


STATE OF MAINE
REVENUE FORECASTING COMMITTEE

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Jerome Gerard, Chair, Acting State Tax Assessor
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Michael LeVert, Acting State Economist
Grant Pennoyer, Director, Office of Fiscal and Program Review
Ellen Jane Schneider, State Budget Officer

May 1, 2009

TO: Governor John Baldacci
Members, 124th Legislature

FROM:  Jerome Gerard, Chair
Revenue Forecasting Committee

RE: **Summary of May 2009 Revenue Forecast**

The Revenue Forecasting Committee (RFC) met on April 28, 2009 to review the revenue forecast and has revised its revenue projections through the fiscal year ending June 30, 2013 for the General Fund, Highway Fund, Fund for a Healthy Maine and the Medicaid Dedicated Revenue Taxes to comply with the statutory May 1st reporting date. This letter with attachments represents the summary of the major findings and recommendations of the RFC. A more detailed report will be available and posted to the RFC's web site as soon as it is completed.

This May forecast is the first forecast under the new statutory reporting dates. During first regular session years, odd-number years, the delayed reporting date allows the RFC to factor in additional information on individual income tax gained from the processing of final income tax returns due on April 15th. This year given the concerns regarding the effect of the decline of financial markets late in calendar year 2008, that additional information gathered from the April income tax collections was critical and resulted in additional downward adjustments to the RFC's assumptions for income tax liability from capital gains.

However, the major driver in this forecast is the change in the economic forecast. The intervening 5-month period since the late October 2008 meeting of the Consensus Economic Forecasting Commission (CEFC) has seen each successive release of national and regional economic forecasts become increasingly pessimistic. The April 1st CEFC economic forecast more fully recognized the recent deterioration in the economy in that intervening period and represents the most significant forecast adjustment in the CEFC's history. The CEFC report is available on the web at:

http://www.maine.gov/legis/ofpr/revenue_forecasting_committee/consensus_economic_forecast/apr2009_full_report.pdf.

The revised economic forecast variables entered into the tax models produced significant reductions to projections for individual income and sales taxes. However, as significant as the economic changes were on the sales tax, they still did not adequately capture recent consumer behavior. As a result, the RFC had to make further manual adjustments downward to capture the recent dramatic drop in taxable sales. Recent federal actions have also significantly affected this forecast. While the federal stimulus from the American Recovery and Reinvestment Act of 2009 is projected to have some mitigating effect on the downward economic slide of this recession, the recent increase in federal cigarette taxes is projected to substantially reduce Maine's cigarette tax collections and tobacco settlement payments.

The RFC has in past reports expressed its concern over the difficulty forecasting economic variables in this extremely volatile economic environment. While the most recent releases of national economic forecasts seem to have stabilized after months of becoming more and more pessimistic with each successive update, the RFC still has some concerns about this forecast. The dramatic effect of the current recession on the consumer and the challenges to the tax models to adequately capture consumer behavior contributes to the risk that actual experience will differ materially from the forecast. The RFC made manual adjustments to the model outputs in the current fiscal year to try and capture recent experience. If the recent behavior of the consumer represents a long-term paradigm shift, then future fiscal year forecasts that rely on the economic tax model outputs will need to be adjusted downward. While there is some hope that the economic picture has stabilized and a bottom to the current recession is in sight, this economy and the consumer psyche seems very susceptible to making minor economic shocks major factors. The current economic forecast and this revenue revision have not factored in any potential economic harm that may result from a swine flu pandemic.

The following tables and narratives along with the attachments highlight the changes to each of the major funds included in this May 2009 forecast of the RFC. The revision in this forecast represents the single largest downward revision in the history of the RFC, largely driven by the largest economic forecast change in the Consensus Economic Forecasting Commission's history.

General Fund Summary

	FY08 Actual	FY09	FY10	FY11	FY12	FY13
Current Forecast	\$3,087,818,992	\$2,961,821,437	\$2,969,236,452	\$3,016,015,691	\$3,106,812,109	\$3,189,762,000
Annual % Growth	2.3%	-4.1%	0.3%	1.6%	3.0%	2.7%
Net Increase (Decrease)		(\$129,288,054)	(\$195,643,156)	(\$244,219,896)	(\$235,414,259)	(\$217,782,553)
Revised Forecast	\$3,087,818,992	\$2,832,533,383	\$2,773,593,296	\$2,771,795,795	\$2,871,397,850	\$2,971,979,447
Annual % Growth	2.3%	-8.3%	-2.1%	-0.1%	3.6%	3.5%
Summary of Revenue Revisions by Major Revenue Category						
Sales and Use Tax		(\$57,622,682)	(\$73,247,544)	(\$89,858,858)	(\$92,625,963)	(\$94,637,802)
Individual Income Tax		(\$45,248,145)	(\$58,631,080)	(\$98,236,800)	(\$99,129,360)	(\$99,541,640)
Corporate Income Tax		(\$19,964,770)	(\$40,144,901)	(\$43,757,697)	(\$31,088,328)	(\$9,921,832)
Cigarette and Tobacco Tax		(\$6,735,000)	(\$12,998,912)	(\$13,565,921)	(\$13,936,632)	(\$14,286,100)
Estate Tax		(\$953,817)	(\$8,581,734)	(\$761,013)	\$0	\$0
Income from Investments		\$401,770	\$121,930	\$78,962	\$78,962	\$78,962
Transfer to Municipal Rev. Sharing		\$6,422,861	\$9,101,223	\$12,212,375	\$11,743,871	\$10,769,266
Transfer from Lottery Commission		(\$3,000,000)	(\$3,000,000)	(\$2,000,000)	(\$2,000,000)	(\$2,000,000)
Other Revenues		(\$2,588,271)	(\$8,262,138)	(\$8,330,944)	(\$8,456,809)	(\$8,243,407)
Total Revisions - Increase (Decrease)		(\$129,288,054)	(\$195,643,156)	(\$244,219,896)	(\$235,414,259)	(\$217,782,553)

The RFC revised downward its December 2008 General Fund revenue forecast for FY09 by an additional \$129.3 million, nearly as much as the \$140.3 million FY09 revision in the December 2008 forecast. For the 2010-2011 biennium, General Fund revenue projections were lowered by \$439.9 million. Most discouraging aspect of the revised General Fund forecast is the continued decline of revenue through FY11 with the largest decline in FY09 of 8.3% followed by an additional 2.1% decline in FY10. Even with the projected growth of 3.6% and 3.5% for FY12 and FY13, respectively, FY13 total General Fund revenue remains approximately \$116 million below FY08 General Fund revenue.

As noted earlier, the General Fund revenue forecast was driven downward primarily by the substantial downward revisions to the key economic variables in the economic forecast. The major reductions in the growth rates for aggregate Personal Income variable, while the largest in the history of the CEFC's changes, only partially explained the effect on State revenue. The Salary and Wage component of Personal Income variable is projected to decline in 2009 and 2010, which significantly lowered individual income tax liability projections for all years of the forecast.

The gross reductions to the major tax categories, Sales and Use Tax, Individual Income Tax and Corporate Income Tax, represent over 90% of the total downward revisions in this forecast in the 3-year current budget window. The bulk of the changes in these categories are driven by the economic forecast changes. However, the Individual Income Tax estimates were adjusted based on the April income tax collections data. The significant decline in final payments, roughly \$60 million below budget, were assumed to reflect an additional decline in capital gains realizations, resulting in a 70% decline in capital gains from 2007 tax year levels (an additional 20% drop in this important assumption). The FY09 Sales and Use Tax adjustments also included an additional manual or "off-model" reduction of \$24 million in addition to the changes produced by the tax models and the economic variables. This adjustment was required to achieve the level of Sales and Use Tax actual experience through April as the tax models were unable to capture the effect of the recession on consumer behavior.

The Cigarette and Tobacco Products Tax category was reduced by the tax models, but the most significant effect on this category was the reduction in volume resulting from the increase in cigarette prices from the federal tax increase. Over the 3-year budget window, FY09 to FY11, the resulting reduction in cigarette tax revenue from the federal tax increase totals \$24.1 million.

The other major revisions within this forecast are the 2 revenue items related to milk. The recent dramatic declines in milk prices have resulted in significant adjustments in these revenue estimates. The increases in revenue estimates from the Milk Handling Fee were drawn by the increases in transfers out to the Maine Milk Pool for the "tier support" program. The net reduction in this forecast from the difference in these milk revenue items is \$20.3 million over the 3-year current budget window.

Highway Fund Summary

	FY08 Actual	FY09	FY10	FY11	FY12	FY13
Current Forecast	\$328,136,579	\$341,858,607	\$322,681,578	\$326,265,735	\$328,629,895	\$331,798,186
Annual % Growth	-0.8%	4.2%	-5.6%	1.1%	0.7%	1.0%
Net Increase (Decrease)		(\$16,708,967)	(\$16,012,121)	(\$26,326,425)	(\$22,921,545)	(\$20,288,268)
Revised Forecast	\$328,136,579	\$325,149,640	\$306,669,457	\$299,939,310	\$305,708,350	\$311,509,918
Annual % Growth	-0.8%	-0.9%	-5.7%	-2.2%	1.9%	1.9%
Summary of Revenue Revisions by Major Revenue Category						
Fuel Taxes		(\$12,548,181)	(\$12,955,016)	(\$22,567,507)	(\$19,839,762)	(\$17,206,485)
Motor Vehicle Registration & Fees		(\$3,768,365)	(\$1,979,689)	(\$2,663,573)	(\$2,068,013)	(\$2,068,013)
Inspection Fees		(\$220,291)	(\$220,291)	(\$220,291)	(\$165,291)	(\$165,291)
Income from Investments		\$54,620	(\$63,409)	(\$151,880)	(\$151,880)	(\$151,880)
Other Revenues		(\$226,750)	(\$793,716)	(\$723,174)	(\$696,599)	(\$696,599)
Total Revisions - Increase (Decrease)		(\$16,708,967)	(\$16,012,121)	(\$26,326,425)	(\$22,921,545)	(\$20,288,268)

Highway Fund revenues are projected lower by \$16.7 million in FY09 and \$42.3 million in the 2010-2011 biennium. Fuel consumption continued to fall well below forecast after the reaction to last summer's peak in fuel prices. The recession has continued to dampen consumption despite the declines in fuel prices. The lower forecast for inflation reduces the increase in the tax rates assumed and even results in a decline of rates as a result of the 1.4% decline in the Consumer Price Index projected for calendar year 2009. Fuel taxes are revised downward in this forecast by \$12.5 million in FY09 and \$35.5 million in the 2010-2011 biennium.

The RFC has also lowered revenue estimates for motor vehicle registration fees and title fees based on recent experience and reduced assumptions for auto sales. Some of this is not consumption-driven and is related to competition for long-term trailer registrations.

Fund for a Healthy Maine Summary

	FY08 Actual	FY09	FY10	FY11	FY12	FY13
Current Forecast	\$62,044,739	\$64,386,190	\$63,760,785	\$64,478,815	\$70,939,420	\$71,202,694
Annual % Growth	21.8%	3.8%	-1.0%	1.1%	10.0%	0.4%
Net Increase (Decrease)		\$3,887,564	(\$4,106,734)	(\$7,384,811)	(\$8,136,691)	(\$8,611,750)
Revised Forecast	\$62,044,739	\$68,273,754	\$59,654,051	\$57,094,004	\$62,802,729	\$62,590,944
Annual % Growth	21.8%	10.0%	-12.6%	-4.3%	10.0%	-0.3%
Summary of Revenue Revisions by Major Revenue Category						
Base Payments		\$3,828,161	(\$4,132,965)	(\$7,313,201)	(\$8,057,778)	(\$8,531,992)
Racino Revenue		\$57,354	\$49,438	(\$41,395)	(\$42,223)	(\$43,068)
Income from Investments		\$2,049	(\$23,207)	(\$30,215)	(\$36,690)	(\$36,690)
Total Revisions - Increase (Decrease)		\$3,887,564	(\$4,106,734)	(\$7,384,811)	(\$8,136,691)	(\$8,611,750)

The Fund for a Healthy Maine (FHM) revenue forecast is being revised upward in FY09 as a result of a \$4.2 million payment at the end of February from arbitration and release of certain disputed payments under the Master Settlement Agreement. Racino revenue also contributed modestly to the short-term increase in the forecast. However, the federal cigarette tax increase

resulted in a significant downward revision to volume adjustment for tobacco settlement payments, which produced a significant drop totaling \$11.5 million in the 2010-2011 biennium.

Medicaid/MaineCare Dedicated Revenue Taxes Summary

	FY08 Actual	FY09	FY10	FY11	FY12	FY13
Current Forecast	\$130,173,249	\$141,057,299	\$142,788,378	\$144,562,735	\$146,381,450	\$148,245,634
Annual % Growth	3.6%	8.4%	1.2%	1.2%	1.3%	1.3%
Net Increase (Decrease)		(\$425,053)	(\$2,062,576)	(\$3,741,039)	(\$5,461,462)	(\$7,224,896)
Revised Forecast	\$130,173,249	\$140,632,246	\$140,725,802	\$140,821,696	\$140,919,988	\$141,020,738
Annual % Growth	3.6%	8.0%	0.1%	0.1%	0.1%	0.1%
Summary of Revenue Revisions by Major Revenue Category						
Nursing Facility Tax		\$1,139,744	\$413,910	(\$330,071)	(\$1,092,650)	(\$1,874,295)
Residential Treatment Facilities Tax		(\$70,581)	(\$111,187)	(\$152,808)	(\$195,470)	(\$239,198)
Hospital Tax		(\$917,094)	(\$917,094)	(\$917,094)	(\$917,094)	(\$917,094)
Service Provider Tax (PNMIs)		(\$577,122)	(\$1,448,205)	(\$2,341,066)	(\$3,256,248)	(\$4,194,309)
Total Revisions - Increase (Decrease)		(\$425,053)	(\$2,062,576)	(\$3,741,039)	(\$5,461,462)	(\$7,224,896)

Medicaid/MaineCare Dedicated Revenue Taxes are revised downward in FY09 by \$0.4 million and by \$5.8 million for the 2010-2011 biennium. Recent legislative changes in the tax rate for the Nursing Facilities Tax and the re-basing of the Hospital Tax are being adjusted in this forecast based on actual experience to date. Future growth rates, which had been projected to be 2.5% for all categories except the Hospital Tax in the December 2008 forecast have been lowered to no growth through the forecast period based on recent experience.

Attachments

cc: Members, Revenue Forecasting Committee
 Members, Consensus Economic Forecasting Commission
 Jane Lincoln, Chief of Staff, Governor's Office
 Ryan Low, Commissioner, DAFS
 Millie MacFarland, Clerk of the House
 Joy O'Brien, Secretary of the Senate
 David Boulter, Executive Director, Legislative Council
 Legislative Staff Office Directors