Minnesota Department of Finance

November 2006 Economic Forecast

November 2006

Highlights

$1.038 Billion Surplus Now Projected for Current Biennium

FY 2006-07 general fund revenues are forecast to exceed end-of-session estimates by $913 million (2.9 percent), while biennial expenditures are expected to fall $125 million (0.4 percent) below prior estimates. A $1.038 billion general fund balance is now projected for the end of the biennium. The projected balance is 3.2 percent of general fund revenues.

FY 2008-09 Budget Outlook Improves by $394 Million

At the end of the 2006 legislative session, a $737 million available balance was projected for FY 2008-09. The forecast for general fund revenues has increased $297 million (0.9 percent), while forecast spending has been reduced $97 million (0.3 percent). Forecast revenues now exceed projected spending by $1.132 billion in FY 2008-09.

$2.170 Billion Available for FY 2008-09 Budget Decisions

The $1.038 billion surplus forecast for FY 2006-07 and the $1.132 billion balance now projected for FY 2008-09 combine to make $2.170 billion available for the FY 2008-09 budget. These estimates, however, are only the starting point for budget development. Projected FY 2008-09 spending estimates are largely an extension of current funding levels, and do not include general inflation. Adjusting for inflation would add $1.0 to $1.2 billion to FY 2008-09 spending.

Little Change in Economic Outlook — Slower Growth Expected in 2007

Forecasters are concerned about the current weakness in the housing sector, but believe the economy has sufficient momentum to avoid a recession. Global Insight expects real GDP to grow at a 2.6 percent annual rate in FY 2007 slightly slower than February's forecast, then return to trend growth of about 3 percent for the 2008-09 biennium. Prices are expected to increase slightly faster than forecast in February, leaving current dollar GDP unchanged at the end of the biennium from February's forecast.

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Budget Summary

$1.038 Billion Surplus for FY 2006-07

FY 2006 receipts were $451 million above end-of-session estimates. The forecast for FY 2007 has been increased by $480 million. After including an $18 million reduction in other resources, FY 2006-07 revenues are now expected to increase by $913 million. Actual spending in FY 2006 was $60 million below forecast; forecast spending in FY 2007 is down $65 million. The $125 million spending reduction and higher forecast revenues combine to produce a projected ending balance of $1.038 billion for the 2006-07 biennium.

FY 2006-07 Forecast
($ in millions)

	End of Session	November Forecast	Change
Beginning Balance	**$1,393**	**$1,393**	**$0**
Revenues	30,374	31,305	931
Other Resources	958	940	(18)
Total Resources	**31,332**	**32,245**	**913**
Expenditures	**31,612**	**31,487**	**(125)**
Cash Flow Account	350	350	0
Budget Reserve	653	653	0
Tax Relief Account	110	110	0
Available Balance	**$0**	**$1,038**	**$1,038**

Statute Defines Rebate Requirements

In 1999, legislation was adopted governing any forecast balance in the second year of a biennium. Minnesota statutes require the Commissioner of Finance to designate a balance that exceeds one-half of one percent of general fund biennial revenues as available for rebate. The current forecast exceeds that threshold. The requirement was pre-empted in 2004 by provisions allocating state surpluses to restoring reserves and repaying accounting shifts.

A rebate is not automatic. Statutes require that the Governor submit a rebate plan to the Legislature. The Legislature is required to enact, modify or reject the Governor's plan. A rebate to taxpayers would require legislation in the 2007 session.

Budget Outlook for FY 2008-09 Has Improved

In 2007 the Governor and Legislature will set the FY 2008-09 budget. This revenue and expenditure forecast is the basis for the Governor's budget proposals.

When the 2006 legislative session closed, FY 2008-09 was projected to end with a balance of $737 million. The financial outlook for 2008-09 has improved modestly. Forecast revenues are up $297 million (0.9 percent). Net spending is down $97 million (0.3 percent). These changes add $394 million to the bottom line, increasing the projected balance to $1.132 billion. The forecast $1.038 billion surplus in the current biennium adds to that amount providing a total of $2.170 billion for use in developing the FY 2008-09 budget.

FY 2008-09 Budget Outlook

($ in millions)

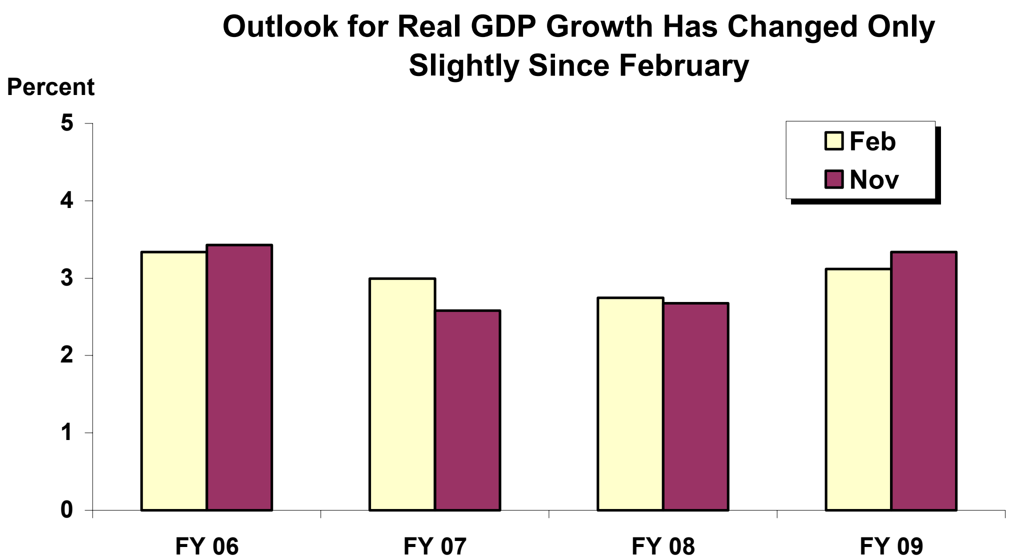
	End of Session	November Forecast	Change
Beginning Balance	**$1,113**	**$2,151**	**$1,038**
Forecast Revenues	33,220	33,518	297
Projected Spending	32,593	32,496	(97)
Reserves	1,003	1,003	0
Projected Balance	**$737**	**$2,170**	**$1,432**

These estimates are the starting point for budget development. Since no budget is currently in place, it is important to recognize that spending projections for FY 2008-09 are based largely on the extension of current law and appropriations. Spending estimates are adjusted only for expected changes in enrollment and caseload. General inflation is not included in the expenditure projections. If it were included, the spending forecast for FY 2008-09 would increase by $1.0 to $1.2 billion.

Little Change in Economic Outlook –Slower Real GDP Growth Still Expected

Economists expect the economy will grow more slowly over the next 18 months than it has in the recent past, but they do not expect a recession. The housing sector is a major concern, but most forecasters believe the U.S. economy has sufficient underlying strength to avoid a downturn. Weakness in housing will leave the economy in a more fragile state during the next 12 to 18 months, greatly reducing its ability to absorb a major oil price increase, international financial shock, or a geo-political incident without going into recession. Economists also are concerned that inflation may be more stubborn than currently thought. Should the Federal Reserve need to resume its inflation fighting, the accompanying higher interest rates could bring real GDP growth to a temporary halt.

November's baseline forecast from Global Insight Inc. (GII), Minnesota's national economic consultant, is very similar to the consensus outlook. While they recognize there are real risks to continued economic growth, they believe the economy remains on track for a slight slowdown through mid-2007 followed by a return to trend (3 percent) growth in calendar 2008. The GII November baseline is very similar to February's baseline, calling for real GDP growth at annual rates of 2.6 percent in fiscal 2007, 2.7 percent in 2008, and 3.3 percent in fiscal 2009. While the real (inflation adjusted) forecast is slightly less optimistic than February's, nominal or current dollar growth rates are virtually unchanged.



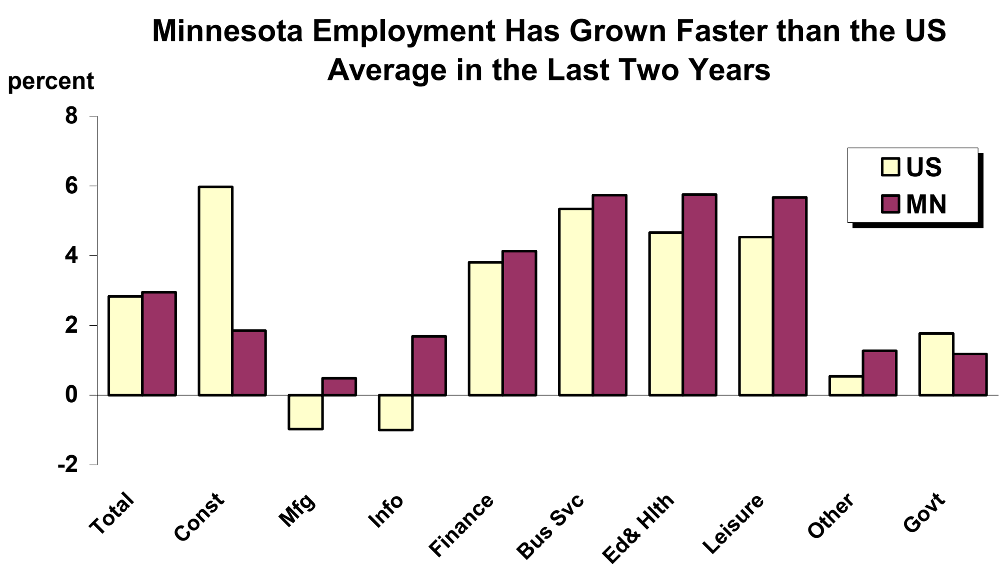
The housing sector is everyone's concern. Construction activity has been strong since 2002 and demand for housing has caused prices of new and existing houses to increase substantially. Now, higher interest rates have caused demand to decrease creating excess inventory of both new and existing homes on the market. Global Insight expects the average prices of existing housing to decline during 2007, the first time this has happened since the depression.

Minnesota Employment Growth Expected to Track U.S. Average Through 2009

Minnesota's economy appears to be performing very well in 2006. Second quarter payroll employment grew by 27,900 jobs. A total of 54,700 jobs have been added in 2006 through October. In 2004 payroll employment during the entire year increased by 28,000; in 2005, by 21,000.

Looking longer term, employment growth in Minnesota since the start of the 2001 recession finally appears to have caught up to the U.S. average. There are now 2.3 percent more jobs in Minnesota than at the start of the 2001 recession; the national growth rate for that period is 2.4 percent. Historically employment in Minnesota has grown slightly faster than the U.S. average.

Minnesota's strong job growth in 2006 may simply have been a catch-up from a temporary slump in 2005. Between October of 2004 and October 2006 employment grew by 3 percent in Minnesota and 2.8 percent nationally. Construction employment grew faster elsewhere in the nation than in Minnesota in the past two years, due in part to the necessary rebuilding from the 2005 hurricane season. In most other major sectors, however, Minnesota employment has grown slightly faster than the U.S. average. In the manufacturing and information sectors employment in Minnesota has grown even though national employment in those sectors has declined. Education and health care, professional and business services, and leisure and hospitality were the three sectors showing the greatest percentage growth in employment during the past two years. All grew about 5.7 percent while their U.S. counterparts grew at a slightly slower pace.



State Revenues Up $913 Million in Current Biennium, Up $297 Million in 08-09

General fund revenues are forecast to total $32.245 billion in the 2006-07 biennium and $33.518 billion in the 2008-09 biennium. For FY 2006-07 state revenues are now expected to exceed end-of-session estimates by $913 million (2.9 percent). The FY 2008-09 forecast adds $297 million (0.9 percent) from previous revenue planning estimates.

General Fund Revenues: Forecast Changes

($ in millions)

	Change 2006-07	%	Change 2008-09	%
Individual Income	$503	3.7	$356	2.4
Sales Tax	(92)	(1.0)	(154)	(1.6)
Corp. Inc. Tax	330	18.0	305	17.4
Motor Vehicles	(17)	(3.4)	(206)	(39.1)
All Other	189	3.0	(4)	(0.7)
Total Change	**$913**	**2.9**	**$297**	**0.9**

Individual income tax receipts showed the largest change from earlier estimates, up $503 million in the current biennium and $356 million in the 2008-09 biennium. Final liability for tax year 2005 was increased reflecting higher final payments and lower than projected refunds. The resulting increase in base liability extends through the full forecast horizon, offsetting a more modest outlook for income growth.

Percentage changes in the corporate income tax were very large. Corporate profits in 2005 were much higher than projected and corporate tax receipts exceeded the forecast by $105 million in fiscal 2006. Corporate revenues have continued to be stronger than projected in fiscal 2007. Through October corporate tax receipts are $98 million more than forecast. That additional revenue was incorporated into the forecast. Revised estimates of the cost of the Hutchinson Technology decision added a total of $167 million to the corporate forecast over the two biennia. Currently the ratio of corporate profits to GDP is higher than it has been in more than 50 years.

The sales tax and the motor vehicle sales tax show significant declines in revenue in both biennia. The reduction in the sales tax forecast is due to slower than previously projected growth in Minnesota taxable sales and revised estimates of the revenue to be gained from the state's streamlined sales tax initiative. About $155 million of the decline in 2008-09 general fund motor vehicle sales tax receipts is due to the phase in of the constitutional dedication of all motor vehicle sales tax collections to transportation funds. The remaining $51 million was due to changes in the forecast for light vehicle sales. The change in dedication of the motor vehicle sales tax did not affect general fund receipts for 2006-07.

FY 2006-07 and FY 2008-09 Spending Down from Prior Estimates

General fund spending for the current biennium is now forecast to be $31.487 billion, down $125 million (0.4 percent) from end-of-session estimates.

The $60 million projected decrease in health and human services spending is driven largely by lower caseloads and slightly lower costs in continuing care grant programs, long-term care and chemical dependency activities. K-12 education spending decreased $19 million. Increases from slightly higher pupil counts were more than offset by lower cost estimates and participation in selective categorical grant programs.

All other changes yield a net $46 million reduction for FY 2006-07. Debt service payments are down $12 million reflecting savings from recent bond sales. A $48 million reduction in tax penalty and interest costs accounts for most of the remaining change.

General Fund Spending: Forecast Changes

($ in millions)

	Change 2006-07	Change 2008-09
K-12 Education	$ (19)	$39
Higher Education	(4)	0
Property Tax Aids & Credits	(9)	(32)
Health & Human Services	(60)	(63)
Public Safety	0	(9)
Debt Service	(12)	(55)
All Other	(21)	23
Total Spending	**$ (125)**	**$ (97)**

Projected current law spending in FY 2008-09 is now expected to total $32.496 billion, $97 million less than end-of-session estimates. Human services savings of $63 million mirror the forecast change in FY 2006-07. Savings projected in FY 2006-07 for property tax aids and credits and debt service both grow in FY 2008-09 to $32 million and $55 million respectively. While pupil units continue to decline, the decline is not expected to be as rapid as previously forecast.

Planning Estimates Provide Guidelines for Future Budget Outlook

This report provides the first revenue and expenditure planning estimates for the 2010-11 biennium. These planning estimates offer a framework for determining the sustainability of FY 2008-09 budget decisions into the future.

Projected revenues for FY 2010-11 reflect the trend of continued growth forecast for the 2008-09 biennium. FY 2011 also includes $327 million of one-time capital gains revenue attributable to the scheduled increase of the federal capital gains tax rate to 20 percent. Current law spending estimates are adjusted only to reflect enrollment and caseload growth in entitlement programs and areas where specific statutory formulae exist. The FY 2010-11 planning estimates provide a benchmark to determine if ongoing spending exceeds revenues in succeeding FY 2011 budget periods.

Budget Planning Estimates

($ in millions)

	FY 2008	FY 2009	FY 2010	FY 2011
Forecast Revenues	**$16,427**	**$17,091**	**$17,939**	**$19,054**
Projected Spending	16,083	16,413	16,719	17,057
Difference	**$344**	**$678**	**$1,220**	**$1,997**
Estimated Inflation (CPI)	*$340*	*$650*	*$970*	*$1,300*

The table shows annual revenues and expenditures excluding beginning balances and reserves. The difference can be thought of as a "structural" balance. That is, how much more is being collected than spent before any tax or spending decisions are made. Since the expenditure projections do not include a general adjustment for inflation, future increases in state spending may be significantly greater than those shown.

Projected inflation based on the consumer price index is now expected to be 2.1 and 1.8 percent for FY 2008 and FY 2009, and 1.8 and 1.7 percent for FY 2010 and FY 2011. At these levels, a general adjustment for inflation would add nearly $340 million per year to spending – compounding to nearly $1.3 billion per year by FY 2011. An alternative inflation measure recommended by the Council of Economic Advisors, the index of government purchased goods and services, is more than one-half percent per year higher. At that level, simple inflation would add nearly $430 million per year, or $1.7 billion by FY 2011.

A complete version of the November 2006 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 2008-09 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, caseloads, enrollments, and cost projections. Additionally this forecast provides closing balances for FY 2006 and compares how actual revenue collections and expenditures in that year compare to end-of-session estimates.

The revised forecast for the FY 2006-07 biennium is followed by the first complete forecast for the next budget period, FY 2008-09, and by revenue and expenditure planning estimates for FY 2010-11. The planning estimates should not be interpreted as explicit forecasts, but rather as a guide to indicate whether proposed budgetary actions are sustainable 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 prepared by Global Insight Incorporated (GII).

The GII baseline forecast is the 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 2010-11 are driven entirely by the longer-term national economic forecast provided by GII. No Minnesota specific forecast is used.

Expenditure estimates in most areas are shown at the level of FY 2007 appropriations 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

Economists are sounding a cautionary note for 2007. Most expect real GDP growth to be below its 3 to 3 ½ percent trend rate until at least mid year. Forecasters cite weaker housing markets, uncertain energy prices, higher interest rates, and continuing inflationary pressures as sources of concern. A soft-landing scenario in which the economy slows just enough to bring inflation under control but not so much as to cause the economy to stall is obviously the preferred outcome, but many wonder whether the Federal Reserve can engineer a truly soft landing. Few consider a recession likely, but bumpier than normal times over the next year are not out of the question.

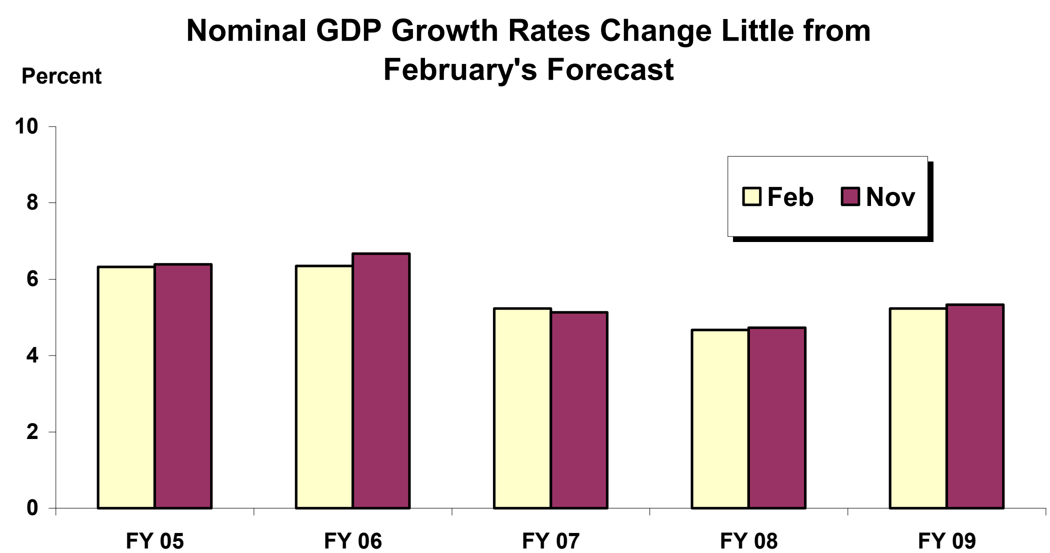
The housing sector is a major concern. Residential construction is only 6 percent of the U.S. economy, but large cutbacks in home building are already underway. The housing downturn is expected to slow U.S. economic growth by 1 percentage point or more over the next year. And, the impact of a weak housing market will extend well beyond the construction industry. Housing purchases typically are accompanied by other, follow-on purchases of items home owners see necessary to further improve their dwellings. Purchases of those items are expected to fall as well. The slowdown in sales of new and existing housing also will reduce incomes for those in the real estate and financial industries. Some forecasters estimate that once the associated losses in housing related business activity are included, slower housing sales could reduce real GDP growth from its trend rate by as much as 1 ½ percentage points over the next 12 months.

There are other potential, housing-related problems as well. Weaker housing prices and higher interest rates also could slow consumer spending indirectly. In recent years some additional consumption was supported by homeowner equity withdrawals, taken at the time existing mortgages were re-financed. Forecasters also believe rising home prices provided a modest stimulus to consumption through the wealth effect. Now with interest rates turning up and housing prices leveling off (or possibly declining) the consumption financed from those sources is expected to disappear. Weakness in the domestic housing market also may have international effects since U.S. mortgage backed securities are held by investors throughout the world. Should U.S. mortgage-backed debt perform poorly that could create financial stresses for the global economy.

Global Insight Inc. (GII), Minnesota's national economic consultant, recognizes those concerns. But while they believe the economy will grow more slowly over the next 18 months than it has in the recent past, they also believe the economy has sufficient underlying strength to avoid a downturn. Their November baseline forecast is very similar to their February 2006 baseline, the forecast used as the starting point for the most recent revenue forecast. GII calls for real GDP to grow at an annual rate of 2.6 percent in fiscal 2007 and 2.7 percent in fiscal 2008. In fiscal 2009 real growth of 3.3 percent is projected. February's GII baseline was slightly more optimistic. That forecast called for real growth of 3.0 percent in fiscal 2007 followed by growth of 2.7 percent in fiscal 2008 and 3.1 percent in fiscal 2009. The Blue Chip consensus expects real GDP to grow at a 2.8 percent annual rate in fiscal 2007.

GII's energy price outlook has changed. Last year at this time forecasters expected oil prices to peak in early 2006, then begin to recede as hurricane damaged production capacity came back on line. GII's forecasts for oil prices around $45 per barrel in 2007 and beyond were consistent with others made at that time. Most forecasts were ratcheted up to the $58 dollar range by February. Now GII expects prices of $63 or more per barrel through the end of fiscal 2009. While oil prices have dropped below $60 per barrel recently, global demand for oil is still strong and higher prices have not led to any significant production expansion or encouraged additional conservation. The possibility of an extended period of much higher prices also remains. The geo-political concerns that caused the spike in summer prices have lessened, but not disappeared.

GII does not expect the higher energy prices to work through the economy and raise prices for other goods. But, unlike in February, they no longer expect lower energy prices to provide a continuing offset to price increases elsewhere in the economy. The November baseline shows the CPI declining in this quarter, but then growing by about 2 percent per year through the forecast horizon. For fiscal 2007 the CPI is expected to grow by 2.4 percent, February's outlook called for 1.8 percent growth. CPI growth rates of 2.1 percent and 1.8 percent are now projected for fiscal 2008 and 2009. February's baseline showed growth of 2.0 percent for both years. The slight increase in the inflation outlook coupled with the modestly slower growth in real output leaves November's baseline forecast for nominal (current dollar) GDP at virtually the same level at the end of the 2009 biennium as was forecast in February.



Global Insight assigns a 60 percent probability to the baseline forecast. A more optimistic scenario is assigned a probability of 20 percent as is a more pessimistic scenario, which includes three consecutive quarters where real GDP grows at less than a 1 percent annual rate.

Members of Minnesota's Council of Economic Advisors agreed that Global Insight's baseline forecast was consistent with the consensus short-term outlook for the U.S. economy. Differences between the GII forecast and those of individual members were small. Council members also agreed that there was a slightly greater probability that the economy would fall short of the forecast than exceed the forecast.

Finance Department economists noted that corporate estimated tax payments had surged in recent months. It appears that the ratio of before tax corporate profits to GDP is now at an historic high. The GII forecast has corporate profits remaining very strong through the 2008-09 forecast horizon. That assumption creates substantial downside risk for state revenues. The path for corporate profits consistent with that used by the Congressional Budget Office was posed as an alternative to the GII forecast.

Finance Department economists indicated they would continue their practice of recent biennia and base revenue planning estimates for 2010 and 2011 on several key aggregate growth rates taken from Global Insight's November baseline forecast. GII expects nominal GDP to grow at a 5.3 percent annual rate in calendar 2010 and a 5.0 percent rate in calendar 2011. The Blue Chip Consensus is for 5.1 percent growth in both 2010 and 2011, while the Congressional Budget Office expects nominal GDP to grow at a 4.6 percent annual rate during those same years. The November baseline projects CPI growth of 1.8 percent in fiscal 2010 and 1.7 percent in fiscal 2011. The Blue Chip panel expects the CPI to grow at a 2.3 percent annual rate in calendar 2010 and 2011, the CBO, 2.2 percent.

Council members noted that the state's financial position had improved significantly in recent years, moving from a deficit to a surplus under GAAP rules and completely reversing shifts made to deal with the budget problems following the 2001 recession. The Council cautioned, however, that while biennial expenditures have grown from $24 billion in 2000-01 biennium to more than $32 billion in fiscal 2006-07, the state's formal budget reserve has only increased by $31 million over that same period. The combined budget reserve and cash flow account was 4 percent of biennial spending in the 2000-01 biennium, now it is 3.1 percent. The Council believes that it would be prudent to add further to the budget reserve.

The Council 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. Council members also noted that use of the CPI understates the effect of inflation on the cost of providing state government services. The Council suggested that the price deflator for state and local government services was the appropriate price index to use.

ECONOMIC OUTLOOK

Last February, the U.S. economy was surging. Inflationary pressures were building, with labor costs accelerating and productivity growth weakening. It did not look like Federal Reserve Bank tightening was working. Economists were hoping higher interest rates and a softening housing market would soon cool consumer spending enough to nudge real GDP growth slightly below its 3.0 percent non-inflationary trend by early 2007, a so-called "soft landing."

It is not yet clear things have turned out as hoped. Third quarter real GDP growth dipped to only 1.6 percent, primarily because of a sharp downturn in homebuilding. But unit labor costs were up sharply and productivity was flat. Now, there are doubts about the economy's future course and it will be several months before the issues resolve. The housing slump and its impact on the economy, massive job losses at domestic automakers, potentially volatile oil prices, stubborn core inflation, and the Federal Reserve's next move are all contributing to the uncertainty. Global Insight has become slightly less optimistic. Their baseline outlook for a soft landing has been lowered slightly compared with February. And the pessimistic alternative now includes a near recession in 2007.

Housing has slowed more than expected, but consumers have not responded. Instead, the pace picked up in the third quarter. And in the current quarter, consumers seem to be further accelerating their spending, the legacy of lower gasoline prices. A Christmas retail season much like last year seems likely. But after Christmas, without slower consumer spending labor markets will tighten further and inflation pressures will increase, making a soft landing less likely. While headline CPI inflation is headed down because of declining energy prices, that is yet to be reflected in core inflation which the Federal Reserve believes to be the best indicator of inflationary trends. Bad news from inflation would almost certainly bring further tightening from the Fed which could turn the housing slump into a crash.

An inflationary surge is very possible. Core inflation is hanging tough, labor costs are flashing warning signals, and productivity gains have evaporated. However, it appears the weak housing market and declining energy prices have convinced the Fed to stop tightening. Global Insight believes the Fed will start slowly lowering interest rates next spring or early summer provided it is then clear a soft landing has occurred.

Financial markets appear to be betting on a soft landing. Long interest rates eased down during the summer and fall, suggesting inflation expectations are still benign. At the same time, stocks rose as though any slowdown will be so mild it will not diminish profits. Of course, all this assumes there are no surprises.

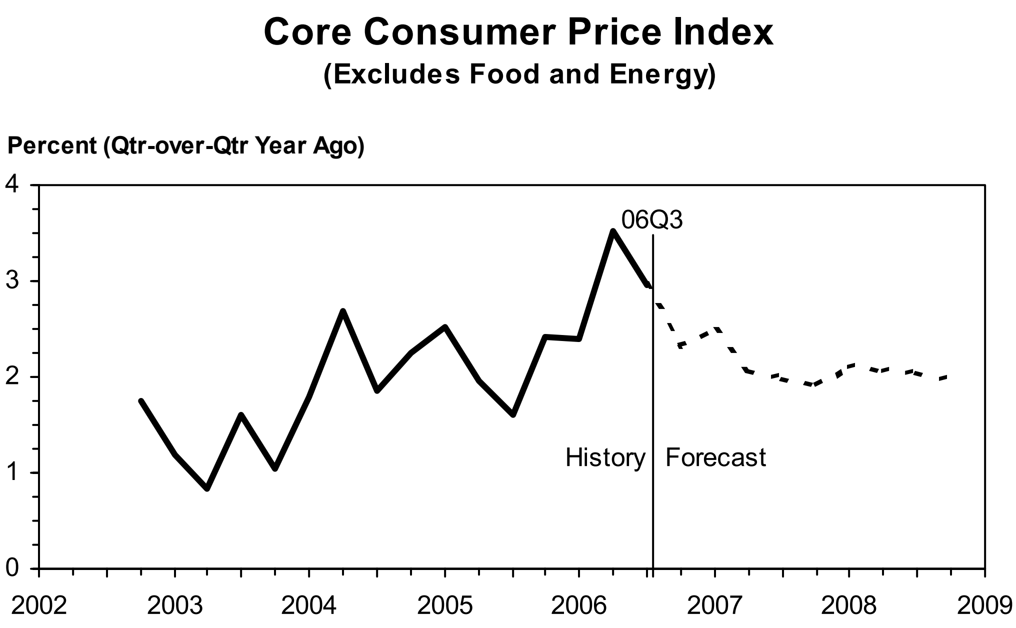
Housing Weaker Than Expected

Housing has dipped sharply, and the downturn could deepen. Home sales are down more than generally anticipated and prices are slipping. The large inventory of new homes for sale seems ominous. Starts dropped in the second quarter, but too late to head off the inventory buildup. That increases the risk of very sharp price declines in some markets, particularly on the East and West Coasts, in Florida, and in parts of the West.

News reports indicate housing markets in 38 states are experiencing at least some weakness. Global Insight predicts a modest 4.0 percent decline in the average sales price of an existing home during 2007. *Newsweek* reports some forecasters expect a deeper downturn. At least one analyst expects the slump will persist well into 2008. But, no one is really sure because there seems to be no good precedent. Some observers cite the drop in prices during the Great Depression, though there is no depression or recession now. Homebuilder Robert Toll is quoted in the *Wall Street Journal* saying this is the first nationwide housing slump in 40 years not associated with a recession and attendant job losses. Compounding the uncertainty, *Business Week* reports forecasters are divided on what impacts housing could have on the economy.

Core Inflation Hangs Tough, While the Fed Waits

As oil and gasoline prices retreated from last summer's peak, CPI increases slowed, prompting the Federal Reserve to stop raising interest rates. However, the headline news is not yet reflected in core inflation, which the Fed watches closely. Core CPI inflation is up 2.9 percent compared to a year ago, well above the Fed's reputed 1 to 2 percent target range.



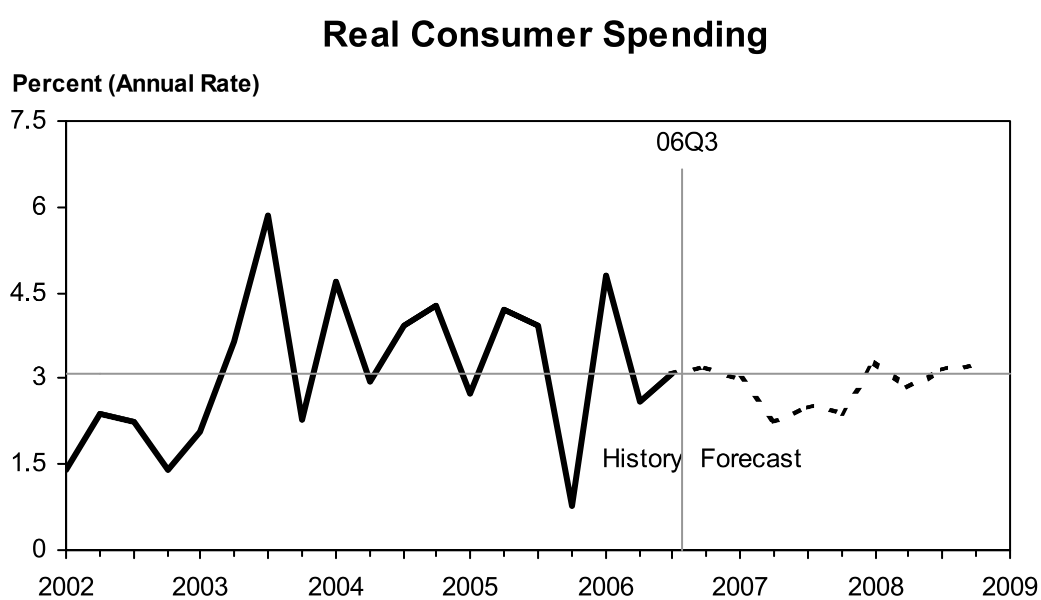
As oil and gasoline prices retreated from last summer's peak, headline CPI increases slowed. However, core inflation is not yet clearly headed downward. The Federal Reserve is watching the core closely for signs of improvement.

Though the Fed has apparently put tightening on hold, Global Insight does not think that reflects a changed view of an acceptable inflation rate. Rather, it seems declining energy prices have bought the Fed time to pause and see how housing and the economy evolve. Provided stable below-trend real GDP growth materializes and core inflation shows clear signs of weakening, Global Insight expects the Fed to slowly begin lowering interest rates in 2007. However, bad news on inflation would likely lead to further tightening which could turn the housing slump into a crash.

Consumption

There is no general consensus as to how housing market weakness will affect consumer spending. Global Insight's view is that consumers spent a significant part of the equity they withdrew from their homes during the past few years. With home values leveling off or dropping, that source of cash is drying up. Consequently, Global Insight predicts slower consumer spending growth.

There are at least two other viewpoints. One is that consumers did not depend on home equity as heavily as Global Insight assumes. There are estimates, but no one really knows for sure just how much mortgage equity withdrawn was actually spent. Some was used to pay refinancing costs. Some was also used to pay down consumer debt and consumers may have held on to some of the cash as well. *Business Week* indicates the other view is that home equity drawdowns do not matter much compared to overall household wealth in determining spending. And the stock market will help sustain household wealth as home values slip.



As energy prices declined, consumer spending accelerated and apparently continues to do so in the current quarter. After Christmas, a slowdown in consumer spending is needed if inflation is to remain subdued without further Federal Reserve tightening.

Investment

Major housing market indicators are signaling a stronger downturn than expected last spring. New and existing home sales, mortgage applications, building permits, and housing starts have dropped. Inventories of unsold new and existing homes have reached record highs. Global Insight has revised its forecast for 2007 housing starts down to 1.6 million compared with 1.8 million last February. Comments by a Global Insight economist quoted in the *Wall Street Journal* suggest a further downward revision could come in the December baseline.

The housing forecast may be further revised early next year because of the large number of unsold houses already on the market. Though permits and starts are down, it is unclear whether builders are finished reacting to current high inventories of new houses. In addition, there is a strong possibility that even more inventory will be added. Inventories of unsold existing homes could soar if there is a sharp increase in foreclosures.

A *U.S. News and World Report* article indicates foreclosures nationwide are up some 20 percent over a year ago. That could get worse. Some analysts fear many more mortgage holders will soon be unable to make their payments. Most at risk are holders of option adjustable mortgages. No one knows how many option ARMs there are, but *Business Week* reports their use grew rapidly in 2005 and 2006 because of very low "teaser" minimum payments, bringing a new group of sub-prime borrowers into the market. The typical payment does not cover the principal nor all the interest. Unpaid interest is added to the principal. Once a threshold is reached, the loan is reset to a higher interest rate and a much larger payment.

In addition to lowering the outlook for housing starts, Global Insight has lowered the baseline forecast for non-residential fixed investment. The reason is that the Bureau of Economic Analysis revised equipment and software spending estimates down going back to 2003. This lower base was projected forward. Nonresidential construction is little changed, but Global Insight reports rising building costs are a downside risk to the outlook.

Government

Despite rising expenses for defense, disaster relief, interest, and entitlement programs, the unified federal budget deficit for fiscal 2006 was $248 billion, down from $319 billion the year before. That was much less than the White House and most analysts expected. Surging profits and incomes in a strong economy were primarily responsible. Corporate receipts rose 27 percent over fiscal 2005 while individual income tax collections rose 13 percent.

If the economy slows as in the baseline scenario, Global Insight does not expect a repeat of the 2006 performance in 2007 or 2008. The deficit for fiscal 2007 is projected at $267 billion and for 2008, $281 billion.

International

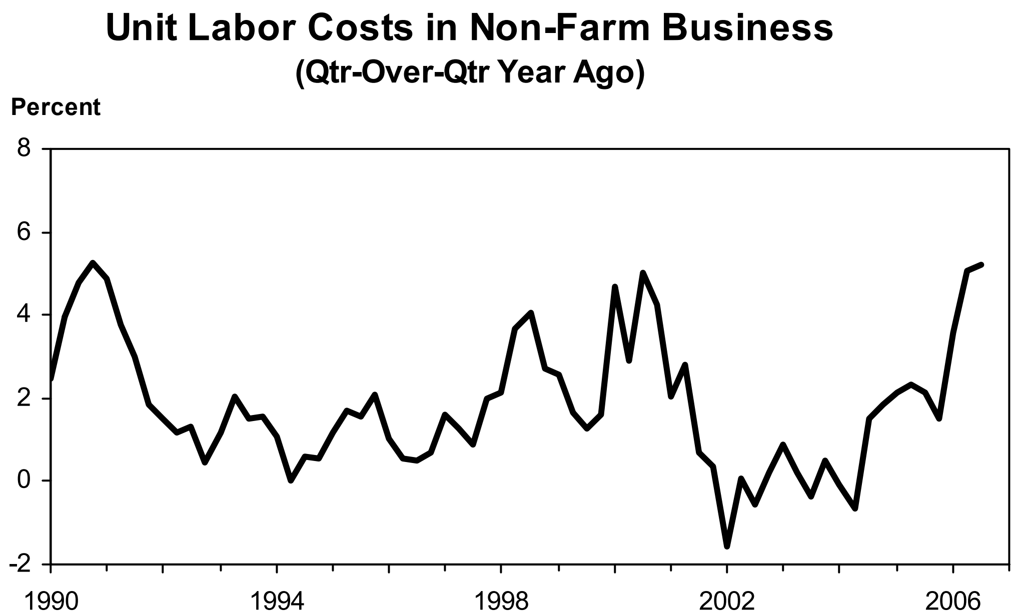
Higher oil prices contributed significantly to a record trade deficit in 2006. If they last, now lower prices will swing the deficit a little the other way. There will be modest improvement in 2007 even if oil rises from its current $60 price to average about $65 per barrel as in the baseline scenario. Improvement will come from downward pressure on the dollar imposed by the still large trade deficit, and from any Federal Reserve easing. That should help boost exports if the major currency trading partners achieve relatively modest 2.0 to 2.5 percent real GDP growth in 2007 as generally expected. Global Insight cites Canada, the major U.S. trading partner, as a risk to the outlook because it is vulnerable to softening commodity and energy prices.

Once a source of concern, the near term potential for a catastrophic dollar depreciation is now downplayed by Global Insight and other analysts. The *Wall Street Journal* reports foreigners currently seem to be showing increasing interest in U.S. securities and Treasury Secretary Henry Paulson is not perceived as likely to try to reduce the trade deficit by talking down the dollar's value.

While apparently not an immediate problem, economists agree a falling dollar could force an abrupt current account reversal if it causes the U.S. to lose access to foreign funds needed to finance the trade deficit. A recent Federal Reserve Bank of San Francisco *Economic Letter* reviews the economic literature concerning possible consequences and finds little theoretical or empirical consensus. Experience in the 1990's with Mexico, South Korea, and Thailand indicates a potential for a catastrophic drop in imports, GDP, asset prices, and the exchange rate. However, those reversals were all in developing countries. Reversals have also occurred in industrialized countries, but studies indicate the impacts were much milder. Consequently, the San Francisco Fed offers the opinion that a sudden halving of the trade deficit, currently at some 7 percent of GDP, would reduce GDP growth by 0.5 percentage points over three years. However, reduced demand for U.S. imports could have severe negative impacts on many overseas economies.

Inflation

Oil does not seem cheap at $60. But, the retreat from July's $78 peak has lowered the near term risk of an inflationary surge. Recent prices for crude oil, gasoline, and natural gas reflect only reduced risk of a major supply disruption. Short-term energy fundamentals have not changed. Given the near absence of excess crude production and refinery capacity, markets almost surely would reinstate the risk premium at any time political instability, vulnerable infrastructure, or bad weather make it look like another supply interruption is likely.



Inflation indicators are flashing warning signals. Labor costs are accelerating as the unemployment rate slips downward. And productivity gains evaporated in the third quarter after weakening all year.

Despite good news from oil markets, inflation indicators are flashing warning signals. Core CPI inflation is not yet clearly headed down and at 2.9 percent over a year ago is well above what observers take to be the Federal Reserve's 1 to 2 percent target zone. As might be expected, labor costs are accelerating as the unemployment rate slips downward. Productivity gains evaporated in the third quarter after weakening all year. And the recent downward revision to business investment spending back to 2003 means potential output is less than previously thought.

Monetary Policy

While inflation signals alone might justify further monetary tightening, both *Wall Street Journal* and *Associated Press* articles suggest the Fed has become slightly less inclined to focus on prices alone. That judgment is based on remarks in Open Market Committee minutes about the uncertain impacts of the housing downturn and the risk of a sharper than expected economic slowdown in coming months. Global Insight's reading is that the Fed is done raising rates and will cut the federal funds rate three times in 2007 beginning in May.

Not all analysts are convinced the Fed will begin easing that soon. A *Wall Street Journal* article suggests public comments by Dr. Bernanke indicate he wants to be sure core inflation is less in about a year than it is now. That is a more explicit goal than any attributed to his predecessor. The *Journal's* view seems to be that rate cuts are on indefinite hold unless a sharp slowdown materializes.

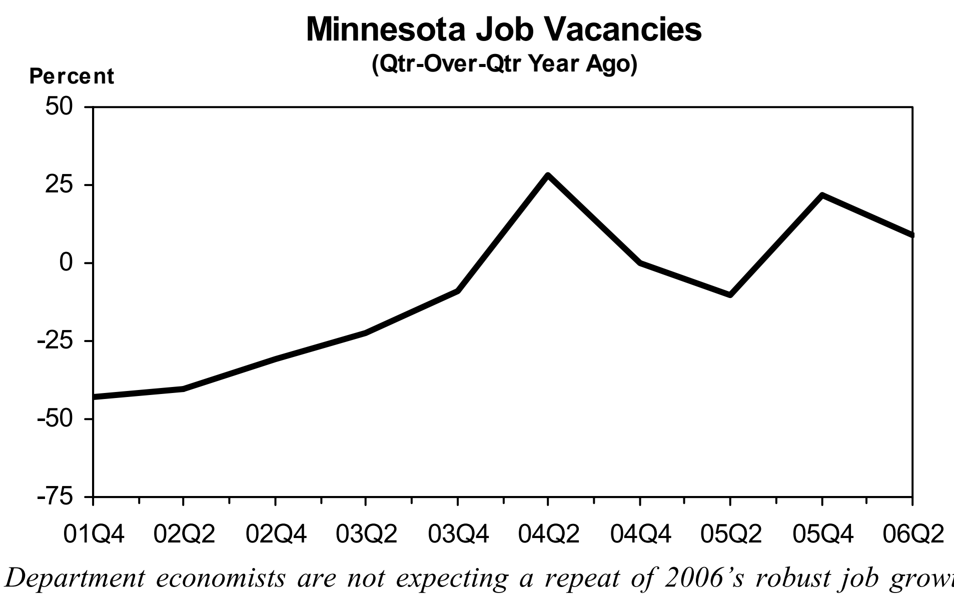
MINNESOTA OUTLOOK

Last February, Minnesota's economy was looking only slightly better after weak growth throughout 2005. The outlook was for sluggish expansion to continue for several months before picking up. However, recent data shows an acceleration was already getting underway. In the first quarter, employment growth exceeded forecast and did so throughout 2006 even though there was a sharp reversal in September. Wage growth also exceeded forecast. Finance Department economists attribute Minnesota's performance to the State's catching up with the U.S. economy in the first half of 2006.

The outlook is cautiously optimistic. If the U.S. economy slows as in the Global Insight baseline, Minnesota will almost surely follow. Consequently, Finance Department economists are not expecting a repeat of 2006's robust job growth in 2007. Some indicators already suggest a cooling off. For example, Second Quarter 2006 job vacancies grew 9.2 percent over a year earlier, down from 21.8 percent in Fourth Quarter 2005. And active unemployment claims remain stuck at about last year's level, in part because of rising claims from the construction sector.

In September, seasonally adjusted employment dropped some 11,000. About one-half was due to quirky seasonal adjustment in the local government sector. The rest reflects a broad based dip in the private sector. That decline is forecast to reverse in coming months. October's 3,000 job increase was entirely in the private sector and should be the beginning of a reversal. The Ford plant's phase out is built into the forecast in two steps. The first is assumed to occur in January 2007, the second in January 2008.

There is at least one favorable new development. It seems Minnesota's housing market correction is being partly offset by a modest acceleration in commercial building. While that will help, it will not be enough to fully offset construction employment losses attributable to the softening housing market.

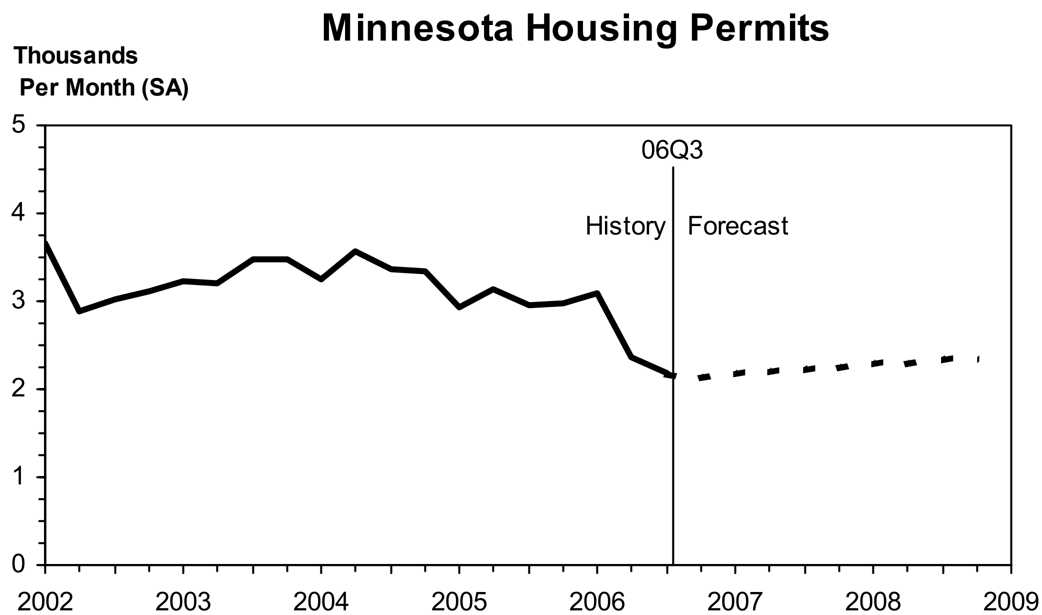


Finance Department economists are not expecting a repeat of 2006's robust job growth in 2007. Some indicators, such as job vacancies, are already suggesting a cooling off.

Minnesota's Housing Market Correction

Minnesota's housing market is experiencing a correction. News reports indicate permits and sales are down, prices have dipped slightly, and inventories of unsold homes rose during the summer and fall. It seems ominous that in September and October some 48 percent fewer building permits were issued in the Twin Cities compared to a year ago. However, the permits data may also mean October's slight decline in the for-sale inventory of homes will continue. That could ease downward pressure on prices and help stabilize the market.

No one really knows how weak housing will become. News reports have real estate professionals suggesting market conditions are just returning to normal after several exceptionally good years. Finance Department economists note that none of the surveys of regional housing market conditions they are aware of put Minnesota at great risk of the sharp correction possible on the East and West coasts, in Florida, and in some places in the Western U.S. Mortgage foreclosures due to option ARMs pose an unknown risk, but a *U.S. News and World Report* article suggests most of them are concentrated in the West.



No one really knows how weak housing will become. February's forecast assumes Minnesota housing permits will soon bottom out. However, that will not be enough to prevent a decline in construction jobs next spring.

Commercial Construction Improves

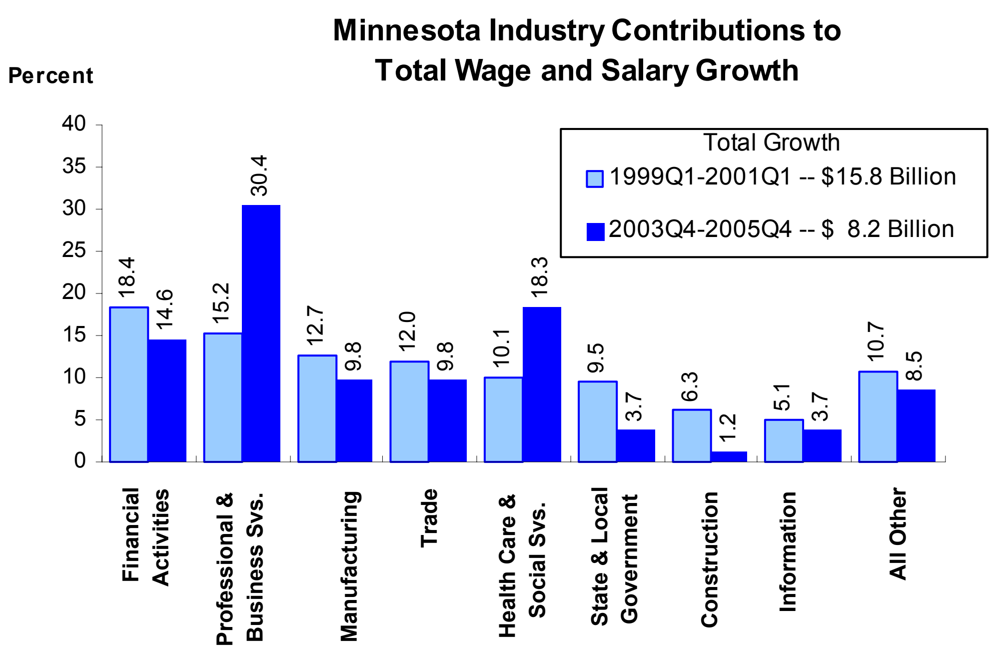
In February, Finance Department economists assumed accelerating commercial construction activity would pick up much of the slack as housing starts declined. Consequently, construction sector employment was expected to edge downward only slightly. That no longer seems possible. Seasonally adjusted construction employment is now forecast to drop several thousand jobs by the end of 2007. The outlook assumes the current decline in housing permits bottoms out early next year.

Last summer's United Properties report indicates there is once again some speculative commercial office construction in the Twin Cities, though not on the scale of the late 1990's. In addition, low vacancy rates are driving medical office development, and large discount retailers are building super centers and replacing smaller stores. Like Global Insight, United Properties cites rising construction costs as a significant downside risk to the outlook.

In addition to rising costs, market conditions help explain the current modest scale of commercial construction activity. Recently, the National Association of Industrial and Office Properties indicated the Twin Cities' office vacancy rate was at 14.6 percent, down from 18.2 percent in 2003. Further recovery is needed for construction activity to accelerate. Industry observers consider a 10 percent vacancy rate the threshold at which significant speculative building begins.

Wages in Minnesota's Job Market

In February, Finance Department economists reviewed developments in Minnesota's job market. For the two-year period ending in Fourth Quarter 2005, jobs growth became more concentrated in fewer industries compared to the two-year period ending with the beginning of the last recession in First Quarter 2001. Compared with the earlier period, health care, leisure and hospitality, and professional and business services account for 67 percent of total jobs growth, up from 41 percent previously.



Industry total wages data indicate a narrowing base for growth. In the two years ending in fourth quarter 2005, professional and business services and health care accounted for 49 percent of total growth, up from 25 percent in the two years prior to the beginning of the last recession in 2001.

Now, industry total wages data are available for a similar comparison. The details differ, but also indicate a narrowing base for growth. In the 2 years ending in Fourth Quarter 2005, professional and business services accounted for 30 percent of growth in total Minnesota wages, up from 15 percent in the earlier period. Health care accounted for 18 percent, up from 10 percent earlier. Financial activities, manufacturing, trade, construction, information, and all other industries made smaller contributions than previously. Finance Department economists are concerned about risks inherent in depending on a narrowing industry base for increases in jobs and wages.

A Revised Forecast

Forecasts for employment and wage and salary income have been revised based on Global Insight's November baseline and information obtained since last February's forecast. Global Insight's baseline was used to drive an updated Finance Department model of the Minnesota economy. That model incorporates technical changes which should improve its performance. The detailed Minnesota forecast now extends through 2009.

MINNESOTA OUTLOOK COMPARED TO THE U.S.

(Calendar Year Percent Changes)

	2005	2006	2007	2008	2009
Non-Farm Employment					
Minnesota					
February 2006	1.4	0.9	1.0	0.9	N/A
November 2006	1.0	2.1	0.9	1.1	1.1
United States					
February 2006	1.5	1.5	1.4	1.1	N/A
November 2006	1.5	1.4	1.1	1.3	1.5
Wage and Salary Income					
Minnesota					
February 2006	3.5	4.7	4.6	4.6	N/A
November 2006	3.0	5.6	4.7	4.7	4.8
United States					
February 2006	6.0	5.1	5.4	5.3	N/A
November 2006	5.1	7.9	4.8	5.0	5.5

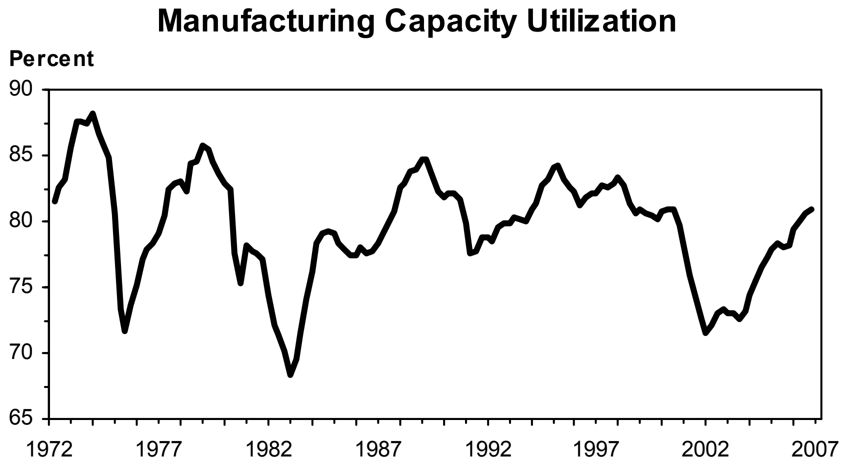
A Summary of Assumptions

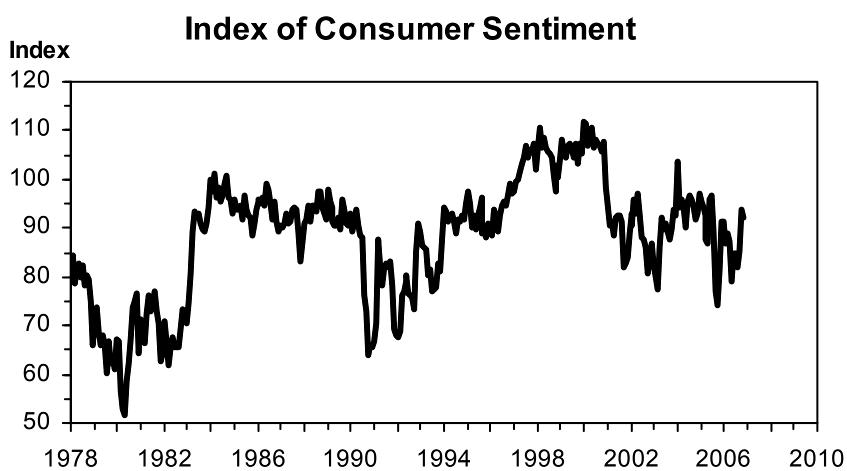
If this forecast is to materialize, Minnesota must add some 1,800 jobs a month on a seasonally adjusted basis through the end of 2007. In 2008, growth must accelerate to 2,700 jobs a month. Future jobs growth is expected to be concentrated much as it has in the recent past, with health care, professional and business services, and leisure and hospitality currently constituting 34 percent of total jobs, contributing 64 percent of growth through Fourth Quarter 2009.

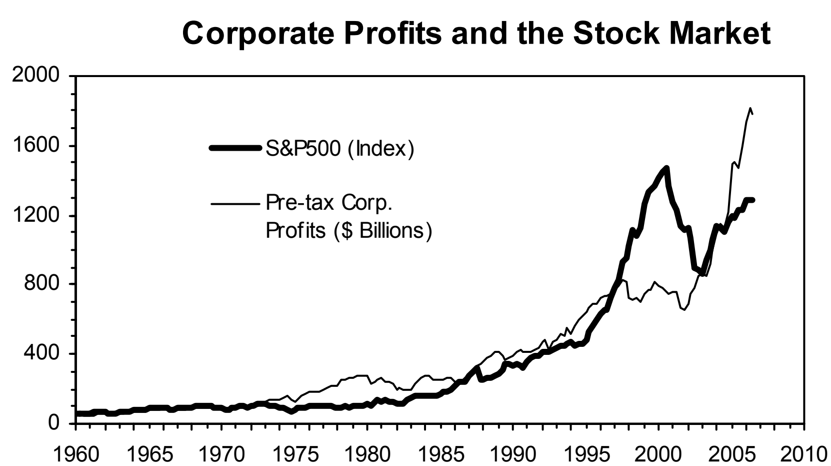
The jobs forecast is for steady expansion at about half the robust rate experienced in 2006, and only slightly slower than Global Insight's baseline outlook for the U.S. As employment increases, improving productivity must continue to drive real wages per job upward. That assumes the recent collapse of productivity gains in the U.S. economy is quickly reversed if it also happened in Minnesota. Short-term productivity changes are not observed directly at the state level.

Unlike jobs, future growth in wage and salary income will depend more on financial services than it has in the recent past. Financial services, professional and business services, and health care, currently constituting 39 percent of total wage income, are assumed to contribute 60 percent of the growth through Fourth Quarter 2009.

Selected National Economic Indicators







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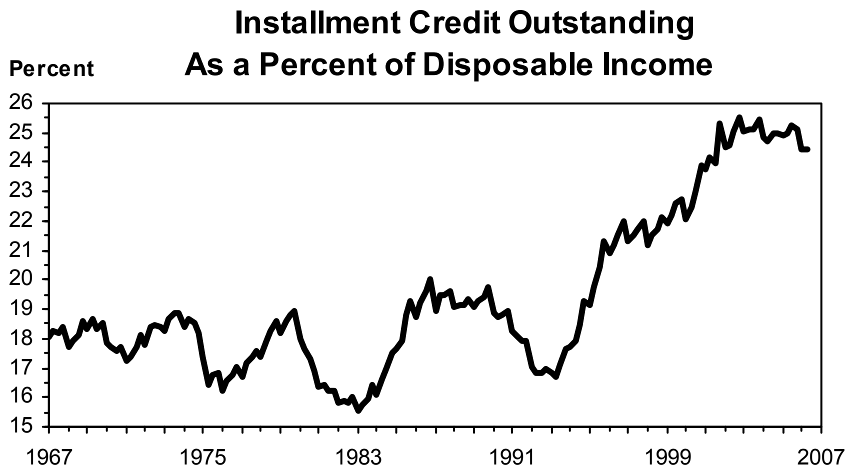
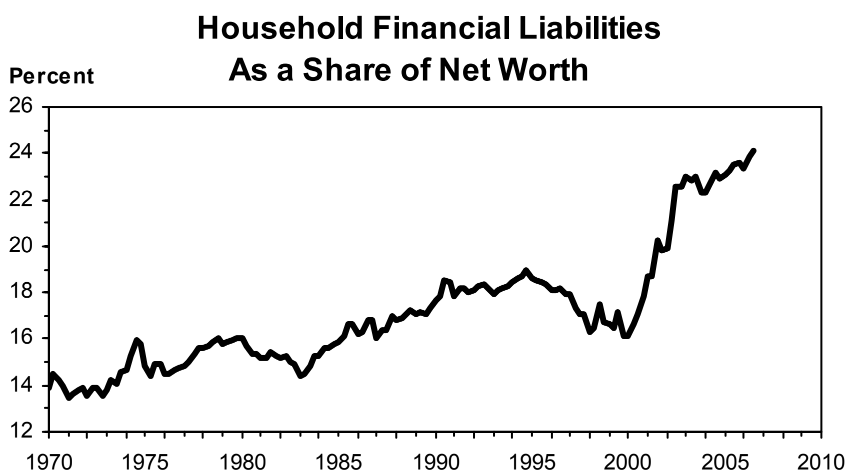
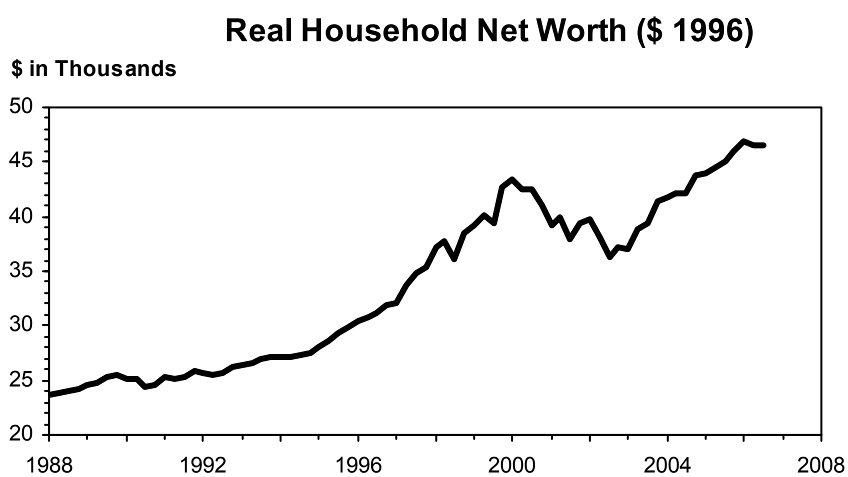
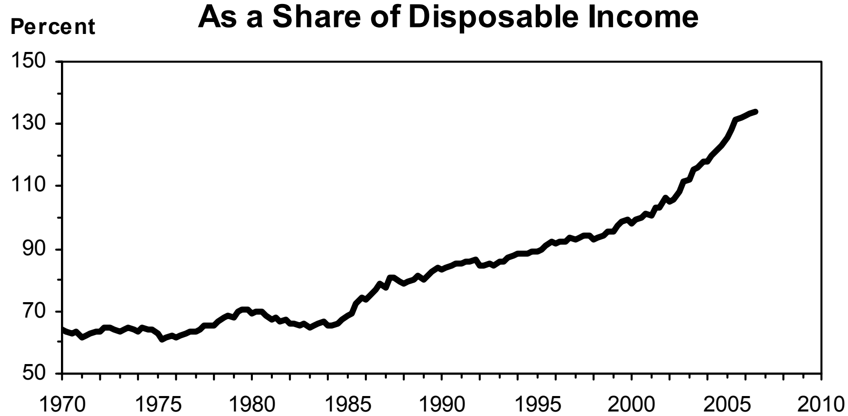




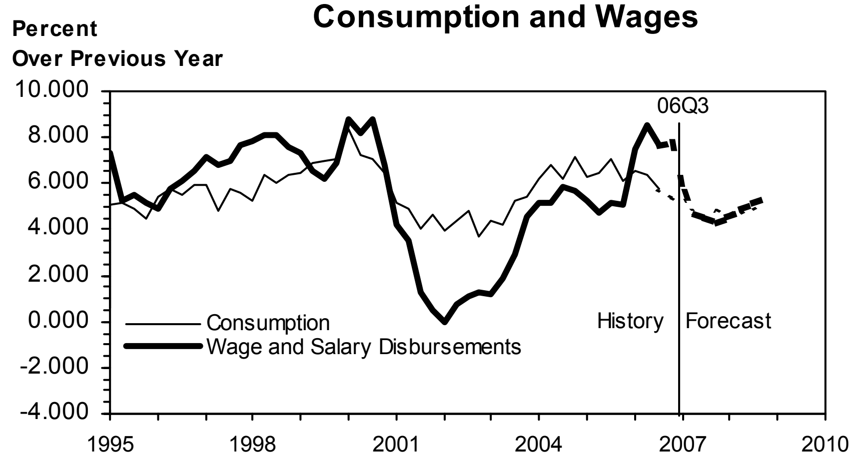


Selected National Economic Indicators

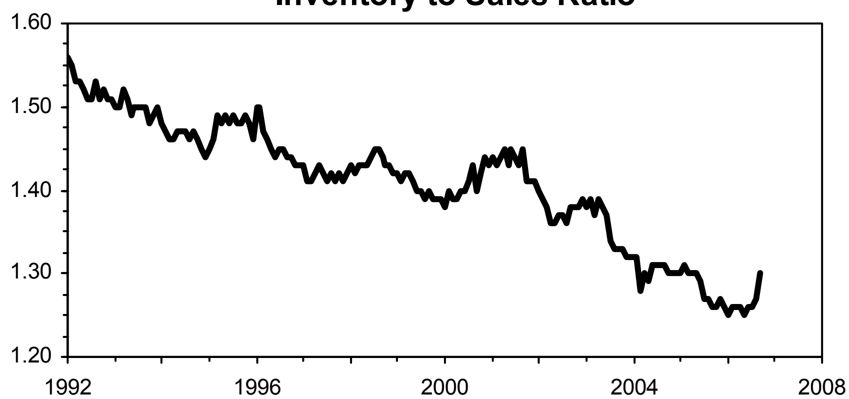
Household Financial Liabilities As a Share of Disposable Income



Consumption and Wages



Manufacturing and Trade Inventory to Sales Ratio



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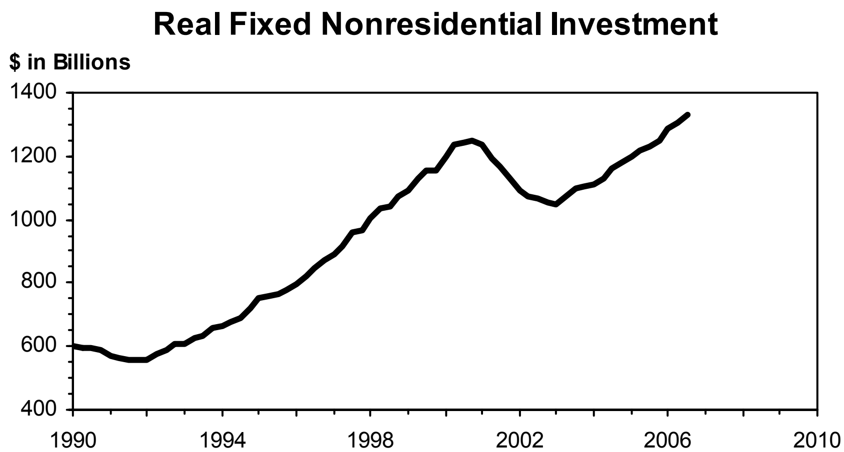

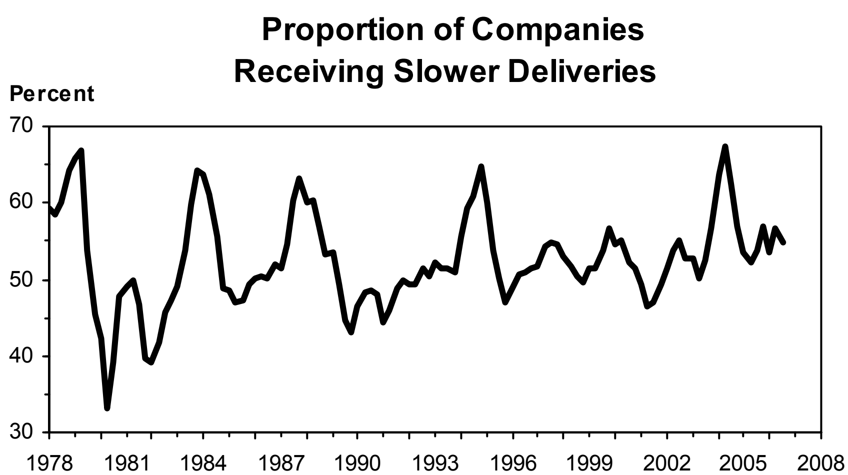

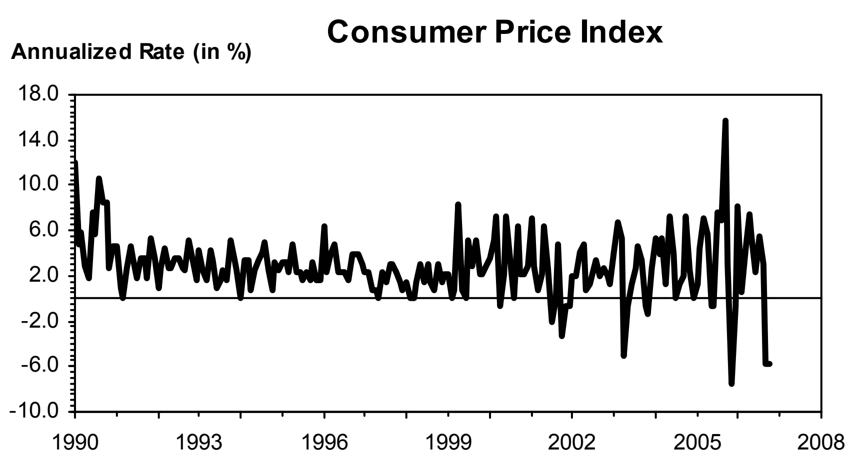

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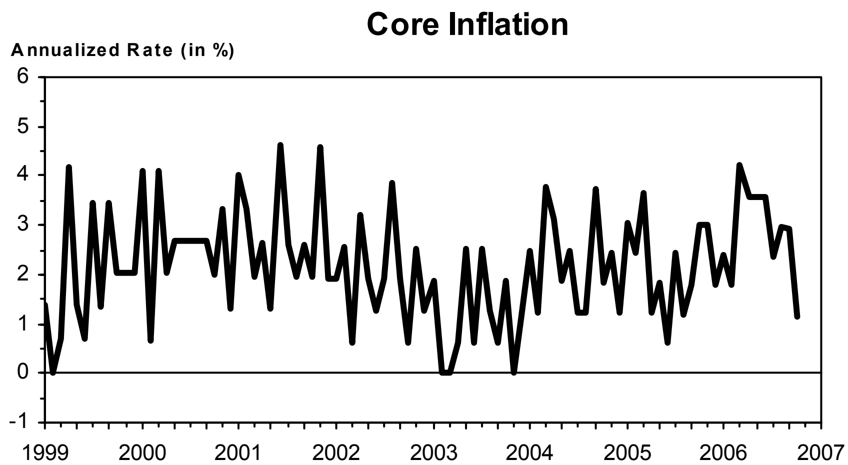
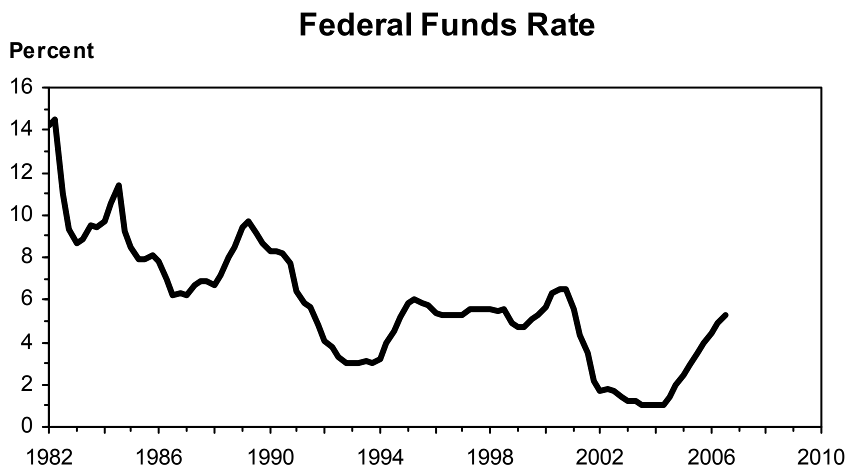
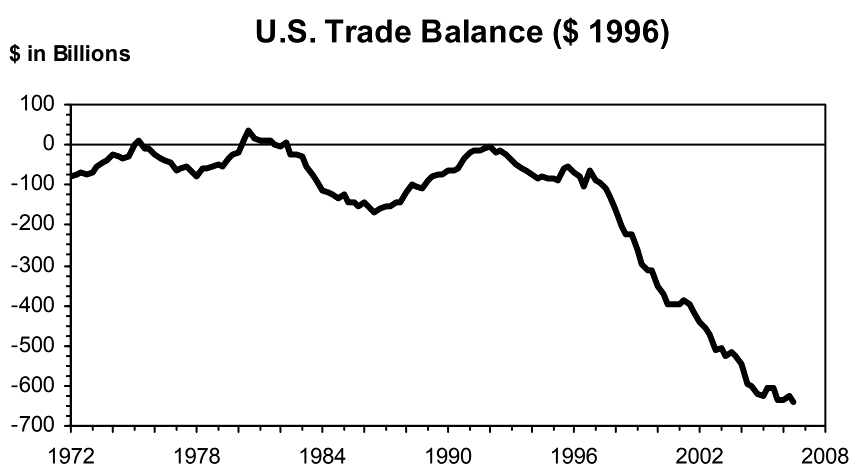






FY 2006-07 Budget Status

At the close of the 2006 Legislative session the general fund budget was balanced - with a zero available balance projected for the end of the biennium, and $1.113 billion in general fund reserves.

Revenues, transfers and other resources for the current biennium are now forecast to be $32.245 billion, an increase of $913 million (2.9 percent) from end-of-session estimates. State general fund expenditures and transfers for FY 2006-07 are now expected to be $31.487 billion, $125 million (0.4 percent) less than prior estimates. These changes yield a projected forecast balance of $1.038 billion.

FY 2006-07 Forecast
($ in millions)

	End of Session	November Forecast	Change
Beginning Balance	$1,393	1,393	$0
Revenues	30,374	3,1305	931
Other Resources	958	940	(18)
Total Resources	31,332	32,245	913
Expenditures	31,612	31,487	(125)
Cash Flow Account	350	350	0
Budget Reserve	653	653	0
Tax Relief Account	110	110	0
Available Balance	$0	$1,038	$1,038

Current Law Designates Forecast Balance as Available for Rebate

In 1999, legislation was approved that governs treatment of projected balances in the November forecast of even-numbered years. Minnesota Statutes 16A.1522 requires that the Commissioner of Finance designate the entire amount of any balance that exceeds one-half of one percent of general fund biennial revenues as available for a rebate to taxpayers. The current forecast exceeds that threshold.

However, a rebate to taxpayers is not automatic. The same statute also requires the Governor to present a plan to the 2007 Legislature to rebate the designated amount with payments beginning no later than August 15, 2007. The 2007 Legislature is required to enact, modify or reject the Governor's plan for the rebate by April 15, 2007. If no action is taken to enact a rebate, the money remains as an available balance in the general fund.

However, any rebate requires action by Legislature to adopt a rebate plan. Without legislative action, the surplus remains available to the general fund for other purposes and carries forward to the FY 2008-09 budget period.

FY 2006 Closing Contributed $499 Million of Projected Surplus

In August, the books were officially closed for the fiscal year that ended June 30, 2006. FY 2006 concluded with a general fund balance of $518 million, $730 million more than estimated at the end of the 2006 legislative session. However, $231 million of the increase is due to revenue and expenditure changes between fiscal years 2006 and 2007. After adjusting for these, the net gain in the forecast for the biennium was $499 million, nearly one-half of the surplus now projected for the biennium.

Final FY 2006 Revenues Were $439 Million Above End of Session Estimates

Total revenues were $649 million higher than previously forecast. However, $210 million of this amount came from an early transfer of health impact fees. Because of litigation contesting the fee, the transfer had been delayed until the end of FY 2007. After resolution by the State Supreme Court, deposit of the fees occurred in FY 2006 as originally enacted in law. After adjusting for this distortion, the gain in actual collections in FY 2006 contributed $439 million to the general fund balance projected for the biennium.

Lower FY 2006 Spending Added $60 Million to Projected Surplus

FY 2006 spending was $263 million below end-of-session estimates. However, of that amount, $182 million of unspent appropriations were carried forward to the next fiscal year and appear as an increase in FY 2007 spending. A $21 million adjustment between fiscal years to appropriation estimates for Human Services State Operated Services also overstates savings. After these are corrected, the real decrease in total spending becomes $60 million. Lower spending in the health and human services area accounted for $40 million of the total savings, while lower K-12 spending contributed an additional $10 million.

Revenue Forecast
FY 2006-07

Current general fund resources for the 2006-07 biennium are now forecast to total $32.245 billion, $913 million (2.9 percent) more than end-of-session estimates. The forecast for non-dedicated revenues has grown by $931 million or 3.1 percent. Slightly more than 48 percent of the additional revenues were received in fiscal 2006. The remainder is projected for receipt in fiscal 2007. The individual income and corporate income taxes were the primary sources of the additional revenue accounting for $833 million of the $931 million revenue gain. The sales tax and the motor vehicle sales tax forecasts were both below prior estimates. Other revenues were above end-of-session estimates.

Revenue Forecast FY 2006-07

$ in millions

	FY2004-05	FY2006	FY2007	FY2006-07
Individual Income	$12,051	$6,863	$7,193	$14,056
Sales	8,340	4,464	4,537	9,001
Corporate	1,554	1,062	1,108	2,170
Motor Vehicle Sales	534	250	237	487
Statewide Property Tax	1,210	631	663	1,295
Five Major Taxes	23,689	13,270	13,738	27,008
Other Revenue	3,513	2,067	1,878	3,945
Tobacco	344	173	178	351
Net Non-dedicated	27,546	15,510	15,794	31,305
Other Resources	1,607	452	489	941
Current Resources	**$29,153**	**$15,962**	**$16,283**	**$32,245**

Receipts reflecting tax year 2005 individual income tax liability exceeded the February's forecast by more than $200 million, increasing the base from which estimates for future tax years are made. The corporate income tax change was due to much stronger than anticipated corporate profits and a reduction in the expected revenue loss attributable to the Hutchinson Technology decision. Lower than projected monthly receipts and a material reduction in projected receipts attributable to adoption of the streamlined sales tax provisions were the sources of the reduction in the sales tax forecast. Other tax and non-tax revenues are projected to be $207 million more than in February. Investment income, fines and surcharges, and departmental earnings were the major sources of increase in the other revenue forecast. Total current resources are projected to increase by 10.6 percent over fiscal 2004-05 levels.

Individual Income Tax

Individual income tax receipts in the 2006-07 biennium are forecast to total $14.056 billion, up $503 million (3.7 percent) from end-of-session estimates. Net income tax receipts were $259 million above forecast in fiscal 2006. Final payments for tax year 2005, including those accompanying extensions were $126 million above forecast while refunds were $76 million less than projected. Fiscal year 2007 receipts through October were $5 million below forecast. Fiscal year 2007 withholding was $14 million below projections. Withholding receipts have been below forecast in three of the four months this fiscal year.

Analysis of tax year 2005 individual income tax returns indicates that individual income tax liability was $6.284 billion, about $200 million more anticipated in February. That increase in baseline liability was the source of almost the entire increase in forecast revenues.

Only preliminary information is available about the sources of the additional income that created the additional tax liability for tax year 2005. Estimated 2005 wage growth in Minnesota remains unchanged so the entire liability increase was assumed to come from stronger than previously projected growth in non-wage income and smaller deductions.

Much of the additional revenue was assumed to come from higher than projected capital gains income. Capital gains realizations in 2005 are now assumed to have grown by 37 percent over tax year 2004. February's forecast anticipated realizations growing by 10 percent. That sizeable increase in income was partially offset by weaker growth in taxable dividends. In this forecast dividends are estimated to have grown by 15 percent in tax year 2005. February's forecast anticipated 27 percent growth. The growth rate for the interest deduction was also reduced. In February interest deducted in tax year 2005 was expected to increase by 14 percent, in the current forecast it is assumed to have grown by 6.6 percent. More detailed Minnesota-specific information about sources of income and amounts deducted will be available from the income tax sample in early 2007. That information will be used to recalibrate a new baseline for tax year 2005 for use in February's forecast.

Wages are now forecast to grow at an annual rate of 5.6 percent in tax year 2006 and 4.7 percent in tax year 2007. In February wage growth rates of 4.7 percent and 4.6 percent were used. The slightly stronger wage growth now projected for tax year 2006 was offset by weaker growth for other, non-wage sources of income for both the 2006 and 2007 tax years. Non-wage income is now projected to grow at a 7.4 percent rate in tax year 2006 and a 6.3 percent rate in tax year 2007. February's growth rates for non-wage income were 9.1 percent and 7.7 percent respectively. Capital gains, proprietors' incomes, and interest all grow more slowly in the current scenario than in February's baseline, but that growth comes from a higher 2005 base.

The November forecast always marks the first use of the current House Income Tax Simulation model. It also is the first time the sample of tax year 2004 income tax filers is used in that model. The new model and the new sample project tax year 2004 liability to be $22 million less than actually observed. An off-model adjustment of $22 million has been made to estimated liability for each year in the forecast horizon.

Sales Tax

Net sales tax collections for the 2006-07 biennium are now projected to be $9.001 billion, $92 million (1 percent) less than forecast in February. The forecast for gross sales tax receipts fell by $86 million from end-of-session estimates while the sales tax refund forecast increased by $6 million.

Gross sales tax receipts in fiscal 2006 were $2.3 million below forecast and refunds were $2.5 million more than forecast leaving a $4.7 million negative variance. Thus far in fiscal 2007 gross sales tax receipts have been $26 million below forecast and refunds $12 million below forecast leaving the sales tax $14 million below forecast for the first four months of the fiscal year. That negative variance understates the recent weakness of the underlying revenue stream since October's receipts were boosted by a one-time, $15 million settlement. In the absence of that settlement gross sales tax receipts through October would be $41 million below forecast.

Consumer durable spending in Minnesota for the remainder of this biennium is expected to grow more rapidly than projected in February, but both business capital equipment spending and construction spending growth is expected to be weaker. In fiscal 2007 spending on construction material is now projected to fall by 3 percent. February's forecast assumed construction spending would be flat in 2007.

Some of the reduction in expected sales tax receipts was attributable to revised estimates of the revenue gain from the streamlined sales tax initiative. Actual receipts have been less than anticipated and projected receipts for future years have been reduced accordingly. For the 2006-07 biennium those adjustments reduced expected sales tax receipts by $36 million.

The receipts elasticity was not changed from February. It is set at 0.9 for the fourth quarter of 2006 and at 0.95 for the first quarter of 2007 and all future quarters. The loss of sales tax receipts attributable to growth in e-commerce and catalog sales continues to be assumed to grow at about 11 percent per year. As in the November, 2005 forecast the factors allocating sales growth to Minnesota were adjusted to reflect what appears to be a discrepancy in the difference in projected growth rates for U.S. and Minnesota wages. A one-time adjustment was made to the level of Minnesota wages, raising them by 1 percent. This assumption will be reviewed for the February forecast.

Corporate Franchise Tax

Net corporate franchise tax receipts during the 2006-07 biennium are now estimated to total $2.169 billion, $330 million (18 percent) more than forecast in February. Receipts in fiscal 2006 were $106 million more than forecast. Through October net corporate receipts for fiscal 2007 were $98 million more than forecast.

Stronger than anticipated corporate profit growth is the source of much of the increase in the corporate franchise tax forecast. Corporate profits in calendar 2005 and 2006 are now projected to grow at annual rates of 24 percent and 19 percent respectively. In February growth rates of 19 percent and 12 percent were anticipated. Those rapid growth rates lifted corporate profit's share of GDP to a 50 year high in 2006.

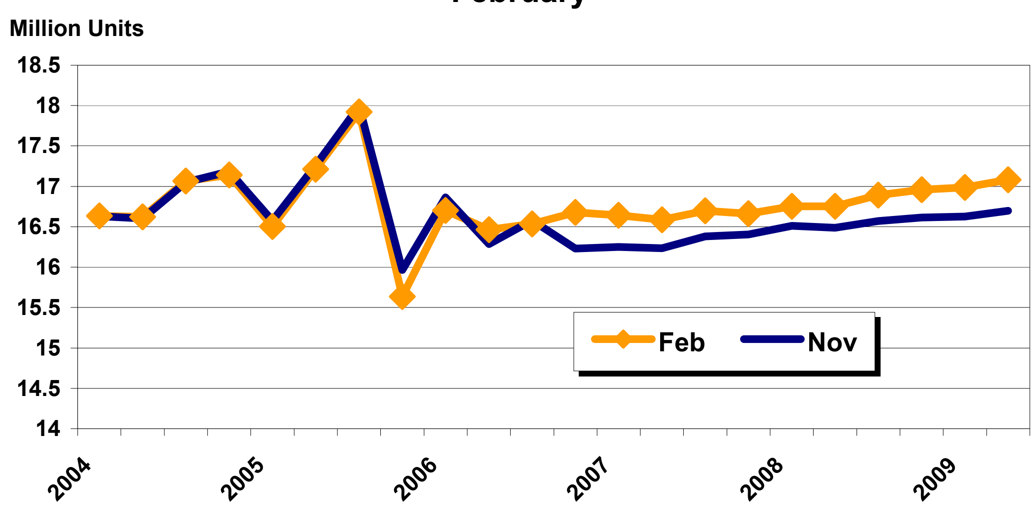
Revised estimates of the cost of the Hutchinson Technology decision also added to the forecast. The Department of Revenue now estimates that refunds and losses in prospective revenues attributable to the Hutchinson decision will total $116 million in the 2006-07 biennium, $134 million less than projected in February. After netting out $31 million reduction in interest payments on expected refunds from prior tax years which is reported elsewhere in this forecast as expenditure savings, this change adds $103 million to corporate income tax forecast for the 2006-07 biennium. These revisions carry forward into the 2007-08 biennium adding to revenues and reducing interest payments below those included in February's planning estimates. In total the revised estimates of the cost of the Hutchinson decision added $220 million to the combined forecasts for the 2006-07 and 2008-09 biennia.

Motor Vehicle Sales Tax

The motor vehicle sales tax is now projected to add $487 million to Minnesota's general fund during the 2006-07 biennium, $17 million (3.4 percent), less than previously forecast. Fiscal year 2006 closed with a negative variance of $100,000. During the first four months of fiscal 2007 motor vehicle sales tax receipts were $2.5 million below forecast.

Global Insight's forecasts for total light vehicle sales and for consumer spending on motor vehicles and parts have both fallen. Light vehicle sales for the U.S. are now projected to fall to 16.5 million units in calendar 2006 and 16.3 million units in 2007. In calendar 2005 light vehicle sales were 17.0 million. Global Insight's February baseline forecast called for light vehicle sales of 16.6 million units in both 2006 and 2007.

Forecast for Light Vehicles Sales Has Been Cut Since February



In November Minnesota voters approved a constitutional amendment dedicating all motor vehicle sales tax collections to transportation. Since the constitutional dedication is phased in beginning with the start of the 2008 fiscal year it has no impact on 2006-07 biennium revenues *(see box on page 43)*.

Other

Other tax and non-tax revenue, including the statewide property tax levy and transfers from other funds to the general fund are expected to total $6.532 billion, $189 million (3.0 percent) more than end-of-session estimates. New forecasts for investment income and fees including a large one-time payment added $122 million to the forecast. Forecasts for the estate tax and the cigarette and tobacco products tax were raised by $30 million and $23 million respectively, consistent with current receipts.

Expenditure Forecast
FY 2006-07 Biennium

Forecast expenditures for the FY 2006-07 biennium now total $31.487 billion, $125 million, (0.4 percent) less than estimated at the end of the 2006 legislative session. Nearly one-half of the savings, $60 million, was realized when the books were closed for FY 2006. The remaining $65 million of savings is expected to occur in FY 2007.

FY 2006-07 Expenditures
($ in millions)

	End of Session	November Forecast	Difference
K-12 Education	$12,779	$12,760	$(19)
K-12 Shift / Buyback	609	609	0
Higher Education	2,766	2,762	(4)
Property Tax Aids & Credits	3,034	3,025	(9)
Health & Human Services	8,316	8,256	(60)
Environ, Agric. and Econ. Develop.	741	713	(28)
Transportation	206	207	1
Public Safety	1,710	1,710	0
State Government	615	614	(1)
Debt Service	764	752	(12)
All Other	1	5	4
Estimated Cancellations	(23)	(15)	8
Subtotal	**31,520**	**31,399**	**(121)**
Dedicated Expenditures	92	88	(4)
Total Expenditures	**$31,612**	**$31,487**	**$(125)**

Lower health and human services spending accounted for $60 million, or nearly one-half of the $125 million reduction in spending for the biennium. Minor revisions to the K-12 education finance forecast reduced spending $19 million, while lower debt service costs created $12 million in savings. Changes in all other spending areas provided an additional $34 million in net savings. One item, a $48 million reduction in estimated payments for tax penalties and interest, contributed significantly to the decline in spending. In part, this reduction was offset a net $14 million increase in all other spending items.

While minor changes in estimates are shown for all other areas and agencies within the budget, none of these represent significant adjustments to the forecast. End-of-session estimates are based on appropriations. This forecast, in the second year of the biennium, incorporates actual spending for FY 2006. Unspent operating appropriations have been carried forward into FY 2007. Differences shown from prior forecasts for individual agencies largely reflect movement of money between categories, transfers of funds between agencies, and changes in dedicated revenue estimates and related dedicated spending – not underlying forecast changes.

Education Finance Estimates Decrease $19 Million for FY 2006-07

For the FY 2006-07 biennium, Education Finance expenditures are now expected to total $12.8 billion ($13.4 billion on a appropriations basis due to shift buybacks). Projected expenditures are $19.2 million lower than at the end of the 2006 legislative session. This change reflects a $14.3 million (0.1 percent) decrease in the General Education appropriation as well as smaller reductions in various categorical aid programs.

General Education

Over 84 percent of K-12 aid ($11.3 billion) is distributed to schools through the General Education program, and most of the forecast change is also in this program. While there are several factors that account for this change, one of the most significant is pupil estimates. Although pupil counts are projected to decrease on an annual basis through FY 2009, the rate of decline is occurring at a more modest pace than was anticipated at the end of session. Public enrollment as measured by Average Daily Membership (ADM) is now projected to fall from 826,994 in FY 2006 to 824,450 in FY 2009.

The changes in ADM projections result in a $24.5 million (0.3 percent) increase in Basic Education entitlements. Referendum Equalization Aid is up $6.0 million (2.6 percent) in FY 2006-07 and Operating Capital Equalization Aid is up $1.1 million (0.5 percent). This is primarily due to continued but slightly slower growth in Adjusted Net Tax Capacity (ANTC) and Referendum Market Value (RMV).

These increases are offset by changes in other components of General Education, most notably Q-Comp. Although interest in Q-Comp remains strong, slower than anticipated program implementation results in underutilization of the FY 2006-07 capped entitlement for this program. Compared to end of session estimates, Q-Comp is forecast to decrease by $39 million (41.4 percent) in FY 2006-07. In addition, funding for Extended Time Aid appears to be leveling off, resulting in an entitlement decrease of $5.1 million (4.7 percent) in FY 2006-07.

Categorical Aids

Categorical aids also contributed to the decrease in estimates for the current biennium. The most significant change is a $2.5 million (15.5 percent) decrease in Interdistrict Desegregation Transportation Aid from end of session due to delayed start-up of programs in the west and northwest metro.

Tax Aids and Credits Spending Reduced $9 Million for FY 2006-07

Tax aids and credits expenditures are now projected to total $3.025 billion for FY 2006-07. This is a reduction of $9.3 million from end-of-session estimates, less than a 0.5 percent change. A number of increases and decreases combined to generate the net savings.

Projected tax penalty and interest payments were reduced $48.4 million, from $75.8 million to $28.9 million. This decrease is the result of two factors. Tax refund claims are down in general, primarily in the sales tax area. Also, claims from the Hutchinson Technology court decision are being processed more slowly than previously projected, reducing the amount of interest to be paid out on those claims. As a result, the total amount of the claims is expected to be significantly less than originally estimated.

State police and fire aid payments are now expected to be $175 million, a $9.5 million reduction from earlier estimate. The savings result from phased changes to the proportions of the insurance gross premiums tax allocated to fire aid.

Payments in Lieu of Taxes (PILT) to counties for state-owned land shows a $33 million increase. However, this represents no overall change in estimates. While now appearing as an increase in aid and credit spending, there is an offsetting reduction in spending in the environmental area. In this case, funds are appropriated to the Department of Natural Resources for PILT, but are later transferred to the Department of Revenue. The payments to local governments are considered as property tax credits.

Finally expected payments for property tax refunds increased $16.4 million to $705.6 million due to projected increases in both the level of property tax collections as well as factors affecting eligibility and participation in the programs.

Health and Human Services Forecast for FY 2006-07 Declines $60 Million

Health and human services spending is now expected to be $8.256 billion in FY 2006-07, down $60 million (0.7 percent) from end-of-session estimates. The most significant decreases occur in Medical Assistance (MA) Long Term Care (LTC) Facilities, MA LTC Waivers, Group Residential Housing, and the Chemical Dependency Program. Those decreases are partially offset by small increases in other DHS entitlement programs.

MA Families and Children Basic Care is up $22.0 million in FY 2006-07 (1.8 percent) from end-of-session estimates. Higher average payments account for the majority of this increase. MA Elderly and Disabled Care and GAMC projections are relatively unchanged.

Estimates from Continuing Care Grants have been reduced $65.6 million (2.1 percent) from end-of-session estimates. Decreased caseload estimates result in lower spending within the MA Long-Term Care (LTC) Waiver and Chemical Dependency activities. Spending estimates for MA LTC Facilities are down $17.7 million (1.8 percent), mainly due to higher projected cancellations from the Alternative Care program and lower average cost for nursing facility recipients.

Debt Service Estimates for FY 2006-07 Reduced $12 Million

Total spending for debt service for FY 2006-07 is now expected to be $752.1 million, $11.6 million lower than prior estimates.

The primary contributor to the reduction in forecast debt service costs is the dollar amount of the premiums paid by the winning bidders on the last two state bond sales. Premiums received were $10.5 million more than forecast. Lower interest rates result in higher premiums on the bonds sold and the actual interest rates at both bond sales were lower than previously forecast.

All Other Spending Areas Show Little Change, Down $25 Million

The remaining spending areas account for $6.084 billion, just over 19 percent of total general fund spending. This is a net $24 million decrease from previous estimates. Several items account for the reduction from end-of-session data.

The $28 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 $33 million of this decrease in spending. The Department of Natural Resources (DNR) receives an open appropriation 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.

The forecast for dedicated revenue spending has decreased $4 million from previous estimates. This decrease occurs because revenues in various dedicated receipt sources fell. Any changes in dedicated spending are offset by changes in estimated dedicated revenues and consequently do not affect the projected general fund balance.

Forecast cancellations, the estimated amount of unused appropriations that state agencies will return to the general fund at the end of a fiscal year, remain unchanged. The forecast comparison shows a decline of $7.5 million. That amount was the forecast for FY 2006. With the closing of the fiscal year, cancellations are reflected as lower spending within individual agencies. For fiscal year 2006 actual cancellation amounted to $4.2 million, $3.3 million less than forecast. The estimate for FY 2007 remains unchanged at $15 million.

FY 2008-11 Budget Outlook

FY 2008-2009 Budget Forecast

With improvement in the revenue forecast for both the current biennium and FY 2008-09, the projected budget balance has increased from a $737 million balance projected at the end of the 2006 session to $2.170 billion. For FY 2008-09, current resources (i.e. revenues and transfers expected within the biennium) are projected to increase by $1.273 billion over the current biennium, while projected expenditures increase by $1.009 billion.

The $2.170 billion projected balance shown for FY 2008-09 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 projected balance includes the forecast $1.038 billion surplus projected for the current biennium.

FY 2008-09 Budget Forecast
($ in millions)

	FY 2006-07	FY 2008-09	$ Change	% Change
Beginning Balance	**$1,393**	$2,151	$758	54.4%
Tax Revenues	26,605	31,205	1,600	5.4
Non-Tax Revenues	1,700	1,512	(188)	(11.1)
Other Resources	940	801	(139)	(14.8)
Current Resources	**32,245**	**33,518**	**1,273**	**3.9**
Expenditures	**31,487**	**32,496**	**1,009**	**3.2**
Cash Flow Account	350	350	0	
Budget Reserve	653	653	0	
Tax Relief Account	110	0	(110)	
Available Balance	**$1,038**	**$2,170**	**$1,132**	

While the forecast estimates show a positive revenue-expenditure balance, this does not diminish financial management challenges in maintaining a stable long-term budget outlook. Even though state tax revenues will continue to grow at a healthy rate, forecast spending, also continues to grow, driven primarily by growth in human services spending.

Expenditure projections 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 $1.0 to $1.2 billion in spending – and draw down projected balances by a like amount.

Forecast Provides Initial Set of FY 2010-11 Long-term Planning Estimates

This forecast provides the first budget estimates for the FY 2010-11 biennium. The planning estimates for FY 2010-11 are materially different from the short-term forecasts for the current and FY 2008-09 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 2010-11 are presented to help identify longer-term state finance issues. Revenue projections are based on GII's November baseline forecast of national economic activity. Expenditure projections assume current funding level and policies continue unchanged, adjusting only for caseload and enrollment changes as well as specific formula-driven items.

As with spending estimates for FY 2008-09, projected current law expenditures for FY 2010-11 do not include the cost of estimated inflation. Inflation, compounded over four years, would more than double the $1.0 to $1.2 billion that would represent a simple inflationary adjustment to FY 2008-09. By the year 2011, simple inflationary costs would add nearly $1.3 to $1.7 billion *annually* to the spending shown in the planning estimates.

FY 2010-11 Long Term Planning Estimates
($ in millions)

	FY 08-09	FY 10-11	$ Change	% Change
Current Resources				
Revenues	$32,717	$36,247	$3,530	10.8%
Transfers, Other	801	746	(55)	(6.8)
Total	33,518	36,993	3,475	10.4
Projected Spending				
Current Law	32,496	33,777	1,281	3.9
Difference	**$1,022**	**$3,216**	**$2,194**	
Estimated Inflation (CPI)	*$1,000*	*$2,200*		

The FY 2010-11 planning estimates display projected "current resources" compared to projected spending – excluding any projected balances for FY 2007-09. 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 – how much more is being collected than spent.

Long Term Planning Estimates Highlight Important Budget Issues

For FY 2010-11 current resources are projected to reach $36.993 billion, an increase of $3.475 billion (10.4 percent) over the forecast for FY 2008-09. Current law expenditures are projected to be $33.777 billion, an increase of $1.281 billion (3.9 percent) over forecast spending levels for FY 2008-09.

As with FY 2008-09, revenue growth exceeds expenditure growth in the planning estimates and projected budget balances begin to increase. This happens largely because the spending projections assume there will be no increases in spending in FY 2008-09 or the FY 2010-11 biennium beyond those incorporated into current law – adjusted only for enrollment and caseload.

To provide perspective, it is useful to recognize that over the last decade general fund spending has, on average, grown more than 5.3 percent *per year*. Contrast this with the 3.8 percent *biennial* growth shown for FY 2010-11. This highlights that significant budget changes would be required to limit the historical trend of spending increases to the levels assumed in the planning estimates.

The planning estimates are not intended to predict surpluses or deficits that far into the future. Rather the purpose is to assist in determining how well ongoing expenditures will likely match revenues based on trend projections of Minnesota's economy, and what it will cost to maintain current programs. The 2010-11 planning estimates provide one baseline against which the longer-term impacts and affordability of budget proposals and decisions in the 2007 legislative session can be measured.

Transportation Constitutional Amendment

Motor Vehicle Sales Tax Forecast

Motor vehicle sales tax (MVST) is paid on purchases of new or used motor vehicles. The revenue generated varies with the number of vehicle purchases, prices of vehicles, the mix of vehicle types and general economic conditions. The forecast for the MVST shown below reflects a slower expected revenue growth for FY2007 and beyond.

$ in millions	FY2006	FY2007	FY2008	FY2009	FY2010	FY2011
Nov 2006	$538.7	$512.5	$505.6	$523.4	$548.6	$582.1
Feb 2006	540.0	549.0	557.7	581.1		
Change	-1.3	-36.5	-52.1	-57.7		

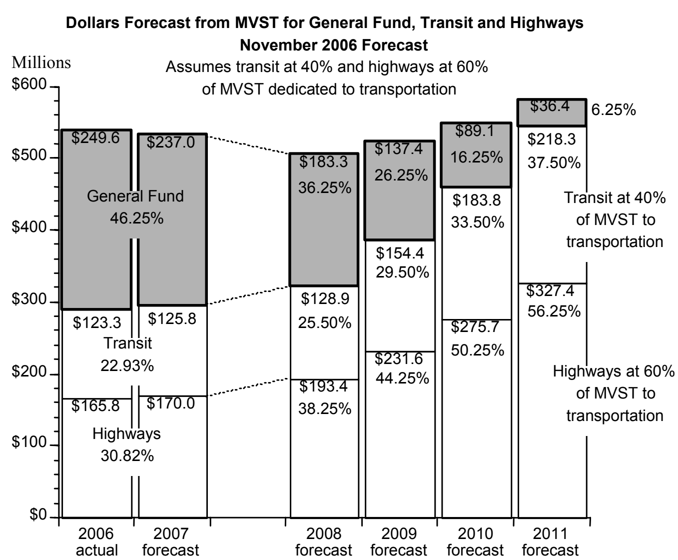
Motor Vehicle Sales Tax Dedicated to Transportation

In November, the voters of Minnesota adopted a constitutional amendment to phase in full dedication of the motor vehicle sales tax for transportation purposes beginning in FY2008.

In fiscal year 2007, 46.25 percent of MVST is deposited in the general fund, 30.82 percent in highway funds, and 22.93 percent in transit funds. The constitutional amendment requires that, starting in fiscal year 2008, the share going to transportation will increase by ten percent to 63.75 percent, and by an additional ten percent each year until it is completely dedicated in fiscal year 2012. The amendment requires that not more than 60 percent of these revenues to transportation must go to the highway user tax distribution fund, and not less than 40 percent to public transit assistance.

The chart shows the declining portion of MVST deposited in the general fund, and increases to funds for transit and for highways. The chart displays 40 percent of the MVST dedicated to transportation each year going to transit and 60 percent to highways. The percentages may change if the legislature approves a different mix of uses.

By FY2011, the phase-in will provide transportation about $546 million from MVST, up from the FY2007 forecast of $289 million, for a forecast increase of $257 million. Future forecasts will change these estimates.



Revenue Forecast
FY 2008-09

Total current resources for the 2008-09 biennium are forecast to be $33.518 billion, $297 million (0.9 percent) more than end-of-session revenue planning estimates and $1.272 billion (4.0 percent), more than projected receipts in the 2006-07 biennium.

Revenue Forecast FY 2008-09

$ in millions

	FY2006-07	FY2008	FY2009	FY2008-09
Individual Income	$14,056	$7,536	$8,006	$15,541
Sales	9,001	4,633	4,852	9,485
Corporate	2,170	1,032	1,024	2,056
Motor Vehicle Sales	487	183	137	321
Statewide Property Tax	1,295	691	711	1,402
Five Major Taxes	27,008	14,075	14,730	28,805
Other Revenue	3,945	1,772	1,780	3,552
Tobacco	351	180	180	360
Net Non-dedicated	31,305	16,026	16,690	32,717
Other Resources	941	401	400	801
Current Resources	**$32,245**	**$16,427**	**$17,090**	**$33,518**

General fund receipts for the five major taxes are now projected to be 6.7 percent more than in the previous biennium. Individual income tax revenues are projected to show the greatest growth, up 10.6 percent ($1.486 billion) over the fiscal 2006-07 forecast. Sales tax receipts are expected to grow by 5.4 percent ($484 million) and the statewide property tax is expected to increase by 8.3 percent ($108 million). General fund receipts from both the corporate income tax and the motor vehicle sales tax are expected to be less than in the 2006-07 biennium. Corporate tax receipts, reflecting a return to a more normal ratio of corporate profits to GDP, are expected to decline by 5.2 percent. Motor vehicle sales tax receipts fall by 34.1 percent from those in 2006-07 due primarily, but not entirely, to the phase-in of the constitutional dedication of the motor vehicle sales tax to transportation funds. Other non-dedicated revenue also falls in the 2008-09 biennium. Fees, investment income, and other non dedicated revenues are expected to decline leaving other non-tax revenue 12 percent below its 2006-07 level.

This is the first detailed revenue forecast for the 2008-09 biennium. Prior revenue estimates have been for planning purposes only and were designed to provide a general guideline about the path of future revenues, not a specific target for budgeting. Those estimates were developed using simpler models and more generic growth rate assumptions. Of particular note is that the planning estimates for the individual income tax estimates are prepared by applying one global growth rate to all sources of income. In this forecast, separate growth rates for each type of income and income tax deduction are used in the HITS model simulations.

Changes in Economic Assumptions

The economic outlook used in this first forecast of revenues for the 2008-09 biennium is almost identical to that used to prepare February's revenue planning estimates. Global Insight now projects real GDP growth of 2.7 percent in fiscal 2008 and 3.3 percent in fiscal 2009. In February their baseline forecast called for growth rates of 2.7 percent and 3.1 percent. For nominal or current dollar GDP both the February and November baseline forecasts from GII called for 4.7 percent growth in fiscal 2008. For fiscal 2009, the November forecast expects 5.3 percent growth. In February, 5.2 percent growth was anticipated. Growth rates for most segments of the economy other than housing are very similar to those used in February, although the levels from which that growth comes has changed for some sectors.

Individual Income Tax

Individual income tax receipts in the 2008-09 biennium are forecast to total $15.541 billion, $1.486 billion more than is currently forecast for the 2006-07 biennium and $356 million more than was projected in end-of–session planning estimates. The additional revenue is largely due to the higher level of liability observed for tax year 2005. The tax base grows more slowly than projected in February, but because it starts from a higher level, revenue is added.

The Department of Finance uses a single, universal growth factor for all types of income when preparing the individual income tax revenue planning estimates. The Global Insight forecast rate for taxable personal income is used as the global growth factor. That growth factor was 5.5 percent for tax year 2008 and 5.7 percent for tax year 2009 in February when the planning estimates were last prepared. Wages are the largest component of taxable income in Minnesota accounting for about 72 percent of adjusted gross income for Minnesota residents. Currently Minnesota wage growth is lower in both the 2008 and 2009 tax years. In this forecast, wages are projected to grow at a 4.6 percent rate in 2008 and 4.8 percent in 2009.

That slightly slower growth rate for wages is offset by a significantly higher growth rate for non-wage income. Non-wage income, including portfolio income, proprietors' incomes, and pensions—is expected to grow by 7.3 percent in tax year 2008 and 6.9 percent in tax year 2009. Capital gains income is projected to grow by 10 percent in both 2008 and 2009. Interest income is projected to grow by 7.5 percent in 2008, and non-farm proprietors' income is projected to grow by 7 percent in 2008.

Sales Tax

Net sales tax collections for the 2006-07 biennium are now expected to reach $9.485 billion, $484 million more than is currently forecast for the 2006-07 biennium but $154 million (1.6 percent) less than end-of-session planning estimates. All of the change occurred in the estimate of gross sales tax receipts. The sales tax refund forecast changed by less than $1 million.

The lower sales tax receipts already observed in fiscal 2006 and 2007 carry forward to affect the sales tax forecast for the 2008-09 biennium by lowering the base from which growth occurs. November's baseline economic outlook has slightly stronger growth in taxable sales than that used to prepare February's planning estimates, but the additional growth was insufficient to make up the revenue lost from starting from a lower base. The forecast was also reduced for technical reasons. Revised estimates of the additional revenue attributable to the adoption of the streamlined sales tax provisions lowered the forecast by $99 million. That was partially offset by a reduction in the estimate of the tax loss due to Internet sales.

Corporate Franchise Tax

Net corporate franchise tax receipts during the 2008-09 biennium are now estimated to total $2.056 billion, down $114 million (5.2 percent) from levels currently anticipated for the 2006-07 biennium, but $305 million more than projected in February's planning estimates. Revised estimates of the cost of the Hutchinson Technology decision added $38 million to forecast revenues in fiscal 2008 and $26 million in fiscal 2009.

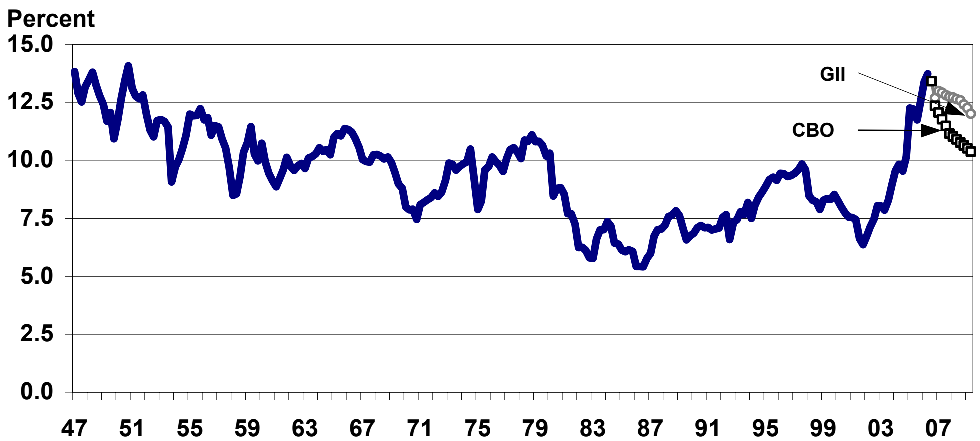
In the national income and product accounts, the level of income received by the various factors of production must equal the economy's total level of output. Most economic forecasters, including Global Insight, balance the two sides of the accounts by adjusting corporate profits. In simplest terms, corporate profits are said to be what is left over after all other items of income are added up and subtracted from the value of goods sold.

Normally that procedure does not create a problem for state revenue forecasts. Corporate profits, while volatile and subject to substantial revision, have been between 6 and 10 percent of national output since the early 1980s. Recently, however, the ratio of corporate profits to GDP has surged. In the second quarter of 2006, profits were 13.8 percent of GDP. That is the highest ratio recorded since the Korean War year of 1950. While it is possible that corporate profits may remain at those levels through the forecast horizon, it is likely that the ratio of profits to GDP will move back to within its traditional range.

Global Insight's forecast has corporate profits remaining at historically high percentages of GDP through the end of the 2008-09 biennium. Their November baseline shows the ratio of corporate profits to GDP at just over 12 percent in the second quarter of 2009, a ratio exceeded only in 1952. If that assumption were not to hold, corporate income tax revenues would fall short of forecast. The Congressional Budget Office has recognized this potential problem and chosen to use a different time path in their corporate profits forecast. They assume that the ratio of corporate profits to GDP returns more quickly to its historical range. Under CBO's assumptions corporate profits are 10 percent of GDP in 2010.

After discussion with the Council of Economic Advisors Finance Department economists decided to base their corporate tax forecast on a projection of future corporate profits that more closely follows the CBO forecast. Given the volatility of corporate profits, the substantial revisions that often occur, and the fact that Global Insight does not estimate corporate profits directly, the Finance Department believed it prudent to choose a path for future corporate profits that has them returning to the upper bound of their traditional relationship to GDP.

Corporate Profits as a Percentage of GDP Are Near Post-War Highs



Motor Vehicle Sales Tax

The sales tax on motor vehicles is now projected to yield $321 million in the 2008-09 biennium, $166 million less than in the 2006-07 biennium and $206 million (39 percent) less than projected in end-of-session planning estimates. While much of the reduction is due to the phase-in of the constitutional deduction of all motor vehicle sales tax receipts to transportation funds, some of the decline is due to a reduction in forecast collections. The forecast for sales of light motor vehicles in Minnesota has been reduced since February. The majority of the reduction in light vehicle sales occurs in fiscal 2007 but growth rates remain below those in the February's planning estimates in both fiscal 2008 and fiscal 2009. The weaker economic data outlook accounts for about $50 million of the decline in general fund revenues.

The remainder of the decline is due to approval of a state constitutional amendment that phases in the full dedication of the motor vehicle sales tax to transportation beginning at the start of the 2008-09 biennium. Under the constitutional amendment the general fund share of the motor vehicle sales tax falls from 46.25 percent in fiscal 2007 to 36.25 percent in fiscal 2008 and 26.25 percent in fiscal 2009. The general fund share of this tax continues to fall by ten percentage points each fiscal year. In fiscal year 2012 all motor vehicle sales tax receipts are dedicated to transportation funds.

Other Revenues

Other tax and non-tax revenues, including the statewide property tax levy are expected to total \$5.314 billion, \$278 million less than in the 2006-07 biennium and \$5 million less than projected in February's planning estimates. Forecasts for receipts from the mortgage, deed and insurance gross premiums taxes were all slightly below forecast.

Revenue Planning Estimates FY 2010-11

Total current resources for the 2010-11 biennium are estimated to be $36.993 billion, an increase of $3.475 billion (10.4 percent) over the level forecast for the 2008-09 biennium. General fund receipts for the five major taxes are now projected to be 11.8 percent more than in the previous biennium despite the reduction in general fund receipts attributable to the dedication of the motor vehicle sales tax to transportation funding. This is the first time the planning horizon has included the 2010-2011 biennium and these are the first revenue planning estimates issued for that period.

Revenue Forecast FY 2010-11

$ in millions

	FY2008-09	FY2010	FY2011	FY2010-11
Individual Income	$15,541	$8,588	$9,485	$18,073
Sales	9,485	5,033	5,231	10,264
Corporate	2,056	1,123	1,131	2,254
Motor Vehicle Sales	321	89	36	126
Statewide Property Tax	1,402	728	745	1,473
Five Major Taxes	28,805	15,561	16,629	32,190
Other Revenue	3,552	1,823	1,874	3,697
Tobacco	360	180	180	360
Net Non-dedicated	32,717	17,564	18,682	36,246
Other Resources	801	375	372	747
Current Resources	**$33,518**	**$17,939**	**$19,054**	**$36,993**

The individual income tax is the major source of growth, up 16.3 percent from levels forecast for the 2010-11 biennium. Typically projected income tax growth is more modest. End-of-session planning estimates for 2008-09, for example, showed 12 percent growth in individual income tax receipts. The unusually large percentage changes for the 2010-2011 biennium are caused by scheduled expiration of certain provisions in the federal tax code in tax year 2010. Those changes in federal tax law will add to state revenue. Some will increase the base level of taxable income and yield a permanent increase in state income tax revenue. A scheduled increase in the capital gains tax rate, however, will produce a one-time surge in tax year 2010 liability as taxpayers accelerate their realization of gains to take advantage of the lower tax rate. Those additional realizations will borrow from future realizations in later tax years.

Sales tax receipts are projected to grow by 8.2 percent ($779 million), the statewide property tax is expected to increase by 5.1 percent ($71 million), and the corporate franchise tax by 9.6 percent ($198 million). State general fund receipts from the motor vehicle sales tax fall by more than 60 percent from fiscal 2008-09 levels due to the increasing percentage dedicated to transportation funding. In 2012 the motor vehicle sales tax is completely dedicated to transportation funding and disappears from the general fund.

No one can forecast the path of the economy five years into the future. The baseline revenue planning estimates presented above are not explicit forecasts, they are extrapolations of projected trends in the economy. Even small deviations from the assumed trend over five years will compound and produce sizeable changes in revenues. In addition, due to the way the estimates are constructed any change in the base level of revenues for fiscal 2009 will change the revenue planning estimates for 2010 and 2011. Other things equal, stronger than anticipated revenue growth through fiscal 2009 will carry forward and add significantly to revenues in the 2010-11 biennium. But, should the economy grow more slowly than forecast during the next thirty-one months, 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 2010-11 biennium will deteriorate.

These revenue planning estimates are only a guide to the level of future revenues. They are not a guarantee. Normally, if the economy remains as strong as GII projects through 2011 the planning estimates are likely to slightly understate actual receipts. But, taxpayer reaction to the scheduled increase in the tax rate on capital gains could be quite different from that forecast. That could lead to either a material increase in revenues in fiscal 2011, or a significant decline. And, the GII baseline forecast includes strong growth with no recession over the entire five year forecast horizon. That scenario could be overly optimistic. Actual revenues could exceed or fall short of the planning estimates by $2.5 billion or more depending on the economy's performance and response to the higher capital gains rate.

Since November 2002 the Finance Department has based its revenue planning estimates on Global Insight's baseline forecast. The revenue planning estimates for fiscal 2010 and 2011 were prepared consistent with the GII baseline forecast for those years. GII projects real GDP growth rates of 3.3 percent and 2.9 percent and nominal GDP growth of 5.3 percent and 5.0 percent. The Blue Chip Consensus has a similar outlook. GII's real GDP growth rate is also consistent with that used by the CBO in its August budget update, but slightly above CBO's forecast for nominal growth of 4.9 percent in 2010 and 4.6 percent in 2011. GII expects the CPI to increase at an annual rate of 1.7 percent in both 2010 and 2012. Those rates are lower than the Blue Chip rate of 2.3 percent for those years. CBO projects CPI growth to average 2.2 percent in those years. When viewed on a fiscal year basis Global Insight is now projecting CPI growth of 1.7 percent in fiscal 2010 and fiscal 2009. Price increases at those rates are implicitly included in the revenue planning estimates for the 2010-11 biennium.

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 (HITS) 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. Calendar year income tax liabilities were converted into fiscal year revenues using the same proportions as forecast for 2007.

The HITS model was calibrated to incorporate most changes in federal tax law that will occur in 2011 when provisions initially enacted in the Economic Growth and Tax Relief Act of 2001 and the Jobs and Growth Tax Relief Reconciliation Act of 2003 expire. Among those changes is the return of the federal capital gains tax rate to 20 percent from its current level of 15 percent. Since Minnesota taxes capital gains at the same rate as ordinary income, that change in the federal code will not affect the rate at which capital gains are taxed in Minnesota. It is likely, however, to have a large indirect impact on Minnesota taxable income as investors seeking to maximize after-tax returns on investment accelerate realizations into 2010. Since that additional capital gains activity would not be part of taxable personal income as defined for the national income accounts, the Finance Department has included one-time off-model adjustments to tax liability in tax years 2010 and 2011. An additional $327 million was added to liability in tax year 2010. In 2011 $313 million was subtracted. Those changes affect tax receipts in fiscal years 2011 and 2012.

As in recent years the complete sales tax model was used to prepare sales tax revenue planning estimates. Each component of the sales tax base was assumed to grow at the national average rate for that group of goods or services. Corporate tax receipts in Minnesota were estimated to grow slightly more slowly than GII's forecast of national before tax corporate profits, consistent with the lower ratio of corporate profits to GDP assumed. Those receipts were then reduced for the reduction in prospective collections expected to follow from the Hutchinson Technology decision. The Department of Revenue now estimates that ruling will reduce receipts in the 2010-11 biennium by $80 million. The general fund's share of Minnesota's motor vehicle sales tax collections falls dramatically due to the phase in of the constitutional dedication of these receipts to transportation funds. Total 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 based on extrapolation of existing trends.

Expenditure Estimates
FY 2008-11

FY 2008-09 Biennial Budget Expenditure Estimates

Projected state general fund spending for FY 2008-09 is now $32.496 billion, a 3.2 percent increase over the current biennium.

FY 2008-09 Expenditures Estimates
($ in millions)

	FY2006-07	FY2008-09	$ Difference	% Change
K-12 Education	$12,760	$12,985	$225	1.8%
K-12 Shift / Buyback	609	(4)	(613)	nm
Higher Education	2,763	2,802	39	1.4
Property Tax Aids & Credits	3,025	3,107	82	2.7
Health & Human Services	8,256	9,369	1,113	13.5
Environ, Agric. and Econ. Develop.	713	683	(30)	(4.2)
Transportation	208	225	17	8.3
Public Safety	1,710	1,723	13	0.8
State Government	614	606	(8)	(1.4)
Debt Service	752	902	150	19.9
Capital Projects	0	20	20	nm
All Other	5	0	(5)	nm
Estimated Cancellations	(15)	(20)	(5)	nm
Subtotal	**31,399**	**32,398**	**999**	**3.2**
Dedicated Expenditures	88	97	9	10.8
Total Expenditures	**$31,487**	**$32,496**	**$1,009**	**3.2%**

Health and human services spending and K-12 education finance costs represent nearly two-thirds of Minnesota's general fund budget. Health and human services spending continues to be the most significant contributor to forecast spending growth. Spending in health and human services programs is now projected to grow $1.113 billion (13.5 percent) over levels in FY 2006-07. Declining K-12 enrollments and no change in the per-pupil formula leaves K-12 education spending growth at less than two percent. Net spending in all other categories is nearly flat due to the fact that current law requires that FY 2007 legislative appropriations are the base for FY 2008-09 budget planning and that the forecast is not adjusted for general inflationary pressures.

Projected Spending in FY 2008-09 Is Down $97 Million from Prior Estimates

This forecast is a $97 million decrease from the comparable estimates at the end of the 2006 legislative session. Decreases in health and human service spending of $63 million and a projected $55 million decrease in debt service were the largest reductions. K-12 education spending increased $39 million.

FY 2008-09 Spending - Forecast Changes

($ in millions)

	End of Session	November Forecast	Difference
K-12 Education	$12,946	$12,985	$39
K-12 Shift / Buyback	(4)	(4)	0
Higher Education	2,802	2,802	0
Property Tax Aids & Credits	3,139	3,107	(32)
Health & Human Services	9,431	9,369	(63)
Environ, Agric. and Econ. Develop.	682	683	1
Transportation	221	225	4
Public Safety	1,733	1,723	(10)
State Government	600	606	6
Debt Service	957	902	(55)
Capital Projects	20	20	0
Estimated Cancellations	(20)	(20)	0
Subtotal	**32,509**	**32,398**	**(111)**
Dedicated Expenditures	84	98	14
Total Expenditures	**$32,593**	**$32,496**	**$(97)**

Current Law is Starting Point for Budget Planning

FY 2008-09 current law expenditure projections set the context for decisions on the next budget. The expenditure estimates represent the cost of major forecast items adjusted only for enrollment, caseload, or cost increases specifically built into current law or formula. Estimates for other grant programs and operating budgets largely represent FY 2007 appropriations carried forward at the same level. The estimates do not include agency requests or other budget proposals.

The current law expenditure estimates are not automatically adjusted for inflation. Except for a small portion of health care programs 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.

Spending Growth is Limited Under Current Law Estimates

Even without general inflation, there is some growth in current law spending from one biennium to the next. Legislative appropriations increase from the first to the second year of the *current* biennium – and the second year is carried forward as the "base" for the next two-year period. There also 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.

The 3.2 percent current law expenditure increase projected for FY 2008-09 is relatively low compared to actual increases in spending over the last decade. One area accounts for $1.1 billion of the total increase of $1.0 billion. If health and human services spending were factored out, biennial growth for all other spending would be flat to slightly negative. This occurs, in part, as the one-time spending of $600 million in FY 2006-07 to buy back school shifts does not recur in FY 2008-09.

It is important to recognize that increases projected for other areas are negligible. Declining enrollments and a constant per pupil formula are the primary factors that limit growth in K-12 education. Lower estimates for inmate populations and completion of the court takeover results in basically flat public safety spending. Increases shown for property tax aids and credit programs are largely driven by projected growth in property tax refund programs and the current local government aid formula.

FY 2010-11 Expenditure Projections are Slightly Higher – 3.9 Percent Growth

The spending growth shown for FY 2010-11 planning estimates is only slightly higher than that for shown for FY 2008-09. Total spending is projected to increase $1.281 billion, 3.9 percent over FY 2008-09.

The trend remains the same as FY 2008-09 in all major forecast programs. Health and human services projections account for all of the growth - while estimates for the other major spending areas remain flat or decline.

FY 2010-11 Planning Estimates

($ in millions)

	FY 2008-09	FY 2010-11	$ Difference	% Change
K-12 Education	$12,985	$12,858	$(127)	(1.0)%
K-12 Shift / Buyback	(4)	0	4	nm
Higher Education	2,802	2,801	(1)	0.2
Property Tax Aids & Credits	3,107	3,112	5	0.2
Health & Human Services	9,369	10,671	1,302	13.9
Environ, Agric. and Econ. Develop.	683	685	2	0.2
Transportation	225	209	(16)	(7.3)
Public Safety	1,723	1,744	21	1.2
State Government	606	606	0	0.0
Debt Service	902	1,036	134	14.9
Capital Projects	20	20	0	0.0
Estimated Cancellations	(20)	(20)	0	0.0
Subtotal	**32,398**	**33,722**	**1,324**	**4.1**
Dedicated Expenditures	98	55	(43)	(44.0)
Total Expenditures	**$32,496**	**$33,777**	**$1,281**	**3.9%**

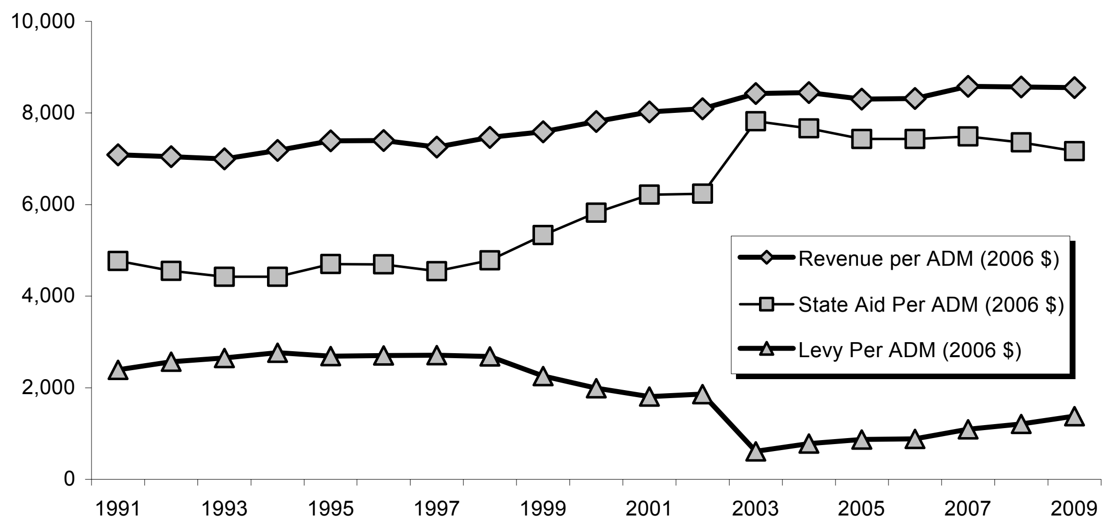
Education Finance Estimates, FY 2008-2011

Education Finance, the largest category of state general fund spending, consists of aid programs for K-12 education, special education, early childhood and family education, charter schools, nonpublic pupil programs and desegregation programs. K-12 aids can be divided into two major funding streams: 1) General Education, the primary source of basic operating funds for schools, and 2) categorical aid tied to specific activities or categories of funding. The number and characteristics of students receiving educational services drive most K-12 education funding.

The most accurate way to evaluate education funding is to examine education spending on a per pupil basis over time. This eliminates swings in overall education spending caused by changes in pupil numbers or accounting shifts. In FY 2003 the state eliminated the General Education levy and began to fully fund the General Education formula with state aid. Since FY 2003, state aid per pupil in constant dollars has decreased while levy per pupil has increased in constant dollars.

Education Funding per ADM in Constant Dollars (2006 $)

***The dollar amounts represent school district general fund dollars which do not include debt service, food service and community education**



Compared to the Previous Biennium, Education Finance Estimates Increase by $225 Million in FY 2008-09

Excluding the impact of accounting shifts, Education Finance expenditures increase by $225.3 million from FY 2006-07 to FY 2008-09. On an appropriations basis, K-12 spending will total $13.0 billion in the next biennium, down $388 million from FY 2006-07. The appropriation decrease is primarily due to K-12 accounting shift buybacks that increased state spending on K-12 education in FY 2006-07. Between November 2004 and February 2006 the state bought back nearly $1.1 billion in shifts.

General Education

Pupil counts continue to decline in FY 2008-09, but not as rapidly as anticipated at the end of the 2006 legislative session. As a result, Basic Education Aid entitlements are expected to increase by $144.5 million (1.6 percent) from FY 2006-07. Compensatory Aid entitlements are expected to be $24 million (4 percent) higher than in the FY 2006-07 biennium. Q-Comp entitlements are expected to be $98 million (177.4 percent) higher than they were in the previous biennium as program phase-in accelerates.

These increases are offset by reductions in other areas largely due to steady growth in school district property tax levies. Entitlements for Referendum Equalization Aid are down $56 million (23.3 percent). Operating Capital Equalization Aid entitlements decline $89.6 million (37 percent) and Equity is down $12.9 million (23 percent).

Categorical Aids

Charter School Lease Aid appropriations are projected to grow by $15.3 million (29 percent) over current levels, reflecting a rising number of students in charter schools and a slight increase in per pupil lease costs. In addition, Interdistrict Desegregation Transportation Aid is expected to increase by $6 million (44 percent) and Integration Revenue is expected to increase by $6.7 million (6 percent). The growth of Interdistrict Desegregation Transportation Aid is a result of both more students participating at more program sites and increases in the cost of transportation. The Integration Revenue growth is also a result of increased participation in the program, including more pupil units in qualifying districts and additional districts qualifying for aid.

Debt Service Equalization Aid appropriations are estimated to decrease by $18.9 million (41 percent), primarily due to increases in Adjusted Net Tax Capacity (ANTC) and a reduction in the passage rate of bonding referendum. Debt Service Equalization Aid as a percentage of total debt service revenue is expected to fall from 2.8 percent in FY 2007 to 1.6 percent in FY 2009.

Special Education Aid is expected to decrease by $30.5 million (2.7 percent) in FY 2008-09 compared to FY 2006-07. This difference is due to the aid payment shift from FY 2005 to FY 2006 that increased the FY 2006 appropriation.

Early childhood and family support programs are expected to increase by $6.6 million (7 percent) in FY 2008-09. The primary driver of this change is a $4.6 million (14 percent) increase in Early Childhood Family Education (ECFE). This increase is largely due to a formula increase that took effect in FY 2007.

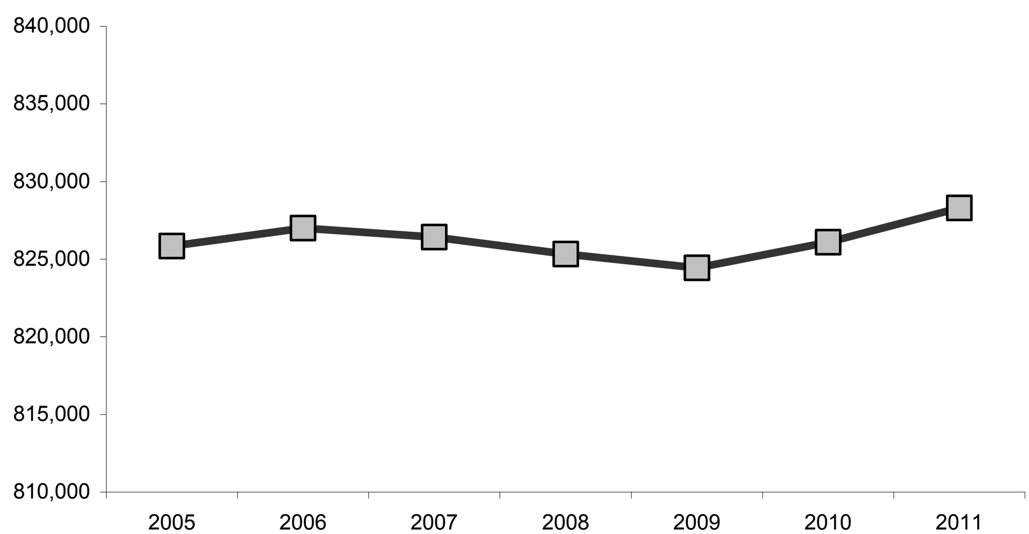
Education Finance Estimates Decrease $127.1 Million in FY 2010-11 From FY 2008-09

Education Finance appropriations will total $12.9 billion in FY 2010-11, down $127.1 million from FY 2008-09 if the trailing impact of shifts is excluded. The vast majority of this change occurs in General Education where continued growth in local property tax levies offset state obligations for Referendum Equalization Aid, Operating Capital Equalization Aid and Equity. Although the longstanding trend of declining enrollment turns around in FY 2010-11, increased ADMs do not result in higher costs during the forecast horizon.

General Education

General Education appropriations are projected to decrease by $149.4 million (1.4 percent), largely due to growth in local property tax levies. As school districts generate more revenue from local sources, state equalization aid declines. When compared to FY 2008-09, entitlements for Referendum Equalization Aid are down $75 million (41 percent). Operating Capital Equalization Aid entitlements decline $41.5 million (27.3 percent) and Equity is down $15 million (34.8 percent). Even though the trend of declining enrollment reverses in FY 2010, the weighting system applied to pupils for purposes of Basic Education Aid causes the entitlement to remain stable with a decline of $4 million. Enrollment growth is concentrated among lower weighted students in grades K-5 while higher weighted students in upper grades continue to decline.

Public Enrollment as Measured by Average Daily Membership (ADM)



Categorical Aids

The decline in General Education is partially offset by increases in categorical aid appropriations. Charter School Lease Aid is expected to increase by $18 million (26 percent) compared to FY 2008-09. This increase is primarily due to growth in charter school student enrollment and higher lease costs. Spending for Special Education programs is expected to grow by $4.8 million. This is due to increasing enrollment in FY 2010-11.

Interdistrict Desegregation Transportation Aid is forecast to increase by $8.7 million (44 percent) as a result of new program sites and increased transportation costs.

In addition to these growth areas, there is a $13.7 million decrease (17 percent) in facilities funding, including Health and Safety Revenue, Debt Service Equalization Aid and Deferred Maintenance. The decrease is due to a declining number of bond referendums and increasing property values, which cause aid to be offset by levy dollars.

Tax Aid and Credit Spending Increases 2.7 Percent in FY 2008-09

Expenditures for tax aids and credits are projected to reach $3.107 billion in FY 2008-09, up $82 million (2.7 percent) over spending for the current biennium.

The majority of this change is a $73.8 million increase in the property tax refund area. Growth in property tax refunds to homeowners is the primary contributor. While the increase is mostly due to higher homestead property tax assumptions, other factors include higher program participation rates and the fact that property tax growth is expected to outpace growth in homeowner income. Renter refunds remain relatively flat.

Other increases include a $48 million increase in city aids between FY 2006-07 and FY 2008-09, reflecting a permanent increase in Local Government Aid that started in FY 2007. A $14.5 million increase in tax penalty and interest payments is also projected between the two biennia. This growth is partly the result of higher interest rates being paid out on refunds.

These increases are partially offset by two decreases. The first is a $30.1 million decrease in estimated Market Value Homestead Credit payments to school districts and local governments. This decline is consistent with current trends in property values since individual market value credits decrease as the average market value of a homestead increases. The second is a $33 million "artificial" reduction for Payments in Lieu of Taxes to counties for state-owned land (discussed in the FY 2006-07 expenditure section). The reduction is a result of how the money is appropriated and reflected in the forecast, not the amount of money that will be paid to cities and counties.

Tax Aids and Credits Spending Grows Less than 0.2 Percent in FY 2010-11

Tax aids and credits spending is estimated to reach $3.112 billion in FY 2010-11, a $5 million increase (0.2 percent) over the forecast for FY 2008-09.

The major changes include an estimated $56.4 million increase for property tax refunds for homeowners. State police and fire aids is expected to increase by $11.3 million, reflecting market trends and the end to tax allocation changes related to fire aid. A decrease of $52.9 million is projected for Market Value Homestead Credits payments to school districts and local governments based on an expectation that assessed property values will continue to rise in the future. Tax penalty and interest payments are also expected to decrease by $8.5

million. However, future tax refund interest payments are difficult to predict because they largely depend on future court cases and the decisions made in those cases.

Health and Human Services

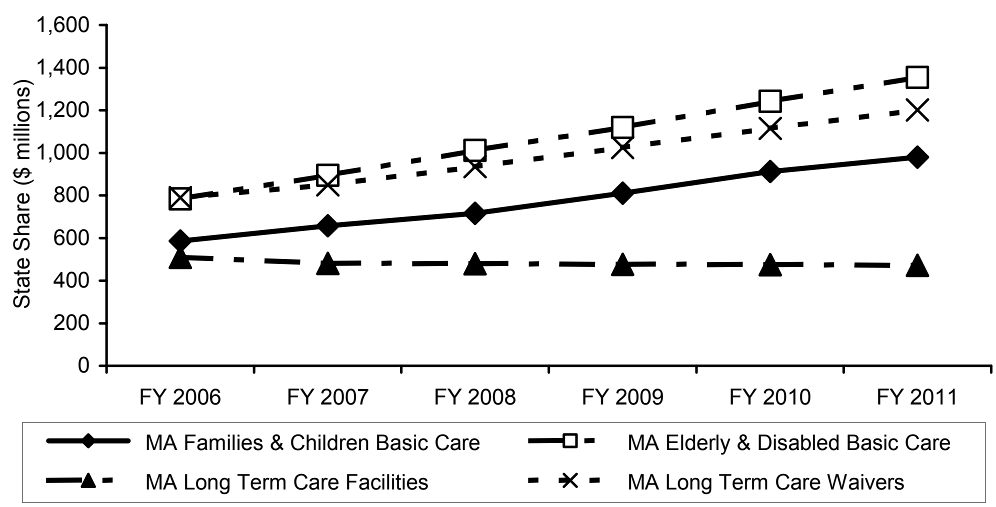
Health and human services includes state payments for direct health care services, such as hospital and physician visits, nursing home services, home care, and other medical and long-term care services. Approximately two-thirds of the spending in this area occurs in the state's Medicaid program, Medical Assistance (MA). MA is a federal entitlement program for low-income families, persons with physical or developmental disabilities, and the frail elderly. In Minnesota, MA costs are split evenly between the state and federal government. The costs described here are the state share only.

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 $1.1 Billion in FY 2008-09

Spending in the Health and Human Services budget is now expected to be $9.4 billion in FY 2008-09, $1.1 billion (13.5 percent) more than the current biennium. Almost all of the growth is within the MA program, as the number of recipients accessing MA services and the average cost continues to increase each year. Of the recipients receiving MA services, families and children comprise 70 percent of the total, although they only account for 24 percent of the cost. Alternatively, the elderly and disabled comprise 30 percent of all MA recipients, yet account for 76 percent of the cost. The MA program is divided into four budget activities: Families and Children Basic Care, Elderly and Disabled Basic Care, Long-Term Care Waivers, and Long-Term Care Facilities. Spending within these four budget activities is highlighted in the following graph.

Components of Medical Assistance Spending



Basic Health Care Forecast

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 Children and Families Basic Care, and General Assistance Medical Care. Basic Health Care general fund spending is forecast to reach $4.1 billion in FY 2008-09, up $614.0 million (17.5 percent) from FY 2006-07.

Public health care programs face many similar cost pressures to the private health care market, including medical inflation and the changing utilization of health care services. However, public health care programs differ from the private market in that public health programs must also accommodate higher enrollment when demand increases.

MA Families and Children Basic Care projections include increases in both average monthly costs and enrollment. FY 2008-09 costs are projected to be $1.5 billion, an increase of $282.6 million (22.7 percent) over FY 2006-07. The majority of this population participates in managed care and the per person cost of this purchasing strategy increases by varying amounts each year. Fee-for-service average costs increase when pharmaceutical costs rise and when there is higher health care services utilization. Also, monthly average enrollment is expected to increase by an average of 44,000 enrollees (6.3 percent) from FY 2006-07 to FY 2008-09.

MA Elderly and Disabled Basic Care costs are projected to grow $453.4 million (27.0 percent) from FY 2006-07 to FY 2008-09. Average monthly caseloads are projected to increase by 18,000 (5.85 percent) from FY 2006-07 to FY 2008-09. Average costs are also expected to increase slightly.

Costs for GAMC are projected to decrease $109.7 million (19.3 percent) from FY 2006-07 to FY 2008-09. Average monthly caseloads are projected to decrease 23,000 (31.7 percent) over the biennia, primarily due to a shift in enrollment from GAMC to MinnesotaCare. Average costs are projected to rise by 17.5 percent. Most of this increase results from expected increases in capitation rates.

Continuing Care Grants

Continuing Care Grants provide ongoing support for chronically ill and disabled individuals in institutions or in home and community-based settings. Spending across all Continuing Care Grants in FY 2008-09 is expected to be $3.3 billion, an increase of $301.5 million (9.9 percent) from FY 2006-07. The growth is almost entirely attributable to the MA Long-Term Care Waiver budget activity, which provides home and community-based services. Total expenditures for MA waiver services are expected to reach $2.0 billion in FY 2008-09, an increase of $319.5 million (19.5 percent) from FY 2006-07. The following details by waiver program explain most of the increase:

- Mental Retardation or Related Conditions (MR/RC) expenditures account for over one-half of total waiver spending and are projected to increase $88.6 million (9.9 percent) over the current biennium. The growth in MR/RC expenditures is slightly mitigated by lower than expected caseload growth in FY 2008-09.

- Community Alternative for Disabled Individuals (CADI) expenditures are expected to reach almost $307.3 million in FY 2008-09, a 66.4 percent increase from the current biennium. The addition of clients with mental illness has significantly increased the number of recipients served in the program and the cost per person. Since July 2003, current law has limited the number of recipients able to access CADI services. Those limits expire at the end of the current biennium, which significantly increases the number of recipients expected to access services in the future.

- Traumatic Brain Injury (TBI) spending is expected to increase $34.5 million (47.3 percent) in FY 2008-09 over the current biennium. Similar to the CADI waiver, the number of recipients has been limited since July 2003. Caseload projections for FY 2008-09 reflect the pent-up demand for TBI services.

Individuals can also receive home care services outside of the waiver programs, although the expenditures are accounted for within the MA LTC Waiver budget activity. Services for personal care assistants and private duty nursing (PCA/PDN) account for almost all of the home care spending. PCA/PDN expenditures are projected to reach $423.0 million in FY 2008-09, a 21.9 percent increase over the current biennium. Limiting the growth in the waiver programs results in significantly higher PCA/PDN use, especially within the disabled population.

The MA LTC Facilities budget activity accounts for almost one-third of all continuing care expenditures. Total expenditures are expected to be $956.8 million in FY 2008-09, a 3.4 percent decrease from the current biennium. Payments for nursing home services are expected to fall to $795.7 million in FY 2008-09, a 2.6 percent decrease from the current biennium, as a result of declining caseloads.

Children and Economic Assistance Grants

Children and Economic Assistance Grants include a wide range of programs for families and individuals, many of which are means tested. Expenditure estimates in this area are projected to reach $977.5 million in FY 2008-09, up $181.8 million (22.9 percent) from FY 2006-07.

General fund spending on MFIP/Diversionary Work Program grants is estimated to increase $35.9 million (42.2 percent), in large part due to the TANF maintenance of effort requirement increasing from 75 to 80 percent. The 75 or 80 percent maintenance of effort is calculated based on the amount the state spent in federal fiscal year 1994 under its old AFDC and related programs. This forecast assumption is based on changes under TANF reauthorization that make it more difficult for states to meet work participation requirements. States that do not meet work participation requirements are required to meet the higher maintenance of effort standard. This change shifts approximately $11 million of spending annually from federal TANF funds to the general fund. Grants to individuals for

Group Residential Housing services are expected to increase $28.8 million (18.1 percent), as both caseload and average cost continue to rise.

FY 2008-09 Health and Human Services Estimates $63 Million Below End-of-Session

Health and human services spending in FY 2008-09 is down $62.6 million (0.7 percent) from previous projections. The decreases occur primarily in Medical Assistance (MA) Long Term Care (LTC) Waivers, MA Families and Children Basic Care, and Group Residential Housing. Decreases in these areas are offset somewhat by increases in Minnesota Family Investment Program (MFIP), MA Elderly and Disabled Basic Care, and General Assistance Medical Care (GAMC).

MA Families and Children is down $44.7 million (2.8 percent) from end-of-session estimates. The majority of this decrease is due to revised HealthMatch assumptions. HealthMatch is an automated eligibility determination system designed to streamline eligibility determination and provide greater accuracy in application of complex eligibility rules. When HealthMatch is fully implemented, a significant shift of enrollees from MinnesotaCare to MA Children and Families is expected to occur. Because this forecast includes the assumption that HealthMatch implementation will be delayed several months, the shift from MinnesotaCare to MA Families and Children will occur later than previously anticipated.

MA Elderly and Disabled Care spending estimates increased $30.9 million (1.8 percent) from previous projections. Increased costs due to the shift of elderly waiver costs to managed care, and higher projected costs for the Minnesota Disability Health Options program increase costs from end-of-session. This increase is partially offset by lower "clawback" payments owed to the federal government for Medicare Part D. GAMC is up $19.0 million (4.2 percent) from end-of-session estimates. Higher average costs and higher enrollment cause the increase in estimated spending.

MA LTC Waivers spending projections fell $71.8 million (3.5 percent), but as described above, over half of the decrease is now being accounted for in the MA Elderly and Disabled Basic Care activity. Lower caseload estimates account for the remaining change in the waiver programs. Chemical Dependency caseload estimates are significantly lower than previous estimates, lowering expected spending by $7.7 million (4.5 percent).

Expenditure estimates for Children and Economic Assistance Grants are now projected to reach $977.5 million in FY 2008-09, up $10.9 million (1.1 percent) from previous estimates. Additional MFIP spending due to the higher maintenance of effort requirement is partially offset by decreases in Group Residential Housing (GRH) and Minnesota Supplemental Aid (MSA) Grants.

Health and Human Services Grows $1.3 billion in FY 2010-11

Basic Health Care spending is projected to grow another $903.7 million (22.0 percent) in FY 2010-11 to an estimated $5.0 billion, due largely to a continuation of trends affecting FY 2008-09 spending. MA Families and Children expenditures are projected to grow $365.9 million (24.0 percent) with enrollment growing 38,000 (8.1 percent) between the two biennia. MA Elderly and Disabled Basic Care costs are projected to grow $466.7 million (21.9 percent) from FY 2008-09 to FY 2010-11. Average monthly enrollment is projected to grow by approximately 19,000 (6.3 percent) from FY 2008-09 to FY 2010-2011, while average costs are estimated to increase by 15.7 percent. General Assistance Medical Care costs are projected to rise $71.1 million (15.5 percent) from FY 2008-09 to FY 2010-11. This change is due primarily to increases in average costs.

Continuing Care Grants spending is now projected to be $3.7 billion in FY 2010-11, an 11.1 percent increase over FY 2008-09. Medical Assistance (MA) Long-Term Care Waivers account for almost all of the increase as projected caseload growth continues to drive expenditures higher, while spending in MA Long-Term Care Facilities remains relatively flat.

Children and Economic Assistance Grants estimates for FY 2010-11 are now $1.0 billion, $33.7 million (3.4 percent) more than FY 2008-09 estimates. Most of this growth is projected to occur in the Minnesota Family Investment Program (MFIP) and Group Residential Housing (GRH).

Debt Service Estimates Reduced $55 Million for FY 2008-09

The forecast debt service cost for the 2008-09 biennium is $902 million, down $55.5 million from the end of session. The forecast of interest rates on bonds to be sold during the biennium are lower than the forecast interest rates at the end of session. Because of the lower interest rates, the premiums paid to the state on the $1.3 billion of bonds to be sold increases by $61.7 million. Lower interest rates also result in higher savings on outstanding bonds that will be refinanced during the biennium.

The additional savings from refinancing bonds is $10 million. The savings are partially offset by the additional debt service cost of selling more bonds than were planned at the end of session.

The forecast assumes future capital budgets of $645 million in each even numbered legislative session and $135 million in each odd numbered legislative session.

Forecast debt service for FY 2010-11 is expected to be $1.036 billion, a $134 million increase (14.9 percent) over projected spending for FY 2008-09.

All Other Spending Remains Essentially Flat Into FY 2008-09

All other spending is expected to total $6.117 billion for FY 2008-09, or about 19 percent of total general fund spending. This is an increase of $31 million, 0.5 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 2007 appropriations generally are the basis for projecting FY 2008-09 spending by year. Some of the unique factors, however are highlighted below:

Higher Education

Higher education spending is expected to reach $2.802 billion in FY 2008-09. While this is a $30.4 million increase (1.4 percent) over projected spending for the current biennium, the growth shown for the University of Minnesota, MnSCU and the Office of Higher Education is limited to the current appropriations levels for FY 2006 projected into fiscal years 2008 and 2009 without enrollment or other adjustments.

Public Safety

Public Safety spending is projected to total $1.723 billion in FY 2008-09, a $13 million (0.8 percent) increase over the current biennium. Historically spending growth in this area has been much higher. A slowing of growth in prison populations and completion of the court takeover in FY 2005 account for reductions in forecast growth.

FY 2008-09 costs of correctional programs have decreased $7.4 million from end-of-session estimates. This is primarily due to smaller numbers of offenders being admitted to prison for new crimes than previously anticipated. Although prison populations continue to increase, it is now projected to do so at a slower rate than previously forecast. By the end of FY 2007, the Department of Corrections projects 9,066 offenders in prison, down from 9,118 offenders projected last year for the same time. By the end of FY 2009 the projection is for 9,575 offenders, down from a previous forecast of 9,653.

The cost of correctional services is projected to increase $21 million in FY 2010-11, reflecting an inmate population expected to reach 10,019 by the end of FY 2011.

Environment, Agriculture and Economic Development

Environment, Agriculture and Economic Development spending is projected to be $683 million for FY 2008-09, $30 million (4.2 percent) lower than FY 2006-07, largely due to reductions for one-time appropriations in FY 2006-07 that do not continue into the next biennium.

Transportation

General fund spending for transportation is projected to be $225 million in FY 2008-09, a $17 million (8.3) percent increase over FY 2006-07. While appropriations to the Department of Transportation, Met Council and transportation-related areas of the Department of Public Safety remains flat at FY 2007 levels, projected spending for FY 2008 includes a one-time transfer to repay money borrowed from the state airports fund in 2003.

State Government

State Government spending is forecast at $606 million for the FY 2008-09 biennium, a $9 million decrease from projected spending in the current biennium. Of this amount, $6 million reflects lower projected contributions in the open appropriation for legislators retirement funding. The remainder largely reflects reductions in one-time appropriations and technical funding changes. As in other areas, FY 2007 appropriations have been carried forward as the forecast level for FY 2008-09.

Capital Projects

General fund cash spending for capital projects in FY 2008-09 is $20.5 million for which there is no comparable spending in FY 2006-07. The state will make twenty-five annual payments of $10.25 million to the University of Minnesota beginning in FY 2008 to help cover the debt service on the $248 million on-campus football stadium authorized in the 2006 legislative session.

Selected Statutory Provisions

16A.1522 Rebate requirements.

Subdivision 1. **Forecast.** If, on the basis of a forecast of general fund revenues and expenditures in November of an even-numbered year or February of an odd-numbered year, the commissioner projects a positive unrestricted budgetary general fund balance at the close of the biennium that exceeds one-half of one percent of total general fund biennial revenues, the commissioner shall designate the entire balance as available for rebate to the taxpayers of this state.

Subd. 2**. Plan**. If the commissioner designates an amount for rebate in either forecast, the governor shall present a plan to the legislature for rebating that amount. The plan must provide for payments to begin no later than August 15 of the odd-numbered year. By April 15 of each odd-numbered year, the legislature shall enact, modify, or reject the plan presented by the governor.

Subd. 3. **Certification.** By July 15 of each odd-numbered year, based on a preliminary analysis of the general fund balance at the end of the fiscal year June 30, the commissioner of finance shall certify to the commissioner of revenue the amount available for rebate.

Subd. 4. **Transfer to tax relief account**. Any positive unrestricted budgetary general fund balance on June 30 of an odd-numbered year is appropriated to the commissioner for transfer to the tax relief account.

Subd. 5. **Appropriation.** A sum sufficient to pay any rebate due under the plan enacted under subdivision 2 is appropriated from the general fund to the commissioner of revenue.

History: 1999 c 243 art 15 s 1; 2005 c 156 art 2 s 17

Alternative Forecast Comparison

Real GDP (Annual Rates)

	06III	06IV	07I	07II	07III	07IV	06A	07A	08A
GII Baseline (11-06)	1.6	2.2	2.8	2.2	2.6	2.4	3.3	2.4	3.1
Blue Chip (11-06)	1.6	2.3	2.6	2.7	2.8	3.0	3.4	2.5	NA
Moody's Economy.Com (11-06)	1.6	2.3	2.8	3.1	3.0	NA	3.3	2.6	NA
Ameriprise (11-06)	1.6	2.6	1.8	2.1	3.0	3.2	3.1	2.5	NA
UBS (11-06)	1.6	2.0	1.8	1.9	2.3	2.7	3.2	2.0	2.8
Standard & Poors (11-06)	1.6	2.3	2.9	2.1	NA	NA	3.3	2.3	2.5

Consumer Price Index (Annual Rates)

	06III	06IV	07I	07II	07III	07IV	06A	07A	08A
GII Baseline (11-06)	2.9	-1.9	3.8	2.6	1.9	1.9	2.9	2.2	1.9
Blue Chip (11-06)	3.0	-0.0	2.8	2.6	2.4	2.3	3.4	2.3	NA
Moody's Economy.Com (11-06)	2.9	1.6	2.3	2.8	2.1	NA	3.5	2.5	NA
Ameriprise (11-06)	2.9	0.7	2.8	2.7	2.5	2.5	2.7*	2.6*	NA
UBS (11-06)	2.9	-1.8	4.3	3.3	2.6	0.9	3.3	2.4	1.7
Standard & Poors (11-06)	2.9	-1.9	3.8	2.7	NA	NA	3.3	2.1	1.9

* 4Q/4Q

Forecast Comparisons

Real Economic Growth
(Annual Percent Change in Real GDP)

	2006	2007	2008	2009	2010	2011
Nov 02 GII Control	3.5	3.1				
Feb 03 GII Control	3.1	2.9				
Nov 03 GII Control	3.6	2.9				
Feb 04 GII Control	3.6	2.9				
Nov 04 GII Baseline	3.6	3.1	3.1	3.2		
Feb 05 GII Baseline	3.1	3.2	3.1	3.3		
Nov 05 GII Baseline	3.4	3.1	3.4	3.1		
Feb 06 GII Baseline	3.3	2.7	2.9	3.2		
Nov 06 GII Baseline	3.3	2.4	3.1	3.3	3.3	2.9

Inflation
(Annual Percent Change in CPI-U)

Nov 02 GII Control	2.2	2.1				
Feb 03 GII Control	2.2	2.5				
Nov 03 GII Control	2.0	2.5				
Feb 04 GII Control	1.5	2.5				
Nov 04 GII Baseline	1.3	1.7	1.9	2.1		
Feb 05 GII Baseline	1.6	2.0	2.1	2.2		
Nov 05 GII Baseline	2.6	1.5	2.0	2.2		
Feb 06 GII Baseline	2.5	1.8	2.0	1.9		
Nov 06 GII Baseline	3.3	2.1	1.9	1.8	1.8	1.7

Minnesota - U.S. Comparison Report

November 2006 Control

(Annual Percent Changes)

	2003	2004	2005	2006	2007	2008	2009
Wage and Salary Income							
United States	2.6	5.5	5.1	7.9	4.8	5.0	5.5
Minnesota	2.9	5.1	3.0	5.6	4.7	4.7	4.8
Implied Annual Wage							
United States	2.9	4.3	3.5	6.4	3.7	3.7	3.9
Minnesota	3.0	4.2	1.9	3.5	3.7	3.6	3.6
Non-Farm Employment							
United States	-0.3	1.1	1.5	1.4	1.1	1.3	1.5
Minnesota	-0.2	0.8	1.0	2.1	0.9	1.1	1.1
Personal Income							
United States	3.2	6.2	5.2	7.2	5.4	5.3	5.9
Minnesota	3.9	6.1	3.3	6.3	5.0	5.1	5.5

COMPARISON OF ACTUAL AND ESTIMATED NON-RESTRICTED REVENUES

October YTD , 2006 -FY2007
($ IN THOUSANDS)

	FORECAST REVENUES	ACTUAL REVENUES	VARIANCE ACT-FCST
Individual Income Tax			
Withholding	1,813,500	1,799,449	-14,051
Declarations	291,473	291,215	-258
Miscellaneous	108,576	110,643	2,067
Gross	2,213,549	2,201,306	-12,243
Refund	56,624	49,393	-7,232
Net	2,156,925	2,151,914	-5,011
Corporate & Bank Excise			
Declarations	262,100	338,064	75,964
Miscellaneous	34,234	53,881	19,647
Gross	296,334	391,945	95,611
Refund	38,100	36,028	-2,072
Net	258,234	355,917	97,683
Sales Tax			
Gross	1,479,280	1,452,893	-26,387
Refunds	71,228	59,696	-11,532
Net	1,408,052	1,393,196	-14,856
Motor Vehicle Sales Tax	88,893	86,400	-2,492
Other Revenues:			
Estate	30,333	46,963	16,630
Liquor/Wine/Beer	19,943	19,747	-196
Cigarette/Tobacco/Cont Sub	59,274	59,282	8
Deed and Mortgage	76,170	79,948	3,778
Insurance Gross Earnings	64,800	63,868	-932
Lawful Gambling	14,246	13,161	-1,084
Health Care Surcharge	68,461	69,774	1,313
Other Taxes	315	280	-35
Statewide Property Tax	93	236	143
DHS SOS Collections	18,536	16,069	-2,467
Income Tax Reciprocity	0	0	0
Investment Income	5,500	26,386	20,886
Tobacco Settlement	0	193	193
Departmental Earnings	67,431	82,197	14,766
Fines and Surcharges	27,568	28,935	1,367
Lottery Revenues	10,691	10,957	266
Revenues yet to be allocated	0	1,259	1,259
Residual Revenues	16,226	10,961	-5,265
Sales Tax Rebates (all years)	0	0	0
County Nursing Home, Pub Hosp IGT	2,264	2,264	0
Other Subtotal	**481,851**	**532,480**	**50,629**
Other Refunds	**9,663**	**12,032**	**2,369**
Other Net	**472,187**	**520,448**	**48,261**
Total Gross	**4,559,906**	**4,665,024**	**105,118**
Total Refunds	**175,616**	**157,149**	**-18,467**
Total Net	**4,384,290**	**4,507,876**	**123,585**

Factors Affecting the Individual Income Tax

($ in billions)

	Calendar Year					
	2004	2005	2006	2007	2008	2009
Minnesota Non-Farm Tax Base						
November 2002 Baseline	154.850	164.940				
February 2003 Baseline	153.580	163.500				
November 2003 Baseline	152.011	160.690				
February 2004 Baseline	152.201	160.413				
November 2004 Baseline	149.277	156.214	163.506	171.373		
February 2005 Baseline	149.075	156.519	163.983	172.200		
November 2005 Baseline	147.263	153.310	161.799	170.983		
February 2006 Baseline	148.030	153.618	161.561	170.274		
November 2006 Baseline	148.372	152.872	161.271	169.111	177.669	187.572
Minnesota Wage and Salary Income						
November 2002 Baseline	106.150	112.830				
February 2003 Baseline	104.690	111.420				
November 2003 Baseline	103.830	109.140				
February 2004 Baseline	103.570	108.910				
November 2004 Baseline	103.632	109.075	114.465	120.202		
February 2005 Baseline	103.416	108.997	114.473	120.360		
November 2005 Baseline	104.225	108.959	114.328	119.824		
February 2006 Baseline	104.992	108.639	113.713	118.957		
November 2006 Baseline	104.680	107.783	113.827	119.133	124.673	130.636
Minnesota Property Income						
November 2002 Baseline	36.104	39.119				
February 2003 Baseline	36.176	38.513				
November 2003 Baseline	36.045	38.041				
February 2004 Baseline	36.027	38.197				
November 2004 Baseline	32.956	33.650	34.760	36.088		
February 2005 Baseline	32.978	34.014	35.200	36.744		
November 2005 Baseline	30.825	31.190	33.432	36.204		
February 2006 Baseline	30.824	31.610	33.754	36.367		
November 2006 Baseline	32.230	32.802	34.633	36.654	38.739	41.925
Minnesota Proprietors' Income						
November 2002 Baseline	12.297	12.996				
February 2003 Baseline	12.712	13.573				
November 2003 Baseline	12.691	13.508				
February 2004 Baseline	12.601	13.308				
November 2004 Baseline	12.689	13.489	14.281	12.083		
February 2005 Baseline	12.681	13.507	14.309	15.156		
November 2005 Baseline	12.213	13.161	14.037	14.956		
February 2006 Baseline	12.213	13.369	14.093	14.950		
November 2006 Baseline	11.461	12.287	12.811	13.324	14.256	15.017

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

($ in billions)

	Fiscal Year					
	2004	2005	2006	2007	2008	2009
SALES TAX						
Minnesota Synthetic Sales Tax Base						
February 2004 Baseline	67.636	70.481				
Pct	7.3%	4.2%				
November 2004 Baseline	66.848	71.014	73.521	75.447		
Pct	6.9%	6.2%	3.5%	2.6%		
February 2005 Baseline	66.710	70.957	74.046	76.286		
Pct	6.8%	6.4%	4.4%	3.0%		
November 2005 Baseline	66.460	70.850	74.979	77.651		
Pct		6.6%	5.83%	3.6%		
February 2006 Baseline	66.355	70.553	74.807	77.366		
Pct		6.3%	6.0%	3.4%		
November 2006 Baseline	67.141	70.888	74.170	76.219	78.115	81.901
Pct			4.63%	2.76%	2.49%	4.85%
Minnesota's Proxy Share of U.S. Consumer Durable Spending (Excluding Autos)						
February 2004 Baseline	12.106	12.685				
November 2004 Baseline	11.705	12.241	12.612	13.021		
February 2005 Baseline	11.700	12.267	12.783	13.205		
November 2005 Baseline	11.775	12.456	12.849	12.265		
February 2006 Baseline	11.775	12.447	12.993	13.247		
November 2006 Baseline	11.807	12.507	13.229	13.606	13.697	14.291
Minnesota's Proxy Share of U.S. Capital Equipment Spending						
February 2004 Baseline	11.616	12.506				
November 2004 Baseline	11.438	12.766	13.674	14.289		
February 2005 Baseline	11.449	12.926	13.957	14.751		
November 2005 Baseline	10.639	11.906	12.862	13.935		
February 2006 Baseline	10.639	11.891	12.610	13.841		
November 2006 Baseline	10.329	10.845	11.616	12.443	13.204	13.778
Minnesota's Proxy Share of U.S. Construction Spending						
February 2004 Baseline	9.814	9.970				
November 2004 Baseline	10.171	11.188	11.620	11.676		
February 2005 Baseline	10.123	10.864	11.444	11.708		
November 2005 Baseline	10.200	10.995	11.868	11.939		
February 2006 Baseline	10.200	10.996	11.714	11.729		
November 2006 Baseline	10.210	11.267	12.135	11.775	11.622	12.398

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

($ in billions)

	Fiscal Year					
	2004	2005	2006	2007	2008	2009
SALES TAX (Cont.)						
Minnesota's Personal Income Excluding Farm Proprietors Income*						
November 2002 Control	181.57	192.47				
February 2003 Control	181.12	192.14				
November 2003 Baseline	178.50	187.08				
February 2004 Baseline	178.82	187.04				
November 2004 Baseline	176.02	185.30	194.41	204.46		
February 2005 Baseline	175.82	184.34	194.76	204.77		
November 2005 Baseline	177.36	188.44	196.70	207.71		
February 2006 Baseline	177.36	188.18	195.47	206.78		
November 2006 Baseline	177.78	187.38	195.19	205.96	216.03	227.93
SALES TAX ON MOTOR VEHICLES						
Minnesota's Proxy Share of U.S. Consumption of Motor Vehicle and Parts						
November 2002 Control	7.568	7.361				
February 2003 Control	7.619	7.676				
November 2003 Baseline	7.988	8.060				
February 2004 Baseline	8.770	8.891				
November 2004 Baseline	9.025	9.095	9.132	9.594		
February 2005 Baseline	9.025	9.207	9.140	9.495		
November 2005 Baseline	8.989	9.185	8.925	9.340		
February 2006 Baseline	8.990	9.194	8.919	9.258		
November 2006 Baseline	8.882	9.110	9.018	9.061	8.993	9.292
CORPORATE FRANCHISE TAX	**Calendar Year**					
U.S. Corporate Profits						
November 2002 Control	873.5	871.0				
February 2003 Control	859.6	857.1				
November 2003 Baseline	869.6	890.9				
February 2004 Baseline	1,016.8	997.5**				
November 2004 Baseline	810.3	949.5**	1,019.7**	1,010.9**		
February 2005 Baseline	810.3	945.5**	971.8**	965.8**		
November 2005 Baseline	853.5	1,016.9**	1,137.8**	1,299.8**		
February 2006 Baseline	853.3	1,016.9**	1,137.8**	1,329.9**		
November 2006 Baseline	837.1	1,039.6**	1,237.4**	1,460.7**	1,481.5**	1,382.8**

* Bureau of Economic Analysis Concept

** Finance Dept Estimate

FY 2006-07 General Fund Budget - Current Biennium Comparison
November 2006 Forecast vs End of Session
($ in thousands)

	5-06 Enacted FY 2006-07	11-06 Fcst FY 2006-07	Fcst vs Enacted FY 2006-07
Actual & Estimated Resources			
Balance Forward From Prior Year	1,393,086	1,393,086	0
Current Resources:			
Tax Revenues	28,802,534	29,604,932	802,398
Non-Tax Revenues	1,571,001	1,699,857	128,856
Dedicated Revenue	121,109	115,422	(5,687)
Transfers In	786,993	776,606	(10,387)
Prior Year Adjustments	50,000	48,190	(1,810)
Subtotal-Current Resources	31,331,637	32,245,007	913,370
Total Resources Available	**32,724,723**	**33,638,093**	**913,370**
Actual & Estimated Spending			
K-12 Education	12,778,682	12,759,519	(19,163)
K-12 Shift / Buyback	609,435	609,435	0
Subtotal K-12 Education	13,388,117	13,368,954	(19,163)
Property Tax Aids & Credits	3,034,245	3,024,911	(9,334)
Higher Education	2,766,485	2,762,597	(3,888)
Health & Human Services	8,316,206	8,255,721	(60,485)
Environment, Agriculture & Economic Dev	740,845	713,081	(27,764)
Transportation	206,429	207,770	1,341
Public Safety	1,710,100	1,710,150	50
State Government	615,405	614,186	(1,219)
Debt Service	763,706	752,098	(11,608)
Capital Projects	1,000	0	(1,000)
Deficiencies/Other	0	4,511	4,511
Estimated Cancellations	(22,500)	(15,000)	7,500
Subtotal Expenditures & Transfers	**31,520,038**	**31,398,979**	**(121,059)**
Dedicated Expenditures	92,025	88,034	(3,991)
Total Expenditures & Transfers	**31,612,063**	**31,487,013**	**(125,050)**
Balance Before Reserves	**1,112,660**	**2,151,080**	**1,038,420**
Cash Flow Account	350,000	350,000	0
Budget Reserve	653,000	653,000	0
Tax Relief Account	109,660	109,660	0
Budgetary Balance	**0**	**1,038,420**	**1,038,420**

FY 2006-07 General Fund Budget - Current Biennium
November 2006 Forecast
($ in thousands)

	Actual FY 2006	11-06 Fcst FY 2007	11-06 Fcst FY 2006-07
Actual & Estimated Resources			
Balance Forward From Prior Year	1,393,086	1,813,145	1,393,086
Current Resources:			
Tax Revenues	14,648,961	14,955,971	29,604,932
Non-Tax Revenues	861,392	838,465	1,699,857
Dedicated Revenue	44,101	71,321	115,422
Transfers In	384,715	391,891	776,606
Prior Year Adjustments	23,190	25,000	48,190
Subtotal-Current Resources	15,962,359	16,282,648	32,245,007
Total Resources Available	**17,355,445**	**18,095,793**	**33,638,093**
Actual & Estimated Spending			
K-12 Education	6,305,239	6,454,280	12,759,519
K-12 Shift / Buyback	569,847	39,588	609,435
Subtotal K-12 Education	6,875,086	6,493,868	13,368,954
Property Tax Aids & Credits	1,463,635	1,561,276	3,024,911
Higher Education	1,347,880	1,414,717	2,762,597
Health & Human Services	3,942,148	4,313,573	8,255,721
Environment, Agriculture & Economic Dev	330,137	382,944	713,081
Transportation	102,201	105,569	207,770
Public Safety	811,562	898,588	1,710,150
State Government	281,380	332,806	614,186
Debt Service	352,447	399,651	752,098
Deficiencies/Other	1,711	2,800	4,511
Estimated Cancellations	0	(15,000)	(15,000)
Subtotal Expenditures & Transfers	**15,508,187**	**15,890,792**	**31,398,979**
Dedicated Expenditures	34,113	53,921	88,034
Total Expenditures & Transfers	**15,542,300**	**15,944,713**	**31,487,013**
Balance Before Reserves	**1,813,145**	**2,151,080**	**2,151,080**
Cash Flow Account	350,000	350,000	350,000
Budget Reserve	653,000	653,000	653,000
Tax Relief Account	109,660	109,660	109,660
Appropriations Carried Forward	182,150	0	0
Budgetary Balance	**518,335**	**1,038,420**	**1,038,420**

Biennial Comparison
FY 2008-09 vs FY 2006-07
($ in thousands)

	11-06 Fcst FY 2006-07	11-06 Fcst FY 2008-09	$ Change	% Change
Actual & Estimated Resources				
Balance Forward From Prior Year	1,393,086	2,151,080	757,994	54.4%
Current Resources:				
Tax Revenues	29,604,932	31,205,416	1,600,484	5.4%
Non-Tax Revenues	1,699,857	1,511,205	(188,652)	-11.1%
Dedicated Revenue	115,422	132,298	16,876	14.6%
Transfers In	776,606	618,581	(158,025)	-20.3%
Prior Year Adjustments	48,190	50,000	0	0.0%
Subtotal-Current Resources	32,245,007	33,517,500	1,272,493	3.9%
Total Resources Available	**33,638,093**	**35,668,580**	**2,030,487**	**6.0%**
Actual & Estimated Spending				
K-12 Education	12,759,519	12,984,867	225,348	1.8%
K-12 Shift / Buyback	609,435	(3,810)	(613,245)	nm
Subtotal K-12 Education	13,368,954	12,981,057	(387,897)	-2.9%
Property Tax Aids & Credits	3,024,911	3,106,793	81,882	2.7%
Higher Education	2,762,597	2,802,020	39,423	1.4%
Health & Human Services	8,255,721	9,368,746	1,113,025	13.5%
Environment, Agriculture & Economic Dev	713,081	683,116	(29,965)	-4.2%
Transportation	207,770	224,964	17,194	8.3%
Public Safety	1,710,150	1,723,372	13,222	0.8%
State Government	614,186	605,609	(8,577)	-1.4%
Debt Service	752,098	901,953	149,855	19.9%
Capital Projects	0	20,500	20,500	nm
Deficiencies/Other	4,511	0	(4,511)	nm
Estimated Cancellations	(15,000)	(20,000)	(5,000)	33.3%
Subtotal Expenditures & Transfers	**31,398,979**	**32,398,130**	**999,151**	**3.2%**
Dedicated Expenditures	88,034	97,498	9,464	10.8%
Total Expenditures & Transfers	**31,487,013**	**32,495,628**	**1,008,615**	**3.2%**
Balance Before Reserves	**2,151,080**	**3,172,952**	**1,021,872**	
Cash Flow Account	350,000	350,000	0	
Budget Reserve	653,000	653,000	0	
Tax Relief Account	109,660	0	(109,660)	
Budgetary Balance	**1,038,420**	**2,169,952**	**1,131,532**	

FY 2008-09 Biennial Comparison - General Fund
November 2006 Forecast vs End of Session
($ in thousands)

	5-06 Plng Est FY 2008-09	11-06 Fcst FY 2008-09	Fcst vs Enacted FY 2008-09
Actual & Estimated Resources			
Balance Forward From Prior Year	1,112,660	2,151,080	1,038,420
Current Resources:			
Tax Revenues	30,896,866	31,205,416	308,550
Non-Tax Revenues	1,523,557	1,511,205	(12,352)
Dedicated Revenue	118,581	132,298	13,717
Transfers In	631,125	618,581	(12,544)
Prior Year Adjustments	50,000	50,000	0
Subtotal-Current Resources	33,220,129	33,517,500	297,371
Total Resources Available	**34,332,789**	**35,668,580**	**1,335,791**
Actual & Estimated Spending			
K-12 Education	12,945,606	12,984,867	39,261
K-12 Shift / Buyback	(3,810)	(3,810)	0
Subtotal K-12 Education	12,941,796	12,981,057	39,261
Property Tax Aids & Credits	3,139,126	3,106,793	(32,333)
Higher Education	2,802,330	2,802,020	(310)
Health & Human Services	9,431,370	9,368,746	(62,624)
Environment, Agriculture & Economic Dev	682,046	683,116	1,070
Transportation	221,442	224,964	3,522
Public Safety	1,732,738	1,723,372	(9,366)
State Government	599,928	605,609	5,681
Debt Service	957,447	901,953	(55,494)
Capital Projects	20,500	20,500	0
Estimated Cancellations	(20,000)	(20,000)	0
Subtotal Expenditures & Transfers	**32,508,723**	**32,398,130**	**(110,593)**
Dedicated Expenditures	83,781	97,498	13,717
Total Expenditures & Transfers	**32,592,504**	**32,495,628**	**(96,876)**
Balance Before Reserves	**1,740,285**	**3,172,952**	**1,432,667**
Cash Flow Account	350,000	350,000	0
Budget Reserve	653,000	653,000	0
Budgetary Balance	**737,285**	**2,169,952**	**1,432,667**

FY 2006-11 Planning Horizon
November 2006 General Fund Forecast
($ in thousands)

	11-06 Fcst FY 2006-07	11-06 Fcst FY 2008-09	11-06 Plng Est FY 2010-11
Actual & Estimated Resources			
Balance Forward From Prior Year	1,393,086	2,151,080	3,172,952
Current Resources:			
Tax Revenues	29,604,932	31,205,416	34,745,661
Non-Tax Revenues	1,699,857	1,511,205	1,500,777
Dedicated Revenue	115,422	132,298	89,426
Transfers In	776,606	618,581	607,071
Prior Year Adjustments	48,190	50,000	50,000
Subtotal-Current Resources	32,245,007	33,517,500	36,992,935
Total Resources Available	**33,638,093**	**35,668,580**	**40,165,887**
Actual & Estimated Spending			
K-12 Education	12,759,519	12,984,867	12,857,811
K-12 Shift / Buyback	609,435	(3,810)	0
Subtotal K-12 Education	13,368,954	12,981,057	12,857,811
Property Tax Aids & Credits	3,024,911	3,106,793	3,111,835
Higher Education	2,762,597	2,802,020	2,801,174
Health & Human Services	8,255,721	9,368,746	10,670,994
Environment, Agriculture & Economic Dev	713,081	683,116	684,661
Transportation	207,770	224,964	208,548
Public Safety	1,710,150	1,723,372	1,744,014
State Government	614,186	605,609	605,915
Debt Service	752,098	901,953	1,036,347
Capital Projects	0	20,500	20,500
Deficiencies/Other	4,511	0	0
Estimated Cancellations	(15,000)	(20,000)	(20,000)
Subtotal Expenditures & Transfers	**31,398,979**	**32,398,130**	**33,721,799**
Dedicated Expenditures	88,034	97,498	54,626
Total Expenditures & Transfers	**31,487,013**	**32,495,628**	**33,776,425**
Balance Before Reserves	**2,151,080**	**3,172,952**	**6,389,462**
Cash Flow Account	350,000	350,000	350,000
Budget Reserve	653,000	653,000	653,000
Tax Relief Account	109,660	0	0
Budgetary Balance	**1,038,420**	**2,169,952**	**5,386,462**