

## **ECONOMIC OVERVIEW**

### **Introduction**

The state budget is affected by state, national, and world economic conditions. The demand for public services is affected by population growth and by how the state's population is faring economically. The cost of providing public services is affected by general inflation and by the costs of specific government purchases, such as utilities. The revenue state government has to pay for public services depends on taxpayers' incomes, property values, and business activity.

The executive budget is based on assumptions about economic conditions through the 2007 biennium. This section describes the key economic assumptions that are common to all of the revenue estimates. It also provides some background by describing long-term trends in the state economy. The sections describing individual revenue estimates explain how each revenue source is related to economic conditions and explain any assumptions that are unique to specific revenue sources.

### **National Economic Growth**

The national economy went through a mild recession in 2000 and 2001. The economy began to recover in 2002, with accelerating growth of gross domestic product (GDP). GDP growth for 2004 is expected to be 4.4%. GDP is expected to grow slower, between 2.9% and 3.5% in 2005 through 2007. National employment fell through the third quarter of 2003, after the economy had resumed growing, and continues to grow slowly. National employment is predicted to grow by 1% in 2004. Employment growth is predicted to accelerate to 1.7% in 2005 and then to slow to about 1% in 2006 and 2007. Inflation has remained low. It is expected to be 2% for 2004 and to be below 2% in 2005 through 2007.

### **Montana Production and Income**

Table 1, on the next page, shows gross state product (GSP), which measures production in the state, and personal income, which measures income state residents receive from all sources, from 1996 through 2003 and Global Insight's forecasts through 2007.

In 2000 and 2001, GSP continued to grow rapidly as the national economy went into a recession. GSP grew more slowly in 2002, but accelerated in 2003 and 2004. In 2004, GSP is expected to grow by almost 6%, faster than in any recent year. GSP growth is expected to slow in 2005 and 2006, but to stay at or above 4.5%.

Personal income in Montana grew rapidly in 2000 and 2001. This growth was due to a combination of increasing economic activity in the state, as reflected in GSP growth, and gains from the stock market boom. Personal income grew by only 1.1% in 2002, but rebounded in 2003.

Personal income growth is expected to be almost 6% in both 2004 and 2005. It is expected to slow in 2006, but to be close to 5% through 2007.

**Table 1**  
**Gross State Product and Personal Income**  
**1996 through 2007**  
**(\$ million)**

Year	Gross State Product	% Change	Personal Income	% Change
1996	18,073	3.04%	16,880	4.95%
1997	18,906	4.61%	17,688	4.79%
1998	19,972	5.64%	18,857	6.60%
1999	20,567	2.98%	19,373	2.74%
2000	21,703	5.52%	20,716	6.94%
2001	22,635	4.29%	22,281	7.55%
2002	23,518	3.90%	22,526	1.10%
2003	24,583	4.53%	23,652	5.00%
<b>2004</b>	<b>26,052</b>	<b>5.98%</b>	<b>25,056</b>	<b>5.94%</b>
<b>2005</b>	<b>27,396</b>	<b>5.16%</b>	<b>26,552</b>	<b>5.97%</b>
<b>2006</b>	<b>28,625</b>	<b>4.49%</b>	<b>27,813</b>	<b>4.75%</b>
<b>2007</b>	<b>29,948</b>	<b>4.62%</b>	<b>29,147</b>	<b>4.80%</b>

### Montana Employment and Population

Table 2 shows Montana employment and population in 1996 through 2003 and Global Insight's forecasts through 2007.

The recession hit Montana's labor market hard. Employment fell by more than 2% in 2001 and was stagnant in 2002. In 2003, employment rebounded slightly above the pre-recession peak in 2000. In 2004, employment is forecast to grow by 1.7%. Employment growth is forecast to peak at almost 2% in 2005 and then to slow.

In the second half of the 1990s, Montana's population grew at about half a percent a year. Growth appears to have slowed slightly in 2001, as some discouraged workers left the state to look for work, but growth accelerated in

**Table 2**  
**Montana Employment and Population**  
**1996 through 2007**

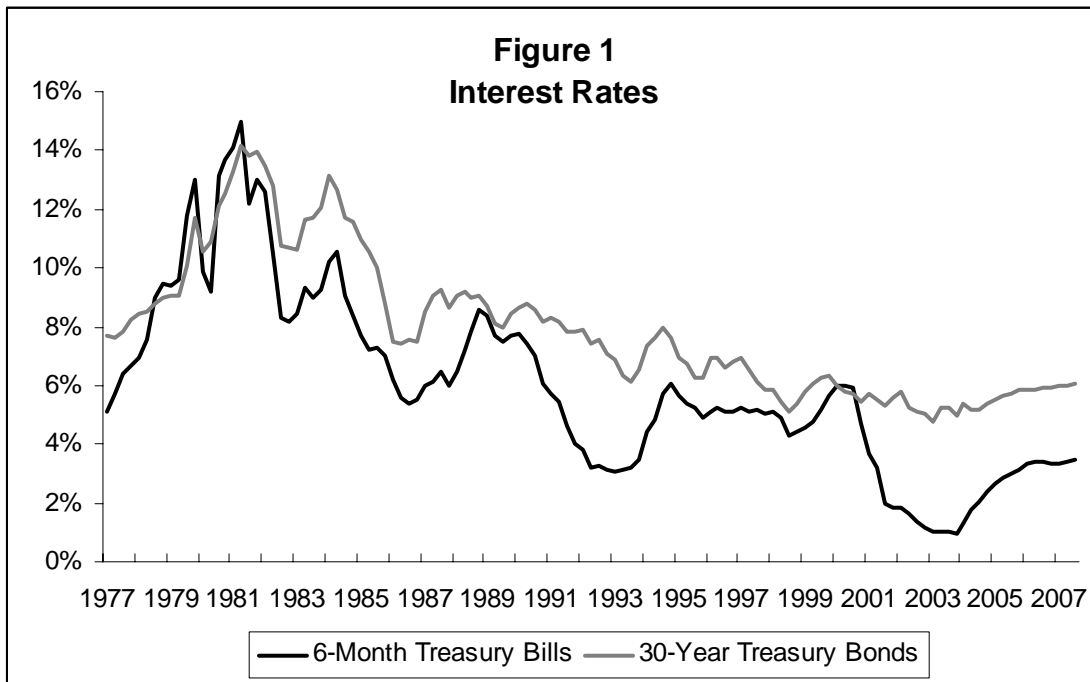
Year	Employment	% Change	Population	% Change
1996	420,694	2.79%	886,321	1.02%
1997	428,580	1.87%	890,120	0.43%
1998	438,029	2.20%	893,221	0.35%
1999	446,689	1.98%	898,288	0.57%
2000	452,149	1.22%	903,494	0.58%
2001	442,015	-2.24%	906,620	0.35%
2002	442,153	0.03%	911,451	0.53%
2003	452,417	2.32%	917,911	0.71%
<b>2004</b>	<b>460,026</b>	<b>1.68%</b>	<b>922,086</b>	<b>0.45%</b>
<b>2005</b>	<b>469,087</b>	<b>1.97%</b>	<b>926,006</b>	<b>0.43%</b>
<b>2006</b>	<b>476,909</b>	<b>1.67%</b>	<b>929,752</b>	<b>0.40%</b>
<b>2007</b>	<b>481,255</b>	<b>0.91%</b>	<b>933,417</b>	<b>0.39%</b>

2002 and 2003. Population growth in 2004 through 2007 is forecast to be about 0.4% per year. This is significantly below national population growth.

### Interest Rates

The state earns interest on trust funds, such as the coal severance tax trust fund, the school trust, and the tobacco settlement trust, and on short-term cash holdings in the general fund and other state funds. The state also pays interest on funds it borrows. Trust fund interest earnings and payments on new long-term debt are affected by changes in long-term interest rates. Most bonds held by the state trust funds are kept for several years, and trust fund interest earnings are affected more by long-term trends in interest rates than by year-to-year variations. Interest earnings on cash balances and interest payments on short-term debt are affected by changes in short term interest rates. Earnings on cash balances are affected by year-to-year variations in short-term interest rates as well as by long-term trends.

Figure 1 shows interest rates on 6-month and 30-year U.S. Treasury obligations from 1977 through the second quarter of 2004 and Global Insight's forecasts through 2007.



Interest rates hit historic highs in 1981, with both short-term and long-term interest rates over 14%. Interest rates vary over the course of business cycles, but had a general downward trend from 1981 through 2003. Short-term interest rates show more variation than long-term rates. They fall when the Federal Reserve tries to stimulate the economy by cutting the rate it charges banks. They rise when the

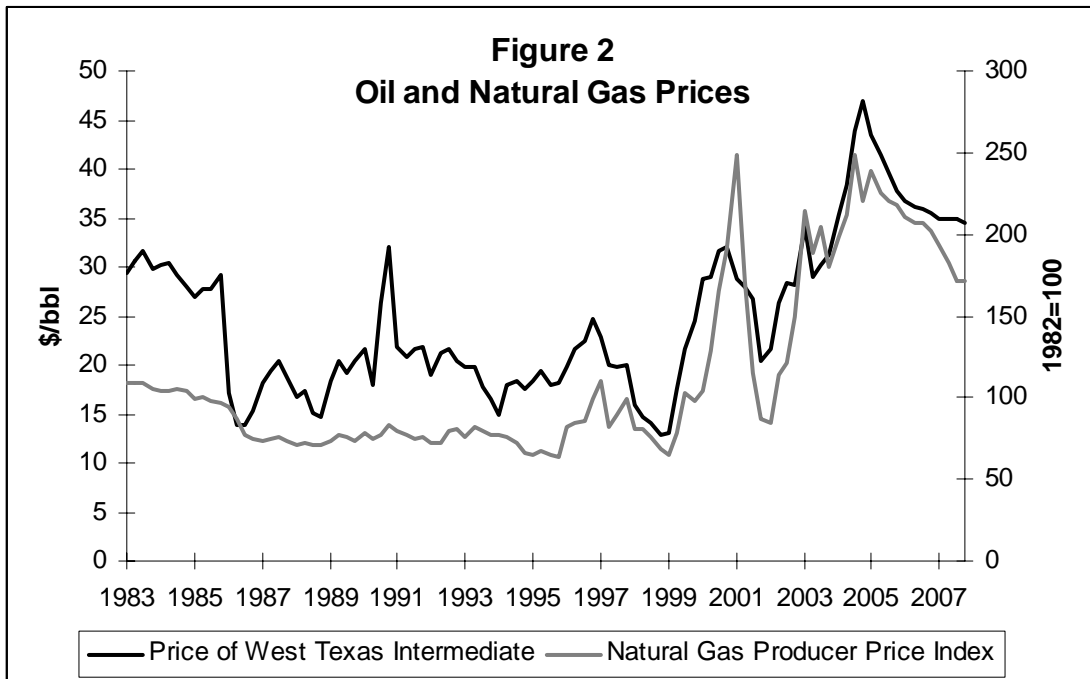
Federal Reserve tries to control inflation by raising the rate it charges banks. Short-term interest rates hit all-time lows early in 2004.

Interest rates began rising in the second quarter of 2004 and are forecast to continue rising through 2007. By the end of 2007, the rate on 6-month Treasury bills is forecast to be 3.5%, and the rate on 30-year treasury bonds is forecast to be 6%.

### Oil and Natural Gas Prices

Oil and natural gas prices affect the state budget several ways. The state taxes oil and natural gas production and receives royalties from production on state lands and a share of the royalties from production on federal land in the state. State government buys gasoline and diesel fuel for state vehicles and natural gas for state buildings. Energy prices also affect the state economy, with higher prices translating into higher incomes for the energy producing sector and higher costs for the rest of the economy.

Figure 2 shows national oil and natural gas prices from 1983 through 2004 and Global Insight's forecasts through 2007. It shows the price of the standard grade of crude oil, West Texas Intermediate, measured on the left hand axis. It shows a price index for natural gas, with the average price in 1982 scaled to 100, on the right hand axis.



Oil prices have always been quite volatile. Natural gas prices were less volatile through about 1995, but since then have been at least as volatile as oil prices.

Energy use is relatively insensitive to prices in the short run. Because of this, short run changes in supplies can produce large price swings. In the longer term, energy users respond to higher prices by conserving and using energy more efficiently. Oil and gas producers respond to sustained higher prices by increasing exploration and development activity that increases supplies.

From about 1987 through 1999, oil and natural gas prices were relatively low because of ample world supplies. Since 1999, oil and natural gas prices have risen significantly. There are several reasons for this. World supplies have been stagnant, as oil and gas fields that were developed in the 1970s when prices were high are beginning to be depleted and low prices have limited exploration. World demand has grown steadily, and that growth has accelerated in the last few years as incomes in some developing countries, particularly China, have reached the point where consumers can afford cars, appliances, and other energy using consumer goods. Short-term supply disruptions or scares due to war, political instability in some producing countries, and hurricane damage in the Gulf of Mexico have led to short-term price spikes.

Both oil and natural gas prices are forecast to peak late in 2004 and then to drop through 2007 as short-term supply problems are solved. However, both are expected to remain well above their pre-2000 levels as growing world demand continues to stretch production capacity.

### **Property Values**

Property tax is the largest revenue source in Montana. State and local governments, school districts and special improvement districts collect over \$900 million in property taxes and related fees each year. Property taxes depend on mill levies; property tax rates, which are the ratio of taxable value to market value; and property values.

In the ten-year period from tax year 1993 (FY 1994) to tax year 2002 (FY 2003), the statewide average mill levy increased 38.8%. Mill levies vary dramatically between different cities and different counties. In 2002, city mill levies ranged from 203.23 mills in Colstrip to 1,009.58 mills in Westby. County mill levies ranged from 211.52 mills in Rosebud County to 660.10 mills in Deer Lodge County. These variances result in the individual properties having considerable differences in their property tax bill for comparably valued property.

Recent legislation has reduced tax rates for most classes of property. As property tax rates decline, or property is exempted, the amount of property tax that must be raised from the remaining property tax owners increases. Table 3 shows statewide taxable values for 1998 and 2004, the percent of total taxable value in each property class, and the percent change in taxable value for each class.

Tax Class	Description	Tax Year 1998			Tax Year 2004			% Change Taxable Value
		Tax Rate	Taxable Value	Share of Base	Tax Rate	Taxable Value	Share of Base	
1	Mine Net Proceeds	100.000%	7,625,083	0.4%	100.000%	8,032,414	0.5%	5.3%
2	Gross Proceeds Metal Mines	3.000%	8,780,907	0.5%	3.000%	10,428,300	0.6%	18.8%
3	Agricultural Land	3.816%	143,007,340	7.4%	3.300%	139,901,823	7.9%	-2.2%
4 Res	Residential Real Property	3.816%	704,132,657	36.3%	3.300%	792,062,821	44.5%	12.5%
4 Com	Commercial Real Property	3.816%	247,920,400	12.8%	3.300%	284,921,721	16.0%	14.9%
Sub 4	<i>Subtotal Class 4</i>	<i>3.816%</i>	<i>952,053,057</i>	<i>49.0%</i>	<i>3.300%</i>	<i>1,076,984,542</i>	<i>60.5%</i>	<i>13.1%</i>
5	Pollution Control Equipment	3.000%	34,074,765	1.8%	3.000%	34,024,275	1.9%	-0.1%
6	Livestock	4.000%	23,833,179	1.2%	0.000%	-	0.0%	-100.0%
7	Non-Centrally Assessed Utilities	8.000%	1,783,935	0.1%	8.000%	974,316	0.1%	-45.4%
8	Business Personal Property	6.000%	203,383,266	10.5%	3.000%	117,240,984	6.6%	-42.4%
10	Forest Land	0.790%	7,677,880	0.4%	0.350%	6,791,382	0.4%	-11.5%
12	Railroad and Airline Property	6.170%	65,266,087	3.4%	3.810%	45,074,061	2.5%	-30.9%
9 & 13	Telecom. & Electric Property	12.000%	494,534,742	25.5%	12% & 6%	340,477,889	19.1%	-31.2%
<b>Totals</b>			<b>1,942,020,241</b>			<b>1,779,929,986</b>		<b>-8.3%</b>

Total taxable value decreased 8.3% from tax year 1998 to tax year 2004. This is primarily attributable to legislation that reduced the tax rates on specific property classes and exempted some types of property from taxation. Total statewide taxable value is expected to increase in 2005 and 2006. All the expected increase is due to new property in class 4, residential and commercial real property, and class 8, business equipment. The total taxable value of all other property classes combined is projected to decline.

The class 4 share of the tax base increased from 49% in 1998 to over 60% in 2004. The percent share of the tax base in class 4 is expected to continue to increase in the future. Under the current property tax structure, class 4 pays the majority of any property tax increases.

Class 8 taxable value declined from 1998 to 2004 because the tax rate was reduced from 6% to 3%. The value of class 8 property is projected to increase through 2007. However, 15-6-138, MCA, provides for a conditional phase-out of tax, referred to as the class 8 trigger, on class 8 property. When inflation-adjusted Montana wage and salary income shows an increase of at least 2.85%, the phase-out of the class 8 property tax is triggered. Beginning three years after the trigger is hit, the tax rate for class 8 property is reduced by 1% each year until it reaches zero. The next trigger test will be based on 2004 data in October of 2005. If the trigger is met, the reduction will begin January 1, 2007. The tax rate for class 8 property would be reduced by 1% each year until it reaches zero.

## Structural Trends

Montana's population and economy have undergone significant structural changes. The population has become older, the mix of industries has changed, and the mix of occupations has changed.

### Population

Table 4 shows the 1980, 1990, and 2000 census counts of Montana population grouped into ten-year age groups and the percent of the total population in each group. For 1990 and 2000, it also shows the ten-year survival percentage for the groups aged 10 and up. This is the ratio of the number of people in an age group to the number in the next lower age group ten years earlier. For the 80 and over age group, it is the ratio of people 80 or over to the number of people 70 or over ten years earlier. For the total population, it is the ratio of total population to the total ten years earlier.

<b>Table 4</b>								
<b>Age Structure of Montana Population</b>								
Age	1980 Census		1990 Census			2000 Census		
	Persons	%	Persons	%	10 yr survival	Persons	%	10 yr survival
0-9	125,315	15.9%	125,603	15.7%		115,931	12.8%	
10-19	136,959	17.3%	120,285	15.0%	96.0%	140,275	15.5%	111.7%
20-29	145,395	18.4%	104,491	13.0%	76.3%	110,151	12.2%	91.6%
30-39	111,036	14.0%	134,798	16.8%	92.7%	118,328	13.1%	113.2%
40-49	77,291	9.8%	104,085	13.0%	93.7%	149,050	16.5%	110.6%
50-59	74,029	9.4%	71,729	8.9%	92.8%	110,143	12.2%	105.8%
60-69	64,756	8.2%	66,959	8.3%	90.4%	70,912	7.8%	98.9%
70-79	37,348	4.7%	49,789	6.2%	76.9%	54,699	6.1%	81.7%
80+	18,263	2.3%	24,201	3.0%	43.5%	34,004	3.8%	46.0%
Total	790,391	100.0%	801,939	100.0%	101.5%	903,494	100.0%	112.7%

### Ageing Population

In 1980, the 20 to 29 age group was the largest. People in this age group were born between 1951 and 1960, the final years of the post-World War II baby boom and the years immediately after. People born between 1951 and 1960 were in the 30 to 39 age group in 1990 and the 40 to 49 age group in 2000, and make up the largest age group in those years too.

In 1990 and 2000, the second largest age group was people born between 1981 and 1990, who were between 0 and 9 in 1990 and between 10 and 19 in 2000. This second peak in the age distribution is caused by the children of the baby boomers and is often called the baby boom echo.

As the baby boomers have aged and life expectancies have increased, the population as a whole has become older. In 1980, 34% of the population was 40 or over and 15% was 60 or over. In 1990, 40% of the population was 40 or over and 18% was 60 or over. By 2000, the percentage 40 or over had increased to 46% and the percentage 60 or over remained at 18%. This aging of the population mirrors the national trend and will continue. In 2010, the 50 to 59 age group will probably be the largest.

	1980 Census	1990 Census	2000 Census	2010 Forecast
Age 40 and Over	34.4%	39.5%	46.4%	49.6%
Age 60 and Over	15.2%	17.6%	17.7%	21.8%

### Population Migration

The ten-year survival percentages, shown in Table 4, give information on population growth and movements into and out of the state. The numbers in the totals row show the change in total population from one census to the next. Montana had very little population growth from 1980 to 1990. Montana's population in 1990 was only 101.5% of the 1980 population. In 2000, Montana's population was 112.7% of what it had been in 1990. This 12.7% population growth is just slightly less than national population growth of 13.2%.

In a population with no one moving in or out, ten-year survival percentages reflect mortality. They are close to 100% for the younger age groups and fall off rapidly after middle age. The 1990 survival percentages follow this pattern with one significant exception. The 20 to 29 age group's survival percentage is 76%. This shows that at least 20% of the 10 to 19 year olds who lived in Montana in 1980 had moved out of the state by 1990, when they were between 20 and 29 years old. Some people in this age group moved into the state, so the percentage that left must be greater than 20%. For the other age groups, people moving into the state about equaled people moving out of the state.

Population growth from 1990 to 2000 was a combination of natural increase due to more births than deaths and net in-migration, with more people moving to the state than moving away. Survival percentages are more than 100% for four age groups, 10 to 19, 30 to 39, 40 to 49, and 50 to 59, and is 99% for the 60 to 69 age group. This shows that more people in these age groups moved to the state than moved away. In the 1990s people over 30 moved to the state and brought their children. In



2000, the survival percentage for the 20 to 29 age group is only 92%, indicating that more people in this age group moved away than moved in.

## Economic Structure

Table 6 shows the Montana economy divided into eleven sectors, with gross state product for each sector and the percentage of gross state product produced by each in 1992, 1997, and 2002, and Global Insight's forecast for 2007. The sectors are sorted in descending order of the value by output in 1992. For sectors that have grown faster than the economy as a whole, the percent of total output has increased over time. For sectors that have not grown as fast as the economy, the percent has decreased. The service sectors are growing the fastest.

Economic Sector	1992		1997		2002		2007	
	\$ Million	% of Total	\$ Million	% of Total	\$ Million	% of Total	\$ Million	% of Total
Services	2,693	17.9%	3,745	19.8%	5,063	21.5%	6,978	23.3%
Finance, Insurance, & Real Estate	1,975	13.1%	2,570	13.6%	3,354	14.3%	4,515	15.1%
Transp., Comm., & Util.	1,855	12.3%	2,229	11.8%	2,547	10.8%	3,004	10.0%
State and Local Gov't, Schools	1,619	10.7%	2,029	10.7%	2,784	11.8%	3,541	11.8%
Retail Trade	1,517	10.1%	1,932	10.2%	2,418	10.3%	3,058	10.2%
Manufacturing	1,180	7.8%	1,438	7.6%	1,562	6.6%	1,880	6.3%
Agriculture, Forestry, & Fishing	957	6.3%	871	4.6%	865	3.7%	754	2.5%
Federal Government	949	6.3%	1,101	5.8%	1,242	5.3%	1,465	4.9%
Wholesale Trade	914	6.1%	1,268	6.7%	1,427	6.1%	1,847	6.2%
Mining	809	5.4%	734	3.9%	857	3.6%	923	3.1%
Construction	617	4.1%	989	5.2%	1,399	6.0%	1,984	6.6%

- Services and finance, insurance, and real estate are the two largest sectors, together accounting for 36% of the value of output in 2002. Both sectors have grown faster than the economy as a whole since 1992 and are forecast to continue to do so. They are forecast to account for 38% of output in 2007.
- Two other sectors also increased over time as a percent of the total. They are the construction sector and state and local government and schools.
- Retail trade and wholesale trade have consistently grown at about the same rate as the economy as a whole. Together they accounted for a little over 16% of output in each of the four years.
- Transportation, communications and utilities, manufacturing, and mining have grown more slowly than the economy as a whole. Together they accounted for 25% of output in 1992, but they are forecast to account for only 19% in 2007.

- Agriculture, forestry, and fishing is the only sector where the value of output has consistently decreased over time.

Like the national economy, the Montana economy is primarily a service-producing economy rather than a goods-producing economy, and this has become truer over time. Four sectors produce services almost exclusively. They are services; finance, insurance, and real estate; retail trade; and wholesale trade. Four sectors produce physical goods almost exclusively. They are manufacturing; agriculture, forestry and fishing; mining; and construction. The other three sectors produce a mix of goods and services. Together, the service-producing sectors accounted for 47% of output in 1992, and they are predicted to account for 55% in 2007. The mixed sectors accounted for 29% of output in 1992 and are predicted to account for 27% of output in 2007. The goods-producing sectors accounted for 24% of output in 1992. This is predicted to fall to 19% in 2007.

Table 7<sup>1</sup> shows the Montana economy divided into fifteen sectors<sup>2</sup> in 1992, 1997, and 2002, and Global Insight's forecasts for 2007.

Economic Sector	1992		1997		2002		2007	
	\$ Million	% of Total	\$ Million	% of Total	\$ Million	% of Total	\$ Million	% of Total
State & Local Govern't, Schools	1,167	17.9%	1,450	17.1%	1,813	16.6%	2,249	16.2%
Educational & Health Svcs	775	11.9%	1,064	12.5%	1,469	13.5%	1,933	13.9%
Retail Trade	672	10.3%	856	10.1%	1,073	9.8%	1,291	9.3%
Construction and Mining	552	8.5%	754	8.9%	960	8.8%	1,345	9.7%
Manufacturing	515	7.9%	643	7.6%	678	6.2%	787	5.7%
Transportation, Warehousing, & Utilities	443	6.8%	529	6.2%	605	5.5%	719	5.2%
Federal Government	417	6.4%	470	5.5%	592	5.4%	705	5.1%
Wholesale Trade	354	5.4%	441	5.2%	523	4.8%	642	4.6%
Professional & Business Svcs	346	5.3%	584	6.9%	915	8.4%	1,276	9.2%
Leisure & Hospitality	335	5.1%	481	5.7%	612	5.6%	799	5.8%
Financial Activities	318	4.9%	438	5.2%	630	5.8%	884	6.4%
Other Services	192	3.0%	266	3.1%	361	3.3%	445	3.2%
Military	154	2.4%	150	1.8%	197	1.8%	232	1.7%
Information	153	2.4%	191	2.3%	256	2.3%	320	2.3%
Agriculture, Forestry, & Fishing	114	1.8%	170	2.0%	223	2.0%	275	2.0%

There are five sectors where total wage and salary payments have consistently grown faster than in the economy as a whole. They are educational and health services, construction and mining, professional and business services, leisure and hospitality, and financial activities. In three sectors, wage and salary payments have grown about as fast as in the economy as a whole. They are other services,

<sup>1</sup> Tables 7 divides the economy into the sectors used in the new North American Industry Classification System while Table 6 uses the sectors from the old Standard Industrial Classification system because historic GSP data have not been converted to the new system yet.

<sup>2</sup> The growth in total wages and salaries for a sector is due to a combination of growth of employment in that sector and growth of average wages. These differ between sectors.

information, and agriculture, fisheries and forestry. In the other seven sectors total wage and salary payments have grown, but not as fast as in the economy as a whole.

### **Economic Overview Summary**

Montana income growth is expected to be about 5% with employment growing steadily and population increasing slightly. The Montana population is aging with the 20-29 year age group leaving the state and older people moving into the state.

Interest rates and oil and natural gas prices will rise and be maintained for a while, enhancing the state's revenue. Property taxes are increasing significantly due more to mill levy increases than to valuation increases.

The economy has turned from a goods-based economy into a service economy. The tax structure will need to be monitored to determine the impact of the shift to a service based economy and the aging population.