



Good News, But Need for Caution: Inside the February 2016 Economic Forecast

The *February 2016 Economic Forecast* brought some fairly good news. The state of Minnesota continues to be in positive budget territory, with a \$900 million positive balance for the current two-year budget cycle, FY 2016-17.¹ Minnesota also has a projected \$1.2 billion positive balance for the upcoming budget cycle, FY 2018-19. The state's economy is improving and performing better than the U.S. economy on some measures, but economic growth is expected to be less robust than previous projections.

In the 2016 Legislative Session, policymakers will choose how to use this positive balance. Minnesota's economy is improving, but the recovery has been uneven. The positive balances projected in the forecast give policymakers the ability to make strategic tax and budget choices so that more Minnesotans can get and keep quality jobs and access ladders into the middle class. However, lawmakers must avoid passing large and unsustainable tax cuts that would prevent building a broader and more durable prosperity in Minnesota.

Minnesota Forecast to Have Positive Balances

The forecast shows that Minnesota's economy is still doing well. As of December, unemployment in Minnesota was 3.5 percent, the lowest among states with a major metro area and the lowest it's been since the early 2000s. The state has seen increasing job growth and a tightening labor market, which has brought continued economic growth.

Minnesota's economic growth contributes to the forecast's projected \$900 million positive balance in FY 2016-17 and \$1.2 billion structural balance in FY 2018-19. However, the FY 2018-19 figures do not include the \$1.7 billion estimated cost if funding for current services were to keep up with the cost of inflation.

It is important to note that the projected structural balance for the two years of the FY 2018-19 biennium is less on an annual basis than the \$900 million surplus for the remainder of FY 2016-17. Any ongoing spending or tax cuts enacted in FY 2017 will likely cost two times as much, or more, in FY 2018-19. To the extent that policymakers use some of the FY 2016-17 surplus for permanent spending or tax changes, they should keep a close eye on the budgetary effect in the next biennium to make sure they do not create a future deficit.

The state's economic forecasts are critical tools that policymakers and the public use to measure the state's fiscal health and form the baseline against which spending and tax proposals are assessed. Minnesota Management and Budget prepares forecasts each November and February. State, national and global economic trends are used to estimate Minnesota's future revenues and expenditures under current laws on taxes and spending.

For more than a decade now, the official forecast figures have left out the impact of inflation in the projections of future spending. Failing to include the impact of inflation can lead policymakers to make tax and budget decisions that are not sustainable. The state's Council of Economic Advisors has recommended

Forecast Numbers at a Glance

- Minnesota has a projected \$900 million positive balance for FY 2016-17.
- Minnesota has a projected \$1.2 billion positive balance for FY 2018-19, which does not include the \$1.7 billion impact of inflation on expenditures.

that Minnesota include inflation in its planning estimates so that they provide a more useful guide to policymaking.

Economic Growth Expected, but Not as Strong as Previous Projections

While it's good news the national economy is growing, it is expected to grow more slowly than was anticipated in the November forecast. National annual growth rates are expected between 2.4 percent and 2.8 percent through 2019.

Like any prediction of the future, this economic forecast is subject to risk. Global Insight assigns a 65 percent probability to their baseline economic forecast. They assign a 20 percent probability to their more pessimistic scenario in which a short recession is triggered by weaker international markets and the U.S. construction sector, and a 15 percent probability to an optimistic scenario in which higher productivity, foreign growth and household formation strengthen the U.S. economy.

Lower Spending Contributes to Positive Balance

The \$900 million projected surplus in FY 2016-17 is \$306 million smaller than was projected in November. Revenues for FY 2016-17 are projected to come in \$427 million lower than expected in November due to the economy's lower projected growth. However, a \$129 million reduction in spending projections makes up in part for the lower revenues.

The primary source of the lower state spending is in Health and Human Services, mostly due to higher federal funding for Children's Health Insurance Program (CHIP) in Medical Assistance. This lower spending also more than offsets some higher expenses in E-12 Education due partially to special education costs.

Policymakers Should Prioritize Broad, Durable Prosperity, Not Unsustainable Tax Cuts

Given that the economic recovery has not yet taken a firm hold across the state, policymakers should prioritize investments in broader prosperity. In contrast, spending too much of the surplus on large, unsustainable tax cuts would make it impossible to invest today and would threaten the state's economic future.

Policy choices that enable more Minnesotans to succeed in the workplace should be priorities for both tax and budget decisions this year. Enacting tax policies that support Minnesotans' work efforts should start with expanding the Minnesota Working Family Tax Credit, which encourages and supports work, makes Minnesota's taxes fairer, helps working people all across the state meet their basic needs, and gets children off to a stronger start.

Policymakers should also enact policies that allow more Minnesota families to afford child care. The high cost of care can leave Minnesota workers on the sidelines. Increased funding for Basic Sliding Fee Child Care Assistance, combined with a targeted expansion of the Child and Dependent Care Tax Credit to better reflect today's costs of child care, would mean more Minnesota parents could succeed in the workforce while their children benefit from stable, reliable care that meets their needs.

What is unlikely to bring about a broader and more durable prosperity would be to enact large and unsustainable tax cuts. The smaller surplus figures in future years measured in the February forecast clearly show the danger of enacting tax cuts that grow over time. That is illustrated by last year's House tax bill, which contains a number of "phased in" tax cuts that grow significantly larger over five or more years. For example, expanding the state's Social Security exemption would have cost \$641 million in FY 2018-19, and repealing the statewide property tax would have cost \$1 billion. Putting those figures up against the \$1.2

billion surplus projected for FY 2018-19 in the February forecast demonstrates that these cuts would have been unsustainable.

The February forecast brought our state some good news, but policymakers would be wise not to threaten our future growth with unsustainable tax decisions. Instead they should make strategic investments that ensure Minnesota workers reach their full potential and ultimately strengthen the state's economic future.

By Clark Biegler

¹ Data in this analysis come from Minnesota Management and Budget, [February 2016 Budget and Economic Forecast](#), February 2016.