

ENERGY PRICE INCREASES: IMPACTS ON STATE AGENCY BUDGETS (MOTOR FUEL)

A Report Prepared for the
Legislative Finance Committee

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BACKGROUND

At the October 2005 Legislative Finance Committee meeting, staff presented a report that provided basic background information for how motor fuel is purchased and paid for to provide state government services. The report highlighted the agencies with the highest expenditures from all sources of funds for motor fuel, including the purchase of gasoline, diesel fuel, and payments to an internal services funded motor pool program. At the time of the October report, retail gasoline prices had risen to more than \$2.90 per gallon following recent price increases attributed to hurricanes in the Gulf of Mexico. This report augments the October report by providing details on the functions of state government that rely on vehicle travel to deliver state services and the impacts high motor fuel costs may have on the related services and budgets.

ASSUMPTIONS

This update focuses only on the fuel purchases by state government funded with HB 2 appropriations. The update excludes \$6.5 million of fuel expenditures paid out of non-budgeted proprietary funds. Proprietary fund expenditures were excluded from the update because the legislature doesn't appropriate funds for the expenditures, but approves the maximum rates the programs can charge for services. The executive can enhance appropriations for proprietary programs to pay for fuel at higher prices as long as the rates do not exceed the levels set by the legislature and contained in HB 2, Section R. Therefore, the report focuses specifically on agencies ability to perform critical functions within their appropriations.

Because the scope of this update is narrower than the October report, the expenditure amounts presented herein are different than those presented in October. The October report indicated that the FY 2005 expenditures for motor fuel totaled \$9.2 million from all funding sources. In contrast, HB 2 appropriations account for \$1.9 million, or 21 percent of all FY 2005 expenditures for motor fuel. In addition to excluding proprietary fund expenditures from this update, FY 2005 expenditures from all other funding sources are excluded. All other funding sources accounted for \$780,000, or 8 percent of FY 2005 fuel purchases.

Excluding proprietary (internal services) funded programs from this update assumes the programs providing the service would either reduce costs in other areas of operations, use fund balance reserves, or use other funding methods, such as debt, to supplement funding from fees during the current biennium. Fees approved by the 2005 legislature are the maximum fees that can be charged by the internal service programs during the current biennium, so budgets of HB 2 funded programs that use the services are shielded from higher fuel costs. Because fees are capped, fee revenues may fall short of funding the proprietary program operations and result in losses. Losses experienced during the current biennium could lead to requests for fee increases in the 2007 Legislature so the programs can recoup losses.

FUEL CONSERVATION INITIATIVES

Coincidental to the high fuel costs following Hurricanes Katrina and Rita, the Governor directed state agencies to conserve motor fuel consumption and to live within existing travel budgets. The conservation initiatives being implemented do not restrict vehicle use necessary to provide state services, but encourages employees to accommodate necessary travel through the following actions:

- Ensure alternate methods to accomplish the work have first been considered and travel in a state vehicle is done only when warranted
- Car pool with other state employees, even those in other agencies, when traveling to similar destinations
- Use alternative communication methods, such as telephone conference calls and videoconferencing, when possible to replace physical travel
- Use the appropriate vehicle for the trip (e.g., use less economical four-wheel drive vehicles only when necessary)

If effective, the conservation initiatives should not impact services of agencies, but should reduce the total number of vehicle-miles state agencies travel and result in less fuel use than would exist without the initiatives. In the end, the rapid rise in fuel costs following Hurricanes Katrina and Rita could actually save the state money by being the catalyst that triggered a culture shift toward more conservation. As an example, if two state workers traveled in one vehicle instead of two and fuel costs were 50 percent higher than before car-pooling, car-pooling would yield a saving to the state of a quarter of the cost that would have been incurred had the two workers traveled separately at the lower cost. Proprietary funded programs are participating in conservation initiatives and the State Motor Pool in the Department of Transportation is implementing a process to identify car pool opportunities when vehicles are reserved.

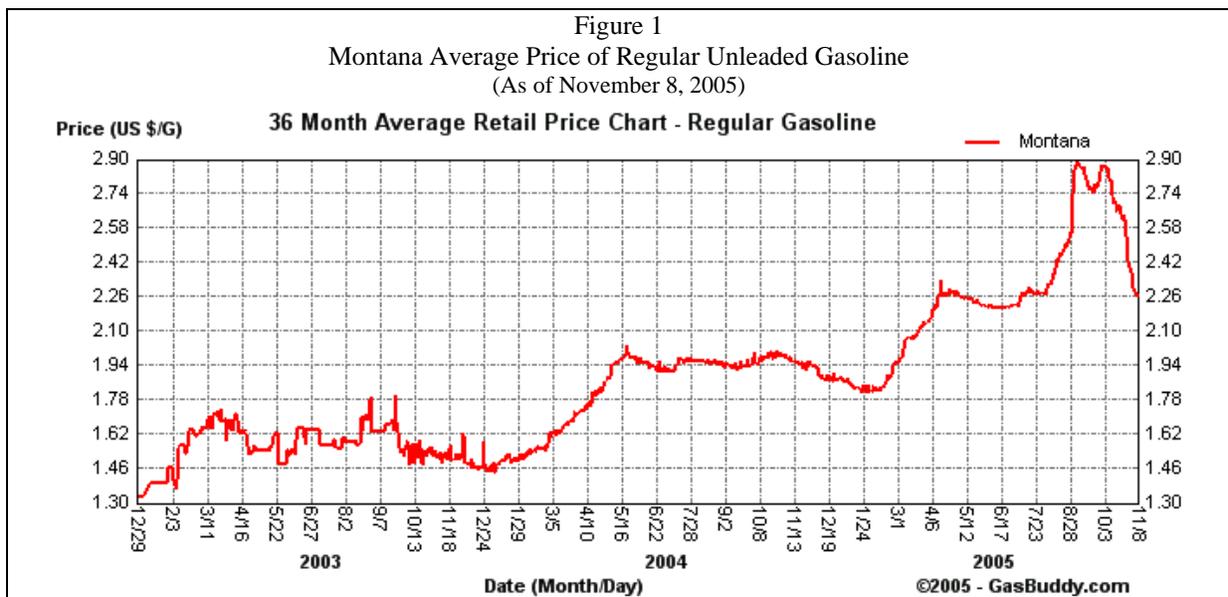
FUEL PRICES HAVE DECLINED

Since the October report, Montana average unleaded gasoline retail prices have returned to levels below those that existed prior to Hurricanes Katrina and Rita¹. The prices in existence prior to the hurricanes were associated with a high point in the typical cycle, in which prices rise in the spring as summer travel increases demand and decline in the fall as demand subsides. This update assumes that future fuel prices will emulate historical patterns for the remainder of the biennium and that prices will continue to decline as the 2005 winter approaches. The October report stated that the U.S. Department of Energy predicted the price would settle around \$2.50 per gallon as a national average. Current prices are significantly lower than

Figure 1 illustrates that the average price of unleaded regular gasoline in Montana on November 7, 2005,² has actually declined to the level that existed around the first week in April 2005, but is about 15 percent above the average price that existed one year ago and 47 percent higher than the same time during the base year for the current budget. The fuel cost increases following the two significant hurricanes lasted only a few months, but prices were higher by nearly 30 percent during the period than the prices that existed just before Hurricane Katrina. As stated in the October report, budgets were not automatically inflated as there was no anticipation of higher gasoline and diesel prices and agencies generally did not ask for increases to their base expenditures for motor fuel. As such, agencies will need to manage with budgets tied to their FY 2004 expenditure levels but with costs significantly higher than existed in FY 2004.

¹ Montana's average price for regular unleaded gasoline was \$2.50 per gallon on August 23, just prior to Hurricane Katrina, and \$2.7 per gallon on November 17.

² Based on information from the montanagasprices.com.



CURRENT MOTOR FUEL BUDGETS AND EXPENDITURES

Figure 2 shows the 10 agencies and the programs of the selected agencies with the highest FY 2005 expenditures for motor fuel paid out of HB 2 appropriations. Combined, the programs listed on Figure 2 account for 93 percent of all FY 2005 expenditures for motor fuel. Figure 2 also lists the following for the selected programs for FY 2006:

- HB 2 program budget for operating expenses
- Budget for gasoline and diesel (motor fuel)
- The percentage of operating expenses budget made up of funding for motor fuel
- Five months of motor fuel budget (assuming even distribution each month)
- Expenditures for motor fuel through November 7
- A comparison between the five-month allocation and expenditures through November 7
- A comparison between full FY 2006 motor fuel budget and expenditures through November 7

Figure 2 shows that the budgets for motor fuel exceeds 5.0 percent of the program operating expenses budget in only 4 of the 37 programs listed, with motor fuel comprising more than 20 percent of the program operating budget in two programs, both in the Department of Livestock. Figure 2 also shows that after five months of operations, three of the programs have already exceeded their full motor fuel budgets for FY 2006 and are using budget authority for other expenditure categories to fund fuel costs. For these programs that have already exceeded their fuel budgets, fuel comprises small percentages, less than 0.5 percent, of their operating expenses budgets. For the programs in which motor fuel comprises more than 0.5 percent of the operating expenses budgets, only the Air Transportation Program of the Governor's Office has expended more than the average month of straight-line budget expenditures would project. Generally, the figure shows that motor fuel costs are not big contributors to agency HB 2 operating expense budgets, but when the percentage is more significant the expenditures are in line with staying under the annual motor fuels budget. Furthermore, no restrictions have been identified that would prohibit budgets for other operating expenditures from being used to fund shortfalls in fuel budgets. Agencies have not indicated that deficiencies in fuel budgets would be a key factor in seeking supplemental funding.

**Figure 2
Selected Program Motor Fuel Expenditures and Budgets
FY 2006**

Department	Program Name	Budget Information				Expenditures on Fuel Through November 7		
		Operating Expenses Budget	Motor Fuel Budget	Fuel as a Percent of Operating Expenses Budget	5 Month Straight Line Fuel Budget	Spending	Amount Under or Over Fuel Budget	Percent of Fuel Budget
Justice	Highway Patrol	\$6,439,533	\$603,906	9.38	\$251,628	\$201,550	\$50,078	33.37
Justice	Motor Vehicle	4,405,303	19,594	0.44	8,164	5,744	2,420	29.32
Justice	Criminal Investigation	2,206,151	89,686	4.07	37,369	25,538	11,831	28.47
Justice	Gambling Control	2,164,209	16,988	0.78	7,078	7,202	(124)	42.39
Natural Resources and Conservation	Forestry and Trust Lands	6,486,998	152,494	2.35	63,539	140,209	(76,670)	91.94
Natural Resources and Conservation	Water Resources	3,337,054	6,005	0.18	2,502	5,157	(2,655)	85.88
Natural Resources and Conservation	Conservation and Resource Development	1,565,615	5,570	0.36	2,321	5,593	(3,272)	100.41
Natural Resources and Conservation	Oil and Gas Conservation	934,208	20,807	2.23	8,670	9,323	(653)	44.81
Labor and Industry	Work Force Services	5,025,857	2,101	0.04	875	507	368	24.13
Labor and Industry	Business Standards	6,561,249	125,595	1.91	52,331	49,956	2,375	39.78
Corrections	Secure Custody Facilities	29,187,958	50,639	0.17	21,100	11,290	9,810	22.30
Corrections	Community Corrections	20,258,405	6,970	0.03	2,904	3,298	(394)	47.32
Corrections	Juvenile Corrections	2,041,200	6,843	0.34	2,851	2,967	(116)	43.36
Corrections	Administration and Support Services	5,671,239	4,102	0.07	1,709	1,835	(126)	44.73
Corrections	Montana Correctional Enterprises	4,896,579	2,485	0.05	1,035	823	212	33.12
Livestock	Brands Enforcement	254,648	58,571	23.00	24,405	20,521	3,884	35.04
Livestock	Animal Health	683,996	22,281	3.26	9,284	5,286	3,998	23.72
Livestock	Meat/Poultry Inspection	224,902	1,744	0.78	727	763	(36)	43.75
Livestock	Milk and Egg	44,482	9,321	20.95	3,884	3,587	297	38.48
Fish, Wildlife & Parks	Fisheries	5,035,665	33,608	0.67	14,003	14,554	(551)	43.31
Fish, Wildlife & Parks	Wildlife	3,653,450	3,386	0.09	1,411	1,770	(359)	52.27
Fish, Wildlife & Parks	Parks	2,722,001	11,165	0.41	4,652	10,297	(5,645)	92.23
Fish, Wildlife & Parks	Enforcement	1,609,372	9,865	0.61	4,110	5,681	(1,571)	57.59
Transportation	Construction	333,050,249	47,420	0.01	19,758	27,536	(7,778)	58.07
Transportation	Aeronautics	3,371,712	29,830	0.88	12,429	11,982	447	40.17
Governor's Office	Air Transportation	231,097	38,087	16.48	15,870	24,964	(9,094)	65.54
Environmental Quality	Permitting and Compliance	18,286,073	16,251	0.09	6,771	5,517	1,254	33.95
Environmental Quality	Remediation	13,590,822	4,790	0.04	1,996	5,172	(3,176)	107.97
Environmental Quality	Planning, Prevention, and Assistance	9,362,917	3,443	0.04	1,435	3,890	(2,455)	112.98
Public Health and Human Services	Senior and Long-Term Care	5,848,726	12,431	0.21	5,180	4,728	452	38.03
Public Health and Human Services	Human and Community Services	5,946,314	14,820	0.25	6,175	13,423	(7,248)	90.57
Public Health and Human Services	Disability Services	9,022,995	17,382	0.19	7,243	6,196	1,047	35.65
Public Health and Human Services	Addictive and Mental Disorders	10,198,517	19,124	0.19	7,968	6,924	1,044	36.21
Public Health and Human Services	Child and Family Services	3,727,084	3,988	0.11	1,662	2,081	(419)	52.18
Public Health and Human Services	Operations and Technology	23,319,817	13,557	0.06	5,649	3,613	2,036	26.65
Public Health and Human Services	Child Support Enforcement	2,933,869	4,659	0.16	1,941	1,359	582	29.17
Public Health and Human Services	Quality Assurance	2,256,916	1,304	0.06	543	743	(200)	56.98

When asked, no programs have indicated that higher motor fuel costs would result in a budget deficit that would lead to a supplemental request. All agencies have submitted fuel conservation plans to the Governor's office and, as directed by the Governor, are taking steps to stay within HB 2 budgets.

FUNCTIONS SUPPORTED BY MOTOR FUEL COSTS

The October report stated that future reports would provide more specific details on the functions performed by agencies through expenditures on motor fuel. State agencies expend HB 2 funds to purchase motor fuel for a variety of functions, mostly related to travel in either a state-owned aircraft or a state-owned automobile. Figure 3 lists functions performed through expenditures on motor fuel by the selected agencies of Figure 2. On Figure 3, the selected programs are separated, through staff and agency input, into categories that correspond to the following categories:

- Category A – travel is essential to provide the statutory services, restricting travel will adversely impact services
- Category B – travel enhances the ability to provide the statutory services, alternative approaches to reduce travel could be used to provide the services but some program impacts would result

- Category C – travel is not required to provide the statutory services, travel could be reduced with minimal service impacts

Figure 3 - Selected Program Travel Characteristics		
Department	Program	Purposes for expenditures on motor fuel
<u>Category A - Essential to service delivery</u>		
Justice	Highway Patrol	patrol Montana highways to enforce motor vehicle laws and assist motorists in need
Justice	Motor Vehicle	site visits to inspect vehicle identification numbers (VIN) and investigate special driver licensing problems and motor vehicle titling and registration fraud
Justice	Criminal Investigation	site visits for criminal investigations; narcotics and fire investigations; fire safety inspections
Justice	Gambling Control	conducts gambling tax field audits of licensed locations; conducts criminal investigations of alleged violations of state gambling statutes and administrative rules; inspects the premises of licensed liquor and gambling establishments; provides training on gambling to local law enforcement personnel and reviews proposed legal gambling activities
Natural Resources and Conservation	Forestry and Trust Lands	direct fire suppression efforts and site visits to enforce streamside management zone regulations; ensure fire hazards created by logging and other forest management operations on private forest land is adequately reduced; provide technical forestry assistance to private landowners, businesses, and communities; and manage trust land resources, including overseeing forest
Natural Resources and Conservation	Water Resources	site visits to promote and coordinate the wise use and conservation of Montana's water resources and manage state-owned dams, reservoirs, and canals
Natural Resources and Conservation	Conservation and Resource Development	site visits to provide technical assistance to local governments, state agencies and private citizens for conservation, development, protection, and management of the state's natural resources
Natural Resources and Conservation	Oil and Gas Conservation	inspects drilling, production, and seismic operations; investigates complaints; plugs orphan wells; collects and maintains well data and production information
Labor and Industry	Work Force Services	site visits for worker training and retraining
Labor and Industry	Business Standards	site visits to provide building code inspections; license, inspect, test, and certify all weighing or measuring devices used in commercial transactions; license and regulate persons and businesses engaged in specific healthcare and non-healthcare related professions and occupations:
Corrections	Secure Custody Facilities	security and perimeter patrols, grounds and facilities maintenance
Corrections	Community Corrections	probation and parole supervision, inspections, and site visits
Corrections	Juvenile Corrections	facilities and grounds maintenance
Corrections	Administration and Support Services	site visits for institution inspections, agency management and supervision
Corrections	Montana Correctional Enterprises	inmate training, motor vehicle maintenance
Livestock	Brands Enforcement	site visits for livestock theft investigations, brand inspections, hide inspections, beef inspections
Livestock	Animal Health	auction market and animal product processing facilities site inspections
Livestock	Meat/Poultry Inspection	site visits for meat and poultry inspections
Livestock	Milk and Egg	site inspections and product sampling
Fish, Wildlife & Parks	Enforcement	site visits to enforce boat, snowmobile, and all-terrain vehicle registration and safety laws and regulation and to enforce wildlife laws and regulations
Transportation	Aeronautics	maintenance of state-owned airports and mountain navigational beacons, air search and rescue, site visits for airport inspections
Governor's Office	Air Transportation	air transportation for the Governor
Environmental Quality	Permitting and Compliance	conduct all facility inspections to determine compliance with environmental permit conditions and the laws and regulations
Environmental Quality	Remediation	oversees investigation and cleanup activities at state and federal Superfund sites; reclamation of abandoned mine lands; and corrective actions at sites with leaking underground storage tanks
Environmental Quality	Planning, Prevention, and Assistance	monitor ambient environmental conditions, site visits to assist local governments develop financing options for projects to improve environmental conditions
Public Health and Human Services	Senior and Long-Term Care	elder abuse and neglect investigations, patient transportation, field staff site visits
Public Health and Human Services	Human and Community Services	commodity distributions, site visits to weatherize homes, visits to outlying offices
Public Health and Human Services	Disability Services	patient transportation
Public Health and Human Services	Addictive and Mental Disorders	patient transportation, public involvement (listening tours), and local outreach
Public Health and Human Services	Child and Family Services	site visits for licensing and investigations of child abuse and neglect, foster child transport and
Public Health and Human Services	Child Support Enforcement	site visits to attend proceeding and carryout other enforcement duties
Public Health and Human Services	Quality Assurance	site visits for inspections associated with licensure and certification activities
<u>Category B - Enhances service delivery</u>		
Fish, Wildlife & Parks	Fisheries	site visits to operate and maintain hatcheries, regulate angler harvests, and monitor fish populations
Fish, Wildlife & Parks	Wildlife	site visits to assess wildlife damage, manage and maintain wildlife management areas, and perform wildlife inventories and surveys
Fish, Wildlife & Parks	Parks	maintenance and management of state parks, recreation areas, and fishing access sites
Transportation	Construction	aircraft operations for photo and staff transport for public involvement activities
Public Health and Human Services	Operations and Technology	travel to outlying offices

As seen on Figure 3, there were no functions that fell within category C for the selected agencies. Instead, the expenditures of funds on motor fuel for the selected agencies are made to provide services in

categories A and B, in which travel is either essential or enhances the services of the programs. Some of the remaining 8 percent of HB 2 expenditures in FY 2005 would likely fall in category C. Restricting vehicle travel for functions supported by these expenditures, in which vehicle travel is not essential nor enhances services of the agency, would have minimal impact on state services.

CONCLUSION

The retail price of motor fuel has increased significantly over the per-gallon price that existed when base year expenditures were made³. Since there was no general inflation factor applied to the base for motor fuel and no budget increases that anticipated higher fuel prices, FY 2006 budget authority for motor fuel is the same as the base level of expenditures.

The current retail prices of motor fuel are roughly 47 percent higher than the price that existed on the same date during the base year. Hurricanes Katrina and Rita further exacerbated the situation by leading to higher prices for about a quarter of the fiscal year that peaked at about \$0.65 per gallon higher than current levels. The high motor fuel prices will increase the budget pressures for agencies that must travel to provide statutory services, like those listed in Figures 2 and 3, but because expenditures for motor fuel represent relatively small portions of the program budgets, will not in-and-of-themselves cause agencies to require budget supplementation. With motor fuel comprising small shares of program budgets and the actions taken by the executive to conserve fuel the likelihood is low that high motor fuel costs will cause a budget crisis or drastically impact program delivery. Alone, conservation measures should not impact services because necessary travel is not being restricted, but the executive is being more diligent in scrutinizing vehicle travel and facilitating processes to car pool more than in the past.

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³ On November 8, 2005, the average retail price for regular unleaded gasoline was \$2.26 per gallon or 47 percent higher than the price that existed on the same date in 2003.