



# Revenue and Transportation Interim Committee

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## 57th Montana Legislature

### SENATE MEMBERS

WM. E "BILL" GLASER, VICE - CHAIRMAN  
VICKI COCCHIARELLA  
BOB DePRATU  
JON ELLINGSON  
GLENN A. ROUSH  
MIKE TAYLOR

### HOUSE MEMBERS

RON ERICKSON, CHAIRMAN  
RONALD R. DEVLIN  
CHRISTINE KAUFMANN  
JESSE LASLOVICH  
ROGER SOMERVILLE  
ROBERT R. STORY JR.

### COMMITTEE STAFF

LEANNE KURTZ  
RESEARCH ANALYST  
LEE HEIMAN  
STAFF ATTORNEY  
MIKO OWA  
SECRETARY

October 14, 2002

## MINUTES

Room 102, State Capitol  
Helena, Montana

Please Note: These are summary minutes. Testimony and discussion are paraphrased and condensed. Committee tapes are on file in the offices of the Legislative Services Division. **Exhibits for this meeting are available upon request. Legislative Council policy requires a charge of 15 cents a page for copies of documents.**

### COMMITTEE MEMBERS PRESENT

Rep. Ron Erickson, Chair  
Sen. William E. "Bill" Glaser, Vice Chair  
Sen. Vicki Cocchiarella  
Sen. Bob DePratu  
Sen. Jon Ellingson  
Sen. Glenn Roush  
Rep. Ronald R. Devlin  
Rep. Christine Kaufmann  
Rep. Roger Somerville  
Rep. Robert R. Story, Jr.

### COMMITTEE MEMBERS EXCUSED

Sen. Mike Taylor  
Rep. Jesse Laslovich

### STAFF PRESENT

Leanne Kurtz, Research Analyst  
Lee Heiman, Attorney  
Dawn Field, Secretary

### AGENDA & VISITORS

Agenda (ATTACHMENT #1)  
Visitors' list (ATTACHMENT #2)

### COMMITTEE ACTION

The Committee adopted the September 5, 2002, minutes as amended.

### CALL TO ORDER AND ROLL CALL

The meeting was called to order by Rep. Erickson, chair, at 8:30 am. Attendance was noted (ATTACHMENT 3).

**NATIONAL ECONOMIC PERSPECTIVE, Andrew Hodge. DRI-WEFA** provided Committee members with a detailed overview of the U.S. economy and DRI-WEFA's predictions. (EXHIBIT #1) Topics covered were as follows:

- ! World Outlook: Foreign markets are unstable and war risks are depressing the markets.
- ! Foreign Economies: Asia --excluding Japan-- will achieve the fastest growth, Japan will have the slowest.
- ! U.S. Recovery: Mr. Hodge highlighted both the strong and weak areas of the economy.
- ! Real Side Indicator: Measures Gross Domestic Product growth and it indicates overall positive growth.
- ! Stock Market and Auto Growth: U.S. has experienced a severe decline in the stock market but incentives offered by car dealers have kept buyers interested through early 2002.
- ! Consumer vs. Investor Sentiment: The U.S. is in tough economic times. Consumer sentiment is being hit and investors are skeptical. Consumers are angry and spending but not investing.
- ! Housing: Housing wealth continues to go up. The median house price nationwide is currently \$166,000.
- ! Labor Market: There has been spotty recovery. Special factors contributed to this effect. The market is moving in the right direction but not close to where it needs to be.
- ! Restructuring Depresses Service Hiring: Provided an explanation why the U.S. saw about 3% GDP growth but very little payroll growth. Sectors discussed were Travel/Restaurants, State Government, Retail, Construction/Manufacturing, Medical, and Finance/Insurance/Real Estate (FIRE). Investment Banking in particular is doing poorly.
- ! Consumer Detail: Compares Travel, Home Goods, and Leisure to show how badly Travel has been hit by 9-11.
- ! Consumer Downturn and Recovery: Consumer spending has not fallen drastically in the past year, income has gyrated all over the chart partly due to tax rebates given and taken away, and the savings rate is back up to about 4%. Consumer consumption growth should hold up.
- ! Computer Orders and Shipments: While the telecom sector is still doing very poorly, the computer and high tech sector generally is experiencing a mild recovery.
- ! Producer Durable Equipment: The Information, Industrial Equipment, and Transportation sectors experienced a severe decline in 2001 and early 2002, there is some recovery going on.
- ! Trade: Imports and Exports: The U.S. experienced a huge decline in 2001 in both categories. Currently the import sector is leading the export sector in the recovery. The export market remains weak because the world economy is weak.
- ! Federal Government: Mr. Hodge emphasized how big it is. Spending is up, real purchases are up dramatically, tax cuts are helping, and 2003 projects even further spending.

- ! U Shaped Fed: While Treasury Bonds and the Federal funds rate both declined, Federal funds in particular have dropped. Interest rates are low and projected to stay that way through 2003. Ten-year Treasury Bonds are showing a slow rebound.
- ! Base Case Forecast Summary: Growth is accelerating at a 2.4% yearly average, with a 3.0% growth rate projected for 2003. The unemployment rate will peak at over 6.0% in early 2003 but will then come back down by the end of 2003.
- ! Iraq War Scenario: Pre-war uncertainty effects are building into the market and as far as the business world is concerned, the war is here. Consumer sentiment/stocks are expected to drop, oil prices will rise, and military spending will increase. It is too early to predict an outcome but a relatively quick and positive outcome would not have a long-lasting negative effect on the economy.
- ! Base Case and War Oil Prices: The U.S. is a little less vulnerable to oil shock than it was in the 1970s because of fewer goods used in the economy, more domestic oil production, and the price having stayed low. Even though the price of oil rose from \$12 to \$30 a barrel in 2000, the economy did not slow down very much. Russia and other countries have stepped up production to further decrease our dependence on Arab oil. Oil prices would have to reach \$40-\$50 dollars per barrel for a sustained amount of time before the U.S. economy would feel the effects.
- ! Credit Crunch Risk: Graphics presented by Mr. Hodge charts the Baa-Aaa and Baa-10-year Treasury Bond spreads. Even with a recovery going on, the spreads are still high. Credit availability is a concern.
- ! Income Share Stays High: The profits in the total economy are calculated and that total income equals total GDP. This gives a good perspective in terms of what problems the economy can sustain.
- ! Dollar Risk: There has been a big decline in the dollar. While U.S. has become a debtor nation, our ability to service that debt has remained strong because of good returns on U.S. investments. However, our account balance is decreasing more rapidly than our debt is shrinking so this won't work on a long-term basis. U.S. debt totals about \$9 trillion and assets currently total about \$7 trillion.
- ! The U.S. Dollar Strengths/Weaknesses: There are more strengths than weaknesses at this time but the long-term outlook is uncertain.
- ! Conclusion: The economy still faces risks and is struggling but the corner has been turned on the outright recession and is heading in the right direction.

Rep. Devlin asked if the double dip recession risk of 25% is about the same as it has been in the past. Mr. Hodge answered that it is a little higher than in the past but he does not believe it is a terribly high risk.

Rep. Somerville stated that Montana has seen a big drop in capital gains revenues. He asked Mr. Hodge if he foresaw an increase in capital gains nationally. Mr. Hodge answered that in his estimate, total federal capital gains are going to drop this year to a level approximately 40% below the 2000 level and that Montana would likely follow that trend. This won't change markedly in 2003 but 2004 and beyond will start a revival.

Sen. Roush asked Mr. Hodge if federal dollars coming into Montana would be decreasing in the future. Mr. Hodge answered that the risk of a drop in federal spending was small.

Rep. Erickson asked Mr. Hodge what numbers coming up on the national scene would be particularly helpful for this Committee to look at when making its revenue estimate. Mr. Hodge answered that since Montana relies mostly on income tax revenue, to focus on those numbers. Numbers for 2002 are going to be down but there is a projected revival beginning in 2003. This Committee should be able to project income growth of 3% to 5 %. However, he cautioned the Committee to be conservative with its estimates.

Sen. Ellingson asked Mr. Hodge if calendar year 2002 capital gains budget would be down from calendar year 2001. Mr. Hodge answered that in his opinion the capital gains would decrease about 23% for tax year 2002. Sen. Ellingson asked Mr. Hodge to get him the exact estimate because the Committee would find that number very useful in making its upcoming estimates.

Rep. Story asked what people are doing with their discretionary income since it appears they are not investing it in the stock market. Mr. Hodge answered that consumers are investing less but the net numbers are still showing slight growth. Rep. Story asked if spending habits have changed. Mr. Hodge answered that people have been putting their money into savings, debt reduction, and other assets such as housing, home furnishings, money market accounts and bonds. Rep. Story asked if home equity was climbing because of homeowners' money being invested or because of the rising market. Mr. Hodge answered that both were factors. Rep. Story asked if people were using their home equity to pay off debt or to support a style of living. Mr. Hodge answered "yes" in both instances. Many owners are choosing to refinance because the interest rates are so low.

**Dr. Paul Polzin, UM Bureau of Business and Economic Research** presented an extensive overview of Montana's economy titled "Montana's Economy: Dodging the Economic Bullet". (EXHIBITS #2 AND #3 ) Topics were as follows:

- ! The U.S. and Montana often exhibit differing economic trends.
- ! Prior to September 11, Montana avoided recessions that the rest of the nation experienced.
- ! In 2001, Montana's economy did slow down but not due to the national business cycle. Montana's slowdown was due to increases in electricity prices. Certain companies elected to stop or slow production and sell their electricity rather than do business as usual.
- ! U.S. economy started to slow in mid-2000 and by mid-2001 showed marked deceleration. The Montana economy did not experience a slowdown to the same extent as the U.S. economy because Montana does not have many of the industries that were affected.
- ! Post-September 11, Montana still was not affected to the same degree as the U.S. because we lack the industries (airline, transportation, manufacturing, financial services, and travel) that were most affected by the attacks.
- ! Montana's economic base consists of nonresident travel, wood products, agriculture, mining, and the federal government. Nonresident travel and the wood products industry were most at risk but were relatively untouched.
- ! A comparison of Montana and U.S. consumer sentiment: Montana's index of consumer sentiment has remained steady and has even experienced growth.
- ! Revised Montana Economic Forecast: the Montana economy will remain stronger than the U.S. economy.

- ! Forecast Risks: forecasted risks from October 2001 in some cases have not been realized, some risks are still uncertain, and some of the forecasted risks have come to fruition. Overall, Montana's economic outlook still looks stronger than the U.S. outlook.

Dr. Polzin said there are some sectors of the Montana tax system that respond more to the U.S. economy, particularly capital gains and corporate income tax. These two revenue sources are more dependant on national factors than they are on local factors. This makes it possible for Montana to have a relatively optimistic economic outlook but a relatively pessimistic fiscal outlook. This suggests we may have a revenue problem, not necessarily an economic problem. Montana may need to find a way to cut expenses and raise revenue rather than trying to find new ways of stimulating the economy in Montana.

Sen. Ellingson asked Dr. Polzin if Montana would lose federal matching dollars if there were too many spending and program cuts. Dr. Polzin answered that this could happen, that the loss of federal dollars is just like losing dollars from real industries, and the loss would be felt in the economy. Sen. Ellingson asked Dr. Polzin where Montana would be if we lost a \$150 million in federal funding. Dr. Polzin answered that for every dollar of federal funding lost, we would lose one more dollar from the rest of the economy. Dr. Polzin estimated it would be about a \$300 million loss.

Sen. Roush commented that small town and rural Montana would suffer devastating effects from the loss of federal dollars and that he did not agree with Dr. Polzin's assessment that Montana's economy is strong. The rural and small town economies in Montana are very depressed.

Sen. Cocchiarella asked Dr. Polzin if he had numbers concerning taxpaying, revenue producing citizens (employed) vs. non-tax or non-revenue producing citizens (retired/unemployed) in Montana. Dr. Polzin answered that the 2000 census gives an indication of what is happening in Montana. The average age of workers in Montana is above the national average because we lose many young people to states that offer better employment opportunities. We lose about as many retirees as we gain so that number stays fairly stable.

Rep. Somerville questioned Dr. Polzin about the Montana Power Company. Dr. Polzin answered that he has concerns about the ownership of the company. It is owned by an out of state company and the Montana-based management jobs are at risk.

Rep. Story referred back to page 10 of Mr. Hodge's handout (EXHIBIT #1) and asked Dr. Polzin how Montana was faring in the construction and manufacturing sector. Dr. Polzin replied that manufacturing in Montana differs from nationwide manufacturing. U.S. manufacturing is depressed because the high tech and automobile industries are suffering. Montana has no automobile manufacturing and very little high tech so we are not affected as much.

Rep. Erickson referred back to Dr. Polzin's revised Montana Forecast. Rep. Erickson specifically wanted to know when the next set of official data would be available. Dr. Polzin said it would be December at the soonest. Rep. Erickson asked Dr. Polzin how the Committee could do its estimates through 2005 with information that only is projected through

2003. Dr. Polzin answered that his next forecast will have projections for 2004 and possibly 2005.

Rep. Erickson asked Mr. Hodge if he had 2004 data for the Committee. Mr. Hodge answered that total GDP growth in 2004 would be at 4% and that it would decrease in 2005 and 2006. Pre-tax income will be 5% in 2003 and 6.1% in 2004 and 2005.

Rep. Story asked Dr. Polzin if part of the construction boom in Montana was a result of replacing and relocating rural and small town businesses into the larger urban areas. Dr. Polzin said there were no numbers available to break down the three main types of construction: home, road, and commercial; but all three sectors appear to be strong. Retail trade is a dynamic industry and Dr. Polzin did not want to predict what the next trend would be.

Mr. Hodge reported that he had a fairly precise number on total government revenues. The personal tax and non tax receipts category (includes all income tax and capital gains) will be down 15% this calendar year and up 3% next calendar year. Capital gains, as a category by itself, will be down 23% this year and up 3% next year.

**LAKESHORE VALUATION, James Stack** presented information concerning what he termed "an impending property tax crisis." Mr. Stack serves on a committee that formed to protect Whitefish Lake for future generations under the Lakeshore Protection Act enacted by the Legislature. Over the last several years, Mr. Stack has observed a phenomenon that has become of great concern and today is of crisis proportions. It not only concerns Whitefish Lake, but all other desirable recreation property in Montana. Montana is going through its normal six year property reappraisal and there is concern about Montana citizens being taxed off their property because of the dramatic rise of land values. Many of these properties are being bid up by an influx of wealth from outside the state, as well as the general economy. Mr. Stack provided a slide show of examples of properties on Whitefish Lake. Ten years ago, average property taxes were less than \$1000 a year. Today's taxes cost at least \$3000-\$4000 per year. Ten years ago, there were no structures valued at over \$1 million, including the property the structure was built on; and there were no "celebrity" homes. Today, there are multiple homes ranging in price from \$1million to \$8 million dollars. Montana residents cannot compete with this level of wealth. Once this current reappraisal goes through, these residents will be hurt dramatically because their property taxes are going to increase drastically.

For example, a residence with the 1997 appraised value of \$413,000 will see the appraised value increase to \$2,778,000. The taxes will go from \$1,340 to \$4,400 this year because the land cap expired. If this property goes to full appraised value, the taxes could increase to over \$29,000. Current lake frontage foot prices are approximately \$12,000 per frontage foot. Very few Montana citizens are able to pay taxes at this level and would be forced to sell, most likely to out of state buyers.

Mr. Stack asked the Committee to consider these questions:

- ! Will property appraisals and property taxes really go to this level? By law, the mill levy is to be adjusted lower if there is an appreciation in real estate but will it be enough to make a difference to the Montana citizen? A mill levy cannot compensate for highly inflated real estate.

- ! Should the increases be "phased in"? This will delay the full impact but the end result will be the same. The Montana residents will still be forced off their property.
- ! What if the Assessor's Office doesn't appraise the comparable sales at full value? The Assessor cannot pick and choose which sales it will appraise at full value and which sales weren't "market sales" and therefore, don't have to be taken into consideration. Also, property taxes are based on the principle of "ad valorem" - according to value. Ad valorem has two requirements: accuracy and equity. Many assessors use an averaging method to find middle ground. This means that the highly inflated properties will not pay as much in taxes as they should and the lower end properties will still see a huge tax increase.

Mr. Stack stated that Montana's property tax system is not accurate on highly inflated properties. It is not working because property prices are being driven by out of state forces. The valuations get distorted, not just by high prices but by speculation as well. The system has become very regressive for long-term residents. A disproportional amount of the tax burden has been placed on these residents. Whether or not this is a crisis depends on how it is viewed. If this situation is viewed as a "cash cow" and all of the desirable recreational property is purchased by out of state wealth, then perhaps not. But, if this situation is viewed as one which affects all Montanans then yes, it is a crisis. This type of situation is not unique to Whitefish Lake. It is happening all over the state.

Are there any solutions? SB 184 (1999) placed a land valuation cap where the value of the land was determined by a percentage of the improvements. It worked but has expired. Legislation to adopt an acquisition-based property tax would also work. This would be the best long-term solution because it deals with a real estate market where the prices are driven by out of state demand.

Mr. Stack concluded that this problem cannot be ignored, even in the face of a \$200 million deficit because once this transfer of property occurs, there is no avenue available to correct it. This is about tax protection, not tax reduction. This must be addressed at the upcoming Legislative session.

Rep. Erickson asked **Judy Paynter, Department of Revenue** to explain a 1999 legislative bill that was an acquisition-based property tax proposal. Ms. Paynter said the 1999 bill was based on the same argument as Mr. Stack presented: that Montana citizens could no longer afford the property taxes on property whose prices are being driven up by out of state purchasers. Ms. Paynter recollected that the bill was defeated. Other concerns about acquisition-based property taxes were how to value the property and how to administer an acquisition-based system.

Rep. Erickson asked Ms. Paynter to summarize the 1999 acquisition-based bill proposal for the November meeting and let the Committee review it.

Rep. Somerville asked Ms. Paynter to also give the Committee a summary of SB 184 for review.

Sen. DePratu asked Ms. Paynter to clarify how SB 184 would determine how some property is taxed at the 75% level and other property is taxed at full value. Mr. Stack added that there was minimum at which the land could be valued.

Sen. Ellingson asked Ms. Paynter how states that have adopted an acquisition-based tax system handle land transfers in estates, for example. Does the value of the land increase at the time of death? Ms. Paynter answered that she did not know but that she would find out.

Rep. Story stated that he served on the Interim Property Tax Committee in 1997. The Committee studied the California Constitutional Amendment (Prop.13) that was an acquisition-based tax law. Rep. Story said that the California law started out as a simple concept but got very convoluted as it was added to.

Sen. Cocchiarella asked Mr. Stack if any realtors serve on the Whitefish Lake Protection Committee. Mr. Stack answered "no". Sen. Cocchiarella asked if Mr. Stack had made this presentation to any groups that included realtors. Mr. Stack answered "yes", that property owners are organizing and that some of those owners are realtors. Mr. Stack said he asked these realtors to find out through a survey how other realtors feel about an acquisition-based tax. The feedback from these realtors was that of almost universal approval of implementing an acquisition-based tax system.

Sen. Cocchiarella commented that this issue is important to the citizens of Montana and they need to be educated about it.

Rep. Erickson commented that property taxes affect all citizens, not just property owners in recreational areas. Homeowners on fixed incomes are just as concerned about their tax bill as the lakefront owners are. Rep. Erickson said he is interested in exploring an acquisition-based tax system but remembers voting against the 1999 bill because it was so complicated. He emphasized that there must be a simpler plan.

**EQUITY MARKETS, James Stack, InvesTech Research** presented an update on the stock market. (EXHIBIT #4) Topics covered were:

- ! Starting in July 2002, investors have suffered new lows in the Dow Jones Industrial Average and all other market indexes.
- ! Investors are in the biggest bear market since the Great Depression.
- ! It is also the longest bear market since the 1930s.
- ! Consumer confidence has been impacted. Over \$8 trillion in wealth has been lost.
- ! Most economists believe the recession has ended but the stock market has continued to fall to new lows. This is a first, historically.
- ! A survey of purchasing managers show that manufacturing activity slipped after 7 months of growth. If it continues to slip, it is indicative of another recession.
- ! The S & P Index has lost 32% just this year, the worst yearly loss since the Great Depression. Yet, some economists say the U.S. is in economic recovery.
- ! The Consumer Sentiment survey by the University of Michigan is an excellent tool for predicting recessions. Consumer Sentiment has fallen to a level lower than it was last fall after September 11. That has never happened before and is



very unusual because historically, consumer sentiment hasn't fallen to new lows in the 6 months or year after a recession.

- ! When comparing the S & P with the NIKKEI average starting in March 2001 through the present, the S & P mirrors the same pattern of loss.
- ! It is reasonable to expect that within the next 6 to 9 months, the equity markets will hit bottom. This is important economically because the sooner the markets stabilize, the sooner the recovery can begin.
- ! The DJWorld Stock Index is dropping to new lows. This indicates the U.S. can't rely on an export driven economic recovery.

Mr. Stack listed 3 areas for the Committee to be watchful of over the next 6 months:

- ! Stock Market: If it keeps going to new lows it is telling us that investor confidence is still falling.
- ! Manufacturing Survey: It is released the first of every month and if it falls, then so do revenue projections.
- ! Confidence Surveys: The University of Michigan and the Confidence Board both release consumer confidence surveys monthly. These surveys are excellent tools for gauging how the consumer is feeling.

Mr. Stack said the danger areas the upcoming Legislature must watch for are:

- ! The economy: There will not be a huge recovery. The recovery will be slow and lengthy.
- ! Federal Reserve Policy: Low interest rate levels are helpful to those trying to get out of debt but detrimental to retirees who make up one-fifth of our population.
- ! Consumer confidence: How Montana survives economically depends on the stability of confidence in this state. The economy is fragile right now. Corporate America has seen its sharpest drop in profits since the 1930s and there are many fears about job stability, restructuring, and higher taxes.

**AGRICULTURAL ECONOMIC OUTLOOK** Dr. Myles Watts, MSU Department of Agricultural Economics and Economics provided the Committee with an outlook on Montana agriculture.

Major points were:

- ! Agriculture is important to the health of Montana's economy.
- ! Wheat and cattle make up the majority of the farm cash receipts.
- ! Agriculture is viewed as a volatile industry because of susceptibility to weather, markets, and government policies.
- ! Montana farm cash receipts generated over \$2.2 billion in 2001.
- ! Montana farm cash receipts have stayed fairly stable over the last decade.
- ! Montana wheat prices have come down steadily since 1952 because production and yield have steadily increased.
- ! The stock market affects the price of wheat - as the stock market has fallen, the price of wheat has risen.
- ! Montana calf prices have declined mostly due to competition from chicken and pork.
- ! The aging population of the U.S. signals a decrease in red meat consumption.

- ! Cattle prices in 2002 are going to be down about 15% from 2001.
- ! Current price issues affecting beef are: low production numbers, consumer taste, higher pork and poultry production, higher corn prices, and decreasing Japanese imports.
- ! In 2002, Montana will lose approximately \$135 million in cattle revenues.
- ! There is little change predicted from 2002 through 2003.
- ! The 2001 price for wheat (\$3.14/bushel) is expected to rise to about \$4.00/bushel in 2002. In 2003 the projected price per bushel is about \$4.40.
- ! Yields have been depressed because of droughts but is projected to increase in 2003.
- ! Revenue from wheat sales is projected to increase by approximately \$150 million in 2002 and 2003 sales should increase by \$247 million.
- ! The government payments will increase 15% increase in direct payments in 2002 due to the design of the Farm Bill. A Livestock Disaster Program will add about \$27 million and no numbers are available for Crop Disaster payments. Overall, Montana will see about \$106 million in government payments in 2002.
- ! In 2003, the government direct payments will be \$71 million, no change from 2002. There is no way to predict whether there will be a disaster program in 2003.

Sen. Ellingson asked Dr. Watts if any of the government payments are going to livestock producers or if they are all directed to crop producers. Dr. Watts answered that nearly all of the payments are directed to crop producers. There is a special disaster provision for livestock producers for 2002.

Rep. Somerville asked Dr. Watts how much of the total economy the \$2.2 billion of agriculture dollars is. Dr. Watts answered that agriculture income "makes up 25% of the driver of Montana's economy."

Sen. Cocchiarella asked if farmers are planting fewer acres and putting it into CRP (Conservation Reserve Program). Dr. Watts answered that 25% of wheat land is in CRP and we are still producing more bushels of wheat. Approximately 80% of our wheat is shipped overseas. Montana's biggest market is the Far East.

Rep. Story asked if a dollar in government payments generates the same kind of economy as a dollar income from actual sales. Dr. Watts said research was inconclusive but in his opinion, they do not.

Sen. Cocchiarella asked Dr. Watts about the status of alternative crops in Montana, such as soy beans and malting barley. Dr. Watts said that malting barley has been fairly successful but other crops haven't been as successful. There is potential but producers must be very careful because there is a lot of financial risk associated with alternative crops.

**GENERAL FUND PRELIMINARY BUDGET OUTLOOK; 2005 BIENNIUM BIG PICTURE REPORT, Clayton Schenck, Legislative Fiscal Analyst**, gave a preliminary projection of the general fund balance for the 2005 Biennium. (EXHIBIT #6) Mr. Schenck reported the following:

- ! The Legislative Fiscal Division (LFD) predicts an ending general fund balance of a negative \$225.8 million dollars, including an ending fund balance reserve of 1% (\$28 million) as required by law.
- ! There will be a negative balance of \$249.5 million if a 2% (vs.1%) ending fund balance reserve is allowed.
- ! There are significant issues not taken into consideration by this estimate and the deficit could grow to over \$300 million if they are to be considered.
- ! Any non-permanent spending reductions made by the August 2002 Special Session or Governor's spending reductions are not reflected in these figures.
- ! If the 2003 Legislature continues all of the above mentioned reductions, it would reduce the deficit by almost \$100 million, leaving a deficit of \$156 million. Mr. Schenck emphasized that these reductions would be difficult to achieve, since a number of these reductions were intended to be a one-time only action.
- ! The LFD used a "present law" projection as required by law for the 2005 projections. This also allows for inflation and other costs to be accounted for. The LFD does not assume that the Legislature will adopt the present law budget, in fact, it is clear that available present law funds will not support continuation of existing present law services.
- ! This report includes no projections for new proposals or other initiatives because those items are not a current present law service.
- ! Revenues estimated for 2005 are estimations based on 2002 actual collections and current economic trends. These estimations will be more closely analyzed and refined when the Revenue and Transportation Committee prepares its revenue estimate for presentation to the 2003 Legislature.
- ! 2005 Biennium base expenditures were determined using a formula that doubled the 2002 actual expenditures and factored out the one-time only expenditures. Mr. Schenck also listed several assumptions used to adjust the base expenditures, with the exception of vacancy savings. The LFD views this as a policy decision that the Legislature must decide.
- ! General fund revenues for the 2005 Biennium are anticipated to increase by approximately \$54 million.
- ! Declining corporate and individual income taxes were the main sources of the current budget deficit. Their outlook is critical in determining the financial status for the 2005 biennium.
- ! Individual income tax is expected to grow by about 2% per year throughout the 2005 biennium. Corporate income tax is expected to remain stable.
- ! The cost of funding a present law budget for the 2005 biennium is estimated at about \$2.8 billion, which includes a \$140.9 million adjustment for supplemental appropriations.
- ! The factors causing the \$140.9 million adjustment are as follows: 2003 biennium supplemental appropriations, public schools, public health, corrections, higher education, the state employee pay plan, District Court assumption, statutory appropriations, transfers, and other adjustments.
- ! Issues not included in the 2005 Biennium projections are: property tax reappraisal, Temporary Assistance for Needy Families (TANF) and Title XX and Child Support Enforcement Division, additional District Court funding, potential cost over-runs by the Department of Public Health and Human Services (DPHHS), the Department of Corrections (DOC), ballot initiatives (must be

approved in the 2002 election), pending lawsuits against the state, a personal property tax rate "trigger", and uncertain economic and revenue trends.

Mr. Schenck concluded that the 2003 Legislature "faces the most severe budget crisis in at least 16 years", mostly due to the sharp decline in general fund revenues. Income tax collections especially have decreased because of the decline in equity markets. Mr. Schenck discussed a handout entitled "General Fund Appropriations - 2003 Biennium Agency Operations/Programs". (EXHIBIT #7) This table shows only HB 2 and HB 13 appropriations for 2003. Mr. Schenck used this table to give Committee members a perspective of how large the budget cuts will have to be to cover the \$250 million deficit (e.g. the deficit equals 25% of the K-12 education budget, 50% of the public health budget, etc).

Rep. Story asked Mr. Schenck if the LFD keeps a chronological record of what new proposals were enacted by past Legislatures, when they became programs and what the cost of these programs have been. Mr. Schenck answered that the LFD did maintain that information.

**Chuck Swysgood, Director, Office of Budget and Program Planning (OBPP)**, addressed the Committee, saying he agreed with Mr. Schenck's assessment of the magnitude of the budget situation facing the Legislature and the general public. Mr. Swysgood pointed out that maintaining present law is not an option under the current circumstances.

Sen. Cocchiarella asked Mr. Schenck if there is a spreadsheet that shows what matching federal funds will be lost with the proposed budget reductions. Mr. Schenck said there was no spreadsheet available yet but that there would be a loss in matching federal funds in childcare, Title XX, child support enforcement, and others as well. Sen. Cocchiarella then asked if Initiative 146 passes and the CHIP program is refigured, what will happen to the money from the Initiative? Mr. Schenck answered that the LFD is working on an analysis of that potential situation but there were no figures available yet.

Rep. Story asked if there was a projection for fiscal growth for the next biennium. Mr. Schenck said there was about a 1% growth projected, which translates into \$54 million in revenues. Rep. Story asked what the present law spending growth is. Mr. Schenck answered that the present law spending growth is \$141 million. The Legislature will be dealing with an increase of \$54 million in revenues and a \$141 million increase in "expenditure pressures".

Rep. Erickson asked **Terry Johnson, Principal Fiscal Analyst, Legislative Fiscal Division**, to address the Committee. Mr. Johnson referred to a report he compiled for the Finance Committee that focused primarily on individual income tax and corporate taxes. The report reflects tax revenue collections through the end of September 2002. Withholding taxes increased 7.8% in September, compared to August 2002. Tax refund activity continues to exceed last year's level and estimated payments are also down from last years level. Overall, income tax collections are up about 3.8%, which is a "significant reversal from what we were seeing in August." Corporate tax collections are lagging but not significantly. Mr. Johnson cautioned the Committee that this is not enough information to base any projections on. During the month of October, the Department of Revenue is going through their accrual reversal process. This distorts numbers considerably and Mr. Johnson said to wait for that process to be completed before looking for any trends.

Rep. Story asked Mr. Johnson to report on how Montana's revenue sources, excluding income tax, are faring for October. Mr. Johnson answered that he had not looked at each source in detail. There were about 5 or 6 revenue sources that were impacted by HB 124. Until the adjustment process is complete, there is no reliable indication of where those components are going. Tax sources that are sensitive to interest rates are seeing a significant downturn. Other sources are doing well, such as the insurance premium tax.

**OTHER BUSINESS**

Rep. Somerville **moved** that the minutes from the September 5, 2002, meeting be approved as amended. He requested that his name be spelled correctly in the body of the minutes. Motion passed unanimously as amended.

**PLEASE NOTE:** These changes have been made to the original minutes which are on file in the Offices of the Legislative Services Division and on the internet at [http://leg.mt.gov/interim\\_committees/Revenue\\_Transportation/index/htm](http://leg.mt.gov/interim_committees/Revenue_Transportation/index/htm).

Rep. Erickson noted that the next Committee meeting would be held on November 19, 2002

There being no further business, the meeting was adjourned at 3:34 p.m.

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