



Minnesota Department of Finance

January 2002

State Revenues on Forecast in November and December

Net general fund revenues totaled \$2.072 billion during November and December, \$2.8 million (0.1 percent), more than forecast. A \$46 million shortfall in individual income tax receipts and a \$13 million shortfall in corporate tax receipts were offset by positive variances in the sales tax, the motor vehicle sales tax and other revenues. Withholding tax receipts and gross sales tax revenues are currently less than collections through the end of the first half of fiscal 2001.

Summary of Tax Receipts: November – December 2001

	<u>Forecast</u>	<u>Actual</u>	<u>Variance</u>	<u>Percent</u>
	-----	(\$ in millions)	-----	
Income	881.8	835.4	(46.4)	(5.3)
Sales	592.5	617.3	24.8	4.2
Corporate	88.7	75.5	(13.2)	(14.9)
Motor Vehicles	61.8	77.9	16.1	26.0
Other	<u>444.5</u>	<u>466.0</u>	<u>21.5</u>	<u>4.8</u>
Total	2,069.3	2,072.1	2.8	0.1

November-December revenue variances are often misleading since they may reflect differences in the timing of filing and processing, not changes in the economy. That is particularly evident this year when total receipts show a small positive variance while receipts most closely linked to current measures of economic activity -- individual withholding and gross sales tax receipts -- are both below forecast. (see p.4)

Sales tax refunds were substantially less than anticipated, but those gains may well reflect only timing of filing and processing. The variance for individual estimated tax payments was set at zero because system conversion prevented processing of those payments during the last week of December. Sales taxes collected by retailers during the December portion of the Christmas shopping season will not be remitted until January. Year-to-date collections through January will provide a better measure of how well Minnesota's revenues are tracking November's estimates. That data will be used in preparing February's revenue forecast

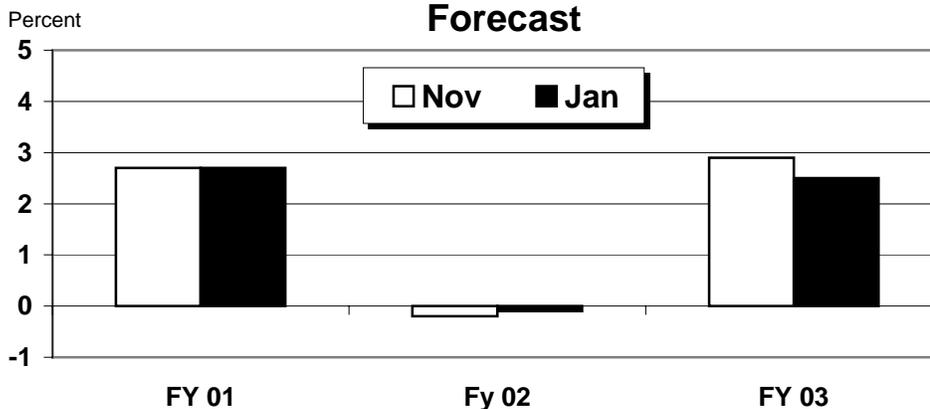
The Worst of the Recession Appears Over

Even though the U.S. unemployment rate has risen to 5.8 percent, December payroll employment is down by 124,000, and the 2001 Christmas retail season can only be described as poor, there are signs that an economic recovery is on the way. Recent improvements in consumer confidence and in the purchasing managers' outlook as well as strong housing starts and low energy prices offer support to those who believe this recession will soon be over. Modest growth in consumer spending when combined with an improving inventory outlook and the federal spending increases already in the pipeline should be sufficient to create real GDP growth by late spring, just as DRI anticipated in November's Control.

Few expect the boom to resume. There is simply not enough pent-up demand to create the surge in production that typically follows a recession. The super-charged growth rates observed in the late 1990's are now recognized for what they were—the best economy in a generation—and not the start of a “new economy” where business cycles were obsolete and productivity growth rates of 4 percent were expected to be the norm.

January's Control forecast from DRI-WEFA, Minnesota's national economic consultant, continues to be consistent with the national consensus forecast of a spring recovery. DRI now expects the economy will decline at a 0.2 per cent annual rate in the first quarter, then begin to grow. While DRI projects a 0.1 percent decline in real GDP in FY 2002, the economy is expected to be growing at a 4.0 percent annual rate at the close of calendar 2002. FY 2003 growth is now projected at 2.5 percent, down slightly from November's forecast of 2.9 percent growth.

Weaker Real GDP Growth for 2003 in January Forecast



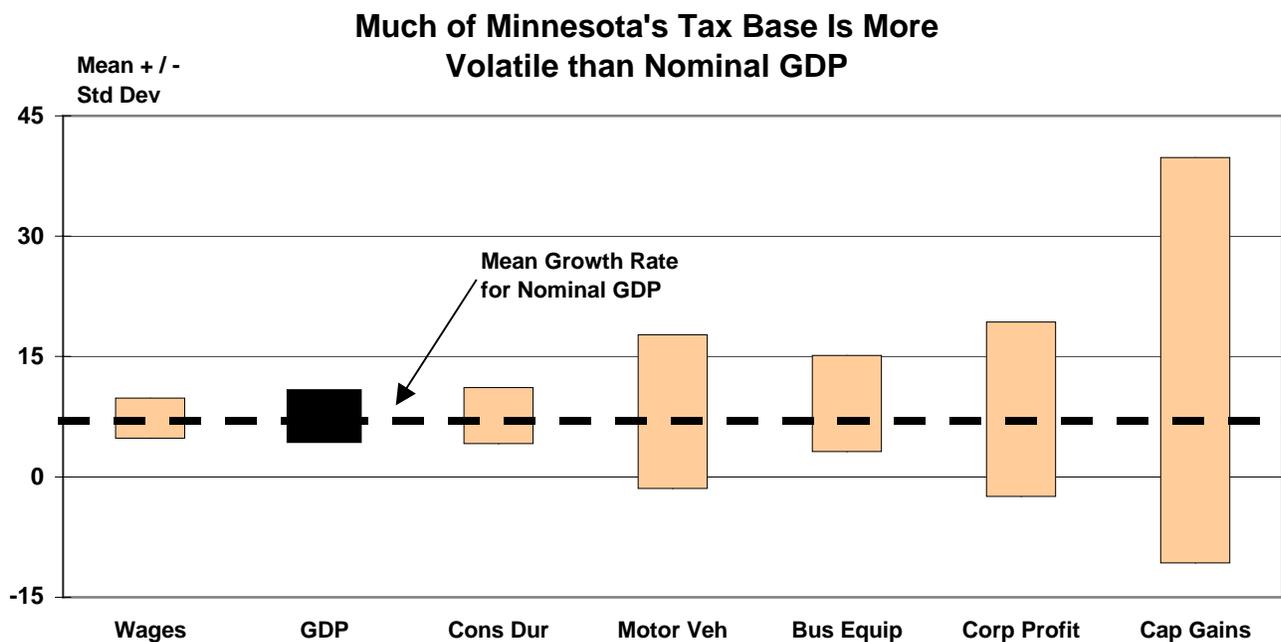
DRI assigns a 15 percent probability to a more optimistic scenario in which the economy rebounds early and posts four strong quarters of growth in calendar 2002. A more pessimistic scenario in which real GDP declines throughout fiscal 2002 is given a probability of 30 percent. The control was assigned a probability of 55 percent, the same as in November.

Volatility of Tax System Helps Explain Shift from Surplus to Shortfall

Minnesota’s tax system must be fair and easy to understand and administer. It is also important to minimize the distortions it causes in individual consumption and investment decisions. And, tax receipts should be relatively stable so that state government finances do not jump from large surplus to deficit and then back again when the economic outlook changes. Unfortunately those tax policy goals often conflict. Fair taxes do not necessarily minimize their impact on individual decisions, and tax systems generally thought fair often can be very volatile.

A revenue system which relies more heavily on taxing corporate profits, for example, will be more unstable than one which receives a smaller percentage of its revenue from the corporate income tax, since corporate profits fluctuate more than the economy in general. Similarly, Minnesota’s sales tax would be more stable if it were restricted to necessities such as food and prescription drugs, while luxury items such as jewelry and fine wines were exempt. The more progressive the income tax, the greater the volatility, and as capital gains have increased as a proportion of the income tax base the volatility of the income tax has increased.

One measure of the volatility of portions of the tax base is the standard deviation of its growth rate. The graph below compares the mean growth rate plus one standard deviation of the growth rate for several components of Minnesota’s tax base with that for nominal GDP, using data from 1973 through 2000. The observed growth rate for any item would be expected to be within one standard deviation of the mean 68 percent of the time. For example, just over two-thirds of the time the growth rate for nominal GDP is within a band of 2.7 percent on either side of the mean growth rate of 7.6 percent. The dashed line on the graph shows the mean growth rate for nominal GDP.



Comparison of Actual and Estimated Non-Restricted Revenues

(\$ in thousands)

	<u>December Year-to-Date</u>			<u>December – November, 2001</u>		
	<u>Forecast</u>	<u>Actual</u>	<u>Variance</u>	<u>Forecast</u>	<u>Actual</u>	<u>Variance</u>
Four Major Revenues:	Revenues	Revenues	Act-Fcst	Revenues	Revenues	Act-Fcst
Individual Income Tax						
Withholding	2,383,900	2,357,974	-25,926	837,882	811,956	-25,926
Declarations	276,416	276,416	0	42,645	42,645	0
Miscellaneous	95,559	84,344	-11,215	30,094	18,880	-11,215
Gross	2,755,875	2,718,734	-37,141	910,622	873,481	-37,141
Refund	71,672	80,972	9,300	28,799	38,099	9,300
Net	2,684,203	2,637,762	-46,441	881,823	835,382	-46,441
Corporate & Bank Excise						
Declarations	292,100	283,462	-8,638	136,801	128,163	-8,638
Miscellaneous	57,900	56,860	-1,040	12,014	10,974	-1,040
Gross	350,000	340,323	-9,677	148,815	139,138	-9,677
Refund	79,000	82,537	3,537	60,055	63,592	3,537
Net	271,000	257,786	-13,214	88,760	75,546	-13,214
Sales Tax						
Gross	1,897,160	1,895,252	-1,908	650,176	648,268	-1,908
Refunds	131,024	104,284	-26,740	57,726	30,986	-26,740
Net	1,766,136	1,790,967	24,831	592,451	617,282	24,831
Motor Vehicle Sales						
	205,830	221,890	16,061	61,811	77,872	16,061
Other Revenues:						
Inherit/Gift/Estate	28,814	33,606	4,792	10,432	15,224	4,792
Liquor/Wine/Beer	27,001	27,293	292	10,316	10,608	292
Cigarette & Tobacco/Cont Sub	81,454	82,885	1,431	26,013	27,444	1,431
Deed and Mortgage	102,403	111,186	8,782	31,875	40,657	8,782
Insurance Gross Earnings	56,617	57,436	820	53,900	54,720	820
Lawful Gambling	24,460	23,662	-798	8,995	8,197	-798
Health Care Surcharge	60,603	61,839	1,235	23,261	24,496	1,235
Other Taxes	627	566	-60	260	200	-60
DHS RTC Collections	26,329	36,972	10,643	8,484	19,127	10,643
Income Tax Reciprocity	47,900	47,899	-1	47,900	47,899	-1
Investment Income	51,195	47,628	-3,568	18,161	14,593	-3,568
Tobacco Settlement	151,545	147,734	-3,811	151,545	147,734	-3,811
Departmental Earnings	98,594	104,371	5,777	38,809	44,586	5,777
Lottery Revenues	16,814	16,855	41	4,012	4,053	41
2000 Sales Tax Rebates	-32	-32	0	0	0	0
2001 Sales Tax Rebates	9,887	7,951	-1,936	0	-1,936	-1,936
Revenues yet to be Allocated	2,749	2,950	201	0	201	201
Residual Revenues Less Refunds	33,897	35,093	1,196	12,497	13,693	1,196
Other Subtotal	820,857	845,892	25,035	446,460	471,496	25,035
Other Refunds	9,209	12,705	3,496	1,991	5,487	3,496
Other Net	811,648	833,187	21,540	444,469	466,009	21,540
Total Gross	6,029,721	6,022,090	-7,631	2,217,885	2,210,254	-7,631
Total Refunds	290,905	280,498	-10,407	148,570	138,163	-10,407
Total Net	5,738,816	5,741,593	2,776	2,069,315	2,072,091	2,776