

## September 2020

### Budget Reserve Recommendation

To adequately manage the underlying risks in Minnesota’s general fund tax revenue system, Minnesota Management and Budget (MMB), in accordance with Minnesota Statutes section 16A.152 subd.8, recommends a budget reserve target of 4.8 percent<sup>1</sup> of the current biennium’s general fund non-dedicated revenues, or a \$2.143 billion budget reserve for the 2020-21 biennium.<sup>2</sup> At the end of the 2020 regular and special legislative sessions, Minnesota’s projected FY 2020-21 budget reserve was \$2.377 billion.

	<u>Current \$ Level</u>
Current Budget Reserve	\$2.377 billion
MMB FY2020-21 Recommendation	\$2.143 billion
Difference	\$0.234 billion

The recommended reserve percentage is based on MMB’s assessment of volatility in Minnesota’s revenue system. We examine the variability over time of the state’s major tax bases and changes in the composition of tax revenues. The recommended reserve percentage assumes the budget is structurally balanced through the remainder of the biennium, and policymakers desire a 95 percent level of confidence that a biennial deficit generated by revenue volatility will not exceed the budget reserve.

We have reviewed the revenue volatility model and updated it to reflect an additional year of data. Note that the update does not include the impact of the 2020 economic downturn on tax base volatility, because data reflecting that impact is not yet available. The result of our analysis is an estimated degree of revenue system volatility that is slightly lower than what we found last year, driven by declining volatility in the bases of the individual income tax and general sales taxes. Consequently, we have decreased the recommended percentage of revenues to 4.8 percent from the 4.9 percent recommendation in our September 2019 report.

The recommended reserve level of \$2.143 billion is derived by multiplying the recommended reserve percentage by the latest estimate of current biennium general fund non-dedicated revenue. In May, we reduced our revenue projection from the prior forecast. Together with the lower recommended percentage, the lower revenue projection reduces the recommended size of the reserve from the prior level.

The target is for the budget reserve account alone. Minnesota also has a cash flow account, which is intended to offset potential cash shortages caused by a mismatch between monthly revenue collections and spending. The cash flow account is currently funded at \$350 million.

<sup>1</sup> Rounded to the nearest tenth of a percent.

<sup>2</sup> Based on end of 2020 regular and special legislative sessions *General Fund Balance Analysis*.