Governor Pawlenty's Directives to Balance the FY 2004-05 General Fund Budget

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Overview

Because the Legislature failed to act during the 2004 regular legislative session to resolve a projected $160 million General Fund deficit for the FY 2004-05 biennium, the Governor directed that actions be taken to resolve the deficit. These actions are where the Governor has some discretion to direct spending changes or delay certain actions. The chart below summarizes those actions. The actions are explained in more detail in the following sections.

Governor's Directives to Balance the FY 2004-05 General Fund Budget *(Dollars in Millions)*	
Agency Operating Budget Cancellations	-16.6
Health Care Access Fund Transfer	-110.0
No 2004 Bonding Bill	-8.3
Delay June 2004 Bond Sale to August 2004	-18.7
Additional Revenue Department Compliance Revenue (net)	-6.4
Total:	**-160.0**

Agency Operating Budget Cancellations

On May 7 in anticipation of a possible legislative impasse, the Commissioner of Finance instructed state agencies except for the Department of Corrections to reduce operating expenditures by at least three percent from the currently authorized spending levels for FY 2005. On May 27, the Department of Finance instructed agencies to prepare FY 2005 spending plans that cancel these amounts. The goal of these reductions is a $16.6 million reduction in agency expenditures for FY 2005. For the most part, these reductions are the same amounts as the Governor recommended in agency budget reductions to the Legislature in March. The reductions are three percent reductions in cabinet level agency operating budgets with a few exceptions. The reduction was not applied to small agencies (agencies not considered "cabinet level"). As noted earlier, the Department of Corrections was exempt from the reduction. The reduction to the Department of Revenue was limited to 1.5 percent. Now the Department of Revenue is being asked to make $1.4 million in reductions but then to use that amount to expand its tax compliance program to bring in more revenue (see summary of the compliance proposal). In his March recommendations, the Governor recommended three percent agency operating budget reductions for the Departments of Military Affairs and Veteran's affairs. However, now those agencies are not being asked to make that reduction.

The amounts that the Governor has directed agencies to cancel back to the general fund in FY 2005 are listed in the chart on the following page.

Governor's Directive - Agency Cancellations - May 2004
(A negative number is a reduction in spending)
(Dollars in Thousands)

Administration Department	-432
Agriculture Department	-497
Animal Health Board	-84
Attorney General	-677
Center for Arts Education	-179
Commerce Department	-347
Commerce Department - Revenue Loss	20
Education Department	-682
Employee Relations Department	-186
Employment & Economic Development Dept.	-594
Environmental Assistance Office	-132
Faribault Academies	-31
Finance Department	-912
Governor's Office	-108
Health Department	-692
Higher Education Services Office	-84
Historical Society	-668
Housing Finance Agency	-628
Human Rights Department	-105
Human Services Department	-2,301
Human Services Dept.- Revenue Loss	920
Labor & Industry Department	-85
Metropolitan Council	-1,737
Minnesota Zoo	-197
Natural Resources Department	-2,266
Pollution Control Agency	-281
Public Safety Department (Judiciary)	-1,452
Public Safety Department (Transportation)	-118
Revenue Department	-1,402
Secretary of State	-181
State Auditor	-249
Transportation Department	-15
Veteran Home Board	-90
Water & Soil Resources Board	-127
Total - Agency Reductions	**-16,599**

Health Care Access Fund Transfer

The Governor has directed that an anticipated one-time transfer of $114.6 million from the General Fund to the Health Care Access Fund (HCAF) be reduced to $4.6 million. This action retained $110 million in the General Fund. However, while the reduced transfer helps with the state's immediate need to balance the General Fund, the resulting void in the HCAF has repercussions for the FY 2006-2007 biennium.

The origin of this funding is the federal Jobs and Growth Tax Relief Reconciliation Act of 2003. The federal Act provided states with fiscal relief in the form of Flexible Grants and FMAP (federal medical assistance percentage) Grants. FMAP grants were distributed through state medical programs using a temporary increase in the federal matching component. Minnesota's share of this increased funding was projected to total $197.5 million.

The federal funds eased the pressure for certain budget reductions to take place in the FY 2004-2005 biennium. The 2003 Health and Human Services Budget Act (Laws of 2003, First Special Session, Chapter 14, Article 13C, Section 2, Subdivision 1) allocated the federal funds to delay reductions in programs and payment shifts that otherwise would have gone into effect. That legislation also gave authority to transfer funds as necessary from the General Fund to the HCAF. The transfer authority was appropriate because all of the federal funds were received in the general fund but some of the expenses to restore programs occurred in the HCAF. In November 2003, the amount to be transferred from the General Fund to the HCAF during FY 2004 was set at $114.6 million.

As of May 2004, the $114.6 million transfer had not yet been made. The Governor reduced that transfer from $114.6 million to $4.6 million. This increases the General Fund balance by $110 million in the FY 2004-05 biennium.

The 2003 Health and Human Services Budget Act also directed certain amounts to be transferred from the HCAF to the General Fund at the end of fiscal years 2005, 2006 and 2007. The amounts transferred were the available balances (up to specified amounts) in the HCAF at the end of each fiscal year. Transferring only $4.6 million into the HCAF in FY 2004 rather than the $114.6 million results in the transfers from the HCAF to the General fund in FY 2006 and 2007 being reduced by $44.3 million. For the General Fund, the net result of the Governor's actions is that the General Fund balance is $110 million higher in FY 2005 and $44.3 million lower in FY 2006-07.

For additional information see the June 2004 Issue Brief, "Health Care Access Fund (HCAF) Transfer Issues."

No 2004 Bonding Bill

The lack of a capital investment bill in the 2004 legislative session will reduce General Fund debt service expenditures by $8.3 million from the forecasted expenditure level. The debt service expenditure in the February forecast assumed a 2004 bonding bill of $530 million (a floating average size for the last ten year period. The absence of a bill this year will require lower debt service payments this biennium and also reduce forecasted debt service for FY 2006 by $24.5 million and for FY 2007 by $48.1 million.

Delay 2004 Bond Sales

The Department of Finance was preparing for a general obligation bond sale in late June 2004 for cash flow for bonding projects authorized in previous years. The Commissioner of Finance will be delaying the sale of those bonds until August 2004. This delay will save $18.7 million in FY 2005, but the $18.7 million cost will occur in future years.

A bond sale in June would have required the state to make four interest payments and two principal payments on those bonds in FY 2005. By delaying the sale until August, the state will have to make three interest payments and one principal payment on those bonds in FY 2005. That change results in the $18.7 million General Fund savings in FY 2005.

Department of Revenue Tax Compliance

The Governor has directed the department to redirect its $1.4 million planned agency reduction towards the expansion of compliance activities. To achieve this reallocation of resources, the department must cut funding for activities that do not directly produce revenues. The cuts will primarily impact the department's technology activities.

The new compliance activities are projected to bring in additional general fund revenues of approximately $7.8 million, for a net gain of $6.4 million. To generate the additional revenue, the department will focus on three areas:

- Expansion of audits of lawful gambling taxes, insurance taxes, corporate franchise taxes and sales taxes.
- Broadening programs for identifying non-filers of business taxes, and
- Increasing delinquent tax collection activities.

This action is, in effect, a scaled-down version of compliance initiatives that were in the House tax bill and the Senate budget bill. Those proposals would have raised net new revenues of $13.1 million per year. The legislative proposals would also have required the department to report back to the legislature on noncompliance with the corporate tax system, the sales and use tax system, and taxes on insurance companies, including information on the number of noncompliant taxpayers and the amount of revenues collected under the initiatives.

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