

What's At Stake: Budget Reforms

One of the primary tasks before the Minnesota Legislature this session is to pass the state's budget for the upcoming FY 2008-09 biennium. While much attention is focused on revenue and spending choices, policymakers are also considering changes to the budget-making process itself.

A good budget process ensures a well-informed debate that includes ample public participation. The Minnesota Budget Project recommends five principles to guide Minnesota to a better budget process:

- Responsible fiscal management.
- Clear lines of accountability.
- Flexibility to respond to short-term challenges and plan for a long-term vision.
- Good financial information.
- Stability in the decision-making process.¹

Based on these principles, the Minnesota Budget Project has recommended two policy changes in the 2007 Legislative Session: building the state's budget reserves, and ensuring the state's Economic Forecasts take inflation into account. This document describes the action taken to date by the Governor and the Legislature on these two critical questions: how much money should be dedicated to the budget reserve, and how should the state take inflation into account when predicting surpluses and deficits?

As of the Legislature's spring recess, the positions of the Senate, House, and Governor can be summarized as follows:

- **Building the budget reserve:** The Governor and Senate both increase the state's budget reserve, though the Senate's proposal sets aside four times more than the Governor's. The House takes a more modest approach to building the reserve.
- **Ensuring the state's Economic Forecasts take inflation into account:** The Senate has taken action to overturn the 2002 law that forbids the inclusion of the impact of inflation on most areas of spending in the state's Economic Forecast. The Governor would leave the current practice in place, and the House has yet to take action on this issue.

Building the State's Budget Reserves

Minnesota's financial standing (including the state's bond rating) depends on adequate reserves. A healthy reserve allows policymakers time to make good budget decisions in the face of challenging economic circumstances. Instead of making quick and drastic choices to balance the state's budget, policymakers can use reserves to buy time to respond to the situation in a more thoughtful and deliberative way.

Currently, the state has \$653 million in the budget reserve, as well as \$350 million in its cash flow account. Together, this adds up to just over \$1.0 billion, or 3.1% of the state's biennial (two

¹ For more on the Minnesota Budget Project's Campaign for a Better Budget Process, see www.mncn.org/bp/betterbudgetcampaign.htm.

year) general fund budget.² The state's Council of Economic Advisors has long recommended reserves of 5% of biennial general fund spending.

The Governor proposes increasing the state's budget reserve by \$147 million in FY 2008, which would bring the budget reserve to \$800 million, or 4.9% of annual general fund spending and 2.5% of biennial spending. In addition, the Governor allocates a portion of future surpluses to the budget reserve until it reaches 5.0% of annual spending.

The Senate's budget reserve proposal goes further than the Governor. The Senate passed legislation (Senate File 2054) that would deposit \$629 million into the budget reserve in FY 2008, as well as the interest earned on that \$629 million. In total, the Senate's proposal brings the budget reserve to \$1.3 billion, or 4.0% of FY 2008-09 biennial spending. If the cash flow account is included, total reserves would equal 5.1% of biennial spending. This is an ambitious and challenging goal, as it sets aside the majority of the \$1.0 billion FY 2006-07 balance.

In their omnibus tax bill (House File 2362), the House increases the budget reserve by \$30 million, less than both the Senate and Governor.

Ensuring the State's Economic Forecasts Take Inflation into Account

Simply put, policymakers and the public need a complete and accurate picture of the cost to maintain the state's current commitments. Although the state's Economic Forecasts adjust future revenues based on inflation, due to a provision passed in 2002, state law prohibits the Department of Finance from considering the impact of inflation on most areas of state spending when determining the size of the state's general fund balance. If inflation is taken into account, the \$2.2 billion FY 2008-09 balance predicted in the state's February 2007 Forecast is cut in half, and the \$2.8 billion FY 2010-11 structural balance disappears.³

On January 26, the Minnesota Senate passed Senate File 25, which would overturn the 2002 law that forbids including the impact of inflation on most areas of spending in the state's Economic Forecasts. Its companion bill, House File 11, awaits action in the House. The Governor did not recommend restoring inflation in his budget, but he did somewhat acknowledge inflationary pressures by not allocating all of the FY 2010-11 structural balance in his proposed budget.

Next Steps

It looks likely that this legislative session will yield a boost to the state's budget reserves, although the actual amount remains to be determined. In the next few weeks, the Senate and House will have to come to a compromise on an amount dedicated to the budget reserve, as part of the tax omnibus bill conference committee.

The outcome for restoring the impact of inflation on spending to the state's Economic Forecasts is less certain. The Minnesota Budget Project continues to call on policymakers to make progress this session on both of these crucial components of a better budget process.

² All calculations of budget reserves as a percentage of general fund spending are based on the level of projected FY 2008-09 spending in the *February 2007 Economic Forecast*, which is based on current law. The actual amount of spending in FY 2008-09 is likely to be higher after the FY 2008-09 budget is passed.

³ For further analysis of the February 2007 Economic Forecast, see Minnesota Budget Project, *The February 2007 Forecast: Little Change in Near Term, Stormier Outlook for the Future*, www.mncn.org/bp/feb07forecast.pdf.