HISTORICAL EXPENDITURES

A Report Prepared for the
Legislative Finance Committee

By

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LFD
MONTANA LEGISLATIVE FISCAL DIVISION

INTRODUCTION

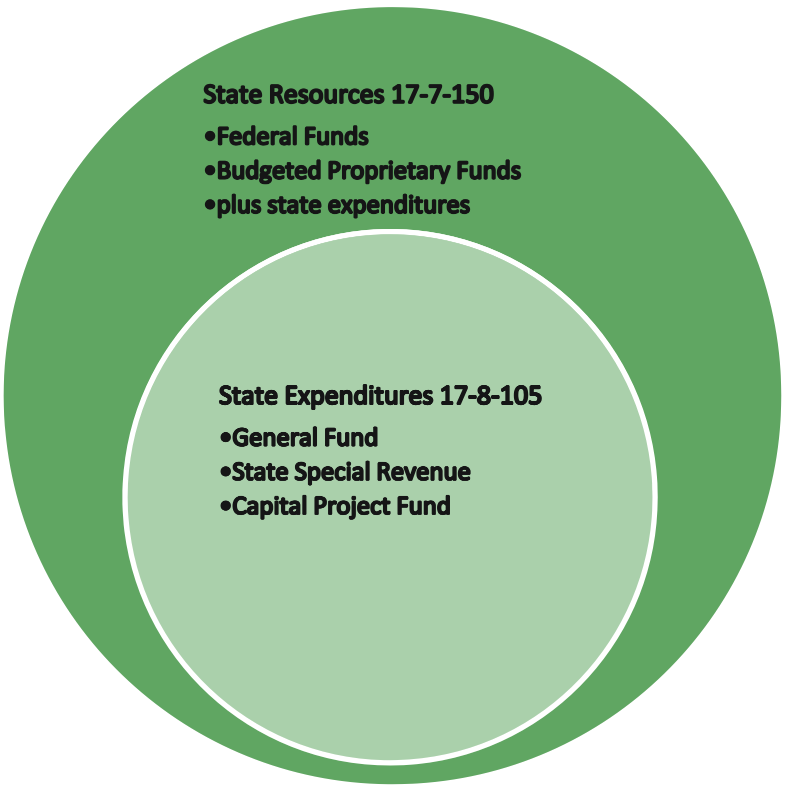
A number of questions have arisen about the growth in state expenditures. In order to respond to the wide range of questions that are being asked, the following analysis has been developed.

ANALYSIS METHODOLOGY

This analysis is developed from two sections of statute: 1) definitions for comparing biennial state resources 17-7-150, MCA; and 2) 17-8-105, MCA definitions of state expenditures for expenditure limitation purposes.

STATUTORY DEFINITION OF STATE RESOURCES

The primary part of the analysis uses the definition of "state resources" included in 17-7-150, MCA, as well as clarifications to the definitions that will be recommended to the 2015 Legislature by the Legislative Finance Committee (LFC). This definition uses general fund, state special funds, federal funds, capital project funds, and appropriated proprietary funds to capture the full breadth of state resources. The definition also attempts to eliminate double counting of appropriations by eliminating transfers and administrative appropriations. The recommended changes clarify these calculations. While 17-7-150 was developed to compare anticipated biennial expenditures, this analysis uses the definition in MCA 17-7-150 to compare expenditures over a longer period of time. For further information on this definition, see the Appendix.



STATUTORY DEFINITION OF STATE EXPENDITURES

The definition of state expenditures in 17-8-105, MCA describes which types of expenditures are considered "state expenditures". See the Appendix for more details. The primary difference between the two definitions is that the 17-8-105, MCA definition of state expenditures excludes federal and budgeted proprietary funds. The diagram to the left illustrates this difference.

This analysis does not break down expenditures between ongoing and one-time-only as is frequently done for biennial budget development. With the various fund types and sources of authority of actual spending, this analysis would take considerable additional time and effort with the possibility of having inconsistent application of the designations. Therefore, all expenditures that meet the definitions are included.

HISTORICAL PARAMETERS

The analysis begins in FY 2002 in order to make the analysis as consistent as possible. There are two primary concerns with using information prior to FY 2002:

1. The “big bill” or HB 124 of the 2001 session substantially altered the sources of state revenue versus local revenue resources. This shift does not impact overall government operations, but it materially impacts the accounting for state resources.
2. The state implemented a new accounting system in FY 2000. While data exists from FY 2000 the accounting details were stabilized in the first two years of use and are more consistent from FY 2002 forward.

Further definitions for fund types, agencies, and expenditure types are contained in the Understanding State Finances document http://leg.mt.gov/css/fiscal/publications.asp.

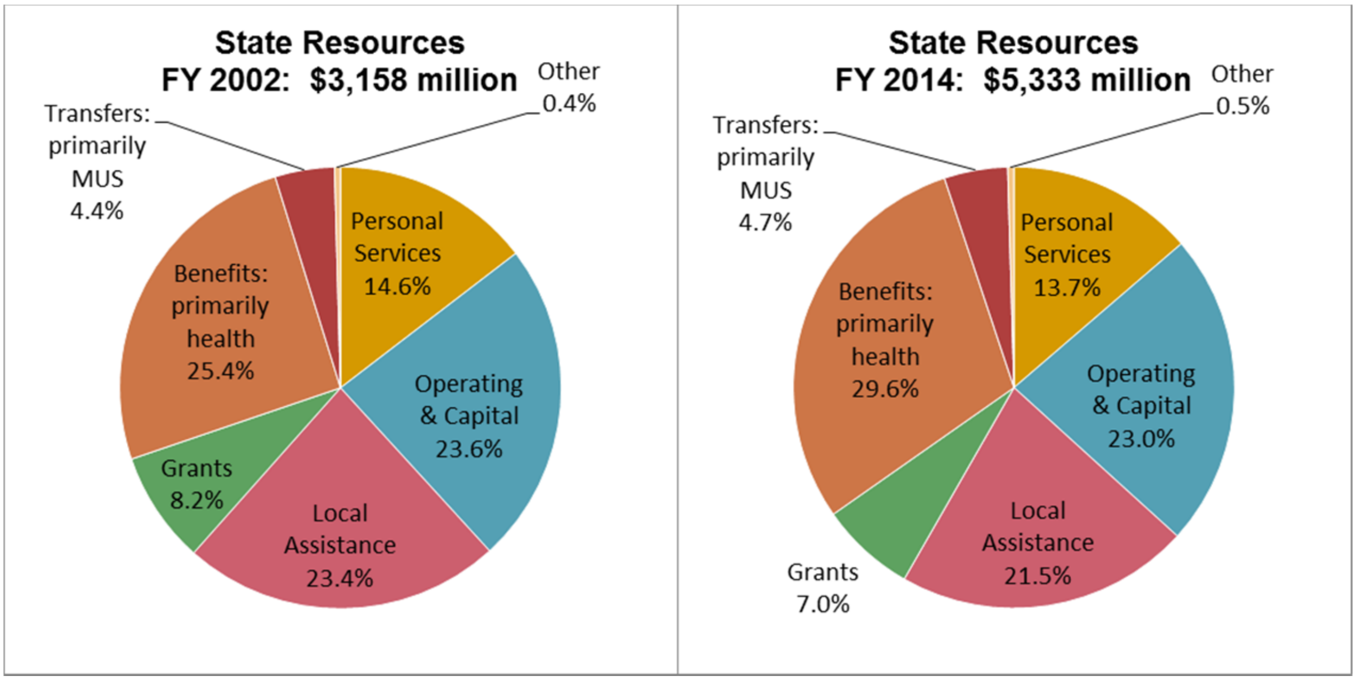
The following analysis begins by comparing FY 2002 to FY 2014 expenditures.

STATE RESOURCE EXPENDITURES FY 2002 TO FY 2014

The primary differences in state expenditures can be seen in the broader definition of state resources from 17-7-150, MCA. The following analysis uses pie charts to illustrate state resources for FY 2002 and FY 2014 for comparison. Major trends are described in the text below the charts.

COMPARISON BY TYPE OF EXPENDITURE

Types of expenditure are accounting definitions set by state policy within the Government Accounting Standards Board guidance. This first set of pie charts uses these major expenditure types to describe the changes. More information on these definitions can be found at the following web link: https://montana.policytech.com/default.aspx?public=true&siteid=1



This comparison shows benefits increasing from 25% to 30% of state resources. Since benefits are primarily used for health related expenses, this area of the budget stands out as a significant area of growth. Most other types of expenditures decrease slightly as benefits increase.

Benefits

The increase in the percent of state resources spent on benefits is the result of several significant policy initiatives in the past 12 years, primarily affecting the budget of the Department of Public Health and Human Services (DPHHS). This significant increase is the result of several factors, but is dominated by the impacts of citizen initiatives and industry sponsored revenue enhancements. Citizen initiatives have created new taxes on tobacco or segregated general fund revenue that is deposited in state special funds for specific health initiatives. For example:

- In FY 2004, two funds were established directing portions of the state tobacco settlement to be used for various public health initiatives, including tobacco prevention for children, tobacco treatment for adults, Children's Health Insurance Program funding, and prevention and stabilization
- FY 2006 saw a citizen initiative that imposed additional taxes on cigarettes and tobacco and deposited them in a fund to generally increase access to health care and to provide Medicaid matching funds
- In FY 2010, another citizen initiative was passed to designate a portion of insurance premium tax collections to a fund supporting the Healthy Montana Kids plan

Additionally, industry groups supported tax increases adopted by the legislature that were designated into state special funds effective FY 2004:

- The hospital utilization bed tax to support increases in Medicaid payments to hospitals
- The nursing facility bed tax above $2.80 per day to support increases in Medicaid payments to nursing facilities

In summary, from FY 2002 to FY 2014 DPHHS benefits and claims expenditures increased by $754 million or nearly double the FY 2002 level. Growth rates for all other expenditure types utilized by DPHHS grew at 61%, or less than the increase in state resources of 69% over the same period.

Expenditure growth from the initiatives in DPHHS and the State Auditor's Office is estimated at $275 million in benefits and $23 million of other expenditures for a total of $297 million in FY 2014.

These initiative and tax or fee increases also create a shift to state special revenue expenditures and is discussed in the section titled "Comparison by Fund Type".

Local Assistance

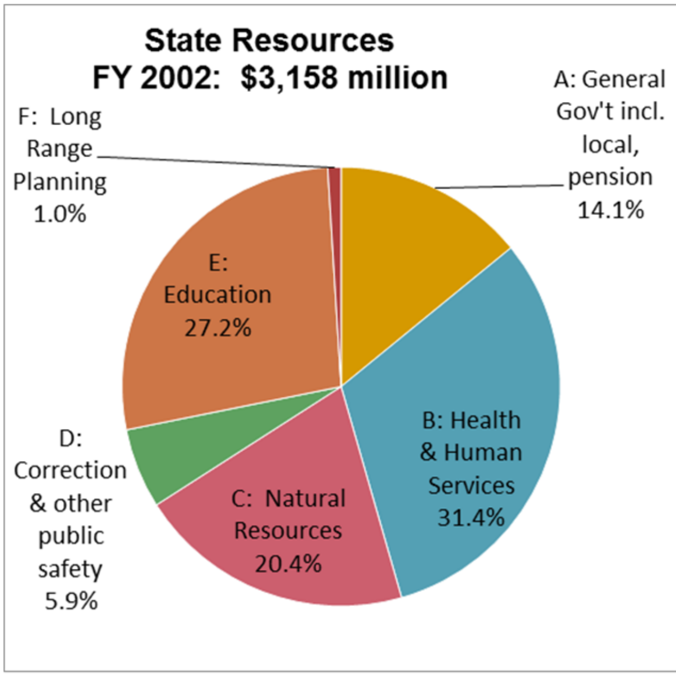
In addition to the growth in benefits, the reduction in local assistance is material. A substantial portion of this reduction is the result of the transfer of responsibility for the operation of District Courts and public defender functions from local governments to the state. In FY 2002, the state partially funded these functions through entitlement share payments and other payments to local governments, which are classified as local assistance. In FY 2014 the cost to fund District Courts and public defender functions is shown primarily as personal services and operating costs. The estimated shift in expenditure types from local assistance to other expenditures in FY 2014 lowers the local assistance share of expenditures by $48 million or 0.9% of state resources.

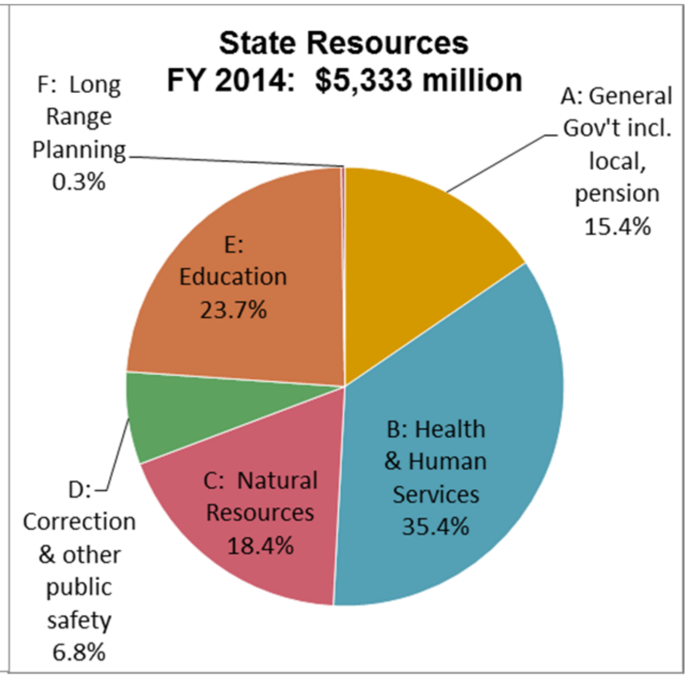
Also impacting the slower growth in local assistance is lower school enrollments as a proportion of the population of Montana. This factor is discussed in the next section of the report: "Comparison by Section" Section E.

COMPARISON BY SECTION

The second option for comparing expenditures is by agency grouping into sections as utilized in HB 2. Note the appropriations in this report include HB 2 and all other sources of authority included in the definition such as statutory and other appropriation bills (cat and dog bills).

The areas of growth by section of state government can be seen in General Government, Health and Human Services, and Public Safety (including the Judicial Branch). Other areas of state government have corresponding decreases.





Section A: General Government

The 1.3% growth in the share of state resource expenditure in Section A is primarily a result of increases in direct state pension contributions. These contributions are primarily on behalf of local governments, but also cover liability of state government entities.

Section B: Health and Human Services

The growth in Section B is the result of initiatives, and tobacco and provider revenue increases described on pages 3 and 4.

Section C: Natural Resources and Transportation

Slower growth was seen in Natural Resource and Transportation agencies relative to other agencies, as ongoing agency operations have not significantly changed over the time period of the comparison. Firefighting costs are relatively high in FY 2002 and relatively low in FY 2014, and cause a slight (less than a third of a percent) reduction in the share of the expenditures.

Section D: Public Safety

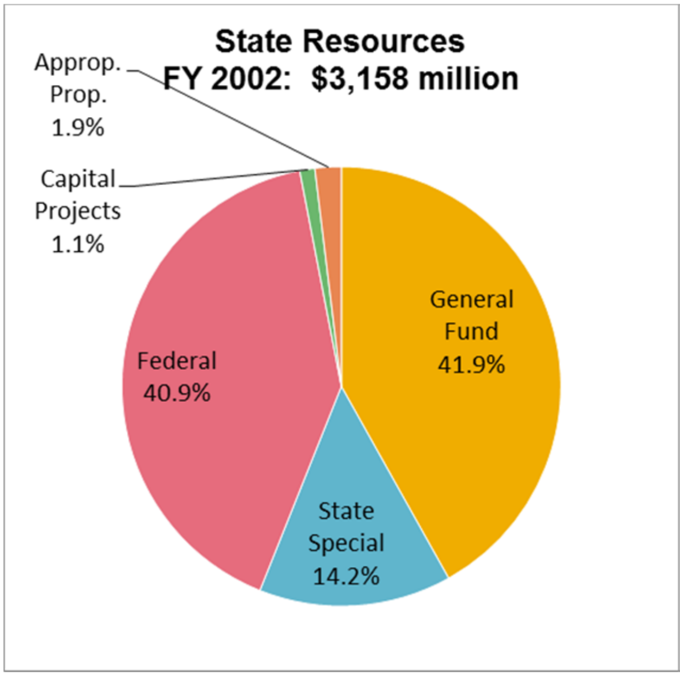
As was seen in the previous set of pie charts, disproportionate growth in Section D is the result of the state assumption of District Courts in the Judiciary Branch and public defender services. These services were local government responsibilities that became state responsibility and part of the Section D expenditures. Without these items, Section D would have grown close to the average growth of all expenditures.

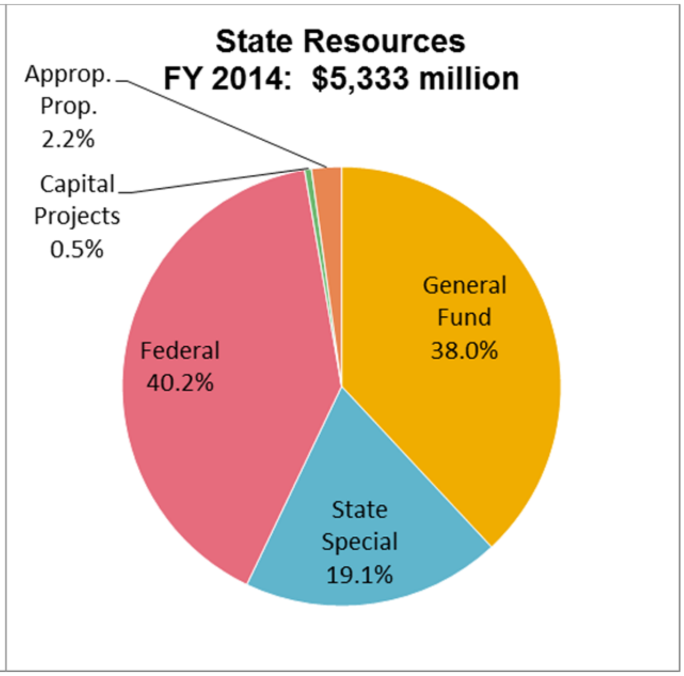
Section E: Education

The reduction in the share of Section E is largely the result of K-12 students decreasing as a share of the total population. Average Number Belonging (ANB) is the equivalent number of students funded by the state in K-12 schools. ANB reflects both the population of school age children and the extent that they participate in public education. In FY 2002 student ANB was 17.0% of the state population and in FY 2014 it had decreased to 14.6%. This reduction would indicate that the budget needed to support these students would be proportionately lower. In addition, some of the newer state contributions to school funding have been made as expenditures in Section A, including: 1) pensions contributions on behalf of local school districts; and 2) a new school district infrastructure grant program in the Department of Commerce.

COMPARISON BY FUND TYPE

Fund types are defined in 17-2-102, MCA http://leg.mt.gov/bills/mca/17/2/17-2-102.htm. The definition of state resources includes general fund, state special funds, federal funds, capital project funds, and appropriated proprietary funds. As stated in the "Methodology" section of this report, this definition is set in 17-7-150, MCA http://leg.mt.gov/bills/mca/17/7/17-7-150.htm.





From this comparison the increase in state special expenditures stands out as the significant area of growth, increasing from 14.2% to 19.1% of the state resources expenditures.

The most significant change in funding from FY 2002 to FY 2014 is the shift from general fund to state special funds as a proportion of the total. The primary causes of this shift are the following:

- As noted in the previous section the increase in benefits was primarily funded with state special revenue that resulted from new funding streams, like higher tobacco taxes, as well as shifting certain revenue deposits from the general fund to a state special fund. The impact of these funding streams is estimated to be 2.0% of state resources in FY 2014
- About 1.2% of the shift results from an accounting shift that moved guarantee account funding used to support schools from the school trusts into a state special fund, rather than into the general fund
- About 0.9% of the shift is due to an increase in the state special funding to local governments from oil and gas revenues and revenue sharing with tribes

EXPENDITURE GROWTH COMPARISON

The next section compares the growth of expenditures over time.

COMPARISON POINTS

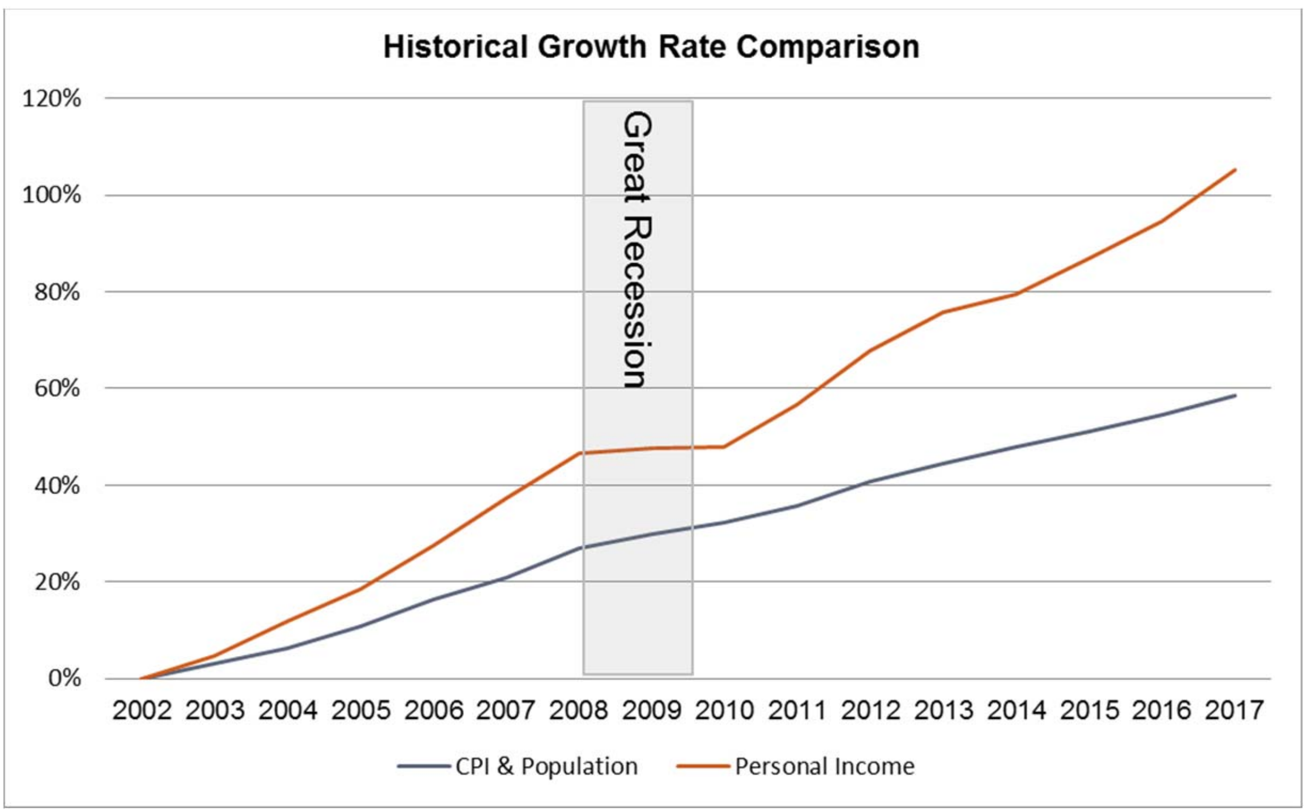
The chart below contains two lines. Each line represents the cumulative growth of a parameter:

- Orange line: Montana personal income as a representation of the economy as a whole
- Purple line: Consumer Price Index (CPI) and population combined, which excludes growth in the economy

In this analysis all lines begin at 0% in FY 2002 and show the cumulative growth from the FY 2002 level. For example, the orange line represents the cumulative growth in state personal income from FY 2002 to the year on the graph. The lines for these parameters extend beyond FY 2014 with forecasts of these elements from IHS Econometrics, the firm the state contracts with for econometric services.

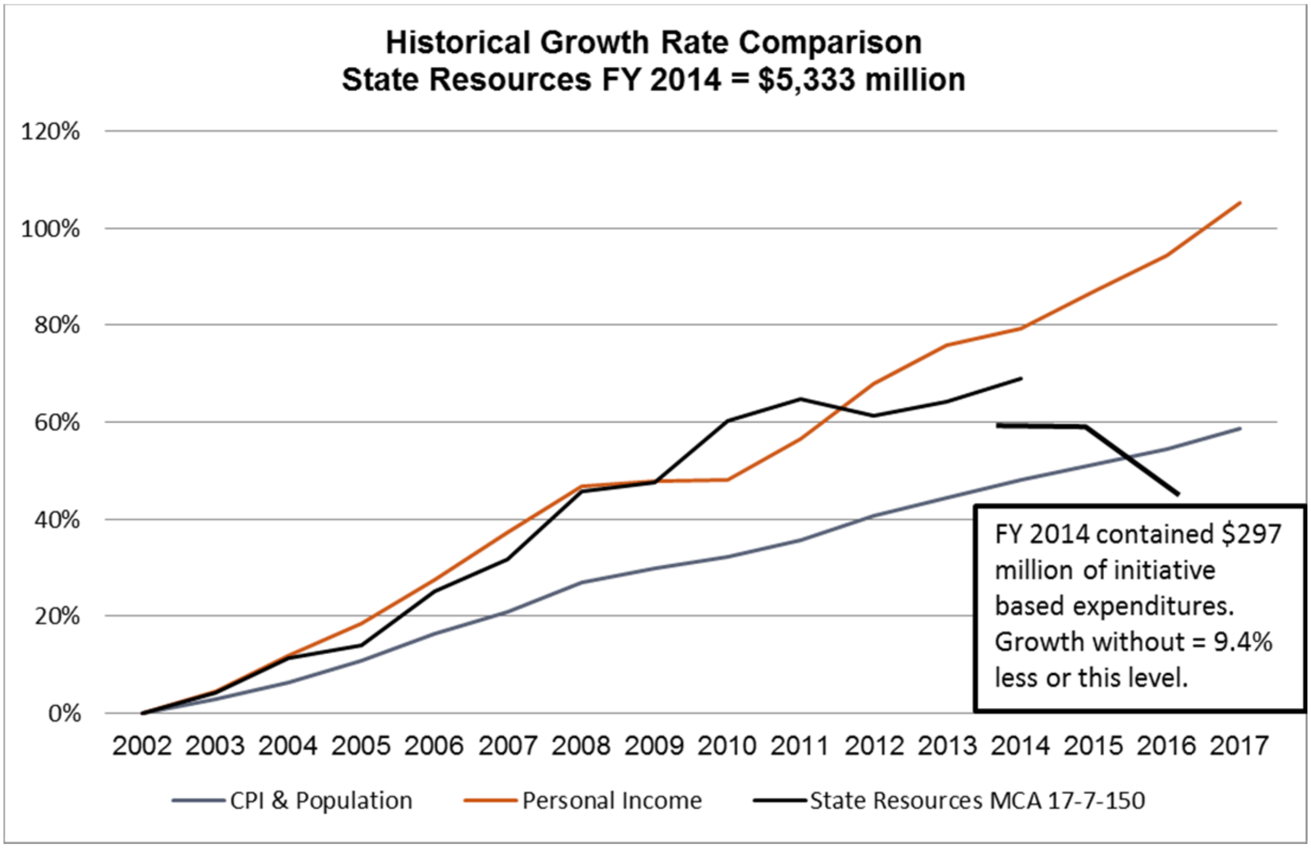
The graph also shows the time period of the Great Recession, December 2007 through June 2009. For reference please see http://www.nber.org/cycles.html.

In general, personal income grows at a greater rate than the CPI and population, as it takes into account growth in the economy as well as CPI and population. Note the exception to this rule was during the Great Recession, when personal income (orange line) remained flat from FY 2008 through FY 2010, and CPI and inflation continued at a relatively even pace.



STATE RESOURCES GROWTH

The following chart adds the black line for expenditures of state resources (17-7-150, MCA) as defined in the “Methodology” section. If state government resources remain a constant share of the state economy, the black line would remain relatively close to the orange personal income line. If state government is growing relative to the economy, the black state resource expenditure line will rise above the personal income line. Likewise if state government shrinks relative to the economy, the black state resource expenditure line dips below the orange line.



As seen in the graphic, growth in state resources since FY 2002 has been above and below the growth in personal income. At times there are important fiscal policy reasons to spend above or below the growth in the economy:

- Economists often recommend government stimulus expenditures during and post-recession to spur the economy as was done in the American Reinvestment and Recovery Act (ARRA). In the years FY 2010 and FY 2011 this type of stimulus spending is reflected in the graph above.
- Likewise, when the economy gets going after the stimulus, a pullback of government expenditures may be warranted to keep government in tandem with the economy. This can be seen in FY 2012 to FY 2014 state resource expenditures

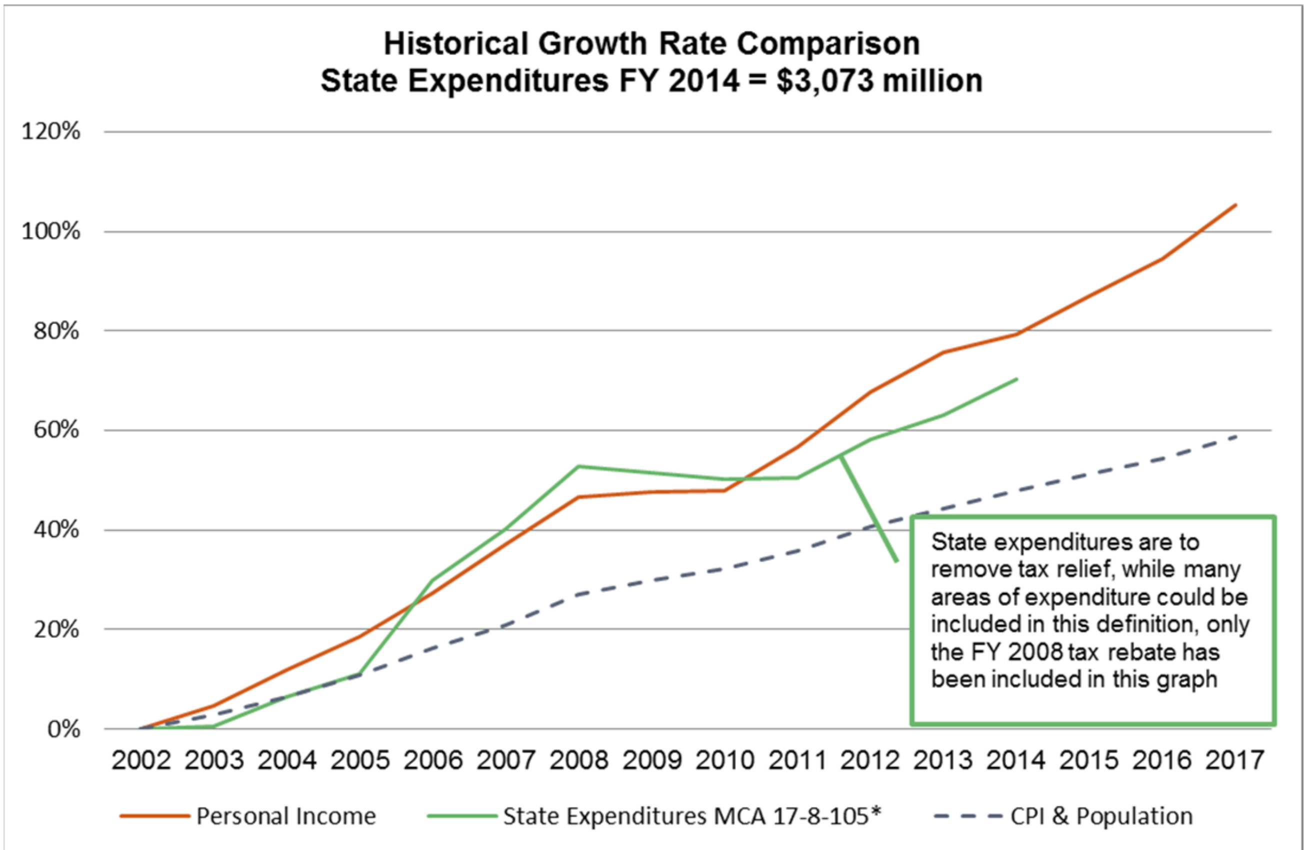
Relative to expenditures in FY 2002, the growth in state resources through FY 2014 averaged 4.46% per year, which is in between the growths in CPI and population, which averaged 3.32% per year, and personal income, which averaged 4.99% per year.

If the analysis is to measure legislatively adopted policy expenses, it may be appropriate to consider the costs without the initiative expenditures. The box on the side of the graph describes the expenditure growth with the impacts from initiatives removed. Over the 12 year period the growth is reduced by 9.4% from 68.9% to 59.5%. The average expenditure growth rate without initiatives is reduced from 4.46% to 3.97% per year over the 12 year period.

STATE EXPENDITURE GROWTH

State expenditures defined in 17-8-105, MCA and the methodology defined in the "Methodology" section and the Appendix are illustrated on the graph in the green line. 17-8-106, MCA defines a 3 year average growth in Montana personal income as the basis for determining the limitation on government expenditure growth[1]. For this reason, the CPI and population line has been dotted to put more emphasis on the personal income growth comparison.

The definition of state expenditures excludes expenditures for tax relief. As this definition is not clear and does not easily break out of the accounting system, only the FY 2008 $400 one-time tax rebate is excluded in this calculation.



Similar to the previous line graph of state resources, growth in state expenditures is above and below the growth in Montana personal income. Relative to expenditures in FY 2002, the growth in state expenditures through FY 2014 averaged 4.53% per year, which is in between the growths in CPI and population, which averaged 3.32% per year, and personal income, which averaged 4.99% per year.

[1] An attorney general opinion in 2005 determined that the statute was not an enforceable limitation. However, the attorney general did not render an opinion on the methodology used to calculate the limitation.

APPENDIX:

BACKGROUND FOR DEFINITION OF STATE RESOURCES

The LFD has published multiple reports on state resources in the past year. The Legislative Finance Committee reports on this subject include the introduction to the issue in March of 2014:
http://leg.mt.gov/content/Publications/fiscal/interim/2014_financemty_March/biennial-comparison.pdf

Also the September 2014 meeting where the first bill draft was discussed.

http://leg.mt.gov/content/Publications/fiscal/interim/2014_financemty_Sept/BudgetComparisonsdm.pdf

The bill draft is continuing to be developed and will be discussed at the December 2014 meeting.

BACKGROUND FOR DEFINITION OF STATE EXPENDITURES

Most areas of calculation are very similar to the definition of state resources in 17-7-150, MCA and the same assumptions are made for state expenditures as were made for 17-8-105, MCA, The following includes the text of the statutory definition and then describes assumptions that are in addition to those in the state resources definition.

17-8-105. Definitions applicable to expenditure limitation. As used in 17-8-106, the following definitions apply:

(1) "Montana total personal income" means the current income from all sources received during a particular period of time by persons residing within Montana as determined by the United States department of commerce or its successor agency.

(2) "State expenditures" means the general fund appropriations, the special revenue fund type appropriations, and the cash portion of the appropriations in the capital projects fund type, excluding:

(a) money received from the federal government;

(b) payments of principal and interest on bonded indebtedness;

(c) money paid for unemployment or disability insurance benefits;

(d) money received from the sale of goods or services provided that the purchase of the goods or services is discretionary;

(e) money paid from permanent endowments, constitutional trusts, or pension funds;

(f) proceeds of gifts or bequests made for purposes specified by the donor;

(g) money appropriated for tax relief; and

(h) funds transferred within state government or used to purchase goods for resale.

This definition was first established in the early 1980s. Two areas of technical calculation issues arise from this definition.

The first is "(*e) money paid from permanent endowments, constitutional trusts, or pension funds;"*

The LFD is interpreting this to mean that transfers or expenditures directly out of permanent funds are excluded. Examples of these include: pension benefit payments, and university trusts. However if these funds are transferred to state special funds, such as in the case of the education trust funds transferred to the Guarantee Account for K-12 schools, these funds have been included as state expenditures.

The second is "*(g) money appropriated for tax relief; and* "

This aspect of the definition is different than the definition of state resources. It is unclear what types of appropriations qualify as tax relief under this definition. The $400 property tax rebate in FY 2008 would qualify under any definition in this calculation and has been removed from the calculation. Examples of the types of expenditures that may qualify but are not included in this analysis are:

1. Increases in entitlement share payments and school block grants as a result of business equipment property tax reductions efforts. In FY 2014 $21.3 million was expended on offsetting local governments' loss from business equipment property tax reductions and was not removed from the calculations.
2. Increases in the Natural Resource Development payment to K-12 school districts designed to reduce required mill levies beginning in FY 2015. In future analysis including FY 2015 this payment will need to be considered.
3. Payments on behalf of local governments and schools to pension systems that would have otherwise increased property taxes or reduced budgets for local governments totaled an estimated $89 million for all pensions systems. The local government share of HB 377 and HB 454 in FY 2014 totaled approximately $42 million. The local government share implemented since FY 2002 totaled approximately $60.5 million.
4. State payments for water and sewer infrastructure that offset local fees for water and sewer totaled $22.5 million in FY 2002 and $60.8 million in FY 2014, a growth rate of 170%, substantially greater than the overall growth rate of 70%
5. Reducing the burden on local taxpayers by assuming district court operations and public defender as a state expense. These expenses were $57.2 million in FY 2014, much of which was offset with a reduction in the entitlement share costs for the state.

Depending on the definitional choices made from the above list, the long term growth rate of state expenditures could be materially affected. As a point of reference, a tax reduction expenditure that is new since FY 2002 would impact the 12 year growth by one percent if the reduction were $18 million. For example, the business equipment reduction mentioned in 1 above cost $21.3 million, this would reduce the 12 year growth rate by 1.2% from 70.2% to 69.0%.