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**The November 1999 General Fund Revenue and Expenditure
Forecast**

Forecast Summary

Available revenue for the current biennium (FY 2000-01) is \$1.584 billion. This amount consists of changes in both FY 1999 and FY 2000-01. There are several components to this amount:

FY 1999, 2000 and 2001 General Fund Status

FY 1999 End of 99 Session Balance	\$ 84 million
FY 1999 Additional Sales Tax Rebate	-50 million
FY 1999 Revenue Increase	315 million
FY 1999 Expenditure Decrease	138 million
FY 1999	\$ 487 million (a)
FY 2000-01 End of 99 Session Balance	47 million
FY 2000-01 Revenue Increase	1,271 million
FY 2000-01 Expenditure Increase	- 166 million
FY 2000-01 K-12 General Ed \$50	- 43 million
FY 2000-01 Dedicated Reserve Increase	-12 million
FY 2000-01	\$1,097 million (b)
FY 1999, 2000 & 2001 Total	\$1,584 million

(a) The \$487 million is a \$34 million balance and \$453 million change.

(b) The \$1,097 million is a \$47 million balance and \$1,050 million change.

Changes in FY 2000-01 Revenues Since End of Session

The singles largest revenue change is in the personal income tax. The following chart shows the changes from the February 1999 forecast in those revenue areas with significant changes:

Income Tax	\$598 million
Sales Tax	221 million
Corporate Franchise Tax	133 million
Motor Vehicle Sales Tax	130 million
Investment Income	34 million
Inheritance & Estate Tax	36 million
Mortgage & Deed Tax	20 million
Annual Tobacco Payments	-23 million
Other Revenues	5 million
Dedicated Revenue	83 million
Prior Year Adjustments	<u>35 million</u>
Total Revenue Change	\$1,271 million

Changes in FY 2000-01 Expenditures Since End of Session

Expenditure changes include the \$43 million cost of adding \$50 per pupil unit in FY 2001 to the K-12 general education formula as provided for in 1999 law. Expenditure changes include both those in open appropriations that require no further legislative action to implement and those that will require legislative action to implement. (See issue number 2 later in this document)

K-12 Education General Ed Formula \$50	\$43 million
Other K-12 Education Changes	31 million
Family & Early Childhood Education	- 3 million
Higher Education	12 million
Property Tax Aids & Credits	44 million
Health & Human Services	36 million
Environment & Agriculture	4 million
Economic Development	4 million
Judiciary/Criminal Justice	5 million
State Government	22 million
Debt Service	-10 million
Dedicated Expenditures	<u>20 million</u>
Total Expenditure Change	\$209 million

FY 2002-03 Budget Situation

The balance for 2002-03 is now \$1,549 million. As noted below, special circumstances apply to several components of that amount.

End of 99 Session Projected Balance	\$ 251 million
Revenue Change	1,590 million
Expenditure Change	<u>292 million</u>
Net Change	\$1,549 million

\$352 million of FY 2002-03 revenues are tobacco settlement payments. These amounts are excluded from several calculations.

\$120 million of FY 2002-03 revenues are investment income earned by the property tax reform account. The total amount of this revenue is only available if all the deposits in the account remain in the account until 6-30-03.

\$906 million of the FY 2002-03 expenditures are for planning estimate inflation.

Issues Regarding the Forecast

1. Planning Estimate Inflation

The forecast adds inflation of 2.5 percent to all expenditure items except debt service and dedicated expenditures for FY 2002 and another 2.5% for FY 2003. The planning estimate inflation totals \$906 million. According to DOF, this inflation is “just a forecast estimate that may or may not eventually be funded in the budget.” DOF also argues that inflation is “a proxy for the general pressure on state government operations and grant programs due to wage and price increases.

DOF has argued that the best indicator of inflation is the consumer price index (CPI/U) which has ranged in the 2.5% range. The CPI/U is projected to be 2.4 percent for FY 2002 and 2.5% for FY 2003. The PCWGS (an indicator of state and local government inflation) is 2.3% for FY 2002 and 2.4% for FY 2003. DOF prefers to cite these indicators but another measure is the percentage changes in the implicit gross domestic product (GDP) price deflator. DOF even uses the GDP price deflator in the forecast booklet (page 64, bottom chart) as a measure of inflation. The GDP price deflator change is 1.7% for FY 2002 and 2.0% for FY 2003.

A change of ½ percent in the inflation factor used would be a difference of approximately \$180 million for FY 2002-03.

2. FY 2000-01 Forecasted Formula Changes

Some forecasted expenditure changes are changes in open appropriations. These changes will occur without any change in law because the statutory open appropriations language provides the appropriation needed to fund a formula set in law. Examples of open appropriations include K-12 general education aid, local government aid, education homestead credit and ethanol subsidies.

Other forecasted expenditure changes reflect the amount needed to fully fund a formula currently in law. However, since the appropriation for that formula is a dollar amount in session law, an increase in the appropriation will not occur unless the Legislature passes a law providing the additional amount and then that language is enacted into law. (Forecast changes that decrease amounts can be effective without law changes since the formula would require less and the amount that the appropriation exceeds the amount needed to fund the formula will automatically cancel after the end of the fiscal year unless the law specifies some other option.)

An example of this would be early childhood family education aid (ECFE). The November forecast projects that this program needs \$40.4 million in FY 2000 and 2001 to be fully funded. The actual appropriation for ECFE is \$39.9 million (and that was the amount thought to fully fund the program at the time the appropriations bill was passed in May). The forecast includes the additional \$500,000 as an expenditure but that actual expenditure of that additional \$500,000 can not occur without additional legislation.

If legislation does not appropriate the additional forecasted amount or if the Governor vetoed a legislative

appropriation for this amount, the funding provided under the formula will be pro-rated at some level less than 100 percent of the formula currently in law.

An approximately \$53 million of additional net expenditures for FY 2000-01 are in this category. However, the variances are greater than \$53 million because some are positive and some are negative.

3. FY 2002-03 Structural Balance

The term “structural balance” is used to show the extent to which current revenues exceed current revenues. Structural balance can be measured by year or by biennium. The major difference between a structural balance and actual fund balance is that any amount carried over from the previous biennium or year is excluded in the calculation of structural balance. The structural balance for FY 2002-03 indicates how much of the FY 2000-01 balance can be sustained into FY 2002-03.

DOF also chooses to subtract tobacco settlement revenue of \$352 million as an adjustment to the structural balance for FY 2002-03 because those payments end after FY 2003. However, that \$352 million will be as available for expenditure as any other projected revenue for FY 2002-03. While there were proposals to dedicate the FY 2002-03 tobacco settlement funds for one-time endowments, such a proposal has not yet been enacted. Furthermore, there are other sources of revenue that will increase or decrease in FY 2004-05 compared to FY 2002-03 and no attempt is made to include or exclude those amounts.

DOF also subtracts \$120 of investment income on the property tax reform account as an adjustment to its structural balance amount. See item number 5 below for more discussion of this issue.

The structural balance for FY 2002-03 is \$1,549 million. The structural balance without property tax reform account interest is \$1,429 million. The structural balance for FY 2002-03 minus property tax reform account interest and the tobacco settlement funds is \$1,077 million.

4. One Time Allocations Versus On-Going Allocations

As stated above, revenues in FY 2002-03 are projected to exceed expenditures by \$1,549 million. If property tax reform account interest is excluded, the amount is \$1,429 million. If property tax reform account interest and tobacco settlement funds are excluded, the amount is \$1,077 million. Essentially, this means that the cost of spending increases or revenue reductions in FY 2002-03 can be up to \$1,549 million and the budget for that biennium will still be balanced. As has been done in past years, balances from the current biennium could be carried into FY 2002-03 to cover additional costs in that biennium. (That has been the case with the property tax reform account in the past.)

In thinking about on-going spending increases or revenue reductions proposed to be enacted during the 2000 legislative session, it is important to remember that most changes will become effective in the second year of the current biennium. An \$500,000 increase in expenditures enacted in the 2000 session that would take effect July 1, 2000 will cost \$500,000 in the second year of the current biennium. However, if the cost remained constant, that expenditure would cost \$500,000 in each of the two years of the FY 2002-03 biennium for a total cost of \$1 million (the “tails”). Revenue reductions may differ on timing issues. Income tax rate reductions could be made effective January 1, 2000. In that case, the first biennial cost would be for approximately 18 months and the tails would be for 24 months.

The costs for most on-going changes proposed in the 2000 session will be considerably greater in FY 2002-03 than in FY 2000-01.

5. Property Tax Reform Account

Sixty percent of the projected 6-30-01 unrestricted fund balance has been transferred in the property tax reform account (PTRA). That amount is \$950 million. The statute provides that the interest earned by the PTRA remains in the PTRA. The PTRA is estimated to earn \$61 million of interest in the current biennium and \$120 million of interest in the FY 2002-03 biennium. However, these interest estimates are based on the assumption that the total \$950 million now in the PTRA remains in the account until the end of the biennium. (The Department of Finance also used this same assumption for investment income for the unrestricted general fund balance - the assumption that the current projected balance will remain in the general fund until the end of the biennium. This assumption regarding investment income is a change in practice from previous years and will overstate investment income if any of the balance is used for revenue reductions or expenditure increases.) Reductions in the balance in the PTRA before the end of the biennium (both 6/30/01 and 6/30/03) will also result in a corresponding reduction in investment income. In other words, the expenditure of \$1 from the PTRA will cost more than \$1, it will also cost the investment income that the \$1 would have earned..

Furthermore, if the balance in PTRA is all used in FY 2000-01, FY 2002-03 revenues will be \$120 million lower because the PTRA will earn no interest in FY 2002-03.

For more information on forecast issues, contact Bill Marx at 651-296-7176 or if the questions are in a specific issue area, contact the fiscal analyst for that area.

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