Historical Analysis of Montana's General Revenues and State Resource Expenditures

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Background

This report is written based on the Legislative Fiscal Divisions (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.

This report includes a series of charts that compare general revenue growth and state resource expenditure growth to the growth in the economy and growth in inflation adjusted for population. 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.

The term "general revenues" includes the 95 mill property tax collections earmarked for K-12 school funding, both actual and anticipated, and short-term interest earnings, both actual and anticipated. While the 2023 Montana Legislature changed the distribution of the 95 mill collections from the general fund to a state special fund, to compare historical trends, the 95 mill collections are included in the data so an apples-to-apples comparison can be made. In addition, short-term interest earnings were temporarily distributed to a state special fund for FY 2023 – FY 2025, but for the purposes of comparing trends, these are also included in the general revenues.

History of General Revenues

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 revenues began a period of unprecedented growth increasing by 9.4% annually from FY 2003 to FY 2008.[1]

The Great Recession that hit world markets in 2008 negatively impacted Montana's general 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 year (CY) 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 CY 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] 2011 Biennium Budget Analysis, Volume 2 Revenue Estimates, Legislative Fiscal Division, December 2008.

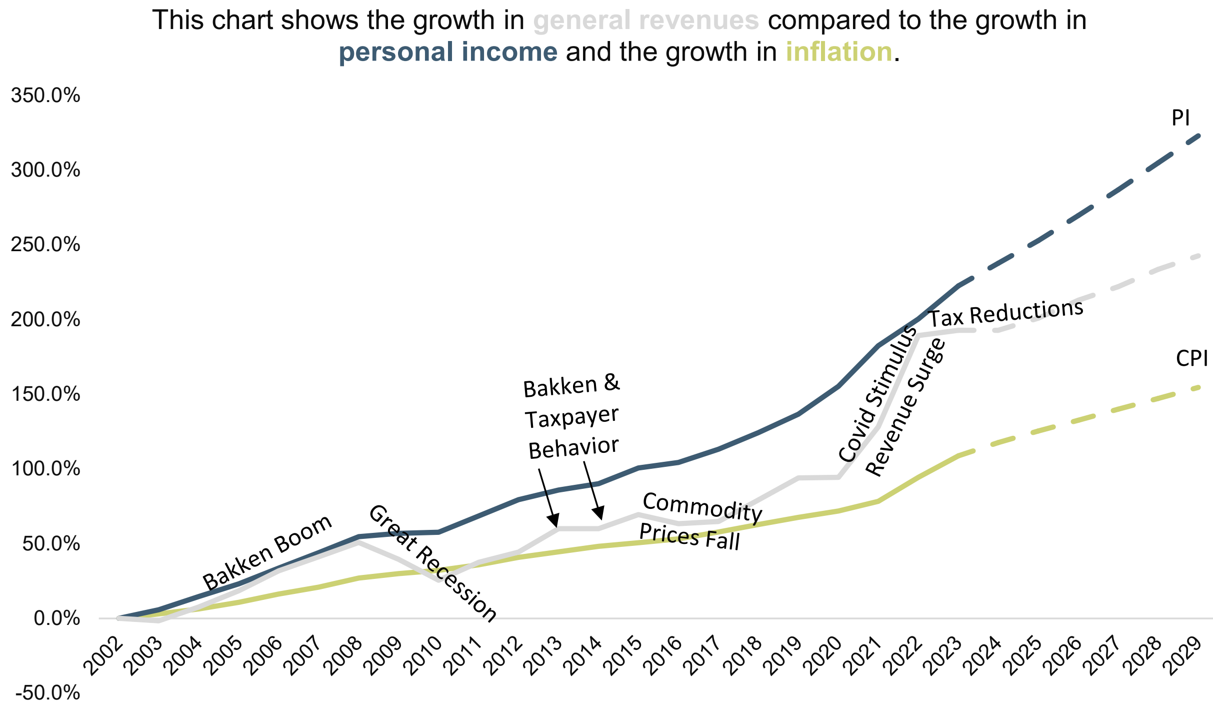
In FY 2016 – FY 2017, economic factors lowered collections. Low wage income and lackluster commodity prices including low oil prices contributed to the decline. FY 2017 was further impacted by income taxpayers choosing to delay realization of income. Despite this recession, the final economic outcomes of the full five-year period of 2014 to 2019 was surprisingly strong. Over that period, general revenues to the state grew 12.6%, when adjusted for inflation.

From FY 2019 - FY 2024, inflation-adjusted general revenues grew 21.0%, likely due to the following:

- higher interest rate earnings on balances in state funds
- new residents that moved to Montana *<u>on average</u>* earned more than full year residents
- Federal stimulus during the COVID health emergency
- higher effective tax rates due to the impact of inflation on the tax brackets

The chart below shows the ongoing general revenue change from one year to the next. The average growth from FY 2002-FY 2019 was 4.1%. From FY 2020 to FY 2023 average growth has been 14.6% but is expected to slow to an average of 3.3% from FY 2025 – FY 2029.

The following chart shows historical revenues compared to growth in the economy (personal income) and the growth in inflation (consumer price index) adjusted for population.



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

Declines in Growth

- FY 2001 – FY 2002: Revenue decline was the result of lower 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 corporate 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 corporate income tax collections were likely the result of continued low commodity prices,[2] which likely resulted in quarterly losses for multiple corporations, increasing the chances of higher-than-average refunds[3]

[2] Montana Annual Bulletin, 2018, USDA, National Agricultural Statistics Service, page 21.

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

- FY 2017: Continued low revenue collections were due to a fall in commodity prices 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 $120.0 million in wage income between December 2016 and January 2017
    - In addition to declines in wage income, declines in rent, royalty and partnership income occurred in CY 2016, 80.0% of which was concentrated in taxpayers with income or loss exceeding $1.0 million[4]
- The 2021 and 2023 Legislatures adopted state income tax policy changes that reduced the top income tax bracket from 6.9% to 6.75% then down to 5.9% by CY 2024

High Growth

- FY 2004 – FY 2005: Montana saw increases in individual income tax revenue and oil and natural gas revenues resulting from high economic activity across the nation and a boom in oil production in the Bakken formation in Montana
- FY 2007- FY 2008: Oil and natural gas prices were at historically high levels, and individual income tax revenues continued to climb. Higher than expected commodity prices kept corporate income taxes, oil and natural gas tax revenues, and U.S. mineral lease revenues high through FYE 2009
- FY 2015 & FY 2022: 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 44.0%. Similarly, CY 2021 saw large stock market growth, and non-wage income grew by 59.0% in FY 2022
- Federal COVID payments as part of the Coronavirus Aid, Relief, Economic Security (CARES) I and II and American Rescue Plan Act (ARPA) increased personal income for Montanans, which had a corollary impact on state income tax collections

Slow Growth Anticipated FY 2025 – FY 2029

Slow economic growth is expected from FY 2025 – FY 2029. Revenues are expected to grow but at a rate slower than was experienced in the prior decade. This slowdown is due to an expected slowdown in the US economy, as interest rates remain high. Furthermore, as inflation slows, tax sources that are based on their price (oil, rental cars, accommodations) will also slow. Finally, the slowdown in inflation is expected to lessen the pressure to increase wages statewide. For additional information on projections, please refer to the 2027 Biennium Financial Outlook Report.

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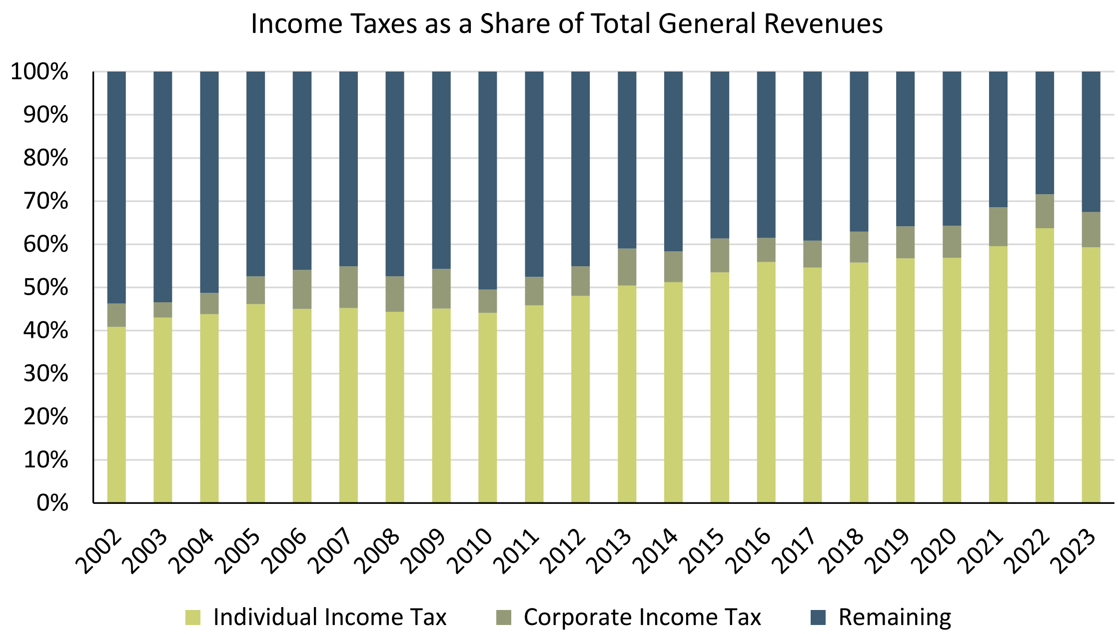
[4] Year-to-Date General Fund Revenue Collections with Highlights of 2016 Individual and 2015 Corporation Income Tax Return Data, pages 4-5, Legislative Fiscal Division, December 5, 2017.

General Revenues Increasing Reliance on Income Taxes

Over the last two decades Montana's general revenues have 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 2023 this share grew to 67.5%, 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 revenues, it is also a source that can be difficult to forecast due to its volatility. Most of the general 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 revenue sources by size and ranks their volatility. A score of 1 indicates most volatile and 10 least volatile. These rankings were developed by adjusting historical collections for inflation, then comparing the median absolute value of the year-over-year percent change. The right-most column displays the largest year-over-year decline and increase for each source in FY 2023 dollars.

($ Millions FY 2023 Dollars)

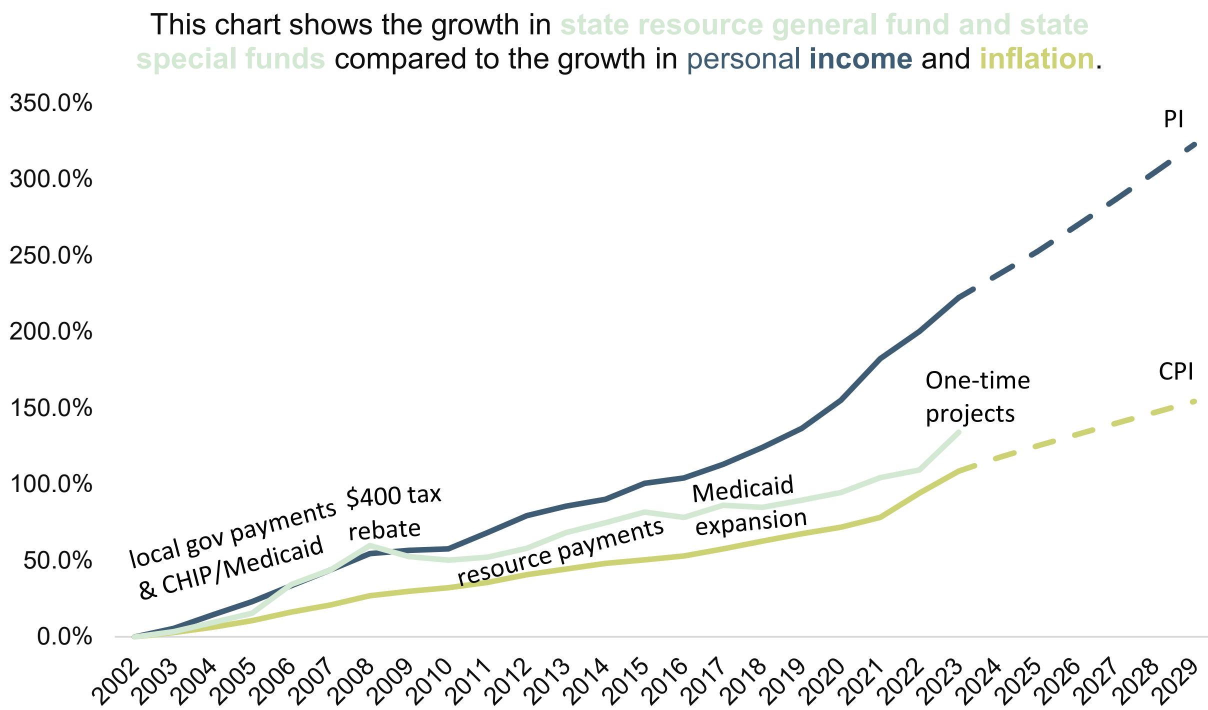
General Revenue Source	Average Collections	Volatility Ranking	Median % Change	Year-to-Year Range
Individual Income Tax	$1,752	4	8.3%	(-$289, $533)
Property Tax	338	10	1.6%	(-$6, $17)
Corporation Tax	229	2	13.7%	(-$69, $85)
Vehicle Taxes & Fees	131	9	2.2%	(-$6, $8)
Insurance Tax	93	6	3.4%	(-$2, $7)
Video Gaming Tax	76	7	2.9%	(-$8, $18)
Oil & Natural Gas Taxes	70	1	15.7%	(-$47, $30)
Cigarette Tax	33	5	3.8%	(-$9, $2)
Lodging Facilities Sales Tax	31	3	8.3%	(-$7, $20)
Liquor Excise Tax	27	8	2.3%	(-$1, $4)

STATE RESOURCES EXPENDITURE GROWTH

State resources is defined in Montana statute, [17-7-150(3)(a)](). The expenditure section of this report includes historical analysis of the three primary governmental funds: general fund, state special revenue funds, and federal special revenue funds.

General Fund and State Special Funds Expenditure Growth

The following chart shows the state resource general fund and state special expenditure growth compared to the growth in personal income and the growth in consumer price index (CPI) adjusted with population.



Early 2000's

Growth during the early 2000's was driven by the following:

1) HB 124 passed during the 2001 Legislative Session revised laws governing local and state government revenue collection and allocation; and
2) Increased natural resource payments to local governments from natural resource development of the Bakken formation (Elm Coulee); and
3) Increased state special resources spending on Medicaid and Children's Health Insurance benefits through the increase on hospital bed and nursing home bed utilization taxes; and
4) General fund expenditure growth in 2008 exceeded Montana personal income growth when the state provided a one-time-only $400 tax rebate to residents.

During 2010's

The 2010's growth in state resource general fund and state special revenues remained between the growth in personal income and the growth in CPI (inflation). Fluctuations during this period were the result of the following:

1) The Great Recession, which began in 2009, saw general fund expenditure growth decline below consumer price index until 2013. This same period saw state special revenue natural resource payments increase to local governments due to the increased oil and gas activity in the Bakken formation; and
2) In 2015, as mentioned in the revenue section, Montana experienced a decline in commodity prices that led to revenue shortfalls in 2017. Legislators returned for a special session in November 2017 to reduce general fund spending; and
3) Medicaid expansion, adopted by the 2015 Legislature and implemented on January 1, 2016, increased both state special fund and general fund expenditure growth.

FY 2020 - FY 2023

Beginning in 2020, the world and the state experienced a period of economic turbulence from the COVID health emergency. After a decade of around 2.0% inflation, Montana saw inflation growth and increased personal income growth. From FY 2019 – FY 2024, inflation grew 22.3%, and real (adjusted for inflation) personal income grew 24.1%.

Legislators during this period were faced with unprecedented changes in the economy. Unsure of the long-term economy, legislators tempered ongoing expenditure growth choosing to fund one-time-only projects like paying off the state general obligation general fund debt of $130.0 million and authorizing $82.0 million in state special revenue appropriations for long-range building program infrastructure projects.

Anticipated Growth beyond FY 2023

While the chart only shows general fund and state special revenue state resource expenditure growth through FY 2023, the trend in growth is anticipated to stay between the personal income growth and the inflation growth for the 2025 biennium.

Legislators during the 2023 Legislative Session were still unsure of the long-term economy and continued to temper ongoing expenditure growth, authorizing various one-time projects with state special revenue appropriation authority like the examples described below:

- Long-range infrastructure projects, $294.5 million
- Increased one-time-only state special appropriations to be used to match federal funding for highways, $100.0 million
- Established and funded a commission to study the behavioral health system in Montana, $75.0 million in state special authority for capital development and $71.6

million in state special appropriation authority for addressing future behavioral health needs

- Established or increased state special revenue trusts for the following:
  - Created new state school health trust for a one-time-only distribution to qualifying school districts' health insurance trusts, $40.0 million
  - Provided an end of watch trust fund for law enforcement officers and their families if the officer is killed or disabled in the line of duty, $10.0 million
  - Others trust funds

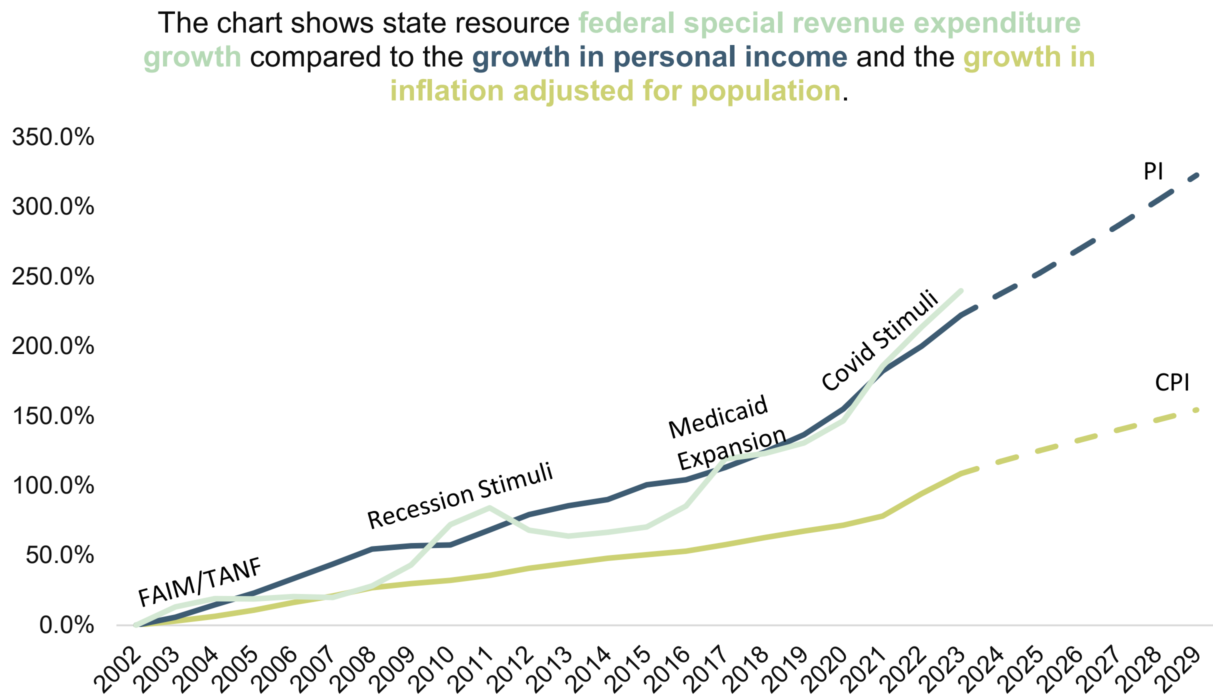
Federal Special Revenue State Resource Expenditure Growth

Growth in federal special revenue state resource expenditures closely mirrors periods when the U.S. and world economies are adversely impacted, and the federal government enacts legislation to support and stimulate the economy. The years 2009-2011, when the U.S. economy fell into the period known as the Great Recession, the federal government came to the aid of states through federal infrastructure stimulus known as the American Recovery and Reinvestment Act (ARRA). In 2020, when the world experienced a COVID health emergency, the U.S. federal government sent aid in the form of various stimuli packages to states.

The Department of Public Health and Human Services federal special budget is determined in large part by the Federal Medical Assistance Percentage (FMAP) rate. This is the rate at which the federal government reimburses the state for benefits provided to individuals on Medicaid, Healthy Montana Kids, and the Children's Health Insurance Program. The rate is based on per capita state income compared to the national per capita income over the most recent three years and can vary from year-to-year. During the COVID health emergency, the federal Centers for Medicare and Medicaid Services increased the Montana FMAP 6.2% for Traditional Medicaid.

Geographically, Montana is a large state and therefore the Montana Department of Transportation (MDT) receives a significant share of federal dollars for federal highway infrastructure funding compared to smaller U.S. states.

The following chart shows the federal special revenue state resource expenditure growth compared to the growth in personal income and the growth in inflation adjusted for population.



Early 2000's

- 2003 biennium saw increased food stamp cash benefits and Montana's Families Achieving Independence in Montana (FAIM) services, the name given to Montana's public assistance reform project
- FAIM was funded through federal funding as part of Temporary Assistance for Needy Families (TANF). The 2001 Legislature appropriated the entirety of the TANF fund balance to FAIM for the 2003 biennium.[5] FAIM included federal special revenue expenditures on things like paying for childcare for FAIM participants and low-income working families, caretaker relative grants, vehicle ownership support, and more[6]

During 2010's

- FY 2009 – FY 2011 the federal government provided federal stimuli to mitigate impacts of the Great Recession through the following:
    - Enhanced the FMAP match

[5] 2003 Biennium Fiscal Report, Public Health and Human Services, Summary, Pages B-1 – B – 10.

[6] 2003 Biennium Budget Analysis, Public Health and Human Services, 02-Human and Community Services Division, page B-23 and B-32.

- The American Recovery and Reinvestment Act (ARRA) which increased federal infrastructure funding to states and provided additional education stimulus to K-12 schools

- The 2015 Legislature adopted the expansion of Medicaid. The federal government provided a 100.0% match for benefits paid to individuals on the expansion in FY 2016, then phased down to 90.0% by FY 2020. The chart shows that by FY 2017 Medicaid Expansion was fully implemented and federal special revenue expenditure growth exceeded Montana's personal income growth

FY 2020 – FY 2023

The federal government responded to the COVID public health emergency by passing the legislation designed to help individuals and state governments during the emergency.

- H.R. 6074 "Coronavirus Preparedness and Response Supplemental Appropriations Act"
- H.R. 6201 "Families First Coronavirus Response Act" (FFCRA)
- H.R. 748 "Coronavirus Aid, Relief, and Economic Security Act" or "CARES Act"
- H.R. 266 "Paycheck Protection Program and Health Care Enhancement Act"
- H.R. 1319 "American Rescue Plan Act of 2021" (ARPA)

> "Montana received 51.5%, or $5.14 billion, of its total revenue from federal grants in fiscal 2021—more than the 50-state share. Montana was one of 31 states during the same period with a higher share than in the prior year." *Pew Charitable Trusts, Fiscal 50 Report*[7]

Of the five resolutions adopted by Congress, CARES, FFCRA, and the ARPA significantly impacted state resource expenditures.

1. CARES Act provided direct federal stimulus to individuals and states, provided the paycheck protection program available to Montana businesses, as well as distributed federal grants to K-12 schools in the form of Elementary and Secondary School Emergency Relief (ESSER) funds to address the impacts of COVID on schools.
2. FFCRA increased the FMAP match for Traditional Medicaid 6.2% from March 2020 – April 2023. The enhanced FMAP for the Children's Health Insurance Program was about 11.0% above the standard during this period.
   In addition, the FFCRA suspended the annual redetermination process of checking if individuals qualified for continued enrollment in Medicaid and Children's Health Insurance Program.
3. Montana implemented the ARPA through SB 297 and HB 632 during the 2021 Legislative Session. SB 297 provided for increased appropriation authority for broadband communication infrastructure. HB 632 provided for water and sewer projects and grants,

[7] Pew Charitable Trust Fiscal 50 Report, June 2024, Federal Share of State Revenue.

workforce development grants, housing and rental assistance, and funding. This significantly increased spending on one-time-only projects.

Beyond FY 2023

While not shown on the historical chart as it ends in FY 2023, a significant impact on MDT will be provisions in the Infrastructure Investment and Jobs Act, H.R. 3684 (IIJA) that was passed by Congress and signed into law in November 2021. This act significantly increased the MDT access to federal highway dollars and the 2023 Legislative increased the MDT 2025 biennium HB 2 budget by about 20.0% to take advantage of the IIJA provisions.