



FISCAL ISSUE BRIEF

Base Budgets And Forecasted Programs

Senate Office of Fiscal Policy Analysis

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Questions

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Introduction

The construction of the state's budget is a complicated and lengthy process. There are literally thousands of decisions on program structure and funding levels required before a budget is complete. Revenue changes to support these spending levels may also be needed. Minnesota has statutorily adopted a biennial budget process that obligates the Legislature to set the budget for the following two-year period. This long time frame further complicates the process by requiring estimates of program demand and revenue receipts for 30 months into the future.

The budget is not a new entity created out of whole cloth, but is, in most respects, a continuation of fiscal policies adopted in previous years. Yet circumstances change persistently and the notion of "continuation" raises many questions. Which programs are continued? How is continuation measured? One response would be a list of currently funded programs - interesting but not very informative. Simple lists without analysis rarely are. The department of finance measures "continuation" when it constructs the base budget; the starting point for budget discussions. The purpose of this Fiscal Issue Brief is to analyze "forecasted programs", one important component of the base budget directly linked to the continuation process.

This Brief is in part an inquiry into process, an undertaking that can be tedious. However, understanding the process is more important than this characterization suggests. Policy makers in the Legislature usually accept the process as given, but they infrequently appreciate the implications for policy results. Process matters a great deal, because it influences the final result to a much larger degree than most realize.

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Determining the Base Budget

In each odd-numbered year session, the Legislature considers a budget for the following two-year period. Budget discussions always start with the base, or the current programs, and “change requests” which are adjustments to standing programs, or recommendations for new programs. As with any starting point, the definition of the base has a significant impact on the final budget eventually adopted.

Why is the construction of the base important? Once government programs are established recipients should have some assurance that services will remain stable. While the variables that affect programs and the state’s general financial situation are always in flux, if adopted government services are considered important, service recipients should not have to justify their position every year. Zero-based budgeting has had its advocates over the years, but there is little record of its implementation. An observed characteristic of legislators is their focus on changes to current programs rather than a review of each program in its entirety. Total program review can be complicated and time consuming, an exercise the legislative schedule accommodates poorly. Program advocates understand these “legislative realities”. For them, it is more important for them to be in the “base” than outside the base.

Unlike Congress, the Minnesota Legislature has not adopted a *detailed* mechanism to construct a budget based on current law. The budget has two major steps, the forecast, which assumes current law in revenues and spending programs, and the Governor’s recommendations, which offer a continuation of, or changes to these programs. The forecast of the budget is broadly defined in state law in Minnesota Statutes, section 16A.103, subd 1a,:

“the forecast must assume the continuation of current laws and reasonable estimates of projected growth in the national and state economies and affected populations. Revenue must be estimated for all sources provided for in current law. Expenditures must be estimated for all obligations imposed by law and those projected to occur as a result of variables outside of the control of the legislature. Expenditure estimates must not include an allowance for inflation.”

The section directing the Governor’s recommendation is Minnesota Statutes section 16A.11, subd. 3:

“Part two of the budget, the detailed budget estimates both of expenditures and revenues, must contain any statements on the financial plan which the governor believes desirable or which may be required by the legislature. The detailed estimates shall include the governor's budget arranged in tabular form.

(b) Tables listing expenditures for the next biennium must show the appropriation base for each year as well as the governor's total recommendation for that year for each

expenditure line. The appropriation base is the amount appropriated for the second year of the current biennium, adjusted in accordance with any provisions of law that specify changes to the base.”

The forecast as a starting point for expenditures requires “*Expenditures must be estimated for all obligations imposed by law and those projected to occur as a result of variables outside of the control of the legislature* “. The Governor’s base is defined as “*The appropriation base is the amount appropriated for the second year of the current biennium, adjusted in accordance with any provisions of law that specify changes to the base.*”

At the outset of the budget process, the department of finance issues instructions to state agencies defining the methods to construct the base budget. The starting point for each program for the upcoming biennium is the appropriation for second fiscal year of the current biennium. This starting point is adjusted for three reasons. First, there are simple technical adjustments. These adjustments reflect one-time appropriations, biennial appropriations, expired programs, system development costs, LCMR projects, agency technical adjustments, fund consolidations or transfers between funds, and documented annual adjustments of new programs started in mid-year. Generally, the end-of-session estimates tracked by legislative analysts anticipate these changes and they are non-controversial.

Second, the numbers are adjusted for any estimated changes in statutorily appropriated dedicated receipts. An increase or decrease in these receipts would require a different spending pattern than the one originally determined . The statutes allow for these types of adjustments.

Third, the starting point will be changed for programs that are “forecasted”.¹ A forecasted program is one where the level of spending is changed to reflect increases or decreases in the client population, cost of services, service levels, or reimbursement rates. This population may include individuals, as in human service programs; local units of government, as in the K-12 programs; or other entities, as in the bondholders of state debt. Forecasted programs are different from grant programs where funding levels stay constant. Forecasted programs are also different from programs that are client driven but for a variety of reasons do not receive the same initial budgeting adjustment.

Why are some client driven programs forecasted and others not.? The department of finance has adopted three criteria for a program to be defined as forecasted. These are:

1. A program contains an open or statutory appropriation.
2. A program contains legal liabilities to clients under law.
3. A program contains an implicit entitlement for recipients

The first two criteria are clear while the third leaves substantial room for interpretation. The

¹ Technically the expenditure estimates for the upcoming biennium are already forecast. They do not start with the second year appropriation.

table in the Appendix indicates the programs that the department forecasts, the rationale for this determination, and other considerations.

A Simple Budget Simulation

Forecasted programs affect the budget setting process. Perhaps an easy way to explain the impact on the decision process is through an example. The following illustration is oversimplified, but it does capture the essence of the issue. Assume there are three programs, A, B and C.

- **Program A** is client-driven but is not a forecasted program. (An example is the student financial aid program in higher education.)
- **Program B** is neither client-driven nor forecasted. (An example may be a grant in the natural resources area.)
- **Program C** is both client-driven and a forecasted program. (An example might be a human service program.)

Table 1 below shows hypothetical resources, programs funding, and a simulation of how these programs are treated under a new forecast. Column 1 shows the budget adopted by the Legislature in the previous year. Assume there was originally \$100 of revenue allocated to the three spending programs. Program A receives funding of \$30, Program B \$10, and Program C \$60 in funding. The remaining balance is zero.

TABLE 1

	Col 1. Adopted Budget	Col. 2 Actual Forecast Need	Col. 3 Official Forecast as Presented
Revenue	\$100	\$115	\$115
Program A	30	40	30
Program B	10	10	10
Program C	<u>60</u>	<u>70</u>	<u>70</u>
Total	\$100	\$120	\$110
Balance	0	(5)	5

Assume a new budget forecast occurs at a later point. The department of finance would develop a new revenue forecast. For our purposes we assume revenue has grown to \$115. Various agencies would estimate modifications in program spending based on new client levels, reimbursement rates, or other related changes. These initial spending estimates are characterized as “actual forecast need” shown in Column 2. Agencies have determined that demand for funds in Program A has risen to \$40, Program B as a grant stays constant, and that demand for services in Program C has risen to \$70. Program A demands may have increased simply because more eligible clients showed up than were expected. In Program C perhaps the same may be true, or possibly reimbursed costs exceeded the earlier estimates. Note that under a ‘actual’ forecast of demand the funds needed to cover demand in all three programs are reflected. Under this scenario, total demand for spending is \$120. This total exceeds revenue and if all program spending reflected ‘true’ need there would be a shortfall of (\$5).

The public would never see the results of Column 2. in an officially released forecast . Rather, the department would present the results in Column 3. Here Program A, the non-forecasted program, is limited the original \$30, even though demand is higher. Program B as a grant program does not change. However, the additional costs in Program C are reflected and “covered” in the forecast. The totals spending is now \$110 and the forecast shows a \$5 surplus, not a deficit.

This simple example demonstrates a very important dynamic in the budget process. Advocates of all programs - A through ZZ- would view the \$5 as an new resources to be pursued. However, not all programs are starting from the same budget position. The current costs of Program C have been met. Any increase in funding from the \$5 surplus for this program would lead to a new level of service for clients. Program A must fight just to get back to even. If no new funds are allocated to Program A, service levels will need to be reduced to fit within the original \$30 funding level.

This simple example demonstrates a second important dynamic in the budget process. It is true that the funds needed to meet the increase of \$10 in Program C must be appropriated by Legislature, although in some cases this may be available through an are open and standing appropriation. The give and take of legislative priority setting tends to work at the margins and is vitally informed by perceived available funding. The reality is that the additional \$10 in Program C is *not* viewed as an additional demand since it is already “covered” in the forecast. Advocates do not have to fight for the additional funds from an available surplus since the surplus was determined after the cost had been taken into account. In one sense the funds are “free”. There is evidence of this attitude in recent years, notably in the 2003 special session by legislative action on HF 3. Recall that in February the Governor had unalloted current and prior year appropriations by \$282 million to balance the 2002-03 biennium. HF 3 increased E-12 spending by over \$8.7 million and human service spending by about \$122.7 million for FY 2003. The bill passed 58-0 in the Senate with only a modicum of discussion. There was more dissent in the House although for reasons unrelated to the actual budget. The only reason these new

expenditures could be funded after the unallotment was that they were “covered in the forecast”.

Conclusions

There are three main conclusions to draw from this Fiscal Issue Brief. First, the process is an important aspect in the final determination of a budget for the state. Process matters a great deal. Second, the process treats client driven programs differently. This distinct treatment changes the dynamics between programs as priorities are determined by the Legislature. As these priorities are set, some programs may be disadvantaged, not for policy reasons, but simply due to the perspective created by the process. Third, although the department of finance develops the revenue and expenditure forecast, it operates from statutes and other directives from the Legislature. It may be valuable to review these statutes and directives to assure that budget results are clearly driven by priorities, not implicitly affected by process.

Appendix

Program	Statutes	Committee	Legal Liability for Benefits (y/n)	Approp: Open or Direct	Mechanism to Allocate Funding Shortfalls	Funding Basis: Individual Cost or Aggregate Costs	Other Considerations (ex. Related to other program, small scale, etc)
Medical Assistance (MA)	256B.0625	Health & Human Services	Yes	Direct	Transfer from other cancellations	Individual Cost	Federal entitlement
Medical Assistance Waivers	256B.0915	Health & Human Services	Maybe	Direct	Transfer from other cancellations	Individual Cost	Waivers granted due to cost neutrality with other MA programs
General Assistance Medical Care (GAMC)	256D.03	Health & Human Services	Probably	Direct	Transfer from other cancellations	Individual Cost	
MNCare	256L.03	Health & Human Services	Probably	Direct	Commissioner may stop enrollment, change subsidy, etc.	Individual Cost	
Group Residential Housing	256I.01	Health & Human Services	Probably	Direct	Transfer from other cancellations	Individual Cost	

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Alternative Care	256B.0913	Health & Human Services	No	Direct	Counties allocated fixed amount for services	Fixed Individual Cost	Only cancellations are forecast. Base is equal to last appropriation.
MN Family Investment Program (MFIP)	256J, plus Laws 97, Ch85, Art 1, Sec. 67	Health & Human Services	Yes	Direct	Transfer from other cancellations	Defined benefit based on income level.	
MFIP Child Care	119B	Health & Human Services	No	Direct	Federal CCDF Block Grant	Defined benefit based on income level	Changed from federal entitlement program to block grant
General Assistance	256D.05	Health & Human Services	Yes	Direct	Transfer from other cancellations	Defined benefit based on income level.	

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Chemical Dependency Entitlements	254B	Health & Human Services	Yes	Direct	Transfer from other cancellations	Funding based on average cost/caseload and caseload estimates	Appropriation is transferred out of the general fund into the 200 fund. Unused appropriation remains in a reserve in the 200 fund. Forecast is not adjusted based on reserve.
MN Supplemental Aid	256D.33 256D.54	Health & Human Services	Yes	Direct	Transfer from other cancellations	Defined benefit	Federally required supplement to SSI benefits.
Sexual Psychopathic Personality Treatment Program <NOT IN FORECAST>	246B 253B	Health & Human Services	Yes	Direct	Transfer from other cancellations	Funding based on average cost/caseload and caseload estimates	Relatively small program (so far), caseload size driven by county referrals, caseload growth

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Adoption Assistance <NOT IN FORECAST>	259.67	Health & Human Services	Probably not	Direct	Stop payments to families?	Defined benefit?	Small program. M.S. 259.67, Subd. 2: "subject to the availability of state and federal funds..."
Prescription Drug	256.955	Health & Human Services	No	Direct	Cap New Enrollment	Defined Benefit	.
Basic Sliding Fee Child Care <NOT IN FORECAST>	119B	Health & Human Services	No	Direct	Waiting Lists	Defined Benefit	Capped Allocation Program (not forecasted)
General Education	126C	E-12	Yes	Open			
Abatement Aid	127A.49	E-12	No	Direct	Excesses and Deficiencies transferred between programs.		

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Referendum Tax Replacement Aid	126C.17	E-12	No	Direct	Excesses and Deficiencies transferred between programs.		
Non-public Pupil Aids	123B.40-43 123B.92	E-12	No	Direct	Excesses and Deficiencies transferred between programs.		
Enrollment Options Transportation	124D.03	E-12	No	Direct	Excesses and Deficiencies transferred between programs.		
Consolidation Transition	123A.485	E-12	No	Direct	Excesses and Deficiencies transferred between programs.		
Charter School Aids	124C.11	E-12	No	Direct	Excesses and Deficiencies transferred between programs.		

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Integration Aid	126D.86 126D.87 126D.88	E-12	No	Direct	Excesses and Deficiencies transferred between programs.		
Tribal Contract School Aid	123D.83	E-12	No	Direct	Excesses and Deficiencies transferred between programs.		
Special Ed. Excess Cost Aid	125A.75-79	E-12	No	Direct	Excesses and Deficiencies transferred between programs.	District Costs	
ECFE Aid	124D.135	E-12	No	Direct	Excesses and Deficiencies transferred between programs.		
Adult Basic Aid	124D.52	E-12	No	Direct	Excesses and Deficiencies transferred between programs.	District Costs	

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Correctional Institutions, Adults	Chapter 241, 243	Health & Human Services	Laws and courts require incarceration and enforce minimal standards.	Direct	Program Transfers, Deficiencies.	Start with aggregate current costs, then attempt to calculate cost changes due to projected changes in number of inmates.	Information is available at different times in the forecast cycle.
Emergency Fire Fighting		Env & Nat'l Resources	N/A	Open	Increase Approp.	Aggregate costs	
Payments in Lieu of Taxes	477A.11	Env & Nat'l Resources	Yes	Open	Increase Approp.	Aggregate costs	
Indian Treaty Payments	97A.165	Env & Nat'l Resources	Yes	Open	Increase Approp.	Aggregate costs	
State Grant Program (undergrad students at Mn colleges)	136A.121	Higher Education	Yes, within appropriation limits.	Direct	Pro rata reductions: law allows for increasing student & parent contributions.	Aggregate costs	State Formula tied to federal Pell grant funding. State law says that grants "must" be awarded on a "funds available basis".

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Homeowner & Renter Property Tax Refunds (distributed to individuals)	290A.04, 290A.23	Taxes		Open	Funding allocated to individuals with property taxes payable that exceed a certain percentage of their household income up to a maximum dollar amount	The appropriation and credit increase with qualified claimants, the thresholds for qualifying are adjusted for inflation on an annual basis	
Targeting Refunds (distributed to individuals)	290A.04, 290A.23	Taxes		Open	Funding allocated to homesteads with property taxes payable that have increased from the prior year by more than 12%, the refund equals 60% of the amount over 12%	The appropriation increases with increases in market values and tax rates	

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Market Value Credit	273.1384	Taxes		Open		Credit equals .4 percent of residential market value up to \$304. Credit is reduced by .09 percent of market value above 76,000.	
Disparity Reduction Aid (distributed to counties and school districts)	273.1398	Taxes		Open	Funding distributed according to historical base, reduced or increased in parallel with reductions or increases in recipients' tax capacities	Appropriation equals previous year reduced or increased in parallel with reductions or increases in the aid recipients' tax capacities,	Aid was originally distributed to jurisdictions with total tax rates exceeding 100%
Police and Fire Aid (distributed to cities and towns)	69.031	Taxes		Open		Funding based on premiums collected for fire insurance	
HACA - Mobile Home		Taxes		Open			

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Taconite Aid Reimbursement (distributed to counties & schools)	477A.15	Taxes		Open			
Supplemental Homestead (distributed to school districts)	273.1391	Taxes		Open	Funding allocated to reduce homesteads' school property taxes by a specific percentage for particular property types	The appropriation and credit increase with property taxes in taxing jurisdictions that qualify for the credit	
Ethanol Development	41A.09	Env & Nat'l Resources	Y (Up to certain limits)	Open with limits	Prorate payments among the producers	Individual cost - \$0.17/gal.	
Debt Service	16A		Y	Open	Statewide property tax		