



Bill Marx, Chief Fiscal Analyst, MN House of Representatives

Civic Caucus, 8301 Creekside Circle #920, Bloomington, MN 55437

December 17, 2010

Present: David Broden, Janis Clay, Paul Gilje, Jim Hetland (phone), Dan Loritz (chair), Tim McDonald, Wayne Popham (phone), Clarence Shallbetter

Summary of Marx's comments: *Veteran Chief House Fiscal Analyst Bill Marx provides projections and context from a recent Minnesota Management and Budget (MMB) economic forecast. Marx describes a projected \$6.2 billion shortfall in Minnesota state government's biennial budget beginning July 1, 2011. He outlines factors contributing to the shortfall, including carryover from the current biennium. He describes various options for dealing with the shortfall, including delaying more payments of school aids, delaying income tax refunds to citizens, cutting spending, and raising taxes.*

A. Welcome and introductions- Bill Marx has been in service to the Minnesota legislature since graduation from Winona State University in 1975. He is chief fiscal analyst at the Minnesota House of Representatives, a non-partisan office.

B. Comments and discussion -During Marx's visit with the Civic Caucus, the following points were raised:

Understanding the \$6.2 billion shortfall for the upcoming biennium

Marx began by sharing a number of charts to help people understand a shortfall of \$6.2 billion that was projected in November by MMB.

How the current biennium budget was balanced- First, one must remember that actions balancing the budget in the current biennium affect a projected shortfall in the upcoming biennium. The Minnesota state general fund is projected to yield \$30.2 billion in revenue for the biennium ending June 30, 2011. The Legislature essentially spent \$34.4 billion in the current biennium. Such an apparent unbalanced budget was possible because additional spending beyond the \$30.2 billion was paid for by one-time federal stimulus grants and other spending shifts totaling \$4.2 billion. A spending shift occurs when the Legislature promises certain dollars-in this case \$1.4 billion to school districts, letting them spend that much in the current biennium. However, the Legislature postpones, or shifts, the receipt of those dollars to early in the following biennium, paid for from state revenues in that biennium, not the current biennium. While waiting for promised revenues to arrive, school districts need to borrow from the bank, and pay interest, or use existing fund balances if they have them.

Projected revenue in the upcoming biennium -For the biennium ending June 30, 2013, the state general revenue fund, under current tax rates, is projected to grow from \$30.2 billion in the current biennium to \$32.0 billion, plus a \$400 million projected general fund balance in the current biennium, a total of \$32.4 billion in available dollars. Were the Legislature to appropriate exactly the same dollar figure (\$34.4 billion) for the 2012-13 biennium as the 2010-11 biennium, the upcoming budget already would be \$2 billion short, with no changes in enrollment in K-12 or higher education, with no changes in case load in social services, with no increase in required debt service payments, and, of course, no increase in any other spending, including salaries.

Furthermore, if the Legislature were to "pay back" school districts for the \$1.4 billion shift (that is return aid payments to school districts to 90% current year/10% next year from the current 70%/30%), another \$1.4 billion would be added to the shortfall, making a total of a \$3.4 billion shortfall. That amount would be needed simply to balance the books with absolutely no change whatsoever in revenue rates and spending from the 2010-11 biennium, but with projected growth in the general fund.

The announced shortfall for 2012-2013 is \$6.2 billion, not \$3.4 billion, a difference of \$2.8 billion. That amount is what the MMB projects would be needed to pay for additional principal and interest on already-committed long-term debt, for increases in personnel caused by changes in K-12 and higher education enrollments (without increasing any per pupil allotments), for changes in special education case load, for changes in social service case load (such as for long term care and for developmental disabilities), for changes in prison enrollments, and other changes caused only by different numbers of people being served. Higher salaries or higher expenses because of inflation are not included, except for provisions already in federal law that require certain inflation factors as a condition for a state to continue to receive matching federal funds.

The MMB projected \$6.2 billion shortfall doesn't include any cuts in spending, any tax increases, any salary increases or any higher spending for new or expanded services beyond any changes already in current law. The MMB also projects a \$5.1 billion deficit in 2014-15. The forecast may be found on the state's management and budget website:  <http://www.mmb.state.mn.us/doc/fu/10/complete-nov10.pdf>.

In the process of forecasting, the state begins with a report put together by a national forecasting organization (Global Insights, Inc. or GII), and then localizes it to the state. For example, the car excise tax is based on expected growth in national auto sales; in this case, the growth rate is unadjusted as there is not enough excise revenue to warrant looking at how Minnesota sales might differ.

Projected increases in spending-27.5 percent or 8.1 percent

From the FY 2010-11 biennium to the FY 2012-13 biennium general fund spending is projected to increase 27.5 percent. This dramatic increase results from much 'one-time use' money being spent. This includes the \$1.4 billion in school shifts. During this past year the state purchased the same levels of service, but spent less from the general fund due to the use of federal stimulus money, federal medical assistance, and the school aid payment shift. Adding in the spending from those sources in FY 2010-11 and subtracting the repayment of the school aid payment shift in FY 2012-13 results in the spending change between bienniums totaling \$4 billion, or 8.1 percent. "An 8.1 percent

increase on a biennial basis, or 4 percent per year, is not that unusual in the state's history," Marx said. It's a case of using one-time money to buy more services than the state had general fund revenue to pay for.

Determining forecasts

Of all spending categories, health and human services, education, and debt service have the most dramatic growth, based on the increase in case load and direct costs. Education growth is not as dramatic as that of health and human services. Debt service is higher in FY 2012-13 because bond refunding lowered cost in FY 2010-11.

There is no inflation included in projections unless that is explicitly written into law. In general when you hear that no inflation being built in, it is not built in across the board-from state employees to the K-12 funding formula.

Working with Senate counterparts

There are 12 employees in the House Office of Fiscal Analysis . The Senate has a similar office that is part of Senate Counsel, Research and Fiscal Analysis. Minnesota Management and Budget has a director with a comparable staff-or a bit larger-that puts together the governor's forecasts. They stay in communication to keep each other informed. They communicate on technical issues. They often talk among themselves on the analysis of important situations as shared with legislators.

Local Government Aid (LGA)

LGA will be considered for spending cuts. In the 2010 session the Legislature voted to reduce aids for local governments by \$400 million for the biennium.

"There has also been talk about restructuring LGA. I suspect there will be significant disagreements over how to get at it."

Options for resolving the budget gap

Does the leadership ask you privately, a participant asked of Marx, what the options are to resolve this?

"Certainly-there are budgeting options, and then there are the politics of it. Taking the broad perspective, the options are cuts, shifts, and revenue increases."

The first and easiest thing that could happen would be not to pay back the school spending shift from 70%/30% to 90%/10% in FY 2012. If I were a school district business manager I would be asking my school board to decrease spending.

We can always shift more for schools, Marx said, but it's a horrible budget practice. Many schools would probably prefer it to cuts, but it's not a generally accepted accounting practice and rating agencies look at it as an issue. It is better to cut spending or raise revenue than to shift, but politically spending cuts and tax increases are very difficult.

There are other shifts that could be looked at, though not on the scale of K-12 schools. LGA would be more challenging. Shifts for the University of Minnesota have been talked about but would yield a smaller amount of money. We cannot shift aid to MnSCU because they are essentially a state agency- so instead cuts would be required. The state could also delay the last employee pay date in June.

Delaying individual income tax refund payments has significant revenue potential, but extremely undesirable political potential. If legislators were to delay refunds from April 2013 into July 2013 they could shift more than \$1 billion to the next biennium.

"The thing about shifts is that once they are there, they are permanent-until you spend money to pay them back." There is language in the law (M.S. 16A.152, Subd. 2) that says any surplus goes to build the reserves first (presently spent down), then to pay back education shifts.

There are other ways to get at the budget, without raising revenue:

Roughly 40 percent of the budget is contained in K-12 education. In the last 2-year period the Democratic Senate included cuts to K-12 Education; the Democratic House and Republican Governor did not.

The next biggest area is health and human services, at 28-30 percent. No doubt that will be cut. A practical challenge is that we have 'maintenance of efforts' agreements with the Federal government. We have been trying to look into those.

The next largest budgeting areas are higher education and local government aids and property tax aids. Then the remaining 10-12 percent of the budget is state agencies and government-we can cut there but won't save all that much money. Debt service is in there and can't be cut; prison services and components of public safety are included. The Department of Revenue is included as well, showing how challenging it is to cut funding-since Revenue collects taxes.

Reform committees

There are a number of active committees that are dedicated to reform, a member observed. Can they have an impact?

Yes, and that would affect projections. But the state has had reform committees lots of times. It is hard to redesign. "As someone once said to me," Marx said, holding a piece of paper and then folding it in half, "you can take this paper and re-form it, but it is still a piece of paper."

Difficult choices ahead

A participant asked Marx for his outlook for the budget. "I'm not sure how we'll get out of this one. In past recessions we had turned around by this point."

The ongoing budget problem will be solved only with a permanent resolution-not shifts.

Marx commented that for many years the goal has been that we don't want to harm people. In the 1980's we had an income tax surcharge-people felt it immediately. In this case now we are instead trying to keep people from feeling pain. It's not unlike at the federal level fighting a war without a war tax.

"Personally I'm surprised bond houses haven't made a big deal out of it-perhaps because every state is in the same boat." With the sovereign European states the reckoning has come. "I suspect if we keep doing this Minnesota's day will come too."