MANAGEMENT AND BUDGET

Budget Reserve Recommendation

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Budget Reserve Recommendation

To adequately manage the underlying risks in Minnesota's general fund tax revenue system, and in accordance with Minnesota Statutes section 16A.152 subd.8, Minnesota Management and Budget (MMB) recommends a budget reserve target of 5.8 percent[1] of the current biennium's general fund non-dedicated revenues, or a budget reserve of $3.889 billion for the FY 2026-27 biennium.[2] The percentage recommendation has increased from 5.2 percent last year. At the end of the 2026 regular session, Minnesota's budget reserve balance was $3.422 billion. Based on our current forecast, the new recommendation would increase the budget reserve by $0.467 billion ($467 million) if the November Budget and Economic Forecast projects a sufficient surplus in the current biennium. The revenue forecast and corresponding reserve target *level* will be updated with the November budget and economic forecast.

	Current Level
Current Budget Reserve	$3.422 billion
MMB FY2026-27 Recommendation	$3.889 billion
Difference	$0.467 billion

The recommended reserve percentage of 5.8 percent was determined by MMB's assessment of the volatility in Minnesota's revenue system. We examined the variability of the state's major tax bases over time and changes in the composition of tax revenues. The recommended reserve percentage assumes the budget is balanced through the remainder of the biennium, and a 95 percent level of confidence that a biennial deficit generated by revenue volatility will not exceed the budget reserve.

[1] Rounded to the nearest tenth of a percent.

[2] Based on end of 2026 legislative session *General Fund Balance Analysis*.

To assess volatility, we incorporated the latest data and updated our methodology in three ways.

First, we updated the methodology to derive revenue share weights from the planning estimates of FY 2028-29 revenues, rather than the current biennium. Past practice has been to weight the individual income tax, sales tax, corporate tax, statewide property tax, and other tax revenues according to their shares of general fund revenues in the current biennium. This change allows the model to better reflect the projected composition of general fund revenues. As illustrated in Figure 1, the share of general fund revenues attributable to the income tax increases from 52 percent in FY 2026-27 to 54 percent in FY 2028-29. The figure below also shows that the share of corporate income tax revenues, the most volatile income stream, has increased over time.

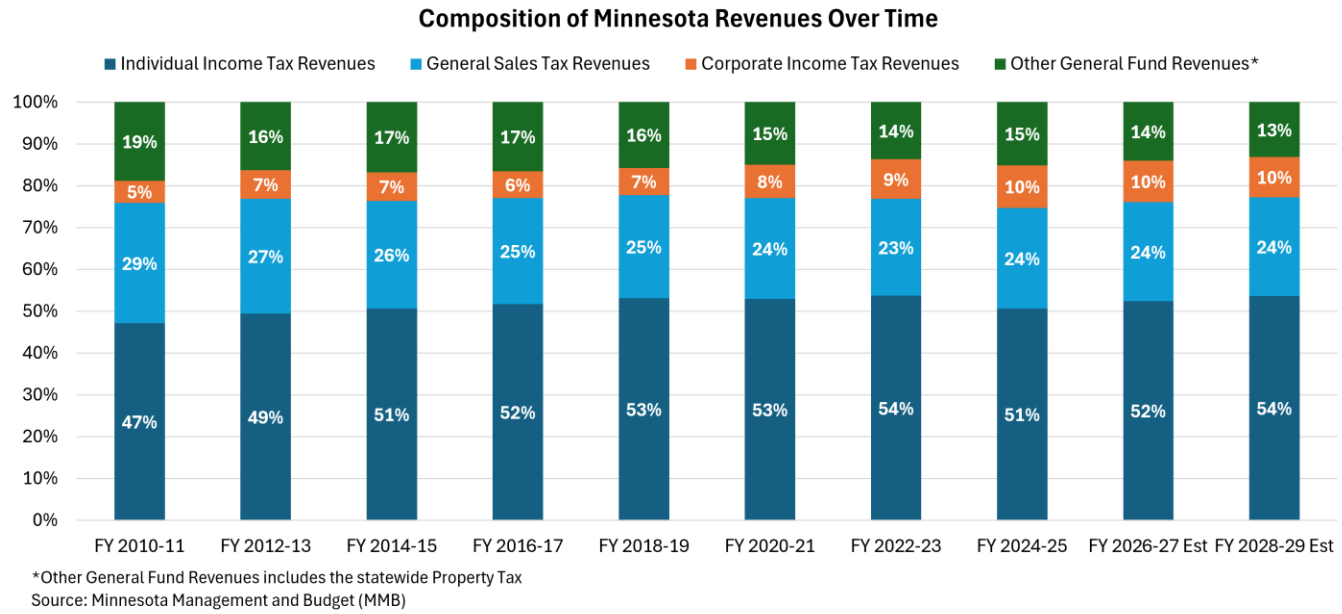


Figure 1: Composition of Minnesota Revenues Over Time. The share of general fund revenues attributable to the income tax increases from 52 percent in FY 2026-27 to 54 percent in FY 2028-29. The figure below also shows that the share of Corporate Income Tax Revenues, the most volatile income stream, has increased over time.

Second, following updates in the academic literature, we expanded the way we estimate the volatility of the series by adding the "Hamilton" filter alongside the traditional "Hodrick-Prescott" filter and refined the study's statistical methodology to better reflect the characteristics of each tax base. These improvements include updating model specifications, strengthening statistical testing, and applying volatility models only when supported by the data. Together, these changes improve the methodological rigor and reliability of the budget reserve analysis and align our analysis with the current cutting-edge academic literature.

As illustrated in Figure 2, volatility within income tax, particularly in capital gains and business income, has increased the volatility of income tax revenues. The variance of corporate tax revenue is high and relatively constant throughout the sample.

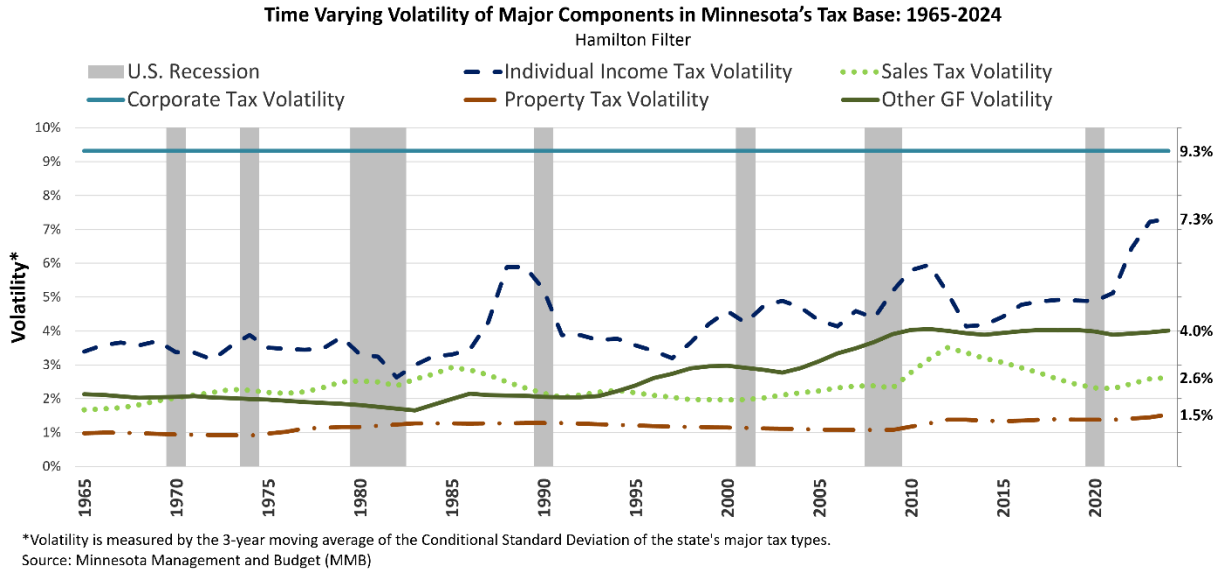


Figure 2: Time Varying Volatility of Major Components in Minnesota's Tax Base: 1965 to 2024. Volatility within income tax, particularly in capital gains and business income, has increased the volatility of income tax revenues. The variance of corporate tax revenue is high and relatively constant throughout the sample.

Third, we revised the methodology to use the three-year moving average of the volatility measure to help avoid large fluctuations in the target from year to year. Figure 3 illustrates the rising volatility of the revenue stream over time, and especially within the last several years.

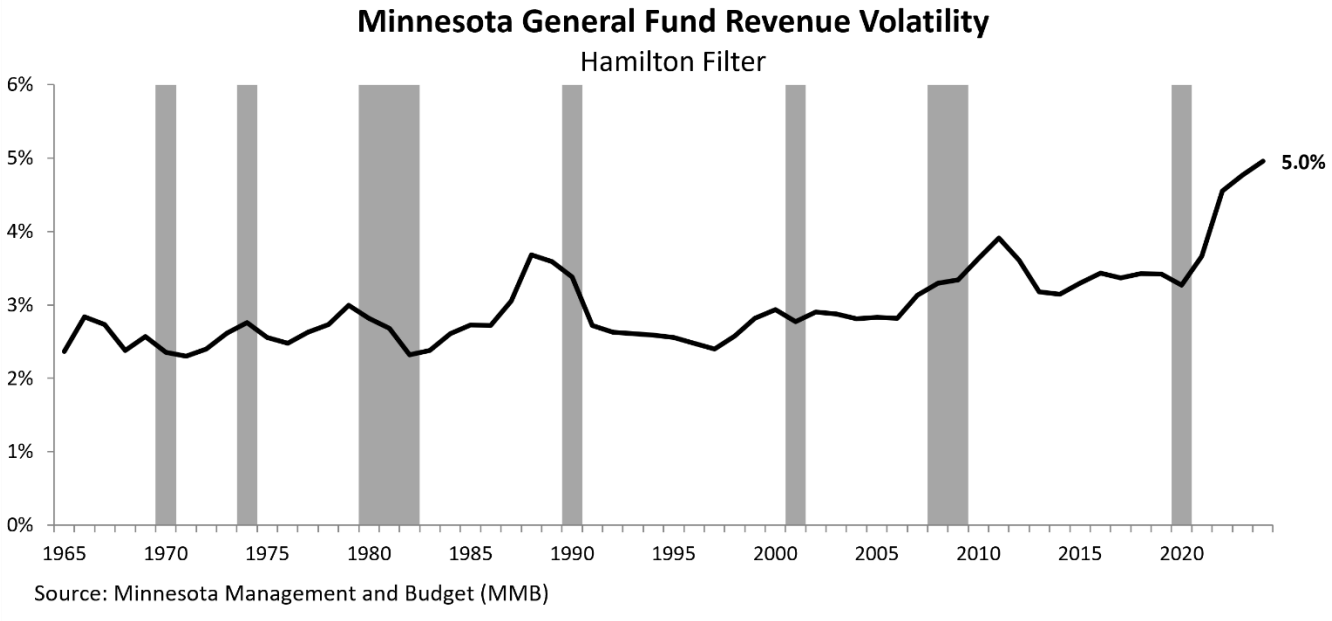


Figure 3. Minnesota General Fund Revenue Volatility. This chart illustrates the rising volatility of the revenue stream over time, and especially within the last several years.

These changes, along with rising volatility of individual revenue components and shifting shares towards more volatile components, increased the measured volatility of Minnesota's tax revenue. Consequently, our budget reserve recommended percentage of revenues increased to 5.8 percent of general fund non-dedicated revenues, from 5.2 percent in our 2025 report.

The recommended reserve level of $3.889 billion is determined by multiplying the latest estimate of current biennium general fund non-dedicated revenues by the recommended reserve percentage.

The target is for the budget reserve account alone. Minnesota also has a cash flow account, which is intended to offset potential cash shortages caused by a mismatch between monthly revenue collections and spending. The cash flow account is currently funded at $350 million.

Additional Risks and Considerations

As required by statute, the methodology used in this study evaluates the adequacy of the budget reserve based on general fund revenue volatility.[3] It does not account for budgetary risk driven by volatility in general fund expenditures, including unexpected increases in state spending obligations or reductions in federal funding. These risks may create additional pressures on the general fund beyond those captured by the revenue volatility model.

[3] Minnesota Statutes 16A.152, Subd 8, paragraph a.