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## STATE BUDGET: LIVING WITHIN OUR MEANS

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### ISSUES

**How should the Legislature address the state's \$5.3 billion budget shortfall? How should the Legislature reform government spending? How large a budget reserve should the state maintain?**

### POLICY

The Minnesota Management and Budget Department projects the state will face a \$426 million deficit for the remainder of FY 2009 and a \$4.85 billion budget shortfall for the FY 2010-2011 biennium. The FY 2010-2011 shortfall represents approximately 13 percent of the biennial budget. The state expects to collect \$31.87 billion during the FY 2010-2011 biennium.

The Minnesota Chamber supports balancing the state's budget by restructuring government and cutting spending.

- **Government restructuring.** Government restructuring and spending reforms are critical whether the state faces a budget shortfall or has a surplus. Minnesota's demographic projections show that the number of Minnesotans who will likely be significant users of government services per 100 Minnesotans of working age (the dependency ratio) will increase 33 percent over the next 25 years. If the Legislature does not restructure and reform the programs that drive spending growth, tax increases are inevitable.

Four principles guide the Minnesota Chamber's spending reform initiatives: (1) target resources to those in need; (2) finance individuals rather than institutions; (3) utilize competition; (4) reduce overhead expenses. The following examples show how the four principles could be implemented:

- **Target resources to those in need.** Medical Assistance (MA) long-term care eligibility requirements could be tightened to reduce caseloads, and the look-back period for determining assets and income eligible for MA estate recovery could be lengthened.
- **Finance individuals rather than institutions.** Student financial aid could be increased while state aid to colleges and universities is declining. This will offset tuition increases for low- and middle-income students. Similarly, more property tax relief dollars could be delivered directly to taxpayers through the circuit breaker and renters credit at the same time local government aid and/or other property tax relief that's paid to governments is being reduced. This will offset property tax increases for low- and middle-income individuals.
- **Utilize competition.** State services could be competitively sourced – i.e. public-sector employees participate with private-sector companies in the bidding for services. Contracts would be awarded based on the cost and quality of the service provided. Where appropriate, reverse auctions, as authorized under current law, could be utilized to reduce the cost of goods and services purchased by the state. School boards also could be allowed to seek competitive bids for educational and noneducational services.
- **Reduce overhead expenses.** Agencies could be consolidated. Defined contribution retirement plans could replace defined benefit plans for new hires. In addition, public-sector wages and health care benefits could be made comparable to those offered in the private sector.
- **General fund spending.** In the face of a national recession, the Chamber supports permanent spending reductions and, where necessary, budget shifts to balance the state's budget shortfall without raising state taxes. For example:
  - **K-12 aid payment shift.** At present, K-12 education payments for the school year are paid on the following schedule: 90 percent in the current fiscal year and 10 percent in the next fiscal year. The timing of payments could be changed to 80 percent-20 percent. This shift has \$686.075 million

been used several times during times of past budget shortfalls. This is consistent with the Governor's recommendation.

- K-12 property tax recognition shift. Property tax revenue could be recognized early which would result in a reduction of state aid payments to schools. This shift has been used several times during times of past budget shortfalls. This is consistent with the Governor's recommendation. \$605.2 million
- Personal care attendants (PCA). This is one of the fastest growing areas of the budget. A health care company believes that not all of the payments for these services are appropriate. If the state allowed personal care attendant services only for those enrollees who were certified as disabled, savings of \$160 million could be achieved. ~\$160 million

The Governor's recommendation for PCA services would reduce costs by \$42.5 million. Increasing this amount to \$160 million would allow lower reductions to hospitals and fewer reductions in eligibility to state health care programs.

- Restructure the MinnesotaCare and General Assistance Medical Care (GAMC) benefit set. MinnesotaCare and GAMC could adopt benefit sets similar to the benefit set purchased by a typical small employer. A health care company estimated that doing so could save \$240 million. ~\$240 million

The Governor recommends eliminating the following services from Medical Assistance, MinnesotaCare and GAMC: chiropractic, dental, podiatry, and rehabilitative services. The Governor's recommendation would reduce costs by \$47.256 million. Further changes to the benefit sets could save additional dollars and allow lower reductions to hospitals and fewer reductions in eligibility to state health care programs.

- Medical Assistance and GAMC. The reimbursement rate for fee-for-service and managed care inpatient hospital services, outpatient services, and all other basic care providers would be reduced by 3%. This is consistent with the Governor's recommendation. \$96.291 million

This reduction could be lessened by expanding the Governor's budget recommendations on PCA services and the Medical Assistance, MinnesotaCare, and GAMC benefit set.

- MinnesotaCare and GAMC eligibility. Eligibility for MinnesotaCare and GAMC (hospital only) would be eliminated for all adults without children. Eligibility for MinnesotaCare would also be eliminated for parents (adults with children and caretakers). This is consistent with the Governor's recommendation. \$573.854 million

This reduction could be lessened by expanding the Governor's budget recommendations on PCA services and the Medical Assistance, MinnesotaCare, and GAMC benefit set.

- Targeted case management. Recover the targeted case management temporary funding grant. The federal government suspended a rule at which these grants were targeted. This is consistent with the Governor's recommendation. \$32.667 million
- Child care assistance. A 3% reduction would be made to the maximum rates paid to child care providers and co-payments would increase by 3% for families that receive a subsidy. This is consistent with the Governor's recommendation. \$10.398 million

- Minnesota Family Investment Program (MFIP). Some prior expansions of MFIP (state's welfare program) eligibility would be reduced.

\$18.014 million
- Long-term care. A 3% reduction would be made to funding for long-term care providers and aging, deaf services and other continuing care grants. This is consistent with the Governor's recommendation.

\$84.87 million
- Reductions in overuse and misuse of services. The overuse and misuse of health care services are significant cost drivers. Examples of policy changes to reduce overuse and misuse of services include, wider use of generic drugs, reducing unnecessary emergency room visits, reduce hospitalization admissions and intensive care stays during the last 30 days of life, reducing unnecessary cesarean deliveries, and reducing unnecessary lab tests, among others.

~\$250 million
- Deductibles and copays for Medical Assistance. Federal law allows states to utilize cost sharing mechanisms in Medical Assistance. The allowable family deductible is \$2.30 per month and copays can increase by \$0.40 on all services.

\$4 - \$10 million
- Dependent care audit. The state could complete a dependent care audit to make sure it is providing coverage for eligible employees and dependents.

\$5 - \$10 million
- Encounter data collection. The Department of Health could cancel a contract with the State of Maine for the collection of encounter data in conjunction with the 2008 health care reform legislation. A better model for this task is the data aggregation that is used with Minnesota Community Measurement.

\$700,000 - \$3 million
- Local government aid. Reduce local government aid by 23%. This is consistent with the Governor's recommendation. This reduction could be partially offset by requiring a wage freeze for entities that receive state funds and/or requiring local governments to use the state's purchasing power to buy commodities. This reduction could also be mitigated by eliminating some of the state's mandates or providing local governments flexibility on how they meet the mandates.

\$245.8 million
- Homestead and agricultural market value credits. Reduce the homestead market value credit by 13% and the agricultural market value credit by 17%. This is consistent with the Governor's recommendation. This reduction could be partially offset by requiring a wage freeze for entities that receive state funds and/or requiring local governments to use the state's purchasing power to buy commodities. This reduction could also be mitigated by eliminating some of the state's mandates or providing local governments flexibility on how they meet the mandates.

\$77.3 million
- County program aid. Reduce county program aid by about 27%. This is consistent with the Governor's recommendation and assumes that counties will participate in the county program reform initiative. Reductions to counties that do not enter into a joint agreement with other counties to cooperatively manage and operate human service programs would be larger. This reduction could also be mitigated by eliminating some of the state's mandates or providing local governments flexibility on how they meet the mandates.

\$125.89 million

- <u>Pension contributions</u> . Reduce the state's share and increase the employee's share of pension contributions by 50% for two years. This should be done on a revenue neutral basis so it has no impact on pension benefits.	~\$658 million
- <u>Wage freeze</u> . A wage freeze could be implemented in a few ways, e.g. not allowing increases to salary schedules and/or freezing step and lane increases. Freezing step increases at the state and local level could save approximately \$349 million over the next two years. This is a conservative estimate because it includes only select state and local government employee compensation plans.	~\$349 million
- <u>Property tax refund</u> . The renters credit property tax refund program would be adjusted so that the rate more closely reflects actual property taxes paid.	\$50.7 million
- <u>Political contribution refund</u> . Eliminate the refund program. This is consistent with the Governor's recommendation.	\$11.6 million
- <u>MnSCU</u> . Reduce aid to MnSCU by 11%. This is consistent with the Governor's recommendation.	\$146 million
- <u>University of Minnesota</u> . Reduce aid to the University by 11%. This is consistent with the Governor's recommendation.	\$151 million
- <u>Agency administrative costs</u> . All agencies took a reduction in administrative costs. The reductions ranged from 2% to 10%. The savings on this line item could be achieved by freezing state government wages for the next two years.	?
- <u>Shared services between Minnesota and Wisconsin</u> . Governor Pawlenty and Wisconsin Governor Doyle have announced an initiative to share certain services and the use of equipment.	?
- <u>K-12 education</u> . Budget reductions in K-12 education should be considered. Savings could be achieved from efficiencies, consolidations, and reorganizations. For example, school districts could be required to share administrative services and purchasing.	?
Total	\$4,582 million*

Key:

~ signifies an estimate provided by a member.

Ranges are estimates provided by a member.

\* The total will be less if the substitution of further PCA cuts and a less generous benefit set for lower reductions to hospitals and eligibility for state health care programs is made.

- **Use of future surplus revenue.** A portion of any future surplus revenue should be used to pursue the following objectives.
  - **Increase the budget reserve.** The state's bond rating depends on sound fiscal management. The state should set its budget reserve in relation to the volatility of state revenues. That currently means the state should increase the budget reserve to \$2.3 billion.
  - **Increase the cash flow account.** At present, the state's cash flow account is \$350 million. According to the Management and Budget Department, that amount is not enough to manage the times of highest cash needs. The cash flow account should be increased to a level the department determines is sufficient to eliminate borrowing from other state funds.

- **Reverse revenue and spending shifts.** Revenue and spending shifts are temporary budget-balancing strategies. They should be reversed when the economy and state revenues improve. For example, the Legislature could convert the capital equipment refund program to an up-front exemption and eliminate the June accelerated sales and excise tax payments.
- **Reduce/restructure taxes to promote economic growth.** Business tax reductions/restructuring promotes economic growth by increasing the return on investment of Minnesota operations. For example, the Legislature could speed up the phase-in of a sales-only apportionment formula for the corporate income tax.
- **Budget forecast.** The Management and Budget Department should change its February and November Forecast methodology by incorporating trend line revenue growth. If forecast revenue exceeds trend line revenue, trend line revenues should be the basis of the Governor's and Legislature's budgets. On the other hand, if forecast revenue is below trend line revenue, forecast revenue should be the basis of the Governor's and Legislature's budgets. This change will ensure that revenue increases that are not sustainable are not used for permanent spending or tax changes and help replenish the budget reserve, increase the cash flow account, and reverse spending shifts. It also should slow the rate of growth of government spending.
- **Inflation in the forecast.** The Minnesota Chamber supports the Management and Budget Department's current policy of excluding discretionary inflation in budget projections, but disclosing the impact of inflation on the budget in its forecasts. Doing so does not presume that all budget areas will receive an inflationary adjustment, but it gives policy-makers the financial information necessary to make informed decisions regarding area-specific inflationary adjustments.

## ***BUSINESS IMPACT***

During the last six years, the Legislature has proposed three major business tax increases – statewide property tax, corporate income tax and personal income tax – to balance past budget deficits and/or increase state spending. In 2008, the Legislature increased corporate income taxes by changing the deduction for foreign operating corporations. That increased business taxes by about \$100 million per year. The Legislature will likely revisit these tax increases to balance the projected shortfall for the FY 2010-2011 biennium.

Chamber members have indicated that their preference for the use of future surpluses is not to increase spending, but rather to increase reserves, reverse spending and revenue shifts, and/or reduce taxes to promote economic growth. Shifts that could be reversed are the capital equipment refund payment delay, converting the capital equipment refund program to an up-front exemption, repealing the June accelerated sales and excise tax payments, and repaying the special compensation fund for the dollars taken to balance the budget. Speeding up the phase-in of a sales-only apportionment formula is a targeted tax reduction that would promote economic growth.