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REVENUE DEDICATION AND ITS EFFECTS ON
STATE GOVERNMENT IN MONTANA

by

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ABSTRACT

The topic addressed in this paper is revenue dedication (earmarking) in state government. Primary emphasis is on revenue dedication in Montana.

The history of revenue dedication is examined based on a review of the literature. The scope of earmarking is defined by a nationwide survey of state dedications. The results show that the average proportion of dedicated revenues nationwide dropped from 41.1 percent in 1963 to 23 percent in 1979. Montana ranked fourth among the states in the proportion of revenue dedicated in 1979.

The paper investigates the political and economic justification for earmarking. It includes a discussion of the benefit theory of taxation and user charges. The advantages and disadvantages of dedication are examined and three observations about the nature of earmarking are made.

A proposal is made to evaluate Montana revenue dedications against seven criteria which are used to define a "sound" dedication. Ten dedicated revenues are selected and evaluated. The results indicate that eight of the dedications are not based on the benefit theory of taxation. They also provide disadvantages to the executive and legislative branches. It is recommended that the eight revenues be de-earmarked.

Based on the evaluations, it is concluded that other Montana dedications may be disadvantages to the Governor and Legislature. It is recommended that a review of all Montana dedications be undertaken to determine their propriety. It is also recommended that proposed new dedications be evaluated using criteria before they are made law.

Chapter I

INTRODUCTION

A dedicated earmarked revenue is a state tax, or fee, the proceeds of which are allocated for the support of a particular government service. Dedicated revenues are used to support functions ranging from occupational licensing boards to long-range building programs. Examples of dedicated revenues in Montana are the gasoline license tax which is used for highway purposes and livestock license fees which are used to fund livestock inspection programs.

A revenue may generally be dedicated to support a function in two ways: by constitution and by statute. In Montana, revenues are also allocated for special purposes based on administrative decisions.

The Montana Constitution sets aside revenues for the support of the Highway Fund, Coal Tax Trust Fund, Public School Fund, University System, livestock services, and the Consumer Council. However, the majority of dedicated revenues are established by statute. Two examples are insurance taxes which are earmarked for workmen's compensation programs, and occupational license fees which are dedicated for the support of occupational licensing boards. While a few statutory dedications have been eliminated in Montana, traditionally their number increases each year with the adoption of new revenue sources and programs. Administrators may also dedicate revenues. They may dedicate money collected by their agencies for particular purposes.

For example, revenue from the sale of Women's Bureau publications is dedicated by administrative decision to pay the costs of the publications.

After collection, dedicated revenues are placed in special accounts which are separate from the general fund. In Montana they are most frequently placed in earmarked fund accounts, sinking fund accounts, and revolving accounts, depending on the purpose to which they are assigned. Montana has 642 accounts in addition to the general fund account. While the sources and purposes of the funds in these accounts differ, they are common in that they are dedicated for special purposes.

In fiscal 1979, Montana dedicated fifty-five percent of its collections from taxes and fees. This was thirty-two percent more than the average dedicated proportion of state revenues nationwide. Montana ranked fourth nationwide in the proportion of revenue dedicated in fiscal 1979.

Montana's high proportion of dedicated revenues occurs despite widespread criticism of earmarking. The literature is critical of revenue dedication for several reasons. Case Sprenkle and William Habacivch (1963, p.817) argue that dedication leads to the misallocation of public funds. They state that when a revenue is dedicated to a particular program the program is likely to be oversupported or

undersupported. They suggest that this depends on whether the dedicated tax yields revenues which are greater or less than the amount which the legislature would have otherwise appropriated from the general fund for the program. Leonard White (1955, p. 249) also criticizes revenue dedication by stating:

...the net result [of dedication] is to reduce flexibility in the use of available funds, to disturb the balance between different programs, and to limit the authority of governors ... Earmarking reflects the power of special interests... and a distrust of both executive and legislative branches.

Walter McMahon and Case Sprenkle (1970, p. 261) condemn revenue dedication for other reasons. In their article, "A Theory of Earmarking," they state that dedication "inhibits quick adjustment to changes in costs and to changes in demand ..."

In Montana, individuals on legislative staffs and in the Executive Office of Budget and Program Planning criticize revenue dedication for its ability to reduce executive and legislative control over the spending of public funds. They also express the opinion that dedications complicate the budget and appropriation processes.

In contrast, others praise revenue dedication. James Buchanan (1963, p. 458) states that revenue dedication makes it possible for individuals to pick and choose among the programs which they desire to support.

Per Ecklund (1973, p. 224) agrees with Buchanan's conclusions about revenue dedication. Ecklund also states that while earmarking

may not lead to efficiency for a state or the country as a whole, "whenever it makes no group worse off than before, it must be considered an efficient instrument ..." (Ecklund 1972, p. 226).

Some individuals who establish dedications suggest that revenue dedication is a necessary tool for bargaining during decision-making processes. They claim that dedication of a tax to a popular program can increase the amount of public support for an otherwise unpopular tax (Deran 1965, p. 357). Charles Goetz suggests that it may also serve as a contract between legislators (Goetz 1968, p. 135). For example, dedicating a tax for public health and education may lead to consensus among those legislators who favor public health programs and those who favor education. Such a consensus may be necessary if benefits to both groups are to be realized.

In summary, opinions on the merits of revenue dedication vary depending on the perspective of the individual expressing the opinion. Those who see advantages from dedicating a revenue for a particular purpose advocate dedication as a valuable tool for public decision making. Those who find disadvantages condemn the practice of dedication and suggest that states take action to eliminate earmarking provisions.

Statement of the Problem

In view of Montana's high proportion of dedicated revenues, it is important to determine whether the executive and legislative branches

of Montana's state government are advantaged or disadvantaged by earmarking. It also appears necessary to determine the effect of revenue dedication on individual choice and centralization in government.

This paper seeks to define the nature of earmarking in order to make a conclusion about its merits. It attempts to define a "sound" revenue dedication in order that Montana's dedications might be evaluated against such a definition. It also attempts to determine how dedications affect Montana state government from the executive and legislative viewpoints.

Through an investigation of the literature and evaluations of Montana's dedications, it is expected that recommendations can be made regarding the future use of revenue dedications. The intent is to suggest changes which will enable Montana to better meet its future financial needs as determined by the Governor and Legislature.

Scope of This Report

Chapters Two through Five investigate, analyze, and make conclusions about revenue dedication in Montana.

Chapter Two examines the history of dedication and its use by state governments. The scope of dedications among the states is defined by a survey of state dedications during fiscal 1979. The chapter also investigates the political and economic justifications

for dedicating revenues. The advantages and disadvantages of earmarking are identified and some observations about the nature of dedicated revenues are made.

Chapter Three proposes an evaluation of individual revenue dedications in Montana in order to determine to what extent they reflect the characteristics of a "sound" revenue dedication as defined by the literature. The proposed evaluation is based on seven criteria which reflect the advantages and disadvantages of revenue dedication. Each of the seven criteria are discussed and the system for weighing the results is explained. Ten dedicated revenues are selected as samples of Montana's dedications.

In Chapter Four, each of the ten dedicated revenues are evaluated using the seven criteria. Based on the analysis, recommendations are made for the future disposition of the revenues.

The final chapter presents several observations and conclusions about revenue dedication in Montana. Some suggestions are made to those who dedicate revenues. These suggestions deal with ways to alter the dedication process in order to increase executive and legislative control over state spending. Ways to deal with the political aspects of earmarking and de-earmarking are also discussed.

Chapter II

REVIEW OF RELATED LITERATURE

Introduction

This chapter presents the background and history of revenue dedication in the United States. Special attention is paid to the history of revenue dedication in Montana. The scope of earmarking by the states is identified based on a survey of state dedicated revenues in fiscal year 1979. Montana's proportion of dedicated revenues is compared with those of other states.

The chapter includes a discussion of the political aspects of earmarking and the reasons why participants in the legislative process seek to dedicate revenues for particular purposes. The economic justifications for dedicating are examined together with the concepts of the "benefit theory of taxation" and user charges.

Finally, there is a discussion of the advantages and disadvantages of revenue dedication. Several observations are made based on these characteristics.

History of Revenue Dedication

All levels of government make use of dedicated revenues. Dedicated revenues are typically used by the federal government when it is necessary to assure funding for a program many years in advance. Congress, for example, uses dedicated revenues to support long-term

obligations such as the payment of interest on the national debt and commitments established under the Social Security Act of 1935.

Local governments also use dedicated revenues. During the 1800s, the practice of dedicating local property tax revenues for the support of landowner services, like police and fire protection, was thought to be equitable (Tax Foundation 1963, p. 10). Since that time, however, many local governments have relied on general funds to support these services. They now recognize that all citizens, not just landowners, benefit from them. Some local governmental units, such as school and street improvement districts still levy and dedicate property taxes for special purposes.

States too have made use of dedicated revenues. As states began collecting property taxes for education, in lieu of locally collected property taxes, they generally allocated a large portion of the revenue for local education purposes (Tax Foundation 1963, p. 10). The intent of the states was to equalize spending for education among different areas within them. Similarly, during the 1930s, states interpreted federal highway policy as encouragement for the practice of dedicating motor fuel taxes for highway construction and maintenance. States now use dedicated revenues to support a wide range of activities. Indiana, for example, dedicates its liquor taxes for "postwar construction." Many states dedicate a portion of their revenues for the support of their local governments.

History of Revenue Dedication in Montana

Revenue dedication began in the Montana Territory in the early 1860s. In 1864, the legislative assembly divided the interest earned on the principal collected from the sale of school lands among the school districts in the territory (Laws of Montana Territory 1864, Ch. 1, Sec. 1). Money from the sale of licenses for bowling alleys, billiard saloons, and liquor sales was also dedicated for education. Four years later, the assembly dedicated property taxes collected by the territorial counties for territorial purposes, county purposes, schools, and welfare (Laws of Montana Territory 1868, p. 6). For example, a levy of not less than one mill nor more than five mills on property was to be used for the benefit of the poor. In 1876, the assembly enacted a bill which permitted counties to dedicate certain amounts to sinking funds for the payment of the principle and interest on bonds (Laws of Montana Territory 1876, p. 50).

When Montana gained statehood, its state legislatures continued to dedicate revenues. The most popular objects of earmarking were education, highways, and livestock programs.

As state revenues increased and the number of state government services expanded, state legislatures increased the number and amount of dedications. In 1921, a State Fish and Game Fund was established to hold the money generated from money from the sale of hunting and fishing licenses, the sale of seized hides, and fines for violations

of fish and game laws. The fund was set apart and made available only for the payment of salaries, expenses, and "expenditures of every source and kind whatsoever, authorized to be made by the State Fish and Game Commission" (Laws of Montana 1921, Ch. 238, Sec. 1).

Other major sources of state revenue were also dedicated to special purposes. The state individual income tax, enacted in 1933, was allocated fifty percent to the general fund and fifty percent to education. The allocation was subsequently changed to sixty-four percent to the general fund, twenty-five percent to education, and eleven percent to the long-range building fund (15-1-501 and 17-5-408 MCA). In 1927, the gasoline license tax was entirely dedicated to highway construction and maintenance. It has since been further dedicated to fund local streets and roads (\$6,500,000) with the remaining collections going to highways and state parks (15-70-101 and 60-3-201 MCA).

In 1975, the legislature enacted a coal severance tax and dedicated the revenue to thirteen different purposes (15-35-108 MCA). The most recent dedication of a portion of the coal tax was to the State Library Commission in 1979.

Most revenues now collected by the state are subject to spending allocations which were established by previous legislatures. Revenues ranging from the architect's exam fee to the corporation income tax are diverted into special accounts and used only for the support of certain services.

Table 1 lists twelve major revenues collected by Montana and their disposition in 1963 and 1979.

TABLE 1
DISPOSITION OF MAJOR MONTANA REVENUES
1979 AND 1963

Revenue Classification	Collections (in Thousands)		% To Gen. Fund		Dedicated to Other Purposes 1979 (1963)
	1979	1963	1979	1963	
Individual Income Tax	\$141,421	\$13,934	64	75	25% Education (25%); 11% Building
Corporation License Tax	36,092	4,723	64	75	25% Education (25%); 11% Building
Property Taxes	24,422	6,394	3	23	92% Schools (72%); 5% Livestock (5%)
Insurance Taxes	14,367	2,472	75	92	12% Firemen (8%); 9% Police; 4% Firemen Pension
Motor Fuel Taxes	48,359	19,682	0	0	98% Highways (97%); .9% Aviation (3%); 1.1% State Parks
Motor Vehicle License	14,827	4,192	0	0	100% Highways (100%)
Operator License	1,243	605	95	85	5% Traffic Education (15% State Police Retirement)
Tobacco Taxes	11,364	6,405	34	60	66% Building (40% Veteran's Bonds Debt Service)
Alcoholic Beverage Tax	11,689	4,135	70	83	30% Local Police (17% Local General Purpose)

TABLE 1 - Continued

Revenue Classification	Collections (in Thousands)		% To Gen. Fund		Dedicated to Other Purposes 1979 (1963)
	1979	1963	1979	1963	
Severance Taxes	\$50,901	\$ 2,769	41	97	59% Other (3%)
Inheritance Tax	6,490	2,074	100	100	0%
Hunting & Fishing	7,841	2,136	0	0	100% Wildlife (100%)

In only one case, vehicle operator license fees, is the percentage placed in the general fund greater in 1979 than in 1963. The allocations to the general fund from four of the revenues remain the same. Most importantly, the general fund proportions of seven major revenues are less in 1979 than in 1963.

Scope of Revenue Dedications

Survey of the States

There has been little recent information about the scope of revenue dedication among the fifty states. The first study of earmarking was done by the Tax Foundation in 1954. It revealed that 51.3 percent of state tax collections nationwide was dedicated for special purposes (Tax Foundation 1955). The second Tax Foundation Study, completed in 1963, indicated that the proportion of dedicated revenues had dropped to 41.1 percent (Tax Foundation 1963, p. 11). The 1963

report suggested that the 10.2 percent decrease in dedications was due to two factors. One cause for the decrease was the removal of dedication provisions from particular revenue sources. North Dakota, for example, de-earmarked its sales tax. The result was a drop in the proportion of dedicated revenues of thirty percentage points between 1954 and 1963 (p. 11).

The second reason for the decrease in dedicated proportions was the expansion of non-dedicated revenue sources. States which levied new major non-dedicated taxes reduced their proportions of dedicated revenues to total collections. In Texas, for example, the earmarked proportion decreased between 1953 and 1964 due to the addition of a non-dedicated general sales tax (p. 11).

In order to determine the present scope of revenue dedications, this author conducted a nationwide survey of state tax collections and dedications for fiscal 1979. The study was undertaken in order to compare the present scope of dedications with the result of past studies. More specifically, the intent was to determine where Montana's proportion of dedications was in relation to dedicated proportions in other states.

Among the difficulties confronted in compiling data from the study were the differences between the states' reporting systems and accounting techniques. As an illustration, when requested to provide income tax collection data, some states included refund amounts; other

states did not. In order to assure consistency in the definitions of taxes and the amounts reported from state to state, the dedicated proportions calculated for each state were based on amounts of state tax collections reported in State Government Tax Collection Report in 1979, compiled by the U. S. Bureau of Census (1979).

Other difficulties arose in determining whether a particular tax should be defined as dedicated. Some states deposited revenues in their general fund even though the revenue was to be used for a special purpose. Similarly some states placed revenues in special clearing accounts and the revenue eventually was deposited in the general fund. When there was difficulty in interpreting a state's response, the state was contacted and assistance requested in determining the status of a particular revenue. In general, the techniques used to collect the data were patterned after the Tax Foundation Studies (1955 and 1963) so that the results of the survey could be compared to the results of the earlier studies.

Forty-six states responded to the survey of dedicated revenues. The four states not responding were Kentucky, Mississippi, Oklahoma, and Wisconsin.

Results of the Survey

Based on the survey of dedicated state tax collections in fiscal 1979, the average proportion of dedicated revenue to total state revenue nationwide was twenty-three percent. This was 18.1 percent

less than the nationwide average in 1963 and 28.3 percent less than the nationwide average in 1954. The survey indicated that the trend among the states was a reduction in the proportion of dedications.

Forty-one states showed decreases in their dedicated proportions between 1963 and 1979. In some states, the decreases were substantial. Louisiana, for example, reduced its dedicated proportion from eighty-seven percent in 1963 to five percent in 1979. The reduction in dedications was primarily due to the removal of constitutional dedication provisions by that state. Decreases in most states were more moderate, however. The average decrease among the states reporting reduced dedicated proportions was 17.9 percentage points.

The proportion of dedicated revenues increased in only five states between 1963 and 1979. The most outstanding increase was in New Jersey where dedications increased twenty-three points, from two to twenty-five percent. Most of the increase was due to the expansion of New Jersey's individual income tax which is dedicated for education, local revenue sharing, and other purposes. Montana was among the states indicating increased dedications. The average increase among the five states reporting increased dedications was seven percentage points.

Table 2 shows the proportion of dedicated revenue for each state in fiscal years 1954, 1963, and 1979. It also shows the change between 1963 and 1979 in the proportion dedicated by each state.

TABLE 2
 PROPORTIONS OF REVENUES DEDICATED BY STATES
 IN FISCAL YEARS 1954, 1963, AND 1979

State	Percentage of State Tax Collections Earmarked ^a			Percentage Points of Change 1963-1979
	1954	1963	1979	
1. Alabama	89	87	88	+ 1
2. Alaska	b	6	1	- 5
3. Arizona	47	51	31	-20
4. Arkansas	41	36	21	-15
5. California	42	28	14	-14
6. Colorado	75	51	17	-34
7. Connecticut	26	23	0	-23
8. Delaware	0	3	0	- 3
9. Florida	40	39	28	-11
10. Georgia	29	22	11	-11
11. Hawaii	b	7	5	- 2
12. Idaho	51	44	38	- 6
13. Illinois	39	43	14	-29
14. Indiana	49	39	43	- 4
15. Iowa	51	44	19	-25
16. Kansas	77	66	29	-37
17. Kentucky	46	29	c	
18. Louisiana	85	87	5	-82
19. Maine	46	39	19	-20
20. Maryland	47	40	34	- 6
21. Massachusetts	56	54	41	-13
22. Michigan	67	57	38	-19
23. Minnesota	73	74	12	-62
24. Mississippi	40	37	c	
25. Missouri	57	40	20	-20
26. Montana	61	53	55	+ 2
27. Nebraska	55	53	41	-12
28. Nevada	55	35	34	- 1
29. New Hampshire	53	54	31	-23
30. New Jersey	7	2	25	+23
31. New Mexico	80	31	36	+ 5
32. New York	13	10	0	-10
33. North Carolina	38	30	20	-10

TABLE 2 - Continued

State	Percentage of State Tax Collections Earmarked ^a			Percentage Points of Change 1963-1979
	1954	1963	1979	
34. North Dakota	73	43	29	-14
35. Ohio	48	48	21	-27
36. Oklahoma	62	59	c	
37. Oregon	47	36	23	-13
38. Pennsylvania	41	63	15	-48
39. Rhode Island	6	4	0	- 4
40. South Carolina	69	62	56	- 6
41. South Dakota	59	54	33	-21
42. Tennessee	72	77	60	-17
43. Texas	81	66	54	-12
44. Utah	74	62	52	-10
45. Vermont	42	39	23	-16
46. Virginia	39	32	27	- 5
47. Washington	35	30	29	- 1
48. West Virginia	57	39	21	-18
49. Wisconsin	63	61	c	
50. Wyoming	61	64	54	-10
Average	51.3	41.1	23	-18.1

^a 1954 and 1963 figures are from Tax Foundation. Earmarked State Taxes. New York: Tax Foundation, Inc., 1963, p. 12.

^b 1954 study did not include Alaska and Hawaii.

^c Information on dedication was not received from this state.

Overall, the tendency toward reduced revenue dedication appears to result from two factors. As concluded in the 1963 study, dedicated revenue proportions have decreased due to actions by states to remove dedication provisions from their constitutions and statutes. For

example, Louisiana, Connecticut, Delaware, and Alaska had taken measures to limit new dedications and remove existing ones. In Alaska, the constitution specifically prohibits the dedication of revenues for special purposes.

The second factor which influenced the reduction in dedications was the expansion of non-dedicated revenues. The growth of non-dedicated general sales and income taxes in Nebraska, Ohio, and South Carolina, for example, caused their dedicated proportions to decrease even though the number of dedications had remained constant or increased.

The questionnaires which were sent to the fifty states grouped state taxes and fees into five major categories. These categories were sales or gross receipts; income; highway user; license; and miscellaneous taxes. Table 3 shows the number of states which levied taxes within these categories and the number of states which dedicated the receipts. If a state dedicated more than ten percent of the receipts from a tax, the tax was defined as dedicated and the state was included in the number dedicating the tax.

TABLE 3
NUMBER OF STATES LEVYING AND DEDICATING CERTAIN TAXES
FISCAL YEAR 1979

State Tax	Number of States Levying Tax	Number of States Dedicating Tax (more than 10% of receipts dedicated)
<u>Sales or Gross Receipts</u>		
1. General	41	11
2. Alcoholic Beverages	46	17 ^a
3. Tobacco Products	46	22 ^a
4. Insurance	46	11 ^a
5. Public Utility	33	12
<u>Income</u>		
6. Individual	40	8 ^a
7. Corporation	42	8 ^a
<u>Highway User</u>		
8. Motor Fuel	46	39 ^a
9. Motor Vehicle Reg.	46	39 ^a
10. Operator License	45	34
<u>Licenses</u>		
11. Corporation	45	3
12. Hunting & Fishing	46	44 ^a
<u>Miscellaneous</u>		
13. Property	29	16 ^a
14. Death & Gift	45	2
15. Severance	20	15 ^a
16. Docum. & Stock Transfer	20	2

^a Montana included in the number of states dedicating the tax.

Hunting and fishing license fees were most frequently dedicated by the states. Taxes in the highway user category were the next most subject to dedication. Death and gift taxes, income taxes, and corporation license fees were among the least frequently dedicated revenues.

Highway user taxes accounted for the largest portion of the dedications in many states. About eighty-five percent of the states dedicated these taxes for highways and transportation. Table 4 shows the percentage of each state's tax collections which was dedicated in fiscal 1979 and the percentage specifically dedicated for highway purposes.

TABLE 4
 PERCENTAGE OF STATE TAX COLLECTIONS
 DEDICATED FOR HIGHWAYS AND
 ALL PURPOSES^a
 (Fiscal Year 1979)

State	Percentage Dedicated For Highways	Percentage Dedicated For All Purposes
Alabama	12	88
Tennessee	17	60
South Carolina	14	56
Montana	17	55
Texas	13	54
Wyoming	20	54
Utah	13	52
Indiana	14	43
Massachusetts	7	41
Nebraska	19	41
Idaho	21	38
Michigan	13	38
New Mexico	12	36
Maryland	15	34
Nevada	12	34
South Dakota	22	33
Arizona	12	31
New Hampshire	27	31
Kansas	17	29
North Dakota	19	29
Washington	12	29
Florida	14	28
Virginia	16	27
New Jersey	0	25
Oregon	15	23
Vermont	21	23
Arkansas	18	21
Ohio	15	21
West Virginia	19	21

TABLE 4 - Continued

State	Percentage Dedicated For Highways	Percentage Dedicated For All Purposes
Missouri	15	20
North Carolina	15	20
Iowa	19	19
Maine	15	19
Colorado	11	17
Pennsylvania	13	15
California	8	14
Illinois	12	14
Minnesota	11	12
Georgia	11	11
Hawaii	4	5
Louisiana	2	5
Alaska	0	1
Connecticut	0	0
Delaware	0	0
New York	0	0
Rhode Island	0	0

^a Kentucky, Mississippi, Oklahoma, and Wisconsin not included in survey.

Dedications for highway and transportation purposes accounted for over one-half of the dedications in twenty-two of the forty-six states responding. They accounted for the largest portion of taxes dedicated to a single purpose in all states except New Jersey and Alaska.

Montana's Proportion of Dedications
in Relation to Other States

Montana ranked high among the states in the proportion of revenue dedicated to special purposes. In 1963, sixteen states had greater

proportions of dedicated revenues than Montana (Tax Foundation 1963, p. 12). By 1979, Montana's rank increased to fourth. Only Alabama (88%), Tennessee (60%), and South Carolina (56%) ranked higher than Montana (55%) in fiscal 1979. The remaining states dedicated smaller proportions of their revenues.

Montana ranked highest in dedications among the other states in the intermountain area. Neighboring states reported the following proportions: Idaho (38%); North Dakota (29%); South Dakota (33%); Utah (52%); Washington (29%); and Wyoming (54%). States in the north-eastern United States appeared to have the lowest proportions of dedicated revenues in the nation.

Montana was one of five states that experienced an increase in dedications between 1963 and 1979. The proportion of dedications increased two percentage points. This increase can be attributed in large part to recent coal tax levies and the dedication of coal tax receipts. Expansion of other dedicated revenues, such as the individual and corporation income taxes and highway user taxes, also contributed to maintaining the level of dedications.

Unlike many other states, Montana's highway user taxes accounted for less than half of the total amount dedicated. Seventeen percent of the fifty-five percent dedicated in Montana was due to dedications for highway purposes. The remaining thirty-eight percent of total revenue was dedicated for other purposes. Montana dedicated a portion

of fourteen of the seventeen revenue sources used in the survey. In general, Montana relied more heavily on dedicated revenues than ninety-one percent of the states responding.

Conclusion

In general the survey indicates a trend toward reduced proportions of dedicated revenues in the states. The reduction is a result of the elimination of dedication provisions and the growth of non-dedicated revenue sources.

Contrary to the nationwide trend, Montana's proportion of dedicated revenues increased two percentage points between 1963 and 1979. The increase can be attributed to the addition of a dedicated coal tax and expansion of other major dedicated taxes. Montana currently ranks fourth nationwide in the proportion of dedicated revenues.

Political Justifications for Revenue Dedication

Introduction

Many authors have suggested that revenue dedications are largely political attempts to control the allocation of public funds. James Maxwell (1969, p. 214), for example, states that pressure groups use dedications in order that their programs avoid "annual legislative scrutiny, evaluation, and vote of money."

Charles Goetz (1968, p. 135) states that if earmarking can increase an interest group's gains at each point in time it is also an

efficient way of maximizing the group's long-range gains from governmental spending. He suggests that revenue dedication may also be rational given the need for interests groups to bargain and make contracts with one another in order to "win" in the majority-rule decision process.

There are, then, political reasons for revenue dedications. These political reasons play a major role in explaining why dedications are made and why it is difficult to eliminate them.

Participants in the Dedication Process

The political aspects of revenue dedication can be defined by examining the major participants in the legislative process and their motives for dedicating revenues. For the sake of this discussion, the participants are identified as legislators, the governor and his staff, agencies, and interest groups.

Legislators are those individuals who have served or presently serve as elected representatives of the public in the state legislature. They are often seen as representing the interests of the general public, but they may also, especially in attempts to dedicate, represent particular groups and causes. In Montana, for example, some legislators favor state policies which help ranchers. This bias influences their outlook on the dedication of taxes for livestock purposes.

The governor and his staff also represent many different interests. These interests vary over time and reflect changes in the environment. They cause the governor to take different stands on proposals to dedicate revenues. At one time, the executive's staff may pursue a course designed to facilitate adoption of a proposal which would increase executive power. At another time their actions may reflect an upcoming gubernatorial election. At yet another time they may support a dedication which has much public support. In terms of the earmarking process, the governor and his staff use revenue dedication as a means of achieving one or a combination of these goals.

Agencies are defined as the governmental units which are responsible for the implementation of state programs. In Montana they include the Department of Fish, Wildlife and Parks; the Department of Social and Rehabilitative Services; and the Department of Highways; among others. In general, they operate from their own agency's perspective and are less concerned with decisions on issues which are outside of their jurisdiction. Like legislators and the executive staff, however, agencies are interested in how revenue dedications might affect them and their interests.

Interest groups are those individuals who, although they are outside of the bureaucracy, still have an interest in making an impact on state government. This interest might be further defined as the

desire to influence state spending. In Montana, interest groups include ranchers, snowmobilers, laborers, librarians, and businessmen. They also include broad groups of people who are served by state programs and therefore have an interest in their funding. While all groups may not express interest in every revenue dedication proposal, they quickly rally when decisions affecting their interests are to be made.

Although described as separate entities, these participating groups in the legislative process overlap in membership and concerns. The administrator of an agency may at one time advocate a dedication proposal which enhances his agency as well as supports the cause of an interest group that he identifies with. A member of an interest group may act on behalf of that group, but he may also act in a way which helps his future election goals. In this way, participants in the legislative process, and more particularly the dedication process, organize and reorganize depending on the time, the issue, and the environment.

Motives for Dedicating Revenues

Just as individuals share memberships in these participant groups, the groups share motives for desiring the dedication of a revenue. In some cases their success in dedicating a revenue is very important, for it will insure that their interests are represented

(i.e. funded) even after they no longer take an active role in decision making.

There are several political motives for earmarking a tax. James Buchanan (1963, p. 458) sees revenue dedication as an effective tool for providing greater individual input into spending decisions. He states that the segregation of state revenues from the general fund can also be a means of insuring more rational individual choice. He suggests that under general fund appropriations an individual may only vote for a legislator or governor who he feels will support the best package of services supported by general fund money. In contrast, when a revenue is dedicated for the support of a program, theoretically an individual may "vote" to support the program by using or not using the service and paying or not paying a fee for it. Under this circumstance, the participant may feel that his options and impact on government are increased. This motive for dedicating a revenue, then, is to increase one's impact on government.

A second motive for dedicating a revenue is to gain public support for new or higher taxes. In its 1955 report, the Tax Foundation discussed earmarking as a device for generating taxpayer support for new taxes and new programs. In order to increase support for a new tax, an attempt is made to dedicate at least a portion of the tax for a popular program. For example, a proposal to increase individual income taxes might be made. If the increased revenue will be used for

general support of state government, it is less likely that the public will support the increase. On the other hand, if a portion of the revenue will be dedicated for education or another popular program, there is more likely to be public support for the proposal. Legislators and the governor are likely to use dedications for this purpose.

Similarly revenue dedication can be used to increase a sense of equity for those who are required to pay a new fee for a government service. As an illustration, snowmobilers may be more willing to pay a fee for snowmobile trail use if they know that the revenue from the fee will be used to groom the trail. This sense of equity is substantially reduced if snowmobilers find that their fees are being used to build a new highway or spent on other state projects.

Revenue dedication may also provide a way to gain a majority consensus among participants in the legislative process. Charles Goetz (1968, p. 136) proposes that revenue dedication is a valuable tool for forming majority coalitions among various interest groups. He sees the legislative process as including many diverse groups and interests. Earmarking is a way in which these groups can make contracts with each other which will provide mutual benefits. For example, the dedication of a particular tax for firemen's pensions and police pensions may provide enough support for the proposal that it becomes law. It then provides benefits for both police and firemen. The possibilities for such contracts are endless. In Montana, for

example, libraries share a portion of coal severance tax receipts with alternative energy development.

Another political motive for dedicating revenue is its ability to insure long-term funding for a particular program (Hyde and Shafritz 1978, p. 407). In an effort to make sure that their interests are supported in the future, legislative participants seek to attach their programs to the revenue from a permanent tax or fee. In this way funding for their program is assured. The program is also less subject to control by the legislature (Maxwell 1969, p. 214). Agencies may be particularly interested in securing a funding source for their programs which reduces the amount of scrutiny which they are subject to. An investigation of the number of times that Montana's Department of Fish, Wildlife, and Parks has sought a new dedication quickly convinces one that the agency perceives that some advantage is to be gained.

A recent example of an agency's attempt to establish a dedication is the dedication of a portion of the coal severance tax to the State Library Commission (15-35-108 MCA). The dedication took place during the 1979 Montana Legislative Session. Historically, the Commission has had difficulty establishing legislative support for its programs. This lack of support often resulted in lower levels of funding than library personnel thought adequate. During the 1979 session, librarians and other interested groups lobbied hard to gain support for a

proposal to earmark a portion of the coal tax for libraries. After several compromises were made, legislators passed a bill which dedicated one-half of one percent of coal tax collections for the support of libraries in the state. With this portion of the coal tax set aside for libraries by law, the State Library Commission is less likely to find the support of the legislature as important in the future. In addition, it is assured a long-term source of funding for its programs.

In general, greater input from interest groups, the ability to reach a majority consensus among legislators, the prospect of increasing public support for new taxes and programs, and reduced legislative control over the programs of agencies comprise the major political motives for dedicating revenues.

Decentralization Through Revenue Dedication

The validity of these motives for earmarking depends in part on the extent to which one feels that dedication can result in the decentralization of government; the result of decentralization being a more responsive government.

The association of a program's funding with a particular tax and group of taxpayers can have the effect of increasing an agency's responsiveness to those taxpayers. For example, fish and game departments must respond to the needs of hunters and fishermen because outdoorsmen usually pay the fees that support such departments. In

contrast, general fund supported agencies may be less concerned with the demands of their clientele because their funding may depend less on being responsive. In this sense, revenue dedication can encourage administrators to respond to local needs and demands.

James Buchanan (1963, p. 458) suggests that revenue dedication can go so far as to increase the ability of individual taxpayers to control state spending. He states that this potential for the involvement of all interested persons can result in the most efficient allocation of limited resources.

Buchanan's argument must, however, be based on an assumption that all individuals have an equal opportunity to propose and gain support for a revenue dedication. A casual survey of those groups which have been successful in dedicating revenues reveals that these groups are generally powerful and have well established organizations. For example, those who favor the dedication of gasoline taxes for highways represent oil producers, the construction industry, and labor groups. It does not appear that the dedication of gasoline taxes is representative of anything other than the concerns of these large interest groups.

Another assumption which needs to be made to support Buchanan's conclusion is that individuals have the discretion to pay taxes which are dedicated to their favorite programs and not pay taxes which are dedicated to others. In the case of fishing license fees this may be

true. However, for many taxes which are levied and dedicated, such as income taxes and sales taxes, the individual has little choice over whether he will pay them.

The argument for decentralization via revenue dedication is less convincing to this author than it apparently is to Buchanan. Because of the assumptions that need to be made, in practice revenue dedication does not seem to result in any different allocation decisions than those which result when the legislature appropriates funds from a general fund for a program. This conclusion is also reached by Elizabeth Deran (1965, p. 361) in her article, "Earmarking and Expenditures: A Survey and a New Test." Deran states that dedicating a revenue appears to have little effect on the level of expenditures for a program in most cases. She suggests that earmarking may, however, provide a greater level of funding for programs which are experiencing a decline in demand.

Conclusions

Arguments for the use of revenue dedication as a way of decentralizing government have been made by proponents such as Buchanan. Until it can be proven that such decentralization results in outcomes which are different from those arrived at under general fund support of programs, it is difficult to argue for revenue dedication on that basis. Instead, since outcomes under dedications are similar to those obtained under general fund support, it appears necessary to determine

the merits of revenue dedication on some other basis. One example might be the effect of revenue dedication on the complexity of a program's funding.

An examination of the political motives for dedicating revenues does underline, however, the need to consider the political implications of earmarking. This may be especially true when recommending the de-earmarking of a dedicated revenue.

Economic Justifications for Revenue Dedication

Introduction

Many authors refer to theories of taxation as the basis for the dedication of revenue. Paul Samuelson (1970, p. 155) distinguishes two major groups of taxation theories.

The first group of theories is based on the principle that taxation should accomplish whatever redistribution of resources that society regards as proper and equitable. Under this principle, individuals having many resources are taxed so that some of their wealth can be redistributed to those individuals having less. A similar principle mandates that wealthier individuals pay the largest proportion of government's costs because they can best afford it. Under these theories people are taxed in a way which leads to an equitable pattern of sacrifice as defined by society.

The second group of taxation theories is based on the concept that taxation should be related to the amount of benefit that an individual receives from an activity. For example, if a first person receives one unit of benefit from a government service and a second person receives two units, the person receiving two units should pay more than the first person. This notion of taxation is often called the "benefit theory of taxation" (Deran 1965, p. 357).

These broad principles of taxation underlie the establishment of income taxes, sales taxes, and other taxes to varying extents. The taxes adopted by states are often combinations of these general groups of theories. As an example, Montana's University System is supported both by student tuition fees and also by appropriations from the general fund. It appears that decision makers have decided that it is equitable for students to pay a portion of the cost of their education, but also that other taxpayers, who may be better able to pay than students, should also contribute to the universities' support. There is also the assumption that universities benefit not only students, but also society in general.

Other considerations also affect tax decisions. Some taxes are levied for ethical reasons. As an illustration, alcoholic beverage taxes are often justified on the basis of the effects of alcohol on society. Taxes on tobacco products receive similar justification.

The administrative feasibility of collecting a tax may also affect how revenues are collected for the support of government.

Benefit Theory and User Charges

Despite the evolution of theories on how and whom to tax, there is no general theory which dictates how tax revenues are to be distributed after their collection. Case Sprenkle and William Habacivch (1963, p. 816) in particular, comment on the lack of such a theory and especially on the lack of such a basis for earmarking. In the absence of a theory on the allocation of tax revenues, authors have often stated that revenues should be allocated in ways which are equitable to those paying the taxes (Simkin 1975, p. 33). In this sense they use the converse of the benefit theory of taxation to justify dedicating a revenue for a particular program.

This rationale and the benefit theory have led to the development of "user charges" by many governments. User charges are charges to consumers of government services which have the characteristics of private goods. John Due and Ann Friedlaender (1973, p. 97) suggest that user charges provide an alternative to distributing government services free of charge and financing their production by general taxation. They state that user charges are only appropriate, however, when the benefits received by those paying the costs can be excluded from those who do not pay. Thus while user charges for a campground might be appropriate, because entrance can be limited to those who

pay, user charges for air pollution controls would not be appropriate due to the inability to exclude the benefits of clean air to non-contributors.

Another constraint on the use of user charges is the problem of determining the proper level of fees. Governments should not collect less than the cost of these services because, they would then have to subsidize the services through general taxation. They should not collect more, because the excess might be used to pay for benefits not received by those paying the charges. The establishment of proper charges for a service is difficult for the type of services often provided by governments.

Finally, user charges are often inappropriate because they undermine other reasons for taxation. They cannot by themselves reflect a resource redistribution policy used by a government. For example levying user charges for welfare services would make it necessary to charge the poor in order to support welfare programs.

Thus while the concepts of user charges and the benefit theory of taxation are appealing, their application to many government functions is inappropriate. Instead, general taxation must be used to support the services.

Despite the limitations on the use of user charges, they have been used extensively by some state governments. Maxwell (1969, p. 214) suggests that user charges and revenue dedications supposedly

based on the benefit theory have been over-extended in many areas. He cites instances in which user charges are used for services which provide collective benefits and examples where dedications are based on petty instances of benefit-cost relationships.

Conclusions

The benefit theory of taxation may be adequate justification for revenue dedication. However, there are limitations on the application of the theory and user charges in government. An examination of these limitations leads to skepticism regarding the widespread use of revenue dedication in Montana. A proposal to evaluate Montana's application of the benefit theory to dedications is the topic of Chapter Three.

Advantages and Disadvantages of Revenue Dedication

The preceding pages have identified some of the reasons why revenues are dedicated to particular purposes. Some of the disadvantages have also been mentioned. In this section, the advantages and disadvantages of earmarking are listed in order that some comparisons and conclusions can be made about them. The literature identifies a number of different outcomes of revenue dedication. The ones listed below are those which appear in the literature most frequently.

Advantages of Revenue Dedication

1. Dedicated revenues can link the cost of government services to those who receive the benefits (Simkin 1975, p. 33).

When a government function provides distinct benefits and its costs and users can be easily identified, dedication can be used to increase taxpayers' sense of equity. Under dedications, taxpayers may feel that the charges they pay directly reflect the amount of benefit they receive from a government service. As Due and Friedlaender (1973) state, however, there are limitations on the use of this principle for government services.

2. Dedicated revenues can provide for more individual participation in governmental decision making (Buchanan 1963, p. 458).

When a revenue source is dedicated to a particular service, an individual taxpayer has more opportunity to choose among the government functions that he wishes to support. For example, if revenues from campground fees are dedicated for campground construction, an individual may, through use or non-use of campgrounds, influence spending for new campgrounds. The same individual input is not available when funds are appropriated in a campground package from the general fund. As stated earlier this advantage depends on the assumption that an individual has a choice of whether to pay a tax or not. If payment is mandatory, the dedication forces the individual to fund

a function which he may not personally support.

3. Dedicated revenues can provide decision makers with information about the public demand for a service (Hirsch 1970, p. 31).

When there is a direct relationship between those who benefit from a service and those who pay for it, dedication can strengthen the relationship. It can provide decision makers with better information about demand through indirect pricing. This link between costs and benefits can also serve to ration government services through the use of user fees.

4. Dedicated revenues can force legislators to consider how they will raise revenue collections at the same time they decide to increase expenditures (Goetz 1968, p. 133).

Since dedication ties expenditures for a program to revenue from a single tax, any increase in program expenditures must be preceded by an increase in the collections from the tax. This forces legislators to determine how taxes will be raised at the same time they decide to increase expenditures for a program.

5. Dedicated revenues can supply an uninterrupted source of funding for programs which require advance decisions (Hyde and Shafritz 1978, p. 407).

The federal government often uses revenue dedication to provide long-term funding for a commitment. Revenue dedication allows

administrators to make more long-range plans for their programs than biennial general fund appropriations permit. In some cases this long-range planning may result in greater program efficiency and better attainment of long-range goals.

6. Dedicated revenues can provide political incentives for participants in the legislative process (Goetz 1968, p. 136).

Revenue dedication can act as a stimulus to gain support for new taxes and a way to reach a majority consensus on issues. It can also act as a written contract between legislators which spells out a bargaining agreement. Dedications are tools which can be used to facilitate the negotiations and compromises which are parts of the legislative process.

Disadvantages of Revenue Dedication

1. Dedicated revenues can become imbedded in the financial structure (Deran 1965, p. 357).

Since de-earmarking requires new laws, and in some cases constitutional amendments, there is a tendency for dedications to remain in effect for a long time. They may continue in force even after the need for them ceases or conditions affecting them have substantially changed. The existence of outdated dedications may preclude the legislature's ability to effectively deal with the current issues faced by state government.

2. Dedicated revenues can correlate public demand to spending initially, but the correlation disappears over time (Deran 1965, p. 356).

The allocation formulas established by dedication provisions reflect public demand for a service at one point in time. Frequently there is no mechanism which adjusts collections to reflect future increases or decreases in demand. As a result, the money generated by dedicated taxes in future years often does not correspond to the amount justified by demand. This can lead to overproduction or underproduction of the service. It can also result in overfunding or underfunding of the program.

3. Dedicated revenues can complicate the administration and evaluation of programs.

The complicated formulas and procedures often associated with dedicated revenues make it difficult to identify revenue patterns and establish revenue estimates. Dedicated revenues can also impair budget flexibility and unity by dictating expenditures and segregating revenues into many small accounts. They can obscure budgeting problems by making it impossible to consider and analyze all state money as a total package.

4. Dedicated revenues can lead to the substitution of revenue dedication for comprehensive state planning (Caiden and Wildavsky 1978, p. 463).

As stated earlier, dedication may enable program managers to make long-range plans for their programs. However, the ability to make long-range plans for many individual programs may preempt the ability of the legislature to design a single long-range plan for all state functions. In this sense, revenue dedications can lead to a multitude of separate and uncoordinated efforts to spend public funds.

5. Dedicated revenues can complicate the debt structure and undermine state credit (Maxwell 1969, p. 218).

When used to service debt, dedications can lead to the development of a confusing system of prior and subordinate liens on a revenue source. Dedicated revenues can affect credit ratings unfavorably because debt repayment depends on continued revenue from a single tax. Maxwell (1969, p. 218) recommends that the general fund be used as the basis for incurring indebtedness.

6. Dedicated revenues can result in a loss of legislative and executive scrutiny and control over state finances (Maxwell 1969, p. 215).

By their nature, dedications remove spending decisions from the legislature. Once dedicated, the proceeds of a tax must be spent for a particular function regardless of other programs' needs. Revenue dedication also reduces legislative scrutiny over spending because dedicated funds are generally allocated and spent outside of the appropriation processes which other funds are subject to. Legislators

often consider dedications to be long-term spending decisions. Consequently, they feel there is less need for them to question program expenditures on a year to year basis.

Conclusions

The extent to which one believes that the advantages of earmarking outweigh the disadvantages, or vice versa, depends on one's perspective. James Buchanan (1963), for example, feels that increased individual input from revenue dedication outweighs the problems of reduced legislative scrutiny and inflexible budgets. Naomi Caiden and Aaron Wildavsky (1978, p. 464) state, "Undesireable consequences flowing from earmarked taxes, secret funds, and autonomous agencies far outweigh advantages."

Based on an examination of the advantages and disadvantages listed above, the following observations about revenue dedication are made.

1. The advantages of earmarking are to a large extent dependent on the sound use of the benefit theory of taxation and user charges. Better demand information, increased individual participation, and the rationing function disappear when there is no direct relationship between those who benefit from a service and those who pay the costs. In order that these advantages be received, dedications should be made only in those instances where there is a direct link between costs and

benefits and the benefit theory is the only basis for the levy of the tax or fee. When such a link is not obvious, the revenue should not be dedicated.

2. Many of the advantages of dedicated revenues, such as demand information and long-range program planning, are at the individual or agency level. Many of the disadvantages, such as spending inflexibility and the inability to carry out statewide priorities, are to the executive and legislature. It appears that advantages should be weighed against disadvantages when a proposal is made to dedicate a revenue. In instances where the advantages do not outweigh the disadvantages, the revenue should not be dedicated.

3. The disadvantages of dedicated revenues are reduced when dedications use simple allocation formulas which reflect current circumstances and funding needs. Dedication provisions should also provide for revenue allocations which will reflect future conditions. The problems of monitoring the expenditure of excess money and appropriating additional money from the general fund are encountered when dedicated revenues do not generate funds which are near the required level for a fiscal year.

As Deran (1965) concluded in her study, the actual funding levels provided by revenue dedications do not appear to differ substantially from those provided by general fund appropriations. In terms of

expenditures, then, either system seems to equally reflect the interests of participants in budgeting decisions. There are differences, however, in the extent to which dedications permit the executive and legislature to control total state spending and establish priorities for state government. These considerations should play some part in the decision to dedicate a revenue.

Summary

This chapter provided an overview of revenue dedication. The history and scope of earmarking were discussed as they relate to earmarking in Montana. There was also a discussion of the political and economic justifications for dedicating revenues. Based on a comparison of earmarking's advantages and disadvantages, it was concluded that revenue dedications can be both an asset and a liability in state government. It was suggested that an evaluation of the advantages and disadvantages be a part of the decision to dedicate a revenue. A proposal for such an evaluation is the topic of the next chapter.

Chapter III

PROPOSAL FOR EVALUATION

Introduction

Chapter Two discussed the advantages and disadvantages of earmarking. It was concluded that while there are reasons for dedicating a revenue, there are also reasons why revenues should not be dedicated. Reasons for not earmarking include lack of a direct benefit-cost relationship, reduced legislative control over spending, and reduced ability of the executive to establish statewide priorities, among others.

This chapter identifies a proposal to evaluate individual revenue dedications in Montana to determine to what extent they provide disadvantages for the Governor and Legislature of Montana. The seven criteria to be used for the evaluation are discussed. These criteria are based on the characteristics of revenue dedication which were presented in Chapter Two. This chapter also lists ten dedicated revenues which are chosen for evaluation.

Proposal

Montana dedicated fifty-five percent of its revenues in fiscal 1979. The purpose of this paper is to determine whether this level of revenue dedication disadvantaged Montana's executive and legislative branches. In order to determine the effect of these dedications, it is proposed that an evaluation of Montana's dedicated revenues be

undertaken. It is intended that such an evaluation will lead to a conclusion on the propriety of a dedication and a recommendation for the revenue's future disposition.

The literature investigated earlier presents a concept of what comprises a "sound" revenue dedication. For example, the application of the "benefit theory" and appropriateness of user charges influences whether a revenue should be dedicated or not. The ability of a dedicated revenue to adequately fund a program is also a factor. Other considerations include the ability of the dedication to reflect future circumstances and provide better demand information about a program.

Seven Criteria

The following list identifies seven criteria which will be used to evaluate individual revenue dedications. These criteria are based on the literature's definitions of dedication's advantages and disadvantages. It is suggested that these criteria identify "sound" revenue dedications. The justifications for using these criteria are also discussed.

1. Is the revenue dedication used to strengthen the link between those who pay the cost and those who benefit?

Authors of earmarking articles often suggest that revenue dedication is based on the benefit theory of taxation (Simkin 1975, p. 33). The benefit theory states that those who receive the benefits of a

program should pay its costs. This criterion will be used to determine whether there is a strong relationship between those who pay the dedicated tax and those who benefit from its use. It will also be used to determine if there are other theories of taxation which justify the use of the tax.

The strength of the relationship between those who benefit and those who pay will be determined by two factors. First, and most important, do all payers receive benefits? If all payers receive a measureable amount of benefit and other conditions of user charges are met, the dedication might be appropriate. If some payers do not receive direct benefits, the tax probably can be justified on some other basis, such as ability to pay. In such instances, the dedication is not appropriate.

Second, do those who benefit pay fees which equal the costs of the benefits they receive? If those who benefit pay amounts which reflect the amount of benefit, dedication might be appropriate. If the amounts that those who benefit pay must be subsidized by others, other principles of taxation, such as welfare considerations, are involved. Consequently, dedication is not appropriate.

The assessment of taxes and fees can be based on several different theories of taxation. These theories include the ability to pay theory, benefit theory, and ethical considerations. Combinations of these theories may be used to determine rates for a single tax.

Revenues from a tax should not be dedicated, however, unless the benefit theory of taxation is the only justification for the tax (Simkin 1975, p. 33). More specifically, dedications should be made only for revenues which can be classified as user charges.

This "direct benefits" criterion will be weighed the most when determining the appropriateness of a dedication.

2. Does the dedicated revenue establish a complex system of revenue assignments?

A major criticism of earmarking is its tendency to complicate the administration of government by segregating revenues into many small accounts. In contrast, collections from a non-dedicated tax are deposited in one account, the general fund. If the revenue from a dedicated tax or fee is distributed to more than one account, it will be concluded that the assignment of revenue is more complex than necessary.

This "complex assignment" criterion will have moderate weight in the evaluation.

3. Does the revenue dedication use collection and distribution formulas which reflect present and future circumstances in state government?

Earmarking is frequently criticized because it reflects obsolete conditions and undermines current budget priorities. This criterion

will be used to identify those dedications which need revision or may need revision in the future. It will also identify those dedications which adequately reflect changing conditions.

The "adequate collection and distribution" criterion will receive moderate weight in the analysis.

4. Does the revenue dedication provide better demand information, better service rationing, or more individual input than available under general funding?

Advantages of revenue dedication include the availability of user demand information, more public input, and the ability to ration services. This criterion will be used to identify these reasons for dedicating a revenue for a particular service.

This "special advantages" criterion will have moderate weight during evaluation.

5. Does the dedicated revenue generate funds at a level which is at or near the required expenditure?

Dedicated revenues which oversupport a function can cause the misallocation of public funds. Those that undersupport a function increase the budget effort required to adequately fund the function. In many cases, the legislature has dedicated revenues in order to insure that a function is self-supporting. This criterion will be used to identify those dedications which do not generate funds at the

level required to support a service. This "adequate funding" criterion will receive moderate weight.

6. Is the money generated by the dedicated revenue less apt to receive legislative scrutiny than other public funds?

The literature argues that earmarking reduces the amount of executive and legislative control over public funds (Sprenkle and Habacivch 1963, p. 317).

In theory, it appears that dedicated funds do result in less scrutiny. However, the executive and legislature can use revenue dedication as a way of segregating a program to make it more subject to scrutiny. Also, some dedications may involve such small amounts of money that they do not threaten legislative control. This criterion will be used to identify those revenues which are in practice less subject to executive and legislative scrutiny than other public funds.

This "reduced scrutiny" criterion will receive moderate weight in the evaluation.

7. Is the revenue dedication established by the Montana Constitution?

Revenue dedications which are established by constitution are more resistant to changes than those established by statute or administrative decision. This criterion will establish the legal basis for a dedication. It will also identify what action is necessary to change or remove the dedication. This "legal basis" criterion will have the least weight in evaluation.

Weighing the Criteria

The nature of the criteria and the proposed evaluation make it impractical to give a numerical value to the ability of a dedication to satisfy a criteria. Likewise it is difficult to assess the importance of the criteria relative to each other. Three distinctions are made, however, between the amounts each criterion will be weighed. The "direct benefits" criterion will receive the most weight in the analysis. If there is no direct relationship between those who pay and those who benefit, it will be concluded that the dedication is inappropriate. Criteria two through six will have equal weight. They will serve as further evidence of a dedication's appropriateness or inappropriateness. The "legal basis" criterion will have the least amount of weight. Its primary purpose is to indicate what action would be necessary to terminate or change a dedication.

The evaluation of a dedication will be done in a narrative style. Based on the facts and conclusions presented during the evaluation, a recommendation will be made regarding the future disposition of the revenue. While an attempt will be made to analyze each dedication objectively, as always it is possible that personal biases may influence the analysis.

Selection of Dedicated Revenues

The number of dedicated revenues in Montana is over 150 in fiscal 1980. These revenues will generate over \$220 million this year.

Because of the number of dedications, it is not feasible to evaluate all of them within this report. Instead ten dedicated revenues are selected which appear to reflect the types of dedications which have been made in Montana. These ten revenues are selected based on the author's investigation of all Montana dedicated revenues. They include taxes, fees, reimbursements, and income from the sale of goods. For the most part, the revenues are dedicated by statute. Several of the revenues are dedicated by administrative decisions. The functions which they support range from the state prison ranch to local government services. Some of the dedications are recently established. Others date back as far as the 1930s. The largest dedication selected will generate just over \$2 million in fiscal 1980. The smallest dedication will generate about \$1,000. When selecting the ten revenues, an attempt was made to choose ones which would reflect the wide range of dedications in Montana.

The following list identifies the dedicated revenues which were selected.

1. Junk Vehicle Fees
2. Prison Ranch Income
3. Revenue from the sale of Women's Bureau Publications
4. Coal Tax Revenue to the State Library Commission
5. Beer Tax
6. Building Code Inspection Fees

7. Antitrust Case Settlements
8. Reimbursements for Prosecutor's Services
9. Investment Income
10. Department of Community Affairs Centralized Service Income

Summary

This chapter discussed a proposal to evaluate the appropriateness of revenue dedications in Montana. It identified seven criteria which will be used for evaluation. These criteria are based on the advantages and disadvantages of earmarking. The justifications for these criteria and their weights in the analysis were discussed.

Ten dedicated revenues were chosen for evaluation. These revenues, in the author's opinion, are typical of Montana's dedications. In the next chapter, these ten revenues will be evaluated using the seven criteria.

Chapter IV

ANALYSIS OF TEN DEDICATED REVENUES

Introduction

Ten of Montana's dedicated revenues are evaluated in this chapter. The evaluations are based on the seven criteria which were discussed in Chapter Three. The ten evaluations are undertaken to determine to what extent Montana's dedications reflect sound earmarking principles. They are also used to develop recommendations for the future disposition of each revenue.

The ten revenues evaluated are:

1. Junk Vehicle Fees
2. Prison Ranch Income
3. Revenue from the sale of Women's Bureau Publications
4. Coal Tax Revenue to the State Library Commission
5. Beer Tax
6. Building Code Inspection Fees
7. Antitrust Case Settlements
8. Reimbursements for Prosecutor's Services
9. Investment Income
10. Department of Community Affairs Centralized Service Income

The evaluation of each revenue is divided into three sections: the first section provides the background and history of the revenue source and its dedication; the second section is an analysis of the

revenue based on the seven criteria; and the third section is a recommendation for the future disposition of the revenue.

The recommendations made for the disposition of each revenue deal only with the question of whether the dedication is appropriate using the selected criteria and the given circumstances. The appropriateness of a tax and the amount of a tax are issues outside the scope of this analysis. Such decisions are often made independently of the decision to dedicate.

Junk Vehicle Fees

History and Background

The junk vehicle program was established in 1973 to fund county junk vehicle programs and license auto wrecking facilities. The legislature authorized fees to support the program.

In 1974, there was a \$4.00 fee on each application for a new or transferred motor vehicle title. For each reregistration of a passenger car or truck there was a fee of \$1.00. The fees were reduced in 1975 and again in 1977. The current fees are \$1.50 for each new title or transfer and \$.50 for vehicle reregistration.

In addition to these fees, the State Solid Waste Bureau collects \$50 per year for each wrecking facility license issued and revenue from the sale of scrapped vehicles. In fiscal 1979, the bureau collected \$703,104 from all revenue sources. The amount of revenue

collected from each source is as follows:

Wrecking facility license fees	\$ 7,500
New title and transfer fees	294,097
Reregistration fees	278,972
Sale of junked vehicles	<u>122,535</u>
Total	\$703,104

These revenues are deposited in an earmarked revenue account to the credit of the state junk vehicle program. Expenditures from the account are made for two purposes: grants to county junk vehicle programs and state administration of the program.

In fiscal 1979, \$578,384 was distributed to Montana's fifty-six counties. The amounts distributed to the counties ranged from \$5,000 to \$92,148. They reflect county budget requests subject to maximum amounts permitted by state law. Amounts not expended by the counties at fiscal year end revert to the earmarked account.

The program cost the state \$44,949 more than it collected in fiscal 1979. Administration of the program cost \$169,669 or twenty-three percent of the \$748,053 program cost.

Analysis

"Direct Benefits?"

The benefits from the junk vehicle program are to all people in Montana. They benefit from reduced numbers of abandoned junk vehicles, better screening and location of vehicle graveyards and junk

vehicle recycling efforts. The public, in general, benefits from an uncluttered environment.

Those individuals who register vehicles in the state or own junkyards pay the fees which support the program. They, like other Montanans, benefit from fewer junked vehicles, but they receive no distinct benefits from paying junk vehicle fees.

Since the benefits of the junk vehicle program are non-divisible and not subject to allocation by charges, these auto registration fees do not appear to be user charges. Instead, the decision to tax vehicle owners appears to be based on the concept that auto owners create the problem and perhaps a notion that they are better able to pay for its solution. The administrative feasibility of charging vehicle owners may also be a factor. The present segregation of this revenue does not appear to be justified on the basis of the benefit theory of taxation.

"Complex Assignment?"

The revenue generated by junk vehicle fees is to be used for a single purpose, the junk vehicle program. All collections go to the Solid Waste Bureau which distributes them to the counties and uses a portion for administrative costs. The assignment of this revenue to the junk vehicle program is no more complex than the allocation of a revenue to the general fund.

"Adequate Collection and Distribution?"

Historically revenues for the program have exceeded the amounts expended. In recent years, revenues have been less than the amounts expended. Table 5 shows the amounts collected, expended, and in reserve for fiscal years 1974-1979.

TABLE 5

Junk Vehicle Amounts Collected, Expended,
and in Reserve During Fiscal Years 1974-1979

Fiscal Year	Amount Collected	Amount Expended	Amount in Reserve
1974	\$1,130,744	\$577,633	\$ 553,111
1975	1,325,337	561,007	1,317,441
1976	812,802	777,742	1,352,501
1977	806,513	656,273	1,502,741
1978	684,493	711,943	1,475,291
1979	699,947	767,571	1,407,667

The fluctuation of collections is primarily due to decreases in the fees required by statute. The sale of scrap metal also provides unpredictable amounts of revenue. In addition, expenditures for county programs are often less than the amounts requested and budgeted for. In fiscal 1979, seventy-five percent of the counties returned \$82,418 to the earmarked account.

Due to fluctuating collections and unexpended county money, it is concluded that the present collection and distribution formulas are

inappropriate. Because of the nature of the program, it appears that adoption of formulas which would eliminate over-collections and under-collections is difficult if not impossible. It is concluded that a general fund appropriation for the program could come closer to producing funding which would equal necessary expenditures.

"Special Advantages?"

There appears to be one special advantage from dedicating these fees to the junk vehicle program. Since there is no direct relationship between costs and benefits there are no advantages of better demand information, rationing, or increased individual input. However, vehicle owners may gain a sense of equity from knowing that their fees are being used for vehicle related purposes. While this sense of equity is hard to measure, it may lead to better acceptance of these fees by the public.

"Adequate Funding?"

A problem in the past has been the oversupport of the junk vehicle program by the assigned fees. A balance of about \$1.4 million was in the earmarked fund account at the end of fiscal 1979. This balance is primarily due to 1974 and 1975 fee levels. In 1978 and 1979, collections undersupported the junk vehicle program and expenditures were supported by reserve funds.

The present account balance illustrates that in the past the dedication has generated revenue in amounts greater than necessary. In contrast, in recent years this surplus is being used up. In the future, fees will have to be increased or general fund support provided.

Based on the past history of fee collections and program expenditures it appears that there is little relationship between the revenue collected and the funding required for the program. Both collections and program funding needs fluctuate on a year to year basis. Because of this, it is concluded that junk vehicle fees provide a suboptimal source of funding for the junk vehicle program.

"Reduced Scrutiny?"

The junk vehicle fee dedication results in substantially reduced legislative control and scrutiny. Several factors lead to this conclusion:

1. Vehicle registration fees have generated a balance of over \$1.4 million in the earmarked account. Under the present dedication, the legislature is unable to divert this money to support other state programs. This dedication constrains the spending of money which might otherwise enable the legislature to fund unsupported programs and accomplish statewide goals.
2. Bureau personnel presently use about \$100,000 of junk vehicle funds to satisfy matching requirements for the federal funding of

two other programs: solid waste disposal and hazardous waste disposal. Junk vehicle money is used to supplement the administration of these programs when federal funding falls short. This use of the revenue is contrary to statute and legislative intent.

3. The Solid Waste Bureau expresses an intent to seek authorization in the upcoming legislative session to spend junk vehicle money on other bureau functions. The granting of such a request would further reduce the validity of the revenue dedication.

"Legal Basis?"

Junk vehicle fees and their dedication are established by 61-3-508 MCA.

Recommendation

Since the junk vehicle program is designed to remedy a vehicle disposal problem, it seems equitable that vehicle owners be assessed fees. However, since all people in Montana benefit from the program general fund support of the program can be justified. It is recommended that vehicle owners continue to be charged a fee which reflects the costs of disposal. It is also suggested, however, that fee collections be deposited in the general fund and general fund appropriations be made to support the program. This recommendation for de-earmarking is further supported by the present dedication's inadequate

collection formula, its inability to fund the program at the required level, and its reduction of legislative scrutiny.

Prison Ranch Income

History and Background

In 1975, the legislature authorized the Department of Institutions to operate the state prison ranch as a separate enterprise. The purpose of this action was to encourage the ranch to become self-supporting.

The ranch derives income for its support from the sale of beef, pork, and dairy products. These products are sold primarily to state institutions and group care homes. The income from these sales is deposited in a separate revolving account for use by the prison ranch. This income finances such operations as meat packing, product distribution, and other support functions. In fiscal 1979, gross sales of ranch products were \$1,051,877.

Montana's Forty-Sixth Legislature expressed concern over the ability of the ranch to operate as a self-supporting enterprise. The General Appropriations Act of 1979, House Bill 483, outlines legislative intent to continue ranch operations on a probationary basis through the 1981 biennium. If ranch operations do not break even or show a profit by then, they will be terminated and the ranch land leased.

Analysis

"Direct Benefits?"

State institutions, group homes, and some private individuals purchase ranch products and benefit from their use. Since the prices of ranch products are based on market prices, purchasers receive benefits in relation to the amounts they pay. The ability to allocate products only to those who pay for them suggests that user charges are justified in this instance.

Since those who benefit from these products are the same ones who pay for them, there is a good benefit-cost relationship. The benefit theory of taxation appears to be the only basis for the assessment of charges for these products.

"Complex Assignments?"

Income from the sale of ranch products is used only for ranch related purposes. This assignment of revenue is no more complex than the allocation of a revenue to the general fund.

"Adequate Collection and Distribution?"

In the past there has been a question whether income from the ranch covered its production costs. At the beginning of fiscal 1980, the Department of Institutions established a new pricing system and better accounting techniques. The new pricing system is designed to

reflect the actual costs of producing ranch products. The new accounting techniques enable the profitability of each ranch production unit to be better monitored. Until data from the new systems is available, it is difficult to judge the adequacy of the collection and distribution formulas.

"Special Advantages?"

It is legislative intent that the prison ranch operate on a self-supporting basis. The dedication and segregation of ranch income provide better decision-making information than is available under other funding methods. This includes better demand information and a product rationing function.

"Adequate Funding?"

Financial reports indicate that the income from ranch operations has been adequate to cover ranch expenditures in past years. Due to inadequate accounting, however, it is difficult to determine whether all expenditures associated with the ranch's operation have been reported properly. Future financial reports, based on the new accounting system, should report profitability more accurately than in the past.

"Reduced Scrutiny?"

In general, the segregation of large amounts of revenue from the general fund appears to reduce the amount of legislative and executive

scrutiny over such funds. In this instance, however, the legislature has segregated ranch income in order to better monitor ranch operations. In addition, the legislature has shown an ongoing interest in the profitability of the ranch. For these reasons, this dedication may facilitate and increase legislative scrutiny of ranch revenue and expenditures.

"Legal Basis?"

The collection and dedication of revenue from the sale of prison ranch products is established by 53-1-301 MCA and 53-1-302 MCA.

Recommendation

The dedication of prison ranch income reflects the use of the benefit theory and user charges. In addition, the dedication results in better demand information, rationing, and increased legislative scrutiny. For these reasons it is recommended that this income remain dedicated to the support of prison ranch operations. It is also suggested, however, that ranch operations continue to be monitored to determine their profitability.

Revenue from the Sale of Women's
Bureau Publications

History and Background

The Women's Bureau in the Department of Labor and Industry was

established in response to Chapter 466, Section 3, Laws of Montana (1973). As part of the bureau's activities, it publishes and distributes a newsletter and other educational materials dealing with employment for women. Most of the publications are distributed free of charge. However, there is a \$1.00 per copy charge for three of the publications when more than one is requested.

The three publications which are sold when multiples are requested are:

1. Montana Women and the Law
2. Getting Hired: A Job-Hunting Manual for Montana Women
3. Montana Working Women: Your Job Rights

As of November 1979, fiscal 1980 collections from the sale of these publications were ten dollars. Bureau personnel estimate that \$1,000 will be collected by the end of fiscal 1980.

The bureau is supported by a general fund appropriation of \$56,924 for fiscal 1980. It receives no other funding. Revenue from the sale of publications is deposited in an earmarked fund account. Presently, the bureau does not have authorization from the department to spend publication revenue.

Analysis

"Direct Benefits?"

Benefits from the use of Women's Bureau publications are to

readers of them. Readers, however, pay only a small portion of the costs. Bureau personnel estimate that initial writing costs for the three publications are \$1,500-1,700. The annual cost of printing them is \$5,000 and postage and handling costs are about \$2,000. In fiscal 1980, publication charges will generate only \$1,000 for these costs.

Since a general fund appropriation supports the majority of the publications' costs it appears that considerations other than the direct benefit theory, such as ability to pay or benefits to society, affect this cost allocation decision.

"Complex Assignment?"

While the bureau does not presently have the authority to spend this revenue, when authority is granted the revenue will only be used to support these publications. Such allocation of the revenue is no more complex than disposition to the general fund.

It might also be considered, however, that this dedication requires more budgeting effort, additional calculations, and the expense of a separate account. In view of the small amount collected so far, \$10, the dedication may create a situation which is more complex than can be justified on the basis of collections.

"Adequate Collection and Distribution Formulas?"

Bureau personnel do not intend that the charge per copy reflect the writing, printing, and mailing costs. Instead the charge is an

arbitrary amount which is used to ration use. Under these circumstances evaluation of the collection and distribution formulas is not appropriate.

"Special Advantages?"

Bureau personnel feel that the \$1.00 charge helps discourage individuals from taking more publications than they need. This rations the use of the publications and reduces waste. Allocation of this revenue to the general fund would not interfere with this rationing function.

Since there is no charge for individual copies of these publications, this dedication provides no advantages of better demand information or increased public participation.

"Adequate Funding?"

Of the anticipated \$1,000 in fiscal 1980, so far the charges have generated only \$10. Based on the annual costs listed earlier in this report, publication revenue alone will not provide funding at the level required for the support of these publications.

"Reduced Scrutiny?"

The Women's Bureau is presently supported 100 percent by general fund appropriations. If authority to spend the revenue from the publications is granted, the amount dedicated would not substantially reduce executive and legislative scrutiny or control. It would,

however, increase the amount of effort required to budget and monitor expenditures.

"Legal Basis?"

The collection of the \$1.00 per copy charge and the assignment of revenue are based on administrative decisions. There does not appear to be legislative authority to collect or allocate this revenue.

Recommendation

There is no direct relationship between those who pay the majority of the costs and those who receive benefits from Women's Bureau publications. In addition, present collections do not appear to justify the increased amount of effort necessary to monitor, budget, and maintain a separate account for these funds. Under these circumstances it is recommended that bureau administrators be directed to deposit all collections in the general fund.

Coal Tax Revenue to the State Library Commission

History and Background

The Forty-Sixth Legislature directed that one percent of the coal severance tax revenue remaining after the coal trust fund allocation be credited to the State Library Commission. This is one-half of one percent of total collections. Although early estimates placed this amount at \$332,000 for fiscal 1980, recent projections indicate that

the commission will probably receive closer to \$500,000 for this period.

The commission's portion of coal tax money is made available for providing basic library services to the public through library federations. The funds are also to be used to pay participation costs in regional and national library networks.

The money collected is distributed by the Library Commission to six library federations in the state. These federations represent six geographic regions. The first distribution to the federations was made as follows:

Bozeman Public Library	\$ 29,090
Broad Valleys Federation	
Missoula City-County Library	27,814
Tamarack Federation	
Great Falls Public Library	26,722
Pathfinder Federation	
Parmly-Billings Library	25,816
South Central Federation	
Miles City Public Library	17,780
Sagebrush Federation	
Glasgow City-County Library	15,614
Golden Plains Federation	
	\$142,836

The Library Commission has established "basic services" as the first priority of the federations' use of coal revenue. Basic services include the provision of interlibrary loans to all librarians within a federation and continuing education for local librarians.

After basic service requirements are met, the federations are to use remaining coal funds to participate in regional library networks. Membership in such networks gives libraries access to regional inter-library loans and a central source of location information.

Analysis

"Direct Benefits?"

All federation member libraries receive benefits from the coal tax revenue. All libraries in the state participate in federations except Ronan City Library and Darby Public Library. The users of federation libraries benefit from better library services and increased access to the resources of federation headquarters' libraries.

Coal producers contribute to the libraries' support under this dedication by paying a thirty percent coal severance tax. There is no direct relationship between coal producers and library users. The coal tax cannot be defined as a user charge. This dedication of the coal tax cannot be justified on this basis.

In addition, the libraries' coal tax money is distributed to all areas of the state. Four of the six areas receiving the revenue contain no coal development or coal related impacts. In this sense, there is no relationship between those areas which have coal development and those areas which are receiving coal tax money.

"Complex Assignment?"

The libraries' portion of the coal tax is allocated to a single account maintained by the State Library Commission. This allocation is no more complex than allocation to the general fund. Money from the account is distributed among the six federations in the state.

"Adequate Collection and Distribution Formulas?"

The amounts collected from coal producers reflect the price and production of coal in Montana. They fluctuate with changes in prices and changes in the demand for coal. There does not appear to be a relationship between the amounts generated by the coal tax and the amount of money necessary to fund libraries. Due to the large fluctuations in coal tax revenue, it would be difficult if not impossible to link library funding to a set percentage of coal tax revenues. Consequently it is concluded that the present collection formula which gives one-half of one percent of collections to libraries is inappropriate.

It is also concluded that the present distribution formula is not appropriate. The formula used by the Library Commission divides one-half of the total amount to be distributed equally between the six federations. The other half is allocated to each federation based on the percentage of state population it serves.

If revenues for the libraries reach \$500,000 as expected in

fiscal 1980, this distribution will oversupport the smaller federations according to State Library Commission personnel. This is due to the unexpected high level of collections and the equal distribution of one-half of the money to federations of all sizes. Commission personnel feel that the unanticipated revenue could be better used by the larger federations.

"Special Advantages?"

Since there is no direct link between coal tax revenue and library services, this dedication does not provide advantages such as demand information or increased response to public needs. In contrast, general fund appropriations might have the advantage of increasing library response to public needs since under the present dedication libraries need only depend on coal production for funding. Under general fund appropriations, libraries would theoretically have to better serve the public in order to gain public and legislative support and receive funding.

"Adequate Funding?"

Coal severance tax collections fluctuate depending on coal prices and mining activity in the state. In fiscal 1980, the State Library Commission will receive about \$170,000 more than estimated during the 1979 legislative session.

The needs of federation libraries also fluctuate. Initially there are high start-up costs for federation membership and participation in regional library networks. Later, funding needs reflect the lower maintenance costs of these activities.

It is unlikely that the revenue in any one fiscal year will coincide with the funding needs of the library federations.

"Reduced Scrutiny?"

In fiscal 1980, approximately \$500,000 will be expended for library services as provided by law. Prior to this dedication, the legislature would have determined the expenditure of this amount based on legislative priorities.

Due to the size of the dedication and the fact that it precludes an alternative spending decision, it is concluded that legislative scrutiny and control are reduced.

"Legal Basis?"

The dedication of the libraries' portion of the coal tax is established under 15-35-108 MCA.

Recommendation

The dedication of coal tax revenue for libraries cannot be justified on the basis of the benefit theory or user charges. In addition, it appears that the dedication reduces legislative control and may result in too much or too little financial support of state libraries.

It is recommended that the libraries portion of the coal tax be de-earmarked. It is suggested that money for the support of libraries be appropriated from the general fund based on library budget requests. In addition to increasing legislative control, it appears that general fund support might permit more public participation in library funding decisions than is possible under the present dedication.

Beer Tax

History and Background

A beer tax of \$.50 per barrel was levied in 1933. The revenue was allocated 15% to the Liquor Control Board, 42.5% to state general fund, and 42.5% to counties. The tax was increased in 1959, 1969, 1974 and 1977. The disposition of revenue has also changed several times.

Presently there is a total tax of \$4.00 per barrel on beer. Of this amount, \$1.50 is deposited in the state general fund, \$1.50 is credited to an earmarked account for distribution to incorporated cities and towns, and \$1.00 of the barrel tax is allocated to the Department of Institutions for the treatment, rehabilitation, and prevention of alcoholism.

In fiscal 1979, the beer tax generated \$3,203,813 in revenue. It was distributed as follows:

To general fund	\$1,201,430
To cities and towns	1,201,430
To alcohol program	800,953

The portion of the beer tax which is distributed to cities and towns is to be "expended for state purposes such as law enforcement, maintenance of transportation systems and public health" (16-1-410 MCA). The money is actually spent for all local government functions. In 1980, this money is distributed to 126 cities and towns comprising 53.3% of the state's population.

The beer tax revenue allocated to the Department of Institutions is to be used to support state alcoholism services and provide grants to state approved alcoholism treatment programs. In fiscal 1980, twenty-one percent of the Institutions' portion is budgeted for distribution to seventeen local programs. The remaining seventy-nine percent is budgeted for state alcoholism services, and in particular Galen State Hospital.

Analysis

"Direct Benefits?"

Sixty percent of the non-general fund benefits from the beer tax go to residents of incorporated cities and towns. These benefits are primarily in the form of local services.

Forty percent of the non-general fund benefits go to users of state and local alcohol treatment programs. Based on admissions to all alcohol programs, about one percent of the state's population benefited directly from this use of beer tax revenue in fiscal 1979.

The beer tax is paid by beer wholesalers and brewers in the state. This cost is passed on to beer consumers in the form of higher retail beer prices.

The beer tax is not a user charge because the benefits it supports are not allocated to only beer drinkers. Local services benefit all those who live in cities and towns. Alcohol treatment programs benefit users of alcoholic beverages other than beer. The basis for levying a beer tax appears to be on ethical grounds rather than the benefit theory.

"Complex Assignments?"

Beer tax revenue is allocated 37.5 percent to the state general fund, 37.5 percent to incorporated cities and towns, and 25 percent to the Department of Institutions for alcohol treatment.

The cities and towns' portion is further divided among 126 localities according to population. In November 1979, the amounts distributed ranged from \$15,426 in Billings to \$10 in Ismay.

The Institutions' share is divided among the Galen State

Hospital, Department of Justice, DWI Lab, corrections projects, local alcohol programs, and administration.

It is concluded that the allocation of beer tax revenue is more complex than the allocation of a revenue to the general fund. It complicates the use of the revenue and results in the fragmentation of the total into small and in some cases inconsequential amounts.

"Adequate Collection and Distribution Formulas?"

Since there is no clearcut relationship between beer consumption and the present uses of beer tax revenue, it is difficult to judge the adequacy of the collection and distribution formulas.

As beer consumption increases, revenue collections also increase. It is questionable, however, whether the increased collections match the needs of local governments or alcohol treatment. In the same sense, even though beer tax revenue is distributed at a fixed percentage, it is likely that the need for local services and alcohol programs varies depending on many factors other than beer consumption.

It is concluded that while there may be some relationship, the present collection and distribution formulas do not adequately reflect the circumstances.

"Special Advantages?"

There appear to be no special advantages from this dedication. The segregation of beer tax collections may provide information about

beer consumption, but this information would also be available if the revenue was placed in the general fund. The segregation provides no relevant information about the demand for local services or alcohol treatment.

Some beer drinkers may find it equitable that this tax is used for alcohol treatment. Others may find it unequitable that beer revenue supports local governments. It may be particularly inequitable for those who live outside of cities and towns.

"Adequate Funding?"

Incorporated cities and towns spend greater amounts of money for general purposes, such as law enforcement and transportation, than they receive from beer tax revenue. At the local level, other local and state revenues must be used to support these programs.

The Department of Institutions spent \$2,131,400 on alcohol treatment in fiscal 1979. It received \$800,953 from beer tax collections. Beer, wine, and alcohol tax collections provide 100 percent of the money used for alcohol treatment programs. Because current expenditures for alcohol treatment depend on revenue collections rather than budget requests, it is difficult to determine whether the need for alcohol programs is being met.

"Reduced Scrutiny?"

The beer tax revenue which is distributed to incorporated cities and towns is deposited in their local general funds. The legislature has no control over the purposes for which it is used.

The expenditure of beer tax revenue and other alcohol revenues for alcohol treatment programs has been a legislative concern in the past. During the 1979 biennium and the Forty-Sixth Legislative Session, the Legislature raised questions regarding uses of these revenues and the number of programs which were being supported. In particular, the Legislature questioned the increase from nineteen to forty-three funded community alcohol programs during fiscal 1979.

It is concluded that the Legislature and Governor have less control over this revenue under the present dedication. While this reduced control may be inherent in revenue dedication, it is significant in this instance because it involves over \$2 million in public funds.

"Legal Basis?"

The dedication of the beer tax for cities and towns and alcohol treatment programs is established under 16-1-407 to 16-1-410 MCA.

Recommendation

The concepts of user charges and the benefit theory are not appropriate justifications for the dedication of the beer tax. In

addition, the dedication is more complex than necessary, it reduces legislative control, and it uses collection and distribution formulas which appear to be inappropriate. The dedication does not provide any special advantages which could not be supplied under a general fund appropriation.

It is recommended that all beer tax collections be deposited in the general fund and appropriated on the basis of budget requests. Seven other alcohol related fees and taxes collected by the state are already so deposited and appropriated.

Building Code Inspection Fees

History and Background

The Building Codes Division in the Department of Administration is responsible for establishing and enforcing state building codes. These codes relate to the design, construction, use and maintenance of public buildings and structures. The division enforces codes on all construction-related activities except for certain installations and in areas where local governments have accepted the responsibility.

The division is made up of three bureaus. These are the Building Standards Bureau which is responsible for code administration and inspection of factory built units; the Mechanical Safety Bureau which is responsible for inspections of plumbing, elevator, and mechanical systems; and the Electrical Safety Bureau which is responsible for

electrical system inspection.

The Department of Administration is given statutory authority to establish and collect fees for inspections conducted by the bureaus. The fees may not exceed the cost of providing the inspections.

In fiscal 1979, the department collected \$630,096 for inspection services. Collections are deposited in a revolving fund account and appropriated for division activities.

Analysis

"Direct Benefits?"

Montana Law states that establishment of minimum building standards and inspection of construction are "for the protection of the people of the state" (50-60-1 through 50-60-6 MCA). Building standards are also designed to promote energy efficiency and insure access to public buildings for physically handicapped persons. In general, all persons in Montana benefit from the activities of the Building Codes Division.

The persons who pay the inspection fees fall into three categories: property owners, architects, and contractors.

The benefits from safe, energy efficient, and accessible public buildings are not divisible. User charges are inappropriate for such benefits. The levy of inspection fees on builders is not based on the concept of benefit theory since the public, not just builders,

benefits from building standards. The decision to charge builders for inspections appears to be based on the administrative feasibility of the tax. Builders can more easily be charged for inspections than each person who enters an inspected building.

Since the benefit theory is not the primary reason for assessing inspection fees, the dedication is not justified on that basis.

"Complex Assignment?"

The revenue from inspection fees is deposited in a revolving fund account. Expenditures from this account are made only for the division's activities. This arrangement is no more complex than depositing a revenue in the general fund.

"Adequate Collection and Distribution Formulas?"

The collection of inspection fees fluctuates depending on several factors. Interest rates, inflation, weather conditions, and other factors affect construction and the revenue from inspections. However, the funding requirements for the division remain fairly constant throughout the year due to fixed staffing levels and fixed expenditures.

The collection and distribution of inspection revenue fluctuates with activity in the construction industry. The amount generated may not always coincide with the relatively constant funding needs of the division.

"Special Advantages?"

The amounts collected from inspection fees may indicate the amount of new construction taking place during a certain period of time. This function would not be interrupted by reallocation of the revenue to the general fund.

Support of the Building Codes Division by builders may make the division more responsive to builders, but it is questionable whether this situation best serves the public's interests. Such support may encourage the division to cater to those regulated rather than be a watchdog of public safety.

It is concluded that there are no special advantages from this dedication.

"Adequate Funding?"

Based on financial reports from past years, inspection fees have generated more funding than necessary for the Building Codes Division. There were fund balances of \$266,500 in fiscal 1978 and \$404,762 in fiscal 1979. In fiscal 1980, budgeted expenditures are \$1,027,583 while revenues are estimated to be \$700,000.

There are several factors which have affected the fund balances in past years. A major factor was the existence of unfilled staff positions. On the basis of projections for fiscal 1980 and the future, it appears that inspection fees will not meet the division's funding needs.

"Reduced Scrutiny?"

It appears that this dedication reduces legislative scrutiny. This conclusion is based on three factors:

a. The use of a revolving account by the division is questionable. A revolving account should be used to defray reimburseable expenditures and supply working capital for enterprise-type operations (17-2-102 MCA). The division's inspection fees are not directly related to the actual cost of providing inspections or the amount needed to reimburse expenses. The division is not an enterprise operation. Its purpose is not to make a profit.

It appears that the use of a revolving account is improper in this instance. It essentially removes this revenue from constraints which the legislature has established for other public funds, such as general or earmarked funds.

b. All revenue from inspection fees is deposited in a revolving fund account. State law specifies that plumbing fees "shall be deposited to the earmarked revenue fund of the department ..." (50-60-508 MCA). The current disposition of plumbing fees is contrary to statute.

c. The dedication of approximately \$1 million per year for division functions precludes the ability of the legislature to establish other priorities for its spending. Considering the amount of revenue involved, the ability to scrutinize is substantially reduced.

"Legal Basis?"

The dedication of inspection fees is established by 50-60-104, 50-60-508, and 50-60-604 MCA.

Recommendation

The basis for levying inspection fees is not the benefit theory but instead the principle of administrative feasibility. The dedication of these fees appears to result in inadequate funding levels and substantially reduced legislative scrutiny. There are no special advantages.

It is recommended that all fees from inspection related activities be deposited in the general fund. Since inspections benefit the public, it appears that appropriations from the general fund based on budget requests can be justified.

Antitrust Case Settlements

History and Background

An Antitrust Enforcement Bureau was created in the Department of Justice in June 1978. It was established to investigate and prosecute violations of state antitrust laws. The bureau also represents the State of Montana, its citizens, and its political subdivisions in cases seeking relief and damages under federal antitrust laws.

The bureau collects revenue in the form of court awards to the state. These awards fall into three categories:

1. reimbursements for legal services and expenditures made by the Antitrust Bureau in seeking damages
2. reimbursements for the services of private attorneys whose services are contracted by the bureau
3. settlements awarded by the courts to various parties seeking damages

Reimbursements for legal services are generally based on the bureau's actual investment of time and money in individual cases. These vary from case to case. Settlements are based on court determination of the amount of damage done to specific parties. Settlements given to state agencies, such as the Montana University System or Department of Institutions, are distributed by the bureau.

During the 1979 session, it was estimated that the bureau would collect \$26,000 in fiscal 1980. Actual collections as of November 1979 were \$22,907. Large additional amounts of revenue are anticipated in fiscal 1980, pending the outcomes of several current anti-trust cases.

Appropriations of \$26,289 from the revolving fund account and \$125,000 from federal funds support the bureau's activities in fiscal 1980.

Analysis"Direct Benefits?"

The benefits of antitrust activities in Montana are to all consumers in the state. Consumers benefit by protection from unfair trade practices. Certain groups also benefit from the monetary awards made by the courts.

A federal grant to the state pays the majority of the antitrust program's costs. Court awards provide only seventeen percent of the program's funding. These court awards are paid by those against whom judgments are made.

There is no direct relationship between those who benefit from antitrust action and those who pay the costs through court awards. The intent of court awards is not to charge benefiteres but instead to penalize those who break laws. The dedication of antitrust settlements cannot be justified on the basis of the benefit theory.

"Complex Assignment?"

Court-awarded reimbursements to the bureau are used to support bureau activities and reimburse other damaged parties. The assignment of settlements depends on the number of parties seeking damages and the amounts awarded by the courts. Although the complexity of the assignment varies from case to case, in general, it is more complex than the disposition of a revenue to the general fund.

"Adequate Collection and Distribution Formulas?"

The collection of revenue by the bureau depends on several factors. These include whether the case is won, the length of the trial, the type of case and the reimbursement rate used by the court.

The distribution of revenue depends on the allocation of awards made by the court. In general, however, the amounts awarded to state agencies for damages reflect expenditures which have already been made and appropriated for by previous legislatures.

For example, the state may receive a \$10,000 settlement for damages due to overpricing by meat producers. One thousand dollars of this total may be allocated by the court to the Department of Institutions. This amount is to compensate the Department for money it overpaid on meat. Such an award would duplicate the amount which the Legislature would have already appropriated from the general fund for increased institutions' food costs. The agency would receive double the amount which it actually overpaid for meat products.

Since collections are unpredictable and distributions provide double compensation for damaged state parties, it is concluded that their formulas do not adequately reflect the circumstances.

"Special Advantages?"

Demand information, rationing, and greater public participation are not relevant considerations for this dedication. There are no special advantages from this segregation of revenue.

"Adequate Funding?"

The revenue received from court reimbursements fluctuates. The bureau may receive large amounts in some years and small amounts in others. Due to the time lag between bureau expenditures on a case and the collection of reimbursements, bureau personnel indicate that revenue will not meet funding needs during the next few years.

The unpredictability of this revenue appears to preclude its ability to meet the bureau's annual funding needs.

"Reduced Scrutiny?"

The amount of revenue affected by this dedication presently does not seriously affect legislative and executive control over state spending. It also appears that part of the reason for dedicating these funds was to insure that the antitrust settlement bureau is fiscally viable. One measure of the program's effectiveness is to determine whether it breaks even or makes a profit.

On this basis it is concluded that legislative scrutiny and control are not substantially reduced under the present dedication.

"Legal Basis?"

The authority to collect settlements and the funding for the Antitrust Enforcement Bureau are established by the General Appropriations Act of 1979, House Bill 483.

Recommendation

The antitrust settlement dedication lacks justification on the basis of the benefit theory of taxation. In addition, it employs formulas which are inappropriate and provides inadequate levels of funding. However, there does not appear to be a serious loss of legislative scrutiny and the dedication may make it easier to determine if the program is fiscally viable.

Based on the lack of a direct benefit-cost relationship, it is recommended that the antitrust revenue be de-earmarked. It is also recommended, however, that revenue collections from this source continue to be monitored as they are placed in the general fund so the effectiveness of antitrust action can be determined.

Reimbursements for Prosecutor's Services

History and Background

The County Prosecutor Service Bureau began operation in July 1977. It is designed to assist county attorneys in investigating and prosecuting special cases. The bureau also provides training and other assistance to county attorneys.

Counties which utilize the bureau's services pay one-third of the personal services costs of the bureau. This is presently twenty-five dollars of the seventy-five dollars cost per hour. Collections are deposited in an earmarked revenue account by the bureau.

In fiscal 1979, the bureau collected \$35,860 from counties. During the 1979 session, the bureau estimated that revenue during fiscal 1980 would be \$26,967. The bureau's budget for fiscal 1980 is comprised of \$26,967 from the earmarked account and \$62,985 from the general fund.

Analysis

"Direct Benefits?"

The benefits of the County Prosecutor Service Bureau are to county governments. The counties receive assistance in meeting demands created by large case loads. They are also provided the opportunity to send their attorneys to training seminars.

Over two-thirds of the costs of the service are paid by state taxpayers through general fund appropriations. The remaining costs (one-third of personnel salaries) are paid by counties utilizing the program.

There is no direct relationship between those who benefit (counties) and those who pay most of the costs (state taxpayers). However, there is a direct relationship between the counties which receive benefits and the counties which reimburse the state for the service. These reimbursements can be defined as user charges.

"Complex Assignment?"

All revenue from reimbursements is assigned for the support of the County Prosecutor Service Bureau. This allocation of revenue is no more complex than a general fund allocation.

"Adequate Collection and Distribution Formulas?"

The bureau collects less than one-third of its total funding from participating counties. County payments fluctuate depending on the amount of assistance received. In contrast, bureau funding requirements remain fairly constant throughout the year.

It is concluded that the collection formula does not adequately reflect the funding requirements of the bureau.

"Special Advantages?"

The dedication of county reimbursements for these services provides two advantages. It provides better information about the use of prosecutor services and it rations use to those counties which are willing to pay for them.

"Adequate Funding?"

The County Prosecutor Service Bureau is budgeted \$89,952 for expenditures in fiscal 1980. Only thirty percent of this amount comes from dedicated reimbursements. The remaining amount is appropriated from the general fund.

The amount collected in reimbursements from the counties is substantially less than the amount necessary to fund the bureau.

"Reduced Scrutiny?"

Due to the relatively small amount of revenue involved, \$35,860 in fiscal 1979, legislative scrutiny is not substantially reduced by this dedication. However, since the bureau receives funding from two sources, the dedication increases the amount of effort required to budget and appropriate.

"Legal Basis?"

Funding for the County Prosecutor Service Bureau is established by the General Appropriations Act of 1979, House Bill 483.

Recommendation

County reimbursements for prosecutor services can be defined as user charges. Dedication of these reimbursements provide better demand information and rationing. Legislative scrutiny is not substantially reduced by it. However, there are disadvantages from inadequate collection formulas and inadequate funding.

It is recommended that revenue from county reimbursements remain dedicated for the support of the bureau. It is also suggested, however, that the amounts charged to counties be evaluated. County support of a larger proportion of service costs or all costs should be considered.

Investment Income

History and Background

The Uniform Investment Program is established by Article VIII, Section 13 of the 1972 Montana Constitution. It is administered by the Board of Investments. The board has sole authority to invest state funds. Investments are made according to rules established in 17-6-201 through 17-6-221 MCA and the State Constitution.

The law specifies six investment fund categories which are to be used by the board. They are:

1. The Trust and Legacy Fund. This fund includes the Public School Fund and Montana University System Funds.

2. A fund which includes the retirement and insurance systems funds maintained by the state. This includes the Highway Patrolmen's Retirement, PERS, and Teachers' Retirement Funds.

3. A fund consisting of coal tax revenue which is allocated to the Permanent Coal Tax Fund under Article IX, Section 5 of the Montana Constitution.

4. A fund which includes gifts, grants, and other contributions which are made or given for a specific purpose.

5. A pooled investment fund of money in the Treasury Cash Account. This account is comprised of state money for which there is no expressed requirement for separate investment. The income from this account is deposited in the general fund.

6. Other investment funds which are expressly required by law. The incomes from the investment of the funds are dedicated to the same purpose as the funds invested.

The following analysis concerns the investment income from funds in the sixth category. There are eleven funds in this category. These funds and their net investment incomes in fiscal 1979 are:

1. Long Range Building Fund	\$618,293
2. Long Range Building Sinking Fund	231,630
3. Wheat Research and Marketing Fund	16,648
4. Livestock Commission-Inspection and Control Fund	29,980
5. Agriculture-Grain Services Fund	17,149
6. Board of Oil and Gas Fund	11,897
7. Agriculture-Commercial Feed Fund	5,565
8. Livestock Commission-Animal Health Fund	1,609
9. Agriculture-Commercial Fertilizer Fund	4,267
10. Livestock Commission-Animal Health Emerg. Fund	3,568
11. Water and Waste Water Operators' Fund	<u>1,489</u>
Total	\$942,185

Analysis

"Direct Benefit?"

Technically, accounting theory dictates that the account whose funds generate investment income should receive the income. This is presently the case in the eleven funds above. Accounting theory would also mandate, however, that accounts bear the cost of their administration and upkeep. Since the termination of the Pro Rata Reimbursement System in 1975, agencies have not been charged for these costs.

Although documentation is scarce, it appears that the decision to stop pro rata charges in 1975 was based on two factors. First, the Department of Administration was able to collect less than half of the assessed charges from agencies in fiscal 1974. This was due to agency protests of the amounts charged and in some cases a lack of funds to pay the charges. Second, it was felt that if the investment income from these accounts was deposited in the general fund, it would cover administration costs and reimburse the state for overhead costs.

It is concluded that, while in a strict sense, there is a direct relationship between a fund and its investment income, other considerations may preempt the dedication of investment income on this basis.

"Complex Assignment?"

The Board of Investments distributes the income on investments. The income generated on invested funds from most accounts is simply deposited in the general fund. The incomes from the investment of these eleven funds must be separately accounted for and credited to eleven different accounts.

This distribution is more complex than the distribution of similarly invested public funds.

"Adequate Collection and Distribution Formulas?"

Because in most cases these investment incomes are small amounts and not regular revenue sources, an evaluation of their collection distribution formulas is not appropriate.

"Special Advantages?"

This dedication does not provide better demand information, rationing, or more public participation. There are no special advantages.

"Adequate Funding?"

In no case do these amounts completely fund a function. However, in two instances they provide substantial support. For example, the investment income from the Long Range Building Fund was \$618,293 in fiscal 1979.

Incomes from the investment of the ten other funds were less. The Water and Waste Water Operators' Fund collected the least, \$1,489, in fiscal 1979.

"Reduced Scrutiny?"

The dedication of investment incomes from these funds segregated \$942,185 from the general fund in fiscal 1979. This amount could only be used for purposes which were established by previous legislatures.

It is concluded that this dedication leads to substantial loss of legislative scrutiny and control over spending.

"Legal Basis?"

Investment incomes from all of the eleven funds are dedicated by statute.

Recommendation

While there is a direct relationship between a fund and its investment income, there is legislative intent that this income be deposited in the general fund to offset administrative costs. There are no special advantages from such a dedication. However, there are disadvantages from the complex assignment of revenue and reduced legislative scrutiny over these revenues.

It is recommended that the income from these eleven funds be deposited in the general fund.

Department of Community Affairs'
Centralized Services Income

History and Background

The Department of Community Affairs (DCA) was created in 1972 under the Executive Reorganization Act. Within the department there are eleven program divisions and a Centralized Service Division. The Centralized Service Division provides support functions for the other divisions. These functions are primarily in the areas of bookkeeping, purchasing and personnel.

In July 1978, DCA established a revolving account to collect centralized service charges from other divisions. These charges and cost allocations were established administratively. Appropriations from the revolving account support the centralized service operations. Appropriations from the general fund, earmarked fund and federal and

private revenue fund support the program divisions. The reimbursements to centralized service for indirect costs are income transfers to the revolving account from the other divisions' funding sources.

In fiscal 1979, the Centralized Service Division collected \$182,730 in reimbursements from the other divisions. In fiscal 1980, income will be about \$200,000.

Analysis

"Direct Benefits?"

The activities of the Centralized Service Division benefit the program divisions of DCA. Benefits are in the form of bookkeeping, budgeting, financial reporting, and payroll services.

The Centralized Service Division's costs are paid by income transfers from other divisions. These transfers are from program funds which are appropriated from the general fund, earmarked revenue funds, and federal funds.

The centralized service charges paid by program divisions are user charges. They are based on the benefit theory of taxation.

"Complex Assignment?"

The income from reimbursements is deposited in a revolving account. Funds in this account are only used to pay centralized service division's costs. This revenue assignment is no more complex than assignment of a revenue to the general fund.

"Adequate Collection and Distribution Formulas?"

The collection of reimbursements from program divisions depends on administrative discretion. Department records indicate that the present collection formula may allow some divisions to be charged amounts which are disproportionate to the services they receive. For example, a division receiving general fund money may be charged more than a division which is funded by federal funds.

Due to the discretionary nature of these formulas it is concluded that they are inadequate.

"Special Advantages?"

Charging user fees for centralized services provides better demand information and it rations services.

"Adequate Funding?"

In fiscal 1979, indirect cost reimbursements over-supported the funding needs of the Centralized Service Division. The division collected \$182,730 and expended \$174,257. This left a fund balance of \$8,473.

The accumulation of a balance in a revolving account undermines the function of such an account. Its purpose should be to collect an amount equal to anticipated expenditures. The fund balance in the centralized service account indicates that the division is not operating on a break-even basis. It is making a profit on charges to

other DCA divisions. The Centralized Service Division and DCA do not need legislative approval to spend collections which are above their expenditures. This acts as an incentive to increase charges above appropriate levels.

"Reduced Scrutiny?"

Legislative scrutiny is reduced by this segregation of income. This conclusion is based on four factors.

1. Unspent money in a revolving account at fiscal year end does not revert to the general fund. For example, even though an income transfer from a general fund appropriation remains unspent, it is not returned to the general fund. This creates an incentive to transfer general fund money into a revolving account and a potential for the misuse of general fund money.
2. Under the present system, the legislature appropriates the same amount of money twice. Once the amount is appropriated to DCA program divisions for their functions, a second amount which includes a portion of the money appropriated to programs is appropriated to the Centralized Services Division. This results in duplication of budget and appropriation effort and an overstatement of the appropriated amounts.
3. Administrative discretion over cost allocations and charges provides an opportunity to manipulate the amounts collected. If

collections increase, there is a potential for increased spending. In addition, there is a possibility of charging more costs against some funds, the general fund for example, than is proper.

4. The transfer of income from one account to another within a department hinders the identification and scrutiny of the uses of such income. It makes accounting more difficult and results in a loss of legislative control over spending.

"Legal Basis?"

The decision to collect and dedicate indirect cost reimbursements for centralized services is administrative.

Recommendation

The dedication of these reimbursements is justified based on the benefit theory and user charges. It also provides the advantages of demand information and rationing. However, there is another consideration which influences the recommendation. That consideration is the potential for this dedication to lead to the misuse of public funds. The present dedication causes an overstatement of appropriations, permits questionable cost allocations, and encourages overcharging the general fund for centralized service costs.

On the basis of reduced legislative control and the potential for fund misuse, it is recommended that the present dedication and system of charges be discontinued. It is suggested instead that centralized

service costs be paid from direct general fund appropriations and direct charges against the operating programs.

Summary

This chapter presented evaluations of ten of Montana's dedicated revenues. The intent of the evaluations was to determine the propriety of these dedications based on seven criteria. Each of the ten evaluations included the revenue dedication's history and background, analysis, and a recommendation for the future disposition of the revenue.

Based on the analyses, it was recommended that two of the evaluated revenues remain dedicated. These revenues were prison ranch income and county prosecutor service reimbursements. Dedications of these revenues were justified based on the benefit theory. They also provided other advantages such as demand information and rationing.

It was recommended that the remaining eight dedications be discontinued. These dedications were not justified by user charges or the benefit theory. They also provided the disadvantages of inadequate funding, reduced legislative scrutiny, and complex assignments of revenue. The de-earmarking of DCA Centralized Service Income was recommended due to the potential for misuse of public funds.

Assuming that the evaluated dedications are somewhat representative of all Montana dedications, it appears that other dedications may fail to pass a test using the seven criteria. As in the case of eight

of the evaluated revenues, these other dedications may provide more disadvantages than advantages to the executive and legislative branches. Due to the number and dollar amount of these dedications, the disadvantages to state government from executive and legislative viewpoints could be substantial.

CHAPTER V

Summary, Conclusions, and Recommendations

The purpose of this paper was: a) to determine the nature of earmarking based on its history, scope, political justifications, economic justifications, and its advantages and disadvantages; b) to define a "sound" dedication based on a review of the literature and test Montana dedications against such a definition; and c) to determine whether the executive and legislative branches of Montana state government are advantaged or disadvantaged by Montana's proportion of dedication revenues.

Summary

A dedicated revenue is defined as a tax or fee, the revenue from which is allocated for a particular purpose. Dedications are established by constitution, statute, and administrative action. All levels of government use dedications. The federal government uses them most. Local governments use them least.

Historically, states have used dedications to promote certain government functions such as education. They have also dedicated revenues to comply with federal guidelines, such as the use of gasoline taxes for highway purposes. In fiscal 1979, states dedicated proportions of revenues ranging from zero to eighty-eight percent. The nationwide average was twenty-three percent. This was 18.1 percent less than the nationwide average in 1964. The trend toward

decreased dedicated proportions of revenue was due to de-earmarking by state legislatures and the expansion of non-dedicated revenue sources.

In Montana, the proportion of dedicated revenues increased two percentage points between 1963 and 1979. Montana was one of only five states in which the proportion of dedications increased. Montana's increase was due to the levy and dedication of a coal severance tax and the growth of major dedicated revenues such as the income taxes. Montana ranked fourth nationwide in dedications in fiscal 1979, with fifty-five percent of its revenue dedicated.

Political motives are often reasons for dedicating revenues. Dedications can provide insured, long-term funding for a favorite program, increased support for new taxes, and the ability to reach a consensus among decision makers. Some suggest that they also permit more individual participation in budget decisions. These motives are strong incentives to dedicate for participants in the legislative process. They also explain the resistance to proposals to de-earmark revenues.

The economic justification for dedicating revenues is the benefit theory of taxation. The benefit theory states that those who benefit from a service should pay its costs. The benefit theory is often implemented through the use of user charges. The application of the theory and user charges is limited in government, however. Many government services are not divisible and their benefits cannot be

allocated to only those who pay. In addition, other considerations such as the ability to pay, ethical questions, and administrative feasibility can preempt the use of the benefit theory and user charges. In instances where the benefit theory is not applicable, revenue dedications are inappropriate.

Most of the advantages of revenue dedications are dependent on the ability to apply the benefit theory. Advantages such as better demand information, more individual participation and rationing are nonexistent if there is no direct relationship between those who pay and those who benefit. The advantages of dedicating are primarily to individuals and government agencies. In contrast, the disadvantages of dedicating are generally to the governor and legislature. The disadvantages include the loss of scrutiny and control over state funds, an inability to establish and carry out statewide priorities, and the misallocation of public funds. These disadvantages can be reduced if dedications employ simple collection and distribution formulas which reflect their program's funding needs.

The advantages and disadvantages of dedication from the literature provided the basis for developing seven criteria which were used to define a "sound" revenue dedication. The criteria included questions such as whether the benefit theory was applicable, whether the dedication provided adequate funding, and whether the dedication reduced legislative scrutiny. An evaluation, based on these criteria,

was proposed. The evaluation was to determine if Montana's dedications were based on sound dedication principles. The results would indicate whether Montana's Chief Executive and Legislature were advantaged or disadvantaged by Montana's proportion of dedications.

The evaluation was made up of three parts: history and background of the dedication, analysis of the dedication using the criteria, and a recommendation for the future disposition of the dedicated revenue. Ten of Montana's dedicated revenues were evaluated. The ten dedications were selected from over 150 dedications in Montana. They were taxes, fees, and incomes which were dedicated for different purposes. In the author's opinion, the selected dedications were typical of Montana's dedications.

Conclusions

Two of the dedications evaluated were defined as sound dedications. These were prison ranch income and county prosecutor service reimbursements. These dedications showed direct benefit-cost relationships and provided special advantages. In particular, they rationed the use of a government service and provided better demand information.

A majority of the ten dedications evaluated did not fulfill the requirements of a sound dedication. It was recommended that eight of the ten dedicated revenues be de-earmarked and their collections deposited in the general fund. These recommendations were based

primarily on the dedications' lack of a benefit-cost relationship. Considerations such as inappropriate collection formulas, inadequate funding, and reduced legislative scrutiny also influenced the recommendations.

Based on the results of the ten analysis, it appears that Montana's dedications, in general, may not be based on the benefit theory of taxation and other characteristics of a sound revenue dedication. To this extent, it is concluded that the Governor and Legislature of Montana are disadvantaged by the dedications. The disadvantages are especially emphasized by Montana's high proportion of dedicated revenues. In fiscal 1979, the Governor and Legislature had discretion over only forty-five percent of state spending. The remainder of state spending was dictated by dedication provisions.

Recommendations

On the basis of the findings and conclusions of this report, two recommendations are made.

It is recommended that Montana's executive and legislative branches undertake a systematic review of all state revenue dedications. The evaluation of ten dedications in this report revealed that eight of the ten provided more disadvantages than advantages to the Governor and Legislature. The intent of a review of all dedications would be to identify other such dedications to determine if they

should be de-earmarked. It is suggested that reviews be done periodically as there is a tendency for dedications to lose their ability to adequately fund programs and ability to reflect public demand over time. A review similar to Montana's sunset review for regulatory boards is proposed. Each dedication would be subject to re-evaluation after an established period. An appropriate period might be four years. Under the review system, an agency of the executive or legislative branch would evaluate each dedication and recommend that the legislature retain the dedication provision or de-earmark the revenue.

It is also recommended that there be an evaluation of the propriety of proposed new dedications. Such evaluations would determine whether a proposed dedication would be proper based on the benefit theory and other considerations. On the basis of the evaluations, recommendations would be made to not dedicate revenues where established criteria were not met. Such evaluations could be carried out by the same agency which performs periodic reviews of existing dedications. The criteria for initial evaluations and periodic reviews and the responsibilities of the agency would be established by statute.

The intent of the recommended reviews is not to preclude the ability of the Governor, Legislature, and public to impact state spending through dedications. However, the intent is to limit revenue dedications to those which will not handicap the Governor and the

Legislature in their attempts to establish and carry out spending priorities.

Finally, the political implications of these recommendations and the de-earmarking proposals which would result cannot be overlooked. The nature of such implications was well summarized by a member of Montana's Legislative Finance Committee during the committee's December 1979 meeting. The member suggested that a criterion for the evaluation of dedications should be whether it is politically feasible to de-earmark the revenue. This author also concludes that political considerations will have an impact on the ability to carry out this report's recommendations and the ability to de-earmark revenues. For this reason it is suggested that initial attempts to review and de-earmark revenues begin with instances where a dedication is clearly not appropriate under the established criteria. Initially, for example, outdated dedications might be the most politically susceptible to removal. As the review process and de-earmarking gain acceptance, the political feasibility of de-earmarking other revenues may increase. A schedule for the review of dedications might also involve an analysis of the political implications of de-earmarking each revenue. Such an analysis could be based on an investigation of the support that a dedication has from various interest groups.

Initial attempts to de-earmark revenues may be difficult due to

the political motives for dedicating. However, based on the de-earmarking experiences of states such as Alaska and Louisiana, it cannot be concluded that de-earmarking is impossible. Instead, the success of attempts to de-earmark will depend on the ability to convince the Governor, Legislature, agencies, and public that all stand to benefit from a fair, flexible, and comprehensive policy for state spending.

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