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To: Revenue and Transportation Committee

From: Terry W. Johnson
Principal Fiscal Analyst

Subject: General Fund Revenue Trends

Internet: http://leg.mt.gov/Reports/Fiscal/interim/GF_Revenue_April2002.pdf

INTRODUCTION

The purpose of this report is to provide the committee with information on significant revenue trends that are occurring in fiscal 2002 and to provide an outlook for the remainder of the 2003 biennium.

At the committee meeting in December, our office expressed concerns over some of the revenue trends that were developing based on data through the end of November 2001. This report is based on information we have received through the end of March 2002.

The report is organized in three relevant sections. The first section discusses fiscal 2002 general fund revenue trends and is further subdivided into "HB124 Statutory Changes", "Impacts of Economic Trends", and "Other General Fund Issues" components. Section 2 summarizes the potential revenue shortfall for fiscal 2002. Section 3 addresses the outlook for the 2003 biennium and the potential for statutorily required reductions in spending per 17-7-140, MCA.

FISCAL 2002 GENERAL FUND REVENUE TRENDS

Based on information recorded through the end of March 2002 on the Statewide Accounting, Budgeting, and Human Resource System (SABHRS), total general fund receipts for fiscal 2002 were $772.6 million as shown in Table 1. This compares to $737.6 million collected for the same period of fiscal 2001. Total general fund collections are $35.0 million above last year's amount, which represents a 4.7 percent increase.

Table 1
General Fund Revenue Monitoring Report For Mar. 2002

Revenue Source	Estimated Fiscal 2002	Thru Mar. Fiscal 2001	Thru Mar. Fiscal 2002	Dollar Change	Percent Difference	% Actual Fiscal 2001	% Estimate Fiscal 2002
Driver's License Fee	2,178,000	1,143,660	1,787,913	644,253	56.33%	60.33%	82.09%
Insurance Tax & License Fees	42,666,000	17,639,097	19,231,579	1,592,482	9.03%	41.70%	45.07%
Investment License Fee	6,580,000	5,077,314	4,374,480	(702,834)	-13.84%	86.22%	66.48%
Vehicle Tax	77,319,000	0	46,585,193	46,585,193	#N/A	#N/A	60.25%
Motor Vehicle Fee	25,182,000	8,013,556	17,596,053	9,582,497	119.58%	63.93%	69.88%
Nursing Facilities Fee	5,547,000	2,897,802	2,965,704	67,902	2.34%	51.23%	53.47%
Beer Tax	2,885,000	250,470	1,831,040	1,580,570	631.04%	65.12%	63.47%
Cigarette Tax	8,057,000	5,551,564	5,350,803	(200,761)	-3.62%	67.01%	66.41%
Coal Severance Tax	9,073,000	4,635,210	4,476,177	(159,033)	-3.43%	53.51%	49.34%
Corporation Income Tax	81,543,000	52,315,163	42,006,896	(10,308,267)	-19.70%	50.46%	51.52%
Electrical Energy Tax	4,644,000	2,099,597	2,227,111	127,514	6.07%	51.74%	47.96%
Wholesale Energy Tax	3,568,000	1,777,539	1,302,871	(474,668)	-26.70%	50.74%	36.52%
Railroad Car Tax	1,688,000	1,032,630	1,012,930	(19,700)	-1.91%	66.38%	60.01%
Individual Income Tax	574,995,000	362,954,755	352,549,114	(10,405,641)	-2.87%	65.28%	61.31%
Estate Tax	17,118,000	13,823,460	10,465,391	(3,358,069)	-24.29%	68.14%	61.14%
Metalliferous Mines Tax	4,706,000	916,911	476,682	(440,229)	-48.01%	26.83%	10.13%
Natural Gas Production Tax	1,945,000	(265,495)	0	265,495	-100.00%	100.00%	0.00%
Oil Production Tax	10,462,000	5,112,812	3,372,653	(1,740,159)	-34.04%	19.62%	32.24%
Public Contractors Tax	2,441,000	855,641	2,574,760	1,719,119	200.92%	108.09%	105.48%
Property Tax: 1.5 Mill	1,063,000	617,223	543,999	(73,224)	-11.86%	52.68%	51.18%
Property Tax: 40 Mill	62,310,000	37,328,127	37,401,440	73,313	0.20%	58.85%	60.02%
Property Tax: 55 Mill	107,598,000	67,071,806	59,631,163	(7,440,643)	-11.09%	58.09%	55.42%
Telephone License Tax	0	133,980	31,676	(102,304)	-76.36%	100.43%	#N/A
Telecommunications Excise Tax	20,253,000	8,721,901	10,417,703	1,695,802	19.44%	46.30%	51.44%
Tobacco Tax	2,265,000	1,334,249	1,470,825	136,576	10.24%	65.15%	64.94%
Video Gambling Tax	41,518,000	6,812,997	21,653,084	14,840,087	217.82%	32.61%	52.15%
Wine Tax	1,300,000	706,310	811,656	105,346	14.91%	68.39%	62.44%
Public Institution Reimbursements	12,521,000	6,682,980	6,854,130	171,150	2.56%	49.31%	54.74%
Highway Patrol Fines	4,191,000	2,726,763	2,926,897	200,134	7.34%	68.50%	69.84%
Treasury Cash Account Interest	14,671,000	14,354,785	9,632,232	(4,722,553)	-32.90%	66.67%	65.65%
Local Impact Interest	0	82,834	0	(82,834)	-100.00%	100.00%	#N/A
Liquor Excise & License Tax	9,661,000	4,950,702	6,420,022	1,469,320	29.68%	67.42%	66.45%
Liquor Profits	5,831,000	0	0	0	#N/A	0.00%	0.00%
Coal Trust Interest	36,401,000	21,685,623	22,504,079	818,456	3.77%	57.58%	61.82%
Common School Interest and Income	48,703,000	17,757,623	16,108,922	(1,648,701)	-9.28%	37.91%	33.08%
Lottery Profits	6,249,000	2,728,276	4,130,410	1,402,134	51.39%	44.45%	66.10%
Long Range Bond Excess	0	0	0	0	#N/A	#N/A	#N/A
Tobacco Settlement	18,925,000	5,591,251	5,082,085	(509,166)	-9.11%	34.97%	26.85%
US Mineral Royalty	21,756,000	14,387,925	12,344,679	(2,043,246)	-14.20%	46.40%	56.74%
All Other Revenue	32,715,000	38,128,766	34,436,791	(3,691,975)	-9.68%	73.67%	105.26%
Grand Total	$1,330,528,000	$737,635,807	$772,589,143	$34,953,336	4.74%	58.11%	58.07%

This trend by itself indicates that general fund revenue growth may be slipping below expectations since total revenues were expected to increase by 9.6 percent from estimated fiscal 2001 to 2002. However, since fiscal 2001 actual revenues exceeded HJR 2 estimates by $55.8 million, a revenue growth of only 4.8 percent from actual fiscal 2001 to estimated fiscal 2002 would be required to meet HJR 2 estimates. Table 2 shows how these growth rates were calculated. If the growth rate drops below 4.8 percent, the revenue estimate contained in HJR 2 will not be achieved. For the first time this fiscal year, year to date collections are below the 4.8 percent threshold at 4.7 percent.

Table 2
General Fund Revenue Growth Rates

	Amount Millions	Difference Millions	Growth Rate
Estimated 2001 General Fund Revenue	$1,213.719		
Estimated 2002 General Fund Revenue	1,330.528	$116.809	9.62%
Actual 2001 General Fund Revenue	$1,269.472		
Estimated 2002 General Fund Revenue	1,330.528	$61.056	4.81%

HB 124 STATUTORY CHANGES

The aggregate growth trends mentioned above can be misleading when there have been significant statutory changes such as the implementation of HB 124 (The Big Bill). The following is a list of revenue sources that were impacted by the enactment of HB 124 and a brief description of what has occurred:

Beer Tax

Prior to HB 124, $2.80 of the $4.30 per barrel beer tax was statutorily appropriated from the state special revenue fund to incorporated cities and towns. This additional tax revenue of $2.5 million in fiscal 2002 and $2.6 million in fiscal 2003 is now deposited to the general fund. Since fiscal year 2001 general fund collections did not include the additional amount, collections to date in fiscal 2002 show a 631.0 percent increase.

Wine Tax

Prior to HB 124, 10.0 percent of total wine tax was statutorily appropriated from the state special revenue fund to cities, towns, and counties. This additional tax revenue of $193,000 in fiscal 2002 and $201,000 in fiscal 2003 is now deposited to the general fund. Since fiscal year 2001 general fund collections did not include the additional amount, collections to date in fiscal 2002 show a 14.9 percent increase.

Liquor Excise Tax

Prior to HB 124, 34.5 percent of the total liquor excise tax revenue was statutorily appropriated from the state special revenue fund to incorporated cities and towns. This additional tax revenue of $1.7 million in fiscal 2002 and $1.8 million in fiscal 2003 is now deposited to the general fund. Since fiscal year 2001 general fund collections did not include the additional amount, collections to date in fiscal 2002 show a 29.7 percent increase.

Video Gambling Tax

Prior to HB 124, two-thirds of the total video gambling tax revenue was statutorily appropriated from the state special revenue fund to municipalities or towns in which the machines were located. This additional tax revenue of $27.7 million in fiscal 2002 and $30.1 million in fiscal 2003 is now deposited to the general fund. Since fiscal 2001 general fund collections include the local government allocation for the last quarter, the percent of fiscal 2001 actual collections through March is only 32.6 percent of total collections. Collections to date in fiscal 2002 are 52.2 percent of the total estimate, which is more representative of a normal receipt pattern.

Property Tax

Prior to HB 124, a portion of the financial institution corporation tax and certain motor vehicle taxes were distributed based on the ratio of a taxing jurisdiction mills to total mills levied. Therefore, portions of these revenues were distributed to the general fund as property tax for the 40 mill statewide levy and 55 mill county equalization levy share. HB 124 eliminated this distribution mechanism and required the deposit of these revenues directly to the general fund as corporation tax and motor vehicle taxes. The reduction in property tax revenue in fiscal 2002 as a result of HB 124 is expected to be $2.8 million per year. Collections to date in fiscal 2002 reflect a portion of this reduction.

Vehicle Tax

HB 124 required that taxes on all light vehicles, large trucks, trailers, motorcycles, and other vehicles be deposited in the general fund beginning July 1, 2001. Previously this revenue was distributed primarily to local governments and schools. Upon adjournment of the 57th Legislature, the total vehicle tax revenue deposited in the general fund was estimated to be $77.3 million for fiscal 2002 and $77.6 million for fiscal 2003. As of the end of March 2002, which represents eight months of vehicle tax collection activity, the amount of motor vehicle taxes collected was $46.6 million. Annualizing this amount for the entire year would yield only $68.1 million for fiscal 2002, producing a revenue shortfall of $9.2 million. However, based on detailed calendar 2001 vehicle data from the Department of Justice, it is estimated that total vehicle tax revenues may be closer to $69.7 million or $7.6 million less than the HJR 2 estimate. This shortfall is also expected in fiscal 2003. (See the March 14, 2002 LFD report on HB 124 for a more in-depth analysis of vehicles taxes.)

Motor Vehicle Fee

Prior to HB 124, certain fees such as fees for titles, registrations, and personalized license plates were collected and retained by counties. This fee revenue, including revenue from a new $0.25 registration fee for disabled senior citizens' transportation costs, estimated to be $13.1 million in fiscal 2002 and 2003, is now deposited to the general fund. Since fiscal year 2001 general fund collections did not include the additional amount, collections to date in fiscal 2002 show a 119.6 percent increase.

Based on fiscal 2001 city and county fee data reported to the Department of Revenue and state special revenue data from the state accounting system, it is estimated that the increase in total motor vehicle fee revenue may be closer to $15.6 million or $2.5 million above the amount published in the *Legislative Fiscal Report, 2003 Biennium*. A similar increase is also expected in fiscal 2003. (See the March 14, 2002 LFD report on HB 124 for a more in-depth analysis of vehicles fees.)

IMPACTS OF ECONOMIC TRENDS

Changes in general economic conditions can also skew aggregate growth trends especially when the change occurs gradually throughout the year. During fiscal 2002, several economic assumptions adopted by the 57th Legislature have been progressively weakening. Although the revenues associated with these economic assumptions appeared to be within forecasts early in the fiscal year, collections in the later part of the year will show signs of slower growth. This is due to the time lag between the impacts of economic changes and when tax revenues are actually received.

The following section of the report addresses some of the revenue sources that are or will be impacted by the economic changes that have been developing over the past nine months.

Individual Income Tax

Approximately 65 percent of total income reported on individual income tax returns is from wages and salaries. Based on information from the US Bureau of Economic Analysis, wages in Montana have increased by 7.0 percent from the quarter ending September 2000 to September 2001. Although this is an exceptional growth rate, Paul Polzin of the Bureau of Business and Economic Research has projected that Montana will see the impact of the national economic recession during the fourth quarter of calendar 2001 and into calendar 2002. Assuming these projections are correct, individual income tax collections should begin to show signs of weakness beginning in calendar 2002. Financial accounting records for December, January, February, and March of fiscal 2002 support this supposition.

In addition to wage income, over 16 percent of total income is derived from interest, dividends, and net capital gains. Using the federal discount rate as a directional indicator of interest rates, this rate has fallen from 6.0 percent in February 2001 to 1.25 percent in December 2001. The S&P 500 stock index was over 1,500 during August 2000 but has fallen to less than 1,150 by March 2002. This represents almost a 25 percent decrease in equity values.

For the period January through March of this year, the Department of Revenue issued $16.8 million more in refunds than for the same period of last year. One of the reasons for this increased activity is the refund processing efficiency of the department. For this three-month period, the department processed 143,085 refunds out of 214,500 total returns received (66.7 percent). Last year the department had processed 97,573 refunds out of 214,000 total returns received (45.6 percent). To date, the average refund dollar amount has increased by 8.2 percent.

Because of the accelerated refund processing, net individual income tax revenues appear to be lagging significantly from last year's level. At this time, however, there is insufficient information to determine if total refunds for this year will be higher or lower than last year. Since the majority of total refunds will be processed by May 31, information that will be available in early June should provide a better perspective on total refund activity. For purposes of this report, the trend in individual income tax collections through December has been used to estimate the potential $19.9 million revenue shortfall. As more information becomes available on total refunds, the shortfall estimate may require adjustment.

Corporation Income Tax

Corporation income tax collections through March 2002 are $10.3 million below the comparable period of fiscal 2001. This reduction occurred even with a one-time $5.3 million payment that was not anticipated nor included in the HJR 2 estimate. The three factors that explain this significant decrease in revenues are as follows: 1) total audit revenue received through March of this year compared to March of last year is $6.3 million less; 2) two major corporations have paid about $5.0 million less in estimated taxes this year as compared to last year; and 3) the economic recession has reduced the profitability of many corporations thereby reducing corporation income tax revenues. At this time, it can not be determined if corporation income taxes will be below or above HJR 2 estimates.

Property Tax

Most of the revenue from property taxes is determined by assessing the 95 mills against the statewide taxable value. Based on information received from the Department of Revenue, the official statewide taxable value for fiscal 2002 is $12.1 million less than estimated in HJR 2. This amounts to about $1.2 million less in general fund revenues for fiscal 2002 and a potential $2.4 million reduction for fiscal 2003.

Treasury Cash Account Interest

As mentioned under the individual income tax category, the federal discount interest rate has plummeted from 6.0 percent in February 2001 to 1.25 percent in December 2001. Since treasury cash account interest revenue is based on the amount of cash available to invest and the prevailing short-term interest rates, the revenue from this source has already shown signs of weakness. Data from the Board of Investments indicate that the to date yield on the treasury cash account is about 4.4 percent for fiscal 2002. This compares to the HJR 2 short-term interest rate assumption of 6.6 percent.

Oil Production Tax

Oil production taxes are based on the barrels of oil produced and the wellhead price. Data from the US Department of Energy, Energy Information Administration show Montana’s average wellhead oil price for the quarter ending September 2001 was $24.00 per barrel. However, the average price for the quarter ending December 2001 declined to $17.63 per barrel, a 26.5 percent reduction in wellhead prices. Montana’s average wellhead oil prices for January have increased to $16.85 per barrel from $16.33 in December. The oil price estimate contained in HJR 2 was $19.20 per barrel for fiscal 2002.

Metalliferous Mines Tax

The metalliferous mines tax is based on the quantity and price of minerals produced. During the 57th Legislature when the economic assumptions were adopted, palladium prices had spiked to over $700 an ounce due to production reductions by Russia. At that time, it appeared that the higher prices would prevail for the foreseeable future. Therefore, the legislature assumed palladium prices would be $745 per ounce throughout the 2003 biennium. Because palladium prices have averaged about $540 per ounce during calendar 2001, revenues from this source will be approximately $1.4 million below the HJR 2 estimate.

Investment License Fee

Investment advisors and investment companies pay various fees for the registration of securities and agents, for registration for securities by notification, and for notice of federal filing of a federally secured security. Because these advisors and companies are directly involved with the equity markets and are subject to the volatility of the markets over the past year , revenues from this source are expected to be below the HJR 2 estimates by $1.5 million in fiscal 2002.

OTHER GENERAL FUND REVENUE ISSUES

US Mineral Royalty

US mineral royalty collections through March 2002 are $2.0 million below the comparable period for fiscal 2001. However, receipts at the end of February 2002 were only $0.3 million below the same period of fiscal 2001. The exact cause of these fluctuations cannot be determined at this time. This is because the Department of Interior, Mineral Management Services' computer system was inoperative until just recently and has created a significant backlog of data to be processed. Also due to the computer problems, payments Montana received in December, January, February, and March are estimated payments that may have to be adjusted in subsequent months.

It should be noted that HB 226 passed by the 57th Legislature caps the amount of US mineral royalty revenue deposited to the general fund based on the revenue estimates contained in HJR 2. Any revenue received in excess of the HJR 2 estimates is to be returned to the county where the mining or extraction occurred. Pertinent sections of the bill are effective January 1, 2002.

Tobacco Settlement

As negotiated by the settling parties and specified in the Master Settlement Agreement, Montana receives a set percentage of an increasing amount of tobacco settlement money. Because the January 2002 payment to all parties was expected to increase by $76.4 million, Montana's share was also expected to increase. However, major tobacco companies have disputed the tobacco settlement auditor calculations for prior payments and have placed a substantial amount of money into a special account that is not distributed to the settling parties until the dispute is resolved. Montana's share of the disputed amount resulted in a reduction of $811,000 for the January 2002 payment. Since this dispute has been resolved, Montana will receive these monies with the April 15th payment.

In addition, the amount of money each settling party receives is adjusted by the change in volume of cigarettes shipped nationally from the base year of 1997 - fewer cigarettes shipped means a reduction in the payment. The January 2002 payment (and all subsequent payments) was reduced because the number of cigarettes shipped in 2001 was less than anticipated. Due to this reduction, general fund collections are expected to be less than estimates contained in HJR 2 by $362,000 in fiscal 2002 and $366,000 in fiscal 2003.

Common School Interest and Income

Common school interest and income collections through March 2002 are $1.7 million below the comparable period for fiscal 2001. Most of this shortfall is due to agricultural rental fees below the estimated amounts contained in HJR 2. Since most of these rental fees are collected by the end of March, total collections for common school interest and income should be $1.7 million below HJR 2 estimates.

Coal Trust Interest Earnings/Common School Interest and Income

By the end of fiscal 2002, total general fund revenues from these two sources will be overstated by $3.4 million. This double counting occurs when mineral royalty payments are deposited to the guarantee account (a sub-account of the general fund) and when loan payments from the guarantee account are deposited to the general fund. (See the March 4, 2002 LFD report on SB 495 for an in-depth analysis of this issue.) However, the net impact (revenues minus disbursements) to the general fund is zero since there is a guarantee account transfer appropriation equal to $3.4 million.

All Other Revenue

This category is a number of miscellaneous, smaller sources of revenue not contained in the other individual components. Fiscal 2002 collections to date exceed the amount estimated for the entire fiscal year. Greater than anticipated collections have occurred in three main areas: 1) wildfire reimbursements - $4.9 million; 2) certain gross vehicle weight fees - $0.4 million; and 3) $0.5 million settlement payment from Bridgestone-Firestone for false advertising.

FISCAL 2002 SUMMARY

Based on data through the end of March 2002, general fund revenue collections continue to show signs of weakening growth. Sources of revenue that are currently below expectations are individual income tax, property tax, treasury cash account interest, common school interest and income, tobacco settlement payments, investment license fees, and metalliferous mines tax. Additional categories that will begin to show declining growth within the next quarter are oil and gas production tax and potentially coal trust interest earnings.

How significantly these trends will impact the fiscal 2002 and 2003 general fund ending balance is difficult to accurately estimate at this time. As Paul Polzin pointed out in his "*Outlook 2002*" publication, calendar 2002 "depends crucially on how some of the state's major industrial facilities react to a variety of threats. It is not just the national and worldwide recession, but these firms also face issues with respect to electricity prices, management, and regulation." Companies mentioned were:

- Columbia Falls Aluminum Company
- Jore Manufacturing
- Stillwater Mining

- Montana Power Company
- ASARCO

The following table (Table 3) provides a rough estimate of the **potential** revenue shortfall that may occur in fiscal 2002. As mentioned throughout this report, there are a number of economic conditions and business decisions that may change the final outcome for fiscal 2002. The revenue shortfall estimate reflected in Table 3 is based on available data extrapolated to the end of the fiscal year. Some of the smaller sources that may be doing better than expected have not been included in the table nor have other categories that will show declining growth in the future. As fiscal 2002 proceeds, this estimate will be further refined and updated based on new information received. The probability that this shortfall will occur in fiscal 2003 is high.

Table 3
General Fund Revenue Sources
Potential Shortfall Fiscal 2002

	Estimated Millions
Individual Income Tax	($19.9)
Property Tax	(1.2)
Treasury Cash Account Interest	(2.0)
Tobacco Settlement	(0.4)
Investment License Fee	(1.5)
Common School Interest & Income	(1.7)
Metalliferous Mines Tax	(1.4)
FEMA Fire Reimbursement	4.9
Motor Vehicle Tax	(7.6)
Motor Vehicle Fee	2.5
Total	($28.3)

2003 BIENNIUM OUTLOOK

Table 4 provides a projection of the 2003 biennium ending fund balance, taking into consideration the projected impact on reduced revenues in fiscal 2002, an assumption that the shortfall will continue in fiscal 2003, and consideration of other new information that has become available since adjournment.

As shown in the table, the 57th Legislature projected a general fund ending fund balance of $53.8 million on June 30, 2003. A reported improvement was the increased fund balance in fiscal 2001 of $62.7 million, leaving a projected balance on June 30, 2003 of $116.5 million. However, as the table shows, there have been a number of predominantly negative impacts on the general fund balance that have sharply reduced the projected fiscal 2003 ending balance. The most significant is the impact of the fiscal 2002 reduction of $28.3 million, which if assumed to continue in 2003, would reduce revenues by $61.5 million for the 2003 biennium.

The other significant revenue adjustments included in Table 4 are the estimated impacts of the "Economic Growth and Relief Reconciliation Act of 2001" and the "Job Creation and Worker Assistance Act of 2002". The first act is estimated to increase state income taxes by $13.3 million for the 2003 biennium. The most recent act, however, may reduce state income tax revenues significantly. This is because the bill allows a first-year depreciation deduction equal to 30 percent of the adjusted basis for certain qualified property acquired after September 10, 2001 and before September 11, 2004. Our office has acquired an estimate from Senator Burns' office that was prepared by the Congressional Research Service. They are estimating the reduction in Montana's state revenue would be $29.8 million for the 2003 biennium due to this legislation.

Table 4 2003 Biennium General Fund Outlook In Millions	
Ending Fund Balance - End of 57th Legislature	**$53.8**
Fiscal 2001 Net Improvement	62.7
Adjustment to Fiscal 2001 Balance	(0.6)
Continuing Appropriations	(2.3)
Potential Revenue Shortfall	(61.5) [1]
Public School & Other Reversions	5.9
Economic Growth & Relief Recon. Act	13.3
Job Creation & Worker Assistance Act	(29.8) [2]
Forest Fires & Terrorism Costs - Net	(13.5)
Supplementals	???
Potential Ending Fund Balance	**$28.0**

1 Assumes fiscal 2002 shortfall continues into fiscal 2003 adjusted for FEMA fire reimbursements
2 Preliminary estimate from Congressional Research Service

Table 4 also shows other estimated incremental increases and decreases that contribute to a revised potential ending fund balance of $28.0 million for the 2003 biennium.

It should be noted that these projections do not assume any supplemental requests for the rest of this biennium, even though there are identified budget shortfalls in the departments of Public Health and Human Services, Corrections, and Natural Resources and Conservation (fire suppression costs, which are not budgeted). It also does not take into consideration over a $50 million structural imbalance in the general fund (ongoing expenditures exceed ongoing revenues) that was emphasized by our office during the 2001 session. If the potential revenue shortfall of $61.5 million plus the impacts of the federal legislation is included in the structural imbalance calculations, the imbalance mushrooms to about $130 million. In other words, general fund expenditures for the 2003 biennium would exceed revenues by over $130 million.

To the extent that supplemental appropriations materialize, the general fund balance would be further reduced beyond the anticipated amount shown in Table 4. Even without the inclusion of any supplemental appropriations, the executive may be required to implement 17-7-140, MCA. As stated in this section of law, “a "projected general fund budget deficit" means an amount, certified by the budget director to the governor, by which the projected ending general fund balance for the biennium is less than 2% of the general fund appropriations for the second fiscal year of the biennium.” Two percent of the general fund appropriations for the second year of the biennium would be approximately $26.6 million. The following is the applicable section of statute that addresses the roles and responsibilities of the executive, the Legislative Finance Committee, and the Revenue and Transportation Interim Committee (RTIC). The responsibilities of the RTIC have been italicized for your reference.

17-7-140.
Reduction in spending. (1) (a) As the chief budget officer of the state, the governor shall ensure that the expenditure of appropriations does not exceed available revenue. Except as provided in subsection (2), in the event of a projected general fund budget deficit, the governor, taking into account the criteria provided in subsection (1)(b), shall direct agencies to reduce spending in an amount that ensures that the projected ending general fund balance for the biennium will be at least 1% of all general fund appropriations during the biennium. An agency may not be required to reduce general fund spending for any program, as defined in each general appropriations act, by more than 10% during a biennium. Departments or agencies headed by elected officials or the board of regents may not be required to reduce general fund spending by a percentage greater than the percentage of general fund spending reductions required for the total of all other executive branch agencies. The legislature may exempt from a reduction an appropriation item within a program or may direct that the appropriation item may not be reduced by more than 10%.

(b) The governor shall direct agencies to manage their budgets in order to reduce general fund expenditures. Prior to directing agencies to reduce spending as provided in subsection (1)(a), the governor shall direct each agency to analyze the nature of each program that receives a general fund appropriation to determine whether the program is mandatory or permissive and to analyze the impact of the proposed reduction in spending on the purpose of the program. An agency shall submit its analysis to the office of budget and program planning and shall at the same time provide a copy of the analysis to the legislative fiscal analyst. The office of budget and program planning shall review each agency's analysis, and the budget director shall submit to the governor a copy of the office of budget and program planning's recommendations for reductions in spending. The budget director shall provide a copy of the recommendations to the legislative fiscal analyst at the time that the recommendations are submitted to the governor and shall provide the legislative fiscal analyst with any proposed changes to the recommendations. The legislative finance committee shall meet within 20 days of the date that the proposed changes to the recommendations for reductions in spending are provided to the legislative fiscal analyst. The legislative fiscal analyst shall provide a copy of the legislative fiscal analyst's review of the proposed reductions in spending to the budget director at least 5 days before the meeting of the legislative finance committee. The committee may make recommendations concerning the proposed reductions in spending. The governor shall consider each agency's analysis and the recommendations of the office of budget and program planning and the legislative finance committee in determining the agency's reduction in spending. Reductions in spending must be designed to have the least adverse impact on the provision of services determined to be most integral to the discharge of the agency's statutory responsibilities.
(2) Reductions in spending for the following may not be directed by the governor:
(a) payment of interest and principal on state debt;
(b) the legislative branch;
(c) the judicial branch;
(d) the school BASE funding program, including special education; and
(e) salaries of elected officials during their terms of office.
(3) (a) As used in this section, "projected general fund budget deficit" means an amount, certified by the budget director to the governor, by which the projected ending general fund balance for the biennium is less than 2% of the general fund appropriations for the second fiscal year of the biennium. In determining the amount of the projected general fund budget deficit, the budget director shall take into account revenue, established levels of appropriation, anticipated supplemental appropriations for school equalization aid, and anticipated reversions.

(b) If the budget director determines that an amount of actual or projected receipts will result in an amount less than the amount projected to be received in the revenue estimate established pursuant to 5-18-107, the budget director shall notify the revenue and transportation interim committee of the estimated amount. Within 20 days of notification, the revenue and transportation interim committee shall provide the budget director with any recommendations concerning the amount. The budget director shall consider any recommendations of the revenue and transportation interim committee prior to certifying a projected general fund budget deficit to the governor.

In summary, the potential ending fund balance for the general fund at the end of the 2003 biennium is $28.0 million. This projected balance does not include supplementals. Because the projected ending balance is very close to the statutorily defined $26.6 million trigger, the executive may be required to implement the provisions of the "reduction in spending" statute delineated in 17-7-104, MCA.

As outlined in the statute, the executive is required to follow a sequence of events before spending reductions can be implemented. The speculative nature of forecasting revenues over a year in advance combined with the uncertainty associated with the behavior affects of the federal legislation, presents the executive with a difficult policy issue. If reductions are implemented unnecessarily, services will be reduced without reason. Conversely, if reductions are necessary but are not implemented, then the state may face significant budgetary problems this biennium as well as next biennium.

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