EXHIBIT #5
DATE 1/21/09
HB 13

The following is an excerpt from the *Legislative Budget Analysis 2011 Biennium, Volume 1 - Statewide Perspectives*. It is provided to the committee for consideration with HB 13, the pay plan bill, to highlight issues identified in the Legislative Fiscal Division analysis.

PAY PLAN - ISSUES

The Governor has allocated $10.4 million in FY 2010 and $8.3 million in FY 2011 (biennial $18.7 million) general fund for a pay plan in the 2010 biennium. (Please note that the total is for the pay plan received December 18, and does not tie precisely to the Governor's December 15 balance sheet) There are two primary provisions of the pay plan:

- An increase in insurance of $53 per month (8.5 percent) in FY 2010 and a further $54 per month (8.0 percent) in FY 2011 to $679 per month in FY 2010 and $733 per month in FY 2011
- A one-time biennial payment of $450 for each 1.0 FTE and $225 for each 0.50 to 0.99 FTE who makes less than $45,000. The payment would not impact the employee's salary and would not be included in the base budget

The executive also includes $4.0 million general fund and $3.0 million other funds for a contingency for agencies that cannot meet the higher proposed vacancy savings rate of 7 percent, and $75,000 for training.

The following figure shows the total pay plan each year.

Figure 3

Governor's Proposed Pay Plan, by Year and Recipient
2011 Biennium

	-- FY 2010 --			-- FY 2011 --			-- 2011 Biennium --		
Entity	General Fund	Other Funds	Total Funds	General Fund	Other Funds	Total Funds	General Fund	Other Funds	Total Funds
					--- On-going ---				
Insurance Increase									
Consumer Counsel	$0	$1,908	$1,908	$0	$5,760	$5,760	$0	$7,668	$7,668
Legislative Branch	41,022	0	41,022	123,840	0	123,840	164,862	0	164,862
Judicial Branch	133,322	6,599	139,921	408,240	19,920	428,160	541,562	26,519	568,081
Executive Branch	1,629,967	2,102,554	3,732,521	4,931,731	6,353,518	11,285,249	6,561,698	8,456,072	15,017,770
University System	1,429,997	54,696	1,484,693	2,885,088	110,424	2,995,512	4,315,085	165,120	4,480,205
Subtotal	$3,234,308	$2,165,757	$5,400,065	$8,348,899	$6,489,622	$14,838,521	$11,583,207	$8,655,379	$20,238,586
					--- OTO ---				
Lump-Sum Payment									
Consumer Counsel	$0	$527	$527	$0	$0	$0	$0	$527	$527
Legislative Branch	19,744	0	19,744	0	0	0	19,744	0	19,744
Judicial Branch	124,649	3,028	127,677	0	0	0	124,649	3,028	127,677
Executive Branch	1,838,668	2,146,937	3,985,605	0	0	0	1,838,668	2,146,937	3,985,605
University System	1,082,390	29,485	1,111,875	0	0	0	1,082,390	29,485	1,111,875
Subtotal	$3,065,451	$2,179,977	$5,245,428	$0	$0	$0	$3,065,451	$2,179,977	$5,245,428
Training Allowance*	75,000	0	75,000	0	0	0	75,000	0	75,000
Personal Services Contingency*	4,000,000	3,000,000	7,000,000	0	0	0	4,000,000	3,000,000	7,000,000
Total	$10,374,759	$7,345,734	$17,720,493	$8,348,899	$6,489,622	$14,838,521	$18,723,658	$13,835,356	$32,559,014

*Biennial appropriations

The following shows the biennial amount, by funding source and component.

Figure 4

Proposed Executive Pay Plan by Component
2011 Biennium

	--- 2011 Biennium ---				
Component	General Fund	State Special	Federal	Proprietary	Total Funds
Insurance Increase	11,583,207	5,201,352	3,311,872	142,155	20,238,586
Lump-Sum Payment	3,065,451	1,347,925	794,572	37,480	5,245,428
Training	75,000	0	0	0	75,000
Personal Services Contingency**	4,000,000	1,781,472	1,169,215	49,313	7,000,000
Total	$18,723,658	$8,330,749	$5,275,659	$228,948	$32,559,014

*Does not include non-appropriated university funds or proprietary funds.
**The contingency is proposed by "general fund" and "other funds". Table is an extrapolation of funding for the other components.

LFD COMMENT

What Personal Services Goals is the Governor Addressing?

There are a number of potential goals for any pay plan:

- Maintenance or increase of purchasing power through one or both of two means:
  - Inflationary adjustments to salaries
  - Increase in benefits to meet rising medical and other benefits costs
- Attempts to recruit and/or retain qualified employees throughout state government, which is generally addressed through such measures as:
  - Adherence or regular movement to market salaries
  - Opportunities for career path advancement within and among job descriptions
  - Special allowance for difficult to hire/recruit positions
  - Longevity adjustments for continued service
- Statewide compensation equity among and within agencies for like work, the evidence for which is lack of a wide discrepancy in salaries as a percent of market (both experienced and starting positions), and similar movement to market over time for similar positions

Health Insurance and Salary Adjustment

The Governor has addressed maintenance of some portion of purchasing power in the provision of health insurance. According to division officials, employees paying a dependent premium will see an increase above the amount provided in the pay plan of $23 per month in 2010 and a further $26 per month in 2011. Officials indicate that this amount uses a best case assumption on prescription and medical cost trends, and the minimum reserve level recommended by the actuary. Consequently, employees would see a reduction in purchasing power. The one-time payment is designed in some measure to assist lower paid employees to cover increased costs of health insurance not covered by the monthly increase.

LFD COMMENT (CONT.)

Other Factors

In examining the lack of either a standard increase in base salary or a factor that addresses disparity to market or to similar positions in the Governor's proposal, there are a number of factors to keep in mind.

- General inflation (consumer price index – CPI) is expected to increase by about 1.7 percent in FY 2010 and 2.2 percent in FY 2011 (please note that medical inflation is a portion of this increase). Since inflation is expected and no salary increases are provided, state employees will lose some purchasing power under the Governor's proposal. However, the increase in benefits each month equates to a maintenance of most purchasing power for medical expenses, although some co-pays and deductibles will likely increase for employees with dependents
- Although in many instances the gap appears to be narrowing, information provided by agencies continues to show a discrepancy among agencies in percent of market for both starting and experienced employees, although no agency (with the exception of the Judiciary and the Office of the Public Defender), is below 80 percent in total. In addition, any advances to market must be done internally within the agency outside of the pay plan funding if the Governor's pay plan does not include a component that addresses salary progression. This has two impacts:
  - Agencies with fewer resources will be at both an actual and competitive disadvantage to agencies that have more available resources
  - A continuing larger and larger share of personal services adjustments will continue to be made outside of the pay plan and therefore outside of direct appropriation by the legislature

Agencies have used vacancy savings to make market and other salary adjustments. The executive proposal to increase the vacancy savings rate on most positions means that agencies will have less funding available to make these adjustments.

LFD COMMENT

Lump-Sum Payment Addresses Only Purchasing Power Goal

The lump-sum payment of $450 to full-time employees making less than $45,000 per year in base salary does not appear to have a goal other than to temporarily increase purchasing power. For example, anyone making the income threshold or less would get the increase, regardless of how near or far they were from the market salary for their position. Also, the eligibility for the increase is determined based on base salary, and does not consider whether the employee has longevity (additional salary due to length of service). Therefore, an employee doing the exact same job for the exact same base salary but making several percentage points above the base due to longevity would receive the same dollar increase.

LFD ISSUE

Active Employees Subsidize Premium Costs of Retired Employees

Current statute allows retired state employees to continue coverage under the state plan by paying for their premiums. Currently, retirees' premiums are set at the same level as active employees, even though their costs are higher. Therefore, active employees and the state share funded by the legislature subsidize these costs (the Montana University System, which has an independent, self-funded insurance plan, charges retirees at a higher rate than active, although they still are subsidized). While the subsidy for retirees over 65 and eligible for Medicare is low, the subsidy for retirees under 65 years of age can range from $200 to $300 per month per retiree.

The legislature may wish to articulate its policy on the provision of health insurance to current and retired employees, and whether it wishes to continue to subsidize retirees or use a portion of the funds saved by requiring retirees to pay a higher premium to reduce costs or increase other compensation for active employees.

Option
The 2009 legislature will discuss whether to fund a comprehensive study of the impacts on state revenues and expenditures of an aging state population, including an aging state workforce. The legislature may wish to incorporate this issue into that discussion, and direct the study to include a discussion of pay plan issues.

For a further discussion of all issues related to the state employee health plan, see the Health Care and Benefits Division discussion beginning on page A-212 of Volume 3 of the 2011 Biennium Budget Analysis.

LFD ISSUE

Integration of Pay Plan and Budgeting Discussions

Personal services is the single largest expenditure for most agencies, as most agencies directly provide services through the efforts of those employees. Consequently, issues pertaining to personal services and to their adequacy to meet certain goals of state government take on a high importance. The size and character of any pay plan is an important component in addressing those issues. Given its size and importance, the pay plan discussion should be integrated with other budgeting policy decisions of the legislature. Two examples are given:

- The adequacy and policy goals for the rates to fund the state employee health plan are discussed by the Joint Appropriations Subcommittee for General Government when it reviews the budget for the Health Care and Benefits Division of the Department of Administration, which operates the plan, in HB 2. However, this determination and issue discussion is not woven into discussion of the pay plan

- A large number of issues within state agencies pertain to the ability of agencies to recruit and retain qualified personnel to do the job the legislature expects. Salary and benefits, particularly in relation to competition with the private sector or others, are a significant part of those issues. Therefore, any discussion of the policy behind the pay plan, such as whether funds are used to provide an across-the-board increase or target certain professions, to allow flexibility in provision of market and other adjustments, to subsidize retirees or use those funds to recruit and retain active employees, or any number of other issues, should be discussed in tandem.

Option

The legislature may wish to expand the discussion of any pay plan proposal to include the broader goals the pay plan is designed to address, and how success of the pay plan in furthering those goals will be measured. As a part of this discussion, the legislature may wish to articulate specific reporting requirements on recruitment and retention issues and have the Department of Administration report to the Legislative Finance Committee and any other appropriate interim committees during the interim.

This issue is an excerpt from the discussion concerning the Health Care and Benefits Division (HCBD) in the *Legislative Budget Analysis 2011 Biennium – Volume 3 Agency Budgets*. The HCBD is a division of the Department of Administration.

LFD ISSUE

Grandfathered Reserve

When SABHRS was implemented (1999), an additional month's payment for health insurance was deducted from employee's pay. The division maintains a reserve to refund this payment for employees who incurred the extra cost and reimburses eligible employees when they leave state employment. The original deduction was $295. However, the amount paid to eligible employees is the current monthly state share - $626 for 2009. The annual rate of change between the two amounts is 8 percent per year. The current reserve amount for this future obligation is $1.7 million.

Options:

- The legislature could request that HCBD provide the current payout for employees eligible for the grandfathered payment. Depending on the current payment amount, the legislature could request that the division provide the payout at this point in time.
- Another option the legislature could pursue is directing HCBD on the valuation of the individual payout. The legislature could establish a floor and a rate of increase for the one time payout. The floor could start January 1, 2009 at either $590, or $626 the state share for 2008 and 2009 respectively, and then apply a fixed rate of increase, such as the rate of return on HCBD short term investments, the consumer price index, or the health price index.