

**LEGISLATIVE BUDGET ANALYSIS  
2011 BIENNIUM  
VOLUME 1 – STATEWIDE PERSPECTIVES**

**REPORT FROM THE LEGISLATIVE FISCAL DIVISION  
TO THE SIXTY-FIRST LEGISLATURE**

January 2009

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### ACKNOWLEDGEMENTS

The multi-volume *Legislative Budget Analysis* report is the product of many hours of analysis by the staff of the Legislative Fiscal Division (LFD), a nonpartisan office which provides fiscal and policy information and advice to the legislature. The LFD thanks the many entities that assisted in its completion, particularly the Print Services Bureau.

### LFD PUBLICATIONS

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**Legislative Fiscal Analyst**  
CLAYTON SCHENCK

December 2008

Members of the Sixty-first Legislature:

I submit for your consideration a fiscal analysis of the state budget outlook for the 2011 biennium and Governor's Executive Budget. It is our goal that this analysis will provide the information and insight necessary for legislators to craft an effective state budget and fiscal policy for the 2011 biennium. This eight-volume report includes:

- Volume 1: Statewide Perspectives – This volume provides an executive summary and an overview of the state fiscal outlook and the executive budget analysis, as well as major fiscal issues in the 2009 session
- Volume 2: Revenue Estimates – This volume provides the revenue estimates and underlying economic assumptions included in the revenue estimate resolution (HJR 2), and is designed as a working document for the taxation committees
- Volumes 3 through 7: Agency Budgets – These volumes are designed to serve as working documents for the appropriations subcommittees. They provide:
  - The Governor's agency budget recommendations
  - The Legislative Fiscal Division's detailed descriptions and analysis of the various components of the Executive Budget as well as other LFD fiscal issues
- Volume 8 – A general reference document (online only)

I am indebted to an exceptional LFD staff for their thousands of extra hours and dedication in preparing this analysis. Their dedication and professionalism are a credit to the Legislature and the citizens of Montana.

We appreciate the cooperation and assistance of the Office of Budget and Program Planning and agency staff during the budget analysis process.

Your staff of the Legislative Fiscal Division look forward to being of service to the legislature during the 2009 session. We welcome any opportunity to assist you in obtaining the best possible fiscal information to facilitate setting fiscal policy. Staff names, assignments, and phone extensions are listed on page vii. Please call on us!

Respectfully submitted,

Clayton Schenck  
Legislative Fiscal Analyst

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Long-Range Planning.....Section F, Volume 7

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## INTRODUCTION

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### PURPOSE OF VOLUME 1

The purpose of this report is to provide legislators with the information needed to assist them in crafting a balanced state budget and fiscal policy, and in reflecting their priorities in the 2011 biennium general appropriations act and other appropriations bills. It seeks to accomplish this by: 1) providing perspectives on the state's fiscal condition and the budget proposed by the Governor for the 2011 biennium and 2) identifying some of the major issues now facing the Legislature. As such, this document is intended to complement Volumes 2 through 7 of the *Legislative Budget Analysis – 2011 Biennium*, which contains our review of the 2011 Biennium Executive Budget. In addition, this document is a reference document for all legislators, providing a myriad of information about state government.

While Volumes 2 through 7 of the *Legislative Budget Analysis* continue to report the results of our detailed examination of revenue estimates and expenditures and proposed budgets of state programs, Volume 1 presents a broader fiscal overview and discusses significant fiscal and policy issues which either cut across program or agency lines, or do not necessarily fall under the jurisdiction of a single fiscal subcommittee of the legislature. Volume 1 discussions incorporate the December 15 Governor's revisions.

This volume is divided into six parts:

- **2011 Biennium Overview** provides a high level summary of our analysis of the proposed executive budget.
- **Perspectives on the Economy and Demographics** describes the current outlook for the economy.
- **State Revenues Perspectives** provides a review of the revenue projections in the budget and our own assessment of revenues through FY 2011.
- **State Expenditures Perspectives – Part One** provides an overview of the state spending plan for the 2009 biennium.
- **State Expenditures Perspectives – Part Two** evaluates the major expenditure proposals in the budget.
- **Major Issues Facing the Legislature** includes discussions of several issues, a list of which can be found on page 87 of this volume.

## WHAT IS CONTAINED IN VOLUMES 2 THROUGH 7?

### Volume 2

Volume 2 includes a summary and overview of the state's major revenue sources. A review of the table of contents will give the reader a quick idea of revenue sources included and the structure of the report. This volume will be provided to the House and Senate Taxation committees for use as a working document, and delineates the economic assumptions used to derive revenue estimates adopted by the Revenue and Taxation Interim Committee (RTIC) on November 17, 2008 and introduced in the revenue estimate bill (HJR 2).

### Volumes 3 through 7

Volumes 3 through 7 offer detailed analyses of individual agency budgets, as proposed through the *Governor's Executive Budget* submitted in mid-November, but had gone to print before the December 15 revisions were received. These volumes feature program-by-program detail, as well as the LFD analysis of each agency budget. Agency presentations are grouped in sections corresponding to the appropriations subcommittee addressing the agency.

- Volume 3 contains section A – General Government
- Volume 4 contains section B – Health and Human Services
- Volume 5 contains section C – Natural Resources and Transportation
- Volume 6 contains section D – Judicial Branch, Law Enforcement, and Justice
- Volume 7 contains section E and F– Education and Long-Range Planning, respectively

Volumes 3 through 7 briefly describe the agencies from all three branches of state government, as well as each program within an agency. The basic structure used for the analysis is consistent across agencies. These volumes detail an agency's requests, as well as a list of proposals and issues significant to the agency. When appropriate, there may be discussion of circumstances that could hold budgetary impacts (e.g., proposed executive legislation or agency reorganization). These volumes also present detailed discussions of present law adjustments, new proposals, and significant issues facing the various agencies as identified by legislative fiscal analysts.

Agency budgets are presented in three tiers as required by statute:

- **Base budget:** the level of funding authorized by the previous legislature;
- **Present law base:** the additional level of funding needed under present law to maintain operations and services at the level authorized by the previous legislature; and
- **New proposals:** requests to provide new non-mandated services, to change program services, to eliminate existing services, or to change sources of funding.

By making this presentation in this tiered manner, legislators can use the “base budget” as the starting point, then to follow the incremental increases that result in a total budget request for an agency.

# *Budget Overview*

## *- An Executive Summary -*



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### LFD BOTTOM LINE

The 2011 biennium fiscal outlook is considerably different than two years ago. Strong state revenue growth for the past five years has left a projected FY 2009 fund balance of \$387.1 million. Individual, corporation, and oil and gas production taxes were the sources of revenue primarily responsible for the robust revenue growth for the past several years. However, the recent economic recession has begun to impact Montana revenues, with receipts expected to drop off significantly during the 2011 biennium. Legislative fiscal Division revenue estimates were revised in mid December to reflect less optimistic economic indicators as the economic outlook worsens. The executive budget was also revised to reflect lower revenue estimates. While there is a large fund balance carryover, funds available for ongoing services are limited if the general fund is to maintain structural balance (where ongoing revenues meet or exceed ongoing expenditures). Given the volatility of the economic climate the probability for additional revisions to the revenue estimates is high.

The Legislative Fiscal Division's (LFD) analysis of the *2011 Biennium Executive Budget* concludes that the Governor's proposed budget:

- Would finish the 2011 biennium with a \$277.1 million general fund balance, before reserves (compared to the Governor's estimate of \$295.5 million)
- Proposes a general fund budget that is structurally balanced in FY 2011 (\$0.3 million); however, this could easily be impacted with a further deterioration of current economic conditions
- Provides for increases in total general fund of \$312.5 million (9.0 percent) over the current biennium, and for increases in total funds of \$792.6 million (9.0 percent)
- Is predominantly a present law budget that funds existing services at revised caseload, population, and student enrollment levels
- Funds the budget with existing revenues, with no significant new tax policy recommendations other than mitigation of property tax reappraisal

## THE EXECUTIVE BUDGET PROPOSAL<sup>1</sup>

### REVENUE FORECAST – DECLINING REVENUES IN 2011 BIENNIUM

The executive budget revenue forecast is based on economic and revenue trends through early December 2008. Tax receipts during FY 2008 were higher than the *HJ2 Revenue Estimates, May 2007 Special Session* estimate. The executive's forecast assumes a revenue decline of \$147.8 million in the 2011 biennium when compared to the 2009 biennium. Total general fund revenue is expected to decrease by 3.8 percent, reaching \$3.7 billion in the 2011 biennium. Combined with an estimated \$366.8 million general fund balance carried over from the 2009 biennium, the executive anticipates total general fund revenue available to fund the executive budget is \$4.1 billion in the 2011 biennium. This differs from LFD estimates by nearly \$20 million, to be discussed later in this report.

#### Revenue Related Policy Changes.

The executive budget proposes one major tax policy change. Although no specifics were provided in the executive budget, the executive proposes to mitigate the effects of property tax reappraisal. The budget also includes \$3.5 million in new general fund revenues from proposed revenue related changes. The executive also proposes to remove the FY 2009 sunset provision from the wildfire suppression account. This proposal would reduce revenues to the general fund by \$32.9 million in FY 2009. See page 30 in this volume for more information.

### PROPOSED SPENDING

The executive budget proposes \$9.6 billion total state spending for the 2011 biennium. If on-going spending is compared between biennia, total spending increases by \$662.8 million or 7.5 percent. General fund spending is proposed to increase from \$3.5 billion to \$3.8 billion. If on-going spending is compared between biennia, general fund spending increases by \$257.5 million or 7.4 percent. The increases are predominantly to continue existing services at revised caseload, prison population, and student enrollment levels.

### EXECUTIVE'S GENERAL FUND STATUS

Figure 1 shows the general fund balance sheet for the 2009 and 2011 biennia with the executive budget's assumptions and proposals. It shows that:

**FY 2008–2009.** The 2009 biennium concludes with a ending fund balance of \$366.8 million, or about three times the amount estimated by the legislature after the

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<sup>1</sup> As required by law, the executive budget includes proposed expenditures for all funds that require an appropriation – either a general appropriation or a statutory appropriation -- in order to be spent from the state treasury. Several types of funds fall into this category, including general fund, state special revenue, federal special revenue, proprietary funds that transfer profits or ending fund balance to an appropriated fund, and capital projects funds

September 2007 Special Session, reflecting stronger than anticipated individual, corporation, and oil and gas production tax collections.

**FY 2010-2011.** In the next biennium, projected general fund revenue available – which includes the FY 2009 ending general fund balance plus new revenues -- is \$4.1 billion, while proposed disbursements total \$3.8 billion. The difference is proposed to be set aside for a \$295.5 million ending general fund balance.

**Figure 1**

Executive Budget Proposal - General Fund								
Figures in Millions								
	Actual FY 2008	Budgeted FY 2009	Requested FY 2010	Requested FY 2011	2009 Biennium	2011 Biennium	Biennial \$ Change	Biennial % Change
Beginning Fund Balance	\$545.863	\$437.679	\$366.841	\$303.090	\$545.863	\$366.841	(\$179.022)	-32.8%
Revenue								
Executive Revenue Estimate	1,953.519	1,905.623	1,816.445	1,894.911	3,859.142	3,711.356	(147.786)	-3.8%
Executive Revenue Proposals	-	(32,915)	0.022	3.522	(32,915)	3.544	36.459	-110.8%
Total Funds Available	\$2,499.382	\$2,310.387	\$2,183.308	\$2,201.523	\$4,372.090	\$4,081.741	(\$290.349)	-6.6%
Disbursements								
General Appropriations	1,553.705	1,686.303	1,661.325	1,694.740	3,240.008	3,356.065	116.057	3.6%
Statutory Appropriations	264.231	163.655	179.769	182.257	427.886	362.026	(65.860)	-15.4%
Transfers	167.822	106.425	8.679	9.468	274.247	18.147	(256.100)	-93.4%
Other Appropriations	82.111	15.703	33.980	17.080	97.814	51.060	(46.754)	-47.8%
Supplemental Appropriations	-	2.648	-	-	2.648	-	(2.648)	-100.0%
Feed Bill	1.262	6.932	1.215	7.515	8.194	8.730	0.536	6.5%
Reversions	-	(42.360)	(4.750)	(5.000)	(42.360)	(9.750)	32.610	-77.0%
Total Disbursements	\$2,069.131	\$1,939.306	\$1,880.218	\$1,906.060	\$4,008.437	\$3,786.278	(\$222.159)	-5.5%
Fund Balance Adjustments	7.428	(4.240)	-	-	3.188	-	(3.188)	-100.0%
Ending Fund Balance	\$437.679	\$366.841	\$303.090	\$295.463	\$366.841	\$295.463	(\$71.378)	-19.5%

## KEY FEATURES OF THE EXECUTIVE BUDGET

Figures 2 and 3 show the executive budget by function for the general operations of state government and by appropriation type for the remaining budget items. Figure 2 shows the total executive budget from all fund sources. As shown in Figure 2, K-12 (public) education, human services, and “other agencies” (primarily due to transportation and various environmental and wildlife expenditures), consume the largest share of the total funds budget at 75.9 percent.

**Figure 2**

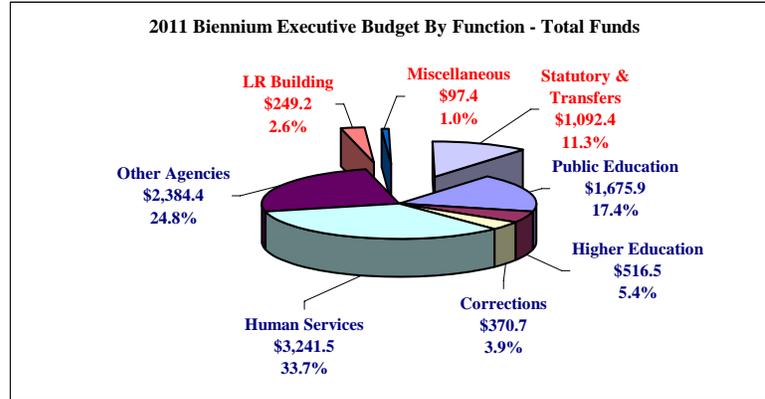
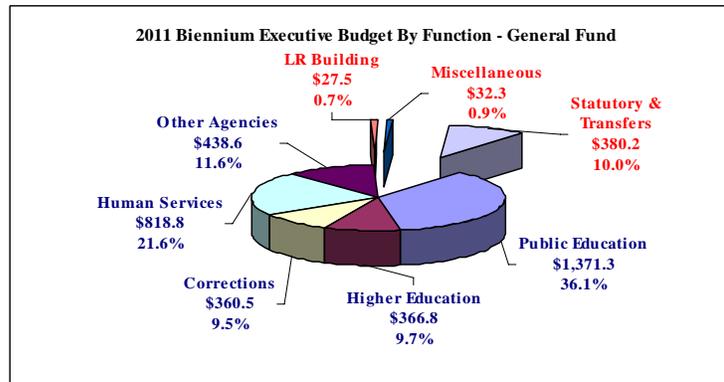


Figure 3 shows the general fund budget proposed by the executive. As shown, the largest expenditures are made from K-12 and higher education, human services, “other agencies”, statutory appropriations and transfers, which comprise almost 79.3 percent of the budget.

**Figure 3**



Some of the key programmatic features of the proposed executive budget are shown in Figure 4 and in the summary paragraphs on the following pages

Figure 4

## KEY PROGRAMMATIC FEATURES OF THE 2011 BIENNIUM EXECUTIVE BUDGET PROPOSAL

### Predominantly a Present Law Budget, Funds Existing Services

- Funding present law adjustments costs \$329.7 million
- Generally funds caseload, population, and student enrollment at current projections

### Education

- Increases K-12 BASE aid and special education by 3.0 percent per year
- Essentially funds the Montana University System at the FY 2009 level and does not continue the College Affordability Program (mitigate tuition increases)

### Public Health and Human Services

- Funds the current projected level of caseload
- Funds voter passed Healthy Kids initiative (I-155)

### Corrections

- Funds a projected population increase of about 4.6 percent each year

### Long Range Planning

- Funds capital projects of \$20.6 million general fund, \$113.1 million total funds
- Included in capital projects is the Governor's 20 x 10 initiative to increase state government energy efficiencies by 20 percent
- Funds major information technology projects of \$5.5 million general fund, \$100.3 million total funds

### State Employee Compensation

- Increases state contribution towards health insurance premiums
- No state employee percentage increase for cost of living or market adjustment
- Provides one time lump-sum payment to employees making \$45,000 or less

### Revenue and Tax Proposals

- Proposes to mitigate the effects of property tax reappraisal
- Removes sunset provision of wildfire suppression account

### 2009 Biennium General Fund Balance Funds One-time Expenditures in 2011

- 15 percent of the 2009 biennium fund balance (\$55 million) would be allocated for 2011 biennium one-time expenditures
- The Governor's "20 x 10" energy savings initiative is 40 percent of the proposed one-time expenditures

### **Predominantly a Present Law Budget, Funds Existing Services**

Of the increases proposed in the executive budget, present law accounts for a majority of the increases with only a minor amount of new proposals requested. The executive essentially funds all projected caseload, population, and enrollment levels (with the exception of a portion of secure care correctional populations). However, human services caseload projections could be problematic during an economic downturn and the executive likely does not fully address the potential impacts (see page 75). The executive also makes an across the board reduction by increasing vacancy savings from 4 to 7 percent for most positions. This proposal may have an impact on present law operations.

### **Education**

The executive funds all projected enrollment increases and adds a 3 percent per year increase in both BASE Aid and special education. Special education is also increased to ensure all federally required maintenance of effort expenditures are made.

The executive essentially funds the university system at the FY 2009 level by funding present law increases. There are two primary components: 1) the executive adds present law, but then assumes a greater share of funding from tuition. By this action, the executive discontinues the college affordability plan adopted by the last legislature to freeze tuition; and 2) the executive applies a reduction to present law through the increase in vacancy savings applied to most positions in state government.

### **Public Health and Human Services**

The executive funds all projected caseload increases and replaces all reduced federal funds due to a change in the percentage of Medicaid costs paid by the federal government. These two actions essentially maintain current services for those currently eligible. The executive also includes funding to implement the Healthy Montana Kids (I-155 initiative). Whether implementation is possible will depend on securing an amendment to the current state plan and a large increase in the federal grant.

### **Corrections**

The executive assumes population increases of about 4.6 percent each year. The executive does not provide funding for about 30 inmates in FY 2010 and 76 inmates in FY 2011 of the projected secure care population increases, which means that some will have to be moved from secure care to lower cost programs and facilities.

### **Long Range Planning**

The executive budget proposes appropriations and authorizations of \$113.1 million for land acquisition and building major maintenance projects. The executive's priorities are on energy improvements (\$26.5 million, or 23 percent) and associated deferred maintenance projects (\$59.4 million, or 52 percent).

The executive budget allocates approximately \$100.3 million of total funds to the state's information technology needs. Over 95 percent of these funds would be non-general fund monies. Almost \$66 million of this total would be for a replacement of the

current Medicaid Management Information System (MMIS) in the Department of Public Health and Human Services.

The budget includes \$13.4 million general fund for energy efficiency projects that are the most significant component of the Governor's "20 x 10" initiative, with a goal to increase energy efficiencies by 20 percent by 2010.

### State Employee Compensation

The executive pay plan proposal provides for a \$450 lump-sum pay adjustment for all employees making \$45,000 or less during FY 2010. Employees making more than this amount would not receive the lump-sum adjustment. There is no percentage increase proposal for state employees. The plan also proposes to increase health insurance benefits by \$53 per month for FY 2010 and \$54 per month for FY 2011. Projected cost of the pay plan is \$18.6 million general fund and \$32.7 million total funds for the 2011 biennium.

### Revenue and Tax Proposals

The executive proposes to mitigate the effects of property tax reappraisal. No specifics were provided in the executive budget for a mitigation strategy. Since the executive budget does not include any revenue impacts of reappraisal, it is assumed the mitigation proposal would be revenue neutral at the state level. Further, the executive budget proposes to remove the sunset provision from a fire suppression fund that would have otherwise reverted \$32.9 million to the general fund.

### 2009 Biennium Fund Balance Funds One-Time Expenditures in 2011 Biennium

As shown in Figure 5, the executive proposes allocating approximately 15 percent of the projected 2009 biennium ending general fund balance, nearly \$55 million, for one-time only disbursements in the 2011 biennium. The executive allocates 40 percent of the proposed one-time disbursements towards the Governor's "20 x 10" initiative. Almost 41 percent is allocated to various initiatives contained in HB 2 and 13.

Figure 5

<b>Executive Budget One-Time Only Initiatives - General Fund</b>				
Figures in Millions				
<b>Description of Initiative</b>	<b>Budgeted FY 2010</b>	<b>Budgeted FY 2011</b>	<b>2011 Biennium</b>	<b>% of Total</b>
HB 2 Present Law Adjustments	\$3.392	\$0.208	\$3.600	6.5%
HB 2 New Proposals	7.966	3.728	11.694	21.3%
HB 5 20 x 10 Initiative	14.700	7.260	21.960	39.9%
HB 10 Information Technology	5.500	-	5.500	10.0%
HB 13 Pay Proposal	5.546	1.471	7.017	12.8%
Water Compact Legislation	5.000	-	5.000	9.1%
Statutory Appropriation for Arbitrage	-	0.215	0.215	0.4%
<b>Total One-Time Only</b>	<b>\$42.104</b>	<b>\$12.882</b>	<b>\$54.986</b>	

As shown in Figure 6, the executive allocates \$301.6 million of total funds for one-time-only disbursements. The largest allocation is for information technology projects of \$100 million or nearly 33.1 percent.

Figure 6

<b>Executive Budget One-Time Only Initiatives - Total Funds</b>				
Figures in Millions				
<b>Description of Initiative</b>	<b>Budgeted FY 2010</b>	<b>Budgeted FY 2011</b>	<b>2011 Biennium</b>	<b>% of Total</b>
HB 2 Present Law Adjustments	\$7.426	\$2.796	\$10.222	3.4%
HB 2 New Proposals	14.341	9.098	23.439	7.8%
HB 5 20 x 10 Initiative	14.700	7.260	21.960	7.3%
HB 5 Maintenance & Acquisition	77.562	-	77.562	25.7%
HB 10 Information Technology	99.752	-	99.752	33.1%
HB 13 Pay Proposal	10.256	2.181	12.437	4.1%
School Trust Bonds	21.000	-	21.000	7.0%
Wildfire Account	30.000	-	30.000	9.9%
Water Compact Legislation	5.000	-	5.000	1.7%
Statutory Appropriation for Arbitrage	-	0.215	0.215	0.1%
<b>Total One-Time Only</b>	<b>\$280.037</b>	<b>\$21.550</b>	<b>\$301.587</b>	

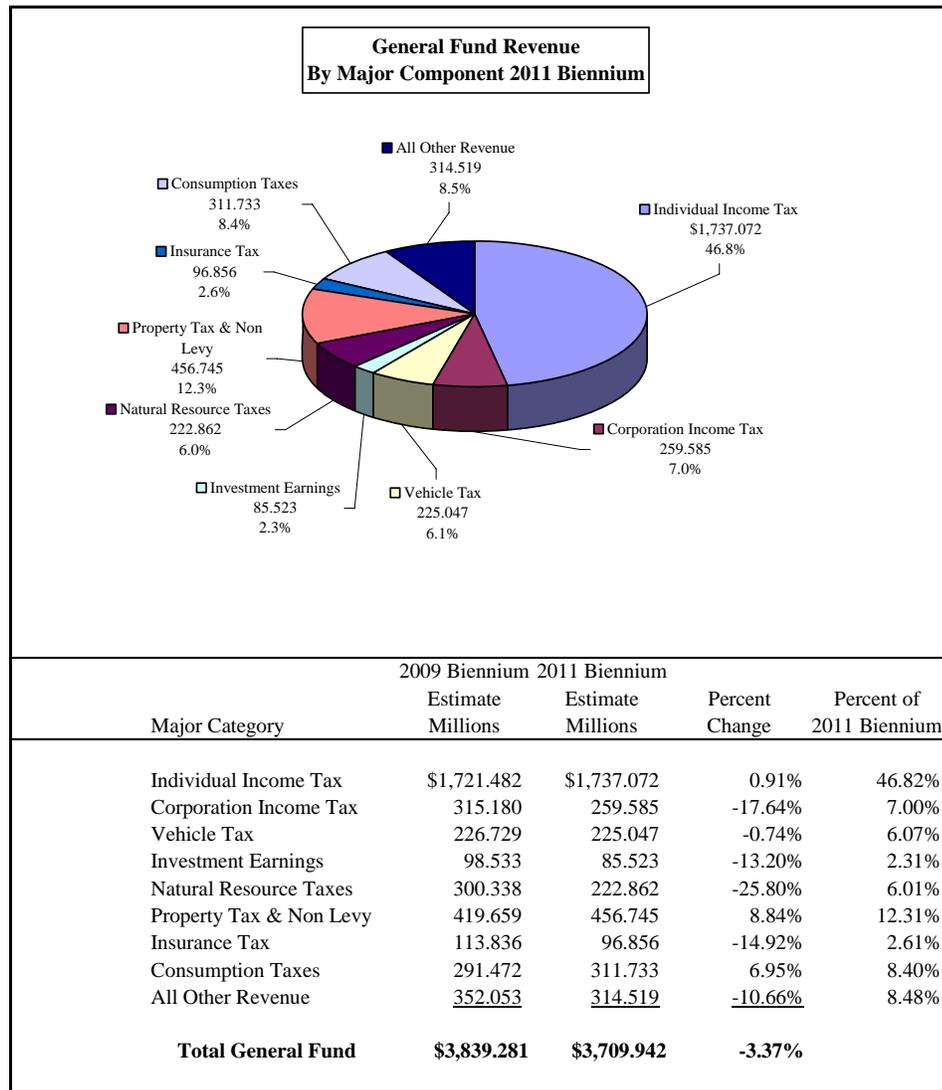
See Pages 83 and B-3 for more detail about the Governor's proposed one-time expenditures.

## LFD ANALYSIS OF EXECUTIVE BUDGET

This section discusses the key LFD budget findings of the proposed *2011 Biennium Executive Budget*. In addition, LFD analyzes the impact of the *2011 Biennium Executive Budget* proposal on the 2011 biennium general fund balance, using the LFD revised revenue estimate recommendations; LFD estimates for statutory appropriations, transfers, reversions; LFD revenue and expenditure adjustments based on an analysis for differences in the executive budget; and the executive's recommendations for present law and new proposals. It should be noted that since the November 17, 2008 meeting of the RTIC economic conditions have changed significantly to warrant revised revenue estimate recommendations. While statute requires the RTIC estimates to be the official estimates of the legislature until changed by legislative action, the current economic climate provides a compelling reason for revised estimates that incorporate the most recent economic data. The revised LFD revenue estimate recommendations will be submitted to the legislature at the beginning of the session.

As shown in Figure 7, the revised LFD revenue estimates provide \$3.7 billion in revenues, with individual and corporate income tax, property tax, comprising 66.1 percent of total general fund revenues.

Figure 7



This section also presents and discusses the differences between the executive budget general fund balance and the LFD general fund balance.

Figure 8

## KEY LFD BUDGET FINDINGS OF THE 2011 BIENNIUM EXECUTIVE BUDGET PROPOSAL

### 2011 Biennium Would Conclude With \$277.1 Million General Fund Balance

- This is an historically high proposed balance, designed to address an economic downturn of unknown duration and intensity
- The executive budget proposal is structurally balanced in the second year of the budgeted biennium

### Can Present Law Services Be Maintained?

- The executive budget has reduced funding for present law services to the point where maintenance of current government services may be jeopardized
- Impacts of an economic downturn generally increase demand for many state services that may not be reflected in the executive budget, particularly Medicaid and other health services

### Executive Budget Doesn't Provide Measurable Performance Indicators

- Measurable performance indicators provide a means for evaluating value and ultimate success of budget proposals
- Performance indicators submitted by the executive are predominantly not measurable and thus don't provide valuable information for prioritization or measurement of progress and identification of corrective action on challenges

### Undeveloped Budget Proposals

- Several executive budget proposals lack sufficient information and details to evaluate their impact and merit
- Statute requires submission of the executive budget by a specific deadline and with sufficient data to evaluate and understand the proposals

## 2011 BIENNIUM WOULD CONCLUDE WITH \$277.1 MILLION GENERAL FUND BALANCE

As indicated in Figure 9, the LFD estimates that if the executive budget proposals were fully adopted, the state would end the 2011 biennium with approximately a \$277.1 million general fund balance. This balance would be used in the advent of a revenue shortfall.

The LFD projects ongoing general fund revenue will decrease 3.4 percent in the 2011 biennium due to an economic slowdown and significant declines in commodity prices. These conditions will severely impact individual, corporation, and oil and gas production taxes. The LFD estimates that the revenue that will be generated from the executive's revenue proposals would be a negative \$1.1 million. This compares to the executive's estimate of \$5.4 million for the 2011 biennium. The revenue proposals contained in the executive budget are anticipated to be ongoing revenues.

The executive budget proposes to increase spending by \$312.5 million for the 2011 biennium when compared to the 2009 biennium. This increase can be summarized by the following categories:

- HB 2 increases of \$205.7 million
- Long-range planning proposals of \$27.5 million
- Miscellaneous proposals of \$32.3 million
- Statutory appropriations/transfers of \$47.0 million

Most of the HB 2 increases are for public health programs (\$74.0 million), public schools (\$62.5 million), corrections (\$21.8 million), and higher education (\$10.4 million). A majority of the HB 2 increases are to maintain present law services. The long-range planning and miscellaneous proposals should be viewed as new proposals or new initiatives. Major items included in this category are the Governor's "20 x 10" initiative, the executive pay plan, and the two water compact proposals. Statutory/transfer increases are for increased retirement system payments and increases in local government entitlement payments. These increases are required by statute.

### LFD General Fund Balance

Figure 9

LFD Estimates with Executive Proposals - General Fund Outlook								
Figures in Millions								
	Actual FY 2008	Budgeted FY 2009	Requested FY 2010	Requested FY 2011	2009 Biennium	2011 Biennium	Biennial \$ Change	Biennial % Change
Beginning Fund Balance	\$543.541	\$437.677	\$354.233	\$290.101	\$543.541	\$354.233	(\$189.309)	-34.8%
Revenue								
HJ2 Revenue Estimate	1,953.540	1,885.741	1,816.452	1,893.490	3,839.281	3,709.942	(129.339)	-3.4%
Executive Revenue Proposals		(32.915)	(0.540)	(0.540)	(32.915)	(1.080)	31.835	-96.7%
Total Funds Available	\$2,497.081	\$2,290.504	\$2,170.144	\$2,183.052	\$4,349.908	\$4,063.095	(\$286.813)	-6.6%
Disbursements								
General Appropriations	1,705.128	1,649.184	1,655.743	1,692.522	3,354.312	3,348.265	(6.047)	-0.2%
Executive New Proposals		-	39.996	23.206	-	63.202	63.202	
Statutory Appropriations	262.666	165.266	177.965	176.948	427.932	354.913	(73.019)	-17.1%
Transfers	166.358	107.049	9.023	9.701	273.407	18.724	(254.683)	-93.2%
Other Appropriations	-	54.253	-	-	54.253	-	(54.253)	-100.0%
Supplemental Appropriations	-	2.648	-	-	2.648	-	(2.648)	-100.0%
Feed Bill	-	9.891	2.589	10.294	9.891	12.883	2.992	30.2%
Reversions	(65.107)	(46.921)	(5.273)	(6.767)	(112.028)	(12.040)	99.988	-89.3%
Total Disbursements	\$2,069.045	\$1,941.370	\$1,880.043	\$1,905.904	\$4,010.415	\$3,785.947	(\$224.468)	-5.6%
Fund Balance Adjustments	9.641	5.099	-	-	14.740	-	(14.740)	-100.0%
Ending Fund Balance	\$437.677	\$354.233	\$290.101	\$277.148	\$354.233	\$277.148	(\$77.085)	-21.8%

### Explanation of Difference of LFD GF Outlook from EB GF Outlook

Figure 10 shows the three year difference (FY 2009-2011) between the LFD and the executive budget for each of the general fund balance items. The LFD estimate for the 2011 biennium ending fund balance is \$277.1 million compared to the executive budget's estimate of \$295.5 million. The differences are due to the following reasons:

- Lower revenue estimates and revenue proposal impacts as estimated by the LFD (\$25.9 million)
- Higher disbursements anticipated by the LFD (\$1.7 million)
- And higher fund balance adjustments by the LFD (\$9.3 million)

Figure 10

<b>FY 2009-2011 Differences - LFD versus Executive Budget</b>				
Figures in Millions				
	<b>LFD</b>	<b>Executive</b>	<b>Biennial</b>	<b>Biennial</b>
	<b>2009-2011</b>	<b>2009-2011</b>	<b>\$ Change</b>	<b>% Change</b>
Beginning Fund Balance	\$437.677	\$437.679	\$0.002	0.0%
Revenue				
HJ2 Revenue Estimate	5,595.684	5,616.979	21.295	0.4%
Executive Revenue Proposals	(33.995)	(29.371)	4.624	
Total Funds Available	\$5,999.366	\$6,025.287	\$25.921	0.4%
Disbursements				
General Appropriations	5,114.904	5,109.131	(5.773)	-0.1%
Statutory Appropriations	520.179	525.681	5.502	1.1%
Transfers	125.773	124.572	(1.201)	-1.0%
Supplemental Appropriations	2.648	2.648	-	0.0%
Feed Bill	22.774	15.662	(7.112)	-31.2%
Reversions	(58.961)	(52.110)	6.851	-11.6%
Total Disbursements	\$5,727.317	\$5,725.584	(\$1.733)	0.0%
Fund Balance Adjustments	5.099	(4.240)	(9.339)	-183.2%
Ending Fund Balance	\$277.148	\$295.463	\$18.315	6.6%

### ***Lower Revenues***

Overall, the LFD projects \$21.3 million less general fund revenue available in FY 2009 through 2011 than the executive budget. This difference is primarily due to the underlying assumptions for individual, corporation, and oil and gas production taxes. The LFD estimates are generally more conservative for corporation and oil and gas production taxes, but more optimistic than the executive for individual income taxes. If the revenue difference is examined by fiscal year, the majority of the difference (\$19.9 million) occurs in FY 2009. The executive estimate for individual income tax is almost \$14 million higher in FY 2009.

The LFD estimate of the executive revenue proposals is \$4.6 million less than the executive. This difference is due to two executive revenue proposals that were incorrectly included on the executive's balance sheet. For more information, see *Perspectives on State Revenues*, page 30.

### ***Higher Disbursements***

The LFD projects \$1.7 million more general fund disbursements in FY 2009 through 2011 than the executive budget. Most of this difference is attributable to two items: 1) The executive budget shows the "net" feed bill costs instead of showing the total amount with a corresponding reversion amount. This is the

method used by the LFD and. 2) the LFD projects higher transfers in the 2011 biennium than the executive. In most instances, the executive and the LFD relied on the same statutory appropriation and transfer information supplied by the respective agencies. However, since the LFD vehicle tax estimates are higher than the executive, the corresponding vehicle transfer amounts will also be higher.

### ***Higher Fund Balance Adjustments***

Fund balance adjustments are the sum of prior year revenue and disbursement adjustments and direct adjustments to fund balance. The LFD used the most recent information available from the accounting system and the Department of Administration.

## **CAN PRESENT LAW SERVICES BE MAINTAINED?**

The executive budget is predominantly a present law budget designed to maintain an existing level of services. However, the proposed reductions in funding raise the question of whether existing state services can be maintained. In particular, there are several areas where the unknown duration and severity of the economic downturn could significantly increase the demand for government services beyond what was included in the executive budget. These areas include the following:

- Projections for Medicaid services are very uncertain in view of the economy and any additional normal increase in Medicaid eligibility and other health services
- Under the current proposal, the executive has underfunded the more expensive secure care beds and will have to move more projected population into less expensive community placements. As the same time, the worsening economic situation would result in higher secure care populations if current community placements cannot find work and are unable to maintain the conditions of their community placement.
- Projected interest and income that offsets general fund in K-12 education could be reduced by worsening economic conditions, and general fund would have to assume more of the statutorily established level of BASE aid to schools
- The executive budget includes an increase from 4 percent to 7 percent vacancy savings for personal services, which constitutes an across-the-board reduction for state agency operations, and the impact on programs will vary widely without regard to prioritization of need
- The impact on operations and service delivery from a reduction in a primary resource in an already tight present law budget will likely be unknown until well into the budgeted biennium
- Positions will likely have to be held open or funds transferred from another budget category to generate enough savings to cover the vacancy savings assessment, having an unknown impact on operations
- Access to higher education could be impacted if tuition costs increase
  - The executive budget does not continue the College Affordability Program included in the current biennium to freeze tuition rates
  - The executive proposal effectively reduces state funding for higher education, as there are present law costs that continue into the 2011 biennium that aren't

funded by state funds, and would have to be funded by tuition increases or expenditure reductions

## BUDGET DOESN'T PROVIDE MEASURABLE PERFORMANCE INDICATORS

Performance measurement is a significant new tool developed at the direction of the Legislative Finance Committee, and is being used in the state budget process to answer questions about what the government does, and the amount of resources necessary to make it happen. By using a very simple performance measurement process, much more information is provided to legislators to help ensure taxpayer dollars are used in the most efficient way based on priorities. It enables the legislature to answer questions basic to its constitutional duty to fund state government, including what government is trying to accomplish (goals), whether goals are being accomplished, and whether expenditures are justified.

While all agencies included goals for their programs in some fashion, there was a consistent pattern of goals that had limited applicability to the specific purpose of the program, where objectives for accomplishing the goal were incomplete or not presented, or where the objectives did not equate to achievement of goals.

The most consistent issue raised in the LFD analysis, and the most challenging to the legislature in determining success and adequacy of funding levels, was that most objectives didn't allow for measurement of progress or identification and corrective action on challenges. Without this information, the legislature is left with the traditional method of budgeting, where the priorities and the details of what the funding will provide are not specified, and the success in achieving the desired results cannot be determined.

## UNDEVELOPED BUDGET PROPOSALS

The executive budget, as submitted, included some proposals that lack sufficient information, accuracy, and detail to evaluate the impact. Statute requires the Legislative Fiscal Analyst to provide an independent analysis of the executive budget, and requires the executive to submit budget information at a specified level of detail. It also requires that the budget be submitted by a specific date with the specified level of detail in order to facilitate an independent analysis and legislative review prior to the start of the legislative session. The LFD has raised the issue with this administration and with prior administrations that the executive budget doesn't provide sufficient explanatory details, hampering the ability of the LFA to perform an independent analysis and the ability of the legislature to get a complete analysis of the executive budget.

Examples of incomplete proposals include:

- A proposal to mitigate the impacts of property tax reappraisal with no explanatory details or proposed tax policy objectives dealing with this issue
- A proposal to issue \$21 million in bonds to purchase additional schools trust land without any explanatory details to prepare a cost-benefit analysis
- A proposal to provide funding for school facilities without the specific details on how the program would be operated or what facilities would receive funding
- A pay plan proposal which is required to be included in the November 15 budget proposal, yet for the past decade, statute is most often not followed, with the argument that negotiations with the labor unions are not complete. If statute were

followed, the state and labor unions would comply with the intent to complete negotiations by November 15. The reasons for the argument that negotiations for the pay plan are an exception to the November 15 deadline are unclear

- Fiscal policy proposals that only have various stages of a complete bill draft, with several cases where the legislation does not conform to the numeric amounts in the printed executive budget

The legislature should be aware of the consequences of consistent violation of budget submission deadlines with regard to fully developed and documented proposals, and may wish to consider methods to remedy this issue.

## BUDGET RISKS

This section briefly discusses any budget risks that are associated with the executive budget, or with the LFD general fund revenue estimates. Each risk is listed in Figure 11 and is discussed briefly in the narrative that follows. The legislature needs to be aware of these liabilities/risks and may want to consider how these budget risks might be mitigated.

Figure 11

### Significant Budget Risks That The Legislature Should Keep in Mind While Crafting a Budget

#### Economic Volatility

- Revenue estimates may have to be revised during the session because of economic uncertainty
- Budget may not reflect full impacts of an economic downturn
- Revenues may fall significantly after the session

#### Pension Plans Unfunded Liability

- The dramatic reduction in asset value of public retirement plans will result in increased unfunded liability of the plans
- If the economic recovery is slow, the legislature may have to again supplement the retirement plans

#### Outstanding Liabilities

- State Fund "Old Fund" liability is the responsibility of the general fund
- State Fund, education lawsuits could affect general fund balance negatively

## ECONOMIC VOLATILITY

### Revenue estimates may have to be revised in a period of economic volatility and impacts on demands for state services

The most obvious risk to the 2011 budgeting process is the economic conditions that may be forthcoming. The duration and intensity of the current economic recession could affect both revenues and expenditures for the 2011 biennium as well as the 2013 biennium. The revenue estimates have been revised several times to date, and the executive budget would leave a \$277 million ending fund balance, by LFD estimates in the advent of further revenue declines.

### Budget may not reflect the full impacts of an economic downturn

Demand and eligibility for state services in a recession typically go up because of increased unemployment and a reduction in wage income. As discussed on page 74, the LFD raises the issue that the executive budget as presented may not reflect the potential impacts of an economic downturn on state services, particularly Medicaid and other human services. The LFD also questions on page 75 the ability of this budget to maintain present law services due to some cutback measures included in the budget, including an across the board reduction in vacancy savings. Throughout the session, the legislature will need to be aware of changing economic conditions and the resulting impacts on the services state government provides to its citizens.

### Post Session – What Happens if Revenues Fall Significantly?

The executive budget would leave an ending fund balance of \$277 million using LFD revenue estimates. Given the volatility of the revenues, the legislature may want to consider how a sizable ending balance should be held in reserve. Under the proposed budget, if revenues fall after the budget is finalized and the session is over, the executive could continue spending by drawing down the reserve. The risk is that spending down the ending balance for ongoing programs can result in a structural imbalance because the ending balance is in essence one-time-only money. The executive would not necessarily be forced to reprioritize for declining revenues. The legislature might want to be an active player in the decision as to the need for reprioritization and service reductions. An alternative would be to establish an adequate ending balance (such as 3 percent of biennium revenues or about \$110 million), and set aside the remaining amount in a rainy day account from which only the legislature could appropriate. This would allow the legislature to exercise its constitutional duty and role to determine spending policy and priorities of state government since this is the role of the legislature.

## PENSION PLANS UNFUNDED LIABILITY

The dramatic reduction in the asset value of the public retirement plans since September 2008 translates to a troubling increase in the unfunded liability of the plans. The net unfunded liability of the 9 defined benefits pension plans as of June 30, 2008 was \$1.457 billion. A rough calculation of the change since June 30 suggests that the unfunded actuarial liability may have doubled since that time (as of this writing). A speedy recovery of the equity markets in the second half of FY 2009 is not anticipated and actuarial valuation reports prepared at the end of June 30, 2009 will likely show at

least some of the plans to be actuarially unfunded. The future is uncertain but if a economic recovery is slow, the legislature may face pressures again to supplement the retirement plans. The legislature provided cash infusions of \$175 million general fund in the 2005 and 2007 biennia, and increased employer contributions for the current biennium and beyond for three of the plans.

## OUTSTANDING LIABILITIES

### Montana State Fund "Old Fund" Liability

Statutes require that when claims for injuries from workers' compensation accidents occurring before July 1, 1990 (Old Fund) are not adequately funded, the general fund must make up the difference. As of June 30, 2008, the estimated liabilities of the "old fund" exceeded assets by \$36.5 million. At this time, the Old Fund is projected to have sufficient invested assets to meet its obligations until FY 2011, when an estimated \$0.760 million general fund would be needed to offset this shortfall. In FY 2012, the cost is estimated to be \$8.0 million. As discussed below, cases currently in the courts may affect both the amount of the liability and how long the fund has sufficient assets to meet its obligations.

### State Fund Lawsuit

As discussed above, the state fund "Old Fund" projected shortfall is \$36.5 million. In addition, court cases brought against the Montana State Fund (MSF) may increase the general fund liability in the Old Fund by up to \$118 million. The largest, *Satterlee*, challenges the constitutionality of terminating disability and rehabilitation benefits when a claimant receives or becomes eligible to receive full Social Security retirement benefits. In December 2008 the Montana Supreme Court issued an order dismissing *Satterlee* without prejudice as two constitutional issues remained for ruling on by the lower court. The Workers' Compensation Court ruled in MSF's favor on both issues. In July 2008 *Satterlee* again appealed the decisions to the Montana Supreme Court. If the statute is ultimately held to be unconstitutional and to apply retroactively, the estimated cost is between \$93 and \$116 million for the Old Fund.

### K-12 Lawsuit

In 2004, a district court judge declared Montana's school finance system to be unconstitutional, holding in part that "the State's school finance system must be based upon a determination of the needs and costs of the public school system, and the school finance system must be designed and based upon educationally-relevant factors." The Supreme Court affirmed the court's determination that the current system violates Article X, Section 1(3) of the Montana Constitution but deferred to the Legislature for the definition of 'quality' as used in that constitutional provision.

The 2005 Legislature passed and the Governor signed SB 152 defining a basic system of free quality schools. In December 2005, the Governor called a special session of the legislature and four new components were added to the K-12 funding formula, costing the state approximately \$35.0 million for FY 2007 in ongoing state support and \$33.5 million in one-time only funding. Subsequently in 2007, the legislature increased ongoing state support for K-12 for the 2009 biennium by \$83.5

million, instituted full-time kindergarten, and instituted one-time only support of \$45.0 million.

In February of 2008, the plaintiffs filed a motion in the district court alleging that the state's school funding formula failed to provide adequate funding for FY 2009. In December 2008, the District Court declined to grant any supplementary relief to the plaintiffs. It is not clear yet whether the ruling will be appealed to the Supreme Court, and the state still has the controversy over adequate funding of schools to work out with the schools.