Fiscal Analysis Department
Minnesota House of Representatives

ISSUE BRIEF

State General Fund Budget Situation

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A new state budget forecast will be released at the end of February. That forecast will be used for 2006 legislative session decisions. Based on the November 2005 forecast and contingent appropriations that occurred as a result of that forecast, the general fund balance currently projected for June 30, 2007 is $0. The property tax relief account has a balance of $317 million.

Property Tax Relief Account - $317 million

FY 2005 ended with a balance of $337 million. Under a provision in 2005 law, $20 million was transferred to the general fund. The remaining $317 million was transferred to the tax relief account and will remain in that account until accessed by future legislative action.

The November 2005 Forecast for FY 2006-07

A combination of revenue increases and spending changes for FY 2006-07 resulted in a projected general fund balance of $701 million. Projections for the three major revenue sources increased as follows: (1) corporate taxes were up $165 million or 10.9 percent, after factoring in a projected $232 million loss from a court ruling, (2) sales tax revenues were projected to be $173 million or 1.9 percent higher, and (3) individual income taxes were projected to be $188 million or 1.4% higher than in the February 2005 forecast.

Under current law any projected positive balance shown in a forecast is appropriated to reduce the education aid payment shift and property tax revenue recognition shift. The education aid payment schedule was changed from 84.3 percent current year and 15.7 percent in the next year to 90 percent current year and 10 percent in the next year. A payment schedule of 90 percent current year and 10 percent in the next year is the goal in law so this shift reduction is now complete. This change cost $370 million.

The property tax revenue recognition shift was reduced from 48.6 percent to 16.8 percent. (This reduces the amount of property tax levy counted as revenue in the previous fiscal year.) This change cost $331 million. The goal in law is to reduce this shift to 0 percent, to reach that will cost another $94 million.

As a result of these allocations, the projected general balance for FY 2006-07 is $0, the entire $701 balance initially projected in the November forecast is appropriated for education shift reductions.

Revenue Increased since the November 2005 Forecast

The Economic Update issued by the Department of Finance in early January shows that revenues in November and December of 2005 exceeded the forecasted amount by $36 million. Within that number, corporate taxes exceeded the forecast by $36 million, sales taxes exceeded the forecast by $11 million, and deed and mortgage taxes exceeded the forecast by $15 million. However, individual income taxes were $43 million below the forecasted amount. The reduction in individual income tax revenue is a major concern since individual income taxes represent over 40 percent of the state's general fund revenue.

Shift Reduction if Positive Balance Projected

Under current law, if there is a positive balance projected for the FY 2006-07 biennium in the February 2006 forecast, that balance will first go to reduce the property tax revenue recognition shift to 0 percent. This will use the first $94 million of any balance. Any balance that exceeds the $94 million would remain on the bottom line as a balance for the current biennium.

If the February forecast projects a negative balance for the FY 2006-07 biennium, amounts appropriated for shift reduction as a result of the November forecast are not automatically available to offset that deficit. Legislative action would be required to increase a shift and reduce an appropriation accordingly.

Health Impact Fee Uncertainty

In December, a Ramsey County District Court ruled that the health impact fee enacted in the 2005 special session on cigarettes ($.75 per pack) and tobacco products was unconstitutional. Since then, the court has issued a stay allowing the fee collection to continue until appeals of the case are resolved. The fee is estimated to add about $400 million to the general fund in FY 2006-07.

Other Budget Proposals

Bonding - The forecast includes an amount for debt service that will support a $560 million bonding bill in the 2006 legislative session. The Governor's recommended general obligation bonding amount of $811 million requires additional debt service of $6 million in FY 2007 and $50 million in FY 2008-09. A bill with general obligation bonding of $965 million, the state's three percent debt limit, would require debt service above the forecast amount of $9.3 million in FY 2007 and $91 million in FY 2008-09.

<u>Veteran's Initiatives</u> - The Governor has proposed a variety of changes to assist veterans. The cost of these changes appears to be in the range of $10 - $15 million per year.

<u>Immigration</u> - The Governor has proposed several initiatives regarding enforcement of immigration laws and assistance for legal immigrants, some of which have costs.

Clean Water Legacy - Bills to achieve and maintain surface water quality standards could have a considerable costs - $80 million per year was an estimate used in the 2005 session.

Human Services - The federal budget reconciliation bill that is awaiting final passage in the U.S. House of Representatives makes changes in the Temporary Assistance for Needy Families (TANF) program, child support enforcement and Medicaid. These changes will have cost implications for state and county budgets.

Property Tax Relief - Property taxes payable in 2006 are projected to increase 11.1%, on a statewide average, over taxes payable in 2005. The pay 2006 tax number is based on the tax levies presented at truth-in-taxation hearings, the final levies could be lower. Concerns have been raised about this increase in property taxes. Any changes enacted in the 2006 session would affect property taxes payable in 2007 and after and may not have state costs until FY 2008.

Next Biennium – FY 2008-09 - The Permanent Versus One-Time Issue

The November forecast projected a balance at the end of the FY 2008-09 biennium of $1.235 billion. Revenues would exceed expenditures by $333 million in FY 2008 and by $902 million in FY 2009.

However, the forecast document also pointed out two items that have the potential to draw down this balance. A constitutional amendment that will be presented to the voters in November 2006 dedicating more motor vehicle sales tax revenue to transportation purposes (and away from the general fund) would reduce general fund revenue by $60 million in FY 2008 and $125 million in FY 2009.

The forecast for FY 2008-09 includes inflation only where it is built into a formula in law. If inflation was built into all appropriations at the projected consumer price index (CPI) rates for the next biennium (1.7 percent in FY 2008 and 2.2 percent in FY 2009), funding that inflation would cost $271 million in FY 2008 and $640 million in FY 2009.

If the costs for both the transportation constitutional amendment and inflation at current CPI rates are built into expenditures for the FY 2008-09 biennium, the ending balance is $139 million rather than $1.235 billion.

The question of whether any additional expenditures or revenue reductions enacted in the 2006 legislative session can be sustained in FY 2008-09 must be considered in this context.

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