

MONTANA TAXPAYER



MONTANA TAXPAYERS ASSOCIATION

HELENA, MONTANA

Volume 42

Number 8

December 2008

Important Dates (*legislative dates subject to change*)

January 5 – 61st Legislative Session Begins
January 5-6 – Business Days at the Capitol–Montana Chamber
January 16 – Last Day to Request General Bills
January 24 – Last Day to Request Revenue Bills
February 16 – Last Day for Committee to Request General Bills
February 26 – Transmittal of General Bills to Other Chamber
February 27-28 – Transmittal Break
March 18 – Transmittal of Revenue Estimating Joint Resolutions
March 20 – Last Day for Committee to Request Revenue Bills
March 26 – Transmittal of Appropriation Bills
March 31 – Transmittal of Revenue Bills
April 2 – Transmittal of Amendments to General Bills
April 4 – Last day to request Study Resolution or Committee Bills to implement HB2
April 14 – Transmittal of amendments to Appropriation Bills
April 16 – Transmittal of amendments to Revenue Bills and Revenue Est. Jnt. Res.
April 20 – Transmittal of Interim Study Resolutions
April 25 – Sine Die

Election of the Board of Directors

We are pleased to announce the following members who will serve as the board of directors of the Montana Taxpayers Association for 2008 – 2009.

Automobiles – Tom Rolfe, Helena
Cable – Mark Baker, Helena
CPA's – Dwaine Iverson - Shelby
Cooperatives – Doug Hardy, Livingston
Chair - Director at Large – Rick Hays, Helena
Director at Large – Walter McNutt, Sidney
Director at Large – Barbara Ranf, Helena
Farm Machinery – Gordon Nelsen, Conrad
Farm & Ranch – Nancy Schlepp, Bozeman
Gas & Electric – John Fitzpatrick, Helena
Healthcare – Mike Foster, Billings
Ind. Power Producers - David Hoffman, Helena
Insurance – Frank Cote, Helena
Legal Profession – Louise Galt, Martinsdale
Manufacturing – Susan Knedler, Lewistown
Natural Resource/Energy – Russ Ritter, Helena
Railroads – Troy Taylor, Texas
Recreation Industry – George Willett, Neihart

Retail – Bill Simkins, Bozeman
Sheep & Wool – Chase Hibbard, Helena
Technology – Ernie Kindt, Butte
Telecommunications – David Gibson, Helena
Vice Chair - Utilities – Tom Ebzery, Billings
Wood Products – Henry Ricklefs, Whitefish

Overview of the 2009 Session

The association will begin our legislative updates beginning in January. If you are not currently receiving emails from us, please email your contact information to phyatt@montax.org. You will also be able to find important updates on our website: www.montax.org.

If you have comments or concerns about specific legislation, please do not hesitate to contact us.

Montana Taxpayer Legislative Staff

This session, the Montana Taxpayers Association will have two professionals assisting us in the session.

Curt Nichols will be reviewing budget and expenditure bills with emphasis on school funding. He worked 16 years for the Legislative Fiscal Division progressing to acting director. Following that he worked for 14 years in the Executive budget office as assistant budget director. Since retiring in December 2003, he has worked on numerous research projects for the Montana Taxpayers Association, worked with the Senate Minority (Republican) office during legislative sessions and more recently with the Montana Public Policy Institute. He has a masters degree in economics from the University of Montana.

Don Hoffman will be helping with tax legislation during the session. He is a life-long Montanan who was raised in the Helena area. He attended East Helena and Helena schools. Don is a graduate of the University of Montana with a degree in accounting.

After graduation from college Don worked for an international construction company as an accountant for a short period of time before returning to Montana to work for the Department of Revenue for 29 years.

Montana Taxpayer

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OFFICERS AND STAFF

RICK HAYS, Helena....Chairman, Board of Directors
 MARY WHITTINGHILL, Helena....President
 PAM HYATT, Helena....Office Manager

DIRECTORS

Automobiles – Tom Rolfe, Helena	Insurance – Frank Cote, Helena
Cable – Mark Baker, Helena	Legal Profession – Louise Galt, Martinsdale
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During his career Don worked in all the major tax areas in the Department, including valuing centrally assessed property, corporation and income tax and spent a significant portion of his career in the Department working in the natural resource tax area.

Don was appointed by Governor Schwinden as Montana's delegate to the U.S. Department of the Interior's Royalty Management Advisory Committee and served two consecutive two year terms from 1985 through 1989, serving as the Chairman during the last year.

Don was instrumental in efforts to simplify and consolidate various natural taxes, implementing and managing compliance efforts in various taxes, he served in several management roles in the Department and spent countless hours working with local government officials and legislators throughout his tenure at Revenue on various issues related to taxation. Don was appointed Acting Director of the Department of Revenue by Governor Martz in March of 2004.

Recently Don has been working part-time for a computer software company that provides tax administration systems to tax agencies all over North America and the Caribbean.

2011 Biennium Revenue Preview

At the November 17th meeting, of the Revenue and Transportation Interim Committee, the State biennial budgeting process began with the initial setting of

revenue estimates for the state fiscal years 2009, 2010 and 2011. These estimates are incorporated into HJ2 (House Joint Resolution) which winds its way through the 90 day legislative session from January through April always providing the official estimate of funds available from “current law” revenues. Current law means those revenues that would continue to be received without legislative action and excludes any revenue legislation which may be passed during the session.

The Revenue and Transportation committee was presented with revenue estimates for the general fund and selected other funds by legislative staff (LFD) and the governor's budget office (OBPP). These offices differed by only \$18 million or one-third of one percent on the total general fund for the three years as shown below. The committee chose to use the estimates provided by legislative staff which was the lower of the two. Subsequently, in mid December the governor's budget office reduced estimates as shown in the table.

General Fund Revenue Estimates
(\$billions)

	LFD	OBPP	Difference	OBPP revised
FY2009	1.92	1.92	0.00	1.91
FY2010	1.87	1.87	(0.01)	1.82
FY2011	1.94	1.96	0.02	1.89
Total	5.73	5.75	0.02	5.62

The resolution, HJ2, also identifies the general fund balance at the end of FY08 which is \$433 million. Since appropriations for FY2009 are already known the only remaining pieces of the puzzle to determine what is available for the legislature's spending in the next session is how much will supplemental appropriations be and how much does the legislature wish held in reserve. The following table shows \$4.11 billion available for the 2011 biennium. Costs of continuing current programs in FY2010 and FY2011 with adjustment for growth in usage/enrollments (**present law**) have been projected by legislative staff to be \$3.74 billion. If reserves, as recommended by legislative staff, are held at \$178 million there will be \$190 million available for new spending or tax relief.

State General Fund Estimates
(\$billions)

FY2008 ending fund balance		0.43
Revenue		
FY2009	1.91	
FY2010	1.82	
FY2011	1.89	
Total Revenue		5.62
Currently authorized disbursements		
FY2009 appropriations ¹	(1.94)	
Anticipated supplementals and emergencies ²	(0.00)	
Total FY2009 disbursements		(1.94)
Available for FY2010 & 2011		4.11
Estimated cost of continuing current programs ²	(3.74)	
Suggested reserves ³	(0.18)	
Current Programs and reserves		(3.92)
Available for new expenditures in FY10 & FY11		0.19

¹Schweitzer 12/15/2008 revised budget

²Legislative Fiscal Division "Big Picture" report October 2008

How accurate are these revenue estimates typically? Averaged over a long period of time they are accurate within a few percentage points however in the three year

time periods they address they have shown considerable error missing especially widely in years of change like the recession of 2001 and the rapid growth in the recent years. In November of 2004 the committee set estimates for FY2006 and FY2007 of \$1.43 billion and \$1.47 billion respectively. Actual revenues for FY2006 were \$1.71 billion, 20 percent higher; and for FY2007 were \$1.83 billion, higher by 25 percent. As the economy sinks into recession will the revenue estimates currently made for 2009-2011 prove overly optimistic?

The relatively large fund balance, \$433 million, available at the end of fiscal year 2008 allows continuation of current programs, maintenance of suggested reserves and the availability of \$190 million for new expenditures/tax relief or holding higher reserves against further deterioration in revenues. However, when the revenues for FY2010 and 2011 of \$3.71 billion are compared to the \$3.74 billion estimated cost of continuing current programs, prudence would dedicate the \$190 million to increasing reserves or for one-time spending. The revised governor's budget does a little of both, proposing \$55 million for one-time projects and increasing reserves by \$117 million.

2011 Biennium Budget Preview

Governor Schweitzer released his budget for the 2011 biennium (July 1, 2009-June 30, 2011) in mid November and subsequently revised it in mid December. The budget proposes to spend \$3.8 billion general fund and nearly \$11 billion total funds in the two year period. The general fund budget commits \$3.7 billion to ongoing expenditures, those that are expected to continue into the future, and \$57 million for one-time items. This compares to Governor Schweitzer's budget proposed in November 2006 for the current 2009 biennium to spend \$4.0 billion of which \$3.5 billion was ongoing and \$500 million one-time.

The governor's budget estimates 2011 biennium general fund revenues, after mitigating the impact of property reappraisal, at \$3.7 billion. This is approximately enough to cover the ongoing spending request. The ability to match ongoing revenues with ongoing expenditures provides a "structural balance" and suggests the budget is sustainable in future years without tax increases. One-time spending is supported by the estimated general fund reserve on June 30, 2009 of \$367 million.

The governor's budget will be modified by the legislature convening in January 2009 and scheduled to adjourn near the end of April. Legislative revenue estimates are embodied in a resolution which is considered and revised as the session proceeds. On adjournment the legislative appropriations become the budget and are balanced with the legislative revenue estimate and any revenue legislation enacted. If,

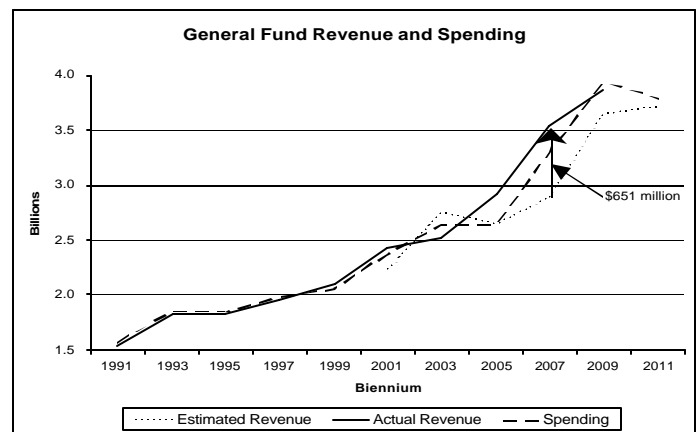
because of the worsening recession, revenue estimates are revised downward by the legislature it will be necessary to make reductions to ongoing expenditures proposed by the Governor or increase taxes or other ongoing revenues to avoid an unsustainable "structural deficit".

This brief perspective of state revenues and expenditures from the 2005 biennium to the Governor's budget for the 2011 biennium focuses on the General Fund.

I. Rapid revenue and spending growth is seen coming to an end.

The period from the 2005 to 2011 has witnessed a dramatic increase in state general fund budgets, revenues and expenditures. Revenue estimated for the 2011 biennium increased \$1.1 billion from the 2005 biennium estimates. Proposed spending in the 2011 biennium budget is \$1.2 billion higher than 2005 biennium expenditures and in the governor's budget for the 2011 biennium will exceed estimated revenues. Spending can exceed revenues because, as shown in the graph below, actual revenues have significantly exceeded estimated revenues over the last three biennia generating reserves which can be drawn upon in the subsequent biennium.

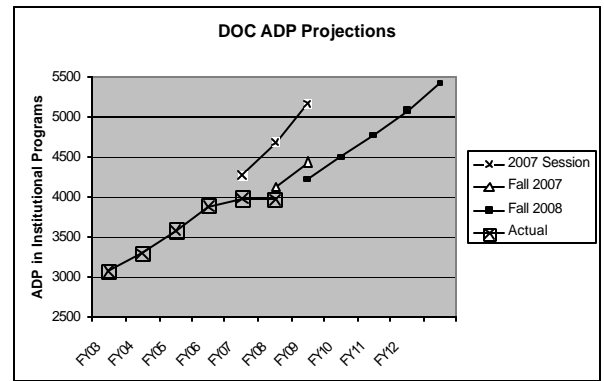
The graph shows a small drop in expenditures for the 2011 biennium as the growth in revenues is estimated to flatten. As mentioned earlier the reduction in spending growth is accomplished by a significant fall in one-time spending and continued growth in ongoing commitments.



The graph above indicates revenues during this period were consistently underestimated even though estimates were raised significantly. The underestimates in revenue for the 2005, 2007 and 2009 biennia were cumulatively \$1.13 billion and peaked with the 2007 biennium revenues exceeding estimates by \$651 million. These underestimates contributed to significant growth in general fund reserves as biennial expenditure budgets were based on revenues estimated during the legislative session preceding the biennium. Special legislative sessions in 2005 and 2007 and supplemental appropriations each biennium depleted a portion of the

rapidly rising reserves. The remaining general fund reserves then allowed appropriations to exceed estimated revenues in the 2007, 2009 and Governors budget for 2011 biennia.

The most rapidly increasing revenues are coal, gas, oil and mines and corporate income taxes. The oil revenues are driven by the development of a new field and sharply higher prices. Expenditures have been increasing most significantly for natural resources and corrections and public safety. The table on the following page shows the numbers and charts are attached following the report.



	2005 biennium	2011 Biennium	05-11 biennium	% Change
Revenue				
Personal Income Tax	1,136,121,000	1,702,668,000	566,547,000	49.9%
Property Tax	348,207,000	451,916,000	103,709,000	29.8%
Corporation Income Tax	133,807,000	285,645,000	151,838,000	113.5%
Vehicle Tax and Fees	224,101,000	225,047,000	946,000	0.4%
Coal, Oil, Gas and Mines	122,041,000	298,079,000	176,038,000	144.2%
Alcohol, Tobacco and Gambling	225,819,000	319,951,000	94,132,000	41.7%
Other revenues	455,799,000	428,051,000	(27,748,000)	-6.1%
Total Revenue	2,645,895,000	3,711,357,000	1,065,462,000	40.3%
Expenditures				
General government	107,017,468	183,540,921	76,523,453	71.5%
Health and Human Services	536,970,199	818,791,514	281,821,315	52.5%
Natural Resources	42,929,270	63,127,887	20,198,617	47.1%
Corrections and Public Safety	310,704,702	528,443,106	217,738,404	70.1%
K12 and other Education	1,043,624,597	1,395,361,447	351,736,850	33.7%
Higher Education	278,514,996	366,799,703	88,284,707	31.7%
Pay Plan		18,600,000	18,600,000	NA
Other	296,437,000	411,613,000	115,176,000	38.9%
Total Expenditures	2,616,198,232	3,786,277,578	1,170,079,346	44.7%

II. Major government caseloads grow more slowly than expenditures.

The major factors driving the general fund budget show varying growth from 2005 to 2011. The estimated corrections institutional populations are up 33 percent and public school enrollment is down slightly. Expenditure growth has been much higher than combined caseload and CPI inflation rates would suggest. Estimates have not been received for 2011 biennium caseloads of major public assistance programs such as TANF, Medicaid and CHIP. Through 2008 TANF and Medicaid caseloads have fallen 35% and 17% respectively from 2005. CHIP caseloads increased 52% from 2005 thru 2008.

Selected Growth Rates 2005 to 2011

Montana Population	6.5%
CPI	18.0%
Public School ANB	-1.1%
University FTE resident enrollment	1.7%
Corrections institutional ADP	33.1%

In the past the estimates of higher education and public school enrollments, which grow relatively slowly, have been fairly reliable however corrections population estimates have been consistently high as illustrated in the following chart.

III. Using one-time appropriations to maintain “structural balance” becoming less significant

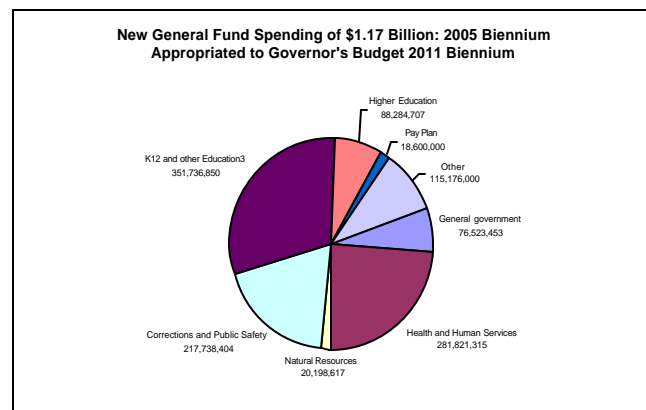
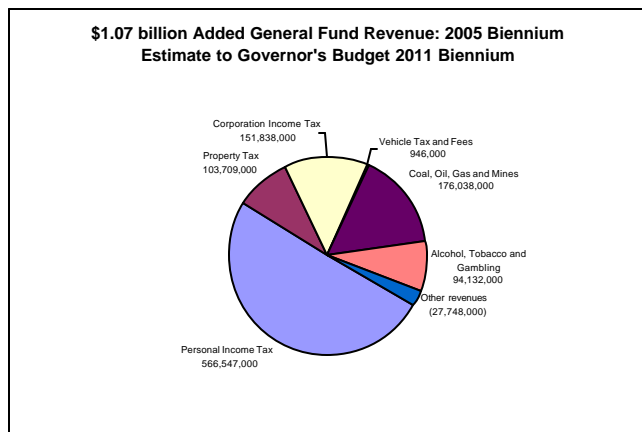
In simple terms a structural balance occurs when ongoing spending commitments are covered by revenue expected to be produced from the current tax structure. Failure to achieve a structural balance means unresolved problems are being put off to the future – either new revenue will have to be found or programs will have to be cut or eliminated. The availability of a one-time surplus coupled with demands to incorporate these funds into ongoing commitments creates pressure for a structural deficit. In the past similar circumstances have led to structural deficits.

One-time surpluses are generated when revenues exceed estimates or appropriations based on those estimates. As cited above the cumulative underestimate of revenues by \$1.14 billion in recent biennia have created substantial one-time surpluses. The administration and legislature have used one-time appropriations to drawdown these one-time surpluses. In the current 2009 biennium one-time appropriations exceeded \$571 million. These are budgeted to decline to \$55 million in the governor’s 2011 biennium budget as revenue estimates level off and a \$2956 million reserve is targeted. The \$295 million reserve is \$249 million above the \$46 million reserve targeted for the 2005 biennium. The major one-time appropriations of the 2007, 2009 and 2011 biennia are listed below.

Major One-Time Appropriations

	\$millions
State building program	256
Government employee retirement systems support	175
\$400 property tax rebate	100
Create Fire suppression fund	40
One-time school aid in 2005 special session	34
Elimination of water adjudication fee	25
Blackfeet Tribe water rights	15
Full time kindergarten start-up	10

State Revenue and Expenditure Charts



Montana Public Employee Pension Systems in FY2008

At the October 10th meeting of the Legislative Finance Committee, Jon Moe of committee staff presented a summary of the actuary reports for fiscal years 2006 through 2008 showing the funded status of each of the retirement funds. This report indicates that by fiscal year end 2008 all but the Teachers Retirement System met the constitutional and statutory 30 year amortization requirement¹. Aware that stock markets were continuing to fall in the first few months of fiscal year 2009, the committee expressed concern about the prognosis for these funds in the future.

Carroll South, Executive Director of the Montana Board of Investments, advised that a long term view was important and stated the markets will hit bottom and the retirement funds will stay in. He illustrated that while investment returns have fluctuated they have exceeded the actuary assumptions from fiscal years 1994 through

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http://leg.mt.gov/content/Publications/fiscal/interim/financecm ty_oct2008/2008_ValuationRetirement.pdf

2008². He also pointed out that only by investing in stocks can the Board of Investments achieve the long term gains required to meet the growth assumed by actuaries.

In fiscal year 2008 Montana government retirement fund investments lost \$393 million. Investments are assumed to grow 8 percent³ per year by actuaries in projecting the ability of retirement funds to meet their future obligations to pay retirement benefits. This means these investments should have gained approximately \$640 million on the \$8 billion of assets in the retirement funds. The over \$1 billion gap (\$640+393) in investment income will be phased-in to calculations of retirement fund valuations over a four year period. Fortunately, investment returns in fiscal year 2007 were strong, at \$1.24 billion, which allowed the retirement funds to meet the requirement of amortizing their unfunded liability in less than 30 years⁴ and provide partial offsets to the 2008 shortfall.

Taxpayer risk - good years lead to increased benefits

The late 1990s witnessed the expansion of retirement benefits as the double digit growth of investments in the tech boom of the 1990's raised the actuarial soundness of the retirement funds. Rather than hold the gains for future hard times, benefit expansions were enacted including post retirement guaranteed annual benefit adjustments (GABA). These GABAs were initially set at 1.5% applicable after the third year of retirement and increased to 3% applicable after the first year of retirement. Fiscal notes given to the legislature on enactments indicated little or no additional employer contributions were required as the costs could be absorbed.

Benefit increases, once added, become guaranteed to all employees participating in the retirement system at the time and those hired while they are in effect. In contrast, benefit reductions can only be applied to new hires. Since benefit increases apply to all current employees, benefit increases have a large impact on costs while reductions are much slower to impact savings.

Taxpayer risk – bad years lead to increased employer contributions

The bursting of the dotcom bubble and subsequent recession in 2001 left the state retirement programs

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http://leg.mt.gov/content/Publications/fiscal/interim/financecm ty_oct2008/Pension Plan_CS.pdf

³ 7.75% for Teachers Retirement System

⁴ The requirement generally regarded necessary to meet the constitutional mandate in Article VIII Section 15 and codified in 19-2-409, MCA.

actuarially unsound and exposed the risk being borne by the state's taxpayers for these defined benefit retirement systems. The response was injection of \$175 million of cash, raising employer contributions by \$21 million annually⁵ and adjustments to retirement benefits for new hires. Fiscal year 2009 is off to an uncertain start as markets are down and forecasts that the recession of 2008 will continue thru mid 2009 are common. If 2009 brings good investment returns, the funds may once again become stable. However, if investments underperform the target rates of 8 percent, the funds may remain or become more unsound and require increased employer (taxpayer) contributions, one-time injections of cash and benefit reductions for new employees. The state fortunately had a large surplus available to provide the \$175 million cash appropriations in December 2005 and April 2007. The state has a much smaller surplus available for appropriation in the 2009 legislative session and the needs of the retirement systems will not likely be clear until later, possibly after the surplus is expended.

Reality Check

On June 30th, the end of state fiscal year 2008, the S&P500 index stood at 1280. The index fell to 752 on November 20. If this represents the low for the current recession and stocks bounce back 32 percent, the average in the 9 months following the S&P500 low experienced in the ten recessions since World War II, the index will show a net decline of 22.4 percent for fiscal year 2009. Given the mix of equities and fixed investments held by retirement funds this would point to a 12.7 percent loss for the retirement funds in 2009 or over \$800 million dollars. Set against the actuarially expected gain of 8 percent, the total shortfall would approach \$1.4 billion. Such a gap on the heels of the 2008 shortfall of over \$1 billion would likely drive all

retirement funds into actuarial unsoundness and may trigger requests for increased employer contributions, cash infusions and reduced benefits for new hires.

Retirement fund investments growing the 8 percent expected in fiscal year 2009 would imply an S&P500 of 1395 by the June 30th 2009. This would be an increase of 86 percent from the November 20 low. Not once in the ten recessions since WWII has the S&P500 risen this much in less than a year following a recession low. It will take extraordinary markets the remainder of 2009 to avoid another shortfall to the retirement funds.

Based on past practice it appears the state is not required to act immediately to increase contributions or inject cash into the retirement funds when actuaries calculate the unfunded liabilities will not be amortized in less than 30 years. In fiscal years 2004-2006 the funds could not meet this requirement yet funds were not added until fiscal year 2006. This reflects the reality that equity markets tend to rise and fall over extended periods. Funding and benefit policies of the Public Employees Retirement Board and the Teachers Retirement System require the respective Boards to request legislation increasing funding when the amortization period is projected to exceed 30 years for two consecutive annual valuations. The valuations are conducted annually after the close of the fiscal year and typically available by October. If the retirement systems fail to meet 30 year requirement at the end of fiscal year 2009 (June 30th 2009) the Teachers Retirement Board may make a request while the Public Employees Retirement Board would not pass the threshold requirement until the end of fiscal year 2010. Such a scenario would have requests first appearing before the legislature in the 2011 session. If action is delayed too long the response is biased in favor of increased employer (taxpayer) contribution because increases in employer contributions are immediate while benefit reductions can only be applied to new employees and are therefore slow to reduce the unfunded liability.

⁵ When fully implemented in 2011. From fiscal notes for HB63 and HB131.