

February 2009

HIGHLIGHTS

\$4.6 Billion Shortfall Forecast for 2010-11 Biennium

There has been no material change in Minnesota's FY 2010-11 budget outlook. There have, however, been significant changes affecting the forecast. A \$1.166 billion reduction in forecast revenues caused by further deterioration in the U.S. economic outlook was more than offset by \$1.359 billion in general fund assistance from the federal stimulus package. After factoring in a small (\$152 million) spending increase and the carry-forward of FY 2009's projected ending balance (\$236 million) the projected shortfall for the 2010-11 biennium falls by \$277 million to \$4.570 billion. In November the shortfall was \$4.847 billion. In both this forecast and the November forecast expected revenues fall short of projected expenditures by more than 13 percent.

\$236 Million Balance Now Projected for FY 2009

A budget deficit is no longer forecast for the 2008-09 biennium. Minnesota is now expected to end the 2008-09 biennium with a balance of \$236 million and a \$350 million cash flow account. The deficit was eliminated by withdrawing the remaining \$155 million from the budget reserve and unallotting \$271 million. Expected federal stimulus aid of \$464 million was more than sufficient to offset a forecast reduction in FY 2009 revenues.

A Longer and Deeper Recession Is Now Forecast

We are currently in what is likely to be the longest and deepest recession since World War II. Global Insight expects real GDP to fall by 2.7 percent in 2009. November's baseline called for a 1 percent decline. The stimulus is expected to shorten the recession. The economy now is expected to begin growing again by early fall. But job growth is not expected to resume until early 2010. Through January, U.S. payroll employment has fallen by more than 3.6 million. Further job losses of more than 2.5 million are expected through the end of 2009.

Federal Stimulus Aid Helps, But It Is Not a Permanent Budget Solution

One-time federal stimulus aid helps in the upcoming biennium. But it only reduces budgetary pressures through FY 2011. In FY 2012-13 revenues are now expected to be \$5.133 billion less than projected expenditures before adjusting for inflation.

February Forecast

BUDGET UPDATE AND OUTLOOK

FY 2010-11 Budget Shortfall Is \$4.570 Billion, but \$236 Million Balance Forecast for FY 2008-09

The short term outlook for the U.S. economy has deteriorated significantly since November's forecast. Over the past 3 months the nation has lost nearly 1.8 million jobs and the end of this downward spiral is not yet in sight. Most observers now believe the national recession will be the longest and deepest since World War II. The recently approved federal stimulus package will help, but even under the most optimistic assumptions the tax relief and spending increases it contains are not expected to stabilize the national economy until late 2009.

Minnesota's economy is also expected to struggle, but the weaker economic outlook has not translated into large changes in the state budget outlook. State revenues do decline more than forecast in November, but after taking into account the projected budgetary impacts of the stimulus package and the actions taken by the Governor to eliminate the projected FY 2009 deficit Minnesota's fiscal position has not changed materially from that reported in November. For the 2010-11 biennium a budget shortfall of \$4.570 billion is forecast. A \$236 million balance is now projected for FY 2008-09.

FY 2009-2011 Forecast Changes Compared to November (\$ in millions)

	<u>FY 2009</u>	<u>FY 2010-11</u>
November Forecast Shortfall	(\$426)	(\$4,847)
Changes:		
Budget Reserve Used	155	—
Governor's Unallotment	271	—
February Forecast Changes	(228)	(1,318)
Federal Stimulus	<u>464</u>	<u>1,359</u>
February Forecast Balance	\$236	(\$4,806)
Budget Deficit FY 2009-11		(\$4,570)

The larger than anticipated downturn in the economy has reduced state revenues through the end of the forecast horizon. Other things equal the further decline in the national economic outlook would have increased the 2008-09 budget deficit by \$228 million and \$1.318 billion for the 2010-11 biennium. But the federal stimulus package, coupled with

use of the budget reserve and the Governor's unallotment more than offset the additional projected decline in revenue and increase in spending.

Budget Balance of \$236 Million Projected for 2008-09 Biennium

Minnesota's general fund revenues are now forecast to total \$32.232 billion in the 2008-09 biennium, \$213 million (0.7 percent) less than forecast in November. State general fund expenditures are now expected to be \$33.891 billion, \$720 million (2.1 percent) below earlier estimates. The budget reserve has been eliminated, but the state's cash flow account continues to have a balance of \$350 million.

FY 2008-09 Budget Forecast

(\$ in millions)

	<u>November Forecast</u>	<u>February Forecast</u>	<u>Difference</u>
Beginning Balance	\$2,245	\$2,245	—
Revenues	32,445	32,232	(213)
Expenditures	34,611	33,891	(720)
Cash Flow Acct	350	350	—
Budget Reserve	<u>155</u>	<u>—</u>	<u>(155)</u>
Balance	(\$426)	\$236	\$662

Much of the change to this forecast was unrelated to changes in the economic outlook. In December, the Governor acted to eliminate the projected deficit for FY 2009 by drawing down the state's budget reserve and unallotting \$271 million. The unallotment decreased spending by \$193 million and yielded \$78 million in transfers. The stimulus package also improved the budget outlook by reducing projected FY 2009 spending by \$464 million. Revenues would have declined by \$291 million and expenditures fallen by \$63 million in the absence of unallotment and the stimulus package.

Budget Shortfall of \$4.570 Billion Projected for 2010-11 Biennium

General fund revenues for the next biennium are now forecast at \$30.700 billion, \$1.166 billion (3.8 percent) less than projected in November. Net general fund revenues for the 2010-11 biennium are projected to fall by 4.8 percent from 2008-09 levels. Excluding the unallotment related transfers, revenues fall by 4.6 percent. Expenditures are now projected to be \$35.506 billion, a decline of \$1.207 billion (3.3 percent) from November's estimate. The federal stimulus funding has the effect of reducing projected 2010-11 spending by \$1.359 billion. Without that assistance projected expenditures for

the next biennium would be \$36.865 billion, an increase of 7.3 percent over the current biennium.

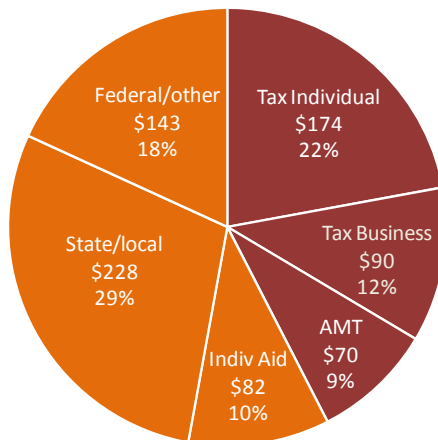
FY 2010-11 Budget Outlook
(\$ in millions)

	<u>November Forecast</u>	<u>February Forecast</u>	<u>Difference</u>
Beginning Balance	\$79	\$586	\$508
Revenues	31,866	30,700	(1,166)
Expenditures	36,713	35,506	(1,207)
Cash Flow Acct	350	350	—
Budget Reserve	<u>155</u>	<u>—</u>	<u>(155)</u>
Balance	(\$5,273)	(\$4,570)	\$704

Federal Stimulus Bill Will Provide Relief

President Obama signed the American Recovery and Reinvestment Act (ARRA) into law on February 17, 2009. The ARRA provides \$787 billion of federal tax reductions and federal spending increases to accelerate the nation’s economic recovery and preserve and create jobs. The Congressional Joint Committee on Taxation estimates the act contains \$334 billion in tax relief between now and the close of the 2011 federal fiscal year. Individual filers receive a tax reduction of \$174 billion; businesses, \$90 billion. The alternative minimum tax is also reduced for tax year 2009 at a cost of \$70 billion.

Composition of Federal Stimulus Bill
By Type of Tax Relief and Type of Spending



The ARRA also provides for \$453 billion in additional federal spending. About 20 percent of the additional federal spending goes directly to individuals through increases in spending on programs such as food stamps. The remainder goes to pay for federal projects and to state and local governments. The National Governors Association estimates about one-half of the spending authorized by the ARRA will be directed through state and local governments.

Much of the spending is not expected to occur until 2010 or 2011. About 20 percent of ARRA authorized spending will occur before October, 2009 and an additional 38 percent is projected to be spent before October 2010. By the close of the 2011 federal fiscal year about 80 percent of stimulus package-related spending will have taken place according to Congressional Budget Office estimates.

State and local governments in Minnesota are expected to be eligible to receive nearly \$4.6 billion in assistance under the ARRA. At this time, however, the forecast impact of the additional federal spending on the state's budget outlook is much smaller than that amount. Much of the spending authorized by the ARRA is dedicated to specific purposes and projects so it will have no direct impact on Minnesota's general fund outlook. For example, Minnesota is expected to be eligible to receive about \$450 million in additional funds for highway and bridge construction projects. When received those funds will be directed into dedicated highway construction funds and not comingled with general fund revenues, leaving the state's general fund budget outlook unchanged.

This forecast includes only one direct ARRA related budget adjustment, the change in the Federal Medical Assistance Percentage (FMAP). Unlike other federal funds, Minnesota can recognize and spend these funds within current law and without additional review. In fact, the state is already preparing to receive the retroactive portion of the FMAP increase. The change in FMAP is expected to provide Minnesota with an additional \$464 million in FY 2009 and \$1.359 billion in FY 2010-11. The change in the FMAP is shown in this forecast as a reduction in expenditures in FY 2009, FY 2010, and FY 2011, not as an increase in revenues.

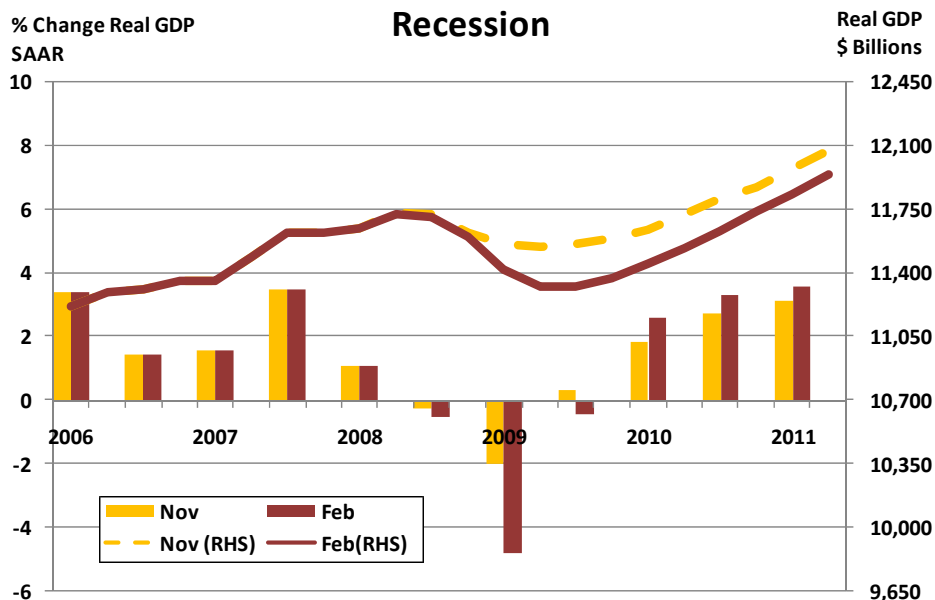
But, It Will Not Jump-Start the U.S. Economy

The 2009 stimulus package will provide a welcome lift to the U.S. economy, but the tax reductions and spending increases it contains will not arrive soon enough to offset the large declines in real GDP already largely in place for the first and second quarters of 2009. Households are reacting to job losses and what seems like a never ending run of bad-news stories about financial institutions by cutting back their spending. The economy is now in a consumer-led recession where reduced demand for goods and services leads managers to cut back employment, which then leads to further cutbacks in demand. Since consumer spending accounts for more than 70 percent of U.S. economic activity, it will be extremely difficult for the economy to rebound until this self-reinforcing downward cycle is broken and consumer spending once again begins to grow.

The enormous decline in household net worth that has occurred during the past 18 months further complicates the problem since baby-boomers approaching retirement are likely to increase their savings to rebuild their retirement accounts. In the short term money saved is money that will not be spent. Policy makers also face the challenge of dealing with declining export demand for U.S. produced goods, since much of the rest of the world is also in recession.

February’s baseline economic forecast from Global Insight (GII), Minnesota’s national macro-economic consultant, calls for real GDP to decline at a 2.7 percent annual rate in 2009. The recession extends into early fall, with the economy growing at below trend rates through mid 2010. The unemployment rate reaches 9.4 percent in early 2010 and remains at that level until the fall of that year. By the end of 2009 U.S. payroll employment is expected to be 6 million below its fourth quarter 2007 peak, it then recovers very slowly. It is not until mid-2012 that the number of U.S. jobs exceeds the 2007 high. In GII’s February baseline real GDP grows at a 2.0 percent annual rate in 2010 and at a 3.5 percent annual rate in 2011.

GII's February Forecast Contains a Deep Recession



Inflation is no longer a concern, at least until the economy once again begins to grow. A CPI increase of 1.0 percent is expected for the current fiscal year; a decline of 0.7 percent is anticipated for fiscal 2010. In fiscal 2011, the CPI is projected to increase by 2.3 percent. Oil prices are expected to remain under \$40 per barrel until late this year, then gradually trend higher, reaching \$60 per barrel by mid 2011.

Global Insight assigns a probability of 60 percent to their baseline forecast, the same as in November. Their optimistic and pessimistic scenarios are both given probabilities of 20

percent. In the optimistic scenario the economy starts to grow again by midsummer. In the pessimistic scenario, growth is delayed until early 2010.

**FY 2009 Revenues Down \$213 Million from November's Estimate,
Revenue Forecast for FY 2010-11 Reduced by \$1.166 Billion**

General fund revenues for the 2008-09 biennium are forecast to total \$32.232 billion, \$213 million less than projected in November. The change in revenues is large for a biennium that has just four months remaining, and it indicates how rapidly the economic outlook has deteriorated since November. Between November and January receipts from the individual income tax, the sales tax, and the corporate franchise tax all were below forecast. For the past three months actual general fund revenues were \$133 million less than November's estimates. The difference between actual and projected receipts accounted for more than one-half of the reduction in the FY 2008-09 revenue forecast. A lower forecast for corporate tax receipts accounted for about 60 percent of the decline. About one-half of the expected reduction in corporate tax receipts has already occurred. The declines in the individual income tax and the sales tax also build on lower than expected receipts since November. The \$87 million increase shown in other revenues is almost entirely due to transfers of balances to the general fund under the Governor's unallotment actions.

**FY 2008-09 and FY 2010-11 Revenues
Forecast Changes**
(\$ in millions)

	<u>FY 2008-09</u>	<u>FY 2010-11</u>
Income	(\$83)	(\$701)
Sales	(84)	(202)
Corporate	(133)	(230)
Motor Vehicle	<u>1</u>	<u>(7)</u>
Subtotal	(299)	(1,140)
Other	<u>87</u>	<u>(26)</u>
Total	(\$213)	(\$1,166)

General fund revenues for the 2010-11 biennium are projected to decline by \$1.166 billion from November's forecast. Revenues are now expected to be \$30.700 billion, 3.7 percent less than previously projected and 4.7 percent less than expected receipts for the 2008-09 biennium. Again, declines in projected receipts from the three major taxes account for almost the entire decline in the forecast. More than 60 percent of the revenue decline was in individual income tax receipts forecast. Larger than previously projected declines in wages and capital gains realizations in tax year 2009 were the primary sources of the reduction in the income tax forecast.

Significant Changes in Spending for FY 2008-09, FY 2010-11

Forecast spending for FY 2008-09 is now \$33.892 billion, \$720 million below November's estimates. The decline is almost exclusively due to unallotment and the federal stimulus bill. Of the projected \$561 million reduction in costs for health and human services, \$90 million was due to unallotment and \$464 million was due to lower state Medical Assistance obligations under federal stimulus. Projected costs for property tax aids and credits were reduced \$108 million, almost exclusively due to unallotment.

**FY 2008-09 and FY 2010-11 Spending
Forecast Changes**
(\$ in millions)

	<u>FY 2008-09</u>	<u>FY 2010-11</u>
K-12 Education	(\$12)	(\$9)
Higher Education	(20)	(1)
Property Tax Aids & Credits	(108)	16
Health & Human Services	(561)	(1,214)
Public Safety	—	—
Debt Service	—	(1)
All Other Spending	<u>(19)</u>	<u>2</u>
Total Change	(\$720)	(\$1,207)

Projected current law spending for the upcoming biennium is now \$35.506 billion, a decline of \$1.207 billion (3.3 percent) since November. Lower anticipated state Medical Assistance spending of \$1.359 billion due to the federal stimulus bill is offset by somewhat higher health and human services caseloads and small revisions in other spending areas.

Impact of Federal Stimulus Bill on Health and Human Services Spending

The Federal Medical Assistance Percentage (FMAP) is used in determining the amount of Federal matching funds for Minnesota's Medical Assistance program and portions of the MinnesotaCare program. Minnesota's FMAP is currently 50 percent. That is, the state draws 50 cents in federal funding for every dollar it spends on medical services.

Under the American Recovery and Reinvestment Act (ARRA), Minnesota's FMAP rate is projected to increase to 60.19 percent from October 1, 2008 through June 30, 2009 and to 61.59 percent from July 1, 2009 to December 31, 2010. During this period, all states are eligible for a 6.2 percentage point FMAP increase, and Minnesota would be eligible for an additional 3.99 percentage point FMAP increase for the first three calendar quarters and 5.39 percentage points for the next six quarters based on projected changes in the state's unemployment rate. The enhanced FMAP results in reductions in state general fund obligations for Medical Assistance of \$464 million for FY 2009, \$862 million for FY 2010, and \$497 million for FY 2011. Since the FMAP also applies to

portions of the MinnesotaCare program, a reduction in Health Care Access Fund spending is also expected.

FY 2012-13 Planning Outlook Tightens

Changes in the FY 2012-13 planning outlook have implications for FY 2010-11 budget decisions. The long-term budget outlook for FY 2012-13 has deteriorated slightly since November. General fund revenues are \$314 million below November's projections while projected spending is \$215 million higher. The gap between ongoing revenues and spending has increased by \$529 million for FY 2012-13.

FY 2012-13 Planning Outlook

(\$ in millions)

	<u>FY 2008-09</u>	<u>FY 2010-11</u>	<u>FY 2012-13</u>
Forecast Revenues	\$32,232	\$30,700	\$34,244
Projected Spending	33,891	35,506	39,377
One-time Savings, Federal Stimulus	<u>(464)</u>	<u>(1,359)</u>	<u>—</u>
Adjusted Spending	34,355	36,865	39,377
Difference	(\$2,123)	(\$6,165)	(\$5,133)
Estimated Inflation (CPI)		\$170	\$1,360

The impact of the one-time enhanced federal matching rate from the federal stimulus bill on projected spending is shown above. When compared to November's estimates, the structural deficit for FY 2010-11 has increased, from \$4.847 billion to \$6.165 billion due to the worsening economy.

The impact of inflation is not reflected in expenditure projections. The consumer price index (CPI) is projected to fall by 0.7 percent for FY 2010, then grow by 2.3 percent for FY 2011, 2.2 percent for FY 2012, and 2.4 percent for FY 2013.

The planning estimates become more meaningful when specific budget proposals for closing the FY 2010-11 budget gap are being considered and a starting point for the following biennium is being established. The large structural gap for FY 2012-13 has implications for determining the long term impact of FY 2010-11 budget reductions.

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

February 2009 General Fund Forecast
FY 2008-09 Biennium Comparison: February 2009 vs November 2008
(\$ in thousands)

	11-08 Fcst FY 2008-09	2-09 Fcst FY 2008-09	Difference
<u>Actual & Estimated Resources</u>			
Balance Forward From Prior Year	2,244,935	2,244,935	0
Current Resources:			
Tax Revenues	29,916,788	29,646,194	(270,594)
Non-Tax Revenues	1,583,838	1,561,353	(22,485)
Subtotal - Non-Dedicated Revenue	31,500,626	31,207,547	(293,079)
Dedicated Revenue	162,896	162,908	12
Transfers In	731,763	815,685	83,922
Prior Year Adjustments	49,951	46,569	(3,382)
Subtotal - Other Revenue	944,610	1,025,162	80,552
Subtotal-Current Resources	32,445,236	32,232,709	(212,527)
Total Resources Available	34,690,171	34,477,644	(212,527)
<u>Actual & Estimated Spending</u>			
K-12 Education	13,799,898	13,788,000	(11,898)
K-12 Ptx Rec Shift/Aid Payment Shift	(10,525)	(10,525)	0
Subtotal K-12 Education	13,789,373	13,777,475	(11,898)
Higher Education	3,139,859	3,119,469	(20,390)
Property Tax Aids & Credits	3,172,177	3,064,166	(108,011)
Health & Human Services	9,594,253	9,033,517	(560,736)
Public Safety	1,686,829	1,686,529	(300)
Transportation	452,210	451,002	(1,208)
Environment, Energy & Natural Resources	428,962	422,515	(6,447)
Agriculture & Veterans	270,937	269,937	(1,000)
Economic Development	398,915	396,235	(2,680)
State Government	706,776	695,023	(11,753)
Debt Service	862,058	862,071	13
Capital Projects	20,495	20,495	0
Deficiencies/Other	12,140	16,030	3,890
Estimated Cancellations	(23,700)	(23,700)	0
Subtotal Expenditures & Transfers	34,511,284	33,790,764	(720,520)
Dedicated Expenditures	100,262	100,686	424
Total Expenditures & Transfers	34,611,546	33,891,450	(720,096)
Balance Before Reserves	78,625	586,194	507,569
Cash Flow Account	350,000	350,000	0
Budget Reserve	154,922	0	(154,922)
Budgetary Balance	(426,297)	236,194	662,491

FY 2010-11 Biennial Comparison
February 2009 Forecast vs November 2008 Forecast
(\$ in thousands)

	11-08 Fcst FY 2010-11	2-09 Fcst FY 2010-11	Difference
<u>Actual & Estimated Resources</u>			
Balance Forward From Prior Year	78,625	586,194	507,569
Current Resources:			
Tax Revenues	29,589,108	28,474,593	(1,114,515)
Non-Tax Revenues	1,480,987	1,430,184	(50,803)
Subtotal - Non-Dedicated Revenue	31,070,095	29,904,777	(1,165,318)
Dedicated Revenue	164,514	164,514	0
Transfers In	581,281	580,993	(288)
Prior Year Adjustments	50,000	50,000	0
Subtotal - Other Revenue	795,795	795,507	(288)
Subtotal-Current Resources	31,865,890	30,700,284	(1,165,606)
Total Resources Available	31,944,515	31,286,478	(658,037)
<u>Actual & Estimated Spending</u>			
K-12 Education	13,903,227	13,894,099	(9,128)
Higher Education	3,157,824	3,156,864	(960)
Property Tax Aids & Credits	3,418,955	3,435,395	16,440
Health & Human Services	11,406,553	10,192,223	(1,214,330)
Public Safety	1,696,831	1,696,831	0
Transportation	389,888	389,440	(448)
Environment, Energy & Natural Resources	369,661	369,795	134
Agriculture & Veterans	259,006	258,598	(408)
Economic Development	280,078	280,078	0
State Government	624,302	626,767	2,465
Debt Service	1,067,310	1,066,530	(780)
Capital Projects	29,800	29,800	0
Estimated Cancellations	(20,000)	(20,000)	0
Subtotal Expenditures & Transfers	36,583,435	35,376,420	(1,207,015)
Dedicated Expenditures	129,714	129,714	0
Total Expenditures & Transfers	36,713,149	35,506,134	(1,207,015)
Balance Before Reserves	(4,768,634)	(4,219,656)	548,978
Cash Flow Account	350,000	350,000	0
Budget Reserve	154,922	0	(154,922)
Budgetary Balance	(5,273,556)	(4,569,656)	703,900

General Fund Biennial Comparison
FY 2010-11 vs FY 2008-09
(\$ in thousands)

	2-09 Fcst FY 2008-09	2-09 Fcst FY 2010-11	\$ Change	% Change
<u>Actual & Estimated Resources</u>				
Balance Forward From Prior Year	2,244,935	586,194	(1,658,741)	-73.9%
Current Resources:				
Tax Revenues	29,646,194	28,474,593	(1,171,601)	-4.0%
Non-Tax Revenues	1,561,353	1,430,184	(131,169)	-8.4%
Subtotal - Non-Dedicated Revenue	31,207,547	29,904,777	(1,302,770)	-4.2%
Dedicated Revenue	162,908	164,514	1,606	1.0%
Transfers In	815,685	580,993	(234,692)	-28.8%
Prior Year Adjustments	46,569	50,000	3,431	7.4%
Subtotal - Other Revenue	1,025,162	795,507	(229,655)	-22.4%
Subtotal-Current Resources	32,232,709	30,700,284	(1,532,425)	-4.8%
Total Resources Available	34,477,644	31,286,478	(3,191,166)	-9.3%
<u>Actual & Estimated Spending</u>				
K-12 Education	13,788,000	13,894,099	106,099	0.8%
K-12 Ptx Rec Shift/Aid Payment Shift	(10,525)	0	10,525	-100.0%
Subtotal K-12 Education	13,777,475	13,894,099	116,624	0.8%
Higher Education	3,119,469	3,156,864	37,395	1.2%
Property Tax Aids & Credits	3,064,166	3,435,395	371,229	12.1%
Health & Human Services	9,033,517	10,192,223	1,158,706	12.8%
Public Safety	1,686,529	1,696,831	10,302	0.6%
Transportation	451,002	389,440	(61,562)	-13.7%
Environment, Energy & Natural Resources	422,515	369,795	(52,720)	-12.5%
Agriculture & Veterans	269,937	258,598	(11,339)	-4.2%
Economic Development	396,235	280,078	(116,157)	-29.3%
State Government	695,023	626,767	(68,256)	-9.8%
Debt Service	862,071	1,066,530	204,459	23.7%
Capital Projects	20,495	29,800	9,305	45.4%
Deficiencies/Other	16,030	0	(16,030)	-100.0%
Estimated Cancellations	(23,700)	(20,000)	3,700	-15.6%
Subtotal Expenditures & Transfers	33,790,764	35,376,420	1,585,656	4.7%
Dedicated Expenditures	100,686	129,714	29,028	28.8%
Total Expenditures & Transfers	33,891,450	35,506,134	1,614,684	4.8%
Balance Before Reserves	586,194	(4,219,656)	(4,805,850)	
Cash Flow Account	350,000	350,000	0	
Budgetary Balance	236,194	(4,569,656)	(4,805,850)	