

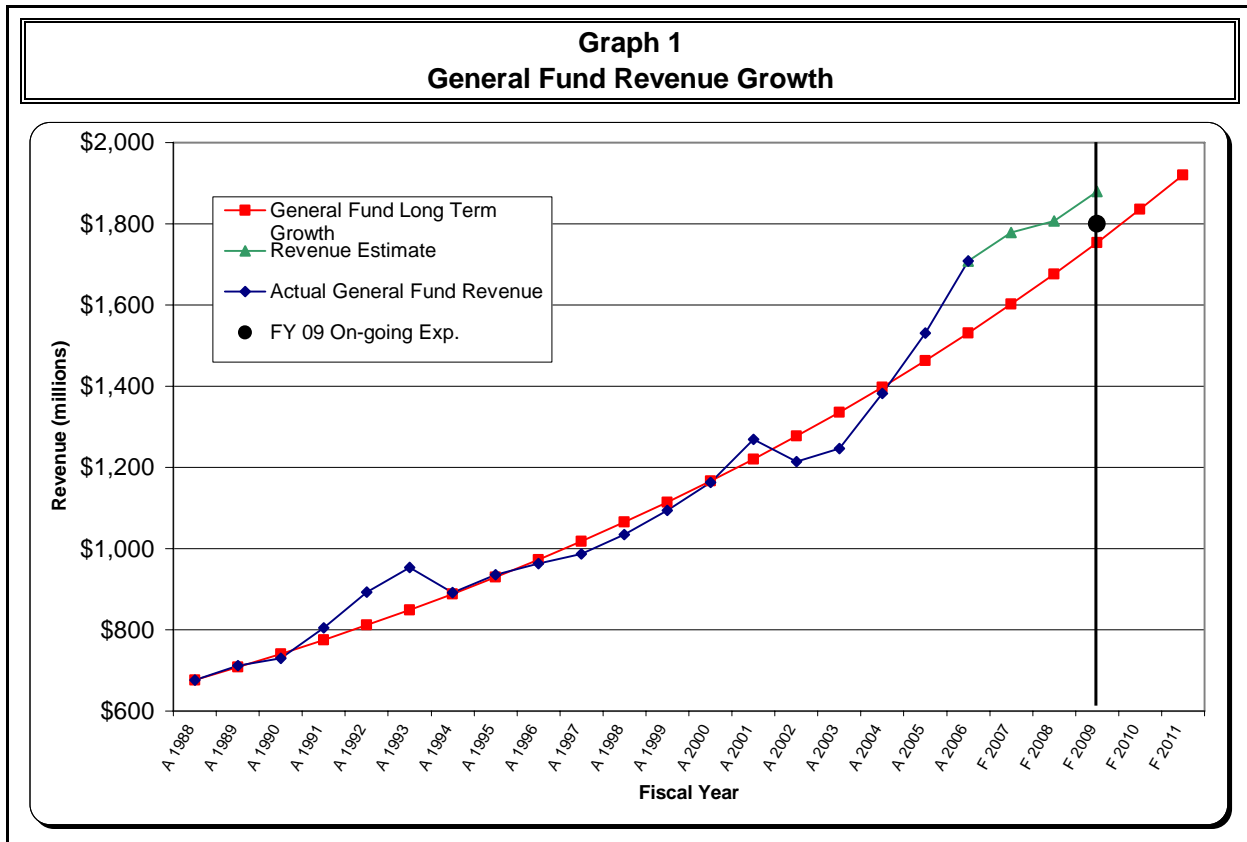
LONG-TERM GENERAL FUND REVENUE GROWTH

The Executive Budget is being constructed so on-going expenditures can be sustained for the long-term and therefore are within the parameters of the long-term general fund revenue growth trend. The information shown in Graph 1 and Table 2 illustrates the detail used to build the following “budget markers”.

In the past, there has been an eight year cycle for revenue: seven years of increasing revenue and one year of declining revenue. When revenue declined, it almost always fell below the long-term trend. The last general fund revenue decline was 4.35% in FY 2002, and the previous general fund revenue decline was 6.42% in FY 1994. The analysis for looking at the “budget markers” uses the long-term revenue trend. The goal is to sustain programs within the current revenue structure in the 2011 biennium. When revenue is above the long-term trend, some of it is reserved to support services during the next general fund revenue decline.

Long-Term General Fund Revenue Growth

The long-term general fund revenue growth trend is about 4.64%. But within this long-term growth trend are large fluctuations; some years with very high growth and some years with revenue decline. Historically, Montana has seen eight-year cycles that feature revenue increases for seven years – with the more rapid growth in the fifth, sixth and seventh years – capped with a revenue drop in the eighth year. This trend is shown in Graph 1.



- From FY 1991 to FY 1993, the state had rapid growth and then revenue declined 6.42 % in FY 1994 and grew slowly for a number of years.
- From FY 1999 to FY 2001, high growth rates were followed by a 4.35 % drop in FY02 and a slow rebound in FY 2003.
- General fund revenue grew by more than 10% for FY 2004, FY 2005, and FY 2006. So far, FY 2007 revenue appears to be continuing that trend.
- However, history indicates the general fund cannot continue to grow at the FY 2004 through FY 2006 pace.

Graph 1 shows the general fund revenue estimates through FY 2009 continuing to grow under the current economic conditions.

Table 1 compares the actual and forecasted unaudited general fund revenue for 24 years, from FY 1988 through FY 2011. The FY 2007 to FY 2009 revenue estimate, based on today's economic conditions, is \$433 million above the historical long-term growth rate.

At the end of FY 2006, the state's general fund had a balance of \$406 million. If \$100 million is considered an acceptable balance, the state had \$306 million already available for one-time expenditures. Adding that extra FY 2006 general fund balance to revenue expected in the following three fiscal years, the 2007 Legislature would have \$739 million in excess of the on-going revenue trend.

Table 1					
General Fund (GF) Long-Term Revenue Growth					
(Millions)					
Fiscal Year	General Fund Revenue	Percent Change	4.64% Growth	Percent Change	Actual vs. Trend \$ Diff.
A 1988	\$677		\$677		\$0
A 1989	\$712	5.21%	\$708	4.64%	\$4
A 1990	\$730	2.58%	\$741	4.64%	(\$11)
A 1991	\$805	10.26%	\$775	4.64%	\$30
A 1992	\$893	10.86%	\$811	4.64%	\$81
A 1993	\$953	6.76%	\$849	4.64%	\$104
A 1994	\$892	-6.42%	\$888	4.64%	\$3
A 1995	\$935	4.88%	\$930	4.64%	\$6
A 1996	\$963	2.98%	\$973	4.64%	(\$10)
A 1997	\$987	2.43%	\$1,018	4.64%	(\$31)
A 1998	\$1,034	4.85%	\$1,065	4.64%	(\$31)
A 1999	\$1,094	5.81%	\$1,115	4.64%	(\$20)
A 2000	\$1,164	6.32%	\$1,166	4.64%	(\$3)
A 2001	\$1,269	9.10%	\$1,220	4.64%	\$49
A 2002	\$1,214	-4.35%	\$1,277	4.64%	(\$63)
A 2003	\$1,246	2.65%	\$1,336	4.64%	(\$90)
A 2004	\$1,382	10.85%	\$1,398	4.64%	(\$17)
A 2005	\$1,531	10.81%	\$1,463	4.64%	\$68
A 2006	\$1,708	11.58%	\$1,531	4.64%	\$177
F 2007	\$1,779	4.15%	\$1,602	4.64%	\$177
F 2008	\$1,807	1.56%	\$1,676	4.64%	\$130
F 2009	\$1,879	4.01%	\$1,754	4.64%	\$125
FY 07 - FY 09 Revenue Est. over Trend					= \$433
FY 2006 Fund Balance above \$100 Million					= \$306
Total General Fund Avail over Long-TermTrend					= \$739

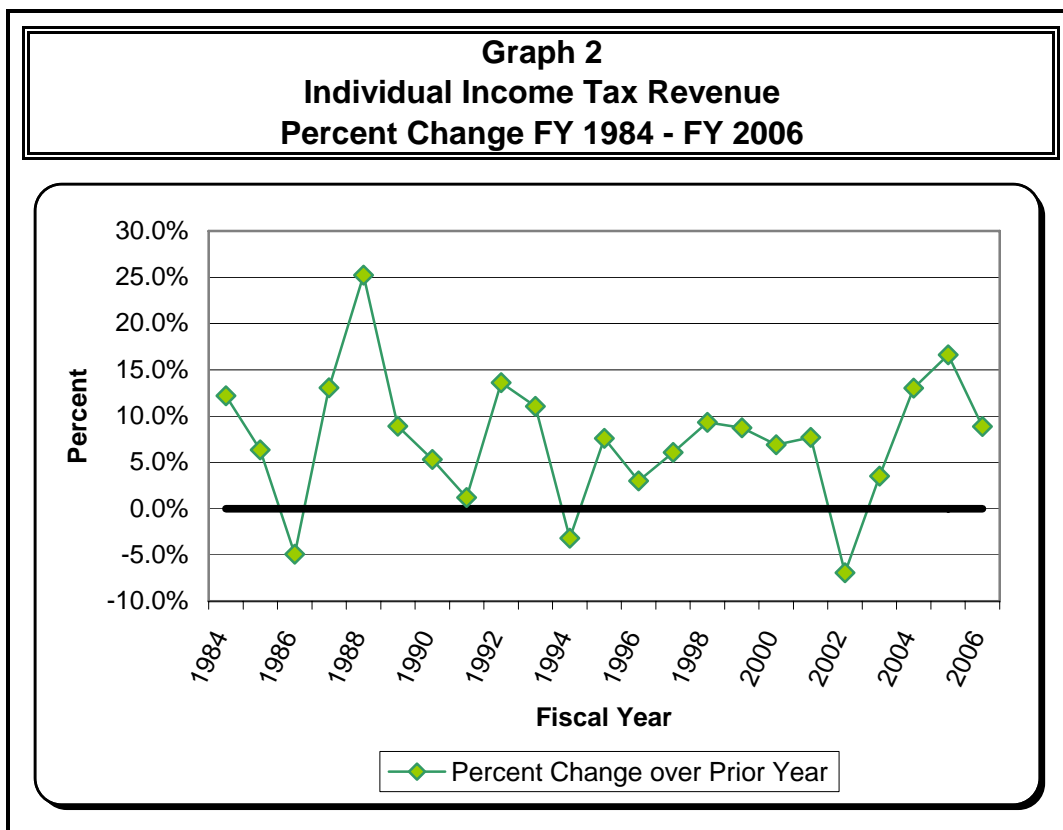
These funds will be available only if the current economic factors continue and if any revenue growth adjustment follows historic trends. The revenue correction usually occurs in the eighth year; but if it happens earlier, the \$739 million excess revenue will not be realized and the overall projections will decrease.

Volatility of Montana's General Fund Revenue

Montana's general fund revenue sources are very volatile. Sixty-three percent of the general fund is dependent upon three very dynamic revenue sources: individual income tax, corporate license tax, and natural resource taxes. As a group, other revenue sources change much more slowly and generally increase each year.

Individual Income Tax

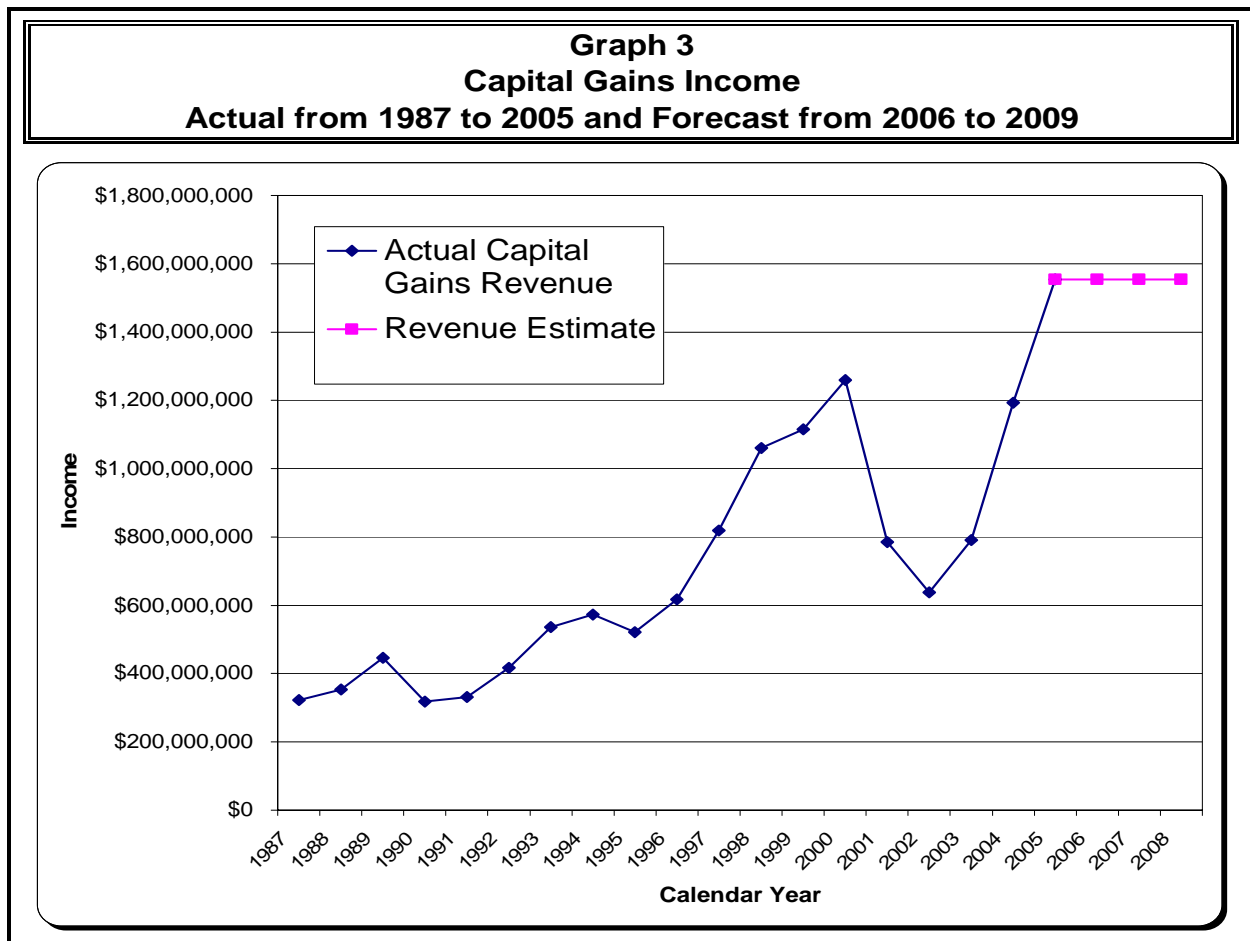
Personal income tax, which accounts for slightly less than half of general fund revenue, can fluctuate significantly from year to year. In FY 2001, for example, the state received \$556 million and the following year the amount dropped 7% to \$517 million. Personal income tax revenue grew 3.5% in FY 2003, jumped 13% in FY 2004, 16% in FY 2005, 9% in FY 2006. Graph 2 shows the history of individual income tax growth yearly since FY 1984.



Individual income tax revenue is expected to continue growing in FY 2007 through FY 2009, but at a slower rate than what occurred from FY 2002 to FY 2005. Based on history, the growth should remain positive until FY 2010. However, the pace of the revenue growth has been more rapid and will need to continue to be positive through FY 2009 to have the \$739 million available above the long-term revenue growth trend.

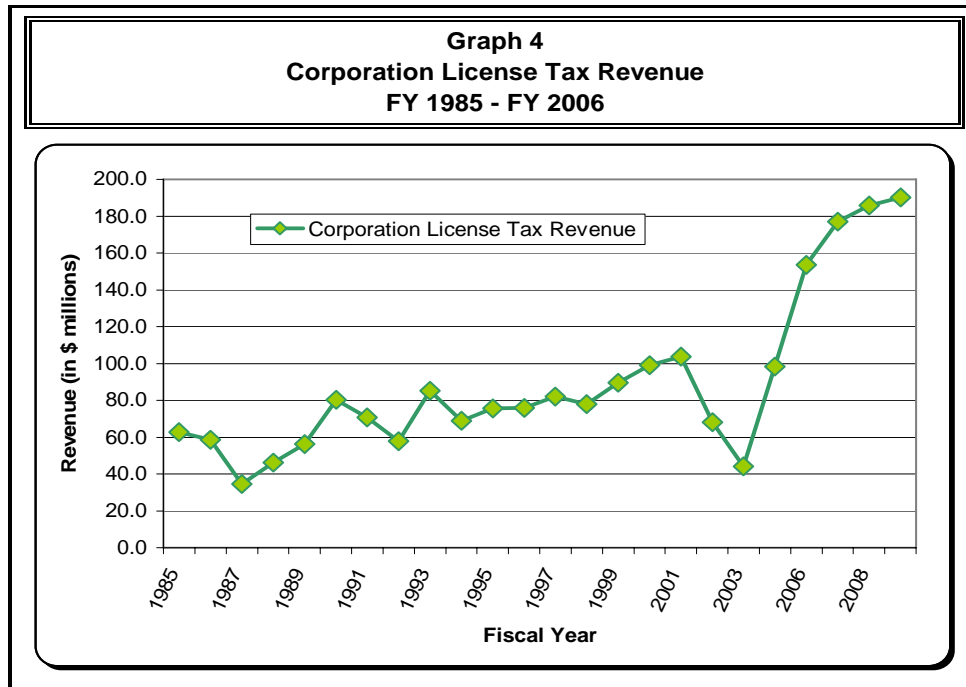
Individual Income Tax - Capital Gains

Since 1997, capital gains have been a driver in the fluctuations seen in state revenue. Capital gains have been much more volatile recently, as shown in the graph. Capital gains has a major impact on the amount of income taxes paid and, therefore, on overall revenue. It was a factor in the general fund revenue increase during FY 2006. However, based on recent history, this does not mean that the income tax on-going revenue base will be higher in future years. As Graph 2 shows, the projected capital gains income is projected to be sustained at the tax year 2005 level, but there is some risk that it will return to the long-term trend.



Corporate License Tax

Corporate tax is very volatile. As shown in Graph 4, corporate tax has ranged from \$104 million in FY 2001 down to \$44 million just two years later, and rebounded to \$154 million in FY 2006.



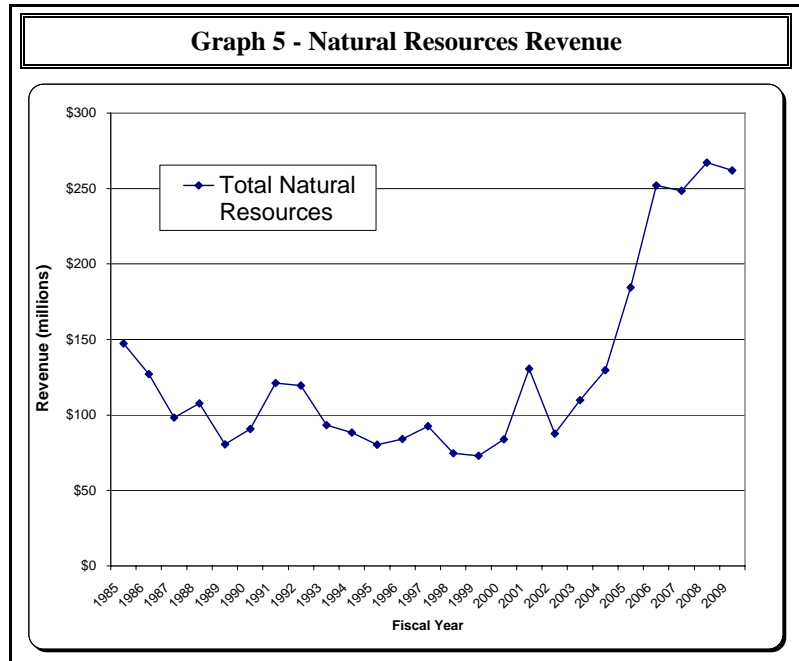
- In FY 2001, revenues reached a peak of \$104 million, but then dropped by more than \$35 million (34%) in a single year.
- In FY 2003, corporate tax declined another 35%.
- In FY 2004, revenues jumped by 53% and increased once again in FY 2005 by 45%.
- This roller-coaster pattern is not unique to that four-year period. In a one-year span, FY 1986 to FY 1987, corporate tax collections plummeted 41% after decreasing just 6% the year before.

As seen in Graph 4, revenue estimates reflect continuing increases in corporate profits as projected in Global Insight's national forecast. Should the Global Insight projection of national corporate profits be too optimistic, Montana corporate profits will be overstated. It is very feasible for corporate profits to decline by half from one fiscal year to the next.

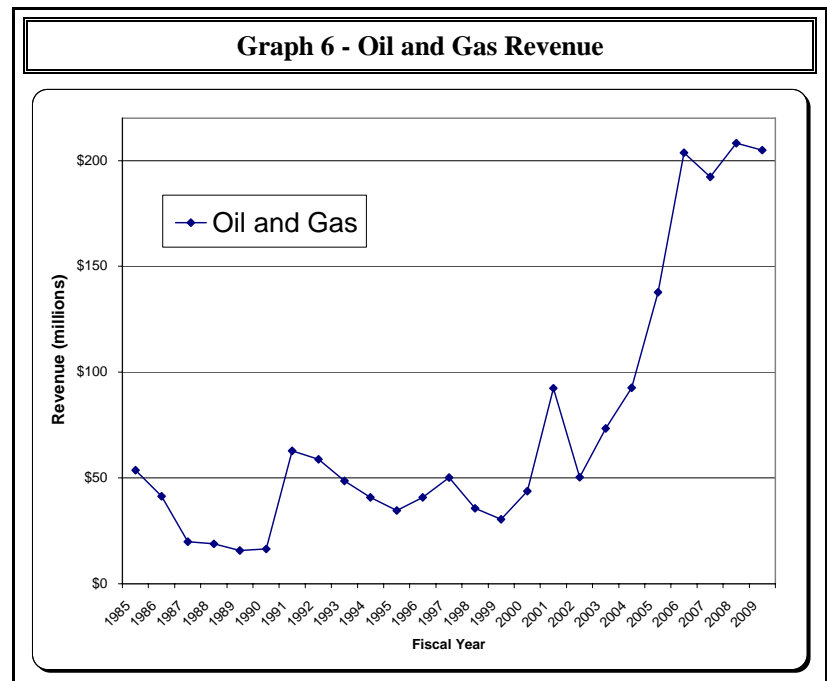
Natural Resource Revenue

Natural resource revenue allocations change frequently. The data shown is oil and natural gas production taxes, total coal severance tax, and metalliferous mine taxes, reported by the Legislative Fiscal Division for FY 1985 to FY 2006 and the budget office revenue estimates for FY 2007 to FY 2009. As shown in Graph 5, revenue from natural resources increased very rapidly after FY 2002. Except for a large increase in FY 2001, natural resource tax revenue had gradually declined prior to FY 2002.

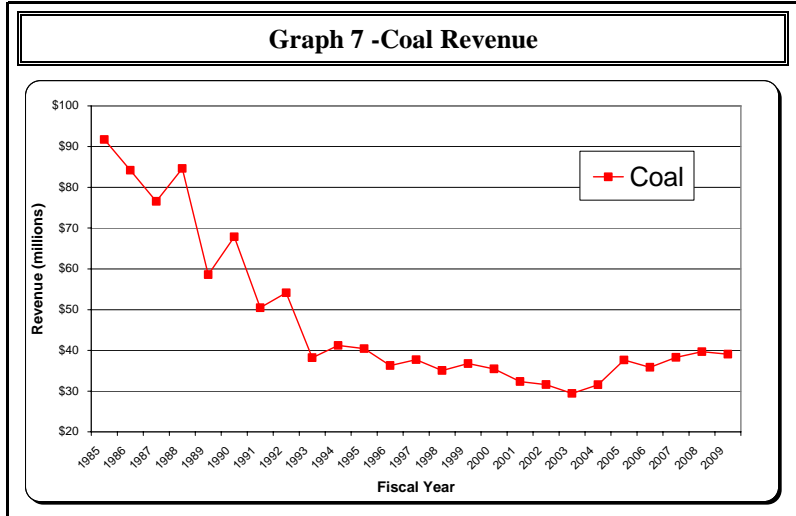
Examining the three natural resource taxes separately, revenue from coal production is decreasing while revenue from oil and natural gas production and metalliferous mines is increasing dramatically.



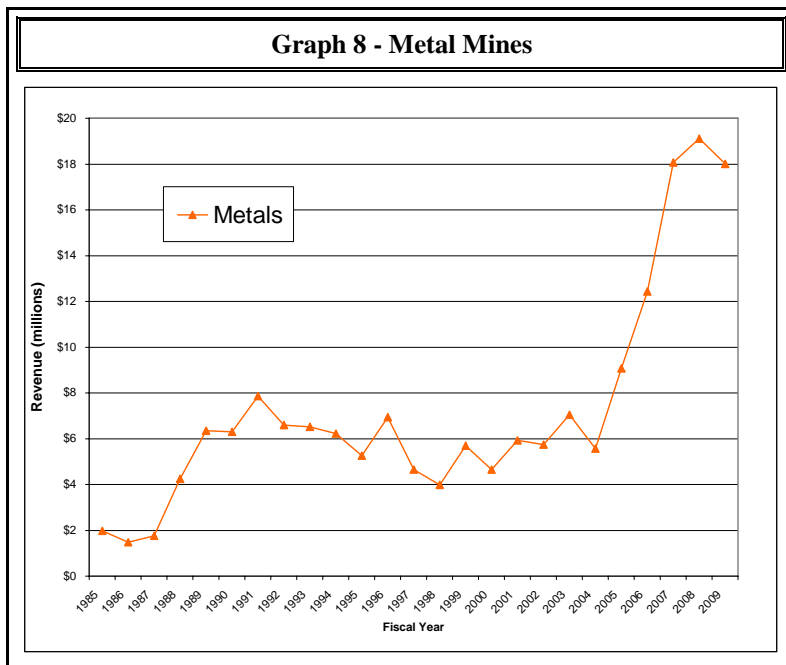
Graph 5 shows the oil and natural gas total tax revenue since FY 1985. During this time, taxes were reduced and that is reflected in lower tax revenue. But oil and natural gas production tax revenue has seen rapid increases since FY 2002. The graph shows that in the past four years, the revenue increased from \$50 million to \$204 million. The governor's budget office revenue estimates show a slight decline in FY 2007, due primarily to declining natural gas prices just in FY 2007. With a 300% growth in four years, there is considerable risk of a rapid revenue decline. The extent of such a reversal will depend mostly on the price of oil and natural gas.



Graph 7 shows a decline in coal tax revenue from \$92 million in FY 1985 to \$29 million in FY 2003, most the decline came from the reduction of the tax from 30% to 15% in three stages beginning in 1988. From FY 1994 to FY 2003 coal taxes went gradually down from \$41 million to \$29 million. Since then they have gradually increased. The state saw growth in FY 2004 and FY 2005 with coal tax revenue flattening in FY 2006. Notwithstanding the possibility of increased coal taxes resulting from the success of the Governor's coal development initiatives, the long lead time for such developments to come on line leads the budget office to estimate that coal tax revenue will remain relatively stable over the near term.



Metalliferous mine taxes, as shown in Graph 8, increased from \$2 million in FY 1985 to around \$6 million for the period FY 1989 to FY 2004. In FY 2005, metal mines revenue increased 65% or \$3.5 million. That was followed by another jump of \$3.4 million, or 37%. Based on a mine survey, the budget office projects this revenue to increase another \$6 million, or 50%, in FY 2007, before leveling off for the next two years.



In summary, the natural resource estimates for FY 2007 to FY 2009 show considerable optimism in the mining companies' production outlook, Global Insight's price estimates, and the futures market. These revenue estimates are built on the economics of today. In Montana as the graphs show, natural resource taxes are an all-time high and they can decline rapidly.