

Excitement about state surplus is misguided

Department of Finance projections don't account for inflation

At first blush, the November state budget forecast appears to present a combined \$2.17 billion surplus for the 2006-2007 and 2008-2009 biennia. While it certainly is a relief to be talking about black ink as opposed to red ink, a more in depth analysis shows that the picture is not nearly as bright as the headlines lead us to believe.

Current Biennium: Fiscal Years 2006-2007

The anticipated surplus for the current biennium, which will end June 30, 2007, is \$1.04 billion. Just over 10% of the projected surplus is a result of reductions in state spending, and the remaining portion is attributable to a fund balance left after the 2006 legislative session and higher-than-projected tax receipts. In particular, corporate income tax receipts are \$330 million (or 18%) higher than anticipated, while individual income taxes are \$503 million (or 3.7%) over projections for the current biennium. It is important to note that the surplus for the current biennium does not represent on-going available funding. Rather, these funds are largely available on a one-time basis.

Coming Biennium: Fiscal Years 2008-2009

The protocol used by the Department of Finance is to project surpluses or deficits assuming growth in state revenues, but no inflation in state spending. This method may be better suited to rhetorical purposes than planning for capital or programmatic investments. The impact of

this practice can be observed using Department of Finance figures for the next biennium.

As the chart below shows, accounting for inflation in the 2008-09 biennium reduces the projected \$1 billion surplus to just \$32 million. The Department of Finance is projecting inflation to run 2.1 percent in FY 2008 and 1.8 percent in FY 2009. Using even these modest projections for inflation, the projected budget surplus is virtually eliminated.

What Does the Current Year's Surplus Mean for Public Education?

The first prospective answer is that with a surplus exceeding a threshold of one-half of one percent of general fund revenues (and it appears this surplus will meet that test), the Governor is required by law to submit a plan for tax rebates for the surplus. The law does not require the rebate – but does mandate that the Governor prepare such a plan for consideration by the Legislature.

When is a surplus not really a surplus?

According to the Department of Education, the state would need to spend an additional \$138.2 million in FY 07 to fully fund its own special education funding formula. School districts are receiving only about 79 percent of what they should receive under the state special education funding formula. And that is just the tip of the iceberg. The Department of Education further shows that in FY 2007, Minnesota school districts will reallocate \$518

million in funds meant for regular instruction to comply with federal and state special education mandates. Should state policymakers be talking about rebates when the State is not meeting its current funding obligations?

As previously discussed, the surplus for the 2008-09 biennium is not really a surplus at all after accounting for inflation. While the sound of \$2.17 billion is attractive, the reality is that this legislative session will continue to offer challenges for state policymakers and advocates of public education.

(figures in millions)	FY2008	FY2009
Revenues	\$16,427	\$17,091
Spending	\$16,083	\$16,413
Surplus (Without Inflation)	\$344	\$678
Dept. of Finance Inflation Projection	2.1%	1.8%
Less: Impact of Inflation	\$340	\$650
Inflation-Adjusted Surplus	\$4	\$28

View the entire budget forecast at
<http://www.finance.state.mn.us/ffeu/forecasts/2006nov/2006nov.pdf>