



Restoring an inflation measure to the state's Budget and Economic Forecast

The state's economic forecasts are essential tools for policymakers and the public to understand the state's fiscal situation. Unfortunately, they have a serious flaw. Forecasts understate the amount of funding needed to maintain most current public services because they do not take into account the impact of inflation.

The state Budget and Economic Forecasts are produced twice a year by Minnesota Management and Budget. The Forecasts provide key information to inform tax and budget decisions, and serve as the baseline for the budget proposals that the governor and Legislature put together.

The forecast starts with the state's current laws for taxation and spending, then, based on current projections of how the economy is expected to perform, estimates what the state would expect to collect in revenue and what the state would spend.

The flaw with the forecast is that it adjusts future revenue projections for the expected inflationary impact on income, sales, and other taxes and revenue sources, but does not adjust most areas of spending for expected inflation.

Each year, the amount of funding needed to provide the same level of public services generally increases as the cost of materials, rent, and personnel rises. If the level of funding remains constant, over time inflation erodes the state's ability to provide the services that Minnesotans count on.

Because the forecast does not include the impact of expected inflation on most areas of spending, policymakers and the public get a mistaken impression of the state's budget situation and future. The forecast understates the amount of funding needed for existing public services to keep up with inflation. Including a measure of inflation's impact on public services in the forecast would help decision-makers and the public understand whether proposed fiscal decisions are sustainable and recognize how inflation puts pressure on the state's ability to meet its current commitments.

How did we get here?

In 2002, the Legislature passed a law that prohibits Minnesota Management and Budget from including the influence of inflation on most budget areas in the state's forecasts.¹

This was done at a time when the state was facing significant projected deficits. However, rather than implementing a *policy decision by passing budget legislation* to freeze or reduce future funding for state services, policymakers passed legislation that *changed how the forecast worked*, removing inflation to artificially reduce the size of projected deficits as measured by the forecast.

By taking this action, policymakers blurred the distinction between 1) providing information about the state's budget situation and the funding needed to maintain current services, and 2) the budget choices about whether to fund an inflationary increase.

How restoring an inflation measure would improve the forecast and the budget process

- Make the forecast a more effective tool to inform tax and budget decisions. Forecasts should give policymakers and the public an accurate picture of the state’s commitments and the impact of past and proposed decisions. The effects of inflation are real, and providing an estimate of the impact of inflation on current services provides a more complete and accurate forecast.
- Encourage responsible fiscal management and accountability by providing a clear understanding of the state’s fiscal health, the funding needed to maintain current levels of services, and the long-term implications of budget decisions.
- Bring the forecast in line with good fiscal management and recommended accounting practices. For every year since 2003, our state’s Council of Economic Advisors has recommended that the state’s forecast planning estimates include inflation in both spending and revenue projections.² The Council is the set of economists who are charged with advising the executive and legislative branches on economic and fiscal matters. They note that our current forecast methodology is “inconsistent with both sound business practices and CBO [Congressional Budget Office] methods.”

What restoring inflation to the forecast does not do

- It does not increase funding for any public service or program. The Legislature still would have to pass, and the governor sign, budget legislation to approve any funding increase in a non-forecasted program or service. (A forecasted program is one that under current law, the level of spending changes to reflect increases or decreases in factors such as the population served, service costs, inflation, or other measures. These changes are reflected in the forecast, and policymakers can change those funding levels by passing budget legislation.)

By Clark Goldenrod

¹ Minnesota Budget Project, [Budget decisions in the 2002 Legislative Session: State's budget balanced in the short term, but large deficit remains for next biennium](#), June 2002.

² Minnesota Management and Budget, [February Budget and Economic Forecast](#), February 2022.