2013 BIENNIUM BUDGET OVERVIEW

A Report Prepared for the
Legislative Finance Committee

By
Amy Carlson, LFA

June 9, 2011

Legislative Fiscal Division
www.leg.mt.gov/css/fiscal

NATIONAL BUDGET PERSPECTIVE

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

> "State officials expressed more confidence about the current fiscal situation than in recent years, possibly indicating that the most difficult times are behind them. A growing number of states report that their fiscal situations are stable or improving as revenue performance continues to meet or exceed projections. However, overall fiscal conditions remain weak and budget gaps continue to present challenges."
>
> **"Projected FY 2012 Budget Gaps**
> Following on the heels of the significant shortfalls already closed in FY 2009, FY 2010 and FY 2011, projected budget gaps for FY 2012 continue to present an ongoing challenge for states. It is still uncertain when states will be free of the budget gaps that have dogged them since FY 2009. The loss of federal stimulus funds in FY 2012 plays a prominent role because state revenue growth has been unable to offset the expiration of enhanced Federal Medical Assistance Percentage (FMAP) or other ARRA funds. States also cite the use of one-time revenues in past fiscal years as a factor contributing to their projected budget gaps in FY 2012."
>
> Page 9, State Budget Update: March 2011, National Conference of State Legislatures

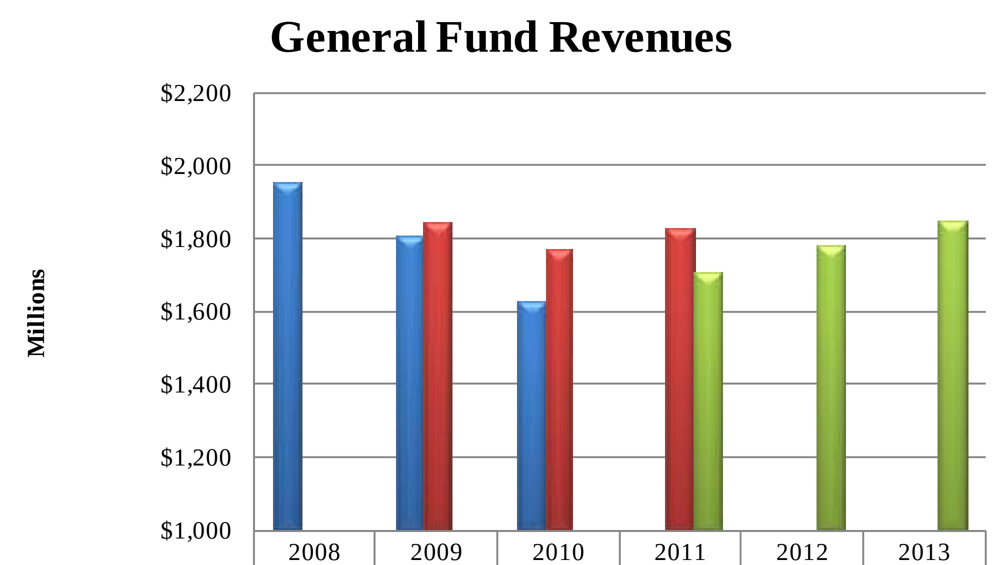
Montana's experience has the same overall trend and continued budget pressure as other states described by NCSL, although the reductions have not needed to be as deep.

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

MONTANA'S EXPERIENCE

REVENUE TRENDS

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



	2008	2009	2010	2011	2012	2013
Actual Revenue	$1,954	$1,808	$1,627			
HJ2/Forecast 2009		$1,845	$1,773	$1,829		
HJ2/Forecast 2011				$1,707	$1,783	$1,852

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

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

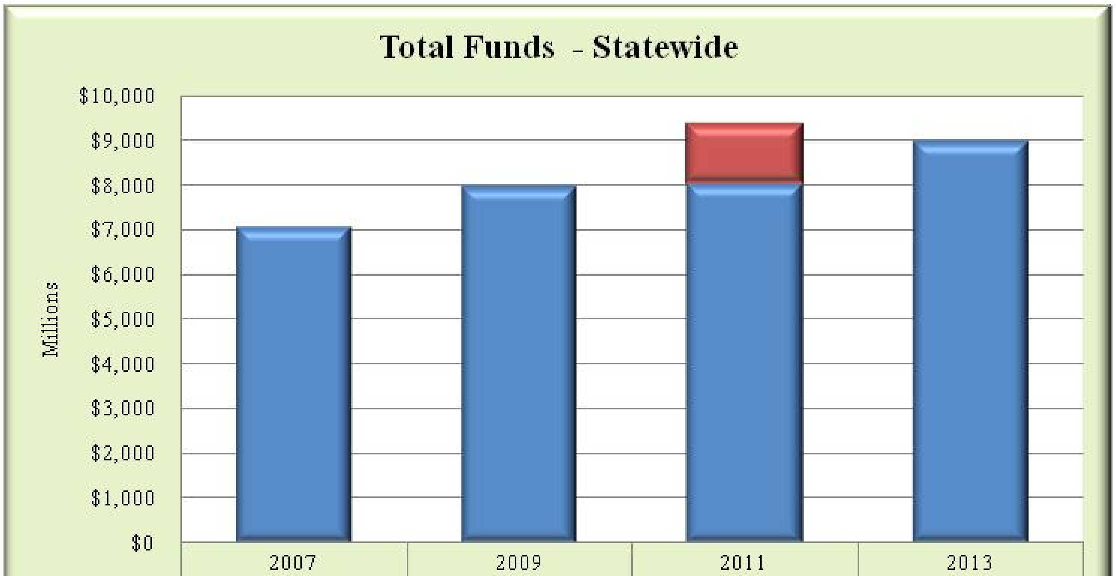
FY 2010 will clearly be the lowest year of general fund revenue with collections steadily increasing since then. The 2011 session HJ 2 estimate is 4.9% higher than the FY 2010 actual collections and current FY 2011 collections are about 10% higher or $67 to 77 million higher than HJ 2 estimates. If the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

SPENDING TRENDS

The spending comparisons are difficult this biennium. The usual comparisons leave an incomplete answer to how spending changed from biennia to biennia. In attempting to equalize the biennia, the following comparisons have been developed and represent a more complete picture of the changes in spending.

All Funds HB 2 and HB 645 Appropriations Authority Only

While revenues are recovering in FY 2011 to FY 2013, the federal stimulus (ARRA) funds end with FY 2011. FY 2012 and FY 2013 were required to be balanced without these temporary federal dollars.



	2007	2009	2011	2013
Stimulus	$0.000	$0.000	$1,337.744	$0.000
HB 2	$7,036.937	$7,952.100	$8,023.840	$8,948.572
Change		$915.163	$1,409.484	($413.012)

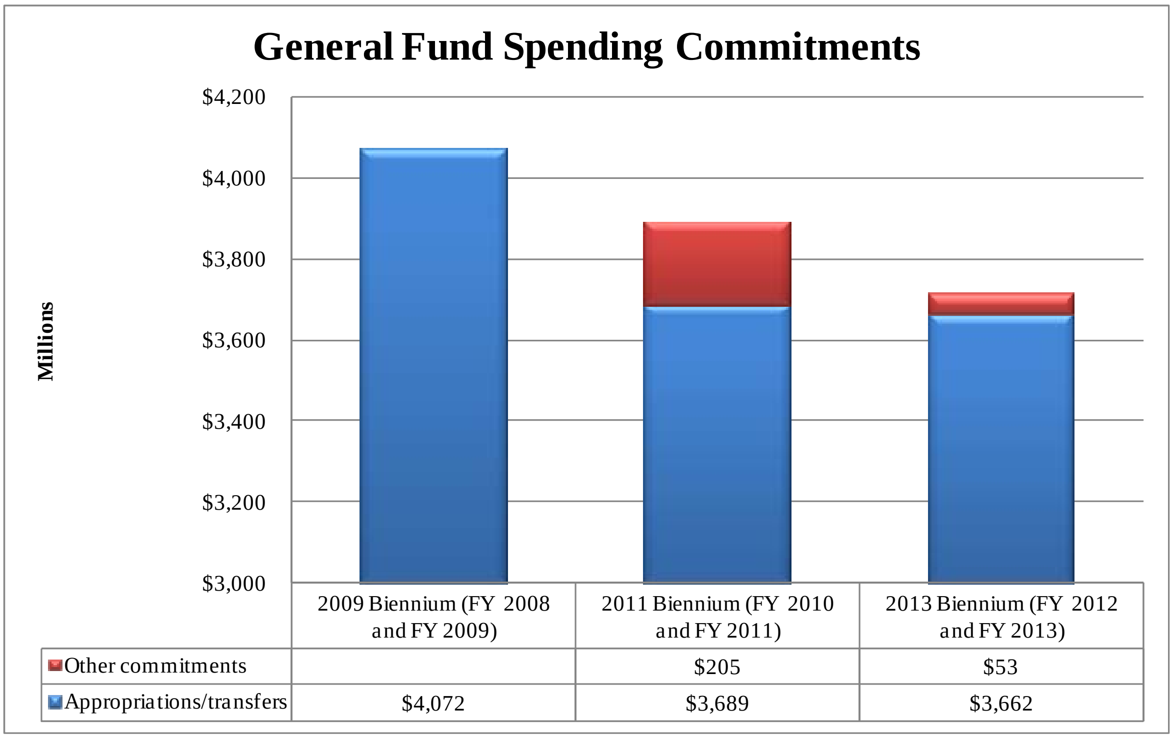
While the HB 2 only appropriations increase between the 2013 and the 2011 biennia, the total appropriation of HB 2 and HB 645 appropriations do not. As shown above, the 2013 biennium $413 million spending is 4.4% lower than the 2011 biennium.

General Fund All Types of Authority

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

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

- In the 2011 biennium, HB 645 required the replacement of certain federal stimulus funds with general fund. These obligations were for higher education, K-12 education and Medicaid.
- In the 2013 biennium, the legislature committed to a certain level of school funding. The Governor's veto of HB 316 reduced the appropriations for school funding, but did not change the commitment of the legislature to fund schools.



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

The spending reductions reflect the loss in the federal funds that are no longer available to support services and the lower revenues than anticipated in the previous biennia as seen in the Revenue Trends section on page 2.

BUDGET ADOPTED BY THE 2013 LEGISLATIVE SESSION

GENERAL FUND BALANCE SHEET THROUGH FY 2013*

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

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

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

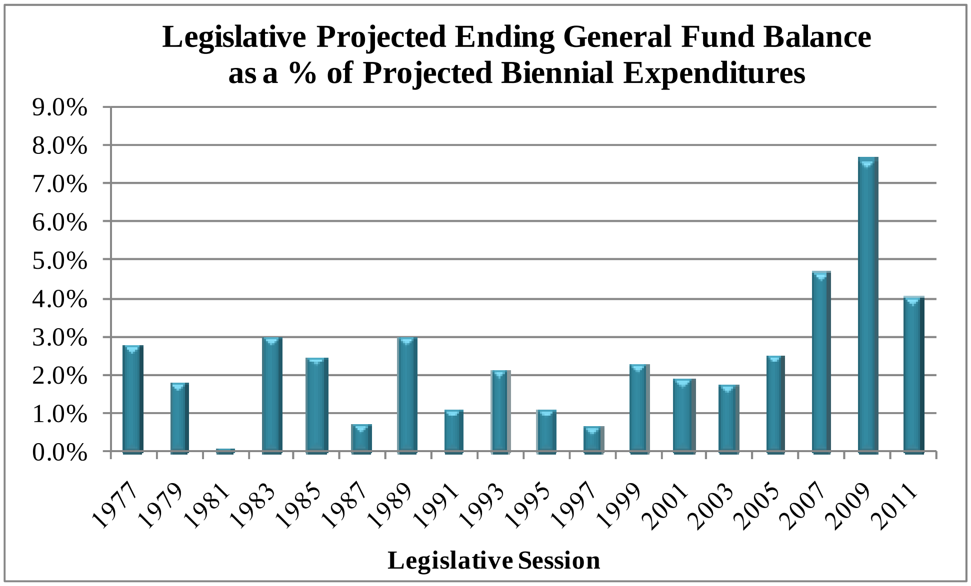
The balance sheet includes all authorized spending, to include the portion of funding for K-12 schools that was eliminated in vetoes of the Governor. These vetoes did not remove the obligation to fund schools contained in SB 329. The balance sheet includes these amounts in the line “Supplementals” for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

Legislative Budget is Lower than Executive Budget

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

HISTORICAL ESTIMATE OF ENDING FUND BALANCE

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



LOOKING FORWARD: REVENUES & SPENDING PRESSURE

END OF SESSION ACTION & GENERAL FUND STRUCTURAL BALANCE[1]

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

Post 2011 Session Structural Balance Changes to General Fund FY 2013

In millions

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

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

- The veto of HB 604 language that removed alternative funding for the State Fund Old Fund liability increased the commitment of general fund on an ongoing basis by almost $7 million per year.
- The veto of SB 253, the sunset of tax credits, reduced the revenue anticipated to be received by the general fund on an ongoing basis by almost $12 million per year.
- The veto of HB 316 reduced nearly $6 million in ongoing revenues that would have been deposited into the general fund and continued the revenue into the state special sources. The shift in funding associated with the change in allocation to the general fund of the

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

U.S. Mineral royalties did not impact structural balance as it nets against the anticipated supplemental appropriation.

- The veto of SB 199, revise administration of income taxes, eliminated a decreased in general fund revenue of $1.5 million per year improved structural balance.

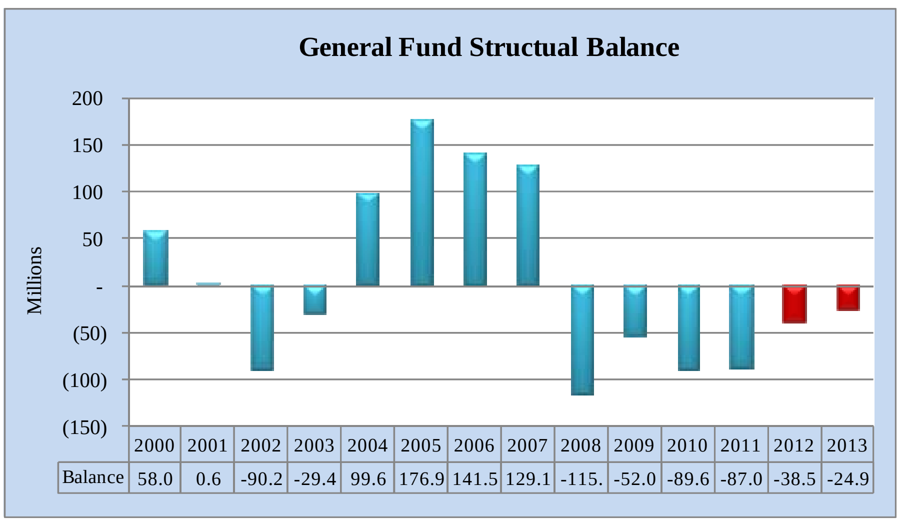
The end of session anticipated general fund structural balance including the Governor's vetoes is negative by nearly $25 million. The final structural balance and historical structural balance is described below:

General Fund Structural Balance

Figures in Millions

		End. Fund Balance	Yearly Adjustments	Yearly Revenue	Yearly Disburse		Yearly Sur./(Def.)
A	2000	$176.000	$8.287	$1,163.638	$1,105.599		$58.039
A	2001	172.897	(3.637)	1,269.472	1,268.938		0.534
A	2002	81.316	(1.391)	1,265.713	1,355.903		(90.190)
A	2003	43.065	(8.805)	1,246.381	1,275.827		(29.446)
A	2004	132.873	(9.719)	1,381.565	1,282.038		99.527
A	2005	299.792	(10.010)	1,530.949	1,354.020		176.929
A	2006	422.209	(19.010)	1,708.166	1,566.739		141.427
A	2007	543.541	(7.767)	1,829.872	1,700.773		129.099
A	2008	441.505	13.469	1,953.540	2,069.045		(115.505)
A	2009	396.335	6.836	1,807.968	1,859.974		(52.006)
A	2010	314.881	8.112	1,627.145	1,716.710		(89.565)
F	2011	227.339	(0.466)	1,706.654	1,793.730		(87.076)
F	2012	188.910	0.000	1,771.048	1,809.511	*	(38.463)
F	2013	150.382	0.000	1,853.138	1,877.990	*	(24.852)

* Legislative Budget On-going Revenue and Expenditure Budget



2015 BIENNIA AND FUTURE IMPACTS

Future structural balances will be influenced by several factors:

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

Each of these items is discussed in the following section.

1. Revenue Upside Risk Higher than the Downside Risk

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

> "There is the distinct possibility that refunds issued may be higher than anticipated when the peak refund season occurs in April and May. However, there is also the possibility that refunds will subside and that less refunds will be issued between now and June 30. Refunds issued from January 1 to March 16 are up 2.5 percent from last year
>
> As the economy recovers, there is a good chance that individual and corporate taxpayers may adjust their estimated payments upward to reflect the improvement in their non-wage income levels. This adjustment could show up in estimated payments received in April and June. However, if taxpayers do not adjust their estimated payments (no penalty assessed), there is a high probability that refunds issued a year from now will be reduced reflecting the higher incomes for tax year 2011. Currently, there is no evidence that non-wage income will be up significantly."

Collections in FY 2011

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

While it was understood that there could be higher revenues in FY 2011 resulting from liabilities owing from calendar 2010 that were not due until April 18, 2011, a definable estimate was included, but known to be conservative. Any increase in FY 2011 revenues will accrue to the ending fund balance. At present, the actual collections in FY 2011 appear to be higher than the HJ 2 level. The final FY 2011 revenues, and to what extent those revenues may be able to be expected to affect future revenue streams and improve structural balance, is unknown at this time.

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

2. Healthy Montana Kids Revenue Impacts

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

3. Spending Pressure

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

Pension Liability

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

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

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

Human Services Spending Pressure

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

<u>Big Sky RX:</u>

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

<u>HB 613 - Generally revise elements of the budget process to implement House Bill No. 2:</u>

While this bill did not spend additional general fund, it committed the next legislature to replace a $1.2 million general fund reduction made in the 2013 biennium in the base budget.

<u>Medicaid funding:</u>

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

Health and Medicaid Initiatives Fund

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

Healthcare Reform

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

Montana University System

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

Unsustainable

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

One-Time-Only

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

K-12 Entitlements

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

SUMMARY STRUCTURAL BALANCE FOR THE NEXT BIENNIUM

If all the above factors are included in the analysis of structural balance a range

- Going into the next biennium, the beginning point would be the structural balance of FY 2013 or $25 million per year negative
- The base revenues being higher than anticipated by $50 to $80 million per year positive
- Healthy Montana Kids initiative will reduce general fund by $11 million per year.

- General fund only liabilities associated with the pension systems over $40 million per year cost to the general fund
- Other spending pressures for the 2015 biennium are at least $25 million per year of additional cost

Significant implications from the final liabilities of the pension systems and if revenue growth continues, then structural balance looking forward to the next biennium could be either positive or negative.