

MINUTES

**MONTANA SENATE
59th LEGISLATURE - REGULAR SESSION**

**COMMITTEE ON FINANCE AND CLAIMS
HOUSE APPROPRIATIONS COMMITTEE
JOINT MEETING**

Call to Order: By **CHAIRMAN MIKE COONEY**, on January 3, 2005 at
8:00 A.M., in Room 303 Capitol.

ROLL CALL

Members Present:

Sen. Mike Cooney, Chairman (D)
Sen. Keith Bales (R)
Sen. Gregory D. Barkus (R)
Sen. John Brueggeman (R)
Sen. John Cobb (R)
Sen. John Esp (R)
Sen. Steven Gallus (D)
Sen. Ken (Kim) Hansen (D)
Sen. Bob Hawks (D)
Sen. Bob Keenan (R)
Sen. Rick Laible (R)
Sen. Lane L. Larson (D)
Sen. Greg Lind (D)
Sen. Don Ryan (D)
Sen. Trudi Schmidt (D)
Sen. Corey Stapleton (R)
Sen. Jon Tester (D)
Sen. Dan Weinberg (D)
Sen. Carol Williams (D)

Members Excused: None.

Members Absent: None.

Members Present:

Rep. Rosalie Buzzas (D) Vice-Chair
Rep. Tim Callahan (D)
Rep. Eve Franklin (D)
Rep. William 'Bill' Glaser (R)
Rep. Ray Hawk (R)
Rep. Verdell Jackson (R)
Rep. Joey Jayne (D)

Rep. Carol Juneau (D)
Rep. Christine Kaufmann (D)
Rep. Gary Matthews (D)
Rep. Walter McNutt (R)
Rep. Penny Morgan (R)
Rep. John L. Musgrove (D)
Rep. Rick Ripley (R)
Rep. Jon Sesso (D)
Rep. John Sinrud (R) Vice-Chair
Rep. Janna Taylor (R)
Rep. Jack Wells (R)
Rep. John E. Witt (R) Chairman

Members Excused: None.

Members Absent: None.

Staff Present: Prudence Gildroy, Committee Secretary
Taryn Purdy, Legislative Branch

Please Note. These are summary minutes. Testimony and discussion are paraphrased and condensed.

Committee Business Summary:

Hearing & Date Posted:

Executive Action:

The joint meeting was called to order by **CHAIRMAN MIKE COONEY**. He introduced **Clayton Schenck, Legislative Fiscal Analyst**. **Mr. Schenck** welcomed new and returning legislators to Helena. He acknowledged and introduced the **Legislative Fiscal Division** staff. The budget office had completed their work and he acknowledged the work of **Chuck Swysgood, Budget Director**. He welcomed **David Ewer**, the new **Budget Director**. **Mr. Schenk** indicated this committee would meet the next day to set the ground rules for the subcommittee budget decision process. These were guidelines to follow to assure consistency in subcommittee work. Subcommittees would attend additional training sessions during the week.

Mr. Schenck explained how to use the *Legislative Budget Analysis, 2007 Biennium* published in four volumes.

EXHIBIT(fcs01a01)

Agency budgets included the base budget, present law base and new proposals. He mentioned other fiscal issues such as the K-12

lawsuit, other litigation issues and the tobacco settlement funds.

Revenue growth was expected to be moderate through the 2007 biennium and when coupled with a large beginning general fund balance, the 2005 Legislature would face an unprecedented surplus as it began to prioritize state spending. Montana generally escaped the economic recession of the early 2000s, but state revenues dropped off sharply. Revenues were expected to slowly recover in the 2005 and 2007 biennia. The recommendation was for the surplus to be used for one-time initiatives. The cost of governmental services would continue to increase, even with a moderate rate of inflation and a slow growth rate in total population. School enrollments were declining, yet costs to support schools continued to increase especially in view of the inflation factors put in last session and the court decision that schools were underfunded. Human services costs would continue to escalate because of greater caseload demands, higher medical costs, and a higher state Medicaid match rate due to improved per capita incomes. Corrections population growth projections suggested significant expenditure growth pressures. **Mr. Schenck** cautioned that income tax growth would be moderate during the transition to SB 407 (tax reform) and the full effects of the SB 407 tax reduction will not be fully felt until FY 2008, when the increase in the capital gains credit to two percent becomes effective for a full fiscal year. Bonus depreciation provisions will not add to corporation tax liabilities past the 2007 biennium. He noted the uncertainty surrounding the price of oil. The situation in Iraq and terrorism issues could have an impact and drilling activity in Montana could slow down if oil prices drop. Additionally, the long-term stability of the general fund was cloudy.

With regard to the general fund, **Mr. Schenck** cited low interest rates as a contributor to the budget crisis in 2003. By June of 2004, it was apparent that key revenue sources would exceed expectations. Three income sources were primarily responsible for the reversal including oil and natural gas taxes, individual income taxes, corporate income taxes. The increase in the Individual Income Tax revenue was due to federal tax reform. On the expenditure side, a federal grant was used to pay for fires. There was a \$23 million one-time reduction in the federal match rate for Medicaid. That left a projected ending fund balance at the end of the current biennium in FY 2005 of \$195 million.

The **Revenue and Transportation Interim Committee** set the revenue estimate in November. There was a difference between the Legislative and Executive projections. The state general fund is the primary account that funds a significant portion of the general operations of state government and is often referred to

as the state's checking account. This account has grown from slightly less than \$700 million in FY 1990 to almost \$1.3 billion in FY 2004, or approximately five percent annually. In the 2007 biennium, over 60 percent of total general fund revenues comes from income and property taxes. Total revenues to the account were projected to be nearly \$2.9 billion, an increase of \$132.1 million or nearly five percent from the 2005 biennium. Total general fund disbursements represented approximately 37 percent of all state expenditures in the general, state special, federal special, and selected proprietary fund types. In the executive budget, for present law only, education consumed 48 percent, human services 21 percent, and corrections eight percent of general fund revenues. **{Tape: 1; Side: B} Mr. Schenck** advised the report came out before the Schweitzer budget and there would be minor adjustments. Based on the revenue estimates as adopted by the **Revenue and Transportation Interim Committee**, there were sufficient revenues to support the executive present law budget recommendations and new proposals including the Executives recommended ending fund reserve of \$162.9 million. If the total executive budget were funded as requested, the ending balance would be \$181 million. The Schweitzer budget recommended an \$87 million ending fund balance. There were \$112 million in new initiatives and there would be other legislative priorities. Spending pressures to be addressed included the K-12 court decision that schools are underfunded and employee union demands for employee pay and benefit increases. Much of the surplus of \$293.3 million would have to be used for one-time initiatives as opposed to expanding services if a structural balance in the general fund is to be maintained.

Mr. Schenck encouraged committee members to review the general fund status on page 43 of volume 1.

He referred to a general fund comparison and an all funds comparison of the 2005 biennium versus the Executive Budget 2007 biennium. The executive is recommending a 2007 biennium budget that includes an additional \$273 million general fund, an 11 percent increase over the 2005 biennium. Total requested increases amounted to \$692 million, a ten percent increase. The best way to compare the growth in the budget is to compare biennium to biennium. This budget was based on the last fiscal year, 2004. Spending proposals were presented as changes to that base. The big items were Medicaid Matching Rate of \$55 million, Human Services Caseloads and Service Changes of \$38 million, State Employee Pay Plan of almost \$32 million, Maintenance of State Buildings of \$30 million, Corrections Population and Overtime \$24 million and paying off the IRIS Computer System and the Crow Tribe Settlement for \$23 million. Human Services programs were over 25 percent of the total, followed by provision of a state employee pay plan and maintenance of state facilities.

If funds to address rising populations in the state institutions were added, the total would increase to over half of the proposed expenditure increase. The executive proposed to spend \$2.5 billion general fund and \$6.9 billion total funds in HB 2 over the 2007 biennium. K-12 education, human services, higher education and corrections would consume 86.9 percent of the general fund budget in the 2007 biennium compared to 88.7 percent in the 2005 biennium. Human services, transportation, and environmental functions all have significant state special and/or federal funding. Human services and "all other government", which includes transportation and environmental functions, were 70.5 percent of the total, compared to 69.1 percent in the 2005 biennium. The largest areas of increase in general fund were human services and all other government. The budget included over \$42 million in one-time expenditures for payoff of debt and settlement agreements, and various one-time computer and other equipment purchases. Several priorities were evidenced by the spending proposals of Governor Martz: caseload increases in human services; anticipated increases in K-12 and higher education; a statutory inflationary increase for K-12 Base Aid costs and increases in a number of other programs; addressing correctional population growth; economic development; etc. He referred to charts breaking out present law and new initiatives. The Governor proposed just over \$40 million in general fund new initiatives in HB 2, and an additional \$72 million outside of HB 2. Long range building was \$30 million and the state employee pay plan was \$31.6 million. There was a summary of executive proposals by program area. The Schweitzer budget reduced revenue enhancements to \$94 million. Both the Schweitzer budget and the Martz budget recommended leaving at least \$80 million in reserve. The Schweitzer budget had some new revenue enhancements including adding new auditors to the Department of Revenue and continuing the court fee adjustment that was intended to cover the automation of the court system. Expenditure increases included K-12 education, economic development, human services, etc. Another part of the Schweitzer budget was the creation of an economic growth trust fund.

Funding for schools is the number one fiscal challenge in view of a district court decision in April of 2004. The state is directed by the court to find a solution by October, 2005. The Martz budget did not address the court's decision. The Governor's proposal included \$428 million general fund for increases to local education activities. Funding cannot be determined until the legislature defines "quality" education and develops a funding methodology based on educationally relevant factors.

Health care cost inflation and caseload continue to be major contributors to greater than average growth in health care

services budgets. With medical cost growth ahead of normal inflation and prescription drug increases, there is no relief in sight. Growing caseloads and an aging population and reductions in the Medicaid matching rate are additional factors that could result in a supplemental request or further reductions in health care services. The executive budget maintains current service levels and the Schweitzer budget provides increases beyond that. It provides \$83 million general fund, \$36.8 million state special and \$214 million federal funds. Of the general fund increase, \$32 million funds service and caseload increases and \$55 million addresses the changes in the federal match rate.

Offender population is an issue the Legislature has dealt with through the years. Controlling expenditures in this area can go beyond simply funding incarceration or supervision programs. It requires legislators to look at sentencing criteria, alternative correction programs, ways to rehabilitate offenders more quickly, and ways to keep people out of the criminal justice system. The executive proposal provides for an increase of \$24 million or 11.5 percent when compared to the 2005 biennium. More than a four percent growth in population is anticipated and added probation and parole officers and an increase in private contract beds are included. All the secure facilities, with the exception of the private prison in Shelby, will be well above their operational capacities in the next biennium. The Shelby facility would be expanded to meet future growth.

Higher education has been increasingly funded with increased tuition. The Governor's proposal attempts to minimize tuition increases. The Board of Regents' projections do not agree with those of the executive.

State employee pay and benefits will be an issue. The executive proposal provides for a three percent increase each year of the biennium plus increases in health insurance contributions.

Public employee retirement funds have suffered from lower interest rates and equity market losses. Reduced investment earnings resulted in estimated unfunded liabilities. The Martz budget proposed to temporarily increase the employer contributions and various plan changes that would impact benefit calculations for future employees. They propose \$7.2 million for increased employer contributions. This was expected to address the current unfunded liabilities. There is the potential to erase the liability with stronger investment return. The state has no legal obligation to address the unfunded liability in this session and the question is more of an assessment of responsible fiscal management, advised **Mr. Schenck**.

Management of capital assets and the repair and maintenance of state facilities was cited as another challenge. Deferred maintenance exposure was estimated to exceed \$100 million. The Legislature may want to request a more accurate estimate, a long-range plan for addressing deferred maintenance and an assessment of risks associated with deferred maintenance.

Public defender services was the topic of a subcommittee of the legislative Law and Justice Interim Committee during the 2003-2004 interim. Partially in response to a pending lawsuit, the subcommittee drafted legislation to create a statewide public defender system. The current estimate of the additional cost is \$6 million. **{Tape: 2; Side: A}**

Pending litigation and subsequent court rulings could impact state finances, **Mr. Schenck** reported. Supplementals for the next biennium are not budgeted by the Legislature and not accounted for in the ending fund balance. The state assumption of district courts has been a difficult issue. The executive budget includes \$7.8 million less than the Judiciary submission. One difficulty has been accountability for variable costs.

Another issue was the potential loss of federal funds. The long-term stability of the general fund needs to be considered. Aging population and the need for services is a factor. **Mr. Schenck** warned against relying on ongoing oil and gas production as was done with capital gains. Economic development efforts need measurable goals and objectives and accountability measures. The structural balance will continue to be a concern. The executive budget was structurally balanced. The adequacy of the ending fund balance reserve will need to be monitored as the session progresses. Both the Martz and Schweitzer budgets recommend leaving at least an \$80 million ending fund balance. National experts consider a three percent reserve to be a minimum. Montana is one of three states without a rainy day fund, according to **Mr. Schenck**. Economic uncertainties can undermine revenue forecasting efforts. Finally, **Mr. Schenck** noted that general fund spending without HB 2 appropriations occurs and the challenge is for the Legislature to minimize the occurrence of spending that does not require regular scrutiny by the Legislature.

Mr. Schenck advised the 2007 biennial executive budget exceeds the statutory limitation by \$12.6 million. The limitation was passed in 1991 by the Legislature. The statute limits the increase in biennial appropriations from the general fund, state special revenues, and the cash portion of capital projects fund to the growth in Montana's personal income. The two exceptions are if the Governor declares an emergency or by a 2/3 vote of the

members of each house to approve a bill stating the amount to be spent in excess of the spending limitation. Certain appropriations are excluded from the calculations. The executive proposed paying off the POINTS system in the current biennium with a supplemental. The limitation will be an issue in the current session.

Mr. Schenck encouraged committee members to use the table of contents and use the staff as a resource.

Questions from the Committee:

SEN. JOHN COBB inquired about the new cost of the Public Defender Program to the general fund. **Mr. Schenck** advised the additional cost in this transitional biennium would be about \$3.5 million and \$6 million in ongoing cost in the next full biennium. **SEN. COBB** wondered if that is already in the budget. **Mr. Schenck** replied it is not in the budget.

SEN. JOHN ESP noted in the Martz budget there is a proposed figure for the Judiciary and district court assumption that **Mr. Schenck** said was below the request of the agency and he wondered how much. **Mr. Schenck** advised \$7.8 million was requested. The executive funded a significant increase. **SEN. ESP** wondered if the \$7.8 million was prior to public defender costs. **Harry Freebourn, Legislative Fiscal Division**, advised most of the \$7.8 million was for the Information Technology Program that was excluded by the Governor's budget. The indigent defense costs were not included. **Mr. Freebourn** explained in reply to further questioning, that the dollars needed to fund a statewide public defender system are not in the Governor's budget nor were they in the Judiciary's.

CHAIRMAN COONEY asked about the Public Employees Retirement Fund and if there were actual dollars in the budget for the increased employer contribution or if agencies would pick that up in this current biennium. **Mr. Schenck** advised there are actual dollars in the budget. **CHAIRMAN COONEY** inquired about the current breakdown between student tuition versus state support. **Alan Peura, Legislative Fiscal Division**, advised the proportion of state funding to tuition has been decreasing while tuition has been increasing. In the Martz budget, state funding is 40%. If this is adopted, tuition increases should remain about two percent per year. The Board of Regents' numbers differ. He advised he had not yet analyzed the impacts of the Schweitzer budget changes. **SEN. COONEY** wondered when that information would be provided and **Mr. Peura** assured him it would be available by the next morning.

David Ewer, Director, Office of Budget and Program Planning (OBPP), thanked **Mr. Schenck** and his staff. He handed out the Governor-Elect's Budget for FY 2006-2007.

EXHIBIT (fcs01a02)

By law they have until January 7 to present the budget and will have additional changes. He expressed concern about ongoing money versus one-time money. Oil and natural gas are volatile revenue sources. Tobacco revenue will go down if we get prevention right. The budget includes a proposal for spending priorities for tobacco money and for sustainability. He agreed with the challenges presented by **Mr. Schenck**. His biggest worry was the potential for sharp cuts in the federal budget. One out of every two dollars that the Legislature authorizes comes from the federal government. There are programs that are matched better than three to one. He indicated they started with the Martz budget as a base. Under the law, the Executive is required to submit a budget that funds present law. There is a 3% inflation increase for education and public employee pay increases. There are many uses of one-time money for one-time expenditures. They've agreed with essentially all of them. He was not sure about the necessity for the set aside for potential property tax settlements. The Schweitzer budget put \$30 million into ongoing education with half to K-12 and half to higher ed. He believed they would be able to meet or at least satisfy some element of quality. There is the inflationary adjustment of 3%. The Schweitzer budget addresses the gap between the elementary and high school formula. They increased special education funding. They anticipate no need to prorate school bond efforts. The Schweitzer budget was thought to fully fund the building part of equalization. There was an additional \$1 million to OPI for Indian cultural integrity and for technology assistance to measure quality. With respect to higher education, they addressed needs-based education and increased monies available for scholarships. Economic development and job retention efforts would be funded adequately to put a plan into action. Energy assistance for low income was fully funded. There is \$8.5 million in the budget for a potential settlement for the Highway Patrol. It is proposed to fully fund a tech for the forensics lab. The Martz budget did not address the tobacco settlement. Before the passage of I-149, SB 485 diverted tobacco funds. The Schweitzer budget proposed a trust for prevention, projects would be moved back to the general fund, and funding is proposed to insure sustainability.

The meeting was recessed until 8:00 a.m. on January 4, 2005.

ADJOURNMENT

Adjournment: 10:40 A.M.

SEN. MIKE COONEY, Chairman

Prudence Gildroy, Secretary

MC/PG

Additional Exhibits:

EXHIBIT ([fcs01aad0.PDF](#))