LEGISLATIVE FISCAL REPORT
2011 BIENNIUM
VOLUME 1 – STATEWIDE PERSPECTIVES

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

June 2009

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Acknowledgements

The multi-volume *Legislative Fiscal Report* is the product of many hours of analysis and staff work by 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.

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June 2009

Members of the Sixty-first Legislature
Members of the Legislative Finance Committee

In accordance with the provisions of Section 5-12-302, MCA, I submit the *Legislative Fiscal Report* for the 2011 Biennium. The report provides an overview and details of the 2011 Biennium budget for the State of Montana adopted by the Sixty-first Legislature in the 2009 session.

This four-volume report includes
Volume 1: Statewide Perspectives – This volume provides an executive summary and an overview of the 2011 Biennium state budget as well as significant policy addressed by the 2009 Legislature.
Volume 2: Revenue Estimate – This volume provides the legislative revenue estimates and underlying economic assumptions that were included in HJR 2.
Volumes 3 and 4: Agency Budgets – These volumes provide a detailed report of the appropriations for each agency and program contained in the general appropriations act (House Bill 2) and in other legislation.

Unique to this report, the enactment of the American Recovery and Reinvestment Act (ARRA) of 2009 by Congress resulted in the Montana Legislature needing to implement its provisions in Montana. The vehicle for that implementation was House Bill 645. Throughout Volumes 1, 3, and 4 of this report, you will see explained how the stimulus bill interacts with House Bill 2 and impacts the various agencies and state programs.

These volumes are intended as a reference document and historical archive of legislative budget action for the use of legislators, the public, and state agencies.

Respectively submitted,

Clayton Schenck
Legislative Fiscal Analyst

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INTRODUCTION

The purpose of this report (Volumes 1 through 4) is to provide legislators and all interested parties with information regarding the fiscal actions of the 2009 Legislature (including both legislation passed and stated legislative intent related to fiscal issues) and the fiscal status of state government through the 2011 biennium. This report seeks to accomplish this by providing an objective perspective on the state's fiscal condition and on the fiscal outcomes of the 2009 regular session. In addition, this report is a reference document for all legislators, as well as an historic record of fiscal decisions, and provides a myriad of information about Montana state government.

PURPOSE OF VOLUME 1

Volume 1 is intended to complement Volumes 2 through 4 of the *Legislative Fiscal Report – 2011 Biennium*, by providing an executive summary and general overview of the budget approved by the legislature. While Volumes 2 through 4 of the *Legislative Fiscal Report* continue to report the detailed results of the 2009 Legislature's actions regarding revenue estimates and expenditures and adopted 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.

This volume is divided into six parts:

- **2011 Biennium Budget Overview** provides a high-level budget executive summary
- **Perspectives on the Economy** describes the current outlook for the economy
- **State Revenues and Fund Balance Perspectives** provides a review of the revenue projections used to craft the 2011 biennium budget
- **Overview of State Expenditures** provides an overview of the state spending plan for the 2011 biennium
- **Other Budget Issues** includes discussions of significant fiscal issues, a list of which can be found on page 101 of this volume
- **Appendix A, B, and C** contain further information that the reader might find interesting as it further defines various aspects of the legislative budget

WHAT IS CONTAINED IN VOLUMES 2 THROUGH 4?

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 delineates the economic assumptions used to derive the revenue estimates adopted by the Revenue and Taxation Interim Committee (RTIC), introduced in the revenue estimate resolution (HJR 2), and amended by the House Taxation Committee. It also describes the legislative actions that affected the various revenue sources.

Volumes 3 and 4

Volumes 3 and 4 offer detailed summaries of individual agency budgets, as adopted by the legislature. These volumes feature program-by-program detail, including a summary of legislative intent where appropriate. Agency presentations are grouped in sections corresponding to the appropriations subcommittee that reviewed each agency budget.

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

Volumes 3 and 4 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 report is consistent across agencies. These volumes detail an agency's appropriations, both in tables and narrative. These volumes present detailed discussions of present law adjustments, new proposals, and new legislation.

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 approved for an agency.

Budget Overview
- An Executive Summary -

THE BOTTOM LINE

The 2011 biennium fiscal picture 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 $369.1 million. However, the current economic recession has begun to impact Montana revenues, with receipts expected to drop off significantly during the 2011 biennium. 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. The legislative budget reflects less optimistic revenue estimates as the economic outlook worsened. 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 during this budget period is high.

The Legislative 2011 Biennium Budget:

- Would finish the 2011 biennium with a $282.4 million general fund balance, before reserves, but could easily be impacted by further determination of economic conditions
- Proposes a general fund budget that is within about $4.4 million of being structurally balanced in FY 2011; however, this could easily be impacted with a further deterioration of current economic conditions
- Increases total general fund $220.7 million (6.3 percent) over the current biennium, and increases total funds $1,888.3 million (21.4 percent)
- Is predominantly a (present law) maintenance budget that funds existing services at revised caseload, population, and student enrollment levels – however, numerous across-the-board and unspecified reductions in the budget will likely result in a reduction in some state services

- Although structurally balanced in simple terms, there are a number of "one-time-only" designated appropriations that would normally be considered ongoing, including a portion of the percentage Base Aid increase for schools, and pending liabilities, such as the unfunded liability in the pension funds, that will place strong pressure on the next legislature to fund
- Funds the budget with existing revenues, with no significant new tax policy recommendations other than mitigation of property tax reappraisal
- Includes over $1.3 billion of one-time-only federal American Recovery and Reinvestment Act (ARRA) funds in HB 645

LEGISLATIVE BUDGET HIGHLIGHTS

ECONOMIC OVERVIEW

The importance of monitoring the economy and understanding the potential risks that it poses for the budget over the 2011 biennium and beyond cannot be overstated. As discussed during the session and restated throughout this publication, there are a number of economic vulnerabilities at the national and state level that may undermine the budget that was approved by the 2009 Legislature. Even though the legislature left a record general fund balance in place to cover contingencies, revenues may still deteriorate if the economy does not turn around or at least stabilize.

From a national perspective, interest rates, global commodity demand, capital gains, and profits of national corporations are major drivers that determine a large portion of the state's general fund revenues. These and many other economic indicators are used to forecast revenue for the fiscal period 2009 – 2011. Revenues are forecast to decline from FY 2008 levels in fiscal years 2009, 2010, and 2011, but with signs of recovery in FY 2011. If the recession lengthens or worsens, the revenue outlook may even be worse.

During the 2009 session, the estimated revenues were revised downward almost monthly. The trend appears to be continuing going into the summer months. Key risks to the economic assumptions that are used in the Montana revenue estimating process are:

- Reductions in salaries and wages reported as they relate to income tax revenues
- Low interest rates as they impact the earnings the state receives on trust funds and other monies held
- Losses reported by corporations as they relate to carrying losses forward to future tax years
- Lower commodity prices that reduce revenues from oil and gas production and serve as a disincentive for production activities

Demographics also play a role in the economic assumptions. The most significant concern at this time relates to the aging baby boomer population. This has the potential to impact the demand for services provided to aging citizens and the sources of funding that might pay for those services if the workforce shrinks relative to the whole population. More on economic factors can be found beginning on page 16 of this volume.

General Fund Status

Figure 1 shows the general fund balance sheet for the 2009 and 2011 biennia as of the end of the 2009 legislative session. It shows that:

- FY 2008 – FY 2009. The 2009 biennium is projected to end with a ending fund balance of $369.1 million, or about three times the amount estimated by the legislature after the September 2007 Special Session, reflecting stronger than anticipated individual, corporation, and oil and gas production tax collections. (It is important to note that as of this writing, actual general fund FY 2009 collections are showing further decline as compared to the same time in FY 2008.)
- FY 2010 – FY 2011. In the budgeted biennium, the projected general fund revenue available, which includes the FY 2009 ending general fund balance plus new revenues, is $4.0 billion, while disbursements total $3.7 billion. The difference is set aside for a $282.4 million ending general fund balance reserve.

Figure 1

Legislative Budget - 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	$437.676	$369.149	$312.668	$543.541	$369.149	($174.392)	-32.1%
Revenue								
HJ2 Revenue Estimate	1,953.540	1,844.604	1,772.916	1,829.348	3,798.144	3,602.264	(195.880)	-5.2%
Total Funds Available	$2,497.081	$2,282.280	$2,142.065	$2,142.016	$4,341.685	$3,971.413	($370.272)	-8.5%
Disbursements								
General Appropriations - HB2	1,705.128	1,598.537	1,498.930	1,565.832	3,303.665	3,064.762	(238.903)	-7.2%
Stimulus Approps. - HB645	-	21.243	57.069	57.052	21.243	114.121	92.878	437.2%
Stimulus Transfers - HB645	-	-	75.947	38.209	-	114.156	114.156	
Statutory Appropriations	262.666	165.266	179.138	181.846	427.932	360.984	(66.948)	-15.6%
Transfers	166.358	106.945	9.421	9.727	273.303	19.148	(254.155)	-93.0%
Other Appropriations	-	54.253	11.576	2.893	54.253	14.469	(39.784)	-73.3%
Supplemental Appropriations	-	3.464	-	-	3.464	-	(3.464)	-100.0%
Feed Bill	-	9.891	2.589	10.809	9.891	13.398	3.507	35.5%
Reversions	(65.107)	(47.921)	(5.273)	(6.767)	(113.028)	(12.040)	100.988	-89.3%
Total Disbursements	$2,069.045	$1,911.678	$1,829.397	$1,859.601	$3,980.723	$3,688.998	($291.725)	-7.3%
Fund Balance Adjustments	9.640	(1.453)	-	-	8.187	-	(8.187)	-100.0%
Ending Fund Balance	$437.676	$369.149	$312.668	$282.415	$369.149	$282.415	($86.734)	-23.5%

Revenue Forecast – Declining Revenues in 2011 Biennium

Major revenue source contributors to the state general fund (and interrelated state special funds) are experiencing deep declines from FY 2008 levels. These declines are expected to continue through FY 2010 before increasing, but will still be below the FY 2008 level by FY 2011. Rapidly deteriorating economic conditions statewide, nationwide, and worldwide bodes ill for the revenues that finance many state-provided services. Such turmoil also complicates the accurate prediction of future revenues and, hence, complicates the budgeting process for the legislature. Throughout the 2009 legislative session, LFD revenue staff updated the legislature on changing economic conditions and offered recommendations for amending HJR 2, the official revenue estimates introduced by the Revenue and Taxation Interim Committee (RTIC). The House Taxation Committee incorporated them into HJR 2. Although the House and Senate failed to pass the revenue estimate resolution, it became the official estimate of the legislature due to statutory language. The forecast assumes a revenue decline of $195.9 million in the 2011 biennium when compared to the 2009 biennium. Total general fund revenue is expected to decrease by 6.8 percent, down to $3.6 billion in the 2011 biennium. Combined with an estimated $369.1 million general fund balance carried over from the 2009 biennium, the legislative budget anticipates total general fund revenue available to fund the legislative budget is $4.0 billion in the 2011 biennium.

Revenue Related Policy Changes,

The legislature adopted one major tax policy change, to mitigate the effects of property tax reappraisal. The legislature also removed the FY 2009 sunset provision from the wildfire suppression account, which reduced revenues to the general fund by $32.9 million in FY 2009. See page 96 in this volume for more information.

While the voter-approved I-155 would have redirected a portion of the insurance tax to a state special revenue account for children's health programs, the legislature reduced the amount to allow for a "ramp-up" period for those health programs.

PROPOSED SPENDING

The legislative budget includes $10.7 billion total state spending for the 2011 biennium - a 21.4 percent increase from the 2009 biennium. This increase is primarily due to the passage of federal economic stimulus legislation included in HB 645 by the legislature. If on-going spending is compared between biennia, total spending increases by $285.2 million or 3.2 percent. General fund spending increases from $3.5 billion to $3.7 billion, a 6.3 percent increase. If on-going spending is compared between biennia, general fund spending decreases by $75.0 million or 2.2 percent. The increases are predominantly to continue existing services at revised caseload, prison population, and student enrollment levels, and to provide a 3.0 percent per year increase for K-12 education and an increase for state employee health plan costs.

KEY FEATURES OF THE APPROVED BUDGET

Figures 2 (total funds) and 3 (general fund) show the approved budget by function for the general operations of state government and by appropriation type for the remaining budget items. Figure 2 shows the total 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 67.4 percent. Higher education and corrections add another 7.5 percent. The federal stimulus funding (HB 645) is 11.3 percent of the total funds budget.

Figure 2

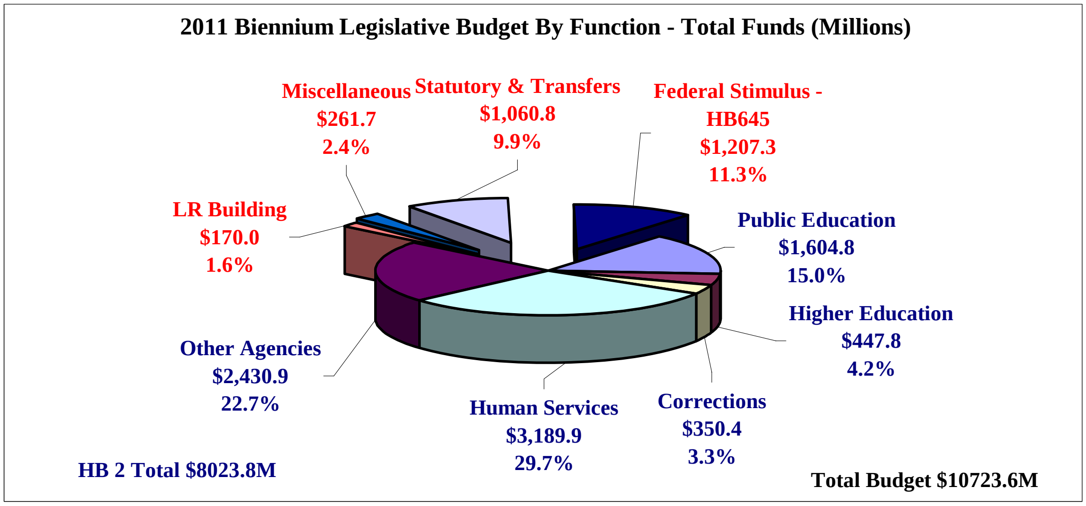
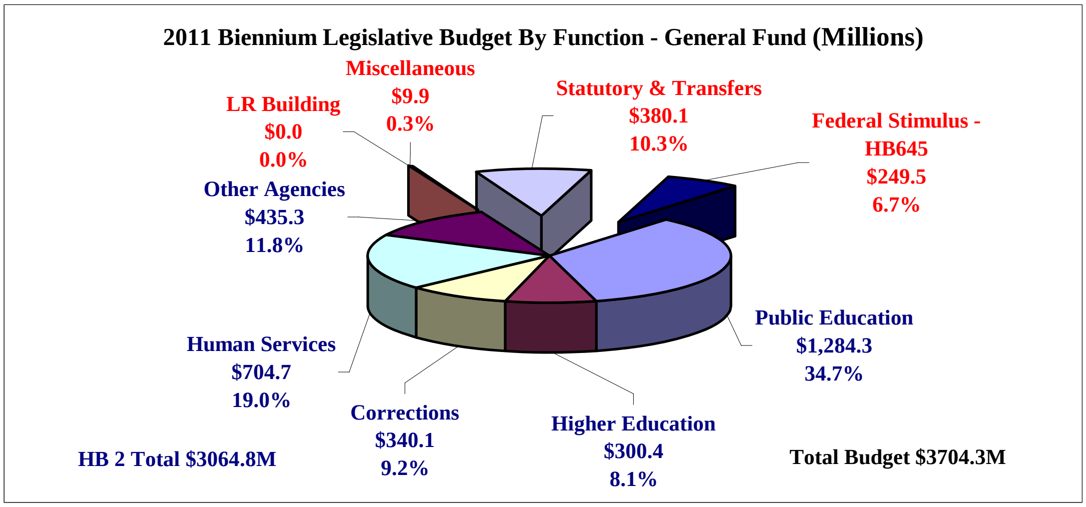


Figure 3



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

Figure 4

KEY PROGRAMMATIC FEATURES OF THE 2011 BIENNIUM LEGISLATIVE BUDGET

Predominantly a Present Law Budget, Funds Existing Services

- Funding present law adjustments costs $991.2 million total funds and $262.5 million general fund
- Generally funds caseload, population, and student enrollment at maintenance levels
- Impacts of an economic downturn may increase demand for many state services that may not be reflected in the legislative budget, particularly Medicaid and other health services

Unspecified Reductions

- Unspecified 2 percent reductions and vacancy savings levels of 7 percent applied to most agency budgets puts policy decisions for reductions in hands of executive branch rather than the legislature
- The unspecified reductions could result in reduced services below present law

Education

- Utilizes state money and federal stimulus money to fund K-12 and higher education
- Increases K-12 BASE aid and special education by 3 percent per year, of which 1 percent in FY 2010 and 3 percent in FY 2011 is ongoing
- Funds a 4 percent increase for the Montana University System -- state general fund support decreases 12 percent

Public Health and Human Services

- Funds the current projected level of caseload
- Funds voter passed Healthy Kids initiative (I-155)
- Requires $24.1 million in reductions be submitted for the 2013 biennium

Corrections

- Funds a projected population increase of about 3 percent each year

Long Range Planning

- Funds long-range planning projects of $394.8 million total funds, including $65.4 million general fund transfers in HB 645
- Included in capital projects is the Governor's 20 x 10 initiative to increase state government energy efficiencies by 20 percent by 2010
- Funds major information technology projects of $4.5 million general fund, $99.3 million total funds

State Employee Compensation

- Increases state contribution toward 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

- Includes legislation to mitigate the effects of property tax reappraisal
- Removes sunset provision of wildfire suppression account
- Reduces by half the insurance tax collections redirected from the general fund by I-155 to a state special revenue account for children's health programs

Predominantly a Present Law Budget, Funds Existing Services

Of the increases approved in the legislative budget, present law accounts for a majority of the increases with only minor positive new proposals approved, more than offset by negative new proposals that reduce present law resources. The legislature essentially funds all projected caseload, population, and enrollment levels in both HB 2 and HB 645 with funds provided for a potential Medicaid spike. The budget also includes two across the board reductions by increasing vacancy savings from 4 to 7 percent for most positions and imposes a 2 percent further across the board reduction on most general fund agencies. These reductions may have an impact on present law operations and result in reduced services.

Unspecified Reductions

An across-the-board 2 percent reduction and a vacancy savings rate of 7 percent was applied to most agency budgets. The 2 percent reduction was applied to a single program within the agency with the agency given authority to allocate the reduction among its various programs. The reduction was not calculated on either Medicaid or BASE Aid. The executive can decide which programs and how much reduction would occur, thereby giving the executive the policy decision as to which programs and services reductions should occur instead of the legislature. As discussed above, the unspecified nature of the reductions makes it difficult to determine the ultimate impact on state services, but service reductions are likely.

Education

K-12 public education increased 8.23 percent when compared to the 2009 biennium from a combination of general fund provided in HB 2 and federal stimulus funding appropriated in HB 645. The combined funding provided for 3 percent per year increase to BASE and per-ANB entitlements as well as supporting other elements of the school funding formulas at FY 2008 levels. The legislature did eliminate $10 million in general fund support for the at-risk payment component of the funding formula. Of the 3 percent per year increase, only 1 percent in FY 2010 and 3 percent in FY 2011 is approved for ongoing base funding in the 2013 biennium. In addition, the legislature provided $35 million in funding for school facilities in HB 645 and $12 million in HB 152. Both appropriations are to the Department of Commerce for grants to school districts.

The legislature utilized state and federal stimulus money to fund the Montana University System (MUS), increasing 4.4 percent when compared to the 2009 biennium. Similar to the K-12 public education funding, $59.5 million of federal stimulus funding provided in HB 645 will be considered ongoing base funding for the MUS in the 2013 biennium. In addition, a portion of the federal stimulus dollars supports tuition mitigation at the university units and community colleges.

Public Health and Human Services

The legislative appropriation is intended to continue all services, with a few exceptions (including the unknown impact of across-the-board reductions left to executive discretion), and provides for increased eligibility and service utilization. The legislature also provided one-time appropriations for expansion of Medicaid community services for the elderly and disabled. It fully funded implementation of Healthy Montana Kids (adopted by voter initiative in November 2008). The legislature moved $24.1 million in general fund into one-time appropriations and included language in HB 676 directing the Department of Public Health and Human Services (DPHHS) to evaluate and include budget reductions in its 2013 biennium budget request to the 2011 Legislature. HB 676 also required the Legislative Finance Committee to review the DPHHS study at each of its interim meetings.

Corrections

The legislative budget provides funding for a population increase of about 3 percent each year. This does not include the unspecified 2 percent reduction mentioned above. The overall increase for the Department of Corrections is about 1 percent ($3.5 million) when the 2011 biennium is compared to the 2009 biennium, most of which is general fund and state special revenue. The low rate of increase is primarily due to the impacts of lower than anticipated expenditures in FY 2008 compared to the appropriation, and adoption of a projected prison population increase that is less than originally projected at less than previous trends.

Long Range Planning

The legislative budget includes appropriations and authorizations of $394.8 million for land acquisition, building and major maintenance, energy conservation, local government water and waste water, and major information technology projects. Of that total, $89.6 million, or 22.7 percent, is attributed to transfers ($65.4 million) resulting from and the direct federal funding ($24.2 million) of the American Recovery and Reinvestment Act (ARRA). The legislature prioritized projects that could be started quickly to increase the state workforce and boost the economy.

The legislative budget appropriates $99.3 million of total funds to the state's information technology needs. Over 91 percent of these funds are non-general fund monies. Almost $66.0 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 $23.2 million funding for energy efficiency projects that are the most significant component of the Governor's "20 x 10" initiative, with a goal of increasing energy efficiencies by 20 percent by 2010.

State Employee Compensation

The approved pay plan (HB 13) 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 will not receive the lump-sum adjustment. There is no percentage increase for state employees. The plan also increases health insurance benefits by $53 per month for FY 2010 and $54 per month for FY 2011. Projected cost of the pay plan is $18.7 million general fund and $32.6 million total funds for the 2011 biennium.

Revenue and Tax Proposals

The legislative budget includes mitigation of the effects of property tax reappraisal (HB 658). Further, the budget via HB 154 includes removal of the sunset provision from a fire suppression fund that would have otherwise reverted $32.9 million to the general fund and left no dedicated fund for wildfires.

In addition, with the approval of Initiative I-155 by the electorate in November, 2008, a portion the insurance tax previously deposited in the general fund, will be deposited in a state special revenue account for children's health care programs. The legislature reduced the amount redirected by I-155 to allow for "ramp up" period, allowing some ($22.3 million) of the portion of insurance tax to continue to go to the general fund.

LEGISLATIVE BUDGET HIGHLIGHTS – HB 645

HB 645 contains all anticipated federal stimulus funding that requires an appropriation, totaling $249.8 million general fund and $1,302.8 million total funds (not including state special revenue derived from general fund transfers), and including Medicaid spike and language appropriations.

The bill provides funding from three sources:

- Federal funds that can only be used for the specific purposes contained in the federal legislation ("silo" funds) totaling $904.3 million (which includes anticipated Medicaid caseload and service utilization increases)
- Federal fiscal stabilization funds totaling $148.7 million, of which over 81 percent must be used for education with the remainder for other critical state services
- General fund of almost $250.0 million freed-up due to an increase in the federal Medicaid match rate and replacement of general fund with federal fiscal stabilization funds

There is interaction between HB 2 and HB 645 through two primary mechanisms:

- HB 645 includes certain on-going expenditures for K-12, higher education, and human services that would normally be in HB 2
- HB 645 reduces general fund in HB 2 by over $99 million in the 2011 biennium and $50.6 million in FY 2009 due to the enhanced Medicaid match rate and other minor replacements. General fund was reduced directly in HB 2 for K-12 education by $40.4 million due to inclusion of funding in HB 645.

Further discussion is found on pages 69 and 88 of this volume, as well as in Appendix A beginning on page A-16.

Figure 5

KEY ELEMENTS OF HB 645 - THE MONTANA STIMULUS BILL

Stimulus Money (American Reinvestment and Recovery Act)

- Provides $1.2 billion* through HB 645 increasing the total state budget to $10.7 billion for the 2011 biennium
- Funds were provided for a variety of purposes on a one-time-only basis

Funds are Provided from Three Sources

- Federal funds that must be expended for specific purposes (silo funds) - $904.3 million
- Federal fiscal stabilization funds - $148.7 million
- Freed-up general fund - $249.8 million

Interaction with HB 2

- HB 645 includes funding for on-going functions, and the bill also reduces general fund in HB 2

*Subsequent tables include Medicaid spike and language appropriations for informational purposes, allowing for the difference to $1.3 billion.

BUDGET ISSUES

This section briefly discusses key budget issues that relate to the budget enacted and future budget deliberations. The legislature needs to be aware of these liabilities and risks through the interim period and into the next legislative session. These and other budget issues are presented beginning on page 101 of this volume.

Figure 6

Highlights of Significant Budget Issues

Economic Volatility

- Budget may not reflect full impacts of an economic downturn
- Revenues may fall significantly after the session

Outstanding Liabilities

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

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, there may be pressure for the legislature to again supplement the retirement plans

ECONOMIC VOLATILITY

Structural Balance and the Long-Term Stability of the General Fund

Ensuring that the general fund is structurally balanced, i.e., that on-going revenues meet or exceed on-going expenditures for the next biennium, provides a simplistic short-term assessment of sustainability of the general fund. However, it does not take into consideration the long-term stability of the funds or whether long-term trend assumptions are based on sound fiscal policies. Structural balance of the general fund budget is in a fragile state at this point in time. Although the budget was nearly structurally balanced at the end of the session, any significant reduction in general fund revenues that causes a spending down of the fund balance will likely move the budget further into a structural imbalance.

With regard to long-term revenue stability, individual income taxes, oil and gas production taxes, and corporate income taxes accounted for 80 percent of revenue growth in the past five completed fiscal years. Future reliance on sustaining these revenues at current levels would ignore ominous signs that warrant careful scrutiny.

With regard to federal funds, the federal stimulus bill provides a huge boost from federal sources at a time when state revenues are dropping. The one-time nature of these funds was well recognized in the crafting of the state budget, but although much of what was funded, particularly in the human services arena, was designated as one-time, the demand for services will still be there when these funds are gone. The availability of historic levels of federal funds may not be maintained as was becoming apparent before the stimulus bill was enacted. Future cutbacks should be anticipated as the federal government deals with huge deficits. Funding demands from shifting demographics related to an aging population and school enrollment patterns, and challenging chronic growth patterns with corrections and human services may be other reasons for concern with long-range stability of the general fund. Collectively, these sample issues bring into question the sustainability of a budget that, while "structurally balanced" from a simplistic short-term perspective, may lead to budget shortfalls in the not-too-distant future.

Revenue estimates and spending proposals in the legislative budget were based on the best information available, particularly with regard to future sustainability. However, if only a few key assumptions miss the mark, budget shortfalls could result in the long-term. There is evidence of that already. The legislature and the executive should be especially vigilant and keep in mind the level of risk that is inherent in the vulnerability of any economic forecasting assumptions.

Post-Session: What Happens if Revenues Fall?

The legislature adjourned with a projected fund balance of $282.4 million. If actual revenues are less than projected for the interim, the fund balance offers some protection. Of course, it depends on the extent to which revenues decline. A few policy issues are included in the decision to rely on fund balance in the event of a revenue downturn:

- Using an ending fund balance in the advent of a revenue shortfall does not provide the legislature the opportunity to re-prioritize spending during a period of declining revenues
- Using the ending fund balance for on-going programs could create a structural imbalance that might not be addressed until the next legislative session and may limit the options available to the next legislature to address the fiscal imbalance
- If the revenue decline extends beyond the biennium, then the utilization of an ending fund balance is not a prudent fiscal policy but rather is merely a policy to "get you through the biennium"

What ending fund balance should the legislature expect? It is difficult to say at this time since it is uncertain if revenue declines have reached bottom. A 10 percent decline in revenues for the biennium would translate into a $360 to $370 million decrease. Even the $282.4 million ending balance would not be adequate in that case. (Note also that the projected ending balance cannot fall below about $37 million.) If the budgeted ending fund balance is not adequate to maintain solvency, then the provisions delineated in 17-7-140, MCA, for Governor's spending reductions may be triggered and, if that is not enough, a special session may be necessary.

POTENTIAL GENERAL FUND LIABILITIES

Montana State Fund "Old Fund" Liability

Statutes require that in any fiscal year when the Montana State Fund is not adequately funded to pay claims arising from accidents that occurred before July 1, 1990, the funds to pay these Old Fund claims must be transferred from the general fund. As of June 30, 2008, estimated liabilities 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 $760,317 general fund would be needed to offset the Old Fund shortfall (this was included in general fund balance projections). In FY 2012, the cost is estimated to be $8.0 million. It should be noted that these estimates were calculated using financial information as of June 30, 2008, prior to the economic recession, which could affect the amount of the estimated general fund liability and the timing of the required transfer.

Pending Lawsuits

K-12 Lawsuit

The Supreme Court is being asked to overturn a District Court decision that requires payment by PPL Montana for rents of riverbeds. The riverbeds of Montana have been determined by the district court to be part of the permanent school trust lands of Montana and as such any income derived from the use of the riverbeds would be considered part of the trust lands income to be distributed as required by law. The issue is multi-faceted. The district court determined that the state school trust is due $34.7 million from PPL Montana for "the rental of state land used for a power site" for the years 2000 through 2006 and $6.2 million for 2007. In a similar case, Avista Corporation made a $4 million negotiated settlement with the state for its use of state school trust navigable riverbed lands. The rental payment was deposited into the guarantee account and the public school trust fund as required in the constitution. The land board considers the PPL Montana payments to be compensatory damages rather than rent. On December 15, 2008, the land board determined it would place the rental payments of $40.9 million into the Common School Land Banking Trust Account rather than, as required by the constitution, 5 percent to the public school trust fund and 95 percent to public schools.

State Fund Lawsuits

Two court cases brought against the Montana State Fund (MSF) may increase the general fund liability in the Old Fund by up to $117.9 million. *Satterlee* challenges the constitutionality of terminating permanent total disability and rehabilitation benefits when a claimant receives or becomes eligible to receive full Social Security retirement benefits or an alternative to that plan. So far, the decisions have favored the Montana State Fund. On July 1, 2008, *Satterlee* again appealed the decisions to the Montana Supreme Court. The potential estimated benefit costs for non-settled permanent total disability claims, if the statute is ultimately held to be unconstitutional and to apply retroactively, is between $93 and $116 million for the Old Fund. *Quick* requests retroactive and future domiciliary care benefits for a claimant. The case is on appeal to the Montana Supreme Court. Should the Montana Supreme Court reverse the lower court decision and award retroactive domiciliary care prior to February 1, 2007, the potential estimated benefit costs are $1.9 million.

PENSION FUNDS UNFUNDED LIABILITY

The net unfunded liability of the nine defined benefits pension plans as of June 30, 2008, was $1.5 billion. Just five months later, a rough calculation of the change since June 30 suggested that the unfunded actuarial liability may have doubled. The collective funded ratio, which was about 85 percent, could be in the neighborhood of 68 percent. The changes are dramatic but do not consider the actuarial assumptions of "smoothing", which refers to the practice of spreading gains and losses over a four year period. Still, there was an unsettling drop in asset value in just a couple of months. More recently, the equity markets have recovered some of the lost value, but the sustainability of the gains might still be in doubt as many economic indicators still signal a weak economy.

Historic economic cycles and the logic of actuarial valuations might suggest that time will resolve the pension plan unfunded liabilities to the degree needed for actuarial soundness. However, this time may be different as it does not appear that the economy is poised to recover quickly or even to the extent in a number of years that would bring the unfunded liabilities into line with the 30-year amortization requirement. Retirement fund experts suggest that, more than likely, additional funding and reductions in liabilities (to the extent that liabilities can be reduced) will also be required. The Montana Constitution requires that retirement systems be funded on an actuarial sound basis. The retirement boards have a policy that provides that after two consecutive "negative" valuation reports, the boards are obligated to pursue legislative remedies. The next valuation for the year ending June 30, 2009, will be available around October

1, 2009. The questions then become: How long might a recovery take and at what point is the legislature obligated to take some action?

For the 2009-2010 interim, the legislature approved HB 659, which tasks the State Administration and Veterans' Affairs Interim Committee to examine and recommend to the 62nd Legislature funding and benefits changes in the statewide public employees' retirement systems and, with respect to the Teachers' Retirement System, the committee is directed to develop legislation to implement a redesign of the teachers' retirement system. In addition, the public employee and teachers retirement plans are planning to do experience studies that will evaluate the assumptions that the plans' actuaries use in performing the actuarial valuations.