GLOBAL FISCAL ISSUES:
LFC RECOMMENDATIONS TO THE 2005 LEGISLATURE

A Report Prepared for the

Legislative Finance Committee

By
Jon Moe
Fiscal Specialist

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Legislative Fiscal Division

www.leg.state.mt.us/css/fiscal/

PURPOSE

The structure of the executive budget proposals is specified in statute. This defined structure is the backbone of a process that involves months of preparation by executive and legislative staff, and months of legislative deliberation. It is the defined structure that allows for a sophisticated level of automation but which also dictates a need for consistency among groups of decision makers. It is the issues of consistency and equity that are addressed here.

The purpose of this report is to provide, in accordance with statute, options for a procedural framework for the legislature in dealing with global fiscal issues, issues that impact the deliberation of most, if not all, agency budgets. Because the legislative budget process employs six appropriations subcommittees reviewing the same components of different agency budgets, a common approach to addressing certain overarching issues is desirable. With global decisions in hand, the subcommittees can proceed with their individual budget reviews knowing that there is equity and consistency in key decisions regarding those overarching issues of the total budget.

BACKGROUND

A bill passed by the 1997 Legislature revised 5-12-205, MCA (powers and duties of the Legislative Finance Committee) to require that the LFC make recommendations to appropriations committee leadership prior to each session on global budget issues. The statute is as follows:

> *5-12-205 (4) [The Legislative Finance Committee] shall, before each regular and special legislative session involving budgetary matters, prepare recommendations to the house appropriations committee and the senate finance and claims committee on the application of certain budget issues. At a minimum, the recommendations must include procedures for the consistent application during each session of inflation factors, the allocation of fixed costs, and the personal services budget. The committee may also make recommendations on other issues of major concern in the budgeting process, such as estimating the cost of implementing particular programs based upon present law.*

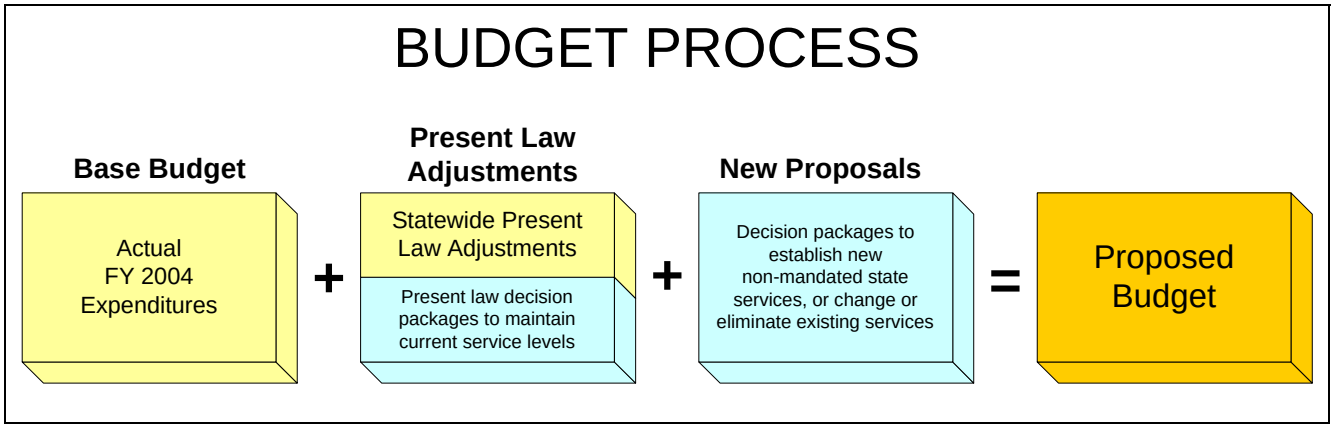
There are a number of issues that should be applied in a global manner. They fall into three general categories:

- Those where some consistency of action is desirable, such as the application of vacancy savings and inflation rates
- Those decisions where required payments are established by previous legislative action, such as application of legislatively authorized pay plan levels
- Those where the budgets of the individual agencies are driven by budgets established centrally, such as the fixed costs used to fund programs like the Information Services Division (ISD) and central purchasing, and where the agency paying the cost has no flexibility in whether or at what level the charges will be paid.

The following sections summarize these issues and provide options for consideration by the Legislative Finance Committee in formulating a recommendation to appropriations leadership in preparation for the 2005 legislative session.

STARTING POINT FOR SUBCOMMITTEE DELIBERATIONS

For consistency and clarity of the budget process, the subcommittees should start from the same starting point. In order to discuss this point, a description of the budget process may help.



The components of the budget process are shown above. The recommendation is that the subcommittees all start at the same point for each agency in their section of the budget. Historically, the subcommittees have started by accepting the base budget and statewide present law adjustments as the starting point (highlighted in yellow).[1] The subcommittees review other present law decision packages and new proposal decision packages individually.

Generally, actual FY 2004 expenditures, excluding the one-time expenditures, are the base budget and are the first step in this process to build the budget. The next step is to identify the funding that is necessary to fund the budget in FY 2006 and FY 2007 at the same level of services. This is not about new programs. It simply maintains existing programs and services at levels consistent with requirements of "present law." There are two components of present law adjustment: 1) statewide present law adjustments, and 2) all other present law adjustments.

Statewide present law adjustments relate to a specific group of expenditures that have broad impact because these expenditures impact every state agency. These items include:

- Personal Services –adjustments which fully fund the existing positions of state government by:
  - Restoring amounts unfunded in the previous session because of vacancy savings or other reductions;
  - Funding employee pay plan costs that result from delayed implementation of pay schedules or employer benefit contributions;
  - Accounting for changes in position costs that result from the reclassification of positions to meet agency needs; and
  - Accounting for changes in employer costs resulting from rate changes such as for workers compensation insurance.
- Vacancy Savings – adjustments for the vacancy savings factor applied in the executive budget, which is expected to be 4 percent for the 2007 biennium.
- Inflation/Deflation – adjustments for a select group of expenditure accounts (about 10) that are expected to see marked increases or decreases during the upcoming biennium (e.g., natural gas costs).

[1] In the 2003 session, a prior year base was adopted at the beginning of the session due to a severe budget deficit.

- Fixed Costs – Adjustments proposed in rates charged to state agencies by other state agencies for services provided such as warrant writing services and office space rent.

The statewide present law adjustments are presented as such because it avoids hundreds of decision packages requiring the same decision, but more importantly, because they represent items that should be treated the same for all agencies and programs and, therefore, should be handled at one time and not by each subcommittee independently. These key elements of every agency budget should be consistently applied as an equity issue among agencies and, to a lesser degree, because of budget system constraints.

By choosing to adopt a starting point that includes the base budget and the statewide present law adjustments, the legislature is not precluded from making changes to the base budget or to elements of the statewide present law budget. As will be discussed in the next section, there are ways to make changes to those items within an individual agency or globally. Options to do so will be explained.

As for the starting point for the subcommittees, there is really only one option. Taking another approach risks inconsistency and inequity in the budget process, and poses significant workload issues for subcommittee members and staff.

> **Option a: Direct the subcommittees to adopt the base budget and the statewide present law adjustments as the starting point of budget deliberations for each agency.**

HOW SUBCOMMITTEES CAN AFFECT STATEWIDE PRESENT LAW

For each of the elements of the statewide present law adjustments, there are methods for addressing concerns about the level of funding or services provided. By the action described in the preceding section, these elements are fully funded except for the application of vacancy savings, which reduces the funding of personal services for each agency by a predetermined percent of the agencies personal services budget. In this section is a discussion of how the elements of the budget can be changed.

PERSONAL SERVICES AND QUANTIFICATION OF FTE CHANGES

Even though a specified level of personal services is adopted in the "starting point" above, subcommittees can add or eliminate funding for positions (FTE). Subcommittee staff can create a budget decision package to accomplish this. Within the budgeting system, each FTE is individually budgeted by using two factors: 1) actual budgeted salary, and 2) related benefits. Benefits are calculated through the use of formulae. Adjustment of funding due to addition or elimination of specific FTE requires a methodology for determining what level of funding will be adjusted. This discussion suggests one question regarding how subcommittees should request FTE changes.

Issue: How should monetary adjustments to each budget be calculated when FTE funding is added or eliminated?

> **Option a: Specify the actual FTE, and allow the legislative budgeting system to calculate the total addition or reduction in funding for that specific FTE.** This option is preferred as it lets the budgeting system do the work.

<u>Option b</u>: Specify an estimated level of funding to be reduced or added. This option will work but is more cumbersome for staff to enter into the budgeting system. It has the effect of being more like a vacancy savings adjustment, and does not provide for a "permanent" reduction of FTE.

VACANCY SAVINGS

Although the executive budget will include application of a vacancy savings factor, the legislature can choose to change it at its discretion, as it is a policy decision for the legislature to make. If the legislature chooses to include a vacancy savings rate, the committee may wish to discuss whether and at what level the application of vacancy savings should be consistently applied among all agencies/programs, or whether subcommittees should consider vacancy savings on a case-by-case basis. With a few exceptions, the 2003 legislature applied an across-the-board 4 percent vacancy savings for agencies with 20 or more FTE. (In prior biennia, there have been a variety of vacancy savings policies, from no vacancy savings, to a global consistent application on a percentage basis, to a selective basis of application.)

<u>Option a</u>: The full appropriations committees shall adopt a global recommended level of personal services reductions (vacancy savings). Subcommittees will be requested to adopt the recommended level as part of their budget recommendation.

<u>Option b</u>: There will be no recommendation from the full committees on personal services reductions. Subcommittees may adopt vacancy savings levels on a case- by-case basis.

FIXED COSTS

Fixed costs include such items as audit, payroll, capitol grounds maintenance, rent, and computer network and data processing charges. These interagency services are provided by a service agency and fees are charged to agencies on a uniform basis via various formulae or estimates of actual costs. Since agencies must pay all billed fixed costs, the appropriation can be adjusted only by the rates charged by the agency providing the service. Any changes in fixed costs could be applied uniformly based upon the recommendation of the subcommittee examining the service provider's budget.

Note: The budgets of agencies/programs providing the services upon which the rates are determined would continue to be examined by subcommittees (primarily general government), and the rates would be adjusted globally by that subcommittee.

<u>Recommendation</u>: Direct subcommittees to consistently apply fixed costs in agency budgets as included by the executive budget request. Adjustments to fixed cost rates shall be determined by the subcommittee examining the service provider (e.g., ITSD costs as reviewed by the General Government Subcommittee) and shall be globally adjusted on a consistent basis.

INFLATION/DEFLATION

The executive budget will include about 10 expenditure categories that are inflated or deflated based upon analysis of those items. The Legislative Finance Committee could recommend that the full joint appropriations committee review those categories or establish categories of expenditures to

inflate/deflate and the appropriate inflation rates to apply. The subcommittees would determine the appropriate level of expenditures in each of the expenditure categories prior to inflation/deflation, and allow inflation/deflation to be automatically calculated based on globally determined inflation rates.

> **Recommendation: If the full committee wishes to vary from the executive budget proposal inflation/deflation factors, it should establish approved inflation/deflation rates (if any) by individual object of expenditure and direct subcommittees to apply these rates to all budget adjustment recommendations.**

ISSUES RELATED TO HB 2 PROCEDURES

PROPOSALS REQUIRING LEGISLATION

Implementation of some proposals that require HB 2 appropriations will require implementation of complementary legislation.

Issue: How will changes in HB 2 that are dependent upon the passage of other bills be made?

> **Option a: Subcommittees make recommendations regarding the proposal. Build all changes requiring legislation into the HB 2 line-items, and include contingency language striking the change if the legislation does not pass.**
>
> **Option b: Do not include the changes requiring legislation in HB 2 line items, but include contingency language enacting the change if the legislation does pass.**
>
> **Option c: Make no recommendations or adjustments to HB 2 until required legislation passes.**

Note: The handling of appropriations contingent on legislation can have a significant impact on the general fund status sheet tracking system. Option (a) was utilized in the 2003 session due to the severe deficit situation. Prior to last session, Option (c) was the traditional method adopted for dealing with pending legislation.

DISPOSITION OF "NEGATIVE" NEW PROPOSALS

Negative proposals have been used in the past to signify a separate reduction in the appropriation, without specifying where the reduction should be made. The legislative budgeting system and statute cannot accommodate a negative appropriation in HB 2.

> **Recommendation: Appropriations committee leadership shall direct the appropriations subcommittees to include negative new proposals in the present law line item in the budget, as opposed to a separate negative line item appropriation.**