2013 BIENNIUM BUDGET PLANNING

A Report Prepared for the

Legislative Finance Committee

By

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UNIQUE CHALLENGE AHEAD OF US

The 2011 Legislature is anticipated to face a budget challenge that has not faced the state in decades. Montana is not alone and in fact Montana's budget challenges are not as great as most states. Montana's economic conditions did not deteriorate as quickly nor as deeply as most states. The legislative budget challenge delayed until 2011 as a result of a very high beginning fund balance and biennial sessions. The budget gap anticipated by the Legislative Fiscal Division (LFD) is approximately 10 percent. In other words, the current level of services supported with state general fund cost 10 percent more than the level of revenue anticipated to be collected.

2013 BIENNIUM BUDGET PROCESS

Sizing and prioritizing all state government services and allocations of revenue will be a primary mission of the 2011 Legislature. The legislature will need to determine the priorities of citizens under these tight fiscal constraints. An organized, well thought out process can aid the legislature in determining and developing these priorities, especially in tight fiscal times.

Given the current budgeting process in Montana, the first step in a well organized process is the starting point for subcommittee action. To achieve this goal, the Legislative Finance Committee (LFC) requested that the LFD develop ideas to find a workable starting point for the appropriations subcommittees in the 2011 session for the 2013 biennial budget.

CURRENT PROCESS OF BUDGET DEVELOPMENT

The Montana budgeting process develops a 2013 biennium budget based on services provided and ongoing funding available to agencies in FY 2010, otherwise known as the base year. By the end of FY 2010, the services provided, the level of FTE, and the funding mix will be known. The legislature knows what services were provided to citizens with the funds and staff available to agencies in FY 2010. In general, the legislature knows whether funding for those services was sufficient or inadequate. All work to develop a legislative budget builds from that known point.

The first changes from the FY 2010 actual expenditures are adjustments to the base. The budgeting system and current practice establish the adjusted base to include the following:

- Current personal services costs, which include legislatively authorized pay adjustments and benefits approved for the second year of the biennium such as longevity
- Vacancy savings applied to personal services costs
- Globally applied inflation, such as utilities
- Fixed costs that are reviewed by the general government subcommittee

These changes added to the FY 2010 ongoing actual expenditures comprise the adjusted base.

From the adjusted base level, the executive recommends changes in decision packages to complete the Governor's recommended budget. The legislature reviews and adopts changes to the adjusted base budget incrementally.

The overall advantage to this approach is that the legislature knows what services have been funded in the base and at each decision point what changes they are making to services, FTE, and funding. Thus the adjusted base is a definable starting point and decisions from that point are well understood. "Across the board" reductions are the exception because they are not specific to a service. Across the board reductions are usually avoided, if possible, in order to not misunderstand the implications on services provided.

The 2003 session created a starting point based on a previous fiscal year

In the 2003 session, the legislature chose the FY 2000 base as the starting point. This starting point left it unclear what services, FTE, and funding were included in the budget as the FY 2000 spending did not tie to current service levels, nor did it define which services would no longer be provided.

Questions arose from this approach because subcommittees and other stakeholders could not easily understand what was in the base budget, which services had been funded, and the specific impacts to citizens. These questions included:

- What has the legislature funded and what services will be provided?
- Can legislators tell their constituents what services they have authorized?
- Will legislators understand what they are voting on?
- If a service is reduced what is the impact the federal matching funds available?
- Are there state special funds that could offset the reductions?
- What changes to statute are required to implement this reduction?

For all of these reasons, the impact of targeting an "old" base in 2003 was for the subcommittees to actually work from the adjusted base budget, as usual, and get back to the targeted levels set for each appropriation subcommittee. This was accomplished with an odd combination of motions that was confusing for all stakeholders.

If the 2011 Legislature, for example, adopted the FY 2005 expenditures as the starting point, similar problems would arise. Public school support is the clearest example to illustrate the problems, but other agencies would have similar issues. In FY 2005, the court had just declared our school funding system unconstitutional. The legislature adopted many changes in sessions from 2005 to 2007 to change the school funding system to comply with the court decision. If the budget started at the FY 2005 base, would that mean school funding would revert to the old system, or would it assume a prorated adjustment down to the FY 2005 level under the new system? How would this impact the constitutionality of the funding system?

LEGISLATIVE FISCAL DIVISION OPTION

As requested by the LFC, the LFD has evaluated some of the options available. The idea developed relies on tools currently in statute to establish the new starting point.

Option

The subcommittees could adopt the adjusted base budget, less the five percent reductions identified by the executive as required by 17-7-111 (3)(f), MCA. This statute requires that agencies with 20 or more FTE submit a plan to reduce their proposed base budget to 95 percent of the current base budget or lower if directed by the budget director. Thus, the starting point would be five percent lower than the adjusted base.

How would the five percent motion work?

MCA 17-7-111 (3) defines the requirements for agencies to submit their budgets on September 1. Under this statute, state agencies would prepare the adjusted base as usual. MCA 17-7-111 (3)(f) further directs agencies to prepare "a plan to reduce the proposed base budget for the general appropriations act and the proposed state pay plan to 95% of the current base". In the past, this plan has been submitted to the LFD in spreadsheet form. The Budget Director has informed the Legislative Fiscal Analyst that he will require agencies to input the plans into MBARS (the state budgeting system) as decision packages. These decision packages would define the services, FTE, and funding pertinent to these reductions.

Please note that this option does not require that the Governor include these five percent reductions in his recommended budget.

In some cases, the five percent reductions identified will require legislation to implement. Legislative Fiscal and Services Divisions would work with the executive to determine the changes to statute required to implement the identified service reductions. In order to incorporate the reductions in the starting point for subcommittees, the LFC may wish to request that Legislative Fiscal and Services Divisions draft a companion bill prior the beginning of session. This bill would include the statutory changes required to implement the five percent reductions identified by the executive. See comments below on a companion bill.

2011 Biennium Two Percent Across the Board Reduction

The legislature, in HB 676 from the last session, required that the two percent across the board reductions be included in the present law base. Due to budgeting rules, some of these reductions will be included in the adjusted base and some will be in decision packages. In addition to the five percent adjustment, the LFC may wish to recommend that any of the two percent across the board reductions be included in the starting point motion.

Companion Bill Choices

The companion bill, as specified in the current legislative joint rules, is to be requested by House Appropriation committee. This bill makes changes in statute needed to implement the decisions made in HB 2. If the LFC wished to introduce the bill as an interim committee bill, the bill would need to be introduced by December 15, 2010.

In Summary

All of procedural aspects of this work could be completed prior to the start of session. Under this scenario, the starting point for the subcommittees would be clearly defined. Subcommittee members would know what services, FTE levels, and funding are included in the starting point. Legislation would also be drafted that would implement any needed statutory changes.

Impacts of Adopting the five Percent Below the Adjusted Base Motion

If the appropriation subcommittees adopt the above described adjusted base less five percent as a starting point this amount is less than anticipated revenues. This would allow subcommittees to increase spending from the starting point and still produce a balanced budget. Nearly $25 million in FY 2012 and $94 million in FY 2013 may be added to the five percent motion starting point expenditures and still be within currently estimated revenues.

The following table outlines the budget parameters. Please note that all of these numbers are preliminary and will change between now and session:

- Line 1: Revenue anticipated in the next biennium as calculated in the Preliminary Budget Outlook presented at the March meeting.
- Line 2: Current Service Level (CSL) as described in the Preliminary Budget Outlook presented at the March meeting.
- Line 3: Current Service Level (CSL) less 10 percent as described at the March meeting.
- Line 4: Adjusted Base as calculated for the March meeting and as described on pages 1 and 2 of this report.
- Line 5: Adjusted Base, less five percent as described in this report. Note that this number is less than the CSL less 10 percent.
- Line 6: Statutory Appropriations without bonds. This is the currently authorized statutory appropriation level not including bonding. As bonding is previously authorized by the Legislature and a general obligation of the state, it was not included in this line. This line includes all statutory appropriations that are able to be changed by the Legislature in the 2011 session.
- Line 7: Non-budgeted, other, feed bill, bonds – most of the items in this list are either small or not easily changeable by the Legislature.
- Line 8: Total of all lines 4 through 7.
- Line 9: The difference between line 1 and line 8.

Other Options

- Line 10: Pension costs anticipated in the next biennium as calculated in the Preliminary Budget Outlook presented at the March meeting.
- Line 11: Option presented in the March meeting where all general fund spending is reduced 10 percent from the CSL for HB 2 appropriations. The amount in the table is the increased cost to a 10 percent reduction from the CSL from the adjusted base less five percent.
- Line 12: Option presented in the March meeting where all general fund spending is reduced 10 percent from the CSL for Statutory appropriations.
- Line 13: As discussed in the LFC brainstorming session, these amounts reflect the additional general fund revenue that could be received if 10 percent of the general tax revenues that are distributed to state special accounts were redirected to the state general fund.
- Line 14: As discussed in the LFC brainstorming session, these amounts reflect the additional general fund revenue that could be received if 10 percent of the current tax credits were reduced.

		FY 2012	FY 2013
Line 1	**Anticipated Revenue**	**1,744,911,000**	**1,826,637,000**
	Expenditure Background		
Line 2	HB 2 General Current Service Level (17-7-140 out)	1,744,051,154	1,782,737,609
Line 3	HB 2 General Current Service Level less 10%	1,569,646,038	1,604,463,848
Line 4	HB 2 General Appropriations Adjusted Base	1,610,365,989	1,611,518,183
	Expenditure Assumptions for LFD Option		
Line 5	HB 2 General Appropriations Adjusted Base - 5%*	1,529,847,690	1,530,942,274
Line 6	Statutory Appropriations - Current Law - no bonds	157,177,748	163,372,512
Line 7	Other: Non-budgeted, Other, Feed bill, Reversions, Bonds	32,995,344	38,120,464
Line 8	**Total starting point using adjusted base less 5% and current law statutory appropriations**	**1,720,020,782**	**1,732,435,250**
Line 9	**Net Revenue Above or (Below) Starting Point expenditure assumptions**	**24,890,218**	**94,201,750**
	Changes to fund balance Other Options discussed at the March Meeting		
Line 10	Pensions: June 30, 2009 valuation analysis, the same as used in March	(31,127,000)	(37,478,000)
Line 11	Assume all HB 2 appropriations are 10% less than Current Service Level	(28,098,349)	(61,821,575)
Line 12	Assume all Statutrory Appropriations except Bonds at 10% less than Current Service Level (note: do not add to the above option for statutory appropriations)	17,364,509	18,039,898
Line 13	Allocations - reallocate 10% of state special revenue from general tax revenues	30,672,690	30,672,690
Line 14	Tax Credits - reduce by 10%	8,810,010	8,810,010

*Note that the chart reflects the typical calculation for the five percent reductions. A technical reading of the statute would reflect a lower number or five percent less than the actual FY 2010 expenditures.

Note that this list of options is not exhaustive, nor is it a recommendation. It does show an order of magnitude of some of the options available to the legislature. More options and details are contained in the Legislative Options Reference Book.

POTENTIAL LFC MOTIONS

No motion

Make no recommendation to House Appropriations and Senate Finance Committees.

Motion A:

The LFC recommends that House Appropriations and Senate Finance Committees adopt the following:

The initial motion in all appropriation subcommittees for a starting point for budget deliberations shall include: the adjusted base to include personal services adjustments, statewide fixed costs, and inflation; any decision packages necessary to implement the two percent reductions approved in the 2009 session in an ongoing manner; and the five percent reduction plans provided in 17-7-111 (3)(f), MCA.

Motion B:

The LFC requests that the LFD and the LSD draft a bill that includes all statutory changes required to implement the five percent reductions provided in 17-7-111 (3)(f), MCA.

FURTHER STUDY

In addition to recommending a starting point, the Legislative Finance Committee may want to consider how other processes may help manage budget development. The Legislative Fiscal Division could offer potential processes to the October LFC meeting. The process could include:

- Targets for HB 2 and statutory appropriations
- Timelines and reports on subcommittee action and House Appropriations and Senate Finance action
- Coordination of the HB 2 and the HJ 2 processes
- Potential HJ 2 joint subcommittees