Minnesota
Department of Finance

February 2004

Highlights

$160 Million Budget Deficit Projected for FY 2004-05

Minnesota's projected budget deficit for FY 2004-05 has fallen by $25 million since November. The changes to forecast revenues and expenditures were small. Expected revenues are projected to be $21 million (0.1 percent), below November's forecast. That minor revenue decline was more than offset by a $46 million (0.2 percent), reduction in projected spending.

2004 U.S. Economic Growth Expected to Be Strongest in 20 Years

Global Insight's February baseline forecast calls for real GDP to grow at a 4.8 percent annual rate in 2004, and at a 3.8 percent annual rate in 2005. GII's forecast is slightly more optimistic than the consensus forecast of 4.6 percent growth, but even a 4.6 percent growth rate would be stronger than any observed since 1984. GII's baseline requires a significant increase in payroll employment by mid-year and job growth of more than 200,000 per month in the second half of 2004 is projected. Since September U.S. employment growth has averaged just under 75,000 per month.

Budget Outlook for 2006-07 Biennium Worsens; Planning Estimates Show Budget Gap of $441 Million

Current law spending is now projected to exceed projected revenues by $441 million in the 2006-07 biennium, $47 million more than projected in November. A disparity between the spending and revenue growth assumptions used may understate the size of the coming budget problem. Revenues are projected to grow at an average annual rate of more than 4 percent through fiscal 2007. Expenditure projections are flat or declining in most areas. Spending growth largely reflects changes in health care and long-term care caseload and costs. Any spending increases beyond those in current law would add to the future budget shortfall.

400 CENTENNIAL BUILDING, 658 CEDAR STREET, ST. PAUL, MINNESOTA 55155 (651)296-5900

Budget Summary

FY 2004-05 Budget Deficit Now $160 Million

Minnesota's budget outlook has improved slightly since November. There were no major changes in either the revenue or expenditure outlook. A small decline in spending estimates more than offsets a minor drop in projected revenues, reducing the projected deficit by $25 million. The budget deficit for the FY 2004-05 biennium is now estimated to be $160 million, about 0.5 percent of biennial revenues. In November a deficit of $185 million was forecast. Expected revenues have fallen by $21 million (0.1 percent) from November's estimate, while forecast spending for this biennium is $46 million (0.2 percent) below November's estimate.

FY 2004-05 Budget Summary
($ millions)

	Nov 2003	Feb 2004	Change
Beginning Balance	$ 368	$ 368	$ 0
Forecast Revenues	28,235	28,214	(21)
Estimated Expenditures	28,157	28,111	(46)
Budget Reserve	631	631	0
Projected Deficit	**$(185)**	**$(160)**	**$25**

Minnesota general fund revenues are now forecast to total $28.214 billion during the current biennium, $428 million (1.5 percent) less than end-of-session estimates. Forecast receipts from the state's five major taxes are projected to total $22.949 billion, down $109 million from November's estimate, and $568 million from end-of-session estimates. Other tax and non-tax revenues are expected to exceed November's forecast by $88 million, and end-of-session estimates by $181 million.

General fund spending is now projected to total $28.111 billion, $46 million less than projected in November, and $189 million less than end-of-session estimates. Lower spending estimates for E-12 education and for health and human services were the sources of the changes in estimated spending.

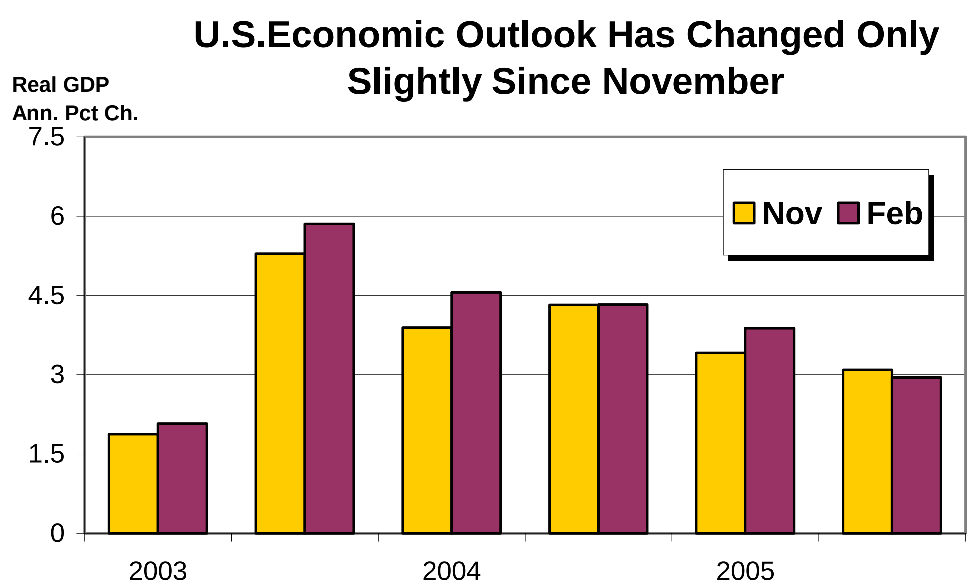
The state's general fund reserve of $631 million represents slightly over 2.2 percent of forecast spending projected for the biennium. The Governor and the legislature are required to take action to balance the general fund budget before the biennium ends.

2004 Expected to Be a Very Good Year for the U.S. Economy

Times are expected to be very good in 2004, but those expectations had already been factored into most forecasts by last November. The result is that current forecasts for the U.S. economy have grown only slightly more optimistic. Business investment has increased in recent months, and productivity gains are expected to remain strong, lifting corporate profits and wages through 2005. The weaker dollar has also made U.S. goods more competitive overseas. While that recent good economic news has not provided reason to raise 2004 forecasts, it has increased forecasters' confidence that their earlier optimism was not ill advised.

A majority of forecasters expect 2004's real GDP growth rate to be the strongest since 1984. But a repeat of the late 1990's when super-normal real GDP growth lasted for more than four years is unlikely. Instead, economic growth rates are expected to drop below 4 percent and move back to a more sustainable level in 2005. As always there is a substantial list of items that could go wrong, but for the short term at least, that list seems less intimidating than in the recent past. No one is expecting a major economic slump, let alone a recession. In the absence of a major geopolitical event, another year of real growth around 3 percent, like occurred in 2002 and 2003, is the worst that is expected.

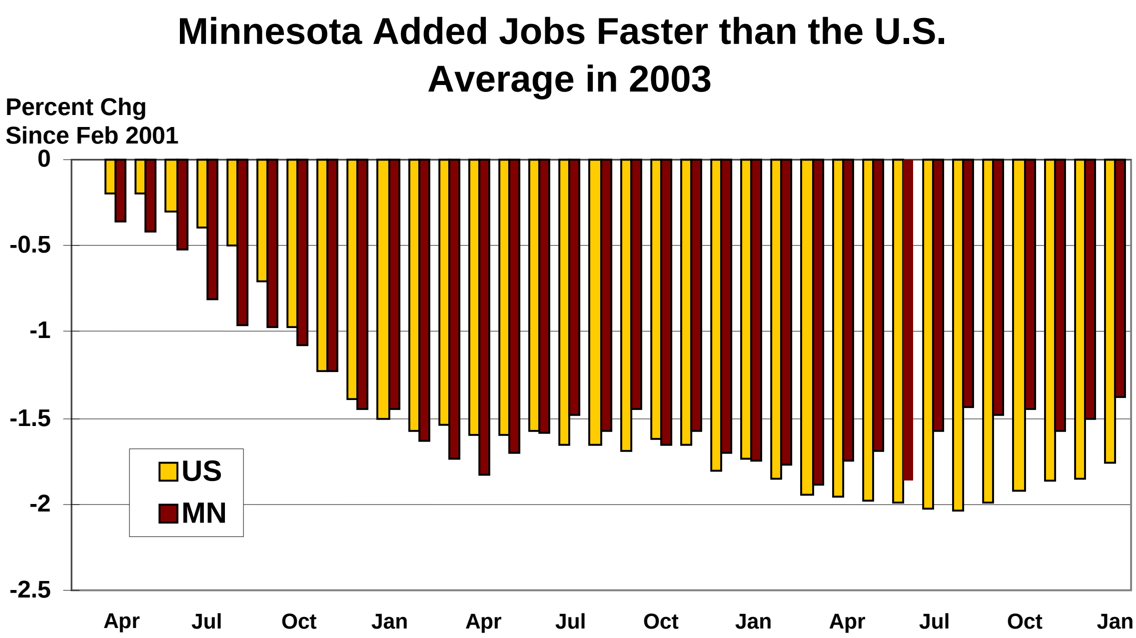
Payroll employment remains stubbornly below end-of-recession levels. But the projected increase in demand for U.S. goods and services is expected to lead to an acceleration in hiring through the spring and early summer and to the creation of more than 200,000 new jobs per month in the second half of this year. Employers have already started to hire. Since September U.S. employment growth has averaged just under 75,000 per month, about one-half the monthly amount needed to keep pace with normal growth in the labor force.



The February baseline forecast from Global Insight Inc., (GII), Minnesota's national economic consultant is for even stronger growth than is in the already optimistic consensus outlook for the economy. GII expects real GDP to grow at an annual rate of 4.8 percent during 2004, and at a 3.8 percent rate in 2005. Their November forecast was only slightly more subdued with projected annual growth rates of 4.3 percent and 3.6 percent, for 2004 and 2005. GII believes inflation will continue to remain well under control. The February baseline shows CPI increases of 1.4 percent in 2004 and 1.3 percent in 2005. Although GII notes, "The baseline forecast could easily be mistaken for an optimistic one," a slightly more optimistic scenario is also provided with growth about 0.5 percent higher than the baseline for 2004 and 2005. That scenario is assigned a probability of 20 percent. A less optimistic scenario, in which real growth in 2004 is still 4.0 percent, is also assigned a 20 percent probability.

Revised Employment Data Show Minnesota Economy Grew Faster than U.S. in 2003

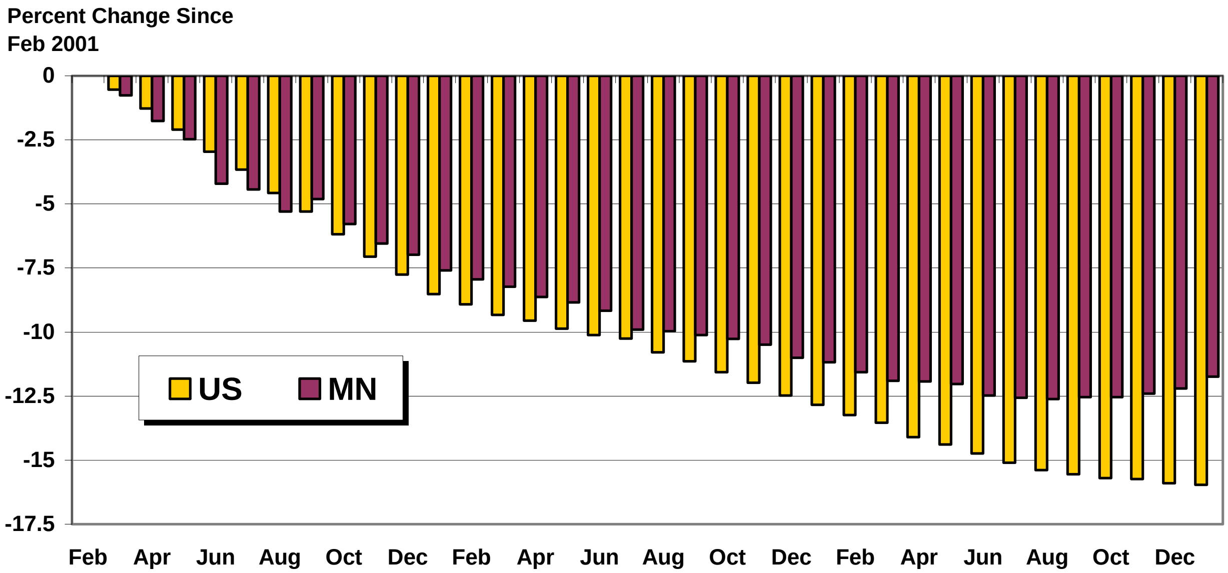
Recently released employment data show Minnesota's job market has recovered a little more rapidly from the recession than its national counterpart. June 2003 payroll employment in the state was down by more than 50,000 jobs from its pre-recession peak in February 2001. More than 12,000 jobs were added during the summer months, but since then employment growth in Minnesota has stalled. Through January Minnesota payroll employment is up by 13,000 from its June low, but it is still 37,000 below the level reported for February 2001. Substantial weakness remains in the labor market. Continuing unemployment claims have yet to show any sign of recovery, remaining at levels observed during and shortly after the recession.



The revised data show Minnesota outperforming the national economy in job growth during 2003. Earlier comparisons, made using data available before the recent revisions, showed Minnesota employment not quite keeping pace with the U.S. averages. Both Minnesota and the U.S. started 2003 with employment 1.74 percent below its pre-recession highs. Growth in Minnesota employment during 2003 has reduced that gap to 1.38 percent. Nationally employment is now 1.78 percent below the February 2001 peak.

Minnesota's manufacturing employment is down substantially from pre-recession levels, but we have fared somewhat better than the nationwide averages. Nearly 3,000 manufacturing jobs have been added in the state since June, while national manufacturing employment is down 208,000 over that same time period. Since February 2001 Minnesota manufacturing employment has fallen by 11.7 percent. Nationally, manufacturing employment has dropped 16 percent. The forecast includes only a modest increase in manufacturing employment through 2005.

Manufacturing Job Losses Have Been Less than the U.S. Average



FY 2004-05 Revenue Forecast Down $21 Million from November's Forecast

Current general fund resources for the 2004-05 biennium are now forecast to total $28.214 billion, $21 million less than was forecast in November and $428 million (1.5 percent) less than end-of-session estimates. The forecast for the five major taxes was reduced by $109 million or 0.5 percent from November's estimate. Projected receipts from other tax and non-tax revenues were increased by $88 million.

FY 2004-05 Revenues

($ millions)

	Nov 2003	Feb 2004	Change	% Change
Individual Income	$11,544	$11,457	$(87)	(0.8)%
Sales	8,260	8,314	54	0.7
Corporate	1,444	1,386	(58)	(4.0)
Motor Vehicle Sales	590	571	(19)	(3.2)
Statewide Levy	1,220	1,221	1	0.1
Subtotal	**23,058**	**22,949**	**(109)**	**(0.5)%**
Other Non-Dedicated Revenues	3,622	3,710	88	2.4
Other Resources	1,555	1,555	0	0.0
Total Resources	**$28,235**	**$28,214**	**$(21)**	**(0.1)%**

Changes in expected revenues from the five major taxes were small, with both the individual income tax and the sales tax differing from November's estimate by less than one percent. The corporate income tax had the largest percentage decline, down 4 percent or $58 million due to lower than projected receipts from estimated payments at the end of calendar 2003. But, even after that forecast reduction, corporate tax receipts are still expected to exceed end-of-session estimates by $81 million. The forecast for other non-dedicated revenues is up $88 million from November. Stronger than anticipated growth in the insurance gross premiums tax and the mortgage and deed taxes provide much of the additional revenue.

Little Change in Forecast Spending

Forecast spending for the biennium is now expected to be $28.111 billion, down $46 million (0.1 percent) from November and down $189 million from end-of-session estimates. Lower forecast spending for E-12 education and health and human services programs account for the net decline.

FY 2004-05 Estimated Expenditures

($ millions)

	Nov 2003	Feb 2004	Change
E-12 Education	$11,789	$11,759	$(30)
Higher Education	2,561	2,561	0
Property Tax Aids & Credits	2,777	2,778	1
Health & Human Services	7,332	7,316	(16)
All Other	3,698	3,697	(1)
Total Spending	**$28,157**	**$28,111**	**$ (46)**

The majority of the $30 million (0.3 percent) reduction in the forecast for E-12 education results from slightly lower pupil counts in 2003 and higher values associated with the early recognition of property tax revenue for school districts. Nearly $25 million of the forecast change was within the General Education program.

Health and human services spending in the current biennium is now expected to be $16 million (0.2 percent) less than November's estimate. Much of the savings came from small reductions in projected spending for basic health care grants and child care and economic support grants. That lower spending was partially offset by increases in spending for continuing care and community support grants.

Planning Estimates Highlight Continued Budget Pressures

Revenue planning estimates for FY 2006-07 total $29.260 billion, $123 million less than projected in November. Expenditures are projected to be $29.702 billion, $76 million less than November's estimates. In the absence of legislative action, a $602 million budget shortfall would occur in the next biennium. When the $160 million deficit for FY 2004-05 is resolved, a budget gap will still remain. How much of the currently projected $441 structural shortfall remains will depend on how the FY 2004-05 budget deficit is solved.

FY 2006-07 Planning Estimates

($ millions)

	FY 2006	FY 2007	Biennial Total
Beginning Balance	**$472**	**$111**	**$472**
Revenues	14,346	14,914	29,260
Spending	14,706	14,996	29,702
Budget Reserve	631	631	631
Projected Balance	**$(520)**	**$(602)**	**$(602)**

The planning estimates assume real economic growth continues at an annual average rate of 3.6 percent during 2005 and 2006. State tax revenues increase at a rate slightly more than 4 percent per year. Current law spending, however, increases only about 2.5 percent per year, largely reflecting growth in health care and long-term care caseload and costs. Other major areas are virtually flat.

FY 2005-07 Structural Balance

($ millions)

	FY 2005	FY 2006	FY 2007
Projected Revenues	13,926	14,346	14,914
Spending	14,267	14,706	14,995
Difference / Structural	**$(341)**	**$(360)**	**$(81)**

A disparity between revenue and expenditure growth assumptions may understate the size of future budget gaps. While state revenues recognize inflation in the growth of the state tax base, inflation is not generally included in projected state expenditures. Projected inflation is expected to be 1.4 and 1.7 percent for FY 2006 and FY 2007 respectively. If expected inflation were included in the expenditures estimates in the same way as it is in the revenue estimates, projected spending would increase by $200 million in FY 2006 and $450 million in FY 2007.

Without action, spending will exceed revenues in each of the next three years. This is the "structural" gap between revenues collected in a year and expenditures for that year. While useful for planning purposes, state policy makers must carefully consider not only the size of the projected FY 2006-07 structural shortfall, but also potential cost pressures in major spending areas that are not built into current law planning estimates for FY 2006-07.

A complete version of the February 2004 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

February's forecast is the second 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. That updated revenue and expenditure information is also used to revise the revenue and expenditure planning estimates for the FY 2006-07 biennium.

The revised revenue estimates reflect changes in the national economic outlook since November. 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 January.

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). Minnesota's Council of Economic Advisors reviewed GII's national forecast. 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 February Control 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.

While wage and price inflation is included in revenue estimates, it is not included in projected expenditures. Estimated inflation during the period is 1.4 and 1.7 percent for FY 2006 and FY 2007 respectively.

As with all budget forecasts, this forecast reflects only current law. It does not reflect the Governor's budget recommendations, or any potential legislative action. Presentation of the current law forecast for a deficit in the current and potential future budget shortfalls will likely be accompanied by discussion of possible future legislative changes. The forecast provides only a current law framework for these discussions. 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

Forecasters expect this year to be a very good year for the U.S. economy. Real output has grown for the past two years, but the recovery has seemed fragile and incomplete. Business investment spending had languished, payroll employment continued to decline, and U.S. exports provided no real support for future growth. Consumer spending and government spending were sufficient to keep the expansion going through mid 2003, but there are limits to what can be done with monetary policy and fiscal policy, and those limits appeared to be close at hand.

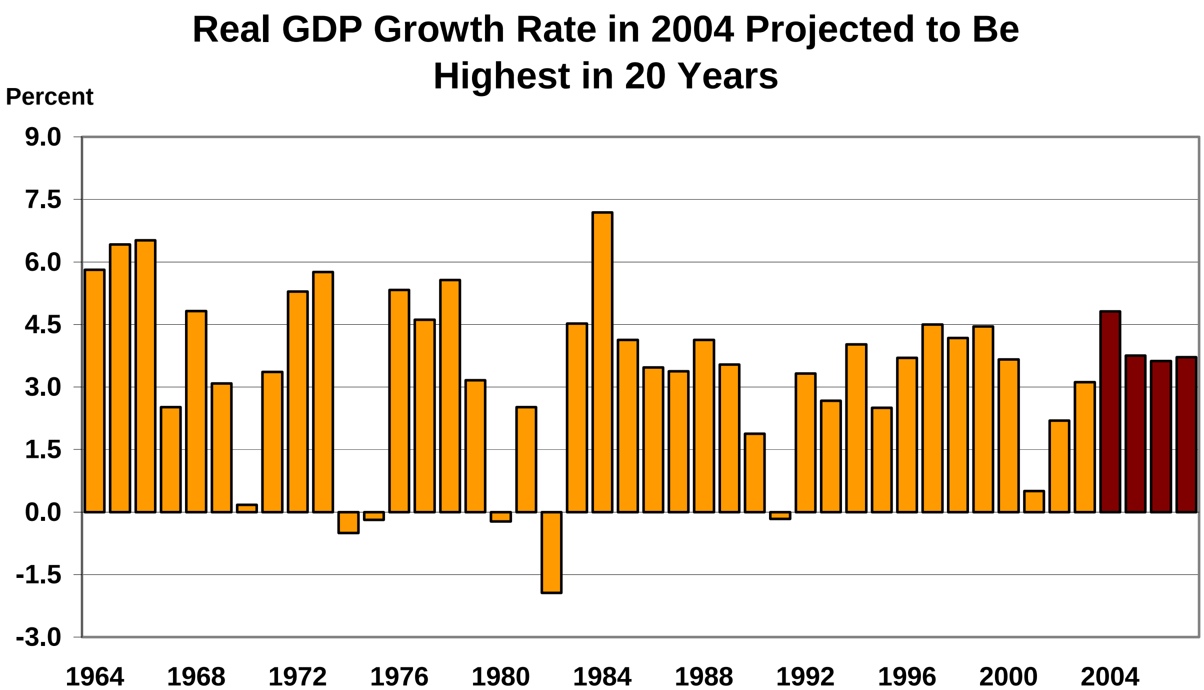
Fortunately the necessary ingredients for increased business investment spending came into place and payroll employment began to grow, albeit only slowly. The weaker dollar has also made U.S. goods more attractive in export markets. Those developments set the stage for a strong economic performance in 2004.

The turnaround in business investment spending was the key. Following a 7-quarter decline, business fixed investment stabilized in late 2002, and then began to grow in the spring of 2003. Over the past year higher corporate profits have strengthened balance sheets and improved cash positions, freeing up funds for additional business investment spending. The added uncertainty associated with the U.S. commitment in Iraq has been set aside, and households and business managers now appear to have adjusted to life in the more uncertain post 9/11 world. Product cycles and normal wear also are also beginning to add to demand for replacement equipment. And, the huge burst of consumer spending observed in the last half of 2003 has demonstrated once again that there is no reason to fear that domestic demand will slacken or that American consumers will lose their willingness to spend. There will be less fiscal and monetary stimulus this year, but the combination of further recovery in business investment spending, additional export demand, and inventory restocking will keep the economy growing strongly through 2004 and early 2005.

There is almost universal optimism among forecasters. The median forecast from February's Blue Chip panel is for 4.6 percent real GDP growth. The U.S. economy has not grown that fast since 1984. Every member of that panel expects the 2004 growth rate to exceed the 3.2 percent rate observed in 2003, and all but 3 of the panel's 53 forecasters believe the economy will grow at a 4.3 percent rate, or faster. The *Wall Street Journal's* poll shows similar results. Only 3 of its forecasting panel expect real GDP growth to be less than 3 percent in even one quarter of 2004.

Global Insight, Inc. (GII) Minnesota's national economic consultant now expects real GDP to grow at a 4.8 percent annual rate during calendar 2004, the strongest growth rate in 20 years. For calendar 2005 the economy is projected to grow at a 3.8 percent annual rate. In November GII was projecting real growth rates of 4.3 percent and 3.6 percent for 2004 and 2005. The GII baseline forecast is slightly more optimistic than the Blue Chip consensus forecast of 4.6 percent real GDP growth in 2004 and 3.6 percent real growth in 2005.

Inflation still is not a concern. GII projects CPI growth of just 1.4 percent in 2004 and 1.3 percent in 2005, even less than forecast in November.



GII assigns a probability of 60 percent to their baseline forecast. A slightly more optimistic scenario and a slightly less optimistic scenario are each assigned a probability of 20 percent. There is no recession in the less optimistic scenario, however. Even in their pessimistic scenario GII has real GDP growth of 4.0 percent in 2004, well above the 3.1 percent growth actually observed in 2003.

Members of Minnesota's Council of Economic Advisors and Finance Department economists agreed that the February GII baseline forecast reflects the consensus short - term outlook. Differences between Council members' forecasts and the GII baseline for 2004 were small, although there were larger differences among outlooks for 2005. One Council member remarked that it was hard to imagine the economic outlook being much better than it is at present. Another noted that the economy was currently in a "sweet spot." Council members believed the likelihood that the economy would out perform the forecast was about the same as that it would under perform the forecast, but noted that the current forecast is such that the there is little room for substantially stronger real growth in the short term. Department of Finance economists cautioned that Minnesota revenues could fall below projections even if U.S. economic growth met the forecast.

Several members expressed concern about the employment outlook, expecting that it will take a little longer to regain the jobs lost to the recession than is projected in the GII baseline scenario. Council members and Finance Department economists also expressed concern about the future economic problems likely to be caused by the federal budget deficit. But, while the long-term implications of federal policy makers' unwillingness to make even a small move toward bringing the deficit under control raises questions about the future growth of the U.S. economy, that is a long term problem, not one for the immediate future. Several Council members noted that their biggest concern for the short-term outlook was some unanticipated geo-political event.

Finance Department economists noted that even though the economic outlook was modestly more optimistic than November's baseline forecast, that improvement in the outlook might not be sufficient to erase the deficit projected in November. They also noted that estimated income tax payments by corporations during the fourth quarter of 2003 were well below forecast.

Council members had an extended discussion of the appropriate size for the state's budget reserve. The Finance Department pointed out that the formal budget reserve was just one of several instruments available to the state to minimize financial disruptions that occur when revenues are below forecast. Other options include leaving larger unspent balances at the end of the biennium or at the end of the out-biennium, adding money to the cash flow account, buying back spending shifts, and paying cash for capital projects. Drawing money from some of these options is more suitable for minor fluctuations in the forecast. Others are more appropriate when the prospective shortfall occurs very late in the biennium, when options are limited. Still others, such as shifts in payment schedules are more properly reserved for times when the revenue outlook has undergone a significant structural change. All of these various types of reserves play a role in state risk management activity, and all were largely depleted in dealing with the 2002-03 and 2004-05 budget deficits.

For years the Council has urged the state to maintain a budget reserve of 5 percent of biennial expenditures. Council members believe a target level of 5 percent of biennial expenditures, or roughly $1.4 billion continues to appear to be an appropriate long-term goal given the volatility of Minnesota's revenues. Council members all agreed on the importance of rebuilding the state's formal budget reserve while economic times are good. They also recognized the value of the flexibility afforded by risk management tools other than formal reserve like the cash flow account, or the buying back of spending shifts.

November's revenue and expenditure planning estimates for the 2006-07 biennium showed a prospective deficit of $394 million even though the spending estimates for many programs are not adjusted for expected inflation. The Council believes that projecting future expenditures without making any allowance for inflation except where required under current law understates the severity of the financial problems the state will face in the next biennium.

Given current economic conditions and uncertainties, the Council strongly recommends that the state continue to strive to rebuild its budget reserves to its recommended 5 percent level as soon as possible. This would provide some cushion against the fiscal disruption that a future economic slowdown or downturn will bring, and it will help maintain the state's high credit rating reducing future borrowing costs. The Council also recommends that, in addition to presenting "current law" expenditure projections for the out biennium, the state calculate and report the structural balance for the next biennium under the assumption that all program expenditures reflect expected inflation.

Economic Outlook

Despite persistent job market weakness, forecasters are becoming more confident. That optimism stems from surprisingly strong real GDP growth during the last half of 2003. Compared to a few months ago, it now appears more likely the recovery will continue though the job market remains a concern.

Federal fiscal policy and low interest rates have pushed the economy out of recession. During the next year, economists believe the economy will transition to self-sustaining expansion. If all goes well, income from more jobs will begin supporting consumer spending just as the boost from federal tax refunds and mortgage refinancing fades. At about the same time, business investment spending and exports are expected to resume making meaningful contributions to real GDP growth.

Without additional income from more jobs, the recovery could slow in 2004. Other possible downside risks include a sharp increase in long term interest rates driven by Treasury borrowing or by a disorderly plunge in the value of the dollar, continued business reluctance to begin capital projects, a faltering global economy, and another terrorist attack. In GII's view, none of the things that could go wrong would necessarily cause a new recession, but the recovery would underperform the baseline forecast.

There is a chance the economy could perform better than expected. Jobs could belatedly begin a normal rebound if productivity growth soon recedes toward its trend. Investment spending may accelerate if financial markets remain orderly and firms' confidence in the future improves quickly. If global growth picks up, U.S. exports would get a boost. Finally, consumer spending could rise faster than expected if interest rates stay low and household real net worth continues to improve.

A Disappointing Job Market

Forecasters are disappointed and puzzled by the weak job market. Payroll employment gains have been slower to appear and smaller than the average of the past 5 recoveries, and little improvement is in sight. Fourth quarter establishment payrolls at last grew about 62,000 jobs per month on a seasonally adjusted basis, only about one-third as fast as normal for a third year of recovery. January's modest 112,000 job increase was the best in three years, but much of that is attributable to unusually weak retail hiring in December. Recent gains pale in comparison to the 2.4 million net job loss since the recession began in early 2001.

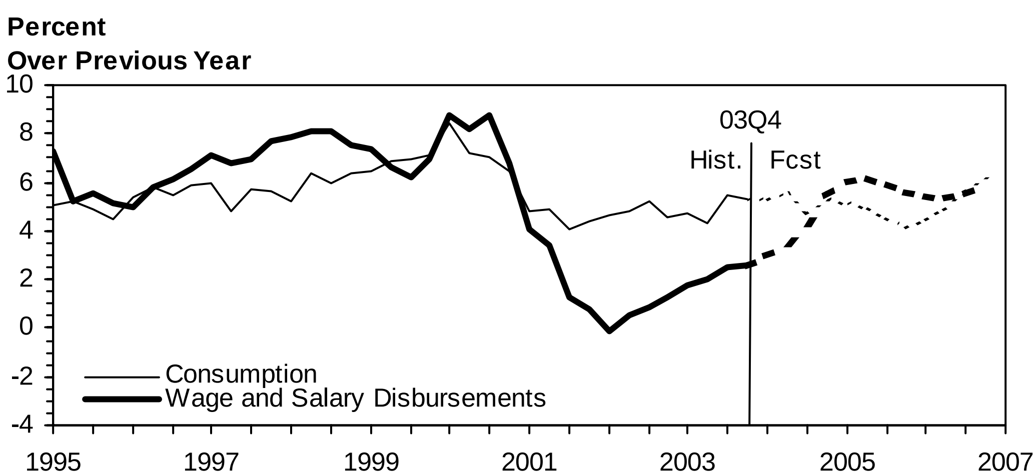
Some economists believe declining initial unemployment claims, more temporary help hirings, rising small business hiring plans, and other indicators show the labor market is stronger than the jobs data imply. They point to the more optimistic household employment series as confirmation. Others suggest the payroll data will be revised upward. In the view of Finance Department economists, these observations are not completely reassuring.

Dr. Greenspan recently testified to Congress that hiring is unusually weak. Hiring is being postponed and jobs lost because of ongoing trends. According to *Business Week*, if manufacturing productivity had increased as slowly as it did in the three years following the onset of the early 1990's recession, there would now be some 750,000 more jobs than there are. Similarly, if exports had grown as rapidly as they did in the 1990's, there would now be some 850,000 more jobs.

However, economists are unable to fully explain the weak job market. Offshore outsourcing seems at least partly responsible, but defies credible quantification. Lack of anything but largely anecdotal information has helped make outsourcing controversial. It is almost impossible to quantify because the reasons for domestic plant closings are often not clear. In addition, it is often difficult to identify overseas hiring which preempts job creation in the U.S., and it is not known whether displaced workers are finding, or will find, equivalent or better jobs.

Productivity gains, weak exports, outsourcing, and other trends are still working against job growth. A normal cyclical rebound may not be just delayed, it may not happen. If a hiring rebound does not occur, GII indicates consumer spending could falter, slowing the recovery.

Consumption Has Been Growing Faster Than Wages



GII's February forecast assumes that additional income form more jobs will begin supporting consumer spending just as the boost from federal tax refunds and mortgage refinancing fades.

2004--A Transition Year

Federal tax cuts, increased defense spending, and accommodative monetary policy have boosted the economy for the last 3 years. Economists are predicting that 2004 will see a transition to a self-sustaining expansion driven by incomes from more jobs, by rising profits, by improving business confidence and spending, and by growing exports. And once that is clearly underway, the Federal Reserve will begin raising interest rates. Already, the Fed seems to be preparing the markets for a future rate hike. Its recent Open Market Committee statement replaced the "considerable period" mentioned earlier with "patience in removing its policy accommodation." GII assumes continued slow hiring will postpone any move until August.

If all goes well, GDP growth will become more balanced than it has been in years, with business investment and the foreign sector making positive contributions. Consumer spending will still play a critical role, but multiple sources of growth will make the economy more resistant to external shocks.

Consumption

Real consumer spending growth has slowed from last summer's unsustainable pace, primarily because of weakening auto sales. Non-auto retailers had their best Christmas season in years, but success was not shared equally. *The Wall Street Journal* reports luxury chains had a good Christmas while some low-end retailers struggled, possibly because of job losses and changed consumer behavior.

Job losses have had a disproportionate impact on the purchasing power of the relatively less skilled. At the same time consumer behavior has changed according to a recent *U.S. News & World Report* article. Many households can now afford upscale goods because they buy staples at discount prices and big-ticket items like autos only when on sale. It remains to be seen whether these developments will make consumer spending more difficult to predict.

Forecasters are optimistic about consumer spending in 2004. Larger than usual federal tax refunds, a hoped for acceleration in job growth, strong confidence, and a robust housing market are leading GII to expect 3.8 percent growth in real spending in 2004, up from 3.1 percent in 2003.

In addition to the labor market, persistently high energy costs and an unexpected rise in interest rates are downside risks to the consumer outlook. Higher rates could force many households to reduce their outlays in order to cover the cost of current record consumer debt. That risk may be mitigated by further stock market and real estate driven increases in household wealth. Though improving, real net worth remains below its previous peak reached in 2000.

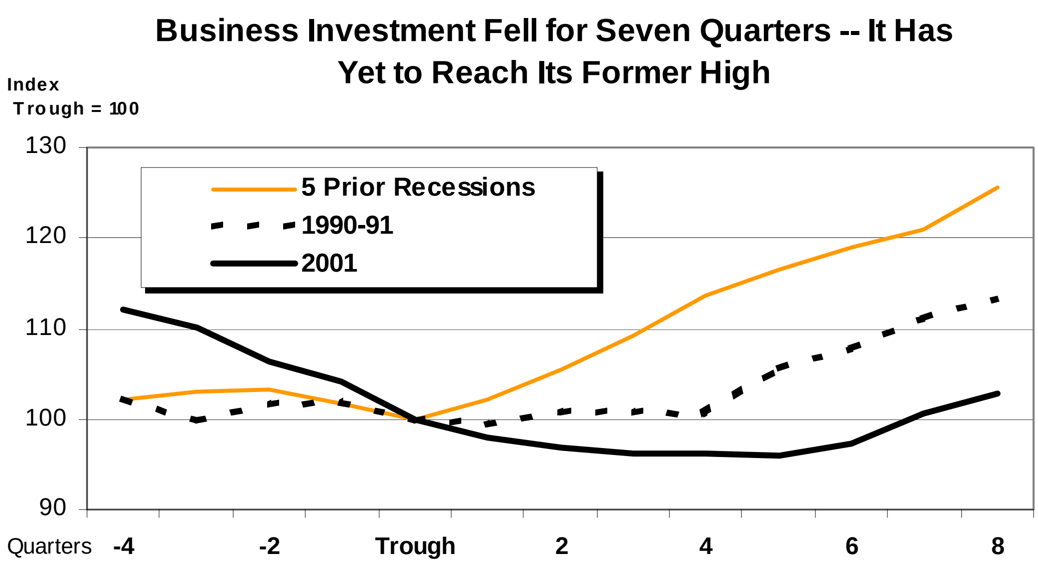
Investment

Rising profits and the economy's recent strength show little sign of accelerating business investment spending. In the view of Finance Department economists, it seems to have gone largely unnoticed that, like jobs, investment spending gains have been slower to appear and smaller than the average of the past 6 recoveries. In February, GII revised its investment forecast downward, primarily because of a weaker outlook for structures.

While firms are spending for computers and software, a rebound in offices and industrial structures is still at least several months and possibly farther away. Vacancy rates are still too high and capacity utilization too low to justify new construction. Economists cannot predict exactly when a turnaround will occur because they do not know how much occupied space is underutilized. In addition, some firms appear to be postponing construction plans because of uncertainty. Though the prospect of war in Iraq is no longer clouding the outlook, it seems firms are waiting for assurance the economy is in a sustainable recovery before commencing multi-year construction projects.

The *Wall Street Journal* reports builders attending January's National Association of Home Builders annual show were very optimistic. Low mortgage rates, strong consumer confidence, and a pool of immigrant buyers are expected to keep housing demand robust. Housing price increases may slow, but a general decline seems out of the question. GII expects housing starts to soften as the year progresses.

Cautious stocking and a good holiday season left most retailers without unwanted stocks to be liquidated. Because of lean stocks and growing demand, forecasters expect the rebound in inventory investment currently underway will continue throughout 2004.



Business investment spending gains have been slower to appear and smaller than in past recoveries. GII has revised its investment forecast downward because of a weaker outlook for structures.

Government

Tax cuts and increased outlays for defense, Medicare, veteran's benefits, and homeland security will be responsible for a large increase in the federal budget deficit. Much less well known, the *Wall Street Journal* recently reported that a shift in compensation toward non-taxable employer paid insurance and pension benefits is also making a significant contribution to the deficit. While budget projections are subject to some uncertainty, in GII's February baseline the deficit reaches a peak of slightly more than $500 billion in fiscal 2004 and then begins a gradual decline.

Federal deficits have helped the economy recover from the recent recession, but some observers are expressing concern that expected large Treasury borrowings could drive up long term interest rates. Higher rates would be an unwelcome drag on growth.

International

In 2004, exports are forecast to once again grow faster than imports, so net trade will begin making a positive contribution to real GDP growth. The February baseline assumes global demand continues improving. More than before, that depends on China which now has the potential to account for 15 percent of global growth though representing only 3 percent of world GDP. A recent *Business Week* editorial questions whether China's current boom is sustainable unless the government reforms a banking system which now often misallocates capital resources.

An accelerating world economy and a falling dollar are helping overseas sales of U.S. made goods. Most forecasters expect further dollar depreciation during 2004 though it should be slower than the 14 percent decline against the major currencies during the past year. Exchange rate projections are uncertain because they are subject to central bank policy changes and the whims of foreign investors. The dollar's value has been falling because overseas investors are no longer willing to buy enough U.S. financial assets to offset the U.S. international trade (current account) deficit. Recently, the *Wall Street Journal* estimated that foreign firms, private individuals, and governments buy $1.5 billion in U.S. assets each day.

Most observers believe the dollar would decline more rapidly, perhaps catastrophically, were it not for the intervention of the Chinese and Japanese central banks. Should these purchases be significantly reduced for any reason, the stock market could weaken or long term interest rates could rise sharply, or both. GII indicates that scenario is not very likely, but it would slow the recovery.

Monetary

Most forecasters believe risks facing the U.S. economy are slowly shifting toward rising inflation. As the risk assessment changes, so does the view of current very accommodative Federal Reserve policy. Higher inflation is not imminent, but the timing of the next Federal Reserve rate increase is an issue because monetary changes affect the economy only with a long lag generally thought to be about 12 to 18 months.

According to *Business Week*, a few economists believe the Fed has kept rates too low, too long, citing signs of emerging inflation including rising import prices and soaring commodity prices. Moreover, they say low rates have led to sharply higher home prices and an unsustainable run-up in consumer debt which many households will have difficulty servicing when rates inevitably rise. As a result, markets for homes and big-ticket consumer items are more fragile than they seem.

These arguments do not appear to be moving Dr. Greenspan and his colleagues. They continue to indicate the Fed will not tighten soon though conceding rates are too low to be consistent with stable inflation. The Fed's Beige Book cites the economy's steady improvement with little change in final goods prices. In addition, in recent Congressional testimony, Dr. Greenspan indicated current job market weakness is evidence the economy still has substantial slack holding down wage and price increases.

Inflation

Most forecasters see very little risk of an abrupt acceleration in inflation anytime soon. While it has attracted considerable attention, the recent sharp increase in industrial commodity prices is not a serious concern. Most economists agree that commodity prices will add only a negligible amount to consumer inflation, and that the short-term inflationary impact of a falling dollar is limited.

Core consumer prices which exclude volatile food and energy rose 1.5 percent in 2003, down from 2.3 percent in 2002. Including food and energy, consumer prices rose 2.3 percent in 2003, up from 1.6 percent the previous year largely because of rising energy costs. If energy prices fall as GII expects, consumer price increases should slow to only 1.4 percent in 2004.

Minnesota Outlook

February's Minnesota outlook is little changed. Compared with November's forecast, job growth is a little faster in both 2004 and 2005. Total wages are expected to rise a little more slowly in 2004 and then slightly faster in 2005. Slightly stronger private sector growth is partly offset by a less optimistic outlook for the public sector.

The Minnesota economy, like its national counterpart, is showing signs of accelerating growth. Those indications include modest employment gains in goods producing industries in recent months, a robust residential real estate market, slightly lower vacancy rates in industrial and office buildings, an increase in manufacturing job vacancies, and rising exports. There are also anecdotes of rising confidence among consumers and business firms.

But, there are disappointments. Minnesota claims for unemployment compensation remain near recession levels. And in the fourth quarter, seasonally adjusted employment declined in retail trade, in educational services, and in state and local government.

Minnesota Outlook Little Changed

Minnesota's employment and wage forecasts have been revised only slightly and changes to the outlook are generally consistent with GII's changes to the national forecast. Expected employment growth is slightly higher, but still only barely sufficient to reduce unemployment and keep up with labor force expansion. For 2004, Minnesota wage growth is revised down from 4.5 percent to 4.1 percent, while U.S. wage growth is now forecast at 4.1 percent, down considerably from the 5.1 percent forecast in November.

Minnesota employment slightly exceeded November's forecast in 2003's fourth quarter. That performance contributed to the slightly improved February outlook for 2004 and 2005. The private sector is looking slightly better with only retail trade and educational services performing below expectations. Industries exceeding November's forecast include manufacturing, leisure and hospitality, professional and business services, and health and social services.

In contrast, the public sector has become a drag on growth. Seasonally adjusted fourth quarter state and local employment declined more than expected. Further small declines are expected in the first two quarters of 2004, which partially offset anticipated gains in the private sector.

MINNESOTA OUTLOOK COMPARED TO THE U.S.
(Calendar Year Percent Changes)

	2001	2002	2003	2004	2005
Non-Farm Employment					
Minnesota					
November 2003	0.2	-1.1	-0.4	0.7	1.3
February 2004	0.2	-1.1	-0.4	0.8	1.4
United States					
November 2003	0	-1.1	-0.3	1.1	2.2
February 2004	0	-1.1	-0.3	1.1	2.3
Wage and Salary Income					
Minnesota					
November 2003	2.9	1.4	2.7	4.5	5.1
February 2004	2.9	1.4	2.8	4.1	5.2
United States					
November 2003	2.4	0.9	2.1	5.1	6.2
February 2004	2.4	0.6	2.2	4.1	6.0

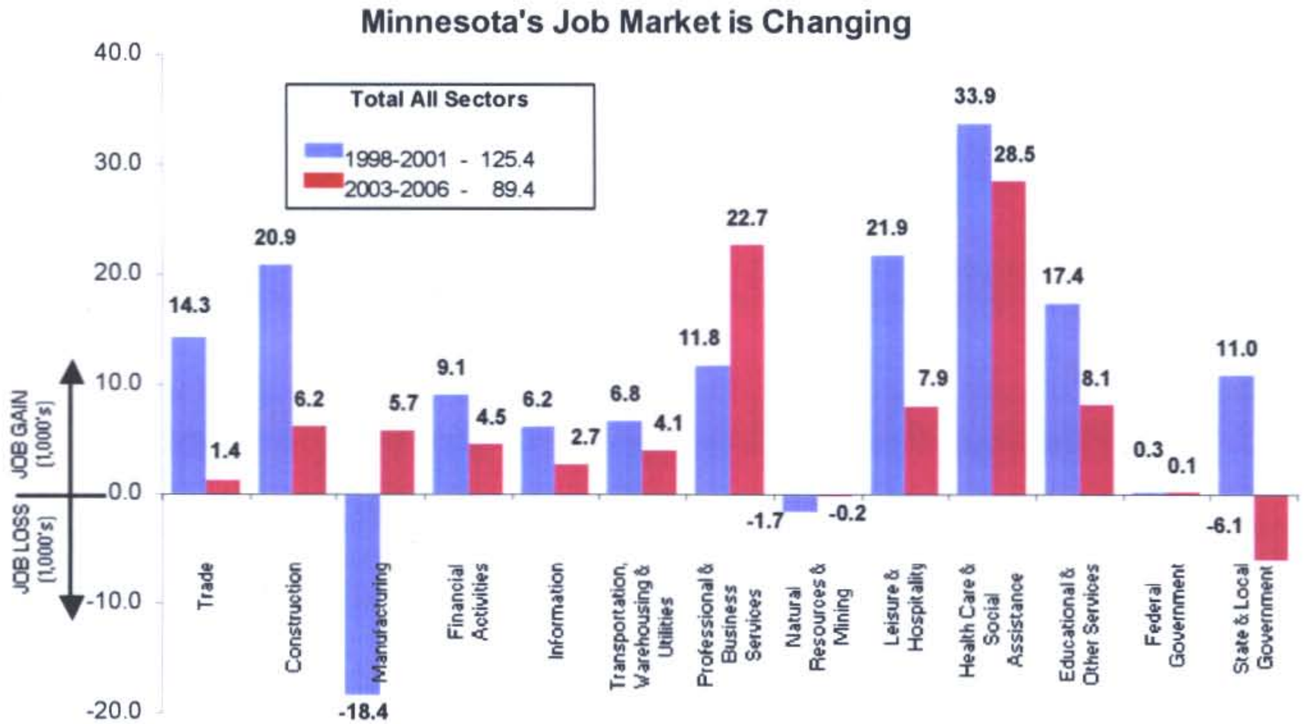
Construction Expected to Remain Strong

Most news suggests continued strength in the construction sector. Housing set records in 2003, and despite some weakness in January seems to be on its way to another good year in 2004. And, at last it appears the depressed Twin Cities commercial real estate market is slowly turning around. A recent United Properties report indicates industrial vacancies declined in 2003's last half. Multi-tenant office vacancies would also have declined were it not for a corporate consolidation in downtown St. Paul that left office space vacant.

While that is good news, vacancy rates are still high and there is still considerable underutilized space, so a rebound in speculative commercial construction is at least one or two years away. Some analysts suggest developers are waiting until job growth signals future demand for office space. The February outlook assumes housing slowly weakens, but helps sustain current levels of construction employment until commercial building picks up.

Manufacturing Seems to be Mending

After losing more than 50,000 jobs since mid-2000, it appears Minnesota's manufacturing sector has bottomed out and is turning up. On a seasonally adjusted basis, manufacturing jobs have increased some 2,900 since last June. Most of this modest increase is in durable goods manufacturing where it is spread over several sectors, a good sign. Other favorable developments reflected in recent manufacturing data include a sharp increase in job vacancies, a decline in initial unemployment claims, and a very sharp increase in exports. The forecast calls for about 6,000 more manufacturing jobs by 2006.



During the next three years there will be significant changes in the industry composition of job gains. Many laid-off workers will have to seek employment in a new industry or occupation. New labor force participants will often work in industries or occupations they previously may not have chosen.

Minnesota's Changing Economy

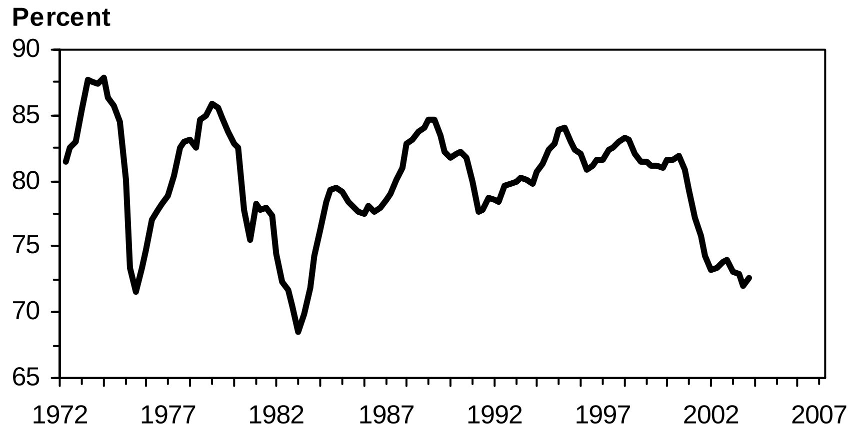
After a 2-year decline, Minnesota employment is forecast to grow once again. By 2006, total employment is expected to increase some 89,000. But, if this scenario materializes, the expansion will not closely resemble the experience during the 3 years leading up to the recession which began in early 2001.

If employment increases as forecast, job growth will be weaker than it was prior to the recession. So, some people will find it harder to find a job. And not only will opportunities be fewer, they will often be in different industries and occupations. In the view of Finance Department economists, many workers will have to seek employment in a new industry or occupation requiring different job skills. And many new labor force participants will work in industries and occupations they previously may not have chosen.

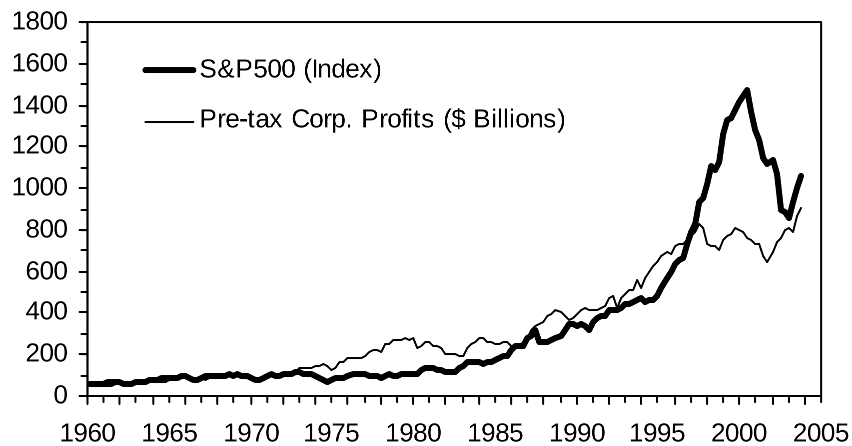
There will be significant changes in the industry composition of employment gains. In the next 3 years, growth will be more concentrated in health care and social services, and in professional and business services. Manufacturing will grow once again, but only by about 6,000 jobs through 2006. State and local employment, which grew prior to the recession, is likely to lose 6,000 jobs. Finally, construction and trade will have a negligible role in overall growth while leisure and hospitality's role will be much diminished compared to the 3 year period leading up to the last recession.

Selected National Economic Indicators

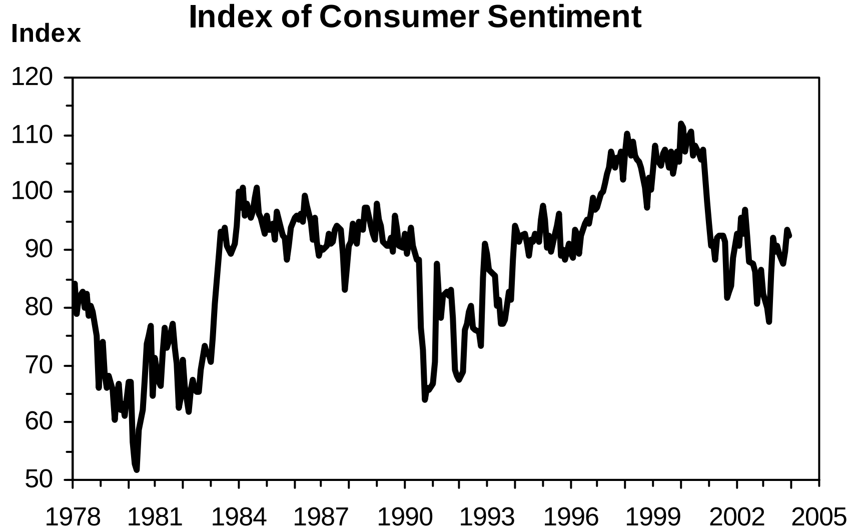
Manufacturing Capacity Utilization



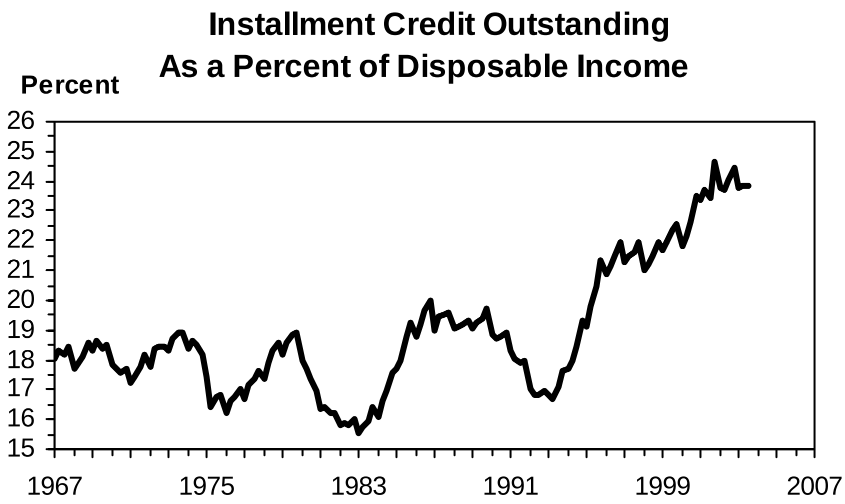
Corporate Profits and the Stock Market

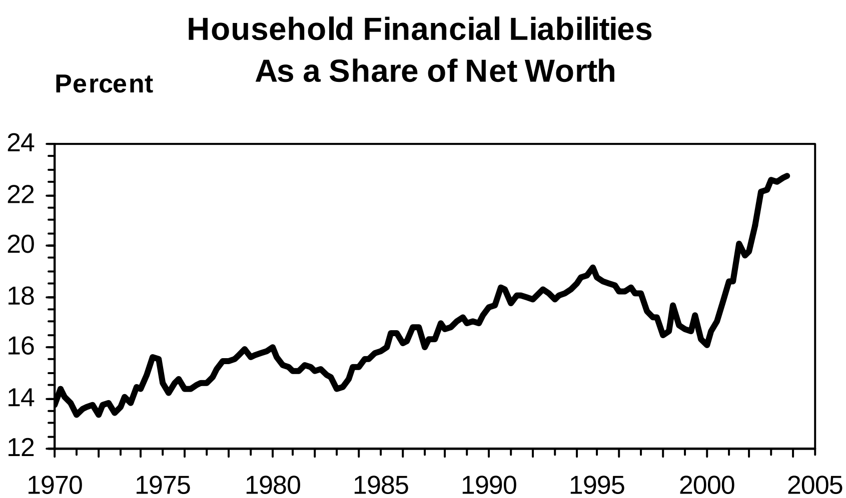


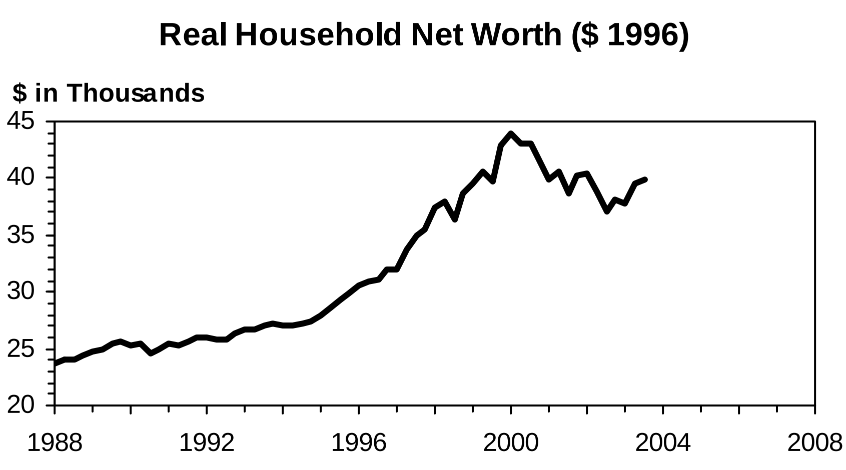
Index of Consumer Sentiment



Selected National Economic Indicators

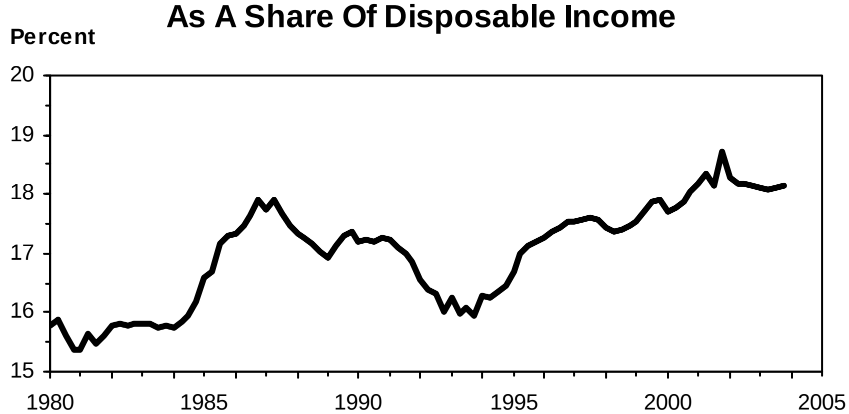




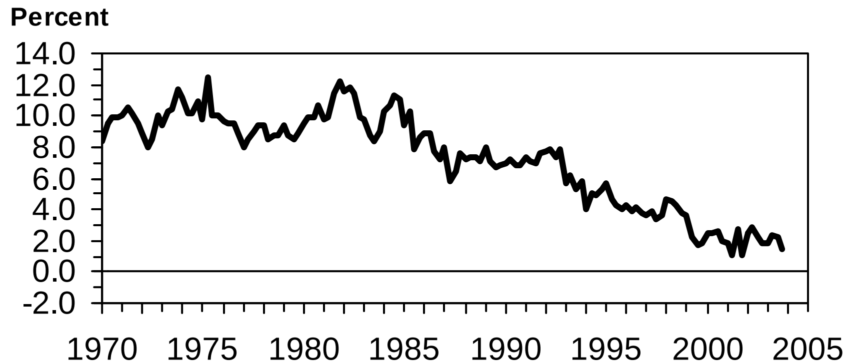


Selected National Economic Indicators

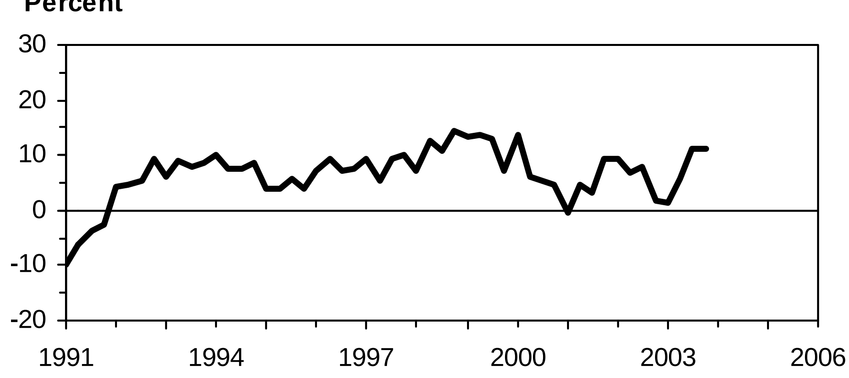
Household Financial Obligations As A Share Of Disposable Income



Saving as a Fraction of Disposable Income

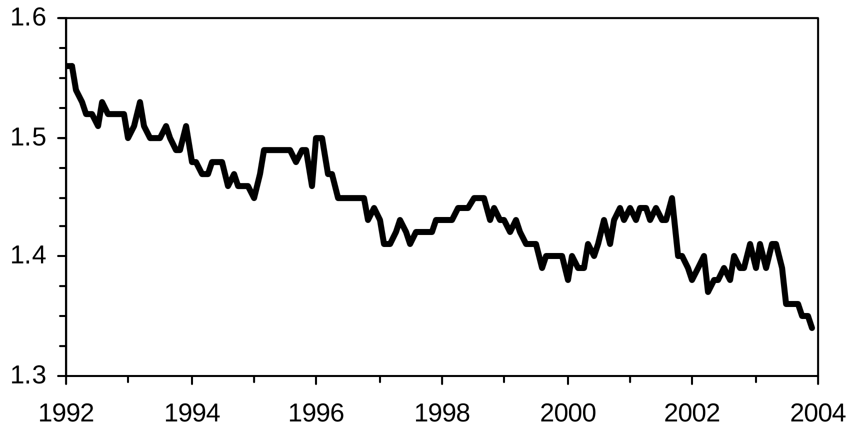


Growth in Real Consumer Durables Spending
(Quarter over Quarter, Previous Year)

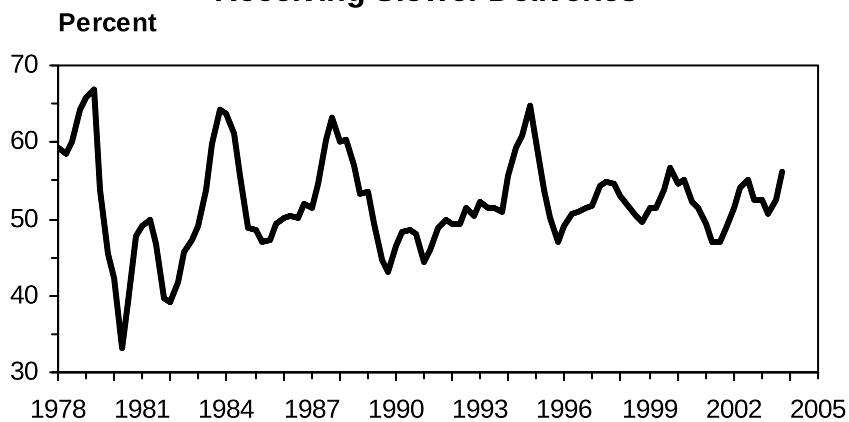


Selected National Economic Indicators

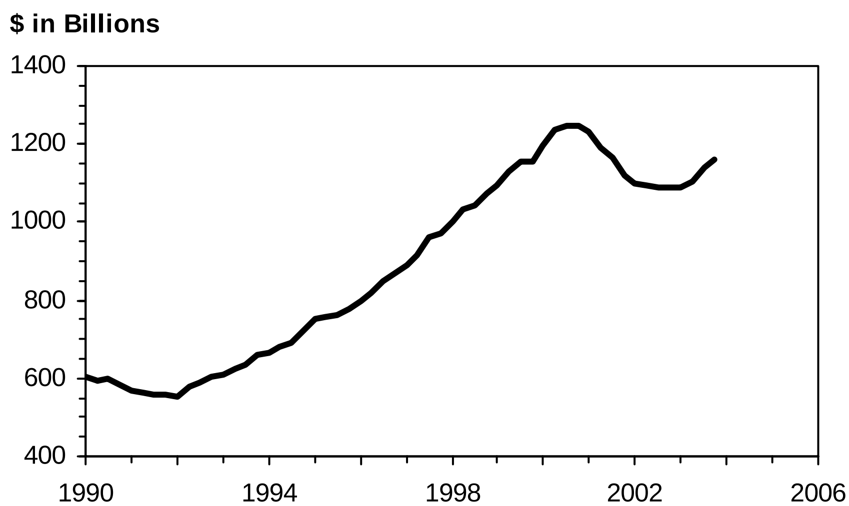
Manufacturing and Trade Inventory to Sales Ratio



Proportion of Companies Receiving Slower Deliveries



Real Fixed Nonresidential Investment



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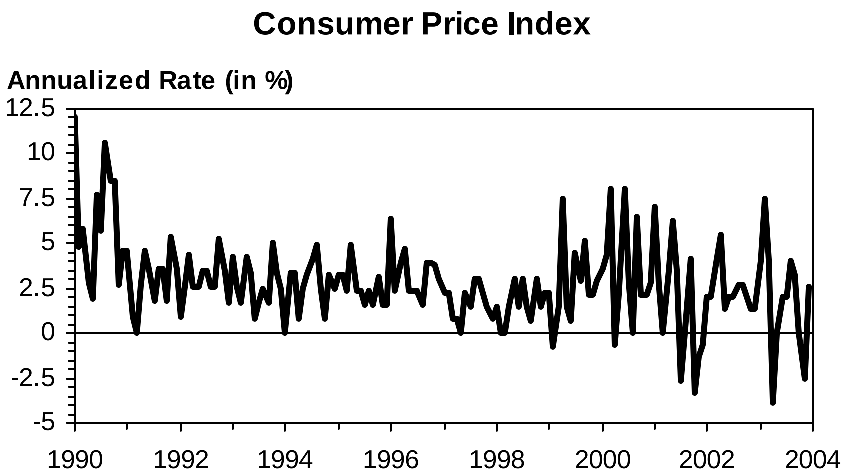

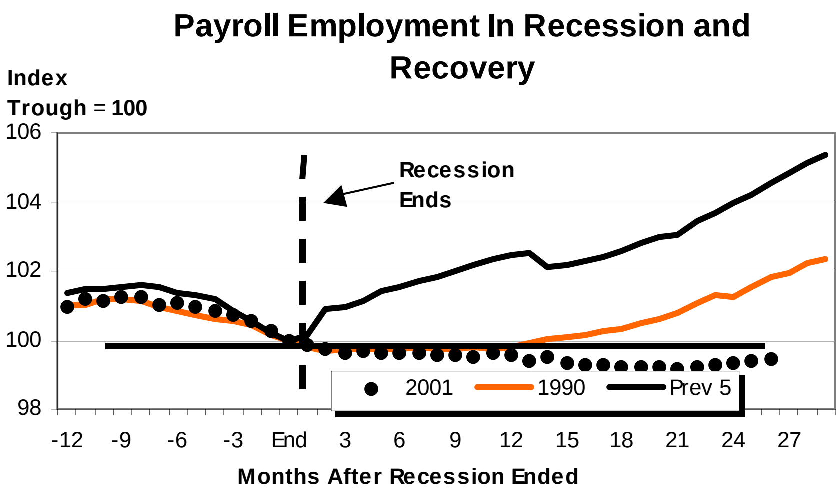

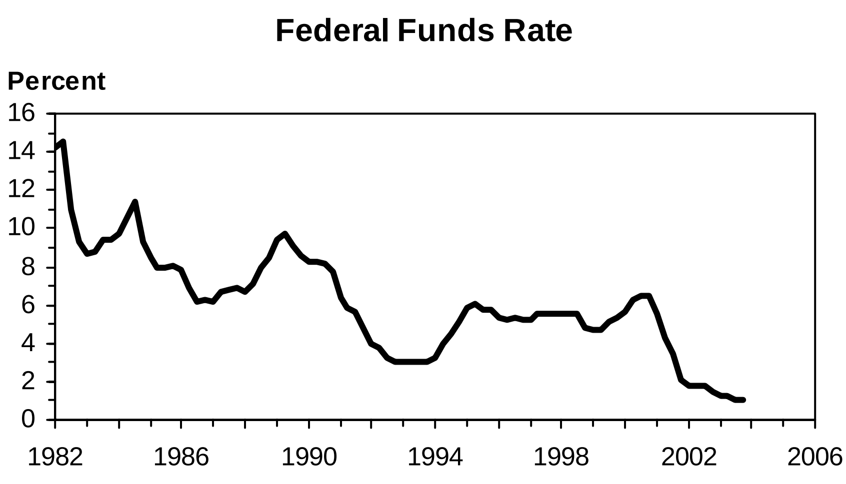

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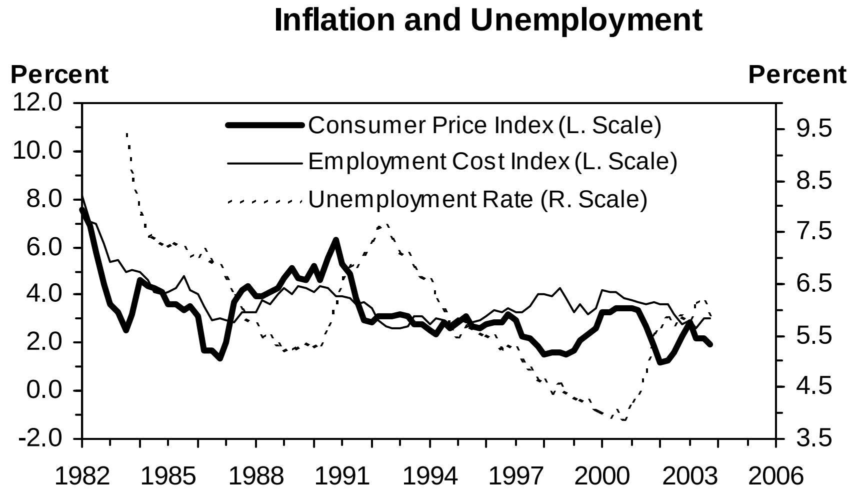
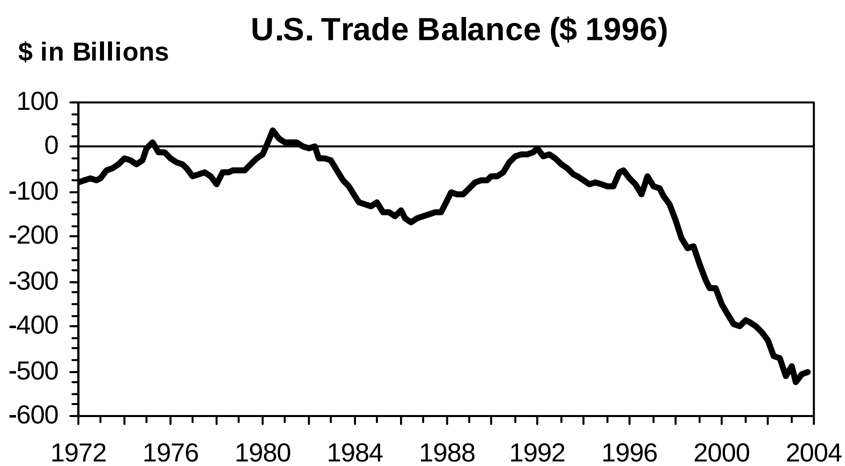
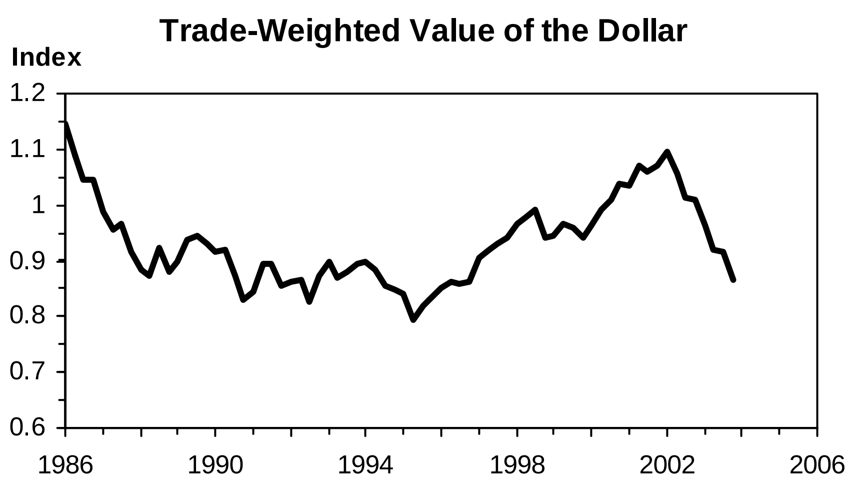






FY 2004-05 Budget Summary
FY 2006-07 Planning Estimates

FY 2004-05 Deficit Now Forecast to be $160 Million

There have been no material changes in the budget outlook for the current biennium. Forecast revenues have been reduced by $22 million, while projected transfers, dedicated revenues and other resources have increased by $1 million, leaving a net revenue decline of $21 million. Estimated biennial spending has decreased $46 million. These changes combine to reduce the projected deficit from the $185 million forecast in November to $160 million.

Comparison: FY 2004-05 Budget
($ millions)

	Nov Forecast	Feb Forecast	Change
Beginning Balance	**$368**	**$368**	**$0**
Non-dedicated Revenues	26,680	26,658	(22)
Other Resources	1,555	1,556	1
Expenditures	28,157	28,111	(46)
Balance before Reserves	447	472	25
Budget Reserve	631	631	0
Available Balance (Deficit)	**$(185)**	**$(160)**	**$25**

Small, Offsetting Changes Reduce FY 2004-05 Revenue Forecast by $21 Million

Net non-dedicated revenues for the 2004-05 biennium are now forecast to be $26.658 billion, $22 million (0.8 percent) less than November's estimate. Net non-dedicated revenues are now projected to fall short of end-of-session projections by $387 million or 1.4 percent.

Changes in the five major revenues were generally small and offsetting. Expected receipts from both the individual income tax and sales tax differed by less than one percent from November's estimates. The corporate income tax forecast was reduced $58 million reflecting lower than projected receipts in the fourth quarter of 2003. This forecast assumes that the reduced receipts came from firms adjusting fourth quarter payments to meet a slightly lower than projected final liability. If the reduced receipts are ongoing, a much larger reduction in the corporate income tax will be necessary.

The forecast for other tax and non-tax revenues grew by $88 million. Higher forecast receipts from the insurance gross premiums tax and the mortgage and deed taxes, plus a substantial one-time boost in the state receipts from unclaimed property, were the major sources of the additional revenue.

Forecast Spending for FY 2004-05 is Slightly Lower

Forecast spending for the biennium is now expected to be $28.111 billion, $46 million (0.2 percent) less than projected in November. This is a $189 million reduction (0.7 percent) from estimates made at the end of the 2003 session. Lower E-12 education spending contributed $30 million of the savings in the current forecast, while lower health and human services estimates accounted for an additional $16 million reduction. Changes in all other spending areas were small and largely offsetting.

FY 2006-07 Planning Estimates Highlight Widening Budget Gap

Projected revenues for FY 2006-07 have been reduced by $123 million (0.4 percent), while spending has decreased $76 million (0.3 percent) from November planning estimates. The reduction in projected revenues primarily reflects slightly lower base revenues for individual income and corporate taxes, now forecast for the current biennium, carried through to the following biennium.

While the total change in spending is small, the impact of changes by major program area mirrors FY 2004-05 experience. Lower spending for E-12 education and health and human services spending accounts for most of the decrease in projected spending, while all other spending areas show little net change. While reduced slightly, projected levels of human services spending still increase substantially over FY 2004-05 levels.

FY 2006-07 Planning Estimates
Forecast Change

($ millions)

	November Forecast	February Forecast	Change
Beginning Balance	**$447**	**$472**	**$25**
Revenues			
Non-Dedicated	$28,985	$28,862	$(123)
Transfers, Other	398	398	0
Total Revenues	29,383	29,260	(123)
Spending			
Current Law	29,778	29,702	(76)
Budget Reserve	631	631	0
Projected Balance	**$(579)**	**$(601)**	**$(22)**

These planning estimates do not reflect Governor's recommendations or legislative actions to eliminate the deficit forecast for the current biennium. Since the forecast makes no assumption about possible budget solutions, the display of planning estimates for FY 2006-07 highlights both the budgetary balance or deficit for the next biennium, as well as the structural balance or deficit — that is the difference between likely on-going revenues and on-going spending.

The structural gap in the FY 2006-07 planning estimates has widened from the forecast in November. In November a $440 million structural shortfall was projected for FY 2006 and a $45 million structural balance for FY 2007. A structural shortfall is now expected in each year, $360 million in FY 2007 and $81 million in FY 2007.

FY 2005-07 Structural Balance
($ millions)

	FY 2005	FY 2006	FY 2007
Projected Revenues	$13,926	$14,346	$14,914
Spending			
Forecast / Current Law	14,267	14,706	14,995
Difference / Structural	**$(341)**	**$(360)**	**$(81)**

Planning Estimates Highlight Continued State Budget Pressures

FY 2006-07 planning estimates illustrate the expected pressures likely to be faced in developing a budget for the next biennium. The differences in projected revenue growth assumptions and spending growth raise concern that the planning estimates may be understating the future budget gap. State revenues are projected to grow at more than double the rate of inflation through FY 2007, while state spending in most areas - with the major exception of health and human services - remains largely constant at FY 2005 levels. The following table highlights revenue and expenditure growth in the planning estimates.

FY 2006-07 Planning Estimates
Projected Growth in Revenues - Spending

($ millions)

	Percent of Budget FY05	% Change FY 2006	% Change FY 2007
Revenues			
Income Tax	42.6	7.2	6.5
Sales Tax	30.4	1.9	3.4
Other Taxes	19.8	2.3	0.0
Subtotal - Taxes	**92.8**	**4.4**	**4.1**
Non-Tax Revenues	7.2	(15.4)	1.2
Total Revenues	**100.0**	**3.0%**	**4.0%**
Spending			
E-12 Education	42.3	(0.8)	(0.6)
Higher Education	8.9	0.1	0.0
Property Tax Aids	9.5	9.8	0.9
Health & Human Services	26.1	8.7	7.2
All Other	13.2	1.7	1.2
Total Spending	**100.0**	**3.1%**	**2.0%**

It is likely the planning estimates understate the structural shortfalls Minnesota will face in FY 2006-07 because they assume that funding for major programs would change based only on specific enrollment, caseload growth, and current law changes – with no inflationary or other increases.

General inflationary growth of 1.4 percent and 1.7 percent in FY 2006 and FY 2007 would add $200 million and $450 million to spending in the respective fiscal years, increasing the gap between state revenues and spending to $560 million in FY 2006 and $531 million in FY 2007.

Revenue Forecast
FY 2004-05

Current general fund resources for the 2004-05 biennium are now forecast to total $28.214 billion, $21 million (0.1 percent) less than forecast in November. When compared to end-of- session estimates, current resources for this biennium are now $428 million less than projected. Net non-dedicated revenues are now projected to be $26.659 billion, $386 million less than end-of-session estimates. Biennial receipts from Minnesota's five major taxes are now expected to total $22.948 billion, $569 million (2.4 percent) less than end-of-session estimates. That loss in revenue was partially offset by an improved outlook for other tax and non-tax revenues. Those revenues now exceed end-of-session estimates by $183 million.

Since November the forecast for net non-dedicated receipts has fallen by $21 million. Projected receipts from the state's five major taxes were reduced by $110 million, (0.5 percent), while the forecast for other non-dedicated revenues revenue was increased by $89 million.

Revenues FY 2004-05
($ in millions)

	FY2002-03	FY2004	FY2005	FY2004-05
Individual Income	$10,815	$5,527	$5,930	$11,457
Sales	7,710	4,083	4,231	8,314
Corporate	1,118	646	740	1,386
Motor Vehicle Sales	705	281	290	571
Statewide Levy	891	603	618	1,221
Five Major	21,239	11,140	11,809	22,949
Other Revenue	3,204	1,796	1,579	3,375
Tobacco	309	168	168	336
Net Non-dedicated	24,752	13,103	13,556	26,659
Other Resources	690	1,185	370	1,555
Current Resources	**25,442**	**14,289**	**13,926**	**28,214**

Individual income tax receipts are now projected to be $577 million less than end-of-session estimates, down an additional $87 million from November's estimate. The corporate income tax forecast was reduced by $58 million, but it remains $81 million above the end-of-session estimate. The sales tax forecast was raised $54 million, leaving it $70 million below the end-of-session estimate.

Individual Income Tax

Individual income tax receipts for the 2004-05 biennium are now forecast to total $11.457 billion, down $87 million from November's forecast and a total of $577 million (4.8 percent) from end-of-session estimates. As noted in November's forecast, $106 million of the reduction came from treating the costs of conforming to federal tax code changes in 2003 as a forecast adjustment rather than as a reduction in the February 2003 baseline. In the absence of that forecast adjustment state income tax revenues would be down $471 million or 3.9 percent.

There were only modest changes to the income tax forecast in February. Actual receipts through January were just $2 million below forecast, with fourth quarter estimated tax payments and miscellaneous revenues less than a $1 million below forecast, and withholding revenues within $5 million of forecast.

Projected growth in wages, proprietors' income, and partnership incomes were all reduced slightly from November's estimate consistent with changes in the GII baseline forecast. Even though GII's outlook for real GDP growth has improved slightly, corporate profits are projected to take a larger share of incomes, leaving a slightly slower growth rate for individual income.

Capital gains realizations in tax year 2003 are now projected to be the same as in tax year 2002 and then to grow by 15 percent in tax years 2004 and 2005. In November capital gains were assumed to grow by 4 percent in 2003, and by 15 percent in 2004 and 2005.

A series of largely offsetting technical adjustments including code changes in the HITS model, and calibrating the model results to observed final liability for tax year 2002 accounted for $6 million of the reduction in the individual income tax forecast between November and February.

Sales Tax

Net sales tax collections for the 2004-05 biennium are now expected to reach $8.314 billion, up $54 million from November's forecast. That improvement in the sales tax outlook leaves projected sales tax receipts $70 million (0.8 percent) less than end-of-session estimates.

The Global Insight baseline forecast for key economic variables influencing Minnesota's sales tax receipts has improved. The outlook for non-auto consumer durable spending is particularly strong. Last fall's combination of lower withholding rates and advanced payment of child credits undoubtedly encouraged household spending in late 2003. It is also likely that the expected expiration of the special accelerated depreciation rules in 2004 will stimulate additional business investment in late 2004.

Minnesota receipts have not fully reflected the actual growth in the economy observed during the second half of 2003. Gross sales tax receipts were more than $19 million below forecast in the last three months of calendar 2003. To adjust for the model's apparent current tendency to overestimate receipts, the elasticity used to convert growth in the simulated sales tax base to gross revenues was reduced to .8 for the remainder of fiscal 2004 and .9 for fiscal 2005. In November an elasticity of .975 was used. As in November revenues lost to E-commerce and catalog sales were assumed to grow by 14 percent in each of the next two years.

Sales tax refunds are now forecast to total $434 million during the biennium, $8 million less than projected in November.

Corporate Franchise Tax

Net corporate tax receipts for the 2004-05 biennium are now estimated to total $1.385 billion, $58 million less than forecast in November, but $81 million more than end-of - session estimates. GII's projected growth rates for corporate profits in both 2004 and 2005 have changed only modestly, and net receipts since November's forecast exceed the forecast by nearly $9 million.

That good news, however, is tempered by the fact that fourth quarter estimated payments were more than $34 million less than forecast. The overall positive variance for corporate taxes came from a combination of lower than projected refunds and stronger than anticipated miscellaneous receipts. The latter category included a substantial one-time payment covering multiple tax years.

The large negative variance in estimated tax receipts is troubling, and could indicate that an even larger revision to the corporate income tax forecast may be necessary. In this forecast it was assumed that the negative variance was the result of firms adjusting their fourth quarter payment after finding that their projected tax year 2003 liability was slightly less than had been anticipated. Tax year 2004 liability was reduced by one-half the negative variance. An alternative interpretation, that would reduce the forecast substantially more, is that the lower fourth quarter revenue reflects an on-going reduction in projected liability in the full amount of that negative variance. Finance Department economists will be monitoring corporate estimated tax payments closely to be sure that the forecast is on track. The corporate income tax remains the most volatile of the state's revenue sources.

Motor Vehicle Sales Tax

General fund receipts from the state's sales tax on motor vehicles are expected to total $571 million during the 2004-05 biennium, $19 million (3.3 percent) less than forecast in November. The reduction in the forecast leaves general fund receipts from the motor vehicle sales tax $3 million below end-of-session estimates. Total receipts from the motor vehicle sales tax receipts forecast have been slightly below projections since the November forecast. February's Global Insight baseline forecast contains slightly stronger light vehicle sales, but the combination of the lower base level of receipts in Minnesota for the last quarter and more modest personal income growth in the state produces a forecast which allocates slightly smaller proportion of those expected sales to Minnesota.

Other Revenues

Other tax and non-tax revenues are expected to total $3.711 billion, $88 million (2.4 percent) more than forecast in November, and $182 million more than end-of-session estimates. The insurance gross premium tax and the mortgage and deed taxes account for nearly $53 million of the increase. Other non-dedicated revenues, including a substantial one-time increase in income from unclaimed property, added an additional $32 million.

Revenue Planning Estimates
FY 2006-07

Current general fund resources for the 2006-07 biennium are now projected to total $29.260 billion, an increase of $1.046 billion or 3.7 percent over current projections for 2004-05 biennial revenues. Net non-dedicated revenues reach $28.861 billion, $2.202 billion (8.2 percent) more than is now forecast for 2004-05. Receipts from the five major taxes grow by 10.2 percent. Individual income tax receipts are expected to be 14.6 percent above the amount forecast for the 2004-05 biennium. The sales tax is projected to grow by 5.5 percent. The slow growth in the sales tax is partly explained by a change in tax law effective in 2006. The forecast for net non-dedicated revenues for the 2006-07 biennium is $124 million below November's estimate. About one half of that decline in projected revenue comes from lower expected receipts from the corporate income tax and one-third from slower growth in the individual income tax.

Revenue FY 2006-07
$ in millions

	FY2004-05	FY2006	FY2007	FY2006-07
Individual Income	$11,457	$6,359	$6,773	$13,132
Sales	8,314	4,313	4,458	8,771
Corporate	1,386	794	728	1,522
Motor Vehicle Sales	571	287	307	594
Statewide Property Tax	1,221	626	642	1,268
Five Major Taxes	22,949	12,379	12,908	25,287
Other Revenue	3,375	1,608	1,640	3,248
Tobacco Settlement	336	165	161	326
Net Non-dedicated	26,659	14,152	14,709	28,861
Other Resources	1,555	194	204	398
Current Resources	**28,214**	**14,346**	**14,914**	**29,260**

The baseline revenue planning estimates are not explicit forecasts, they are extrapolations of projected trends in the economy. No one can forecast the path of the economy five years into the future and 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 eighteen months, or should some item of portfolio income such as capital gains fall well below forecast – as it did in the 2001 and 2002 tax years -- the revenue outlook for the 2006-07 biennium will be adversely affected.

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 items such as capital gains realizations are accurate, the planning estimates are likely to slightly understate actual receipts. But, the GII baseline forecast includes strong growth with no recession over the entire 4-year forecast horizon, and that scenario could be overly optimistic. While the economy appears strong today, a recession or severe slowdown commencing sometime before the end of the 2007 fiscal year cannot be ruled out. Should the economy slow down, actual revenues could fall short of the planning estimates by $2.0 billion or more.

Expenditure Forecast
FY 2004-2007

FY 2004-05 Spending Shows Little Change

Forecast expenditures for FY 2004-05 show little net change from November forecast estimates. Spending has decreased $46 million, or 0.2 percent. Total spending for the biennium is now expected to be $28.111 billion.

Current Biennium Forecast Change

($ millions)

	November Forecast	February Forecast	Change
E-12 Education	$11,789	$11,759	$(30)
Property Tax Aids & Credits	2,777	2,778	1
Higher Education	2,561	2,561	0
Health & Human Services	7,332	7,316	(16)
Envir., Ag., and Econ. Development	710	711	1
Transportation	160	160	0
Criminal Justice	1,440	1,440	0
State Government	645	644	(1)
Debt Service & Borrowing	653	652	(1)
Estimated Cancellations	(5)	(5)	0
Subtotal-Major Spending Categories	28,062	28,016	(46)
Dedicated Expenditures	95	95	0
Total Expenditures & Transfers	**$28,157**	**$28,111**	**$(46)**

The net decrease in forecast spending is attributable to reductions in the two largest program areas, a $30 million decrease in E-12 education spending resulting largely from a decrease in estimated pupil units, and a nearly $16 million decrease in health and human services spending coming from lower anticipated spending for basic health care grants, child care and economic support grants will be partially offset by increases in spending for continuing care and community support grants. Changes in all other spending areas are minor and offsetting, resulting in no change to the bottom-line.

FY 2006-07 Planning Estimates

Compared to November estimates, projected spending for FY 2006-07 shows little change – down slightly from earlier projections. Projected spending for the next biennium has decreased a total of $76 million, 0.3 percent, from earlier estimates. Minor decreases in the estimates for E-12 education spending and health and human services spending generally reflect current forecast savings for FY 2004-05 continuing into FY 2006-07. Changes in all other spending areas are largely offsetting reflecting small savings in forecast debt service matched against small increases in open appropriation estimates in the environment and state government areas.

2006-07 Planning Estimates

($ millions)

	November Forecast	February Forecast	Change
E-12 Education	$11,970	$11,934	$(36)
Property Tax Aids & Credits	2,975	2,976	1
Higher Education	2,548	2,548	0
Health & Human Services	8,416	8,375	(40)
Envir., Ag., and Econ. Development	683	687	4
Transportation	163	163	0
Criminal Justice	1,525	1,525	0
State Government	622	624	2
Debt Service & Borrowing	791	784	(7)
Estimated Cancellations	(5)	(5)	0
Subtotal-Major Spending Categories	29,678	29,612	(76)
Dedicated Expenditures	90	90	0
Total Expenditures & Transfers	**$29,778**	**$29,702**	**$(76)**

It is important to note that the estimated impact of inflation during the FY 2006-07 is *not* included in expenditure planning estimates. Inflation during the planning period is expected to be 1.4 percent in FY 2006 and 1.7 percent in FY 2007 based on GII's forecast of the consumer price index. If major expenditure categories were to be uniformly adjusted for inflation, this would add approximately $200 million to FY 2006 spending and $450 million to FY 2007 amounts.

E-12 Education Finance

E-12 Education Spending Down $30 Million in Current Biennium

The forecast for E-12 Education spending for the current biennium is now projected to total $11.76 billion, down $30 million (0.3 percent) from previously estimated levels. This change is due to a slightly lower pupil count in 2003 actual data and a higher value associated with the aid adjustment from the early recognition of property tax revenue for school districts. Nearly $25 million of the forecast change is within the General Education program.

The overall reduction in the forecast level of spending for the General Education program is the combined effect of many underlying adjustments, though most of the reduction is due to the ripple effect of lower pupil estimates. One other noteworthy change is an increase of $8.3 million in Compensatory Revenue, due to higher poverty concentrations in the October 2003 free and reduced-price lunch counts that school districts and charter schools reported to the Department of Education.

The property tax recognition change is due to a re-estimate of the value of existing levies. Current law requires school districts to recognize a portion of their levy revenue early, which then reduces the amount of state aid paid in the fiscal year of this early recognition. The recalculation of levy values results in a reduction of General Education aid of $16 million. This reduction affects the state aid in FY 2005, and is revenue neutral for school districts.

FY 2006-07 Projections for E-12 Education Down $36 Million

Projected FY 2006-07 spending for E-12 Education is now estimated to be $11.93 billion, a decline of $36 million (0.3 percent) from November. Most of this downward adjustment is due to slightly lower pupil estimates and the continued effect a change in pupil numbers has when it ripples through subsequent fiscal years.

Health and Human Services

Spending On Track - $16 Million Lower in FY 2004-05; and $40 Million Lower 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 $15.4 million (0.2 percent) in the current biennium and a $40.4 million (0.5 percent) reduction in FY 2006-07 from the November 2003 estimates. For the first time, this forecast recognizes the impact of the Medicare Prescription Drug, Improvement and Modernization Act of 2003, which added a prescription drug benefit to Medicare (see highlights for further information). This new law will affect health and human service expenditures in FY 2006-07 and into the future.

MEDICARE PRESCRIPTION DRUG BENEFIT: HOW DOES IT AFFECT MINNESOTA'S BUDGET?

This forecast includes modest state expenditure changes due to the expansion of the federal Medicare program. The Medicare Prescription Drug, Improvement and Modernization Act of 2003 expands federal coverage for prescription drug costs, increases disproportionate share hospital (DSH) payments, raises Medicare Part B premiums, increases payments to rural hospitals, and subsidizes employers who maintain drug coverage for retirees. Despite the breadth and cost of this legislation, it has virtually no impact on the FY 2005 forecast and has only modest net impact on the projections for FY 2006-07.

For Minnesota's budget projections, the new law's most significant feature is the change in drug coverage for Medicare-Medicaid beneficiaries (dual eligibles). Currently, dual eligibles are served in the state Medicaid program known as Medical Assistance (MA). Those costs are split between the state and federal government. Expanded Medicare coverage (Part D benefits) will enable these beneficiaries to receive drug benefits from Medicare, essentially shifting the entire cost to the federal government. Currently, 92,000 of the 667,000 (14 percent) Medicare beneficiaries in Minnesota are considered dual eligible. This shift is reflected in the February forecast and generates $338.5 million in pharmacy savings within MA Elderly and Disabled Basic Care in FY 2006-07.

These state savings are nearly entirely offset by other provisions of federal law and anticipated program changes. A "clawback" provision in the Medicare bill requires the state to return most of the savings from new coverage for Medicare-Medicaid beneficiaries. Further, the state is expected to incur costs due to lost drug rebates and increased Medicaid enrollment. As a result, net state savings created by expanded Medicare prescription drug coverage are expected to be $11.1 million in FY 2006-07.

The implementation of the Medicare prescription drug benefit will begin in June 2004. The first step will be temporary government-approved discount cards to be made available to Medicare eligible beneficiaries with no other access to prescription drug coverage. Card sponsors - retail pharmacy groups, health insurers, pharmacy benefit manages, and other companies - are expected to provide discounts of 10 to 25 percent off the retail price for drugs. Low-income beneficiaries (<135% FPG) receive a $600 credit in 2004 and 2005 for the cost of drugs in addition to the discounts.

On January 1, 2006, the temporary discount card program expires and the Part D Medicare prescription drug benefit begins. The new law provides coverage for all Medicare beneficiaries; however, the benefits are vastly different for beneficiaries receiving the standard benefit (>135% FPG) and the low-income benefit (<135% FPG). Under the standard benefit beneficiaries pay the first $3,600 out of $5,100 in drug costs and pay only five percent of drug costs above $5,100. Under the various low-income plans, beneficiaries pay $0 to $807 out of the first $5,100 in drug costs, but pay nothing above $5,100.

Although not reflected in the expenditure forecast, the Medicare changes will impact demand for state grants made by the Prescription Drug Program. These state beneficiaries will be eligible for the Medicare discount card and should find permanent Part D Medicare coverage preferable to the state program. As a result, nearly all beneficiaries are expected to drop state coverage by FY 2007, potentially yielding state savings of up to $17.4 million for FY 2006-07.

Basic Health Care Grants

Basic Health Care general fund spending is forecasted at $2.8 billion for FY 2004-05, down $39.4 million (1.4 percent) from November estimates. Basic Health Care includes state assistance for acute care such as hospitalization and physician services that are covered under MA Elderly & Disabled Basic Care, MA MFIP & Families Basic Care, and General Assistance Medical Care. Both components of MA Basic Care have lower costs compared to November estimates in this biennium.

- This forecast reflects revised assumptions related to implementation of a new health care program eligibility determination system (HealthMatch) and its effects on MA MFIP & Families Basic Care costs. These expenditures are projected to be lower compared to November estimates for two reasons: 1) because families will start shifting from MinnesotaCare to Medical Assistance at a later date due to later system implementation; and 2) because DHS projects managed care payments can be better aligned between Medical Assistance and MinnesotaCare.
- Average cost projections are lower for Elderly Basic Care.
- GAMC costs are also projected to be slightly lower than November due to a stronger economic forecast, producing lower enrollment than in the November forecast.

Basic Health Care spending will reach $3.5 billion in FY 2006-07, a reduction of $54.5 million (1.6 percent) from November estimates. Some of the trends described above are projected to continue in FY 2006-07, while new factors will also impact expenditure levels.

- The new Medicare legislation will reduce projected MA Elderly & Disabled Basic Care net expenditures. Significantly reduced prescription drug costs for this population are largely offset by related payments to the federal government (see highlights for further details.)
- MA MFIP & Families Basic Care expenditures are projected to increase, mostly because of lower pharmacy rebates related to the effects of the new Medicare legislation on pharmacy spending for the elderly and disabled. Caseload projections in this program area are slightly higher as well; one third of the increase added to the forecast in FY 2007 is due to anticipated MA enrollment of newly arrived Hmong refugees.

Continuing Care and Community Support Grants

Continuing Care and Community Based Support Grants provides ongoing supports for persons with chronic health needs whether living in an institution (e.g. nursing homes) or in the community. Expenditures are estimated to be $3.0 billion in FY 2004-05, up $26.4 million (0.9 percent), and $3.4 billion in FY 2006-07, up $26.8 million (0.8 percent), from the November 2003 estimates. The small increases in the forecast are primarily due to higher caseload projections for ICF/MR and nursing facilities and increased payments in the Developmental Disability (DD) Waiver program; however, reductions in the Elderly Waiver partially offset those costs.

- LTC Facilities increased $16.6 million (1.6 percent) in FY 2004-05, primarily due to a slightly higher Nursing Facility (NF) caseload. The higher NF forecast is partly the result of a lower caseload in Alternative Care (AC). A lower AC caseload was anticipated in estimates at the end of the 2003 session because of a number of law changes, including a new policy that authorizes recoveries against estates and liens against real property of those receiving AC. The caseload impact of the law changes on AC seems to be occurring faster than anticipated. The projected caseload has been reduced for FY 2004, but there is no reduction from the November forecast in the caseload projections for FY 2005 and later years.

- Intermediate Care Facility for Mental Retardation (ICF/MR) and Day Training and Habilitation (DT&H) caseloads are higher, most likely as a result of less movement to waiver programs than in recent years.

- LTC Waivers increased $12.9 million (1.0 percent) in FY 2004-05 and $8.6 million (0.5 percent) in FY 2006-07 due to an increase in the DD Waiver. The DD Waiver increase is mainly the result of a technical change, which brought cash payment projections closer to the accrual projections on which they are built.

- The Chemical Dependency Entitlement is increasing $10.1 million (9.4 percent) in FY 2004-05 and $9.1 million (7.5 percent) in FY 2006-07 due to a decreasing county share of total payments. The lower effective county share, which is assumed in the new projections, continues to exceed the minimum which counties are required to pay.

- Elderly Waivers (EW) provides a limited offset to the general increase throughout Continuing Care and Community Support Grants. Expenditure estimates decreased $10.1 million (7.0 percent) in FY 2004-05 and $13.4 million (6.3 percent) in FY 2006-07 due mainly to lower projections of the average cost per recipient as a result of slower movement to higher cost services within EW. EW caseload projections are also slightly lower.

Child Care Assistance and Economic Support Grants

These programs include cash, food, and/or child care assistance for families and individuals eligible for programs such as Child Care Assistance, Minnesota Family Investment Program (MFIP), and General 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.

Child Care Assistance expenditures are projected to total $197.1 million in FY 2004-05, down $7.3 million (3.6 percent) from November estimates. These costs are anticipated to reach $248.4 million in FY 2006-07, a reduction of $2.3 million (0.9 percent) compared to November projections.

Economic Support Grant expenditures are estimated to reach $241.7 million in FY 2004-05, up $4.8 million (2.0 percent) from end-of-session estimates. Economic Support Grant expenditures are projected to total $222.9 million in FY 2006-07, down $10.4 million (4.5 percent) compared to November estimates.

- MFIP and MFIP child care caseloads are projected to be lower than the November estimates due primarily to a stronger economic forecast. An anticipated settlement of Hmong refugees and subsequent MFIP enrollment for some of this population partially offsets these reductions.
- Federal Supplemental Security Income (SSI) eligibility will end for certain non-citizens based on their length of U.S. residency, which will produce increases in General Assistance and MFIP participants, partially offsetting other General Assistance and MFIP reductions. Because Minnesota Supplemental Aid (MSA) eligibility depends on federal SSI eligibility, MSA caseloads will be lower as a result of the SSI reductions.

All Other Spending Areas

Remaining Spending Areas Show No Net Change

The remaining categories of state spending total $9.036 billion for the current biennium. Funding for these areas are set as fixed amounts by legislative appropriations. Small changes in individual areas largely represent technical adjustments and updates to several small open appropriations. Small increases in these programs were largely offset by other corresponding decreases. Overall they did not contribute to the change in the forecast for spending.

Property tax aid and credit programs showed little net change at $2.778 billion for the current biennium. Small increases in FY 2004-05 occurred in the property tax refund program for renters ($1.3 million) and the residential market value credit program ($3.7 million). These increases however were largely offset by reductions in estimates for political contribution refunds ($1.1 million) and for tax refund interest payments ($3.0 million). Similar changes are reflected in FY 2006-07 planning estimates.

Debt service estimates for the current biennium and the next have been reduced slightly. Expected debt service payments in FY 2004-05 now total $652.0 million, down $1.0 million from November estimates. FY 2006-07 debt service costs are now projected to be $784.3 million, down $6.6 million from November estimates. The reduction in projected debt service costs is mainly the result of lower interest rates on bonds sold and higher forecast interest rates on invested cash balances in the debt service and bond proceeds funds.

Several small changes occurring in the environmental and state government areas are noteworthy. The first is a $587,000 increase in natural resources open appropriations in FY 2004-05, and a $4.6 million increase in FY 2006-07 planning estimates. The increase occurs in the Property In-Lieu of Taxes (PILT) program. The underlying property in the program will be assessed and revalued upward, resulting in higher payments beginning the next biennium. Second, the forecast now includes an estimate for the open appropriation for military forces emergencies. Designed to cover emergency costs when the National Guard is called up, this item was not previously forecast. $1.7 million is now included in FY 2004-05 as the potential cost based on recent historical experience. Finally, these increases are partially offset by a $1.4 million reduction in the estimated transfer for campaigning financing.

Alternative Forecast Comparison

Real GDP (Annual Rates)

	03 IV	04 I	04 II	04 III	04 IV	05 I	03A	04A	05A
GII Baseline (2-04)	4.0	4.8	4.6	4.3	4.2	4.0	3.1	4.8	3.8
Blue Chip (2-04)	4.0	4.5	4.3	4.1	3.9	3.6	3.1	4.6	3.7
Economy.Com (2-04)	4.0	4.3	4.2	3.7	3.6	NA	3.1	4.5	3.2
American Express (2-04)	4.0	4.6	3.8	4.0	3.7	3.2	4.3*	4.0*	3.1*
UBS (2-04)	4.0	5.0	4.0	3.3	3.3	NA	3.1	4.6	3.3
Standard & Poors (2-04)	4.0	4.4	4.1	3.5	NA	NA	3.1	4.5	3.4

Consumer Price Index (Annual Rates)

	03 IV	04 I	04 II	04 III	04 IV	05 I	03 A	04A	05A
GII Baseline (2-04)	0.9	2.5	1.1	1.2	1.3	1.7	2.3	1.4	1.3
Blue Chip (2-04)	0.9	2.1	1.7	1.8	1.9	2.0	2.3	1.6	1.6
Economy.Com (2-04)	0.9	1.1	1.0	1.1	1.2	NA	2.3	1.1	1.4
American Express (2-04)	0.9	2.1	2.5	2.6	2.8	2.7	1.9*	2.5*	2.9*
UBS (2-04)	0.9	2.4	1.7	1.9	2.0	NA	1.6	2.3	1.8
Standard & Poors (2-04)	0.9	2.0	0.2	1.0	NA	NA	2.3	1.4	1.2

* 4Q/4Q

Forecast Comparisons

Real Economic Growth
(Annual Percent Change in Real GDP)

	2002	2003	2004	2005	2006	2007
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
Feb 04 GII Baseline	2.2	3.1	4.8	3.8	3.6	3.7

Inflation
(Annual Percent Change in CPI-U)

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
Feb 04 GII Baseline	1.6	2.3	1.4	1.3	1.5	1.9

(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 2004 Control

(Annual Percent Changes)

	1999	2000	2001	2002	2003	2004	2005
Wage and Salary Income							
United States	6.8	8.1	2.4	0.6	2.2	4.1	6.0
Minnesota	6.5	8.7	2.9	1.4	2.8	4.1	5.2
Implied Annual Wage							
United States	4.3	5.8	2.1	1.7	2.5	3.0	3.6
Minnesota	4.1	6.2	2.7	2.5	3.2	3.3	3.7
Non-Farm Employment							
United States	2.4	2.2	0.3	-1.1	-0.3	1.1	2.3
Minnesota	2.3	2.4	0.2	-1.1	-0.4	0.8	1.4
Personal Income							
United States	5.1	8.0	3.4	2.3	3.1	4.5	5.4
Minnesota	4.7	8.5	3.5	3.3	3.0	4.3	5.2

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

	Forecast Revenues	Actual Revenues	Variance Act-Fcst
Individual Income Tax			
Withholding	2,946,091	2,940,960	-5,131
Declarations	588,600	588,215	-385
Miscellaneous	112,583	112,878	295
Gross	3,647,274	3,642,053	-5,221
Refund	112,705	109,528	-3,177
Net	3,534,569	3,532,525	-2,044
Corporate & Bank Excise			
Declarations	351,700	317,230	-34,470
Miscellaneous	67,235	77,251	10,016
Gross	418,935	394,481	-24,454
Refund	100,510	67,421	-33,089
Net	318,425	327,060	8,635
Sales Tax			
Gross	2,441,150	2,421,767	-19,383
Refunds	129,918	109,340	-20,578
Net	2,311,232	2,312,427	1,195
Sales Tax Rebates all years	-6	-4	3
Motor Vehicle Sales (gross)	164,039	158,833	-5,205
Other Revenues			
Inherit/Gift/Estate	51,356	56,146	4,790
Liquor/Wine/Beer	40,120	40,325	205
Cigarette/Tobacco/Cont Sub	98,680	96,043	-2,637
Deed and Mortgage	209,158	213,945	4,787
Insurance Gross Earnings	105,010	110,053	5,043
Lawful Gambling	31,140	28,710	-2,430
Health Care Surcharge	128,812	131,068	2,256
Other Taxes	1,279	1,127	-152
State Wide Property Tax	272,708	271,031	-1,677
DHS RTC Collections	25,136	24,396	-740
Income Tax Reciprocity	46,242	46,242	0
Investment Income	9,452	8,826	-626
Tobacco Settlement	168,656	168,467	-189
Departmental Earnings	158,921	163,406	4,485
Lottery Revenues	17,793	20,692	2,899
Revenues yet to be allocated	2,092	2,503	411
Residual revenues	138,501	133,693	-4,808
Other Subtotal	**1,505,050**	**1,516,670**	**11,620**
Other Refunds	**16,131**	**19,496**	**3,365**
Other Net	**1,488,919**	**1,497,174**	**8,255**
Total Gross	**8,176,448**	**8,133,805**	**-42,643**
Total Refunds	**359,265**	**305,785**	**-53,480**
Total Net	**7,817,183**	**7,828,020**	**10,837**

Factors Affecting the Individual Income Tax

($ in billions)

	Calendar Year					
	2000	2001	2002	2003	2004	2005
Minnesota Non-Farm Tax Base						
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	138.510	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	136.120	139.980	142.370	146.160	152.011	160.690
*February 2004 Baseline	136.120	139.980	142.370	146.080	152.201	160.413
Minnesota Wage and Salary Income						
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
*February 2004 Baseline	92.780	95.460	96.780	99.520	103.570	108.910
Minnesota Property Income						
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
*February 2004 Baseline	33.060	33.974	34.509	34.780	36.027	38.197
Minnesota Proprietors' Income						
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
*February 2004 Baseline	10.280	10.543	11.086	11.779	12.601	13.308

** 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
Pct		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
Pct		3.9%	0.4%	2.2%	5.1%	3.1%
February 2004 Baseline	59.345	61.483	61.425	63.011	67.636	70.481
Pct		3.6%	0.0%	2.6%	7.3%	4.2%
Minnesota's Proxy Share of U.S. Consumer Durable Spending (Excluding Autos)						
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
February 2004 Baseline	10.234	10.476	10.717	11.118	12.106	12.685
Minnesota's Proxy Share of U.S. Capital Equipment Spending						
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
February 2004 Baseline	10.819	11.225	10.043	10.300	11.616	12.506
Minnesota's Proxy Share of U.S. Construction Spending						
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
February 2004 Baseline	7.660	8.346	8.691	8.864	9.814	9.970

* 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						
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	162.41	166.43	172.40	181.12	192.14
November 2003 Baseline (1)	151.77	162.60	166.40	172.04	178.50	187.08
February 2004 Baseline (2)	151.77	162.60	166.40	172.31	178.82	187.04
SALES TAX ON MOTOR VEHICLES						
Minnesota's Proxy Share of U.S. Consumption of Motor Vehicle and Parts						
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
February 2004 Baseline	7.769	7.916	8.524	8.378	8.770	8.891
CORPORATE FRANCHISE TAX		**Calendar Year**				
U.S. Corporate Profits						
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
February 2004 Baseline	773.4	696.8	745.0	842.9	1,016.8	997.5*

* Finance Dept Estimate

(1) Consistent with October 2003 BEA release

(2) Consistent with January 2004 BEA release

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

	FY 2004	FY 2005	Biennial Total
Actual & Estimated Resources			
Balance Forward From Prior Year	368,922	813,313	368,922
Current Resources:			
Tax Revenues	12,370,328	12,925,573	25,295,901
Non-Tax Revenues	732,998	629,823	1,362,821
Dedicated Revenue	45,050	45,050	90,100
Transfers In	1,130,195	315,197	1,445,392
Prior Year Adjustments	10,100	10,100	20,200
Subtotal-Current Resources	14,288,671	13,925,743	28,214,414
Total Resources Available	**14,657,593**	**14,739,056**	**28,583,336**
Actual & Estimated Spending			
E-12 Education	6,136,565	6,072,341	12,208,906
Property Tax Recog/Payment Change	(414,156)	(35,567)	(449,723)
Property Tax Aids & Credits	1,428,566	1,349,248	2,777,814
Higher Education	1,287,455	1,273,328	2,560,783
Health & Human Services	3,597,504	3,718,877	7,316,381
Environment, Agriculture & Economic Dev	365,496	345,062	710,558
Transportation	79,031	81,131	160,162
Criminal Justice	716,040	724,214	1,440,254
State Government	332,217	312,145	644,362
Debt Service & Borrowing	265,706	386,323	652,029
Estimated Cancellations	0	(5,000)	(5,000)
Subtotal Expenditures & Transfers	**13,794,424**	**14,222,102**	**28,016,526**
Dedicated Expenditures	49,856	45,050	94,906
Total Expenditures & Transfers	**13,844,280**	**14,267,152**	**28,111,432**
Balance Before Reserves	**813,313**	**471,904**	**471,904**
Budget Reserve	306,000	631,434	631,434
Budgetary Balance	**507,313**	**(159,530)**	**(159,530)**

FY 2004-05 General Fund Forecast Change
February 2004 vs November 2003
($ in thousands)

	11-03 Fcst FY 2004-05	2-04 Fcst FY 2004-05	$ Difference	% Change
Actual & Estimated Resources				
Balance Forward From Prior Year	368,922	368,922	0	0.0%
Current Resources:				
Tax Revenues	25,339,442	25,295,901	(43,541)	-0.2%
Non-Tax Revenues	1,341,012	1,362,821	21,809	1.6%
Dedicated Revenue	90,012	90,100	88	0.1%
Transfers In	1,444,664	1,445,392	728	0.1%
Prior Year Adjustments	20,200	20,200	0	0.0%
Subtotal-Current Resources	28,235,330	28,214,414	(20,916)	-0.1%
Total Resources Available	**28,604,252**	**28,583,336**	**(20,916)**	**-0.1%**
Actual & Estimated Spending				
E-12 Education	12,223,348	12,208,906	(14,442)	-0.1%
Property Tax Recog/Payment Change	(433,887)	(449,723)	(15,836)	3.6%
Property Tax Aids & Credits	2,777,097	2,777,814	717	0.0%
Higher Education	2,560,783	2,560,783	0	0.0%
Health & Human Services	7,331,800	7,316,381	(15,419)	-0.2%
Environment, Agriculture & Economic Dev	709,971	710,558	587	0.1%
Transportation	160,162	160,162	0	0.0%
Criminal Justice	1,440,254	1,440,254	0	0.0%
State Government	644,948	644,362	(586)	-0.1%
Debt Service & Borrowing	653,059	652,029	(1,030)	-0.2%
Estimated Cancellations	(5,000)	(5,000)	0	0.0%
Subtotal Expenditures & Transfers	**28,062,535**	**28,016,526**	**(46,009)**	**-0.2%**
Dedicated Expenditures	94,818	94,906	88	0.1%
Total Expenditures & Transfers	**28,157,353**	**28,111,432**	**(45,921)**	**-0.2%**
Balance Before Reserves	**446,899**	**471,904**	**25,005**	
Budget Reserve	631,434	631,434	0	
Budgetary Balance	**(184,535)**	**(159,530)**	**25,005**	

FY 2004-05 General Fund Comparison
February 2004 Forecast vs End of 2003 Legislative Session
($ in thousands)

	5-03 Enacted FY 2004-05	2-04 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	25,295,901	(400,916)	-1.6%
Non-Tax Revenues	1,348,984	1,362,821	13,837	1.0%
Dedicated Revenue	126,505	90,100	(36,405)	-28.8%
Transfers In	1,449,461	1,445,392	(4,069)	-0.3%
Prior Year Adjustments	20,200	20,200	0	0.0%
Subtotal-Current Resources	28,641,967	28,214,414	(427,553)	-1.5%
Total Resources Available	**28,822,394**	**28,583,336**	**(239,058)**	**-0.8%**
Actual & Estimated Spending				
E-12 Education	12,322,548	12,208,906	(113,642)	-0.9%
Property Tax Recog/Payment Change	(439,836)	(449,723)	(9,887)	2.2%
Property Tax Aids & Credits	2,737,026	2,777,814	40,788	1.5%
Higher Education	2,557,657	2,560,783	3,126	0.1%
Health & Human Services	7,425,291	7,316,381	(108,910)	-1.5%
Environment, Agriculture & Economic Dev	693,496	710,558	17,062	2.5%
Transportation	160,162	160,162	0	0.0%
Criminal Justice	1,430,755	1,440,254	9,499	0.7%
State Government	618,408	644,362	25,954	4.2%
Debt Service & Borrowing	673,625	652,029	(21,596)	-3.2%
Estimated Cancellations	(5,000)	(5,000)	0	0.0%
Subtotal Expenditures & Transfers	**28,174,132**	**28,016,526**	**(157,606)**	**-0.6%**
Dedicated Expenditures	126,505	94,906	(31,599)	-25.0%
Total Expenditures & Transfers	**28,300,637**	**28,111,432**	**(189,205)**	**-0.7%**
Balance Before Reserves	**521,757**	**471,904**	**(49,853)**	
Budget Reserve	521,757	631,434	109,677	
Budgetary Balance	**0**	**(159,530)**	**(159,530)**	

FY 2006-07 General Fund Planning Estimates
February 2004 Forecast
($ in thousands)

	FY 2006	FY 2007	Biennial Total
Actual & Estimated Resources			
Balance Forward From Prior Year	471,904	111,392	471,904
Current Resources:			
Tax Revenues	13,499,657	14,057,692	27,557,349
Non-Tax Revenues	652,419	651,707	1,304,126
Dedicated Revenue	45,050	45,050	90,100
Transfers In	138,712	149,109	287,821
Prior Year Adjustments	10,100	10,100	20,200
Subtotal-Current Resources	14,345,938	14,913,658	29,259,596
Total Resources Available	**14,817,842**	**15,025,050**	**29,731,500**
Actual & Estimated Spending			
E-12 Education	6,024,079	5,988,948	12,013,027
Property Tax Recog/Payment Change	(38,044)	(41,182)	(79,226)
Property Tax Aids & Credits	1,480,715	1,495,228	2,975,943
Higher Education	1,273,924	1,273,924	2,547,848
Health & Human Services	4,042,666	4,332,653	8,375,319
Environment, Agriculture & Economic Dev	343,414	343,949	687,363
Transportation	80,740	81,995	162,735
Criminal Justice	759,289	765,747	1,525,036
State Government	309,487	314,926	624,413
Debt Service & Borrowing	385,130	399,120	784,250
Estimated Cancellations	0	(5,000)	(5,000)
Subtotal Expenditures & Transfers	**14,661,400**	**14,950,308**	**29,611,708**
Dedicated Expenditures	45,050	45,050	90,100
Total Expenditures & Transfers	**14,706,450**	**14,995,358**	**29,701,808**
Balance Before Reserves	**111,392**	**29,692**	**29,692**
Budget Reserve	631,434	631,434	631,434
Budgetary Balance	**(520,042)**	**(601,742)**	**(601,742)**

FY 2006-07 General Fund Planning Estimates Change
February 2004 vs November 2003
($ in thousands)

	11-03 Plng FY 2006-07	2-04 Plng FY 2006-07	$ Difference	% Change
Actual & Estimated Resources				
Balance Forward From Prior Year	446,899	471,904	25,005	5.6%
Current Resources:				
Tax Revenues	27,663,898	27,557,349	(106,549)	-0.4%
Non-Tax Revenues	1,321,202	1,304,126	(17,076)	-1.3%
Dedicated Revenue	90,012	90,100	88	0.1%
Transfers In	287,821	287,821	0	0.0%
Prior Year Adjustments	20,200	20,200	0	0.0%
Subtotal-Current Resources	29,383,133	29,259,596	(123,537)	-0.4%
Total Resources Available	**29,830,032**	**29,731,500**	**(98,532)**	**-0.3%**
Actual & Estimated Spending				
E-12 Education	12,036,527	12,013,027	(23,500)	-0.2%
Property Tax Recog/Payment Change	(66,964)	(79,226)	(12,262)	18.3%
Property Tax Aids & Credits	2,975,365	2,975,943	578	0.0%
Higher Education	2,547,848	2,547,848	0	0.0%
Health & Human Services	8,415,695	8,375,319	(40,376)	-0.5%
Environment, Agriculture & Economic Dev	682,793	687,363	4,570	0.7%
Transportation	162,735	162,735	0	0.0%
Criminal Justice	1,525,036	1,525,036	0	0.0%
State Government	622,585	624,413	1,828	0.3%
Debt Service & Borrowing	790,885	784,250	(6,635)	-0.8%
Estimated Cancellations	(5,000)	(5,000)	0	0.0%
Subtotal Expenditures & Transfers	**29,687,505**	**29,611,708**	**(75,797)**	**-0.3%**
Dedicated Expenditures	90,012	90,100	88	0.1%
Total Expenditures & Transfers	**29,777,517**	**29,701,808**	**(75,709)**	**-0.3%**
Balance Before Reserves	**52,515**	**29,692**	**(22,823)**	
Budget Reserve	631,434	631,434	0	
Budgetary Balance	**(578,919)**	**(601,742)**	**(22,823)**	

FY 2006-07 General Fund Planning Estimates Comparison
February 2004 Forecast vs End of 2003 Legislative Session
($ in thousands)

	5-03 Plng FY 2006-07	2-04 Plng FY 2006-07	$ Difference	% Change
Actual & Estimated Resources				
Balance Forward From Prior Year	521,757	471,904	(49,853)	-9.6%
Current Resources:				
Tax Revenues	28,394,224	27,557,349	(836,875)	-2.9%
Non-Tax Revenues	1,458,669	1,304,126	(154,543)	-10.6%
Dedicated Revenue	130,663	90,100	(40,563)	-31.0%
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	29,259,596	(1,037,197)	-3.4%
Total Resources Available	**30,818,550**	**29,731,500**	**(1,087,050)**	**-3.5%**
Actual & Estimated Spending				
E-12 Education	12,168,933	12,013,027	(155,906)	-1.3%
Property Tax Recog/Payment Change	(77,603)	(79,226)	(1,623)	2.1%
Property Tax Aids & Credits	2,922,630	2,975,943	53,313	1.8%
Higher Education	2,547,848	2,547,848	0	0.0%
Health & Human Services	8,327,191	8,375,319	48,128	0.6%
Environment, Agriculture & Economic Dev	682,110	687,363	5,253	0.8%
Transportation	162,735	162,735	0	0.0%
Criminal Justice	1,506,920	1,525,036	18,116	1.2%
State Government	621,936	624,413	2,477	0.4%
Debt Service & Borrowing	782,769	784,250	1,481	0.2%
Estimated Cancellations	(5,000)	(5,000)	0	0.0%
Subtotal Expenditures & Transfers	**29,640,469**	**29,611,708**	**(28,761)**	**-0.1%**
Dedicated Expenditures	130,663	90,100	(40,563)	-31.0%
Total Expenditures & Transfers	**29,771,132**	**29,701,808**	**(69,324)**	**-0.2%**
Balance Before Reserves	**1,047,418**	**29,692**	**(1,017,726)**	
Budget Reserve	521,757	631,434	109,677	
Budgetary Balance	**525,661**	**(601,742)**	**(1,127,403)**	

Minnesota
Department of Finance

February 2004

Highlights

$160 Million Budget Deficit Projected for FY 2004-05

Minnesota's projected budget deficit for FY 2004-05 has fallen by $25 million since November. The changes to forecast revenues and expenditures were small. Expected revenues are projected to be $21 million (0.1 percent), below November's forecast. That minor revenue decline was more than offset by a $46 million (0.2 percent), reduction in projected spending.

2004 U.S. Economic Growth Expected to Be Strongest in 20 Years

Global Insight's February baseline forecast calls for real GDP to grow at a 4.8 percent annual rate in 2004, and at a 3.8 percent annual rate in 2005. GII's forecast is slightly more optimistic than the consensus forecast of 4.6 percent growth, but even a 4.6 percent growth rate would be stronger than any observed since 1984. GII's baseline requires a significant increase in payroll employment by mid-year and job growth of more than 200,000 per month in the second half of 2004 is projected. Since September U.S. employment growth has averaged just under 75,000 per month.

Budget Outlook for 2006-07 Biennium Worsens; Planning Estimates Show Budget Gap of $441 Million

Current law spending is now projected to exceed projected revenues by $441 million in the 2006-07 biennium, $47 million more than projected in November. A disparity between the spending and revenue growth assumptions used may understate the size of the coming budget problem. Revenues are projected to grow at an average annual rate of more than 4 percent through fiscal 2007. Expenditure projections are flat or declining in most areas. Spending growth largely reflects changes in health care and long-term care caseload and costs. Any spending increases beyond those in current law would add to the future budget shortfall.

400 CENTENNIAL BUILDING, 658 CEDAR STREET, ST. PAUL, MINNESOTA 55155 (651)296-5900

Budget Summary

FY 2004-05 Budget Deficit Now $160 Million

Minnesota's budget outlook has improved slightly since November. There were no major changes in either the revenue or expenditure outlook. A small decline in spending estimates more than offsets a minor drop in projected revenues, reducing the projected deficit by $25 million. The budget deficit for the FY 2004-05 biennium is now estimated to be $160 million, about 0.5 percent of biennial revenues. In November a deficit of $185 million was forecast. Expected revenues have fallen by $21 million (0.1 percent) from November's estimate, while forecast spending for this biennium is $46 million (0.2 percent) below November's estimate.

FY 2004-05 Budget Summary

($ millions)

	Nov 2003	Feb 2004	Change
Beginning Balance	$ 368	$ 368	$ 0
Forecast Revenues	28,235	28,214	(21)
Estimated Expenditures	28,157	28,111	(46)
Budget Reserve	631	631	0
Projected Deficit	**$(185)**	**$(160)**	**$25**

Minnesota general fund revenues are now forecast to total $28.214 billion during the current biennium, $428 million (1.5 percent) less than end-of-session estimates. Forecast receipts from the state's five major taxes are projected to total $22.949 billion, down $109 million from November's estimate, and $568 million from end-of-session estimates. Other tax and non-tax revenues are expected to exceed November's forecast by $88 million, and end-of-session estimates by $181 million.

General fund spending is now projected to total $28.111 billion, $46 million less than projected in November, and $189 million less than end-of-session estimates. Lower spending estimates for E-12 education and for health and human services were the sources of the changes in estimated spending.

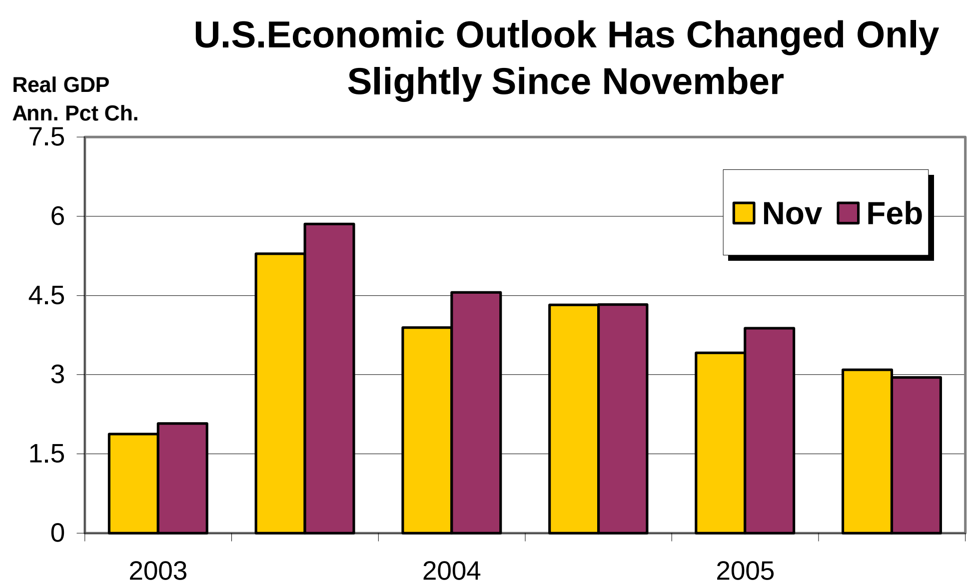
The state's general fund reserve of $631 million represents slightly over 2.2 percent of forecast spending projected for the biennium. The Governor and the legislature are required to take action to balance the general fund budget before the biennium ends.

2004 Expected to Be a Very Good Year for the U.S. Economy

Times are expected to be very good in 2004, but those expectations had already been factored into most forecasts by last November. The result is that current forecasts for the U.S. economy have grown only slightly more optimistic. Business investment has increased in recent months, and productivity gains are expected to remain strong, lifting corporate profits and wages through 2005. The weaker dollar has also made U.S. goods more competitive overseas. While that recent good economic news has not provided reason to raise 2004 forecasts, it has increased forecasters' confidence that their earlier optimism was not ill advised.

A majority of forecasters expect 2004's real GDP growth rate to be the strongest since 1984. But a repeat of the late 1990's when super-normal real GDP growth lasted for more than four years is unlikely. Instead, economic growth rates are expected to drop below 4 percent and move back to a more sustainable level in 2005. As always there is a substantial list of items that could go wrong, but for the short term at least, that list seems less intimidating than in the recent past. No one is expecting a major economic slump, let alone a recession. In the absence of a major geopolitical event, another year of real growth around 3 percent, like occurred in 2002 and 2003, is the worst that is expected.

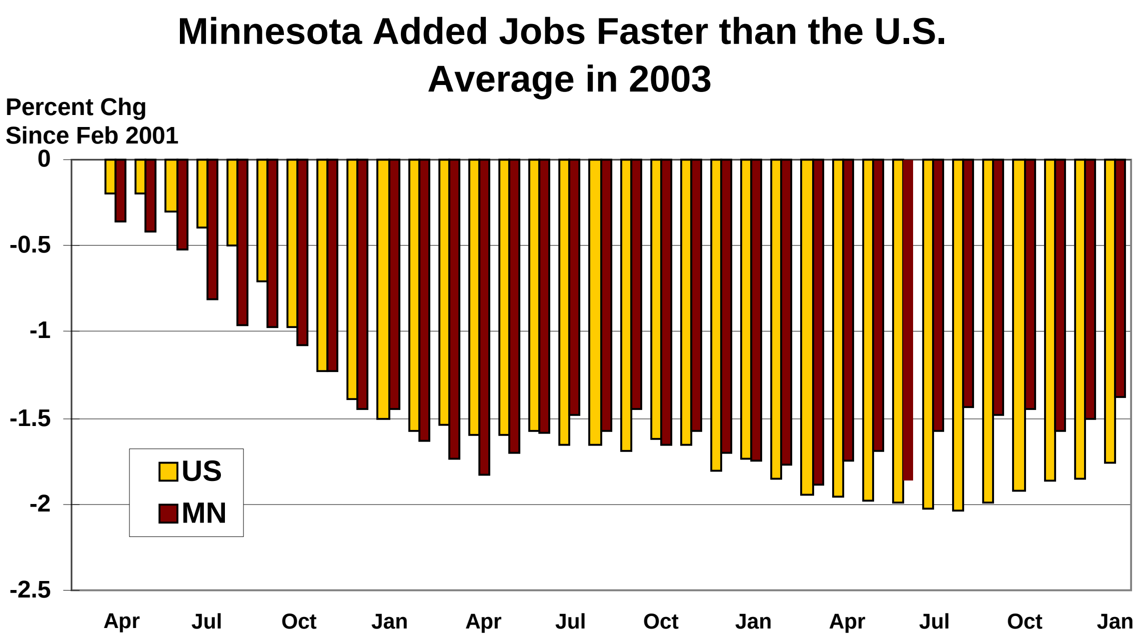
Payroll employment remains stubbornly below end-of-recession levels. But the projected increase in demand for U.S. goods and services is expected to lead to an acceleration in hiring through the spring and early summer and to the creation of more than 200,000 new jobs per month in the second half of this year. Employers have already started to hire. Since September U.S. employment growth has averaged just under 75,000 per month, about one-half the monthly amount needed to keep pace with normal growth in the labor force.



The February baseline forecast from Global Insight Inc., (GII), Minnesota's national economic consultant is for even stronger growth than is in the already optimistic consensus outlook for the economy. GII expects real GDP to grow at an annual rate of 4.8 percent during 2004, and at a 3.8 percent rate in 2005. Their November forecast was only slightly more subdued with projected annual growth rates of 4.3 percent and 3.6 percent, for 2004 and 2005. GII believes inflation will continue to remain well under control. The February baseline shows CPI increases of 1.4 percent in 2004 and 1.3 percent in 2005. Although GII notes, "The baseline forecast could easily be mistaken for an optimistic one," a slightly more optimistic scenario is also provided with growth about 0.5 percent higher than the baseline for 2004 and 2005. That scenario is assigned a probability of 20 percent. A less optimistic scenario, in which real growth in 2004 is still 4.0 percent, is also assigned a 20 percent probability.

Revised Employment Data Show Minnesota Economy Grew Faster than U.S. in 2003

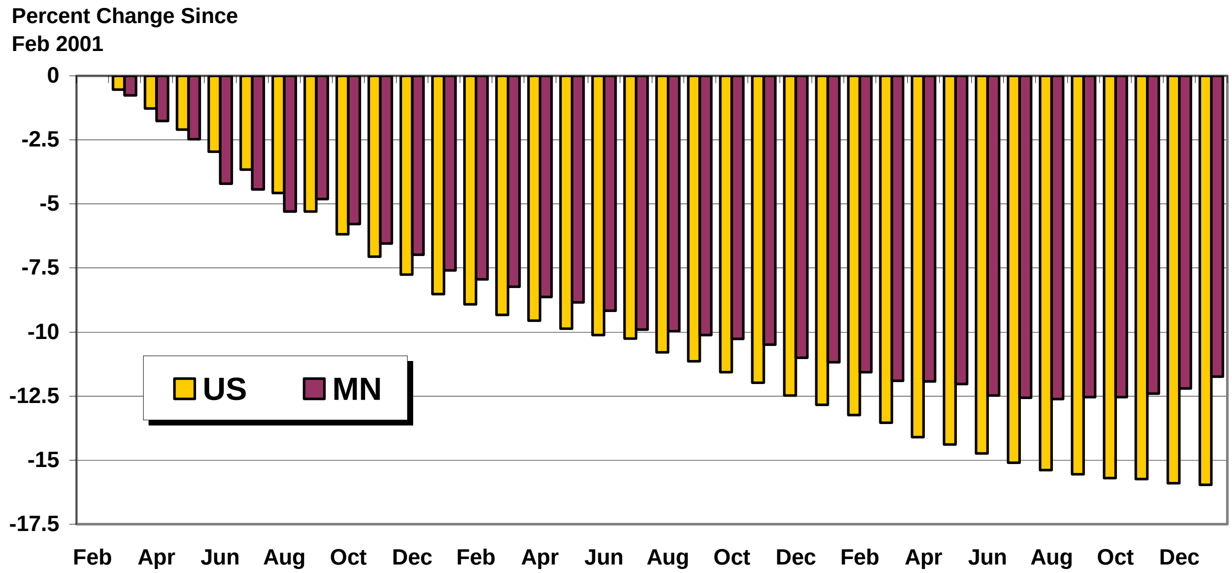
Recently released employment data show Minnesota's job market has recovered a little more rapidly from the recession than its national counterpart. June 2003 payroll employment in the state was down by more than 50,000 jobs from its pre-recession peak in February 2001. More than 12,000 jobs were added during the summer months, but since then employment growth in Minnesota has stalled. Through January Minnesota payroll employment is up by 13,000 from its June low, but it is still 37,000 below the level reported for February 2001. Substantial weakness remains in the labor market. Continuing unemployment claims have yet to show any sign of recovery, remaining at levels observed during and shortly after the recession.



The revised data show Minnesota outperforming the national economy in job growth during 2003. Earlier comparisons, made using data available before the recent revisions, showed Minnesota employment not quite keeping pace with the U.S. averages. Both Minnesota and the U.S. started 2003 with employment 1.74 percent below its pre-recession highs. Growth in Minnesota employment during 2003 has reduced that gap to 1.38 percent. Nationally employment is now 1.78 percent below the February 2001 peak.

Minnesota's manufacturing employment is down substantially from pre-recession levels, but we have fared somewhat better than the nationwide averages. Nearly 3,000 manufacturing jobs have been added in the state since June, while national manufacturing employment is down 208,000 over that same time period. Since February 2001 Minnesota manufacturing employment has fallen by 11.7 percent. Nationally, manufacturing employment has dropped 16 percent. The forecast includes only a modest increase in manufacturing employment through 2005.

Manufacturing Job Losses Have Been Less than the U.S. Average



FY 2004-05 Revenue Forecast Down $21 Million from November's Forecast

Current general fund resources for the 2004-05 biennium are now forecast to total $28.214 billion, $21 million less than was forecast in November and $428 million (1.5 percent) less than end-of-session estimates. The forecast for the five major taxes was reduced by $109 million or 0.5 percent from November's estimate. Projected receipts from other tax and non-tax revenues were increased by $88 million.

FY 2004-05 Revenues

($ millions)

	Nov 2003	Feb 2004	Change	% Change
Individual Income	$11,544	$11,457	$(87)	(0.8)%
Sales	8,260	8,314	54	0.7
Corporate	1,444	1,386	(58)	(4.0)
Motor Vehicle Sales	590	571	(19)	(3.2)
Statewide Levy	1,220	1,221	1	0.1
Subtotal	**23,058**	**22,949**	**(109)**	**(0.5)%**
Other Non-Dedicated Revenues	3,622	3,710	88	2.4
Other Resources	1,555	1,555	0	0.0
Total Resources	**$28,235**	**$28,214**	**$(21)**	**(0.1)%**

Changes in expected revenues from the five major taxes were small, with both the individual income tax and the sales tax differing from November's estimate by less than one percent. The corporate income tax had the largest percentage decline, down 4 percent or $58 million due to lower than projected receipts from estimated payments at the end of calendar 2003. But, even after that forecast reduction, corporate tax receipts are still expected to exceed end-of-session estimates by $81 million. The forecast for other non-dedicated revenues is up $88 million from November. Stronger than anticipated growth in the insurance gross premiums tax and the mortgage and deed taxes provide much of the additional revenue.

Little Change in Forecast Spending

Forecast spending for the biennium is now expected to be $28.111 billion, down $46 million (0.1 percent) from November and down $189 million from end-of-session estimates. Lower forecast spending for E-12 education and health and human services programs account for the net decline.

FY 2004-05 Estimated Expenditures

($ millions)

	Nov 2003	Feb 2004	Change
E-12 Education	$11,789	$11,759	$(30)
Higher Education	2,561	2,561	0
Property Tax Aids & Credits	2,777	2,778	1
Health & Human Services	7,332	7,316	(16)
All Other	3,698	3,697	(1)
Total Spending	**$28,157**	**$28,111**	**$ (46)**

The majority of the $30 million (0.3 percent) reduction in the forecast for E-12 education results from slightly lower pupil counts in 2003 and higher values associated with the early recognition of property tax revenue for school districts. Nearly $25 million of the forecast change was within the General Education program.

Health and human services spending in the current biennium is now expected to be $16 million (0.2 percent) less than November's estimate. Much of the savings came from small reductions in projected spending for basic health care grants and child care and economic support grants. That lower spending was partially offset by increases in spending for continuing care and community support grants.

Planning Estimates Highlight Continued Budget Pressures

Revenue planning estimates for FY 2006-07 total $29.260 billion, $123 million less than projected in November. Expenditures are projected to be $29.702 billion, $76 million less than November's estimates. In the absence of legislative action, a $602 million budget shortfall would occur in the next biennium. When the $160 million deficit for FY 2004-05 is resolved, a budget gap will still remain. How much of the currently projected $441 structural shortfall remains will depend on how the FY 2004-05 budget deficit is solved.

FY 2006-07 Planning Estimates

($ millions)

	FY 2006	FY 2007	Biennial Total
Beginning Balance	**$472**	**$111**	**$472**
Revenues	14,346	14,914	29,260
Spending	14,706	14,996	29,702
Budget Reserve	631	631	631
Projected Balance	**$(520)**	**$(602)**	**$(602)**

The planning estimates assume real economic growth continues at an annual average rate of 3.6 percent during 2005 and 2006. State tax revenues increase at a rate slightly more than 4 percent per year. Current law spending, however, increases only about 2.5 percent per year, largely reflecting growth in health care and long-term care caseload and costs. Other major areas are virtually flat.

FY 2005-07 Structural Balance

($ millions)

	FY 2005	FY 2006	FY 2007
Projected Revenues	13,926	14,346	14,914
Spending	14,267	14,706	14,995
Difference / Structural	**$(341)**	**$(360)**	**$(81)**

A disparity between revenue and expenditure growth assumptions may understate the size of future budget gaps. While state revenues recognize inflation in the growth of the state tax base, inflation is not generally included in projected state expenditures. Projected inflation is expected to be 1.4 and 1.7 percent for FY 2006 and FY 2007 respectively. If expected inflation were included in the expenditures estimates in the same way as it is in the revenue estimates, projected spending would increase by $200 million in FY 2006 and $450 million in FY 2007.

Without action, spending will exceed revenues in each of the next three years. This is the "structural" gap between revenues collected in a year and expenditures for that year. While useful for planning purposes, state policy makers must carefully consider not only the size of the projected FY 2006-07 structural shortfall, but also potential cost pressures in major spending areas that are not built into current law planning estimates for FY 2006-07.

A complete version of the February 2004 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.