Governor Tim Pawlenty's 2004 Supplemental Budget Recommendations

Money Matters 04.03
March 2004

This paper summarizes the Supplemental Budget recommendations submitted to the Legislature by Governor Tim Pawlenty. Part one summarizes the overall budget recommendations. Part two provides detailed recommendations organized according to the jurisdictions of the House of Representatives' fiscal committees. Part three discusses recommended changes to the tax laws. The Governor's Capital Budget recommendations are summarized in a separate Money Matters.

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Fiscal Analysis Department
Minnesota House of Representatives

Overview of Governor's Supplemental Budget

The Governor's supplemental budget recommendations would resolve the $160 million General Fund deficit for the FY 2004-05 biennium as projected by the state budget forecast released on February 27, 2004. The Governor's recommendations are a combination of spending reductions as well as spending increases, transfers from other state funds and changes in the way some taxes are collected.

Most of the spending reductions are in the Health and Human Services area, most of the spending increases are in the Judiciary/Crime Prevention area. Most of the revenue increases are in the Tax area and the largest revenue increase results from a change in payment of the sales tax on leased vehicles. The largest transfer is $70 million from the Health Care Access Fund to the General Fund.

The chart below shows the changes recommended by the Governor by type of change.

Governor's Recommendations: March 2004
(dollars in thousands)

	FY 2004-05	**FY 2006-07**
Spending Decreases	-$68,158	-$176,699
Spending Increases	$33,604	$92,143
Net Spending Changes	**-$34,554**	**-$84,556**
Revenue Decreases	$2,967	$25,984
Revenue Increases	-$50,751	-$45,155
Net Revenue Changes	**-$47,784**	**-$19,171**
Transfers	-$77,492	$0
Total	**-$159,830**	**-$103,727**
Budget Problem	**$159,530**	**$442,212**
Difference (Bottom Line)	**$300**	**-$338,485**

For FY 2004-05, the Governor's recommendations would leave balance of $300,000 in the general fund on June 30, 2005.

For FY 2006-07, the Governor's recommendations result in reducing the projected budget problem from $442 million to $338 million.

The Governor's recommendations affect all areas of the general fund budget. The following chart shows the recommended changes by House finance committee. The Governor's recommendations include three percent reductions in the operating budgets of most larger state agencies. Those reductions are included in the numbers for the committee that has jurisdiction over those agencies. The Governor does not recommend reductions in operating appropriations for small agencies.

Governor's 2004 Supplemental Budget Recommendations - by House Committee Structure

Amounts are differences from Feb. 2004 forecast, all dollars in thousands

A negative number is a spending reduction or revenue increase, a positive number is a spending increase or revenue reduction.

	FY 2004	FY 2005	FY 04-05	FY 2006	FY 2007	FY 06-07
Education	0	5,233	**5,233**	9,606	10,487	**20,093**
Higher Education	-18,600	-684	**-19,284**	-1,684	-1,684	**-3,368**
Taxes	0	-46,732	**-46,732**	-19,585	2,940	**-16,645**
Health & Human Services	137,206	-243,082	**-105,876**	-63,508	-79,211	**-142,719**
Environment & Natural Resources	0	-3,008	**-3,008**	-3,008	-3,008	**-6,016**
Agriculture	0	-381	**-381**	-381	-381	**-762**
Jobs & Economic Development	0	-7,817	**-7,817**	-2,093	-2,093	**-4,186**
Transportation	0	-2,588	**-2,588**	-2,651	-2,651	**-5,302**
Judiciary	-353	18,294	**17,941**	16,444	17,016	**33,460**
State Government	-7,416	-3,762	**-11,178**	-2,481	-2,481	**-4,962**
Capital/Debt	10,269	3,591	**13,860**	9,416	17,264	**26,680**
Total	**121,106**	**-280,936**	**-159,830**	**-59,925**	**-43,802**	**-103,727**

The Governor's budget recommendations would transfer $350 million from the budget reserve to the cash flow account but leave overall General Fund reserves at $631.4 million.

For more information, contact Bill Marx at 651-296-7176 or bill.marx@house.leg.state.mn.us

Education Finance

The Governor's 2004 session supplemental budget recommendations for the fiscal year 2004-05 biennium includes $2.9 million in state aid reductions, $2.0 million in state aid savings from shifts and $10.1 million in new state aid spending, for a net increase of $5.2 million in state spending. In addition, the recommendations include a net increase of $20.1 million for the fiscal year 2006-07 biennium, and $6.5 million in property tax increases for the taxes payable in calendar year 2005 and 2006 (for fiscal years 2006 and 2007, respectively).

All appropriations are for fiscal year 2004-05 from the General Fund, unless otherwise noted.

General Education

- $3.1 million for mandated summer school for students that fail to pass the basic skills test in 10th or later grades.

- $388,000 in additional general education program costs from a new requirement that the driver's licenses of students who drop out of school or are truant be cancelled. Each district has the option of opting out of imposing the penalty. An additional $22,000 of property tax levy costs are associated with this program.

- $969,000 of transition revenue for districts that had a 4-year-old pre-kindergarten program during the school year 2003-04 and would otherwise lose funding for these pupils. The program revenue would be added in a fixed amount to the districts' current transition revenue. In addition to the aid, $6.4 million of property tax levy revenue is associated with this program. The $6.4 million in property tax revenue includes a pay 2005 levy that will be forward shifted 100 percent to provide revenue for the districts for the 2004-05 school year, and revenue that will be used for the 2005-06 school year.

- $11,000 in the 2006-07 biennium (with no current biennium costs) for costs associated with requiring districts to provide differential instruction or prevent students from moving to the next grade level if they have excessive absenteeism or are not performing at grade level.

- $2.0 million in levy shift savings. Currently, 48.7 percent of property tax levy amounts are shifted into the prior fiscal year through the early recognition by school districts of property tax payments. The Governor's budget recommends an additional $6.5 in property tax levies, of which $4.0 million are shifted into the prior year, reducing state aid by $2.0 million on a one-time basis.

- The Governor's Supplemental Tax Bill recommendations includes a provision that would require that future state General Fund budget surpluses be allocated to reduce the property tax recognition shift (currently at 48.7 percent) instituted during the 2003 legislative session, and then to reduce the state aid payment shift, which was increase by reducing the payment schedule from 90 percent current year to 80 percent current year during the 2002 and 2003 legislative sessions. The cost of eliminating the property tax recognition shift would be $268.4 million for the current biennium. The cost to reduce the payment schedule shift by increasing the current year payment amount from 80 percent to 90 percent would be $604.2 million for the current biennium.

Education Excellence

- $291,000 in savings in the 2006-07 biennium (with no current biennium impact) from excluding salaries and benefits for administrators and other primarily non-transportation staff from transportation expenditures used to calculate special education and nonpublic pupil transportation aid. The savings are in nonpublic pupil transportation aid, as the changes for special education purposes will only reallocate the current special education funding.

- $1.0 million in the 2006-07 biennium (with no current biennium costs) to establish a high performance super teachers program. The program would allow school sites serving large numbers of disadvantaged students to hire teachers who are paid up to $100,000 per year.

- $2.0 million in the 2006-07 biennium (with no current biennium costs) in charter school startup and lease aid costs for an estimated seven additional charter schools sponsored by the Minnesota Department of Education and up to five organizations it designates.

- $500,000 on a one-time basis for financial incentives for school districts to coordinate services and programs outside the classroom on a regional basis.

- $210,000 on a one-time basis for a Scholars of Distinction program to recognize high achieving students.

- $250,000 for a contract that will initiate a value-added assessment program to measure growth in student academic achievement.

- $900,000 of savings from eliminating the Youthworks Grant program, which provides funding for ServeMinnesota! And Americorps program.

- $1.0 million in savings from eliminating the Best Practices grant program for professional development.

Facilities and Technology

- $4.5 million for rural telecommunications access. State aid will be provided to school districts with high telecommunications costs, reimbursing 90 percent of all costs that exceed $15 per pupil.

Early Childhood and Family Support

- $180,000 to refocus the existing School Readiness program on a more limited set of requirements related to kindergarten preparation.

Self-Sufficiency and Lifelong Learning

- $100,000 in savings from transferring the Lead Abetment program to the Department of Health (the cost will show up in the Health and Human Services area).

State Agency Operating Budgets – The Governor's supplemental budget recommends that most state agencies reduce their operating budgets by three percent, with some exceptions. In the Education Finance area, those reductions amount to:

- $682,000 for the Department of Education
- $31,000 for the Faribault Academies for the Deaf and Blind (a 0.3 percent reduction)
- $179,000 for the Perpich Center for Arts Education

Implications

The overall reduction in education spending is 0.04 percent for the fiscal year 2004-05 biennium and 0.17 percent for the fiscal year 2006-07 biennium. The property tax increase will amount to 0.5 percent for fiscal year 2006 and 0.3 percent for fiscal year 2007.

For additional information on early childhood and K-12 education issues, contact Greg Crowe at 651-296-7165 or greg.crowe@house.leg.state.mn.us

Higher Education

The Governor's supplemental budget for higher education recommends a net general fund reduction of $19.3 million for FY 2004-2005 and $3.4 million in FY2006-07. The recommendation would reduce the state grant fund by $15 million on a one-time basis in FY2004. Appropriations for tuition reciprocity would be reduced by $3.6 million in FY2004 and by $1.6 million in FY2005 and the base for this program would be reduced by $1.6 million annually in FY2006-2007. In addition, The Higher Education Services Office would be subject to an annual base reduction of 3% or $84,000 on the agency operation budget beginning in FY2005. The Governor also recommends a new one-time appropriation of $1 million to the University of Minnesota Extention Service for 4H programs.

Higher Education - Governor's Recommendations
(Dollars in thousands)

	FY 2004	FY 2005	FY 04-05	FY 2006	FY 2007	FY 06-07
University of Minnesota - 4H Programs	0	1,000	1,000	0	0	0
HESO - State Grant Surplus	-15,000	0	-15,000	0	0	0
HESO - Reciprocity Agreements	-3,600	-1,600	-5,200	-1,600	-1,600	-3,200
HESO - 3% Operation Budget Reduction	0	-84	-84	-84	-84	-168
Totals:	**-18,600**	**-684**	**-19,284**	**-1,684**	**-1,684**	**-3,368**

For further information on Higher Education Issues contact Doug Berg at 296-5346 or Doug.Berg@house.leg.state.mn.us

Health and Human Services

The Governor's recommendations in the Health and Human Services area would have a $106.143 million positive impact on the general fund. $70 million of this amount is a result of a transfer to the general fund from the health care access fund. The other $36.143 million is the net result of various spending changes and some revenue changes.
(Note: these numbers are from an update to the Governor's budget recommendations and may differ from the numbers presented in overview information.)

Health and Human Service Changes by Fund
(Dollars in Millions)

	FY 2004	FY 2005	FY 04-05	FY 2006	FY 2007	FY 06-07
Human Services	179,200	-219,436	-40,236	-73,301	-89,688	-162,989
General Fund	137,206	-242,736	-105,530	-64,084	-79,677	-143,761
Health Care Access	41,994	23,300	65,294	-9,217	-10,011	-19,228
TANF	0	0	0	0		0
Health	0	-592	-592	-592	-592	-1,184
General Fund	0	-592	-592	-592	-592	-1,184
Veterans Home Boards	0	-90	-90	-90	-90	-180
General Fund	0	-90	-90	-90	-90	-180
Totals (all funds)	**179,200**	**-220,118**	**-40,918**	**-73,983**	**-90,370**	**-164,353**
General Fund	137,206	-243,418	-106,212	-64,766	-80,359	-145,125
Health Care Access	41,994	23,300	65,294	-9,217	-10,011	-19,228
TANF	0	0	0	0	0	0

Below is a summary of the changes recommended by the Governor. Changes are to the general fund unless otherwise indicated. The "HS" references are to the Department of Human Services budget proposals. More detail is available on these proposals on the Department of Human Services web site at: http://edocs.dhs.state.mn.us/lfserver/Legacy/DHS-4055a-ENG

Department of Human Services

Agency –Wide Initiatives

- $2,300,000 reduction in the agency budget to reflect a reduction equal to three percent of the agency's operating budget. This reduction results in a $920,000 loss in federal revenue so the net impact on the general fund is a savings of $1,380,000. *(HS – 1 Administrative Reduction)*

- $70 million one-time transfer from the Health Care Access Fund (HCAF) to the General Fund in FY 2005. This transfer leaves the Health Care Access Fund with a projected balance of $0 on June 30, 2007. *(HS – 21 HCAF Transfer)*

- $1.233 million one-time transfer from the Temporary Assistance for Needy Families Fund (TANF) to the General Fund in FY 2005, which reflects the net cost savings associated with three Governor's proposals on funding for the Minnesota Family Investment Program (MFIP). This amount will increase to $2,319,000 in FY 2006 and $2,260 in FY 2007. *(HS – 39 TANF Transfer)*

Health Care Initiatives

- $139,000 from the General Fund and $142,000 from the Health Care Access Fund to conduct investigations, improve capacity to identify and analyze patterns of abuse and fraudulent practices for publicly funded health care programs. These changes are expected to result in significant savings in future years. *(HS – 2 Health Care Program Integrity)*

- $2,301,000 of savings in FY 2006 and $9,226,000 of savings in FY 2007 as a result of requiring state prescription drug program applicants and enrollees to enroll in and use the new federal Medicare prescription drug discount card and subsidy. The Governor also recommends repealing the state prescription drug program effective January 1, 2006 when with implementation of federal Medicare prescription drug coverage. *(HS - 4 Change PDP/Fed Medicare)*

- $282,000 in FY 2004 and $329,000 in FY 2005 to provide state funded Medical Assistance (MA) to people who are not eligible for federally matched MA because they have been committed to the Minnesota Extended Treatment Option (METO) program. This program is expected to cost $345,000 in FY 2006 and $363,000 in FY 2007. *(HS – 5 Health Care, METO)*

- $182,000 in FY 2005 to restore General Assistance Medical Care (GAMC) eligibility for people with tuberculosis. These people are not currently eligible for publicly funded health care because of their immigration status. This program is estimated to cost $281,000 in FY 2006 and $350,000 in FY 2007. *(HS – 6 Expand Tuberculosis Treatment)*

- $100,000 in FY 2005 to modify GAMC to allow those who meet the GAMC income limit, but not the asset limit, to qualify for the limited-benefit GAMC Hospital-Only (GHO) coverage if their assets are within the GHO limits. This change is estimated to cost $100,000 in FY 2006 and beyond. *(HS – 7 Clarify Income Limits GAMC-GHO)*

- $1,257,000 in spending from the general fund in FY 2005 to restore:
- the Medical Assistance (MA) income standard of 275 percent of the federal poverty guidelines for pregnant women, and
- (2) the MA special work expense deduction for infants and pregnant women. This change is

needed to preserve continued access to federal match under the State Children's Health Insurance Program (SCHIP) and is estimated to cost $3,083,000 in FY 2006 and $3,475,000 in FY 2007. This change would also create a in savings in the HCAF of $377,000 in FY 2005, $1,302,000 in FY 2006 and $1,390,000 in FY 2007. *(HS – 8 Federal Reqts-MA Pregnant Women)*

- $143,000 in savings in FY 2005 for eliminating publicly funded MA coverage for undocumented and non-immigrant pregnant women who have other health insurance. This change is estimated to save $363,000 in FY 2006 and $424,000 in FY 2007. *(HS – 9 Eliminate State MA Eligibility – Pregnant Women w/other health insurance)*

- $38,000 of one-time general fund cost in FY 2005 to align certain eligibility requirements of publicly funded health care programs to promote consistency among programs, maximize opportunities for more expedient eligibility determinations across programs and reduce client confusion. This change is estimated to save the HCAF $905,000 in FY 2005, $1,020,000 in FY 2006 and $1,112,000 in FY 2007. *(HS – 10 Align Health Care Eligibility Policies)*

- $96,000 in savings in FY 2005 for increasing the authority for DHS and county agencies to bring cause of action against those who receive assets or income for less than fair compensation from individuals who receive MA services following the transfers. This change is estimated to save $144,000 in FY 2006 and $192,000 in FY 2007. *(HS – 11 Increase Authority for Lawsuits – Uncompensated Transfers)*

- $15,000 in savings in FY 2005 for restricting the use of long term care (LTC) expenses to achieve eligibility for MA payment for acute care costs under certain circumstances. Specifically, enrollees would be deemed ineligible for MA payment of LTC costs when a transfer of assets or income is less than fair compensation. This change is estimated to save $15,000 in FY 2006 and beyond. *(HS – 12 MA Spenddown Limitations)*

- $25,000 in savings in FY 2005 for conforming GAMC hospital-only policy with the existing GAMC policy regarding eligibility periods for assets transferred without fair compensation. This change is estimated to save $25,000 in FY 2006 and beyond. *(HS – 13 Asset Transfer Penalties-GAMC)*

- $150,000 in FY 2005 to assist persons with chronic medical conditions to better manage their disease and avoid hospitalization and emergency room visits. This change is estimated to save $38,000 in FY 2006 and $63,000 in FY 2007. *(HS – 14 MA Disease Management)*

- $1,087,000 in the HCAF to 1) reinstate MinnesotaCare coverage of diabetic supplies and equipment, and 2) reinstate mental health services for adults without children who have incomes between 75 percent and 175 percent of the federal poverty guidelines. This change is estimated to cost $2,958,000 in FY 2006 and $3,305,000 in FY 2007. *(HS – 15 MnCare Ltd Benefit/Diabetic and MH)*

- $670,000 in savings in the HCAF for requiring a $3 co-pay for non-preventive office visits and a $6 co-pay for emergency room visits that are not emergencies for most adult

MinnesotaCare program enrollees. (These co-pay provisions were implemented for GA and GAMC recipients last session.) This change is estimated to save $2,088,000 in FY 2006 and $2,292,000 in FY 20007. *(HS – 16 MnCare Copays/OV & ER)*

- $231,000 savings in the HCAF for eliminating restorative dental benefits for MinnesotaCare caretakers with incomes over 175 percent of the federal poverty levels. This change is estimated to save $844,000 in FY 2006 and $930,000 in FY 20007. *(HS – 17 MnCare Remove Restorative Dental >175% FPL)*

- $5,758,000 in general fund savings for reducing pharmacy payments of publicly funded health care programs to the average wholesale price minus 14 percent. This change is estimated to save $4,881,000 in FY 2006 and $3,128,000 in FY 20007. *(HS18 – Pharmacy AWP less 14%)*

- $12,899,000 in general fund savings for reducing by 5 percent publicly funded health care program payment rates for inpatient and outpatient hospital services along with a corresponding reduction to managed care payment rates. Mental health diagnostic related groupings and Indian Health facilities are excluded from this change. This change is estimated to save $24,781,000 in FY 2006 and $26,565,000 in FY 20007. This change is also estimated to save in the HCAF $2,603,000 in FY 2005, $6,967,000 in FY 2006 and $7,592,000 in FY 2007. *(HS – 19 Reduce Hospital Rates 5%)*

- $6,348,000 in net general fund savings from shifting the June and July 2004 managed care capitation and performance withhold payments to June 2004, instead of July 2004. This proposal would also result in a net savings in the HCAF of $1,149,000. *(HS – 20 Change Delay of Managed Care Capitation/Performance Withhold)*

Continuing Care

- $3,810,000 in FY 2004 and $4,788,000 in FY 2005 to address program growth in Minnesota Forensic Services Treatment System. This increase funds expected growth in the sexual offender program of 38 individuals per year instead of the nine individuals per year that were assumed in original budget calculations. This cost is expected to grow to $9,378,000 in FY 2006 and $12,172,000 in FY 2007. *(HS –22 MSOP Changes)*

- $2,112,000 in FY 2005 is to cover a projected shortfall in the HIV/AIDS programs. This change will cost $3,299,000 in FY 2006 and $4,679,000 in FY 2007. *(HS23 – HIV/AIDS Shortfall)*

- $528,000 savings in FY 2006 and $134,000 cost in FY 2007 to implement a new Medical Assistance Nursing Facility reimbursement system which would be phased in over four years. The new system will reward services provided with higher quality and greater efficiency. *(HS –25 New MA NF Reimbursement)*

- $7,678,000 in savings in FY 2006 and $16,279,000 in savings in FY 2007 from suspending the automatic MA rate adjustments for operating costs for nursing facilities under contract through the alternative payment system. *(HS - 26 Eliminate NF COLA)*

- $693,000 in savings in FY 2005 for eliminating the MA per diem paid to nursing facilities for a scholarship program. This change would save $738,000 in FY 2006 and $739,000 in FY 2007. *(HS – 27 Eliminate NF Scholarship)*

- $18,373,000 in savings in FY 2005 form reducing continuing care provider payments and grants by 1.5 percent from the FY 2004 funding level. This change would save $22,236,000 in FY 2006 and $23,790,000 in FY 2007. *(HS – 28 Reduce Continuing Care by 1.5%)*

- $10,668,000 in general fund savings in FY 2006 and $13,906,000 in FY 2007 by controlling caseload growth in the Community Alternative for Disabled Individuals and Traumatic Brain Injury home and community base waiver programs. *(HS - 29 Limits on CADI/TBI Growth)*

Children and Families

- $31,000 in TANF (temporary assistance for needy families) to exclude from the requirement that $50 of a housing subsidy be counted as income for Minnesota Family Investment Program (MFIP) cases that include a grandparent or other relative caregiver who receives federal Supplemental Security Income (SSI). This change would cost $30,000 from TANF in FY 2006 and in FY 2007. *(HS – 30 MFIP, Housing Subsidy)*

- $63,000 in savings to TANF for considering a proportional share of all income received on behalf of a child who is excluded from MFIP assistance due to the family cap when determining the MFIP benefit, and from excluding months during which a family received Diversionary Work Program benefits from the ten-month grace period for the MFIP family cap. The savings area estimated to be $23,000 in FY 2006 and $21,000 in FY 2007. *(HS – 31 MFIP Family Cap/Child Support)*

- $1,201,000 of TANF savings by limiting MFIP participants to 12 months of post-secondary education and training. This change is estimated to save $2,326,000 in FY 2006 and $2,269,000 in FY 2007. *(HS – 32 MFIP Education and Training)*

- $1,800,000 in general fund savings by using existing state spending in MFIP Consolidated Fund to leverage additional federal Food Stamp Employment and Training funds. The change is expected to result in $2,000,000 of additional general fund revenue in FY 2006 and in FY 2007. *(HS – 33 Federal Food Stamps)*

- $190,000 in Child Care Development Fund savings by limiting payments for the number or days a child is absent from child care. This change is estimated to save $1.507 million in FY 2006 and $1.811 million in FY 2007. *(HS- 34 Child Care Absent Day Cap)*

- $2.389 in spending of Child Care Development Funds to create a contingency fund to address county funding needs associated with program changes implemented in FY 2004.

Anticipated spending would increase by $2.574 million in FY 2006 and $1.722 in FY 2007. *(HS – 35 Child Care Investments)*

- $46,000 in FY 2005 for expanding housing options available to adults with disabilities by allowing those who are eligible for SSI and who are relocating from a residential care facility to be eligible for the Minnesota Supplemental Aid shelter needy standard. This change will cost $140,000 in FY 2006 and $191,000 in FY 2007. *(HS – 36 Community Living Supplement)*

Department of Health

- $692,000 reduction in the agency budget to reflect a reduction equal to three percent of the agency's operating budget.

- $100,000 transfer of a lead abatement program from the Department of Education.

- $238,000 reduction of revenue and expenditures in FY 2004 and $40,000 reduction of revenues and expenditures in FY 2005 to reflect changes in the agreement with the U.S Nuclear Regulatory Commission for the Department of Health to assume regulatory authority over radioactive materials. These changes are in the state government special revenue fund.

Veterans Home Board

$90,000 reduction in the agency budget to reflect a reduction equal to three percent of the agency's operating budget.

For more information, contact Katherine Schill at 651-296-5384 or Katherine.schill@house.mn.

Judiciary Policy and Finance

The Governor's supplemental budget recommends general fund spending of $155,000 for FY 2004, $18.565 million for FY 2005 and $34.283 million for FY 2006-07 in the criminal justice area. There are also revenue adjustments of $508,000 in FY 2004, $271,000 in FY 2005 and $830,000 in FY2006-07.

Judiciary Finance - Governor's General Fund Recommendations
(Dollars in thousands)

	FY 2004	FY 2005	FY 04-05	FY 2006	FY 2007	FY 06-07
General Fund Expenditure Changes						
District Courts		455	**455**	504	504	**1,008**
Board of Judicial Standards	155		**155**			**0**
Public Defense Board		8,232	**8,232**	8,473	8,473	**16,946**
Public Safety		3,129	**3,129**	3,089	3,089	**6,178**
Human Rights		(105)	**(105)**	(105)	(105)	**(210)**
Corrections		6,854	**6,854**	4,898	5,470	**10,368**
subtotal expenditure Changes:	**155**	**18,565**	**18,720**	**16,859**	**17,431**	**34,290**
General Fund Revenue Increases						
Fine/CD Assessment Fees	0	271	**271**	415	415	**830**
Criminal Justice Special Projects Account to GF	**508**		**508**	**0**	**0**	**0**
subtotal revenue changes:	**508**	**271**	**779**	**415**	**415**	**830**
Net General Fund Change:	**(353)**	**18,294**	**17,941**	**16,444**	**17,016**	**33,460**

Department of Corrections

- The Governor recommends funding of $6.854 million for FY 2005, and $10.368 million for FY 2006-07.

- A reduction of $84,000 for the removal of gate money for supervised release violators and short-term offenders. Gate money is the $100 that inmates receive once they leave prison.

- $2.85 million due to the Department exceeding their forecasted numbers for prison beds. They are currently over their forecast by 47 beds in this fiscal year and it is anticipated that they will be over their forecast numbers by 115 in FY 2005.

- $322,000 for an increase in prison beds due to the proposed methamphetamine legislation. The bed impact will be 71 prison beds by FY 2007.
- An increase of one million dollars for inmate treatment programs.

- $162,000 for global positioning for level three sex offenders.

- $1.8 million for increased intensive supervised release for level 3 sex offenders. This recommendation will fund 18 probation agents.

- $335,000 for the additional costs of referring all level 3 sex offenders for civil commitment. This recommendation funds 5 new positions.

- $190,000 for the increase in revocation hearings for sex offenders. This recommendation funds three new positions.

- $69,000 is for the increase efforts to capture fugitive sex offenders. This recommendation funds one position.

- $210,000 is for the increase costs in beds and probation for the proposed 0.08 DWI legislation. This recommendation funds prison beds and probation officer positions.

Department of Public Safety

The Governor recommends funding of $3.1 million for FY 2005 and $6.2 million for FY 2006-07.

- $283,000 for the state fire marshal division to carry out the motel, hotel, and resort inspections. The Governor is also recommending repeal of the exemption for small hotels and resorts and charging them at a lesser rate than the original proposal that the Department had last year.

- $2.65 million each year for the gang and drug task force. Last year the gang strike force was reduced by $1.5 million, and the Governor now recommends restoring the reduction and combining the gang task force with the drug task force.

- $7,000 for the costs for the proposed 0.08 DWI legislation.

- $1.495 million for increase tracking of sexual predators. This includes money to improve the computer tracking system, eight new scientists for DNA analysis, three special agents and support staff.

- $106,000 each year is to provide a state match in order to access federal funds. This match will bring in $1.06 million in federal Title II Part B Formula grant funds.

- $40,000 for costs to develop, print and distribute written educational publications to retailers and businesses for methamphetamine awareness and education.

- $1.452 reduction as part of the Governor's state budget reduction. This is the three percent reduction in operating costs.

- $508,000 is transferred from the criminal justice special projects account to the general fund.

- Increasing the 911 fee by 10 cents per month. This is the fee charged to each customer for their phone lines.

District Courts

The Governor is recommending an increase of $455,000 for FY 2005 and $1.008 million for FY 2006-07 for the increased costs associated with the proposed 0.08 DWI legislation and for the methamphetamine legislation.

Public Defense Board

- The Governor is recommending $8.232 million for FY 2005 and $16.9 million for FY 2006-07.
- $7.681 million per year to make up the co-pay revenue that the Supreme Court ruled as unconstitutional.
- $145,000 per year for the increase costs due to the proposed 0.08 DWI legislation.
- $200,000 per year for the increase costs associated with the sex offender assessment process for community notification.
- $206,000 per year for the increase costs due to the additional methamphetamine cases.

Board of Judicial Standards

The Governor is recommending a deficiency appropriation of $155,000 in FY 2004 for their increased costs for the proceedings instituted against a judge. This is a one-time appropriation.

Human Rights Department

Their operating budget is reduced by 3 percent. This results in a savings of $105,000 each year beginning in FY 2005.

Implication of the Governor's budget proposals:

Much of the spending increases in the criminal justice area are to pay for the additional costs due to the proposed 0.08 DWI legislation, methamphetamine legislation, and sex offender legislation. In addition, there is a three percent reduction in operating costs for the Department of Public Safety and the Department of Human Rights. The Governor's recommendations also will have a future impact in the next several bienniums (tails) with on-going spending and the increase in prison beds.

For additional information on Judiciary Finance issues, contact Gary Karger at 296-4181 or gary.karger@house.mn

Environment and Natural Resources

The Governor is recommending changes in expenditure and revenue that result in a net General Fund reduction of $3.8 million for the Environment and Natural Resources Finance area in FY 2004-05. Recommended expenditure and revenue changes result in a net General Fund reduction for FY 2006-07 of $6.0 million.

Environment: Governor's Recommended General Fund Change
(dollars in thousands)

	FY 2004	FY 2005	FY 04-05	FY 2006	FY 2007	FY 06-07
Base	$177,610	$171,543	$349,153	$171,983	$176,120	$348,103
Governor's Recommendation	$0	($3,008)	($3,008)	($3,008)	($3,008)	($6,016)
% Change	na	-1.75%	-.86%	-1.75%	-1.71%	-1.73%

Pollution Control Agency

The Governor is recommending total General Fund expenditure reductions of $281,000 in FY 2004-05, and $562,000 in FY 2006-07 for the Pollution Control Agency. The chart below indicates the changes requested by the Governor.

Pollution Control Agency: Governor's General Fund Changes in Detail
(dollars in thousands)

	FY 2004	FY 2005	FY 04-05	FY 2006	FY 2007	FY 06-07
Base	$15,791	$14,715	$30,506	$14,715	$14,715	$29,430
Governor's Recommendation	$0	($281)	($281)	($281)	($281)	($562)
Percent Change	na	-1.91%	-.92%	-1.91%	-1.91%	-1.91%

The Governor's supplemental budget requests that the General Fund appropriation to the Pollution Control Agency be reduced by three percent of the operating budget. No specific recommendation is made as to which activities or programs should be reduced.

Office of Environmental Assistance

The Governor is recommending total General Fund expenditure reductions of $132,000 in FY 2004-05, and $264,000 in FY 2006-07 for the Office of Environmental Assistance. The chart on the following page indicates the changes requested by the Governor.

Office of Environmental Assistance: Governor's General Fund Changes in Detail *(dollars in thousands)*	**FY 2004**	**FY 2005**	**FY 04-05**	**FY 2006**	**FY 2007**	**FY 06-07**
Base	$11,847	$11,721	$23,568	$11,760	$11,760	$23,520
Governor's Recommendation	$0	($132)	($132)	($132)	($132)	($264)
% Change	na	-1.13%	-.56%	-1.12%	-1.12%	-1.12%

The Governor's supplemental budget requests that the General Fund appropriation to the Office of Environmental Assistance be reduced by three percent of the operating budget. No specific recommendation is made as to which activities or programs should be reduced.

Minnesota Zoological Gardens

The Governor is recommending total General Fund expenditure reductions of $197,000 in FY 2004-05, and $394,000 in FY 2006-07 for the Minnesota Zoo. The chart below indicates the changes requested by the Governor.

MN Zoological Gardens: Governor's General Fund Changes in Detail *(dollars in thousands)*	**FY 2004**	**FY 2005**	**FY 04-05**	**FY 2006**	**FY 2007**	**FY 06-07**
Base	$6,557	$6,422	$12,979	$6,557	$6,557	$13,114
Governor's Recommendation	$0	($197)	($197)	($197)	($197)	($394)
% Change	na	-3.07%	-1.52%	-3.0%	-3.0%	-3.0%

The Governor's supplemental budget requests that the General Fund appropriation to the Minnesota Zoo be reduced by three percent of the operating budget. No specific recommendation is made as to which activities or programs should be reduced.

Department of Natural Resources (DNR)

The Governor is recommending total General Fund expenditure reductions of $2,266,000 in FY 2004-05, and $4,532,000 in FY 2006-07 for the DNR (excluding a forestry fund switch recommendation). The chart below indicates the changes requested by the Governor.

Dept. of Natural Resources: Governor's General Fund Changes in Detail *(dollars in thousands)*	**FY 2004**	**FY 2005**	**FY 04-05**	**FY 2006**	**FY 2007**	**FY 06-07**
Base	$126,802	$122,154	$248,956	$122,420	$126,557	$248,977
Governor's Recommendation	$0	($2,266)	($2,266)	($2,266)	($2,266)	($4,532)
% Change	na	-1.86%	-.91%	-1.85%	-1.79%	-1.82%

The Governor's supplemental budget requests that the General Fund appropriation to the DNR be reduced by three percent of the operating budget. No specific recommendation is made as to which activities or programs should be reduced.

- The Governor requests the establishment of authority for the DNR to issue administrative penalty orders for violations of rules and laws governing natural resources. These penalty orders are estimated to increase revenue to the General Fund by $5,000 in each year beginning with fiscal year 2005.

- The request includes an increased appropriation of $50,000 in FY 2005 from the Permanent School Trust Fund forest suspense account for acceleration of aggregate evaluations on school trust fund land. The initiative forecasts increased revenue to the trust fund beginning in FY 2006.

- The Governor recommends establishment of a dedicated forest management investment account for deposit of certain timber sale receipts. The funds would be appropriated for use by the DNR in forestry activity.

Board of Water and Soil Resources (BWSR)

The Governor is recommending total General Fund expenditure reductions of $127,000 in FY 2004-05, and $254,000 in FY 2006-07 for BWSR. The chart below indicates the changes requested by the Governor.

BWSR: Governor's General Fund Changes in Detail
(dollars in thousands)

	FY 2004	**FY 2005**	**FY 04-05**	**FY 2006**	**FY 2007**	**FY 06-07**
Base	$15,513	$15,431	$30,944	$15,431	$15431	$30,862
Governor's Recommendation	0	($127)	($127)	($127)	($127)	($254)
% Change	na	-.82%	-.41%	-.82%	-.82%	-.82%

The Governor's supplemental budget requests that the General Fund appropriation to the Board of Water and Soil Resources be reduced by three percent of the operating budget. No specific recommendation is made as to which activities or programs should be reduced.

For additional information on environment finance issues, contact Jim Reinholdz, Fiscal Analyst, at 651-296-4281 or <u>Jim.Reinholdz@house.mn</u>

Agriculture and Rural Development Finance

The Governor is recommending changes in expenditure and revenue that result in a net General Fund reduction of $381,000 for the Agriculture Finance area in FY 2004-05. Recommended expenditure and revenue changes result in a net general fund reduction for FY 2006-07 of $762,000.

Agriculture Finance: Governor's Recommended General Fund Change
(dollars in thousands)

	FY 2004	FY 2005	FY 04-05	FY 2006	FY 2007	FY 06-07
Base	$46,332	$44,584	$90,916	$41,913	$38,438	$80,351
Governor's change	$0	($381)	($381)	($381)	($381)	($762)
% Reduction	na	-.85%	-.42%	-.91%	-.99%	-.95%

Minnesota Department of Agriculture (MDA)

The Governor is recommending total General Fund expenditure reductions of $300,000 in FY 2004-05, and $606,000 in FY 2006-07 for the Department of Agriculture. The chart below indicates the changes requested by the Governor.

Department of Agriculture: Governor's General Fund Changes in Detail
(dollars in thousands)

Program	FY 2004	FY 2005	FY 04-05	FY2006	FY2007	FY 06-07
3% Operating Budget Reduction	0	($497)	($497)	($497)	($497)	($994)
Gypsy Moth Program increase	0	$200	$200	$200	$200	$400
Total	**0**	**($297)**	**($297)**	**($297)**	**($297)**	**($594)**

Specific General Fund changes in the budget of the Department of Agriculture include the following for FY 2005.

- A reduction of $497,000, which is a three percent reduction in the agency General Fund operating budget. The agency proposes using current vacancy and salary saving where possible to meet this reduction.

- Expanded treatment of start-up gypsy moth populations and expanded annual trappings is recommended. The requested increase in appropriations is $200,000.

In addition to the above General Fund changes the Governor's supplemental budget requests changes to non-general fund items for FY 2005 as listed below.

- A $10,000 increase in appropriations for inspection of produce grown outside of the state. The inspections are part of a federal agreement and will have a corresponding increase in revenue.

- An increase in appropriations of $4,000 to provide scale testing services at export locations in the state. The increased in appropriations will be matched by an increase in revenue from fees charged for the inspections.

- Plant protection and export certification appropriations are requested to be increased by $9,000. It will be funded from an equal increase in expected revenue under the program.

- The appropriation for grain inspection activity is requested to be increased by $54,000.There is a corresponding increase in estimated revenue generated by increasing the fees charged for program activities.

Board of Animal Health

The Governor is recommending total General Fund expenditure reductions at the Board of Animal Health of $84,000 in FY 2004-05, and $168,000 in FY 2006-07.

Board of Animal Health: **Governor's General Fund Changes in Detail**
(dollars in thousands)

	FY 2004	FY 2005	FY 04-05	FY2006	FY2007	FY 06-07
3% Operating Budget Reduction	$0	($84)	**($84)**	($84)	($84)	**($168)**

The Governor's supplemental budget requests that the General Fund appropriation to the Board be reduced by three percent of the operating budget. No specific recommendation is made as to which activities or programs of the Board should be reduced.

For additional information on agriculture finance issues, contact Jim Reinholdz, Fiscal Analyst, at 651-296-4281 or Jim.Reinholdz@house.mn

Jobs & Economic Development

The Governor's 2004 supplemental budget recommendations would have a net General Fund impact of a positive $7.817 million in the FY 2004-05 Biennium. Agencies' General Fund spending would be reduced by $2.072 million. New General Fund revenues would increase by $5.745 million. The 2006-07 General Fund impact would be a positive $4.186 million.

Jobs & Economic Development - Governor's Recommendations
(Dollars in thousands)

	FY 2004	FY 2005	FY 04-05	FY 2006	FY 2007	FY 06-07
General Fund Expenditure Changes						
Agency Operating Budget Reductions		(1,026)	**(1,026)**	(1,026)	(1,026)	**(2,052)**
Agency Program Reductions		(1,396)	**(1,396)**	(1,396)	(1,396)	**(2,792)**
Project Innovation -- Small Business Innovation Research Grants		100	**100**	100	100	**200**
Methamphetamine Enforcement & Awareness		250	**250**	250	250	**500**
subtotal expenditure Changes:		**(2,072)**	**(2,072)**	**(2,072)**	**(2,072)**	**(4,144)**
General Fund Revenue Increases						
Minerals 21st Century Fund Transfer		5,724	**5,724**			
Certificate of Authority to Sell Insurance Fee		18	**18**	18	18	**36**
Appraiser License Fee		3	**3**	3	3	**6**
subtotal revenue changes:		5,742	**5,742**	21	21	**42**
Net General Fund Change:		**(7,814)**	**(7,814)**	**(2,093)**	**(2,093)**	**(4,186)**

Department of Employment & Economic Development

The Department's General Fund overall budget would be reduced by $224,000 in FY 2005 under the Governor's proposed budget.

- $594,000 is a reduction in the DEED's operating budget. The operating budget can best be described as the Department's administrative overhead including salaries and benefits, rents, travel, equipment and supplies, etc. The reduction is three percent of the Department's operating budget.
- $100,000 is new funding for Small Business Innovation Research Grants. This program is part of the Governor's bioscience initiative. The money will be used to match federal funds from the Small Business Administration.
- $250,000 is for creating a new Methamphetamine Cleanup Revolving Loan Program. The program, which will be admninistered by the Public Facilities Authority, will make loans to local governments.

The Governor also proposes to double (increase by $1 million) the tax credit amount that can be issued by the Department to qualifying business under the appropriation for biotechnology and health sciences industry tax-free zones. This initiative is discussed in more detail in the Taxes section.

The Minnesota Investment Fund would receive an annual increase of $400,000 under the Governor's supplemental budget. The money would come from changing current law so that more loan repayments go the statewide fund administered by DEED. Local governments will retain fewer repayments. Current law allows local governments to retain $100,000 of repayments from a MIF award. The proposed change would limit the amount retained locally to 20% of the award, not to exceed $100,000.

State Independent Living programs would receive additional funding under another of the Governor's proposals. The money would come from leveraging additional federal dollars. The federal government matches every $1 in state vocational rehabilitation funding with $3.68. The proposal would transfer $1.35 million from the Centers for Independent Living (CILS) General Fund appropriations to the Vocational Rehabilitation (VR) program. VR would use Social Security Administration funding to immediately repay the $1.35 million. The bottom line would be $1.35 million in additional state VR dollars that could be used to match up to $4.876 million. The CILS would receive 50% of the additional federal match. The best-case scenario would be an additional $2.438 million per year. The remaining 50% would go to the State Vocational Rehabilitation (VR) program.

The Governor proposes to transfer $5.724 million from the Minerals 21st Century Fund to the General Fund. The transferred amount is one-half of the Fund's estimated unobligated balance on June 30, 2004.

Minnesota Housing Finance

The Governor recommends a General Fund reduction in MHFA's FY 2005 budget of $628,000. The proposed reduction is 1.8 percent of the Agency's fiscal year total general fund appropriation. Details are not available on how this reduction will be spread across the various housing programs.

Department of Commerce

The Department's FY 2005 budget would be reduced by $447,000 under the Governor's recommendations.

- $347,000 reduction in the Department's operating budget. The reduction is three percent of the Department's operating budget. Traditionally, any savings realized from reductions in Commerce's budget are partially offset by revenue losses owning to the agency's cost recovery charge backs. The Governor's budget does not include any anticipated revenue losses.
- $100,000 reduction in the administrative cost of the Contractor's Recovery Fund program. Beginning in FY 2005, the programs administrative costs will be paid for by the Recovery Fund and not with General Fund dollars. The reallocation will result in a General Fund savings.

The Governor also recommends that the Department's Insurance Fraud Division receive a $1.5 million appropriation in FY 2005 from the Special Revenue Fund. This initiative will be funded through increased fees paid by the insurance industry. The Insurance Fraud Division was created by the Legislature in 2002.

The Governor's budget also includes two additional fee changes that together are expected to yield $21,000 for the General Fund in FY 2005.

- The Certificate of Authority to sell insurance in Minnesota would have a $1,500 filling fee. This is a new fee and would only apply to new companies seeking to sell insurance in the state and not current companies.
- The Appraiser License fee for a first-time appraiser would be a flat $150 no matter when in the year the license is issued. Currently the fee is prorated.

Department of Labor & Industry

The Governor is recommending the department's operating budget be reduced by $85,000 in FY 2005. The reduction is three percent of the Department's operating budget. Details are not available on how this reduction will be implemented.

Minnesota Historical Society

The Governor recommends that the General Fund appropriation to the Minnesota Historical Society be reduced by $668,000. The reduction is three percent of the Historical Society's total General Fund appropriation for FY 2005. Details were not included in the Governor's budget on how the proposed budget cuts would be implemented.

For additional information on Jobs & Economic Development committee issues, contact Ron Soderberg at 296-4162, or ron.soderberg@house.mn

State Government Finance

The Governor is recommending a net General Fund reduction of $10.9 million for the State Government Finance area in FY 2004-05. This net amount includes $9.6 million in reduced expenditures, and $1.3 million in new revenues. Recommended expenditure reductions for FY 2006-07 total $4.5 million, with a permanent increase in revenues of $46,000 each year.

State Government - Governor's Recommendations
(Dollars in thousands)

	FY 2004	FY 2005	FY 04-05	FY 2006	FY 2007	FY 06-07
General Fund Expenditure Changes						
Legislative Carryforward Cancellation	(7,000)	0	(7,000)	0	0	0
Agency Operating Budget Reductions	(456)	(3,991)	(4,407)	(3,991)	(3,991)	(7,982)
Attorney General: Lower DWI to .08, Add'l Staff Costs	0	275	275	300	300	600
National Guard Mid-Career Re-enlistment Bonus	0	1,500	1,500	1,500	1,500	3,000
Severance Costs For Ombudsmen for Corrections	40	0	0	0	0	0
subtotal expenditure Changes:	**(7,416)**	**(2,216)**	**(9,632)**	**(2,191)**	**(2,191)**	**(4,474)**
General Fund Revenue Increases						
Attorney General: .08 increased revenues	0	42	42	46	46	92
Lottery: Unclaimed prizes transfer	0	1,260	1,260	0	0	0
subtotal revenue changes:	0	1,302	1,302	46	46	92
Net General Fund Change:	**(7,416)**	**(3,518)**	**(10,934)**	**(2,237)**	**(2,237)**	**(4,474)**

Legislature: *$7 million cancellation to legislative carryforward*
The Governor is proposing a one-time cancellation of 50 percent, or $7 million, of the bodies' carry-forward balances[1] at the end of FY 2003. The total legislative carry-forward balance at the end of FY 2003 was $13.9 million. However, actual carry-forward balances as of March 2004 were $12.5 million because the House, Senate and LCC have expended portions of their balances.

[1] MN Statute 16A.281 permits the legislature to carry-forward balances between bienniums for three specific purposes: Special session and public outreach activities, severance costs, and one-time investments that "enhance efficiency and improve effectiveness." This general carry-forward authority is unique to the legislature; appropriations to state agencies, the courts and constitutional offices cancel at the end of each biennium unless specific authority to carry-forward an appropriation in authorized in law.

Constitutional Offices

The Governor is recommending a 3 percent reduction to the base budgets of all constitutional officers, beginning in FY 2005. In addition, the Governor is recommending $275,000 in new funding for the Attorney General's costs associated with implementation of the .08 DWI law.

Constitutional Offices: General Fund Changes
(dollars in thousands)

Office	**FY 05 Change**
Governor's Office	(108)
State Auditor	(249)
Attorney General	(677)
Attorney General: .08 Staff Costs	275
Secretary of State	(181)
Total Change:	**(940)**

Governor's Office: Base reduction of $108,000. This reduction would leave the department with an operating budget of $16.6 million for the biennium. The office will implement the reduction by evaluating staffing options, using employee leaves for salary savings, holding vacancies open, and reducing other operating expenses where possible.

Office of the Attorney General*:* Base reduction of $677,000. The Attorney General has estimated that this reduction would result in the elimination of 3 to 4 attorneys, and 1-2 legal assistants.

The Governor is also recommending $275,000 in new funding to cover the Attorney General's anticipated costs for implementation of the .08 DWI bill. The AGO has requested funding for 2 additional attorneys to handle an anticipated increase in implied consent hearings.

The net impact of these recommendations would be a reduction of $400,000, leaving the office with an operating budget of $47.9 million for the current biennium.

Secretary of State: Base reduction of $181,000, reducing the office's biennial operating budget to $12.1 million. The office has stated that due to the federal maintenance of effort requirements of the Help America Vote Act (HAVA), no reductions can be made to the elections division of the office. The office also suggests that one option for implementing the reduction would be to eliminate the office's handling of paper UCC filings, thus encouraging more use of online filings, and reducing labor costs. Any remaining paper filings would be re-directed to county satellite offices.

State Auditor: Base reduction of $249,000, reducing the office's biennial operating budget to $16.5 million. The office has raised the issue that further cuts to the Audit Practice division will be accompanied by a loss of General Fund revenues (since the office bills local governments for the costs of this program), resulting in no net gain to the General Fund.

State Agencies

The Governor is also recommending a 3 percent reduction to the base operating budgets of cabinet level state agencies.

State Agencies: General Fund Changes
(dollars in thousands)

Agency	**FY 04**	**FY 05**
Administration	0	(432)
Finance	(456)	(456)
Finance Non-Operating: Severance Costs for Ombudsman for Corrections	40	0
Employee Relations	0	(186)
Revenue*	0	(1,402)
Military Affairs	0	(222)
Military Affairs: Mid-Career Bonus	0	1,500
Veterans Affairs	0	(78)
Total Change:	**(416)**	**(1,276)**

**Dept. of Revenue reduction is 1.5 percent rather than 3%, because of its revenue generating functions.*

Department of Administration: Base reduction of $432,000, beginning in FY 2005. The department's new General Fund operating budget would be $12.3 million for the biennium. The department is still developing its plans to implement a reduction.

Department of Employee Relations: Base reduction of $186,000, reducing the department's General Fund operating budget to $12.1 million for the biennium. The department proposes to achieve this reduction through the elimination of two currently vacant positions ($130,000), reduction in postage costs ($20,000) and reduction in technical upgrades to internal technology services ($30,000).

Department of Finance: Base reduction of $456,000 beginning in FY 2004. This reduction would leave the department with an operating budget of $31.7 million for the current biennium. The department plans to implement this reduction by continuing to hold two positions vacant, and by eliminating contingency funds in the technology services program.

Department of Revenue: 1.5 percent reduction, or $1.4 million. The department's remaining General Fund operating budget would be $180.9 million for the biennium. The recommended reduction is only 1.5 percent, because it has only been applied to the non-revenue generating programs at the department.

Military Affairs: Base reduction of $222,000, beginning in FY 2005. This reduction would leave the department with an operating base of $16.6 million for the biennium (excluding the enlistment incentives program). The agency has not yet determined how it will implement the 3% reduction. The Governor is also recommending $1.5 million in new spending for a new mid-career reenlistment program. This program would provide reenlistment bonuses of $1,000 per year, for up to 5 years, or $5,000 per individual.

Note: The Governor is also recommending an income tax exemption for National Guard members for their state active duty pay. This initiative is discussed in the Tax section.

Department of Veterans Affairs: Reduction of $78,000, beginning in FY 2005. The department's remaining General Fund operating budget would be $8.97 million for the biennium Department officials will be meeting with County Veterans Service Officers to seek input on where reductions should occur.

State Lottery: The Governor is recommending transfer of the $2.1 million of the remaining balances in the unclaimed Lottery prize account. Sixty percent, or $1.26 million, of the balance would be transferred to the General Fund. The remaining $840,000 would be directed to the Environmental Trust Fund. Approximately $200,000 will remain in the account to pay winners in the "Powerball Game Show."

This recommendation is an outcome of the February 2004 Legislative Auditor's report on state lottery operations. That report recommended that the Legislature prohibit the Lottery from spending unclaimed prize money on any additional lottery games. The auditor found that Lottery's use of unclaimed prize money has not been productive in increasing lottery profits.

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

Transportation

Governor Pawlenty's recommendations for Transportation did not include any specific provisions other than the recommended 3% across the board agency operating cut. Because the Department of Public Safety's transportation related functions and the Department of Transportation have little general fund money, impact will be minimal. Impact will be greater on Metropolitan Council Transit, which relies heavily on general fund dollars. The Metropolitan council may be able to make up some of the cuts on strike savings depending on the agreement reached with the transit union.

The general fund reductions proposed equal $118,000 for transportation related programs in Public Safety, $15,000 for MN/DOT, and $1.737 million for the Metropolitan Council.

Transportation: Governor's General Fund Recommendations
(dollars in thousands)

Agency	Reduction
Dept. of Public Safety	-118
Dept. of Transportation	-15
Metropolitan Council Transit	-1,737
Total:	**-1,870**

If you have any questions regarding this or other Transportation issues, contact John Walz at (651) 296-8236 or john.walz@house.mn

Taxes & Local Aids And Credits

To help eliminate the projected budget shortfall for the current biennium, the Governor recommends increasing general fund tax revenues by $46.7 million and making tax policy changes that would reduce departmental expenditures by $24 thousand. For FY 2006-07, the Governor's proposals would increase general fund revenues by $17.5 million and reduce expenditures by $1.1 million.

General fund revenue increases for FY 2004-05 would come mostly from accelerating sales tax payments on leased cars ($35.6 million). Replacing the sales tax on cigarettes with a gross receipts tax would accelerate tax collections ($7 million one-time shift) as well as increase compliance (a permanent increase of $3.5 million each year).

The Governor proposes three tax changes that reduce revenue. First, he proposes to change corporate apportionment rules, phasing in 100 percent sales apportionment over eight years to promote economic development (reducing revenue by $1.9 million in the current biennium and $19.75 million in FY 2006-07). Second, the Governor proposes an income tax exemption for certain National Guard income. Third, he recommends increasing the FY 2004-05 limit on total benefits to businesses located in the Bioscience Zone by $1 million. By FY 2007 the cost of these new initiatives would exceed the tax revenue his other proposals would raise.

Proposed general fund expenditure reductions include a change in the market value credit ($1million in FY 2006-07) and administrative changes that reduce departmental costs. The Governor also proposes to transfer $350 million from the general fund Budget Reserve to the Cash Flow Account.

Changes in General Fund Tax Revenues

Table 1 summarizes the impact of the proposed changes in general fund revenues.

Table 1
Changes in General Fund Tax Revenues
(*Dollars in thousands*[1])

	Effec. Date	FY 2004	FY2005	FY 04-05 Biennium	FY 2006	FY 2007	FY 06-07 Biennium
Individual Income Tax							
Exempt National Guard active duty pay (in-state)	1/1/04	**$0**	**$(42)**	**$(42)**	**$(42)**	**$(42)**	**$(84)**
Corporate Franchise Tax							
Phase-in 100% sales apportionment over 8 years	1/1/05	$0	$(1,900)	**$(1,900)**	$(8,700)	$(15,200)	**$(23,900)**
Limit applicability of Foreign Operating Corp. (FOC) rules	1/1/04	0	1,300	**1,300**	975	650	**1,625**
Total:		**$0**	**$(600)**	**$(600)**	**$(7,725)**	**$(14,550)**	**$(22,275)**

[1]*Negative numbers represent a cost to the state and positive numbers represent a gain to the state.*

Table 1 is continued on following page.

Table 1 (continued)

Changes in General Fund Tax Revenues

(*Dollars in thousands*[1])

	Effec. Date	FY 2004	FY2005	FY 04-05 Biennium	FY 2006	FY 2007	FY 06-07 Biennium
Sales & Use Taxes							
Up-front payment of tax on car and small truck leases	7/1/04	$0	$35,600	**$35,600**	$18,500	$1,250	**$19,750**
Collect sales tax on cigarettes from distributors	8/1/04	0	10,500	**10,500**	3,500	3,500	**7,000**
Industrial production defined to exclude natural gas pipelines	7/1/04	0	1,600	**1,600**	3,200	3,200	**6,400**
Remote sellers must collect MN sales tax to do business with State of Minnesota	1/1/05	0	650	**650**	2,600	4,150	**6,750**
Total Sales & Use Tax:		**$0**	**$48,350**	**$48,350**	**$27,800**	**$12,100**	**$39,900**
Tax Free Zones							
Increase Bioscience Zone cap on benefits	7/1/04	$0	$(1,000)	$(1,000)	$0[2]	$0[2]	$0[2]
TOTAL: All Taxes		**$0**	**$46,708**	**$46,708**	**$20,033**	**$(2,492)**	**$17,541**

[1] *Negative numbers represent a cost to the state and positive numbers represent a gain to the state.*
[2] *Initial budget documents showed $1 million in FY 2006 and FY 2007 as well, but this did not match the intent or bill language.*

Tax Revenues

Individual Income Tax

Exempt National Guard income for active duty in Minnesota: The Governor proposes to allow a subtraction for National Guard pay earned when called to active duty in Minnesota. This would include service when called up by either the Governor ("state active service") or the President ("federally funded state active service" such as recent airport security).

> Under current law, Minnesota residents on active duty *outside* Minnesota (National Guard, reserves, or other military personnel) are treated as nonresidents for tax purposes. This effectively exempts their active duty pay from tax. In contrast, active duty pay of Minnesota residents on active duty *inside* Minnesota is now fully taxable. Federal law prohibits Minnesota from taxing *nonresidents* on pay received by U.S. armed forces personnel who are nonresidents and on active duty in Minnesota.

Phase-in 100% sales apportionment over eight years: Multi-state corporations pay tax based on the share of their total income that is apportioned to Minnesota. Under current law, Minnesota's share of that income is calculated as a weighted average of the share of the corporation's total sales that are located in Minnesota (75 percent), the share of its total property that is located in Minnesota (12.5 percent), and the share of its total payroll that is paid in Minnesota (12.5 percent).

The proposal would increase the importance of the sales factor from 75 percent to 100 percent, over eight years, as shown below.[2]

Tax year	Apportionment Factors (percent)		
	Sales	Property	Payroll
2005	78%	11.0%	11.0%
2006	81%	9.5%	9.5%
2007	84%	8.0%	8.0%
2008	87%	6.5%	6.5%
2009	90%	5.0%	5.0%
2010	93%	3.5%	3.5%
2011	96%	2.0%	2.0%
2012	100%	--	--

The proposed change would reduce a corporation's tax liability if Minnesota's share of its production (property and payroll) exceeds Minnesota's share of its sales. Conversely, the proposal would increase a corporation's tax liability if Minnesota's share of sales exceeds Minnesota's share of its production. Corporations with all their sales, property, and payroll in Minnesota would see no change in their tax liability.

When fully phased in, this proposal would reduce corporate tax revenues by about $45 million per year.

Winners and Losers: The proposal would reduce taxes for 4500 corporations while increasing taxes for 6500 corporations. If 100% sales apportionment were in effect in 2004, those 4500 corporations would pay $85 million less tax. This tax reduction would be partially offset by a tax increase totaling $42 million for 6500 corporations. Some of the tax changes are large. It is estimated that 130 corporations would see tax cuts exceeding $100 thousand (an average of $500 thousand each), while 80 corporations would see tax increases exceeding $100 thousand (an average of $200 thousand each).

Those with large tax cuts would include manufacturing firms whose production facilities are concentrated in Minnesota but who sell in national markets. Those with large tax increases would include manufacturing firms with significant sales in Minnesota but negligible production facilities here. Single sales apportionment increases the incentive to locate production facilities in Minnesota.

Every year about 50,000 corporations file tax returns, and 39,000 of them would see no change in tax. These include many who have all their payroll, property and sales in Minnesota, along with others who have zero taxable income.

Limit applicability of Foreign Operating Corporation rules: Minnesota law defines a special

[2] The apportionment formula used for occupation taxes on taconite and other mining would remain unchanged at 75 percent sales, 12.5 percent payroll, and 12.5 percent property.

category of corporations – foreign operating corporations (FOC) – that qualify for special tax treatment. Generally, these corporations are domestic corporations with less than 20 percent of their property and payroll in the US. The special tax treatment (foreign royalties subtraction and dividends received deduction) can result in 80 percent of their income being exempt from taxation.

These tax rules were enacted in the late 1980s, at the time Minnesota adopted a unitary business combined reporting method for taxing corporate income. It was argued that these provisions were necessary to offset the heavy taxation of foreign operations that would otherwise occur using the combined reporting method.

The Governor's proposals aim to ensure that an FOC's foreign operations have economic substance and are not just a guise to shift profits into a nontaxable shell or form. The proposal would require an FOC to have at least $2 million in total property and $1 million in total payroll, with *either* 80 percent of its property *or* 80 percent of its payroll outside the United States.[3] This limitation would raise an estimated $1.3 million in the current biennium (in FY 2005), but the estimated gain declines in future years.[4]

Sales and Use Taxes

Require up-front payment of sales tax on car and truck leases:[5] Under current law, a consumer who leases a motor vehicle pays sales tax on each lease payment. The proposal would require that the tax on lease payments all be paid at the time the lease is signed. Although total tax liability would not change, the tax would be paid earlier.[6] Unless the leasing company accepts a lower profit, either the down payment or the monthly lease payment would increase.

This tax shift would raise revenue by $35.6 million in FY 2005, $18.5 million in FY 2006, and $1.25 million in FY 2007. There would also be a small revenue increase in later years due to the growth in lease payments.

At least 16 states currently sales tax on car leases to be paid up front, either by the lessor or the lessee. These include three neighboring states (Iowa, North Dakota, and South Dakota).

Collect sales tax on cigarettes from distributors: Under current law, cigarettes are subject to sales

[3] In addition, a corporation qualifying under IRS Code section 936 (generally located in Puerto Rico) automatically qualifies.

[4] The Department of Revenue's *2004 Tax Expenditure Budget* estimates that the FOC provisions benefit about 2000 corporations, reducing taxes by $70 to $75 million per year. The Governor's proposal is largely in response to the decision in the *Hutchinson Technology* case, which allowed a corporation with no property or payroll to obtain FOC status. The decline in estimated revenue in the 2006 and 2007 reflects the Revenue Department's belief that corporations will be successful in adapting to the new rules, thus reducing their impact.

[5] Although some descriptions of the proposal claimed that the proposal applied only to automobiles and "small" trucks, both bill language and the revenue estimate show it applying to *all* trucks.

[6] Total tax paid by an individual taxpayer would increase if the lease were terminated early, because the proposal does not allow a refund of taxes paid on the remaining lease payments.

tax at the retail level. The proposal would exempt cigarettes from the sales tax and levy a gross receipts tax levied at the wholesale level. The tax would be paid earlier – at the time the wholesaler receives the product rather than at the time of the retail sale. This speedup in the timing of the tax would yield $7 million in one-time revenue in FY 2005. Collecting the tax at the distributor level is also expected to increase compliance, because tax would be collected from about 75 distributors rather than thousands of retail outlets. Increased compliance is estimated to increase tax collections by $3.5 million per year, starting in FY 2005.[7]

Impact on local sales tax revenue: Because the sales tax on cigarettes is repealed, local sales taxes (where they exist) would no longer be collected on cigarettes. Local governments will lose an estimated $1 million to $1.5 million in tax revenue as a result.

Define industrial production to exclude natural gas pipelines: Under current law, certain types of companies are eligible for a refund of taxes paid on purchases of capital equipment.[8] The Minnesota Supreme Court recently ruled that certain pipeline companies met that definition. The proposal would clarify the definition to make those companies ineligible.

Require remote sellers to collect and remit sales tax in order to do business with the State of Minnesota: Out-of-state companies who have no physical presence in Minnesota cannot be required to pay sales tax on the sales they make to Minnesotans. This includes some companies who sell to the State of Minnesota. The Governor proposes to require any company making sales to the state to collect and remit Minnesota tax on all sales to Minnesotans.

Tax Free Zones

Increase Bioscience Zone cap by $1 million: The Biotechnology and Health Science Zone was created in 2003. Under current law, the tax benefits for qualifying Biotechnology Zone businesses are limited to a total of $1 million and must be claimed in the 2004-05 biennium. Businesses apply to the Department of Employment and Economic Development (DEED) for their share of the maximum $1 million in tax certificates. *Although the zone was authorized for 12 years, no state tax exemptions or credits were authorized beyond the 2004-05 biennium.*[9]

The Governor recommends raising the FY 2004-05 cap from $1 million to $2 million. This is a one-time increase, and no benefits would be authorized after the FY 2004-05 biennium.

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[7] Sales tax revenue will fall, but gross receipts tax revenue would exceed the loss in sales tax revenue. The numbers refer to the *net* change in revenue. The gross receipts tax rate on distributors would be equivalent to the current 6.5 percent sales tax at the retail level. Because retail markups are estimated to average about 12 percent, the 6.5 percent gross receipts tax would be levied on *112 percent* of gross receipts. The proposal also includes a one-time "floor tax" on the stock of cigarettes at the retail level which would be subject to neither sales nor gross receipts tax.

Total cigarette sales tax revenue is about $85 million per year, so increased compliance would raise revenues by about 4 percent.

[8] M.S. 297A.68 limits eligibility to capital equipment purchased used "primarily for manufacturing, fabricating, mining, or refining tangible personal property."

[9] This differs from the JOBZ zones, which were also authorized for 12 years but which have an open appropriation to cover the cost of the tax benefits over the life of the zones.

Changes in General Fund Expenditures

Table 2
Changes in General Fund Expenditures
(Dollars in thousands) [1]

	FY 2004	FY 2005	FY 2004-05	FY 2006	FY 2007	FY 2006-07
Property Tax Aids & Credits						
Fractional homestead market value credit correction	$0	$ 0	$ 0	$(500)	$(500)	$(1,000)
Sub-total aid & credit expenditure reductions:	**$0**	**$0**	**$0**	**$(500)**	**$(500)**	**$(1,000)**
Other Expenditures [2]						
Administer new National Guard pay subtraction (income tax)	0	25	25	0	0	0
Require electronic filing for partner-ship returns when federally mandated	0	(43)	(43)	(43)	(43)	(86)
Create threshold for separation of liability allocations	0	(4)	(4)	(4)	(4)	(8)
Lower E-pay threshold for all business tax types except petroleum	0	(2)	(2)	(5)	(5)	(10)
Sub-total other expenditure reductions:	**$0**	**$(24)**	**$(24)**	**$(52)**	**$(52)**	**$(104)**
TOTAL SPENDING CHANGES	**$0**	**$(24)**	**$(24)**	**$(552)**	**$(552)**	**$(1,104)**
Transfer $350 Budget Reserve to Cash Flow Account (net impact)	**$0**	**$0**	**$0**	**$0**	**$0**	**$0**

[1]***Negative numbers represent expenditure reductions (budget savings) and positive numbers represent expenditure increases.***

[2]***Other expenditures include administrative savings to the Department of Revenue operating budget.***

Expenditures

Property Tax Aids & Credits

Change Market Value Credit calculation for fractional homesteads: The Governor's supplemental budget amends the calculation of the Market Value Homestead Credit for fractional homesteads (i.e., homestead property where at least one owner does not reside on the premises) for the purposes of computing the credit. Prior to the class rate compression in the 2001 property tax reform, the major benefit a fractional homestead received was the classification rate of a homestead property for the portion of the property that was homesteaded. Under current law, homestead and non-homestead properties have the same class rate; therefore the current benefit to fractional homesteads is the market value credit.

The phase-out mechanism on the current calculation of the market value credit decreases the amount of credit a homestead property can receive as the market value increases above $76,000. The credit is calculated on the full market value of a homestead property, whereas for a fractional homestead, the credit is calculated on the fraction of the property's market value that is homesteaded. This results in fractional homesteads receiving a higher credit amount and therefore a lower net tax than a full homestead due to the phase-out mechanism. The Governor's recommendation amends the calculation of the credit so that a fractional homestead's credit is calculated as if the entire property was homestead and then the amount of the credit is multiplied by the fraction of the property that is homesteaded. (See example calculation below in Table 3.)

Table 3

Example of Homestead vs. Fractional Homestead Current Law and Correction

Property Type:	**Homestead (Full)**	**Fractional Hmstd (50/50-NonHmstd)**	**Fractional Homestead *Correction***
A. Market Value	$200,000	$200,000 ($100,000 Hmstd/ $100,000 Non-Hmstd)	$200,000 ($100,000 Hmstd/ $100,000 Non-Hmstd)
B. Class Rate	1.0	1.0/1.0	1.0/1.0
C. Net Tax Capacity (A x B)	$2,000	$2,000	$2,000
D. Total Local Tax Rate (sum of all tax rates for each jurisdiction authorized to levy on property)	115.00	115.00	115.00
E. Gross Tax (C x D)	$2,300	$2,300	$2,300
F. Market Value Credit (0.40% of MV, max = $304; phase-out rate of 0.09% after $76,000)	**$192.40** (Calculated on homestead MV = $200K)	**$282.40** (Calculated on homestead fraction of MV = $100K)	**$96.2** (Calculated on Homestead MV =$200K, but then multiplied by homestead fraction
G. Total Net Tax (H – I)	**$2,107.60**	**$2,017.60**	**$2,203.80**

Other Expenditures

Administrative cost of new National Guard subtraction: It is estimated to cost $25 thousand (one time) to add a line and instructions to the tax forms. (Provision discussed under Tax Revenues.)

Require electronic filing for partnership returns when federally mandated: Additional electronic filing estimated to reduce income tax processing costs by $43 thousand per year.

Create threshold for separation of liability allocations: The Department is required to allocate tax debts between spouses in cases of divorce. The proposal would waive the requirement if the total tax debt is less than $100, saving $4 thousand per year.

Lower E-pay threshold for all business tax types except petroleum: Under current law, for most business taxes the threshold is $120,000 ($50,000 for income tax withholding). The Governor proposes to reduce the threshold to $20,000 (except for petroleum), effective 1/1/05 with threshold based on taxes paid in 2004.

Authorize Commissioner of Revenue to negotiate with other states involved in the Streamlined Sales Tax Project: The Streamlined Sales Tax Agreement will require participating states to reimburse some businesses for the costs of collecting and remitting the tax. The level and form of these vendor allowances will be negotiated among participating states. The language authorizing the commissioner to participate has no cost.

Budget Reserve

Transfer to Cash Flow Account: In the 2002 legislative session, the $350 million balance of the general fund cash flow account was used to help eliminate the FY 2002-03 budget deficit. Since that time the cash flow account has maintained a zero balance. The Governor recommends transferring $350 million from the budget reserve to the cash flow account. The current balance of the general fund budget reserve is $631.4 million in FY 2005. A transfer to the cash flow account results in a budget reserve balance of $281.4 and a cash flow account balance of $350 million. The cash flow account is typically utilized for state cash flow shortages. However it is important to note that the cash flow account is inaccessible to offset a budget deficit without legislative action. This transfer results in a zero net impact on the general fund budget.

Use of Future Surpluses

Current law requires future surpluses to be allocated first to the cash flow account (until it reaches $350 million), then to the budget reserve (until it reaches $653 million). After these transfers, if the November 2004 or February 2005 forecast projects a surplus exceeding ½ percent of biennial revenues at the end of the FY 2004-05 biennium, the entire surplus would be appropriated to the tax relief account to fund tax rebates.

The Governor proposes to require that surpluses also be used to undo two shifts enacted in 2002 and 2003 before any of the surplus could be appropriated to the tax relief account – the school aid payment shift and the property tax recognition shift.

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