

Government Cuts Should Be Minimized and Targeted to Avoid Further Harm to the Economy and Struggling Montana Families

The governor is faced with the unenviable task of making cuts to state spending at a time when the economy and struggling families can least afford it. These cuts can be made in a way that minimizes harm to the already fragile economy and protects hardworking Montana families struggling to make ends meet.

Because of the economic downturn, revenue coming into the state for this budget cycle is below the amount anticipated by the 2009 Legislature. On January 29, the governor's budget director, David Ewer, announced that the projected ending fund balance is now low enough to trigger a law that requires the governor to make emergency spending cuts.

The cuts should be the smallest cuts necessary to comply with the law, and they should be targeted so as to do the least harm to the Montana economy and families already struggling to make ends meet.

Revenue Collections Are Below Expectations

In 2009, the 61st Legislature was faced with the daunting challenge of balancing the budget during a time of economic downturn and extreme revenue uncertainty. Montana has been experiencing both declining revenues and revenue volatility that have made revenue estimating particularly difficult. Table 1 illustrates the revenue estimates that were created during the legislative session after several downward revisions reflecting the impact of the economic downturn. Revenues were expected to be lower for fiscal year (FY) 2010 than they were in FY 2009. Revenues were expected to start improving in FY 2011 but not recover to FY 2009 levels.

Key Terms

Ending Fund Balance- An ending fund balance exists when the amount of anticipated general fund revenue exceeds general fund appropriations. An ending fund balance can be used to maintain fiscal stability over a biennium when revenues collected are not as high as anticipated.

General Fund- The general fund is money available for the state to use for most of its functions without restrictions. The biggest source for general fund revenue is individual income taxes. General funds do not include payments to the state from the federal government or fund sources that are restricted for specific purposes.

61st Legislature- The 61st Legislature met for 90 days beginning in January 2009. The 62nd Legislature will meet in 2011.

Fiscal Year (FY)- The state accounts for its finances using a "fiscal year" that begins July 1 and ends June 30. It is named for the calendar year in which it ends.

Biennium- Montana is one of the few states that has a true biennial budget. The Montana legislature meets every two years (every odd year), at which time it approves a budget for a two-year period, also called a biennium. The biennium is named for the calendar year in which it ends. During the 2009 Legislative Session, the legislature considered and approved a budget for fiscal years 2010 and 2011; this two-year period is also referred to as the *2011 biennium*.

Table 1: General Fund Revenue Estimates (HJR2 Revised)	
2009	\$1.845 billion
2010	\$1.773 billion
2011	\$1.829 billion
Source: Legislative Fiscal Division, 2011 Biennium Report	

Using the above revenue estimates, the legislature passed a budget that included a \$282 million ending fund balance. An ending fund balance, much like an individual's checking account balance, is the difference between the amount of money the state expects to bring in and the amount of money it expects to spend during a given budget cycle.

Unfortunately, state revenue appears to be declining much more severely than anticipated by the legislature, resulting in a smaller than anticipated projected ending fund balance.

Montana Law Requires Cuts When the Ending Fund Balance is Too Low

Montana law requires the governor to reduce spending when the ending fund balance falls below a certain trigger.¹ The trigger phases down as the state progresses further into the biennium. For the time period between June 2009 and September 2010, the trigger is \$36.37 million.² The governor's budget director makes the ending fund balance projections that determine whether the trigger has been met.

On January 29, Budget Director Ewer officially notified the governor and the legislature that he expects projected revenue to be approximately \$275 million less than anticipated by the legislature, with the projected ending fund balance dwindling from \$282 million to just \$5.6 million.³ The projected ending fund balance is low enough to trigger the mandatory spending reductions by the governor. Now that the trigger has been met, the governor must reduce state spending so that the projected ending fund balance remains at least 1% of the general fund appropriations for the biennium, or \$36.8 million.

¹ Montana Code Annotated 17-7-140.

² The triggers for the entire biennium are:

6/2009 – 9/2010: \$36.37 million (2% of FY2010 general fund appropriations)

10/2010 – 12/2010: \$13.64 million (.75% of FY 2010 general fund appropriations)

1/2011 – 2/2011: \$9.09 million (.5% of FY 2010 general fund appropriations)

3/2011 – 6/2011: \$4.55 million (.24% of FY 2010 general fund appropriations)

Legislative Fiscal Division, General Fund Revenue Update Fiscal 2010, January 6, 2010.

³ Legislative Fiscal Division's most recent general fund revenue update projects a more significant decrease in revenue than Director Ewer's estimates. LFD is now projecting that general fund revenues will be \$349.9 million below the 2009 Legislature's estimates, resulting in a projected ending fund balance of *negative* \$62.5 million, or \$98.9 million below the statutory trigger. See Legislative Fiscal Division, General Fund Revenue Update Fiscal 2010, Feb. 8, 2010 at http://leg.mt.gov/content/Publications/fiscal/rev_transp/Gen_Fund_Update_Feb.pdf. However, as noted above, the budget director's estimate is the projection that matters for the purposes of determining both whether spending cuts are required and how much needs to be cut to maintain the statutory minimum.

Limitations on Cuts Made by Governor

Montana law places some limitations on the governor's ability to make spending cuts without the legislature's authority. For example:

- No agency can be required to reduce general fund spending by more than 10% during a biennium.
- Agencies that are headed by an elected official (e.g. Department of Justice, Department of State, Office of Public Instruction) or the Board of Regents (higher education) cannot be required to cut a greater percentage of their budgets than the total cuts made by the executive branch.
- The governor cannot direct spending cuts for: (1) payment of interest and principal on state debt, (2) the legislative branch, (3) the judicial branch, (4) K-12 BASE funding, including special education, (5) salaries of elected officials, (6) the Montana School for Deaf and Blind Children.

Spending cuts for an agency must "be designed to have the least adverse impact on the provision of services determined to be most integral to the discharge of the agency's statutory responsibilities." In addition, the legislature can exempt cuts to a particular appropriation within a program area or can direct that the appropriation may not be reduced by more than 10%.

Governor Makes Reduction Decisions but Must Seek Input from Agencies and Legislature

Although the governor has the ultimate authority to make spending cuts subject to the conditions listed above, he must first seek input from the agencies, his budget director, and the Legislative Finance Committee. The process for making spending cuts is:

- The governor seeks input from each agency. For each program within an agency, the agency is required to analyze (1) the nature of the program, (2) whether the program is mandated by law, and (3) the impact that a cut to the program would have.
- The agencies must submit their analysis to both the governor's budget office and to the Legislative Fiscal Division (LFD).
- The governor's budget office, the Office of Budget and Program Planning, then reviews each agency's analysis and submits proposed spending cuts to the governor and LFD, including any proposed changes to the agency recommendations.
- The Legislative Finance Committee meets within 20 days after LFD receives the budget office's recommendations.
- LFD provides a copy of the legislative analysis of the proposed cuts to the governor's budget director at least 5 days before the meeting of the Legislative Finance Committee.
- The Legislative Finance Committee makes recommendations on the spending cuts proposed by the governor's budget director.
- The governor must consider all of the following when making final spending cuts: (1) each agency's analysis, (2) the recommendations from the governor's budget director, and (3) the Legislative Finance Committee recommendations.

What if Governor's Cuts Aren't Enough?

The law only allows the governor to cut each agency by a maximum of 10% of the agency's general fund appropriations. If those cuts are not enough to maintain an ending fund balance of at least 1% of total general fund appropriations for the biennium, the legislature may have to make further cuts during a special session. A special session can be called either by the governor or by a majority of the legislators.

Governor Has Asked Agencies to Begin Preparing for Cuts

The governor already asked state agencies to submit proposals for 5% cuts to their general fund budgets. He proposed the following timeline for reviewing cuts and getting the necessary feedback before making final decisions:

- January 29: (1) Agencies were required to submit reduction proposals to the governor's budget office, and (2) the governor's budget director announced to the Revenue and Transportation Interim Committee that the statutory trigger had been reached.⁴
- February 19: The governor's budget office will make its formal recommendations for spending cuts and provide copies of the recommendations to both the governor and the Legislative Fiscal Division.
- March 4 -5: The Legislative Finance Committee will meet to review the governor's recommendations. LFC may make its own recommendations to the governor for him to consider when making his final decisions.

Using the budget director's revenue projections from January 29, the governor will have to make cuts totaling \$31.2 million- the amount necessary to bring the currently projected ending fund balance of \$5.6 million up to \$36.8 million, the minimum balance required by law.⁵ In comparison, if the governor were to adopt the 5% across-the-board cuts submitted by agencies, those cuts would amount to approximately \$47 million.⁶

⁴ For a list and preliminary analysis of the proposals made by agencies, see Legislative Fiscal Division, "Agency analysis of possible reductions submitted to the Office of Budget & Program Planning," at http://leg.mt.gov/css/fiscal/Budget_reductions.asp.

⁵ The governor has already announced millions of dollars in spending reductions. However, most of those cuts do not impact the general fund and thus do not contribute to a larger ending fund balance. In our original report, dated 1/21/2010, we erroneously estimated that \$5.15 million of the governor's cuts to date would reduce general fund spending. However, \$4.5 of that amount was for the cancelling of renovations to the Montana State Hospital, which would have used state special revenue not general fund dollars. In other words, less than \$1 million of general fund savings have been realized by the governor's cuts to date.

⁶ Legislative Fiscal Division, <http://leg.mt.gov/content/Publications/fiscal/17-7-140/timeline.pdf>.

Recommendations to Protect the Fragile Economic Recovery and Struggling Montanans

1. Cuts should be limited to the minimum required by law.

Five percent across-the-board cuts would go beyond what is necessary to bring the ending fund balance up to the required level and would add additional strain on Montana families and the economy.

- Cuts in government services harm the economy. Government spending and government jobs are *more* important when private demand for goods and services and private jobs are contracting. Money circulating through the economy is needed to move out of a recession. This is true whether the money is from individuals, private businesses or government. Governments pay salaries, buy goods and services, and generate jobs, which is particularly important during a recession, when individuals and businesses are spending and investing less in the economy. Excessive budget cuts will be a drag on the economic recovery and extend the economic downturn.
- The federal government may provide additional relief to the states during this budget cycle, reducing or eliminating the need for spending cuts in Montana. For example, the U.S. House of Representatives has passed a “jobs bill” that would extend some relief to states originally provided in the American Recovery and Reinvestment Act. The House jobs bill would extend the increase in the federal matching rate for Medicaid (FMAP) by six months and put more money into the State Fiscal Stabilization Fund intended to prevent cuts to education and other important government programs. If passed, the extension of the FMAP increase alone could provide Montana with at least \$40-50 million in additional funds during this biennium.⁷ Montana should not make preemptive and harmful cuts that may not be necessary in light of proposed federal legislation.

2. Programs and services that provide relief to Montanans struggling to make ends meet should not be cut.

- Hardworking Montanans across the state are suffering through the recession and are being forced to rely more heavily on government programs, such as health insurance and unemployment insurance, in order to get by. Maintaining these programs is the best policy for Montanans and the best policy for the fastest possible economic recovery. Cutting the same percentage from every state agency would be an excessively blunt tool that could increase suffering and threaten the recovery.

⁷ The U.S. Senate is currently considering its own jobs bill. As of this brief’s publication date, the FMAP increase extension is not in the version being considered. An extension of the FMAP increase is also being considered as part of federal health care reform and is included in President Obama’s proposed federal budget.

- Assisting those most impacted by the recession is a critical mechanism for creating jobs and stimulating the economy. Programs targeted at low-income households are an efficient way to achieve increased demand for goods and services because low-income families are likely to spend all of the increased resources, resulting in an immediate boost to the economy. For example, an increase in food stamps benefits results in an increase in spending at local grocery and convenience stores, which in turn provides for increased business and profit, which helps to maintain or increase local jobs.

“Lower-income households are . . . more likely to be among those with the highest propensity to spend. Therefore, policies aimed at lower-income households tend to have greater stimulative effects.”

Congressional Budget Office (“Options for Responding to Short-Term Economic Weakness,” January, 2008).

3. One-time-only infrastructure and development projects that were funded with general fund dollars freed up by the American Recovery and Reinvestment Act (recovery act) should be looked at as sources for cuts before education, healthcare, or other programs helping Montanan’s most impacted by the recession.

- The 2009 Montana legislature appropriated roughly \$1.5 billion in federal recovery act dollars. In some cases, the funding provided through the recovery act for specific purposes freed up state funding that would have otherwise gone toward those programs. The most significant example of this phenomenon is the increased federal funding for Medicaid. Montana expects to receive over \$163 million in increased federal Medicaid assistance because of the recovery act. The additional federal dollars “freed up” state funding that would have otherwise gone toward Medicaid. Similarly, the recovery act provided \$122 million in funds meant to prevent cuts to K-12 and higher education. Unlike most states, Montana had state resources available to fund its education systems. Therefore, the recovery act education funds freed up significant state funding that would have otherwise gone toward education.⁸
- The resulting freed up general funds were primarily used by the legislature to fund one-time-only infrastructure and development projects. Appropriations for one-time-only projects (that have not already been spent or committed) should be carefully analyzed as sources for potential cuts before any cuts are contemplated to the programs intended to be protected by the recovery act (DPPHS, K-12, and Higher Education). See Appendix A for a list of appropriations made with freed up general fund dollars.⁹ As important and worthy as many of these infrastructure and development projects are, the funding that made them possible was only available because of the influx of federal relief for Medicaid and education *and* because

⁸ For more information about the appropriation of recovery act funding and the impact on current and future budgets, see Montana Budget and Policy Center, “The 2011 Biennium Budget: Maintenance, Recovery, and Future Cuts,” 12/21/2009, at <http://www.montanabudget.org/reports/2011-biennium-budget-maintenance-recovery-and-future-cuts>.

⁹ MBPC estimates that approximately \$30 million of the \$250 million freed up general fund appropriations is still available as a source for spending reductions. Approximately \$82 million of the \$250 million was directed back to programs in DPPHS and education. Of the \$168 million in remaining projects, approximately \$112 million have been transferred to the long range building program account and are thus not available as sources of general fund savings. Finally, approximately \$26 million of the remaining available appropriations have already been spent according the governor’s most recent monthly ARRA report (http://recovery.mt.gov/content/docs/AgencyProjects_Dec09.pdf).

the state was not yet facing cuts to DPHHS or education when the legislature decided how to use those federal funds.

4. Some agencies already operating under a present law budget should be protected from additional cuts.

- During this biennium, most state agencies received enough funding to meet their present law budgets with a combination of state and federal (including ARRA) funding. However, several agencies were cut below present law levels, meaning they likely will be unable to maintain the same level of programs and services delivered during the last biennium. See Appendix B for a comparison between legislative appropriations for each state agency and the amount necessary to maintain a present law budget for each agency.
- Several of the agencies cut below present law provide services that are vital to the state during an economic downturn and should be protected from additional cuts.
 - The Office of the Public Defender’s mission is to “ensure equal access to justice for the state’s indigent.” As the economy worsens, more Montanans are likely to qualify for the services of the Office of the Public Defender.
 - Department of Revenue cuts will impact future revenue. By not fully funding the present law for the Department of Revenue (DOR), the legislature has likely reduced the amount of revenue the department will be able to collect under current tax laws as compared to the previous biennium. For example, DOR has shown that for every additional dollar spent in the audit function, \$18 of revenue is collected.

Conclusion and Looking Forward

By law, the governor will have to make over \$31 million in painful cuts to state government in order to preserve the statutorily required ending fund balance. These cuts will put a drag on our already struggling economy and should be kept to the smallest amount necessary to comply with the law. In addition, required cuts should be targeted to ensure the greatest possible protection for Montanans who have been hit hardest by the recession. Government programs and services that protect Montanans when times are tough are more important now than ever.

Even with the governor's emergency cuts, revenues for the next biennium may be inadequate to cover costs for ongoing programs and services. If revenues are not adequate, the state will need to take a balanced approach to filling budget gaps. A balanced approach includes looking at both sides of the budget equation- revenue increases and spending cuts.

Ensuring that Montana can maintain government services during a time of increased need is critical to economic recovery. Over 200 economists from 38 states (including Montana) have signed a letter urging state governments to "maintain the public services that are critical to the health of the economy and the well-being of working families," because "cutbacks at this time would further slow the economy and harm those already hardest hit by the downturn . . . We understand that the law requires a balanced budget, which forces officials to make difficult decisions. But even when options are limited, some choices are better than others. Economic theory and historical experience both show that raising taxes during a downturn—particularly taxes that affect only higher-income families—is generally better for a state's economy, and better for its citizens, than sharp budget cuts."¹⁰

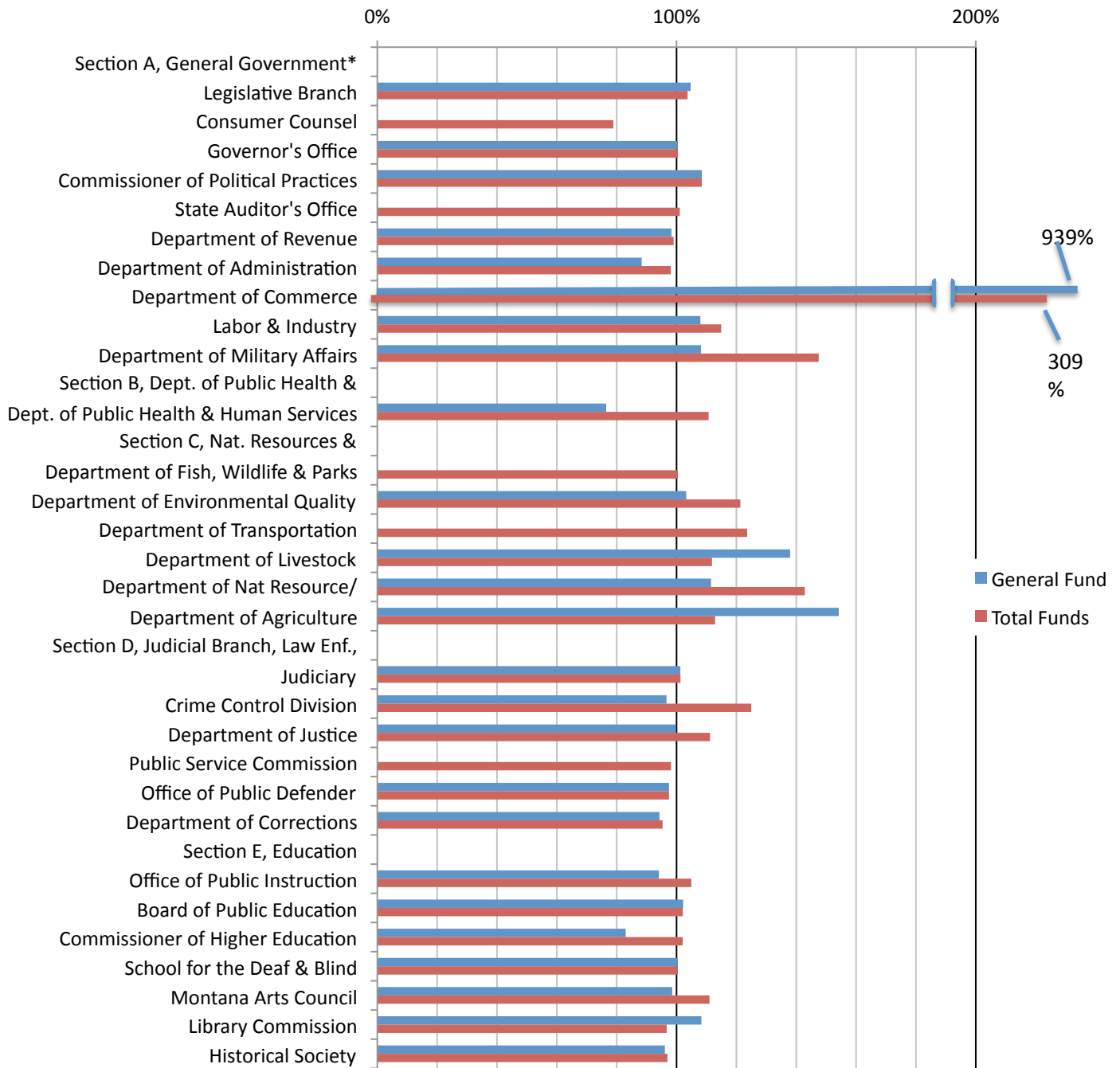
¹⁰ Montana Economists Join Hundreds Across Nation Urging States to Maintain Public Services.

<http://www.montanabudget.org/reports/montana-economists-join-hundreds-across-nation-urging-states-maintain-public-services>

Appendix A: Appropriations Using General Fund Dollars Freed Up by Recovery Act Funding				
Purpose	Line Item	FY 2010	FY 2011	Biennium
Infrastructure local	Grants for Tribal and Local Governments	25,000,000	0	25,000,000
Infrastructure local	Historic Preservation Competitive Grants	2,000,000	2,000,000	4,000,000
Infrastructure local	Broadband Mapping Grants	300,000	0	300,000
Economic Development	Main Street *	125,000	125,000	250,000
Economic Development	Distressed Wood Products	3,752,548	3,747,452	7,500,000
Economic Development	Energy Promotion Division *	255,000	255,000	510,000
Economic Development	New Worker Training *	655,698	655,698	1,311,396
Economic Development	Tribal Economic Development *	798,496	798,496	1,596,992
Economic Development	Community Service Planning Grants	25,000	0	25,000
Economic Development	BioMass Energy study	475,000	0	475,000
Economic Development	MT Agro-Energy Park (Havre)	150,000	150,000	300,000
Economic Development	High Performance Computing *	1,000,000	1,000,000	2,000,000
Other	Military Museum	250,000	0	250,000
Other	IED Fort Harrison	750,000	0	750,000
Other	Legislative Committees and Activities	117,084	121,520	238,604
Public Health and Human Services	Medicaid Caseload	18,433,433	22,219,989	40,653,422
Public Health and Human Services	2% Annual Provider Rate Increase	4,650,830	10,333,165	14,983,995
Public Health and Human Services	Direct Care Worker Wages - SLTC	1,915,738	2,446,846	4,362,584
Public Health and Human Services	Food Banks	250,000	250,000	500,000
Public Health and Human Services	Emergency Homeless Shelters	750,000	750,000	1,500,000
Public Health and Human Services	Non Mcd Aging Services	58,919	58,918	117,837
Public Health and Human Services	Mental Health/Corrections	25,000	0	25,000
Public Health and Human Services	Implement House Bill 130	475,000		475,000
Public Health and Human Services	Kids Management Areas	333,500	333,500	667,000
Public Health and Human Services	Native American property exclusion for Medicaid eligibility	231,764	310,188	541,952
Public Health and Human Services	Transitional Medicaid	196,432	248,020	444,452
Public Health and Human Services	HB -173 National Public Health Standards	200,000	200,000	400,000
Public Health and Human Services	Blind Newspaper	323,000	0	323,000
Public Health and Human Services	Transportation for Senior Citizen and Persons with Disabilit	300000		300,000
Other	Health Information Technology	357,000	357,000	714,000

Other	Permitting and Compliance Div Admin	359,794	367,918	727,712
Other	Permitting and Compliance Div Admin 09	101,500	0	101,500
Infrastructure local	Fort Belknap Water Compact	1,000,000		1,000,000
Infrastructure local	Blackfeet Water Compact	4,000,000		4,000,000
Infrastructure local	Water Project Admin	230,000	230,000	460,000
Other	Self Help Law Program	250,000	250,000	500,000
Education	Community College Assistance OTO (Infra)	137,944	113,299	251,243
Education	Community College Assistance	606,189	671,586	1,277,775
Education	PBS Satellite Delivery	200,000	200,000	400,000
Education	Ag Exper Station Add'l Funding - Sawfly	250,000	250,000	500,000
Education	Extension Service Add'l Funding	150,000	150,000	300,000
Education	Distance Learning	1,000,000	1,000,000	2,000,000
Education	Virtual Academy	1,000,000	1,000,000	2,000,000
Education	Tuition Mitigation for Resident Students	3,154,033	2,506,230	5,660,263
Education	Tribal College Assistance	450,000	450,000	900,000
Education	Special Ed Maintenance of Effort FY 2009	1,233,764	1,233,764	2,467,528
Education	Montana Learning center	50,000		50000
Education	Special Needs Equipment - School for the Deaf and Blind	34,507	18,000	52,507
Infrastructure local	Regional Water System	4,000,000	4,000,000	8,000,000
Infrastructure local	TSEP Infrastructure	11,500,000	11,500,000	23,000,000
Infrastructure local	Water Projects	2,074,398	2,074,398	4,148,796
Infrastructure local	Reclamation Projects	897,133	897,133	1,794,266
Infrastructure local	School Facilities HB 152 - Commerce	84,000	0	84,000
Infrastructure local	Grants for School Districts	20,000,000		20,000,000
Infrastructure local	Quick Start Energy Program Grants to School Districts	14,950,000		14,950,000
Infrastructure local	Interoperability Montana	500,000	500,000	1,000,000
Infrastructure state	LRBP Transfer	1,792,586	1,792,586	3,585,172
Infrastructure state	State Energy Conservation Repayment Account Transfer	750,000	750,000	1,500,000
Infrastructure state	State Energy Conservation Capital Project Account Transf	750,000	750,000	1,500,000
Infrastructure state	LRBP Allocation	7,248,486	6,544,914	13,793,400
Infrastructure state	MUS Energy Conservation Improvements	6,150,000	6,150,000	12,300,000
Infrastructure state	UMWestern Main Hall	3,000,000	3,000,000	6,000,000
Infrastructure state	ESSC Equipment and Moving	1,750,000	1,750,000	3,500,000
Infrastructure state	SOS Information Management System	750,000	750,000	1,500,000
	Total	154,558,776	95,260,620	249,819,396

Appendix B: Appropriations as a Percent of Present Law, 2011 Beinnium



Source: MBPC calculations based on Legislative Fiscal Division, 2011 Biennium Report
Please note that Department of Commerce numbers are not depicted to scale.