MONTANA LEGISLATIVE BRANCH

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Director
AMY CARLSON

DATE: September 20, 2012

TO: Members of the Legislative Finance Committee

FROM: Barbara Smith, Assistant Principal Fiscal Analyst

RE: Global Motions for the 2013 Legislative Session

The Legislative Finance Committee (LFC), is directed in statute (5-12-205(7), MCA) to make recommendations to the House Appropriations and Senate Finance and Claims committees on the application of certain budget issues. Statute specifically directs the LFC to recommend procedures for the consistent application of inflation factors, fixed costs and personal services. Additionally, the LFC may also make other recommendations on other issues of major concern in the budgeting process.

For the upcoming 2013 session, global motions can be segregated into two groups. 1) standard motions that are considered for consistency; and 2) additional global motions that address major budget issues. The attached reports discuss both items in the following manner:

- Standard: A "decision matrix" of the standard items that the LFC should consider at its November 2012 meeting.
- Major Issues: A discussion of the applicability of global motions to address items such as the impact of potential federal funds reductions, the stability of key state special revenue funds, coordination between Long Range Planning and appropriation subcommittees and information technology requests. Additional direction is needed from the LFC to staff to prepare for the November 2012 meeting.

If you are in need of additional information, please do not hesitate to contact me at basmith@mt.gov or (406)444-5347.

POTENTIAL GLOBAL MOTIONS TO ADDRESS CURRENT BUDGET ISSUES

A Report Prepared for the

Legislative Finance Committee

By

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September 2012

MONTANA LEGISLATIVE FISCAL DIVISION

PURPOSE AND BACKGROUND

A bill passed by the 1997 Legislature revised 5-12-205, MCA (powers and duties of the Legislative Finance Committee) to require that the LFC make recommendations to the appropriations committee leadership prior to each session on global budget issues and issues of major concern. The statute is as follows:

> *5-12-205 (7) [The Legislative Finance Committee] shall, before each regular and special legislative session involving budgetary matters, prepare recommendations to the house appropriations committee and the senate finance and claims committee on the application of certain budget issues. At a minimum, the recommendations must include procedures for the consistent application during each session of inflation factors, the allocation of fixed costs, and the personal services budget. The committee may also make recommendations on other issues of major concern in the budgeting process, such as estimating the cost of implementing particular programs based upon present law*.

The recommendations for the standard global budget issues are addressed in a decision matrix attached to the cover memo to this report. This report will focus on current budget issues that could potentially benefit from the utilization of a global motion to assist the legislature in the deliberations process. This report will identify a few such options and requests input from the committee for further work.

OPPORTUNITIES FOR GLOBAL MOTIONS

Over the course of the interim, the LFC has heard reports, taken testimony and discussed major budget issues such as potential federal funds reductions, state special revenue funds, revenue volatility and large scale IT investments. The global motion process provides the opportunity for the LFC to make recommendations regarding how such items are to be considered in the appropriations process. If the LFC wishes to pursue any additional global motions, staff would need to establish the process and procedure to implement such motions and return to the committee in November for final approval. A few suggestions are addressed in this report.

Potential Federal Funds Reduction[1]

The federal government has run a very large budget deficit that began in earnest in the early 2000's and was accelerated by a number of factors, the latest being the Great Recession. In August 2011, Congress passed the Deficit Control Act of 2011 (DCA). The DCA contained two types of budget reductions, a reduction in spending caps of the federal appropriations bill and additional across the board reductions (sequestration) triggered by the failure of the "super committee" to make deficit reduction recommendations. Absent of a legislated alternative, sequester of funds will occur in January of 2013.

An estimate by Federal Funds Information for States (FFIS) is that about 82% of federal funds that pass through the state budget will be exempt, leaving about 18% subject to reduction. Using the general outlines and assumptions of FFIS, the Council of State Governments (CSG) has estimated the Montana impact from federal fiscal year (FFY 2011 to FFY 2013 as about $48 million, or an estimated 9% reduction in state and local grant programs subject to reduction. Other estimates are that an 8-9% reduction in FFY 2013 would be in addition to an estimated overall reduction of 2.7% in FFY 2012.

The status of the DCA leaves the legislature in an uncertain state. The sequestration of funds could occur in January of 2013, but due to flexibility granted to the Office of Management and Budget (OMB) actual reductions can occur at a later date. Using a global motion to gauge impacts of the DCA would provide subcommittees the ability to examine the impact on specific programs to evaluate what, if any additional action is warranted by the Legislature.

[1] Tomsic, Trinity; Federal Funding Update: The Craziest Year Yet (2012), Federal Funds Information For the States.

A potential directive to the subcommittees could be structured as such:

> *Direct the joint appropriation subcommittees to request a plan from state agencies to operate the affected programs in the event federal funds are reduced through sequestration.*

State Special Revenue

During the 2013 interim the LFC determined a review of state special revenue accounts should be included in the work plan. The initial plan was to inventory, screen and analyze the state special revenue funds to determine consistency with statute and provide options for addressing identified issues. This information would be captured in a SSR database for future legislative needs such as identifying revenue sources fund projects and/or cash balances that could be made available for other purposes. The LFD has the structure of the database started, including some identification of issues, including funds that are obsolete. The data project does need additional work to meet the goals of the original plan; however, staff can locate pertinent information as necessary.

Per statute (17-1-505, MCA) dedicated revenue provisions are subject to review by the LFD as part of analyzing the executive budget and if the provision is considered not justified, it should be reported to the LFA and subsequently reported to the LFC. Traditionally, issues with major state special revenue funds are raised in the Budget Analysis and may or may not be discussed by appropriation subcommittees. Using a global motion to direct all subcommittees to complete a consistent examination of these funds could allow the Legislature to address dedicated revenue issues.

> *Direct the joint appropriation subcommittees to examine major state special revenue funds for adherence to dedicated revenue provisions and other issues as identified in the Budget Analysis.*

Potential adjustments to statute to address any issues can be rolled into the companion bill to HB2 or addressed in a subcommittee bill.

Volatile Revenue Sources[2]

Up to this point, global motions have focused on the appropriation side of budgeting. However, opportunity exists to utilize the global motion process to set budgeting rules for volatile sources of revenue. Some states have such rules in place to prevent the expenditure of all the anticipated revenues, softening fiscal consequences if estimates are off in the current year or future years[3].

Currently natural resource revenues are deposited to the general fund as well as numerous state special revenue accounts that support natural resources agencies and the University system. During the interim, some committees discussed using the increased natural resource revenues for a variety of programs such as, shoring up the pension systems, investing in education and building infrastructure in areas of development. While the natural resource revenues have increased, predictability and stability of those sources remains questionable and pressure to use those additional revenues continues.

There is some national attention focused on the volatility of revenues. Some states utilize an overall factor such as 98% of revenues (Rhode Island and Mississippi) or limited the amount of a specific revenue sources such limiting the use of capital gains revenue in Massachusetts to $1.0 billion. Revenues realized beyond these levels go to either the ending fund balance or a rainy day fund. In these states, the rules are governed by statute.

If the LFC wishes to pursue any additional global motions, staff would need to establish the process and procedure to implement such motions and return to the committee in November for final approval. If the LFC is interested in such controls, global motions could be crafted to set such rules. Drafting of the motion would be dependent on the rule(s) selected.

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[2] Carlson, et al, "Managing Financial Volatility" report presented to Legislative Finance Committee, September 27, 2012.
[3] Pew Center on the States and The Nelson A. Rockefeller Institute of Government, "States' Revenue Estimating Cracks in the Crystal Ball', March 2011.

Personal Services[4]

Personal services expenses are anticipated to be of special interest this session. The primary forces driving the interest will include the recruitment, retention, as well as, the budgetary impacts of the Governor's approved pay increases in the spring of 2012, and the potential pay plan. This is further complicated by the means in which pay plans are managed (decentralized), the application of vacancy saving rates (inconsistent) and retirement pressures. Subcommittees will need to have a working knowledge of each agencies personal services budget and the impact of any changes via statewide present law, decision packages or the pay plan. Using a global motion to direct subcommittees to evaluate potential personal services issues per agency for the biennium could bring all parts together to provide a comprehensive view of the issues. A potential directive to the subcommittees could be structured as such:

> *Direct the joint appropriation subcommittees to examine personal services issues on an agency basis to identify the impacts on the agency budget, including reliance on special revenue sources, costs of implementing agency pay plans and the impacts to completing the agency's mission.*

Joint Hearings between Long Range Planning (LRP) and Joint Subcommittees

One issue that the Legislature is faced with is the link between long range investments and future operations and maintenance costs. Typically, HB 5- Long Range Building and HB 10 – Information Technology cover major capital appropriations, but HB 2 covers operations and maintenance costs. When capital appropriations are deliberated by the LRP subcommittee, ongoing costs are considered but not evaluated by the appropriate joint subcommittee. There are two areas that could be considered, major information technology investments and capital appropriations.

Information Technology Investments- HB 10

Throughout the biennium the LFC has had routine updates on the design, development and implementation of major IT projects, such as Medicaid Management Information System (MMIS) and the Public Safety System. Since these systems are under development, the LFC has had the opportunity to discuss future costs, cost overruns and the like. The process question to consider is: "Would it improve the budgeting process to identify and consider impacts of future costs at the time of deliberation?"

Capital Appropriations- HB 5

When buildings are built or land is acquired, additional operation and maintenance costs for future years are committed. Expansion of state facilities, additional parks or fishing access sites, and new buildings all influence an agency's operational budget. The same question can be asked: "Would it improve the budgeting process to identify and consider impacts of future costs at the time of deliberation?"

If so, a potential directive to the subcommittee could be structured as:

> *Direct the Long Range Planning Subcommittee to notify the appropriate joint appropriations subcommittee of potential future operational and maintenance costs resulting from the potential funding of IT and/or Long Range Building investments and request that subcommittee comment on budgetary impacts if any exist.*

NEXT STEPS

If the LFC wishes to pursue any additional global motions, staff would need to establish the process and procedure to implement such motions and return to the committee in November for final approval. The LFC would need to identify the budget issue to be addressed and any subsequent guidelines to be contained in the motion. Helpful to staff would be two point persons to facilitate the development of the motions.

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[4] Wilkinson, Kris, "Personal Services Analysis" report presented to Legislative Finance Committee, September 28, 2012.

2015 Biennium Budget
Standard Global Decisions and Directions for 2013 Legislative Session

#	*Decision Item*	*Discussion*	*History*
1	Budget Starting Point Direct the appropriations subcommittees to adopt the starting point for budget deliberations as the adjusted base including personal services adjustments, statewide fixed costs, and inflation/deflation.	The adoption of the base and statewide present law adjustments as the starting point does not prevent a subcommittee, the full committees, or the legislature from reducing the budget later in the process.	Historically this is the starting point for the budget. However given the fiscal condition at the time, the 2011 Legislature used a different starting point that included continuation of the 2% personal service reductions from the 2009 biennium budget and the implementation of the 5% reduction plan.
2	Vacancy Savings Rate Direct the appropriations subcommittees to adopt a global level of a personal services reduction (vacancy savings) as a starting point: Option A – 4% as proposed in the Executive Budget; or Option B – Another specified level.	An individual appropriations subcommittee could still determine that a certain group of positions within a program under their purview should be exempted from, or allowed a reduced level of vacancy savings, or even determine that a higher level of vacancy savings be applied.	The 2011 Legislature applied a 4 % vacancy savings for agencies with 20 or more FTE. The 2009 Legislature opted for a 7% vacancy savings rate.
3	Fixed Costs in the Budget Direct subcommittees to consistently apply fixed costs in agency budgets as included by the executive budget request. Adjustments to fixed cost rates shall be determined by the subcommittee examining the service provider (e.g., ITSD costs as reviewed by the General Government Subcommittee) and shall be globally adjusted on a consistent basis.	This decision does not preclude the General Government Subcommittee from increasing, or decreasing a fixed cost rate. If such change occurs, these types of adjustment would occur as decision packages in all agency budgets. Subcommittees should not reduce budgeted fixed costs unless directed to do so by the General Government Subcommittee.	This has been historically adopted by the LFC.

4	<u>Inflation or Deflation Factors in the Budget</u> Direct subcommittees to not vary from the executive budget proposed inflation or deflation factors.	If the full appropriations committee wishes to vary from the executive budget proposal of inflation/deflation factors, it should establish approved inflation/deflation rates (if any) by individual object of expenditure and direct subcommittees to apply these rates to all budget adjustment recommendations. For tracking purposes, these types of adjustment would occur as decision packages. (See attachment for inflation/deflation factors included in the executive request.)	This has been historically adopted by the LFC.
5	<u>Budget Proposals Requiring Legislation</u> Direct the appropriation subcommittees to make no recommendations or adjustments to HB 2 until required legislation passes, except for K-12 inflation which is present law.	Legislation is often accompanied by fiscal notes, but not all fiscal notes need to be incorporated into HB 2. Deliberations in policy committees may influence some modifications to HB 2 to account for situations where an adjustment in funding is necessary to implement legislation.	During the 2003 session the legislature used a process whereby the subcommittees made recommendations regarding the inclusion of the contingent funding. The decision point represents the direction provided by the LFC for the 2011 legislative session.
6	<u>Separate Legislation to implement HB 2</u> Direct the appropriation subcommittees to determine any appropriate items for inclusion into a HB 2 companion bill and provide those items to the full House Appropriations Committee for further review. The appropriations committee leadership shall request legislation to provide a vehicle or vehicles for enacting substantive language related to the implementation of appropriations in HB 2 and the legislation will be considered as part of the appropriations process.	Legislation to implement HB 2 is purposeful by providing a vehicle for the legislature to enact provisions related to appropriations that are not appropriate for inclusion in HB 2. This is commonly referred to as the companion bill to HB 2. Among the potential uses are to: • Provide statutory changes necessary to implement provisions of the budget • Provide special instructions on use of or access to appropriations • Require agency action	This was included in the items discussed and adopted for the 2009 and 2011 sessions. The companion bill should follow HB 2 as closely possible.

7	Establish key performance measures Direct joint appropriation subcommittees to select a few critical performance measures for each agency for monitoring purposes during the 2015 interim and formalized as part of a separate bill(s) or resolution(s).	State law requires agency and program goals and objectives to be specific and quantifiable to enable the legislature to establish appropriations policy. Reviewing this information and selecting related performance measures for further review may demonstrate to the legislature where budgetary adjustments are warranted and where the legislature might direct resources accordingly	This process has evolved over the past several biennia. The 2011 Legislature agreed to SJR 26 and the LFC monitored a number of programs identified in the legislation during the 2013 interim. If the LFC considered this a valuable task, a recommendation to the joint committees would include the selection of performance measures for review during the 2015 interim.
8	Internal Service Funded Proprietary Programs Direct joint appropriation subcommittees that review proprietary rates not to approve decision packages of internal service funded proprietary programs unless quantifiable rate impact information is provided.	"Internal service funded proprietary programs" refer to state programs that provide services to other state programs for fees based upon rates approved by the legislature. Budget instructions direct agencies to provide quantifiable rate impact information when submitting requests for rate changes.	This recommendation was first adopted for the 2009 session and subsequently adopted during the 2011 session.