

State Revenue Perspectives



SUMMARY

This chapter briefly discusses the economic outlook and the major revenue sources for the state of Montana. More detailed data can be found in the *LFD Legislative Fiscal Report 2015 Biennium, Volume 2 – Revenue Estimates*.

Beginning in 1999, the revenue estimating responsibilities were assigned to the Revenue and Transportation Interim Committee (RTIC). In the past, RTIC has adopted the revenue estimates in November of the year proceeding the next regular session. As a practical matter, RTIC cannot adopt the estimates much earlier than mid-November because the Department of Revenue's income tax data is not available until November 1 (October 15 is the general deadline for taxpayers who requested an extension of time for filing an income tax return).

Staff of the Legislative Fiscal Division and the Governor's Office of Budget and Program Planning each present assumptions and corresponding revenue estimates for RTIC's consideration. In the past, RTIC has initially adopted the revenue estimates of the Legislative Fiscal Division and made changes to those estimates based on information presented by OBPP, economists from the Montana university system, and other experts. Finally, the resolution containing the revenue estimates must be pre-introduced by December 15, 2010 (see Rules of the Montana Legislature, Joint Rules 40-40(5)(a)). The RTIC estimate, as introduced in the Legislature, constituted the Legislature's current revenue estimate until amended or until final adoption of the estimate by both houses.

On November 19th, 2012, RTIC met to review and adopt a revenue estimate recommendation, but were unable to agree on the estimate. Therefore, the committee did not introduce a resolution with a revenue estimate. The Rules Committee subsequently met and adopted rules for the 63rd Legislative Session, including a requirement that the chair of the Senate Taxation Committee prepare a revenue estimate to be introduced in the Senate. The rules also provided that the Senate transmit the revenue estimate to the House no later than the 15th legislative day and that the Senate Joint Resolution did not constitute the Legislature's revenue estimate until passed by the House and any House amendments were concurred in by the Senate.

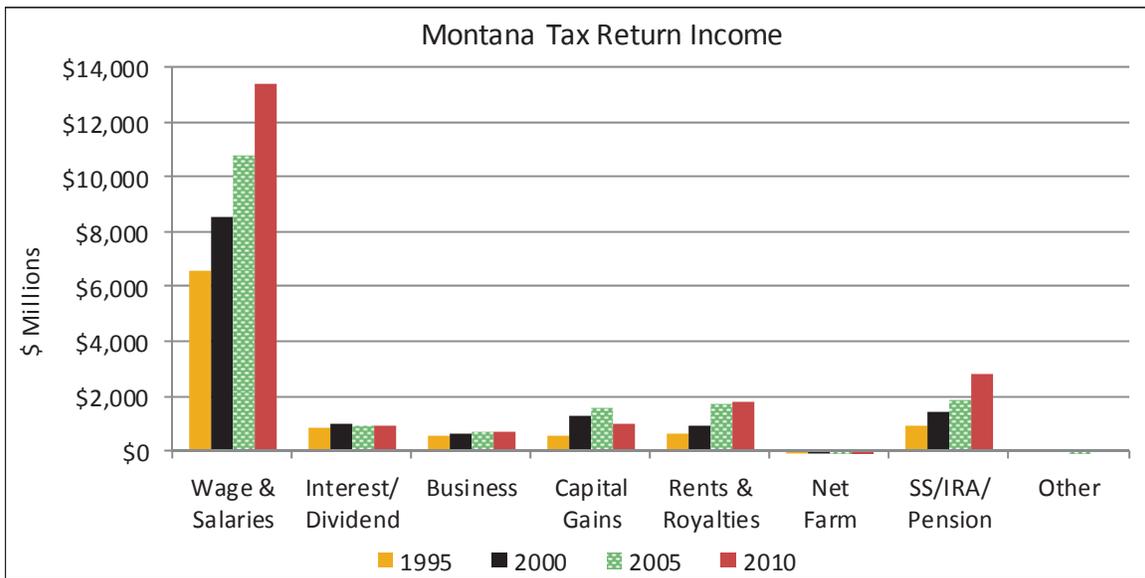
The estimate contained in Senate Joint Resolution 2, along with an initial set of amendments, passed both houses by early February of the 2013 Legislative Session. A revised estimate contained in Senate Joint Resolution 27 was introduced in early April, but failed to pass both houses.

ECONOMIC AND REVENUE OUTLOOK FOR MONTANA

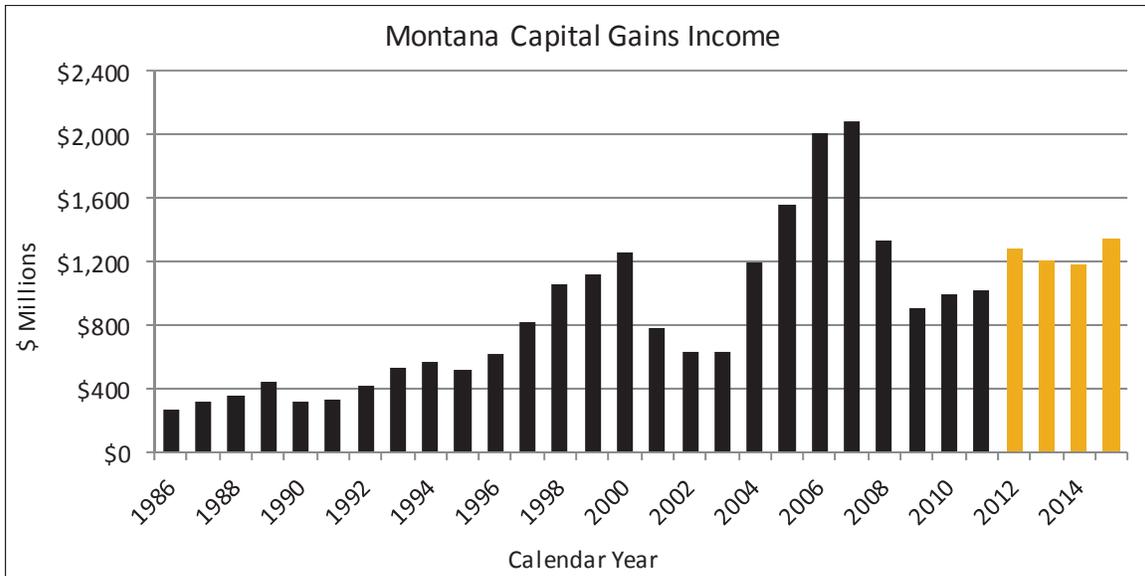
The following section outlines the significant economic factors that drive the general fund revenue in Montana. A recap of the relative value of each revenue stream can be found on page 25 of this document.

Individual Income

The total of all income sources listed on the Montana personal income tax form is referred to as Montana total income, it is the single most important variable to consider in the revenue estimation process. Of the income items, wage and salary income provides the largest portion of Montana total income. Since 1990, wage and salary income has contributed an annual average of 64.9% of total income. In 2011, it contributed 65.6%, or \$14.0 billion. The average compounded growth from 1990 to 2011 is 5.0%.

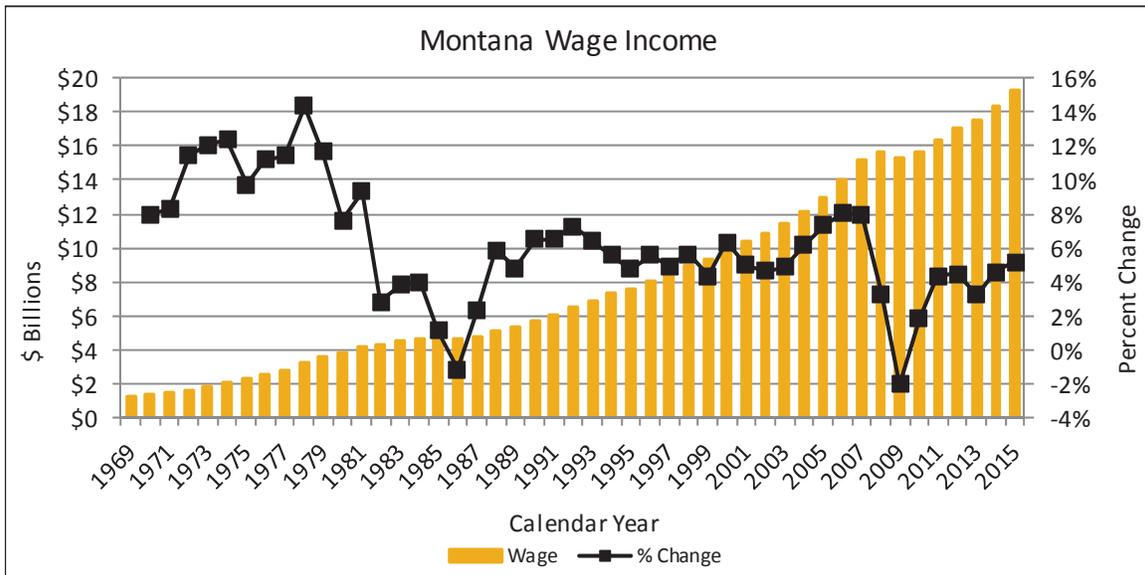


Capital gains income has increased in relative importance over the decade. In 2009, capital gains income declined by almost 32% reaching the amount of \$912 million. Projections based on IHS, Inc. indicators suggest that capital gains income will increase moderately annually between 2012 and 2015.



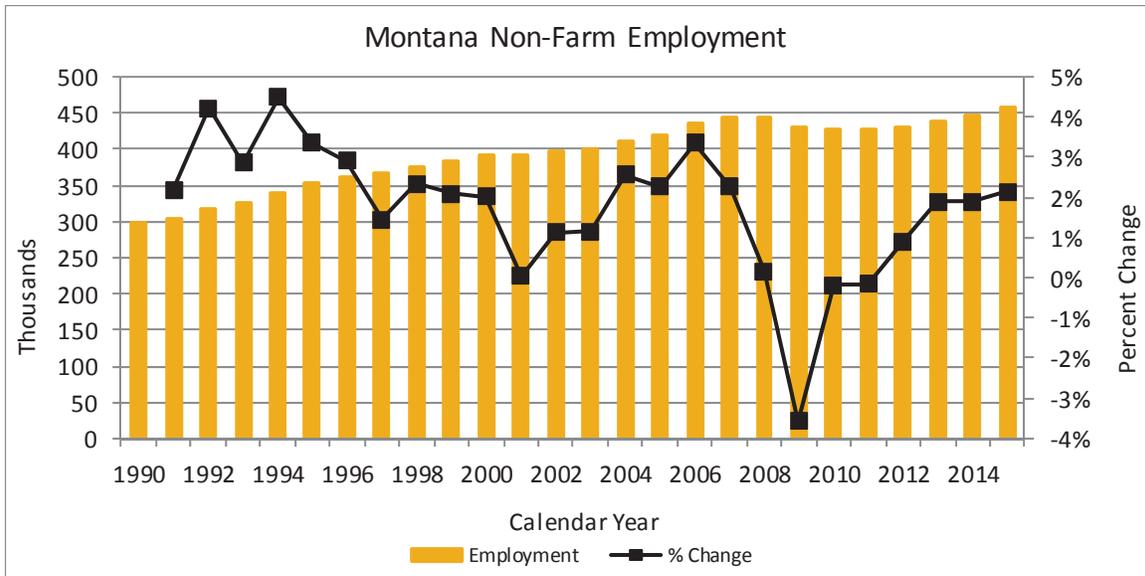
Wages

The average annual growth in Montana wages and salaries income is 5.1% between 1990 and 2011. During the recession, the growth of wages declined sharply to rates of -2.1% and 1.8% in 2010 and 2011 respectively. The growth in wages between 2012 through 2015 is modeled on IHS Montana wage and salary projections. Wage income is expected to increase throughout the forecast period.



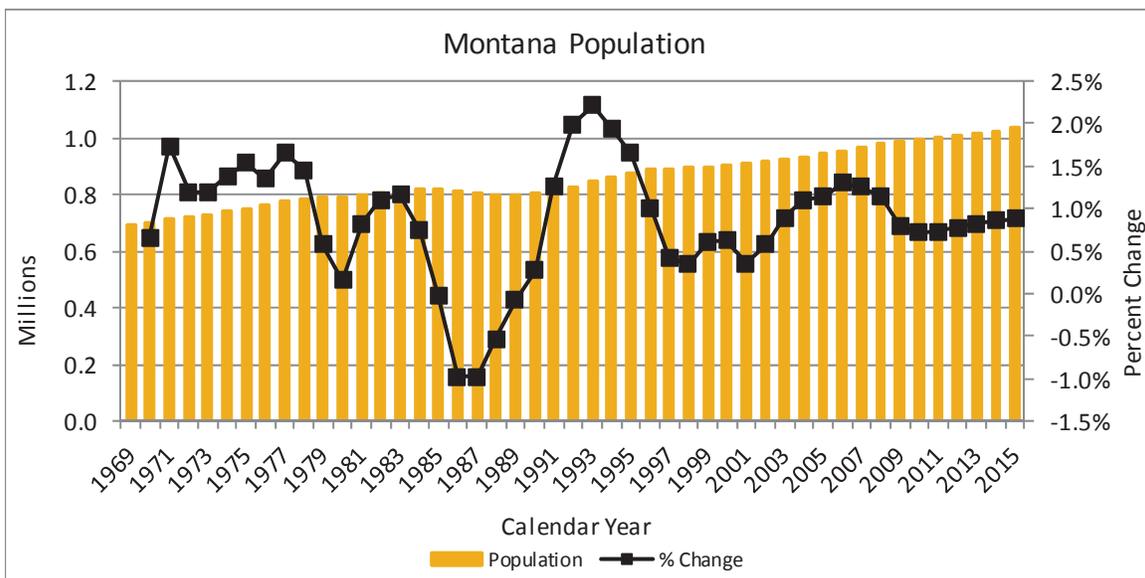
Employment

Average annual growth in total Montana employment between 1990 and 2011 is 1.7%. It is expected that total non-farm employment growth through 2012 will be 0.9%, and continue to grow slowly in the forecast period.



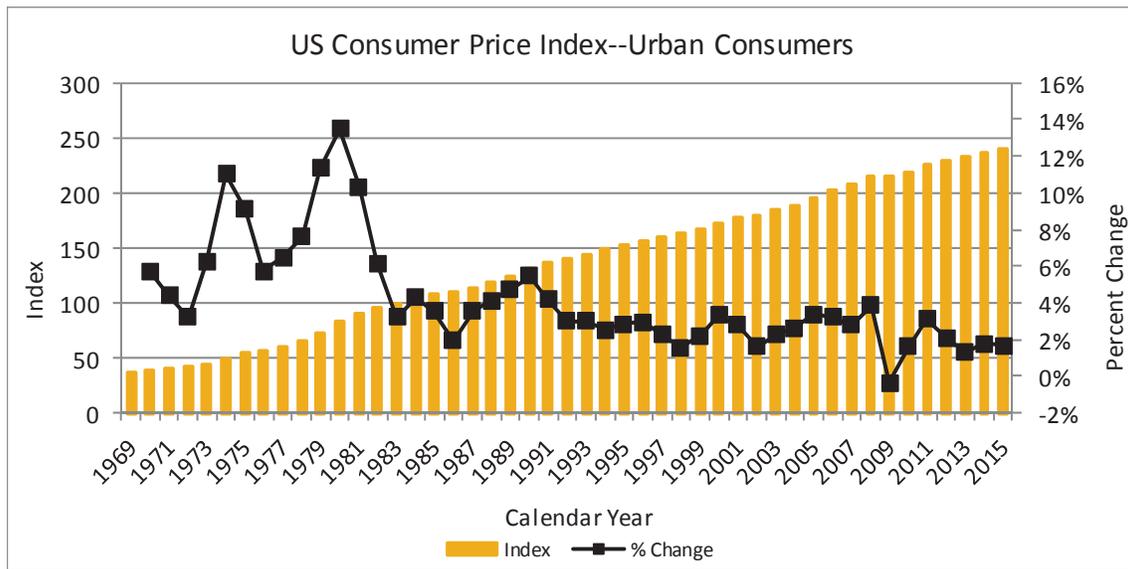
Population

Population statistics are used to develop estimates for many of the revenue sources including beer, wine, liquor, and cigarette taxes. Historic population data is gathered from the U.S. Census department while projections are obtained from IHS. Growth in recent years has been slow, averaging 0.8% growth annually from 2007 to 2010. Growth through the next biennium is expected to continue this trend.



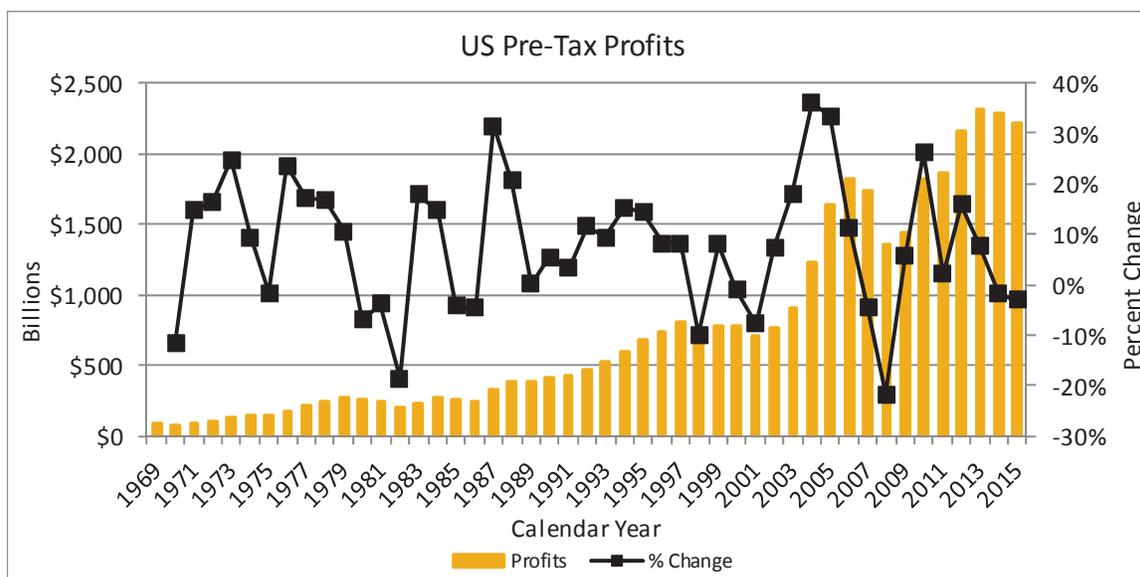
Inflation Rates

The inflation rate is measured by the price change of the Consumer Price Index (CPI) “shopping basket” of goods and services. Since Montana’s individual income tax structure is fully indexed by changes in the consumer price index, this assumption is critical in the formulation of the individual income tax forecasts. The U.S. Bureau of Labor Statistics provides the historical CPI data for the all-urban customers data set. Since 1990, the average annual rate of inflation has been 2.6%. The IHS forecasts suggest inflation will remain low through the forecast biennium.



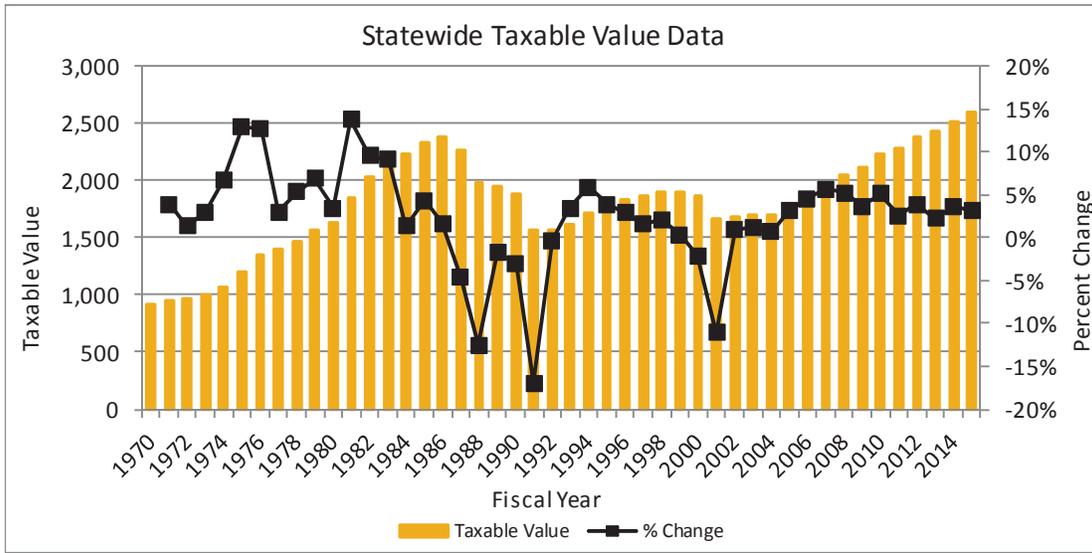
Corporate Profits

The profitability of corporate America is an important factor in estimating revenues. Corporate profitability affects both corporation license tax and individual income tax estimates. During the most recent years, the reduction of corporate profits has translated to lower corporate license tax collections. According to IHS, between 1990 and 1997, U.S. corporation pre-tax profits increased by an annual average of 10.3%. However, from 1997 through 2001, profits decreased by an average of 3.0%. Between 2006 and 2011, corporate profitability grew an average annual rate of 0.3%. During the forecast period, corporation profits are expected to grow slowly, then decline slightly.

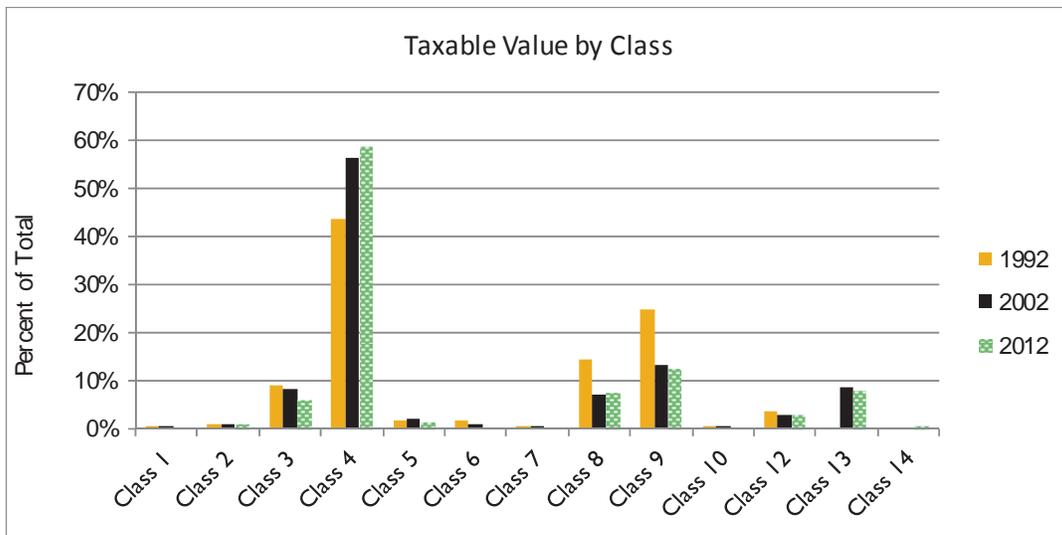


Property Values

Change in statewide property values is the critical assumption behind the estimates for property taxes. Historic property values are obtained from the Montana Department of Revenue. On January 1, 2009, new reappraisal values were placed on residential, commercial, agricultural land and timber land. The 2009 legislature mitigated these increases by continuing to phase in assessed values and providing a schedule over the following six years by which tax rates are decreased and homestead and comstead exemptions are increased. Taxable values are expected to increase throughout the biennium in line with recent historical trends.



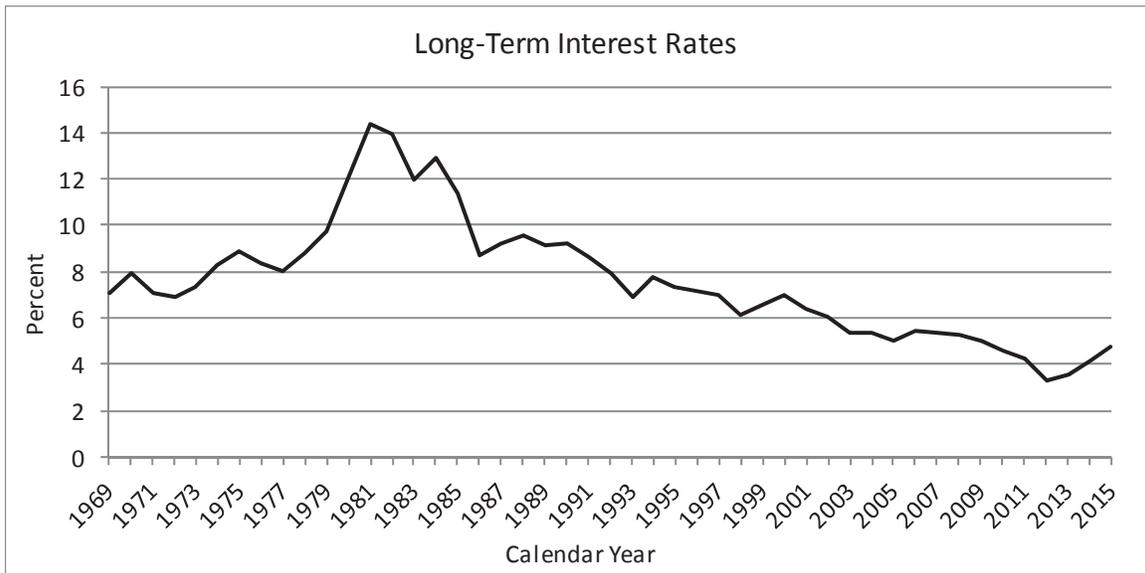
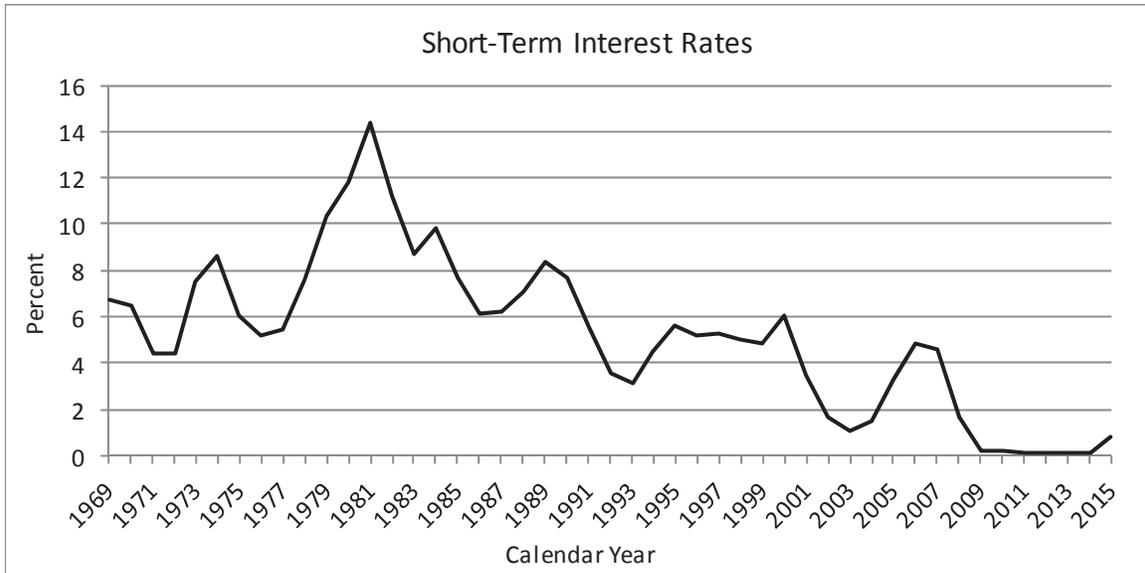
Significant changes have taken place in statewide property values since FY 1998. In that year, 48.0% of total statewide value was in class 4, residential and commercial property, and 11.5% of total value was in class 8, business equipment personal property. In FY 2012, the class 4 taxable value was 58.7% of the total property tax base, while class 8 was only 7.7% of the base. For additional information on the tax classes, please refer to page 272 of Volume 2.



Interest Rates

A large portion of Montana’s revenues is derived from investment earnings from trust accounts and daily invested cash. Interest rates also affect the amount of investment income that is reported on individual income tax returns. As such, interest rates are a significant assumption when estimating future state revenues.

Two types of interest rates, long and short-term, are estimated and used in determining future revenues. Both rates are an average across a selection of investment instruments. The forecast rates are obtained from IHS. The fiscal year computation of short-term interest rates reached unprecedented low rate of 0.1% in 2011. The future short-term interest rates are expected to remain at historic lows, while long-term rates are expected to recover slightly through 2015.



Energy Prices and Consumption

West Texas Intermediate (WTI) spot oil prices are a good indicator of Montana oil prices, and are expected to decline slowly throughout the forecast period. Since 2006, oil production has declined but has stabilized at about 6 million barrels per quarter since the first quarter of 2011. That trend is expected to change with a modest improvement in total production through 2015. Montana oil production is expected to increase gradually through 2015.

Natural gas production in Montana almost tripled between 1981 and 2007, from 40 million MCF (thousand cubic feet) to 119 million MCF. As in the oil market, new drilling activity was up substantially in 2003 and 2004, but production has started to drop and that trend is expected through 2015. The average price in 2012 is expected to be \$2.67 per MCF. IHS is forecasting a small average growth throughout the forecast period. 2015. Montana prices are expected to follow a similar trend.

