The Montana budget is how “we the people of Montana” identify, prioritize, and fund the public structures and services that help create our safety, prosperity, and stability. Unfortunately, Montana, like virtually every other state in the country, is feeling the effects of the recession. As individual and corporate incomes have fallen, we have seen a record-breaking decline in our state’s revenues.

Funding for schools, roads, parks, libraries, law enforcement, prescription assistance for low-income seniors, fire protection, regulatory systems, child care assistance for working families, and numerous other public structures and services are at stake.

This report is designed to inform advocates and policymakers alike about the current revenue crisis, why it matters, and how policymakers can meet the crisis with a balanced approach that builds a brighter future for the next generation of Montanans.

Declining Revenue

Montana has been late to feel the worst effects of the national recession. Almost every state—all but Montana and North Dakota—already experienced budget shortfalls totaling $192 billion for fiscal year 2010.¹ In a recession, people buy less and earn less, reducing what the state gets from individual and corporate income taxes. Unfortunately, this happens just as more Montanans are losing their jobs, facing reduced work hours and wages, struggling to get by, and having to rely more heavily on public programs from children’s health insurance to job training as a result.

Montana is not alone. States are expected to face a $180 billion combined budget shortfall during the current budget year. Montana deserves a balanced approach to this revenue crisis that looks not just at dramatic and harmful cuts to public services, but also targeted efforts to increase revenue. This brief is one in a series of MBPC reports that explores potential policies to raise revenue in the state.

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year, the largest combined shortfall on record.

When Montana’s 2009 legislature balanced the current budget (the 2011 biennium budget), they assumed that state revenue would decline by approximately 2% as a result of the recession. Unfortunately, state revenue has declined by almost 16%, or $229 million, through the first 11 months of the budget. In part because of revenue uncertainty, the 2009 legislature also passed the current budget with a $282 million ending fund balance. An ending fund balance is the difference between the amount of money the state expects to bring in and the amount of money it expects to spend during a given budget cycle. As revenue has declined, the projected ending fund balance has fallen as well. In fact, the balance has fallen dramatically enough that it triggered a law requiring the governor to reduce spending before the legislature meets again in 2011. On April 5, 2010, the governor announced $41.1 million in spending cuts, representing roughly 5% of each of the affected agencies’ fiscal year 2011 general fund budgets.

With the governor’s interim cuts and a few sources of unanticipated revenue such as the Otter Creek lease and additional federal funding for Medicaid, legislative staff is now anticipating an ending fund balance of $91.7 million, compared to the $282 million ending fund balance projected by the legislature. Before the governor’s cuts and additional revenue sources were included, Legislative Fiscal Division was anticipating a negative ending fund balance of -$63 million.

State revenue is not expected to reach 2008 levels again until 2015.

**What Does this Mean for Our Next State Budget?**

Legislative Fiscal Division is now estimating that the 2011 legislature will have to either increase revenue or cut spending by $405 million in order to balance the next budget.

Table 1 shows a projected balance sheet based on a beginning fund balance of $91.7 million (the current budget’s new projected ending fund balance).

The projected shortfall of $405 million is roughly equivalent to 10% of total state general fund spending.

Included in the estimated shortfall is $78 million of current funding for K-12, higher education, and health and human services that will need to be included in the next budget as “new proposals.” New proposals are typically reserved for new programs or services that weren’t a part of the previous budget’s ongoing services.

When the 2009 legislature replaced state funding with federal recovery act funding for ongoing programs and services in education and human services, it required that some of the dollars be taken out of those agencies’ base budgets for the next budget cycle. This is an important point because new proposals are typically met with greater scrutiny than ongoing funding in an agency’s base budget. The current revenue crisis means new proposals are likely to be met with even more scrutiny during the 2011 legislative session.

| Table 1: General Fund Projected Balance 2013 Biennial Budget (in millions) |
|---------------------------------|-----------------|
| Beginning Balance               | $91.7           |
| LFD Revenue Estimates           | $3,571.5        |
| Current Level Services          | ($3,968.4)      |
| Estimated Fund Balance Reserve  | ($100)          |
| Potential Budget Gap            | ($405.2)        |

Source: Legislative Fiscal Division
Why Does the Revenue Crisis Matter?

If the revenue crisis is addressed by cuts alone, the consequences will be dire for the public structures that maintain safe and healthy communities where all Montanans have the chance to prosper. A few of the preliminary options being considered by legislators for closing the budget gap include:

- Eliminating full-time kindergarten.
- Decreasing funding for K-12 education and higher education.
- Eliminating funding for Area Agencies on Aging for services such as meals on wheels.
- Reducing or eliminating payments to local governments.
- Early release of inmates.
- Reducing funding for mental health services.
- Reducing funding for child care assistance for low-income working parents.
- Reducing prescription assistance for low-income Medicare recipients.
- Eliminating funding for the autism group home.
- Closing courts one day per week.
- Eliminating funding for Big Brothers Big Sisters.
- Eliminating Medicaid coverage for dental, optometric, physical therapy, and other “optional services.”

A cuts-only approach to the revenue crisis jeopardizes our ability to invest in the public structures that will build a stronger future. It also reduces our ability to meet the needs of the growing number of Montanans who have lost their jobs, seen reduced wages and hours, and are struggling to get by. Furthermore, when states cut spending, they lay off workers and cancel contracts with vendors, putting a drag on an already struggling economy.

A Balanced Approach to the Revenue Crisis

Montana can respond to the revenue crisis in ways that protect families, revitalize the economy, and prepare us for a more prosperous future. The problem is too big to solve with cuts alone. Rather, Montana needs an approach that will look at every option, including targeted attempts to raise revenue. A balanced approach will protect our ability to educate our children, keep our communities safe, protect our land and water, and provide health care and other services for the far too many Montanans struggling to make ends meet.

A balanced approach would include:

1. **Improving Collections.** Most Montana families and businesses lawfully pay the taxes they owe and contribute to our collective ability to fund the programs, services, and infrastructure that help make our communities strong, safe, and healthy.

Unfortunately, not all taxpayers are paying the money due for taxes. Montana can improve collections by:

- Increasing funding for Department of Revenue audit and compliance efforts.
- Automatic income withholding of income taxes for non-residents selling real estate in Montana.

2. **Curb Tax Expenditures.**

- Eliminate the state capital gains credit.
- Eliminate the domestic production deduction.

3. **Find True Efficiencies in Public Spending.**

- Other states have found savings in corrections spending while increasing criminal justice objectives.
- Carefully evaluate economic development incentives to make sure they are meeting their policy goals.

4. **Targeted Tax Increases.**

- Restore progressivity to Montana’s income tax system.
- Modernize corporate income tax policy by indexing the minimum tax to inflation.

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Examples of Balanced Policy Options to Address Montana’s Revenue Challenges

1. **Improve Revenue Collections**
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   - Automatic income withholding of income taxes for non-residents selling real estate in Montana.

2. **Curb Tax Expenditures**
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   - Modernize corporate income tax policy by indexing the minimum tax to inflation.

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they owe. The Department of Revenue has estimated that the state has as much as a $300 million tax gap, meaning that $300 million dollars of owed taxes are not being collected each year. Montana can raise revenue by further investing in the Department of Revenue and pursuing concrete policy proposals that ensure all taxpayers are paying what they owe.

2. Curbing Tax Expenditures. Each year Montana loses millions of dollars in revenue in the form of tax credits, deductions, and exemptions through the tax code. Although some of these expenditures may be good policy, unlike state spending, tax expenditures are rarely reevaluated after they are passed.

3. Finding True Efficiencies in Public Spending. The term “efficiency” has been used as a justification for massive cuts in public services, without a serious look at how the cuts would impact states’ goals and populations. As the Center on Budget and Policy Priorities has reported, “When seriously measured, management of state functions turns out to be more efficient than popular opinion and political rhetoric might suggest.”

However, the current revenue crisis allows us to ask if our current goals can be met at a lower cost by changing the policies we use to achieve them. For example, other states have found significant savings in corrections reform and economic development expenditures without jeopardizing--and, in fact, sometimes enhancing--the goals of public safety and economic development.

4. Targeted Tax Increases. Most states have both raised taxes and made spending cuts to address the impact of the recession on state revenues. In past recessions, both “red” and “blue” states in every region of the country have raised taxes. Their economies did just as well as states that didn’t, and many highly-regarded economists have argued that raising taxes, especially on the wealthiest, does less economic harm than deep cuts to public programs, services, and infrastructure.

In recent years, Montana has actually reduced taxes on the wealthiest taxpayers, costing the state hundreds of millions of dollars in funding for education, health care, roads, parks, and other public structures that Montana communities, businesses, and families rely on.

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2003 Income Tax Changes Benefiting Few at Great Cost to All. Senate Bill 407:

- Almost half of the benefits of the credit go to Montana families making over $500,000 per year.
- Costs the state approximately $100 million per year, roughly four times the cost estimated when it was passed.
- Reduced the income at which the top rate is effective from $82,400 to $13,900.
- Lowered the top rate from 11% to 6.9%.
- Reduced effective rates on capital gains by giving a nonrefundable credit on capital gains.

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In fact, when looking at our entire tax system, Montana’s low and middle-income families pay higher effective tax rates than Montanans making over $434,000 per year. See Chart 2 below.

Montana Can’t Cut Its Way to Prosperity

Reliance on a cuts-only approach would be devastating to Montana. Just as the recession has decreased state revenue, it has also taken a heavy toll on Montana workers all across the state. The unemployment rate in Montana has more than doubled since the start of the recession while personal incomes have fallen. As a result, an increasing number of Montana families have to rely on public programs and services to get by. Food Stamp (now known as the Supplemental Nutrition Assistance Program) participation increased by almost 40% from January 2008 to January 2010, and Medicaid participation increased by almost 32% over the same time period. An approach to the revenue crisis that only cuts programs and services will threaten to increase the suffering of hardworking Montanans trying to get through the greatest economic downturn since the Great Depression.

Budget Cuts Can Harm the Economy More than Targeted Revenue Increases.

An increased focus on cuts to programs and services will threaten to increase the suffering of hardworking Montanans trying to get through the greatest economic downturn since the Great Depression. Two highly regarded economists—Nobel Prize winner Joseph Stiglitz of Columbia University, and Peter Orszag, the former director of the federal Office of Management and Budget—argued during the last recession that spending cuts could actually be more harmful for a state’s economy during a recession than tax increases:

“[E]conomic analysis suggests that tax increases would not in general be more harmful to the economy than spending reductions. Indeed, in the short run (which is the period of concern during a downturn), the adverse impact of a tax increase on the economy may, if anything, be smaller than the adverse impact of a spending reduction, because some of the tax increase would result in reduced saving rather than reduced spending.”

- Joseph Stiglitz, Nobel Prize winning economist

In a recession, you want to raise (or not decrease) the level of total spending – by households, businesses and government – in the economy. That keeps people employed and buying things, and makes it more likely that businesses will want to invest to serve that consumer demand.”

- Joseph Stiglitz, Nobel Prize winning economist

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consumption."\textsuperscript{21}

Stiglitz recently reiterated his insight in a letter to New York Governor David Paterson, who, like most governors, is facing significant budget challenges.\textsuperscript{22} A similar letter addressed to state Governors and legislators was signed by over 200 economists across the nation.\textsuperscript{23}

**Deep Cuts to Public Programs Can Have Devastating Long-Term Social and Economic Consequences for Us All.** To take just one example, increases in tuition costs and cuts to financial aid can put higher education out of reach for children of working families. Limiting access to higher education can negatively impact both personal earning potential and statewide economic growth far into the future.\textsuperscript{24}

Decreasing the quality of education, job training, and health and human services diminishes the strength of our human capital. Companies now research the entire world for places to set up operations. When they see a state with poorly trained workers, bad roads, unsafe water, and a strained health system, they usually look elsewhere. We need to attract investment more than ever, and we don’t want to be overlooked by private businesses because we didn’t adequately invest in our communities.

**Conclusion**

Policymakers in Montana have tough decisions ahead. The recession is jeopardizing Montana’s ability to maintain adequate funding for the public structures that support safe and healthy communities and invest in a better future. Montanans deserve a balanced approach to our revenue challenges -- an approach that looks at every available tool, from increasing tax compliance and closing tax loopholes to looking at spending efficiencies and targeted tax increases. The scope of Montana’s revenue challenge requires that state leaders move beyond dangerous suggestions of a cuts-only approach that could devastate our communities and economic growth for years to come.

For more detailed research and analysis on specific strategies for raising revenue, sign up for updates at MontanaBudget.org.
Endnotes


3. Montana law requires the governor to reduce spending when the ending fund balance falls below a certain trigger. Montana Code Annotated 17-7-140. The trigger phases down as the state progresses further into the biennium. For the time period between June 2009 and September 2010, the trigger was $36.37 million. The governor’s budget director makes the ending fund balance projections that determine whether the trigger has been met. For more information on the law requiring interim cuts, see “Government Cuts Should Be Minimized and Targeted to Avoid Further Harm to the Economy and Struggling Montana Families,” Montana Budget and Policy Center, updated Feb. 10, 2010, at http://www.montanabudget.org/sites/default/files/reports/Interim%20Spending%20Cuts%20Final%204_1.pdf.

4. Some agencies were cut more than 5% and some less. For a list of cuts, see Governor Schweitzer’s memo to agency directors, April 5, 2010 at http://leg.mt.gov/content/Publications/fiscal/17-7-140/Governors_Reductions-11.pdf.


8. With the help of the American Recovery and Reinvestment Act and a large ending fund balance from the previous biennium, the 2009 Montana legislature was able to create a budget that largely maintains programs and services during the current budget cycle (FY 2010-2011), despite well-founded predictions by the legislature that revenue would decline throughout the two years of the budget. For an overview of the 2011 biennium budget, including appropriation of federal Recovery Act funding, see “The 2011 Biennium Budget: Maintenance, Recovery, and Future Cuts,” Montana Budget and Policy Center, updated Feb. 12, 2010, at http://www.montanabudget.org/reports/2011-biennium-budget-maintenance-recovery-and-future-cuts.

9. The 2009 legislature replaced substantial state funding for K-12, higher education and health and human services with federal recovery act funding, and used the freed up state funds primarily for one-time-only infrastructure projects. As a result of the switch, education and health and human services will need a total of $253 million more in state general fund dollars than they received this biennium in order to maintain current programs and services. The table on the next page shows the amount of federal dollars that will need to be replaced by state general fund dollars in the next biennium. Column A shows the general fund dollars that were replaced by federal dollars for the 2011 Biennium but that will be included in calculating the base budgets for the 2013 Biennium. Column B shows the amount of general fund dollars that were replaced by federal dollars for the 2011 Biennium that will not be added back to the base for the 2013 Biennium and thus will result in a cut to the base budgets for those programs. For the 2013 Biennium, the amounts in column B will be considered new proposals despite the fact that they funded ongoing programs and services in the 2011 Biennium.


11. Legislative Audit Division, Memo to Legislative Audit Committee, June 2009.


21. Ibid.
