

Minnesota Should Get on a Sustainable Track: A Look at the November 2012 Economic Forecast

Budget deficits continue to plague Minnesota, even though the state is beginning to recover from the Great Recession. The state's *November 2012 Economic Forecast* showed some good news for the state, but the nation's economic recovery is fragile and Minnesota policymakers have not put the state's budget on a sustainable path. Additionally, the federal fiscal cliff and changes to federal health care requirements add to uncertainty in this particular forecast.

The state's labor market is improving, with many employment indicators, like average hours worked and job vacancies, approaching pre-recession levels. This good news has played a role in Minnesota's economy outperforming the national economy, resulting in higher-than-expected state revenue collections in the current budget cycle. That additional revenue, coupled with lower-than-expected spending, has resulted in a \$1.3 billion positive balance in the current budget cycle, the FY 2012-13 biennium.¹ These resources allow Minnesota to reverse some of the school aid shift that was used during recent legislative sessions to help balance the budget. This payment takes care of over half of the outstanding shift, leaving another \$1.1 billion remaining.

However, this positive balance does not continue into the upcoming biennium. The forecast projects a \$1.1 billion deficit for the FY 2014-15 budget cycle. Taking into account the impact of inflation on expenditures would increase the size of the deficit, requiring \$2.0 billion to maintain services at their current level in the next budget cycle. Furthermore, in the FY 2016-17 budget cycle, a \$2.1 billion deficit is predicted, including inflation.

As policymakers consider how to sustainably fund education, health care and other vital services, their decisions will impact the state's economic growth and the vitality of our communities. Minnesota's past investments are paying off today, since the state's competitive advantage is due in part to a highly educated workforce that keeps and attracts businesses. Policymakers must reform Minnesota's outdated tax system to raise sufficient revenues to continue to invest in the building blocks of a strong economy, including a highly skilled workforce and safe and vibrant communities.

The Forecast is the Official Measure of the State's Fiscal Health

Minnesota's constitution requires the state to have a balanced budget. The forecast is a critical tool that the Governor and Legislature use to measure the state's fiscal health and assess spending and tax proposals. Minnesota Management and Budget prepares forecasts each November and February. They consider state, national and global economic trends, and use them to estimate Minnesota's future revenues and expenditures based on current laws.

Improved Revenues and Lower Spending Create a Positive Balance in this Budget Cycle

The national economy has not improved as quickly as expected, so it was a surprise when the forecast showed the state's current budget cycle has such a strong positive balance of \$1.3 billion. These additional revenues came primarily from increased income, corporate and sales tax collections. On the spending side, expenses

Forecast Numbers at a Glance

- Minnesota has a \$1.3 billion positive balance for the remainder of FY 2012-13. By statute, the funds will go to repaying the school aid shift.
- Minnesota has a projected \$1.1 billion deficit for FY 2014-15, or \$2.0 billion including the impact of inflation on expenditures.
- Minnesota's projected deficit for FY 2016-17 is \$2.1 billion with inflation.

were lower than expected primarily due to lower state health care costs. Minnesota had savings in Medicaid because fewer people enrolled than previously anticipated. Also, thanks to the Affordable Care Act, Minnesota was able to collect \$37 million more in rebates from pharmaceutical companies than estimated at the end of the 2012 Legislative Session.

If a positive balance appears in a biennium, state law has clear rules for how the funds must be used. The current balance will continue repaying the \$2.4 billion in various school funding shifts that remained at the end of the 2012 Legislative Session. With this payment, the state is now over halfway to paying off the shifts.²

Despite this short-term good news, the forecast still projects a \$1.1 billion shortfall for FY 2014-15, which grows to \$2.0 billion if the impact of inflation on the cost to provide services is included. In FY 2016-2017, there is a projected \$2.1 billion dollar deficit with inflation. These figures do not include the remaining \$1.1 billion cost to repay the school funding shifts.

Without a Prompt Resolution of the Fiscal Cliff, A Second Recession is a Possibility

The national economy is still on a slow road to recovery, and the forecast predicts a modest 1.9 percent growth in GDP for next year, but the state forecasters only assign a 60 percent probability to this baseline forecast. Alternatively, forecasters predicted that if federal policymakers did not find a relatively timely alternative to scheduled dramatic across-the-board spending cuts and expiring tax cuts, the country could sink into recession, causing state revenues to fall by \$1.8 billion for the FY 2014-15 biennium. Additionally, while the baseline economic forecast predicts 100,000 more jobs created in Minnesota in the next two years, a recession would bring this estimate down to only 30,000 jobs created in the next two years, and unemployment would increase to 7.1 percent. State forecasters assigned a 20 percent probability to this worst-case scenario. However, they also assigned a 20 percent probability to a best-case scenario where federal decision makers avoid the fiscal cliff and a strong housing market boosts economic growth.

Forecast Assumes Medicaid Dollars from the Affordable Care Act

Another uncertainty is \$4.2 billion over the next four years in federal Medicaid dollars that are included in the forecast. The July Supreme Court decision on the Affordable Care Act changed the rules of the game, and Minnesota will now need legislative action before we qualify for all those federal funds. However, the forecast assumes that beginning in 2014, Minnesota will get a 100 percent federal match for covering adults without children with incomes up to 75 percent of the federal poverty line (\$8,378 for an individual or \$11,348 for a couple) through Medicaid.

State lawmakers can secure the 100 percent federal match on newly eligible individuals by covering Minnesotans with incomes up to 138 percent of the federal poverty line, \$15,415 for an individual or \$20,879 for a couple. Not only would this save the state money, but it would allow more than 140,000 very low-income Minnesotans to gain access to affordable and comprehensive health insurance.

Minnesota Has the Opportunity to Get on a Sustainable Track

The positive balance in this budget cycle means the state will continue to reverse the school funding shift, one of the budget gimmicks used to bring a short-term budget balance in past years. However, the deficits in upcoming budget cycles indicate that policymakers have not yet found a way to sustainably fund education, health care and other critical investments in our future. How policymakers choose to address this challenge will have consequences for quality of life. During this upcoming legislative session, it is imperative that the state reforms its revenue system so that Minnesota's priorities are sustainably and fairly funded.

By Caitlin Biegler

¹ Data in this analysis come from Minnesota Management and Budget's *November 2012 Economic Forecast*.

² A small residual amount, \$6 million, went to the state budget reserve.