EXECUTIVE BUDGET OVERVIEW

INTRODUCTION

This chapter is an overview of the budget submitted for the 2005 Biennium by Governor Martz, pursuant to statute. This overview provides a summary of the more detailed agency budget presentation contained in Volumes 3 and 4 of the Legislative Fiscal Division Budget Analysis. It is intended to provide the reader with a general understanding of the major components of the budget. This and subsequent sections of this chapter include the following:

- Highlights of revenue and expenditure proposals
- Comparisons with the previous biennium
- Executive revenue and tax policy proposals
- Executive expenditure proposals
- Statewide budget proposals and issues
- Other Executive Budget issues identified through Legislative Fiscal Division analysis

HIGHLIGHTS OF THE PROPOSED BUDGET

The Governor's budget reflects a 1.8 percent general fund increase and a 7.5 percent increase in total funds over the 2003 biennium. The budget is a combination of increases and decreases in the various program areas, but the low net increase in general fund expenditures is clearly the result of significant proposed reductions (a net of $120.6 million) in funding for state present law spending. The largest general fund dollar increases appear in the Judiciary and Corrections. The largest total fund increases occur in Transportation and Public Health and Human Services.

The highlights of the proposed budget are:

- **Human Services.** Human services would increase $222.2 million, or 11.3 percent. General fund would increase $5.7 million, or 1.1 percent. The relatively low increase in general fund spending authority occurs because what would have been significant increases in health care costs and program caseloads are offset by significant reductions in program operations and services and refinancing efforts that are aimed at balancing the budget. Increases in other funds of nearly $217 million reflect $20.2 million additional state special revenue that comes largely from tobacco settlement monies and refinancing, and a net of $196.3 million federal funds that relate to various programs including Medicaid, food stamps and bio-terrorism grants.

- **Education.** General fund for K-12 education would decrease $53.2 million; total funds decrease $6.8 million. However, the decreases are primarily a result of the earmarking of over $45 million of state equalization funds that occurred in the special session in August 2002. Monies that were deposited and appropriated to the general fund are now statutorily appropriated from a special revenue account.

- o The remaining almost $8.0 million decrease is due to enrollment decreases and other factors. When adjusted for the change in fund designation, K-12 education shows a smaller general fund decrease of 0.7 percent, and total funds would increase by 3.1 percent

- o **Higher Education.** Governor Martz nearly holds the line on general fund, including only a $376,498 or 0.1 percent increase for higher education. Total funds decrease $5.2 million or 1.3 percent.

- o **Corrections.** Governor Martz proposes adding general fund of $14.7 million, or 7.5 percent, primarily due to increasing populations.

- o **Judiciary.** The Executive Budget includes a $20.3 million general fund increase, most of which results from the state assumption of district courts.

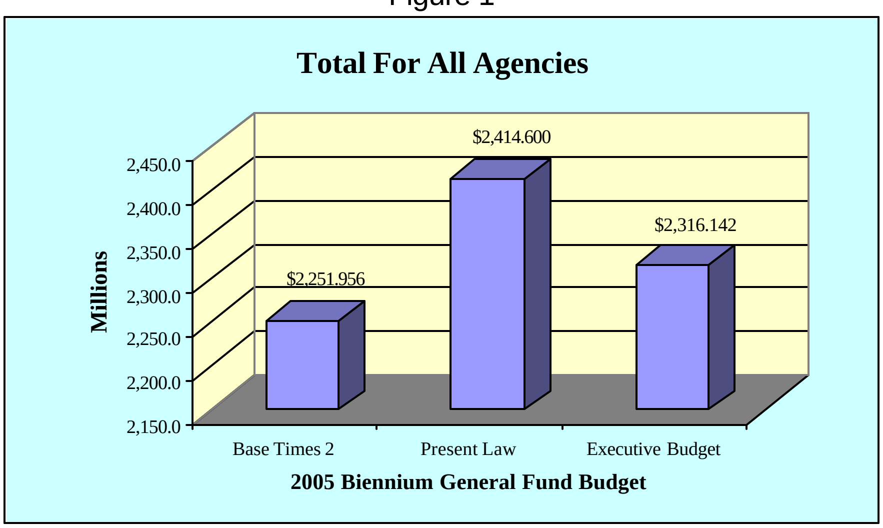
- o **Long-Range Building Program (LRBP).** The LRBP request is for $46.1 million, entirely for "cash" projects. The LRBP budget proposal contains no bonded projects. $2.3 million is from the Long-Range Building Program Account, which is funded primarily from coal severance and cigarette taxes.

- o **Local Government Entitlements.** The Governor provides funding for local government entitlements as provided in statute, including inflationary increases of $7.5 million.

BUDGET LEVEL COMPARISON

In this volume and Volumes 3 and 4, the reader will see references to base budget, present law budget, and the Executive Budget. Important to consider is the relationship between these different looks at the budget. Base budget describes the actual costs for the base year (fiscal 2002). The present law budget, the amount of funding needed to maintain government services at the level authorized by the previous legislature, is developed for the upcoming biennium, which includes fiscal 2004 and fiscal 2005. The Executive Budget is the budget that is submitted to the legislature for the upcoming biennium and, by statute, must include the components of base and present law, plus the addition of any new proposals that the Governor wishes to pursue. These three different levels of the budget are compared in Figure 1.

Figure 1



The base is represented as the base budget times two in order to compare on a biennium basis, and because the fiscal 2004 and fiscal 2005 budgets are developed from the base budget data. Figure 1 shows that the present law budget exceeds the base budget by $162.6 million, reflecting adjustments to the base for such things as annualization of the 2003 biennium pay plan and caseload increases, as well as changes in fixed costs and inflation (or deflation). The Executive Budget, which reflects the executive's efforts to balance the budget due to the revenue shortfall, is $98.5 million less than the present law budget, resulting from $120.6 million in present law reductions, offset by $22.2 million in positive new proposals. The Executive Budget is $64.2 million greater than the base budget.

HOW THE EXECUTIVE BUDGET ADDRESSES THE SHORTFALL

Figure 2 provides a summary of the actions suggested by the Executive Budget that are intended to provide for a balanced budget for the 2005 biennium. A page reference at the right of each listed item directs the reader to a further description of the action item. This figure gives the reader a high level look at the variety of budget balancing measures the executive employed in the development of the proposed budget. There is a net of $218 million in budget balancers, which would leave an ending fund balance of $36 million. As shown in the table, the executive proposal includes $102.6 million in net expenditure reductions and $115.4 million in revenue solutions (transfers from other funds, such as the coal tax trust and state fund, are classified as revenue sources for this purpose).

Figure 2
Executive Proposed General Fund Deficit Mitigation Measures
2005 Biennium
in Millions

Component	Detail Subtotal	Total	Page Number
Projected Deficit		$ (232.001)	45
Ending Fund Balance Projection		50.06	
Subtotal Deficit Without Ending Fund Balance Projection		$ (181.941)	
Revenue Proposals			
Fund Balance Transfer		$ 103.540	
State Fund	17.260		75
Permanent Coal Tax Trust (net of interest impact)	86.280		79
Diversions to the General Fund - Extend Coal, Oil & Gas, Metal Reallocations*		8.250	77
Oil and Gas Accrual		3.000	78
Terminate Infrastructure Credit		2.000	79
Coal Tax Trust Reallocation		-0.520	77
Revenue Reduction due to Expenditure Proposals		-0.909	85
Total Revenue Measures		$ 115.361	
Disbursement Proposals			
Cultural and Aesthetic Grants		-0.500	E-56
Eliminate Transfers from the General Fund		14.350	
Transportation	5.970		76
Research and Commercialization/Growth Through Agriculture*	8.380		76
Pay Plan Proposal/Personal Services Contingency		-9.680	95
HB 2 Reduction Measures		120.628	
Fee Increases	2.679		106
Funding Switches	21.069		109
Specific Service Reductions	38.560		105
Unspecified Montana University System Reductions**	17.270		70
Miscellaneous/Other Unspecified Reductions	41.050		122
HB 2 Positive New Proposals		-22.170	
Total Disbursement Measures		$ 102.628	
Total Executive Deficit Mitigation Measures		217.989	
Projected Actual Ending Fund Balance - Executive Budget		$ 36.048	

*Some reductions in service will also result.
**The executive offsets enrollment increases with a like reduction in the same decision package. If the enrollment had been appropriately added in present law and reduced in a new proposal, the resulting unspecified reduction would total $25.4 million.

BIENNIAL BUDGET COMPARISON

This section summarizes executive recommendations in comparison to expenditures for the preceding biennium.

The executive is recommending a 2005 biennium budget that includes an additional $45.4 million general fund, a 1.8 percent increase. Total requested increases (all funds) amount to $471.5 million, a 7.5 percent spending increase. The executive proposal for general fund and total spending increases is supported by existing sources of revenue, with the minimal general fund increase being indicative of the reduced revenues from individual and corporate income taxes. Although "present law" adjustments dictate increases beyond the state's fiscal capacity, numerous "proposed law" adjustments for program operations and services reductions largely offset the statutorily required present law adjustments, as the executive pursues a balanced budget.

COMPARISON METHODOLOGY

The state budget is highly complex, and the methods used to compute comparisons within the context of that budget can vary considerably. Without consistent comparison methodology, the comparisons can also be subject to manipulation. The Legislative Finance Committee (LFC) developed a budget comparison methodology that measures budget performance using total state expenditures for state general operations funded by taxpayer taxes, licenses, and fees. This method helps ensure proper representation, fairness, balance, and consistency. Adopted by the 1997 legislature, use of the comparison procedures became a statutory requirement at that time. These procedures provide consistency of application and help avoid the potential for manipulation when comparing information.

The comparisons on the following pages were prepared using the statutory methodology. A discussion of budget comparison methodology and the statutory requirements is included in the Budget Basics Section of this volume.

COMPARISON TO 2003 BIENNIUM

Figures 3 and 4 compare expenditures between the 2003 to 2005 biennia for general fund and total funds. As shown in the tables, the largest general fund increases are found in the Department of Corrections and the Judiciary. Education (K-12) shows the largest general fund decrease, most of which is the result of the shift of certain general fund revenue sources to a state special revenue account.

The following figures (3 and 4) are divided into three sections:

1. The top part of the table includes all appropriations recommended for inclusion in HB 2 (the General Appropriations Act), by agency.

2. Because HB 2 does not include all appropriations authorized by the legislature, the second part of the table includes additional executive recommendations. This section is referred to as "Comparable Adjustments," because the items can be compared across biennia. The total shown in the "Total Executive Budget Fiscal 04-05" (2005 biennium) column represents all recommendations made by the executive, with the exception of the non-cash portion of Long-Range Building proposals and statutory appropriations. Long-Range Building proposals are specifically excluded because spending and timing vary considerably on most building projects.

The building expenditures are reflected by the debt service paid over the term of any bonding/leasing agreement. Statutory appropriations represent the executive request with adjustments made by the Legislative Fiscal Division for Revenue and Taxation Committee estimates and updated information. (Note: The total in the "Total Adjusted Fiscal 02-03" (2003 biennium) column does not represent all contingent appropriations in that biennium, which are included in the third section.)

3. The third section, "Non-comparable Adjustments," includes all 2003 biennium appropriations, including budget amendments, supplemental appropriations, and disaster/emergency costs that cannot be estimated for the next biennium. Excluded from the comparable adjustments total are probable 2005 biennium expenditures that belong in this category. Consequently, the comparisons do not represent a true picture of potential growth between biennia.

House Bill 2 Comparisons

As shown in Figures 3 and 4, general fund recommendations in HB2 increase 2.3 percent, and all funds reflect an increase of 7.8 percent, with $189.4 million of increases in state special revenue and $202.5 million in federal special revenue. These are primarily due to additional state special expenditures in the Department of Transportation ($121.0 million), and the Department of Public Health and Human Services ($20.2 million), and additional federal funds expenditures in K-12 education ($38.2 million) and Public Health and Human Services ($196.3 million). The $77.6 million total funds reduction shown for the Department of Commerce is primarily due to a change in how federal housing funds are accounted for in the state accounting system, which change from a federal account to a proprietary account.

Expenditure increases are summarized in the “Expenditure Proposals” section of this volume, page 63, and are detailed in the narratives of the specific agencies in Volumes 3 and 4.

As shown in Figure 3, the executive general fund recommendations for HB 2 increase by $5.6 million, or 0.24 percent, from the 2003 biennium. If adjusted for the funding shift in K-12 education funding, the general fund increase is $51.2 million, or a 2.3 percent increase. These increases includes a net reduction of $64.7 million from new proposals, most of which suggest program operation and services reductions.

Total funds (Figure 4) increase by $441.9 million, or 7.8 percent. See page 65 of this volume for a table and discussion of present law adjustments and new proposals.

Total Comparable Adjustments

Total comparable adjustments include HB2 and all miscellaneous appropriations including the employee pay plan bill and other appropriations bills, statutory appropriations, and other expenditures and adjustments. The executive recommends $45.4 million in increased general fund expenditures for the 2005 biennium as compared to the 2003 biennium, an increase of 1.8 percent. The increase in total all funds spending over comparable 2003 biennium spending is $471.5 million, or 7.5 percent.

Non-Comparable Adjustments

Non-comparable Adjustments, the third section, shows increases of 0.64 percent general fund and 4.7 percent total funds between biennia. As stated earlier, this comparison tends to be distorted by the lack of comparable information for the 2005 biennium. This section and these comparisons are shown for informational purposes only and to complete the listing of 2003 biennium expenditures.

COMPARISON CAUTION

Comparisons vs. Budget Base Adjustments

This section compares the 2005 biennium Executive Budget to actual expenditures and adjusted fiscal appropriations for the 2003 biennium. The methodology used is that prescribed by the budget comparison statute, and upholds the concept of a comparison of the total state budget from biennium to biennium. This is a particularly useful practice due to the cyclical nature of annual budgets. However, because the Executive Budget is prepared using a different statutorily defined process, there is a difference between the total changes indicated in this volume and those indicated in the individual agency and program budgets discussed in the Agency Budgets and Analysis Section in Volumes 3 and 4.

Because present law adjustments are added to the base year (fiscal 2002) to determine a present law budget for the 2005 biennium and budget growth as prescribed by total adjustments, the intermediate year (fiscal 2003) is ignored. This method facilitates budget development from a vantage point of recent, actual experience, but overstates true budget growth because all increases are measured from the base year.

Conversely, using the base year (2002) plus fiscal 2003 appropriations for budget comparisons more accurately reflects true budget growth. This is because the increases/decreases are measured from a biennial perspective that takes into account the annual increase from the base year to the fiscal 2003 appropriated amount.

While consideration of increases over the base year is necessary to making budgetary decisions, the adjustments should not be used as measures of growth or for comparative purposes. When making comparisons, the total recommended budget for the 2005 biennium should be examined in comparison with the total 2003 biennium, as described in the preceding paragraph.

Figure 3

General Fund Comparison

03 Biennium Versus Executive Budget 05 Biennium

Agcy Code	Agency Name	Total Adjusted Fiscal 02-03	Total Exec. Budget Fiscal 04-05	Difference 05 Biennium - 03 Biennium	% Change 03 Biennium 05 Biennium
1104	Legislative Branch	$15,896,490	$17,765,704	$1,869,214	11.76%
2110	Judiciary	38,191,290	58,535,818	20,344,528	53.27%
3101	Governor's Office	8,368,227	8,619,692	251,465	3.00%
3202	Commissioner of Political Prac	686,465	640,438	(46,027)	-6.70%
3401	State Auditor's Office	658,140	0	(658,140)	-100.00%
3501	Office of Public Instruction	1,076,198,614	1,023,021,758	(53,176,856)	-4.94%
4107	Crime Control Division	3,608,569	3,292,188	(316,381)	-8.77%
4110	Department of Justice	40,308,016	46,306,640	5,998,624	14.88%
5101	Board of Public Education	341,818	312,141	(29,677)	-8.68%
5102	Commissioner of Higher Ed	272,998,574	273,375,072	376,498	0.14%
5113	School for the Deaf & Blind	6,913,790	7,012,990	99,200	1.43%
5114	Montana Arts Council	658,135	601,848	(56,287)	-8.55%
5115	Library Commission	3,569,077	3,535,405	(33,672)	-0.94%
5117	Historical Society	3,645,083	3,488,665	(156,418)	-4.29%
5201	Dept. of Fish,Wildlife & Parks	559,307	511,867	(47,440)	-8.48%
5301	Dept of Environmental Quality	7,479,706	7,082,497	(397,209)	-5.31%
5401	Department of Transportation	0	0	0	
5603	Department of Livestock	1,150,748	1,059,723	(91,025)	-7.91%
5706	Dept Nat Resource/Conservation	28,146,201	35,746,355	7,600,154	27.00%
5801	Department of Revenue	57,555,923	60,431,020	2,875,097	5.00%
6101	Department of Administration	8,254,908	7,578,418	(676,490)	-8.20%
6102	Appellate Defender	183,760	377,492	193,732	105.43%
6201	MT Dept of Agriculture	1,486,641	1,351,105	(135,536)	-9.12%
6401	Dept of Corrections	195,203,921	209,856,878	14,652,957	7.51%
6501	Department of Commerce	3,760,840	4,406,232	645,392	17.16%
6602	Labor & Industry	3,143,831	3,724,020	580,189	18.45%
6701	Dept of Military Affairs	6,042,205	6,304,555	262,350	4.34%
6901	Public Health & Human Services	525,526,015	531,203,907	5,677,892	1.08%
	Total	$2,310,536,294	$2,316,142,428	$5,606,134	0.24%
	Adjusted for OPI Fund Switch	$2,264,895,677	$2,316,142,428	$51,246,751	2.26%
	Comparable Adjustments				
	Employee Pay Proposal	In Above	9,680,000	9,680,000	
	Statutory Appropriations	261,782,818	262,510,000	727,182	0.28%
	Legislative Session Costs	8,621,661	6,699,000	(1,922,661)	-22.30%
	Miscellaneous Appropriations	11,731,000	499,150	(11,231,850)	-95.75%
	One-Time Only Costs	17,416,133		(17,416,133)	-100.00%
	Anticipated Reversions	(23,678,000)	(9,370,000)	14,308,000	-60.43%
	Total With Comparable Adjustments	$2,540,769,289	$2,586,160,578	$45,391,289	1.79%
	Non Comparable Adjustments				
	Budget Amendments	0		0	
	Supplementals	15,685,523		(15,685,523)	-100.00%
	Disaster/Emergency Costs	13,275,001		(13,275,001)	-100.00%
	Total With All Adjustments	$2,569,729,814	$2,586,160,578	$16,430,764	0.64%

Figure 4

All Funds Comparison

03 Biennium Versus Executive Budget 05 Biennium

Agcy Code	Agency Name	Total Adjusted Fiscal 02-03	Total Exec. Budget Fiscal 04-05	Difference 05 Biennium - 03 Biennium	% Change 03 Biennium 05 Biennium
1104	Legislative Branch	$19,978,468	$21,789,183	$1,810,715	9.06%
1112	Consumer Counsel	2,256,504	2,428,954	172,450	7.64%
2110	Judiciary	41,477,075	64,579,669	23,102,594	55.70%
2115	Mt.Chiropractic Legal Panel	18,776	30,000	11,224	59.78%
3101	Governor's Office	11,162,946	12,020,882	857,936	7.69%
3202	Commissioner of Political Prac	686,465	640,438	(46,027)	-6.70%
3401	State Auditor's Office	7,317,730	8,512,127	1,194,397	16.32%
3501	Office of Public Instruction	1,291,631,586	1,284,796,519	(6,835,067)	-0.53%
4107	Crime Control Division	26,429,354	24,134,094	(2,295,260)	-8.68%
4110	Department of Justice	99,308,522	109,062,308	9,753,786	9.82%
4201	Public Service Regulation	5,942,027	5,459,453	(482,574)	-8.12%
5101	Board of Public Education	666,167	683,996	17,829	2.68%
5102	Commissioner of Higher Ed	391,955,729	386,748,185	(5,207,544)	-1.33%
5113	School for the Deaf & Blind	7,672,716	7,890,140	217,424	2.83%
5114	Montana Arts Council	1,891,381	2,111,373	219,992	11.63%
5115	Library Commission	6,869,536	7,622,308	752,772	10.96%
5117	Historical Society	7,886,433	7,850,539	(35,894)	-0.46%
5201	Dept. of Fish,Wildlife & Parks	94,035,448	114,309,086	20,273,638	21.56%
5301	Dept of Environmental Quality	108,707,944	123,619,655	14,911,711	13.72%
5401	Department of Transportation	996,064,778	1,128,845,704	132,780,926	13.33%
5603	Department of Livestock	15,932,488	18,348,945	2,416,457	15.17%
5706	Dept Nat Resource/Conservation	60,673,493	74,745,124	14,071,631	23.19%
5801	Department of Revenue	67,225,076	70,260,764	3,035,688	4.52%
6101	Department of Administration	32,899,433	35,367,486	2,468,053	7.50%
6102	Appellate Defender	362,670	377,492	14,822	4.09%
6201	MT Dept of Agriculture	20,451,741	23,934,691	3,482,950	17.03%
6401	Dept of Corrections	201,349,134	216,048,567	14,699,433	7.30%
6501	Department of Commerce	117,272,710	39,683,422	(77,589,288)	-66.16%
6602	Labor & Industry	118,553,598	124,144,991	5,591,393	4.72%
6701	Dept of Military Affairs	20,946,190	35,647,142	14,700,952	70.18%
6901	Public Health & Human Services	1,973,397,909	2,195,582,098	222,184,189	11.26%
	Total	$5,751,024,027	$6,147,275,335	$396,251,308	6.89%
	Adjusted for OPI Fund Switch	$5,705,383,410	$6,147,275,335	$441,891,925	7.75%

Comparable Adjustments

	Total Adjusted Fiscal 02-03	Total Exec. Budget Fiscal 04-05	Difference	% Change
Employee Pay Proposal	In Above	24,382,307	24,382,307	
Statutory Appropriations	597,226,015	618,692,678	21,466,663	3.59%
Miscellaneous Appropriations	11,731,000	499,150	(11,231,850)	-95.75%
Legislative Session Costs	8,621,661	6,699,000	(1,922,661)	-22.30%
One-Time Only Costs	17,416,133	0	(17,416,133)	-100.00%
Anticipated Reversions	(23,678,000)	(9,370,000)	14,308,000	-60.43%
Total With Comparable Adjustments	$6,316,700,219	$6,788,178,470	$471,478,251	7.46%

Non Comparable Adjustments

	Total Adjusted Fiscal 02-03	Total Exec. Budget Fiscal 04-05	Difference	% Change
Budget Amendments	113,897,969		(113,897,969)	-100.00%
Supplementals	15,685,523		(15,685,523)	-100.00%
Disaster/Emergency Costs	34,528,619	0	(34,528,619)	-100.00%
Total With All Adjustments	$6,480,812,330	$6,788,178,470	$307,366,140	4.74%

* Only the general fund portion is shown. All funds cannot be determined based on existing accounting records.

EXECUTIVE REVENUE PROPOSALS - SUMMARY

HIGHLIGHTS

The Executive Budget relies on a variety of revenue measures, totaling $115.4 million, to achieve a balanced budget. Although some measures being proposed by the executive would, if enacted, substantially change the tax structure of the state, their impacts are not considered in the overall general fund balance.

Measures used to balance the budget include:

- Fund transfers, including $93.0 million from the coal severance tax trust
- Accounting changes
- Increased allocations of various tax revenues
- Increased general fund tax revenues.

Some proposals reduce general fund revenue through reallocation of the coal severance tax revenue and funding switches in House Bill 2.

Figure 1 on the next page summarizes the fiscal impact of each executive revenue proposal. The first section of the figure shows the fiscal impacts of the executive proposals based on assumptions adopted by the Revenue and Transportation Interim Committee and contained in House Joint Resolution 2. The second half of the figure shows fiscal impacts used by the executive to balance the Executive Budget.

LFD ISSUE

Based on legislative revenue assumptions contained in House Joint Resolution 2, the executive revenue proposals generate $2.2 million less revenue over the 2005 biennium. Thus, the executive ending general fund balance is $2.2 million less.

Figure 1
Executive Revenue Proposals
General Fund

		General Fund Revenue			
	Legislation	Fiscal 2003	Fiscal 2004	Fiscal 2005	Biennium
Legislative Estimate					
State Fund Transfer	LC 1541	$9,180,000	$4,300,000	$3,780,000	$17,260,000
Extend Revenue Allocations *					
Coal Tax: Long-range Building	LC 1322	0	612,000	573,500	1,185,500
Coal Tax: Shared Account	LC 1322	0	1,092,190	1,023,554	2,115,743
Coal Tax: Parks Acquisition Trust	LC 1323	0	389,000	364,000	753,000
Oil & Gas: Orphan Share Account	LC 1322	0	903,358	887,149	1,790,507
Oil & Gas: Reclam. & Devel. Account	LC 1322	0	903,358	887,149	1,790,507
Metalliferous Mines: Reclam. & Devel. Account	LC 1322	0	358,000	332,000	690,000
Subtotal		0	$4,257,906	$4,067,352	$8,325,257
Oil and Gas Accrual		3,000,000	0	0	3,000,000
Terminate Telecommunications Infrastructure Credit *	LC 933	0	300,000	300,000	600,000
Permanent Coal Severance Tax Trust Transfer	LC 74	0	93,000,000	(6,755,613)	86,244,387
TSEP Reallocation *	LC 1486	0	(120,000)	(360,000)	(480,000)
Revenue Reductions Due to Expenditure Proposals					
DEQ Earmarking of Environmental Penalties	HB 2	0	(150,000)	0	(150,000)
State Auditor Increased in State Special Approp.	HB 2	0	(380,514)	(378,285)	(758,799)
Subtotal		0	($530,514)	($378,285)	($908,799)
Total		$12,180,000	$101,207,392	$653,454	$114,040,845
Executive Balance Sheet					
State Fund Transfer		$9,180,000	$4,300,000	$3,780,000	$17,260,000
Extend Revenue Allocations			4,250,000	4,000,000	8,250,000
Oil and Gas Accrual		3,000,000	0	0	3,000,000
Terminate Telecommunications Infrastructure Credit		0	2,000,000	0	2,000,000
Permanent Coal Severance Tax Trust Transfer			93,000,000	(6,720,000)	86,280,000
TSEP Reallocation			(130,000)	(390,000)	(520,000)
Revenue Reductions Due to Expenditure Proposals**		0	(530,514)	(378,285)	(908,799)
Total		$12,180,000	$102,889,486	$291,715	$115,361,201
Difference to Due to Use of HJR 2 Assumptions		0	($1,682,094)	$361,739	($1,320,356)

*Amounts are based on HJR 2 revenue assumptions recommended by the RTIC, not on the executive balance sheet.
** Reductions were not included in the Executive Budget because of an oversight.

Each of the proposals shown the table above are presented in more detail, along with LFD issues, in the “Executive Revenue and Tax Policy Proposals/Issues” section, beginning on page 75.

EXECUTIVE EXPENDITURE PROPOSALS - SUMMARY

INTRODUCTION

This section discusses the major changes in expenditures in the 2005 biennium proposed by Governor Martz. The purpose of this document is to provide the reader with a summary view of major trends and policies proposed. A detailed discussion of each agency's proposed budget is included in Volumes 3 and 4 of the Legislative Budget Analysis.

The discussion is confined to HB 2, which appropriates over 80 percent of all general fund expended by state government. It does not include a discussion of other major initiatives, such as the state employee pay plan, statutory appropriations, and other non-HB 2 measures to balance the general fund budget.

HIGHLIGHT AND SUMMARY

The Executive Budget increases general fund by $5.6 million, or less than 1 percent, in the 2005 biennium compared to the 2003 biennium. However, this figure, which includes a large general fund reduction in K-12, is misleading, in that fiscal 2002 includes general fund to support schools that was reclassified as state special revenue and statutorily appropriated by the legislature in the August 2002 Special Session. This funding will still be used to support schools. If this factor were excluded (over $45 million in fiscal 2002), the results would show a $51.3 million increase, or 2.3 percent growth.

Figure 1

General Fund Increases by Major Component
2005 Biennium (in Millions)

Component	Executive Budget	Increase Over 2003	Percent Increase	Percent of Increase
K-12 Education*	$ 1,023.02	$ (7.54)	-0.7%	-14.7%
Higher Education	273.38	0.38	0.1%	0.7%
Human Services	531.20	5.68	1.1%	11.1%
Corrections	209.86	14.65	7.5%	28.6%
All Other Government Agencies	278.68	38.08	15.8%	74.3%
Total	$ 2,316.14	$ 51.25	2.3%	

*The 2003 figure used to compare to the 2005 biennium is adjusted for the change in classification of school trust interest and income to reflect the true change. Fiscal 2002 expenditures were adjusted by $45.641 million. Actual general fund expenditures in fiscal 2002 were $560.55 million, which would have resulted in a biennial reduction of $53.18 million.

Figure 2 shows the same information for total funds, again adjusting K-12 education for the reclassification of funds. As shown, growth in total funds above the 2003 biennium is $441.9 million or 7.7 percent.

Figure 2
Total Funds Increases by Major Component
2005 Biennium (in Millions)

Component	Executive Budget	Increase Over 2003	Percent Increase	Percent of Increase
K-12 Education*	$ 1,284.80	$ 38.81	3.1%	8.8%
Higher Education	386.75	(5.21)	-1.3%	-1.2%
Human Services	2,195.58	222.18	11.3%	50.3%
Corrections	216.05	14.70	7.3%	3.3%
All Other Government Agencies	2,064.10	171.41	9.1%	38.8%
Total	$ 6,147.28	$ 441.89	7.7%	
Funding				
General Fund*	$ 2,316.14	$ 51.25	2.3%	11.6%
State Special	949.06	189.45	24.9%	42.9%
Federal	2,855.85	202.52	7.6%	45.8%
Capital Projects	1.03	(0.84)	-44.8%	-0.2%
Proprietary	25.20	(0.48)	-1.9%	-0.1%
Total	$ 6,147.28	$ 441.89	7.7%	

*The 2003 figure used to compare to the 2005 biennium is adjusted for the change in classification of school trust interest and income to reflect the true change. Fiscal 2002 expenditures were adjusted by $45.461 million. Actual general fund expenditures in fiscal 2002 were $560.55 million, which would have resulted in a biennial reduction of $53.18 million.

The 2005 biennium Executive Budget is defined by a series of additions and reductions in varying sizes and impacts among all agencies. The following summarizes the primary factors.

FTE

110.02 total FTE in fiscal 2004 and 56.84 FTE in fiscal 2005 would be added. This total is the net after reductions in a number of agencies totaling 156.87 FTE in fiscal 2004 and 213.00 FTE in fiscal 2005 (page 98). The FTE increases are predominantly funded by non-general fund.

General Fund

After adjustment for the K-12 education interest and income funds, general fund increases by $51.3 million.

- o The increase is dominated by funding to assume costs of the district courts and by population increases in corrections
- o While K-12 education shows a slight decrease, total funds proposed by the executive for K-12 education remain constant when all adjustments are taken into account. This maintenance of funding is in spite of a reduction in average number belonging (ANB) and other factors that reduce the budget by a net $7.9 million (page 69)
- o Higher education is essentially held to the 2003 biennium level as adjusted by the Governor under 17-7-140 and the legislature in special session, despite anticipated enrollment increases (page 70)
- o The net increase of $5.7 million in the Department of Public Health and Human Services (DPHHS) is a net result of increases, primarily for Medicaid, foster care, and subsidized adoption caseloads, offset by significant program reductions, primarily in other Medicaid services and mental health (page 70)

Present Law and New Proposals

General fund present law changes are dominated by four factors:

- o Increases for statewide present law adjustments, including full funding of personal services (minus vacancy savings), fixed costs, and inflation
- o Caseload and enrollment changes
- o Assumption of the district courts
- o Reductions to continue the Governor's 17-7-140 spending reductions (although maintenance of precise actions taken in fiscal 2003 cannot be assumed)

General fund new proposals are dominated by program reductions to meet general fund balancing goals within individual agencies. Positive new proposals add a total of $22.2 million general fund, but are dwarfed by reductions of $86.9 million.

- o General fund new proposals that add funding are distinguished by a lack of clear executive policy initiative. Major increases are to replace funding and address caseload increases in foster care, for developmental disabilities services (in part due to a reduction in federal funding), to discontinue POINTS II (although the total funding request would increase), and to provide $6.0 million for schools.

All funds new proposals decrease by $0.7 million in fiscal 2004 and $4.8 million in fiscal 2005. The smaller decrease than general fund primarily reflects additional state (most notably highway state special revenue bonding proceeds) and federal funds available.

Fund Source

The budget once again continues a trend in recent biennia of a growing federal share of the total state budget (page 73). This biennium reverses recent trends by showing a large increase in state special revenue. However, this increase is skewed by the addition of bonding proceeds for Highway 93 that will be repaid by the federal government

Reduction Measures

Service Reductions or Eliminations - Few functions of state government are eliminated or significantly reduced, and these are primarily concentrated in human services programs (page 105). In most cases, the executive has identified a general fund reduction goal, but is nebulous about what precise measures will be taken to achieve this level of expenditure and the potential impact on services. Defined service reductions total $38.6 million, while miscellaneous and unspecified reductions (excluding the university system) are over $41 million

- Human services program reductions total over $35 million
- The executive recommends that the Montana University System (MUS) be maintained at the reduced 2003 biennium level, which is a reduction of over $25 million general fund from the fiscal 2002 base with enrollment adjustments. (The reduction is about $40 million when compared to the total present law base.) The executive has not provided the Board of Regents with any guidelines on policy or programmatic changes necessary to operate within the proposed appropriation

Fee Changes – The executive proposes $2.6 million in additional or new fees (page 106).

Fund Switches – The executive proposes over $21 million in fund switches, the largest single category of which is refinancing efforts in the Department of Public Health and Human Services. Over $900,000 of general fund revenues would be reduced (page 109).

ADJUSTMENTS TO THE FISCAL 2002 BASE

Figure 3 shows the major increases and decreases in the Executive Budget from the doubled fiscal 2002 base. This comparison is used to allow for a comparison that more closely resembles the budget decisions facing the legislature in HB 2, which appropriates over 80 percent of the general fund. HB 2 uses the fiscal 2002 base as the foundation for building the 2005 biennium budget. The K-12 interest and income adjustment is made to the doubled base to more accurately reflect actual change.

Major Increases

Statewide Present Law Adjustments - The primary increases made in the Executive Budget are due to statewide present law adjustments, which consist of:

- Annualization of the 2003 biennium pay plan
- Agency payments for certain fixed costs such as insurance
- Inflation
- Vacancy savings, which nets against the other categories of increases

Total statewide present law adjustments include $21.5 million for personal services costs for just over 245 additional FTE due to assumption of the district courts.

District Court Assumption – Operating costs to assume district courts are included in this category. Because the district courts were assumed in fiscal 2003, no expenses appear in the base year. The total cost of assumption (including costs in the statewide adjustments) in the 2005 biennium is $18.2 million in fiscal 2004 and $19.1 million in fiscal 2005. This figure does not include additional funding requested by the executive for administration, equity pay adjustments, or information technology.

Caseload Adjustments – Changes in Medicaid, foster care, and subsidized adoption caseloads, as well as K-12 education ANB, university enrollment, and corrections FTE, are included here. Please note that a portion of this increase is due to replacement of lost federal funds for foster care.

Other Present Law Adjustments – Included in this category are all other present law adjustments, including adjustments for workload changes and other base adjustments.

Figure 3

HB 2 - Major Executive Changes to the Fiscal 2002 Base
2005 Biennium to Doubled Fiscal 2002 Base

Adjustment	Total
Doubled Fiscal 2002 Base	$ 2,343.24
K-12 Interest and Income Adjustment	(91.28)
Adjusted Doubled Base	$ 2,251.96
Major Additions	
Statewide Present Law Adjustments*	$ 64.43
District Court Assumption	15.76
Caseload/Enrollment Changes	38.38
Other New Proposals	17.17
Other Present Law Adjustments	57.22
Major Reductions	
Service Reductions	(38.57)
Funding Switches	(21.07)
Fee Changes	(2.68)
Unspecified MUS Reductions**	(25.42)
Other Miscellaneous/Unspecified Reductions	(41.05)
Total Executive HB 2	$ 2,316.14

*Includes $21.5 million for district court assumption

**Represents the net of present law increases and reductions to maintain expenditures at the reduced 2003 biennium level as classified by the executive, with adjustments for caseload. Total reductions from present law, including statewide adjustments and caseload increases, total over $40 million.

New Proposals – The executive requests a total of $17.2 million in positive new proposals.

Major Decreases

The general fund increases are significantly offset by actions to either reduce general fund expenditures or increase revenues.

Service Reductions - Service reductions are reductions for which the service impact is explicit. Major service reductions are discussed in more detail on page 105.

Funding Switches - Funding switches to replace general fund with other funds reduce general fund expenditures by about $21.1 million. The major funding switches are discussed in more detail beginning on page 109 of this volume. Please note that a reduction in general fund revenue of about $0.9 million would also result.

Fee Increases - Fee increases are used to replace $2.7 million general fund. Major fee increases are discussed in more detail beginning on page 106 of this volume.

Unspecified Reductions to the Montana University System - The executive has specified a reduction but not articulated how they would recommend the Board of Regents, which is responsible for implementing the reductions, address the reduced funding.

Other Miscellaneous/Unspecified Reductions – This category includes all other reductions, including those reductions where the executive has not articulated any policy regarding what, if any, functions should be curtailed or eliminated, and the impact.

EXECUTIVE PROPOSALS BY PROGRAM AREA

The Governor's proposed budget by program area is shown in the figure below, without the influence of interest and income payments for K-12 education, which would distort the distribution.

As shown, the general fund increases are concentrated in "All Other State Agencies" ($38.0 million) and corrections ($14.6 million). This increase in "All Other" is dominated by costs to assume the district courts beginning in fiscal 2003 and in corrections, by increases in corrections populations. The proposal is noteworthy for the lowest increase for human services in many biennia, which is the result of increases in caseload and other costs, substantially offset by reductions in other services, refinancing efforts, and reclassification of certain tobacco revenues from general fund to state special revenue as a result of the passage of I-146. The reduction in K-12 primarily reflects a reduction in ANB.

All funds show significant increases in human services ($222.2 million), underlining that agency's significant federal support for Medicaid and other programs, and "All Other State Agencies", which includes the Department of Transportation, where $87.6 million in bonding proceeds are added.

Figure 4
Proposed Executive Budget by Program Area - HB 2
2003 to 2005 Biennia

--- General Fund ---

Component	Executive Budget	Increase Over 2003	Percent Increase	Percent of Increase
K-12 Education*	$ 1,023.02	$ (7.54)	-0.7%	-14.7%
Higher Education	273.38	0.38	0.1%	0.7%
Human Services	531.20	5.68	1.1%	11.1%
Corrections	209.86	14.65	7.5%	28.6%
All Other Government Agencies	278.68	38.08	15.8%	74.3%
Total	$ 2,316.14	$ 51.25	2.3%	

--- Total Funds ---

Component	Executive Budget	Increase Over 2003	Percent Increase	Percent of Increase
K-12 Education*	$ 1,284.80	$ 38.81	3.1%	8.8%
Higher Education	386.75	(5.21)	-1.3%	-1.2%
Human Services	2,195.58	222.18	11.3%	50.3%
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All Other Government Agencies	2,064.10	171.41	9.1%	38.8%
Total	$ 6,147.28	$ 441.89	7.7%	

*The 2003 figure used to compare to the 2005 biennium is adjusted for the change in classification of school trust interest and income to reflect the true change. Fiscal 2002 expenditures were adjusted by $45.641 million. Actual general fund expenditures in fiscal 2002 were $560.55 million, which would have resulted in a biennial reduction of $53.18 million.

The following graphically illustrates the comparison between the 2003 and 2005 biennium, by program area, for general fund and for total funds.

Figure 5

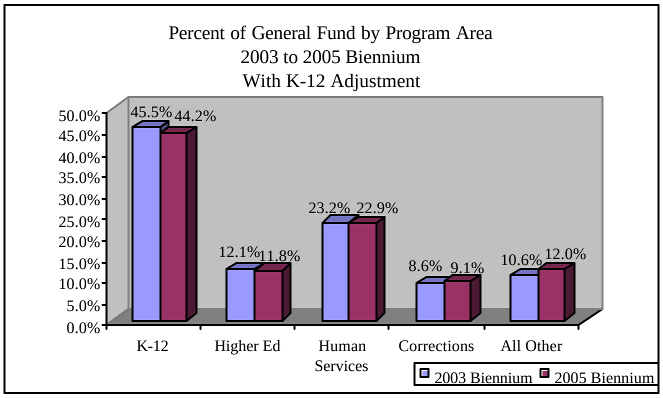
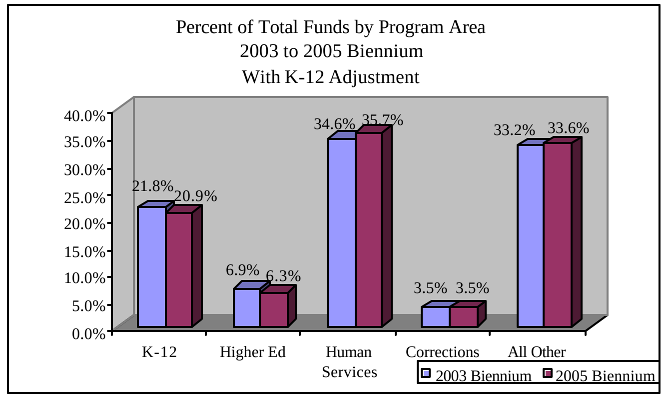


Figure 6



Each of the program areas, along with the Department of Transportation, is discussed in the narrative that follows. Further discussion is included in the individual agency narratives in Volumes 3 and 4.

K-12 EDUCATION

The executive proposes a biennium-to-biennium reduction in total general fund spending for the Office of Public Instruction (OPI), as budgeted in HB 2, of $53.2 million. However, this gives a misleading picture of the biennial change in the general fund budget for K-12 education. HB 7, passed during the August 2002 special session, removed common school interest and income revenue from the general fund and deposited it in a new state special guarantee fund beginning in fiscal 2003. This money is statutorily appropriated for Base aid to schools and does not appear in HB 2. The amount of this revenue spent on Base aid in fiscal 2002 was $45.6 million Thus, the true general fund reduction between biennia is $7.6 million for the agency, which is the net of a $7.9 million reduction in the Distribution to Schools Program and a $0.3 million increase in state level activities. The Distribution to Schools reduction is the net result of:

- Declines in present law ANB
- Allowing averaging of ANB in fiscal 2005
- Increases in entitlements
- Reductions in the direct state aid percent
- Savings in retirement GTB costs
- Using timber revenue to pay for Base aid
- A teacher loan repayment proposal
- Increasing state support for school facility costs

A further biennial comparison of state effort in OPI can be made by comparing all state funds, including state special revenue accounts. During the 2003 biennium, state special account spending will be $5.1 million for the flex account and drivers education. For the 2005 biennium, the executive proposes the use of state special revenue from diversion of Treasure State Endowment interest revenues for school district facility reimbursements in the amount of $8.5 million. Thus state special spending in OPI between biennia will increase by $3.4 million. With the decrease of $7.6 million in general fund spending, the net change in OPI's budget between the 2005 biennium and the 2003 biennium for all state accounts is a reduction of $4.2 million.

For a further discussion, see the narrative for the Office of Public Instruction beginning on page E-1 of Volume 4.

HIGHER EDUCATION

The Executive Budget proposes the Montana University System receive approximately the same amount of general fund in the 2005 biennium as was appropriated in fiscal 2002 and fiscal 2003 following special session action, or $273.4 million. To accomplish this objective, the Executive Budget:

- Eliminates general fund support for all statewide present law adjustments, a biennial total of $21.2 million
- Eliminates general fund support for all other present law adjustments, including enrollment growth, continuation of the $100 per resident student authorized by the 2001 legislature, and fee waiver increases. The total biennial reduction is $16.0 million
- Reduces the proposed general fund budget an additional $3.8 million ($0.9 million of this reduction is replaced with six-mill levy revenue)

The Executive Budget proposes that increased tuition revenue from anticipated student enrollment increases and tuition rate increases fund present law and pay plan cost increases at the educational units.

For a further discussion see the narrative for the Office of the Commissioner of Higher Education beginning on page E-91 in Volume 4.

HUMAN SERVICES

The Department of Public Health and Human Services (DPHHS) 2005 biennium budget request grows $5.7 million general fund and $222.2 million total funds from the 2003 biennium. The increase in general fund is net after several offsetting reductions. The most significant changes include the following:

- Medicaid caseload changes, eligibility reductions, provider rate reductions, and service limitations and eliminations net to an increase of $18 million general fund ($62 million total funds). Significant Medicaid program changes include:
  - Eligibility changes that reduce services or delay eligibility for 511 persons, with nursing home residents impacted most significantly
  - Elimination of hospice services
  - In-home Medicaid therapy services for elderly and physically disabled adults
  - Provider rate reduction of 1.87 percent
- Institutional cost increases add $8 million general fund
- Foster care and subsidized adoption caseload growth adds $6 million general fund ($9 million total funds)
- Funding shifts that reduce general fund and increase other funds by $15 million and include:
- $9 million of tobacco settlement revenue allocated by Initiative 146 that offsets Children's Health Insurance Program, tobacco control, and Medicaid matching costs
- $2 million of alcohol tax proceeds formerly allocated to local programs to offset Medicaid mental health match
- $1 million of county funds previously paid to community mental health centers for mental health Medicaid match
- Program eliminations and reductions of $31 million general fund ($14.6 million total funds). Eliminations include:
  - MIAMI (reduce infant mortality and low-birth weight babies)
  - End state renal disease program
  - Poison control

Reductions include:

- Mental Health Services ($16 million)
- Childcare funding
- Adult protective services grants
- Aging community services
- In-home services for abused and neglected children
- Refinancing general fund costs in foster care and developmental disability services by increasing the federal share of costs reduces general fund by $10 million

For a further discussion, see the narrative for the Department of Public Health and Human Services beginning on page B-1 of Volume 3.

DEPARTMENT OF CORRECTIONS

For the 2005 biennium, the department is requesting total funds of $216.0 million, of which $209.9 million is general fund. This request represents an increase in total funds of 7.3 percent (7.5 percent general fund) from the 2003 to the 2005 biennia. The majority of the requested increase $14.7 million is to fund community corrections and adult secure facilities. Annualization of the WATCh DUI Unit and the expansion at Montana Women's Prison accounts for $8.4 million of the general fund increase.

The average daily population of adult offenders in community corrections and secure facilities is projected to grow approximately 2.7 percent in fiscal 2003 and 3.5 percent each year of the 2005 biennium, or an increase of 948 adult offenders from fiscal 2002 to fiscal 2005. The average daily population of adult offenders in secure facilities is projected to decrease by 3.3 percent in fiscal 2003 and increase approximately 2.4 percent each year of the 2005 biennium, or an increase of 33 adult offenders from fiscal 2002 to fiscal 2005.

For a further discussion, see the narrative for the Department of Corrections beginning on page D-56 of Volume 4.

TRANSPORTATION

The Department of Transportation 2005 biennium budget request is $132.8 million more than the 2003 biennium expenditures and appropriation. The majority of the increase, $87.6 million state special revenue, is for bonding proceeds associated with highway revenues bonds to expedite construction activities on Highway 93. The remaining requests that contribute significantly to this increase are:

- Increases for payments to highway construction contractors for the federal-aid and state-funded construction programs
- An increase of federal funds for an information technology project to integrate the financial management systems of the department
- Runway rehabilitation projects at the West Yellowstone and Lincoln airports
- An increase to provide federal transit infrastructure grants to local transit authorities

For a further discussion, see the narrative for the Department of Transportation beginning on page A-93 of Volume 3.

ALL OTHER AGENCIES

As stated above, the general fund increase for all other agencies is dominated by the costs to assume the district courts mandated by SB 176, passed by the 2001 legislature. Courts were assumed in fiscal 2003, so only one year of costs is included in the 2003 biennium. Two other major increases are proposed:

- The Department of Justice would increase $6.0 million, primarily because the legislature switched funding for the Motor Vehicle Division in fiscal 2003 from general fund to highways state special revenue for one-time-only. The executive proposes to fund the division with general fund in the 2005 biennium
- The Department of Natural Resources and Conservation would increase $7.6 million due primarily to statewide present law adjustments, and a reduced fiscal 2003 base due to funding switches

The increase in total funds primarily reflects: 1) increases in the Department of Transportation, including $87.6 million of bonding proceeds; 2) general increases in the Department of Fish, Wildlife, and Parks; and 3) the assumption of district courts. Other increases and partially offsetting decreases are widespread among other agencies.

IMPACT OF GOVERNOR'S PROPOSALS ON INDIVIDUAL AGENCIES

The impact on individual agencies of the Governor's proposals to balance the general fund budget is extremely varied. In addition, while examining the change in general fund from the 2003 biennium or the doubled fiscal 2002 base can be instructive, it may not necessarily provide the entire picture, as the large funding shifts attest. Also, other funds were not decreased proportional to general fund. On the contrary, the policy of the Governor's budget is to access as many stand-alone federal funds as possible, and generally to attempt to meet maintenance of effort requirements.

To illustrate, the following figure shows the total impact of proposed reductions on six agencies.

Figure 7
Illustration of Impact of Reductions
2005 Biennium Executive Budget

Agency	General Fund Actual Doubled Fiscal 2002 Base*	General Fund Proposed 2005 Biennium	Percent Change	Total Funds Actual Doubled Fiscal 2002 Base	Total Funds Proposed 2005 Biennium	Percent Change
Commissioner of Political Practices	$ 663,330	$ 640,438	-3.5%	$ 663,330	$ 640,438	-3.5%
Transportation**	0	0	--	865,280,080	1,128,845,704	30.5%
Montana University System	277,178,716	273,375,072	-1.4%	381,239,234	386,748,185	1.4%
Justice	47,294,788	46,306,640	-2.1%	96,237,920	109,062,308	13.3%
Fish, Wildlife, and Parks	563,632	511,867	-9.2%	90,662,162	114,309,086	26.1%
Corrections	193,780,508	209,856,878	8.3%	199,457,280	216,048,567	8.3%

*The doubled base is used to avoid one-time-only fiscal 2003 budget adjustments, such as replacement of general fund with state highways funds in the Motor Vehicle Division.

**Increase in the 2005 biennium is skewed by the addition of $87.6 million in bonding proceeds for Highway 93 that will be repaid by the federal government.

Please note that the provision of additional non-general funds does not necessarily mean maintenance of the same services that may be reduced as a result of reduced general fund. Additional other funds may not be proposed or available for use in the same manner.

EXECUTIVE PROPOSALS BY FUND SOURCE

The following figure shows the change in funding source of state government in HB 2 from the 2003 to the 2005 biennium. The figure reflects the reclassification of interest and income revenues used to support K-12 Education, which otherwise skews the general fund totals from which the percentages are derived. As a comparison, the figure on the right factors out the impact of the interest and income reductions.

Figure 8

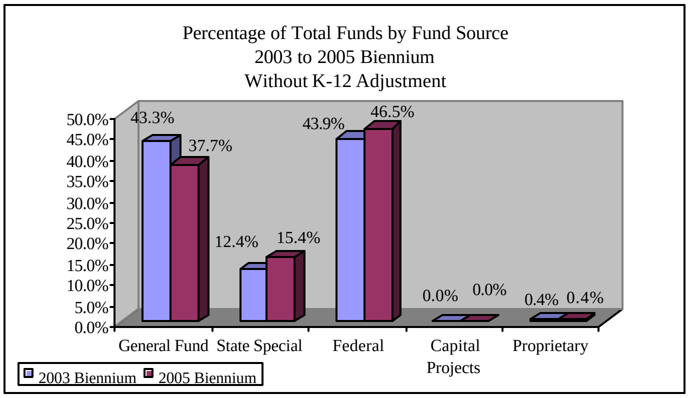
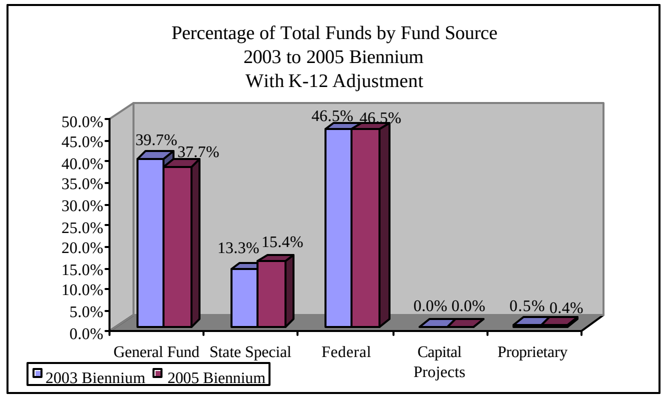


Figure 9



GENERAL FUND

General fund continues to be a smaller percentage of the total state budget.

- A portion of the reduction is due to the accounting change that reclassifies about $45 million in interest and income revenues per year from the general fund to statutorily appropriated state special revenue. In addition, the allocation of some tobacco proceeds from the general fund to state special revenue as a result of the passage of I-146 reclassifies $9.0 million
- District court assumption and increasing correctional populations dominate the increases. DPHHS caseloads and costs (including institutional costs) are also increasing, but are generally offset with federal and state funds refinancing and program reductions
- K-12 ANB continues to fall, reducing general fund present law adjustments
- The executive does not condition the higher education proposed budget on anticipated student FTE, instead maintaining state support at roughly the reduced 2003 biennium level
- The general fund budget for most agencies is below the adjusted present law level, although the impact differs due to the availability of other funds

STATE SPECIAL REVENUE

State special revenue fund growth as a percentage of the budget is contrary to recent trends, but bonding proceeds and accounting changes skew the growth.

- The figures reflect bonding proceeds of $87.6 million in the Department of Transportation for Highway 93 that will be repaid by the federal government
- A change in allocation of some tobacco revenues from general fund to state special revenue accounts as a result of the passage of I-146 adds an additional $9.0 million
- The proposal to use Treasure State Endowment Program (TSEP) funds in the Office of Public Instruction adds $8.5 million
- True increases include:
- Additional intergovernmental transfer authority from counties in DPHHS

- o Additional general license account and other state special revenue appropriations in the Department of Fish, Wildlife, and Parks
- o A proposal to increase the current court fee surcharge for information technology in the Judiciary
- o Additional highways state special revenue funds for road construction and maintenance
- o Use of state special revenue in the Department of Military Affairs from Employment Security Account funds to replace general fund to support the Youth Challenge Program (because the legislature made this program one-time-only, no funds to support the program are included in the 2003 biennium general fund figures)

Federal Funds

Federal funds continue to be a growing part of the state budget

- o As stated earlier, the Governor's budget attempts to utilize all available stand-alone federal funds, and generally to attempt to continue to meet maintenance-of-effort requirements. Consequently, the additional federal funds are widely dispersed across state government.
- o The federal presence in K-12 education continues to grow. While still only a fraction of total expenditures in this area, federal funds increase by $38.2 million, or 17.9 percent.
- o Increases in federal funds in the Department of Transportation have slowed from the large increases in recent years
- o Human services continues to see large increases
- o Some of the reductions in DPHHS and the Department of Commerce would result in the loss of federal funds (page 108)
- o An accounting change for food stamps adds about $69.5 million that does not represent a fund increase. This increase is completely offset by the reclassification of House and Urban Development (HUD) funds to an enterprise account, which does not require an appropriation. This reclassification removes over $80 million in the 2005 biennium.

Impact and Ramifications

The impact and ramifications of increasing federal funds at a time when general fund spending is curtailed can be uncertain. The resulting funding mix could either:

- o Signal a greater efficiency in the use of general fund, as with the refinancing efforts in DPHHS, or
- o Indicate a shifting from state priorities funded with general fund to federal priorities in order to take advantage of the available funding. This scenario is also evidenced in DPHHS, where a number of programs are being eliminated, but overall funding is increased by over $150 million (if food stamp impact is not included) due in part to the provision of funding for other federal priorities, such as bioterrorism

In addition, in a time of growing federal deficits, increased reliance on the federal government to maintain programs, or to expand state government programs or services, exposes the state to greater risk and fewer choices if and when federal budget reduction measures are taken.

EXECUTIVE REVENUE AND TAX POLICY PROPOSALS / ISSUES

INTRODUCTION

This section presents a description of the revenue and tax policy proposals of the Governor, plus LFD issues and comments about the proposals. These proposals are listed below and are discussed in more detail in the following pages. The first part discusses the proposals included in the Executive Budget submitted to the legislature on November 15, 2002. The second part discusses briefly the Governor's proposals for tax policy reform that are being submitted outside of the formal Executive Budget.

REVENUE AND TAX POLICY PROPOSALS – EXECUTIVE BUDGET

STATE FUND TRANSFER

The Executive proposes to transfer $9.2 million to the general fund from the State Fund "old fund" account. The old fund refers to workers compensation claims occurring before July 1, 1990. Statute requires that the fund maintain sufficient monies to cover its full costs, plus a 10 percent contingency. Monies in excess of that are to be transferred to the "new fund". These excess monies exist for a variety of reasons, but primarily because of overestimated claims liability and higher than average investment earnings. Legislation is being proposed that will allow the identified excess to be transferred to the general fund instead. The amount identified as available to transfer as of the end of June 2002 is $13.2 million, which would be transferred in fiscal 2003. SB 19 of the August special session authorized the transfer of $4.0 million of those funds to the general fund. The executive identifies additional amounts of $4.3 million to be transferred in fiscal 2004 and $3.8 million to be transferred in fiscal 2005. These estimates were provided by the State Fund to the Office of Budget and Program Planning.

EXTEND REVENUE ALLOCATIONS

The executive proposes to extend a number of temporary revenue actions enacted by the legislature in the August 2002 special legislative session to balance the general fund budget. These are: 1) eliminating the transfer of general fund to the Department of Transportation's state special revenue fund; 2) eliminating the transfer of general fund to the Department of Commerce's research and commercialization fund; 3) reducing the general fund statutory appropriation to the Department of Agriculture for the Growth Through Agriculture program; 4) increasing the amount of coal severance tax revenue deposited to the general fund by reducing current allocations in three programs; 5) increasing the amount of metalliferous mines tax revenue deposited to the general fund; and 6) increasing the amount of oil and natural gas production tax revenue deposited to the general fund.

Transfers

House Bill 5 from the August 2002 Special Session reduced the fiscal 2003 general fund transfer to the Department of Transportation state special revenue account from $2.92 million to $75,000. The executive proposes (LC 187) to eliminate the transfer for the 2005 biennium for a general fund savings of $5.97 million.

House Bill 5 from the August 2002 Special Session reduced the fiscal 2003 transfer of general fund to the Department of Commerce's research and commercialization fund from $4.85 million to $3.17 million and reduced the annual transfers in the 2005 biennium from $4.85 million to $3.65 million. The executive proposes (LC 1322) to eliminate the 2005 biennium transfers for a general fund savings of $7.30 million. Under current law, this transfer terminates at the end of fiscal 2005.

LFD COMMENT Although the legislation proposed by the executive eliminates $7.30 million in general fund transfers over the biennium, the executive general fund balance sheet shows $7.13 million.

Statutory Appropriations

Among other reductions and eliminations, House Bill 10 from the August 2003 Special Session reduced the fiscal 2003 general fund statutory appropriation for the Growth Through Agriculture program from $1.25 million to $0.93 million. The executive proposes (LC 1322) to reduce the 2005 biennium appropriations for the Growth Through Agriculture program from $2.50 million to $1.25 million, a reduction in expenditures of $1.25 million. Under current law, this statutory appropriation terminates at the end of fiscal 2005.

LFD COMMENT Economic development has been a high priority for the Martz administration. However, the Executive Budget reduces funding available for agricultural, research, and commercialization economic programs by $8.55 million* over the 2005 biennium. These programs were enacted and funded by the legislature to stimulate and enhance economic activity within the state.

* The executive general fund balance sheet shows $8.38 million for these reductions.

Coal Severance Tax Allocations

Among other reductions and eliminations, House Bill 10 from the August 2003 Special Session changed the fiscal 2003 allocation of coal severance tax revenue for three programs. The allocations for the:

- Long-range building program were reduced from 12 percent to 10 percent with the difference deposited to the general fund. The executive proposes (LC 1322) to reduce the 2005 biennium allocations from 12 percent to 10 percent for a $1.19 million increase in general fund revenue.
- Shared allocations were reduced from 8.36 percent to 6.01 percent with the difference deposited to the general fund. The executive proposes (LC 1322) to reduce the 2005 biennium allocations from 7.75 percent to 4.18 percent, for a $2.12 million increase in general fund revenue.
- Parks acquisition trust fund of 1.27 percent was diverted to the general fund. The executive proposes (LC 1322) to eliminate the 2005 biennium allocations for a $0.75 million increase in general fund revenue.

LFD COMMENT

House Bill 10 from the August 2002 Special Session eliminated the 0.63 percent fiscal 2003 allocation of coal severance tax revenue to the cultural trust and also eliminated the annual $0.43 million statutory appropriation for certified communities in fiscal 2003. The executive proposal does not continue these eliminations into the 2005 biennium as is done with other changes enacted by House Bill 10. Including these eliminations would increase the ending general fund balance by $1.22 million.

The legislature reduced the shared coal severance tax allocation to 6.01 percent for fiscal 2003 and allocated 7.75 percent for the 2005 biennium. The executive proposes to reduce the allocation in the 2005 biennium to 4.18 percent.

Oil and Natural Gas Production Tax Allocations

Among other reductions and eliminations, House Bill 10 from the August 2003 Special Session eliminated the fiscal 2003 distribution of oil and natural gas revenue to the orphan share account and the reclamation and development grants account and increased the amount deposited to the general fund. The executive proposes (LC 1322) to eliminate these allocations in the 2005 biennium for a $3.58 million increase in general fund revenue.

Metalliferous Mines Tax Allocation

Among other reductions and eliminations, House Bill 10 from the August 2003 Special Session eliminated the fiscal 2003 distribution of metalliferous mines tax revenue to the reclamation and development grants account and increased the amount deposited to the general fund. The executive proposes (LC 1322) to eliminate this allocation in the 2005 biennium for a $0.69 million increase in general fund revenue.

Figure 1 shows the combined general fund impacts of proposed reductions in disbursements and increased revenue from proposed changes to tax allocations.

Figure 1
Reduced Disbursements and Increased Revenue
Proposed Executive Legislation
General Fund

Tax/Program	Legislation	General Fund Savings/Revenue Fiscal 2004	Fiscal 2005	Biennium
Transfers (reduced disbursements)				
Department of Transportation	LC 187	$2,960,715	$3,005,126	$5,965,841
Research & Commercialization *	LC 1322	3,650,000	3,650,000	7,300,000
Executive Balance Sheet		3,565,000	3,565,000	7,130,000
Subtotal		$6,610,715	$6,655,126	$13,265,841
Statutory Appropriation (reduced appropriations)				
Growth Through Agriculture	LC 1322	$625,000	$625,000	$1,250,000
Subtotal		$625,000	$625,000	$1,250,000
Tax Allocations ** (increased revenue)				
Coal Tax: Long-range Building	LC 1322	$612,000	$573,500	$1,185,500
Coal Tax: Shared Account	LC 1322	1,092,190	1,023,554	2,115,743
Coal Tax: Parks Acquisition Trust	LC 1323	389,000	364,000	753,000
Oil & Gas: Orphan Share Account	LC 1322	903,358	887,149	1,790,507
Oil & Gas: Reclam. & Devel. Account	LC 1322	903,358	887,149	1,790,507
Metalliferous Mines: Reclam. & Devel. Account	LC 1322	358,000	332,000	690,000
Subtotal		$4,257,906	$4,067,352	$8,325,257
Executive Balance Sheet		4,250,000	4,000,000	8,250,000
Total		$11,493,621	$11,347,477	$22,841,098

Executive balance sheet amounts are not reflected in totals.
* The amounts are consistent with the proposed legislation, not with the executive general fund balance sheet.
** Revenue changes are based on HJR 2 revenue assumptions recommended by the RTIC, not on the executive balance sheet.

OIL AND NATURAL GAS ACCRUAL

Under current law, the state collects all oil and natural gas production taxes 60 days after the end of each calendar quarter. The state has an additional 60 days to distribute the local share to counties. Within 30 days, counties' allocate the revenue to local jurisdictions and to the state's 95 and 6 mill levy account. Under current law, the state does not accrue year-end receivables for the 95 and 6 mill share of oil and gas receipts.

The executive proposal is for the state to retain the 95 and 6 mill share of oil and natural gas receipts, instead of remitting the money to the counties and waiting 90 days for the return of the state's share. The state would be able to accrue this portion at the end of the fiscal year, resulting in a one-time increase in oil and natural gas production tax revenues of $3 million in fiscal 2003.

The proposal would eliminate the distribution of oil and natural gas production taxes across mill levies. Instead, these revenues would also be distributed to counties, school districts, and the countywide education accounts on the basis of fixed shares. The fixed shares in each jurisdiction would be based on the ratio of historical average of receipts in the jurisdiction to all receipts in the county in which the jurisdiction is located.

TELECOMMUNICATIONS INFRASTRUCTURE CREDIT

The executive proposes to terminate the telecommunications credit for investments in telecommunications infrastructure. The 2001 legislature in SB 494 temporarily suspended the credit during the 2003 biennium. Under present law the credit will be restored in fiscal 2004 and then terminate June 30, 2004. The executive proposal would terminate the credit as of July 1, 2003.

LFD ISSUE The executive estimates that the credit will increase general fund revenues by $2 million in fiscal 2004. The maximum allowable credit for all firms combined is $2 million per year. However, the estimate that was adopted by the Revenue and Transportation Interim Committee in November 2002 for the telecommunications infrastructure credit for 2005 biennium was $0.6 million. Actual credits claimed during the two years of the 2001 biennium were just under $0.6 million.

COAL SEVERANCE TAX TRUST TRANSFER

Executive Proposal

To maintain a balanced budget through the 2005 biennium, the executive relies on a $93.0 million transfer from the principal of the coal severance tax trust fund to the general fund at the end of fiscal 2004 (House Bill 74). The executive estimates an interest earnings loss of $6.72 million during fiscal 2005 from the trust, which is a loss of general fund revenue. However, the executive proposal is silent on the details of the transaction, other potential fiscal impacts, and other implications of liquidating $93.0 million of trust investments. In addition, the executive proposes legislation to deposit any unanticipated increase in the general fund ending balance to the trust until the $93.0 million is replaced (House Bill 74). The following discussion and analysis address these issues.

Constitutional Considerations

Article IX, Section 5 of the Montana Constitution, in part, addresses when the principal of the trust can be appropriated or transferred:

> "The principal of the trust shall forever remain inviolate unless appropriated by vote of three-fourths (3/4) of the members of each house of the legislature."

The legislature has appropriated trust principal in the past. Examples include:

- 2001 session - $75,000,000 loaned to the Department of Natural Resources and Conservation to buy mineral production rights from the common school trust (Senate Bill 495)
- 2001 session - $990,000 loaned to the Department of Justice to fund the natural resource damage and litigation program (House Bill 444)
- 2001 session - pledged to pay debt service for $18,856,102 in bonds, the proceeds from which are loaned for renewable resource projects (House Bill 8)
- 1999 session - $1,650,000 loaned to the Department of Justice to fund the natural resource damage and litigation program (House Bill 92)
- 1999 session - pledged to pay debt service for $22,897,465 in bonds, the proceeds from which are loaned for renewable resource projects (House Bill 8)
- 1995 session – $3,250,000 for the microbusiness finance program (HB 354)
- 1995 session – $2,359,857 loaned to the Department of Justice to fund the natural resource damage and litigation program (HB 305)

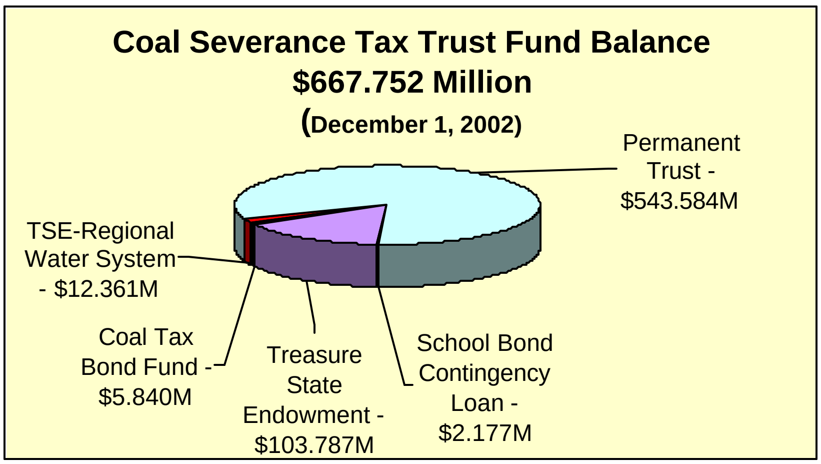
- o 1993 session – $7,794,105 loaned to the Department of Health and Environmental Sciences to fund the natural resource damage and litigation program (HB 401)
- o 1991 session - $3,250,000 for the microbusiness finance program (House Bill 477)

Loans that are written down or written off result in a loss of the trust fund principal. For example, in fiscal 2002, write-offs for five Montana Science and Technology Alliance loans (the 1997 legislature abolished this program) and one participation loan resulted in a principal loss of $1,794,968.

The coal severance tax trust fund receives 50 percent of total coal tax collections according to Article IX, Section 5 that states:

> "The legislature shall dedicate not less than one-fourth (1/4) of the coal severance tax to a trust fund, the interest and income from which may be appropriated. The principal of the trust shall forever remain inviolate unless appropriated by vote of three-fourths (3/4) of the members of each house of the legislature. After December 31, 1979, at least fifty percent (50%) of the severance tax shall be dedicated to the trust fund."

Figure 2



The money flows through five sub-trust funds within the trust. The combined fund balances of these sub-trusts as of December 1, 2002 was $667,752,380 (Figure 2).

In order, these trusts and an explanation of each are:

1. Coal Tax Bond Fund (Title 17, Chapter 5, Part 7) – The legislature authorizes the sale of coal severance tax bonds to finance renewable resource projects (Title 85, Chapter 1, Part 6) and local government infrastructure projects (Title 90, Chapter 6, Part 7). A maximum of $250 million in bonds is authorized as loans for renewable resource projects (17-5-719, MCA) to provide:
   - o a healthy economy;
   - o alleviation of social and economic impacts created by coal development; and
   - o a clean and healthful environment.

The total amount of outstanding principal of renewable resource bonds at any time cannot exceed $20 million (85-1-624, MCA). An amount equal to the following year's principal and interest payments is maintained in the fund. Money in the fund is pledged to pay the debt service on the bonds if interest and principal payments by the loan recipients are insufficient to fully pay the debt service. Bonds are authorized, projects approved, loan rates established, and bond proceeds are appropriated by the legislature to the Department of Natural Resources in House Bill 8.

2. School Bond Contingency Loan Fund – In the January 1992 Special Session, the legislature created this fund and provided for $25 million of school district bonds to be secured by loans from the fund (20-9-466 & 467, MCA). An amount is maintained in the fund equal to the following year's principal and interest payments of loans secured by the fund. All outstanding loans will be retired in 2012.

3. Treasure State Endowment Fund – In June 1992, the voters approved a legislative referendum establishing the treasure state endowment program. Initially funded with $10 million from the

permanent fund, the fund receives 75 percent (37.5 percent of the total) of the remaining coal severance tax money after deposits (if any) to the coal tax bond fund and the school bond contingency loan fund through the 2003 biennium. From then forward, the fund will receive 50 percent (25 percent of the total). Projects are approved and interest earnings from the fund are appropriated to the Department of Commerce by the legislature in House Bill 11 as grants for local government infrastructure projects.

4. Treasure State Endowment Regional Water System Fund – The 1999 legislature established the treasure state endowment program to fund regional water system projects. The fund receives 25 percent (12.5 percent of the total) of the remaining coal severance tax money after deposits (if any) in the coal tax bond fund and the school bond contingency loan fund. Projects are restricted to drinking water systems that provide water for domestic, industrial, and stockwater use for communities and rural residences that lie in specific northcentral and northeastern geographic areas. Projects are approved and interest earnings from the fund are appropriated to the Department of Commerce by the legislature in House Bill 11 as grants for local government infrastructure projects. Originally scheduled to sunset at the end of fiscal 2013, the 2001 legislature approved House Bill 40 that extends the program through fiscal 2016.

5. Permanent Fund – Prior to the establishment of the previous four funds, all the coal severance tax allocated to the trust fund was deposited to the permanent fund. From fiscal 2000 through fiscal 2003, the permanent fund does not receive any deposits of coal severance tax. Beginning fiscal 2004, the fund receives 25 percent of the remaining coal severance tax money after deposits (if any) in the coal tax bond fund and the school bond contingency loan fund. Interest earnings from the fund are deposited to the general fund (17-5-704, MCA). These earnings are equivalent to approximately a 23 mill statewide levy or a 7.0 percent individual income tax surtax. General fund is appropriated in the general appropriation act (House Bill 2), in statute (statutory appropriations), or in other pieces of legislation (cat and dog bills).

Availability

Money in the coal severance tax trust fund is held by the Board of Investments in three basic types of investments: 1) bonds; 2) loans; and 3) cash or cash equivalents.

Bonds in the trust, consisting of U.S. government-backed bonds and corporate bonds, comprise a portion of the state's trust fund bond pool (TFBP) that contains investments from 11 other participating funds in addition to the permanent fund, school bond contingency bond fund, treasure state endowment fund, and TSE regional water system fund. At the end of fiscal 2002, investments in the TFBP comprised 61 percent or $403 million of the coal severance tax trust fund balance. The trust provides loans to entities for a number of different programs and purposes:

- Commercial loans
- Department of Natural Resources and Conservation for the purchase of school trust mineral production rights
- Montana Science and Technology Alliance (although the program was eliminated, some loans are still outstanding)
- Infrastructure
- Value added
- Department of Justice to fund the state's natural resource damage and litigation efforts; and
- Montana Facility Finance Authority

At the end of fiscal 2002, these investments comprised 35 percent, or $232 million of the coal severance tax trust fund balance. Cash or cash equivalents are investments in the state's short-term investment pool (STIP) when the money is in-between being invested in either the TFBP or loans. At the end of fiscal 2002, these investments comprised 4 percent, or $26 million of the coal severance tax trust fund balance.

If the legislature decides to implement the executive proposal or one of its own that requires a large sum of money to be transferred out of the trust, the amount and availability of funds must be determined. Money invested in the TFBP or STIP is mostly liquid and can be converted to available cash by the Board of Investments relatively easily. However, the loan portfolio is not liquid and could not be relied upon to provide the cash needed to address a budget shortfall. Since the amount of money in the TFBP and STIP exceeds the $93.0 million needed to implement the executive proposal, there does not appear to be a problem with the availability of money. However, the Board of Investments is continually adjusting the portfolios and, in recent years, has been moving more money from the TFBP into the loan programs, thus lessening the liquidity of the trust. There is, therefore, a question of compliance with statute if a large sum of money is transferred out of the trust. Section 17-6-305, MCA, states:

> "17-6-305. Investment of up to twenty-five percent of coal tax trust fund in Montana economy -- report by board. (1) Subject to the provisions of 17-6-201(1), <u>the board shall endeavor to invest up to 25% of the permanent coal tax trust fund established in 17-6-203(6) in the Montana economy</u>, with special emphasis on investments in new or expanding locally owned enterprises. Investments made pursuant to this section do not include investments made pursuant to 17-6-309(2). For purposes of calculating the 25% of the permanent coal tax trust fund, the board shall include all funds listed in 17-5-703(1). The portion of the permanent coal tax trust fund contained in portfolios formerly administered by the Montana board of science and technology development is included in the 25% of the trust fund allocated to the board for in-state investment under this section.
>
> (2) In determining the probable income to be derived from investment of this revenue, the long-term benefit to the Montana economy must be considered.
>
> (3) The legislature may provide additional procedures to implement this section.
>
> (4) The board shall include a report on the investments made under this section as a part of the information required by 17-7-111." (emphasis added)

LFD ISSUE

If the investment of up to 25 percent of the coal tax trust is not a cap, but merely a target for the Board of Investments to invest as in-state loans, then there is no issue in complying with this statute by transferring a large sum of money out of the trust. If the statute establishes a cap that the Board of Investments cannot exceed, removing a large sum of money from the trust would increase the in-state loan percent and could jeopardize the loan programs. At the end of fiscal 2002, the in-state loan amount invested was 24.97 percent. Transferring $93.0 million out of the trust would cause the amount invested to exceed 25 percent.

Fiscal Impact

If the legislature transfers $93.0 million out of the trust, the following need to be considered:

- The amount of the reduction in trust earnings and the corresponding loss of general fund revenue in fiscal 2005 based on revenue assumptions contained in House Joint Resolution 2 (HJR 2);
- the time requirements of the Board of Investments to liquidate the required amount of investments and the additional general fund revenue loss in fiscal 2004 due to this liquidation;
- impacts of potential gains or losses from the liquidation of $93.0 million in bonds; and
- other considerations.

Based on revenue assumptions contained in HJR 2, it is estimated that the transfer of $93.0 million from the trust would result in general fund revenue loss of $6.8 million in fiscal 2005 and a similar amount each year thereafter, assuming that none of the $93.0 million is returned to the trust.

The Board of Investments can quickly liquidate enough bonds in the TFBP to acquire $93.0 million in cash by June 29, 2004, the date of transfer specified in the House Bill 74. However, the fiscal impacts depend on the timing of the liquidation, the market conditions at the time of the liquidation, and how it is structured. These items are discussed below.

Timing: If the liquidation occurred at the beginning of fiscal 2004, the money would be invested in STIP for a full year at an interest rate lower than it would have received in the TFBP. This would result in a loss of approximately $3.5 million in earnings. The loss would be progressively less the closer to June 29, 2004 the liquidation occurred.

Market Conditions: To obtain the $93.0 million in cash, $93.0 million of bonds must be liquidated. The value of the bonds depends on the market value at the time they are sold. The market value depends on the prevailing interest rate - if interest rates increase, the value of the bonds decrease. Board of Investment staff feel that it is likely interest rates will increase in the next 1.5 years, thus decreasing the market value of the bonds. If the bonds are sold within the next 1.5 years, the risk for substantial losses is high.

Figure 3
Funds Owning TFBP Shares
Fiscal 2002

Fund	Percent of Total
TRUST AND LEGACY	35.80%
PERM COAL TRUST	27.36%
UCFRB RESTORATION	10.16%
RESOURCE INDEMNITY	8.84%
TREASURE STATE ENDOWMENT	6.82%
STREAMSIDE TAILINGS	4.21%
TOBACCO TRUST	1.95%
COAL TAX PARK ACQUISITION	1.35%
UPPER CLARK FORK COST RECOVERY	1.07%
TREASURE STATE REGIONAL WATER	0.89%
MT POLE SUPERFUND	0.83%
CULTURAL TRUST	0.38%
SCHOOL BOND LOAN	0.18%
UM ENDOWMENT	0.16%
BOI DEFERRED COMP	0.00%
	100.00%

Structure: Since all 15 funds that own shares in the TFBP own a portion of all bonds in the pool, if the liquidation were structured by selling units in the pool (and the underlying securities), all 15 funds would share in the losses (or in the more improbable scenario, the gains). Figure 3 shows the funds that owned shares in the TFBP at the end of fiscal 2002. Another possibility of structuring the liquidation suggested by the Board of Investments would be to transfer $93.0 million out of the TFBP into the ownership of the permanent fund. The permanent fund would then be liable for all losses incurred from the liquidation. Since all losses would be realized as a reduction in earnings, the earnings from the permanent fund would be reduced with a corresponding decrease in general fund revenue.

Other potential impacts of transferring $93.0 million out of the coal trust need to be considered. Bond rating companies look at the balance in the trust as one measure of the state's credit worthiness. Although not the only criteria used to rate the state's bonds, a $93.0 million decrease in the trust balance will not be viewed favorably. The loan programs may be adversely affected by the transfer. If the $93.0 million were transferred out of the trust, the liquid portion of the trust would be reduced substantially. At the same time, the potential for future transfers out increases. Board of Investment staff state that, as prudent managers, they would need to increase the liquidity of the trust in the event additional transfers were required. To achieve the added liquidity, the loan program would be reduced and more bonds purchased.

Figure 4
Fiscal Impacts of Transferring $93.0 Million out of the Coal Trust
General Fund

Item	Fiscal 2004	Fiscal 2005	Total
Earning Loss from Liquidation	$0	($6,755,613)	($6,755,613)
Maximum Loss - TFBP to STIP	(3,453,648)	0	(3,453,648)
Loss/Gain from Bond Liquidation	Unknown	Unknown	Unknown
Bond Rating Change	Unknown	Unknown	Unknown
Smaller Loan Programs	Unknown	Unknown	Unknown
Total	($3,453,648)	($6,755,613)	($10,209,261)

A summary of the potential fiscal impacts of transferring $93.0 million out of the trust is shown in Figure 4.

The executive also proposes legislation to transfer any unanticipated increase in the general fund balance from the general fund to the trust until the $93.0 million is replaced. House Bill 74 defines this yearly amount, beginning fiscal 2005, as the positive difference between the balance reported in the comprehensive annual financial report and the balance contained in the most recent revenue estimating resolution adopted by the legislature. Although difficult to accurately estimate what these amounts may be, if no transfers occur, the general fund will continue to lose approximately $6.8 million in coal trust interest earnings revenue each fiscal year.

LFD ISSUE

To determine if any excess general fund balance exists at the end of a fiscal year, House Bill 74 references "the projected ending general fund balance contained in the most recent revenue estimating resolution adopted by the legislature". However, the revenue estimating resolution does not contain a projected ending general fund balance for each year of the upcoming biennium. The final projected ending general fund balances for the upcoming biennium are determined by the Legislative Fiscal Division after the session. These projections are based on legislative appropriations, official revenue estimates, and determination of the final fiscal impacts of enacted legislation. In the case of veto overrides, the final fiscal impacts of approved legislation may not be known for up to 50 days after the end of a session.

One possible alternative to consider would be to amend House Bill 74 to reference the projected ending general fund balances as shown in the most recent Legislative Fiscal Division's fiscal report. However, this also has problems. Since some appropriations continue into the second year of a biennium, transferring the excess fund balance based on this methodology from the first year of the biennium would deplete general fund monies needed to cover legislative authorized biennial appropriations. In addition, this method may not capture the effects of appropriations transferred from the second year of the biennium to the first.

If enacted in such a way that the excess ending general fund balance can be accurately determined, the excess fund balance will not be available as a cushion for unforeseen circumstances in future fiscal years. Recently, fund balances larger that anticipated have been available for the next legislature. Since the growth in the ending fund balance would be stagnant, the legislature would be guaranteed that there would be no additional funds for future biennia until the trust is repaid.

LFD ISSUE The executive proposal to transfer $93.0 million from the coal trust to the general fund also contains a provision in House Bill 74 for implementing a payback mechanism. Although the mechanism does not guarantee a specific amount, it remains in effect until the $93.0 million is paid back. However, because the proposed legislation does not provide for a contractual agreement, the transfer is not considered a loan and, therefore, there is no legal obligation for the $93.0 million to be repaid if the statute were repealed. To ensure that the coal trust transfer is repaid, the legislature would need to amend House Bill 74 to include language stipulating that the $93.0 million transfer is a loan and that a contract is required, similar to language in LC 132. This legislation provides a loan of $650,000 from the coal trust for the state's natural resource damage assessment and litigation efforts and requires a contract between the Board of Investments and the Department of Justice.

TREASURE STATE ENDOWMENT PROGRAM

The executive proposes significant ongoing changes to the Treasure State Endowment Program (TSEP) in the 2005 and future biennia. Under the proposal, $8.4 million of earnings from the treasure state endowment trust fund will be diverted away from local government infrastructure projects to fund K-12 school facility payments (see page F-6 for any discussion and analysis of the executive's proposals). To partially recover this diverted interest revenue, the executive proposes to increase the coal severance tax allocation to the treasure state endowment trust fund from 25.0 percent of total coal severance tax collections to 37.5 percent. To do this, the 12.5 percent allocation ($7.0 million over the biennium) to the permanent coal severance tax trust fund would be eliminated. Since earnings from the permanent coal severance tax trust fund are deposited to the general fund, general fund revenue would be reduced. Based on revenue assumptions contained in HJR 2, the loss of general fund revenue would be $120,000 in fiscal 2004 and $360,000 in fiscal 2005, and will increase over time.

REVENUE REDUCTIONS

As new proposals, the executive is proposing funding switches that reduce general fund revenue. One funding switch requires legislation to earmark revenue currently deposited to the general fund and the other is implemented based on legislative appropriations. These proposals are:

- Department of Environmental Quality, Central Management Division – Over the biennium, $150,000 in new state special revenue funding is requested for legal contingencies and database development. The source of the revenue is from various environmental penalties that are currently deposited in the general fund. The executive is proposing legislation (LC 1406) to earmark the penalties (see the LFD Comment below), thus reducing general fund revenue. Although the increased state special revenue authority is in the Executive Budget, the executive general fund revenue estimates do not include the revenue reduction.
- Office of the State Auditor, Securities Program – The proposal is to reduce 2005 biennium general fund appropriations by $758,799, and increase state special revenue appropriations derived from portfolio notice filing fees by the same amount. Since unspent revenue in the state special revenue fund is transferred to the general fund, this proposal would also reduce general fund revenue by $758,799 over the biennium. The executive general fund revenue estimates do not include this reduction in revenue.

LFD ISSUE The legislature has established principles for earmarked revenue (also termed dedicated revenue) in statute in an attempt to avoid unnecessary use of earmarked revenue (17-1-507,MCA). The principles are useful to determine if a particular revenue source should or should not be earmarked. This section reads in part:

"(1) It is the policy of the legislature that a revenue source not be dedicated for a specific purpose unless one or more of the following conditions are met:

(a) The person or entity paying the tax, fee, or assessment is the direct beneficiary of the specific activity that is funded by the tax, fee, or assessment; the entire cost of the activity is paid by the beneficiary; and the tax, fee, or assessment paid is commensurate with the cost of the activity, including reasonable administrative costs.

(b) There is an expectation that funds donated by a person or entity will be used for a specified purpose. Grants from private or public entities are considered donations under this subsection.

(c) There is a legal basis for the revenue dedication. A legal basis is a constitutional mandate, federal mandate, or statutory requirement in which a source of funds is designated for a specific purpose.

(d) There is a recognized need for accountability through a separation of funding from the general fund consistent with generally accepted accounting principles.

(2) The total funding for a program is a legislative budget and policy issue for which a dedicated revenue provision may not be justified if:

(a) a general fund appropriation is needed to supplement the dedicated revenue support for the program or activity; or

(b) dedicating a revenue source or portion of a revenue source diverts funds that could be considered a general revenue source."

Based on 2(b) above, it does not appear that the proposed earmarking of penalties in the Department of Environmental Quality is justified, since by statutory definition "general revenue source" includes fines. Likewise, the funding switch proposed for the Office of the State Auditor does not appear to be justified under 1(a) above because most of the portfolio notice filing fee revenue ($2.2 million out of $2.5 million in fiscal 2002) is transferred to the general fund, and is not used for the benefit of those paying the fees. Instead of approving the proposal, the legislature may want to consider replacing all appropriations from the state special revenue fund with general fund appropriations. This would have no impact of the general fund balance since general fund revenue will increase by the same amount.

TAX POLICY NOT INCLUDED IN THE GOVERNOR'S BUDGET

In May 2002, the Governor announced the formation of three advisory committees to provide recommendations on possible revenue neutral changes to Montana's tax policy. The three committees were: 1) an income tax advisory council; 2) a tourist tax advisory council; and 3) a local option tax advisory council. Each council finished their work by November 2002.

The recommendations of the income tax advisory council were to:

- Cut income taxes by 10 percent,
- Create 7 tax brackets with a top marginal tax rate of 6.9 percent,
- Limit the deductibility of federal taxes paid to $5,000, ($10,000 for married joint returns),
- Create a nonrefundable tax credit for 1 percent of capital gain realizations, thereby reducing the top effective marginal tax rate on capital gains to 5.9 percent.

The income tax proposal is expected to reduce individual income tax revenues by $55 million per year.

The tourist tax advisory council made the following recommendations

- o Where practical, tax sales of goods and services; where impractical, tax gross receipts
- o The tax base should include prepared food, alcohol sold by the drink, accommodations, rentals of cars and recreational equipment, guided recreation, admissions to events, recreation fees, and souvenirs
- o The tax rate should be sufficient to offset the revenue loss associated with the income tax proposal
- o The vendor allowance should be 5 percent, with a maximum amount of $1,000 per quarter
- o The tax rate should be the same for all products and be the same for the entire year
- o The tax should be called something other than a tourist tax

The tourist advisory council recommended a 3.32 percent tax rate, with a 5 percent vendor allowance. It was estimated that tax would generate $55 million in tax revenues and that 46 percent of the tax would be paid by nonresidents. The net tax reduction for Montana residents for both the individual income and tourist tax plan was estimated to be $9 million per year, after accounting for reduced state income tax liability, increased tourist tax liability, and increased federal income tax liability.

On December 10, 2002, in an overview of the plan, the Governor recommended a 4 percent sales tax, with an individual income tax reduction large enough to consume the additional sales tax revenues.

The local option advisory council made the following recommendations:

- o 3 percent local option tax on the same items as the tourist tax, dependent on voter approval
- o 30 percent of the revenues from the tax to be shared with counties and cities within the economic region
- o At least 10 percent of the tax proceeds to be used for property tax relief
- o Local option tax would be administered by the state

LFD ISSUE The executive does not include any administrative costs for any of the proposed tax or changes in their budget for the 2005 biennium. The estimated costs associated with the tourist tax are estimated to be $2 million per year. The administrative costs associated with the other proposals are unknown.

STATEWIDE EXECUTIVE BUDGET PROPOSALS / ISSUES

INTRODUCTION/HIGHLIGHTS

INTRODUCTION

This section discusses several stand-alone features of the Executive Budget that either do not pertain to any one agency, or which impact several agencies. These proposals are listed below and discussed in more detail in the following pages.

HIGHLIGHTS

- **Supplemental Appropriations – Fiscal 2003.** The executive's preliminary fiscal 2003 supplemental recommendation totals $14.5 million general fund, with the largest being a $9.1 million supplemental appropriation for fire suppression costs.
- **Executive Pay Plan.** The executive includes no pay increase, although she is proposing a $19.9 million ($8.5 million general fund) increase for health insurance contributions for state employees in the 2005 biennium to help keep pace with rising costs.
- **FTE.** Total FTE would increase by 110.02 in fiscal 2004 and 56.84 in fiscal 2005 over the fiscal 2002 level. However, these increases are the net of a number of proposed increases (primarily non-general fund) and decreases (primarily general fund) in FTE.
- **Broadbanding.** A sizable number of state employee positions have migrated to the "broadband" classification system, raising questions concerning the potential fiscal impact as agencies apply the increased flexibilities related to pay in a more market-based system.
- **Vacancy Savings.** The executive has applied a 4 percent vacancy savings rate to all personal services including insurance contributions. Vacancy savings reductions total $47.2 million over the 2005 biennium, of which about $20.5 million would come from the general fund.
- **Service Reduction.** The executive is proposing known service reductions totaling $38.6 million general fund from the fiscal 2002 base expenditures.
- **Fee Changes.** The Executive Budget proposal includes changes in fees in various agencies, with the effect of reducing general fund expenditures and increasing expenditures from other funds. The reduction in general fund is estimated to be $2.7 million with an increase in other funds of $13.7 million.
- **Reduced Federal Funds.** General fund reductions of $23.2 million in the executive proposal translate into a federal fund reduction of $45.5 million.
- **Fund Switches.** Funding switches totaling $21.1 million (general fund reduction) are included in the Executive Budget proposal.
- **Governor's Economic Development Program.** Although a priority of the Martz administration, economic development budgets shrink in the 2005 budget.

- o **Fixed Costs.** In each agency budget, fixed costs refer to costs for services from several programs within state government that provide services to other functions of state government, for which they charge a fee. Fixed costs increase by over $14 million in the 2005 biennium.
- o **Inflation/Deflation.** Applying inflation to only selected expenditure categories and underestimating others does not maintain the same level of buying power for state agencies as fiscal 2002 and, therefore, the statutory present law is not maintained.
- o **Long-Range Planning Proposals.** The Governor's request for Long-Range Planning includes a total of $75.5 million for grants, loans, and capital projects, including environmental cleanup in the Libby and Troy areas.

SUPPLEMENTAL APPROPRIATIONS

Supplemental appropriations are used to increase existing spending authority for a fiscal year. The supplemental appropriations requested by the executive are for additional funding applicable to the current year, fiscal 2003. The original budget for fiscal 2003 was approved by the 2001 legislature.

There can be two components to a supplemental appropriation request:

- o Costs in the current year in excess of appropriations
- o A request to replace funding if a transfer of appropriation authority was made from the second year of the biennium (current year) to the first year to address funding shortfalls in that year

The executive's preliminary supplemental recommendation consists of both types of components.

Figure 1
General Fund Supplementals
1987 to 2003 Biennia

Biennium	Millions
1987	$ 32.7
1989	17.1
1991	20.4
1993	82.2
1995	19.9
1997	14.2
1999	11.5
2001	68.2
2003*	14.5

*HB 3 and HB 16. *Does not include $1.2 million included as a contingentcy in the Executive Budget general fund balance sheet.

Figure 1 shows supplemental appropriations since the 1987 biennium.

As shown, the requested amount is significantly below the 2001 biennium level, primarily due to a lower cost fire season (and expedited receipt of certain reimbursable costs) and significantly lower costs in the Department of Public Health and Human Services (DPHHS) and the Office of Public Instruction (OPI).

Figure 2 provides detail on the executive's requested supplemental appropriations.

As shown, funds are being requested for a number of agencies. In addition to the funds requested in HB 3 and HB 16, the executive includes $1.6 million general fund in the Executive Budget balance sheet as a contingency for unanticipated other costs.

Figure 2
Supplemental Appropriation Requests
Executive Budget - Fiscal 2003

Department/Program	General Fund
Public Health and Human Services	
Disability Services Division	$ 924,354
Natural Resources and Conservation	
Forestry*	9,069,629
Justice	
Legal Services Major Litigation	250,000
Highway Patrol Prisoner Per Diem	250,000
Montana University System	
Indirect Cost Recoveries	76,000
Office of Public Instruction	
County Block Grants	377,471
School BASE Aid	3,503,000
Total**	$ 14,450,454

*Includes $6,571,766 included in HB 16 and $2,497,863 included in HB 3.
**The Executive Budget general fund balance sheet also includes a contingency for potential other supplemenals of $1,235,069 not included in either HB 3 or HB 16 as drafted.

REQUESTED SUPPLEMENTAL APPROPRIATIONS

The following briefly discusses each request. The individual supplemental requests are discussed in more detail in the individual agency narratives in the *Agency Budget Analysis* section of the *Legislative Budget Analysis*.

DPHHS - Montana Developmental Center

DPHHS requests a supplemental of $924,354 for costs at the Montana Developmental Center (MDC). The Office of Budget and Program Planning lists two reasons for the request: 1) increased staffing to maintain Medicaid certification; and 2) costs of a lawsuit initiated by the Montana Advocacy Program (MAP). The executive notes that additional revenue will be deposited to the general fund from retroactive billing of costs at MDC. However, the additional revenue from MDC retroactive billing has already been included in the revenue estimates in HJR 2 as introduced.

Requirement to Reduce Expenditures

The 1993 legislature passed legislation requiring that, in order to receive a supplemental appropriation in the first year of the biennium, agencies must detail how expenditures in the second year of operation would be reduced to contain total expenditures within the biennial appropriation. Statute makes exceptions to this requirement for the following (all of which are included in the fiscal 2003 supplemental appropriation request):

- Fire costs in the Department of Natural Resources and Conservation
- BASE aid, guaranteed tax base, or transportation aid in the Office of Public Instruction
- Prisoner per diem and litigation costs in the Department of Justice

In June, the executive presented a request to transfer $3.9 million from fiscal 2003 to fiscal 2002 primarily for additional Medicaid costs. The executive's mitigation plan consisted of an offset of additional revenue anticipated as a result of additional billing for past allowable costs that were eligible for federal reimbursement, but for which reimbursement had not previously been sought. The Legislative Finance Committee informed the Governor that this plan did not appear to meet the statutory requirements. The executive transferred $3.9 million general fund from fiscal 2003 to fiscal 2002, of which $416,457 was for the Montana Developmental Center. Further, the additional revenue has already been included in the HJR 2 revenue estimates, and will not affect the supplemental cost.

A complete discussion of this supplemental request is included in the narrative for the Department of Public Health and Human Services in Volume 3 of the Legislative Budget Analysis.

DNRC - Fire Suppression

The legislature does not appropriate for the costs of fire suppression in the General Appropriations Act, and does not assume any costs when projecting the ending fund balance. Instead, all costs of fire suppression are requested of the next legislature as supplemental appropriations. Figure 3 shows that fire suppression costs have fluctuated widely in the last several biennia.

The amount requested by the executive, $9.1 million, represents anticipated state costs for fire suppression that must be met in the 2003 biennium fire season. In prior years, this supplemental request would have been higher. Fire suppression consists of three activities: 1) direct expenditures on state-responsibility fires; 2) activities on behalf of other jurisdictions. (Montana incurs the initial cost, and is reimbursed by the responsible jurisdiction, i.e. other states or the federal government. Delayed receipt of the reimbursement usually necessitates a supplemental appropriation for the incurred cost); and 3) activities of other jurisdictions on our behalf. As in (2), the other jurisdiction incurs the initial cost, for which Montana provides reimbursement. The amount owed by Montana is also included in the supplemental request, as accounting

Figure 3
Supplemental Appropriations for Fire Costs

Biennium	Supplemental Appropriation	Statutory Appropriations	Total
1983	$ 0.80	$ -	$ 0.80
1985	2.90		2.90
1987	3.74		3.74
1989	12.64		12.64
1991	3.00	0.50	3.50
1993	7.94	1.96	9.90
1995	15.50	8.92	24.42
1997	4.47	3.10	7.57
1999	10.55		10.55
2001	33.22	6.20	39.42
2003*	9.07	7.01	16.08

*Fiscal 2003 executive request

principles require that costs incurred in a given year must be paid from that year's appropriation, even if the actual payment is made in the next fiscal year.

Under conditions existing in prior years, the supplemental request would have been $3.6 million higher. In fiscal 2003, the state incurred costs on behalf of the federal government (which acts as a clearinghouse for all inter-jurisdictional costs to simplify billing and reimbursements). Montana requested and received expedited payment of $3.6 million in billable costs, eliminating the need to request a supplemental for that amount.

Department of Justice

There are two requests for the Department of Justice: 1) legal services major litigation; and 2) highway patrol prisoner per diem.

Legal Services Major Litigation

The 2001 legislature approved $400,000 general fund as a biennial appropriation for major litigation on behalf of the state. The executive moved $200,000 from fiscal 2003 to fiscal 2002 as nearly the entire biennial appropriation had been expended in fiscal 2002. The executive is requesting replacement of the transferred funds, with an additional $50,000 for a total of $250,000.

Major litigation funds of approximately $129,000 were spent for the lawsuit regarding the Automated Accounting and Reporting System in the Gambling Control Division. Other major cases represented by the department during the 2003 biennium and ongoing include: mining regulation, laws regulating game farms, the school fund lawsuit, and potential tobacco lawsuits.

Highway Patrol Prisoner Per Diem

The executive requests approval for a $250,000 general fund supplemental for prisoner per diem. This request is partially to replace funding transferred from fiscal 2003 to fiscal 2002. In June 2002, the department requested a transfer of $112,894 from fiscal 2003 funds to fiscal 2002 for costs associated with boarding prisoners in county detention facilities. Fiscal 2003 funds were also reduced by $32,500 in the reductions ordered by the Governor under 17-7-140, MCA.

It appears that the entire amount may not have had to be transferred in fiscal 2003. The agency also has carry-forward funds that could be used to partially mitigate the costs of this supplemental. For a further discussion, see the Department of Justice narrative in Volume 4.

Montana University System – Indirect Cost Recoveries

The executive recommends approval of $76,000 general fund to allow the Office of the Commissioner of Higher Education (OCHE) to comply with a legislative audit recommendation to properly account for indirect costs associated with federal grants. Proper accounting procedures call for indirect cost recoveries to be deposited to the state general fund and costs to be paid from the state general fund. The OCHE had been reducing general fund expenditures in the amount of federal indirect cost recoveries because it lacked sufficient general fund authority to spend the indirect cost recoveries. The executive notes a like amount of revenue will be deposited into the general fund.

Office of Public Instruction - County Block Grants

The executive will request a supplemental for HB 124 block grants to the countywide transportation and retirement accounts for fiscal 2003. HB 124 based the block grants in fiscal 2002 and 2003 on revenues redirected to the state. The base year for collecting this information was fiscal 2001. The block grants in fiscal 2002 and 2003 were fiscal 2001 revenues redirected times 0.76 percent growth in each year. Recently, however, county officials reviewed estimates of revenue received in fiscal 2001, and it was discovered that in many counties not all revenues given up were counted. The new data indicate that the block grants in fiscal 2003 should be increased by $0.377 million. The executive will offer legislation to allocate this amount among the counties.

Office of Public Instruction – BASE Aid

The executive recommends a $3.5 million general fund supplemental appropriation for BASE aid. The increase is due to lower than estimated deposits to the common school trust interest and income account established by the legislature in the August 2002 Special Session. The account was established as a result of the passage of SB 495 by the 2001 legislature that authorized the purchase of mineral rights funded by a loan from the coal trust. The revenue must be used to pay back the loan, including interest. When estimating revenues to the account, the legislature reduced the general fund appropriation to schools by the amount of anticipated deposits to the account. However, the amount of general fund reduced should have been adjusted for the amount of funds from the account that must first be used to make interest payments.

The amount requested may be too high, based upon the estimates of interest and income deposits to the account. For a further discussion, see the Office of Public Instruction narrative on page E-1 of Volume 4.

OTHER CONCERNS

As stated, the Executive Budget general fund balance sheet includes an additional $1.2 million for contingencies. The Legislative Fiscal Division remains concerned with two areas of the budget: 1) the Department of Corrections; and 2) the Department of Public Health and Human Services.

Department of Corrections

In fiscal 2003, the Department of Corrections estimated appropriations were $9.0 million less than anticipated costs, and instituted reduction measures. A key component of this reduction was the conditional release of 400 inmates for the remainder of the year. The department did not release as many inmates as early as anticipated, reducing its anticipated savings.

Department of Public Health and Human Services

There are two areas of concern in the Department of Public Health and Human Services:

- The department has recently taken additional reduction measures in mental health services to offset a $1.8 million shortfall and stay within its fiscal 2003 appropriation, and indicated Medicaid primary care will be short an additional $3.8 million in fiscal 2003
- The Child Support Enforcement Division must either reduce operations significantly or seek a supplemental appropriation of up to $3.5 million in fiscal 2003, as its primary state account is in a deficit situation

EXECUTIVE PAY PLAN PROPOSAL

Unlike recent years, the executive does not come into the legislative session with a negotiated state employee pay plan proposal. As of the writing of this report, the executive is not in formal discussions with employee unions.

The executive has submitted legislation to increase insurance contributions per employee by $44 per month beginning January 1, 2004 and an additional $50 per month beginning January 1, 2005.

The legislation includes the following appropriations:

- o $8.2 million general fund and $11.7 million other funds ($19.9 million total) for the insurance increase
- o $1.5 million general fund and $3.0 million other funds ($4.5 million total) for a personal services contingency

Figure 4
Proposed Pay Plan Appropriation - Executive Budget
2005 Biennium

	--- Fiscal 2004 ---			--- Fiscal 2005 ---			--- 2005 Biennium ---		
Entity	General Fund	Other Funds	Total Funds	General Fund	Other Funds	Total Funds	General Fund	Other Funds	Total Funds
Legislative Branch	$ 24,969	$ 7,676	$ 32,645	$ 81,583	$ 24,915	$ 106,498	$ 106,552	$ 32,591	$ 139,143
Judiciary	85,726	12,247	97,973	268,867	38,410	307,277	354,593	50,657	405,250
Executive Branch	1,042,381	1,926,519	2,968,900	3,263,472	6,015,663	9,279,135	4,305,853	7,942,182	12,248,035
University System	1,087,384	1,182,729	2,270,113	2,323,048	2,526,739	4,849,787	3,410,432	3,709,468	7,119,900
Total	$ 2,240,460	$ 3,129,171	$ 5,369,631	$ 5,936,970	$ 8,605,727	$ 14,542,697	$ 8,177,430	$ 11,734,898	$ 19,912,328
Personal Services Contingency	$ 1,500,000	$ 3,000,000	$ 4,500,000				1,500,000	3,000,000	4,500,000
Total Proposed Appropriation							$ 9,677,430	$ 14,734,898	$ 24,412,328

The executive is proposing to maintain current fiscal 2003 pay schedules in effect in fiscal 2003 in the 2005 biennium, including those for teachers and blue-collar workers.

INSURANCE INCREASE

The executive includes funding to maintain the same level of insurance coverage as the employee is currently receiving, thereby keeping the employee "whole". If approved the additional funding would bring the state's contribution for an employee's insurance to $410 per month in calendar 2004 and $460 per month in calendar 2005 from the current (as of January 1, 2003) contribution of $366.

The executive includes a four percent vacancy savings on the total anticipated cost of the increase.

LFD ISSUE The pay plan includes funding for all positions, regardless of funding source. As a result, positions supported with funds not appropriated by the legislature are also included. The appropriation of other funds could consequently be reduced by about $1.6 million.

Future Costs

Because the insurance increase is phased in over the biennium, costs in the next biennium will be significantly higher - $15.1 million general fund and $19.3 million other funds (excluding positions for which the legislature does not appropriate funds).

PERSONAL SERVICES CONTINGENCY

The executive is proposing a contingency pool for allocation by the Office of Budget and Program Planning to agencies when personnel vacancies do not occur, retirement costs exceed agency resources, or other contingencies arise.

The legislature has appropriated funds for this purpose for several biennia.[1] In the 2003 biennium, the legislature appropriated $1.3 million general fund and $3.0 million other funds as a contingency. The Governor ordered that $65,000 of the general fund appropriation not be spent under 17-7-140, MCA. During the August 2002 Special Session the legislature reduced the appropriation to $735,000 general fund, or only enough to meet all prior obligations on the fund.

OTHER ISSUES

As stated, the executive is not proposing an increase in state employee pay in the 2005 biennium. However, agencies have other options for increasing an individual employee's pay.

- Broadband Pay – The state has embarked upon a means of classifying and paying personnel called a broadband pay plan, which is part of a larger human resource classification and pay initiative called the Montana Human Resources Competency Project. Instead of employees being in one of a number of narrowly defined "bands" for purposes of determining pay, the bands are widened to allow greater flexibility to managers to adjust duties and pay within the band. Certain agencies have made conversions to broadbanding for significant numbers of employees. While not universally true, generally the move to broadbanding has resulted in increased pay for the individuals occupying the positions. For a further discussion, see the narrative on the broadband pay plan on page 101.
- Position upgrades and reclassifications – If the duties of a position change, the position could be reclassified at a higher (or lower) pay level

Unlike a pay plan where all employees (with very limited exceptions) would receive an increase, the above options apply only to certain positions and often only certain agencies.

- Not all positions are part of the broadband pay plan
- Position upgrades, by definition, only apply to certain types of employees, and only upon specific review and reclassification
- For either adjustment, the agency would need to find the funding for any increase in its existing budget, as no additional funds are added prospectively for these purposes during budgeting
- Agencies with more discretionary funding (such as those with little general fund) have more leeway to provide increases to employees, and to have those increases funded in the next biennium[2]

[1] For a complete history of vacancy savings assumptions and contingency appropriations, see the Vacancy Savings narrative in this volume.

[2] The Department of Fish, Wildlife, and Parks and the Department of Transportation both have either all or a significant cohort of employees on a broadband pay plan, with extremely limited or no general fund.

A discussion of the broadband pay plan and associated issues is included on page 101 of this volume and in the narratives of impacted individual agencies in Volumes 3 and 4. For purposes of the pay plan discussion, the legislature should note that, while most state employees will receive no increase under the current pay plan proposal, some employees could still receive increases, and the distribution of those increases could highly favor employees of only select agencies.

FTE IMPACTS

The proposed Executive Budget will have an impact on the number of state government FTE (Full-time equivalent employees). As shown in Figure 5, total FTE would increase by 110.02 in fiscal 2004 and 56.84 in fiscal 2005 over the fiscal 2002 level. However, these increases are the net of a number of proposed increases and decreases in FTE. Generally, increases in FTE fall into two categories:

- Almost half of the net increase in fiscal 2004 and nearly the entire net increase in fiscal 2005 is due to the inclusion of the Youth Challenge Program in the Department of Military Affairs. The 2001 legislature made this program one-time-only, meaning expenditures and FTE do not appear in the 2002 base.
- A significant percentage of the remaining net increases are due to the provision of additional federal funds, particularly in the Office of Public Instruction and the Department of Public Health and Human Services

Figure 5
Total Proposed FTE Levels
2005 Biennium Executive Budget

Section/Agency	Base Fiscal 2002	Net Change Fiscal 2004	Total Fiscal 2004	Net Change Fiscal 2005	Total Fiscal 2005
Section A*					
Legislative Branch	125.27	(1.50)	123.77	(1.50)	123.77 **
Consumer Counsel	5.04	0.00	5.04	0.00	5.04
Judiciary	357.43	16.00	373.43	16.00	373.43
Governor's Office	57.00	0.00	57.00	0.00	57.00
COPP	5.00	0.00	5.00	0.00	5.00
State Auditor	69.50	4.00	73.50	4.00	73.50
Transportation	2,170.16	(6.48)	2,163.68	(57.66)	2,112.50
Revenue	663.53	(17.50)	646.03	(21.00)	642.53
Administration	145.38	2.29	147.67	2.29	147.67
Appellate Defender	3.00	0.00	3.00	0.00	3.00
Section B					
PHHS	2,788.09	30.24	2,818.33	32.74	2,820.83
Section C					
Fish, Wildlife, Parks	581.18	17.42	598.60	18.42	599.60
Env. Quality	361.03	10.25	371.28	10.25	371.28
Livestock	139.49	6.00	145.49	6.00	145.49
DNRC	492.36	(4.10)	488.26	(4.10)	488.26
Agriculture	109.05	2.50	111.55	2.50	111.55
Commerce	68.50	(17.50)	51.00	(17.50)	51.00
Section D					
PSC	39.00	0.00	39.00	0.00	39.00
Crime Control	18.00	2.00	20.00	2.00	20.00
Justice	713.20	1.55	714.75	(0.45)	712.75
Corrections	1,092.80	0.00	1,092.80	0.00	1,092.80
Labor/Industry	659.64	1.50	661.14	1.50	661.14
Military Affairs	114.00	51.90	165.90	51.90	165.90
Section E					
OPI	114.91	10.40	125.31	10.40	125.31
Board of Public Ed	4.00	0.00	4.00	0.00	4.00
MSDB	81.68	0.00	81.68	0.00	81.68
CHE	87.06	3.00	90.06	3.00	90.06
Arts Council	7.00	0.00	7.00	0.00	7.00
Library Commish	30.50	(2.00)	28.50	(2.00)	28.50
Historical Society	57.63	0.05	57.68	0.05	57.68
Totals	11,160.43	110.02	11,270.45	56.84	11,217.27

*Secretary of State FTE are all supported with proprietary funds.
**Does not include session staff 5.17 FTE.

Figure 6 highlights identified FTE reductions. There are a number of issues associated with the figures shown.

- Reduced FTE represent FTE that will not be a part of the base in the 2007 biennium. If an entire function was being reduced, the FTE were generally reduced at the same time. If FTE are reduced, the positions are not maintained as part of present law for building the 2007 biennium budget, and the reductions are "permanent" until the legislature specifically restores funding. However, many agencies chose to take unspecified reductions, meaning that they would reduce personal services or operating expenditures sufficiently to live within the appropriation, without identifying particular functions. These reductions could entail involuntary employment terminations or keeping positions unfilled. However, the FTE would not be removed from the agency's present law base and would be used to build the budget for the 2007 biennium
- Not all of the FTE reductions shown in the figure are due to budget reduction measures. For example, the largest single reduction – downsizing of Montana State Hospital and the Montana Mental Health Nursing Care Center in the Addictive and Mental Services Division in the Department of Public Health and Human Services - is in reality a shift to community services with increased overall costs. In the Department of Transportation, a large change in projected FTE is a standard feature of the budget, as FTE are estimated based upon the number and size of projected highways projects
- There may be either more or fewer involuntary layoffs than the figures shown.
  - Some positions are currently vacant
  - Some employees may have the opportunity to move into other unfilled positions, including positions added in other proposals
  - Some layoffs may occur even though the positions are not being eliminated. As stated above, if the agency has a reduced general fund appropriation, employment may be involuntarily terminated due to other budget constraints

Because of the "permanent" nature of reductions that also reduce FTE, the legislature may want to carefully consider whether reductions should include FTE. While the legislature does not appropriate FTE, and does not dictate either the level of FTE or its composition, as stated above, reduction of FTE associated with the appropriation means that the positions are not part of the budget building foundation in the 2007 biennium. Rather, reinstatement must be addressed in a new proposal.

The reductions are discussed in the narratives of the individual agencies in Volumes 3 and 4.

Figure 6

Proposed FTE Reductions
2005 Biennium Executive Budget

Agency Number	Program	FY 2004 FTE	FY 2005 FTE	Biennial Cost General Fund	Biennial Cost Other Funds
Legislative Branch					
	Audit & Examination	1.50	1.50	$ -	$ 53,704
Governor's Office					
	Executive Office	1.00	1.00	78,948	
	Office of Budget & Program Plan	1.00	1.00	109,799	
Office of Public Instruction					
	State Level Activities	3.00	3.00	808,966	
Justice					
	Gambling Control Division	3.00	3.00		289,387
	Motor Vehicle Division	7.45	9.45	502,399	
	Legal Services Division	1.00	1.00	72,040	
	Division of Criminal Investigations	3.00	3.00	420,240	(153,315)
State Library					
	Statewide Library Resources	2.00	2.00	106,232	
Historical Society					
	Administration	0.30	0.30	29,179	
Transportation					
	General Operations Program	2.00	2.00		155,000
	Construction Program		50.63		1,098,742
	Maintenance Program	11.03	11.03		1,037,508
Natural Resources and Conservation					
	Centralized Services	3.00	3.00	269,085	
	Conservation & Resource Development	1.00	1.00	97,540	
	Water Resources Division	1.00	1.00	156,794	
	Forestry Division	4.15	4.15	241,880	119,136
Revenue					
	Director's Office	5.00	5.00	530,600	
	Director's Office	1.00	1.00	68,575	
	Resource Management	9.50	13.00	787,816	
	Compliance Valuation and Resolution	3.00	3.00	202,367	
Administration					
	Compliance Valuation and Resolution	3.00	3.00		232,867
	Information Technology Services	1.13	1.13	89,877	
	State Personnel	1.00	1.00	50,270	50,540
Military Affairs					
	Disaster and Emergency Services Div.	1.00	1.00	72,136	
	Veterans' Affairs Division	1.00	1.00	24,828	24,828
Public Health and Human Services					
	Human and Community Services	7.50	7.50	247,145	247,145
	Human and Community Services - OPA	6.30	6.30	261,860	193,302
	Child and Family Services	1.00	1.00	40,418	44,722
	Health Policy and Services Division	2.00	2.00	63,656	115,916
	Quality Assurance Division	9.02	9.02	433,946	129,271
	Disability Services Division	5.00	5.00	530,637	66,420
	Senior and Long Term Care	1.50	1.50	81,090	34,642
	Addictive and Mental Disorders	44.49	44.49	1,553,420	
	Addictive and Mental Disorders	6.00	6.00	309,952	66,420
	Addictive and Mental Disorders	3.00	3.00		206,704
Totals		156.87	213.00	$ 7,931,743	$ 3,739,815

BROADBAND PAY PLAN

During the 2003 biennium, agencies moved a large number of state employees to a newly developed position classification and compensation system. Under the authority of 2-18-303, MCA, the State Personnel Division of the Department of Administration developed the alternative classification and compensation system known as the broadband plan. The broadband plan was developed to address several human resources management challenges, like employee recruitment and retention, that agencies state was evident by high staff turnover rates. The broadband plan places FTE into fewer position classifications with wider ranges between minimum and maximum pay levels than the other existing classification systems.

According to the State Personnel Division, the plan simplifies the classification of positions, increases the emphasis on market-based pay, and promotes competency-based human resource systems, including compensation. It also provides flexibility for adoption of other job and employee-based pay components. The plan combines grades 4 through 25 in the statewide classification plan into nine broad pay bands. Pay raises are given at the discretion of agency management and the collective bargaining process, where applicable.

In fiscal year 2002, state agencies moved 3,922.31 FTE from other classification systems to the broadband plan. Figure 7 shows the statewide movement of positions between the various plans. The figure shows the change from the pay matrix profile that existed upon completion of the 2001 legislature, to the profile that existed when the 2005 biennium personal services budgets were developed. The figure only shows information for 15 agencies that have converted positions to the broadband plan.[3]

Figure 7
Pay Matrix Changes
2003 Biennium to 2005 Biennium
FTE by Pay Matrix

Classification and Compensation Plan	2003 Biennium	2005 Biennium	Change
Statewide Classified Plan	8,505.13	5,209.28	(3,295.85)
Exempt Employee Plan	111.35	126.46	15.11
Information Technology and Engineering Plan	752.78	147.50	(605.28)
Broadband Plan	-	3,922.31	3,922.31
	9,369.26	9,405.55	36.29

FUNDING OF IMPLEMENTATION

While the concept of broadbanding alone does not increase employee costs, in almost all instances, the actual implementation of broadbanding has resulted in employee pay increases.

For most agencies, funding during the 2003 biennium to provide pay raises under the broadband plan was provided out of existing agency appropriations. Except for a few agencies that received funding specifically for broadband plan raises, the legislature did not provide funding. Therefore, while the agency had to find funding in existing appropriations initially, all increases are incorporated into the statewide present law adjustments in the 2005 biennium. As a consequence, the Office of Budget and Program Planning required agencies to submit negative new proposals to fund the broadband plan.

[3] In addition to movement to the broadband plan, all classified positions in the Montana University System were moved to the Montana University System Achievement Project (MAP). MAP is a compensation and classification system for university system employees similar to the broadband plan for the executive.

If the reduction proposals to pay for the broadband pay increases are taken from operating expenses, the reductions can be permanent, as they reduce the base funding. Also, if the executive is proposing to reduce FTE to pay for the increases, this reduction is also permanent, as costs of those FTE will not be included in the 2007 biennium budget. However, if the executive is proposing to increase vacancy savings without impacting funded FTE, these reductions will be temporary.

ISSUES

The narratives for the individual agencies impacted contained in Volumes 3 and 4, include discussions of broadband pay implementation and the attendant issues. There are two main issues discussed, as appropriate:

- Whether the reduction measures proposed by the executive would result in permanent savings to fund the increases in future years, or whether the reductions are only temporary
- Whether the executive has requested decision packages to add back in functions proposed for elimination or curtailment to pay for the broadbanding increases

VACANCY SAVINGS

Vacancy savings is the difference between the cost of fully funding a position for the entire year and the actual cost of authorized employee positions during that period. A vacancy savings reduction, usually a percentage reduction from full funding, has been applied to budgets in prior years in recognition of the fact that staff turnover and vacancies often result in personal services expenditures lower than appropriated. This section outlines the executive's proposal for vacancy savings.

EXECUTIVE PROPOSED VACANCY SAVINGS

The executive has applied a four percent vacancy savings rate to all personal services including insurance contributions. The rate is applied to all positions in state government with the following exceptions.

- Agencies with fewer than 20 FTE
- University system faculty
- Elected officials
- The legislative branch
- The judicial branch

The executive has applied vacancy savings to on-going positions and those proposed for inclusion by present law adjustments or new proposals. Vacancy savings reductions total $47.2 million over the 2005 biennium, of which it is estimated that $20.5 million is general fund. Of the $47.2 million, $38.7 million is from state government (excluding the university system) and $8.5 million is from the university system.

PERSONAL SERVICES CONTINGENCY

Vacancy savings are assessed against personal services budgets on the assumption that actual vacancy savings will be sufficient to cover the reduction. Sometimes, agencies don't generate enough actual vacancy savings, which results in a budget shortfall.

In order to assist agencies that have insufficient authority to meet all personal services costs in the 2005 biennium, the executive is proposing, in the pay plan bill, a contingency fund including $1.5 million general fund and $3.0 million other funds. Agencies experiencing this problem would have to apply to the Office of Budget and Program Planning for these funds during the biennium.

For the 2003 biennium, the legislature provided $1.3 million general fund and $3.0 million other funds for a contingency fund. The Governor's spending reductions implemented in June 2002 reduced the general fund amount by $65,000. The August special session further reduced the general fund contingency amount by $500,000. These two actions resulted in a general fund contingency fund authority for the 2003 biennium of $735,000, instead of the $1.3 million.

Figure 8 shows the allocations from the contingency through December 1, 2002 (fiscal 2003). Only seven agencies received funding to date, totaling $406,457 from the general fund contingency. Three agencies were allocated $1,681,027 from the "other funds" contingency.

Figure 8

Allocations of the Personal Services Contingency
2003 Biennium

Agency	General Fund	Other Funds
Montana Arts Council	$11,415	$0
School for the Deaf & Blind	59,855	0
Historical Society	32,000	0
Department of Justice	0	60,000
Natural Resources & Conservation	12,686	0
Public Health & Human Services	185,232	1,607,827
Department of Revenue	101,969	0
Library Commission	3,300	13,200
Total	$406,457	$1,681,027

SERVICE REDUCTIONS

The executive is proposing known service reductions totaling $38.6 million general fund from the fiscal 2002 base expenditures. These reductions are concentrated in human services. As stated, while general fund expenditures in other agencies are being reduced from the present law level, the executive has not specified service reductions for many of these adjustments. As a result, the actual impact to agency operations and services to citizens is not known, and may complicate the legislature's efforts to understand the impacts of and prioritize service reductions.

The figure highlights the known service reductions proposed by the executive. Service reductions are discussed in more detail in the individual agency narratives in Volumes 3 and 4.

Figure 9

Service Reductions
2005 Biennium Executive Budget

Item	Biennial Gen. Fund	Biennial Total Funds
Public Health and Human Services		
Childcare - reduction in general fund	(953,862)	(3,532,822)
FAIM Phase IIR	-	(9,954,286)
Food Stamp Employment and Training	(176,000)	(352,000)
Childcare - TANF Transfer	-	(15,224,478)
Office of Public Assistance Reductions	(329,061)	(658,122)
Visual Service Medical	(169,668)	(169,668)
Extended Employment Benefits	(541,278)	(541,278)
Indpendent Living	(457,532)	(457,532)
Donated Dental	(50,000)	(50,000)
Computer maintenance and mainframe usage	(505,501)	(995,304)
Big Brothers Big Sisters	(366,528)	(366,528)
In-home Services (Foster Care)	(2,280,754)	(2,280,754)
CPS Daycare	(650,026)	(2,407,504)
Domestic Violence	(155,282)	(155,282)
DD Community Supports and Supported Living*	(2,848,790)	(5,666,190)
DD Medicaid Provider Rate Reduction*	(383,406)	(1,402,092)
Personal Services - Agencywide	(3,155,910)	(3,977,514)
Operating Plan Reductions		
HPSD		
Lower Medicaid Eligibility	(184,202)	(673,667)
Reduce Optional Services	(500,000)	(1,828,612)
Limit Physician Services	(1,461,370)	(5,342,744)
Eliminate End State Renal	(200,000)	(200,000)
Eliminate MIAMI	(1,134,256)	(1,134,256)
Eliminate Poison Control	(77,908)	(77,908)
Public Health Lab Reduction	(370,748)	(370,748)
Reduce Family Planning	(51,896)	(51,896)
HIV/AIDS Reductions	(84,000)	(84,000)
Eliminate Farmer's Market WIC	(25,656)	(25,656)
SLTC	-	-
Lower Medicaid Eligibility	(1,381,286)	(5,045,796)
Eliminate Hospice	(367,514)	(1,355,451)
Reduce Funding to Area Aging Agencies	(514,000)	(514,000)
Reduce Home Therapy Bens.	(68,000)	(248,691)
APS Prevention Grants	(100,000)	(100,000)
AMDD	-	-
Lower Medicaid Eligibility	(31,092)	(113,699)
Reduce MHSP	(16,171,067)	(18,054,401)
Subtotal DPHHS	(35,746,593)	(83,412,879)
Other Agencies		
Justice - Motor Vehicle Division		
Titling/lien filing/drivers' licence stations/fraud investigations	(455,995)	
Justice - Division of Criminal Investigations		
Reduce services performed by fire marshals	(266,925)	
Montana Arts Council		
Art pros consultant/ arts education program/local grants	(116,446)	
Montana State Library		
Interlibrary loan reimbursements/library federation funding	(557,432)	
Natural Resources and Conservation		
Fire services to counties in western Montana	(349,893)	
Labor and Industry		
Apprenticeship Program reduction	(154,000)	
Military Affairs		
Disaster and Emergency Services/Veterans' Division FTE	(72,050)	
Revenue		
County tax appraisal services	(847,486)	
Total	(38,566,820)	(83,412,879)

Notes:
FTE reductions, some of which are service reductions, were not included in the human services totals above - except the reduction in Public Assistance Offices
*Division will seek refinancing to avoid service reductions.

FEE CHANGES

The executive is proposing a number of fee changes that would reduce general fund expenditures in HB 2. Changes in fees can either require legislation, or be done under the authority of governing or oversight entities or within executive authority. All but two of the changes proposed by the executive require legislation to enact.

The following table shows all requested fee increases that impact expenditures in HB 2, along with the general fund and other fund impact. The fee change with a significant general fund impact would impose surcharges of $7 on civil and criminal court cases to replace general fund that currently supports the Law Enforcement Academy. Other significant changes included in HB 2 is a title transaction fee to fund the automation of motor vehicle registration, a proposal by the Supreme Court to maintain and increase the current surcharge on civil and criminal court cases from $5 to $10 for court automation, and the inclusion of fee revenue in the Child Support Enforcement Division.

Figure 10
Fee Changes Reflected in HB 2
2005 Biennium Executive Budget

Agency/Program	Biennial Impact General Fund	Biennial Impact Other Funds	Legislation Required?	Comments
Corrections				
Secure Care	$ (100,000)	$ 100,000	Yes	Inmates would need to buy their own utensils
Justice				
Information Technology Services	(241,633)	580,960	Yes	Increase name-based background check fee
Motor Vehicle Division		4,800,000	Yes	Title transaction fee to pay for motor vehicle registration automation
Division of Criminal Investigations	(2,210,352)	2,210,352	Yes	Surcharge on civil & criminal court cases of $7
Supreme Court				
Supreme Court Operations	0	3,408,917	Yes	Extend automation surcharge & increase from $5 to $10
Agriculture				
Diagnostic Laboratory	(19,712)	19,712	No	Increase fees at Diagnostic Laboratory
Agricultural Sciences Division	(58,030)	58,030	Yes	Increase Apiary (Honey Bee) Inspection and Registration Fees
Public Health				
Child Support Enforcement*	0	1,570,800	Yes	Fee would be charged for collection of child support
Fish, Wildlife, Parks				
Field Services	0	920,000	Yes	Increase the conservation license fee to compensate school trust for hunter/angler access
Natural Resources/Conservation				
Water Resources	(46,000)	46,000	No	Require water rights applicants to pay notice fees. Requires ARM change.
	$ (2,675,727)	$ 13,714,771		

*Does not include federal matching funds

LFD COMMENT

Court Surcharges

Currently, a surcharge of $5 is applied to all court cases, including courts of limited jurisdiction, to fund court automation. The Montana Supreme Court coordinates this effort. While the surcharge is scheduled to sunset at the end of the 2003 biennium, the Supreme Court is requesting legislation that would eliminate the sunset provision and increase the fee to $10 per case. At the same time, the Department of Justice is proposing a surcharge of $7 on all cases in courts of limited jurisdiction to fund the Law Enforcement Academy. Consequently, if both proposed surcharges were enacted, the total surcharge in courts of limited jurisdiction would be $17 from the current $5.

LFD COMMENT (Continued)	Both proposed surcharges are discussed in more detail the narratives for the Judiciary in Volume 3 and the Department of Justice in Volume 4.

Each of the requested changes is discussed in the individual agency narratives in Volumes 3 and 4.

REDUCED FEDERAL FUNDS

As stated, it appears to be the policy of the executive to secure as many stand-alone federal grants and programs as possible, and the executive generally attempts to meet all maintenance-of-effort requirements to ensure continued receipt of federal funds having that requirement[4]. However, the executive is proposing to reduce general fund expenditures through curtailment or elimination of some programs for which the general fund is used to match federal funds.

Figure 11 shows reduced federal funds of over $45.0 million as a result of the executive proposals to eliminate or curtail current programs, with a general fund savings of just over $23.0 million. As shown, the reductions are concentrated in the Department of Public Health and Human Services. Please note that the reductions are from the fiscal 2002 base.

The loss of over $45.0 million in “imported” revenues from outside Montana could have a significant economic impact, and the legislature may want to consider this impact when setting budget priorities.

Figure 11
Reduced Federal Funds as a Result of Budget Balancing Actions
2005 Biennium Executive Budget

Agency/Function	Biennial General Fund Reduction	Biennial Federal Reduction
Public Health and Human Services		
CPS Daycare	$ (650,026)	$ (1,700,000)
Reduce Optional Medicaid	(500,000)	(1,328,612)
Limit Physicians Visits to 10	(1,461,370)	(3,881,374)
Reduce Provider Reimbursement	(2,668,670)	(7,087,018)
Transportation Program	(168,926)	(448,779)
Pharmacy Program Changes	(164,744)	(437,762)
Property Eligibility Exclusion - all	(1,596,580)	(5,833,162)
FTE Reduction (HPSD)	(40,418)	(44,722)
FTE Reduction (HCSD)	(24,828)	(24,828)
FTE Reduction (CFSD)	(261,860)	(187,818)
FTE Reduction (DSD)	(433,946)	(129,271)
FTE Reduction (AMDD)	(309,952)	(66,420)
FTE Reduction (SLTC)	(81,090)	(34,642)
FTE Reduction (QAD)	(63,656)	(118,916)
Hospice Elimination	(367,514)	(987,937)
Eliminate In-Home Health Therapy	(68,000)	(180,691)
Eliminate Community Supports*	(2,848,790)	(2,817,400)
DDP Medicaid Provider Rate Reduction*	(383,406)	(1,018,686)
Medicaid Provider Rate Reduction - SLTC	(1,799,771)	(4,780,783)
Medicaid Provider Rate Reduction - AMDD	(898,548)	(2,386,075)
County Offices of Public Assistance	(576,206)	(576,206)
TEAMS Computer System	(301,419)	(301,419)
CAPS Computer System	(204,082)	(188,384)
Childcare	offset against DP increase	
Food Stamps	offset against DP increase	
Subtotal DPHHS	$ (15,873,802)	$ (34,560,905)
Commerce		
Research and Commercialization**	(7,300,000)	(10,950,000)
Total	$ (23,173,802)	$ (45,510,905)

*Division hopes to create general fund savings through refinancing rather than implement this reduction.
**Based on three-year average of federal match ratios.

[4] See the individual agency narratives in Volumes 3 and 4 for any LFD issues regarding the adequacy of proposed expenditures for maintenance of effort requirements for individual federal grants.

FUND SWITCHES

The executive has included a number of funding switches in her plan to balance the general fund budget. As shown, funding switches total $23.6 million. However, portions of these reductions are due to fee changes and are also included in Figure 12. The unduplicated reduction in general fund due to fund switches totals $21.1 million. Also, please note that almost $900,000 of these switches will have no net effect on the general fund, as revenues are reduced by a like amount.

As shown in Figure 12, significant refinancing efforts are included in the Department of Public Health and Human Services, although the executive is also requesting replacement of federal funds in the Disabilities Services Division with general fund. In addition, the executive is recommending the replacement of about $2.8 million lost general fund for foster care services. However, the executive did not reduce federal funds by a corresponding amount and this proposed change is not included in the figure.

The figure also includes funding switches proposed by the Governor for functions that the 2001 legislature denoted as one-time-only (OTO). Consequently, these expenditures are not included in the fiscal 2002 base and do not contribute to reduction of the projected deficit.

Each proposed funding switch is discussed in more detail in the individual agency narratives in Volumes 3 and 4.

Figure 12

Proposed Funding Switches

2005 Biennium Proposed Executive Budget

Agency/Program	General Fund Biennium	Other Funds Biennium	Comments
Supreme Court			
Supreme Court Operations	$ (59,444)	$ 59,444	Automation surcharge replaces general fund for computer replacements. Legislation required.
Boards and Commissions**	(50,000)	50,000	Fund training for judges of courts of limited jurisdiction with registration fees
Governor's Office			
Executive Office	(100,739)	100,739	Replace Consensus Counsel general fund with state special revenue
Executive Office	(127,179)	127,179	Replace Managed Care Ombudsman general fund with federal funding authority
State Auditor			
Securities**	(758,779)	758,779	Fund program entirely with security fees/portfolio revenues.
Justice			
Central Services Division	(23,220)	23,220	Natural resource damage funds replace general fund
Division of Criminal Investigations	(153,315)	155,315	Fund grant writer position with federal funds
Division of Criminal Investigations*	(2,210,352)	2,210,352	Fund Law Enforcement Academy with a surcharge on civil & criminal cases. Pending legislation
Information Technology Services Div.*	(241,633)	580,960	Background check fee to replace general fund
University System			
Appropriation Distribution	(860,175)	860,175	Increased six-mill levy revenue offsets like amount of state general fund
School for the Deaf and Blind			
Education	(113,990)	113,990	Continue special session fund switch replacing general fund with MTAP funds
Historical Society			
Administration Program	(35,000)	35,000	Replace general fund with increased administrative charge to commissions
Environmental Quality			
Enforcement Division	(130,000)	130,000	Legislation is required to divert air quality fees from general fund to state special fund for switch
Permitting and Compliance Division	(80,000)	80,000	Re-assign positions to utlize junk vehicle fee in a funding switch
Permitting and Compliance Division	(73,000)	73,000	Funding switch would utilize water permit fees
Natural Resources and Conservation			
Forestry*	(46,000)	46,000	Require water rights applicants to pay notice fees. Funding switch would utilize state special revenue
Forestry	(173,150)	173,150	Federal funds would be used to replace general fund to pay personal services costs
Administration			
Administration and Finance	(33,441)	33,441	Move 0.33 FTE to proprietary funding
Administration and Finance	(913,878)	913,878	Move centralized services, including 6.00 FTE, to an indirect cost pool
General Services	(853,727)	853,727	Fund common area maintenance with capital land grant funds
Public Health and Human Services			
Child and Family Services	(3,000,000)	3,000,000	Refinance existing general fund costs with federal funds, Title IV-E and Medicaid
Health Policy and Services Division	(8,137,892)	8,137,892	Offsets CHIP general fund match ($4.2 million) and Medicaid match ($3.9 million) - I-146
Disability Services Division	(1,800,000)	1,800,000	Services previously funded with general fund to be paid by Medicaid
Disability Services Division	1,899,878	(1,899,878)	General fund increase to maintain services previously funded with federal funds
Addictive and Mental Disorders Division	(2,190,316)	2,190,316	Increase amount of nursing home intergovernmental transfer to fund mental health Medicaid benefits
Addictive and Mental Disorders Division	(2,000,000)	2,000,000	Divert alcohol tax funds previously distributed to local chemical dependency programs for mental health Medicaid match
Addictive and Mental Disorders Division	(1,306,200)	1,306,200	Use county funds that support community mental health centers as mental health Medicaid match
Total	$ (23,571,552)	$ 23,912,879	
Total Unduplicated in "Fee Changes" Figure	$ (21,073,567)	$ 21,075,567	
Funding Switches for Programs OTO by Previous Legislature (Not in Fiscal 2002 Base)			
Agriculture			
Agricultural Development Division	$ (118,887)	$ 118,887	Organic Certification Program
Military Affairs			
Youth Challenge Program	(2,250,880)	2,250,880	Youth Challenge Program

*Also included in the "Fee Changes" figure and discussion.

**No impact on general fund, as revenues are reduced a like amount.

GOVERNOR'S ECONOMIC DEVELOPMENT PROGRAM

In the 2005 biennium, the Governor carries over all economic development programs funded in HB 2, but makes several changes to economic development programs receiving statutorily appropriated funding. Figure 13 below is a funding comparison for programs funded in the 2003 biennium and those proposed for the 2005 biennium. It should be noted that 2003 biennium funding includes the Governor's mandated expenditure reductions and reductions made during the August 2002 Special Session, which reduced general fund to these programs by over $2.6 million. Additionally, the 2005 biennium figures include proposals contained in the Executive Budget that are contingent on passage and approval of specific legislation.

Figure 13
Economic Development Funding Comparison
2003 Biennium to 2005 Biennium

		2003 Biennium		2005 Biennium	
Agency/Program	**Authority**	**General Fund**	**Other Funds**	**General Fund**	**Other Funds**
Commerce					
Business Resources Division	HB 2	$2,326,698	$8,139,846	$3,285,954	$6,770,000
Small Business Development Center	Statutory	250,000	-	250,000	-
Small Business Innovative Research	Statutory	100,000	-	100,000	-
Certified Communities	Statutory	425,000	-	850,000	-
Montana Manufacturing Extension Center (1)	Statutory	400,000	-	400,000	-
Export Trade Enhancement	Statutory	600,000	-	600,000	-
Research and Commercialization	Statutory	8,015,000	-	-	-
Governor's Office					
Office of Economic Development	HB 2	1,630,151	-	1,621,000	-
Workforce Development (2)	HB 2	-	-	-	231,586
State-Tribal Economic Development Com. (3)	HB 2	-	2,000,000	-	2,000,000
Business Recruitment and Retention	Statutory	390,637	-	-	-
Agriculture					
Growth Through Agriculture (4)	HB 2	-	579,949	-	387,666
Growth Through Agriculture	Statutory	2,175,000	-	1,250,000	-
Total		$16,312,486	$10,719,795	$8,356,954	$9,389,252

(1) Funding provided to Department of Commerce, but administered by MSU.
(2) Funding provided to Governor's Office through transfer of Workforce Development Act funding from DLI.
(3) Biennial appropriation for authority to spend federal funds that might be received for state-tribal economic development.
(4) Funded from coal severance tax shared state special revenue fund.

In the 2005 biennium, the executive proposes to reduce general fund spent on economic development by almost 50 percent from the 2003 biennium funding levels. The major changes effecting this reduction include:

- Elimination of the statutory appropriation for Research and Commercialization Grants. This reduction is part of an overall executive proposal to eliminate the Board of Research and Commercialization and all funding for grants. This proposal would reduce general fund expenditures by over $8.0 million over the biennium, and is contingent upon passage and approval of legislation
- Elimination of the statutory appropriation for Business Recruitment and Retention. For the 2003 biennium, the Governor's Office of Economic Development was to receive an annual appropriation of $350,000 for business recruitment and retention. During the August 2002 Special Session, the appropriation was reduced to $175,000 for fiscal 2003 through fiscal 2005, when the appropriation was to sunset. This reduction, combined with prior reductions under 17-7-140, MCA, of $134,363, resulted in $40,637 available

for expenditure in fiscal 2003. For the 2005 biennium, the executive proposes to eliminate the statutory appropriation and 1.00 FTE within the Office of Economic Development. Elimination of the statutory appropriation is contingent upon passage and approval of legislation

- o Reduction of the statutory appropriation for the Growth Through Agriculture Program. During the August 2002 Special Session, the $1,250,000 million annual statutory appropriation to the Growth Through Agriculture Program was reduced to $925,000 for fiscal 2003 only. For the 2005 biennium, the executive proposes to reduce the appropriation by 50 percent from the current level, to $625,000 per year. This proposal is contingent upon passage and approval of legislation.

Additionally, the executive proposes a reduction in Growth Through Agriculture Program funding from the coal severance tax shared state special revenue fund. For the 2005 biennium, the executive proposes to reduce the portion of coal severance tax collections allocated to the shared account. This will, in turn, necessitate a reduction in the appropriations from that account. The net result is an approximate 50 percent reduction to the state special revenue appropriation to the Growth Through Agriculture Program.

Under current law, all of the statutory appropriations in Figure 13 will sunset at the end of fiscal 2005. While the Governor has proposed legislation to extend some of those appropriations, the proposal was not received in time for inclusion in this analysis. Further analysis to determine the overall affect on these programs will be conducted for the legislative session.

For more information on the programs in Figure 13, see the corresponding agency narratives in Volumes 3 and 4 of this analysis.

FIXED COSTS

Several programs within state government provide services to other functions of state government, for which they charge a fee. The legislature budgets funds so that the agencies receiving services can meet the costs of those services. The legislature does not appropriate funds for the provider programs because they are utilizing internal service funds, which do not require appropriations. In those cases, the legislature approves the rates charged by provider programs.

Figure 14 details each of the internal service programs and the total fixed costs included in the Executive Budget in support of funding those functions. The figure also compares total costs in the Executive Budget in the 2005 biennium with costs budgeted in the 2003 biennium.

Figure 14
Comparison of Fixed Costs
2003 to 2005 Biennium
(in Millions)

Subcommittee/Agency	Program	2003 Biennium	2005 Biennium	Difference	Percent
General Government					
Administration	Insurance and Bonds	$ 16.714	$ 30.223	$ 13.509	80.8%
	Warrant Writing Fees	1.677	1.733	0.056	3.4%
	Payroll Service Fees	0.727	0.897	0.170	23.4%
	Data Network Services	18.836	19.455	0.619	3.3%
	SABHRS Operating	8.351	9.446	1.095	13.1%
	Messenger Services	0.34	0.268	(0.072)	-21.2%
	Rent - Buildings	8.941	11.506	2.565	28.7%
Legislative Audit Division	Audit Fees	2.973	2.799	(0.174)	-5.9%
Natural Resources and Commerce					
Fish, Wildlife, and Parks	Grounds Maintenance	0.64	0.653	0.013	2.0%
Various	State Fund Allocation Plan/MTTPRIME Bonds	5.811	2.209	(3.602)	-62.0%
Total		$ 65.010	$ 79.188	$ 14.178	21.8%

As shown, fixed costs increase by over $14.2 million in the 2005 biennium over the 2003 biennium appropriations. Unlike previous biennia, costs for most charges do not show significant increases, with the allocation reduced in three functional areas. While rent shows a significant increase, over 95 percent of the overall increase in fixed costs is attributable to one area – insurance, which increases over 80 percent. The increase has been attributed to the following:

- o Repayment of a general fund loan
- o Increased number of exposure units
- o Increased value of assets
- o Unfavorable insurance market conditions due to the downturn in the equity market and the insurance payouts associated with the events of September 11, 2001
- o Inflation in medical costs, attorney fees, and court awards

For a further discussion of the insurance cost increase, see the narrative for the Department of Administration in Volume 3 page A-245.

Each of the fixed costs and related issues enumerated above are discussed in greater detail in the respective agency budget narratives included in Volumes 3 and 4 of the *Legislative Budget Analysis*.

INFLATION/DEFLATION

The Executive Budget does not include a general inflation factor for all operating expenses, but instead applies an inflation or deflation factor to fiscal 2002 expenditures for 18 specific items.

Figure 15 shows Executive Budget inflation and deflation factors and the items to which they are applied. Of the 18 items, 8 are purchased outside of state government. The other items or services are purchased from other state agencies, and payments for these items or services go into a proprietary account. The legislature sets the rates that other state agencies must pay for the items or services, and thus determines the fund levels maintained in proprietary accounts.

Figure 15

Inflation and Deflation Factors

		Percent Change From Fiscal 2002		Dollar Change					
				State Agencies		University System		Total	
Account	Item Name	Fiscal 2004	Fiscal 2005	Fiscal 2004	Fiscal 2005	Fiscal 2004	Fiscal 2005	Fiscal 2004	Fiscal 2005
Inflation									
62142	Disk Storage Charges DofA	10.00%	10.00%	$83,211	$83,211	$51	$51	$83,263	$83,263
62168	Read/Write Computer Trans DofA	10.00%	10.00%	35,801	35,801	9	9	$35,810	$35,810
62172	Batch CPU Seconds DofA	10.00%	10.00%	140.452	140.452	166	166	$140.618	$140.618
62175	System Development DofA	20.00%	20.00%	4.923	4.923	0	0	$4.923	$4.923
62177	TSO CPU Seconds DofA	10.00%	10.00%	28,191	28,191	15	15	$28,206	$28,206
62178	IDMS CPU Seconds DofA	10.00%	10.00%	197,717	197,717	6	6	$197,722	$197,722
62180	CICS CPU Seconds DofA	10.00%	10.00%	15.361	15.361	6	6	$15.366	$15.366
62185	Laser Print DofA	30.00%	30.00%	98,255	98,255	56	56	$98,311	$98,311
62216 *	Gasoline	11.00%	16.00%	139,277	202,585	9,051	13,166	$148,328	$215,750
62242 *	Diesel Fuel	11.00%	16.00%	2,872	4,177	2,926	4,256	$5,798	$8,433
62304	Postage & Mailing	8.00%	8.00%	420.065	420.065	86.723	86.723	$506.789	$506.789
62370	Telephone Equipment Charges DofA	33.00%	33.00%	586,826	586,826	155,970	155,970	$742,796	$742,796
62404 *, **	In-State State Motor Pool	1.00%	9.00%	17,181	154,632	384	3,453	$17,565	$158,085
62601	Electricity	10.00%	11.00%	403.994	444.394	342.505	376.755	$746.499	$821.149
Subtotal				$2.174.124	$2.416.587	$597.868	$640.632	$2.771.992	$3.057.219
Deflation									
62141	Tape Megabytes	-100.00%	-100.00%	($21.980)	($21.980)	($8)	($8)	($21.988)	($21.988)
62141	Tape Storage Charges DofA	-100.00%	-100.00%	0	0	$0	$0	$0	$0
62385	Long Distance Charges DofA	-22.00%	-22.00%	(527,178)	(527,178)	($101,487)	($101,487)	($628,665)	($628,665)
62603 *	Natural Gas	-5.00%	-4.00%	(104.405)	(83.524)	($126.638)	($101.311)	($231.043)	($184.834)
Subtotal				($653.563)	($632.682)	($228.133)	($202.805)	($881.695)	($835.487)
Net Change				$1,520,562	$1,783,906	$369,735	$437,827	$1,890,297	$2,221,732

* Actual percentages used for inflation in the Executive Budget are greater than those noted in the "Governor's Executive Budget".

** Actual amounts used for inflation/deflation in the Executive Budget are less than those noted in the "Governor's Executive Budget".

LFD COMMENT The items in the table with asterisks denote inflation/deflation factors that are different than those shown in the "Governor's Executive Budget" publication.

LONG-RANGE PLANNING PROPOSALS

The Governor's request for Long-Range Planning includes a total of $75.5 million for grants, loans, capital projects, and environmental cleanup. The request is summarized in Figure 16.

The most significant funding request for Long-Range Planning includes a total of $46.1 million for projects included under the Long-Range Building Program (LRBP). This request, if approved, would represent the smallest LRBP request since the 1995 biennium. For the first time since the 1989 biennium, the LRBP contains no recommendations for bonded projects. Consequently, no new general fund debt service payments will be incurred during the 2005 biennium through this program.

The Governor's Long-Range Planning package includes a request for bonds to match funding through the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) to pay for the environmental cleanup efforts in the Libby and Troy areas. In 2002, the Governor shot the "silver bullet" and had the cleanup of Libby and Troy moved to a priority position on the federal government's superfund list. Past legislatures provided the authorization for $10.0 million for CERCLA match (75-10-623, MCA), and the executive is requesting $9.0 million for the project. The debt service for a $9.0 million bond issue, assuming a 20-year period, is estimated to cost $712,753 annually.

If the Governor's Long-Range Planning package is approved, two ongoing programs will experience significant funding reductions. Both the Cultural and Aesthetic Grant Program (C&A) and the Treasure State Endowment Program (TSEP) will face reduced grant funding in the 2005 biennium.

C&A will see reduced interest earnings in the future because of a temporary diversion of the flow of the coal severance tax away from the corpus of the Cultural Trust and into the general fund through the 2005 biennium. This change will reduce the interest flowing into the C&A grant program by approximately $27,000 during the 2005 biennium, which equates to a reduction in the grant program of approximately 11.0 percent.

TSEP will have fewer funds for grants during the 2005 biennium and into the future. This is the result of a diversion of $8.4 million of the expected TSEP interest earnings to replace general fund support of K-12 school facility payments. In the future, the proposal includes an increased coal severance tax allocation to the TSEP trust from 25.0 percent (50.0 percent of 50.0 percent) to 37.5 percent (75.0 percent of 50.0 percent) to generate higher interest earnings in the future. Despite the increased coal severance tax distribution, the trust fund will never be able to generate sufficient future interest earnings to fund projects at the current law level.

Section F, in Volume 4, includes detailed information regarding each of the programs related to Long-Range Planning.

Figure 16
Executive Budget Request
Long-Range Planning
2005 Biennium

Program/Project	Amount	Program Total
Long-Range Building Program		$46,134,312
Projects Funded with Cash/Current Revenues	46,134,312	
Projects Funded with Bonded Debt	-	
Treasure State Endowment Program		6,973,695
Grants	6,973,695	
Loans	-	
State Building Energy Conservation Program		2,500,000
Resource Indemnity Trust Grant & Loan Programs		19,169,290
Renewable Resource Grants	4,000,000	
Renewable Resource Loans	12,169,290	
Reclamation & Development Grants	3,000,000	
Cultural & Aesthetic Grant Program		762,827
Grants	732,827	
Capital Artwork Care and Conservation	30,000	
Libby Bond Program		9,000,000
Total		$75,540,124

EXECUTIVE BUDGET – OTHER LFD ISSUES

INTRODUCTION

This section contains LFD issues related to the Executive Budget as a whole. These issues are in addition to specific issues raised in the agency budget presentations. Each item is listed here and discussed in further detail in the following pages.

HIGHLIGHTS

Structural Balance. Structural balance refers to the matching of ongoing expenditures of government with ongoing revenues. If revenues equal or exceed expenditures, then structural balance is achieved. The legislature is facing a structural imbalance in the proposed Executive Budget.

Present Law and New Proposals. The distinction between what constitutes a present law adjustment and what constitutes a new proposal is an important one. Statute requires delineation as to whether existing services or new initiatives are being funded. The LFD identified instances in which the decision packages reported as present law adjustments should have been considered new proposals.

Budget Detail. The Executive Budget, in many instances, lacks sufficient detail to allow LFD staff to perform an effective budget analysis.

Policy Issues – Lack of Specificity. Unspecified reductions in the Executive Budget are a large part of the executive solution to the deficit. As a result, the legislature does not have the information on actual impacts of the spending level proposed by the executive necessary for making policy and prioritizing services.

STRUCTURAL BALANCE

GENERAL FUND

Structural balance refers to the balancing of ongoing expenditures with ongoing revenues. If revenues equal or exceed expenditures, then structural balance is achieved. If expenditures exceed revenues, then structural *imbalance* occurs. General fund expenditures exceeded ongoing revenues for 12 of the past 20 years (see Figure 1). In the mid- to late-1990's, the legislature made significant progress, reaching a sizable positive balance in fiscal 2000. It should be noted that during this time, Montana as well as other states were reaping the benefits of an information technology boom and the significant increase in capital gains taxes. However, the pendulum shifted the other way beginning in fiscal 2001, where revenues were slightly above expenditures. The unprecedented revenue shortfall in this biennium intensifies the potential for an imbalance in the upcoming biennium. Historically, legislators have faced the ever-present difficulty of holding down budget growth when confronted with double-digit growth in corrections costs, increased human services demands, rising enrollments and funding requirements in education, and a larger debt service obligation. In the 2003 session, legislators will face the difficult task of reducing or eliminating programs and services and/or adopting revenue enhancements. Achieving structural balance is a significant fiscal issue that not only affects the Fifty-eighth Legislature but will also establish policy decisions for subsequent legislatures.

Figure 1
General Fund Structural Balance

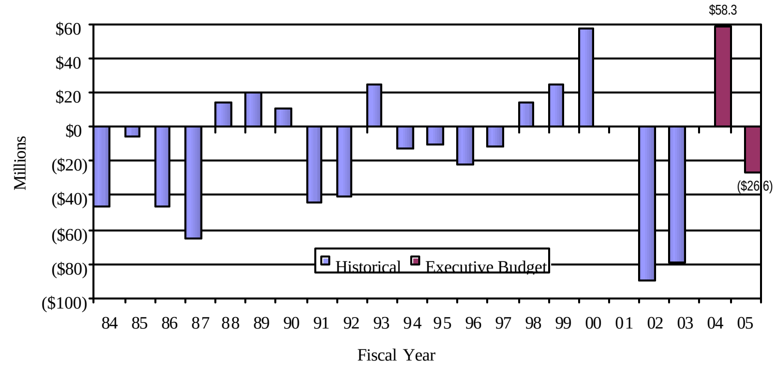


Figure 2
Revenue and Disbursement History
General Fund & School Equalization Accounts
In Millions

	Fiscal Year	General Fund Revenue	General Fund Disburse.	Surplus / Deficit	School Equalization Revenue		School Equalization Disburse.	Surplus / Deficit	GF/SEA Revenue	GF/SEA Disburse.	Surplus / Deficit	Biennium Surplus/Deficit
A	84	$330.305	$357.387	($27.082)	$242.384		$261.753	($19.369)	$572.689	$619.140	($46.451)	
A	85	364.522	380.359	(15.837)	281.275		271.016	10.259	645.797	651.375	(5.578)	($52.029)
A	86	349.541	366.815	(17.274)	252.899		282.166	(29.267)	602.440	648.981	(46.541)	
A	87	346.690	391.325	(44.635)	263.052		283.428	(20.376)	609.742	674.753	(65.011)	(111.552)
A	88	391.152	370.853	20.299	276.216	*	281.886	(5.670)	667.368	652.739	14.629	
A	89	411.729	388.270	23.459	275.589	*	279.536	(3.947)	687.318	667.806	19.512	34.141
A	90	447.962	432.323	15.639	282.389		287.393	(5.004)	730.351	719.716	10.635	
A	91	420.257	457.612	(37.355)	385.031		391.500	(6.469)	805.288	849.112	(43.824)	(33.189)
A	92	487.036	523.072	(36.036)	393.591	*	398.059	(4.468)	880.627	921.131	(40.504)	
A	93	539.955	523.553	16.402	412.903		405.067	7.836	952.858	928.620	24.238	(16.265)
A	94	480.021	497.921	(17.900)	411.834		406.388	5.446	891.855	904.309	(12.454)	
A	95	646.149	535.461	110.688	289.199	*	409.822	(120.623)	935.348	945.283	(9.935)	(22.389)
A	96	963.193	984.997	(21.804)					963.193	984.997	(21.804)	
A	97	986.570	997.835	(11.265)					986.570	997.835	(11.265)	(33.069)
A	98	1,034.382	1,020.591	13.791					1,034.382	1,020.591	13.791	
A	99	1,068.111	1,043.418	24.693					1,068.111	1,043.418	24.693	38.484
A	00	1,163.641	1,105.598	58.043					1,163.641	1,105.598	58.043	
A	01	1,269.472	1,268.938	0.534					1,269.472	1,268.938	0.534	58.577
A	02	1,265.713	1,355.903	(90.190)					1,265.713	1,355.903	(90.190)	
F	03	1,208.408	1,287.279	(78.871)					1,208.408	1,287.279	(78.871)	(110.484)
F	**04**	**1,350.845**	**1,292.539**	58.306			**Executive Budget**		**1,350.845**	**1,292.539**	**58.306**	
F	**05**	**1,291.225**	**1,317.838**	(26.613)			**Executive Budget**		**1,291.225**	**1,317.838**	**(26.613)**	**31.693**

* Excludes education trust & general fund transfers.
Note: The 1995 Legislature de-earmarked school equilization revenue to the general fund.

Figure 2 shows that the anticipated revenues, using revenue estimates adopted in HJR 2, would exceed expenditures proposed in the Executive Budget during the 2005 biennium by $31.7 million. However, included in the anticipated revenue is the impact of all executive revenue proposals, including the $93 million transfer from the coal severance tax permanent trust fund as well as three other one-time revenue sources totaling over $18 million. Inclusion of one-time sources of revenue results in a misleading estimation of structural balance. Since the Executive Budget uses a large amount of one-time revenues to resolve the deficit, it is important to adjust for them to determine ongoing revenues. Further, since there is a significant difference in the revenue estimates for fiscal 2004 versus fiscal 2005 due to assumptions that the revenue collections will show increased recovery in fiscal 2005, it would be appropriate to use fiscal 2005 alone to estimate the level of structural balance. The following narrative establishes the adjustments necessary for one-time revenues and expenditures to arrive at a comparison of ongoing revenues to ongoing expenditures.

One-time revenues

The Executive Budget includes $111.3 million in one-time revenues for the biennium, as shown in Figure 3. However, most are received in fiscal 2004, and only $7.8 million are applied in fiscal 2005.

Figure 2 shows a $26.6 million structural imbalance even before removing one-time revenues. Excluding the $7.8 million in one-time revenues from the structural balance equation would result in a fiscal 2005 structural imbalance of $34.4 million.

Figure 3
Executive Budget Proposal
One-Time Revenue
(Millions)

Item	Fiscal 2004	Fiscal 2005	2005 Biennium
State Fund Transfer	$4.3	$3.8	$8.1
Extend Coal, Oil & Gas, Metal Reallocation	4.2	4.0	8.2
Terminate Infrastructure Credit	2.0	0.0	2.0
Permanent Coal Tax Trust Transfer	93.0	0.0	93.0

One-time expenditures

The Executive Budget as submitted does not designate any significant expenditures as one-time. Therefore, there is no need to adjust the projected structural balance estimate for one-time expenditures. It is possible, however, that the legislature may budget for some services on a one-time only basis. If this occurs, such expenditures can be used to offset the negative implications of one-time revenue.

LFD ISSUE

Based on their submitted balance sheet, the Executive Budget proposal for fiscal 2005 shows revenues are nearly $7 million less than disbursements. Further, the executive uses at least $7.8 million in one-time revenues in fiscal 2005. Additionally, since the revenue estimates adopted by the Revenue and Transportation Interim Committee in HJR2 and other adjustments are lower than the executive estimates, the imbalance becomes even greater when using legislative numbers. Figure 4 shows the structural imbalance for fiscal 2005, comparing executive and legislative numbers. The structural imbalance in fiscal 2005 is $16 million using executive numbers, and $34 million using legislative numbers. As mentioned above, this is a fiscal recommendation that will have an impact on subsequent legislatures.

Figure 4
Structural Imbalance
Fiscal 2005
(Millions)

Item	Executive	Legislative
Anticipated Revenue	$1,306.3	$1,291.2
One-Time Revenue	($7.8)	($7.8)
Ongoing Revenue	1,298.5	1,283.4
Ongoing Expenditures	1,314.8	1,317.8

Expenditure proposals

There are three other ways in which structural balance can be adversely impacted in subsequent biennia, on the expenditure side:

- o Expanded expenditure growth such as that adopted by the 2001 legislature at 8.6 percent (subsequent actions reduced that increase). The 2005 biennium Executive Budget is proposing

extensive reductions, which should impact the structural balance positively, if those reductions are permanent.
- o Realization of delayed implementation of expenditures. Annualization of the 2005 biennium pay plan will require an additional $6.9 million general fund, and the averaging of school funding ANB in 2005 will cost an additional $14.0 million general fund in the 2007 biennium.
- o Growth in services rising from expansions in such programs as Medicaid or from increases in populations supervised by the Department of Corrections. For any increase in annual expenditures, there must be ongoing revenue with which to fund it. In order to attain or maintain a structural balance, annual revenue growth must equal or exceed expenditure growth.

Achieving structural balance is a significant policy issue that the Fifty-eighth Legislature will need to address. If successful, in the 2005 biennium the legislature will make the budget process less problematic for both the executive and legislative branches in subsequent biennia.

OTHER FUNDS

In addition to issues of structural balance in the general fund, there are issues of structural balance in some of the state special revenue accounts included in the Executive Budget. A number of functions of state government are funded from accounts that receive their income from dedicated taxes and fees. One example is the highway special revenue account, which funds highway construction and maintenance, and safety related costs. This fund is in a state of structural imbalance. In other parts of the Executive Budget, the legislature will find instances in which the executive has proposed expenditures that exceed revenue. By budgeting from these accounts at expenditure levels that exceed ongoing revenues, the executive draws down the fund balance and creates program expenditure levels that cannot be sustained. Therefore, future legislatures would be faced with reducing program expenditure levels or increasing revenue. In agency sections of the Budget Analysis, staff has identified those instances in which expenditures from an account exceed anticipated ongoing revenues.

PRESENT LAW AND NEW PROPOSALS

Present law is defined in statute as "that level of funding needed under present law to maintain operations and services at the level authorized by the previous legislature, including but not limited to:
- o Changes resulting from legally mandated workload, caseload, or enrollment increases or decreases;
- o Changes in funding requirements resulting from constitutional or statutory schedules or formulas;
- o Inflationary or deflationary adjustments; and
- o Elimination of nonrecurring appropriations."

New proposals are defined as "requests to provide new non-mandated services, to change program services, <u>to eliminate existing services</u>, or to change sources of funding."

Statute also states that the distinction between new proposals and adjustments to the base will be based on constitutional and statutory requirements. If either is absent, the change should be requested in a new proposal.

The concept of present law versus new proposals allows the legislature to examine requested adjustments to the budgets by determination of what constitutes a change necessary or desired because of decisions already made and currently in place, versus changes desired to implement new programs or a change in direction, or because of changing financial circumstances. As such, the legislature can determine whether underlying and current decisions, policies, or statutes must be changed in order to avoid or reduce the requested adjustment, or whether the decision is significantly more discretionary. Subsequently, new proposals are generally given more scrutiny than present law adjustments because of the increased discretion they embody. There are two primary rationales for why it is imperative that requested adjustments be appropriately categorized between new proposals and present law adjustments.

- If new programs or other policy decisions are inappropriately categorized as present law, they may not be examined with the same scrutiny as new proposals because of this inherent assumption. In addition, it is imperative to maintain the integrity of the present law adjustment concept as one that truly reflects what is needed to maintain operations.
- New proposals are used to determine the rate or level of expansion or retraction of state government, both as requested by the executive and as implemented by the legislature. Therefore, inappropriate categorization clouds the determination of the "real" costs of providing services as currently required by law and the cost of something new or service reductions. Consequently, the distinction begins to lose meaning.

The distinction between a present law adjustment and a new proposal will often be nebulous for certain types of adjustments. However, there should be little doubt in most instances, and no doubt when statutes specifically direct the type of adjustment.

Events in the 2003 biennium made the determination of present law more challenging than normal. The large budget deficit, the first time implementation of executive spending reductions under 17-7-140, MCA, and a special session clouded the characterization of present law. The executive has generally maintained an appropriate distinction between general fund present law adjustments and new proposals. However, there were two categories of adjustments made by the executive that are brought to the legislature's attention:

- The executive treated the Governor's spending reductions for fiscal 2003 as present law reductions. Statute clearly states that present law is "that level of funding needed under present law to maintain operations and services <u>at the level authorized by the previous legislature</u>."(emphasis added) The reductions were made by the Governor and did not have legislative action. In an opinion issued by the legislative legal counsel, executive reductions under 17-7-140, MCA are not present law reductions, and should be treated as reductions of existing services, which would be new proposals. While in most cases a decision package for the reduction exists, it may create confusion as to whether it is implementation of previous legislative decisions or a reduction in existing legislatively authorized services.
- The executive treated the majority of the fiscal 2003 legislative appropriation reductions (August 2002 special session) as a present law reduction. Statute is not clear as to whether this should be a present law or new proposal adjustment. It is only important that the legislature recognize how they were classified in the Executive Budget. The reductions were generally characterized as if the legislature had made these reductions permanent, although it is not clear that is what the legislature intended. It is also important to note that the reductions imposed in the Executive Budget to achieve the level of reductions taken in special session were simply taking the appropriation authority away. The services or functions being reduced are in most cases non-specific, and do not necessarily represent the same service reductions taken in special session.

BUDGET DETAIL

Statute addresses the need of the legislature and its staff for early submission of budget detail of the entire Executive Budget, and establishes a November 15 deadline for this submission. This provides the legislature an opportunity for analysis and review of the budget proposal in preparation for the session.

Some portions of the published Martz Budget are presented in only outline form, with little explanation of the policies needed to implement the proposed change or the mechanics of implementing the initiatives. In some instances, initiatives are not discussed at all in the November 15 budget document. The LFD has raised this same concern in the last four budget analyses, and this continues to be an area that should be of concern to legislators. The lack of budget detail makes it difficult for legislators and the public to review the budget and for staff to analyze many proposals thoroughly. In some cases staff could only raise questions, since budget details were insufficient to reach conclusions and provide options. Therefore, the opportunity for the legislature to obtain a clear understanding or analysis of these issues in advance of the session is impaired.

POLICY ISSUES - LACK OF SPECIFICITY

The executive proposes a number of reductions to agency budgets to achieve a proposed HB 2 appropriation level. In many instances, the executive establishes a target general fund level in individual agencies but does not specify what service or operational reductions would be necessary or desirable to meet the targets. Unspecified reductions in the Executive Budget are a large part of the executive solution to the deficit. As a result, the legislature does not have the information on actual impacts of the spending level proposed by the executive necessary for making policy and prioritizing services for these proposed reductions.

The largest single component for which this applies is the Montana University System (MUS). As shown on page 70, the executive is proposing over $25 million in reductions to the MUS[5]. While the Board of Regents is responsible for managing the system and will make all decisions on how the system will live within the appropriation, the executive has not provided the Board of Regents with any guidelines or suggestions on priorities or inherent policy within the proposed reduction, including the level of any potential offsets with increased tuition.

LFD staff has attempted to ascertain potential impacts on services within agencies, as discussed in the narratives for individual agencies in Volumes 3 and 4. However, the legislature may want to require specific statements of impact of the proposed reductions in each agency and articulate its own expectations and priorities to ensure they are maintained in the 2005 biennium.

[5] If offsets taken against statewide present adjustments are added, the unspecified reduction from present law is over $40 million.