November 2011

HIGHLIGHTS

Budget Outlook Improves -- $876 Million Balance Projected for FY 2012-13

Minnesota's closing balance for FY 2011 was $526 million greater than forecast. Revenues exceeded forecast by $358 million and state spending was $205 million below estimates. A balance of $876 million is now expected for the 2012-13 biennium as spending decreases an additional $348 million while forecast revenues, despite starting from a higher level, fall by $24 million.

Current Law Allocates Entire Balance to Restoring Reserves

Current law requires any forecast balance be used to restore the state's reserves. This forecast adds $255 million to the cash flow account, increasing it to $350 million, and $621 million to the budget reserve, bringing it to $648 million.

Economic Outlook Has Dimmed, Slower Growth Expected Through 2013

Recovery from the Great Recession continues to be slower than anticipated and Global Insight expects that slow economic growth will extend through the biennium. Real GDP growth in FY 2012 and 2013 is now expected to average 1.7 percent. In February, 3.1 percent growth was projected. Domestic economic and political uncertainties and Europe's sovereign debt problems have led Global Insight to set the risk of a 2012 recession at 40 percent.

Revenues Up in FY 2011, Down Slightly in FY 2012-13

State revenues for FY 2011 were $358 million (1.2 percent) more than projected in February. Higher than anticipated final individual income tax liability for tax year 2010 was the source of much of the additional revenue. A significant reduction in the economic growth rates for fiscal 2012 and 2013 reduced forecast revenues in the current biennium, despite the higher base level for FY 2011.

Expenditures Down in FY 2011, Down More in FY 2012-13 Forecast

Lower human services spending accounts for more than 80 percent of a forecast spending reduction of $205 million in FY 2011, and $348 million in FY 2012-13. Most of the savings occurs in the Medical Assistance program where a variety of factors contributed to lower spending growth.

BUDGET UPDATE AND OUTLOOK

FY 2011 Ended with $976 Million Balance, Up $526 Million

The books are now officially closed for the 2011 fiscal year. They show an ending general fund balance of $976 million, $525 million more than previously estimated. This improvement in the state's finances reflects both revenue gains previously reported in September's *Economic Update*, and significant year-end expenditure savings, primarily in human services programs.

FY 2011 - Changes from End-of-Session

($ in millions)

	End of Session	Actual	$ Change
Beginning Balance	$440	$440	-
Income Taxes	7,252	7,529	277
All Other Revenue	8,573	8,655	82
Total Revenues	**15,825**	**16,184**	**358**
Health and Human Services	4,472	4,323	(149)
All Other Spending	15,540	11,012	(56)
Total Expenditures	**15,540**	**15,335**	**(205)**
Balance Before Reserves	725	1,289	564
Reserves / Carryfoward	275	313	38
Ending Balance	**$450**	**$976**	**$526**

Final spending for FY 2011 was $205 million below previous estimates. However, current law authorizes some appropriations unspent at the end of the biennium to carry forward into the next fiscal year. Those appropriations totaled $38 million. After adjusting for appropriations carried forward, actual spending in FY 2011 declined by a net $167 million.

A reduction of $149 million in human services spending accounted for about three-quarters of FY 2011 expenditure savings. Most of the savings occurred in the Medical Assistance program. The principal sources of those savings were a higher than expected federal matching rate for the last quarter of the fiscal year, increased pharmacy rebates and other recoveries, lower than anticipated costs in several programs, and other technical changes.

$876 Million Projected Balance for 2012-13 Biennium Reflects FY 2011 Gain, Small Revenue Decline, and Additional Expenditure Savings

Minnesota's budget outlook is forecast to improve further in the 2012-13 biennium. Forecast revenues are now expected to be $33.700 billion, down $24 million from end-of-session estimates. However, spending is expected to be $33.991 billion, $348 million lower than previous estimates. The ending balance, which includes the additional balance carried forward from FY 2011, is now projected to be $876 million.

FY 2012-13 Budget Summary

($ in millions)

	End of Session	Forecast	$ Change
Beginning Balance	**$725**	**$1,289**	**$564**
Income	16,179	16,214	35
All Other Revenue	17,545	17,486	(59)
Total Revenues	**33,724**	**33,700**	**(24)**
Health and Human Services	11,372	11,064	(308)
All Other Spending	22,967	22,926	(41)
Total Expenditures	**34,339**	**33,991**	**(348)**
Balance Before Reserves	110	998	888
Reserves	95	122	27
Ending Balance	**$15**	**$876**	**$861**

About two-thirds of the projected increase in this biennium's ending balance comes from funds carried forward from FY 2011. The remainder comes from reductions in forecast spending in fiscal 2012 and 2013. A $308 million reduction in human services spending accounted for nearly 90 percent of the decrease in the current expenditure forecast. Approximately $294 million of the savings comes from lower estimates of spending for Medical Assistance.

Revenues are now forecast to be only $24 million below end-of-session estimates despite a significant reduction in expected economic growth during 2011 and 2012. While a larger revenue decline may have been expected, the higher 2010 tax base offsets much of the loss in forecast revenues that would accompany the lower projected rate of real economic growth.

Statutes Direct Forecast Balance To Reserves

Long-standing statutory provisions allocate forecast balances to reserve accounts when these "rainy day" funds have been depleted. This provision was last triggered in 2004 and 2005 to restore reserves and reverse school payment shifts that had been enacted. Based on this forecast, the entire projected balance of $876 million will be placed in reserves – leaving no available budget balance for FY 2012-13.

FY 2012-13 Budget Summary

($ in millions)

	End of Session	November Forecast	Difference
Beginning Balance	**$725**	**$1,289**	**$564**
Forecast Revenues	33,724	33,700	(24)
Projected Spending	34,339	33,991	($348)
Reserves	95	122	$27
Projected Balance (Allocated To Reserves)	**$15**	**$876**	**$861**

The allocation of forecast balances to reserves is one of a series of automatic actions designed to improve the state's finances when forecasts improve. Current law specifies a required priority-ordered allocation of any forecast balance. If, on the basis of a forecast of general fund revenues and expenditures, the commissioner of Management and Budget determines that there will be a positive general fund balance at the close of the biennium, Minnesota Statutes 16A.152 requires that money be allocated to: *first*, the cash flow account; *second*, the budget reserve; *third*, to repay and reverse school aid payment shifts, and; *fourth,* to reverse the school property tax recognition shift.

Based on this requirement, the forecast balance of $876 million is allocated as follows:

1) $255 million to restore the cash flow account from $95 million to the $350 million maximum set in statute.

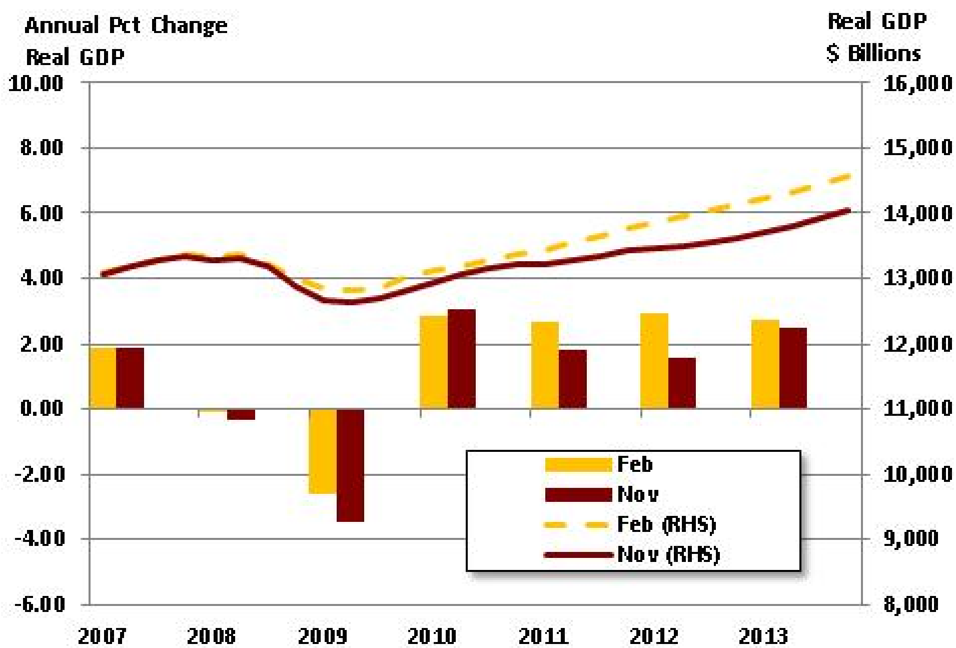
2) $621 million to restore the budget reserve. This additional funding, combined with $27 million received in July from an excess balance in the workers' compensation assigned risk plan, will increase the reserve from zero at the end of the legislative session to $648 million -- $5 million below the $653 million statutory maximum.

Forecasters See Slower Growth, Increased Risk of Recession for U.S. Economy

Economists have tempered their optimism since February's forecast. Part of the reason is that the U.S. economy began 2011 with less underlying strength than had been assumed. Oil price shocks, tepid employment growth, and supply chain disruptions also contributed to slower than anticipated economic growth. The weakness observed appears to have been compounded by a general decrease in the public's confidence in the ability of existing institutions to put the economy back on track. The Eurozone's financial problems remain unresolved and appear to be becoming both more severe and more intractable. And, in the U.S., the belief that partisan political gridlock will dramatically slow, or even prevent, implementation of needed economic policy changes has grown. Regaining the confidence needed to underpin an extended period of healthy economic growth will take some time and will not be easy.

The current forecast for an extended period of sub-par economic growth coupled with a loss of confidence in government's ability to take needed fiscal policy actions on a timely basis also led economists to increase the downside risk in their forecasts. In early 2011 forecasters were setting the probability of a 2012 recession at 20 percent or less. By August that probability had grown to 40 percent. Since then the domestic economic situation appears to have improved slightly, leading some to reduce their estimated probability of recession. But, almost all forecasters still believe the probability of a recession is greater than normal.

Global Insight Has Significantly Lowered Forecast GDP Growth for 2011 and 2012



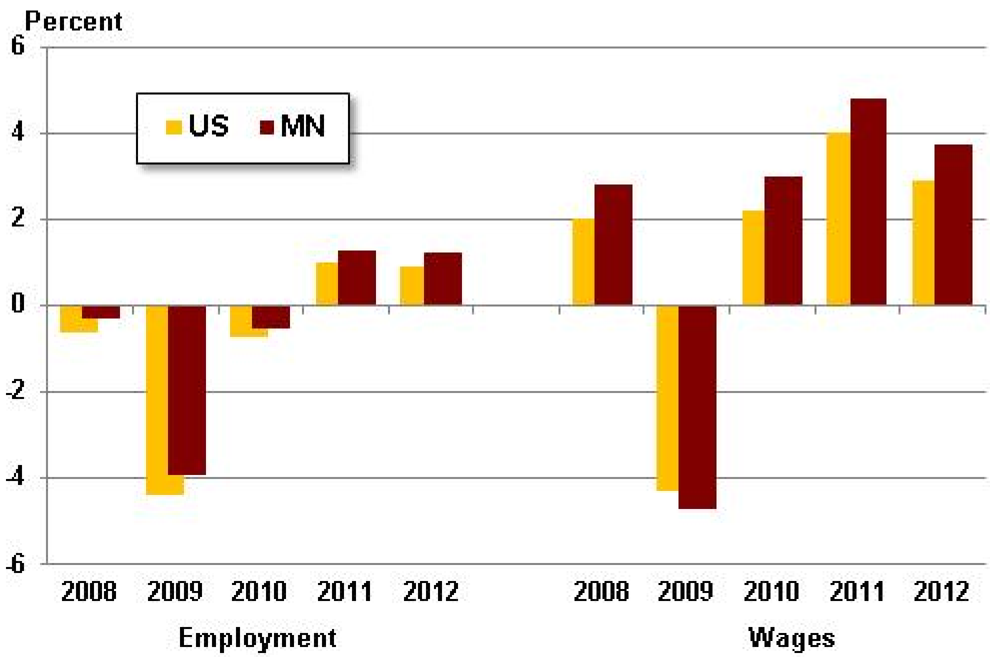
November's baseline forecast from Global Insight Inc. (GII), Minnesota's national macro-economic consultant, is much more subdued than their February forecast. Real GDP continues to grow through the 2011-13 forecast horizon, but growth rates now expected for 2011 and 2012, 1.8 percent and 1.6 percent respectively, are well below February's expected 3.2 percent and 2.9 percent. Global Insight's outlook for 2011 is now identical to the Blue Chip Consensus, but their forecast of 1.6 percent real growth for 2012 is well below the 2.1 percent growth anticipated by the Blue Chip panel. Indeed, GII's 2012 growth rate places it in the bottom fifth of Blue Chip respondents.

Global Insight assigned a 50 percent probability to their November baseline and a 40 percent probability to a more pessimistic scenario containing a three quarter recession beginning at the end of 2011. The extremely high recession probability was attributable in part to GII's perception that the likelihood of a "disorderly" solution to the Eurozone's financial problems had increased.

Minnesota's Economy Has Been Growing Faster than the U.S. Averages

Minnesota's economy struggled during the Great Recession. Employment and wages fell and the unemployment rate shot up dramatically. But, the economic downturn appears to have been less severe in Minnesota than nationally, and the recovery somewhat stronger. Minnesota's labor market is still struggling, unemployment is unreasonably high and it now appears that payroll employment will not yet return to its pre-recession level until early 2014. But, state unemployment rates continue well below the national average and job growth and wage growth are expected to exceed the U.S. average in 2012.

Minnesota Payroll Employment and Wages Expected to Continue Growing in 2012



Payroll employment in Minnesota fell by more than 5.5 percent (155,000 jobs) during the Great Recession. Nationally, however, the percentage loss was even greater at 6.3 percent. Since the recovery began Minnesota has recovered 35 percent of the jobs lost in the downturn. Nationally, only 22 percent of the jobs lost have been regained.

A distinctive feature of the Great Recession was that total wages fell below year earlier levels in 2009. Wages actually fell by a greater percentage in Minnesota than nationally in that one year, but over a longer time period wage growth in Minnesota has been stronger. From 2008 through 2011 total wages paid in Minnesota are estimated to have increased by 2.9 percent, while national growth has been just 1.7 percent.

Slower Economic Growth Offsets Higher FY 2011 Revenue Base -- FY 2012-13 Revenues Down $36 Million from End-of-Session Estimates

Minnesota ended fiscal year 2011 with general fund revenues $358 million above forecast. About 80 percent of the additional revenues were from the individual income tax and more than two-thirds of those revenues came from greater than anticipated final payments on tax year 2010 tax returns due April 15, 2011. Net sales tax receipts were $30 million below forecast, corporate tax receipts were $11 million above forecast and all other revenues $100 million above forecast. Nearly $60 million of the increase in other revenues reflects a change in the timing of the posting of Wisconsin's income tax reciprocity settle-up payment. February's forecast assumed that payment would be posted in fiscal year 2012 revenues.

Changes in General Fund Revenues by Fiscal Year

($ in millions)

	FY 2011	FY 2012	FY 2013
Individual	$277	$153	($117)
Sales	(30)	(39)	(66)
Corporate	11	79	71
Other	100	(44)	(61)
Total	$358	$149	($173)

Typically, when actual revenues exceed projections, the forecast for future revenues increases, reflecting the fact that future revenue growth will come from a higher base than thought earlier. This holds true even if projected future growth rates are modestly below rates earlier assumed. Only if the expected future growth rate is well below that assumed in the prior forecast is a significant increase in the base unlikely to produce an increase in forecast revenues. This is one of those times. The projected growth rates in Global Insight's November baseline are sufficiently lower than those used in February that revenues for the 2012-13 biennium are now projected to be less than forecast in February despite the additional revenues received in fiscal 2011.

The individual income tax showed the largest change, dropping to a level $117 million below February's estimate. By 2013 Minnesota wages are 1.1 percent below February's forecast and non-wage income, 2.3 percent below levels used in February. The corporate income tax is the exception, showing significant growth due to a projected increase in corporate profits in 2011.

FY 2012-13 Forecast Spending Declines One Percent

General fund spending for the 2012-13 biennium is forecast to be $33.991 billion, down $348 million (1.0 percent) from end-of-session estimates. The largest decrease, $308 million, occurs in health and human services and is driven almost entirely by changes in the Medical Assistance (MA) program.

The revised forecast for Medical Assistance spending is lower due to incorporating current enrollment and cost trends, particularly in program segments with recent changes in state or federal laws. One-quarter of the savings in the MA program is due to increased pharmacy rebates which Minnesota is now eligible to receive under federal law. Another quarter of the savings is due to lower than expected enrollment in the recently implemented early expansion of MA for adults without children. Additionally, lower enrollment and lower average costs are now projected for other MA categories.

Forecast Spending, FY 2012-13
($ in millions)

	End of Session	Nov Forecast	$ Change	% Change
K-12 Education	$14,545	$14,520	($25)	(0.2)
K-12 Payment Shifts	(907)	(867)	40	nm
Higher Education	2,566	2,566	-	0.0
Property Tax Aids & Credits	2,864	2,839	(25)	(0.9)
Health & Human Services	11,372	11,064	(308)	(2.7)
Debt Service	532	474	(58)	(10.7)
All Other	3,367	3,395	28	0.8
Total Spending	**$34,339**	**$33,991**	**($348)**	(1.0)

Changes in other expenditure areas were modest. Property tax aids and credits declined nearly $25 million from end-of-session estimates reflecting slightly lower projected property tax refunds and local aid estimates. Debt service costs decreased $58 million, primarily reflecting higher expected premiums paid by investors in state bonds.

The forecast for K-12 spending has increased $15 million reflecting minor changes in projected referendum revenues, reductions in the property tax base, offset by a slight reduction in forecast enrollments. All other spending is $28 million higher largely reflecting $38 million of appropriations, unspent in FY2011, that carry forward and are available to be spent in FY 2012.

FY 2014-15 Planning Outlook Improves

A modest $422 million improvement in the longer term revenue forecast, accompanied by a $171 million reduction in projected spending, leaves a $1.3 billion structural shortfall projected for the 2014-15 biennium. This compares with the $1.9 billion gap between expected revenues and expenditures projected at the end of July's special session. Planning estimates for FY 2014-15 now show general fund revenues of $35.717 billion and projected spending of $37.017 billion. The gap between ongoing revenues and spending has decreased $591 million from end-of-session estimates.

FY 2014-15 Planning Estimates

($ in millions)

	FY 2014	FY 2015	FY 2014-15
Resources	$17,492	$18,225	$35,717
Spending	18,474	18,543	37,017
Difference	($982)	($318)	($1,300)
Inflation	*$425*	*$882*	*$1,307*

Expenditure projections do not include any adjustment for projected inflation. Inflation, based on the Consumer Price Index (CPI), is expected to be 2.3 percent in FY 2014 and 2.4 percent in FY 2015. At these levels, recognizing inflation would cost an additional $1.3 billion in the next biennium.

The planning estimates make no assumptions about any actions that might be taken in the 2012 legislative session affecting FY 2012-13 or to reduce the structural shortfall expected for the 2014-15 biennium. The planning estimates are simply a benchmark to determine if ongoing spending will exceed revenues in succeeding budget periods. Economic changes as well as the nature and timing of budget actions will materially affect both revenue and expenditure projections.

A complete version of this forecast can be found at the Minnesota Management & Budget's World Wide Web site at -- www.mmb.state.mn.us. This document is available in alternate format.

FY 2010-11 Comparison: End of Session vs. Close

November 2011 General Fund Forecast

($ in thousands)

	7-11 Spec Sess 1 FY 2010-11	11-11 Fcst FY 2010-11	Difference
Actual & Estimated Resources			
Balance Forward From Prior Year	446,921	446,921	0
Current Resources:			
Tax Revenues	27,883,752	28,220,967	337,215
Non-Tax Revenues	1,595,773	1,613,244	17,471
Subtotal - Non-Dedicated Revenue	29,479,525	29,834,211	354,686
Dedicated Revenue	17,983	17,967	(16)
Transfers In	882,360	875,873	(6,487)
Prior Year Adjustments	65,376	75,392	10,016
Subtotal - Other Revenue	965,719	969,232	3,513
Subtotal-Current Resources	30,445,244	30,803,443	358,199
Total Resources Available	**30,892,165**	**31,250,364**	**358,199**
Actual & Estimated Spending			
K-12 Education	13,312,526	13,304,995	(7,531)
K-12 Ptx Rec Shift/Aid Payment Shift	(1,882,941)	(1,883,254)	(313)
Subtotal K-12 Education	11,429,585	11,421,741	(7,844)
Higher Education	2,814,217	2,812,613	(1,604)
Property Tax Aids & Credits	3,016,002	3,015,602	(400)
Health & Human Services	8,575,672	8,426,753	(148,919)
Public Safety	1,822,206	1,801,964	(20,242)
Transportation	167,036	166,458	(578)
Environment, Energy & Natural Resources	312,018	302,204	(9,814)
Agriculture & Veterans	86,727	83,051	(3,676)
Economic Development	195,430	195,866	436
State Government	884,802	857,295	(27,507)
Debt Service	829,701	830,241	540
Capital Projects	22,898	22,898	0
Deficiencies/Other	16,814	12,212	(4,602)
Estimated Cancellations	(18,700)	0	18,700
Subtotal Expenditures & Transfers	**30,154,408**	**29,948,898**	**(205,510)**
Dedicated Expenditures	12,703	12,793	90
Total Expenditures & Transfers	**30,167,111**	**29,961,691**	**(205,420)**
Balance Before Reserves	**725,054**	**1,288,673**	**563,619**
Cash Flow Account	266,000	266,000	0
Budget Reserve	8,665	8,665	0
Appropriations Carried Forward	0	37,860	37,860
Budgetary Balance	**450,389**	**976,148**	**525,759**

FY 2012-13 Current Biennium Forecast Comparison
November 2011 General Fund Forecast - Before Statutory Allocations
($ in thousands)

	7-11 Spec Sess 1 FY 2012-13	11-11 Fcst FY 2012-13	Difference
Actual & Estimated Resources			
Balance Forward From Prior Year	725,054	1,288,673	563,619
Current Resources:			
Tax Revenues	31,192,811	31,181,960	(10,851)
Non-Tax Revenues	1,441,168	1,450,994	9,826
Subtotal - Non-Dedicated Revenue	32,633,979	32,632,954	(1,025)
Dedicated Revenue	3,200	1,200	(2,000)
Transfers In	1,036,580	1,015,887	(20,693)
Prior Year Adjustments	50,000	50,000	0
Subtotal - Other Revenue	1,089,780	1,067,087	(22,693)
Subtotal-Current Resources	33,723,759	33,700,041	(23,718)
Total Resources Available	**34,448,813**	**34,988,714**	**539,901**
Actual & Estimated Spending			
K-12 Education	14,545,312	14,520,262	(25,050)
K-12 Ptx Rec Shift/Aid Payment Shift	(906,741)	(866,726)	40,015
Subtotal K-12 Education	13,638,571	13,653,536	14,965
Higher Education	2,565,517	2,565,517	0
Property Tax Aids & Credits	2,864,001	2,839,097	(24,904)
Health & Human Services	11,372,201	11,064,055	(308,146)
Public Safety	1,807,417	1,814,510	7,093
Transportation	125,658	125,658	0
Environment, Energy & Natural Resources	252,704	257,758	5,054
Agriculture & Veterans	76,601	79,876	3,275
Economic Development	170,270	176,632	6,362
State Government	905,000	912,936	7,936
Debt Service	532,400	474,148	(58,252)
Capital Projects	45,219	45,219	0
Estimated Cancellations	(20,000)	(20,000)	0
Subtotal Expenditures & Transfers	34,335,559	33,988,942	(346,617)
Dedicated Expenditures	3,200	1,527	(1,673)
Total Expenditures & Transfers	**34,338,759**	**33,990,469**	**(348,290)**
Balance Before Reserves	**110,054**	**998,245**	**888,191**
Cash Flow Account	95,000	95,000	0
Budget Reserve	0	26,995	26,995
Budgetary Balance	**15,054**	**876,250**	**861,196**

FY 2012-13 Biennium
November 2011 General Fund Forecast
($ in thousands)

	11-11 Fcst FY 2012	11-11 Fcst FY 2013	Biennial Total
Actual & Estimated Resources			
Balance Forward From Prior Year	1,288,673	1,323,514	1,288,673
Current Resources:			
Tax Revenues	15,388,573	15,793,387	31,181,960
Non-Tax Revenues	753,075	697,919	1,450,994
Subtotal - Non-Dedicated Revenue	16,141,648	16,491,306	32,632,954
Dedicated Revenue	600	600	1,200
Transfers In	462,797	553,090	1,015,887
Prior Year Adjustments	25,000	25,000	50,000
Subtotal - Other Revenue	488,397	578,690	1,067,087
Subtotal-Current Resources	16,630,045	17,069,996	33,700,041
Total Resources Available	**17,918,718**	**18,393,510**	**34,988,714**
Actual & Estimated Spending			
K-12 Education	7,116,650	7,403,612	14,520,262
K-12 Ptx Rec Shift/Aid Payment Shift	(755,904)	(110,822)	(866,726)
Subtotal K-12 Education	6,360,746	7,292,790	13,653,536
Higher Education	1,282,884	1,282,633	2,565,517
Property Tax Aids & Credits	1,470,014	1,369,083	2,839,097
Health & Human Services	5,572,596	5,491,459	11,064,055
Public Safety	908,602	905,908	1,814,510
Transportation	62,829	62,829	125,658
Environment, Energy & Natural Resources	131,410	126,348	257,758
Agriculture & Veterans	48,681	31,195	79,876
Economic Development	93,997	82,635	176,632
State Government	454,977	457,959	912,936
Debt Service	192,070	282,078	474,148
Capital Projects	20,471	24,748	45,219
Estimated Cancellations	(5,000)	(15,000)	(20,000)
Subtotal Expenditures & Transfers	16,594,277	17,394,665	33,988,942
Dedicated Expenditures	927	600	1,527
Total Expenditures & Transfers	**16,595,204**	**17,395,265**	**33,990,469**
Balance Before Reserves	**1,323,514**	**998,245**	**998,245**
Cash Flow Account	350,000	350,000	350,000
Budget Reserve	648,245	648,245	648,245
Budgetary Balance	**325,269**	**0**	**0**

* The November 2011 forecast balance of $876 million for FY 2012-13 is allocated by statute to restoring reserves: cash flow account ($255 million) and budget reserve ($621 million)