Minnesota
Department of Finance

November, 2003

Highlights

$185 Million Budget Deficit Projected for FY 2004-05

Minnesota general fund revenues for the 2004-05 biennium are now forecast to total $28.235 billion, $407 million (1.4 percent) less than end-of-session estimates. Projected expenditures have declined, falling by $143 million (0.5 percent) to $28.157 billion. Changes to carry forwards and reserves reduce the projected deficit by $79 million.

FY 2002-03 Closes Modestly Higher, Excess Balance Is Added to Budget Reserve

A combination of higher revenues and lower expenditures left fiscal 2003 with an ending balance of $369 million, $188 million more than planned. After adjusting for appropriations carried forward to the 2004-05 biennium, a surplus of $104 million remained. Under current law that money is allocated to the state's budget reserve. It does not automatically reduce the projected FY 2004-05 budget deficit.

Minnesota Economic Outlook Remains Favorable

The U.S. and Minnesota economies appear to be entering a period of robust growth, just as was forecast last February. Global Insight's November baseline forecast calls for real GDP growth rates of 4.1 and 4.0 percent for fiscal 2004 and fiscal 2005, growth rates which are just below those forecast in February. November's baseline forecast is assigned a probability of 60 percent. A slightly more optimistic alternative is assigned a probability of 20 percent as is a slightly weaker scenario which contains no recession. The Global Insight baseline forecast is slightly more optimistic than November's Blue Chip consensus.

FY 2006-07 Planning Estimates Show $46 Million Structural Balance in FY 2007

Fiscal 2006-07 revenues and other resources fall by $914 million from end-of session estimates, and expenditures increase by $6 million. This creates a structural deficit of $440 million for fiscal 2006, and leaves just a $46 million structural balance in fiscal 2007. At the end of the 2003 legislative session a structural balance of $474 million was projected for fiscal 2007..

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Budget Summary

FY 2003 Ended on a Positive Note, $104 Million Restored to Budget Reserve

The state has closed the books on the 2003 fiscal year. The Governor and the 2003 Legislature had left a $181 million balance as a cushion against end-of-year surprises. The year-end deposit of $84 million of federal flexible assistance funds, combined with lower than projected expenditures resulted in a $104 million increase in the ending balance. Under current law, this additional money was transferred to the budget reserve at year-end.

FY 2003 Actual
Change from End-of-Session
($ millions)

	End of Session	Actual	Change
Beginning Balance	**$1,130**	**$1,130**	**$0**
Non-Dedicated Revenue	12,534	12,575	41
Transfers, Other Revenue	516	558	42
Total Resources	**14,180**	**14,263**	**83**
Expenditures	**13,999**	**13,894**	**(105)**
Balance Before Reserves	181	369	188
Appropriations Carried Forward	0	84	84
Budget Reserve	0	104	104
Ending Balance	**$181**	**$181**	**$0**

As reported in October's *Economic Update*, final revenues for the year were $83 million more than estimated at the end of the legislative session, due to receipt of $84 million in federal Flexible Assistance grants, revenue that was not included in end-of-session estimates. That grant revenue and contingent actions allocating it in FY 2004-05 are now included as part of the November forecast.

Actual spending in FY 2003 was $105 million below estimates. Of that total, however, $84 million of unspent funds were authorized to carry forward to FY 2004 leaving a net reduction in spending of $21 million. The expenditure savings came largely from slightly lower costs for E-12 education and human services programs.

$185 Million Deficit Now Forecast for Current Biennium

Minnesota's financial outlook for the 2004-05 biennium has weakened slightly since the end of the legislative session. The adopted budget had a zero unspent balance and a projected budget reserve of $522 million.

A lower revenue forecast, due primarily to lower individual income and sales tax projections, reduces expected state revenues by $365 million. Dedicated revenue and transfers are now projected to be $41 million lower than end-of-session estimates. The decline in projected revenue is partially offset by a $143 million decline in biennial expenditures. E-12 education and human services expenditures both now reflect lower levels of spending than expected when the 2003 Legislature concluded.

FY 2004-05 Budget Forecast Changes

($ in millions)

Ending Balance (Enacted Budget)	**$-0-**
FY 2004-05 Forecast Changes	
Balance From FY 2003	188
Taxes, Other Revenues	(365)
Transfers and Dedicated Revenue	(41)
Net Savings in Spending	143
Increase in Budget Reserve	(110)
Subtotal Forecast Changes	**(185)**
Forecast Deficit	**$(185)**

Budget Reserve At $631 Million By End of Biennium

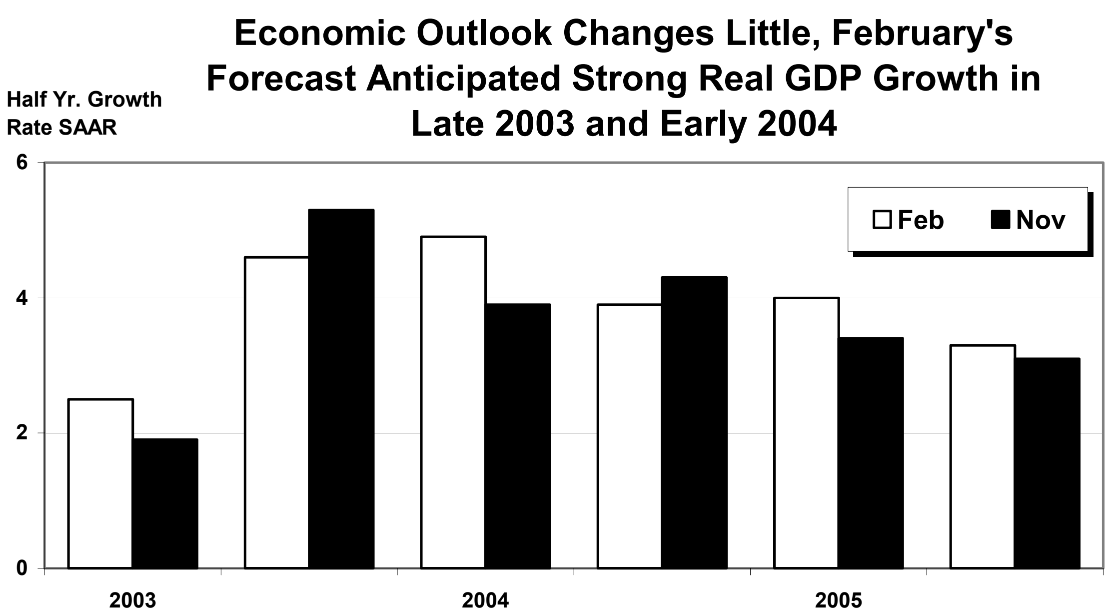
Under current law any available budget balance at the close of the 2002-03 biennium is assigned to the budget reserve. In addition, the excess surplus in the assigned risk plan is transferred annually to the budget reserve. The result has been an increase of $110 million in the budget reserve, $104 million from FY 2003 surplus plus $6 million from the assigned risk plan surplus. This raises the projected budget reserve to $631 million by the end of the biennium. At that level the budget reserve is approximately 2.2 percent of biennial spending.

The forecast deficit is not automatically reduced by the state’s $631 million budget reserve. Gubernatorial or legislative action is required to access the reserve.

U.S. Economy Has Grown Rapidly Since Mid-Summer

Recent economic news has been positive. The U.S. economy appears to be back on track, and most forecasters believe the sustained period of substantial economic growth needed to put people back to work is finally underway. Payroll employment remains below the level observed at the end of the recession, but there has been some job growth in each of the last three months. Third quarter real GDP growth was the strongest in nearly 20 years.

The improvements in the economy are reassuring, but they were anticipated. In early 2003 the consensus outlook called for the economy to strengthen markedly after midyear. Geo-political concerns introduced more uncertainty than usual into economic forecasts for 2003 and 2004, but in the absence of an extended conflict with Iraq and a major spike in oil prices most forecasters expected a very robust economy in late 2003 and early 2004. And, while no one was projecting a third quarter 2003 real GDP growth rate of more than 8 percent, many forecasters were even more optimistic about the average rates of real GDP growth in 2003, 2004 and 2005 when they made their forecasts at the start of 2003 than they are today.

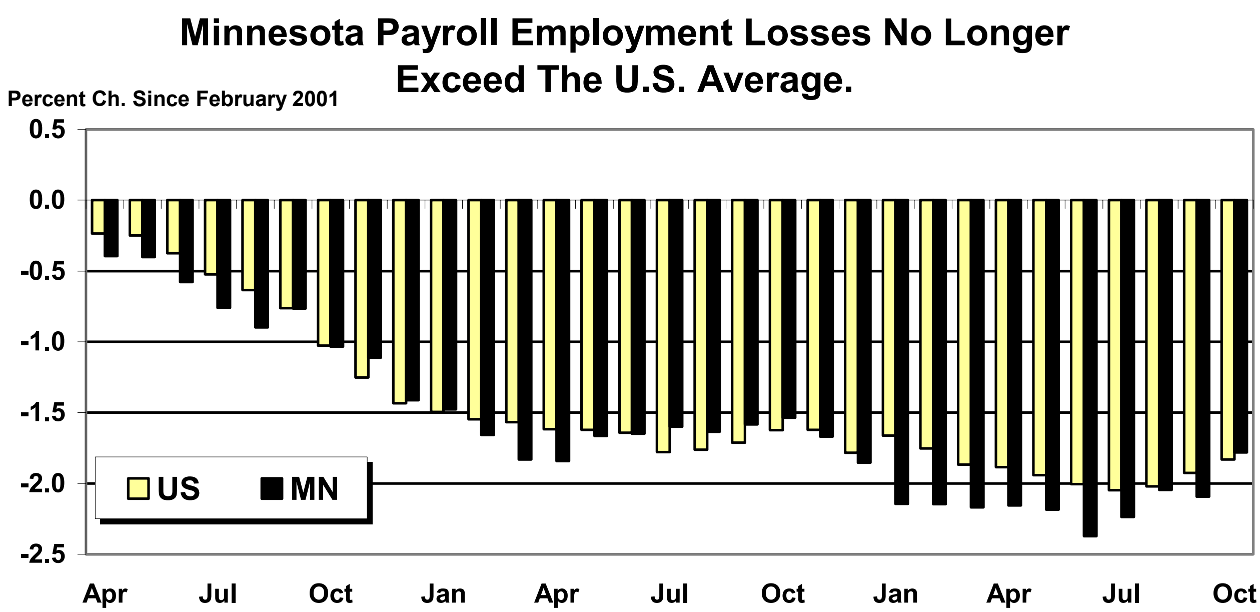


Global Insight Inc. (GII), Minnesota's national economic consultant, is among those who in early 2003 were anticipating strong GDP growth by mid-year. Their February baseline called for real GDP growth of 4.1 percent and 4.2 percent in fiscal 2004 and fiscal 2005, growth rates which are slightly greater than the 4.1 and 4.0 percent growth projected in this November's baseline. It is not that GII expects only modest economic growth in the remainder of the biennium. Their current baseline forecast for real GDP growth is by no means anemic--it is simply not quite as optimistic as February's forecast.

GII still sees no inflationary pressures on the horizon, and their inflation forecast has been reduced slightly. The CPI is now expected to grow by just 1.4 percent in calendar 2004, and by 1.9 percent in calendar 2005. In February slightly higher CPI growth rates of 1.9 percent and 2.1 percent were anticipated. Global insight assigns a probability of 60 percent to their baseline forecast. A modestly more optimistic forecast is assigned a probability of 20 percent, as is a slightly weaker forecast, which contains no recession.

Minnesota's Economy Began Adding Jobs in June

The 2001 recession was more severe in Minnesota than in much of the nation. More than 64,000 jobs were lost statewide between February 2001 and June 2003, a decline in payroll employment of 2.4 percent. Nationally, payroll employment declined by just over 2.0 percent. Since June, however, Minnesota's economy appears to be on the rebound, adding jobs at a faster rate than the national average. Statewide payroll employment is up by 16,000 since June, recovering about one-fourth of the decline over the prior 17 months. Payroll employment in Minnesota is now down 1.78 percent from its pre-recession peak. U.S. employment is down 1.83 percent.



Although there has also been a slight increase in manufacturing employment since June, Minnesota's manufacturing sector continues to struggle. More than 49,000 manufacturing jobs have been lost since the start of the recession and more than 54,000 since the June 2000 peak. Even with those losses, however, Minnesota manufacturing employment has not declined as rapidly as the U.S. average. Since the start of the recession U.S. manufacturing employment is down 14.6 percent, Minnesota manufacturing employment by 11.8 percent.

The employment outlook for both the U.S. and the Minnesota economy has been reduced slightly since February. Some of the growth previously expected to occur in calendar 2004 has been pushed back into calendar 2005. Employment levels in Minnesota are not projected to grow as rapidly as the national average during the remainder of the biennium. Minnesota's diversified manufacturing industry mix is unlikely to benefit greatly from the increased emphasis on production of defense material.

Federal Assistance Complicated Revenue and Spending Forecast

The federal Jobs and Growth Reconciliation Act was signed on May 28, 2003 near the end of the 2003 legislative session. This legislation provided one-time federal assistance to states in federal fiscal years 2003 and 2004. Minnesota's enacted budget contained contingent provisions allocating portions of the one-time federal monies anticipated to be received by Minnesota. These contingent provisions were not recognized in the end-of-session estimates. Their recognition at this time creates revenue and expenditure changes in the forecast.

Minnesota's share of Flexible Assistance Grants totaled $167.2 million. One-half, $83.6 million was deposited in the general fund as non-dedicated revenues in FY 2003. The remainder, $83.6 million, was received in October, or state fiscal year 2004. Under current law receipt of those funds triggers changes necessary to Minnesota tax code that conform to federal tax changes contained in the Jobs and Growth Reconciliation Act. The changes begin in FY 2004, and they reduce forecast tax revenues for FY 2004-05 by $103 million.

The state also will receive an additional $175 million in temporary funding through enhanced federal Medical Assistance participation. This money does not flow directly to the general fund. Since federal dollars will pay a greater percentage of state Medical Assistance costs the additional funds reduce the state general fund portion of spending for human services beginning in FY 2004. Current law provisions contingent upon receipt of these federal funds, delayed some eligibility and participation changes in the budget for the Medical Assistance and Minnesota Care programs. The effects of these changes are now incorporated in the forecast. Although the new federal revenue does not contribute to net general fund savings, it does impact many parts of the human services forecast.

Forecast for FY 2004-05 Revenues Down $407 Million

Current general fund resources for the 2004-05 biennium are now forecast to total $28.235 billion, $407 million (1.4 percent) less than end-of-session estimates. Tax and non-tax revenues are projected to be $365 million below end-of-session estimates and transfers and dedicated revenues were $41 million less than previous expected. The forecast changes include both $84 million in receipts from the federal Flexible Assistance Grants and a reduction of $103 million in state tax revenue reflecting the cost of conforming to federal tax changes made as part of the 2003 federal tax bill, neither of which were included in end-of-session estimates.

Forecasts for the two largest sources of state income, the individual income tax and the sales tax were reduced by $387 million and $124 million, respectively. An increase in expected corporate franchise tax receipts of $140 million partially offsets those declines in projected revenues.

Forecast Revenues, FY 2004-05

($ in millions)

	End of Session	Nov Forecast	Change	Pct Change
Individual Income	$12,034	$11,647	$(387)	-3.2
Federal Conformity	0	(103)	(103)	- -
Sales	8,384	8,260	(124)	-1.5
Corporate	1,304	1,444	140	10.7
Motor Vehicle Sales	574	590	16	2.8
Subtotal	22,296	21,838	(458)	-2.1
Other Taxes	3,401	3,501	100	2.9
Non-Tax Revenue	1,349	1,341	(8)	-0.6
Dedicated, Transfers	1,596	1,555	(41)	-2.6
Total Revenues	**$28,642**	**$28,235**	**$(407)**	**-1.4%**

Individual income tax liability in tax year 2002 is now estimated to be $88 million less than was assumed in February's revenue forecast. Since this reduces the base from which estimates of all future income tax receipts are derived, other things equal, receipts in all future years are reduced by a similar amount. When carried forward through tax year 2005 the lower 2002 base year liability explains about $200 million of the reduction in the income tax forecast. Weaker than projected gross sales tax receipts in each of the three quarters since the February forecast reduced the sales tax base. That lower base, in turn, reduced the forecast of future sales tax revenue by $34 million.

Although changes in the outlook for real GDP growth between February and November were relatively small, there was a key change in the composition of the national income forecast. Projected U.S. wage growth has been reduced substantially, and U.S. corporate profits increased. When applied to Minnesota the result has been an increase in expected corporate franchise tax receipts, but a larger decline in the income tax forecast due to lower wage growth. That lower wage growth also reduced projected state sales tax receipts. Lower growth rates, and in some cases absolute declines, for portfolio income--capital gains income, interest, dividends, and rent--also were sources of the reduction in the income tax forecast.

Lower Spending for FY 2004-05 Offsets Part of the Revenue Decline

Total general fund spending for the biennium is now expected to be $28.157 billion, down $143 million (0.5 percent), from end-of-session estimates. However, the spending decline includes $84 million of unspent appropriations carried forward from FY 2003. Since this increase in spending is matched by an equal amount of resources carried forward from FY 2003, the projected ending deficit is not affected.

Forecast Spending, FY 2004-05

($ in millions)

	End of Session	Nov Forecast	Change	Pct Change
Education Finance	$11,883	$11,789	$(93)	-0.8%
Higher Education	2,558	2,561	3	0.1
Property Tax Aids & Credits	2,737	2,777	40	1.5
Health & Human Services	7,425	7,332	(93)	-1.3
Debt Service	674	653	(21)	-3.1
All Other	3,023	3,045	22	0.7
Total Spending	**$28,300**	**$28,157**	**$(143)**	**-0.5%**

The decrease in forecast expenditures is one-half percent of biennial spending. Three areas account for the majority of the change. Estimates for E-12 education have been reduced by $93 million to reflect lower estimates for student enrollment. Net projected health and human services spending also falls by $93 million from revised estimates for intergovernmental transfers, lower HMO rates for basic health care, and revised estimates of the effects of 2003 Legislative changes. Refinancing of existing bonds provided $21 million in savings. Offsetting those reductions in spending is a $40 million increase in property tax aids and credits. All other spending is estimated to increase by $22 million, largely reflecting appropriations brought forward from FY 2003.

Revenues Down Through 2006-07, Expenditures Increase Slightly

Projected revenues and other resources for the 2006-07 biennium are now $914 million lower than end-of-session estimates, while expenditures are $6 million higher than previously projected. Differences between end-of-session estimates and November's revenue planning estimates parallel the decline in fiscal 2005 revenues.

FY 2006-07 Planning Estimates

($ in millions)

	End of Session	November Forecast	Change
Resources			
Revenues	$29,853	$28,985	$(868)
Other Resources	444	398	(46)
Total Resources	30,297	29,383	(914)
Spending			
Forecast Current Law	$29,771	$29,777	$6

Projected Structural Balances for FY 2007 is $46 Million

The planning estimates for FY 2006-07 now show a structural deficit of $440 million in FY 2006 and a significant drop in the projected structural balance for FY 2007. As required under current law the expenditure projections do not include any adjustment for inflation. This gap must be considered in actions resolving the current biennium's forecast deficit, as well as in preliminary planning for the FY 2006-07 budget.

FY 2006-07 Structural Balance

($ in millions)

	End of Session		November Forecast	
	FY 2006	FY 2007	FY 2006	FY 2007
Revenues	$14,856	$15,441	$14,312	$15,071
Spending	14,804	14,967	14,752	15,025
Structural Balance (Deficit)	**$52**	**$474**	**$ (440)**	**$46**

A complete version of this forecast can be found at the Department of Finance's World Wide Web site at -- www.finance.state.mn.us. This document is available in alternate format.

Forecast Fundamentals:
About the Revenue and Expenditure Forecast

November's forecast provides the first comprehensive review of Minnesota's financial outlook for FY 2004-05 since the close of the 2003 Special Legislative Session. It is the first of four forecasts that will occur during the biennium. This forecast provides revised revenue and expenditure estimates for the current biennium based on the most recent information about the national and state economic outlook, and caseload, enrollment, and cost projections. Actual closing data for fiscal year 2003 revenues and expenditures are also included in this report as are updates of the revenue and expenditure planning estimates for the FY 2006-07 biennium.

The revised revenue estimates reflect changes in the national economic outlook since February. That forecast was the basis for the FY 2004-05 enacted budget. This forecast also makes use of additional revenue collection experience. For example, state individual income tax receipts now incorporate data on withholding tax collections through October.

Revenue estimates for the remainder of the current biennium are based on econometric forecasts of the U.S and Minnesota economy. The revenue forecast is prepared based on a national economic forecast provided by Global Insights Inc. (GII). GII's national forecast, was reviewed by Minnesota's Council of Economic Advisors. The council's comments are found in the "Economic Summary." The "Economic Outlook" which follows provides a more comprehensive overview of the current outlook for the U.S. and Minnesota economies.

Revenue planning estimates for FY 2006-07 are obtained from less complex models. As in past years the economic growth assumptions used to develop the revenue planning estimates have been updated. Calendar year 2006 economic growth rates are now taken from the GII November baseline scenario. The economic growth rates assumed for calendar 2007 are the same scenario as used in February 2003. Planning estimates should not be interpreted as explicit forecasts, but rather as a guide to indicate whether proposed actions will create financial problems in future years.

Expenditure estimates in most areas are shown at the level of the appropriations made for FY 2004-05 by the 2003 legislature, plus any authorized spending carried forward from prior years. Entitlement programs--such as E-12 general education, intergovernmental aids, health care, and family support--are forecast based on expected changes in eligibility, enrollment, and average cost.

Wage and price inflation is included in the revenue planning estimates which are based on current law tax rates. It is not included in projected expenditures. Estimated inflation during the period is 1.9 and 2.0 percent for FY 2006 and FY 2007 respectively.

As with all budget forecasts, this forecast reflects only current law. It does not anticipate any Gubernatorial budget recommendations, or any potential legislative action. The difference between the forecast and the budget process is clearly defined, but often confused. Presentation of the current law forecast for various areas will likely be accompanied by discussion of possible future legislative changes. The forecast provides a current law framework for these discussions, it does not anticipate the outcome. Similarly, a forecast deficit or surplus for the current biennium--or in planning estimates for the next biennium--does not preclude the Governor or the legislature from proposing budget changes that will have a significantly different result than that shown in the current forecast.

Economic Summary

Real GDP growth in the third quarter was nothing short of spectacular. Inflation adjusted output increased at an 8.2 percent annual rate, the strongest growth rate in nearly 20 years. No one expects the economy to continue to grow at its recent break-neck pace, but most forecasters believe that real GDP growth rates averaging around 4 percent are possible through the end of 2004.

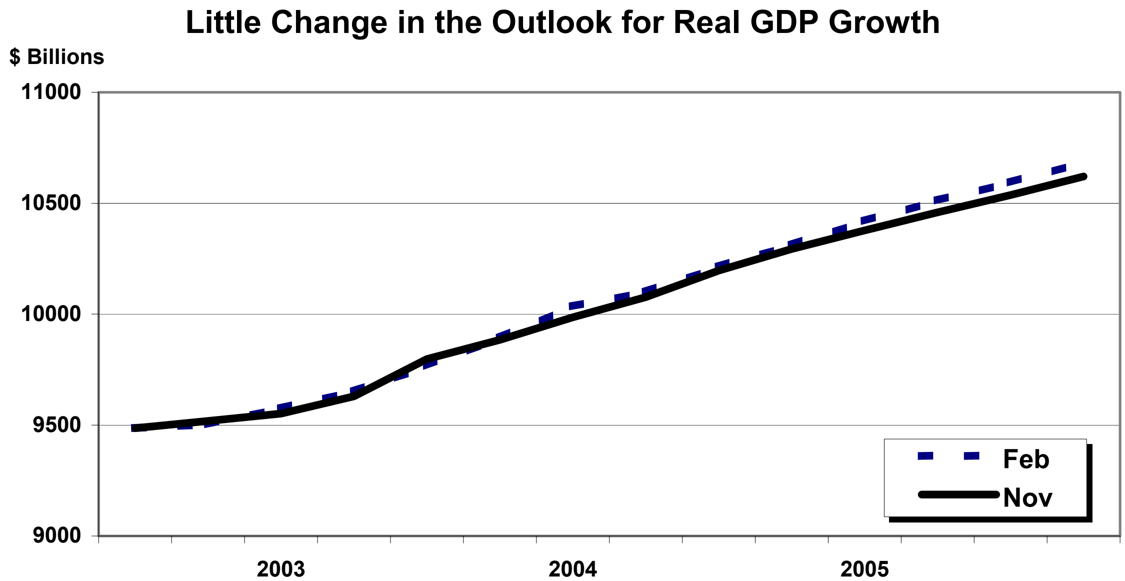
Almost all short term signs in the economy are now positive. Inflation is under control, interest rates are low, and the long awaited increase in business capital equipment spending appears under way. A weaker dollar and the need to re-build inventories add to the general optimism. Corporate profits have picked up and even though the capacity utilization rate remains well below normal levels, business investment spending is increasing. Even the stock market has been cooperating, with broad market averages up at double-digit rates since early 2003.

Most important, there is welcome news that payroll employment has again begun to grow. The U.S. Bureau of Labor Statistics now estimates that a total of 286,000 jobs were created nationwide during August, September and October. Although it is true that for unemployment rate is to turn down noticeably job growth must be even higher, most economists see the recent growth in jobs as a sign the economic expansion has finally reached the labor market.

A turn-around in employment by the start of 2004 had already been factored into most forecasts. Indeed, if the labor market did not begin to strengthen the U.S. economy was unlikely to perform at levels generally anticipated over the next 18 months. Future federal deficit projections paint a picture so bleak that further fiscal policy action appears quite unlikely, and short-term interest rates are already at historic lows. Federal income tax changes approved earlier in 2003 will provide some slight stimulus in the first quarter of 2004 through larger than normal tax refunds, but that by itself will be insufficient to ensure strong growth through 2004. If the expansion is to continue on track, consumers must find additional buying power, and at this point the only realistic source of that buying power is from additional jobs.

Global Insight Inc (GII), Minnesota's national economic consultant, now believes real GDP will grow at a 4.3 percent annual rate during calendar 2004, down slightly from the 4.6 percent growth rate forecast in their February baseline. For calendar 2005, GII's November baseline forecast is slightly weaker, with a real growth rate of 3.6 percent now anticipated. In February, the GII baseline forecast called for real growth to continue in 2005 at a 3.8 percent annual rate. There was no material difference between Global Insight's current forecast for real growth in 2003 (2.9 percent) and their February baseline forecast (3.0 percent).

GII continues to see no reason to be concerned about price increases over the forecast horizon. Inflation is forecast not only remains under control, it to slows further, dropping to just 1.6 percent in calendar 2004, as oil prices come down from their current levels. Consumer prices increase a little faster in 2005, but the projected inflation rate of 2.3 percent presents little threat to the economy.



GII assigns a probability of 60 percent to their baseline forecast, the same as in February. More optimistic and more pessimistic scenarios are assigned probabilities of 20 percent each. It is worth noting, however, that differences between the baseline and the optimistic and pessimistic scenarios are smaller than has typically been the case. The more pessimistic scenario does not include a recession, but only an extension of the slow growth rates observed earlier in this year for another year.

Members of Minnesota's Council of Economic Advisors and Finance Department economists agreed that the November GII baseline reflects the consensus short-term outlook. As usual some Council members were slightly more optimistic than GII, and others believed the economy would under-perform the baseline forecast, but differences among individual forecasts were small and narrower than usual. The Council's narrower consensus is repeated at the national level, where there also are only slight differences in the outlook of most major forecasters. More than 60 percent of the forecasts of members of the Blue Chip Panel for real growth in 2004 fall within the range of 3.9 to 4.5 percent.

But, while there was general agreement on the expected real GDP growth rate, several council members questioned whether the employment and wage outlook in the GII baseline might be somewhat optimistic. Finance Department economists agreed, noting as in February their model of the Minnesota economy might not yield as strong an employment and wage growth forecast as is in the GII national baseline.

The Finance Department reported that withholding tax and gross sales tax receipts have been less than one percent from forecast for the past four months. GDP growth in the third quarter was much stronger than anticipated. But that simply lifted third quarter nominal GDP to approximately the level projected in February's baseline forecast. The proportion of the increase in national income going to wages appears to be smaller than in the recent past, leading to smaller growth in the wage base subject to the individual income tax. During the most recent quarter, for example, wage gains amounted to only just over 10 percent of the growth in nominal national income.

Finance Department economists also noted that individual income tax liability for tax year 2002 was less than projected in February's forecast. Lower than anticipated interest and dividend income, and greater use of the working family credit appear to be the major sources of that shortfall. Absent other changes to the forecast this will cause base income tax liability for tax year 2003 and each future tax year to be reduced. Lower growth estimates for future interest and dividend income are also likely.

Council members agreed with Global Insight's assessment that the economy is as likely to outperform the forecast as fall below it, but they noted that the upside potential from this forecast is relatively small compared to possible downside losses from weaker than expected economic performance. Council members once again noted the important role the state's budget reserve plays in helping offset the volatility in state revenues.

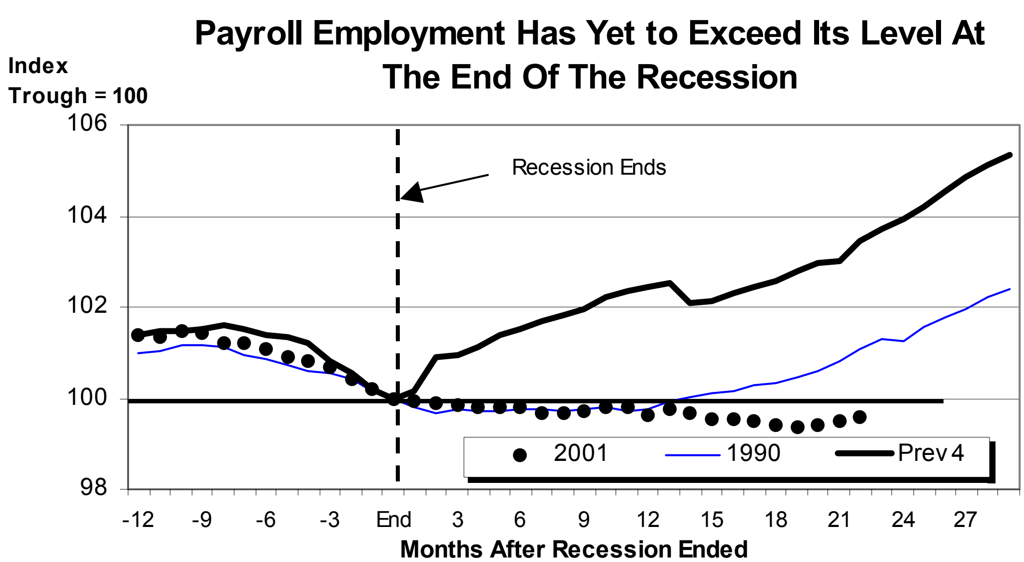
ECONOMIC OUTLOOK

Most reports show the economy is picking up speed. Real GDP growth has accelerated, manufacturer's orders are rising, capital spending is stirring, and the jobs market is slowly turning up at last. Economists credit the good news to a sharp increase in defense spending, rising profits, federal tax cuts, mortgage cash-outs and strong consumer spending. GII has taken recent developments into account, but their November outlook is still less optimistic than February's.

Early next year, the discretionary income boost from tax cuts and refinancing will begin to fade. When that happens, GII believes income from new jobs will be needed to sustain the recovery. More jobs depend on additional demand from revived capital spending, renewed inventory accumulation, and rising exports. Unless these follow through, the recovery will weaken, though it seems the near term risk of another recession is quite low.

A Jobloss Recovery

Last summer, the National Bureau of Economic Research declared the recession ended in November 2001. Historically, employment normally rebounds several months to a year into a recovery. Since this recovery began, non-farm payrolls have declined an unprecedented 770,000 jobs. Federal Reserve Bank of New York economists attribute the "jobloss recovery" to restructuring, the permanent relocation of workers from some industries to others. More than ever before, future employment gains will depend on new job creation, a slow process. If they are to create jobs, firms must expand and develop new products and services. And many dismissed workers will need new skills before they find employment.



Normally, employment is rebounding by the time a recovery is several months old. But since the recession ended in November 2001, non-farm payrolls have declined an unprecedented 770,000 jobs.

Intense Competition--An Uncertain Future

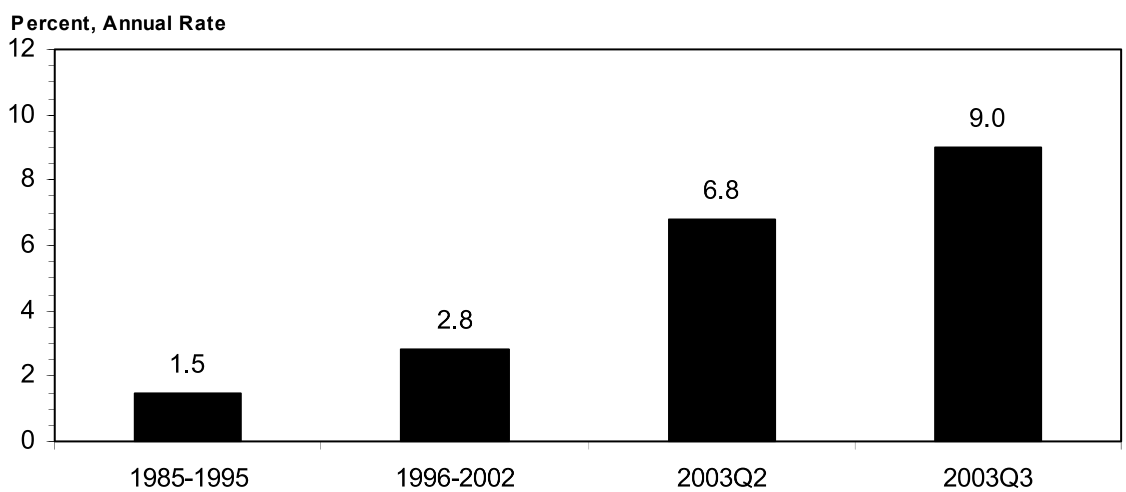
Firms are restructuring in order to cut costs. In most industries, there is no other way to rebuild profits because low inflation and competition make it difficult to raise prices. *BusinessWeek* attributes much of the intense competition to imported goods whose inflation adjusted prices have declined an estimated 20 percent in 10 years. Also, so-called big box retailing has proved highly competitive. During the past several months, import prices appear to have bottomed out, but the highly competitive retailing environment is almost certainly here to stay.

Jobs have been lost in many industries, but manufacturing faces the most uncertain future. Since the recession's end, some 1.3 million manufacturing jobs have vanished. It is not clear how many can be regained. The president of the National Association of Manufacturers thinks about one-half the loss will eventually be recovered. But GII's November forecast has virtually a zero increase during the next few years. Everyone agrees a great many jobs are gone for good.

No Guarantees Yet

Real GDP growth accelerated sharply last summer, but the surge has come primarily from above-trend labor productivity gains, not more workers. Output per hour rose 2.8 percent annually during 1996-2002, up from 1.5 percent during 1980-1995. But productivity surprised observers by rising at a 9.0 percent annual rate in third quarter 2003, after a 6.8 percent increase the previous quarter.

Output Per Hour in Non-Farm Business Has Increased Dramatically



Economists attribute the jobloss recovery to industry restructuring. Recent acceleration in real GDP growth has come primarily from above-trend labor productivity gains, not more workers.

Economists generally believe recent productivity increases are not sustainable. GII thinks new jobs will at last be added in service producing industries where firms are thought to have squeezed as much additional output as possible from the existing workforce. That view is supported by surveys of hiring intentions, and by modest gains in seasonally adjusted non-farm employment during the past three months. While encouraging, three months are not a trend. So, there is no guarantee the jobs drought is over.

Will the Recovery Fizzle?

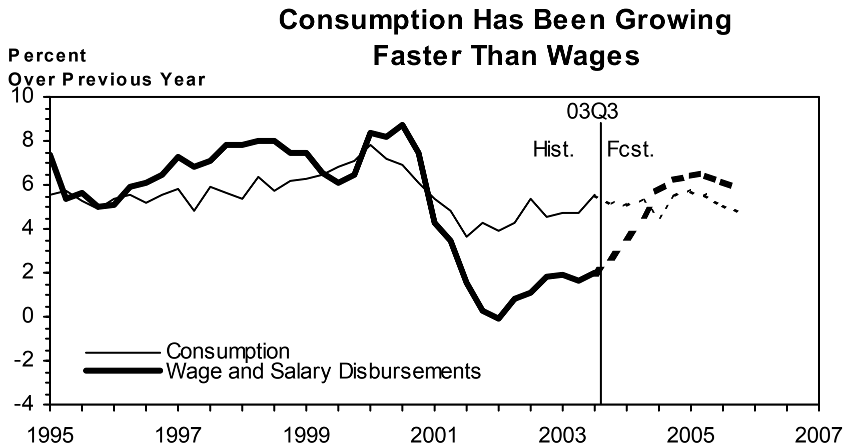
When the proceeds from tax cuts and mortgage cash-outs are gone, GII's November forecast assumes additional income from new jobs will support normal levels of consumer spending. The recent spending surge will not continue because consumers have already satisfied their post-recession pent up demand for durable goods. If the recovery is to retain its strength, more jobs-creating demand from other sources will be required. For that, the forecast assumes inventories grow while capital outlays and exports accelerate. Otherwise, GII says the recovery could fizzle though a new recession would be unlikely.

Monetary policy also poses risks to the recovery. No one expects current very low inflation to last indefinitely. So, it is widely anticipated the Federal Reserve will begin raising interest rates next summer or fall. Recently, the *Wall Street Journal* reported some economists are concerned that tightening could begin too soon. Others worry that even well timed moves could destabilize financial markets if the Fed fails to effectively communicate its intentions.

Consumption

Consumer outlays accelerated during the summer and fall. Most of that was discretionary spending on autos, home furnishings, computers, apparel, restaurant meals, and tourism. Boosts in discretionary income helped. Those came from multiple sources including child care tax credit checks, federal withholding cuts, and cash-out refinancings. In addition, productivity driven increases in real wages have appeared despite job losses. Spending has also been encouraged by improving household finances. Net worth is rising and debt service expenses as a share of disposable income are declining.

Forecasters doubt the recent durable goods spending binge is sustainable. While disposable income growth will accelerate with new jobs, consumers' pent-up demand for durable goods is nearly satisfied. Much recent spending has been for price sensitive big ticket items, or in response to very low interest rates. Auto sales have been inflated by incentives which manufacturers are likely to scale back because the market appears increasingly saturated. And, the housing market is expected to soften in 2004, so sales of furnishings must almost certainly do the same.



Child care tax credit checks, federal withholding cuts, and mortgage cash-outs have helped consumption grow faster than wages. As these sources of discretionary income fade, GII's November forecast assumes wages from new jobs will sustain consumer spending.

As durables spending wanes over the next several quarters, GII's November outlook assumes consumers will shift a significant part of their discretionary outlays to cyclically sensitive sectors including travel, recreation, and personal services. Spending on services is forecast to accelerate sharply in 2004.

Investment

Business capital spending of virtually all kinds led the late 1990's economic boom, a performance not likely to be repeated soon. Firms are now spending selectively. Currently, investment in information processing equipment and software has turned up, much of it to replace short-lived equipment purchased in anticipation of Y2K. Business spending for light vehicles and heavy trucks is also rebounding. Forecasters expect that will continue, in part because most federal bonus depreciation allowances are scheduled to sunset at the end of 2004.

An immediate recovery in other major categories of capital spending is unlikely. That would require sharp increases for communications gear, for industrial equipment, and for office buildings and factories. Current weakness in communications and manufacturing virtually precludes strong spending by these sectors for at least several months. And recent news articles indicate office and industrial vacancy rates are still rising while rents are falling, an unfavorable environment for planning new construction projects. There is some improvement in the market for existing structures, but that seems speculative and driven primarily by relatively low interest rates.

Analysts are encouraged by signs firms have decided it is time to rebuild depleted inventories, and GII has an inventory rebound in its forecast for the current quarter. For some time, inventory-to-sales ratios have languished at or near historic lows as firms hesitated to restock shelves. Currently, rising factory orders suggest firms are discovering demand cannot be met with existing stocks. It remains to be seen, though, whether manufacturing job losses will cease as output rises.

Stores have stocked up for Christmas, but cautiously according to most observers. A *Wall Street Journal* article indicates that although retailers expect a better season than last year, they kept inventories relatively lean out of fears recent tax-cut and mortgage driven spending will not carry over into the holiday shopping period.

Government

Observers generally expect the federal deficit for this fiscal year will easily exceed last year's record $374 billion. That should not disturb financial markets. GII estimates a $500 billion deficit would amount to only about 4.0 percent of GDP, much less than fiscal 1983's 5.5 percent.

Forecasters were surprised at the large increase in real federal spending for second quarter, 2003, some 25 percent at an annual rate on a National Income and Product Accounts basis. A 44 percent increase in defense spending was largely responsible. While expenses for Iraq and Afghanistan are expected to continue for the foreseeable future, GII projects no more big increases.

Federal budget projections are subject to significant uncertainty. New military contingencies may arise. Further changes to Medicare are likely. And Congress and the President may address sunset provisions in recent tax cuts. Forecasters generally expect at least some of the tax cuts will be extended or made permanent.

International

Since the recession ended, U.S. manufacturing jobs have declined by some 1.3 million. Global competition and low wages overseas are often blamed. The media regularly report U.S. plant closings and movement of U.S. manufacturers to third world countries. Lost U.S. production is then replaced with lower cost imports which remaining U.S. based firms cannot compete with. The quadrupling of the U.S. current account deficit since 1997, and especially the record deficit with China, are frequently cited as evidence the anecdotes correctly indicate a pervasive problem with imports.

Most policymakers know consumers benefit from high quality, low priced imported goods. So, broad-based protectionism is out of the question. There were tariffs on steel and President Bush recently imposed selective tariffs on Chinese apparel after he failed to persuade China to let the now-pegged yuan's value float. If floated, most analysts agree the yuan's value would rise, thereby raising the price of imported Chinese goods while lowering the prices of U.S. exports.

That would help, but most economists think there are more reasons than low wages and undervalued currencies for U.S. manufacturing job losses and the trade deficit. A *Wall Street Journal* article points out that factory jobs are in worldwide decline, including in China, with technology driven productivity improvements playing an important role. And while low wages are a factor, many firms move overseas to be closer to their expanding markets. Finally, the U.S. is suffering from a shortfall in exports. That is attributable to weak demand in Europe and Japan, but not China where demand is booming. *Business Week* calculates that over the past year U.S. exports to China are up some 21 percent, while to the rest of the world, only 2 percent. China has emerged as a major importer of foodstuffs and raw materials, driving up prices despite economic weakness in major industrial countries.

GII's November forecast anticipates gradual improvement in U.S. exports as currently weak world demand improves. Much depends on recovery in Japan and Europe. Meanwhile, continued slow depreciation of the dollar is expected to help U.S. exporters gain market share.

Monetary

Though the economy is recovering, there is still so much excess capacity, and inflation is so low, that virtually no one expects the Federal Reserve to raise interest rates for at least several months. The *Wall Street Journal* interprets recent Fed announcements to mean it will be slow to raise rates as the economy expands because it wants to be sure inflation goes no lower. The risk remains that either intensified global competition or a random shock which reduces demand could force inflation closer to zero, or even precipitate a general decline in prices.

There is speculation about how the Fed will proceed when it again makes a move. In his speeches, Dr. Greenspan insists the workings of the economy are too complex for simple monetary policy rules. Dr. Greenspan defends his past practice, a so-called discretionary policy. That has consisted of responding to shocks like a stock market crash, and pre-emptive hedging against uncertain events like accelerating inflation or, deflation.

If a discretionary policy is followed, then not only must the Federal Reserve time its moves correctly, it must also communicate its intentions clearly in order to avoid creating uncertainty by surprising the markets. Recent Open Market Committee announcements have indicated the federal funds rate will stay at its current 45-year low of 1 percent for a "considerable period." Press articles interpret that to mean the Fed sees no reason to make a pre-emptive move against inflation for the foreseeable future. According to the *Wall Street Journal*, observers agree the effect has been to keep long term interest rates from rising as the economy accelerates.

No one knows when or how the Fed will indicate the “considerable period” is coming to an end. Some Fed watchers are already attaching significance to the fact that Dr. Greenspan has not repeated the phrase in recent speeches.

Inflation

GII estimates consumer inflation is rising at a 2.3 percent annual rate, up from 1.6 percent last year. Energy prices are rising 11.9 percent. Consumer commodity prices are falling at 1.7 percent while non-energy services prices are rising at 2.8 percent. Excluding volatile energy and food prices, core CPI inflation is currently rising at only 1.5 percent annually, the slowest in almost 40 years.

Despite low inflation, forecasters see little risk of the general deflation mentioned last spring by Dr. Greenspan and others. Energy prices are expected to decline about 6.4 percent next year, but that will not wipe out this year's gain. Import prices fell for several years, but they have been almost flat this year and should rise if the dollar slowly declines as expected. And services prices are expected to continue increasing. On the bottom line, GII expects the CPI will rise 1.4 percent in 2004, with core inflation accelerating slightly to 1.8 percent.

MINNESOTA OUTLOOK

Minnesota's economy appears to be performing below last February's forecast. Preliminary data for the first two quarters of 2003 indicate total wages are almost exactly on forecast. However, third quarter seasonally adjusted non-farm employment in the private sector is about 15,000 jobs below projected levels. Consequently, Finance Department economists have revised the Minnesota outlook downward. The forecast assumes, and recent signs suggest, a sustainable pickup in Minnesota employment will at last get underway by early 2004.

Since February, there has been a landmark change in economic data used for forecasting the national and Minnesota economies. The February forecast was based on industry detail determined according to the Standard Industrial Code (SIC). Since then, federal agencies have discontinued SIC in favor of new industrial classifications determined by the North American Industry Classification System (NAICS). While the definition of total non-farm employment is unchanged, there is no exact correspondence between SIC and NAICS industry detail for the entire private sector. Both GII's U.S. model and the Finance Department model of the Minnesota economy have been converted to NAICS.

Minnesota's Outlook Revised Down

Compared with last February, Minnesota employment and wage forecasts have been reduced for 2004 and 2005. Those revisions reflect the state’s weaker than projected performance for 2003, GII’s less optimistic outlook for the U.S. economy, and a lower outlook for state and local employment and wages.

February’s forecast assumed no growth in employment and very modest growth in public sector wages through 2005. Preliminary statewide data for October show some 2,000 fewer state government jobs and 5,000 fewer local government jobs than existed in October 2002. For the November forecast, Finance Department economists assumed those are permanent reductions in the public sector workforce. The decline in public sector employment, the likely impact of new labor contracts for state government and the University of Minnesota, and projected local government wage restraint lead to slower public sector wage and salary growth than is typical for Minnesota.

November’s outlook for 2003 Minnesota total wages has been reduced only slightly from February’s baseline, even though the Global Insight forecast for U.S. wage and salary growth was revised down by more than 50 percent. The Finance Department model of the Minnesota economy, which attempts to take explicit account of changes in performance based compensation in addition to regular wages and salaries, appears to have performed well during the past year. But, consistent with GII’s more restrained outlook, wage and salary growth rates for 2004 are lower in the current forecast. The Minnesota model indicates increases in Minnesota employment and wages and salaries will trail the national averages through 2005.

MINNESOTA OUTLOOK COMPARED TO THE U.S.

(Calendar Year Percent Changes)

	2001	2002	2003	2004	2005
Non-Farm Employment					
Minnesota					
February 2003	-0.1	-0.9	0	1.7	2.1
November 2003	0.2	-1.1	-0.4	0.7	1.3
United States					
February 2003	0.2	-0.9	0.4	2.3	2.2
November 2003	0	-1.1	-0.3	1.1	2.2
Wage and Salary Income					
Minnesota					
February 2003	2.8	0.9	2.8	5.9	6.4
November 2003	2.9	1.4	2.7	4.5	5.1
United States					
February 2003	2.4	1.5	4.2	6.4	5.7
November 2003	2.4	0.9	2.1	5.1	6.2

A NAICS Model of the Minnesota Economy

Conversion to NAICS has made econometric model construction and forecasting more difficult. When they exist, NAICS time series are significantly shorter than SIC series. That is a disadvantage in constructing econometric models able to track business cycles. While there are NAICS employment series which begin before the 1990-1991 recession, there are no corresponding official Bureau of Economic Analysis (BEA) time series for wages and salaries paid by Minnesota industries.

To obtain needed data, Finance Department economists developed their own wage series going back to 1988 based on data files provided by the Minnesota Department of Employment and Economic Development. The methodologies used to prepare those series seem to work, but are not proven.

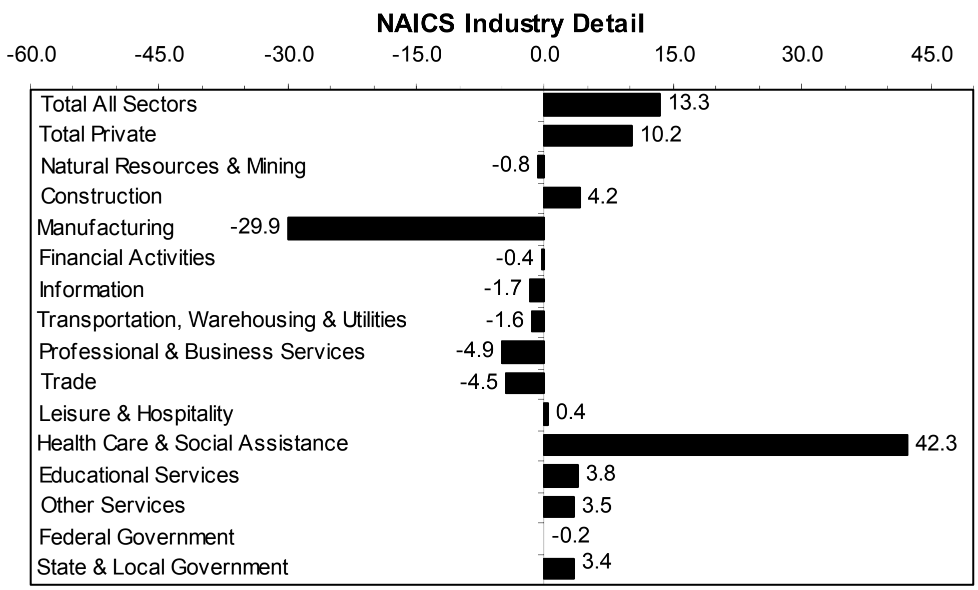
Using that data, Finance Department economists constructed a NAICS based quarterly econometric model of Minnesota employment and income. While no additional economic activity has been discovered, there is more industry detail. Compared to the SIC model, the new Minnesota model projects employment in 36 private industry categories instead of 34. Total wages are now projected in 14 private sector categories, compared with 11 previously. As part of the wage calculation, bonuses paid and stock options exercised are projected in 7 industry categories, up from 5 previously.

Despite the conversion, the causal structure of the NAICS model remains basically the same as its predecessor. In short, it treats the Minnesota economy as a satellite of its U.S. counterpart. As before, the new model's industry detail is specified to estimate the state economy's share of projected national economic activity as forecast by GII. Detail in the GII and Minnesota models makes it possible to distinguish between industries present in Minnesota and those that are not.

Minnesota Industry Restructuring

Minnesota's economy is clearly in a period of restructuring. While most sectors are forecast to grow modestly from current depressed levels, significant employment increases will occur only in the health care and social assistance sector. In November's forecast, only 4 of 12 major sectors in Minnesota's private economy are projected to experience modest employment increases over 2001 levels through 2005. Sectors showing small gains include construction, educational services, and other services. With the possible exceptions of leisure and hospitality, and financial activities, all other private sector industry groups are likely to have fewer jobs in 2005 than in 2001, the year the recession ended.

Projected Changes in Minnesota Non-Farm Jobs (1,000's) 2001-2005



By 2005, only 4 of 12 major sectors in Minnesota's private economy are likely to have more jobs than in 2001, the year the recession ended.

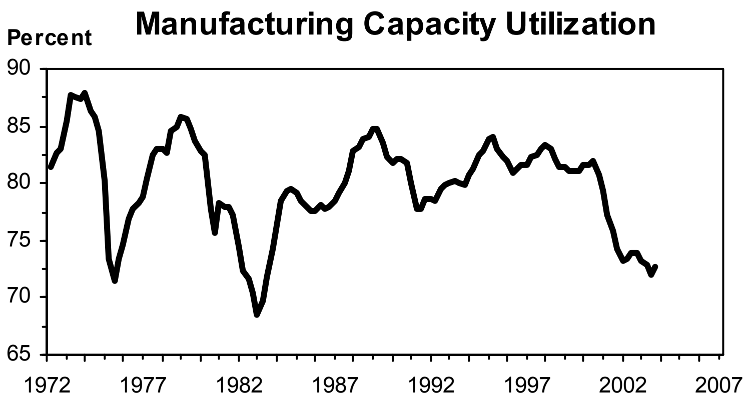
Manufacturing Uncertainty

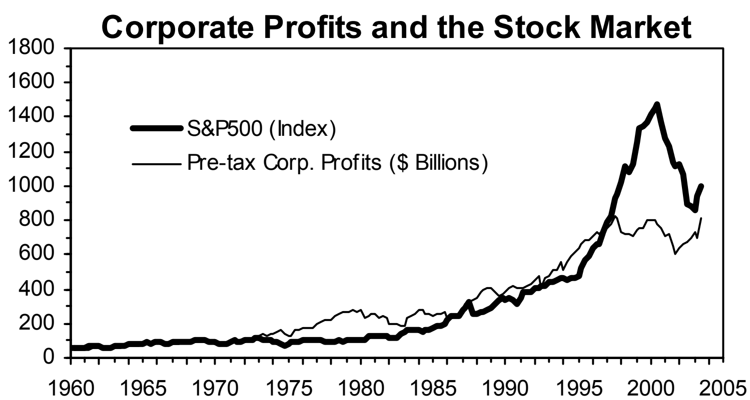
Like its national counterpart, Minnesota's manufacturing sector faces an especially uncertain future. About 32,000 manufacturing jobs have been lost since calendar 2001. Some of those losses are the permanent result of industry restructuring while others are short-term cyclical layoffs attributable to the recession and weak exports. However, as a recent *Minneapolis Star Tribune* article indicates, industry experts are unable to objectively identify the temporary layoffs.

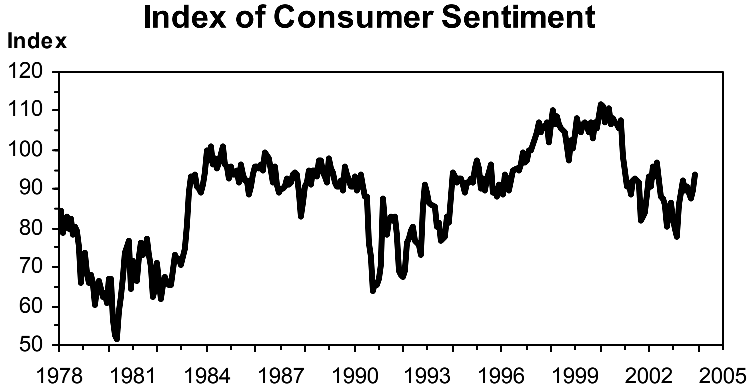
Finance Department economists used the NAICS model of the Minnesota economy to prepare the November jobs forecast for the manufacturing sector. Like many economic models, the new model of the Minnesota economy cannot identify the effects of underlying structural changes. So, where needed, small judgmental adjustments were made based on press articles and GII's outlook for the U.S. manufacturing sector.

In the outlook through 2005, modest employment gains are projected in wood products, furniture, fabricated metal products, electrical equipment, transportation equipment, and miscellaneous durables which in Minnesota is dominated by medical devices. Over the same period, employment levels in food manufacturing, printing and related products, and paper are forecast to remain steady. Plastics and rubber, machinery, and computers and electronics lose jobs. By 2005, total manufacturing jobs are forecast to be some 2,500 or 0.7 percent above current levels, but almost 30 thousand less than in 2001.

Selected National Economic Indicators







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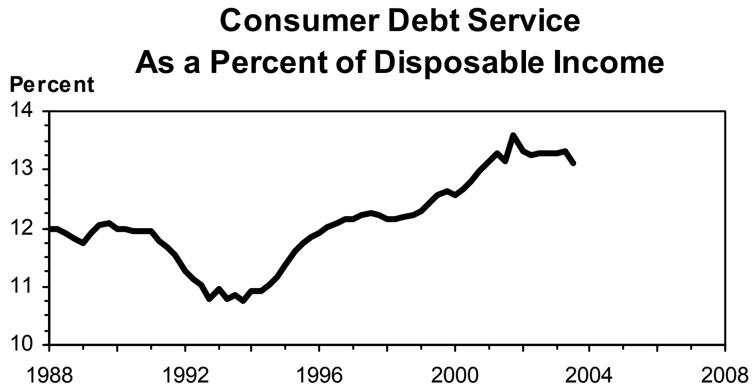

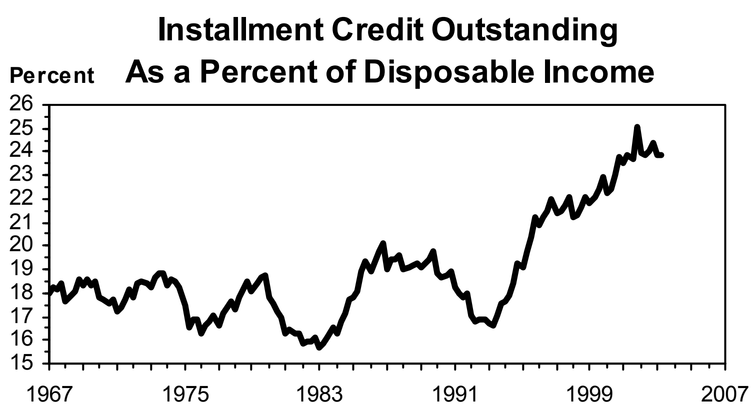

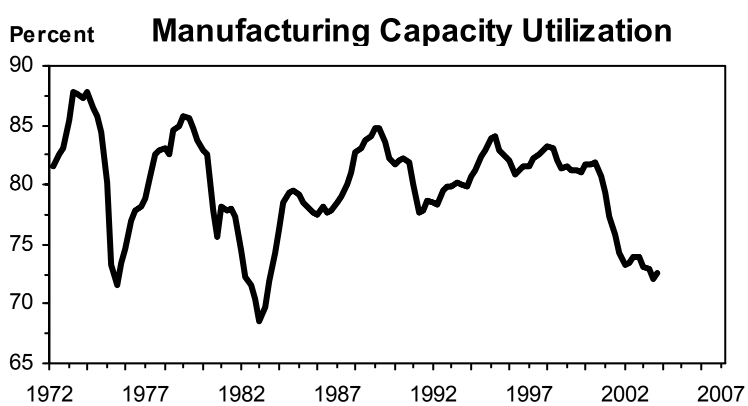

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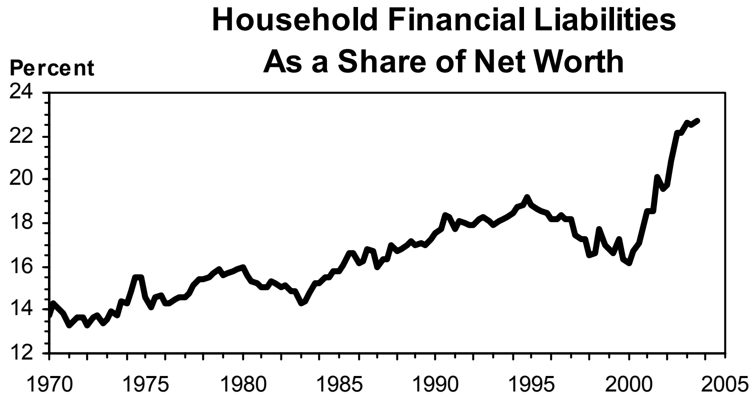

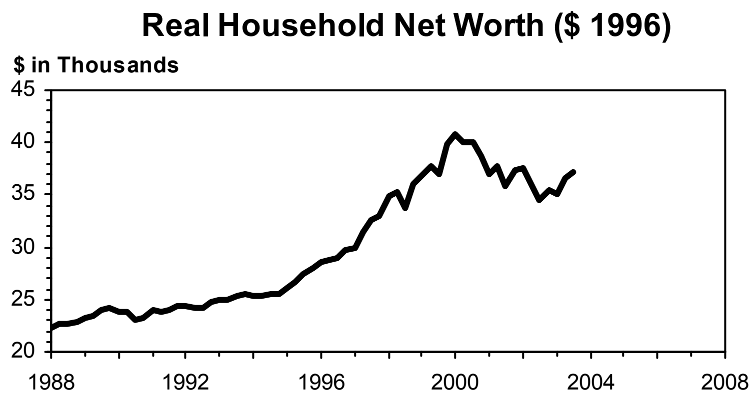

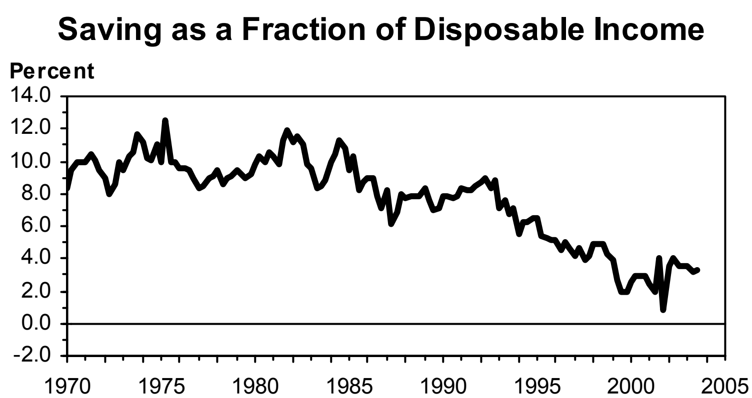

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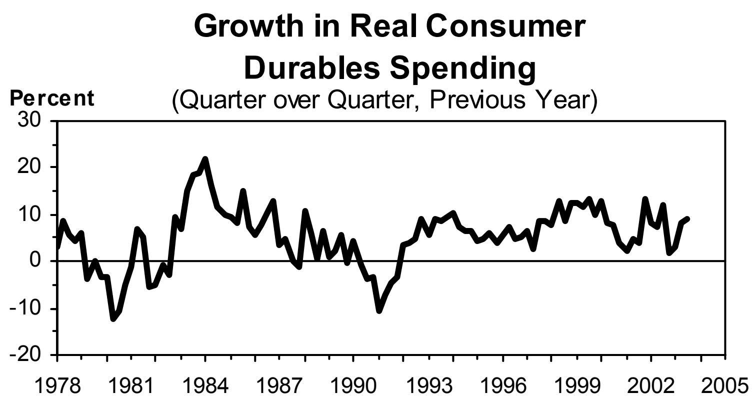

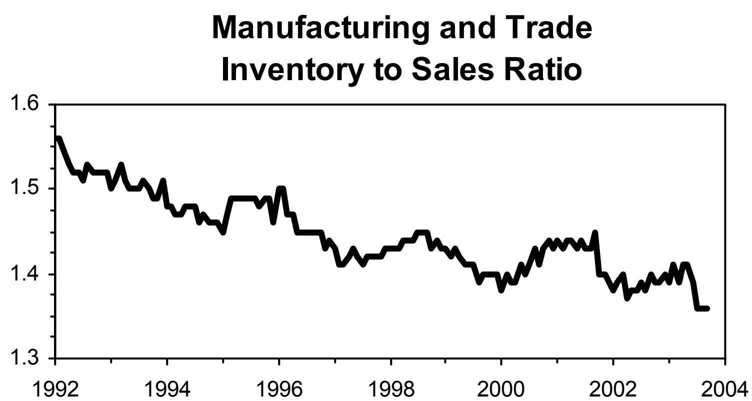

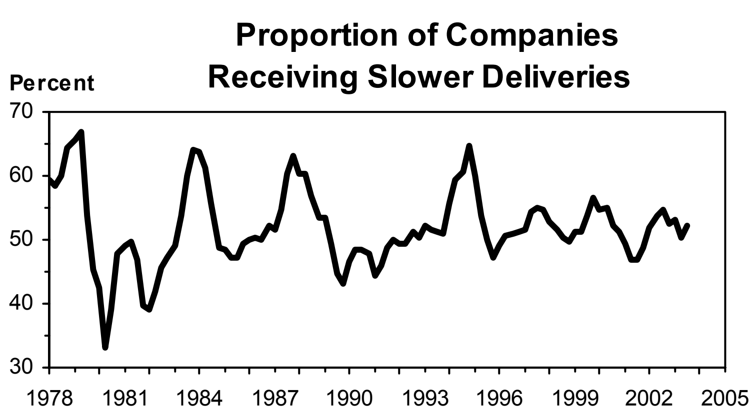

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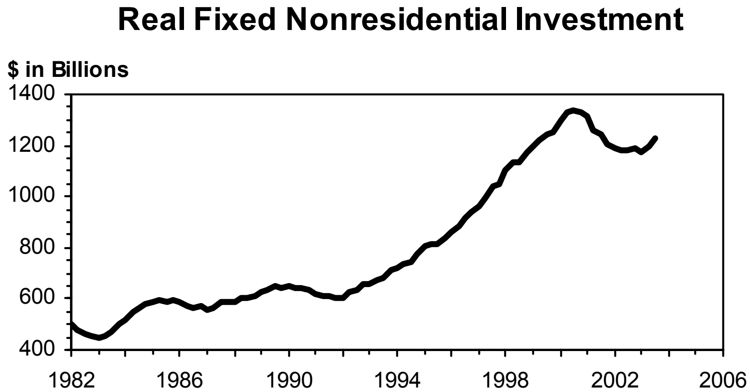

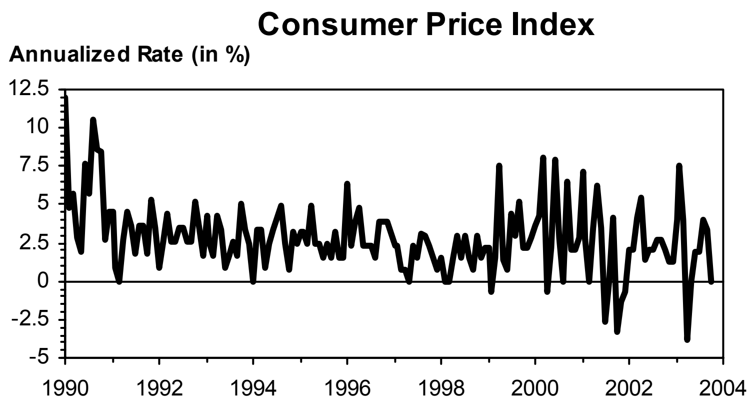

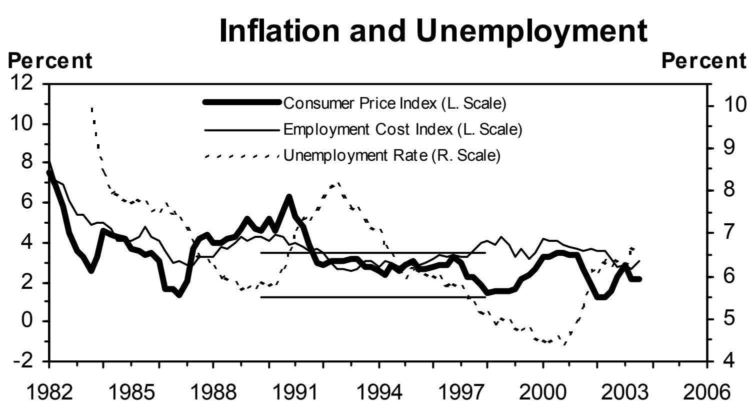

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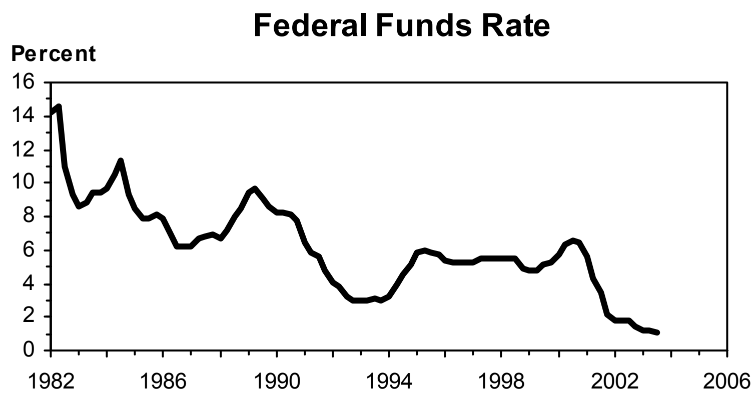
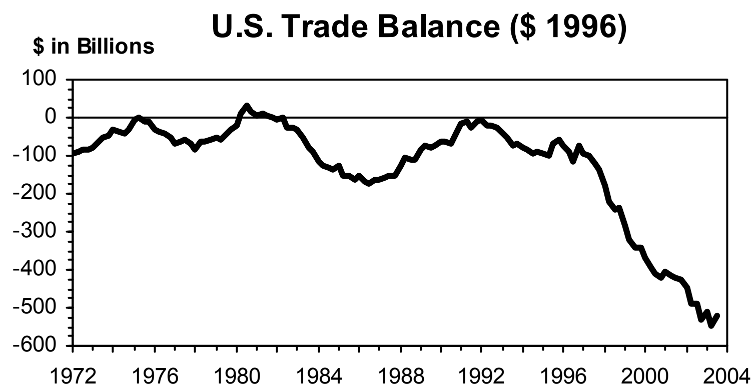
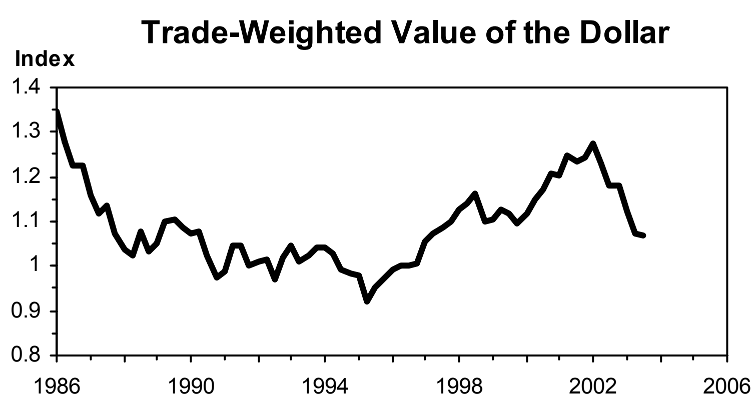






FY 2003 Year End Summary

In September 2003 the books were officially closed for the fiscal year ending June 30, 2003. This also marked the end of the FY 2002-03 biennium.

FY 2003 concluded with a general fund balance of $369 million before any reserves are considered. Funding reserved for appropriations carried forward to FY 2004, $84 million, reduced this amount to $285 million. Laws 2002 Chapter 374, Article 8, Section 7 required that any positive general fund balance on June 30, 2003 be transferred to the budget reserve. The excess above the $181 million estimated at the end of session, $104 million, has been transferred to implement this requirement. The table below shows final FY 2003 data compared to estimates made at the of the 2003 legislative session.

FY 2003 Actual
Changes From End of Session Estimates
($ in millions)

	End of 2003 Sessions	FY 2003 Close	Change
Beginning Balance	$1,130	$1,130	$0
Non-Dedicated Revenue	12,534	12,575	41
Transfers, Other Revenue	516	558	42
Total Resources	14,180	14,263	83
Expenditures	13,999	13,894	(105)
Balance Before Reserves	**181**	**369**	**188**
Budget Reserve	0	104	104
Appropriations Carried Forward	0	84	84
Ending Balance	**$181**	**$181**	**$0**

Although end-of-session estimates forecast a $181 million balance after accounting for actions taken by the Governor and 2003 legislature to re-balance the FY 2003 budget, final revenue and expenditure data between June and the September 2003 closing resulted in additional resources available for the fiscal year.

Final FY 2003 Revenues Were $83 Million Over End-of-session Estimates

As reported in the October *Economic Update*, total revenues for FY 2003 were $83 million higher than end-of-session estimates. This was due entirely to federal flexible assistance payments of $84 million received by the state. Even though there was an estimate of these federal receipts during the legislative session, the funds were not received until late June after the session had concluded.

For FY 2003 total revenues, excluding federal flexible assistance payments were just about on target with end-of-session estimates. Individual income tax receipts were $129 million lower than estimated, and corporate income tax receipts were $59 million higher. Mortgage and deed taxes were $44 million higher and insurance gross earnings taxes were $36 million higher than estimated. All other resources were $10 million lower than estimated.

FY 2003 Spending $105 Million Below Forecast

FY 2003 expenditures were $105 million lower than estimated. However, the 2003 Legislature provided expanded carry forward authority that allowed agencies to carry unspent FY 2003 operating funds into the next fiscal year. Along with $33 million in carry forwards allowed under previously existing authority, an additional $51 million in unspent appropriations were carried forward under the expanded authority. Excluding the $84 million carried forward, net spending decreased $21 million. This reduction in spending resulted primarily from slightly lower costs for E-12 Education and Human Services programs. These savings contributed to the increase in the ending balance for the fiscal year.

FY 2004-05 Budget Summary
FY 2006-07 Planning Estimates

Projected Deficit of $185 Million Now Forecast for FY 2005

Forecast revenues for the current biennium have been reduced by $365 million, while estimates for transfers, dedicated revenues and other resources are $41 million below prior estimates. Spending for the biennium has decreased $143 million. However, in that amount is $84 million of appropriations carried forward from FY 2003 at year-end. Lower revenues, offset by slightly lower spending, combine to turn the zero balance left at the end of the 2003 legislative session into a $185 million projected budget deficit by June 30, 2005.

Comparison: FY 2004-05 Budget

($ in millions)

	End of Session	November Forecast	Difference
Beginning Balance	**$181**	**$369**	**$188**
Revenues	27,046	26,680	(365)
Other Resources	1,595	1,554	(41)
Expenditures	28,300	28,157	(143)
Balance before Reserves	522	446	(76)
Budget Reserve	522	631	110
Available Balance (Deficit)	**$0**	**$(185)**	**$(185)**

A $458 million decrease in the forecast for the general fund's four major tax sources accounts for the total revenue decrease of $407 million. Of the reduction in major revenues, $490 million is attributable to individual income tax collections and $124 million to lower than expected sales tax collections. Offsetting these reductions is a $140 million increase in forecast corporate income tax collections and a $16 million increase in forecast motor vehicle sales tax collections.

General Fund Reserves

The state has two distinct general fund reserve accounts. The primary account is the budget reserve, sometimes referred to as the "rainy day fund." The amount in the Budget Reserve Account was increased from $622 million to $653 million in the 2001 legislative session. Budget actions in the 2002 and 2003 legislative sessions reduced funding in the budget reserve to zero. In FY 2004-05, $522 million was restored by appropriations to the reserve.

Two current law provisions act to increase the budget reserve from the $522 million appropriated in the 2003 legislative session to the $631 million now shown for FY 2005. First, Laws 2002 Chapter 374, Article 8, Section 7, allocated available balances on June 30, 2003 to the budget reserve. Of the balance for FY 2003, $104 million was allocated to the reserve at the close of the year. Second, excess surpluses in the assigned risk plan are annually transferred to the budget reserve. This is projected to add $6 million in FY 2004. As a result, the budget reserve is expected to be $631 million by FY 2005, or approximately 2.2 percent of biennial spending.

Statutes provide that the Budget Reserve may be used to offset a shortfall forecast for the end of the biennium, with the approval of the Governor and after consultation with the Legislative Advisory Commission.

In addition to the Budget Reserve, there is currently one other general fund reserve. The Cash Flow Account is designed to offset potential cash shortages caused by the mismatch of monthly revenue collections and expenditure payments. It may be thought of as a checking account's minimum balance to avoid overdrafts. Prior to FY 2002, the cash flow account had carried a balance of $350 million. Budget actions in the 2002 legislative session reduced the balance to zero. Provisions in statute require that, in the event of a forecast balance, funds first be allocated to the cash flow account to restore it to a maximum of $350 million.

State Constitution and Statutes Require a Balanced Budget

Action will be required to eliminate the $185 million budget deficit now forecast for the current budget. Both the Constitution and state statutes require that the budget for the two-year biennial period be balanced. Article XI, section 6 of the Constitution prohibits issuing certificates of indebtedness beyond the end of a biennium and requires that a statewide property tax levy be instituted if funds are insufficient to pay back short-term borrowing within a biennium.

Minnesota Statutes 16A.152 governs use of the state budget reserve and the Governor's unallotment authority. Current statute requires that the budget reserve first be used in its entirety, before the commissioner of finance has the authority to unallot or reduce state general fund appropriations with the approval of the Governor and after notification to the Legislative Advisory Commission

FY 2006-07 Estimates Highlight Longer Term Revenue-Spending Issue

This forecast updates planning estimates for the next biennium that were prepared at the end of the 2003 legislative session based on the February 2003 forecast. These estimates are prepared in a different way than the forecast for the current biennium.

Planning estimates for current law revenues and expenditures for FY 2006-07 are presented to help decision-makers identify longer-term impacts of current budget decisions. Revenue planning estimates are now based on the November baseline Global Insight's forecast for calendar 2006. The economic assumptions for calendar 2007 remain the same as February. Expenditure estimates assume that current laws and policies are updated for caseload, enrollment, and other forecast variables in major program areas. This current law "baseline" forecast does not include any adjustment for potential inflation expected during the period. Inflation, based on forecast consumer price index is expected to be 1.9 percent in FY 2006 and 2.0 percent in FY 2007. If total spending were uniformly adjusted for inflation, this would add $280 million to FY 2006 spending and $592 million to the spending shown for FY 2007.

FY 2006-07 Planning Estimates

($ in millions)

	End of Session	November Forecast	Difference
Beginning Balance	**$522**	**$447**	**($75)**
Revenues			
Non-Dedicated	29,853	28,985	(868)
Other Resources	444	398	(46)
Total Revenues	30,297	29,383	(914)
Spending			
Current Law Forecast	29,771	29,777	6
Balance Before Reserves	1,048	53	(995)
Budget Reserve	522	631	109
Ending Balance (Deficit)	**$526**	**$(578)**	**$(1,104)**

These planning estimates do not reflect potential Governor's recommendations or legislative actions to reduce the deficit forecast for the current biennium. Since the forecast is based on current law, the projected deficit for FY 2006-07 includes the $185 million deficit from FY 2004-05, and the budget reserve is shown remaining at current forecast levels.

Revenue Forecast
FY 2004-05

Current general fund resources for the 2004-05 biennium are now expected to total $28.235 billion, down $407 million (1.4 percent) from February's forecast after adjusting for action by the 2003 Legislature. The forecast change includes both receipts from the federal Flexible Assistance Grants and the loss in state income tax revenue attributable to conforming to federal individual income tax changes made in 2003, neither of which were accounted for in end-of-session estimates.

Revenues FY 2004-05
($ in millions)

	FY2002-03	FY2004	FY2005	FY2004-05
Individual Income	10,815	5,563	5,980	11,544
Sales	7,710	4,076	4,184	8,260
Corporate	1,118	687	757	1,444
Motor Vehicle Sales	705	290	301	590
Statewide Levy	891	604	616	1,220
Five Major	21,239	11,220	11,838	23,058
Other Revenue	3,204	1,734	1,550	3,284
Tobacco	309	169	170	339
Net Non-dedicated	24,752	13,123	13,558	26,680
Other Resources	690	1,183	371	1,555
Current Resources	**25,442**	**14,306**	**13,929**	**28,235**

Receipts from the five major taxes are expected to fall short of prior estimates by $459 million or 2.0 percent. Projected individual income tax receipts were down $490 million from February's forecast, and sales tax receipts, $124 million. Corporate income tax revenues are now expected to exceed end-of-session estimates by $140 million. The forecast for other tax and non-tax revenues was increased by $94 million.

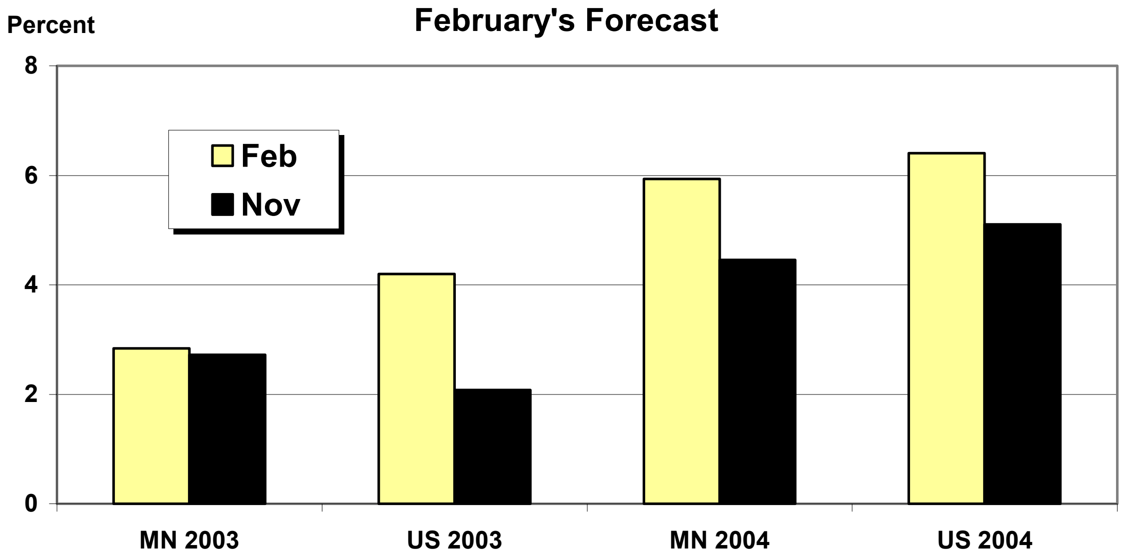
Individual Income Tax

Individual income tax receipts for the 2004-05 biennium are now forecast to total $11.543 billion, down $490 million (4.1 percent) from end-of-session estimates. Typically, revenue losses or gains from changes in state tax law are incorporated into February's revenue forecast at the end of the legislative session and that end-of-session estimate becomes the new baseline against which the November revenue forecast is compared. This year the exact details and timing of payments to the states from the federal Flexible Assistance Grant program were not known at the close of the session. By agreement with the legislature modifications of the Minnesota individual income tax code to conform with some recently enacted changes to the federal income tax code were made contingent on receipt of sufficient flexible assistance funds to offset the income tax revenue lost due to conforming. Both the cost of those changes in the state tax code and receipt of the flexible assistance revenue were to be recognized in the November forecast. Choosing to treat that legislative change as a forecast adjustment, rather than a reduction to the February baseline forecast, causes the difference between the February and November individual income tax forecast to be $106 million greater than if standard procedures had been followed. In the absence of the $106 million reduction in state revenue, income tax revenues would have been down $364 million or 3.2 percent.

Individual income tax liability for tax year 2002 is currently estimated to be $88 million less than forecast in February. Greater than anticipated use of Minnesota's working family credit program accounted for $13 million of the reduction in liability. The end-of-fiscal year 2003 income tax receipts include the negative variances for final payments and higher refunds consistent with that reduced liability. But, other things equal, those revenue losses are on-going since lowering the base liability in any tax year reduces projected income tax receipts in all future years by a similar amount. The lower estimate of tax year 2002 liability when carried forward through tax year 2005 accounts for about $200 million of the reduction in the income tax forecast for fiscal 2004-05.

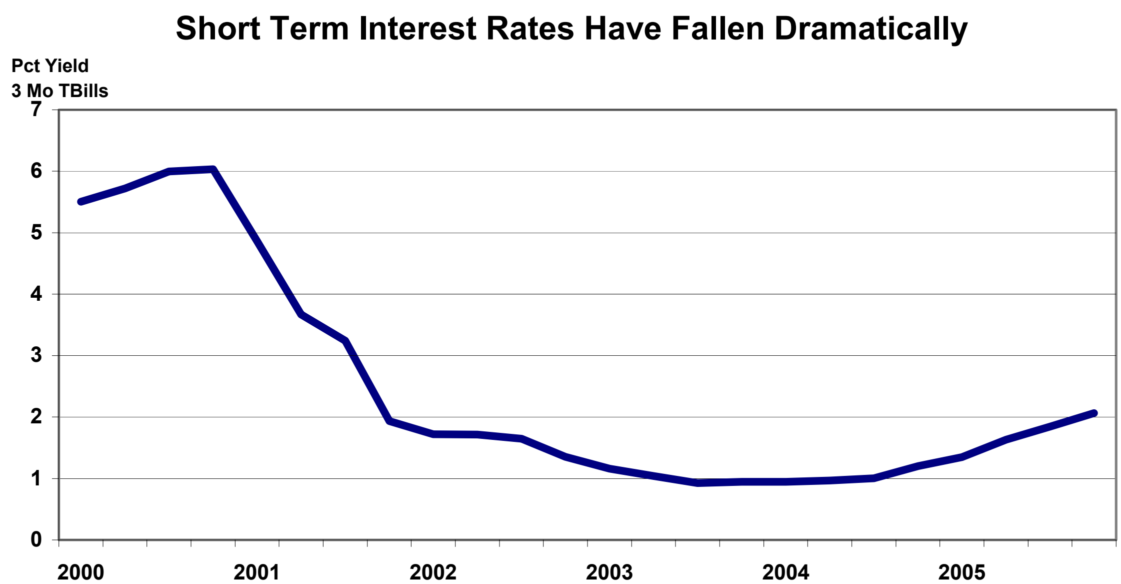
Global Insight's less optimistic outlook for the U.S. economy during 2004 and 2005 coupled with a reduction in the forecast for state and local employment and wages has produced a reduction in forecast wage growth in Minnesota for the next two years. Minnesota wages are now expected to grow at a 4.4 percent rate during calendar 2004 and at a 5.1 percent rate during calendar 2005, noticeably below February's estimates. February's Minnesota baseline economic forecast called for growth rates of 5.9 percent and 6.4 percent. The lower wage growth explains roughly one-half the remaining decline in the income tax forecast for the 2004-05 biennium.

Expected Wage Growth in 2004 Still Strong, But Less than February's Forecast



Preliminary results from tax year 2002 returns indicate that portfolio income was well below forecast. Because households tend to invest a much larger proportion of their taxable assets in very short term accounts than do financial intermediaries, lower short term interest rates have a disproportionate effect on taxable interest earnings. And, since returns from money market accounts are reported on the tax return as dividends, taxable dividends would also fall. For tax year 2002 it now appears that reported interest income was 26 percent below levels observed in tax year 2001, and reported dividend income, 14 percent below tax year 2001. February's forecast projected a decline in interest of less than 1 percent, and dividends were projected to grow by more than 6 percent.

Finance Department economists have developed a new method for forecasting taxable interest and dividend growth rates which appears to better reflect individual holdings of fixed income securities. Results from that model show interest income shrinking an additional 25 percent during the current tax year, then increasing by 11 percent in 2004 and by 14 percent in 2005. Dividend income falls by less than 1 percent in 2003, and then follows a similar path increasing 10 percent in 2004 and 27 percent in 2005.



Tax year 2002 capital gains income appears to have been slightly weaker than projected in February. Preliminary estimates indicate that net realizations fell by 26 percent in 2002. February's forecast anticipated a drop of 20 percent. Capital gains revenues in Minnesota for tax year 2002 are now estimated to be just $2.75 billion, about 30 percent of their tax year 2000 high of $9 billion.

The forecast for capital gains realizations in 2003, 2004 and 2005 has been reduced slightly, even though the Global Insight stock market outlook has improved modestly since February. More recent information on the size of capital loss carry-forwards into tax year 2003 as well as projected weaker than normal sales of items other than traded corporate equities led to a reduction of 5 percentage points in the forecast for each year in the forecast. Capital gains are now expected to grow at a 4 percent rate in the current tax year. For tax years 2004 and 2005 growth in net realizations is projected to be at a 15 percent rate.

Results from the capital gains model include the change in the federal tax rate on capital gains approved in mid 2003. No additional realizations from unlocking large past gains are assumed, however, since there has been little opportunity for most investors to build substantial equity after the prior capital gains tax cut. Revised capital gains estimates account for about one-sixth of the decline in 2004-05 revenues, lower interest and dividend income, about one-third.

Since final tax year 2002 liability is not available until the end of the calendar year, that liability was estimated based on collections received and the number of returns filed to date. Those returns are then adjusted by an estimate of the number of returns remaining to be processed and the expected average liability of the remaining returns. Tax year 2002 returns processed after November 1 have, to this point, had a smaller average liability than is typical of returns processed after November 1 in the past, and the projected final liability was based on that figure. But, the average liability of late returns can be affected by receipt of a few additional large returns so the final liability used in calibrating the model could be increased in February. That, other things equal, would add revenue to the forecast.

As in prior Novembers this forecast marks the first use of a version of the House Income Tax Simulation (H.I.T.S) model, which incorporates revised recent law changes. Unlike in prior Novembers, however, a new sample was not incorporated into the model this year. No sample of tax year 2001 tax filers was compiled due to the systems change-over at the Department of Revenue in spring 2002. A tax year 2002 sample has been drawn and the H.I.T.S. model will be calibrated to preliminary results from that sample for February's forecast.

When calibrating the model to hit tax year 2002 estimated liability it was necessary to hold the estimated level of Minnesota capital gains realizations in 2001 to the level assumed in last February's revenue forecast. An additional $8 million was removed off model to hit tax year 2002. That $8 million carries forward through the entire forecast horizon.

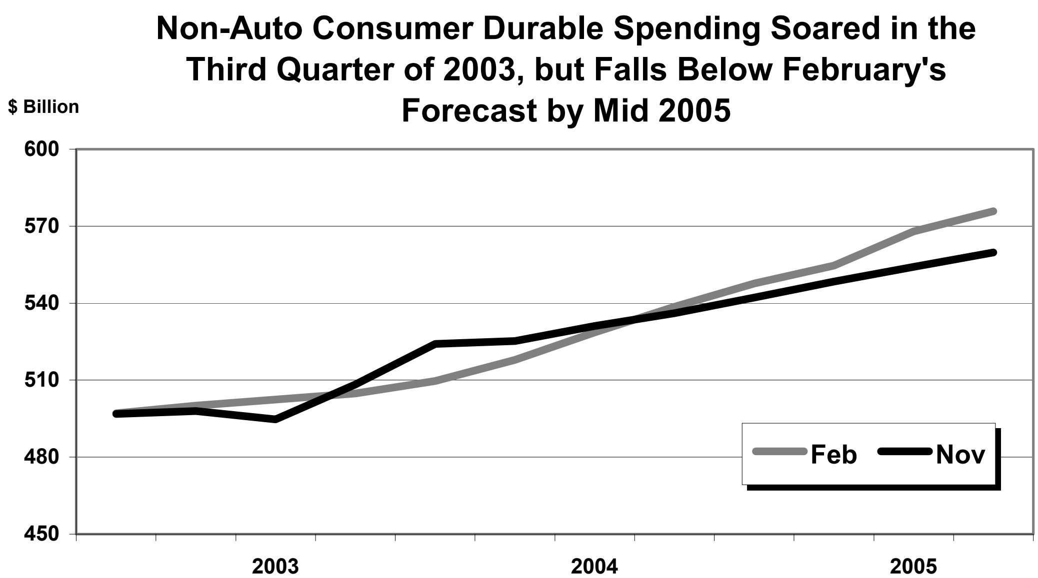
A one-time adjustment of $20 million to both withholding and final liability was made to reflect the strong withholding growth observed from October through mid-November Changes in assumptions about the timing of income tax receipts and refunds reduced the income tax forecast by $20 million. All these calibration assumptions will be revisited in February after preliminary results from the 2002 income tax sample are available.

Sales Tax

Net sales tax collections for the 2004-05 biennium are now expected to reach $8.260 billion, $124 million (1.5 percent), less than end-of-session estimates. The forecast for gross sales tax receipts fell by $149 million, while sales tax refunds are now projected to be

$25 million less than February's estimates. Gross sales tax receipts in FY 2003 were $16 million below February's forecast. Through the first quarter of FY 2004 sales tax receipts were $7 million less than projections. October collections, however, reduced the net negative variance to just over $1 million.

Recent estimates of consumer spending and business spending show stronger growth during the third quarter of 2003 than were anticipated in February's Global Insight baseline forecast. Unfortunately Minnesota sales tax collections did not reflect that stronger than forecast growth. The negative variances from each of the prior three quarters leave a lower base for Minnesota's sales tax model to grow from in the remainder of the biennium. The Global Insight forecast for each of the major components of the sales tax base also is weaker than in February, and Minnesota's share of personal income and wage and salary income are projected to be lower than forecast in February. When all elements of Minnesota's simulated sales tax base are combined, the base changes little in fiscal 2004, but then drops back significantly in fiscal 2005.



The factor used to convert the growth in the simulated sales tax to gross revenues was set at .975, as in recent forecasts. Revenues lost to E-commerce and catalog sales were assumed to grow by 14 percent in each of the next two years. Actual taxable internet sales are assumed to increase at a 25 percent annual rate, but some of that growth is offset by a reduction in non-internet catalog sales. Adjusting for internet sales reduces the forecast for fiscal 2004 by roughly $22 million in fiscal 2004 and $26 million in fiscal 2005. In February revenues lost to e-commerce were assumed to be $16 million in fiscal 2004 and $18 million in fiscal 2005.

Corporate Franchise Tax

Net corporate tax receipts for the 2004-05 biennium are now estimated to total $1.444 billion, $140 million (10.7 percent) more than end-of-session estimates. In fiscal 2003 corporate refunds were nearly $62 million less than forecast, leaving net corporate tax receipts $58 million above forecast. That reduction in the base level of refunds was assumed to be permanent. GII sees stronger near term growth in corporate profits than was expected last February, and that increase coupled with the lower refund base increases corporate revenues in both 2004 and 2005. Before tax corporate profits as a share of GDP is over 9.0 percent by mid 2005. For 2002 corporate profits share of GDP was about 6.4 percent. The corporate franchise tax remains the most volatile of the state's revenue sources.

Motor Vehicle Sales Tax

The sales tax on motor vehicles is now projected to add $590 million to general fund revenues during the 2004-05 biennium, $16 million (2.8 percent) more than end-of-session estimates. Much of that increase has already been received. While fiscal 2003 collections were $3 million less than forecast, motor vehicle sales were strong during the third quarter of calendar 2003. Through October general fund receipts of motor vehicle sales taxes were $4 million (8.3 percent) above forecast and that variance has been added to the forecast. Global Insight's outlook for motor vehicle sales remains strong. While their November forecast of light vehicle sales of 17 million units in calendar 2004 and 17.2 million units in calendar 2005 is a slight reduction from February's estimates, their estimated average price per vehicle sold has been increased resulting in a slight increase to the motor vehicle sales tax base.

Other Revenues

Other tax and non-tax revenues are expected to total $3.623 billion, $94 million (4.0 percent) more than end-of-session estimates. There were several large changes to other tax and non-tax revenues. The stronger than anticipated housing market and an extended period of re-financing brought on by historically low mortgage rates has increased projected mortgage and deed tax revenues by a combined $136.4 million from end-of-session estimates. Insurance gross premiums receipts for fiscal 2004 and 2005 were increased by $37 million for the biennium, reflecting the increased level of receipts already observed during calendar 2003. And, as noted above, revenues from the federal Flexible Assistance Grants were not included in end-of-session estimates but treated as a forecast adjustment. That adjustment added $84 million to the forecast for other receipts. Two sources of other revenues are now forecast to decline from end-of–session estimates. Forecast general fund receipts from the tobacco settlement for the 2004-05 biennium were reduced by $41 million, reflecting both lower consumption and reduced profitability for the tobacco companies. Projected income from DHS regional treatment center collections has been reduced by $39 million. The correction of a prior estimate of dedicated revenues was the largest factor contributing to the $41 million decline in transfers and dedicated revenues.

Revenue Planning Estimates
FY 2006-07

Current general fund resources for the 2006-07 biennium are now projected to total $29.383 billion, an increase of $1.148 billion or 4.1 percent over the current forecast for the 2004-05 biennium. Net non-dedicated revenues reach $28.985 billion, $2.305 billion (8.6 percent) more than is forecast for 2004-05. Receipts from the five major taxes grow by 10.3 percent. Individual income tax receipts grow by 14.1 percent from levels forecast for the 2004-05 biennium; the sales tax, by 6.5 percent. The forecast for net non-dedicated revenues for the 2006-07 biennium is $868 million below November's estimate. About 62 percent of that difference comes from a reduction in projected individual income tax collections.

Revenues FY 2006-07
$ in millions

	FY2004-05	FY2006	FY2007	FY2006-07
Individual Income	11,544	6,369	6,803	13,172
Sales	8,260	4,310	4,488	8,798
Corporate	1,444	760	828	1,588
Motor Vehicle Sales	590	304	324	628
Statewide Property Tax	1,219	623	639	1,262
Five Major Taxes	23,058	12,366	13,082	25,448
Other Revenue	3,284	1,586	1,622	3,207
Tobacco Settlement	339	167	163	330
Net Non-dedicated	26,680	14,119	14,867	28,985
Other Resources	1,555	193	203	396
Current Resources	**28,235**	**14,312**	**15,070**	**29,383**

No one can accurately forecast the path of the economy five years into the future. The baseline revenue planning estimates are not explicit forecasts, they are extrapolations of projected trends in the economy. Even small deviations from the assumed trend over five years will compound and produce sizeable changes in revenues. In addition, because of the way the estimates are constructed, any change in the base level of revenues for fiscal 2005 will be reflected in the revenue planning estimates for 2006 and 2007. Other things equal, stronger than anticipated revenue growth through fiscal 2005 will carry forward and add significantly to revenues in the 2006-07 biennium. But, should the economy grow more slowly than forecast during the next three years, or should some item of portfolio income such as capital gains fall well below forecast – as it did in tax year 2001 -- the revenue outlook for the 2006-07 biennium will deteriorate.

Revenue planning estimates are only a guide to the level of future revenues. They are not a guarantee. If the economy remains as strong as GII projects through 2007, and if projections of taxable items that are not part of personal income, such as capital gains realizations grow at their trend rate, the planning estimates are likely to slightly understate actual receipts. But, the GII baseline forecast includes strong growth with no recession over the forecast horizon, and that scenario could be overly optimistic. While the economy appears strong today, a recession or even a modest slow down commencing sometime before the end of the 2007 fiscal year cannot be ruled out. Actual revenues could exceed or fall short of the planning estimates by $2.0 billion or more depending on the economy's performance over the next 4 years.

Beginning in 1994 the Finance Department based the planning estimates on a series of alternative, hybrid forecasts to overcome an apparent positive bias in the Trendlong estimates on which the planning estimates had been based. It was also Finance Department practice to replace the first year of the hybrid estimate with values from the Control forecast in November of odd numbered years. This practice limited the use of hybrid projections to forecasts for calendar years beginning more than 3 years into the future, consistent with the length of the forecast made by DRI's short-term macro-economic model. For example, last February's 2004-05 planning estimates were based on Global Insights calendar year 2004 baseline forecast. The hybrid estimates were used only for the final six months of fiscal 2005.

The set of revenue planning estimates originally constructed last November for the 2006-07 biennium were based on the November GII baseline forecast, and not a hybrid as in the past. The original real growth rates assumed, 3.5 percent and 3.1 percent, were consistent, but slightly above those assumed by the CBO and those of the Blue Chip Consensus. The inflation rates, a CPI rate of 2.2 percent and 2.1 percent, while slightly below both the Blue Chip Consensus and CBO, are well within normal limits. February's GII Baseline called for slightly slower real GDP growth rates in 2006 and 2007, and slightly higher inflation rates. The February 2003 revenue planning estimates were constructed using the assumption that real GDP growth would average 3.1 percent in calendar 2006 and 2.9 percent in calendar 2007. CPI growth rates of 2.2 percent and 2.5 percent were also assumed.

As in the past, in this mid-biennium update to the planning estimates, the current GII baseline forecast is used to provide the growth rate assumptions for calendar 2006. The real economic growth rate assumed, 3.6 percent, is slightly above what most would consider to be trend growth. That is offset, in part by a projected CPI inflation rate of 2.0 percent, that is slightly below the historical averages. The same growth rates as were used in February were used for the portion of calendar 2007 that is in the 2006-07 biennium. Finance Department economists note, however, that because this forecast calls for strong economic growth lasting for at least 5 years, revenue projections based on this forecast are more likely to prove to be too optimistic than too pessimistic.

The individual income tax estimates were prepared using the House Income Tax Simulation Model. Assumed filer growth in Minnesota was consistent with average national employment growth for the years in question. All elements of income and all individual itemized deductions were assumed to grow at the growth rate of taxable personal income – the combination of wages and salaries, proprietors' incomes, dividend, interest and rents – projected by GII in their baseline forecast.

As in the last two reports the complete sales tax model was used to estimate sales tax revenue planning estimates. In prior years sales tax planning estimates had been made based on a model using 14 broad categories of items in Minnesota's sales tax base. Corporate tax receipts in Minnesota were estimated to grow at the same rate as GII's forecast of national before tax corporate profits. Minnesota's motor vehicle sales tax collections are expected to grow at the GII baseline growth rate for national consumption of motor vehicles and parts. The deed and mortgage tax was forecast based on the projected growth in the value of new and existing home sales. Planning estimates for other tax and non-tax revenues were prepared by extrapolating existing trends.

Expenditure Forecast
FY 2004-2007

Actual, Forecast and Projected Spending, FY 2002-2007

Actual spending for the biennium that ended June 30, 2003 totaled $26.648 billion. The forecast for the current biennium now totals $28.157 billion, a $143 million decrease from end-of-session estimates. Included in the spending amount for the current biennium is $84 million of authorized appropriations carried forward from FY 2003. Projected spending for FY 2006-07 is expected to reach $29.778 billion, excluding the impact of estimated inflation.

Actual & Estimated Spending
($ in millions)

	Biennial Budget Period				
	2002-03	**2004-05**	**Change**	**2006-07**	**Change**
E-12 Education	$9,953.3	$11,789.5	$1,836.2	$11,969.6	$180.1
Property Tax Aids & Credits	3,378.6	2,777.1	(601.5)	2,975.4	198.3
Higher Education	2,742.0	2,560.8	(181.2)	2,547.8	(13.0)
Health & Human Services	6,726.4	7,331.8	605.4	8,415.7	1,083.9
Envir., Ag, & Econ. Development	792.5	710.0	(82.5)	682.8	(27.2)
Transportation	328.3	160.3	(168.0)	162.7	2.6
Criminal Justice	1,344.9	1,440.1	95.2	1,525.0	84.9
State Government	704.0	644.9	(59.1)	622.6	(22.3)
Debt Service	581.1	653.1	72.0	790.9	137.8
Capital Projects, Other	39.5	0.0	(39.5)	0.0	0.0
Est. Cancellations	0.0	(5.0)	(5.0)	(5.0)	0.0
Subtotal	26,590.6	28,062.5	1,471.9	29,687.5	1,625.0
Dedicated Expenditures	57.5	94.8	37.3	90.0	(4.8)
Total	**$26,648.1**	**$28,157.3**	**$1,509.2**	**$29,777.5**	**$1,620.2**

The current FY 2004-05 budget of $28.157 billion is a $1.509 billion (5.7 percent) increase over the last biennium. Four areas account for the growth in spending: E-12 education, health and human services, criminal justice and debt service. Spending in other areas of the budget actually declines from the FY 2002-03 biennium to FY 2004-05. A significant portion of the growth in E-12 education between biennia is attributed to education finance and property tax reform and relief enacted in the 2001 legislative session, that begins in state fiscal year 2003. It is reflected primarily as an increase in state revenues (the statewide property tax levy) and an increase in state spending (state assumption of general education funding).

FY 2006-07 planning estimates now total $29.777 billion, a $1.620 billion increase over the current biennium. The planning estimates do not include the cost of estimated inflationary increases. The 5.8 percent growth in the expenditure planning estimates is largely due to changes in the two largest areas of the budget, E-12 education and health and human services. Projected spending for E-12 Education increases only slightly on a biennium-to-biennium basis. This increase largely reflects the payment shifts enacted in FY 2003 and FY 2004 that reduces the percentage of current year payments and increase the "settlement" payments that school districts receive under the school aid formulae. Health and human services spending continues to be the most rapidly growing segment of the state budget. Projected current law increases are expected to continue to be determined by enrollment pressures, utilization increases, and changing demographics.

FY 2004-05 Spending Shows Little Change, Down $143 Million

Forecast expenditures for FY 2004-05 show little net change from end-of-session estimates. Spending has decreased $143 million, or 0.5 percent. This net decrease, however, includes an increase of $84 million that represents authorized spending moved forward to FY 2004 when the books were closed for FY 2003 in September.

Forecast Change in FY 2004-05 Spending

($ in millions)

	End of Session FY 2004-05	November FY 2004-05	Forecast Change
E-12 Education	$11,882.7	$11,789.5	($93.2)
Property Tax Aids & Credits	2,737.0	2,777.1	40.1
Higher Education	2,557.7	2,560.8	3.1
Health & Human Services	7,425.3	7,331.8	(93.5)
Envir., Ag, & Econ. Dev.	693.5	710.0	16.5
Transportation	160.3	160.3	0.0
Criminal Justice	1,430.6	1,440.1	9.5
State Government	618.4	644.9	26.5
Debt Service	673.6	653.1	(20.5)
Estimated Cancellations	(5.0)	(5.0)	0.0
Subtotal	28,174.1	28,062.5	(111.6)
Dedicated Expenditures	126.5	94.8	(31.7)
Total	**$28,300.6**	**$28,157.3**	**$(143.3)**

Three areas account for most of the overall decrease in forecast spending. E-12 education costs have been reduced $93 million, human services spending will be $93 million less than previously forecast, while debt service estimates have been lowered by $21 million. These decreases, however, are in part offset by a $40 million increase in property tax aids and credits.

Change in FY 2006-07 Projected Spending is Minimal

Compared to end-of-session estimates, projected spending for FY 2006-07 shows little fundamental change. Spending has increased a total of $6 million, 0.1 percent, from earlier estimates. Savings from lower pupil units in E-12 Education in FY 2004-05 continue through the planning estimates, while forecast reductions for health and human services in the current biennium largely evaporate in the next.

Apart from the major areas, continued growth in projected property tax refunds and in spending for criminal justice represents the primary drivers of spending in the planning estimates.

Forecast Changes in FY 2006-07 Expenditure Projections

($ in millions)

	End of Session FY 2006-07	November FY 2006-07	Forecast Difference
E-12 Education	$12,091.3	$11,969.6	($121.7)
Property Tax Aids & Credits	2,922.6	2,975.3	52.7
Higher Education	2,547.8	2,547.8	0.0
Health & Human Services	8,327.2	8,415.7	88.5
Envir., Ag, & Econ. Dev.	682.1	682.8	0.7
Transportation	162.7	162.7	0.0
Criminal Justice	1,506.9	1,525.0	18.1
State Government	621.9	622.5	0.6
Debt Service	782.8	790.9	8.1
Estimated Cancellations	(5.0)	(5.0)	0.0
Subtotal	29,640.5	29,687.5	47.0
Dedicated Expenditures	130.6	90.0	(40.6)
Total	**$29,771.1**	**$29,777.5**	**$6.4**

ENHANCED FEDERAL FUNDS: HOW MUCH WILL MINNESOTA RECEIVE AND HOW WILL THESE FUNDS BE USED?

The November 2003 forecast recognizes federal funds received as a result of federal law adopted early this summer. These new funds were not anticipated in the February 2003 forecast and were not recognized in of end of session estimates. The federal aid comes to Minnesota in two ways: direct payments and temporary enhanced matching funds for Medicaid. This narrative addresses only the enhanced Medicaid matching funds.

Under current law, the state receives federal matching funds for every dollar it spends associated with the federal Medicaid program. That matching rate is known as the Federal Medical Assistance Percentage (FMAP) and most of the revenue is tied to Minnesota's Medical Assistance (MA) program. The higher the match rate, the lower the cost to the state. Due to the federal aid package, Minnesota's normal fifty percent match is increased by 2.95 percentage points from April 1, 2003 through July 1, 2004. The money does come with a catch – in order to receive additional federal funds the state cannot reduce eligibility guidelines or increase local financial participation until the enhanced match period has ended. The 2003 appropriation bill included contingent language to ensure that the state would not violate this maintenance of effort requirement. The bill also specifies how funds are to be used, including:

- Delay reduction of MA pregnant women eligibility from 275% of federal poverty line to 200%
- Delay reduction of MA children eligibility from 170% of federal poverty line to 150%
- Modify two provisions related to MA Employed Persons with Disabilities eligibility
- Increase the primary care cap for MNCare adults without children to $5,000 from $2,000 through FY 2007
- Eliminate payment shifts for MFIP payments; county payments; and the delay in medical assistance and general assistance medical care fee-for-service payments.

The Commissioners of Human Services and Finance jointly reported the availability of these funds on July 15, 2003 to the Legislative Advisory Commission and state appropriations have been modified accordingly. The November forecast of Medical Assistance expenditures is significantly lower (11.6 percent) for 2004 than was estimated at end of session, partially because these enhanced federal funds offset other costs. Although some of the enhanced funding was earned in FY 2003, all revenue will be recorded in FY 2004. The forecast also includes a transfer of $114.6 million from the general fund to the health care access fund as part of this contingent appropriation. This transfer, which is based on permissive language, ensures that the savings associated with federal funds lines up with the policy changes in the appropriation.

ENHANCED FEDERAL FUNDS: HOW MUCH WILL MINNESOTA RECEIVE AND HOW WILL THESE FUNDS BE USED? (*CONTINUED*)

Enhanced FMAP: End of Session (EOS) vs. November Estimates ($ in Millions)

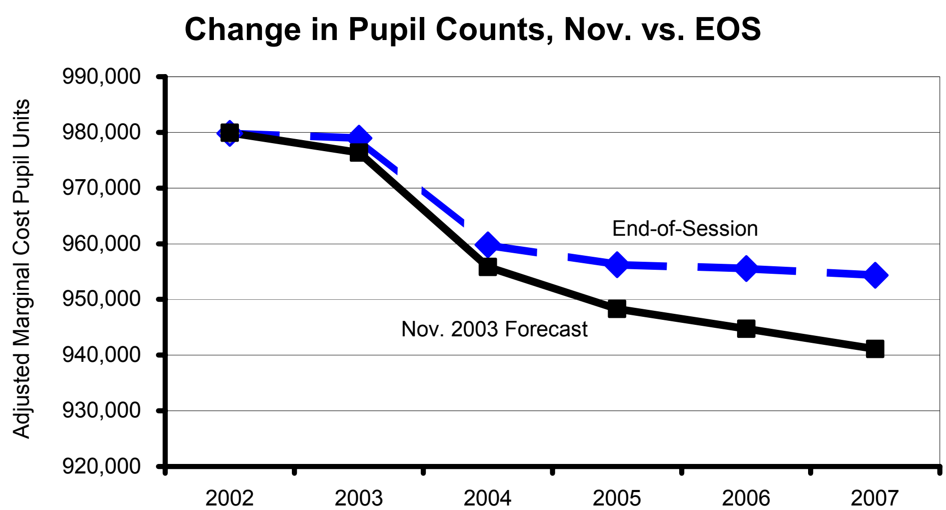
Revenue Effects	**EOS Estimates**	**November Estimates**
General Fund	176.5	168.3
HCAF	13	6.9
Counties/School Districts	7.9	7.7
Total Estimated Revenue	197.4	182.9
Total Estimated State Share of Revenue	**189.5**	**175.2**
General Fund expenditures		
1) Delay MA/MNCare eligibility changes	10.4	2.6
2) Avoid payment shifts		
• MFIP Support Services Grants	14.0	14.0
• Fee for service payments	36.9	36.9
• County payments	14.8	14.8
Health Care Access Fund expenditures		
3) Raise cap from $2000 to $5000 through FY 2007	93.0	121.5
Total Estimated State Share of Expenditures	**169.1**	**189.8**
Difference	20.4	(14.6)
Adjusted by difference in eligibility delays [1]	7.6	0
Additional enhanced FMAP to be spent	**28**	**(14.6)**

[1] At end of session, DHS estimated that up to $10.4 Million worth of eligibility reductions might have to be delayed to earn the enhanced FMAP. By July 2003, it was clear that only. $2.8 Million of eligibility reductions would be delayed. The difference ($7.6 Million) is reflected here.

Education Finance Forecast Down $93 Million for FY 2004-05

"E-12 Education" consists of K-12 education and early childhood education programs. For the current biennium, state education finance spending is estimated to be $11.8 billion, a decline of $93 million from end-of-session estimates.

Estimated pupil counts for public school enrollment have declined compared to end-of-session estimates. This reduction ripples through a number of aid payment formulas, most significantly the Basic portion of General Education. While the decline in pupil units is less than 1 percent, the dollars associated with this change are significant. Public school enrollment (on an average daily membership basis) for 2004 is now estimated to be 829,604, with slight declines in each succeeding year of the forecast (the comparable figure in adjusted marginal cost pupil units—the basis of education aid payments—is 955,822).



General Education Changes

Estimated state aid spending for General Education for FY 2004-05, including all components, declined by $76.3 million compared to earlier estimates. Basic Revenue is down almost $59 million, as a result of lower pupil estimates. Compensatory Revenue is now projected to be $6 million (1.2 percent) higher due to slightly higher caseload projections of students eligible for free and reduced lunch. This is driven by an estimated increase in caseload for the Minnesota Family Investment Program, the main data source for the compensatory forecast.

Revenue for students of Limited English Proficiency (LEP) is down sharply for 2004-05, dropping $22 million (23 percent) from earlier estimates. The much lower base resulted from a decline of just over 9,500 students (16 percent) served with LEP Revenue in 2003.

Referendum Revenue for districts is down just over 2 percent ($22 million), primarily due to the lower pupil counts, but it also reflects the fact that districts sought voter approval for slightly less revenue than assumed previously. Most of the Referendum Revenue change ($19 million) is levy revenue, so this has little impact on state-funded equalization aid.

Categorical Changes

Most changes in the categorical education programs show only modest changes from end-of-session estimates. Some aid and levy programs, however, are more significantly affected by increasing values for participating districts' adjusted net tax capacity (ANTC). ANTC figures for districts participating in both Health and Safety and Debt Service Equalization increased more that the statewide average, thus reducing the previously assumed aid needs for both programs. Additionally, new information for Payable 2004 levies has resulted in a downward adjustment to the level of district participation. State aid for Health and Safety is down $6.7 million from earlier projections. State aid for Debt Service Equalization also shows a drop of $12.7 million, although approximately $8 million of this reduction reflects an adjustment to estimated values as compared to statutorily-defined levels.

FY 2006-07 Estimates Reflect Enrollment Savings in Education Finance

The level of estimated state spending for education finance in the next biennium is now expected to be $11.97 billion, a decline of $122 million from earlier projections. Aside from relatively small changes in a few categorical programs, the 2006-07 projections continue to reflect the budgetary implications of lower pupil counts rippling through the aid formulas.

General Education Changes

General Education funding accounts for most of the decline from end-of-session levels for 2006-07. Again, the 1 percent reduction in pupil counts largely drives the change in projected general fund spending that is $102.5 million lower than end-of-session estimates. Basic Revenue and LEP Revenue account for most of the decline, and are offset somewhat by slightly higher Compensatory Revenue.

Categorical Changes

Health and Safety and Debt Service Equalization also both continue the trend of lower projections compared to the previous estimates at end-of-session. Both are affected by the change in participation levels and increases in adjusted net tax capacity values that are growing more rapidly in the participating districts than comparable values statewide. State support for Health and Safety is estimated to be $8.6 million lower than end-of-session estimates and state support for Debt Service Equalization is $15.5 million lower than end-of-session estimates.

Special Education also shows slight savings in FY 2006-07 due to the downward revisions in pupil counts. While FY 2004-05 Special Education Revenue is fixed in law, the figures for the planning years adjust for changes in statewide pupil counts, resulting in projected savings of $4.5 million.

Health and Human Services Spending $93.5 Million Lower in FY 2004-05, $88.5 Million Higher in FY 2006-07

Total Health and Human Services spending is projected to total $7.3 billion in FY 2004-05 and $8.4 billion in FY 2006-07. This is a reduction of $93.5 million in the current biennium and an $88.5 million increase in FY 2006-07 from end-of-session estimates. An infusion of $168.3 million in enhanced federal medical assistance percentage (FMAP) dollars in FY 2004 significantly reduces general fund expenditure estimates; these reductions, however, are offset by contingent spending and a transfer to the health care access fund. These federal funds, which impact all segments of Medical Assistance, were still uncertain during last legislative session and are recognized along with corresponding expenditures for the first time in this forecast.

Basic Health Care Grants

Basic Health Care general fund spending is forecasted at $2.8 billion for FY 2004-05, down $227.2 million (7.4 percent) from end-of-session estimates. Basic Health Care reflects state assistance for acute care such as hospitalization and physician services that is paid for within MA Elderly & Disabled Basic Care, MA MFIP & Families Basic Care, and General Assistance Medical Care. Decreased spending is largely the result of new federal matching funds and other significant reductions in MA MFIP & Families Basic Care partially offset by higher than expected GAMC costs.

Enhanced FMAP dollars and associated policy changes are projected to reduce Basic Health Care Grant expenditures by a net $40.6 million during the current biennium. In addition to the enhanced FMAP effects, this forecast projects slightly smaller caseloads and lower average costs in MA MFIP & Families Basic Care and lower average costs in MA Elderly and Disabled Basic Care compared to end-of-session estimates.

- Much of the reduction in MA MFIP & Families Basic Care comes from correction of a data error in which one element of hospital payments was duplicated in the base expenditures for this part of the forecast, thereby inflating average payment projections.
- HMO payment rates, which were negotiated at significantly lower increases than assumed in end-of-session estimates, also contribute to the lower average cost projections. Recently completed contract negotiations raised capitation rates by only one to three percent compared to anticipated growth rates of five to ten percent.
- The increases in GAMC cost projections are related to revised savings estimates and to higher caseload projections. GAMC savings projections from the 2003 Session related to coverage prior to the application date and creating hospital-only coverage have been reassessed; the revised estimates reduce projected FY 2004-05 savings by $43 million.

Similar trends in Basic Health Care grants are expected to continue into FY 2006-07, when spending is projected to reach $3.5 billion. This represents a $52.8 million (1.5 percent) reduction from end-of-session estimates. Reductions in both MA MFIP & Families Basic Care (down $106.9 million) and Elderly & Disabled Basic Care (down $27.5 million) are partially offset by increases in GAMC (up $81.7 million) accounting for this change. Although there are no further federal revenues anticipated in FY 2006-07, policy changes tied to the enhanced FMAP dollars reduce Basic Health Care grant expenditures by $36.9 million. Significant revisions to GAMC projections described above also reduce FY 2006-07 savings by $54.8 million.

FY 2006-07 decreases for basic care would be greater if not for a caseload shift of children and parents from MinnesotaCare to Medical Assistance (MA) due to implementation of HealthMatch, a new web-based eligibility determination system for medical programs. This new system will direct applicants for health care coverage to the health care program offering them the most benefits at the least cost. Approximately one-third of current MinnesotaCare enrollees are MA-eligible. Although MA-eligible applicants may still be able to choose to enroll in MinnesotaCare once HealthMatch is implemented, much of this population is expected to shift to MA because the new system will inform them of the financial advantages of MA coverage. The projected caseload shift increases the general fund cost $144.8 million in FY 2006-07.

Continuing Care and Community Support Grants

Continuing Care and Community Support Grant expenditures are estimated to be $3.0 billion for the FY 2004-05 biennium, down $6.9 million (0.2 percent) from end-of-session estimates. This funding provides ongoing supports for persons with chronic health needs whether living in an institution (e.g. nursing home) or in the community. The forecast change is due to enhanced federal matching funds offset by small increases in anticipated spending.

- Enhanced FMAP and associated policy changes decrease Continuing Care and Community Support Grant costs by a net $74.4 million in the FY 2004-05 biennium.
- Reductions in MA LTC Facilities (down $12.2 million) are driven primarily by enhanced FMAP, partially offset by increases in average costs in Nursing Facilities, ICF/MRs and Day Training & Habilitation.
- MA LTC Waiver expenditures are projected to decrease $18 million from end-of-session estimates. A combination of enhanced FMAP and lower average costs in the Developmental Disabilities, Elderly, and Traumatic Brain Injury (TBI) waivers reduce projected expenditures, while increased average costs in the Community Alternative for Disabled Individuals (CADI) waiver and Community Alternative Care (CAC) waivers partially offset those reductions. CADI and Personal Care caseloads are also projected to increase significantly.

For FY 2006-07 Continuing Care Grant spending is now projected to be $3.4 billion, up $152.1 million (4.7 percent) from end-of-session estimates. Costs in both MA Long Term Care Facilities and MA Long Term Care Waivers are expected to be higher ($37.5 million and $114.4 million, respectively) compared to previous estimates.

- Use of enhanced FMAP decreases projected Continuing Care Grant spending by $14.8 million in this biennium.
- LTC Facility increases are primarily driven by higher than previously projected nursing and intermediate care facilities costs.
- LTC waiver and home care costs will increase due to much higher personal care/private duty nursing caseloads and home health agency caseloads compared to end-of-session estimates.
- The forecast also revises savings projections from the 2003 Session related to enrollment caps in the CADI and TBI waivers. These projections had assumed that the caps were effective for four years, but the new forecast recognizes that the caps are effective for the current biennium only, reducing projected savings by $50.9 million.
- Chemical Dependency Entitlement caseload increases are projected to continue into FY 2006-07.

Child Care Assistance and Economic Support Grants

Child Care Assistance and Economic Support Grant expenditures are estimated at $430.2 million for FY 2004-05, up $7.6 million from end-of-session estimates. This area includes cash and services for low-income families enrolled in programs such as the Minnesota Family Investment Program (MFIP) and child care assistance. Because many of these activities are also funded by federal TANF and child care funds, change in total program activity may be different than changes in general fund spending.

FY 2004-05 Child Care Assistance expenditures are projected to increase $10.6 million (5.8 percent) over end of session estimates. These changes reflect a higher projected MFIP caseload and a one-time acceleration of child care payments as the Minnesota Electronic Child Care system is implemented, speeding up the flow of payments to child care assistance providers. Child Care Assistance expenditures are expected to increase $16.5 million compared to end of session estimates for 2006-07. As in the previous biennium, this results from higher MFIP caseload projections.

FY 2004-05 general fund spending in Economic Support Grants is expected to total $236.9 million, down $3.0 million (1.3 percent) from end of session. This reflects both changes in expenditure estimates and an interim modification of appropriations to reflect contingent changes in 2003 legislation related to use of state savings resulting from the enhanced FMAP rate. These interim appropriation changes raised spending estimates by $2.0 million. These adjustments are augmented by a projected $4.1 million increase in GA due to higher caseload estimates. Lower projected spending in MFIP grants (down $6.7 million) and Minnesota Supplemental Aid (down $2.3 million) offset these spending increases. Total MFIP grant expenditures are expected to increase by $4.9 million in FY

2004-05, but general fund spending on MFIP grants is $6.7 million lower for the biennium due to federal maintenance of effort requirements.

Economic Support Grant expenditures are projected to be $233.4 million for FY 2006-07, down $5.2 million from end-of-session estimates. The reduction in estimates is due to state savings resulting from use of enhanced FMAP dollars to buy back a payment shift in this area and by decreases in MSA. These changes are partially offset by small increases in MFIP grants, GA, and Group Residential Housing.

FY 2004-05 Property Tax Aids and Credits Increase $40 Million

Spending for local government aids, property tax credits paid to schools and local units of government and property tax refunds paid to individuals is expected to total $2.777 billion for the current biennium. This is a $40.1 million increase in compared to end-of-session estimates, a 1.5 percent change. The major factor in this change is a $41.3 million increase in property tax refunds paid to homeowners and renters due to certified levies that were higher then expected. A smaller increase, $3.2 million, is forecasted for Taconite Production Tax Replacement Aid. These increases are partially offset by a $6.2 million decrease in the Market Value Credit.

FY 2006-07 planning estimates project spending for property tax aids and credits will reach $2.975 billion, a $52.7 million increase from end-of-session estimates, a 1.8 percent change. The major change is a $69.2 increase in property tax refunds that reflects higher local levy estimates due to referenda and local tax increases. The increase in property tax refunds is partially offset by a $17.9 million reduction in the estimates for Market Value Credits.

Higher Education Forecast Remains Virtually Unchanged

General fund spending for the University of Minnesota, Minnesota State Colleges and Universities (MnSCU), Mayo Medical Foundation, and the Higher Education Services Office (HESO) will be $2.561 billion for the current biennium. This is an increase of $3.1 million from previous estimates. Since appropriations for the biennium are fixed, there is little to impact the forecast for higher education. The $3.1 million increase shown from end-of-session estimates reflects unspent appropriations in HESO that were authorized to carry forward from FY 2003 to FY 2004-05, primarily $2.4 million for the MnLINK program.

FY 2006-07 planning estimates for higher education remain FY 2006-07 remain at $2.548 billion, unchanged from previous estimates. The planning estimates continue to reflect only adjustments for enrollment, while the decrease from spending in the current biennium is largely one-time spending items that do not continue into the next biennium.

Debt Service Estimates for Current Biennium Reduced $21 Million

The total estimated debt service cost for the 2004-05 biennium is now $653.1 million, $20.6 million lower than end-of-session estimates.

Savings comes primarily from the refinancing earlier this year of five state bond issues that were sold in the early 1990's at higher interest rates. At the end of the legislative session, the estimate of the savings for FY 2004-05 from refinancing was $13.3 million, with an additional savings of $11.8 million in FY 2006-07, or a total of $25.1 million over four years. When the refinancing was completed the total savings was $52 million, but all the savings will occur in the current biennium, with little impact on the following biennium.

Bidders continue to place high premiums in their bids on state bonds. While high premiums were forecast, the actual premiums were higher than expected. This resulted in the savings from the refinancings being reflected in premiums rather than in interest rate savings over the life of the bonds. Total premiums, including the refinancing savings, is $36.7 million over that forecast at the end of session.

Several changes partially offset the savings from refinancing. The investment interest rates on cash balances in the Debt Service Fund and the Bond Proceeds Fund are now lower than forecast at the end of session. Lower interest rates result in a $12.8 million reduction in investment earnings. Similarly, receipts for the Debt Service Fund have also been reduced by $4.7 million. Projected loan repayments from Maximum Effort School Loans have been reduced by $12.9 million while the expected repayments on Rural Finance Authority Loans have increased $6.7 million.

Finally the amount of planned bond sales has been adjusted to reflect updated cash flow needs for capital projects. The amount of principal included in the August 2003 bond sale was less than forecast and interest rates were lower than forecast resulting in a savings of $4.2 million. The size of future bond sales was increased, increasing costs $5.9 million. Other factors resulted in savings of $1.6 million.

FY 2006-07 projected debt service costs are now $798.7 million, up $8.6 million from previous estimates. The forecast assumes that $530 million capital budgets are approved in even-numbered years and $100 million capital budgets are approved in the odd-numbered years.

All Other Spending

The remaining categories of state spending total $3.045 billion for the current biennium. This amount represents slightly over 10 percent of total general fund spending. While a relatively small percentage of the total budget, these areas include a broad range of agencies, programs and services. The breadth of activities includes: natural resources and environmental programs; trade, economic development, and agriculture programs; housing programs; the state prisons, public safety activities and courts; state regulatory and licensing activities; a portion of general fund financed transit and transportation-related funding; state funding for the arts, the Minnesota Zoo and Historical Society – as well as general state administration including tax collection, accounting and financial management, and human resources functions and legislative and constitutional offices.

Other Spending, FY 2004-05

($ in millions)

	End of Session	Nov. Fcst	Change
Environ., Agr., and Econ. Development	693.5	710.0	16.5
Transportation	160.3	160.3	- 0 -
Criminal Justice	1,430.6	1,440.1	9.5
State Government	618.4	644.9	26.5
All Other	121.5	89.8	(31.7)
Total	**$3,024.3**	**$3,045.1**	**$20.8**

Funding for these areas are set as fixed amounts by legislative appropriations. Changes in estimates associated with the forecast largely reflect transfers or amounts carried forward from FY 2003, transfers between agencies, or other technical adjustments. The differences shown from end-of-session estimates are almost exclusively appropriations carried forward from FY 2003. Generally, these are not significant changes related to the forecast and have little or no effect on the general fund projected balance.

Similarly, planning estimates for FY 2006-07 remain largely unchanged. The single exception is planning estimates for the Department of Corrections. Correctional programs increase $18 million from end-of-session estimates due to increasing prison populations and limits on a double-bunking initiative passed in the 2003 session. By the end of the FY 2004-05 biennium, the state prison population is expected to exceed the prior forecast by 115 inmates. By the end of the FY 2006-07 biennium, the population is expected to exceed the prior forecast by 196 inmates. This reflects a continued increase in new court commitments first noted in 2002, with the largest increases occurring for drug offenses. The additional costs for the population change is $5 million. Also, additional savings of $13 million previously projected for FY 2006-07 due to continued expansion of a double-bunking initiative are not expected to be realized due to infrastructure limitations and fire marshal concerns at the affected correctional institutions.

For other agencies, FY 2006-07 current law planning estimates generally represent the FY 2005 level of appropriations extended into the following two fiscal years. Adjustments are made only to remove one-time or appropriations that sunset in current law or to annualize the costs of programs only partially reflected in FY 2005. These adjustments are identified and made as part of the legislative and executive branch tracking of out-year costs when the budget is enacted.

Alternative Forecast Comparison

Real GDP (Annual Rates)

	03 III	03IV	04I	04II	04III	04IV	03A	04A	05A
GII Baseline (11-03)	7.2	3.6	4.1	3.7	4.9	3.9	2.9	4.3	3.6
Blue Chip (11-03)	7.2	3.8	3.9	3.9	4.0	3.6	2.9	4.2	NA
Economy.Com (11-03)	7.2	3.5	3.9	4.4	3.7	NA	2.9	4.2	NA
American Express (11-03)	7.2	4.3	4.4	3.9	4.0	3.5	4.0	4.0	NA
UBS Warburg/Paine Webber (11-03)	7.2	3.5	3.9	4.0	3.4	3.3	2.9	4.1	3.3
Standard & Poors (11-03)	7.2	4.9	3.9	4.5	NA	NA	3.0	4.6	3.8

Consumer Price Index (Annual Rates)

	03 III	03IV	04I	04II	04III	04IV	03A	04A	05A
GII Baseline (11-03)	2.3	2.3	1.1	0.9	1.2	2.0	2.3	1.4	1.9
Blue Chip (11-03)	2.4	1.8	1.8	1.8	2.0	2.1	2.3	1.9	NA
Economy.Com (11-03)	2.3	1.7	0.9	0.9	1.0	NA	1.6	2.3	NA
American Express (11-03)	2.4	2.4	2.3	2.5	2.7	2.8	2.3	2.6	NA
UBS Warburg/Paine Webber (11-03)	2.3	1.5	1.8	1.9	2.0	2.0	1.6	2.3	1.8
Standard & Poors (11-03)	2.6	0.6	0.8	0.9	NA	NA	2.3	1.2	1.8

* 4Q/4Q

Forecast Comparisons

Real Economic Growth
(Annual Percent Change in Real GDP)

	2002	2003	2004	2005	2006	2007
Nov 99 DRI Control	2.0[1]	2.0[1]				
Feb 00 DRI Control	3.4	2.0[1]				
Nov 00 DRI Control	4.3	4.8	3.2[2]	3.2[2]		
Feb 01 DRI Control	4.0	4.8	3.2[2]	3.2[2]		
Nov 01 DRI Control	0.4	4.4	3.8	3.2[2]		
Feb 02 DRI Control	1.0	4.0	3.9	3.2[2]		
Nov 02 GII Baseline	2.3	2.6	4.1	3.8	3.5	3.1
Feb 03 GII Baseline	2.4	3.0	4.6	3.8	3.1	2.9
Nov 03 GII Baseline	2.4	2.9	4.3	3.6	3.6	3.6

Inflation

(Annual Percent Change in CPI-U)

Nov 99 DRI Control	2.6	2.8				
Feb 00 DRI Control	2.5	2.6				
Nov 00 DRI Control	1.7	1.9	2.4[2]	2.7[2]		
Feb 01 DRI Control	1.8	1.6	2.4[2]	2.7[2]		
Nov 01 DRI Control	1.9	2.4	2.6	2.7[2]		
Feb 02 DRI Control	1.4	2.4	2.5	2.7[2]		
Nov 02 GII Baseline	1.6	2.3	2.4	2.3	2.2	2.1
Feb 03 GII Baseline	1.6	2.1	1.9	2.1	2.2	2.5
Nov 03 GII Baseline	1.6	2.3	1.4	1.9	2.0	2.2

(1) Long-term trend from DRI Cyclelong, Summer 1999

(2) 10 year trend from DRI Early Recession (Pessim), November, 2000

Minnesota - U.S. Comparison Report

February 2003 Control

(Annual Percent Changes)

	1999	2000	2001	2002	2003	2004	2005
Wage and Salary Income							
United States	6.6	8.2	2.4	0.9	2.1	5.1	6.2
Minnesota	6.5	8.7	2.9	1.4	2.7	4.5	5.1
Implied Annual Wage							
United States	4.1	5.9	2.1	2.0	2.4	4.0	3.9
Minnesota	4.1	6.2	2.7	2.5	3.1	3.8	3.8
Non-Farm Employment							
United States	2.4	2.2	0.3	-1.1	-0.3	1.1	2.2
Minnesota	2.3	2.4	-0.2	-1.1	-0.4	0.7	1.3
Personal Income							
United States	4.9	8.0	3.3	2.7	3.2	5.2	5.6
Minnesota	4.7	8.5	3.5	3.3	3.1	4.6	5.2

Comparison of Actual and Estimated
Non-Restricted Revenues - October YTD, Fiscal 2004
($ in Thousands)

	Forecast Revenues	Actual Revenues	Variance Act-Fcst
Individual Income Tax			
Withholding	1,623,988	1,638,491	14,503
Declarations	218,129	219,648	1,519
Miscellaneous	68,295	68,934	639
Gross	1,910,412	1,927,073	16,661
Refund	57,768	42,860	(14,908)
Net	1,852,644	1,884,213	31,569
Corporate & Bank Excise			
Declarations	177,500	179,100	1,600
Miscellaneous	42,339	31,835	(10,504)
Gross	219,839	210,935	(8,904)
Refund	34,800	21,510	(13,290)
Net	185,039	189,425	4,386
Sales Tax			
Gross	1,313,440	1,312,274	(1,166)
Refunds	65,600	67,153	1,553
Net	1,247,840	1,245,121	(2,719)
Sales Tax Rebates all years	0	-6	(6)
Motor Vehicle Sales (gross)	97,611	101,647	4,036
Other Revenues			
Inherit/Gift/Estate	19,050	34,170	15,120
Liquor/Wine/Beer	21,538	22,950	1,411
Cigarette/Tobacco/Cont Sub	57,160	58,317	1,157
Deed and Mortgage	78,863	132,343	53,480
Insurance Gross Earnings	53,900	55,510	1,610
Lawful Gambling	15,819	15,920	101
Health Care Surcharge	79,816	72,882	(6,933)
Other Taxes	397	897	500
State Wide Property Tax	6,029	119	(5,910)
DHS RTC Collections	19,735	14,315	(5,420)
Income Tax Reciprocity	0	0	0
Investment Income	4,325	5,529	1,204
Tobacco Settlement	0	100	100
Departmental Earnings	76,135	82,240	6,105
Lottery Revenues	9,036	8,628	(408)
Revenues yet to be allocated	0	2,092	2,092
Residual revenues less refunds	25,316	107,344	82,028
Other Subtotal	**467,119**	**613,356**	**146,237**
Other Refunds	**6,530**	**6,676**	**146**
Other Net	**460,589**	**606,680**	**146,091**
Total Gross	**4,008,421**	**4,165,278**	**156,857**
Total Refunds	**164,698**	**138,199**	**(26,499)**
Total Net	**3,843,723**	**4,027,079**	**183,356**

Factors Affecting the Individual Income Tax
($ in billions)

	Calendar Year					
	2000	2001	2002	2003	2004	2005
Minnesota Non-Farm Tax Base						
November 1999 Control	126.630	133.200				
February 2000 Control	127.870	134.090				
November 2000 Control	138.670	146.530	155.040	165.080		
February 2001 Control	139.420	145.300	152.840	162.610		
November 2001 Control	139.610	144.440	146.880	155.990		
February 2002 Baseline	139.610	143.910	145.890	153.470		
*November 2002 Baseline	134.530	138510	140.600	145.760	154.850	164.940
*February 2003 Baseline	134.530	138.510	140.520	144.940	153.580	163.500
*November 2003 Baseline	13.6120	139.980	142.370	146.160	152.570	160.690
Minnesota Wage and Salary Income						
November 1999 Control	95.060	100.590				
February 2000 Control	95.600	100.500				
November 2000 Control	96.555	102.910	109.420	116.870		
February 2001 Control	97.350	102.290	108.100	115.190		
November 2001 Control	96.490	100.340	102.920	109.210		
February 2002 Control	96.490	99.840	101.910	107.140		
*November 2002 Baseline	92.580	95.220	96.100	99.790	106.150	112.830
*February 2003 Baseline	92.580	95.220	96.100	98.830	104.690	111.420
*November 2003 Baseline	92.780	95.460	96.780	99.410	103.830	109.140
Minnesota Property Income						
November 1999 Control	22.523	23.243				
February 2000 Control	22.984	23.956				
November 2000 Control	32.711	33.690	35.015	36.754		
February 2001 Control	32.670	33.216	34.163	36.102		
November 2001 Control	33.339	33.868	33.184	35.201		
February 2002 Control	33.339	33.851	33.466	35.074		
November 2002 Baseline	32.124	32.918	33.564	34.408	36.104	39.119
February 2003 Baseline	32.124	32.918	33.464	34.389	36.176	38.513
November 2003 Baseline	33.059	33.974	34.509	34.946	36.045	38.041
Minnesota Proprietors' Income						
November 1999 Control	9.045	9.365				
February 2000 Control	9.288	9.636				
November 2000 Control	9.405	9.938	10.607	11.455		
February 2001 Control	9.407	9.800	10.570	11.323		
November 2001 Control	9.778	10.232	10.779	11.586		
February 2002 Control	9.778	10.216	10.515	11.256		
November 2002 Baseline	9.828	10.373	10.936	11.761	12.297	12.996
February 2003 Baseline	9.828	10.373	10.955	11.720	12.712	13.573
November 2003 Baseline	10.280	10.543	11.086	11.803	12.691	13.508

** Wages reflect ES202 Data*

Factors Affecting Sales Tax, Corporate Income Tax, and Sales Tax on Motor Vehicles

($ in billions)

	Fiscal Year					
	2000	2001	2002	2003	2004	2005
SALES TAX						
Minnesota Synthetic Sales Tax Base						
February 2003 Baseline	59.276	61.529	61.794	62.968	65.876	70.137
Percent		3.8%	0.4%	1.9%	4.6%	6.5%
November 2003 Baseline	59.141	61.423	61.647	62.976	66.185	68.232
Percent		3.9%	0.4%	2.2%	5.1%	3.1%
Minnesota's Proxy Share of U.S. Consumer Durable Spending (Excluding Autos)						
February 2000 Control*	9.648	10.100				
November 2000 Control	9.875	10.512	11.124	11.978		
February 2001 Control**	10.307	10.783	11.180	12.043		
November 2001 Control*	10.193	10.725	10.477	10.784		
February 2002 Control	10.193	10.723	10.740	10.843		
November 2002 Baseline	10.052	10.404	10.806	11.146	11.733	12.451
February 2003 Baseline	10.052	10.404	10.807	11.137	11.617	12.394
November 2003 Baseline	10.048	10.397	10.793	11.119	11.764	12.174
Minnesota's Proxy Share of U.S. Capital Equipment Spending						
February 2000 Control*	11.362	12.161				
November 2000 Control	11.243	12.887	13.717	14.577		
February 2001 Control	11.267	12.272	12.850	13.868		
November 2001 Control*	10.913	11.475	9.671	9.812		
February 2002 Control	10.913	11.474	9.683	9.850		
November 2002 Baseline	10.768	10.998	8.799	10.252	10.693	11.579
February 2003 Baseline	10.768	10.998	9.795	10.082	10.624	11.577
November 2003 Baseline	10.726	10.997	9.785	10.143	11.080	11.703
Minnesota's Proxy Share of U.S. Construction Spending						
February 2000 Control*	7.404	7.540				
November 2000 Control	7.595	7.677	7.985	8.507		
February 2001 Control	7.595	7.818	7.955	8.386		
November 2001 Control*	7.545	8.152	8.438	8.545		
February 2002 Control	7.545	8.152	8.345	8.420		
November 2002 Baseline	7.582	8.227	8.467	8.337	8.612	9.424
February 2003 Baseline	7.582	8.227	8.479	8.429	8.798	9.191
November 2003 Baseline	7.418	8.093	8.364	8.404	8.990	8.915

* Reflects data revision.

** Reflects change in data definition

Factors Affecting Sales, Corporate Income And Sales Tax on Motor Vehicles

($ in billions)

	Fiscal Year					
	2000	2001	2002	2003	2004	2005
SALES TAX (Cont.)						
Minnesota's Personal Income Excluding Farm Proprietors Income						
November 1999 Control*	141.35	147.91				
February 2000 Control	142.37	149.75				
November 2000 Control	152.34	161.70	170.86	181.54		
February 2001 Control	152.78	161.59	169.03	179.41		
November 2001 Control	151.24	161.58	163.61	174.93		
February 2002 Control	157.17	162.38	165.28	173.63		
November 2002 Baseline	151.51	162.41	166.54	173.04	181.57	192.47
February 2003 Baseline	151.51	16241	166.43	172.40	181.12	192.14
November 2003 Baseline (1)	151.77	162.60	166.40	172.04	178.50	187.08
SALES TAX ON MOTOR VEHICLES						
Minnesota's Proxy Share of U.S. Consumption of Motor Vehicle and Parts						
November 1999 Control*	6.425	6.519				
February 2000 Control	6.574	6.517				
November 2000 Control	6.646	6.671	6.764	7.452		
February 2001 Control	6.630	6.444	6.566	7.080		
November 2001 Control	6.780	7.097	7.007	7.484		
February 2002 Control	6.894	7.163	7.403	7.506		
November 2002 Baseline	6.737	6.939	7.493	7.353	7.568	7.361
February 2003 Baseline	6.737	6.939	7.496	7.572	7.619	7.676
November 2003 Baseline	6.735	6.934	7.512	7.800	7.988	8.060
CORPORATE FRANCHISE TAX Calendar Year						
U.S. Corporate Profits						
November 1999 Control*	883.8	894.2	883.8	894.2		
February 2000 Control	849.7	823.4	849.7	823.4		
November 2000 Control	940.7	910.0	993.5	1,089.0		
February 2001 Control	929.5	892.2	1,006.3	1,066.2		
November 2001 Control	845.4	663.6**	685.7	761.2		
February 2002 Control	845.4	631.9**	722.1	786.0		
November 2002 Baseline	782.3	670.2	662.2	771.1	873.5	871.0
February 2003 Baseline	782.3	670.2	650.7	753.8	859.6	857.1
November 2003 Baseline	782.3	670.2	665.2	770.0	869.6	890.9

* Data Revision.
** Finance Dept Estimate
(1) Consistent with October 2003 BEA release

FY 2003 Year End Summary
General Fund
($ in thousands)

	FY 2002	FY 2003	Biennial Total
Actual & Estimated Resources			
Balance Forward From Prior Year	1,574,200	1,130,269	1,574,200
Current Resources:			
Tax Revenues	11,421,412	11,923,959	23,345,371
Non-Tax Revenues	755,938	650,818	1,406,756
Dedicated Revenue	34,599	54,600	89,199
Transfers In	67,585	455,371	522,956
Prior Year Adjustments	30,491	48,063	78,554
Subtotal-Current Resources	12,310,025	13,132,811	25,442,836
Total Resources Available	**13,884,225**	**14,263,080**	**27,017,036**
Actual & Estimated Spending			
E-12 Education	4,418,781	5,976,849	10,395,630
Property Tax Recog/Payment Change	0	(442,350)	(442,350)
Property Tax Aids & Credits	1,779,747	1,598,875	3,378,622
Higher Education	1,394,932	1,347,090	2,742,022
Health & Human Services	3,172,182	3,554,193	6,726,375
Environment, Agriculture & Economic Dev	430,287	362,194	792,481
Transportation	209,526	118,803	328,329
Criminal Justice	640,526	704,388	1,344,914
State Government	378,866	325,188	704,054
Debt Service & Borrowing	285,553	295,499	581,052
Capital Projects	2,146	0	2,146
Deficiencies/Other	11,615	25,731	37,346
Subtotal Expenditures & Transfers	**12,724,161**	**13,866,460**	**26,590,621**
Dedicated Expenditures	29,795	27,698	57,493
Total Expenditures & Transfers	**12,753,956**	**13,894,158**	**26,648,114**
Balance Before Reserves	**1,130,269**	**368,922**	**368,922**
Budget Reserve	0	103,677	103,677
Tax Relief Account	158,148	0	0
Appropriations Carried Forward	316,393	84,818	84,818
Budgetary Balance	**655,728**	**180,427**	**180,427**

FY 2002-03 Biennial Summary
General Fund
($ in thousands)

	6-03 Enacted FY 2002-03	Closing FY 2002-03	Difference
Actual & Estimated Resources			
Balance Forward From Prior Year	1,574,200	1,574,200	0
Current Resources:			
Tax Revenues	23,351,410	23,345,371	(6,039)
Non-Tax Revenues	1,359,899	1,406,756	46,857
Dedicated Revenue	93,853	89,199	(4,654)
Transfers In	475,266	522,956	47,690
Prior Year Adjustments	79,212	78,554	(658)
Subtotal-Current Resources	25,359,640	25,442,836	83,196
Total Resources Available	**26,933,840**	**27,017,036**	**83,196**
Actual & Estimated Spending			
E-12 Education	10,423,215	10,395,630	(27,585)
Property Tax Recog/Payment Change	(442,350)	(442,350)	0
Property Tax Aids & Credits	3,378,679	3,378,622	(57)
Higher Education	2,756,633	2,742,022	(14,611)
Health & Human Services	6,754,296	6,726,375	(27,921)
Environment, Agriculture & Economic Dev	799,189	792,481	(6,708)
Transportation	318,013	328,329	10,316
Criminal Justice	1,351,277	1,344,914	(6,363)
State Government	734,857	704,054	(30,803)
Debt Service & Borrowing	581,047	581,052	5
Capital Projects	2,146	2,146	0
Deficiencies/Other	12,362	37,346	24,984
Estimated Cancellations	(5,000)	0	5,000
Subtotal Expenditures & Transfers	**26,664,364**	**26,590,621**	**(73,743)**
Dedicated Expenditures	89,049	57,493	(31,556)
Total Expenditures & Transfers	**26,753,413**	**26,648,114**	**(105,299)**
Balance Before Reserves	**180,427**	**368,922**	**188,495**
Budget Reserve	0	103,677	103,677
Appropriations Carried Forward	0	84,818	84,818
Budgetary Balance	**180,427**	**180,427**	**0**

FY 2004-05 General Fund Budget
November 2003 General Fund Forecast
($ in thousands)

	FY 2004	FY 2005	Biennial Total
Actual & Estimated Resources			
Balance Forward From Prior Year	368,922	825,347	368,922
Current Resources:			
Tax Revenues	12,420,303	12,919,139	25,339,442
Non-Tax Revenues	702,586	638,426	1,341,012
Dedicated Revenue	45,006	45,006	90,012
Transfers In	1,128,317	316,347	1,444,664
Prior Year Adjustments	10,100	10,100	20,200
Subtotal-Current Resources	14,306,312	13,929,018	28,235,330
Total Resources Available	**14,675,234**	**14,754,365**	**28,604,252**
Actual & Estimated Spending			
E-12 Education	6,145,754	6,077,594	12,223,348
Property Tax Recog/Payment Change	(414,748)	(19,139)	(433,887)
Property Tax Aids & Credits	1,427,733	1,349,364	2,777,097
Higher Education	1,287,455	1,273,328	2,560,783
Health & Human Services	3,595,700	3,736,100	7,331,800
Environment, Agriculture & Economic Dev	365,397	344,574	709,971
Transportation	79,137	81,131	160,268
Criminal Justice	715,934	724,214	1,440,148
State Government	332,013	312,935	644,948
Debt Service & Borrowing	265,700	387,359	653,059
Estimated Cancellations	0	(5,000)	(5,000)
Subtotal Expenditures & Transfers	**13,800,075**	**14,262,460**	**28,062,535**
Dedicated Expenditures	49,812	45,006	94,818
Total Expenditures & Transfers	**13,849,887**	**14,307,466**	**28,157,353**
Balance Before Reserves	**825,347**	**446,899**	**446,899**
Budget Reserve	409,677	631,434	631,434
Budgetary Balance	**415,670**	**(184,535)**	**(184,535)**

FY 2004-05 Biennial Comparison
November 2003 Forecast vs End of 2003 Session
($ in thousands)

	6-03 Enacted FY 2004-05	11-03 Fcst FY 2004-05	$ Difference	% Change
Actual & Estimated Resources				
Balance Forward From Prior Year	180,427	368,922	188,495	104.5%
Current Resources:				
Tax Revenues	25,696,817	25,339,442	(357,375)	-1.4%
Non-Tax Revenues	1,348,984	1,341,012	(7,972)	-0.6%
Dedicated Revenue	126,505	90,012	(36,493)	-28.8%
Transfers In	1,449,461	1,444,664	(4,797)	-0.3%
Prior Year Adjustments	20,200	20,200	0	0.0%
Subtotal-Current Resources	28,641,967	28,235,330	(406,637)	-1.4%
Total Resources Available	**28,822,394**	**28,604,252**	**(218,142)**	**-0.8%**
Actual & Estimated Spending				
E-12 Education	12,322,548	12,223,348	(99,200)	-0.8%
Property Tax Recog/Payment Change	(439,836)	(433,887)	5,949	-1.4%
Property Tax Aids & Credits	2,737,026	2,777,097	40,071	1.5%
Higher Education	2,557,657	2,560,783	3,126	0.1%
Health & Human Services	7,425,291	7,331,800	(93,491)	-1.3%
Environment, Agriculture & Economic Dev	693,496	709,971	16,475	2.4%
Transportation	160,268	160,268	0	0.0%
Criminal Justice	1,430,649	1,440,148	9,499	0.7%
State Government	618,408	644,948	26,540	4.3%
Debt Service & Borrowing	673,625	653,059	(20,566)	-3.1%
Estimated Cancellations	(5,000)	(5,000)	0	0.0%
Subtotal Expenditures & Transfers	**28,174,132**	**28,062,535**	**(111,597)**	**-0.4%**
Dedicated Expenditures	126,505	94,818	(31,687)	-25.0%
Total Expenditures & Transfers	**28,300,637**	**28,157,353**	**(143,284)**	**-0.5%**
Balance Before Reserves	**521,757**	**446,899**	**(74,858)**	
Budget Reserve	521,757	631,434	109,677	
Budgetary Balance	**0**	**(184,535)**	**(184,535)**	

FY 2006-07 Planning Estimates Comparison
November 2003 Forecast vs End of 2003 Session
($ in thousands)

	6-03 Enacted FY 2006-07	11-03 Fcst FY 2006-07	$ Difference	% Change
Actual & Estimated Resources				
Balance Forward From Prior Year	521,757	446,899	(74,858)	-14.3%
Current Resources:				
Tax Revenues	28,394,224	27,663,898	(730,326)	-2.6%
Non-Tax Revenues	1,458,669	1,321,202	(137,467)	-9.4%
Dedicated Revenue	130,663	90,012	(40,651)	-31.1%
Transfers In	293,037	287,821	(5,216)	-1.8%
Prior Year Adjustments	20,200	20,200	0	0.0%
Subtotal-Current Resources	30,296,793	29,383,133	(913,660)	-3.0%
Total Resources Available	**30,818,550**	**29,830,032**	**(988,518)**	**-3.2%**
Actual & Estimated Spending				
E-12 Education	12,168,933	12,036,527	(132,406)	-1.1%
Property Tax Recog/Payment Change	(77,603)	(66,964)	10,639	-13.7%
Property Tax Aids & Credits	2,922,630	2,975,365	52,735	1.8%
Higher Education	2,547,848	2,547,848	0	0.0%
Health & Human Services	8,327,191	8,415,695	88,504	1.1%
Environment, Agriculture & Economic Dev	682,110	682,793	683	0.1%
Transportation	162,735	162,735	0	0.0%
Criminal Justice	1,506,920	1,525,036	18,116	1.2%
State Government	621,936	622,585	649	0.1%
Debt Service & Borrowing	782,769	790,885	8,116	1.0%
Estimated Cancellations	(5,000)	(5,000)	0	0.0%
Subtotal Expenditures & Transfers	**29,640,469**	**29,687,505**	**47,036**	**0.2%**
Dedicated Expenditures	130,663	90,012	(40,651)	-31.1%
Total Expenditures & Transfers	**29,771,132**	**29,777,517**	**6,385**	**0.0%**
Balance Before Reserves	**1,047,418**	**52,515**	**(994,903)**	
Budget Reserve	521,757	631,434	109,677	
Budgetary Balance	**525,661**	**(578,919)**	**(1,104,580)**	

FY 2002-07 Planning Horizon
November 2003 General Fund Forecast
($ in thousands)

	Closing FY 2002-03	11-03 Fcst FY 2004-05	11-03 Plng FY 2006-07
Actual & Estimated Resources			
Balance Forward From Prior Year	1,574,200	368,922	446,899
Current Resources:			
Tax Revenues	23,345,371	25,339,442	27,663,898
Non-Tax Revenues	1,406,756	1,341,012	1,321,202
Dedicated Revenue	89,199	90,012	90,012
Transfers In	522,956	1,444,664	287,821
Prior Year Adjustments	78,554	20,200	20,200
Subtotal-Current Resources	25,442,836	28,235,330	29,383,133
Total Resources Available	**27,017,036**	**28,604,252**	**29,830,032**
Actual & Estimated Spending			
E-12 Education	10,395,630	12,223,348	12,036,527
Property Tax Recog/Payment Change	(442,350)	(433,887)	(66,964)
Property Tax Aids & Credits	3,378,622	2,777,097	2,975,365
Higher Education	2,742,022	2,560,783	2,547,848
Health & Human Services	6,726,375	7,331,800	8,415,695
Environment, Agriculture & Economic Dev	792,481	709,971	682,793
Transportation	328,329	160,268	162,735
Criminal Justice	1,344,914	1,440,148	1,525,036
State Government	704,054	644,948	622,585
Debt Service & Borrowing	581,052	653,059	790,885
Capital Projects	2,146	0	0
Deficiencies/Other	37,346	0	0
Estimated Cancellations	0	(5,000)	(5,000)
Subtotal Expenditures & Transfers	**26,590,621**	**28,062,535**	**29,687,505**
Dedicated Expenditures	57,493	94,818	90,012
Total Expenditures & Transfers	**26,648,114**	**28,157,353**	**29,777,517**
Balance Before Reserves	**368,922**	**446,899**	**52,515**
Budget Reserve	103,677	631,434	631,434
Appropriations Carried Forward	84,818	0	0
Budgetary Balance	**180,427**	**(184,535)**	**(578,919)**