LEGISLATIVE FISCAL REPORT
2013 BIENNIUM
VOLUME 1 – STATEWIDE PERSPECTIVES

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

June 2011

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LFD Publications

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PURPOSE OF VOLUME 1

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 2011 Legislature (including both legislation passed and stated legislative intent related to fiscal issues) and the fiscal status of state government through the 2013 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 2011 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.

Volume 1 is intended to complement Volumes 2 through 4 of the Legislative Fiscal Report – 2013 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 2011 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:

- **2013 Biennium Budget Overview** provides a high-level executive summary
- **Perspectives on the Economy** describes the current outlook for the economy
- **State Revenues 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 85 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:
  - House Bill 2 – General Appropriations Act of 2011
  - 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
- 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 a 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.

2013 Biennium Budget Overview

BOTTOM LINE

The 2011 legislative session faced serious budget challenges as anticipated revenues were significantly below the cost to maintain the services provided. Many choices were evaluated. In the end, the budget was balanced with a combination of spending reductions, transfers to the general fund, and shifts in funding from the general fund to other funds.

With all the impacts from legislation included, the anticipated general fund balance is $150 million or about 4% of biennial expenditures. This ending fund balance is the third highest, both in terms of the percentage of the budget and dollars in recent biennia.

Another common measure of a budget is the structural balance or the difference between ongoing revenues and spending. The budget is not structurally balanced as FY 2013 anticipated ongoing revenues are less than ongoing spending by $25 million.

In comparing spending from the previous biennium, analysis to make the budgets comparable was required. With adjustments for comparability, the “All Funds” budget was reduced from the prior biennia by about 4.4% and the general fund commitment was reduced about 4.6%.

NATIONAL BUDGET PERSPECTIVE

Montana has challenging budget issues, but so does almost every other state. Budget cuts across the country over the past two years have been cited throughout the national press. The revenue situation is clearly better than it has been in recent years with revenues growing since the lowest revenue year, FY 2010. However, in Montana like the rest of the country the overall fiscal conditions remained weak. The following quotes are from the National Conference of State Legislatures March 2011 update.[1]

"State officials expressed more confidence about the current fiscal situation than in recent years, possibly indicating that the most difficult times are behind them. A growing number of states report that their fiscal situations are stable or improving as revenue performance continues to meet or exceed projections. However, overall fiscal conditions remain weak and budget gaps continue to present challenges."

"Projected FY 2012 Budget Gaps

Following on the heels of the significant shortfalls already closed in FY 2009, FY 2010 and FY 2011, projected budget gaps for FY 2012 continue to present an ongoing challenge for states. It is still uncertain when states will be free of the budget gaps that have dogged them since FY 2009. The loss of federal stimulus funds in FY 2012 plays a prominent role because state revenue growth has been unable to offset the expiration of enhanced Federal Medical Assistance Percentage (FMAP) or other ARRA funds. States also cite the use of one-time revenues in past fiscal years as a factor contributing to their projected budget gaps in FY 2012."

Montana's experience has the same overall trend and continued budget pressure as other states described by NCSL, although the gaps have not been as deep.

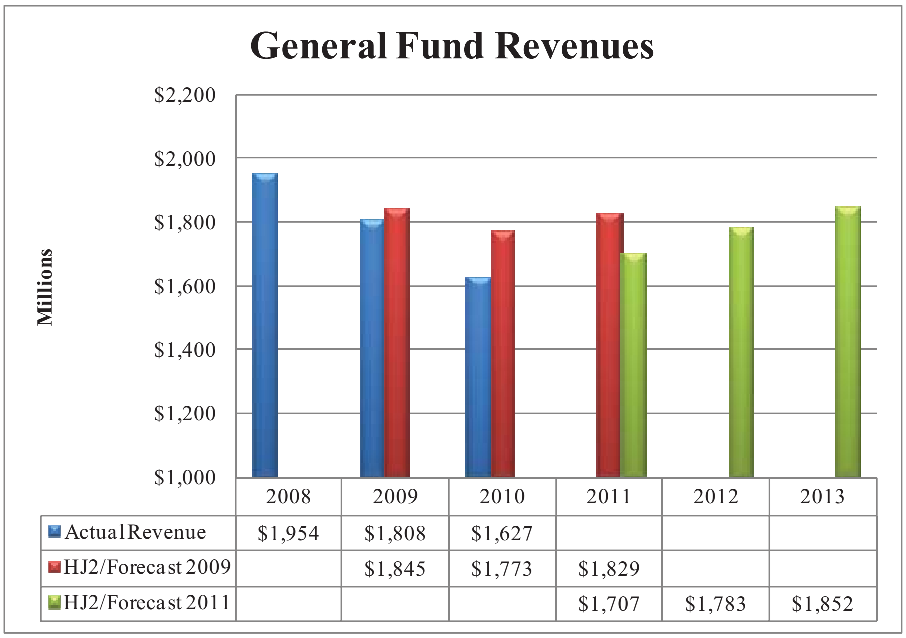
The 2011 session reflected both an improving revenue forecast and budget reductions for many of the same reasons as other states. This overview covers the high level Montana trends of revenue and spending and reflects on the 2013 session and the implications for the 2015 biennia.

[1] State Budget Update: March 2011, National Conference of State Legislatures, Page 9

MONTANA'S EXPERIENCE

REVENUE TRENDS

The following graph illustrates the actual and HJ 2 anticipated revenues in the past three years, the current year, and the next two years. It demonstrates how the anticipated and unanticipated revenue reductions have impacted Montana's availability of funds for services for citizens.



In the 2009 session, spending levels were set based on the revenue forecasts of FY 2009 through FY 2011 or the red bars shown above. Actual collections, the blue bars, for FY 2009 and FY 2010 were below the estimates. These reductions in revenue caused expenditures to exceed ongoing revenues in the 2011 biennium that persisted into the 2013 biennium.

The 2011 session forecast revenues, the green bars, were based on lower actual collections for FY 2009 and FY 2010 and updated economic conditions through early April 2011.

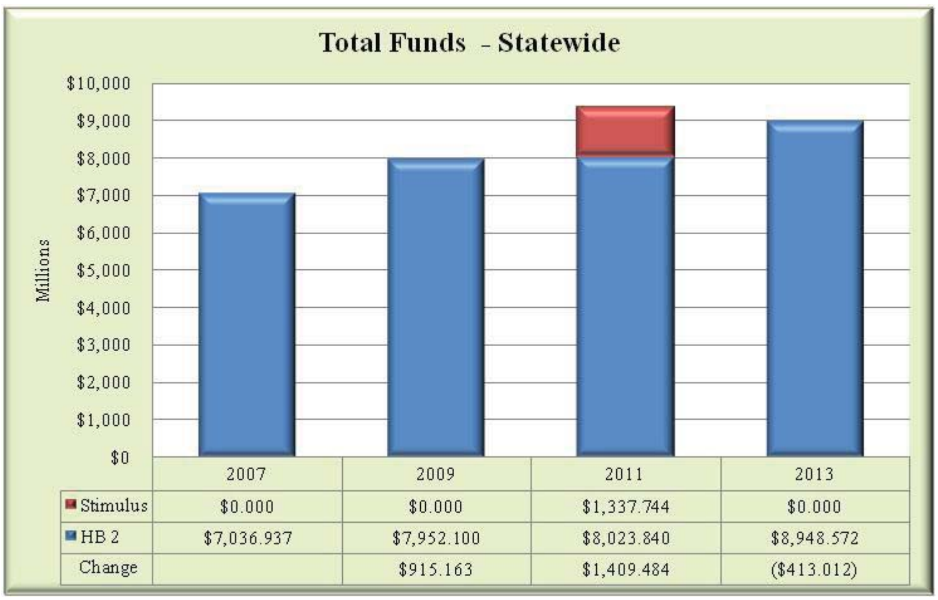
FY 2010 will clearly be the lowest year of general fund revenue with collections steadily increasing since then. The 2011 session HJ 2 estimate is 4.9% higher than the FY 2010 actual collections and current FY 2011 collections are about 10% or $67 to $77 million higher than HJ 2 estimates. If the higher collections for FY 2011 continue through fiscal year end, the anticipated revenues for FY 2012 and FY 2013 may also increase, although official changes in estimates do not occur without legislative action.

SPENDING TRENDS

The spending comparisons are difficult this biennium due to the receipt of significant one-time-only stimulus and other revenues in the 2011 biennium. The usual comparisons leave an incomplete answer to how spending changed from biennia to biennia. In attempting to equalize the biennia, the following comparisons have been developed and represent a more complete picture of the changes in spending.

All Funds HB 2 and HB 645 Appropriations Authority Only

While revenues are recovering in FY 2011 to FY 2013, the federal stimulus (ARRA) funds end with FY 2011. FY 2012 and FY 2013 were required to be balanced without these temporary federal dollars, some of which replaced general fund for ongoing functions.



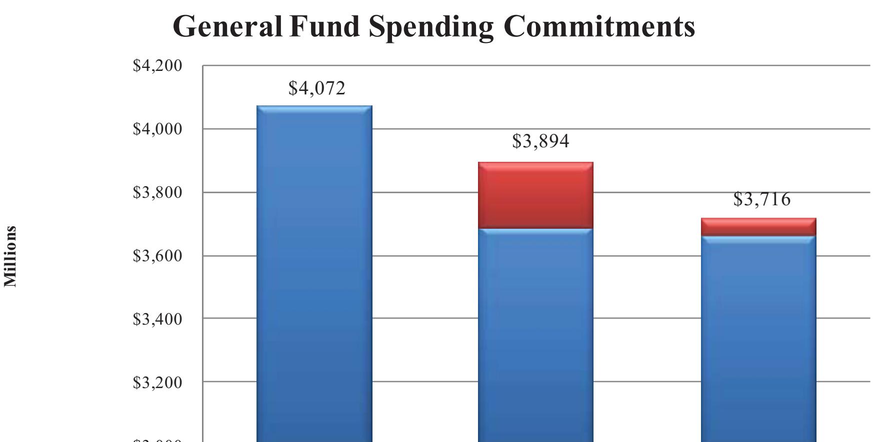
While the HB 2 only appropriations increase between the 2013 and the 2011 biennia, the total HB 2 and HB 645 appropriations do not. As shown above, in the 2013 biennium spending is 4.4% ($413.0 million) lower than the 2011 biennium.

General Fund All Types of Authority

Likewise, the measurement of general fund spending was more difficult to compare than in a typical biennium due to the federal stimulus funds and other reversions of general fund appropriations in the 2011 biennium. As a result, the following measurement was developed to compare spending between the biennia. The blue bars represent the appropriations and transfers made by each legislature. The red bars represent other commitments of general fund.

Including other commitments is not a typical comparison, but in this biennial comparison, to not include them in the comparison would misrepresent the actual changes occurring. "Other commitments" include spending needed to support the current general fund obligations, but that were not appropriated from the general fund in the respective biennium. Included in other commitments are the following:

- In the 2011 biennium, HB 645 replaced certain estimated ongoing general fund obligations with federal stimulus funds, and required the replacement of those funds with general fund in the 2013 biennium. These obligations were for higher education, K-12 education and Medicaid.
- In the 2013 biennium, the legislature committed to a specified level of school funding. The Governor's veto of HB 316 reduced the appropriations for school funding more than it reduced the statutory commitment to fund schools, resulting in an estimated supplemental appropriation of over $53 million.



	2009 Biennium (FY 2008 and FY 2009)	2011 Biennium (FY 2010 and FY 2011)	2013 Biennium (FY 2012 and FY 2013)
Other commitments		$205	$53
Appropriations/transfers	$4,072	$3,689	$3,662

As shown above, the total commitment of general fund has decreased for the past two biennia. And, while the 2011 and 2013 biennia have similar general fund appropriations, the commitment level of general fund has decreased. The total commitment reduction from the 2009 biennium to the 2011 biennium was 4.4%. The commitment reduction from the 2011 biennium to the 2013 biennium was a further 4.6%.

The spending reductions reflect the loss in the federal funds that are no longer available to support services and the lower revenues than anticipated in the previous biennia, as seen in the Revenue Trends section on page 3.

BUDGET ADOPTED BY THE 2011 LEGISLATIVE SESSION

GENERAL FUND BALANCE SHEET THROUGH FY 2013*

The following table describes the annual revenues and spending anticipated for the general fund.

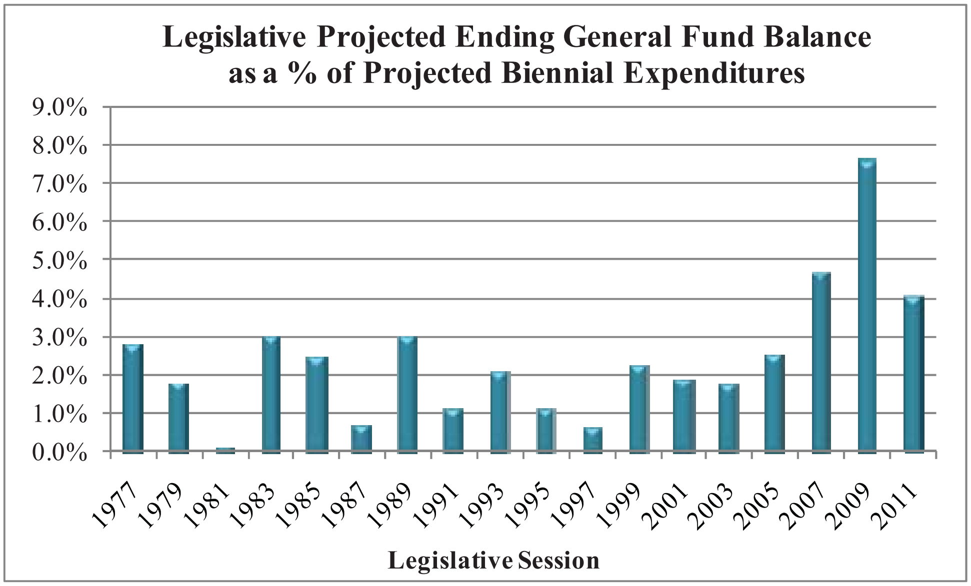
Legislative Budget - General Fund Outlook Figures in Millions	Actual FY 2010	Budgeted FY 2011	Estimated FY 2012	Estimated FY 2013	2011 Biennium	2013 Biennium
Beginning Fund Balance	$396.334	$314.880	$227.338	$188.909	$396.334	$227.338
Revenue						
HJ2 Revenue Estimate	1,627.145	1,706.654	1,785.623	1,853.138	3,333.799	3,638.761
Total Funds Available	$2,023.478	$2,021.534	$2,012.961	$2,042.047	$3,730.132	$3,866.099
Disbursements						
General Appropriations - HB2	1,575.921	1,533.314	1,601.307	1,648.383	3,109.235	3,249.690
Statutory Appropriations	169.872	180.683	184.532	195.170	350.555	379.702
Transfers	88.877	49.144	17.122	12.898	138.021	30.020
Other Appropriations	-	139.737	0.661	1.822	139.737	2.483
Supplementals	-	2.775	23.344	30.070	2.775	53.414
Feed Bill	-	9.640	2.469	10.009	9.640	12.478
Reversions	(117.960)	(121.563)	(5.383)	(6.686)	(239.523)	(12.069)
Total Disbursements	$1,716.710	$1,793.730	$1,824.052	$1,891.666	$3,510.440	$3,715.718
Fund Balance Adjustments	8.112	(0.466)	-	-	7.646	-
Ending Fund Balance	$314.880	$227.338	$188.909	$150.381	$227.338	$150.381

*Note that this balance sheet is how budgets are usually compared and so does not adjust for one-time and other funds replaced with general fund in the 2013 biennium. For a comparison that makes this adjustment see page 4.

The balance sheet includes all authorized spending, including the portion of funding for K-12 schools that was eliminated in vetoes of the Governor. These vetoes did not remove the obligation to fund schools contained in SB 329. The balance sheet includes these amounts in the line "Supplementals" for FY 2012 and FY 2013.

HISTORICAL ESTIMATE OF ENDING FUND BALANCE

The anticipated ending fund balance at the end of the 2013 biennium is $150 million or 4.0% of anticipated expenditures in the biennium. Previous legislatures have anticipated ending fund balances ranging from 0.1% to 7.7% of anticipated spending. While this level is lower than the 7.7% anticipated in the 2009 session and the 4.6% in the 2007 session, it is higher than any other session since 1977.

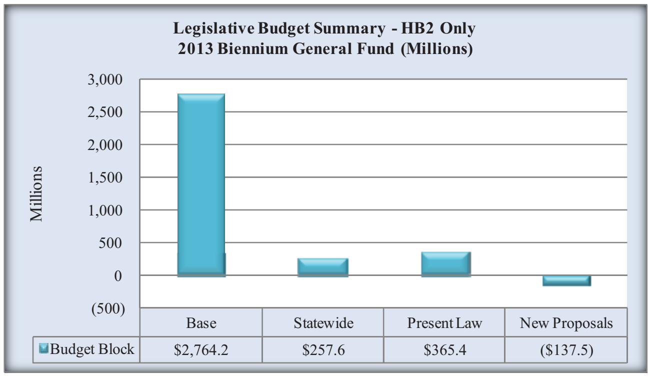


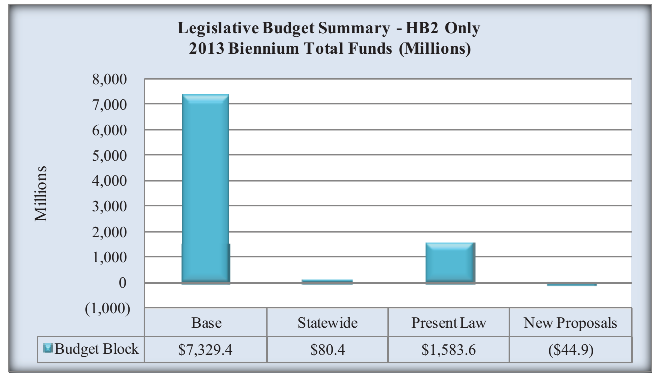
THE ADOPTED BUDGET IS GENERALLY A REDUCED PRESENT LAW (MAINTENANCE)

Present law is considered to be the funding necessary to maintain operations of state government at the level passed by the previous legislature, including phased-in legislation. The budget passed by the 2013 Legislature is essentially reduced present law. As shown in the "Further Examination" section, present law comprises over 100% of the total increases to the base for all funds and for general fund, and new proposals are negative. The legislature essentially funded present law adjustments, but then reduced those adjustments by items primarily included in plans submitted by agencies as required by statute to reduce general fund and certain state special revenues by 5%.

The following figures show the allocation of base, statewide present law adjustments, other present law adjustments, and new proposals for general fund and other funds. Statewide present law adjustments are those adjustments to account for ongoing costs of personal services (including the pay plan passed by the previous legislature, partially offset by a vacancy savings rate), inflation, and fixed costs.

The statewide present law adjustments include replacement of one-time federal and other funds with general fund, resulting in the large difference between general fund and total funds appropriated for those adjustments. Because of this factor, the total fund change, which includes the net of the replacement, more accurately reflects the actual increase.





Legislative Budget is Lower than Executive Budget

The total budget is $78.8 million lower than the proposed executive HB 2 budget in general fund and $33.5 million in total funds. The differences within each agency are due to a number of sometimes offsetting factors. The Overview of State Expenditures section of Volume 1 outlines the major differences.

LOOKING FORWARD: REVENUES & SPENDING PRESSURE

END OF SESSION ACTION AND GENERAL FUND STRUCTURAL BALANCE[2]

The budget of the legislature at the end of session as projected in the final budget status sheet (#9) was close to structurally balanced based on HJ 2 revenues without considering retirement backfill or other pressures. Action after status sheet #9 and vetoes by the Governor eroded the structural balance.

The legislature did not approve all bills at the end of session and the Governor vetoed several items that added to the structural imbalance as follows:

- The veto of HB 604 language that removed alternative funding for the State Fund Old Fund liability increased the commitment of general fund on an ongoing basis by almost $7 million per year
- The veto of SB 253, the sunset of tax credits, reduced the revenue anticipated to be received by the general fund on an ongoing basis by almost $12 million per year
- The veto of HB 316 reduced nearly $6 million in ongoing revenues that would have been deposited into the general fund and continued the revenue into the state special sources. The shift in funding associated with the change in allocation to the general fund of the U.S. mineral royalties did not impact structural balance as it nets against the anticipated supplemental appropriation.
- The veto of SB 199, revise administration of income taxes, eliminated a decrease in general fund revenue of $1.5 million per year improved structural balance

[2] Structural balance is the difference between revenues that are expected to continue compared to costs that are expected continue. A positive structural balance has revenues exceeding spending. A negative structural balance has spending exceeding revenues. A budget can be balanced without structural balance when one time revenues are added or fund balance (similar to a checking account balance) is spent down.

As a result, the end of session anticipated general fund structural balance including the Governor's vetoes is negative by nearly $25 million.

Post 2011 Session Structural Balance Changes to General Fund FY 2013 *In millions*			
Type	Bill	Action	FY 2013
Structural Balance on Status Sheet # 9 - Dated: 4/27/2011			($2.220)
Revenue Legislation Changes			
HB0316	Redistribute certain revenue and income	Veto	22.584
SB0199	Revised administration of income taxes	Veto	1.524
SB0253	Eliminate certain individual and corporation tax credits	Veto	(11.891)
	Other smaller bills	Various	0.092
Appropriation Legislation Changes			
HB0002	General Appropriations Act	Corrected data, contingent appropriation	1.016
HB0604	Provide for fund transfers to various accounts	Line Item Veto	(6.910)
	Other smaller bills	Various	1.023
Adjustments/Supplemental			
	Public school anticipated supplemental (includes impact of reduced need for 0.83% school funding)	Veto of HB 316	(30.070)
Total impact to Structural Balance			($24.852)

2015 Biennia and Future Impacts

Future structural balances will be influenced by several factors:

1. More risk that revenues will exceed estimates (upside risk) than risk that the revenues will be lower than the estimates (downside risk) into the 2015 biennia, which could improve structural balance;
2. Healthy Montana Kids reduction in general fund revenue; and
3. Spending pressure points causing risk to the structural balance including:
   - Pension liability
   - Human Services spending and funding pressure
   - Montana University System
   - K-12 schools
   - State Fund Old Fund Liability

Each of these items is discussed in the following sections.

1. Revenue Upside Risk Higher than the Downside Risk

The legislature understood that there was more upside than downside risk to the revenue estimate at the end of session. The final session analysis had revenues being higher than previously anticipated. The March analysis outlined the upside risk as follows:

"There is the distinct possibility that refunds issued may be higher than anticipated when the peak refund season occurs in April and May. However, there is also the possibility that refunds will subside and that less refunds will be issued between now and June 30. Refunds issued from January 1 to March 16 are up 2.5 percent from last year

As the economy recovers, there is a good chance that individual and corporate taxpayers may adjust their estimated payments upward to reflect the improvement in their non-wage income levels. This adjustment could show up in estimated payments received in April and June. However, if taxpayers do not adjust their estimated payments (no penalty assessed), there is a high probability that refunds issued a year from now will be reduced reflecting the higher incomes for tax year 2011. Currently, there is no evidence that non-wage income will be up significantly."

Collections in FY 2011

FY 2011 is a turning point year in revenue collections. It is the first year of higher revenues after two years of declining revenues. In times of expansion after a decline, several volatile components are difficult to anticipate.

Any increase in FY 2011 revenues will accrue to the ending fund balance. At present, the actual collections in FY 2011 appear to be higher than the HJ 2 level. The final FY 2011 revenues, and to what extent those revenues may be expected to affect future revenue streams and improve structural balance, is unknown at this time.

An analysis of the FY 2011 estimates and the implications, if any, for FY 2012 and FY 2013 will be done in the fall of 2011 by the Legislative Fiscal Division. If current revenues continue into future years the revenues in FY 2012 and beyond could be $50 to $80 million per year higher than currently estimated in HJ 2.

2. Healthy Montana Kids Revenue Impacts

Initiative 155 provided that 33% of the insurance taxes collected would be set aside for funding Healthy Montana Kids passed by the voters in November of 2008. HB 676 of the 2009 session lowered the percentage of the insurance tax in half until FY 2014. The 2015 biennia will have a reduction in revenue of approximately $11 million per year from the current revenue levels.

3. Spending Pressure

In every biennium growth in inflation, caseload and utilization add pressure to the budget. In the 2015 budget there are several items that will change this pressure to the general fund structural balance beyond these typical factors. Items that have been identified include:

Pension Liability

While the session did not include a solution to the pension gap, the liability for these costs still lies with the state and local governments whose employees benefit from these systems.

Based on the FY 2010 actuarial valuations, FY 2013 estimated general fund share of the costs to fund the pension liabilities was $36 million. The long-term general fund share of the pension liabilities is expected to be in excess of $40 million per year. The state-wide liability, including schools and local government, is approximately $190 million per year.

Pension liabilities will continue to put pressure on all state and local government spending. For more information see the Other Budget Issues in this volume.

Human Services Spending Pressure

There are several areas where the costs or funding of current human services will put pressure on general fund spending.

Big Sky RX: With the Governor's amendatory veto to HB 2, $4.0 million for Big Sky RX was funded with a one-time state special fund revenue source. This source will discontinue and could put pressure on the general fund or some other state special fund to continue this spending.

HB 613 - Generally revise elements of the budget process to implement House Bill No. 2: While this bill did not spend additional general fund, it committed the next legislature to replace a $1.2 million general fund reduction made in the 2013 biennium in the base budget.

Medicaid funding: The funding in Medicaid services included about $8 million per year of funding from a one-time source of state special funds. In order to continue these services, the general fund or some other state special fund will be needed.

Health and Medicaid Initiatives Fund: The Health and Medicaid Initiatives Fund has been structurally out of balance for several biennia, yet had enough fund balance to maintain expenditures. During the 2015 biennium this fund is expected to not have enough funding to maintain current service levels. Absent any legislative changes, annual revenues to the account will exceed ongoing costs by approximately $10 million. In order to continue these services, the general fund or some other state special fund will be needed.

Healthcare Reform: Healthcare reform is anticipated to require additional state funding in future biennia. Additional costs may be required as early as the 2015 biennium as Medicaid enrollment may grow by 80,000 persons. The federal government will cover 100% of the cost of individuals newly eligible in 2014 through 2016 with the federal share of costs gradually declining to 90% from 2017 to 2020.

Montana University System

The final budget funded current services within the MUS with funds that are unsustainable or with funds that were designated as one-time-only.

Unsustainable: The legislature reduced general fund in the Student Assistance Program in the Office of the Commissioner of Higher Education by $5.8 million in the 2013 biennium and replaced it with a like amount of federal special revenue funds available in fund balance in the Guaranteed Student Loan Program administration account. These funds will not be available in the 2015 biennium. In order to continue these services, the general fund or some other state special fund will be needed.

One-Time-Only: In addition to base funding, the legislature also appropriated $9.2 million of additional general fund in the 2013 biennium on a one-time-only basis for the state funding allocated to the MUS educational units. These funds will be used for the general operations of the educational units and help mitigate what would have been higher tuition rates had the funding not been provided. If the same level of service is to be offered, the general fund or additional tuition will be needed.

K-12 Entitlements

The 0.83% increase in school funding or $4.6 million in state spending vetoed by the Governor funds schools below the statutory present law level of funding and could put pressure to replace this level of funding in the next biennium.

State Fund Old Fund Liability

The state obligation to fund the cost of the State Fund Old Fund Liability is anticipated to be a continually reducing cost. In FY 2015 the anticipated obligation will be $1.7 million less than in FY 2013.

SUMMARY STRUCTURAL BALANCE FOR THE FUTURE BIENNIA

In summary, the factors impacting the structural balance are:

- Going into the next biennium, the beginning point would be the structural balance of FY 2013 or $25 million per year negative
- Base revenues would be higher than anticipated by $50 to $80 million per year
- Healthy Montana Kids initiative will reduce general fund by $11 million per year
- General fund only liabilities associated with the pension systems would cost over $40 million per year
- Other spending pressures for the 2015 biennium are $24 to 34 million per year of additional cost

Given these influences and the range of potential impacts, the structural balance looking forward to future biennia could be either positive or negative.