

2011 Economic Outlook Seminar

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2011 Seminar Agenda

7:45 - 8:00	Registration & Networking
8:00 - 8:05	Introductions <i>Ian Marquand</i>
8:05-8:45	Keynote Presentation <i>Patrick M. Barkey</i>
8:45-9:30	National, State, and Local Outlooks <i>Patrick M. Barkey and Paul E. Polzin</i>
9:30 - 9:40	Coffee Break
9:40 - 10:00	Nonresident Travel <i>Norma P. Nickerson</i>
10:00 - 10:20	Health Care <i>Gregg Davis</i>
10:20 - 10:40	Agriculture <i>George Haynes</i>
10:40 - 10:50	Coffee Break
10:50 - 11:10	Real Estate <i>Scott Rickard</i>
11:10 - 11:30	Manufacturing & Forest Products <i>Todd A. Morgan</i>
11:30 - 11:45	Issues in Local Economy <i>Local Speaker</i>
11:45 - 12:00	Break
Noon - 12:50	Luncheon Program Panel Discussion
12:50	Closing Remarks

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Paying for the Recession

Rebalancing Economic Growth

by Patrick M. Barkeby

Economic downturns are emotionally charged events. The fireside chats of President Franklin Roosevelt during the Depression of the 1930s encouraging Americans to ward off the demons of fear and panic remain relevant today. But now more than a full year after the officially declared end of the 2007-09 recession, our fears have shifted to something a bit different: How we will pay the full cost of bringing this recession to a close?

The concern is not just about how we will close the government deficits that ballooned as economic growth went into reverse. It's about reconfiguring and rebalancing everything from household budgets to international trade to adjust to what might be called a post-housing bubble reality. It's a reality where everything built on the assumption of faster growth fueled by booming construction and real estate needs to be reassessed, from household savings rates to government entitlement programs.

Four Challenges to Balanced Economic Growth

There has perhaps never been a time when growth in the U.S. economy has been in perfect balance. But by any standard, the number and the size of the imbalances that the economy faces today are daunting. They represent a challenge to policymakers and the private sector alike. Specifically, the list includes:

Low savings rates. U.S. households went on a borrowing binge during the bubble years before the recession, helped by rapidly rising home prices and inflows of investment capital from abroad. In the post-bubble recovery, savings must increase if households are to avoid drastic reductions in standards of living in retirement.

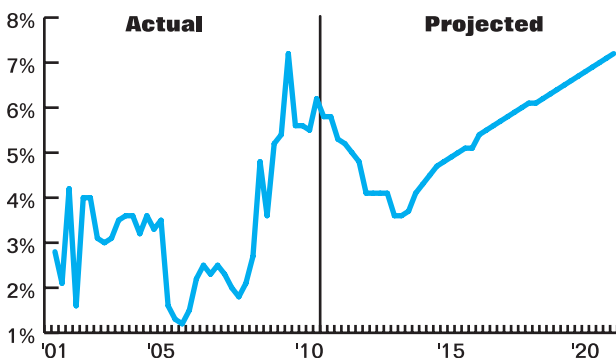
Financial sector adjustments. During the past decade, the financial services slice of the overall economy grew from 12 percent to 14 percent, an unprecedented development which is now expected to reverse.

Global trade imbalances. As the global economy has expanded, so have the persistent surpluses and deficits in goods and service flows in some parts of the world, building pressures on exchange rates that are becoming increasingly more difficult to effectively manage.

Government budgets. Paying for the deficits that exploded at all levels of government during the recession will be tough, but not as tough as solving the longer-term structural issues the post-bubble recovery has revealed.

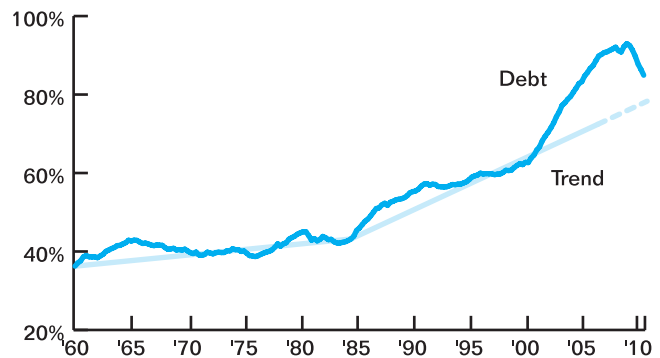
On the bright side, both market forces and policymakers are producing progress in all of these areas. And for Montanans, certainly, some of these issues loom larger than others. Together they presage a new economic environment that households, businesses, and governments should be preparing for.

Figure 1
Savings as a Percent of After-Tax Income, U.S., Actual and Forecast, 2001-2020



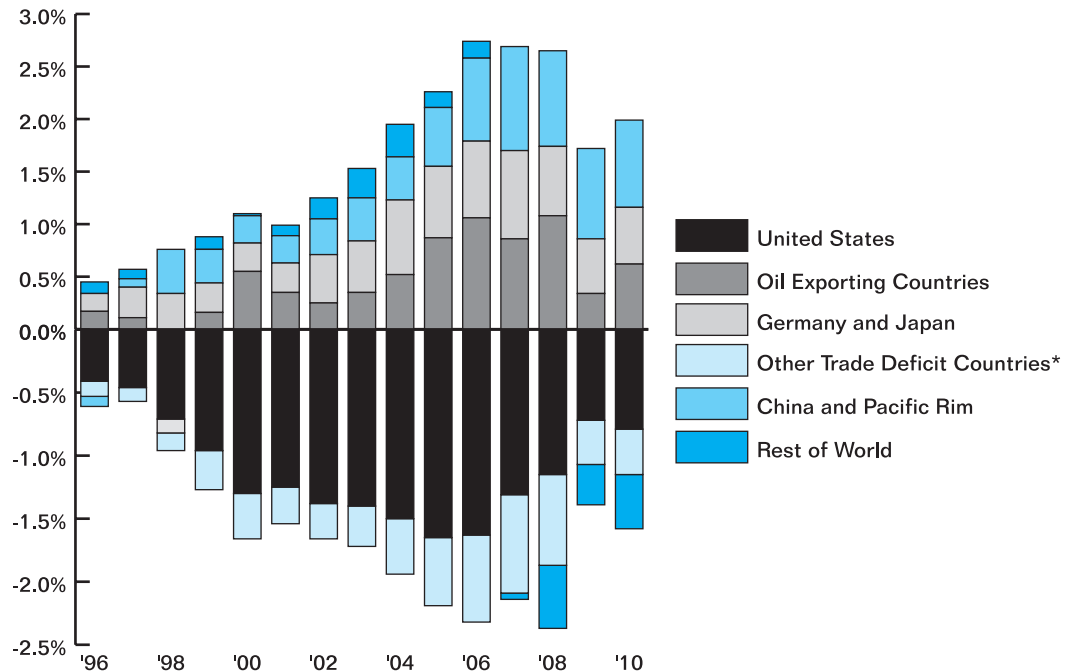
Source: U.S. Bureau of Economic Analysis and IHS Global Insight.

Figure 2
U.S. Mortgage and Consumer Debt as a Percent of Gross Domestic Product (GDP), 1960-2010



Source: Federal Reserve and Bureau of Economic Analysis.

Figure 3
Trade Surpluses and Deficits
as a Percent of World GDP, 1996-2010



*17 countries including former Warsaw Pact countries plus Ireland, U.K., Spain, Turkey, and Greece.
 Source: International Monetary Fund.

Low Savings Rates

Levels of debt held by households in the U.S. economy have been increasing faster than income since the early 1990s. Although low interest rates that have largely prevailed over this time period have limited the increases in the cost of servicing that debt, household financial obligations rose from 16 percent of after-tax income in 1993 to just short of 19 percent at just as the recession hit in 2007. During this same time, household savings flows, defined as the difference between total income and total consumption in any period, hovered between 1 percent and 2 percent of after-tax income, as shown in Figure 1.

Since 2007 consumer debt levels have fallen steeply, as shown in Figure 2. Almost all of this has been due to write-downs of bad loans by banks and other lending institutions. Mortgage and consumer debt as a percentage of the total economy has now largely closed the gap between its pre-recession peak and the long-term trend. Savings rates have rebounded to between 5 percent and 6 percent of income – lower than most developed countries but much higher than the very low rates prior to the recession.

Higher savings rates mean lower consumer spending. That, in turn, means fewer restaurants and car dealers and shorter vacations. But it also could mean fewer imported goods and a smaller trade deficit.

Financial Sector Adjustments

Changes in the size and structure of the financial services industry are also well underway. The industry has shrunk by almost 9 percent nationwide, with many fewer employees in mortgage originations and many more in loss mitigation activities.

Employment in mortgage originations doubled in Montana between the years 2002 and 2004, compared to a 40 percent increase that took place nationally spread out over the years 2002 and 2006. As the housing market collapsed in 2007, those gains were abruptly reversed. The mortgage securitization industry that helped fuel the housing boom is almost totally gone, but the government-supported mortgage guarantee behemoths Freddie Mac and Fannie Mae continue on with significant taxpayer support.

Adjustments in the financial services industry, particularly those associated with housing, are not yet complete. And Montanans have a big stake in how smoothly and painlessly they take place.

Global Trade Imbalances

There is clearly one way in which global trade imbalances – defined as the persistent difference between what a country buys and sells to/from the rest of the world – can be brought down. The global economic downturn of 2008-09, when more than 80 percent of countries in the world were in

recession at the same time, certainly took a bite out of surpluses and deficits around the world, as shown in Figure 3. But no one wants to pull the plug on the global commerce that has done so much to raise living standards around the world just to halt the red ink in trade.

With recovery in global trade post-recession, most forecasters expect surpluses in Asian countries plus Germany, and deficits in the United States, to grow again for the next few years. And we are increasingly aware of the problems that result as other countries pile up dollars and the United States piles up debt. It is difficult to predict the ultimate outcome, but it is difficult to reconcile this trajectory with the spending power and the dominance of the dollar in world markets that we have been long accustomed to.

Government Finance

The tsunami that hit governments in the recession was real. But not all governments were equally affected. And for local governments in particular, the worst may be ahead as housing price declines start to show up in the assessed value of property.

State governments overall took a huge hit in tax revenues, as shown in Figure 4. This was largely due to their dependence on economically sensitive taxes including income and (outside Montana) general sales taxes. Plugging budget holes with one-time instruments such as rainy day funds and federal stimulus dollars has helped states tread water. Even without

the recession-related stress on state budgets, the twin problems of dealing with pension underfunding and Medicaid costs would be daunting. Add to that mix the need to replenish rainy day funds for the next downturn and it is apparent why state capitols are such glum places.

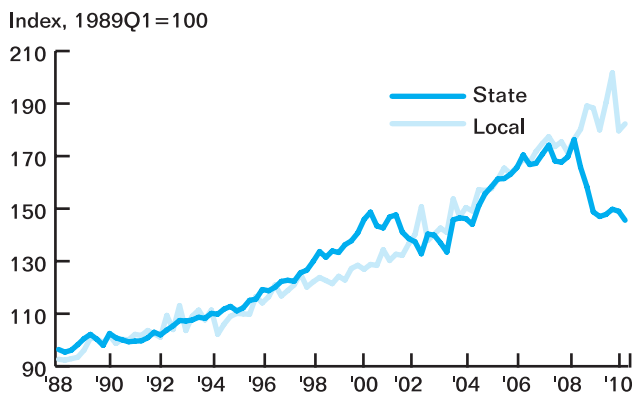
The federal government's budget problems are of a completely different order of magnitude. The recession was deep and the past two year's deficits were huge, but the real problem is what happens after the recession, when total government debt takes off as baby boomers retire. Thirty years of congressional dysfunction has narrowed the range of options for dealing with entitlement reform.

The aging of baby boomers is upon us and that will impact spending on Social Security as well as the federally funded share of health care, as shown in Figure 5. The promises to older Americans must be kept, and the obligations of past deficits must be paid. But what can and must be changed are the promises to future generations, no matter how unpleasant this may be. There are good ideas out there to right this ship, and it's time we started taking them seriously.

Conclusion

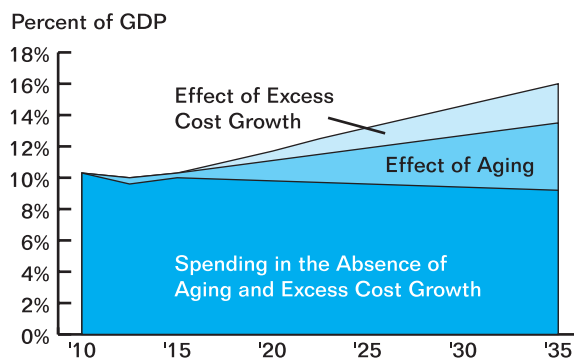
Fixing all of our economic problems is either frightening or exhilarating, depending on how you look at it. The challenges are huge, but so are the talents and capabilities of the most flexible, dynamic, and innovative economy in the world. Addressing these problems is certainly a daunting task, but looking the other direction is a less and less feasible option.

Figure 4
State and Local Tax Revenues, U.S., 1988-2010



Note: BBER has adjusted the data for seasonality.
Source: U.S. Census Bureau.

Figure 5
Components of Future Cost Growth in Social Security, Medicaid, and Medicare, 2010-2035



Source: Congressional Budget Office.

U.S. Recession Officially Over Is Recovery Ever Going to Arrive?

by Patrick M. Barkey

You can be forgiven for missing it – but the worst recession since the 1930s ended in the summer of 2009, according to the National Bureau of Economic Research. With sluggish hiring, weak growth, and a whiff of fresh banking problems in Europe and the United States, it sure doesn't feel like the economy is getting better. But with tax policy at last in place, with a weaker dollar and a slowly improving consumer mood, 2011 shapes up as the year that the recovery finally gets rolling in the national economy.

The U.S. economy will grow a bit faster in 2011, but still not fast enough to bring unemployment rates down much from 9.6 percent. Following are the top ten predictions for the coming year, courtesy of IHS Global Insight, Inc.

Top Ten Economic Predictions for 2011

(Courtesy of IHS Global Insight, Inc.)

1. The U.S. economic recovery will pick up steam as the year progresses. The newly enacted tax package will help push growth close to 3 percent in 2011.
2. Europe and Japan also will see stronger growth in GDP in the second half of 2011. Unless a full crisis envelops the Euro, growth will flatten before improving later in the year.
3. Emerging markets such as Latin America and China will slow, but will continue to grow three times faster than advanced economies.
4. Interest rates will be mostly unchanged in the United States and other G-7 countries, but will rise in Brazil, Russia, China, and India. Central banks are expected to keep rates at very low levels for the next 12 months.
5. Fiscal policy will tighten across the developed economies. Whether by choice or under duress, pressure to close deficits will tighten government belts.
6. Commodity prices will continue their gradual rise. Look for prices to be 5-10 percent higher for most commodity goods by this time next year.
7. Inflation will not be a problem in advanced economies, but prices will heat up in emerging economies. Consumer price inflation in mature economies will be only 1.5 percent in 2011, compared to 5.5 percent in the developing world.
8. Global imbalances will neither worsen nor improve. The United States will continue to run a trade imbalance with the rest of the world in general and with China in particular.
9. The dollar will continue to weaken against most currencies, with the exception of the Euro.
10. Risks to global growth are becoming more balanced, on the upside and the downside. Faster growth in business and consumer spending is possible, as is a new crisis in sovereign debt finance.

Table 1
Economic Trends for the U.S. Economy, 2005-2014
Actual and Projected as of December 2009

	Actual					Projected				
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Real GDP (chained \$), percent change	3.1	2.7	1.9	0.0	-2.6	2.8	2.4	3.0	3.2	3.3
Inflation (CPI-U), percent change	3.4	3.2	2.9	3.8	-0.3	1.6	1.3	1.8	2.0	2.2
Interest Rates										
90-day T-bills, percent	3.1	4.7	4.4	1.4	0.2	0.1	0.3	1.4	3.4	3.6
Mortgage rates (30 years), percent	5.9	6.4	6.3	6.0	5.0	4.7	4.5	5.0	6.1	6.2
Housing starts, millions	2.07	1.81	1.34	0.90	0.55	0.59	0.70	1.09	1.41	1.62
Unemployment rate, percent	5.1	4.6	4.6	5.8	9.3	9.6	9.5	8.9	8.2	7.5
Oil, West Texas Intermediate (\$/barrel)	56.56	66.12	72.18	99.76	61.77	78.87	82.83	89.16	93.02	96.27

Source: IHS Global Insight Inc.

The Montana Outlook

Stronger Growth Ahead

by Patrick M. Barkey and Paul E. Polzin

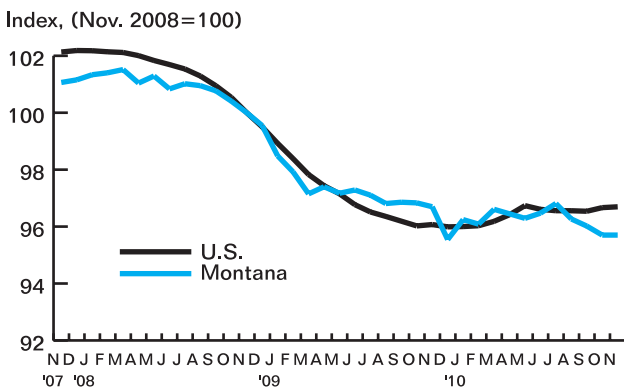
After enduring the broadest, deepest recession seen in the state in 25 years, Montanans can expect to see better growth arrive in the state economy in 2011. The weak growth that we projected at this time last year for 2010 was exactly what we got, and it did little to ease concerns over our economic future. It also did little to help labor markets or state tax revenues, both of which moved sideways for most of the year.

But compared to the steep declines most sectors of the state economy experienced in 2009, 2010 was a year when consumer spending stabilized, financial institutions returned to normality, and virulent cost-cutting by businesses came to an end. And for some Montana industries, most notably agriculture and natural resources, prospects brightened considerably.

We expect that 2011 will be the year when growth in the state economy kicks up a notch. Compared to the housing bubble-related growth in pre-recession times, growth will be tame. But beginning in the second half of 2011 and continuing into 2012, the Montana economy will turn in its best performance since 2006, due to:

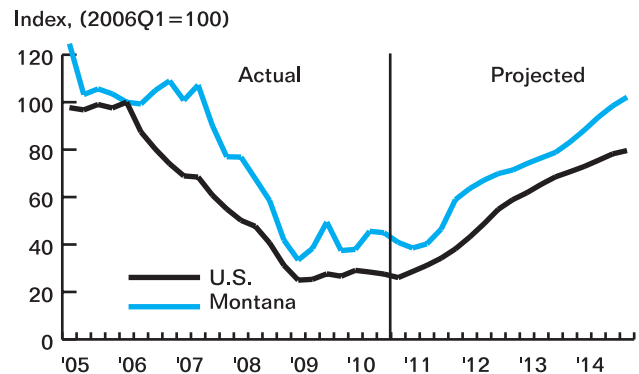
- continued and expanded investment in the state's energy and natural resource infrastructure,
- strong growth in farm receipts due to improved global market conditions,
- growth in exports fueled by a weaker dollar, and
- continued strengthening in consumer spending in the national economy.

Figure 1
Nonfarm Wage and Salary Employment, Montana and U.S.



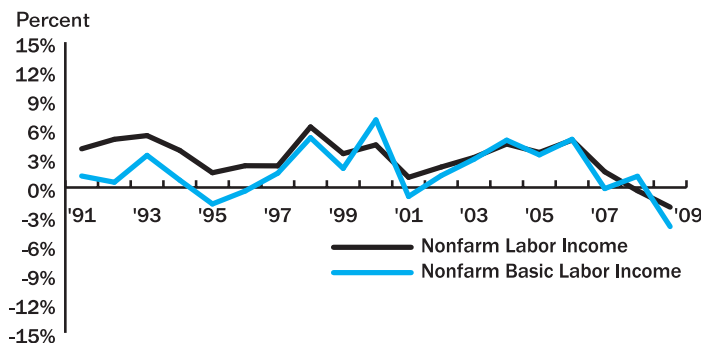
Sources: U.S. Bureau of Labor Statistics and Montana Department of Labor and Industry.

Figure 2
Residential Housing Starts, Montana and U.S. 2005 Q1 to 2014 Q4



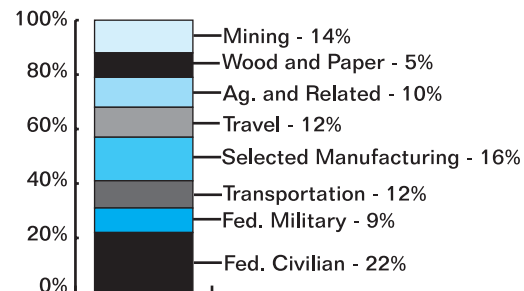
Source: U.S. Bureau of the Census and IHS Global Insight, Inc.

Figure 3
Nonfarm Labor Income and Nonfarm Basic Labor Income, Montana, Percent Change, 1991-2009, [In Constant Dollars]



Source: Bureau of Economic Analysis, U.S. Department of Commerce.

Figure 4
Labor Income in Basic Industries, Montana, 2008-2010 [Percent of Total]

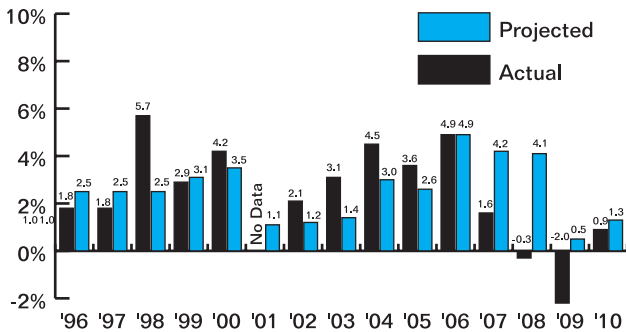


Sources: Bureau of Business and Economic Research, The University of Montana; Bureau of Economic Analysis, U.S. Department of Commerce.

Still sitting on the sidelines will be Montana's construction and forest products industries. While we are more optimistic about a return to housing construction, it will be another two years before we will see anything resembling healthy demand for new homes.

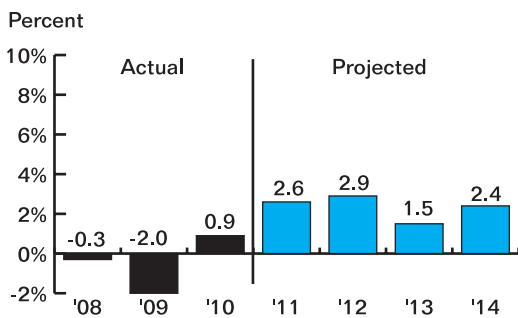
Governments are another sector that continues to face challenges. The unsustainable federal budget situation presents a key risk to our forecast, as do the fiscal pressures other governments face worldwide. Prudent management of a still-fragile situation in housing finance is also vital if this recovery is to spread its wings in the coming year.

Figure 5
Actual and Projected Percent Change in Nonfarm Labor Income, Montana, 1996-2010



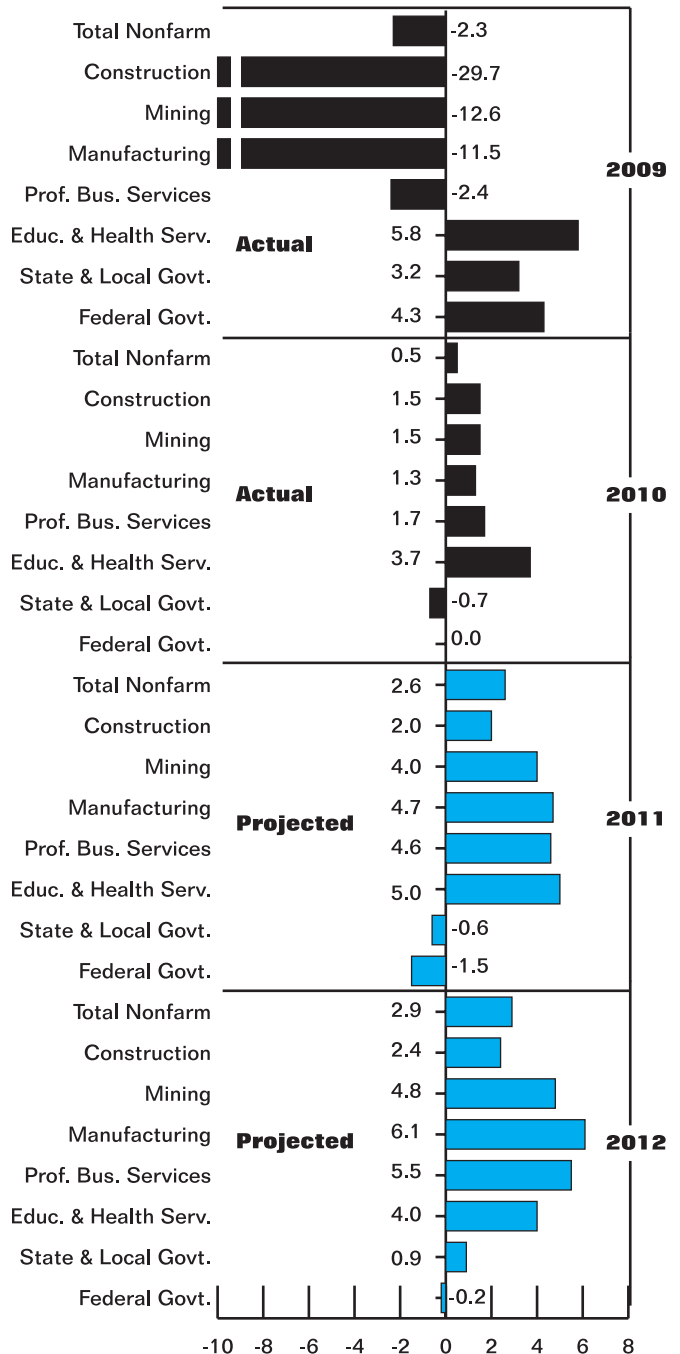
Sources: Bureau of Business and Economic Research, The University of Montana; Bureau of Economic Analysis, U.S. Department of Commerce.

Figure 6
Actual and Projected Percent Change in Nonfarm Labor Income, Montana, 2008-2014



Note: Data seasonally adjusted by BBER.
Source: U.S. Bureau of Labor Statistics.

Figure 7
Percent Change in Wage and Salary Disbursements, Montana, Selected Industries 2009-2012

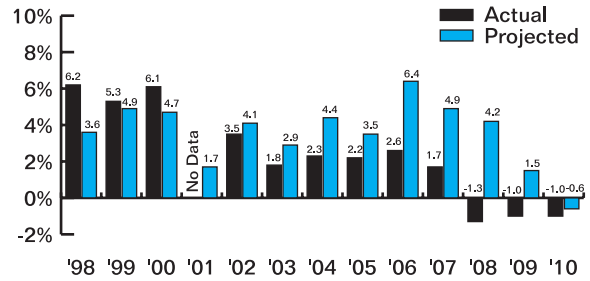


Sources: Bureau of Business and Economic Research, The University of Montana, IHS Global Insight Inc.

Missoula County

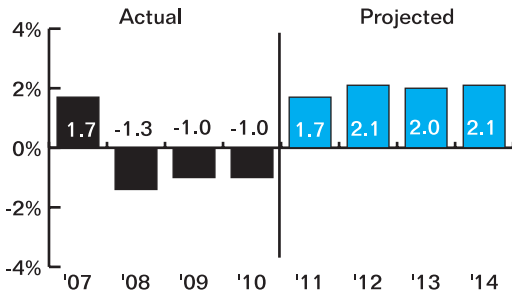
The recession has been long and hard for Missoula because cyclic job losses have been exacerbated by permanent closures and shutdowns. Missoula is the only major Montana city to experience three straight years of economic declines. The downward spiral began with the shutdown of the Bonner plywood plant in 2007 and was followed by the Bonner sawmill closure in 2008. The final shoe to drop was the closing of the Smurfit-Stone pulp mill in early 2010. Growth is projected to turn positive in 2011. Economic growth in Missoula County has consistently lagged behind the statewide average since mid-decade, and this is unlikely to change in the near future. Missoula continues as the dominant trade and service center in western Montana, but competition from other communities means that these sectors are contributing much less to local growth. It will be at least 2012 before Missoula's real nonfarm labor income (an overall measure of the economy) regains its 2007 peak.

Figure 1
Actual and Projected Percent Change in Nonfarm Labor Income, Missoula County, 1998-2010



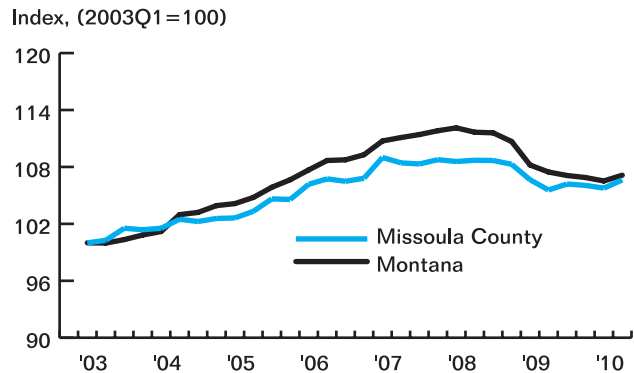
Sources: Bureau of Business and Economic Research, The University of Montana; Bureau of Economic Analysis, U.S. Department of Commerce.

Figure 2
Actual and Projected Percent Change in Nonfarm Labor Income, Missoula County, 2007-2014



Sources: Bureau of Business and Economic Research, The University of Montana; Bureau of Economic Analysis, U.S. Department of Commerce.

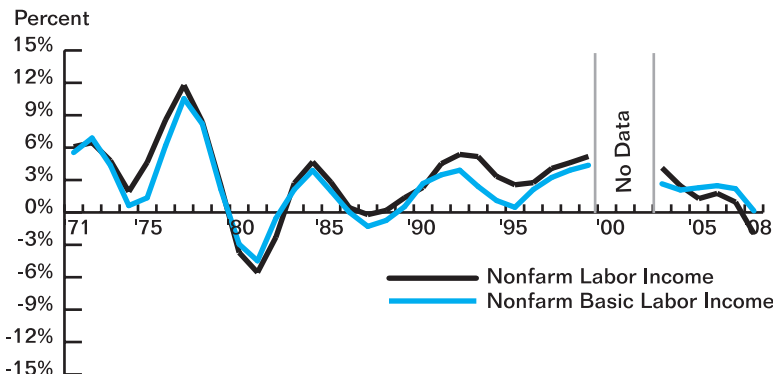
Figure 3
Nonfarm Wage and Salary Employment, Montana & Missoula County, 2003 Q1 to 2010 Q2



Note: Data seasonally adjusted by BBER.

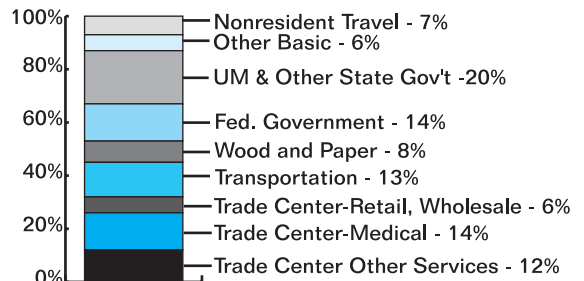
Source: U.S. Bureau of Labor Statistics, Quarterly Census of Employment and Wages.

Figure 4
Nonfarm Labor Income and Nonfarm Basic Labor Income, Missoula County, Percent Change, 1971-2008 (In Constant Dollars)



Note: 1971-1999 are three-year averages. 2002-2008 are two-year averages.
Source: Bureau of Economic Analysis, U.S. Department of Commerce.

Figure 5
Labor Income in Basic Industries, Missoula County, 2008-2010 (Percent of Total)

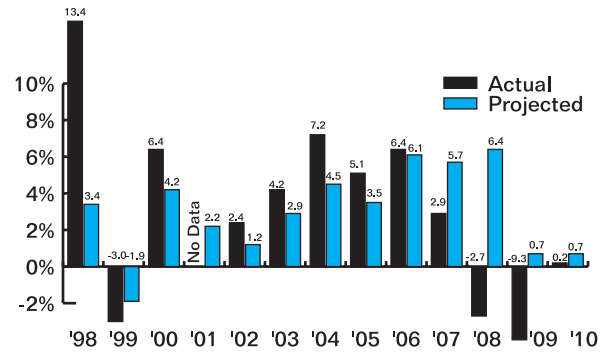


Sources: Bureau of Business and Economic Research, The University of Montana; Bureau of Economic Analysis, U.S. Department of Commerce.

Flathead County

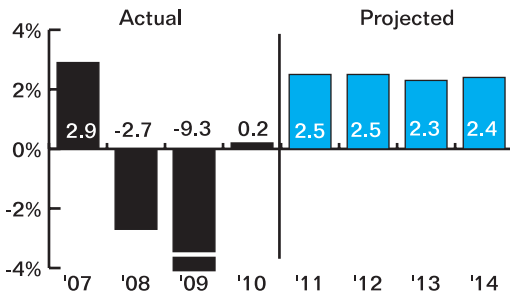
According to the numbers, the recession hit the Flathead economy harder than any other major urban area in the state. The nonfarm labor income decline of 2.7 percent in 2008 and the 9.3 percent decrease in 2009 were the largest among the cities reported. Although not shown in the *Outlook* book, Flathead County's unemployment rate hit 11.3 percent in November 2010, higher than any of the other large counties in the state. These sizable impacts were the result of permanent closures (such as Columbia Falls Aluminum Company) combined with cyclic declines in major industries such as wood products, nonresident travel, and construction. On the positive side, the evolution of Kalispell into a regional trade and service center continues to be one of the growing sectors of the economic base. It will be at least 2014 before real nonfarm labor income (an overall measure of the economy) in Flathead County regains its 2007 peak. It will take even longer for employment to regain its pre-recession level.

Figure 1
Actual and Projected Percent Change in Nonfarm Labor Income, Flathead County, 1998-2010



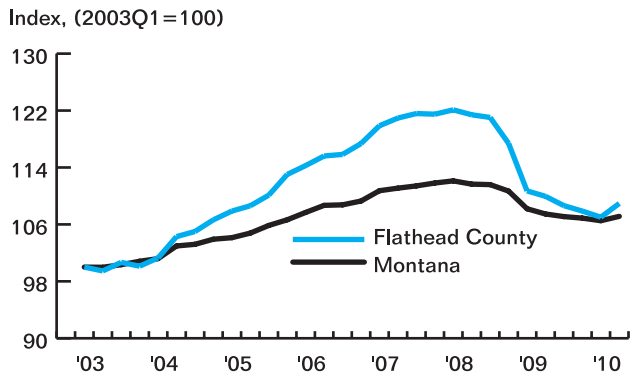
Sources: Bureau of Business and Economic Research, The University of Montana; Bureau of Economic Analysis, U.S. Department of Commerce.

Figure 2
Actual and Projected Percent Change in Nonfarm Labor Income, Flathead County, 2007-2014



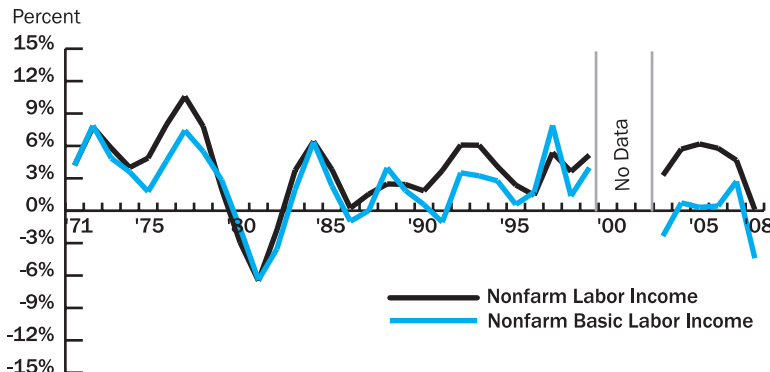
Sources: Bureau of Business and Economic Research, The University of Montana; Bureau of Economic Analysis, U.S. Department of Commerce.

Figure 3
Nonfarm Wage and Salary Employment, Montana & Flathead County, 2003 Q1 to 2010 Q2



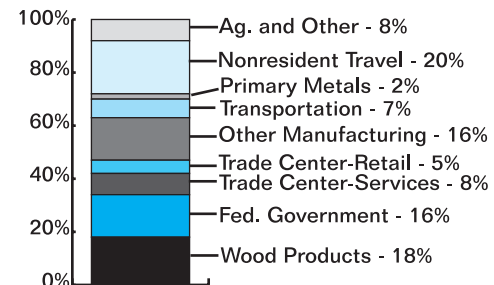
Note: Data seasonally adjusted by BBER. Source: U.S. Bureau of Labor Statistics, Quarterly Census of Employment and Wages.

Figure 4
Nonfarm Labor Income and Nonfarm Basic Labor Income, Flathead County, Percent Change, 1971-2008 (In Constant Dollars)



Note: 1971-1999 are three-year averages. 2002-2008 are two-year averages. Source: Bureau of Economic Analysis, U.S. Department of Commerce.

Figure 5
Labor Income in Basic Industries, Flathead County, 2008-2010 (Percent of Total)

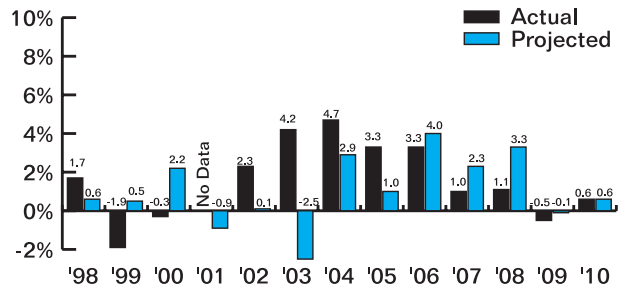


Sources: Bureau of Business and Economic Research, The University of Montana; Bureau of Economic Analysis, U.S. Department of Commerce.

Butte-Silver Bow County

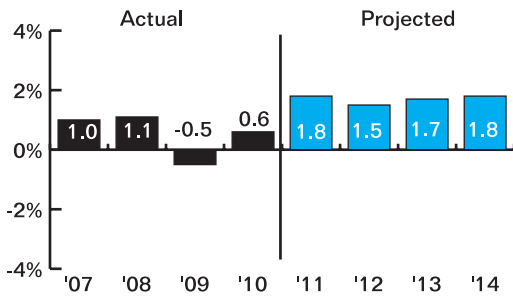
The recession was relatively mild for the Butte area economy. There was only a one-year decline in nonfarm labor income. There were, however, decreases in construction and retail trade. The forecast assumes that the Montana Resources mine remains open and operating at about current levels, but that employee bonuses reflect changes in the price of copper. Chip and solar panel producer REC Silicon, located in Butte, continues to serve worldwide markets. The trade center components of Butte's economic base (retail trade and services) continue to grow, reflecting the city's continued development as a regional trade and service center.

Figure 1
Actual and Projected Percent Change in Nonfarm Labor Income, Silver Bow County, 1998-2010



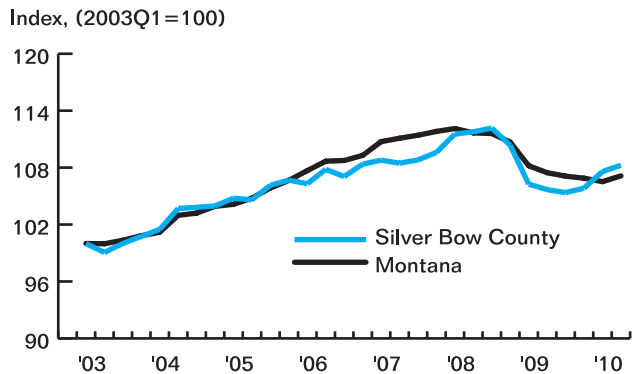
Sources: Bureau of Business and Economic Research, The University of Montana; Bureau of Economic Analysis, U.S. Department of Commerce.

Figure 2
Actual and Projected Percent Change in Nonfarm Labor Income, Silver Bow County, 2007-2014



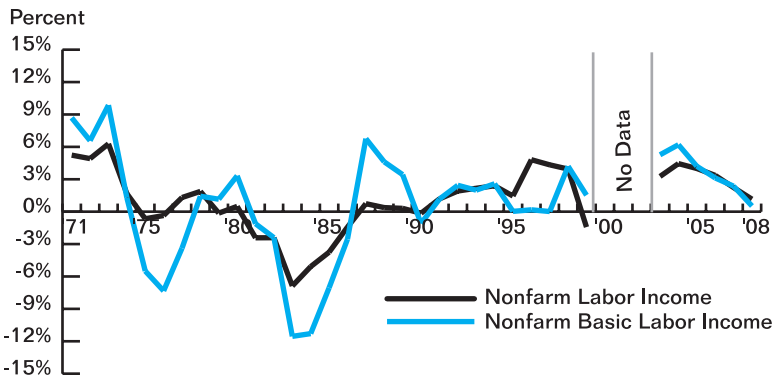
Sources: Bureau of Business and Economic Research, The University of Montana; Bureau of Economic Analysis, U.S. Department of Commerce.

Figure 3
Nonfarm Wage and Salary Employment, Montana & Silver Bow County, 2003 Q1 to 2010 Q2



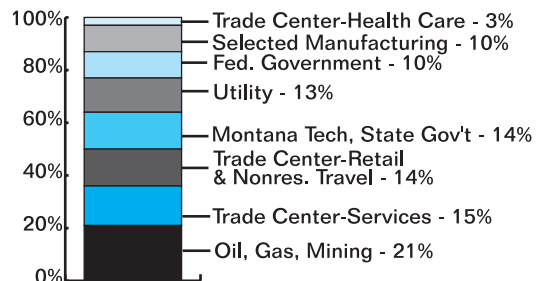
Note: Data seasonally adjusted by BBER. Source: U.S. Bureau of Labor Statistics, Quarterly Census of Employment and Wages.

Figure 4
Nonfarm Labor Income and Nonfarm Basic Labor Income, Silver Bow County, Percent Change, 1971-2008 (In Constant Dollars)



Note: 1971-1999 are three-year averages. 2002-2008 are two-year averages. Source: Bureau of Economic Analysis, U.S. Department of Commerce.

Figure 5
Labor Income in Basic Industries, Silver Bow County, 2008-2010 (Percent of Total)

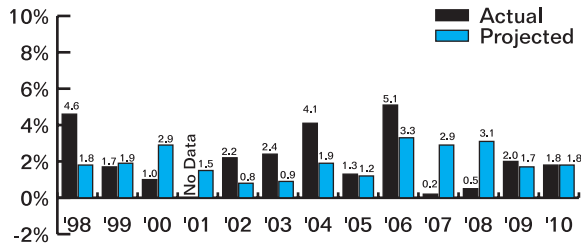


Sources: Bureau of Business and Economic Research, The University of Montana; Bureau of Economic Analysis, U.S. Department of Commerce.

Cascade County

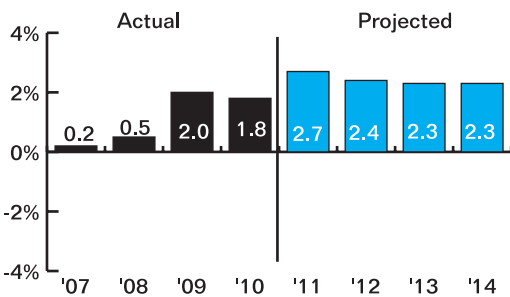
The Great Falls area economy experienced fewer recession impacts than any other area in Montana. It was the only major city in Montana that did not decline at anytime. Even so, certain sectors – mostly wholesale trade, retail trade, and construction – were hard hit. Malmstrom Air Force Base (including both civilian and military workers) accounts for almost one-half of the economic base in Cascade County, and stable or slightly increasing staffing levels lend stability to the local economy. Great Falls continues as the dominant medical center in North Central Montana, and growth in the sector during 2008 and 2009 helped to mute recession effects in other industries.

Figure 1
Actual and Projected Percent Change in Nonfarm Labor Income, Cascade County, 1998-2010



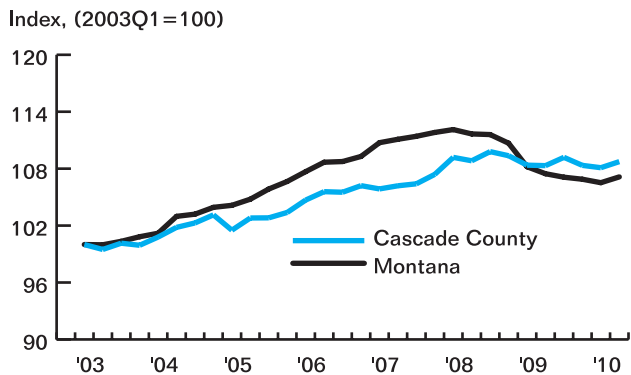
Sources: Bureau of Business and Economic Research, The University of Montana; Bureau of Economic Analysis, U.S. Department of Commerce.

Figure 2
Actual and Projected Percent Change in Nonfarm Labor Income, Cascade County, 2007-2014



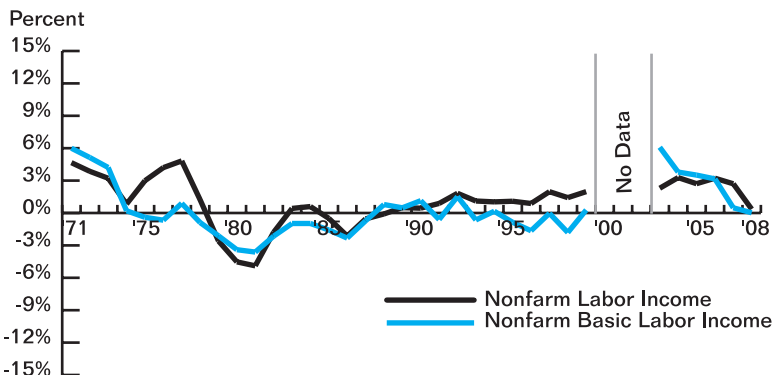
Sources: Bureau of Business and Economic Research, The University of Montana; Bureau of Economic Analysis, U.S. Department of Commerce.

Figure 3
Nonfarm Wage and Salary Employment, Montana & Cascade County, 2003 Q1 to 2010 Q2



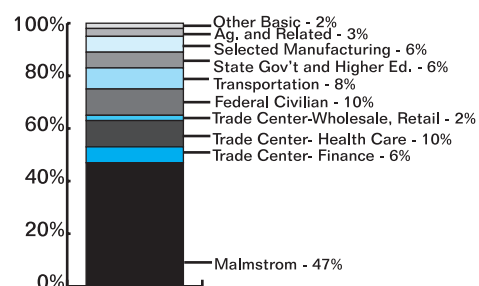
Note: Data seasonally adjusted by BBER. Source: U.S. Bureau of Labor Statistics, Quarterly Census of Employment and Wages.

Figure 4
Nonfarm Labor Income and Nonfarm Basic Labor Income, Cascade County, Percent Change, 1971-2008 (In Constant Dollars)



Note: 1971-1999 are three-year averages. 2002-2008 are two-year averages. Source: Bureau of Economic Analysis, U.S. Department of Commerce.

Figure 5
Labor Income in Basic Industries, Cascade County, 2008-2010 (Percent of Total)

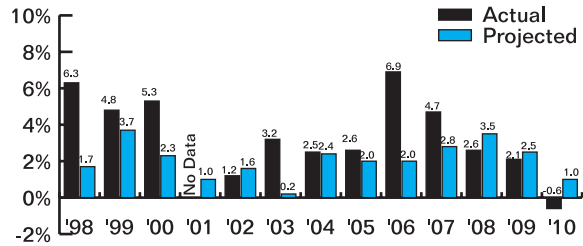


Sources: Bureau of Business and Economic Research, The University of Montana; Bureau of Economic Analysis, U.S. Department of Commerce.

Lewis and Clark County

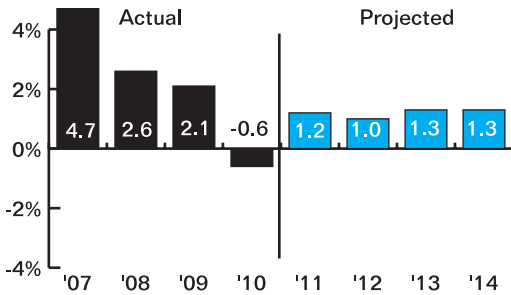
The legacy of the Great Recession for the Helena area economy is likely to be a relatively long period of tepid growth. Lewis and Clark County experienced a modest decline during only one year – 2010. But the lagged recession impacts on state government revenues mean only small increases for state workers and continued tight budgets. Growth is projected to be about 1 percent per year from 2010 to 2014, well below the 3 percent to 5 percent increases before the recession. Despite the small overall recession impact, construction activity in and near Helena has dropped to a fraction of that occurring before the recession.

Figure 1
Actual and Projected Percent Change in Nonfarm Labor Income, Lewis & Clark County, 1998-2010



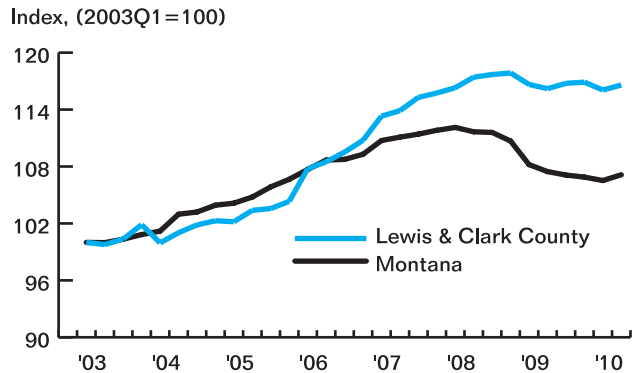
Sources: Bureau of Business and Economic Research, The University of Montana; Bureau of Economic Analysis, U.S. Department of Commerce.

Figure 2
Actual and Projected Percent Change in Nonfarm Labor Income, Lewis & Clark County, 2007-2014



Sources: Bureau of Business and Economic Research, The University of Montana; Bureau of Economic Analysis, U.S. Department of Commerce.

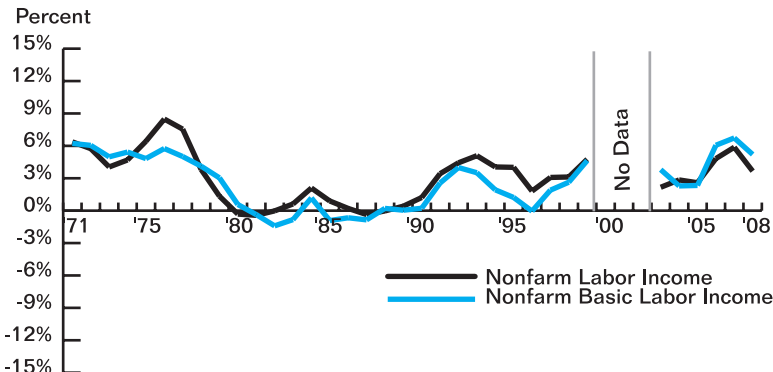
Figure 3
Nonfarm Wage and Salary Employment, Montana & Lewis & Clark County, 2003 Q1 to 2010 Q2



Note: Data seasonally adjusted by BBER.

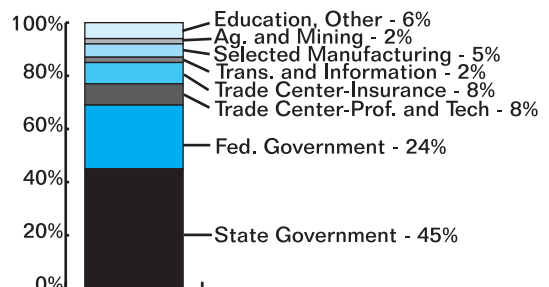
Source: U.S. Bureau of Labor Statistics, Quarterly Census of Employment and Wages.

Figure 4
Nonfarm Labor Income and Nonfarm Basic Labor Income, Lewis & Clark County, Percent Change, 1971-2008 (In Constant Dollars)



Note: 1971-1999 are three-year averages. 2002-2008 are two-year averages.
Source: Bureau of Economic Analysis, U.S. Department of Commerce.

Figure 5
Labor Income in Basic Industries, Lewis & Clark County, 2008-2010 (Percent of Total)

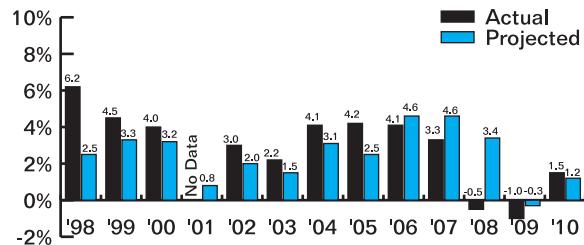


Sources: Bureau of Business and Economic Research, The University of Montana; Bureau of Economic Analysis, U.S. Department of Commerce.

Yellowstone County

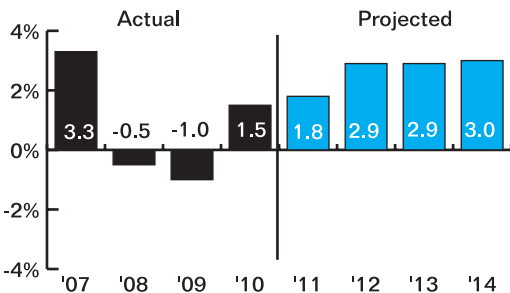
The recession was relatively mild for the Billings area economy. There were only modest declines in 2008 and 2009. However, certain sectors of the economy such as construction and retail trade did experience significant declines. Billings has been an indirect beneficiary of the energy/commodity boom. Although there are no mines or oil rigs in Yellowstone County, the regional headquarters and other support employment has located in and near Billings. The future of the vital oil refineries appears more secure, and employment and earnings has been increasing modestly. Billings's retail industries continue to face competition from second-order trade centers such as Miles City and Bozeman.

Figure 1
Actual and Projected Percent Change in Nonfarm Labor Income, Yellowstone County, 1998-2010



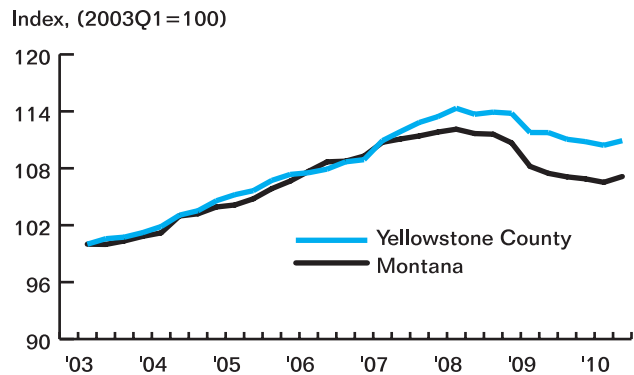
Sources: Bureau of Business and Economic Research, The University of Montana; Bureau of Economic Analysis, U.S. Department of Commerce.

Figure 2
Actual and Projected Percent Change in Nonfarm Labor Income, Yellowstone County, 2007-2014



Sources: Bureau of Business and Economic Research, The University of Montana; Bureau of Economic Analysis, U.S. Department of Commerce.

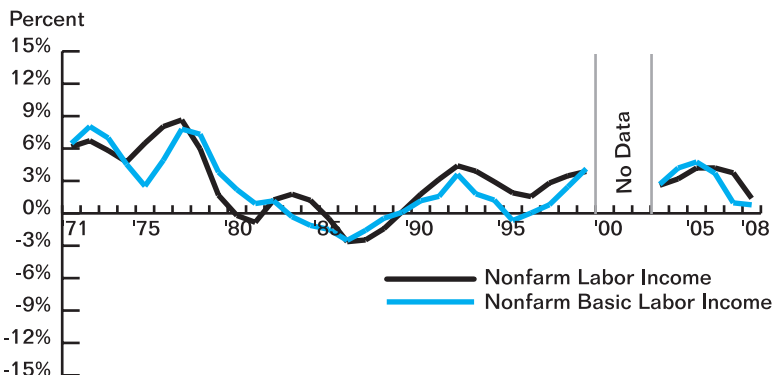
Figure 3
Nonfarm Wage and Salary Employment, Montana & Yellowstone County, 2003 Q1 to 2010 Q2



Note: Data seasonally adjusted by BBER.

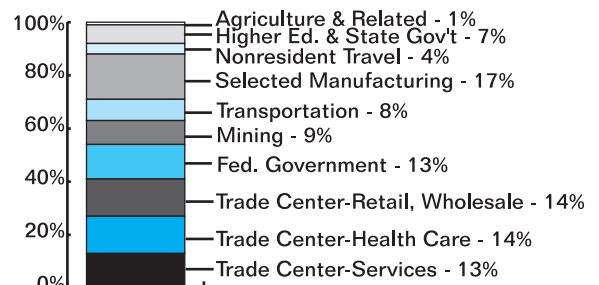
Source: U.S. Bureau of Labor Statistics, Quarterly Census of Employment and Wages.

Figure 4
Nonfarm Labor Income and Nonfarm Basic Labor Income, Yellowstone County, Percent Change, 1971-2008 (In Constant Dollars)



Note: 1971-1999 are three-year averages. 2002-2008 are two-year averages.
Source: Bureau of Economic Analysis, U.S. Department of Commerce.

Figure 5
Labor Income in Basic Industries, Yellowstone County, 2008-2010 (Percent of Total)

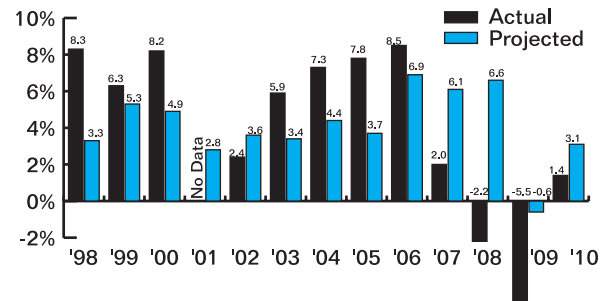


Sources: Bureau of Business and Economic Research, The University of Montana; Bureau of Economic Analysis, U.S. Department of Commerce.

Gallatin County

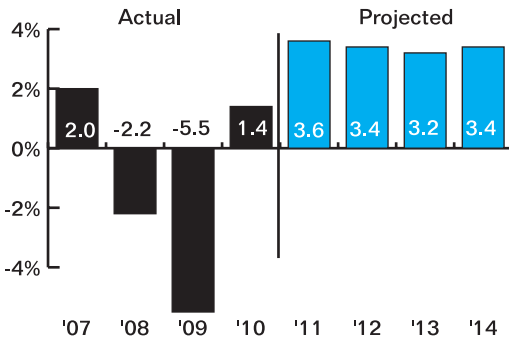
Despite the sharp declines in 2008 and 2009, the Bozeman area economy should emerge from the recession relatively unscathed. Construction and real estate plummeted and nonresident travel (which accounts for 13 percent of the local economic base) decreased sharply in response to the national recession. But Bozeman's high-tech industries (which suffered greatly during the 2001 recession) continue to expand. Employees of Montana State University will see their wages increase only slightly. The roughly 3.5 percent annual growth projected for 2010 to 2014 may appear buoyant compared to the recession years, but it is a full percentage point lower than the prerecession average of 4.4 percent per year.

Figure 1
Actual and Projected Percent Change in Nonfarm Labor Income, Gallatin County, 1998-2010



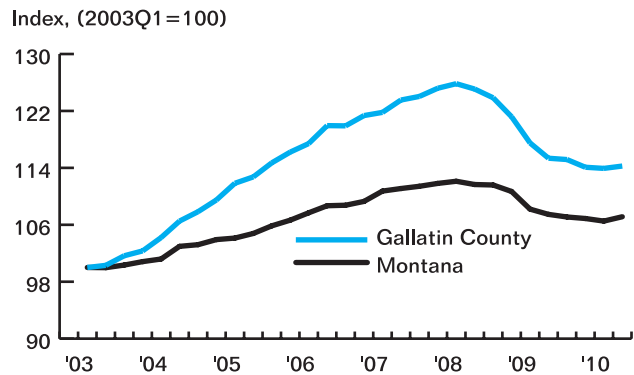
Sources: Bureau of Business and Economic Research, The University of Montana; Bureau of Economic Analysis, U.S. Department of Commerce.

Figure 2
Actual and Projected Percent Change in Nonfarm Labor Income, Gallatin County, 2007-2014



Sources: Bureau of Business and Economic Research, The University of Montana; Bureau of Economic Analysis, U.S. Department of Commerce.

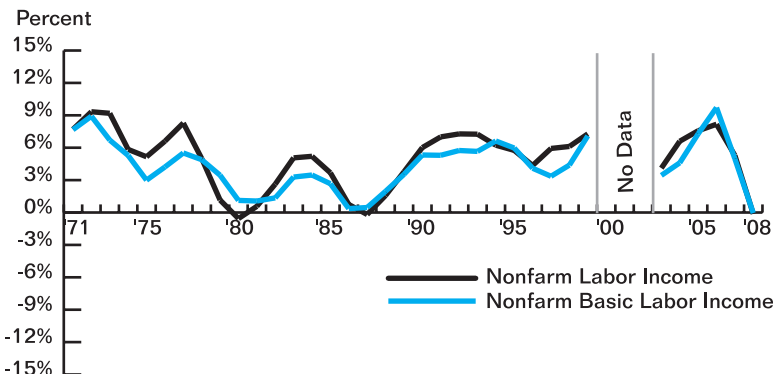
Figure 3
Nonfarm Wage and Salary Employment, Montana & Gallatin County, 2003 Q1 to 2010 Q2



Note: Data seasonally adjusted by BBER.

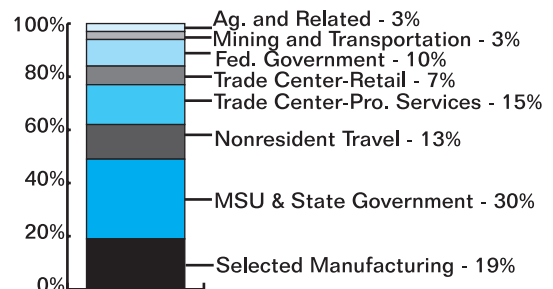
Source: U.S. Bureau of Labor Statistics, Quarterly Census of Employment and Wages.

Figure 4
Nonfarm Labor Income and Nonfarm Basic Labor Income, Gallatin County, Percent Change, 1971-2008 (In Constant Dollars)



Note: 1971-1999 are three-year averages. 2002-2008 are two-year averages.
Source: Bureau of Economic Analysis, U.S. Department of Commerce.

Figure 5
Labor Income in Basic Industries, Gallatin County, 2008-2010 (Percent of Total)

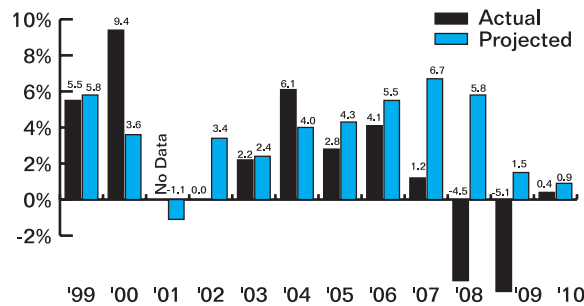


Sources: Bureau of Business and Economic Research, The University of Montana; Bureau of Economic Analysis, U.S. Department of Commerce.

Ravalli County

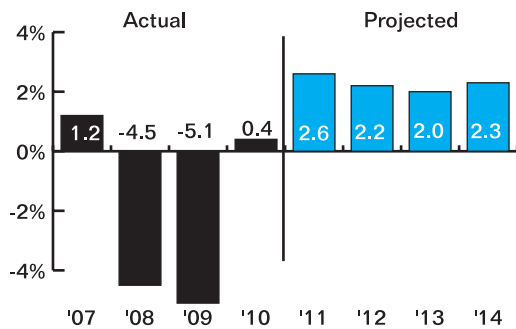
Despite its reputation as an amenity area and retiree destination, Ravalli County suffered as much from this recession as anywhere else in the state. The 4.5 percent and 5.1 percent declines in 2008 and 2009 rival those in Gallatin and Flathead counties. The surprisingly large cyclic decline in Ravalli County is partially due to the bursting of the large construction sector associated with recreational and second-home building. In addition, the doldrums in the U.S. housing market significantly impacted the local wood products industry, especially the log home manufacturers who were producing for the high-end market. The slowdown in nearby Missoula also contributed because of the large number of workers who live in Ravalli County but commute to jobs across the county line. The one bright spot is that Hamilton continues to evolve into a regional trade and service center, with the presence of major retailers and growth in selected services.

Figure 1
Actual and Projected Percent Change in Nonfarm Labor Income, Ravalli County, 1998-2010



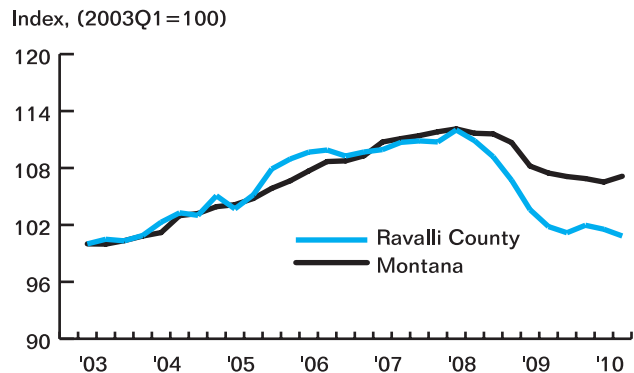
Sources: Bureau of Business and Economic Research, The University of Montana; Bureau of Economic Analysis, U.S. Department of Commerce.

Figure 2
Actual and Projected Percent Change in Nonfarm Labor Income, Ravalli County, 2007-2014



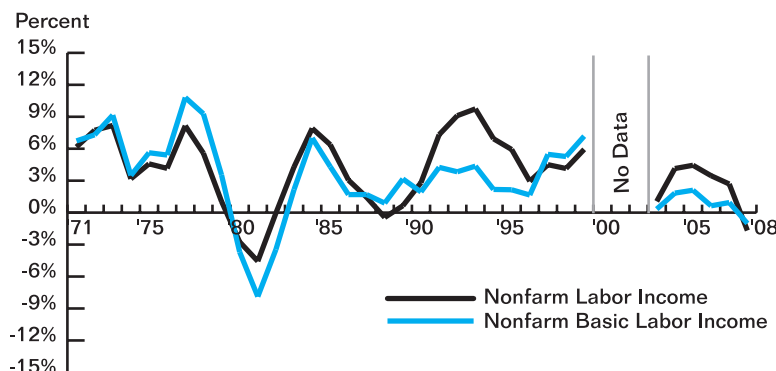
Sources: Bureau of Business and Economic Research, The University of Montana; Bureau of Economic Analysis, U.S. Department of Commerce.

Figure 3
Nonfarm Wage and Salary Employment, Montana & Ravalli County, 2003 Q1 to 2010 Q2



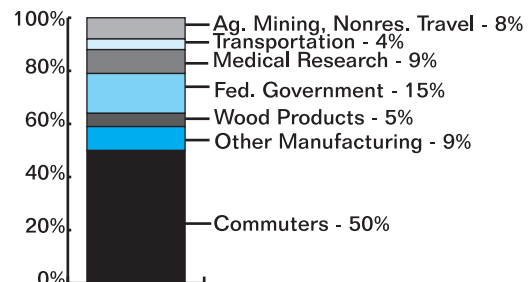
Note: Data seasonally adjusted by BBER.
Source: U.S. Bureau of Labor Statistics, Quarterly Census of Employment and Wages.

Figure 4
Nonfarm Labor Income and Nonfarm Basic Labor Income, Ravalli County, Percent Change, 1971-2008 (In Constant Dollars)



Note: 1971-1999 are three-year averages. 2002-2008 are two-year averages.
Source: Bureau of Economic Analysis, U.S. Department of Commerce.

Figure 5
Labor Income in Basic Industries, Ravalli County, 2008-2010 (Percent of Total)



Sources: Bureau of Business and Economic Research, The University of Montana; Bureau of Economic Analysis, U.S. Department of Commerce.

Housing Markets Still Struggling

by Scott Rickard

National Housing Markets

Despite efforts by the federal government to increase home sales in 2010, the U.S. housing market continued to contract, with home sales declining by one-quarter. At the same time, the average number of homes offered for sale each month increased by one-half. For properties that did find buyers, estimates of the change in average and median sales prices ranged from a -3 percent to a small positive of 1 percent. Estimates of real estate valuation and debt-to-equity suggest that U.S. residential property owners lost another \$1.7 trillion in value in 2010 (and a total of \$9 trillion since the 2006 peak). And one in five homeowners with mortgages owes more on their residences than these homes are worth.

Of course, compared to the U.S. averages and totals, residents of different parts of the country witnessed different market dynamics. For example, prices fell by 16 percent in Atlanta while rising by nearly 10 percent in Washington, D.C.

Foreclosures were another important feature of the U.S. housing market. In 2010, on average, one in every 492 homes was in foreclosure. At the state level this varied from one in 99 homes for Nevada to one in 6,395 houses in North Dakota.

Nationwide, the residential construction market continues to shrink. In 2010, housing starts declined almost 6 percent year-over-year, and building permits fell 15 percent for the same time period. Single family home construction remained weak, while there were some signs of improvements in the construction of multifamily or apartment units.

In the mortgage markets, 2010 was a year where 80 percent of the activity was in refinancing existing loan products, likely due to low mortgage interest rates. But, unlike just a few years ago, far fewer of these refinancing involved withdrawing equity from the home along with changing the terms or interest rates.

Regional Housing Markets

For Montana and our region, state-level statistics are a little more encouraging (see Table 1). Using the Office of Federal Housing Enterprise Oversight Home Price Index (HPI), Montana's home prices were 3 percent lower in the third quarter of 2010 than they were one year earlier. To the east, the Dakotas experienced either price stability (South Dakota)

Table 1
Home Price Index Price Changes

State	Year-over-Year Price Change	Total Price Change Since Peak
Colorado	-2.9%	-5.7%
Idaho	-9.8%	-22%
Montana	-3.0%	-6.0%
North Dakota	+3.9%	at peak
South Dakota	+0.3%	-0.3%
Wyoming	-4.4%	-8.0%

Note: Data are seasonally adjusted.

Sources: Office of Federal Housing Enterprise Oversight.

or price increases (North Dakota). Our southern neighbors witnessed price declines of 3 percent (Colorado) and 4 percent (Wyoming). To the west, Idaho home prices have fallen nearly 10 percent. From their peak values, Montana's prices are down 8 percent, according to the HPI, below Idaho's 22 percent drop but above our other neighbors.

For each state, the estimated price changes in the major cities are reasonably close to their respective statewide averages, and while the HPI shows some differences between the performances of rural vs. urban markets, the imprecision of the estimates don't allow us to declare that the cities were doing better, or worse, than the outlying areas.

Concerning foreclosures, Montana and several neighboring states are still experiencing lower levels than the national average. There were 2,578 Montana houses listed in foreclosure in November 2010, representing one out of every 1,642 units. With 559 homes listed, Flathead County accounted for 22 percent of the state's total. Across the region, foreclosure ratios ranged from one in 6,395 and one in 2,540 for North and South Dakota, respectively, to one in 301 for Idaho.

Sales statistics reported by the Multiple Listing Services (MLSs) across Montana provide some additional details on in-state markets. From the data available, which covers a little more than one-half of the population, it appears that there were fewer single-family homes sold in Montana areas in 2010 than there were in 2009, although this decline was not as large as the national average. The overall average price paid for these homes held steady, while median prices are improving. This could signify that there was an increase in the sales of the more expensive homes. And it appears that the time it takes to sell a home increased in 2010.

These estimates do not necessarily hold for every reporting area. In particular, the home sales in Gallatin and Park counties are exhibiting higher sales numbers but lower average and median prices. These estimates are also based upon the performance of the urban Montana counties, and the performance of markets in rural areas may be different.

As measured by building permits, it's likely that new residential construction in Montana improved in 2010. Based upon historic patterns it is projected that nearly 1,900 building permits will be issued in Montana in 2010, a 26 percent improvement over 2009. This level of improvement was seen in all major Montana cities. This of course doesn't negate the fact that, for areas such as Flathead, Gallatin, and Missoula counties, these numbers are still 80 percent below their 2004-05 peak values.

Prospects for 2011

Nationally, the housing market in 2011 will not be appreciably better than it is currently. The likelihood of rising interest rates, combined with continued high unemployment rates and the equity losses for many current homeowners, will restrain the demand for residential homes, and the number of foreclosed units entering the market will keep a lid on housing prices. In terms of construction, multifamily apartments may continue to grow, but this is a double-edged sword since it represents backers betting upon renting, not ownership.

Montana's 2011 prospects during this same time are about the same. Local economic growth may generate some additional demand, and sales totals may pick up marginally, but it is unlikely that there will be anything more than a 1 percent to 2 percent improvement in prices.

Travel and Recreation

Visitors Attracted to Open Space, Wildlife, and Character

by Norma P. Nickerson

It is safe to say that the reasons we all live in and love Montana are the same reasons that 3.4 million people choose to vacation in Montana each year – and why Montanans host nearly 2 million friends and family members who sleep in their spare bedrooms.

For years, data from UM's Institute for Tourism and Recreation Research (ITRR) has shown that nonresidents visiting Montana in the summer months are attracted to the two national parks, mountains, forests, open space, and uncrowded areas. Scenic driving, wildlife watching, nature photography, day hiking, and camping are the top five activities for nonresident vacationers. Two-thirds of overnight vacations are spent in the Glacier Country or Yellowstone Country travel regions. Almost half of the vacationers reside in the 11 western U.S. states or in the two western Canadian provinces, and 90 percent of nonresident summer visitors drive into the state.

In the winter months, nearly half of all vacationers to

Montana are here to ski or snowboard. Unlike summer months, 48 percent of nonresident skiers fly rather than drive into the state. The downhill ski industry provides a combined \$83 million to the state. Nonresidents represent 35 percent of skiers at Montana's ski areas.

In addition to summer and winter activities, many people come to Montana to take a trip with an outfitter and guide. In 2005, 319,000 people took guided trips, and only 10 percent were from Montana. While the combined economic impact of guided trips in 2005 was \$167 million, \$83 million was from nonresidents who came to Montana solely for the guided trip.

A recent ITRR study showed that certain attributes of Montana were important to nonresidents when visiting: clean waterways, clean air, wildlife viewing opportunities, scenic vistas, open space, an opportunity to view the night sky, and access to public lands and waterways (Table 1). Visitors were

Table 1
Top Montana Attributes Important to Nonresident Visitors

Attributes	Mean Score
Clean waterways	5.5
Clean air	5.5
Wildlife viewing opportunities	5.4
Scenic vistas	5.4
Amount of open space	5.4
Opportunity to view the night sky	5.2
Access to public lands	5.2
Access to waterways	5.0
Pedestrian-friendly atmosphere	4.9
Montana's land ethic	4.7
Main streets that reflect the local culture and heritage of the destination	4.7
Paths for walking and biking	4.7
Eating at restaurants where locals eat	4.7

1= Not at All Important; 6= Extremely Important

Source: Institute for Tourism and Recreation Research, The University of Montana.

quite satisfied with the amount of open space, scenic driving opportunities, the “character” of Montana, the condition of the natural environment, wildlife viewing opportunities, a feeling of being welcomed, and the stewardship of the land (Table 2).

Common sense suggests that Montana residents, along with the tourism industry, should strive to maintain the open spaces, public land access, wildlife, and so forth. For the most part, Montana residents and tourism industry

business owners agree with the priorities of the tourism industry, albeit in a different order. Survey results indicate that the top priority for the industry was to “help maintain Montana’s destination appeal,” but residents rated it sixth out of seven listed priorities. Residents’ top priority was for the industry to hire local people, but tourism business owners rated it fourth out of seven priorities. However, each of the seven listed priorities had a mean above 3.6 on a 5-point scale, indicating that all were priorities (Figure 1).

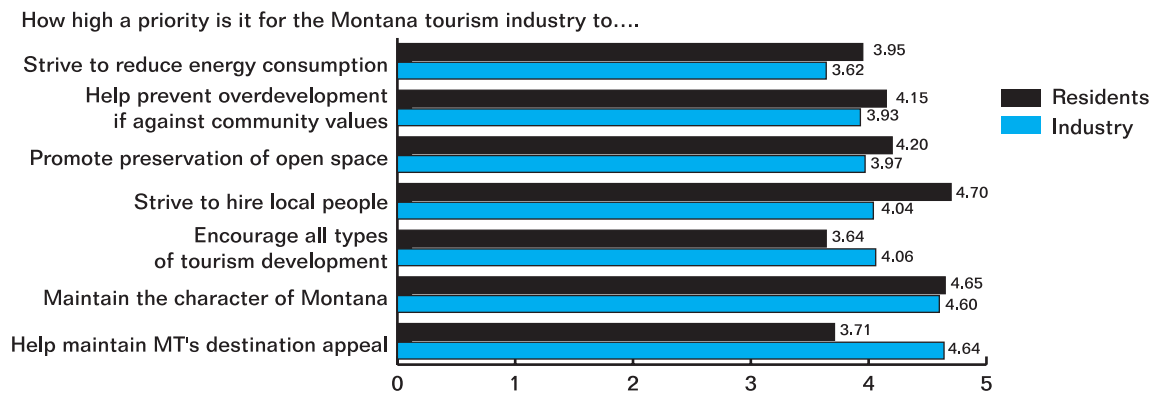
Table 2
Nonresident Visitor Satisfaction with Montana Attributes

Please rate your overall satisfaction with the following aspects of Montana:	
Amount of open space	5.67
Scenic driving opportunities	5.64
The "character" of Montana	5.57
Condition of natural environment	5.51
Wildlife viewing opportunities	5.44
A feeling of being welcomed	5.43
Stewardship of the land	5.38
A feeling of authenticity	5.37
Availability of travel information	5.26
Main streets reflecting local culture/heritage	5.26
Variety of lodging choices	5.24
Access to public lands	5.22
Amount of historical roadside information	5.22
Availability of local arts and crafts	5.19
Directional road signage	5.17
Restaurants with local products	5.14
Environmental practices of accommodations	5.02
Road conditions	5.02
Highway rest areas	5.00
Availability of recycling bins	4.25

Scale: 1= Very Dissatisfied; 6= Very Satisfied

Source: Source: Institute for Tourism and Recreation Research, The University of Montana.

Figure 1
Top Priorities for Tourism Industries, Responses by Montana Residents and Montana Tourism Business Owners



Scale: 1=very low priority; 5=very high priority

Source: Institute for Tourism and Recreation Research, The University of Montana.

The Scorecard Past and Future

Preliminary numbers for nonresident travel in Montana show an increase of 4 percent in 2010 over 2009. Nationally, domestic leisure travel estimates show an increase of nearly 3 percent while domestic business travel appears to have increased 4 percent in 2010. Here are some more facts on travel and recreation:

- Montana airline travel was up 2 percent in 2010 while the national rate was flat.
- Glacier National Park visitation increased 8.9 percent and Yellowstone increased 8.3 percent, while all U.S. national parks were down nearly 1 percent in 2010.
- Rooms sold in Montana were up 5.6 percent in 2010 while rooms sold throughout the nation were up 7.6 percent.
- Montana skier visits were up 2.3 percent for 2009-10 while national skier visits were up 4.2 percent.
- 2009 nonresident travel industry had a \$1.5 billion direct impact and a \$2.3 billion total impact.
- 2009 nonresident travel industry income had a \$447 million direct impact and a \$661 million total impact.
- 2009 nonresident travel industry employment amounted to 19,160 direct jobs and 25,480 total jobs.

2011 Forecast

The tourism industry will experience increases in 2011 including:

- Nonresident visitor numbers will increase by 2 percent.
- Rooms sold (hotel/motel) will increase by 1.5 percent.
- Yellowstone National Park visitation will increase by 3.3 percent.
- Glacier National Park visitation will increase by 0.3 percent.
- Skier visits will increase by 2 percent.
- Airline travel will increase by 1 percent.

Table 3
Montana Tourism Charter

Maintain integrity of place and destination appeal.
Promote and highlight the businesses, services, and opportunities that are unique to Montana.
Promote sustainable resource conservation, including conservation of energy, water, and wildlife.
Participate in and help lead community stewardship partnerships to maintain Montana assets.
Identify and appeal to markets that value and seek to help sustain Montana's distinct character.
Foster a diversity of products and services that meet the demand of a demographic cross-section of the "geotourist market."
Ensure visitor satisfaction and an enduring market demand through education of Montana residents about the benefits of sustainable tourism
Work with the Institute for Tourism and Recreation Research, Travel Montana, and other tourism organizations throughout the state to evaluate effective implementation of the Tourism Charter.

Source: Montana Tourism Charter (2007). Accessed January 4, 2011. <http://travelmontana.mt.gov/charter/>.

Geotourism

One marketing and promotion strategy that is growing popular throughout the tourism industry is geotourism, which incorporates the concept of sustainable tourism – that destinations should remain unspoiled for future generations – while protecting a place's character.

In Montana, two geotourism map guides have been developed for the Crown of the Continent area (Glacier National Park vicinity) and the Greater Yellowstone area. Local input was important in generating these maps, which encourage travelers to visit locally owned businesses and attractions. Additionally, the tourism industry has created a Montana Tourism Charter centered around geotourism principles (Table 3). Communities, organizations, and businesses are being asked to sign onto the charter espousing sustainability in their operations and thereby empowering locals in community development. ITRR research has shown that visitors to Montana have geotourism tendencies and are more likely to share the same values that Montana residents do concerning the environment, the communities, and the landscapes. All of this advocates that Montanans have the power to direct the type of tourism development in line with the values of people in the state which, in turn, draws people to visit who hold the same values.

Future and Challenges

In late 2010, 357 tourism business owners and organizations responded to the annual ITRR outlook survey. Here are comments about some of the challenges facing the industry and Montana as a whole:

Land use and natural resource planning

- Should we be managing the wolves so elk aren't endangered?
- Montana's niche of open space, wildlife, and fisheries is like nowhere else in the Lower 48. ... It's high time that land-use planning becomes this state's focus.
- Maintain the multiple-use concept in Montana – we are losing business by eliminating where folks can snowmobile and drive their four-wheelers.
- Green/sustainable practices are wanted, but Montana businesses are not doing it. What are the barriers?
- As long as the Missouri River continues to produce the blue-ribbon trout that our guests are catching, our business will continue.
- Recycling is too expensive, and the efforts for biodegradable items are lost when thrown in a plastic garbage bag. Wind, solar, and hydro power should be the focused green direction.

Policy and infrastructure

- Initiative 161 assaulted the outfitter business and livelihoods. Montana needs to support small business like outfitting, not make it more difficult. We are sending out the message loud and clear that nonresident hunters are not welcome.
- Montana needs lower airline prices to encourage visitation and maintain residents' ability to travel.
- Couldn't we fund state parks, national parks, forests, and other public land agencies so they can provide interpretation? The more people learn, the more likely they will return. Visitors want to "gawk" less and learn more.

Economy

- Finding local help for entry level work is near to impossible. Is there a fix?
- If the U.S. dollar remains tepid, we will get more international visitors, especially from Canada. Is this a solution to our economy – be the bargain country for visitors?

- If we had more big businesses in Montana we would have more visitors coming here.
- The economy is killing small business like ours that don't deal with high-end spenders. The present economic climate is crushing the middle class who are our main business clients.
- People are coming but spending less. Will this change?
- With 10 million nonresidents spending money in Montana, is it time to look at a sales tax so visitors can help us out?

Marketing

- Is the travel region concept still valid today? Should bed tax monies go directly to communities rather than to a region? Are we duplicating efforts?
- What kind of marketing could increase bookings from October to May? We generally have decent weather in October, April, and May yet it's hard to entice folks.

It is difficult to summarize the multitude of issues and challenges facing the tourism industry in Montana. However, 2011 will be a better year than 2010 in terms of visitation. As Table 4 shows, 55 percent of business owners are expecting an increase in 2011 while only 8 percent are expecting a decrease. The travel industry is focusing on enticing visitors who will support local economies, encourage local business, and value the landscape as Montanans do. As long as visitors and residents have the same values, Montana tourism will grow in a manner appreciated by everyone.

Table 4
Business Owner Projections Over the Years

Projected Year	Expect an increase	Expect to remain the same	Expect a decrease
2011	55%	37%	8%
2010	47%	42%	12%
2009	32%	39%	27%
2008	55%	34%	10%
2007	64%	31%	5%
2006	63%	31%	6%
2005	67%	26%	7%
2004	79%	18%	3%
2003	70%	22%	8%
2002	56%	33%	10%

Source: Institute for Tourism and Recreation Research, The University of Montana.

Health Care

Medicare: the 800-Pound Gorilla in the Room

by Gregg Davis

Background

The biggest challenge facing health care in the next decade is how to pay for health care, and, to a more impassioned level of debate, who is to pay? Private health insurance grew rapidly following World War II as employers competed for workers by expanding benefits since wage freezes were in place. Later, legislation for “Medical Assistance to the Aged” was passed in 1960, but it wasn’t until 1965 that Congress passed Title XVIII of the Social Security Act establishing Medicare as the medical care program for the elderly. Coverage was later added in 1973 for certain disabled persons and people with kidney disease.

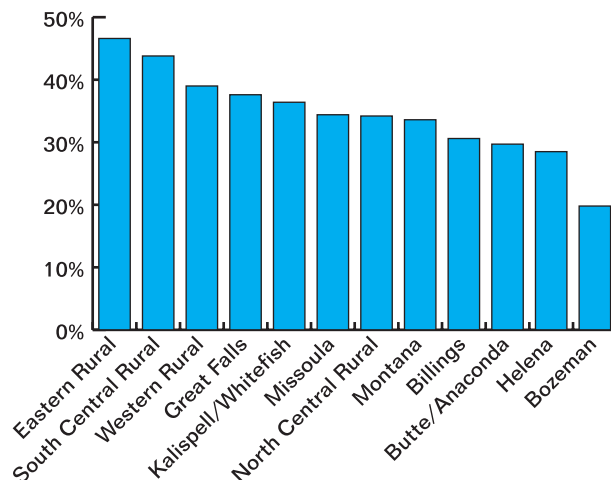
Medicare, along with Medicaid and the State Children’s Health Insurance Program (CHIP), account for almost half of the \$1.95 trillion spent on health care nationally and more than 75 percent of all public spending for health care. But due to aging baby boomers, a major shift toward funding from federal, state, and local government will occur over the next few years.

The Challenge Ahead

General revenues (federal tax dollars not dedicated to a particular use) accounted for 44 percent of total non-interest Medicare income in 2009, surpassing payroll taxes as the largest source of Medicare financing for the first time in history. When general revenue funding exceeds 45 percent of total Medicare spending, Medicare financing is either inadequate or general revenues under current law are unduly large.

In 2008, expenditures for hospital and other services paid from the Hospital Insurance (HI) Trust fund exceeded its revenues, and if left unchecked, could exhaust the fund in the next six years. Even under the most optimistic of assumptions, the trust fund could remain solvent only until 2028. The Supplemental Medical Insurance (SMI) trust is under similar pressure. Both the Board of Trustees of the Medicare Trust Fund and the Congressional Budget Office expect Medicare spending to grow at an annual average rate of 7 percent over the next decade, surpassing even the most optimistic growth rates for the entire economy. As a result, Medicare’s share of the total economy will grow from just under 1 percent in 1970 to more than 6 percent by 2030.

Figure 1
Percent of Net Operating Hospital Revenue
from Medicare, 2009



Source: Certificate of Need Annual Report of Hospitals, 2009, unpublished, Montana Department of Health and Human Services.

Medicare Funding in Montana

In 2009, Montana received more than \$594 million for Medicare Hospital Insurance funding, \$515 million for Medicare Supplemental Medical Insurance, and \$734 million for Medicare prescription drug coverage.

On the consumer side, Medicare is an important source of health insurance for nearly 17 percent of Montana's population. A third of Medicare beneficiaries have incomes below 150 percent of the Federal Poverty Level, putting them at additional risk in terms of potentially higher taxes, premiums, and reduced benefits given the current trajectory of Medicare financing.

Medicare funding has drastic ramifications for all Montanans, not just for Medicare beneficiaries. Medicare has long been used as the bellwether for reimbursement rates for all providers. Shortfalls in cost reimbursement by one payer must be made up by other payers.

One way to see the importance of Medicare financing in the Montana economy is to examine Medicare payments to hospitals. In Montana, Medicare accounts for 34 percent of all hospital net revenues. But hospitals depend on Medicare funding to varying degrees. Hospitals in rural areas are particularly dependent on Medicare as a funding source, due to their older populations and lower private insured rates. (Figure 1).

Medicare and Hospital Profit Margins

Rural areas are served by Critical Access Hospitals, which are paid 101 percent of their allowable Medicare costs for most services. Acute Care Hospitals, on the other hand, are reimbursed according to a complicated formula under the acute Inpatient Prospective Payment System. Under the system, rates are supposed to cover costs that reasonably efficient providers would incur in providing high-quality care. But the consensus is that Medicare falls short of true cost reimbursement. This shortfall in Medicare reimbursement is absorbed by the hospital through efficiency improvements and shifted to other payers, primarily the uninsured and private third-party payers.

Hospital Medicare profit margins nationally are dismal, suggesting a significant cost shift to private pay and third-party payers. This cost shift is further necessitated by the hospitals' role of "catastrophic insurer of last resort" in providing charity care to the uninsured. Last year uncompensated care in Montana totaled \$220 million. Table 1 shows Medicare margins for Metropolitan Statistical Area (MSA) and non-MSA hospitals receiving Medicare reimbursement under the Inpatient Prospective Payment System, which excludes Critical Access Hospitals. MSAs include urban areas with populations of 50,000 or more. Even when critical access hospitals are added, the Medicare profit margin improves but remains negative (-4.5).

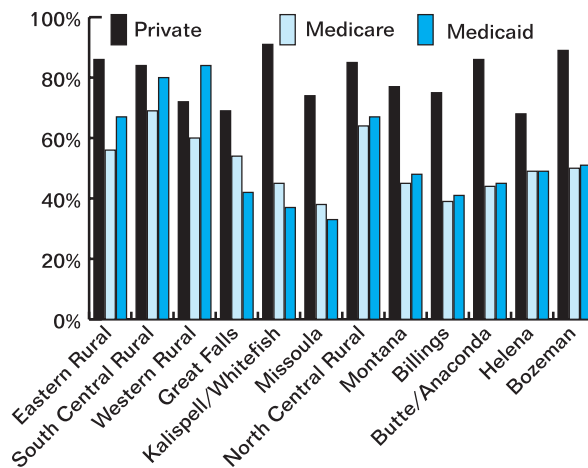
Table 1
Medicare Margins for Services Covered by
Acute Inpatient Prospective System

	2004	2005	2006	2007	2008
Non MSA Hospitals	-3.3	-2.8	-4.5	-5.4	-6.4
MSA Hospitals	-3.0	-3.1	-4.7	-6.1	-7.3
All Hospitals	-3.1	-3.1	-4.7	-6.0	-7.2

Note: Metropolitan Statistical Areas (MSA) include urban areas with populations of 50,000 or more.

Source: Medicare Payment Advisory Commission, June 2010.

Figure 2
Percent of Hospital Charges Recovered
by Payer, 2009



Source: Price Points System, Montana Hospital Association,
http://www.montanapricepoint.org/Basic_INP.aspx.

Hospitals more dependent on Medicare revenue experienced lower total margins, according to a recent BBER study. Other studies also suggest declines in hospitals' total margins tend to be associated with major Medicare policy changes.

Figure 2 examines the share of charges received by Montana's hospitals from private, Medicare, and Medicaid payers. Although charges are not costs, and Medicare charges over costs have increased by a factor of three nationally, it still provides a snapshot of the degree of disparity between charges billed and collected by payer. As shown, private payer reimbursements for charges to private payers are uniformly higher than the public payer charges recovered from charges to public payers. It should be noted that underpayments do not necessarily result in a dollar-for-dollar cost shift. Hospitals are under continued to pressure to treat patients more cost efficiently.

Conclusion

If Medicare spending increases at a 7 percent annual rate over the next decade, virtually no provider or consumer of health care will go unaffected. For hospitals, the ability to continually serve Medicare patients, particularly at a time

when more of the population enters the Medicare years for health care coverage, will continue to be a financial challenge. Medicare, by virtue of serving an older and generally sicker population than other payers, changes the level as well as the distribution of spending across different providers of health care. Efforts to provide medical treatment for Medicare's costliest beneficiaries will assume even more importance in the future. The costliest 25 percent of fee-for-service Medicare beneficiaries account for over three-fourths of Medicare spending. These beneficiaries tend to have chronic medical conditions, use hospital inpatient care, are Medicaid eligible, and in the last year of life.

In essence, there really is an 800-pound gorilla in the room. Our nation's ability to reconcile the health care spending dilemma is illustrated by the Medicare program, but not certainly limited to it. Montanans continued access to doctors and health care will depend on the ability of the nation to bend the cost curve of health care while still providing the necessary reimbursement for health care providers. Whether across the board cuts in Medicare will achieve this outcome is questionable.

Outlook for Montana Agriculture

by George Haynes

General Financial Overview

Montana farmers and ranchers have rebounded from a year of lower prices and production in 2009 to higher prices and near record production in 2010. U.S. net farm income is expected to increase by more than 30 percent in 2010, with much of the increase resulting from increases in prices in the dairy and hog complexes. Although Montana has limited dairy and hog production, Montana net farm income is likely to rise between 15 percent and 25 percent from 2009 to 2010 because of near record crop production.

A relatively stable agricultural market was jolted in early August when Russian Prime Minister Vladimir Putin announced an embargo on Russian wheat exports because of the continuing drought in the region. The Putin announcement and decreased Russian and Canadian wheat production drove up grain prices in late summer. The grain price increase, coupled with a near record-setting production year, culminated in an excellent year for Montana crop producers. Even Montana beef producers, who have had several years of lackluster profits, had reasons to be optimistic as domestic and international consumption of U.S. beef improved, pushing beef prices higher.

These increases in agricultural commodity prices after a year of food price deflation in 2009 have shoppers realizing modest food price increases in 2010. These increases have been somewhat lower than expected because of the slow economic recovery. Grocery store and restaurant prices increased by less than 1 percent, which was well below typical annual price increases in the early 2000s of 2.5 percent or more.

While traditional wheat and beef production comprises

about 75 percent of gross sales from Montana agriculture, one of the most rapidly growing sectors is organic products. U.S. organic food sales are expected to reach \$25 billion in 2010, up from \$3.6 billion in 1997. Organic products account for more than 3.5 percent of food sold for at-home consumption, with produce and dairy products accounting for over half of organic food sales, followed by soymilk and other beverages. Montana ranks seventh in the nation in total acreage dedicated to organic production. The 215,000 acres, less than 1 percent of farm land in Montana, is divided between crop use (about 60 percent) and pasture use (about 40 percent). A substantial share of this agricultural production is marketed at local farmers' markets and specialty sections in grocery stores. The U.S. Department of Agriculture is lending support to the farmers' market movement with a new website showing the locations of farmers' markets throughout the United States (<http://apps.ams.usda.gov/FarmersMarkets/>). Montana currently has 35 farmers' markets that the department has identified.

Grain/Wheat Outlook

World and U.S. average wheat prices increased over 6 percent between 2009 and 2010 from \$5.18 per bushel in 2009 to around \$5.50 per bushel in 2010. Even though production remained virtually unchanged in the United States, an extended drought dramatically decreased production in the former Soviet Union (FSU-12) countries (Table 1). The FSU-12 drought lowered their production by over 27 percent, which accounted for nearly 75 percent of reduction in world wheat

Table 1
World, U.S., and Montana Wheat Production

Geographic Area	2008	2009 (Millions of Bushels)	2010
World	25,053	25,032	23,573
United States	2,494	2,214	2,204
U.S. share of world market	10.0%	8.8%	9.3%
Montana	165	177	215
Montana share of world market	0.7%	0.7%	0.9%
Montana share of U.S. market	6.6%	8.0%	9.8%
Prices of all wheat, \$/bushel (10/2009)	6.84	5.18	5.50

Source: World Agricultural Supply and Demand Estimates (WASDE-476, 11/10/2010) and National Agricultural Statistics Service, Montana.

production. Montana and U.S. shares of world wheat production and sales increased slightly to around 0.9 percent (world) and 9.8 percent (U.S.), respectively. The USDA is forecasting somewhat higher wheat prices in 2011, but below the \$6.84 average wheat price realized in 2008.

In Montana, wheat production increased by more than 21 percent from 177 million bushels in 2009 to 215 million bushels in 2010. An excellent winter wheat crop emerged in the spring and relatively warm weather allowed the wheat and barley crops to take advantage of above-average moisture conditions. Many producers realized the best crop production year in the last several years with average per acre wheat and barley yields up by over 20 percent. At harvest time, winter wheat production was nearly 5 percent higher than in 2009, even though fewer acres were planted. Spring wheat production increased by a whopping 47 percent from 2009 because of record-setting average yields. Barley production decreased by more than 6 percent because of fewer planted acres.

The United States typically exports about 10 times more wheat than it imports. U.S. wheat exports are expected to be up over 25 percent from 2009 because of lower production in several major exporting countries, especially Russia. Wheat imports, totaling less than 4 million metric tons in 2009, are expected to decline by about 8 percent. End-of-year wheat supplies are nearly unchanged from a year ago, even though global production has increased. Increases in the price of corn have increased the use of wheat as an animal feed, especially in China and other parts of Asia.

Increased consumer demand for wheat in the United States and abroad, a weakening dollar (against most all currencies, except the Euro), and continued increase in biofuels production will impact the price of wheat. Total domestic

use of wheat is expected to increase by 5 percent from last year. The Russian drought and a weaker dollar will mean that U.S. wheat exports are likely to increase. Finally, the use of corn for the production of ethanol continues to affect crop and livestock markets. The increased demand for corn for ethanol production has led to an increase in the price of corn from \$2.00 per bushel in 2005 to over \$4.40 per bushel in 2010. While the growth of ethanol usage has slowed, it is still expected to grow to about 4.7 billion bushels, or 35 percent of total corn usage. To meet the renewable fuels standard, the rate of growth will be about 215 million bushels per year through the 2014 crop. In addition, the demand for corn in the export market is very strong. Somewhat higher prices for corn will increase feed costs for cattle, resulting in downward pressure on stocker and feeder cattle prices.

Cattle Outlook

Montana cattle producers finally have escaped a couple of years of lackluster profits, with calf prices increasing nearly 20 percent this year. Improving economies worldwide are increasing the demand for beef; in fact, beef exports are expected to be 18 percent higher in 2010. In addition, supplies of beef will be limited, as commercial production is expected to remain low into 2011 and prices for competing meats, chicken, and pork have increased substantially over the past year. All of this translates into higher prices for Montana's cow-calf producers.

U.S. commercial beef production has been relatively stable since 2007 (Table 2), although the demand for beef has changed substantially over the past two decades. In 1990, beef represented about 34 percent of total red meat and poultry consumed in the U.S.; however, by 2011 beef is

Table 2
U.S. and Montana Beef Production

Geographic Area	2007 (1,000 Tons - Carcass Weight Equivalent)	2008	2009
United States	20,718.5	20,339.7	20,460.0
Montana	539.9	484.9	476.2
Montana share of U.S. market	2.6%	2.4%	2.3%
Prices received, calves, \$/hundred weight	123	109	130

Source: National Agricultural Statistics Service, Montana.

expected to represent less than 30 percent of this total. As the national cow herd approaches cow numbers of the 1950s, the total quantity of beef produced per cow has increased from 310 pounds in the 1950s to over 630 pounds today.

U.S. beef exports for 2009 are expected to be more than 15 percent higher than in 2010, but are expected to remain virtually unchanged in 2011. Most recently, beef exports have been positively affected by a weak dollar. U.S. beef exports to Japan and South Korea through the third quarter were 24 percent and 133 percent higher than last year, respectively. Exports to our largest customer, Mexico, are down 26 percent, while exports to Canada have remained virtually unchanged since last year. Some additional export potential is developing with Russia, where our beef exports have increased nearly eight-fold over the past year.

Cattle imports into the United States from all sources are expected to be the lowest since 1997, primarily because of a 28 percent decline in imports from Australia. Canada, one of the largest exporters of cattle to the United States, has increased U.S. exports by 12 percent over the past year. However, declining cattle inventories, along with the desire to rebuild herds in Canada, will constrain production and limit their export potential in 2011.

Montana's beef production decreased slightly between 2008 and 2009, with Montana's share of the U.S. beef market remaining around 2.5 percent to 3.0 percent (Table 2). Futures prices for the cattle market suggest that calf prices will be somewhat stronger in 2010.

Growth in U.S. beef consumption is predicted to be slow over the next few years. Slower growth rates in the U.S. and global economies will cause consumers to watch their food budgets more carefully. Recent information on food sales

suggests that consumers are spending about 2 percent less on food prepared at home and are spending about 6 percent more on food prepared away from home in 2010 than 2009. The increase in food-away-from-home spending is good news for Montana cattle producers, who depend on the restaurant market for their high quality beef.

Grocery Bill

The largest increases in food prices over the past year have been in ground beef, whole milk, and bacon, with prices increasing by more than 10 percent. Wheat flour and pasta products have realized price decreases of 6 percent or more. The USDA expects food prices to increase by 2 percent to 3 percent in 2011. Of course, this food price inflation depends on the pace of the U.S. and global economic recovery and unforeseen production events, such as the Russian drought, in 2011.

Public Policy and Farm Bill

The 2012 Farm Bill negotiations are looming on the horizon in Washington, D.C. High agricultural prices have reduced government spending on many agricultural subsidy programs; however, some storm clouds are gathering. The United States lost a World Trade Organization case to Brazil on cotton subsidies, which will influence the structure of agricultural subsidy program proposed in the Farm Bill. The tight federal budget has focused attention on direct payment programs, which is likely to shift agricultural support away from direct payments and toward revenue protection and insurance programs in the 2012 Farm Bill. Stay tuned as the 2012 Farm Bill negotiations heat up in 2011.

Montana's Manufacturing Industry

by Todd A. Morgan, Charles E. Keegan III, and Colin B. Sorenson

Despite the recent recession and extensive declines in wood products, manufacturing remains a substantial component of Montana's economy, with sales of \$10 billion during 2010. The state's manufacturers employed 21,000 workers in 2010 (Figure 1), earning more than \$1 billion in labor income (Figure 2).

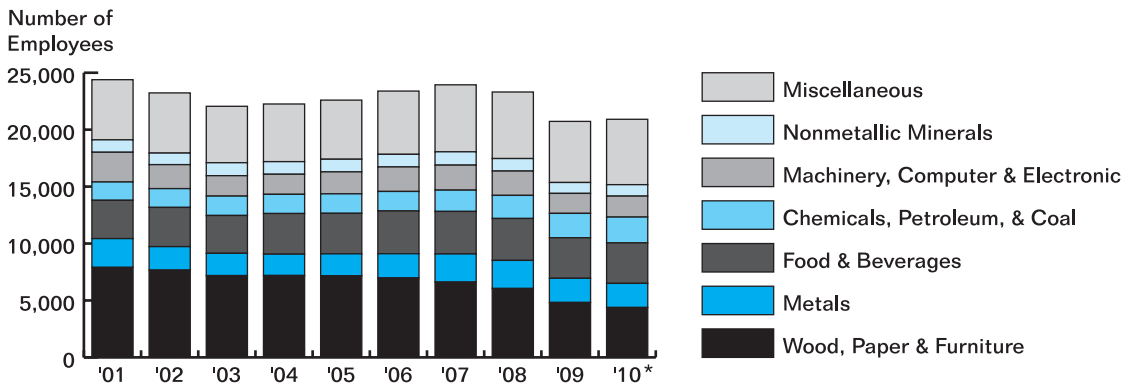
The manufacturing sectors account for more than 20 percent of Montana's economic base, and prior to the recent downturn, four Montana counties each had more than 2,400 manufacturing employees and more than \$135 million in labor income from manufacturing (Table 1). Recent declines primarily in the wood and paper products, primary metals,

and machinery industries have dropped Flathead County below 3,000 manufacturing workers and Missoula County below 2,000.

The value of production rose in 2010 by an estimated \$1.7 billion to approximately \$10 billion. The increase was due to generally higher product prices and output across most sectors, with Montana's petroleum refineries accounting for the bulk of the increased sales value compared to 2009.

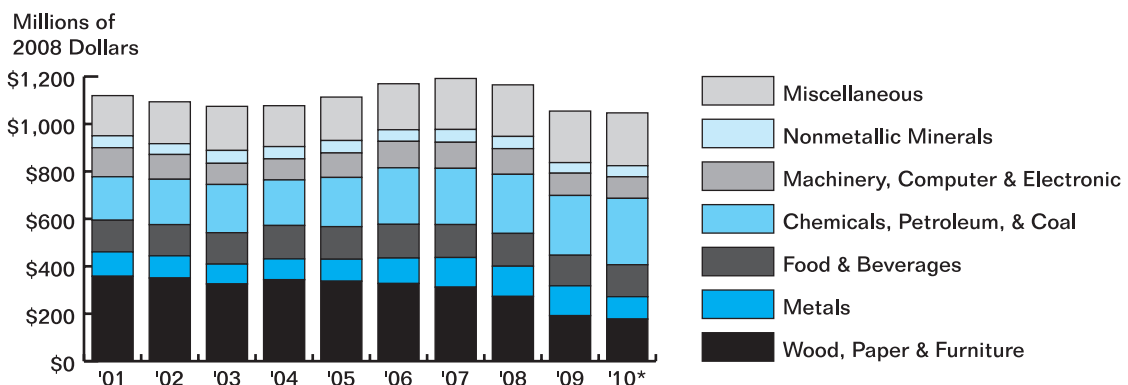
After substantial declines in employment during 2009, Montana manufacturing employment turned upward as 2010 progressed, with a net increase of an estimated 200 workers. Estimated workers' earnings in 2010 were approximately

Figure 1
Montana Manufacturing Employment, 2001-2010



* 2010 estimated by BBER.
Source: Bureau of Economic Analysis, U.S. Department of Commerce.

Figure 2
Labor Income in Montana Manufacturing, 2001-2010



* 2010 estimated by BBER.
Source: Bureau of Economic Analysis, U.S. Department of Commerce.

equal to the \$1 billion reported for 2009. This is in contrast with the U.S. manufacturing sector, which had lower employment in 2010 versus 2009. The largest single loss in 2010 was the closure of the Smurfit-Stone Container pulp and paper mill in Frenchtown, dropping overall manufacturing employment by 400 workers. All other manufacturers combined added an estimated 600 workers.

Looking at the past decade and comparing 2001 to 2010, total employment and labor income for 2010 are estimated to be lower than 2001 levels for manufacturing as a whole in Montana (Table 2). However, a number of sectors have shown growth over that period including chemicals, petroleum and coal, food and beverage, and a mix of manufacturers in the miscellaneous category, including high-tech and light manufacturing. Declines since 2001 were largest in Montana's wood and paper products industry (see pages 30-31) with segments of Montana's metals, machinery, and nonmetallic minerals manufacturers also suffering declines.

Outlook: 2011 and Beyond

The 2011 outlook is for modest improvement in Montana manufacturing activity, with expectations that the United States and other major economies will continue the slow recovery that began in the last half of 2009. Montana manufacturers should continue to benefit from improved export activities. The weakness of the dollar has spurred sharp increases in U.S. exports as the global economy improved in 2010; emerging economies such as Latin America and China showed rapid growth. Exports are projected to continue to increase by 8 percent in 2011 and 10 percent in 2012. In part due to strong global markets, the high-tech related sectors have shown recent growth, which will continue through 2011. Also benefitting U.S. and Montana manufacturers in 2011 and 2012 is an expected reduction in the rate of imports of manufactured goods, which increased during 2010.

Montana manufacturers who responded to the BBER's annual manufacturers survey continue to express optimism in their outlook for the coming year. Nearly 50 percent expected improved conditions for 2010, and about 45 percent expect better conditions for 2011. About 15 percent expect worsening conditions in 2011, very similar to the 15 percent that expected worsening conditions for 2010. Nearly 64 percent of manufacturing respondents expect to keep their workforce at the same level in 2011, while 29 percent foresee an increase in employment.

More than 60 percent of responding firms indicated the recession has caused their firm to fundamentally change the way they plan to operate in the future. Most of the major changes involved reducing costs and operating more efficiently. Other major changes included diversification into new products and markets, or focusing on key products and projects.

**Table 1
Montana Manufacturing Employment and Labor Income, by County, 2008**

County	2008 Manufacturing Employment	Percent of Total	2008 Manufacturing Labor Income (Millions of 2008 \$)	Percent of Total
Yellowstone	3,543	15%	287	25%
Flathead	3,501	15%	196	17%
Gallatin	2,577	11%	151	13%
Missoula	2,434	10%	138	12%
Ravalli	976	4%	45	4%
Cascade	963	4%	55	5%
Lake	750	3%	33	3%
Lewis and Clark	703	3%	43	4%
Silver Bow	597	3%	38	3%
Park	303	1%	18	2%
Lincoln	290	1%	12	1%
Other counties	6,672	29%	138	12%
Montana total	23,309	100%	1,152	100%

Source: Bureau of Economic Analysis, U.S. Department of Commerce.

**Table 2
Employment and Labor Income in Montana Manufacturing Sectors, 2001 and 2010**

	Labor Income (millions 2008 \$)		Employment	
	2001	2010*	2001	2010*
Wood, paper & furniture	358	178	7,907	4,385
Metals	103	94	2,526	2,116
Food & beverage	134	135	3,365	3,558
Chemicals, petroleum & coal	183	280	1,607	2,266
Machinery, computers & electronics	123	91	2,612	1,842
Nonmetallic minerals	50	47	1,090	1,005
Miscellaneous	169	223	5,283	5,742
Total	1,120	1,047	24,390	20,912

* 2010 estimated by BBER.

Source: Bureau of Economic Analysis, U.S. Department of Commerce.

Montana's Forest Products Industry

Current Conditions and 2011 Forecast

by Todd A. Morgan, Charles E. Keegan III, Steven W. Hayes, and Colin B. Sorenson

Operating Conditions

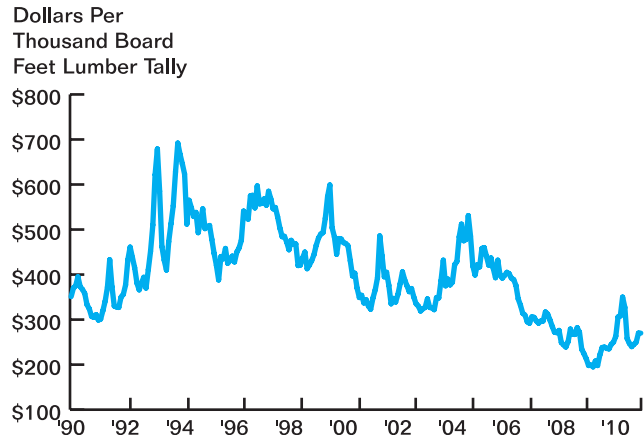
The dreadful economic conditions experienced by the country's forest products industry in 2009 improved somewhat during 2010. Lumber consumption in the United States remained at historically low levels, although softwood lumber exports increased by more than 50 percent. Annual U.S. housing starts, which fell to 554,000 units during 2009 – their lowest level in more than six decades – rebounded about 10 percent to just over 600,000 units in 2010. In response to rising exports and a slight uptick in housing starts, lumber prices were approximately 27 percent higher during 2009 (Figure 1).

Montana's sawmills, plywood, and reconstituted board facilities showed modest increases in output during 2010 from very low levels in 2009. However, the January 2010 closure of the Smurfit-Stone Container linerboard facility in Frenchtown cost the state's forest products industry its largest single employer and largest user of wood fiber. Permanent closures also continued to impact the state's log home industry. Logging employment was relatively stable from 2009 to 2010 after sharp declines from 2008 to 2009. Additionally, several hundred Montana forest industry workers were kept active conducting much needed road and trail restoration, forest health protection, and hazardous fuels reduction, aided by more than \$70 million in federal stimulus funds and a variety of federal, state, and private lands projects.

2010 Sales, Employment, and Production

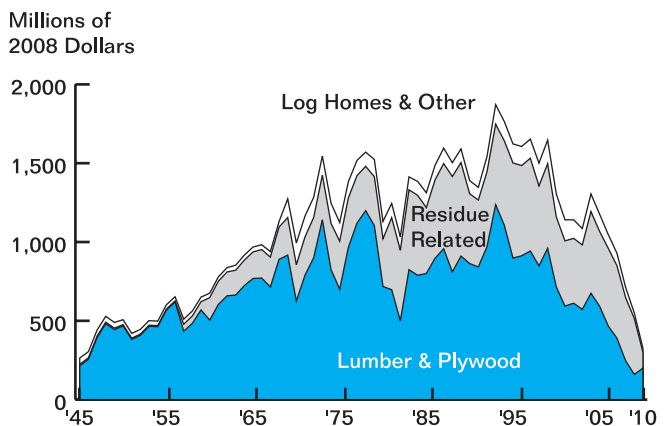
Total sales value of Montana's primary wood and paper products was approximately \$325 million (fob the producing mill) during 2010. Sales were down about \$225 million or 40 percent from 2009, and were about \$850 million lower than 2005, when sales were just under \$1.2 billion (Figure 2). Total forest industry employment during 2010 was about 6,840 workers (including the self-employed), down by about 3 percent from the revised 2009 estimate of 7,060 workers. Labor income in Montana's forest industry was estimated to be less than \$265 million during 2010, about 7 percent lower than 2009. Among Montana's remaining sawmills, lumber production in 2010 actually increased from 2009 levels to an estimated 480 million board feet lumber tally. Production was still down more than 50 percent from 2005 levels and almost 30 percent lower than 2008 (Figure 3).

Figure 1
Nationwide Composite Lumber Prices
Monthly, 1990-2010



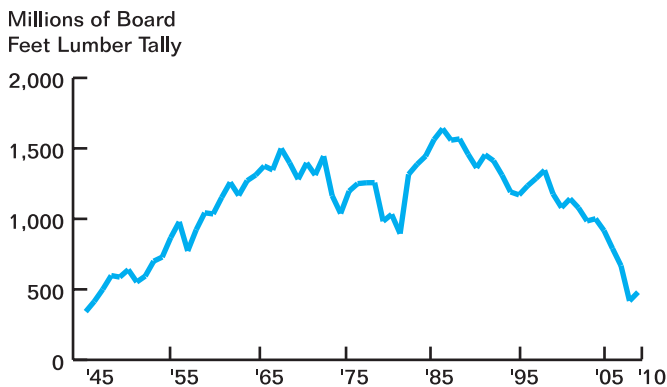
Source: Random Lengths Publications.

Figure 2
Sales Value of Montana's Wood and Paper
Products, 1945-2010



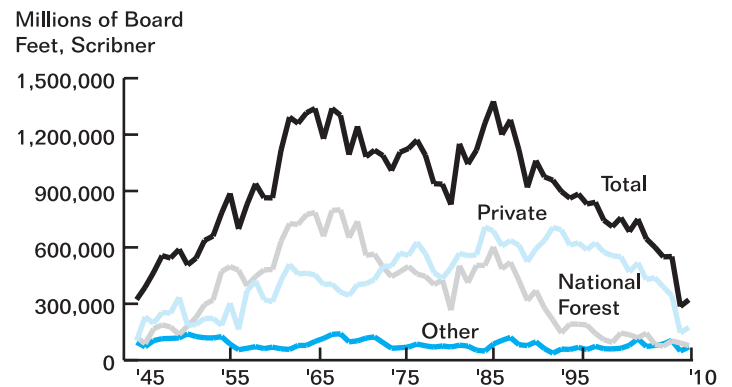
Sources: Bureau of Business and Economic Research, The University of Montana; Western Wood Products Association.

Figure 3
Montana Lumber Production, 1945-2010



Sources: Bureau of Business and Economic Research, The University of Montana; Western Wood Products Association.

Figure 4
Montana Timber Harvested by Ownership, 1945-2010



Sources: Bureau of Business and Economic Research, The University of Montana; U.S. Forest Service Region One.

Despite the numerous stimulus-supported activities, which included little commercial timber harvest, Montana's timber harvest volume during 2010 was an estimated 321 million board feet (Scribner), about 12 percent higher than 2009. This is the second lowest timber harvest on record since 1945, the lowest being in 2009 (Figure 4). The harvest from private lands increased somewhat, but was still only 50 percent of the 2008 harvest and just 40 percent of the 2005 harvest. National forest timber harvest during fiscal year 2010 (Figure 5) was reported to be about 10 percent higher than 2009, marking a third consecutive year of increases from the record low of 2007. National forest cut volumes, however, include considerable amounts (nearly 50 percent by volume) of residential firewood and non-sawlog material.

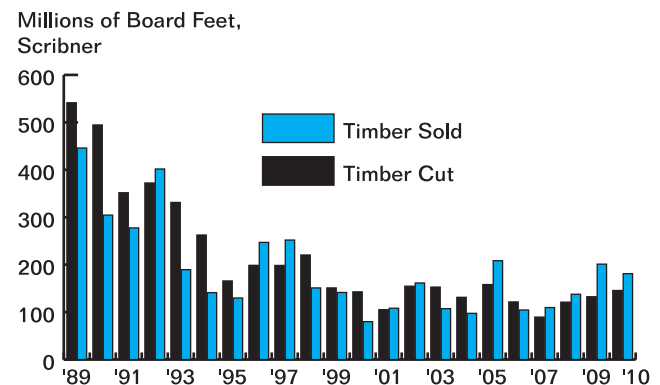
Outlook for 2011

National forecasts once again call for a modest uptick in the U.S. economy, housing starts, and consumption of wood and paper products in 2011, with larger improvements in 2012. Some optimism is also reflected in the outlook of Montana's remaining wood products industry executives, with 46 percent expecting 2011 to be better than 2010 and 35 percent expecting conditions to be about the same as 2010.

About 40 percent of executives anticipate that production and prices for their products will increase, and 50 percent expect gross sales to increase in 2011. Almost 50 percent expect the cost of inputs to be higher than in 2010, while more than 48 percent indicated that raw material availability is still very important to their business. Health insurance costs, workers' compensation rates, and workers' compensation rules continued to be very important concerns for the majority of Montana's wood products manufacturers.

As a whole, Montana's forest industry faces a high degree

Figure 5
Montana National Forest Timber Cut and Sold Volumes, 1989-2010



Source: USDA Forest Service Region One, Missoula, MT.

of uncertainty in the near-term. The purchaser and fate of the Smurfit-Stone mill are still unknown. Attempts to locally develop a woody biomass energy industry are being hampered by a confusing and often contradictory mix of federal laws, incentives, and agency policies. Continued increases in domestic housing and foreign demand for lumber could benefit Montana's forest industry by improving markets for wood products, provided mills in the state can overcome the chronic shortage of available timber. Continued increases in activity on federal timber lands, however, are not expected, as most of the pipeline of shovel-ready projects was depleted with 2009 and 2010 stimulus activities and federal budget cuts expected. Despite these uncertainties, many in Montana's forest industry remain optimistic and eager to capitalize on new opportunities.

Outlook 2011 Speakers

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