




STATE OF MAINE REVENUE FORECASTING COMMITTEE

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Jerome Gerard, Chair, Acting State Tax Assessor
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Catherine Reilly, State Economist
Ellen Jane Schneider, State Budget Officer

February 28, 2008

TO: Governor John Baldacci
Members, 123rd Legislature

FROM:  Jerome Gerard, Chair
Revenue Forecasting Committee

RE: **Summary of March 2008 Revenue Forecast**

The Revenue Forecasting Committee (RFC) met February 25, 2008 to review the revenue forecast and has revised its revenue projections through the fiscal year ending June 30, 2011 for the General Fund, Highway Fund, Fund for a Healthy Maine and the Medicaid Dedicated Revenue Taxes to comply with the statutory March 1st reporting date.

The updated economic forecast of the Consensus Economic Forecasting Commission (CEFC) in its February 1, 2008 report and several additional economic variables were used as inputs to Maine Revenue Services' tax models to help project the major tax revenue sources. After reviewing the tax recommendations of Maine Revenue Services and others from a number of state agencies, the RFC decided to revise downward its December 2007 General Fund revenue forecast for the 2008-2009 biennium by \$94.8 million and its projection for the 2010-2011 biennium by \$139.9 million. In addition, the RFC revised Highway Fund revenue downward by \$4.3 million in the current biennium, and made minor adjustments to its revenue forecast of the Fund for a Healthy Maine and MaineCare dedicated revenue taxes. The table on the next page summarizes the aggregate impact on each of the funds forecast by the RFC. Additional detail is available in the attached tables.

This revenue forecast is driven largely by the deteriorating national economy. The RFC is once again expressing its concerns about the substantial amount of economic risk that still surrounds this forecast. In the short time frame since the January meeting of the CEFC, most national economic forecasts, including the models upon which the CEFC forecast was based, have been updated with much more pessimistic outlooks. While some of the economic variables, primarily corporate profitability and oil prices not established within the CEFC economic forecast, reflect the more pessimistic forecasts, some of the core components of the economic forecast underlying this revenue forecast may not have captured recent events, leaving a greater potential for downside risks when the forecast is revised again later this fall.

Summary of March 2008 Revenue Revisions

General Fund Summary

	FY07 Actual	FY08	FY09	FY10	FY11
Current Forecast	\$3,019,595,389	\$3,067,920,438	\$3,136,529,661	\$3,206,392,774	\$3,236,866,340
Annual % Growth	3.0%	1.6%	2.2%	2.2%	1.0%
Net Increase (Decrease)		(\$26,870,994)	(\$67,910,570)	(\$65,977,780)	(\$73,965,529)
Revised Forecast	\$3,019,595,389	\$3,041,049,444	\$3,068,619,091	\$3,140,414,994	\$3,162,900,811
Annual % Growth	3.0%	0.7%	0.9%	2.3%	0.7%

Highway Fund Summary

	FY07 Actual	FY08	FY09	FY10	FY11
Current Forecast	\$330,821,083	\$328,637,877	\$339,173,861	\$343,978,189	\$348,933,780
Annual % Growth	1.3%	-0.7%	3.2%	1.4%	1.4%
Net Increase (Decrease)		(\$2,280,838)	(\$1,981,227)	\$2,989,937	\$2,024,366
Revised Forecast	\$330,821,083	\$326,357,039	\$337,192,634	\$346,968,126	\$350,958,146
Annual % Growth	1.3%	-1.3%	3.3%	2.9%	1.1%

Fund for a Healthy Maine Summary

	FY07 Actual	FY08	FY09	FY10	FY11
Current Forecast	\$50,950,512	\$61,353,071	\$65,626,578	\$70,567,505	\$69,667,817
Annual % Growth	8.6%	20.4%	7.0%	7.5%	-1.3%
Net Increase (Decrease)		(\$78,318)	(\$12,000)	(\$12,000)	(\$12,000)
Revised Forecast	\$50,950,512	\$61,274,753	\$65,614,578	\$70,555,505	\$69,655,817
Annual % Growth	8.6%	20.3%	7.1%	7.5%	-1.3%

Medicaid/MaineCare Dedicated Revenue Taxes Summary

	FY07 Actual	FY08	FY09	FY10	FY11
Current Forecast	\$125,704,185	\$129,627,152	\$131,380,798	\$130,492,181	\$135,020,703
Annual % Growth	6.4%	3.1%	1.4%	-0.7%	3.5%
Net Increase (Decrease)		(\$346,130)	\$1,342,884	\$517,145	\$530,074
Revised Forecast	\$125,704,185	\$129,281,022	\$132,723,682	\$131,009,326	\$135,550,777
Annual % Growth	6.4%	2.8%	2.7%	-1.3%	3.5%

As the Administration and the Legislature develop solutions to close the budget gap created by this and the last forecast, the RFC wants to point out two issues that may exacerbate the current situation. First, the forecast agreed to on Monday assumes an uneventful April 15th. Should the economic forecast for 2007 be too optimistic, it is certainly possible that payments and refunds associated with the 2007 tax year will deviate from this forecast and create a bigger short-fall in this fiscal year, leaving little time for policymakers to make adjustments before the close of the fiscal year. Second, there are some alternative economic scenarios that assume a longer and deeper impact from the housing downturn and oil prices that linger in the range of 90 dollars per barrel, or more, for a prolonged period. If this occurs, it is possible that the US economy could have a so-called “double-dip” recession, where later this year, when the impact of the economic stimulus package wears off, the economy enters another period of slow or declining economic growth.

General Fund

Of the \$94.8 million adjustment to the General Fund revenue for the current biennium, roughly \$75 million is associated with the major tax lines that produce the vast majority of General Fund revenue. These changes to General Fund tax receipts are a reflection of a deteriorating national

economy that has been significantly impacted by a tightening in credit markets as the correction in the residential housing market continues to unfold, and high volatile energy prices that are putting considerable stress on low and middle income households, particularly here in Maine. Taken together, these two factors are limiting household borrowing and drawing disposable income away from taxable goods and services and toward non-taxable energy products. This forecast represents a continuation of the recognition of this further squeeze on disposable income, even taking into account the federal economic stimulus package. As a result, tax lines associated with consumption, such as the sales tax and cigarette excise tax are now projected to be lower in this biennium by \$29.5 million and \$5.6 million, respectively.

The slowing national economy is also beginning to affect corporate profitability. Unlike the previous revenue forecast, this forecast is now based on a national economy that will experience extremely slow growth at best and a mild recession at worst during this calendar year. As a result, corporate profits are estimated to decline by 15% in 2008, which translates into a reduction in corporate income tax receipts of approximately \$23.2 million in the 2008-2009 biennium.

While the individual income tax is not expected to deviate much from the previous forecast in this fiscal year, the forecast for FY09 and beyond is reduced substantially because of the much lower projection of income growth during 2008 by the CEFC.

While Maine has not been as dramatically affected by the sub-prime mortgage crisis as some other states, for the first time since the December 2006 forecast, the RFC projects a reduction in the Real Estate Transfer Tax totaling \$7.3 million for the 2008-2009 biennium.

The majority of the remaining \$12.3 million of net reductions to the General Fund forecast for this biennium is related to revenue collections by the Department of Health and Human Services (DHHS). Of the total \$15.0 million reductions to Targeted Case Management revenue of DHHS, \$12.2 million of this change is associated with the federal Medicaid rule changes.

Highway Fund

Highway Fund revenues were projected lower by \$2.3 million in FY08 and \$2.0 million in FY 2009. High oil prices, which had been expected to return to more normal (lower) levels sooner than what is now expected, lower Fuel Taxes revenue by decreasing demand for diesel fuel and gasoline. The gasoline tax, like other consumption taxes, is the most severely affected, while diesel fuel consumption seems to be less affected by consumer decisions.

The RFC also lowered motor vehicle registration fees and title fees. While some of this is not consumption-driven and is related to competition for long-term trailer registrations and some problems with receipts from municipalities, the bulk of the changes reflect declining motor vehicle sales.

Fund for a Healthy Maine

The Fund for a Healthy Maine (FHM) revenue forecast was revised downward slightly due to a small downward adjustment in interest earnings to reflect lower balances in the fund and an adjustment in FY08 to reflect the effect of winter weather and some FY08 changes to

assumptions for slot machine revenue. The total change to Fund for a Healthy Maine revenue during the 2008-2009 biennium is less than \$0.1million.

Medicaid/MaineCare Dedicated Revenue Taxes

Medicaid/MaineCare Dedicated Revenue Taxes were revised upward on a net basis by \$1.0 million for the 2008-2009 biennium. The adjustments are based on updated trends with an additional quarter of actual experience and, within the Hospital Tax, a delay in the receipt of a tax payment between FY08 and FY09.

Attachments

cc: Members, Revenue Forecasting Committee
Members, Consensus Economic Forecasting Commission
Jane Lincoln, Chief of Staff, Governor's Office
Rebecca Wyke, 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