



August 2, 2002

MEMORANDUM

To: Cabinet Commissioners, Agency Heads, Directors of Boards and Commissions

From: Pamela Wheelock, Commissioner
Minnesota Department of Finance

Re: *FY 2004-05 Operating Budget Preparation*

The outlook for preparing the next budget is not encouraging. The backdrop for preparing the FY 2004-05 budget is a projected \$1.6 to 2.7 billion shortfall for the state's general fund, based on current law and the potential impact of inflation. Preliminary data for fiscal 2002 year-end revenues through June 30 were \$212 million below end-of-session estimates, indicating that potential problems for the current biennium might not yet be over. Finally, the gubernatorial and legislative elections now assure that a transition in administrations will be a certainty.

These circumstances call for a different approach to developing the upcoming biennial budget. Last fall, we asked agencies to reprioritize their services and look for ways to restructure and refocus government to fit within available means to balance the budget for the current biennium. To your credit, agencies identified cuts to valuable, but lower priority programs. Still, projections for FY 2004-05 indicate that the state will face a significant gap between resources and spending demands. Consequently, we must concentrate on building background information and developing a range of options that will assist the incoming governor in making choices for a responsible budget for the coming two years.

What is necessary to accomplish this? Agencies must begin by preparing a ten-percent reduction from current law spending levels projected for FY 2004-05. Cuts totaling at least ten percent of the total agency expenditures must be submitted. The financial outlook clearly suggests that agencies should not be spending time developing new initiatives. The parameters for new initiatives, if any, will be set by the new administration and be developed quickly after the election.

There should be no ambiguity about the starting point or "base" for agency budgets. The general fund planning estimates that define the lower end of the FY 2004-05 budget gap of \$1.6 billion do not include inflation. Simply adjusting the total budget for inflation increases the gap to \$2.7 billion. In addition to the ten-percent reduction, agencies must plan to absorb potential labor contract increases and other general inflationary pressures within their budget. The base will not be "automatically" adjusted for possible future labor contract increases. Whether or not there may be supplemental funding for this purpose, or the nature of it, will be a decision made by the new governor as part of the overall budget review.

The “base” for agency budgets is FY 2003 direct appropriations adjusted for only a limited number of technical adjustments (e.g., removing one-time spending, biennial appropriations, annualizing documented new program costs). For statutory and dedicated funds, the base is FY 2003 estimated spending and the ten-percent reduction and related guidelines similarly apply.

While clearly the focus will be on eliminating projected general fund deficits, the use of one-time balances and monies used from other funds in the 2002 session highlight the links between general fund and other state funds. In the end, every dollar is “green” and someone is paying. Therefore, the budget requirements apply to all state funds, not just general fund activities.

We communicated early changes to the budget process to agencies in June. The budget process and timing has been altered to develop earlier and more useful information about agencies’ services. Agency profiles and lower level narratives that are due by the end of August should provide background on what services are delivered, who benefits, at what cost, and, most importantly, with what results.

Agencies should complete their preliminary budget reduction plans by mid-October -- the statutory due date for agency budget submissions. We expect that agency budgets will more closely resemble a list of cuts and alternative options than they will a “traditional” agency request which may have included requests for funding increases.

Of course, tax and revenue changes will be considered through the process. The adequacy of the state’s tax structure and revenue streams to meet future demands need to be an important consideration in any budget plan. A key question will be how to best balance state revenues and personal income growth with spending pressures from demographic changes, inflationary pressures, and citizen demands.

There is little to suggest that economic conditions will improve dramatically. It is likely these budget pressures will put us all at risk of cuts in current budgets. I ask that you be prepared to work with Department of Finance executive budget officers to identify agency priorities, alternatives, and cost-saving policy changes and lower-priority activities that can be cut.

Our challenge is to match state government’s highest priorities with available resources. In doing so, we not only meet our obligation to an incoming administration, but we are able to recognize and preserve the important changes that have been put into place during the last four years.

Please don’t hesitate to contact your executive budget officer if you have any questions about these instructions.