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Montana Budget & Policy Center

Investing in Our Common Good:

A Guide to the Montana Budget

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The Montana Budget and Policy Center is an independent non-partisan research organization. The Center provides timely and objective analysis of budget, tax, and policy issues in Montana. The Center seeks to promote fair and informed public policy for the benefit of all Montanans.

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Our Common Good: Why Should We Care about the Montana Budget?

Virtually every hour of every day we benefit in some way from the numerous public structures and services provided by Montana's state and local governments. These public structures - including schools, roads, parks, libraries, law enforcement, fire protection, courts, and regulatory systems – are integral to our quality of life in Montana. As individuals, each of us would find it virtually impossible to provide this infrastructure for ourselves. Rather, our collective investments- through taxes, fees, and other government revenue- help to sustain our well-being and ensure opportunity for all Montanans. Often our public structures are so integral to our individual and community health that we fail to recognize their importance until one of them fails- from something as small as the corner stoplight breaking to something as large as the failure of an adequate emergency response to the tragedy of Hurricane Katrina.

"We the people of Montana … desiring to improve the quality of life, equality of opportunity and to secure the blessings of liberty for this and future generations do ordain and establish this constitution."
-Montana Constitution

Through the Montana budget, **"we the people of Montana"** identify, prioritize, and fund the public structures and services we all rely on for our safety, prosperity, and stability. The budget process is essential in our collective efforts to define our goals and plan for our future. Through the budget process, we must collectively answer the questions: What do we want for our future? What public systems do we need to meet those goals? What will these systems cost? How do we prioritize the allocation of public funds? How do we raise the money? At the Montana Budget and Policy Center, we believe that a good budget is fiscally responsible. A good budget promotes future economic prosperity through investments that create opportunities for all Montanans, including our most vulnerable neighbors. A good budget sets aside money when times are good to provide protection to Montana families and communities when times are tough.

Chapter 1 of this guide, "Appropriations: What are Montana's Spending Priorities?" analyzes the areas of public investment we currently prioritize, compares our investments to other states, and looks at how our priorities have changed over time.

A good revenue system generates sufficient funding to provide the public goods and services we need to ensure prosperity, security, and stability in our communities. A good revenue system is fair and does not make arbitrary distinctions between taxpayers. A good revenue system contributes to economic growth. A good revenue system relies on diverse sources for stability. A good revenue system draws upon the strongest parts of our economy to support the structures which make our economy strong. Chapter 2, "Revenue: How Does Montana Fund Its Priorities?" explores the state's various sources of revenue, compares Montana revenue sources and amounts to other states, and analyzes who pays Montana taxes.

Chapter 3 of this guide, "Process: How is the Montana Budget Made?" outlines the steps by which Montana's priorities are solidified in a state budget. The Montana Budget and Policy Center hopes that this guide will inform the public and policymakers alike and encourage greater involvement in important budget and tax debates.

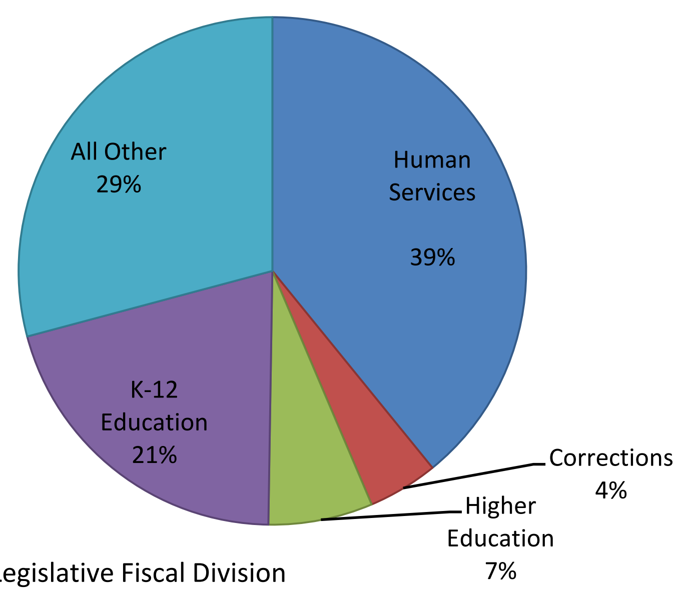
Appropriations: What are Montana's Spending Priorities?

The state of Montana works in partnership with local governments and the federal government to invest in the public programs, services, and infrastructure we all rely on. Although this chapter focuses primarily on state spending priorities, areas in which local governments or the federal government play a particularly important role will also be highlighted.

Where Does Montana Spend Its Money?

The total state budget for Montana is approximately $8 billion dollars for the fiscal years of 2008 and 2009, or roughly equivalent to $4 billion dollars per year. Chart 1 shows the "Total Funds" budget by major governmental function. It differs from the "General Fund" budget (Chart 2) in that it includes over $3 billion in federal funds and over $1 billion in state special revenue funds restricted by law for specific purposes.

Chart 1: Total Funds 2 Year Budget by Government Function FY 2008-2009, Total: $7,952 million



Source: Legislative Fiscal Division

Key Terms

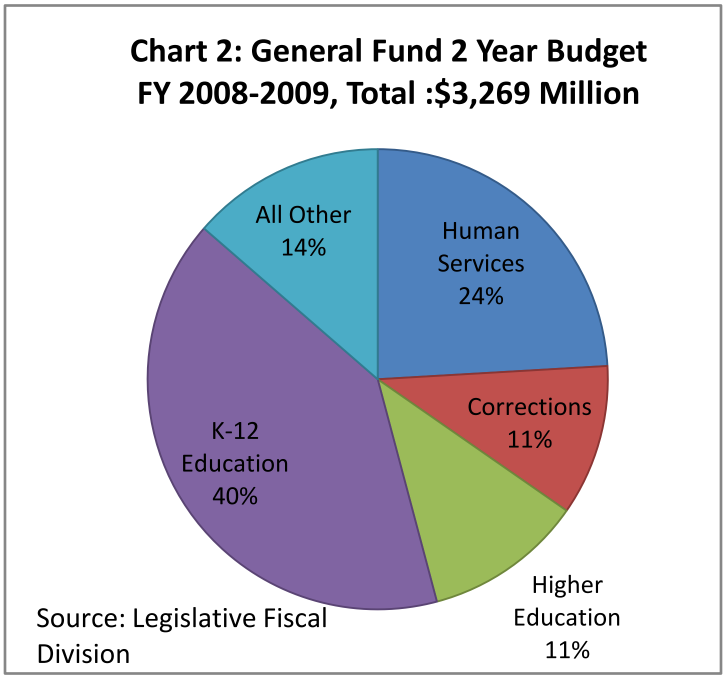
What Does "Appropriation" Mean?
An appropriation is authority given to a government agency or institution to spend a specified amount of government money. Appropriations are made through legislation.

What Does "Fiscal Year" Mean?
The state accounts for its finances using a "fiscal year" that begins July 1 and ends June 30. It is named for the calendar year in which it ends.

What Does "Biennium" Mean?
Montana is one of the few states that have a true biennial budget. The Montana legislature meets every two years (every odd year), at which time it approves a budget for a two-year period, also called a biennium. The biennium is named for the calendar year in which it ends. During, the 2009 Legislative Session, the legislature will consider and approve a budget for fiscal years 2010 and 2011; this two year period is also referred to as the ***2011 biennium***.

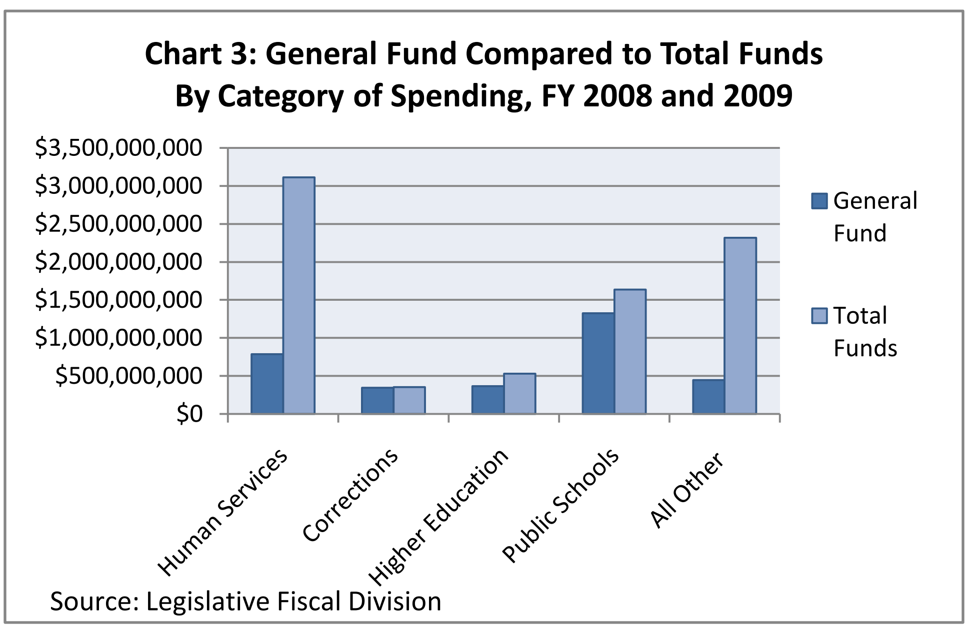
What is the "General Fund?"
The General Fund is money available for the state to use for most of its functions without restrictions. The biggest source for general fund revenue is individual income taxes. General funds do not include payments to the state from the federal government or fund sources that are restricted for specific purposes.

What are "State Special Revenue Funds?"
State special revenue funds are kept separate from the general fund and are legally restricted for specific uses. In other words, the legislature can only use state special revenue funds for their intended purpose. State special revenue funds also tend to be funded by specific funding sources and/or fees rather than general taxes.



Why is the distinction between total funds and general funds important?

Total spending, as reflected in Chart 1 on the preceding page and encompassing roughly $4 billion in annual expenditures, includes state expenditures funded with federal funds. General fund spending, as reflected in Chart 2 above and encompassing roughly $1.6 billion in annual expenditures, represents most of the state's share of total spending. As such, the general fund budget receives most of the focus during the executive and legislative budget process and is a better reflection of both the amount of revenue we choose to raise and how we choose to allocate those revenues among public structures and services. Chart 3 compares general fund spending to total funds pending for each budget category.



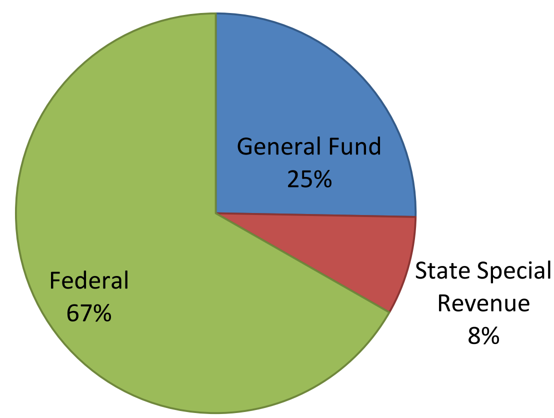
What programs and services are encompassed in each of the budget categories, and which funds pay for them?

Human Services

The human services category primarily covers funding for the Montana Department of Health and Human Services (DPHHS). The mission of DPHHS is, "Improving and protecting the health, well-being and self-reliance of all Montanans." DPHHS administers a wide variety of programs including health care programs (Medicaid and the Children's Health Insurance Program (CHIP)), senior and long-term care programs, foster care and adoption services, public assistance programs, disability services, child support enforcement, and many other social services. DPHHS also oversees the state's hospital, dependency center, veterans' home, and most other state institutions that are not prisons. Over one-half of DPHHS' budget is spent on Medicaid services.

The difference between the total funds budget (Chart 1) and the general fund budget (Chart 2) is particularly evident in the funding for human services, which constitutes 39% of total spending and only 24% of the general fund budget. The primary reason for this difference is that state dollars spent from the general fund for human services programs are often matched by federal funds that support specific programs such as Medicaid and the Children's Health Insurance Program. Chart 4 shows the portion of DPHHS funding derived from the general fund, state special revenue funds, and federal funds. Roughly two-thirds of the total budget for human services programs in Montana comes from federal funding.

Chart 4: Human Services Funding by Fund Type
FY 2008-2009, Total: $3.1 Billion

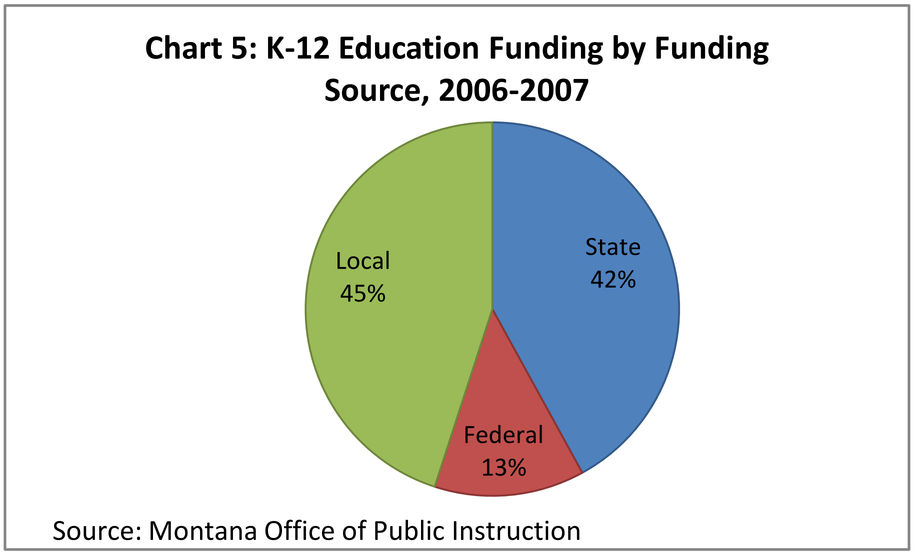


Source: Legislative Fiscal Division

K-12 Public Education

The K-12 Public Education category contains funding for primary and secondary schools in Montana, which includes teacher salaries and other instruction costs, Indian Education for All, gifted and talented programs, special education, education licensure for teachers and administers, and student assessment under the federal No Child Left Behind Act.

K-12 education receives 40% of all general fund dollars and 21% of total funds. Primary and secondary education take up a larger share of the general fund budget because a relatively small portion of the federal funds funneled through the state are earmarked for public education as compared to other categories of spending. State and federal funding are distributed to local school districts by the Montana Office of Public Instruction based on legislative formulas. Local governments also contribute substantially to the costs of providing public education to Montana's children. Chart 5 shows the portion of K-12 education funded by federal, state, and local governments.

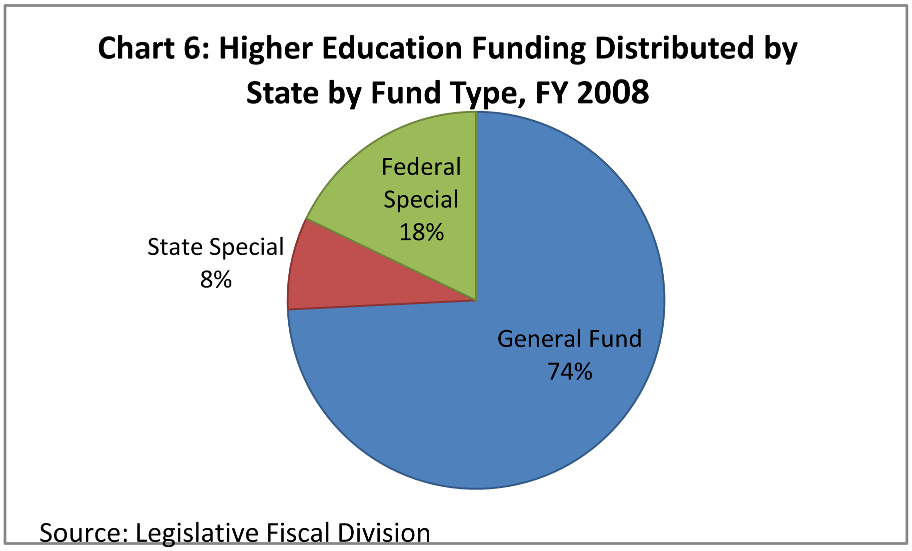


Higher Education

The higher education budget category includes funding for Montana's university system, including the University of Montana and Montana State University four-year colleges, two-year technology campuses, and research/public service agencies. Funding for community colleges, tribal colleges, teacher loan forgiveness, and student assistance, grants, work-study, and scholarship programs are also included in this category. Funding for the Montana University System is distributed by the Office of the Commissioner of Higher Education, which is governed by the seven-member Board of Regents (appointed by the Governor). Chart 6 shows the proportion of funds distributed by the state and federal government for Montana's University System.

In addition to state and federal funding, the Board of Regents collects tuition and fees from registered students. The tuition and fees are collected directly and do not have to be appropriated by the Legislature. In fiscal year 2008, tuition and fees made up 58% of the total budget for the Montana State and University of Montana four-year and two-year campuses.[1]

[1] Legislative Fiscal Division, Legislative Budget Analysis 2011 Biennium, Vol. 7, p E-132, January 2009.



Corrections

The corrections budget category primarily funds the Montana Department of Corrections, which is charged with running the Montana State Prison, Montana Women's Prison, and the youth correctional facilities. Corrections funding also supports community-based correctional alternatives and services, adult probation and parole, youth transitional centers and parole, prerelease centers, and chemical dependency programs. Almost all of the funding for the Department of Corrections comes from the general fund (almost 98%), an additional 2% from state special revenue, and less than 1% from federal funds.[2]

All Other

The four categories discussed above- human services, K-12 education, higher education and corrections- together make up 86% of all general fund expenditures and 71% of total funds. Many other important government functions are included in the "all other" budget category, including funding for the Legislative Branch, the Governor's Office, the Judicial Branch, the Department of Justice, Fish, Wildlife and Parks, Environmental Quality, and many other programs.

Funding for the Department of Transportation (DOT) is also included in the "all other" category. Among other functions, the DOT is responsible for highway construction and maintenance. One of the reasons that the "all other" category comprises a larger share of the total funds budget (29%) than the general fund budget (14%) is that the Department of Transportation does not receive any funding from the general fund. Rather, 41% of DOT funding is derived from state special revenue accounts (e.g. motor fuel taxes), and 59% comes from federal funding. By itself, funding for the Department of Transportation makes up approximately 13% of the total funds budget.

[2] Legislative Fiscal Division, Legislative Budget Analysis 2011 Biennium, Vol. 6, p. D-138, January 2009.

How Does Montana's Spending Compare to Other States?

Our budget reflects our collective decisions about how much to invest in the public services and structures that promote our security, prosperity, and opportunities. However, because Montana has a relatively low average personal income and a relatively low "gross domestic product," we invest more than most other states as a percent of both of those measures. In other words, because our economy is smaller than most other states, we must invest a greater percentage of our economy in order to achieve a lower level of investment per person.

The category of state and local government "own source" spending excludes our spending of federal funds. We rank 32nd among other states in this category of spending. In other words, we are collectively investing less per person in all of the common goods, services, and infrastructure we need to create and maintain safe, healthy, and prosperous communities.

Table 1: Montana State Spending Compared to Other States, 2006

	U.S. Average	Montana	Montana Rank
Total state and local government spending per capita	$8,393	$7337	34
Total state and local government spending as a share of gross domestic product	19.11%	21.71%	10
Total state and local government spending as a percent of personal income	22.96%	23.83%	19
State and local Government "own-source" spending per capita	$6957	$6188	32
Federal government spending per capita	$1248	$1612	14
Federal government spending as a percent of personal income	3.51%	5.41%	12
Source: U.S. Census Bureau State and Local Government Finance and Bureau of Economic Analysis			

What Do the Different Measures of State Spending Tell Us?

Spending per capita- Spending per capita is simply a reflection of how much we invest per person. This measure captures increased or decreased capacity to spend based on population shifts.

Spending as a share of gross domestic product- Gross domestic product is a measure of the state's total economy. Spending as a share of gross domestic product captures growth or contraction of the state economy and our corresponding overall capacity to invest in common goods.

Spending as a share of personal income- Personal income measures all earnings received by individuals. Spending as a share of personal income captures individual Montanan's ability to contribute to our common investments.

Montana Spends Less than the National Average in Almost all Categories of Spending.
Table 2 (below) and Chart 7 (on the following page) show how Montana spending compares to national averages by category of spending. Please note that Montana total spending, as represented on this table and chart, includes the state's spending of non-state funds, such as federal funds received by the state. As such, this chart does not necessary reflect our collective Montana investments in those categories. Furthermore, Montana receives more federal funding per capita than all but 13 other states. Because federal funding is included in the following figures and rankings, we can conclude that Montana "own source" spending on our collective investments would be even further below comparable national averages. For example, Montana's total spending is higher than the national average for higher education. However, Montana ranks only 42nd among the states on the appropriation of state tax funds for operating expenses of higher education per capita and 32nd as a percent of personal income.3

"In Montana, we spend less than all but two other states per person on public health and welfare."

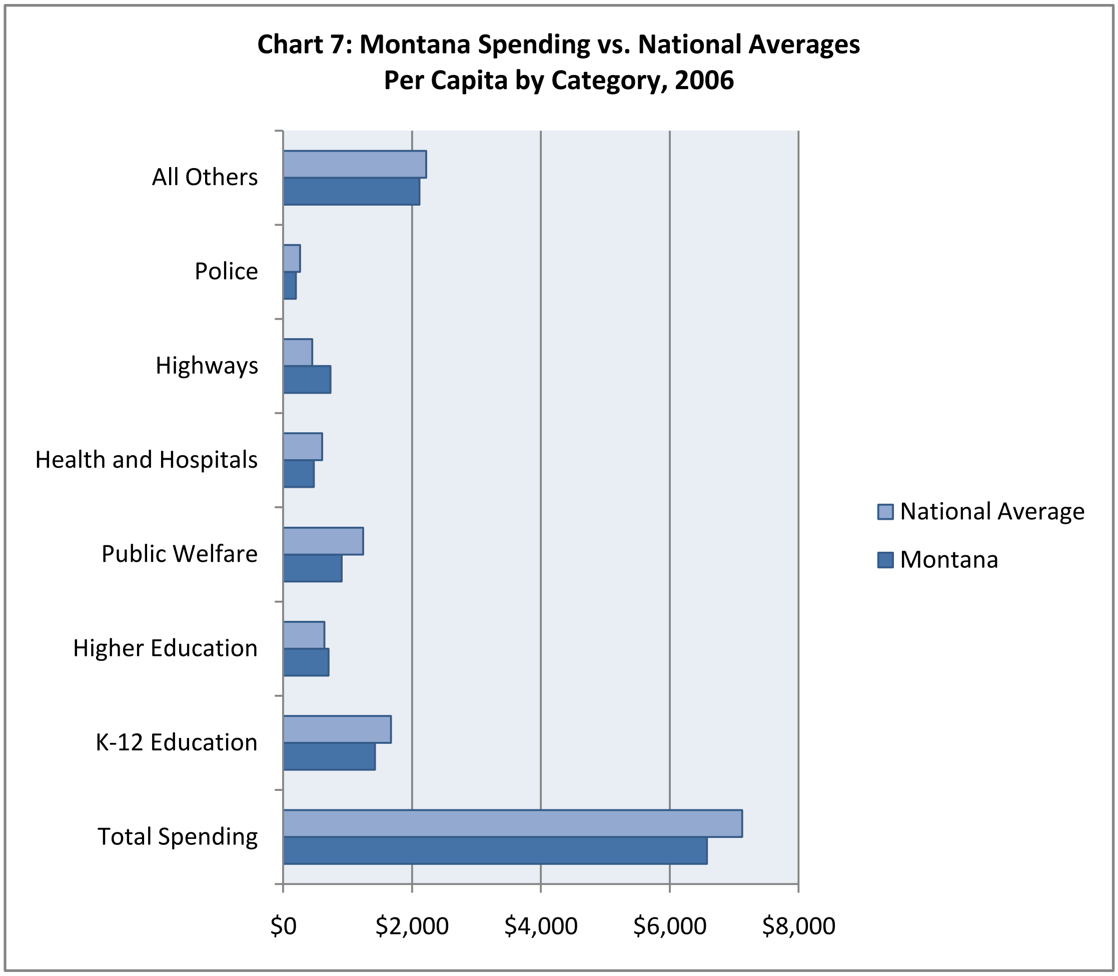
Even including federal and other non-state funding sources, state and local spending per person in Montana is less than the national average in all categories of spending except for highways and higher education. In Montana, we spend less than all but two other states per person on public health and welfare and less than all but eleven other states on K-12 education.

Table 2: Montana Spending vs. National Averages 2006

	Montana Per Capita State & Local Spending	Nation Average	Montana Ranking
Total Spending	6,578	7,124	33
K-12 Education	1,427	1,675	39
Higher Education	707	642	21
Public Welfare (including Medicaid)	909	1,240	48
Health and Hospitals	478	608	30
Highways	736	453	5
Police	201	265	36
All Others	2,118	2,220	23

Source: State & Local Government Finance Data Query System. http://www.taxpolicycenter.org/tpc/pages.cfm. The Urban Institute-Brookings Institution Tax Policy Center. Data from U.S. Census Bureau, Annual Survey of State and Local Government Finances, Government Finances, Volume 4, and Census of Governments (Years). Date of Access: (25-Jul-08 1:52 PM).

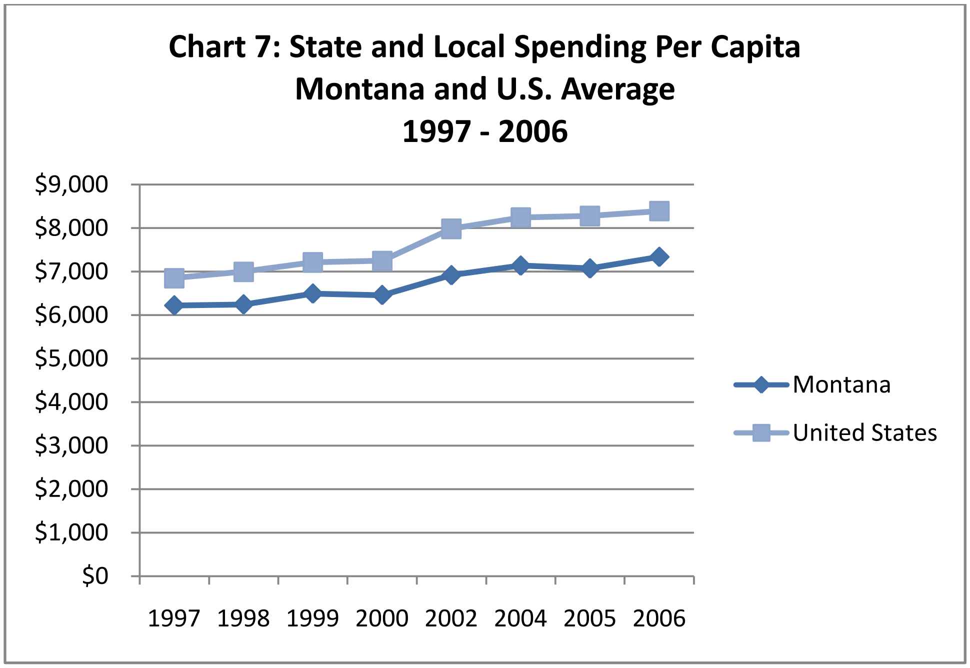
[3] Grapevine at http://www.grapevine.ilstu.edu/tables/pdf/Table5_08.pdf.

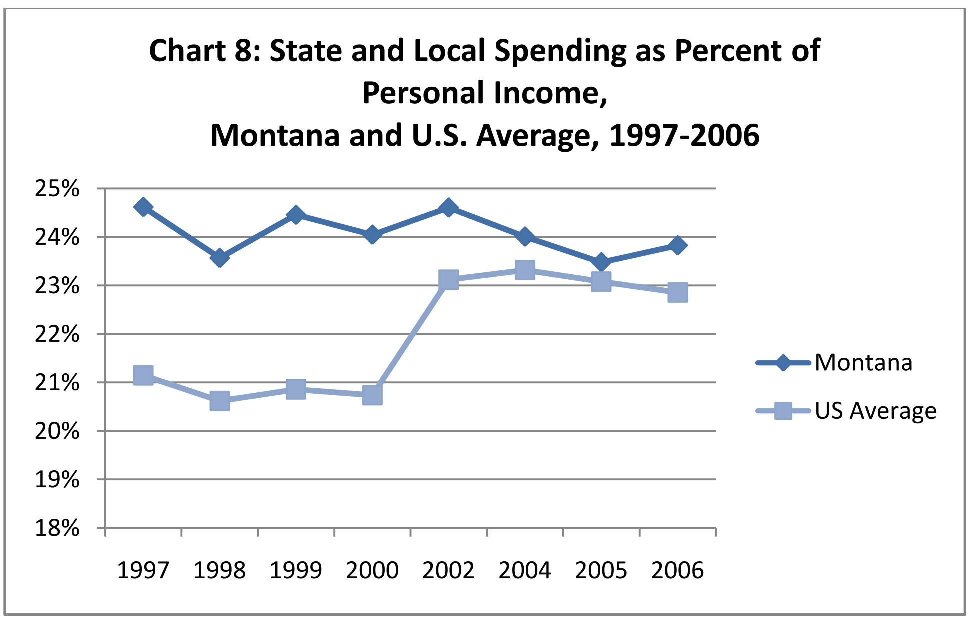


Source: State & Local Government Finance Data Query System. http://www.taxpolicycenter.org/tpc/pages.cfm. The Urban Institute-Brookings Institution Tax Policy Center. Data from U.S. Census Bureau, Annual Survey of State and Local Government Finances, Government Finances, Volume 4, and Census of Governments [hereinafter State & Local Government Finance Data Query System] (2006). Date of Access 25-Jul-08 1:52 PM.

Have Our Spending Priorities Changed Over Time?

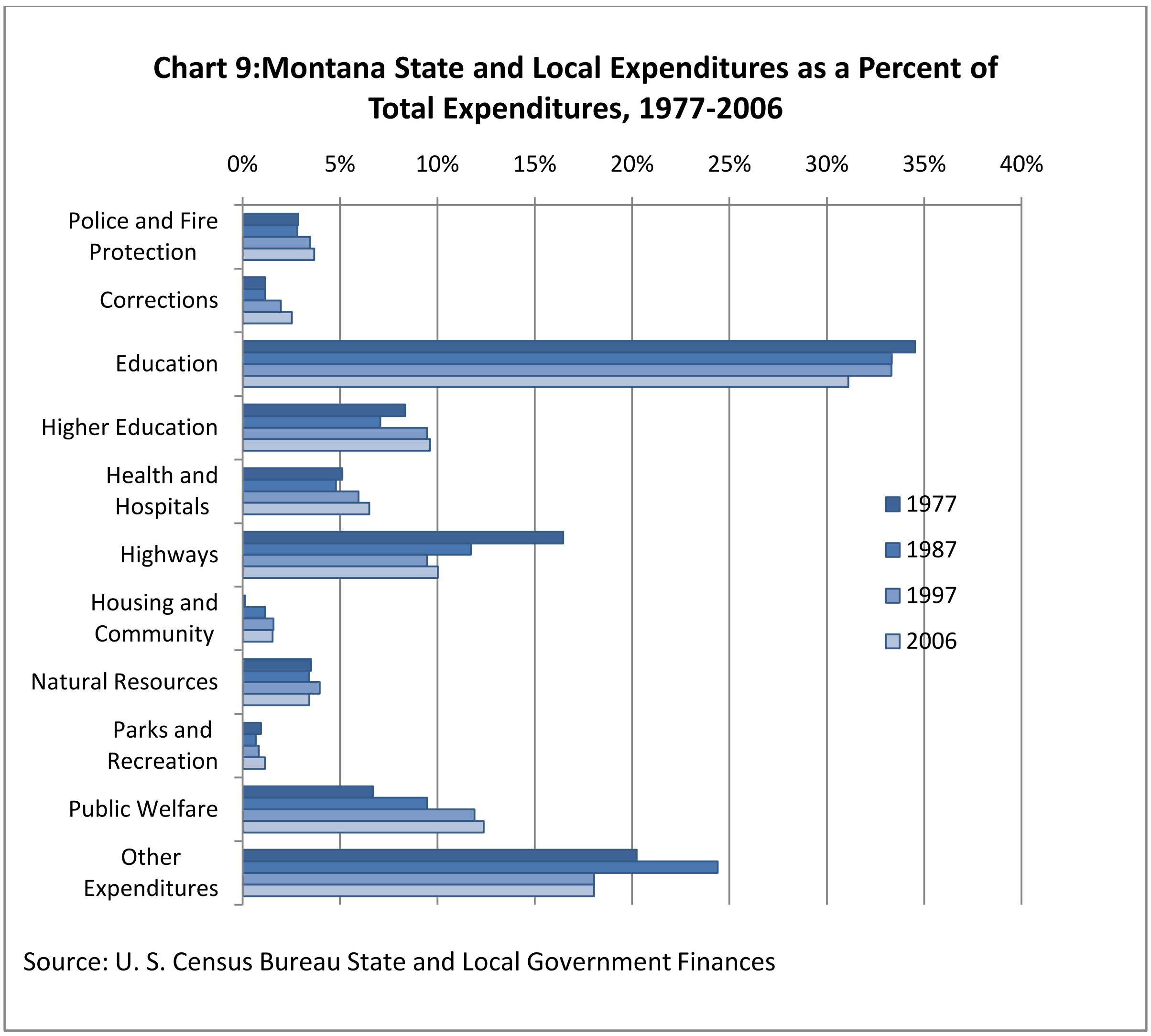
Total state and local spending in Montana has increased by 18% per capita from 1997 to 2006, roughly following the U.S. trend in increased **spending** per capita. However, state and local spending as a percent of personal income has decreased slightly over the same time period.





Source: State & Local Government Finance Data Query System (1997-2996). Date of Access 1 Dec. 08.

Chart 9 shows how our spending priorities have changed from 1977 to 2006. Most spending categories have maintained roughly the same share of the total Montana budget. However, both K-12 education and highway spending have decreased as a share of total spending. Public welfare, which includes spending on Medicaid, has increased as a share of total government spending. Relative growth in the public welfare category can be explained in large part by the skyrocketing costs of health care. Other changes in the relative share of spending are largely attributable to changing trends in the populations served. For instance, from 1987 to 2006, the statewide K-12 enrollment declined by over 11%, from 162,164 to 143,282,[4] even as Montana's total population increased. In contrast, from FY 1998 to FY 2008, enrollment in public colleges and universities increased by over 6% (from 33,430 to 35,556).[5]



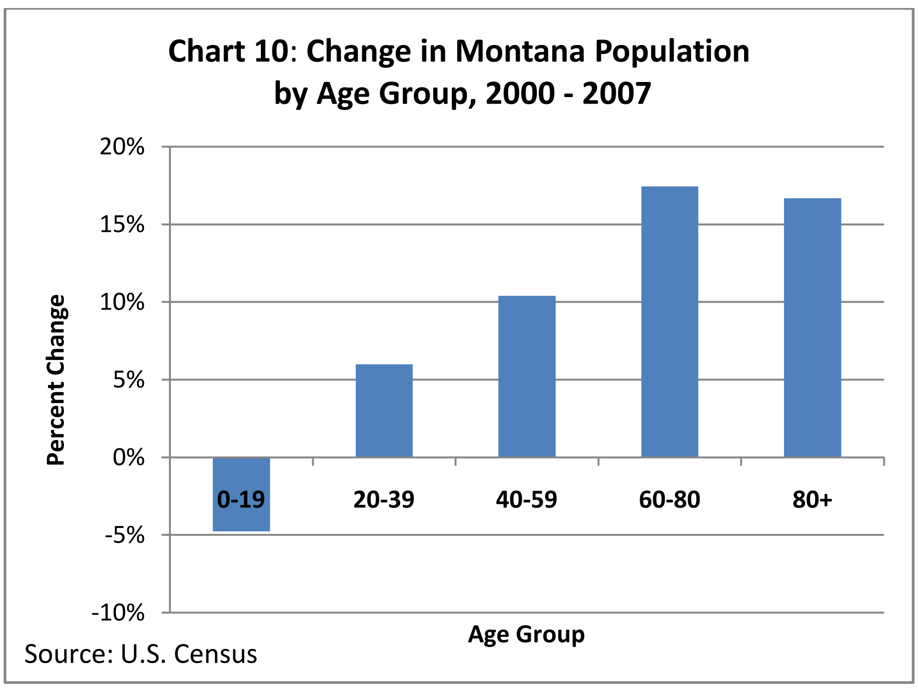
[4] Montana Office of Public Instruction at http://www.opi.mt.gov/.
[5] Montana University System Official Enrollment Record, Summary FTE Report (FY97-FY08).

Why Does State Spending Tend to Grow Over Time?

Montana, like every other state, must spend more over time simply to provide the same level of services, public infrastructure, and protection for Montana families and businesses. In other words, we must collectively invest more than our parents in order to provide the same level of education, transportation infrastructure, police and fire protection, clean air and water, and public health programs. Even without identifying new priorities for collective investment, state spending will increase because of population growth, fluctuations in populations eligible for particular government programs, inflation, and other factors such as court rulings and federal mandates.

Population Growth and Changes

From 1990 to 2006, Montana's population increased by over 18%, from 799,065 to 944,632.[6] As a result, we need to build more schools, roads, and other infrastructure to support our larger numbers. Montana's population isn't just growing; it is also changing. Perhaps the most dramatic demographic shift occurring in Montana is the rapid increase in the number and proportion of Montana residents age 60 and older. Although the general population in Montana only increased by 6.2% from 2000 to 2007, the population age 60 and older increased by 17.3% (Chart 10). One recent report estimates that the number of Montanans over 65 will double by 2030.[7]



[6] U.S. Census Bureau.
[7] Project 2030.

As "baby boomers" in the state continue to age, this trend is likely to become more exaggerated, and demand for government programs serving senior citizens is likely to increase dramatically. Even if eligibility requirements stay the same, the state will need to spend more money to provide these important benefits to aging Montanans.

Inflation

Another reason that state spending tends to increase over time is that the cost of providing goods and services increases over time. Just as families must pay more for a loaf of bread and gallon of milk than they did 10 years ago, we must pay more for highway and school construction costs and state employee salaries than we did 10 years ago. In addition, some critical areas of state spending experience higher rates of inflation than the general economy. For example, health care costs are growing much more rapidly than most other types of goods and services. Therefore, over time we must spend more money just to cover *the same number* of Montana children and families in programs such as the Children's Health Insurance Program (CHIP) and Medicaid.

Federal Requirements

Federal requirements can also increase state costs. In 2007, the state of Montana and local governments within Montana received over $1.8 billion in federal funds to help cover costs for programs ranging from highway construction to Medicaid, Medicare, and the Children's Health Insurance Program.[8] However, sometimes our federal government imposes requirements on the states which do not come with the funding needed to meet those requirements. The Center for Budget and Policy Priorities estimates that between 2002 and 2005, the federal government imposed $80 billion on the states for unfunded mandates, such as Homeland Security and No Child Left Behind.[9]

Policy Choices and Priorities

State spending may also increase when we make collective decisions to invest more in certain public goods. For instance, in November 2008, over 70% of Montana voters passed Ballot Initiative 155, expanding health care to eligible Montana children. This collective investment in

The Rising Cost of Health Care and the Impact on the State Budget

Healthcare expenditures have outpaced economic growth over the past several decades. In 1965, health expenditures accounted for 7.2% of Gross Domestic Product (GDP). In 2008, health expenditures will account for 16.6% of GDP, and by 2017 they are expected to account for 19.5% (Centers for Medicare & Medicaid Services, Office of the Actuary).

"Projected increases in Medicaid costs reflect the steady rise in health care costs that affect private insurance, Medicare, and Medicaid alike. This rise in costs throughout the U.S. health care system is driven in substantial part by advances in medical technology that improve health and prolong life, but increase health care costs" (Center on Budget and Policy Priorities).

While the rising costs of healthcare have impacted almost everyone in Montana, the state of Montana is particularly affected. In addition to matching federal funds for the costs of the Children's Health Insurance Program and Medicaid, the state purchases health care for state employees, foster children, prison inmates, higher and public education employees and others.

[8] U.S. Census Bureau, *Federal Aid to States for Fiscal Year 2007*, September 2008.
[9] Iris Lav, *Federal Policies Contribute to the Severity of the State Fiscal Crisis*, Center on Budget and Policy Priorities, December 3, 2003.

our children's health will require either an increase in our overall spending or a shifting of priorities from another category of spending.

A Special Note about Sustaining Spending During Recessions
State spending is particularly important during economic downturns because of the state's important role in helping to protect the most vulnerable Montanans and because state spending can be a critical force in bolstering the economy. Demand for government services often increase during economic downturns. As incomes decrease and unemployment rises, more of our neighbors must rely on government supports such as Unemployment Insurance, Temporary Assistance to Needy Families (TANF), the Children's Health Insurance Program, and Medicaid. In addition, one of the basic tenets of economic policy is that money circulating through the economy – buying goods, paying salaries, generating jobs – is needed to move out of a recession. This is true whether the money is from a big corporation, a small mom-and-pop operation or state and local governments. Governments pay salaries, buy goods and services, and generate jobs, which can be particularly important during a recession, when individuals and businesses are necessarily spending and investing less in the economy.

Are There Any Limits on State Spending?

Unlike the federal government, the state of Montana- and almost every other state in the country- can not engage in deficit spending. The Montana Constitution provides that "[a]ppropriations by the legislature shall not exceed anticipated revenue." Therefore, our spending is necessarily restricted by the amount of money we bring in through taxes, fees, federal matches and grants, and other revenue sources.

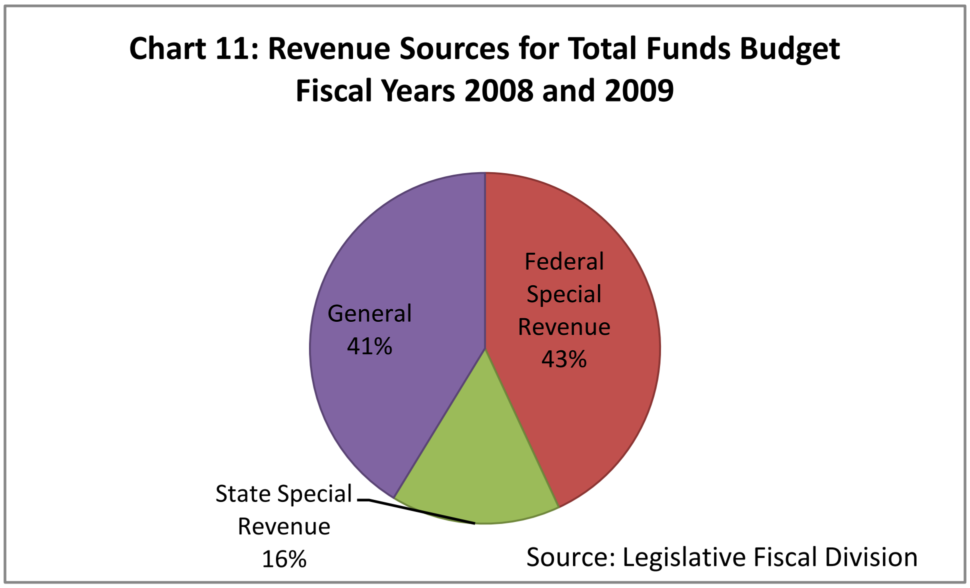
Montana is one of only five states in the country that does not have a "rainy day fund," sometimes referred to as an economic stabilization fund. Rainy day funds are reserves that states build during good times in order to sustain spending during economic downturns.

Revenue: How Does Montana Fund Its Priorities?

In order to invest in our public structures, the state collects revenue from residents and businesses in the form of taxes and fees. The state also receives money from the federal government to assist in providing certain government services.

Where Does Montana Get Its Money?

Montana's greatest single source of revenue is from the federal government. In broad categories, the next largest source of revenue is from the general fund, and a much smaller share of total revenue comes from state special revenue accounts.



Federal Funds

In fiscal years 2008 and 2009, an estimated $3.4 billion, or 41%, of total state spending came from funding by the federal government. The federal government provides money to states to help pay for specific programs. Often, the state is required to pay a portion of the program costs by matching the federal dollars with state dollars. For example, in fiscal year 2006, the state's federal Medicaid match rate was 71%, meaning that for each dollar of Medicaid spending in Montana, 29 cents were paid by the state and 71 cents were paid by the federal government.[10]

[10] Georgetown University Health Policy Institute Center for Children and Families, FY2006 Medicaid Spending by State at http://ccf.georgetown.edu/index/cms-filesystem-action?file=statistics/medicaid%20spending.pdf, accessed on Dec. 15, 2008.

State Special Revenue

In fiscal years 2008 and 2009, an estimated $1.2 billion, or 16%, of total state spending came from state special revenue accounts. State special revenue accounts are funded by specific taxes and/or fees that must be used for specific and restricted purposes. Montana has hundreds of state special revenue accounts. For example, Montana has a table wine tax. Thirty-one percent of the proceeds from that tax are deposited into a state special revenue account to fund Department of Public Health and Human Services programs for treating and preventing alcoholism. Another example of state special revenue is Montana's constitutionally based restriction that state taxes on motor fuels must be used on expenses related to highway and road construction, repair, and other related activities.

General Fund

The General Fund, discussed in much more detail below, is largely funded through taxes of Montana individuals and businesses.

What Makes a Tax System Good?

There are a number of factors we can use to evaluate a particular tax or an entire tax system. While opinions on what qualifies as a good tax system differ widely, there is general agreement that some of the most important factors include adequacy, fairness, and stability.[11]

Adequacy

A tax system is considered adequate if it collects enough revenue to pay for the public structures we want our government to provide. One threat to the adequacy of a tax system is a **structural deficit**. In states with a structural deficit, revenues do not grow at the same rate as the costs of providing government services. As noted earlier, providing services and building infrastructure tends to become more expensive each year as the costs of goods and labor increase. If revenues do not keep up with these increased costs, the state must either raise taxes or cut services.

Key Terms

Structural Deficit- A situation in which our tax structure is not designed to collect enough revenue to pay for public goods and services as costs increase.

Progressive- A tax system is progressive if persons with higher incomes pay a greater percentage of their incomes than those with lower incomes.

Proportional or Flat- A tax system is proportional, or flat, if all persons, regardless of income, pay the same percentage of their income in taxes.

Regressive- A tax system is regressive if persons with lower incomes pay a higher percentage of their incomes in taxes than those with higher incomes. Sales taxes are typically regressive because families with lower incomes tend to spend a larger portion of their income buying items that are taxed.

Fairness

Most people agree that a tax system should be "fair." However, there are widely varying viewpoints on what constitutes fairness. One principle for evaluating fairness is that those in similar financial situations should be treated the same, and that a tax system should not make arbitrary distinctions between taxpayers or distinctions based on irrelevant criteria.

Another principle for evaluating the fairness of a tax system is the "ability to pay principle." This principle suggests that persons with higher incomes, or greater ability to pay, should pay more in taxes than those with lower incomes. Based on this principle, taxes can be categorized into three types: **progressive**, **proportional**, and **regressive** (see side bar for definitions). While there is general agreement that that there should be some connection between ability to pay and level of taxation, there are different opinions on whether a fair tax asks everyone to pay the same percentage of their income in taxes (proportional) or whether higher income people, who have more disposable income, should be asked to pay a higher share of their income in taxes (progressive).

A third principle for evaluating fairness is the "benefit principle." The benefit principle maintains that persons who benefit more from public structures should pay more for those public structures. An example of the benefit principle in our Montana tax system is the motor fuel tax which is used for

[11] Institute on Taxation and Economic Policy, *Guide to Fair State and Local Taxes*, February 2005; Tax Foundation, *Ten Principles of Sound Tax Policy*; and the National Conference on State Legislators, *Principles of a High-Quality State Revenue System,* Fourth edition, June 2001.

repairing and constructing new roads and highways. The benefit principle can sometimes confuse tax debates. Most general taxes fund programs and services that society thinks should be provided for everyone: police and fire protection, clean air and water, education, roads and bridges, a safety net, and other public institutions. Our whole society is stronger when we have good schools, safe neighborhoods, clean air, and well-maintained roads. Few would argue that these public structures should only be financed by those who directly use them.

Stability

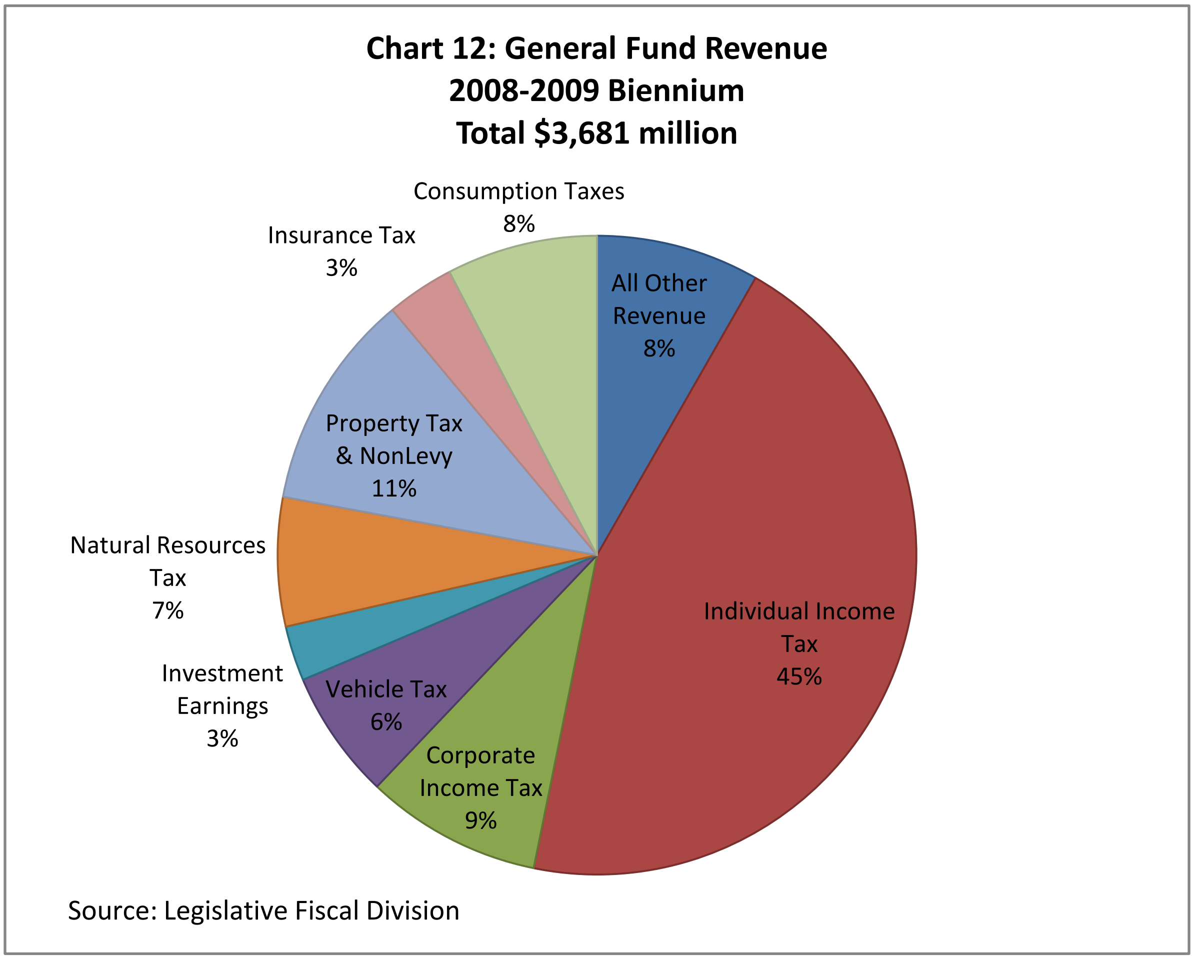
A stable tax system provides a steady revenue stream as the economy rises and falls. A tax system that is sensitive to economic downturns results in less tax revenue when government services are often needed most. Over time, a tax system's stability can be enhanced by the ability to generate revenues from a diverse array of taxes and fees, so that market forces effecting changes or volatility in a particular area have only a proportionate impact on overall revenues.

The various principles for evaluating a tax system will often point in different directions. For example, gas taxes that fund highway repairs and construction assign more cost to those who drive the most, generally adhering to the benefit principle. However, lower income people often spend a greater share of their income on transportation than higher income people, colliding with the principle that people should pay taxes in relation to their ability to pay. Because tax principles can often be contradictory, they should not be used to provide formulaic answers to questions about how a tax system should be structured but rather as tools to guide democratic discourse and decision-making.

What State Taxes Support the General Fund and Who Pays Them?

The general fund is the repository for most of our general taxes in Montana. Our taxes are the way that we combine resources, through government, to get things done that we can't do as individuals: educate our children, build and maintain transportation infrastructure, provide police and fire protection, keep our air and water clean, promote public health, and maintain a social safety net. In a democracy people are ultimately responsible for deciding how much of their resources to commit to paying for these public goods and how to share those costs.

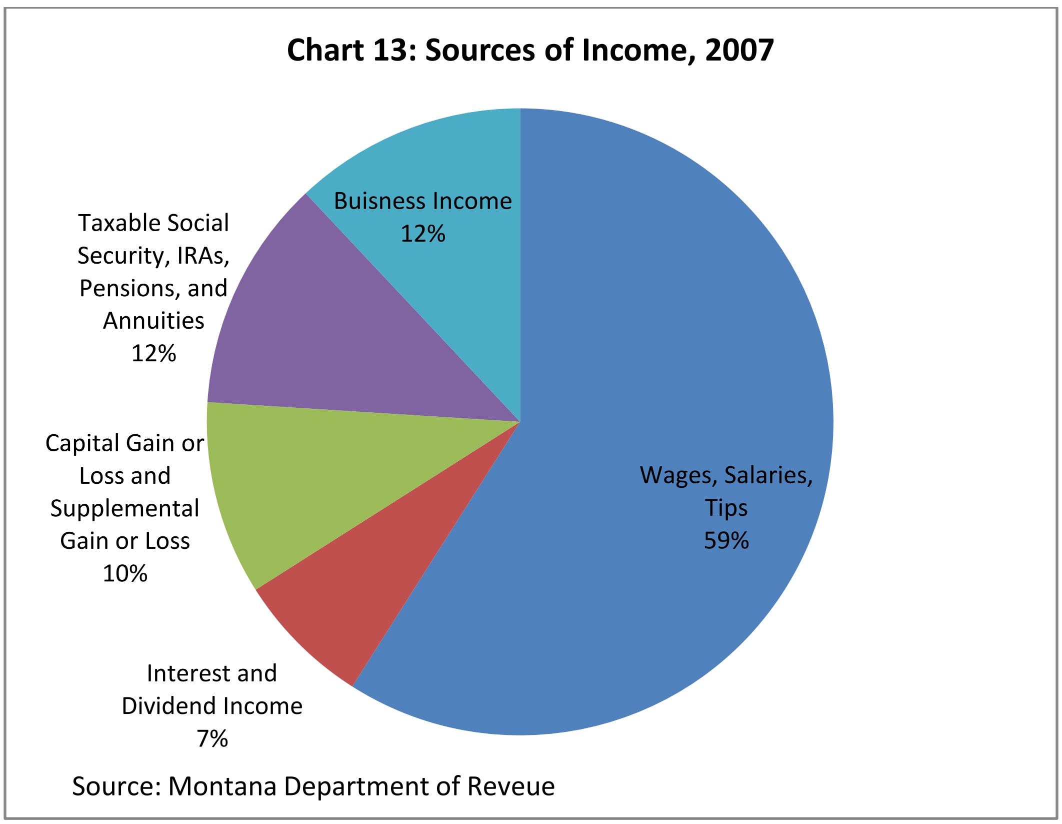
Individual income tax is the single largest source of general fund revenue. Montana collects 45% of its general fund revenue from individual income taxes. Property taxes make up the next largest share of general revenue (11%), followed by corporate income tax (9%) (Chart 12).



When we look at who is asked to share the costs of our public investments, we typically look at how our current taxes and overall tax system affect different groups of people within the state. That analysis will dominate this section. In this discussion, we can not forget that *what* we choose to tax (our tax base) and at what rate we choose to tax different parts of that base also have bearing on the question of "who pays Montana taxes?" For example, under our current tax system individuals pay a much larger share of total taxes than corporations. Another example is that we have collectively chosen *not* to have a general sales tax in Montana, which, if instituted, would result in a greater burden on low-income individuals and families as a share of their income.

Income Tax

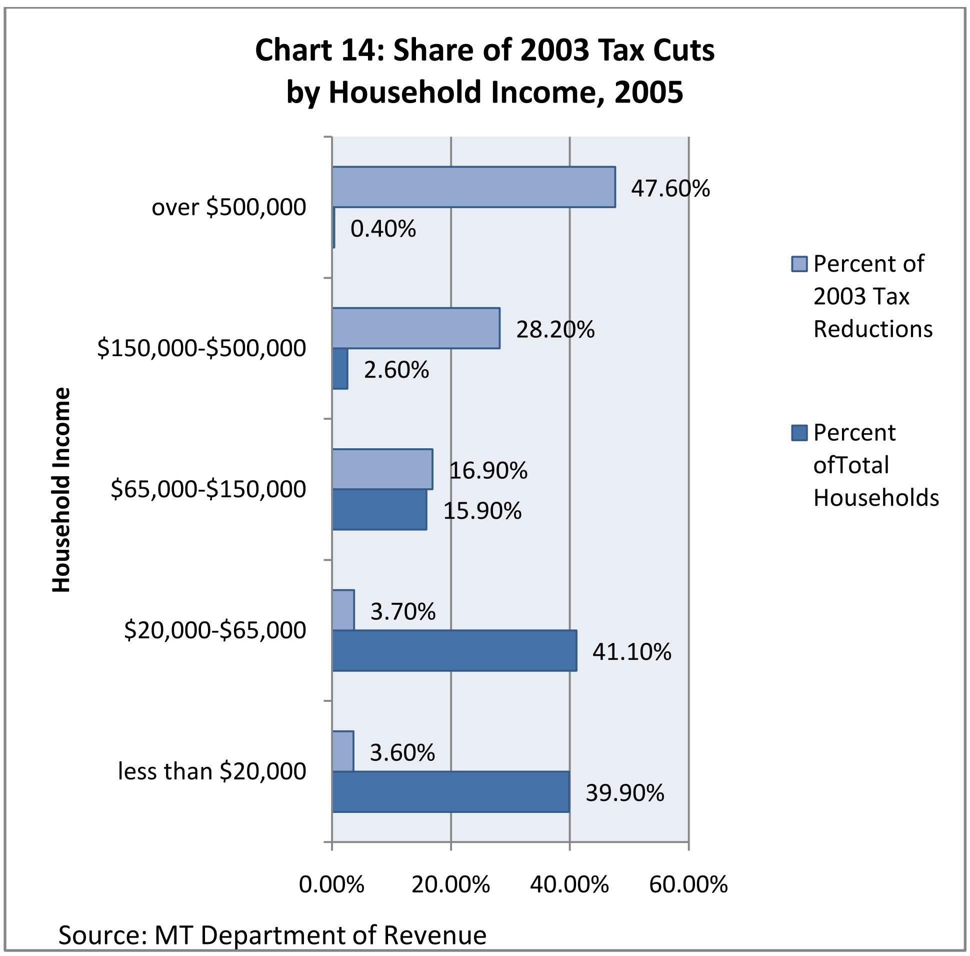
In Montana, the taxes we pay on our individual incomes make up the biggest source of state tax revenue. Our income tax includes both taxes on individual income and business income. However, taxes on business income made up just 13% of total income taxes paid in 2005. By comparison, taxes on wages, salaries, and tips made up 62% of all income taxes paid (Chart 13).



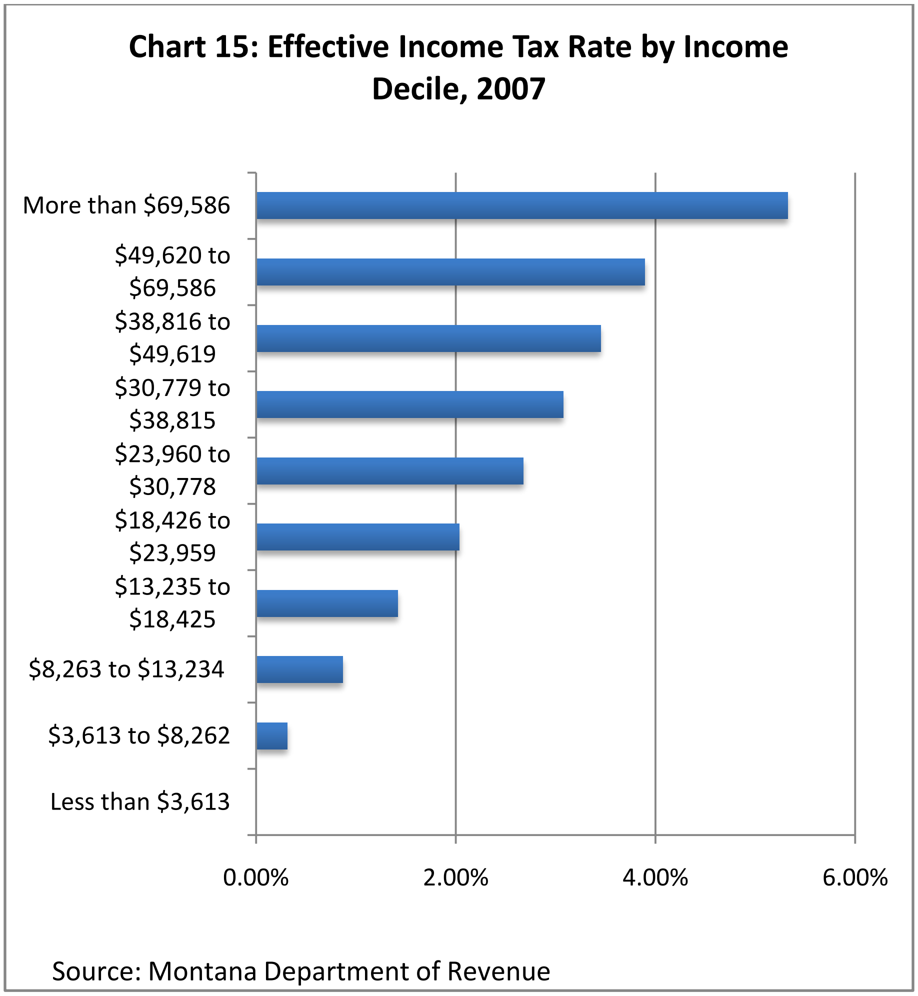
2003 Changes to the Montana Income Tax

In 2003, the Montana legislature made significant changes to our income tax system. Under previous law, Montana had ten different income brackets, with each higher income bracket paying a slightly larger share of their income in taxes. The lowest income bracket paid 2% of income and the highest bracket (applying to incomes over $80,300) paid 11% of income. Under the 2003 law, the number of income brackets was reduced to 6, and all households making over $13,900 pay the same rate- 6.9% of their income- in income taxes.

In 2006, the Montana Department of Revenue reported that the 2003 changes to Montana's income tax both cost the state more in revenue than had been anticipated and that the majority of the benefits of the changes went to Montanans with the highest incomes. The Department found that households earning over $500,000 per year received an average tax cut of over $30,000 per year as a result of the 2003 changes, resulting in just .5% of Montana households receiving almost 48% of the total cut. On the other hand, households earning less than $65,000 per year received average tax cuts of $23 per year, meaning that over 80% of Montana households received only 7.2% of the total tax cuts (Chart 14).



Even with the 2003 changes, Montana's income tax system is slightly progressive after taking into account exemptions and deductions, with the 10% of Montana households making the highest incomes paying an effective tax rate of 5.38%, and the 10% of Montana households with the lowest incomes paying an effective tax rate of 0%. (Note: Effective tax rates are lower than statutory rates because they are calculated after credits, exemptions, and deductions have been included.)



A Note about Montana's Income Tax Threshold

In Montana, our income tax system has the effect of making many low-income working families even more strapped for the income they need to meet their basic human needs. By all measures, our income tax is one of the worst in the country in terms of the burden it places on low-income households. Montana begins taxing a single worker with two children at a lower annual income than any other state in the country; we begin taxing such a family when their income reaches $9,600 per year, which is $6,930 *below* the federal poverty line. For a two-parent family with two children, we begin taxing at a lower income than all other states except West Virginia.

Key Term

Income Tax Threshold- The income tax threshold is the amount of family income at which a household first begins to owe taxes.

We also tax the income of workers living in poverty at a higher *rate* than most other states. We are one of only nine other states that tax four person families living at the poverty line an average of $200 or more. Most states do not impose income taxes on families living below the federal poverty line. In fact, twenty-four states have enacted state earned-income tax credits to *supplement* the income of working families who fall below the poverty line despite their work.[12]

Corporate Income Tax

Corporations that operate in Montana (own property, pay staff, or sell products) are required to pay a tax as a percentage of their net income earned in Montana. In 2005, Montana collected $98 million in total corporate taxes, making up less than 9% of total taxes collected by the Department of Revenue. Of the 17,325 corporations that filed corporate tax returns in 2006, 9,496 paid only the minimum payment of $50.

[12] Jason A. Levitis and Andrew C. Nicholas, *The Impact of State Income Taxes on Low-Income Families in 2007,* Center for Budget and Policy Priorities, October 2008.

A Note on the Relationship between Corporate Income Taxes and Where Corporations Choose to Locate

Economic studies have repeatedly found that corporate tax breaks have limited impact on economic development in a state but, rather, can seriously undermine the ability of a state to attract businesses and support families. In March of 2004, the Economic Policy Institute issued *Rethinking Growth Strategies: How State and Local Taxes and Services Affect Economic Development*. The report reviewed hundreds of studies on the topic and concluded that the quality of public services is more important than low taxes in influencing businesses' location decisions.[13]

Analysis from the Center for Budget and Policy Priorities finds that the six states that cut taxes most deeply between the mid 1990s and 2001 experienced job loss almost four times worse than the 44 states which did not cut taxes as deeply. Overall, states that cut taxes the most endured the worst economic and fiscal outcomes during the 2001-2003 recession: they suffered bigger budget deficits, lower reserves, deeper spending cuts, higher tax increases and more bond downgrades. [14]

> *"The real lesson here for legislators and local policy-makers is that what makes a community a good place to do business looks a lot like what makes a community a good place to live. That means good schools, good police and fire protection, a modern and well-maintained transportation infrastructure, and good all-around public services. Instead of creating jobs, tax cutting strategies that undermine government's ability to provide quality services can end up destroying jobs."*
>
> *-Dr. Robert G. Lynch,* Rethinking Growth Strategies

[13] Robert G. Lynch, *Rethinking Growth Strategies, How State and Local Taxes and Services Affect Economic Development, Economic Policy Institute,* 2004.

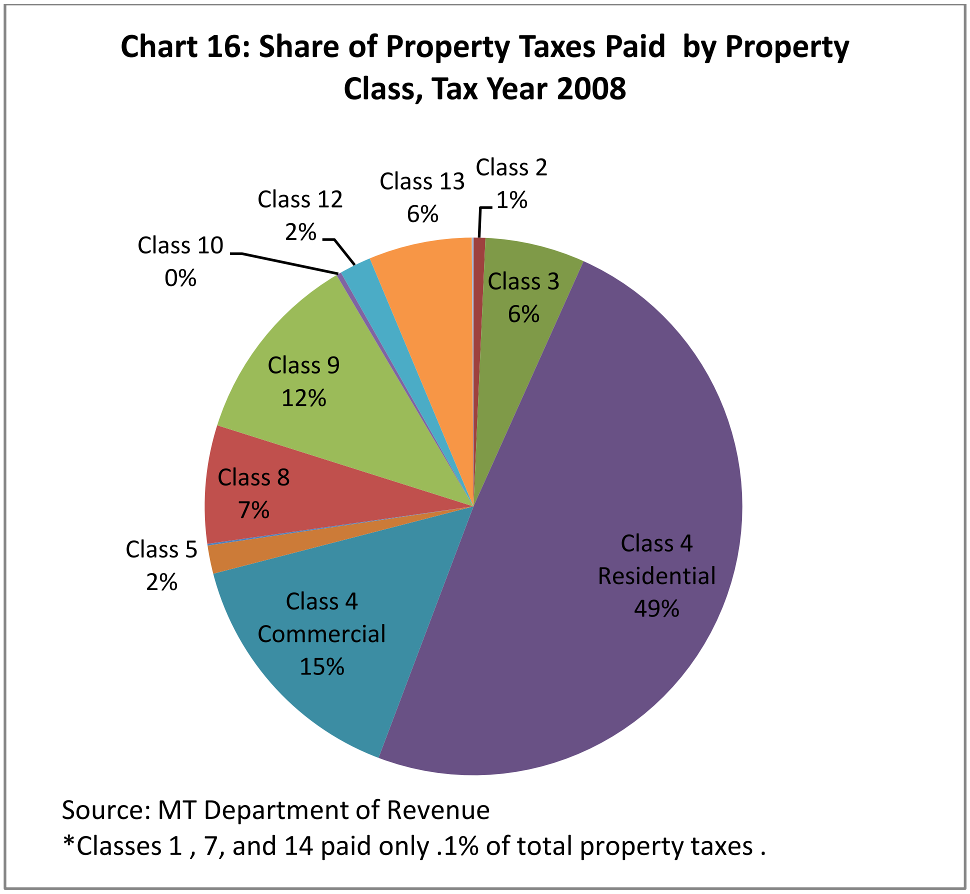
[14] Robert Zahradnik, *Tax Cuts and Consequences: The States That Cut Taxes the Most During the 1990s Have Suffered Lately,* Center on Budget and Policy Priorities, **[look up date**].

Property Tax

Montana has a very complicated property tax system. We have 12 different "classes" of property. (Note: Classes 6 and 11 have been repealed.) The focus of this section will be primarily on property taxes levied against residential and commercial property, which made up over 64% of all property taxes paid in 2008.

Property Class	Description	Percent Share of Total Property Tax Rev., Tax Year 2008
1	Net proceeds of mines and mining claims except coal and metal	.01%
2	Gross proceeds of metal mines	0.7%
3	Agricultural land Non-productive patented mining claims Non-qualified agricultural land	6.0%
4	Residential, commercial, industrial lands and improvements, incl. improvements on agricultural lands One acre homesteads on agricultural, forest, and non-qualified land Mobile/manufactured homes Golf courses	64.2%
5	Air and water pollution control equipment Independent and rural electric telephone cooperatives Real and personal property of "new industries" Machinery and equipment used in electrolytic reduction facilities Real and personal property of research and development firms Real and personal property used in the production of gasohol	1.7%
7	Non-centrally assessed utilities	.1%
8	Business equipment (a business with less than $20,000 in equipment is exempt)	7.1%
9	All property of pipelines and the non-electric generating property of electric utilities	11.6%
10	Forestland	.3%
12	All property of railroads and airlines	1.9%
13	All property of telecommunication utilities and the electric generating property of electric utilities	6.2%
14	Commercial wind generation facilities	0.1%

Source: Montana Department of Revenue.



<u>How Does the Montana Property Tax System Work?</u>

All property is appraised, or valued, centrally in Montana by the Department of Revenue. The Department of Revenue is required to re-appraise the property every three years to ensure that the values reflect the current market conditions. The Department is in the final stages of completing the most current reappraisal effort to be applied to 2009 property taxes.

The appraisal determines the **market value** for each piece of taxable property in the state. A tax rate, set by the legislature for each class of property, is then applied to the market value to determine the **taxable value** of the property. For example, the statutory tax rate for residential property in 2008 was 3.01%. Therefore, in 2008 a home with a market value of $100,000 would have a taxable value of $3,010 ($100,000(market value) x .0301(tax rate)= $3,010).

Key Terms

Market Value- The value of piece of property as appraised by the Montana Department of Revenue.

Taxable Value- Each class of property has a statutory tax rate which is applied to the market value of a piece of property to determine the taxable value of the property.

Assessed Value- When the legislature decides to allow new market values to be phased in over time, the reduced values of property during the phase-in are called assessed values.

Mill levy- is a tax rate applied to the taxable value of a property, per thousand dollars of value. A 40 mill levy is applied to the taxable value at a rate of 40/1000, or 4%.

State and local **mill levies** are then applied to the taxable value of the property to determine the amount of property taxes paid. A mill levy is a tax rate per thousand dollars of taxable value of property. For example, the 6 mill levy that helps pay the cost of our university operations is applied to the taxable value of property at a rate of 6/1000, .006, or.6%. In total, the state imposes five different mill levies totaling 101 mills.[15] Using the example of the $100,000 residence above, with a taxable value of $3,010, the state property taxes owed on the property would be $304.01 ($3,010 (taxable value) x 101/1000 (mill/1000)= $304.01). In addition to the state mills, local cities and counties can and do apply mill levies to the property within their jurisdiction to help fund local government functions, from schools to police and fire protection. Of the property taxes levied by the state, over 90% are deposited in the general fund. Revenue from the 6 mill university levy is deposited into a state special revenue account for university operating expenses.

Do Higher Appraised Market Values Always Lead to Higher Property taxes?

Typically, when property is reappraised in Montana our legislature passes laws to mitigate the effect of the higher property values on taxpayers. For example, after the last reappraisal, the 2003 Legislature passed a law that allowed for the phasing in of the higher property values over a six year period for property classes 3, 4, and 10 and reduced the tax rates for classes 3 and 4 in each of the six years (from 3.3% in 2004 to 3.01% in 2008). Although mitigation efforts can help homeowners and businesses with stagnant incomes but rising property values, they also apply to high-income owners who could afford to pay increased property taxes on their increased property values. Across the board mitigation efforts also our ability to increase revenues- and thus services and infrastructure- as property values increase.

Have property taxes changed over time?

Over time, Montana homeowners (Class 4 Residential) have seen an increase in the share of property taxes they pay compared to other classes of property, including commercial property (Class 4 Commercial) and business equipment (Class 8) (Chart 17).

Property Tax Relief Programs

Montana's Elderly Homeowner/Renters Credit- This tax credit is available to homeowners and renters in Montana who are age 62 or older and have less than $45,000 in gross household income. Elders who qualify for the credit are eligible to receive up to $1000 in a refundable credit for a portion of the property tax (or "rent equivalency") paid. The credit is applied to income tax liability but does not require the filing of an income tax return.

Property Tax Assistance Program (PTAP)- PTAP reduces the tax rate applied to residential property owned by low-income homeowners by up to 80%. The income limit for the PTAP was $17,670 for an individual in 2006 and is adjusted each year for inflation. **To receive the PTAP reduction, eligible homeowners must apply to the Department of Revenue by March 15 of each year.** Only 9,151 low-income homeowners took advantage of PTAP in 2006.

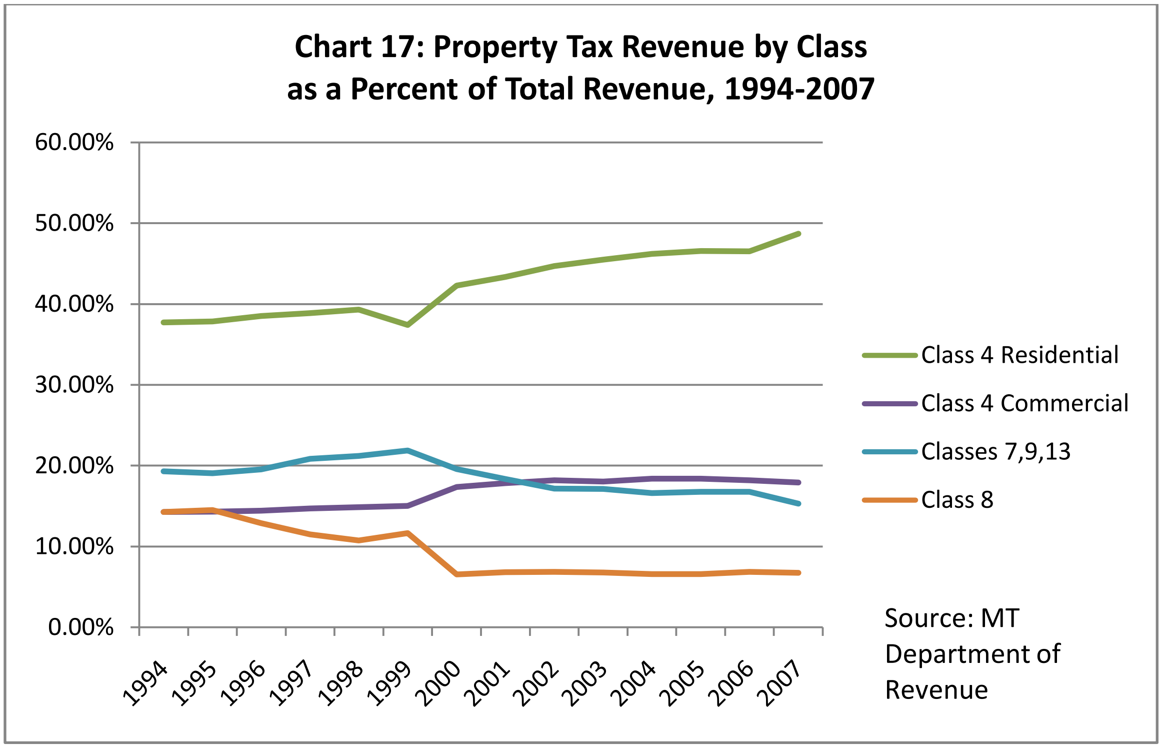
Extended Property Tax Assistance Program(EPTAP)- EPTAP applies to homeowners earning less than $75,000 in household income, whose taxable value increased by more than 24% as a result of the 2002 reappraisal and whose tax liability increased by $250 or more as a result. Depending on income level, EPTAP caps the increase in taxable value of the property over the six year appraisal cycle.

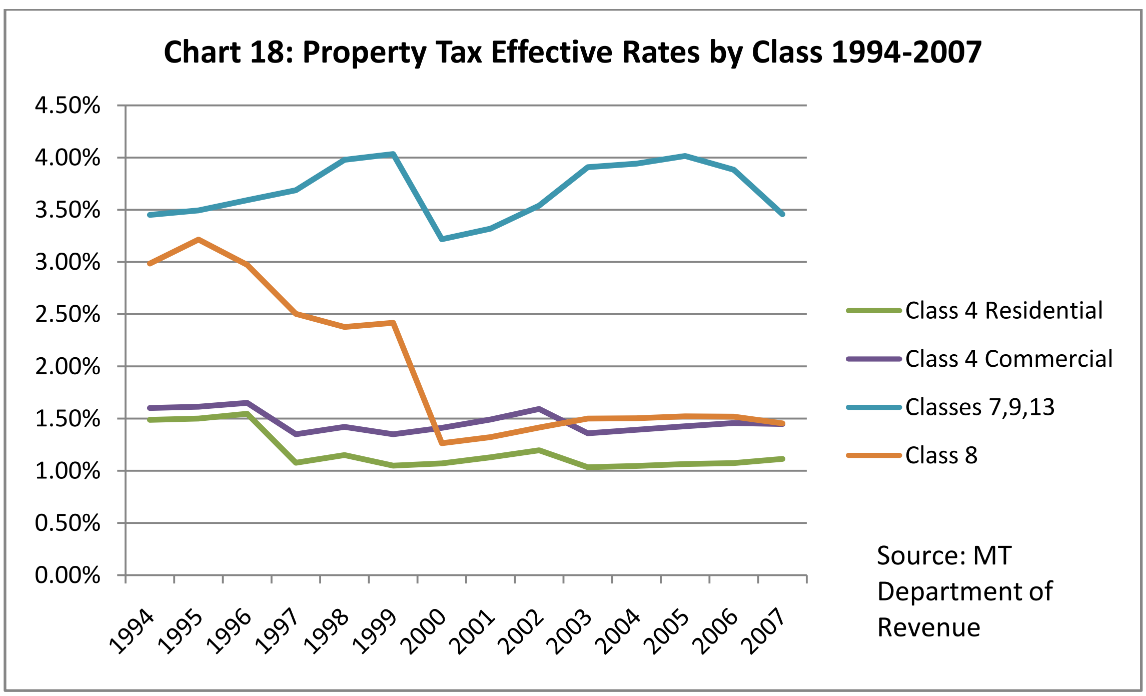
Disabled American Veteran's Exemption- applies to disabled veterans who own and occupy their residence and who meet an income threshold which is adjusted each year for inflation ($41,806 for a single veteran in 2005). Based on income, the tax rate of the veteran homeowner is reduced by up to 50%.

For more information about any of the property tax relief programs, contact the Montana Department of Revenue at: http://mt.gov/revenue/formsandresources/forms.asp#property

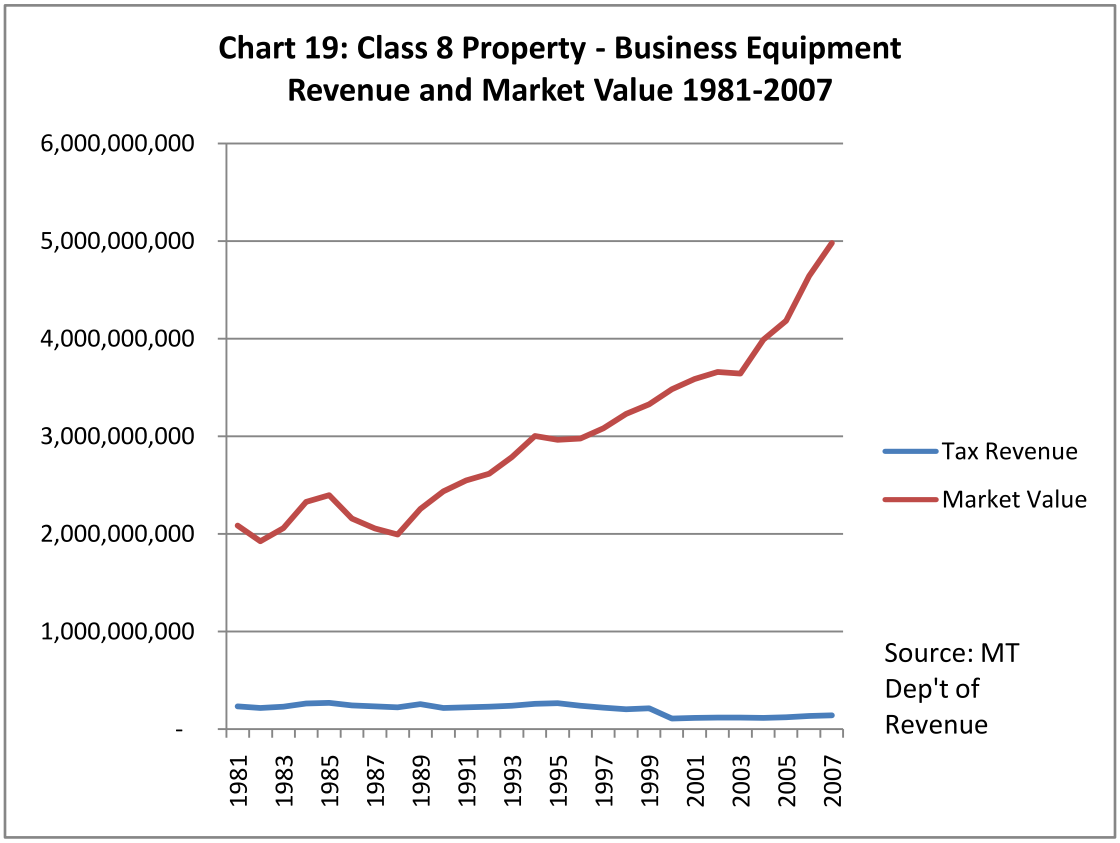
[15] An additional 1.5 mill is applied to properties in the five counties with vo-tech colleges.

Homeowners also pay a higher effective tax rate on the market value of their property than owners of any other class of property (Chart 18).





In stark comparison, taxes paid on business equipment have decreased, even as the market value of business equipment has skyrocketed.



Unlike our income tax, Montana's property tax system is regressive, meaning that lower-income households pay a greater share of their income in property taxes than higher-income households. Property taxes tend to be regressive because they do not take into account a homeowner's income, or ability to pay, and because home values tend to be larger in proportion to the income of low-income homeowners than to high-income homeowners. For example, a family making $25,000 a year may own a home costing $100,000, or four times their income, while a family making $1 million per year may own a home costing $500,000, or half of their income. The property taxes paid by the low-income household will represent a greater proportion of the family income than the property taxes paid by the high-income household.

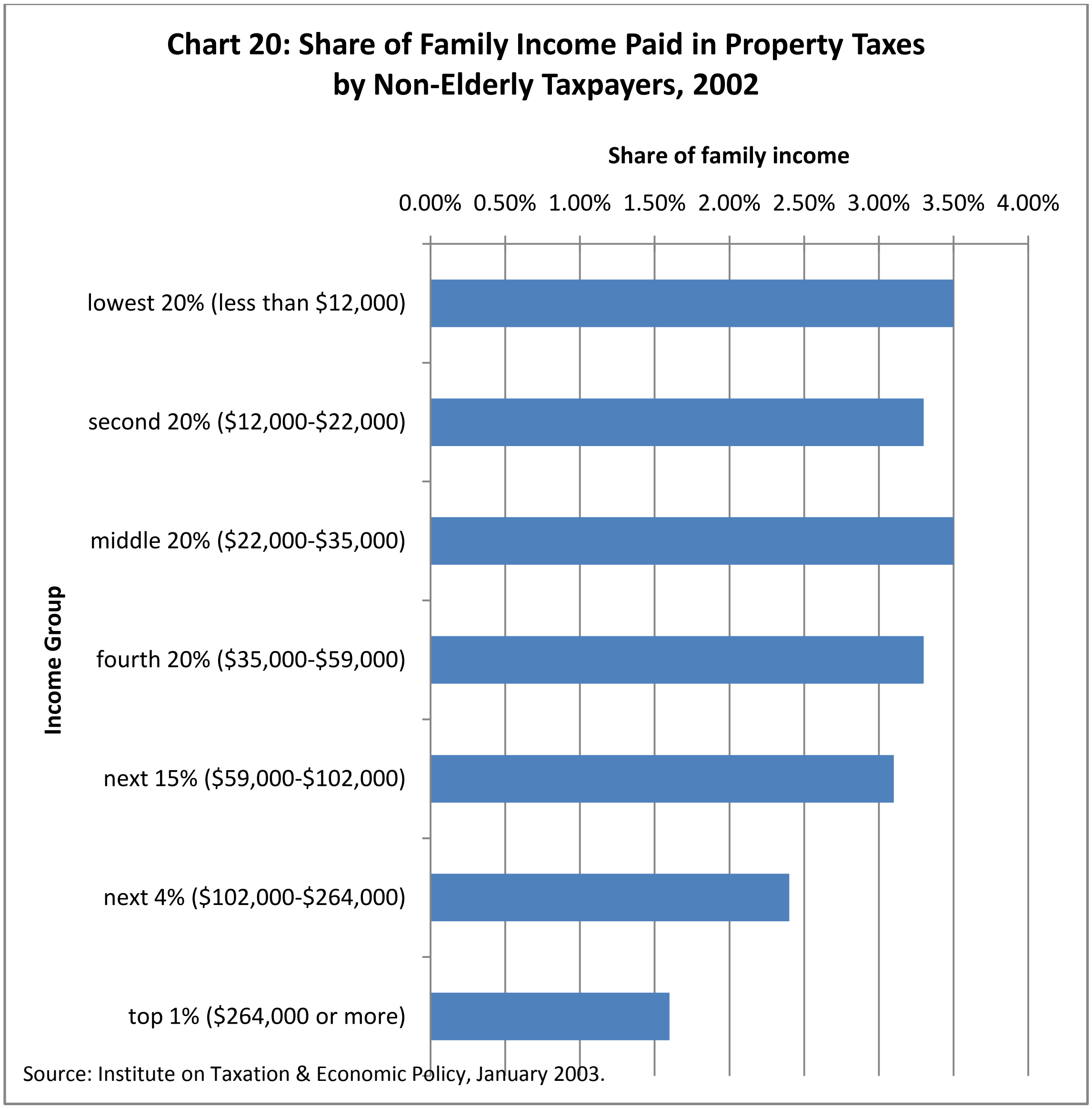
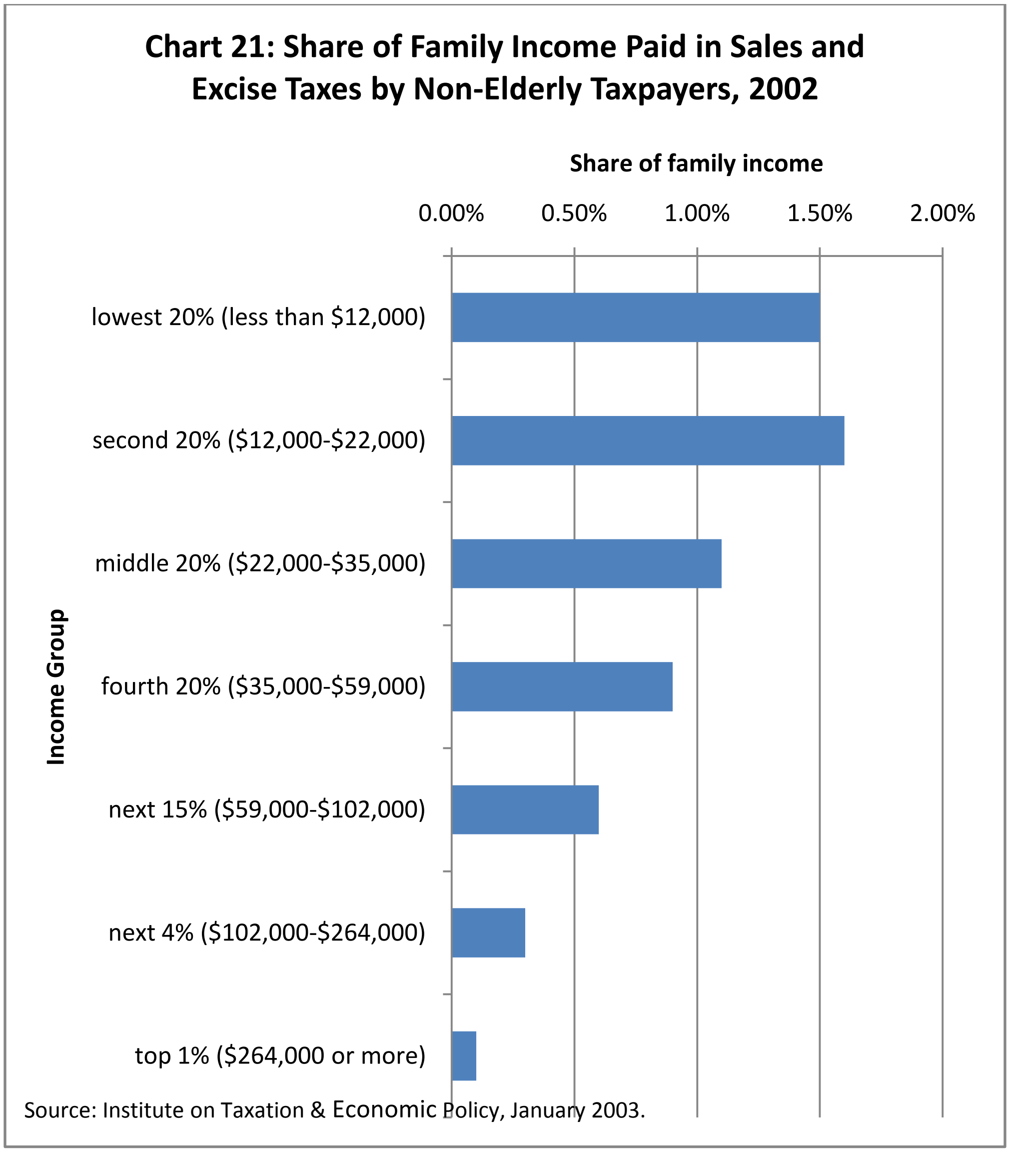


Chart 20: Share of Family Income Paid in Property Taxes by Non-Elderly Taxpayers, 2002
Share of family income
0.00%
0.50%
1.00%
1.50%
2.00%
2.50%
3.00%
3.50%
4.00%
Income Group
lowest 20% (less than $12,000)
second 20% ($12,000-$22,000)
middle 20% ($22,000-$35,000)
fourth 20% ($35,000-$59,000)
next 15% ($59,000-$102,000)
next 4% ($102,000-$264,000)
top 1% ($264,000 or more)
Source: Institute on Taxation & Economic Policy, January 2003.

Selective Sales Tax

Unlike almost all other states, Montana does not have a general sales tax. In those states that have a general sales tax, it tends to be a large source of general revenue. Instead, in Montana we levy "selective" sales taxes on certain kinds of items such as tobacco and alcohol. These taxes make up only 8% of the general fund revenue. As with most sales taxes, our selective sales taxes are borne disproportionately by people with lower incomes. In other words, the portion of income contributed to Montana sales and excise taxes decreases as income increases.



How Does Montana's Tax System Compare to Other States?

In Montana, we pay less in total taxes per capita than all but nine other states in the country. Per capita we rank 41st among all states in total taxes paid, and as a percent of personal income, we rank 32nd. Our ranking as percent of our personal income is higher than our ranking per capita because we have lower average incomes in Montana than almost all other states. In other words, we would have to invest more as a percentage of our income and economy in order to achieve the same level of investment per person found in most other states. Instead we invest *less* as a percent of our income than most other states, leaving us with substantially less revenue to invest per person in the public infrastructure and services that promote our health, safety, economic security, and children's futures.

Montana Revenue Per Capita vs. National Averages, 2006

	Montana State & Local Revenue Per Capita	National Average	Montana Ranking
Total Taxes	3,189	4,001	41
Individual Income	812	899	28
Property	1,118	1,202	22
General Sales	---	945	47*
Selective Sales	547	435	11
Corporate Income	162	177	13
***Tied for 47th with other states with no general sales tax**			

Montana Taxes as a Percent of Personal Income vs. National Averages, 2006

	Montana State & Local Revenue as a Percentage of Personal Income	National Average	Montana Ranking
Total Taxes	10.4	10.9	32
Individual Income	2.6	2.4	20
Property	3.6	3.3	17
General Sales	----	2.6	47*
Selective Sales	1.8	1.2	6
Corporate Income	.5	.5	14
*** Tied for 47th with other states with no general sales tax**			

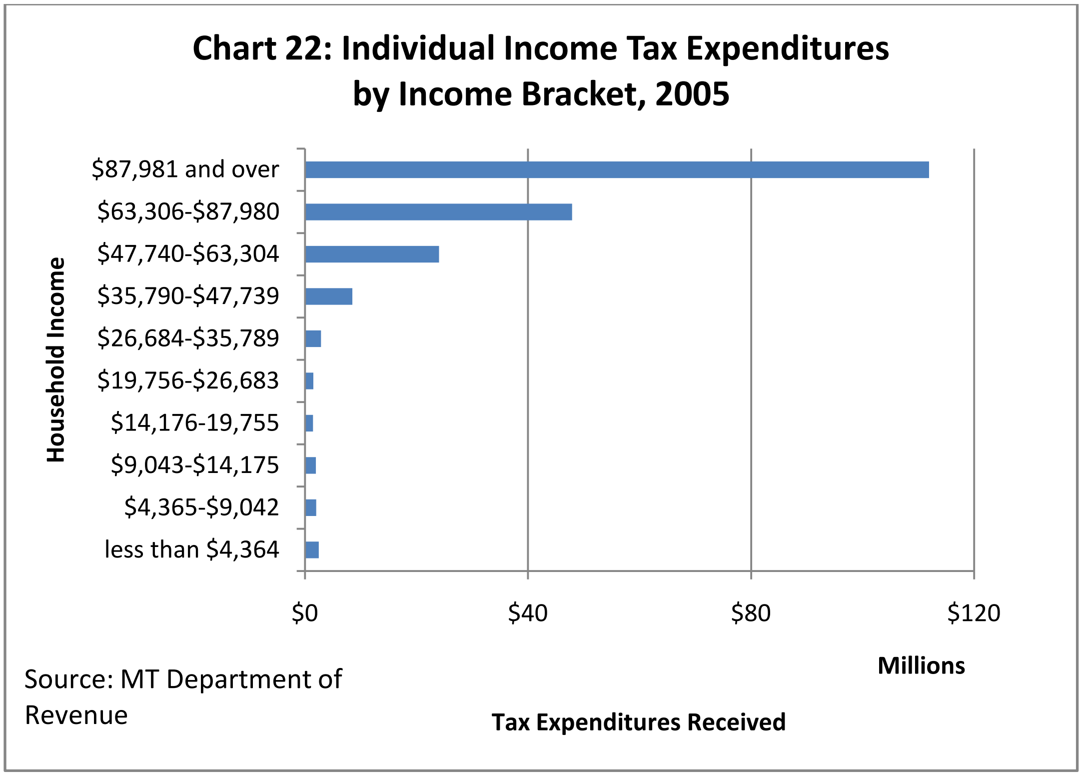
Source: State & Local Government Finance Data Query System. http://www.taxpolicycenter.org/tpc/pages.cfm. The Urban Institute-Brookings Institution Tax Policy Center. Data from U.S. Census Bureau, Annual Survey of State and Local Government Finances, Government Finances, Volume 4, and Census of Governments (2006). Date of Access: (10-Jul-08 10:54 AM)

What Are "Tax Expenditures" and Why Do They Matter?

The Montana legislature has the power to make exceptions to each of the taxes listed above. These tax exemptions, deductions, rate reductions, and credits are called "tax expenditures." Rather than taking in money through taxes and then spending it on an individual or business through a direct appropriation of state funds, we "spend" money by not collecting taxes that would otherwise be due from an individual or business.

Some of Montana's tax expenditures are the result of deductions and exemptions written into federal law which are then automatically tied to the Montana tax code. These are sometimes referred to as "passive expenditures." Other tax expenditures are the direct result of decisions made by Montana policy makers. These are often called "non-passive expenditures." Tax expenditures are an overlooked form of spending. They do not need to be re-enacted every year, and unless a "sunset" date is placed on a tax expenditure provision, it continues indefinitely (or until amended or repealed). By contrast, the state's direct expenditure of funds on salaries, programs, services, buildings and other purposes must be *re*-appropriated in each legislative session and are adopted only after detailed review, public hearings, and lengthy debate and negotiations

All Montanans do not benefit equally from our tax expenditures. Rather, the 10% of Montana households making the most income receive over half of the individual income tax expenditures (Chart 22).



Tax expenditures can encourage responsible corporate behaviors of various sorts, provide tax relief to overburdened working people, or simply generate vast windfalls for particular corporations. They also cost the state millions of dollars each year in lost revenue that can not then be invested in our other collective priorities. Montana "spent" over $266 million in individual income tax expenditures in 2005; almost $2.3 million in corporate tax expenditures in 2004; $170 million in natural resource expenditures in 2009; and $5.8 million in property tax expenditures in 2006.[16] Every two years, the Montana Department of Revenue produces a Tax Expenditure Report as a part of its "Biennial Report." The report lists the various exemptions, deductions, and credits for all taxes and the revenues we are losing from each of them.

[16] The most recent data available from the Department of Revenue in the 2006 Biennial Report is used for all categories of tax expenditures.

Process: How is the Montana Budget Made?

The creation of our biennium budget involves numerous state players and takes over a year to complete. Below is a timeline of important events in the budget creation process.

Date	Step	Who
by July 1 of even years	The Governor sends instructions to all government agencies on submitting a budget for the next biennium.	Governor
Fall of even years	Agencies submit their budgets to the Governor, indicating any proposed spending increases or decreases.	Government agency staff
	The Governor and the Legislative Fiscal Division both estimate the state's revenue for the next biennium and provide the estimates to the legislature's Revenue and Transportation Interim Committee (RTIC).	Legislative Fiscal Division and the Office of Budget and Program Planning, under the direction of the Governor
By November 15 of even years	The Governor submits a draft proposed budget to the Legislative Fiscal Division.	Office of Budget and Program Planning, under the direction of the Governor
By December 1 of even years	The Revenue and Transportation Committee considers the Executive and LFD revenue estimates and makes formal revenue recommendations to the entire legislature. These recommendations become the first draft of House Joint Resolution 2. If the House and Senate do not vote to change the estimates, those provided by the RTIC are used to determine if the budget created by legislature is balanced.	Revenue and Transportation Interim Committee
By December 15 of even years (or January 7 of odd years for newly elected Governors)	The Governor provides a final draft of the proposed budget to the Legislative Fiscal Division. The Governor's budget becomes the first draft of House Bill 2.	Office of Budget and Program Planning, under the direction of the Governor
By the first day of the legislative session (January of odd years)	The Legislative Fiscal Division provides a detailed analysis of the Governor's budget, including	Legislative Fiscal Division

	highlights of new spending priorities or cuts, to the legislature, agencies, and public.	
By the 67th day of the legislative session	All spending/appropriation bills, including HB2 must be considered by the House before they are "transmitted" to the Senate. The bills are first considered by the House Appropriations Committee where public comment is heard and recommended amendments are made to the governor's budget. The entire House then debates and votes on the budget and various amendments.	House Appropriations Committee, full House, and public
By the end of the legislative session	After the budget is transmitted to the Senate, the Senate Finance and Claims Committee considers public comment and suggests additional amendments to the bill. The budget and the amendments are considered by the entire Senate.	Senate, Senate Finance and Claims Committee, and public
	Once the Senate has voted on the budget, the bill goes to a conference committee where representatives from the House and the Senate try to reach agreement on the bill. The Senate and House then must reject or approve the budget.	Joint Conference Committee of House and Senate, full Senate and House, and public
	The Governor can accept or veto the bill. The Governor may also accept, reject, or amend any particular part of the budget bill. Any amendments made by the governor must go back to the legislature. If the legislature overrides the amendments, the Governor must either sign the entire bill or veto it.	Governor, full House and Senate

The budget is a reflection of our collective priorities and determines the future health, safety, and prosperity of our children, families, and communities. The Montana legislature is required to hear our testimony during budget hearings. If you can not attend the hearings, consider contacting your representatives or the representatives on the House Appropriations and Senate Finance and Claims Committees. Make sure your voice is heard!

Glossary of Key Terms

Appropriation – Authority given to a government agency or institution to spend a specified amount of government money. Appropriations are made through legislation.

Assessed Value- When the legislature decides to allow new market values to be phased in over time, the reduced values of property during the phase-in are called assessed values.

Biennium - Montana is one of the few states that have a true biennial budget. The Montana Legislature only meets every two years (every odd year), at which time it approves a budget for a two-year period, or a biennium. The biennium is named for the calendar year in which it ends. During the 2010 Legislative Session, the legislature will consider and approve a budget for fiscal years 2010 and 2011; this two year period is also referred to as the 2011 biennium.

Budget – A spending plan including sources and uses of funds.

Fiscal Year- The state budgets and accounts for its finances using a "fiscal year" that begins July 1 and ends June 30. It is named for the calendar year in which it ends. This report was published during fiscal year 2009, which began July 1, 2008 and will end June 30, 2009.

Flat Tax – A tax system is proportional, or flat, if all persons, regardless of income, pay the same percentage of their income in taxes. Note that a tax is not necessarily flat just because it applies the same rate to all people. For example, property taxes and sales taxes tend to apply the same tax rate to all people regardless of income, but because low-income households pay a greater proportion of their income on items and property that are taxed, these taxes are regressive.

General Fund - The funding available for the state to use for most of its functions without restrictions. The biggest source for general fund revenue is individual income taxes. General funds do not include payments to the state from the federal government ("federal funds") or fund sources that are restricted for specific purposes.

Gross Domestic Product (GDP) - a measure of the total income produced in the state in a given year, including salaries, dividends, and interest. As a measure of the state's income, state GDP is useful for determining how much the state can afford to spend.

Market Value- The value of a piece of property as appraised by the Montana Department of Revenue

Mill levy- is a tax rate applied to the taxable value of a property, per thousand dollars of value. A 40 mill levy is applied to the taxable value of a property at a rate of .04, or 4%.

Progressive Tax – A tax is progressive if persons with higher incomes pay a greater percentage of their incomes than those with lower incomes.

Regressive Tax - A tax is regressive if persons with lower incomes pay a higher percentage of their incomes in taxes than those with higher incomes.

Special Fund - Fund sources that are restricted for specific purposes, like transportation or environmental programs.

Structural balance, structural deficit – The difference between ongoing revenues and on-going expenditures during a fiscal year. If on-going expenditures exceed on-going revenues, the state is in a structural deficit. The state can have a structural deficit but still have a constitutionally-balanced budget because of an adequate beginning fund balance to absorb the difference, or because of the use of fund transfers or other temporary revenues.

Taxable Value- Each class of property has a statutory tax rate which is applied to the market value of a piece of property to determine the taxable value of the property.