

Money Matters

A Publication of the House Fiscal Analysis Department Staff on Government Finance Issues

The November Forecast of Revenues and Expenditures

This paper examines the forecast of revenue and expenditure prepared by the Department of Finance and released on November 26, 1996. It is important to note that these estimates are based on the requirements of current law. They are not predictions of what the Legislature and Governor will eventually adopt as funding levels in the coming budget, but are baseline projections of revenue and expenditure if current policies are unchanged.

Forecasted Surplus Grows to \$1.4 billion

The General Fund forecast released by the Department of Finance on November 26, 1996 projects that \$521 million more will be available by the end of the current biennium (FY96-97) than was projected at the end of last session. Revenues available for FY96-97 are now forecast at \$19.099 billion and expenditures are forecasted at \$18.801 billion, with \$350 million set aside in the cash flow account, \$261 million in the budget reserve account, \$114 million in the school aid account, and an unrestricted ending balance of \$522 million.

The forecast for FY98-99 is for revenues of \$20.485 billion and expenditures of \$19.568 billion. The budget reserve is at \$261 million, the cash flow account at \$350 million, and the school aid reserve account at \$114 million. This leaves a forecast unrestricted balance of \$1.439 billion at the end of the biennium. The table below shows the calculation of the surplus and a comparison of the revenues and expenditures between the current and FY98-99 biennia.

FORECAST EXPENDITURE AND REVENUE GROWTH

(\$'s in millions)	FY96-97	FY98-99	\$ Change	% Change
Beginning Balance	\$1,021	\$1,319	\$299	
Forecast Revenue	\$19,099	\$20,485	\$1,386	+ 7.3%
Forecast Expenditure	\$18,801	\$19,568	\$768	+ 4.1%
Reserve Account	\$261	\$261	\$0	
Cash Flow Account	\$350	\$350	\$0	
Dedicated Reserve(MnSCU)	\$72	\$72	\$0	
School Aid Reserve	\$114	\$114	\$0	
Budgetary Balance	\$522	\$1,439	\$916	

It is important to note that these forecasted amounts include the adjustments required under Laws of 1996, Chapter 471, Article 10, section 3, and Chapter 461, Section 3. Implementation of this provision results in approximately \$114 million being set aside in a School Aid Reserve account. Any balance in the account may not be expended until appropriated by law for education aid for fiscal years 1998 and 1999. Also included, as required in M.S. 121.904, Subdivision 4d, is an expenditure of \$157 million that reduces the education aids settle-up payment from 15% to 10%.

Economic Summary and Outlook

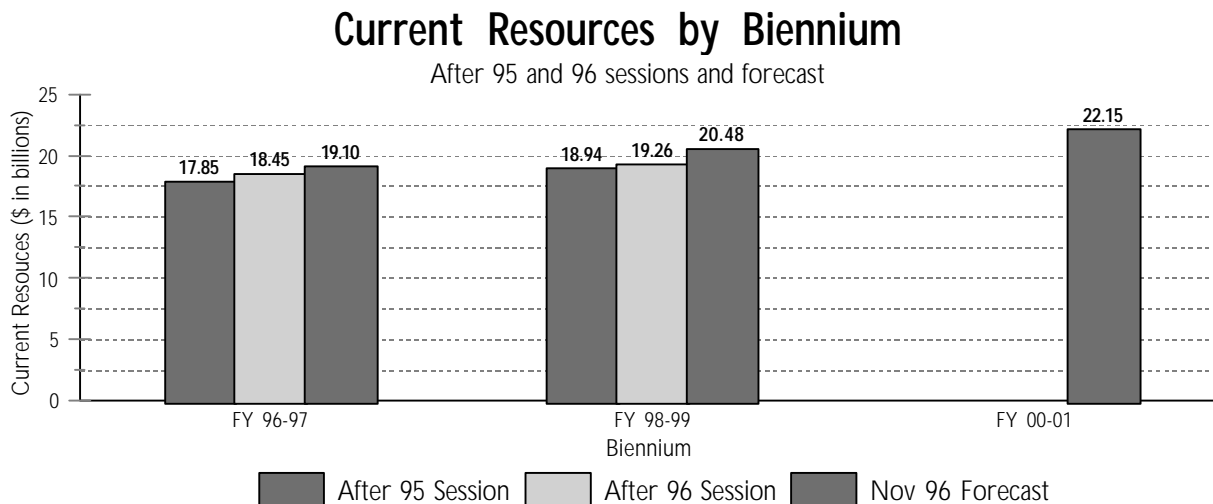
The positive changes expressed in this forecast as compared to the forecast in February are due primarily to changes in the expected rate of Gross Domestic Product (GDP). The February control forecast from Data Resources Inc. (DRI) called for real GDP to grow in 1996 at a rate of only 1.7 percent. The GDP estimate for 1996 in the current forecast is for growth of 2.4 percent. The current control forecast calls for the economy to continue at near this rate of growth through the end of the FY98-99 biennium.

DRI currently believes that there is very little risk of a recession during the forecast time period, giving the control forecast a probability rating of 55 percent. Their alternative forecast, a boom-bust scenario is given a probability of 35 percent. DRI is forecasting that inflation as measured by the consumer price index (CPI) will come in at 3 percent for 1996, slightly above the 2.8 percent rate of 1995.

Forecast of Revenues

Increased Revenues Projected During FY96-97 And FY98-99

The chart below illustrates how forecasts of “current resources” (which excludes the balance carried forward from the preceding biennium) have been increased since the budget for FY96-97 was adopted during the 1995 session. Note that the November 96 forecast projects current resources for FY96-97 to be \$1.247 billion greater than had been projected after the 1995 session and \$646 million greater than had been projected after the 1996 session. This is the first forecast in which FY00-01 has been addressed.



Most of the \$646 million increase in projected revenue since the end of the 1996 session came from individual income tax revenue, the projection of which increased \$427 million (5.3 percent), and revenue from the sales and use taxes on motor vehicles, the projection of which increased \$38 million (5.4 percent). It appears that total Minnesota wages grew much more rapidly during late calendar 1995 and most of calendar 1996 than previously had been projected. Capital gains realization and taxable interest income also appear to have been stronger than previously projected. In addition, purchases of cars and light trucks also appear to have been stronger than projected. The projection of revenues from corporate income and bank excise taxes increased \$51 million (3.9 percent), while the projection of revenues from the general sales and use taxes increased by only \$80 million (1.4 percent).

Similarly, the November 96 forecast projects current resources for FY98-99 to be \$1.547 billion greater than had been had been reported in planning estimates after the 1995 session and \$1.223 billion greater than had been reported in planning estimates after the 1996 session. The November 96 forecast contains the first official forecast of revenues during FY98-99. Previous forecasts reported only "planning estimates" of revenues for FY98-99. Planning estimates are extrapolations from the forecast revenue base in the previous biennium, rather than detailed projections generated by carefully tailored models and data. The revenue base for the FY98-99 planning estimates was FY96-97. Because the previous forecast significantly understated that revenue base, the extrapolated planning estimates for FY98-99 also were significantly understated.

Based solely on changes in revenue projections, the Legislature will have \$1.87 billion more in total resources to allocate in the FY98-99 biennial budget under the November 1996 forecast than was projected at the end of the 1996 session. For FY98-99, the balance forward from the previous biennium is \$646 million larger as a result of the increased projection of FY96-97 current resources. To that amount is added the \$1.223 billion positive difference between current resources forecast for FY98-99 and the previous planning estimates of those resources.

When the \$52 million in savings on projected expenditures for FY 96-97 is added in, the Legislature will have \$1.921 billion more in total resources to allocate in the FY98-99 biennial budget than previously had been projected. If current law had not allocated part of the surplus in FY 1997 to reducing the K-12 education aids hold-back from 15 percent to 10 percent, the Legislature would have \$2.078 billion more in total resources to allocate.

Revenues by Tax Type

The tables below show the annual and biennial increases in projected current resources by type of revenue. The growth in revenues is provided almost exclusively by projected increases in revenues from the individual income tax and the general sales and use taxes. Little growth is projected in the other two "major" taxes, the corporate income and bank excise taxes and the sales tax and use taxes on motor vehicles. Similarly, little growth is projected in other non-dedicated revenue sources. Forecasted rate of growth in revenue for FY98-99 in all categories is down substantially from the forecasted rate of growth in revenues in FY96-97.

Annual Change in Current Resources, FY 1997 – FY 1999
November 1996 Forecast (\$ in millions)

Revenues	FY 1997	FY 1998	\$ Change	% Change	FY 1999	\$ Change	% Change
Individual Income Tax	\$4,377	\$4,553	\$176	4.0%	\$4,788	\$235	5.2%
Corp. Income Tax	\$675	\$677	\$2	0.3%	\$708	\$31	4.6%
Sales Tax–General	\$3,029	\$3,172	\$143	4.7%	\$3,329	\$157	5.0%
Sales Tax–Motor Veh.	\$375	\$371	(\$4)	-1.0%	\$385	\$14	3.7%
Four “Major” Taxes	\$8,455	\$8,773	\$318	3.8%	\$9,210	\$438	5.0%
Other Non-Dedicated	\$887	\$883	(\$4)	-0.4%	\$879	(\$4)	-0.4%
Net Non-Dedicated	\$9,342	\$9,656	\$314	3.4%	\$10,090	\$434	4.5%
Dedicated Revenues	\$130	\$120	(\$10)	-7.7%	\$120	\$0	0.0%
Adjust. and Transfers	\$226	\$240	\$14	6.2%	\$258	\$18	7.7%
Current Resources	\$9,698	\$10,016	\$318	3.3%	\$10,468	\$452	4.5%

Biennial Change in Current Resources, FY 1996-97 – FY 1998-99
November 1996 Forecast (\$ in millions)

Revenues	FY 1996-97	FY 1998-99	\$Change	% Change
Individual Income Tax	\$8,512	\$9,341	\$829	9.7%
Corp. Income Tax	\$1,377	\$1,385	\$8	0.6%
Sales Tax–General	\$5,930	\$6,501	\$571	9.6%
Sales Tax–Motor Veh.	\$756	\$756	\$0	0.0%
Four “Major” Taxes	\$16,575	\$17,983	\$1,409	8.5%
Other Non-Dedicated	\$1,755	\$1,763	\$8	0.4%
Net Non-Dedicated	\$18,330	\$19,746	\$1,416	7.7%
Dedicated Revenues	\$267	\$241	(\$27)	-10.0%
Adjust. and Transfers	\$502	\$498	(\$4)	-0.8%
Current Resources	\$19,099	\$20,485	\$1,385	7.3%

Individual Income Tax receipts are projected to be \$9,341 billion in FY98-99 according to the November 96 forecast, an increase of \$829 million (9.7 percent) over FY96-97. The national and Minnesota economies are expected to continue their steady growth throughout the next biennium, resulting in increases in both employment and wages. In addition, farm income is expected to increase. The rate of capital gains realization is expected to be stable.

Corporate Income and Bank Excise Taxes are projected to generate \$1.385 billion in FY98-99, an increase of only \$8 million (0.6 percent) over FY96-97. Revenue from the corporate income and bank franchise taxes is projected to grow 13.1 percent for FY96-97 over FY94-95. International competition is expected to retard growth in corporate income during the upcoming biennium. The \$159 million in additional revenue from the corporate income and bank franchise taxes for FY96-97 over FY94-95 will be more than negated by the \$166 million in payments to banks and corporations under the *Cambridge Bank* judgment during the current biennium. Those payments were paid from the Cambridge settlement fund.

General Sales and Use Taxes are projected to yield \$6.501 billion in FY98-99, an increase of \$571 million (9.6 percent) over FY96-97. Strong growth in purchases of both consumer durables and business capital equipment is projected. Sales and use tax receipts would be projected to grow by 10 percent if the growth in refunds were ignored. Refunds are projected to grow more rapidly than receipts as a result of completing the phase out of the sales tax on replacement capital equipment.

Sales and Use Taxes on Motor Vehicles, formerly known as the Motor Vehicles Excise Tax, are projected to generate \$756 million in FY98-99, the same as in FY96-97. Receipts from the sales and use taxes on motor vehicles are projected to decrease slightly from FY97 to FY98, before recovering in FY99. Revenue from the sales and use taxes on motor vehicles is projected to grow 11.0 percent for FY96-97 over FY94-95.

Planning Estimates Of Revenues For FY2000-01

Under the planning estimates, receipts from the four "major" taxes are expected to be \$1.625 billion (9.0 percent) greater for FY2000-01 over FY98-99, net non-dedicated revenues are expected to be \$1.653 billion (8.4 percent) greater, and current resources are expected to be \$1.666 billion (8.1 percent) greater. The accuracy of the planning estimates of revenues will be determined in large part by the accuracy of the revenue forecasts for the remainder of the FY96-97 and FY98-99. If revenues grow more than forecast for those earlier periods, the planning estimates of revenues will be too low. Conversely, if revenues grow more slowly than forecast for those earlier periods because economic growth slows down (even if the economy does not slip into a recession), the planning estimates of revenues will be too high.

Forecast of Expenditures

Forecast and Planning Estimates Include Inflationary Adjustments

In making its forecast of expenditures the Department of Finance (DOF) must assume the continuation of current law. In addition, the DOF makes adjustments based on estimates of variables outside the control of the legislature, primarily caseload changes. The forecast also applies a discretionary inflation adjustment of 3 percent per year to the estimate of expenditures. This discretionary inflation is forecasted in the FY98-99 expenditures at \$440 million. The actual inflationary increase proposed by the governor or adopted by the Legislature may differ substantially from the rate used in the November forecast.

Forecast Estimates FY98-99 Expenditures at \$19.6 billion

In its forecast DOF now estimates total General Funding expenditures for FY98-99 to be \$19.568 billion. This is an increase of \$768 million from forecasted FY96-97 expenditures. The table below compares the estimate of expenditures by the major spending categories.

General Fund Expenditures by Major Category

(\$'s in millions)	FY96-97	FY98-99	\$ Change	% Change
Education Finance	\$5,892.0	\$5,939.1	\$47.1	0.8%
Property Tax Recognition	494.8	0.0	(\$494.8)	
School Payment Change	156.7	0.0	(156.7)	
Post-Sec. Education	2,148.7	2,170.3	21.6	1.0%
Local Aids & Credits	2,411.9	2,451.0	39.1	1.6%
Other Major Local Assistance	861.2	1,016.6	155.4	18.1%
Health Care	2,976.3	3,856.1	879.8	29.6%
Family Support	488.9	559.4	70.5	14.4%
State Operated Institutions	826.5	900.4	73.9	8.9%
Legislature, Judicial & Constitutional	476.3	480.2	3.9	0.8%
State Agencies	1,422.4	1,428.8	6.4	0.5%
Debt Service	438.9	545.9	107.0	24.4%
Dedicated Expenditures	221.1	240.5	19.4	8.8%
Cancellations	(15.0)	(20.0)	(5.0)	33.3%
Total	\$18,800.7	\$19,568.3	\$767.6	4.1%

Expenditure Details by Category

Education Aids spending for FY98-99 is forecasted to increase only \$47 million over the current biennium after adjusting for one time only spending. Spending limits (caps) were placed on education finance programs in previous sessions. These spending limits reduce the forecasted FY98-99 expenditure growth by \$270 million. Also, without the spending limits in law the forecast would increase by \$330.3 million in discretionary inflation.

Post-Secondary Education expenditures for the FY98-99 are forecasted to increase by \$21.6 million over the current spending. The increase is the result of a combination of factors including a reduction in the base by removing one time

items from current year levels, forecast adjustments for enrollment changes, and adding \$94.5 million for inflation to the MnSCU system.

Local Aids and Credits are expected to increase \$39 million over the current biennium in FY98-99. Expenditures will vary due to a combination of changes including an increase of \$28.4 million in the Regular Homeowner's Refund, an increase of \$5.8 million in the Regular Renter's Credit, and a decrease of \$2.3 million in the Special Property Tax Refund. Local Government Aid (LGA) is forecast to increase by \$40.1 million. Homestead and Agricultural Credit Aid (HACA) are forecast to decrease by \$100 million due to conversion of HACA to other aid payments. Aid to Police and Fire is forecast to grow \$19.5 million due to growth in contributions to retirement funding.

Other Major Local Assistance, which includes a variety of programs spread across state agencies, is projected to increase by \$155.5 million in FY98-99. A variety of Human Services grants account for approximately \$93 million of the increase. The Ethanol Development subsidy is forecast to increase by \$24 million. Discretionary inflation accounts for \$35 million of the total increase.

Health Care spending will increase by the \$880 million in FY98-99, an increase of 29.6%. This category has the largest dollar and percentage increase in the forecast. The Medical Assistance (MA) program is forecast to increase by \$810 million, General Assistance Medical Care (GAMC) by \$73 million, and Chemical dependency Entitlement by \$3 million. A change in the federal matching fund rate is forecast to add \$100 million to the state cost of MA in FY98-99. Delays in converting state medical programs to managed care are forecast to add \$62 million to FY98-99 costs.

Family Support spending is forecast to grow by \$71 million in FY98-99 over the current biennium level. The largest portion of the increase is due to the estimate of caseload growth in the programs. The federal welfare programs were changed substantially by the actions of Congress in the summer of 1996. The Aid to Families with Dependent Children (AFDC) entitlement program was replaced with the Temporary Assistance for Needy Families (TANF) block grant program. In the forecast, the total state revenues received from the federal government under the new block grant are forecasted to be approximately the same as would have been received under the old AFDC funding.

State Operated Institutions spending is forecast to increase by \$73.8 million on FY98-99. Inflation amounts for \$38 million of the forecast growth. An increase of \$23 million is forecast for the costs associated with the opening of the new correctional institution and an \$11 million increase is expected to occur for the rental of space for additional inmates. The growth in spending on Human Services residential facilities is forecast at \$27 million, most of which is due to inflation costs.

FY2000-01 Planning Estimates

As part of the November forecast the Department of Finance is required to prepare estimates of current law revenues and expenditures for the biennium beyond the upcoming budget years. The revenue planning estimates are based on long term forecasts for the output of the Minnesota economy through the planning period. Expenditure estimates are based on current laws and forecast through the period as if laws were to be unchanged. The forecast of expenditures are adjusted from the base amount by an estimate of caseload changes and contain an inflationary adjustment factor.

FY2000-01 Planning Estimates

(S's in millions)	FY98-99	FY2000-01
Beginning Balance	\$1,319	\$2,235
Forecast Revenue	20,485	22,150
Estimated Expenditures	19,568	21,445
Balance	2,235	2,940
Dedicated Reserves(MnSCU)	72	72
Cash Flow Account	350	350
School Aid Reserve	114	114
Budget Reserve	261	261
Ending Balance	\$1,439	\$2,144

The long term planning estimates make no assumptions regarding the actions of the Governor or the Legislature on the FY98-99 budget. They give an estimate of the balance of the current law revenues to the current law expenditures. The long term planning estimate are useful to the Legislature in determining if the current structure of state expenditures is supportable by the trend projections of the current revenue system.

Measuring the Price of Government

The Department of Finance is required by statute to submit estimates of the personal income for each of the years covered by the forecast. In addition the Commissioner of Revenue is required to prepare and deliver to the Legislature, a forecast of the revenue to be received by certain local units of government. These forecasts are to assume the continuation of current laws, include projections of valuation changes in real property, and estimates of growth in the national and state economies.

The law further requires that in January of each odd-numbered year, the governor submit to the legislature a recommended revenue target which specifies the maximum share of Minnesota personal income to be collected in taxes and other revenues to pay for state and local government services. The Legislature is required by concurrent resolution to adopt revenue targets for the next two biennia, specifying the maximum share of Minnesota personal income to be collected in taxes and other revenues to pay for state and local government services.

Personal income is a measure of the income produced by goods and services. It is reported in the aggregate by the U.S. Census Bureau. Personal income represents the amount of income received by individuals, it does not include some items often included in a measurement of economic activity such as corporate profits. Over half of the total amount of income included in the measure is wages. Also included are social security, social welfare and other transfer payments.

While revenues or expenditures as a percent of personal income provide a benchmark against which to measure state and local government activity, the determination of actual spending is more difficult. The measure does nothing to measure the relative need for an existing or proposed government service, nor does it provide for a priority ranking of a particular services. Whether or not the price of government is high, low, or right is a decision that the citizens and their elected officials must make taking into account items in addition to the percentage of personal income.

Note: MN Statutes requires that the November forecast include forecasts of Minnesota personal income and estimates of local government revenues, two items necessary to calculate the “price of government”. Our intention was to include information on those forecasted amounts in this section. This information was not included in the forecast documents released by the Department of Finance and has not been issued as of the date of issue of this Money Matters. Updates will be included in a future issue of Money Matters.

For further information Contact: Jim Reinholdz, 6-4119, House Fiscal Staff. For more information on the revenue section, contact one of the following House fiscal analysts assigned to serve the Committee on Taxes: Bill Connors, 6-5813; M.J. Hedstrom, 6-1237, or Matt Shands, 6-4162. For further information on expenditure forecast detail contact the analyst for that particular area, or Bill Marx, Acting Chief Fiscal Analyst, 6-7176.

For