

LEGISLATIVE FISCAL DIVISION 2007 BIENNIUM PROPOSED WORK PLAN

A Report Prepared for the

Legislative Finance Committee

By
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June 8, 2005

Legislative Fiscal Division



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INTRODUCTION

This report summarizes the proposal of the Legislative Fiscal Analyst for the Legislative Fiscal Division interim work plan for the 2007 biennium. It represents a recommendation based upon legislature, legislator, and staff input as to topics for study, and is designed as a decision-making document, allowing for committee discussion, input, and adoption. Included in this proposal are the following:

- An explanation the work plan proposal, including how the LFD plans its work and developed the proposed studies
- Instructions for using the draft work plan to make decisions about the final work plan
- A description of the potential work plan topics and options for addressing those topics

Two additional documents are provided – an attachment containing copies of study resolutions passed by the 2005 Legislature that might involve the LFC and LFD staff, and a committee major studies prioritization worksheet.

WORK PLAN CONCEPT

BACKGROUND

LFD staff begin the work plan process with a compilation of anticipated statutory, discretionary, and administrative duties that will require staff resources during the 2007 biennium interim period. These duties range from major statutory and mandated studies to maintenance tasks of the staff. They summarize a significant portion of staff commitments over the next 15 months, although they do not include all administrative and minor tasks, and time is allowed for emergent studies and tasks not yet known.

DEVELOPMENT OF PROPOSED MAJOR STUDIES

While the entire interim studies and commitments of LFD staff (as summarized in Attachment A) are subject to review and approval of the LFC, it is anticipated that the LFC will focus on a few major committee/staff study topics, while maintaining oversight of “all matters bearing upon the financial matters of state that is relevant to issues of policy and questions of statewide importance” (5-12-502, MCA). Staff proposes nine major committee study topics for committee consideration and prioritization. These proposals include studies that were requested by legislators through study resolutions, and suggested topics by LFC members and LFD staff. A proposal paper summarizing the study topic, goals, and objectives is provided for each of the nine proposed studies.

The committee/staff statutory mandates are broad, and there may be other study topics of interest to the committee that are not included in the draft work plan. The committee is encouraged to propose other potential projects as additions or replacement studies.

It must be understood that the studies and staff projects/duties cannot all be completed, and that prioritization will allow the projects to be undertaken as staff/committee resources allow. The primary constraint limiting the LFC study agenda for the interim is the number of issues that can be effectively addressed within the available time and resources of the LFC members and LFD staff. Ultimately, the committee should adopt a plan that is prioritized and realistic in terms of limited staff, committee, and other resources.

This work plan is a DRAFT, and is a decision-making tool to help the LFC members work together to set priorities and decide how and where to spend the LFC’s limited time and resources. Once the LFC collectively prioritizes the work plan items and sets the scope and focus of the studies, they will become the work plan for the 2007 biennium interim. Staff will then develop specific staff tasking assignments, target dates, and specific work plans for each task as needed. The plan will then be submitted for review and update at every LFC meeting during the interim, and is subject to additions, deletions, and re-prioritization by the committee as deemed appropriate.

While the listing of staff ongoing and administrative tasks in attachment A is largely informational, the committee may wish to offer suggestions or directives in this area in the process of prioritizing the major goals of the interim. The items on the reference work plan document other than the nine proposed committee studies that will consume extensive staff resources are as follows:

Item 1	Analysis of Executive Budget for 2005 Biennium	Statutory
Item 2	Biennial Revenue Estimates	Statutory
Item 6	Special Session Analysis/Staffing	Statutory
Item 7	Staff Interim Committee on PEPB	Discretionary
Item 10	SB 525 – Staff School Funding Formula Study	SB 525
Item 21	2009 Biennium Budget Projection – Big Picture Report	LFA
Item 27	Oversight/monitoring of human services new initiatives	HB2/other legislation
Item 50	Use of Staff Comp Time/Leave Balances	LFA/Legislature
Item 53	Full Implementation of Staff Evaluations/Merit Pay Plan	LFA/Legislature

RESOURCE LIMITATIONS

Please keep in mind the following when examining the proposed work plan:

- The work plan assumes staff time to explore and develop other emergent policy issues for presentation to the committee/legislature, and may impact the number of discretionary projects addressed.
- This work plan takes into consideration that a special session is planned for December to deal with the school funding lawsuit, and the session will require extensive staff resources. It does not take into consideration an expanded session agenda, nor does it consider other special session or other extraordinary commitments in a traditionally dynamic environment that might occur during the interim. If such events occur, it will directly impact the ability of staff to accomplish designated projects. In that event, the LFC would be asked to re-prioritize projects.

The reference work plan document provides an inventory of the workload commitments that staff considered in developing the work plan proposal, and is included for reference purposes as Attachment A.

INSTRUCTIONS

A committee major studies prioritization worksheet is included as a separate document. The worksheet is intended to help committee members prioritize the proposed studies in preparation for the LFC meeting and make notes for the committee discussion. Please perform the following steps in advance of the June 17 meeting:

1. Review the proposed work plan – A proposal document for each of the nine study topics follows these instructions
2. Refer to the prioritization worksheet. Review the topics and add any additional topics that are important to you.
3. Prioritize the proposed topics
4. Make notes regarding scope, focus, and objectives of each proposal for committee discussion.

The proposed studies will be discussed at the June 17 LFC meeting, and at the end of the discussion, a general plan of what the LFC intends to work on should be the result. Any direction on how you think the studies can best be accomplished will assist staff in preparing the specific individual work plans for each selected topic. The committee may wish to consider assigning one or two committee members for each study topic as contact points for staff to develop work plans and seek consultation as the study progresses.

It is once again emphasized that the proposed work plan is a decision-making tool, and that everything in the plan is subject to approval by the committee.

PROPOSED WORK PLAN TOPICS

Financial Reliance on Federal Funds/Implication of Deficits

Source/authority: HJR 26

Legislative Poll Ranking: #14

Background - Montana state government receives almost 50 percent of its funding from federal funds for a variety of purposes. In addition, local governments also receive significant federal funds. Federal expenditures in Montana, either through direct support of federal activities or direct payments to individuals, are in the billions of dollars each year, and decisions on the federal level will by definition have a major impact on Montana's overall economy and the well-being of its individuals.

The current on going and growing deficit at the federal level will require action on a national level to either reduce expenditures or raise revenues. Most notably because the current political climate makes major revenue enhancement unlikely in the near term, actions to address the deficit will likely require significant action on expenditures. Those actions will likely impact funding now flowing to the states for a multitude of varied purposes.

Study resolution requirements - The resolution does not mention the Legislative Finance Committee. Rather, it charges the Legislative Council with assigning the appropriate interim committee. The Legislative Council does not have jurisdiction over this committee, but has referred this study to the Legislative Finance Committee for consideration.

The resolution includes the following requirements.

- 1) Examine and analyze the history and trends of the state's reliance on the use of federal funds in programs administered by the state or jointly by the state and local governments;
- 2) Examine and analyze:
 - a) The potentially dramatic increases in future federal budget deficits and, by default, the national debt;
 - b) The probability that increases in federal budget deficits will result in substantial and permanent decreases in federal funding for state-administered programs; and
 - c) The possible nature and scope of impacts to state-administered programs, including programs that affect local governments and tribal governments, that may be inferred from potential decreases in federal funding; and
- 3) Identify policy options available to future legislatures to prepare for and address reductions in federal funding for state-administered programs

Staff resources: The project would require a lead staff and at least one other staff who will devote a significant amount of available interim time to the project. In addition, although most federal funds are spent on four areas (human services, workforce development, transportation, and environmental/wildlife), only a handful of agencies do not receive any federal funds. While the absolute dollar amount received by many agencies may be small, the federal funds may be an integral or indispensable part of operations. Therefore, this project would require resources from all staff to varying degrees during the interim to provide data and other information to the staff directly assigned to the project.

Scope of project: As stated above, the resolution specifically directs the study to “...programs administered by the state or jointly by state and local governments.” Therefore, unless the committee voted to expand the scope to examine all federal revenues received by local governments, or federal revenues directly spent in Montana, the study would be limited to the scope envisioned in the resolution.¹

The study would include:

- Creation of inventory of the use of federal funds in state administered programs
- Review of national experts’ analysis of national trends and their potential impact on federal revenues and expenditures
- Overview of action on the budget through the 2005 federal fiscal year, including the President’s initial budget, and legislative action
- Analysis of potential impact on Montana programs and economy
 - Examination of the potential impact of the budget on individual programs would not be feasible given time and staff restraints
 - The implications for state programs might not be readily apparent

Goals and Outcomes

- Provide information that aids the legislature in:
 - Understanding the scope of federal funds and the services funded
 - Understanding current and potential federal financial picture and action, and its general impact on receipt of federal funds and provision of services
- Provide options for how the legislature may proactively deal with the potential loss of federal funds and services

Proposal:

Given the complexity of federal funding uses and sources, concentration would have to be given to major funding sources involving services to the most Montanans, and there would likely have to be a less in-depth analysis. NCSL would be utilized as a major resource, and current staff operational funds may be needed to contract with/subscribe to services that specialize in providing information to states to gauge federal action and potential state impacts.

This project should not need a subcommittee, and reports would probably not be necessary at each meeting of the LFC. However, assignment of 3 or 4 committee members for reporting, consultation, and feedback between reports to the full committee would be valuable.

¹ Expanding the scope to include funds that do not have state oversight would require staff resources very likely beyond the capacity of the LFD.

Resource Indemnity Trust Statutes and Policies

Source/authority: HJR 36

Legislative Poll Ranking: #3

Background: HJR 36 was requested by the joint appropriations subcommittee on natural resources and commerce to establish a study of the on-going issues associated with the appropriation of resource indemnity trust (RIT) and related taxes. Direct proceeds of the taxes and interest from the trust, in whole or in part, fund a number of accounts for a wide range of programs. The flow of funds and the use of funds were altered by both the 2003 and 2005 Legislature. This further compromised the ability of the legislature to allocate funds for the right purpose to the correct agency. Several additional issues were cited by staff:

- ◆ Accounts are over appropriated
- ◆ Funds, in some cases, subsidize other accounts
- ◆ Uses for which the law does not allow
- ◆ No central oversight to determine where funds should go and who should spend them

Study resolution requirements: The resolution requires an examination of laws and appropriation practices of the resource indemnity related funds for the purpose of:

- ◆ Examining funding priorities
- ◆ Examining possible uses of funds
- ◆ Proposing revisions to the laws

The resolution also requires inclusion of the affected agencies and OBPP in the process and a report to the LFC by September of 2006.

Staff resources: This resolution will require staff time to compile historical information related to funding and/or statute changes, coordination of the RIT subcommittee, coordination with the legislative environmental policy office for legal assistance, and development of final report.

Scope of project: This project will include potential revisions to RIT related statutes and development of funding priorities.

Proposal: To meet the full intent of this resolution, the LFC should consider establishing a subcommittee for the RIT study. The subcommittee would meet for four hours on the day prior to LFC meetings. The study could be broken down into two parts, 1) statutes and 2) funding. Resolution on statute changes should be reached prior to dealing with any funding or process changes. A detailed work plan would be developed with the subcommittee.

Affected Agencies: Department of Natural Resources and Conservation, Department of Environmental Quality, Judiciary, State Library Commission, Montana University System

Lead Staff: Barbara Smith

Long-Range Building Funding Interim Study Recommendation

Source/authority: HB 5
Legislative Poll Ranking: N/A

Background: While not readily apparent in the 2007 biennium, the Long-Range Building Program (LRBP) continues to experience reduced revenues that could become a significant problem in the future. The LRBP cash program has been supported by distributions from cigarette tax for many years. Coal severance tax support was added to the LRBP to provide debt service payments on three bond issues and since has become increasingly important to the support of the program. These two revenue sources provide the greatest part of the funding for the LRBP. Unfortunately, both the cigarette tax and the coal severance tax sources have experienced a diminishing base for revenue collections, and the base of the cigarette tax is expected to further deteriorate in future years.

Deferred maintenance is the vehicle used to care for and maintain state buildings. Without a comprehensive deferred maintenance program, the state would likely incur increased maintenance expenses for state buildings in the future. The cost of deferred maintenance increases both as an issue of time (maintenance costs increase as building grow older and inflation increases costs in time) and as buildings are added to the state's inventory. Since the early 1980's, LRBP account revenues have declined from an annual proportion of 1.74 percent to a current 0.24 percent of building replacement value. The Department of Administration, Architecture and Engineering Division (A&E) estimates that not less than 1 percent, or near \$11.0 million, of building replacement value should be re-invested in state owned buildings annually for deferred maintenance of Montana's \$1.1 billion of general fund supported state owned buildings (including the university system). The 1 percent of building replacement value addresses construction needs beyond what would be considered typical operations and maintenance included in the operational budgets of the state agencies. Reduced revenues and increased expenses can only equate to problems for the LRBP in the future.

The purpose and goal of this proposal is to conduct a study and make policy recommendations on the funding of the LRBP, enabling the program to in time eliminate costly backlogs of deferred maintenance and provide sufficient funding for deferred maintenance in the future. The desired result would be a draft recommendation to elicit changes in the current funding of the LRBP.

Study requirements: The 59th Legislature appropriated \$8,000 of LRBP funds in HB 5 for the interim Legislative Finance Committee (LFC) to use in a study on program funding. The appropriation was made to permit the LFC to establish a subcommittee to undertake a funding study. It is estimated that this work could be completed in six, two-hour meetings of the subcommittee.

Staff resources: This study will require significant staff time to evaluate current LRBP funding and propose changes to the funding mechanism. Legislative Fiscal Division (LFD) staff, in collaboration with A&E, will work with the subcommittee to facilitate the research component of the study. Time requirements of this work will be highly dependent upon the activities of the subcommittee, which will be completing the policy analysis.

Scope of project: This project includes:

- Determination of the actual extent of the back log of deferred maintenance
- Determination of a sufficient measure for the state's ongoing deferred maintenance requirements
- Consideration and analysis of policies associated with new construction in light of the current backlog of deferred maintenance
- Development of a proposal to adequately fund the program using the information found in its work

Proposal: LFD staff will participate in a LRBP funding study with a LFC subcommittee. The subcommittee will meet quarterly to discuss analysis, information, and research provided by LFD and A&E staff, provide staff direction, and create policy concepts. The subcommittee will make policy recommendations to the LFC. If the findings of the subcommittee are found as credible, the LFC may wish to request draft legislation for recommendations to the 60th Legislature.

Wildland Fire Suppression Statutes and Policies

Source/authority: HJR 10
Legislative Poll Ranking: #8

Background: In December 2004, the Legislative Audit Division released a performance audit on wildland fire administration, finding that Montana's statutes are outdated or silent with regard to wildfires, costs of wildfire suppression, fuel accumulation, and the wildland/urban interface. HJR 10, sponsored by Rep. Hal Jacobson, was a Legislative Audit Committee bill to request a study of wildfire statutes. The study was assigned to the Environmental Quality Council (EQC). The EQC will undertake the issues of wildfire statute and policy review, but the bill also calls for a study of the funding methodology for wildfire suppression. The EQC has asked that the LFC assume that portion of the HJR10 study.

Goal: The goal of this study would be to identify fiscal issues as the EQC reviews the fire-policy related statutes. The LFC would study options for funding suppression, as compared to the current methodology, which doesn't budget for wildfires, and requires borrowing from other programs until reimbursed by a supplemental appropriation. Staff would provide a history of previous work and studies done in this area and provide historical fire data and trends.

Study resolution requirements: The resolution requires "sufficient staff to develop, consolidate, and update fire-related statutes, in collaboration with the Department of Natural Resources and Conservation, wildland fire service organizations, and any other organizations to address dangerous environmental conditions and areas of wildland/urban interface, to improve wildland fire suppression and mitigation and to recommend legislation to appropriately fund wildland fire protection and suppression costs."

Staff resources: This resolution will require significant staff time to evaluate the fiscal impact of current and proposed changes to fire-policy related statutes for fiscal impacts. Timing of this work will be dependent upon the activities of the fire funding working group, which will be completing the policy analysis.

Scope of project: This project will include trending fire costs, historical fire data, development of funding models, explanation of funding alternatives as it relates to the appropriations process, plus education regarding the process to access federal funds (i.e FEMA) for fire suppression.

Proposal: LFD staff will be participating in the fire statute work group that will report to the EQC study subcommittee. The LFC might want to consider discussing with EQC to allow LFC members to participate in the work group and/or the EQC subcommittee to address the fiscal issues as they arise. This would provide LFC members with background information that establish the basis for fire funding discussion. The LFC members would convene as a subcommittee at the point in time where fiscal issues must be resolved. This would allow the project to flow, staff to spread out their workload and LFC members the opportunity to hear the policy discussion as it occurs.

Lead Staff: Barbara Smith

State Government Budget Model

Background: This particular project was undertaken during the last interim. Because of competing priorities and the significant amount of human resources required to do this project, a final product was not completed during the last interim. Although a final report was not produced, significant analysis was done on both state revenues and disbursements.

Many of state government services provided rely on the ability of the state's tax policy structure to raise sufficient revenues to provide those services. Public schools and higher education, human service programs, public safety, and many more services depend on state funds. Most of these funds are raised from taxes, fees, and investment earnings.

Unfortunately state revenues are not always stable and predictable. For example, during the late nineties, the gradual but significant increase in the equity markets contributed to unusual large increases in the state's revenue base. Since this occurred over a period of years, most state financial professionals felt these increases would continue into the future. Budget reductions, a special session, and a projected deficit of \$235 million proved this premise to be false.

Because Montana is required to balance its budget even during revenue turndowns, the state's budget may face a severe problem often referred to as a structural deficit or imbalance. In simple terms, this means the inability of state revenues to grow in tandem with the cost of providing governmental services

Study requirements

This project would require staff to do an in-depth review of both state revenues and disbursements. Considerable research and analysis would be required to identify and quantify data in order to answer the following questions:

- What drives or determines the growth of state revenues?
- What is the long-term trend in the growth of state revenues?
- What drives or influences the growth of state disbursements?
- What is the long-term trend in the growth of state disbursements?
- Does the current state tax policy structure support the existing cost of providing governmental services?
- What options are available to the legislature if the revenue base is or is not sufficient to support the level of existing services provide?

In actuality, some of this work has already been done.

Staff resources: This project will require significant staff time to research and analyze historical data relative to state revenue and disbursement growth patterns. For each revenue source and disbursement area, growth drivers or factors would need to be identified. Each factor would need to be extrapolated (trended) into the future to assess the cumulative affects on state revenues and disbursements. After the accumulation of this data, a conclusion could be determined. The amount of additional staff resources would depend on the conclusion of the analysis. The development of options could be very time consuming and could be viewed as bias.

Scope of project: This project will include development of a historical financial database on state revenues and disbursements. An analysis of each revenue and disbursement category will be prepared with the objective to identify major factors that quantify growth patterns for the respective components.

To the extent possible, identified growth drivers will be correlated with economic variables to provide the basis for long-term trending. A complete report will be prepared identifying and discussing major drivers, their relationship to economic conditions, option recommendations, and a summary conclusion. The conclusion will identify whether state revenues are sufficient to support the cost of providing existing services and what major factors contribute to state revenue and disbursement growth. As stated previously, identification of options to address the issue will depend on the results of the initial analysis.

Proposal: Staff will continue this project from where it was left at the end of the last interim. The results of the analysis will be presented to the Legislative Finance Committee in October 2006.

Performance Management Options

Source/authority: Committee Member/Staff Initiation

Background: The legislature defines the activities of state government through policy development, including the appropriations process. With these activities the legislature determines what state government should be doing and where government doesn't belong, and establishing accountability for how the work of government gets done. This project is the opportunity to introduce the concept of performance management to provide new tools to assist in establishing the goals of state government, raise accountability of those involved in the process, and establish a process to assure goals are met.

Requirements: The report on performance management is enclosed with this mailing. This report provides background information and potential options to incorporate performance management into the budgeting and appropriations process.

Staff resources: This project would require staff resources at two different levels. First, three staff persons will cooperate on executing the first phase of the project. Second, all staff will need to participate in the process to implement performance management at the appropriations level.

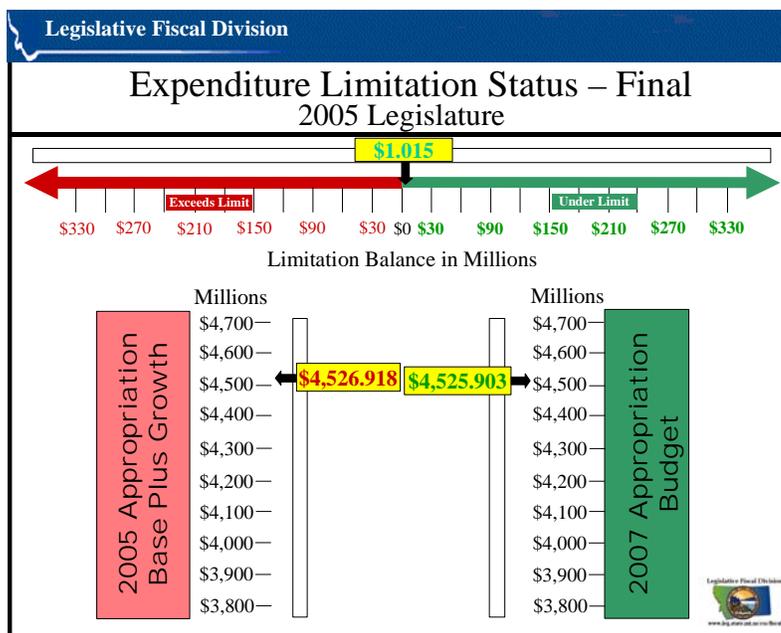
Scope of project: The project is divided into four phases. Each phase of the project is explained in detail in the corresponding report.

Proposal: See decision points in the report. The committee has the opportunity to modify, streamline, expand or disapprove the project.

Examine Expenditure Limitation Statute

Background: Enacted by the 1981 legislature (and amended by the 1983 and 1987 legislatures), 17-8-105 & 106, MCA, (attached) limits the growth of appropriations between biennia to the growth in Montana personal income. Although a part of the LFD budget analysis every biennium since the 1993 biennium analysis (and sporadically prior to that), the analysis for the 2007 biennium was the first time the executive budget exceeded the limitation. The 2005 session was also the first session in which the LFD provided updated statuses on the limitation throughout the session. The limitation achieved high visibility during the session and budget decisions were made based on the calculations. Therefore, the accuracy of the calculation is of extreme importance to the LFD and the legislature.

Problem: The expenditure limitation is inherently inaccurate. The statute does not provide adequate guidance on how to calculate the limitation. Written prior to the revised governmental fund structure of the state, the statute is unclear in certain areas and does not address certain areas of the current fund structure. Because of this, certain types of appropriations have to be estimated. At certain points in time, as the actual amounts of these appropriations become known, the expenditure limitation could change substantially. Appropriations such as budget amendments and statutory appropriations are also estimated. Since these types of appropriations are established by the



executive and can change over time, another layer for potential change is added to the limitation. The fact that the limitation can change with no additional action by the Legislature, puts the legislature in a difficult situation. It could adjourn a session with a budget below the limit only to learn some time later, through no additional action of the legislature, that the limit was exceeded.

Proposal: LFD staff will solicit ideas from the Legislative Finance Committee and propose ideas on ways to make the calculation of the expenditure limitation more accurate. These ideas for changes will be brought before the committee for its approval. To make the necessary changes will require legislation sponsored by the committee.

Timing: Because of the looming special session in December, there are two timing possibilities for completion of this examination:

1. Decide on proposed changes and have a bill draft ready to be introduced in the special session and, if passed, effective immediately. The advantage of this possibility is that improved accuracy of the calculation could be applied to special session action and to the 2009 executive budget; or
2. Delay the examination until after the special session and have it ready prior to the 2007 session. The advantage of this possibility is that more time could be spent in examining the issue.

Expenditure Limitation Statutes

17-8-105. Definitions applicable to expenditure limitation. As used in 17-8-106, the following definitions apply:

(1) "Montana total personal income" means the current income from all sources received during a particular period of time by persons residing within Montana as determined by the United States department of commerce or its successor agency.

(2) "State expenditures" means the general fund appropriations, the special revenue fund type appropriations, and the cash portion of the appropriations in the capital projects fund type, excluding:

- (a) money received from the federal government;
- (b) payments of principal and interest on bonded indebtedness;
- (c) money paid for unemployment or disability insurance benefits;
- (d) money received from the sale of goods or services provided that the purchase of the goods or services is discretionary;
- (e) money paid from permanent endowments, constitutional trusts, or pension funds;
- (f) proceeds of gifts or bequests made for purposes specified by the donor;
- (g) money appropriated for tax relief; and
- (h) funds transferred within state government or used to purchase goods for resale.

17-8-106. Expenditure limitation -- exception. (1) Except as provided in subsection (2), the state expenditures for a biennium may not exceed the state expenditures for the preceding biennium plus the product of the state expenditures for the preceding biennium and the growth percentage. The growth percentage is the percentage difference between the average Montana total personal income for the 3 calendar years immediately preceding the next biennium and the average Montana total personal income for the 3 calendar years immediately preceding the current biennium.

(2) The legislature may appropriate funds in excess of this limit from the reserve account if:

- (a) the governor declares that an emergency exists; and
- (b) two-thirds of the members of each house approve a bill stating the amount to be spent in excess of the expenditures limitation established in subsection (1), the source of the excess revenue to be spent, and an intention to exceed the limitation.

(3) Expenditures may exceed the expenditures limitation only for the year or years for which an emergency has been declared.

(4) The legislature is not required to appropriate the full amount allowed in any year under subsection (1).

The Graying of Montana: Effect on State Government Workforce, Revenue, and Expenditures

Source/Authority: LFD Staff Suggestion

Legislative Poll Ranking: Not Applicable

Outcomes:

1. Understand demographic projections for Montana and potential impact on Montana state government revenues, expenditures, workforce, and operations
2. Review, and potentially recommend for legislative consideration, policy and appropriation changes in the following areas:
 - a. Amendments to statutes governing:
 - i. Taxation
 - ii. Programs for the elderly
 - iii. State government workforce/labor
 - iv. State institution costs, including commitment, sentencing, and incarceration policies
 - b. Appropriation changes for:
 - i. Programs for the elderly
 - ii. State institution medical costs
 - iii. State employee benefits

Background: Montana is one of 10 states projected to have a higher number of persons over the age of 65 than school aged children by 2024. Within the next decade, U.S. census estimates project that 15 percent of Montana's population will be over 65, the 6th highest percentage in the U.S. This shift in demographics will have important ramifications for Montana state government.

State Revenue Impact As the average age of the Montana population rises, there will be a proportionally higher number of taxpayers who are retired. The impact on state revenues may be a shift from reliance on wage and salary income to a greater reliance on transfer payments, capital gains, and other sources of investment and fixed income.

Consumption patterns of older persons are different than other age groups. Changes in consumption spending may also impact state revenue collections, but could be more pronounced within regional areas of the state.

There may be tax expenditures in the form of different types of tax exemptions for persons over the age of 65 that will impact state revenue.

State Appropriation Impact As the Montana population ages, the types of state services desired by taxpayers may also change. There may be greater demand for services for the elderly, including Medicaid community, home-based, and nursing home services, prescription drug assistance, and other senior services. Medical costs for state institutions, including prisons, may increase also if the average age of the institutional population increases. There may be less demand, maybe even less public support, for education services and funding.

The medical workforce required to support an aging population might not be adequate unless current shortages are resolved. Additionally, the types of medical services needed for an aging population are

different than a younger population and may not be readily accessible throughout the state. This change could impact the higher education system.

State Workforce Impact Retirement of the baby boomer workforce could cause a system wide “brain drain” that may be significant if large numbers of persons retire within the same time span. Competition for replacement workers from a smaller labor pool may not result in the savings typically assumed when long-time employees retire and are replaced by new comers to state government employment. Additionally, retirees who opt to keep state employee health insurance may pose disproportionately higher costs for the state self-insurance pool due to extended life spans, and the current policy of charging retirees no more than the premium paid by active employees.²

Study Resolution Requirements: Not applicable.

Staff Resources: This proposal would require a variety of LFD staff expertise and time to identify and evaluate the most significant impacts to state government due to an aging state population. Depending on the scope and number of impacts identified, the project could span more than one interim or the LFC may need to reduce the scope of the project and prioritize work issues.

Proposal/Scope of Project: The proposal and the scope of the project as outlined are the same, with the caveat that this initial list of issues would be refined and may expand. The following list includes the major issues that would be reviewed initially. Policy options that could be considered by the legislature will be identified and presented to the LFC as the research and evaluation proceeds. Preliminary topics include:

- Evaluation of various demographic projections for Montana, including key indicators that could signal a change in projected trends
- Identification of impacts to state revenue sources, including potential revenue changes that could be expected with a certain demographic change – eg a 1 percent proportional increase in the number of persons over 65 creates an estimated defined change in specific revenue sources
 - Review of other states’ experience with property tax relief as persons age and property values increase
 - Review Montana tax code with respect to taxation of persons over the age of 65
- Identification of state expenditures related to an aging population and policy options:
 - Non discretionary:
 - Health care entitlements (mostly some Medicaid services)
 - Projections related to a 1 percent proportional change in Montana population in persons over the age of 65
 - State institution medical costs
 - Personal services costs for state government
 - Discretionary state spending:
 - Aging services such as Meals on Wheels, adult protective services
 - State prescription drug programs
- Identification of workforce issues and potential legislative options including:
 - Potential for a “brain drain” and contingency plans
 - Reemployment options for retirees
 - Financial soundness of retirement system
 - Benefits and costs of early retirement incentives

² The average benefit per retiree in the state group insurance pool is 135 percent of the cost of an active employee.

Study Rainy Day Fund

Source/authority: LFA/LFC Recommendation

Background: Montana is one of three states that does not have a budget stabilization fund, oftentimes referred to as a “rainy day fund”. Montana has primarily depended on a fund balance reserve to provide the cushion needed to mitigate fluctuations in its fiscal condition, whether as a response to a revenue shortfall or unexpected supplemental appropriation requests (like for a severe wildfire season), or both.

The level of reserves maintained must be sufficient to offset the volatility of revenues and the potential for unforeseen expenditure increases, and as true in recent years, economic uncertainty is an important consideration. The shortfall of revenues in the 2002-2003 time-period is a poignant reminder of such volatility. During the 2003 biennium, actual revenue growth was well below forecasts, primarily because of reduced income tax collections and lower interest rates, circumstances that could not be predicted when the 2003 biennium budget was being approved. The Fifty-eighth Legislature began its deliberations with a looming \$230 million deficit. The absence of a larger reserve to rely on meant that the legislature had to apply some very significant and “painful” reductions, in addition to enacting several revenue enhancement measures. Had Montana had a rainy day fund equal to just 5 percent of projected revenues, there would have been enough in the rainy day account to offset at least half of that deficit. In effect, a rainy day fund can level off the revenue collections by setting aside moneys in the good years and holding it for the bad years.

In the past two legislative sessions, the legislature has considered rainy day fund legislation. During the 2003 Legislature, five bills were introduced that included provisions for a rainy day fund. Select concepts from these bills were combined into one bill that passed out of the House but failed to advance in the Senate. In the 2005 session, three bills were introduced, but ultimately, none were adopted. One of the bills considered in the 2005 session was brought forward by the Legislative Finance Committee (LFC) and carried by an LFC member. A second bill was introduced by an individual LFC member, and the third was introduced by a non-LFC legislator.

Study requirements: The recommendation is to review the bills that were considered in the 2005 session, study the rainy day funds of other states, and develop options that would result in a acceptable rainy day fund bill for introduction in the 2007 session.

Staff resources: This study will not require a significant amount of staff time to determine problems in the bills considered during the 2005 session, nor will very much time be needed to study other states. Much of the necessary research was completed during the last interim. The development of options comes right out of the research that has been done. It estimated that this study would not require more than 80 hours of staff time during the interim.

Scope of project: This project will include:

- a review of the legislation of the 2005 session
- an assessment of why that legislation did not succeed
- an assessment of the data available from other states, and inquiries to states where additional information is needed
- an analysis of best practices of the various states relative to Montana’s needs
- a report on options available with estimates of the fiscal impact of each

In the end, the Legislative Finance Committee would be asked to decide whether or not it wishes to request a bill draft for a rainy day fund bill, and what form the legislation should take.

Proposal: LFD staff will perform the necessary research, assessments and analyses of data collected, and development of options for presentation to the full committee. It is requested that two LFC members be identified as advisors (“sounding boards”) for the LFD staff. Senator Laible and Representative Buzzas each carried rainy day fund bills in the 2005 session and would have some perspective on the resistance these bills met. It is not anticipated at this time that there would be any need for these members and staff to meet formally, but rather the members’ input and feedback would be sought by e-mail or telephone.

RECOMMENDATION

As discussed above, the proposed work plan constitutes a complete and ambitious work plan that exceeds existing staff resources and prioritization will be essential. With that in mind, the following committee motion after reviewing/amending the proposed plan is recommended:

Adopt the projects in the LFD work plan as presented, with amendments as discussed by the committee to meet legislative priorities. Prioritization is necessary, and projects will be undertaken only as limited resources can be identified to complete projects in priority order. The committee shall review the list of discretionary projects as well as emergent issues at each scheduled meeting for prioritization and scheduling as resources allow. The LFA shall seek the advice of the chair and the Management Advisory Subcommittee between meetings as circumstances warrant to efficiently allocate/reallocate resources toward the task list.

ATTACHMENT A

REFERENCE WORK PLAN DOCUMENT

The primary constraint limiting the interim agenda will be available staff and committee time and resources. The tasks are categorized on the reference work plan document as discussed below, and the reference work plan document follows.

1. “Statutory/Imperative”-- The LFD and LFC must perform a number of tasks in the next biennium, due either to statutory requirement or the imperative nature of the task. These studies and tasks are listed first on the work plan as items 1 through 7.
2. “Legislative Interim Studies” -- There are several interim projects approved by the 2005 Legislature that involve LFD staff and may involve the LFC. Items 8 and 9 are interim study resolutions referred to the LFC for consideration. Item 10 is the school funding formula study that will involve extensive LFD staff work. Item 11 was funded in HB2 for a study of the long range building deferred maintenance project backlog, appropriated to the Department of Administration, but with expectations of legislative oversight. Item 10 was referred to the Environmental Quality Council, but assistance on development of a funding methodology for wildfire suppression costs is being referred to the LFC. Items 11 and 12 were referred to other interim committees, but the resolutions specifically call for LFD staff assistance if requested.
3. There is a category of “LFC/LFD Interim Studies” (items 10 through 14) which are listed by staff as potential major committee study projects and are presented for committee consideration as to whether there is a committee mandate for these items.
4. “Priority Staff Projects/Reports” are recommended that are “discretionary” in nature and that might involve reports to the LFC, but not a major committee study. They are at the will of the committee.
5. The remaining classifications in the work plan, “Staff Ongoing Tasks” and “LFD Administrative” provide a partial inventory of additional significant tasks staff will be completing over the interim and are listed to provide a more complete picture of the total time obligation and duties of staff. These tasks must be taken into consideration when determining total staff time available for other tasks during the interim.