Finance Plan**
*(dollars in thousands)*

| | FY 02 | FY03 | **FY 02-03** | FY 04 | FY 05 | **FY 04-05** |
|---|---|---|---|---|---|---|
| Sales tax exemption for construction materials | $0 | ($1,600) | **($1,600)** | ($4,800) | ($4,300) | **($9,100)** |

*Positive numbers represent increased revenue or reduced expenditures; negative numbers represent reduced revenue or increased expenditures.*

Fireworks Act (Chapter 350): General Fund revenues are estimated to rise because Chapter 350 legalized some fireworks (including sparklers). The estimated increase in sales tax revenue is shown below.

**Sales Tax Impact from Legalized Fireworks**
*(dollars in thousands)*

| | FY 02 | FY 03 | **FY 02-03** | FY 04 | FY 05 | **FY 04-05** |
|---|---|---|---|---|---|---|
| Sales tax on legalized fireworks | $0 | $315 | **$315** | $325 | $340 | **$665** |

*Positive numbers represent increased revenue or reduced expenditures; negative numbers represent reduced revenue or increased expenditures.*

***For additional information on income, corporate, sales and health care taxes, contact Paul Wilson at 651-296-8405, or paul.Wilson@house.leg.state.mn.us.***

***For additional information on property aids and credits, motor vehicle taxes and other taxes, contact Matt Massman at 651-296-7171 or matt.massman@house.leg.state.mn.us***

[25] Some argue that there is no cost to the General Fund, because no tax would be collected if the stadium were not built. The Department of Revenue consistently counts the cost of sales tax exemptions granted to specific projects, arguing that the "but for" test is not conclusively satisfied. It is not clear that failure to grant a sales tax exemption would be the proverbial straw that broke the camel's back.

An additional annual cost to the General Fund would appear only after construction is completed, starting in FY 2006. The stadium is granted a property tax exemption, which will shift taxes partly on to homes, increasing property tax refunds. If the stadium were assessed at $280 million, property tax refunds would increase by about $270 thousand in FY 2006.

# Staff Assignments - 2002 Session

| Committee / Subject Area | Fiscal Analyst | Telephone | Room |
|---|---|---|---|
| | | | |
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The House Fiscal Analysis Department Home Page is at:
**http://www.house.leg.state.mn.us/fiscal/FAHOME.HTM**

The Web page has fiscal staff publications from recent years as well as spreadsheets for the major finance bills for the past five legislative sessions.