

DEDICATED FUNDS BACKGROUND

The state's budget is divided into almost 40 separate funds. These include the Environment and Natural Resource Fund, General Fund, Health Care Access Fund, Highway User Tax Distribution Fund, Solid Waste Fund, Special Revenue Fund and Workforce Development Fund. Some of these like the Workforce Development Fund and the Trunk Highway Fund are considered dedicated funds. The former is financed with a 0.1-percent payroll tax while the latter by the motor fuels tax, motor vehicle registration fee, and the motor vehicle sales tax. The history behind these two funds illustrates our principal concern with dedicated funds.

- The Workforce Development Fund began as the Dislocated Worker Fund. It was established in 1990 as a means to supplement federal dislocated worker dollars. The dislocated worker program did not have ongoing state financing until a “temporary” 0.1-percent payroll tax was enacted during the 1990 session. The tax went into effect January 1, 1991, and was scheduled to sunset June 30, 1992. The sunset of the payroll tax was repealed during the 1991 session. Between 1991 and 2002, the payroll tax raised about \$300 million. Of that amount, \$75 million was transferred to the general fund or used for other programs. Employers have paid \$272 million since the payroll tax was scheduled to sunset. In 1999, the Legislature reduced the payroll tax from 0.1 percent to 0.07 percent, effective July 1, 2000, and created the Workforce Development Fund (WDF). The new fund is financed by the payroll tax, but is responsible for funding additional programs. In 2003, the payroll tax was increased to 0.1 percent for calendar years 2004 and 2005. In 2005, the payroll tax was kept at 0.1 percent (rather than letting it decrease to 0.07 percent) for two more years and set at 0.085 percent for calendar years 2008 and beyond. However, in 2007, this provision – reducing the payroll tax to 0.085 percent in 2008 – was eliminated, and therefore the payroll tax remains at 0.1 percent.
- The Trunk Highway Fund is financed with proceeds of Minnesota's motor fuels tax, motor vehicle license registration fees and the motor vehicle sales tax. Its purpose, as defined in the Constitution, is to construct, improve and maintain public highways, roads and streets. Over the years, the Legislature has diminished the ability of the Trust Fund to finance this infrastructure by funding administrative costs of the Departments of Transportation and Public Safety and the State Patrol with Trust Fund dollars. Much of the administrative costs now are financed by the general fund; however, the State Patrol remains financed through the Trunk Highway Fund.

Dedicated funds are also accounts within these funds in which fees or taxes are collected to finance a specific service or project. According to research conducted for the Legislative Commission on Planning and Fiscal Policy, the Special Revenue Fund has more than 970 appropriations accounts. Many of these accounts have a dedicated revenue source. In addition, there are dedicated funds within the general fund and other state government funds.

Legislative Commission on Planning and Fiscal Policy Recommendations: In 2001 and 2002, the Legislative Commission on Planning and Fiscal Policy discussed the proper use of dedicated funds. The commission found that most government budget experts agree that a minimum number of funds should be used. According to the National Conference of State Legislatures, large numbers of funds are a “relic of 19th century state budgeting.” Today, accounting software can manage different revenue streams and program expenditures without establishing separate funds. House and Senate fiscal staff have identified several additional concerns with respect to the large number of separate funds. They are:

- **Complexity.** The more funds the state has, the more complex its budgeting will become. In addition, dedicated funds complicate establishing budget priorities because their programs and associated revenue are off budget and not available when determining general fund priorities.
- **Accountability.** Budget accountability is maximized when the public understands the budgeting process. The more complex the state's budget structure is, the more difficult it will be for the public to understand.

- **Inefficiency.** Dedicated funds oftentimes result in an inefficient allocation of resources because the funds are allowed to carry forward balances. A positive balance indicates that the financing mechanism raises too much revenue and should be reduced.

The commission recommended to the Legislature that the following criteria be considered before a fund is created. The Department of Finance currently uses the criteria.

- Does the law require the agency to establish a new fund?
- Will the fund need to create discrete financial statements?
- Does an agency currently use a separate side system to duplicate accounting information to facilitate fund reporting?
- Will the new fund improve information necessary for the agency's management of resources?
- Does the activity require the tracking of assets or liabilities beyond the fiscal year?
- Are activities across agency lines going to be consolidated for reporting purposes?
- Will the activity, as a fund, have sufficient resources to make timely payments on its obligations?
- Will the activity be material in relationship to other funds so as to require that it be tracked discreetly?
- Will there be appropriations made from an accumulated balance of which any unused portion will cancel back?

The commission also recommends that a fund should be created or continue to exist when a majority of the following criteria apply:

- If either the revenues or expenditures of the activity will exceed \$10 million.
- If the activities create assets or liabilities that will continue beyond a normal budget cycle.
- If multiple agencies will be involved in collection or use of fund resources.
- If enough resources are available to cash flow the activity when the program begins.
- If a separate fund is necessary to comply with constitutional requirements, federal regulatory requirements or generally accepted accounting principles.

The commission meant these criteria to be applied to the state's 38 funds; however, many seem to apply to the dedicated funds within them.

Minnesota Center for Public Finance Research Study: The Minnesota Center for Public Finance Research is the research arm of the Minnesota Taxpayers Association. In 2004, it released a study titled "Hidden Funds, An Analysis of Special Fund Activity in Minnesota." It recommends that state government should operate with as few funds as possible and the funds should have clearly defined purposes. Specific recommendations include:

- The rationale for all special funds should be carefully reviewed to ensure a legitimate policy purpose for each fund. Consideration should be given to reducing the number of special funds.
- Consideration should be given to a sunset clause for special funds.
- Special fund balances should be more widely disseminated and publicized in the press.

It also made recommendations related to the special revenue fund, the fund that contains hundreds of separate accounts. The recommendations included: (1) renaming the special revenue fund so the public can better understand what it is and how its accounts are used; (2) the rationale for accounts in the special revenue fund should be reviewed to ensure a legitimate policy purpose for each account; and (3) state government must provide more and better information about the cash flow of accounts in the special revenue fund.

In 2004, legislation passed that gives the commissioner of finance the authority to eliminate dedicated funds that no longer are needed for the purposes specified in law. It also directs the commissioner to eliminate dedicated funds that meet the following criteria:

- Receipts and transfers average less than \$1,000 per year in the past four years.
- Yearend balances in the past four years average less than \$1,000 per year.
- The dedicated fund has been in existence for at least four years.

Balances from dedicated funds that are eliminated will be deposited in the general fund unless otherwise specified in law.

The legislation also requires the commissioner to review one-fourth of the dedicated funds within the Special Revenue Fund each year for four years. The review must include a legislative history, a financial history and a rationale for the existence of each dedicated fund under generally accepted accounting principles. The review also must explain why the account should not be in the general fund. The 2004 legislation addressed many of the concerns outlined by the Legislative Commission on Planning and Fiscal Policy and the Minnesota Center for Public Finance Research.