Minnesota
Department of Finance

November 2004

November 2004 Economic Forecast

Highlights

Budget Outlook for FY 2006-07 Worsens by $302 Million, Projected Budget Shortfall Now $700 Million

Despite increases in forecast revenues in both the current biennium and the next, the forecast budget shortfall for FY 2006-07 has increased from $398 million to $700 million. Current law spending in FY 2006-07 is now expected to total $30.177 billion, $556 million more than end-of-session estimates. This increase is driven largely by human services increases and enrollment adjustments for post-secondary education systems. Projected revenues are $254 million higher. The revenue and spending changes combine to increase the projected budget shortfall for FY 2006-07 to $700 million.

$495 Million Balance Projected for FY 2004-05

Revenues in FY 2004-05 are now expected to total $29.042 billion, $455 million more than end-of-session estimates. When combined with a $34 million decrease in expenditures and a $6 million forecast reduction in the budget reserve, an ending balance of $495 million is forecast.

Cash Flow Account and Budget Reserve Restored to 2001 Levels

The $495 million FY 2004-05 forecast balance does not reduce the projected 2006-07 shortfall. Under current law it must be used to restore the cash flow account to $350 million, rebuild the state's budget reserve to $653 million, and buy back a portion of the school aid payment shifts used to balance recent budgets.

Expenditure Growth Exceeds Revenue Growth in 2006-07 Biennium

Current law spending in FY 2006-07 increases by 7.6 percent. Health and human services spending grows by 20 percent, accounting for two-thirds of the total spending increase. Total revenues are projected to increase 2.8 percent even though tax revenues grow by 7.9 percent. Much of the difference in revenue growth is explained by the one-time transfers from other funds used to balance the current budget.

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Budget Summary

$700 Million Budget Shortfall Projected for FY 2006-07

Minnesota's budget outlook for the 2006-07 biennium has deteriorated by $302 million. The general fund revenue forecast is up $254 million from end-of-session estimates, but projected state expenditures are up by $556 million from earlier projections. When the net forecast reduction of $302 million is combined with the $398 million shortfall projected in end-of-session budget planning estimates, Minnesota faces a $700 million budget shortfall in the 2006-07 biennium.

FY 2006-07 General Fund Forecast

($ in Millions)

Revenues	**$29,477**
Expenditures	**$30,177**
Balance (Shortfall)	**($700)**

This is the first actual forecast of revenues and expenditures for the 2006-07 biennium. It establishes the specific current law context for budget development decisions for the next biennium. Since no enacted budget is currently in place, expenditure projections assume the extension of current programs, adjusted only for projected changes in caseload and enrollment. The expenditure projections do not include a general adjustment for inflation.

FY2004-05 Surplus Restores Cash Flow and Budget Reserves, Buys Down School Shift

A $495 million surplus is now projected for the current biennium. General fund revenues are forecast to total $29.042 billion, up $455 million from end-of-session estimates. State spending is projected to be $27.921 billion, down $34 million from end-of-session estimates. When combined with a $6 million reduction in the budget reserve caused by loss of an expected transfer from the assigned risk plan surplus, the balance projected for the current biennium totals $495 million.

More than 80 percent of the additional FY 2004-05 revenue comes from the individual income tax. A projected increase in health and human services spending is more than offset by savings elsewhere in the budget.

FY 2004-05 Forecast

($ in Millions)

	End of Session	November Forecast	Forecast Change	Statutory Allocation
Beginning Balance	$369	$369	$0	
Revenues	28,218	28,673	455	
Expenditures	27,955	27,921	(34)	118
Cash Flow Account	0	0	0	350
Budget Reserve	631	625	(6)	27
Balance	$1	$495	$495	$495

Under current law any forecast balance in the 2004-05 biennium must first be used to restore the state's reserve funds to their 2001 levels. Then, any remaining funds are directed to reversing school payment shifts enacted in 2002 and 2003 as part of the solutions to prior state budget shortfalls. These funds are specifically set aside in current law, they do not carry forward as an available balance to reduce any shortfall projected for the 2006-07 biennium.

The forecast $495 million balance for FY 2004-05 is allocated as follows:

- **$350 million** to restore the state's cash flow account
- **$27 million** to restore the state's budget reserve to $653 million
- **$118 million** to reverse a portion of the school aid shifts

Disparity in Revenue and Expenditure Growth Explains FY 2006-07 Budget Problem

Revenues for FY 2006-07 are forecast to increase $805 million, or 2.8 percent over levels in the current biennium. Current law spending is projected to increase by $2.139 billion, or 7.6 percent. This mismatch between revenue and spending growth highlights Minnesota's budget challenge.

Biennial Comparison

($ in Millions)

	FY 2004-05	FY 2006-07	$ Change	% Change
Revenues				
Taxes	25,627	27,658	2,031	7.9
Non-Tax Revenues	1,466	1,406	(60)	(4.1)
Other	1,580	414	(1,166)	(73.8)
Total Revenues	**$28,673**	**$29,478**	**$805**	**2.8**
Spending				
E-12 Education	$11,902	$11,969	$67	0.6
Health & Human Services	7,245	8,684	1,439	19.9
All Other	8,892	9,524	632	7.1
Total Spending	**$28,039**	**$30,177**	**$2,139**	**7.6**

Tax revenues for FY 2006-07 are forecast to grow by 7.9 percent to $27.658 billion. Nearly three quarters of that growth is in state income tax receipts, which increase by 13.5 percent.

Non-tax revenues including fees, charges, lottery and other receipts are expected to decline slightly under current law. Transfers from other funds decline by over $1.1 billion from the current biennium, reflecting one-time transfers of over $1 billion in revenues from the tobacco funds and other funds.

Two-thirds ($1.4 billion) of projected spending growth in FY 2006-07 occurs in the health and human services area. Spending for the state's largest budget component, E-12 education, is almost unchanged as the per pupil unit formula remains constant and enrollments continue to decline. Spending for all other areas including higher education, local aids, and criminal justice increases by 7.1 percent.

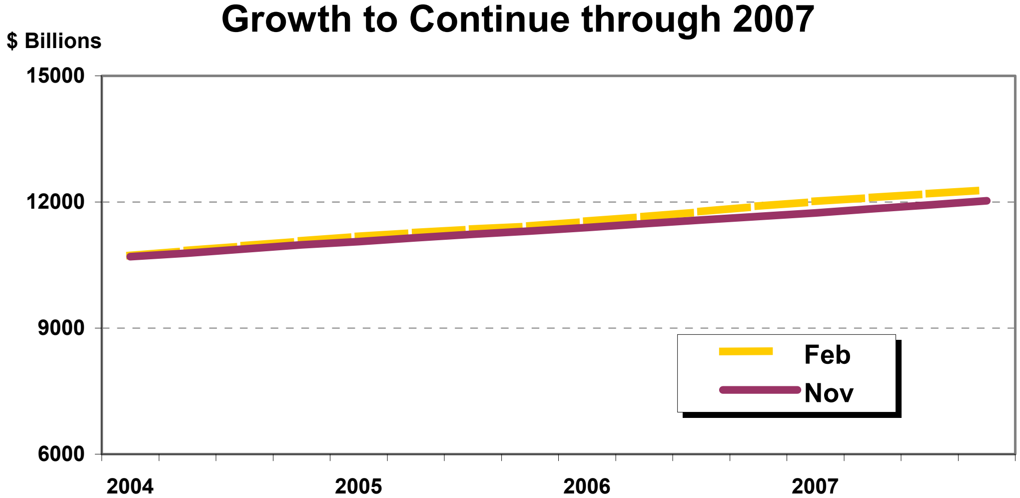
2004 Was a Very Good Year for the U.S. Economy

Economic forecasters had been looking for 2004 to be a very good year, and to this point they have not been disappointed. Although real GDP growth is unlikely to reach the lofty levels some envisioned at the start of the year, the U.S. economy has performed well and the current consensus forecast of 4.4 percent real growth is similar to growth rates seen in the good years of the late 1990's. While higher oil prices and higher interest rates, and some concerns over global growth and international trade have signaled most forecasters to trim back expectations for 2005 and beyond, nearly all forecasters still call for the real economy to grow at annual rates in excess of 3 percent through the end of fiscal 2007. In the absence of a sizeable unexpected shock to consumer confidence, an extended period of sub-par growth appears unlikely, and a recession highly improbable.

Employment remains the chief concern. Forecasters welcomed results from October's payroll employment survey since it provided tangible evidence that the U.S. economy had regained its ability to produce the jobs needed to keep up with the natural growth of the work force.

November's baseline forecast from Global Insight Inc. (GII), Minnesota's national economic consultant, is very similar to the consensus forecast for 2005, 2006 and 2007. GII expects 2004's real GDP growth rate of 4.4 percent to be followed by real growth rates of 3.2 percent in 2005, and then 3.0 percent in 2006 and 3.1 percent in 2007. These growth rates are more than 0.5 percentage points below February's projected real growth rates of 3.8 percent, 3.6 percent, and 3.7 percent.

Global Insight Expects Strong Real GDP Growth to Continue through 2007



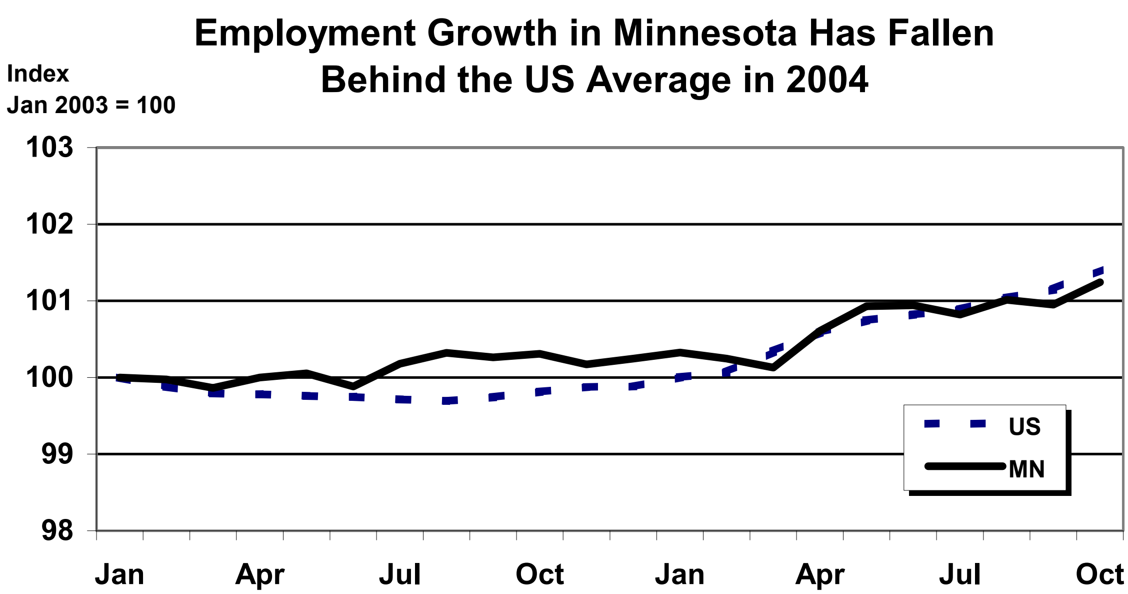
GII assigns a 60 percent probability to their baseline forecast. A slightly more optimistic scenario in which oil prices are lower and productivity higher is assigned a 20 percent probability as is a more pessimistic scenario. In the pessimistic scenario higher oil prices and higher inflation cause the Federal Reserve to tighten beyond levels assumed in the baseline forecast. The economy "does not sink into recession…but merely fails to come as close to its potential as in the baseline," growing by just 2.1 percent in 2006.

Job Growth in Minnesota Again Appears to Be Lagging Behind That in the U.S.

Minnesota's economy appears to be performing as forecast. Unfortunately, strong employment growth in Minnesota was not in the forecast. Through the end of the third quarter of calendar 2004 wage growth and employment growth in Minnesota were identical to the forecast. U.S. employment and wages have grown faster than forecast and faster than Minnesota. Nationally, total wage and salary income is now expected to grow by 4.5 percent in calendar 2004. The current forecast for Minnesota wage growth calls for 4.1 percent growth, the same as projected in February.

Employment has grown in Minnesota during 2004. Thus far this year we have added 24,000 jobs. In calendar 2003 Minnesota payroll employment increased by only 8,600. Minnesota's unemployment rate of 4.3 percent continues well below the national average, but through October U.S. employment grew by 1.4 percent in 2004, while Minnesota employment has grown by 0.9 percent.

Manufacturing employment in Minnesota continues to grow slowly from its August, 2003 low point. At that time state manufacturing employment was down 55,000 from its pre-recession high. In October manufacturing employment was up by 9,400 jobs from its August 2003 low, but still more than 46,000 jobs below its peak level.



State Revenue Outlook for Current Biennium Improves by $455 Million

Minnesota's general fund revenues are now forecast to total $28.673 billion, $455 million (1.6 percent) more than end-of-session estimates. The forecast for non-dedicated revenues grew by $406 million or 1.5 percent. More than 46 percent of the positive revenue variance occurred in fiscal 2004 when receipts were $210 million more than forecast.

Current forecasts for the individual income tax and the corporate income tax exceed end-of-session estimates. The sales tax, the motor vehicles sales tax, and the statewide property tax are projected to fall short of earlier projections by modest amounts. The forecasts for other tax and non-tax revenues also exceed earlier projections due to higher expected receipts from the insurance gross premium tax and mortgage and deed taxes. Growth in the individual income tax was the source of more than 80 percent of the additional revenue.

2004-05 General Fund Revenues

($ in Millions)

	End of Session	November Forecast	$ Change	% Change
Revenues				
Income tax	$11,456	$11,819	$362	3.2
Sales Tax	8,314	8,300	(13)	(0.2)
Corporate Income	1,386	1,393	7	0.5
Motor Vehicle	571	540	(31)	(5.5)
Statewide Property	1,221	1,217	(4)	(0.4)
Major Taxes	22,948	23,269	321	1.4
Other Non-Dedicated	3,739	3,824	85	2.6
Non-Dedicated Revenues	**26,687**	**27,093**	**406**	**1.5**
Transfers, Other	1,531	1,580	49	3.2
Total	**$28,218**	**$28,673**	**$455**	**1.6**

FY 2006-07 Revenues Up $254 Million from End-of-Session Planning Estimates

State revenues in the 2006-07 biennium are forecast to be $29.477 billion, a $254 million increase (0.9 percent) over end-of-session estimates. An improved outlook for the individual income tax receipts more than offsets lower forecasts for the sales tax, the corporate income tax and the motor vehicle sales tax. An increase in projected receipts from other taxes and non-tax receipts provides a further boost to projected revenues in the coming biennium. The forecast for individual income tax receipts was $280 million more than end-of-session estimates.

FY 2006-07 Revenue Forecast

($ in Millions)

	End-of Session	November Forecast	$ Change	% Change
Revenues				
Income tax	$13,132	$13,412	$280	2.1
Sales Tax	8,770	8,733	(37)	(0.4)
Corporate Income	1,522	1,380	(142)	(9.4)
Motor Vehicle	594	550	(44)	(7.3)
Statewide Property	1,269	1,289	20	1.6
Major Taxes	25,287	25,364	77	1.4
Other Non-Dedicated	3,582	3,699	117	3.3
Non-Dedicated Revenues	**28,869**	**29,063**	**194**	**0.7**
Transfers, Other	354	414	60	17.0
Total	**$29,223**	**$29,477**	**$254**	**0.9**

Revenues Expected to Grow 2.8 Percent in 2006-07 Biennium

Total revenues for the 2006-07 biennium are projected to grow by 2.8 percent over 2004-05 biennium receipts. Non-tax revenues decline by 4.1 percent, while other revenues and transfers fall by 74 percent from FY 2004-05 levels. Tax revenues grow by 7.9 percent.

2006-07 General Fund Revenue Growth

($ in Millions)

	FY 2004-05	FY 2006-07	$ Change	% Change
Revenues				
Income tax	$11,819	$13,412	$1,592	13.5
Sales Tax	8,300	8,733	433	5.3
Corporate Income	1,393	1,380	(14)	(1.0)
Motor Vehicle	540	550	10	1.9
Statewide Property	1,217	1,289	72	5.9
Other Taxes	2,358	2,294	(63)	(2.7)
Taxes	**25,627**	**27,658**	**2,031**	**7.9**
Non-Tax Revenues	1,466	1,406	(60)	(4.1)
Other, Transfers	1,580	414	(1,166)	(73.8)
Total Revenues	**$28,673**	**$29,477**	**$805**	**2.8**

The large discrepancy between the growth rate for tax revenues and that shown for total revenues is explained by the use of one-time transfers to balance the 2004-05 budget. Transfers in FY 2004-05 included a $1.031 billion one-time transfer of tobacco funds.

Individual income tax revenues show the most growth in the 2006-07 biennium, up $1.592 billion (13.5 percent) from 2004-05 levels. The modest growth in net sales tax revenues is partially attributable to expiration of supplemental sales taxes on liquor and rental cars in 2006. Other tax revenues fall primarily due to lower mortgage and deed tax receipts. Higher interest rates bring the home mortgage refinancing boom to an end, leaving a projected decline of $136 million in mortgage tax receipts.

FY 2004-05 Spending Down $34 Million from Prior Estimates

General fund spending for the current biennium is forecast to be $27.921 billion, down $34 million from end-of-session estimates after adjusting for the Governor's executive actions to eliminate the $160 million shortfall forecast in February.

A $39 million projected increase in health and human services spending is driven largely by higher caseloads and higher average costs in health care programs. E-12 education spending increased $25 million due primarily to slightly higher pupil unit estimates.

All other changes provide a net $98 million reduction from previous forecasts. Debt service payments are down $36 million reflecting savings from recent bond sales, and estimated program cancellations of $39 million now expected in the higher education financial aid and tuition reciprocity programs account for most of the change.

FY 2004-05 Expenditure Forecast

($ in Millions)

	End of Session	November Forecast	$ Change	% Change
E-12 Education	$11,759	$11,784	$25	0.2
Higher Education	2,561	2,542	(19)	(0.7)
Property Tax Aids & Credits	2,778	2,808	30	1.1
Health & Human Services	7,206	7,245	39	0.5
Criminal Justice	1,440	1,437	(3)	(0.2)
Debt Service	625	589	(36)	(5.8)
All Other	1,586	1,516	(70)	(4.4)
Total Spending	**$27,955**	**$27,921**	**$(34)**	**(0.1)**

The education finance spending estimates shown above are ***before*** the $118 million in additional spending required to buy back a portion of the school aid payment shift. The shift buy back increases E-12 education spending in 2004-05 by $118 million. The revised total for E–12 education, $11.902 billion, is used in comparative tables throughout the remainder of this forecast document.

FY 2006-07 Expenditure Forecast Increases by $556 Million

Expenditures for the 2006-07 biennium are forecast to total $30.177 billion, $556 million more than end-of-session planning estimates. Increased health care and human services spending accounts for $309 million of the increase, while an enrollment adjustment in higher education largely accounts for $205 million of the remaining increase in projected current law spending.

FY 2006-07 Expenditures Forecast

($ in millions)

	End of Session	November Forecast	Change	Percent
E-12 Education	$11,934	$11,969	$35	0.3
Higher Education	2,548	2,753	205	8.0
Property Tax Aids & Credits	2,976	2,966	(10)	(0.3)
Health & Human Services	8,375	8,684	309	3.7
Criminal Justice	1,527	1,569	42	2.8
Debt Service	712	721	9	1.3
All Other	1,465	1,442	(23)	(1.6)
Subtotal	**29,531**	**30,103**	**571**	**1.9**
Dedicated Expenditures	90	75	(15)	(16.7)
Total Expenditures	**$29,621**	**$30,177**	**$556**	**1.9**

The $309 million increase in health and human services spending forecast for FY 2006-07 occurs primarily within programs that provide basic health care to low-income individuals and families, and is driven by both higher enrollment projections and average cost growth. Many compounding factors contribute to this increase, and much of it begins in the current year. These increases in health care programs in 2005 lead to higher growth in the next biennium.

Revised assumptions for the enrollment implications of new eligibility determination processes being undertaken by the Department of Human Services also accounts for a significant increase in the forecast. A higher percentage of enrollees are now expected to move from the separately financed MinnesotaCare program to general fund-financed Medical Assistance or General Assistance Medical Care. This results in $53 million of the $309 million increase. This shift creates largely offsetting savings in the health care access fund, which is now projected to have a balance of $226 million by the end of FY 2007.

FY 2006-07 Projected Spending Grows $2.139 Billion

Current law spending for the FY 2006-07 biennium is projected to increase by $2.139 billion, (7.6 percent) from 2004-05 biennium spending levels.

FY 2006-07 Expenditure Growth

($ in Millions)

	FY 2004-05	FY 2006-07	$ Change	% Change
E-12 Education	$11,902	$11,969	$67	0.6
Higher Education	2,542	2,753	211	8.3
Property Tax Aids & Credits	2,808	2,966	158	5.6
Health & Human Services	7,245	8,684	1,439	19.9
Criminal Justice	1,437	1,569	132	9.2
Debt Service	589	721	132	22.4
All Other	1,516	1,515	(1)	(0.1)
Total Spending	**$28,039**	**$30,177**	**$2,139**	**7.6**

Health care spending for low-income families and individuals continues to be the most significant increase in of the budget. Of the $2.1 billion total growth in state spending from FY 2004-05 to FY 2006-07, two-thirds is in public health care programs. While these programs face the same health care cost inflation as the private health care market does, the growing number of program participants further adds to spending increases. Spending in health care and human service programs is now projected to grow $1.4 billion (20 percent) over levels expected in the 2004-05 biennium.

Declining E-12 enrollments and no change in the per pupil formula leaves E-12 education spending growth at less than one percent. Higher education spending increases 8 percent, reflecting statutory enrollment adjustments for the University of Minnesota and MnSCU. Criminal justice spending is expected to increase at just over 9 percent due to growing costs in corrections and courts caused by continuing growth in inmate populations and the completion of the state takeover of district courts. All other spending declines slightly, reflecting the projection of the remainder of the operating budget at FY 2005 funding levels.

Planning Estimates Provide Guidelines for Future Budget Outlook

This report provides the first revenue and expenditure planning estimates for the 2008-09 biennium. These planning estimates provide a necessary framework against which the potential impact of FY 2006-07 budget decisions can be judged. Projected revenues for FY 2008-09 reflect the trend of continued growth forecast for the 2006-07 biennium.

The planning estimates do not include any tax or spending decisions beyond those in current law. Current law spending estimates have been adjusted only to reflect enrollment and caseload growth in entitlement programs and areas where specific statutory formulae exist. The expenditure and revenue planning estimates make no assumptions about the Governor's proposed budget or legislative action in the 2005 session to remedy the budget shortfall forecast for FY 2006-07. The FY 2008-09 planning estimates represent a benchmark to determine if ongoing spending exceeds revenues in succeeding budget periods. Economic changes, as well as the amount and timing of budget changes, will materially affect both revenue and expenditure projections for the FY 2008-09 biennium.

Budget Planning Estimates

($ in Millions)

	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Forecast Revenues	$14,173	$14,470	$15,007	$15,564	$16,252
Projected Spending	14,439	14,955	15,223	15,524	15,802
Difference	**(266)**	**(485)**	**(216)**	**40**	**450**

Since a general adjustment for inflation is not included in the expenditure projections, it is important to recognize that, given historical growth trends in state spending, potential increases in state spending may be significantly greater than those shown. Projected inflation in the planning horizon is now expected to be 1.5 and 1.6 percent for FY 2006 and FY 2007, with 1.8 and 2.0 percent forecast for FY 2008 and FY 2009.

A complete version of the November 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

The November forecast establishes the starting point for FY 2006-07 budget considerations. It contains revised revenue and expenditure estimates for the current biennium based on the most recent information about the national and state economic outlook, caseload, enrollments, and cost projections. Additionally this forecast provides closing balances for FY 2004 and compares how actual revenue collections and expenditures in that year compare to end-of session estimates.

The revised forecast for the current FY 2004-05 biennium is followed by the first complete forecast for the next budget period, FY 2006-07, and by revenue and expenditure planning estimates for FY 2008-09. 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.

Revenue estimates for the current year and the next biennium are based on econometric models that forecast the Minnesota economy. Those models are driven by a national economic forecast provided by Global Insight Incorporated (GII).

The GII baseline forecast is then reviewed by Minnesota's Council of Economic Advisors. Their 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 2008-09 come from slightly less complex models and are driven entirely by the longer term national economic outlook provided by GII. No Minnesota specific forecast is used.

Expenditure estimates in most areas are shown at the level of the appropriations made during the 2003 legislative sessions, plus any authorized future spending increases. Entitlement programs –such as K-12 education, property tax aids, health care, and family support are forecast based on expected changes in eligibility, enrollment, and average cost. No general adjustments for inflation were made in future spending.

The difference between the forecast and the budget process is clearly defined, but often confused. The forecast does not reflect the Governor's budget recommendations or potential legislative action, only current law. Presentation of the current law forecast for various areas will likely be accompanied by a discussion of possible future legislative changes. The forecast presents only a current law framework for those discussions. A forecast increase in spending for any area in the current biennium or the next biennium does not preclude the governor or the legislature from proposing budget changes that would lead to significantly different spending levels than are shown in this forecast.

Economic Summary

October's payroll employment report was just what was needed to brighten the economic outlook for 2005. By most measures the economy had been performing acceptably, but ever increasing oil prices coupled with five months of tepid jobs growth had raised questions about this expansion's strength and durability. Only a few perennial pessimists were seeing signs of a possible recession, but many others were beginning to wonder whether an extended period of sub-par growth was on the way. Discovering that the U.S. economy had added 337,000 jobs in October and that both August and September's employment growth had been stronger than previously reported removed much of that concern. Even though October's gain was undoubtedly hurricane affected, the payroll employment report appears to be signaling that the economic recovery has gone beyond the soft patch and is once again on firm ground.

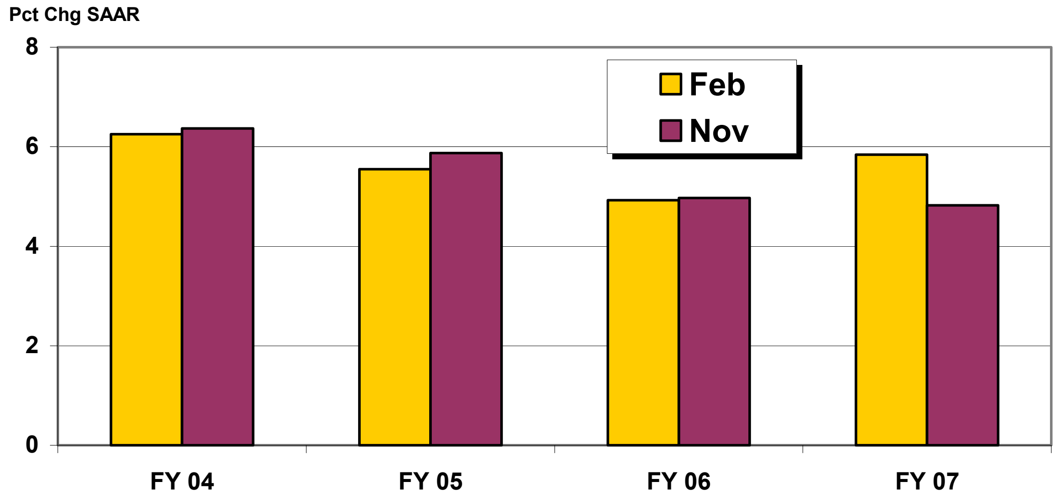
It is not that economists have nothing to worry about. The outlook for the federal budget deficit is depressing, the trade deficit is unsustainable, and the decline in the value of the dollar is likely to continue. Interest rates are on the way up, and those higher interest rates will reduce demand for residential construction. Some of this year's strong auto sales were likely borrowed from future. And, higher energy prices are expected to produce a further drag on consumer spending for at least the remainder of 2004.

Given those concerns and others, few anticipate a return to the boom years of the late 1990s any time soon. Those days are gone. Steady, sustained growth averaging slightly over three percent at an annual rate is now the consensus forecast for 2005 and beyond.

November's baseline forecast from Global Insight Inc. (GII), Minnesota's national economic consultant, is consistent with the consensus outlook for real GDP growth. GII expects real GDP growth rates of 3.2 percent in 2005, followed by 3.0 percent growth in 2006 and 3.1 percent real growth in 2007. The Blue Chip Consensus for real growth for the 2005-07 forecast horizon is slightly stronger, but differences between their forecast and the Global Insight forecasts are not material. The current forecasts for real GDP growth from both the Congressional Budget Office and the federal Office of Management and Budget are also very similar to GII's projections.

Even though inflation in 2004 has been well above the level forecast at the start of the year, GII remains optimistic about the outlook for 2005 and beyond. November's baseline forecast calls for the CPI to increase by 2.2 percent in 2005. Then, as oil prices begin to recede in 2006 and 2007 CPI growth drops to just 1.3 percent and 1.7 percent. As has been true for some time, GII's forecast for inflation is more optimistic than consensus for the entire forecast horizon. However, GII's oil price outlook is more pessimistic. They now expect oil prices to hold near $50 per barrel through the summer of 2005, and average $46 per barrel for the entire year. Oil prices in 2006 and 2007 are projected to average $36 and $35 per barrel, respectively.

**Slightly Higher Inflation Offsets Outlook for Slower Real Growth--
Nominal GDP Growth Rates Largely Unchanged**



GII assigns a probability of 60 percent to their baseline forecast An optimistic scenario in which total factor productivity is stronger and exports grow more rapidly than in the baseline is assigned a 20 percent probability as is a more pessimistic scenario where a combination of a falling dollar, a doubling of oil prices, and a lack of production capacity feeds further growth in inflation. In that scenario, by midsummer 2005 core inflation is at 3 per cent and the Fed accelerates its pace of tightening. The fed funds rate reaches 4.5 percent by the end of 2005, 150 basis points higher than in the baseline, and the economy weakens. While growth in the pessimistic alternative is slower than in the baseline, there is no recession.

Members of Minnesota's Council of Economic Advisors and Finance Department economists agreed that the November GII baseline forecast reflects the consensus short-term outlook. One council member noted that the forecast was "absolutely achievable" and "very middle of the road." Although most the personal forecasts of most council members were modestly more optimistic for 2005 than Global Insight, all were comfortable with the November baseline.

Council members believed that there was an equal risk that the economy would outperform the forecast as that it would fall short of projections. While the federal budget deficit and the trade deficit are a major concern for many of the Council, all see those items as longer term issues, and very unlikely to affect the outlook for 2005 or 2006.

The recent behavior of oil prices was an item of considerable interest and discussion, with most members noting that energy prices had been stronger than they had anticipated at the start of 2004. The Council was not as pessimistic as GII about the oil price outlook. Most members expect oil prices to begin their decline earlier in 2005 than is projected in the GII baseline. GII's fed funds target of 3 percent at the end of 2005 was lower than the expectations of some Council members.

Finance Department economists indicated that they would follow the same procedure as they did two years ago and base the revenue planning estimates for 2008 and 2009 on the Global Insight November baseline forecast. The nominal GDP growth rates of 5.1 percent for 2008 and 5.2 percent for 2009 fall between those used by the Bush administration and those used by the Congressional Budget Office in their mid-range planning. The Blue Chip consensus expects nominal growth of 5.4 percent in 2008 and 5.3 percent in 2009. The GII baseline projects CPI growth of 1.9 percent in calendar 2008 and 2.1 percent in calendar 2009.

Council members continue to urge the state to maintain a budget reserve of 5 percent of biennial expenditures now when economic times are good. The state's budget under GAAP rules has moved dramatically from surplus to deficit in 2003, a shift that was noted by bond rating agencies. In addition to providing some insurance against future revenue shortfalls, restoring reserves will improve the states financial picture. The Council also recognized the flexibility afforded by risk management tools other than the formal reserve like the cash flow account or buying back spending shifts. The Council also continues to believe 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 future biennia.

ECONOMIC OUTLOOK

Last spring, surging oil prices gave consumers pause. Since then spending has rebounded, though only temporarily. GII expects high debt levels, gasoline prices, and anxiety over geopolitical unrest to gradually slow growth in consumer outlays. Already, a few signs of softening are emerging. Stores catering to lower income households report weak sales, and a poll of retailers leads Standard and Poor's to forecast less holiday sales growth than last year. But even if Christmas sales are disappointing, forecasters expect consumers to decelerate their spending only modestly in 2005 because receding oil prices and incomes from new jobs should ease some of their concerns. As consumers back off, rising capital outlays are expected to keep the economy strong.

If forecasters are right, consumers will slow their spending only selectively in 2005. Tight budgets and a weaker housing market will lead to decelerating outlays on purchased meals, autos, and goods for the home. No one, except an occasional doomsayer, is concerned because it seems the economy has successfully transitioned to a self-sustaining expansion led by rising business investment. Convinced growth will remain strong, the Federal Reserve has begun a series of gradual interest rate increases, which Dr. Greenspan hopes will head off accelerating inflation. GII indicates the absence of significant consumer inflation is the single best indication the expansion will proceed uneventfully though, of course, there are always risks.

Short term upside and downside potential seems balanced. On the upside, exports could strengthen and job growth could accelerate. In addition, companies have a large cash hoard, so they are in a good position to increase investment outlays once capacity bottlenecks appear. On the downside, there are two major risks. The principal concern is that a geopolitical shock will cause still relatively high oil prices to stop receding or even rise, damping both consumer spending and business investment. In a GII simulation, oil some 10 dollars higher than currently would reduce 2005 real GDP growth by about 0.3 percentage point, but that is nowhere near a recession. The other risk is posed by a declining dollar, which *Business Week* reports has begun to weaken bond markets.

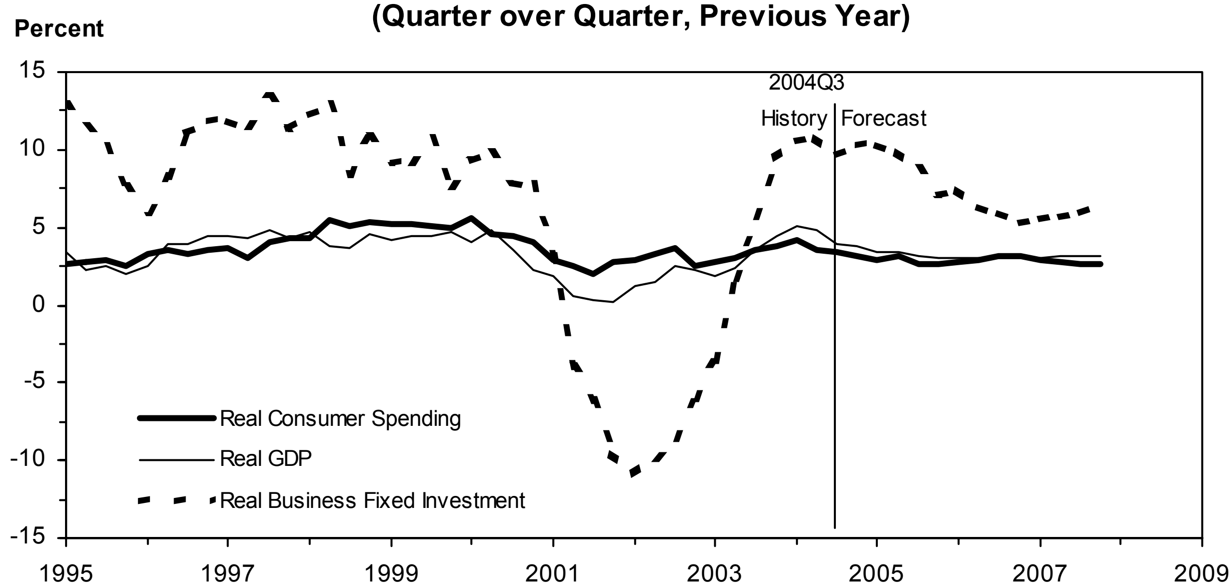
The most worrisome risks are long term. Both the federal budget deficit and the trade deficit are not indefinitely sustainable. Left unchecked, the budget deficit could lead to accelerating inflation, rising long-term interest rates, and slow GDP growth, a so-called stagflationary situation which would not readily respond to monetary or fiscal policy changes. Stagflation would also leave the economy vulnerable to financial market turmoil caused by a plunge in the dollar. A *Wall Street Journal Online* survey indicates a majority of economists rate the budget deficit their top concern, ahead of the dollar, the trade deficit, the job market, federal tax overhaul, and Social Security and Medicare changes. Oil is not considered a long-term risk because eventually supply increases and conservation measures should drive prices down.

A Self-Sustaining Expansion

One year ago, the economy was led by consumer spending driven by low interest rates, tax cuts, rising federal outlays, and cash infusions from mortgage refinancings. Now, the expansion has become self-sustaining with accelerating business capital outlays leading the economy and consumers taking a critical supporting role. The November baseline assumes rising exports will also begin to make a contribution in 2005, though GII notes disappointing slippage in the export orders component of the Institute for Supply Management manufacturers survey. Most analysts agree current energy prices will not derail the expansion, but U.S. growth will slow if prices remain high throughout 2005.

GII's November baseline assumes consumer spending growth slows only a little in 2005. Many people seem to have shrugged off higher gasoline prices, but the reaction to this winter's heating bills remains to be seen. GII estimates that in 2004 annual energy consumption per household is up almost $700 or 22 percent from 2002. The baseline assumes consumers perservere until relief arrives. That should come gradually in 2005 first as hurricane damaged facilities in the Gulf of Mexico are repaired and later as new crude supply becomes available.

Business Capital Outlays Are Now Leading The Expansion
(Quarter over Quarter, Previous Year)



One year ago, the economy was led by consumer spending driven by low interest rates, tax cuts, rising federal spending, and cash infusions from mortgage refinancing. Now, business capital outlays are leading a self-sustaining expansion.

Are Oil Prices Really Headed Down?

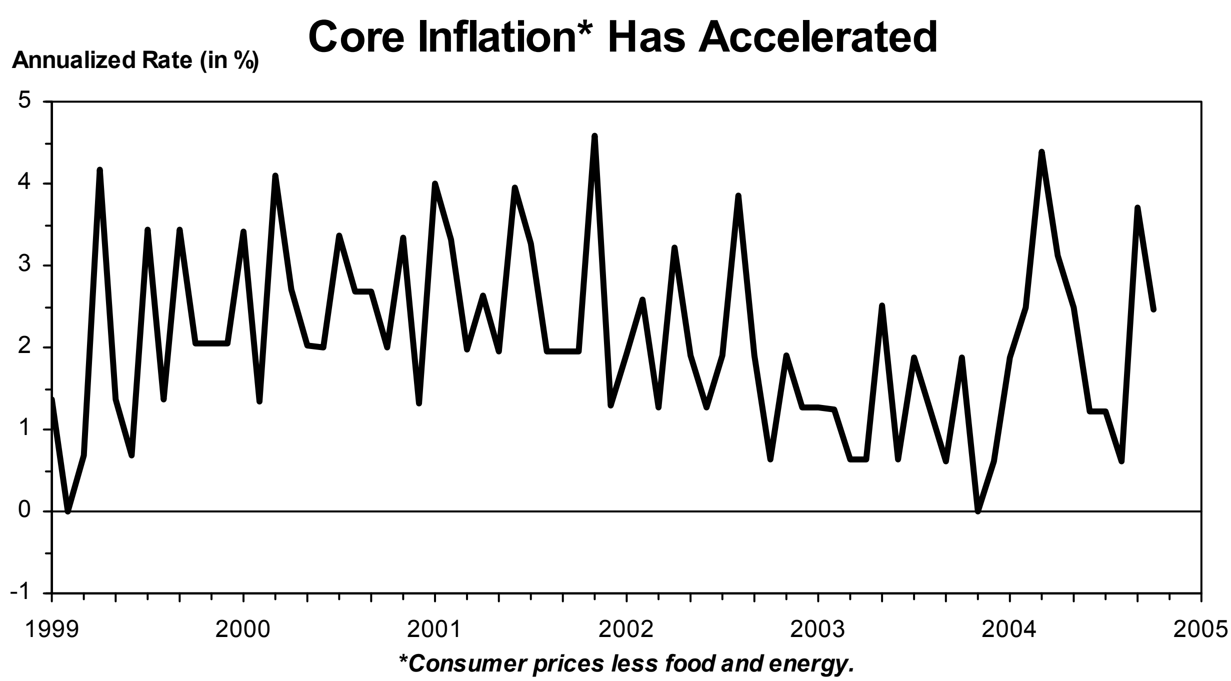
When the hurricanes came, world oil prices were already up. The good news is the run-up is the best possible kind, namely one caused by strong global demand, rather than by producer imposed supply constraints. Much of the additional demand came unexpectedly from China and India whose surging economies are now major players in world markets.

West Texas Intermediate Crude (WTI) now selling for almost $50 a barrel fetched only $11 in December, 1998, so producers appear to have strong incentive to invest in additional capacity. *Business Week* reports that, already, private equity available for North American exploration is double its level of three years ago. So, some new oil and gas supply from domestic sources should gradually appear on the market. That alone will be far from enough, so additional supply from politically unstable countries overseas is also needed, but much more uncertain. A recent Wall Street Journal article reports increased drilling in Saudi Arabia, a good sign.

Unless geopolitical risk becomes reality, GII expects oil prices to slowly decline as supply increases. Their November baseline scenario has WTI at $35 per barrel in mid-2007, compared to almost $50 currently.

The Fed is Nudging Interest Rates Up

Convinced a durable expansion is underway, the Federal Reserve shifted its attention to inflation, raising short-term interest rates 100 basis points in four installments beginning June 30. Virtually all observers agree more increases are coming. That the financial markets remain undisturbed reflects the fact that the Fed has communicated its intentions clearly. And the markets know the current policy environment of still low interest rates and a large federal budget deficit is very stimulative and inconsistent with stable inflation. GII expects the Fed to raise the federal funds rate from the current 2.0 percent to 3.0 percent by the end of 2005, and to 3.5 percent one year later.



Over the past year, core inflation has accelerated. GII expects only a modest further increase as higher energy prices finish feeding into the costs of consumer goods and services. Much of that adjustment is already behind us.

Consumption

In GII's view, a very low saving rate and a high debt level indicate many household budgets are tight. So, it is no surprise that household outlays are decelerating. Consequently, for the first time since the late 1990's, real GDP growth is exceeding increases in real consumer spending. And consumer outlays should slow further this winter as relatively high gasoline, heating oil, and natural gas prices drain purchasing power.

In 2004, GII expects real GDP will increase 4.4 percent with consumer outlays rising 3.6 percent. In 2005, GDP should rise 3.2 percent while household spending increases 2.8 percent. And that subdued outlook assumes consumers have additional income from monthly employment gains averaging a seasonally adjusted 180,000. It also assumes there are no adverse shocks.

Some analysts think there is potential for a debilitating shock from the housing market. A *Fortune* article suggests rapid increases in home prices are part of a speculative bubble. The article points out that both the ratios of home prices to incomes and home prices to rents are well above historic norms. The shortfall in incomes and rents appears to make the housing market vulnerable to rising interest rates which might cause a sharp, widespread reversal in home prices. The resulting severe loss of wealth could then precipitate a consumer retrenchment.

There seems to be little consensus on this matter. In a forthcoming paper, Federal Reserve Bank of New York economists dismiss indicators of the housing market like those used by *Fortune*. Their structural model of the housing market leads them to conclude that housing prices have risen because of fundamentals including income increases and low mortgage interest rates. While conceding that housing prices have declined occasionally in the past, they have done so only modestly in recessions or when interest rates have been unusually high. If there is a decline, the Fed economists suggest it will happen along the east and west coasts where prices have risen sharply because of an inelastic housing supply. They note that past regional price declines have not significantly damaged the national economy.

Investment

As consumer spending growth slows in 2005, GII expects business investment outlays will pick up the slack. After declining for two years, real capital spending turned up in early 2003 and has accelerated since, but the pace is still tepid compared to earlier recoveries from recession. Money is not the reason since profits are strong and firms have accumulated a very large cash hoard.

It seems firms are being cautious for several reasons. A recent *Wall Street Journal* article indicates there is considerable anxiety about the economic outlook and uncertainty over the implications of rules imposed after the corporate accounting scandals. Other anecdotal reports suggest investment opportunities are not there because of existing excess capacity. Finally, some analysts expect oil prices will weigh heavily on the world economy, diminishing prospects for accelerating demand from China, India, Japan, and Europe.

Despite the caution, some forecasters think capital spending is now temporarily surging as the December 31 expiration date for bonus depreciation approaches, pulling some investment into 2004 from 2005. But, no one is sure how much difference this tax break is making. GII assumes there is some pulling-ahead into 2004, but notes that since there seems to be no evidence of this in manufacturer's orders, any surge will have to come from inventories.

Government

Projections by both the Congressional Budget Office and GII show large federal budget deficits for at least the next 5 years. Expenses for existing programs outstrip revenue estimates based on most likely growth assumptions.

Though projected deficits are not as high relative to GDP as the record-setter of 1983, economists are concerned because they are large and are likely to persist year after year. That much fiscal stimulus for an extended period will almost certainly cause aggregate demand to outstrip supply sooner or later. Likely consequences are accelerating inflation, rising interest rates, private capital formation crowded out by government borrowing, and slower GDP growth.

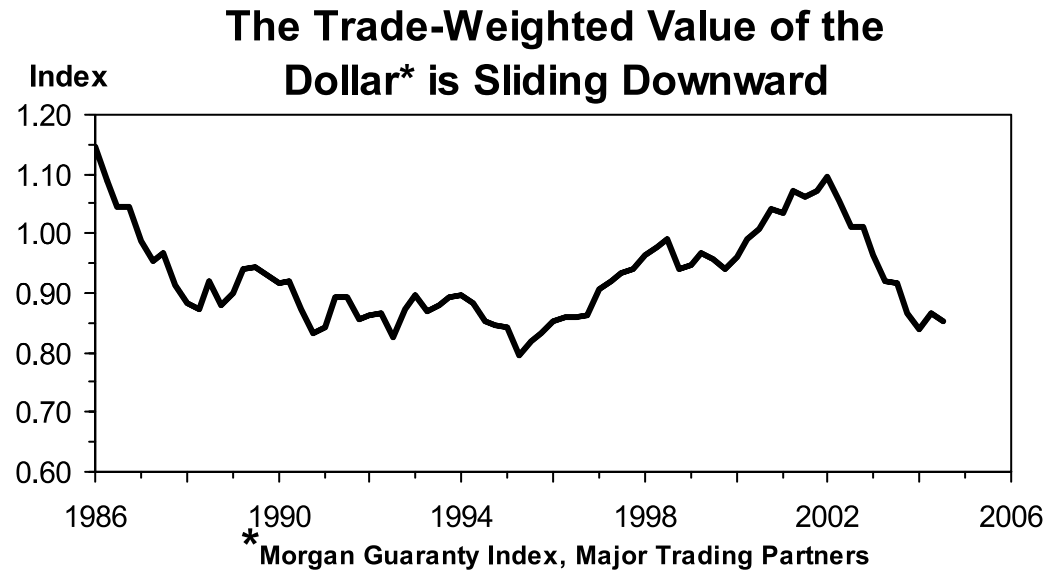
So, it is no surprise that Dr. Greenspan is urging Congress to restore the 1990's deficit control rules which required additional tax cuts and new spending to be offset by increased taxes or reduced spending elsewhere. That would be a start, but not enough because so-called "paygo" applies only to new initiatives, not existing programs. To solve that problem, Dr. Greenspan is proposing "triggers" which would automatically reduce existing tax breaks and benefits like Medicare and Social Security if they exceed expected costs.

The *Wall Street Journal* summed up the reaction by quoting one Congressman as saying, "Trigger is a horse." But, the Congressman spoke before the election. In the November baseline, GII assumes Congress will one way or another hold expenditures to about 20 percent of GDP. That, plus somehow tinkering with personal taxes so as to gradually raise receipts from about 17 percent of GDP currently to about 19 percent is enough to slowly reduce the projected deficit to 275 trillion dollars in fiscal 2009, down from some 413 trillion in 2004.

International

In coming months, oil prices may become a significant drag on a currently strong world economy. A few signs of softness seem to be emerging in Europe and Asia, and the International Monetary Fund recently lowered its world growth projection for 2005. No one is sure how much impact there ultimately will be, but a serious global slowdown would reduce U.S. export growth, further worsening a record trade deficit inflated by high imported oil prices.

The deficit is financed by offsetting foreign purchases of dollar denominated securities, primarily Treasury issues as well as some U.S. stocks and corporate bonds. So far, the Federal Reserve has not needed to raise interest rates to attract foreign buyers, in part because much of the Treasury buying is being done by the central banks of China and Japan who are eager to slow the dollar's decline.



Driven by a record and growing trade deficit, the dollar is slipping downward in a manner reminiscent of its decline in the late 1980's. Many analysts believe only central bank intervention from China and Japan is keeping the dollar's decline orderly. A sharp plunge in the dollar could force foreigners to dump their U.S. stocks and bonds with potentially disastrous consequences.

So far, the banks seem successful. The dollar is slipping downward in an orderly manner reminiscent of its decline between 1985 and 1990. Consequently, it is unclear when foreigners might become concerned about the diminishing value of dollar denominated investments and start dumping their holdings. However, *Business Week* reports that hedge funds are shorting the dollar and buying Asian currencies. That only confirms Dr. Greenspan's and most other economists' view of the current situation as unsustainable.

Even central bank intervention has limits, so it can only help temporarily. Most economists believe the central banks, especially China's, will soon let their currencies rise because there is no practical long run policy fix for the trade deficit. Ultimately, either exports rise enough to close the gap, or, more unlikely, import growth falls. If world demand for U.S. products does not rise sufficiently, then eventually the currency markets will force a solution by driving the dollar down drastically. In that case, foreigners would dump U.S. stocks and bonds, leading to sharply higher interest rates, and to significant inflationary pressures in the U.S. as the cost of imported goods rises. In the November baseline, the dollar trends downward, the financial markets remain calm, and rising exports halt the deficit's growth in 2005.

Monetary

After signaling its intentions for months, the Federal Reserve raised the federal funds rate 25 basis points on June 30. And there have been three increases since, leaving federal funds at 2.0 percent. Further increases are expected, though observers differ as to the timing. In the November baseline, GII has federal funds at 3.0 percent by the end of 2005, and 3.5 percent one year later.

Inflation shows few early signs of picking up, so higher interest rates may seem unnecessary. But, analysts note that still relatively low rates and a very large federal deficit are excessively stimulative when the economy is expanding fast enough to absorb excess capacity as is now the case. Unless policy stimulus is reduced, aggregate demand will eventually exceed supply and price increases will accelerate. Since short-term interest rates impact slowly with a lag of up to 18 months, they must be raised now if the economy is to slow as output approaches its maximum level consistent with stable inflation.

There has been speculation about Dr. Greenspan's ultimate goal for rates. Using macro-economic models or various calculations, some analysts have concluded that a 3.5 to 4.0 percent federal funds rate is "neutral" or "normal" in the sense that inflation would be stable in the absence of strong adverse shocks. However, a recent *Newsweek* article entitled "By The Seat of His Pants" points out that the Fed must make decisions without benefit of reliable rules or hard data. Most observers believe Dr.Greenspan will act as he subjectively judges necessary to pre-empt accelerating inflation.

Inflation

The Federal Reserve's attention has clearly shifted to pre-empting price increases which could end the expansion. Rising inflation erodes purchasing power and drives up interest rates as lenders demand compensation for the declining value of their money. Other things like a widespread decline in housing prices could also end the expansion, but inflation is much more a sure thing, and something policymakers have at least some control over.

Despite strong real GDP growth, an approximately 40 percent increase in oil prices, and a sinking dollar, consumer inflation shows few if any signs of accelerating. GII attributes that to competition, productivity growth, and the existence of excess industrial capacity. The sharp increase in producer prices in October is a wake up call, but is not likely to become a trend since most of the adjustment to higher energy prices has already occurred. In addition, competition among suppliers and retailers is expected to keep higher producer prices from moving into consumer prices. This year's bumper crops mean agricultural prices will also help moderate consumer inflation.

Dr. Greenspan's presumed success and currently favorable conditions lead GII to a sanguine outlook for inflation. In the November baseline, the consumer price index rises 2.2 percent in 2005 and 1.3 percent in 2006, down from an estimated 2.7 percent in 2004. Producer prices for finished goods rise 2.3 percent in 2005 and fall 0.7 percent in 2006, down from an estimated 3.5 percent in 2004.

MINNESOTA OUTLOOK

Minnesota's economy has matched last February's forecast, but encouraging jobs growth in October is not enough to indicate the expansion is accelerating. Unlike its national counterpart, Minnesota's jobs market was stagnant last summer and has yet to demonstrate the upward momentum which seems to be present in the national economy.

Other indicators suggest Minnesota's expansion will remain modest. Though job vacancies are up from a year ago, hiring only may have picked up in October, and seasonally adjusted initial unemployment claims have not improved since April. Home sales probably will set a record in 2004, but the real estate industry expects softening in 2005 as interest rates rise. A recent United Properties report indicates there are at last weak signs of improvement in office and commercial construction, but that industry will remain in the doldrums as long as high vacancy rates persist. In what is perhaps the best news from some greater Minnesota industries in a long time, one large paper mill has been sold to a buyer who will keep it open, and some idle Iron Range capacity is being put back to work. Finally, Minnesota manufacturing employment is once again slowly expanding.

A Revised Outlook

Minnesota's employment and wage forecasts have been revised to be consistent with changes to GII's November baseline as well as with recent experience. Expected employment growth is lower than forecast in February, while the outlook for growth in total wages over the 2005-2007 forecast horizon is virtually unchanged. In 2005, jobs are forecast to increase 1.0 percent, down from 1.4 percent in February. In comparison, expected U.S. employment growth is forecast at 1.7 percent, down from 2.3 percent. Total Minnesota wages are forecast to rise 5.3 percent compared to 5.2 percent in February. GII forecasts U.S. wages to rise 5.4 percent in 2005, down from 6.0 percent in February.

Recent experience helps explain much of the difference in the jobs outlook for the U.S. and Minnesota. November's U.S. employment report not only showed a big increase in seasonally adjusted jobs in October, but there were also significant upward revisions for August and September. October was probably distorted by the hurricanes, but most economists believe data for the two previous months shows the U.S. jobs market gained upward momentum during the summer. In Minnesota, jobs also increased sharply in October, but there were no significant gains in August and September. And part of October's increase seems to reflect shifting seasonality in local government employment. For those reasons, Finance Department economists conclude that Minnesota's jobs recovery continues to lag behind its U.S. counterpart, something which began earlier this year.

MINNESOTA OUTLOOK COMPARED TO THE U.S.

(Calendar Year Percent Changes)

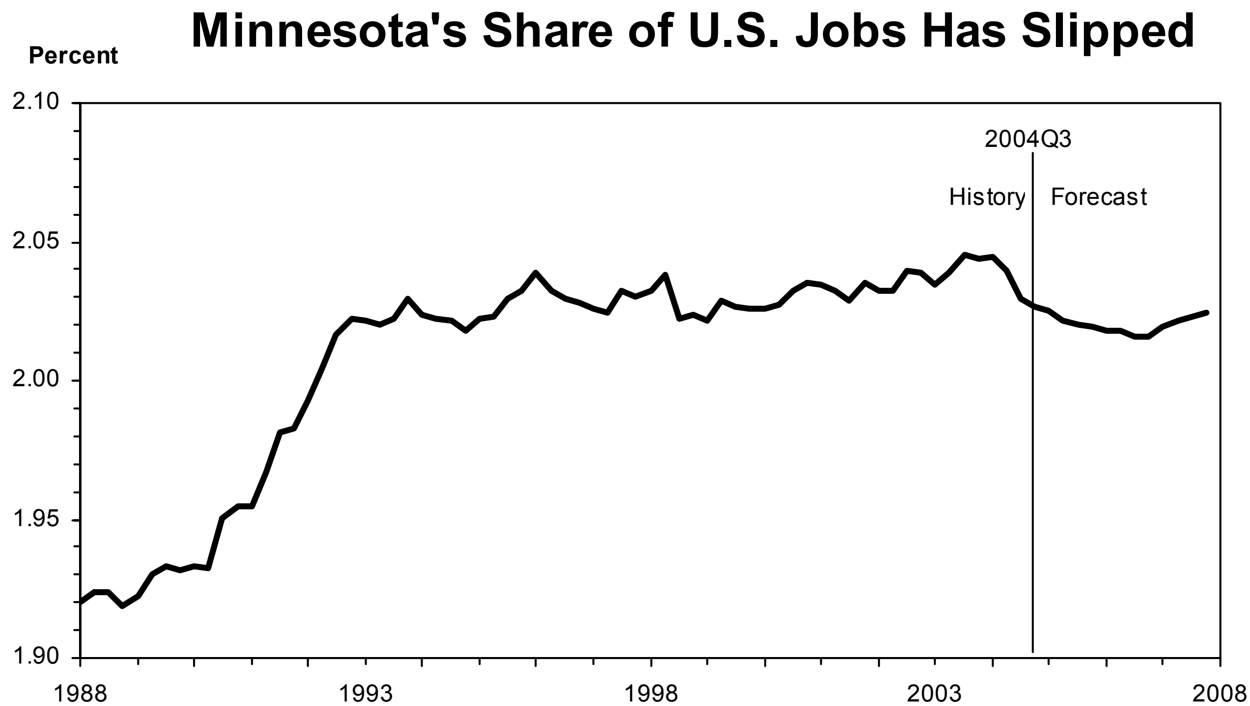
	2003	2004	2005	2006	2007
Non-Farm Employment					
Minnesota					
February 2004	-0.4	0.8	1.4		
November 2004	-0.1	0.8	1.0	0.9	1.1
United States					
February 2004	-0.3	1.1	2.3		
November 2004	-0.3	1.0	1.7	1.2	0.8
Wage and Salary Income					
Minnesota					
February 2004	2.8	4.1	5.2		
November 2004	2.7	4.1	5.3	4.9	5.0
United States					
February 2004	2.2	4.1	6.0		
November 2004	2.6	4.5	5.4	5.4	5.2

Wages are a happier story. Minnesota’s income tax withholding data indicates wage growth generally consistent with last February's forecast. That performance is a major reason the wage forecast for 2005 is unchanged, though coupled with a lower jobs outlook it implicitly assumes stronger productivity growth than in February.

Minnesota's Job Share Slips

Preliminary data indicate that after performing at or slightly above the national rate for more than 10 years, Minnesota's job growth slipped a little behind the U.S. in 2004. Natural resources and mining, transportation and warehousing, financial activities, information, leisure and hospitality, professional and business services, and state and local government all showed some slippage.

A quick recovery seems unlikely because such a broadbased downturn probably has multiple causes. Finance Department economists note that possibly Minnesota’s share is returning to the largely inexplicable volatility of the 1980's. But, it seems more likely that recent developments in some industries are the result of competitive forces, while in others the slippage may be associated with the sharp downshift in Minnesota population growth which occurred in 2001. In the view of Finance Department economists, that demographic change should have observable impacts sooner or later.

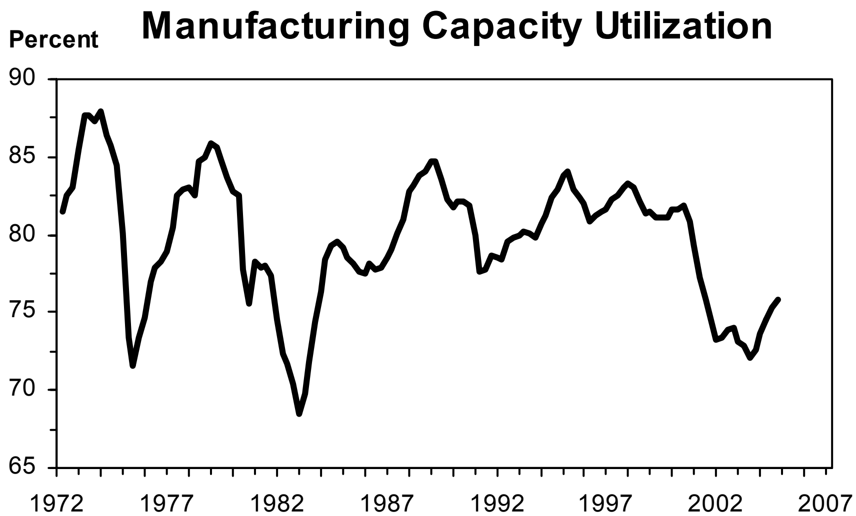


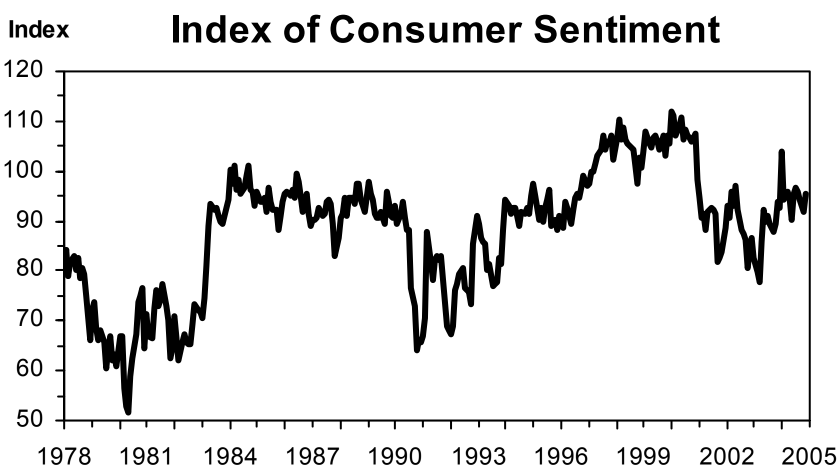
Preliminary data indicate Minnesota's job growth slipped behind the U.S. in 2004. A quick recovery is unlikely because several major industries participated in the downturn, including state and local government.

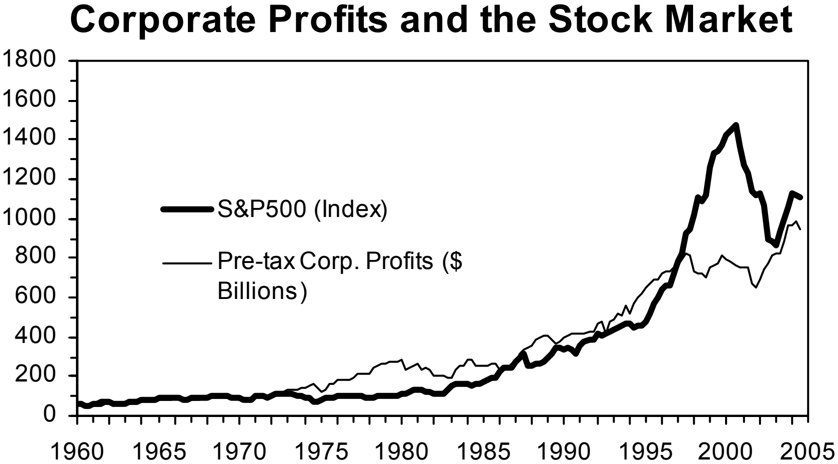
Some Key Assumptions

As in previous forecasts, the Minnesota outlook has some state specific assumptions in addition to assumptions about the U.S. embedded in GII's November baseline. The principal reason for the additional assumptions is that the Finance Department model of the Minnesota economy is heavily dependent on industry wage and employment data. The most important assumptions are that the state's manufacturing industry continues to add jobs and outperform its national counterpart, that the current slowdown in mortgage refinancing and the coming softening in housing does not cause a significant decline in financial services employment, and that there is enough housing activity to sustain current levels of construction jobs until commercial building picks up. Finally, the outlook assumes local government budgets ease enough to permit modest increases in public employment beginning in 2005's third quarter.

Selected National Economic Indicators







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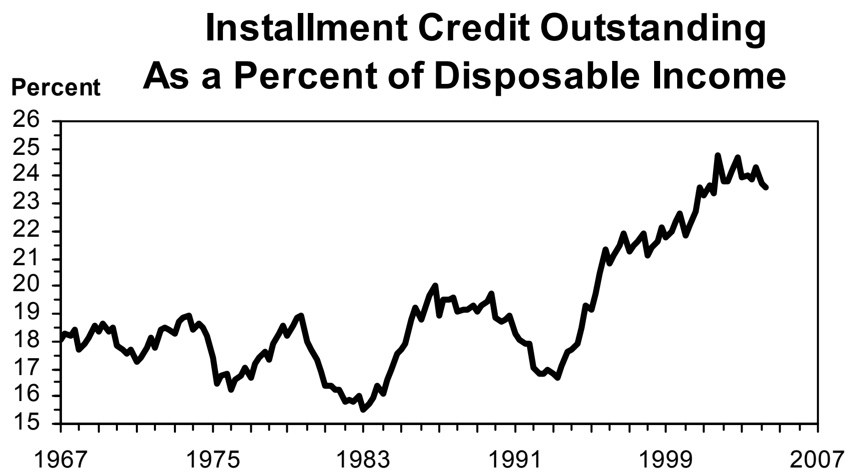
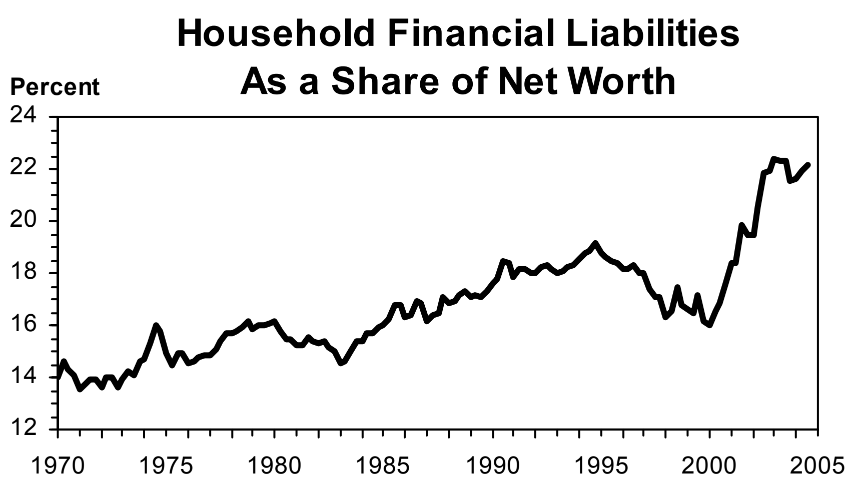
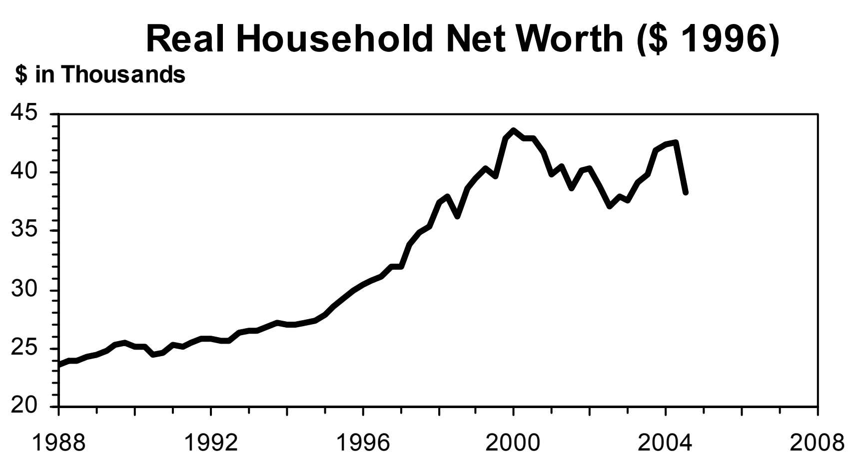
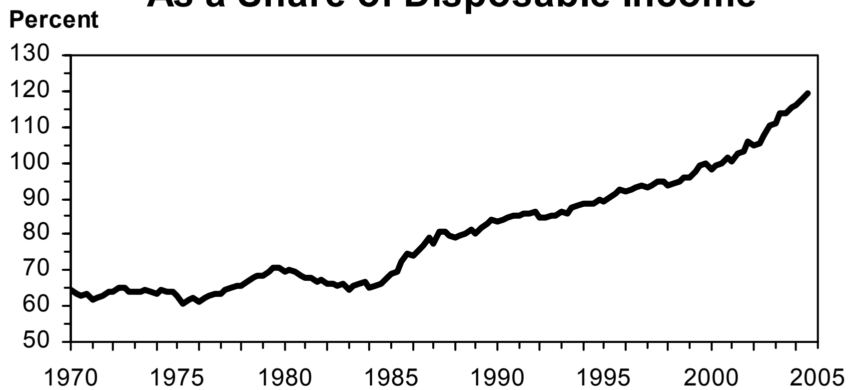




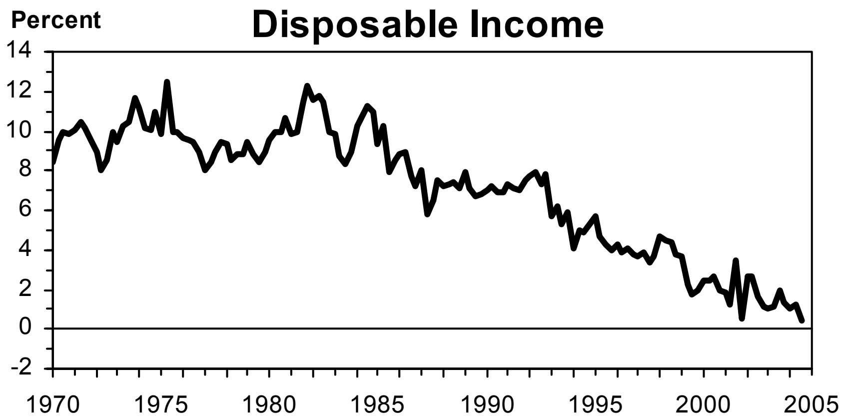


Selected National Economic Indicators

Household Financial Liabilities As a Share of Disposable Income

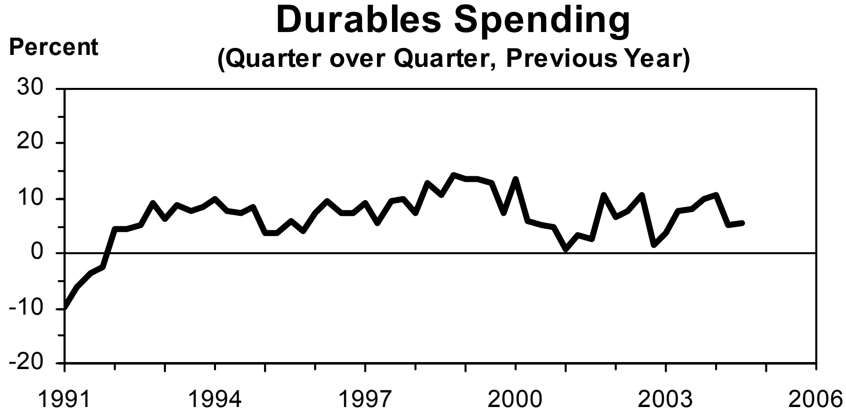


Saving as a Fraction of Disposable Income



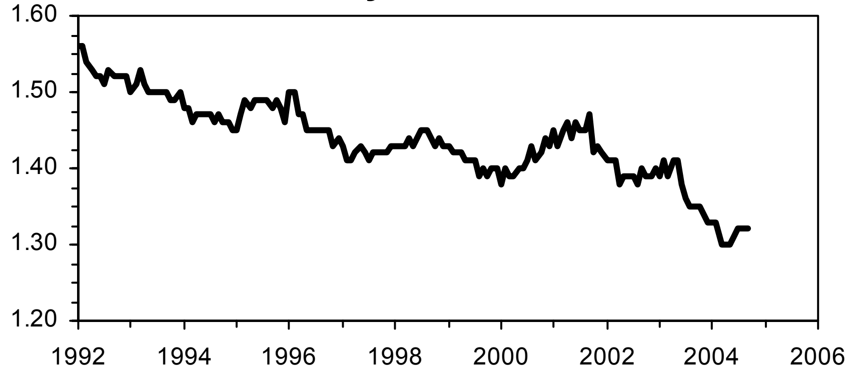
Growth in Real Consumer Durables Spending

(Quarter over Quarter, Previous Year)

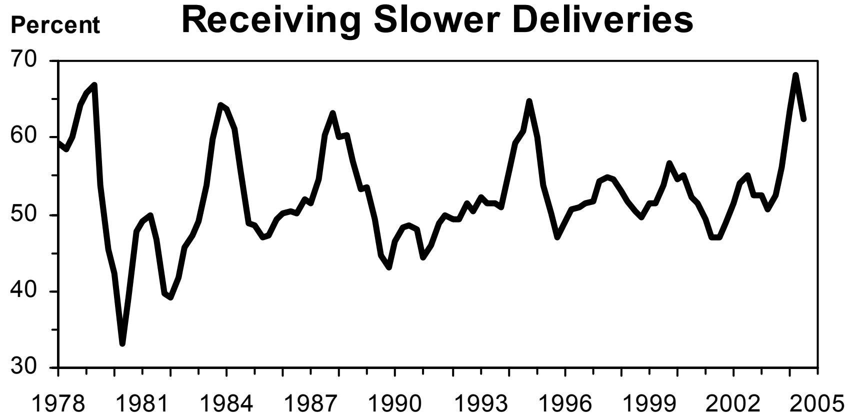


Selected National Economic Indicators

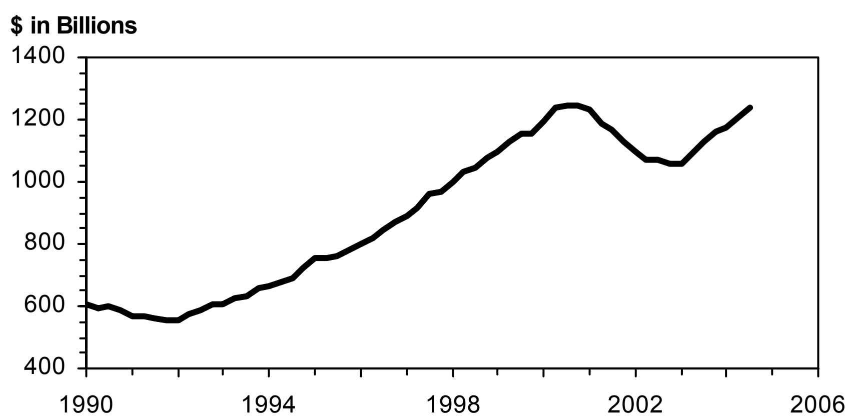
Manufacturing and Trade Inventory to Sales Ratio



Proportion of Companies Receiving Slower Deliveries



Real Fixed Nonresidential Investment



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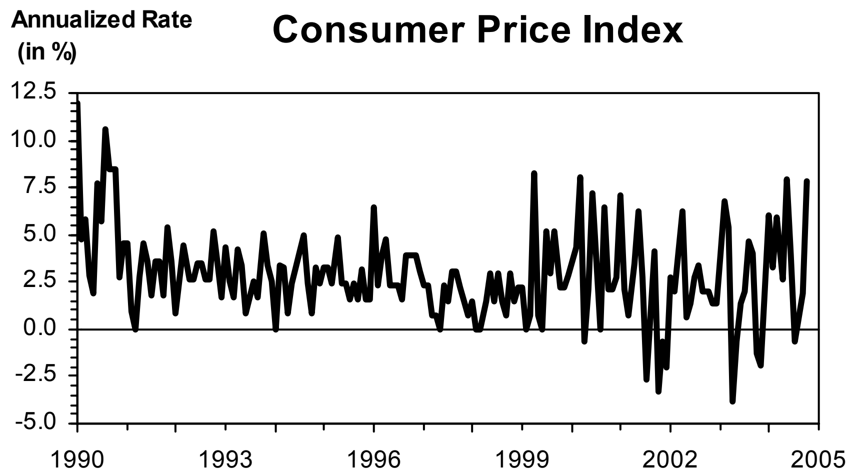

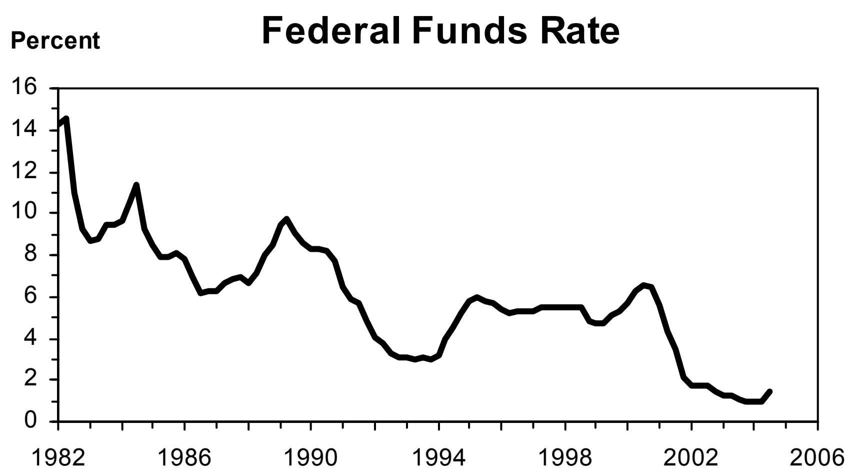

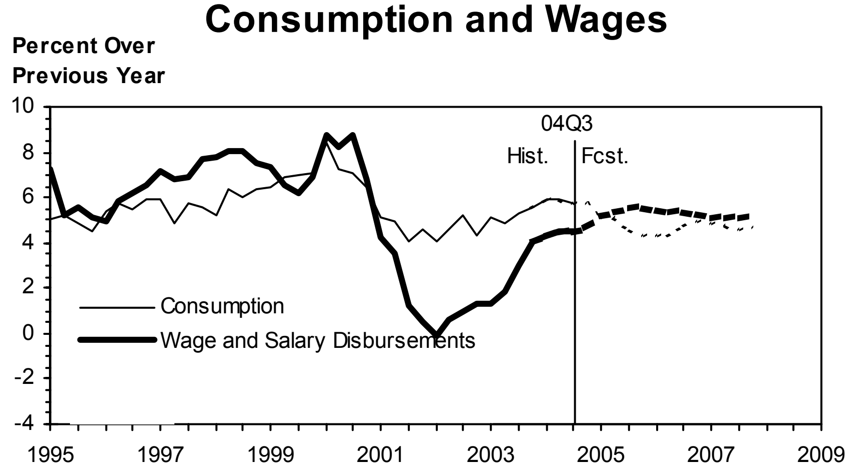

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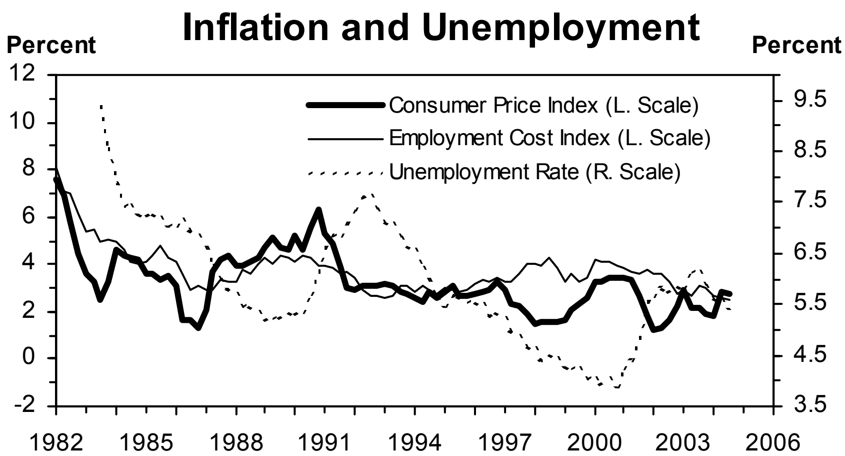
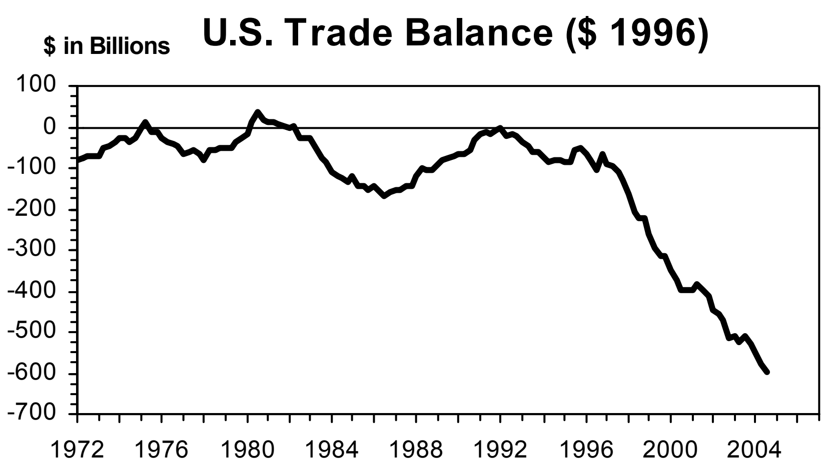




FY 2004-05 Budget Status

Actions taken after the close of the 2004 Legislative session by the Governor eliminated a projected $160 million general fund shortfall and left a $1 million budget balance for the FY 2004-05 biennium.

Revenues, transfers and other resources for the current biennium are now forecast to be $28.673 billion, an increase of $455 million (1.6 percent) from end-of-session estimates. State general fund expenditures and transfers for FY 2004-05 are now expected to be $27.921 billion, $34 million (0.1 percent) less than prior estimates.

These changes yield a projected forecast balance of $495 million. The entire balance is allocated by current law to restore depleted general fund reserves and partially buy back school aid payment shifts enacted in 2002 and 2003. After these allocations, a zero available balance is forecast for FY 2004-05.

FY 2004-05 Forecast

($ in Millions)

	End of Session	November Forecast	$ Change
Beginning Balance	**$369**	**$369**	**0**
Revenues	26,687	27,093	406
Other Resources	1,531	1,580	49
Total Resources	**28,218**	**28,673**	**455**
Expenditures	**27,955**	**28,039**	**84**
Cash Flow Account	0	350	350
Budget Reserve	631	653	22
Available Balance (Deficit)	**$1**	**0**	**$(1)**

Current Law Allocates Forecast Balance to Reserves and Shift Buybacks

The general budget reserve and cash flow accounts were entirely depleted by the Legislature's 2002 budget solution. Statutory changes (MS 16A.152, Subd. 2) enacted in 2002 and 2003, direct any subsequent forecast balances be allocated to restoring the reserves to their prior levels. In the 2004 session, additional provisions were added stating that once the cash flow and budget reserve accounts were fully funded, any additional forecast balance must be directed to reversing the E-12 school aid payment shifts enacted in 2002 and 2003 as part of the budget solution.

Under these statutory requirements the $495 million projected balance at the end of the biennium produced by the forecast changes is distributed as follows:

- $350.0 million to the Cash Flow Account
- $ 27.6 million to restore the Budget Reserve to $653 million
- $117.9 million to FY 2005 Education Aid Payments

FY 2004 Closed on a Positive Note

In August 2004, the books were officially closed for the fiscal year ending June 30, 2004. FY 2004 ended with a general fund balance of $681 million. This included a budget reserve of $404 million.

Total revenues were $210 million higher than estimated at the end of the 2004 legislative session.

Final FY 2004 expenditures were $134 million lower than estimated at the end of session. However, carry forward authority exists that allows some agencies to carry unspent FY 2004 dollars into the next fiscal year. After adjusting for the $183 million in carry forward authority, spending for FY 2004 would be $49 million above forecast. $53 million of Human Services appropriations for FY 2005 was spent earlier in FY 2004 to leverage additional one-time federal participation available in the emergency federal assistance provided to states in FY 2004. This movement of monies between fiscal years, while increasing FY 2004 spending above prior estimates, has little impact on the forecast for the biennium.

Budget Reserve

The budget reserve for FY 2004 was reduced $6 million from $410 million to $404 million. Statutes provide that annually any excess surplus in the Assigned Risk Plan should be transferred to the budget reserve – an excess surplus of $6 million had been forecast. However, there was no excess surplus on the Assigned Risk Plan so no transfer was made.

Revenue Forecast
FY 2004-05

Current general fund resources for the 2004-05 biennium are now forecast to total $28.673 billion, $455 million (1.6 percent) more than end-of-session estimates. The forecast for non-dedicated revenues grew by $406 million or 1.5 percent. Just over 45 percent of the positive revenue variance occurred in fiscal 2004, the remainder in fiscal 2005. The individual income tax was the source of about 80 percent of the additional revenue.

The current forecasts for individual income tax and the corporate income tax receipts exceed end-of-session estimates. The sales tax, the motor vehicles sales tax, and the statewide property tax are expected to fall short of prior estimates by modest amounts. The forecast for other tax and non-tax revenue is $85 million more than previously forecast. Higher forecasts for the mortgage and deed taxes and the insurance gross premiums tax were the source of the additional miscellaneous revenues. Current resources are projected to increase by 12.7 percent over fiscal 2002-03.

Revenue Forecast FY 2004-05
$ in Millions

	FY2002-03	FY2004	FY2005	FY2004-05
Individual Income	$10,815	$5,710	$6,110	$11,819
Sales	7,710	4,101	4,199	8,300
Corporate	1,118	628	765	1,393
Motor Vehicle Sales	705	275	265	540
Statewide Levy	891	600	617	1,217
Five Major Taxes	21,239	11,314	11,956	23,270
Other Revenue	3,204	1,812	1,673	3,487
Tobacco	309	169	168	336
Net Non-dedicated	24,752	13,295	13,797	27,093
Other Resources	690	1,204	376	1,580
Current Resources	**$25,442**	**$14,499**	**$14,173**	**$28,673**

Individual Income Tax

Individual income tax receipts in the 2004-05 biennium are forecast to total $11.819 billion, up $362 million (3.2 percent) from end-of-session estimates. Net income tax receipts were $182 million above forecast in fiscal 2004. Fiscal year 2005 individual income tax receipts, through October, were $3 million (0.2 percent) below end-of-session projections.

Net income tax liability for tax year 2003 is estimated to be $171 million more than was projected in February. The additional taxable income responsible for producing that increase in individual income tax liability continues into the future, and is the source of nearly all the additional income tax revenue projected for the current biennium. There was almost no change in projected growth rates for Minnesota wage or non-wage income for tax year 2004.

At present only preliminary information is available on sources of taxable income in tax year 2003. The current estimate of Minnesota's wage growth in 2003, is almost unchanged from February's estimate, so the entire increase in tax liability was attributed to stronger than forecast non-wage income growth and to lower than anticipated deductions. About two-thirds of the additional revenue is presently attributed to lower than projected mortgage interest deductions. The estimate of 2003 final liability also reflects higher than anticipated capital gains and stronger farm income. More detailed, Minnesota specific information will be available following analysis of a sample of 2003 Minnesota tax returns. That sample will be available in early 2005 and will be used to calibrate the income tax model for February's revenue forecast.

Wages are forecast to grow at an annual rate of 4.1 percent in tax year 2004 and 5.2 percent in tax year 2005, the same as projected in February. Non-wage income growth is slightly stronger than previously forecast, up 8.4 percent in 2004 and 9.6 percent in 2005. February's forecast called for growth of 8 percent and 8.3 percent. Modestly higher interest rates and stronger farm and non-farm proprietors' income account for much of the additional growth in the income tax base.

As in the past, the November forecast marks the first use of the current House Income Tax Simulation model. It also marks the first use of a sample of tax year 2002 income tax filers. Typically the sample is updated annually, but changes to the income tax processing system in 2001 made it impossible to draw a sample for that year. Consequently, the tax year 2000 sample had to be used as the base for the micro simulation for two years. The new model and sample project tax year 2002 income tax liability to be $37 million less than the actual, observed liability for that tax year. To force model results to equal actual observed liability an off-model adjustment was used. The income tax micro-simulation was calibrated to match a preliminary estimate of tax year 2003 liability based on collections and returns received to date and projected future receipts. The model will be recalibrated in February to reflect actual tax year 2003 final liability and preliminary tax year 2003 sample results.

The largest adjustments made to projected tax year 2003 growth rates were to home mortgage deductions, net interest income, farm income, and capital gains. Capital gains are now forecast to have grown 5.7 percent in tax year 2003. February's forecast called for no growth. For tax years 2004 and 2005 growth rates are now 14.2 and 14.0 percent, down only slightly from the 15.5 percent growth rates assumed in February. Home mortgage interest paid in 2003 is now assumed to have fallen by 9 percent.

Sales Tax

Net sales tax collections for the 2004-05 biennium are now expected to reach $8.30 billion, $13 million, (0.2 percent), less than end-of-session estimates. The forecast for gross sales tax receipts increased by $36 million, while projected refunds grew by $49 million.

Gross sales tax receipts during fiscal 2004 exceeded forecast levels by $7 million and refunds were $11 million below forecast, leaving an $18 million positive variance for FY 2004. That additional revenue has been incorporated into this forecast. Gross sales tax receipts in fiscal 2005 through October were $20 million below forecast. Sales tax refunds were below forecast as well, leaving sales tax receipts for fiscal 2005 $4 million below end-of-session estimates.

Minnesota's sales tax base is projected to grow at a healthy rate through the current biennium. Slightly weaker growth in consumer durable goods spending is accompanied by strong growth in business spending and purchases of construction materials. However, sales tax receipts in Minnesota have grown significantly more slowly than its simulated sales tax base since late 2000. In February, to adjust for that slower receipts growth Finance Department economists reduced the elasticity used to convert the growth rate of the sales tax base to receipts. The receipts elasticity was reduced from its historical level of .975 to .80 for the remainder of fiscal 2004, then raised to .90 in fiscal 2005. Actual receipts in fiscal 2005 appear to indicate that the sales tax receipts elasticity did not rebound as anticipated. In this forecast the .80 receipts elasticity was extended for the remainder of the biennium. Revenues lost to e-commerce were assumed to grow by 15 percent in 2005.

Refunds for fiscal year 2005 include a large, one time payment required under the Minnesota Supreme Court's decision *Sprint Spectrum LP, et al v. Commissioner of Revenue.* This decision requires the state to refund $64.7 million in sales taxes collected on equipment used to build telecommunications networks. Under current law, estimated refunds due to a judicial decision that exceed $50 million may be paid out in five annual installments at the discretion of the Commissioner of Finance. The Commissioner has chosen to pay the entire judgment in fiscal 2005 saving $5 million in additional interest payments.

Corporate Franchise Tax

Net corporate tax receipts for the 2004-05 biennium are now estimated to total $1.393 billion, $7 million (0.5 percent) more than forecast in February. An off-model adjustment to the quarterly estimated payment forecast was insufficient to prevent quarterly estimated payments from falling $56 million below forecast in fiscal 2004. Even though refunds were lower than anticipated and miscellaneous (final) payments higher, net corporate tax receipts for fiscal 2004 closed $18 million below forecast.

Corporate tax receipts had a positive variance of $56 million the first four months of fiscal 2005. Both quarterly estimated payments and miscellaneous payments exceeded forecast, and refunds were below projections. The increase in estimated payments appears to be attributable to one-time events, including a large capital gain realized by a local headquarters company.

Global Insight's baseline forecast for corporate profits has improved slightly since February, but that growth is being applied to a lower base, so there is little additional revenue. A combination of one-time items and higher final payments in fiscal 2005 account for almost the entire increase in the corporate tax forecast.

The effects of recent federal corporate tax law changes on corporate profits were incorporated in November's GII baseline forecast and thus are included in this forecast. One section of the recently approved American Jobs Creation Act of 2004 provides for lower federal corporate tax rates on foreign earnings repatriated during calendar 2005. The Minnesota corporate tax forecast was adjusted to specifically reflect that additional income, and the subsequent losses in income for future years were based on the Congressional Joint Tax Committee's estimates of federal revenue gains and losses.

Motor Vehicle Sales Tax

The motor vehicle sales tax is now projected to add $540 million to Minnesota's general fund during the 2004-05 biennium, $31 million (5.5 percent), less than end-of-session estimates. Fiscal year 2004 closed with a negative variance of $7 million. During the first four months of fiscal 2005 motor vehicle sales tax receipts were $8 million below forecast.

Global Insight's baseline forecasts for total light vehicle sales and for consumer spending on motor vehicles have both fallen. Growth rates for 2004 were also reduced by an upward revision in spending estimates for 2003. In February, GII's baseline called for light vehicle sales of 17.2 million in 2004 and 17.4 million in 2005. The GII November baseline calls for light vehicle sales of 16.8 million in 2004 and 16.9 million in 2005. A reduction in consumer purchasing power due to higher oil prices is partially to blame. GII now has oil prices staying near $50 per barrel through mid 2005.

Other Revenues

Other tax and non-tax revenues are expected to total $3.824 billion during the current biennium, up $85 million from end-of-session estimates. Mortgage and deed tax collections both continued to exceed forecast as the interest rate environment remained favorable for housing purchases and home mortgage refinancing through the end of calendar 2004. At the close of fiscal 2004 there was a positive variance of $21 million in deed and mortgage tax receipts. After the first four months of fiscal 2005, deed and mortgage tax receipts were a further $15 million above forecast. Consistent with that collection experience, the forecast for mortgage tax collections was increased by $51 million for the 2004-05 biennium; the forecast for the deed tax increased by $23 million. The forecast for the insurance gross premiums tax is up $26 million reflecting current receipt levels. Projected receipts from the statewide property tax levy and the cigarette and tobacco products tax were both reduced slightly from end-of-session estimates. The investment income forecast was increased by $5 million, consistent with funding the cash flow account at $350 million.

Other resources including dedicated revenues, transfers and prior year adjustments are now projected to total $1.580 billion in the current biennium, up $49 million from end-of-session estimates and $890 million (129 percent) from the 2002-03 biennium. The unusual biennium over biennium growth in this item is due to the transfer of tobacco funds into the general fund. That one-time action increased transfers by $1.031 billion.

Expenditure Forecast
FY 2004-05 Biennium

Forecast expenditures for the FY 2004-05 biennium now total $28.039 billion, $84 million more than comparable estimates at the end of the 2004 legislative session and after the Governor's executive actions to re-balance the budget. This change in total estimated spending reflects a 0.3 percent increase over previous estimates.

FY 2004-05 Expenditures

($ in millions)

	End of Session	November Forecast	Difference
E-12 Education	$11,759	$11,784	$25
Aid Payment Change	0	118	118
Higher Education	2,561	2,542	(19)
Property Tax Aids & Credits	2,778	2,808	30
Health & Human Services	7,206	7,245	39
Environ, Agric. and Econ. Develop.	705	670	(35)
Transportation	160	159	(1)
Criminal Justice	1,440	1,437	(3)
State Government	645	649	4
Debt Service	625	589	(36)
All Other	0	7	7
Estimated Cancellations	(20)	(44)	(24)
Subtotal	**27,860**	**27,964**	**104**
Dedicated Expenditures	95	74	(21)
Total Expenditures	**$27,955**	**$28,039**	**$84**

The projected increase in spending is attributed to the statutory allocation of $117.9 million of the forecast balance for the purpose of partially buying back school payment changes enacted in 2002 and 2003. Without this current law adjustment, total spending would have decreased nearly $34 million. Projected increases in the cost of health and human services programs account for a $39 million increase in projected spending. However, all other net spending is $79 million less than previously forecast. Accounting for almost all of the net decrease in other spending areas is a $36 million reduction in estimated debt service payments for FY 2004-05. The debt service reduction is largely the product of higher than expected premiums received from recent bond sales. In addition to the debt service savings, estimated program cancellations of $39 million are now expected in the higher education financial aid and tuition reciprocity programs.

While changes in estimates are shown for other areas of the budget, none of these represent significant adjustments to the forecast. Typically, end-of-session estimates are based on appropriations. With the November forecast in the second year of the biennium, actual spending is included for FY 2004 and authorized appropriations may be carried forward into FY 2005. Additionally there are differences shown that reflect adjustments between categories, transfers of funds between agencies, and changes in dedicated revenue estimates and related dedicated spending. In a limited number of areas, end-of-session estimates have been restated to reduce changes caused by treatment or alignment issues different than end-of-session tracking. However, these changes have no material impact on total estimated spending or the ending balance.

E-12 Education Increases by $25 Million in FY 2004-05, $143 Million After Shift Buyback

For the current biennium, E-12 Education spending is now projected to total $11.9 billion, $25.4 million higher than at the end of the 2004 legislative session and $143 million higher after adjusting for shift buyback provisions. The underlying forecast change reflects a $37.6 million increase in the General Education program, which is partially offset by reductions in other programs.

The primary reason for the forecast change in General Education is an increase in pupil estimates since the end of session, leading to a $39 million increase in basic education. Lower than anticipated investment earnings from the Permanent School Fund (down $5.6 million) and fewer one-time savings from the property tax recognition shift (down $13.8 million) also add costs to the state's obligation for General Education.

These increases are partially offset by changes in other components of General Education. An $8.6 million decline in private alternative aid is the result of lower enrollments in FY 2004 and projected stable enrollments over the next few years, which replaced a previous estimate of continued significant growth. A $4.7 million decline in extended time aid resulted from scaled back offerings within school districts and an overestimation of extended time pupils in the February forecast. Other changes include fewer than expected Limited English Proficiency (LEP) students (down $1.4 million), and a plateau in compensatory aid (down $0.5 million).

Categorical aids also help offset increases in General Education. Interdistrict desegregation transportation aid is down $3.8 million from end of session due to delayed start-ups of programs in the northwest metro. Nonpublic pupil aid is down $2.3 million since end of session because enrollment is increasing more slowly than anticipated.

Finally, savings anticipated from reducing the aid payment percentage to 80 percent have been increased by $9.9 million. This aid payment percentage change was enacted first in the 2002 session, and extended in the 2003 session, as a component of the state's budget deficit solution.

Higher Education Spending $19 Million Below End-of-Session Estimates

Spending for higher education in the current biennium is $19 million below end-of-session estimates. This includes a $17 million reduction in the University of Minnesota's general fund appropriation that is related to a methodology change in how the University's contribution to Prepaid Medical Assistance Program (PMAP) funding is recorded for FY 2004. (The University's contribution to PMAP allows the Department of Human Services to make higher medical education payments.) This change was made between the end-of-session estimates and the November forecast. Its effect was to record the $17 million contribution as a dedicated expenditure for FY 2004 only, which shows as a reduction of the University's general fund appropriation.

The remaining $2 million decrease is the net effect of two items in the Higher Education Services Office (HESO), including $2.2 million in one-time spending in the MN Library Information Network (MnLink) program, and $4.6 million in one-time funds that HESO carried forward from the previous biennium.

Property Tax Aids and Credits Spending Up $30 Million from Previous Forecast

Estimates for general fund spending on intergovernmental aids now total $2.808 billion for the FY 2004-05 biennium, up just over $30 million from end-of-session estimates.

Most of the increase can be attributed to a $25.7 million transfer of funds to support Payments in Lieu of Taxes (PILT) to counties that include tracts of Department of Natural Resources (DNR)-owned land. This adjustment has routinely occurred in previous biennia because funds are appropriated to the DNR, but are transferred to the Department of Revenue for payment appearing in property tax aids. An offsetting decrease of $25.7 million appears in the budget for environment programs.

Other, generally offsetting, forecast adjustments for the 2004-2005 biennium include:

- $11.6 million more will be distributed in Police and Fire Pension Aids than forecast at end-of-session. The increase is a function of increases in premiums paid for personal property insurance. The tax on premiums is partially dedicated to support local contributions to police and fire pension funds.
- $5.2 million increase in property tax refunds, mostly to homeowners.
- $9.7 million less for Market Value Homestead Credit payments to cities, towns and counties, with $3.1 million more for payments to school districts than had been forecasted, yielding a net reduction of $6.6 million;
- $6.7 million less for transfer to the IRRRB for distribution to local governments through the Taconite Production Tax Replacement Aid program. Nearly 60 percent of the change is due to an over-payment in 2004.

Health and Human Services Forecast for FY 2004-05 Increases $38.6 Million

Health and human service spending is now expected to be $7.2 billion for FY 2004-05, up $38.6 million (0.5 percent) from end-of-session estimates. The most significant forecast increases occur in Medical Assistance (MA) MFIP and Families Basic Care and General Assistance Medical Care (GAMC). Higher caseloads and higher average costs drive MA MFIP and Families Basic Care increases, while higher caseloads for GAMC are partially mitigated by lower average costs in that program. The increases were mitigated by a decrease in projected MA Long-Term Care Facility expenditures. Spending recorded at the close of FY 2004 was $34.7 million (1.0 percent) above forecast, due largely to health care payments that were advanced from FY 2005 to FY 2004 in order to leverage an additional $2.5 million in federal funding for MA available from the emergency federal assistance provided in FY 2004.

Children and Economic Assistance Forecast Increases $17.4 Million

Most of the change in Children's and Economic Assistance Grants is due to non-entitlement program dollars being budgeted in this program rather than in other DHS spending areas. This difference is offset by entitlement spending reductions of $700,000 compared to end-of-session estimates.

Minnesota Family Investment Program/Transitional Year child care (MFIP/TY child care) spending projections have decreased $15 million from end-of-session estimates. Maximum payment freezes enacted during the 2003 legislative session appear to have had a previously unanticipated effect, reducing MFIP child care caseloads, and in turn reducing estimates for general fund program spending. Carry forward of federal child care funding into FY 2005 further reduces projected general fund spending for child care.

General fund spending on MFIP cash assistance is now projected to be $15.7 million above end-of-session estimates. While projected MFIP caseload and average grants are higher in this forecast, the primary reason for this projected general fund increase is a shift in funding source. Because the state is projected to spend fewer general fund dollars on MFIP child care in FY 2005, DHS must make up its federal TANF maintenance-of-effort requirements by spending more general fund dollars for cash assistance.

An increase in the projected caseloads in General Assistance raised FY 2004-05 estimates by $2.2 million (4.1 percent) over end-of-session estimates. The increase was more than offset by decreases in Minnesota Supplemental Aid and Group Residential Housing, both as a result of lower than expected caseloads.

Basic Health Care Grants Increase $28.6 Million

MA MFIP and Families Basic Care for FY 2004-05 are now $57.3 million (6.2 percent) higher than end-of-session estimates. Higher average payments and higher caseloads account for almost all of this increase.

MA Elderly and Disabled Basic Care projections are down $43.8 million (3.2 percent) from previous estimates. Elderly and, to a lesser extent, disabled caseloads are projected to grow more gradually than earlier estimates. Increases in elderly average costs are offset by decreases in average costs for enrollees with disabilities. These savings would have been greater except this forecast recognizes a shift in Elderly Waiver expenditures to MA Elderly and Disabled Basic Care.

GAMC spending projections are $19.7 million (4.2 percent) higher then end-of-session estimates. Caseloads are expected to be almost 17 percent higher than earlier estimates. This significant caseload revision is partially offset by lower average costs. Costs are lower than previously anticipated for fee-for-service enrollees.

Continuing Care Grants Change Little, Down $6.5 Million

Continuing Care expenditures are $6.5 million (0.2 percent) below end-of-session estimates. The largest change is in MA Long-Term Care (LTC) Waivers, where spending is down $12.2 million (0.9 percent); however, over half the decrease is the result of spending occurring in another activity within the same program.

Elderly Waiver (EW) displayed the largest change within MA LTC Waivers, $15.3 million (11.4 percent) less than previously estimated. This decrease however, does not result in savings for the state. EW recipients are increasingly receiving care through managed care providers, as opposed to traditional fee-for-service, and the cost has been shifted to the MA Elderly and Disabled Basic Care activity. The Mentally Retarded/Related Condition (MR/RC) Waiver expenditures are $10 million (1.3 percent) above end-of-session estimates due to higher costs per person. Like EW, the increase is a result of expenditures occurring in different activities. Group Residential Housing costs were refinanced in 2003, shifting expenditures above the standard room and board level to home and community based services waivers.

MA Long-Term Care Facilities spending is $10 million (1.0 percent) less than previously forecast. The savings are primarily due to lower than expected caseloads within nursing facilities. Two factors contributing to the decline in caseloads are higher than expected voluntary bed closings and lower than expected movement of Alternative Care (AC) recipients to nursing facilities.

Personal Care Attendant/Private Duty Nursing expenditures are $9 million (3.8 percent) above prior estimates, primarily as a result of increased caseloads. Disabled individuals in the Community Alternative Care (CAC) waiver are increasingly choosing private duty nursing under the state's home plan as opposed to waiver services.

Debt Service Estimates for Current Biennium are $36.1 Million Lower

Estimated debt service for FY 2004-05 is now $589 million, $36.1 million lower than end-of-session estimates. A significant part of the savings results from the refinancing of two outstanding state bond issues that were sold initially in 1995 at higher interest rates. Prior estimates assumed refinancing these bonds in calendar year 2005 with savings credited to the 2006-07 biennium. The bonds were actually refinanced in November 2004. The saving from the refinancings was $14.9 million in the FY 2004-05 biennium.

Bidders also continue to place high premiums on bids for state bonds. While high premiums were forecast, the actual premiums bid were even higher than forecast. Premiums actually received were $20.3 million over the amount expected at the end of the 2004 session.

All Other Spending Changes Slightly, Down $73 million

The remaining spending areas account for $2.952 billion, just over 10 percent of total general fund spending. This is a net $73 million decrease from previous estimates. Several items account for the reduction from end-of-session data.

The $35 million decrease shown for environment, agriculture and economic development programs is primarily driven by one item. As noted in Property Tax Aids and Credits, an artificial distortion accounts for nearly $26 million of this decrease in spending. The Department of Natural Resources (DNR) receives an open appropriation ($25.7 million) for payment in lieu of tax (PILT) payments but the money is transferred to the Department of Revenue for payment. PILT expenditures are now recognized in Aids and Credits, rather than in the environmental spending numbers.

Most of the changes are technical adjustment to previous estimates. One example is the treatment of the Governor's action to reduce executive branch agency budgets after the deadlock at the end of the 2004 session. End-of-session estimates had $15.2 million as a single lump sum cancellation in FY 2005 and did not specify individual agency reductions.

Subsequently, the reduction was allocated to individual executive branch agencies. As a result, the $15.2 million is now reflected in lower net spending for FY 2005 by agency, and the FY 2005 cancellation estimate reduced by a like amount. The total of these cuts by area is highlighted below:

- E-12 Education – $892,000
- Higher Education (HESO only) – $84,000
- Health and Human Services - $2,163,000
- Environment, Agriculture and Economic Development – $5,559,000
- Transportation - $1,752,000

- Criminal Justice - $1,675,000
- State Government - $3,072,000

Forecast dedicated revenue spending has decreased $21 million from previous estimates. This decrease is related primarily to various dedicated receipt sources for state programs. Changes in dedicated spending is directly offset by offsetting changes in estimated receipts, and do not affect the ending general fund balance.

Finally, FY 2005 cancellation estimates have been increased to $44 million, up from $5 million in previous estimates. This change is due to expected cancellations in the Higher Education Services Office appropriations, where $39 million is expected to remain unspent at year-end. Of this amount, $32 million is from appropriations for student financial aid grants, and $7 million from the tuition reciprocity program.

FY 2006-09 Budget Outlook

FY 2006-2007 Budget Forecast

The FY 2006-07 budget forecast is a current law forecast based on GII's November 2004 Baseline forecast for the U.S. economy. Revenues are forecast based on specific Minnesota based projections. The 2006-07 revenue planning estimates were based on longer-term trend projections for the U.S. economy. Expenditure estimates are based on current law adjusted only for enrollment, caseload changes, and specific formula requirements. No adjustment is included for estimated inflation. If expenditures were uniformly adjusted for estimated inflation, it would add approximately $600 million in spending – and increase the forecast deficit by a like amount.

FY 2006-07 Biennial Budget Forecast

($ in millions)

	FY 2004-05	FY 2006-07	$ Change	% Change
Beginning Balance	**$369**	**$1,003**	**$634**	
Tax Revenues	25,627	27,658	2,031	7.9
Non-Tax Revenues	1,466	1,406	(60)	(4.1)
Other Resources	1,580	414	(1,166)	(73.8)
Current Resources	**28,673**	**29,478**	**805**	**2.8**
Expenditures	28,039	30,177	2,139	7.6
Cash Flow Account	350	350	0	
Budget Reserve	653	653	0	
Available Balance (Deficit)	**$ -0-**	**$(700)**	**$(700)**	

The $700 million projected shortfall for FY 2006-07 does not represent an enacted budget. The November revenue forecast, when matched against "base level" current law expenditures, provides the framework for developing the budget for the next two years.

The Forecast is the Starting Point for FY 2006-07 Budget Development

Despite increases in the revenue forecast for both the current biennium and FY 2006-07, the projected budget gap has widened. For FY 2006-07, current resources (i.e. revenues and transfers expected within the biennium) are projected to increase by $805 million over the current biennium, while projected expenditures increase by $2.139 billion. This mismatch between revenue and expenditure growth highlights the budget challenge faced by the Governor and legislature. Even though state tax revenues will continue to grow at a healthy rate, one-time monies used to balance the FY 2004-05 budget will not recur. Forecast spending, however, also continues to grow driven primarily by growth in human services spending. Increases in post-secondary education enrollment funding, growth in property tax aid and credit programs, increases in criminal justice funding for corrections and the courts, as well as growth in forecast debt service for state bonds for capital projects also contribute to the spending growth expected in FY 2006-07.

Budget Reserves Restored in FY 2004-05

Although a deficit is forecast for the coming biennium, under current law the $495 million projected balance for FY 2004-05 is set aside to restore general fund reserves and reduce school payment shifts. With this forecast the general fund Cash Flow Account is restored to $350 million and the Budget Reserve increased to $653 million. $118 million to school shift buy back in FY 2005, is a one-time expenditure that does not increase FY 2006-07 spending.

Initial Set of FY 2008-09 Planning Estimates

This forecast provides the first revenue and expenditure planning estimates for the FY 2008-09 biennium. The planning estimates for FY 2008-09 are materially different from the short-term forecasts for the current and FY 2006-07 biennia. Projection methods are different and the longer-term projections carry a higher degree of uncertainty and an inherently larger potential range of error.

Planning estimates for FY 2008-09 are presented to help identify longer-term state finance issues. Revenue projections are based on GII's November 2004 baseline forecast of national economic activity. Expenditure projections assume current laws and policies continue unchanged, adjusting only for caseload and enrollment changes as well as specific formula-driven items.

As with the estimates for FY 2006-07, projected current law expenditures for FY 2008-09 do not include the cost of estimated inflation. Inflation for FY 2008-09, compounded over four years, would more than double the $600 million estimate that would represent a simple inflationary adjustment to FY 2006-07. By FY 2009, simple inflationary costs would add over $1.5 billion to the spending shown in the planning estimates.

The FY 2008-09 planning estimates shown below display projected "current resources" compared to projected spending – without carrying forward the projected deficit for FY 2006-07. The term "current resources" refers to revenues and transfers received *within* a fiscal year or biennium. Balances or deficits from prior years, as well as any reserves are excluded. When compared with projected spending, the difference highlights the "structural" balance or gap – how much more is being spent than collected.

FY 2008-09 Long Term Planning Estimates
($ in millions)

	FY 06-07	FY 08-09	$ Chg.	% Chg.
Current Resources				
Revenues	$29,064	$31,516	$2,452	8.4
Transfers, other	414	300	(114)	(27.5)
Total	29,478	31,816	2,338	7.9
Projected Spending				
Current Law	30,177	31,326	1,149	3.8
Difference	**$(699)**	**$490**		

Long Term Planning Estimates Highlight Continuing Budget Challenges

For FY 2008-09 current resources are projected to reach $31.816 billion, an increase of $2.338 billion (7.9 percent) over the forecast for FY 2006-07. Projected current law expenditures are projected to be $31.326 billion, a biennial increase of $1.149 billion (3.8 percent) over forecast spending levels for FY 2006-07.

Revenue growth exceeds expenditure growth in the planning estimates and projected budget gaps begin to shrink. This happens largely because the spending estimates assume there will be no increases in spending over the five-year period FY 2005-09 beyond those incorporated into current law for enrollment, caseload, and current formula-driven aids.

To provide perspective, it is useful to recognize that over the last decade general fund spending has grown, on average, more than 5.3 percent *per year*. Contrasting this with the 3.8 percent *biennial* growth shown for FY 2008-09, highlights that significant budget changes would be required to limit the future spending levels to the levels assumed in the planning estimates.

These planning estimates are not intended to predict a balanced or unbalanced budget that far into the future. Rather their purpose is to assist in determining how well ongoing expenditures will match revenues based on trend projections of Minnesota's economy and what it will cost to maintain the same programs. The FY 2008-09 planning estimates provide a baseline against which the longer-term impacts of FY 2006-07 budget proposals and decisions can be measured.

Revenue Forecast
FY 2006-07

Total current resources for the 2006-07 biennium are forecast to be $29.478 billion, $254 million (0.9 percent) more than end of session estimates. In this forecast, current resources are $805 million (2.8 percent) more than projected 2004-05 receipts. General fund receipts from the five major taxes are now projected to grow by 9.0 percent over levels forecast for the 2004-05 biennium.

Revenue Forecast FY 2006-07
$ in Millions

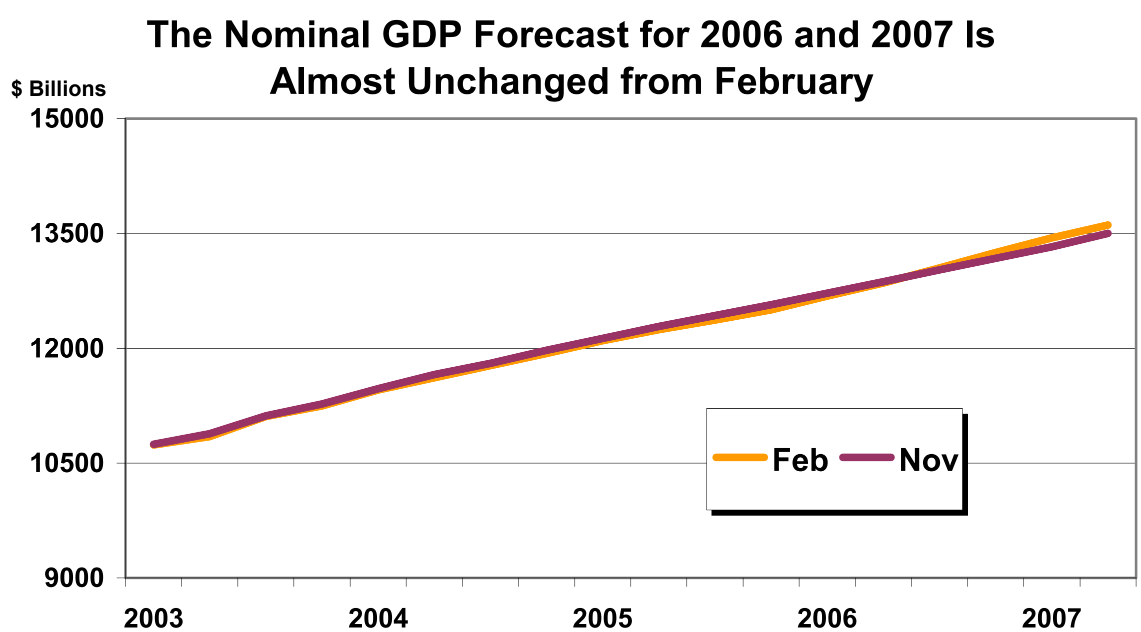
	FY2004-05	FY2006	FY2007	FY2006-07
Individual Income	$11,819	$6,495	$6,916	$13,411
Sales	8,300	4,344	4,389	8,733
Corporate	1,393	689	691	1,380
Motor Vehicle Sales	540	268	282	550
Statewide Levy	1,217	633	655	1,289
Five Major Taxes	23,269	12,430	12,933	25,364
Other Revenue	3,487	1,673	1,701	3,374
Tobacco	337	165	161	326
Net Non-dedicated	27,093	14,268	14,795	29,064
Other Resources	1,580	202	212	414
Current Resources	**$28,673**	**$14,470**	**$15,008**	**$29,478**

Individual income tax revenues are expected to show the most growth in the 2006-07 biennium, up $1.592 billion (13.5 percent) from FY 2004-05 levels. Sales tax revenues are forecast to grow by $433 million or 5.2 percent. The modest growth in net sales tax revenues is partially attributable to the expiration of supplemental sales taxes on liquor and rental cars in 2006. Corporate income tax receipts are projected to decline by just under one percent or $13 million dollars, while motor vehicle sales tax receipts increase by 1.9 percent or $10 million. Expected receipts from other tax revenues decline by $63 million to $2.295 billion. Transfers fall by $1.167 billion (80 percent) reflecting the one time transfer of tobacco funds done as part of the 2004-05 budget solution.

This is the first detailed forecast of revenues for the 2006-07 biennium. To this point revenue planning estimates have been provided. Those estimates are designed to provide a general guideline about the path of future revenues, not a specific target for budgeting. Since both simpler models and more generic growth rate assumptions are used, changes between end-of-session estimates and the forecast are likely to be larger for this first biennial forecast than for later biennial forecast updates. More detail on the procedures used in preparing the revenue planning estimates is provided in the section discussing the fiscal 2008-09 revenue outlook.

Changes in Economic Assumptions

The economic outlook used in this first forecast of revenues for the 2006-07 biennium is slightly less optimistic than that on which February's planning estimates were based. Real, inflation adjusted, GDP growth is now forecast to be 3.0 percent in fiscal 2006 and 3.1 percent in fiscal 2007. February's planning estimates for those two years were based on real growth rates of 3.4 percent and 3.9 percent. Nominal growth rates changed less. For fiscal 2006 nominal GDP is expected to grow at a 4.9 percent rate. This forecast assumes a growth rate of 5.0 percent. For fiscal 2007, February's planning estimates assume 5.8 percent growth. The November forecast assumes 4.9 percent growth.



Income Tax

Individual income tax receipts for the 2006-07 biennium are forecast to total $13.412 billion, $1.592 billion (13.5 percent) more than currently is expected in 2004-05 and $280 million more than was projected in end-of-session planning estimates. The higher base level liability established in tax year 2003 carries forward and boosts revenues in 2006 and 2007 even though the economic outlook has cooled slightly from that assumed when the planning estimates were prepared.

Department of Finance practice is to use a single, universal growth factor for all types of income when preparing revenue planning estimates for the individual income tax. Global Insight's forecast growth rate for taxable personal income is used for that global growth rate. This forecast is the first to report revenue estimates obtained when separate growth factors are applied to different categories of income for the 2006 and 2007 tax years.

Minnesota wage and salary disbursements are forecast to grow by 4.9 percent in tax year 2006 and 5.0 percent in tax year 2007. Wage and salary income is the single largest source of taxable income in the state, comprising about 75 percent of adjusted gross income. Capital gains are assumed to grow at an average annual rate of 11 percent in the 2006 and 2007 tax years. Capital gains were assumed to grow at a 14 percent rate in both 2004 and 2005. Higher interest rates are expected to produce significant increases in interest income in 2006, with interest income forecast to grow by more than 25 percent. A decline in farm income to more normal levels is also projected.

Sales Tax

Net sales tax receipts for the 2006-07 biennium are projected to reach $8.733 billion, up 5.2 percent from levels currently anticipated for FY 2004-05. Expiration of $104 million in supplemental sales taxes on liquor and rental cars artificially depresses the biennium-to-biennium growth rate. Had those taxes remained in place, net sales tax receipts would have grown by 6.5 percent.

Forecast 2006-07 sales tax receipts are $37 million less than projected end-of-session planning estimates. The slightly weaker nominal economic growth assumptions used in this forecast and a reduction of the revenue elasticity from previous assumptions are the sources of the change. The sales tax revenue elasticity is now set to average 0.825 in fiscal 2006 and 0.925 in fiscal 2007. Sales tax losses to e-commerce are expected to continue to grow at a 14.5 percent annual rate. Sales tax refunds are projected to total $503 million, $3 million more than end of session estimates and $20 million more than in 2004-05.

Corporate Franchise Tax

Corporate tax revenues for the 2006-07 biennium are forecast to total $1.380 billion, $13 million (1 percent) less than expected corporate tax receipts in the 2004-05 biennium. The corporate tax forecast is $142 million (9.4 percent) less than the end-of-session planning estimate for 2006-07. The decline in expected corporate revenues is not due to a change in the corporate profit outlook. GII's before tax corporate profit forecast remains almost unchanged. The revenue decline comes from the extrapolation of current receipts experience. Corporate quarterly estimated tax payments have been below forecast since March after one-time events are identified and removed.

Motor Vehicle Sales Tax

The sales tax on motor vehicles is now projected to yield $550 million, $44 million less than end-of-session estimates. Global Insight's baseline forecast for growth in consumer spending on motor vehicles and parts has been reduced, and that lower growth rate is being applied to the smaller base level carried forward from fiscal 2005. Light vehicle sales were remarkably strong during the past three years. This forecast indicates that some of those auto sales may have been borrowed from the future.

Other Revenues

Other tax and non-tax revenues, including the statewide property tax levy are expected to total $4.989 billion, $51 million less than in the 2004-05 biennium, but $137 million more than end-of-session estimates. Higher interest rates cause home refinancing activity to slow drastically, and mortgage tax receipts fell $136 million from levels projected for the current biennium. Cigarette and tobacco taxes and the deed tax also are down from fiscal 2004-05 levels, while the insurance gross premiums tax is up $59 million from current levels.

Other resources including dedicated revenues, transfers and prior year adjustments are now expected to total $414 million in the current biennium, up $60 million from end-of-session estimates, but down $1.166 billion from the 2004-05 biennium's level. One-time events explain almost all the difference, with transfer of the tobacco funds into the general fund increasing this category of revenues by $1.026 billion on a one time basis in the prior biennium.

Revenue Planning Estimates
FY 2008-09

The first planning estimates for the 2008-09 biennium call for general fund current resources to total $31.816 billion, an increase of $2.339 billion or 7.9 percent over the current forecast for the 2006-07 biennium. Net non-dedicated revenues reach $31.516 billion, $2.452 billion more than is forecast for 2006-07. Receipts from the five major taxes grow by 9.4 percent. Individual income tax receipts grow by 13.1 percent from levels forecast for the 2004-05 biennium; net receipts for the sales tax grow by 5.4 percent.

Revenue Forecast FY 2008-09
$ in Millions

	FY2006-07	FY2008	FY2009	FY2008-09
Individual Income	$13,411	$7,353	$7,814	$15,167
Sales	8,733	4,522	4,680	9,202
Corporate	1,380	697	727	1,425
Motor Vehicle Sales	550	290	298	588
Statewide Levy	1,289	671	688	1,359
Five Major Taxes	25,364	13,533	14,207	27,741
Other Revenue	3,374	1,725	1,740	3,464
Tobacco	326	157	154	311
Net Non-dedicated	29,064	15,416	16,100	31,516
Other Resources	414	149	152	301
Current Resources	**$29,478**	**$15,565**	**$16,252**	**$31,816**

No one can accurately forecast the path of the economy five years into the future. All that can be done is extend existing trends in the economy. Consequently, the baseline revenue planning estimates are not explicit forecasts, they are extrapolations based on the continuation of current trends in the economy. Even small deviations from the assumed trend over five years will compound and produce sizeable changes in revenues. In addition, because of the way the estimates are constructed, any change in the base level of revenues for fiscal 2007 will be reflected in the revenue planning estimates for 2008 and 2009. Other things equal, stronger than anticipated revenue growth through fiscal 2007 will carry forward and add significantly to revenues in the 2008-09 biennium. But, should the economy grow more slowly than forecast during the next three years, or should some item of portfolio income such as capital gains fall well below forecast – as it did in tax year 2001 -- the revenue outlook for the 2008-09 biennium will need to be revised down.

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 2009, 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 through the entire 5-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 2009 fiscal year cannot be ruled out. Actual revenues could exceed or fall short of the planning estimates by $2.5 billion or more depending on the economy's performance over the next 5 years.

Prior to 1994 the Finance Department relied on the Data Resources Incorporated (DRI) trend long forecast for the revenue planning estimate projections. DRI's control forecast covered only three years, and once an additional year of the control forecast was available, growth rates from that forecast were used. In the early 1990's Finance Department economists noticed a systematic positive bias to the trend long forecast, and after consulting with its Council of Economic Advisors developed a hybrid projection methodology to neutralize the positive bias in the DRI forecast. Between 1994 and 2002 the Finance Department used those hybrid estimates when preparing the revenue planning estimates. The Finance Department continued its practice of replacing the first year of the hybrid estimate with values from the Control forecast in November of odd numbered years. That procedure limited use of the hybrid projections to forecasts for calendar years beginning more than 3 years into the future.

In November 2002 the Finance Department, after consulting with the Council of Economic Advisors, provisionally changed its procedure for computing the revenue planning estimates. The hybrid model was eliminated and estimates for national economic aggregates were taken directly from the November GII baseline forecast. GII's purchase of DRI and WEFA had necessitated a reworking of their U.S. macro model and those improvements appeared to produce a steadier and smoother growth path for the forecast in years four and five and a less abrupt transition to the long term growth path. To reduce volatility in the planning estimates further, the Finance Department decided to adjust year four revenue growth rates consistent with the current GII baseline forecast, but to maintain year five revenue growth rates at a rate consistent with economic growth rates used for the February forecast in odd numbered years.

After reviewing this policy with the Council of Economic Advisors the Department of Finance decided to continue its use in budget planning for the 2005 legislative session. Revenue planning estimates for fiscal 2008 and 2009 were prepared consistent with the GII baseline growth rates for 2008 and 2009. GII's projected real GDP growth rates of 3.1 percent and 3.2 percent are consistent with the Blue Chip Consensus, as well as those assumed by the CBO and the Bush Administration. Nominal GDP increases of 5.1 percent and 5.3 percent are slightly below the Blue Chip Consensus of 5.4 percent and 5.3 percent, but above the CBO's estimates of 4.8 percent and 4.7 percent. The Bush Administration's forecast is the same as the Blue Chip Consensus. GII expects the CPI to increase at an annual rate of 1.9 percent in calendar 2008 and 2.1 percent in calendar 2009. Those rates are lower than the Blue Chip rate of 2.4 percent for those years. The Bush administration assumes CPI growth of 2.4 percent and 2.5 percent. CBO projections assume the CPI grows by 2.2 percent in both 2008 and 2009.

Finance Department economists caution that because this forecast calls for strong economic growth lasting for at least 5 more years, revenue projections based on this forecast are more likely to prove to be too optimistic than too pessimistic.

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

As was done in the preparation of the 2006-07 revenue planning estimates the complete sales tax model was used to prepare sales tax revenue planning estimates. Corporate tax receipts in Minnesota were estimated to grow at the same rate as GII's forecast of national before tax corporate profits. Minnesota's motor vehicle sales tax collections are expected to grow at the GII baseline growth rate for national consumption of motor vehicles and parts. The deed and mortgage tax was forecast based on the projected growth in the value of new and existing home sales. Planning estimates for other tax and non tax revenues were prepared by extrapolating existing trends.

Expenditure Estimates
FY 2006-09

FY 2006-07 Biennial Budget Expenditure Estimates

Projected state general fund expenditures for FY 2006-07 total $30.177 billion, up 7.6 percent from spending estimates for the current biennium. This projection of current law spending is now $556 million higher than estimates at the end of the 2004 legislative session.

FY 2006-07 Expenditures Estimates
($ in millions)

	FY2004-05	FY2006-07	$ Difference	% Change
E-12 Education	$11,902	$11,969	$67	0.6
Higher Education	2,542	2,753	211	8.3
Property Tax Aids & Credits	2,808	2,966	158	5.6
Health & Human Services	7,245	8,684	1,439	19.9
Environ, Agric. and Econ. Develop.	670	667	(4)	(0.5)
Transportation	159	163	4	2.5
Criminal Justice	1,437	1,569	132	9.2
State Government	649	632	(18)	(2.7)
Debt Service	589	721	132	22.4
All Other	7	0	(7)	nm
Estimated Cancellations	(44)	(20)	24	nm
Subtotal-Major Spending Categories	**27,964**	**30,103**	**2,138**	**7.6**
Dedicated Expenditures	74	75	1	0.4
Total Expenditures	**$28,039**	**$30,177**	**$2,139**	**7.6**

Significant growth in state spending for FY 2006-07 continues in heath and human services. Smaller, but still significant, increases are projected for property tax aids and credits, higher education, criminal justice and debt service. Net spending in all other categories is nearly flat due to declining enrollment in E-12 education and little change in appropriations for other areas.

The current forecast is a $556 million increase from the comparable estimates at the end of the 2004 legislative session. Increased health care and human service spending of $309 million accounts for slightly over one-half of the change from end-of-session estimates, while the projected $205 million increase due to higher education enrollment adjustments accounts for another third of the total change in forecast spending for the next biennium.

FY 2006-07 Expenditures Forecast Changes

($ in millions)

	End of Session	November Forecast	Difference
E-12 Education	$11,934	$11,969	$35
Higher Education	2,548	2,753	$205
Property Tax Aids & Credits	2,976	2,966	(10)
Health & Human Services	8,375	8,684	309
Environ, Agric. and Econ. Develop.	676	667	(9)
Transportation	163	163	0
Criminal Justice	1,527	1,569	42
State Government	626	632	6
Debt Service	712	721	9
Estimated Cancellations	(5)	(20)	(15)
Subtotal-Major Spending Categories	**29,531**	**30,103**	**571**
Dedicated Expenditures	90	75	(15)
Total Expenditures	**$29,621**	**$30,177**	**$556**

FY 2006-07 Current Law is Starting Point for Budget Planning

FY 2006-07 current law expenditure estimates set the context for decisions on the next budget. The expenditure estimates represent the cost of current law for major forecast items adjusted only for enrollment, caseload, or cost increases built into current law or formula. Estimates for individual agency operating budgets or grants largely represent FY 2005 appropriations carried forward at the same level, only adjusted for one-time items, specific increases in law, and a limited number of technical changes.

Current law expenditure estimates are not automatically adjusted for inflation. Except for health care and a limited number of other areas, where rising prices are an integral part of forecast costs, the estimated impact of inflation on salaries and benefits, goods, or services is *not* generally included in the forecast for current programs.

Spending Growth is Driven by Current Law

Even without general inflation, some level of current law growth from one biennium to the next is normal. This occurs as increases from the first to the second year in the current biennium carry forward into the following two years. Second, there are “fiscal tails” – costs reflected for only a single year or part of the current biennium that are fully reflected in each of the next two years.

However, the 7.6 percent current law expenditure increase projected for FY 2006-07 is large. One area accounts for over $1.4 billion of the total increase of $2.1 billion. If health and human services spending were factored out, biennial growth for the remainder of the budget would be about 3.4 percent.

Higher education is the next largest factor driving increases in forecast spending for the next biennium. Driven by enrollment growth costs and corresponding adjustments in forecast funding required by statute, higher education spending will grow by $211 million.

Increases projected for other areas are more modest. Declining enrollments and a constant per pupil formula are the primary factors that limit growth in E-12 education. Increasing inmate populations and court costs result in growth in criminal justice spending. Increases shown for property tax aids and credits aid programs are largely driven by projected growth in property tax refund programs and current local government aid formula.

FY 2008-09 Expenditure Projections are Comparatively Flat – 3.8 Percent Higher

The growth shown for FY 2008-09 planning estimates is lower than that for shown for FY 2006-07. Without general inflation, total spending is projected to increase $1.149 billion, 3.8 percent over FY 2006-07. For all the major forecast areas with the exception of higher education, from E-12 education to heath care and intergovernmental aids, the trend remains the same as FY 2006-07. Health and human services projections account for nearly all of the growth. Higher education projections actually decline as the one-time portion of FY 2006-07 enrollment adjustments is removed.

The 2008-09 planning estimates project expenditures beyond the upcoming budget biennium. These out-year estimates provide a baseline from which to measure the longer-term affordability of policy choices that might be considered in the 2005 legislative session.

FY 2008-09 Planning Estimates
($ in millions)

	FY 2006-07	FY 2008-09	$ Difference	% Change
E-12 Education	$11,969	$11,772	$(197)	(1.6)
Higher Education	2,753	2,651	(102)	(3.7)
Property Tax Aids & Credits	2,966	3,035	68	2.3
Health & Human Services	8,684	9,983	1,299	15.0
Environ, Agric. and Econ. Develop.	667	667	0	0.0
Transportation	163	179	16	10.0
Criminal Justice	1,569	1,612	43	2.8
State Government	632	626	(6)	(0.9)
Debt Service	721	746	25	3.5
Estimated Cancellations	(20)	(20)	0	0.0
Subtotal-Major Spending Categories	**30,103**	**31,252**	**1,149**	**3.8**
Dedicated Expenditures	75	75	0	0.0
Total Expenditures	**30,177**	**31,326**	**1,149**	**3.8**

FY 2008-09 expenditure projections begin with the forecast level of spending for FY 2007. Like the estimates for FY 2006-07, these projections are based on current law, only incorporating forecast caseload, enrollment changes, and formulae in current law. The planning estimates are not adjusted for the potential impact of inflation

E-12 Education Increases by $185 Million in FY 2006-07 over Current Biennium

E-12 Education will grow to $12.0 billion in the next biennium, up $184.6 million over FY 2004-05. Total spending grows in FY 2006-07 because two budget balancing changes enacted in the 2002 and 2003 legislative sessions (the property tax recognition shift and the aid payment percentage change) reduced spending in FY 2004-05 on a one-time basis, leading to a relative increase in FY 2006-07.

Most E-12 education funding is driven by the number and characteristics of students receiving educational services. This forecast includes higher projections for pupil counts than assumed at the end of the 2004 legislative session, although the overall trend in E-12 enrollment continues to show a slight decline year to year. In the current school year (2004-05), E-12 enrollment is projected to be 825,261 students.

E-12 aids can be divided into two major parts: 1) General Education, the primary source of basic operating funds for schools, and 2) categorical aid tied to specific activities or categories of funding.

General Education

Over 80 percent of E-12 aid ($10 billion in FY 2004-05) is distributed to schools through the General Education program, and most of the forecast change is also in this program. Basic education revenue, the largest component of General Education, is expected to decrease by $72 million from FY 2004-05. Compensatory aid estimates are up, with spending expected to be $14.3 million higher than in FY 2004-05. Limited English Proficiency (LEP) revenue is projected to remain relatively stable in FY 2006-07 with a projected increase of $1 million.

Referendum revenue (aid + levy) will grow by $192 million in the next biennium, with an increasing proportion of funding coming from levy proceeds and a declining portion from state sources. These figures are lower than previous projections due to the fact that districts sought only 17 percent of their unrealized referendum authority and fewer than 50 percent of the proposed levies passed in the last election. Previous estimates had projected that districts would seek 26 percent of their referendum authority and that 50 percent of the levies would be approved in the election.

Categorical Aids

Charter school lease aid is projected to grow by $18.6 million over current levels, a smaller increase than previously anticipated, reflecting rising numbers of students in charter schools and a slight decrease in the per pupil lease costs. In the current school year (2004-05), 17,965 students attend charter schools. Charter school start-up aid is expected to increase by $3.5 million in FY 2006-07 as start-up funding resumes following a temporary suspension in FY 2004-05.

Debt service equalization aid is estimated to decrease by $18.3 million, primarily due to increases in Adjusted Net Tax Capacity (ANTC). In addition, interdistrict desegregation transportation aid is expected to increase by $7.2 million in the FY 2006-07 biennium as programs in the northwest metro become operational.

Special education aid is expected to grow by $11.7 million while special education excess cost aid is projected to decrease by $2.1 million. The increase in special education aid is a result of the aid payment shift, which reduced the FY 2004-05 base. Declining enrollment in special education leads to the decrease in special education excess cost aid, which is not subject to the aid payment shift.

Early childhood family education (ECFE) and community education funding are projected to decrease in FY 2006-07, largely because of funding formula reductions that took effect in FY 2005. ECFE is projected to decrease by $7.8 million. Community education is forecast to decline by $5.3 million due to both the funding formula reduction and rising property values, which will increase the share of program revenue supported by local levies.

E-12 Education Estimates Decrease $197 million in FY 2008-09

E-12 Education is projected to total $11.7 billion in FY 2008-09, with lower spending due mainly to continuing declines in enrollment.

General Education

General Education is projected to decrease by $216 million, again largely due to declining enrollment. Basic education aid is expected to decline by $74.8 million in FY 2008-09 below FY 2006-07 levels. Compensatory aid is expected to remain relatively stable in the FY 2008-09 biennium. Referendum revenue (aid + levy) is projected to continue growing with an increase of $218.6 million expected in FY 2008-09.

Categorical Aids

A decline is forecast in special education ($7 million) and special education excess cost aid ($1.2 million), both due to declining enrollment.

Spending for charter school programs is expected to rise by $26.2 million in FY 2008-09, attributable in part to charter school lease aid increases and growth in charter school student enrollment. Additionally, the FY 2008-09 increase reflects full implementation of charter school start-up aid following the FY 2004-05 program suspension.

Spending for early childhood programs is forecast to remain relatively flat, increasing by $1.5 million over FY 2006-07. All of the forecast growth is due to population changes in the early childhood family education program, which has a fixed levy target of $22.1 million. Increases in Adjusted Net Tax Capacity (ANTC) values result in a decline in the state aid portion of community education revenue, despite a projected increase in total program revenue.

Post-Secondary Education Spending Forecasts Increase $211 Million in FY 2006–07

FY 2006-07 spending for post-secondary education is projected to be $2.753 billion, $211 million higher than FY 2004-05. Nearly all, $205 million, of the increase is explained by the impact of growing enrollment.

The $205 million increase related to enrollment reflects the impact of the statutory funding formula (M.S. 135A.031) that triggers funding adjustments for the public post-secondary institutions with each two percent change in their enrollment. The value of each of these two-percentage point "enrollment bands" is then applied to 65 percent of the institution's instructional services base. Minnesota State Colleges and Universities' (MnSCU) enrollment adjustments are based on actual enrollment through 2004 and estimated 2005 enrollment, while the University of Minnesota's adjustments are based on actual enrollment through 2004. This difference reflects the flexibility that the institutions have under current law on when they can request that enrollment changes be recognized in their state funding.

These forecast adjustment reflects the enrollment growth at both the MnSCU and University systems in recent years. MnSCU's recognized enrollment has grown from 110,216 in FY2003 to 119,033 for FY2005. The University of Minnesota's recognized enrollment has increased from 49,634 in FY2002 to 55,768 in FY2004.

The enrollment formula provides both one-time adjustments in FY 2006 and ongoing adjustments in FY 2006 and FY 2007 that become part of each institution's continuing funding base. The table below summarizes the parts of the $205 million in adjustments.

Post Secondary Education Enrollment Formula Adjustments
($ in millions)

	FY 2006		FY 2007		FY 2006-07	
MnSCU	$59	one-time			$ 59	one-time
	$36	ongoing	$36	ongoing	$ 72	ongoing
MnSCU Total:	**$95**		**$36**		**$131**	
University of Minnesota	$43	one-time			$43	one-time
	$15	ongoing	$15	ongoing	$31	ongoing
University Total:	**$58**		**$15**		**$74**	

The increase for post secondary education is $205 million over end-of-session estimates due to these enrollment adjustments, which were not included in previous forecasts.

Background on Higher Education Enrollment Adjustment M.S. § 135A.031

The current higher education funding formula was first enacted in 1994, with the enrollment adjustment first being implemented in the FY 1998-99 biennial budget. Conceptually, it acknowledges that certain costs at higher education institutions fluctuate as enrollment changes.

Higher Education
Enrollment Requests

Biennium		Net Amount*
FY 2004-05	MnSCU	$40 million
	Univ. of Minn.	$15 million
	Total	$55 million
FY 2002-03	MnSCU	$13 million
	Univ. of Minn.	($6 million)
	Total	$7 million
FY 2000-01	MnSCU	($14 million)
	Univ. of Minn.	($ 3 million)
	Total	($17 million)
FY 1998-99	MnSCU	($ 5 million)
	Univ. of Minn.	$ 9 million
	Total	$ 4 million

**Positive numbers reflect forecast payments to be made to the institutions by the state. Negative numbers reflect forecast payments to be made by the institutions to the state.*

Source: Department of Finance November Forecast documents.

FY 2008-09 Planning Estimates for Post-Secondary Show $102 Million Reduction

Post-secondary education spending decreases by $102 million in planning estimates for the FY 2008-09 biennium, reflecting the one–time portion of the enrollment adjustments for the University of Minnesota ($43 million) and MnSCU ($59 million) in FY 2006-07 that do not continue into the following biennium.

Property Tax Aid and Credit Spending Increases 5.8 Percetn in FY 2006-07

Non-School Intergovernmental Aid expenditures are projected to reach $2.97 billion in FY 2006-07, up just over $158 million over spending for the current biennium. Changes represent the impact of fundamental changes in local aid formulas adopted in 2003.

County Program Aid – Beginning in 2005, money is appropriated to counties based on a two-part formula. The first relates to age-adjusted population, households receiving food stamps and the incidence of Part I crimes. The second is based on a calculation of the county's net tax capacity. This new funding stream replaces a combination of aid programs including Homestead Agricultural Credit Aid (HACA), Criminal Justice Aid, Family Preservation Aid and Attached Machinery Aid.

The forecast shows a $298 million increase in County Program Aid in FY2006-07 over the current biennium. It also reflects the elimination of HACA ($135 million/year), Criminal Justice Aid ($32 million/year), Family Preservation Aid ($24 million/year) and Attached Machinery Aid ($.5 million/year) halfway through the FY 2004-05 biennium. On balance, total spending on aid to counties is expected to increase by over $200 million for the biennium.

City Aid – The LGA formula for cities was also revised in 2003, with the result being a $29 million decrease in aid to cities between FY2004-05 and FY 2006-07. A portion of the reduction is offset by a restoration of Market Value Homestead Credits for those municipalities that saw reduction in MVH Credits during the current biennium.

Growth in other expenditures includes:

- Property tax refunds – Refunds are estimated to increase $73 million in the FY 2006-07 biennium. The growth is the result of increasing property taxes, declining income, and greater participation in the refund program.
- Police and Fire Pension Aids – Increasing property insurance gross premiums increases the portion of these premiums dedicated for the support of police and fire pension plans. This is projected to add $26 million to these aid programs.
- Market Value Homestead Credits – A net increase of $15 million in credits to local jurisdictions is forecast for FY 2006-07 over FY 2004-05. This reflects an increase of $30 million to Cities, Towns and Counties and a decrease of $14 million to School Districts. In addition to the restoration of MVH Credits discussed above, the shift between jurisdictions is generally a function of the relative tax burden of the cities and school districts.

A $25.7 million projected reduction in Payments in Lieu of Taxes (PILT) for DNR-owned land is an "artificial" reduction. It is expected that, as in previous years, DNR will transfer monies appropriated for PILT to the Department of Revenue during the biennium so that payments can be made to local governments out of the property tax aids budget.

Property Tax Aids Growth Slows in FY 2008-09

Non-School Intergovernmental Aid expenditures for FY 2008-09 are expected to be just over $3.03 billion, a 2.3 percent ($68 million) increase over the forecast for FY2006-07. Local Government Aid to cities and County Program Aid are both held constant by legislation adopted in 2003.

Increases occur, however, in the following areas:

- Property tax refunds – Refunds are projected to increase nearly 12 percent ($79 million) from FY 2006-07 to FY 2008-09. Higher property taxes, lower incomes and greater participation in the refund program account for the growth.
- Aid to Police and Fire Pensions – Increases in insurance gross premiums are expected to continue. The portion of the tax on premiums dedicated to support police and fire pensions is expected to grow $30 million in FY 2008-09 over FY 2006-07.

Market Value Homestead Credits to school districts and local governments will decline $37 million, consistent with the forecast that assessed property values will continue to rise.

Health and Human Services

Health and Human Services includes state payments for direct health care services, such as hospital and physician visits, nursing home services, home care, and other medical and long-term care services. Most of the spending in this area occurs in the state's Medical Assistance (MA) program, a federal entitlement program for low-income families, persons with physical and developmental disabilities, and the frail elderly. The state and federal government split the costs for MA, while the General Assistance Medical Care (GAMC) program is funded fully by the state.

This area of the state's budget also includes a wide range of non-health care programs and services, many of which are means-tested. These programs include cash assistance, child care, and grants to counties for child protection, child support enforcement, and other services.

Health and Human Services Expected to Grow $1.4 Billion in FY 2006-07

Nearly all of the growth in this area is within health care programs that grow significantly over the next two biennia. Projected spending increases are concentrated in basic health care programs and are due to a combination of factors: 1) cost of services is increasing from a higher 2005 base than originally anticipated; 2) enrollment increases have occurred and are expected to continue; and 3) changes in eligibility determination processes will lead to a redistribution of costs, with more health care paid from the general fund and offsetting savings in the health care access fund.

Basic Health Care Forecast is $3.8 Billion for FY 2006-07, 37% Higher than Current Biennium

Basic Health Care includes state assistance for acute care such as hospitalization and physician services that are covered under MA Elderly and Disabled Basic Care, MA MFIP and Families Basic Care, and General Assistance Medical Care. Basic Health Care general fund spending is forecasted to reach $3.8 billion in FY 2006-07, up $1.0 billion (37 percent) from FY 2004-05. Much of this spending growth occurs in MA MFIP and Families Basic Care and, to a lesser extent, GAMC.

Public health care programs face many similar cost pressures as the private health care market does, and it is therefore not surprising to see projected increases in this area. In addition to medical inflation and changing utilization of health care services, public health care programs must also accommodate higher enrollment when demand increases.

MA MFIP and Families Basic Care projections include increases in both average costs and enrollment. FY 2006-07 costs are projected to be $1.4 billion, an increase of $465 million (48 percent) over FY 2004-05. Most of this population participates in managed care and the per person cost of this purchasing strategy increases by varying amounts each year. Average costs for fee-for-service enrollees also increase because of higher health care services utilization and when pharmaceutical ingredient costs rise. In addition, monthly average enrollment is expected to increase by an average of 49,000 (15 percent) enrollees from FY 2004-05 to FY 2006-07. (Much of that increase is due to planned improvements to health care eligibility determination processes that will likely shift a significant portion of MinnesotaCare enrollees to MA and GAMC. See page 72 for further information on this change.)

MA Elderly and Disabled Basic Care costs are projected to grow $375.4 million (29 percent) from FY 2004-05 to FY 2006-07. Average monthly caseloads are projected to increase by roughly 11,400 (7.8 percent). Average costs are projected to decline slightly because of the new Medicare Part D drug benefit, which will effectively take over a significant portion of Elderly and Disabled pharmaceutical costs. (These savings, however, are offset by required state payments to the federal government.)

Costs for GAMC are projected to rise $183.7 million (37 percent) from FY 2004-05 to FY 2006-07. Average monthly caseloads are projected to increase almost 11,250 (31.2 percent) between the two biennia. The caseload increase is due in part to a shift in enrollment from MinnesotaCare to GAMC. Average costs are projected to rise 4.6 percent.

Continuing Care Grants Rise Due to Waiver Costs

Continuing Care Grants provide ongoing support for frail elderly, chronically ill and disabled individuals in institutions or in the community. Spending across all continuing care grants in FY 2006-07 is expected to be $3.2 billion, an increase of $357.9 million (12.6 percent) from FY 2004-05. The growth is largely attributable to MA long-term care waiver expenditures. Total expenditures within the MA waiver programs are expected to reach $1.8 billion in FY 2006-07, an increase of $392.4 million (28.8 percent) from FY 2004-05. The following waiver programs explain most of the increase:

- Mental Retardation/Related Conditions (MR/RC) Waiver expenditures account for over one-half of total waiver spending and are projected to increase $85.1 million (10.7 percent) over the current biennium.

- Community Alternative for Disabled Individuals (CADI) expenditures are expected to reach almost $240 million in FY 2006-07, a 99 percent increase from the current biennium. The addition of clients with mental illness has significantly increased the cost per person.

- Traumatic Brain Injury (TBI) spending is forecasted to be $100.2 million in FY 2006-07, a 77.9 percent increase from the current biennium.

Personal Care Assistant/Private Duty Nursing (PCA/PDN) spending is projected to reach $334.1 million in FY 2006-07, a 35.3 percent increase over the current biennium. Waiver caseload caps established during the 2003 session have resulted in significantly higher PCA/PDN use, especially within the disabled population.

Long-term care facilities expenditures are expected to be $1.0 billion in FY 2006-07, accounting for one-third of all continuing care expenditures. That represents a 2.4 percent decrease from the current biennium. Nursing home and ICF/MR expenditures are both expected to decline from current biennium levels, both resulting from caseload declines.

Children and Economic Assistance Grants Increase $88 Million in FY 2006-07

Children and Economic Assistance Grants include a wide range of programs for families and individuals, many of which are means tested. Expenditure estimates for in this area are projected to reach $926.2 million in FY 2006-07, up $88.3 million (10.5 percent) from FY 2004-05.

General fund spending on MFIP/Diversionary Work Program grants is estimated to decline some $48.6 million, in large part due to declining caseload projections in the FY 2006-07 biennium. Federal TANF dollars will also pay for a higher portion of MFIP/Diversionary Work Program grants in FY 2006-07 compared to FY 2004-05, reducing the need for general fund spending. Average monthly grants are projected to grow slightly due to anticipated future federal food stamp cost-of-living adjustments.

The child care provider maximum payment freeze enacted in the 2003 session and affecting FY 2004 and FY 2005 are slated to end in July 2005. This forecast recognizes a caseload decline in the current biennium associated with the payment freeze. The payment freeze appears to have made some child care settings too expensive for some low-income families. Caseload estimates are projected to increase in FY 2006-07 as maximum payments are readjusted to reflect market prices. As a result of associated higher caseloads and higher average costs, MFIP/Transitional Year child care expenditures are estimated to increase $58.2 million (48 percent) over the current biennium. Basic Sliding Fee child care is also projected to increase $12.8 million over the current biennium. This funding increase is due to the temporary nature of the maximum payment freeze.

Caseload growth results in modest increases in the General Assistance and Minnesota Supplemental Aid programs, which are forecasted to rise $5.0 million (9.0 percent) and $3.2 million (5.6 percent), respectively, over the current biennium.

Outside of normal forecast changes, expenditures for FY 2006-07 are further increased by $50 million for competitive grants for "projects of regional significance," which were earmarked in the 2003 appropriation law within the Children and Community Services Grant activity.

FY 2006-07 Health & Human Services Estimates $309 Million Higher than End-of-Session

While much of the projected growth in health and human services spending in FY 2006-07 was anticipated in prior forecasts and at the end of the legislative session, estimates have now increased $308.6 million (3.7 percent) over previous projections. These increases occur primarily in MA MFIP and Families Basic Care and General Assistance Medical Care (GAMC).

A significant portion of this increase, $53 million, is due to revised assumptions related to projected movement of MinnesotaCare enrollees into general fund programs (see page 72). Caseload projections are now higher in MFIP, Families Basic Care, and GAMC. MA MFIP and Families Basic Care average cost estimates have increased due to higher-than-projected increases in calendar year 2005 managed care rates. Higher enrollment growth, coupled with the higher average cost base in 2005, compound to cause the increase in estimated spending. GAMC average costs are projected to decline relative to earlier estimates, due to substantially lower fee-for-service estimated costs. These reductions are offset by higher enrollment, higher managed care rate increases, and updated assumptions related to the split of GAMC enrollees between managed care and fee-for-service payment arrangements.

Continuing Care spending estimates fell $62.3 million (1.9 percent), primarily as a result of caseload declines. MA LTC Facilities expenditures are now $52 million less than previously estimated, and MA LTC Waivers expenditure estimates are now $19 million lower. These decreases are partially offset by inclusion of additional activities within this program area compared to previous categorizations.

All other forecast changes in Health and Human Services were relatively small and offsetting.

Forecast Changes for Health & Human Services
($ in Millions)

	End-of Session 2006-07	Nov 2004 Forecast 2006-07	Change 2006-07
Health Care and Continuing Care			
MA LTC Facilities	$1,068	$1,015	$(52)
MA LTC Waivers	1,772	1,753	(19)
MA Elderly & Dis. Basic	1,687	1,686	(1)
MA MFIP & Fam Basic	1,233	1,440	207
Gen Asst. Medical Care	510	673	163
	$6,269	**$6,567**	**$297**
Children and Economic Assistance Grants			
MN Family Inv. Program	$71	$65	$(6)
MFIP/TY Child Care	174	180	6
Group Res. Housing	176	175	(2)
General Assistance	55	60	5
MN Supplemental Aid	65	61	(4)
	$542	**$541**	**$(1)**

New Health Care Eligibility Determination Processes and Related Forecast Implications

There are significant general fund costs and offsetting health care access fund savings associated with planned changes to eligibility determination processes for Minnesota's publicly funded health care programs. The new processes will result in many people enrolling in a different health care program and funding sources changing accordingly.

Fiscal Impact of Projected HealthMatch Shift ($ in 000s)[1]

	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
MNCare Families and Kids	0	($11,555)	($70,219)	($91,479)	($106,557)
MnCare Adults Without Kids	0	($9,666)	($60,493)	($80,301)	($95,160)
Total, Health Care Access Fund	**0**	**($21,221)**	**($130,712)**	**($171,780)**	**($201,717)**
MA Basic Care - Families and Kids	0	$10,870	$64,230	$84,368	$95,880
General Assistance Medical Care	0	$11,069	$68,908	$91,270	$107,951
Total, General Fund	**0**	**$21,939**	**$133,138**	**$175,638**	**$203,831**
All Funds Impact	$0	$718	$2,426	$3,858	$2,114

[1]There are lower costs in Medical Assistance due to lower projected federal match assumptions in MinnesotaCare, and higher costs in GAMC due to a more robust benefit set in that program.

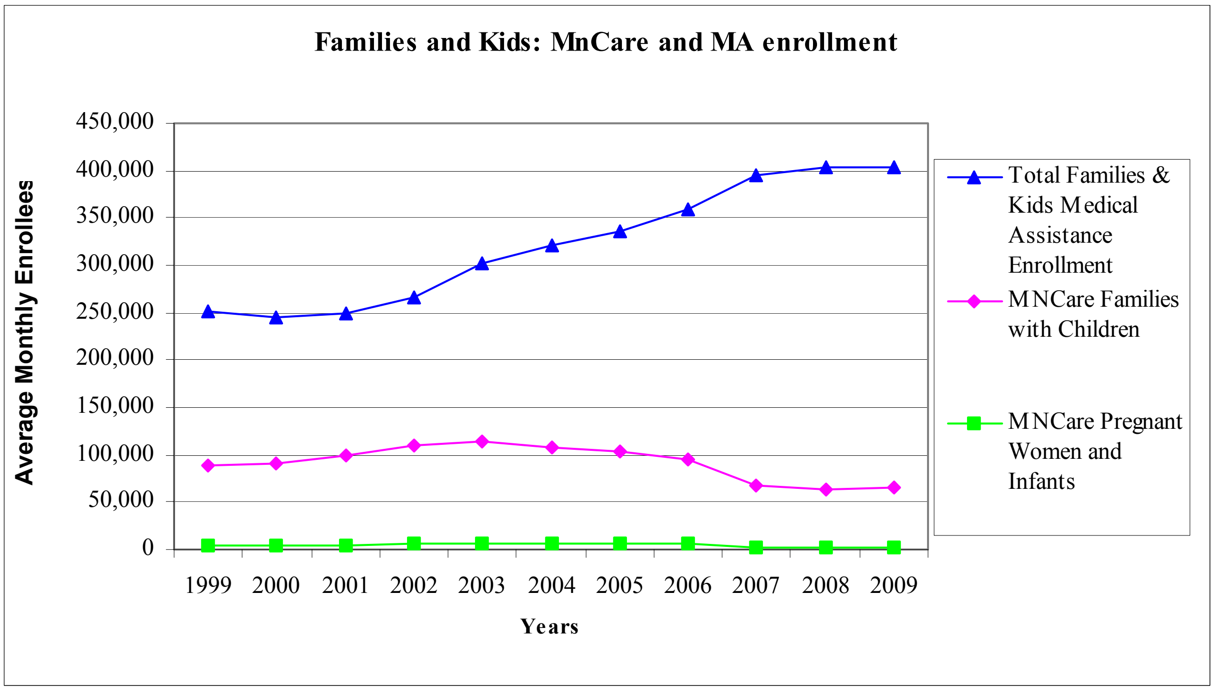
The Department of Human Services (DHS) is developing an automated eligibility determination system called HealthMatch for Minnesota's publicly funded health care programs. HealthMatch is designed to streamline eligibility determination and provide greater accuracy in application of complex eligibility rules. The system will also provide applicants with information about health care programs for which they are eligible (i.e. Medical Assistance (MA), MinnesotaCare, and General Assistance Medical Care (GAMC)) and the costs and benefits associated with each option. Consistent with state law (Minnesota Statutes 256L.04, Subd. 8, para (c)), all applicants will be able to choose among the programs for which they are found eligible. Additionally, under the state's MinnesotaCare waiver with the federal government, MA- or GAMC-eligible enrollees may participate in MinnesotaCare, but must also be provided information about other programs for which they may be eligible. HealthMatch will substantially improve Minnesota's ability to comply with this waiver requirement.

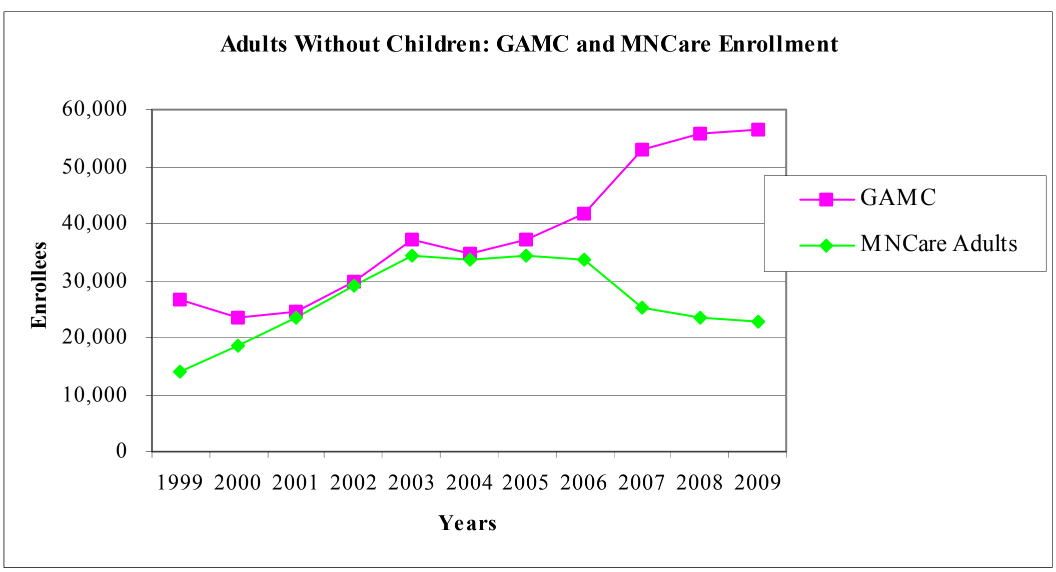
DHS estimates that about one-third of all MinnesotaCare enrollees are likely eligible for Medical Assistance or General Assistance Medical Care, programs through which they would obtain coverage at lower out-of-pocket cost and would receive more comprehensive coverage for adults and similar benefits for children. Some of these applicants may not realize they are eligible for these other health care programs, while others may prefer instead to participate in a premium-based program administered at the state level. Once fully implemented, HealthMatch will automatically assign new and continuing enrollees to the health care program that provides them the most benefits at the least cost to the enrollee. Enrollees will be able to opt into MinnesotaCare if they choose.

Previous forecasts have recognized a significant shift of enrollees from MinnesotaCare to MA, under the assumption that half of applicants would choose a lower cost program if they knew they could qualify. This forecast also recognizes that some enrollees will be eligible for GAMC as well and will shift to that program. At this stage of the design for the new eligibility processes, it also appears likely that more people will shift into either MA or GAMC than initially assumed.

DHS now estimates that HealthMatch implementation will begin in September 2005, with full implementation to begin by July 1, 2006. This forecast assumes that of those people who are eligible for either MA or GAMC, up to 60 percent will gradually shift from MinnesotaCare to MA and GAMC in FY 2006, and 80 percent of eligible cases will shift by June 2007. These enrollees are not "new" to Minnesota health care programs; they would be served by MinnesotaCare if not participating in either MA or GAMC.

The following graphs demonstrate how projected enrollment will shift between relevant programs:





Health and Human Services Grows $1.3 Billion in FY 2008-09

Basic Health Care spending is projected to grow another $905.9 million (24 percent) in FY 2008-09 to an estimated $4.7 billion, due largely to a continuation of trends affecting FY 2006-07 spending. MA MFIP and Families Basic Care expenditures are estimated to grow $372.2 million (26 percent) with caseloads growing almost 26,000 (6.9 percent) between the two biennia. MA Elderly and Disabled Basic Care costs are projected to grow $312.7 million (19 percent) from FY 2006-07 to FY 2008-09. Average monthly caseloads are projected to grow by roughly 11,700 (7.5 percent), while average costs are estimated to increase by almost six percent. General Assistance Medical Care costs are projected to rise $218.1 million (32 percent) from FY 2006-07 to FY 2008-09. Average monthly caseloads are projected to increase roughly 8,900 (18.8 percent) between the two biennia.

Continuing Care Grants are expected to reach $3.5 billion in FY 2008-09, a 10 percent increase from FY 2006-07. Waiver expenditures continue to account for the increase, primarily within CADI, MR/RC, and TBI. PCA/PDN is also expected to continue its double-digit growth. MA long-term care facility expenditures remain relatively stable, with little changes expected in nursing facility spending and continued decreases in ICF/MR spending.

In the planning estimates, general fund spending on MFIP/Diversionary Work Program grants is estimated to increase $27.5 million over the 2006-07 biennium. Caseloads are projected to decline slightly over this time period, while average cash payments are estimated to remain fairly constant. Thus, the primary reason for the increase in general fund financing is that general fund dollars are projected to pay for a greater share of MFIP/DWP program expenditures in FY 2008-09 compared to FY 2006-07.

MFIP/TY Child Care expenditures are projected to increase another $23.1 million (13 percent) from FY 2006-07 to 2008-09. Caseloads are expected to decline slightly, while average costs will increase 9.3 percent due to projected increases in child care provider maximum payments.

FY 2006-07 Debt Service Grows Based on Assumptions of Future Capital Budgets

Forecast debt service estimates for the 2006-07 biennium is $721 million, up $11 million over the end-of-session and an increase of $132 million over the current biennium. The forecast change is largely the result of refinancing of outstanding state bonds earlier than planned with the savings occurring in the FY 2004-05 biennium rather than in FY 2006-07.

The forecast assumes future capital budgets of $400 million in each even numbered legislative session and $110 million in each odd numbered legislative session.

The forecast debt service for the 2008-09 biennium is expected to grow to $747 million based on the same assumptions.

All Other Spending Remains Essentially Flat Into FY 2006-07

All other spending is expected to total $3.086 billion for FY 2006-07, or about 10 percent of total general fund spending. This is an increase of $132 million, 4.3 percent, over the current biennium. Almost all of that increase occurs in criminal justice programs. The majority of state agencies and programs, outside the major forecast areas, show little or no net change from the current biennium. FY 2005 appropriations generally are the basis for projecting FY 2006-07 spending by year. Some of the unique factors, however are highlighted below:

Criminal Justice

Criminal Justice spending is projected to total $1.569 billion in FY 2006-07, a $132 million increase over the current biennium. Primary factors behind this increase include the growing prison populations, completing the court takeover, and changes in public defender funding.

The cost of correctional services, including adult and juvenile institutions, community services, and management services, will increase $72.8 million in FY 2006-07. Virtually this entire amount is for the increasing numbers of Minnesota inmates. Current year populations are nearly 240 more than forecast one year ago. The Department of Corrections projects inmate populations at 8,793 by the end of FY 2005 growing to 9,835 by the end of FY 2007. Significant factors behind this increase include the felony DWI law which took effect August 1, 2002, increased numbers of admissions from revocation of supervised release, and increased drug offenders, especially those involved with methamphetamine.

The cost of correctional services is estimated to increase another $43.5 million in FY 2008-09 planning estimates, reflecting an inmate population expected to reach 10,502 by the end of FY 2009.

Funding for trial court costs in FY 2006-07 grows $68.5 million over the current biennium. The final step of the court takeover in the 6th and 10th judicial districts on July 1, 2005 accounts for $46.3 million of the increase. An additional $21.3 million reflects the full biennial cost of the court takeover in the 1st and 3rd judicial districts that occurred on July 1, 2004.

Spending for the Board of Public Defense is projected to decrease $7.3 million in the FY 2006-07 biennium from current levels. This is primarily the result of a $7.5 million reduction in FY 2005 funding enacted in conjunction with a Public Defender co-pay provision. The co-pay provision was ruled unconstitutional by the Minnesota Supreme Court, but the underlying funding amount is not changed in current law.

Environment, Agriculture and Economic Development

Spending for environment, agriculture, and economic development programs is projected to be $677 million in FY 2006-07. This is a $4 million decrease from the current biennium and a $10 million decrease from previous estimates. Contributing to the net reductions is $10 million savings from a decline in the number of recipients eligible to receive ethanol producer payments. The number of eligible ethanol producers will continue to decline as they reach the 10-year limit for receiving payments.

Higher Cancellation Estimates Reduce Net Spending

Finally, the estimate of cancellations of unused appropriations in FY 2006-07 has been increased from $5 million to $20 million. The cancellation estimate represents a forecast of individual agency appropriations (excluding major forecast items) that will remain unspent during the next biennium. Unspent operating and grant appropriations cancel back to the general fund either at the end of a fiscal year or at the end of the biennium. The increase in the cancellation estimate reflects a return to more historical amounts, after the estimates had been lower following the substantive budget cuts made in FY 2003-05.

Selected Statutory Provisions

Allocation of Forecast Balances

16A.152 Budget reserve and cash flow accounts.

Subdivision 2. Additional Revenues; Priority.

(a) If on the basis of a forecast of general fund revenues and expenditures, the commissioner of finance determines that there will be a positive unrestricted budgetary general fund balance at the close of the biennium, the commissioner of finance must allocate money to the following accounts and purposes in priority order:

(1) the cash flow account established in subdivision 1 until that account reaches $350,000,000;

(2) the budget reserve account established in subdivision 1a until that account reaches $653,000,000;

(3) the amount necessary to increase the aid payment schedule for school district aids and credits payments in section 127A.45 to not more than 90 percent; and

(4) the amount necessary to restore all or a portion of the net aid reductions under section 127A.441 and to reduce the property tax revenue recognition shift under section 123B.75, subdivision 5, paragraph (c), and Laws 2003, First Special Session chapter 9, article 5, section 34, as amended by Laws 2003, First Special Session chapter 23, section 20, by the same amount.

(b) The amounts necessary to meet the requirements of this section are appropriated from the general fund within two weeks after the forecast is released or, in the case of transfers under paragraph (a), clauses (3) and (4), as necessary to meet the appropriations schedules otherwise established in statute.

(c) To the extent that a positive unrestricted budgetary general fund balance is projected, appropriations under this section must be made before any transfer is made under section 16A.1522.

(d) The commissioner of finance shall certify the total dollar amount of the reductions under paragraph (a), clauses (3) and (4), to the commissioner of education. The commissioner of education shall increase the aid payment percentage and reduce the property tax shift percentage by these amounts and apply those reductions to the current fiscal year and thereafter.

Determination of Higher Education Base

MS 135A.031 Appropriations for instructional services.

Subdivision 3. Determination Of Instructional Services Base.
The instructional services base for each public postsecondary system is the sum of:
(1) the state share;
(2) the legislatively estimated tuition for the second year of the most recent biennium; and;
(3) adjustments for inflation, enrollment changes as calculated in subdivision 4, and performance as calculated in subdivision 5.

Subdivision 4. Adjustment For Enrollments.
(a) Each public postsecondary system's instructional services base shall be adjusted for estimated changes in enrollments. For each two percent change in estimated full-year equivalent enrollment, an adjustment shall be made to 65 percent of the instructional services base. The remaining 35 percent of the instructional services base is not subject to the adjustment in this subdivision.
(b) For all purposes where student enrollment is used for budgeting purposes, student enrollment shall be measured in full-year equivalents and shall include only enrollments in courses that award credit or otherwise satisfy any of the requirements of an academic or vocational program.
(c) The enrollment adjustment shall be made for each year of the subsequent biennium. The base enrollment year is the 1995 fiscal year enrollment. The base enrollment shall be updated for each two percent change in estimated full-year equivalent enrollment. If the actual enrollment differs from the estimated enrollment, an adjustment shall be made in the next biennium.

Subdivision 5. Adjustment For Performance.
Each public postsecondary system's instructional services base shall be adjusted, up to one percent, if the system meets the performance standards established by the system's governing board as part of the biennial budget document.

Subdivision 6. Adjustment For Change Items.
The instructional services base may be adjusted for change items as determined by the governor and the legislature after adjustments for inflation, enrollments, and performance.

Subdivision 7. Reports.
Instructional expenditure and enrollment data for each instructional category shall be submitted in the biennial budget document.

HIST: 1994 c 532 art 3 s 2; 1995 c 212 art 2 s 1; 1Sp2001 c 1 art 2 s 6

Alternative Forecast Comparison

Real GDP (Annual Rates)

	04III	04IV	05I	05II	05III	05IV	04A	05A	06A
GII Baseline (11-04)	3.7	3.6	2.9	3.3	2.9	2.8	4.4	3.2	3.1
Blue Chip (11-04)	3.7	3.6	3.3	3.5	3.6	3.5	4.4	3.5	3.4
Economy.Com (11-04)	3.7	4.3	3.3	NA	NA	NA	4.4	3.4	NA
American Express (11-04)	3.7	4.4	3.4	3.1	3.8	3.7	4.5	3.7	NA
UBS (11-04)	3.7	3.5	3.2	2.7	3.0	3.0	4.4	3.2	3.0
Standard & Poors (11-04)	3.7	3.6	3.2	3.3	NA	NA	4.4	3.4	3.5

Consumer Price Index (Annual Rates)

	04III	04IV	05I	05II	05III	05IV	04A	05A	06A
GII Baseline (11-04)	1.9	3.1	2.3	2.0	0.7	1.0	2.7	2.2	1.3
Blue Chip (11-04)	1.9	2.5	2.2	2.2	2.2	2.3	2.6	2.4	2.3
Economy.Com (11-04)	1.9	2.9	1.5	NA	NA	NA	2.7	2.2	1.3
American Express (11-04)	1.9	2.8	2.7	2.5	2.3	2.0	3.2*	2.4*	NA
UBS (11-04)	1.9	2.6	1.4	1.4	1.8	2.2	2.6	2.0	2.3
Standard & Poors (11-04)	1.9	3.1	2.3	2.0	NA	NA	2.7	2.2	1.5

*4Q/4Q

Forecast Comparisons

Real Economic Growth

(Annual Percent Change in Real GDP)

	2004	2005	2006	2007	2008	2009
Nov 00 DRI Control	3.2[1]	3.2[1]				
Feb 01 DRI Control	3.2[1]	3.2[1]				
Nov 01 DRI Control	3.8	3.2[1]				
Feb 02 DRI Control	3.9	3.2[1]				
Nov 02 GII Baseline	4.1	3.8	3.5	3.1		
Feb 03 GII Baseline	4.6	3.8	3.1	2.9		
Nov 03 GII Baseline	4.3	3.6	3.6	2.9		
Feb 04 GII Baseline	4.8	3.8	3.6	2.9		
Nov 04 GII Baseline	4.4	3.2	3.6	3.1	3.1	3.2

Inflation

(Annual Percent Change in CPI-U)

	2004	2005	2006	2007	2008	2009
Nov 00 DRI Control	2.4[1]	2.7[1]				
Feb 01 DRI Control	2.4[1]	2.7[1]				
Nov 01 DRI Control	2.6	2.7[1]				
Feb 02 DRI Control	2.5	2.7[1]				
Nov 02 GII Baseline	2.4	2.3	2.2	2.1		
Feb 03 GII Baseline	1.9	2.1	2.2	2.5		
Nov 03 GII Baseline	1.4	1.9	2.0	2.5		
Feb 04 GII Baseline	1.4	1.3	1.5	2.5		
Nov 04 GII Baseline	2.7	2.2	1.3	1.7	1.9	2.1

(1) 10 year trend from DRI Early Recession (Pessim), November, 2000

Minnesota - U.S. Comparison Report

November 2004 Control
(Annual Percent Changes)

	2001	2002	2003	2004	2005	2006	2007
Wage and Salary Income							
United States	2.4	0.7	2.6	4.5	5.4	5.4	5.2
Minnesota*	3.2	1.4	2.7	4.1	5.3	4.9	5.0
Implied Annual Wage							
United States	2.1	1.8	2.9	3.5	3.6	4.2	4.4
Minnesota	3.0	2.4	2.8	3.3	4.3	4.0	3.9
Non-Farm Employment							
United States	0.3	-1.1	-0.3	1.0	1.7	1.2	0.8
Minnesota	0.2	-1.0	-0.1	0.8	1.0	0.9	1.1
Personal Income							
United States	3.5	1.8	3.2	5.2	4.9	5.4	5.2
Minnesota	3.0	2.4	3.3	4.9	4.7	5.2	5.2

* Es 202 Wages

COMPARISON OF ACTUAL AND ESTIMATED
NON-RESTRICTED REVENUES
Oct Ytd, 2004 -FY2005
($ IN THOUSANDS)

	FORECAST REVENUES	ACTUAL REVENUES	VARIANCE ACT-FCST	FORECAST REVENUES	ACTUAL REVENUES	VARIANCE ACT-FCST
Individual Income Tax						
Withholding	1,604,000	1,597,615	-6,385	384,700	393,162	8,462
Declarations	232,778	240,005	7,227	16,613	11,292	-5,321
Miscellaneous	70,375	75,282	4,907	21970	26,501	4,531
Gross	1,907,153	1,912,902	5,748	423282	430,954	7,672
Refund	43,667	52,716	9,050	19853	18,730	-1,122
Net	1,863,487	1,860,185	-3,301	403430	412,224	8,794
Corporate & Bank Excise						
Declarations	206,800	231,149	24,349	26,900	37,602	10,702
Miscellaneous	31,700	58,672	26,972	10100	24,167	14,067
Gross	238,500	289,820	51,320	37,000	61,769	24,769
Refund	22,000	17,141	-4,859	9000	6,306	-2,694
Net	216,500	272,679	56,179	28,000	55,463	27,463
Sales Tax						
Gross	1,360,700	1,340,249	-20,451	404,280	397,850	-6,430
Refunds	64,358	53,579	-10,779	12,921	10,722	-2,199
Net	1,296,342	1,286,670	-9,672	391,359	387,128	-4,231
Motor Vehicle Sales	101,288	92,867	-8,420	26224	22,087	-4,137
Other Revenues:						
Inherit/Gift/Estate	24,667	27,420	2,754	6167	6,529	362
Liquor/Wine/Beer	18,650	20,431	1,782	5133	6,001	868
Cigarette/Tobacco/Cont Sub	48,223	46,111	-2,111	12434	11,499	-935
Deed and Mortgage	68,275	83,651	15,376	21591	25,938	4,347
Insurance Gross Earnings	57,700	61,673	3,973	600	-12,156	-12,756
Lawful Gambling	11,965	14,018	2,053	1985	3,030	1,046
Health Care Surcharge	65,892	65,225	-667	16,473	14,723	-1,750
Other Taxes	499	305	-194	84	74	-10
state wide property tax	1,104	253	-851	912	8	-904
dhs rtc Collections	17,791	13,883	-3,908	4448	2,834	-1,614
Income Tax Reciprocity	0	0	0	0	0	0
Investment Income	2,500	4,623	2,123	833	1,210	377
Tobacco Settlement	0	100	100	0	0	0
Departmental Earnings	70,297	69,218	-1,079	19,265.7	20,574	1,308
Fines and Surcharges	11,309	25,343	14,034	2,961	6,674	3,713
Lottery Revenues	9,044	9,822	778	3014.7	4,018	1,003
Revenues yet to be allocated	0	1,464	1,464	0	-125	-125
Residual revenues	40,532	31,253	-9,279	10,638	6,332	-4,306
Sales Tax Rebates (all years)	0	1	1	0	-1	-1
Other Subtotal	**448,447**	**474,794**	**26,347**	**106,540**	**97,163**	**-9,377**
Other Refunds	**6,760**	**8,751**	**1,991**	**1500**	**3,396**	**1,896**
Other Net	**441,687**	**466,043**	**24,356**	**105,040**	**93,767**	**-11,273**
Total Gross	**4,056,088**	**4,110,632**	**54,544**	**997,326**	**1,009,823**	**12,497**
Total Refunds	**136,785**	**132,188**	**-4,597**	**43,273**	**39,154**	**-4,119**
Total Net	**3,919,303**	**3,978,444**	**59,141**	**954,052**	**970,668**	**16,616**

Factors Affecting the Individual Income Tax
($ in billions)

	Calendar Year					
	2002	2003	2004	2005	2006	2007
Minnesota Non-Farm Tax Base						
November 2000 Control	155.040	165.080				
February 2001 Control	152.840	162.610				
November 2001 Control	146.880	155.990				
February 2002 Baseline	145.890	153.470				
*November 2002 Baseline	140.600	145.760	154.850	164.940		
*February 2003 Baseline	140.520	144.940	153.580	163.500		
*November 2003 Baseline	142.370	146.160	152.011	160.690		
*February 2004 Baseline	142.370	146.080	152.201	160.413		
*November 2004 Baseline	138.871	142.592	149.277	156.214	163.506	171.373
Minnesota Wage and Salary Income						
November 2000 Control	109.420	116.870				
February 2001 Control	108.100	115.190				
November 2001 Control	102.920	109.210				
February 2002 Control	101.910	107.140				
*November 2002 Baseline	96.100	99.790	106.150	112.830		
*February 2003 Baseline	96.100	98.830	104.690	111.420		
*November 2003 Baseline	96.780	99.410	103.830	109.140		
*February 2004 Baseline	96.780	99.520	103.570	108.910		
*November 2004 Baseline	96.941	99.558	103.632	109.075	114.465	120.202
Minnesota Property Income						
November 2000 Control	35.015	36.754				
February 2001 Control	34.163	36.102				
November 2001 Control	33.184	35.201				
February 2002 Control	33.466	35.074				
November 2002 Baseline	33.564	34.408	36.104	39.119		
February 2003 Baseline	33.464	34.389	36.176	38.513		
November 2003 Baseline	34.509	34.946	36.045	38.041		
February 2004 Baseline	34.509	34.780	36.027	38.197		
November 2004 Baseline	30.809	31.287	32.956	33.650	34.760	36.088
Minnesota Proprietors' Income						
November 2000 Control	10.607	11.455				
February 2001 Control	10.570	11.323				
November 2001 Control	10.779	11.586				
February 2002 Control	10.515	11.256				
November 2002 Baseline	10.936	11.761	12.297	12.996		
February 2003 Baseline	10.955	11.720	12.712	13.573		
November 2003 Baseline	11.086	11.803	12.691	13.508		
February 2004 Baseline	11.086	11.779	12.601	13.308		
November 2004 Baseline	11.120	11.747	12.689	13.489	14.281	15.083

** Wages reflect ES202 Data*

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

($ in billions)

	Fiscal Year					
	2002	2003	2004	2005	2006	2007
SALES TAX						
Minnesota Synthetic Sales Tax Base						
February 2003 Baseline	61.794	62.968	65.876	70.137		
Pct	0.4%	1.9%	4.6%	6.5%		
November 2003 Baseline	61.647	62.976	66.185	68.232		
Pct	0.4%	2.2%	5.1%	3.1%		
February 2004 Baseline	61.425	63.011	67.636	70.481		
Pct	0.0%	2.6%	7.3%	4.2%		
November 2004 Baseline	61.092	62.542	66.848	71.014	73.521	75.447
Pct	-1.0%	2.4%	6.9%	6.2%	3.5%	2.6%
Minnesota's Proxy Share of U.S. Consumer Durable Spending (Excluding Autos)						
February 2002 Control	10.740	10.843				
November 2002 Baseline	10.806	11.146	11.733	12.451		
February 2003 Baseline	10.807	11.137	11.617	12.394		
November 2003 Baseline	10.793	11.119	11.764	12.174		
February 2004 Baseline	10.717	11.118	12.106	12.685		
November 2004 Baseline	10.573	10.856	11.705	12.241	12.612	13.021
Minnesota's Proxy Share of U.S. Capital Equipment Spending						
February 2002 Control	9.683	9.850				
November 2002 Baseline	8.799	10.252	10.693	11.579		
February 2003 Baseline	9.795	10.082	10.624	11.577		
November 2003 Baseline	9.785	10.143	11.080	11.703		
February 2004 Baseline	10.043	10.300	11.616	12.506		
November 2004 Baseline	10.005	10.177	11.438	12.766	13.674	14.289
Minnesota's Proxy Share of U.S. Construction Spending						
February 2002 Control	8.345	8.420				
November 2002 Baseline	8.467	8.337	8.612	9.424		
February 2003 Baseline	8.479	8.429	8.798	9.191		
November 2003 Baseline	8.364	8.404	8.990	8.915		
February 2004 Baseline	8.691	8.864	9.814	9.970		
November 2004 Baseline	8.823	9.101	10.171	11.188	11.620	11.676

* Reflects data revision.

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

($ in billions)

	Fiscal Year					
	2002	2003	2004	2005	2006	2007
SALES TAX (Cont.)						
Minnesota's Personal Income Excluding Farm Proprietors Income						
November 2000 Control	170.86	181.54				
February 2001 Control	169.03	179.41				
November 2001 Control	163.61	174.93				
February 2002 Control	165.28	173.63				
November 2002 Baseline*	166.54	173.04	181.57	192.47		
February 2003 Baseline*	166.43	172.40	181.12	192.14		
November 2003 Baseline*	166.40	172.04	178.50	187.08		
February 2004 Baseline*	166.40	172.31	178.82	187.04		
November 2004 Baseline*	160.35	165.44	173.29	181.51	190.34	200.13
SALES TAX ON MOTOR VEHICLES						
Minnesota's Proxy Share of U.S. Consumption of Motor Vehicle and Parts						
November 2000 Control	6.764	7.452				
February 2001 Control	6.566	7.080				
November 2001 Control	7.007	7.484				
February 2002 Control	7.403	7.506				
November 2002 Baseline	7.493	7.353	7.568	7.361		
February 2003 Baseline	7.496	7.572	7.619	7.676		
November 2003 Baseline	7.512	7.800	7.988	8.060		
February 2004 Baseline	8.524	8.378	8.770	8.891		
November 2004 Baseline	8.514	8.856	9.025	9.095	9.132	9.594
CORPORATE FRANCHISE TAX		Calendar Year				
U.S. Corporate Profits						
November 2000 Control	993.5	1,089.0				
February 2001 Control	1,006.3	1,066.2				
November 2001 Control	685.7	761.2				
February 2002 Control	722.1	786.0				
November 2002 Baseline	662.2	771.1	873.5	871.0		
February 2003 Baseline	650.7	753.8	859.6	857.1		
November 2003 Baseline	665.2	770.0	869.6	890.9		
February 2004 Baseline	745.0	842.9	1,016.8	997.5**		
November 2004 Baseline	755.8	690.9	810.3	949.5**	1019.7**	1010.9**

* Wages reflect ES202 date

** Finance Dept Estimate

FY 2004-05 Current Biennium Forecast Comparison
November 2004 vs End of Session (Before Statutory Allocations)
($ in thousands)

	5-04 EOS FY 2004-05	11-04 Fcst FY 2004-05	Fcst vs EOS FY 2004-05
Actual & Estimated Resources			
Balance Forward From Prior Year	368,922	368,922	0
Current Resources:			
Tax Revenues	25,190,792	25,627,138	436,346
Non-Tax Revenues	1,495,915	1,465,776	(30,139)
Dedicated Revenue	65,100	58,506	(6,594)
Transfers In	1,445,631	1,456,362	10,731
Prior Year Adjustments	20,200	64,897	44,697
Subtotal-Current Resources	28,217,638	28,672,679	455,041
Total Resources Available	**28,586,560**	**29,041,601**	**455,041**
Actual & Estimated Spending			
E-12 Education	12,208,906	12,230,445	21,539
Property Tax Recog/Payment Change	(449,723)	(445,861)	3,862
Subtotal E-12 Education	11,759,183	11,784,584	25,401
Property Tax Aids & Credits	2,777,814	2,808,016	30,202
Higher Education	2,560,783	2,541,702	(19,081)
Health & Human Services	7,206,481	7,245,112	38,631
Environment, Agriculture & Economic Dev	704,982	670,142	(34,840)
Transportation	160,162	158,721	(1,441)
Criminal Justice	1,440,322	1,436,740	(3,582)
State Government	645,038	649,393	4,355
Debt Service	625,078	589,027	(36,051)
Other	0	6,901	6,901
Estimated Cancellations	(20,217)	(44,000)	(23,783)
Subtotal Expenditures & Transfers	**27,859,626**	**27,846,338**	**(13,288)**
Dedicated Expenditures	94,906	74,363	(20,543)
Total Expenditures & Transfers	**27,954,532**	**27,920,701**	**(33,831)**
Balance Before Reserves	**632,028**	**1,120,900**	**488,872**
Cash Flow Account	0	0	0
Budget Reserve	631,434	625,434	(6,000)
Budgetary Balance	**594**	**495,466**	**494,872**

November 2004 General Fund Forecast

Current Biennium (After Statutory Allocations)

($ in thousands)

	Actual FY 2004	11-04 Fcst FY 2005	11-04 Fcst FY 2004-05
Actual & Estimated Resources			
Balance Forward From Prior Year	368,922	1,268,455	368,922
Current Resources:			
Tax Revenues	12,520,041	13,107,097	25,627,138
Non-Tax Revenues	775,448	690,328	1,465,776
Dedicated Revenue	19,929	38,577	58,506
Transfers In	1,143,977	312,385	1,456,362
Prior Year Adjustments	39,897	25,000	64,897
Subtotal-Current Resources	14,499,292	14,173,387	28,672,679
Total Resources Available	**14,868,214**	**15,441,842**	**29,041,601**
Actual & Estimated Spending			
E-12 Education	6,138,298	6,092,147	12,230,445
Property Tax Recog/Payment Change	(424,004)	(21,857)	(445,861)
E-12 Aid Payment Change	0	117,900	117,900
Subtotal E-12 Education	5,714,294	6,188,190	11,902,484
Property Tax Aids & Credits	1,438,722	1,369,294	2,808,016
Higher Education	1,235,604	1,306,098	2,541,702
Health & Human Services	3,511,023	3,734,089	7,245,112
Environment, Agriculture & Economic Dev	332,406	337,736	670,142
Transportation	77,623	81,098	158,721
Criminal Justice	682,531	754,209	1,436,740
State Government	299,163	350,230	649,393
Debt Service	265,706	323,321	589,027
Other	6,901	0	6,901
Estimated Cancellations	0	(44,000)	(44,000)
Subtotal Expenditures & Transfers	**13,563,973**	**14,400,265**	**27,964,238**
Dedicated Expenditures	35,786	38,577	74,363
Total Expenditures & Transfers	**13,599,759**	**14,438,842**	**28,038,601**
Balance Before Reserves	**1,268,455**	**1,003,000**	**1,003,000**
Cash Flow Account	0	350,000	350,000
Budget Reserve	403,677	653,000	653,000
Appropriations Carried Forward	183,613	0	0
Budgetary Balance	**681,165**	**0**	**0**

Biennial Comparison
FY 2006-07 vs FY 2004-05
($ in thousands)

	11-04 Fcst FY 2004-05	11-04 Fcst FY 2006-07	$ Change	% Change
Actual & Estimated Resources				
Balance Forward From Prior Year	368,922	1,003,000	634,078	171.9%
Current Resources:				
Tax Revenues	25,627,138	27,658,161	2,031,023	7.9%
Non-Tax Revenues	1,465,776	1,405,540	(60,236)	-4.1%
Dedicated Revenue	58,506	74,685	16,179	27.7%
Transfers In	1,456,362	289,151	(1,167,211)	-80.1%
Prior Year Adjustments	64,897	50,000	(14,897)	-23.0%
Subtotal-Current Resources	28,672,679	29,477,537	804,858	2.8%
Total Resources Available	**29,041,601**	**30,480,537**	**1,438,936**	**5.0%**
Actual & Estimated Spending				
E-12 Education	12,230,445	12,045,122	(185,323)	
Property Tax Recog/Payment Change	(445,861)	(76,041)	369,820	
E-12 Aid Payment Change	117,900	0	(117,900)	
Subtotal E-12 Education	11,902,484	11,969,081	66,597	0.6%
Property Tax Aids & Credits	2,808,016	2,966,359	158,343	5.6%
Higher Education	2,541,702	2,752,758	211,056	8.3%
Health & Human Services	7,245,112	8,683,916	1,438,804	19.9%
Environment, Agriculture & Economic Dev	670,142	666,530	(3,612)	-0.5%
Transportation	158,721	162,735	4,014	2.5%
Criminal Justice	1,436,740	1,568,535	131,795	9.2%
State Government	649,393	631,727	(17,666)	-2.7%
Debt Service	589,027	721,055	132,028	22.4%
Other	6,901	0	(6,901)	nm
Estimated Cancellations	(44,000)	(20,000)	24,000	-54.5%
Subtotal Expenditures & Transfers	**27,964,238**	**30,102,696**	**2,138,458**	
Dedicated Expenditures	74,363	74,685	322	0.4%
Total Expenditures & Transfers	**28,038,601**	**30,177,381**	**2,138,780**	**7.6%**
Balance Before Reserves	**1,003,000**	**303,156**	**(699,844)**	
Cash Flow Account	350,000	350,000	0	
Budget Reserve	653,000	653,000	0	
Budgetary Balance	**0**	**(699,844)**	**(699,844)**	

FY 2006-07 Biennial Comparison
November 2004 Forecast vs End of Session
($ in thousands)

	5-04 EOS FY 2006-07	11-04 Fcst FY 2006-07	Fcst vs EOS FY 2006-07
Actual & Estimated Resources			
Balance Forward From Prior Year	632,028	1,003,000	370,972
Current Resources:			
Tax Revenues	27,460,091	27,658,161	198,070
Non-Tax Revenues	1,409,397	1,405,540	(3,857)
Dedicated Revenue	90,100	74,685	(15,415)
Transfers In	243,804	289,151	45,347
Prior Year Adjustments	20,200	50,000	29,800
Subtotal-Current Resources	29,223,592	29,477,537	253,945
Total Resources Available	**29,855,620**	**30,480,537**	**624,917**
Actual & Estimated Spending			
E-12 Education	12,013,027	12,045,122	32,095
Property Tax Recog/Payment Change	(79,226)	(76,041)	3,185
Subtotal E-12 Education	11,933,801	11,969,081	35,280
Property Tax Aids & Credits	2,975,943	2,966,359	(9,584)
Higher Education	2,547,848	2,752,758	204,910
Health & Human Services	8,375,319	8,683,916	308,597
Environment, Agriculture & Economic Dev	676,133	666,530	(9,603)
Transportation	162,735	162,735	0
Criminal Justice	1,526,940	1,568,535	41,595
State Government	625,832	631,727	5,895
Debt Service	711,688	721,055	9,367
Estimated Cancellations	(5,000)	(20,000)	(15,000)
Subtotal Expenditures & Transfers	**29,531,239**	**30,102,696**	**571,457**
Dedicated Expenditures	90,100	74,685	(15,415)
Total Expenditures & Transfers	**29,621,339**	**30,177,381**	**556,042**
Balance Before Reserves	**234,281**	**303,156**	**68,875**
Cash Flow Account	0	350,000	350,000
Budget Reserve	631,434	653,000	21,566
Budgetary Balance	**(397,153)**	**(699,844)**	**(302,691)**

Fiscal Year Comparison
Percent Change
($ in thousands)

	11-04 Fcst FY 2005	11-04 Fcst FY 2006	% Change	11-04 Fcst FY 2007	% Change
Actual & Estimated Resources					
Balance Forward From Prior Year	1,268,455	1,003,000		518,195	
Current Resources:					
Tax Revenues	13,107,097	13,567,788	3.5%	14,090,373	3.9%
Non-Tax Revenues	690,328	700,633	1.5%	704,907	0.6%
Dedicated Revenue	38,577	37,384	-3.1%	37,301	-0.2%
Transfers In	312,385	139,232	-55.4%	149,919	7.7%
Prior Year Adjustments	25,000	25,000	0.0%	25,000	0.0%
Subtotal-Current Resources	14,173,387	14,470,037	2.1%	15,007,500	3.7%
Total Resources Available	**15,441,842**	**15,473,037**	**0.2%**	**15,525,695**	**0.3%**
Actual & Estimated Spending					
E-12 Education	6,092,147	6,043,570	-0.8%	6,001,552	
Property Tax Recog/Payment Change	(21,857)	(47,612)	117.8%	(28,429)	
E-12 Aid Payment Change	117,900	0	-100.0%	0	
Subtotal E-12 Education	6,188,190	5,995,958	-3.1%	5,973,123	-0.4%
Property Tax Aids & Credits	1,369,294	1,474,917	7.7%	1,491,442	1.1%
Higher Education	1,306,098	1,427,266	9.3%	1,325,492	-7.1%
Health & Human Services	3,734,089	4,149,976	11.1%	4,533,940	9.3%
Environment, Agriculture & Economic Dev	337,736	333,539	-1.2%	332,991	-0.2%
Transportation	81,098	80,740	-0.4%	81,995	1.6%
Criminal Justice	754,209	777,318	3.1%	791,217	1.8%
State Government	350,230	314,546	-10.2%	317,181	0.8%
Debt Service	323,321	368,198	13.9%	352,857	-4.2%
Estimated Cancellations	(44,000)	(5,000)	-88.6%	(15,000)	200.0%
Subtotal Expenditures & Transfers	**14,400,265**	**14,917,458**		**15,185,238**	
Dedicated Expenditures	38,577	37,384	-3.1%	37,301	-0.2%
Total Expenditures & Transfers	**14,438,842**	**14,954,842**	**3.6%**	**15,222,539**	**1.8%**
Balance Before Reserves	**1,003,000**	**518,195**		**303,156**	
Cash Flow Account	350,000	350,000		350,000	
Budget Reserve	653,000	653,000		653,000	
Budgetary Balance	**0**	**(484,805)**		**(699,844)**	

FY 2004-09 Planning Horizon
November 2004 General Fund Forecast
($ in thousands)

	11-04 Fcst FY 2004-05	11-04 Fcst FY 2006-07	11-04 Plng Est FY 2008-09
Actual & Estimated Resources			
Balance Forward From Prior Year	368,922	1,003,000	303,156
Current Resources:			
Tax Revenues	25,627,138	27,658,161	30,136,038
Non-Tax Revenues	1,465,776	1,405,540	1,379,639
Dedicated Revenue	58,506	74,685	74,560
Transfers In	1,456,362	289,151	176,203
Prior Year Adjustments	64,897	50,000	50,000
Subtotal-Current Resources	28,672,679	29,477,537	31,816,440
Total Resources Available	**29,041,601**	**30,480,537**	**32,119,596**
Actual & Estimated Spending			
E-12 Education	12,230,445	12,045,122	11,856,217
Property Tax Recog/Payment Change	(445,861)	(76,041)	(84,434)
E-12 Aid Payment Change	117,900	0	0
Subtotal E-12 Education	11,902,484	11,969,081	11,771,783
Property Tax Aids & Credits	2,808,016	2,966,359	3,034,699
Higher Education	2,541,702	2,752,758	2,650,984
Health & Human Services	7,245,112	8,683,916	9,983,434
Environment, Agriculture & Economic Dev	670,142	666,530	667,365
Transportation	158,721	162,735	178,990
Criminal Justice	1,436,740	1,568,535	1,612,067
State Government	649,393	631,727	625,997
Debt Service	589,027	721,055	746,358
Other	6,901	0	0
Estimated Cancellations	(44,000)	(20,000)	(20,000)
Subtotal Expenditures & Transfers	**27,964,238**	**30,102,696**	**31,251,677**
Dedicated Expenditures	74,363	74,685	74,560
Total Expenditures & Transfers	**28,038,601**	**30,177,381**	**31,326,237**
Balance Before Reserves	**1,003,000**	**303,156**	**793,359**
Cash Flow Account	350,000	350,000	350,000
Budget Reserve	653,000	653,000	653,000
Budgetary Balance	**0**	**(699,844)**	**(209,641)**