

Historical Analysis of Montana Revenues

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BACKGROUND

This report is written based on LFD analysis of state accounting data and the three primary budgeted funds, also known as governmental funds: general fund, state special funds and federal special funds. The definition of these funds is described in statute, [17-1-102, MCA](#). Although other reports prepared for January 2020 Legislative Week focus on U.S. Census data, this report does not include analysis of U.S. Census data.¹

This report includes a series of charts that compare revenue growth to the growth in the economy and growth in inflation adjusted for population. Montana statute, 17-8-106, MCA, recommends using growth in personal income for comparison purposes. Personal income is a measure for growth in the economy. Comparing growth allows financial planners to consider past and future demands in services or changes in revenues.

HISTORY OF GENERAL FUND REVENUE

Montana experienced above average employment and wages during the 1990's that translated into strong tax revenue growth. This revenue growth was further enhanced by the significant increase in the equity markets and the resulting growth in capital gains income. Despite a mild recession from 2001-2002, Montana's general fund revenues began a period of unprecedented growth increasing by 9.4 % annually from FY 2003 to FY 2008.²

The Great Recession that hit world markets in 2008 negatively impacted Montana's general fund revenue collections causing two years of declining revenue: FY 2009 (down 7.5%) and FY 2010 (down another 10.0%). Although revenue increased by 9.6% in FY 2011, general fund revenues did not recover to pre-recession levels until FY 2012.

In calendar 2012, taxpayers adjusted their behavior in anticipation of the higher federal tax rates on capital gains, or as it was commonly known as, the federal fiscal cliff of 2012. The federal policy change resulted in revenue shifting from FY 2014 to FY 2013 as individuals accelerated the realization of their capital gains income in calendar 2012. This adjusted behavior flattened the revenue between FY 2013 and FY 2014. Since FY 2014 income was shifted to FY 2013, FY 2014 had artificially low collections. As a result, FY 2015 revenues had strong year-over-year growth.

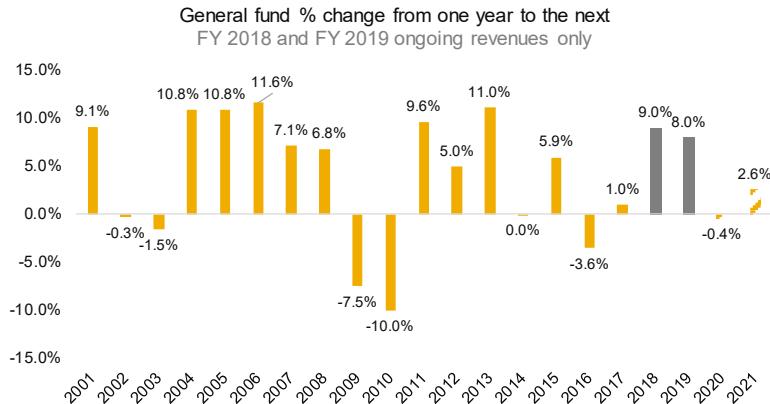
¹ U.S. Census data analysis does not include the same level of granularity as state accounting data, and therefore will not tie for several reasons, but will have the same overall trend. The primary difference is U.S. Census data includes more funds than the three primarily budgeted funds mentioned here. In addition, U.S. Census data does not use accruals and state accounting data includes accruals. While Census data is excellent trend data, detailed analysis cannot be done with U.S. Census data. The LFD relies on state accounting data for reporting on state finances.

² [2011 Biennium Budget Analysis, Volume 2 Revenue Estimates](#), Legislative Fiscal Division, December 2008.

In FY 2016 – FY 2017, economic factors lowered collections. Low wage income and lackluster commodity prices including low oil prices contributed to the decline. FY 2017 was further impacted by income taxpayers choosing to delay realization of income.

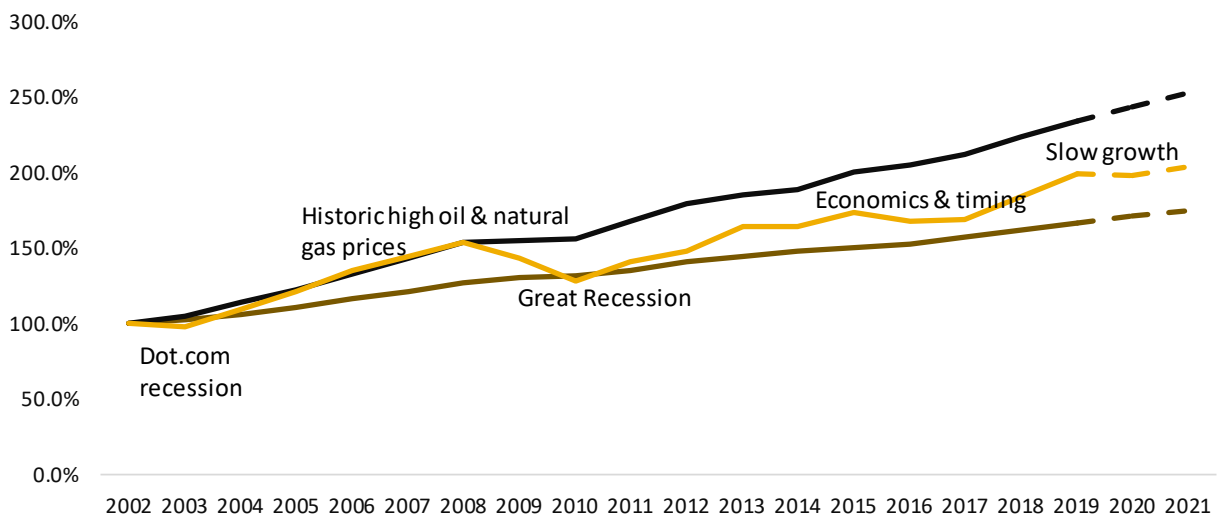
Recent general fund revenue collections have been and continue to be influenced by the changing economy and taxpayer choices made in response to anticipated and actual federal tax changes. FY 2018 and FY 2019 saw strong growth, likely spurred by individuals shifting income from FY 2017 to future years to take advantage of tax reductions at the federal level.

The chart at right shows general fund revenue change from one year to the next. Average growth has been 4.0%. A slow recovery of revenues began in FY 2018 with continued, slow growth forecast through FY 2021. The growth in FY 2020 - FY 2021 is modest in comparison to the long term trended growth rate due to anticipated normalization of income tax revenues and slow economic growth.



The following chart shows historical revenues compared to growth in the economy (personal income) and the growth in inflation adjusted for population. Please note that FY 2018 and FY 2019 include ongoing revenue, those years had unusually high one-time-only revenues, which are excluded.

The chart shows **general fund revenue change** compared to the **growth in the economy** and the **growth in inflation** by fiscal year.



The inflection points in the chart include the following significant variations in state general fund revenues:

Declines in Growth

- FY 2001 – FY 2002 revenue decline was the result of lower in taxable income from stock options and capital gains and a reduction in corporation tax revenues the result of low corporate profits. This decline led to a 2002/2003 budget crisis and a special session in 2002
- FY 2009 – FY 2011 the state experienced the impacts of the Great Recession and individual income tax revenue collections, particularly in non-wage components, and corporation income tax estimated tax payments significantly declined
- FY 2016 and FY 2017 the price of oil fell which drove declines in the mining and manufacturing sectors of the economy and state tax revenues in both calendar years 2015 and 2016. FY 2017 declines in corporation income tax collections were likely the result of continued low commodity prices,³ which likely resulted in quarterly losses for multiple corporations, increasing the chances of higher-than-average refunds⁴
- FY 2017 continued low revenue due to economic conditions mentioned above plus taxpayer timing issues related to the anticipation of lower corporate and personal income tax rates:
 - CY 2016 declines in wage income and taxpayers shifted \$120 million in wage income between December 2016 and January 2017. If the \$120 million was added to CY 2016 wage income, growth from CY 2015 would have been about 2.4% and more in line with other measures of wage growth
 - In addition to declines in wage income, declines in rent, royalty and partnership income occurred in CY 2016, 80% of which was concentrated in taxpayers with income or loss exceeding \$1.0 million⁵

High Growth

- FY 2004 – FY 2005 saw increases in individual income tax revenue and oil and natural gas revenues resulting from general high economic activity across the nation and a boom in oil production in Montana
- FY 2007- FY 2008 oil and natural gas prices were at historic high levels, and individual income tax revenues continued to climb. Higher than expected commodity prices kept

³ [Montana Annual Bulletin, 2018, USDA, National Agricultural Statistics Service, page 21.](#)

⁴ [Corporation Income Tax Model Update and Refunds by Sector Memorandum, Legislative Fiscal Division, September 7, 2016.](#)

⁵ [Year-to-Date General Fund Revenue Collections with Highlights of 2016 Individual and 2015 Corporation Income Tax Return Data, pages 4-5, Legislative Fiscal Division, December 5, 2017.](#)

corporation income tax, oil and natural gas tax revenues, and U.S. mineral lease revenues high through FYE 2009

- FY 2015 – Non-wage income, especially capital gains realizations, increased. CY 2014 was a very good year as measured by stock market growth, as capital gains income in Montana grew by 44%

Flat Growth Anticipated

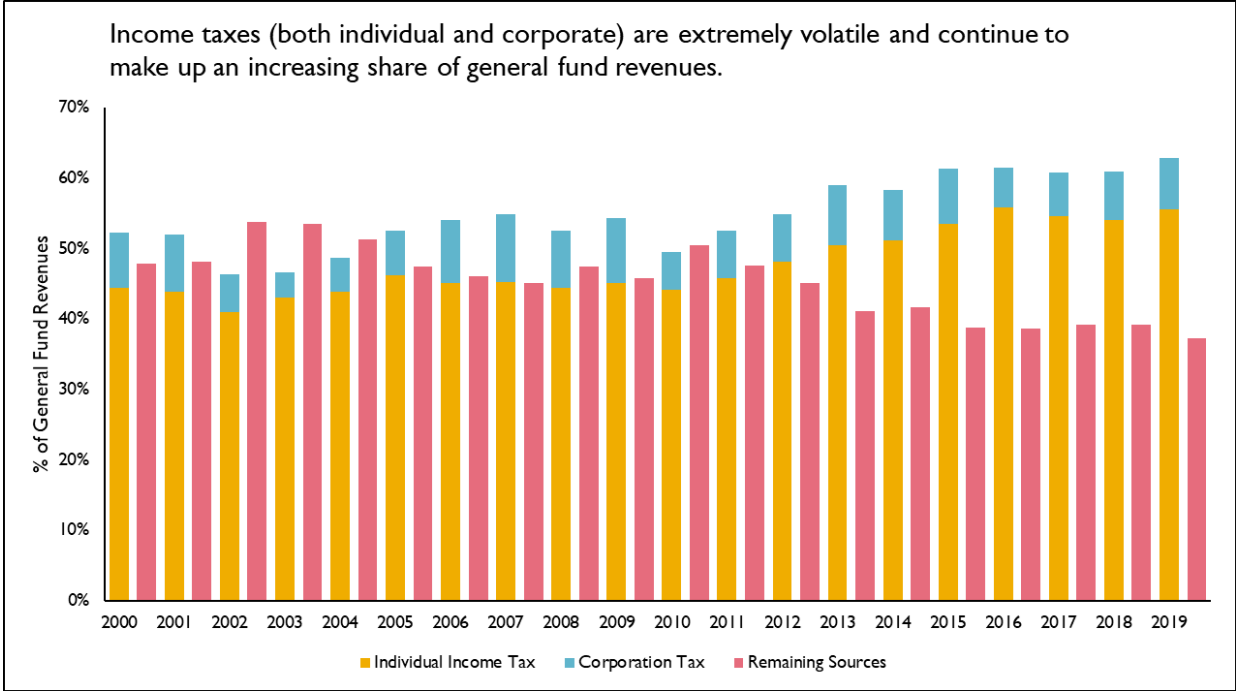
- FY 2020 and FY 2021 a return to normal income tax collections and slow economic growth is expected to continue through FY 2021

Income Tax - Taxpayer Behavior shifting revenues

- FY 2013 – FY 2014 unusual taxpayer behavior for non-wage income contributed to low growth. Current year payments for FY 2013 were unusually high, likely due to taxpayers' responses to the federal tax uncertainty at the end of calendar year 2012. Therefore, FY 2014 current year payments were unusually low: as taxpayers realized gains in CY 2012 that they would have primarily realized in CY 2013, resulting in FY 2014 estimated and current year payments lower than otherwise anticipated
- FY 2017 – FY 2019 taxpayer behavior contributed to low growth in FY 2017 and likely contributed to high growth in FY 2019. Income growth for FY 2017 was unusually low, likely due to taxpayers' responses to the federal tax uncertainty at the end of calendar year 2016. Taxpayers anticipated a federal tax reduction in calendar 2017 and delayed realizing income in calendar 2016 thus lowering income tax collections in FY 2017. A reduction ultimately passed in December of 2017 and FY 2018 and FY 2019 revenues increased, suggesting income from calendar 2016 and 2017 was shifted into future years

General Fund Increasing Reliance on Income Taxes

Over the last two decades Montana's general fund has become increasingly reliant on income tax (individual and corporate) collections. In fact, as recently as FY 2010 Montana's income taxes accounted for 49.5% of total general fund revenues. By FY 2019 this share had grown to 62.8%, as shown in the figure below.



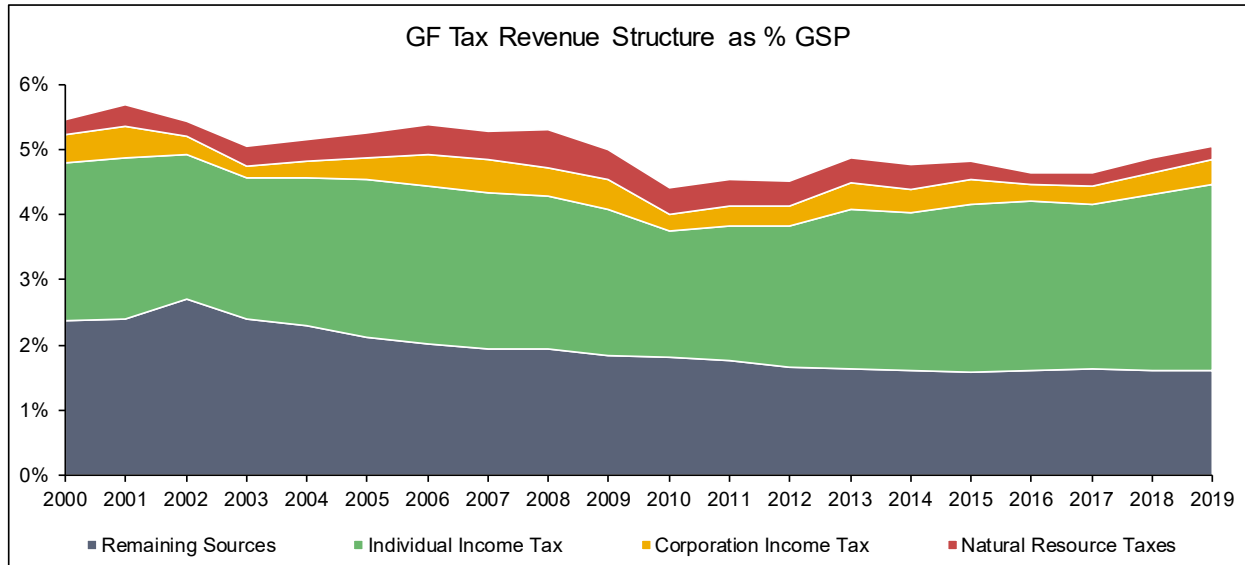
Volatility Over the Last Decade

While individual income taxes continue to grow relative to the rest of the general fund, it is also a source that can be difficult to forecast due to its volatility. Many of the general fund revenue sources grow every year, and if this growth pattern is easy to understand, revenue forecasts should be relatively accurate. However, if the growth is sporadic, revenue collections may come in far higher or lower than anticipated, leading to budgetary surpluses or shortfalls. The following chart lists the top ten general fund revenue sources, and ranks the volatility of their year-over-year change from most volatile to least volatile. These rankings were developed by calculating the standard deviation of each sources year-over-year percent change for the last decade. The ranking of the source relative to its contribution to the general fund is also included.

Year-Over-Year % Change Volatility Rankings		
Revenue Source	Volatility Rank	Size Ranking
Treasury Cash Account	1	10
Corporation Income Tax	2	3
Oil and Natural Gas Tax	3	7
Individual Income Tax	4	1
Video Gambling Tax	5	6
Lodging Facility Tax	6	9
Insurance Tax	7	5
Cigarette Tax	8	8
Vehicle Taxes	9	4
Property Tax	10	2

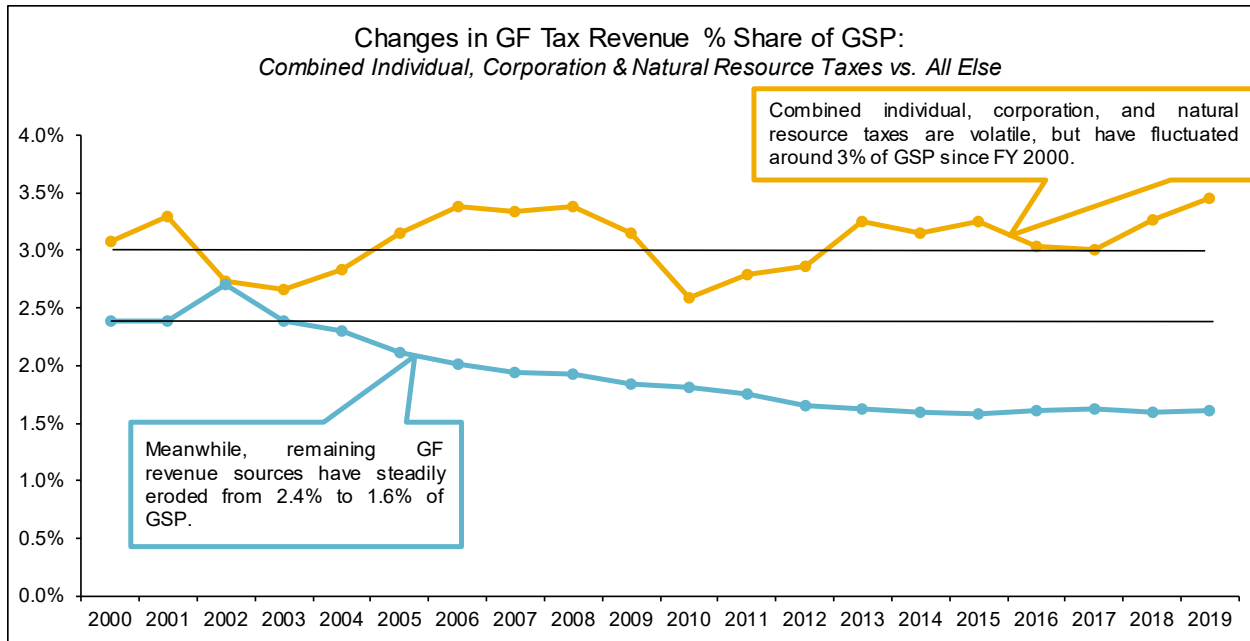
KEY REVENUE SOURCES DECLINE AS A SHARE OF GROSS STATE PRODUCT

Total general fund revenue as a share of gross state product (GSP) has declined since FY 2000, as shown in the chart below. To better understand the underlying cause of the decline, key revenue sources—individual income tax, corporation income tax, and natural resource taxes—are shown separately.



As depicted in the chart above, the primary source of decline seems to be due to the “Remaining Sources” category. The chart below groups individual, corporation and natural resource tax revenue as a share of GSP, and compares it with remaining sources of general fund revenue as a share of GSP. While combined individual, corporation, and natural resource taxes are certainly volatile, the amount has fluctuated around 3% of GSP since FY 2000. The decline on overall revenue as a share of GSP appears to be due to the decline in the remaining sources of general fund revenue.

An approximation of the revenue impact attributable to the erosion of remaining sources from 2.4% to 1.6% of GSP can be generated by multiplying annual GSP by the difference between 2.4% and the actual share collected. Under this calculation, the difference in FY 2019 was \$398 million and the cumulative total since FY 2000 is over \$4.0 billion.



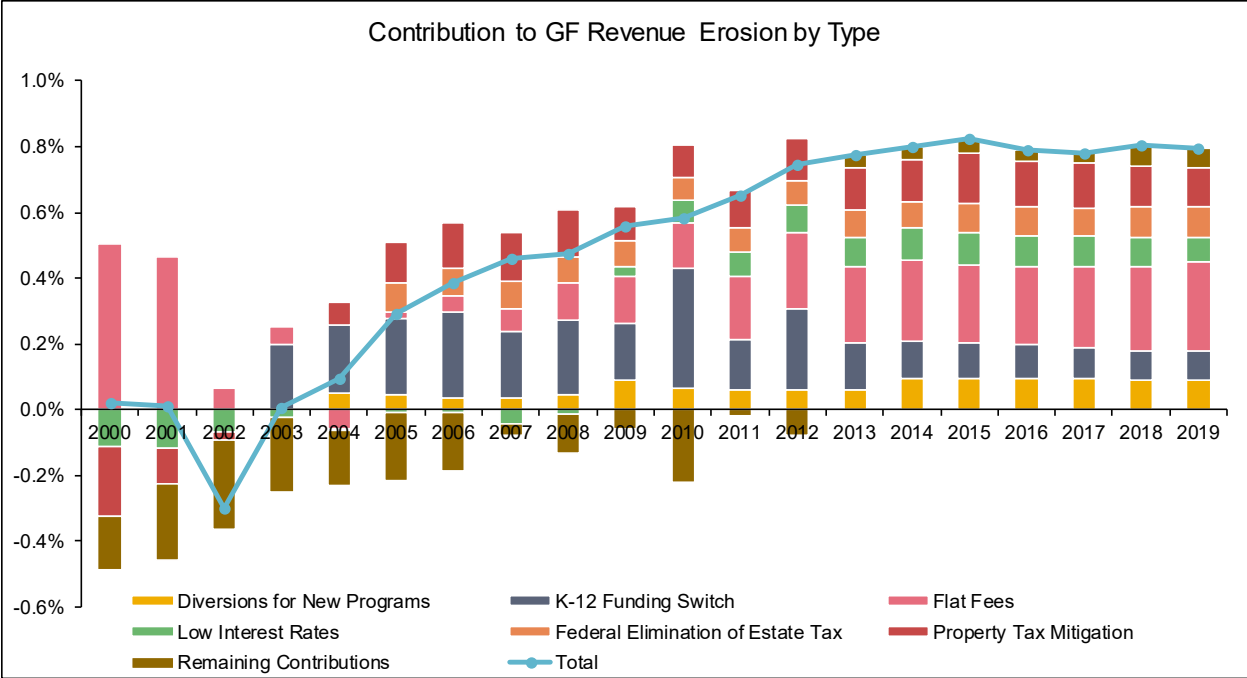
The following table summarizes the primary sources responsible for the overall decline in general fund revenue as a share of GSP. For most sources, an estimate of recent years' revenue impact is calculated based on an average share of GSP; however, for sources diverted to other funds, actual declines in revenue are known.

Sources of GF Revenue Erosion & Estimate of Recent Years' Impact				
(\$ Millions)				
Revenue Source	FY 2017	FY 2018	FY 2019	Possible Reason for Decline
Property Tax	\$63.5	\$59.3	\$60.0	Legislative & executive policy decisions
Vehicle Taxes & Fees	75.8	82.3	90.0	Permanant registration, consumer behavior
Insurance Tax*	30.3	30.8	30.9	Revenue diverted by voter initiative
Video Gambling Tax	23.3	26.0	26.6	Smoking ban, consumer behavior
Other Business Taxes	14.7	15.0	15.1	Flat fee structures, consumer behavior
Interest Earnings	43.9	43.1	34.6	Low short-term interest rates
Other Consumption Taxes	22.4	27.1	29.2	Flat fee structures, consumer behavior
Tobacco Settlement*	14.9	12.4	13.5	Revenue diverted to state special revenue accounts
Common School Interest and Income*	43.1	41.8	46.0	Revenue diverted to Guarantee Fund
Estate Tax	39.0	43.0	47.1	Federal tax law change
Remaining Sources	(10.3)	4.4	4.6	Flat fee structures, consumer behavior
Total	\$360.6	\$385.1	\$397.6	

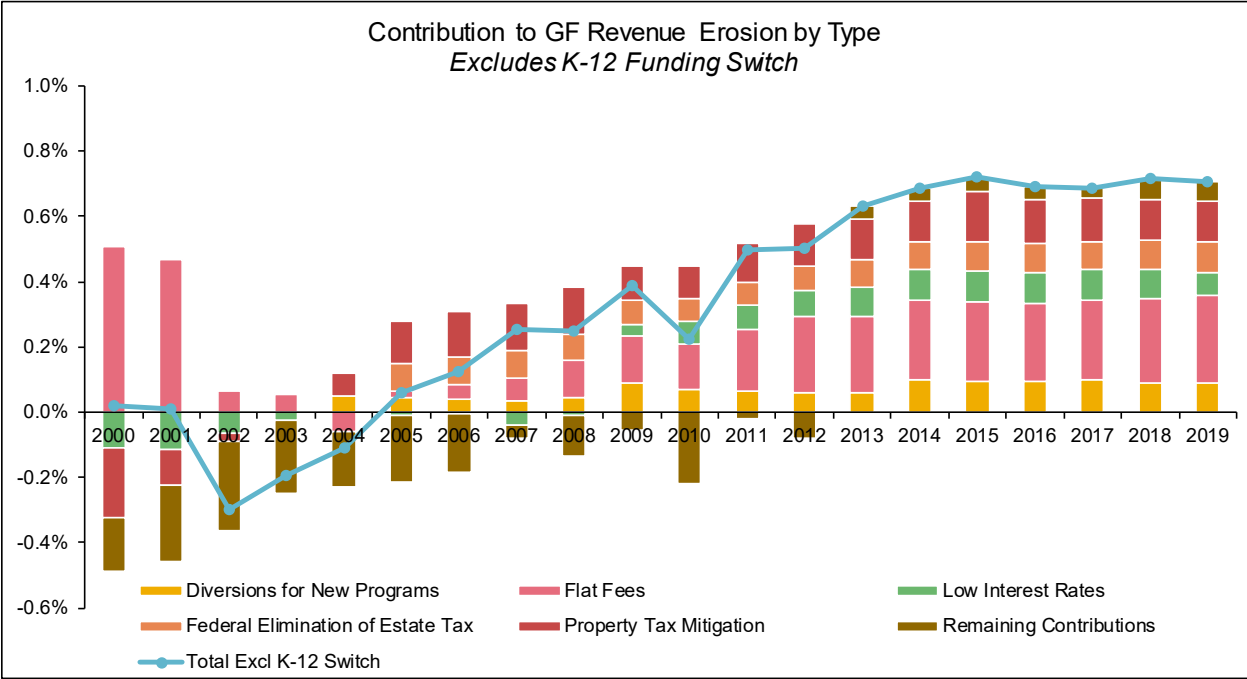
*Insurance tax, tobacco settlement revenue, and common school interest and income actual amounts are known, as these revenue sources were diverted to other funds.

Contribution to Revenue Erosion

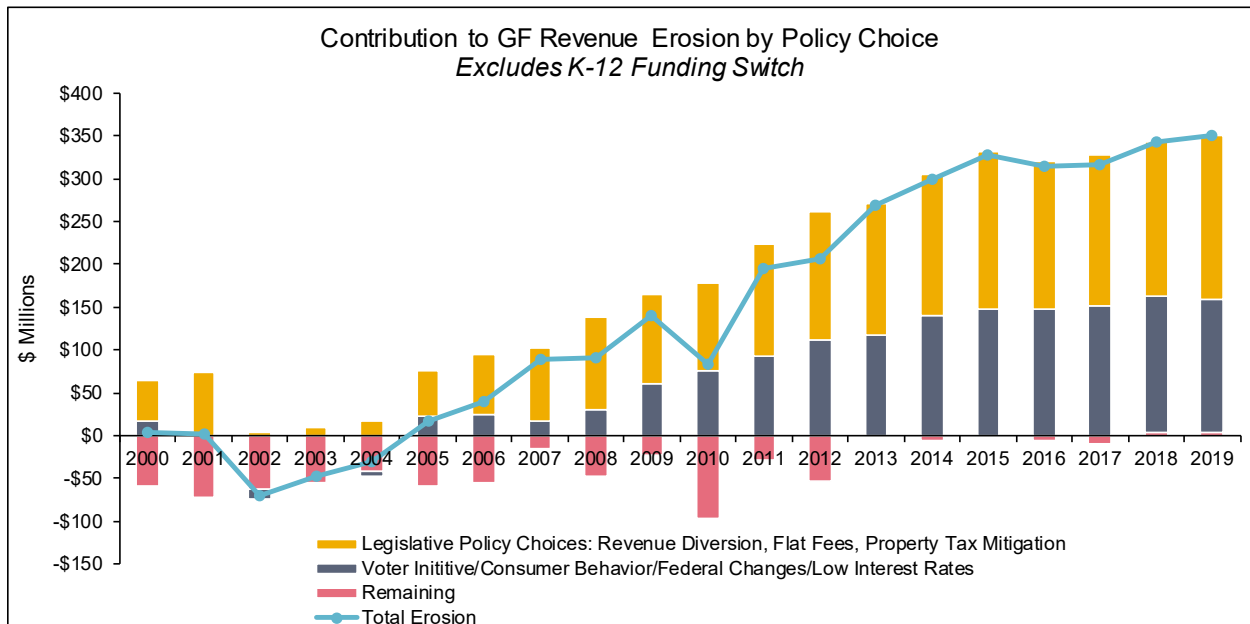
The chart below provides a different perspective on the general fund revenue erosion of the previous page and shows the contribution to the overall erosion by type.



The K-12 funding switch, in which the Common Schools Interest & Income revenue source was diverted to the Guarantee Fund, ultimately had a net zero impact on the general fund, as the Guarantee Fund became the first source of funding for schools. Any windfall or shortfall that the Guarantee Fund experiences impacts how much the general fund contributes to school funding. As a result, it is reasonable to exclude the K-12 funding switch as a contributor to general fund revenue erosion. The next chart excludes the K-12 funding switch.



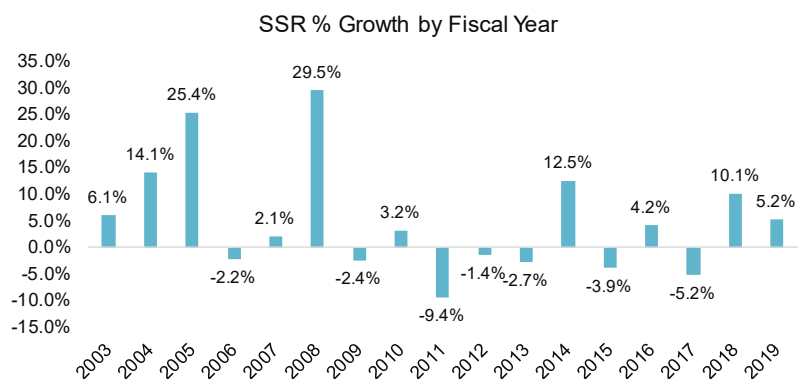
The next chart shows the revenue erosion as an amount rather than a percentage of GSP, and categorizes the erosion in roughly two ways: due to legislative policy choices, or due to other changes outside the legislative purview. In recent years, nearly half of the revenue erosion is due to factors the legislature cannot control, such as voter initiatives and short-term interest rates. However, over half of the erosion —averaging \$180 million in the past three years—is due to factors the legislature can control, such as non-inflation-adjusted fee structures and property tax mitigation.



SUMMARY OF HISTORICAL STATE SPECIAL REVENUE

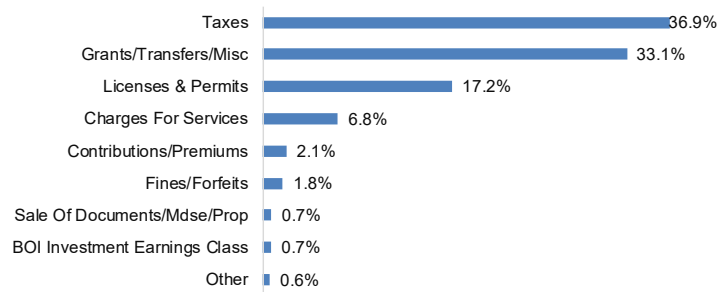
In addition to general fund revenues, Montana has state special revenue (SSR) funds that are used for specific purposes.

The chart at right shows state special revenue growth from one year to the next. Average growth over the past 17 years has been 5.0%. FY 2005 and FY 2008 showed significant increase primarily the result of higher oil and natural gas prices.



Taxes, are typically the largest revenue source for state special revenue generating between 35% - 42% of revenue during the period studied. The largest state special revenue tax sources are gasoline and diesel fuel taxes, comprising 52% of all state special revenue taxes collected in FY 2019.

The chart shows FY 2019 state special revenues by account, with taxes as the largest source.



While the grants/transfers/miscellaneous source is high, a significant portion of this source is bond proceeds, which are categorized by state accounting as an other financial source, rather than revenue. An example of how bond proceeds are used is the renewable resource program. The general obligation renewable resource program bonds are secured by a pledge from certain coal severance taxes and pledges of loan repayments from loans made from bond proceeds.⁶

The largest licenses and permits source is the general license account which generated \$63.1 million in FY 2019. Revenue collected from hunting and fishing license fees is combined with federal funding and used for education, enforcement, management, improvement of wildlife habitat, and acquisition of public access.

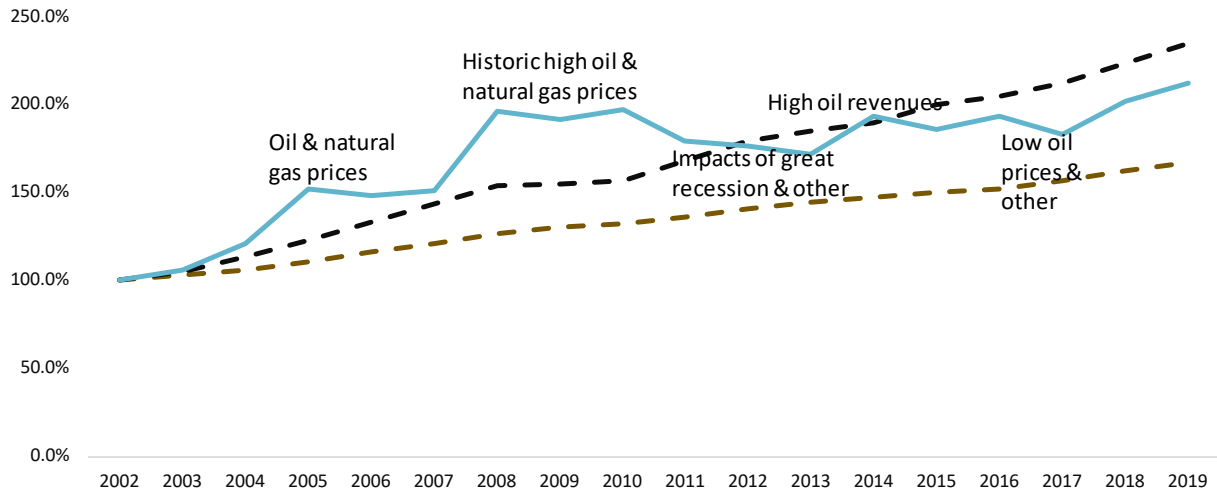
Of the state agencies that receive state special revenue, the Department of Transportation (DOT) is the top receiver. In FY 2019, DOT received 25.2% of all state special revenue, 19.2% generated from taxes like gasoline and diesel fuel taxes.⁷

The inflection points in the chart below include the following significant variations in state special fund revenues:

⁶ [Montana Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 2018](#), page 163.

⁷ [Montana Highway Funding](#) brochure, Legislative Fiscal Division, October 2018.

The chart shows **state special revenue growth** compared to the **growth in the economy** and the **growth in inflation** by fiscal year.



High Growth

- FY 2005 & FY 2006 – increase in oil and natural gas prices providing a 47.4% increase in state special revenue between FY 2004 and FY 2006 for the local oil and gas state special revenue fund
- FY 2008- FY 2009 – natural gas and oil prices were at historic highs, generating over \$100 million each year for state special revenue funds, these state special revenue funds are primarily distributed to local governments
- FY 2010 - one-time-only Otter Creek bonus payment, brought in an extra \$85.8 million that offset general fund expenditures
- FY 2014 – high oil tax revenues at the end of CY 2013 and in the first quarter of CY 2014, contributed to the increase

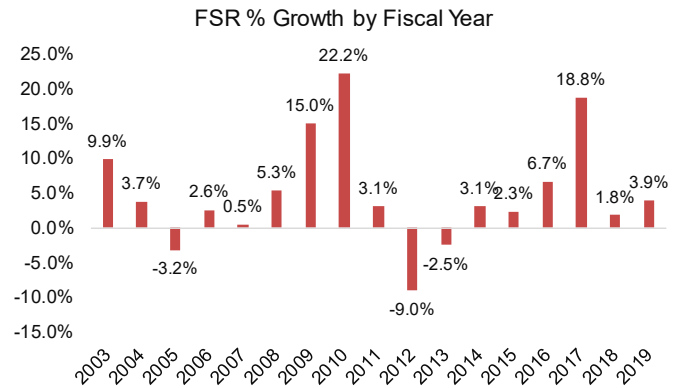
Declines in Growth

- FY 2009 – FY 2012 – the Great Recession impacted all tax types, causing decline in state special revenues
- FY 2015 - FY 2017 – Revenue declines due to low oil and natural gas revenues and lower transfers from other funds. The oil and natural gas state special revenue to local governments fell 47.4% from FY 2014 to FY 2017. Transfers into state special revenue funds were lower in FY 2017

SUMMARY OF HISTORICAL FEDERAL SPECIAL REVENUE

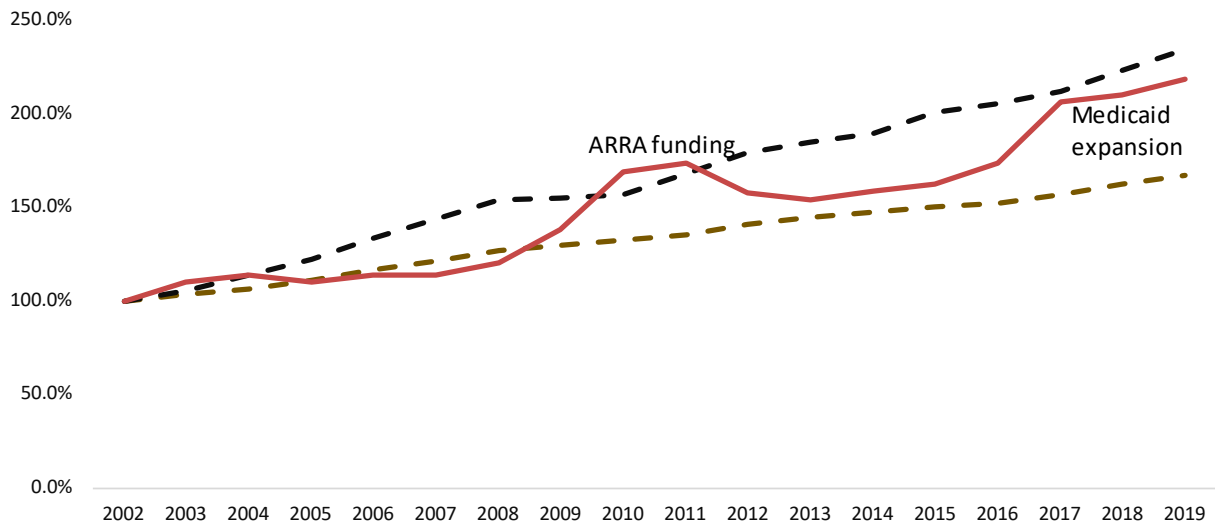
Montana ranks as one of the top receivers of federal special revenues compared to other states. Three functions of state government: Health and Human Services, Transportation, and Education, receive 92.4% of the HB 2 federal funds.

The average growth for the past 17 years was 5.0%. When the growth rate increased in FY 2009 – FY 2011 the state received American Recovery and Reinvestment Act funding. The growth rate increased significantly in FY 2017 with the full effect of higher Federal Medical Assistance Percentage (FMAP) rates for Medicaid expansion.



The following table shows federal special revenues compared to growth in personal income and to the growth in inflation adjusted for population.

The chart shows the growth in **federal special revenues** compared to the **growth in the economy** and the **growth in inflation** by fiscal year.



High Growth

- During the Great Recession, FY 2009 – FY 2011, the federal government sent states American Recovery and Reinvestment Act (ARRA) funding to finance projects normally funded with state monies
- FY 2017 – FY 2019, Medicaid Expansion - with the passage of the Affordable Care Act, states that expanded Medicaid to include individuals at 138% of poverty were provided a higher federal medical assistance percentage (FMAP) match rate to implement the program. Montana’s expanded Medicaid program began in January 2016. The chart shows the increase in federal revenues during FY 2017 – FY 2019 when federal share of Medicaid expansion ranged from 95% to 93%. For more information please refer to the [Medicaid in Montana brochure](#)