MANAGING VOLATILITY: BUDGET STABILIZATION

SB 261 “Budget Stabilization”

Entering into the 2017 session, lawmakers were faced with a decline in ending fund balance from over $300.0 million forecast for the end of the 2017 biennium to essentially zero forecast by the end of the 2019 biennium. Lawmakers were concerned that the application of current law allowed this substantial depletion of general fund balance prior to addressing any spending reductions. This impetus began the process of finding a better statutory method of managing volatile revenues and stabilizing the budget.

The result of this process lead to both a short term and a long term budget stabilization plan in SB 261. The short term plan created triggered appropriation reductions and transfers from the fire fund. The long term plan created a budget stabilization fund with deposit and withdrawal rules, plus a defined operating reserve level.

Short-term Triggered appropriation reductions and transfers

With the passage of SB 261, the legislature adopted a planned operating reserve of 8.3% of second year appropriations, along with triggers for additional budgetary reductions based on the actual revenues received in the general fund. These reductions limit the risk of using the operating reserve if actual revenues are below a baseline revenue projection of $2,216 million. Different levels and reductions are as follows:

SB 261 Potential Triggered Reductions
($ Millions)

Level	Revenue Triggers	Description	FY 2018	FY 2019	SB 261 Potential Reductions	Totals Per Level
1	$0-12 million below	Fire Fund Transfer to general fund (equivalent to shortfall)			($12.000)	
1.5	(<$2,216 million)	HB 17 triggered out (@ $6 million down)	(1.765)	(3.520)	(5.285)	(17.285)
2		Fire Fund Transfer			(12.000)	
2	$12-$24 million below	0.5% across the board reductions (K-12 exclusions)	(6.395)	(6.457)	(12.852)	
2	(<$2,204 million)	Reduce Old Fund Administrative costs (MCA 39-71-23-52)	(0.625)	(0.625)	(1.250)	
2		Eliminate TPA for HELP Act	(2.000)	(2.000)	(4.000)	(30.102)
3		Fire Fund Transfer to general fund			(6.000)	
3		General fund reduction in Governor's Office	(0.090)	(0.090)	(0.180)	
3		General fund reduction in Legislative Branch	(0.134)	(0.134)	(0.268)	
3	$24-36 million below	Cut digital Library general fund by half	(0.667)	(0.670)	(1.336)	
3	(<$2,192 million)	Cut research center gf by half (Historical Society)	(0.609)	(0.610)	(1.218)	
3		Reduce Tourism Promotion by 8.1%	(1.640)	(1.640)	(3.280)	
3		Cut Agriculture Marketing general fund by half	(0.128)	(0.128)	(0.257)	
3		DPHHS provider rate reduction of approximately 1%	(3.500)	(3.500)	(7.000)	
3		Reduce Targeted Case Mgmt - Children/Adult Mental Health	(1.925)	(1.925)	(3.850)	(23.389)
4		Eliminate approps for 1st year of pay plan, pay increase remains	(2.326)	(5.345)	(7.671)	
4		Delay new Secondary Vocational Education funding	(0.500)	(0.500)	(1.000)	
4	$36 million+ below	Delay Data for Achievement	(3.109)	(3.180)	(6.289)	
4	(<$2,180 million)	Reduce HB124 Combined Fund Block Grant	(2.800)	(2.800)	(5.600)	
4		Delay school facilities payment to schools		(5.800)	(5.800)	
4		Reduce the Native Language Preservation Program appropriation	(0.125)	(0.125)	(0.250)	(26.610)
Total Potential Reductions						($97.386)

Many of these reductions have the potential to be enacted for the entire biennium if FY 2017 revenues come in low, or only for FY 2019 based on FY 2018 revenues. The reduction to the pay plan appropriation would not affect the actual pay plan. Agencies would still be responsible for providing a 1% increase within existing budgets.

Additionally, SB 261 coordinates with several other bills which would be impacted depending upon actual revenues:

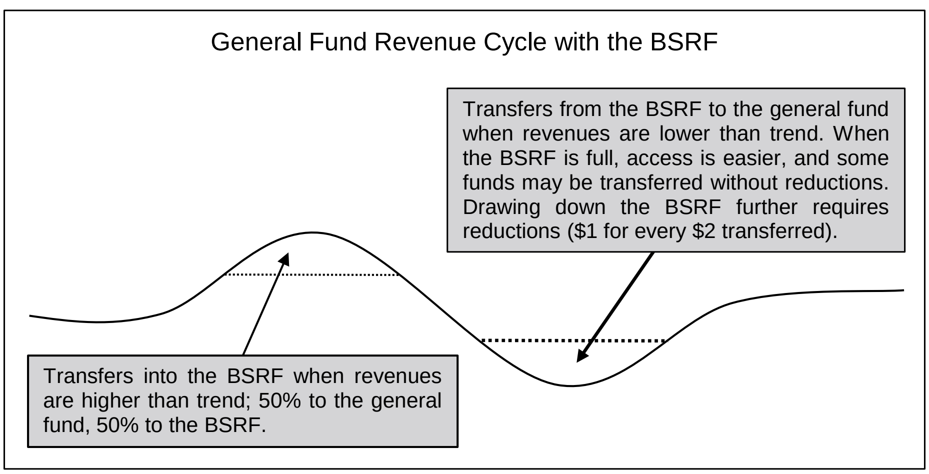
- o HB 17 SB 261 delays the implementation of HB 17, eliminating 2019 biennium appropriations of $5.3 million if general fund revenues are below $2,216.0 million in FY 2017 (as indicated in table above)
- o SB 281 This bill modifies the way the fire suppression fund is used for fire mitigation and has a delayed implementation if FY 2017 revenues are less than $2,209.0 million
- o HB 261 A statutory appropriation for libraries facing a sunset was extended, but coordination language in SB 261 voids those appropriations for the 2019 biennium unless FY 2017 revenues exceed $2,217.0 million
- o HB 638 This bill included a contingent appropriation for direct care worker wages, and the revenue trigger is modified in SB 261 to indicate implementation happens only if FY 2017 revenues exceed $2,220.0 million or if FY 2018 revenues exceed $2,375.0 million

Long-term Plan

The legislature adopted a budget stabilization plan that creates a Budget Stabilization Reserve Fund as a long term method of managing volatility.

The Budget Stabilization Reserve Fund (BSRF) is a "rainy day fund" (RDF). SB 261 requires that deposits are made into the fund when the state has periods of excess general fund revenue. Available BSRF balance may then be used by the executive and legislature (with specific conditions and limits) to avoid drastic reductions or tax increases during periods when revenues are lower than expected.

Other states began to extensively adopt RDF's in the early 1990s. While twelve states had RDF's in the early 1980s, forty-four had them by 1994. Academic evidence suggests a well-designed RDF smooths state finances over the business cycle and helps states avoid tax increases during economic contractions. Prior to SB 261, Montana was one of three states without a RDF.



SB 261 Solution

1. Deposit Rules - Mandatory deposits when the revenue cycle is positive build the fund to a useful level
2. Timely Response Rules - Ensures the state has a proactive and timely response to more difficult revenue cycles
3. Codified Spending Reductions - Expenditure reductions are clearly defined and tied to BSRF access
4. Limits Expansion of Government when Revenues are High - The BSRF solution limits the temptation to add new ongoing programs during periods of temporarily heightened revenue
5. Reduces "Pain" when Revenues are Low - Transfers from the BSRF can reduce the need for drastic expenditure reductions

6. Shared Executive/Legislative Responsibility - The executive and legislature work together to manage state finances with the BSRF

<u>Operating Reserve and Study under the Long-term Plan</u>

Operating Reserve

The legislature defined the level of ending fund balance useful for managing cash and offering an immediate cushion against revenue shocks. This level was established at 8.3% of the general fund appropriations in the second year of the biennium and is calculated at $199 million for the 2019 biennium.

Study

The legislature recognized that while the budget stabilization plan adopted in SB 261 is substantial step forward to managing revenue volatility of the general fund, the long term plan may benefit from additional study. The Legislative Finance Committee (LFC) was assigned to study components of the plan and recommend any changes to the next legislature. The Office of Budget and Program Planning and the Legislative Fiscal Division were assigned to provide analysis to the LFC.

ALL FUNDS SUMMARY

Fire Fund

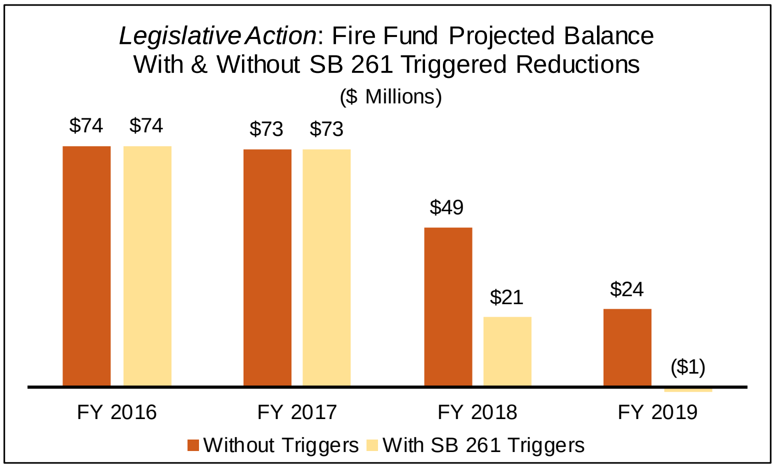
After legislative action, the fire fund balance is expected to be $23.7 million at the end of the 2019 biennium. Decreasing balance is the result of a temporary halt to transfers into the fund from the general fund.

Potential Impact of SB 261 Triggered Transfers on
Fire Suppression Fund (02847)
($ Millions)

	FY 2016	FY 2017	FY 2018	FY 2019
Beginning Fund Balance		$73.7	$72.7	$48.7
Transfer In		12.0		
Fires		(11.5)	(21.5)	(22.5)
Fuel Reduction		(1.5)	(2.5)	(2.5)
Fire Fund Balance Without Triggers	$73.7	$72.7	$48.7	$23.7
SB 261 Triggers				
Level 1: Fuel Reduction Delay			2.5	2.5
Level 1: Transfer Out			(12.0)	
Level 2: Transfer Out			(12.0)	
Level 3: Transfer Out			(6.0)	
Fire Fund Balance With Triggers	$73.7	$72.7	$21.2	($1.3)

Impacts of SB 261 included triggers that could significantly impact the ending fund balance of the fire fund. (See the section on SB 261 for more detail on the overall general fund impacts.) Depending upon the level of triggers hit as determined by actual general fund revenue, up to $30.0 million could be transferred out of the fire fund to the general fund. Additionally, $5.0 million of expenses for fuel reduction would be delayed, partially offsetting those transfers.

SB 261 would reduce the ending fund balance in the fire suppression fund by $25.0 million causing the estimated ending fund balance to decline to zero. Under this scenario, $1.3 million of typical fire costs would be paid from the governor’s emergency fund, which is statutorily appropriated from the general fund.



Fire Suppression Fund Balance Assumptions

The fire suppression fund is available to manage expenditure risk associated with wildland fire costs. By law, the executive normally makes two deposits into the fund on a regular basis:

1) Reversion Transfer: General fund appropriations that are underspent (or reverted) by more than 0.5% of all appropriations. This transfer need not be made by the executive if there is a risk that the ending fund balance is lower than the minimum directed by the MCA 17-7-140, or $121.0 million.
2) Unspent Governor's Emergency Authority: Remaining authority from the Governor's emergency statutory appropriation is transferred to the fire suppression fund after the end of the biennium. Unlike the reversion transfer there is no statutory provision to not make this transfer if the general fund balance is low.

Both of these transfers were suspended for the 2019 biennium.

Present law expenditures are forecast to be as follows: Anticipated fire costs $13.0 million in FY 2017. Fire costs vary dramatically from year to year. In the past several years they have varied from $4.7 to $61.5 million. While the variance is wide, the seven year trended fire costs are $21.5 million in FY 2018 and $22.5 million in FY 2019. Fuel mitigation statutory appropriations are $5 million each biennium, but would be suspended if SB 261 triggers are hit.