

Potential Finding and Recommendations on Inflation

SCHOOL FUNDING INTERIM COMMISSION
PAD MCCrackEN, LSD, AND KATE JOHNSON, LFD – JUNE 2026

At your April meeting, commission staff presented a memo with potential findings and recommendations, including one on inflationary adjustments. Based on Commission discussion/direction, staff developed this memo and attached provisional bill draft for your June 17-18 meeting.

The excerpt below is taken from the April memo with the language in *italics* added based on Commission discussion.

Potential findings and recommendations

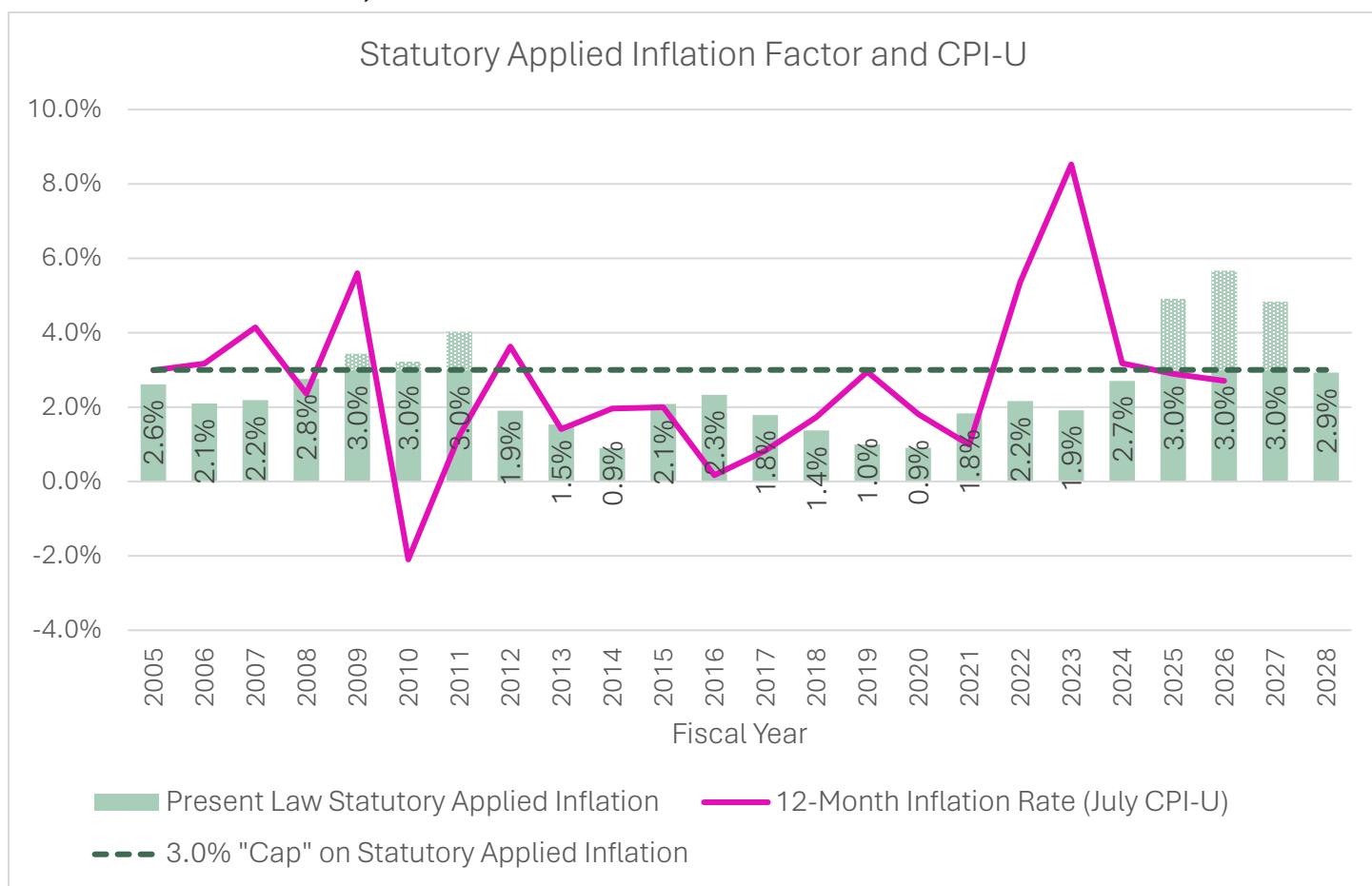
- Montana’s current inflationary adjustment calculations lag real-time inflation due to the 3-year annualization.
 - Make the inflationary adjustment calculation in 20-9-326, MCA more contemporary with current inflation *or base it on a forecast rather than a 3-year look back*
- When inflation exceeds 3% and the legislature does not exercise its authority to exceed the 3% cap on the budgetary starting point (“present law base”) school districts fall behind.
 - Remove *(or increase)* the 3% cap
- *The consumer price index “basket of goods” does not reflect school district expenditures in the district general fund.*
 - *Utilize a metric for inflation that better reflects school district expenditures than the consumer price index (CPI)*
- *The lack of permissive authority to increase over-BASE levies by the same rate of inflation applied to the BASE budget leads to election fatigue, voter confusion, and potentially erodes a district’s operational adequacy.*
 - *Provide trustees permissive authority to increase existing voter-approved over-BASE levies by the same rate of inflation provided by the Legislature to district BASE budgets*
- Recent changes to 20-9-326 increasing the visibility of how inflationary adjustments provided by the Legislature have kept paced (or not) with actual inflation may help prevent school funding from falling behind inflation as it did from 2021 to 2025.
 - The Legislature, Superintendent of Public Instruction, and Governor, should exercise their authority to propose inflationary adjustments beyond those calculated under 20-9-326, especially during times of high inflation.

This memo will provide more information on the above and options for the Commission to consider.

Figure 1, seen below, shows the statutory applied inflation factor, calculated as outlined in 20-9-326, and the 12-month (or year-over-year) change in the inflation rate (percent change of the July CPI-U). The horizontal line represents the 3% “cap” on inflation in the statute, and in fiscal years when the statutorily defined inflationary adjustment calculation would exceed the 3% cap (fiscal years 2009-2011 and 2025-2027), the inflationary adjustment exceeding that cap is represented by the patterned bars.

Figure 1. Statutory Inflation Adjustment and CPI-U. The consumer price index, U.S. city average, all urban consumers (CPI-U) data shows the 12-month (or year-over-year) inflation rate from the July price index to the previous July price index. Please note that the x-axis of this graph (and other graphs) displays state fiscal years, which begin on July 1. This means that the 12-month inflation rate is displayed by fiscal year, not the calendar year in which it is measured (i.e. the 12-month inflation rate for FY 2026 is the 12-month change in CPI-U between July 2024 and July 2025).

CPI-U data retrieved June 1, 2026 from the [U.S. Bureau of Labor Statistics](https://www.bls.gov/).



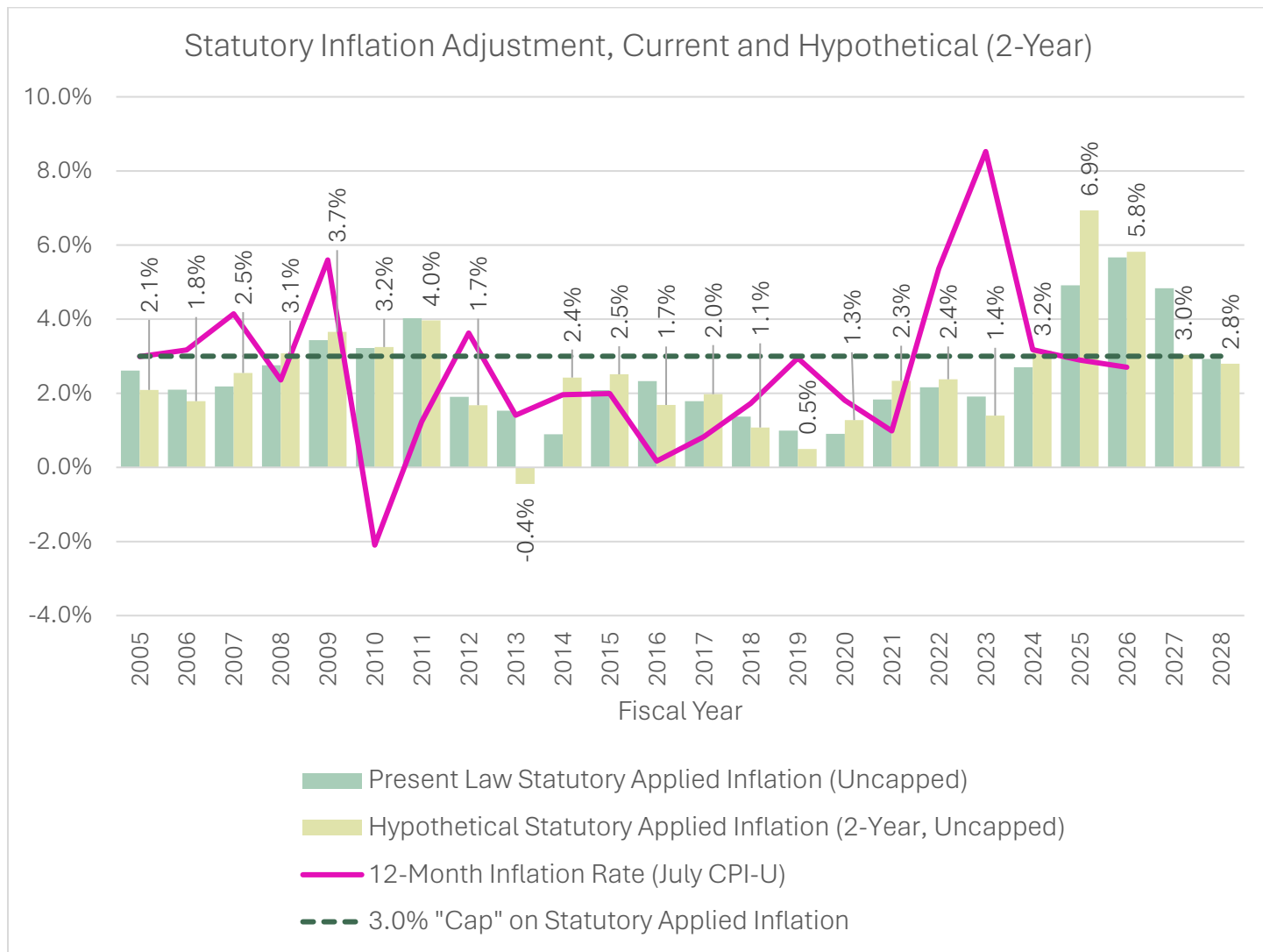
POSSIBLE REC: ADDRESS THE LAG

One challenge with 20-9-326 is that it is used to determine the present law base or starting point for the next biennium budget in advance of a legislative session such that the inflationary adjustment for FY 28 (the 2027-2028 school year) is based on the annualized changes in the CPI from July 1, 2022 to July 1, 2025, and the adjustment for FY 29 (the 2028-2029 school year) is based on the annualized changes in the CPI from July 1, 2023 to July 1, 2026. This lag is highly visible in Figure 1.

Shortening the annualization period to two years would help some (2023 to 2025) or the adjustment could simply be the percent increase from one year to the next (2024 to 2025). Additionally, the adjustment provided to both years of the biennium could be the percent change in the two most recent years available (e.g. FYs 28 and 29 could both be adjusted by the percent change in CPI from calendar years 2025 to 2026).

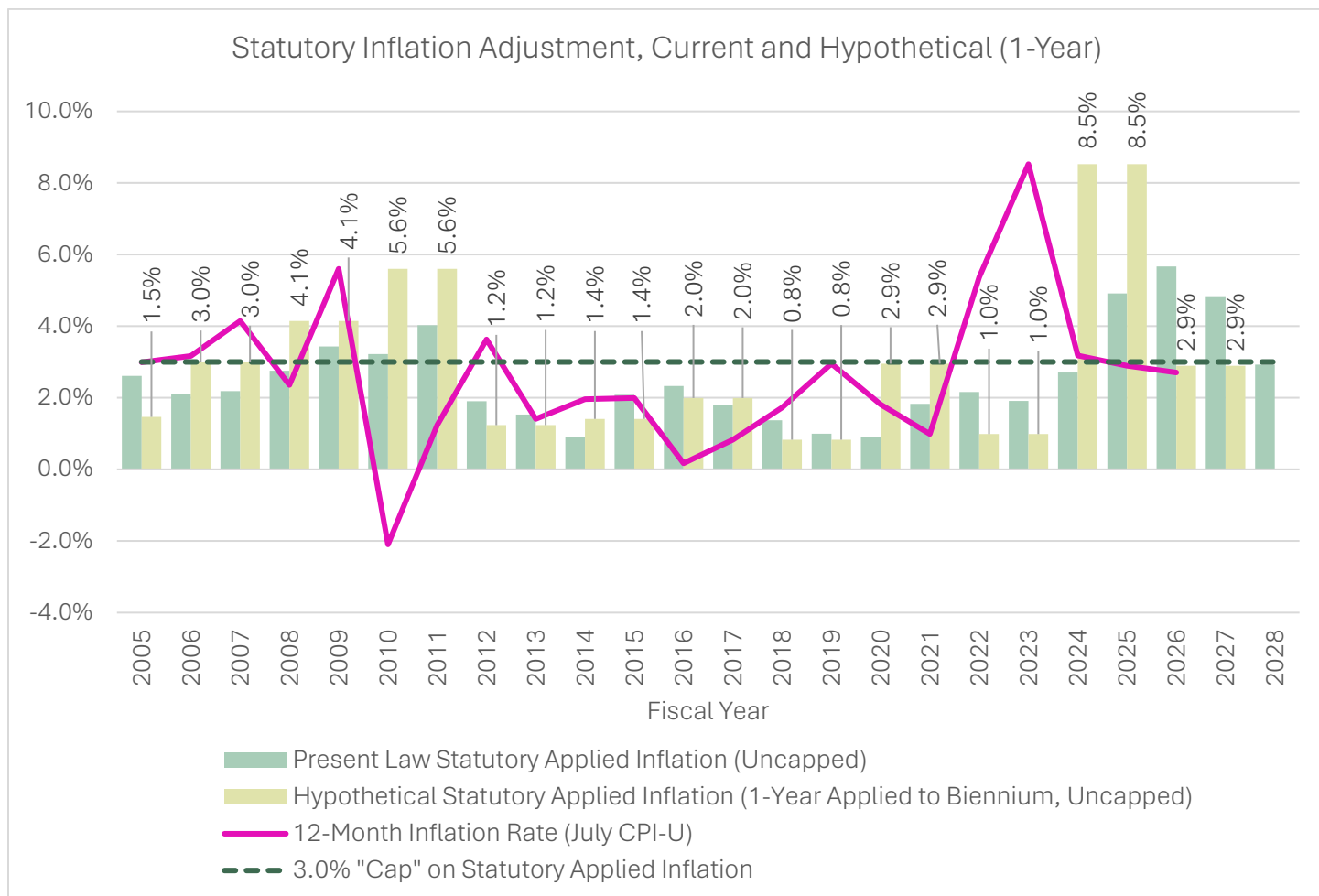
Figure 2 (page 4) models the 12-month inflation rate from the July CPI, existing (but uncapped) inflationary adjustment calculation in 20-9-326, and a hypothetical inflationary adjustment calculation based on a two-year annualization period. The hypothetical two-year inflation factor columns are labeled. The current inflationary adjustment for FY 2028 is calculated from the change in CPI from July 1, 2022, to July 1, 2025; the two-year hypothetical inflationary adjustment calculation for FY 2028 would be based on the annualized change in CPI from July 1, 2023, to July 1, 2025.

As seen in Figure 2, an uncapped inflationary adjustment based on a two-year period would create a larger response to periods of high or low inflation than an adjustment based on a three-year period – the uncapped FY 2025 two-year inflationary adjustment would be two percentage points higher than the three-year adjustment (6.93% vs. 4.91%), and the uncapped FY 2027 inflationary adjustment would be nearly two percentage points lower than the three-year adjustment (3.04% vs. 4.83%). The hypothetical inflationary adjustments still show the time lag between periods of high inflation and the effect of the inflationary adjustment as the current inflationary adjustment shows.

Figure 2. Statutory Inflation Adjustment, Current and Hypothetical (2-Year).

The time lag seen between periods of high or low inflation and the corresponding applied inflation factor could partially be addressed by applying the 12-month inflation rate measured in July in advance of a legislative session and applied to both fiscal years of the biennium. If a period of high inflation preceded a legislative session (like what we saw with inflation rates before the 2023 session), a one-year inflation adjustment would provide more immediate funding catch-up than the inflation adjustment in statute. For example, the one-year hypothetical adjustment calculation for FY 2028 would be based on the change in CPI from July 1, 2024 to July 1, 2025. Basing the applied inflation factor on the 12-month inflation rate preceding a legislative session would create larger responses than the inflation adjustments based on two- or three-year periods – annualized rates with more years of data tend to “smooth” the years with unusually high or low rates of inflation – and still would not eliminate the time lag from the onset of an inflationary period and inflation-adjusted funding for districts.

Figure 3. Statutory Inflation Adjustment, Current and Hypothetical (1-Year). This one-year inflation adjustment is based on the 12-month inflation rate for the July in advance of a legislative session and applied to both fiscal years of the biennium.

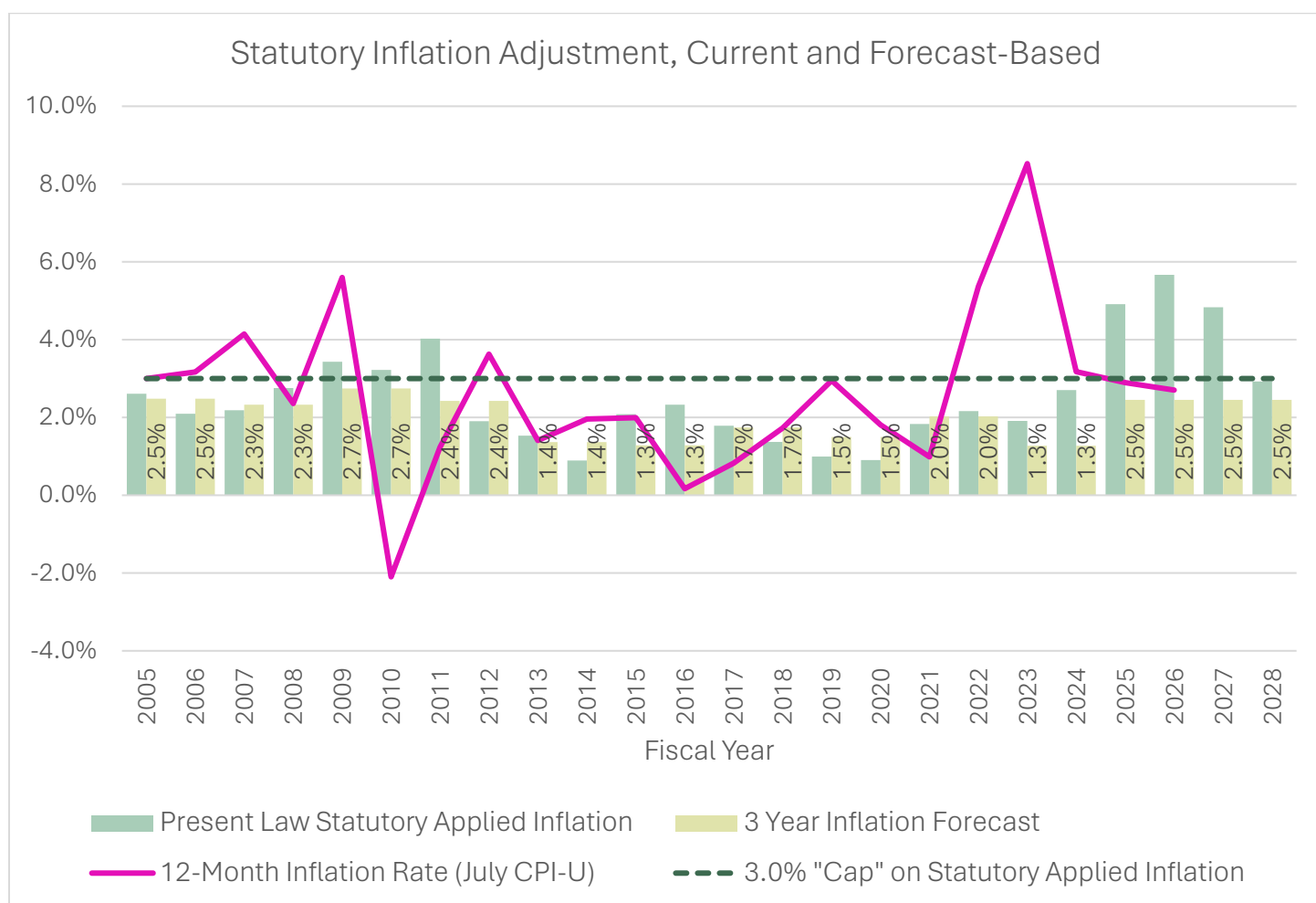


The statutory inflation adjustment could be based on forecasted inflation estimates rather than historical inflationary data. The Bureau of Labor Statistics does not forecast inflation; however, the Federal Reserve Bank of Cleveland's Center for Inflation Research produces publicly available expected CPI inflation rate estimates (annualized) in 1- to 30-year forecast horizons. Various private organizations publish CPI and PPI forecasts, but statute does not generally reference private organizations. Statute allows DPHHS to use a "reliable national index" for inflation adjustments for certain services in its

budget preparation.¹ Statute could be amended to direct the superintendent of public instruction to do similar in selecting a forecast metric to use in preparing the agency budget.

Figure 4 shows the current statutorily defined inflation factor, a forecast-based inflation factor, and the 12-month change in the inflation rate. The forecast-based inflation factor is based on the Federal Reserve Bank of Cleveland's Center for Inflation Research July 3-year expected inflation forecast horizons published in July preceding a legislative session; the expected inflation forecast rate is applied to both years of the biennium. For example, the FY 2026 and 2027 forecast-based inflation factors are based on the 3-year forecast horizon published in July 2024.

Figure 4. Statutory Inflation Adjustment, Current and Forecast-Based. Forecasted inflation (3-year annualized rate) data retrieved June 2, 2026 from the [Federal Reserve Bank of Cleveland](https://frb.cleveland.gov/).



¹ See 17-7-111(7), MCA: https://mca.legmt.gov/bills/mca/title_0170/chapter_0070/part_0010/section_0110/0170-0070-0010-0110.html

POSSIBLE REC: ELIMINATE (OR INCREASE) THE 3% CAP

Removing (or increasing) the 3% cap would be accomplished by striking (or modifying) the light blue highlighted language on page 1, line 24 of the draft. Figure 1 (page 2) shows the impact of this change on the shaded areas of the columns above the dotted 3% cap line. Figure 2 (page 4), Figure 3 (page 5), and Figure 4 (page 6) all show the 3% “cap” dotted line but also show what the current 3-year inflation adjustment and a hypothetical inflation adjustment would yield if the 3% cap did not exist.

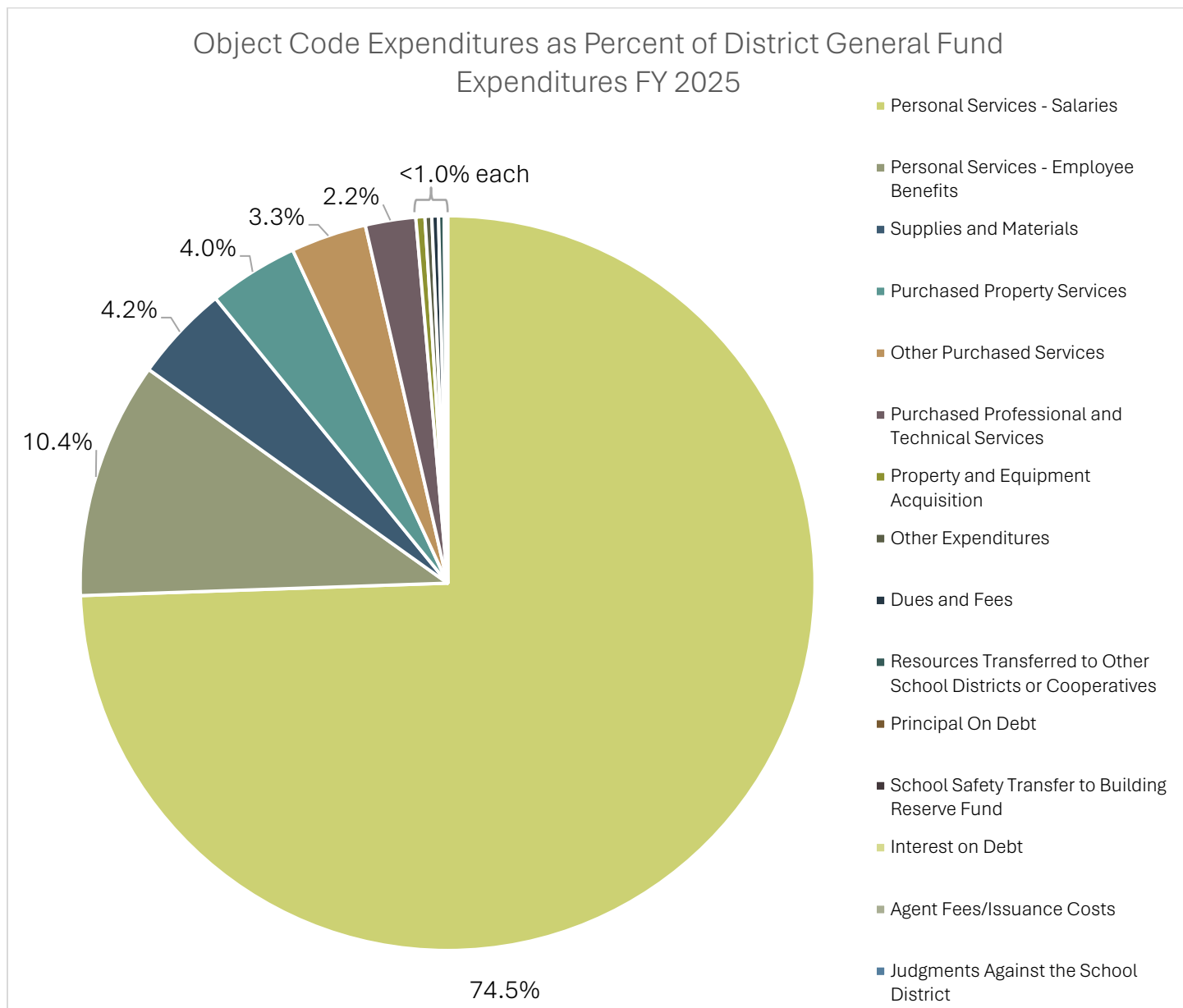
POSSIBLE REC: USE A METRIC OTHER THAN CPI

The inflationary adjustment under 20-9-326 applies to the funding components of the district general fund. Figure 5 (page 8) shows that about 75% of the FY 2025 district general fund was spent on salaries, 10% on benefits, 4% on supplies and materials, 4% on purchased property services, and smaller portions spent on purchased professional and technical services, other purchased services, and other expenditures.

The current inflation adjustment in statute ties inflationary changes in school spending to the consumer price index, which is based on consumer expenditure surveys of the costs of a “market basket,” or eight major groups of goods and services purchased by households: food and beverages, housing, apparel, transportation, medical care, recreation, education and communication, and other goods and services.² Public education spending does not necessarily mirror household spending; Figure 5 demonstrates that about 85% of district general fund spending was dedicated to employee salaries and benefits.

Alternative cost indices the commission could consider for inflation adjustments include employment cost indices (ECI) produced by the US Bureau of Labor Statistics, which measure changes in employee compensation (or the cost of labor), rather than a “basket of goods” typically purchased by households. There are several employment cost indices, including ones that measure the cost of labor for state and local government workers, state and local government workers who work in elementary and high schools, and all civilian workers. Figure 6 (page 9) provides a comparison of these ECI with the CPI and shows that while the indices generally track each other, the ECI tends to show moderate year-to-year changes, while CPI tends to be more volatile.

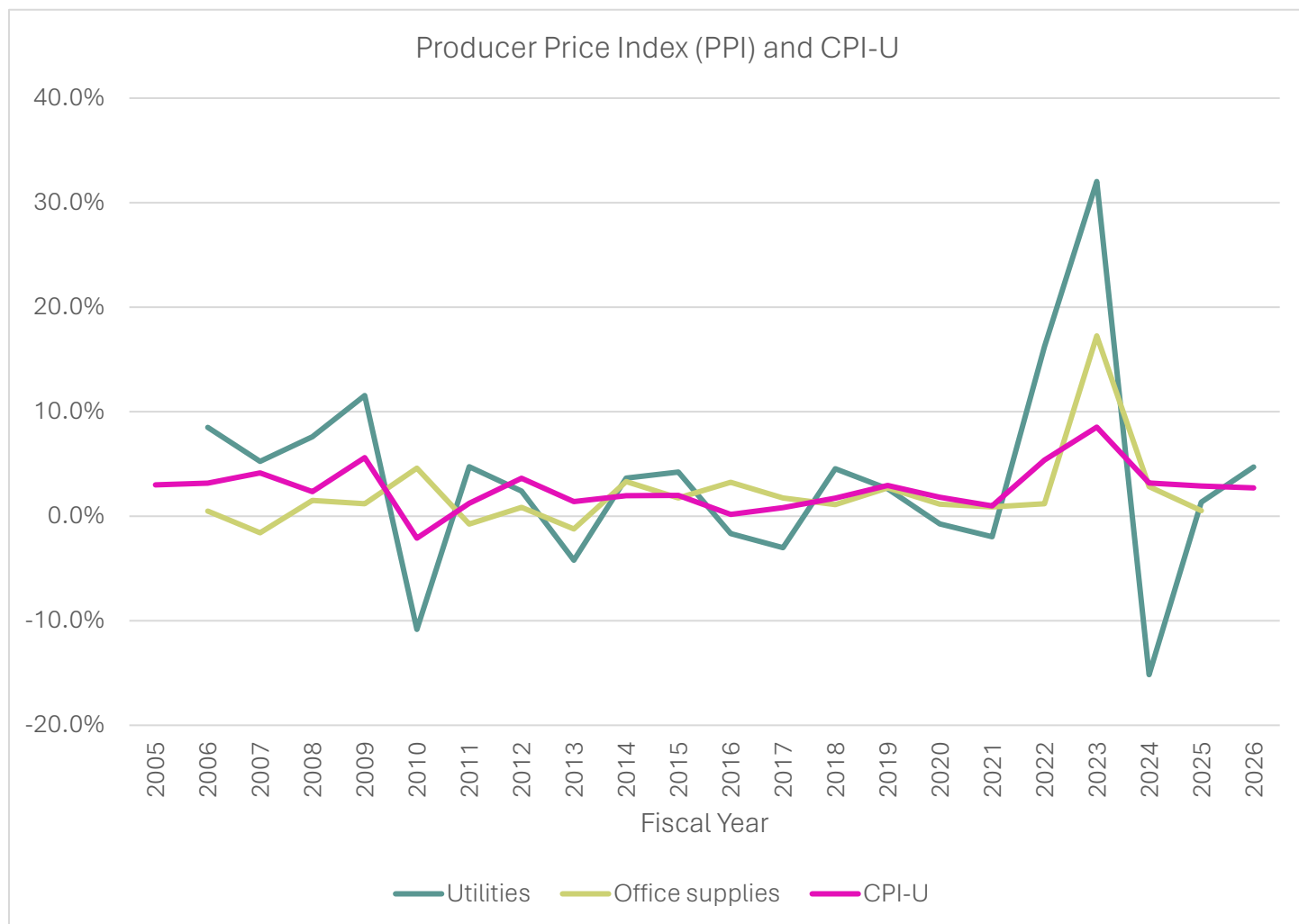
² <https://www.bls.gov/cpi/questions-and-answers.htm>

Figure 5. Object Code Expenditures as Percent of District General Fund Expenditures FY 2025.

As seen in Figure 5, object code expenditures for supplies and materials comprised 4.2% of FY 2025 district general fund expenditures. Instruction, technology, and administration supplies and materials accounted for 2.8% of FY 2025 total district general fund expenditures. Supplies and materials for facilities operations and maintenance, which include gas, oil, coal, vehicle and equipment fuel, and other energy supplies comprise another 1.1% of total district general fund expenditures. Purchased property services, which include utilities, repair, maintenance, and minor construction services, comprise another 4.0% of FY 2025 total district general fund expenditures.

Figure 7 (page 11) shows the 12-month change in prices for the utilities and office supplies producer price indices compared to CPI-U. An inflation adjustment for facilities operation and maintenance and energy costs could be based on the PPI for utilities, while an inflation adjustment for instruction, technology, and administration supplies and materials could be based on the PPI for office supplies. CPI and PPI for office supplies show variation between years, but PPI for utilities shows the greatest volatility.

Figure 7. Producer Price Index (PPI) and CPI-U. Monthly PPI data for utilities ([PCU221221](#)) and office supplies ([PCU3399403399402](#)) retrieved from the Federal Bank of St. Louis website. PPI data for utilities and office supplies are available starting in December 2003; therefore, the first time period of 12-month price changes for both measures are calculated from July 2004 to July 2005 and show as FY 2006 data. PPI data for office supplies are current through June 2025, so the FY 2026 12-month price change for that index will not be calculated until July 2025 data become available.



A “market basket” of final demand goods purchased by schools – utilities and office and instructional supplies, for example – in addition to a measure of labor costs (CPI, ECI, or another measure that captures price changes of salaries and benefits) could be constructed to represent the price change in the categories that represent the largest portions of district general fund spending. Inflationary adjustments for each component of that market basket of goods could be tied to each index, with each expenditure category weighted by the percent of school district general fund spent on that category, to

create one inflationary adjustment measure. An example of the methods for creating this type of inflation adjustment and monitoring several price indices for inflationary pressures on school funding is this [report on Wyoming's external cost adjustments model](#).

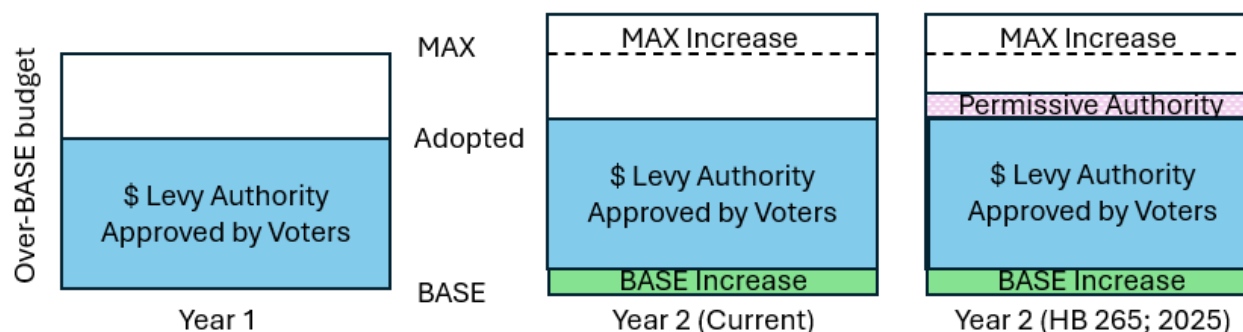
Figure 8 (page 13) shows an example market basket of school purchases – ECI for state and local government workers (personal services salaries and benefits), PPI for utilities (facilities operations and maintenance and energy costs), PPI for office supplies (instruction and administration supplies and materials), and CPI-U for comparison, with 12-month changes in prices, based on July index data, included for each fiscal year. At the bottom of the table, proposed general fund weights are listed based on the portion of FY 2025 district general fund expenditures that each object code category accounted for – 85% for employee salaries and benefits, 5.1% for operations and maintenance and energy, and 2.8% for instruction and administration supplies and materials. The unaccounted remaining 7.1% of general fund expenditures could be tied to another price index, such as another PPI measure specific to education services, or the CPI-U.

Figure 8. Example Education Price Indices.

Fiscal Year	ECI: State and local government workers	PPI: Utilities	PPI: Office supplies	CPI-U
2005	3.4%			3.0%
2006	3.9%	8.5%	0.5%	3.2%
2007	4.1%	5.2%	-1.6%	4.1%
2008	4.3%	7.6%	1.5%	2.4%
2009	3.4%	11.6%	1.2%	5.6%
2010	2.3%	-10.8%	4.6%	-2.1%
2011	1.8%	4.7%	-0.7%	1.2%
2012	1.5%	2.4%	0.8%	3.6%
2013	1.8%	-4.2%	-1.2%	1.4%
2014	1.7%	3.6%	3.3%	2.0%
2015	2.1%	4.2%	1.7%	2.0%
2016	2.3%	-1.7%	3.2%	0.2%
2017	2.6%	-3.0%	1.7%	0.8%
2018	2.4%	4.5%	1.1%	1.7%
2019	2.5%	2.6%	2.7%	2.9%
2020	3.1%	-0.7%	1.2%	1.8%
2021	2.3%	-2.0%	0.9%	1.0%
2022	2.3%	16.2%	1.2%	5.4%
2023	4.6%	32.0%	17.3%	8.5%
2024	4.8%	-15.2%	2.8%	3.2%
2025	4.7%	1.3%	0.5%	2.9%
2026	3.6%	4.7%		2.7%
General Fund Weight	85.0%	5.1%	2.8%	

POSSIBLE REC: INFLATIONARY INCREASES FOR THE OVERBASE

This potential recommendation is not about changing the inflationary adjustment, but about ensuring that districts receive the full benefit of the inflationary adjustment, including in the over-BASE portion of the budget without needing to seek voter approval every year. When inflationary adjustments are applied to the funding components, both the BASE and MAX budget limits increase, but the MAX increases more, expanding the over-BASE area. Unless districts propose, and voters approve, increases to the over-BASE levy, the MAX budget limit “grows away” from the adopted budget. The diagram below attempts to portray this. This recommendation would allow the previously approved levy authority to grow permissively (at the discretion of trustees) at the same rate of inflation applied to the components, allowing for example a district operating at 93% of MAX to maintain that percentage rather than have it erode to 92%, 91%, etc. over time. This was proposed in [HB 265](#) (2025; Muszkiewicz) and if the commission chooses to proceed with this recommendation, staff will prepare a bill draft substantively similar to HB 265.



ADDITIONAL CONSIDERATION

It's worth remembering that the inflationary adjustment under 20-9-326 applies to the general fund funding components (the basic and per-ANB entitlements, the QE payment, IEFA, etc.) but not to state funding mechanisms supporting other district funds. We [presented information](#) (see slide 8) to you at your February meeting that shows the impacts of stagnant transportation reimbursement amounts over two decades: a large increase in the burden shouldered by local property taxes. The Commission could consider including these other mechanisms in the inflationary adjustments.

*** BILL NO. ***

INTRODUCED BY ***

BY REQUEST OF THE ***

Working draft for discussion
purposes at SFIC June 17-18
meeting

A BILL FOR AN ACT ENTITLED: "AN ACT ***; AMENDING SECTION 20-9-326, MCA."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MONTANA:

Section 1. Section 20-9-326, MCA, is amended to read:

"20-9-326. Annual inflation-related adjustments to basic entitlements and per-ANB entitlements

-- reporting. (1) In preparing and submitting an agency budget pursuant to 17-7-111 and 17-7-112, the superintendent of public instruction shall determine the inflation factor for the basic and per-ANB entitlements, the data-for-achievement payment, the per-ANB amount used to calculate the total special education allocation in 20-9-306, and the general fund payments in 20-9-327 through 20-9-330 in each fiscal year of the ensuing biennium. The inflation factor is calculated as follows:

(a) for the first year of the biennium, divide the consumer price index for July 1 of the prior calendar year by the consumer price index for July 1 of the calendar year 3 years prior to the prior calendar year and raise the resulting ratio to the power of one-third; and

(b) for the second year of the biennium, divide the consumer price index for July 1 of the current calendar year by the consumer price index for July 1 of the calendar year 3 years prior to the current calendar year and raise the resulting ratio to the power of one-third.

(2) (a) The present law base for the entitlements referenced in subsection (1) of this section, calculated under Title 17, chapter 7, part 1, must consist of any enrollment increases or decreases plus the inflation factor calculated pursuant to this section, not to exceed 3% in each year, applied to both years of the biennium.

(b) This subsection (2) does not limit the superintendent or the governor from recommending, or limit the legislature from adopting, inflationary adjustments other than those calculated in this section.

(3) Beginning in fiscal year 2026 and then every even-numbered fiscal year thereafter, the

1 superintendent of public instruction shall provide a report no later than September 1 to the education interim
2 budget committee and the education interim committee and no later than December 31 to the legislative finance
3 committee, in accordance with 5-11-210, regarding the educational relevance in the implementation of this
4 section. The report must include:

5 (a) the increase in funding over the prior year on a per-ANB basis for the BASE aid elements
6 represented in [20-9-306(2)(a), (2)(c) through (2)(g), and (2)(i)] budgeted to be provided to school districts in
7 the current fiscal year and provided to school districts in the preceding 5 fiscal years, which must be reported in
8 both dollar and percentage amounts, with the six percentages rounded to the nearest one hundredth;

9 (b) the percentage change from July of the preceding year to July of the applicable year in the
10 consumer price index for the current year and the preceding 5 years, with the six percentages rounded to the
11 nearest one hundredth; and

12 (c) a cumulative numerical comparison of the difference between the percentages reported in
13 subsections (3)(a) and (3)(b), rounded to the nearest one hundredth.

14 (4) For the purposes of this section, "consumer price index" means the consumer price index, U.S.
15 city average, all urban consumers, for all items, using the 1982-84 base of 100, as published by the bureau of
16 labor statistics of the U.S. department of labor."

17 - END -