MINNESOTA Management & Budget

MINNESOTA · REVENUE

April 12, 2011

The Honorable Kurt Zellers
Speaker of the House
463 State Office Building
St. Paul, MN 55155

The Honorable Mary Liz Holberg, Chair
Ways & Means Committee
453 State Office Building
St. Paul, MN 55155

The Honorable Amy Koch
Senate Majority Leader
208 State Capitol
St. Paul, MN 55155

The Honorable Claire Robling, Chair
Senate Finance Committee
226 State Capitol
St. Paul, MN 55155

Dear Senators and Representatives:

We are writing to express our deep concern about the fiscal status of the budget bills adopted by the House and Senate. While the bills purport to resolve the $5 billion deficit, they do not. It is our hope and expectation that the fiscal discrepancies in the bills will be resolved in conference committee and that bills sent to the Governor will be fiscally sound and balanced.

We appreciate the magnitude of the budget deficit and the speed with which legislature has acted to address it. However, we are seriously concerned that the administration could be presented a budget that is predicated on incomplete information, unsubstantiated assumptions, and inaccurate fiscal estimates. The numbers must directly reflect the reasonable impact of the policies put forward in law.

Minnesota has a long history of sound fiscal management, with budgets built on analysis that is agreed upon by the legislature and administration. In most bills this process was used to inform policymakers. Unfortunately, this was not the case for the two bills with the most significant changes—Health and Human Services and State Government.

Like his predecessors of all parties, Governor Dayton believes the nonpartisan staff at Minnesota Management and Budget (MMB) and the Department of Revenue must be the official source for fiscal estimates as conference committee work proceeds.

Analysis by the Administration shows that budget bills are out of balance by $1.203 billion in the House, and $1.164 billion in the Senate (a preliminary summary is attached). This represents almost one-third of the deficit after the K-12 shift. Beyond this, $1.030 billion of savings in the House Health and Human Services bill has not been reviewed and agreed to by MMB. All of these issues must be resolved by Conference Committees and vetted and agreed to by the Administration.

1. The proposed Health and Human Services waivers are unobtainable. While the House and Senate have taken different approaches to their budget proposals, \$750 million of savings in the House and \$600 million in the Senate rely on the approval of federal waivers or rate reductions that the Department of Human Services has stated the federal government would not approve in the next biennium. These provisions cannot be relied upon to reduce the state deficit in the next two years.

2. State Government efficiencies are already in place. Both the House and Senate rely on strategies to ensure the state is being as efficient as possible. We welcome these ideas. In fact, we are already doing much of this. The House and Senate are counting on \$133 million of additional tax compliance revenue specifically from tax analytics software that has not been tested or vetted by the Department of Revenue. An additional \$36 million of revenue is from cooperative collection efforts with the federal government. The Department of Revenue has testified that their level of effort in this area includes many of the elements being proposed and that additional strategies would only yield \$4 million of additional collections.

   In addition, the Department of Administration has testified that they are already implementing best practices in the area of strategic sourcing, fleet management and building efficiencies.

   We are prepared to meet with any of these consultants to assess assumptions behind the estimates. On the other hand, adopting hypothetical estimates of private contractors as part of an actual budget has never been an accepted approach and such hypothetical estimates cannot seriously be used as the basis of budget proposals.

3. State Government operating reductions overstate savings. Both the House and the Senate significantly reduce state agency operating budgets in each individual omnibus bill. The State Government bill makes additional unspecified reductions to agency operating budgets. When combined, they misrepresent savings in two ways.

   First, the operating reductions to departments do not account for state revenue impacts. Department of Revenue operating reductions do not reflect the loss of \$111 million General Fund revenue for the House proposal and \$47 million for the Senate proposal. Over the past decade, the legislature has explicitly, and bi-partisanly, appropriated funds to the department for tax compliance efforts with the expectation of increased revenue collections. Those expectations have been met, with the appropriations and ongoing revenues being included in the current law budget base. Both bills now propose base budget reductions, a portion of which will reduce funding for current tax compliance efforts.

   Second, our analysis shows that overlap among all the omnibus bills results in the same dollar being saved more than once, specifically in regard to workforce reductions. The State Government bills assume savings from additional employee and salary reductions <u>of the same</u> employees reduced in other bills. Clearly, this will not work.

4. Savings from bond refunding is overstated. Both the House and Senate have built into their budget proposals \$70 and \$60 million of savings, respectively, from refinancing state general obligation various purpose bonds. Bond refinancing is only favorable under specific market conditions. The current interest rate outlook only supports \$10 million of savings in the coming biennium.

5. Unspecified across-the-board reductions are unworkable. Both the House and Senate rely on unspecified reductions to achieve budget savings (up to $264 million in the House and $302 million in the Senate). First, these reductions are in addition to the operational reductions specified in each omnibus bill. By placing them in the State Government bill and not the individual omnibus bills, the impact of the full budget solution on each agency is not apparent. Second, these reductions would take effect if other strategies fail to achieve their intended savings. MMB would allocate reductions late in the biennium, requiring departments to cut much deeper in order to achieve the same level of savings. The magnitude of the savings attributed to unspecified reduction targets for MMB is unprecedented and the policy direction is unworkable.

The Governor has instructed commissioners and department staff to provide you the information and analysis you need in the coming weeks to achieve balanced budget bills. We are available to assist you to reach this goal.

Sincerely,

Jim Schowalter, Commissioner
Minnesota Management & Budget

Myron Frans, Commissioner
Department of Revenue

Attachment

cc: Michele Kelm Helgen
Representative Paul Thissen
Senator Thomas Bakk
Bill Marx, House Fiscal Analysis
Brent Gustafson, Senate Fiscal Analysis