GENERAL FUND / FEDERAL FUNDS UPDATE
2005 BIENNIUM PROJECTED

A Report Prepared for the

Legislative Finance Committee

By the

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December 5, 2003

Legislative Fiscal Division

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To: Legislative Finance Committee

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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%

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

Revenue from vehicle taxes was $0.4 million above estimate for fiscal 2003. Likely some of this was due to dealer incentives increasing the purchase of new cars.

The current forecast of vehicle tax revenue for the 2005 biennium exceeds the HJR2 legislation-adjusted amount by $3.9 million. This reflects a higher fiscal 2003 starting base, and a higher growth rate of 1.6 percent per year when compared with the growth rates in HJR2. The forecast includes $7.9 million biennial for the impacts of HB 559, which allows for a one-time lifetime flat fee on watercraft, snowmobiles, motorcycles, quadricycles, and trailers, effective January 1, 2004.

Motor Vehicle Fee

Revenue from vehicle registration fees was $0.6 million above estimate in fiscal 2003. More cars registered was the likely reason.

The current forecast of vehicle registration fee revenue for the 2005 biennium is below the HJR2 legislation-adjusted amount by $5.2 million. This is primarily due to new information about the impacts of legislation passed during the 2003 legislative session. Specifically a new fiscal note for SB118 was produced well after the 2003 session was over with less revenue than had been predicted previously. Effective January 1, 2003, SB 118 increased the license plate fees on new motor vehicles by $0.50, increased the generic specialty license plate administration fee, and delayed the issuance of new license plates.

Also the revenue from SB 336, a bill that instituted a new optional $4 fee on each light vehicle to be used to pay for operations at state parks and fishing access sites, beginning January 1, 2004, will be deposited in a state special revenue account, not the general fund as had been assumed in the fiscal note. The bill is expected to generate $3.3 million during the 2003 biennium. The bill specifically states that the revenue is to be deposited in the general fund.

Telecommunications Excise Tax

The revenue from the telecommunications excise tax exceeded the estimate by $0.7 million in fiscal 2003. The current forecast for the this revenue source for the 2005 exceeds the HJR2 legislation –adjusted amount by $1.4 million, due to a higher starting base in fiscal 2003.

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.

(new) Corporation Income Tax

Corporation income tax collections through November 2003 are slightly higher than the comparable period of 2002. The continued weakness in corporate income tax reflects the fiscal impact of the recession that occurred in 2001. Three factors that explain the significant changes in revenues are as follows:

1) Corporate refunds are well above the expected level of refunds, and there is a further expectation that several significant refunds will be made during the 2004 fiscal year. Current refunds coupled with those unusually large refunds that are known suggest that HJR 2 is overestimated by $17.0 million in fiscal 2004 and $11.6 million in fiscal 2005.
2) The 2003 Job Growth Tax Relief and Reconciliation Act increased the bonus depreciation provision from 30 percent to 50 percent and extended it an additional year. The new provision will cause an additional decrease to HJR 2 estimates of $3.7 million in fiscal 2004 and $1.8 million in fiscal 2005.
3) Net operating losses (NOL) continue to reduce corporation license tax liabilities. While NOL carry-forward reductions were considered in the HJR 2 estimates, the effects have been nearly $1.0 million greater than expected in fiscal 2004. In fiscal 2005, NOL patterns are expected to return to a more normal pattern increasing corporate tax revenues by over $3.0 million.
4) Corporate audits continue to contribute unexpectedly high revenues to the corporate license tax. To date, collections from audits are approximately twice the level of the comparable period in fiscal 2003. The increased audit collections suggest that HJR 2 estimates are underestimated by approximately $3.0 million in fiscal 2004 and $3.5 in fiscal 2005.

Combining the changes in refunds, extended bonus depreciation, NOL carry-forwards, and audit revenues corporate income tax collections are expected to be lower than HJR 2 estimates by $18.6 million in fiscal 2004 and $6.8 million in fiscal 2005.

(new) Estate Tax

Estate tax collections continue to be strong following the unpredictably high collections of 2003. While HJR 2 anticipated reduced collections as the federal estate tax is eliminated, revenues in fiscal 2004 are only $350,733 below fiscal 2003 collections for the same period. Careful analysis of estate collections show that in fiscal 2004, normal collections have fallen off substantially, yet two large estates with tax liabilities in excess of $1.0 million were settled. As a result, estate taxes are expected to be greater than the HJR 2 estimates by $0.374 million in fiscal 2004. No changes will be considered for either year of the 2005 biennium.

(new) Public Institution Reimbursements

Adjustments in numerous assumptions have led to changed expectations for revenue collections in the institution reimbursements revenue source. Most of the total change is captured in revisions to three major assumptions.

1) Changes in the expected FMAP rates were made in the Federal Jobs and Growth Tax Relief Reconciliation Act of 2003. The FMAP rate increases were instituted beginning in April 2003. As a result, the increased rates applied to the end of fiscal 2003 and through the third quarter of fiscal 2004. The effective annual FMAP rate for fiscal 2004 is 75.15 percent, or 2.18 percent greater than initially assumed. In fiscal 2005, the FMAP is now expected to be less than thought while compiling the HJR 2 estimates. The fiscal 2005 FMAP assumption of 72.81 percent has been revised to 72.29 percent, a reduction of 0.52 percent.
2) Changes in the number of Medicaid eligible patients at the Montana Mental Health Nursing Care Center and Montana Development Center have reduced reimbursement revenues for fiscal 2004 and fiscal 2005.
3) The bond issued for the Montana Developmental Center project was refinanced during fiscal 2003 creating a savings of $247,055 for the 2005 biennium.

Combined, these changes are expected to increase public institution reimbursements by $1.57 million in fiscal 2004, while reducing reimbursements by $1.57 million in fiscal 2005. Because the changes for each fiscal year are almost equal, the net effect on the revenues for the biennium is only an increase of $3,000.

Property Tax

Property tax revenues were $1.4 million above estimate in fiscal 2003. This is probably due to higher than anticipated oil and natural gas prices during the first half of fiscal 2003. Before January 1, 2003, as per the passage of HB 748, oil and natural gas revenues were distributed to the state property tax mills. HB 748 requires that these revenues now are distributed directly to the state general fund.

The current forecast of property tax revenues is $5.0 million below the HJR2 forecast adjusted for legislation. The estimates for the 2005 biennium included the impact of SB 294 which required that the state's share of taxes protested by the Pennsylvania and Power and Light Company from prior years and the current year be removed from an escrow account and be deposited in the general fund. This was expected to be $8.5 million in fiscal 2004. However, in fiscal 2003, $3.8 million of the protested taxes were deposited in the general fund, thus reducing the amount available for deposit in fiscal 2004. The remaining $1.2 million reduction in property taxes reflects slightly smaller growth rates for taxable value than were in HJR2. Both the old estimates and the new estimates reflect the impacts of SB 461, the bill that phased in the new reappraisal values, tax rates and exemptions for commercial and residential property.

Treasury Cash Account Interest (new)

Treasury cash account interest revenue is based on the amount of cash available to invest and the prevailing short-term interest rates. Both determining factors have declined. Cash balances in the account have decreased, necessitating the need to borrow more money for cash flow purposes than anticipated. In addition, the federal discount interest rate has plummeted from 6.0 percent in December 2001 to 0.75 percent in December 2002. Data from the Board of Investments show the yield on the treasury cash account for fiscal 2003 was 2.3 percent. The yield to date for fiscal 2004 is about 1.9 percent. This compares to the HJR 2 short-term interest rate assumption of 4.7 percent.

All Other (new)

Changes to all other revenue are the result of increases in a number of minor sources and a decrease in a major one-time revenue source. Increases include $750,000 more than anticipated in security fraud settlements, a $1,000,000 transfer from the orphan share account (this transfer was expected to occur in fiscal 2003 as directed by the HB 9 in the August 2002 special session, but actually occur in fiscal 2004), and a $450,000 premium resulting from the sale of $73.4 million in tax revenue anticipation notes. House Bill 363 directed that $8.08 million of excess funds be transferred from the old state fund to the general fund in the 2005 biennium. State Fund officials estimate that only $815,000 will be available for transfer.

US Mineral Royalty (new)

US mineral royalty collections through October 2003 are $1.0 million above the comparable period for fiscal 2003. Higher natural resource prices, particularly oil and natural gas, increase the amount of royalties Montana receives from these commodities above HJR 2 estimates. It should be noted that HB 226 passed by the 57th Legislature transfers 12.5 percent of US mineral royalty revenue deposited to the general fund in fiscal 2004 and 25 percent in fiscal 2005 to the counties where the mining or extraction occurred. Therefore, although higher natural resource prices result in additional general fund revenue, disbursements from the general also increase by an estimated $357,000.

Common School Interest and Income (new)

Income (state special revenue) from common school trust lands is increasing due to higher natural resource prices, particularly oil and natural gas. However, the increase is mitigated due to lower than anticipated coal prices for a net increase of $956,000 over the biennium. The increase in mineral royalty revenue is more than offset with a reduction in investment earnings from the permanent trust balance. Even though fiscal 2004 earnings were anticipated to increase from fiscal 2003, the first three months of fiscal 2004 are $310,000 behind the comparable period of fiscal 2003. If earnings continue at the current pace, revenues will be reduced $4.0 million over the biennium. Because general fund covers and shortfall in state special revenue from school trust lands to maintain total state funding at the statutorily required level, the reduction is state special revenue increases general fund expenditures by the same amount or an estimated $3.1 million over the 2005 biennium.

Oil & Gas Production Tax

Revenue from oil and natural gas production taxes was $7.4 million above the estimate for fiscal 2003, primarily due to much higher prices for both commodities. Also, special low tax rates for incentive production were increased temporarily in the 2nd quarter of fiscal 2003 because the price of West Texas Intermediate oil was above $30. Current law requires these incentive tax rates be increased each quarter that WTI is above $30 per barrel.

The current forecasts of oil and natural gas production tax revenues during the 2005 biennium exceed those in HJR2 by $9.5 million. This is primarily due to higher forecasts of oil and natural gas prices.

Montana prices for oil and natural gas in fiscal years 2004 and 2005 are now expected to be substantially above prices in HJR2. The HJR2 prices for the two years of the 2005 biennium were between $21 and $22 per barrel for oil, and between $2.80 and $2.90 per MCF for natural gas. Currently, the forecasts for oil prices are $27 fiscal 2004 and $24.50 for fiscal 2005. The current forecasts for natural gas are $3.50 for fiscal 2004 and $3.20 for fiscal 2005. These are consistent with futures prices for these commodities.

In addition, current forecast production levels for oil are around 2.2 million barrels above HJR2 levels. However, current forecast production levels for natural gas are below those in HJR2 by 16 million MCF in fiscal 2004 and by 18 million MCF in fiscal 2005. This is due to a reduction in natural gas production in fiscal 2003 of around 13 million MCF below the HJR2 estimate.

FISCAL 2004 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)

2005 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;

(e) salaries of elected officials during their terms of office; and

(f) the Montana school for the deaf and blind.

(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:

(i) 2% of the general fund appropriations for the second fiscal year of the biennium prior to October of the year preceding a legislative session;

(ii) 3/4 of 1% in October of the year preceding a legislative session;

(iii) 1/2 of 1% in January of the year in which a legislative session is convened; and

(iv) 1/4 of 1% in March of the year in which a legislative session is convened.

(b) 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.

(4) 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 5-5-227, 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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