

Federal Revenues in Montana

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FEDERAL REVENUES IN MONTANA

1. INTRODUCTION

This report discusses federal revenues in Montana for both the state government and local governments in the context of research performed for the Legislative Finance Committee studies detailed in [HB 715 \(2019\)](#). In particular, it addresses the requirement that this study examine “fiscal and economic conditions.... revenue volatility, revenue trends.... local government expenditures and funding.”

Transfers from the federal government to Montana (both to the state government and local governments) support many significant programs: Medicaid, highway maintenance, and the Children’s Health Insurance Program (CHIP) are several examples. Montana receives higher than average federal grants: Montana’s proportion of federal grants as a percent of expenditures is the highest in the nation (FY 2017, Pew). Federal changes to the programs that generate these grants could have a significant impact on the amount of state funds required to offer the current level of services.

It is possible that federal changes to certain programs could have upside risk for the state. Consider a scenario in which “Medicare for All,” or a similar policy change, is implemented. Under some iterations of that plan Medicaid would be eliminated and all public health coverage would be managed and funded at the federal level. In such a case the state would no longer be responsible for funding its portion of the Medicaid program.

It is also possible that federal changes carry downside risk for the state: that in order to fund the current service level more state dollars will be required. If the federal government implemented deficit or spending reduction measures one possibility is that the costs of some programs could be shifted to the states. For example, a change in the federal matching rate for Medicaid could reduce federal expenditures for that program while not making any broader policy changes.

This report discusses the nature of federal revenues in Montana and weighs the risk potential federal revenue changes pose for state and local finance.

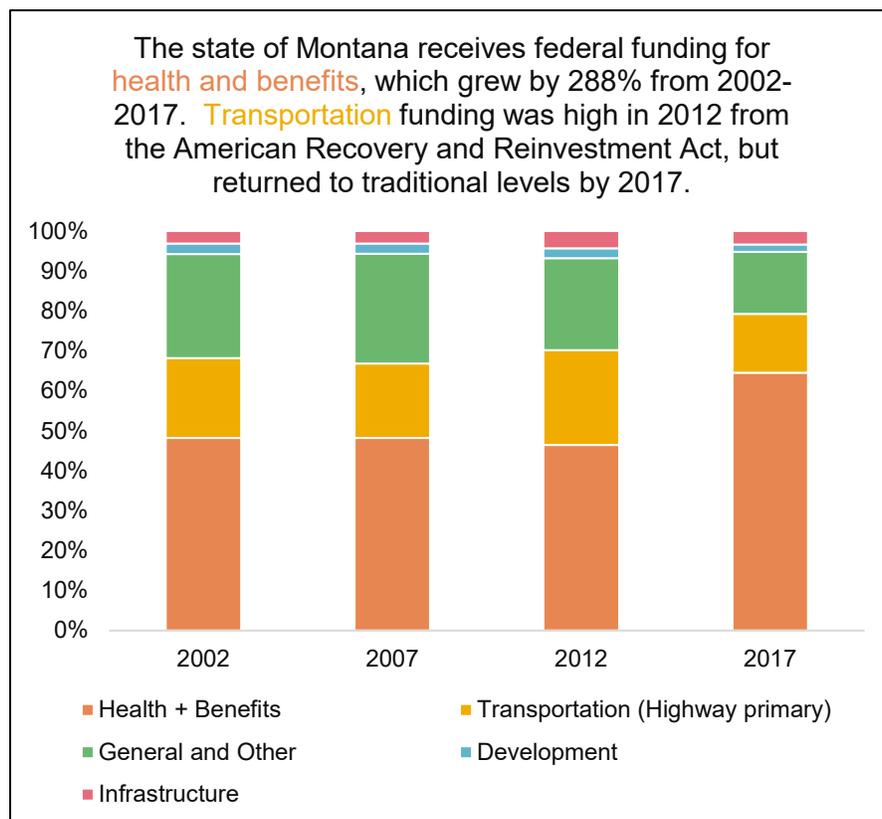
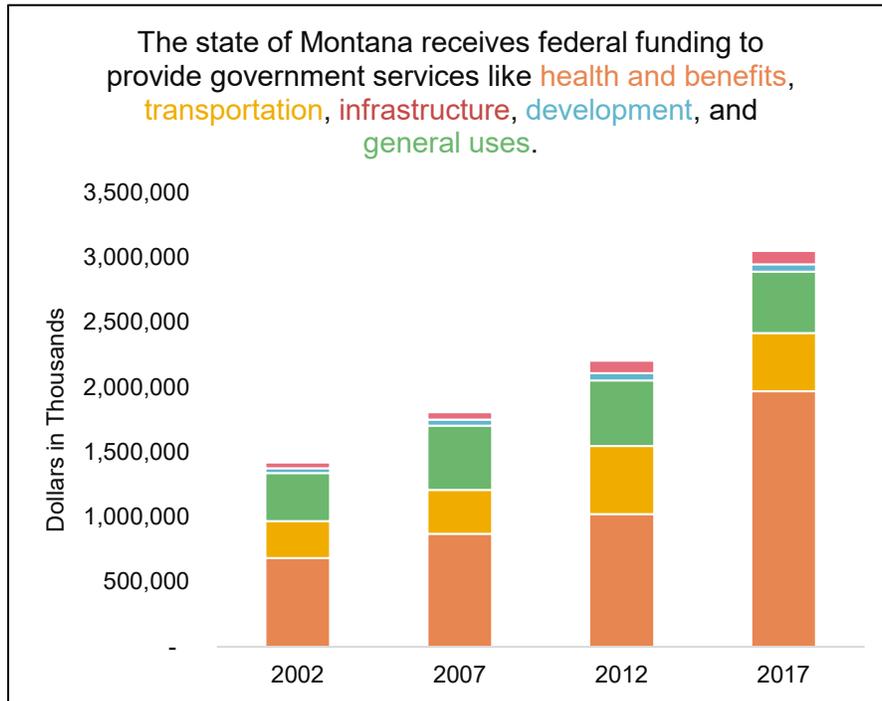
2. FEDERAL REVENUES IN MONTANA’S STATE AND LOCAL GOVERNMENTS

State Government

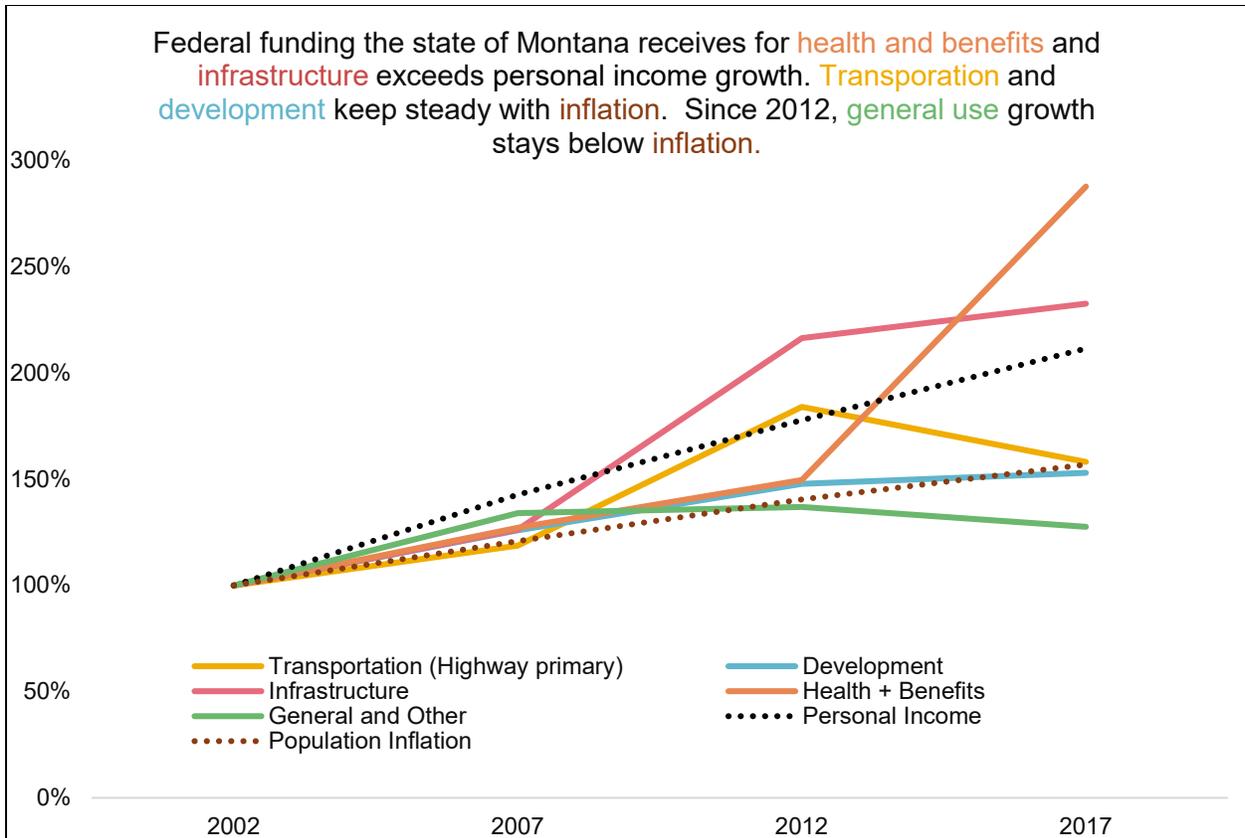
Federal grants have made up 38-46% of Montana state government revenues from FY 2002 to FY 2017 according to the U.S. Census Bureau¹. The graphs below illustrate the service sectors where

¹ LFD analysis indicates federal grants make up 6.2-9.3% of local government revenues over the same period.

these revenues are used by the state government. Note that the public health category includes federal grants for Medicaid expansion, which began in 2016.



The magnitude of federal revenues has changed in real terms over time. The graph below shows federal grant growth indexed to 2002 for the state government. Public health (including Medicaid) and infrastructure grants have grown faster than personal income growth over the 2002-2017 period. Note that the American Recovery and Reinvestment Act (ARRA) led to a temporary period of larger than usual federal transfers to state and local governments. Note also that this graph does not represent the size of these categories: while the water, sewer, and natural resources (infrastructure) has increased over time it remains a very small portion of the total as illustrated in the graphs above.

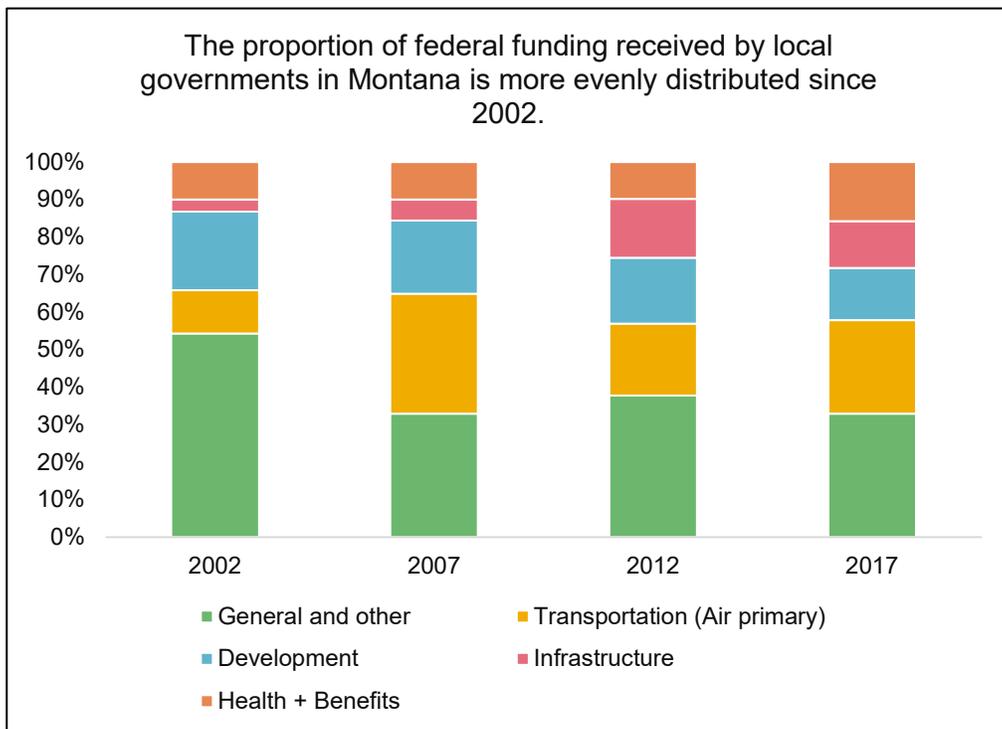
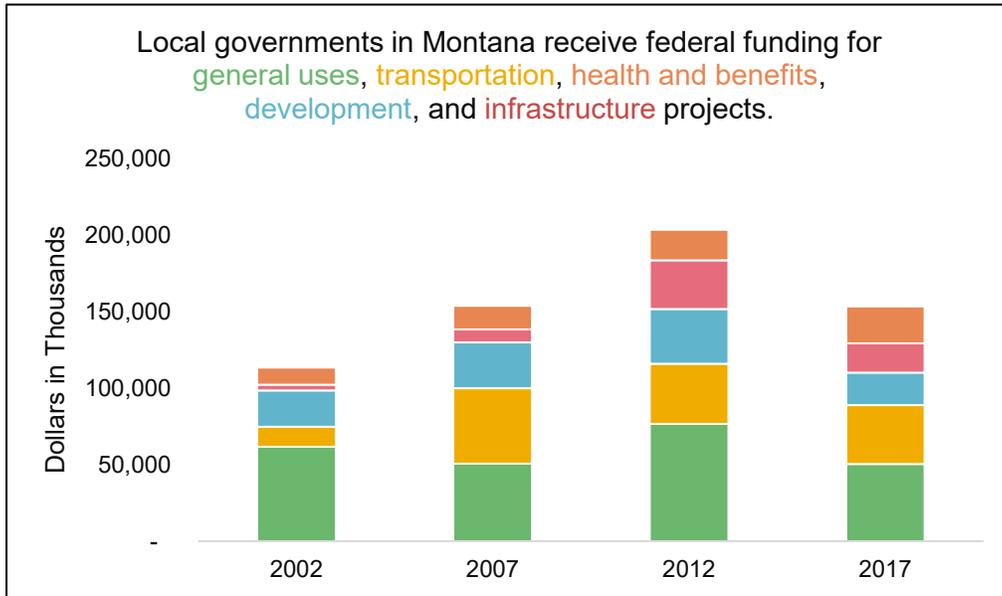


Local Government other than schools

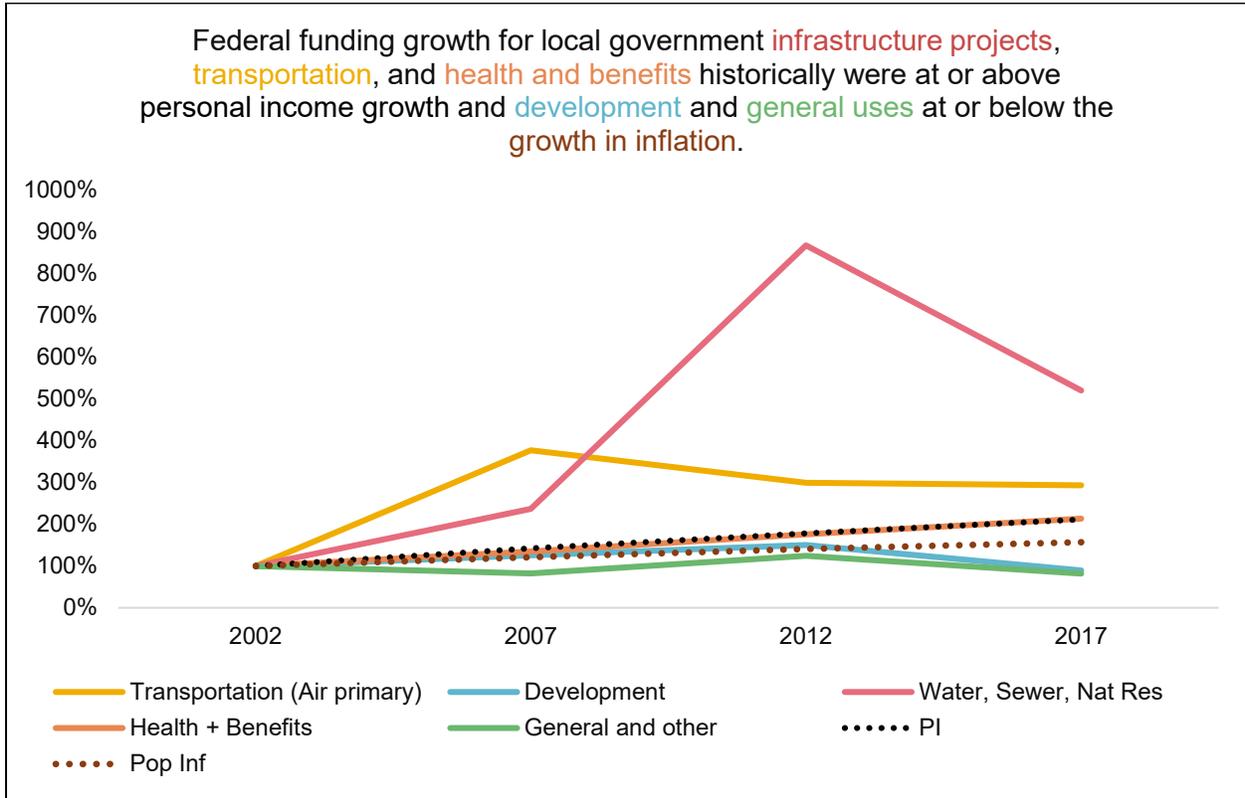
Some federal transfers are made directly to local governments. Federal grants have made up 6-9% of Montana local government revenues from FY 2002 to FY 2017 according to the U.S. Census Bureau. So, certain changes to federal transfers could impact both state and local government revenues in Montana.

Federal funding increased from FY 2002 to FY 2012 where it peaked at over \$200 million. Since that time, local support from federal sources has decreased by 25% and is now \$150 million.

The largest federal transfers to local governments include payments in lieu of taxes and federal revenue sharing. Payments in lieu of taxes (PILT) compensate local governments for federal lands that would generate property tax revenue if privately owned. The majority of federal transportation funding that goes to local governments goes to air transportation. Federal support for water, sewer, and natural resource projects has fluctuated substantially, but has trended above the growth in personal income. The graphs below illustrate the service sectors where federal revenues are used by local governments.

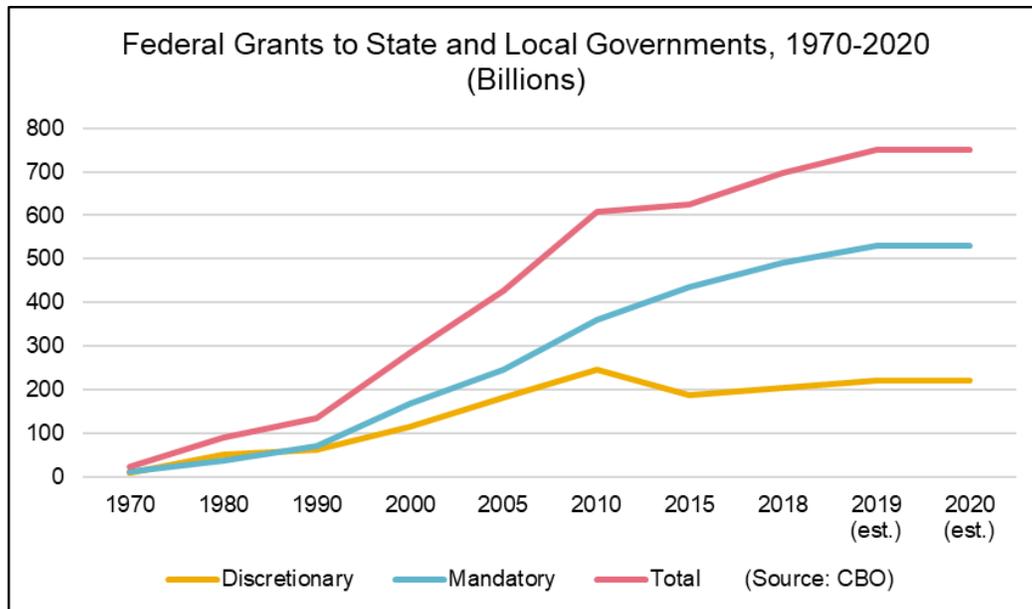


The graph below shows federal grant growth indexed to 2002 for local governments. Infrastructure, transportation, and public health grants have grown as fast as or faster than personal income growth over the 2002-2017 period. Note that this graph does not represent the size of these categories: while the water, sewer, and natural resources (infrastructure) has increased over time it remains a modest portion of the total as illustrated in the graphs above.



3. STABILITY OF FEDERAL REVENUES

The discussion above has established that federal revenues are a large source of government revenue for both the Montana state government and local governments in the state. Given the nature of the HB 715 fiscal sustainability study it is important to consider the stability of this large source of state and local government revenue. Federal revenues to state and local governments have largely increased over time, although not always in a uniform fashion as illustrated in the graph below. State and local governments may face situations in the future in which federal grants increase, decrease, or remain relatively flat.



The federal Congressional Budget Office (CBO) projects the 2019 federal deficit at \$960 billion with total outlays of \$4.4 trillion. The CBO projects the federal deficit to average \$1.2 trillion between 2020 and 2029, significantly above the average (when adjusted for gross domestic product) over the last 50 years. It is reasonable to consider the possibility that policymakers may attempt to reduce the size of the federal deficit in the near future, and such changes would likely impact state and local finance.

There are many ways changes to federal transfers could impact the state, but as a “base case” consider the possibility that the federal government wishes to reduce the federal budget deficit by 50% through expenditure reductions. This type of deficit reduction would result in roughly a 10% annual reduction in federal expenditures, assuming the federal revenue mix did not change. Three options for potential 10% reductions to spending are considered here:

Across the board reductions

“Across the board” reductions would result in a 10% reduction to each federal program. In FY 2018 the state government received \$3,088 million in federal grants (\$1,606 million in Medicaid grants). A 10% reduction to this amount would result in about \$310 million fewer federal grant dollars

annually: an amount that would increase over time. Of course, it is unlikely that the state would backfill this entire amount with state funds. Some programs would simply lapse or offer fewer services. A 10% reduction in federal grants to local governments in Montana would result in an annual reduction of about \$15.3 million.

Shift service costs to state and local governments

There are other ways to think about potential federal fund risk. Attempts at federal expenditure reduction could also utilize the Congressional Budget Office resource “Options for Reducing the Deficit: 2019 to 2028.” This report contains an extensive list of potential spending reductions divided by mandatory and discretionary programs. Aside from the “reduce the Dept. of Defense budget” option (\$248 to \$517 billion in savings 2019-2028) many of the large potential reduction items are related to Medicaid. Other items on this list could also significantly impact Montana federal grants (highway spending, income support, etc.).

Avoid shifting service costs to state and local governments

Another option to help conceptualize future federal funding risk is to consider past action: namely, the Budget Control Act of 2011 (BCA), which established the “sequester” mechanism that caps federal spending through 2023. Note that the Bipartisan Budget Act of 2013 (BBA) made some changes to the BCA. This package of legislation aims to “decrease the rate of increase” in federal spending. It applies spending reductions to defense and non-defense programs in equal amounts. The BCA exempts Medicaid (as well as most other entitlements and some highway spending), so its impact on states is minimal compared to other federal deficit reduction plans. Federal Funds Information for States (FFIS) authored a helpful [report](#) on potential changes to Medicaid that *could have* resulted from the BBA of 2013. The BCA and BBA were bipartisan efforts, so it is certainly worth considering their structure if one anticipates future bipartisan efforts to reduce federal deficits.

4. CONCLUSION

Federal grants are a large revenue source for both the Montana state government and, to a lesser extent, local governments in the state. These transfers are not static over time: overall, federal grants have increased over time but not in a uniform fashion. For example, the ARRA period included a temporary increase in discretionary federal grants. Given the magnitude of federal grants and the downside risk for the state it is important to consider potential changes to federal transfers that could occur in the future. While the future is uncertain there are resources that offer clues on the nature of the downside risk in federal grants that may exist for the state.