

Recessions Happen. Understand Montana's Risk

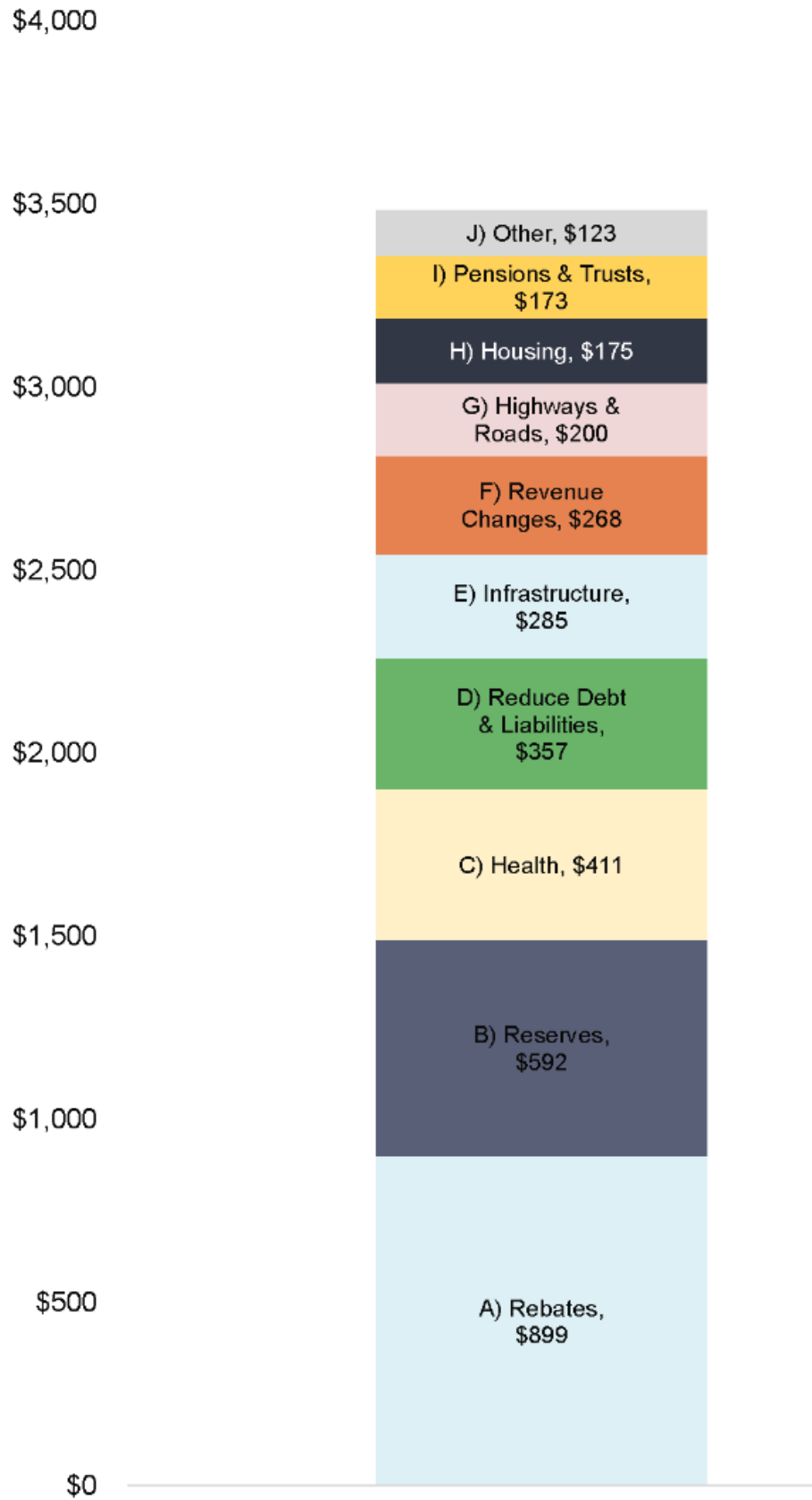
Analysis of Economic Risks on Montana's State Finances

**Legislative Fiscal Division: Amy Carlson, Susie Lindsay, Josh Poulette,
and Sam Schaefer**
Draft

2023 Session Summary - State Finances

The 2023 legislature allocated general fund resources to rebates, filling reserve balances, behavioral health, debt reduction, infrastructure, funding for highways and roads, pensions and trust funds, and tax policy changes.

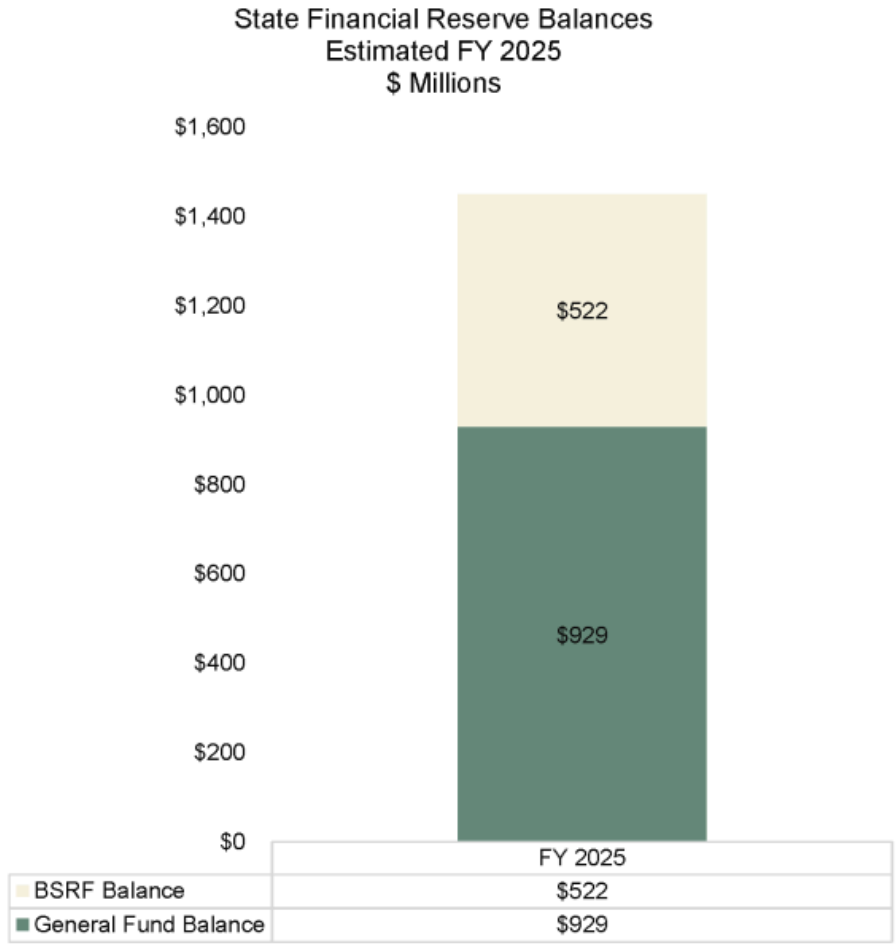
Included in these financial decisions was the decision to leave reserve balances at 40% of annual expenditures. to provide a cushion if revenue collections declined. In addition, the legislature adopted a positive structural balance that was 16.0% of annual ongoing revenues. In other words, ongoing revenues were 16.0% higher than ongoing expenditures.



This chart shows the legislative decision categories for the 2025 biennium general fund. Legislators began with approximately \$4.0 billion ending fund balance for FY 2025 and used nearly \$3.5 billion leaving a balance of \$539.3 million.

State Financial Highlights - Sept. 2024

The updated state general fund is estimated at \$929 million for FY 2025 and the budget stabilization reserve fund at \$522 million is at its FY 2025 statutory limit. Both provide the state with solid financial resources in the event of an economic downturn or recession. Current reserves are 55.0% of annual ongoing general fund expenditures.



A combination of nearly \$1.5 billion in state reserves.

Risks to State Finances

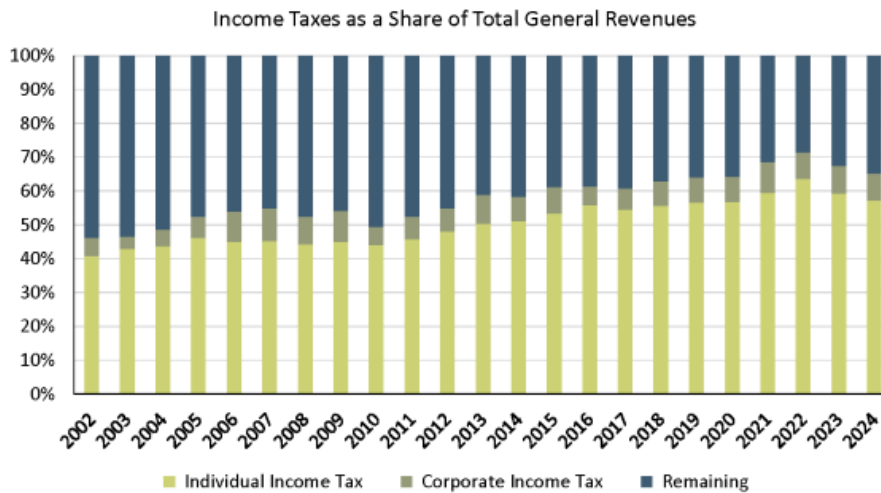
Risk to the state’s budget can come from a variety of sources. The report takes a look at these highest risk categories:

- Volatile Revenue Sources like Income Taxes
- Montana's Federal Funding Risk

- Aging Infrastructure
- Unfunded Liabilities like Pension Systems

Reliance on Volatile Sources like Income Taxes

Shortfalls often occur during economic recessions, and the severity of the shortfall can be dependent on both the severity of the recession as well as the volatility of a state’s revenue portfolio. A volatile revenue source is one that tends to deviate from its long-term trend, or one where a long-term trend is not easily discernible. Furthermore, if a state’s larger sources tend to be more volatile, revenue shortfalls may occur at a higher frequency than if a state’s revenue portfolio was composed of large, stable sources. A recent [report](#) from the Pew Charitable Trusts found that over the last fifteen years Montana had the 12th most volatile revenue out of the 50 states. Key reasons for the volatility: 1) in the past, reliance on natural resource revenue; and 2) increasing reliance on individual and corporate income taxes.



The chart shows that over time the share of income taxes of total general revenues has grown from about 45% to 66%.

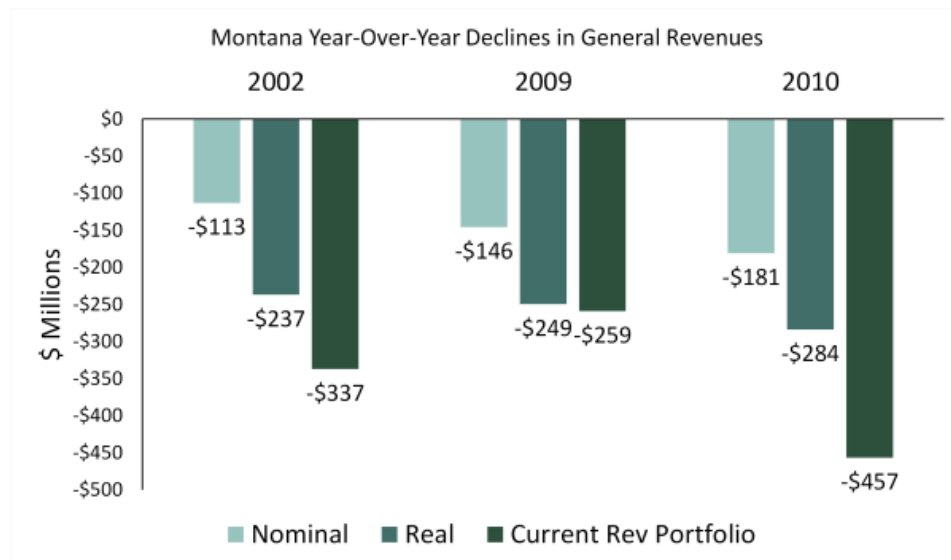
Past Shortfalls Under Today’s Revenue Structure

Montana's revenue streams are anticipated to be more volatile than in the past. Corporate and individual income taxes have

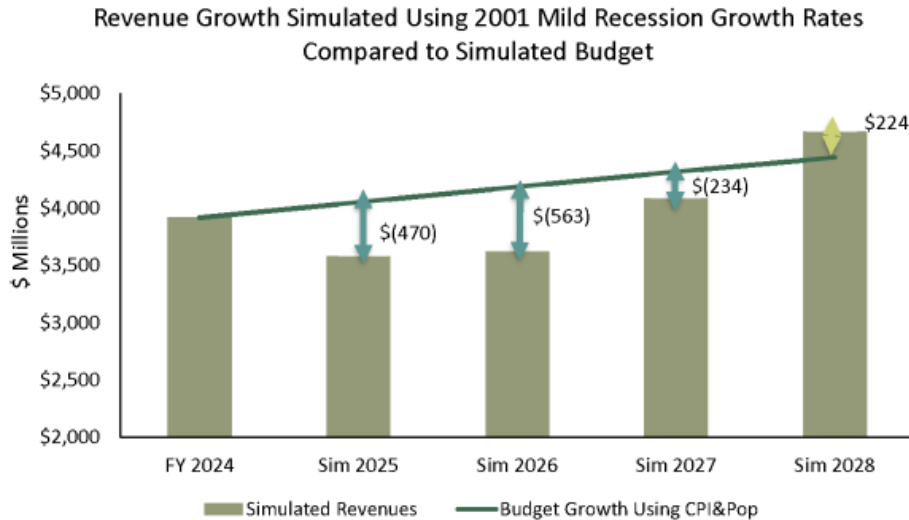
grown faster than other predominant revenue sources and in recent years have accounted for roughly two-thirds of total general revenues. Comparatively, two decades ago the income tax share of general revenues was closer to approximately 50%.

During periods of economic downturns, income and other volatile taxes often experience greater declines and can be counter cyclical of natural resources. For example, during the Great Recession, natural resource revenues remained stable, while income tax collections dropped significantly. Back in 2009, natural resource revenues were 8.8% of total collections, but in FY 2024 were just 2.9%. As a result the use of natural resources as a stabilizing factor during a recession is not as impactful as it once was.

As more volatile sources account for a larger share of general revenues, the collective decline in revenues will likely be greater than was seen in past recessions. To analyze the impact of both a minor and major recession under Montana’s current revenue composition, each revenue source’s growth rate from both the 2001 recession and Great Recession were applied to FY 2024 revenue collections. The results are shown in the figure. The two-year decline in FY 2009 and FY 2010 totals \$716 million.



During economic volatility, in addition to year-over-year revenue declines there is an additional budget pressure due to the growing nature of the budget to keep up with inflation and population growth. The following chart illustrates simulated growth rates during a recession and the length of time it takes to return to structural balance.



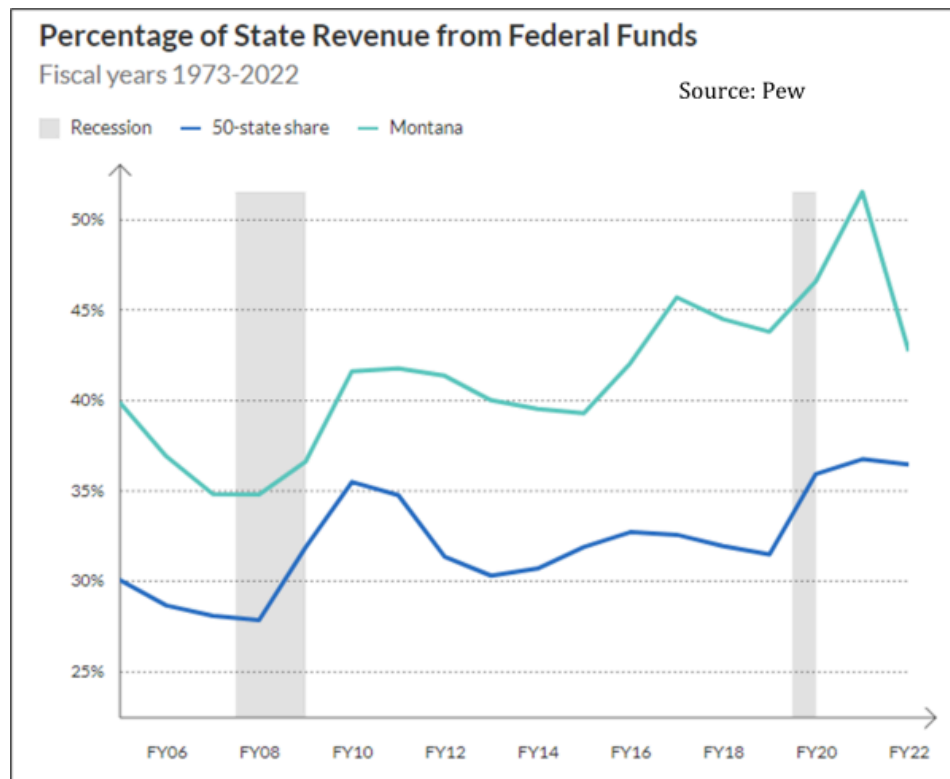
The chart illustrates that compared to a budget that grows with inflation and population, the cumulative three-year structural imbalance is about \$1.3 billion before returning to positive levels.

Montana's Federal Funding Risk

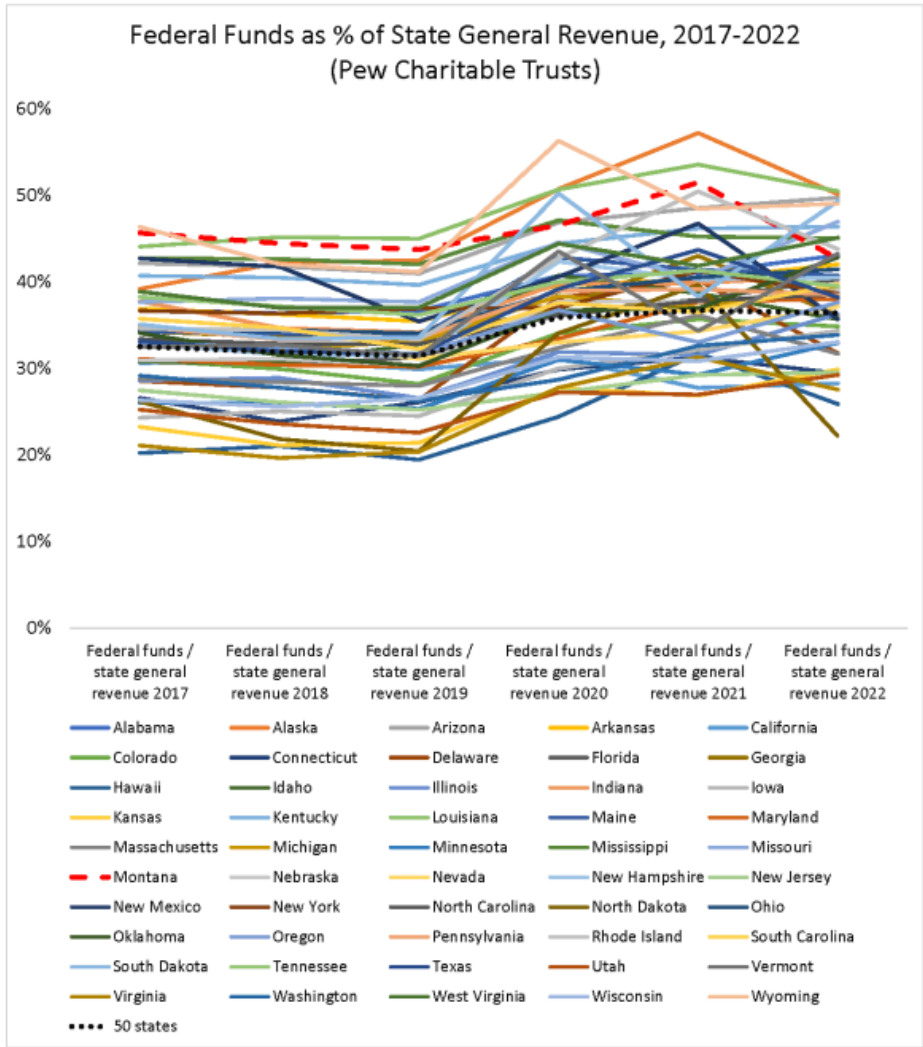
While Montana's revenue streams are currently exceeding ongoing expenditures, the same is not true with the federal government budget. Future federal action may lead to a reduction in spending in the states in order to reduce the federal gap between revenues and expenditures.

Montana receives more federal revenues than most states. Data in the following two graphs comes from the [Pew Charitable Trusts' Fiscal 50](#). First, compare Montana's percentage of state revenue from federal funds with the total for all 50 states – This chart shows years 2006-2022. Over this time, Montana averages north of 40% of state revenue from federal funds, considerably higher than the total for all 50

states. Should Congress decide to trim back federal funding to states, Montana's state funds (general and state special) would need to offset the federal funding losses.



The next graph shows the same metric for all 50 states, including Montana (red dashes) and the 50 state total (black dots). It is clear from this image that Montana has been near the top of this distribution for the past several biennia.



Aging Infrastructure

Aging infrastructure adds risk to budgets and failure of infrastructure can cause expenditure emergencies. The Legislative Fiscal Division plans to expand data collection activities beyond local government water and wastewater system baseline data to include evaluation of that data and to begin collection of additional data related to local government stormwater systems, roads, bridges, and buildings. Also planned is an update of the 2008 inventory of K-12 facilities. This work will give the legislature a better sense of the status of current infrastructure in the state.

Unfunded Liabilities - How Montana Compares to Other States

According to the [Pew Charitable Trusts' Fiscal 50](#) ". . . Outstanding [Montana] debt was 3.0% of the state's own-source revenue, compared with 18.7% for the 50-state total. And in fiscal 2019, the most recent year of data, unfunded retiree health care was 2.3% of Montana's own-source revenue, compared with 45.0% for the 50-state total."

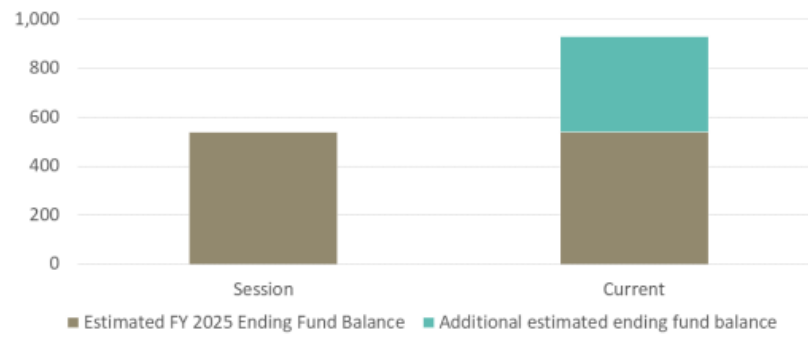
In comparison, Montana has higher liabilities for pensions than other states. Pew further stated that . . . "in fiscal year 2021, Montana's unfunded pension liability stood at 79.9% of the state's own-source revenue, compared with 49.1% for the 50-state total." Pension liabilities are the largest source of financial risk from liability.

2027 Biennium Financial Outlook for Montana

In June 2024, the Legislative Fiscal Division staff presented a [Financial Outlook for Montana](#). The report focused on the unique financial situation at this point in time for Montana. State reserve balances are strong and can cushion finances from quick shocks. General fund structural balance is strong, with ongoing revenues exceeding anticipated costs for current services. Yet, the state has various risks for the future. The analysis identified four key areas of risk on future state finances:

- State revenues are volatile and federal income tax changes may compound volatility
- General fund pressures if federal funding changes for transportation and public health
- Aging infrastructure may cause unexpected emergencies
- Unfunded liabilities of pension systems higher than other states

Outlook Fund Balance = Strong
The FY 2025 ending fund balance is currently anticipated to be greater than the estimate during session



Next Steps

1. Evaluate an updated structural balance with HJ 2 revenues and present law expenditures.
2. Evaluate alternatives for the legislature to consider use of structural balance to pay down infrastructure and pension liabilities.