

# MONTANA TAXPAYER



MONTANA TAXPAYERS ASSOCIATION

HELENA, MONTANA

Volume 43

Number 1

January/February 2009

## **Important Dates** (*legislative dates subject to change*)

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

## **MonTax Publications**

The *Montana Tax Digest* has just been completed and has been mailed to our members. It contains a list of all taxes, incentives, exemptions, deductions and some of the major fees and licenses. Each section has the corresponding Chapter and Section for both the citation to Montana code as well as the administrative rules.

In the next few weeks the *Montana Taxation 2008* will be completed and mailed to our members also. *Montana Taxation* contains historical expenditure and revenue information as well as detailed information on mill levies and school expenditure and student populations. Additional copies of these publications are \$15 for members and \$20 for non-members. Please email Pam at [phyatt@montax.org](mailto:phyatt@montax.org) if you have any questions.

## **2011 Biennium Budget**

One of the most difficult tasks the 2009 Legislature faces is setting the budget for the state for the 2011 Biennium. The economic downturn in the U.S. and the World economies has been well documented in the news, and how long and how significant the economic downturn is being debated by economists daily.

As we reported in the December newsletter the budgeting process began in November with the Revenue and Transportation Interim Committee (RTIC) adopting an initial set of general fund revenue estimates for the state for the fiscal years 2009, 2010 and 2011. These are now incorporated into HJ2 (House Joint Resolution) which will wind its way through the legislative session from January through April and will provide 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 that might be passed during the session.

The Legislative Fiscal Division (LFD) assists the Legislature in developing the general fund revenue estimates, including the November RTIC revenue estimates, based upon various economic conditions and trends observed at the time of the estimates. Since the adoption of the RTIC revenue estimates, the LFD has continued to review the data and has revised the revenue estimates downward twice. The LFD’s first revision in December was \$135 million less than the general fund revenue contained in HJ2 adopted in November. In January the LFD did an additional analysis and reduced the estimate another \$85 million for a total reduction of \$220 million for the three year period.

## **What New Information Does LFD Have?**

Each month, the Legislative Fiscal Division (LFD) receives a revised national economic outlook from IHS Global Insight (IHS). This is the economic forecasting company that Montana has a contract with to provide national and regional economic forecasting services. This service includes written material as well as a variety of economic forecasts for “hundreds” of economic variables. The information received from IHS in early January reflects their forecasts as of December 2008.

The statewide budgeting and accounting system (SABHRS) produces a “snapshot” of accounting transactions on the last day of each month. The LFD has internal computer processes to download this data and produce a variety of reports and spreadsheets. While this

# Montana Taxpayer

Address all communications to:  
MONTANA TAXPAYERS ASSOCIATION

P.O. BOX 4909, HELENA, MT 59604

Telephone (406) 442-2130

FAX (406) 442-1230

Web Site – [www.montax.org](http://www.montax.org)

E-mail – [mwhitt@montax.org](mailto:mwhitt@montax.org)

[phyatt@montax.org](mailto:phyatt@montax.org)

Business Office: 506 North Lamborn



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Wood Products – Henry Ricklefs, Whitefish

data is critical in monitoring year to date collection trends; this system does not contain any tax return or economic information such as individual and corporate income components, oil and gas production, and prevailing interest rates. This type of detailed data must be extracted from other sources provided the information is available. The accounting transaction detail that is available to the LFD reflects revenue collections through December 2008. Historical collection data by month is available back to FY 2000.

The LFD, in cooperation with the Department of Revenue (DOR), developed a process whereby the DOR sends the LFD tax return data for fifty different tax types at the beginning of each month. This data is extremely helpful in analyzing various trends that may be occurring within a given tax type. For example, the DOR data shows oil production by calendar quarter as reported by the taxpayer. This data is invaluable in tracking production trends throughout the year. It should be noted, however, that since oil production taxes are payable sixty days after the end of quarter, there is a considerable lag time before the LFD can analyze the data. Nonetheless, this new data was received January 1 and included return information captured in the DOR system as of December 31, 2008.

During each month, there are numerous articles and economic reports that are produced by newspapers, economic websites, and federal entities. To the extent possible, this information is reviewed for relevancy to Montana's economy and the impact it may have on state revenues. Usually this information is for reference and

does not necessarily have a quantifiable impact on the revenue outlook. This type of information is received daily throughout the month.

Based on this new information, the following section of the report highlights an analysis of the new data and summarizes the impacts on the general fund revenue estimates for FY 2009, 2010, and 2011.

## RESULTS OF LFD ANALYSIS

The primary components of total general fund revenues are individual and corporate income taxes, property taxes, investment earnings, and natural resource taxes. If all of these components are added together, almost 75 percent of total general fund revenues are produced from these sources. The analysis included in this report is focused on selected components of individual and corporate income tax, property tax, investable balances and interest rates, and commodity prices (oil, gas, metals). The remaining sources of general fund revenue are fairly stable and are not subject to the same wide variations as the major sources mentioned above.

### Individual Income Tax

Individual income tax assumptions for selected income components were analyzed based on new IHS data. These components were wage and salary, capital gains, interest, dividend, rent, royalty and partnership incomes. The consumer price index forecasts of IHS were also reviewed. Based on this data, the individual income tax estimates are shown in Figure 1. The estimates as adopted by RTIC on November 18 (HJ2) and the LFD recommendations developed in December are shown for reference. The change amount is calculated by comparing the HJ2 estimate with the January LFD analysis. A negative number means the new estimate is below the amount contained in HJ2.

Figure 1

Individual Income Tax (in millions)		Estimated	Estimated	Estimated	Estimated
Month	General Fund Revenue Estimate	FY 2009	FY 2010	FY 2011	3 Year Total
November	Rev. & Transportation Committee (HJ2)	\$871,655	\$884,954	\$908,994	\$2,665,603
December	LFD Recommendation	854,823	856,291	880,781	2,591,895
January	LFD Analysis	851,275	839,182	860,512	2,550,969
	Change Amount (HJ2 to LFD Analysis)	(\$20,378)	(\$45,745)	(\$48,482)	(\$114,605)

### Corporation Income Tax

Corporation income tax assumptions for selected economic variables were analyzed based on new IHS data. These variables were consumer consumption expenditures, US pre-tax profits, financial sector data (loans, interest rates, etc.) and commodity prices. Based on this data, the corporation income tax estimates are shown in Figure 2. The estimates as adopted by RTIC on November 18 (HJ2) and the LFD recommendations developed in December are shown for reference. The change amount is calculated by comparing the HJ2 estimate with the January LFD analysis. A negative number means the new estimate is below the amount contained in HJ2.

Figure 2

Corporation Income Tax (in millions)		Estimated	Estimated	Estimated	Estimated
Month	General Fund Revenue Estimate	FY 2009	FY 2010	FY 2011	3 Year Total
November	Rev. & Transportation Committee (HJ2)	\$156,132	\$136,293	\$149,352	\$441,777
December	LFD Recommendations	154,838	125,911	133,674	414,423
January	LFD Analysis	150,740	118,115	128,571	397,426
Change Amount (HJ2 to LFD Analysis)		(\$5,372)	(\$17,178)	(\$20,781)	(\$43,531)

### Oil and Gas Production Tax

Both oil and gas production and price assumptions were analyzed based on new IHS and DOR data. Based on this data, the oil and gas production general fund estimates are shown in Figure 3. The estimates as adopted by RTIC on November 18 (HJ2) and the LFD recommendations developed in December are shown for reference. The change amount is calculated by comparing the HJ2 estimate with the January LFD analysis. A negative number means our new estimate is below the amount contained in HJ2.

Figure 3

Oil & Gas Production Tax (in millions)		Estimated	Estimated	Estimated	Estimated
Month	General Fund Revenue Estimate	FY 2009	FY 2010	FY 2011	3 Year Total
November	Rev. & Transportation Committee (HJ2)	\$116,771	\$100,066	\$105,177	\$322,014
December	LFD Recommendations	106,690	84,323	102,825	293,748
January	LFD Analysis	96,342	69,921	94,193	260,456
Change Amount (HJ2 to LFD Analysis)		(\$20,429)	(\$30,145)	(\$10,784)	(\$61,358)

Total production is expected to decline significantly, over thirty percent from calendar 2007 to estimated calendar 2011. This trend is based on tax return data for the first three quarters of calendar 2008 compared to the same period of calendar 2007. With the outlook for prices to remain well below previous levels and the limited number of oil rigs in Montana, the probability of this production decline abating is very low.

Montana oil prices are expected to average slightly over \$30 per barrel during calendar 2009. While staff has received several comments about Montana oil selling for far less than this amount, it should be pointed out that this is an average price for all grades of oil and represent an average price for the entire calendar year. Oil prices are expected to edge upward in calendar 2010 and 2011 as the nation begins to recover from the economic recession.

### US Mineral Royalty

The adjustment to the US mineral royalty estimate is the result of the changes in the assumptions for oil and gas production and price. Based on this data, the US mineral royalty estimates are shown in Figure 3. The estimates as adopted by RTIC on November 18 (HJ2) and the LFD recommendations developed in December are shown for reference. The change amount is calculated by comparing the HJ2 estimate with the January LFD analysis. A negative number means our new estimate is below the amount contained in HJ2.

Figure 3

US Mineral Royalties (in millions)		Estimated	Estimated	Estimated	Estimated
Month	General Fund Revenue Estimate	FY 2009	FY 2010	FY 2011	3 Year Total
November	Rev. & Transportation Committee (HJ2)	\$28,259	\$31,518	\$32,505	\$92,282
December	LFD Recommendations	26,311	29,641	32,113	88,065
January	LFD Analysis	24,953	28,457	32,861	86,271
Change Amount (HJ2 to LFD Analysis)		(\$3,306)	(\$3,861)	50,356	(\$6,011)

### Metalliferous Mines Tax

The metalliferous mines tax was adjusted to reflect the significant drop in several metal prices. Reductions in the price estimates were made for the following commodities: copper, silver, lead, zinc, platinum, palladium, and molybdenum. Adjustments for calendar 2008 prices were based on return data for the first six months combined with estimated prices for the remainder of calendar 2008. Estimates for calendar 2009 through 2011 were based on current prices. Based on this data, the metalliferous mines tax estimates are shown in Figure 4. The estimates as adopted by RTIC on November 18 (HJ2) and the LFD recommendations developed in December are shown for reference. The change amount is calculated by comparing the HJ2 estimate with the January LFD analysis. A negative number means our new estimate is below the amount contained in HJ2.

Figure 4

Metalliferous Mines Tax (in millions)		Estimated	Estimated	Estimated	Estimated
Month	General Fund Revenue Estimate	FY 2009	FY 2010	FY 2011	3 Year Total
November	Rev. & Transportation Committee (HJ2)	\$9,854	\$8,085	\$8,066	\$26,005
December	LFD Recommendations	8,666	5,294	5,278	19,238
January	LFD Analysis	6,777	3,248	3,279	13,304
Change Amount (HJ2 to LFD Analysis)		(\$3,077)	(\$4,837)	(\$4,787)	(\$12,701)

### Treasury Cash Account Interest

The treasury cash account interest estimate is impacted by the underlying assumptions for short-term interest rates and cash available for investment. Short-term interest rates as estimated by IHS are at historical low levels for calendar 2009 with a modest improvement in 2010 and a return to a more normal rate by calendar 2011.

After a review of current investment income and the average daily cash balance in the treasury cash account, the average cash balance was adjusted upward to reflect the current trends as well as the legislature's desire to maintain an ending fund balance consistent with the level recommended by the executive branch. Based on this data, the treasury cash account interest estimates are shown in Figure 5. The estimates as adopted by RTIC on November 18 (HJ2) and the LFD recommendations developed in December are shown for reference. The change amount is calculated by comparing the HJ2 estimate with the January LFD analysis. A positive number means the new estimate is above the amount contained in HJ2.

Figure 5

Treasury Cash Account Interest (in millions)		Estimated	Estimated	Estimated	Estimated
Month	General Fund Revenue Estimate	FY 2009	FY 2010	FY 2011	3 Year Total
November	Rev. & Transportation Committee (HJ2)	\$11,107	\$10,185	\$19,381	\$40,673
December	LFD Recommendations	9,341	8,905	19,265	37,711
January	LFD Analysis	10,341	11,178	25,124	52,643
Change Amount (HJ2 to LFD Analysis)		\$8,234	\$0,993	\$8,743	\$11,970

**Property Tax**

Since the RTIC meeting in November, revised property tax values from DOR were received for FY 2009. These new values were incorporated into the estimates. In addition, two court cases were resolved that impacted property tax estimates. NorthWestern settled its case with the state and the Montana Supreme Court ruled in favor of Omimex over the proper classification of its pipeline properties. The impacts of these cases have been incorporated into the estimates. Based on this data, property tax estimates are shown in Figure 6. The estimates as adopted by RTIC on November 18 (HJ2) and the LFD recommendations developed in December are shown for reference. The change amount is calculated by comparing the HJ2 estimate with the January LFD analysis. A positive number means our new estimate is above the amount contained in HJ2.

Figure 6

Property Tax (in millions)		Estimated	Estimated	Estimated	Estimated
Month	General Fund Revenue Estimate	FY 2009	FY 2010	FY 2011	3 Year Total
November	Rev. & Transportation Committee (HJ2)	\$211,495	\$222,983	\$228,935	\$663,411
December	LFD Recommendations	214,615	226,382	230,365	671,360
January	LFD Analysis	214,615	225,628	229,438	669,671
Change Amount (HJ2 to LFD Analysis)		\$3,120	\$2,645	\$0,495	\$6,260

**Summary of LFD Analysis**

Based on the above analysis of the new data received from all the sources mentioned previously, the information indicates that total general fund revenue estimates could be overstated by \$220 million as compared to the revenue estimates contained in HJ2, shown in Figure 7. A majority of this amount is due to the change in the underlying assumptions for individual income tax, corporation income tax, and oil and gas production tax.

The LFD estimates used for the pre-session budget analysis were \$135 million below the RTIC November estimate. This revised analysis shows an additional \$85 million below the RTIC estimates for a total change of \$220 million.

Figure 7

Totals For Selected Sources (in millions)		Estimated	Estimated	Estimated	Estimated
Month	General Fund Revenue Estimate	FY 2009	FY 2010	FY 2011	3 Year Total
November	Rev. & Transportation Committee (HJ2)	\$1,403,271	\$1,394,064	\$1,432,408	\$4,231,743
December	LFD Recommendations	1,375,394	1,336,747	1,454,299	4,116,440
January	LFD Analysis	1,361,063	1,296,736	1,374,168	4,031,967
Change Amount (HJ2 to LFD Analysis)		(\$44,208)	(\$97,328)	(\$78,240)	(\$219,776)

**The University of Montana Bureau of Business and Economic Research**

Subsequent to the issuance of the LFD updated estimates, the University of Montana’s Bureau of Business and Economic Research (BBER) provided the legislature with their 2009 Montana Economic Outlook. During this presentation Patrick Barkey from the BBER

stated many economists believe the recession we are now in will be worse than any recession since the Depression.

The Bureau has revised its projections at midyear 2008 and revised them downward again when presenting their outlook for 2009. Paul Polzin wrote **The Montana Outlook – Changing Conditions Lead to Changed Forecast:**

“Montana’s economic outlook has darkened during the past year as a national economic slowdown concentrated in a few industries (most of which aren’t important here) spread to more and more sectors (some of which are important here). The Bureau slightly lowered its forecast at midyear 2008 to account for the deterioration then present. The current forecast calls for barely positive growth in 2009 (e.g. .5 percent growth in nonfarm labor income), with modest accelerations to 2.2 percent in 2012.”

“The blows to the Montana economy include (in rough order of appearance):

- Closures and shutdowns in the wood product industry.
- Construction plummeting and real estate stalled, with Missoula housing prices now turning negative.
- Announced closing of Columbia Aluminum Company.
- Wheat prices plummet. Agriculture’s record revenue growth confined to one year.
- Plunging metal prices lead mines to issue precautionary layoff notices.
- Announced layoffs in “high-tech” and other manufacturing industries.
- Montana’s consumer sentiment dropped matching the all-time low, probably signaling bad news for the state’s retailers.

“The biggest risks to the forecast are:

- How many of the announced layoffs actually materialize. In the mining industry, this will depend on how far commodity prices fall and whether or not they rebound.
- The financial gridlock worsens. U.S. credit flows have already dried up, almost insuring a dearth of investment spending in the future.
- The depth of the U.S. recession. If the malaise continues to spread to more sectors, some of these impacts will be felt here in Montana.”

On January 28 the House Taxation Committee held a hearing on HJ2. Representative Jopek is the primary sponsor in the House of HJ2. Terry Johnson presented his latest projections which as stated above are that the general fund revenue estimate contained in the HJ2 should be reduced by the \$220 million as outlined above.

He also pointed out that the revision the LFD did in January was the third revision since October and the revenue estimate has dropped \$696 million since then. Mr. Johnson told the Committee that he is expecting additional information from Global Insight by the end of January and should have additional information then to further refine the estimates if necessary.

The Governor's Budget Director, David Ewer, was present and pointed out that the Governor had started with the RTIC revenue estimate adopted in November and then reduced his budget in December by more than \$100 million to take into account the weakening of the economy.

The Committee did not attempt to act on HJ2 until 2/5. In Executive Action an amendment was proposed to reduce the HJ2 revenue estimate by \$220 million. That motion failed on a tie vote with all Republicans voting for the amendment and the Democrats voting against it. Another amendment was proposed to reduce the revenue estimate by \$135 million that also failed on a party line vote, all Democrats voting for the amendment and all Republicans voting against the amendment. The Democrats want to wait another week until the LFD has had an opportunity to review additional information, while the Republicans were prepared to reduce the RTIC's November revenue estimate by the full \$220 million recommended by the LFD.

#### **Legislative update**

SB 36, Senator Erickson's bill on Water's-edge election (opposed), would eliminate the water's edge election for what is commonly known as an 80/20 corporation. Under existing law even if a corporation is incorporated in the U.S. and has less than 20% of its payroll and property assignable to locations inside the U.S. the income and apportionment factors can be excluded from the water's-edge combined group. Under SB 36 this exclusion would be eliminated for any corporation incorporated in the U.S. The Taxpayers Association opposed this legislation, and the bill is awaiting action in Senate Tax. We have also prepared a corporate taxation educational document and have given it to the Committee Chair.

SB 181, Senator Esp's requiring 1099S's for real estate sales (supported), has already passed the Senate 49 to 0 on second reading and passed unanimously in House Tax. This bill would require the reporting of real estate sales in Montana to the Department of Revenue on what is known as a 1099S. This is an alternative to having title and other companies from having to withhold for real estate sales of property. There were no opponents to the House Tax and the Department spoke as a proponent.

SB 211, Senator Wazenreid's bill on insurance stuffing (opposed), is the attempt of the Department to stop what is commonly known as insurance stuffing. According to

the Department, stuffing occurs when non-insurance corporations use affiliated insurance companies to shelter regular non-insurance income from taxation. Testimony by the opponents demonstrated that this is not an issue in Montana. The bill has been tabled in Senate Tax.

#### **School Funding Proposals – Quality Educator Payment**

Many of the school funding proposals this session contain increases for the Quality Educator Payment. This component was added to the school funding formula in 2005 as an attempt to address the education lobby's continued litigation in Montana's court systems. Our association has testified against these proposals as we believe this mechanism does not efficiently distribute revenue to the schools and creates distortions in hiring decisions. Our association decided to review the data to see the effect of this new component for funding on schools statewide.

A [report](#) prepared by Curt Nichols analyzed the quality educator component to determine if the original purpose of the payment was being met (the report is on our website: legislative sessions, 2009 Legislature). The stated purposes and benefits of the per-educator payment include:

- improves teacher recruitment and retention;
- provides a stable funding source independent of enrollment;
- does not increase local taxes;
- meets the needs of isolated schools;

(School Funding Status Report to Attorney General" Governor Schweitzer, Feb 8, 2008).

Curt looked at districts that would benefit from an increase of the per-educator payment vs. increasing existing entitlement components. Curt compared equal amount spent through basic and per-ANB entitlements (average number belonging which is approximately the number of students in each school district).

#### Equity

The analysis indicates the beneficiaries of the per-educator payment are much more likely to be districts with high wealth or high staffing. This is counter to most equity considerations as it helps districts who have higher ability to support spending and/or who have the most educators i.e. those who already are ahead. The per-educator payment undermines the equity provided through basic and per-ANB entitlements.

#### Stability

Between 2006 and 2008, 33 of 69 high schools with less than 200 ANB reduced their number of educators in response to enrollment declines while 2 of 16 high schools with greater than 500 ANB did so. The ANB net decline for the 200 and under group was 117 while for the 500 and over group it was 134 ANB. From these figures it appears that little stability is provided to the

group most vulnerable to the impacts of decline – small high schools. The per-educator payment for these small high schools represents a drain on resources because as they determine the need to reduce educators they are further penalized by the reduction in state aid. The same amount of state aid invested in the basic and per-ANB entitlements would remove the penalty from the decision. Increases in the basic entitlement provide aid that is not subject to enrollment either directly or indirectly.

The per-educator payment may be an obstacle when districts facing continued decline in enrollment must decide to make resource allocation adjustments to balance their budgets. When a district chooses to reduce the number of educators the amount received from the per-educator payment is reduced thereby limiting the resources that are freed for other priorities of the district. In the case of a district with increasing enrollment the decision to add teachers generates additional funds.

#### Incentives

Because the per-educator payment ties an amount to each educator it creates the incentive for the district to hire and retain more educators. It may have a negative incentive to increase salaries. If more district resources are allocated to a higher number of educators the amount available for higher pay is reduced. Also it diminishes the gain from reductions in staffing for the purpose of increasing salaries, a common approach used by districts. The short history of the payment does not provide enough data to analyze the effects of these incentives on pay and staffing levels. The perverse incentives created by the per-educator payment to

overstock educators and pay lower salaries become more severe as the payment level increases. One can see that if the per-educator payment equaled the full salary of a new teacher that from the district perspective added teachers would be free while eliminating a teacher would save nothing.

#### Summary

The per-educator payment generally fails to be the optimal approach for the goals set out for it. It does not efficiently meet the needs of small and isolated high schools neither as a better method of delivering state aid nor a stabilizing mechanism. It may increase the districts desire to retain the same number of teachers but it isn't clear that it increases the teacher's decisions to remain in a district and its affect on teacher recruitment is unclear.

Use of the per-educator as a means of distributing state aid represents an unwarranted intrusion on districts' management prerogatives. By subsidizing a district's decision to add teachers and penalizing the decision to reduce teachers it interferes with district resource allocation decisions.

The per-educator payment is a poor substitute for a true adjustment to recognize the unique problems rural and isolated schools face in hiring and retaining teachers. It does little to stabilize school funding for these schools in the face of declining enrollments. If the purpose is to stabilize funding by weakening its relationship with ANB, the per-educator payment should be replaced with approaches that more specifically target declining enrollment such as higher basic entitlements, further modification of enrollment averaging, use of the classroom unit concept or minimum fixed amounts for the smallest schools.