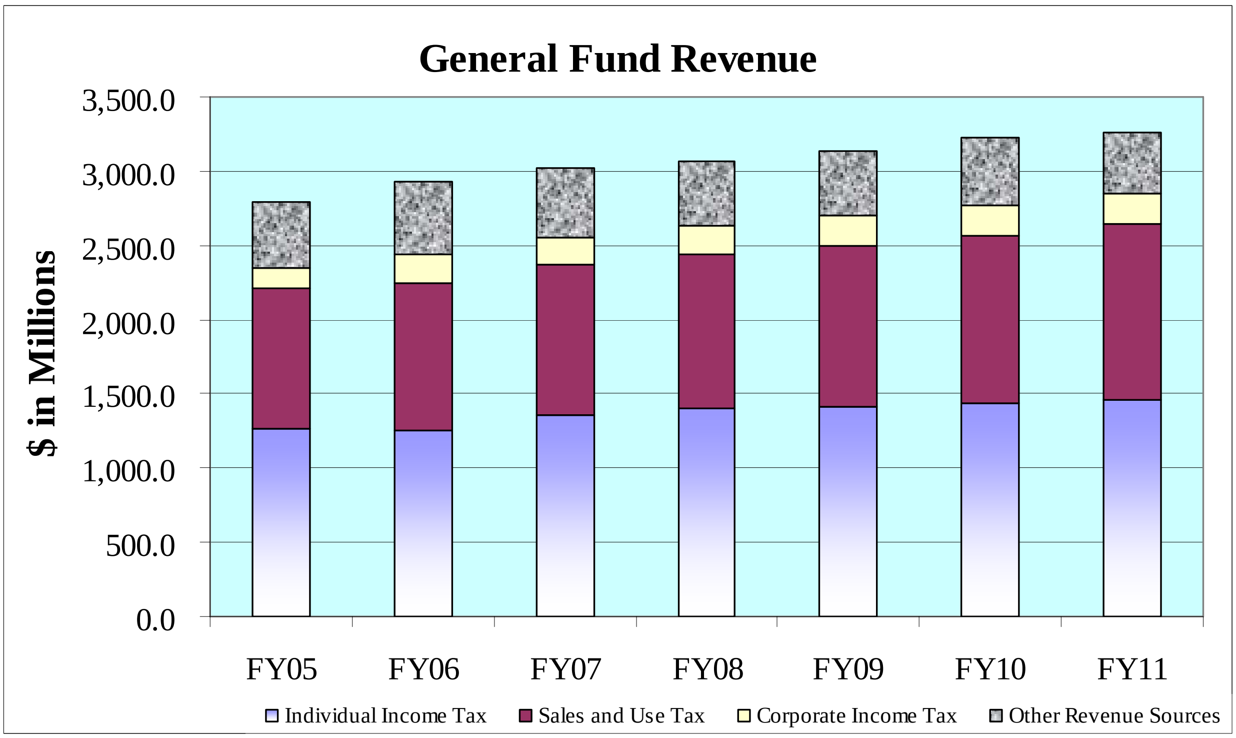
REPORT OF THE MAINE STATE REVENUE FORECASTING COMMITTEE

December 2007



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Report of the Maine State Revenue Forecasting Committee
December 2007 Forecast

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I. INTRODUCTION AND BACKGROUND TO REVENUE FORECAST

This report represents the conclusion to the fall forecast for the December 1st statutory reporting deadline of the Revenue Forecasting Committee (RFC). A description of the revenue forecasting process is provided in Appendix F. This report and appendices provide a description of all the key elements of the General Fund and Highway Fund revenue forecasts. In addition to the statutorily required updates of General Fund and Highway Fund, the RFC also includes forecasts of revenue accruing to the Fund for a Healthy Maine and the dedicated revenue from the Medicaid/MaineCare provider taxes. This forecast updates the revenue forecasts through the fiscal year ending June 30, 2011. This forecast also reflects all legislative changes through the 1st Regular Session of the 123rd Legislature and incorporates the revised economic forecast presented by the Consensus Economic Forecasting Commission (CEFC) for its November 1st reporting deadline. The RFC met on November 19th to deliberate and discuss the recommendations of Maine Revenue Services and other revenue analyses.

A. Economic Forecast Update

The December 2007 revenue update began with the fall economic forecast in October. The Consensus Economic Forecasting Commission (CEFC) met on October 16th to review and update its February 2007 forecast. Based on economic data available through the first nine months of 2007, the commission made slight adjustments to its previous forecast. Table I-A below summarizes the incremental change of the CEFC forecast. The full report of the CEFC is included in Appendix E.

TABLE I-A

Consensus Economic Forecasting Commission

Comparison of February 2007 and November 2007 Economic Forecasts

Calendar Years	2006	2007	2008	2009	2010	2011
• Wage & Salary Employment (Annual Percentage Change)						
> Consensus 2/2007	0.5	0.7	0.8	0.8	0.7	0.6
> Consensus 11/2007	*0.5*	0.5	0.3	0.6	0.7	0.7
Difference		-0.2	-0.5	-0.2	0.0	0.1
• Personal Income (Annual Percentage Change)						
> Consensus 2/2007	5.2	4.3	4.5	4.5	4.3	4.2
> Consensus 11/2007	*3.9*	4.9	4.4	4.5	4.5	4.6
Difference		0.6	-0.1	0.0	0.2	0.4
• Consumer Price Index (Annual Percentage Change)						
> Consensus 2/2007	3.5	2.5	2.2	2.2	2.2	2.2
> Consensus 11/2007	*3.2*	2.8	2.5	2.5	2.5	2.5
Difference		0.3	0.3	0.3	0.3	0.3

B. Capital Gains Forecast

A major variable that is not included in the economic forecast is a projection of net capital gains. Maine's exceptional capital gains growth during the stock market "bubble" of the late 1990's (in excess of 20% annual increases for 5 consecutive years through tax year 2000) came to an abrupt end in tax year 2001, plummeting 54.3%, resulting in a very unpleasant April surprise in 2002. Based on realizations in tax year 2004, Maine received an opposite surprise in April 2005. It is estimated that net capital gains realizations increased by nearly 43% that year, whereas the RFC had assumed they would grow by only 5.5%.

The RFC and Maine Revenue Services, like their counterparts in other states and the federal government, have had much difficulty trying to accurately forecast this variable. Maine data is not captured at the state level and may only be accessed through federal tax data. That information is shared with Maine Revenue Services, but it lags by as much as 2 years. Since November 1999, Maine Revenue Services has been required to provide a report on the net capital gains and losses realized by taxpayers filing Maine individual income tax returns. That report is provided to the Legislature through the RFC and is included in Appendix G of this report. Table I-B on page 3 summarizes the current assumptions. The differences from the assumptions included in the March 2007 report are:

- 2005 data have been updated to reflect actual data;
- 2006 projections (note they are still projections due to filing extensions that will change the data) have been increased from 9.9% growth to 24.4% growth as a result of preliminary data from the IRS;
- 2007 projections have been increased from no growth to 10% growth based on the strong performance of the stock market during 2007; and
- Negative annual growth in capital gains realizations beginning in 2008 is increased to a 15% decline each year through 2011.

With the bursting of the stock market "bubble," in 2001 the extent of the Maine resident individual income tax liability derived from net capital gains had dropped from its peak in 2000 of 17.3% to a level more in line with historical patterns before the "bubble," in the range of 6% to 7% of tax liability. The recent double-digit growth in capital gains realizations is estimated to have returned that ratio back to over 10%; peaking in 2007 at 14.3%. Starting with the March 2006 forecast, the RFC has assumed capital gains liability will return to its historical average of approximately 6% of total tax liability for Maine residents by the end of the forecast period (see far right column in Table I-B below). This assumption requires the 15% decline noted above and pulls roughly $30 million per year out of the individual income tax liability. Beginning in 2001, it took only 2 years and a drop of 54.3% in 2001 to get to the longer term assumption. The RFC assumes that this decline will happen gradually over 4 years, thereby reducing the extent of the risk to the forecast by a major downward correction in the markets. This assumption will require adjustment each forecast as new federal data becomes available.

Table I-B
Maine Resident - Net Capital Gains

Tax Year	Capital Gains Realizations ($ Millions)	Capital Gains Realizations Annual % Change	Capital Gains Tax Liability ($ Millions)	Capital Gains Tax Liability Annual % Change	Capital Gains % of Resident Tax Liability
1995	$551.7		$38.3		6.2%
1996	$799.7	45.0%	$57.3	49.6%	8.4%
1997	$1,218.7	52.4%	$104.5	82.4%	13.6%
1998	$1,551.0	27.3%	$120.0	14.8%	13.9%
1999	$1,867.2	20.4%	$141.7	18.1%	15.5%
2000	$2,360.4	26.4%	$179.6	26.7%	17.3%
2001	$1,079.3	-54.3%	$74.1	-58.7%	7.6%
2002	$908.8	-15.8%	$59.1	-20.3%	6.1%
2003	$1,069.4	17.7%	$69.4	17.4%	6.8%
2004	$1,526.9	42.8%	$104.9	51.2%	9.2%
2005	$1,960.3	28.4%	$137.0	30.6%	11.3%
2006*	$2,439.4	24.4%	$174.7	27.5%	13.4%
2007*	$2,683.4	10.0%	$194.6	11.4%	14.3%
2008*	$2,280.9	-15.0%	$161.3	-17.1%	11.6%
2009*	$1,938.7	-15.0%	$134.9	-16.4%	9.5%
2010*	$1,647.9	-15.0%	$111.1	-17.6%	7.7%
2011*	$1,400.7	-15.0%	$94.3	-15.2%	6.3%

* Represents Projections

C. Corporate Profits

A major variable of the tax models that drives the corporate income tax forecast is corporate profitability. Again, this forecast is not part of the CEFC economic forecast. The RFC used Global Insight's November 2007 forecast of pre-tax corporate profits. Table I-C below presents a comparison of Global Insight's forecasts used in the March 2007 forecast and the current national forecast, which calls for a 4.8% increase in calendar year 2007, then a decline in profitability in calendar year 2008, a rebound in 2009 and then slight declines in 2010 and 2011. The dominant taxpayers in Maine's corporate income tax liability mix have shifted to national retailers and energy companies. As a result, Maine is insulated from significant regional variances in corporate profitability as a result of Maine's method of corporate income taxation. For national companies operating in Maine, the amount of corporate income tax due to Maine is calculated by apportioning total profits earned in the continental United States by the amount of business that they conduct in Maine based on sales, payroll and property. Maine's apportionment formula was modified during the 123rd Legislature, 1st Regular Session to be based solely on sales. This legislative change results in a substantial increase in budgeted revenue within the corporate income tax (also see section on Legislative Changes).

Table I-C
Corporate Profit Growth (Percentage Annual Change)

	2006	2007	2008	2009	2010	2011
March 2007 Forecast	19.4%	3.5%	2.1%	0.1%	-1.1%	-0.2%
December 2007 Forecast	14.3%	4.8%	-2.1%	3.3%	-0.5%	-0.1%

D. Oil Prices

Recent experience in Maine's sales tax collections seems to demonstrate a substantial effect from variations in oil prices. Sales tax collections dropped below budgeted projections at about the same time as energy prices began their steep ascent in the spring of 2005. With the recent tax model updates, Maine Revenue Services has added this variable to the sales and excise tax model so that the model might better capture the effect that oil and fuel price changes have on taxable sales and fuel purchases. Relying on Global Insights' November 2007 US economic forecast, the RFC used the assumption that oil prices, which are currently in the $90 per barrel range and had nearly reached the $100 per barrel mark, will average out to $72.15 for calendar year 2007. The assumption is that oil prices will stay in roughly the $75 per barrel range for the remainder of the forecast period. This is roughly $10 per barrel higher than the previous forecast's assumptions.

Table I-D
Oil Price Assumptions
(West Texas Intermediate - Price per barrel – Calendar Year Average)

	2006	2007	2008	2009	2010	2011
March 2007 Forecast	$66.12	$64.44	$64.75	$63.88	$63.39	$61.78
December 2007 Forecast	$66.12	$72.15	$75.66	$74.33	$74.02	$73.42

E. Legislative Changes

The RFC bases the revenue forecast on current law. This forecast includes all legislative changes through the 123rd Legislature's 1st Regular Session. Table I-E on the next page summarizes the adjustments to budgeted revenue from legislative changes during the 1st Regular Session. The table provides total annual changes in each of the major revenue categories. These changes recorded through the fiscal note process were incorporated into budgeted base revenue when signed into law.

The 2 largest changes to revenue were in the Corporate Income Tax with the change of the apportionment formula as noted in the previous section and in Other Revenue with the repeal of the annual transfers to the Fund for the Efficient Delivery of Educational Services. The change in the corporate income tax apportionment formula to be based solely on sales is projected to increase corporate income tax by roughly $10 million per year (see Appendix A for additional detail). This apportionment change had a net negative effect on individual income tax revenue. The repeal of the transfers to the Fund for the Efficient Delivery of Education Services eliminated a negative revenue transfer of $14.9 million in FY08 and $21.5 million in FY09.

As with some previous forecasts, the RFC was forced to make adjustments to offset budgeted revenue recorded through the budget and fiscal note process. The legislative revenue change that is reversed in this forecast was enacted during the 1st Regular Session of the 122nd Legislature in Part GG of PL 2005, c. 12, the General Fund Current Services Budget. At that time, the Legislature approved a change in the policy regarding the treatment of stored value cards also known as gift cards and recorded revenue equal to $5,738,200 in FY07, $15,835,500 in FY08 and $18,210,825 in FY09. This forecast reverses most of this additional revenue (see discussion in Appendix A).

Table I-E
Summary of Legislative Changes - 123rd Legislature, 1st Regular Session

General Fund

	FY07	FY08	FY09	FY10	FY11
Sales Tax	$0	$1,062,256	$3,258,048	$2,610,573	$2,669,366
Individual Income	($109,129)	$2,046,817	$1,614,879	($569,562)	($3,680,938)
Corporate Income	$148,386	$16,842,405	$16,395,494	$16,708,797	$15,932,049
Cigarette Tax	$0	$0	$0	($69,240)	($108,423)
Estate Tax	$0	$285,000	$570,000	$593,750	$618,688
Prop. Tax - UT	$0	$305,768	$321,057	$337,109	$353,965
Investment Earnings	$0	$0	($4,926,253)	$0	$0
Revenue Sharing	($2,002)	$1,604,674	$1,629,127	($974,991)	($775,865)
Other Revenue	$211,770	$27,577,850	$35,317,026	$29,765,640	$30,701,183
Totals	**$211,770**	**$27,577,850**	**$35,317,026**	**$29,765,640**	**$30,701,183**

Highway Fund

	FY07	FY08	FY09	FY09	FY09
Motor Vehicle Reg. & Fees	$0	$382,005	$361,475	$361,475	$361,475
Other Revenue	$0	$5,000	$500	$500	$500
Totals	**$0**	**$387,005**	**$361,975**	**$361,975**	**$361,975**

II. OVERVIEW OF REVENUE PROJECTIONS

This section provides a summary of the revenue projections in this forecast. These summaries are supplemented by additional detail in 4 corresponding appendices, which provide descriptions of the major revenue categories. Appendix G contains the materials presented by Maine Revenue Services on November 19th to support the forecast recommendations for the major tax categories.

A. General Fund

For the **General Fund,** revenues were revised downward by $95.2 million over the 2008-2009 biennium, led by Sales and Use Tax revenues with downward adjustments of $21 million in FY 2008 and $19.6 million in FY 2009. Exceptionally high oil prices were thought to be a major drag on the economy and a main reason for the drop in this category, with consumer confidence as a contributing factor. Corporate Income Tax was revised downward by $7.5 million in FY 2008 and $7.3 million in FY 2009. Cigarette and Tobacco Tax revenue was reduced by $6.1 million in FY 2008 and $6.4 million in FY 2009. The only major tax line to show improvement in FY 2008 was the Individual Income Tax which was raised by $18,165,000 largely on the basis of a year-to-date positive variance thought to be caused by higher than expected capital gains in 2006 and 2007. However, the RFC continued to assume that capital gains will return to its long-term historical trend of just over 6% of tax liability by the end of the forecast period. This assumption significantly reduces Individual Income Tax revenue growth in FY 2009 through FY 2011 by reducing capital gains liability by roughly $30 million per year.

More than one-half of the downward adjustment to General Fund revenue during the 2008-2009 biennium resulted from non-economic related revenue adjustments. Unclaimed Property Transfers were reduced by $13.1 million in FY 2008 and $15.5 million in FY 2009 because out-of-state corporations have refused to comply with Maine's unclaimed gift card statutes. Although enforcement action is under review by the Attorney General, it is clear that no revenues from this source will be forthcoming until the issue is resolved. The other major non-economic related revenue adjustments were in the Targeted Case Management and DHHS Services Rendered revenue categories collected by the Department of Health and Human Services. These categories were adjusted downward by $10.9 million each year.

Table II-A - General Fund Summary

	FY07 Actual	FY08	FY09	FY10	FY11
Current Forecast	$3,019,595,389	$3,105,693,525	$3,193,917,944	$3,291,745,050	$3,354,444,227
Annual % Growth	3.0%	2.9%	2.8%	3.1%	1.9%
Net Increase (Decrease)		($37,773,087)	($57,388,283)	($85,352,276)	($117,577,887)
Revised 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%
Summary of Revenue Revisions by Major Revenue Category					
Sales and Use Tax		($21,066,117)	($19,584,072)	($10,640,919)	($5,264,777)
Individual Income Tax		$18,165,000	($338,000)	($32,618,000)	($52,051,000)
Corporate Income Tax		($7,452,405)	($7,281,196)	($10,903,484)	($32,732,049)
Cigarette and Tobacco Tax		($6,068,061)	($6,409,223)	($6,620,207)	($6,751,011)
Estate Tax		$0	($1,715,301)	($2,877,102)	($244,373)
Prop. Tax - Unorganized Territory		$348,000	($300,000)	($300,000)	($300,000)
Income from Investments		($522,429)	($522,429)	($522,429)	($522,429)
Transfer to Municipal Rev. Sharing		$528,030	$1,387,367	$2,816,445	$4,682,487
Other Revenues		($21,705,105)	($22,625,429)	($23,686,580)	($24,394,735)
Total Revisions - Increase (Decrease)		**($37,773,087)**	**($57,388,283)**	**($85,352,276)**	**($117,577,887)**

Appendix A provides additional explanations and detail of the General Fund revenue changes recommended in this forecast.

B. Highway Fund

For the **Highway Fund**, revenues were projected lower by $10.6 million in FY 2008 and $5.5 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 gasoline and diesel fuel. Lower motor vehicle registration fees also contributed to lower revenue projections in FY 2009 and beyond. See Appendix B for additional detail of the Highway Fund revenue changes recommend below.

Table II-B - Highway Fund Summary

	FY07 Actual	FY08	FY09	FY10	FY11
Current Forecast	$330,821,083	$339,283,065	$344,645,761	$347,617,154	$353,213,511
Annual % Growth	1.3%	2.6%	1.6%	0.9%	1.6%
Net Increase (Decrease)		($10,645,188)	($5,471,900)	($3,638,965)	($4,279,731)
Revised 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%
Summary of Revenue Revisions by Major Revenue Category					
Fuel Taxes		($10,940,953)	($4,665,240)	($2,538,878)	($3,360,750)
Motor Vehicle Registration & Fees		$480,000	($484,115)	($777,542)	($596,436)
Income from Investments		$205,000	$205,000	$205,000	$205,000
Other Revenues		($389,235)	($527,545)	($527,545)	($527,545)
Total Revisions - Increase (Decrease)		**($10,645,188)**	**($5,471,900)**	**($3,638,965)**	**($4,279,731)**

C. Fund for a Healthy Maine (FHM)

The **Fund for a Healthy Maine (FHM)** revenue forecast was revised upward for the 2008-2009 biennium primarily based on increased tobacco settlement payments and improved racino revenue projections. The net result for the 2008-2009 biennium is an upward revision of $1.6 million. See Appendix C for the additional explanations of the changes summarized below.

Table II-C - Fund for a Healthy Maine Summary

	FY07 Actual	FY08	FY09	FY10	FY11
Current Forecast	$50,950,512	$61,193,656	$64,160,177	$69,384,772	$73,292,290
Annual % Growth	8.6%	20.1%	4.8%	8.1%	5.6%
Net Increase (Decrease)		$159,415	$1,466,401	$1,182,733	($3,624,473)
Revised 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%
Summary of Revenue Revisions by Major Revenue Category					
Base Payments		$152,776	$1,016,647	$947,895	($3,866,136)
Racino Revenue		$16,639	$459,754	$244,838	$251,663
Income from Investments		($10,000)	($10,000)	($10,000)	($10,000)
Total Revisions - Increase (Decrease)		**$159,415**	**$1,466,401**	**$1,182,733**	**($3,624,473)**

D. MaineCare Dedicated Revenue Taxes

In aggregate, **Medicaid/MaineCare Dedicated Revenue Taxes** were revised upward by $5.3 million in the 2008-2009 biennium and by $5.4 million in the 2010-2011 biennium. The increases came after review of recent actual experience. The higher base from this review increased projections for future years assuming the same future growth assumptions. Appendix D provides additional detail of the changes in these revenue sources.

Table II-D - Medicaid/MaineCare Dedicated Revenue Taxes Summary

	FY07 Actual	FY08	FY09	FY10	FY11
Current Forecast	$125,704,185	$127,070,482	$128,760,211	$130,192,181	$132,267,451
Annual % Growth	6.4%	1.1%	1.3%	1.1%	1.6%
Net Increase (Decrease)		$2,556,670	$2,620,587	$2,686,100	$2,753,252
Revised Forecast	$125,704,185	$129,627,152	$131,380,798	$132,878,281	$135,020,703
Annual % Growth	6.4%	3.1%	1.4%	1.1%	1.6%
Summary of Revenue Revisions by Major Revenue Category					
Nursing Facility Tax		$207,736	$212,928	$218,252	$223,708
Residential Treatment Facilities Tax		($53,127)	($54,455)	($55,816)	($57,212)
Service Provider Tax (PNMIs)		$2,402,061	$2,462,114	$2,523,664	$2,586,756
Total Revisions - Increase (Decrease)		**$2,556,670**	**$2,620,587**	**$2,686,100**	**$2,753,252**

III. CONCLUSIONS

General Fund and Highway Fund downward revisions for the current 2008-2009 biennium are relatively small at 1.5% and 2.4%, respectively. However, any downward revision is difficult for the Legislature particularly after establishing the biennial budget. With the exception of the adjustment to reverse the legislative initiative related to gift cards, the warning signs of the tax adjustments in this forecast were evident in each of the monthly revenue reports since the beginning of the fiscal year if not sooner. The changes to tax receipts are a reflection of a national and state 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 burden on low and middle income households, particularly here in Maine. Combined, these two factors are limiting household borrowing and drawing disposable income away from taxable goods and services and toward non-taxable energy products. This effect is most notable in the taxes driven by consumption decisions: sales tax, gas tax and the cigarette tax.

As we have warned in previous forecasts, there is a substantial amount of economic risk surrounding this forecast. These are very volatile times and the timing of the CEFC, in late October, may not have fully captured recent events. The RFC found itself, particularly with respect to the Sales Tax estimates, trying to force the tax model outputs to match actual experience. When the CEFC meets in late January for the February 1st economic update, there is a greater downside risk for the underlying economic forecast. Maine, unlike several other states, has not been as severely affected by the sub-prime mortgage crisis. That crisis along with the weakening US dollar and oil prices, now in excess of $90 per barrel, present substantial downside risk to this current forecast, particularly if Maine has a cold winter.